Euro wrap-up

Overview

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- Bunds made gains as a weak showing from German factory orders data preceded the significant downside surprise in the US non-manufacturing ISM.
- Gilts similarly gained after a weaker UK retail sales survey.
- Tomorrow brings July industrial production data from Germany and the UK. Attention will also be on Carney's testimony before the Treasury Select Committee.

Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.666	-0.024
OBL 0 10/21	-0.551	-0.041
DBR 0 08/26	-0.102	-0.054
UKT 1¼ 07/18	0.098	-0.039
UKT 3¾ 09/21	0.194	-0.058
UKT 1½ 07/26	0.666	-0.053

*Change from close as at 4.30pm BST.
Source: Bloomberg

Euro area

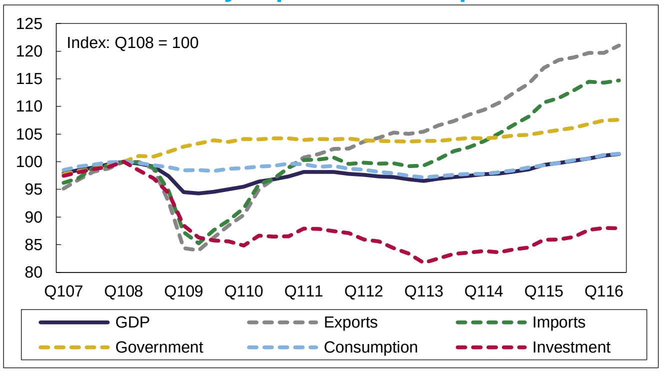
Euro area GDP growth confirmed at 0.3%Q/Q

Today's revised euro area GDP figures for Q216 aligned with expectations, confirming that growth slowed to 0.3%Q/Q, the softest pace for two years. And while growth was downwardly revised in Q1, by 0.1ppt to 0.5%Q/Q, this still left the year-on-year rate unrevised at 1.6%. The first official expenditure breakdown unveiled nothing overly surprising either. As was the case in Germany, GDP growth in the euro area was overwhelming supported by net trade in the second quarter, with exports rising more than 1%Q/Q to contribute ½ppt to quarterly growth, while imports were up less than ½%Q/Q as domestic demand slowed notably. Private consumption growth was down by 0.4ppt to just 0.2%Q/Q, the weakest since the start of 2014, while government spending growth of 0.1%Q/Q was the softest in six quarters, admittedly from an upwardly revised increase of 0.6%Q/Q previously. And private sector capex was unchanged over the quarter, albeit having been expected to decline. So, domestic demand just about continued to contribute positively to growth for the thirteenth consecutive quarter. Indeed, in the absence of the drag from private sector inventories (0.2ppt), the euro area economy would have expanded at a rate just above the average of the recovery to-date. And having subtracted from growth for the second successive quarter, stock-building seems less likely to act as a drag over coming quarters. Similarly, and more importantly, with yesterday's retail sales figures for July having surprised on the upside, consumption in the third quarter should also provide more support than in Q2. Overall, therefore, we continue to expect GDP growth in Q3 to be close to the rate of last quarter.

German factory orders remain subdued

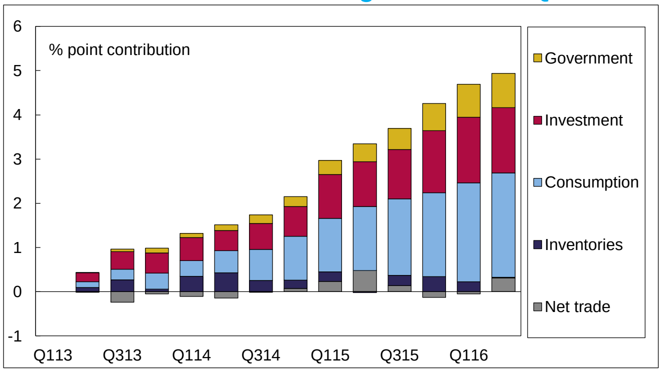
While we think that euro area GDP growth has been relatively well maintained in the third quarter, recent economic data have hinted at a loss of momentum in Germany, with a softer Ifo survey followed yesterday by a significant downwards revision in the services PMI in August to a three-year low of 51.7 and the respective new business index also revised down to the lowest in more than one year. And today's German factory orders figures were disappointing too, with a rise of just 0.2%M/M in July insufficient to reverse the weakness the previous month as increased demand from overseas was insufficient to offset the drop of 3%M/M in domestic orders. Looking through recent monthly volatility, the trend is negative, with orders below their level a year earlier in three of the past four months and down almost ½%3M/3M in July weighed by domestic orders for consumer, capital and intermediate goods alike. Not least with employment at a post-reunification high and wage growth set to pick up, we continue to expect this soft patch in the German dataflow to be temporary and – particularly following a strong start to the quarter for retail sales (up more than 1½%M/M) – expect GDP growth in Q3 broadly to match the 0.4%Q/Q rate of Q2. But we'll certainly be watching the incoming dataflow closely.

Euro area: GDP by expenditure component



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Cumulative GDP growth since Q113



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area and US

Focus in the euro area tomorrow will remain the German manufacturing sector, with the latest IP numbers for July due. Not least given the recent weakness in factory orders, these are expected to show that output remained subdued to rise just 0.1%M/M at the start of Q3, which would leave it broadly unchanged from its level one year earlier. French trade and current account data for the same month are also due. Supply-wise, Germany will sell 10Y Bunds. In the US, Wednesday brings the latest JOLTS job openings figures for July, as well as the Fed's latest Beige Book.

UK

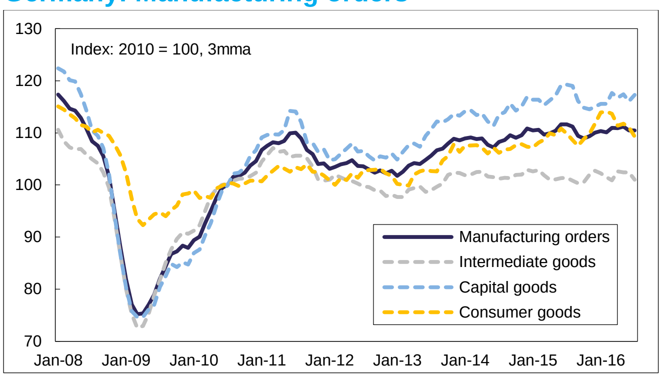
A weaker retail survey

While yesterday's services PMI tallied with the equivalent surveys for manufacturing and construction to point to a notable rebound in economic activity in August, taken together with the exceptionally weak July figures, stable PMIs in September would still be consistent with a notable slowdown in UK GDP growth (but no recession) in the third quarter. The retail sector, however, is notable by its absence from the coverage of the PMIs. And the latest survey in that respect – the BRC's retail sector monitor published today – was disappointing. In particular, this suggested that the value of total sales fell 0.3%Y/Y in August, the weakest performance since September 2014 (when excluding Easter distortions), following an increase of 1.9%Y/Y in July. And the decline in the value of like-for-like sales was even steeper at -0.9%Y/Y in August from 1.1%Y/Y the previous month to leave them trending lower, down 0.2%3M/3M. Within the detail, total food sales were up 0.9%3M/Y, the strongest rate since 2013 thanks not least to the warmer weather. In contrast, non-food sales rose just 0.4%3M/Y, compared with the average rate of 1.9% of the past twelve months. And while some of the weakness in High Street sales in August was speculatively attributed by the BRC to the distraction of the Olympics, it remains to be seen whether – against the backdrop of still subdued consumer sentiment and uncertainty about the nature and impact of the Government's response to the Brexit vote – consumers will step up their spending over coming months. Certainly, we expect private consumption growth to have slowed significantly in the third quarter from the 0.9%Q/Q rate of Q2, albeit still likely remaining in positive territory.

The day ahead in the UK

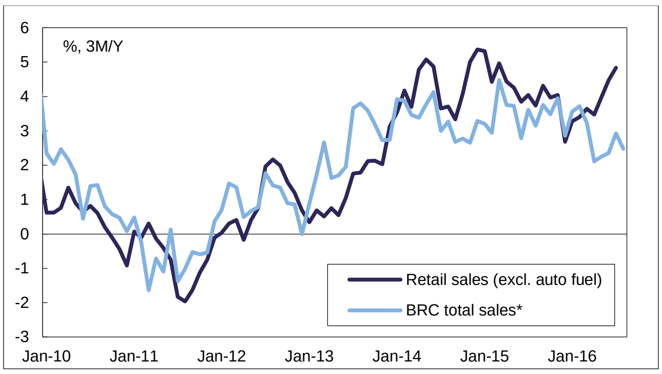
Tomorrow brings several events of note, including the first of this week's hard economic indicators – July's industrial production figures. While the manufacturing output PMI was firmly in contraction territory that month at its lowest level since October 2012, market consensus is for only a modest drop in industrial output in the first month following the referendum to leave it still almost 2% higher compared with a year earlier. Beyond the economic data, attention will also be on the testimony of Mark Carney and other MPC members on the BoE's August Inflation Report. This is likely to be a feisty affair, with the Brexiteer members of the Committee likely to be on the attack again following the recent PMI surveys. But Carney will stick to his guns - the forecast presented last month did not foresee recession and, indeed, was predicated on a slowdown driven by weaker investment. To the extent that no data on investment have been seen since the referendum vote, the recent volatility in various sentiment surveys should not (yet) have materially altered the MPC's overall assessment of the future path for growth.

Germany: Manufacturing orders



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Retail sales



**Adjusted using BRC-Nielsen shop price index.*
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results							
Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
EMU		GDP – second estimate Q/Q% (Y/Y%)	Q2	**0.3 (1.6)**	*0.3 (1.6)*	0.6 (1.7)	**0.5 (-)**
Germany		Factory orders M/M% (Y/Y%)	Jul	**0.2 (-0.7)**	0.5 (-0.2)	-0.4 (-3.1)	**-0.3 (-3.0)**
UK		BRC sales like-for-like Y/Y%	Aug	**-0.9**	1.4	1.1	**-**
Auctions							
Country		Auction					
Germany sold		€0.4bn of 0.1% 2026 index-linked bonds (15-Apr-2026) at an average yield of -1.00%					
UK sold		£2.5bn of 1.5% 2026 bonds (22-Jul-2026) at an average yield of 0.685%					
		BoE APF operation: £1.17bn of 15Y+ Gilts purchased (4.14 cover ratio)					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases						
Economic data						
Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		07:00	Industrial production M/M% (Y/Y%)	Jul	0.1 (0.2)	0.8 (0.5)
France		07:45	Trade balance €bn	Jul	-3.6	-3.4
		07:45	Current account balance €bn	Jul	-	-0.6
UK		08:30	Halifax house price index M/M% (3M/Y%)	Aug	-0.1 (7.0)	-1.0 (8.4)
		09:30	Industrial production M/M% (Y/Y%)	Jul	-0.2 (1.9)	0.1 (1.6)
		09:30	Manufacturing production M/M% (Y/Y%)	Jul	-0.3 (1.7)	-0.3 (0.9)
		15:00	NIESR GDP 3M/3M%	Aug	-	0.3
Auctions and events						
Country		BST	Auction / Event			
Germany		10:30	Auction: To sell €5bn of 2026 zero-coupon bonds (15-Aug-2026)			
UK		14:15	BoE's Carney, Cunliffe, Forbes and McCafferty are scheduled to testify before the Treasury Select Committee in London			
		14.50	BoE APF operation: To purchase 7-15Y Gilts			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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