

# Euro wrap-up

## Overview

- Bunds ended the day little changed, even as euro area GDP contracted at a record double-digit quarterly rate as lockdowns took their toll.
- Gilts were also little changed, even as the UK government slowed the easing of some lockdown restrictions across England.
- The coming week will bring final European PMIs and new car registrations figures for July. The BoE's latest MPC meeting will see policy unchanged, but bring updated economic forecasts.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.730	-
OBL 0 10/25	-0.734	-0.002
DBR 0 08/30	-0.536	+0.008
UKT 0½ 07/22	-0.079	+0.007
UKT 0% 06/25	-0.132	-
UKT 4% 12/30	0.092	+0.004

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

Source: Bloomberg

## Euro area

### A record drop in GDP in the euro area

With much of the euro area having been in some form of lockdown during the second quarter, today's preliminary Q2 GDP estimate unsurprisingly suggested that economic output contracted at a record rate. Aggregate euro area GDP plunged 12.1%Q/Q, roughly four times the steepest drop during the global financial crisis, to leave output down 15%Y/Y. While this was a slightly softer pace of contraction than projected in the ECB's central scenario, GDP in Q2 was almost 15½% below the pre-pandemic peak in Q419 and at its lowest level since the start of 2005. There were no details published on the expenditure or production breakdowns, but figures published by member states suggested widespread double-digit declines in output across the economy.

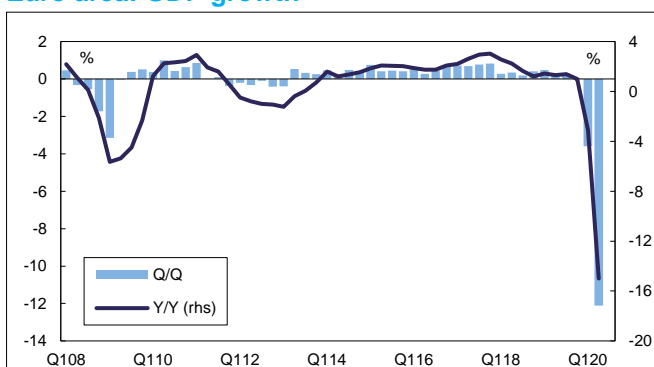
### Spanish contraction most abrupt of the member states

After [Germany's GDP](#) posted the first double-digit quarterly decline in the post-war period taking it to its lowest level since 2010, today's figures from France, Italy and Spain reported even sharper contractions last quarter. With containment measures having been most stringent in Spain, GDP appears to have contracted most abruptly of the member states, dropping a whopping 18.5%Q/Q, following a decline of more than 5%Q/Q in Q1, to its lowest level since the start of 2002. Household consumption plunged 21.2%Q/Q, while fixed investment fell at a slightly faster pace. And on the production side, retail, transport and hospitality activity inevitably fell most sharply, down 40.4%Q/Q, with arts and entertainment down by more than a third too. Construction output was also down by almost a quarter and manufacturing production was down by more than a fifth.

### French GDP declines at historical pace

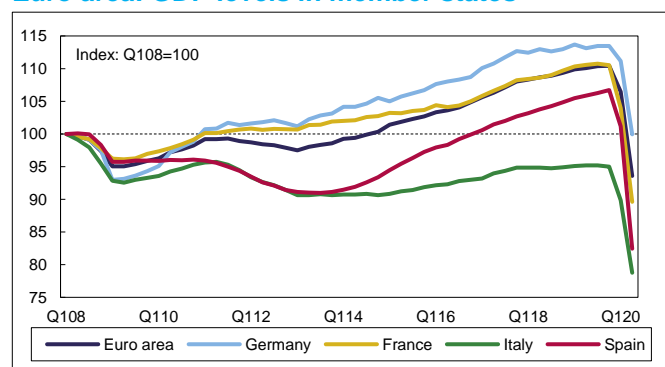
While the drop in French GDP in Q2 was less abrupt than in Spain, output was still down a historically large 13.8%Q/Q – the biggest quarterly fall of the respective series which dates back to 1949 – and followed a steeper-than-previously estimated decline in Q1 (-5.9%Q/Q). This left output 19% below the pre-pandemic peak, at its lowest level for eighteen years. On the production side, construction output fell most sharply (-25.1%Q/Q), while services activity and industrial production also fell at double-digit rates. And reflecting significant weakness in construction, fixed investment was down a steep 17.8%Q/Q, while exports plummeted 25.5%Q/Q. Meanwhile, household consumption fell (-11.0%Q/Q) at almost double the rate in Q1, with spending on total services down by more than 15%Q/Q and declines in expenditure on transport services (-45.8%Q/Q) and hospitality (-56.9%Q/Q) most severe. But while expenditure on manufactured goods fell 12% over the quarter as a whole, today's monthly spending figures reported a further notable increase in June (9%M/M), to leave it almost 2½% above

### Euro area: GDP growth



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: GDP levels in member states



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.



February's pre-pandemic level. Elsewhere, although the fall in Italian GDP was a touch smaller than in France, it was still down a record 12.4%Q/Q in Q2 and by a little more than 17% compared with Q419, to leave it at its lowest level since the early 1990s.

### Inflation surprises on the upside

Despite the weak economic backdrop and downside surprise to yesterday's German inflation figures, today's euro area flash CPI estimate for July came in ahead of expectations. In particular, despite a fall in consumer prices on the month (-0.3%M/M), the annual rate of inflation unexpectedly rose 0.1ppt to 0.4%Y/Y. While there was a further moderation in the pace of decline in energy inflation (up 1ppt to -8.3%Y/Y), the upwards impulse was largely driven by non-energy industrial goods inflation, which leapt 1.5ppts to 1.7%Y/Y, the strongest reading for more than eighteen years. But this principally reflected a surge in clothing inflation in certain member states as containment measures saw summer sales delayed this year. For example, in France, there was a sharp rebound in manufactured goods inflation from -1.1%Y/Y in June to +1.8%Y/Y in July, while in Italy, the annual increase in clothing prices jumped from 0.4%Y/Y in June to 18.7%Y/Y, as sales were postponed to August this year from July last year. As such, core inflation also jumped in July, by 0.4ppt to 1.2%Y/Y, a five-month high. However, this seems bound to be reversed in August. Certainly, services inflation was extremely subdued in July, falling 0.2ppt to 0.9%Y/Y, its lowest for more than four years.

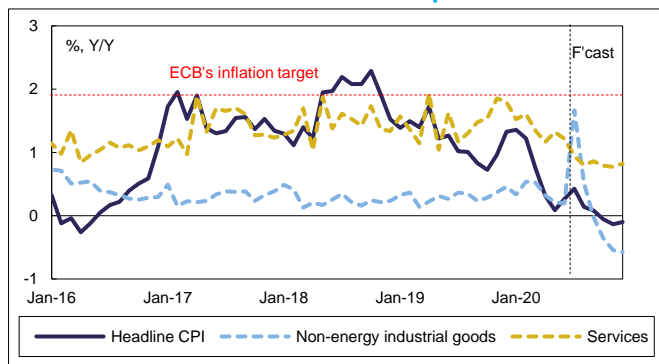
### But underlying price pressures remain weak

While some firms will put prices up to cover the costs of social distancing, we would expect many, particularly in hospitality and leisure, to continue to offer sizeable discounts to try to attract custom over coming months. And the 3ppt VAT cut in Germany through the second half of this year will also provide a modest downward pull. Furthermore, the deteriorating labour market outlook – with a large share of furloughed workers likely to be made permanently unemployed in due course – seems bound to weigh on wage growth, further weakening domestically-generated inflation. As such, we expect headline and core inflation to resume a downwards trend from August, with headline inflation likely to slip into negative territory and core inflation set to fall close to zero by the end of the year.

### The coming week in the euro area

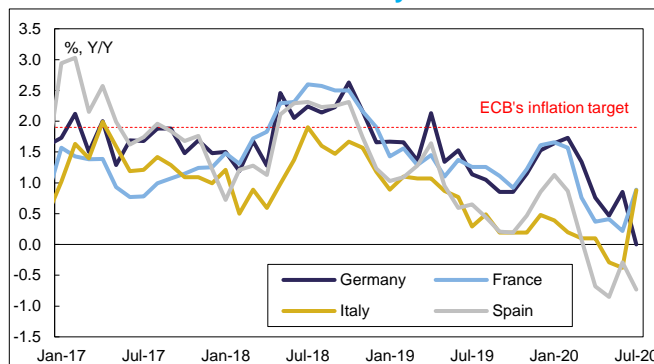
The coming week will bring the final euro area manufacturing and services PMIs for July, on Monday and Wednesday, as well as the equivalent construction sector survey on Thursday. In line with the preliminary release all are expected to report a marked improvement in conditions at the start of Q3, consistent with ongoing expansion as containment measures continued to relax. In particular, the flash euro area composite PMI rose 6.3pts to 54.8, with the German and French indices up to 55.5 and 57.6 respectively. Admittedly, the improvement in the Italian and Spanish composite PMIs might well be more limited, with a recent pickup in infections in likely to have weighed on sentiment. Meanwhile, national car registrations figures for July will be published in France, Italy and Spain on Monday, with German numbers to be released later in the week. While car sales are likely to have remained relatively subdued this month, euro area retail sales data (due Wednesday) are expected to report another strong month of growth at the end of Q2 – indeed, consistent with national releases from the largest four member states, we expect the level of sales to have returned close to February's pre-pandemic peak. At the country level, meanwhile, the back end of the week will bring June industrial production releases from the largest four member states, while French wage figures for Q2 will also be published.

#### Euro area: Inflation and core components\*



\*July-20 figures are flash estimates. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Headline inflation by member state\*



\*July-20 figures are flash estimates. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.
















## UK

### The coming week in the UK

In an otherwise quiet end to the week in the UK, the recent rise in Covid-19 cases saw the government on Friday delay further easing in lockdown measures in England due to come into effect this weekend for at least two weeks, while also announcing stricter containment measures in certain areas in the North of the country. So against the backdrop of ongoing uncertainty, the main event in the UK in the coming week will be the BoE's latest monetary policy announcement on Thursday. But having expanded its asset purchases in June by a further £100bn, we expect the main policy parameters – Bank Rate at 0.1% and the asset purchase target of £745bn – to be left unchanged. Of more interest will be the Bank's updated economic forecasts in its latest Monetary Policy Report (MPR). At June's MPC meeting, Bank staff assessed that the recent contraction had been somewhat less severe than initially anticipated, estimating that the level of GDP in Q220 might be 20% below the peak reached in Q419, compared with the 27% projection under its illustrative scenario in the May MPR. And that would be broadly consistent with recent activity data. So, with output set to remain well below the pre-pandemic level for several years to come, and the temporary VAT cut to the hospitality and entertainments sector set to add further downward pressure over the near term, we would expect the Bank to maintain its view that underlying price pressures will remain subdued for the foreseeable future.

In terms of economic releases, the focus will be on final July PMIs, with the manufacturing, services and construction surveys due on Monday, Wednesday and Thursday respectively. In line with the flash estimates, these are likely to confirm a notable improvement this month, with the headline indices for all sectors returning comfortably above 50 and pointing to meaningful expansion. Indeed, the composite PMI (due Wednesday) is expected to confirm that it rose 9.4pts to 57.1, its strongest reading for five years. Wednesday will also bring new car registration figures for July, which are expected to show a further modest recovery as more dealerships re-opened across the UK, albeit demand will likely remain subdued by the gloomy outlook for the labour market. Indeed, Thursday's release of the REC/KPMG jobs report is likely to report that demand for both permanent and temporary placements remains extremely weak, while increased supply will continue to limit wage growth.



































## Daiwa economic forecasts

	2019		2020				2020	2021	2022
	Q3	Q4	Q1	Q2	Q3	Q4			
<b>GDP growth, %, Q/Q</b>									
Euro area 	0.3	0.0	-3.6	-12.1	8.0	0.5	-8.6	3.9	3.3
Germany 	0.3	0.0	-2.0	-10.1	5.0	1.0	-7.0	2.9	2.4
France 	0.2	-0.2	-5.9	-13.8	13.0	0.5	-10.3	5.4	4.0
Italy 	0.0	-0.2	-5.4	-12.4	7.0	0.5	-11.3	2.0	2.2
Spain 	0.4	0.4	-5.2	-18.5	12.0	0.5	-13.1	4.9	4.3
UK 	0.5	0.0	-2.2	-19.0	13.0	0.5	-10.5	4.2	2.9
<b>Inflation, %, Y/Y</b>									
Euro area									
Headline CPI 	1.0	1.0	1.1	0.2	0.2	-0.1	0.4	0.8	1.3
Core CPI 	0.9	1.2	1.1	0.9	0.7	0.2	0.7	0.7	1.1
UK									
Headline CPI 	1.8	1.4	1.7	0.6	0.2	0.0	0.6	1.2	1.5
Core CPI 	1.7	1.6	1.6	1.3	0.8	0.4	1.0	1.2	1.3
<b>Monetary policy</b>									
ECB									
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate % 	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
Net asset purchases* 	0	20	20	140	140	140	140	20	20
BoE									
Bank Rate % 	0.75	0.75	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Net asset purchases** 	0	0	36	40	17	17	17	0	0

\*Monthly target €bn, end of period. \*\*Monthly target £bn, end of period.  
 Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.














# Coming week's data calendar

## The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
<b>Monday 03 August 2020</b>					
EMU		09.00 Final manufacturing PMI	Jul	51.1	47.4
Germany		08.55 Final manufacturing PMI	Jul	50.0	45.2
France		08.50 Final manufacturing PMI	Jul	52.0	52.3
		- New car registrations* Y/Y%	Jul	-	1.2
Italy		08.45 Manufacturing PMI	Jul	51.3	47.5
		17.00 New car registrations Y/Y%	Jul	-	-23.1
Spain		08.15 Manufacturing PMI	Jul	51.6	49.0
		- New car registrations* Y/Y%	Jul	-	-36.7
UK		09.30 Manufacturing PMI	Jul	53.6	50.1
<b>Tuesday 04 August 2020</b>					
EMU		10.00 PPI Y/Y%	Jun	-	-5.0
Spain		08.00 Unemployment change '000s	Jul	-	5.1
<b>Wednesday 05 August 2020</b>					
EMU		09.00 Final services (composite) PMI	Jul	55.1 (54.8)	48.3 (48.5)
		10.00 Retail sales M/M% (Y/Y%)	Jun	6.8 (0.4)	17.8 (-5.1)
Germany		08.55 Final services (composite) PMI	Jul	56.7 (55.5)	47.3 (47.0)
		- New car registrations* Y/Y%	Jul	-	-32.3
France		08.50 Final services (composite) PMI	Jul	57.8 (57.6)	50.7 (51.7)
Italy		08.45 Services (composite) PMI	Jul	52.6 (51.1)	46.4 (47.6)
Spain		08.15 Services (composite) PMI	Jul	52.0 (52.0)	50.2 (49.7)
UK		9.00 New car registrations Y/Y%	July	-	-34.9
		09.30 Final services (composite) PMI	Jul	56.6 (57.1)	47.1 (47.7)
<b>Thursday 06 August 2020</b>					
EMU		09.00 Construction PMI	Jul	-	46.3
Germany		07.00 Factory orders M/M% (Y/Y%)	Jun	9.7 (-18.2)	10.4 (-29.3)
		08.30 Construction PMI	Jul	-	41.3
Italy		09.00 Industrial production M/M% (Y/Y%)	Jun	9.0 (-12.8)	42.1 (-20.3)
UK		07.00 BoE Bank Rate %	Aug	0.10	0.10
		07.00 BoE gilt and corporate purchase bond target £bn	Aug	745	745
		09.30 Construction PMI	Jul	57.0	55.3
<b>Friday 07 August 2020</b>					
Germany		07.00 Trade balance €bn	Jun	-	7.0
		07.00 Industrial production M/M% (Y/Y%)	Jun	9.7 (-10.8)	7.8 (-19.3)
France		07.45 Industrial production M/M% (Y/Y%)	Jun	11.9 (-12.5)	19.6 (-23.4)
		07.45 Manufacturing production M/M% (Y/Y%)	Jun	-	22.0 (-25.2)
		07.45 Trade balance €bn	Jun	-	-7.1
Italy		09.00 Trade balance €bn	Jun	-	5.6
Spain		08.00 Industrial output M/M% (Y/Y%)	Jun	-	14.7 (-24.5)

\*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.












### The coming week's key events & auctions

Country	BST	Event / Auction
<b>Monday 03 August 2020</b>		
- Nothing scheduled -		
<b>Tuesday 04 August 2020</b>		
UK		10.00 Auction: £3.25bn of 0.125% 2026 bonds
		11.30 Auction: £2.25bn of 1.25% 2041 bonds
<b>Wednesday 05 August 2020</b>		
Germany		10.30 Auction: €5bn of 0% 2025 bonds
UK		10.00 Auction: £2.75bn of 0.375% 2030 bonds
		10.30 Auction: £500mn of 0.125% 2048 index-linked bonds
<b>Thursday 06 Aug 2020</b>		
France		09.50 Auction: 5.5 % 2029 bonds
		09.50 Auction: 2.5% 2030 bonds
		09.50 Auction: 1.5% 2031 bonds
		09.50 Auction: 1.5% 2050 bonds
		09.50 Auction: Index-linked bonds
UK		00.01 REC/KPMG Report on UK Jobs for July
		07.00 BoE publishes its August Monetary Policy and Financial Stability Report
		07.00 Bank of England interest rate and asset purchase programme target announcement
<b>Friday 07 Aug 2020</b>		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Preliminary GDP Q/Q% (Y/Y%)	Q2	<b>-12.1 (-14.5)</b>	-12.21 (-14.5)	-3.6 (-3.1)	-
	 Preliminary CPI (Core CPI) Y/Y%	Jul	<b>0.4 (1.2)</b>	0.2 (0.8)	0.3 (0.8)	-
Germany	 Retail sales M/M% (Y/Y%)	Jun	<b>-1.6 (5.9)</b>	-3.0 (3.0)	13.9 (3.8)	12.7 (3.2)
France	 Preliminary GDP Q/Q% (Y/Y%)	Q2	<b>-13.8 (-19.0)</b>	-15.2 (-20.0)	-5.3 (-5.0)	-5.9 (-5.7)
	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jul	<b>0.8 (0.9)</b>	0.3 (0.4)	0.2 (0.2)	-
	 Consumer spending M/M% (Y/Y%)	Jun	<b>9.0 (1.3)</b>	6.8 (-2.5)	36.6 (-8.3)	37.4 (-7.2)
Italy	 Preliminary GDP Q/Q% (Y/Y%)	Q2	<b>-12.4 (-17.3)</b>	-15.5 (-17.3)	-5.3 (-5.4)	-5.4 (-5.5)
	 Preliminary CPI (EU-harmonised) Y/Y%	Jul	<b>-0.3 (0.9)</b>	-0.1 (-0.2)	-0.2 (-0.4)	-
	 Retail sales M/M% (Y/Y%)	Jun	<b>12.1 (-2.2)</b>	-	24.3 (-10.5)	-
Spain	 Preliminary GDP Q/Q% (Y/Y%)	Q2	<b>-18.5 (-22.1)</b>	-16.6 (-19.7)	-5.2 (-4.1)	-
UK	 Nationwide house price index M/M% (Y/Y%)	Jul	<b>1.7 (1.5)</b>	-0.2 (-0.3)	-1.4 (-0.1)	-1.6 (-)
<b>Auctions</b>						
Country	Auction					
- Nothing to report -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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