

Euro wrap-up

Overview

- Bunds made modest losses while Spanish GDP growth unexpectedly accelerated in Q2.
- Gilts followed USTs higher even as a UK survey signalled a further pickup in food inflation in July and ongoing recovery in mortgage lending.
- Wednesday will bring Q2 GDP estimates from the euro area, Germany, France and Italy, as well as the July Commission survey results and flash inflation from Spain.

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Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.926	+0.014
OBL 2.2 10/30	2.274	+0.010
DBR 2.6 08/35	2.688	+0.002
UKT 3¼ 03/27	3.867	-0.032
UKT 4% 03/30	4.044	-0.026
UKT 4½ 03/35	4.610	-0.034

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

Euro area

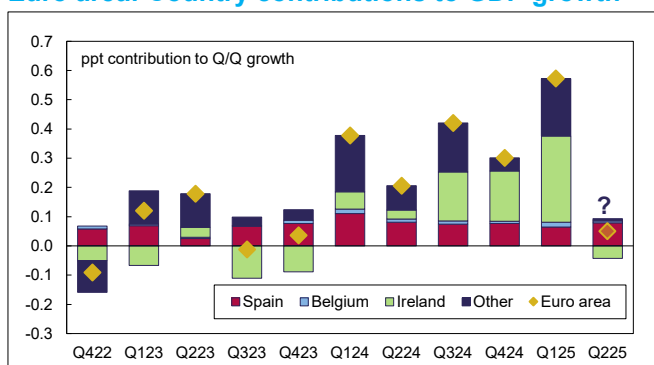
Euro area GDP likely avoided contraction in Q2 due to strong growth in Spain

After the front-running of higher US tariffs led the acceleration in GDP in Q1 (0.6%Q/Q) and amid ongoing trade and geopolitical uncertainties, economic growth undoubtedly slowed sharply in Q2. But judging from the first estimates of Q2 GDP from Spain, Ireland and Belgium, activity in the euro area likely avoided a contraction last quarter. Admittedly, Irish GDP fell for the first time in six quarters, by 1.0%Q/Q in Q2 amid a pullback in production and shipments in certain industries that had significantly frontloaded earlier in the year. This decline was smaller than anticipated, reversing merely a fraction of the outsized increase in Q1 (7.4%Q/Q), to leave output still up an impressive 12.5%Y/Y. Belgium GDP growth also halved in Q2 (0.2%Q/Q), nevertheless remaining positive thanks to growth in services and construction. And today's figures from Spain were stronger than expected, with growth accelerating 0.1ppt to 0.7%Q/Q. As a result, Spanish GDP rose 2.8%Y/Y – above potential – and 8.8% above the pre-pandemic level in Q419. Moreover, the expenditure breakdown suggested that Spanish growth was broad based. Private consumption growth (0.8%Q/Q) was again supported by solid growth in employment and pay. All major subcomponents of fixed investment grew, with the cumulative increase since Q324 of more than 7% benefitting from the ongoing moderation in borrowing costs and support from NGEU funds. But, despite support from tourism, net trade was a modest drag as imports outpaced exports. Overall, those three countries will together contribute 0.04ppt to the regional figure. With a rebound also expected in Portugal, we maintain our own forecast that euro area GDP rose 0.1%Q/Q in Q2, albeit a marked slowdown from Q1 (0.6%Q/Q), with risks skewed to the downside not least due to an expected modest contraction in Germany.

The day ahead in the euro area

The highlight of Wednesday's euro area dataflow will be the aforementioned first estimates of Q2 GDP growth for the aggregate euro area and remaining member states. These are likely to show that euro area GDP growth slowed sharply in Q2, not least due to a likely drag from net trade. But we note that economic activity has shown surprising resilience in recent months, with industrial production, construction activity and retail sales all trending above their Q1 levels through May. So, we still expect GDP growth to have been positive in Q1, if only 0.1%Q/Q. With respect to the member states, we expect German GDP to be most susceptible to an export-led pullback after the surge in Q1, which had supported growth of 0.4%Q/Q, a ten-quarter high. Moreover, construction output and retail sales – with tomorrow's release for June bound to show a first quarterly drop in five – have been particularly weak in the first two months of Q2, supporting our prediction for modest contraction (-0.1%Q/Q) in Q2. Meanwhile, the dampening effects of broader uncertainty are likely to have weighed on demand in France (0.0%Q/Q) and Italy (0.1%Q/Q) too. Like today's Spanish figures, tomorrow's French release will also include a breakdown by expenditure components.

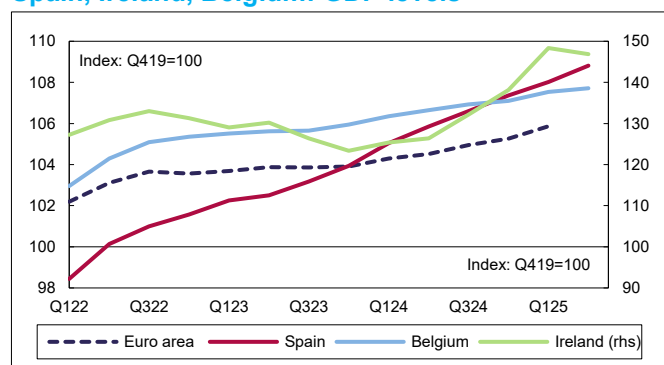
Euro area: Country contributions to GDP growth*



*Euro area figure for Q225 is Daiwa's forecast.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

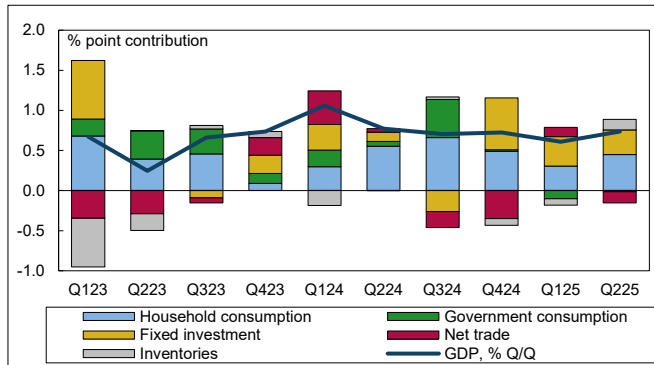
Spain, Ireland, Belgium: GDP levels



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

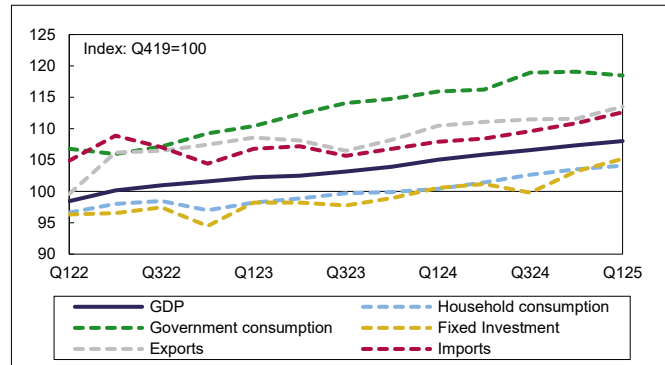
Looking ahead to Q3, July's Commission economic sentiment indicators will provide a cross-check to the improvement noted by last week's flash euro area PMIs. Meanwhile, contrasting our expectations for a moderation in Friday's flash euro area inflation release, tomorrow's preliminary Spanish estimates are expected to report a step-up in headline inflation in July - indeed, the Bloomberg survey consensus expects headline HICP to rise 0.3ppt to a five-month high of 2.6%Y/Y. But that increase should be principally driven by unfavourable base effects relating to energy and food, while core components are expected to be better behaved. Meanwhile, the ECB's post-Governing Council update of their forward-looking wage tracker tool will also be expected to reaffirm their predictions for a further slowdown in wage growth over the second half of the year.

Spain: Contributions to GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Spain: GDP & expenditure components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

BRC survey flags further uptick in food inflation in July

While services inflation in the UK has moderated a touch more than the BoE expected in the May MPR projections, headline inflation in June (3.6%Y/Y) was tracking 0.2ppt above the Bank's monthly profile. This in part reflected the Bank's underestimation of the recent pickup in food inflation, which rose to 4.5%Y/Y in June, 1.1ppts higher than the BoE's forecast. With respect to food inflation, the BRC's shop price index has proved to be a decent indicator for its evolution, and today's release signalled the likelihood of a further uptick in July. Indeed, the BRC's measure rose 0.3ppt to a 17-month high of 4.0%Y/Y. Within that, fresh food prices reassuringly showed signs of stabilisation to leave the annual rate unchanged for a first month in four (3.2%Y/Y). But inflation of 'ambient' foods accelerated to 5.0%Y/Y, up 0.8ppt from June and 1.8ppts cumulatively since May. Consequently, the overall BRC's shop price index was slightly firmer than expected at the start of Q3, up 0.3ppt to 0.7%Y/Y, a 15-month high. In addition to hotter food prices, that reflected a potential absence of more meaningful discounts across non-food categories typically observed in July. Indeed, non-food shop prices rose 0.1%M/M this month compared with a historical average decline of 0.5%M/M, due in part to a sizable jump in prices of electrical goods (1.1%M/M). While this took the annual rate up to a 12-month high, at -1.1%Y/Y it remained firmly in negative territory, with ongoing deflation across the furniture, clothing and DIY segments. So, overall, today's release suggests that core goods inflation in July likely remained relatively muted.

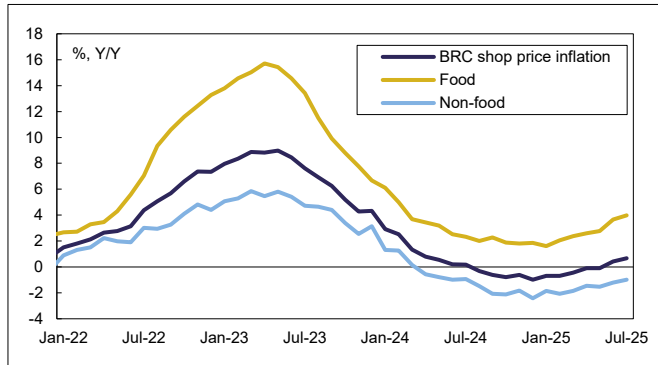
Mortgage lending and approvals continue to recover after previous Stamp Duty distortion

Today's monetary figures suggested that the recent slowdown in the housing market related to April's change in Stamp Duty thresholds will prove temporary. In particular, the net increase in mortgage lending in June of £5.3bn was more than double the Bloomberg survey consensus and the second-strongest in almost three years. Given the net repayment in April, the cumulative increase in the three months to June (£7.0bn) was still the softest in 11 months and significantly weaker than in Q1 (£21bn). Nevertheless, there was also a pickup in mortgage approvals in June, to 64.2k, a four-month high, pointing to a further moderate recovery in mortgage lending over coming months as the impact of the stamp duty distortion fades. But while new borrowers continue to benefit from lower interest rates, we note that the average rate on the outstanding stock of mortgages rose marginally further (to 3.89%) as homeowners remortgaged at higher rates than expiring fixes. And while almost 30% of mortgage holders are expected to refinance onto lower rates between Q225 and Q228, roughly 40% will be refinancing onto higher rates. While the monthly increase in household deposits (£7.8bn) was the largest since January, there was also a modest recovery in consumer credit growth in June, with the monthly net increase (£1.4bn) in line with the pre-pandemic five-year average. Beyond the household sector, however, there was a drop in bank lending to businesses in June (-£2.5bn). But this followed the strongest monthly increase in five years in May. And encouragingly, lending to SMEs rose for a third consecutive month to take the annual rate into positive territory (0.3%Y/Y) for the first time in almost four years.

The day ahead in the UK

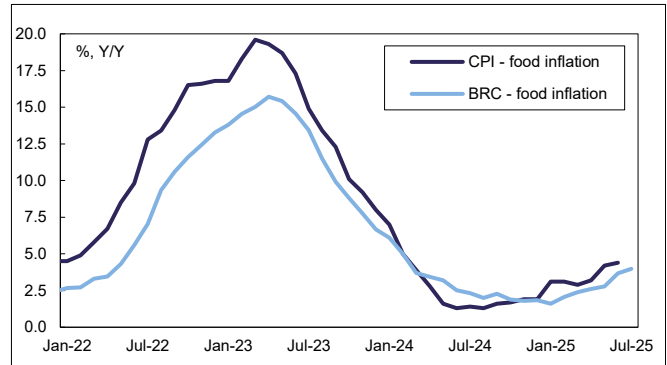
With no top-tier data releases scheduled for Wednesday, it should be a quiet day ahead for economic news in the UK.

UK: BRC shop price inflation



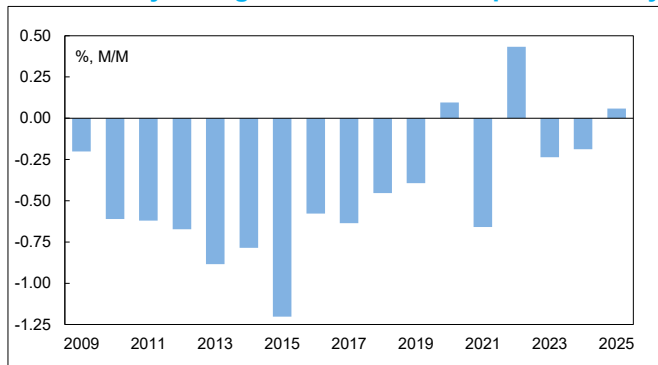
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: CPI & BRC food price inflation



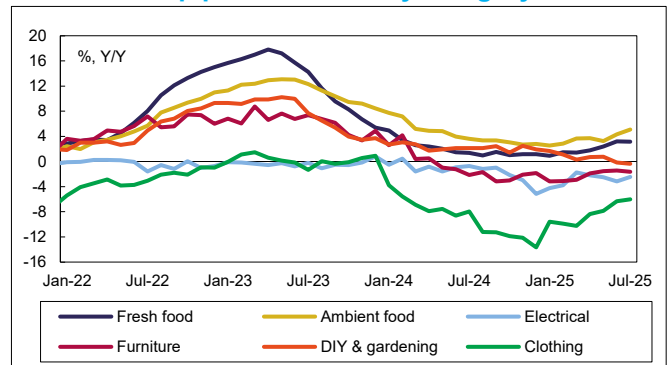
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Monthly change in BRC non-food prices in July



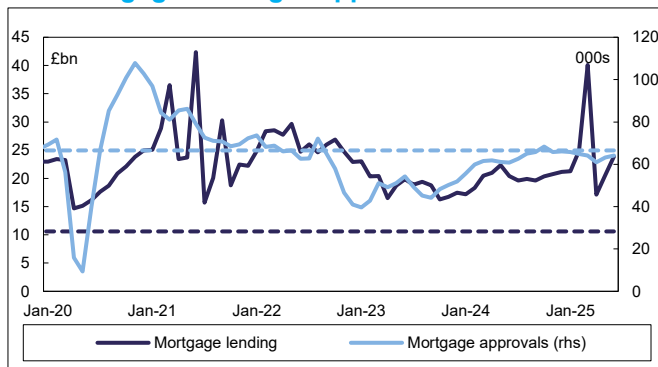
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BRC shop price inflation by category



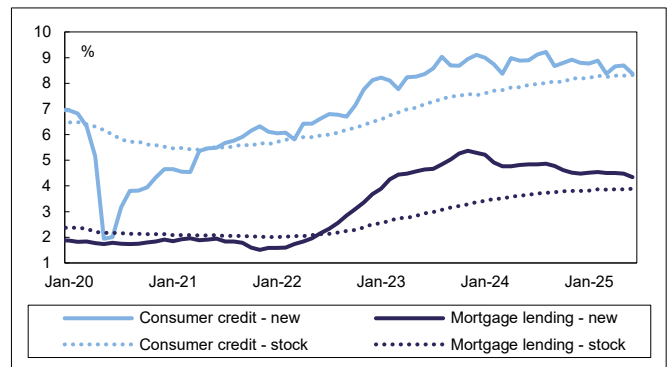
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending & approvals*



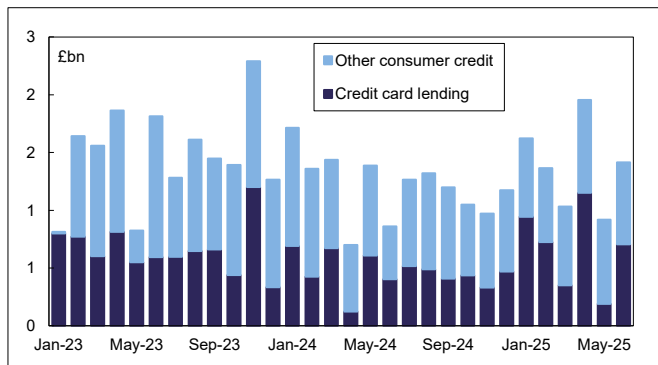
*Dashed lines show pre-pandemic 5Y averages.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Interest rates on loans to households



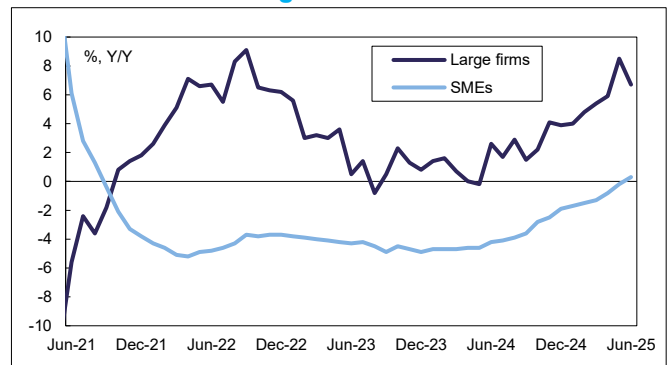
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Consumer credit



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Growth of lending to businesses










Source: 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	 ECB consumer expectations survey – 1Y (3Y) CPI Y/Y%	Jun	2.6 (2.4)	- (2.4)	2.8 (2.4)	-
France	 Total jobseekers mn	Q2	3.00	-	3.19	-
Spain	 GDP – first estimate Q/Q% (Y/Y%)	Q2	0.7 (2.8)	<u>0.6 (2.6)</u>	0.6 (2.8)	-
	 Retail sales Y/Y%	Jun	6.2	-	4.8	5.0
UK	 Net consumer credit £bn (Y/Y%)	Jun	1.4 (6.7)	1.2 (-)	0.9 (6.5)	-
	 Net mortgage lending £bn (mortgage approvals 000s)	Jun	5.3 (64.2)	2.4 (63.1)	2.1 (63.0)	2.2 (63.3)
	 BRC shop price index Y/Y%	Jul	0.7	-	0.4	-


Auctions

Country	Auction
Germany	 sold €3.409bn of 2.2% 2030 bonds at an average yield of 2.28%
UK	 sold £5bn of 4.375% 2028 bonds at an average yield of 3.941%

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
UK	 CBI distributive trades survey – reported retail sales balance %	Jul	-34	-	-46	-












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	 10.00	GDP – first estimate Q/Q% (Y/Y%)	Q2	<u>0.1 (1.4)</u>	0.6 (1.5)
	 10.00	Commission economic sentiment indicator	Jul	94.5	94.0
	 10.00	Commission services (industrial) confidence indicator	Jul	3.2 (-11.0)	2.9 (-12.0)
	 10.00	Final Commission consumer confidence indicator	Jul	<u>-14.7</u>	15.3
Germany	 07.00	Retail sales M/M% (Y/Y%)	Jun	-	-0.9 (4.5)
	 09.00	GDP – first estimate Q/Q% (Y/Y%)	Q2	<u>-0.1 (0.2)</u>	0.4 (-0.2)
France	 06.30	GDP – first estimate Q/Q% (Y/Y%)	Q2	<u>0.0 (0.4)</u>	0.1 (0.6)
	 06.30	Consumer spending M/M% (Y/Y%)	Jun	-0.3 (0.0)	0.2 (-0.5)
Italy	 09.00	GDP – first estimate Q/Q% (Y/Y%)	Q2	<u>0.1 (0.5)</u>	0.3 (0.7)
	 10.00	Hourly wages M/M% (Y/Y%)	Q2	-	0.4 (4.0)
Spain	 08.00	Preliminary HICP (CPI) Y/Y%	Jul	2.6 (2.4)	2.3 (2.3)

Auctions and events

Euro area	 09.00	ECB to publish updated wage tracker indicators
Italy	 10.00	Auction: to sell €1.5bn of 1.35% 2030 bonds
	 10.00	Auction: to sell €2bn of 2.7% 2030 bonds
	 10.00	Auction: to sell €3.5bn of 3.6% 2035 bonds
	 10.00	Auction: to sell €2bn of 2034 floating bonds
UK	 10.00	Auction: to sell £300m of 3.75% 2052 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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