

# Euro wrap-up

## Overview

- Bunds and other euro area government bonds made significant losses as the latest German ifo survey signalled ongoing economic recovery.
- Gilts also followed USTs lower despite a weaker-than-expected UK retail sector survey.
- Wednesday will bring the latest French INSEE consumer confidence survey with the counterpart business survey due on Thursday along with euro area bank lending data.

**Chris Scicluna**  
+44 20 7597 8326

**Emily Nicol**  
+44 20 7597 8331

### Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.667	-
OBL 0 10/25	-0.646	+0.049
DBR 0 08/30	-0.428	+0.066
UKT 0½ 07/22	-0.024	+0.028
UKT 0% 06/25	0.001	+0.045
UKT 4¾ 12/30	0.270	+0.059

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

Source: Bloomberg

## Euro area

### German ifo survey points to continued recovery

According to today's German ifo business survey, the economic recovery in the euro area's largest member state has been sustained in August. While the increased flow in new covid-19 cases, as well as some levelling off in recent high-frequency data, had raised concerns of a loss of momentum, the headline ifo Business Climate Index rose a further 2.2pts to 92.6, to be just 3.2pts below February's pre-pandemic level. Respondent firms judged that their current business situation had improved significantly further, with the respective survey indicator up 3.4pts – the most since the recovery began – to 87.9. That, nevertheless, was still more than 10pts below February's level and suggested that less than 60% of the peak-to-trough deterioration has so far been reversed. But, on balance, expectations for the coming six months, which had already improved markedly over recent months, were again more upbeat, with the respective indicator up 0.8pt to 97.5, the highest since November 2018.

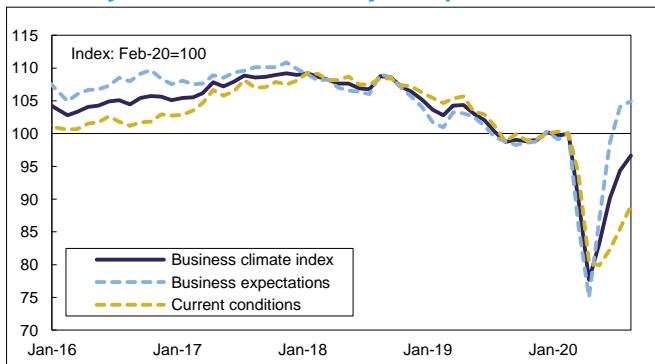
### A favourable contrast with the flash services PMIs

At the sectoral level, like Friday's flash PMIs, the ifo survey suggested that manufacturers are much less downbeat. But while the respective index for current manufacturing conditions rose to a five-month high, it still suggested that less than half of the peak-to-trough deterioration had been reversed. In contrast, the survey indicator of manufacturers' expectations for six months' time rose to the highest since late 2017 and suggested broad optimism about the outlook, with the ifo institute also citing a welcome pickup in new orders. And contrary to the findings of the flash PMIs, the ifo survey suggested that services firms were notably happier this month, with current conditions the most favourable since March and expectations about the coming six months broadly positive and the best in fifteen months. However, the ifo survey suggested that the uptrend in conditions in trade had levelled off, with wholesalers downbeat about the outlook, perhaps anticipating a drop in demand once the temporary VAT cut – of 3ppts in the main rate to 16% and 2ppts in the reduced rate to 5% – expires at year-end. Finally, construction firms judged current conditions to be more favourable and indeed the best since March but also remained largely pessimistic about the outlook.

### Private demand led record drop in German GDP in Q2

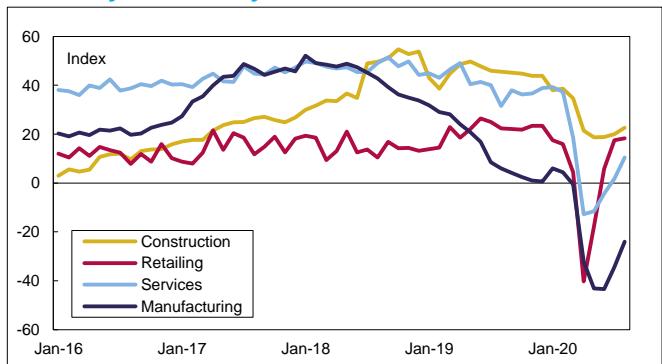
Separately, updated estimates of German GDP, also published today, suggested that the decline in economic activity in Q2 was not quite as severe as previously thought, but was still the steepest on the 50-year series and roughly twice as sharp as the worst quarter during the global financial crisis. In particular, having contracted 2.0%Q/Q in Q1, German GDP in Q2 dropped 9.7%Q/Q (compared to the initial estimate of a decline of 10.1%Q/Q) to be down 11.3%Y/Y. The expenditure components, published for the first time, inevitably confirmed that all types of private demand fell sharply. In particular, household final consumption expenditure fell 10.9%Q/Q. Gross fixed capital formation in machinery and equipment fell almost twice that pace, down 19.6%Q/Q. But the decline in construction investment was somewhat more moderate at 4.2%Q/Q, and failed fully to reverse the surge in Q1

### Germany: Headline ifo survey components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany: Ifo survey – current business situation



Source: Ifo and Daiwa Capital Markets Europe Ltd.



Follow us on twitter @DaiwaEurope

(5.1%Q/Q). Moreover, government consumption provided some support, rising 1.5%Q/Q. Meanwhile, the shock to German external demand in Q2 was also far more severe than during the global financial crisis. Following a drop of 3.3%Q/Q in Q1, exports of goods and services fell by a record 20.3%Q/Q in Q2. And imports fell 16.0%Q/Q in Q2 having dropped 1.9%Q/Q in Q1. So, net trade subtracted 2.8pppts from the quarterly GDP growth rate while inventories added just 0.3ppt.

## Household spending at risk of renewed pull back in the New Year

Employment fell 1.3%Y/Y in Q2 to mark the first decline in a decade. But the drop would have been much sharper without the government's short-term working (kurzarbeit) scheme. Indeed, the average number of hours worked per person fell a record 8.8%Y/Y, with total hours worked thus down 10%Y/Y. Average wages and salaries per employee fell 4.8%Y/Y. But government support meant that disposable income fell just 0.8%Y/Y. So, with spending down more than 10%Q/Q, the household savings ratio almost doubled in Q2 to 20.1%. According to an ifo survey published earlier this month, about 5.6mn employees were still being supported by the kurzarbeit scheme at the end of July. So, a further extension of the maximum duration of support under the scheme to 24 months per worker – which was being debated by the Cabinet today – could help provide a modest additional boost to consumer confidence and spending over the near term. Of course, household consumption will have rebounded significantly and the household savings rate fallen back somewhat in Q3. But if uncertainty related to the pandemic and the future path of the economy remain high, household savings will likely remain elevated by historical standards and private consumption will be at risk of falling back again in early 2021 once the VAT cut has expired.

## The coming two days in the euro area

The focus of the coming two days will turn to French sentiment surveys, with INSEE's consumer and business confidence indicators due for release tomorrow and Thursday respectively. Given the resurgence in coronavirus cases in France and the downside surprises in last week's flash PMIs, which saw the manufacturing output index fall 6.4pts to 50.7 and the services index fall 5.4pts to 51.9, INSEE's survey might also point to some leveling off in activity this month. Thursday will also bring euro area bank lending figures for July. In terms of policy-speak, ECB Executive Board member Schnabel will participate in a virtual event discussing 'Monetary policy, low interest rates and risk taking' tomorrow, while she, as well as ECB Chief Economist Lane and fellow Board member Panetta, will take part in the Jackson Hole economic symposium from Thursday.

## UK

### Sharp fall in retail employment as sales expected to be weaker

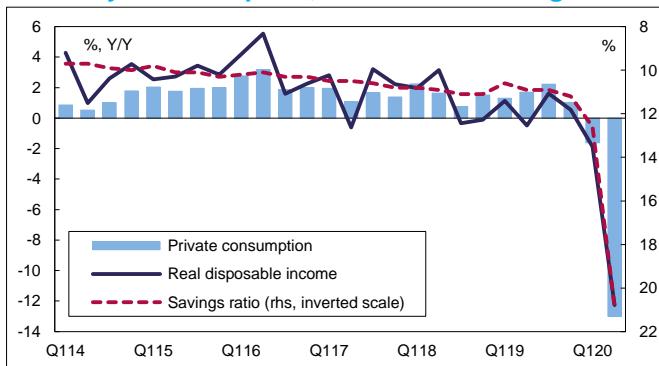
The rebound in retail activity following the lockdown slump has been relatively vigorous, with last week's official figures confirming that sales had risen back above the pre-pandemic peak in July. But while shopping-centre footfall continues to improve, today's CBI distributive trades survey suggested that sales fell slightly this month compared to a year ago – the headline indicator fell 10pts to -6 – to leave them on average 27% lower than in 'normal' conditions. While retailers were more optimistic than they were three months ago, they remained concerned about the near-term outlook, not least reflecting the non-negligible risk of future lockdowns as well deteriorating household incomes. Moreover, retailers expected a further weakening in sales in September. So, having reportedly cut employment over the past three months by the most since February 2009, and the government's Job Retention Scheme currently being tapered – almost 30% of those employed in the sector were still furloughed at the end of June – retailers anticipated a faster pace of job losses over the coming quarter. And unsurprisingly, their investment intentions for the year ahead remained firmly negative too.

## The coming two days in the UK

It should be a quiet few days for UK economic news, with no top-tier data scheduled for release.

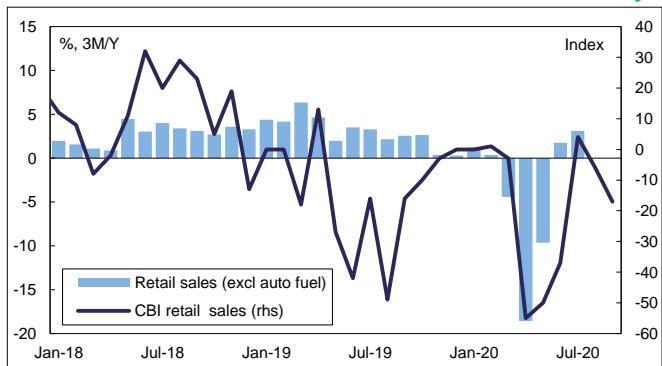
*The next edition of the Euro wrap-up will be published on 27 August 2020*

### Germany: Consumption, income and savings



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: Retail sales and CBI distributive trades survey\*



\*September figure is survey forecast. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

# European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <u>Daiwa forecast</u>	Previous	Revised	
Germany	GDP – revised estimate Q/Q% (Y/Y%)	Q2	-9.7 (-11.3)	-10.1 (-11.7)	-2.2 (-2.3)	-2.0 (-2.2)	
	Ifo business climate	Aug	92.6	92.5	90.5	90.4	
	Ifo current assessment balance (expectations)	Aug	97.5 (96.7)	87.0 (98.4)	84.5 (97.0)	- (96.7)	
UK	CBI distributive trades survey, total sales	Aug	-6	8	4	-	
Auctions							
Country	Auction						
Germany	sold €4.9bn of 2022 bonds at an average yield of -0.69%						
UK	sold £3bn of 0.125% 2026 bonds at an average yield of 0.026%						
	sold £1.25bn of 1.625% 2054 bonds at an average yield of 0.816%						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases							
Economic data							
Country	GMT	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous		
France	07.45	INSEE consumer confidence	Aug	94	94		
Auctions and events							
Country	BST	Auction / Event					
EMU	12.30	ECB's Schnabel scheduled to speak at EEA conference					
Germany	10.30	Auction: €3.5bn of 0% 2035 bonds					
Italy	10.00	Auction: €3.0bn of 0% 2022 bonds					
UK	10.00	Auction: £2.75bn of 0.375% 2030 bonds					
	17.00	BoE's Haldane scheduled to speak					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's data releases							
Economic data							
Country	BST	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous		
EMU	09.00	M3 money supply Y/Y%	Jul	9.3	9.2		
Germany	-	Retail sales* M/M% (Y/Y%)	Jul	0.5 (4.1)	-2.0 (6.0)		
France	07.45	INSEE business confidence	Aug	87	85		
	07.45	INSEE manufacturing confidence (production outlook)	Aug	-	82 (-3)		
Italy	09.00	Industrial orders (sales) Y/Y%	Jun	-	-34.7 (-25.9)		
Auctions and events							
Country	BST	Auction / Event					
EMU	-	ECB's Lane, Panetta and Schnabel to participate in Jackson Hole Symposium					

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

## Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FCA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.