

# Euro wrap-up

## Overview

- Bunds made further notable gains at the longer end of the curve today in line with the global trend, as GDP data confirmed that the German economy went into reverse in Q2.
- Gilts also made gains, with 10Y yields falling below 2Y yields for the first time since 2008 despite an upside surprise to UK inflation in July.
- The data focus in Europe tomorrow will be UK retail sales figures for July.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 06/21	-0.884	+0.006
OBL 0 10/24	-0.864	-0.016
DBR 0 08/29	-0.655	-0.042
UKT 1½ 01/21	0.459	-0.006
UKT 1 04/24	0.339	-0.014
UKT 1 % 10/28	0.446	-0.048

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

## Euro area

### Germany's economy contracted in Q2

The first estimate of German GDP in Q2, released today, predictably confirmed that the economy slowed markedly in the euro area's largest member state last quarter. Indeed, GDP declined 0.1%Q/Q, in line with expectations, following growth of 0.4%Q/Q in Q1, to mark the second contraction in the past four quarters. This left GDP up just 0.4% compared with a year earlier, the weakest annual rate for six years. The detailed expenditure breakdown has yet to be released. But the German statistical agency reported that growth came from domestic demand, with private and government consumption higher in Q2, but likely rising at a softer pace than in Q1. Meanwhile, the increase in fixed investment in equipment and machinery more than offset a decline in investment in construction. But while both exports and imports reportedly fell, a steeper drop in exports left net trade subtracting from growth for the first quarter in three. Economic surveys suggest that exporters will again struggle in Q3 as a more challenging global environment weighs on external demand. And following some disappointing PMI and Ifo indices in July, yesterday's dire [ZEW survey](#) also suggested that Germany's economy might be heading for a technical recession.

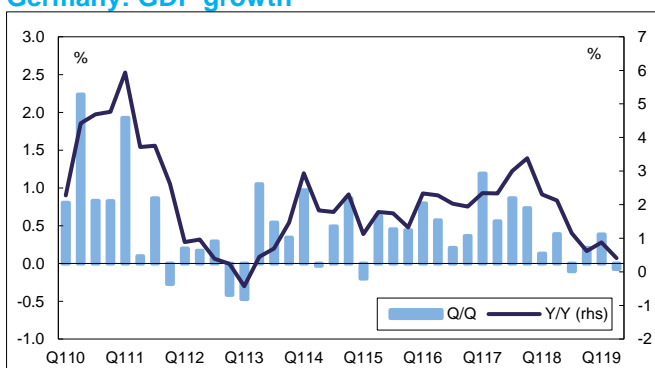
### Euro area GDP confirmed at 0.2%Q/Q, but IP declined

With no surprises out of Germany, the second reading of euro area Q2 GDP confirmed the flash estimate of growth of 0.2%Q/Q, half the pace of Q1, to leave output 1.1% higher than a year earlier. While we will have to wait until 6 September for the detailed breakdown, today's industrial production figures suggested a sharp contraction in manufacturing in Q2. In particular, IP declined 0.6%Q/Q, reversing the increase in Q1, while manufacturing fell a steeper 0.8%Q/Q. And the monthly breakdown indicated a worsening in conditions towards the end of the quarter. For example, IP declined 1.6%M/M in June, the steepest monthly drop since February 2016, to leave output down a sizeable 2.6% compared with a year earlier. There were notable declines across the key manufacturing sub-sectors too – i.e. production of capital was down 4.0%M/M, consumer goods down 2.6%M/M and intermediate goods down 0.8%M/M. And surveys suggest a further deterioration in manufacturing conditions at the start of Q3 too. So, we continue to expect manufacturing output to be a drag on euro area GDP growth in the current quarter. And while services and construction might offer support, GDP growth will likely remain subdued at a rate similar to Q2.

### Euro area employment growth moderated too

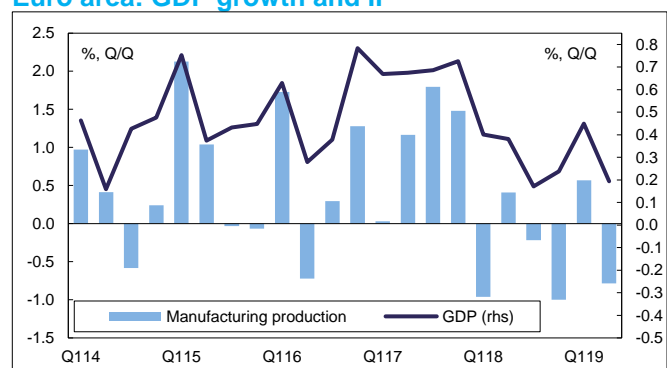
Against the backdrop of softer growth, euro area employment growth also moderated in Q2 by 0.2ppt to 0.2%Q/Q. Nevertheless this still marked the 24<sup>th</sup> consecutive quarter of increase in the total number of people employed, with the 375k

### Germany: GDP growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: GDP growth and IP



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



rise in Q2 taking employment to a new record high close to 160m, more than 11mn above the post-crisis trough six years ago. Admittedly, annual growth of 1.1% was the softest pace since Q315. And with July's composite PMI having signalled the weakest employment growth for more than three years, principally reflecting the scaling back of manufacturers' workforces, we would expect to see only limited improvements in the euro area's labour market through the second half of the year.

## Euro area headline inflation to be revised lower

Turning to inflation, there were also no significant adjustments to the final French July CPI figures today, which showed the headline EU-harmonised rate unrevised from the flash estimate of 1.3%Y/Y, down 0.1ppt from June. (To two decimal places it was revised down by 0.02ppt to 1.26%Y/Y.) But this principally reflected lower energy inflation. And so core CPI was unchanged from the flash estimate and its June reading at 0.7%Y/Y. But while yesterday's German inflation data were similarly unrevised, there were modest downward revisions to the equivalent headline Italian and Spanish figures. As such, 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.

## The day ahead in the euro area and US

It should be a quieter day for economic news from the euro area tomorrow, with no data of note due for release. In contrast, in the US, tomorrow will bring a number of top-tier releases, including industrial production and retail sales figures for July, Q3 productivity and labour costs data, the Philly Fed, Empire Manufacturing and NAHB housing market indices for August as well as business inventories numbers for June. While retail sales look set to have had a solid start to the third quarter, manufacturing production is expected to have largely reversed the gain seen at the end of the second quarter.

## UK

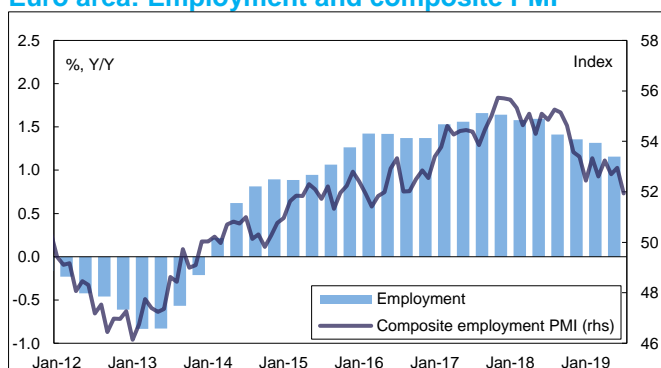
### Inflation surprises on the upside

There was an upside surprise to UK inflation in July, with headline CPI rising 0.1ppt to 2.1%Y/Y, back above the BoE's 2.0% target for the second month out of the past four. Core CPI also unexpectedly ticked higher in July, rising 0.1ppt to 1.9%Y/Y, the highest rate since January. The upwards move was driven principally by recreation and culture prices (up 0.6ppt to 2.4%Y/Y, a four-month high) on the back of a likely one-off jump in computer prices that month – indeed, price movements for these items can be particularly volatile depending on the composition of bestseller charts. Clothing and footwear prices also provided a modest boost, with the first year-on-year increase (0.4%Y/Y) for eleven months. As such, non-energy industrial goods inflation increased in July by ½ppt to 1.2%Y/Y, a ten-month high. But services inflation remained relatively subdued at 2½%Y/Y. And there was another notable drop in energy inflation, down 1ppt to 3.5%Y/Y as fuel prices were lower and price increases at electricity and gas suppliers seen last year were not repeated.

### Headline CPI to edge lower over near-term

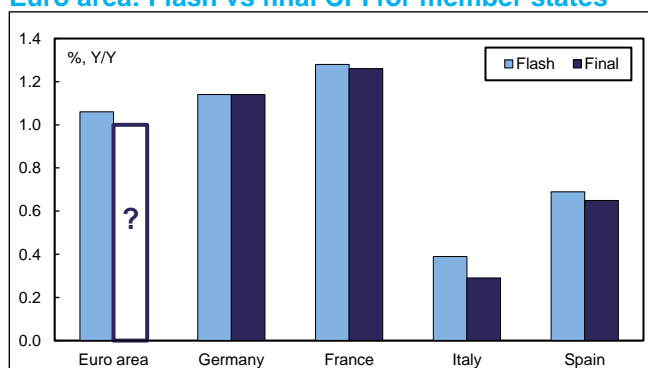
Looking ahead, recent events in the foreign exchange market seem likely to impact the near-term inflation outlook. The sterling effective exchange rate is now at its lowest level since October 2016, down 4½% from a year ago and more than 8% from the peak earlier this year. So, non-energy industrial goods inflation is likely to edge higher still on the back of higher import prices. But given the recent loss of momentum in the sector, we expect services inflation to move broadly sideways. And with the contribution from energy inflation set to decline further over coming quarters due to shifts in global energy prices and Ofgem's decision to lower the cap on electricity and natural gas prices in October, we still expect headline CPI to edge back below 2% through to year-end.

### Euro area: Employment and composite PMI



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: Flash vs final CPI for member states\*



\*July-19 figures. EU harmonised measure. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

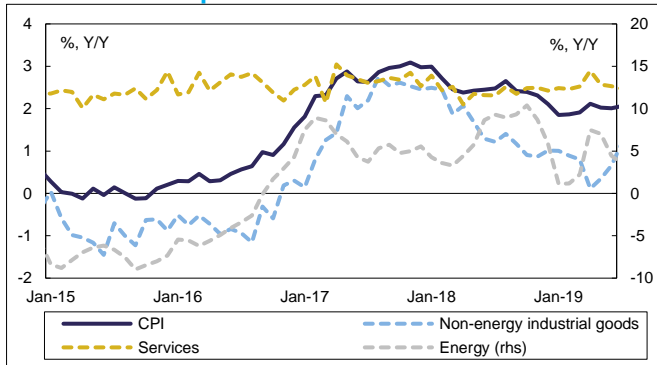
### House price growth at weakest since 2012

The ONS official house price index today confirmed weak residential property inflation in June, with national house price growth unchanged at the downwardly revised rate of 0.9%Y/Y in May, which was the weakest since late 2012. There was another decline reported in London, where prices fell 2.7%Y/Y, albeit a touch smaller than the drop reported in May, while prices in the South East and South West were also down compared with a year earlier. While prices continued to rise on an annual basis in other regions across England, and remained firm in Wales (4.4%Y/Y), Scotland (1.3%Y/Y) and Northern Ireland (3.5%Y/Y), leading indicators suggest that aggregate UK house price growth will continue to remain subdued over coming months. Of course, the end-October Brexit deadline will no doubt continue to have a huge bearing on the trajectory of prices from the autumn onwards.

### The day ahead in the UK

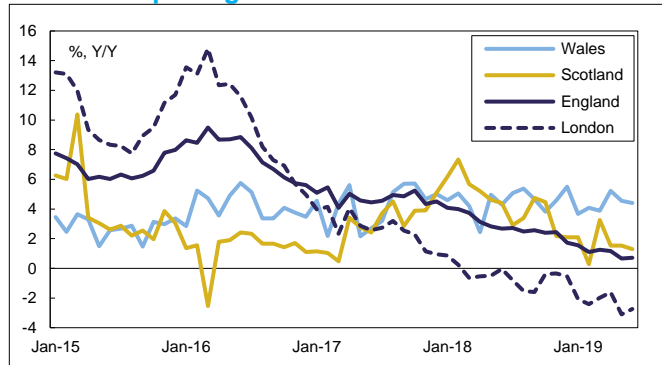
Focus tomorrow turns to the retail sector. But while prices on the high street have declined over recent months, surveys suggest that retail sales weakened in July – indeed, sales are expected to have declined ½%M/M, albeit only partly offsetting the increase in June.

#### UK: Consumer price inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

#### UK: House price growth











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	 GDP – second estimate Q/Q% (Y/Y%)	Q2	<b>0.2 (1.1)</b>	0.2 (1.1)	0.4 (1.2)	-
	 Industrial production M/M% (Y/Y%)	Jun	<b>-1.6 (-2.6)</b>	-1.1 (-1.3)	0.9 (-0.5)	<b>0.8 (-0.8)</b>
	 Employment Q/Q% (Y/Y%)	Q2	<b>0.2 (1.1)</b>	0.2 (1.1)	0.3 (1.3)	<b>0.4 (-)</b>
Germany	 GDP – first estimate Q/Q% (Y/Y%)	Q2	<b>-0.1 (0.4)</b>	-0.1 (0.1)	0.4 (0.7)	<b>- (0.9)</b>
France	 Final CPI (EU-harmonised) Y/Y%	Jul	<b>1.1 (1.3)</b>	1.1 (1.3)	1.2 (1.4)	-
UK	 CPI (core CPI) Y/Y%	Jul	<b>2.1 (1.9)</b>	1.9 (1.8)	2.0 (1.8)	-
	 PPI input prices (output prices) Y/Y%	Jul	<b>1.3 (1.8)</b>	0.2 (1.7)	-0.3 (1.6)	<b>0.3 (-)</b>
	 ONS house price index Y/Y%	Jun	<b>0.9</b>	1.0	1.2	<b>0.9</b>



### Auctions

Country	Auction
- Nothing to report -	

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
UK		09.30 Retail sales including fuel M/M% (Y/Y%)	Jul	-0.2 (2.5)	1.0 (3.8)
		09.30 Retail sales excluding fuel M/M% (Y/Y%)	Jul	-0.2 (2.3)	0.9 (3.6)

### Auctions and events

Country	BST	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.



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