

Euro wrap-up

Overview

- Longer-dated Bunds reversed some of yesterday's losses as German manufacturing production data disappointed expectations.
- Gilts also made notable gains, while UK opposition parties looked set to block another attempt on Monday by PM Johnson to hold a general election in mid-October.
- While UK politics will remain in focus, all eyes should also be on the ECB's policy announcement on Thursday, with a package of new easing measures under consideration.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.878	+0.002
OBL 0 10/24	-0.882	-0.014
DBR 0 08/29	-0.637	-0.039
UKT 3% 09/21	0.389	-0.048
UKT 1 04/24	0.342	-0.082
UKT 0% 10/29	0.506	-0.093

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

Euro area

German production disappoints again

Once again, Germany's industrial production data disappointed expectations that were already downbeat. Total production fell 0.6%M/M in July to leave it down 4.2%Y/Y and 2.0%3M/3M, the steepest three-month decline since January 2013. Manufacturing and mining output was down 0.8%M/M and 1.6%3M/3M, with lower production of capital goods (down 1.2%M/M and 1.0%3M/3M) and intermediate items (down 0.7%M/M and 3.1%3M/3M) offset only slightly by increased production of consumer goods (up 0.6%M/M and 0.1%3M/3M). Construction output rose for the second month, albeit up just 0.2%M/M to be down still a hefty 2.4%3M/3M. And energy production fell for a sixth successive month, down 1.3%M/M and a whopping 6.8%3M/3M. Looking ahead, while car output looks to have picked up in August, downbeat survey measures such as the [ifo indices](#) and shrinking [order books](#) would suggest that further declines in total manufacturing output are likely to be forthcoming.

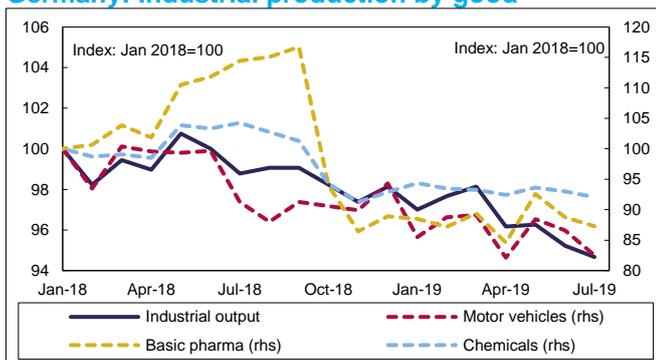
German labour cost growth picks up, but for how long?

More positively for the ECB, Germany's latest labour cost data, also released today, were stronger. Indeed, while the quarterly increase moderated slightly in Q2 by 0.3ppt to 0.8%Q/Q, this still marked the fourth consecutive quarterly rise, with costs of gross earnings and non-wage costs rising at the same pace. So, on an annual basis, overall labour cost growth in the business economy picked up 0.7ppt to 3.2%Y/Y, back to the top of the range of the past four years, with wage and non-wage costs rising at a similar rate. While this might suggest a modest inflationary impulse from the tight labour market, we expect no further meaningful increase in labour cost growth over coming quarters not least given the recent marked weakening of economic growth. Indeed, German employment growth slowed in Q2 to 0.1%Q/Q, the weakest in eighteen quarters, and we expect minimal job growth in Q3 and Q4.

Euro area employment slowed with GDP in Q2

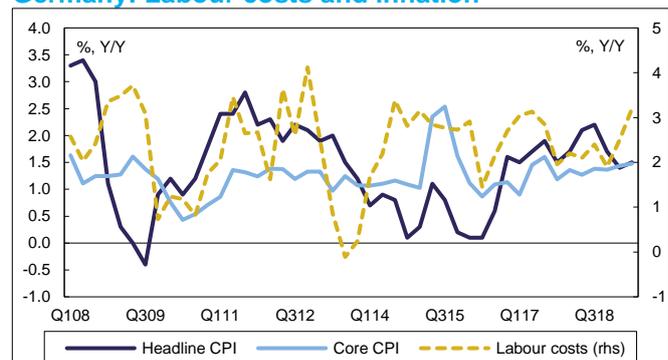
As in Germany, job growth in Q2 was also weaker in Spain (down 0.4ppt to 0.3%Q/Q, the softest in more than six years). But it was steady in France (0.3%Q/Q), and remarkably stronger in Italy (up 0.3ppt to 0.5%Q/Q). Nevertheless, in the euro area as a whole, employment growth slowed 0.2ppt to 0.2%Q/Q and 1.2%Y/Y, the weakest rates since Q115. Those rates matched Q2 growth in GDP, which today was confirmed at 0.2%Q/Q and (an upwardly revised) 1.2%Y/Y, implying flat labour productivity. The expenditure GDP breakdown, published for the first time, provided no surprises, confirming that growth came from final domestic demand. However, tallying with the slowdown in job growth, private consumption moderated 0.2ppt to 0.2%Q/Q, the weakest in three quarters. Fixed investment growth was a touch firmer on the quarter, up 0.3ppt to 0.5%Q/Q, but still down on the average of the past four years. And net trade subtracted from growth as export volumes failed

Germany: Industrial production by good



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: Labour costs and inflation



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.



to grow for the first time in five quarters while imports rose modestly. Having subtracted from GDP growth in the previous two quarters, inventories made no contribution in Q2. We forecast a similar composition of growth, albeit with a marginally weaker headline rate, in Q3.

The week ahead in the euro area and US

The coming week will be all about the ECB, whose latest monetary policy meeting is set to conclude on Thursday. At the last meeting in July, the policymakers revised their forward guidance, stating that they expect the key interest rates to remain unchanged 'or lower' at least through the first half of 2020. They also emphasised that they are ready to adjust all policy instruments. And in a clear sign that they are now preparing for new action, they tasked the relevant Eurosystem Committees with examining a wide range of policy options that might be taken if the medium-term inflation outlook continues to fall short of the ECB's aim.

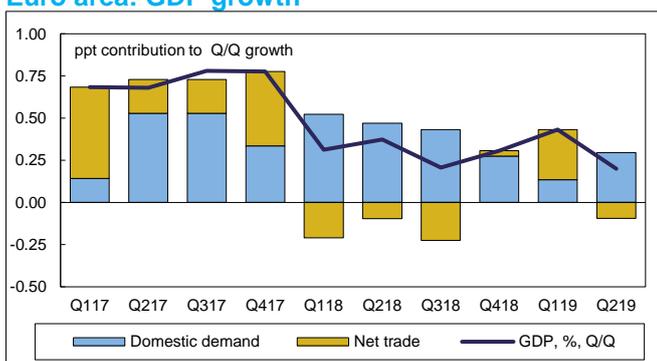
At the coming week's meeting, the ECB will publish updated economic forecasts, which we expect to revise down the outlooks for euro area GDP growth and inflation over the projection horizon, while also acknowledging the continued downward skew in the balance of risks. Indeed, we suspect that the forecast for inflation at the end of the horizon, in 2021, will be revised down to 1.5%Y/Y, well below target. And with market- and survey-based inflation expectations recently having fallen to record lows to raise significant concerns about the ECB's lack of credibility, the case for further monetary easing will be strong.

Not least given the extreme current policy settings, the precise measures which the Governing Council will take, however, are highly uncertain. We currently anticipate a package along the following lines:

- A further interest rate cut seems inevitable, not least given the change to rate guidance in July. But the size of the rate cut is difficult to predict with confidence. We forecast a reduction of 20bps in the deposit rate, to -0.60%, a slightly larger cut than is currently priced in to the market.
- To mitigate possible negative side-effects on the banking sector, we also expect the ECB to announce a new tiering framework for reserve remuneration. But how this might work in practice is also uncertain. We suspect that the Governing Council will prefer a system which excludes from the negative rate only a relatively small share of excess reserves (as is the case in Denmark, for example) rather than one which excludes a large share (as is the case in Japan).
- To demonstrate the ECB's willingness to do whatever it takes to achieve its inflation target, and as a full policy package combining rate cuts and net asset purchases should be considered more effective in boosting inflation than a sequence of selective actions, we also expect the Governing Council to approve a new QE programme. However, it is clear that this policy decision will not be unanimous. Hawkish members who have not favoured the ECB's original QE programme (i.e. Weidmann, Lautenschläger and Knot) have already expressed doubts on the merits of more net asset purchases, and they are not alone on the Governing Council. Nevertheless, we think that they are in a minority. And Lane (and Draghi) will persuade a majority of members to back a new programme of net asset purchases, of about €30bn per month lasting through to end-June 2020. This will also require a decision to increase the ECB's self-imposed issue and issuer limits, from 33% to 50%.

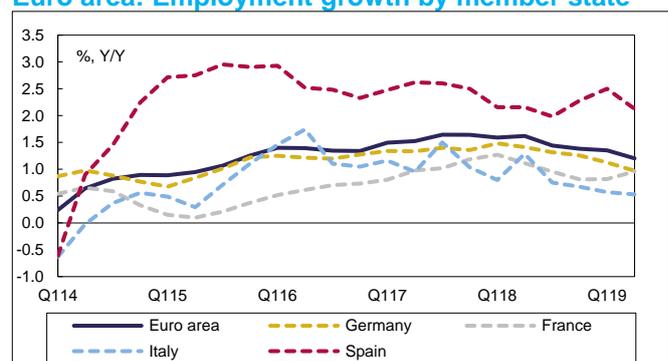
The coming week's euro area data calendar will focus on industrial production and trade figures for July. Following today's German figures and the release of French, Italian and Spanish production numbers in the first half of the coming week, aggregate euro area IP data (Thursday) are expected to show that output reversed only a fraction of the marked decline seen at the end of Q2, to leave it still trending lower on a three-month basis and down roughly 3%Y/Y. The weakening trend will reflect to some extent ongoing soft external demand, which is likely to be highlighted in July's euro area trade report

Euro area: GDP growth*



*Q2 and Q317 figures show the average of the two quarters. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Employment growth by member state



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

(Friday) and Germany's trade figures (Monday). The coming week will also bring the Bank of France's business sentiment survey for August (Monday), as well as euro area labour costs numbers for Q2 (Friday). In the markets, Germany will sell index-linked bonds on Tuesday, while Italy will sell bonds on Thursday.

In the US, while the back end will bring some notable releases, the coming week will start on a relatively quiet note for economic data. Only July consumer credit figures are due on Monday with the latest NFIB small business survey and JOLTS job data due on Tuesday. The following day will bring producer price figures for August, and wholesale trade and inventory numbers for July. Thursday, however, will bring the August CPI report, as well as the federal budget statement for the same month and usual weekly claims numbers. And Friday will bring August data for retail sales and import and export prices, as well as the preliminary University of Michigan consumer confidence survey for the current month. In the markets, the Treasury will sell 3Y Notes on Tuesday, 10Y Notes on Wednesday, and 30Y Bonds on Thursday.

UK

Opposition parties again to reject Johnson's proposal for an early general election

After a week of high political drama, Friday saw the various party leaderships prepare their positions ahead of the new vote, scheduled for Monday evening, to determine whether to call an early general election. Reports suggested that the opposition parties had agreed to resist PM Johnson's overtures for an election on 15 October. Instead, they prefer to leave Johnson in position as Prime Minister for a little longer, and use the anti-no-deal legislation, which passed the House of Lords today, to force him to request an extension of the Article 50 deadline later next month if (as seems highly likely) he fails to reach a deal with the EU by 19 October. Of course, yesterday saw Johnson double down on his promise not to request that Article 50 extension even if the law would compel him to do so. So, without an election before that date, Johnson would be left in an ignominious position, having to either (1) go back on his word, (2) break the law, or (3) resign as Prime Minister (but not necessarily as Conservative party leader) when it is time to request the extension. On balance, we would expect scenario (3) to play out.

Job survey signals drop in recruitment

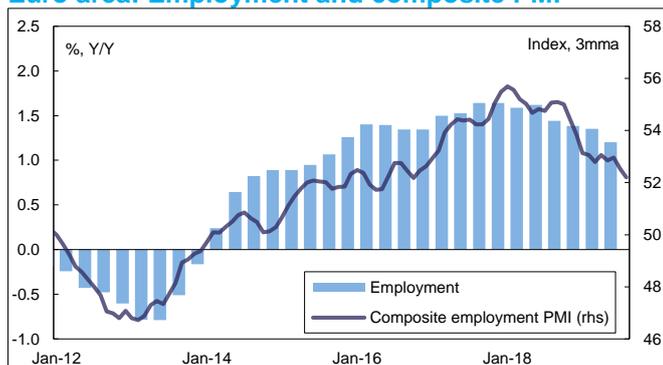
Data-wise, the end of the week brought the KPMG/REC report on UK jobs, which provided an update from recruitment consultancies on labour market conditions in August. Against the backdrop of heightened political uncertainty, this unsurprisingly suggested a further drop in hiring last month, with the number of people placed in permanent roles declining at the fastest rate for over three years. Temporary placements continued to rise only marginally. While the supply of job candidates also fell sharply in August, the number of vacancies increased at the slowest pace since the start of 2012, with reduced demand for both permanent and temporary staff alike.

The week ahead in the UK

In the UK, politics will dominate at the start of the week. Most notably, Monday should see MPs pass the draft legislation seeking to prevent a no-deal Brexit before it gains royal assent to enter into law later in the day. That evening, MPs are set to vote again on a Government motion seeking an early general election. If approved, Parliament would subsequently be prorogued (i.e. shut down) that evening. But as all the indications today were that the opposition parties had united to reject to reject the Government's proposal, Parliament will likely continue to sit through to Thursday, providing further time for Johnson to try to find agreement on a general election (although, of course, he might well fail to do so). If MPs fail over the course of the week to set a date for a new poll, there will be no general election before November.

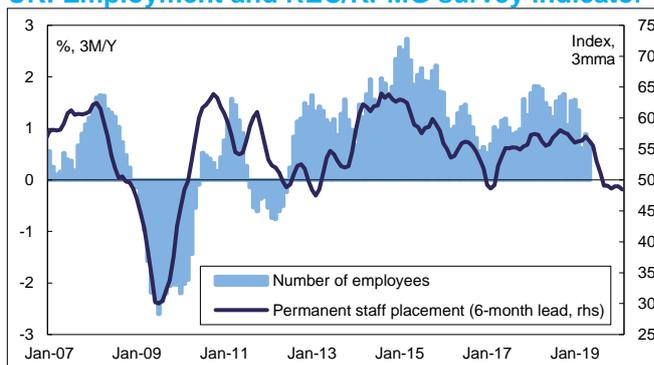
The UK data highlights will also come at the start of the week, with the monthly GDP, output and trade figures for July out on Monday. Having declined 0.2%Q/Q in Q2, GDP is expected to rise 0.1%M/M at the start of Q3 to leave it still down

Euro area: Employment and composite PMI



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

UK: Employment and REC/KPMG survey indicator



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

0.1%3M/3M. The following day will bring the latest labour market report, which is expected to report a notable slowing of job growth in the three months to July but no change to the unemployment rate (3.9%) or average weekly earnings growth (3.7%Y/Y). The remainder of the week will be quiet for new economic data, with just the RICS housing market survey for August coming on Thursday. Beyond the economic data, on Monday MPC member Gertjan Vleighe will speak on a panel discussion on macroeconomic policy.

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	0.1	0.2	0.2	0.2	0.2	0.1	1.9	1.0	0.7
Germany 	0.4	-0.1	-0.1	0.1	0.1	0.2	0.1	0.1	1.5	0.5	0.4
France 	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	1.7	1.3	1.2
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	0.1	0.0	0.2	0.2	0.2	0.1	1.4	1.0	0.5
Inflation forecasts %, Y/Y											
Euro area											
Headline CPI 	1.4	1.4	1.0	1.0	1.3	1.2	1.4	1.5	1.8	1.2	1.4
Core CPI 	1.0	1.1	0.9	1.0	1.1	1.1	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	30	30	30	0	0	15	30	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 	Final GDP Q/Q% (Y/Y%)	Q2	0.2 (1.2)	0.2 (1.1)	0.4 (1.2)	-	
	Final employment Q/Q% (Y/Y%)	Q2	0.2 (1.2)	0.2 (1.1)	0.4 (1.3)	-	
Germany 	Industrial production M/M% Y/Y%	Jul	-0.6 (-4.2)	0.4 (-3.9)	-1.1 (-4.7)	-	
	Labour costs Q/Q% (Y/Y%)	Q2	0.8 (3.2)	-	1.3 (2.5)	-	
France 	Trade (current account) balance €bn	Jul	-4.6 (0.2)	-4.5 (-)	-5.2 (-0.8)	-5.3 (-1.1)	
Italy 	Retail sales M/M% (Y/Y%)	Jul	-0.5 (2.6)	-	1.9 (1.3)	-	
UK 	Halifax house price index M/M% (Y/Y%)	Aug	0.3 (1.8)	-	0.4 (1.5)	-	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 9 September 2019					
Germany		07.00 Trade (current account) balance €bn	Jul	15.9 (16.0)	16.6 (20.6)
UK		09.30 Monthly GDP estimate M/M% (3M/3M%)	Jul	0.1 (-0.1)	0.0 (-0.2)
		09:30 Industrial production M/M% (Y/Y%)	Jul	-0.2 (-1.3)	-0.1 (-0.6)
		09:30 Manufacturing production M/M% (Y/Y%)	Jul	-0.3 (-1.3)	-0.2 (-1.4)
		09:30 Construction output M/M% (Y/Y%)	Jul	0.2 (0.0)	-0.7 (-0.2)
		09:30 Services activity M/M% (3M/3M%)	Jul	0.1 (0.1)	0.0 (0.1)
		09:30 Trade balance (goods trade balance) £bn	Jul	-1.0 (-9.9)	1.8 (-7.0)
Tuesday 10 September 2019					
France		07.45 Industrial production M/M% (Y/Y%)	Jul	0.5 (0.3)	-2.3 (0.0)
		07.45 Manufacturing production M/M% (Y/Y%)	Jul	-	-2.2 (-0.6)
Italy		09.00 Industrial production M/M% (Y/Y%)	Jul	-0.1 (0.4)	-0.2 (-1.2)
UK		09:30 Claimant count rate % (change '000s)	Aug	-	3.2 (28.0)
		09:30 Average weekly earnings (excl. bonuses) 3M/Y%	Jul	3.7 (3.8)	3.7 (3.9)
		09:30 ILO unemployment rate 3M%	Jul	3.9	3.9
		09:30 Employment change 3M/3M '000s	Jul	55	115
Wednesday 11 September 2019					
Spain		08.00 Industrial production M/M% (Y/Y%)	Jul	-0.3 (1.4)	-0.2 (1.8)
Thursday 12 September 2019					
EMU		10.00 Industrial production M/M% (Y/Y%)	Jul	-0.1 (-1.3)	-1.6 (-2.6)
		12:45 ECB main refinancing rate %	Sep	0.00	0.00
		12:45 ECB marginal lending facility %	Sep	0.25	0.25
		12:45 ECB deposit facility rate %	Sep	<u>-0.60</u>	-0.40
Germany		07.00 Final CPI (EU-harmonised CPI) Y/Y%	Aug	1.4 (1.0)	1.7 (1.1)
France		07.45 Final CPI (EU-harmonised CPI) Y/Y%	Aug	1.1 (1.2)	1.1 (1.3)
UK		00.01 RICS house price balance	Aug	-10	-9
Friday 13 September 2019					
EMU		10.00 Trade balance €bn	Jul	17.4	17.9
		10.00 Labour costs Y/Y%	Q2	-	2.4
Spain		08.00 Final CPI (EU-harmonised CPI) Y/Y%	Aug	0.3 (0.4)	0.5 (0.6)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 9 September 2019		
UK		09.00 BoE's Vlieghe due to speak in London
Tuesday 10 September August		
Germany		10.30 Auction: to sell €0.5bn of 0.1% 2046 index-linked bonds
Wednesday 11 September 2019		
- Nothing scheduled -		
Thursday 12 September 2019		
EMU		12:45 ECB monetary policy announcement
		13.30 ECB's Draghi speaks at a press conference following the Governing Council meeting
Italy		10.00 Auction: to sell 3Y bonds
		10.00 Auction: to sell 7Y bonds
Friday 13 September 2019		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.



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