

Euro wrap-up

Overview

- Bunds were little changed as the euro area services and composite PMIs for July were revised down but French and Spanish manufacturing output data for June beat expectations.
- Gilts made modest losses at the shorter end of the curve as the UK services and composite PMIs for July were revised up.
- Wednesday will bring data for euro area retail sales, German factory orders and Italian industrial output in June as well as the July construction PMIs.

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Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.902	+0.005
OBL 2.2 10/30	2.210	-0.004
DBR 2.6 08/35	2.621	-0.001
UKT 3½ 03/27	3.810	+0.021
UKT 4½ 03/30	3.946	+0.014
UKT 4½ 03/35	4.508	+0.001

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

Source: Bloomberg

Euro area

Factory output made significant contribution to growth in France & Spain in Q2

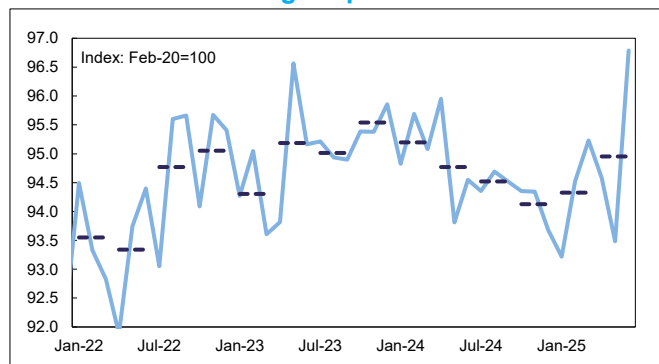
Of all the member states, France (0.3%Q/Q) and Spain (0.7%Q/Q) made the largest contributions to euro area GDP growth in Q2, more than fully accounting for the 0.1%Q/Q rate in the region. Today's June industrial production figures showed that the factory sector made a significant contribution to that expansion in both countries. In France, manufacturing output at the end of the quarter was particularly vigorous, with growth of 3.5%M/M the strongest since the reopening of businesses from the initial lockdowns in 2020 to take the level to the highest since the start of the pandemic in February of that year. So, while it declined in April and May, French factory output rose for a second successive quarter in Q2 and by 0.7%Q/Q. The driver was an exceptional jump in production of aircraft and spacecraft due to improved functioning of supply chains in the subsector, the result of which the 'other transport' component jumped by more than one quarter on the month to be up more than 10%Q/Q in Q2. Output of motor vehicles, chemicals and machinery and equipment also increased in both June and Q2, but food products provided some offset on a quarterly basis.

In Spain, manufacturing production rose for the second successive month in June and by 1.0%M/M to be up 0.9%Q/Q in Q2 after a small dip in Q1. As in France, it rose to the highest level since February 2020. And growth in Spanish production over the quarter was relatively broad-based, led by autos (6.8%Q/Q) but also with support from food products, metals and pharmaceuticals. Despite the growth in France and Spain, the strength of euro area manufacturing output in June (data due 14 August) will be determined principally by Germany and Ireland, which are much more dependent on exports to the US and saw more significant front-running of tariffs earlier in the year. Surveys, however, point to broad resilience in both countries. And so, manufacturing production in the euro area likely grew for a second successive quarter in Q2, albeit relatively modestly at a softer pace than in France and Spain.

Euro area composite PMI points to a services-led recovery at the start of Q3

Despite a modest downwards revision from the preliminary release, today's final July services PMIs implied an improvement in euro area economic conditions at the start of Q3 after GDP growth slowed in Q2. In particular, the euro area's composite output index (50.9) was still the joint best since last August, 0.3pt higher than in June and 0.5pt above the Q2 average. Like the manufacturing survey, the headline services activity PMI was nudged slightly lower from the flash release in July, by just 0.15pt to 51.0. But this still marked a four-month high, some 0.9pt above the Q2 average and bang in line with the Q1 average when services activity rose 0.3%Q/Q to add 0.2ppt to GDP growth. Amid reports of strong spending by overseas visitors, the recovery continues to be led by strong services growth in Spain, where the respective PMI jumped more than 3pts in July to 55.1, a five-month high. And this took that country's composite PMI (54.7) to the highest since February,

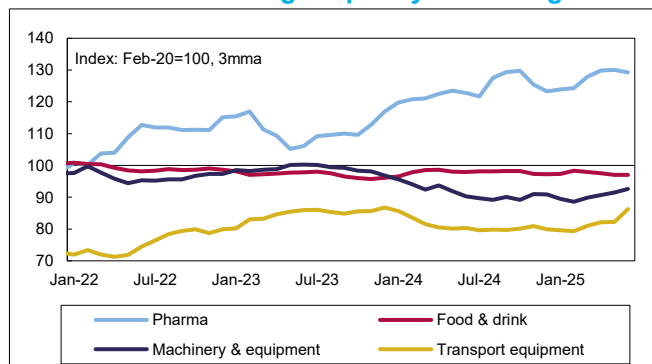
France: Manufacturing output*



*Dashed lines show quarterly averages.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

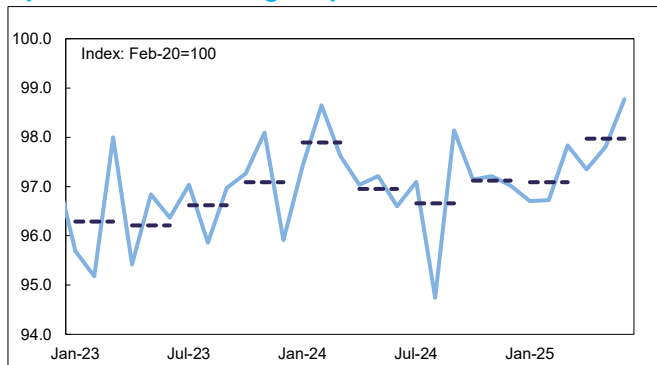
France: Manufacturing output by selected good



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

suggesting continued outperformance within the region. The Italian services PMI (52.3) also recovered at the start of Q3, taking the composite index (51.5) back to the (admittedly lacklustre) long-run average. And despite an implied slowdown in German manufacturing at the start of Q3, a revival in services activity pushed the composite PMI (50.6) to a four-month high, to suggest a return to modestly positive GDP growth this quarter. In contrast, the French final PMI was revised down from the flash release, by a non-negligible 1.2pts to 48.5. This took the composite PMI (48.6) to a three-month low, implying a contraction. However, the French PMIs have been below 50 for three out of the past four quarters while GDP growth has been positive for the same amount of time. And on balance, we expect French economic growth to remain modestly positive this quarter. But while the aggregate euro area PMIs point to a slight pickup in growth in Q3, yesterday's Sentix investor survey flagged a pickup in downside risks following the unfavourable EU-US trade deal, with some survey respondents also perhaps influenced by Friday's weak US payrolls report. The headline Sentix euro area index dropped 8pts in August – the most since April – to -3.7, a three-month low, with the expectations balance similarly the lowest since May, albeit still above the long-run average level.

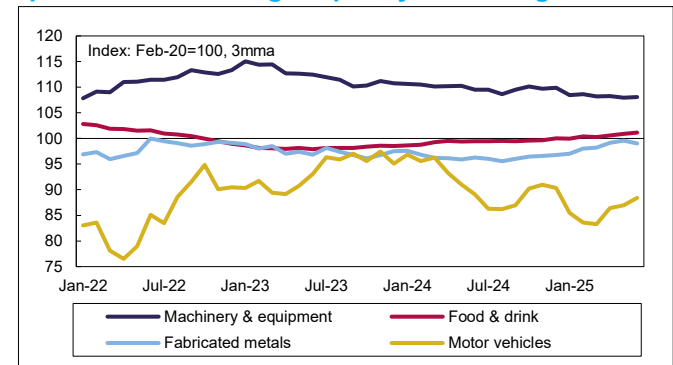
Spain: Manufacturing output*



*Dashed lines show quarterly averages.

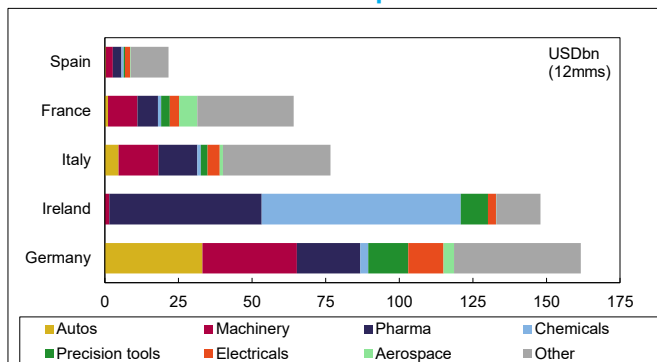
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Spain: Manufacturing output by selected good



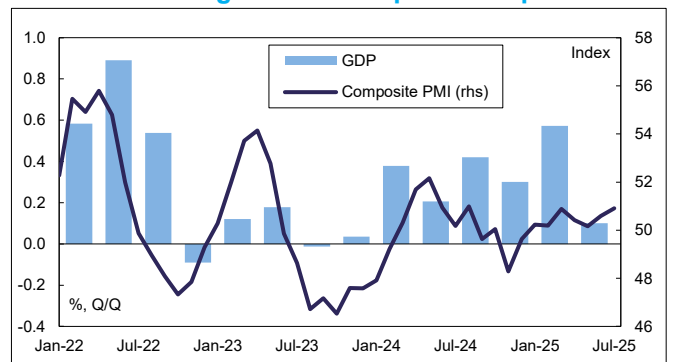
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Exports to the US



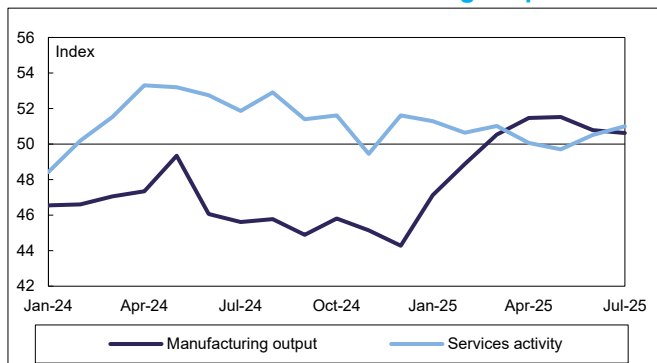
Source: US Census Bureau, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & composite output PMI



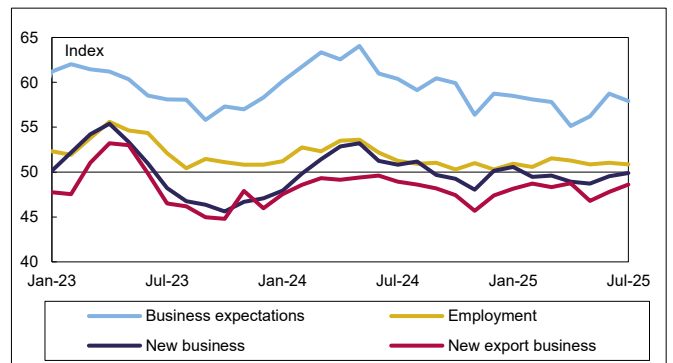
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Services & manufacturing output PMIs



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

Euro area: Selected services PMIs



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

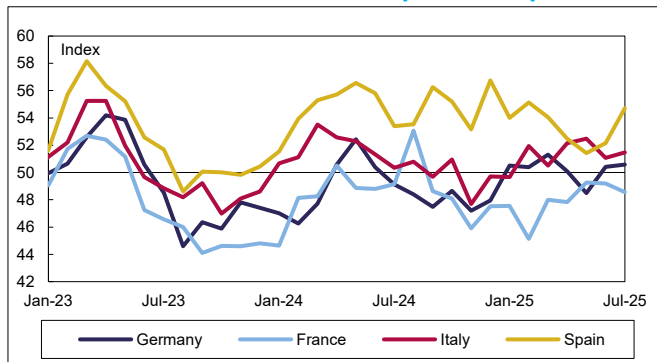
Factory output price pressures remain subdued despite a pickup in energy prices

In terms of inflation, today's PMIs suggested a further waning in price pressures at the start of Q3. In particular, the services input price index fell for the fifth month out of the past six in July to a ten-month low (56.5), broadly in line with the long-run average. While the services output price index was consistent with above-target inflation in the sector, it was still a touch softer than the average over the past twelve months. And while the equivalent manufacturing price index rose to its highest since April, at 49.9 it remained consistent with an ongoing absence of meaningful factory price pressures. At face value, today's producer price figures suggested that the factory sector might provide a little upwards pressure on inflation over the near term, with industrial producer output prices rising for the first month in three in June (0.8%M/M). But this left the annual rate up just 0.6%Y/Y. Moreover, the pickup merely reflected a jump in producer energy prices (3.2%M/M), after declining a cumulative 15% in the previous three months. Indeed, when excluding energy, factory output prices fell (-0.1%M/M) for the first month in eleven. While producer prices of consumer and capital goods were up slightly (0.1%M/M) this was softer than in recent months, while prices of intermediate goods fell for a third month (-0.2%M/M). Wholesale energy prices have subsequently stabilised. And the appreciation of the euro since the start of the year, as well as the influx of cheap goods from China, should continue to contain prices of imported items. So, we continue to expect core CPI goods inflation to remain very subdued over coming quarters.

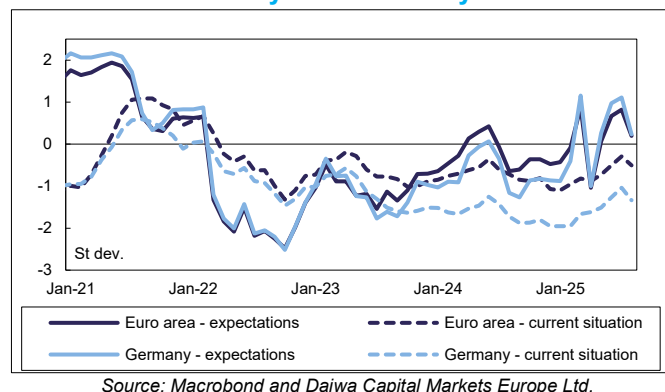
The day ahead in the euro area

While today's French and Spanish IP releases bode positively for next week's aggregate euro area industrial output data, figures from Italy (Wednesday) and Germany (on Thursday) will help to form a more complete view. With regards to the latter, Wednesday's German manufacturing orders and turnover data for June will offer some clues. Survey indicators like the PMIs and ifo indices have flagged resilience in recent months, suggesting the likelihood of a rebound in factory orders after the drop in May (-1.4%M/M). June's euro area retail sales figures will provide another focus. An uptick in sales volumes in Germany, Italy and Spain that month points towards a modest increase for the euro area in June and growth of between ¼-½%Q/Q in the second quarter. Meanwhile, the euro area construction PMIs will provide an update on activity in the building sector at the start of Q3.

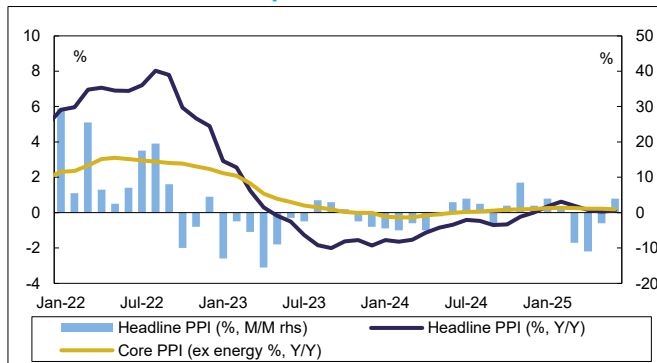
Euro area member states: Composite output PMIs



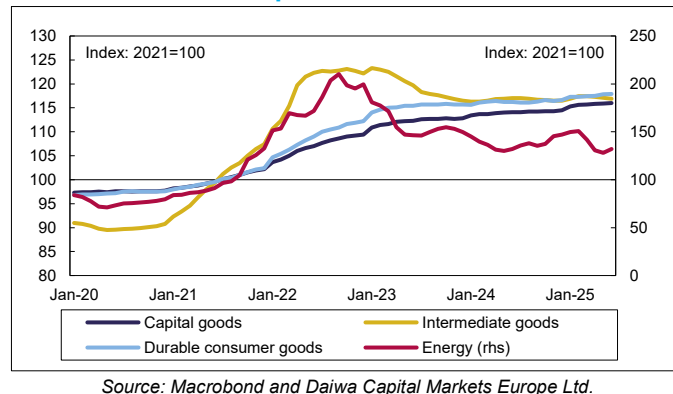
Euro area & Germany: Sentix survey indices



Euro area: Producer price inflation



Euro area: Producer price levels



UK

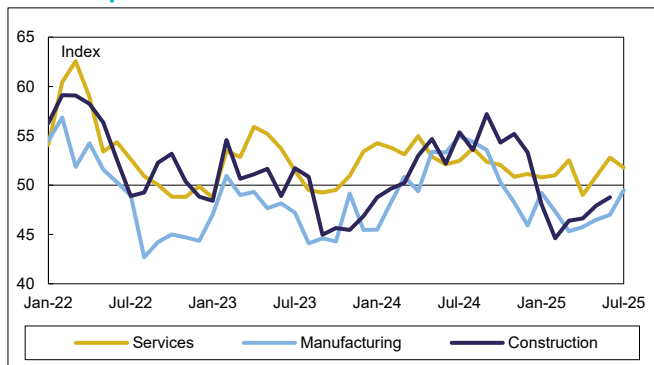
July services PMI revised up but composite indices suggest flat activity amid falling orders & jobs

Friday's final manufacturing PMIs for July brought a downwards revision to the output index, of 0.5pt to 49.5, to remain below the key 50 mark for the ninth successive month and suggest ongoing retrenchment in the UK factory sector. In contrast, today's final services PMIs brought an upwards revision to the activity index of 0.6pt to 51.8 to signal modest expansion in the all-important tertiary sector for a third successive month. While it represented a decline of 1pt from June, it was still almost 1pt above the Q2 average, hinting at slightly more positive momentum at the start of Q3. However, like the manufacturing PMIs, much of the services survey detail was downbeat. New business in the sector reportedly fell for the third month in the past four and by the most since the Truss crisis more than 2½ years ago. And jobs were reportedly cut at the fastest pace since February. Nevertheless, firms still saw some light at the end of the tunnel, with expectations for the coming twelve months close to the top of the range of the first half of the year. And services input cost pressures moderated to the softest level since December, albeit remaining above the long-run average. Unfortunately, with firms still looking to pass on to customers recent cost increases associated not least with government policies, output price inflation reportedly ticked higher, albeit with the respective index the second-lowest level in more than four years. With the services sector far larger than manufacturing, today also brought an upwards revision to the composite output PMI, of almost ½pt to 51.5. That was also ½pt down on June but more than 1pt above the composite PMI for Q2. More importantly perhaps, it was also a level that before the pandemic would have been consistent with broadly flat economic output. So, the BoE will continue to judge that underlying economic growth remains weak. And with the composite indices also suggesting that new orders are falling sharply and jobs are being cut at a faster pace, today's survey results will have reinforced the case for a cut to Bank Rate on Thursday.

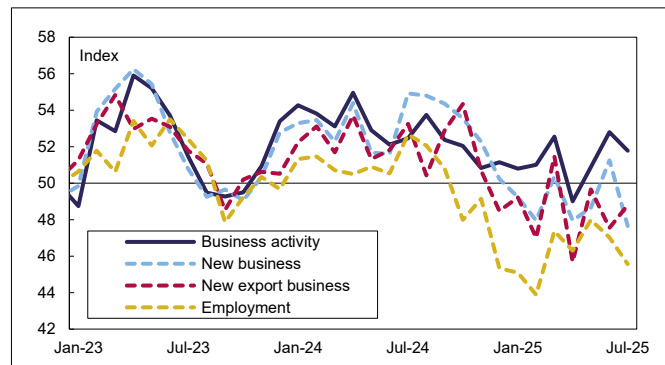
The day ahead in the UK

With Thursday's monetary policy announcement firmly in view, Wednesday should be another relatively quiet day for UK economic news. July's construction PMIs will mark the sole economic data release, having in June reported the softest contraction in the sector in six months (48.8) to extend the modest improving trend. Despite a deeper pullback in the commercial and civil engineering subsectors, improvement in this instance was driven principally by an uptick in residential building activity, reporting a first expansion in (50.7) in nine months.

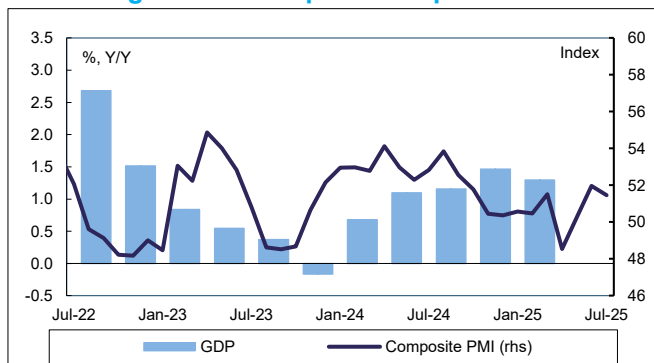
UK: Output PMIs



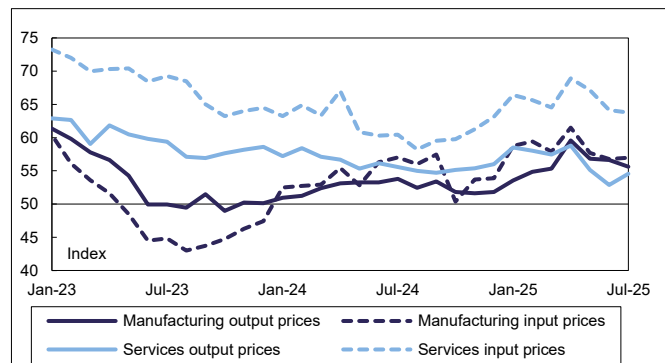
UK: Selected services PMIs



UK: GDP growth & composite output PMI













UK: Price PMIs





European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final composite (services) PMI	Jul	50.9 (51.0)	<u>51.0 (51.2)</u>	50.6 (50.5)	-
	 PPI Y/Y%	Jun	0.6	0.6	0.3	-
Germany	 Final composite (services) PMI	Jul	50.6 (50.6)	<u>50.3 (50.1)</u>	50.4 (49.7)	-
France	 Industrial production M/M% (Y/Y%)	Jun	3.8 (2.0)	0.6 (-0.5)	-0.5 (-0.9)	-0.7 (-1.1)
	 Final composite (services) PMI	Jul	48.6 (48.5)	<u>49.6 (49.7)</u>	49.2 (49.6)	-
Italy	 Composite (services) PMI	Jul	51.5 (52.6)	51.5 (52.6)	51.1 (52.1)	-
Spain	 Industrial production M/M% (Y/Y%)	Jun	1.0 (2.3)	-	0.6 (1.7)	0.5 (-)
	 Composite (services) PMI	Jul	54.7 (55.1)	52.6 (52.5)	52.1 (51.9)	-
UK	 Final composite (services) PMI	Jul	51.5 (51.8)	<u>51.0 (51.2)</u>	52.0 (52.8)	-
	 New car registrations Y/Y%	Jul	-5.0	-	6.7	-



Auctions

Country	Auction
Germany	 sold €3.916bn of 1.9% 2027 bonds at an average yield of 1.9%
UK	 sold £4.5bn of 4.5% 2035 bonds at an average yield of 4.522%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Sentix investor confidence indicator	Aug	-3.7	6.9	4.5	-
Spain	 Unemployment change (employment net change) M/M 000s	Jul	-1.4 (31.1)	-	-48.9 (40.4)	-










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
Euro area	 08.30	Construction PMI	Jul	-	45.2
	 10.00	Retail sales M/M% (Y/Y%)	Jun	0.3 (2.6)	-0.7 (1.8)
Germany	 07.00	Factory orders M/M% (Y/Y%)	Jun	1.1 (2.1)	-1.4 (5.3)
	 08.30	Construction PMI	Jul	-	44.8
France	 07.45	Preliminary private sector payrolls Q/Q%	Q2	-	-0.1
	 08.30	Construction PMI	Jul	-	41.6
Italy	 08.30	Construction PMI	Jul	-	50.2
	 09.00	Industrial production M/M% (Y/Y%)	Jun	-	-0.7 (-0.9)
UK	 09.30	Construction PMI	Jul	48.8	48.8

Auctions and events

Germany	 10.30	Auction: to sell €1.5bn of 1% 2038 bonds
	 10.30	Auction: to sell €1bn of 3.25% 2042 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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