Euro wrap-up

Overview

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- While euro area negotiated wage growth moderated and consumer confidence softened slightly, Bunds made losses as the flash PMIs pointed to a slight pickup in economic activity in August thanks not least to the Paris Olympics.
- Gilts also made losses as the UK flash PMIs surprised on the upside to point to a pickup in growth momentum.
- Friday will bring updates on UK consumer confidence, French business conditions and euro area consumer inflation expectations.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.391	+0.045
OBL 2½ 10/29	2.154	+0.054
DBR 2.6 08/34	2.241	+0.055
UKT 0⅛ 01/26	3.702	+0.056
UKT 0½ 01/29	3.767	+0.070
UKT 4⅝ 01/34	3.958	+0.067

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

Euro area

Unexpected pick up in euro area composite PMI reliant on temporary French Olympics boost

If the flash PMIs are to be believed, euro area economic activity unexpectedly firmed in August. Having dropped in July to a four-month low consistent with stagnation and been expected to remain thereabouts this month, the headline euro area composite output PMI rose 1.0pt in August to a three-month high of 51.2. The rebound was driven by France, where the respective index jumped to a 17-month high of 52.7. French improvement was concentrated in services, for which the activity PMI leapt almost 5pts – the second-sharpest increase on the series outside of the pandemic – to a more than two-year high of 55.0, reportedly due to the boost to demand provided by the Paris Olympics. To us, that strength looks questionable, perhaps exaggerated by the usual French August lull associated with “Les Grandes Vacances” or sampling. Indeed, the French services PMI often provides a misleading signal. And even if it is validated by the final release and other indicators, the pickup in French services activity looks set to fade rapidly with the extinguishing of the Olympic flame. Notably perhaps, the survey measure of outstanding business in French services dropped to a seven-month low in August while the PMI for 12-month expectations in that sector fell to an 11-month low, suggestive of a non-negligible loss of forward momentum.

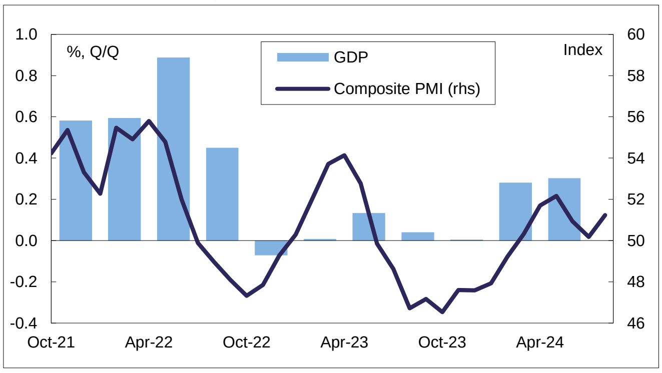
Flash PMI details & consumer confidence index point to softening underlying growth momentum

The survey also reported a modest pickup in services growth outside of the two largest member states, helping to push the euro area activity PMI for the sector to a four-month high (53.3). But many of the remaining details of the flash PMIs, as well as today’s flash consumer confidence index, were less encouraging. For example, German services activity reportedly slowed to a five-month low (51.4). Business expectations in the sector in the euro area as a whole deteriorated to the worst so far this year amid a notable decline in external demand. Due to weakening in the two largest member states, the drops in manufacturing output and orders in the region were the sharpest since December. With seemingly no end in sight to the painful adjustments in the sector, the pace of job-shedding in manufacturing was reportedly the strongest in 14 months. And overall, despite the pickup in August, the trend in the composite PMI currently suggests that euro area GDP will grow just 0.1%Q/Q in Q3, 0.3ppt less than the ECB’s projection. Today’s flash Commission consumer confidence index, which registered an unexpected slight drop from July’s 2½-year high, also pointed to a softening of recovery momentum.

PMIs suggest moderating cost pressures but uptick in selling prices

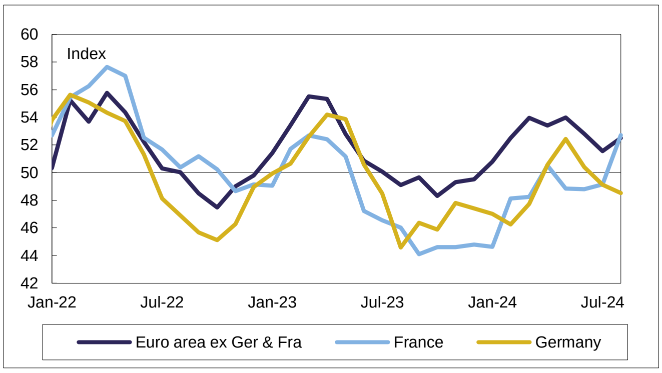
In terms of inflation, the flash PMIs offered little clarity. Encouragingly perhaps, input cost growth in the euro area moderated to the lowest in eight months, with such pressures in services the softest since April 2021. Nevertheless, with firms appearing

Euro area: GDP growth & composite output PMI



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

Euro area member states: Composite output PMIs



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

to take advantage of the slight firming in demand, selling prices reportedly rose at the fastest pace in four months, albeit with the relevant index still close to the bottom of the range of the past three years.

Negotiated wage growth slows in Q2 to reduce concerns about inflation persistence

Beyond the survey indicators, today's ECB estimate of negotiated wage growth in Q2 tallied with yesterday's data on labour costs and vacancies to suggest that cost pressures from the jobs market, while still non-negligible, are starting gradually to dissipate. Euro area negotiated wage growth moderated 0.9ppt in Q2 from the prior quarter's series high to 3.6%Y/Y. While that was a six-quarter low, it was still some 1.4ppts above the 2019 average and above levels that, if sustained, would be considered consistent with a return of inflation to target over the medium term. The moderation was not unexpected. National data from Germany – where growth in Q1 had been flattered by one-off payments – and France had already signalled a slowing in growth of pay settlements in Q2, more than offsetting a pickup in Italy. Coupled with evidence of a pickup in labour slack, the slowdown in pay settlement growth suggests that labour cost growth should remain on a downtrend over the coming year or so in line with the ECB's projections, as real-wage catch-up dynamics fade amid well-anchored inflation expectations.

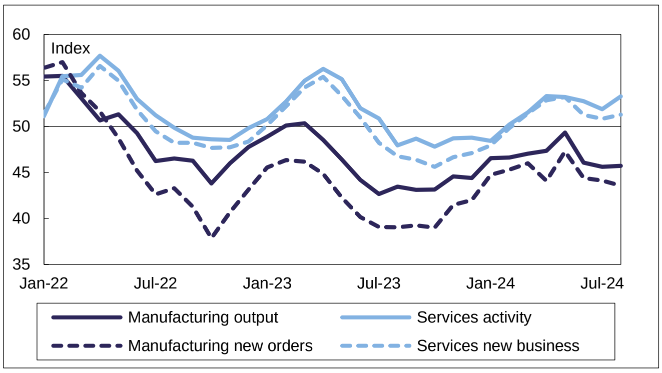
ECB account notes open mind to September rate decision, but data favour another rate cut

Today's published account of the ECB's July monetary policy meeting, when rates were left unchanged, suggested that Governing Council members agreed widely that the forthcoming meeting in September "should be approached with an open mind" with no presumption either way whether or not policy should be amended. In our view, the data released so far this week – including the underwhelming flash PMIs and moderating figures for labour costs, negotiated wages and job vacancies – appear fully compatible with a further rate cut next month. Admittedly, today's account flagged further forthcoming data, including on inflation in August and compensation per employee, profits and productivity in Q2, along with the ECB's updated macroeconomic projections, as important inputs to the next policy decision. However, not least given developments in energy prices, we expect inflation to take a step down in August. And yesterday's data on labour costs and wages suggest that growth in compensation per employee moderated while productivity picked up. So, we certainly maintain our expectation that rates will be cut by a further 25bps next month.

The day ahead in the euro area

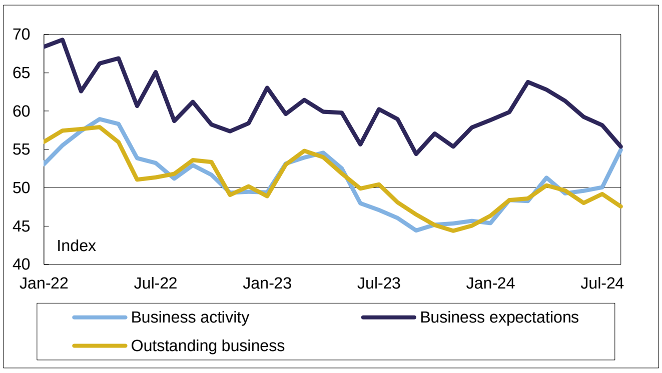
Friday will bring the INSEE French business survey results for August, which will provide an alternative – and probably more reliable signal – on the strength of economic activity to today's PMIs. Certainly, we expect the INSEE survey's signals on

Euro area: Selected services & manufacturing PMIs



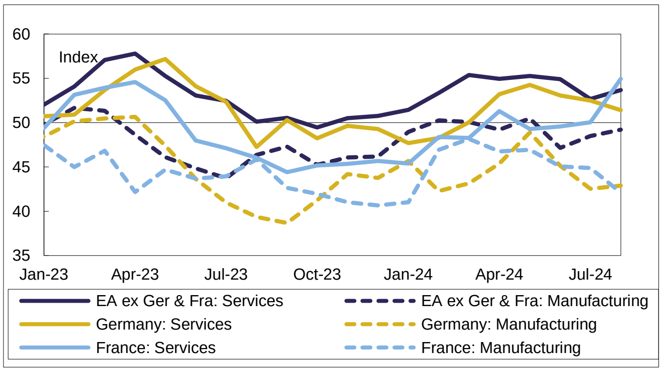
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

France: Services PMI components



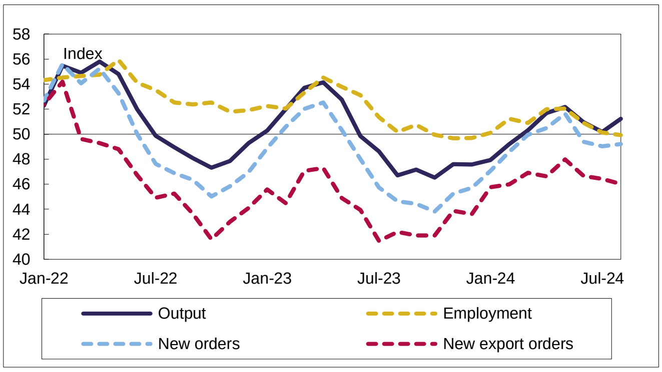
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Output PMIs by member state



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

Euro area: Selected composite PMIs



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

French services output to be significantly less buoyant than today's PMIs, while the lack of momentum in manufacturing will likely be underscored. Separately, the ECB's consumer survey results for July are likely to suggest that inflation expectations in the euro area remain well anchored and consistent with further monetary policy easing.

UK

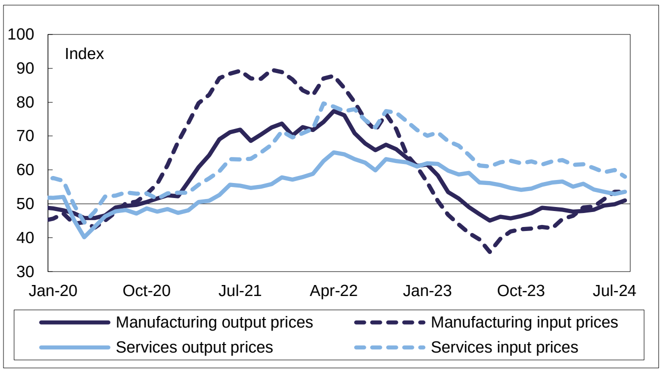
UK PMIs beat expectations as demand boosted by reduced borrowing costs & political uncertainty

While UK GDP posted another quarter of solid growth in Q2 (0.6%Q/Q), the monthly profile showed that output merely moved sideways in June. This was broadly consistent with the slowdown implied by the PMIs that month that saw the composite index declining to its softest in six months. Nevertheless, like in July, today's flash UK PMIs for August beat expectations, as lower borrowing costs and prospects of further interest rate cuts, as well as reduced political uncertainty reportedly gave a boost to demand. Indeed, the headline composite PMI rose 0.6pt to 53.4, a four-month high and the second-strongest reading since May 2023. The improvement in August was led by the services sector, for which the business activity index rose 0.8pt to a four-month high of 53.3. But while the manufacturing output component slipped back slightly this month, at 54.2 it was still the second-highest since April 2022 and consistent with ongoing solid expansion in the sector over the summer. Looking ahead, despite reports of lacklustre demand from overseas, new orders increased at a robust pace in the manufacturing and services sectors alike. Given the strength in economic activity in the first half of 2024, we expect to see some moderation in the pace of expansion through the second half of the year. Indeed, on the whole, the PMIs seemingly underestimated economic momentum in H124. So, while the composite PMI in the first two months of Q3 (53.1) was bang in line with the Q2 average, the level was broadly consistent with GDP growth of 0.3%Q/Q, matching our current expectation for this quarter and 0.1ppt below the BoE's recent projection.

Price PMIs point to below-average input costs and softest services inflation since spring 2021

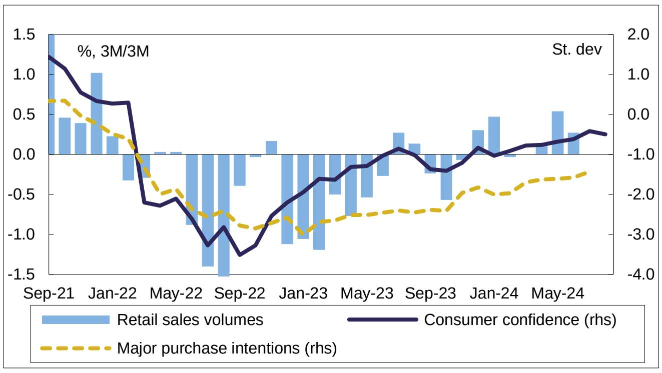
BoE policymakers might take some encouragement from the survey's inflation components, which suggested a further easing in price pressures this month. Indeed, despite reports of still elevated pay pressures in the services sector, the respective input price PMI declined to a 2½-year low (58.7) back below the long-run average. And while prices charged in the sector were still above average, the implied increase was nevertheless one of the softest since April 2021, suggesting that the very gradual disinflationary trend in services CPI inflation should be maintained over the summer. Meanwhile, having risen to an 18-month high in July amid higher transport costs associated with the persisting crisis in the Middle East, the manufacturing input price index fell 0.9pt to a three-month low. Moreover, the ability to pass on past increases in costs appeared to remain limited, as the implied increase in factory output prices was the softest for five months. That suggests

Euro area: Price PMIs



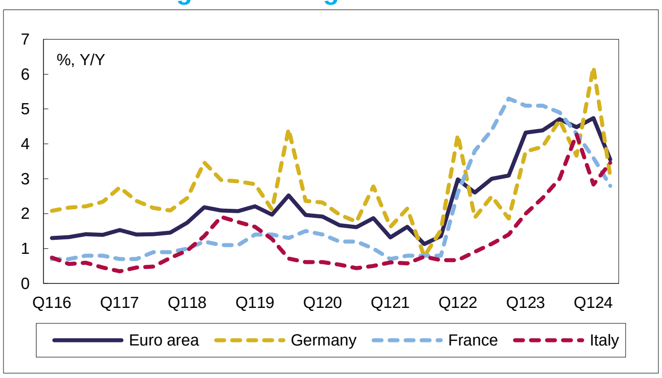
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales & consumer confidence



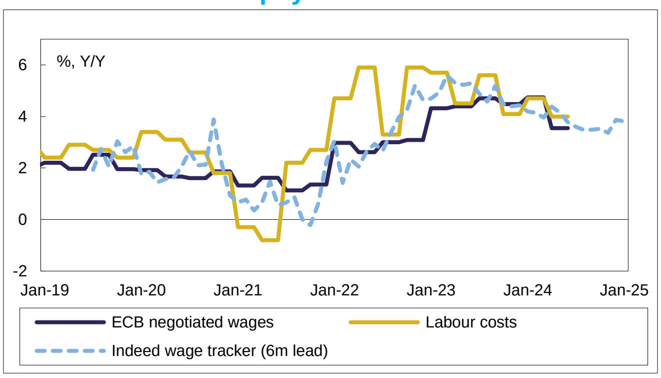
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Negotiated wages



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

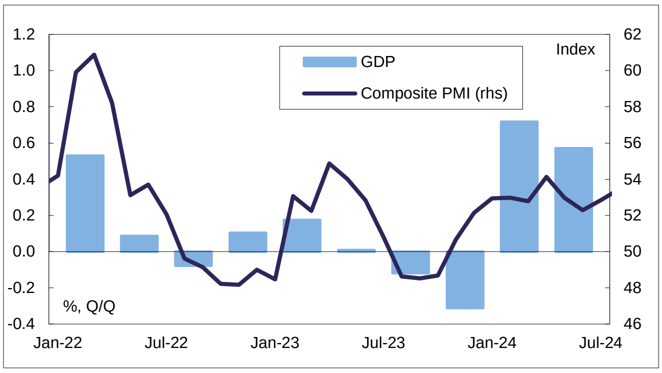
Euro area: Selected pay measures



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

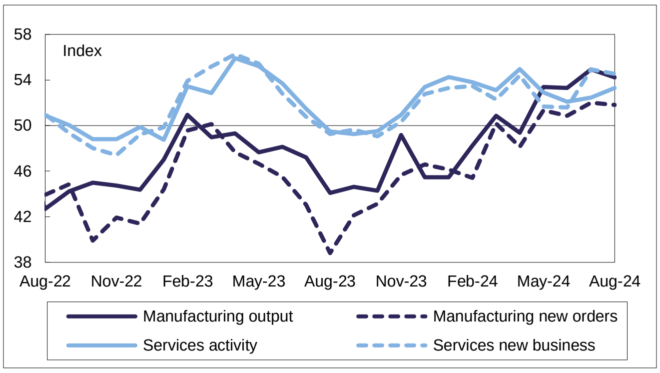
that core consumer goods inflation, which was just 0.1%Y/Y in July, will remain subdued over coming months despite a likely gradual pickup associated with base effects. Overall, today's survey supports our view that the MPC will maintain policy at its forthcoming meeting in September before cutting Bank Rate again in November by a further 25bps.

UK: GDP growth & composite output PMI



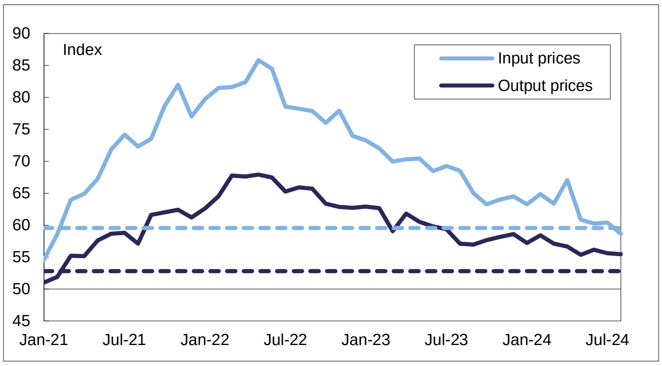
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Selected services & manufacturing PMIs



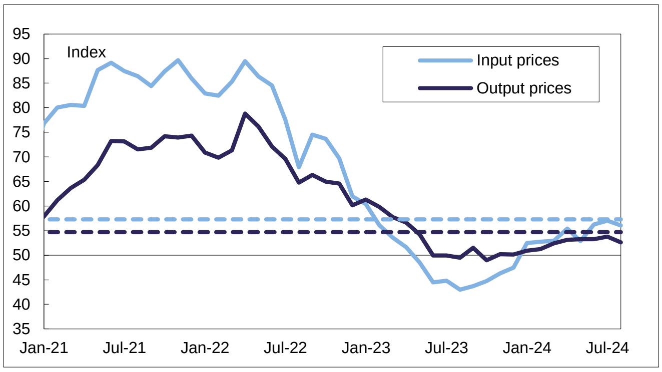
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services price PMIs*



**Dashed lines represent pre-pandemic average. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

UK: Manufacturing price PMIs*



**Dashed lines represent pre-pandemic average. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

The day ahead in the UK

Friday will bring the GfK consumer confidence survey results for August. The headline index rose for the fourth successive month in July to -13, the highest level since September 2021. And we expect to see further modest improvement in the current month.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Preliminary manufacturing (services) PMI	Aug	**45.6 (53.3)**	45.8 (51.7)	45.8 (51.9)	-
		Preliminary composite PMI	Aug	**51.2**	50.1	50.2	-
		Negotiated wages Y/Y%	Q2	**3.6**	-	4.7	-
		Preliminary Commission consumer confidence indicator	Aug	**-13.4**	-12.6	-13.0	-
Germany		Preliminary manufacturing (services) PMI	Aug	**42.1 (51.4)**	43.3 (52.3)	43.2 (52.5)	-
		Preliminary composite PMI	Aug	**48.5**	49.2	49.1	-
France		Preliminary manufacturing (services) PMI	Aug	**42.1 (55.0)**	44.5 (50.3)	44.0 (50.1)	-
		Preliminary composite PMI	Aug	**52.7**	49.2	49.1	-
		Retail sales Y/Y%	Jul	**-0.5**	-	-0.7	-0.6
UK		Preliminary manufacturing (services) PMI	Aug	**52.5 (53.3)**	52.2 (52.8)	52.1 (52.5)	-
		Preliminary composite PMI	Aug	**53.4**	53.0	52.8	-
		CBI industrial trends survey – total orders (selling price) balance	Jul	**-22 (15)**	-25 (5)	-32 (2)	-

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/ *Daiwa forecast*	Previous
Euro area		09.00	ECB consumer expectations survey – 1Y CPI (3Y CPI) Y/Y%	Jul	2.7 (2.3)	2.8 (2.3)
France		07.45	INSEE business (manufacturing) confidence indicator	Aug	96 (96)	93.9 (95.0)
UK		00.01	GfK consumer confidence indicator	Aug	-12	-13

Auctions and events

Country		BST	Event
UK		16.00	BoE Governor Bailey scheduled to speak at Jackson Hole Symposium

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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