

Euro wrap-up

Overview

- Bunds largely followed USTs higher even after German factory orders figures surprised significantly on the upside.
- Gilts also made gains despite a stronger than expected UK construction sector survey.
- The coming week will bring new data on German industrial production in June and UK GDP in Q2.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	2.988	-
OBL 2.4 10/28	2.574	-0.021
DBR 2.6 08/33	2.565	-0.033
UKT 0% 06/25	4.856	-0.059
UKT 1% 10/28	4.390	-0.058
UKT 3% 01/33	4.398	-0.064

*Change from close as at 4:00pm BST.
Source: Bloomberg

Euro area

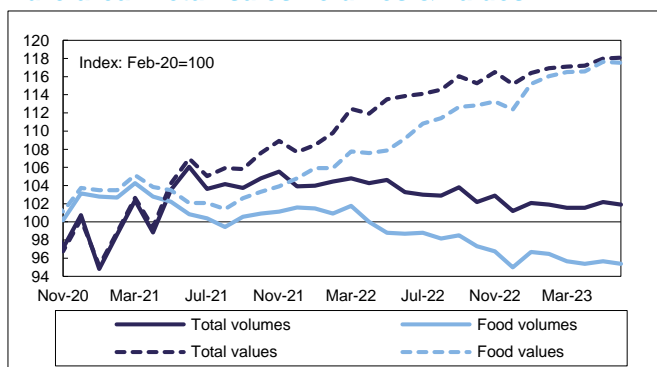
Retail sales edge down in June to be flat over Q2 as a whole

Euro area retail sales volumes were softer than expected in June, declining 0.3%M/M in contrast to expectations of a modest increase. However, thanks not least to revisions in Germany, sales growth in May was revised up to 0.6%M/M. So, sales in June were down 1.4%Y/Y but still some 1.9% above the pre-pandemic level in February 2020. And, over the second quarter as a whole, retail sales volumes were unchanged from Q1, ending the run of five successive quarterly declines, albeit only just. With inflation still elevated, the value of sales rose 0.1%M/M in June to be up 0.8% over Q2 as a whole. In particular, price pressures contributed to continued weakness in the volume of food sales, which fell for a fifth successive quarter, while core sales volumes (excluding food and fuel) rose 0.1%Q/Q in Q2 marking a second successive modest quarterly increase. Given evidence of increased spending on services, not least hospitality and tourism, the data therefore point to a return to (probably modestly) positive growth in private consumption in Q2 following non-negligible declines in the prior two quarters. The stabilisation in retail sales volumes in Q2 is consistent with the steady improvement in consumer confidence over past months since the series low was registered in September amid extreme pressures on wholesale gas prices. Indeed, consumer confidence rose in July to its best level since Russia's invasion of Ukraine, with willingness to make major purchases over the coming twelve months up to a 16-month high. Overall, however, consumer sentiment remains some way below its long-run average and consistent with still-modest household spending growth at best in Q3.

Surge in German new orders in June flattered by one-offs leaving underlying trend soft

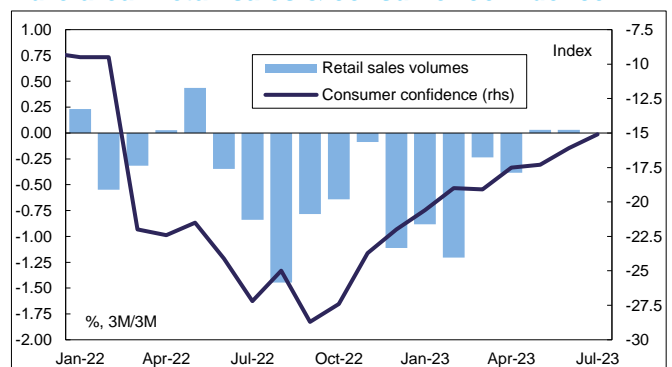
Recent survey results from the manufacturing sector have been downbeat, pointing to contraction in output amid lower domestic and external demand for goods and shrinking orderbooks. However, today's June data from the euro area's industrial sector were mixed, with German factory orders significantly beating expectations but French industrial production somewhat weaker than anticipated. In both cases, the headline figures were distorted by substantive one-offs. Contrary to expectations of a decline, German new factory orders rose a whopping 7.0%M/M, the most in three years, following similarly vigorous growth of 6.2%M/M the prior month. That left them 5.7% above the pre-pandemic level in February 2020. Growth was particularly strong for capital goods including transport items (9.9%M/M) and consumer goods (7.7%M/M), but all major categories increased. However, the increase was driven by orders from abroad (13.5%M/M), particularly the rest of the euro area, while new domestic demand fell. And more importantly, given the sharp decline (-10.9%M/M) in March, new orders rose just 0.2%Q/Q in Q2, with falls in machinery (-3.4%Q/Q) and motor vehicles (-3.9%Q/Q). Moreover, as in May, the strength in June reflected major orders (including both large-scale one-offs and bulk orders), which often distort the underlying picture. Indeed, due to a particularly large order in the aerospace sector, the "other transport" category rose an

Euro area: Retail sales volumes & values



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales & consumer confidence



Source: EC, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

extraordinary 89.2%M/M. And excluding all major items, orders dropped 2.6%M/M in June, with declines in both domestic and external new demand, to be 6.7% below the pre-pandemic level and down 3.0%Q/Q in Q2.

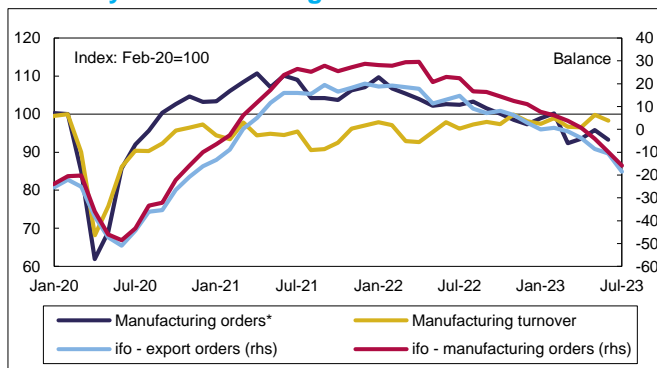
French IP drops in June but rises in Q2 with the opposite in Italy

Consistent with a subdued trend in the industrial sector, German manufacturing turnover fell 1.6%M/M in June following upwardly revised growth of 3.4%M/M in May. So, German manufacturing production (for which data are due on Monday) might have dropped by 0.5%M/M or more in June, albeit with the increase in May (initially estimated at 0.2%M/M) likely to be revised up, to leave growth over Q2 as a whole in negative territory. Elsewhere, French manufacturing output dropped 1.0%M/M in June following growth of 1.2%M/M in May. Production in most major sectors reversed in June having increased the previous month. Over the second quarter, however, French manufacturing output rose 0.7%Q/Q, buoyed by growth in motor vehicles (3.5%Q/Q) and other transport including ships (5.1%Q/Q), machinery and equipment (0.9%Q/Q) and, boosted by the end of strike action, coke and refined petroleum (2.6%Q/Q). And while construction output fell 2.6%M/M in June, it was up 0.5%Q/Q in Q2. So, overall, French industrial production dropped 0.9%M/M in June. But it rose for a second successive quarter and by a respectable 0.9%Q/Q in Q2 to make a significant contribution to GDP growth of 0.5%Q/Q. In contrast, Italian IP (excluding construction) rose 0.5%M/M in June following growth of 1.7%M/M in May. But that still left it down for a fourth successive quarter in Q2, and by 1.2%Q/Q, with declines in most major subsectors contributing to the decline of 0.3%Q/Q in GDP.

Construction PMIs signal intensified contraction in sector at start of Q3

Being particularly sensitive to interest rates, the construction sector has unsurprisingly been especially impacted by the ECB's aggressive monetary tightening. According to today's euro area construction PMIs, with the headline index dropping 0.7pt to 43.5, activity in the sector in July weakened by the most since December, maintaining the contractionary trend on the survey that has been in place for more than a year. With affordability stretched by higher interest rates, and house prices falling, the challenges in residential construction appear most acute, with the index for activity in the subsector (39.3) the lowest since the first wave of Covid-19. However, the PMIs for the commercial (43.8) and civil-engineering (45.9) subsectors also deteriorated in July, pointing to broad-based weakness in building investment despite ongoing support from NextGenerationEU projects and ongoing capex in decarbonisation and digitisation projects. Each of the three largest member states also reported a worsening of conditions in the sector at the start of Q3, with Germany (41.0) most-affected and signalling the steepest decline in activity in seventeen months and the downturn seemingly mildest in Italy (48.0). As in recent manufacturing surveys, the construction PMIs also continued to signal falling new orders. But they also suggested

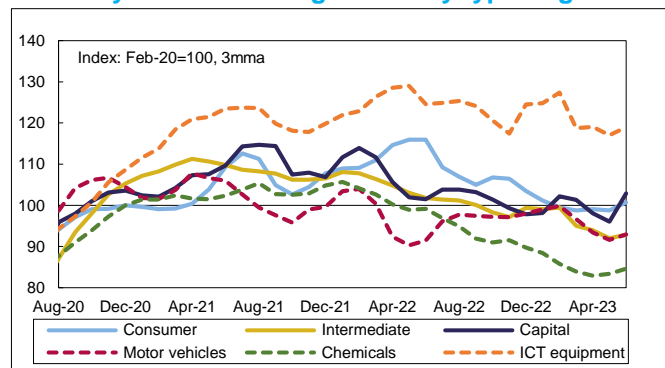
Germany: Manufacturing orders & turnover



*Excluding major orders.

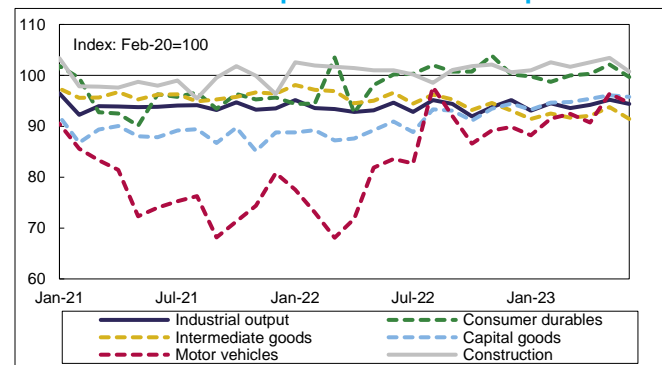
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing orders by type of good



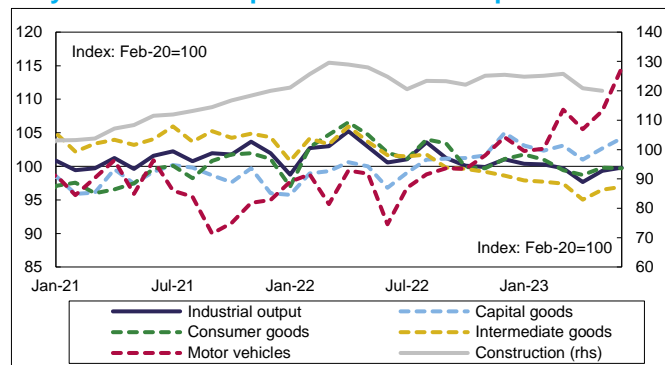
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

France: Industrial output & selected components



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Italy: Industrial output & selected components



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

that input costs rose minimally and by the least since 2016. And supply-chain challenges continued to ease significantly with delivery times speeding up and subcontractor availability much-improved from last year and the first part of 2023.

The week ahead in the euro area

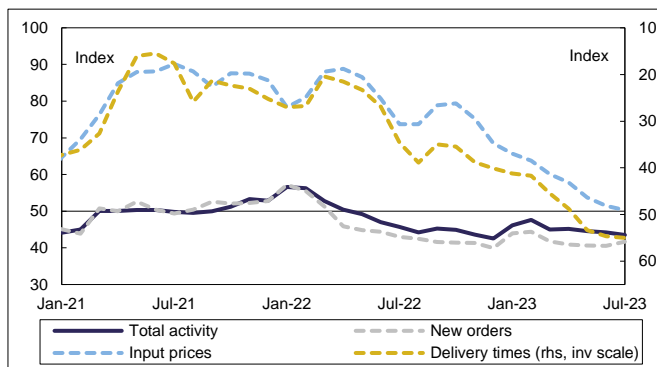
A relatively quiet week ahead for top-tier euro area releases kicks off on Monday with the aforementioned German industrial production data for June. Surveys suggest that manufacturing conditions deteriorated markedly at the end of Q2, with the output PMI (43.7) implying the steepest contraction for eight months, while the ifo institute business climate index fell to the weakest since August 2020. So, tallying with today's turnover figures, German manufacturing production is expected to have declined for a second successive month in June. Monday will also bring the euro area sentix investor confidence survey for August, for which the headline index dropped in July to its lowest since November. Focus on Tuesday, meanwhile, will turn to the ECB's consumer expectations survey for June, which will provide an update on households' expectations for inflation, income, economic activity and house prices. In May, the median expectation for inflation three years ahead remained stable at 2.5%Y/Y, while the mean expectation edged slightly higher to 4.0%Y/Y. Final July inflation estimates from member states will be published throughout the week, including from Germany (Tuesday), Italy (Thursday), France and Spain (Friday). The flash readings saw the headline HICP rates ease in Germany, France and Italy by 0.3ppt apiece to 6.5%Y/Y, 5.0%Y/Y and 6.4%Y/Y respectively. But Spanish inflation jumped last month, by 0.5ppt to 2.1%Y/Y, albeit still the lowest of the member states. These releases will provide more granular detail, with summer discounting on clothing and package holidays expected to have played a role in the latest shifts.

UK

Construction PMIs point to surprising pickup in activity in July despite housing sector weakness

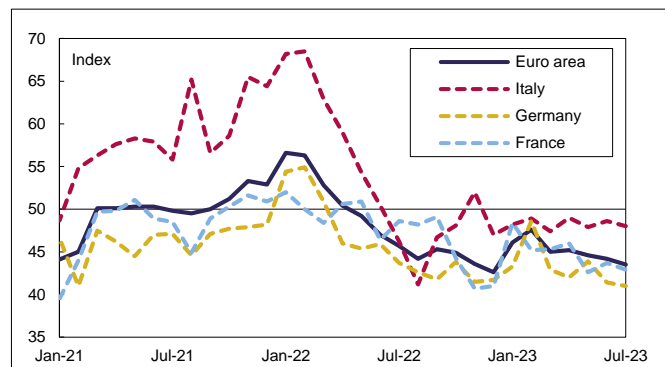
Following a dip below the key 50 mark in June, the headline UK construction activity PMI surprisingly rose back into expansion territory in July (up 2.8pts to a five-month high of 51.7). With new orders growing slightly, firms also signalled a desire to increase worker headcount. As in the euro area, the PMIs also suggested that supplier delivery times had markedly shrunk, and improved supply-side conditions were also reflected in a relatively modest increase in input costs. According to the survey, the improvement in activity was led by commercial work (54.4), which extended its run of positive growth to six months, while civil engineering also continued to pick up (53.9). In contrast, despite still firm demand for refurbishments, residential building work continued to contract markedly (43.0) as higher mortgage rates and declines in house prices continued to bite. According to the Construction Products Association (CPA), which represents manufacturers of products used in the sector, private housebuilding will drop about 19.0% this year with the decline in public housing only moderately less acute.

Euro area: Construction PMIs



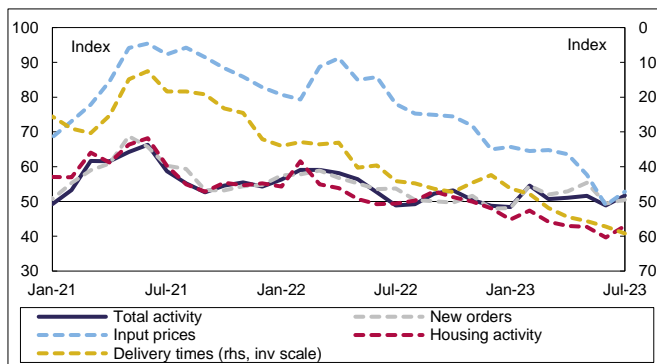
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area member states: Construction PMIs



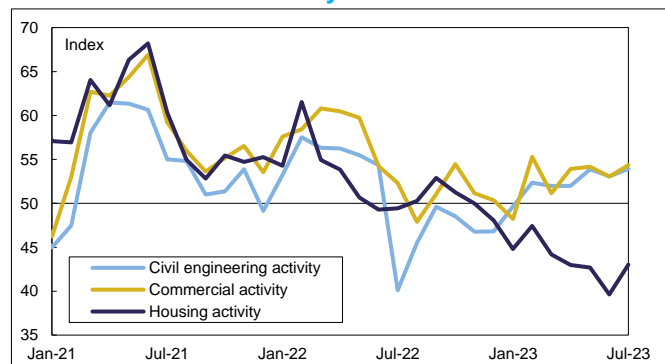
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Construction PMIs



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

UK: Construction PMIs by sub-sector




















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

The week ahead in the UK

The main release in the UK in the coming week will be the first estimate of Q2 GDP on Friday. While we might expect to see some bounce back in June as the adverse impact of the additional bank holiday in May reversed, surveys suggest a notable slowdown in recovery momentum at the end of the second quarter. As such, we expect GDP to have merely moved sideways in Q2 to leave the level of output still 0.5% below the pre-pandemic benchmark in Q419, with modest growth in household consumption likely to be offset by some payback in fixed investment and a negative contribution from net trade. The risks to that view, however, are skewed to the upside. And in its latest projections published yesterday, the BoE projected growth of 0.1%Q/Q. June's monthly services, manufacturing, construction and trade figures (also due Friday) will give greater insight into economic momentum at the end of the second quarter. Ahead of this, the BRC's retail monitor on Tuesday will provide an update on retail spending in July. Like the CBI distributive trades survey, this is likely to show a notable weakening in sales growth at the start of the third quarter, not least reflecting lower footfall on the High Street due to unusually heavy rainfall that month.







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 07 August 2023					
Euro area 	09.30	Sentix investor confidence	Aug	-25.0	-22.5
Germany 	07.00	Industrial production M/M% (Y/Y%)	Jun	-0.5 (-0.2)	-0.2 (0.7)
Tuesday 08 August 2023					
Germany 	07.00	Final HICP (CPI) Y/Y%	Jul	<u>6.5 (6.2)</u>	6.8 (6.4)
France 	07.45	Trade balance €bn	Jun	-	-8.4
UK 	00.01	BRC retail monitor, like-for-like sales Y/Y%	Jul	-	4.2
Wednesday 09 August 2023					
- Nothing scheduled -					
Thursday 10 August 2023					
Italy 	10.00	Final HICP (CPI) Y/Y%	Jul	<u>6.4 (6.0)</u>	6.7 (6.4)
UK 	00.01	RICS house price balance %	Jul	-52	-46
Friday 11 August 2023					
France 	07.45	Final HICP (CPI) Y/Y%	Jul	5.0 (4.3)	5.3 (4.5)
Italy 	09.00	Trade balance €bn	Jun	-	4.7
Spain 	08.00	Final HICP (CPI) Y/Y%	Jul	2.1 (2.3)	1.6 (1.9)
UK 	07.00	GDP – 1st estimate Q/Q% (Y/Y%)	Q2	0.0 (0.2)	0.1 (0.2)
	07.00	Monthly GDP M/M%	Jun	0.2	-0.1
	07.00	Industrial production M/M% (Y/Y%)	Jun	0.0 (-1.3)	-0.6 (-2.3)
	07.00	Manufacturing production M/M% (Y/Y%)	Jun	0.0 (0.0)	-0.2 (-1.2)
	07.00	Services activity M/M% (Q/Q%)	Jun	0.2 (0.0)	0.0 (0.0)
	07.00	Construction output M/M% (Y/Y%)	Jun	-0.1 (2.9)	-0.2 (0.2)
	07.00	Trade (goods) balance £bn	Jun	-	-6.6 (-18.7)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.










The coming week's key events & auctions

Country	BST	Event / Auction
Monday 07 August 2023		
UK		17.00 BoE Chief Economist Huw Pill scheduled to hold an online Q&A event
Tuesday 08 August 2023		
Euro area		09.00 ECB publishes monthly consumer expectations survey
Germany		10.30 Auction: €4.0bn of 2.4% 2028 bonds
UK		10.00 Auction: £900mn of 0.125% 2039 index-linked bonds
Wednesday 09 August 2023		
Germany		10.30 Auction: €5.0bn of 2.6% 2033 bonds
UK		10.00 Auction: 3.25% 2033 bonds
Thursday 10 August 2023		
- Nothing scheduled -		
Friday 11 August 2023		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Construction PMI	Jul	43.5	-	44.2	-
	 Retail sales M/M% (Y/Y%)	Jun	-0.3 (-1.4)	0.3 (-1.7)	0.0 (-2.9)	0.6 (-2.4)
Germany	 Factory orders M/M% (Y/Y%)	Jun	7.0 (3.0)	-2.0 (-5.3)	6.4 (-4.3)	6.2 (-4.4)
	 Construction PMI	Jul	41.0	-	41.4	-
France	 Industrial production M/M% (Y/Y%)	Jun	-0.9 (-0.3)	-0.3 (1.7)	1.2 (2.6)	1.1 (2.2)
Italy	 Industrial production M/M% (Y/Y%)	Jun	0.5 (-0.8)	-0.3 (-2.0)	1.6 (-3.7)	1.7 (-3.5)
Spain	 Industrial production M/M% (Y/Y%)	Jun	-1.0 (-3.0)	-0.5 (-1.6)	0.6 (-0.1)	0.5 (-0.6)
UK	 New car registrations Y/Y%	Jul	28.3	-	25.8	-
	 Construction PMI	Jul	51.7	48.0	48.9	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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