

Euro wrap-up

Overview

- While German factory orders beat expectations, Bunds made modest gains as manufacturing turnover fell further and euro area retail sales growth remained subdued.
- Gilts also made modest gains as a BoE survey suggested that firms' expectations for their output prices and wage growth have moderated.
- Tomorrow will bring updated national accounts for Q2 from the euro area, as well as German industrial production figures for July.

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Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.290	-0.027
OBL 2½ 10/29	2.091	-0.016
DBR 2.6 08/34	2.207	-0.014
UKT 4% 01/27	3.988	-0.034
UKT 4% 07/29	3.803	-0.024
UKT 4% 07/34	3.912	-0.021

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

Source: Bloomberg

Euro area

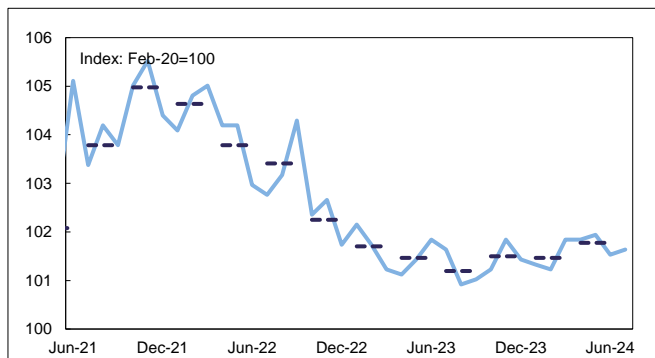
Euro area retail sales growth remains subdued

Despite the improvement in consumer confidence at the start of the summer, today's euro area retail sales figures suggested that demand for goods remained lacklustre at the start of Q3. In particular, retail sales rose just 0.1%M/M in July, only partially reversing the 0.4%M/M decline in June to leave them a touch below the level a year ago. The modest increase in July was led by spending on food (0.4%M/M) as consumers were able to get more for their money as prices fell back again. There was also a modest rise in core spending (non-food & fuel items) for the first month in three (0.1%M/M). In contrast, spending on auto fuel fell for a second-successive month and by 1.0%M/M, the most since February. Among the larger member states to have published data, the Netherlands, Belgium and Austria recorded growth above 1.0%M/M in July, with sales in Spain up for a fourth month out of five (0.5%M/M) and France also eking out a slight increase (0.1%M/M). So, the lack of growth appears to reflect weakness in Germany and/or Italy, although published data for both countries has remained absent from the Eurostat figures since April. With the recovery in consumer confidence having paused in August and the Commission survey having suggested that retail sales in the three months to August fell the most in two years, core spending on goods looks to have remained subdued over the summer as a whole. But the near-2%M/M decline in petrol prices should have supported fuel sales last month. And increased expenditure on services – boosted not least by the Paris Olympics – also probably supported economic growth.

German factory orders jump to highest level in seven months

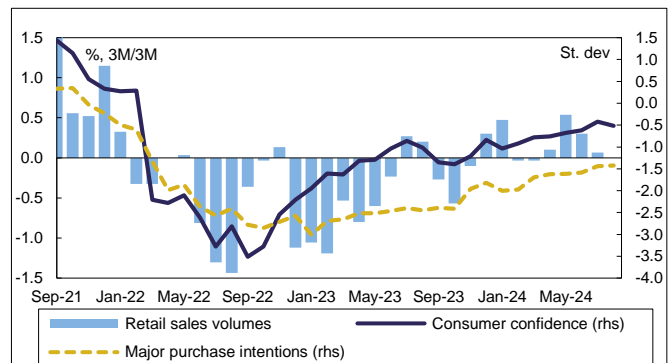
Germany's lacklustre economic performance over recent quarters in part relates to structural adjustments in the manufacturing sector, which has provided a drag on GDP growth in four out of the past five quarters. But a notable upside surprise in today's factory orders data raised some tentative hopes that manufacturing output might provide some modest support to overall activity over the near term. Contrary to the expected decline, real new factory orders rose 2.9%M/M in July, with the increase in June also upwardly revised to 4.6%M/M, the most in a year. This left orders up 1.6%3M/3M and 3.7%YY, to their highest level in seven months, albeit still some 18% below the peak in mid-2021 and almost 4% below the pre-pandemic level. The pickup was led by increased demand from overseas (5.1%M/M), while domestic orders remained unchanged having jumped sharply in the previous month. And, as is often the case, several large-scale orders – from the rail, aerospace and electrical machinery subsectors – provided a notable boost in July. Indeed, excluding bulk items, core orders fell 0.4%M/M that month. Nevertheless, smoothing for monthly volatility, core orders on a three-month basis were still up 1.0%3M/3M to a six-month high, suggesting that the underlying trend is finally starting to improve.

Euro area: Retail sales*



*Dashed dark blue line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales & consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Manufacturing turnover slumps in July to suggest weak production that month

This notwithstanding, today's figures for manufacturing turnover continued to disappoint. Indeed, turnover fell for a fifth successive month in July and by 2.3%M/M – the most since January 2023 – to the lowest level since August 2010 aside from the initial pandemic slump in Q220. The weakness was broad-based, but driven by a 4% fall in capital goods that month. So, while turnover data have been a less accurate guide over recent months, today's release flags a non-negligible risk of a contraction in overall production in July when the IP data are published tomorrow, particularly given the strong increase in June. Moreover, with survey measures such as the ifo indices and PMIs pointing to renewed deterioration in momentum in output in August as the order-inventory ratio fell back amid a significant weakening in overseas demand, we might well have to wait a little longer for a more sustained recovery in German manufacturing.

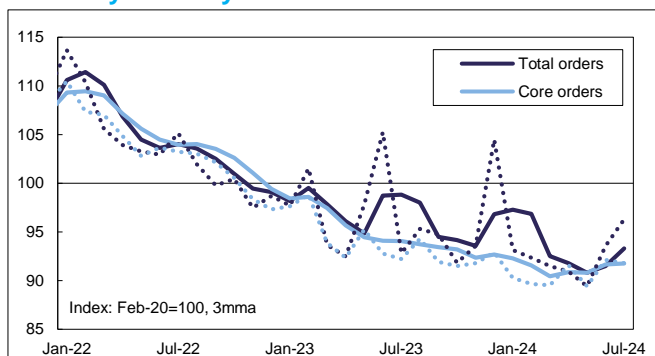
Construction PMIs point to ongoing challenges

Today's construction PMIs also suggested that ongoing challenges in the sector remained more prominent in Germany. In particular, the German construction output index fell to a three-month low in August (38.9), with the house-building component (30.0) dropping sharply to its lowest since April. Admittedly, conditions were not much better in France, where the activity PMI rose just 0.4pt to 40.1, with the housing component similarly signalling steep contraction (31.1). So, it was mainly due to an improvement in Italy – up 1.6pts to a three-month high of 46.6 – that the euro area activity PMI moved sideways at a still-meagre 41.4, the second-softest reading since the euro crisis aside from the initial pandemic collapse. Today's survey implied an ongoing downturn in the housing sector, with the respective activity index (34.6) the lowest since May 2020 and early-2010 before that. And despite the recent moderation in borrowing costs, a further decline in new orders and only minimal improvement in business expectations for the coming year suggest that the ECB's restrictive monetary policy stance will continue to weigh on construction over the near term.

The day ahead in the euro area

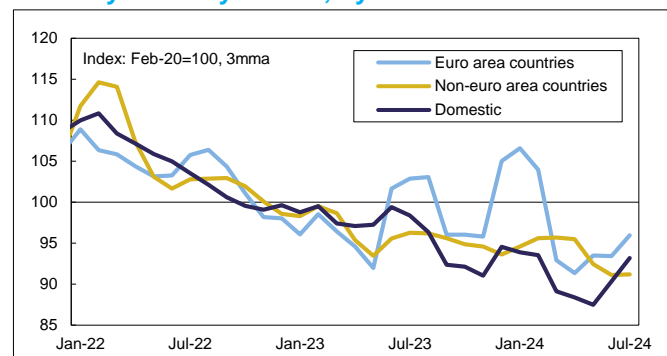
Friday will bring updated national accounts figures for Q2 from the euro area. The preliminary reading reported GDP growth of 0.3%Q/Q, supported by an ongoing solid expansion in Spain (0.8%Q/Q), modest growth in France and Italy, and a sharp rebound in Ireland (1.2%Q/Q). However, figures published by Ireland's Central Statistical Office today suggested that the economy actually contracted by 1.0%Q/Q, led by a substantial decline in fixed investment (-65.1%Q/Q) amid a significant export of intellectual property arising from global corporate restructuring in the multinational sector. So, having initially added 0.05ppt to euro area GDP, Ireland now appears to have subtracted 0.04ppt. And with French GDP having been revised

Germany: Factory orders*



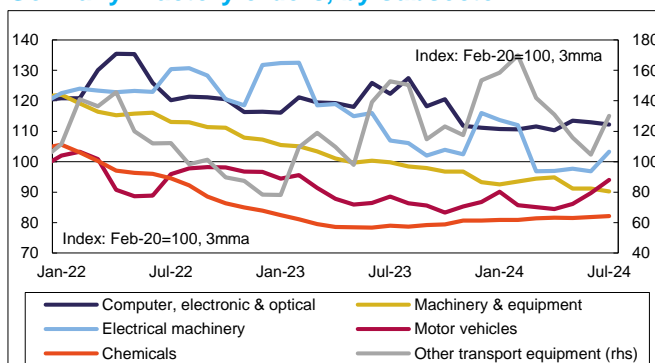
*Dotted lines represent unsmoothed data. Core orders excluding large-scale orders. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders, by destination



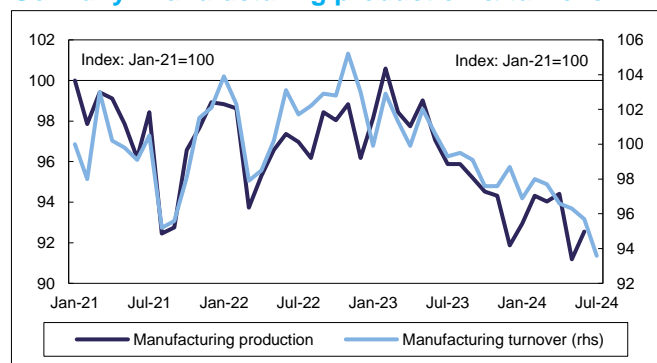
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders, by subsector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing production & turnover



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

0.1ppt lower to 0.2%Q/Q, we now expect aggregate euro area GDP to have risen 0.2%Q/Q in Q2, 0.2ppt below the ECB's projection. Tomorrow's release will bring the official expenditure breakdown for the first time. Given the sharp decline in Germany and Ireland, fixed investment likely contracted sharply last quarter, offset in part by positive government spending and a solid contribution from net services trade. This release will also bring an updated estimate of unit labour costs and insight into unit profits, with the latter expected to show that wage pressures were again largely absorbed by profit margins.

Looking ahead to developments at the start of Q3, tomorrow will bring the aforementioned German industrial production figures for July. Given the strength in IP at the end of Q2 and the weakness in turnover, we expect the drop in output to exceed the current Bloomberg survey expectation of 0.5%M/M. July figures for French and Spanish IP and German goods trade are also due.

UK

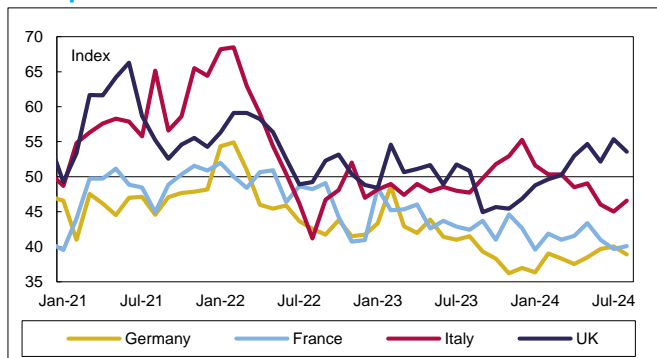
Firms' inflation expectations revised up but expected selling prices & wage growth nudged down

In gauging the risks of inflation persistence, the BoE has kept an eye on price and wage expectations, especially those of businesses. And the moderation in those expectations over recent quarters was one factor behind its judgement that the risks of inflation persistence have diminished, which contributed to the MPC's decision to cut Bank Rate last month. Judging from the BoE's Decision Maker Panel (DMP) survey, however, firms' inflation expectations have levelled off over recent months. Inflation expectations one year ahead were unchanged on a three-month average basis in August at 2.7%3M/Y with expectations three years ahead ticking up 0.1ppt, also to 2.7%3M/Y. Nevertheless, firms' own selling price expectations for the coming year continue to be revised down, falling to a near-three-year low of 3.6%3M/Y in August. 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 remained steady at 4.1%3M/Y, matching the lowest in more than two years, almost 2ppts below the end-2022 peak.

Construction PMI slips back slightly, but housing component the highest since September 2022

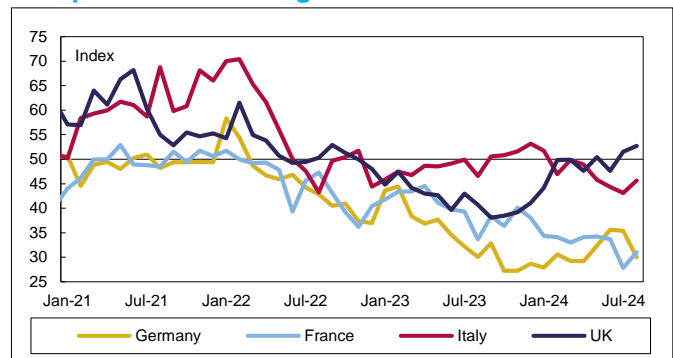
Like the equivalent services and manufacturing surveys, today's construction PMIs signalled ongoing expansion in the sector over the summer. Admittedly, after rising to a more than two-year high in July, the headline activity index slipped back in August, by 1.7pts to 53.6. But this was bang in line with the long-run trend and still left the index so far in Q3 trending some 1.2pts above the Q2 average. The moderation in August principally reflected a softer pace of expansion in civil engineering after a temporary spike in July. The index for commercial activity also slipped back, albeit implying the best performing subsector. Meanwhile, signs of improvements in the housing market amid a decline in borrowing costs, increase in mortgage

Europe: Construction PMIs



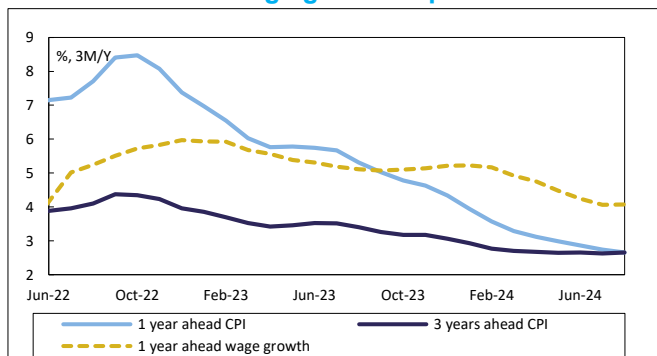
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Europe: House building PMIs



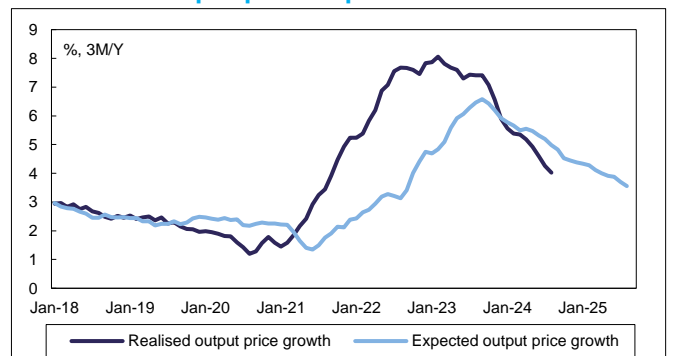
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Firms' CPI & wage growth expectations



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

UK: Firms' output price expectations



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

approvals and expectations of higher property prices, saw the house building component jump 1.3pts to 52.7, the highest since September 2022. And improving economic conditions supported a further increase in new orders, with the respective index (55.3) well above the average in the previous 18 months.











The day ahead in the UK

There are no top-tier UK data due on Friday.










European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Construction PMI	Aug	41.4	-	41.4	-
	 Retail sales M/M% (Y/Y%)	Jul	0.1 (-0.1)	0.2 (0.2)	-0.3 (-0.3)	-0.4 (-0.4)
Germany	 Factory orders M/M% (Y/Y%)	Jul	2.9 (3.7)	-1.7 (-1.9)	3.9 (-11.8)	4.6 (-11.2)
	 Construction PMI	Aug	38.9	-	40.0	-
France	 Construction PMI	Aug	40.1	-	39.7	-
Italy	 Construction PMI	Aug	46.6	-	45.0	-
Spain	 House price index Q/Q% (Y/Y%)	Q2	3.6 (7.8)	-	2.6 (6.3)	-
UK	 Construction PMI	Aug	53.6	54.5	55.3	-
	 DMP 3M output price (1Y CPI) expectations Y/Y%	Aug	3.6 (2.6)	3.5 (2.6)	3.7 (2.5)	-
	 New car registrations Y/Y%	Aug	-1.3	-	2.5	-








Auctions

Country	Auction
France	 sold €6.97bn of 3% 2034 bonds at an average yield of 2.95%
	 sold €1.4bn of 1.25% 2036 bonds at an average yield of 3.04%
	 sold €1.78bn of 0.5% 2040 bonds at an average yield of 3.23%
	 sold €1.85bn of 3.25% 2055 bonds at an average yield of 3.49%
Spain	 sold €1.3bn of 2.5% 2027 bonds at an average yield of 2.531%
	 sold €1.5bn of 3.5% 2029 bonds at an average yield of 2.58%
	 sold €535.1mn of 1% 2030 inflation-linked bonds at an average yield of 0.908%
	 sold €3.23bn of 3.45% 2034 bonds at an average yield of 3.04%
UK	 sold £4bn of 4.125% 2029 bonds at an average yield of 3.811%

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	GDP – final estimate Q/Q% (Y/Y%)	Q2	<u>0.2 (0.5)</u>	0.3 (0.5)
	10.00	Employment – 2 nd estimate Q/Q% (Y/Y%)	Q2	0.2 (0.8)	0.3 (1.0)
Germany 	07.00	Industrial production M/M% (Y/Y%)	Jul	<u>-1.0 (-3.9)</u>	1.4 (-4.1)
	08.30	Trade balance €bn	Jul	20.9	20.4
France 	08.30	Industrial production M/M% (Y/Y%)	Jul	-0.3 (-0.9)	0.8 (-1.6)
	08.00	Trade balance €bn	Jul	-	-6.1
Italy 	09.30	Retail sales M/M% (Y/Y%)	Jun	-	-0.2 (-1.0)

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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