Euro wrap-up

Overview

Economic Research Team
+44 20 7597 8326

- Bunds made gains as German factory orders disappointed at the start of Q3 amid a pullback in demand from outside the euro area.
- While UK retail sales were firmer than expected in July, Gilts also followed the global trend higher.
- The ECB will leave interest rates on hold on Thursday, with updated projections likely to push the near-term inflation profile higher; July data for German industrial production, goods trade and UK GDP are also due.

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.923	-0.036
OBL 2.2 10/30	2.215	-0.051
DBR 2.6 08/35	2.658	-0.058
UKT 3¾ 03/27	3.901	-0.038
UKT 4⅜ 03/30	4.043	-0.063
UKT 4½ 03/35	4.642	-0.076

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

Euro area

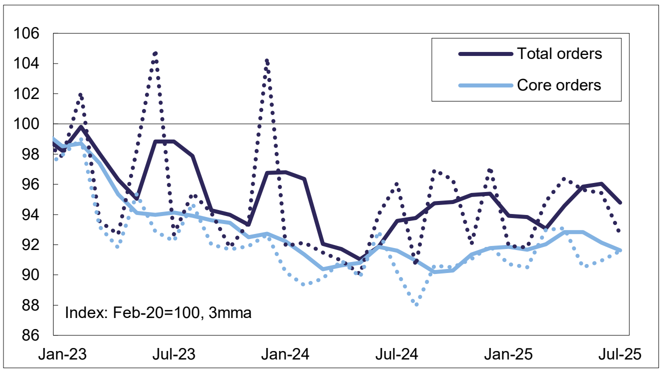
German factory orders disappoint amid a pullback in demand from outside the euro area

While the pullback in German manufacturing output in Q2 (-1.3%Q/Q) was widely expected after tariff front-running in Q1, today's German factory orders data for the start of Q3 disappointed, flagging downside risks to the near-term production outlook. Total new orders fell for a third successive month in July, by 2.9%M/M – the most since January – to a five-month low. Admittedly, the decline in June was largely revised away. And the weakness reflected a fallback in large-scale orders that had been particularly strong in certain subsectors last quarter. Indeed, orders of other transport equipment – including ships, aerospace and railway apparatus – fell a striking 39%M/M to the lowest level since March 2023. Orders for electrical equipment (-17%M/M) also partially reversed the jump in June. More encouragingly, orders for German autos leapt to the highest level in 3½ years. And pharmaceutical orders rose for the first month in four. When excluding bulk items, core orders also rose for a second successive month (0.7%M/M), with underlying domestic orders rising almost 2%M/M and core orders from elsewhere in the euro area (>1%M/M) up to the second-highest level since 2023. But perhaps unsurprisingly given persisting US tariff-related uncertainty, underlying orders from countries beyond the euro area fell for a third consecutive month. As such, total core orders were merely in line with the Q2 average raising uncertainties about the extent to which manufacturing will rebound this quarter. Today's turnover figures, however, were more upbeat, suggesting a second successive increase in July (0.9%M/M). Certainly, given the marked contraction in manufacturing output in June (-2.8%M/M), we expect some bounce back in July when the data are published on Monday. And given the notable mismatch between the turnover and production data in May and June, we wouldn't be surprised to see an upward revision to the level of output at the end of Q2 too.

Euro area GDP growth eeks out modest growth in Q2 despite decline in exports & capex

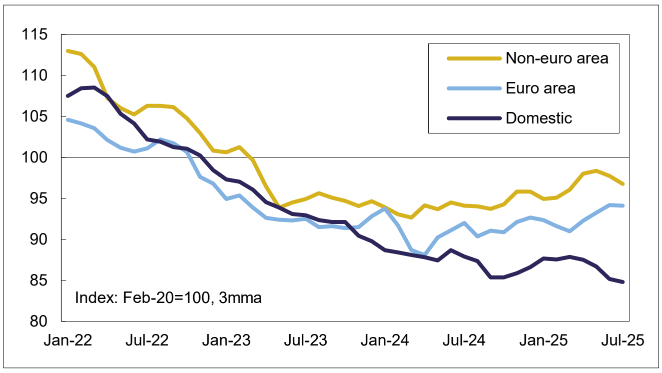
Despite the downwards revision to German GDP in Q2 (-0.3%Q/Q), the outsized upwards Irish revision (from -1.0%Q/Q to +0.2%Q/Q) meant that euro area economic growth was unrevised at 0.1%Q/Q. While this represented a marked slowdown from Q1 (0.6%Q/Q), it left the annual rate at an above-potential 1.5%Y/Y and the level of GDP 6% above the pre-pandemic benchmark. The expenditure breakdown, published for the first time today, unsurprisingly illustrated the payback for the tariff-related surge at the start of the year and the impact of ongoing policy uncertainty. In particular, export volumes fell 0.5%Q/Q, dropping for a first quarter in three, with goods shipments (-1.0%Q/Q) down the most in seven quarters. So, despite some offset in services, with no growth in imports, net trade subtracted 0.2ppt from GDP growth. Fixed investment was also predictably weak, knocking off a further 0.4ppt, with significant payback in spending on intellectual property and transport equipment. But government expenditure (0.5%Q/Q) provided some offset, not least reflecting higher spending in Germany. And while household consumption slowed again in Q2 (0.1%Q/Q), it contributed positively to GDP growth for a sixth straight

Germany: New factory orders*



Dotted lines represent unsmoothed data. Core orders excluding major items.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: New core factory orders*



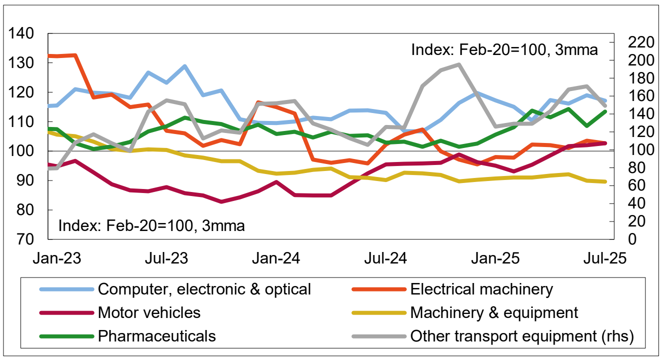
Excluding major items.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

quarter. With GDP matching employment growth in Q2, labour productivity remained at the joint-highest rate since Q322 on a per person basis (0.8%Y/Y), some 0.3ppt above the ECB's projection. At the same time, employee compensation growth slowed just 0.1ppt to 3.9%Y/Y, a near-four-year low but 0.5ppt above the ECB's previous projection. And unit labour cost growth merely moved sideways (3.3%Y/Y), similarly above the ECB's expectation. Nevertheless, unit profit growth rebounded to 1.1%Y/Y, the first positive rate since Q423, and we expect the uptrend in unit profits to extend throughout next year and 2027 as growth in unit labour costs moderates further.

ECB to hold rates, content with the positioning of the current policy

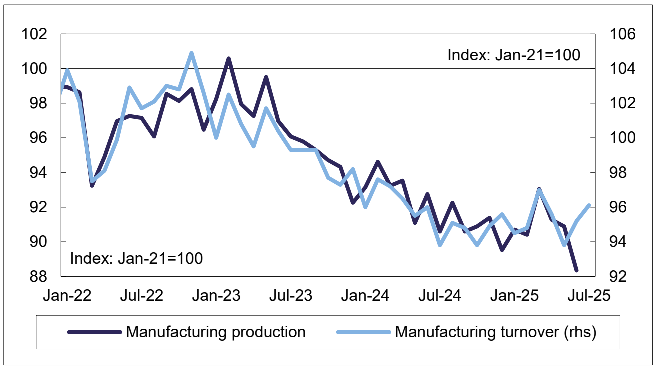
The monetary policy highlight in the coming week will be Thursday's ECB decision, which will be accompanied by its fresh set of macroeconomic projections. But in line with the consensus, we expect the Governing Council to hold rates for a second successive meeting, leaving the Deposit Rate at a broadly neutral 2.00%. Indeed, most comments from policymakers since the summer break have echoed Lagarde's sentiment about policy being in a 'good place' with no need to rush to move policy in either direction. And the data have also been broadly supportive of standing pat. Indeed, GDP growth came in on the high side of expectations over the first half of the year, and subsequent business survey indicators have remained surprisingly resilient to alleviate concerns about a slowdown in activity. With inflation close to target at 2.1%Y/Y in August but expected to edge higher over the remainder of the year, and the main core rate steady at 2.3%Y/Y for four

Germany: New factory orders



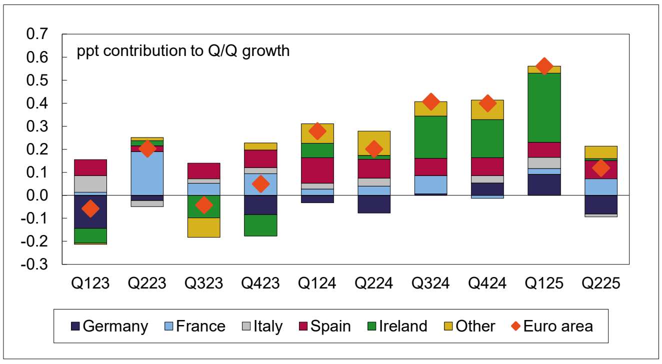
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing production & turnover



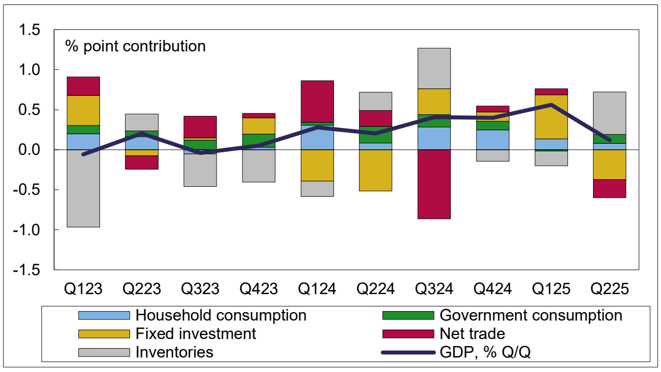
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & country contributions



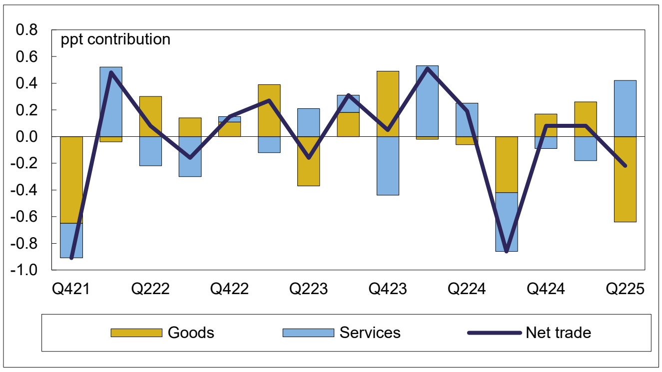
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & expenditure contributions



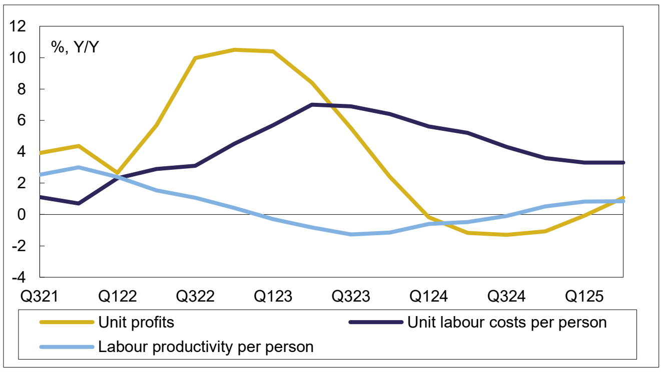
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Trade contributions to GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Unit profit, labour costs & productivity



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

months, the ECB should be happy to maintain its ‘wait-and-see’ stance. As such, our baseline view is that the ECB has already cut for the last time this cycle. But we acknowledge that the risks to rates are still skewed to the downside. As such, we think Lagarde will stop short of coming across overly hawkish in her post-meeting press conference by calling time on the possibility of further rate cuts. Indeed, the Governing Council’s policy statement will surely maintain its forward guidance of a ‘data-dependent’, ‘meeting-by-meeting’ approach.

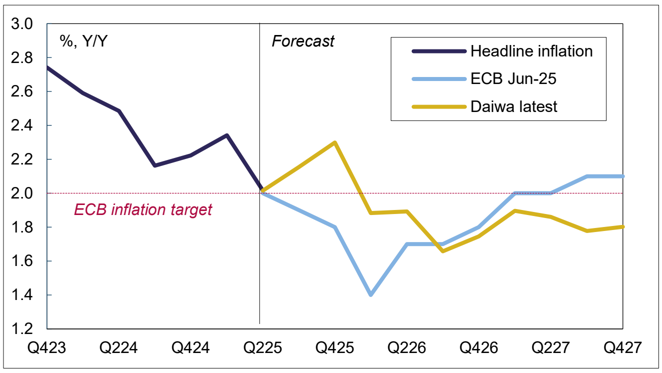
Projections to nudge inflation slightly higher in the near term before converging back to target

Thursday’s decision will be informed by the ECB’s projections, which may provide a guide as to the scope for a further rate cut later this year. But we expect little change to the pattern of the forecasts published in June, despite the 3% strengthening of the trade-weighted euro and 5% appreciation against the dollar since then. While opinions on the significance of exchange rate shifts vary across the Governing Council, most members will be relatively unperturbed by the euro’s current level. And the ECB will assess the euro’s appreciation to weigh only slightly on inflation across the forecast horizon, as too will the changes in market pricing for the future path of rates. So, it will still expect inflation to drop slightly below target in 2026, including with respect to the core rate amid downside risks to core goods prices and the promise of further moderation in services as wage settlements decelerate. But the ECB will also revise up its assumptions for prices of commodities and energy. Indeed, oil futures have settled around 4% higher over the course of next year since being marked up in June, and food is likely to overshoot the ECB’s forecast (2.9%Y/Y) by 0.3ppt in Q3. So, while it will still anticipate a moderation in inflation next year, unlike in June it will also expect headline inflation to remain above target in Q4. And the policymakers will be mindful of upside risks from food prices related to the hot European summer.

Growth forecast to be revised higher, but downside risks remain

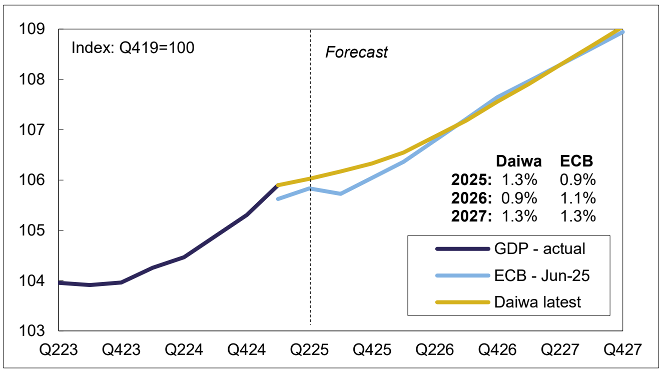
As in June, the ECB will still expect GDP growth this quarter to be absent. But not least owing to the stronger than expected growth in the first quarter of the year, and with activity expected to pick up momentum from Q4, the ECB is likely to revise higher its full-year GDP projection for this year (from 0.9%Y/Y to above 1.0Y/Y). Indeed, while the EU-US trade agreement implies a higher baseline US tariff of 15% for most goods and net trade certainly represents a non-negligible downside risk, we expect the ECB will see benefits from reduced uncertainty for business investment and consumption. As such, with the labour market having remained resilient, it will likely expect GDP growth to remain close to 1¼%Y/Y in 2026 before picking up slightly in 2027 thanks not least to German fiscal policy support. So, the extent of the anticipated inflation undershoot in 2026 may be less severe than the 1.6%Y/Y forecast in June. And we strongly expect the updated projections to continue to signal the convergence of inflation back to 2% in 2027.

Euro area: Inflation projections



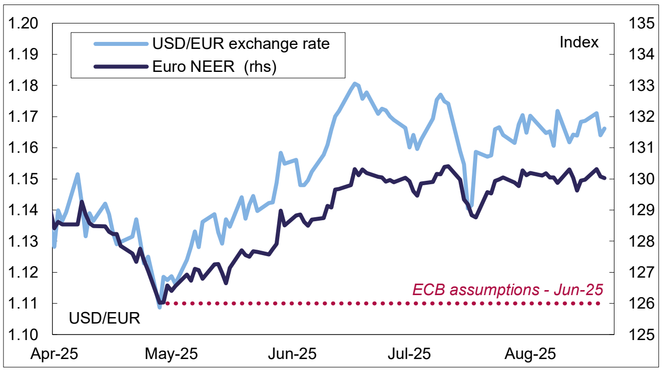
Source: Macrobond, ECB and Daiwa Capital Markets Europe Ltd.

Euro area: GDP levels projections



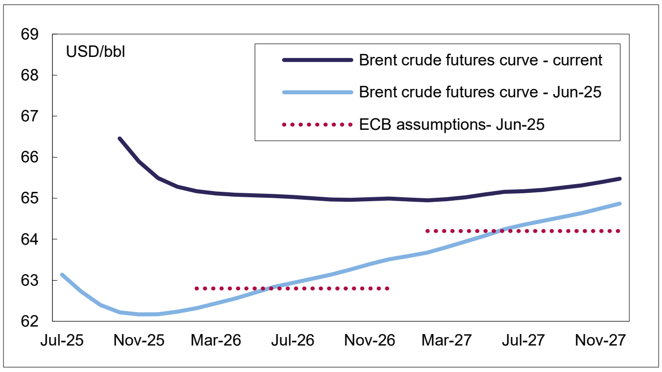
Source: Macrobond, ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Exchange rates



Source: Bloomberg, ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Oil price



Source: Bloomberg, ECB and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

Ahead of Thursday's ECB policy meeting in Frankfurt, events in Paris on Monday may generate volatility in European markets. While talks between the representatives of France's minority centrist government and opposition parties should continue over the weekend, PM Bayrou's no-confidence vote gamble – called in a desperate attempt to garner consensus on his fiscal consolidation proposals – currently looks likely to backfire. While abstention by the centre-left socialists or far-right RN would likely suffice for the PM to survive, at the time of writing that outcome appeared unlikely. If he is indeed rejected, Bayrou would become the third Prime Minister to be outed in 20 months, and set President Macron the task of identifying a new PM with the unenviable challenge of restoring fiscal discipline with an extremely fragmented national assembly. And while headlines about the growing risks of IMF intervention (as in the UK recently) are exaggerated, the likelihood of continued delays to fiscal consolidation would likely be reflected in Fitch's scheduled credit rating update (on Friday) with clear risks of a downgrade to a new low of A+, from AA- (negative outlook).

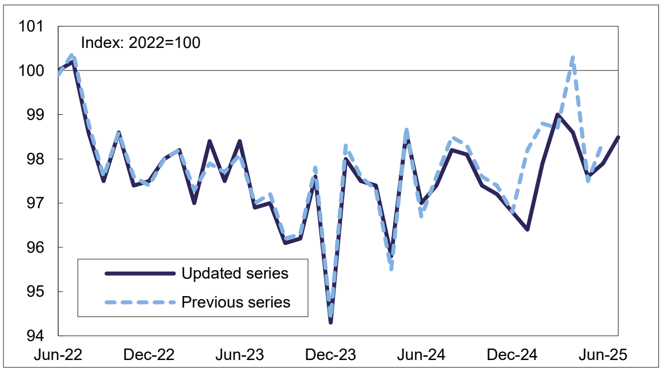
With regards to the data, the coming week will bring July industrial production (Monday to Wednesday) and August inflation detail from the largest member states (Friday). Monday's release of German IP will be supplemented by July's trade figures, with production expected to see only a modest rebound following a drop of almost 2%M/M in June amid weakness in new orders. And French IP (Tuesday) will likely soften as output in June was flattered by a temporary boost from aerospace manufacturers. Meanwhile, after Thursday's ECB decision, Friday's inflation detail from Germany, France and Spain will provide greater clarity into the drivers behind the slight step-up in the euro area headline rate in August to 2.1%Y/Y. According to the flash data, that principally reflected the 0.3ppt rise in the German HICP measure (also to 2.1%Y/Y) amid a pickup in food and energy inflation. Elsewhere, the flash releases showed that headline inflation moved sideways in Spain (2.7%Y/Y) and eased 0.1ppt in France (0.8%Y/Y) due to transport services.

UK

Retail sales firmer than expected in July while ONS confesses to errors to data for prior months

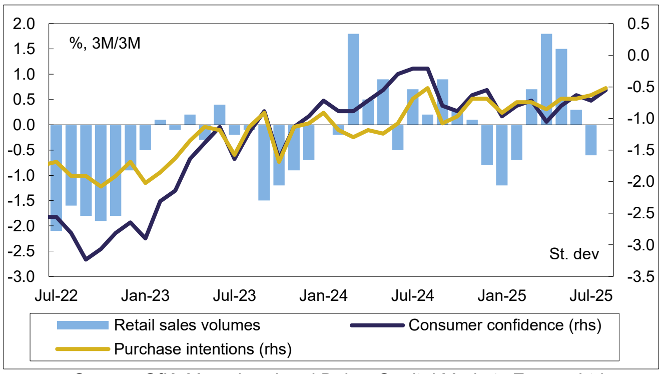
Retail sales volumes grew for a second successive month in July and by a stronger-than-expected 0.6%M/M to be 0.4% above the Q2 average and up 1.3%Y/Y. Sales of clothing and footwear were particularly strong (up 2.5%M/M to be more than 3% above the Q2 average) while household goods and auto fuel also provided support. In contrast, the food category was a touch softer (0.2%M/M) and fell below the Q2 average. Despite concerns that speculation about the nature of tax increases likely to be announced in November will weigh heavily, the positive figure for July as well as the uptick in consumer confidence in August to the highest level this year point to the likelihood of continued, albeit subdued, private consumption in the third quarter. More striking than the July outcome were the marked revisions to the profile of sales in the first half of the year, as the calamity-stricken ONS corrected newly discovered errors in seasonal adjustment. For example, the dip in sales initially estimated for March was replaced with firm growth while the subsequent surge previously reported for April was revised to a drop. Looking through the monthly volatility, the ONS revised down significantly sales growth in Q1 by a chunky 0.6ppt to 0.7%Q/Q but nudged up slightly the figure for Q2 by 0.1ppt to 0.3%Q/Q. As a result, the contribution of the retail sector to Q1 GDP growth to two decimal places has been halved to 0.03ppt, and household consumption growth is also likely to be revised down slightly. But the contribution from the retail sector to growth in Q2 remains at 0.01ppt. Overall, other things being equal, GDP growth to one decimal place should remain unchanged at 0.7%Q/Q in Q1 and 0.3%Q/Q in Q2, matching retail sales growth. And today's data are unlikely to change the views significantly of any members of the MPC about the underlying strength of UK economic activity or households' willingness to spend.

UK: Retail sales



Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Retail sales & consumer confidence



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

The week ahead in the UK

The July GDP report (due on Friday) will be the most notable new data to be released in the coming week. Surveys suggest that growth moderated from June's firm 0.4%M/M pace, which was the strongest in three months. For example, as an improvement in manufacturing output growth to a nine-month high failed to offset fully a softening in services, the composite PMI fell 0.5ppt in July to 51.5. And the construction PMI fell sharply to a five-year low (44.3). Nevertheless, we caution that the construction PMI has not provided a reliable guide to output in that sector. Today's retail sales data suggest ongoing expansion in the all-important services sector, which likely benefited from an early start to the school summer holidays. And the composite PMI in July was still firmly above the Q2 average and consistent with positive, albeit relatively subdued, growth. Overall, we anticipate GDP growth of 0.2%M/M, with modest expansion in services and manufacturing but a decline in construction, to leave the three-month rate steady at 0.3%3M/3M. After a pickup in production in Q2, manufacturing output might pose a downside risk not least given the unpredictable impacts of summer maintenance and US tariffs. However, with respect to the latter, we note that US goods imports from the UK rose to a four-month high in July.

Beyond the GDP report, the coming week brings a handful of surveys that will be of interest to the MPC. The REC report on jobs (Monday) will likely point to continued softening of the labour market in August, with recruitment agencies having the prior month reported the biggest drop in demand for permanent staff in five months as well as the softest rate of starting salary growth in more than four years. The BRC retail sales survey (Tuesday) will give a guide as to the strength of spending on the high street in August. The CBI distributive trades survey painted a gloomy picture of falling sales on a year-on-year basis, but we caution that report has failed to tally with the official ONS retail data. The RICS residential survey (Thursday) will likely suggest that housing market activity remained subdued in August after the prior survey reported falling demand, as well as declines in agreed sales and near-term price expectations. Finally, while the headline CPI rate is expected to peak at about 4.0%Y/Y this month, the BoE's inflation attitudes survey (Friday) should suggest that households expect inflation to moderate somewhat over the coming 12 months, albeit remaining somewhat sticky above 3.0%Y/Y.

Daiwa economic forecast

	2025				2026		2025	2026	2027
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.6	0.1	0.1	0.2	0.2	0.3	1.3	0.9	1.3
UK	0.7	0.3	0.4	0.3	0.3	0.3	1.4	1.2	1.4
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.3	2.0	2.2	2.3	1.9	1.9	2.2	1.8	1.8
Core HICP	2.6	2.4	2.3	2.5	2.3	1.8	2.5	1.9	1.6
UK									
Headline CPI	2.8	3.5	3.9	3.7	3.3	2.6	3.5	2.6	1.9
Core CPI	3.6	3.7	3.8	3.6	3.5	2.7	3.7	2.7	1.7
Monetary policy, %									
ECB									
Deposit Rate	2.50	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Refi Rate	2.65	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.15
BoE									
Bank Rate	4.50	4.25	4.00	3.75	3.50	3.25	3.75	3.25	3.25

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	GDP – third estimate Q/Q% (Y/Y%)	Q2	**0.1 (1.5)**	*0.1 (1.4)*	0.6 (1.5)	-
	GDP – private consumption Q/Q%	Q2	**0.1**	-	0.3	-
	GDP – government spending Q/Q%	Q2	**0.5**	-	-0.1	-
	GDP – fixed investment Q/Q%	Q2	**-1.8**	-	2.7	-
	Employment – final estimate Q/Q% (Y/Y%)	Q2	**0.1 (0.6)**	*0.1 (0.7)*	0.2 (0.7)	
Germany	Factory orders M/M% (Y/Y%)	Jul	**-2.9 (-3.4)**	0.5 (-0.6)	-1.0 (0.8)	-0.2 (1.7)
France	Trade balance €bn	Jul	**-5.6**	-	-7.6	-7.2
Italy	Retail sales M/M% (Y/Y%)	Jul	**0.0 (1.8)**	-	0.6 (1.0)	0.7 (1.1)
Spain	House price index Q/Q% (Y/Y%)	Q2	**4.0 (12.7)**	-	3.5 (12.2)	-
UK	Retail sales – incl. auto fuel M/M% (Y/Y%)	Jul	**0.6 (1.1)**	0.4 (1.3)	0.9 (1.7)	0.3 (0.9)
	Retail sales – excl. auto fuel M/M% (Y/Y%)	Jul	**0.5 (1.3)**	0.3 (1.1)	0.6 (1.8)	- (1.3)

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
		Monday 8 September 2025			
Euro area	09.30	Sentix investor confidence indicator	Sep	-2.1	-3.7
Germany	07.00	Industrial production M/M% (Y/Y%)	Jul	1.0 (-0.3)	-1.9 (-3.6)
	07.00	Trade balance €bn	Jul	15.4	14.9
		Tuesday 9 September 2025			
France	07.45	Industrial production M/M% (Y/Y%)	Jul	-1.0 (0.7)	3.8 (2.0)
UK	00.01	BRC retail monitor – like-for-like sales Y/Y%	Aug	2.0	1.8
		Wednesday 10 September 2025			
Italy	09.00	Industrial production M/M% (Y/Y%)	Jul	0.3 (0.0)	0.2 (-0.9)
Spain	08.00	Industrial production M/M% (Y/Y%)	Jul	-0.2 (2.6)	1.0 (2.3)
		Thursday 11 September 2025			
Euro area	08.30	ECB Deposit (Refinancing) Rate %	Sep	*2.00 (2.15)*	2.00 (2.15)
UK	00.01	RICS house price balance %	Aug	-10	-13
		Friday 12 September 2025			
Germany	07.00	Final HICP (CPI) Y/Y%	Aug	*2.1 (2.2)*	1.8 (2.0)
France	07.45	Final HICP (CPI) Y/Y%	Aug	*0.8 (0.9)*	0.9 (1.0)
Spain	08.00	Final HICP (CPI) Y/Y%	Aug	*2.7 (2.7)*	2.7 (2.7)
UK	07.00	Monthly GDP M/M% (3M/3M%)	Jul	*0.2 (0.3)*	0.4 (0.3)
	07.00	Services output M/M% (3M/3M%)	Jul	0.0 (0.3)	0.3 (0.4)
	07.00	Industrial output M/M% (Y/Y%)	Jul	0.0 (1.2)	0.7 (0.2
	07.00	Construction output M/M% (Y/Y%)	Jul	-0.2 (1.9)	0.3 (1.5)
	07.00	Trade (goods trade) balance £bn	Jul	-4.1 (-21.7)	-5.0 (-22.2)
	09.30	BoE/Ipsos inflation attitudes survey – 1Y ahead CPI Y/Y%	Q3	-	3.2

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		BST	Event / Auction
			Monday 8 September 2025
France		-	Vote of confidence in the Bayrou Government
UK		00.01	REC, KPMG and S&P Global UK Report on Jobs for August
			Tuesday 9 September 2025
Germany		10.30	Auction: to sell €500m of 0% 2031 green bonds
		10.30	Auction: to sell €1bn of 2.5% 2035 green bonds
		12.30	Bundesbank President Nagel to give speech on 'future-proofing central banks' at BIS Innovation Summit, Basel
France/UK		16.15	BdF Governor Villeroy in fireside chat moderated by BoE Deputy Governor Breeden at BIS Innovation Summit, Basel
UK		10.00	Auction: to sell £1.75bn of 4.75% 2043 bonds
			Wednesday 10 September 2025
Germany		10.30	Auction: to sell €1bn of 4.75% 2040 bonds
		10.30	Auction: to sell €1.5bn of 2.6% 2041 bonds
UK		10.00	Auction: to sell £4bn of 4% 2031 bonds
			Thursday 11 September 2025
Euro area		13.15	ECB monetary policy announcement
		13.45	ECB President Lagarde to hold post-Governing Council meeting press conference, Frankfurt
		14.45	ECB to publish updated macroeconomic projections
Italy		10.00	Auction: to sell bonds*
UK		10.00	Auction: to sell £1.25bn of 0.5% 2029 bonds
		10.00	Auction: to sell £1bn of 4.25% 2032 bonds
			Friday 12 September 2025
			- Nothing scheduled -

**Details to be announced. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs