

Euro wrap-up

Overview

- Bunds continued to sell off as German producer price data surprised significantly on the upside.
- Despite a new series low in UK consumer confidence, Gilts also made big losses as UK retail sales slightly beat expectations.
- The coming week will bring the flash August PMIs and the account of the ECB's July monetary policy meeting.

Chris Scicluna

+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	0.802	+0.078
OBL 1.3 10/27	1.032	+0.119
DBR 1.7 08/32	1.225	+0.129
UKT 1 04/24	2.470	+0.072
UKT 1½ 07/27	2.261	+0.094
UKT 4¼ 06/32	2.415	+0.108

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

Source: Bloomberg

Euro area

German producer prices smash expectations on power crisis

After key Executive Board member Isabel Schnabel yesterday expressed concern about the rapid pass-through from producer to consumer prices, and suggested that the ECB should place relatively more weight on actual inflation outturns rather than its inflation projections when deciding monetary policy, today's German producer price inflation smashed expectations to underscore the likelihood of further substantive tightening to come. In particular, producer prices rose a record 5.3%M/M, more than seven times the median forecast on the Bloomberg survey. As a result, contrary to expectations of a decline on the month, the annual PPI rate leapt 4.5ppts to a new series high of 37.2%Y/Y. The cause of the increase was the intensifying pressure in the wholesale markets for natural gas and electricity. Indeed, producer energy prices rose 14.7%M/M, just 1ppt below December's record, to be up 105%Y/Y and account for more than 25ppts of overall PPI inflation. Prices of natural gas rose more than 160%Y/Y with electricity up more than 125%Y/Y.

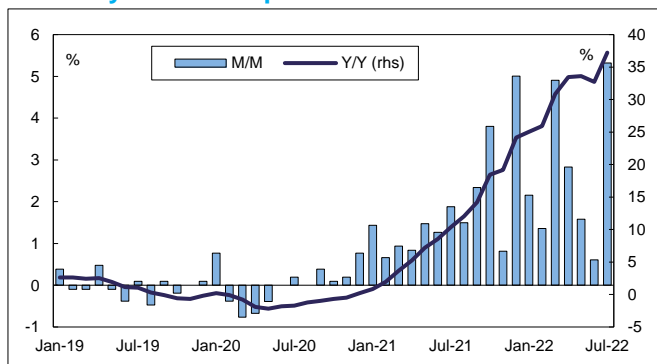
Intermediate goods prices offer relief, but capital and consumer goods PPI rates hit new highs

Reflecting falls in certain wholesale commodity markets, prices of intermediate goods declined for a second month, with the respective annual rate slowing more than 3ppts to 19.1%Y/Y. However, inflation of capital goods (8.0%Y/Y), as well as durable (10.9%Y/Y) and non-durable consumer items (16.2%Y/Y) continued to hit new highs, the latter not least due to higher food prices. Given the softer intermediate goods component, the non-energy PPI rate fell for a second successive month to 14.4%Y/Y. But the continued worsening of conditions in wholesale power markets amid concerns about the supply of natural gas from Russia, as well as forthcoming gas levies – the impact of which will be only partially offset by lower VAT – suggest that the inflation outlook for producers and consumers alike continues to deteriorate significantly.

The week ahead in the euro area

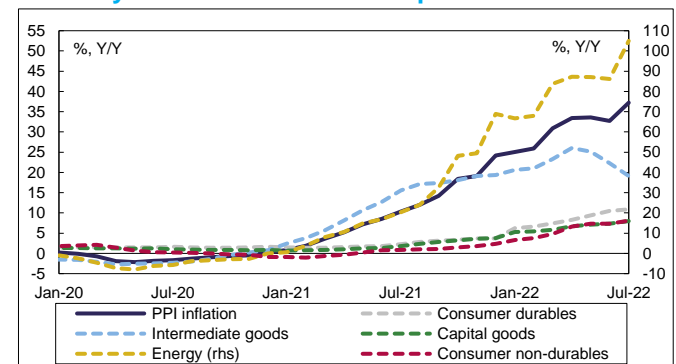
The coming week will bring further information on the debate on the ECB's Governing Council with the account of the [20-21 July monetary policy meeting](#) – where the previous forward guidance was ignored and the key interest rates were raised by 50bps to bring an end to the era of negative interest rates – to be published on Thursday. While President Lagarde insisted that future policy decisions would from now on be made on a meeting-by-meeting basis, the account will be watched for any further insights into the likely magnitude of tightening to be agreed at the ECB's 7-8 September policy meeting. The debate surrounding the criteria for activation of the new Transmission Protection Instrument (TPI) will also be of interest.

Germany: Producer prices index



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: PPI and selected components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The euro area's data flow in the coming week will be dominated by August survey indicators, with most noteworthy being the flash PMIs and consumer confidence index on Tuesday. Given concerns about high inflation, supply disruptions, rising interest rates and slowing global demand, the PMIs seem likely to signal a further weakening in conditions in August, with the headline euro area composite output index falling further into contractionary territory from 49.9 in July. Signals from the German manufacturing seem likely to remain extremely downbeat as concerns about energy supply were compounded by fears about the implications of low water levels in the Rhine. The Commission's preliminary consumer confidence indicator is likely to remain at or below July's record low level of -27.0, as households become increasingly concerned about their future financial situation amid higher inflation and rising interest rates. National business and consumer sentiment indicators to be published throughout the remainder of the week include the German ifo survey on Wednesday. That day will also bring revised German GDP figures for Q2, including the first official expenditure breakdown. According to the first estimate, GDP was unchanged from Q1, with Destatis noting that activity was supported by household and government consumption but that net trade subtracted from growth. Finally, Friday's releases include the ECB's bank lending numbers for July.

UK

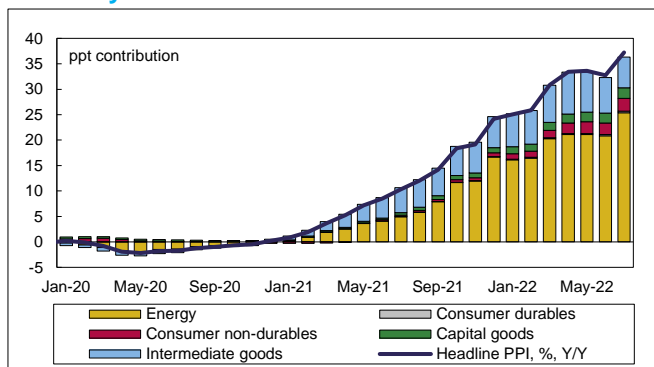
Retail sales beat expectations but downtrend in volumes continues

Retail sales volumes slightly beat expectations in July, rising 0.3%M/M following the revised decline of 0.2%M/M the prior month. While that left them 2.3% above the pre-pandemic level in February 2020, they were still down 3.4%Y/Y and 6.5% below the peak in April 2021. Indeed, the clear downward trend of recent quarters appears to remain intact, with sales volumes in the three months to July falling 1.2%3M/3M. The increase in sales volumes on the month reflected promotions online (e.g. Amazon's Prime Day event), thanks to which non-store volumes rose 4.8%M/M. In contrast, non-food store sales volumes fell 0.7%M/M with weakness seemingly broad-based across categories. In addition, auto fuel sales volumes fell 0.9%M/M as the UK's record heatwave deterred travel. And food store sales volumes inched up just 0.1%M/M.

Outlook for spending weakens further as consumer confidence hits new low

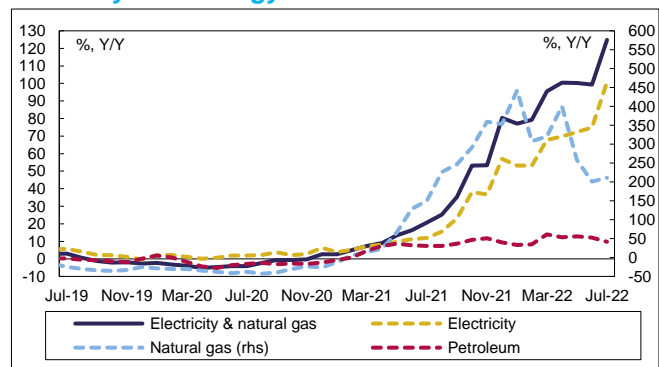
While the downtrend in retail sales volumes appears to have continued, higher prices mean that households are having to pay more despite buying less. Indeed, the value of retail sales rose 1.3%M/M in July to be up 2.5%3M/3M, 7.8%Y/Y and more than 15% above the pre-pandemic level in February 2020. Given widespread public alarm about the rising cost of living, household sentiment continues to deteriorate. The headline GfK consumer confidence index fell a further 3pts in August to -44, the lowest on the series dating back to 1974. All survey subcomponents weakened, with expectations for personal finances and general economic conditions over the coming twelve months both also down to new series lows. The climate for making major purchases was judged to be the worst on the survey bar the worst month of the global financial crisis and the first wave of Covid-19. So, in the absence of major new policy initiatives to offset the impact of higher

Germany: PPI and contributions



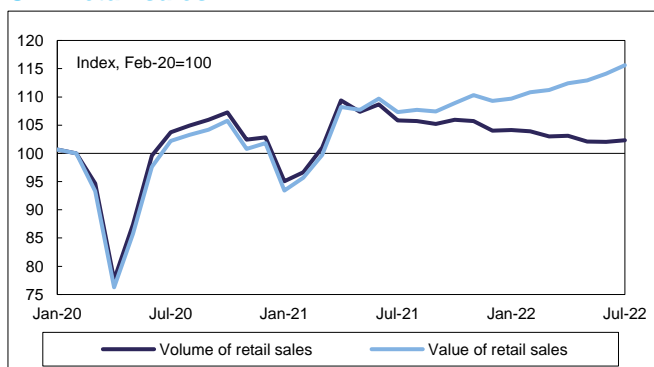
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: PPI energy



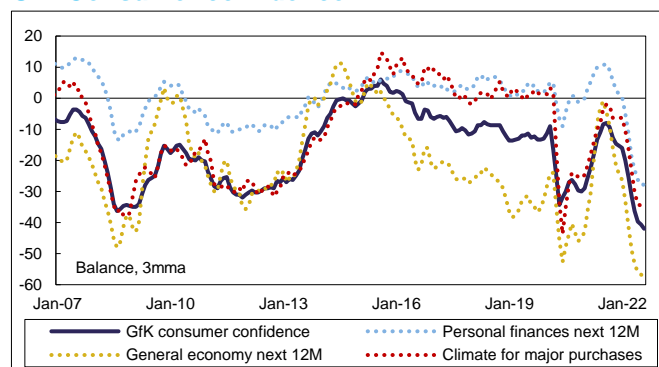
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

household energy prices, we expect the downtrend in real retail sales to continue over coming quarters, contributing to overall declines in household consumption and GDP.

Government borrowing close to OBR forecast in July

As Liz Truss and Rishi Sunak continue to discuss options for possible new fiscal support for UK households, today's public borrowing data provided the final update on the health of the public finances before one or the other will be confirmed as Boris Johnson's successor as Prime Minister on 5 September. Net public borrowing (excluding public sector banks) in July of £4.9bn was above most market forecasts, albeit close to the OBR's forecast (£4.7bn) published in March. While it was £0.8bn lower than a year earlier, it was almost £6bn above the level in July 2019 ahead of the pandemic. Central government current expenditure was up £3.4bn from a year earlier. In part, that again reflected higher debt interest payments, which were up £2.3bn from July 2021 at £5.8bn, due to the impact of high inflation on index-linked Gilt, which account for about 25% of the government's outstanding debt stock. Nevertheless, due to the methodology used to calculate such outlays, whereby the inflation-linked portion is calculated with a three-month lag, debt interest payments were down from the record £19.7bn in June. Meanwhile, central government receipts were up £2.3bn from July 2021, in part reflecting higher nominal economic growth and the tight labour market. Today's data also brought a downward revision to the estimate of net public borrowing in the three months to June by £5.5bn, largely as public expenditure was lower than previously thought. So, total net borrowing in the financial year to July was down £12.1bn from the same period a year ago at £55.0bn, 'only' £3.0bn above the OBR forecast.

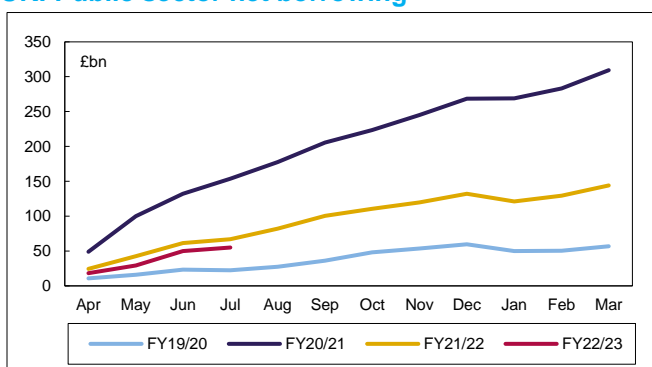
Inflation, recession and new policies suggest big upside risks to borrowing over coming years

Looking ahead, with inflation set to take another step up in the autumn as the regulated household energy price cap is increased again, debt interest payments look set to exceed £100bn in the current and next fiscal years. And future spending on welfare benefits and state pensions will eventually be uprated in line with inflation too, pushing current spending well above the OBR's forecast for coming years. Many government departmental budgets will need to be augmented to cope with the impact of high inflation too. And while high inflation will boost tax revenues in cash terms, the likely substantive contraction in real GDP over coming quarters will take a toll. So, when it provides an update on the state of the public finances for the incoming Prime Minister, the OBR seems likely to revise down its assessment of the scope for permanent increases in spending or tax cuts, instead pointing to the need for extra fiscal support for households and firms to be temporary and targeted if future sustainability concerns are to be guarded against. Of course, if – as the bookies' odds suggest – she wins the Conservative party leadership and becomes PM, Liz Truss has already committed, among other things, to reverse April's hike in National Insurance Contributions (which was estimated to raise some £16bn this year), remove the so-called "green levies" from energy bills, and cancel next April's planned hike in the main rate of corporation tax, with no commensurate plans to offset the impact of borrowing through cuts in public expenditure. So, risks to the outlook for public borrowing in FY23 (which the OBR forecast at 'just' £50.2bn) and beyond appear very highly skewed to the upside.

The week ahead in the UK

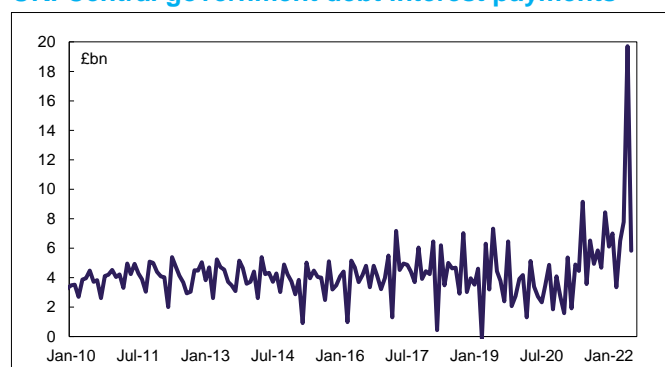
The coming week data-wise will be somewhat quieter than the past week, although we will get new survey indicators, which are likely to point to increasingly troubling times for the UK economy. The preliminary August PMIs are due on Tuesday. Having dropped in July for the third month out of the past four, to 52.8 – roughly 3pts below the average in the first half of the year and implying the softest growth since February 2021 – the composite PMI is likely to fall further towards 50 in August.] reflecting a deterioration in both services and manufacturing. The CBI's industrial trends survey for this month is due the same day and will likely similarly point to a slowdown in manufacturing activity and a further deterioration in firms' selling price expectations. This will be followed on Thursday by the release of the CBI's distributional trades survey for August, which is likely to indicate that conditions remain challenging for retailers as high inflation squeezes household budgets.

UK: Public sector net borrowing












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

UK: Central government debt interest payments



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

Daiwa economic forecasts





	2022				2023		2022	2023	2024
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	%, Q/Q						%, Y/Y		
Euro area 	0.5	0.7	0.0	-0.1	-0.3	0.0	2.9	-0.1	0.9
UK 	0.8	-0.1	-0.1	-0.4	-0.1	-0.2	3.3	-0.6	0.4
Inflation, %, Y/Y									
Euro area									
Headline HICP 	6.1	8.0	8.9	8.8	7.3	5.8	8.0	5.4	2.5
Core HICP 	2.7	3.7	4.2	4.4	4.4	4.1	3.7	3.7	2.2
UK									
Headline CPI 	6.2	9.2	10.1	13.6	13.1	9.5	9.8	8.4	2.0
Core CPI 	5.1	6.0	6.2	6.1	5.1	3.9	5.8	3.7	2.0
Monetary policy, %									
ECB									
Refi Rate 	0.00	0.00	1.00	1.50	1.75	1.75	1.50	1.75	1.50
Deposit Rate 	-0.50	-0.50	0.50	1.00	1.50	1.50	1.00	1.50	1.25
BoE									
Bank Rate 	0.75	1.25	2.25	2.50	2.50	2.50	2.50	2.50	2.00

Source: Bloomberg, ECB, BoE 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 	Current account balance €bn	Jun	4.2	-	-4.5	-6.9
Germany 	PPI M/M% (Y/Y%)	Jul	5.3 (37.2)	0.7 (31.8)	0.6 (32.7)	-
France 	Bank of France retail trade M/M% (3M/3M%)	Jul	-0.3 (-1.5)	-	-2.6 (0.1)	-
UK 	GfK consumer confidence survey	Aug	-44	-42	-41	-
	Retail sales including auto fuels M/M% (Y/Y%)	Jul	0.3 (-3.4)	-0.2 (-3.3)	-0.1 (-5.8)	-0.2 (-6.1)
	Retail sales excluding auto fuels M/M% (Y/Y%)	Jul	0.4 (-3.0)	-0.3 (-3.1)	0.4 (-5.9)	0.2 (-6.2)
	Public sector net borrowing, excluding banks £bn	Jul	4.9	3.2	22.9	20.9

Auctions






















Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 23 August 2022

The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous	
Monday 22 August 2022						
- Nothing scheduled -						
Tuesday 23 August 2022						
Euro area		09.00	Preliminary manufacturing (services) PMI	Aug	49.0 (50.5)	49.8 (51.2)
		09.00	Preliminary composite PMI	Aug	48.9	49.9
		15.00	European Commission's preliminary consumer confidence	Aug	-28.0	-27.0
Germany		08.30	Preliminary manufacturing (services) PMI	Aug	48.2 (49.0)	49.3 (49.7)
		08.30	Preliminary composite PMI	Aug	47.3	48.1
France		08.15	Preliminary manufacturing (services) PMI	Aug	49.0 (53.0)	49.5 (53.2)
		08.15	Preliminary composite PMI	Aug	50.8	51.7
UK		09.30	Preliminary manufacturing (services) PMI	Aug	51.0 (52.0)	52.1 (52.6)
		09.30	Preliminary composite PMI	Aug	51.0	52.1
		11.00	CBI industrial trends survey, total orders (selling prices)	Aug	2 (40)	8 (48)
Wednesday 24 August 2022						
- Nothing scheduled -						
Thursday 25 August 2022						
Germany		07.00	Final GDP Q/Q% (Y/Y%)	Q2	<u>0.0 (1.5)</u>	0.8 (3.9)
		09.00	Ifo business climate	Aug	86.8	88.6
		09.00	Ifo current assessment (expectations) balance	Aug	96.1 (78.7)	97.7 (80.3)
France		07.45	Business confidence	Aug	101	103
		07.45	Manufacturing confidence (production outlook)	Aug	104 (-)	106 (-5)
Spain		08.00	PPI M/M% (Y/Y%)	Jul	-	1.9 (43.2)
UK		11.00	CBI distributive trades survey, reported sales	Aug	-	-12
Friday 26 August 2022						
Euro area		09.00	M3 money supply Y/Y%	Jul	5.6	5.7
Germany		07.00	GfK consumer confidence	Aug	-31.8	-30.6
France		07.45	Consumer confidence	Aug	79	80
Italy		09.00	Economic sentiment	Aug	-	110.8
		09.00	Consumer (manufacturing) confidence	Aug	90.8 (104.4)	94.8 (106.7)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction	
Monday 22 August 2022			
- Nothing scheduled -			
Tuesday 23 August 2022			
Euro area		12.00	ECB's Panetta participates in an ECB policy panel
UK		10.00	Auction: £705mn of 0.125% 2038 inflation-linked bonds
Wednesday 24 August 2022			
Germany		10.30	Auction: €4bn of 2032 bonds
Thursday 25 August 2022			
Euro area		12.30	ECB publishes account of July policy meeting
Italy		10.00	Auction: 2Y bonds
Friday 26 August 2022			
- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are MiFID 2 Professional (or equivalent) Clients and should not therefore be distributed to such Retail Clients. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: <https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Opinions [and/or estimates] reflect a judgment as at the date of publication and are subject to change without notice. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.