

Euro wrap-up

Overview

- Bunds followed the global trend lower, while euro area retail sales fell in June to be a drag on GDP growth in Q2 and the final euro area composite PMI remained in contractionary territory despite an upwards revision.
- Gilts also made losses, even as the UK services PMIs signalled a more significant slowdown at the start of Q3 than initially implied.
- Thursday will bring the BoE latest policy announcements, with Bank Rate expected to rise for the sixth consecutive meeting and the MPC set to lay out plans for active Gilt sales.

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Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.355	+0.064
OBL 1.3 10/27	0.600	+0.070
DBR 1.7 08/32	0.867	+0.055
UKT 1 04/24	1.851	+0.082
UKT 1¼ 07/27	1.731	+0.100
UKT 4¼ 06/32	1.922	+0.054

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

Source: Bloomberg

Euro area

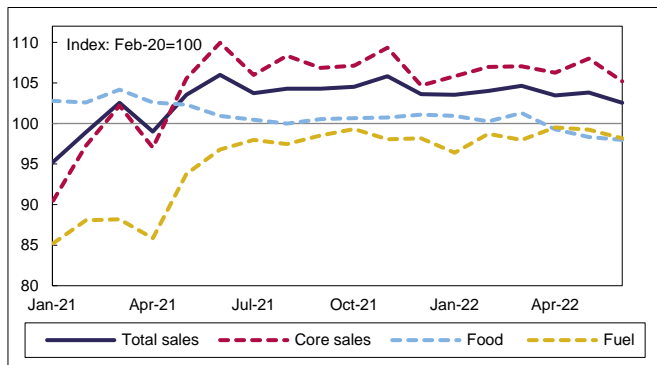
Euro area retail sales fall further in June

Given increased opportunities for spending on services, record low consumer confidence and squeezed real disposable income, today's euro area retail sales figures suggested that household spending on goods weakened further at the end of Q2. Indeed, sales fell by a steeper-than-expected 1.2%M/M in June, to be 3.7% lower than the pandemic peak a year ago. The weakness in June was broad based, with a notable decline in sales at non-food stores – by 2.6%M/M, the steepest monthly drop since December – more than reversing the jump in May and likely reflecting a marked drop in clothing sales as was evident in the latest German figures. Online sales were down a sizeable 2.6%M/M, with fuel sales also weaker (-1.1%M/M) despite the introduction of the fuel discount in Germany. Meanwhile, sales at food stores, where price pressures are particularly acute, fell for the third consecutive month (-0.4%M/M), to leave them down more than 2%Q/Q in Q2. So, while core sales were broadly unchanged over the quarter, total retail sales fell 0.8%Q/Q in Q2 to be a drag on GDP. Of course, overall household consumption last quarter will have been boosted by spending on services. But looking ahead, with confidence having fallen further and inflation risen again at the start of Q3, we expect spending on goods and services to remain weak over the near term. Indeed, with activity having slowed in the services sector (see below), we see little reason to expect a pickup in overall consumption in Q3.

Euro area PPI inflation eases slightly, but pressures more significant along supply chain

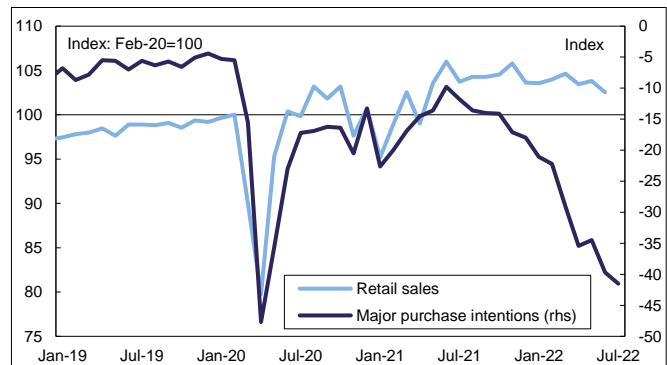
The worsening inflation outlook seems bound to weigh on household spending for the time being. And today's euro area producer price data suggested significant pressures up the supply chain as producers continued to pass on higher cost burdens to consumers in June. Admittedly, the headline annual PPI rate edged slightly lower that month, by 0.4ppt to a still-lofty 35.8%Y/Y. But this again principally reflected a slight easing in energy price inflation, by 1.3ppt to 92.8%Y/Y, still extraordinarily high and accounting for almost three-quarters of total inflation. While there was a further easing in the annual rate of intermediate goods in June (by 1.2ppt to 23.8%Y/Y), capital goods price inflation rose to a new series high (7.6%Y/Y). And producer inflation of consumer goods prices increased 0.4ppt to 12.1%Y/Y, also a record high. Even if producers continue to absorb a sizable portion of their extra input costs, the lagged effects of recent pressures are still likely to be felt on consumer price inflation over the coming couple of quarters. And, of course, the near-term outlook for energy prices remains clouded by the risks that Russia will continue to significantly ration its supply of natural gas to the EU, which has seen wholesale gas price futures rise considerably over recent weeks.

Euro area: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales and consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Final services PMIs revised higher but still consistent with slowing economic momentum

While the final services PMIs were firmer than initially estimated in July, they remained consistent with much weaker recovery momentum at the start of the third quarter as the bounce back from recent pandemic restrictions waned and demand was hit by households' eroded purchasing power. Indeed, despite being revised higher by 0.6pt from the flash release, the euro area headline activity index was down 1.8pts on the month to 51.2 in July, a six-month low and almost 4½pts lower than the Q2 average. The new business component fell into contractionary territory (49.5) for the first time since April 2021 as respondents cited higher inflation, while overseas demand fell more sharply. The employment PMI implied ongoing jobs growth but it fell to the lowest in five months, with business confidence about the year ahead slumping to a 21-month low in July. The weakening trend was evident across all of the large member states, and most striking in Germany and Italy, with the respective headline PMIs down 2.7pts to 49.7 and 3.2pts to 48.4, the lowest since Spring 2021. The declines in France (53.2) and Spain (53.8) were somewhat more modest perhaps supported by summer tourism.

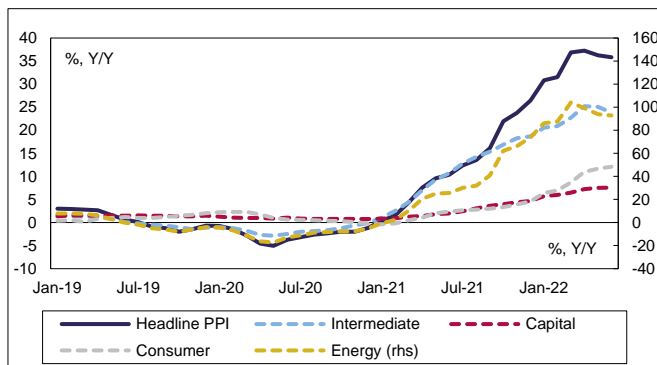
Composite PMI implies contraction at the start of Q3, with weakness set to continue

Taken together with declining manufacturing output, the euro area's composite output PMI slipped into contractionary territory in July (down 2.1pts to 49.9) for the first time since February 2021 and was more than 4pts lower than the Q2 average, implying significantly weaker economic growth. And the near-term outlook remains clouded by heightened concerns about the domestic and global economic outlooks amid higher inflation, supply constraints, energy supply and tighter monetary policy. Indeed, the composite new business index (47.6) was the weakest outside of the pandemic lockdown periods since 2013. And with firms the most downbeat about business expectations for the coming twelve months since the onset of the pandemic, the employment component implied the softest jobs growth for fourteen months. Among the member states, Germany's composite PMI fell for the fifth consecutive month, by 3.2pts to 48.1, the lowest since June 2020, with the Italian PMI (down 3.6pts to 47.7) signalling contraction for the first time since the start of 2021. While the French (51.7) and Spanish (52.7) PMIs implied ongoing expansion at the start of Q3, the respective indices were still well down on the Q2 averages.

Germany's goods trade performance improved in June, but net trade a drag on GDP in Q2

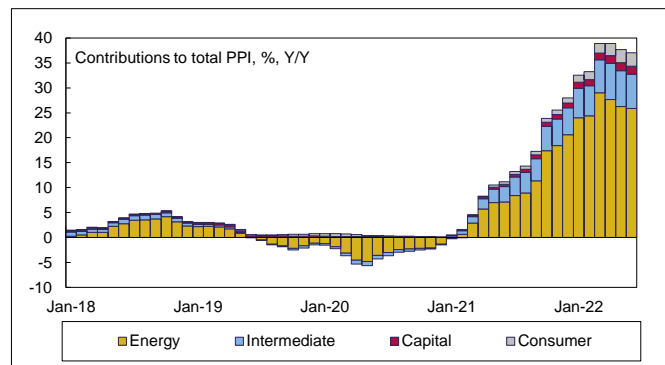
Despite the slowing global economic momentum, today's German goods trade report suggested that the deterioration recorded over recent months was partly reversed at the end of the second quarter. Having recorded its lowest surplus in May since 1991 (€0.8bn on seasonally adjusted basis), the goods trade balance increased in June to €6.4bn, a four-month high. This reflected a jump in the value of exports, by 4.5%/M/M, driven by another solid rise in shipments to the US (Germany's

Euro area: PPI inflation



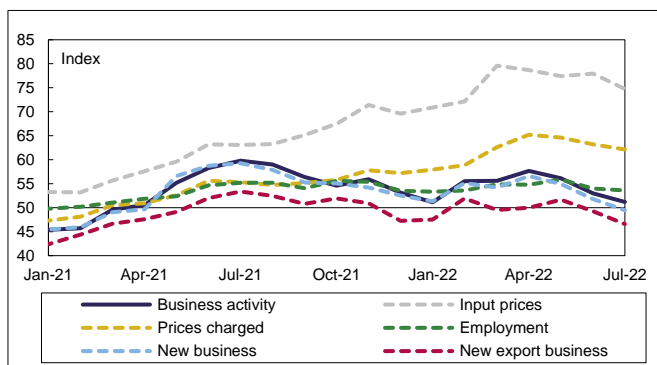
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to PPI inflation



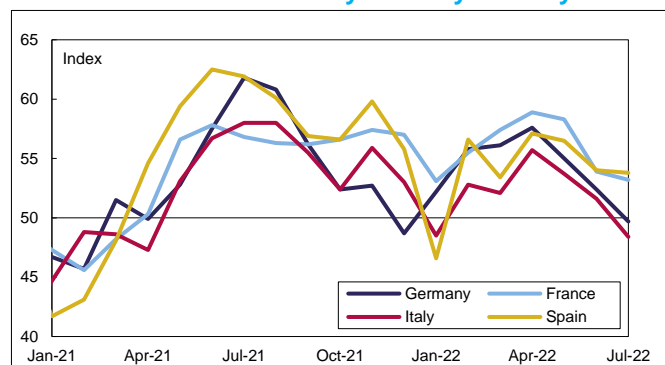
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Services PMIs



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Services activity PMIs by country



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

number one market) by 6.2%M/M, while exports to other EU countries rose 3.9%M/M and those to China rose 2.4%M/M. There was another increase in exports to Russia (14.5%M/M), but this still left them more than 40% lower than a year earlier. This compared with the increase in the total value of exports of 14.6%Y/Y. And overall, exports were up almost 7%3M/3M, the strongest quarterly performance since Q320. Admittedly, when adjusting for shifts in relative prices, the increase in exports in Q2 was more moderate, at 2.4%3M/3M, nevertheless still the strongest quarterly growth since 2020. But with import volumes up 3.5% on the same basis, today's release confirmed that net goods trade was a notable drag on German GDP last quarter.

The day ahead in the euro area

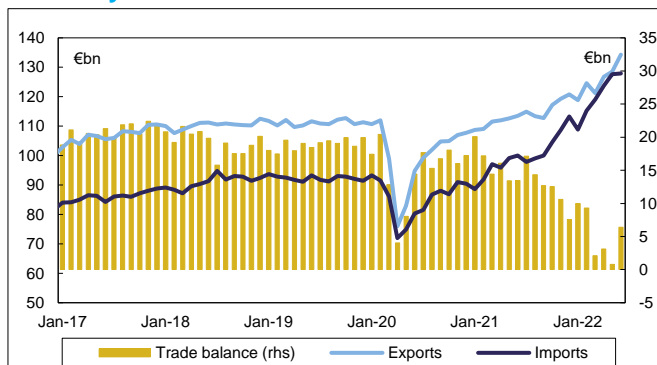
Looking ahead, tomorrow brings the release of German factory orders data for June, which are expected to report the fourth decline in the past five months due to weakening demand – the Bloomberg survey consensus is for a drop of 0.9%M/M, following May's modest increase of 0.1%M/M, to leave them down 9.2%Y/Y. Also due to be published tomorrow are the euro area construction PMIs for July, which are expected to suggest that activity in the sector continues to contract.

UK

Final UK services PMI downwardly revised in July to a seventeen-month low

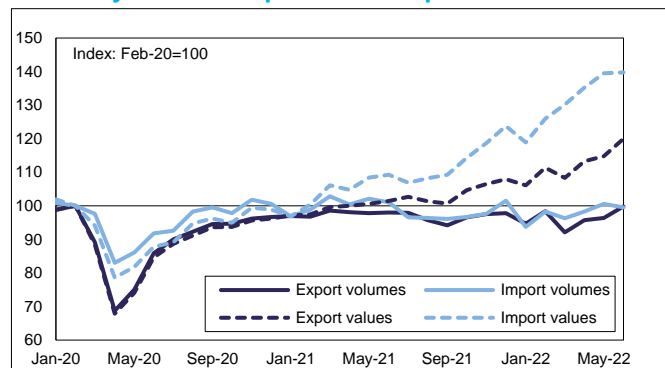
Contrasting with the euro area, the UK's services PMIs implied an even weaker performance at the start of Q3 than initially thought. In particular, the headline activity index declined by 1.7pts in July – some 0.7pt more than suggested by the flash release – to 52.6, to lowest since February 2021. Admittedly, the new business component (52.1) edged slightly higher, although it still represented the second-weakest reading for seventeen months as respondents cited diminished client budgets amid high inflation and heightened economic uncertainty. And so overall confidence in the outlook for the sector remained subdued, with business optimism the second-lowest since May 2020. Taken together with a contracting manufacturing sector, today's surveys saw the composite output PMI drop a steeper 1.6pts in July to 52.1, a seventeen-month low and almost 3pts below the Q2 average, suggesting a further marked slowdown in GDP at the start of Q3. There was at least a sizeable drop in the input price PMI in July, by 6.1pts to a seven-month low of 78.4, nevertheless still roughly 20pts above the long-run average. And although the output price index also fell, at 65.9, it remained well above the average and still consistent with substantial rates of inflation.

Germany: Goods trade balance*



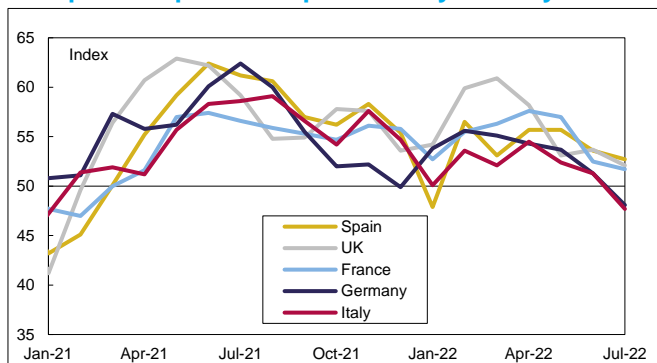
*Seasonally adjusted, nominal terms. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Goods exports and imports



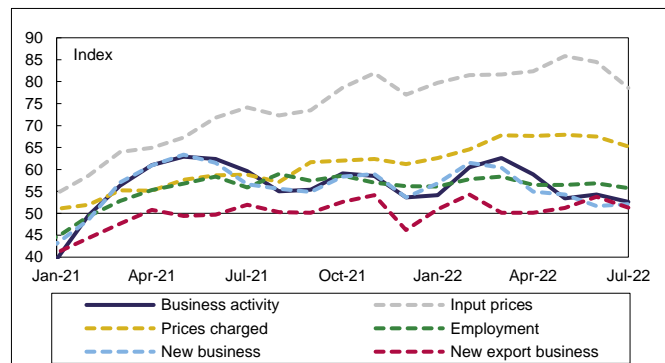
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Europe: Composite output PMIs by country



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Services PMIs














Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK




All eyes in the UK tomorrow will be on the Bank of England, with the monetary policy announcements and latest Monetary Policy Report out at midday. While there is no doubt that Bank Rate will be hiked for the sixth consecutive meeting, expectations for the magnitude of increase are split between 25 or 50bps. At the last meeting in June, the MPC stated that it “will be particularly alert to indications of more persistent inflationary pressures, and will if necessary act forcefully in response”, hinting that hikes of a larger magnitude could gain majority support. Since then, the inflation outlook has clearly deteriorated. June’s inflation report saw the headline CPI rate increase 0.3ppt to 9.4%Y/Y, to leave the average in Q2 at 9.2%Y/Y. Moreover, the MPC will be fully aware of the ongoing upwards trend in services inflation, which is typically more sensitive to wage growth and might flag increased risks of inflation persistence due to the tightness in the labour market. Energy inflation is also likely to be higher than the Bank previously projected reflecting not least a higher anticipated increase in the Ofgem price cap in October. So with the Bank’s inflation forecast likely to be revised higher, through to 2023, we think the majority on the MPC will favour a larger rate increase of 50bps to 1.75%, with signals of further monetary tightening ahead too (possibly of a similar magnitude). The BoE will also publish its plans for active Gilt sales, which will likely start in September depending on market conditions – Bailey previously suggested that, combined with redemptions, the BoE will likely aim to reduce its stock of Gilts (currently £847bn) by between £50-100bn in the first year.

While of secondary importance, UK data releases include the July construction PMIs and new car registrations.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
Euro area	 Final services (composite) PMI	Jul	51.2 (49.9)	<u>50.6 (49.4)</u>	53.0 (52.0)	-
	 Retail sales M/M% (Y/Y%)	Jun	-1.2 (-3.7)	0.0 (-1.7)	0.2 (0.2)	0.4 (0.4)
	 PPI M/M% (Y/Y%)	Jun	1.1 (35.8)	1.0 (35.7)	0.7 (36.3)	0.5 (36.2)
Germany	 Trade balance €bn	Jun	6.4	0.2	0.9	-
	 Final services (composite) PMI	Jul	49.7 (48.1)	<u>49.2 (48.0)</u>	52.4 (51.3)	-
	 New car registrations (production) Y/Y%	Jul	-13.4 (7.4)	-	-18.1 (19.2)	-
France	 Final services (composite) PMI	Jul	53.2 (51.7)	<u>52.1 (50.6)</u>	53.9 (52.5)	-
Italy	 Services (composite) PMI	Jul	48.4 (47.7)	50.1 (49.6)	51.6 (51.3)	-
Spain	 Services (composite) PMI	Jul	53.8 (52.7)	52.0 (51.5)	54.0 (53.6)	-
UK	 Final services (composite) PMI	Jul	52.6 (52.1)	<u>53.3 (52.8)</u>	54.3 (53.7)	-
Auctions						
Country	Auction					
Germany	 sold €1.23bn of 1% 2038 bonds at an average yield of 1.04%					









Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
Spain	 Unemployment change '000s	Jul	3.2	-	-42.4	-
UK	 Nationwide house price index M/M% (Y/Y%)	Jul	0.1 (11.0)	0.3 (11.6)	0.3 (10.7)	0.2 (-)
Auctions						
Country	Auction					
UK	 sold £2.75bn of 1% 2032 bonds at an average yield of 1.782%					











Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area		08.30 Construction PMI	Jul	-	47.0
Germany		07.00 Factory orders M/M% (Y/Y%)	Jun	-1.2 (-9.7)	0.1 (-3.1)
		08.30 Construction PMI	Jul	-	45.9
France		08.30 Construction PMI	Jul	-	46.4
Italy		08.30 Construction PMI	Jul	-	50.4
UK		08.30 Construction PMI	Jul	52.4	52.6
		09.00 New car registrations Y/Y%	Jul	-	-24.3
		12.00 BoE Bank Rate %	Aug	<u>1.75</u>	1.25

Auctions and events

Euro area		09.00 ECB publishes Economic Bulletin
France		09.50 Auction: 2% 2032 bonds
		09.50 Auction: 1.25% 2034 bonds
Spain		09.30 Auction: 1.3% 2026 bonds
		09.30 Auction: 0.8% 2029 bonds
		09.30 Auction: 2.55% 2032 bonds
		09.30 Auction: 0.7% 2033 index-linked bonds
UK		12.00 BoE monetary policy announcement, minutes and Monetary Policy Report to be published
		12.30 BoE Governor Bailey press conference
		14.00 BoE publishes Decision Maker Panel survey

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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