Euro wrap-up

Overview

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- Bunds made significant losses despite some weak figures for German trade and French manufacturing output.
- Gilts made significant losses as UK construction data beat expectations and the latest UK trade report showed a narrowing of the deficit.
- The coming week brings a BoE monetary policy meeting as well as data for UK inflation, retail sales and unemployment and euro area inflation, IP and labour costs.

Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.631	+0.016
OBL 0 10/21	-0.482	+0.041
DBR 0 08/26	0.016	+0.077
UKT 1¼ 07/18	0.182	+0.043
UKT 3¾ 09/21	0.311	+0.064
UKT 1½ 07/26	0.867	+0.108

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

Euro area

A weak start to Q3 for German exporters…

Following yesterday's ECB policy announcements today's most notable economic data illustrated why euro area GDP growth in the third quarter is unlikely to be significantly firmer than the 0.3%Q/Q rate in Q2. Most strikingly, German exporters had a much weaker-than-expected July, with the value of exports falling more than 2½%M/M, the most in eleven months. That left them down more than 3½% on a three-month basis and 10% lower than a year earlier, the steepest year-on-year decline since 2009. With the value of imports down 0.7%M/M and 6½%Y/Y, the trade surplus fell to its lowest level since January, albeit at €19.5bn still exceptionally high by historical standards. The weak export figures tally with the drop of more than 2½%M/M in manufacturing output in July, and so, not least given the softening of business sentiment reported in August, heightened attention should be paid to risks of a sudden loss of momentum. However, we suspect that the weakness is exaggerated by flawed adjustment for calendar effects and strongly expect to see a rebound in both production and exports in August. Moreover, the exceptionally strong performance of retail sales in July (up 1.7%M/M) suggests activity on the High Street will adequately compensate for a weaker quarter in the factories and ensure that German GDP growth is relatively well maintained in the third quarter.

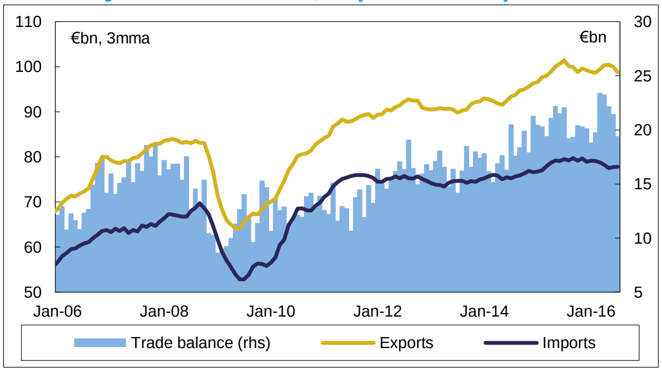
…and French manufacturers too

The weak start to the third quarter in the manufacturing sector was not confined to Germany. Contrasting with expectations of a modest increase, French industrial production fell for the third successive month and by 0.6%M/M in July to leave output just below its level a year earlier. With the exception of construction output (up almost 5%M/M), the weakness was widespread with, most notably, manufacturing output down for the second successive month, by 0.3%M/M weighed by falling output of consumer durables and capital goods. Nevertheless, the improvement reported in yesterday's Bank of France business survey suggests that the lost ground in July might yet be recouped in the following two months to prevent a third successive quarterly drop in manufacturing production in Q3.

The week ahead in the euro area and US

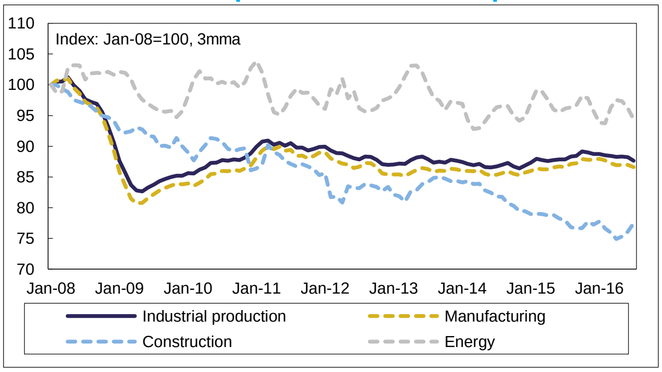
The coming week in the euro area should be far less eventful for economic news, with no show-stopping data seemingly in the offing. After a quiet Monday free of top-tier data, Tuesday brings the September German ZEW survey of financial market participants along with the final German and Spanish inflation figures for August, euro area employment figures for Q2 and Italian IP numbers for July. The equivalent euro area IP figures, which now seem bound to post a drop for the second month

Germany: Trade balance, export and import values*



*Goods only. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

France: Industrial production and components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

out of the past three, are due on Wednesday along with final French and Italian CPI numbers for August. The final euro area inflation figures for August – for which the flash estimates saw headline CPI stuck at 0.2%Y/Y and the main core measure drop 0.1ppt to 0.8%Y/Y – are due the following day along with new car registration numbers for the same month and the July euro area trade report. And most notable at the end of the week will be Q2 euro area labour cost data, which following the weak German figures seem likely to show a moderation from recent rates implying a continued absence of pressures in the price pipeline. In the bond markets, Italy will sell a range of bonds on Tuesday, Germany will sell 30Y Bunds on Wednesday and France will sell a range of bonds on Thursday.

In the US, it should also be a quiet start to the coming week too with just the Federal budget statement and import price data due in the first half. The data flow picks up on Thursday with arguably the most noteworthy releases being August's industrial production and retail sales figures. Expectations are for a modest increase in retail sales (0.3%M/M) which would reverse the decline seen at the start of Q3, while IP is forecast to have posted a modest decline (0.2%M/M) for the first month in three. Thursday also brings September's Empire Manufacturing and Philly Fed indices, and Q2 current account and August PPI data. These will be followed on Friday by August CPI figures – a modest increase in prices on the month is expected to see the annual rates of headline and core inflation rise back to June's multi-month highs of 1.0%Y/Y and 2.3%Y/Y respectively. The preliminary University of Michigan consumer sentiment survey for September will also be worth watching. Supply-wise, the Treasury will sell 3Y and 10Y notes on Monday and 30Y bonds on Tuesday.

UK

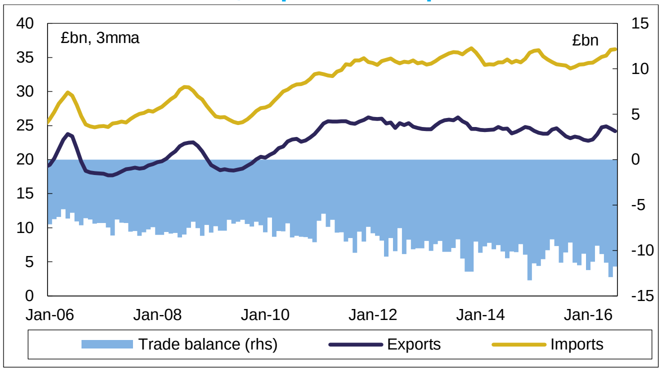
Trade balance starting to turn gradually for the better

In contrast to Germany, a firmer start to the third quarter for exporters saw the UK's headline deficit on trade in goods and services narrow in July by £1.1bn to £4.5bn. The improvement was due largely to a near-2%M/M increase in the total value of exports thanks to an increase of almost 3½%M/M in exports of goods, with a jump in shipments of oil – tallying with the sharp increase in oil and gas output that month – making the largest contribution. Lower imports (down ½%M/M) also made a contribution to the drop in the headline deficit. However, trade data are notoriously volatile. And with the better performance in July coming after a period of particular weakness, on a three-month basis the figures were not pretty, with the headline deficit jumping to its highest level since 2013, reflecting both weaker exports and stronger imports. On an underlying basis, adjusting for changes in prices and excluding oil and erratic items, the volume of goods exports fell marginally in July while the volume of goods imports fell almost 4%M/M to suggest a positive contribution to economic growth from net trade, albeit one emanating from subdued domestic demand rather than enhanced competitiveness. And on a three-month basis the drop in the volume of exports (almost 6½%3M/3M) far outweighed that of imports (a touch over 1½%3M/3M) flagging persistent weakness. Of course, the depreciation of sterling – roughly 10% since the referendum – should serve to support exports and restrain imports further over coming months. And with weaker domestic demand also set to weigh on imports, the trade deficit should continue to narrow. However, sterling weakness will not be a boon for every export sector, with import intensity and participation in global supply chains a complication for manufacturers, and services, where the UK runs a large surplus, also likely to be relatively less responsive. So, we expect net trade to provide moderate, rather than particularly substantive, support to GDP growth over coming quarters.

Construction sector adds to run of improved data

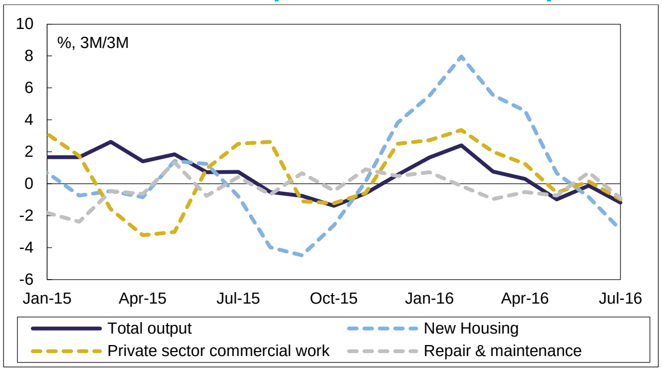
On the whole, while they certainly suggest that GDP growth has weakened, recent UK economic data have beaten expectations. And the latest construction sector figures maintained that trend. Contrary to expectations of a third consecutive monthly contraction, construction output was flat in July, as an increase in new infrastructure and other public sector work offset declines in new housing, industrial and commercial activity and repair and maintenance. In addition, revisions to recent

UK: Trade balance, export and import values*



Goods and services. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Construction output and selected components



Source: ONS, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

data showed that output in the sector in the second quarter was not as soft as previously thought, down 0.1%Q/Q compared to an earlier estimate of a drop of 0.7%Q/Q, albeit a change that will have no discernible impact on GDP growth. Nevertheless, looking through the recent volatility, the underlying trend remains weak, with construction output down in July by 1.2%3M/3M, the weakest in ten months. Looking ahead, despite some improved sentiment surveys and a likely increase in public sector investment to be announced in the Chancellor's Autumn Statement on 23 November, we expect activity in the sector to remain subdued as Brexit-related uncertainty weighs on both residential and commercial activity.

The week ahead in the UK

The coming week brings the latest BoE monetary policy announcement (on Thursday) along with a number of top-tier UK data releases that should provide further insights into economic conditions in the aftermath of the referendum. From a policy perspective, the MPC meeting seems bound to be a non-event with no changes imaginable following the significant package of measures unveiled last month. But not least given Carney's comments to the Treasury Select Committee this week, the MPC might be expected to acknowledge that economic activity appears to have been slightly firmer than it anticipated then, albeit with significant uncertainties about the outlook persisting. Meanwhile, we expect the August inflation figures (due Tuesday) to show headline CPI inching up 0.1ppt to a twenty-one-month high of 0.7%Y/Y, with the core measure also rising 0.1ppt to 1.4%Y/Y. The official ONS house price figures for July are due the same day. Meanwhile, the latest labour market data (Wednesday) are expected to show the unemployment rate flat on a three-month basis in July at an eleven-year low of 4.9%, and the claimant count rate also flat in August at 2.2%, but also average labour earnings growth moderating in July following an uptick the previous month. Finally, following a strong July, retail sales numbers (Thursday) look set to post a decline in August, although the annual rate of growth is expected to remain vigorous above 5%Y/Y. In the bond markets, the DMO will sell 30Y inflation-linked bonds on Wednesday.

The next edition of Euro wrap-up will be published on 13 September 2016.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
Germany	Trade balance €bn	Jul	**19.5**	23.7	24.7	**-**
	Current account balance €bn	Jul	**18.6**	24.5	26.3	**-**
	Imports (exports) M/M%	Jul	**-0.7 (-2.6)**	0.5 (0.4)	1.1 (0.2)	**1.1 (0.2)**
France	Industrial production M/M% (Y/Y%)	Jul	**-0.6 (-0.1)**	0.3 (1.0)	-0.8 (-1.3)	**-0.7 (-1.1)**
	Manufacturing production M/M% (Y/Y%)	Jul	**-0.3 (0.4)**	0.7 (1.8)	-1.2 (-1.5)	**-1.1 (-1.2)**
Spain	Industrial production M/M% (Y/Y%)	Jul	**0.2 (0.3)**	0.1 (0.4)	0.2 (0.8)	**-**
UK	Visible trade balance £bn	Jul	**11.8**	-11.7	-12.4	**-12.9**
	Total trade balance £bn	Jul	**4.5**	-4.2	-5.1	**-5.6**
	Construction output M/M% (Y/Y%)	Jul	**0.0 (-1.5)**	-0.5 (-3.4)	-0.9 (-2.2)	**-1.0 (-0.7)**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

Key data releases

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
		Monday 12 September 2016			
EMU	14:45	ECB QE net purchases €bn	Weekly	*12.0*	11.1
		Tuesday 13 September 2016			
EMU	10:00	Employment Q/Q% (Y/Y%)	Q2	-	0.3 (1.4)
	10.00	ZEW expectations balance	Sep	-	4.6
Germany	07:00	Final EU-harmonised CPI Y/Y%	Aug	*0.3*	0.4
	10:00	ZEW current assessment balance (expectations)	Sep	56.0 (2.5)	57.6 (0.5)
Italy	09:00	Industrial production M/M% (Y/Y%)	Jul	0.2 (-1.0)	-0.4 (-1.0)
Spain	08:00	Final EU-harmonised CPI Y/Y%	Aug	*-0.3*	-0.7
UK	09:30	CPI (core CPI) Y/Y%	Aug	*0.7 (1.4)*	0.6 (1.3)
	09.30	PPI input (output) price inflation Y/Y%	Aug	8.1 (1.0)	4.3 (0.3)
	09:30	House price index Y/Y%	Jul	-	8.7
		Wednesday 14 September 2016			
EMU	10:00	Industrial production M/M% (Y/Y%)	Jul	-0.9 (-0.7)	0.6 (0.4)
France	07:45	Final EU-harmonised CPI Y/Y%	Aug	*0.4*	0.4
Italy	09:00	Final EU-harmonised CPI Y/Y%	Aug	*0.0*	-0.2
UK	09:30	Average earnings incl. bonuses (excl. bonuses) 3M/Y%	Jul	2.2 (2.2)	2.4 (2.3)
	09:30	ILO unemployment rate 3M%	Jul	4.9	4.9
	09:30	Employment change 3M/3M '000s	Jul	180	172
	09:30	Claimant count rate % (change 000s)	Aug	2.2 (1.8)	2.2 (-8.6)
		Thursday 15 September 2016			
EMU	07.00	EU27 new car registrations	Aug	-	6.9
	10.00	Trade balance €bn	Jul	22.0	23.4
	10.00	Final CPI (core CPI) Y/Y%	Aug	*0.2 (0.8)*	0.2 (0.9)
UK	09:30	Retail sales excluding petrol M/M% (Y/Y%)	Aug	-0.7 (4.8)	1.5 (5.4)
	09:30	Retail sales including petrol M/M% (Y/Y%)	Aug	-0.4 (5.4)	1.4 (5.9)
	12:00	BoE bank rate %	Sep	*0.25*	0.25
	12:00	BoE asset purchase target £bn	Sep	*435*	435
		Friday 16 September 2016			
EMU	10:00	Labour costs Y/Y%	2Q	-	1.7
Italy	09:000	Trade balance total €bn	Jul	-	4.7
Spain	08:00	Labour costs Y/Y%	Q2	-	-0.2

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

Key events & auctions

Country	BST	Event / Auction
		Monday 12 September 2016
UK	14.50	BoE APF operation: To purchase 3-7Y Gilts
		Tuesday 13 September 2016
Italy	10:00	Auction: To sell up to €2bn of 0.1% 2019 bonds (15-Apr-2019)
	10:00	Auction: To sell up to €4bn of 0.65% 2023 bonds (15-Oct-2023)
	10:00	Auction: To sell up to €1.25bn of 2.25% 2036 bonds (01-Sep-2036)
	10:00	Auction: To sell up to €750mn of 3.25% 2046 bonds (01-Sep-2046)
UK	14.50	BoE APF operation: To purchase 15Y+ Gilts
		Wednesday 14 September 2016
Germany	10:30	Auction: To sell €1bn of 2.5% 2044 bonds (04-Jul-2044)
UK	10.30	Auction: To sell £800mn of 0.125% 2046 index-linked bonds (22-Mar-2046)
	14.50	BoE APF operation: To purchase 7-15Y Gilts
		Thursday 15 September 2016
France	09:50	Auction: To sell 0% 2019 bonds (25-Feb-2019)
	09:50	Auction: To sell 0% 2021 bonds (25-May-2021)
	10:50	Auction: To sell 0.1% 2021 index-linked bonds (01-Mar-2021)
	10:50	Auction: To sell 0.1% 2025 index-linked bonds (01-Mar-2025)
Spain	09.30	Auction: To sell 0.75% 2021 bonds (30-Jul-2021)
	09.30	Auction: To sell 1.3% 2026 bonds (31-Oct-2026)
		Friday 16 September 2016
EMU	-	EU27 leaders scheduled to hold summit to discuss Brexit in Bratislava

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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