Euro wrap-up

Overview

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- Bunds made further gains at the longer end of the curve as a German sentiment survey suggested a collapse in confidence in August.
- Shorter-dated Gilts made modest losses as UK wage growth accelerated to the highest in eleven years.
- Tomorrow will bring the first estimate of German Q2 GDP, as well as updates on euro area GDP, IP and employment and UK inflation figures for July.

Daily bond market movements

Bond	Yield	Change
BKO 0 06/21	-0.889	+0.001
OBL 0 10/24	-0.846	-0.008
DBR 0 08/29	-0.614	-0.019
UKT 1½ 01/21	0.461	+0.016
UKT 1 04/24	0.348	+0.017
UKT 1 ⅝ 10/28	0.490	-

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

Euro area

ZEW survey suggests collapse in confidence

The ZEW indices – the first noteworthy economic survey results for August – were dire, suggesting a collapse in economic confidence. In particular, the survey's index of German current economic conditions fell the most in six months to -13.5, the lowest level since May 2010. And the equivalent index of expectations for the coming six months plunged almost 20pts, the most in three years, to -44.1, a level only previously reached very briefly during the global financial crisis and euro crisis. Within the detail, the survey reported significant pessimism with respect to the outlooks for banking, autos, chemicals, steel and mechanical engineering, among others. And expectations of lower short-term and long-term interest rates increased, as did pessimism regarding equity markets. Today's survey suggests that the flash PMIs due next week, and the Ifo indices the following week, will post further declines. And with a significant probability that German GDP fell slightly in Q2, the risk that the German economy is slipping into recession appears to be increasing.

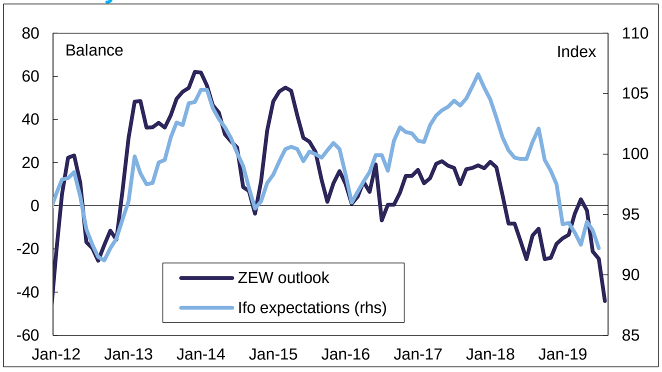
German inflation confirmed, Spanish rate revised down

There were no significant surprises from today's final German inflation figures for July, which showed the headline EU-harmonised rate unrevised from the flash estimate at 1.1%Y/Y, down 0.4ppt from June and the lowest since November 2016. While there was upwards pressure from food and clothes prices, the core inflation measure on the EU-harmonised basis fell a steep 0.6ppt to 0.9%Y/Y due to a steep drop in the recreational services component, not least reflecting lower prices of package holidays. However, given the different methodology governing inflation of package holidays, the CPI rate on the national measure rose 0.1ppt to 1.7%Y/Y and the core rate on this basis was unchanged at 1.6%Y/Y, suggesting firmer underlying price pressure. Elsewhere, as in Italy last week, Spain's final inflation figures for July reported a modest downwards revision to the EU-harmonised rate, by 0.1ppt to 0.6%Y/Y, leaving it unchanged from the 2½-year low seen in July. As a result, notwithstanding the risk of an upwards revision to the final French figure due tomorrow, we now expect the final euro area CPI data, due on Monday, to report a downwards revision in the headline CPI rate of 0.1ppt to 1.0%Y/Y, but confirm the flash core rate of 0.9%Y/Y.

Italian no-confidence vote likely next week

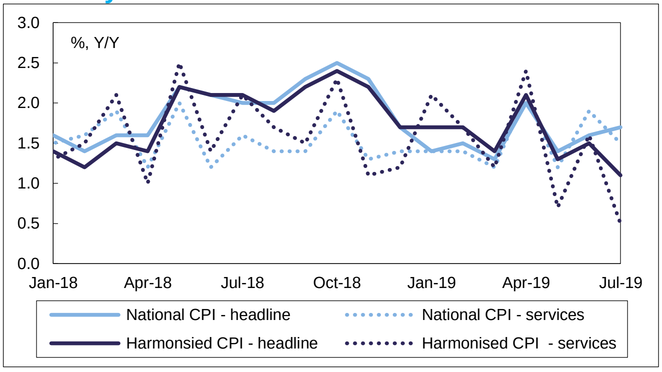
At the time of writing, Italy's political crisis was set this evening to pass an early milestone on what seems likely to be a lengthy process to determine the identity of the next government. In particular, the Senate was due to confirm a date for the no-confidence vote in PM Conte's coalition government, as required in light of the withdrawal of support of Matteo Salvini's populist right-wing League. The expectation was that the no-confidence vote will be confirmed for 20 August, with the result –

Germany: ZEW and Ifo business indicators



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: National and EU-harmonised CPI



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

a rejection of Conte – seemingly a formality. What comes thereafter, however, will depend on President Mattarella, who, on the basis of forthcoming consultations, will have to determine whether to call a new general election or instead propose an alternative government capable of winning the support of a majority in parliament. The only such alternative administration that is remotely feasible would be a temporary 'institutional' technocratic government, backed by the populist Five Star Movement and centre-left Democrats. The key objective of that government would be to prepare the draft 2020 Budget – which is due in the second half of October – in a way that avoids the contractionary in-built VAT hikes currently legislated while also avoiding another confrontation with the European Commission. Given the recent years of animosity between the parties, we doubt, however, that Five Star and the Democrats will reach such an agreement. So, our baseline forecast is that a general election will in due course be called for late October. And that election will be won by the League, which will form the next government, perhaps with the backing of the right-wing Fratelli d'Italia or Forza Italia, and be set on course for more intensive confrontation with the EU institutions.

The day ahead in the euro area and US

The main economic focus from the euro area tomorrow will be the first estimate of German Q2 GDP. With industrial production having contracted sharply, the value of exports having fallen at the fastest quarterly pace since 2012, and retail sales having eked out only a modest rise in the second quarter, GDP growth is now expected to have turned negative in Q2, with a decline of 0.1%Q/Q. While an updated GDP figure from the euro area is expected to confirm that growth moderated to 0.2%Q/Q in Q2 (half the pace in Q1), June industrial production data are likely to confirm a notable drop that month and over the second quarter as a whole. Against the backdrop of softer economic growth, euro area labour market figures are likely to report only modest employment growth in Q2. In addition, tomorrow will bring final French inflation figures for July.

In the US, tomorrow will bring just export and import price indices for July.

UK

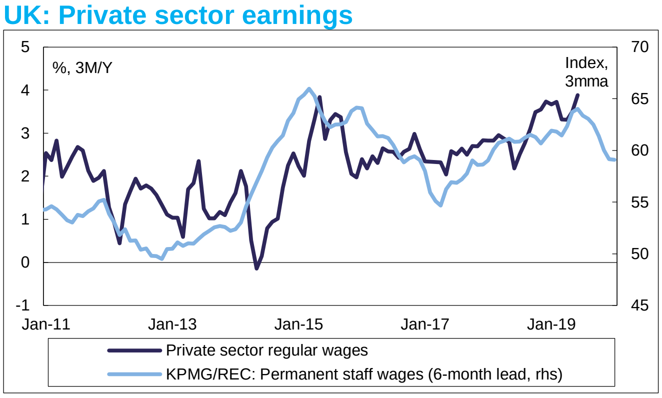
Wage growth strongest for eleven years…

Despite the marked slowing in the UK's economy in the second quarter – with GDP contracting for the first quarter since 2012 – today's labour market report signalled stronger wages growth last quarter. Certainly, there was a notable improvement in labour earnings in the three months to June, with total and regular wage growth up 0.3ppt to a headline-grabbing 3.7%3M/Y and 3.9%3M/Y respectively, the strongest for eleven years, while real wage growth rose to 1.7%3M/Y, the firmest since late-2015. And while single-month developments can be volatile, private sector regular wage growth in June rose 0.4ppt to 4.2%Y/Y, the strongest rate in more than a decade. The improvement in part reflects labour market tightness and the introduction of the new national living wage in April. But whole-economy wage growth has also been boosted by the public sector – regular wage growth jumped in April on the back of a change in timing of pay increases of some NHS staff this year compared with last. So, while public sector wage growth continued to trend higher in the three months to June, to 3.8%3M/Y, there was a further moderation in the year-on-year rate to 3.3%Y/Y from the recent peak of 4.6%Y/Y in April. As such, public sector pay will weigh on headline growth from July. Certainly, surveys have been more downbeat about the near-term pay outlook, while the further decline in productivity in Q2 – down 0.6%Y/Y, the fourth consecutive quarterly decline – suggests more limited upwards pressures ahead.

…but unemployment rate ticks higher

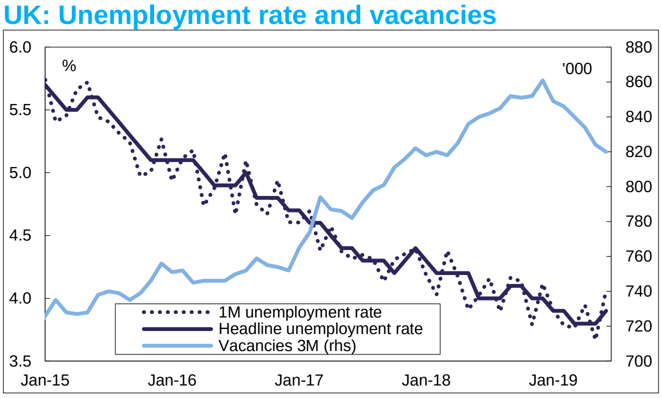
Of course, wages are a lagging indicator of economic developments. And with underlying economic growth having turned for the worse, there are already signs that the labour market is softening. For example, while employment growth jumped in the three months to June (115k), this masked another notable decline on the month (employment was down around 120k for the second successive month). Moreover, much of the increase in the headline rate reflected an increase in part-time employment. Admittedly, there was a pickup in the number of full-time employees, but this was offset by a drop in those in full-time self-employment. So, there was an increase in the unemployment rate in the three months to June by 0.1pt to 3.9%,

UK: Private sector earnings



Source: KPMG/REC, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Unemployment rate and vacancies



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

the first such increase for ten months. And when looking at the single-month figures, the unemployment rate was 0.4pt higher at 4.1%. While remaining at historically elevated levels, there was also a further drop in the number of vacancies in the three months to July to the lowest since March 2018. And with surveys signalling little improvement in business conditions at the start of the third quarter, not least reflecting ongoing Brexit uncertainty as well as heightened risks to the global outlook, we expect to see a further moderation in employment growth over coming months and further uptick in the unemployment rate.

The day ahead in the UK

Focus in the UK tomorrow turns to July's inflation release, which is expected to show both the headline and core CPI rates moving sideways at 2.0%Y/Y and 1.8%Y/Y respectively. But producer price figures are likely to illustrate the disinflationary pressures down the pipeline, not least associated with falling energy prices. Wednesday will also bring the official ONS house price index for June, which is expected to show that year-on-year growth declined to just 1.0%Y/Y, which would be the softest annual rate since 2012.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Final CPI (EU-harmonised CPI) Y/Y%	Jul	**1.7 (1.1)**	1.7 (1.1)	1.6 (1.5)	**-**
		ZEW current conditions balance (expectations)	Aug	**-13.5 (-44.1)**	-5.0 (-27.0)	-1.1 (-24.5)	**-**
Spain		Final CPI (EU-harmonised CPI) Y/Y%	Jul	**0.5 (0.6)**	0.5 (0.7)	0.4 (0.6)	**-**
UK		ILO unemployment rate 3M%	Jun	**3.9**	3.8	3.8	**3.8**
		Employment change 3M/3M '000s	Jun	**115**	69	28	
		Average weekly earnings (excl. bonuses) 3M/Y%	Jun	**3.7 (3.9)**	3.7 (3.8)	3.4 (3.6)	**3.5 (-)**
		Claimant count rate % (change '000s)	Jul	**3.2 (28.0)**	-	3.2 (38.0)	**- (31.4)**

Auctions

Country		Auction
UK sold		£2.0bn of 1.75% 30Y bonds at an average yield of 1.148%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		10.00	GDP – second estimate Q/Q% (Y/Y%)	Q2	0.2 (1.1)	0.4 (1.2)
		10.00	Industrial production M/M% (Y/Y%)	Jun	-1.1 (-1.3)	0.9 (-0.5)
		10.00	Employment Q/Q% (Y/Y%)	Q2	0.2 (1.1)	0.3 (1.3)
Germany		07.00	GDP – first estimate Q/Q% (Y/Y%)	Q2	-0.1 (0.1)	0.4 (0.7)
France		07.45	Final CPI (EU-harmonised) Y/Y%	Jul	1.1 (1.3)	1.2 (1.4)
UK		09.30	CPI (core CPI) Y/Y%	Jul	1.9 (1.8)	2.0 (1.8)
		09.30	PPI input prices (output prices) Y/Y%	Jul	0.2 (1.7)	-0.3 (1.6)
		09.30	ONS house price index Y/Y%	Jun	1.0	1.2

Auctions and events

Country	BST	Auction / Event
		- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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