# Euro wrap-up

## Overview

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- Gilts made big losses, with the 2-10Y curve inverted, as UK CPI inflation jumped into double-digits for the first time in at least four decades, with price pressures broad-based.
- Bunds followed Gilts lower while euro area GDP growth in Q2 was revised down a touch and employment rose for the fifth consecutive quarter but at a softer pace.
- Thursday brings updated euro area CPI inflation figures for July, as well as construction activity for June.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 0.4 09/24 | 0.697 | +0.148 |
| OBL 1.3 10/27 | 0.662 | +0.143 |
| DBR 1.7 08/32 | 1.072 | +0.106 |
| UKT 1 04/24 | 2.399 | +0.230 |
| UKT 1¼ 07/27 | 2.139 | +0.173 |
| UKT 4¼ 06/32 | 2.280 | +0.154 |

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

# Euro area

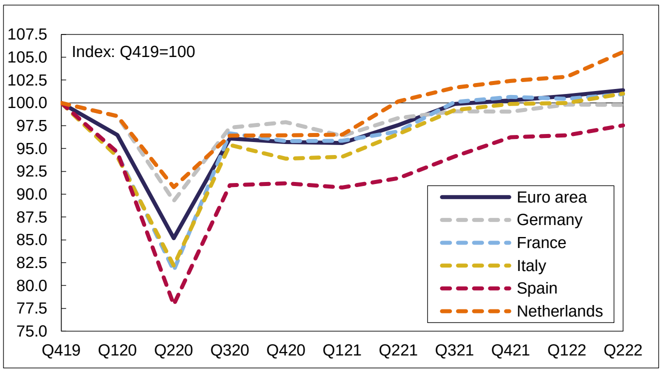
## Euro area GDP revised slightly lower, but remains well above ECB forecast

Today's updated euro area Q2 GDP estimate saw growth revised marginally lower, by 0.1ppt (just 0.06ppt to two decimal places) to 0.6%Q/Q, nevertheless still the fastest pace for three quarters and well above the ECB's most recent forecast of 0.2%Q/Q. This left output up 3.9%Y/Y and 1.4% above the pre-pandemic level in Q419. There were no changes to the estimates from the largest four member states – Germany (0.0%Q/Q), France (0.5%Q/Q), Italy (1.0%Q/Q), and Spain (1.1%Q/Q) – which together accounted for just over 55% of total euro area GDP growth. But new data today reported a marked acceleration in Dutch GDP, which grew 2.6%Q/Q to be more than 5½% above the pre-pandemic level and contribute 0.2ppt to euro area growth. As in Ireland, however, strong Dutch GDP growth might well have reflected the economic activity of multinational companies registered in that country rather than economic activity there. And the strong contribution from the Netherlands seems unlikely to be repeated this quarter. Indeed, with household budgets and firms' profit margins being increasingly squeezed by high inflation, and supply-chain challenges remaining a constraint on production, surveys suggest that a marked slowdown in euro area economic growth is already underway. Indeed, the July PMIs implied a contraction in economic output for the first time in more than two years.

## Employment rises for fifth consecutive quarter, but at a softer pace

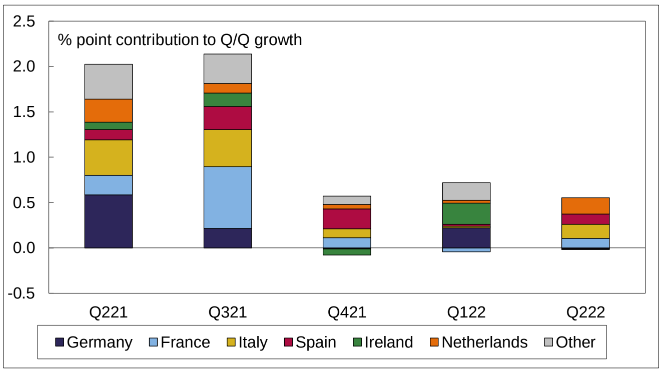
The euro area's economic expansion in Q2 was accompanied by another quarter of steady job growth, with employment up for the fifth consecutive quarter, albeit by a softer 0.3%Q/Q (435k) to be up 2.4%Y/Y (almost 3.80mn). The increase in employment in Q2 was just half the pace seen in Q1, the softest of the past five quarters, and only half the rate of GDP growth in Q2, suggesting that, in contrast to the US and UK, labour productivity in the euro area improved further last quarter. Moreover, like GDP, the level of employment rose further above the pre-pandemic level, by 1.3% or 2.08mn workers, to a new series high. But while employment in Germany increased a further 133k in Q2, to be almost 200k above the Q419 level, the number of employed workers (counterintuitively) fell in Spain in Q2 (-220k) back below the pre-pandemic level. And so, jobs growth in the euro area appears to have been driven by France and Italy last quarter. Of course, given the deteriorating economic outlook, the Q2 level might well be close to the peak for this cycle. Indeed, the Commission's latest sentiment survey signalled a further easing in firms' employment intentions at the start of the third quarter, to a fourteen-month low, albeit remaining comfortably above the long-run average. The softening was most marked in Germany and France, with the latter index returning back to its long-run average.

### Euro area: GDP by member state




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: Contribution to euro area GDP




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

## The day ahead in the euro area

Tomorrow brings the release of final euro area inflation data for July. These should confirm that the headline HICP rate increased 0.3ppt to 8.9%Y/Y, with core inflation also up 0.3ppt to 4.0%Y/Y, both series highs. While we know that the rise in inflation was broad-based with increases in the components of services, non-energy industrial goods and food, this release will also provide the granular detail. Construction output data for June are also due. Declines in Germany (-0.8%M/M) and France (-1.9%M/M) suggest that aggregate euro area construction activity slipped back at the end of Q2 and contracted over the quarter as whole. In the afternoon, key ECB Executive Board member Isabel Schnabel is scheduled to speak at two separate events on the outlook for inflation.

# UK

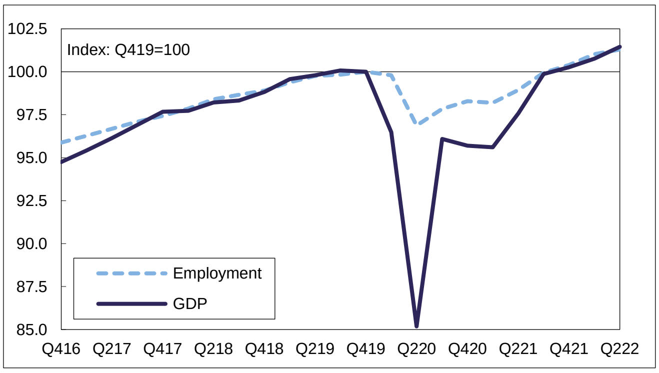
## Inflation reaches double-digits with pressures highly broad-based

UK consumer price inflation ignominiously reached double-digits in July. But ominously, it likely has significantly further to rise. In particular, consumer prices rose 0.6%M/M in a month in which they fell on average by 0.2%M/M in the two decades ahead of the pandemic. As a result, the headline CPI rate rose 0.7ppt – the most since April – to 10.1%Y/Y, effectively a four-decade high. Food prices explained almost half of the rise in headline inflation in July, increasing the most in any single month on the series to push the annual rate up 3ppts to 12.8%Y/Y. However, there were additional pressures in every major category, illustrating the extremely broad-based nature of current high inflation. For example, due in part to diesel prices, energy inflation rose 0.5ppt to a new high of 57.8%Y/Y, to account still for more than one third of overall inflation. The services component also rose 0.5ppt to a new high of 5.7%Y/Y due to a range of additional pressures, including increased rail and air fares, higher prices in hospitality and package holidays, and increased prices from insurance to care homes where rising labour costs are likely to be playing a role. And inflation of non-energy industrial goods edged up 0.1ppt to 6.6%Y/Y, due to increased prices of numerous items from toys and recreation goods to personal hygiene products. So, core inflation rose 0.4ppt to return to April's high of 6.2%Y/Y. And an alternative measure of underlying inflation – the NIESR 10% trimmed mean – rose 1.0ppt to 7.2%Y/Y, the highest on the series dating back to 1992.

## Pressures on core prices to be sustained over the near term

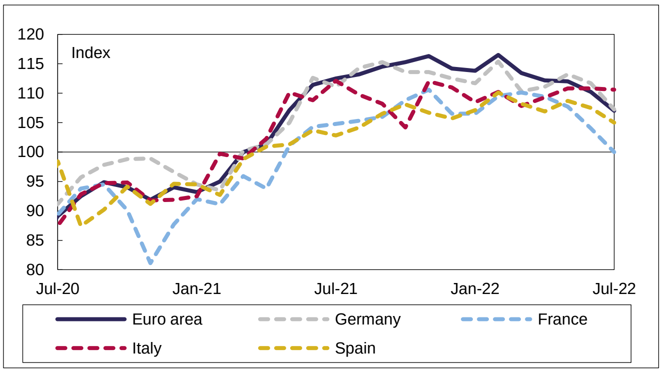
Further up the goods supply chain, thanks in part to lower oil prices, producer input prices were broadly steady overall, allowing the annual input PPI rate to ease back slightly to 22.6%Y/Y. However, producer output prices rose a further 1.6%M/M to push the annual output PPI rate up to a new high of 17.1%Y/Y, suggesting that manufacturers will continue to pass on costs to consumers over coming months. In addition, elevated wage growth will maintain pressure on services prices while Europe's drought is likely to maintain pressure on food prices. So, headline CPI inflation looks set to remain close to 10%Y/Y in both August and September, while core inflation will remain around 6¼%Y/Y. And looking further ahead,

### Euro area: GDP and employment



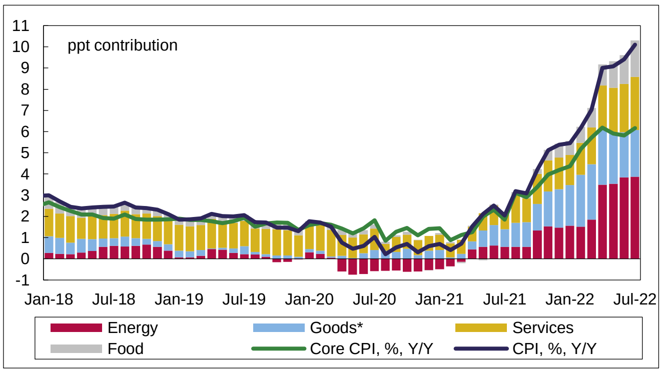

*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: Employment intentions indices



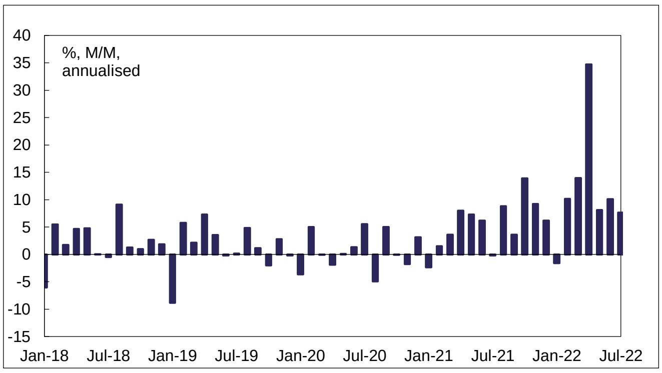

*Source: Refinitiv, European Commission and Daiwa Capital Markets Europe Ltd.*

### UK: Contributions to consumer price inflation




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

### UK: Consumer prices - annualised monthly rate




*Source: Refinitiv, ONS and Daiwa Capital Markets Europe Ltd.*

firms' expectations for inflation of their own prices continue to rise – in July, respondents to the BoE's Decision Maker Panel survey revised up their expectations for twelve-month inflation in their average selling prices by 0.3ppt from June to 6.6%Y/Y.

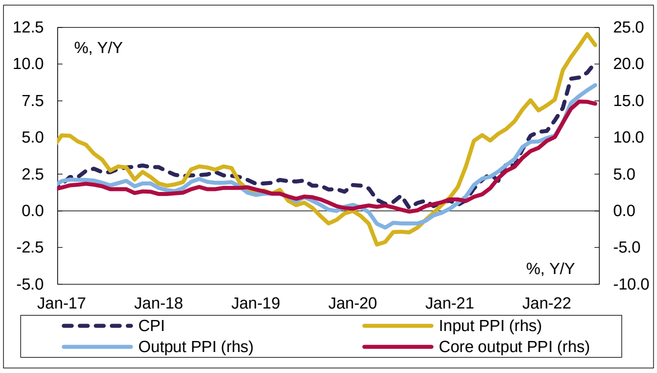
## Pending policy decisions on energy prices to determine inflation peak in Q4 and profile in 2023

Most importantly, however, the profile of inflation in Q4 and 2023 will hinge upon policy decisions yet to come. These include OFGEM's increase in its regulated household energy price cap from October, which is due to be announced on 26 August and is currently on track to rise from £1971 to above £3500. In addition, on 31 August, the ONS will confirm its statistical treatment of government plans to reduce (somewhat) the impact of the rise in energy bills on household budgets. And any additional policy efforts to offset the impact of higher household energy costs will have to await the announcement of Boris Johnson's successor as Prime Minister (presumably Liz Truss) on 5 September. For the time being, neither Truss nor her competitor Sunak have signalled a willingness to match the Labour party's proposal to freeze household energy prices at current levels between October and April. And based on current policy settings, inflation could reach 14%Y/Y in October. Moreover, given the increase in wholesale gas prices since the BoE finalised its forecast earlier this month, and the associated risks of further increases in the household energy price cap in January and April next year, the pace of decline in inflation in 2023 currently appears set to be gradual, and indeed slower than anticipated by the MPC earlier this month. So, we maintain our expectation of a further 50bps hike in Bank Rate at the next monetary policy meeting on 15 September.

## The day ahead in the UK

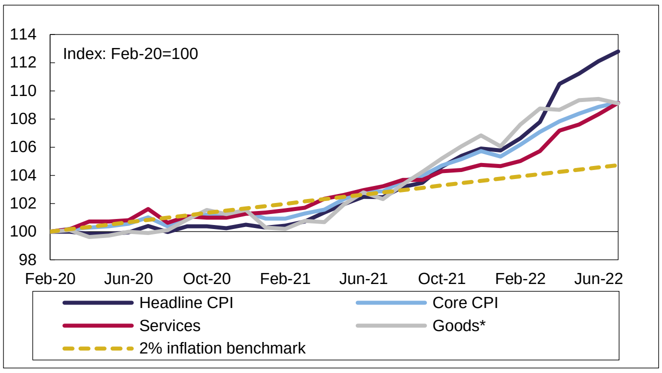
Looking ahead, it should be a very quiet day on the data front in the UK tomorrow with no top-tier releases scheduled.

### UK: Producer and consumer price inflation



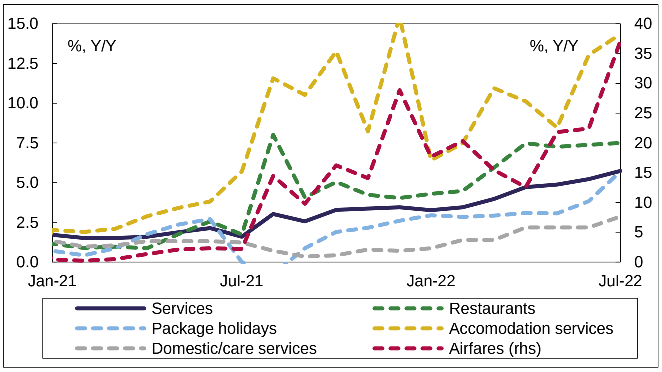

*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### UK: Consumer price levels



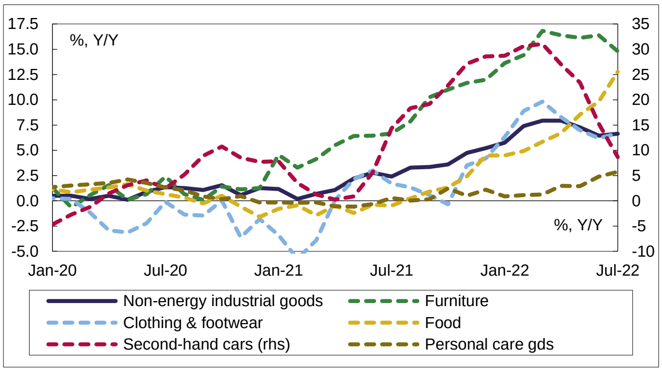

*Source: Refinitiv, ONS and Daiwa Capital Markets Europe Ltd.*

### UK: CPI inflation: selected services components



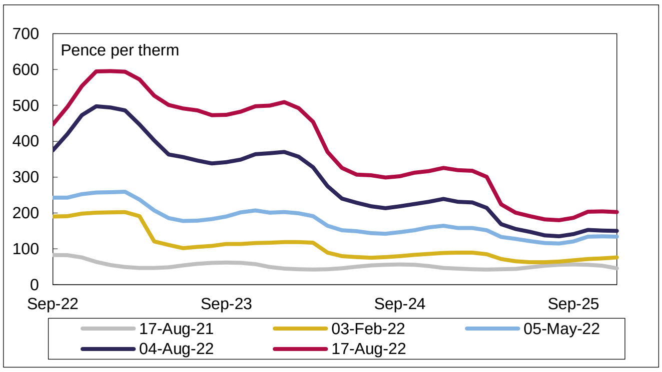

*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### UK: CPI inflation – selected goods components



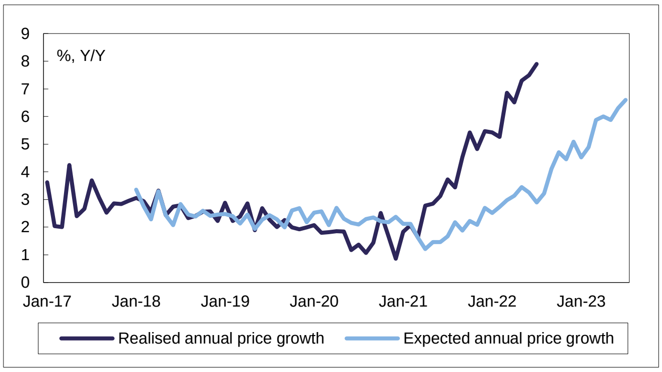

*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### UK: Natural gas futures




*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

### UK: BoE Decision maker panel: Firms' own prices




*Source: BoE and Daiwa Capital Markets Europe Ltd.*

# European calendar

## Today's results

**Economic data**

| Country | | Release | Period | **Actual** | Market consensus/ *Daiwa forecast* | Previous | Revised |
|---|---|---|---|---|---|---|---|
| Euro area | | GDP – second estimate Q/Q% (Y/Y%) | Q2 | **0.6 (3.9)** | *0.7 (4.0)* | 0.5 (5.4) | - |
| | | Employment – first estimate Q/Q% (Y/Y%) | Q2 | **0.3 (2.4)** | - | 0.6 (2.9) | - |
| UK | | CPI M/M% (Y/Y%) | Jul | **0.6 (10.1)** | *0.5 (10.0)* | 0.8 (9.4) | - |
| | | Core CPI Y/Y% | Jul | **6.2** | *6.3* | 5.8 | - |
| | | PPI output prices M/M% (Y/Y%) | Jul | **1.6 (17.1)** | 0.8 (16.2) | 1.4 (16.5) | **- (16.4)** |
| | | PPI input prices M/M% (Y/Y%) | Jul | **0.1 (22.6)** | 0.7 (23.1) | 1.8 (24.0) | **- (24.1)** |
| | | House prices Y/Y% | Jun | **7.8** | - | 12.8 | - |

**Auctions**

| Country | Auction |
|---|---|
| - Nothing to report - | |

*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 | Final CPI M/M% (Y/Y%) | Jul | *0.1 (8.9)* | 0.8 (8.6) |
| | | 10.00 | Final core CPI Y/Y% | Jul | *4.0* | 3.7 |
| | | 10.00 | Construction output M/M% (Y/Y%) | Jun | - | 0.4 (2.9) |
| Spain | | 09.00 | Trade balance €bn | Jun | - | -4.8 |

**Auctions and events**

| Country | | BST | Event |
|---|---|---|---|
| Euro area | | 14.45 | ECB's Schnabel scheduled to speak |
| France | | 09.50 | Auction: 0.50% 2025 bonds |
| | | 09.50 | Auction: 0.75% 2028 bonds |
| | | 09.50 | Auction: 1.85% 2027 index-linked bonds |
| | | 09.50 | Auction: 0.10% 2032 index-linked bonds |
| | | 09.50 | Auction: 3.15% 2032 index-linked bonds |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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