

Euro wrap-up

Overview

- Bunds made gains and BTPs outperformed as euro area headline inflation fell into negative territory and core inflation hit a record low.
- Gilts also made gains as BoE data showed ongoing strong loan demand from SMEs while demand for credit from individuals picked up.
- Wednesday will bring euro area produce price and German retail sales figures for July, while BoE Governor Bailey will testify before the Treasury Select Committee on the economic impact of Covid-19.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.686	-0.023
OBL 0 10/25	-0.656	-0.022
DBR 0 08/30	-0.415	-0.016
UKT 0½ 07/22	-0.102	-0.018
UKT 0% 06/25	-0.032	-0.018
UKT 4% 12/30	0.301	-0.009

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

Euro area

Negative inflation for first time since 2016

According to the flash estimate, euro area consumer price inflation fell much further than expected last month, with the annual rate of CPI plunging 0.6ppt in August to -0.2%Y/Y, the first negative reading since May 2016. With summer sales belatedly getting underway, the downwards trend in inflation of non-energy industrial goods was reasserted, more than fully reversing July's rise by dropping 1.7ppts to -0.1%Y/Y, the lowest since early 2015. In addition, services inflation declined 0.2ppt to a series low of 0.7%Y/Y. And so, core inflation fell 0.8ppt to a record low of 0.4%Y/Y. Food inflation also continued to fall back from the initial lockdown surge, down 0.3ppt to 1.7%Y/Y, just under half April's peak. But the year-on-year pace of decline in energy prices continued to ease, with the associated rate up 0.6ppt to -7.8%Y/Y, the highest since March. Nevertheless, judging from today's data, it's hard to argue that the pandemic has been highly disinflationary in the euro area.

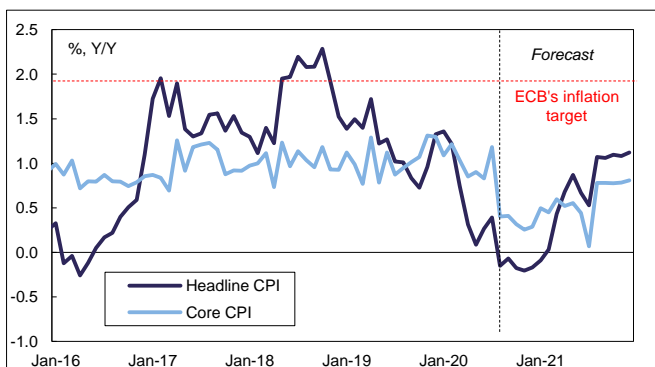
Risks to the ECB inflation forecast skewed to the downside

Looking ahead, we expect headline inflation to remain in slightly negative territory, close to current levels, until the first quarter when the end of the temporary German VAT cut and base effects related energy price shifts should push it back above zero. However, as substantive amounts of spare capacity will persist, wage growth will remain under downwards pressure, and recent significant euro appreciation – which has pushed the broad trade-weighted euro exchange rate close to its series high – will weigh on prices of imported goods, we expect headline inflation to remain below 1.0%Y/Y through to next August. On average, we forecast inflation to average 0.3%Y/Y in 2020, 0.7%Y/Y in 2021 and 1.1%Y/Y in 2022 – with the figures for the latter two years 0.1ppt and 0.2ppt below the ECB's June forecast. Similarly, our forecast for core inflation is also a touch weaker than that of the ECB, at just 0.7%Y/Y in 2022. So, if anything, we would expect the ECB to make slight downwards revision to its inflations projections when its updates are published on 10 September. And we expect no substantive change to its policy stance or forward guidance at next week's Governing Council, thus maintaining flexibility in its PEPP asset purchases and leaving the door open to further easing, such as via an increase in the PEPP envelope, by the end of the year.

Euro area unemployment continues gradual rise

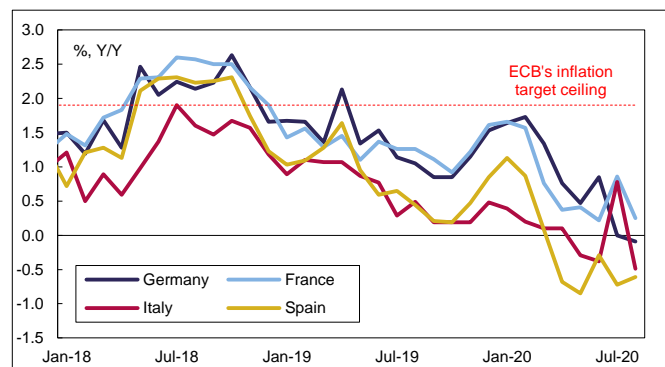
The euro area unemployment rate rose for the fourth successive month in July, up 0.2ppt to 7.9%, the highest since November 2018. The equivalent rates on the international measure in each of the three largest member states also rose, up 0.1ppt in Germany to 4.4%, up 0.3ppt in France to 6.9%, and up 0.4ppt in Italy to 9.7%. Of course, the extent of the rise in joblessness has been restrained by government short-term working and furlough schemes, which at the peak saw almost

Euro area: Headline and core inflation forecast*



*August 2020 figures are flash estimates. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation in selected member states*



*EU harmonised headline CPI. August 2020 figures are flash estimates. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

30mn workers registered for support in those largest member states alone. And while there are significant lags involved in publishing the data, roughly half of that number of workers is likely still to be receiving support under such schemes, which have been extended to varying extents, in many cases to be funded by European Commission loans under the SURE scheme. From the second half of this month, the European Commission is set to borrow from markets more than €80bn for on-lending to fund labour market interventions in at least sixteen EU member states – of which Italy is set to receive €27.4bn and Spain €21.3bn. Despite the extension of the government support programmes, and while Germany's claimant count rate remained unchanged in August at 6.4%, we expect the euro area unemployment rate to continue to drift higher over coming months. However, the rate is likely to peak below 10%, a more favourable outcome than the peak of 10.8% in the current quarter previously forecast by the ECB.

Recovery in car registrations stalls

While the French auto subsidy programme appeared to give a boost to sales in June and July, today's figures for August suggested that new registrations went back into reverse last month, falling 20%Y/Y, with domestic registrations down by 13%Y/Y and foreign purchases down by more than a quarter. And so, over the first eight months of the year, French car sales were almost one third lower than the equivalent period in 2019. Having briefly returned to positive growth in July, Spanish auto registrations were also down in August, by 10%Y/Y, to leave them in the first eight months of the year down by more than 40%YTD/Y. In Italy, the year-on-year pace of decline was just 0.4%Y/Y. But that still left new car registrations down 38.9%YTD/Y over the first eight months of the year.

Final euro area manufacturing PMI unrevised...

The final euro area manufacturing PMIs for August, meanwhile, offered no major surprises, with the headline index unchanged from the flash estimate of 51.7, which itself was just 0.1pt lower than July's reading, a twenty-month high. The output component was also confirmed to have risen 0.3pt to 55.6, the highest for more than two years and consistent with solid growth, with improving operating conditions seen across the consumer, intermediate and investment goods subsectors alike. But while new orders reportedly continued to recover as domestic demand improved, manufacturers' margins remained squeezed by falling output prices. And so, according to the PMI survey, firms continued to scale back their workforces at a similar pace to that seen after the global financial crisis.

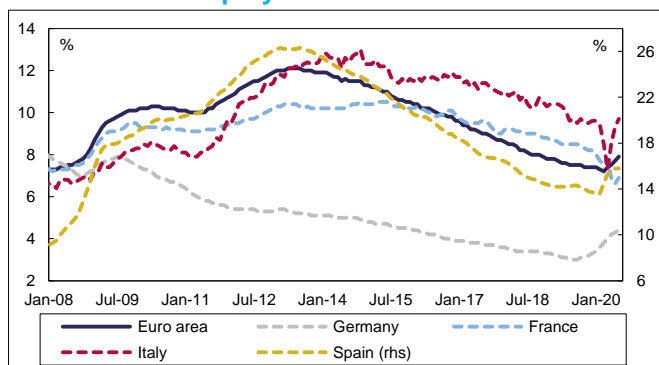
...but diverging trends among member states

But the country breakdown flagged some diverging trends in the sector last month. Despite being revised down from the preliminary estimate, the German manufacturing output PMI in August (57.8) was still 3pts higher than July, the strongest reading since February 2018, the highest of the member states and consistent with ongoing solid recovery in the sector. The Italian output PMI also recorded a further notable increase (up 1.5pts to 56.2, its highest since early 2018) as the reopening of the economy continued to revive demand. But elsewhere in the region – and in particular those countries that have seen the biggest resurgence in new Covid-19 cases – conditions remain more challenging. For example, even though the French output PMI was revised higher from the flash, it was still down by 4.7pts from July at 52.7, while the headline index (49.8) was consistent with stagnation. The Spanish PMIs painted a similar picture, with the headline index down 3.6pts to 49.9 and the output component down 4.9pts to 51.2. And with the absence of Italy, where job-shedding in the sector reportedly slowed significantly last month, manufacturers across the larger member states continued to cut back employment at a considerable pace.

The day ahead in the euro area

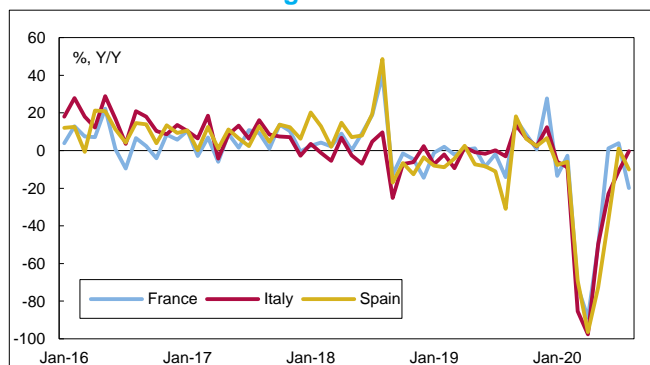
Ahead of Thursday's euro area release, tomorrow will bring July retail sales figures from Germany, which are expected to confirm a pickup on the month as shoppers took advantage of the temporary cut in VAT on 1 July. Meanwhile, in contrast to today's German figures, Spanish unemployment numbers are expected to have risen in August as a spike in new Covid-19

Euro area: Unemployment rates



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: New car registrations



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

infections saw localised restrictions reinforced. Wednesday will also bring euro area PPI data for July.

UK

Lending to SMEs and individuals picked up

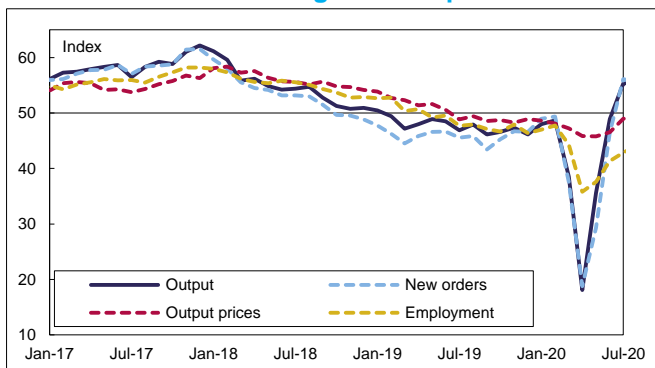
Not least reflecting the impact of UK fiscal and monetary policy initiatives, today's BoE bank lending figures suggested that borrowing by SMEs continued to rise to historically high levels in July. Indeed, such borrowing was up £5.3bn, having leapt a cumulative £28.5bn in the three months to June, to see the annual growth rate rise 3.2ppts to a record-20.7%Y/Y. This was, however, offset by a further net repayment by large firms by £7.7bn, leaving the annual increase in such firms falling further to 3.7%Y/Y, down from the peak of 15½ %Y/Y earlier in the year.

Demand for lending from individuals continued to recover in July (£3.9bn), supported principally by increased mortgage lending (£2.7bn) as banks continued to process a backlog of applications. Admittedly, this was still well below the average seen in the six months to March, while the number of approved mortgages (66.3k) remained below that seen in the first two months of the year, despite being significantly improved from the 9.2k trough in May. But with spending having improved in July as lockdown restrictions gradually relaxed, today's figures confirmed the first increase in consumer credit for four months, with the £1.2bn rise broadly in line with the average in the eighteen months to February. Nevertheless, coming on the back of net repayments of £15.9bn, this still left the outstanding stock of such lending firmly in negative territory (-3.6%Y/Y). And with labour market conditions deteriorating and concerns about the outlook still heightened, we would expect demand for consumer credit to remain relatively subdued over coming quarters.

The day ahead in the UK

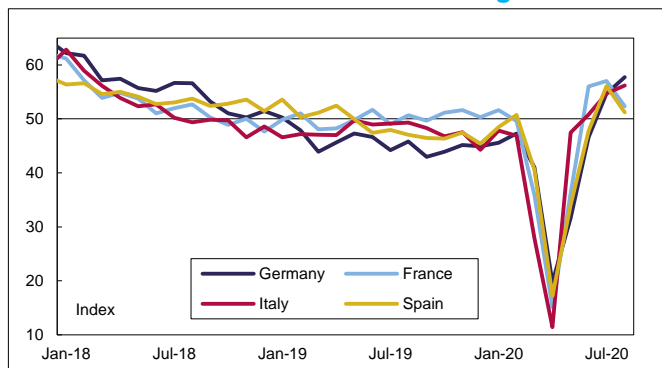
It should be a quieter day for UK economic releases tomorrow, with just the BRC shop price and Nationwide home price indices for August scheduled for release. Of more interest will be the appearance of BoE Governor Bailey and other MPC members before the Treasury Select Committee to discuss the economic impact of the coronavirus. BoE Deputy Governor Broadbent will also give a keynote speech at the 2020 annual meeting of the Central Bank Research Association.

Euro area: Manufacturing PMI components



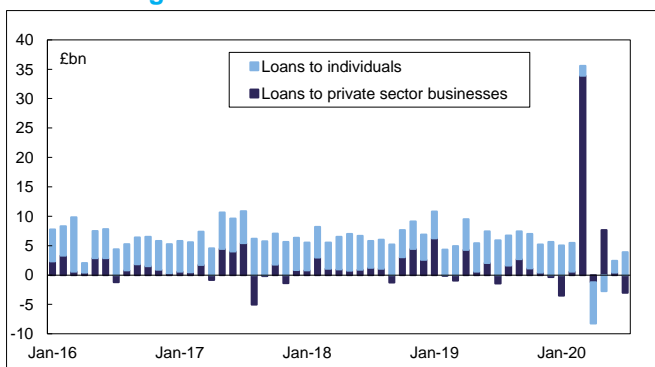
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Euro area: Member state manufacturing PMIs



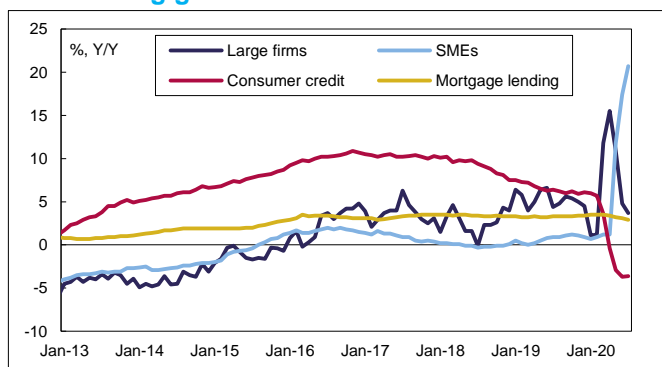
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

UK: Lending flows to firms and individuals



Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Lending growth to firms and individuals


















Source: BoE 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	 Final manufacturing PMI	Aug	51.7	51.7	51.8	-
	 Preliminary CPI (core CPI) Y/Y%	Aug	-0.2 (0.4)	0.2 (0.9)	0.4 (1.2)	-
	 Unemployment rate %	Jul	7.9	7.9	7.8	7.7
Germany	 Final manufacturing PMI	Aug	52.2	53.0	51.0	-
	 Unemployment rate % (change 000s)	Aug	6.4 (-9.0)	-	6.4 (-18.0)	- (-17.0)
France	 Final manufacturing PMI	Aug	49.8	49.0	52.4	-
	 New car registrations Y/Y%	Aug	19.8	-	3.9	-
Italy	 Manufacturing PMI	Aug	53.1	-	51.9	-
	 Unemployment rate %	Jul	9.7	-	8.8	9.3
	 New car registrations Y/Y%	Aug	-0.4	-	-11.0	-10.9
Spain	 Manufacturing PMI	Aug	49.9	-	53.5	-
	 New car registrations Y/Y%	Aug	-10.1	-	1.1	-
UK	 Final manufacturing PMI	Aug	55.2	55.3	53.3	-
	 Net consumer credit Y/Y% (£bn)	Jul	-3.6 (1.2)	-	-3.6 (-0.1)	-3.7 (-0.4)
	 Mortgage approvals 000s (net lending £bn)	Jul	66.3 (2.7)	-	40.0 (1.9)	- (2.4)





Auctions

Country	Auction
Germany	 sold €183mn of 0.1% 2026 index-linked bonds at an average yield of -1.15%
	 sold €144mn of 0.1% 2046 index-linked bonds at an average yield of -1.17%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Preliminary CPI (EU harmonised CPI) Y/Y%	Aug	0.0 (-0.1)	0.1 (0.1)	-0.1 (0.0)	-
Italy	 GDP – revised estimate Q/Q% (Y/Y%)	Q2	-12.8 (-17.7)	-12.4 (-17.3)	-5.4 (-5.5)	-5.5 (-5.6)
	 Preliminary CPI (EU harmonised CPI) Y/Y%	Aug	-0.5 (-0.5)	-0.4 (0.0)	-0.4 (0.8)	-
Spain	 Preliminary CPI (EU harmonised CPI) Y/Y%	Aug	-0.5 (-0.6)	-0.6 (-0.7)	-0.6 (-0.7)	-






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/ <i>Daiwa forecast</i>	Previous
EMU 	10.00	PPI Y/Y%	Jul	-	-3.7
Germany 	07.00	Retail sales M/M% (Y/Y%)	Jul	0.5 (4.1)	-2.0 (6.0)
Spain 	08.00	Unemployment change 000s	Aug	-	-89.8
UK 	00.01	BRC shop price index Y/Y%	Aug	-	-1.3
	07.00	Nationwide house price index M/M% (Y/Y%)	Aug	0.5 (2.0)	1.7 (1.5)

Auctions and events

Country	BST	Auction / Event
Germany 	10.30	Auction: €4bn of 0% 2025 bonds
UK 	10.00	Auction: £400mn of 0.125% 2056 index-linked bonds
	14.00	BoE Governor Bailey to discuss the economic impact of the coronavirus before the Treasury Select Committee
	16.30	BoE Deputy Governor Broadbent to give keynote speech at 2020 Annual meeting of the Central Bank Research Association

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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