Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds and other euro area government bonds followed USTs sharply lower and European stocks made big gains, while the German ZEW survey suggested concern about current economic conditions but optimism about the future.
- Gilts also made losses despite steep drops in UK payrolls and real wages as data also pointed to stronger spending in July.
- Wednesday will bring the first estimate of UK Q2 GDP and euro area industrial production data for June.

Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.690	+0.028
OBL 0 10/25	-0.687	+0.037
DBR 0 08/30	-0.476	+0.054
UKT 0½ 07/22	-0.002	+0.036
UKT 0⅝ 06/25	-0.020	+0.054
UKT 4¾ 12/30	0.202	+0.073

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

Euro area

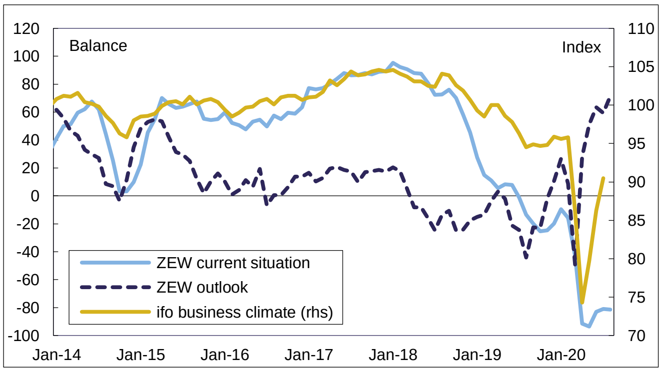
German ZEW optimistic about outlook but cautious about current climate

While Germany's ZEW survey of financial analysts pointed to improved optimism about the economic outlook – with the expectations index jumping to its highest since 2003 – the respondents remained far more cautious about their assessment of the current situation. Indeed, the relevant indicator unexpectedly slipped back slightly in August, by 0.4pt to -81.3, just 12pts off April's trough and leaving it still a whopping 72pts below the pre-Covid level. Admittedly, this survey does not always provide an accurate assessment of economic activity. However, it typically offers a guide to the findings of the more broad based ifo survey (due 25 August). So, while the ifo's headline business climate index had recovered roughly three-quarters of the February-April drop by July, the August reading might underwhelm somewhat. Indeed, high-frequency data point to some levelling-off of activity over recent weeks. And a separate ifo survey yesterday suggested that firms on average expect Covid-related restrictions to remain in place for a further 8½ months, and longer for services, impeding economic recovery ahead.

Bank of France less optimistic about the economic outlook

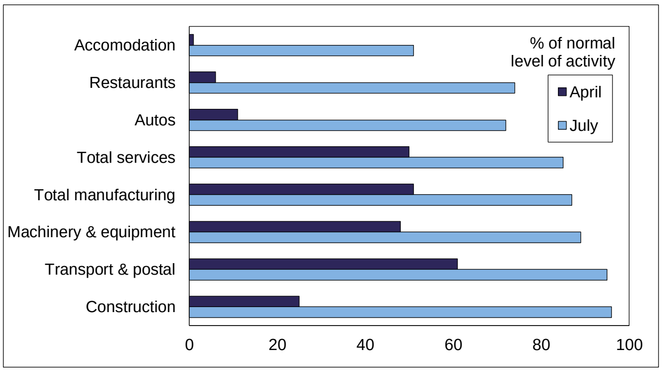
While yesterday's Bank of France business sentiment survey saw further notable gains in the headline manufacturing sentiment index – up 10pts to 99, a fourteen-month high – the improvement in the equivalent services index was more modest (up 3.5pts to 92), while the construction index slipped back slightly (down 1pt to 103). And overall, the Bank of France's monthly economic update offered a somewhat more downbeat assessment of conditions. Indeed, after an initial surge in activity as the economy reopened in May and June following the lockdown restrictions in the spring, the Bank of France judged that, while still improving, the pace of recovery moderated in July. Having previously estimated that French GDP was in June down about 9% from the pre-crisis level (from a drop of 17% in May), the Bank saw the equivalent shortfall in GDP in July to be around 7%. And informed by its latest business survey, it thinks that activity broadly stabilised in August. While the recovery in construction and certain manufacturing subsectors – notably food and pharmaceuticals – continued to progress to leave output close to pre-crisis levels, other manufacturing industries – in particular autos and metals – still saw a significant shortfall. And unsurprisingly, activity remained well below normal in the hospitality subsector during the summer vacation period. Indeed, other data published yesterday by the European Organisation for the Safety of Air Navigation suggested that the number of international flights to and from France in July was still down more than 62%Y/Y, similar to the drop in Germany (-61%Y/Y) but admittedly better than in Italy (-68%Y/Y), Spain (-65%Y/Y) and the UK (-73%Y/Y).

Germany: ZEW and ifo sentiment indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: BoF survey – level of output vs normal



Source: BoF and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

Wednesday will bring euro area industrial production figures for June. Following strong growth in manufacturing output in the large member states, we expect to see an increase of about 10%M/M in the aggregate euro area IP, following growth of 12.4%M/M in May. This would mean that roughly two-thirds of the initial drop between February and April had been reversed, but output would still be about 10% below the pre-pandemic peak. Tomorrow will also bring final Italian CPI figures for July for which the flash estimate on the EU measure jumped 1.5ppt to 0.9%Y/Y, the highest level in fourteen months, as the start of the summer sales period for clothing and footwear was postponed. For the same reason, core inflation on the EU measure rose 1.6ppts to 2.1%Y/Y.

UK

Employment down almost 750k from peak in July

Conditions in the UK labour market deteriorated notably again last month despite the ongoing relaxation of lockdown restrictions, which included the reopening of restaurants and pubs. Having dropped only 20k in June, the number of people in paid employment fell a steep 114k in July, to be down 742k (2.6%) from the peak in January and down 626k (2.2%) from a year earlier, to the lowest level in more than three years. As activity in some sectors normalized, the inflow into paid employment picked up for the first time since January. But it remained well below pre-Covid levels. And while the number of vacancies in the three months to July rose about 10% from the previous month's record low to 370k, supported by a significant increase in hospitality, the outflow from paid employment also increased for the first time since April. Although the pace of that outflow remained below the average for the pre-pandemic period, a far more severe shake-out looks imminent.

About 7.5mn temporarily away from work in June

Indeed, in June, about 7.5mn people were still temporarily away from work, with more than 5mn furloughed, and over 3mn having been off for three months or more. So, the phasing out of the government's Job Retention Scheme from now to October seems set to be the trigger for a marked acceleration of redundancies of many of these workers. Indeed, the past few weeks have already brought announcements of tens of thousands of job losses from high-profile firms, while a CIPD survey released earlier this week suggested that one in three employers plans imminent job cuts.

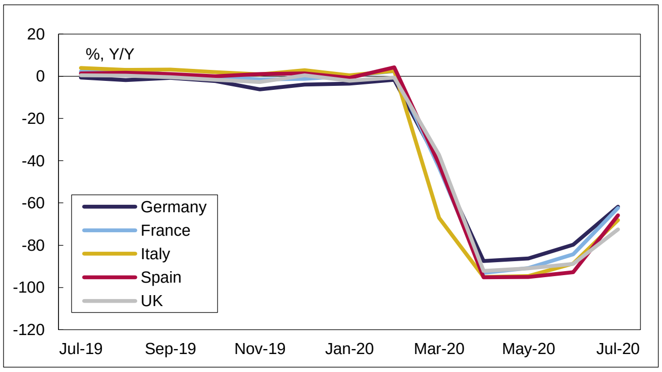
Regular pay falls for first time on the series

With so many workers furloughed or working reduced hours, the total number of weekly hours worked in Q2 fell by a record 18.4%Q/Q and 19.3%Y/Y to the lowest level since late 1994. So, with many workers on the Job Retention Scheme receiving 80% of their usual pay, the impact of the pandemic on labour incomes was inevitably marked too. Indeed, the three months to June 2020 saw total nominal pay fall 1.2%Y/Y to be down a hefty 2.0%Y/Y in real terms. While the drop was led by bonuses (down 19.4%Y/Y), regular nominal pay fell 0.2%Y/Y, the first ever drop on the series dating back to 2001. Regular pay growth fell 1.2%Y/Y in the private sector, where furlough was widespread, but rose 4.1%Y/Y in the public sector.

Little comfort from stronger pay growth in July

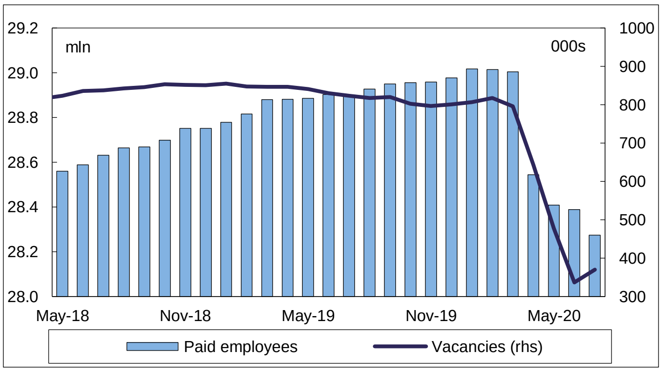
Higher frequency data point to a pickup in labour income in July as furloughed workers returned to work. But accelerated growth in median pay, up 1.3ppts to 2.5%Y/Y in July, might partly reflect compositional effects, as the lower paid are more likely to lose their jobs. Meanwhile, the claimant count – which includes some low income workers as well as those out of work – rose in July to 2.7mn, more than double the level in March, probably in part reflecting an easing of the conditions attached. But the number of people on zero-hours contracts rose a hefty 156k (17.4%) in the three months to June from a year earlier, to above 1mn for the first time, as workers sought employment and employers sought staff on the most flexible of terms.

Europe: International flights to and from countries



Source: European Organisation for the Safety of Air Navigation, Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: Paid employment and vacancies



Source: ONS and Daiwa Capital Markets Europe Ltd.

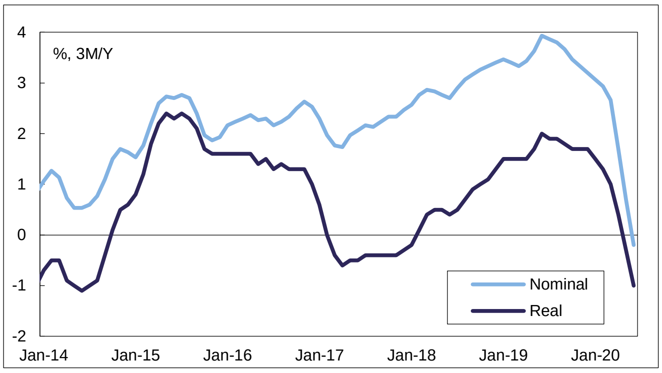
Spending rebound unlikely to prevent further job cuts

Today's other data appeared more encouraging, e.g. with the BRC's survey measure of retail sales up 3.2%Y/Y in July, the second successive positive month of growth. Sales growth on this measure was driven by food, up 6.1%3M/Y, as well as furniture and other items associated with home-working. The more comprehensive guide to spending provided by Barclaycard also suggested ongoing recovery in July. On this basis, spending on essential items including food was up 3.2%Y/Y. And while spending on non-essentials was down 4.7%Y/Y, that represented a marked improvement from the drop of more than 22%Y/Y the previous month. Among other items, spending in newly reopened restaurants and pubs was down 64%Y/Y and 43%Y/Y respectively, with further improvement likely this month thanks partly to the government's hospitality VAT cut and "Eat out to help out" meal subsidies. Overall travel spend was down a touch more than 60%Y/Y following the drop of 80%Y/Y the prior month. But these improvements likely remain too modest to prevent further significant job losses, with workers in hospitality, travel, retail and leisure sectors set to dominate the flow of redundancies over coming months as the Job Retention Scheme is phased out.

The day ahead in the UK

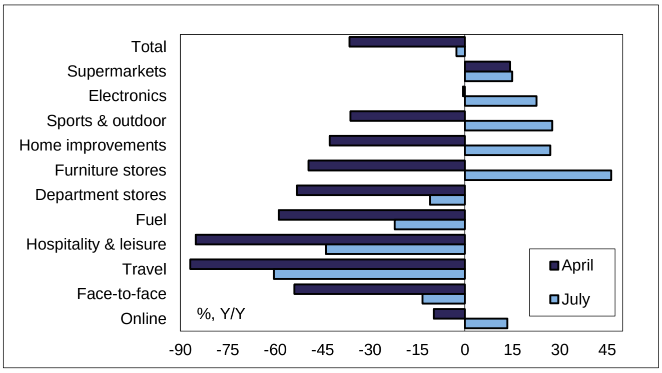
The focus tomorrow will be on the first estimate of Q2 GDP, as well as monthly output and trade figures for June. With strict containment measures in place for much of the second quarter, the hit to economic activity will inevitably be hard. Broadly in line with the BoE's latest projections and representing the worst performance of all of the major economies, we expect GDP to have contracted at a record rate, by almost 21%Q/Q, taking it to its lowest level since 2003. So, while the monthly figures for June are likely to reveal a sharply accelerated monthly pick-up in activity (with GDP up about 8%M/M), with vigorous growth across the services, manufacturing and construction sectors alike as the country eased out of lockdown, output will still have remained well below the pre-pandemic level that month.

UK: Regular wage growth



Source: Refinitiv, ONS and Daiwa Capital Markets Europe Ltd.

UK: Barclaycard spending



Source: Barclaycard and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
Germany	ZEW current situation balance (expectations)	Aug	**-81.3 (71.5)**	-69.0 (55.5)	-80.9 (59.3)	-
UK	BRC retail sales monitor, like-for-like sales Y/Y%	Jul	**4.3**	-	10.9	-
	Unemployment claimant count rate %, change '000s	Jul	**7.5 (94.4)**	-	7.3 (-28.1)	7.2 (-68.5)
	Average earnings including bonuses (excluding bonuses) 3M/Y%	Jun	**-1.2 (-0.2)**	-1.2 (-0.1)	-0.3 (0.7)	-
	ILO unemployment rate 3M%	Q2	**3.9**	4.2	3.9	-
	Employment change 3M/3M, '000s	Jun	**-220**	-295	-125	-

Auctions

Country	Auction
UK	sold £3.25bn of 0.625% 2025 bonds at an average yield of -0.049%
	sold £1.25bn of 1.75% 2057 bonds at an average yield of 0.674%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	Sentix investor confidence	Aug	**-13.4**	-16.0	-18.2	-
France	Bank of France industrial sentiment	Jul	**99**	-	89	89

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/ Daiwa forecast	Previous
EMU	10.00	Industrial production M/M% (Y/Y%)	Jun	10.0 (-11.4)	12.4 (-20.9)
Italy	09.00	Final CPI (EU-harmonised CPI) Y/Y%	Jul	-0.3 (0.9)	-0.2 (-0.4)
UK	07.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	-20.5 (-22.0)	-2.2 (-1.7)
	07.00	Monthly GDP M/M%	Jun	8.1	1.8
	07.00	Industrial production M/M% (Y/Y%)	Jun	9.9 (-12.2)	6.0 (-20.0)
	07.00	Manufacturing production M/M% (Y/Y%)	Jun	10.0 (-15.0)	8.4 (-22.8)
	07.00	Construction output M/M% (Y/Y%)	Jun	15.0 (-29.8)	8.2 (-39.7)
	07.00	Index of services M/M% (Q/Q%)	Jun	8.2 (-20.3)	0.9 (-18.9)
	07.00	Total trade balance (goods trade balance) £bn	Jun	2.6 (-4.5)	-4.3 (2.8)

Auctions and events

Country	BST	Auction / Event
Germany	10.30	Auction: €4bn of 0% 2030 bonds
UK	10.00	Auction: £2.75bn of 0.125% 2028 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FCA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory. Regulatory disclosures of investment banking relationships are available at https://daiwa3.bluematrix.com/sellside/Disclosures.action.