

Euro wrap-up

Overview

- Despite an upside surprise to Germany's flash July inflation estimates, Bunds followed USTs higher while the European Commission's economic sentiment index slumped to a seventeen-month low at the start of Q3.
- Gilts also followed USTs higher on a quiet day for UK economic releases.
- Friday will bring the flash euro area July inflation estimates, along with Q2 GDP data from the euro area and larger member states. German labour market figures also due.

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Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.218	-0.188
OBL 1.3 10/27	0.504	-0.190
DBR 1.7 08/32	0.807	-0.132
UKT 1 04/24	1.706	-0.185
UKT 1½ 07/27	1.583	-0.148
UKT 4¼ 06/32	1.853	-0.104

*Change from close as at 4:30pm BST.

Source: Bloomberg

Euro area

German HICP inflation unexpectedly rises in July as food and goods inflation rise

After the [ECB](#) last week surprised with a larger 50bps interest rate hike to reflect the deteriorating inflation outlook, today's flash estimates of July inflation from Germany came in stronger than expected. Admittedly, the national CPI measure fell a further 0.1ppt to 7.5%Y/Y, a three-month low. But, in marked contrast, the harmonised HICP rate unexpectedly rose in July, by 0.3ppt to 8.5%Y/Y, just off May's series high of 8.7%Y/Y. Moreover, the cause of the decline in the national measure continues to be the temporary policy measures implemented last month to soften the impact of high energy prices. While difficult to precisely quantify, Destatis estimated last month that without them – i.e. if prices for fuel and public transport had remained unchanged in June – headline CPI inflation would have increased by 0.7ppt to 8.6%Y/Y rather than falling 0.3ppt to 7.6%Y/Y. And today's release reported a further easing in energy inflation in July, by 2.3ppts to 35.7%Y/Y. But this was countered by a jump in food inflation, up 2.1ppts to 14.8%Y/Y, a post-reunification record. Persisting underlying pressures were reflected in our estimate of non-energy industrial goods inflation, which rose 0.2ppt to a new high of 5.8%Y/Y. Admittedly, this was offset by lower services inflation, which eased 0.1ppt to a thirteen-month low of 2.0%Y/Y, and almost certainly partly reflected the discounted €9 monthly national rail pass. And so the national measure of core inflation appears to have moved sideways in July (3.2%Y/Y). Of course, when the government's energy support measures come to an end in August, we expect to see a rebound in both headline and core inflation, with the harmonised inflation measures likely to exceed the previous highs too.

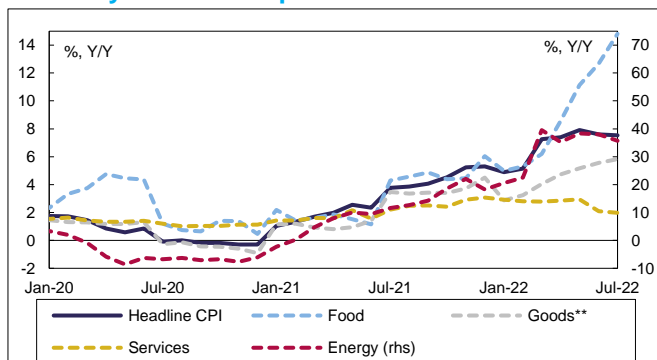
Selling price expectations ease further, but remain at elevated levels

Certainly, today's European Commission survey reported a further increase in consumer's perceptions of price developments over the past twelve months to the highest on the series. But while their expectations for the coming year are well down on the highs recorded earlier in the year, the relevant index still ticked slightly higher in July to remain well above the long-run average. Encouragingly, the survey's measures of selling price expectations for the coming three months eased further at the start of Q3, with a notable drop in the industry measure to a nine-month low, while the respective services, retail and construction indices fell to their lowest in four months. Of course, all the survey's pricing expectations indices remain very high by historical standards, suggesting that inflation will remain elevated even after it peaks.

Consumers most downbeat on record amid concerns about the year ahead

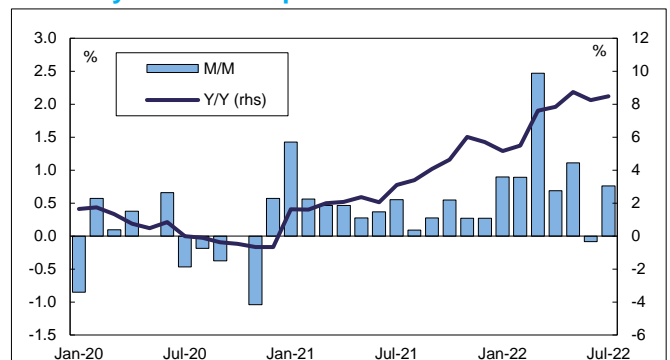
Given still elevated inflation expectations and increased unemployment fears, households' expectations for their personal finances over the coming year deteriorated markedly further in July to a fresh series low. With consumers considering the

Germany: Consumer price inflation*



*National measure. **Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation*



*EU-harmonised measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

general economic outlook also to have worsened, they were less inclined (or able) to save, and therefore considered it a less favourable time to make major purchases. Indeed, the Commission survey's relevant index was the second-weakest on the series and only some 6pts above the initial post-pandemic trough, suggesting that household spending weakened at the start of Q3. Overall, consistent with the flash release, the headline consumer sentiment indicator fell 3.2pts to -27.0, a record low and some 16pts lower than the long-run average. Against this backdrop, retailers were similarly more downbeat in July, as the outlook for sales was considered to be as weak as at the start of the second pandemic wave in November 2020.

Euro area ESI drops below long-run average as manufacturing and services conditions weaken

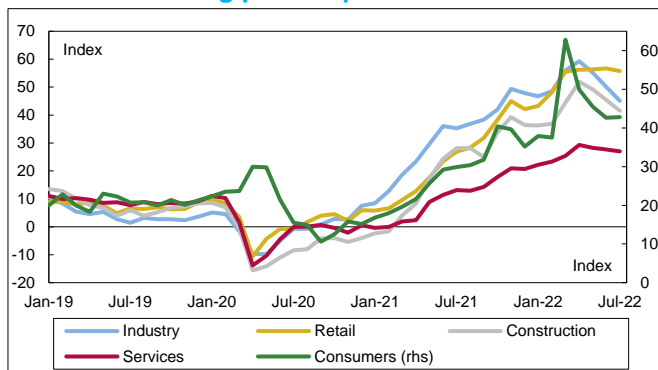
Consistent with the gloomy [flash PMIs](#), and offsetting the modest improvement signalled at the end of Q2, the Commission's business survey also implied a marked deterioration in conditions in industry and services at the start of the third quarter. For example, the manufacturing sentiment index fell sharply this month (down 3.5pts to 3.5, a seventeen-month low) as firms judged their recent output to have been weaker, while also citing a significant deterioration in near-term production plans despite an easing in supply constraints, as order books declined to their lowest in twenty months. Services sentiment also slumped to its weakest since May 2021 (down 3.4pts to 10.7) reflecting a deterioration in the recent business climate, as well as a further loss of optimism about their demand expectations, with that measure at its lowest in fifteen months.

Overall, the Commission's headline economic sentiment indicator (ESI) fell a steeper-than-expected 4.5pts in July from a downwardly revised June reading to 99, a seventeen-month low. While this left the ESI below the long-run average (100), it still remains some 38pts above the initial pandemic low and therefore perhaps suggestive of a loss of growth momentum in the euro area at the start of Q3 rather than contraction. Among the member states, Germany recorded a further notable worsening of conditions, with its headline ESI down 4.9pts to a below-average 99.8 and the lowest since February 2021. But while the Italian ESI (down 3.4pts to 101.6) and Spanish ESI (down 5.0pts to 97.1) were also the weakest since Q121, the French ESI (down just 0.1pt to 102.3) suggested broadly stable conditions in July. So, all the headline ESIs, with the exception of Italy, are below the pre-pandemic level. Against this backdrop, it was not overly surprising to see a further notable weakening in firms' employment plans in July, particularly among retailers and services.

The day ahead in the euro area

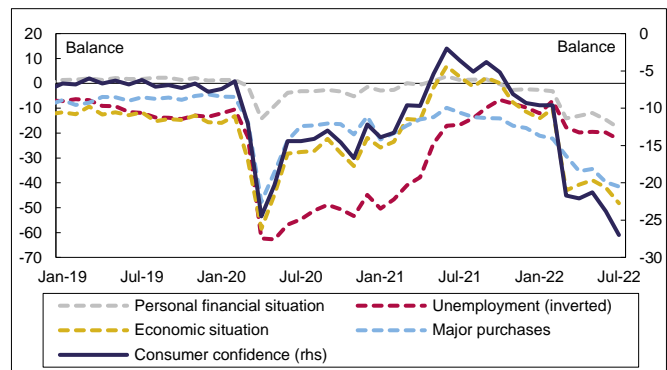
It will be a busy end to the week for top-tier euro area economic data, with the release of flash inflation figures for July and Q2 GDP. Following today's upside surprise to the German CPI figures, we now forecast that the euro area's headline HICP rate will rise to a new series high in July, by 0.2ppt to 8.8%Y/Y on the back of higher food inflation. And we expect the core rate to rise 0.2ppt to 3.9%Y/Y as cost pressures continue to be passed by firms to consumers. Also published tomorrow are

Euro area: Selling price expectations



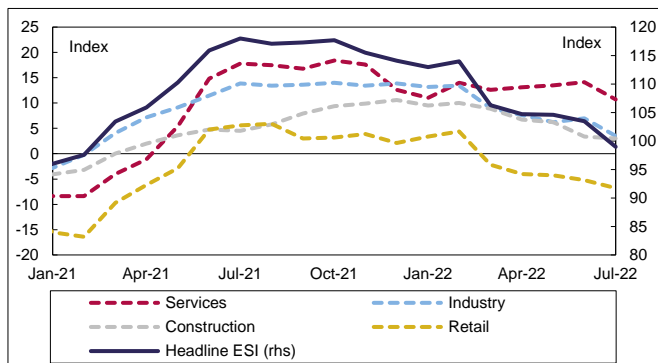
Source: Refinitiv, European Commission and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer sentiment indices



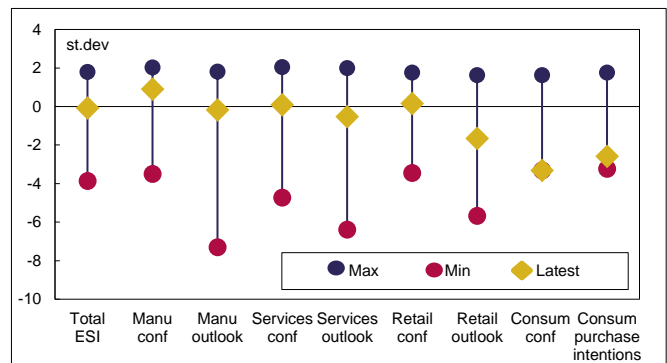
Source: Refinitiv, European Commission and Daiwa Capital Markets Europe Ltd.

Euro area: Commission sentiment indices



Source: Refinitiv, European Commission and Daiwa Capital Markets Europe Ltd.

Euro area: Selected Commission sentiment indices



Source: Refinitiv, European Commission and Daiwa Capital Markets Europe Ltd.

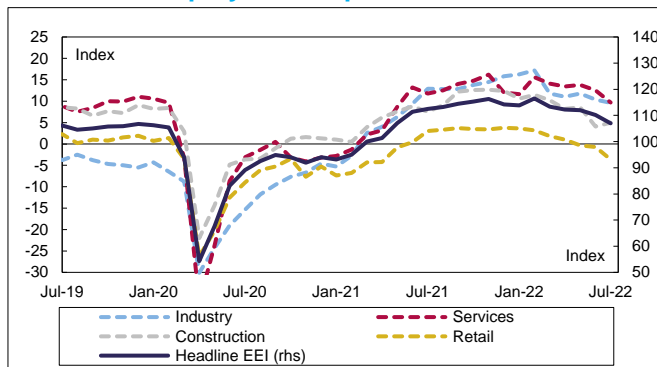
the first estimates of Q2 GDP data for the euro area and the four largest member states. We forecast that euro area GDP was unchanged on the quarter (+3.2%Y/Y) as household consumption was constrained by high inflation and external demand softened. However, the risks to that forecast are likely skewed to the upside, as spending on tourism and recreational services likely rebounded as pandemic restrictions eased. In Germany, we expect GDP to contract 0.2%Q/Q (+1.4%Y/Y) as the manufacturing sector continued to struggle with supply constraints. But we expect modest growth in France, Italy and Spain thanks to the pickup in consumer-facing services. The latest German labour market data for July are also due.

UK

The day ahead in the UK

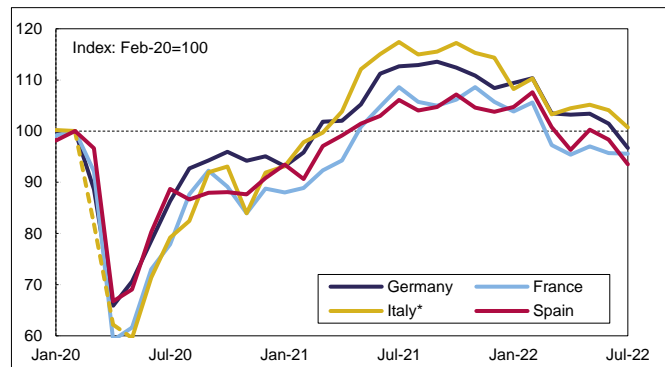
After a day bereft of top-tier UK data, Friday will bring the release of the Lloyds business barometer for July, which is likely to align with the deterioration seen in other recent UK surveys. Also published are BoE lending data for June, which might well reveal that consumer credit continued to trend higher, as households feel the strain of the ongoing cost of living crisis, while mortgage lending is expected to be somewhat softer last month.

Euro area: Employment expectations indices



Source: Refinitiv, European Commission and Daiwa Capital Markets Europe Ltd.

Euro area: Economic sentiment indices



Source: Refinitiv, European Commission and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	EC economic sentiment indicator	Jul	99.0	102.0	104.0	103.5
	EC industrial (services) confidence	Jul	3.5 (10.7)	6.0 (13.7)	7.4 (14.8)	7.0 (14.1)
	EC consumer confidence	Jul	-27.0	-27.0	-23.8	-
Germany	Preliminary CPI M/M% (Y/Y%)	Jul	0.9 (7.5)	0.6 (7.4)	0.1 (7.6)	-
	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jul	0.8 (8.5)	0.4 (8.1)	-0.1 (8.2)	-
France	PPI M/M% (Y/Y%)	Jun	1.3 (27.0)	-	-0.1 (27.3)	-0.3 (27.1)
Spain	Retail sales Y/Y%	Jun	1.0	-	1.4	1.3




















Auctions

Country	Auction
Italy	sold €2.75bn of 2.65% 2027 bonds at an average yield of 2.82%
	sold €1.25bn of 0.95% 2032 bonds at an average yield of 3.36%
	sold €2.00bn of 2.50% 2032 bonds at an average yield of 3.46%
	sold €1.25bn of 2030 floating-rate bonds at an average yield of 1.26%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous	
Euro area		10.00	Preliminary CPI M/M% Y/Y%	Jul	<u>0.5 (8.8)</u>	0.8 (8.6)
		10.00	Preliminary core CPI Y/Y%	Jul	<u>3.9</u>	3.7
		10.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	<u>0.0 (3.2)</u>	0.6 (5.4)
Germany		08.55	Unemployment claimant rate % (change 000s)	Jul	5.4 (17.0)	5.3 (133)
		09.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	<u>-0.2 (1.4)</u>	0.2 (3.8)
France		07.45	Preliminary CPI M/M% (Y/Y%)	Jul	0.1 (6.0)	0.7 (5.8)
		07.45	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jul	0.2 (6.7)	0.9 (6.5)
		07.45	Preliminary GDP Q/Q% (Y/Y%)	Q2	<u>0.2 (3.7)</u>	-0.2 (4.5)
		07.45	Consumer spending M/M% (Y/Y%)	Jun	-0.9 (-4.9)	0.7 (-3.4)
Italy		09.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	<u>0.2 (3.7)</u>	0.1 (6.2)
		10.00	Preliminary CPI M/M% (Y/Y%)	Jul	0.5 (8.1)	1.2 (8.0)
		10.00	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jul	-0.9 (8.8)	1.2 (8.5)
		11.00	PPI M/M% (Y/Y%)	Jun	-	0.3 (42.7)
Spain		08.00	Preliminary CPI M/M% (Y/Y%)	Jul	-0.3 (10.4)	1.9 (10.2)
		08.00	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jul	-0.8 (10.5)	1.9 (10.0)
		08.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	<u>0.2 (5.3)</u>	0.2 (6.3)
UK		00.01	Lloyds business barometer	Jul	-	28
		09.30	Net consumer credit £bn (Y/Y%)	Jun	1.0 (-)	0.8 (5.7)
		09.30	Mortgage lending £bn (approvals 000s)	Jun	5.5 (65.0)	7.4 (66.2)

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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