

Euro wrap-up

Overview

- While euro area PPI inflation dropped to a 14-year low and the euro area services PMI flagged recession risks, Bunds followed USTs lower as a survey reported a pickup in medium-term consumer inflation expectations.
- Gilts also made losses as the UK headline services PMI was revised up and a retail survey beat expectations.
- Wednesday will bring data for euro area retail sales and German factory orders as well as the construction PMIs.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.018	+0.009
OBL 2.4 10/28	2.581	+0.017
DBR 2.6 08/33	2.604	+0.029
UKT 0% 06/25	5.237	+0.065
UKT 1% 10/28	4.785	+0.062
UKT 3% 01/33	4.517	+0.060

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

Source: Bloomberg

Euro area

Euro area producer price inflation declines to a fourteen-year low

After last's week flash HICP inflation estimates suggested that core consumer goods inflation moderated to a thirteen-month low of 4.8%Y/Y in August, today's euro area producer price figures indicated that this downtrend should continue over coming months. Indeed, producer prices declined in July for the ninth month out of the past ten, to leave the headline PPI rate at a fourteen-year low of -7.6%Y/Y. While energy prices fell for the seventh consecutive month to be down a record 24.3%Y/Y, the decline also reflected lower prices of non-energy industrial goods. Amid weaker supply- and demand-side pressures, prices of intermediate goods fell by the most since 2009 (-1.2%M/M), to leave the respective annual rate in negative territory for a third consecutive month and by a steeper -3.9%. While prices of capital and consumer goods rose slightly in July, the respective inflation rates eased to 4.7%Y/Y and 7.3%Y/Y, their lowest in 19 and 17 months. And excluding food and related items, producer prices of core consumer goods failed to rise for the first time since 2020, allowing the annual rate to moderate 0.9ppt to 5.0%Y/Y, the lowest since before Russia's invasion of Ukraine. So, while core consumer goods prices on the HICP measure rose in August above the norm for the month, and the manufacturing price PMIs ticked slightly higher in August, the body of evidence remains consistent with steady disinflation in goods inflation into next year.

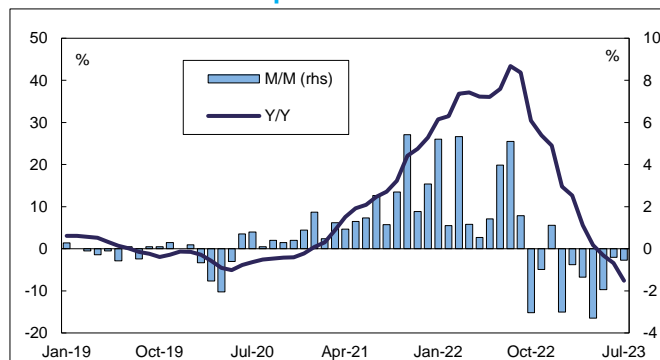
Services input price PMI and household medium-term inflation expectations tick higher

Of course, the ECB remains more concerned about the stickiness of services prices. And while the final services price PMIs were revised a touch lower than the initial estimates, they were still consistent with elevated cost pressures in the sector. In particular, the input price PMI rose for the first month in six, by 1.2pts to 62.2, admittedly well below the peak (79.6) in March but still above the long-run average (57.3). And although the prices charged component (55.6) moderated to its lowest in almost two years, the monthly drop was negligible (-0.2pt) to leave it still some 5pts above the long-run average. The survey suggested that price pressures in the sector remain most acute in Germany, where the prices charged PMI (60.1) was still roughly 9pts above the long-run average. Coupled with this further evidence of persistence of inflation pressures in services, Governing Council members might also be discouraged by the recent uptick in measures of consumer price expectations. Following the increase in 12-month consumer price expectations reported in the August Commission survey, the equivalent measure in the ECB's July consumer survey published today moved sideways at 3.4%Y/Y, with a jump in Germany to a four-month high. Moreover, the median consumer forecast for inflation three years ahead rose 0.1ppt to 2.4%Y/Y, with a more marked increase only prevented by large drops in Spain and the Netherlands.

Final services activity PMI signals steeper decline in activity

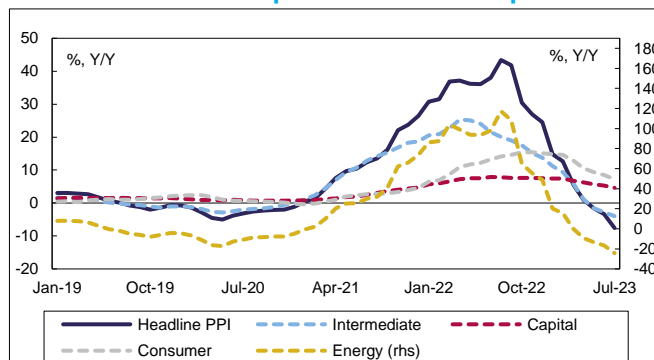
While wage growth remains historically elevated as workers seek compensation for the past year's high rate of inflation, and fuel prices have recently picked up too, the recent marked slowdown in economic momentum will limit the ability of firms to

Euro area: Producer price inflation



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Producer price inflation components



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

pass on pressures to consumers. Certainly, today's final survey results suggested that the drop in services output last month was greater than initially estimated. In particular, the euro area services activity PMI fell a full 3pts from July to 47.9, the lowest since February 2021, and May 2013 when excluding the pandemic. The deterioration in August was most striking in Germany, where the activity index fell 5pts to a nine-month low of 47.3. And the services sectors in France (46.0), Italy (49.8) and Spain (49.3) also failed to grow. And for the first time since March 2021, the new business components in all four member states collectively signalled contraction, with the aggregate euro area index (46.8) the lowest since mid-2013 barring the pandemic. Overall, the composite PMIs in the largest four member states implied a drop in overall economic output in August, with the euro area index (46.7) at a level in the first two months of Q3 that before the pandemic would have been consistent with a decline in GDP this quarter of between 0.2-0.3%Q/Q.

The day ahead in the euro area

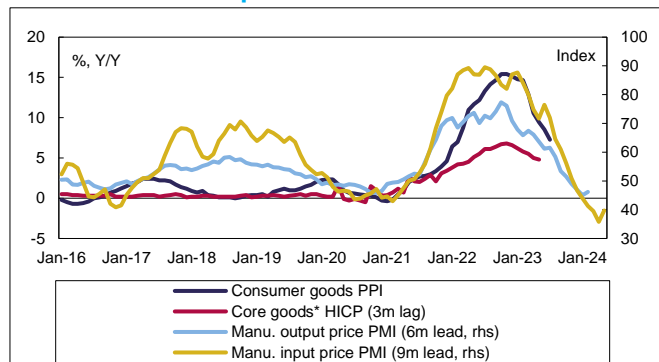
Wednesday's data releases will provide an update on euro area's economic activity in the third quarter. Based on figures already published in Germany and France, euro area retail sales figures for July are likely to suggest that spending on goods declined for a second successive month. Meanwhile, after yesterday's German goods trade data showed that the volume of exports fell for the first month in four in July (-0.6%M/M), German factory orders are expected to have started Q3 on the back foot too. Indeed, the median forecast on the Bloomberg is for a drop of more than 4.0%M/M in July. However, given the very strong growth of almost 14% reported cumulatively over the prior two months, which was exaggerated by bulk orders, the risks are skewed towards a much bigger decline than currently expected. The construction PMIs, meanwhile, are likely to signal that activity continued to contract in the sector in August. The survey is likely to suggest that Germany's construction sector continued to struggle the most, but will also probably imply that French and Italian output in the sector fell further over the summer too.

UK

BRC survey points to an unexpected rebound in retail sales in August

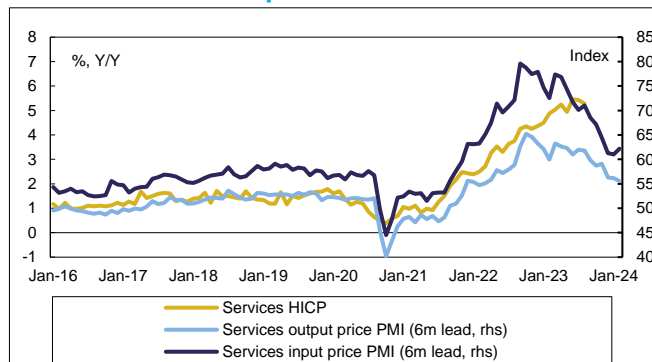
While bad weather likely dampened demand somewhat again in August, today's BRC retail monitor nevertheless suggested a rebound in spending last month, perhaps benefitting from rising household real disposable income and slight improvement in consumer confidence. According to the BRC, growth in retail sales values jumped 2.6ppts to 4.1%Y/Y, with like-for-like sales up 4.3%Y/Y, the best month since April. Smoothed for monthly volatility, like-for-like sales growth (up 0.2ppt to 3.5%Y/Y) was still the second-softest since November. And although sales of non-food items had their best month since February as firmer spending on health and beauty offset weaker clothing sales, they were still down slightly on a year earlier.

Euro area: Goods price inflation indicators



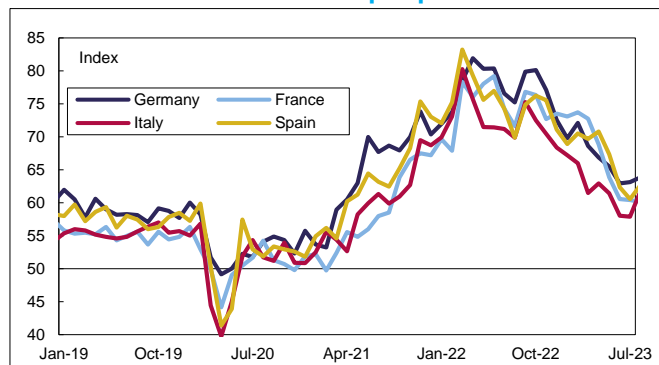
*Non-energy industrial goods. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Services price inflation indicators



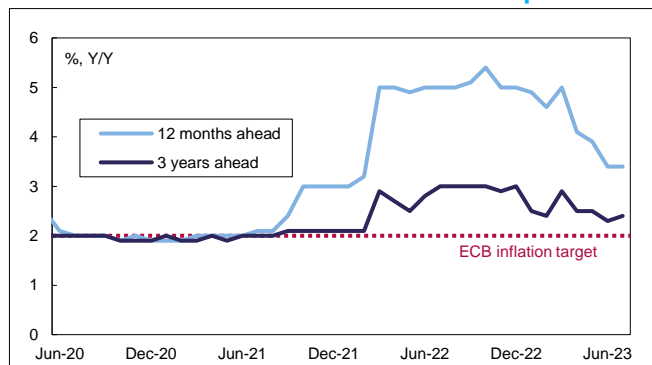
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area member states: Input price PMIs



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Median consumer inflation expectations



Source: ECB and Daiwa Capital Markets Europe Ltd.

Meanwhile, growth in the value of food sales moderated slightly to a five-month low (8.6%Y/Y). Of course, the value of retail sales continues to be inflated by elevated prices. Indeed, when adjusting for the BRC's measure of shop price inflation, the volume of like-for-like sales fell 2.6%Y/Y, a marked improvement on the drop of 5.8%Y/Y in July but nevertheless extending the run of negative growth to eighteen months. The recovery reported in the BRC's survey contrasted with the weak CBI distributive trades survey. And the Barclaycard consumer spending report today suggested that growth in credit card spending moderated in August (by 0.5ppt to 2.5%Y/Y) as the rainy weather negatively impacted a range of categories including restaurants, as well as spending in outdoor and sports goods shops, furniture stores and petrol stations. Taken together, the surveys suggest that retail sales growth remained relatively muted, if not in reverse, over the summer.

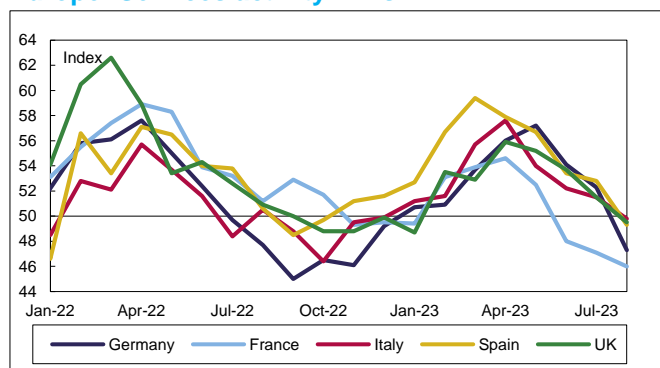
August services activity PMI not as bad flash estimates but still signal contraction in Q3

The UK's final services PMIs for August were also not as downbeat as the preliminary estimates. However, they still suggested a marked deterioration in the sector from July, and signalled that services output will likely provide only minimal support to GDP growth in Q3. In particular, the headline activity PMI was revised up 0.8pt from the flash estimate to 49.5. Nevertheless, that was still the lowest in seven months and left it trending in July and August some 4.4pts below the Q2 average. Taken together with the implied contraction in manufacturing production, the composite output PMI fell to a seven-month low in August of 48.6, to be trending more than 4pts lower in Q3 and at a level that before the pandemic was consistent with a contraction of around 0.3%Q/Q. Despite a modest upwards revision, at 49.2 the services new business component was the weakest so far this year as concerns about the economic outlook weighed on demand and with some firms continuing to cite Brexit-related difficulties and weak external demand too. As such, the backlogs of work component implied the steepest decline since the first wave of Covid and bar that the global financial crisis, while firms reported the softest jobs growth since March. MPC members might be most disheartened to see that the implied moderation in input cost pressures in August was smaller than initially estimated, with firms flagging rising salary burdens as well as high fuel prices. Admittedly, the input price PMI (68.5) was still down to its lowest since May 2021. But while the prices charged component fell 2½pts in August, at 57.1, it remained almost 5pts above the long-run average.

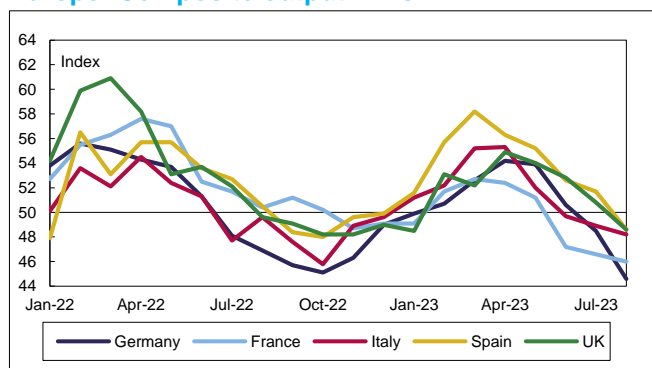
The day ahead in the UK

Like in the euro area, Wednesday will bring the latest construction PMIs for August. Following the deterioration in the manufacturing and services surveys, these are expected to show that activity slipped back last month amid the ongoing weakening in the housing market. Indeed, the index is expected to fall back below the key-50 'no growth' level for the second month out of the past three. Beyond the data, BoE Governor Bailey and colleagues will testify before the House of Commons Treasury Select Committee on the MPC's updated economic forecasts published in its August Monetary Policy Report.

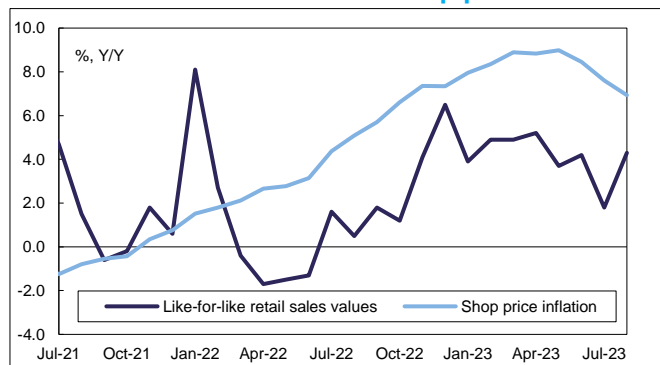
Europe: Services activity PMIs



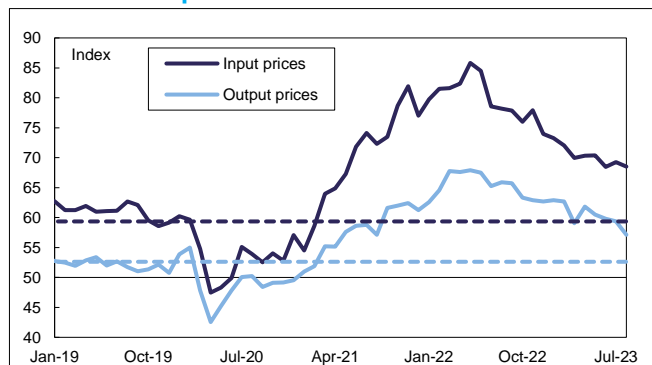
Europe: Composite output PMIs



UK: BRC retail sales values & shop price inflation













UK: Services price PMIs





European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 ECB 1 (3) year ahead CPI expectations Y/Y%	Jul	3.4 (2.4)	-	3.4 (2.3)	-
	 Final services (composite) PMI	Aug	47.9 (46.7)	<u>48.3 (47.0)</u>	50.9 (48.6)	-
	 PPI Y/Y%	Jul	-7.6	-7.6	-3.4	-
Germany	 Final services (composite) PMI	Aug	47.3 (44.6)	47.3 (44.7)	52.3 (48.5)	-
France	 Final services (composite) PMI	Aug	46.0 (46.0)	<u>46.7 (46.6)</u>	47.1 (46.6)	-
Italy	 Services (composite) PMI	Aug	49.8 (48.2)	50.5 (48.1)	51.5 (48.9)	-
Spain	 Services (composite) PMI	Aug	49.3 (48.6)	51.5 (51.0)	52.8 (51.7)	-
UK	 BRC retail monitor, like-for-like sales Y/Y%	Aug	4.3	-	1.8	-
	 New car registrations Y/Y%	Aug	24.4	-	28.3	-
	 Final services (composite) PMI	Aug	49.5 (48.6)	<u>48.7 (47.9)</u>	51.5 (50.8)	-




Auctions

Country	Auction
Germany	 sold €340mn of 0.1% 2033 index linked bonds at an average yield of 0.19%
	 sold €180mn of 0.1% 2046 index linked bonds at an average yield of 0.21%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Sentix investor confidence	Sep	-21.5	-19.7	-18.9	-
Germany	 Trade balance €bn	Jul	15.9	18.0	18.7	-
Spain	 Unemployment change '000s	Aug	24.8	-	-11.0	-








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
Euro area	 08.30	Construction PMI	Aug	-	43.5
	 10.00	Retail sales M/M% (Y/Y%)	Jul	-0.1 (-1.2)	-0.3 (-1.4)
Germany	 07.00	Factory orders M/M% (Y/Y%)	Jul	-4.0 (-3.9)	7.0 (3.0)
	 08.30	Construction PMI	Aug	-	41.0
France	 08.30	Construction PMI	Aug	-	42.9
Italy	 08.30	Construction PMI	Aug	-	48.0
UK	 09.30	Construction PMI	Aug	50.5	51.7

Auctions and events

Germany	 10.30	Auction: €5bn of 2.6% 2033 bonds
UK	 10.30	Auction: £4.0bn of 4.5% 2028 bonds
	 14.15	BoE Governor Bailey to testify to Treasury Select Committee on the MPC's latest Monetary Policy Report

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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