

Euro wrap-up

Overview

- Bunds ended today little changed as a further pickup in euro area employment in Q2 contrasted with a slightly more downbeat German sentiment survey.
- Gilts made modest losses despite a softer than expected UK inflation release.
- Tomorrow brings euro area IP data for July, along with UK labour market figures for the same month.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.625	+0.005
OBL 0 10/21	-0.469	+0.005
DBR 0 08/26	0.048	+0.012
UKT 1¼ 07/18	0.187	+0.017
UKT 3¼ 09/21	0.324	+0.021
UKT 1½ 07/26	0.891	+0.025

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

Euro area

German ZEW index slips back at end-Q3

After a quiet start to the week for euro area economic data, today saw a handful of new releases. The first sentiment survey results for September – the German ZEW survey of financial market participants – suggested only a slight loss of confidence in economic conditions at the end of the third quarter but reaffirmed the broadly pessimistic assessment of the outlook signalled previously. In particular, the index of current conditions posted only a slight decline to remain close to the average of the past 12 months and leave its average for the third quarter comfortably higher than in Q2. However, the expectations balance was unchanged from August to leave its average in Q3 more than 14pts lower than in Q2 and the lowest since 2012. Perhaps reassuringly, the current conditions indicator typically more closely aligns with other measures of German economic sentiment. However, with the survey readings also often correlated with equity market developments, and this survey having been conducted before the increase in volatility of the past week, these indices might not be an altogether accurate gauge of current sentiment.

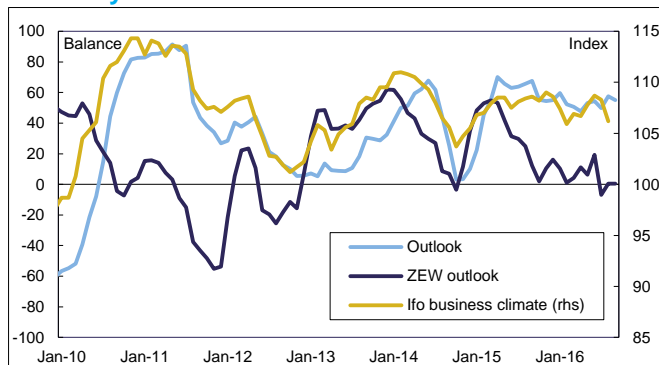
Euro area employment and Italian IP more upbeat

Among today's other releases, euro area employment figures for Q2 were more encouraging, recording the eleventh consecutive quarter of jobs growth (up 0.4%Q/Q, 1.4%Y/Y maintaining the recent trend), to leave the number of people in employment at 153.3mn, up more than 600k on the quarter and 2.2mn higher than one year earlier. Germany remained the principal source of employment growth in Q2, rising 122k, although there was also a further notable increase in Italy and Spain, up around 113k and 92k on the quarter to the highest levels since Q212 and Q311 respectively. But this still left the number of people in employment in Italy and Spain 650k and 2¼mn below their pre-crisis peaks. And while employment in Germany and France rose to new series highs, in the euro area as a whole it remains more than 1mn below the pre-crisis peak, explaining why growth in labour costs (data due on Friday) remains subdued. Elsewhere, Italian industrial production figures also came in slightly ahead of market expectations, rising 0.4%M/M in July, although that still did little more than reverse the decline seen in June. Within the detail, manufacturing output was firmer, up 0.9%M/M, with solid increases in production of intermediate, capital and consumer goods. But this still left it (and overall IP) down ½% on a three-month basis.

Final German and Spanish CPI unrevised

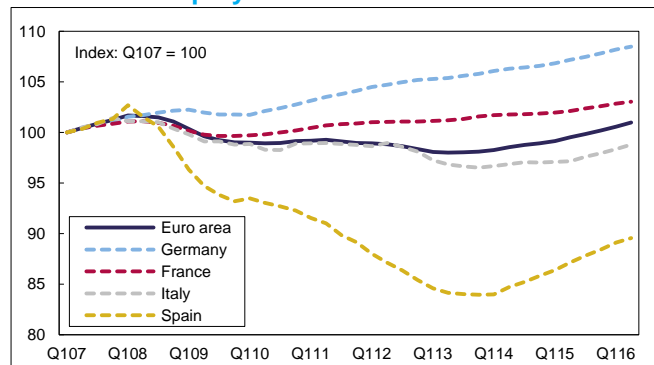
Today also saw the release of final German CPI figures for August, which saw the EU-harmonised rate unrevised at 0.3%Y/Y, down from 0.4%Y/Y in July. The detailed breakdown published on the national methodology confirmed that, disappointingly, the weakness was related principally to core components, with services prices (excluding rents) down 0.2ppt to 1.4%Y/Y and non-energy goods prices down 0.2ppt to 0.9%Y/Y, with the latter at its lowest since March 2015. Elsewhere, the EU-harmonised measure of Spanish inflation was similarly confirmed at the flash estimate of -0.3%Y/Y, up from -0.7%Y/Y previously. Unlike the German figures, in Spain the increase in headline CPI was driven by rising core inflation, up 0.2ppt on the national measure to an eight-month high of 0.9%Y/Y. While the final French and Italian figures are still to come tomorrow, the final euro area figure, due Thursday, currently seems likely to confirm the flash estimate of 0.2%Y/Y, the same rate as in July.

Germany: ZEW and Ifo sentiment indicators



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Employment



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



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The day ahead in the euro area and US

Aside from the aforementioned French and Italian inflation numbers, Wednesday brings euro area industrial production figures for July. Notwithstanding the upside surprise to today's Italian data, notable declines in German and French industrial output suggest that aggregate euro area IP started the third quarter on the back foot: we forecast a fall of around 1%M/M in July to leave output almost 1% lower than one year earlier, which would be the steepest year-on-year pace of decline for almost three years. Tomorrow also brings the first estimate of Q2 Irish GDP, while Germany will auction 2044 bonds and Portugal will sell 2023 and 2037 bonds.

It should be another quiet day for US economic data, with just August import and export price indices due for release.

UK

Despite weaker currency, inflation remained steady in August

Today's inflation figures brought a downward surprise showing the headline CPI rate unchanged in August at 0.6%Y/Y, the joint highest level since the end of 2014. The upward pressure on prices in recent months has come mainly from base effects around energy prices, where price falls have gone from -6.0%Y/Y in March to -2.6%Y/Y in the latest month. But today's release showed that the core rate was unchanged too, at 1.3%Y/Y, matching the average of this year. Most surprisingly, inflation in non-energy industrial goods, a broad CPI category which should be sensitive to exchange rate movements, decreased to -1.2%Y/Y, the lowest rate in almost a year, with clothing and footwear and furniture and household equipment among the biggest downward contributors to the headline rate. Overall, today's figures will be good news for the BoE, which is faced with the challenge of stimulating the economy even as inflation picks up due to the sharp drop in the exchange rate. But, of course, exchange rate movements affect prices only with a significant lag, and we expect inflation to accelerate in the months ahead to a more rapid pace than the BoE had envisaged.

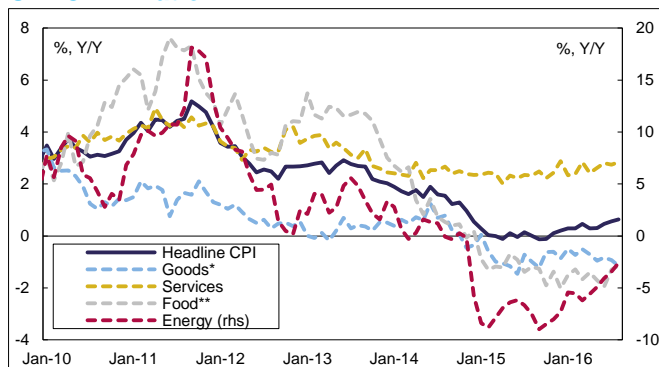
House price growth moderated in the middle of summer

Further evidence on how the housing market is performing after the referendum arrived today in a form of the ONS/Land registry house price index. The figures suggested that price growth moderated from the upwardly revised pace of 9.7%Y/Y in June to 8.3%Y/Y in July. But while the figures clearly pointed to a significant post-referendum slowdown in house price growth, the 1.4ppt change is not particularly unusual for this index. And while the monthly rise of 0.4%M/M was lower than in the previous few months, rates of increase closer to zero were recorded at the start of the year. Obviously, for a large share of transactions, the prices of houses sold in July would have been agreed ahead of the referendum result. And a further fall in house price inflation in coming months remains firmly on the cards. But with mortgage rates continuing to fall, this may go some way to mitigating the downward adjustment in the housing market.

The day ahead in the UK

The focus tomorrow turns to the labour market. The Manpower Employment Outlook Survey released today suggested that the overall Brexit impact on the labour market has been muted, with the headline index measure remaining unchanged and consistent with positive employment growth in July. And tomorrow's official figures are expected to bring a similar message. Employment is expected to have continued growing at a firm pace at the start of the third quarter, while the unemployment rate is expected to have remained flat on a three-month basis in July at an eleven-year low of 4.9%. Meanwhile, average labour earnings growth is expected to have headed slightly lower in July following an uptick the previous month.

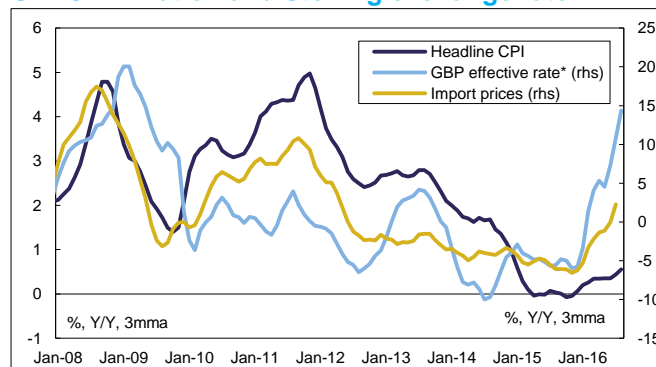
UK: CPI inflation



*Excluding food and energy. **Including alcohol and tobacco.

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

UK: CPI inflation and Sterling exchange rate













*Positive numbers correspond to depreciation.

Source: ONS, 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		Employment Q/Q% (Y/Y%)	Q2	0.4 (1.4)	-	0.3 (1.4)	0.4 (-)
		ZEW expectations balance	Sep	5.4	-	4.6	-
Germany		Final EU-harmonised CPI Y/Y%	Aug	0.3	<u>0.3</u>	0.4	-
		ZEW current assessment balance (expectations)	Sep	55.1 (0.5)	56.0 (2.5)	57.6 (0.5)	-
Italy		Industrial production M/M% (Y/Y%)	Jul	0.4 (-0.3)	0.2 (-0.9)	-0.4 (-1.0)	-0.3 (-0.9)
Spain		Final EU-harmonised CPI Y/Y%	Aug	-0.3	<u>-0.3</u>	-0.7	-
UK		CPI (core CPI) Y/Y%	Aug	0.6 (1.3)	<u>0.7 (1.4)</u>	0.6 (1.3)	-
		PPI input (output) price inflation Y/Y%	Aug	7.6 (0.8)	8.2 (1.0)	4.3 (0.3)	4.1 (-)
		House price index Y/Y%	Jul	8.3	-	8.7	9.7
Auctions							
Country		Auction					
Italy sold		€2bn of 0.1% 2019 bonds (15-Apr-2019) at an average yield of -0.02%					
		€4bn of 0.65% 2023 bonds (15-Oct-2023) at an average yield of 0.69%					
		€1.25bn of 2.25% 2036 bonds (01-Sep-2036) at an average yield of 1.91%					
		€750mn of 3.25% 2046 bonds (01-Sep-2046) at an average yield of 2.28%					
UK		BoE APF operation: £1.17bn of 5Y+ Gilts purchased (3.21 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	
EMU		10:00 Industrial production M/M% (Y/Y%)	Jul	-1.0 (-0.8)	0.6 (0.4)	
France		07:45 Final EU-harmonised CPI Y/Y%	Aug	<u>0.4</u>	0.4	
Italy		09:00 Final EU-harmonised CPI Y/Y%	Aug	<u>0.0</u>	-0.2	
UK		09:30 Average earnings incl. bonuses (excl. bonuses) 3M/Y%	Jul	2.1 (2.2)	2.4 (2.3)	
		09:30 ILO unemployment rate 3M%	Jul	<u>4.9</u>	4.9	
		09:30 Employment change 3M/3M '000s	Jul	<u>180</u>	172	
		09:30 Claimant count rate % (change 000s)	Aug	2.2 (1.8)	2.2 (-8.6)	
Auctions and events						
Country	BST	Auction / Event				
Germany		10:30	Auction: To sell €1bn of 2.5% 2044 bonds (04-Jul-2044)			
UK		10.30	Auction: To sell £800mn of 0.125% 2046 index-linked bonds (22-Mar-2046)			
		14.50	BoE APF operation: To purchase 7-15Y Gilts			

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 public sector asset purchases €bn	Weekly	16.4	12.0	11.1	-
Auctions						
Country	Auction					
UK	 BoE APF operation: £1.17bn of 3-7Y Gilts purchased (3.16 cover ratio)					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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