Euro wrap-up

Overview

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- Bunds made losses despite some disappointing French and Italian IP data.
- Gilts also made losses as UK data showed the strongest wage growth for eleven years.
- With just Spanish IP data due for release tomorrow, most attention over the coming two days will be on the ECB's policy announcement on Thursday, which seems bound to include the unveiling of new stimulus measures.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.855	+0.013
OBL 0 10/24	-0.840	+0.021
DBR 0 08/29	-0.561	+0.029
UKT 3¾ 09/21	0.466	+0.039
UKT 1 04/24	0.425	+0.032
UKT 0⅞ 10/29	0.629	+0.039

*Change from close as at 4:00pm BST.
Source: Bloomberg

Euro area

French manufacturing output remains subdued in July

Today's most notable economic data focused on the industrial sector. And just like the German figures published last week, the July production data from France and Italy were also weaker than expected. In France, total IP and manufacturing output both rose 0.3%M/M, a paltry rate after declines of more than 2.0%M/M in June, to leave the respective levels both 0.6% below their Q2 averages and suggestive of a trend that is sideways at best. Within the detail, French production of capital goods rose 1.2%M/M, which was insufficient to reverse the drop the prior month. And for a second successive month production of autos fell significantly (dropping 1.7%M/M) to be down a steep 4.1%Y/Y, with output of consumer durables and intermediate items also again weaker. As a result, manufacturing output was down 0.3%Y/Y. And a particularly sharp drop in construction output (down 4.2%M/M) left that component down 2.4%Y/Y. Survey indicators, such as the PMIs and the Bank of France manufacturing confidence index, point to an improved performance in August. However, after manufacturing production fell in Q2, any growth over the third quarter as a whole is likely to be very weak indeed.

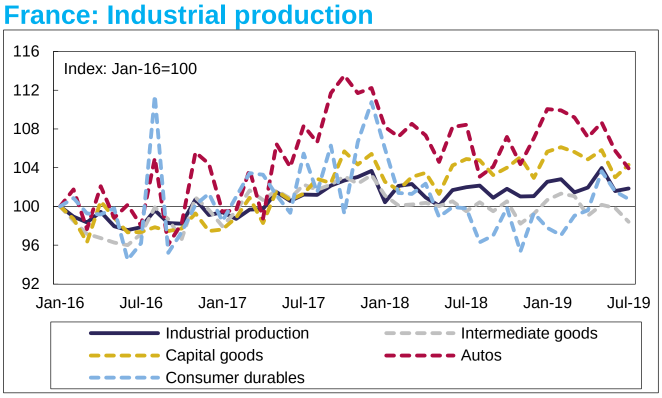
Italian production trending gradually lower

In Italy, performance in July was also disappointing, with manufacturing output and total industrial production both down for a second successive month and by 0.7%M/M, leaving them a touch more than 0.5% below their respective Q2 averages. Like in Germany and France, production of capital goods was particularly weak, suggestive of an environment for business investment (in Italy, the euro area and at the global level) that is continuing to deteriorate. Unlike in France, survey indicators (such as the respective ISTAT index) suggest a possible further deterioration in conditions in the Italian manufacturing sector in August. Confidence in the current month might have been bolstered somewhat by the resumption of a modicum of political stability, with Italian PM Conte yesterday having won comfortably his first of two mandatory parliamentary confidence votes on the new Five Star/Democratic Party coalition government. Nevertheless, we expect Italian manufacturing production to decline for a second successive quarter in Q3, and a gradual downwards trend to remain in place towards year-end. Meanwhile, given also the drop in German output in July, in the absence of a significant upside surprise in the Spanish data which are due tomorrow, figures to be released on Thursday are likely to show a decline in euro area IP (excluding construction) of a little more than ½%M/M.

The coming two days in the euro area and US

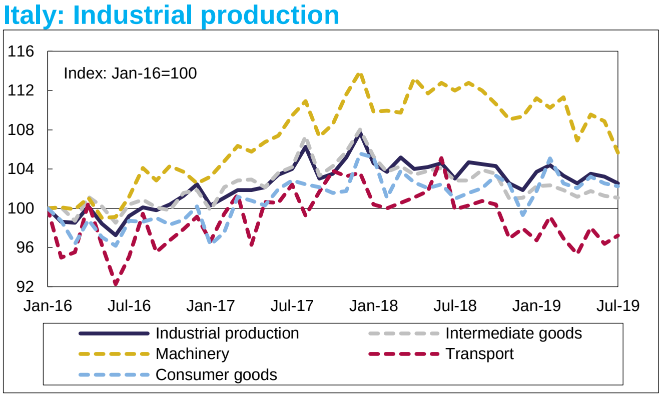
Wednesday will be a relatively quiet day for economic news from the euro area, with Spanish industrial production figures for July most notable. These are expected to post a modest decline for a second successive month, although that would still

France: Industrial production



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Italy: Industrial production



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

leave the level of output well above the Q2 average. The equivalent data for the euro area as a whole will come on Thursday, and – notwithstanding an upside surprise from Spain – are likely to report a decline in production (excluding construction) of ½% or more due not least to the falls in Germany and Italy. Other data due on Thursday include final German and French inflation figures for August.

Of course, far more important will be the latest announcements from the ECB, which seem bound to include the unveiling of new stimulus measures. The precise measures which the Governing Council will agree, however, are highly uncertain. We currently anticipate a package along the following lines:

I. A cut of 20bps in the deposit rate, to -0.60%, a larger reduction than is currently priced in to the market. The ECB will also extend its forward guidance, to state that interest rates might remain at the new levels or below at least through the fall 2020.

II. A new tiering framework for reserve remuneration to mitigate possible adverse side-effects on the banking sector from the negative deposit rate. But how this might work in practice is highly 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 or Switzerland, for example) rather than one which excludes a large share (as is the case in Japan), and as such might have a relatively limited initial market impact.

III. A new QE programme, to demonstrate the ECB's willingness to try 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. This policy decision will not be unanimous. But the hawkish members who did not favour the ECB's original QE programme (i.e. Weidmann, Lautenschläger and Knot) are again likely to be in a minority. In particular, we expect ECB Chief Economist Lane (and Draghi) to 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%.

To justify the new policy package, the ECB will cite its updated economic forecasts, which we expect to revise down the outlooks for euro area GDP growth and inflation over the projection horizon. Indeed, we suspect that the key forecast for inflation at the end of the horizon, in 2021, will be revised down to 1.5%Y/Y, well below target. Draghi will also continue to emphasise the downward skew in the balance of risks to the outlook. And with market- and survey-based inflation expectations recently having fallen to record lows, he will emphasise the need to act to counter concerns about the ECB's lack of credibility.

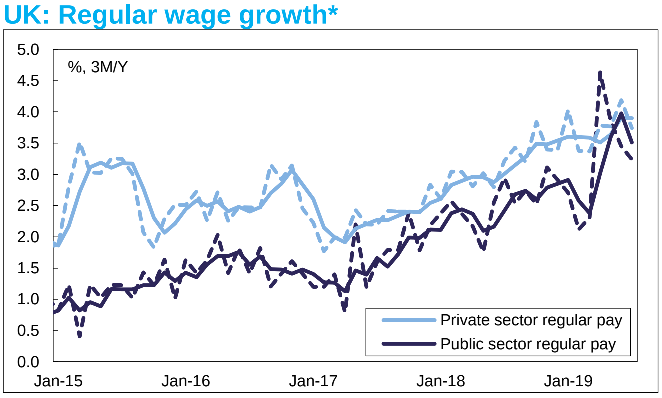
In the US, the main focus over the coming two days will be Thursday's CPI figures for August. Lower energy prices are likely to keep headline CPI constrained, with a 0.1%M/M increase set to leave the annual rate unchanged at 1.7%Y/Y. But core inflation is expected to have ticked slightly higher, by 0.1ppt to 2.3%Y/Y, which would be the highest for thirteen months. Ahead of this will bring producer price data for August tomorrow, while Thursday will also see the release of the Federal monthly budget statement and weekly jobless claims numbers. In the markets, the Treasury will sell 10Y notes tomorrow and 30Y notes on Thursday.

UK

Wage growth rises to more-than-11-year high

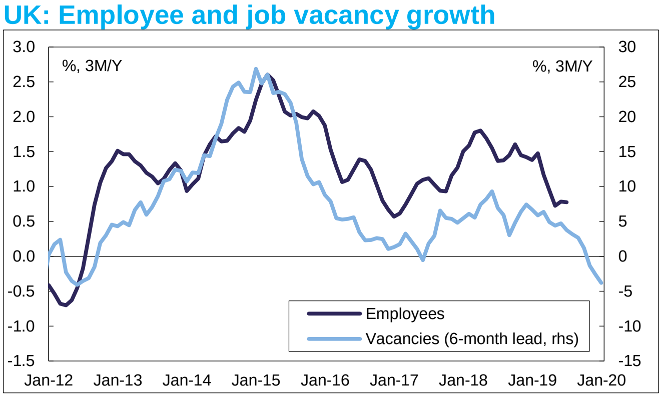
Against the backdrop of subdued economic momentum and heightened uncertainties regarding the near-term outlook, today's labour market report revealed another surprising pickup in wage growth in the three months to July. In particular, total labour earnings increased 4.0%3M/Y, the strongest since June 2008, with private sector pay rising 4.1%3M/Y, similarly the

UK: Regular wage growth*



*Dashed lines represent single-month indicator (Y/Y%).
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Employee and job vacancy growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

fastest growth for more than eleven years. And when looking at the single-month indicators, wage growth (whole economy and private sector alike) accelerated 0.4ppt to an even firmer 4.2%Y/Y. July's figures appear to have been flattered by the timing of some private sector bonus payments this year – when excluding bonus payments, regular wage growth moderated in the three months to July, by 0.1ppt to 3.8%Y/Y. And on a single-month basis, regular wage growth fell 0.4ppt to 3.7%Y/Y. Moreover, with the exception of the construction sector – where shortages of skilled workers might be most acute – the annual increase in scheduled earnings was lower across the board. Meanwhile, with the effect of one-off payments to NHS staff in April this year having petered out in July, public sector wage growth eased 0.4ppt to 3.5%3M/Y.

Employment growth easing

While the unemployment rate fell back in the three months to July, by 0.1ppt to 3.8%, to match the more-than four-decade low seen earlier in the year, with underlying economic growth having turned for the worse, there were other signs in today's report that the labour market is softening. For example, employment growth eased more than expected in the three months to July to 31k, with a marked slowing in the number of employees during that period, up just 5k compared with an increase of 76k in the three months to June. 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 October 2017, marking the steepest annual decline since 2012. The REC/KPMG labour market survey 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. So, all evidence points to a further moderation in employment growth over coming months.

The coming two days in the UK

It should be quieter for UK economic and political news over coming days, with just the RICS house price survey for August due for release on Thursday.

In the absence of significant news, the next edition of the Euro wrap-up will be published on 12 September 2019

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
France	🇫🇷	Industrial production M/M% (Y/Y%)	Jul	**0.3 (-0.2)**	0.5 (0.5)	-2.3 (0.0)	- (-0.1)
	🇫🇷	Manufacturing production M/M% (Y/Y%)	Jul	**0.3 (-0.3)**	0.8 (0.1)	-2.2 (-0.6)	- (-0.7)
Italy	🇮🇹	Industrial production M/M% (Y/Y%)	Jul	**-0.7 (-0.7)**	-0.1 (0.3)	-0.2 (-1.2)	-0.3 (-)
UK	🇬🇧	Claimant count rate % (change '000s)	Aug	**3.3 (28.2)**	-	3.2 (28.0)	- (19.8)
	🇬🇧	Average weekly earnings (excl. bonuses) 3M/Y%	Jul	**4.0 (3.8)**	3.7 (3.7)	3.7 (3.9)	3.8 (-)
	🇬🇧	ILO unemployment rate 3M%	Jul	**3.8**	3.9	3.9	-
	🇬🇧	Employment change 3M/3M '000s	Jul	**31**	55	115	-

Auctions

Country		Auction
Germany sold	🇩🇪	€207mn of 0.1% 2046 index-linked bonds at an average yield of -1.27%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Spain		08.00	Industrial production M/M% (Y/Y%)	Jul	-0.3 (1.4)	-0.2 (1.8)
Auctions						
Country		BST	Auction/Event			
			- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
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	*-0.60*	-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
Auctions						
Country		BST	Auction/Event			
EMU		12:45	ECB monetary policy announcement			
		13.30	ECB President Draghi speaks at the post-Governing Council meeting press conference			
Italy		10.00	Auction: to sell 0.05% 2023 bonds			
		10.00	Auction: to sell 2.1% 2026 bonds			
		10.00	Auction: to sell 3.85% 2049 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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