Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made modest gains while the German dataflow confirmed a rebound in industrial output and firm goods export growth in Q2.
- Gilts also followed the global trend higher on a quiet day for UK economic news.
- The week ahead brings the first estimates of UK GDP and euro area employment in Q2 as well as updates on euro area IP and inflation in the large member states.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	2.739	-0.014
OBL 2.9 10/31	2.855	-0.016
DBR 3 08/36	3.130	-0.008
UKT 4⅜ 03/28	4.272	-0.022
UKT 4⅛ 03/31	4.459	-0.019
UKT 4¾ 10/35	4.923	-0.014

*Change from close as at 4:00pm BST.
Source: Bloomberg

Euro area

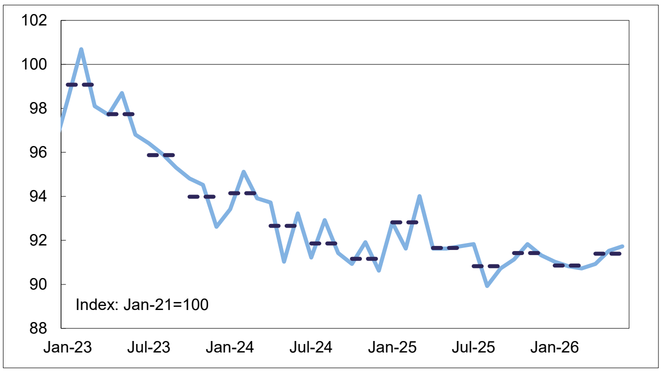
German industrial production rebounded in Q2 supported by stock-building and construction

According to today's release, German industrial output edged up in June (0.2%M/M) for the third consecutive month. And while May's upside surprise was revised down, German IP still expanded by 0.6%3M/3M in Q2, virtually reversing its decline from Q1 – as it did (and then some) in France, Italy and Spain. So, production certainly appears to have contributed to the firming of euro area GDP growth last quarter. There were further parallels between Germany and the other member states within the detail too. With high temperatures in Europe lending a boost to electricity demand, energy production provided most of the upwards impetus in June (1.9%M/M) and rose almost 1%Q/Q in Q2. Construction output was little better than flat in June but nonetheless grew for just a second quarter in eight (2.0%Q/Q) reflecting the boost to civil engineering work from higher public infrastructure investment. But while manufacturing output stagnated in June, it only recouped half of its drop last quarter (0.5%Q/Q). Amongst the subsectors, developments in transport equipment were notable. Albeit insufficient to offset its weakness at the start of the quarter, production of autos rose by more than 3½%M/M for a second successive month, while other transport equipment – which includes military-related production adjacent to shipping and aerospace – jumped by more than 8%M/M. As a result, non-autos transport saw its largest quarterly gain in nine years (5.3%Q/Q), a figure which – besides weapons and ammunition (11.4%Q/Q), which rose to another record high in June – was only surpassed in Q2 by coke and refining activity (8.5%Q/Q), predictable given the energy shock from the Middle East. Moreover, given its earlier boost as manufacturers sought to front-load production ahead of potentially acute supply shortages, output in energy-intensive subsectors – including chemicals and metals – collectively rose 2½%Q/Q in Q2.

While surveys point towards growing momentum, risks to IP in Q3 remain

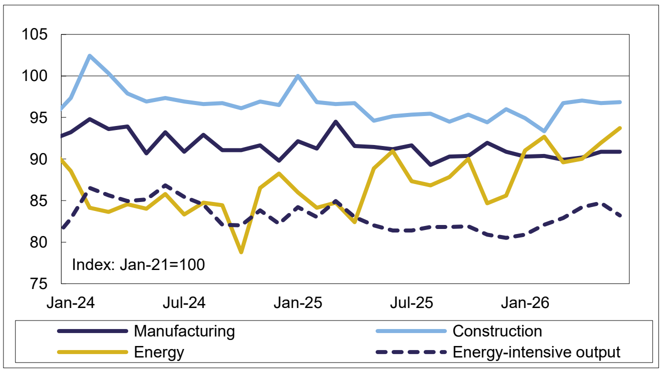
Looking ahead to Q3, the risks to German IP appear two-sided. The quarterly increase in energy-intensive production in Q2 would certainly have been larger were it not for a 1.8%M/M drop in June. And machinery (-3.9%M/M) fell to its lowest level since 2010 outside of two pandemic-affected months. The former might be indicative of weaker urgency given the initial energy price lull, but it might also suggest payback for the earlier front-loading of production. In either case, both imply weak carryover into Q3 for those sectors. Energy prices also edged higher again last month with natural gas – a more widely-used input according to Destatis – briefly eclipsing its March highs and remaining elevated. Supply chains could also be strained by the heatwave, particularly given record freight rates and disrupted transit on the historically shallow Rivers Rhine and Danube. Reassuringly, however, the latest ifo survey detected no significant increase in material supply shortages. In fact, July's business surveys were wholeheartedly more upbeat, with the latest ifo indices signalling that manufacturers and constructors were the most optimistic in six and four months respectively. Recent factory orders data have been firm too, particularly for ICT equipment, machinery and aerospace work, suggesting that those sectors could offer additional support, thanks not least to increased defence and infrastructure spending and AI-related demand.

Germany: Industrial production*



*Dashed blue lines show quarterly averages.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industrial production by subsector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

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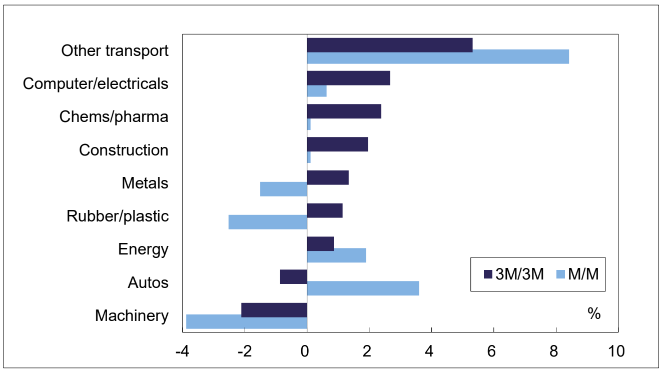
German export values hit series high in June but deficit with China widens further

Just as German manufacturing output supported economic activity in Q2, so too did goods exports. Indeed, the value of German goods exports rose for a fifth successive month in June to mark the longest unbroken run of growth since the turn of 2021-22. And the increase of 0.9%M/M took the value of goods exports (€139.3bn) above the previous peak reached in September 2022. Quarterly growth in export values of 2.9%Q/Q was the strongest since Q322. However, goods import values rebounded in June, rising 4.4%M/M and 5.0%Q/Q and touching their highest level since November 2022. Of course, the trade figures in value terms have been flattered over recent months by strong increases in prices of exports and imports alike. Nevertheless, goods export volumes rose for a second successive month in June and by 0.7%M/M to the highest level in more than two years. And over Q2, they rose for a third successive quarter and by a respectable 0.8%Q/Q. But as import prices fell back at the end of Q2, goods import volumes leapt in June by 4.9%M/M, the most in more than two years. That left them up 1.0%Q/Q over the quarter suggesting that – despite the boost from external demand – the direct contribution to GDP growth from net trade in Q2 might have been slightly negative. Moreover, despite the broadly favourable headline export figures, the geographical distribution flagged persistent structural challenges. While strong in Q2 to the rest of the EU (4.5%Q/Q), and up for a second successive quarter to the US (2.0%Q/Q), the value of exports to China fell for the fourth quarter out of the past five (-1.7%Q/Q) while imports from China rose sharply (5.3%Q/Q). So, the German bilateral deficit with China rose above €10bn for the first time in June. And Chinese data for July reported a further widening in July, heaping further pressure on Chancellor Merz – whose job security is looking increasingly fraught – and raising the likelihood that Germany will back new EU protectionist measures in the autumn.

The day ahead in the euro area

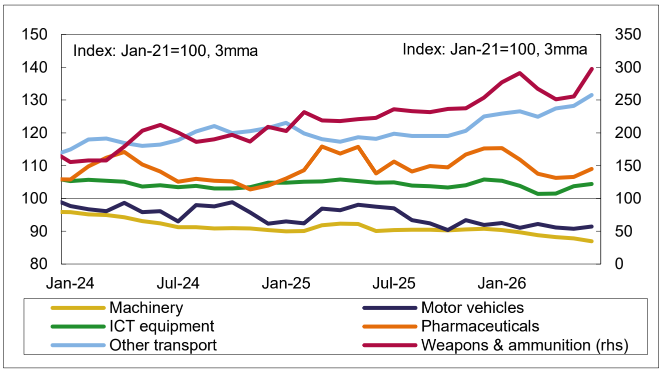
The euro area data flow over the coming two weeks will provide fresh insights into growth momentum and the evolution of underlying inflationary pressures. Following last week's upside surprise to the initial estimate of Q2 GDP, which showed euro area growth accelerating to a five-quarter high of 0.4%Q/Q, the second estimate (on Friday 14th August) will incorporate information from June data on industrial production (Thursday 13th) and goods trade (Friday 14th). These will likely suggest that manufacturing output and goods exports made positive contributions to euro area GDP growth in Q2 for the first time since Q125. Construction activity data (Thursday 20th) should also be consistent with expansion in Q2 due not least to strong gains in German civil engineering. But employment (Friday 14th) likely remained relatively sluggish as some firms put hiring on hold in the face of geopolitical uncertainty. In terms of signals on growth in Q3, sentiment surveys, including the flash August PMIs and Commission consumer indicator (both Friday 21st) should point to continued expansion this quarter. Tourism and ICT-related activity should have buoyed services while manufacturers are benefiting from firmer order books and a further slight easing of cost pressures. Admittedly, supply constraints might have become more binding in certain subsectors, with German manufacturers having to contend with record low water levels on the Rhine. Households may also be drawing confidence from stabilising fuel prices.

Germany: Output in selected industrial subsectors



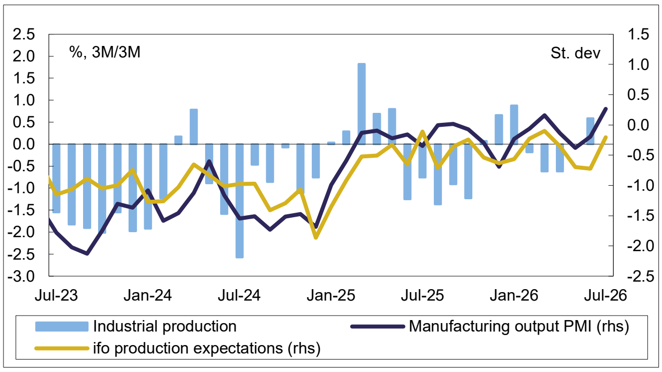
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Selected manufacturing output indices



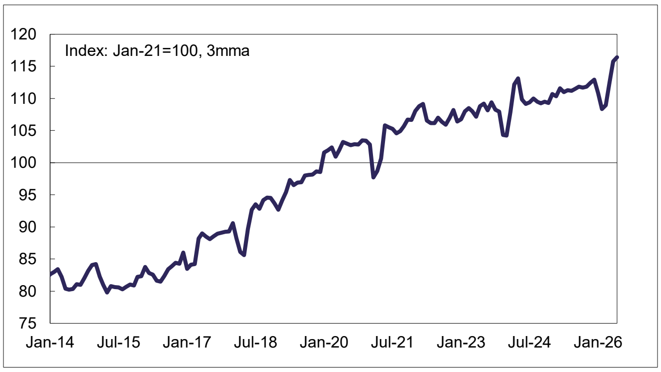
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industrial production & survey indicators



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

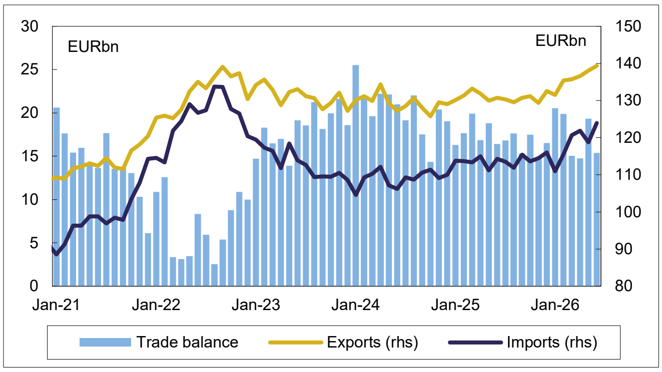
Germany: Civil engineering output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

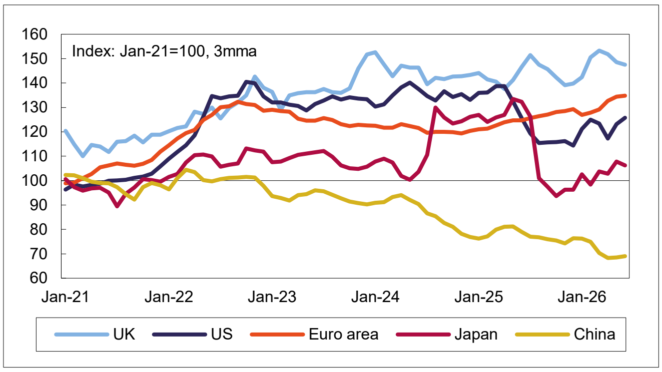
On the inflation front, the final July consumer price estimates (Wednesday 19th) are expected to confirm that the euro area headline rate edged up 0.1ppt to 2.9%Y/Y, as a jump in energy inflation due to the ending of fiscal support measures more than offset continued food disinflation. Core inflation also rose 0.1ppt, to 2.5%Y/Y, reflecting modest increases in non-energy industrial goods and services. However, the detail should suggest that these pressures remained largely contained to seasonal components, including airfares, accommodation and clothing. Separately, German PPI data (Thursday 20th) will provide an update on whether pipeline pressures remain confined to the early stages of the production chain. Meanwhile, labour costs (Wednesday 19th) and negotiated wage figures (Friday 21st) will be scrutinized for hints of second-round effects, which up to now have remained lacking. And while the ECB's consumer expectations survey (also Friday 21st) might show a pickup in the near-term inflation expectations due to the most recent rebound in oil prices, medium-term expectations should remain well anchored.

Germany: Goods trade values



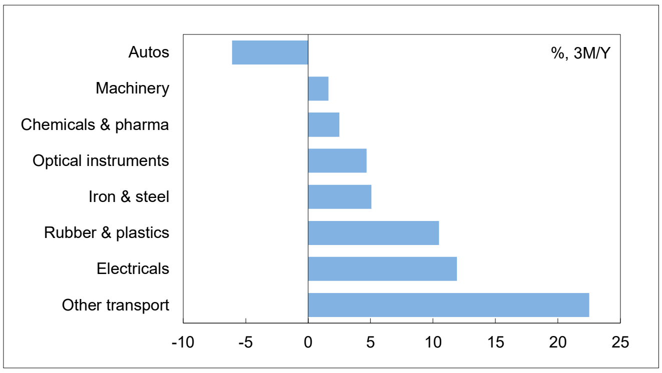
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Goods exports by destination*



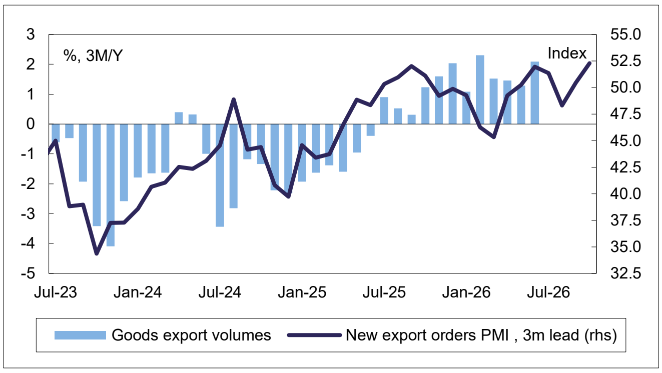
**Value terms. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Germany: Exports* by selected good (June-26)



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

Germany: Goods export volumes & orders PMI



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

UK

The two weeks ahead in the UK

While the next fortnight will bring several top-tier economic data releases to help inform the BoE's September monetary policy discussion, we suspect that they will not shift the reluctance of the MPC to adjust rates. Indeed, recent inflation data have been encouragingly well-behaved, with the annual rate easing to 2.6%Y/Y in June. And while July's figures (Wednesday 19th) will see headline inflation tick higher, the reacceleration will reflect the increase in the Ofgem regulated household energy price cap. The BoE expects inflation to rebound merely to 2.8%Y/Y, which is softer than our own forecast of 3.0%Y/Y. That difference can be partly explained by the slightly firmer increase in fuel prices last month, although the BoE's more dovish forecasts for food and services inflation also contribute to the divergence. Core inflation, however, should be little changed, perhaps moving sideways at 2.6%Y/Y for a third straight month.

Given the risks posed by fluctuating energy prices, extreme weather and AI-related pressures, the risks to the inflation outlook remain firmly to the upside. But other forthcoming data releases should reinforce the view of most policymakers that, amidst tighter financial conditions, the likelihood of high inflation becoming embedded is sufficiently low. In particular, the latest labour market data (Tuesday 18th) are likely to report a further moderation in private sector wage growth, potentially undershooting slightly the BoE's projection of 2.8%3M/Y. And while the Bank sees the unemployment rate temporarily easing to 4.8%3M in June, consistently weak signals from business surveys about firms' employment intentions point to persistent slack. Moreover, the BoE assesses underlying activity to be weaker than that implied by the headline GDP figures. Indeed, while preliminary national accounts data (Thursday 13th) are expected to signal that GDP was surprisingly firm in Q2 – perhaps rising as much as 0.4%Q/Q – the Bank was already unimpressed by the official estimate of growth in Q1 (0.6%Q/Q). Though GDP growth is bound to be somewhat softer in Q2 than in Q1, consumption is likely to have been somewhat resilient, and net trade is also well positioned to have rebounded. But precautionary inventory building might also have provided support, implying the likelihood of some payback later. And fixed investment seems likely to have suffered amidst the broader uncertainty of the oil shock and chaos in the Middle East.

Looking ahead to the current quarter, the UK flash PMIs (Friday 21st) will provide an indication as to whether tentative signs of firmer momentum at the start of Q3 were sustained into August. Despite a near-3pt increase to the composite output PMI in July, to 52.2, demand indicators in the services sector were relatively less upbeat, helping to keep selling price expectations contained. Favourable base effects from Q2 also imply that retail sales could rise for a third consecutive quarter, and another solid reading in July (also Friday 21st) cannot be discounted given the persistently warm weather and rebound in consumer confidence last month. Indeed, while often volatile, the CBI's retail sales indicator in July was notably its least downbeat for six months. Then again, the rise in household electricity bills last month will have constrained real incomes. And higher prices could have weighed on sales of auto fuels, as they did in April. And we see risks of modest payback to August's consumer confidence reading (again, Friday 21st) as a result too. The BRC's retail monitor (Tuesday 11th) will help to further inform expectations of July's retail sales reading ahead of its release, while a separate survey from RICS (Thursday 13th) is likely to remain downbeat about near-term prospects for housing market activity. July's update to the public finances data is also due (Friday 21st).

The next Euro wrap-up will be published on Tuesday 18 August 2026

Daiwa economic forecast

	2026				2027		2026	2027	2028
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.0	0.4	0.2	0.2	0.3	0.4	0.8	1.1	1.4
UK	0.6	0.4	0.1	0.1	0.4	0.3	1.1	1.1	1.4
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.0	3.0	3.1	3.4	3.4	2.7	2.9	2.7	2.0
Core HICP	2.3	2.4	2.5	2.7	2.9	2.8	2.5	2.8	2.2
UK									
Headline CPI	3.1	2.8	3.3	3.5	3.4	2.9	3.2	2.7	2.0
Core CPI	3.2	2.5	2.8	3.0	3.2	3.2	2.9	3.0	2.5
Monetary policy, %									
ECB									
Deposit Rate	2.00	2.25	2.50	2.50	2.50	2.50	2.50	2.25	2.25
Refi Rate	2.15	2.40	2.65	2.65	2.65	2.65	2.65	2.40	2.40
BoE									
Bank Rate	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.25	3.25

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

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European calendar

Today's results							
Economic data							
Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Industrial production M/M% (Y/Y%)	Jun	**0.2 (-0.1)**	0.2 (0.1)	0.9 (0.0)	0.7 (-)
	Trade balance €bn	Jun	**15.4**	17.2	19.1	19.3
France	Trade balance €bn	Jun	**-5.8**	-	-6.9	-7.7
	ILO unemployment rate %	Q2	**8.3**	8.2	8.1	-
Auctions						
Country	Auction					
- Nothing to report -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Key data releases: 10 August 2026 – 21 August 2026

Mon 10	Tue 11	Wed 12	Thu 13	Fri 14
EURO AREA SENTIX INVESTOR CONFIDENCE (AUG) **UK** REC, KPMG AND S&P GLOBAL UK REPORT ON JOBS (JUL)	**ITALY** TRADE BALANCE (JUN) **UK** BRC RETAIL MONITOR (JUL)	**GERMANY** FINAL HICP INFLATION (JUL) **ITALY** FINAL HICP INFLATION (JUL)	**EURO AREA** INDUSTRIAL OUTPUT (JUN) **SPAIN** FINAL HICP INFLATION (JUL) **UK** GDP – FIRST ESTIMATE (Q2) MONTHLY GDP (JUN) RICS HOUSING MARKET SURVEY (JUL)	**EURO AREA** GDP – SECOND ESTIMATE (Q2) EMPLOYMENT – FIRST ESTIMATE (Q2) TRADE BALANCE (JUN) **FRANCE** FINAL HICP INFLATION (JUL)

Mon 17	Tue 18	Wed 19	Thu 20	Fri 21
NOTHING TO REPORT	**GERMANY** ZEW ECONOMIC SENTIMENT (AUG) **UK** LABOUR MARKET REPORT: WAGES, EMPLOYMENT, UNEMPLOYMENT (JUN) PAYROLLS, JOBLESS CLAIMS (JUL)	**EURO AREA** FINAL HICP INFLATION (JUL) FLASH LABOUR COSTS & JOB VACANCY RATE (Q2) ECB CURRENT ACCOUNT (JUN) **UK** CPI INFLATION (JUL) PPI (JUL) HOUSE PRICE INDEX (JUN)	**EURO AREA** CONSTRUCTION OUTPUT (JUN) **GERMANY** PPI (JUL)	**EURO AREA** FLASH PMI (AUG) FLASH EC CONSUMER CONFIDENCE (AUG) ECB CONSUMER EXPECTATIONS SURVEY (JUL) NEGOTIATED WAGES (Q2) **GERMANY** FLASH PMI (AUG) GDP – FINAL ESTIMATE* (Q2) **FRANCE** FLASH PMI (AUG) INSEE BUSINESS SURVEY (AUG) **UK** RETAIL SALES (JUL) FLASH PMI (AUG) GFK CONSUMER CONFIDENCE (AUG) PUBLIC SECTOR NET BORROWING (JUL)

**Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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