# Euro wrap-up

## Overview

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- Bunds followed the global trend higher, while euro area retail sales fell at the start of Q3.
- Gilts also made gains, while the BoE's DMP survey reported the slowest employment growth expectations since the pandemic and a further slowdown in pay growth.
- Friday will bring final estimates for euro area Q3 GDP growth with the expenditure breakdown, along with German factory orders and UK retail sales figures for July.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 1.9 09/27 | 1.958 | +0.004 |
| OBL 2.2 10/30 | 2.266 | -0.010 |
| DBR 2.6 08/35 | 2.716 | -0.021 |
| UKT 3¾ 03/27 | 3.939 | -0.012 |
| UKT 4⅜ 03/30 | 4.106 | -0.020 |
| UKT 4½ 03/35 | 4.718 | -0.028 |

*Change from close as at 5:00pm BST.
Source: Bloomberg

# Euro area

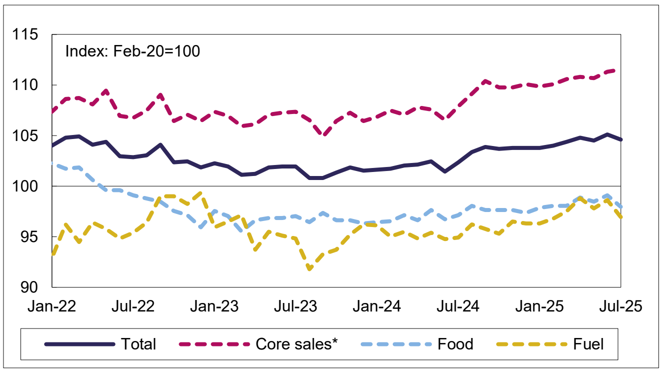
### Retail sales fall sharply in July, but spending on core goods continued to rise

The expenditure breakdown for euro area Q2 GDP – due to be published tomorrow – is likely to show that household consumption growth slowed amid heightened economic uncertainties. And with consumer confidence still subdued, today's euro area retail sales figures suggested that household spending started the third quarter on the back foot too, with sales down 0.5%M/M in July, the most in 13 months. But following strong growth in June (0.6%M/M), sales were still trending in positive territory on a three-month basis (0.3%3M/3M). The deterioration at the start of Q3 was led by Germany (-1.5%M/M), where sales fell the most since March 2023. But while sales also fell in Spain (0.4%M/M), they moved sideways in France and rose for a second-successive month in the Netherlands (1.1%M/M). Moreover, the decline in euro area sales volumes was underpinned by spending at food stores (-1.1%M/M) and auto fuel stations (-1.7%M/M), perhaps reflecting the uptick in prices. More encouragingly, however, spending on core items – i.e. non-food and fuel – increased for a second successive month (0.2%M/M). Indeed, this left the level of core sales some 0.6% above Q2. And with the savings ratio still elevated and household purchase intentions at the top of the recent range, we continue to expect household consumption to provide a positive contribution to euro area GDP growth in Q3.

### Construction PMI jumps to a 3½-year high amid a rebound in France

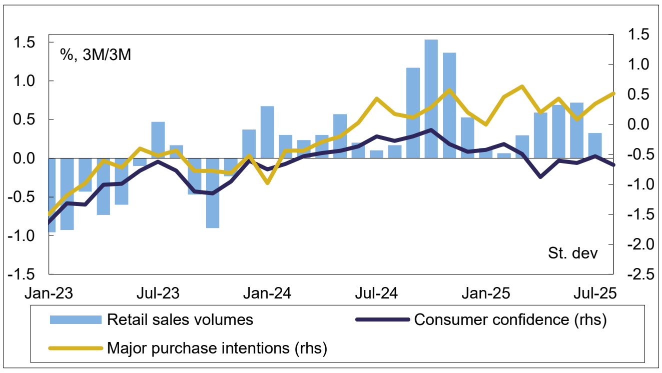
While the construction sector provided a positive contribution to euro area GDP growth in Q2 – the 2.3%Q/Q increase was the strongest since Q123 – the pickup principally reflected a surge in building work in Spain. Indeed, when excluding Spanish construction, euro area activity in the sector was down a little more than ½%Q/Q, with sharp declines in Germany (-2.3%Q/Q) and France (-1.1%Q/Q). But if today's construction PMIs are to be believed, momentum in the sector in the two largest member states appears to have improved in Q3. Indeed, despite slipping back slightly in August and recording successive sub-50 readings for more than three years, the German activity index (46.0) was nevertheless trending some 1½pts above the Q2 average, led by a recovery in both housing and commercial work and the second-strongest growth in civil engineering since spring 2022. There was also a notable rebound in the French PMI (up 7pts to 46.7) to the highest in more than 2½ years. So, while the equivalent Italian index (47.7) slipped to the softest in a year, the aggregate euro area PMI jumped 2pts to 46.7, the highest since February 2022. Admittedly, this left the index trending so far in Q3 broadly sideways from Q2. And given the negative carry over from the end of Q2 and likely continued pull back in Spain, we expect little support from the construction sector to euro area GDP in Q3. But, not least given the continued pass through of past interest rate cuts and improvement in the housing market, we anticipate a rebound in the region as a whole in Q4.

**Euro area: Retail sales**




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

**Euro area: Retail sales & consumer confidence**




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

## The day ahead in the euro area

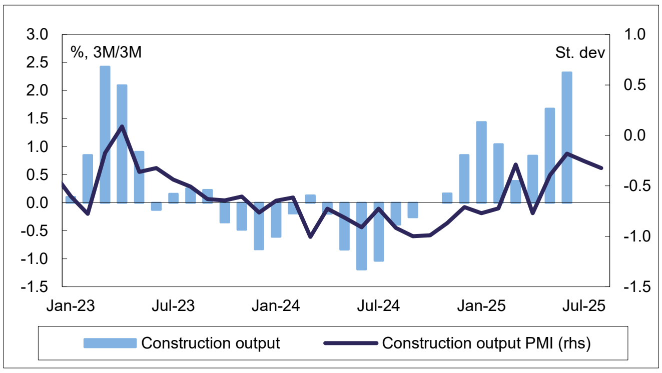
Courtesy of the surprise upwards revision to Q2 GDP growth in Ireland – from an initially estimated contraction of 1%Q/Q to a modest expansion of 0.2%Q/Q – Friday's final estimates of euro area GDP seem likely to affirm modest growth of 0.1%Q/Q last quarter. In line with the releases from the member states, a first look at the breakdown by expenditure contributions are likely to confirm that household consumption slowed from Q1, partly offset by an increase in government expenditure. Fixed investment and net trade look to have subtracted significantly from growth after making substantive contributions in Q1, not least related to tariff front-running. But inventory accumulation likely provided some offset. Looking ahead to Q3 releases, German manufacturing orders are expected to have ticked higher in July, following two monthly drops and corresponding with firmer demand suggested by business surveys. Goods trade data for France in July are also due.

# UK

## DMP offers little clarity on the balance of MPC views, but wages still gradually moderating

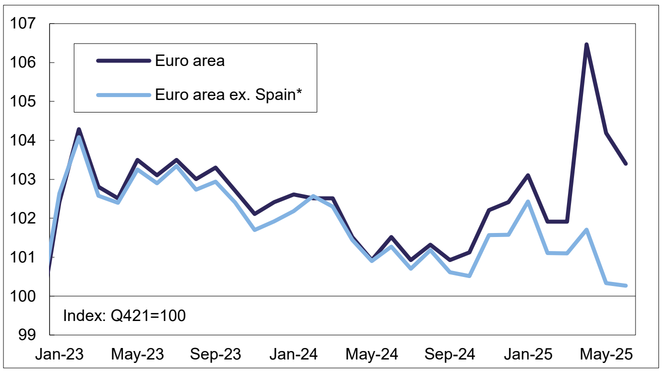
At yesterday's Treasury Select Committee hearing, BoE Governor Bailey reiterated his view that with monetary policy still restrictive, he continued to expect the path for rates to continue gradually downwards. But with risks to inflation having shifted higher, he also acknowledged the considerable uncertainty about how far and when that restrictiveness could be withdrawn further. In many ways, August's DMP survey results offered little clarity to that question. In terms of inflation, businesses' assessments of both realised and expected output prices continued to trend broadly sideways since May, around 3.5-3.7%3M/Y, still well down on the highs in 2022. But those policymakers concerned about the risks of inflation persistence might view the rise in firms' CPI inflation expectations – to a five-month high, and some 0.9ppt and 0.5ppt above their pre-pandemic lows at the 1Y (3.4%Y/Y) and 3Y (3%Y/Y) ahead measures – as further justifying their decision to vote to keep Bank Rate on hold in August. Crucially, market expectations have not been so volatile. And other MPC members might attach greater weight to developments in the labour market than the aforementioned inflation expectations. Though realised wage growth remains elevated (4.6%3M/Y), it still remains more than 2ppts below the peak in 2023. And expectations for pay growth over the coming year (3.6%3M/Y) point to an ongoing downwards trajectory. Indeed, to two decimal places, both were respectively their lowest since Q222. Wage demands will also be tempered by the ongoing downtrend in employment growth, with expectations for the coming year down to the weakest since the pandemic.

### Euro area: Construction output & PMI



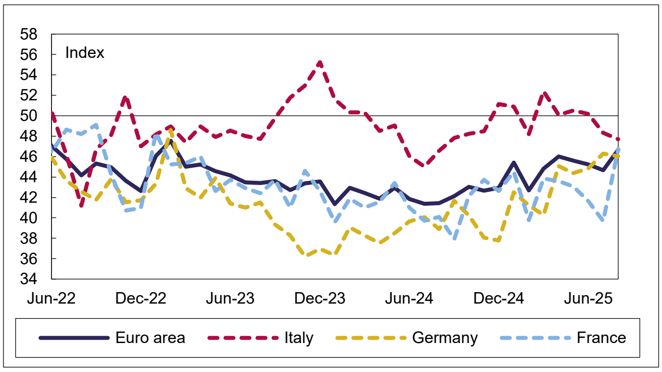

*Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.*

### Euro area: Construction output



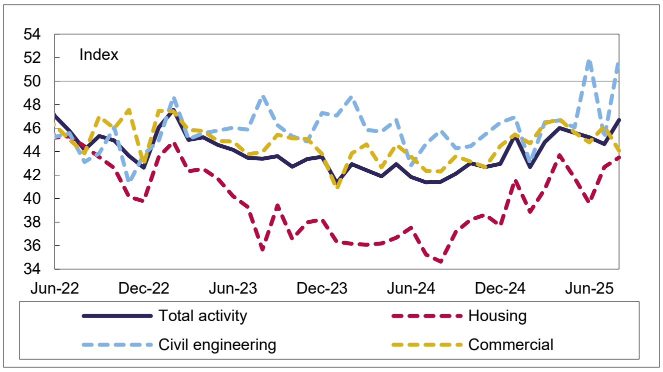

**Composite euro area figure based on the nine member states with the largest construction sectors. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Euro area: Construction activity PMIs by country




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

### Euro area: Construction activity PMIs by subsector




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

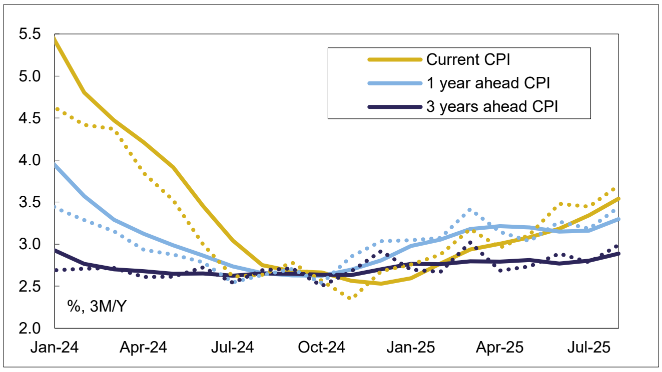
## Construction PMIs remain firmly downbeat, consistent with a pullback in Q3

While today's UK construction PMI survey flagged a softer rate of contraction compared to July's 5-year low (up 1.2pts to 45.5), it remained downbeat. Indeed, the total activity index continued to hover around the bottom of its recent range in August amid a sharper slowdown in residential (44.2) and civil engineering (38.1) work, the lowest in six months and almost five years respectively. And while the reported contraction in new orders (46.4) was its softest since January, future output expectations sunk to their lowest level since December 2022, reflecting the underlying sluggishness in demand. So, mirroring the trends observed in other sectors, firms unsurprisingly reported cuts to headcount (45.9) for an eighth consecutive month. And weak demand conditions also saw input price growth (57.0) decelerate to its slowest pace since the 2024 budget. Ultimately, whilst construction output expanded a sizeable 1.2%Q/Q last quarter, today's PMIs will reinforce expectations for some payback in Q3. Of course, the PMIs have proved to be a relatively unreliable guide to construction output growth over recent quarters. And with respect to GDP growth more broadly, we note that the all-economy composite PMI – combining the respective activity PMIs from the services, manufacturing and construction sectors – reported its largest expansion in 11 months, courtesy of yesterday's services release. As such, we still expect GDP growth to be relatively solid in Q3 (0.4%Q/Q).

## The day ahead in the UK

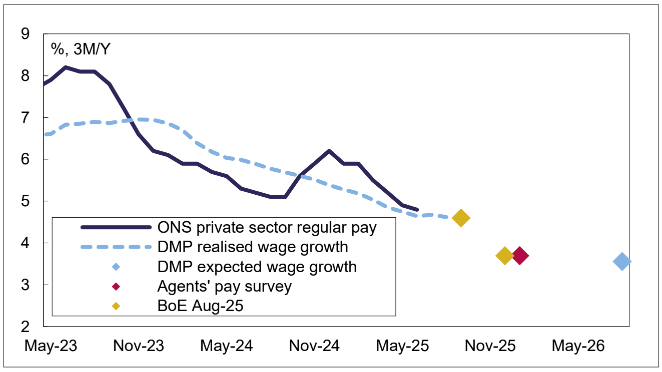
Two weeks since their release was initially postponed for quality assurance purposes, Friday will bring UK retail sales data for July. The Bloomberg survey consensus is for a second successive month of growth in sales volumes, albeit moderating from 0.9%M/M in June to just 0.3%M/M. But we note that a less upbeat survey from the BRC and a drop in consumer confidence that month – which was accompanied by a spike in consumer savings intentions to 2007-levels – suggests that the risks to that view may be skewed to the downside. In any case, with additional risks of revisions to the series linked to its postponement, uncertainty about Friday's release is higher than usual.

### UK: BoE DMP – inflation expectations



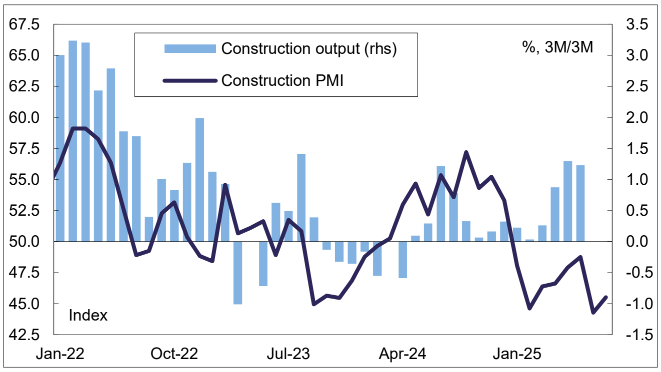

*Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

### UK: Private sector regular pay growth



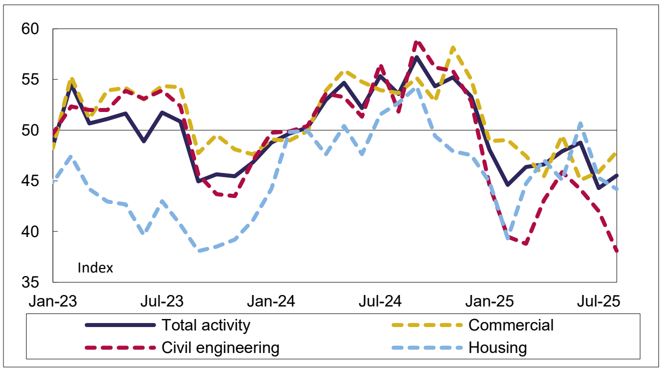

*Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

### UK: Construction output & PMI




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

### UK: Construction activity PMIs by subsector




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

Daiwa Capital Markets

# European calendar

## Today's results

**Economic data**

| Country | Release | Period | **Actual** | Market consensus/ _Daiwa forecast_ | Previous | Revised |
|---|---|---|---|---|---|---|
| Euro area | Retail sales M/M% (Y/Y%) | Jul | **-0.5 (2.2)** | _-0.4 (2.3)_ | 0.3 (3.1) | 0.6 (3.5) |
| | Construction PMI | Aug | **46.7** | - | 44.7 | - |
| Germany | Construction PMI | Aug | **46.0** | - | 46.3 | - |
| France | Construction PMI | Aug | **46.7** | - | 39.7 | |
| Italy | Construction PMI | Aug | **47.7** | - | 48.3 | - |
| UK | DMP 3M output price (1Y CPI) expectations Y/Y% | Aug | **3.4 (3.7)** | - | 3.7 (3.2) | - |
| | Construction PMI | Aug | **45.5** | 45.0 | 44.3 | - |
| | New car registrations Y/Y% | Aug | **-2.0** | - | -5.0 | - |

**Auctions**

| Country | Auction |
|---|---|
| France | sold €7.261bn of 3.5% 2035 bonds at an average yield of 3.57% |
| | sold €1.93bn of 2.6% 2042 bonds at an average yield of 4.04% |
| | sold €1.809bn of 3.75% 2056 bonds at an average yield of 4.43% |
| Spain | sold €1.555bn of 1.4% 2028 bonds at an average yield of 2.204% |
| | sold €1.919bn of 3.1% 2031 bonds at an average yield of 2.734% |
| | sold €1.48bn of 4.2% 2037 bonds at an average yield of 3.425% |
| | sold €536m of 1% 2030 inflation-linked bonds at an average yield of 0.877% |
| UK | sold £800m of 0.625% 2045 inflation-linked bonds at an average yield of 2.412% |

*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 | GDP – third estimate Q/Q% (Y/Y%) | Q2 | _0.1 (1.4)_ | 0.6 (1.5) |
| | 10.00 | GDP – private consumption Q/Q% | Q2 | - | 0.3 |
| | 10.00 | GDP – government spending Q/Q% | Q2 | - | -0.1 |
| | 10.00 | GDP – fixed investment Q/Q% | Q2 | - | 2.7 |
| | 10.00 | Employment – final estimate Q/Q% (Y/Y%) | Q2 | _0.1 (0.7)_ | 0.2 (0.7) |
| Germany | 07.00 | Factory orders M/M% (Y/Y%) | Jul | 0.5 (-0.6) | -1.0 (0.8) |
| France | 07.45 | Trade balance €bn | Jul | - | -7.6 |
| Italy | 09.00 | Retail sales M/M% (Y/Y%) | Jul | - | 0.3 (0.7) |
| Spain | 08.00 | House price index Q/Q% (Y/Y%) | Q2 | - | 3.5 (12.2) |
| UK | 07.00 | Retail sales – incl. auto fuel M/M% (Y/Y%) | Jul | 0.2 (1.3) | 0.9 (1.7) |
| | 07.00 | Retail sales – excl. auto fuel M/M% (Y/Y%) | Jul | 0.3 (1.1) | 0.6 (1.8) |

**Auctions and events**

- Nothing scheduled -

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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