Euro wrap-up

Overview

- Despite stronger-than-expected euro area producer prices and final August PMIs consistent with solid expansion in Q3, Bunds followed USTs higher.
- While BoE Chief Economist Pill's renewed call for a rate hike, Gilts outperformed as the final UK PMIs continued to signal subdued demand.
- Friday will bring euro area retail sales and German factory orders data, alongside a BoE survey of business inflation and wage expectations.

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Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	2.955	-0.037
OBL 2.9 10/31	3.083	-0.036
DBR 3 08/36	3.346	-0.028
UKT 4 05/29	4.526	-0.087
UKT 4⅛ 03/31	4.630	-0.088
UKT 4⅞ 07/36	5.143	-0.086

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

Euro area

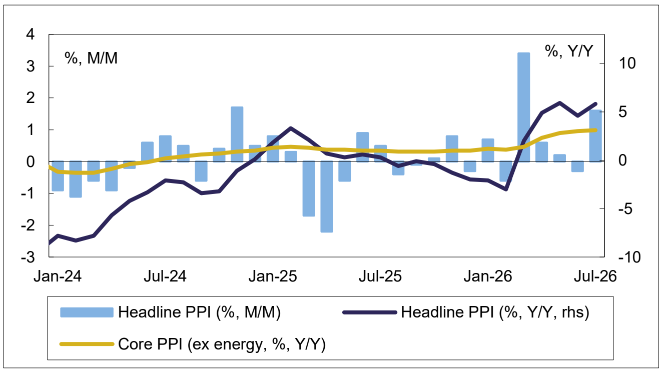
Producer prices accelerate on energy costs, signs of some pass-through along supply chain too

When ECB policymakers meet next week, there is little doubt that the Governing Council will raise the deposit rate by a further 25bps to 2.50%. The outlook for policy beyond that point, however, remains less certain. Nevertheless, today's producer goods price figures might add weight to the case for extra tightening before year-end, as they suggested that pipeline price pressures reinflated at the start of Q3. Producer prices jumped 1.6%M/M in July, the most since March, to push the annual rate up 1.2ppts to 5.8%Y/Y, just shy of May's three-year high. Admittedly, energy remained the main driver, with prices of that component surging 5.6%M/M, also the most in four months, to be up 12.9%Y/Y and 14% since before the start of the Iran conflict at end-February. In contrast, prices of non-energy goods were unchanged on the month. At face value, that might suggest only limited cost pass-through from the energy shock along the supply chain. But core PPI inflation (excluding energy) still rose for a fifth successive month to 3.1%Y/Y, 2ppts higher than before the start of the Iran conflict and the firmest in more than three years. Despite being unchanged in July, prices of intermediate goods were more than 6% higher than a year ago, while capital goods prices rose for a seventh successive month to be up 2.6%Y/Y, the most since end-2023. And there remain pressures in hydrocarbon-intensive items, including chemicals, and certain goods benefiting from AI-related demand. The pass-through to consumer goods prices appeared limited so far, with prices up just 0.4%Y/Y. But this figure was flattered by falling food prices. Indeed, excluding food, beverages and tobacco, consumer goods PPI inflation increased to 2.4%Y/Y, up 0.8ppt from the start of the year. And while surveys suggest that manufacturing selling price expectations moderated slightly in August, they remain well above levels seen before the war. Overall, we still expect core goods HICP inflation to take a further step up over coming quarters due to increased cost pass-through from the energy shock as well as pressures from global AI-related demand.

PMIs point to solid expansion in Q3, with rising orders suggesting momentum to extend into Q4

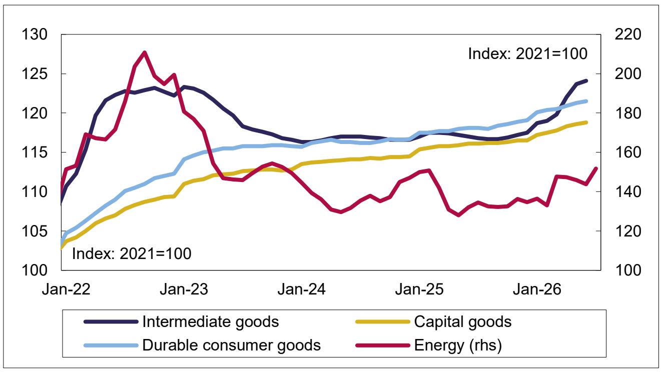
Policymakers might take some comfort from survey findings that firms have not panicked in the face of the renewed spike in wholesale energy prices over the summer. Certainly, the final composite PMIs for August showed the input price index moderating to a six-month low. But prices charged – particularly in services – were slightly firmer than initially estimated, perhaps reflecting pricing power in the face of resilient demand. Indeed, despite a modest downwards revision from the flash release, today's final composite activity PMIs reinforced signals from the Commission survey that the euro area economy continued to regain momentum over the summer. At 52.0, the headline composite output index was tracking almost 3½pts above its Q2 average, pointing to another solid quarter of expansion in Q3. While the upturn remained manufacturing-led (53.3), the services activity index (51.6) also signalled firmer growth in the sector this quarter. Much of that resilience continued to come from Southern Europe, where Italy's services PMI (55.2) rose to its highest level since April 2023,

Euro area: Producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Producer price levels



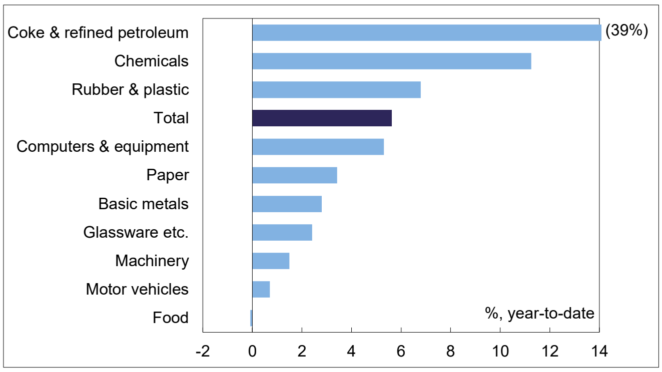
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

surpassed only by Spain (57.8). As such, the composite PMIs pointed to GDP outperformance this quarter in both major Southern European economies. Meanwhile, although its services sector reportedly stagnated in August, the German composite PMI (51.8) nevertheless rose to the highest level in five months, consistent with a fourth successive quarterly expansion. The survey also suggested that the recovery should extend into Q4. New orders accelerated across most member states in August to match the fastest pace since last November, while export orders increased for the first time in 4½ years. Firms responded by increasing headcount for a third successive month and by the most so far this year. Nevertheless, amid ongoing geopolitical tensions and elevated wholesale prices, expectations for output over the coming year were no better than in July, remaining above the Q2 average but still relatively subdued by historical standards.

The day ahead in the euro area

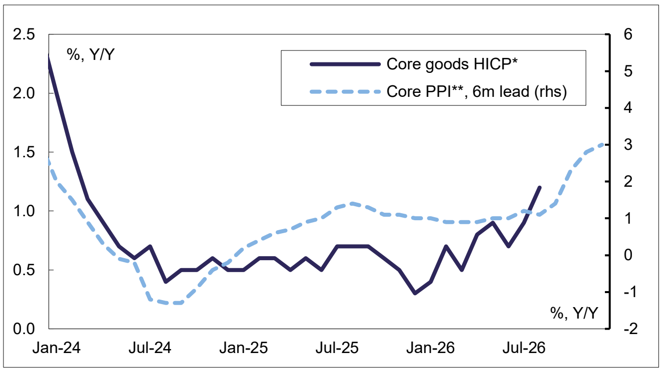
The end of the week will bring a handful of noteworthy activity data from the euro area, including July's regional retail sales and German factory orders data. Despite the encouraging signals from surveys regarding a further pickup in underlying growth momentum this quarter, the outlook for retail spending is less assured given the effects of rising inflation and lasting uncertainty. The removal or watering down of fiscal support for energy in some member states – namely Germany and Spain – was also expected to temper any upside in July via lower fuel volumes. But the weakness in Germany was particularly stark, and broad-based, with volumes experiencing their sharpest decline (-3.4%M/M) for five years. So, while June's euro

Euro area: YTD change in producer prices*



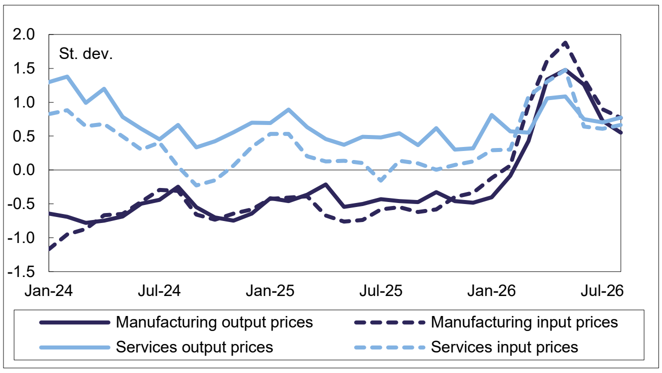
*January-July 2026. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core goods HICP & PPI inflation



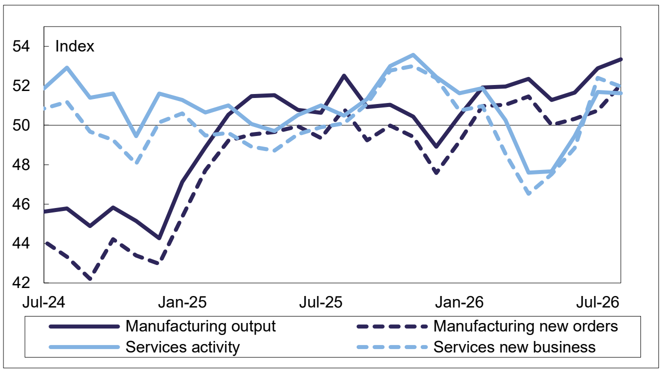
*Non-energy industrial goods. **Excluding energy.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing & services price PMIs



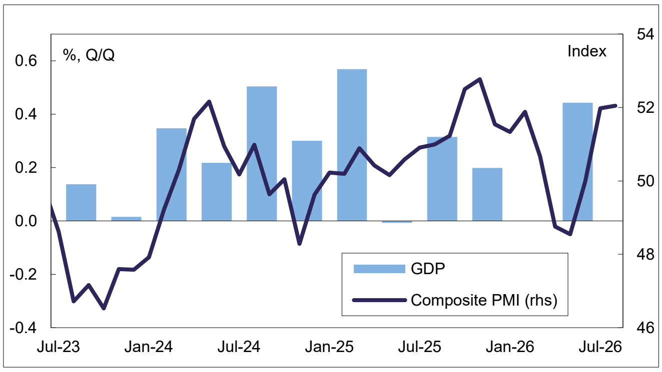
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing & services activity PMIs



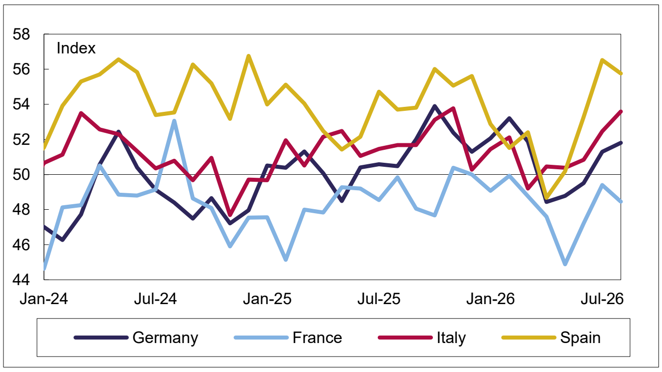
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & composite output PMI



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

Euro area member states: Composite output PMIs



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

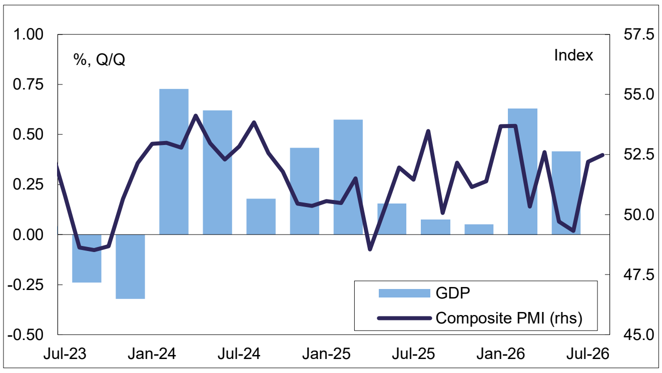
area sales figure could be revised modestly positively, July's is highly likely to report a steep fall, perhaps by as much as ¾%M/M. And while core spending in Germany might recover quickly, such a decline would leave sales this quarter facing an uphill battle to avoid a first negative quarter since Q323. On the other hand, surveys suggest that the mix of higher defence spending, AI-related investment and precautionary stockpiling for manufacturers are continuing to counter the headwinds from the Middle East. Indeed, the latest output and new orders PMIs for Germany were the best since January 2022. So, while German factory orders grew firmly at the end of Q2, further increases in July could be on the cards. Meanwhile, ahead of next Monday's final euro area GDP release, a loose eye will also be kept on the final estimates from Ireland. The Irish data – whose preliminary figures pointed towards a partial, if not large, rebound in Q2 (3.9%Q/Q) – are often revised and have an outsized effect on euro area GDP, to the extent that the ECB excluded certain components from the Eurosystem staff projections in June. The construction PMIs will also provide an indication as to whether infrastructure investment in Germany and cooler weather elsewhere might have supported activity in that sector last month.

UK

Services activity accelerated over the summer, but outlook clouded by subdued demand

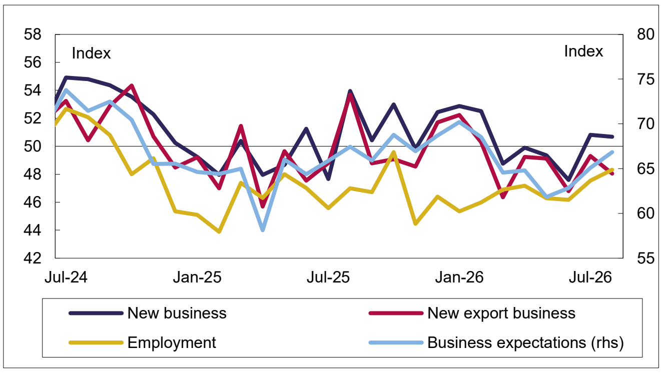
There were no major surprises in today's final UK services PMIs, which flagged a further pickup in business activity in the sector midway through Q3 as the summer heatwave and greater domestic certainty seemingly gave a boost. Indeed, despite a modest downwards revision from the flash release, the headline activity index in August (52.5) was the highest in six months and tracking some 2pts above the Q2 average. With the equivalent manufacturing PMI having been nudged higher, the composite output index was unrevised at a four-month high of 52.5, albeit at a level that implies still sluggish growth momentum, below levels before the Middle East conflict. While firms were more upbeat about expected output over the coming 12 months, the survey suggested that demand remains relatively subdued, with new foreign orders reportedly slipping back. So, while the survey implied the softest decline in headcount since late-2024, according to S&P Global, firms continued to report hiring freezes due to cost pressures and excess capacity, with some also noting efforts to boost productivity through automation. Indeed, the implied decline in service sector employment has now extended to almost two years, marking the longest such run on the survey's 30-year history. Meanwhile, the price PMIs were somewhat mixed. Likely reflecting recent volatility in energy markets, both the input and output price indices for services firms rose for the first month in four. But inflationary pressures reportedly remained less intense than in June. Moreover, the manufacturing PMI suggested that cost pressures in that sector have not worsened, with the respective output price PMI falling the most since the start of the conflict. Overall, the PMIs suggest that, while growth momentum has probably improved modestly over the summer, demand conditions likely remain too subdued to generate persistent substantive domestic inflation pressures. Combined with continued labour market softening, that should leave most MPC members comfortable keeping rates on hold this month.

UK: GDP growth & composite output PMI



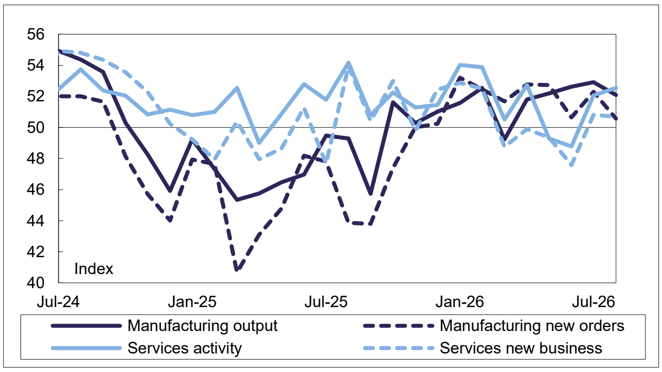
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected composite PMIs



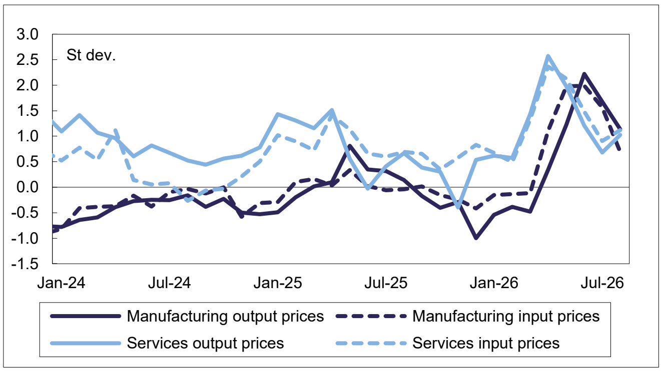
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing & services activity PMIs



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

UK: Manufacturing & services price PMIs



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

The day ahead in the UK

The highlight of Friday's UK dataflow will be August's Decision Maker Panel survey. Given policymakers' attentiveness to signals of potential indirect and second-round effects on inflation and today's confirmation of a modest reacceleration in the services price PMIs, all eyes in the UK on Friday will be on the signals of firms' price- and wage-setting intentions in August's Decision Maker Panel survey. Certainly, the risks to the August update are skewed to the upside. Lower energy prices at the start of July and hopes for a broader deescalation in the Middle East saw firms' inflation expectations moderate significantly that month, at least to their pre-war levels and to a 21-month low (2.6%Y/Y) at a three-year horizon. And firms' price and wage expectations eased to five-month and series-lows respectively. But the subsequent rebound in wholesale energy prices, and particularly gas prices, suggests that CPI expectations will be notched up again with similar implications for firms' output price expectations. The UK construction PMIs will also provide an indication as to whether those factors had any implications for builders' materials costs. While chronically downbeat, hot weather and tight financial conditions suggest that the survey will continue to flag subdued activity in the sector last month. Otherwise, in terms of BoE speak, a speech by Governor Bailey at a conference in London might also be of interest.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Final composite (services) PMI	Aug	**52.0 (51.6)**	*52.1 (51.7)*	52.0 (51.7)	-
		PPI Y/Y%	Jul	**5.8**	5.5	4.6	-
Germany		Final composite (services) PMI	Aug	**51.8 (49.7)**	*51.0 (48.5)*	51.3 (49.8)	-
France		Final composite (services) PMI	Aug	**48.5 (48.0)**	*48.8 (48.4)*	49.4 (49.6)	-
Italy		Composite (services) PMI	Aug	**53.6 (55.2)**	53.1 (53.4)	52.5 (52.5)	-
Spain		Composite (services) PMI	Aug	**55.8 (57.8)**	57.4 (58.8)	56.5 (58.3)	-
UK		Final composite (services) PMI	Aug	**52.5 (52.5)**	*52.5 (52.8)*	52.2 (52.1)	-

Auctions

Country		Auction
France		sold €3.300bn of 1.25% 2036 bonds at an average yield of 4.19%
		sold €6.862bn of 3.7% 2036 bonds at an average yield of 4.23%
		sold €1.676bn of 0.5% 2040 bonds at an average yield of 4.51%
		sold €1.659bn of 4.1% 2046 bonds at an average yield of 4.74%
Spain		sold €2.063bn of 2.35% 2029 bonds at an average yield of 3.079%
		sold €1.575bn of 2.6% 2031 bonds at an average yield of 3.255%
		sold €1.996bn of 3.3% 2036 bonds at an average yield of 3.736%
		sold €639mn of 2.05% inflation-linked 2039 bonds at an average yield of 1.822%
UK		sold £900mn of 1.875% 2049 inflation-linked bonds at an average yield of 2.496%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Italy		PPI Y/Y%	Jul	**9.3**	-	6.8	-
Spain		Unemployment change (employment net change) 000s	Aug	**44.4 (83.8)**	-	19.5 (79.6)	-

Auctions

Country	Auction
- Nothing to report -	

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	-	44.3
		10.00	Retail sales M/M% (Y/Y%)	Jul	*-0.6 (0.8)*	-0.3 (0.7)
Germany		07.00	Factory orders M/M% (Y/Y%)	Jul	0.3 (10.5)	3.1 (6.5)
		08.30	Construction PMI	Aug	-	42.1
France		08.30	Construction PMI	Aug	-	41.5
Italy		08.30	Construction PMI	Aug	-	49.1
		09.00	Retail sales M/M% (Y/Y%)	Jul	-	-0.1 (3.1)
UK		09.00	New car registrations Y/Y%	Aug	-	11.7
		09.30	DMP – year-ahead output price (CPI) expectations 3M/Y%	Aug	-	3.9 (3.0)
		09.30	Construction PMI	Aug	46.0	44.7

Auctions and events

UK		09.50	BoE Governor Bailey to give keynote speech at LSE TRIUM Anniversary Conference, London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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