

Euro wrap-up

Overview

- While flash German inflation ticked slightly higher, Bunds made gains as euro area GDP growth fell short of the ECB's projection in Q2 and the Commission's survey signalled softer growth and lower inflation expectations at the start of Q3.
- While a UK survey suggested that shop price inflation is still very weak, shorter-dated gilts made modest losses as Thursday's BoE decision remained too close to call.
- Tomorrow will bring the flash July inflation estimates from the euro area.

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Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.540	-0.043
OBL 2½ 10/29	2.257	-0.029
DBR 2.6 08/34	2.335	-0.019
UKT 0½ 01/26	3.857	+0.013
UKT 0½ 01/29	3.840	-0.015
UKT 4½ 01/34	4.042	-0.005

*Change from close as at 5.00pm BST.
Source: Bloomberg

Euro area

GDP growth in Q2 misses ECB projection to remain firmly below pre-Covid trend

Broadly in line with expectations, euro area GDP rose 0.3%Q/Q in Q2 to match the pace of Q1. To two decimal places the figure for Q2 was a touch less flattering at 0.26%Q/Q, down marginally from 0.28%Q/Q in Q1. More importantly, growth in Q2 fell short of the ECB's projection of 0.4%Q/Q. GDP was also up just 0.6%Y/Y, below reasonable estimates of euro area potential growth. And it was just 3.9% above the pre-pandemic level of Q419, 5.5ppts lower than US GDP growth against the same benchmark, and about 2¼% below the pre-Covid trend suggestive of persistent scarring from the coronavirus and Russian invasion of Ukraine. So, the ECB should be underwhelmed by the recent performance of euro area GDP, which appears to be consistent with ongoing disinflation and compatible with a further rate cut in September.

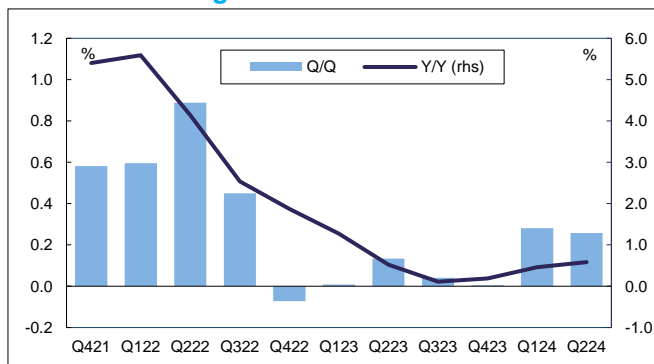
Germany contracts again as euro area GDP growth becomes increasingly reliant on Spain

Among the member states, in line with the recent trend, euro area GDP in Q2 was dragged down by Germany where economic output fell for the second quarter in the past three, albeit by just 0.1%Q/Q. That left German GDP down 0.1%Y/Y and just 0.3% above the pre-pandemic level. In contrast, France (0.3%Q/Q) and Italy (0.2%Q/Q) again grew close to the euro area aggregate rate to be up a moderate 1.1%Y/Y and 0.9%Y/Y respectively. Similarly as in Q1, Spain (0.8%Q/Q) and Ireland (1.2%Q/Q) significantly outpaced the other larger member states. However, on a year-on-year basis, only Spanish growth (2.9%Y/Y) can be considered relatively vigorous while Irish GDP was still well down on its level a year earlier (-1.4%Y/Y). Indeed, with growth in Portugal having slowed 0.7ppt in Q2 to just 0.1%Q/Q, euro area growth appears to have become increasingly reliant on Spain where the boost from post-pandemic pent-up demand might be expected soon to fade.

Domestic demand appears to have disappointed expectations, except in Spain

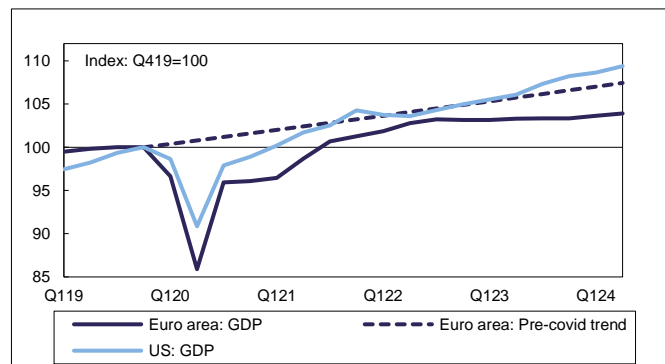
The ECB had projected GDP growth in Q2 to be driven by all major components of final domestic demand as well as a first positive contribution in four quarters from stock-building. With firm domestic demand having been expected to trigger a rebound in imports, it had also expected net trade to subtract from growth in Q2. The limited information provided by the member states leaves uncertainty regarding the composition of euro area GDP last quarter. But final domestic demand appears to have disappointed expectations. For example, Destatis merely reported that German investment in equipment and buildings contracted in Q2 – a predictable outcome given the weather-assisted strength of that component in Q1. Meanwhile, ISTAT reported that the modest Italian GDP growth had been reliant on inventories. Where detailed data were published, in France household consumption again failed to increase while fixed investment growth was minimal (0.1%Q/Q). And thanks principally to the delivery of a large ship, exports made the largest contribution (0.2ppt) to French GDP growth.

Euro area: GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area & US: GDP level*



*Pre-Covid trend based on ten-year average up to Q419. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Only in Spain was GDP growth driven by broad-based final demand with positive contributions from household and government consumption, fixed investment and exports.

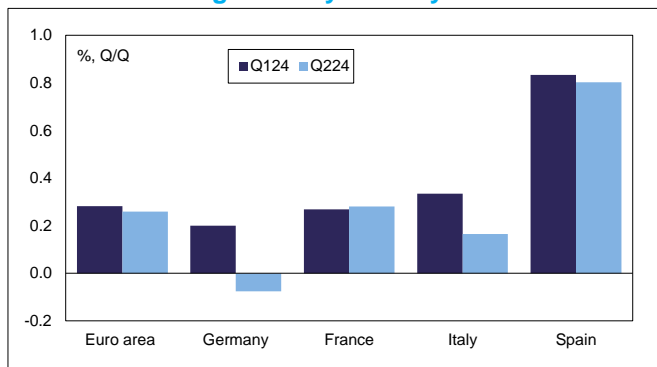
Commission survey suggests softer euro area growth momentum at start of Q3

After the unexpected decline in the [flash July PMIs](#), today's Commission survey results marginally beat expectations, with the headline Economic Sentiment Indicator (ESI) falling just 0.1pt to 95.8, to maintain a broadly sideways trend in place since the start of the year. However, this was still some 4% below the long-run average. And compared with the pre-pandemic long-run average, both the headline ESI and composite output PMI point to a slowdown in GDP growth to around 0.1%Q/Q at the start of Q3, some 0.3ppts below the ECB's June projection and thus also supportive of the case for a rate cut in September. Contrasting the decline in the PMIs, the German ESI (92.3) edged a touch higher in July. But the French ESI (94.8) fell a striking 2.2pts to a nine-month low. And both indices were tracking well below the long-run average at the start of Q3. In contrast, the Italian ESI (100.1) was bang in line with the trend. And the Spanish ESI (104.1) jumped to its second-highest level since March 2022, suggesting that Spain's economy will continue to outperform the other larger member states for the time being.

Widespread deterioration in business sentiment, while consumers were more upbeat

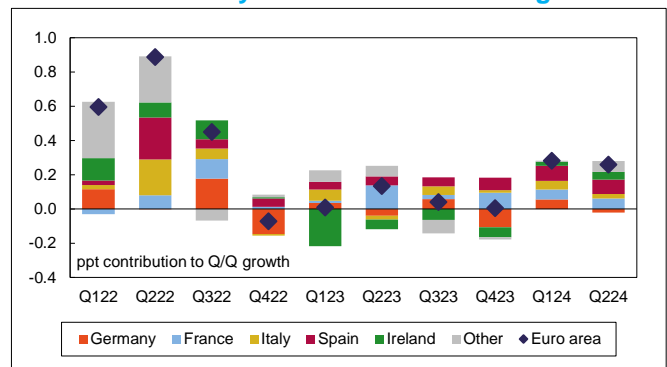
The sideways move in the ESI, however, masked a further deterioration in euro area business sentiment in July, tallying with the more downbeat assessment of the PMIs. Indeed, the Commission business climate index fell to its lowest since September 2020 led by a worsening of services and retail conditions as firms judged the recent and near-term business situation to have weakened considerably. Weakness in services was particularly significant in France, likely at least in part due to political uncertainty. Meanwhile, reflecting not least ongoing challenges in Germany, industrial sentiment fell to a four-year low as orders continued to decline. And construction confidence remained near the bottom of the recent range with activity reportedly restrained by a lack of demand and inclement weather conditions. Against this backdrop, firms scaled back significantly their hiring plans, with German and French employers signalling a desire to cut headcount. Nevertheless, consumers were the most upbeat since Russia's invasion of Ukraine in February 2022 amid expectations of rising household incomes. Indeed, the share of consumers considering it a good time to make major purchases also rose to the highest since February 2022, with purchase intentions for the year ahead back in line with the long-run average. As such, we still expect household consumption growth to offset weakness in fixed investment over coming quarters.

Euro area: GDP growth by country



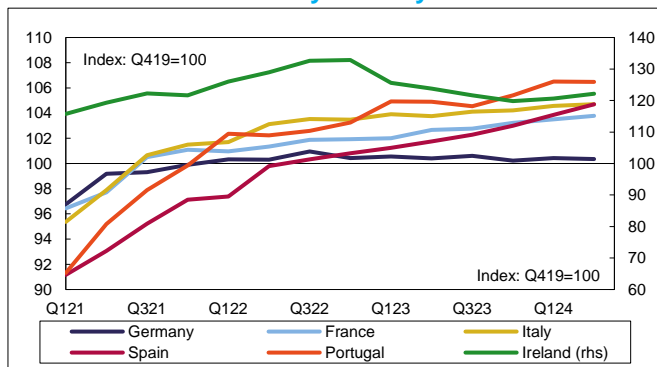
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Country contributions to GDP growth



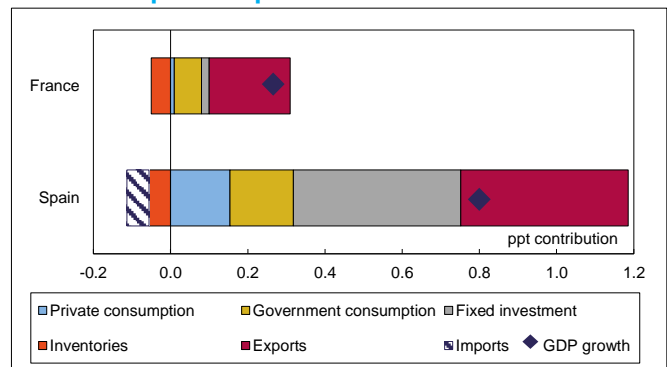
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP levels by country



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France & Spain: Expenditure contributions to GDP



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

German inflation ticks up slightly in July due to non-core components

Like the Q2 GDP data, the messages from today's flash estimates of inflation in July varied among the member states. Above expectations, German inflation ticked slightly higher, with the EU-harmonised HICP and national CPI measures both up 0.1ppt to 2.6%Y/Y and 2.3%Y/Y respectively. The detail on the national measure showed that the rise related to non-core items. An unfavourable base effect meant that inflation of food and non-alcoholic drinks rose to a six-month high (1.3%Y/Y) despite a decline in prices from June. And a pickup in prices of diesel and heating oil meant that energy inflation also ticked up in July (-1.7%Y/Y). In contrast, inflation of services (3.9%Y/Y) and non-energy industrial goods (1.4%Y/Y on our calculation) remained unchanged, as therefore did core inflation (2.9%Y/Y). In Spain, however, inflation cooled further than expected, and by a chunky 0.7ppt to 2.9%Y/Y on the EU-harmonised measure. While the Spanish statisticians reported that the decline was principally due to lower electricity prices, recreation and culture inflation was also softer. So, the Spanish national core measure (which excludes fresh food and energy) moderated 0.2ppt to 2.8%Y/Y. Elsewhere, Irish HICP inflation was unchanged at 1.5%Y/Y. And while Belgian inflation on the EU-harmonised measure ticked up 0.1ppt to 5.5%Y/Y, that was at least in part due to pressures in the tobacco component so underlying inflation remained steady. Based on today's data, we continue to expect the headline and core euro area HICP rates to move sideways in July at 2.5%Y/Y and 2.9%Y/Y respectively. But the risks to those forecasts are probably skewed slightly to the upside.

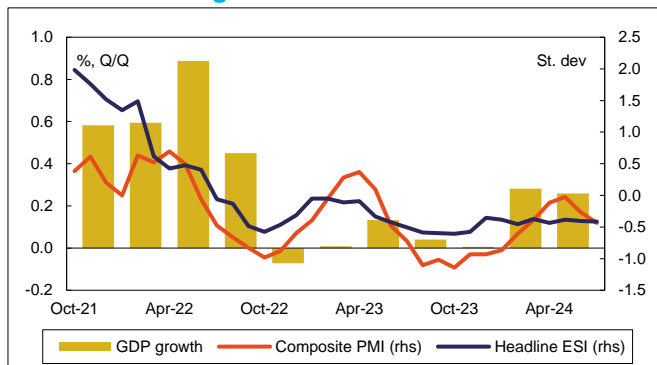
Services selling-price expectations fell to three-year low, consumer expectations well anchored

Looking at the near-term price outlook, today's Commission survey results were encouraging. Services firms' expectations for selling prices in three months' time declined for the fifth month out of the past six in July to the lowest in more than three years. Selling-price expectations also fell sharply in the construction sector. And despite rising to the highest in 15 months – perhaps reflecting higher shipping costs associated with events in the Red Sea – the respective index for manufacturing remained below the long-run average, suggesting only modest pipeline pressures in the factory sector. Admittedly, retailers' selling price expectations rose to a five-month high. But they remained well off the highs seen over recent years. And consumer price expectations twelve months ahead fell to a seven-month low comfortably below the long-run average, suggesting that expectations remain well anchored and broadly consistent with the ECB's target.

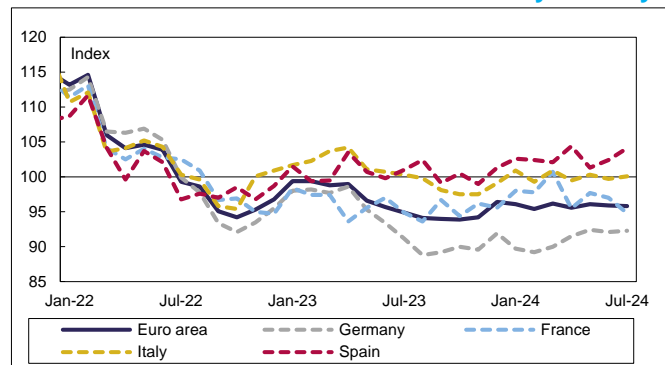
The day ahead in the euro area

The European data highlight tomorrow will be the aforementioned flash estimate of euro area inflation in July. Based on national figures published so far, we continue to expect the headline euro area HICP rate to move sideways at 2.5%Y/Y. But

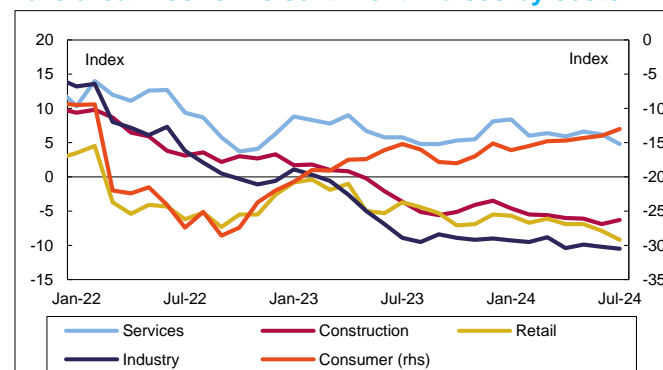
Euro area: GDP growth & sentiment indices



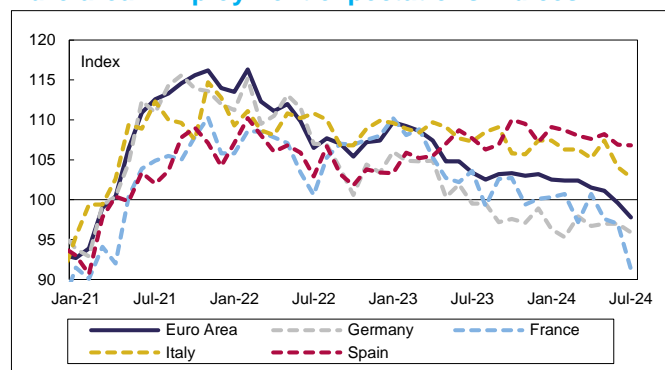
Euro area: Economic sentiment indices by country



Euro area: Economic sentiment indices by sector



Euro area: Employment expectations indices



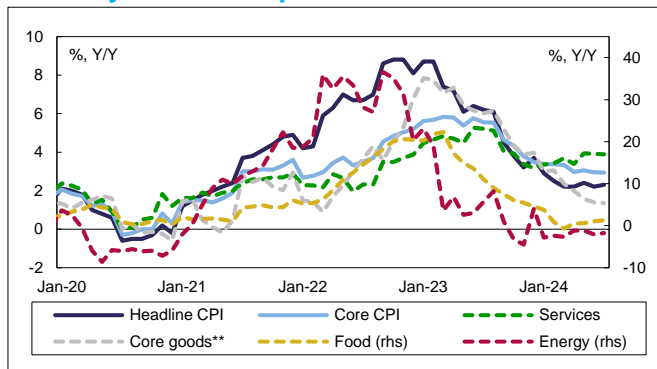
risks to this forecast are skewed slightly to the upside. We also expect core inflation to be unchanged at 2.9%Y/Y. Of course, the outcome for euro area inflation will depend in part on French, Italian and Dutch HICP figures, which will also be published tomorrow. Wednesday will also bring German labour market data for July. While the number of unemployed people is expected to rise for a 19th consecutive month, the claimant count rate is forecast to move sideways at 6.0%, nevertheless still the joint-highest rate since May 2021.

UK

BRC survey signals continued absence of price pressures on the high street in July

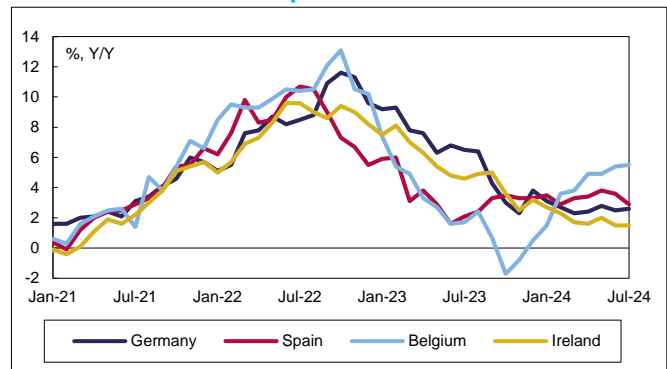
According to the British Retail Consortium (BRC), price pressures on the UK high street remained very subdued in July with its shop price inflation measure unchanged at just 0.2%Y/Y, the lowest since October 2021. Reflecting global goods price trends, intense competition, and soft demand for summer-related clothing and furniture items due to inclement weather, non-food inflation remained in negative territory, edging up just 0.1ppt to -0.9%Y/Y. Meanwhile, with further declines reported in both fresh and processed prices categories, food inflation eased a further 0.2ppt to 2.3%Y/Y, also the lowest in more than 3½ years. While food inflation might be expected to move higher from here, subdued demand and global trends should keep the core goods CPI rate – which dropped to -0.1%Y/Y in May and June – weak over coming quarters.

Germany: Consumer price inflation*



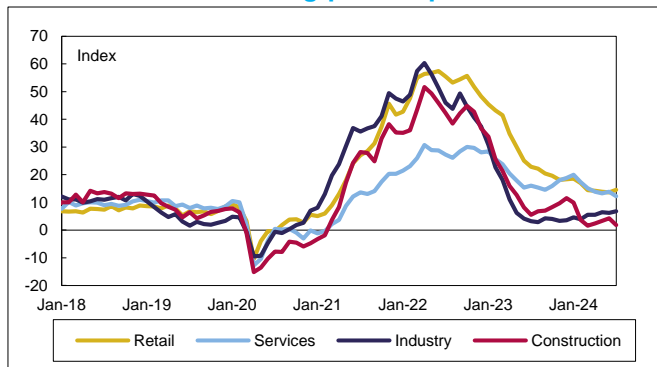
*National CPI measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation*



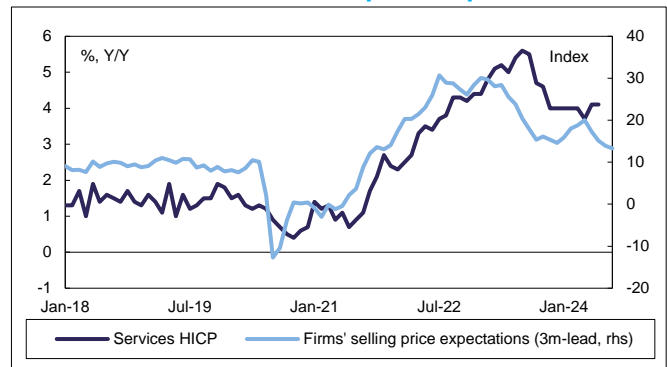
*Eurostat HICP measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Firms' selling-price expectations



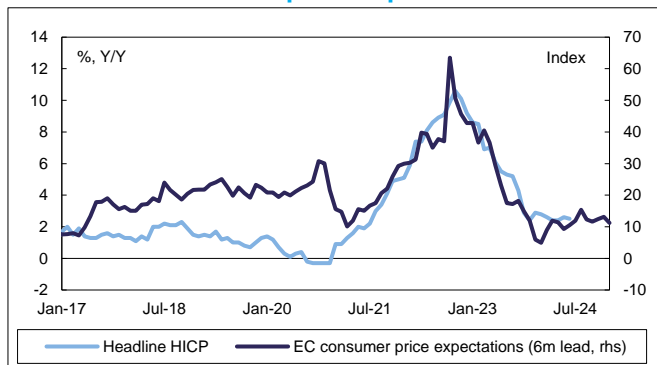
Source: Macrobond, EC and Daiwa Capital Markets Europe Ltd.

Euro area: Services HICP & price expectations



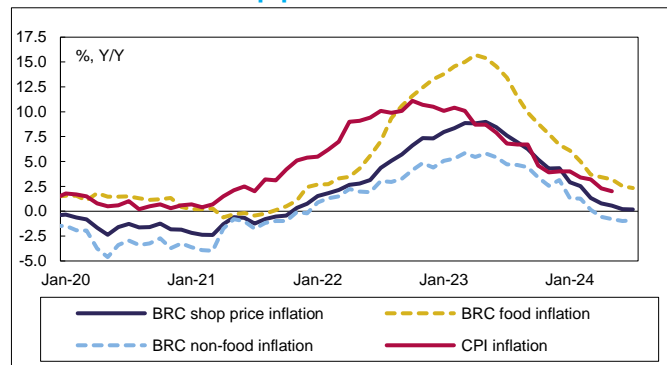
Source: Macrobond, EC and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price expectations & HICP



Source: Macrobond, EC and Daiwa Capital Markets Europe Ltd.

UK: CPI & BRC shop price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.













The day ahead in the UK

Tomorrow should be a quiet day for UK economic news with no top-tier data due for release.






European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 GDP – first estimate Q/Q% (Y/Y%)	Q2	0.3 (0.6)	<u>0.2 (0.5)</u>	0.3 (0.4)	- (0.5)
	 Commission Economic Sentiment indicator	Jul	95.8	95.2	95.9	-
	 Commission industrial (services) confidence indicator	Jul	-10.5 (4.8)	-10.6 (6.3)	-10.1 (6.5)	-10.2 (6.2)
	 Final Commission consumer confidence indicator	Jul	-13.0	-13.0	-14.0	-
Germany	 GDP – first estimate Q/Q% (Y/Y%)	Q2	-0.1 (-0.1)	<u>0.1 (0.0)</u>	0.2 (-0.2)	- (-0.1)
	 Preliminary HICP (CPI) Y/Y%	Jul	2.6 (2.3)	2.5 (2.2)	2.5 (2.2)	-
France	 GDP – first estimate Q/Q% (Y/Y%)	Q2	0.3 (1.1)	<u>0.1 (0.7)</u>	0.2 (1.3)	0.3 (1.5)
	 Consumer spending M/M% (Y/Y%)	Jun	-0.5 (-1.0)	-0.1 (-0.2)	1.5 (0.9)	0.8 (0.5)
Italy	 GDP – first estimate Q/Q% (Y/Y%)	Q2	0.2 (0.9)	<u>0.1 (1.0)</u>	0.3 (0.7)	- (0.6)
Spain	 GDP – first estimate Q/Q% (Y/Y%)	Q2	0.8 (2.9)	<u>0.5 (2.5)</u>	0.8 (2.5)	- (2.6)
	 Preliminary HICP (CPI) Y/Y%	Jul	2.9 (2.8)	3.2 (3.0)	3.6 (3.4)	-
UK	 BRC shop price index Y/Y%	Jul	0.2	0.0	0.2	-








Auctions

Country	Auction
Italy	 sold €1.75bn of 3.35% 2029 bonds at an average yield of 3.18%
	 sold €1.5bn of 4.1% 2029 bonds at an average yield of 3.14%
	 sold €1.5bn of floating rate 2032 bonds at an average yield of 4.89%
	 sold €4.5bn of 3.85% 2035 bonds at an average yield of 3.76%
UK	 sold £3.75bn of 4.25% 2034 bonds at an average yield of 4.082%


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 headline (core) HICP Y/Y%	Jul	<u>2.5 (2.9)</u>	2.5 (2.9)
Germany	08.55	 Unemployment rate % (change 000's)	Jul	6.0 (15.0)	6.0 (19.0)
France	07.45	 Preliminary HICP (CPI) Y/Y%	Jul	2.8 (2.4)	2.5 (2.2)
	07.45	 PPI Y/Y%	Jun	-	-6.7
Italy	10.00	 Preliminary HICP (CPI) Y/Y%	Jul	1.2 (1.1)	0.9 (0.8)
	11.00	 PPI Y/Y%	Jun	-	-4.9
UK	00.01	 Lloyds business barometer (own price expectations)	Jul	-	41 (53)

Auctions and events

Germany	 10.00	Auction: to sell €3.0bn of 2.4% 2030 bonds
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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