Euro wrap-up

Overview

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- While the region's equity indices fell again, Bunds and other euro area government bonds also made losses despite a moderation of German factory orders growth and a weak euro area construction sector survey.
- Gilts also fell even as a member of the MPC made the case for further monetary easing and UK car sales data disappointed.
- The ECB's Governing Council meeting on Thursday is highly unlikely to bring a change to policy or forward guidance, but the updated economic forecasts will be watched.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.713	+0.007
OBL 0 10/25	-0.701	+0.011
DBR 0 08/30	-0.481	+0.010
UKT 1¾ 09/22	-0.087	+0.008
UKT 0⅝ 06/25	-0.051	+0.009
UKT 4¾ 12/30	0.247	+0.014

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

Euro area

A moderation in German factory orders growth in July

Judging from July's factory orders data, the pace of recovery in the German industrial sector slowed at the start of the third quarter. In particular, new orders in July rose a weaker-than-expected 2.8%M/M to be down 7.3%Y/Y and still a little more than 8% below February's pre-pandemic level. That, however, meant that roughly three-quarters of the initial peak-to-trough decline had been reversed by then. And to some extent the relative sluggishness of the recovery in July was accounted for by a drop in major orders, which are typically highly volatile. Excluding such items, new orders rose a firmer 6.2%M/M. Meanwhile, with manufacturing turnover up 5.2%M/M, the July industrial production report due on Monday should confirm output growth of a similar rate.

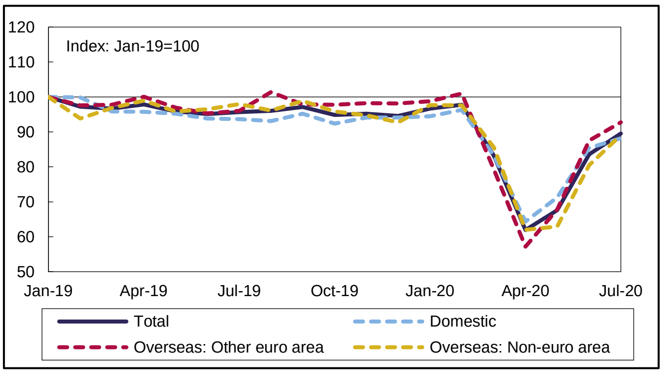
Autos to drive manufacturing recovery into the autumn?

The orders data suggested something of a mismatch in demand from at home and abroad in July. Foreign orders rose a spritely 14.4%M/M, with those from other euro area member states up 7.3%M/M and those from other countries up 19.2%M/M. But domestic orders fell 10.2%M/M, tallying with some other soft German data for the start of Q3, such as Wednesday's retail sales numbers, which implied that the temporary VAT cut has provided only modest support. At the sectoral level, there was also significant variation, with orders of intermediate goods up a firm 9.5%M/M but those of consumer goods up just 0.2%M/M and capital goods down 0.4%M/M. But new orders in the car industry continued to recover, up 8.5%M/M to be down just 2.4% from the pre-pandemic level in February, with strong growth in demand for related items, not least batteries for electric vehicles. While those stronger orders, however, failed to register significantly in yesterday's August new car registration data, the ifo institute's business survey suggested that sentiment among manufacturers and suppliers in the industry improved markedly last month. So, we expect September to be a better month for German domestic car sales. And with the German manufacturing new orders PMI having remained elevated at 59 in August, we expect continued growth in total factory orders and production to be sustained into the autumn.

Construction PMIs suggest broad-based weakness in the sector

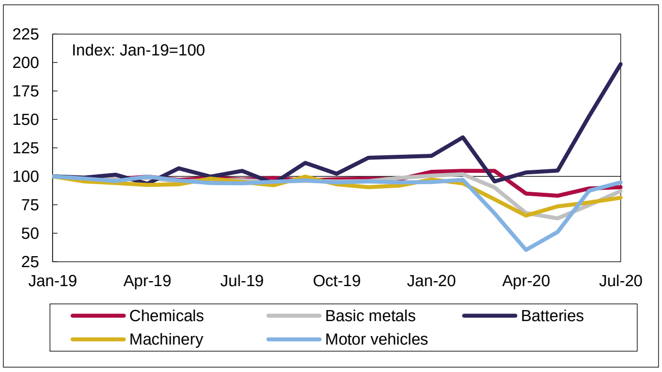
While the manufacturing PMIs pointed to ongoing expansion but the services PMIs suggested a loss of recovery momentum last month, today's construction PMIs implied that the sector continues to struggle. Indeed, the euro area's headline activity index dropped 1.1pt to just 47.8, implying the weakest performance for three months. And, of the three largest member states, the PMIs suggested that only Italy saw positive growth in total construction output last month, and even that was modest (a headline PMI of 50.6). In contrast, the headline indicators from Germany (48.0) and France (46.0) suggested a

Germany: New factory orders by destination



Source: *Refinitiv and Daiwa Capital Markets Europe Ltd.*

Germany: New factory orders by type of good



Source: Destatis and Daiwa Capital Markets Europe Ltd.

drop in overall activity. And the detail at the euro area level suggested a relatively broad-based deterioration. However, civil engineering output reportedly declined at a sharper pace than commercial activity. And the performance of house-building was mixed, with modest growth in Germany and Italy outweighed by significant weakness in France. Among other detail, new business received by euro area construction firms dropped again, as did employment. And overall sentiment in the sector with respect to the outlook turned negative again, with firms reportedly (appropriately) concerned about the longer-term impact of the pandemic on demand in the sector.

The week ahead in the euro area

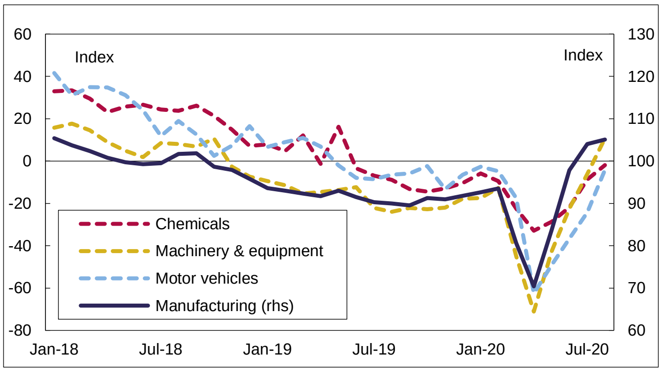
The main event in the coming week will be the conclusion of the ECB's monetary policy meeting on Thursday. Coming just a month after the ECB increased its PEPP asset purchase envelope by €600bn to €1.35trn, the last policy meeting in July was inevitably something of a non-event with little to report on the policy front. While differences of view among some Governing Council members about the nature of the €1.35tn envelope were aired following the meeting, the account subsequently revealed that the main presumption was that the amount would eventually have to be purchased in full. But Governing Council members also noted that they would be in a better position to judge the appropriateness of the policy stance at the forthcoming meeting, when the ECB's updated economic forecasts will be available. And those forecasts will indeed be a key focus on Thursday.

Recent comments from senior ECB officials suggest that the amendments to the GDP projections are likely to be minimal. But data suggest that, if anything, the ECB's previous central projection of a contraction of 8.7% in 2020 might have been a little too downbeat. Moreover, the policymakers might take comfort from the agreement of EU leaders in July to allow the Commission to borrow up to €750bn over the coming few years to fund a mix of grants and loans to member states to support economic recovery. They are also likely to be encouraged by yesterday's announcement by the French government that it plans a new fiscal stimulus programme, worth €100bn (more than 4% of GDP) to be spread over two years, about 40% of which will be funded by EU grants. At the same time, signs of a levelling off in economic activity over recent weeks, as well as continued uncertainty surrounding the path of the pandemic and new headwinds such as recent euro appreciation should limit any upwards revisions to the GDP forecasts for 2021 (5.2%) and 2022 (3.3%).

In terms of inflation, the forecasts will need to take account of this week's flash estimates for August, which revealed a drop in the headline CPI rate into negative territory for the first time since 2016 and a record low core rate, thus underscoring the net disinflationary impact of the pandemic. And the euro's recent appreciation will mean that the exchange rate assumption used in the projections will be more than 4% stronger than that used previously, a revision that should mechanistically weigh on the forecast path of inflation up to two years ahead – as was seemingly acknowledged by ECB Chief Economist Philip Lane earlier this week. So, we expect to see modest downside revisions made to the inflation projections, which previously suggested that core inflation would still be just 0.9%Y/Y in 2022. Maintenance of that forecast, or indeed a downwards revision, would support the case for additional stimulus in due course. For the time being, however, Governing Council members will see no need to adjust policy just yet, thus maintaining maximum flexibility in the PEPP purchases. And it will also retain the current forward guidance, which would leave the door open to further easing, such as via an increase in the PEPP envelope, in due course.

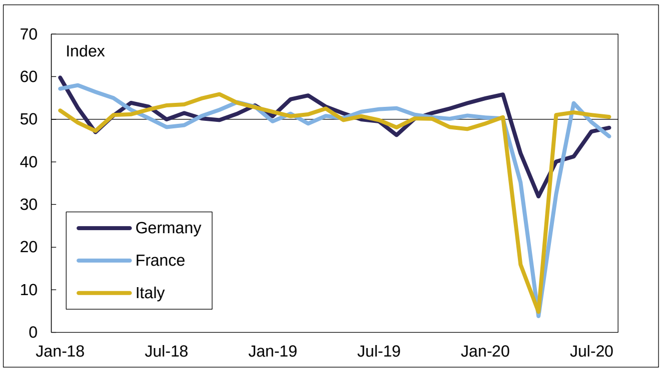
In terms of economic releases, the coming week will bring revised euro area GDP figures for Q2 on Tuesday. These are expected to confirm that output contracted at a record pace last quarter, close to the previous estimate of 12.1%Q/Q, to leave output more than 15% below its pre-pandemic peak. And the expenditure breakdown – due to be released for the first time – will report steep declines in private consumption, investment and trade alike. That day will also bring revised employment data for Q2, which are expected to confirm the initial estimate of a drop of more than 4.5mn to 155.9mn, the lowest level for three years. This release will also bring the first official figures from member states, which, despite various government job support schemes, are likely to confirm widespread weakness.

Germany: Ifo sentiment indices by sector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Construction PMIs



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

In terms of country releases, the week's data calendar gets underway with the aforementioned German IP figures on Monday, which will be followed by the equivalent July reports from France and Italy on Thursday and Spain on Friday. German and French trade figures for July will be published on Tuesday, while Wednesday will see the Bank of France (BoF) publish it monthly business conditions indices and monthly economic update for August – the previous release saw the BoF forecast a GDP shortfall of around 7% in August from the pre-pandemic level, similar to that estimated in July. Finally, revised German and Spanish CPI figures for August will also be published on Friday.

UK

Construction survey points to ongoing growth

Unlike the euro area, the UK's PMIs pointed to relatively steady recovery momentum in services and manufacturing alike last month. And while the UK's construction PMI fell back 3.5pts from July's five-year high, at 54.6 it also still implied an ongoing growth trend. Against the backdrop of a rebound in housing market activity and prices, the survey reported strong growth in house-building, with a respective headline index of 60.7. However, the equivalent indices for commercial work (52.5) and civil engineering activity (46.6) were significantly weaker, with the latter pointing to a drop in output in the subsector. While new business volumes rose again, they did so at a softer pace last month, and firms in the sector reportedly cut jobs again last month. But expectations for the coming twelve months improved, with more than twice as many respondent firms expecting positive growth than those expecting a drop in output. The cause, however, was optimism with respect to public sector investment and associated infrastructure projects.

Car sales on track for weakest year since at least 2009

Following a rare jump in sales (up 11.3%Y/Y) in July, UK new car registration growth returned to negative territory in August, falling 5.8%Y/Y to be the weakest for that month since 2017. As a result, new car registrations were down 39.7%YTD/Y over the first eight months of the year, broadly in line with Italy and Spain but significantly worse that Germany (-29%YTD/Y) and France (-33%YTD/Y). August is typically one of the weakest months for new car sales in the UK. However, with consumer confidence having retraced less than one third of its peak-to-trough deterioration, and unemployment expected to rise sharply in the autumn, car registrations risk remaining weak through to the New Year. And in the absence of a sudden rebound, full-year new car sales in the UK appear on track to be weaker even than in 2009 following the global financial crisis.

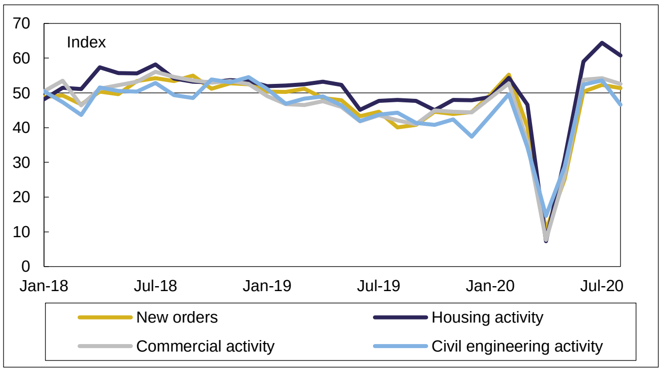
MPC member notes that further easing might be required

Of course, car sales and production is only one of many areas of the UK economy where activity remains too low for comfort. And persistent weakness across many troubled subsectors means that the phasing out of the government's Job Retention Scheme will accompanied by a sharp increase in unemployment this autumn. Moreover, in a speech today, MPC external member Michael Saunders argued that the risks to the BoE's most recent forecasts are clearly skewed to the downside, with additional concerns ranging from the path of the pandemic to the end of the Brexit transition and worries that the current stance of monetary policy is providing less stimulus than might be hoped. So, he noted that further policy loosening might well be needed. And that is certainly our baseline scenario – we expect an announcement of a further £100bn of asset purchases to be made at the November MPC meeting.

The week ahead in the UK

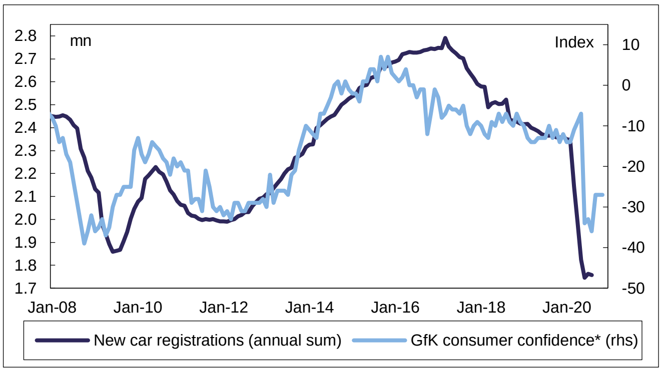
The main focus in the UK in the coming week will be Friday's release of monthly GDP figures for July, which will be accompanied by sectoral output and trade numbers for the same month. With lockdown measures across the hospitality sector having been relaxed further that month, and surveys signaling ongoing improvements in business conditions, we would expect to see another solid increase in activity at the start of Q3, with expectations for a rise of about 6%M/M. However, this would still leave output down more than 12% compared with the pre-pandemic level in February and down

UK: Construction PMIs



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

UK: Car registrations and consumer confidence



**3 -month lead. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

more than 7½%3M/3M. Output in both services and manufacturing is expected to have continued to recover. Ahead of this release, the BRC's retail sales monitor for August is due on Tuesday, while the RICS residential market survey for the same month is due on Thursday.

Daiwa economic forecasts

	2020				2021		2020	2021	2022
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP growth, %, Q/Q									
Euro area	-3.6	-12.1	9.5	0.9	0.9	1.0	-7.9	4.3	3.1
Germany	-2.0	-9.7	7.5	1.5	1.0	1.0	-5.5	4.5	2.4
France	-5.9	-13.8	12.0	1.5	0.9	1.0	-10.4	5.5	4.0
Italy	-5.5	-12.8	9.0	0.5	0.5	0.8	-10.8	2.8	2.2
Spain	-5.2	-18.5	13.0	1.0	1.0	2.0	-12.5	6.0	4.4
UK	-2.2	-20.4	18.0	1.8	1.0	1.0	-9.5	6.0	3.0
Inflation, %, Y/Y									
Euro area									
Headline CPI	1.1	0.2	0.1	-0.2	0.1	0.7	0.3	0.7	1.1
Core CPI	1.1	0.9	0.7	0.3	0.5	0.5	0.7	0.6	0.8
UK									
Headline CPI	1.7	0.6	0.7	0.4	0.7	1.7	0.9	1.4	1.6
Core CPI	1.6	1.4	1.4	0.8	1.0	1.5	1.3	1.3	1.3
Monetary policy									
ECB									
Refi Rate %	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
Net asset purchases*	20	140	100	100	100	70	140	20	20
BoE									
Bank Rate %	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Net asset purchases**	36	40	17	17	17	17	17	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	Construction PMI	Aug	**47.8**	-	48.9	-
Germany	Factory orders M/M% (Y/Y%)	Jul	**2.8 (-7.3)**	5.0 (-6.0)	27.9 (-11.3)	**28.8 (-10.6)**
	Construction PMI	Aug	**48.0**	-	47.1	-
France	Construction PMI	Aug	**46.0**	-	49.4	-
Italy	Construction PMI	Aug	**50.6**	-	51.0	-
UK	New car registrations Y/Y%	Aug	**-5.8**	-	11.3	-
	Construction PMI	Aug	**54.6**	58.3	58.1	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
		Monday 07 September 2020			
EMU	09.30	Sentix investor confidence	Sep	-12.0	-13.4
Germany	07.00	Industrial production M/M% (Y/Y%)	Jul	4.5 (-6.3)	8.9 (-11.7)
		Tuesday 08 September 2020			
EMU	10.00	Final GDP Q/Q% (Y/Y%)	Q2	-12.1 (-15.0)	-3.6 (-3.1)
	10.00	Final employment Q/Q% (Y/Y%)	Q2	-2.8 (-2.9)	-0.2 (0.4)
Germany	07.00	Trade balance €bn	Jul	15.5	15.5
France	07.45	Trade balance €bn	Jul	-	-8.0
Italy	09.00	Retail sales M/M% (Y/Y%)	Jul	-0.1 (-1.0)	12.1 (-2.2)
UK	00.01	BRC retail sales monitor, like-for-like sales Y/Y%	Aug	3.5	4.3
		Wednesday 09 September 2020			
France	07.30	Bank of France industrial sentiment*	Aug	-	99
		Thursday 10 September 2020			
EMU	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	-0.50	-0.50
France	07.45	Industrial production M/M% (Y/Y%)	Jul	4.9 (-8.4)	12.7 (-11.7)
	07.45	Manufacturing production M/M% (Y/Y%)	Jul	-	14.4 (-12.5)
Italy	09.00	Industrial production M/M% (Y/Y%)	Jul	3.5 (-9.8)	8.2 (-13.7)
UK	00.01	RICS house price balance	Aug	25	12
		Friday 11 September 2020			
Germany	07.00	Final CPI (EU harmonised CPI) Y/Y%	Aug	0.0 (-0.1)	-0.1 (0.0)
Spain	08.00	Final CPI (EU harmonised CPI) Y/Y%	Aug	-0.5 (-0.6)	-0.6 (-0.7)
	08.00	Industrial production M/M% (Y/Y%)	Jul	-	14.0 (-14.0)
UK	07.00	Monthly GDP M/M% (3M/3M%)	Jul	6.9 (-7.4)	8.7 (-19.1)
	07.00	Industrial production M/M% (Y/Y%)	Jul	4.2 (-8.6)	9.3 (-12.5)
	07.00	Manufacturing production M/M% (Y/Y%)	Jul	5.0 (-10.4)	11.0 (-14.6)
	07.00	Construction output M/M% (Y/Y%)	Jul	11.5 (-16.4)	23.5 (-24.8)
	07.00	Index of services M/M% (3M/3M)	Jul	7.0 (-7.7)	7.7 (-19.9)
	07.00	Total trade balance (goods trade balance) £bn	Jul	3.1 (-6.9)	5.3 (5.1)

**Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

The coming week's key events & auctions

Country		BST	Event / Auction
			Monday 07 September 2020
			- Nothing scheduled -
			Tuesday 08 September 2020
			- Nothing scheduled -
			Wednesday 09 September 2020
Germany		10.30	Auction: €4bn of 0% 2030 bonds
			Thursday 10 September 2020
EMU		12:45	ECB monetary policy announcement
		13:30	ECB President Lagarde's policy meeting press conference
Italy		10.00	Auction: 3Y and 7Y bonds
UK		10.00	Auction: £3.25bn of 0.125% 2023 bonds
		11.30	Auction:£2.0bn of 0.625% 2050 bonds
			Friday 11 September 2020
EMU		09.00	ECB's Weidmann and Villeroy scheduled to speak
		-	ECB President Lagarde to attend Eurogroup and informal ECOFIN meetings
		13.00	ECB's Chief Economist Lane to participate in online event
UK		-	BoE publishes Inflation Attitudes Survey

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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