Euro wrap-up

Overview

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- After the ECB predictably left the deposit rate unchanged at 2.00%, Bunds made losses as President Lagarde emphasised that the Governing Council was in 'wait-and-see' mode.
- Gilts made modest gains as the UK flash PMIs flagged a slowdown in economic activity and further declines in headcount in July.
- Friday will bring July's German ifo business survey, French, Italian and UK consumer confidence, and June retail sales figures from the UK.

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.927	+0.091
OBL 2.2 10/30	2.278	+0.087
DBR 2.6 08/35	2.699	+0.063
UKT 3¾ 03/27	3.855	-0.015
UKT 4⅜ 03/30	4.029	-0.011
UKT 4½ 03/35	4.620	-0.012

*Change from close as at 5:00pm BST.
Source: Bloomberg

Euro area

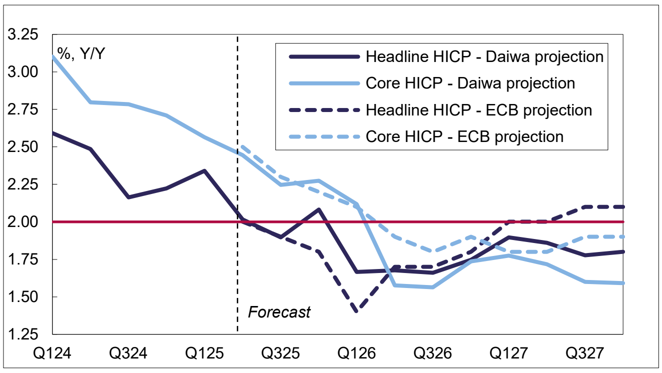
ECB predictably leaves interest rates unchanged

Having steadily cut interest rates by a cumulative 200bps in the 12-months through June, and signalled strongly at that meeting at a likely pause this month, the ECB predictably left its deposit rate unchanged, at 2.00%, for the first Governing Council meeting in seven. With inflation back at target, recent activity more resilient than anticipated, and incoming information broadly consistent with the ECB's inflation outlook, President Lagarde noted that the decision to hold policy was unanimous. But, given what it judged to be exceptional uncertainty, the Governing Council's forward guidance offered few clues on the path of policy ahead, maintaining the commitment to 'follow a data-dependent and meeting-by-meeting approach' to setting policy. While Lagarde seemingly left all options on the table, she repeated that policy was in a 'good position' to navigate current and incoming uncertainties.

Governing Council firmly in 'wait and see' mode

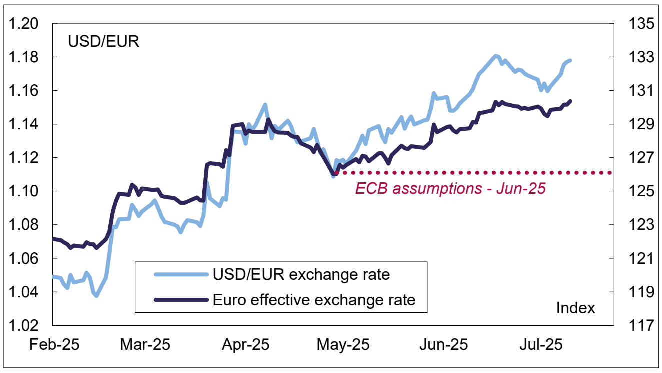
Admittedly, Lagarde acknowledged that the 'risks to the growth outlook remain tilted to the downside', related not least to ever-present global trade uncertainties, geopolitical tensions and deterioration in financial market sentiment. But she also flagged the likely boost to activity from higher public spending on defence and infrastructure investment. And with the net effects of global trade disruption on inflation uncertain, and the EU-US trade deal yet to be finalised, the Governing Council also judged the outlook for inflation to be more uncertain than normal, underpinning its 'wait and see' stance. Lagarde seemingly downplayed concerns about a near-term inflation undershoot from the recent euro strengthening, noting that the ECB's macroeconomic projections, published in June, had inflation falling below 2% in 2026 before returning to target within the forecast horizon. Indeed, Lagarde emphasised the importance of inflation expectations, which remained well anchored around 2% for both the near- and medium-term outlook. Of course, the ECB's June projections were based on one further rate cut. And our current forecast assumes that headline and core inflation will also undershoot the 2% target in 2027, arguably justifying another rate cut this cycle. While Lagarde repeatedly stated that policy was not on a pre-determined path, reports subsequently suggested that policymakers seeking another cut would face an uphill battle, echoing recent commentary by influential Executive Board member Schnabel that the bar for another cut was high. Of course, there will be plenty of data and economic news – not least the current 1 August deadline to negotiate a US trade deal – to digest before the next policy-setting meeting on 11 September. The ECB's updated macroeconomic projections to be presented at that meeting will also play a crucial role in the decision process. However, in the absence of a risk of a meaningful deviation from the 2% target over the forecast horizon, we could well see the majority prefer to wait a little longer to assess when and whether a final rate cut this cycle is appropriate.

Euro area: Inflation projections



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

Euro area: Euro exchange rate



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

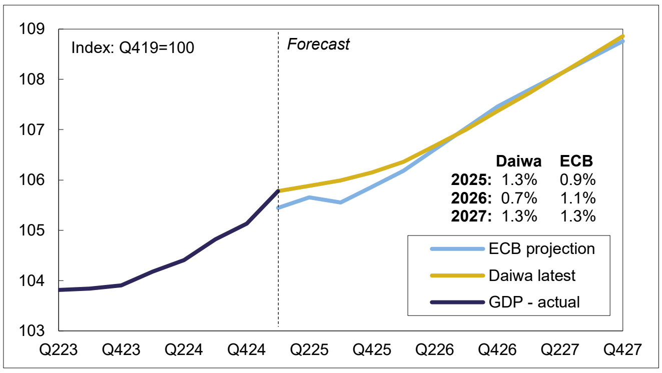
Flash PMIs point to ongoing moderate recovery at the start of Q3

According to today's flash July PMIs, the euro area's economy continued to present signs of moderate recovery at the start of Q3, supporting the Governing Council's decision today to keep policy steady. In particular, the headline euro area composite output PMI rose 0.4pt to 51.0, an 11-month high, a little more than ½pt above the average in the first half of the year and consistent with ongoing moderately positive GDP growth. Policymakers will be encouraged by signs of more favourable conditions in the services sector, where the respective activity index rose 0.7pt to 51.2, a six-month high. And while still muted by historical standards, there were signs of stabilisation in new business in the sector for the first time in 14 months. Given persisting trade uncertainties, the manufacturing sector also signalled ongoing resilience, with the output component edging down only slightly to 50.7, to imply continued production growth. Admittedly, the PMIs suggested that the slowdown in that sector was more marked in Germany (down 1.3pts to 50.6) and still in decline in France (48.6). And while services provided some offset, the respective composite PMI for the largest member state (50.3) was broadly consistent with ongoing stagnation at the start of Q3. Despite rising to an 11-month high, the French composite PMI (49.6) was consistent with modest contraction, echoing the message from the latest INSEE business survey – which typically provides a better guide to French GDP growth – which saw the headline sentiment index move sideways at 96, some 4% below the long-run average. As such, the improvement in July was principally driven by elsewhere in the euro area, with the respective composite PMI (52.7) the strongest since February, supporting our view that GDP growth in Spain – that has less exposure to US tariffs – will continue to outperform the largest two member states this quarter.

Euro area consumers more upbeat at the start of Q3, despite deterioration in Germany

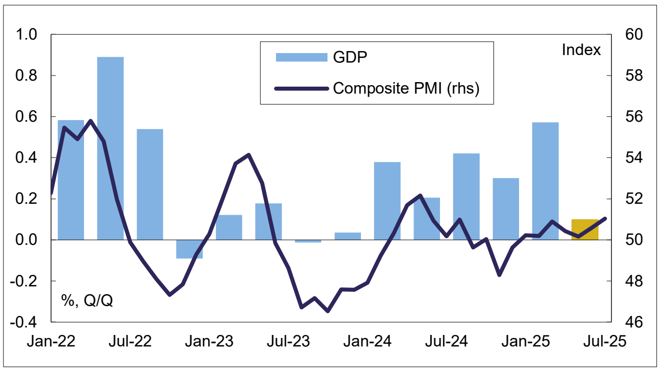
According to the preliminary Commission consumer confidence indicator published yesterday, aggregate euro area household sentiment also improved at the start of Q3, echoing the implied improvement in demand in the PMIs. Indeed, while remaining below the long-run average, the headline index rose 0.6pt to -14.7 in July, a four-month high. Among the member states to publish figures, there was a recovery in sentiment in the Netherlands amid reduced pessimism about economic conditions and purchase intentions. But this masked a deterioration in confidence in Germany, where the GfK's headline index – presented as a forecast for August – unexpectedly declined 1.2pts to -21.5, a four-month low. Despite a further rise in income expectations, a clouding in the economic outlook – perhaps relating to trade- and geopolitical-related uncertainties and rising job insecurities – fuelled a persisting preference to save, with the respective survey index rising to a 17-month high. As such, purchase intentions dropped to the lowest since February, suggesting that household expenditure might provide less support to GDP growth this quarter than in the first half of the year.

Euro area: GDP levels projections



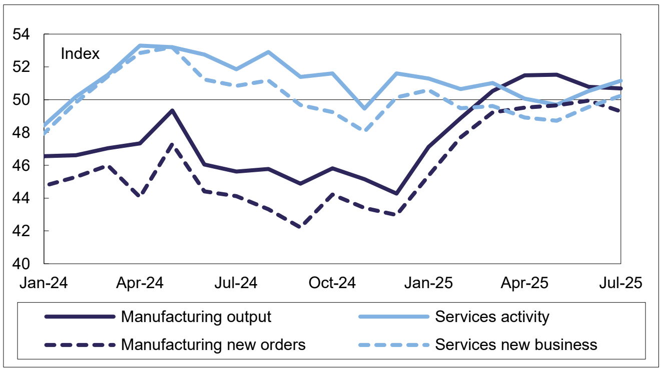
*Source: **ECB,** Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: GDP growth & composite output PMI*



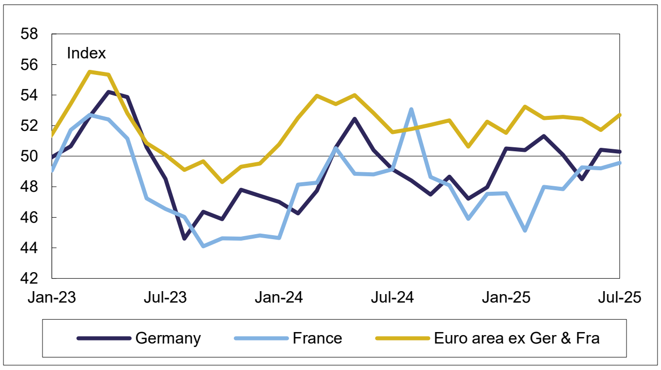
**Gold bar shows Daiwa's forecast for Q225.*
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing & services PMIs



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.

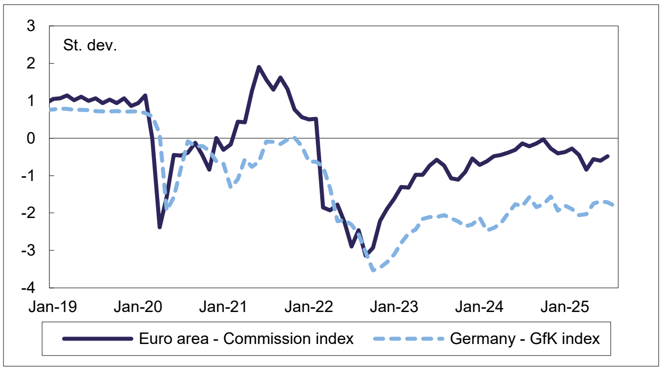
PMIs point to an ongoing absence of jobs growth and moderating price pressures

Given significant economic uncertainties, surveys unsurprisingly suggest that many firms currently have no intention to recruit. In this respect, today's composite employment PMI maintained the sideways trend of the past five months at a broadly neutral 50.3. Admittedly, the German employment PMI implied an ongoing cut to headcount at the start of Q3, with the first sub-50 reading in the services sector in seven months, tallying the steady downtrend in job vacancies. And overall, an absence of labour demand should continue to constrain pay negotiations, supporting the gradual downtrend in wage growth back to rates consistent with sustaining inflation at target over the medium term. The flash price PMIs were also supportive of ongoing underlying disinflation in the euro area. Indeed, the composite input price PMI fell for a fifth consecutive month to 54.9, a nine-month low and some 2½pts below the long-run average, with services costs also moderating back close to the long-run average. So, while the composite output price PMI (52.1) was above May's low, it fell back in July and remained ½pt below the average over the past six months.

The day ahead in the euro area

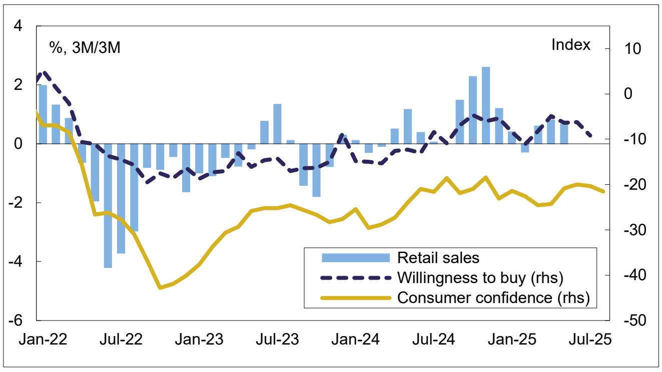
After the somewhat disappointing flash July PMI print from Germany, Friday's ifo survey will bring additional insight into economic conditions at the start of Q3. Like the PMIs, the ifo signalled improving economic outlook at the end of Q2, as reflected by a 13-month high in the headline business climate index (88.4). While that improvement was accompanied by a modest uptick in current economic assessments (86.2), it owed principally to the continued growth in optimism about expectations for the German economy (90.7), likely related to anticipation of higher spending on defence and public infrastructure investment. Notwithstanding the prospects of higher baseline US trade levies, we think those fiscal pledges likely continued to offer subtle support to the ifo indices this month. Meanwhile, the equivalent ISTAT business survey will also provide an update on Italian sentiment in July. And with respect to consumer confidence, we might also expect some upside to the French and Italian readings in July, not least to explain the uptick in the Commission's preliminary euro area indicator (up 0.6pts to -14.7). June's euro area bank lending data will also be of particular interest, with this week's ECB Bank Lending Survey indicating that lenders expect the recent recovery in business lending to extend beyond Q2.

Euro area & Germany: Consumer confidence



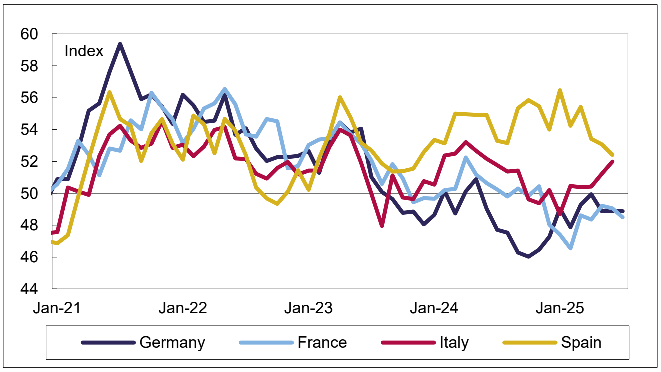
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumer confidence indices



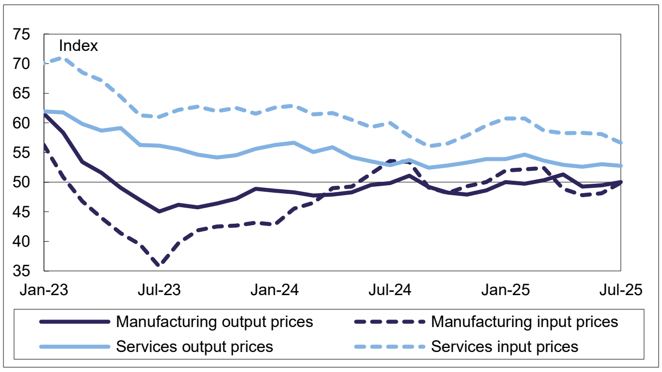
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Employment PMIs



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

Euro area: Price PMIs



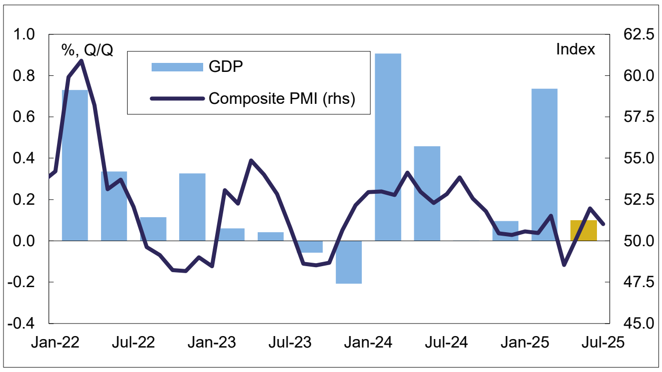
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK

UK PMIs more downbeat about activity and employment at the start of Q3 amid weaker demand

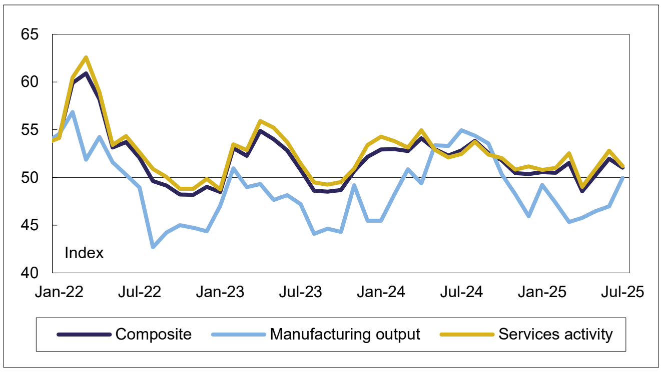
Having rebounded to a nine-month high in June, the flash UK PMIs surprised to the downside at the start of Q3. Though still consistent with a marginal expansion in economic activity, the composite output PMI was notably weaker than expected, declining 1.0pt from June to 51.0, some 2.5pts below the long-run average. But while it still remained ½pt above the average of the past six months, renewed contraction in new orders – down 2.7pts to 48.1, to fully-reverse June's increase – also flagged fragile underlying demand amid ongoing geopolitical uncertainty. With regards to the respective sectoral PMIs, the drop in the composite output PMI was chiefly driven by a slowdown in the dominant services sector (down 1.6pts to 51.2), with new business also falling back sharply (down 3.2pts to 48.0). More encouragingly, manufacturing conditions appeared to stabilise at the start of Q3, with the output component rising to a nine-month high in July (up 3.0pts to 50.0) as order backlogs rose to the highest for ten months. Likely reflecting the UK-US trade deal, the CBI's industrial trends survey also suggested that manufacturers were their least downbeat in three quarters (albeit with only 8% of firms more optimistic about their export prospects compared with 34% that assess them to be less favourable). Still, today's survey signalled ongoing intentions to reduce headcount in the sector. And overall, the MPC will undoubtedly note a further deterioration in the

UK: GDP growth & composite PMI*



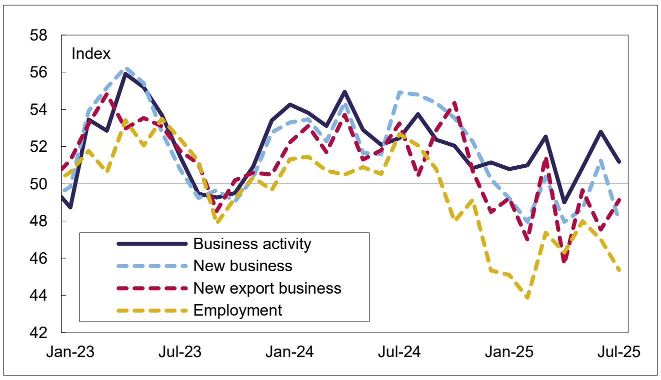
**Gold bar shows Daiwa forecast for Q225.*
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output PMIs



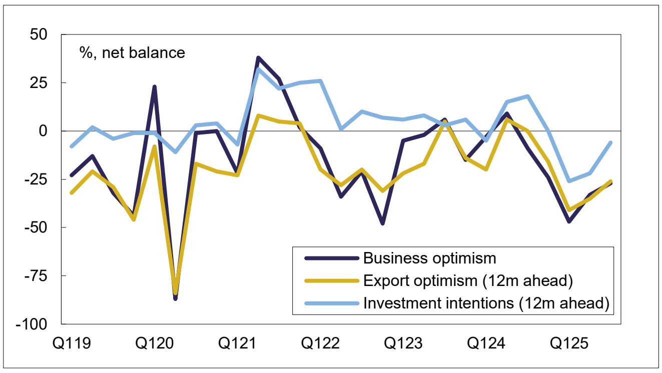
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services PMI



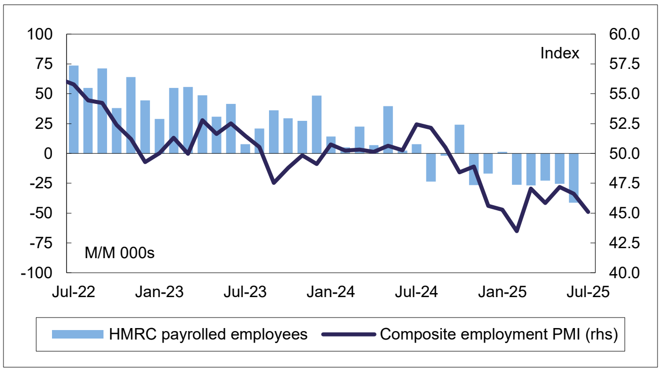
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: CBI industrial trends – optimism net balances



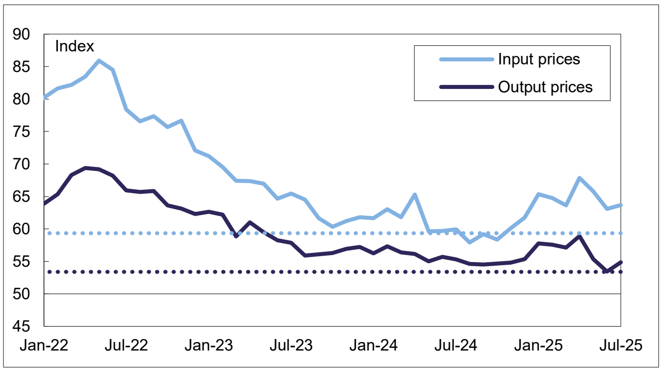
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employees & employment PMI



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

UK: Composite price PMIs*



**Dotted lines show long-run averages.*
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

composite employment PMI, which at 45.1 implied a tenth consecutive cut in headcount and at the second-fastest rate since 2020, suggesting a further loosening in the labour market, This should help the MPC to look through the temporary increase in inflation, supporting the case for a further rate cut in August. Indeed, while today's PMIs showed the composite output price index rising back above its long-term average in July (up 1.5pts to 54.9), it nonetheless remained 4pts below April's peak, and second lowest since November 2024.

The day ahead in the UK

Friday's UK dataflow will feature June's retail sales figures and an update on consumer confidence in July. With respect to the former, following the contraction in May's retail sales volumes – that surprisingly sharp drop (-2.7%M/M) being the largest since December 2023 – it seems probable that June's release would be due some payback at the end of Q2. Indeed, we expect the improvement in consumer confidence and warmer weather to have provided a boost to consumer spending last month, consistent with the evidence from the BRC retail monitor that month. So, despite May's pronounced weakness amid heightened economic uncertainty around the start of the quarter, we expect retail sales in Q2 to have been broadly flat, with a rebound in June in line with Bloomberg's market consensus forecast (1.2%M/M) consistent with an increase of 0.1%3M/3M.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	ECB Deposit (Refinancing) Rate %	Jul	**2.00 (2.15)**	*2.00 (2.15)*	2.00 (2.15)	-
	Preliminary services (manufacturing) PMI	Jul	**51.2 (49.8)**	50.6 (49.8)	50.5 (49.5)	-
	Preliminary composite PMI	Jul	**51.0**	50.7	50.6	-
	New car registrations Y/Y%	Jun	**-7.5**	-	1.5	-
Germany	Preliminary services (manufacturing) PMI	Jul	**50.1 (49.2)**	50.0 (49.5)	49.7 (49.0)	-
	Preliminary composite PMI	Jul	**50.3**	50.7	50.4	-
	GfK consumer confidence indicator	Aug	**-21.5**	-19.3	-20.3	-
France	Preliminary services (manufacturing) PMI	Jul	**49.7 (48.4)**	49.6 (48.6)	49.6 (48.1)	-
	Preliminary composite PMI	Jul	**49.6**	49.4	49.2	-
	INSEE business (manufacturing) confidence indicator	Jul	**96 (96)**	96 (97)	96 (96)	- (97)
Spain	PPI Y/Y%	Jun	**0.8**	-	0.0	-0.1
	Unemployment rate %	Q2	**10.3**	10.6	11.4	-
UK	Preliminary services (manufacturing) PMI	Jul	**51.2 (48.2)**	52.9 (48.0)	52.8 (47.7)	-
	Preliminary composite PMI	Jul	**51.0**	51.8	52.0	-
	CBI industrial trends survey – total orders (selling prices) balance %	Jul	**-30 (21)**	-28 (20)	-33 (19)	-
	CBI industrial trends survey – business optimism %	Jul	**-27**	-25	-33	-

Auctions

Country	Auction
Italy	sold €2.75bn of 2.1% 2027 bonds at an average yield of 2.11%
	sold €1.5bn of 1.1% 2031 inflation-linked bonds at an average yield of 1.13%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro Area	Preliminary Commission consumer confidence indicator	Jul	**-14.7**	15.0	15.3	-

Auctions

Country	Auction
Germany	sold €3.832bn of 2.6% 2035 bonds at an average yield of 2.62%
UK	sold £3bn of 4.375% 2040 bonds at an average yield of 5.066%

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	M3 money supply Y/Y%	Jun	3.7	3.9
Germany		09.00	ifo business climate indicator	Jul	89.0	88.4
		09.00	ifo current assessment (expectations) indicator	Jul	86.7 (91.1)	86.2 (90.7)
France		07.45	INSEE consumer confidence indicator	Jul	88	88
Italy		09.00	ISTAT consumer confidence indicator	Jul	95.9	96.1
		09.00	ISTAT business (manufacturing) confidence indicator	Jul	- (87.5)	93.9 (87.3)
UK		00.01	GfK consumer confidence indicator	Jul	-20	-18
		07.00	Retail sales – incl. auto fuel M/M% (Y/Y%)	Jun	1.2 (1.8)	-2.7 (-1.3)
		07.00	Retail sales – excl. auto fuel M/M% (Y/Y%)	Jun	1.2 (1.9)	-2.8 (-1.3)
Auctions and events						
Euro area		09.00	ECB to publish quarterly Survey of Professional Forecasters for Q325			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
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