

Euro wrap-up

Overview

- Bunds and other euro area government bonds made losses despite a weaker-than-expected increase in German industrial production.
- Gilts made gains and sterling weakened after an FT report suggested that the UK Government was preparing legislation inconsistent with the Brexit Withdrawal Agreement, highlighting risks of a breakdown in the negotiations on an EU-UK FTA.
- Tuesday will bring data for German and French trade and Italian retail sales in July, a UK retail survey for August, and final euro area GDP and employment figures for Q2.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.709	+0.000
OBL 0 10/25	-0.693	+0.004
DBR 0 08/30	-0.462	+0.013
UKT 1% 09/22	-0.100	-0.015
UKT 0% 06/25	-0.059	-0.019
UKT 4% 12/30	0.247	-0.013

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

Euro area

German industrial production data disappoint

German industrial production data for July were softer than expected, with growth in overall IP of 1.2%M/M contrasting with expectations of growth of more than 4%. While growth in June was revised up 0.4ppt to a vigorous 9.3%M/M, the level of production in July was still down 10.0%Y/Y and 10.8% below February's pre-lockdown level, albeit almost 10% above the average level in Q2. Within the detail, manufacturing production rose 2.8%M/M to be up a little more than 13% from Q2 but still down almost 12% from February. Output of intermediate goods was up 4.0%M/M, with consumer goods up 1.8%M/M and capital goods up 2.1%M/M. Auto production was up 6.9%M/M, leaving it still down more than 15% from the pre-lockdown level. Chemicals production was up 1.8%M/M but still down more than 10% from the pre-lockdown level. And production of machinery fell 3.9%M/M to be down almost 18% from the pre-lockdown level. Beyond the manufacturing sector, the data were also weak. Construction output fell 4.3%M/M to be down about 6½% from February's level. And energy production fell 0.6%M/M to be down more than 8½% from the pre-lockdown level.

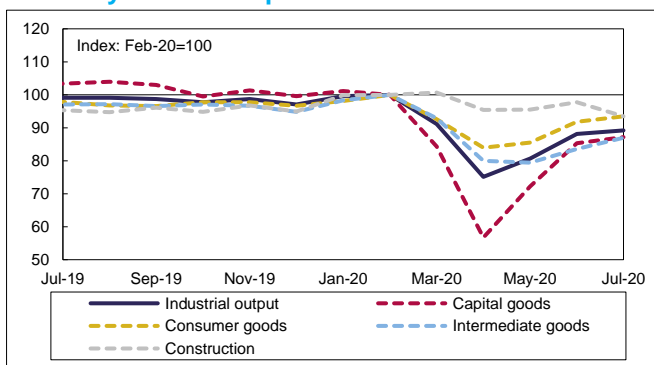
Growth in IP likely to be gradual over coming months

Survey indicators, such as the [ifo business sentiment](#) indices and the [August PMIs](#), as well as July's [new orders data](#), point to continued growth in Germany's manufacturing sector over the near term. However, the pace of that ongoing recovery looks likely to be relatively gradual and relatively patchy. Today's final ifo manufacturing expectations indices pointed to a further modest improvement in production plans last month, with the headline indicator rising 1.1pts in August to +15.4, the highest since April 2018. Within the detail, manufacturers of machinery, equipment and metals expect to sustain an expansion in production for the first time in a year or more. And producers of autos, computers, chemicals and pharmaceuticals all plan for ongoing growth too. But the respective indicators for leather items, textiles, clothing and beverages were also consistent with declines in production over coming months. Moreover, the latest truck-toll mileage data point to a levelling off below the pre-pandemic level over the past fortnight, further suggesting that recovery momentum is rather patchy. While the quarterly growth rate of manufacturing production is likely to be in double-digits, the pace of expansion in Q4 will be far more modest, and the level of production will remain well down on the pre-pandemic level well into 2021 and perhaps into 2022 too.

The day ahead in the euro area

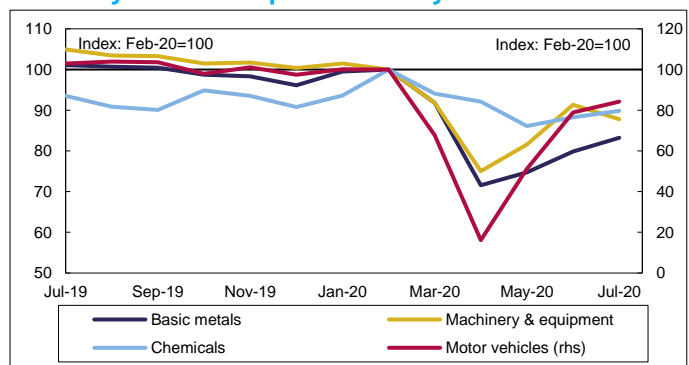
Looking ahead to tomorrow, one data focus will be revised euro area GDP figures for Q2, which are expected to confirm that output contracted at a record pace last quarter, close to the previous estimate of 12.1%Q/Q, to leave output more than 15%

Germany: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Industrial production by sector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

below its pre-pandemic peak. More noteworthy than the headline numbers will be the expenditure breakdown – due to be released for the first time – which will nevertheless no doubt see steep declines in private consumption, investment and trade alike. Also published tomorrow are employment data for Q2, which are expected to confirm the initial estimate of a drop of more than 4.5mn to 155.9mn, the lowest level for three years. This release will also bring the first consistent figures from the member states, which, despite the various government job support schemes, are likely to confirm widespread declines in employment. Sticking with the jobs market, German labour cost data for Q2 are also out. Separately, Italian retail sales numbers for July, also out tomorrow, are expected to reveal that sales fell 1.0% on the month, after June's strong 12.1%M/M increase, leaving sales 1.9% lower compared to a year earlier. Meanwhile, July trade data from Germany and France are expected to show ongoing growth in exports, led by increased demand from China, albeit at a softer pace than in June to leave the level still well down from February.

UK

UK seeking to renege on EU-UK Withdrawal Agreement commitments?

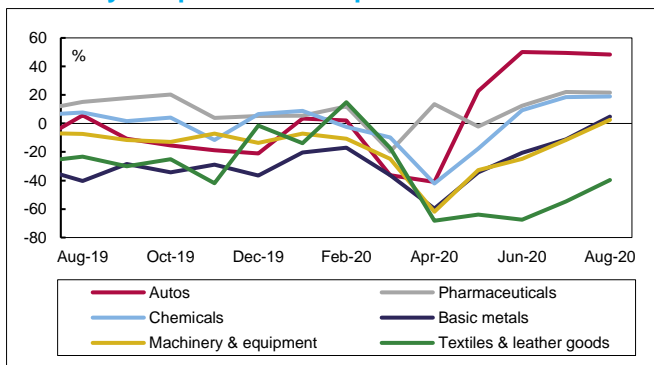
The main focus in the UK this week is Brexit, with FT reports having suggested that the Government will publish new legislation on Wednesday (the UK internal market bill) that will be incompatible with the EU-UK Withdrawal Agreement treaty – particularly the so-called Northern Ireland protocol and its proposed arrangements on state aid and customs – which was signed by UK PM Boris Johnson in January and entered into legal force on 1 February this year. While the Government will present the legislation as contingency planning for the event that no FTA is reached with the EU by mid-October, it risks derailing the ongoing negotiations between the EU and UK so that significant new trade barriers, including tariffs on UK exports of a range of items, from autos to food, would be imposed by the EU from 1 January on. The Government's apparent willingness to breach an international treaty could damage its international reputation, and might also jeopardise its ability to sign future trade agreements with third countries too. Indeed, a future Democrat-led US administration and Congress would likely be unimpressed by any new UK legislative initiative that ultimately undermined the Good Friday Peace Accord in Northern Ireland.

Of course, the veracity of the FT report is unclear, and - as with many policy initiatives associated with this UK Government - might simply represent a provocative negotiating gambit or presentational stunt. A Government spokesperson today stated that the legislation would only make "minor clarifications in extremely specific areas", with no detail on what those clarifications would be. For the time being, we continue to assume that a new FTA will be agreed between the EU and UK before year-end to avoid the significant economic disruption that the absence of such an accord would cause. However, that FTA will still represent the imposition of significant damaging trade barriers between the EU and UK. And we also acknowledge the non-negligible probability that no agreement will be reached.

The day ahead in the UK

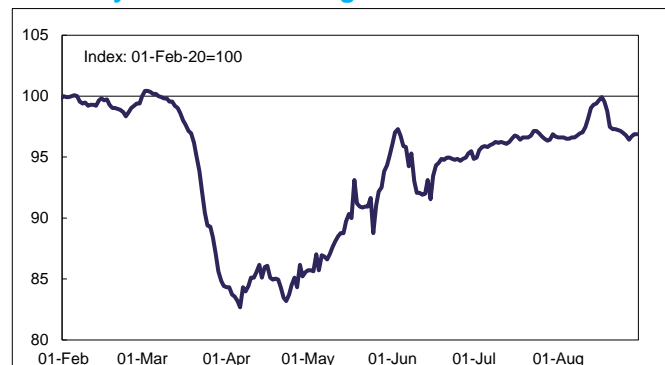
After today's quiet start to the week for economic data, tomorrow brings the publication of the BRC's retail sales monitor for August. This might be expected to show that sales were up again in August, as the Government's "Eat out to help out" restaurant subsidies helped to boost shopping-centre footfall. However, the CBI's [distributive trades survey](#) for August suggested that, after rebounding above the pre-lockdown level in July, sales fell back last month.

Germany: Ifo production expectations



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Truck toll mileage





Source: 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	 Sentix investor confidence	Sep	-8.0	-12.0	-13.4	-
Germany	 Industrial production M/M% (Y/Y%)	Jul	1.2 (-10.0)	4.5 (-7.4)	8.9 (-11.7)	9.3 (-11.4)








Auctions

Country	Auction
- Nothing to report -	

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		10.00 Final GDP Q/Q% (Y/Y%)	Q2	-12.1 (-15.0)	-3.6 (-3.1)
		10.00 Final employment Q/Q% (Y/Y%)	Q2	-2.8 (-2.9)	-0.2 (0.4)
Germany		07.00 Trade balance €bn	Jul	15.9	15.5
		07.00 Labour costs Q/Q% (Y/Y%)	Q2	-	2.4 (4.3)
France		07.45 Trade balance €bn	Jul	-6.2	-8.0
Italy		09.00 Retail sales M/M% (Y/Y%)	Jul	-1.0(-1.9)	12.1 (-2.2)
UK		00.01 BRC retail sales monitor, like-for-like sales Y/Y%	Aug	3.5	4.3

Auctions and events

Country	BST	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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