Euro wrap-up

Overview

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- Bunds made modest gains while the August PMIs signalled a modest improvement in euro area economic growth led by German manufacturing, despite a loss of momentum in services activity.
- While the UK PMIs were revised higher in August and BoE Governor Bailey cautioned about the pace of future rate cuts, Gilts made gains after Chancellor Reeves confirmed the Autumn Budget for 26 November.
- Thursday will bring euro area retail sales figures for July, construction PMIs for August and updated Irish Q2 GDP data.

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.954	-0.014
OBL 2.2 10/30	2.275	-0.035
DBR 2.6 08/35	2.737	-0.045
UKT 3¾ 03/27	3.952	-0.020
UKT 4⅜ 03/30	4.129	-0.038
UKT 4½ 03/35	4.748	-0.051

*Change from close as at 4:45pm BST.
Source: Bloomberg

Euro area

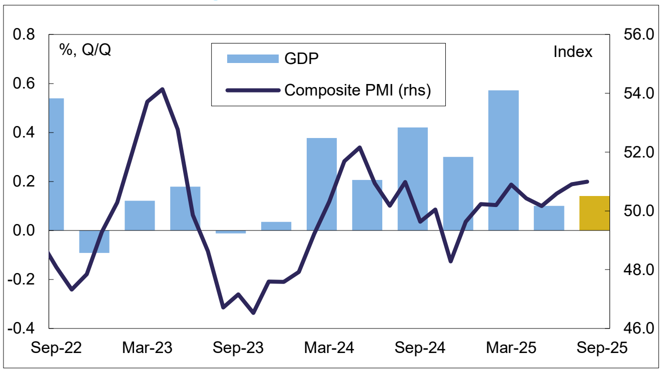
August PMIs signal a modest improvement in growth momentum led by manufacturing

Despite a modest downwards revision to the final August PMIs, today's survey still implied a slight pickup in euro area economic growth momentum in the middle of Q3, with the composite output PMI rising for a third consecutive month to a 12-month high. Admittedly, the monthly increase was modest at just 0.1pt. And despite trending some 0.6pt above the Q2 average, the index, at 51.0, was broadly consistent with GDP growth not materially stronger than the current estimate of 0.1%Q/Q in Q2. The revision was led by the services sector (down 0.5pt on the month to 50.5), for which the flash release had already signalled a slight loss of momentum over the summer as new business stagnated. But this was partly offset by a recovery in the manufacturing sector, where the output PMI jumped 1.9pts to 52.5 – the most since January – to imply the strongest growth in almost 3½ years. And despite softness in external demand, the new factory orders index suggested growth 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. And given the non-negligible negative carry-over from the end of Q2, it remains to be seen whether manufacturing will provide a meaningful boost to economic activity this quarter.

German manufacturing leads recovery, but Spanish economy continues to outperform

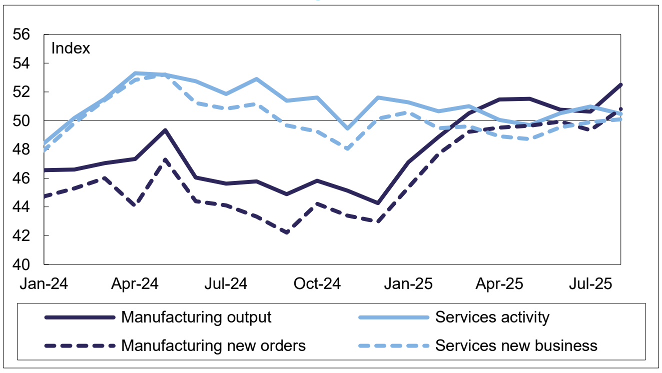
The improvement in the August PMIs was led by German manufacturing, for which the output index jumped more than 2pts to 52.9, the best since Russia's invasion of Ukraine. And despite renewed weakness in overseas orders, manufacturers reported new business to be the best in more than three years, likely supported by the government's tax incentive scheme. Monday's releases also confirmed a marked pickup in factory output in Italy (52.2) and Spain (56.0). But this was partly countered by signals of merely flat production in the sector in France and a further deterioration in Ireland, where the respective index fell to its lowest since January. Contrasting the recovery in German manufacturing, the German services PMI was consistent with a modest contraction in August. So, overall, the German composite PMI (50.5) edged slightly lower to signal a return to only modestly positive GDP growth in Q3. Despite rising to the highest in a year, the equivalent French PMI (49.8) appeared to be suggestive of flat economic output. Of course, it is worth noting that the PMIs failed to signal the acceleration in French GDP growth in Q2 (0.3%Q/Q). While the Italian survey was also an unreliable guide to Q2 GDP, the composite PMI (51.7) was nevertheless the highest for three months in August and consistent with trend growth. And while the respective Spanish index dropped 1pt in August, at 53.7 it was still the firmest index of any European country and well above the long-run average, suggestive of continued vigorous economic growth in that country over the summer, supported not least by a record tourism season.

Euro area: GDP growth* & composite PMI



*Gold bar represents Daiwa forecast for Q325.
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing & services



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

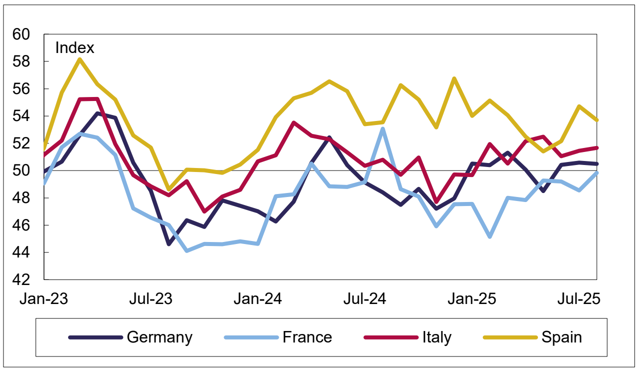
Services price PMIs tick higher, but factory price pressures remain muted

In terms of inflation, today's PMIs were somewhat less encouraging, suggesting that input cost rose in both sectors – and particularly so in services – by the most since March. Overall output price growth was also reportedly the firmest since April, with prices charged in the services sector still firmly above the long-run trend. In contrast, the PMIs suggest that factory price pressures remain broadly absent in the euro area. Admittedly, at face value, today's producer price figures suggested that the factory sector might provide a little upwards pressure on inflation over the near term, with industrial producer output prices rising for the second successive month in July (0.4%M/M). But due to favourable base effect, this pushed the annual rate down to just 0.2%Y/Y, a seven-month low. Moreover, the pickup once again principally reflected a further jump in producer energy prices. Indeed, when excluding energy, factory output prices were flat in July. While producer prices of consumer durable and capital goods were up slightly, prices of intermediate goods fell for a fourth month (-0.2%M/M). Wholesale energy prices have subsequently stabilised. And the appreciation of the euro since the start of the year, as well as the influx of cheap goods from China, should continue to contain prices of imported items. So, we continue to expect core CPI goods inflation to remain very subdued over coming quarters.

The day ahead in the euro area

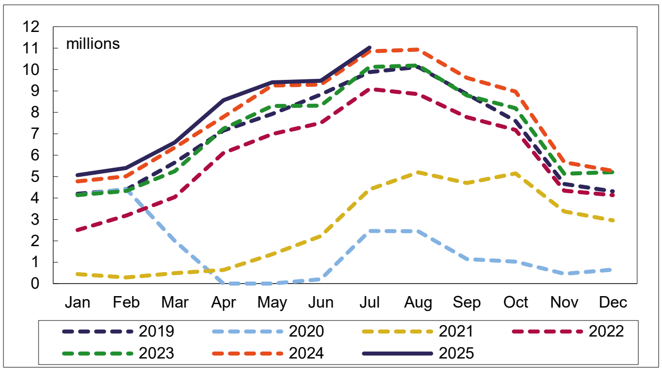
The data highlight on Thursday will be euro area retail sales figures for July. The weakness in July's German sales (-1.5%M/M) would imply a soft reading for the aggregate euro area at the start of Q3, to follow Q2's strong performance of 0.7%Q/Q, a three-quarter high. The available member state data suggests that the Q2 figure may yet be revised up. But we expect the contraction in July to be slightly to the low side of the Bloomberg consensus estimate, in the region of -½%M/M. Meanwhile, following on from today's services indices, the euro area construction PMIs will provide an update on business conditions in that sector in August. Despite a steady increase in the headline activity PMI in Germany in July – which at 46.3, reported its softest contraction in close to 2½-years – a deterioration in the French and Italian indices led the euro area construction PMI to a five-month low (44.7). Finally, ahead of the third estimate of euro area Q2 GDP this Friday, we will also be mindful of potential revisions to Thursday's final estimates out of Ireland. Indeed, with June's industrial production (-11.3%M/M) having more than reversed May's increase, the risks to the first estimates for GDP (-1%Q/Q) appear to be to the downside. And such a revision, taken alongside the 0.2ppt markdown in Germany last quarter (-0.3%Q/Q), would likely be material for the euro area figure, leaving growth either flat or negative.

Euro area member states: Composite PMIs



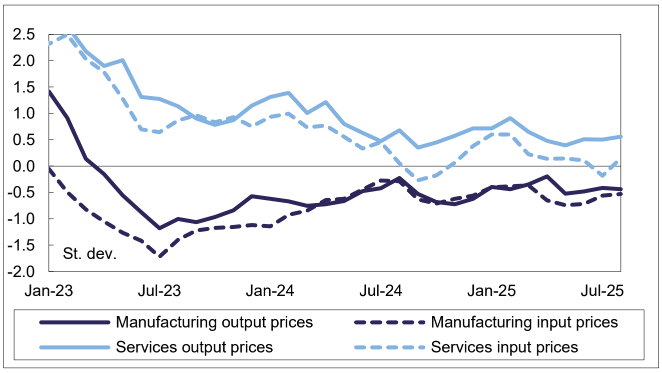
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Spain: Overseas visitors



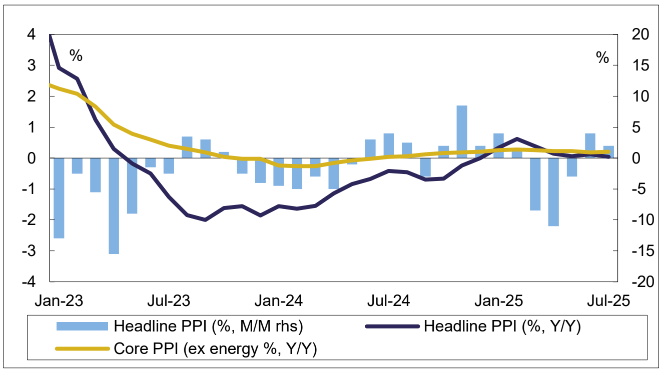
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Price PMIs



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

Euro area: Factory producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

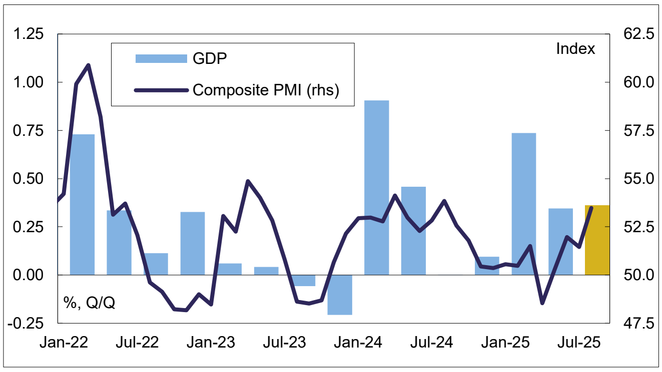
Services PMI revised up to a 16-month high in August, but price pressures remain elevated

The final PMIs for the UK did little to alter the narrative of their flash releases too. But contrasting the modest downward revision in the euro area, the UK indices were nudged higher, reinforcing their positive message. The final services activity PMI was marked up to 54.2, 2.4pts higher than in July and signalling the firmest expansion in 16 months. So, while manufacturing output was nudged slightly lower (49.3), the composite PMI was revised up by ½pt to 53.5, a 12-month high and bang in line with the series' historical average. And with the expansion in Q3 thus far averaging some 2.2pts higher than in Q2, the PMIs remain broadly supportive of our expectation of another resilient quarter of GDP growth (0.4%Q/Q, 0.1ppt above the BoE's projection). After falling sharply in the previous month, today's release confirmed a solid rebound in new services business in August (54.0), including from overseas (53.7), to an 11- and 10-month high respectively. That contrasted with signals from manufacturers, for which demand was seen as its softest since tariff uncertainty peaked in April. But it's worth noting that, despite implying marginal contraction, the output PMI in that sector was averaging 3pts higher than in Q2, possibility hinting to brighter prospects for industrial production this quarter. Encouragingly too, the manufacturing price PMIs were consistent with the continued absence of inflationary pressures in core goods. But the equivalent indices for the services sector remained elevated, which alongside resilient economic activity may reinforce concerns about inflation persistence. The prolonged scaling back in employment, now for an 11th month, should offer some comfort that wage pressures will continue to moderate. And with today's confirmation that the government's Autumn Budget (26 November) will come after November's MPC meeting, the prospects for a final rate cut this year will hinge even more so on developments in the labour market. Certainly, BoE Governor Bailey today reiterated that, while he still anticipated the trajectory for rates will be downwards over time due to downside risks to the labour market, there is considerably more doubt about when and how quickly the Bank can cut rates.

The day ahead in the UK

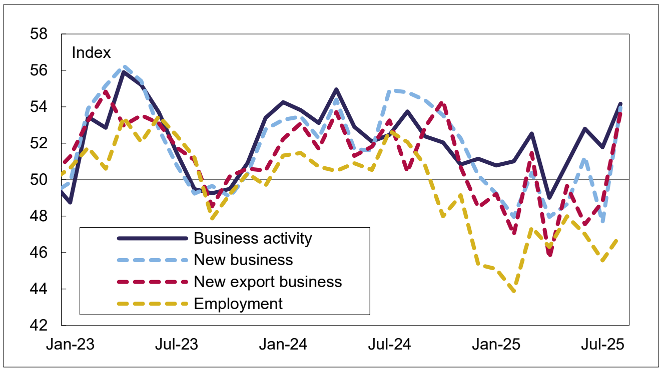
Given its significance to the BoE policymakers' reaction functions, August's DMP survey results will provide Thursday's key release. With inflation now expected to peak this month at around 4%Y/Y, businesses' CPI expectations and price-setting intentions will receive particular scrutiny, though the effects of the realised inflation hump to date on firms' longer-term inflation expectations have been only modest. For the more dovish cohort on the MPC, further evidence of stabilising wage growth might be of relatively greater significance. Elsewhere, the UK construction PMIs for August will also warrant attention, with the sector having grown an outsized 1.2%Q/Q in Q2. But July's construction PMI reported a broad-based decline at the start of Q3, leading the headline output PMI to slump 4.5pts to 44.3, its lowest level since the first pandemic lockdown.

UK: GDP growth* & composite PMI



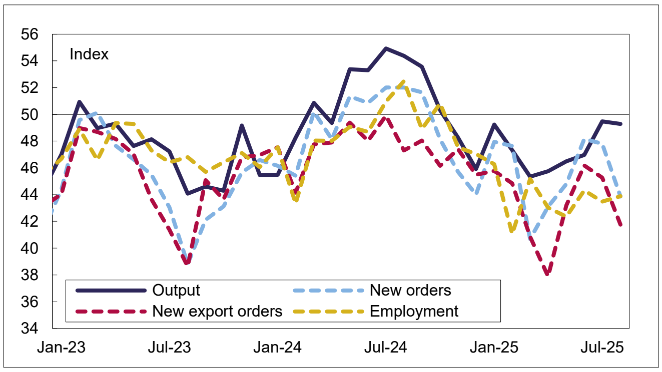
*Gold bar represents Daiwa's forecast for Q325.
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services PMIs



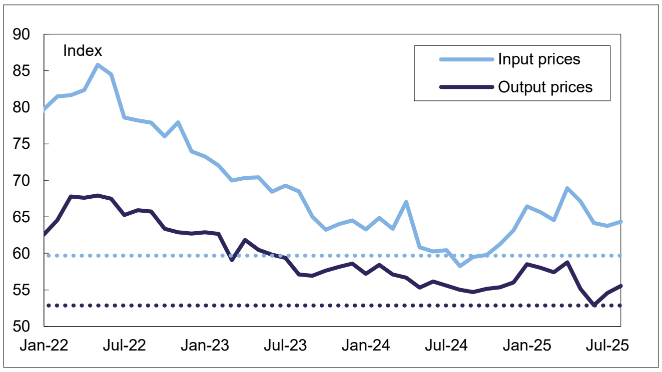
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing PMIs



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

UK: Services price PMIs*



*Dotted lines show pre-pandemic averages.
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Final composite (services) PMI	Aug	**51.0 (50.5)**	*51.1 (50.7)*	50.9 (51.0)	-
		PPI Y/Y%	Jul	**0.2**	0.1	0.6	-
Germany		Final composite (services) PMI	Aug	**50.5 (49.3)**	*50.9 (50.1)*	50.6 (50.6)	-
France		Final composite (services) PMI	Aug	**49.8 (49.8)**	*49.8 (49.7)*	48.6 (48.5)	-
Italy		Composite (services) PMI	Aug	**51.7 (51.5)**	51.6 (52.6)	51.5 (52.3)	-
Spain		Composite (services) PMI	Aug	**53.7 (53.2)**	54.9 (54.5)	54.7 (55.1)	-
UK		Final composite (services) PMI	Aug	**53.5 (54.2)**	*53.0 (53.6)*	51.5 (51.8)	-

Auctions

Country		Auction
Germany		sold €3.81bn of 2.6% 2035 bonds at an average yield of 2.77%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		08.30	Construction PMI	Aug	-	44.7
		10.00	Retail sales M/M% (Y/Y%)	Jul	*-0.4 (2.3)*	0.3 (3.1)
Germany		08.30	Construction PMI	Aug	-	46.3
France		08.30	Construction PMI	Aug	-	39.7
Italy		08.30	Construction PMI	Aug	-	48.3
UK		09.00	New car registrations Y/Y%	Aug	-	-5.0
		09.30	DMP 3M output price (1Y CPI) expectations Y/Y%	Aug	-	3.7 (3.2)
		09.30	Construction PMI	Aug	45.0	44.3

Auctions and events

Country		BST	Auction/event
France		09.50	Auction: to sell up to €11bn of 3.5% 2035, 2.6% 2042 and 3.75% 2056 bonds
Spain		09.30	Auction: to sell 1.4% 2028, 3.1% 2031, 4.2% 2037 bonds and 1% 2030 inflation-linked bonds
UK		10.00	Auction: to sell £800m of 0.625% 2045 inflation-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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