

Euro wrap-up

Overview

- Euro area government bonds were little changed after Christine Lagarde stated that the ECB was not complacent about the inflation outlook and that monetary policy would continue to play its role.
- Gilts made losses as the BoE postponed a scheduled purchase operation due to technical problems at the CREST settlement system.
- Tuesday will bring data on the UK labour market, euro area labour costs and investor sentiment, and French and Italian inflation.

Chris Scicluna

+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.708	-0.002
OBL 0 10/25	-0.692	+0.003
DBR 0 08/30	-0.478	+0.004
UKT 1¼ 09/22	-0.100	+0.036
UKT 0% 06/25	-0.095	+0.033
UKT 4% 12/30	0.200	+0.020

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

Euro area

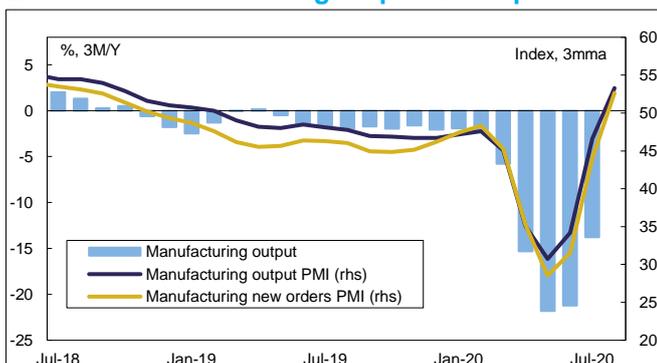
Lagarde echoes Lane's caution against complacency

In her post-policy meeting press conference last week, [Christine Lagarde](#) was upbeat, seemingly unperturbed by the return of headline inflation to negative territory in August and the associated all-time low on the core measure. Indeed, rather than dwelling on the challenges, she emphasized the temporary factors affecting those numbers, including the timing of the start of the summer sales and Germany's VAT cut. And instead of cautioning strongly about the downside skew to the risks to the outlook, including those posed by the euro exchange rate, she trumpeted the upwards revisions to the ECB's GDP and inflation forecasts. At the time, that positive tone had seemed misjudged. So, the following morning, Chief Economist Philip Lane re-injected a dose of realism into the Governing Council's communication, reminding that underlying price pressures had weakened and that the ECB had made only "partial progress in combating the negative impact of the pandemic on projected inflation dynamics". And in a speech yesterday, Lagarde echoed Lane's commentary. She emphasised that while recovery has so far been "substantial", it remains "uneven, uncertain and incomplete". Leaving the door open to further easing by year end, she insisted that "monetary policy will continue to play its role in the euro area with full commitment to its mandate". And she emphasized that "there is and there will be no complacency" at the ECB. Expect "no complacency" to be the new mantra of ECB communication over the coming couple few months, before the updated projections in December determine whether or not the Governing Council decides to take any further policy action.

About four-fifths of lockdown drop in euro area IP reversed

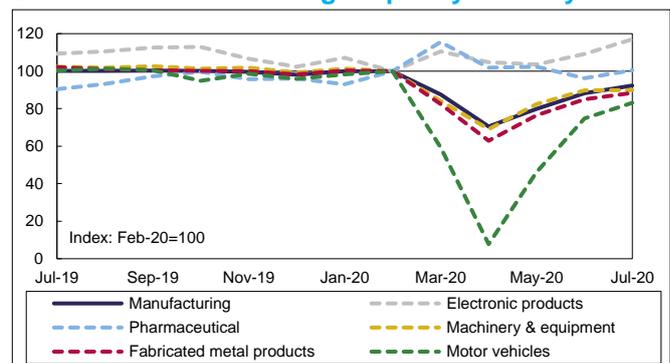
In terms of the unevenness of the economic recovery, Lagarde again highlighted the divergence between conditions in services and manufacturing, with growth in the latter seemingly having far more momentum. With the data from the large member states having been released last week, today's euro area industrial production figures for August predictably confirmed expansion for a third successive month. Growth of 4.1%M/M was still relatively vigorous, albeit representing inevitable moderation from (upwardly revised) growth of 9.5%M/M in June and 12.2%M/M at the end of the lockdown in May. That left production down 7.7%Y/Y and 7.2% below the pre-lockdown level in February, so that roughly four-fifths of the initial lockdown-related drop had been reversed. By type of good, energy production was down just 2.5% from February with consumer non-durables (down 3.5% on the same basis) and consumer durables (down 4.4%) also closer to the pre-lockdown level than overall IP. In contrast, despite further growth in July, output of intermediate goods (down 9.7% from February) and capital goods (down 7.8%) had bigger gaps to close. And despite firm growth of 11.0%M/M in July, production of motor vehicles was still 16.9% below the pre-lockdown level and 17.2% below the level a year earlier. Surveys and new orders data suggest ongoing production growth into August, perhaps reassuringly led by car production.

Euro area: Manufacturing output and expectations



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

Euro area: Manufacturing output by industry



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Bank of France survey suggests ongoing growth in August

Today's Bank of France (BoF) business survey for August added to evidence of further manufacturing growth in August, albeit with several sub-sectors losing momentum relative to autos. While improved, order books in the French manufacturing sector were judged still to be below normal levels. And firms in the sector expected production to be essentially flat in September. In services, the relatively softer performance flagged in the PMIs was repeated in the BoF survey, although moderate growth was registered in most sub-sectors in August, albeit with IT services reportedly losing ground, and further growth was expected in the current month. And while growth in construction appeared to have been firm last month, activity in the sector was expected to fall back at the end of Q3. Based on the survey, the Bank of France judged that the level of economic activity in August was likely only about 5% below the pre-lockdown level, compared with the shortfall of 7% in the prior month.

BoF upgrades projections but again flags birdwing-shaped recovery

Assuming little change in September, the BoF suggests that GDP would now rise about 16%Q/Q in Q3 following the decline of 13.8%Q/Q in Q2. With ongoing levelling-off of momentum, more moderate growth in Q4 is expected to narrow the gap from the pre-lockdown level further to between 3.5-4%, with the birdwing-shaped recovery projected to continue thereafter. Overall, French GDP is now forecast by the BoF to drop 8.7% in 2020 (an improvement from the decline of 10.3% predicted in June), before rising 7.4% in 2021 (up from 6.9% in the previous forecast) and 3.0% in 2022 (down from 3.9% previously). And overall activity is now predicted to return to the level of Q419 in Q122, a little sooner than previously thought. In the labour market, the BoF expects net job losses in the French economy to reach just over 800k by end-2020 compared to the end-19 employment level before a return to mild job creation in 2021. The French unemployment rate is expected to rise sharply over coming quarters from 7.1% in Q219 to peak around 11% in the first half of next year and remain above 10% into 2022. And French inflation is expected to edge down to 0.1%Y/Y by year-end, before rising only gradually over coming years. Indeed, with the headline rate expected to average just 1.0%Y/Y in 2020, and core inflation to average just 0.7%Y/Y that year, the BoF forecasts suggest that conditions in the euro area's second-largest member state merit further monetary easing by year-end.

The day ahead in the euro area

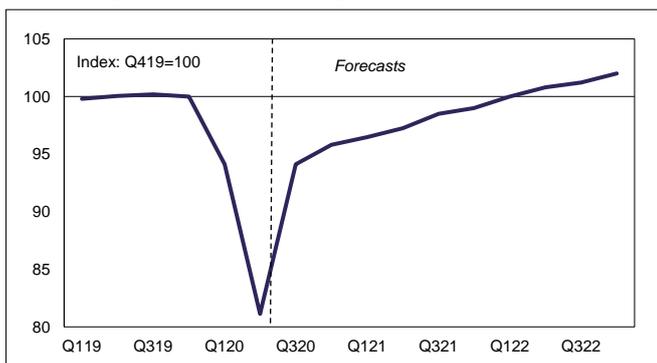
Looking ahead to tomorrow, final inflation figures from France and Italy are expected to confirm their preliminary estimates, which reported significant declines in response to the delayed start to summer sales. So, the EU-harmonised measure in France would fall to 0.2%Y/Y in August, from 0.8%Y/Y previously, and in Italy to -0.5%Y/Y, from 0.8%Y/Y in July. Tomorrow also sees the release of euro area labour costs data for Q2. With firmer wage growth over the past year, labour costs rose 3.4%Y/Y in Q1, the strongest rate since Q209. While this headline growth rate will remain firm in Q2 – indeed German labour cost growth accelerated a further 0.4ppt to 5.1%Y/Y in Q2 – weak demand has prevented a pass-through to inflation, and wages will slow over coming quarters slow in response to rising labour market slack. Finally, Germany's ZEW investor confidence survey is expected to show an improvement in perceptions of current and future economic conditions.

UK

The day ahead in the UK

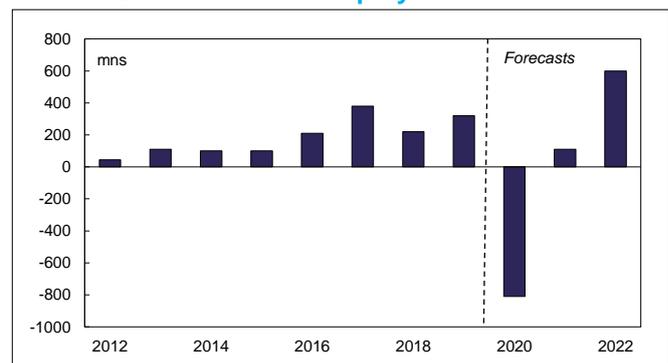
Following a quiet start to the week on the UK economic data front, the focus tomorrow will be on the release of the latest labour market report. This will likely suggest a worsening of conditions in the jobs market, although the increase in the ILO unemployment rate will likely appear relatively modest, perhaps up just 0.2ppt to 4.1% in the three months to July. As numerous firms have announced plans for large-scale redundancies, with the Job Retention Scheme now being phased out, it is clear that a steeper rise in the unemployment rate will come in the autumn. Meanwhile, growth in labour earnings is expected to remain negative.

France: Bank of France GDP forecast



Source: Bank of France, Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Bank of France employment forecast



Source: Bank of France and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	 Industrial production M/M% (Y/Y%)	Jul	4.1 (-7.7)	4.2 (-8.1)	9.1 (-12.3)	9.5 (-12.0)
France	 Bank of France industrial sentiment	Aug	106	100	99	-
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	Labour costs Y/Y%	Q2	-	3.4
Germany		10.00	ZEW current situation (expectations)	Sep	-72.0 (69.5)	-81.3 (71.5)
France		07.45	Final CPI (EU-harmonised CPI) Y/Y%	Aug	0.2 (0.2)	0.8 (0.9)
Italy		09.00	Final CPI (EU-harmonised CPI) Y/Y%	Aug	-0.5 (-0.5)	-0.4 (0.8)
UK		07.00	Unemployment claimant count rate % (change '000s)	Aug	-	7.5 (94.4)
		07.00	Average earnings including bonuses (excluding bonuses) 3M/Y%	Jul	-1.3 (-0.2)	-1.2 (-0.2)
		07.00	ILO unemployment rate 3M%	Jul	4.1	3.9
		07.00	Employment change Q/Q, '000s	Jul	-118	-220
Auctions and events						
Country	BST	Auction / Event				
EMU		08.15	ECB's Panetta scheduled to speak			
Germany		10.30	Auction: €4bn of 0% 2027 bonds			
UK		10.00	Auction: £2.75bn of 1.25% 2027 bonds			
		11.30	Auction: £1.75bn of 1.75% 2037 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>.