Euro wrap-up

Overview

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- Bunds made losses as the euro area PMIs improved slightly while the ECB's latest meeting account suggested that a rate cut and QE will be announced next month.
- Gilts also made losses as Macron and Merkel appeared open to, albeit sceptical about, new proposals on Brexit.
- The coming week will bring the August euro area flash CPI, further sentiment surveys, and news on Italian politics.

Daily bond market movements

Bond	Yield	Change
BKO 0 06/21	-0.873	+0.027
OBL 0 10/24	-0.863	+0.025
DBR 0 08/29	-0.645	+0.029
UKT 1½ 01/21	0.517	+0.014
UKT 1 04/24	0.416	+0.022
UKT 1 ⅝ 10/28	0.518	+0.040

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

Euro area

ECB fretting about its diminishing credibility

The ECB's account of its July policy meeting, published today, offered a couple of clues about the detail of the next phase of monetary policy easing likely to be agreed next month. At last month's meeting, the Governing Council's forward guidance was revised to open the door to a possible reduction in rates sometime between now and mid-2020. And the relevant Eurosystem committees were tasked with examining options to reinforce its rate policy, including consideration of mitigating measures such as a tiered system for reserve remuneration and potential new net asset purchases. That reflected undoubted concern among the Governing Council members about recent events, with today's account noting, among other things, that "the absence thus far of signs of the expected recovery in the second half of the year was worrying". And they were particularly exorcised by further declines in inflation expectations, both market-implied and survey-based, with the latter judged now to be at historical lows.

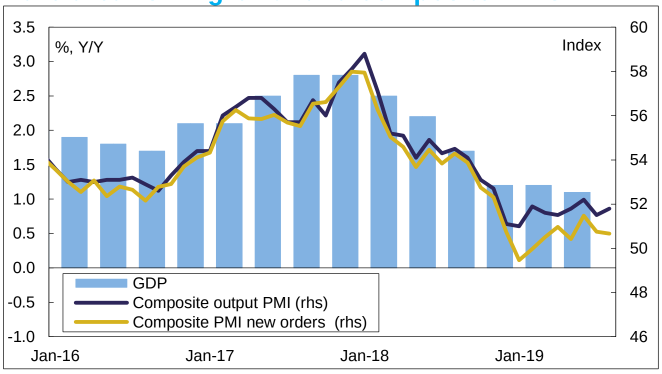
Easing package due in September, but some scepticism remains about tiering

So, the ECB now seems determined to try to counter scepticism in its ability to return inflation to target on a sustainable basis. To do so, at least one member of the Governing Council suggested that the ECB might change its inflation target as part of a broader strategic review. That indeed might eventually occur. Over the near term, however, the clear implication is that the ECB's downgraded economic forecasts, to be published next month, will be used to justify a substantive easing of policy. Judging from today's account, a range of instruments will be adjusted, as it noted that "experience had shown that a policy package – such as the combination of rate cuts and asset purchases – was more effective than a sequence of selective actions". Rather than pursuing an 'operation twist', net purchases might be conducted across much of the curve (but perhaps exclude super-long-dated bonds), with the account noting that "the risk of an unwarranted tightening of financial conditions was higher at the short end than at the long end of the yield curve". But a tiering rate framework is still not a done deal, as "some concerns were raised regarding possible unintended consequences of a tiered system and its ability to fully mitigate the potential effects of negative policy rates on bank intermediation." Nevertheless, we think that such concerns will be alleviated through the design of the framework for reserve remuneration. And so, we still expect a tiering system to be announced next month along with a further 20bp cut in the deposit rate (to -0.60%) and a new programme of net asset purchases through to June 2020 amounting to up to €50bn per month.

Minimal improvement in the August flash PMIs

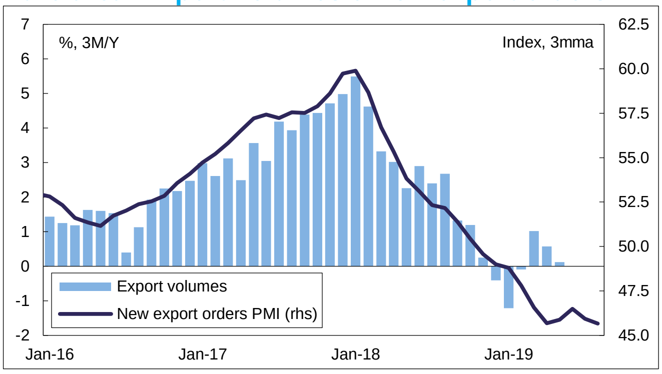
Given their weakness over recent months, today's top-tier survey indices were closely watched for signs of further

Euro area: GDP growth and composite PMIs



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

Euro area: Export volumes & new export orders PMI



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

deterioration in economic conditions in the third quarter. There was some relief, therefore, that the headline flash PMIs for August were a touch improved from the previous month. Nevertheless, on the whole, they suggested that economic momentum remains lacking and that euro area GDP growth will likely be no firmer in Q3 than in Q2. Most concerns, of course, have been focused on the industrial sector. And having declined in July to the lowest level since 2012, the euro area manufacturing PMI rose 0.5pt. But at 47.0, this was still the second-worst reading in 6½ years and strongly suggestive of ongoing contraction. The equivalent index for services was marginally higher too, up 0.2pt to 53.4, consistent with ongoing steady growth in the sector. And so the euro area composite PMI rose 0.3pt to 51.8, in line with the Q2 average but indicative of GDP growth of between 0.1-0.2%Q/Q in Q3. Most notably within the survey detail at the euro area level, the PMIs suggested a further slowing of employment growth in the current quarter to the softest in about four years, ongoing weakness in new orders, and a moderation in price pressure from Q2.

German manufacturers still struggling

Among the two largest member states, there was also a modest improvement in Germany's manufacturing PMI, which rose 0.4pt in August to 43.6, a level that nevertheless still suggests significant contractionary forces at play. Indeed, despite a more sizeable increase (1.6pts) in the output component, at 45.8 this still implied declining production. And there was no improvement in the index for new orders, which seemingly continue rapidly to shrink. There were also further suggestions that manufacturers' trials were weighing more heavily on other sectors, as Germany's services PMI slipped back 0.1pt to 54.4, the lowest since January. So, while Germany's composite PMI rose 0.5pt to 51.4, this was insufficient to allay fears that the euro area's largest member state might now have slipped into technical recession. Indeed, the composite new orders, employment and future output expectations indices fell back to multi-year lows, pointing to further weakness ahead.

French firms continue to fare better

Benefiting from a lower dependence on external demand and easier fiscal policy, the French economy remains more resilient to current headwinds than its larger neighbour. Indeed, the French preliminary PMIs for August more comfortably exceeded expectations, with the headline manufacturing index rising 1.4pts to 51.0, and the output and new orders components also rising back above the key 50 level. Moreover, the services PMI increased 0.7pt to 53.3, a nine-month high. As such, the French composite PMI rose 0.8pt to 52.7, matching June's seven-month high and signalling a relatively steady pace of expansion in the middle of Q3. Indeed, consistent with the Bank of France's most recent survey-based estimate, we still anticipate a slight acceleration in French GDP growth in the current quarter to 0.3%Q/Q.

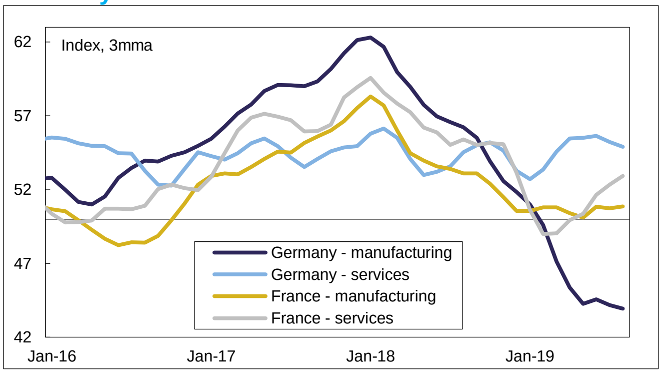
Consumer confidence dips

While the PMIs, on the whole, suggested that businesses were slightly less pessimistic in August, the opposite was true for euro area households according to the Commission's preliminary consumer confidence indicator. The headline index fell ½pt to -7.1, a touch below the average in the year to date. Essentially, however, since the start of the year confidence has oscillated gently around a broadly sideways trend. But with hard data and surveys suggesting a slowing of improvements in the labour market over recent months, household consumption growth might also moderate somewhat over the near term.

The week ahead in the euro area and US

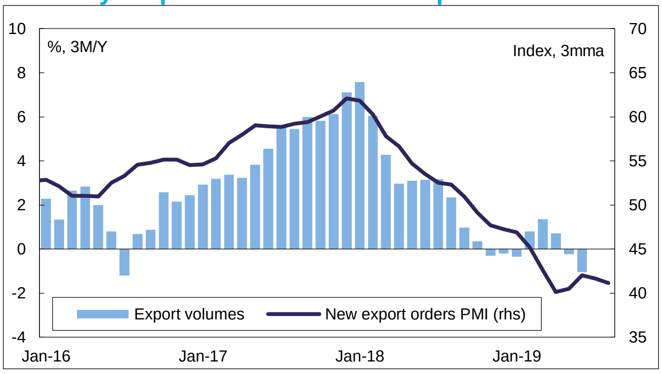
While focus over the coming few days will be firmly on the Jackson Hole symposium, with the ECB's Lane, Cœuré and Lautenschläger scheduled to participate, the coming week will be a busy one for top-tier euro area economic releases from the euro area, including most notably the European Commission's economic sentiment survey (Thursday) and flash CPI estimate (Friday) for August. In particular, the Commission survey's headline indicator – arguably the best guide to euro area GDP growth – is expected to report a further decline in August possibly to its lowest level since early 2015, as conditions in the manufacturing sector likely deteriorated, sentiment in services remained subdued and consumers became more downbeat. Against the backdrop of slowing economic momentum, preliminary inflation figures are expected to show that

Germany and France: Headline PMIs



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

Germany: Export volumes & new export orders PMI



Source: Markit, Thomson Reutersand Daiwa Capital Markets Europe Ltd.

headline and core CPI remained subdued in August, unchanged from July's rates of 1.0%Y/Y and 0.9%Y/Y respectively. Friday will also bring euro area unemployment figures for July, while euro area bank lending figures for the same month are due on Wednesday.

Data-wise at the country level, the coming week kicks off on Monday with the German ifo survey for August, which seems bound to reiterate the downbeat message from today's flash PMIs. Other German releases include revised Q2 GDP figures (Tuesday), the latest GfK consumer confidence survey (Wednesday), and August labour market and flash CPI numbers (Thursday).Preliminary CPI figures are also due from France and Italy (Friday) and Spain (Thursday), while the first half of the week will also bring national business and consumer confidence surveys from France and Italy.

Italian politics will also, of course, remain in focus, with President Mattarella having given the leaders of the populist Five Star Movement (M5S) and centre-left Democrats (PD) until Monday to reach an agreement on a new coalition government. If they fail to reach agreement, Mattarella will supposedly call a new general election. Reports at the time of writing suggested that the PD's pre-conditions might scupper chances of an accord with M5S. Among other things, PD appeared to be demanding the repeal of laws on national security and immigration adopted during the M5S coalition with the League, reforms to cut the number of parliamentarians, "EU loyal membership", and certain detail on the 2020 Budget.

In the bond markets, finally, Germany will sell 2Y Schatz on Tuesday and 10Y Bunds on Wednesday, while Italy will sell a range of bonds on Thursday.

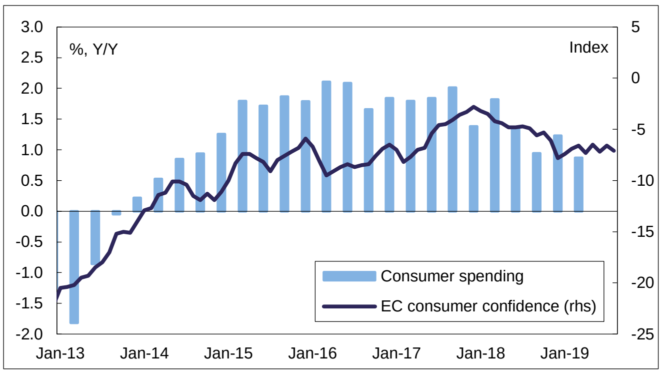
In the US, the main event will clearly be the aforementioned Jackson Hole symposium, with Fed Chair Powell's speech on Friday to be analysed closely. Data-wise, following the release of new home sales numbers for July tomorrow, the coming week will also bring the FHFA and S&P Corelogic house price indices for June (Tuesday) and pending home sales figures (Thursday). Likely of more interest will be July's preliminary durable goods orders data on Monday and the advance goods trade and inventories figures on Thursday. That day will also bring revised Q2 GDP figures, which are likely to confirm annualised growth of around 2%Q/Q. Friday, meanwhile, will see the release of the monthly personal income and spending figures for July, including the closely watched deflators, as well as the revised University of Michigan's consumer sentiment survey for August. Other indicators due include the Chicago Fed's national activity index (Monday), Conference Board's consumer confidence survey (Tuesday) and the Chicago PMI (Friday). In the markets, the US Treasury will sell 2Y notes on Tuesday, 2Y floating-rate and 5Y fixed-rate notes on Wednesday and 7Y bonds on Thursday.

UK

Johnson's search for backstop alternative bound to be fruitless

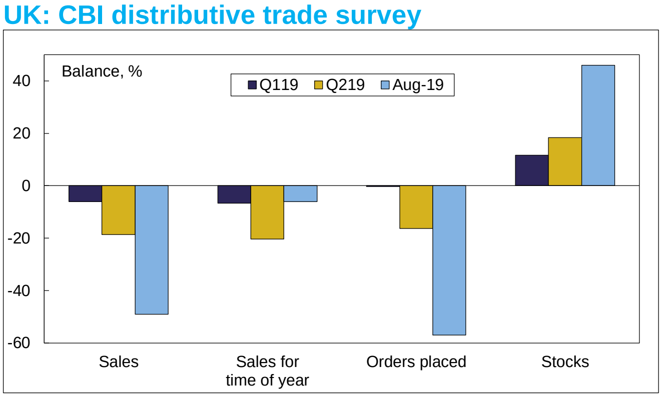
Perhaps unsurprisingly, Boris Johnson's first meetings with Angela Merkel (yesterday) and Emmanuel Macron (today) delivered little constructive progress on Brexit. In order to avoid being blamed in the event of a no-deal Brexit at end-October, both EU leaders were happy to appear open to new practical suggestions that might break the current deadlock. And some seemingly upbeat comments from Merkel in this respect today gave a boost to sterling. But both leaders, politely but firmly, placed the ball in the court of the UK to find the alternative solution that might maintain an open border on the island of Ireland if and when the UK leaves the Customs Union and Single Market. Of course, neither believes that a solution can be found, unless Northern Ireland was to remain with the Customs Union and Single Market while Great Britain left. And Macron today was clear that, if no sensible proposals were made within the coming month, negotiations between the EU and UK would be able to solve nothing and the fault would lie with British politics. If so, the onus will fall back on UK MPs to act to prevent a no-deal Brexit. However, by seemingly granting the UK government one month to find new proposals, Merkel and Macron have jeopardised the chances of MPs being able to unseat Johnson in a vote of no confidence in September, narrowing significantly their options to prevent a no-deal Brexit at the end of October.

Euro area: Retail sales and consumer confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: CBI distributive trade survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Retailers most downbeat since financial crisis

Datawise, today's CBI distributive trades survey suggested that British retailers aren't being fooled by Johnson's upbeat Brexit rhetoric. Indeed, the survey's headline retail sales balance declined a whopping 33pts in August to -49, the lowest reading since the global financial crisis and signalling the second-steepest year-on-year drop since the series began in the early 1980s. Growth in online sales was also reportedly below the long-run average this month. While retailers anticipated a softer pace of decline in sales in September, orders placed on suppliers fell sharply in August to the lowest level since 2008 and there was a significant deterioration in their expectations for the business environment over the coming three months. Against this backdrop, today's survey also showed that investment intentions remained weak, while employment reportedly fell for the eleventh consecutive quarter. Due to its limited sample, the CBI survey does not always provide the best guide to spending. Indeed, it failed to capture the strength in the first quarter of the year. However, retail sales growth has been on a downward trend over recent months. And today's release strongly suggests that, as Johnson took the reins in Downing Street, households tightened their purse strings significantly as the outlook for Brexit became increasingly uncertain.

The week ahead in the UK

With no UK economic data due, most attention tomorrow will be on the G7 leaders' summit, the first for UK Prime Minister Johnson. And there will be little domestic data flow in the coming week to distract from Brexit-related political noise. Most noteworthy will be Friday's GfK consumer confidence survey for August, which seems bound to illustrate that households remain concerned about the near-term outlook. The Lloyds barometer, also due that day, will similarly likely suggest that business conditions remain considerably weaker than in recent years. Against this backdrop, we would expect the Bank of England's lending figures – also due Friday – to signal a further easing in consumer credit growth at the start of Q3. A Bank of England External MPC Unit Discussion Paper, produced by Deputy Governor Broadbent and external MPC member Tenreyro among others, and titled "The Brexit vote, productivity growth and macroeconomic adjustments in the United Kingdom" will be published on Tuesday and might also grab some headlines.

The next edition of the Euro wrap-up will be published on 27 August 2019

Daiwa economic forecasts

	2019				2020				2018	2019	2020
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP forecasts %, Q/Q											
Euro area	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.1	1.9	1.1	0.8
Germany	0.4	-0.1	0.1	0.2	0.2	0.3	0.2	0.1	1.5	0.6	0.7
France	0.3	0.2	0.3	0.3	0.3	0.3	0.2	0.2	1.7	1.2	1.1
Italy	0.1	0.0	0.0	0.0	0.0	0.1	-0.1	-0.1	0.7	0.0	0.1
Spain	0.7	0.5	0.4	0.4	0.4	0.4	0.4	0.3	2.6	2.2	1.6
UK	0.5	-0.2	0.2	0.0	0.2	0.2	0.2	0.1	1.4	1.1	0.6
Inflation forecasts %, Y/Y											
Euro area											
Headline CPI	1.4	1.4	1.0	1.0	1.4	1.3	1.4	1.5	1.8	1.2	1.4
Core CPI	1.0	1.0	0.9	1.0	1.1	1.2	1.3	1.4	1.0	1.0	1.2
UK											
Headline CPI	1.9	2.0	1.8	1.6	1.9	1.6	1.5	1.7	2.5	1.8	1.8
Core CPI	1.9	1.7	1.7	1.7	1.8	1.9	1.8	1.7	2.1	1.7	1.8
Monetary policy											
ECB											
Refi Rate %	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %	-0.40	-0.40	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.40	-0.60	-0.60
Net asset purchases*	0	0	0	50	50	50	0	0	15	50	0
BoE											
Bank Rate %	0.75	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.75	0.50	0.50
Net asset purchases**	0	0	0	0	0	0	0	0	0	0	0

*Monthly target €bn, end of period. **Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.*

European calendar

Today's results

Economic data							
Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Preliminary composite PMI	Aug	**51.8**	51.2	51.5	-
	Preliminary manufacturing PMI (services PMI)	Aug	**47.0 (53.4)**	46.3 (53.0)	46.5 (53.2)	-
	Preliminary consumer confidence	Aug	**-7.1**	-7.0	-6.6	-
Germany	Preliminary composite PMI	Aug	**51.4**	50.6	50.9	-
	Preliminary manufacturing PMI (services PMI)	Aug	**43.6 (54.4)**	43.0 (54.0)	43.2 (54.5)	-
France	Preliminary composite PMI	Aug	**52.7**	51.8	51.9	-
	Preliminary manufacturing PMI (services PMI)	Aug	**51.0 (53.3)**	49.5 (52.5)	49.7 (52.6)	-
UK	CBI distributive trades survey – reported retail sales	Aug	**-49**	-13	-16	-

Auctions	
Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data						
Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Spain	Trade balance €bn	Jun	**-1.5**	-	-2.1	-
UK	Public sector net borrowing £bn	Jul	**-1.3**	-2.9	7.2	6.3

Auctions	
Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

The coming week's key data releases

Country		BST	Release	Period	Market consensus/ _Daiwa forecast_	Previous
			Monday 26 August 2019			
Germany		09.00	Ifo business climate	Aug	96.0	95.7
		09.00	Ifo current assessment (expectations)	Aug	-	99.4 (92.2)
			Tuesday 27 August 2019			
Germany		07.00	GDP – second release Q/Q% (Y/Y%)	Q2	-0.1 (0.4)	0.4 (0.9)
		-	Retail sales* M/M% (Y/Y%)	Jul	-	3.5 (-1.6)
France		07.45	Business confidence (manufacturing confidence)	Aug	-	105 (101)
		07.45	Consumer confidence	Aug	-	102
UK		09.30	UK Finance loans for house purchase '000s	Jul	-	42.7
			Wednesday 28 August 2019			
EMU		09.00	M3 money supply Y/Y%	Jul	-	4.5
Germany		07.00	GfK consumer cofidence	Sep	-	9.7
Italy		09.00	Consumer confidence	Aug	-	113.4
		09.00	Business confidence (manufacturing confidence)	Aug	-	101.2 (100.1)
UK		00.01	BRC shop price index Y/Y%	Aug	-	-0.1
		-	Nationwide house price index* M/M% (Y/Y%)	Aug	-	0.3 (0.3)
			Thursday 29 August 2019			
EMU		10.00	Economic sentiment indicator	Aug	102.7	102.7
		10.00	Industrial confidence (services confidence)	Aug	-	-7.4 (10.6)
		10.00	Consumer confidence	Aug	-7.0	-6.6
Germany		08.55	Unemployment rate % (change '000s)	Aug	-	5.0 (1.0)
		13.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	-	1.7 (1.1)
France		07.45	GDP – second release Q/Q% (Y/Y%)	Q2	0.2 (1.3)	0.3 (1.2)
		07.45	Consumer spending M/M% (Y/Y%)	Jul	-	-0.1 (-0.6)
Italy		09.00	Industrial sales M/M% (Y/Y%)	Jun	-	1.6 (-2.5)
		09.00	Industrial orders M/M% (Y/Y%)	Jun	-	2.6 (-2.5)
Spain		08.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	-	0.5 (0.6)
			Friday 30 August 2019			
EMU		10.00	Preliminary CPI (core CPI) Y/Y%	Aug	_1.0 (0.9)_	1.0 (0.9)
		10.00	Unemployment rate %	Jul	7.5	7.5
France		07.45	Preliminary CPI (EU-harmonised) Y/Y%	Aug	-	1.1 (1.3)
Italy		09.00	Unemployment rate %	Jul	-	9.7
		10.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	-	0.4 (-1.8)
		11.00	GDP – second release Q/Q% (Y/Y%)	Q2	0.0 (0.0)	0.1 (-0.1)
Spain		08.00	Retail sales Y/Y%	Jul	-	2.4
UK		00.01	GfK consumer confidence indicator	Aug	-10	-11
		00.01	Lloyds business barometer	Aug	-	13
		09.30	Net consumer credit £bn (Y/Y%)	Jul	-	1.0 (5.5)
		09.30	Mortgage lending £bn (approvals '000s)	Jul	-	3.7 (66.4)

**Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

The coming week's key events & auctions

Country		BST	Event / Auction
			Monday 26 August 2019
UK		-	Public holiday
			Tuesday 27 August
Germany		10.30	Auction: to sell €5bn of 0% 2021 bonds
			Wednesday 28 August 2019
Germany		10.30	Auction: to sell €3bn of 0% 2029 bonds
			Thursday 29 August 2019
Italy		10.00	Auction: to sell bonds
			Friday 30 August 2019
			- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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