

Euro wrap-up

Overview

- Bunds again followed USTs lower while data confirmed a relatively strong rebound in euro area industrial production in June.
- Gilts also again made significant losses while data confirmed that UK GDP contracted more sharply than in any other major economy in Q2.
- Thursday will bring revised estimates of German and Spanish inflation in July, while the following day will bring updates on euro area GDP and employment in Q2 and French inflation in July.

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Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.673	+0.019
OBL 0 10/25	-0.663	+0.027
DBR 0 08/30	-0.452	+0.028
UKT 0½ 07/22	0.004	+0.009
UKT 0% 06/25	-0.007	+0.021
UKT 4¾ 12/30	0.238	+0.040

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

Euro area

Euro area IP maintains recovery

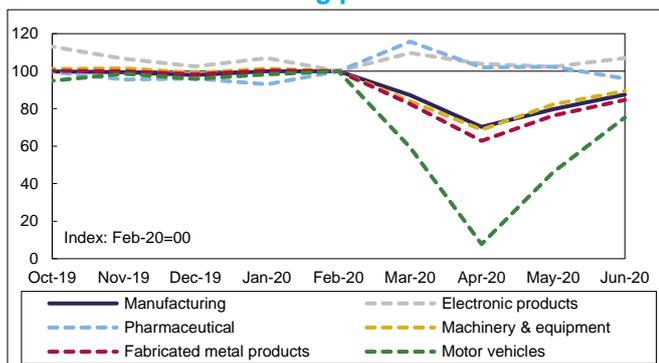
Following last week's confirmation of strong growth in manufacturing output in the large member states, there were no surprises from today's aggregate euro area IP figures, which confirmed ongoing recovery in June as lockdown restrictions relaxed. Admittedly, the monthly increase fell a touch short of expectations, but at 9.1%M/M it still marked the second-strongest on the series following the 12.3%M/M increase in May. As such, almost 60% of the initial drop between February and April had been reversed by June, although this still left output a little more than 11% below the pre-pandemic peak. Within the detail, the strongest growth was again seen in production of autos (63.1%M/M having risen almost five-fold in May), although this still left output down by one quarter from February's peak. Production of rubber and fabricated metal products also saw double-digit monthly growth in June, although the level in both subsectors still remained more than 15% below the pre-pandemic level. Indeed, the only sector to see output now above February's level was that of computers and electronic products. Surveys such as the [manufacturing PMIs](#) point to further production growth in July, although with operating capacity still limited by ongoing containment measures, the total level of industrial output seems likely to remain below the pre-pandemic level for some time to come.

The coming two days in the euro area

The back end of the week will bring several releases of note. At the euro area level, Friday's release of revised Q2 GDP figures is expected to confirm that the economy contracted at a record rate close to the initial estimate of 12.1%Q/Q, to leave output more than 15% below its pre-pandemic peak. We will have to wait until 8 September for a full expenditure breakdown. Meanwhile, June trade figures (also due Friday) will provide some insight into the performance of external demand during the second quarter. Despite various government job support schemes, the sharp contraction in output will see employment (data similarly due Friday) having fallen significantly in Q2.

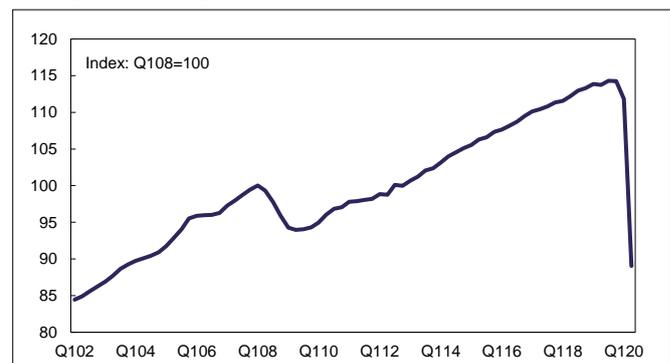
At the country level, focus will be on final July inflation, with German and Spanish figures due tomorrow, followed by French numbers on Friday. Not least reflecting the VAT cut, the preliminary German release showed that headline inflation on the EU measure fell 0.8ppt last month to zero, the first non-positive reading since May 2016. And Spanish inflation also fell 0.4ppt to -0.7%Y/Y. In marked contrast, the flash French estimate showed inflation unexpectedly rise 0.7ppt to 0.9%Y/Y, a five-month high, as the start of the summer sales period for clothing was postponed. For the same reason, today's final Italian figures confirmed that the EU inflation measure surged 1.4ppt in July to 0.8%Y/Y, a touch weaker than the initial estimate but still the highest level in fourteen months. Indeed, this rise fully reflected the spike in the annual increase in clothing prices jumped

Euro area: Manufacturing production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Level of GDP



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

from 0.4%Y/Y in June to 18.7%Y/Y, as sales were postponed to 1 August this year from 1 July last year in most regions. As such, despite services inflation falling to zero, core inflation on the EU measure rose 1.6ppts to 2.1%Y/Y.

UK

UK Q2 GDP drops more than other major economies

As expected, today's data confirmed that the UK was one of the worst hit of all major economies from the Covid-19 shock. Following the initial drop of 2.2%Q/Q in Q1, UK GDP fell at a record rate of 20.4%Q/Q in Q2 – a sharper fall than all other major economies last quarter – to be down 21.7%Y/Y. Looking at the first half of the year as a whole, the UK's cumulative decline of 22.1% was exceeded only by Spain (-22.7%), was more than double that in the US (-10.6%), and was also more than 10ppts steeper than in Germany (-11.9%). It was also more than three times the full peak-to-trough drop in UK output recorded over five quarters during the global financial crisis. The UK's particularly poor performance reflects policy failure – the delayed and thus necessarily longer-lasting imposition of lockdown restrictions – as well as the relatively larger share of GDP accounted for by activities requiring face-to-face interaction (so-called social consumption) including leisure, hospitality and transport).

Despite eventual rebound, level in June still extremely low

Of course, the steepness of the drop in UK GDP principally reflected the extreme contraction in March and April as the country's lockdown was implemented. And with the phased easing of restrictions on various types of activity, GDP subsequently edged up in May (an upwardly revised 2.4%M/M) and accelerated a vigorous 8.7%M/M in June. However, the level at the end of the quarter was still a marked 17.2% below February's pre-lockdown peak and indeed still below levels recorded as far ago as 2005.

Business investment collapsed

Needless to say, all major categories of domestic expenditure posted record quarterly declines in Q2. Private consumption fell 23.1%Q/Q to account for about 70% of the total drop in GDP. Government expenditure was down 14.0%Q/Q, due principally to lower healthcare and education activity. And strikingly, business investment plunged 31.4%Q/Q, more than three times the drop during the global financial crisis and contributing to a decline in total gross fixed capital formation of 25.5%Q/Q. Exports fell a somewhat more moderate 11.3%Q/Q, albeit with services exports hit much harder. Imports dropped at more than double that pace (-23.4%Q/Q due principally to lower imports of machinery, equipment and transport items) so that the UK recorded a rare trade surplus of 4.0% of GDP (1.9% excluding precious metals).

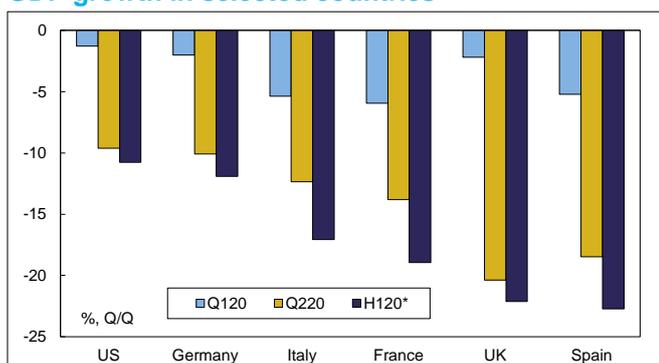
Record declines in every major sector

Perhaps inevitably, there were also record quarterly falls in all main sectors in Q2. Output of services was down 19.9%Q/Q with the accommodation and food services subsector down 86.7%Q/Q. Production was down 16.9%Q/Q with manufacturing output down a little more than one fifth and output of transport equipment roughly halved. And construction output fell 35.0%Q/Q. Of course, by June, most sub-sectors had returned to growth following the easing of restrictions on activity. But while services grew 7.7%M/M that month the level was still down 17.6% from February. Output of accommodation and food services was still down more than 80% from the pre-Covid level despite rising more than two-thirds in June. Production was down 11.6% from before the lockdown despite growth of 9.3%M/M at end-quarter. And while construction jumped 23.5%M/M in June it was still about one quarter below February's level.

Recovery to slow as unemployment rises, with risks of further shocks to come

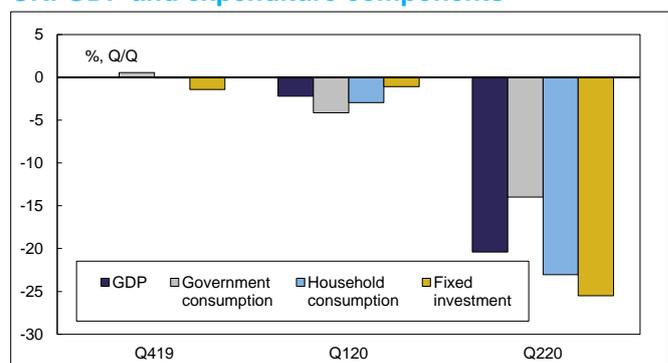
All the evidence – such as yesterday's Barclaycard [spending data](#) – points to ongoing recovery in July and probably August too. And so we expect to see record growth in GDP in Q3 in excess of 15%Q/Q. However, a shortfall relative to the pre-crisis

GDP growth in selected countries



*H120 is change in GDP between Q419 and Q220. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: GDP and expenditure components



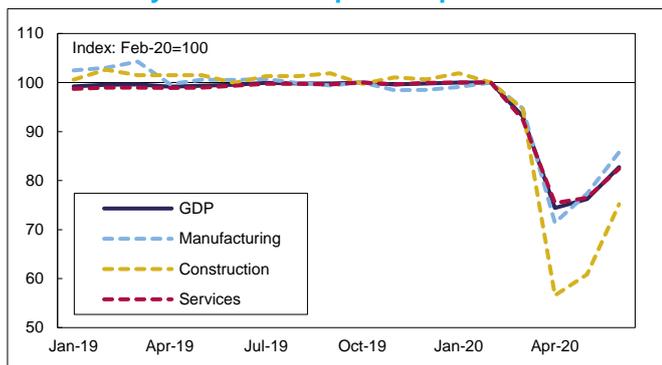
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

level is likely to persist for several quarters. Indeed, while the BoE’s central projection anticipates that milestone will be passed at the end of 2021, we fear it will take even longer than that as sharply rising unemployment as the economy adapts to ongoing social distancing weighs on private spending. Clearly, a renewed wave of pandemic when the weather turns for the worse in the autumn would be particularly damaging, as would a self-harming failure to agree an FTA with the EU when the Brexit transition period concludes at end-year.

The coming two days in the UK

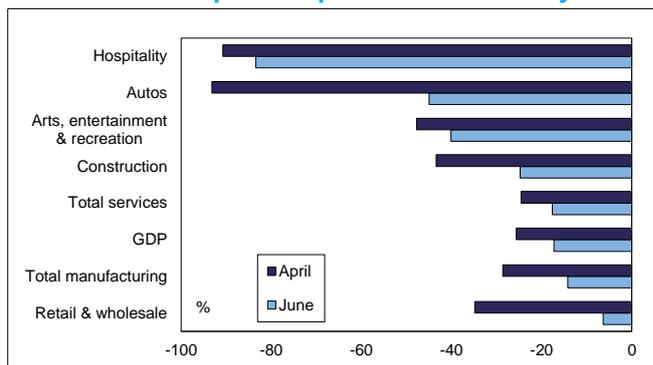
It should be a very quiet end to the week for UK economic news, with just the RICS residential market survey for July due for release tomorrow. This is expected to show a further recovery in housing market activity, not least reflecting the Chancellor’s announcement last month of a temporary cut in stamp duty. Indeed, we would expect to see a further increase in the number of enquiries, as new buyers and sellers entered the market. But while the pace of decline likely moderated further, surveyors are expected to report that average house prices remained lower than a year for the fourth consecutive month.

UK: Monthly GDP and output components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Level of output compared with February 2020



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 14th August 2020

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	 Industrial production M/M% (Y/Y%)	Jun	9.1 (-12.3)	10.0 (-11.6)	12.4 (-20.9)	12.3 (-20.4)
Italy	 Final CPI (EU-harmonised CPI) Y/Y%	Jul	-0.4 (0.8)	-0.3 (0.9)	-0.2 (-0.4)	-
UK	 Preliminary GDP Q/Q% (Y/Y%)	Q2	-20.4 (-21.7)	-20.5 (-22.0)	-2.2 (-1.7)	-
	 Monthly GDP M/M%	Jun	8.7	8.0	1.8	2.4
	 Industrial production M/M% (Y/Y%)	Jun	9.3 (-12.5)	9.0 (-13.1)	6.0 (-20.0)	6.2 (-)
	 Manufacturing production M/M% (Y/Y%)	Jun	11.0 (-14.6)	10.0 (-15.0)	8.4 (-22.8)	8.3 (-23.1)
	 Construction output M/M% (Y/Y%)	Jun	23.5 (-24.8)	15.0 (-29.5)	8.2 (-39.7)	7.6 (-40.0)
	 Index of services M/M% (Q/Q%)	Jun	7.7 (-19.9)	8.0 (-20.7)	0.9 (-18.9)	1.5 (-18.5)
	 Total trade balance (goods trade balance) £bn	Jun	5.3 (-5.1)	2.6 (-4.5)	-4.3 (2.8)	7.7 (-1.8)

Auctions

Country	Auction
Germany	 sold €3.2bn of 0% 2030 bonds at an average yield of -0.46%
UK	 sold £2.75bn of 0.125% 2028 bonds at an average yield of 0.151%

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 Final CPI (EU-harmonised CPI) Y/Y%	Jul	-0.1 (0.0)	0.9 (0.8)
Spain		08.00 Final CPI (EU-harmonised CPI) Y/Y%	Jul	-0.6 (-0.7)	-0.3 (-0.3)
UK		00.01 RICS house price balance %	Jul	-5	-15

Auctions and events

Country	BST	Auction / Event
Italy		10.00 Auction €2.75bn of 0.3% 2023 bonds
		10.00 Auction: €2.75bn of 0.95% 2027 bonds
		10.00 Auction: €1.25bn of 2.45% 2050 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's data releases

Economic data

Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous
EMU		10.00 GDP – second estimate Q/Q% (Y/Y%)	Q2	-12.1 (-15.0)	-3.6 (-3.1)
		10.00 Employment Q/Q% (Y/Y%)	Q2	-	-0.2 (0.4)
		10.00 Trade balance €bn	Jun	14.5	8.0
France		07.45 Final CPI (EU-harmonised CPI) Y/Y%	Jul	0.8 (0.9)	0.2 (0.2)

Auctions and events

Country	BST	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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