

Euro wrap-up

Overview

- While the final manufacturing PMIs signalled falling output and disinflation in the sector, Bunds largely made losses as the euro area unemployment rate reached a new series low and German jobless claims fell.
- Gilts also made losses despite a drop in a survey measure of UK shop prices and a further decline in house prices.
- The main event over the coming two days will be the BoE's monetary policy announcement on Thursday, which will be accompanied by updated economic projections.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.028	+0.005
OBL 2.4 10/28	2.575	+0.045
DBR 2.6 08/33	2.548	+0.061
UKT 0% 06/25	5.001	+0.062
UKT 1% 10/28	4.457	+0.081
UKT 3¼ 01/33	4.388	+0.087

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

Euro area

Euro area unemployment rate registers new series low throughout Q2

The euro area unemployment rate was unchanged in June from the two prior months. But as the figures for April and May were revised down by 0.1ppt, the steady rate of 6.4% throughout the second quarter was lower than had been previously thought. Indeed, consistent with respectable GDP growth of 0.3%Q/Q that quarter, the unemployment in Q2 was down 0.2ppt from the Q1 average, and a new record low on the series. In addition, the number of people registered unemployed in the euro area continued to edge lower in June, dropping for a fifth successive month and by just 62k to 10.814mn, also a new series low. The declines in joblessness continued to be led by countries in the Mediterranean. Indeed, buoyed by another quarter of firm GDP growth (0.4%Q/Q), the ILO unemployment rate measure in Spain fell a chunky 0.8ppt between March and June to a 15-year low of 11.7%. And despite its contraction in GDP last quarter (-0.3%Q/Q), Italy's rate dropped 0.4ppt over the same period to a 14-year low of 7.4%. In contrast, the equivalent German ILO rate was unchanged (3.0%) while that in France edged up slightly (7.1%).

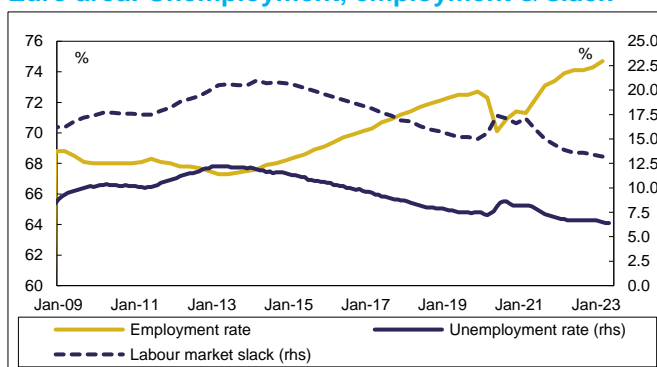
German jobless claims unexpectedly fall in July despite lack of economic growth momentum

The ongoing decline in euro area joblessness in Q2 follows the further rise in the employment rate and decline in broader labour market slack to new records in the prior quarter, as well as survey reports of ongoing labour shortages across all major sectors. And while the job vacancy rate edged down slightly in Q1 to 3.0%, it remained highly elevated by historical standards and almost 1.0ppt above the pre-pandemic level in Q419. Moreover, despite survey reports of a weakening of economic momentum at the start of Q3, there remains no evidence of a significant loosening of labour market conditions to allay the concerns of the ECB hawks about second-round effects on inflation from wage growth. Indeed, German jobless claims declined in July for the first month in six, allowing the claimant count rate to reverse the rise in June to edge back down to 5.6%. Admittedly, on a seasonally adjusted basis, the number of German job vacancies fell for the sixth successive month in July, dropping 10k to be down 57k from January. But while the level of vacancies was the lowest since August 2021, at 751k it was still some 40k above the pre-pandemic level in February 2020.

Final manufacturing PMIs point to most acute weakness in the sector since first wave of Covid-19

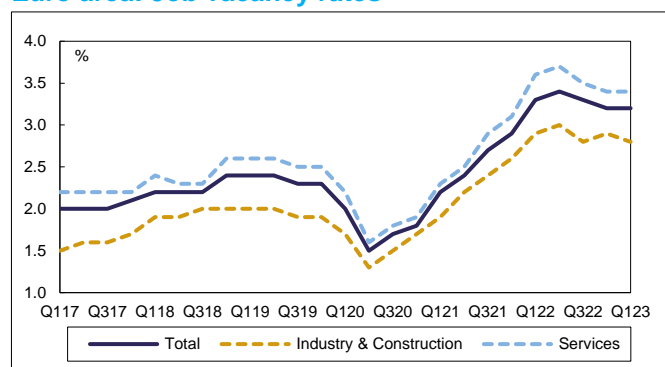
The resilience of the labour market was also illustrated in today's final manufacturing PMIs for July, which nevertheless otherwise flagged the significant weakening in activity and intensifying disinflation trend in the sector. The euro area manufacturing output PMI was revised down from the flash estimate to 42.7, 1.5pt below the level in June and the lowest since the first wave of pandemic in May 2020 and, before that, the global financial crisis in early 2009. And following today's

Euro area: Unemployment, employment & slack



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Job vacancy rates



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

first release of the July survey results for Italy, Spain and several others, the output PMIs for all member states to report PMIs bar Greece (53.5) were below the key 50 level for the first time in three years to suggest broad-based contraction in the factory sector across the region. Moreover, the euro area indices for total new orders and new export orders both fell below 40, as did the PMI for work backlogs, all similarly the lowest since the first wave of Covid-19 and pointing to the likelihood of further retrenchment in production amid falling domestic and external goods demand. Nevertheless, with the manufacturing employment PMI falling just 0.5pt to 49.3, on a net basis still relatively few firms in the sector appear willing to reduce worker headcount through the downturn. Indeed, in Italy the employment PMI remained above 50 pointing to ongoing net demand for new labour. At the same time, however, wage pressures seem to be of diminishing concern in the sector, not least as the euro area input costs PMI fell sharply to 35.8 (and below 30 in Germany) while the output price PMI fell to 45.0, both arguably consistent with the most significant deflationary pressures in the factory sector since 2009. Overall, therefore, in contrast to today's unemployment data, the manufacturing PMIs strengthen the hand of the doves on the Governing Council ahead of September's monetary policy meeting.

The coming two days in the euro area

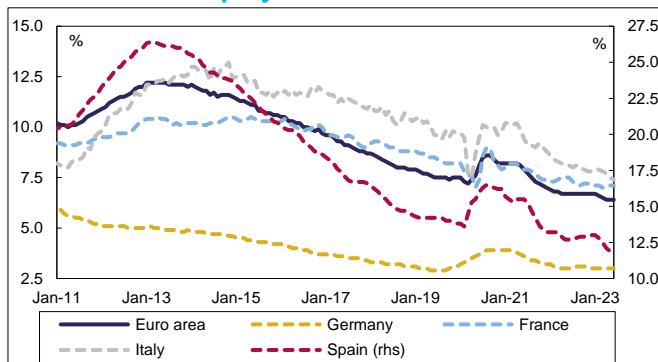
After a relatively quiet day for top-tier economic data tomorrow, Thursday will bring further updates on price pressures, with euro area producer price figures expected to reflect the global downtrend in manufacturing sector costs. With producer prices likely to have declined for a sixth successive month in June, the headline PPI inflation rate is forecast to fall further into negative territory from the 2½-year low of -1.5%Y/Y reached in May, probably to below -3.0%Y/Y. The final services PMIs for July, however, are likely to show that price pressures remain stickier in that sector. The flash survey saw the euro area's input price index move sideways (61.2), while the prices charged index (55.8) remained well above the long-run average despite easing to a near-two-year low. In terms of economic activity, the headline index fell to a six-month low (51.1), with the new business component declining sharply too (48.5). At the country level, German goods trade figures for June are expected to report a slight widening in the surplus reflecting modest growth in the value of exports and a modest decline in imports. In addition, dovish ECB Executive Board member Panetta is scheduled to give a talk on "Getting disinflation right".

UK

UK shop price inflation down to lowest since December with prices down in several key items

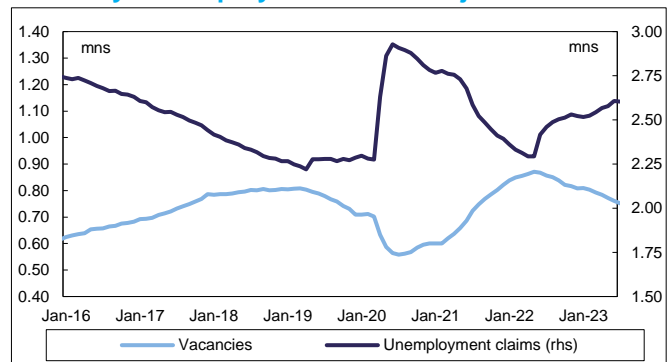
According to the BRC survey, UK shop price inflation fell in July to an eight-month low, dropping 0.8ppt to 7.6%Y/Y. Notably, the BRC also reported that prices fell from the previous month for the first time in two years. The declines in prices were led

Euro area: Unemployment rates*



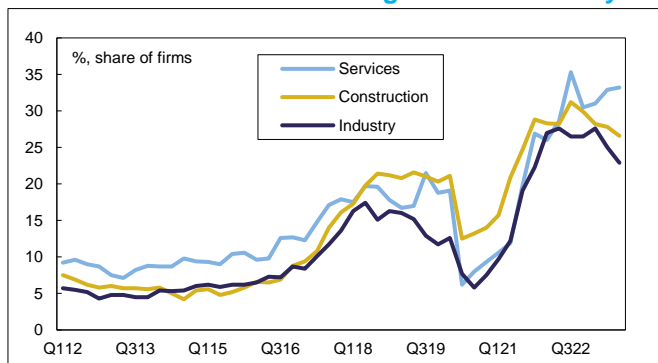
*ILO measure. Source: Refinitiv Datastream and Daiwa Markets Europe Ltd.

Germany: Unemployment claims & job vacancies



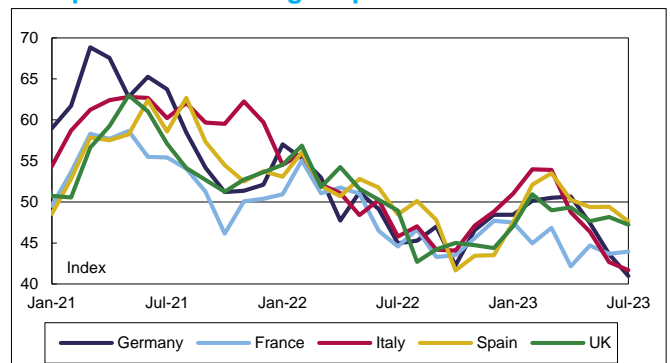
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Labour as a limiting factor on activity*



*Construction figures based on monthly survey. Source: EC, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Europe: Manufacturing output PMIs



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

by clothing and footwear, for which the BRC measure of inflation dropped 1.1ppt to -1.3%Y/Y as retailers responded to inclement weather with additional discounting. Encouragingly, food inflation also slowed more than 1.0ppt to 13.4%Y/Y, the lowest level since December, with falling prices across several key staples. The survey measure of prices of electrical items was also down on the month, suggesting a welcome dampening impact on UK inflation from developments in global goods prices. This was further illustrated by today's final manufacturing PMIs. Indeed, while the input price index was nudged slightly higher from the flash release, at 44.8 it was more than 11pts below the long-run average and consistent with a deflationary trend. And the output price PMI was unchanged at 49.9, some 4.5pts below the long-run average and consistent with broadly flat prices of consumer goods.

Manufacturing PMIs point to a steeper decline in output, orders and employment

As in the euro area, the reduction in price pressures in the UK's manufacturing sector in part reflects a welcome further significant easing of supply-chain strains in July, with the supplier delivery times PMI the best on the series dating back to 1992. But, of course, the moderation in price pressures also reflects weaker demand. With the factory output PMI down 0.9pt to 47.2, a six-month low consistent with ongoing contraction, firms attributed the weakness to overstocked clients, efforts by firms to streamline their operations, and the downturn in both domestic and overseas demand – indeed, the new export orders PMI (41.4) was one of the weakest readings in the past three years. As such, the rate of job losses reportedly accelerated in July, with marked cuts reported at producers of consumer and intermediate goods.

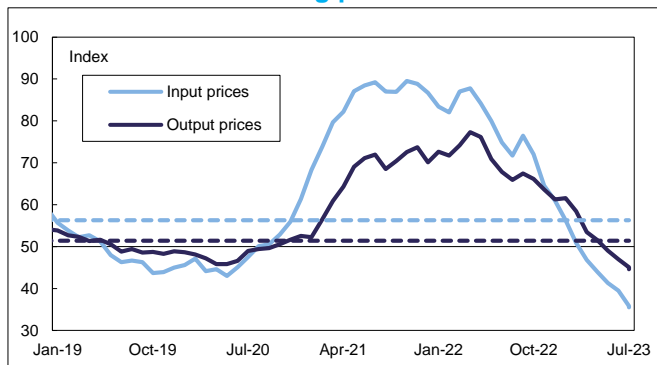
Nationwide house price index falls at steepest annual pace since 2009

According to Nationwide, UK house prices fell 0.2%M/M in July to the lowest level since March. Compared to a year earlier, prices were down 3.8%Y/Y, the steepest rate since 2009 and were some 4½% below last year's peak. With rates on new mortgages sharply higher over recent months and lenders having reduced availability of products, data released yesterday reported the weakest flow of net mortgage lending on a three-month basis (-£1.1bn) since the series began in the early 1990s. This tallies with the low level of residential market transactions, which were down 27%Y/Y in May at close to 80k, the lowest since April 2016 when excluding pandemic-related distortions. And while the number of mortgage approvals rose more than expected in June, to an eight-month high of 54.7k, it remained well below pre-pandemic norms.

Housing affordability at 15-year low with re-mortgagors still facing big hit to disposable incomes

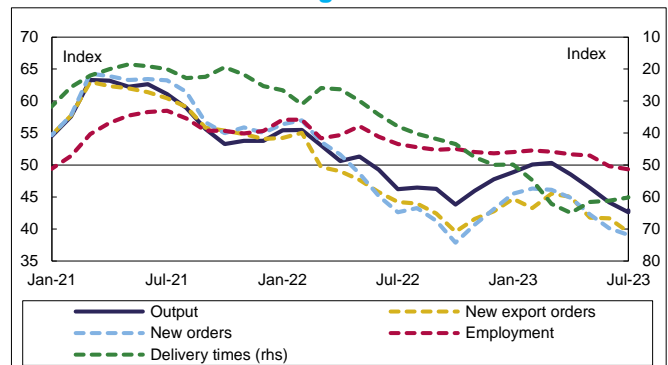
We expect house prices to continue to sag over coming months as affordability will remain stretched for first-time buyers, while higher interest rates will further erode disposable incomes of the substantive share of households that will need to

Euro area: Manufacturing price PMIs*



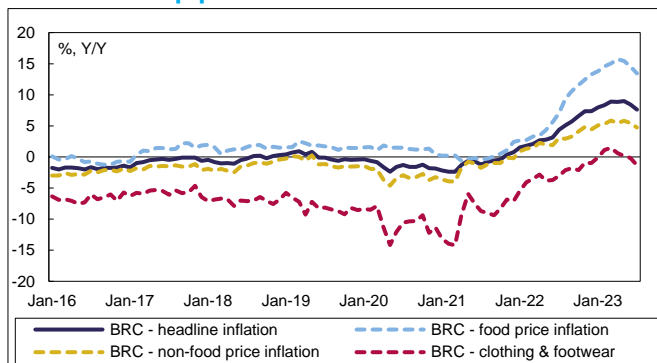
*Dashed lines represent long-run averages. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing PMIs



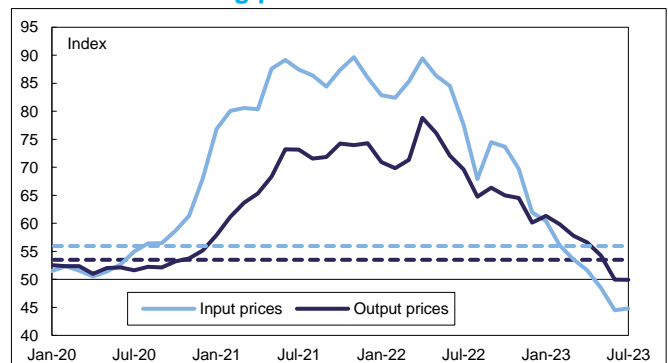
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: BRC shop price inflation



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing price PMIs*



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

refinance their mortgages over coming quarters. The Nationwide measure of first-time buyer mortgage payments as a share of take-home pay rose in Q2 to a fifteen-year high of 39%, up 12ppts from the recent trough in Q320. In June, the average interest rate on a new 2Y fixed-rate 75% loan-to-value (LTV) mortgage was 5.5%, more than 410bps higher than two years ago. And the rate on a 5Y fixed 75% LTV mortgage was 4.95%, roughly 300bps higher than five years ago. According to the BoE, about 6.5mn mortgages – about 60% of the total – are due to expire between June-23 and end-2026. And monthly interest payments for the typical mortgagor rolling off a fixed-rate deal over the second half of 2023 would increase by around £220 if their mortgage rate rose by the 325bps implied by quoted mortgage rates at the end of June.

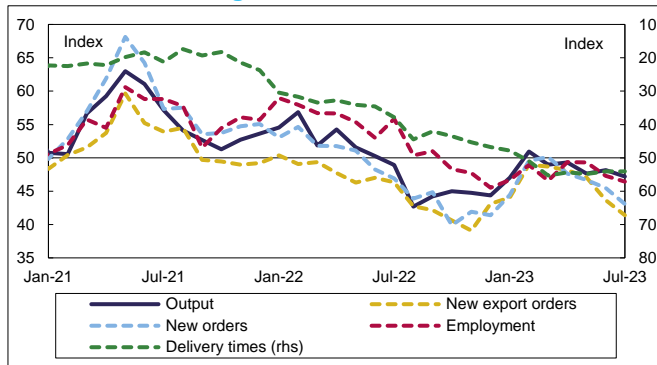
The coming two days in the UK – BoE policy announcement the main event

The main event over the coming two days will be the BoE's announcement on Thursday, which will be accompanied by updated macroeconomic projections in the Bank's latest Monetary Policy Report. Since last month's meeting, the economic newsflow has been mixed. Surveys have signalled a marked slowdown in economic momentum at the start of the third quarter, while headline inflation fell a little further than expected in June too. However, the moderation in core inflation that month failed to reverse the spike in May, to leave it on average in Q2 up 0.7ppt at 6.9%Y/Y, with the key services component above the BoE's expectation. Moreover, with private sector regular wage growth accelerating further in the three months to May to a series high with the exception of pandemic-related distortions – again contrary to more dovish Bank expectations – inflation persistence will remain a concern for the majority of MPC members this month.

Therefore, with the Committee's guidance having previously stated that "If there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required", another hike in Bank Rate on Thursday seems a certainty. We expect the majority – including new external representative Megan Greene who this month replaced uber-dove Silvana Tenreyro on the MPC – to favour the more moderate pace of increase of 25bps (from 50bps in June) to take Bank Rate to 5.25%. Nevertheless, we would not be surprised if at least one member voted for 50bps again. And, with the BoE also to set out a new Gilt sales programme for the coming twelve months alongside its September rate announcement, the MPC might at this meeting endorse a faster pace of quantitative tightening going ahead.

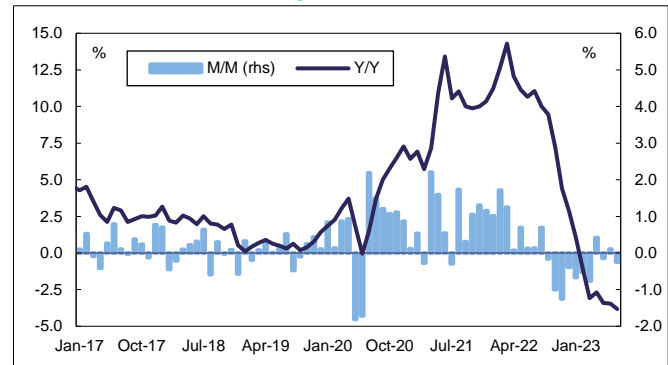
Just as important as the latest monetary policy decision will be the MPC's updated guidance on the likely path of future policy, which will be determined and contextualized by the BoE's updated macroeconomic projections. Given the significant surprises in the inflation and wage data, as well as marked shifts in the market-implied path of Bank Rate and sterling, the net impact on the Bank's forecasts is uncertain. But with the future path for energy prices likely to be somewhat lower than

UK: Manufacturing PMIs*



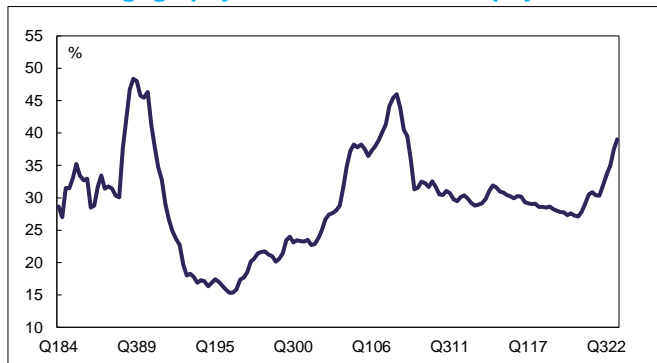
Source: Refinitiv Datastream, S&P Global and Daiwa Markets Europe Ltd.

UK: Nationwide house price index



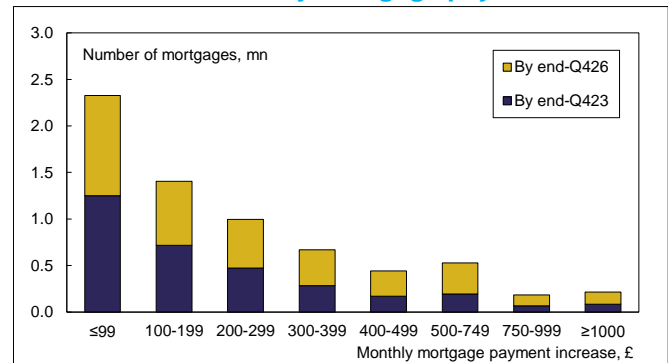
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Mortgage payments as a share of pay*



*First-time buyers. Source: Nationwide, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Increase in monthly mortgage payments*















*BoE's estimated increase in monthly mortgage payments based on end-June mortgage rates and end-2022 stock of outstanding mortgages. Source: BoE and Daiwa Capital Markets Europe Ltd.

previously thought, and employment and wage growth stronger than anticipated, the BoE's full-year growth forecasts of ¾%Y/Y in 2024 and 2025 might be revised down only moderately. At the same time, despite the higher starting point in June, the BoE might well expect headline inflation to decline over coming quarters more sharply than previously expected, reflecting the lower wholesale gas prices and weakening momentum in global manufacturing prices. But the BoE's expectation for core inflation is likely to be nudged higher. And while its modal forecast might continue to suggest again that headline inflation will on average be only slightly above 2% in 2024 and firmly below 2% in 2025, a significant upwards skew to risks might suggest that its mean inflation forecast will likely still be close to 2% into 2025, arguably validating market expectations of a terminal Bank Rate of 5.75% or more.

Data-wise, like in the euro area, Thursday will bring the final UK services PMIs for July. According to the flash estimates, the activity index fell 2.2pts to a six-month low of 51.5, suggesting a significant slowing in recovery momentum at the start of Q3. The new business PMI also dropped to 51.1, its lowest level since January. But while the input price (68.2) and prices charged PMIs (57.3) eased to their lowest since mid-2021, they remained well above the respective long-run averages and consistent with still elevated cost pressures in the sector. The results from the BoE's Decision Maker Panel survey will also offer an update on firms' inflation and wage expectations.

The next edition of the Euro wrap-up will be published on 03 August 2023


European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final manufacturing PMI	Jul	42.7	42.7	43.4	-
	 Unemployment rate %	Jun	6.4	6.5	6.5	6.4
Germany	 Final manufacturing PMI	Jul	38.8	38.8	40.6	-
	 Unemployment rate % (change '000s)	Jul	5.6 (-4.0)	5.8 (20.0)	5.7 (28.0)	- (30.0)
France	 Final manufacturing PMI	Jul	45.1	44.5	46.0	-
Italy	 Manufacturing PMI	Jul	44.5	-	43.8	-
Spain	 Manufacturing PMI	Jul	47.8	48.5	48.0	-
UK	 Lloyds business barometer	Jul	31	-	37	-
	 BRC shop price index Y/Y%	Jul	7.6	-	8.4	-
	 Nationwide house price index M/M% (Y/Y%)	Jul	-0.2 (-3.8)	-0.5 (-4.0)	0.1 (-3.5)	-
	 Final manufacturing PMI	Jul	45.3	45.0	46.5	-
Auctions						
Country	Auction					
UK	 sold £4bn of 3.5% 2025 bonds at an average yield of 5.272%					



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Spain		08.00 Unemployment change '000s	Jul	-	-50.3













Auctions and events

Germany		10.30 Auction: €1.25bn of 1% 2038 bonds
		10.30 Auction: €750mn of 0% 2036 bonds









Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area		09.00 Final services (composite) PMI	Jul	<u>51.1 (48.9)</u>	52.0 (49.9)
		10.00 PPI Y/Y%	Jun	-3.2	-1.5
Germany		07.00 Trade balance €bn	Jun	15.0	14.6
		08.55 Final services (composite) PMI	Jul	<u>52.0 (48.3)</u>	54.1 (50.6)
		- New car registrations (production)* Y/Y%	Jul	-	24.8 (32.8)
France		08.50 Final services (composite) PMI	Jul	<u>47.4 (46.6)</u>	48.0 (47.2)
Italy		08.45 Services (composite) PMI	Jul	52.3 (49.3)	52.2 (49.7)
		09.00 Retail sales M/M% (Y/Y%)	Jun	-	0.7 (3.0)
Spain		08.15 Services (composite) PMI	Jul	-	53.4 (52.6)
UK		09.30 Final services (composite) PMI	Jul	<u>51.5 (50.7)</u>	53.7 (52.8)
		09.30 BoE Decision Maker Panel, 1Y ahead CPI expectations y/y%	Jul	-	5.7
		12.00 BoE Bank Rate %	Aug	<u>5.25</u>	5.00

Auctions and events

Euro area		10.00 ECB's Panetta to give speech on "Getting disinflation right"
France		09.50 Auction: To sell 3% 2033 bonds
		09.50 Auction: To sell 1.25% 2038 bonds
		09.50 Auction: To sell 4% 2060 bonds
Spain		09.30 Auction: To sell 0.65% index-linked 2027 bonds
		09.30 Auction: To sell 1.5% 2027 bonds
		09.30 Auction: To sell 0.6% 2029 bonds
		09.30 Auction: To sell 3.55% 2033 bonds
UK		12.00 BoE monetary policy announcement, statement, minutes and Monetary Policy Report to be published
		12.30 BoE Governor Bailey holds press conference on the BoE's latest Monetary Policy Report

*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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