

Euro wrap-up

Overview

- Bunds made gains as euro area retail sales missed expectations and the services PMIs and German car registration data pointed to a loss of recovery momentum.
- Gilts made modest losses as the final UK PMIs pointed to solid expansion despite a downwards revision from the flash estimates.
- Friday will bring European construction PMIs, German factory orders and UK car registrations figures.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.717	-0.007
OBL 0 10/25	-0.713	-0.009
DBR 0 08/30	-0.492	-0.016
UKT 1½ 09/22	-0.098	+0.018
UKT 0% 06/25	-0.058	+0.012
UKT 4% 12/30	0.233	+0.003

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

Euro area

Retail sales miss expectations with July drop

Contrary to expectations of ongoing growth, euro area retail sales fell 1.3%M/M in July, representing the first decline since April. As a result, the level of sales dipped back 1.2% below February's pre-pandemic level, but was still 0.4% above the level a year earlier. Within the detail, sales of food flattened off slightly below February's level, while those of non-food and non-fuel items dropped 2.9%M/M, with falls in all main categories. In particular, sales of textiles and clothing declined more than 10%M/M to be more than 23% below the February level as retailers in several countries postponed the start of the summer sales to August. But while sales of electrical items fell back too, they remained well above the pre-pandemic level. Likewise, online and mail order sales fell back sharply for a second month (down 7.7%M/M) but were still more than 9% above February's level to suggest a lasting impact on shopping behavior from the lockdown.

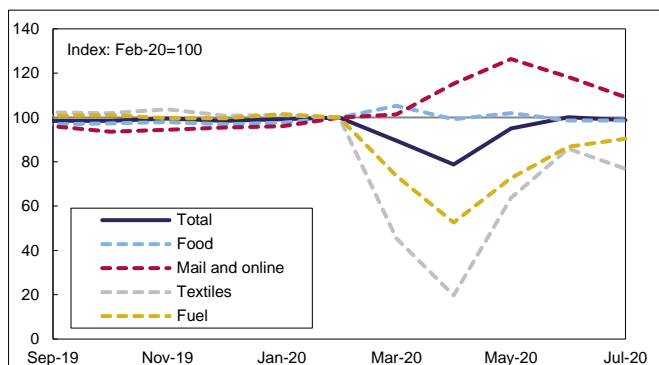
An uncertain path ahead for retailers

At the country level, the drop in the euro area was similar to that in Germany (-0.9%M/M), where sales fell despite a temporary cut in VAT. And while France and Spain registered positive growth of more than 1.0%M/M, sharp reversals in Belgium (-5.1%M/M) and Finland (-2.0%M/M) were decisive. We expect to see a return to positive sales growth in August, supported not least by the summer sales, which were reflected in the significant step down in the flash estimates of [inflation](#). But a levelling off in consumer confidence, only roughly half-way between the pre-pandemic level and the lockdown trough, amid rising unemployment, downwards pressure on wage growth and signs of a weakening in broader recovery momentum (see below), underscore the significant uncertainty about the future trend in retail sales from now on.

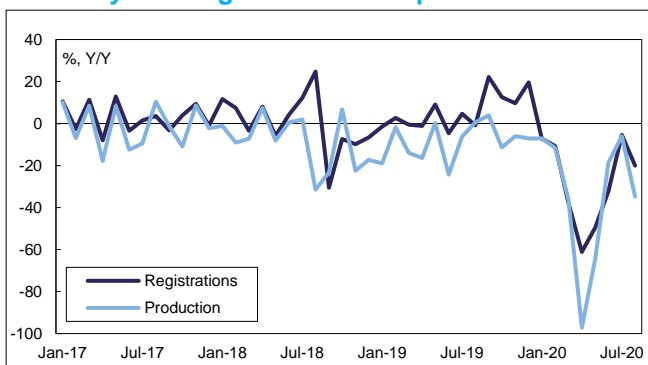
German car registrations remain in reverse gear

While spending on autos accounts for just 5% of consumption, today's new car registrations numbers from Germany completed a disappointing set of August data from the euro area's largest four member states. While the temporary VAT cut provided an incentive for consumers to bring forward purchases, and their annual pace of decline in July had moderated to just 5 ½%Y/Y, German car sales fell a steeper 20%Y/Y last month. This marked the eighth consecutive year-on-year decline, and at 251k units was the lowest August reading for four years. As such, German new car registrations in the first eight months of the year were down 29%YTD/Y, admittedly a slightly more favourable outturn than in France (-33%), Italy (-39%) and Spain (-40%). With demand still weak, according to the VDA, car production was also weaker last month, down 35%Y/Y. And with the GfK consumer confidence survey pointing to a deterioration in sentiment this month, we expect spending on big-ticket items to remain relatively restrained despite the VAT cut.

Euro area: Retail sales



Germany: Car registrations and production



Final PMIs suggest a loss of recovery momentum in services

While it was revised up slightly from the flash estimate, the final euro area services PMI for August was also consistent with a loss of recovery momentum last month, dropping a sizeable 4.2pts from July to just 50.5. Likewise, the equivalent index for new business in the services sector suggested a weaker outlook ahead, unrevised at 49.8, and thus down 1.6pts on the month and suggestive of a sector that risks flat-lining well below the pre-Covid-19 level of activity. So, while the [manufacturing](#) PMIs broadly suggested ongoing steady recovery as Europe heads into autumn, overall the composite euro area PMI (down 3pts to 51.9) was suggestive of a slowdown in the pace of expansion last month, while the composite new orders index (down 1.4pts to 51.3) implied a further softening of economic growth ahead.

Spanish and Italian activity weakens amid renewed pandemic

Among the member states, the German services PMI was revised up from the flash, and at 52.5 suggested ongoing improvement albeit at a somewhat more moderate pace than in July. But the equivalent French indicator was weaker than previously thought, dropping to just 50.1 and implying risks of stagnation amid the renewed pandemic wave. Even worse were the Italian and (where the recent spread of Covid-19 has been most severe) Spanish services PMIs, released for the first time, which each fell more than 4pts from July to 47.1 and 47.7 respectively. In both cases, similar sub-50 readings for new business and a deterioration in economic expectations highlight risks of a further weakening in activity into the autumn as the continued need for social distancing restrains both demand and supply. Indeed, while Spain's [labour market data](#) for August offered some cause for cautious optimism, and ongoing gradual recovery is our base-case scenario, the risks of a double-dip in output in either country are non-negligible.

The day ahead in the euro area

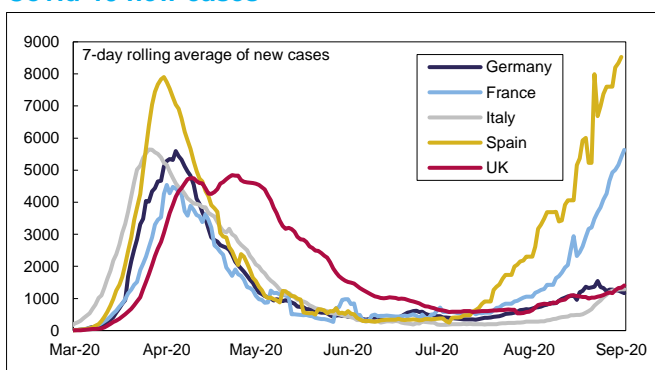
The economic data calendar ends the week with the release of the latest construction PMIs for the euro area and the three largest euro area member states. Following the less upbeat services sector PMIs, the construction survey might similarly suggest that the sector continues to struggle to regain traction in the face of ongoing uncertainties, with the headline index expected to remain below the key-50 expansion/contraction level in August. Also due out tomorrow are German factory orders data, which are expected to show a further increase in July, albeit at a softer rate than the near-28%/M/M surge recorded in June. They are thus highly likely to remain well below this year's high reached in January.

UK

Services PMI points to solid growth despite downwards revision

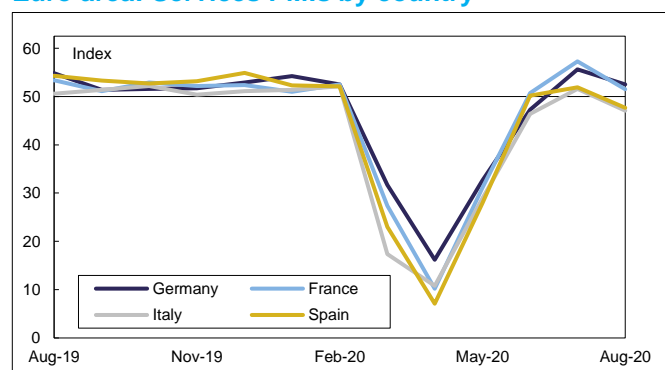
At face value, today's final UK services PMI disappointed, with sizeable downwards revisions to the survey's main components, including a 1.3pt drop in the business activity index from the flash estimate. However, this still left the headline PMI up 2.3pts from July at 58.8, the highest reading since April 2015 and consistent with a strong rebound in activity last month. Indeed, in the first two months of Q3, the services PMI averaged 57.7 compared with an average reading of just 29.8 in Q2. And taken together with the solid manufacturing survey – of which the headline index was up 1.9pts to 55.2 and the output index was up 1.7pts to 61.0 – the composite PMI still stood at 59.1 in August, the firmest reading for six years and consistent with solid economic expansion. Firms in the services sector were also more encouraged about new business, noting a boost in consumer spending related to the government's 'eat out to help out' scheme and increased housing market activity on the back of the temporary stamp duty holiday. But reflecting concerns about a possible loss of momentum as these initiatives taper off, as well as increased quarantining of travelers from several European countries and uncertainties relating to the course for the pandemic heading in autumn, businesses were somewhat less upbeat about the outlook. Despite subdued wage pressures, firms' profit margins continued to be squeezed by higher operating costs related to social distancing rules. As such, services firms reportedly continued to scale back their workforces, with roughly one-third of respondents reporting job-shedding, while just 11% reported an increase. And this trend is expected to accelerate when the

Covid-19 new cases



Source: ECDC and Daiwa Capital Markets Europe Ltd.

Euro area: Services PMIs by country



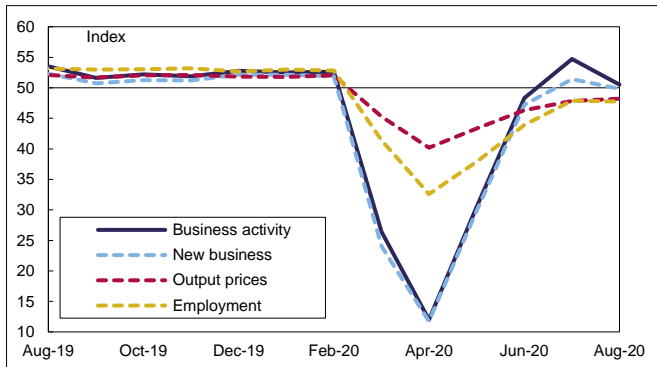
Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

government's Jobs Retention Scheme is completely phased out at the end of next month.

The day ahead in the UK

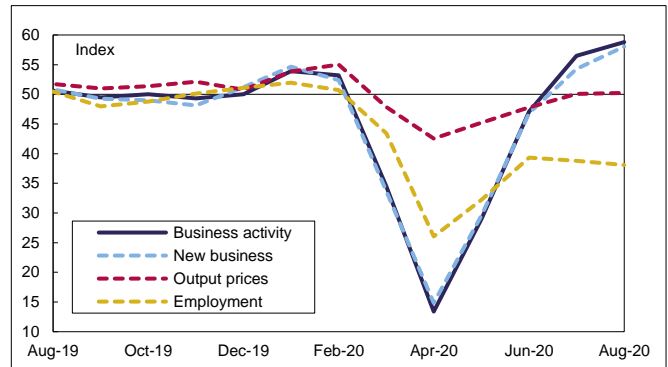
Tomorrow brings the release of the UK's construction PMI survey for August. Unlike in the euro area, the UK's headline construction index has indicated that activity has recovered relatively vigorously since lockdown measures relaxed, with the headline indicator expected to tick up slightly from 58.1 in July. Also due out tomorrow are new car registrations data for August. Elsewhere, MPC external member Michael Saunders is due to give a speech about the economy's recent performance and his view on the outlook.

Euro area: Services PMIs



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

UK: Services PMIs











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











European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Final services (composite) PMI	Aug	50.5 (51.9)	50.1 (51.6)	54.7 (54.9)	-
	 Retail sales M/M% (Y/Y%)	Jul	-1.3 (0.4)	1.2 (3.7)	5.7 (1.3)	5.3 (-)
Germany	 Final services (composite) PMI	Aug	52.5 (54.4)	50.8 (553.7)	55.6 (57.3)	-
	 New car registrations Y/Y%	Aug	-20.0	-	-5.4	-
France	 Final services (composite) PMI	Aug	51.5 (51.6)	51.9 (51.7)	57.3 (57.3)	-
Italy	 Services (composite) PMI	Aug	47.1 (49.5)	49.5 (50.0)	51.6 (52.5)	-
Spain	 Services (composite) PMI	Aug	47.7 (48.4)	48.0 (49.3)	51.9 (52.8)	-
UK	 Final services (composite) PMI	Aug	58.8 (59.1)	60.1 (60.3)	56.5 (57.0)	-

Auctions

Country	Auction
France	 sold €5.73bn of 0% 2030 bonds at an average yield of -0.19%
	 sold €1.96bn of 1.25% 2036 bonds at an average yield of 0.09%
	 sold €1.77bn of 0.75% 2052 bonds at an average yield of 0.53%
	 sold €1.06bn of 4% 2060 bonds at an average yield of 0.57%
Spain	 sold €880mn of 0% 2025 bonds at an average yield of -0.276%
	 sold €961mn of 1.4% 2028 bonds at an average yield of 0.047%
	 sold €488mn of 0.7% 2033 index-linked bonds at an average yield of -0.432%
	 sold €2.19bn of 1.85% 2035 bonds at an average yield of 0.636%
UK	 sold £2.75bn of 0.125% 2028 bonds at an average yield of 0.126%
	 sold £2.0bn of 1.25% 2041 bonds at an average yield of 0.784%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU	09.00	Construction PMI	Aug	-	48.9
Germany	07.00	Factory orders M/M% (Y/Y%)	Jul	5.0 (-6.0)	27.9 (-11.3)
	08.30	Construction PMI	Aug	-	47.1
France	-	Construction PMI	Aug	-	49.4
Italy	-	Construction PMI	Aug	-	51.0
UK	09.00	New car registrations Y/Y%	Aug	-	11.3
	09.30	Construction PMI	Aug	58.3	58.1

Auctions and events

Country	BST	Auction / Event
UK	-	BoE's Saunders to give a speech on the economy's recent performance and view on the outlook

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

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