

Euro wrap-up

Overview

- Bunds made gains as euro area industrial data predictably reported a drop to a six-month low constrained by supply bottlenecks.
- With the exception of the short end of the curve where near-term monetary tightening continued to be priced in, Gilts made gains as UK GDP rose close to expectations in August.
- Thursday will bring speeches from two BoE MPC members, which might give further clues to the near-term path of UK monetary policy, while Friday will bring data on euro area goods trade.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.681	-0.010
OBL 0 10/26	-0.486	-0.016
DBR 0 08/31	-0.131	-0.043
UKT 0 ⁷ / ₈ 01/24	0.564	+0.013
UKT 0 ³ / ₈ 10/26	0.757	-0.015
UKT 0 ¹ / ₂ 07/31	1.086	-0.059

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

Source: Bloomberg

Euro area

Industrial production drops to six-month low on supply challenges

With supply constraints acting as a brake, euro area industrial production (excluding construction) dropped 1.6% M/M in August to a six-month low. Given the fall of 4.1% M/M in Germany, where bottlenecks appear most acute, the decline in the euro area as a whole was inevitable. And while France (up for a third successive month and by 1.0% M/M) provided some offset, and production in Italy and Spain was little changed from July, the Netherlands (down 3.1% M/M) and Ireland (-2.8% M/M) also weighed significantly. The fall in manufacturing output in August was larger, at 2.0% M/M, and also left it at the lowest level since February. However, the average level for the first two months of Q3 was up 0.4% from Q2. And, looking through the month-to-month volatility, the trend arguably remains broadly sideways.

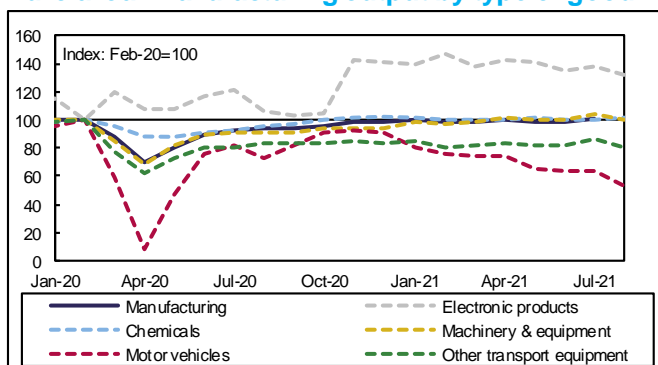
Autos production down for ninth successive month, but restraints on growth widespread

Among the various sub-sectors, autos production remains especially hard-hit by the shortage of semiconductors, falling for a ninth successive month and by 17.2% M/M, the most of this losing streak. Indeed, the level of motor vehicle output dropped to the lowest since the first wave of pandemic in May 2020, down more than 42% from November's pandemic peak and barely more than half the pre-pandemic level. In addition, with output of machinery and equipment down 3.3% M/M, overall capital goods production fell 3.9% M/M to the lowest level since September, 5.8% below the pre-pandemic level and more than 10% below the pre-pandemic peak. Moreover, every other major category of manufacturing output fell in August too, with intermediate goods down 1.5% M/M to a six-month low and consumer durables down 3.4% M/M to a five-month low. With surveys suggesting that difficulties sourcing raw materials and intermediate items continue to bind across a wide range of sub-sectors, energy price hikes increasingly problematic for power-intensive sectors, and new orders growth having slowed, the near-term outlook for production is likely to remain challenging. The broad sideways move of recent months risks evolving into a clear downtrend towards year-end.

The coming two days in the euro area

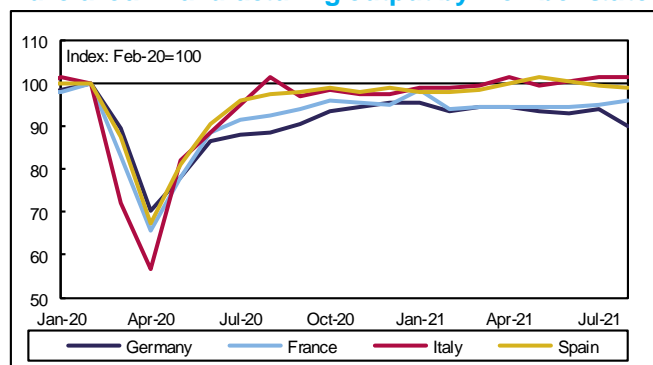
After final German inflation for September today confirmed that the headline measure (on the EU-harmonised measure) rose to a series high of 4.1% Y/Y, the equivalent releases from Spain, France and Italy are due on Thursday and Friday respectively. The preliminary estimates showed headline Spanish CPI rising 0.7ppt to 4.0% Y/Y, principally reflecting higher electricity prices. The upwards shift in the preliminary French CPI rate was more moderate, by 0.3ppt to 2.7% Y/Y, nevertheless still a near-decade high, while Italian CPI rose 0.5ppt to 3.0% Y/Y, the highest since September 2012. Thursday will also see Eurostat publish the latest quarterly labour force survey, which among other things will provide an update on

Euro area: Manufacturing output by type of good



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output by member state



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

spare capacity in the labour market back in Q2. Euro area trade figures for August and car registration numbers for September are also due on Friday.

UK

UK GDP continued to narrow gap with the pre-pandemic level in August

Broadly aligning with expectations, today's UK GDP data showed a further narrowing of the gap with the pre-pandemic level of output. But given that August was largely free of pandemic restrictions, and in contrast to yesterday's strong [labour market](#) data, today's report was arguably a little underwhelming, with economic activity rising just 0.4% M/M after a revised contraction of 0.1% M/M in July to suggest a loss of vigour over the summer. Overall, GDP was still 0.8% below the pre-pandemic level in August. Nevertheless, given the profile over prior months, the average level of GDP in July and August was 1.3% above the Q2 average, suggesting a rate of growth that was still clearly above-potential over the third quarter as a whole.

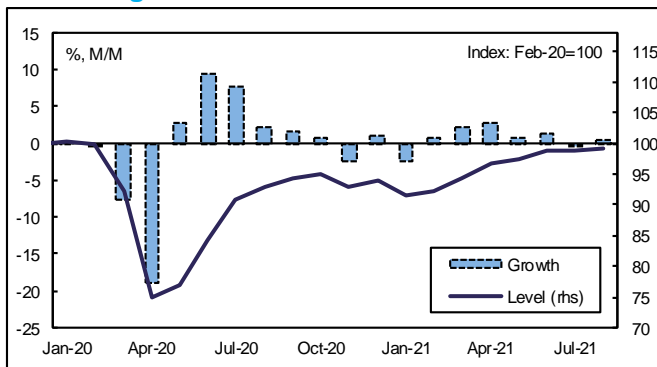
Services boosted by staycations in the summer

Within the detail, despite further easing of restrictions, services activity grew just 0.3% M/M in August, to be still 0.6% below the pre-Covid level. There was again significant variation in performance between sub-sectors, although 11 out of 14 reported growth. Accommodation and food services (10.3% M/M) almost fully accounted for monthly growth in services in August, to be trending in the first two months of Q3 some 28% above the Q2 average. And while we might expect some payback in September, strikingly the level in August was more than 2½% higher than the pre-pandemic level. There were also strong rebounds in arts and entertainment (24.7% M/M) and sports and amusement park activities (4.0% M/M), with the latter supported not least by the start of the football season and increased staycations this year. But while travel agencies similarly reported vigorous growth (47.9% M/M), activity was still some 60% lower than the pre-pandemic level, with air transport down 75% on an equivalent basis. Meanwhile, healthcare continued to contract as doctor visits, vaccinations and test and trace activity fell, as did retail and wholesale trade. Overall, the level of consumer-facing services was still more than 4½% below the pre-pandemic level, while other services were up almost ½% relative to that benchmark.

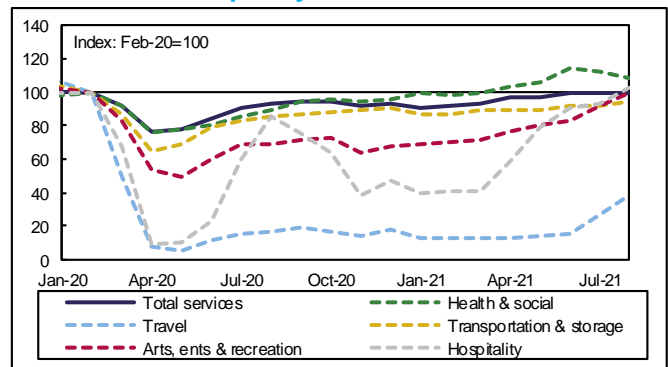
Supply constraints still impacting output

In the other main sectors, manufacturing output was a touch firmer than expected, with growth of 0.5% M/M in August driven by a surprising acceleration in the autos sector (6.6% M/M). But given the supply bottlenecks in the industry, auto production was still down by 14½% from February 2021 and almost one fifth lower than the pre-pandemic level, with overall

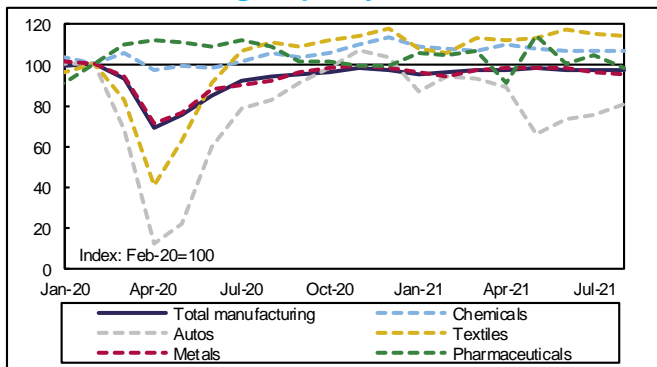
UK: GDP growth and level



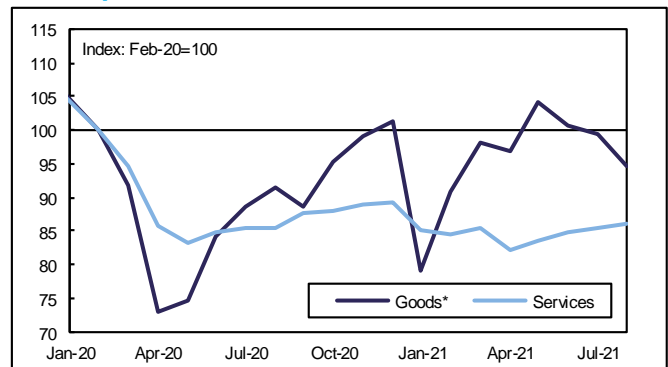
UK: Services output by selected subsector



UK: Manufacturing output by selected subsector



UK: Export volumes



manufacturing still roughly 2½% lower than in February 2020 too. Despite the rebound in manufacturing, exports of UK goods were weak in August, down more than 4%MM, to leave them 11½% lower than May's peak. Services exports also remained subdued, rising just 0.9%MM to leave them still almost 14% below the pre-pandemic level. So, overall export volumes were trending in July and August some 2% lower than the Q2 average. Construction output also continued to disappoint in August, down for the third month out of the past four as firms struggled to meet demand in the face of rising input costs and supply shortages, to leave it 1.4% lower than pre-pandemic level and trending 1.3% lower than the average in Q2.

Downside risks to near-term demand remain to the fore

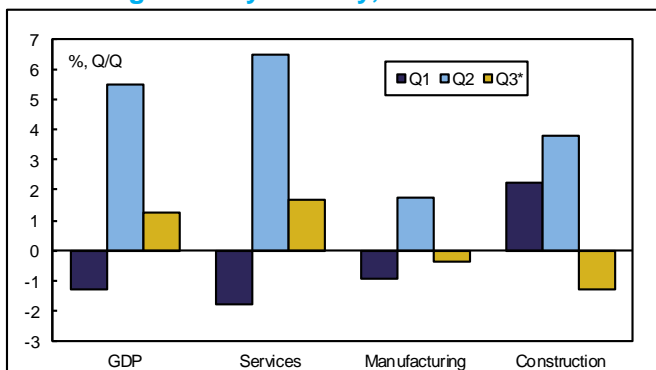
Overall, given the revisions to the national accounts announced at the end of last month, there appears to be considerably less spare capacity in the economy than previously estimated by the BoE. But unlike the labour market figures, today's GDP data did not shake the impression of a levelling off of economic momentum in the middle of the summer despite the relaxation of restrictions. And given the termination of the government's job support schemes, the cut in Universal Credit payments, significantly higher household energy bills from this month, and persistent supply constraints in certain sectors, the near-term outlook for demand has deteriorated. A hike in Bank Rate as early as next month might thus seem a little hasty. However, when it reviews its assessment of potential output next month, the BoE might judge that demand is outstripping supply to such an extent that a rate hike is required no matter what.

The coming two days in the UK

A relatively quiet couple of days for UK top-tier releases brings the release tomorrow of the RICS house price balance for September. This is likely to indicate another month of strong house prices, but a further moderation in the supply of new houses and buyer enquiries as the government's stamp duty holiday drew to a close. The BoE's latest quarterly credit conditions survey is also due. But given recent hawkish commentary from several MPC members, likely of most interest tomorrow will be speeches by the up-to-now dovish externals Tenreyro and Mann.

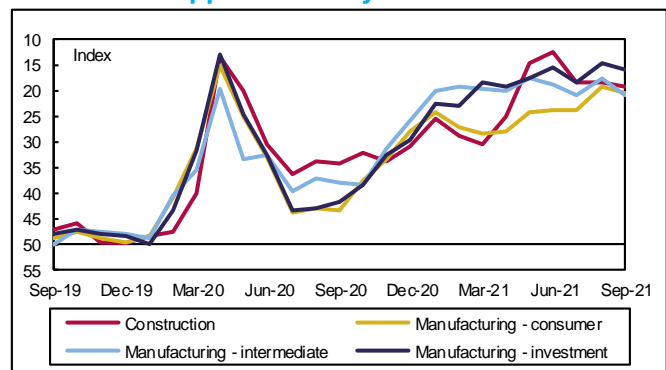
The next edition of the Euro wrap-up will be published on 15 October 2021

UK: GDP growth by industry, 2021



*Q3 figures are based on average level in July and August.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: PMIs – supplier delivery times











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






European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Industrial production M/M% (Y/Y%)	Aug	-1.6 (5.1)	-1.7 (4.7)	1.5 (7.7)	1.4 (8.0)
Germany	 Final CPI (EU-harmonised) Y/Y%	Sep	4.1 (4.1)	4.1 (4.1)	3.9 (3.4)	-
UK	 Monthly GDP M/M% (3M/3M%)	Aug	0.4 (2.9)	0.5 (3.0)	0.1 (3.6)	-0.1 (4.2)
	 Industrial production M/M% (Y/Y%)	Aug	0.8 (3.7)	-	1.2 (3.8)	0.3 (4.4)
	 Manufacturing production M/M% (Y/Y%)	Aug	0.5 (4.1)	-	0.0 (6.0)	-0.6 (6.1)
	 Index of services M/M% (3M/3M%)	Aug	0.3 (3.7)	0.6 (3.8)	0.0 (4.5)	-0.1 (5.2)
	 Construction output M/M% (Y/Y%)	Aug	-0.2 (10.1)	0.4 (5.7)	-1.6 (8.6)	-1.0 (13.1)
	 Goods trade balance £bn	Aug	-14.9	-12.0	-12.7	-14.1



Auctions

Country	Auction
Germany	 sold €816mn of 0% 2052 bonds at an average yield of 0.35%
Italy	 sold €2bn of 0.5% 2028 bonds at an average yield of 0.48%
	 sold €3bn of 0% 2024 bonds at an average yield of -0.19%
	 sold €1.5bn of 1.7% 2051 bonds at an average yield of 1.82%
UK	 sold £500mn of 0.125% 2051 index-linked bonds at an average yield of -2.261%





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
UK	 00.01 RICS house price balance %	Sep	70	73
Spain	 08.00 Final CPI (EU-harmonised) Y/Y%	Sep	4.0 (4.0)	3.3 (3.3)





Auctions and events

Euro area	 10.00 Eurostat publishes labour force survey for Q2
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"

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

Country	BST Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	 07.00 EU27 new car registrations Y/Y%	Sep	-	-19.1
	 10.00 Trade balance €bn	Aug	14.2	13.4
France	 07.45 Final CPI (EU-harmonised) 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)

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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