Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds followed the global trend lower as the ECB left interest rates unchanged but reinforced expectations of a hike in September.
- Despite survey signals of weak UK manufacturing output and orders and declining capex intentions, Gilts made gains.
- A deluge of survey indicators on Friday will include the flash July PMIs, UK and German consumer confidence, and UK business expectations of wages and prices.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	2.897	0.051
OBL 2.9 10/31	2.989	0.043
DBR 3 08/36	3.213	0.035
UKT 4⅜ 03/28	4.499	0.072
UKT 4⅛ 03/31	4.684	0.070
UKT 4¾ 10/35	5.117	0.076

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

Euro area

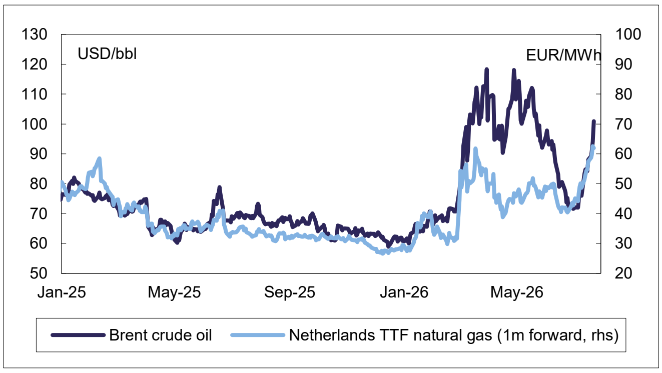
ECB leaves rates & guidance unchanged but reinforces expectations that September hike is coming

After the ECB tightened policy last month and President Lagarde subsequently suggested there was no need to respond “forcefully” to the energy shock, the Governing Council predictably left rates unchanged today. Also as expected, the Governing Council’s policy statement again eschewed forward guidance, insisting that decisions will remain data dependent and taken on a meeting-by-meeting basis. But the statement and Lagarde’s press conference underscored the likelihood that, unless conditions in the Middle East stabilise and wholesale energy prices soon fall significantly, rates are highly likely to be hiked at the next policy meeting in September. While Lagarde confirmed that the decision was unanimous, she acknowledged that some members questioned whether a hike today might already have been appropriate. She distanced herself from her assessment made in Sintra last month that the upside risks to inflation and downside risks to growth had become “more broadly balanced”. Indeed, she judged that the ECB’s ‘milder’ projection scenario, which was previously the only one considered by the policymakers to be consistent with an eventual drop in inflation back below the 2% target by end-2028, was now “quite unlikely”. And the statement noted that "The outlook for energy prices... currently stands close to the baseline of the June Eurosystem staff projections" which had assumed that up to three hikes would eventually be required to get inflation back to target. Moreover, Lagarde added that today’s news of the escalation of the conflict via attacks by Houthis on ships in the Red Sea – which plays a far greater role in facilitating trade flows in and out of the euro area than the Strait of Hormuz – was “alarming” but had come too late to be taken into consideration in today’s policy decision. And not least given the low level of inventories, she flagged particular concerns about the outlook for prices of natural gas.

Still no evidence of second-round effects but Lagarde appears content with market pricing of rates

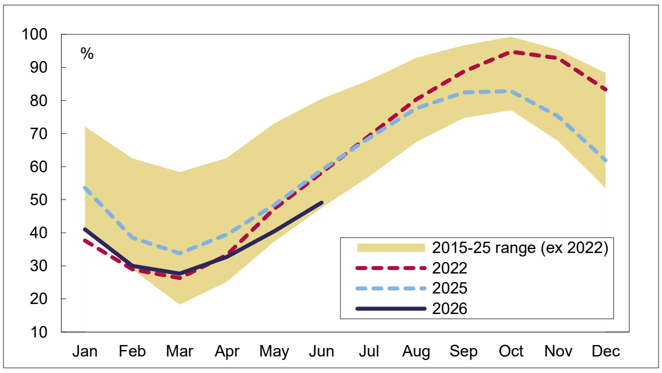
Of course, the news for the ECB has not been uniformly bad over recent weeks. For example, Lagarde was able to take comfort that inflation in June had undershot the ECB’s expectation while economic activity appeared to have picked up. And she confirmed that the policymakers still saw no evidence yet in data or surveys of second-round effects via wages. So, despite today’s escalation of the Middle East conflict to the Red Sea, the policymakers will likely still agree that a “forceful” policy response is unnecessary. Nevertheless, the statement reminded that "the full inflationary impact of the energy shock has yet to play out". And echoing hawkish signals used in the past to imply that a rate hike would likely come at the next policy meeting, it added that the Governing Council is “closely monitoring" the intensity and duration of the shock and its indirect and second-round effects. Moreover, as Lagarde asserted that the ECB’s reaction function is now well understood by the markets, she intimated that current market pricing of up to three further rate hikes is not unreasonable. Certainly, we would not be surprised if the Governing Council also raised rates in December. And further tightening next year cannot be ruled out, but probably only if the conflict drags on and energy prices remain higher for longer.

Euro area: Brent crude oil & natural gas prices



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Europe: Natural gas storage levels

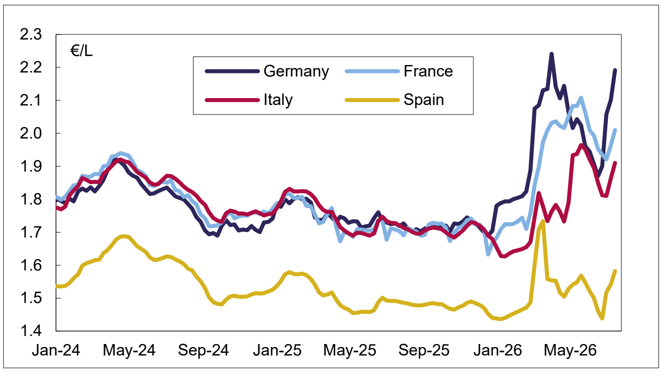


Source: Macrobond, GIE and Daiwa Capital Markets Europe Ltd.

Consumer confidence up for third successive month, new car registrations buoyant

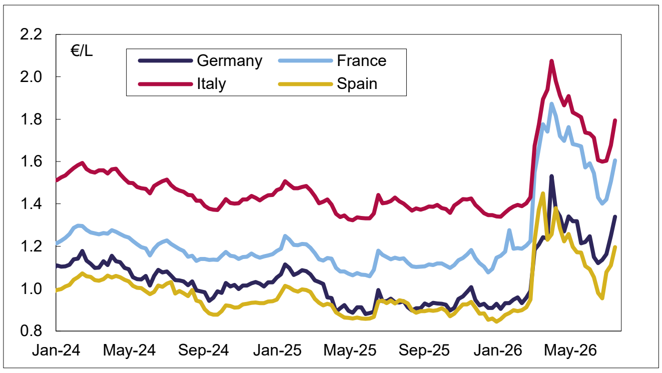
The Governing Council's assessment that the economy remains resilient was supported by today's flash Commission consumer confidence index for July. This suggested that households were the least downbeat since February as it rose for a third successive month and by a larger than expected 1.8pts to -15.9. While still one standard deviation below its long-run average, the index nevertheless sat more than 3pts above its Q2 average. The equivalent national survey indicators released so far paint a similarly encouraging picture. For example, Belgian consumer confidence also improved to its strongest level since February despite lingering concerns about labour market conditions. And Dutch households reported a greater readiness to make major purchases. The June Commission survey had already suggested that consumers across the region, but particularly in Spain and Portugal, expected spend more on big-ticket items over the coming 12 months. And today's car registrations figures suggested that spending held up well last month, with sales accelerating 12.7%Y/Y, the most since April 2024. This left new car registrations up 7.0%3M/Y in Q2, almost 3ppts above the pace of growth in Q1 and the firmest since Q323. Stronger growth was reported across most member states. And sales of battery electric vehicles (BEVs) remained a key support, with such registrations rising 67%Y/Y in June and by more than 50%3M/Y in Q2. This strength in part reflects government incentives – particularly in Germany and France where roughly half of new EVs are registered in the euro area – as well as cheaper cars and heightened interest in the face of higher oil prices. With increased demand also for plug-ins and hybrid EVs, the combined share of petrol and diesel cars fell close to one quarter, down 10ppts from a year ago and almost 50% in mid-2024.

Euro area member states: Weekly petrol prices



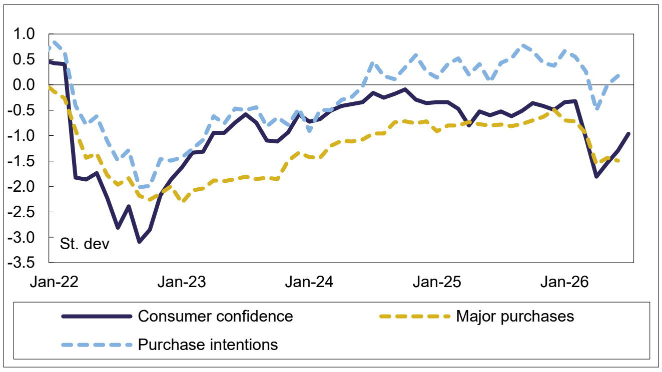
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Weekly heating oil prices



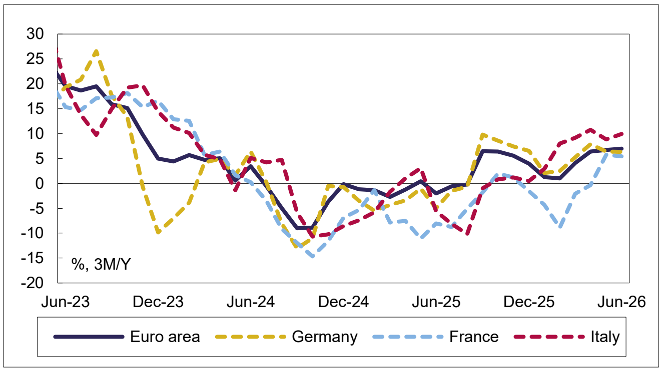
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence indices*



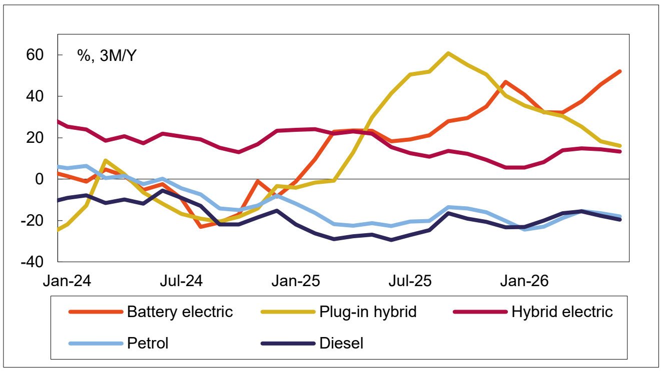
**July flash estimate for headline index.*
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: New car registrations



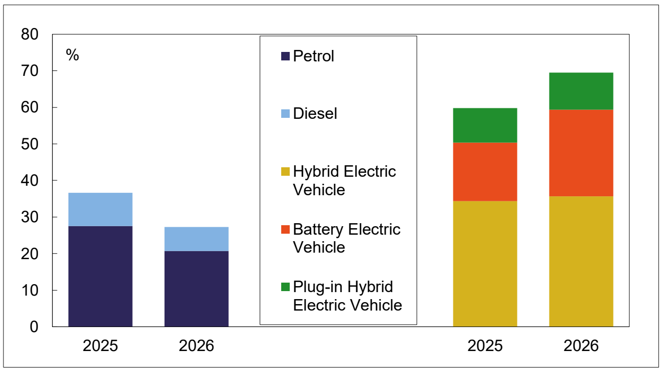
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: New car registrations by power



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Share of new car registrations by power*



**June. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

The day ahead in the euro area

July's flash PMIs will be the most significant euro area data for markets to digest on Friday. The PMIs pointed to further stabilisation in June as cost pressures receded. But, at just 50.0, the composite output PMI was merely consistent with stagnation. The odds of a similarly tepid signal at the start of Q3 seem fair, considering that reescalation in the Gulf is bound to have scuppered some of last month's improvement. But whether the latest pressure on energy prices has merely prolonged or amplified existing pressures will be of particular interest. For what it's worth, today's INSEE survey failed to detect much meaningful upside pressure on price expectations, but flagged a subtle, broad-based improvement in business conditions. Contrasting expectations that the boost to manufacturing might be starting to wane, output and demand in that sector reportedly strengthened. Overall conditions, however, were still judged to be worse than in Q1 and consistent with a subdued recovery. Meanwhile, the GfK's latest consumer survey for Germany will provide some additional context to today's flash Commission consumer confidence reading. Given events in the Middle East and the sharp increase in fuel prices this month following the expiry of a temporary tax cut, German consumer confidence (which is presented as a forecast for August) might have remained more subdued in contrast to the improvement in the Commission's euro area indicator. The end of the week will also bring a couple of ECB surveys, including June's consumer expectations survey. Policymakers will be cautious to draw too much comfort from June's survey. Indeed, while year-ahead expectations are likely to have softened last month, the recent increase in energy prices will skew the risks to July's release back to the upside.

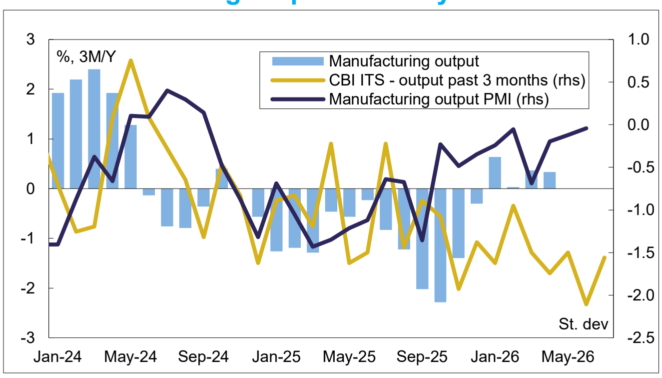
UK

The day ahead in the UK

Ahead of the BoE's monetary policy decision in the coming week, Friday will bring several UK data releases of importance. In addition to the flash PMIs, the June retail sales figures, consumer confidence indices and the BoE's Decision Maker Panel survey will be in focus. Indeed, given the latest pressure in energy markets, the DMP is bound to remain especially pertinent. The stability of forward-looking price- and wage-setting indicators in recent months provided a key source of reassurance to some policymakers that the initial oil shock was unlikely to generate significant second-round effects. But the risks to inflation expectations are undoubtably now skewed towards the upside. And to what extent, if any, that might bear on future wage expectations will be closely watched. At the very least, the PMIs are likely to show that price pressures remain significant too. Today's CBI industrial trends survey offered tentative encouragement to the contrary, however. Against a backdrop of still subdued demand – which has contrasted noticeably the resilience suggested by both the PMIs and hard data since the shock – the net balance of firms expecting to raise prices in the next three months fell to an eight-month low (11%).

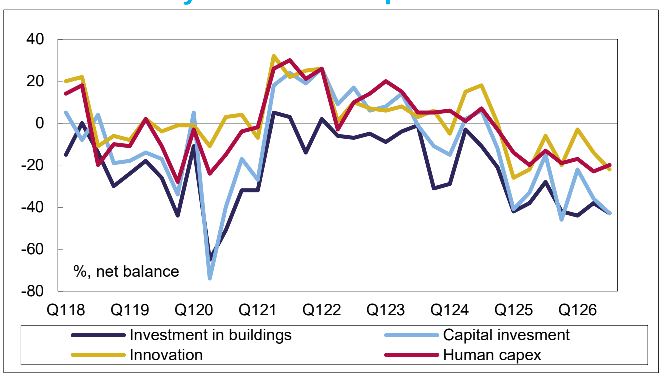
Given ongoing declines in manufacturing output volumes and orders, the CBI also reported a pullback in capex intentions this quarter. So, while hospitality might have benefitted from England's ill-fated World Cup run and prolonged heatwaves, we expect another subdued PMI reading, broadly consistent with stagnation at the start of Q3. Greater demand for football shirts, paddling pools, electric fans and, potentially, a boost from cheaper fuel might have supported June's retail sales figures. Some surveys, however, suggest that such a boost will be relatively muted, with persistently intense heat hurting footfall but benefitting online retailers. Consumer confidence also remained subdued in June, albeit that survey was conducted prior to the announcement of the doomed US-Iran agreement. We expect another broadly subdued account this month but note that anticipation of a change in Prime Minister and sampling before the US-Iran peace deteriorated pose upside risks to the headline reading.

UK: Manufacturing output & survey indicators



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

UK: CBI survey – industrial capex intentions



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

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		ECB Deposit (Refinancing) Rate %	Jul	**2.25 (2.40)**	*2.25 (2.50)*	2.25 (2.50)	-
		Preliminary Commission consumer confidence indicator	Jul	**-15.9**	-17.0	-17.7	-
		New car registrations Y/Y%	Jun	**12.7**	-	3.3	-
France		INSEE business (manufacturing) confidence indicator	Jul	**97 (101)**	95 (101)	94 (100)	95 (-)
		INSEE production outlook (own-company) indicator	Jul	**-10 (-1)**	-14 (4)	-15 (2)	- (3)
UK		CBI industrial trends – total orders (selling prices) net balance %	Jul	**-45 (11)**	-	-45 (22)	-
		CBI industrial trends survey – business optimism net balance %	Q3	**-36**	-	-65	-

Auctions

Country		Auction
UK		sold £500mn of 4% 2063 bonds at an average yield of 5.722%

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	Preliminary services (manufacturing) PMI	Jul	49.8 (51.5)	49.4 (51.4)
		09.00	Preliminary composite PMI	Jul	50.2	50.0
		09.00	ECB consumer expectations survey – 1Y (3Y) -ahead CPI Y/Y%	Jun	3.2 (2.9)	3.5 (2.9)
Germany		07.00	GfK consumer confidence indicator	Aug	-28.5	-29.2
		08.30	Preliminary services (manufacturing) PMI	Jul	49.0 (50.5)	48.6 (50.3)
		08.30	Preliminary composite PMI	Jul	49.7	49.5
France		08.15	Preliminary services (manufacturing) PMI	Jul	47.5 (51.0)	46.8 (51.2)
		08.15	Preliminary composite PMI	Jul	47.8	47.2
Spain		08.00	PPI Y/Y%	Jun	-	10.5
UK		00.01	GfK consumer confidence indicator	Jul	-22	-23
		07.00	Retail sales – incl. auto fuel M/M% (Y/Y%)	Jun	-0.3 (2.4)	1.2 (3.2)
		07.00	Retail sales – excl. auto fuel M/M% (Y/Y%)	Jun	-0.5 (3.2)	1.2 (4.6)
		09.30	Preliminary services (manufacturing) PMI	Jul	49.4 (52.0)	48.8 (52.5)
		09.30	Preliminary composite PMI	Jul	49.8	49.3
		09.30	DMP – 3M output price (1Y CPI) expectations Y/Y%	Jul	4.0 (3.2)	4.1 (3.3)

Auctions and events

Euro area		09.00	ECB to publish quarterly Survey of Professional Forecasters (SPF)
		16.30	ECB Chief Economist Lane in conversation on 'Europe's Economic Future', Donegal
UK		09.30	BoE to publish Agents' summary of business conditions for July 2026

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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