Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made modest gains as flash euro area data showed that GDP in Q2 rose in line with the ECB's expectation, headline inflation eased slightly but core inflation picked up due to the sticky services component.
- Apart from at the short end of the curve, Gilts made gains as UK consumer credit picked up but net mortgage lending remained very weak.
- Tuesday will bring updates on euro area unemployment and UK house prices, as well as the final manufacturing PMIs for July.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.014	-0.024
OBL 2.4 10/28	2.527	-0.013
DBR 2.6 08/33	2.485	-0.004
UKT 0⅝ 06/25	4.938	+0.020
UKT 1⅝ 10/28	4.372	-0.017
UKT 3¼ 01/33	4.297	-0.018

*Change from close as at 4:45pm BST.
Source: Bloomberg

Euro area

Euro area GDP rises in line with ECB projection in Q2 despite Italian dip

After ECB President Lagarde last week judged that the near-term euro area economic outlook had weakened, the Governing Council will be relieved that today's data confirmed that activity in the second quarter was resilient. Indeed, bang in line with the ECB's projection made in June, but 0.1ppt above the median forecast on the Bloomberg survey, euro area GDP rose 0.3%Q/Q (0.27%Q/Q to two decimal places) in Q2 following zero growth in Q1. That left it up 0.6%Y/Y and 2.7% above the pre-pandemic level in Q419. The aggregate euro area figure masked significant differences between the member states. Roughly half of all of the expansion in the euro area came from Ireland, where GDP grew 3.3%Q/Q due to the activities of US multinationals based there for tax purposes. France (0.5%Q/Q) and Spain (0.4%Q/Q) also made significant positive contributions to aggregate euro area growth. At the opposite end of the spectrum, with German economic output unchanged from Q1, Italy was the only large member state to report a contraction, with figures released today reporting that GDP fell 0.3%Q/Q. That likely reflects payback for the significant strength in Italy in Q1 (0.6%Q/Q), and surveys currently suggest a good chance that Italian GDP will avoid recession and return to positive (albeit modest) growth in Q3.

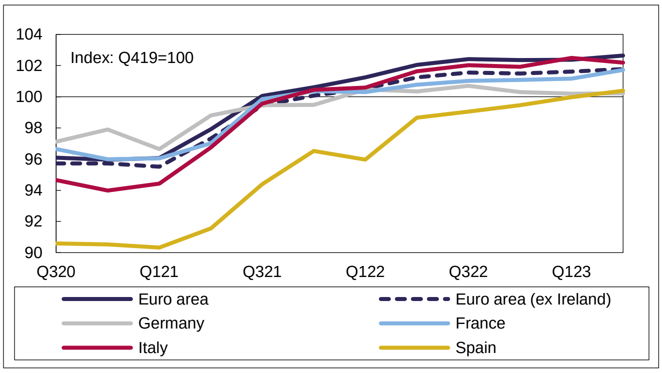
Expenditure breakdown of GDP unclear with notable contrasts among the member states

The expenditure breakdown of euro area GDP in Q2 remains extremely unclear, with no detailed data published today. That was also the case in Italy, where ISTAT merely reported that domestic demand gross of inventories subtracted from economic growth while net trade was neutral. Data released on Friday had shown that French domestic demand last quarter was also soft but French exports were strong, with the opposite true in Spain. And Destatis had merely reported that German consumption was stable. On balance, we think that overall euro area GDP growth in Q2 was supported for a third successive quarter by net trade. Household consumption also probably provided a modest boost, as sentiment improved in response to slowing inflation, rising wages and the firm labour market. But fixed investment likely made little contribution, weighed not least by contraction in construction.

German retail sales volumes up in Q2 for first quarter in four

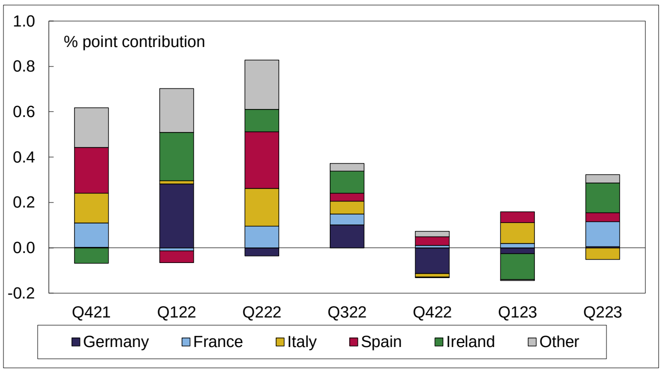
The resilience of German private consumption on goods in Q2 was reflected in today's retail sales figures for June. While the volume of sales that month fell 0.8%M/M, a little further than had been anticipated, growth in May was revised up a marked 1.5ppts to 1.9%M/M. So, with April also having registered an increase, German retail sales volumes rose for the first quarter in four in Q2 and by a respectable 1.1%Q/Q, with positive growth in sales of food, household goods, clothing and footwear. Given previous weakness, sales volumes in June were up just 0.1%Y/Y to be 0.8% above the pre-pandemic level in

Euro area: GDP levels by selected member states



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Country contributions to GDP growth



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

February 2020. But due to high inflation, the value of retail sales was up 2.2%Q/Q and 7.5Y/Y, to be 18.8% above the pre-pandemic level.

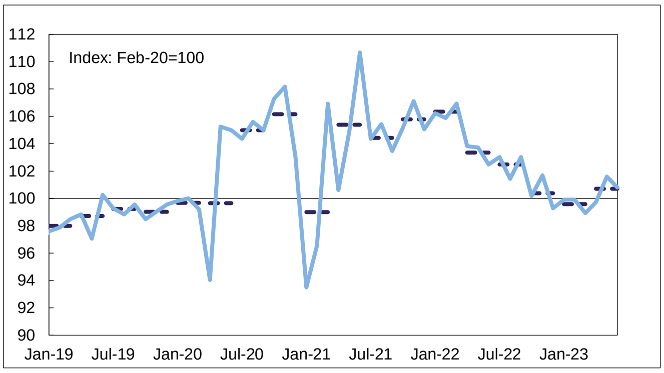
Flash euro area inflation eases slightly, but core inflation still sticky

Of course, the ECB is currently more preoccupied by inflation than GDP. And notably. today's flash euro area inflation estimates for July came in a touch firmer than expectations. With consumer prices falling for the first month in six (-0.1%M/M), headline HICP inflation eased a further 0.2ppt in July to 5.3%Y/Y, the lowest rate since January 2022 and exactly half the peak recorded last October. Base effects associated with last year's substantial shocks to energy and food prices were evident in the inflation rates of the major components. Indeed, while the monthly rise in food prices was once again above the seasonal average, the annual rate of that component eased 0.8ppt to 10.8%Y/Y, almost 5ppts below March's peak. Meanwhile, despite an increase in petrol prices, and so likely reflecting a further decline in household electricity bills, energy prices also fell further this month, resulting in the steepest annual drop in the respective annual rate (-6.1%Y/Y) since December 2020. And with the monthly change in core goods prices below the seasonal norm for the first time in 28 months, inflation of that component moderated a further 0.5ppt to 5.0%Y/Y, the softest for a year. However, with the monthly rise in services prices (1.36%M/M) the second-strongest on the series (exceeded only by July 2018), services inflation rose a further 0.2ppt to a new series high of 5.6%Y/Y. And as a result, core HICP inflation moved sideways at 5.5%Y/Y, still 0.2ppt lower than the series high reached in March but nevertheless 0.1ppt above the median forecast on the Bloomberg survey.

Momentum in services starting to slow but risks still skewed to the upside

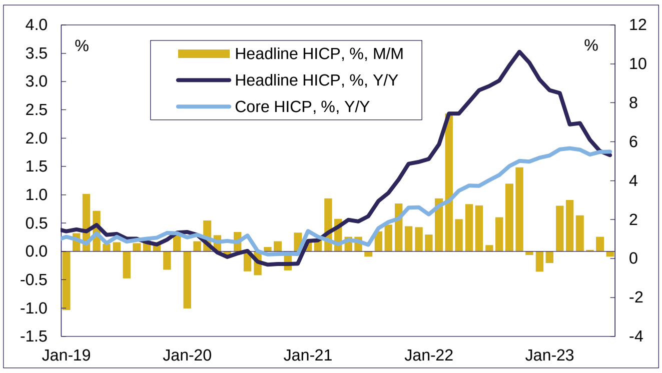
While it is still far from consistent with the ECB's inflation target, however, there are signs that momentum in services inflation is starting to slow. Indeed, the increase in services prices in July on a three-month annualised basis (4.5%) was the softest since September. And reflecting recent developments in wholesale and producer prices, momentum in core goods prices has now faded significantly. Base effects will continue to push energy and food inflation lower over coming months too. As such, we continue to expect headline inflation to maintain a steady downwards trend. But we still expect it to average around 3.0%Y/Y in Q423 and remain above the ECB's 2.0% target throughout much of 2024. Moreover, over the near term, core inflation will remain stickier at above 5.0%Y/Y until base effects associated with Germany's public transport subsidies wear off in September, and probably averaging closer to 4.0%Y/Y in Q423. And many Governing Council members will remain concerned that the risks to the near-term outlook are likely still to be skewed slightly to the upside. So, taken together with the resilient GDP data, today's inflation figures suggest that a pause at the Governing Council's September meeting is

Germany: Retail sales volumes*



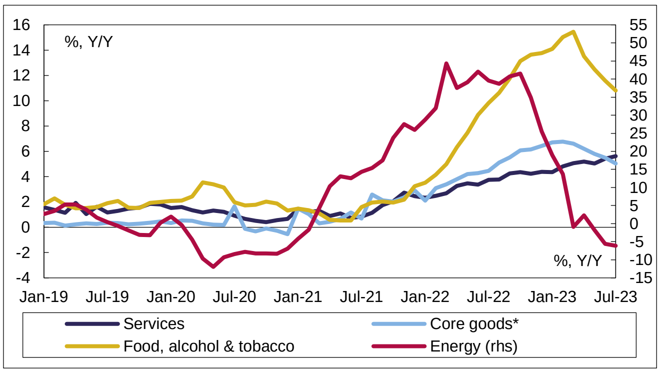
*Dashed dark blue lines represent quarterly average. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



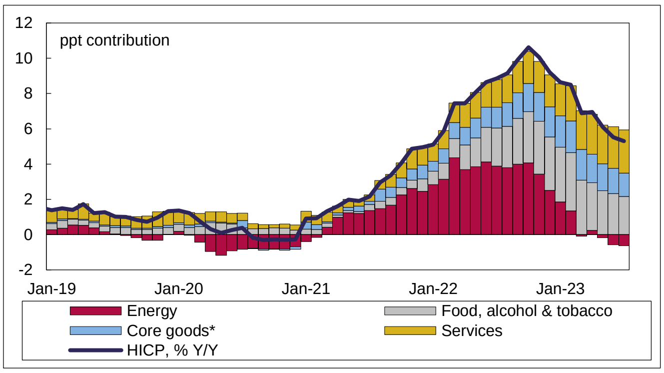
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation components



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

Euro area: Contributions to consume price inflation



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

far from a done deal. And, as noted by President Lagarde in a weekend interview with Le Figaro, a pause in rates in September would certainly not preclude a further hike in October or December.

The day ahead in the euro area

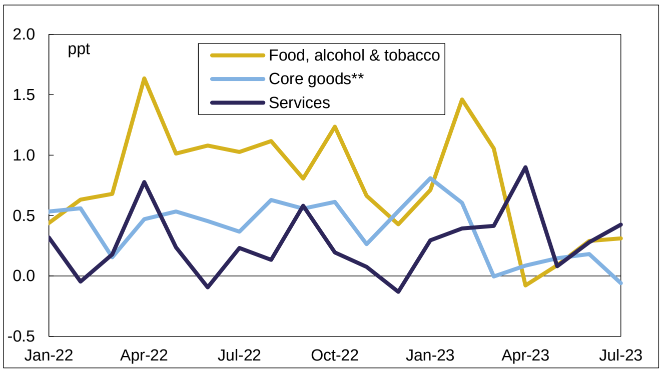
Tuesday will bring euro area unemployment data for June, with the headline rate likely to remain unchanged at the series low of 6.5% for a third successive month to provide a reminder that the labour market remains tight. German jobless claims data for July are also due, with the anticipated further increase of 20k – broadly in line with the average since March – expected to leave the claimant count rate unchanged at 5.7%. The final July manufacturing PMIs are also due and are likely to highlight ongoing weakness in the sector. According to the flash estimates, the euro area output PMI fell for the fourth successive month and by 1.2pts to a highly contractionary 43.0. In addition, the new orders PMI fell below 40. And strikingly, the input cost (35.5) and output price (44.6) PMIs suggested significant disinflation in the sector. The Italian and Spanish survey results for July, due to be released for the first time, are likely to send a similar message.

UK

Consumer credit jumps in June perhaps reflecting concerns about higher interest rates

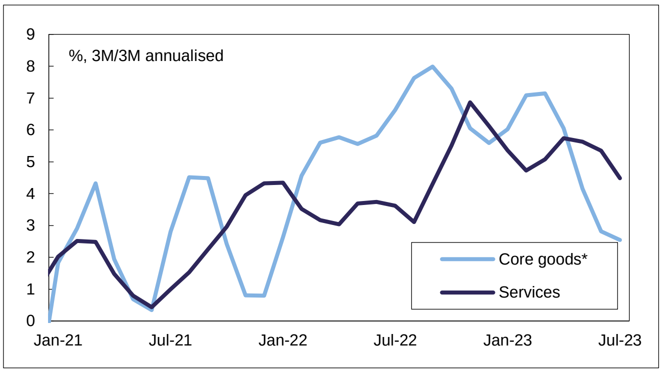
With the BoE's latest Consumer Credit Survey having highlighted that banks were less willing to lend in the second quarter and expected credit availability to fall further over the summer months, today's UK monthly monetary data, at face value at least, were arguably better than might have been feared. Indeed, despite the steady upwards rise in interest rates, for which the average rate on a new unsecured loan was 170bps higher than a year ago at 8.41%, the net increase in household consumer credit of £1.7bn was the strongest since April 2018, up from an increase of £1.1bn in June and £0.3bn above the pre-pandemic five-year average. This largely reflected a jump in other credit in June – i.e. car dealership finance and personal loans – perhaps reflecting consumer concerns that interest rates were set to rise further and remain higher for longer. Borrowing on credit cards remained stable in June (£0.6bn), albeit leaving the stock of such lending still up 12%Y/Y amid the ongoing squeeze in household budgets. Meanwhile, although today's data also showed that total household deposits increased in June (£3.8bn), this largely offset the withdrawal in May to maintain a broadly sideways trend since January. But the ongoing shift from sight deposits into higher-yielding time deposits was again evident. Indeed, over the three months to June, the net increase in time deposits and ISAs of £24bn was roughly double the increase three months earlier, suggesting that consumers continue to prefer to save rather than spend.

Euro area: Deviation from l-r average price change*



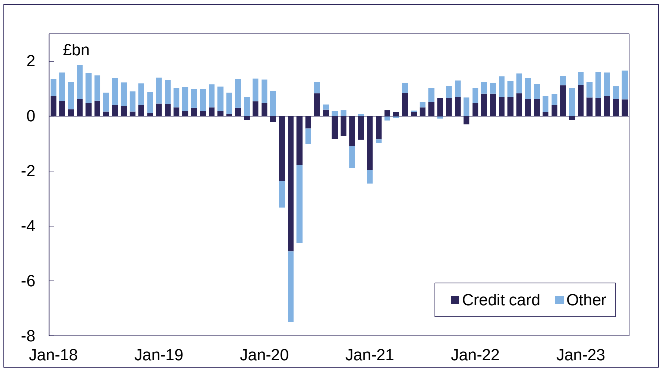
**Deviation from long-run average price change. **Non-energy industrial goods. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.*

Euro area: Services and goods momentum



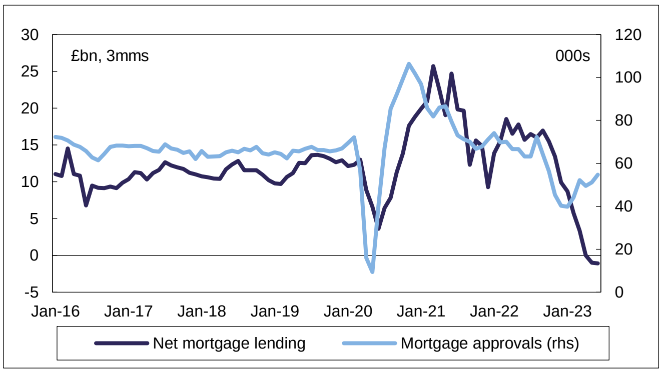
**Non-energy industrial goods. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.*

UK: Net flow of consumer credit



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Net flow of mortgage lending and approvals



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Net mortgage lending remained historically weak even as approvals rose in June

With banks having reduced the supply of mortgage loans significantly and the average interest rate on a 2-year fixed-rate 75% LTV mortgage having leapt some 75bps on the month to 5.50% in June, mortgage lending remained unsurprisingly weak last month, with the net increase of just £136mn well below the average in 2022 (£5.1bn) and the five years before the pandemic (£3.6bn). Indeed, coming on the back of two successive net repayments, the flow of mortgage lending on a three-month basis (-£1.1bn) was the weakest since the series began in the early 1990s and compared with an increase of £15½bn a year ago. And while the number of mortgage approvals rose more than expected in June, to an eight-month high of 54.7k, it was still more than 17k below last summer's peak and remained well below the pre-pandemic five-year average (66.5k). Moreover, we suspect this in part reflects home-buyers rushing to lock in deals as mortgage lenders withdrew products in the wake of the stronger-than-expected wage and price data and subsequent larger hike in Bank Rate last month. Certainly, many households will continue to try to pay down their mortgage debt in fear of even higher rates to come.

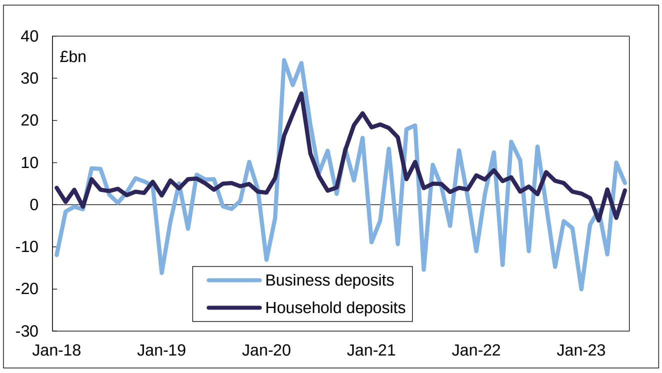
Business lending fall sharply, while firms increase deposit holdings

Businesses also continued to pay off debt in June, with the net repayment of £5.6bn the third largest since the series began in 2011. This in part reflected a sizeable net repayment by large firms (£4.3bn), to leave the outstanding stock of such loans up just 0.6%Y/Y, the softest annual growth rate since September 2021. Meanwhile, SMEs made a seventh consecutive net repayment (£1.3bn), to leave the outstanding stock down 4.3%Y/Y. In addition, firms deposited an additional £5.1bn with banks in June, the second monthly increase out of the past seven, also suggesting that businesses remain reluctant to spend.

The day ahead in the UK

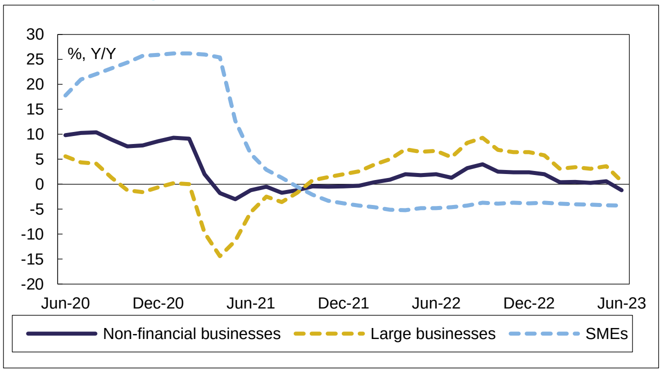
As in the euro area, in the UK Tuesday will bring the final July manufacturing PMIs. According the flash estimates, the output index fell 1.6pts to an eight-month low of 46.5, suggesting significant contraction. The new orders PMI dropped to 44.0, its lowest level since December. And, as in the euro area, the input cost (43.8) and output price (49.0) indices signalled disinflation. In addition to the manufacturing PMIs, Nationwide house price data for July are expected to report a renewed drop in prices following two months of stability previously, to be down about 4.0%Y/Y. The Lloyds business barometer and BRC shop price index, both for July, are also due tomorrow.

UK: Net flow of household & business deposits



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Lending to businesses



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	Preliminary HICP (core HICP) Y/Y%	Jul	**5.3 (5.5)**	_5.2 (5.3)_	5.5 (5.5)	-
	First estimate - GDP Q/Q% (Y/Y%)	Q2	**0.3 (0.6)**	_0.2 (0.5)_	0.0 (1.1)	-
Germany	Retail sales M/M% (Y/Y%)	Jun	**-0.8 (0.1)**	0.1 (-0.4)	0.4 (-5.1)	1.6 (-3.9)
Italy	First estimate - GDP Q/Q% (Y/Y%)	Q2	**-0.3 (0.6)**	_-0.2 (0.7)_	0.6 (1.9)	-
	Preliminary HICP (CPI) Y/Y%	Jul	**6.4 (6.0)**	6.6 (6.1)	6.7 (6.4)	-
UK	Net consumer credit £bn (Y/Y%)	Jun	**1.7 (7.6)**	-	1.1 (7.5)	- (7.6)
	Net mortgage lending £bn (approvals '000s)	Jun	**0.1 (54.7)**	0.5 (48.8)	-0.1 (50.5)	- (51.1)
	M4 money supply M/M% (Y/Y%)	Jun	**-0.1 (0.1)**	-	0.2 (0.0)	0.3 (-)

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	09.00	Final manufacturing PMI	Jul	_42.7_	43.4
	10.00	Unemployment rate %	Jun	_6.5_	6.5
Germany	08.55	Final manufacturing PMI	Jul	_38.8_	40.6
	08.55	Unemployment rate % (change '000s)	Jul	5.8 (20.0)	5.7 (28.0)
France	08.50	Final manufacturing PMI	Jul	_44.5_	46.0
Italy	08.45	Manufacturing PMI	Jul		43.8
	10.00	Unemployment %	Jun		6.5
Spain	08.15	Manufacturing PMI	Jul	48.5	48.0
UK	00.01	Lloyds business barometer	Jul	-	37
	00.01	BRC shop price index Y/Y%	Jul	-	8.4
	07.00	Nationwide house price index M/M% (Y/Y%)	Jul	-0.5 (-4.0)	0.1 (-3.5)
	09.30	Final manufacturing PMI	Jul	_45.0_	46.5

Auctions and events

UK	10.00	Auction: £4bn of 3.5% 2025 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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