Daiwa Capital Markets

Euro wrap-up

Overview

Emily Nicol
+44 20 7597 8331

- Bunds were little changed while OAT spreads remained wide as German factory orders data disappointed on weak demand from outside the euro area.
- Gilts were also little changed on a quiet day for economic news from the UK.
- Wednesday will bring German industrial production data for August.

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.998	-0.002
OBL 2.2 10/30	2.294	-0.008
DBR 2.6 08/35	2.710	-0.007
UKT 3¾ 03/27	3.979	-0.004
UKT 4⅜ 03/30	4.145	-0.006
UKT 4½ 03/35	4.725	-0.009

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

Euro area

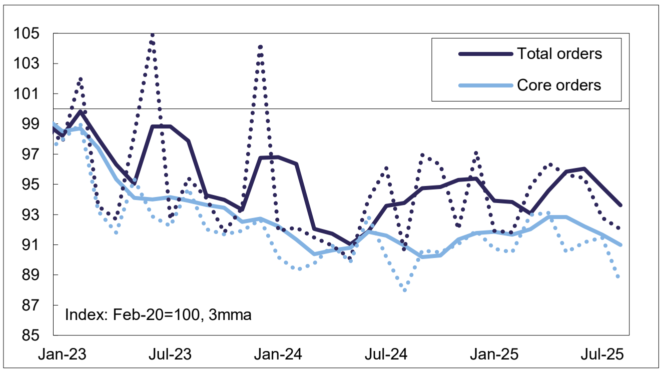
German factory orders disappoint as demand from overseas slumps

After a rebound in German new orders in Q2 – when their growth of 3.2%Q/Q was the firmest in four years – surveys had signalled a further improvement in manufacturing conditions over the summer, raising some hopes of a more sustained recovery in demand in the sector. But today's factory orders data disappointed, suggesting that the production outlook remains subdued. In particular, total new orders in August fell for a fourth consecutive month, by 0.8%M/M, to a six-month low. And when excluding major items, core orders dropped a more striking 3.3%M/M, to a 12-month low. As such, in the first two months of Q3, total new orders were trending more than 3½% below the Q2 average, with core orders almost 2% lower. Given the significant front-running of US tariffs by firms earlier in the year, the weakness continues to be driven by foreign demand. Indeed, new orders from outside of the euro area fell for a second successive month in August, and by a cumulative 12½%. And core orders from outside of the euro area fell to the lowest level for more than 12 years when the first Covid-19 lockdown period is excluded. But domestic orders were also trending some 1% below the Q2 average despite a pickup in August to a four-month high.

Orders for autos and pharmaceuticals hit by tariffs and competition

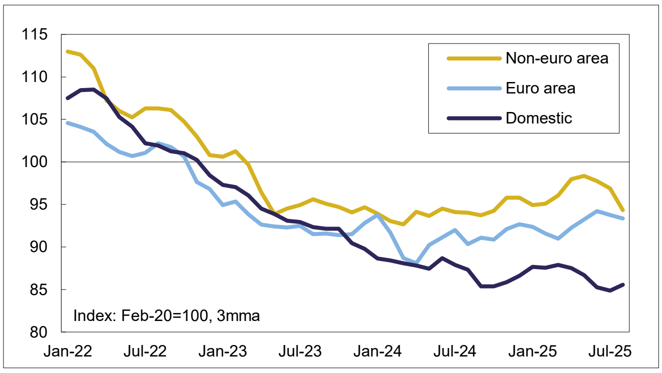
In addition to facing up to higher US tariffs, German car manufacturers continue to suffer from increased international competition, including from Chinese EV models. And the weakness in new orders in August was principally driven by new demand for autos, which dropped 9.0%M/M to a six-month low to be tracking some 2% below the Q2 average. Despite a partial rebound in orders of other transport equipment – notably in the aerospace subsector – that component was trending a whopping 40% below the Q2 level that had been boosted by a major ship order. Orders of electrical machinery also looked set to be a non-negligible drag in Q3 despite a pickup in August. And reflecting payback for a jump in July, pharmaceutical orders slumped to a nine-month low over the summer. Admittedly, the uptrend in order backlogs in the pharmaceutical, electrical and other transport equipment subsectors should provide some support to the near-term production trend. Surveys, however, have provided mixed signals for September. Indeed, while the manufacturing output PMI implied the strongest production growth for 3½ years, the ifo indices pointed to the steepest drop in output for three months and the biggest fall in new orders since January. Truck toll mileage – often a proxy for production – also appears to have moderated for a fourth month out of the past five. In terms of the outturn for August – for which data are due to be published tomorrow – we expect some payback for the bounce in July (1.3%M/M). The Bloomberg survey consensus is for a drop of 1.0%M/M, which is consistent with today's manufacturing turnover data, which recorded a fourth decline (-0.7%M/M) out of the past five. Furthermore, the recent profile for manufacturing turnover raises risks of a downward revision to July's production growth estimate (2.2%M/M), which may well leave output trending no better than sideways so far in Q3.

Germany: New factory orders*



Core orders exclude bulk items.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: New core factory orders*



**Excludes bulk items.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

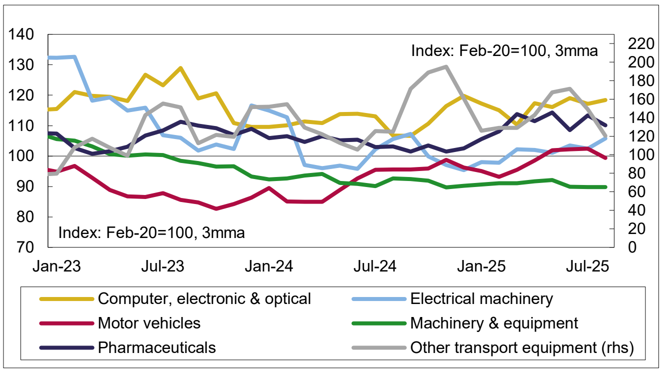
The day ahead in the euro area

Aside from the aforementioned release of the August German IP data, Wednesday's headlines are bound to revolve around French politics ahead of the evening deadline set by President Macron for his reluctant Prime Minister Lecornu to negotiate a governable platform. As noted in yesterday's Euro wrap-up, the likelihood of those talks yielding a positive outcome appears to remain slim. And the odds of a successful technocratic appointment appear just as weak, all of which would serve to boost the chances of fresh legislative elections and, in the probable scenario of another divided Assembly, that the current budget will be temporarily rolled over into 2026. While the consensus remains that a premature resignation by Macron would be unlikely, today's interjection by his ally and former PM Edouard Philippe – as the centrist candidate currently projected as the most likely to run-off against Bardella (or Le Pen) for President in 2027 – calling on Macron to announce an "early presidential election" once the budget has passed, provides a notable development.

The day ahead in the UK

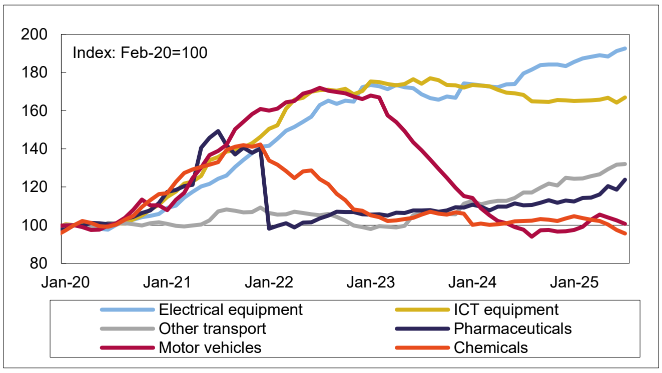
It should be another quiet day in terms of UK economic data. The highlight otherwise will be Wednesday evening's speech from BoE Chief Economist Huw Pill, who is currently in the minority of MPC members to have not commented on monetary policy in recent weeks. But given his consistent votes for a 'cautious' pause to rate cuts since February's meeting and stated concerns about inflation persistence, his speech will be predictably hawkish and thus should not markedly change assessments about the balance of opinions on the MPC.

Germany: Manufacturing orders by sector



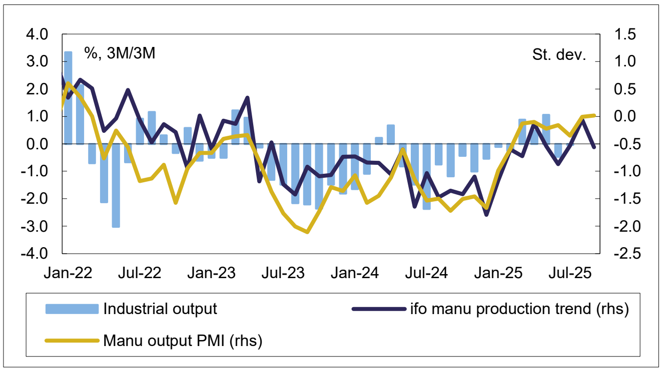
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing order backlogs



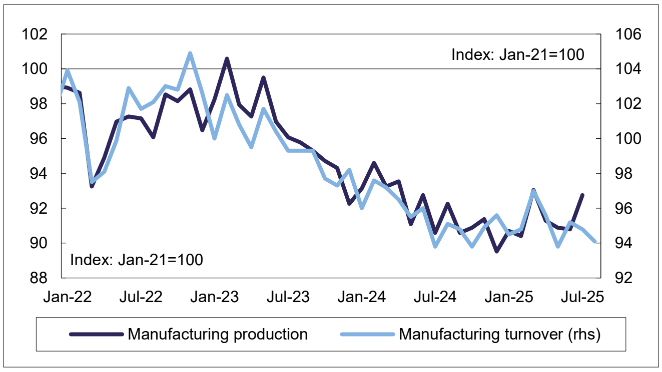
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing output & survey indices



Source: S&P Globlal, ifo institute, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing output & turnover



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Factory orders M/M% (Y/Y%)	Aug	**-0.8 (1.5)**	1.4 (3.0)	-2.9 (-3.4)	-2.7 (-3.3)
France	Trade balance €bn	Aug	**-5.5**	-	-5.6	-5.7

Auctions

Country	Auction
Germany	sold €3.405bn of 2.2% 2030 bonds at an average yield of 2.31%
UK	sold £1.25bn of 0.125% 2028 bonds at an average yield of 3.783%

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	-1.0 (-0.9)	1.3 (1.5)

Auctions and events

Germany	10.30	Auction: to sell up to €1bn of 2.6% 2041 bonds
	10.30	Auction: to sell up to €1bn of 3.25% 2042 bonds
UK	10.00	Auction: to sell £5bn of 4% 2029 bonds
	16.00	BoE Chief Economist Pill to give speech at the University of Birmingham

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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