

Euro wrap-up

Overview

- Longer-dated Bunds made gains as German industrial production slumped in June to the lowest level since the first Covid-19 lockdown.
- While the BoE cut rates by 25bps and signalled the likelihood of further gradual easing in future, shorter-dated Gilts made sizeable losses as four MPC members voted to keep rates unchanged.
- The coming week will bring estimates of Q2 GDP from the euro area and UK, as well as the latest figures for euro area IP and the UK's labour market.

Economic Research Team

+44 20 7597 8326

Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 1.9 09/27 | 1.914 | +0.002 |
| OBL 2.2 10/30 | 2.224 | -0.008 |
| DBR 2.6 08/35 | 2.628 | -0.020 |
| UKT 3½ 03/27 | 3.870 | +0.058 |
| UKT 4% 03/30 | 3.999 | +0.045 |
| UKT 4½ 03/35 | 4.544 | +0.021 |

*Change from close as at 5.00pm BST.

Source: Bloomberg

Euro area

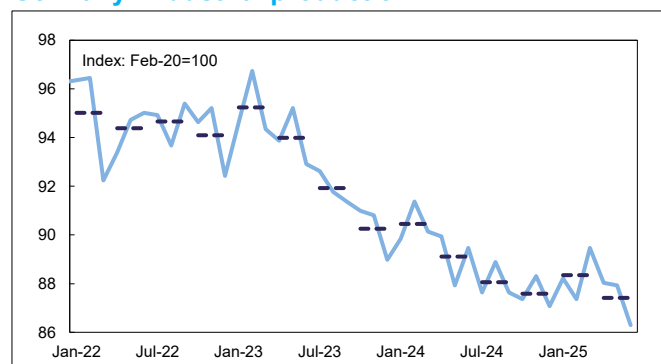
German manufacturing output slumped in June as impact of higher US tariffs hit

Contrasting yesterday's pickup in German manufacturing turnover in June, today's manufacturing output data reported a marked retrenchment at the end of Q2, raising the risk of a possible downwards revision to Q2 GDP and representing a substantial negative carry-over into Q3. Factory production fell for a third consecutive month in June and by a larger-than-expected 2.8%M/M, the most since March 2022. And with the increase initially reported in May more than fully revised away, output fell to the lowest level since April 2010 when excluding the first Covid-19 lockdown. And that left it down 1.3%Q/Q in Q2, the steepest quarterly contraction since Q423. As in Q2, the weakness in June was driven by the pharma sub-sector that had significantly increased production in Q1 to front-run higher US tariffs, where output fell 11.0%M/M to a seven-month low. Other sectors more exposed to the US also cut production sharply in June, including basic metals (-6.6%M/M) and machinery and equipment (-5.3%M/M), which fell to the lowest levels since the initial pandemic-related slump. And while autos production rose more than 1%Q/Q in Q2 this principally reflected a positive carry over from March – indeed, output in the sector fell for a third month in June to a five-month low.

German exports fell sharply to the US, while imports from China rise

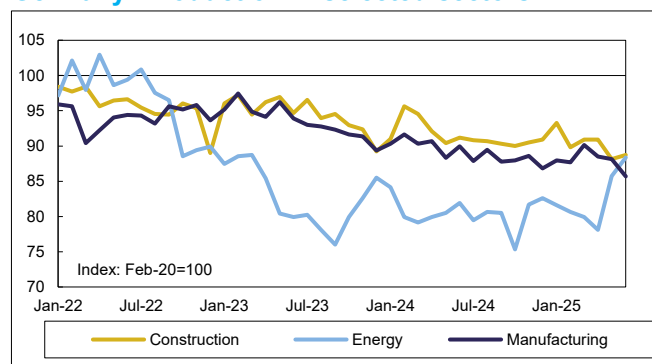
With roughly 10% of German goods exports shipped to the US, the impact of higher tariffs and lower production was evident in today's goods trade report. The value of German exports to the US declined in June for a third consecutive month to the lowest level since March 2022 to be down more than 11%Q/Q in Q2. Despite a modest increase in June, shipments to China fell 1%Q/Q in Q2 as the steady downtrend in autos and machinery continued. Exports to the UK (5.3%Q/Q) provided some offset, while demand from elsewhere in the euro area appeared resilient, with shipments rising to a 14-month high in June. So, despite sizeable declines in certain subsectors such as chemicals, pharmaceuticals and machinery, total export values fell just 0.8%Q/Q in Q2, only partly reversing the front-loading in Q1 (2.6%Q/Q). But the trade surplus narrowed sharply in June to an eight-month low (€14.9bn) as imports jumped more than 4%M/M to a more than two-year high to be up 0.8%Q/Q in Q2. This in part reflected another sizeable inflow of goods from the US (4.3%Q/Q). But there was also strong growth in imports from China – which have risen roughly 10% since the start of the year – a trend that seems highly likely to persist given the increase in US tariffs on Chinese imports this year.

Germany: Industrial production*



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Production in selected sectors



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

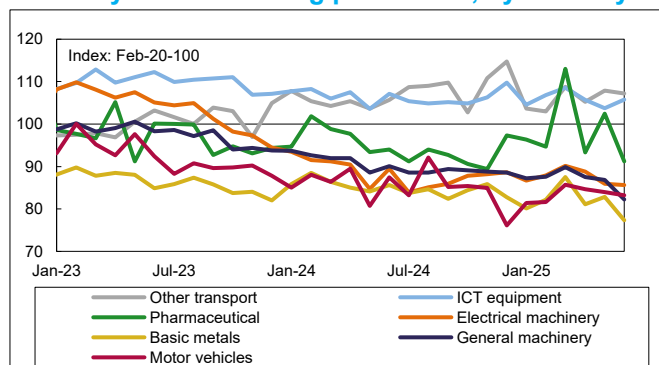
Recovery in construction activity disappoints, while building permits continue to decline

While the construction sector returned to growth in June, the rebound (0.7%M/M) was disappointing in light of the significant decline in activity in May. As a result, output in the sector in Q2 registered the steepest quarterly contraction (-2.3%Q/Q) in a year. Strikingly too, building work fell to the lowest level since the severe cold spell in early 2018. There was, however, a notable boost to energy production in June which pushed quarterly growth in that sector to more than 4%Q/Q. As such, the monthly drop in total industrial production was limited to 'just' 1.9%M/M, nevertheless still the steepest in 11 months. And with the initially estimated increase in May revised away, total industrial output fell 1.0%Q/Q in Q2, the most in three quarters with a significant negative carryover into Q3 too. Admittedly, the recent mismatch between the turnover and production data raises the possibility of a favourable revision to the June production data in due course. And the jump in new factory orders in Q2 should support manufacturing output growth over coming months. But while surveys point to an improvement in construction at the start of Q3 too, a further decline in new building permits suggests than any near-term recovery in that sector will remain lacklustre. As such, while we expect German GDP to resume a modest expansion this quarter, risks to the near-term growth outlook appear skewed to the downside.

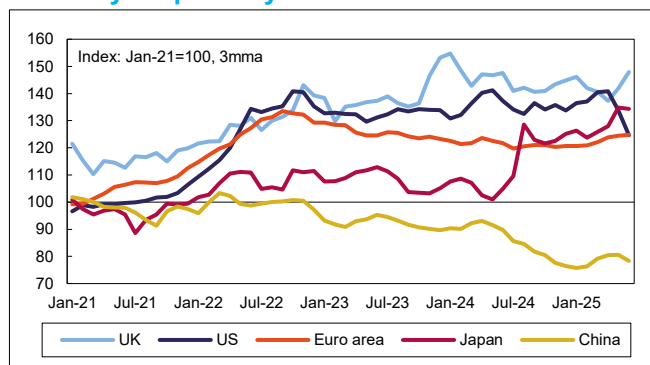
The week ahead in the euro area: Penultimate Q2 GDP, June IP and July inflation detail

While the member state data released so far were consistent with a marginal decline in euro area IP in June (data due next Thursday), we caution that tomorrow's Irish figures – which are often extremely volatile and showed growth of 12.4%M/M in May – will be necessary to confirm that view. Still, notwithstanding some payback in Ireland and subsequent decrease in the euro area in June, euro area manufacturing output was likely flat in Q2 as a whole. Thursday will also bring an update to Q2 GDP growth in the euro area, although we do not expect any revisions from the recently published first growth estimate, which at 0.1%Q/Q marked a notable, albeit predictable, slowdown from Q1. But the accompanying preliminary estimates for euro area employment growth in Q2 will be of interest. Despite the ongoing gradual loosening in the German labour market – which last quarter shed jobs (-7k) for a second quarter in the last five – employment growth in Southern Europe, led especially by Spain (adding 156k), will be expected to drive another modest quarterly increase across the aggregate euro area. Meanwhile, the coming week will also bring final inflation prints for July from several member states. While we will have to wait until the following week for granularity at the euro area level – the flash headline HICP rate moved sideways at the 2% target – the detail from the member states reported a more muddled picture, with energy leading a step-up in Spanish inflation (Wednesday) while gradual services disinflation saw German inflation dip below target for a first month in ten (also Wednesday). Finally, Germany's ZEW survey (Monday) may mirror this week's Sentix indices, whose downside surprise in August was likely amplified by negative sentiment surrounding the initial details of the EU-US trade deal and announcements of new reciprocal rates on other third parties, and possibly also Friday's downbeat US labour market report.

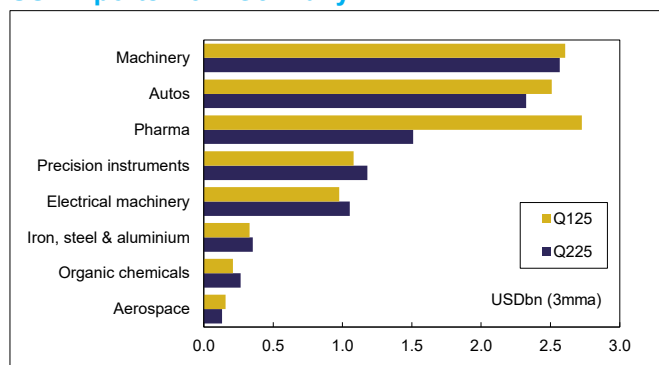
Germany: Manufacturing production, by industry



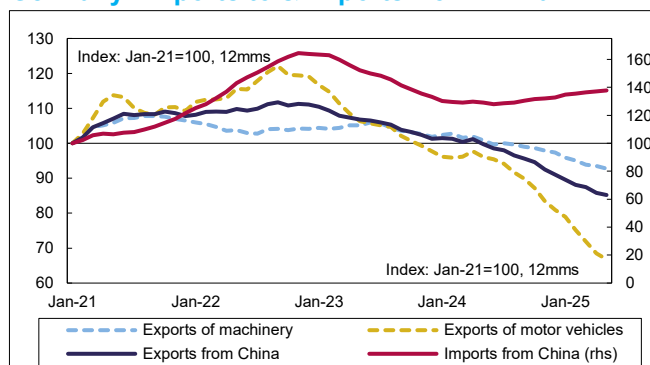
Germany: Exports by destination



US: Imports from Germany



Germany: Exports to & imports from China



UK

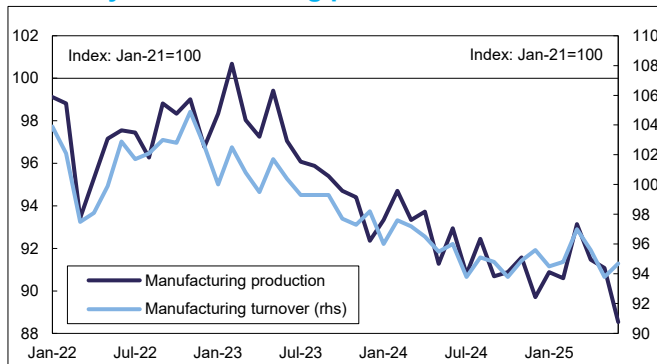
BoE cuts by 25bps & signals ongoing gradual easing, but divided MPC flags uncertain outlook

As was widely expected, the BoE cut Bank Rate by 25bps for the fifth time this policy cycle to 4.00%, the lowest since March 2023. Also as anticipated, the MPC was divided. But four members – split equally between BoE staff and external members, and notably two more than the consensus expectation – voted for unchanged rates. So, just five members voted in favour of policy easing, with one of that group (external member Taylor) having preferred a reduction of 50bps. As such, today's rate cut was backed by only a slender majority, prompting a modest sell-off in Gilts and strengthening of sterling. Nevertheless, the MPC left intact its forward policy guidance, restating that "a gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate". We have long interpreted that guidance to imply a continuation of the current cadence of one cut of 25bps per quarter until a broadly neutral stance is reached, for as long as underlying disinflation continues. And in his press conference, Governor Bailey, who voted in favour of today's cut, insisted that rates were indeed likely to continue to be cut again from current levels. But he acknowledged that the pace of future easing and the eventual terminal rate is now more uncertain than it appeared just three months ago. For the time being, we maintain our expectation that Bank Rate will be cut by 25bps in each of November, February and May to settle at 3.25% by next summer. But there are two-sided risks to that view, with decisions on UK fiscal policy to be taken in the autumn, as well as developments in global food prices and the US economy, likely to have an important bearing. And today's vote, as well as the BoE's updated projections, suggest that the risks to that rate path are skewed to the upside.

BoE revises up inflation outlook but target still expected to be achieved from Q227 onwards

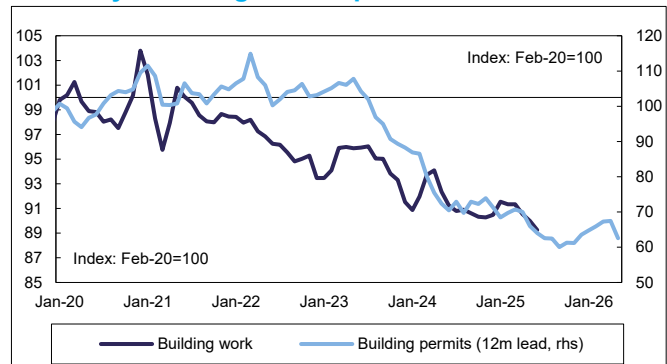
Bailey's view that there likely remains further easing to come reflects the BoE's assessment that monetary policy is still restrictive, albeit inevitably less so than a year ago. Appropriately, in our view, he (and the MPC majority) judge that the recent undershoot in wages relative to the Bank's May forecast, signals of continued wage moderation to come, and ongoing underlying services disinflation – all of which appears consistent with continued labour market loosening and emerging economic slack – means that CPI inflation remains on track to return to the 2% target by the end of the projection horizon. Nevertheless, not least given higher food inflation and a slightly higher assumption for energy prices, the MPC's inflation projection was revised up, particularly over the next couple of years. Indeed, the headline CPI rate is now expected to peak around 4.0%Y/Y in September – 0.3ppt more than previously – before moderating only gradually to below 3.0%Y/Y by Q326 and back to the 2.0%Y/Y target from Q227. Given the market-based assumption that Bank Rate will be cut to 3.50% by the middle of next year and remain thereabouts thereafter, if the economic outlook pans out in line with the BoE's updated projection, the MPC might be expected to cut Bank Rate just twice more by then. Like the inflation outlook, however, there remain significant two-sided risks to that outlook. And the four members who voted this month for unchanged policy fear that

Germany: Manufacturing production & turnover



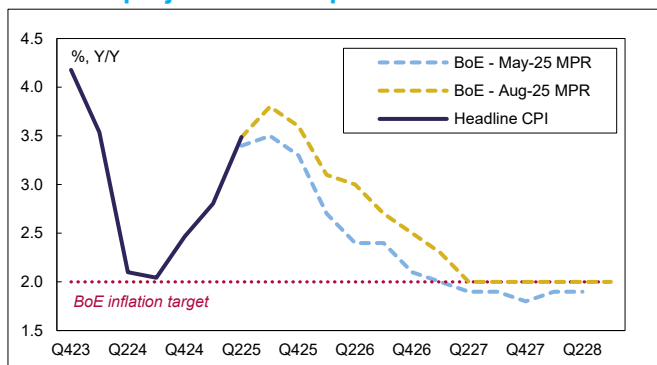
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Building work & permits



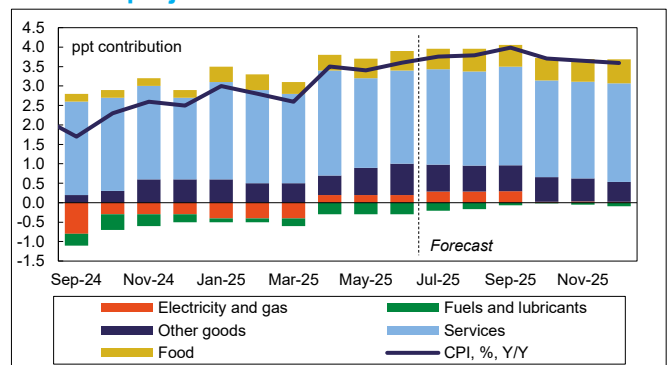
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BoE projections compared – CPI inflation



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

UK: BoE projection – CPI inflation & contributions



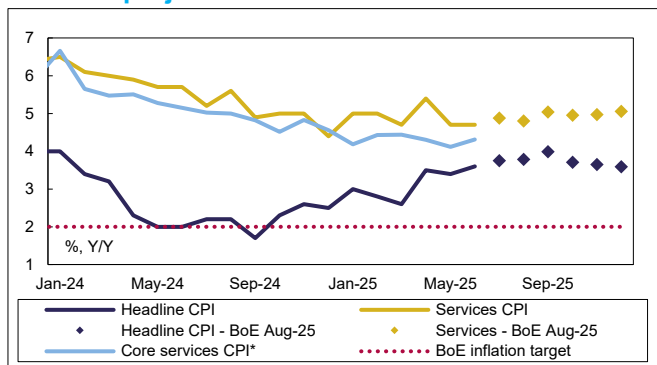
Source: BoE and Daiwa Capital Markets Europe Ltd.

the disinflationary process has slowed. They also think the risks of second-round effects from ongoing high inflation have increased, not least as business and household inflation expectations remain elevated and higher food and energy price pressures might give them a further boost. While valid concerns, however, we suspect they are a little overdone. Indeed, we think some of the hawks will be ready again to vote for rate cuts if and when inflation has passed its peak in the autumn.

BoE GDP outlook little changed but conditioned on unchanged fiscal policy, which needs to tighten

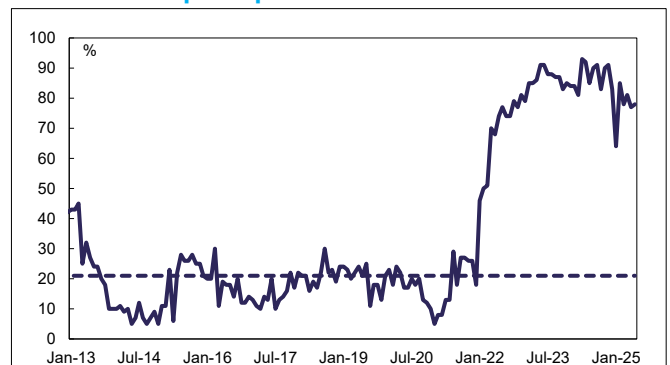
Given the strength of growth in Q1 and signs of some resilience since then, the BoE today revised up slightly its GDP forecast for 2025, to 1¼%Y/Y. But it thinks that growth in Q2 (data for which are due next week) slowed to just 0.1%Q/Q before a pickup to quarterly rates of 0.3%Q/Q from the current quarter through to mid-2027. As a result, it left unchanged its full-year growth projections for 2026 and 2027 at 1¼%Y/Y and 1½%Y/Y respectively. Our baseline forecast is only marginally more downbeat than the BoE's in that respect. But like the Bank, we see the risks to the GDP outlook as skewed to the downside. Certainly, the pickup in unemployment might weigh a little more heavily on private consumption than expected particularly in light of households' recent preference for saving than spending. Global uncertainty and a weakening of growth in the US might hit business investment and exports. Moreover, unlike the BoE, which assumes unchanged government policy, we expect the autumn budget to tighten the fiscal stance, perhaps by as much as 1% of GDP, further hitting demand.

UK: BoE projections – Headline & services CPI



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

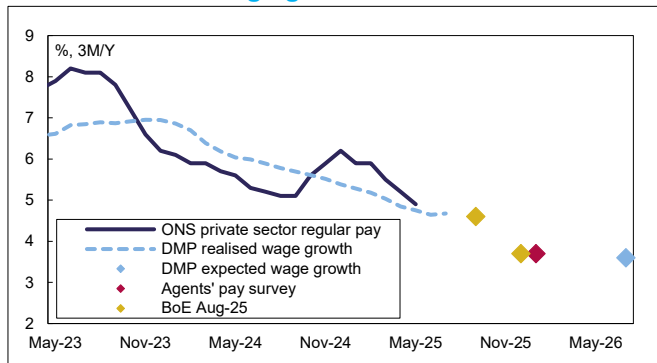
UK: Services price pressure indicator*



*Weighted share of services subcomponents with inflation rates over 1ppt above their 2012-2019 averages.

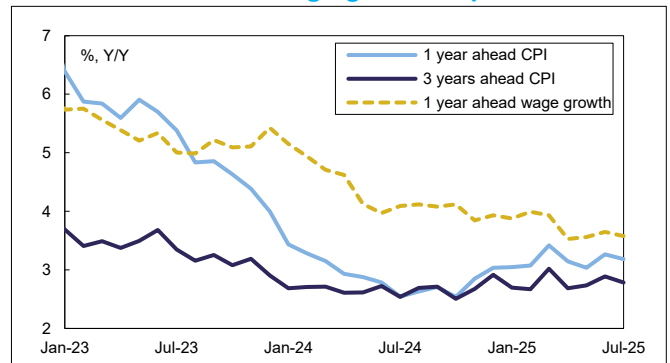
Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Measure of wage growth



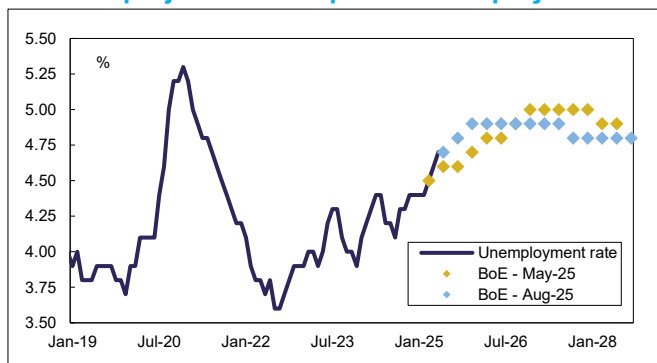
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: DMP inflation & wage growth expectations



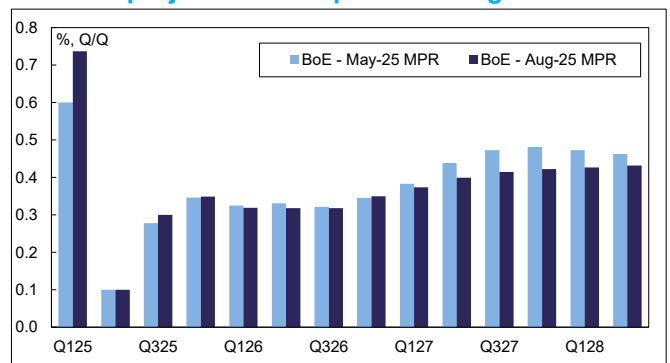
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BoE projections compared: Unemployment rate



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

UK: BoE projections compared: GDP growth



Source: BoE and Daiwa Capital Markets Europe Ltd.

Monetary Policy Report hints at a slower pace of QT from next month










Thankfully, however, the BoE might provide some modest relief for longer-dated Gilts next month, when it will make its latest annual announcement on its quantitative tightening (QT) policy. In today's Monetary Policy Report, the BoE noted that the impact of QT to date had probably been a little larger than it initially expected, increasing longer-dated yields via the Gilt term premium, albeit only by between 15-25bps. Its ready reckoners suggest that might have shaved up to ½ppt off GDP growth and ¼ppt off inflation respectively. It also recognised the recent decline in demand for long-term Gilts might mean that future QT could have a greater impact on market liquidity, yields and the economic outlook. The implication is that the pace of QT will slow next month from the reduction in its Gilt holdings of about £100bn in the 12 months to September. While the volume of bonds held by the BoE due to redeem over the coming 12 months will fall to a little less than £50bn, from £87bn in the current 12-month period, the MPC ought to be mindful of its potentially adverse impact on the activities of the DMO. As such, while it might not be willing to reduce the amount of its Gilt sales from £13bn in the current period, we do think it will reduce or even halt all sales of longer-dated bonds.

The week ahead in the UK: Q2 GDP estimates and labour market data in focus

Growth will be the main focus in the UK in the coming week, with preliminary estimates for Q2 GDP and June economic output due on Thursday. In many ways, we expect the quarterly GDP figures to mirror the broader trends observed in the [first euro area estimates](#) last week. Following outsized growth in Q1 (0.7%Q/Q) flattered by temporary factors, UK GDP is expected to have slowed markedly in Q2, which the provisional expenditure breakdown will attribute in part to a pullback in net trade and weaker fixed investment. Nonetheless, we expect growth to have been positive, and at 0.2%Q/Q just marginally above the BoE's projection (0.1%Q/Q). Indeed, the monthly GDP series has made clear the significant carry-over from Q1, with both services and construction set to add to GDP growth in Q2 despite contractions in April and May. Recovery in housing market activity, an uptick in retail sales and favourable weather should all lend themselves to a more upbeat monthly GDP reading in June, consistent with the broader improvement in the PMIs that month. Industrial output may also be due some payback in June, albeit contracting on a three-month basis.

Beyond the GDP data, and of consequence from a monetary policy perspective, Tuesday's labour market update will also garner significant attention. Indeed, amid evidence of a broader loosening in the labour market, private sector regular pay growth decelerated to a three-year low of 4.9%3M/Y in May and undershot the MPC's projection to that point. We expect a brief pause in June before further moderation over the second half of the year. But business surveys also suggest that firms continue to rein in their hiring plans, flagging the possibility of a sixth consecutive month of negative payroll growth. We also expect the unemployment rate to nudge up to a more than four-year high of 4.8% in June, marking a fourth-such increase in as many months. Meanwhile, with regards to July's activity, the coming week will also bring surveys from the RICS and the BRC, which will provide insights into activity in the housing market and retail sectors respectively at the start of Q3. The REC's jobs report will also provide a view on labour market conditions last month.
























Daiwa economic forecast

| | | 2025 | | | | 2026 | | 2025 | 2026 | 2027 |
|---------------------------|---|---------------|------|------|------|------|------|---------------|------|------|
| | | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | | | |
| GDP | | %, Q/Q | | | | | | %, Y/Y | | |
| Euro area |  | 0.6 | 0.1 | 0.1 | 0.2 | 0.2 | 0.3 | 1.2 | 0.9 | 1.3 |
| UK |  | 0.7 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 1.2 | 1.2 | 1.4 |
| Inflation, %, Y/Y | | | | | | | | | | |
| Euro area | | | | | | | | | | |
| Headline HICP |  | 2.3 | 2.0 | 2.0 | 2.3 | 1.9 | 1.9 | 2.2 | 1.8 | 1.8 |
| Core HICP |  | 2.6 | 2.4 | 2.3 | 2.4 | 2.3 | 1.7 | 2.4 | 1.8 | 1.6 |
| UK | | | | | | | | | | |
| Headline CPI |  | 2.8 | 3.5 | 3.7 | 3.3 | 2.9 | 2.2 | 3.3 | 2.3 | 1.8 |
| Core CPI |  | 3.6 | 3.7 | 3.7 | 3.4 | 3.1 | 2.3 | 3.6 | 2.4 | 1.6 |
| Monetary policy, % | | | | | | | | | | |
| ECB | | | | | | | | | | |
| Deposit Rate |  | 2.50 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 |
| Refi Rate |  | 2.65 | 2.15 | 2.15 | 2.15 | 2.15 | 2.15 | 2.15 | 2.15 | 2.15 |
| BoE | | | | | | | | | | |
| Bank Rate |  | 4.50 | 4.25 | 4.00 | 3.75 | 3.50 | 3.25 | 3.75 | 3.25 | 3.00 |

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

| Country | BST | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|---------------------------------|---|---|--------|--|--------------|
| Monday 11 August 2025 | | | | | |
| Italy |  | 09.00 Final HICP (CPI) Y/Y% | Jul | <u>1.7 (1.7)</u> | 1.8 (1.7) |
| Tuesday 12 August 2025 | | | | | |
| Germany |  | 10.00 ZEW current situation (expectations) balance | Aug | -65.0 (42.5) | -59.5 (52.7) |
| UK |  | 00.01 BRC retail monitor – like-for-like sales Y/Y% | Jul | - | 2.7 |
| |  | 07.00 Averages wages (excluding bonuses) 3M/Y% | Jun | - | 5.0 (5.0) |
| |  | 07.00 Private sector regular wages 3M/Y% | Jun | <u>4.9</u> | 4.9 |
| |  | 07.00 Unemployment rate 3M% | Jun | <u>4.8</u> | 4.7 |
| |  | 07.00 Employment 3M/3M change 000s | Jun | - | 134 |
| |  | 07.00 Payrolled employees M/M change 000s | Jul | - | -41 |
| |  | 07.00 Claimant count rate % (change 000s) | Jul | - | 4.5 (25.9) |
| Wednesday 13 August 2025 | | | | | |
| Germany |  | 07.00 Final HICP (CPI) Y/Y% | Jul | <u>1.8 (2.0)</u> | 2.0 (2.0) |
| Spain |  | 08.00 Final HICP (CPI) Y/Y% | Jul | <u>2.7 (2.7)</u> | 2.3 (2.3) |
| Thursday 14 August 2025 | | | | | |
| Euro area |  | 10.00 GDP – second estimate Q/Q% (Y/Y%) | Q2 | <u>0.1 (1.4)</u> | 0.6 (1.5) |
| |  | 10.00 Employment – first estimate Q/Q% (Y/Y%) | Q2 | - | 0.2 (0.7) |
| |  | 10.00 Industrial production M/M% (Y/Y%) | Jun | - | 1.7 (3.7) |
| France |  | 07.45 Final HICP (CPI) Y/Y% | Jul | <u>0.9 (1.0)</u> | 0.9 (1.0) |
| UK |  | 00.01 RICS house price balance % | Jul | - | -7 |
| |  | 07.00 GDP – first estimate Q/Q% (Y/Y%) | Q2 | <u>0.2 (1.0)</u> | 0.7 (1.3) |
| |  | 07.00 Monthly GDP M/M% (3M/3M%) | Jun | <u>0.2 (0.2)</u> | -0.1 (0.5) |
| |  | 07.00 Services output M/M% (3M/3M%) | Jun | - | 0.1 (0.4) |
| |  | 07.00 Industrial output M/M% (Y/Y%) | Jun | - | -0.9 (-0.3) |
| |  | 07.00 Construction output M/M% (Y/Y%) | Jun | - | -0.6 (1.2) |
| |  | 07.00 Trade (goods trade) balance £bn | Jun | - | -5.7 (-21.7) |
| |  | 09.30 Preliminary output per hour Y/Y% | Q2 | - | -0.2 |
| Friday 15 August 2025 | | | | | |
| - Nothing scheduled - | | | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions







| Country | BST | Event / Auction |
|---------------------------------|---|---|
| Monday 11 August 2025 | | |
| - Nothing scheduled - | | |
| Tuesday 12 August 2025 | | |
| UK |  | 00.01 REC, KPMG & S&P Global UK Report on Jobs for July |
| |  | 10.00 Auction: to sell £4.75bn of 4.375% 2030 bonds |
| Wednesday 13 August 2025 | | |
| Germany |  | 10.30 Auction: to sell €5bn of 2.6% 2035 bonds |
| Thursday 14 August 2025 | | |
| - Nothing scheduled - | | |
| Friday 15 August 2025 | | |
| - Nothing scheduled - | | |

*Details to be announced. Source: Bloomberg 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 |
|---------|--|--------|--------------------|--|-----------|-------------|
| Germany |  Industrial production M/M% (Y/Y%) | Jun | -1.9 (-3.6) | -0.5 (-1.0) | 1.2 (1.0) | -0.1 (-0.2) |
| |  Trade balance €bn | Jun | 14.9 | 17.3 | 18.5 | - |
| France |  Trade balance €bn | Jun | -7.6 | - | -7.8 | -7.6 |
| |  Preliminary wages Q/Q% | Q2 | 0.5 | - | 0.7 | - |
| UK |  BoE Bank Rate % | Aug | 4.00 | <u>4.00</u> | 4.25 | - |
| |  DMP 3M output price (1Y CPI) expectations Y/Y% | Jul | 3.7 (3.2) | - | 3.6 (3.3) | - |


Auctions

| Country | Auction |
|---------|--|
| France |  sold €4.580bn of 1.25% 2034 bonds at an average yield of 3.17% |
| |  sold €2.396bn of 1.25% 2036 bonds at an average yield of 3.41% |
| |  sold €2.175bn of 0.5% 2040 bonds at an average yield of 3.70% |
| |  sold €1.348bn of 4% 2055 bonds at an average yield of 4.09% |
| Spain |  sold €1.675bn of 2.4% 2028 bonds at an average yield of 2.166% |
| |  sold €1.602bn of 3.2% 2035 bonds at an average yield of 3.199% |
| |  sold €1.221bn of 3.45% 2043 bonds at an average yield of 3.758% |
| |  sold €490m of 1% 2030 inflation-linked bonds at an average yield of 0.81% |


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

| Country | BST | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|---------|---|------------------------------------|--------|--|-----------|
| France |  06.30 | ILO unemployment rate (mainland) % | Q2 | 7.5 (7.3) | 7.4 (7.2) |

Auctions and events

| | | |
|----|---|--|
| UK |  12.15 | BoE Chief Economist Pill to brief Bank's Agents on updated macroeconomic projections |
|----|---|--|

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 12 August 2025

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