

Euro wrap-up

Overview

- Bunds made gains as the flash estimates of German Q2 GDP and July inflation declined by more than expected.
- Gilts also made gains as UK car production figures remained relatively weak in June, as output was limited by strict social distancing rules and subdued demand.
- Tomorrow will bring the flash euro area Q2 GDP and July inflation estimates, as well GDP figures from France, Italy and Spain.

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Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.729	-0.029
OBL 0 10/25	-0.738	-0.040
DBR 0 08/30	-0.549	-0.046
UKT 0½ 07/22	-0.090	-0.012
UKT 0% 06/25	-0.136	-0.014
UKT 4% 12/30	0.086	-0.034

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

Euro area

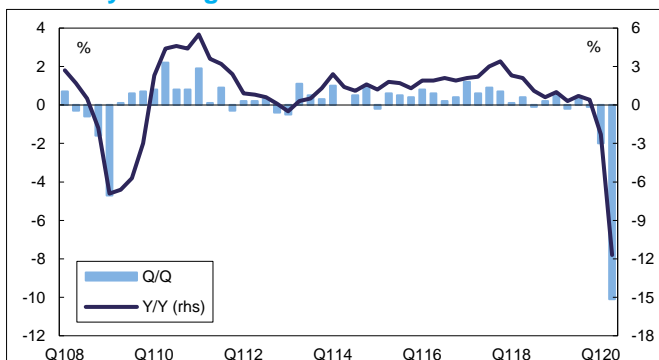
German GDP contracted at a record rate

While the stringency and duration of Germany's lockdown was less severe than other larger euro area countries, today's flash Q2 GDP release suggested that output plunged a steeper-than-expected 10.1%Q/Q, the largest quarterly decline recorded since the series began in 1970. Indeed, it was more than double the drop at the height of the global financial crisis. And while today's release suggested that the decline in Q1 (-2.0%Q/Q) was not quite as steep as previously estimated, GDP in Q2 was still down a whopping 11.7%Y/Y. We will have to wait for revised figures on 25 August for the official expenditure breakdown, but Destatis inevitably implied that household consumption, investment and trade all declined sharply in Q2, easily offsetting a positive contribution from government spending, which was increased to support the economy through the crisis. GDP data published by other member states similarly posted historically large declines in Q2, with growth in Belgium down 12.2%Q/Q and Austria down 10.7%Q/Q. And with steeper contractions anticipated in France, Italy and Spain, tomorrow's flash euro area figure might well come in at the lower end of expectations.

Commission's survey points to ongoing recovery

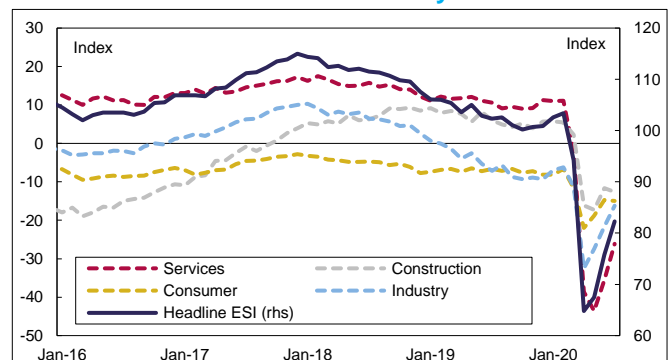
Of course, with containment measures having been relaxed throughout last quarter, Q2 should – in the absence of a significant second wave of infections – mark the trough in the current crisis. Certainly, the Commission's July economic sentiment survey results added to evidence of continued recovery in activity following the deep retrenchment during the height of the lockdown. This was particularly evident in the services, retail and industrial sectors, where firms were more upbeat about past activity, as well as expectations of future output and demand – indeed, manufacturers reported the first improvement in order books since February. This notwithstanding, the headline sectoral indices still remained well below their pre-pandemic levels with the rebound in the services indicator notably smaller than that seen in the retail and industrial indices. So, overall, while the euro area's headline Economic Sentiment Indicator (ESI) posted another sizeable increase in July, up 6.5pts to 82.3, this still suggested that less than half of the decline in sentiment from the pre-pandemic peak to trough had been recovered. A little more than half of equivalent decline had been reversed in the German ESI. But the rebound in the French and Italian ESIs were still less than 40%. And this supports our view that despite an anticipated bounce back in growth in Q3, the level of euro area output will remain significantly lower than the pre-pandemic peak for a considerable time to come, with the shortfall unlikely to be recovered before 2023.

Germany: GDP growth*



*Q220 is flash estimate. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Economic sentiment by sector



Source: European Commission, Refinitiv and Daiwa Capital Markets Europe Ltd.



Inflation fell more than expected in July

While manufacturers and services expectations of selling prices increased markedly in July, there was a further notable decline in consumer price expectations, with the respective index falling to its weakest since 2017. This tallied with a marked drop in the German and Spanish flash inflation figures for this month, which showed the EU-harmonised CPI rates declining a steeper-than-expected 0.8ppt to 0.0%Y/Y – a more than four-year-low – and 0.4ppt to -0.7%Y/Y respectively. Admittedly, the German figures will have been negatively impacted by the temporary 3ppt VAT cut from 1 July. Indeed, Germany's national measure revealed that goods inflation fell 1.6ppts to -1.4%Y/Y, while services inflation moderated 0.2ppt to 1.2%Y/Y, to leave headline inflation on this basis in negative territory (-0.1%Y/Y) for the first time since April 2016. While much of this weakness will reverse when the VAT rate returns to 19% at the start of 2021, there is a significant risk that price pressures will remain subdued by the still significant output gap.

Euro area unemployment rate inched higher in June

The anticipated deterioration in the labour market as various government furlough schemes come to an end will inevitably weigh on wage growth, and so domestically-generated price pressures seem likely to remain weak. For now at least, the headline unemployment figures are certainly not representative of current labour market conditions, with government subsidies having helped to keep millions in employment over recent months. Indeed, the overall increase in euro area unemployment in June was still relatively modest at 203k, having risen by a cumulative 629k in the previous two months. That left the total jobless at 12.69mn, with the unemployment rate rising just 0.1ppt to 7.8%, a sixteen-month high but nevertheless well below the peaks seen during the euro crisis. However, the headline unemployment figures fail to adequately reflect the decline in employment seen since the pandemic as a significant number of workers left the labour force altogether rather than registered as jobless. As government furlough schemes are phased out, we expect the euro area unemployment rate to continue to rise, albeit gradually. A German ifo survey suggested that still 42% of respondents were making use of the government's 'kurzarbeit' short-term work scheme in July. And while today's German national figures (which exclude those under the government scheme) suggested that unemployment claims had fallen in July, the drop of 18k compares with a cumulative increase of 678k since February, and job vacancies fell to their lowest since mid-2015.

The day ahead in the euro area

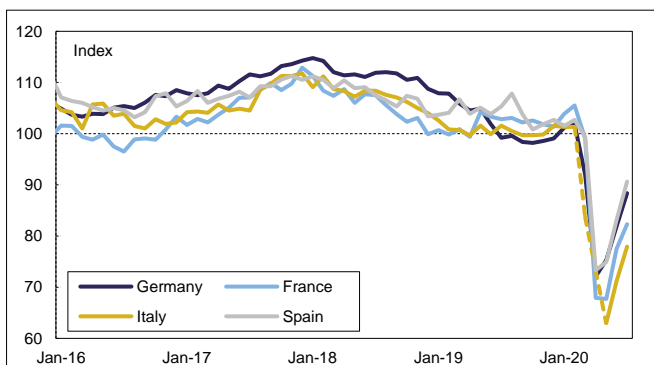
The main focus tomorrow will be the euro area's flash GDP release. Following today's weaker than expected outturn from Germany, along with other smaller member states, risks to the consensus euro area forecast of -12%Q/Q seem to be skewed to the downside, possibly more in line with the ECB's prediction of a fall of 13%Q/Q. Certainly, equivalent figures from France, Italy and Spain are expected to report more significant quarterly contractions than in Germany. Also due for release tomorrow are preliminary estimates of euro area inflation for July. Against a backdrop of weaker demand, still negative energy inflation and the downside surprise to today's German and Spanish figures, the headline CPI rate is likely to have more than reversed the 0.2ppt increase seen in June taking it back close to zero. Core inflation is also expected to have fallen further to its lowest level since early 2015. Friday will also bring German and Italian retail sales numbers for June.

UK

Car production in first half of the year weakest since 1954

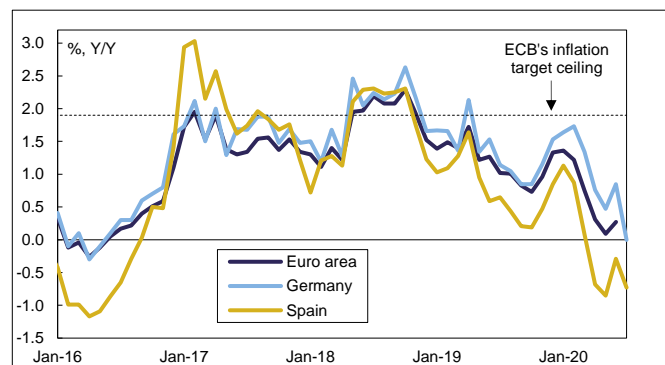
While UK manufacturers were encouraged back to work from the middle of May and car dealerships were allowed to reopen from the start of June, car production for that month remained relatively weak, limited by strict social distancing rules and subdued demand. Admittedly, the 56.6k units produced was a notable step up from the cumulative 5½k cars made in April and May. But this was down by almost half compared with a year earlier, with the number of vehicles produced for the domestic market (6.7k) down 64%Y/Y, while those for export (49.9k) were down 45%Y/Y. And over the first half of the year

Euro area: ESIs in selected member states*



*Italy's survey for April 2020 was not conducted. Source: European Commission, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation in selected member states*



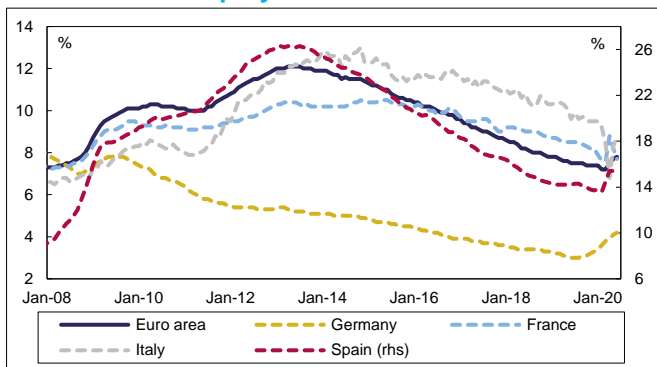
*German and Spanish figures for July 2020 are flash estimates. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

as a whole, the number of cars produced (381k) was the lowest since 1954. Against this backdrop, SMMT suggested that more than 11k jobs had already been cut across the industry, while production for 2020 as a whole was now expected to be 880k, around a third lower than in 2019, 30% lower than projected ahead of the Covid outbreak and would be the weakest full-year outturn since 1957. Moreover, with 80% of production for export markets, car manufacturers remain worried about the outlook, suggesting that in the absence of a positive trade agreement with the EU, output could stay around the 800k mark or less for several years to come.

The day ahead in the UK

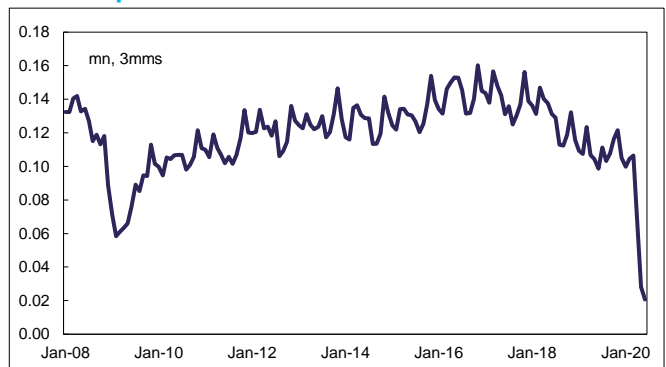
In the UK, tomorrow sees the final release of the GfK consumer confidence survey for July. The preliminary headline index came in at -27, up slightly from June’s downwardly revised result of -30, but still 20pts below the peak seen earlier in the year, suggesting that the recovery in overall household spending might remain subdued. Indeed, with the phasing out of the government’s job retention scheme set to commence next month, and the prospect of significant job losses later in the year, we expect consumers to remain extremely cautious over the coming quarters.

Euro area: Unemployment rates in member states














Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Car production













Source: SMMT, Refinitiv and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	 Economic confidence (final consumer confidence)	Jul	82.3 (-15.0)	81.4 (-15.0)	75.7 (-14.7)	75.8 (-)
	 Industrial confidence (services confidence)	Jul	-16.2 (-26.1)	-17.0 (-24.5)	-21.7 (-35.6)	-21.6 (-35.5)
	 Unemployment rate %	Jun	7.8	7.7	7.4	7.7
Germany	 Unemployment rate % (change '000s)	Jul	6.4 (-18.0)	6.5 (41.0)	6.4 (69.0)	- (68.0)
	 Preliminary GDP Q/Q% (Y/Y%)	Q2	-10.1 (-11.7)	-9.0 (-11.5)	-2.2 (-2.3)	-2.0 (-)
	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jul	-0.1 (0.0)	0.2 (0.4)	0.9 (0.8)	-
Italy	 Unemployment rate %	Jun	8.8	8.6	7.8	8.3
Spain	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jul	-0.6 (-0.7)	-0.3 (-0.2)	-0.3 (-0.3)	-
Auctions						
Country	Auction					
Italy	 sold €2.75bn of 1.85% 2025 bonds at an average yield of 0.46%					
	 sold €3.25bn of 1.65% 2030 bonds at an average yield of 1.04%					
	 sold €1.25bn of 2025 floating-rate notes at an average yield of 0.72%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases						
Economic data						
Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous	
EMU		10.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	-12.0 (-14.5)	-3.6 (-3.1)
		10.00	Preliminary CPI (Core CPI) Y/Y%	Jul	0.2 (0.8)	0.3 (0.8)
France		06.30	Preliminary GDP Q/Q% (Y/Y%)	Q2	-15.2 (-20.0)	-5.3 (-5.0)
		07.45	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jul	0.3 (0.4)	0.2 (0.2)
		07.45	Consumer spending M/M% (Y/Y%)	Jun	6.8 (-2.5)	36.6 (-8.3)
Italy		09.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	-15.2 (-17.3)	-5.3 (-5.4)
		10.00	Preliminary CPI (EU-harmonised) Y/Y%	Jul	-0.1 (-0.2)	-0.2 (-0.4)
		11.00	Retail sales M/M% (Y/Y%)	Jun	-	24.3 (-10.5)
Spain		08.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	-16.3 (-19.7)	-5.2 (-4.1)
UK		00.01	Final GfK consumer confidence	Jul	-27	-30
Auctions and events						
Country	BST	Auction / Event				
- Nothing scheduled -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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