

Euro wrap-up

Overview

- Bunds and other euro area government bonds reversed some of yesterday's gains as data from the member states pointed to a resumption of euro area industrial production growth in July.
- Gilts made modest losses at the longer end of the curve, outperforming other major sovereign bonds as UK GDP data showed a significant loss of growth momentum in July.
- The coming week brings UK data for the labour market, inflation and retail sales, and updates on euro area IP and inflation.

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Daily bond market movements

| Bond | Yield | Change |
|---|--------|--------|
| BKO 0 09/23 | -0.715 | +0.005 |
| OBL 0 10/26 | -0.644 | +0.020 |
| DBR 0 08/31 | -0.337 | +0.027 |
| UKT 0 ¹ / ₈ 01/23 | 0.221 | +0.003 |
| UKT 0 ³ / ₈ 10/26 | 0.411 | +0.002 |
| UKT 0 ¹ / ₄ 07/31 | 0.749 | +0.015 |

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

Source: Bloomberg

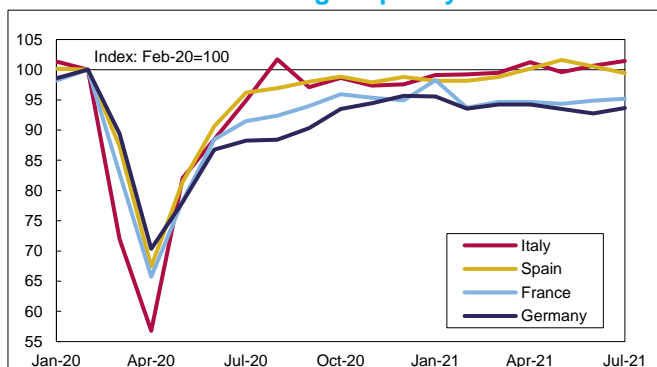
Euro area

Member state data points to IP growth in July

The week's flow of euro area economic data ended with a focus on July industrial production in several of the large member states. Broadly consistent with surveys for the month, the figures pointed to a resumption of the manufacturing recovery at the start of Q3. But growth was still undoubtedly impeded by supply bottlenecks with production in most countries still below the pre-pandemic level. In particular:

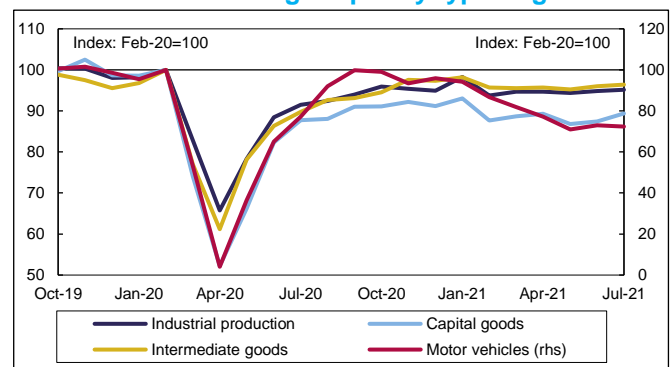
- Like in [Germany](#), French industrial production grew at the start of Q3, albeit slowing 0.3ppt to 0.3%M/M to leave it still some 4.8% below the pre-pandemic level in February 2020. Manufacturing output growth moderated 0.4ppt to 0.6%M/M to be down 5.5% from the pre-pandemic level. Within the detail, production of transport equipment rose for a second month, slowing just 0.1ppt to 2.9%M/M to suggest a slight easing of the semiconductor shortage. But it was still down more than 25% from the pre-pandemic level. In addition, output of machinery and equipment slowed 0.5ppt to 0.7%M/M to be down 3.0% from February 2020. Beyond manufacturing, French construction output rose 1.4%M/M but was down 2.4% from the pre-pandemic level.
- In Italy, industrial production (excluding construction) also continued to grow in July, albeit slowing 0.3ppt to a still-respectable 0.8%M/M. As such, it rose 1.5% above the February 2020 level. Unlike in France but as seen in Germany, output of transport goods fell at the start of Q3, down 3.8%M/M to reverse the prior month's increase. That left it 4.6% below the pre-pandemic level, a far more moderate shortfall in the sector to those in Germany and France. In addition, machinery production rose 2.7%M/M to be back at the February 2020 level.
- In Spain, industrial production (excluding construction) dropped for a second successive month, falling 1.1%M/M in July to be 0.6%M/M below the pre-pandemic level. As in France, output of motor vehicles rose from a low level at the start of Q3, up 8.6%M/M but still down almost 24% from the February 2020 level. But production of capital goods fell for a third successive month and by 0.6%M/M to be 10.8% down from the pre-Covid level. Output of intermediate goods rose 1.4%M/M while consumer goods fell 1.0%M/M, with both categories remaining above the February 2020 benchmark.
- In Ireland, following two consecutive declines in excess of 4.0%M/M, manufacturing output rebounded vigorously in July, rising 7.6%M/M. While that left it below levels registered between November and April, it was still up a whopping 35% from the February 2020 level.

Euro area: Manufacturing output by member state



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Manufacturing output by type of good



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Overall, the data from the member states suggest a return to growth in euro area industrial production in July following two monthly declines. In particular, IP is likely to have grown about 1.1%M/M to take the level of output to the highest since April. Unfortunately, with autos production having probably weakened again in August, IP is likely to have dropped back again last month. But we look for growth over the third quarter as a whole, with orders data pointing to the likelihood of a continued uptrend towards year-end and into 2022 as long as supply bottlenecks gradually ease.

The week ahead in the euro area

The euro area economic data calendar is set to be relatively uneventful in the coming week with releases unlikely to prove market-moving. A very quiet start to the week will bring the August business sentiment survey from the Bank of France on Monday and final consumer price data from Spain for the same month on Tuesday. Wednesday will bring the final inflation data from France and Italy ahead of Friday's release of the euro area numbers. Today's final German inflation figures aligned with the preliminary estimates, with the EU-harmonised measure up 0.3ppt in August to 3.4%Y/Y, the highest in thirteen years, and the national CPI measure up 0.1ppt to 3.9%Y/Y, the highest since December 1993. Within the detail, higher inflation of household energy and transport, as well as package tours, was partly offset by a substantive drop in clothing inflation associated with changes to the timing of summer discounting. The flash estimate of euro area inflation was stronger than had been anticipated – the headline HICP rate rose 0.8ppt to 3.0%Y/Y, the highest since November 2011, while core inflation (excluding energy, food, alcohol and tobacco) rose 0.9ppt to 1.6%Y/Y, the highest since July 2012. Other data due in the coming week include the aforementioned euro area industrial production figures for July on Wednesday and EU27 new car registrations for August on Thursday. As noted above, despite the drop reported today in Spanish production, gains in the other large member states and Ireland should ensure that euro area IP rose about 1.1%M/M in July to more than reverse the declines recorded in May and June.

UK

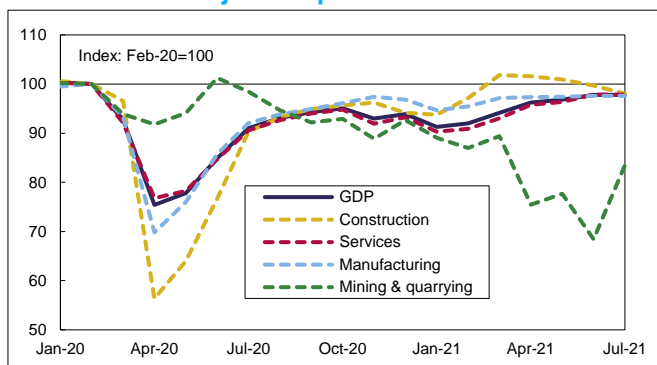
GDP slows further than expected in July

Earlier this week, BoE Governor Bailey acknowledged that the UK's economic recovery appeared to be levelling off. And today's GDP figures for July were fully consistent with that message, and indeed surprised to the downside. Economic output rose just 0.1%M/M in July, compared to the consensus on the Bloomberg survey of 0.5%M/M and down from 1.0%M/M in June, to leave it still some 2.1% below the pre-pandemic level. Despite further easing of pandemic restrictions, services activity failed to grow in July, to be similarly 2.1% below the pre-Covid level. There was significant variation in performance between sub-sectors, however. ICT and financial services both rose more than 2.0%M/M while arts and leisure jumped more than 9.0%M/M as reopening continued. But real estate and legal services weakened as property market activity slowed due to the tapering of the stamp duty holiday from the start of the month. Healthcare fell 1.1%M/M as doctor visits and vaccinations fell. And, overall, consumer-facing services dropped 0.3%M/M in their first decline since January to be still 6.7% below the pre-pandemic level. In part, that reflected a fall of 2.5%M/M in retail trade as food sales dropped as opportunities to eat out increased.

Autos and mining output offset declines in other production sub-sectors

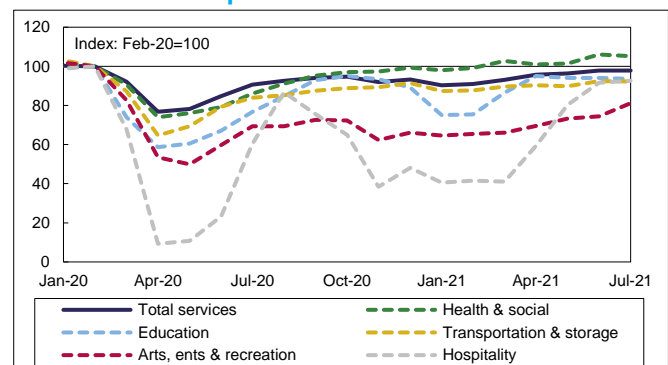
In the economy's other main sectors, manufacturing output was also flat in July to remain 2.4% below the pre-Covid level. A second successive increase of more than 11%M/M in autos production, as the semiconductor shortage appeared to ease somewhat, still left it more than 17% below the pre-pandemic level. And that contrasted with a drop of 4.3%M/M in output of machinery and equipment with most other factory sub-sectors weakening too. In addition, construction activity contracted for a fourth consecutive month, dropping 1.6%M/M to be 1.8% below the pre-pandemic level. Indeed, UK GDP growth in July would have been negative had it not been for the reopening of an oil field after its closure for maintenance. With the associated production coming back on line, UK mining and quarrying output leapt more than 20%M/M to make the biggest single contribution to growth in July. Despite the increase in oil shipments, meanwhile, the loss of economic recovery

UK: GDP and major components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Services output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

momentum was also reflected in July's trade data, with the value of exports (down 1.0%M/M excluding precious metals) and imports (down 0.3%M/M on the same basis) falling due particularly to weakening flows to and from the EU.

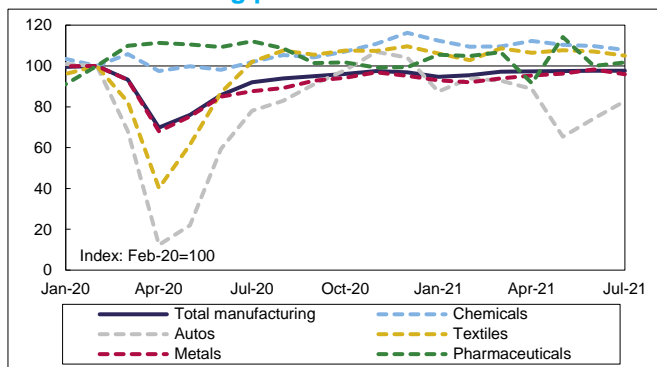
Q3 GDP to be softer than the BoE expected

While we should not jump to conclusions on the basis of a single month's data, which can be highly volatile, the slowdown in UK GDP growth in July bears the hallmark of the supply-side bottlenecks that are restraining activity across a wide range of sub-sectors. Despite certain more positive developments in July (e.g. the rise in production of autos), these appear to continue to take a toll. Surveys such as yesterday's REC report on jobs suggest that labour and skill shortages became even more acute in August with the PMIs having highlighted further lengthening of delivery times across the major sectors too. While the ending of the government's furlough scheme at the end of this month might provide a near-term boost to labour supply, persistent skill mismatches and the drop in the number of foreign workers due to Brexit and Covid suggest that capacity constraints will bind for several months to come. The more persistent spread of the delta variant in the UK, which contrasts with the more benign recent trend in the large EU member states, is also likely to prevent a full return to normal economic activity in the UK over the near term. Nevertheless, the rebound in hospitality, transport and arts subsectors is likely to have continued in August and September, supporting another quarter of positive GDP growth in Q3. However, the pace of around 3%Q/Q pencilled in the BoE's August forecast now looks too optimistic. We have revised down our own forecast to 1.8%Q/Q. And while there are downside risks further ahead – particularly to consumer spending given the government's intention to cut its Universal Credit benefits to 6mn people from 6 October as well as the end of the furlough scheme – we expect full-year growth in 2021 to reach 6.5%Y/Y and the pre-pandemic level of GDP to be reached by Q122.

The week ahead in the UK

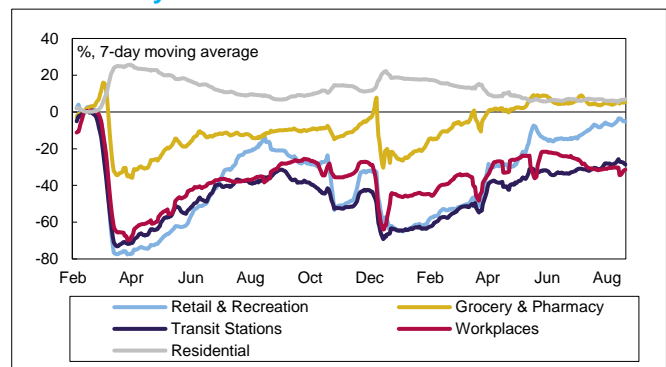
The coming week will bring plenty of top-tier UK economic data including the latest labour market (Tuesday), inflation (Wednesday) and retail sales numbers (Friday). With the government's Job Retention Scheme still in operation and most pandemic restrictions having been eased, we expect to see a further rise in payrolls and vacancies, which hit a record high of 953K in the three months to July. At the same time, the ILO unemployment rate is expected to edge down 0.1ppt to 4.6% in the three months to July, down from the peak of 5.2% in the three months to December 2020 but up from 4.0% in the three months to February 2020. And with still roughly 2mn more workers either unemployed, on furlough or inactive compared to before the pandemic, the high level of vacancies will suggest a significant skills mismatch in the UK labour market. And with demand for labour not being met by supply in many sectors, and given big base and compositional effects, growth in average labour earnings seems bound to remain strong, with average earnings including bonuses to remain above 8.0%3M/Y, albeit down from close to June's series high of 8.8%Y/Y. Meanwhile, we expect the UK's inflation rate to take a

UK: Manufacturing production



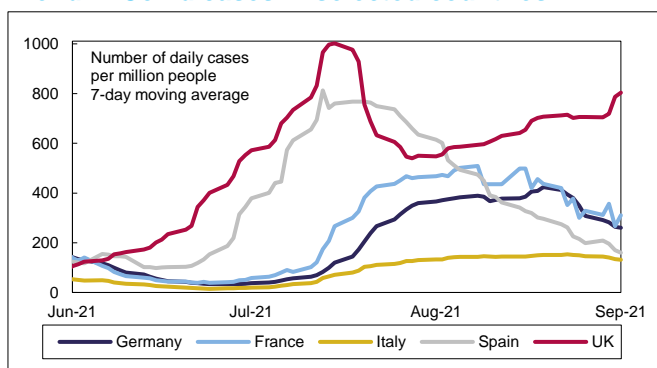
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Mobility indicators*



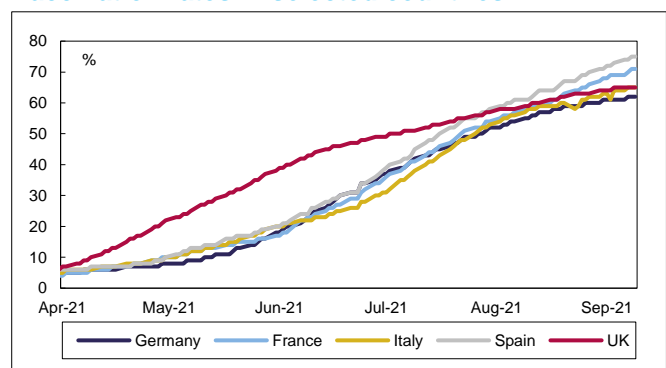
*Compared to the median value from 3rd Jan – 6th Feb 2020. Source: Google Mobility Reports and Daiwa Capital Markets Europe Ltd.

Trend in Covid cases in selected countries



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Vaccination rates in selected countries*














*Fully-vaccinated. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

notable step up in August – thanks not least to base effects associated with last year’s hospitality subsidies and VAT cut – after unexpectedly falling 0.5ppt to 2.0%Y/Y in July. We forecast an increase of 1.0ppt to 3.0%Y/Y in the headline inflation rate with core inflation rising 1.2ppts, also to 3.0%Y/Y. On Friday, the BoE will publish its inflation attitudes survey, which will give insight into households’ inflation expectations. Meanwhile, retail sales data for August due the same day are expected to reveal that sales failed to reverse the drop of 2.5%M/M in July – total sales are expected to rise 0.7%M/M to be up 2.7%Y/Y.

The next edition of the Euro wrap-up will be published on 14th September 2021

Daiwa economic forecasts






| | 2021 | | | | 2022 | | 2021 | 2022 | 2023 |
|---|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | | | |
| Euro area  | -0.3 | 2.2 | 1.8 | 1.1 | 1.0 | 0.8 | 5.1 | 4.4 | 2.1 |
| UK  | -1.6 | 4.8 | 1.8 | 1.6 | 1.3 | 0.8 | 6.5 | 5.7 | 1.7 |
| Euro area | | | | | | | | | |
| Headline CPI  | 1.1 | 1.8 | 2.8 | 3.1 | 2.1 | 2.0 | 2.2 | 1.6 | 1.2 |
| Core CPI  | 1.2 | 0.9 | 1.4 | 1.8 | 1.1 | 1.6 | 1.3 | 1.2 | 1.1 |
| UK | | | | | | | | | |
| Headline CPI  | 0.6 | 2.1 | 2.7 | 3.7 | 3.6 | 3.6 | 2.3 | 2.5 | 1.9 |
| Core CPI  | 1.1 | 1.9 | 2.6 | 3.2 | 3.1 | 3.1 | 2.2 | 2.4 | 2.0 |
| 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 |
| PEPP envelope* (€bn)  | 1850 | 1850 | 1850 | 1850 | 1850 | 1850 | 1850 | 1850 | 1850 |
| BoE | | | | | | | | | |
| Bank Rate %  | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.25 |
| Bond purchases* (€bn)  | 895 | 895 | 895 | 895 | 895 | 895 | 895 | 895 | 895 |

*Target 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 |
|---|--------------------------------------|--------|-------------------|-------------------------------------|-------------|--------------------|
| Germany  | Final CPI (EU-harmonised CPI) Y/Y% | Aug | 3.9 (3.4) | 3.9 (3.4) | 3.8 (3.1) | - |
| France  | Industrial production M/M% (Y/Y%) | Jul | 0.3 (4.0) | 0.4 (4.2) | 0.5 (7.1) | 0.6 (7.3) |
| | Manufacturing production M/M% (Y/Y%) | Jul | 0.6 (4.0) | - | 0.9 (7.5) | - |
| Italy  | Industrial production M/M% (Y/Y%) | Jul | 0.8 (7.0) | -0.2 (5.6) | 1.0 (13.9) | 1.1 (13.8) |
| Spain  | Industrial production M/M% (Y/Y%) | Jul | -1.1 (3.4) | 0.5 (5.9) | -1.0 (11.1) | -1.1 (11.0) |
| UK  | GDP M/M% (3M/3M%) | Jul | 0.1 (3.6) | <u>0.5 (3.7)</u> | 1.0 (4.8) | - |
| | Industrial production M/M% (Y/Y%) | Jul | 1.2 (3.8) | 0.4 (3.0) | -0.7 (8.3) | - |
| | Manufacturing production M/M% (Y/Y%) | Jul | 0.0 (6.0) | 0.1 (6.1) | 0.2 (13.9) | - |
| | Construction output M/M% (Y/Y%) | Jul | -1.6 (8.6) | 0.4 (10.9) | -1.3 (30.0) | - |
| | Index of services M/M% (3M/3M%) | Jul | 0.0 (4.5) | 0.6 (4.7) | 1.5 (5.7) | - |
| | Goods trade balance £bn | Jul | -12.7 | -11.0 | -12.0 | - |
























Auctions

| Country | Auction |
|-----------------------|---------|
| - Nothing to report - | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.























The coming week's data calendar

The coming week's key data releases

| Country | BST | Release | Period | Market consensus/ <i>Daiwa</i> forecast/actual | Previous | |
|------------------------------------|---|---------|--|--|------------------|------------|
| Monday 13 September 2021 | | | | | | |
| France |  | - | Bank of France industrial sentiment | Aug | 105 | 105 |
| Italy |  | 09.00 | Unemployment rate % | Q2 | 10.0 | 10.4 |
| Tuesday 14 September 2021 | | | | | | |
| Spain |  | 08.00 | Final CPI (EU-harmonised CPI) Y/Y% | Aug | 3.3 (3.3) | 2.9 (2.9) |
| UK |  | 07.00 | Unemployment claimant count rate % (change '000s) | Aug | - | 5.7 (-7.8) |
| |  | 07.00 | Average earnings including bonuses (excluding bonuses) 3M/Y% | Jul | 8.2 (6.8) | 8.8 (7.4) |
| |  | 07.00 | ILO unemployment rate 3M% | Jul | 4.6 | 4.7 |
| |  | 07.00 | Employment change 3M/3M, '000s | Jul | 178 | 95 |
| Wednesday 15 September 2021 | | | | | | |
| Euro area |  | 10.00 | Industrial production M/M% (Y/Y%) | Jul | 0.6 (6.0) | -0.3 (9.7) |
| |  | 10.00 | Labour costs Y/Y% | Q2 | - | 1.5 |
| France |  | 07.45 | Final CPI (EU-harmonised CPI) Y/Y% | Aug | 1.9 (2.4) | 1.2 (1.5) |
| Italy |  | 09.00 | Final CPI (EU-harmonised CPI) Y/Y% | Aug | 2.1 (2.6) | 1.9 (1.0) |
| UK |  | 07.00 | CPI (core CPI) Y/Y% | Aug | <u>3.0 (3.0)</u> | 2.0 (1.8) |
| |  | 07.00 | PPI input prices (output prices) Y/Y% | Aug | 10.3 (5.4) | 9.9 (4.9) |
| |  | 09.30 | House price index Y/Y% | Jul | 12.5 | 13.2 |
| Thursday 16 September 2021 | | | | | | |
| Euro area |  | 07.00 | EU27 new car registrations | Aug | - | 10.4* |
| |  | 10.00 | Trade balance €bn | Jul | 16.7 | 12.4 |
| Italy |  | 09.00 | Trade balance €bn | Jul | - | 5.7 |
| Friday 17 September 2021 | | | | | | |
| Euro area |  | 10.00 | Final CPI (core CPI) Y/Y% | Aug | 3.0 (1.6) | 2.2 (0.7) |
| |  | 10.00 | Construction output M/M% (Y/Y%) | Jul | - | -1.7 (2.8) |
| France |  | 07.45 | Final wages Q/Q% | Q2 | 0.3 | 0.6 |
| UK |  | 07.00 | Retail sales including auto fuel M/M% (Y/Y%) | Aug | 0.7 (2.6) | -2.5 (2.4) |
| |  | 07.00 | Retail sales excluding auto fuel M/M% (Y/Y%) | Aug | 0.8 (2.5) | -2.4 (1.8) |
| |  | 09.00 | BoE inflation expectations survey, next 12 months | Aug | - | 2.4 |

*For June. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

| Country | BST | Event / Auction |
|------------------------------------|---|--|
| Monday 13 September 2021 | | |
| Euro area |  10.00 | ECB's Schnabel participates at an entrepreneurs' talk |
| |  14.30 | ECB President Lagarde speaks at a conference on 'Why post-covid recovery needs women' |
| |  - | ECB's Panetta participates in G20 finance and central bank deputies' meeting |
| Italy |  10.00 | Auction: 30Y bonds |
| Tuesday 14 September 2021 | | |
| Germany |  10.30 | Auction: €5bn of 0% 2023 bonds |
| Italy |  10.00 | Auction: €2bn of 0% 2024 bonds |
| |  10.00 | Auction: €2bn of 0.5% 2028 bonds |
| |  10.00 | Auction: €1.75bn of 1.7% 2051 bonds |
| UK |  10.00 | Auction: £3bn of 0.375% 2026 bonds |
| Wednesday 15 September 2021 | | |
| Euro area |  13.30 | ECB's Schnabel takes part in the ECB Bond Market contact group annual online conference |
| |  16.00 | ECB Chief Economist Lane speaks at a webinar about the ECB's strategy review |
| UK |  10.00 | Auction: £2.5bn of 0.25% 2031 bonds |
| Thursday 16 September 2021 | | |
| Euro area |  13.00 | ECB President Lagarde scheduled to speak - 'Moving forward: The Euro and the European economy in a changing world' |
| France |  09.50 | Auction: 0.25% 2026 bonds |
| |  09.50 | Auction: 2.25% 2024 bonds |
| |  09.50 | Auction: 0% 2027 bonds |
| |  10.50 | Auction: 0.1% 2031 index-linked bonds |
| |  10.50 | Auction: 0.1% 2026 index-linked bonds |
| Spain |  10.50 | Auction: 1.8% 2040 index-linked bonds |
| |  09.30 | Auction: 0% 2024 bonds |
| |  09.30 | Auction: 0% 2026 bonds |
| |  09.30 | Auction: 0.5% 2031 bonds |
| Friday 17 September 2021 | | |
| - Nothing scheduled - | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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