

# Euro wrap-up

## Overview

- Bunds made modest gains as German manufacturing production plunged to a 12-month low as supply shortages continued to take their toll.
- Gilts made further modest losses as new BoE Chief Economist Pill noted increased concerns over the inflation outlook.
- After the release of German trade figures and a UK jobs survey tomorrow, the coming week will bring euro area IP data as well as UK monthly GDP and labour market reports.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.714	-0.009
OBL 0 10/26	-0.564	-0.010
DBR 0 08/31	-0.189	-0.005
UKT 0 <sup>7</sup> / <sub>8</sub> 01/24	0.474	+0.010
UKT 0 <sup>3</sup> / <sub>8</sub> 10/26	0.694	+0.013
UKT 0 <sup>1</sup> / <sub>4</sub> 07/31	1.076	+0.007

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

## Euro area

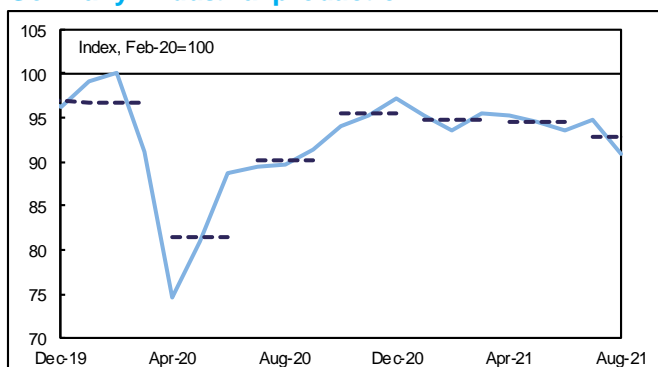
### German IP plunges to 12-month low as shortage of inputs continues to take its toll

After yesterday's poor [turnover numbers](#), today's German IP figures were widely expected to be weak. And the 4% M/M drop in August was the steepest since April 2020. So, while growth was revised slightly higher in July (+1.3% M/M), having contracted in five out of the first seven months of the year, output was still a whopping 9% lower than the pre-pandemic level and at a twelve-month low. And when excluding construction and energy, output was down an even steeper 4.7% M/M, to leave it almost 10½% below the February 2020 level. This compares with a shortfall of 4½% in France and just 1% in Spain on an equivalent basis. Manufacturers continued to attribute the weakness to a shortage of intermediate goods. And the challenge remains most acute in the autos sector, with output down a staggering 17.5% M/M in August, taking the cumulative drop since December to 36% and the level down by more than 40% compared with February 2020. And with production of machinery and equipment down 6.3% M/M, output of capital goods fell 7.8% M/M to be almost 19% lower than the pre-pandemic level and trending in the first two months of Q3 some 2.8% lower than in Q2. While more modest, there were also declines in production of intermediate (-2.4% M/M) and consumer goods (-2.6% M/M).

### Outlook remains clouded by supply constraints

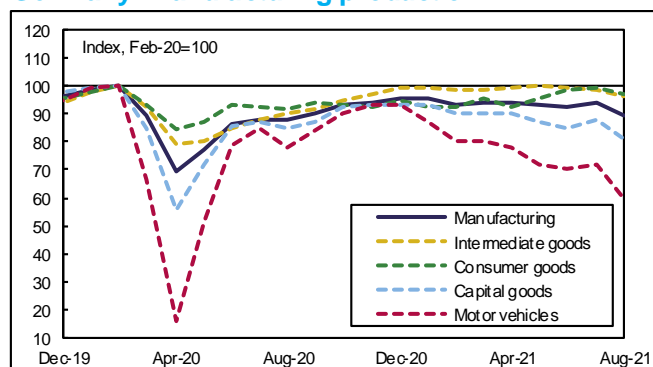
So, overall, on average in July and August, German manufacturing output was 1.7% lower than the Q2 average. In addition, construction activity also fell sharply in August, by 3.1% M/M, to be trending so far in Q3 0.6% lower than in Q2. And while energy production rose more than 4% M/M in August, weakness in earlier months points to a notably softer outturn in Q3 as a whole. As such, total IP in July and August was trending more than 1½% below the level in Q2, which itself was down ½% Q/Q. September [car production](#) figures implied another difficult month for Germany's auto industry and, with supply bottlenecks widespread, survey measures including the [PMIs](#) and [ifo](#) indicators point to another weak month for some other subsectors. So, industrial output in the third quarter seems likely to have provided the largest drag on German GDP growth since Q220. Of course, with services turnover having rebounded since May and high frequency figures signalling strong growth in hospitality over the summer, we still anticipate solid GDP growth in Q3 (circa 1½% Q/Q). But while the backlog of manufacturing orders continues to rise and incoming orders remain relatively strong, the near-term production outlook remains clouded by supply constraints. And demand more generally might well come under pressures as real disposable income is eroded by increased prices of household energy and fuel. So, while we continue to expect German GDP to maintain an upwards trend, we have delayed our expectation for output to return to the pre-pandemic level until the first quarter of 2022.

### Germany: Industrial production\*



\*Dashed blue line represents quarterly average. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany: Manufacturing production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

## Irish manufacturing falls back, but output still significant higher than pre-pandemic level

While the manufacturing recovery in Ireland has been far more vigorous than those of other member states, industrial production also fell in August, by 2.8% M/M. And the drop in manufacturing was even steeper at 4.4% M/M, reflecting sizeable declines in clothing (-18.3% M/M), metal (7.8% M/M) and food (-6.5% M/M), while output of transport equipment moved broadly sideways. But this still left Irish manufacturing output 26% higher compared with a year earlier and more than 30% higher than its level in February 2020. Nevertheless, based on national figures currently published, aggregate euro area industrial production (data due for release on Wednesday) looks likely to have fallen by at least 2% M/M in August to its lowest level since October and to be still almost 2% lower than the pre-pandemic level.

## Some ECB policymakers called for a sharper slowing of the pace of PEPP purchases last month

At its September monetary policy meeting, the ECB signalled that it expected to conduct its net PEPP purchases this quarter at a “moderately lower pace” than the past two quarters. As expected, the account of that meeting, published today, suggested that the policy decision reflected the easing of financial conditions since the second quarter. And it also reflected the upwards revisions to the ECB’s GDP and inflation forecasts for the current year, the (admittedly very slight) upwards revision to the inflation forecasts for the coming two years, and an increase in inflation expectations. With the monthly purchase pace to be “implemented flexibly according to market conditions”, the ECB would be able to react to upward pressure on rates with extra purchases, or would be able to reduce the pace of purchases if it could get away with doing so without generating upwards pressures on yields. Chief Economist Lane warned the Governing Council that a “substantially lower pace of purchases under the PEPP... could risk an unwarranted tightening in market interest rates (with associated currency appreciation)”. However, the account confirmed that some members of the Governing Council wanted a “more substantial reduction in the pace of purchases similar to the level prevailing at the beginning of the year”. And it was also suggested that “even without the PEPP, the overall monetary stance remained highly accommodative”.

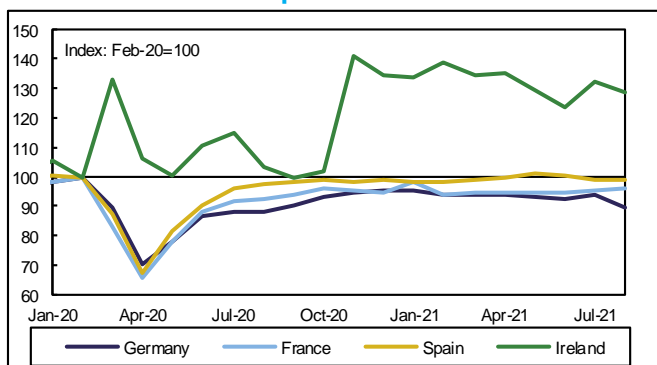
## December policy meeting to be more heated given persistent supply shocks

Among some members of the Governing Council, there certainly appeared to be greater unease about current policy settings, not least given the recent failures of the ECB to predict accurately the rise in inflation this year. At least one member “raised doubts about how well the ECB’s models were able to capture what was currently happening in the economy, the structural changes implied by the pandemic and the impact of the ECB’s new monetary policy strategy.” It was also questioned whether there were now “regime shifts” with respect to inflation. Moreover, it was noted that “even if the current inflation shock was largely temporary, it would only require a relatively small percentage of the current shock to become permanent for inflation to be close to 2 per cent at the end of the projection horizon”. Of course, since the September meeting, supply bottlenecks have appeared likely to last longer than previously expected, weighing more heavily on production but also pushing inflation higher and for longer. And while there remains little evidence that is feeding through into accelerated labour cost growth, market-based measures of inflation expectations have risen further. Questions about the impact of post-pandemic structural changes on the inflation outlook also look pertinent, even if open to debate. So, the ECB’s December policy meeting, when the Governing Council will discuss both the pace and nature of asset purchases in the New Year seems likely to prove a contentious affair. Many members seem bound to call for a far more significant slowing of purchases in Q1 and perhaps even minimal net buying thereafter. However, given the lack of evidence of rising wage pressures, the majority seems likely to back only a measured reduction in the pace of buying in the first quarter, and ongoing flexible purchases of a still-significant amount (€30-40bn perhaps) under a reformed asset purchase programme from Q2 on.

## The week ahead in the euro area

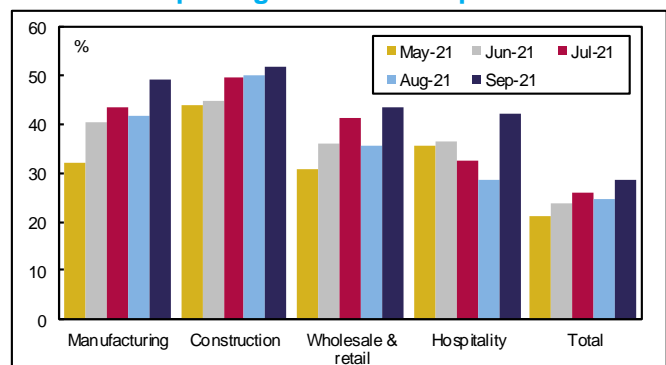
After tomorrow’s release of German trade numbers for August and ahead of Wednesday’s aforementioned euro area industrial production release, the coming week’s data calendar kicks off on Monday with the equivalent figures from Italy, which are similarly expected to have fallen in August. Given subdued production and supply bottlenecks, euro area goods

### Euro area: Industrial production in member states



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: Firms reporting above-normal price increases\*



\*Share of firms reporting greater price increases than normal. Source: ONS BICS survey and Daiwa Capital Markets Europe Ltd.

trade figures (due Friday) are likely to show that exports remained subdued in August. And with production in the autos sector particularly impacted by supply shortages, euro area car registration figures for September (Friday) are likely to confirm ongoing weakness at the end of the third quarter too. Indeed, based on the national figures from the four largest member states, car registrations fell 25% Y/Y. Sentiment indicators due in the first half of the week include the German ZEW survey for October and French BoF survey for September, of which the latter will provide an update on the Bank's forecast for Q3 GDP growth and the estimated pandemic-related shortfall in the level of output at the end of September. Meanwhile, final inflation numbers from Germany, Spain and France (due Wednesday, Thursday and Friday respectively) are expected to confirm that headline inflation jumped in September as energy prices shifted notably higher. And in the context of the inflation outlook, the euro area's latest labour force survey (Thursday) will provide an update on labour market slack in Q2. In terms of policy, ECB Chief Economist Lane will give opening remarks at an ECB conference on "Monetary Policy: Bridging science and practice" on Monday.

## UK

### ONS BICS survey repeats concerns about supply challenges

The ONS' latest coronavirus business insights survey (BICS) again flagged concerns about the shortage of labour and supply on activity and prices. Of those businesses surveyed, around 12% suggested that vacancies in the two weeks to 19 September were more difficult to fill than a month earlier, with this proportion rising to more than 40% in small businesses. Firms in hospitality in particular reported a notably higher-than-normal turnover in staff last month. Admittedly, the survey also suggested that there was still more than 5% of the workforce (more than 1mn people) on either full- or part-time furlough, which concluded at the end of September. But while some of these workers might be expected to fill some of the rising level of vacancies – the number of online job adverts on 1 October was almost 140% higher than the average number in February 2020 – there will remain a significant skill mismatch in many sectors. Indeed, the near-four-fold increase in online job adverts in transport, logistics and warehouses compared with the pre-pandemic level seems to have been magnified by the lack of EU workers since Brexit. And such shortages are hitting economic activity – the associated lack of petrol supply over the past two weeks saw traffic on London roads fall to its lowest level since early July.

### BoE Chief Economist flags concerns over inflation outlook












Consistent with the narrative of the PMIs, the BICS also flagged increasing price pressures. This was predominantly evident in the construction and manufacturing sectors, where roughly 50% of respondent firms reported that prices of materials had increased at an above-normal rate. And while almost one third of all businesses cited that prices of inputs were increasing by more than normal, only around 10% of firms noted that they had increased their selling prices. That marked a relatively modest rise, from 8% in August. But we expect this share to rise further over coming months. The recent surge in wholesale gas prices will also sustain a further notable increase in consumer price inflation over the near term. Against this backdrop, it was no surprise that new BoE Chief Economist Huw Pill today wrote to the Treasury Select Committee that the strength of inflation looks set to prove longer-lasting than originally anticipated. And so, he also argued that the balance of risks to the inflation outlook is also shifting towards the upside.

### The week ahead in the UK

After tomorrow's release of the REC/KPMG report on jobs for October, the coming week's data calendar gets underway with the ONS's labour market statistics on Tuesday. Having returned back above the pre-pandemic level in August, the number of payrolled employees is expected to have risen further in September before the government's Job Retention Scheme came to an end. The number of job vacancies is likely to have risen to a new record high too. And headline wage growth (which slowed modestly to 6.8% 3MY excluding bonuses previously) will have remained elevated, even if it continues to moderate. Indeed, the ONS previously judged underlying earnings growth to be between 3.6-5.1% in the three months to July, with the upper end stronger than the range ahead of the pandemic. Of equal importance will be Wednesday's release of August GDP numbers, alongside the monthly output components. Having moved broadly sideways at the start of the third quarter, GDP is expected to have been boosted by a pickup in services activity as hospitality was supported by "staycations". Manufacturing and construction output, however, seem likely to have been constrained by persistent supply bottlenecks. The latest goods trade figures for August will also be published on Wednesday. Other releases include the BRC retail sales monitor (Tuesday) and the RICS house price survey for October – the first since the conclusion of the stamp duty holiday – as well as the BoE's latest quarterly credit conditions survey (Thursday). The second half of the week will also see several BoE MPC members in action, with a pre-recorded speech from Deputy Governor Cunliffe on Wednesday followed by speeches from (up to now dovish) external members Tenreiro and Mann on Thursday, with the latter's titled "Coping with the legacy of the Covid-19 crisis".












*The next edition of the Euro wrap-up will be published on 12<sup>th</sup> October 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		-1.4	5.5	1.8	1.0	0.7	0.7	7.2	4.8	2.2
Euro area										
Headline CPI		1.1	1.8	2.8	3.5	2.7	2.9	2.3	2.4	1.3
Core CPI		1.2	0.9	1.4	1.9	1.3	1.8	1.3	1.4	1.2
UK										
Headline CPI		0.6	2.1	2.9	4.3	4.5	4.0	2.5	3.4	1.8
Core CPI		1.2	1.8	2.7	3.4	3.6	3.1	2.3	2.7	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	0.25	0.10	0.25	0.75
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	 Industrial production M/M% (Y/Y%)	Aug	<b>-4.0 (1.7)</b>	-0.5 (5.0)	1.0 (5.7)	<b>1.3 (6.0)</b>		
France	 Trade balance €bn	Aug	<b>-7.0</b>	-	-7.0	-		
Italy	 Retail sales M/M% (Y/Y%)	Aug	<b>0.4 (1.9)</b>	0.3 (2.0)	-0.4 (6.7)	<b>-0.3 (-)</b>		
Auctions								
Country	Auction							
France	 sold €2.96bn of 2.5% 2030 bonds at an average yield of -0.05%  sold €4.93bn of 0% 2031 bonds at an average yield of 0.15%  sold €2.04bn of 0.75% 2053 bonds at an average yield of 0.96%  sold €1.08bn of 1.75% 2066 bonds at an average yield of 1.04%							
Spain	 sold €1.59bn of 0% 2028 bonds at an average yield of -0.025%  sold €1.69bn of 0.5% 2031 bonds at an average yield of 0.446%  sold €1.14bn of 2.7% 2048 bonds at an average yield of 1.256%  sold €510mn of 0.7% 2033 index-linked bonds at an average yield of -1.074%							

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	Trade balance €bn	Aug	15.0	17.9				
Auctions and events										
UK		00.01	KPMG/REC report on jobs							














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> <u>forecast/actual</u>	Previous	
<b>Monday 11 October 2021</b>						
Italy		09.00 Industrial production M/M% (Y/Y%)	Aug	-	0.8 (7.0)	
France		- Bank of France industrial sentiment survey	Sep	-	104	
<b>Tuesday 12 October 2021</b>						
Germany		10.00 ZEW current situation (expectations) balance	Oct	-	31.9 (26.5)	
UK		00.01 BRC sales, like-for-like Y/Y%	Sep	-	1.5	
		07.00 Unemployment claimant count rate % (change '000s)	Sep	-	5.4 (-58.6)	
		07.00 Average earnings including bonuses (excluding bonuses) 3M/Y%	Aug	-	8.3 (6.8)	
		07.00 ILO unemployment rate %	Aug	-	4.6	
		07.00 Employment change 3M/3M, '000s	Aug	-	183	
<b>Wednesday 13 October 2021</b>						
Euro area		10.00 Industrial production M/M% (Y/Y%)	Aug	-2.0 (3.0)	1.5 (7.7)	
Germany		07.00 Final CPI (EU-harmonised) Y/Y%	Sep	4.1 (4.1)	3.9 (3.4)	
UK		07.00 Monthly GDP M/M% (3M/3M%)	Aug	-	0.1 (3.6)	
		07.00 Industrial production M/M% (Y/Y%)	Aug	-	1.2 (3.8)	
		07.00 Manufacturing production M/M% (Y/Y%)	Aug	-	0.0 (6.0)	
		07.00 Index of services M/M% (3M/3M%)	Aug	-	0.0 (4.5)	
		07.00 Construction output M/M% (Y/Y%)	Aug	-	-1.6 (8.6)	
		07.00 Goods trade balance £bn	Aug	-	-12.7	
<b>Thursday 14 October 2021</b>						
UK		00.01 RICS house price balance %	Sep	-	73	
Spain		08.00 Final CPI (EU-harmonised CPI) Y/Y%	Sep	4.0 (4.0)	3.3 (3.3)	
<b>Friday 15 October 2021</b>						
Euro area		07.00 EU27 new car registrations Y/Y%	Sep	-	-19.1	
		10.00 Trade balance €bn	Aug	-	13.4	
France		07.45 Final CPI (EU-harmonised CPI) Y/Y%	Sep	2.1 (2.7)	1.9 (2.4)	
Italy		07.45 Final CPI (EU-harmonised) Y/Y%	Sep	2.6 (3.0)	2.0 (2.5)	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### The coming week's key events & auctions

Country	BST	Event / Auction
<b>Monday 11 October 2021</b>		
Euro area	 13.00	ECB Chief Economist Lane delivers opening remarks at ECB conference on monetary policy
	 15.45	ECB's Elderson participates in a panel on Green and sustainable finance
<b>Tuesday 12 October 2021</b>		
Euro area	 13.30	ECB Chief Economist Lane speaks at conference on EU and US Perspectives: Changing climates
	 14.00	ECB's Elderson delivers opening remarks at second day of ECB conference on monetary policy
Germany	 10.30	Auction: €5bn of 0% 2023 bonds
UK	 10.00	Auction: £1.25bn of 0.5% 2061 bonds
<b>Wednesday 13 October 2021</b>		
Germany	 10.30	Auction: €1bn of 0% 2052 bonds
Italy	 10.00	Auction: 3Y & 7Y bonds
UK	 10.00	Auction: £500mn of 0.125% 2051 index-linked bonds
	 15.30	BoE Deputy Governor Cunliffe gives a pre-recorded speech at SWIFT's global financial services networking event
<b>Thursday 14 October 2021</b>		
UK	 09.30	BoE publishes bank liabilities/credit conditions survey
	 11.10	BoE's Tenreyro speaks gives a speech "Dominant currency and the impact of monetary policy"
	 15.40	BoE's Mann gives a speech "Coping with the legacy of the Covid-19 crisis"
<b>Friday 15 October 2021</b>		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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