

Euro wrap-up

Overview

- While German factory orders unexpectedly extended their downtrend, Bunds made modest losses while the ECB's account of its June policy meeting offered no further clues on the likely future path of rates.
- Gilts also made modest losses despite a further moderation in UK business wage and price expectations and a softer construction sector survey.
- Friday will bring data for euro area retail sales and German industrial production as well as confirmation of the Labour Party's victory in the UK general election.

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Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.935	+0.022
OBL 2.1 04/29	2.584	+0.026
DBR 2.2 02/34	2.603	+0.023
UKT 0% 01/26	4.170	+0.036
UKT 0½ 01/29	4.044	+0.022
UKT 4% 01/34	4.199	+0.029

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

Euro area

Factory orders extend downtrend in May to reach lowest level since first wave of Covid-19

Contrary to expectations, the downtrend in German factory orders continued in May. Indeed, real new orders in manufacturing fell for the fifth successive month and by 1.6%M/M, the most since January, with the 0.6%M/M drop the prior month also larger than previously thought. That left them down a steep 6.2%3M/3M and 8.6%Y/Y to languish at the lowest level since June 2020 and 10.5% below the pre-pandemic level. Excluding large-scale orders, core orders fell a larger 2.2%M/M, not quite fully reversing the prior month's gain, to suggest that the underlying trend is only just starting to flatten out at a very low level. By destination, the weakness in orders in May was concentrated principally in those from outside of the euro area, which fell a steep 4.6%M/M. In contrast, orders from other euro area member states edged down just 0.1%M/M, and domestic orders rose for the first month in three, up 0.5%M/M. Within the detail, adjusting for large-scale items, new orders of consumer items grew for the fourth successive month and by a firm 4.9%M/M to rise back above the pre-pandemic level and tally with expectations of a recovery in household spending on goods domestically and across the euro area as a whole. In contrast, orders of intermediate goods grew for only the first month in three and by a moderate 0.6%M/M. And pointing to a weak outlook for fixed investment, those of capital goods fell a steep 5.3%M/M to a four-year low, almost 12% below the pre-pandemic level. At a more granular level, orders for computers, electronics and photographic equipment saw strong growth as did those for ships. But orders for cars and aircraft weakened, with machinery, pharmaceuticals and textiles among the items to report significant declines in May.

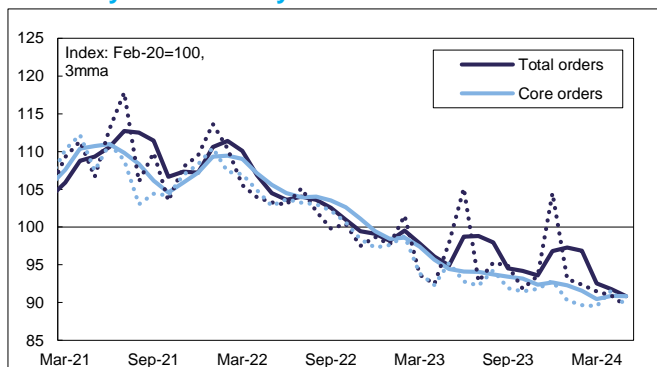
Soft turnover suggests risks to tomorrow's IP data are skewed to the downside

Like today's figures for new orders, the manufacturing turnover data also disappointed. Indeed, turnover fell for a third successive month in May and by 0.7%M/M to the lowest level since September 2021, flagging risks of a contraction in overall production that month when the IP data are published tomorrow. Moreover, with survey measures such as the PMIs and other leading indicators such as truck-toll mileage having all pointed to a renewed deterioration in momentum in both output and orders in German manufacturing in June, growth in the sector over Q2 as a whole now risks being negligible at best following the welcome rebound of 0.4%Q/Q in Q1.

Construction PMIs point to ongoing contraction, with a notable deterioration in Italy

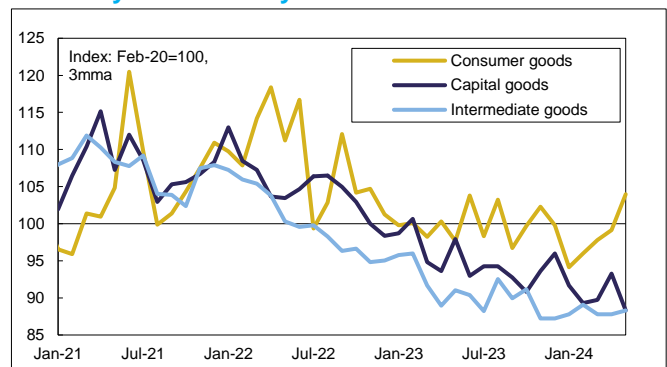
Consistent with the downbeat assessment in last week's [Commission survey](#) results, today's construction PMIs suggested that activity in the sector in the euro area weakened at end-Q2. In particular, the headline euro area construction activity index fell 1.1pts in June to 41.8, the lowest for five months, some 6pts below the pre-pandemic average and the second-

Germany: New factory orders*



*Core orders exclude large-scale orders. Dotted lines represent single-month data. Source: Macrobond and Daiwa Capital Markets Europe Ltd. Source:

Germany: New factory orders*



*Excluding large-scale orders. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

lowest since the first Covid-19 lockdown in mid-2020. The deterioration this time around was led by civil engineering, with the respective activity index dropping 3.9pts – the most since November 2022 – to 42.8. But while the house-building PMI (37.5) implied a steeper pace of contraction than in civil engineering and commercial activity, it was nevertheless the highest in six months, perhaps reflecting the recent improvement in consumer confidence, lower interest rates and signs that the downturn in house prices has bottomed out. Certainly, the pickup in Germany's housing PMI – up 3.3pts to a 13-month high of 35.6 – followed the softest annual decline in house prices in Q1 for five quarters. But the respective PMIs in France (33.7) and Italy (44.4) fell back in June, with the latter the lowest in 18 months as demand fell due to the phasing out of tax incentives. With civil engineering activity also contracting sharply in June, the headline Italian construction PMI (-3pts to 46.0) was the lowest for almost two years. But while the equivalent German (39.7) and French (41.0) indicators remained lower than in Italy, they were still up over the second quarter as a whole. On average, the overall euro area construction index moved sideways in Q2 (42.2) reinforcing our expectation that output in the sector fell from Q1.

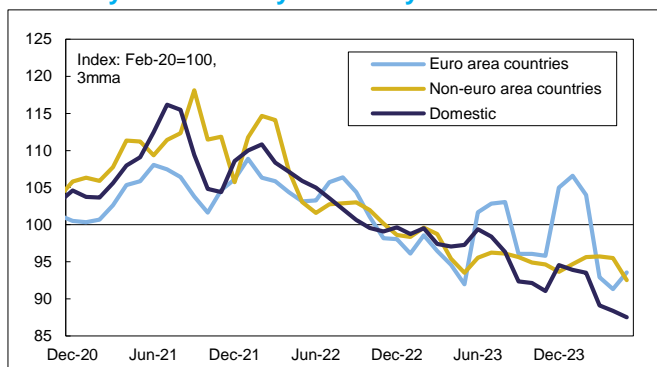
Despite easing in June, composite PMIs point to positive GDP growth in Q2 led by Spain

Despite being modestly upwardly revised from the flash estimates, the final June services and manufacturing output PMIs, published earlier this week, also signalled softer growth momentum at the end of Q2. In particular, the euro area services activity index fell 0.4pt from May to a three-month low of 52.8, while the manufacturing output PMI declined a more notable 3pts to 46.1, the lowest for six months. As such, while the composite output PMI was nudged up 0.1ppt from the flash, it was still down 1.2pt from May to 50.9, the softest since March. Nevertheless, over Q2 as a whole, the average composite index (51.6) was still the best in four quarters and some 2½pts higher than in Q1. And so, on the whole, the latest surveys support our expectation that euro area GDP rose a further 0.3%Q/Q last quarter. At the country level, despite the ongoing weakness in manufacturing and surprising deterioration reported in services conditions in June – despite the likely boost to hospitality from the Euros championship – the German composite PMI in Q2 (51.1) was some 4pts above the Q1 average and consistent with another quarter of modestly positive GDP growth. While the French composite PMI (49.4) remained in 'contractionary' territory for a fourth successive quarter, this was still 2.4pts higher than the Q1 average. And while the Italian composite PMI slowed to a four-month low in June, the quarterly index (52.1) was the firmest for four quarters, again supporting our expectation of modest expansion last quarter. But once again, the PMIs suggested that the Spanish economy continues to outperform, with the composite index (56.0) in Q2 up almost 2½pts from Q1 and the strongest for ten quarters.

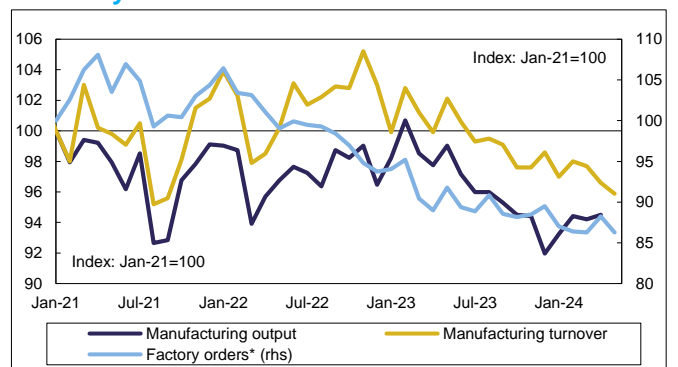
The day ahead in the euro area

Friday will bring euro area retail sales figures for May, which are expected to report a modest increase following the drop in

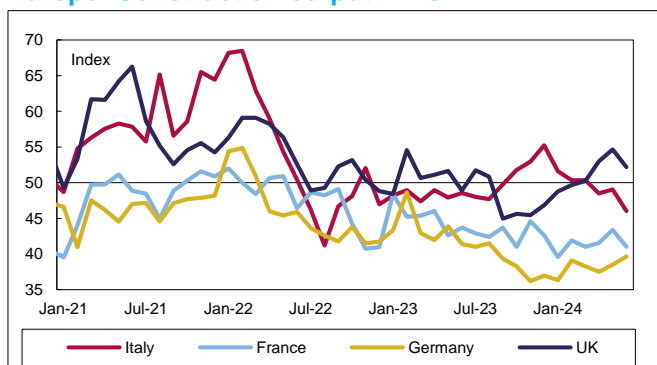
Germany: New factory orders by destination



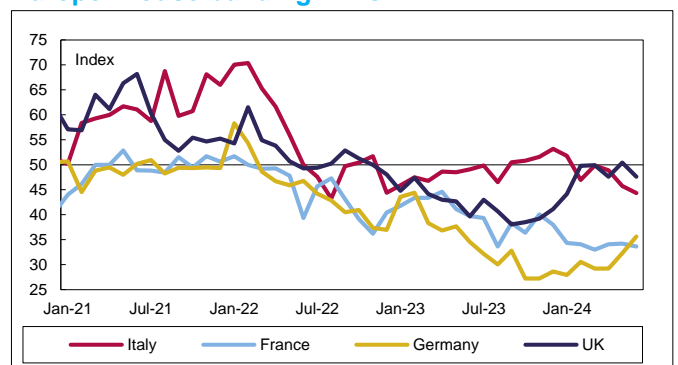
Germany: Selected industrial sector indicators



Europe: Construction output PMIs



Europe: House building PMIs



April (-0.5%M/M). Indeed, French consumer spending on goods jumped in May (1.5%M/M) and sales growth was positive in Portugal (+1.4%M/M), offsetting a decline in Spain (-0.6%M/M). Furthermore, revised German figures suggest that the decline in sales in that country in April was significantly smaller than initially estimated (from -2.0%M/M to -0.2%M/M), suggesting a likely upwards revision to euro area retail sales at the start of Q2. Tomorrow will also bring May industrial production data from Germany, France and Spain. Like in Germany, French output is expected to have declined in May and merely moved sideways in Spain. In addition, tomorrow will bring euro area services turnover figures for April and house price numbers for Q1.

UK

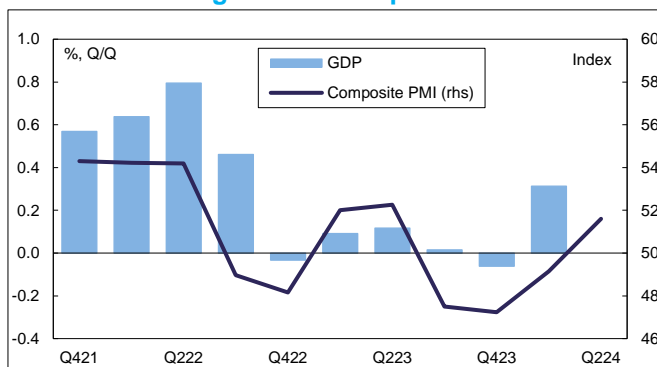
Firms revise down expectations for inflation and wage growth

In gauging the risks of inflation persistence, the BoE continues to keep an eye on price and wage expectations. Judging from its own Decision Maker Panel (DMP) survey, firms continue to revise down their expectations in those respects, thus seemingly reducing further the risks of inflation persistence and strengthening the case for a rate cut at the MPC's next policy meeting on 1 August. In particular, following a notable pickup in April, firms revised down in June for the second successive month both their median estimate of realised selling-price growth over the past 12 months as well as their expectation for selling-price growth over the coming twelve months. Both figures fell to the lowest levels since August 2021, with the latter down 0.2ppt to 3.6%Y/Y. While that is admittedly still more than 1ppt above the pre-pandemic average, firms' expectation for CPI inflation twelve months ahead dropped for the ninth successive month to 2.8%Y/Y, the lowest on the admittedly short series. And while the expectation for three years ahead edged up to 2.7%Y/Y, this was only 0.1ppt above the series low and more than 2ppts below the peak. Moreover, with realised pay growth also down to the softest rate in almost two years, firms' expectation for wage growth over the coming twelve months dropped to 4.0%Y/Y, the lowest in more than two years, some 2.3ppts below the peak in December 2022.

Downward revisions to services cost and price PMIs also ease concerns about inflation persistence

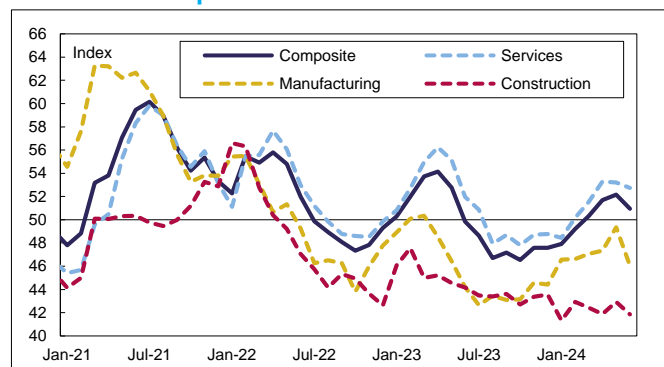
The moderation in wage and price expectations reported in the DMP survey tallies with the softening in cost pressures reported in the final June services PMIs, with the respective index revised down substantially – by more than 1½ppts – from the flash estimate to a more than three-year low (60.3), only about ½pt above the pre-pandemic average. While the services output price index ticked up from May and was still almost 3½ppts above the long-run average, it was still the second-lowest in more than three years consistent with gradual disinflation in the sector. Moreover, although the PMI for manufacturing sector costs rose to the highest level in more than a year (56.3), reportedly in part due to increased shipping freight tariffs,

Euro area: GDP growth & composite PMI



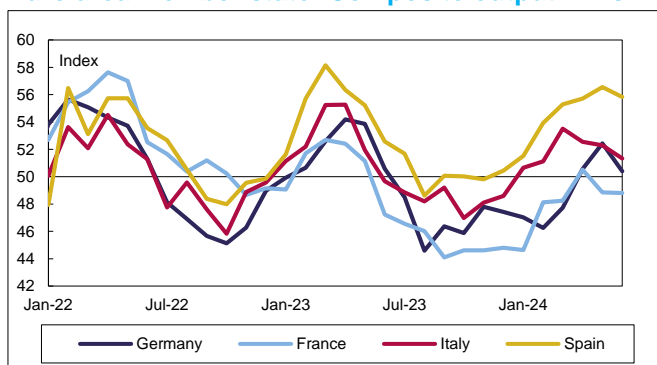
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Output PMIs



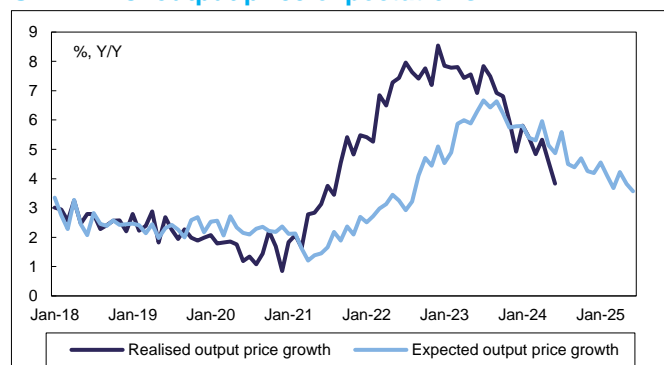
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area member state: Composite output PMIs



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

UK: Firms' output price expectations



Source: BoE DMP survey, Macrobond and Daiwa Capital Markets Europe Ltd.

that was still somewhat below the respective long-run average. And the equivalent index for manufacturing output prices was marginally softer on the month and also 1½pts below its long-run average suggesting that core goods CPI inflation should remain well below 2%Y/Y for a while to come.

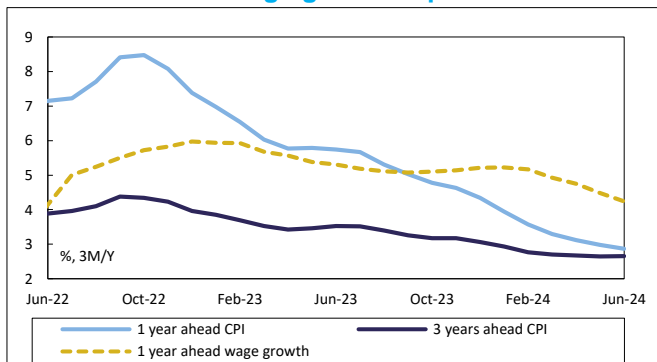
Construction PMI slips back in June as delayed interest rate cut expectations hits house building

Like in the euro area, today’s UK construction PMI survey suggested a moderation of growth momentum at the end of the second quarter, with signs that certain building projects were put on hold as firms waited for a first rate cut. In particular, the headline activity index fell 2.5pts in June to a three-month low of 52.2, with the housing component returning to ‘contractionary’ territory (47.6). But having risen to a two-year high in May, the headline index in Q2 (53.3) was more than 3½pts above the Q1 average, led by a jump in commercial activity (+5.5pts to 54.9) and civil engineering (+2.7pts to 52.7). And firms maintained their optimism for the coming year, with more than 50% of survey respondents projecting an increase in output. While the services PMIs also signalled a loss of momentum in June, the final survey results – published yesterday – were less downbeat than initially suggested. For example, the upwards revision (+0.9pt) to the activity index left it down just 0.8pt from May at 52.1 and the quarterly index (53.3) was still consistent with steady expansion in the sector in Q2. Despite a modest easing in June, the manufacturing output PMI in Q2 (52.0) was the strongest quarterly reading for two years. So, although the composite output PMI eased to a six-month low in June (52.3), the quarterly index in Q2 (53.1) was marginally higher than Q1 and therefore still suggestive of another quarter of relatively solid GDP growth. Indeed, we expect GDP growth of 0.4%Q/Q in Q2, a touch below the BoE’s most recent projection (0.5%Q/Q).

The day ahead in the UK

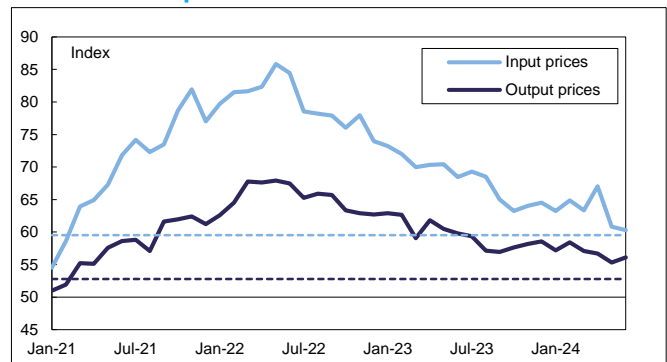
The main focus in the UK on Friday will be the results of today’s [general election](#). A landslide win for the Labour Party, to send its broadly centrist and relatively technocratic leader Keir Starmer to Downing Street and offer greater stability and predictability in policymaking after five very different Conservative Prime Ministers in eight years, should have long been fully priced by the financial markets.

UK: Firms’ CPI & wage growth expectations



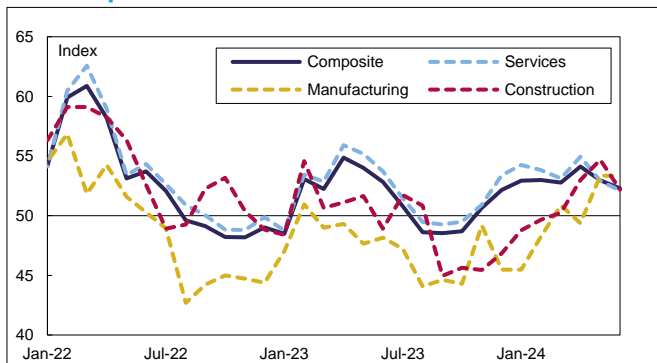
Source: BoE DMP survey, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services price PMIs*



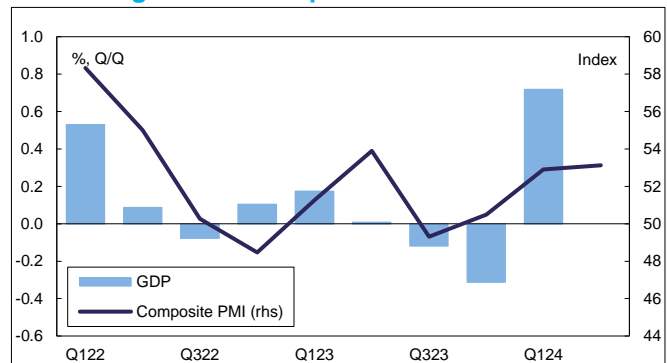
*Dashed lines represent quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output PMIs



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

UK: GDP growth & composite PMI











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









European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Construction PMI	Jun	41.8	-	42.9	-
Germany	 Factory orders M/M% (Y/Y%)	May	-1.6 (-8.6)	0.8 (-6.0)	-0.2 (-1.6)	-0.6 (-1.8)
	 Construction PMI	Jun	39.7	-	38.5	-
France	 Construction PMI	Jun	41.0	-	43.4	-
Italy	 Construction PMI	Jun	46.0	-	49.0	-
UK	 New car registrations Y/Y%	Jun	1.1	-	1.7	-
	 Construction PMI	Jun	52.2	54.0	54.7	-
	 DMP 3M output price (1Y CPI) expectations Y/Y%	Jun	3.9 (2.8)	-	3.9 (2.9)	-








Auctions

Country	Auction
France	 sold €3.98bn of 3% 2033 bonds at an average yield of 3.17%
	 sold €3.59bn of 1.25% 2034 bonds at an average yield of 3.23%
	 sold €1.73bn of 0.75% 2053 bonds at an average yield of 3.61%
	 sold €1.20bn of 1.75% 2066 bonds at an average yield of 3.48%
Spain	 sold €1.73bn of 2.5% 2027 bonds at an average yield of 3.067%
	 sold €2.58bn of 3.1% 2031 bonds at an average yield of 3.132%
	 sold €1.60bn of 1.85% 2035 bonds at an average yield of 3.416%
	 sold €520mn of 0.7% 2033 index-linked bonds at an average yield of 1.212%


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	 Final services (composite) PMI	Jun	52.8 (50.9)	52.6 (50.8)	53.2 (52.2)	-
	 PPI Y/Y%	May	-4.2	-4.2	-5.7	-
Germany	 Final services (composite) PMI	Jun	53.1 (50.4)	53.5 (50.6)	54.2 (52.4)	-
France	 Final services (composite) PMI	Jun	49.6 (48.8)	48.8 (48.2)	49.3 (48.9)	-
Italy	 Services (composite) PMI	Jun	53.7 (51.3)	56.5 (-)	54.2 (52.3)	-
Spain	 Services (composite) PMI	Jun	56.8 (55.8)	53.9 (-)	56.9 (56.6)	-
UK	 Final services (composite) PMI	Jun	52.1 (52.3)	51.2 (51.7)	52.9 (53.0)	-

Auctions

Country	Auction
Germany	 sold €4.07bn of 2034 bonds at an average yield of 2.63%

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 Retail sales M/M% (Y/Y%)	May	0.2 (0.1)	-0.5 (0.0)	
Germany		07.00 Industrial production M/M% (Y/Y%)	May	0.2 (-4.2)	-0.1 (-3.9)	
France		07.45 Trade balance €bn	May	-	-7.6	
		07.45 Industrial production M/M% (Y/Y%)	May	-1.2 (-1.2)	0.5 (0.9)	
Spain		08.00 Industrial production M/M% (Y/Y%)	May	-	0.3 (0.8)	
Auctions and events						
- Nothing scheduled -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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