

Euro wrap-up

Overview

- Bunds were little changed as economic surveys suggested that euro area GDP growth remains steady in the third quarter.
- Despite a positive UK manufacturing survey, longer-dated Gilts made gains as the BoE purchased bonds with maturities of 15Y and above.
- Wednesday brings the second estimate of German GDP in Q2 together with its expenditure breakdown, and UK bank lending data for July.

Chris Scicluna
+44 20 7597 8326

Mantas Vanagas
+44 20 7597 8318

Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.631	-0.006
OBL 0 10/21	-0.518	+0.007
DBR 0 08/26	-0.091	-0.002
UKT 1¼ 07/18	0.128	+0.004
UKT 1½ 01/21	0.207	+0.003
UKT 2 09/25	0.551	-0.030

*Change from close as at 4.30pm BST.
Source: Bloomberg

Euro area

Flash PMIs signal steady euro area expansion in Q3

Recent economic data have been consistent with steady GDP growth in the euro area in the third quarter close to the 0.3%Q/Q rate of Q2. That pattern was maintained today as the euro area flash composite PMI for August slightly exceeded expectations, inching up 0.1pt to 53.3 – a seven-month high but only a touch above the average for the year to-date – to leave intact the broadly sideways trend in the series so far in 2016. The slight improvement from July emanated from the services sector, where the activity index rose to a three-month high, albeit still a touch below the average for the year so far. In contrast, the manufacturing headline index slipped back to a three-month low but still matched the norm for the year to-date to suggest that there is no cause for concern about a loss of momentum within the sector. At the country level, there was a welcome rise in the French composite PMI to a ten-month high (51.6) to imply a return to economic expansion in Q3 following a flat second quarter. While the improvement in France was concentrated on the services sector, Germany's flash PMIs saw the headline services index fall to its lowest level in fifteen months. And with the survey indicating a slight weakening in the country's manufacturing sector too, Germany's composite PMI fell almost one point, the most since January, to reverse fully the previous month's gain which had taken it to its highest level for the year to-date, suggesting no marked acceleration in growth in the euro area's largest member state in Q3. Among other detail, the euro area's survey signalled continued steady employment growth in line with the rates seen over the past year. But there remains no sign of inflation stirring, with the composite output price PMI slipping back further below the key 50 mark.

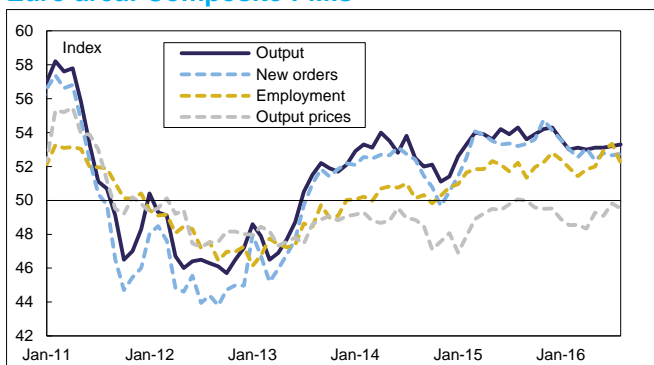
A slight softening of consumer confidence

In contrast to the flash PMIs, the European Commission's preliminary estimate of consumer confidence in August disappointed expectations, slipping for the third successive month to the lowest level since April, firmly in the bottom half of the range of the past eighteen months. However, at this level, consumer confidence remains consistent with continued consumer spending growth close to the average rate of 0.3%Q/Q recorded since the economic recovery began in mid-2013. And with the flash PMIs holding up well, while the deterioration in consumer sentiment is disappointing, it seems unlikely to provide any cause for the ECB to take a dimmer view of the economic outlook as it updates its forecasts ahead of the next monetary policy meeting, which concludes on 8 September.

The day ahead in the euro area and US

Wednesday will bring the second estimate of German GDP in Q2, which is expected to confirm the initial estimate of growth of 0.4%Q/Q, down from 0.7%Q/Q in Q1. The expenditure breakdown of GDP will be released for the first time, and this is expected to confirm that consumption slowed and business investment contracted, but also that net trade provided a positive

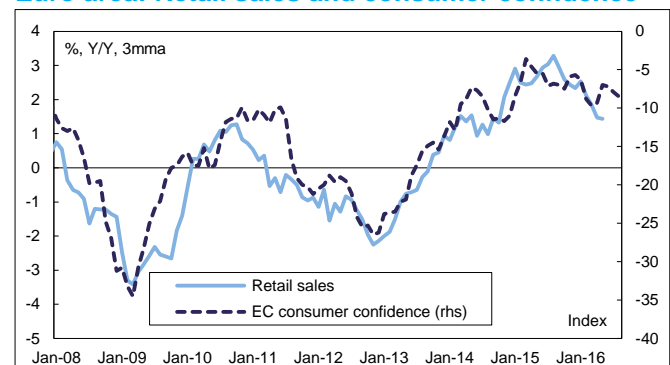
Euro area: Composite PMIs*



*August 2016 readings are flash estimates.

Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales and consumer confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



contribution to German growth for the first time in one year. French jobseeker data for July are also due late in the day, and these are expected to show a further fall to the lowest level in seventeen months. In the bond markets, Germany will sell 5Y Bunds.

In the US, existing home sales figures for July will be released in addition to the June FHFA house price indices. The US Treasury will sell 2Y FRNs.

UK

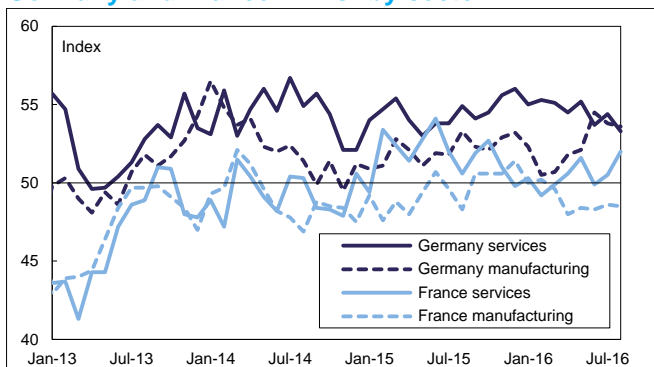
CBI survey suggests manufacturing growth continues post-referendum

On an otherwise quiet day in the UK, the CBI's latest Industrial Trends Survey for August was the most notable data release. Last month, the survey suggested that manufacturing output growth fared relatively well after the referendum vote, and the main figures of today's survey were broadly similar. In July, the output indicator reached its highest level since February 2015, and although a small decrease was reported this month the index was still broadly in line with recent values, suggesting above-average growth in the sector in August. Meanwhile, the survey measure of total orders was little changed and expectations for future output growth recovered notably having fallen in July to the lowest level this year. Perhaps unsurprisingly, the improvement seems to have been driven by sterling depreciation as the export orders index rose notably. Of course, the flipside of the weaker currency is higher input costs: in line with the sharp rise in producer input prices reported last week, the survey showed that a significant increase in average prices is expected in coming months. But, overall, the survey suggests that, with little chance of Article 50 being triggered to start the formal Brexit process anytime soon, manufacturers are being supported by the current relatively stable operating environment and weak currency. Of course, the key to the UK economic outlook over the coming quarters will be the services sector, which accounts for almost 80% of the economy and is driven mainly by domestic demand, which seems likely to be more adversely affected by Brexit uncertainty.

The day ahead in the UK

BBA data from the major retail banks are due tomorrow. Ahead of the release of similar lending data from the BoE next week, tomorrow's figures are likely to show that UK households were less eager to borrow in July after an increase in uncertainty following the Brexit vote.

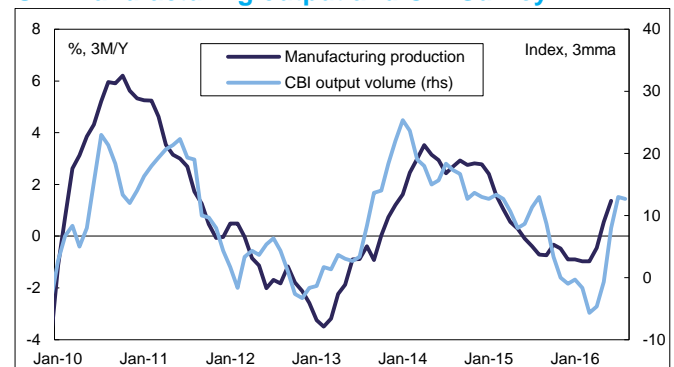
Germany and France: PMIs* by sector



*August 2016 readings are flash estimates.

Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output and CBI Survey











Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.


European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Preliminary manufacturing PMI	Aug	51.8	52.0	52.0	-
	 Preliminary services PMI (preliminary composite PMI)	Aug	53.1 (53.3)	52.8 (53.1)	52.9 (53.2)	-
	 Preliminary consumer confidence	Aug	-8.5	-7.7	-7.9	-
Germany	 Preliminary manufacturing PMI	Aug	53.6	53.6	53.8	-
	 Preliminary services PMI (preliminary composite PMI)	Aug	53.3 (54.4)	54.3 (55.1)	54.4 (55.3)	-
France	 Preliminary manufacturing PMI	Aug	48.5	48.8	48.6	-
	 Preliminary services PMI (preliminary composite PMI)	Aug	52.0 (51.6)	50.5 (50.4)	50.5 (50.1)	-
UK	 CBI Industrial Trends survey, total orders	Aug	-5	-10	-4	-


Auctions

Country	Auction
UK	 BoE APF operation: £1.17bn of 15Y+ Gilts purchased (1.54 cover ratio)


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 ECB QE net purchases €bn	Weekly	11.9	<u>13.0</u>	11.4	-



Auctions

Country	Auction
UK	 BoE APF operation: £1.17bn of 3-7Y Gilts purchased (2.93 cover ratio)



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany	 07:00	GDP – second release Q/Q% (Y/Y%)	Q2	<u>0.4 (1.8)</u>	0.7 (1.9)
UK	 09:30	BBA loans for house purchase 000s	Jul	38.0	40.1

Auctions / Event

Country	BST	Auction / Event
Germany	 10:30	Auction: To sell €4bn of 0% 2021 bonds (08-Oct-2021)
UK	 15:00	BoE APF operation: To purchase £1.17bn of 7-15Y Gilts

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<http://www.uk.daiwacm.com/research-zone/research-blog>



Follow us
[@DaiwaEurope](https://twitter.com/DaiwaEurope)

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FCA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.