

Euro wrap-up

Overview

- Bunds made gains as the flash euro area PMIs surprised on the downside in July, signalling a steeper pace of contraction amid waning demand.
- Gilts also made gains as the flash UK PMIs similarly pointed to a marked slowing in economic recovery as higher interest rates and weaker demand started to bite.
- Tuesday will bring the ECB's bank lending survey, as well Germany's ifo business sentiment and the UK CBI industrial trends indices.

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.003	-0.073
OBL 2.4 10/28	2.493	-0.055
DBR 2.6 08/33	2.409	-0.052
UKT 0% 06/25	4.868	-0.007
UKT 1% 10/28	4.313	-0.032
UKT 3% 01/33	4.232	-0.030

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

Euro area

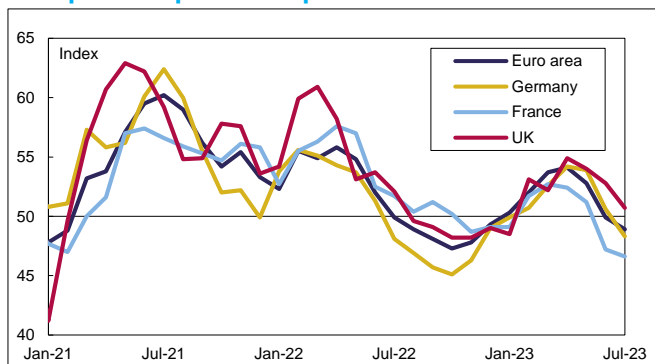
Flash euro area PMIs again surprise on the downside at the start of Q3

Having weakened sharply towards the end of Q2, the flash PMIs implied a further notable deterioration in economic conditions at the start of Q3, with uncertainties about the outlook for demand intensifying too. Indeed, the euro area composite PMI fell for a third consecutive month in July and by a full percentage point to an eight-month low 48.9. This left the index in contractionary territory for a second successive month, almost 3½pts below the Q223 average and a level that before the pandemic would have been consistent with GDP growth of between -0.2% and -0.1%. There was a further (albeit not surprising) deterioration in the manufacturing sector in July, for which the output PMI fell for a fourth consecutive month to 42.9, the lowest since the initial Covid lockdown in 2020 and before that the global financial crisis in 2009. But while the services survey suggested ongoing expansion, the activity index was nevertheless down for a third consecutive month, by 0.9pt, to 51.1, a six-month low and more than 5pts below April's recent high. The near-term outlook remains clouded by weakening demand too, with today's survey implying ongoing contraction in manufacturing new orders and the steepest for nine months, as well as a downturn in new business in the services sector, for the first time in seven months. So, the respective composite new orders PMI fell more than 2pts for a third consecutive month, to 45.9, leaving the largest divergence with the composite output component since February 2009. Waning demand saw backlogs of work fall sharply in July, with the index the lowest since the euro crisis in early 2013 when excluding the initial pandemic slump. And with output expectations for the year ahead deteriorating, firms reported the softest jobs growth since February 2021.

German output PMI implies contraction, with the French PMI the weakest of the member states

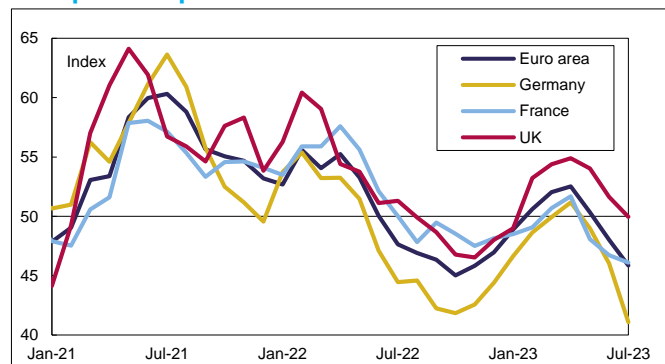
At the country level, the July flash PMIs were also weaker than expected. The German composite PMI dropped 2.3pts to 48.3, the first contractionary reading since January, the lowest since November, and some 4½pts below the Q223 average. And new orders declined sharply. The deterioration was led by a further marked deterioration in the manufacturing sector, for which the output index (41.0) stood at the lowest since April 2009 when excluding the initial Covid lockdown period. But recovery momentum also slowed sharply in the German services sector, with the activity index (52.0) the softest for five months and almost 4pts below the Q2 average. But the PMIs suggested that the weakness was again led by France, where the composite index fell a further 0.6pt to 46.6, the lowest since November 2020, to be 3½pts below the Q2 average. Perhaps impacted by the protests earlier this month, the services activity index (47.4) fell to the lowest since February 2021, with the manufacturing survey (43.2) signalling steep contraction too. We note, however, that last week's [INSEE survey](#) results – which often tally more closely with French GDP – pointed to broadly stable activity in July. Meanwhile, with a similar combination of slowing services and falling factory output, S&P Global reported that the rest of the euro area eked out only modest growth in economic output in July, by the slowest pace for seven months.

Europe: Composite output PMIs



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

Europe: Composite new orders PMIs



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

Price PMIs continue to ease, but pressures remain elevated in services

The combination of weaker demand and easing supply constraints delivered a further notable improvement in the survey's price indices. Indeed, the manufacturing sector reported the sharpest declines in output and input prices since 2009. However, in services, where labour costs are proportionately far more important, the flash PMIs suggested that prices charged and, in particular, input costs continue to rise at rates that remain well above their long-run averages. And while those PMIs were the lowest since 2021, suggesting some gradual moderation in cost pressures in the sector, the ECB will remain concerned about second-round price effects. As such, while the marked slowdown in euro area economic activity implied by recent surveys will undoubtedly feature in the ECB's discussions this week, we continue to expect that, in addition to a 25bps hike in interest rates this month, the Governing Council will likely signal that further tightening will be necessary this cycle.

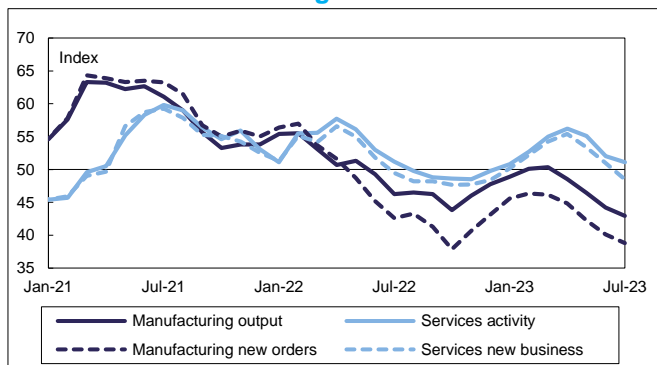
Spain's election stalemate points to extended period of political uncertainty

The outcome of the weekend's snap general election in Spain points to an extended period of political uncertainty. As predicted, the centre-right Popular Party (PP) won the largest share, increasing the number of seats in parliament from the 2019 election by 47 to 136 (33%), which would in theory have given its leader Alberto Núñez Feijóo the first opportunity to form a coalition government. But with his party having taken a notable proportion of votes from the far-right Vox, which saw its seat count drop from 52 to 33 (12%), they fell short of the 176 seats needed for a majority. On the other hand, the Socialists performance beat expectations, with the number of seats increasing by 2 to 122 (31%). But together with Sumar, which holds 31 seats (12%), current Prime Minister Pedro Sánchez will also fall short of a majority. A grand coalition seems highly unlikely. And with other political parties unwilling to support a right-wing coalition that includes Vox, Sánchez arguably has the better chance at forming a working majority than Feijóo, but would need the support of Basque and Catalan separatist groups. Spain's parliament is due to reconvene on 17 August, when the leaders of the two largest parties will meet with the King to put forward who has the better chance at forming a coalition. If Sánchez is invited to form a government, but fails to meet parliamentary approval, Spain will likely face a new snap election latter this year or early 2024. Either way, we expect a period of policy paralysis in Spain.

The day ahead in the euro area

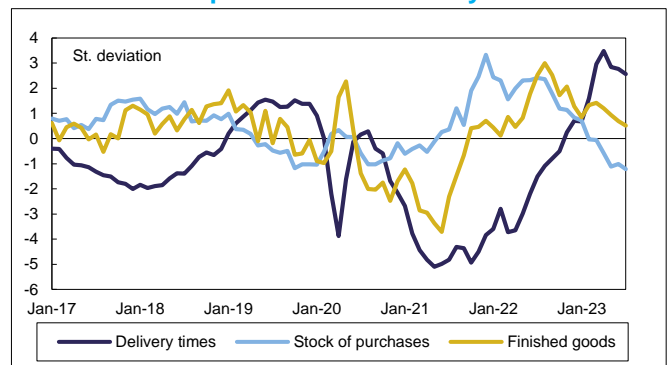
Ahead of the ECB's latest policy announcement on Thursday, most focus tomorrow will be on the publication of its quarterly Bank Lending Survey, which is likely to highlight the effects of the central bank's aggressive policy tightening since last summer. With credit standards having likely remained historically tight and borrowing costs having increased, we would

Euro area: Manufacturing & services PMIs



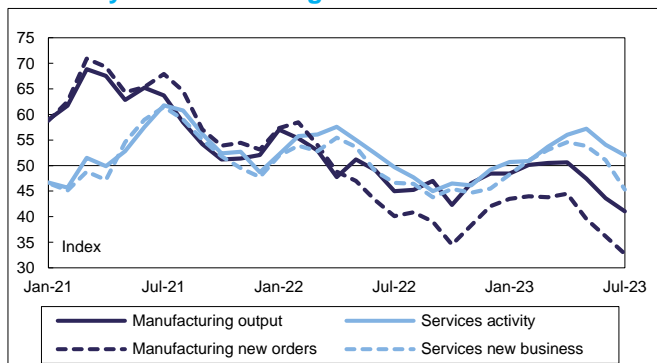
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Composite PMIs - delivery times & stocks



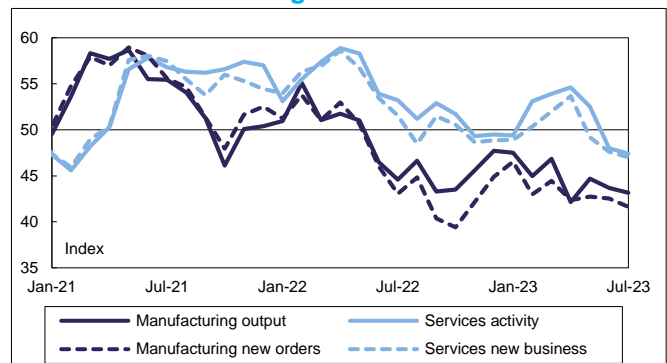
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing & services PMIs



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

France: Manufacturing & services PMIs



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

expect banks to indicate a further net decline in demand for loans last months. The flow of economic sentiment surveys also continues tomorrow, with the German ifo business confidence survey of interest. Following the deterioration in the manufacturing and services sector in today's PMIs, the ifo survey will also provide insight into conditions at retailers and construction firms at the start of Q3. Before the flash PMIs, the overall business climate index was expected to fall just 0.5pt to 88.0 in July, but risks are now to the downside.

UK

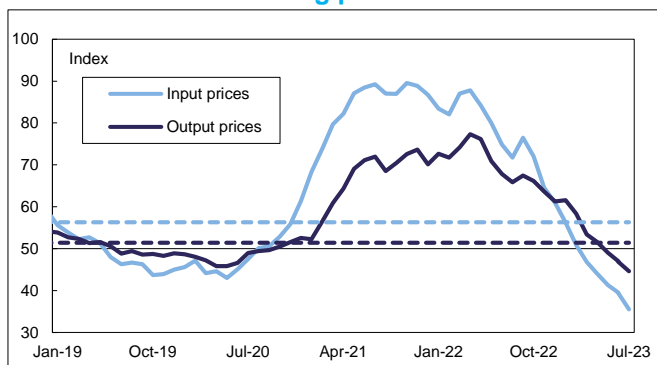
Flash UK PMIs slowed sharply at the start of Q3 as higher interest rates and weaker demand bite

Like in the euro area, today's flash PMIs signalled a marked slowdown in UK economic recovery momentum at the start of Q3 as survey respondents noted the negative impact of rising interest rates, elevated inflation and weakening demand amid rising economic uncertainties. In particular, the composite output PMI declined for the third consecutive month in July, by a steeper-than-expected 2.1pts to a six-month low of 50.7. This left it more than 3pts below the Q223 average and a level that before the pandemic would have been consistent with no GDP growth. While the services survey still suggested modest expansion, the activity index was down 2.2pts to 51.5, a six-month low and some 5½pts below April's high. Demand for new business in the sector slowed further in July, to a six-month low, with a number of firms noting weaker residential property market conditions as well as diminished discretionary business and consumer spending. Despite supplier lead times having improved to the greatest extent in the survey's 31-year history, today's survey again illustrated the ongoing challenges in manufacturing, with the output component declining 1.7pts to 46.5 and the new orders component falling to a seven-month low (44.0).

Price pressures ease, but services prices remain sticky

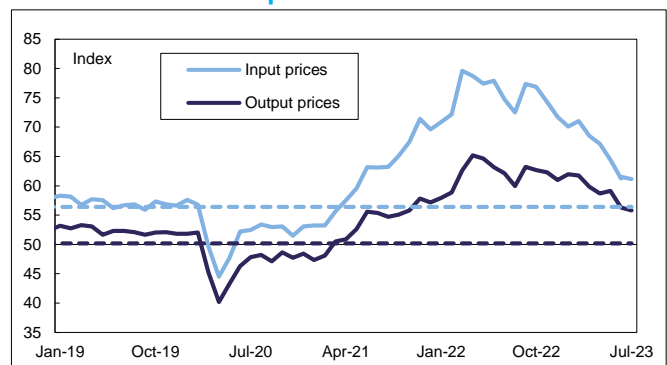
Given improving global supply chains, declining input costs and softer demand, the manufacturing survey implied a second successive decline in manufacturers' output prices and by the most since February 2016. Indeed, the respective PMI dropped to 49.0, 30pts below last year's peak and almost 4.5pts below the long-run average. But the pace of increase in input costs in the services sector moderated only very slightly in July, with the respective index down just 0.2pt to a still-elevated 68.2 as firms reported strong wage pressures. So, tallying with the MPC's concerns about the stickiness of services inflation, the services prices charged component (57.3) remained almost 5pts above the long-run average, albeit easing to its lowest for almost two years in July. On balance, alongside the improvement in June's [inflation](#) numbers, we think the findings from today's survey provide further support to the case for slowing the pace of rate increases to 25bps when the BoE meets next month, although we would also expect the MPC to leave the door open to further policy tightening.

Euro area: Manufacturing price PMIs*



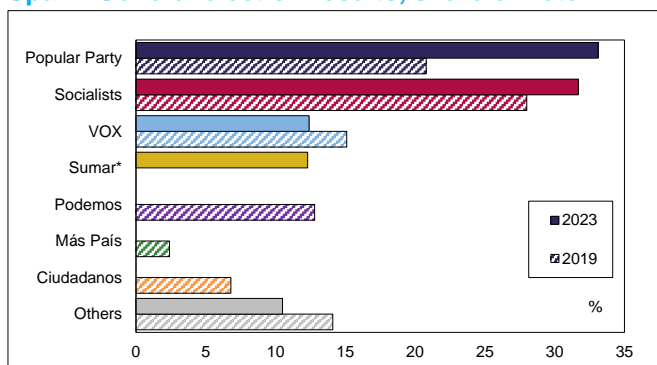
*Dashed lines represent pre-pandemic averages. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Services price PMIs*



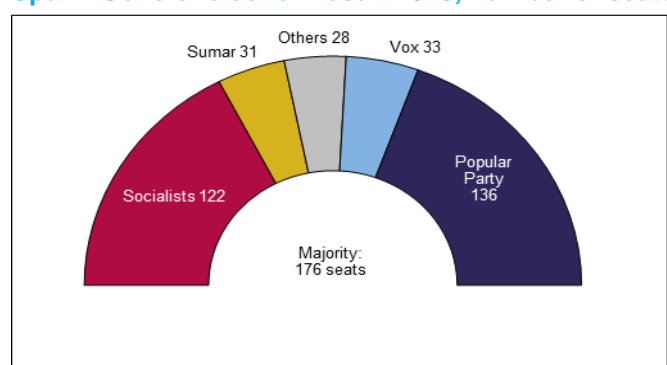
*Dashed lines represent pre-pandemic averages. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Spain: General election results, share of vote



*Sumar includes Podemos and Más País. Ciudadanos did not contest the 2023 election. Source: Spanish Interior Ministry and Daiwa Capital Markets Europe Ltd.

Spain: General election result 2023, number of seats

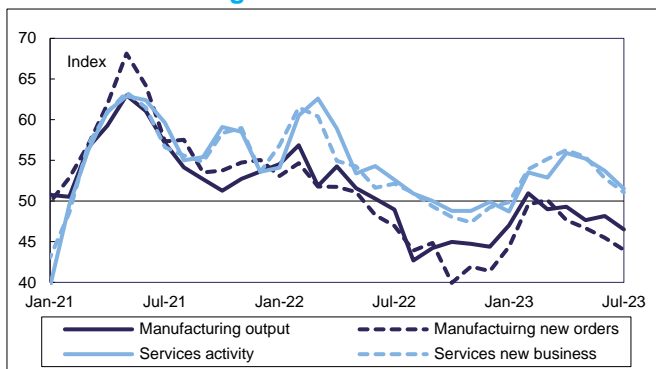


Source: Spanish Interior Ministry and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

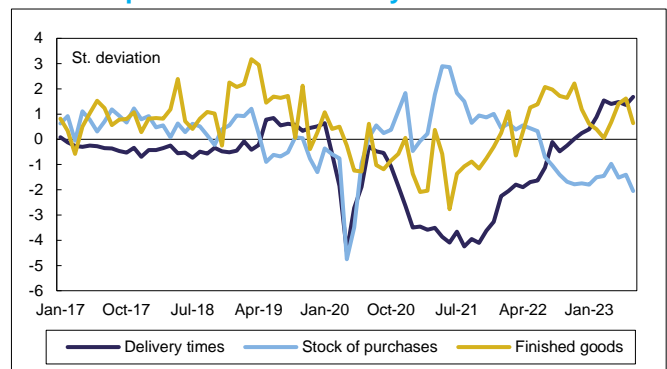
Tomorrow brings the release of the CBI's industrial trends survey for July, which is expected to align with the downbeat tone in today's manufacturing PMIs. But while the survey's orders component will signal an ongoing decline, the survey's quarterly expectations balance is expected to have risen to +3 in Q2 – the highest since Q321 – from -5 in Q1. This perhaps reflects reduced cost burdens in the sector, with the survey also expected to report a further easing in selling prices, with the respective balance expected to fall for the seventh successive month in July, to 16, although that would remain well above the long run average.

UK: Manufacturing & services PMIs



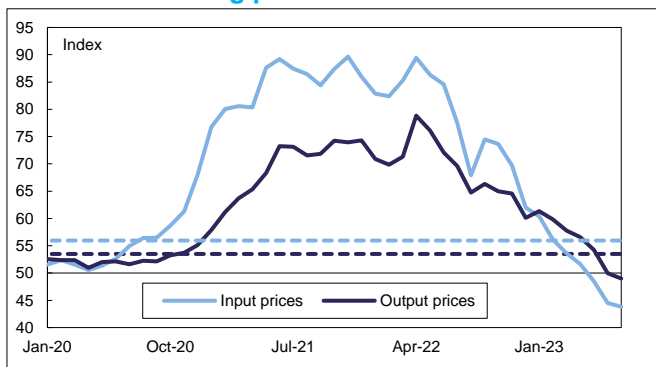
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UK: Composite PMIs – delivery times & stocks



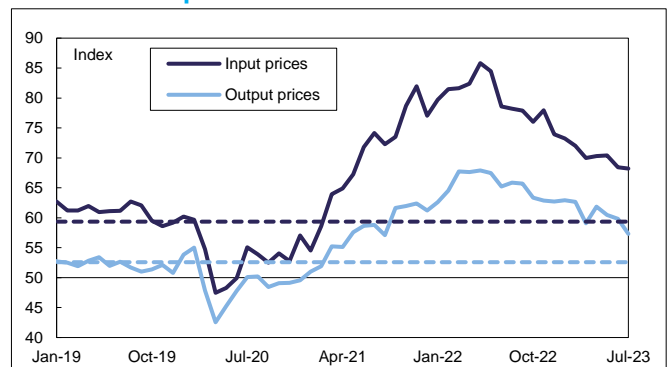
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing price PMIs*



*Dashed lines represent pre-pandemic averages. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Services price PMIs*












*Dashed lines represent pre-pandemic averages. Source: Refinitiv Datastream, S&P Global 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	 Preliminary manufacturing (services) PMI	Jul	42.7 (51.1)	43.4 (51.6)	43.4 (52.0)	-
	 Preliminary composite PMI	Jul	48.9	49.5	49.9	-
Germany	 Preliminary manufacturing (services) PMI	Jul	38.8 (52.0)	41.0 (53.0)	40.6 (54.1)	-
	 Preliminary composite PMI	Jul	48.3	47.4	50.6	-
France	 Preliminary manufacturing (services) PMI	Jul	44.5 (47.4)	45.9 (48.5)	46.0 (48.0)	-
	 Preliminary composite PMI	Jul	46.6	47.4	47.2	-
Spain	 PPI Y/Y%	Jun	-8.1	-	-6.9	-6.8
UK	 Preliminary manufacturing (services) PMI	Jul	45.0 (51.5)	46.0 (53.0)	46.5 (53.7)	-
	 Preliminary composite PMI	Jul	50.7	52.4	52.8	-




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/ <i>Daiwa forecast</i>	Previous
Germany	 09.00	Ifo business climate	Jul	88.0	88.5
	 09.00	Ifo current assessment (expectations) balance	Jul	93.0 (83.5)	93.7 (83.6)
UK	 11.00	CBI industry trends survey, total orders (business optimism)	Jul	-18 (3)	-15 (-2)

Auctions and events

Euro area	 09.00	ECB publishes Bank Lending Survey
Italy	 10.00	Auction: €3.75bn of 3.60% 2025 bonds
	 10.00	Auction: €1.25bn of 0.10% 2033 index-linked bonds
UK	 10.00	Auction: £3.00bn of 3.75% 2038 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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