

Euro wrap-up

Overview

- Bunds were little changed despite upbeat new car registration and construction data from the euro area.
- Gilts made losses as the latest UK inflation data surprised significantly on the upside.
- Thursday will bring data on euro area consumer confidence and UK retail sales as well as the latest EU summit deliberations on Brexit.

Chris Scicluna
+44 20 7597 8326

Mantas Vanagas
+44 20 7597 8318

Daily bond market movements

Bond	Yield	Change*
BKO 0 06/20	-0.543	-0.006
OBL 0 04/23	-0.174	-
DBR 0¼ 08/28	0.485	+0.006
UKT 2 07/20	0.842	+0.024
UKT 0¼ 07/23	1.189	+0.038
UKT 1½ 10/28	1.607	+0.039

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

Euro area

Surge in car registrations to prove temporary

While today's new economic data were of secondary importance, they were nevertheless upbeat. Indeed, euro area new car registrations surged in August by almost 20%M/M on a seasonally adjusted basis and 30.8%Y/Y, up from 2.3%M/M and 12.7%Y/Y in July. While August is typically a slow month in the auto sector, the strength this time around saw new registrations rise more than 7% on a year-to-date basis, representing an acceleration from growth close to 5%YTD/Y in the first seven months of this year. The leap in August principally reflected a response to the new 'WLTP' (Worldwide Harmonised Light Vehicle Test Procedure) emission-testing standards, which have been implemented in the EU from September and led manufacturers to offer particularly attractive deals to shift inventory. So, going forward, growth is likely to moderate significantly due to payback from this regulatory distortion. Indeed, while the boost to registrations in August has likely given a boost to euro area private consumption in Q3, we think that the ECB's assessment in June that new car registrations 'have plateaued' is likely to characterize the pattern from Q4 on.

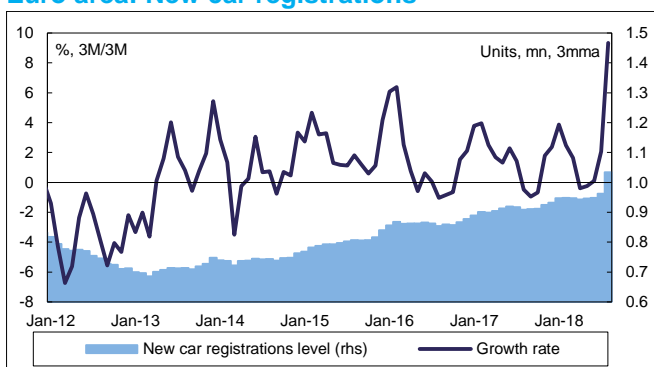
Construction recovery continues

Having rebounded in the second quarter from weather-related weakness in Q1, construction activity maintained its uptrend at the start of Q3. Indeed, output in the sector rose for the fourth consecutive month in July, by 0.3%M/M from an upwardly revised gain of 0.7%M/M the previous month. Growth in the latest month came from building work, up 1.9%M/M, while civil engineering work fell back. Compared to a year earlier, construction output was up a healthy 2.6%Y/Y and 1.7%3M/3M, the best on that basis in more than a year. At the country level, however, growth in the sector was driven by Germany, up 2.6%M/M and 4.0%Y/Y, but fell back in France and Italy following strong showings in Q2. Looking ahead, we expect payback in Germany in September, and shifts in the weather will no doubt inject some volatility into the winter. However, all indicators point to an ongoing positive growth trend in the sector. Indeed, confidence in the sector rebounded in August to a historically high level, while new orders indicators remain elevated too. And with property prices rising steadily in most member states (up 4.5%Y/Y in the euro area in Q1), GDP growth likely to remain close to potential for a while yet, and bank lending rising amid historically low interest rates, demand should remain firm too.

The day ahead in the euro area and US

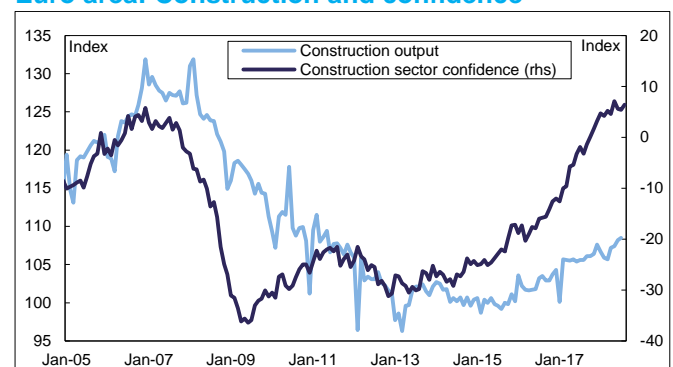
Thursday will bring the Commission's preliminary estimate of consumer confidence in September. Having risen in January to 1.4, the highest level since 2000, consumer confidence has fallen steadily, reaching a sixteen-month low of -1.9 in August.

Euro area: New car registrations*



*Seasonally adjusted data. Source: ECB, Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Construction and confidence*



*European Commission construction confidence indicator. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

And the September reading is expected edge down a little further, suggesting that consumer spending continued to rise at a pace somewhat below that of GDP in Q3. In addition, ECB Chief Economist Praet will speak in New York City on “Challenges to monetary policy normalisation”. In the bond market, France and Spain will sell a range of bonds.

In the US, Thursday will bring August existing home sales figures, the September Philly Fed indices, the usual weekly claims numbers and the Fed’s Q2 flow of funds. In addition, the Treasury will sell 10Y TIPS.

UK

A surprise lift in inflation in August

Having previously been on a downward trajectory, in recent months UK inflation had stabilised at around 2½%Y/Y. But instead of the small 0.1ppt decline to 2.4%Y/Y expected by the market consensus (and the BoE), today’s figures showed a pick-up in August to 2.7%Y/Y, a rate last seen in February. Food inflation picked up by 0.3ppt to 2.9%Y/Y, a four-month high, while energy inflation, albeit slightly weaker, remained very strong, at nearly 9.0%Y/Y. But the upward surprise was accounted for mainly by core inflation, which rose 0.2ppt to 2.1%Y/Y with services and goods categories both showing increases of the same magnitude, to 2.5%Y/Y and 1.4%Y/Y respectively. The details seem to suggest that the increase to a large extent reflected special circumstances. For example, the largest upward contribution to the monthly rise came from the recreation and culture category, and within that, computer games – prices of which often oscillate depending on the timing of new releases of popular games – were a significant factor. With August normally marking the start of a new season for fashion retailers, clothing and footwear also provided a large positive contribution. The ONS suggested that the proportion of discounted items in this category fell by more this August compared to a year ago, perhaps reflecting the fact that seasonal sales this year started earlier than usual because of the unseasonably hot spring weather. We think that inflation in this category will ease back over coming months putting downward pressure on the headline rate. And, overall, we do not think that today’s figures will significantly alter the trajectory going forward. However, inflation is likely to remain above-target for longer – on our forecast it should remain above 2.0%Y/Y through to Q319. Nevertheless, with the MPC having tightened monetary policy last month, and with the Brexit process having reached a key stage, we do not think that another Bank Rate hike is on the cards in the near term.

House price growth eases further

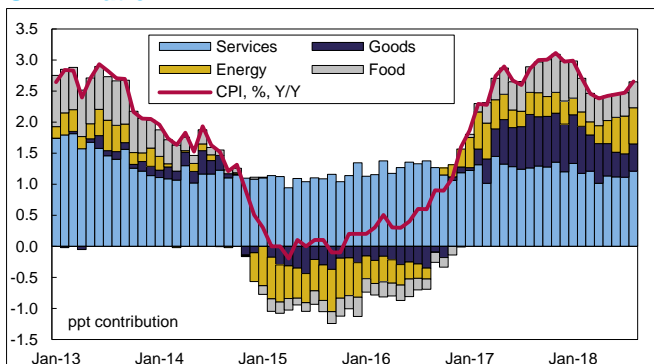
Despite the evidence that consumer spending on the UK High Street recovered over the summer, the positive sentiment did not spread to the UK housing market. Indeed, the UK House price index, released by the ONS today, showed that headline price growth eased further in July to 3.1%Y/Y, which was the weakest rate since August 2013. Different regions continued to show different patterns, with North West England and Northern Ireland reporting the steepest increases in prices of 5.6%Y/Y and 4.4%Y/Y, while London saw prices falling by 0.7%Y/Y. With the level of transactions remaining down on last year, and the RICS market sentiment survey suggesting that momentum remains subdued but stable, we expect that UK house price growth will remain on a gradually downward sloping path towards year-end.

The day ahead in the UK

Retail sales in August will be tomorrow’s UK data focus. The strength of consumer spending since the spring has been a pleasant surprise to many observers, including for the MPC, which last week noted upside risks to its August forecast for household spending in Q3. But having risen by 0.7%M/M and 2.1%3M/3M in July, retail sales are expected to have dipped slightly in August, suggesting a modest loss of momentum in Q3.

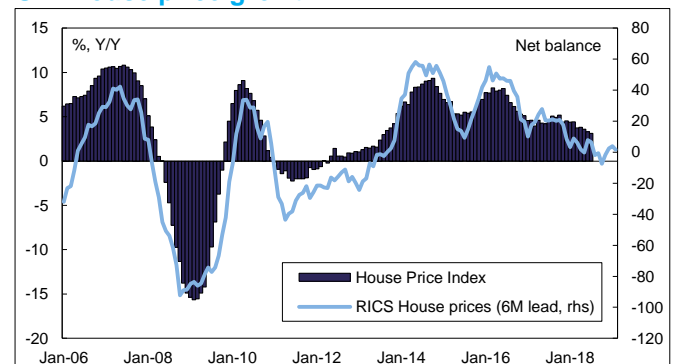
Meanwhile, once Theresa May has addressed the Salzburg informal summit over dinner this evening, the EU27 leaders will discuss their next steps for Brexit over lunch tomorrow. Among other things, they will discuss how to organise the final phase of the Brexit talks, including the possibility of calling a special summit in November to agree the draft Withdrawal Treaty and a

UK: Inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.









UK: House price growth





Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

separate joint political declaration about the future partnership with the UK. In addition, they intend to agree a common view on the nature and overall shape of that joint political declaration. And while they will reconfirm the need for a legally operational backstop on Ireland, to ensure that there will be no hard border in the future, they are also likely to try to 'de-dramatise' the differences of position with the UK. Overall, therefore, they will try to keep the process on course for a 'blind Brexit' whereby the UK would leave the EU and enter a transition phase on 29 March 2019 without any legally binding agreement on the nature of the long-run future relationship.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 EU27 new car registrations Y/Y%	Aug	31.2	-	10.5	-
	 Current account balance €bn	Jul	21.3	-	23.5	23.8
	 Construction output M/M% (Y/Y%)	Jul	0.3 (2.6)	-	0.2 (2.6)	0.7 (3.0)
Italy	 Current account balance €bn	Jul	8.6	-	5.1	5.3
UK	 CPI (core CPI) Y/Y%	Aug	2.4 (1.8)	<u>2.4 (1.8)</u>	2.5 (1.9)	-
	 Input (output) PPI Y/Y%	Aug	8.7 (2.9)	9.1 (2.9)	10.9 (3.1)	10.3 (-)
	 UK House Price Index Y/Y%	Aug	3.1	2.7	3.0	3.2
Country	Auction					
Germany sold 	€2.4bn of 0.25% 2028 bonds (15-Aug-2028) at an average yield of 0.49%					




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
Spain	 Labour costs Y/Y%	Q2	0.7	-	0.7	-
Country	Auction					
Germany sold 	€3.1bn of 0% 2020 bonds (11-Sep-2020) at an average yield of -0.54%					












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		15:00 Flash consumer confidence indicator	Sep	-2.0	-1.9
UK		09:30 Retail sales excluding auto fuel M/M% (Y/Y%)	Aug	-0.2 (2.4)	0.9 (3.7)
		09:30 Retail sales including auto fuel M/M% (Y/Y%)	Aug	-0.2 (2.3)	0.7 (3.5)

Auctions and events

Country	BST	Auction / Event
EMU		18:20 ECB's Praet scheduled to speak in New York
France		09:50 Auction: to sell 0% 2021 bonds (25-Feb-2021)
		09:50 Auction: to sell 0% 2024 bonds (25-Mar-2024)
		09:50 Auction: to sell 0.5% 2026 bonds (25-Mar-2026)
		10:50 Auction: to sell 0.1% 2036 index-linked bonds (25-Jul-2036)
		10:50 Auction: to sell 0.7% 2030 index-linked bonds (20-Sep-2030)
		09:50 Auction: to sell 0.1% 2028 index-linked bonds (01-Mar-2028)
Spain		09:45 Auction: to sell 0.05% 2021 bonds (31-Jan-2021)
		09:45 Auction: to sell 1.4% 2028 bonds (30-Jul-2028)
		09:45 Auction: to sell 0.45% 2022 bonds (31-Oct-2022)
		09:45 Auction: to sell 1.6% 2025 bonds (30-Apr-2025)
UK		10:30 Auction: to sell £2.75bn off 1.625% 2028 bonds (22-Oct-2028)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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