Daiwa Capital Markets

# Euro wrap-up

## Overview

**Chris Scicluna**
+44 20 7597 8326

**Emily Nicol**
+44 20 7597 8331

- Bunds made modest gains while a central bank survey indicated a strengthening of French GDP growth in Q3.
- Gilts underperformed as UK data pointed to strong gains in payrolls and job vacancies in August while the UK government again postponed full implementation of post-Brexit customs checks on imports from the EU.
- Wednesday will bring new data on UK inflation and euro area industrial production.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 0 09/23 | -0.714 | +0.001 |
| OBL 0 10/26 | -0.648 | -0.003 |
| DBR 0 08/31 | -0.341 | -0.008 |
| UKT 0⅞ 01/23 | 0.226 | +0.005 |
| UKT 0⅜ 10/26 | 0.417 | +0.007 |
| UKT 0¼ 07/31 | 0.738 | -0.005 |

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

# Euro area

### Bank of France forecasts GDP acceleration in Q3

On a quiet day for new economic data from the euro area, the Bank of France's latest business survey was upbeat, tallying with other recent surveys to suggest that economic growth was well maintained in August and that growth has likely remained positive in September too. While the government rolled out its "Health pass" more widely from 9 August, requiring proof of vaccination to enter restaurants, bars and some shopping centres, momentum in services was judged to have remained positive. Admittedly, the catering sub-sector was reported to have seen a loss of activity but with tourism faring better accommodation continued to recover. In manufacturing, growth was also reported to be solid, even as the share of companies experiencing supply difficulties edged up 2ppts to 51%. Nevertheless, firms also reported that stocks were recovering while order books remained ample. A marginally higher share of firms in construction (up 0.1ppt to 61%) reported supply-side challenges, which were acting to restrain growth in that sector last month but were not seen as an obstacle to a pickup in September. So, in light of its survey findings, the Bank of France estimated that French GDP was just 1% below the pre-pandemic level in August, and is likely to be down just 0.5% on the same basis in September. Overall, it expects GDP growth of 2.5%Q/Q in Q3, up from 1.1%Q/Q in Q2 and 0.5ppt stronger than our own forecast for the current quarter.

### The day ahead in the euro area

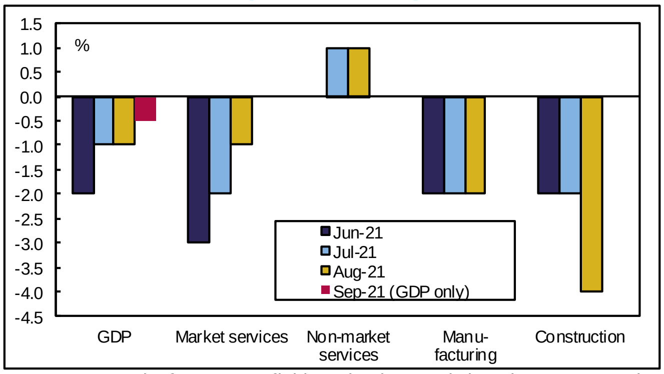
Wednesday will bring euro area industrial production figures for July. Following last week's release of national data, which reported growth in the three largest member states and significant expansion in Ireland, we expect industrial production (excluding construction) to have risen by 1.1%M/M to be up 6.6%Y/Y and 0.3% above the Q2 average. Euro area labour cost data for Q2 are also due. And, like the respective German and Spanish numbers, final French and Italian inflation data for August are expected to broadly align with the flash estimates. Those figures reported increases in the EU-harmonised HICP measure respectively of 0.9ppt to 2.4%Y/Y and 1.6ppts to 2.6%Y/Y in part related to the shift in the timing of summer sales from a year ago.

# UK

### Labour demand remains strong over the summer despite GDP slowdown

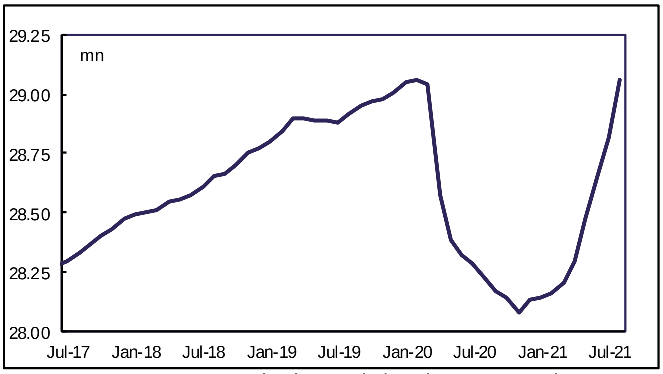
While UK economic growth all but came to a halt in July, momentum in the labour market remained positive over the summer. In particular, following three months of increases of almost 200k, the number of payrolls jumped 241k in August, to return back above the pre-pandemic level for the first time at 29.1mn. Perhaps unsurprisingly, with the economy having

**France: Estimated pandemic impact on value-added**




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

**UK: Payrolled employees**




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

largely reopened, the biggest increases in payrolls were seen in those sectors that had previously been most acutely impacted by the pandemic – e.g. accommodation and food services, arts and entertainment, and wholesale and retail. Consistent with labour and skill shortages, which appear to have acted as a restraint on economic activity in certain sectors , the number of vacancies in August maintained a firm upwards trend too, above 1mn for a second successive month and therefore leaving the ONS's preferred three-month measure at a record high above 1mn for the first time. Despite the decent growth in jobs, the largest increases in vacancies last month were also seen in accommodation and food, as well as administrative and support services. In addition, the number of hours worked predictably surged in the three months to July (albeit remaining more than 4% below the pre-pandemic level), while the unemployment rate dropped 0.3ppt to 4.6%, down 0.6ppt from the pandemic peak at end-2020, albeit still 0.8ppt (261k) above the pre-pandemic trough. And the inactivity rate (for workers aged 16-64 years) dropped 0.3ppt from the previous quarter to 21.1%, still some 0.9ppt (341k) above the level before the outbreak of Covid.

## Wage growth moderates on base effects, underlying trend unclear

Despite the strong uptrend in jobs, wage growth moderated somewhat, with average weekly earnings slowing 0.5ppt to 8.3%Y/Y in the three months to July. Excluding bonuses, growth in earnings also slowed 0.5ppt to 6.8%Y/Y. The high rates of pay growth still in part reflect base effects associated with the initial drop in earnings at the onset of the pandemic last year. Distortions from composition effects also remain significant (i.e. lower earners were more likely to lose their jobs or experience a drop in hours worked at the onset of the pandemic). And the drop in the number of workers on furlough by some 3.8mn over 12 months to about 1.6mn in July, as well as the increase in hours worked, has also added upwards pressure to measures of pay growth. Looking through the various distortions, the ONS estimates that underlying earnings growth might be somewhere in the range of 3.6-5.1%Y/Y, suggesting some pickup over recent months. Indeed, by reference, the peak in pay growth 2019 ahead of the pandemic was 3.9%Y/Y.

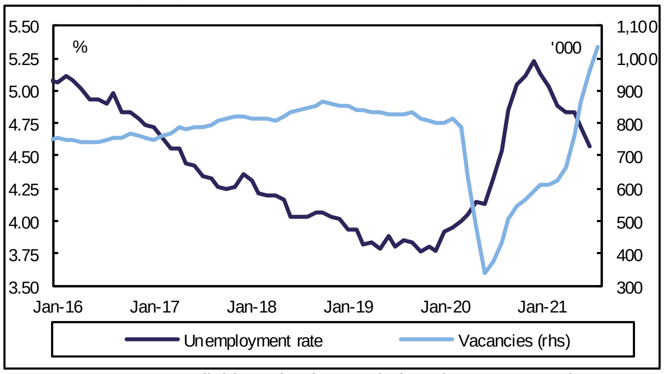
## Skill shortages to persist despite sizeable spare capacity in the labour market

Certainly, upwards pressure on earnings from labour and skills shortages, often exacerbated by the impact of Brexit or other policy changes (e.g. the IR35 rules on the use of contractors), is evident in certain sectors. Among others, total pay growth in finance and business services was 12.2%3M/Y in July with the equivalent figures of 11.8%3M/Y for construction and 10.1%3M/Y for wholesale, retail and hospitality. In each of these sectors, however, wage growth was negative a year earlier, and the rebound in pay in 2021 is unlikely to represent a lasting trend. Nevertheless, just last month, the BoE's Agents survey reported a pickup in wage settlements, with signs of pay pressures emerging more broadly. And with MPC members having cited the labour market as a key potential upside risk to the inflation outlook, and hence a possible trigger for a rate hike next year, the BoE will keep a close eye on forthcoming developments with respect to job and labour earnings growth. But the near-term outlook for the UK labour market is highly uncertain, not least with the Job Retention Scheme, and associated support for the self-employed, being wound up at the end of this month. And with more than 2mn workers still either unemployed, inactive or furlough, in aggregate spare capacity undoubtedly persists in the labour market. Nevertheless, given significant skills mismatches, the level of job vacancies is likely to remain high. And firms in many sectors are likely to continue to report difficulties in hiring for several months to come, acting as a restraint on economic growth.

## Government postpones implementation of Brexit customs rules in face of supply shortages

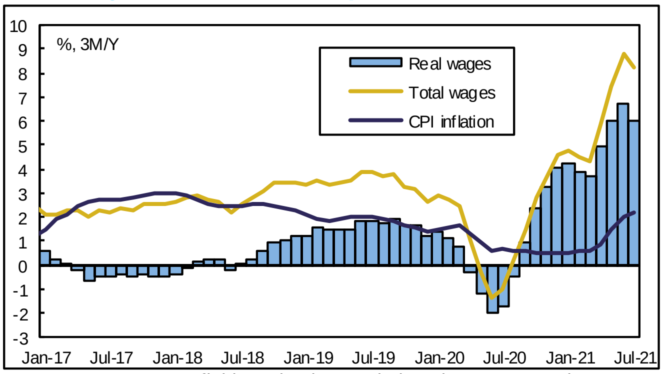
With labour and skill shortages currently coinciding with wider supply bottlenecks to restrain output, increase business costs and constrain sales, it was a relief that the UK government announced today that it had decided not to make things worse at the start of next month. In particular, perhaps spooked by retailers' warnings of shortages of many food items at Christmas, ministers confirmed that the implementation of further Brexit-related customs checks on imports from the EU, which were supposed to have been introduced from 1 October, would again be delayed. The requirement for pre-notification of agri-food imports to the UK was put back to 1 January 2022. And safety and security declarations, including health certificates, will not

### UK: Unemployment rate and vacancies




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

### UK: Wages and consumer prices




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

be required until 1 July 2022, when physical checks at border control posts will be introduced. Of course, UK exports to the EU have already been subject to customs checks since the start of the year, placing UK-based firms at a relative disadvantage to their competitors. So, while welcome for UK consumers and firms reliant on supplies from the EU, today's announcement sustains an unfavourable asymmetry in the trade rules faced by UK and EU producers.

## The day ahead in the UK

The flow of top-tier UK economic data continues on Wednesday with inflation figures for August. We expect these to report a notable step up due not least to base effects associated with last year's hospitality subsidies and VAT cut. After falling 0.5ppt to 2.0%Y/Y in July due in part to differences in the profile of summer discounting of prices of clothing and certain recreational goods, 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.

# European calendar

## Today's results

**Economic data**

| Country | | Release | Period | Actual | Market consensus/ *Daiwa forecast* | Previous | Revised |
|---|---|---|---|---|---|---|---|
| France | | Bank of France industrial sentiment | Aug | **104** | 105 | 105 | **-** |
| Spain | | Final CPI (EU-harmonised CPI) Y/Y% | Aug | **3.3 (3.3)** | 3.3 (3.3) | 2.9 ( (2.9) | **-** |
| UK | | Unemployment claimant count rate % (change '000s) | Aug | **5.4 (-58.6)** | - | 5.7 (-7.8) | **5.6 (-48.9)** |
| | | Average earnings including bonuses (excluding bonuses) 3M/Y% | Jul | **8.3 (6.8)** | 8.2 (6.8) | 8.8 (7.4) | **- (7.3)** |
| | | ILO unemployment rate 3M% | Jul | **4.6** | 4.6 | 4.7 | **-** |
| | | Employment change 3M/3M, '000s | Jul | **183** | 178 | 95 | **-** |

**Auctions**

| Country | | Auction |
|---|---|---|
| Germany | | sold €3.9bn of 0% 2023 bonds at an average yield of -0.70% |
| Italy | | sold €2bn of 0% 2024 bonds at an average yield of -0.27% |
| | | sold €2bn of 0.5% 2028 bonds at an average yield of 0.32% |
| | | sold €1.75bn of 1.7% 2051 bonds at an average yield of 1.69% |
| UK | | sold £3bn of 0.375% 2026 bonds at an average yield of 0.429% |

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

## Tomorrow's releases

**Economic data**

| Country | | BST | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|---|
| Euro area | | 10.00 | Industrial production M/M% (Y/Y%) | Jul | *1.1 (6.6)* | -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 | *3.0 (3.0)* | 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 |

**Auctions and events**

| | | | |
|---|---|---|---|
| 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 |

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