

Euro wrap-up

Overview

- Shorter-dated Bunds made modest losses as euro area Q2 GDP beat expectations, the Commission economic sentiment index pointed to a pick up in growth in Q3 and Spanish inflation in July surprised to the upside.
- Gilts made gains on a quiet day for UK economic news.
- Thursday will bring flash July inflation estimates from Germany, France and Italy, as well as euro area unemployment figures for June.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 1.9 09/27 | 1.947 | +0.012 |
| OBL 2.2 10/30 | 2.292 | +0.003 |
| DBR 2.6 08/35 | 2.703 | -0.003 |
| UKT 3¾ 03/27 | 3.870 | -0.016 |
| UKT 4¾ 03/30 | 4.037 | -0.026 |
| UKT 4½ 03/35 | 4.602 | -0.030 |

*Change from close as at 5.00pm BST.
Source: Bloomberg

Euro area

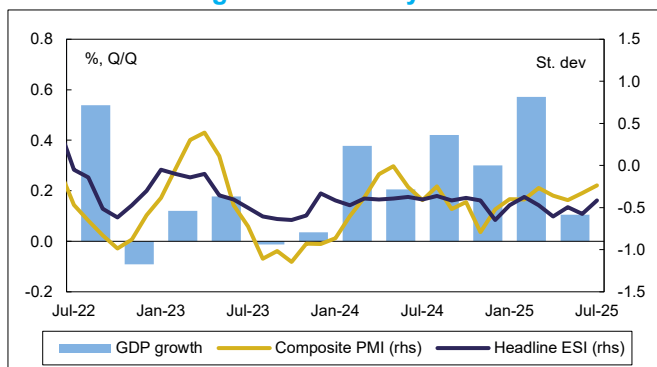
Euro area GDP up again in Q2 despite modest dips in Germany & Italy

In line with our expectation but slightly stronger than the Bloomberg consensus forecast, euro area GDP expanded for a sixth successive quarter in Q2, edging up 0.1%Q/Q despite the tariff-related uncertainty that persisted throughout the period. Inevitably, that marked a significant slowdown from the 11-quarter high of 0.6%Q/Q in Q1, which benefited from front-loading of goods shipments to the US. But the moderation in the annual rate was minimal, down just 0.1ppt to 1.4%Y/Y, a pace likely above the euro area's potential rate. As over recent quarters, there was significant variation among the member states in Q2. The performances of the German and Italian economies were similar, however, with GDP in both countries contracting 0.1%Q/Q following growth of 0.3%Q/Q the prior quarter to be up just 0.4%Y/Y. [Ireland](#) (-1.0%Q/Q, reported Monday) was the only other member state to report negative growth in Q2. In contrast, French growth significantly beat expectations, accelerating 0.2ppt to 0.3%Q/Q, the best in three quarters. Alongside the pickup in growth in [Spain](#) (0.7%Q/Q, reported yesterday), Portuguese GDP rebounded vigorously (0.6%Q/Q) after a drop in Q1. And the economies of several other member states, including Belgium (0.2%Q/Q), the Netherlands and Austria (both 0.1%Q/Q), also continued to expand. Overall, Spain and France made the largest contributions to euro area growth in Q2 while Ireland subtracted most.

Growth likely led by household spending & inventories while net trade & fixed capex subtracted

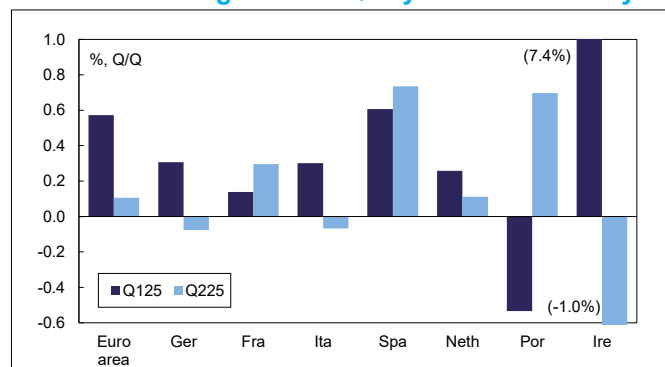
As usual, there was no detail published with the initial euro area GDP estimate. However, the limited information from the member states predictably suggested that net trade subtracted from growth in Q2 having added 0.2ppt in Q1. Indeed, that was the case in France and Spain, which were the only large member states to publish expenditure figures, while ISTAT reported that net exports also made a negative contribution in Italy. Moreover, after it grew in Q1 by the most in more than three years, capex also likely suffered payback to subtract from euro area GDP in Q2. Certainly, despite rising in Spain, fixed investment subtracted from growth in France. And, according to Destatis, it also declined in Germany, where capex on machinery, equipment and construction fell back after two firm quarters. In contrast, inventories likely added to euro area growth in Q2, making a very significant contribution (+0.5ppt) in France for a second successive quarter and adding to the expansion in Spain. Most reassuringly, private consumption appears to have grown in the euro area for a tenth successive quarter in Q2. Indeed, its expansion in France and Spain was confirmed in the initial member state data. And Destatis's assertion that German household spending grew for a fourth successive quarter was reinforced by surprisingly strong preliminary retail sales figures for June (1.0%M/M and 0.3%3M/3M), which were also published today.

Euro area: GDP growth & survey indicators



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

Euro area: GDP growth in Q2 by selected country



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

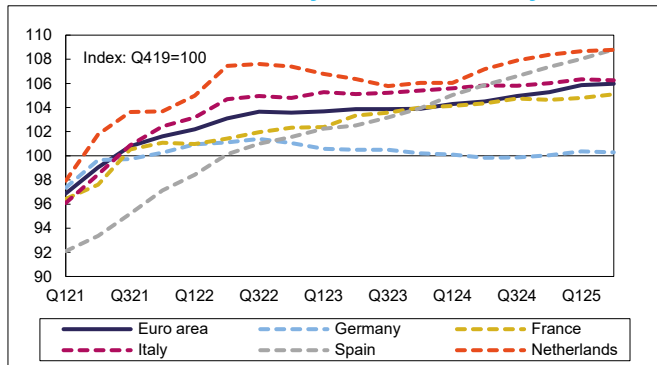
Commission survey points to improvement in economic conditions at start of Q3

Like the flash July PMIs, today's Commission survey suggested that economic conditions improved somewhat at the start of Q3. Indeed, the headline Economic Sentiment Indicator (ESI) rose a larger-than-expected 1.6pts in July to 95.8, a five-month high. Admittedly, like the composite PMI, that left the ESI still some way below the long-run average. But it was nevertheless suggestive of a pickup in euro area economic growth this quarter. The improvement in the Commission survey in July was also relatively broad-based. While manufacturers suggested that output had recently been a little weaker than expected and judged order books still to be disappointing, they were nevertheless the most upbeat about the production outlook for more than two years. Optimism was particularly notable among German manufacturers, likely benefiting from the government's tax incentives and infrastructure spending package. Meanwhile, firms in the services sector reported a recent pickup in demand, particularly in the hospitality, real estate and telecommunications subsectors. Retailers were also more upbeat, revising up their expectations of future sales amid an improvement in consumer confidence and signals of greater willingness among households to make major purchases. And while construction firms were somewhat less upbeat than in June, the respective sentiment index was still the second highest since end-2023.

Improvement widespread with ongoing outperformance in Southern Europe

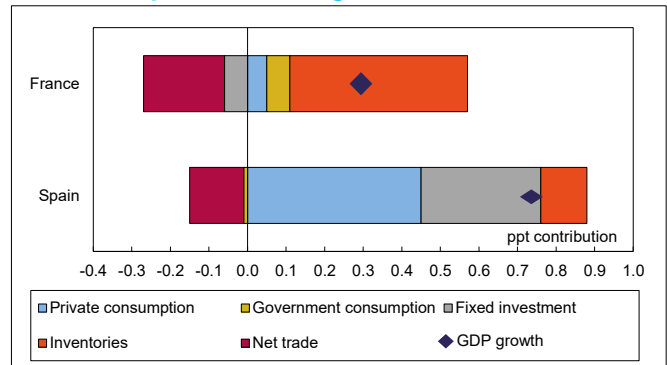
After a widespread deterioration in June, economic conditions were judged to have improved in July in each of the four largest member states. Reassuringly perhaps, the German ESI (92) rose to the highest level in a year to maintain expectations of a return to growth this quarter. But like in France, it remained some 8% below the long-run average, suggestive of a continued sub-potential rate of expansion. Conditions in Italy were judged to be the best in five months and broadly in line with the (admittedly lacklustre) long-run average. Most notably, however, the elevated ESIs in Spain (104.3), Portugal (106.6) and Greece (109.1) point to continued solid economic growth in the remainder of Southern Europe this quarter. Overall, the ESIs and PMIs point to a modest pickup in the pace of expansion of euro area GDP in Q3 to 0.2%Q/Q. Alongside that slightly firmer growth momentum, the Commission survey also suggested an improvement in firms' willingness to recruit and retain staff, implying that the unemployment rate should remain close to its series low. And with the survey's measure of consumer price expectations up to the second highest level in 2½ years, today's resilient GDP data and more sanguine Commission survey results – as well as the further weakening of the euro exchange rate – increase the likelihood that the ECB's rate-cutting cycle has now come to an end.

Euro area: GDP levels by selected country



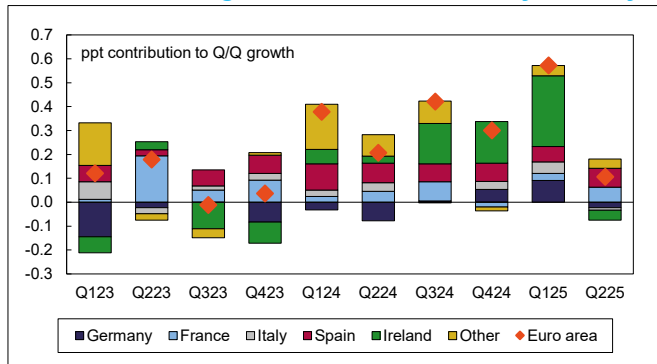
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France & Spain: Q2 GDP growth & contributions



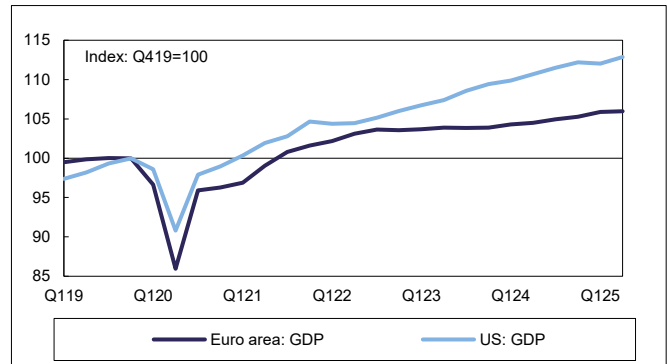
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & contribution by country



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area & US: GDP levels

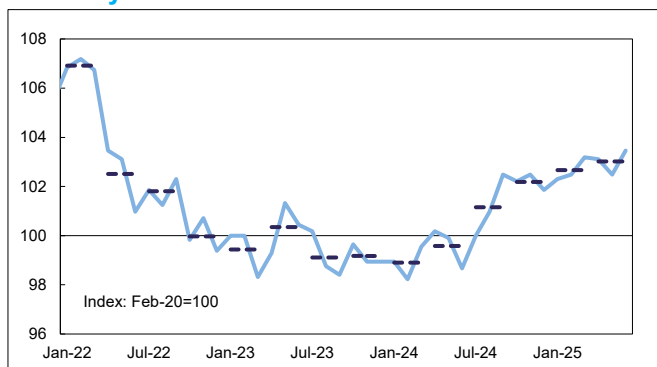


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Spanish inflation surprises to upside due to higher energy prices

Today's flash Spanish inflation figures for July also surprised to the upside, with the headline EU-harmonised HICP and national CPI rates both rising 0.4ppt to 2.7%Y/Y, a five-month high. The limited detail provided by INE suggested the uptick principally related to increased electricity prices and to a lesser extent higher auto fuel prices. But when excluding energy and non-processed foods, the monthly decline in prices of core items (-0.2%M/M) was softer than the norm for this month (-0.8%M/M). So, the annual core CPI rate edged slightly higher to 2.3%Y/Y. We suspect the upside impulse in part relates to the conclusion on 30 June of the public transport subsidies provided by the government since the energy crisis. In contrast, however, today's flash Belgian data were well-behaved. The national measure of core inflation in Belgian moderated 0.2ppt to 2.4%Y/Y in July, with services inflation easing further despite upwards price pressures on tourism-related categories. And the headline Belgian HICP inflation rate fell 0.3ppt to 2.6%Y/Y, the softest since January 2024. With the flash inflation estimates from Germany, France and Italy also expected to moderate, we maintain our view that euro area inflation will ease slightly below the 2% target this month. And despite the ongoing resilience of the labour market, the ECB's updated wage tracker – also published today – pointed to a continued moderation in pay growth through the second half of the year back to rates that should be consistent with sustaining the 2% inflation target over the medium term.

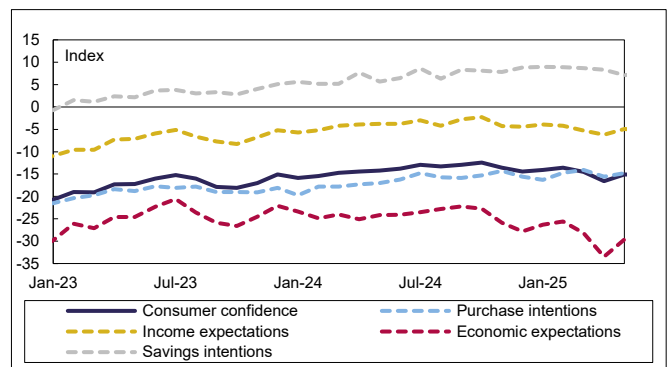
Germany: Retail sales volumes*



*Dashed lines represent quarterly average.

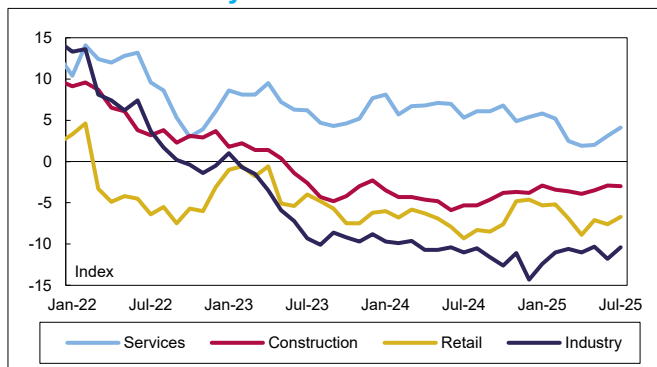
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence



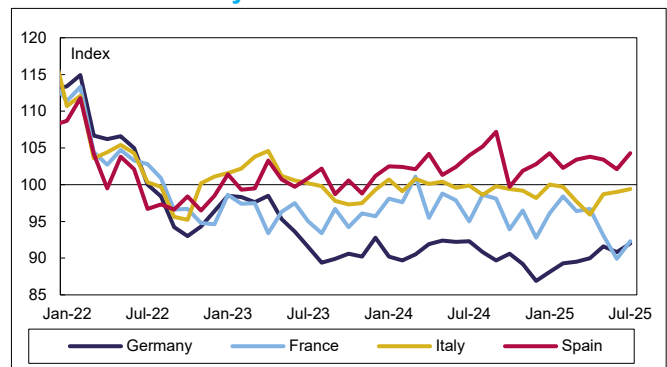
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ESIs by sector



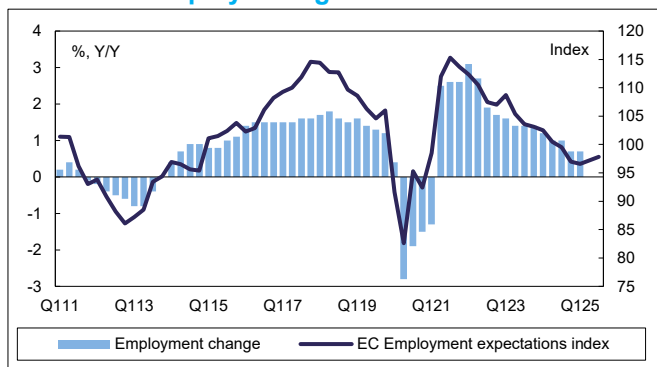
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ESIs by member state



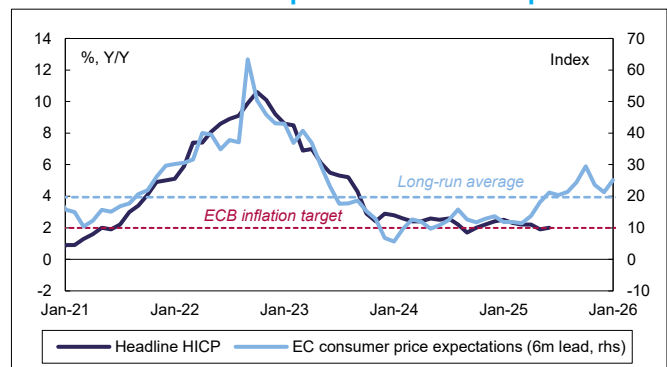
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Employment growth & EEI



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation & expectations*



*Twelve months ahead. Source: Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

Contrasting with the rise in July's flash Spanish inflation reading, Thursday's estimates for Germany, France and Italy are expected to be better behaved. Indeed, the unfavourable energy base effects and reduced public transport subsidies which principally contributed to the upside in Spain were absent in Germany and France, while in Italy base effects appear set to increase the drag from energy on headline inflation. So, amid the broader stabilisation in fuel and household energy prices in July, and expectations for gradual moderation in certain core components, the risks to inflation in those member states – and, indeed, the wider euro area – that month appear skewed to the downside. Meanwhile, despite the likelihood of a further rise in German jobless claims in July, the euro area unemployment rate is expected to hold steady in June at 6.3%, just 0.1ppt above the series low.












The day ahead in the UK

Besides an update from Lloyds on business sentiment in July, it should be another quiet day for the UK.






European calendar

Today's results

Economic data

| Country | Release | Period | Actual | Market consensus/ Daiwa forecast | Previous | Revised |
|-----------|---|--------|--------------------|-------------------------------------|-------------|-------------|
| Euro area |  GDP – first estimate Q/Q% (Y/Y%) | Q2 | 0.1 (1.4) | <u>0.1 (1.4)</u> | 0.6 (1.5) | - |
| |  Commission economic sentiment indicator | Jul | 95.8 | 94.5 | 94.0 | 94.2 |
| |  Commission services (industrial) confidence indicator | Jul | 4.1 (-10.4) | 3.2 (-11.1) | 2.9 (-12.0) | 3.1 (-11.8) |
| |  Final Commission consumer confidence indicator | Jul | 14.7 | <u>-14.7</u> | 15.3 | - |
| Germany |  GDP – first estimate Q/Q% (Y/Y%, WDA) | Q2 | -0.1 (0.4) | <u>-0.1 (0.4)</u> | 0.4 (0.0) | 0.3 (0.3) |
| |  Retail sales M/M% (Y/Y%) | Jun | 1.0 (2.4) | 0.5 (-) | -1.6 (3.6) | -0.6 (4.6) |
| France |  GDP – first estimate Q/Q% (Y/Y%) | Q2 | 0.3 (0.7) | <u>0.0 (0.4)</u> | 0.1 (0.6) | - |
| |  Consumer spending M/M% (Y/Y%) | Jun | 0.6 (0.9) | -0.3 (0.0) | 0.2 (-0.5) | 0.1 (-0.6) |
| Italy |  GDP – first estimate Q/Q% (Y/Y%) | Q2 | -0.1 (0.4) | <u>0.1 (0.5)</u> | 0.3 (0.7) | - |
| |  Hourly wages M/M% (Y/Y%) | Q2 | 0.5 (2.7) | - | 0.4 (4.0) | - |
| Spain |  Preliminary HICP (CPI) Y/Y% | Jul | 2.7 (2.7) | 2.6 (2.3) | 2.3 (2.3) | - |










Auctions

| Country | Auction |
|---------|---|
| Italy |  sold €1.5bn of 1.35% 2030 bonds at an average yield of 2.6% |
| |  sold €2bn of 2.7% 2030 bonds at an average yield of 2.8% |
| |  sold €3.5bn of 3.6% 2035 bonds at an average yield of 3.52% |
| |  sold €2bn of 2034 floating bonds at an average yield of 3.13% |
| UK |  sold £300m of 3.75% 2052 bonds at an average yield of 5.383% |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

| Country | BST | Release | Period | Market consensus/ Daiwa forecast | Previous |
|-----------|---|--|--------|-------------------------------------|-------------|
| Euro area |  10.00 | Unemployment rate % | Jun | 6.3 | 6.3 |
| Germany |  07.00 | Import prices M/M% (Y/Y%) | Jun | -0.2 (-1.6) | -0.7 (-1.1) |
| |  08.55 | Unemployment claims rate % (change 000s) | Jul | 6.3 (15) | 6.3 (11) |
| |  13.00 | Preliminary HICP (CPI) Y/Y% | Jul | 1.9 (2.0) | 2.0 (2.0) |
| France |  07.45 | Preliminary HICP (CPI) Y/Y% | Jul | 0.8 (1.0) | 0.9 (1.0) |
| |  07.45 | PPI Y/Y% | Jun | - | 0.2 |
| Italy |  10.00 | Preliminary HICP (CPI) Y/Y% | Jul | 1.6 (1.5) | 1.8 (1.7) |
| |  10.00 | PPI Y/Y% | Jun | - | 2.8 |
| UK |  00.01 | Lloyds business barometer (own price expectations) % balance | Jul | - | 51 (61) |

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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