

Euro wrap-up

Overview

- Bunds followed USTs lower, despite an extremely downbeat German investor survey.
- Gilts also made modest losses on a quiet day for UK economic news.
- Ahead of the Fed's monetary policy announcement, tomorrow will bring August inflation figures from the UK and euro area.

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Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.218	+0.041
OBL 2½ 10/29	2.026	+0.034
DBR 2.6 08/34	2.141	+0.022
UKT 4½ 01/27	3.822	+0.040
UKT 4½ 07/29	3.636	+0.027
UKT 4½ 07/34	3.770	+0.013

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

Euro area

Investors significantly more downbeat about Germany's economic outlook

Echoing the downbeat assessment of last week's Sentix survey, today's ZEW investor survey reported a marked worsening in perceptions of German economic conditions at the end of Q3. Indeed, the survey's current conditions balance fell a steeper-than-expected 7.2pts in September to -84.5, the weakest reading since the initial pandemic lockdown and the global financial crisis before that, adding to concerns that the economy slipped back into recession over the summer. Almost 85% of respondents considered current conditions to be 'bad', while no-one judged them to be 'good' for the first time since Q423 when the economy contracted sharply (-0.4%Q/Q). Moreover, the share of respondents expecting conditions to improve over the coming six months fell back to just a quarter, compared with more than half three months ago. As such, the survey's expectations balance fell sharply for a third successive month to an eleven-month low (3.6), back below the long-run average. So, while the ZEW survey arguably provides a less reliable guide to actual economic activity than the ifo business indices and PMIs, today's results still point to ever more widespread expectations that German GDP will remain subdued into next year.

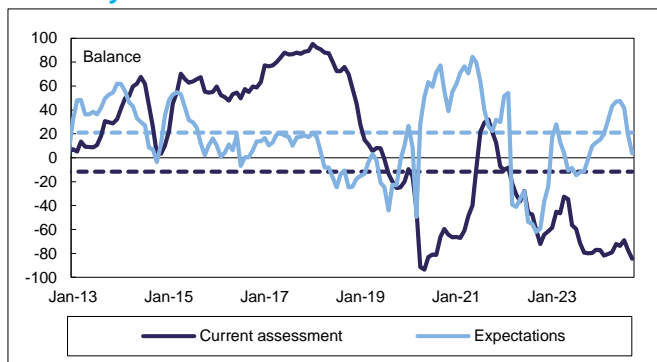
Widespread deterioration in sentiment across subsectors

With more than 90% of respondents to the ZEW survey unsurprisingly expecting the ECB to cut rates again over coming months, investor expectations for the construction sector were marginally positive in September. But conditions were judged to have deteriorated in a range of other sectors. Indeed, while they were still considered positive in services, the outlook was the least upbeat since the start of the year. The retail outlook was also considered to have deteriorated from earlier in the year as consumer spending remains subdued. And the profit outlook was increasingly unfavourable in the steel, chemicals and banking subsectors. But sentiment with respect to German auto manufacturers was the most downbeat, with the respective index declining for a fifth consecutive month to a 3½-year low, as subdued demand and weak production continued to weigh on the profit outlook.

German trade subtracts from growth in July as rise in imports outpaces exports

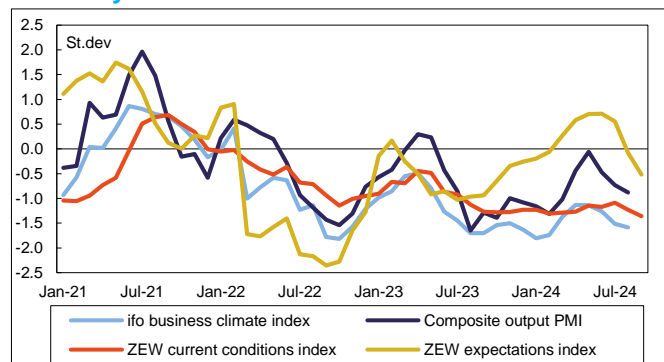
Part of Germany's economic weakness over the past year or so relates to trade. Export volumes fell in Q2 (-0.2%Q/Q) for the fourth quarter out of the past five, with goods shipments declining (-0.4%Q/Q) for a fifth quarter out of six. The latest export figures for July were somewhat more encouraging, with volumes rising for the first month in three and by 1.7%M/M, the most in six months. But this still left them almost 2% below the Q2 average. And with import volumes up more than 5½%M/M to be some 3½% above the Q2 level, these data strongly suggest that net trade was a significant drag on GDP

Germany: ZEW investor sentiment indices*



*Dashed lines represent long-run averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Sentiment indices



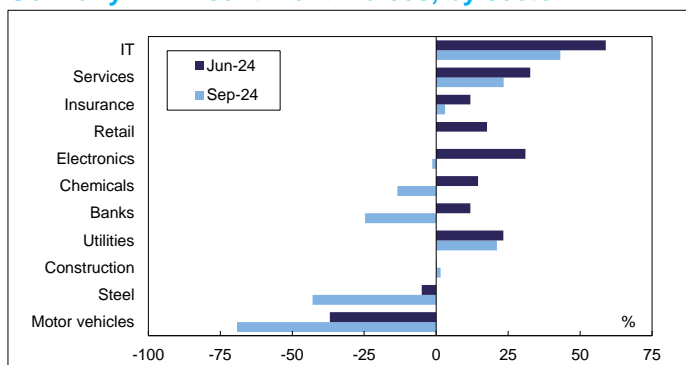
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

growth at the start of Q3, while surveys point to a further weakening in external demand in August too. The strength of imports in July meant that the goods trade surplus narrowed to a 14-month low of €16.8bn, down almost €10bn from last year's peak. While the deterioration was widespread, it was led by the largest deficit with China since November 2022 as the value of exports fell to a seven-year low outside of the initial pandemic-related slump. The recent downtrend in exports to that country has been broad-based, reflecting weaker demand for German autos (-7%Y/Y), machinery (-13½%Y/Y) and electrical equipment (-1½%Y/Y) – which together account for more than 60% of exports – amid ongoing trade tensions between the EU and China. Moreover, Eurostat figures published yesterday showed that the euro area's trade deficit with China rose to a 14-month high in July (-€19.2bn) by far the largest of its trading partners. In contrast, the trade surplus with Japan rose to a new record (€1.4bn), with the bilateral balances with the UK (€12.1bn) and US (€14.2bn) also close to series highs.

The day ahead in the euro area

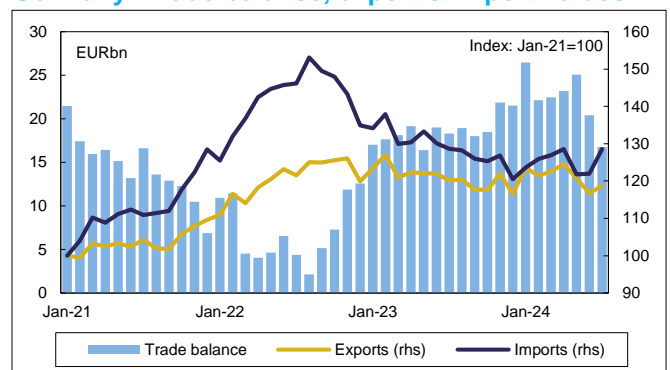
Wednesday will bring the final estimates of euro area inflation in August including the full detailed breakdown. In the flash release, headline inflation fell 0.4ppt to 2.2%Y/Y, the softest rate in more than three years, due principally to a notable decline in the energy component. Consistent with the subdued global trend, core goods inflation also fell to the lowest since

Germany: ZEW sentiment indices, by sector



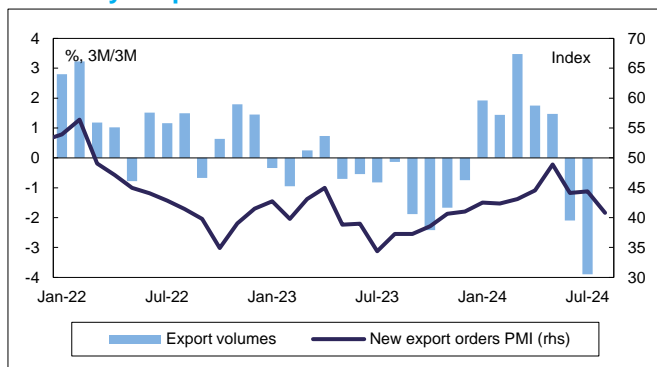
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Trade balance, export & import values



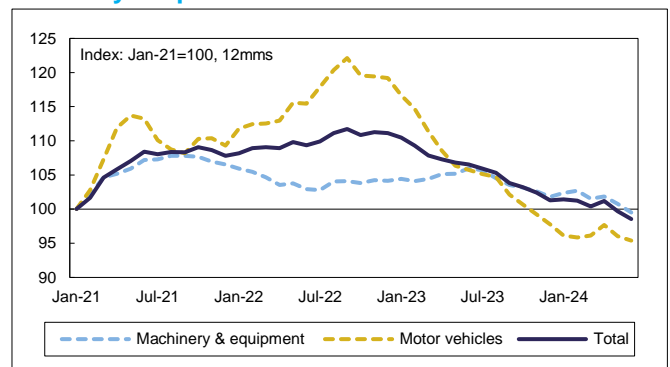
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Export volumes & new orders PMI



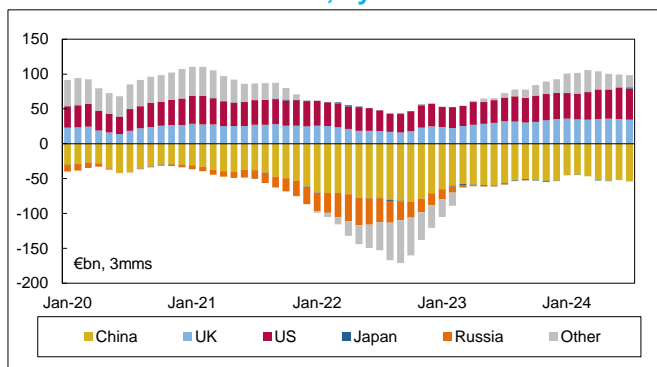
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Germany: Exports to China



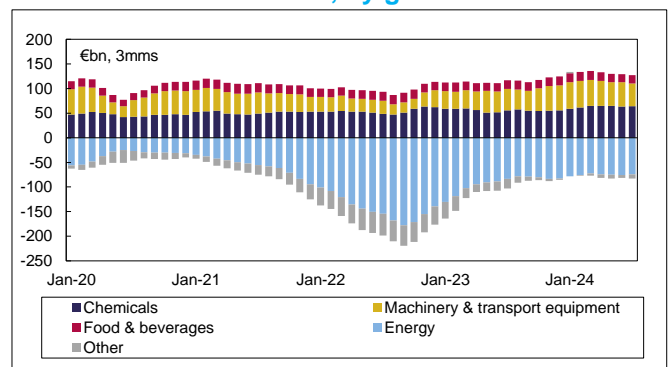
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Trade balance, by destination



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Trade balance, by good



Source: Macrobond and Daiwa Capital Markets Europe Ltd.



April 2021. And the detail will likely confirm ongoing disinflation in a range of items including clothing, motor vehicles, furniture and household goods. While services inflation rose to a 10-month high (3.7%Y/Y), the detail is likely to confirm that price pressures were concentrated in the hospitality, tourism and transport-related subsectors related in part to the Paris Olympics. Overall, in line with the flash estimate, core inflation likely edged only slightly lower, by 0.1ppt to 2.8%Y/Y. Tomorrow will also bring euro area construction output figures for July. Following a notable rebound in June (1.7%M/M), these are expected to report more moderate growth at the start of Q3 – in line with modest increases in Germany (0.3%M/M) and France (0.4%M/M) – albeit still leaving activity at its highest level in more than a year.

UK




The day ahead in the UK

After a quiet start to the week for top-tier UK releases and ahead of the BoE's monetary policy announcement on Thursday, the data focus tomorrow will be August's CPI report. Headline inflation is expected to move sideways at 2.2%Y/Y – 0.2ppt below the BoE's projection – thanks in part to lower petrol prices. But having declined to a near-three-year low in July (3.3%Y/Y), core inflation is expected to have jumped back as the services component rebounds, due in part to pay-back for the temporary decline in typically volatile components in July. Admittedly, our forecast assumes that services inflation will remain below the MPC's projection of 5.8%Y/Y. While we expect the MPC to keep Bank Rate unchanged on Thursday, if tomorrow's report delivers a significant downside surprise, we do not rule out a majority voting for a further 25bps cut this week.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany 	ZEW investor survey – current situations (expectations) balance %	Sep	-84.5 (3.6)	-80.0 (17.0)	-77.3 (19.2)	-
Auctions						
Country	Auction					
UK 	sold £2.25bn of 4.375% 2054 bonds at an average yield of 4.329%					






Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area 	Labour costs Y/Y%	Q2	4.7	-	5.1	5.0
	Trade balance €bn	Jul	15.5	15.0	17.5	17.0
Italy 	Final HICP (CPI) Y/Y%	Aug	1.2 (1.1)	1.3 (1.1)	1.6 (1.3)	-
	Trade balance €bn	Jul	6.7	-	5.1	5.2
UK 	Rightmove house prices M/M% (Y/Y%)	Sep	0.8 (1.2)	-	-1.5 (0.8)	-
Auctions						
Country	Auction					
- Nothing to report -						




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area 	10.00	Final HICP (core HICP) Y/Y%	Aug	<u>2.2 (2.8)</u>	2.6 (2.9)
	10.00	Construction output M/M% (Y/Y%)	Jul	-	1.7 (1.0)
UK 	07.00	CPI (core CPI) Y/Y%	Aug	<u>2.2 (3.7)</u>	2.2 (3.3)
	07.00	PPI – output (input) prices Y/Y%	Aug	0.5 (-0.8)	0.8 (0.4)
	09.30	House price index Y/Y%	Jul	-	2.7

Auctions and events

Germany 	10.30	Auction: to sell €1bn of 1.8% 2053 bonds			
	10.30	Auction: to sell €1bn of 2.5% 2054 bonds			
UK 	10.00	Auction: to sell £2.75bn of 0.875% 2033 bonds			

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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