

Euro wrap-up

Overview

- Bunds made minimal gains as the flash PMIs suggested that euro area economic conditions remained stable despite heightened geopolitical risks and price pressures remained muted.
- Gilts made larger gains as the flash UK services output price PMI fell back below the long-run average for the first time since early 2021.
- Tuesday will bring the results of the German ifo business survey for June, while focus in the UK will be on BoE speak.

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Daily bond market movements

Bond	Yield	Change
BKO 1.7 06/27	1.833	-0.007
OBL 2.4 04/30	2.108	-0.008
DBR 2½ 02/35	2.505	-0.010
UKT 3% 03/27	3.881	-0.032
UKT 4% 03/30	4.004	-0.036
UKT 4½ 03/35	4.490	-0.046

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

Euro area

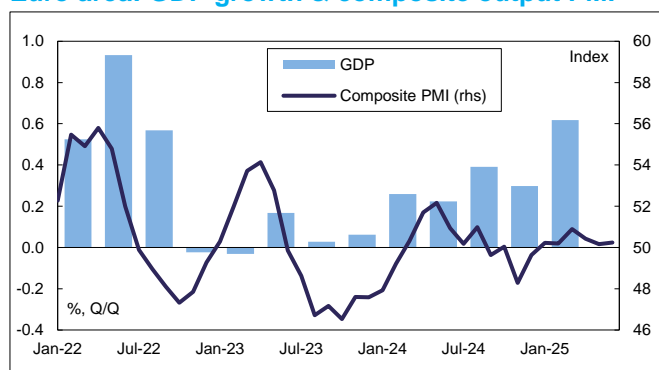
Flash PMIs point to broadly stable conditions at end-Q2 despite heightened geopolitical risks

While we caution that survey responses were submitted before the US launched strikes on nuclear sites across Iran, the flash June PMIs suggested that euro area economic conditions remained broadly stable despite rising geopolitical risks and persisting trade uncertainties ahead of the 9 July deadline to negotiate a deal with the US to avoid the reimposition of reciprocal tariffs. In particular, the headline euro area composite output PMI moved sideways this month at 50.2 to leave the quarterly average just 0.1pt below the Q1 level. It is worth noting that the PMIs offered a poor guide to growth over recent quarters. But while GDP growth will slow from the export-led jump in Q1 (0.6%Q/Q), today's survey did little to alter our view that the economy will likely expand modestly this quarter (0.1%Q/Q). Certainly, despite the significant front-running of production in certain subsectors in Q1 and although the manufacturing output index slowed in June (down ½pt to 51.0) it still implied a fourth consecutive month of growth in the sector, the longest run in three years. As such, this left the quarterly average more than 2pts higher in Q2. And supported by another improvement in export sales, the new orders index rose to the highest in more than three years. Admittedly, the broadly favourable conditions in the factory sector were diminished by continued sluggishness in services. Indeed, despite a modest pickup in June, the respective activity PMI (50.0) was trending some 1.1pts below the Q1 average to imply no growth in the sector this quarter. This notwithstanding, with new business having picked up slightly, firms in the sector were the least downbeat about the coming 12 months since February, raising hopes of a recovery in Q3.

German manufacturing strength and services recovery offsets renewed weakness in French PMIs

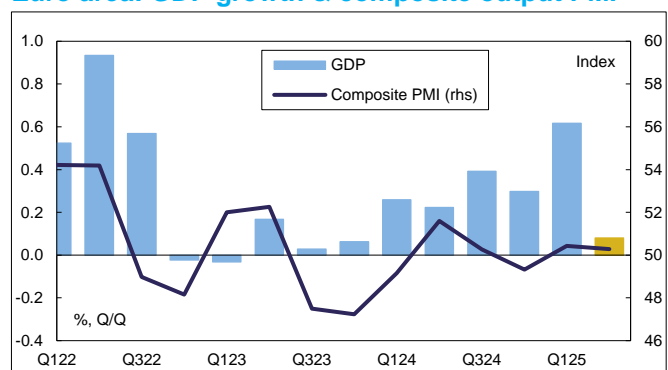
The country detail provided mixed messages. Likely reflecting the continued front-loading of production, the German manufacturing survey signalled the strongest output growth since March 2022. And new export orders similarly rose the most in more than three years, suggesting that positive production momentum might continue into Q3. Having declined to a 2½-year low in May, the German services activity PMI also rose a chunky 2.4pts to 49.4, with the new business component up to a 10-month high. As a result, the German composite PMI jumped 1.9pts to a three-month high of 50.4, albeit trending on average in Q2 (49.7) a full point below Q1. In contrast, the French composite PMI (48.5) edged lower in June thanks to a marked contraction in manufacturing output (down 3.8pts to 47.2). But while this was suggestive of declining GDP, the composite PMI was nevertheless trending more than 1½pts above the Q1 average. And although the respective index for the rest of the euro area (51.3) eased to the softest in seven months, it still implied ongoing expansion and was trending only slightly below the Q1 average, supporting our view that GDP growth in Spain will continue to outperform the largest two member states this quarter.

Euro area: GDP growth & composite output PMI



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

Euro area: GDP growth & composite output PMI*

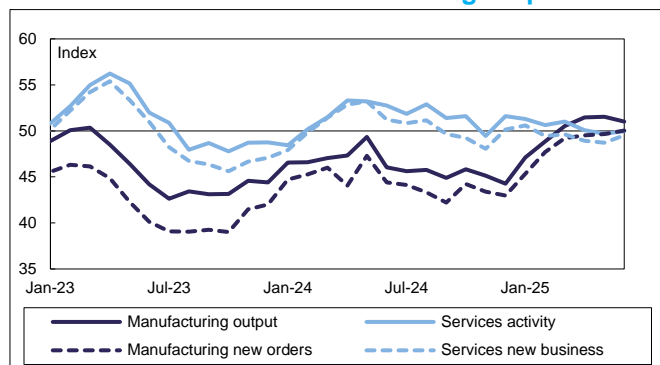


*Gold bar is Daiwa's Q225 GDP forecast. PMI show quarterly averages.
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Inflation pressures remain muted (for now)

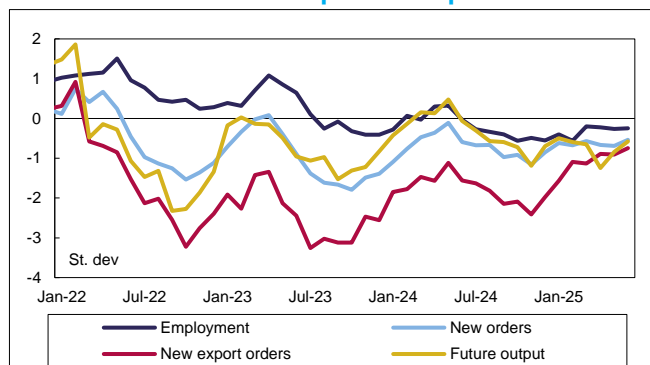
With respect to inflation, the flash PMIs were on the whole supportive of ongoing underlying disinflation in the euro area. Admittedly, the services input price index edged up to a three-month high in June. But this remained below the average of the past six months. And we suspect the ongoing subdued demand in the sector will limit firms' ability to pass on higher costs to customers. Certainty, today's survey showed output prices in the sector moderating further in June, with the implied rate of inflation the softest in more than four years. Meanwhile, both input costs and output prices in manufacturing held steady, with the former the joint-lowest in 15 months. As a result, the composite input cost PMI edged down to an eight-month low. But while the oil price barely reacted to the weekend's US airstrikes on Iran, crude oil prices are still some 12½% higher since 12 June, adding to cost burdens in a range of sectors over the near term. And if the conflict significantly disrupts oil and gas exports from the region, energy prices would likely rise notably higher.

Euro area: Services & manufacturing output PMIs



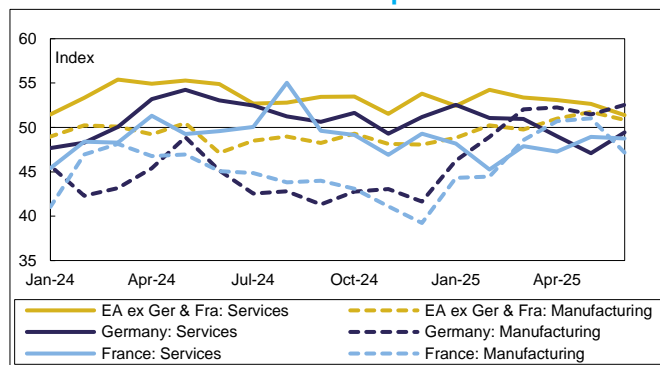
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected composite output PMIs



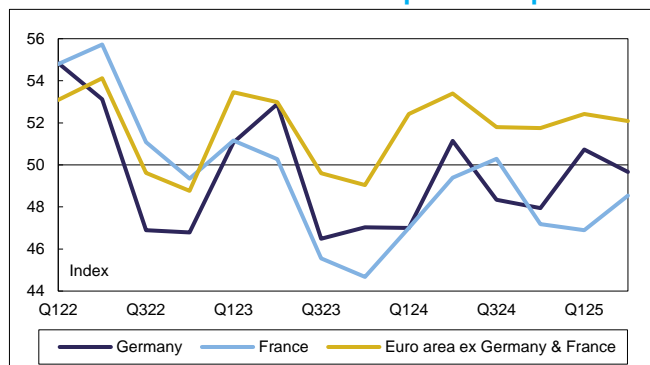
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Output PMIs



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

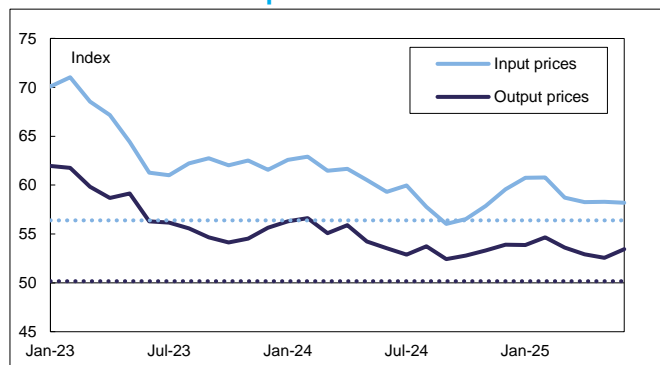
Euro area member states: Composite output PMIs*



*Quarterly averages.

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

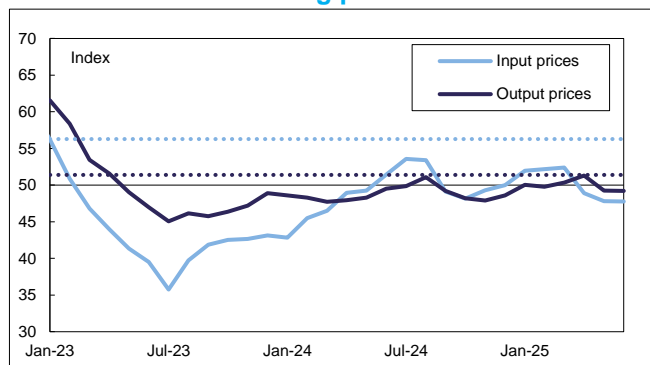
Euro area: Services price PMIs*



*Dotted lines represent long-run average.

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

Euro area: Manufacturing price PMIs*



*Dotted lines represent long-run average.

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

The day ahead in the euro area

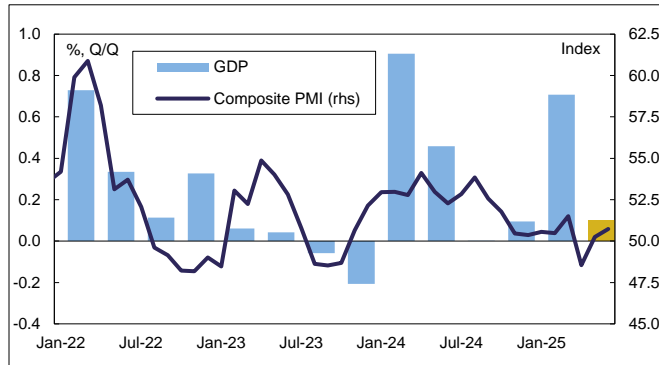
Much like today's flash PMIs, Tuesday's ifo survey is expected to report a modest improvement in Germany's overall business climate. Of course, the results will not reflect this weekend's escalation of events in the Middle East. But while current conditions might be judged to be slightly better in June, an expected uptick should owe principally to growing optimism about the economic outlook, with expectations likely to be receive a boost from the government's tax reform proposals. The new German government's draft 2025 budget is also due to be adopted in cabinet tomorrow, ahead of discussion in parliament early next month. Comments from ECB Chief Economist Lane, who is due to give a keynote speech and feature on a panel discussion at a conference in London, should also be of interest.

UK

Flash PMIs continue to stabilise after April's slump, but signal slowdown in GDP growth in Q2

Contrasting the sideways move in the euro area, today's flash UK PMIs showed modest improvement at the end of Q2. Indeed, when excluding the jump in March (51.5), the composite output PMI rose – up 0.4pt to 50.7 – to the highest since October's budget announcements. Admittedly, this left the index still well below the long-run average (53.5) suggestive of subdued underlying output growth, and the quarterly average (49.8) some 1pt below the Q1 level, arguably suggestive of modest contraction. But the PMIs have been a poor guide to headline GDP growth over recent quarters. And while a slowdown in economic activity in Q2 is expected after the front-running of tariffs in Q1, we still forecast GDP growth to be marginally positive this quarter. Perhaps boosted by the return of the warm weather, June's uptick was principally services-led, with the activity index (51.3) 0.4pt stronger than in May and a three-month high. The new business component (50.6) was also its firmest since November. While the manufacturing output PMI (47.1) signalled ongoing contraction, it suggested the softest fall since February. And positive signs were also evident in a further notable increase in the new orders component (up 3.9pts to a nine-month high of 48.7). However, despite the recent trading arrangements with the EU and US, new export orders remained firmly in contractionary territory (45.2) despite being more than 7pts above April's low. And today's survey flagged ongoing pessimism about the year ahead, with the composite future output expectations – again discounting April's weakness – the most downbeat since December 2022. Against this backdrop, the composite employment PMI remained consistent with ongoing job shedding (46.9).

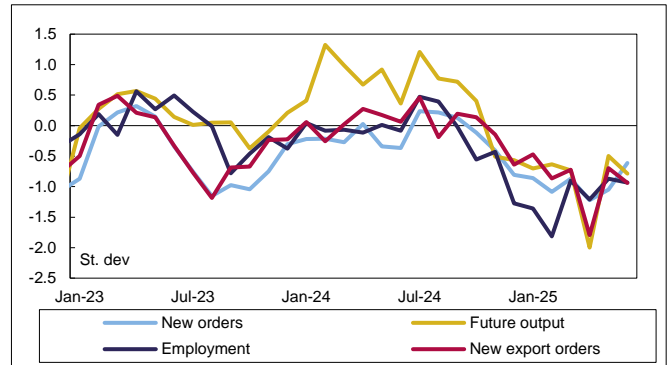
UK: GDP growth & composite output PMI*



*Gold bar is Daiwa's Q225 GDP forecast.

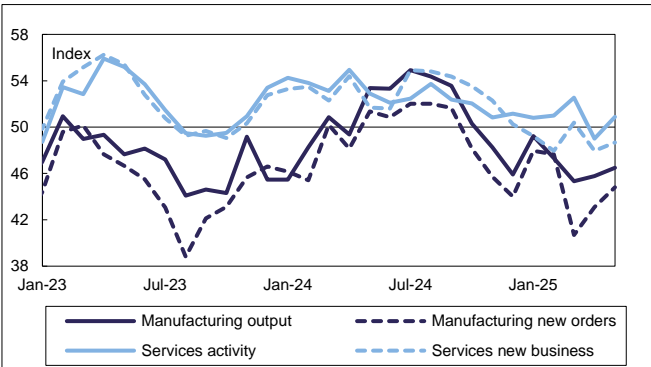
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Standardised composite PMIs



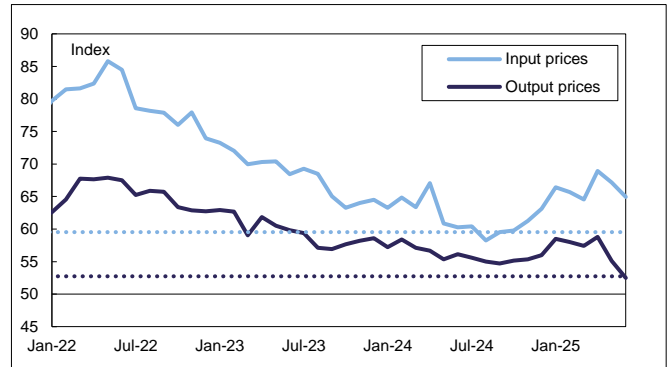
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services & manufacturing output PMIs



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

UK: Services price PMIs*



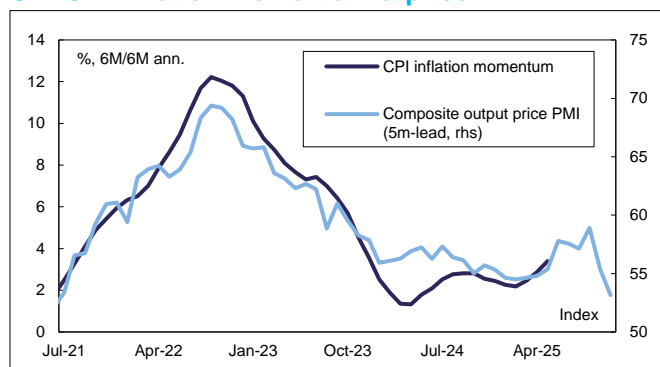
*Dotted lines show long-run average.

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

Output price PMI back to long-run average for first time since January 2021

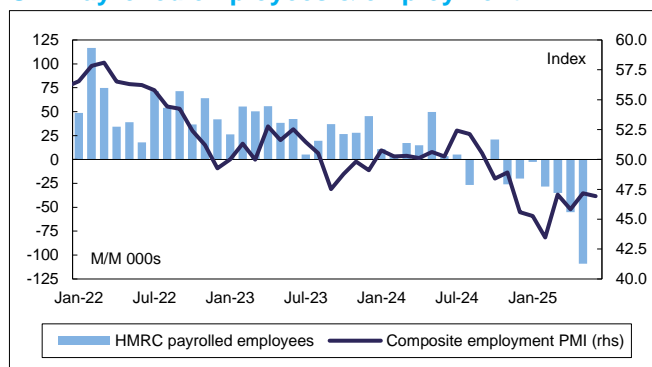
Notwithstanding recent developments in wholesale oil and gas markets and the associated upside risks to energy prices, BoE officials will be encouraged that the flash PMIs continued to imply that risks of inflationary persistence were subsiding. Having risen over the course of Q1 and peaked in April (58.9), the composite output price PMI dropped for a second consecutive month, by 2.2pts – the most in 13 months – to just 53.2, back below its long-term average for the first time since January 2021. And the all-important services output price PMI was similarly back below the long-run average. Meanwhile, the composite input price PMI fell similarly to a six-month low. But at 63.7, it remained elevated, more than 4pts above its long-term average, potentially hinting towards a lack of pricing power by firms given the weak demand outlook. Certainly, contrasting the modest improvement in the GfK consumer survey, today's S&P Global's consumer sentiment index survey noted weaker spending against the backdrop of heightened job insecurity and softer income expectations. Cash availability was also the weakest for 15 months amid elevated precautionary savings. While MPC members will be mindful of the escalation of the conflict in the Middle East, on balance, today's surveys remained consistent with fading inflationary persistence and subdued underlying demand, and therefore consistent with our view that the BoE will cut rates again in August.

UK: CPI inflation momentum & price PMI



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

UK: Payrolled employees & employment PMI



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









The day ahead in the UK

With regards to economic data, Tuesday's CBI industrial trends survey will provide a cross-check to the marginal upturn reported by June's flash manufacturing PMI. But tomorrow's Bank speakers will likely take precedent. Comments by Governor Bailey before the House of Lords Economic Affairs Committee will be of particular interest. So too will those of Deputy Governor Ramsden, who is scheduled to give a keynote speech and feature in a panel discussion alongside ECB Chief Economist Lane, following his dissenting vote for a 25bps cut at last week's [monetary policy meeting](#). Meanwhile, ahead of the BoE's review of its Asset Purchase Facility (APF) in September, external MPC member Greene is expected to deliver a speech on the 'monetary policy implications of differences in central bank balance sheet management' at NIESR

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro Area	 Preliminary services (manufacturing) PMI	Jun	50.0 (49.4)	<u>50.5 (50.5)</u>	49.7 (49.4)	-
	 Preliminary composite PMI	Jun	50.2	<u>50.5</u>	50.2	-
Germany	 Preliminary services (manufacturing) PMI	Jun	49.4 (49.0)	47.8 (49.0)	47.1 (48.3)	-
	 Preliminary composite PMI	Jun	50.4	49.1	48.5	-
France	 Preliminary services (manufacturing) PMI	Jun	48.7 (47.8)	49.0 (49.8)	48.9 (49.8)	-
	 Preliminary composite PMI	Jun	48.5	49.3	49.3	-
UK	 Preliminary services (manufacturing) PMI	Jun	51.3 (47.7)	51.3 (46.8)	50.9 (46.4)	-
	 Preliminary composite PMI	Jun	50.7	50.5	50.3	-




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
Germany	 09.00	ifo business climate indicator	Jun	88.0	87.5
	 09.00	ifo current assessment (expectations) indicator	Jun	86.5 (89.9)	86.1 (88.9)
UK	 11.00	CBI industrial trends survey – total orders (selling prices) balance %	Jun	-27 (25)	-30 (26)

Auctions and events

Euro Area	 14.55	ECB Chief Economist Lane to give speech at Barclays/CEPR conference followed by panel discussion, London			
Germany	 10.30	Auction: to sell up to €4bn of 1.7% 2027 bonds			
UK	 10.00	Auction: to sell £1.7bn of 1.125% 2035 inflation-linked bonds			
	 10.30	MPC external member Greene gives lecture on monetary policy & central bank balance sheets at NIESR, London			
	 14.35	BoE Deputy Governor Ramsden to give speech at Barclays/CEPR conference followed by panel discussion, London			
	 15.00	BoE Governor Bailey gives evidence to the House of Lords Economic Affairs Committee			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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