

Euro wrap-up

Overview

- While the Commission sentiment survey flagged recession risks, Bunds made losses as the flash estimate of German headline inflation in August edged only slightly lower and the core rate remained unchanged, while euro area business and consumer price expectations picked up.
- Gilts made modest gains at the shorter end of the curve as UK net lending to households remained very subdued.
- Thursday will bring the August flash estimate of euro area inflation, as well as updates on unemployment in the region and German retail sales.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.043	+0.020
OBL 2.4 10/28	2.553	+0.020
DBR 2.6 08/33	2.531	+0.026
UKT 0% 06/25	5.206	-0.007
UKT 1% 10/28	4.722	-0.018
UKT 3% 01/33	4.416	-0.001

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

Source: Bloomberg

Euro area

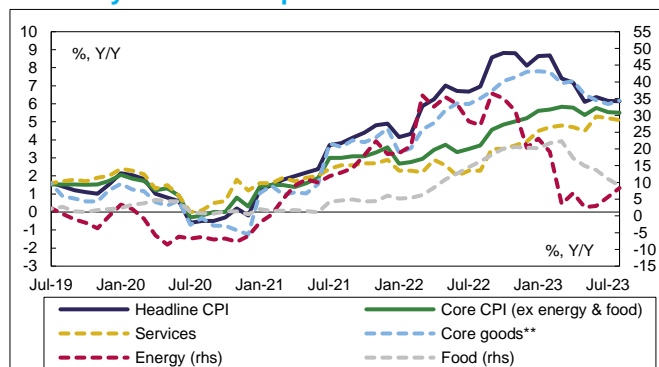
German inflation edges slightly lower on food prices, but core inflation moved sideways

With the ECB's Governing Council having opened the door to a possible pause in its rate-hike cycle at its next policy-setting meeting on 14 September, the August inflation data will play a role in influencing the eventual decision. Ahead of tomorrow's flash euro estimates, the figures published today by several member states were mixed, but largely came in a touch firmer than expectations. German headline inflation did at least drop for a second successive month in August to the lowest levels in three months, with the EU-harmonised HICP rate easing 0.1ppt to 6.4%Y/Y, while the national CPI rate also moderated 0.1ppt to 6.1%Y/Y, matching the lowest since April 2022. But these declines principally reflected developments in food prices, which on the national measure fell for the fifth consecutive month in August (-0.3%M/M). So, with food prices having risen by an average 1.9%M/M in the five months to August 2022 following the Russian invasion of Ukraine, the annual rate of that component fell a further 2ppt to 9.0%Y/Y, a sixteen-month low and more than 13ppts below the peak in March. The impact of lower food prices was, however, partly offset by energy, prices of which jumped more than 2%M/M – in part due to higher prices of auto fuel – to push the respective annual rate up 2.6ppts to 8.3%Y/Y, a six-month high. Meanwhile, contrasting survey evidence of a significant recent decline in factory costs, core goods inflation picked up in August, by around 0.2ppt to 6.0%Y/Y, with regional data suggesting upwards pressure on prices of clothing and household appliances. So, despite downwards pressure in hospitality, which led to a modest easing in services inflation of 0.1ppt to 5.1%Y/Y, the national core CPI rate merely moved sideways at 5.5%Y/Y.

Inflation in Spain, Belgium and Ireland rises on higher fuel prices

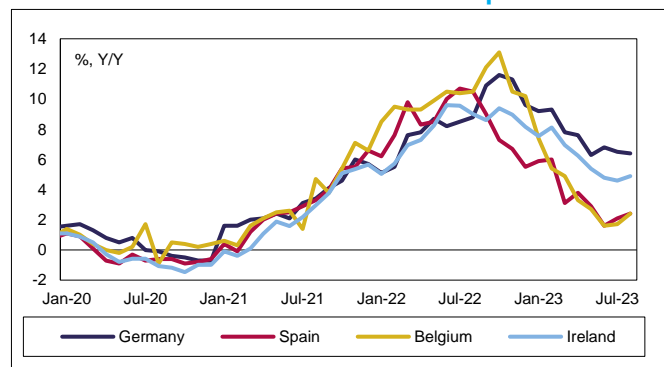
While in line with expectations, Spanish inflation ticked higher in August, with the HICP and national headline rates rising 0.3ppt apiece to 2.4%Y/Y and 2.6%Y/Y respectively, both three-month highs. Spain's statistical institute (INE) suggested that the increase reflected higher auto fuel prices, which more than offset lower household energy bills. More surprisingly perhaps, when excluding energy and unprocessed foods, INE's measure of core inflation also increased in August, by 0.1ppt to 6.1%Y/Y. The increases in the HICP rates in Belgium (up 0.7ppt to 2.4%Y/Y) and Ireland (up 0.3ppt to 4.9%Y/Y) also principally reflected higher fuel prices. But in contrast to Spain, core inflation moderated in both countries. Overall, based on today's figures – which account for almost 45% of the euro area – we now expect euro area inflation to drop only 0.1ppt in August to 5.2%Y/Y. But much will depend on the outturns in France where inflation is expected to rise, and Italy where inflation is expected to have fallen sharply. And the decline in core inflation might be negligible.

Germany: Consumer price inflation*



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

Euro area member states: Consumer price inflation*



*EU harmonised measure. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

ECB hawks to note broad-based rise in business & consumer price expectations in August

While inflation appears to have remained relatively sticky in August, the Commission's economic survey results suggested that, by and large, inflation expectations have stopped falling too. Among the various business sectors, selling price expectations three months ahead increased in industry, construction and services alike in August, marking the first month to register a broad-based pickup since the surge in wholesale energy prices in September 2022. Most notably, selling-price expectations in services rose to a three-month high still well above levels consistent with a decline in inflation back close to the ECB's target. And while the survey's barometer of retail price expectations moderated further to a ten-month low, it also remained well above its long-run average. Strikingly too, consumer price expectations for the coming twelve months also rose to a three-month high this month, with the respective indices increasing in each of the four largest member states. We suspect that higher auto fuel prices were the principle driver of the increase in consumer price expectations. And we note that the respective index remains below the long-run average in the euro area as a whole and in negative territory in Italy and Spain. However, with headline inflation still so elevated, many of the hawks on the ECB's Governing Council are likely to feel a sense of unease at such a widespread pickup in price expectations of businesses and consumers.

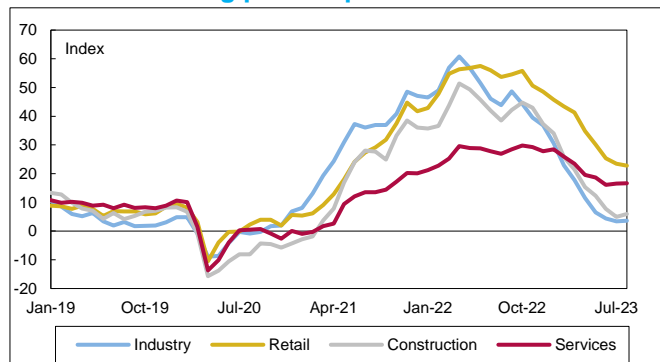
But deterioration in economic sentiment flags rising recession risks, especially in the core

So, today's new data on inflation and price expectations arguably supported the case for a further ECB rate hike in September. However, most of the other detail of the Commission's survey tallied strongly with the [flash PMIs](#) to signal the growing probability of a contraction in economic output in Q3, thus underscoring the case for a pause in the tightening cycle next month. In particular, the headline euro area Economic Sentiment Index (ESI) fell for the seventh month in the past eight and by a slightly larger-than-expected 1.2pts to 93.3, the lowest since the early phase of the pandemic in 2020 and 6.7% below the long-run average. For the first time since March, the respective ESIs declined for consumers and each major business sector. They also fell in each of the three largest member states. Indeed, the German and French indices fell well below their long-run averages to their lowest levels since 2020 to flag rising recession risks in the euro area's core. More reassuringly perhaps, the ESIs for Italy and Spain remained above-average, with the latter even rising in August, suggesting that Southern Europe should still see positive growth this quarter. However, with the tourism season approaching its end, whether it can remain immune from the negative momentum further to the north is debatable.

Services confidence sagging as manufacturing & construction shift more firmly into reverse

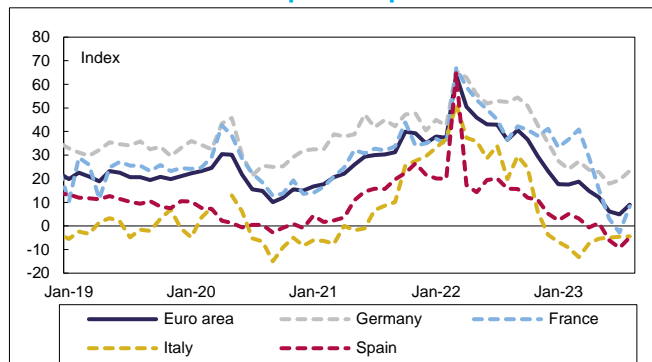
Like the flash PMIs, the August Commission survey highlighted that weakness remains most acute in manufacturing. New external demand for goods reportedly weakened further and overall order books continued to thin, while inventories

Euro area: Selling price expectations*



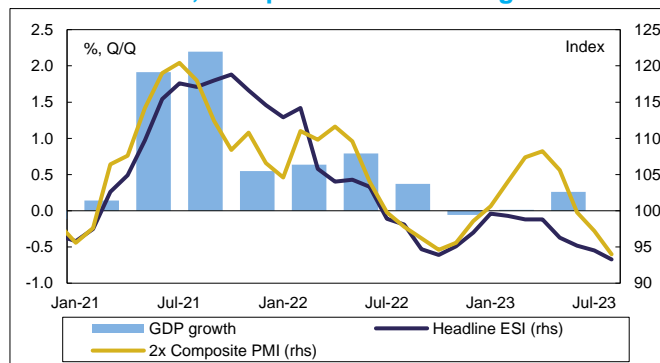
*3 months ahead. Source: EC, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price expectations*



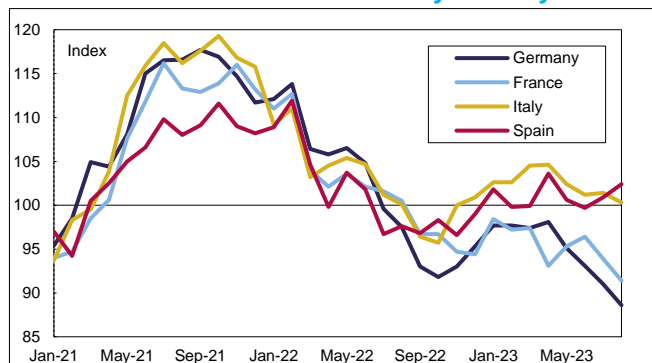
*12 months ahead. Source: EC, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: ESI, Composite PMI & GDP growth



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

Euro area: Economic sentiment by country



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

continued to accumulate. As a result, the euro area ESI for the industrial sector dropped a further point to -10.3, the lowest level since summer 2020 and, bar that first wave of pandemic, the euro crisis in early 2013. With higher interest rates taking their toll on real estate as well as business fixed investment, construction sector confidence fell to the lowest level since the end of 2020. But while consumer confidence was confirmed to have dipped in August, the index (-16.0) was still closer to the long-run average than last year's trough, and the index representing household purchase intentions for the coming twelve months edged up to a seventeen-month high. Moreover, for the time being at least, tourism continues to support consumer-facing firms across the Mediterranean – e.g. the Spanish services ESI rose to a 14-month high. But the troubles in manufacturing and construction appear to be weighing on B2B activity. And with optimism in the sector fading in Germany and, in particular, France, the euro area services sentiment index fell 1.5pts to 3.9, a ten-month low some way below the long-run average.

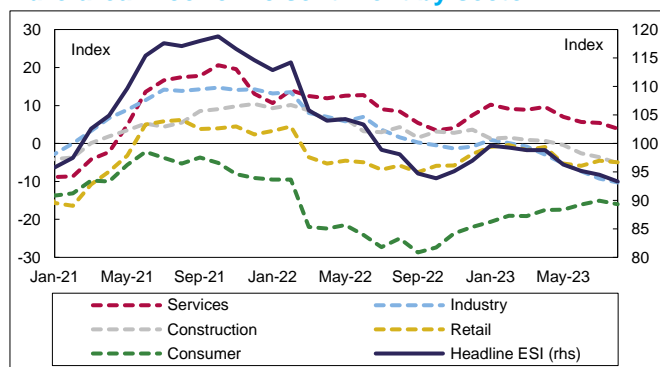
Continued labour market resilience offers comfort

Perhaps encouragingly, the labour market continues to behave differently to the years before the pandemic, appearing to remain broadly resilient in the face of the increasingly gloomy economic outlook. Indeed, the overall euro area Employment Expectations Index (EEI) remained above its long-run average in August, pointing to continued net labour demand across all sectors bar retail. Admittedly, at 102.1, the euro area EEI still declined more than 1pt to a 28-month low, while the respective indices in Germany and France fell further below their long-run averages to suggest increased reluctance to add to headcount in the largest two member states. However, labour demand appears firm in Italy and Spain. And the Commission survey still reported no pressing desire on behalf of firms across the euro area to shed workers. For as long as that remains the case, the ECB will see no urgent need to pivot to an easier monetary stance.

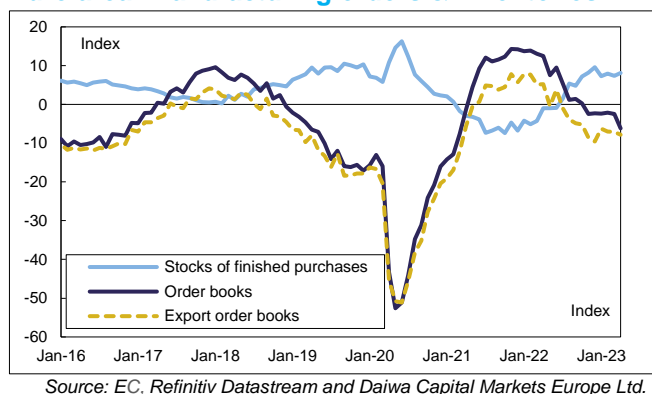
The day ahead in the euro area

Thursday will be busy for key economic releases, with the aforementioned flash euro area August inflation estimate key. Having eased to an eighteen-month low in July (5.3%Y/Y) and just half the peak last October, headline inflation is now expected to have moderated only slightly further this month, by 0.1ppt to 5.2%Y/Y. Of course, developments in the core components and in particular services will be of most significance to next month's policy decision. Following today's member state data, we now expect core inflation to ease just 0.1ppt to 5.4%Y/Y. Thursday will also bring euro area unemployment figures for July, with the jobless rate expected to have moved sideways at a series low of 6.4%, while German labour market data will provide an update for August. German retail sales and French consumer spending numbers for July will give insight into household consumption at the start of Q3. Updated Q2 GDP figures will also be published in various member states including France, Portugal and Belgium.

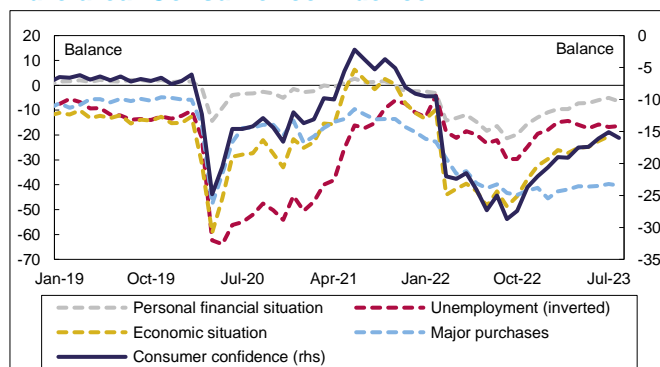
Euro area: Economic sentiment by sector



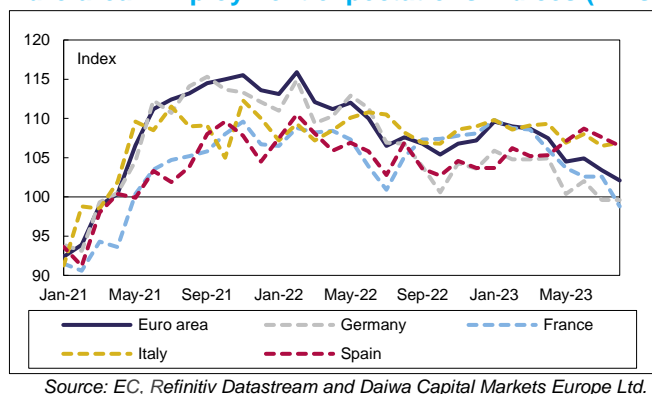
Euro area: Manufacturing orders & inventories



Euro area: Consumer confidence



Euro area: Employment expectations indices (EEl)s



Beyond the economic data, the ECB's account of its [July](#) policy meeting will be closely analysed for further insight into the Governing Council's decision to open the door to a possible pause in the tightening cycle next month. While President Lagarde was clear that the September policy decision would depend upon both the forthcoming data and the ECB's updated macroeconomic projections, the account of the July might shine light on the balance of views regarding the risks to the outlook and offer clues about next month's policy decision. Meanwhile, influential Governing Council hawk Isabel Schnabel is due to give opening remarks at an academic conference jointly organised by the ECB and the Federal Reserve Bank of Cleveland.

UK

Mortgage lending remains historically subdued while new approvals fall sharply

The BoE's monetary data today continued to illustrate the significant impact of the MPC's aggressive policy tightening on mortgage lending. While net borrowing increased for the third consecutive month in July, at £0.2bn it was historically weak. Indeed, the cumulative net increase in the three months to July of £0.3bn compared with an increase of £16.5bn a year ago. And with the effective interest rate on newly drawn mortgages (4.66%) still well below the average interest rates quoted in July – with the average rate on a 2Y mortgage based on a 75% LTV ratio quoted at 6.26% and that on a 2Y mortgage with a LTV ratio of 95% at 6.89% – we expect net mortgage lending to remain very subdued over coming months too. Indeed, net approvals for new house purchases fell more than expected in July, by 5.2k to 49.4k, a five-month low and 23k below last summer's peak and well below the pre-pandemic five-year average (66.5k). And repayments of mortgage debt are likely to remain high.

Consumer credit moderates slightly as households switch deposits to higher-yielding accounts

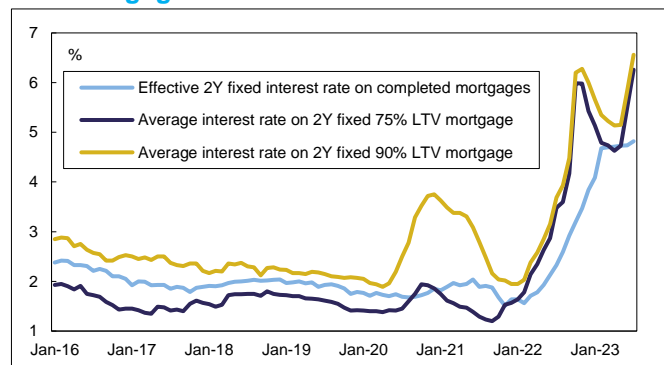
Given the anticipated weakening in credit availability this quarter flagged by the BoE's most recent Credit Conditions Survey, and the steady upwards rise in the average interest rate on a new unsecured loan (up 170bps from a year ago at 8.61%), household consumer credit was arguably firmer than might have been feared at the start of Q3. Having jumped in June by £1.6bn, the net increase in credit slowed in July to £1.2bn. But this was bang in line with the average over the past year, and only £0.2bn below the pre-pandemic five-year average. Meanwhile, the net increase in credit card lending was unchanged for a third consecutive month at an above-average £0.6bn, with the outstanding stock of such lending up 11½%Y/Y, suggesting that household budgets remain squeezed despite strong wage growth. And households increased only slightly

UK: Mortgage lending & approvals



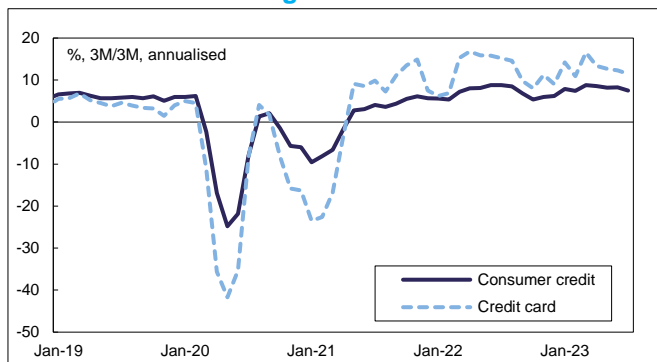
Source: BoE, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Mortgage interest rates



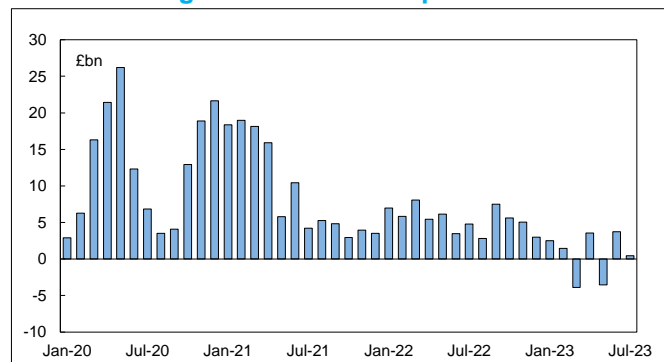
Source: BoE, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Consumer credit growth



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

UK: Net change in household deposits



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

their deposit holdings in July (£0.4bn), to maintain a broadly sideways trend since the start of the year. Of course, the ongoing shift from sight deposits into higher-yielding time deposits was again evident, with a net inflow of £10.1bn into interest-bearing time accounts and £4.3bn into ISAs.

The day ahead in the UK

On a day bereft of top-tier UK economic data, focus will turn to BoE Chief Economist Huw Pill's speech "Back to target, monetary policy in advanced economies" at a South African Reserve Board conference.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	European Commission economic sentiment indicator	Aug	93.3	93.6	94.5	-
	European Commission industrial (services) confidence indicator	Aug	-10.3 (3.9)	-10.0 (5.0)	-9.4 (5.7)	-9.3 (5.4)
	Final European Commission consumer confidence indicator	Aug	-16.0	<u>-16.0</u>	-15.1	-
Germany	Preliminary HICP (CPI) Y/Y%	Aug	6.4 (6.1)	6.2 (6.0)	6.5 (6.2)	-
Italy	ISTAT business (manufacturing) confidence indicator	Aug	106.8 (97.8)	- (98.0)	109.1 (99.3)	108.9 (99.1)
	ISTAT consumer confidence indicator	Aug	106.5	-	106.7	-
Spain	Preliminary HICP (CPI) Y/Y%	Aug	2.4 (2.6)	-	2.1 (2.3)	-
UK	Net consumer credit £bn (Y/Y%)	Jul	1.2 (7.3)	-	1.7 (7.6)	1.6 (7.5)
	Net mortgage lending £bn (approvals '000s)	Jul	0.2 (49.4)	- (52.0)	0.1 (54.7)	- (54.6)
	M4 money supply M/M% (Y/Y%)	Jul	-0.5 (-0.9)	-	-0.1 (0.1)	-









Auctions

Country	Auction
Germany	sold €1.43bn of 1.3% 2027 bonds at an average yield of 2.61%
Italy	sold €3.25bn of 3.8% 2028 bonds at an average yield of 3.79%
	sold €1.5bn of 4.35% 2033 bonds at an average yield of 4.20%
	sold €3.75bn of 4.2% 2034 bonds at an average yield of 4.24%
	sold €1.5bn of 2031 floating-rate bonds at an average yield of 4.62%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area		10.00	Preliminary (core) HICP Y/Y%	Aug	<u>5.2 (5.4)</u>	5.3 (5.5)
		10.00	Unemployment rate %	Jul	6.4	6.4
Germany		07.00	Retail sales M/M% (Y/Y%)	Jul	0.1 (-1.4)	-0.6 (0.4)
		08.55	Unemployment change '000s (rate %)	Aug	10.0 (5.7)	-4.0 (5.6)
France		07.45	Preliminary HICP (CPI) Y/Y%	Aug	5.3 (4.3)	5.1 (4.3)
		07.45	Consumer spending M/M% (Y/Y%)	Jul	-	0.9 (-2.8)
		07.45	Final GDP Q/Q% (Y/Y%)	Q2	<u>0.5 (0.9)</u>	0.1 (0.9)
Italy		10.00	Preliminary HICP (CPI) Y/Y%	Aug	5.3 (5.0)	6.3 (5.9)

Auctions and events

Euro area		08.00	ECB's Schnabel scheduled to given opening remarks at conference – 'Inflation: Drivers and dynamics'
		12.30	ECB publishes account of 27 July monetary policy meeting
		17.00	ECB's de Guindos scheduled to speak at an academic seminar
UK		08.15	BoE Chief Economist Pill scheduled to speak on 'Back to target, monetary policy in advanced economies'

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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

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