

Euro wrap-up

Overview

- Ahead of the outcome of this evening's French confidence vote and despite an upside surprise to German industrial production, Bunds followed the global trend higher.
- Gilts also made modest gains on a quiet day for UK economic news.
- Tuesday will bring French industrial production figures for July and a UK retail sales survey for August.

Emily Nicol

+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.917	-0.008
OBL 2.2 10/30	2.202	-0.015
DBR 2.6 08/35	2.638	-0.022
UKT 3¾ 03/27	3.892	-0.010
UKT 4¾ 03/30	4.018	-0.026
UKT 4½ 03/35	4.604	-0.039

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

Source: Bloomberg

Euro area

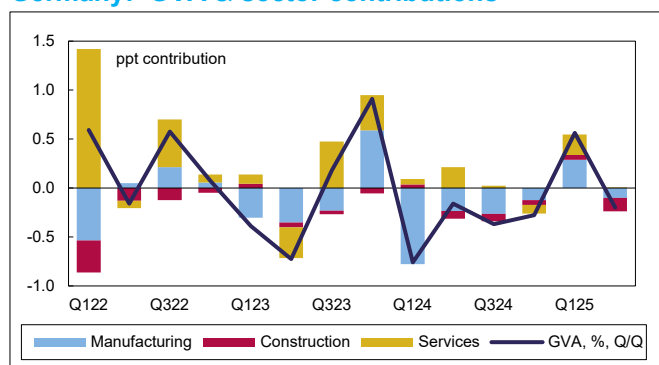
German IP surprises to the upside, raising expectations that manufacturing will boost Q3 GDP

While manufacturers led the contraction in German GDP in Q2 as payback for front-running of US tariffs in the first quarter, today's industrial production figures were more positive, suggesting that the sector started the summer on the front foot. In particular, output rose for a first month in four in July, by 1.3%M/M. When excluding energy production – which fell for a sixth month out of seven and by a non-negligible 4.5%M/M – manufacturing output jumped a firmer 2.2%M/M. Furthermore, with the steep decline initially estimated for manufacturing output in June (-2.7%M/M) largely revised away due to additional reporting from the autos sector, the level rose close to March's recent peak to be up 2.4%Y/Y, the first positive annual rate since May 2023. So, not only does today's release raise expectations that German GDP growth has returned to positive territory this quarter, but it also flags a significant possibility that the contraction in Q2 GDP (-0.3%Q/Q) was smaller than previously estimated. Meanwhile, the revision to autos production in June, combined with a second-successive monthly increase in July (2.3%M/M), drove the level in that subsector to an 11-month high 5½% above the Q2 average. A marked rebound in machinery and equipment left that subsector at a 17-month high and some 7½% above the Q2 average. And while it remained more than 10% below the pre-tariff surge in March, the level of output from the pharmaceutical subsector was also almost 5% higher than in Q2. In contrast, energy-intensive production remained subdued into the summer. Indeed, due to persistent weakness in chemicals and precious metals, overall energy-intensive output rose just 0.4%M/M in July, leaving the level still almost 1% below the Q2 average. And with industrial gas usage in August the lowest since the Russian invasion of Ukraine, we suspect that production from these subsectors remained soft last month.

Surveys point to ongoing manufacturing growth, but orders remain subdued

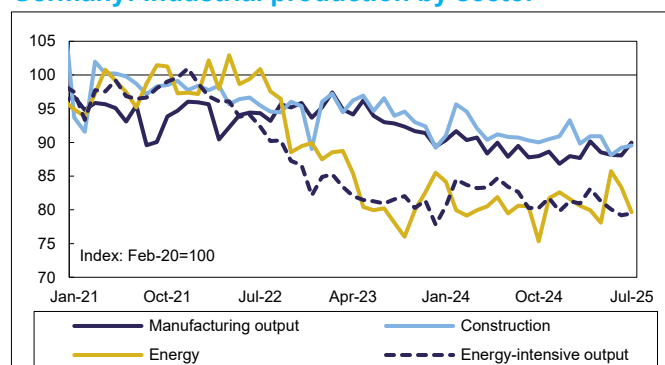
Overall, surveys point to ongoing growth in manufacturing in August, with the sector's output PMI signalling the strongest growth since Russia's invasion of Ukraine. The ifo survey also suggested that firms were relatively upbeat about the coming six months amid signs of recovery in underlying domestic demand. Manufacturing order backlogs have also trended to the highest in almost two years. But order backlogs of motor vehicles and machinery have been run down over recent months. And while core factory orders rose slightly at the start of Q3, total new orders fell sharply in July (-2.5%M/M). While the weakness in part reflects diminishing new orders from beyond the euro area, domestic orders also fell to the bottom of the range since the first Covid-19 lockdown, raising doubts about the near-term path of manufacturing output. This notwithstanding, the government's tax incentives scheme should reinforce crowding-in of private capex from increased public spending on infrastructure and defence, supporting a more meaningful recovery in the sector towards the end of the year and into 2026.

Germany: GVA & sector contributions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industrial production by sector

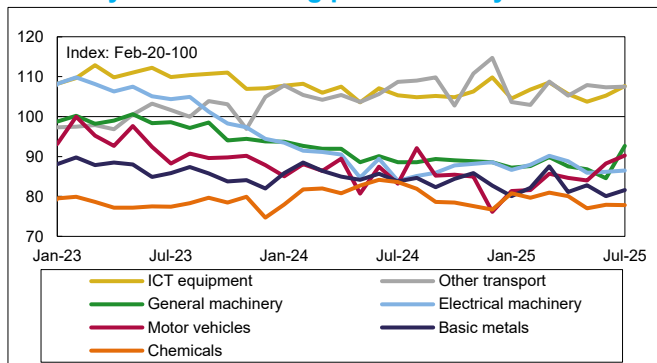


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

German exports fall as shipments to the US continue to slump

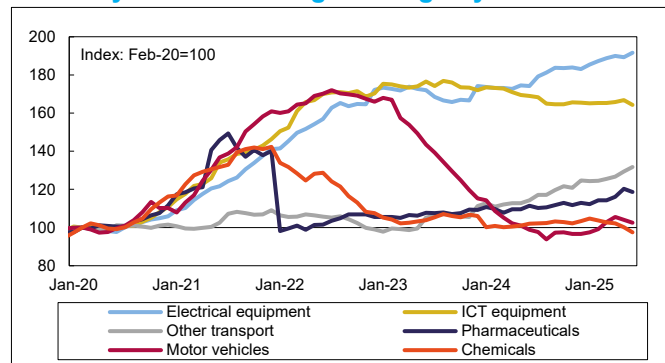
Of course, a significant near-term risk to Germany's manufacturing outlook relates to global trade. And while the tentative EU-US trade deal might in due course provide some reassurance, today's goods trade figures illustrated the negative impact of continued tariff-related uncertainty at the start of Q3. The seasonally-adjusted surplus slipped to a nine-month low in July (€14.8bn), as the value of exports fell for a third month out of the past four (-0.6%M/M). Admittedly, the decline in exports was limited by a further pickup in shipments to elsewhere within the EU, with exports to the euro area up more than 7%Y/Y to the highest since the start of 2023. In marked contrast, shipments to countries beyond the EU fell sharply (-4.5%M/M) to the lowest level since March 2022. Much of this weakness related to a decline in demand from the US, where exports fell for a fourth consecutive month (-7.9%M/M), leaving them down 14%Y/Y and at the lowest level since December 2021. Meanwhile, exports to China slumped to their lowest level for almost nine years, reflecting the continued downtrend in shipments of autos and machinery equipment, presumably due to both soft demand and increasingly intense competition. Despite a modest decline in exports to the UK in July, the recent uptrend left the level still more than 5% above the Q2 average. And total export values moved broadly sideways compared with the Q2 average. Nevertheless, with imports tracking more than 1% higher than in Q2, today's release suggests that net trade will be a drag on GDP growth this quarter, just as it was in Q2.

Germany: Manufacturing production by subsector



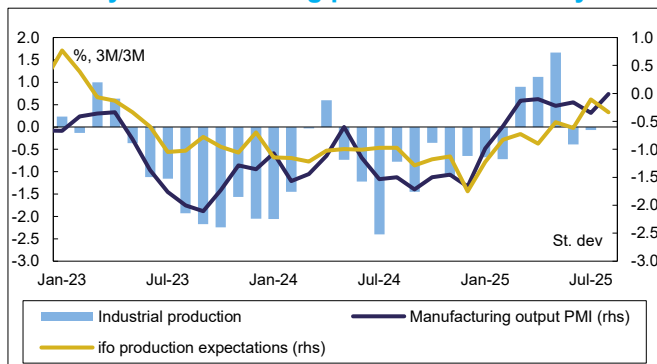
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing backlogs by subsector



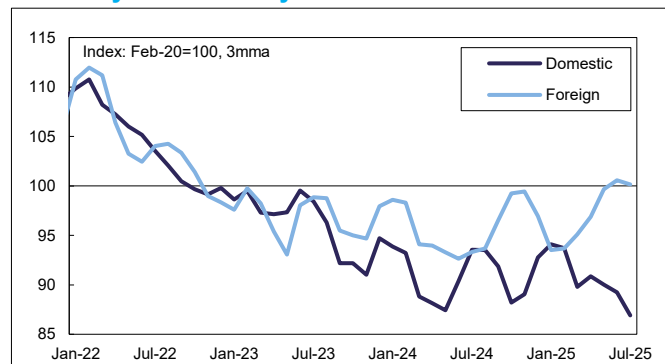
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing production & surveys



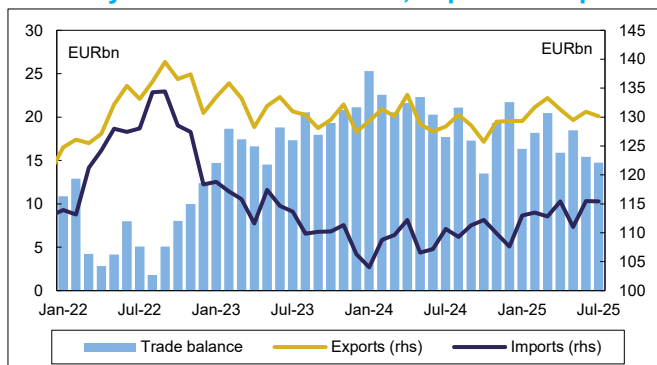
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: New factory orders



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

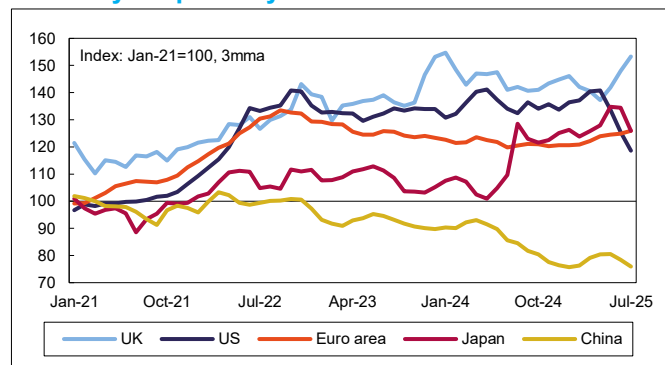
Germany: Goods trade balance, exports & imports*



*Seasonally adjusted values.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Exports by destination*



*Seasonally adjusted values.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

Attention tomorrow will be firmly on the euro area's second largest member state, as markets digest the outcome of this evening's confidence vote in Prime Minister Bayrou's government. At the time of writing, we strongly suspect that Bayrou will lose this vote, leading to a collapse in his government, putting Macron in the unenviable position of finding a fifth Prime Minister in two years, and illustrating the likelihood of prolonged policy paralysis. Persisting political uncertainty will heighten uncertainty and likely continue to weigh on the near-term economic outlook. In terms of tomorrow's dataflow, the only release of note will be French industrial production figures for July. Given the surge in June (3.8%M/M), production seems bound to fall back in July – the Bloomberg survey consensus is for a drop of 1½%M/M.

The day ahead in the UK

After a quiet start to the week, Tuesday's sole data release in the UK will come from the BRC's survey of retail sales in August. While July's official ONS retail sales figures were a touch stronger than expectations, they remained broadly consistent with the message from the BRC survey. So, with August's official retail sales release due next week, tomorrow's survey will provide a guide as to the outcome of that release and the prospects for another positive contribution from the sector to quarterly GDP growth.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Sentix investor confidence indicator	Sep	-9.2	-2.0	-3.7	-
Germany	 Industrial production M/M% (Y/Y%)	Jul	1.3 (1.5)	1.0 (-0.3)	-1.9 (-3.6)	-0.1 (-1.8)
	 Trade balance €bn	Jul	14.7	15.5	14.9	15.4

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
France	 07.45	Industrial production M/M% (Y/Y%)	Jul	-1.4 (0.7)	3.8 (2.0)
UK	 00.01	BRC retail monitor – like-for-like sales Y/Y%	Aug	2.0	1.8

Auctions and events

Germany	 10.30	Auction: to sell €500m of 0% 2031 green bonds			
	 10.30	Auction: to sell €1bn of 2.5% 2035 green bonds			
	 12.30	Bundesbank President Nagel to give speech on 'future-proofing central banks' at BIS Innovation Summit, Basel			
France/UK	 16.15	BdF Governor Villeroy in fireside chat moderated by BoE Deputy Governor Breeden at BIS Innovation Summit, Basel			
UK	 10.00	Auction: to sell £1.75bn of 4.75% 2043 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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