

Euro wrap-up

Overview

- Bunds at the longer end of the curve fell after the ECB's Knot (a well-known hawk) stated that he is open to a rate cut but sees no need to resume QE right now.
- Despite a late sell-off, longer-dated Gilts made very modest gains on the day after data confirmed another fall in UK car production.
- Tomorrow will bring the euro area's flash inflation data for August, German retail sales figures and UK consumer and business sentiment surveys.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.921	-0.016
OBL 0 10/24	-0.911	-0.011
DBR 0 08/29	-0.697	+0.021
UKT 3¼ 09/21	0.358	+0.012
UKT 1 04/24	0.289	+0.002
UKT 0% 10/29	0.434	-0.008

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

Euro area

Commission survey hints at stabilisation in business sentiment

Tallying with last week's [flash PMIs](#), today's European Commission business and consumer survey – which often provides a reliable guide to euro area economic activity – hinted at a stabilisation in conditions in August. In particular, having trended steadily lower over the past year and a half, the headline euro area Economic Sentiment Indicator (ESI) ticked up 0.4pt to 103.1. That level was nevertheless the second lowest since March 2016 and left the average for the first two months of Q3 still 1.2pts down on Q2, suggesting that economic growth will be no firmer in the current quarter. Among the country level ESIs, despite a slight improvement in August, Germany's is on track for a marked decline in Q3, adding to evidence of technical recession. In contrast, the ESIs point to a modest improvement in the current quarter in France and Italy, and a notable turn for the better in Spain.

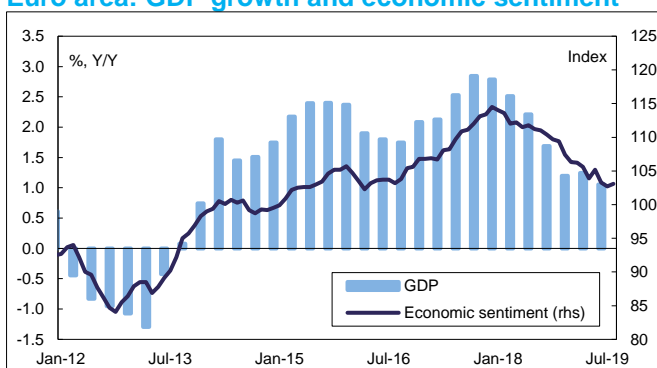
Further evidence of increased weakness in services

At the sectoral level, the slight increase in the ESI in August partly reflected an improvement in confidence in industry, where firms reported increased orders and production expectations, with German auto manufacturers notably less downbeat. But this failed fully to reverse the steep drop in the headline industry index the prior month and left the average for Q3 so far still inferior to Q2. Firms in the retail sector were also reportedly more content in August, not least thanks to a more favourable assessment of current conditions. In contrast, however, sentiment in services deteriorated to the worst since June 2015, while construction firms were the least optimistic since end-2017. Both indicators therefore suggest that the extended recent period of manufacturing sector weakness is starting to take a greater toll on other sectors, in which today's survey suggested that employment intentions are being revised down too. More downbeat perceptions of the economic outlook also weighed on consumer confidence, for which the drop in August flagged by the flash indicator was confirmed.

French Q2 GDP revised up, consumption stronger at start of Q3

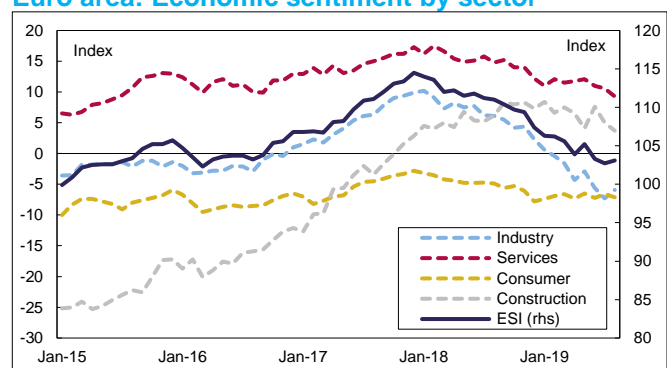
The modest improvement implied in the French ESI so far in Q3 followed a sizeable increase (1.9pts) in Q2, which contrasted markedly with the downward trend seen in the other larger member states. This had been somewhat at odds with the initial estimate of French GDP in Q2, which suggested that growth moderated by 0.1ppt to 0.2%Q/Q. However, updated national accounts today revised up growth in the last quarter to 0.3%Q/Q and 1.4%Y/Y, principally reflecting a slightly larger contribution from net trade due to a drop in imports. But household consumption was also a touch firmer. And today's monthly consumption figures for July suggested that spending on goods picked up further at the start of Q3. In particular, consumption rose 0.4%M/M following a 0.2%M/M decline in June, driven by rising spending on durable goods, up for the third consecutive month and by 1.6%M/M. This left consumption up 0.3% on a three-month basis, the first such rise since April 2018. Overall, the French economy is benefiting from President Macron's fiscal U-turn, which is supporting consumer confidence and is set to provide ongoing support to demand. Of course, a limited reliance on the manufacturing sector and external demand is also undoubtedly helping at this stage in the global

Euro area: GDP growth and economic sentiment



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

Euro area: Economic sentiment by sector



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



economic cycle. As such, we maintain our view that GDP growth likely remained steady in Q3 at a relatively respectable 0.3%/Q/Q.

Inflation edges lower

Against the backdrop of softer GDP growth, subdued economic sentiment and waning inflation expectations, the first of the preliminary August inflation releases from the larger member states today came in weaker than anticipated. Contrasting with an expected increase, German consumer prices declined for the first month in seven to leave the annual rate on the EU-harmonised measure 0.1ppt lower at just 1.0%Y/Y, the lowest since November 2016. On the national measure, following the notable increase in July, the headline CPI rate declined a larger 0.3ppt to 1.4%Y/Y. And this drop principally reflected lower goods inflation (down 0.5ppt to 1.3%Y/Y) on the back of significantly weaker energy inflation (down 1.8ppts to 0.6%Y/Y). While services inflation edged slightly higher (up 0.1ppt to 1.6%Y/Y), this was barely stronger than the average over recent years. Lower electricity prices appear to have dragged Spanish inflation lower in August too, with headline CPI down 0.2ppt on both the EU-harmonised and national basis to 0.4%Y/Y and 0.3%Y/Y respectively, both near-three-year lows.

The day ahead in the euro area and US

In another busy day for top-tier euro area releases, Friday's highlight will be the flash CPI estimate for August. Against the backdrop of declining energy prices, headline inflation is expected to have fallen further this month by 0.1ppt to 1.0%Y/Y, which would mark the weakest rate since November 2016. In contrast, core CPI is expected to have nudged very slightly higher, albeit to a still very subdued 1.0%Y/Y. Tomorrow will also bring preliminary CPI figures from France and Italy. In addition, following the release today of the latest German labour market figures for August – which reported the third monthly rise out of the past four in the number of people unemployed, albeit leaving the unemployment rate on this national measure unchanged at 5.0% – Friday will see the release of euro area unemployment figures for July. German and Spanish retail sales data for the same month and a revised Italian Q2 GDP estimate are also due.

In the US, the main focus tomorrow will be on the monthly personal income and spending figures, including the closely watched deflators, for July. The final reading of the University of Michigan's consumer confidence survey for August is also due for release.

UK

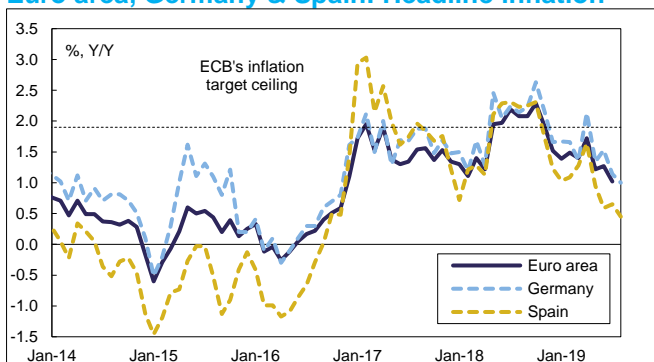
UK car production remains in reverse

UK-based car manufacturers are undoubtedly struggling in the face of ailing demand and the existential threat posed by a no-deal Brexit. And today's car production figures added to the steady flow of negative news from the sector, suggesting that output fell a further 10.6%Y/Y in July, the fourteenth consecutive year-on-year decline, to leave production in the year to date down a whopping 18.9%YTD/Y. Some of the weakness in the year-to-date figure reflected the earlier summer maintenance in car factories which was brought forward to April. Indeed, there was a pickup in production for the domestic market in July (10.2%Y/Y) for the second successive month. But this in part reflected base effects as production this month last year was cut significantly in preparation for the implementation of new standards testing. Moreover, the domestic market accounts for a relatively small share of total output, with demand from overseas markets representing roughly 80% of car production. And so, despite sterling's depreciation, against the backdrop of weaker demand from the EU and Asia in particular, production for export fell a sizeable 14.6%Y/Y, to leave the level of such output over the past twelve months at its lowest for eight years.

The day ahead in the UK

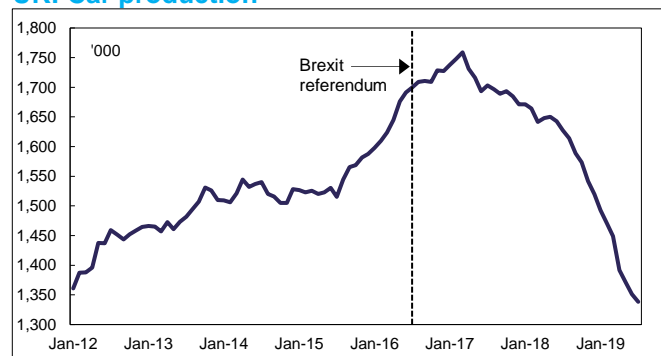
The end of the week brings a flurry of UK data releases including the GfK consumer confidence survey for August, which seems bound to highlight household unease about the near-term outlook. The Lloyds barometer, also due that day, will similarly likely suggest that business conditions remain considerably weaker than in recent years. But despite this backdrop, the Bank of England's lending figures might echo the findings from the UK Finance numbers earlier this week, which indicated a pickup in consumer credit and mortgage lending at the start of Q3.

Euro area, Germany & Spain: Headline inflation*



*EU-harmonised rates. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Car production













Source: Thomson Reuters, SMMT 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	 Economic sentiment indicator	Aug	103.1	102.3	102.7	-
	 Industrial confidence (services confidence)	Aug	-5.9 (9.3)	-7.4 (10.6)	-7.4 (10.6)	-7.3 (-)
	 Consumer confidence	Aug	-7.1	-7.1	-6.6	-
Germany	 Unemployment rate % (change '000s)	Aug	5.0 (4.0)	5.0 (4.0)	5.0 (1.0)	-
	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	1.4 (1.0)	1.5 (1.2)	1.7 (1.1)	-
France	 GDP – second release Q/Q% (Y/Y%)	Q2	0.3 (1.4)	0.2 (1.3)	0.3 (1.2)	-
	 Consumer spending M/M% (Y/Y%)	Jul	0.4 (0.1)	0.4 (0.1)	-0.1 (-0.6)	-0.2 (-0.8)
Italy	 Industrial sales M/M% (Y/Y%)	Jun	-0.5 (-0.8)	-	1.6 (0.3)	1.5 (-)
	 Industrial orders M/M% (Y/Y%)	Jun	-0.9 (-4.8)	-	2.5 (-2.5)	2.8 (-2.3)
Spain	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	0.3 (0.4)	0.4 (0.6)	0.5 (0.6)	-

Auctions

Country	Auction
Italy sold	 €2.25bn of 1.75% 2024 bonds at an average yield of 0.32%
	 €4.0bn of 1.35% 2030 bonds at an average yield of 0.96%
	 €1.0bn of 2025 floating-rate bonds at an average yield of 0.77%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU	 10.00	Preliminary CPI (core CPI) Y/Y%	Aug	<u>1.0 (1.0)</u>	1.1 (0.9)
	 10.00	Unemployment rate %	Jul	7.5	7.5
Germany	 07.00	Retail sales M/M% (Y/Y%)	Jul	-1.3 (3.3)	3.5 (-1.6)
France	 07.45	Preliminary CPI (EU-harmonised) Y/Y%	Aug	1.0 (1.2)	1.1 (1.3)
Italy	 09.00	Unemployment rate %	Jul	9.6	9.7
	 10.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	0.3 (0.5)	0.4 (0.3)
	 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	2.5	2.4
UK	 00.01	GfK consumer confidence indicator	Aug	-12	-11
	 00.01	Lloyds business barometer	Aug	-	13
	 07.00	Nationwide house price index M/M% (Y/Y%)	Aug	0.1 (0.7)	0.3 (0.3)
	 09.30	Net consumer credit £bn (Y/Y%)	Jul	1.0 (-)	1.0 (5.5)
	 09.30	Mortgage lending £bn (approvals '000s)	Jul	3.7 (66.1)	3.7 (66.4)

Auctions

Country	BST	Auction/Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.



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