Euro wrap-up

Overview

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- Bunds made modest losses despite a sharp fall in German factory orders and softer-than-expected euro area retail sales data.
- Gilts made losses at the short end of the curve while a UK construction survey signalled ongoing supply challenges in the sector.
- Thursday will bring data for German IP and French goods trade as well as the account of the ECB's September monetary policy meeting.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.705	+0.002
OBL 0 10/26	-0.553	+0.004
DBR 0 08/31	-0.184	+0.005
UKT 0⅛ 01/24	0.465	+0.022
UKT 0⅜ 10/26	0.688	+0.010
UKT 0¼ 07/31	1.076	-0.006

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

Euro area

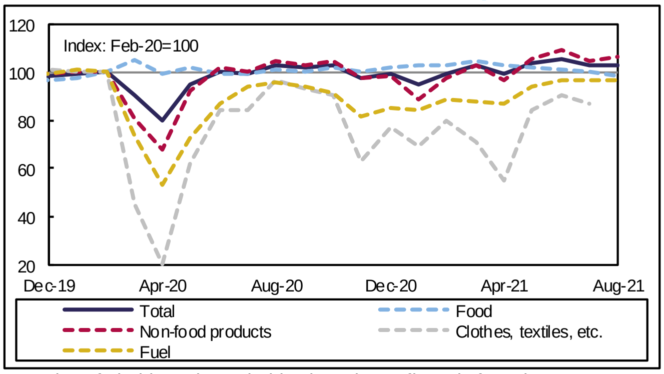
Retail sales trending broadly sideways in Q3, headwinds growing

With growth already having been recorded in Germany in August, retail sales in the euro area had been expected to rebound that month following a drop of 2.6%M/M at the start of Q3. However, the increase was disappointing at just 0.3%M/M, which left the average level of sales over the first two months of the quarter little different to that in Q2. So, with car sales hit by supply shortages, spending on goods appears to have fallen back over the summer. While the level of retail sales in August was also unchanged from a year earlier, however, it was still some 3.1% above the pre-pandemic level in February 2020 and arguably close to the pre-pandemic trend. The weakness in August reflected food sales, which dropped for the fifth successive month and by 1.7%M/M, the most of this losing streak, to move back below the pre-pandemic level. That, however, likely reflects the greater opportunity for households to spend on consumer-facing services, not least eating out. In contrast, non-food non-fuel sales rose 1.8%M/M to be a marked 6.6% above the pre-pandemic level. That, however, was insufficient to reverse the steep drop of 4.2%M/M in such 'core' sales at the start of the quarter. Looking ahead, headwinds to spending on goods appear to be rising. Opportunities for spending on consumer services continue to rise. As already seen in the auto market, supply shortages risk impeding the availability of a wider set of goods. And rising prices of household energy and petrol risk eroding real disposable incomes, and thus crowding out discretionary spending on other items. So, retail sales might do well to extend the sideways trend towards year end and into 2022.

German factory orders slump

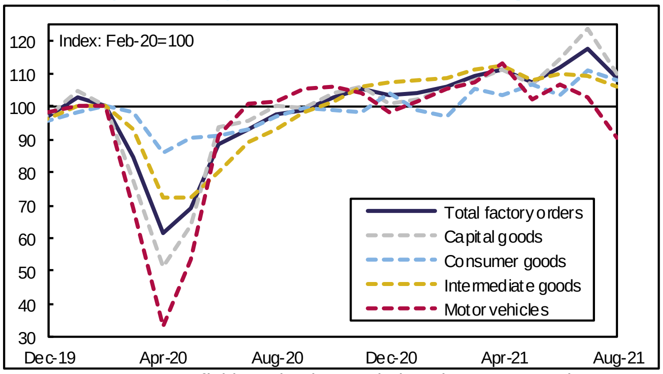
Contrasting with yesterday's broadly upbeat French IP figures but aligning with downbeat car production numbers, today's German factory orders and turnover data were extremely weak. In particular, orders were down a whopping 7.7%M/M in August, the largest monthly drop since April 2020. Admittedly, this followed significant upward revisions to growth in June (4.6%M/M) and July (4.9%M/M), therefore leaving total orders in August still more than 11½% higher than a year earlier and 8½% higher than the pre-pandemic level. However, the strength in June and July had been principally thanks to one-off major orders (i.e. aircraft, ships, trains etc). Excluding such items, orders were up just 1.8%M/M and 0.3%M/M respectively in those months. And the drop in August on this basis was still significant (-5.1%M/M). So, while orders excluding large items were still roughly 4½% higher than the pre-pandemic level in August, they were also down a steep 7½% from April, with underlying orders trending in Q3 almost 2½% below than Q2 average. The data thus broadly tally with the loss of momentum in orders reported in the recent ifo and PMI surveys.

Euro area: Retail sales, selected components*



*Sales of clothing released with a lag – latest figure is for July 2021. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders, selected components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Supply bottlenecks take toll on demand for German autos

Within the detail, the weakness reflected a drop in orders placed both domestically (-5.2%M/M) and overseas (-9.5%M/M), with a decline of more than 15%M/M from countries outside the euro area. The weakness was most acute in the autos sector, with orders down 12%M/M to be more than 20% below April's peak, as persistent supply bottlenecks appeared to take its toll on demand. In addition, orders for metals were also down by almost 10%M/M. Overall, incoming orders for capital goods fell 11.1%M/M, while the declines in orders for intermediate and consumer goods were more modest at 2.8%M/M and 2.7%M/M respectively. The level of orders in most subsectors remains considerably higher than the pre-pandemic level, suggesting that as and when supply chain disruption eventually eases, manufacturing production should rebound. For now, however, today's manufacturing turnover data – which typically offer an insight into production for the same month – suggested a particularly weak outturn in August. Indeed, the slump of 5.9%M/M was the largest since April 2020, to leave turnover more than 10% lower than the pre-pandemic level. While last month's increase in turnover (1.9%M/M) outpaced production (1.0%M/M), today's data certainly suggest that there are significant downside risks to tomorrow's IP release, with the decline in August likely to be considerably larger than the current Bloomberg consensus forecast of -½%M/M.

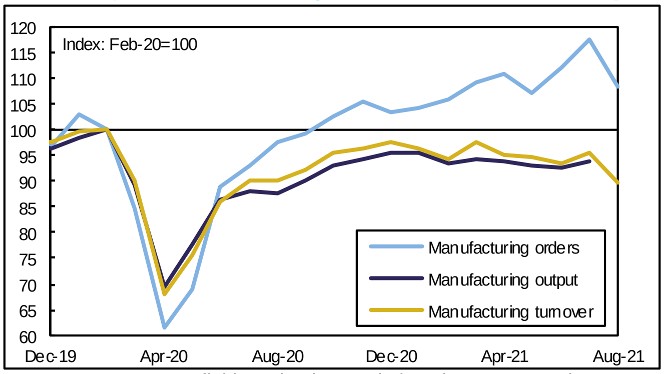
Spanish IP softer than expected, despite pick up in autos output

Spanish industrial production also came in below expectations in August, with output falling 0.3%M/M, the third consecutive monthly drop. So, having risen above the pre-pandemic level in May, output in August was now 1% lower than in February 2020. The weakness in part reflected a near-20% drop in manufacturing of pharmaceuticals, to leave it 16% below the pre-pandemic level. So, despite a rebound in clothing production (34%M/M), production of consumer goods fell by 1½%M/M, the third monthly decline out of the past four. Production of intermediate goods was also down 1%M/M. Like in France, there was a surprising increase in production of autos for the second successive month, and by a sizeable 10.8%M/M to its highest level since March, albeit still a touch more than 13% below the pre-pandemic level. And overall, capital goods output rose more than 3%M/M in August to its highest level since January. Contrasting with France, but similar to Germany, manufacturing output in Spain is currently trending lower in Q3 compared with Q2, by around 1½%.

Supply bottlenecks a restraint on construction activity too

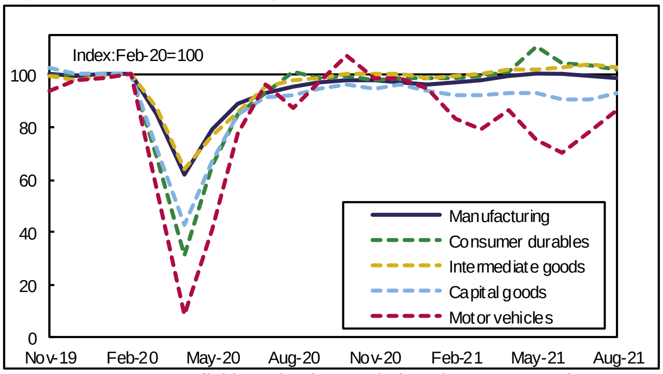
According to the Markit construction PMIs, activity in the sector stabilised last month following two consecutive months of decline. Indeed, the headline euro area construction PMI rose 0.5pt to 50.0, suggesting that overall output was unchanged in September, with supply constraints related to shortages of raw materials acting as a brake on growth despite reports of stronger demand. The survey detail suggested that house-building work remained the principal source of growth for a seventh successive month (the respective PMI eased modestly to 52.6), while commercial construction work fell only marginally (49.8). But civil engineering work continued to decline at a relatively marked pace (45.2). September survey data pointed to a further expansion in home building activity across the eurozone, stretching the current period of growth to seven months. At the country level, growth was again centred on Italy, where the pace of expansion nevertheless slowed from the prior month's series high but new orders growth was strong. Elsewhere, French construction firms reported a slowing in the pace of decline thanks to a rebound in home building. And German firms in the sector also signalled ongoing contraction at a slightly softer pace. But new orders reportedly continued to decline in each of the two largest member states. Global supply challenges continued to fuel rapid increases in input costs, even though the respective PMI (83.9) was the lowest in six months. And the survey results also suggested that supplier delivery times continued to lengthen while subcontractor availability and quality continued to diminish amid an acceleration of subcontractor rates. So, supply-side bottlenecks look set to remain a constraint on growth in the construction sector for a while yet.

Germany: Manufacturing turnover, orders & output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Spain: Manufacturing output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

A key focus tomorrow will be the aforementioned German industrial production release, which is likely to show that output fell significantly in August, likely by the most since April 2020 and marking the fifth monthly decline out of the past seven. Thursday will also bring the ECB account from September's monetary policy meeting, when the Governing Council signalled that it expected to conduct its net PEPP purchases at a "moderately lower pace" this quarter. In addition, ECB Chief Economist Lane will participate in a panel discussion on "The ECB strategy – the 2021 review and its future" and Executive Board member Schnabel will give the opening speech at a joint ECB–Cleveland Fed conference on the drivers and dynamics of inflation.

UK

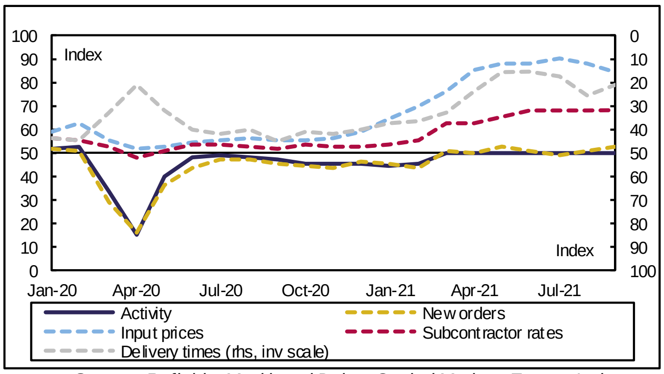
Construction PMI flags ongoing supply-side disruption

Contrasting with the euro area's survey, today's UK construction PMIs remained broadly consistent with ongoing expansion in the sector at the end of the third quarter. Nevertheless, the indicators pointed to persistent challenges from supply-side disruption, which led to a further notable slowdown in the recovery in September. Indeed, the headline activity index dropped a further 2.6pts to 52.6, its lowest reading since January and more than 13½pts lower than June's peak, with a loss of momentum reported in each of the civil engineering, commercial and housing sub-sectors, the latter of which was the weakest since June 2020. Activity remained disrupted by a severe lack of materials as supplier delivery times continued to lengthen (albeit reportedly to a lesser extent than earlier in the summer), and a shortage of staff, with the availability of subcontractors close to survey lows. But firms also flagged slowing demand last month, with the new orders PMI down a sizeable 6.1pts to 52.3, the weakest since January. Against this backdrop, firms continue to face significant cost pressures, with almost 80% of those surveyed reporting a rise in their cost burdens, associated with supply shortages, higher transport costs and subcontractor pay rates at a survey high. Indeed, while down from the record in July, the input price PMI was still extremely high at 91.5.

The day ahead in the UK

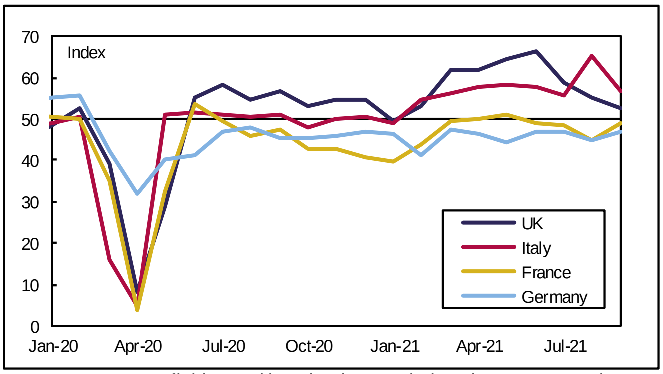
Another relatively quiet day in the UK tomorrow brings just unit labour costs data for Q2.

Euro area: Construction PMIs



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

Europe: Construction PMI by country



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

Daiwa Capital Markets

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Construction PMI	Sep	**50.0**	-	49.5	**-**
	Retail sales M/M% (Y/Y%)	Aug	**0.3 (0.0)**	0.8 (0.4)	-2.3 (3.1)	**-2.6 (-)**
Germany	Factory orders M/M% (Y/Y%)	Aug	**-7.7 (11.7)**	-2.2 (16.4)	3.4 (24.4)	**4.9 (26.1)**
	Construction PMI	Sep	**47.1**	-	44.6	**-**
France	Construction PMI	Sep	**48.9**	-	44.9	**-**
Italy	Construction PMI	Sep	**56.6**	-	65.2	**-**
Spain	Industrial production M/M% (Y/Y%)	Aug	**-0.3 (1.8)**	0.9 (3.5)	-1.1 (3.4)	**- (3.3)**
UK	Construction PMI	Sep	**52.6**	54.0	55.2	**-**

Auctions

Country	Auction
Germany	sold €3.24bn of 0% 2026 bonds at an average yield of -0.54%
UK	sold £2.5bn of 0.5% 2029 bonds at an average yield of 0.948%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany	07.00	Industrial production M/M% (Y/Y%)	Aug	-0.5 (5.0)	1.0 (5.7)
France	07.45	Trade balance €bn	Aug	-	-7.0
Italy	09.00	Retail sales M/M% (Y/Y%)	Aug	0.5 (2.0)	-0.4 (6.7)

Auctions and events

Country	BST	Event
Euro area	09.30	ECB Chief Economist Lane participates in discussion on The ECB Strategy: the 2021 review and its future
	12.30	Publication of the account of the ECB's monetary policy meeting held on 8-9th September
	-	ECB Board Members Lane and Schnabel speak at joint ECB/Cleveland Fed conference on Inflation: Drivers and Dynamics
France	09.50	Auction: 2.5% 2030 bonds
	09.50	Auction: 0% 2031 bonds
	09.50	Auction: 0.75% 2053 bonds
	09.50	Auction: 1.75% 2066 bonds
Spain	09.30	Auction: 0% 2028 bonds
	09.30	Auction: 0.5% 2031 bonds
	09.30	Auction: 2.7% 2048 bonds
	09.30	Auction: 0.7% 2033 index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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