Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made losses after the August flash PMIs suggested a modest pickup in euro area growth momentum led by German industry, and the EU and US agreed a framework for implementation of last month's trade deal.
- Gilts also made losses as the flash UK PMIs flagged a strengthening of economic activity in Q3 centred on the services sector.
- Jackson Hole aside, Friday will bring new data on euro area negotiated wages growth and the detail of German GDP in Q2, as well as further August surveys of economic sentiment in France and the UK.

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.966	+0.040
OBL 2.2 10/30	2.310	+0.039
DBR 2.6 08/35	2.751	+0.036
UKT 3¾ 03/27	3.953	+0.041
UKT 4⅜ 03/30	4.116	+0.044
UKT 4½ 03/35	4.722	+0.052

*Change from close as at 4:40pm BST.
Source: Bloomberg

Euro area

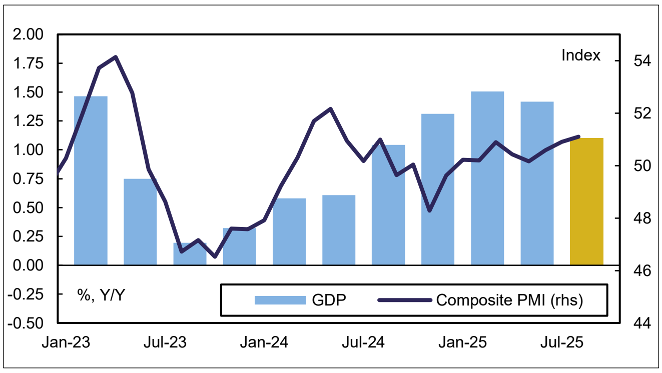
Flash August PMIs suggest modest pickup in growth momentum in Q3

According to today's flash PMIs for August, euro area economic growth momentum picked up slightly in the middle of Q3. The headline euro area composite output PMI rose for a third successive month to a 15-month high. But the increase of 0.2pt was modest, and pushed the index up merely to 51.1, a level that would be consistent with GDP growth in Q3 not materially stronger than the estimate of 0.1%Q/Q in Q2. The pickup in momentum was concentrated in the manufacturing sector, where the output PMI jumped 1.7pts – the most since March – to 52.3, to suggest the best growth in the sector in more than three years. And despite softness in external demand, the respective index reported a pickup in new factory orders for the first time since April 2022. Nevertheless, with work backlogs and purchasing activity down, the manufacturing outlook was judged to be the least favourable since April's 'Liberation Day' shock. The flash PMIs also reported a pickup in new business in services in August. But the activity index for that sector edged down slightly to 50.7, still above its range in Q2 but implying very modest expansion. And like in manufacturing, services firms were less upbeat about the outlook. Among other survey detail, however, there were further signs of labour market resilience, with the euro area employment composite PMI (50.8) up to the best in more than a year. Less encouragingly, however, input costs were judged to be rising in both main sectors – and particularly so in services – by the most since March. Overall output price growth was reportedly a touch firmer too and the firmest since the spring, albeit still broadly absent in manufacturing.

Improvement concentrated in German manufacturing, but periphery still leading expansion in Q3

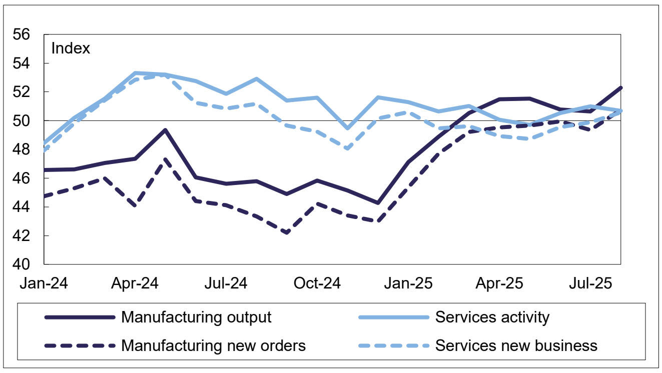
Among the member states, the improvement in the August flash PMIs was largely due to German manufacturing, for which the output index jumped more than 2pts to 52.7, the best since Russia's invasion of Ukraine. So, after a dip in Q2 as payback for tariff front-running in Q1, today's survey points to a return to growth in German industrial production in Q3. That should in part reflect crowding-in of private capex from the government's plans to increase public spending on infrastructure and defence. In France, while improved, the manufacturing output PMI was merely consistent with flat production. Likewise, the German and French services PMIs were consistent with little change in activity in August. So, overall, while it rose to a five-month high (50.9), the German composite PMI signalled a return to only modestly positive GDP growth in Q3. And the equivalent French PMI (49.8) appeared to be suggest flat economic output. Nevertheless, it was the best in a year, and tomorrow's INSEE survey is likely to provide a more accurate (and hopefully more encouraging) guide to French GDP growth in Q3. Finally, beyond Germany and France, the flash PMIs suggest that activity continued to expand in the rest of the euro area in August. Although the respective composite PMI (52.2) dropped ½pt from July, it left the average for the first two months of Q3 in line with that of Q1, when economic growth in Italy, Spain and Ireland was relatively vigorous. So, the periphery member states are likely again to be leading the economic expansion in the euro area in Q3.

Euro area: GDP growth & composite PMI



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

Euro area: Selected services & manufacturing PMIs



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

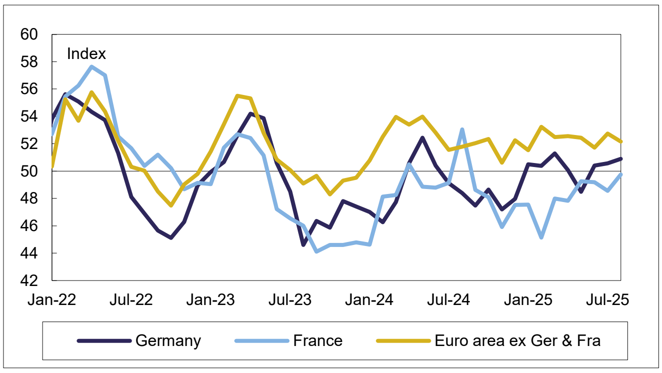
Consumer confidence down to 4-month low but households likely to keep spending in Q3

Contrasting the improvement in the region's composite output PMI, the flash Commission euro area consumer confidence index dropped 0.8pt in August, to -15.5, its lowest level since April. That, however, left it slightly above the average in Q2, when retail sales rose a respectable 0.7%Q/Q and overall household consumption likely grew for a sixth successive quarter. Indeed, while the consumer confidence index has been tracking well below its long-run average this year, the opposite has been the case for the survey's measure of household willingness to make major purchases. And with the labour market broadly resilient and real incomes rising, we expect private consumption to continue to support GDP growth this quarter and next. We note also that the deterioration in the flash consumer confidence index in August returned it to the lowest level since the shock of Trump's Liberation Day tariff announcements in April. Renewed anxieties about the trajectory of Russian ceasefire talks and dissatisfaction at the initial details of the EU-US trade deal reached last month might also have contributed to the greater unease among households in this month's survey. But, in the latter case, discontent might also have been associated with the delay to operationalising that agreement as the US and EU haggled over further details. Today, however, the EU and US published a joint statement on their framework, linking the timing of the application of the lower 15% tariff on US imports of European autos and auto parts to the introduction of a legislative proposal in Brussels to operationalise Europe's own commitments to eliminating its tariffs on US industrial goods and providing preferential access for a range of US seafood and agricultural goods. Comments by the EU trade commissioner suggest that legislative proposal could be issued before the end of this month. While that should provide greater certainty about the tariff landscape and accordingly bolster business sentiment, particularly in autos, any recovery in consumer confidence might be expected first to require a broader revival in economic growth.

Construction output contributed to euro area GDP growth in Q2, but only thanks to Spain

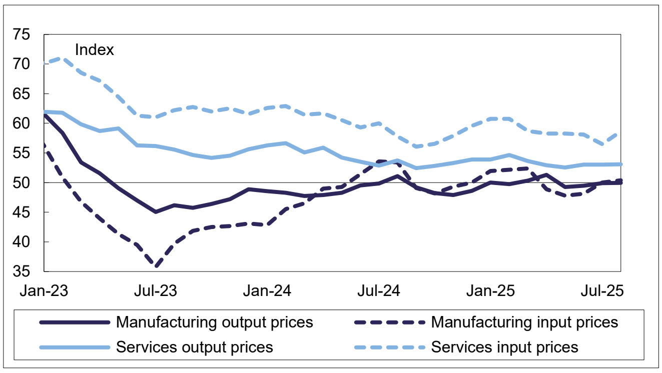
Euro area construction output fell for a second successive month in June and by 0.8%M/M to be some 2.9% below April's 15-year high. Nevertheless, given that surge at the start of the quarter, and with the level in June still well above the Q1 average, construction output rose in Q2 by 2.3%Q/Q, marking the strongest quarter for the sector since Q123. We caution, however, that the strength in April reflected a scarcely credible surge (of more than 40%M/M) in Spain thanks to an extreme rise of two-thirds in new building work. So, while construction output shrank in Germany (-2.3%Q/Q), France (-1.1%Q/Q) and several other member states in Q2, growth in Spain (32.6%Q/Q) more than fully explained the increase in the euro area as a whole last quarter. If the construction PMIs are to be believed, momentum in the sector in the three largest member states was still negative last month. Indeed, the euro area construction activity PMI fell in July to a five-month low (44.7). But while the equivalent indices for Germany, France and Italy were all below the 50 mark, the German headline PMI for the sector was still the best in almost 2½ years. We also 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

Euro area: Composite PMIs by member state



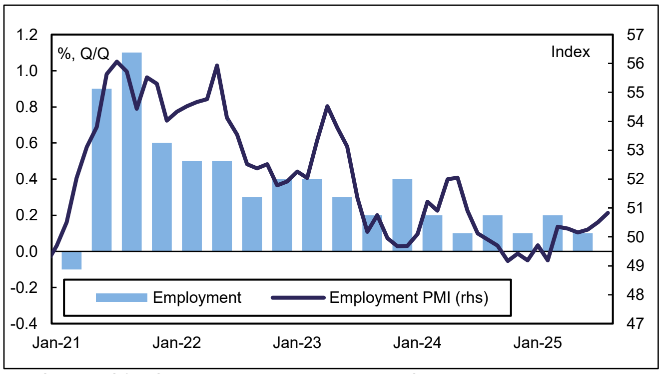
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Price PMIs



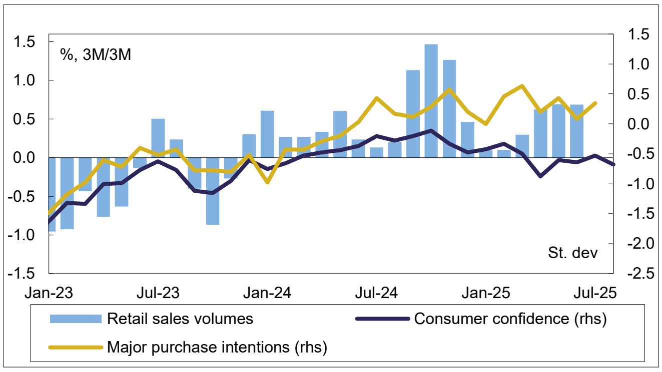
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Employment & PMI



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

Euro area: Retail sales & consumer confidence*



**Flash consumer confidence index for August 2025. Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.*

whole last month. The likelihood of negative payback in Q3 for the strength in Spain in Q2 suggests that euro area construction output will subtract from GDP growth in Q3. But we don't expect it to fully reverse the rise in Q2. And supported by increased commercial work and public infrastructure activity, we anticipate a return to growth in construction in Germany and Italy this quarter and a rebound in the region as a whole in Q4.

The day ahead in the euro area

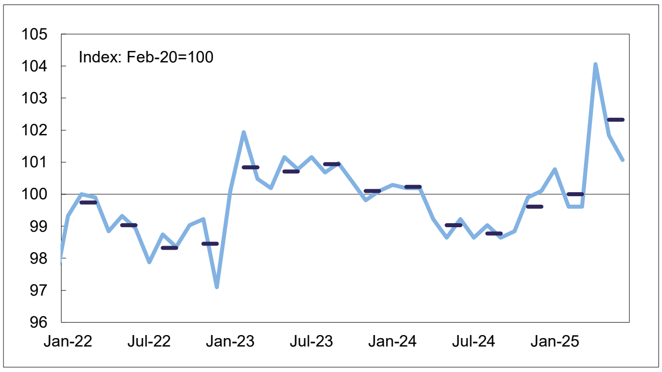
Given our suspicions about the reliability of the French PMIs as a guide to growth, tomorrow's INSEE business sentiment survey will provide a helpful cross-check on the 1.2pt improvement in the flash August composite index. In addition, Friday will bring data for euro area negotiated wages in Q2. Growth in wage settlements in Q1 slowed markedly to just 2.45%Y/Y, the slowest pace since Q421 and broadly consistent with a sustained return to the inflation target over the medium term. That deceleration was flattered by a base effect related to one-off payments in Germany (0.9%Y/Y). So, despite further moderation in France last quarter – down 0.2ppt to 1.6%Y/Y – payback in Germany (5.7%Y/Y) in Q2 will likely lead euro area negotiated wage growth higher. But to the extent that underlying pay settlements likely continued to slow in Q2 and the increase in the top-line figure might remain consistent with the ECB's forward-looking wage tracker tool, we think that such a rise would be unlikely to impact on the ECB's perception of risks. Final GDP estimates for Germany in Q2 are also due, including for the first time the expenditure components. Having been among the major beneficiaries of front-loaded demand from the US in Q1 – contributing to the fastest expansion in German GDP for 10 quarters (0.4%Q/Q) – we expect the expenditure breakdown will confirm that exports and fixed investment weighed on economic growth last quarter but also that household consumption provided some offset. The first estimates for Q2 showed a mild contraction in GDP (-0.1%Q/Q), but we note that the detrimental revisions to German IP in Q2 (-0.8%Q/Q) present downside risks to that number.

UK

UK composite PMI up to 12-month high to signal firmer GDP growth in Q3

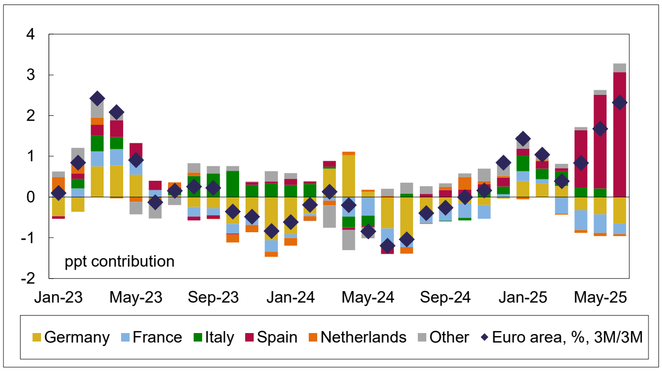
Despite the somewhat justifiably downbeat commentary about the UK economic outlook of late, the upside surprise to GDP growth in Q2 (0.3%Q/Q) means that the UK probably saw the fastest growth in H125 of its G7 peers. And with notable carryover expected, we forecast an acceleration in Q3. Today's flash PMIs for August were also consistent with firmer growth this quarter as the composite output PMI rose 1.5pts to a 12-month high of 53.0. Future output expectations recovered too (66.8) to the most upbeat since October. The improvement in output was customarily led by the services sector, for which the activity PMI rose 1.8pts to 53.6, back above its pre-pandemic average. Following an errant deterioration last month, demand dynamics also appeared stronger. Indeed, the new orders PMI (53.7) saw its sharpest monthly improvement (6.1pts) in

Euro area: Construction output*



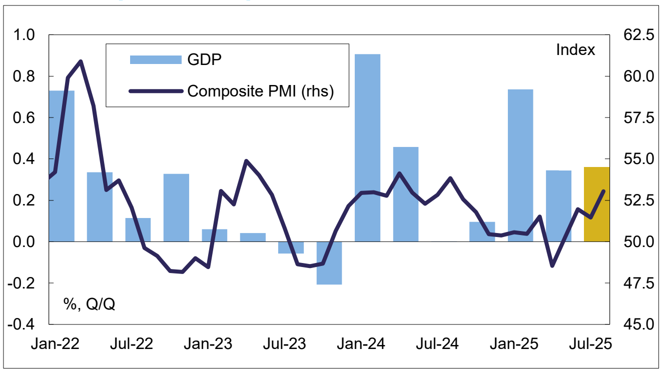
Dark blue lines show average quarterly level.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Country contributions to construction*



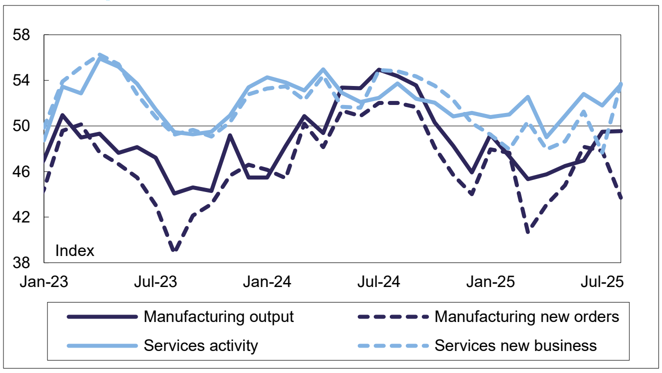
June data for Italy yet to be published.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Composite output PMI & GDP*



Gold bar shows Daiwa forecast.
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output and new orders PMI



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

almost 4½ years, while new export demand (53.5) reportedly rose the most since October. Admittedly, that contrasted with the signal of notably softer manufacturing demand, for which overseas orders (40.1) contracted at the fastest pace since April's tariff-shock with the respective index down the most since January 2021 (down 5.1pts). Consequently, the headline manufacturing PMI pared 1pt to 47.3. But with manufacturers looking to rebuild inventories following a hotter start to the year, factory output was broadly stable at its highest level since October (49.6). And while still consistent with a contraction, that improvement may be suggestive of improved IP in Q3.

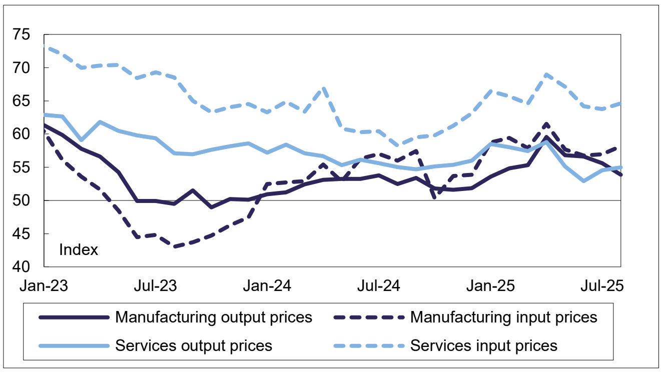
Services price PMIs offer little relief, but employment decline extends for 11th consecutive month

With economic growth looking to be fairly resilient and potentially to the upside of the BoE's projection of 0.3%Q/Q in Q3, and inflation already expected to peak at 4%Y/Y in September, the concerns of the MPC's hawks about inflation persistence are likely to have been reinforced by today's flash PMIs. Indeed, the survey failed to signal any further slowdown in inflation momentum. Notably, the services output price PMI nudged up a further 0.4pts to 55.0, some 2.1pts higher than in June when it briefly returned to its long-run average, while the input cost PMI for the sector rose to a 3-month high (64.6). More optimistically, however, the manufacturing output price PMI (53.9) dropped below its long-run average for the first month in seven – a drop which tallied with a decline in the separate CBI survey indicator of manufacturers' selling prices to a 10-month low. Moreover, those MPC members who backed the cut in Bank Rate earlier this month will note the signalled of a sustained loosening of the labour market suggested by the employment PMI, which signalled cuts to headcount for an 11th consecutive month in August. That should map to a further slowing of wage growth, keeping alive the possibility of one further rate cut before the end of the year.

OBR public borrowing forecast remains on track after lower-than-expected July figure

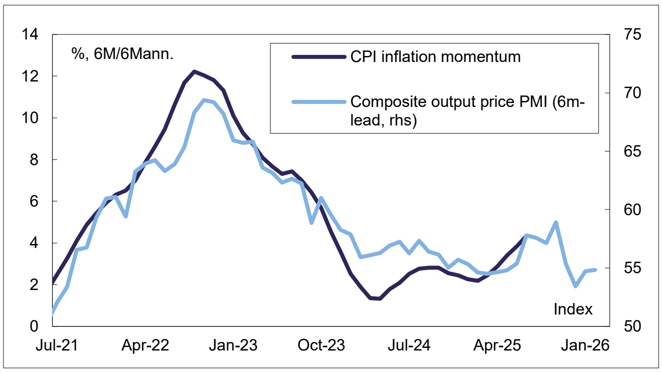
Public sector net borrowing came in a touch below expectations at £1.1bn in July, down £2.3bn on a year earlier and the lowest since for the month in three years. And while the prior month's figure was revised up, net borrowing in the first four months of this fiscal year amounted to £60bn, effectively in line with the OBR's forecast albeit up £6.7bn from the same period last year. The current budget deficit – which the government targets to return to balance by FY29/30 – was £42.8bn in the first four months of the fiscal year, up £5.4bn from the same period a year ago. On the revenue side, central government current receipts were up £24.4bn from the same period last year, but central government current expenditure was up a steeper £29.0bn with more than a quarter of that extra spending due to higher debt interest payments. While, so far, the OBR's borrowing forecast for this fiscal year appears on track, the headroom of £9.9bn estimated by the OBR for the Chancellor to maintain her binding fiscal rule still looks set to be more than fully wiped out by a combination of government U-turns on winter fuel payments and welfare benefits, weaker potential growth and higher debt interest payments. That will

UK: Price PMIs



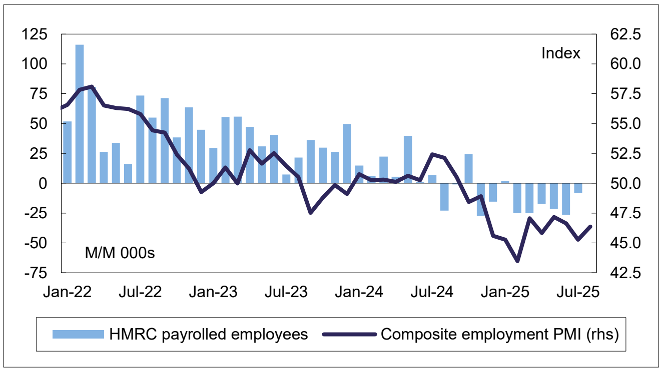
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Inflation momentum & composite price PMI



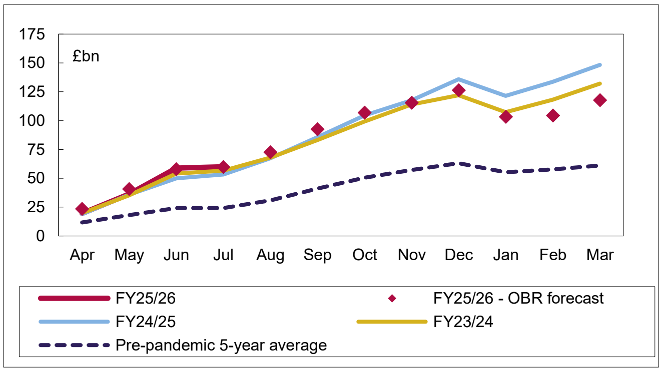
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolls & employment PMI



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

UK: Public sector net borrowing



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

leave Chancellor Reeves with the need to tighten the fiscal stance by a further £20bn or more in the autumn, presumably predominantly via taxation. The precise nature and size of those tax hikes – which media reports this week suggest might be related to property wealth, e.g. via the imposition of capital gains tax on sales of primary residences worth more than £1.5mn – will have an impact on the outlook for GDP, inflation and Bank Rate.

The day ahead in the UK

As the ONS have postponed the release of July's retail sales data – characteristically, to allow for 'further quality assurance' – it should be a quieter end to the week for UK data. The August GfK consumer confidence survey will now mark the solo data release on Friday, and while a fourth cut in Bank Rate this cycle may offer some support to the top-line figure, we note that slowing growth in real incomes, concerns about high inflation and speculation about the form of tax-raising measures to come in the Autumn are likely to dampen the potential upside for consumers' willingness to spend.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Preliminary services (manufacturing) PMI	Aug	**50.7 (50.5)**	*51.0 (49.6)*	51.0 (49.8)	-
	Preliminary composite PMI	Aug	**51.1**	*50.8*	50.9	-
	Preliminary Commission consumer confidence indicator	Aug	**-15.5**	*-14.9*	-14.7	-
	Construction output M/M% (Y/Y%)	Jun	**-0.8 (1.7)**	-	-1.7 (2.9)	-2.1 (3.6)
Germany	Preliminary services (manufacturing) PMI	Aug	**50.1 (49.9)**	50.4 (48.8)	50.6 (49.1)	-
	Preliminary composite PMI	Aug	**50.9**	50.3	50.6	-
France	Preliminary services (manufacturing) PMI	Aug	**49.7 (49.9)**	48.6 (48.1)	48.5 (48.2)	-
	Preliminary composite PMI	Aug	**49.8**	48.5	48.6	-
UK	Preliminary services (manufacturing) PMI	Aug	**53.6 (47.3)**	*52.3 (48.5)*	51.8 (48.0)	-
	Preliminary composite PMI	Aug	**53.0**	*52.0*	51.5	-
	Public sector net borrowing £bn	Jul	**1.1**	2.0	20.7	22.6
	CBI industrial trends survey – total orders (selling prices) % balance	Aug	**-33 (9)**	-28 (20)	-30 (21)	-

Auctions

Country	Auction
France	sold €5.154bn of 2.4% 2028 bonds at an average yield of 2.31%
	sold €1.345bn of 2.5% 2030 bonds at an average yield of 2.62%
	sold €4bn of 2.7% 2031 bonds at an average yield of 2.77%
	sold €399m of 3.15% 2032 inflation-linked bonds at an average yield of 1.11%
	sold €393m of 1.8% 2040 inflation-linked bonds at an average yield of 1.76%
	sold €330m of 0.1% 2053 inflation-linked bonds at an average yield of 1.98%

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	Negotiated wages Y/Y%	Q2	-	2.5
Germany	07.00	GDP – final estimate Q/Q% (Y/Y%)	Q2	*-0.1 (0.0)*	0.4 (-0.2)
	07.00	GDP – private consumption Q/Q%	Q2	0.2	0.5
	07.00	GDP – government spending Q/Q%	Q2	0.3	-0.3
	07.00	GDP – fixed investment Q/Q%	Q2	-0.8	0.9
France	07.45	INSEE business (manufacturing) confidence indicator	Aug	97 (96)	96 (96)
	-	BdF retail sales Y/Y%	Jul	-	-1.1
UK	00.01	GfK consumer confidence indicator	Aug	*-20*	-19

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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