

Euro wrap-up

Overview

- Bunds made modest losses as euro area retail sales rose in Q2 for a seventh successive quarter, while German factory orders surged in Q2 despite a fall back in demand in June.
- Gilts also made losses despite a weak UK construction PMI survey.
- On Thursday the BoE will cut Bank Rate by 25bps and publish updated macroeconomic projections, while German industrial production and goods trade data for June are also due.

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Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.915	+0.013
OBL 2.2 10/30	2.235	+0.023
DBR 2.6 08/35	2.649	+0.029
UKT 3½ 03/27	3.819	+0.003
UKT 4½ 03/30	3.961	+0.009
UKT 4½ 03/35	4.530	+0.016

*Change from close as at 4:45pm BST.
Source: Bloomberg

Euro area

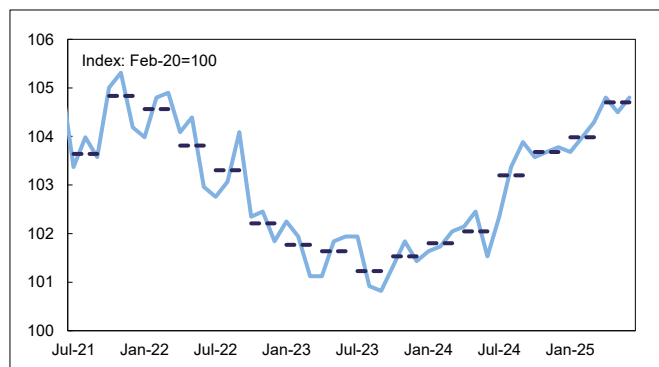
Retail sales up in Q2 for seventh successive quarter

Euro area retail sales volumes rose 0.3% M/M in June, fully reversing the dip in May which was less marked than originally estimated. As a result, sales matched their highest level since March 2022 and rose in Q2 by a vigorous 0.7% Q/Q, marking the seventh successive quarter of growth and the strongest since Q324. Sales growth in Q2 was broad-based, with a firm pickup in food (0.7% Q/Q), auto fuel (1.5% Q/Q) and core (i.e. non-food and non-fuel) items (0.6% Q/Q). Sales growth was also widespread, with increases in each of the four largest member states. Of those, Spain (1.9% Q/Q) predictably led the way, with more moderate growth (0.3-0.4% Q/Q) in Germany, France and Italy. The vigour of retail sales in Q2 reinforces our expectation that household consumption growth was also positive in Q2 for a sixth successive quarter. Likewise, May data for services production should be consistent with a sixth successive quarter of growth in the tertiary sector, in part due to expansion in hospitality and tourism as well as IT services. And with real wage growth still positive, the unemployment rate at the series low and consumer surveys signalling an above-average willingness to make major purchases over the coming 12 months, we expect retail sales and household consumption to continue to grow throughout the second half of the year.

German factory orders jumped in Q2 despite a fall back in demand in June

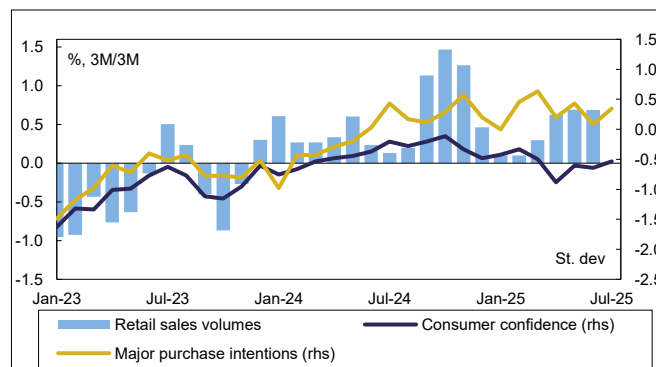
At face value, today's German factory orders data disappointed, with overseas demand seemingly impacted by the petering out of US tariff front-running. Total new orders fell in June for a second successive month, by 1.0% M/M to the lowest level since February, due principally to a near-8% M/M drop in orders from non-euro area countries. However, this slump in overseas orders followed strong growth in previous months as firms had brought forward bulk orders, which rose a striking 6.1% Q/Q in Q2. And despite a decline in domestic orders in Q2, total new orders increased 3.1% Q/Q last quarter, the most in four years. But this in part reflected an exceptional large-scale ship order, which led to a more than eightfold increase in orders of 'other transport equipment' last quarter. And despite a softening in June, new auto orders increased more than 5% Q/Q having jumped to a near-3½-year high in May. Less positively, today's figures suggested some weakening in demand for capital goods at the end of the quarter, with orders of machinery (-3½% M/M) also falling back. Consumer non-durable goods orders also declined due to pull-back in pharmaceuticals, which had previously seen the most significant front-running of tariffs. And while there was a marked increase in orders of electrical equipment, overall intermediate goods orders remained close to the bottom of the recent range. When excluding bulk items, 'core' factory orders rose slightly in June (0.5% M/M). But this merely left them flat over the second quarter, suggesting that underlying demand for German goods remains relatively subdued. This notwithstanding, a recent pickup in order backlogs should be consistent with ongoing output growth in the sector, as suggested by signals from the PMIs and ifo indices. And having declined in April and May, today's manufacturing turnover data also reported a return to growth in June (1.0% M/M), albeit still down some ½% Q/Q in Q2.

Euro area: Retail sales volumes*



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales & consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

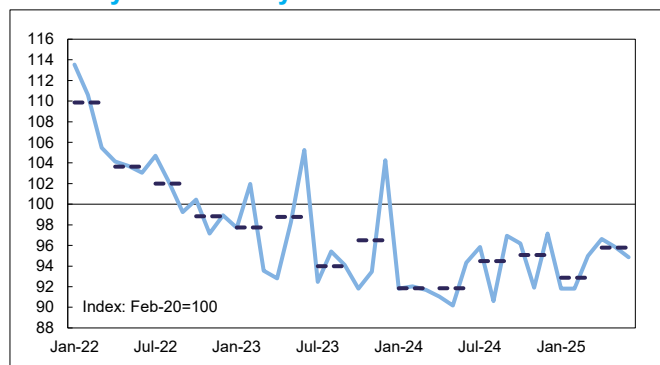
Spain drove construction output growth in Q2 but PMIs suggest weakness across the region in July

Like retail, in the absence of revisions, the construction sector looks to have contributed positively to euro area GDP growth in Q2. Indeed, in the first two months of the quarter, construction output was trending more than 2½% above the Q1 level to be on track for a third successive quarter of growth. However, that reflects an exceptional jump in Spanish production, excluding which euro area construction output was trending about ¾% below the Q1 level. Production in the sector contracted 1.1%Q/Q in France, the only large member state to publish June figures so far, while German data tomorrow will also likely confirm a decline in Q2. And if today's construction PMIs are to be believed, momentum in the sector in the three largest member states remained negative at the start of Q3. The headline euro area construction activity PMI fell 0.5pt in July to a five-month low of 44.7. And the equivalent indices for Germany (46.3), France (39.7) and, for the first time since February, Italy (48.3) were all below the 50 mark to signal contraction. The deterioration was also reportedly broad-based, with the surveys for housing, commercial and civil engineering all consistent with falling output. However, while the French construction activity PMI was the weakest in ten months, the German was the best in almost 2½ years. And we note that the Commission construction survey has presented a more upbeat impression of conditions in the sector, with confidence above the long-run average in Germany, Italy and the region as a whole in July, albeit a touch weaker on the month. The likelihood of negative payback in Q3 for the strength in Spain – which has also been flagged by the Commission survey – suggests that euro area construction output will drop in Q3. But despite the softness in the July survey, we anticipate a return to growth in Germany and Italy this quarter and – assuming no sudden deterioration in broader economic growth momentum – a rebound in the region as a whole in Q4.

The day ahead in the euro area

Contrasting the jump in industrial output in France and Spain at the end of Q2, today's Italian data suggested only a modest return to growth in June (0.2%M/M). Following a decline in May (-0.8%M/M), this left the level of output still down 0.9%Y/Y and merely flat over the second quarter. The detail suggested a mixed performance, with production of consumer goods falling for a fourth month in five to its lowest level since December 2020, while capital goods output edged up to a five-month high. Thursday's German IP may be expected to show a similar trend, with construction in particular likely to receive some payback for a sharp drop in May (-3.9%M/M). Meanwhile, German and French trade data for June are likely to confirm that net goods trade contributed negatively to growth in Q2 as demand, particularly from the US, weakened. Indeed, timelier US data for June highlighted downside risks for Germany, with US imports of German autos and pharmaceutical products dropping to their lowest levels since February 2022 and April 2017 respectively.

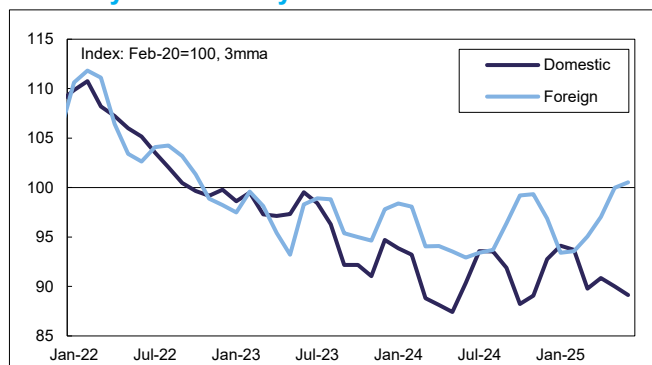
Germany: New factory orders*



*Dashed line represents quarterly average.

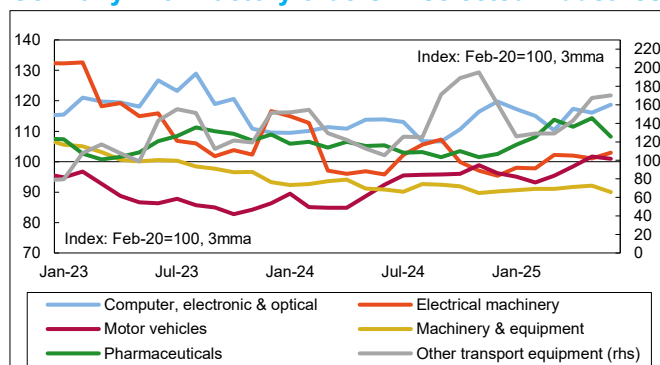
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: New factory orders



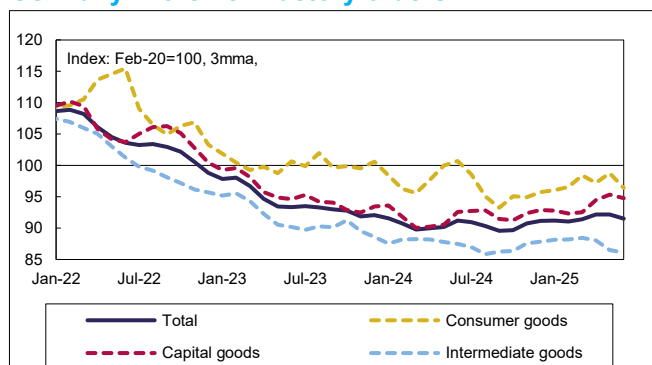
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: New factory orders in selected industries



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Core new factory orders*



*Excluding major orders.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

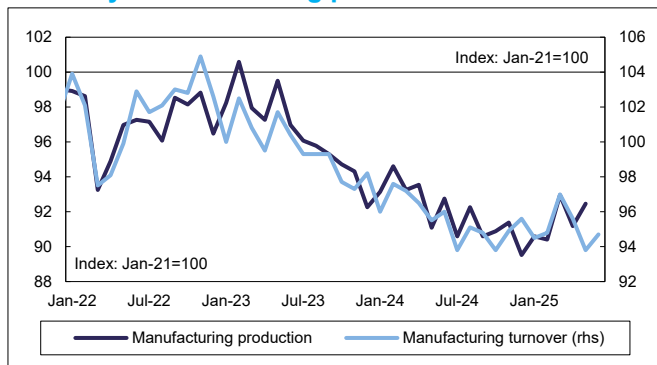
UK construction PMIs point to a slump in activity at the start of Q3

While the July PMIs pointed to modest expansion in the services sector and only modest contraction in manufacturing, today's equivalent construction survey disappointed, suggesting that weak demand continued to weigh on output in the sector. In particular, the headline activity index fell for the first month in five and by a striking 4.5pts to 44.3, the lowest since May 2020 and some 1.5 standard deviations below the long-run average. There was renewed weakness in residential work, with the respective PMI dropping more than 5pts to 45.3. Civil engineering work (42.0) was also the weakest since March. And while the commercial activity index improved slightly from June, it continued to point to ongoing contraction (45.9). With the volume of incoming business similarly declining for the seventh consecutive month and by the most since February, constructors continued to buy less inputs and reduce headcount. And expectations for the coming 12 months remained underwhelming. Admittedly, the PMIs have provided a pretty poor guide to the official ONS data for construction activity. Part of the mismatch since the start of the year likely reflects distortions to the housing market caused by adjustments to Stamp Duty thresholds which led transactions to be brought forward to March. But today's survey also suggests that momentum in the housing market might remain absent despite the recovery in new buyer enquiries signalled in the July RICS residential survey and a recent pickup in mortgage lending. Nevertheless, we expect the likely further cut in Bank Rate tomorrow and additional gradual easing thereafter to provide support. And following a likely contraction in Q2, we expect construction output to return to modest growth in Q3 and Q4.

The day ahead in the UK

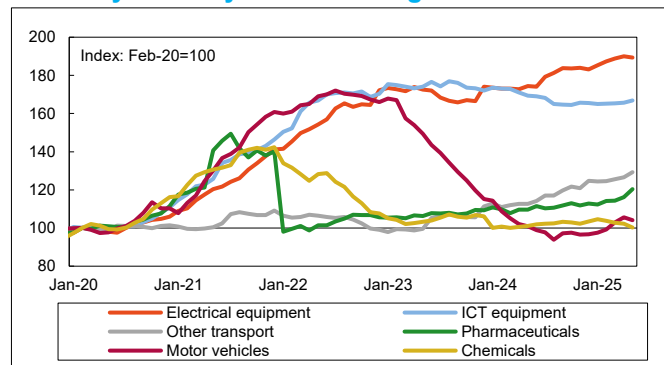
Of course, Thursday's main event will come courtesy of the BoE's monetary policy announcement, which will be accompanied by the Monetary Policy Report and the MPC's updated macroeconomic projections. Like the consensus, we expect the MPC to vote to ease policy by another 25bps, marking a fifth such quarterly reduction this cycle and taking Bank Rate to a near-2½-year low of 4.00%. We acknowledge, however, that the decision to cut rates is unlikely to be unanimous. Indeed, the recent step-up in inflation seems likely to leave the hawks, Chief Economist Pill and external member Mann, reluctant to withdraw policy restrictiveness while private sector pay growth sits around 5%3M/Y and some inflation expectations gauges show signs of creaking. But as observed in May's meeting, we expect a majority to adjudge that inflation persistence continues to moderate given the restrictive stance of monetary policy, and that a cut is justified to guard against downside risks posed by the ongoing deterioration in the labour market. With that in mind, we also cannot rule out a three-way split, with external member Dhingra, and perhaps Taylor, calling for easing to be frontloaded. As always, the Bank's macroeconomic projections will help to guide the MPC's internal discussions, although on this occasion we expect

Germany: Manufacturing production & turnover



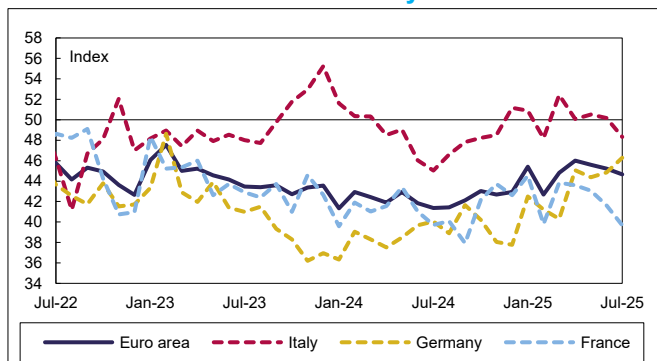
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory order backlogs



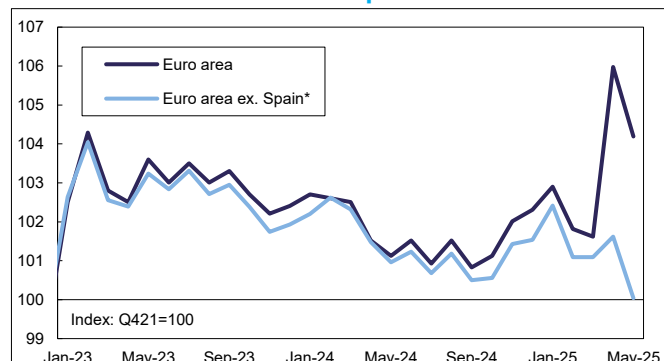
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction PMIs by member state



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

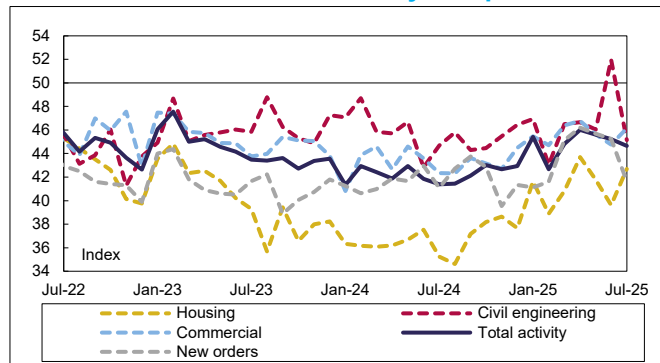
Euro area: Construction output



*Composite based on the nine member states with the largest construction sectors. Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

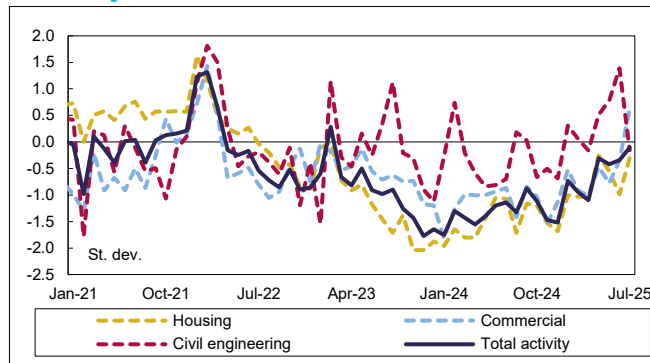
little change of substance when compared to May's MPR, implying that the MPC will maintain that a "gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate". Furthermore, the MPR is expected to include an excerpt regarding the BoE's QT program which we suspect will offer clues as to whether the BoE will slow the pace of its Gilt sales at September's monetary policy meeting. Our BoE look-ahead can be read in last Friday's [Euro wrap-up](#). Meanwhile, on the data front, the BoE's Decision Maker Panel survey will also be of interest.

Euro area: Construction PMIs by component



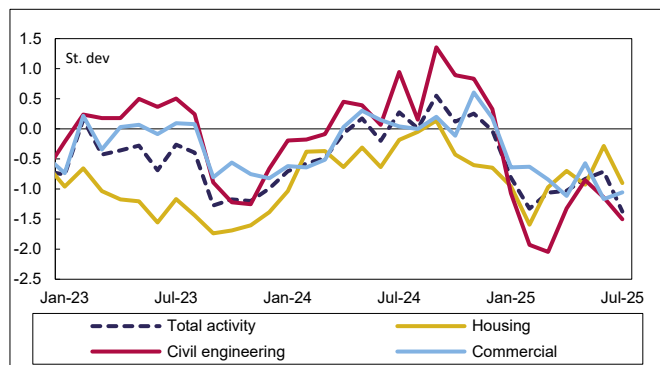
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Construction PMIs



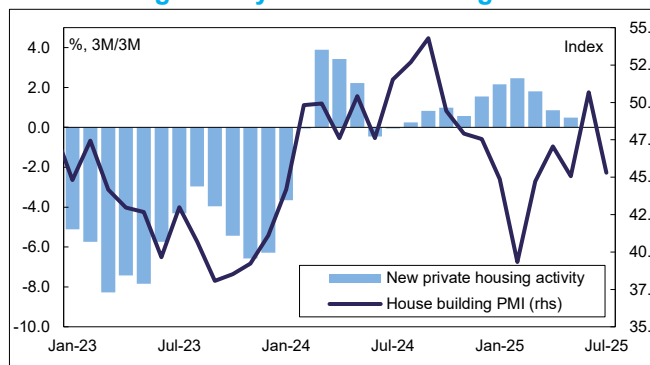
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Construction PMIs



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

UK: Housing activity & house building PMI












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



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Retail sales M/M% (Y/Y%)	Jun	0.3 (3.1)	0.3 (2.6)	-0.7 (1.8)	-0.3 (1.9)
	 Construction PMI	Jul	44.7	-	45.2	-
Germany	 Factory orders M/M% (Y/Y%)	Jun	-1.0 (0.8)	1.1 (2.1)	-1.4 (5.3)	-0.8 (6.1)
	 Construction PMI	Jul	46.3	-	44.8	-
France	 Construction PMI	Jul	39.7	-	41.6	-
	 Preliminary private sector payrolls Q/Q%	Q2	0.0	-	-0.1	-
Italy	 Industrial production M/M% (Y/Y%)	Jun	0.2 (-0.9)	-	-0.7 (-0.9)	-0.8 (-1.0)
	 Construction PMI	Jul	48.3	-	50.2	-
UK	 Construction PMI	Jul	44.3	48.8	48.8	-







Auctions

Country	Auction
Germany	 sold €1.262bn of 1% 2038 bonds at an average yield of 2.86%
	 sold €782m of 3.25% 2042 bonds at an average yield of 3.00%






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	 07.00	Industrial production M/M% (Y/Y%)	Jun	-0.5 (-1.0)	1.2 (1.0)
	 07.00	Trade balance €bn	Jun	18.2	18.5
France	 07.45	Trade balance €bn	Jun	-	-7.8
	 07.45	Preliminary wages Q/Q%	Q2	-	0.7
UK	 12.00	BoE Bank Rate %	Aug	<u>4.00</u>	4.25
	 14.00	DMP 3M output price (1Y CPI) expectations Y/Y%	Jul	-	3.6 (3.3)

Auctions and events

Euro area	 09.00	ECB to publish Economic Bulletin 5/2025
France	 09.50	Auction: to sell up to €10.5bn of 1.25% 2034, 1.25% 2036, 0.5% 2040 & 4% 2055 bonds
Spain	 09.30	Auction: to sell 2.4% 2028, 3.2% 2035, 3.45% 2043 bonds and 1% 2030 inflation-linked bonds
UK	 12.00	BoE monetary policy announcement, minutes and Monetary Policy Report to be published
	 12.30	BoE Governor Bailey to present updated macroeconomic projections in post-MPC press conference

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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