

Euro wrap-up

Overview

- Bunds followed Treasuries lower, even though German IP data fell short of expectations.
- Gilts also made losses, although reports of repeated threats from the UK Government to walk away from talks with the EU on a new FTA if the “outlines of a deal” don’t materialise next week.
- Tomorrow will bring the release of the ECB account from its September Governing Council meeting, German trade data, the BoF’s monthly economic update and a UK housing market survey.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.706	+0.005
OBL 0 10/25	-0.698	+0.010
DBR 0 08/30	-0.495	+0.015
UKT 1¼ 09/22	-0.010	+0.012
UKT 0% 06/25	-0.018	+0.017
UKT 4¾ 12/30	0.306	+0.019

*Change from close as at 4:00pm BST.
Source: Bloomberg

Euro area

German IP recovery pauses in August

While yesterday’s [German factory orders](#) data exceeded expectations and pointed to ongoing output growth ahead, the figures for manufacturing turnover had suggested that the recovery in industrial output might have paused in August. And today’s data confirmed just that, with IP down 0.2%M/M, the first monthly decline in four. So, having recovered only a little more than 50% of the initial post-pandemic slump, output was still almost 11% below February’s peak and down more than 9½% compared with a year earlier. Total production in August was supported by a substantive 6.7%M/M increase in energy production. In contrast, manufacturing output fell 0.7%M/M, to leave it more than 12% lower than the pre-pandemic level. But various indicators, including yesterday’s orders figure and the September manufacturing PMI survey – for which the output index jumped 4.6pts to 62.4, the highest reading since 2017 – suggests that this pause in manufacturing production should prove temporary with a return to growth at the end of Q3. Moreover, the ifo production expectations index rose in September to its highest level since January 2018, pointing to an ongoing uptrend in output over coming months.

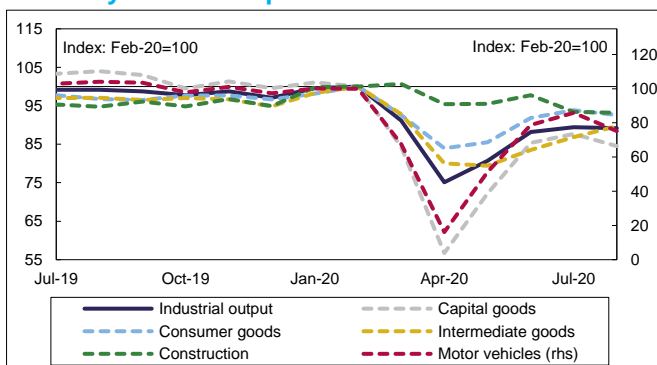
Autos drag likely to be temporary

Within the manufacturing output detail, the weakness in August was caused by declines in production of capital goods (-3.6%M/M) and consumer goods (-1.3%M/M) while production of intermediate goods continued a gradual upwards trend (but had still recovered less than half the decline between February and April). Most notably, autos production fell 12½%M/M following a near-9%M/M increase in July to be still around one-quarter below the pre-pandemic level in August. But there were also falls in production of pharmaceuticals (-10½%M/M), chemicals (-2.6%M/M) and machinery and equipment (-1.8%M/M). The orders data and ifo expectations indices suggest that the decline in production of autos and chemicals in August will prove temporary, but the outlook for output of pharmaceuticals and machinery and equipment is somewhat less encouraging. Moreover, after yesterday’s construction PMI pointed to further weakness in September, today’s figures confirmed a drop in output in the sector in August (-0.3%M/M) following a near-4½%M/M decline in July. So, while manufacturing output in the first two months of Q3 was still more than 12½% higher than the Q2 average, construction activity was down more than 3% on the same basis.

Spanish IP maintains upwards trend (for now)

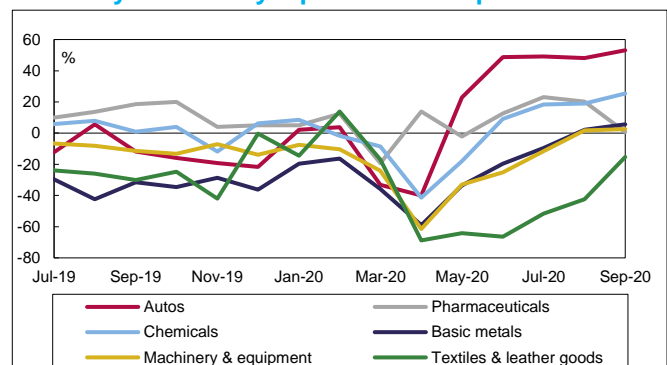
The latest Spanish IP figures also came in a bit softer than expected, but nevertheless still posted a modest rise in August of 0.4%M/M. This suggested that 90% of the drop in output earlier in the year had now been recovered to leave output just 3%

Germany: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ifo survey – production expectations



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

below February's level. Within the detail, there was a further notable improvement in production of capital and intermediate goods (up 3.8%M/M and 1.9%M/M) in August. But while output of consumer durables posted another solid increase (5.1%M/M) to take it back above the pre-pandemic level, production of non-durables fell for the second successive month. Of course, the recent surge in coronavirus cases in Spain will likely weigh on domestic demand going forward. And so the August production level might well mark the high point for the country's manufacturing sector for the time being.

Italian retail sales surge on summer discounting

Contrasting with today's production data, today's Italian retail sales release offered a significant upwards surprise. Indeed, boosted by delayed summer discounting, sales surged 8.2%M/M in August, more than reversing the downwardly revised 6%M/M drop in July. And when adjusting for price effects, volumes were up more than 11%M/M, with a jump of 19.2%M/M in non-food sales. This left total sales up more than 1% compared with a year earlier and just 0.8% below the pre-pandemic level. Indeed, spending on non-food items had almost fully reversed the 58% drop seen between February and April. Admittedly, in-store spending remained more subdued, up just 0.4%Y/Y with spending at non-food stores still down 1½%Y/Y. In contrast, growth in online sales remained extremely strong at 36.8%Y/Y. Of course, like elsewhere in the euro area, spending on services will have remained much weaker. And while Europe's second pandemic wave has so far remained more limited in Italy, risks to the near-term spending outlook look skewed to the downside.

The day ahead in the euro area

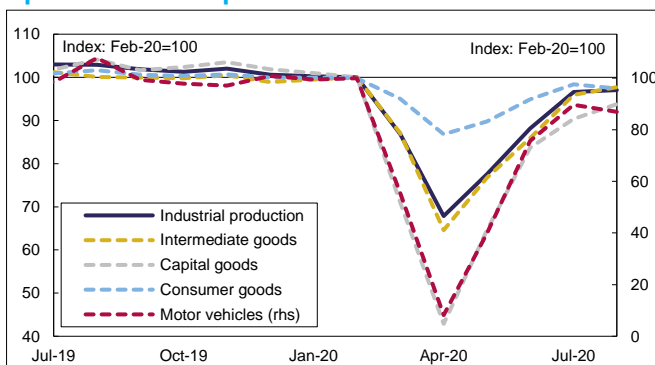
Tomorrow will bring the Bank of France's latest monthly economic update for September, incorporating the results from its latest business sentiment indicators (also published tomorrow). And given the spike in coronavirus cases in that country over the past month and reintroduction of stricter containment measures (including the closure of Parisian bars, gyms and swimming pools from yesterday), this seems likely to paint a relatively bleak picture for the near-term outlook. Certainly, INSEE's economic update yesterday suggested that although GDP growth was forecast to rise around 16%Q/Q in Q3, the outlook for Q4 had deteriorated with the resurgence of infections. Indeed, INSEE suggested that French growth could be zero or negative in the current quarter – and if the former, this would likely leave GDP at the end of the year still 5% below the pre-pandemic level. In addition, German trade figures for August will be published, which are likely to show that exports and imports maintained an upwards trend in the middle of Q3. Thursday will also bring the ECB account from the 9-10 September Governing Council meeting. While this meeting has been followed by more recent comments from influential ECB policymakers – not least President [Lagarde at last week's ECB watchers' conference](#) – suggesting that more easing by year-end is on the cards, the Governing Council's October meeting will reportedly feature a discussion of the various asset purchase programmes, and so the account of the September meeting will also be watched for clues as to what to expect from that forthcoming stock-take.

UK

The day ahead in the UK

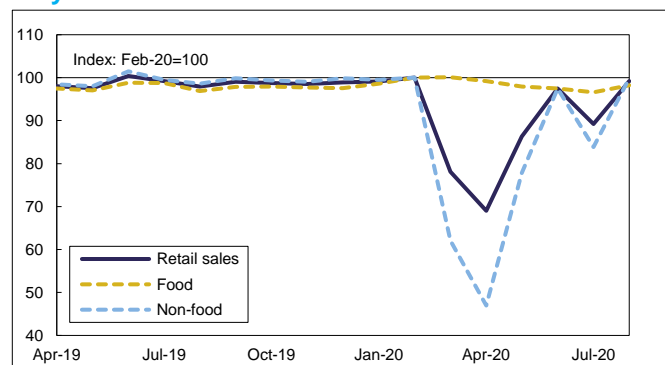
After today's ONS house price figures suggested a moderation in growth in July (down 0.6ppt to 2.9%Y/Y), tomorrow's RICS survey will provide a broader and more timely assessment of conditions in the housing market. In particular, the headline house price balance is expected to ease slightly to 40 in September from 44 in August, although that would still leave it elevated and at levels not seen since the beginning of 2016. The recent surge in activity in the housing market is partly the result of pent-up demand following the coronavirus lockdown and a cut in property sales taxes. And looking ahead, the survey might flag that upwards pressure on house prices is likely to ease as the effects of subdued economic growth, renewed local lockdowns and a deteriorating labour market are felt. Separately, BoE Governor Bailey will also participate in a panel discussion with ECB Executive Board member Schnabel at an online conference.

Spain: Industrial production












Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Italy: Retail sales











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	
Germany	 Industrial production M/M% (Y/Y%)	Aug	-0.2 (-9.6)	1.5 (-8.7)	1.2 (-10.0)	1.4 (-)	
France	 Current account (trade) balance €bn	Aug	-4.7 (-7.7)	-	-6.2 (-7.0)	-5.7 (-7.0)	
Italy	 Retail sales M/M% (Y/Y%)	Aug	8.2 (0.8)	3.8 (-)	-2.2 (-7.2)	-6.0 (-7.1)	
Spain	 Industrial production M/M% (Y/Y%)	Aug	0.4 (-5.7)	-4.9 (-5.9)	9.3 (-6.4)	9.6 (-6.2)	
UK	 House price index Y/Y%	Jul	2.3	3.6	3.4	2.9	
	 Unit labour costs Y/Y%	Q2	27.4	-	6.2	6.7	
Auctions							
Country	Auction						
Germany	 sold €2.5bn of 0% 2030 bonds at an average yield of -0.51%						
UK	 sold £2.5bn of 0.375% 2030 bonds at an average yield of 0.313%						
	 sold £750mn of 0.125% 2041 index-linked bonds at an average yield of -2.302%						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases							
Economic data							
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous		
Germany	 07.00	Current account (trade) balance €bn	Aug	16.2 (16.0)	20 (19.2)		
France	 -	Bank of France industrial sentiment	Sep	105	106		
UK	 00.01	RICS house price balance	Sep	40	44		
Auctions and events							
Country	BST	Auction / Event					
EMU	 08.25	ECB's Schnabel and BoE Governor Bailey to participate in a panel discussion at Single Resolution Board's annual conference					
	 09.00	ECB's de Guindos scheduled to speak					
	 09.20	ECB's Hernández de Cos scheduled to speak					
	 11.15	ECB's Mersch scheduled to speak					
	 12.30	ECB publishes its account of the September monetary policy meeting					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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