

Euro wrap-up

Overview

- Bunds made modest losses, even though euro area industrial production was subdued at the end of Q2 as the autos sector remained a drag.
- Gilts lost ground as the first estimate of UK GDP showed rapid growth in Q2, underpinned by increased household spending as lockdown restrictions eased.
- The coming week will bring the second estimate of euro area Q2 GDP, as well as July inflation from the euro area and UK. Labour market and retail sales figures are also due from the UK.

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Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.754	+0.004
OBL 0 10/26	-0.730	+0.003
DBR 0 08/31	-0.464	+0.003
UKT 0 ¹ / ₈ 01/23	0.141	+0.027
UKT 0 ¹ / ₈ 01/26	0.303	+0.033
UKT 4 ³ / ₄ 12/30	0.594	+0.025

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

Source: Bloomberg

Euro area

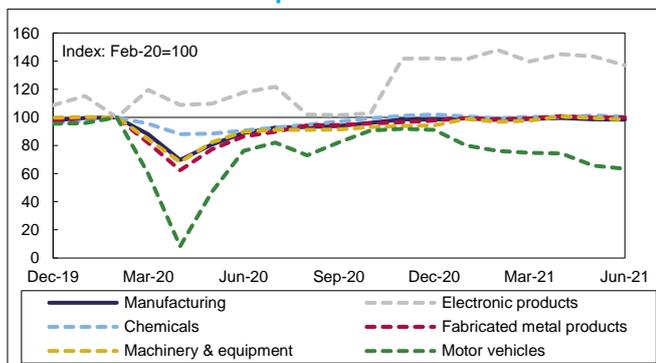
Euro area IP remains subdued as autos remain a drag

Despite extremely upbeat survey indicators – the Commission’s industry sentiment index stood at a record high and the manufacturing output PMI remained historically elevated – euro area industrial production (excluding construction) was a damp squib at the end of Q2, falling for the second successive month in June (-0.3%M/M) with manufacturing output similarly subdued (-0.4%M/M). As a result, industrial production was down 0.3%Q/Q in Q2 and still 1½% below the pre-pandemic level. Not least given ongoing supply bottlenecks related to the semiconductor shortage, the weakness was principally driven by the autos sector, where output fell for the seventh consecutive month (-3.7%M/M in June) to leave it down 11.9%Q/Q in Q2 and a whopping 36% below its pre-pandemic level. Machinery output was also down 1.1%M/M in June, although this was from an elevated level to leave it almost 2%Q/Q higher in Q2. Overall, production of capital goods declined (-0.6%M/M) for the fifth month out of the past six and therefore down a sizeable 2.4%Q/Q in Q2. In contrast, production of intermediate goods grew 1.0%Q/Q over the quarter as a whole despite moving broadly sideways in June. And after increasing 1.2%M/M in June, output of consumer goods was up 3.3%Q/Q in Q2. Recent surveys suggest that supply-chain issues will likely continue to act as a brake on production for a while yet. But with production backlogs and orders sky-high, as and when supply bottlenecks ease output is likely to continue to grow rapidly.

German inflation rises to 13-year high

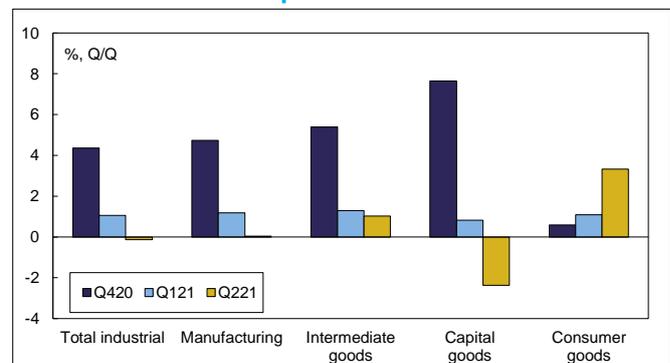
Final German CPI figures for July, published yesterday, aligned with the preliminary estimate, which showed the headline HICP inflation rate rising 1ppt to 3.1%Y/Y, a thirteen-year high, while the national measure saw headline inflation jump 1.5ppts to 3.8%Y/Y. Admittedly this surge principally reflects base effects from last July’s temporary VAT cut – for example, despite falling on the month (-2.4%M/M) clothing price inflation jumped 2.4ppts to 5.8%Y/Y. There was some tentative evidence that prices of goods principally impacted by supply bottlenecks were also increasing. Energy inflation also trended higher this month, up 2.2ppts to 11.2%Y/Y, a rate last exceeded in 2008. Certain seasonal effects were at play too, with package holiday prices up 22.1%M/M, while the continued reopening of the services sector added to price pressures. Overall, when excluding energy and food, core inflation (on the HICP measure) rose a more modest 0.6ppt to 1.8%Y/Y. The pickup in the national measure of core inflation was more marked, by 1ppt to 2.7%Y/Y, but this will likely ease back in due course.

Euro area: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

But Italian inflation eases back on summer discounting

There was a modest uptick in the final Italian inflation figures in July compared with the initial estimate. But this still left the headline HICP measure down 0.3ppt on the month at 1.0%Y/Y. Indeed, despite a jump in energy inflation, by 4.5ppts to 18.9%Y/Y, the moderation principally reflected the timing of summer discounting, which fell in July this year compared with the lockdown-delayed sales in August 2020 – indeed, clothing inflation was down 12.1%Y/Y in July compared with growth of 0.6%Y/Y in June. So, despite a modest uptick in recreation services inflation, core inflation fell sharply, by 0.9ppt to -0.6%Y/Y, a move which will likely be reversed in August. Assuming tomorrow's final inflation figures from France and Spain broadly align with the respective preliminary readings (down 0.3ppt to 1.6%Y/Y in France and up 0.4ppt to 2.9%Y/Y in Spain), we would expect the final euro area inflation estimate – due next Wednesday – to confirm the findings from the preliminary release, with the headline rate up 0.3ppt to 2.2%Y/Y while the core rate fell 0.2ppt to 0.7%Y/Y.

The week ahead in the euro area

A relatively quiet end to the week brings the aforementioned final July inflation figures from France and Spain, as well as euro area goods trade numbers for June. Looking to the week ahead, the data calendar gets underway on Tuesday with the second estimate of euro area Q2 GDP expected to confirm growth of 2%Q/Q, 13.7%Y/Y. While this release will again merely provide an aggregate output figure, monthly construction activity figures for June – due the same day – will offer some further insight in the sectoral breakdown. Tuesday will also bring quarterly employment numbers, which, in line with stronger GDP growth and relaxation of lockdown restrictions are likely to report a notable increase last quarter. Wednesday will bring the aforementioned revised July euro area inflation release – expected to confirm that the headline CPI rate rose 0.3ppt to 2.2%Y/Y, while core CPI moderated 0.2ppt to 0.7%Y/Y – followed by German PPI numbers on Friday. Euro area balance of payments data for June are also due on Thursday.

UK

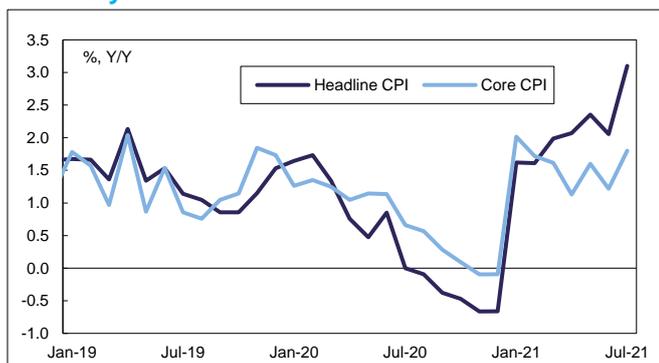
UK GDP grew a solid 4.8%Q/Q in Q2

Broadly in line with expectations, the preliminary estimate of UK GDP in Q2 reported solid growth of 4.8%Q/Q. This left output up a whopping 22.2%Y/Y (admittedly flattered by the low base last year), but still 4.4% below the pre-pandemic level in Q419. With lockdown restrictions having gradually eased throughout the second quarter, however, the monthly profile was more encouraging, with output having risen for the fifth consecutive month in June (1.0%M/M), to leave it just 2.2% below the February-2020 level. Despite the resurgence in coronavirus cases in July and associated 'pingdemic' disruption to activity, as well as ongoing supply bottlenecks in the manufacturing and construction sectors, survey indicators generally point to ongoing recovery, particularly in the services sector as it continues to benefit from the lifting of the final lockdown restrictions. And so while the pace of growth in Q3 will no doubt moderate from that in Q2, we still forecast a solid expansion (circa 2½%Q/Q), with the pre-pandemic output level possibly to be surpassed in the current quarter.

Services led the recovery as restrictions eased

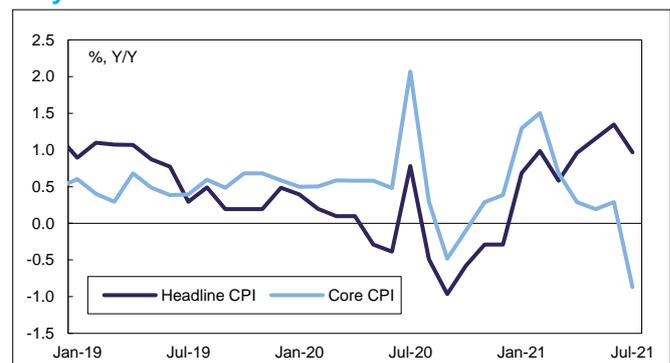
Unsurprisingly, the acceleration in GDP in Q2 was driven by the reopening of the services sector, with consumer-facing activities surging 16.7%Q/Q. In particular, accommodation and food services jumped 87.8%Q/Q, while wholesale and retail trade increased by 12.8%Q/Q. There was also a notable increase in education output (19.4%Q/Q) reflecting the reopening of schools. Overall, services output rose 5.7%Q/Q in Q2, to be 3.5% below Q419 levels. But given the gradual relaxation of restrictions as the quarter progressed, the monthly profile suggested this shortfall had narrowed to 2.3% by the end June. Meanwhile, industrial production rose ½%Q/Q in Q2, merely reversing the decline in Q1 as the temporary maintenance closures of oil field sites weighed. Manufacturing output was up a stronger 1.8%Q/Q despite a notable drag from the transport equipment sub-sector. Indeed, production of motor vehicles fell for the second successive quarter and by a

Germany: Headline and core CPI*



*HICP measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Italy: Headline and core CPI*



*HICP measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

substantial 16.7%Q/Q, as the global semiconductor shortage disrupted supply chains. More encouragingly, autos output did rise in June (13.7%M/M) for the first month in seven, although it still remained more than one quarter below its pre-pandemic level. And overall, industrial production in Q2 remained 3.3% below the Q419 level. Despite declining for the third consecutive month in June (-1.3%M/M) as firms also cited supply difficulties, construction output rose 3.3%Q/Q in Q2 to leave it just 0.6% below the pre-pandemic level.

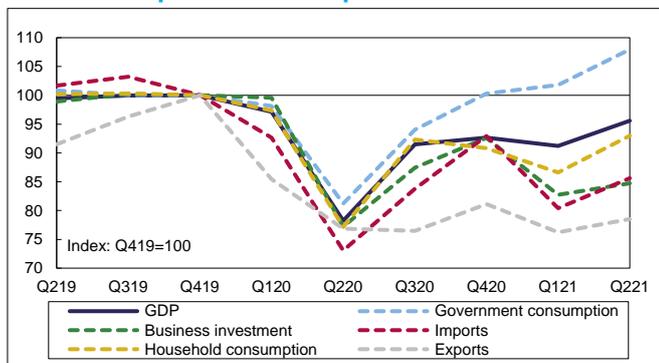
Households and businesses support growth, but net trade subtracts

On the expenditure side, household consumption accounted for much of the quarterly increase in GDP, rising 7.3%Q/Q in Q2, as spending on hospitality and transport accelerated with the easing of restrictions. But this still left consumption 7% lower than in Q419. Business investment also improved, although the 2.4%Q/Q increase still left it more than 15% below the pre-pandemic levels. And a notable decline in public sector activity saw total fixed investment fall a modest ½Q/Q in Q2. Given the test-and-trace and vaccination programmes, as well as a pickup in non-Covid-related health activity, and increased education services, government consumption remained supportive, rising 6.1%Q/Q. But with imports (up 6.5%Q/Q) outpacing exports (up 3.0%Q/Q), net trade subtracted 0.9ppt from GDP growth in Q2. The softer export outturn partly reflected ongoing weakness in services exports as restrictions disrupted tourism among other sub-sectors. In contrast, goods exports jumped in Q2 reversing the near-10%Q/Q decline recorded in Q1 when Brexit took its toll. While monthly figures are extremely volatile, today's release suggests that services exports rose for the second successive month in June. And these should continue to recover over the summer months as travel and other restrictions ease.

RICS reports strong house price growth even a stamp duty relief starts to taper

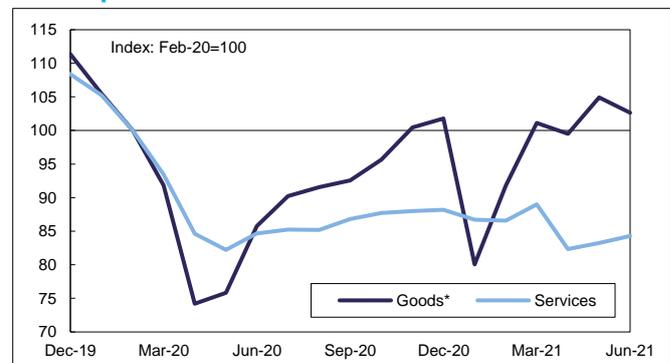
The latest RICS residential survey today suggested that house prices remained buoyant in July despite the tapering of the government's stamp duty tax relief from the start of the month. In particular, the headline price indicator showed a net balance of 78% of respondents reported a rise in house prices last month, down slightly from June (+82%), but nevertheless a historically elevated level as supply of new properties on the market fell again. Survey respondents did, however, report a drop in the number of new buyer enquiries – the respective index fell 19pts to -9% – and therefore a reduced number of agreed sales too. Overall, a larger share of net respondents (up 10ppts to 66%) expected house prices to rise over the coming twelve months. This notwithstanding, we expect to see housing market activity slow further when the stamp duty holiday ends in September.

UK: GDP expenditure components



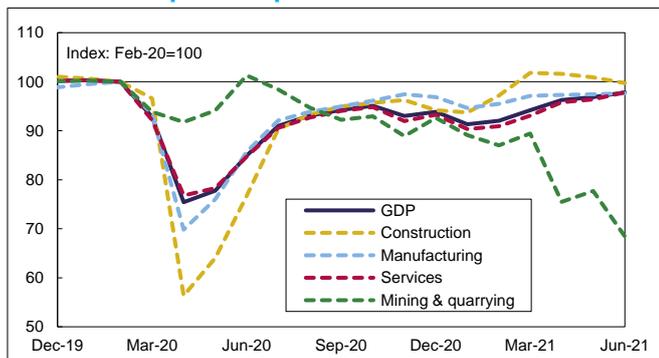
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Exports volumes



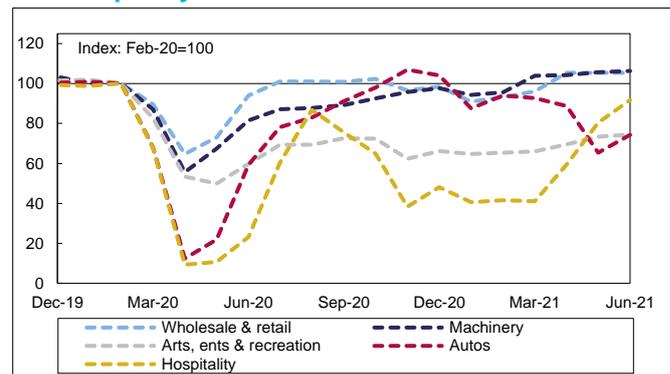
*Excluding precious metals. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: GDP output components



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

UK: Output by selected sub-sectors



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The week ahead in the UK

There will be several top-tier UK data releases in the coming week, with the latest labour market report on Tuesday, July inflation figures on Wednesday and retail sales data on Friday. With the government's Job Retention Scheme still in full operation in June and the economy continuing to return to some form of post-lockdown normality, we expect to see a further tightening in labour market conditions, including a further notable increase in payrolls and vacancies and a modest drop in the unemployment rate. Meanwhile, growth in average labour earnings seems highly likely to rise further from the 7.3%3M/Y growth in May, supported in part by base and composition effects. Meanwhile, having jumped to 2.5%Y/Y in June, we expect a temporary easing in the headline CPI rate last month driven by a modest easing in non-energy industrial goods inflation, in part reflecting a change in seasonal price patterns. As such, core inflation might also briefly return back below the BoE's 2% target. Focus at the end of the week will turn to July's retail sales report, which might well reveal a drop in spending on goods at the start of the third quarter as the weather dampened visits to the High Street and spending on services increased as the final lockdown restrictions were eased. The coming week will also bring the August Rightmove and June ONS house price indices on Monday and Wednesday respectively, while public finance figures for July will be published alongside the GfK's latest consumer confidence survey on Friday.

Daiwa economic forecasts

		2021				2022		2021	2022	2023
		Q1	Q2	Q3	Q4	Q1	Q2			
GDP growth, %, Q/Q										
Euro area		-0.3	2.0	1.8	1.1	1.0	0.8	4.7	4.4	2.1
UK		-1.6	4.8	2.7	2.3	1.0	0.6	7.2	6.1	1.3
Headline and Core Inflation										
Euro area										
Headline CPI		1.1	1.8	2.6	2.8	1.7	1.8	2.1	1.7	1.6
Core CPI		1.2	0.9	1.3	1.7	1.0	1.5	1.2	1.3	1.3
UK										
Headline CPI		0.6	2.0	2.9	3.8	3.7	3.7	2.3	2.6	2.0
Core CPI		1.2	1.8	2.7	3.3	3.2	3.2	2.2	2.5	2.0
ECB										
Refi Rate %		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %		-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
PEPP envelope* (€bn)		1850	1850	1850	1850	1850	1850	1850	1850	1850
BoE										
Bank Rate %		0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.25
Bond purchases* (£bn)		895	895	895	895	895	895	895	895	895

*End of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 17 August 2021

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Industrial production M/M% (Y/Y%)	Jun	-0.3 (9.7)	-0.2 (10.5)	-1.0 (20.5)	-1.1 (20.6)
UK	 RICS house price balance %	Jul	79	76	83	-
	 Preliminary GDP Q/Q% (Y/Y%)	Q2	4.8 (22.2)	<u>4.7 (22.0)</u>	-1.6 (-6.1)	-
	 GDP M/M%	Jun	1.0	<u>0.7</u>	0.8	0.6
	 Industrial production M/M% (Y/Y%)	Jun	-0.7 (8.3)	0.3 (9.4)	0.8 (20.6)	0.6 (20.7)
	 Manufacturing production M/M% (Y/Y%)	Jun	0.2 (13.9)	0.3 (13.4)	-0.1 (27.7)	0.1 (28.2)
	 Index of services M/M% (3M/3M%)	Jun	1.5 (5.7)	0.9 (5.7)	0.9 (3.9)	0.7 (-)
	 Construction output M/M% (Y/Y%)	Jun	-1.3 (30.0)	1.0 (32.2)	-0.8 (56.5)	-0.7 (57.6)
	 Goods trade balance £bn	Jun	-12.0	-9.2	-8.5	-9.6

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tuesday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 ZEW current situation balance (expectations)	Aug	29.3 (40.4)	30.0(55.0)	21.9 (63.3)	-
UK	 BRC retail sales monitor, like-for-like sales Y/Y%	Jul	4.7	5.0	6.7	-

Auctions

Country	Auction
UK	 sold £2.75bn of 0.25% 2031 bonds at an average yield of 0.664%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Final CPI (EU-harmonised CPI) Y/Y%	Jul	3.8 (3.1)	3.8 (3.1)	2.0 (2.1)	-
Italy	 Final CPI (EU-harmonised CPI) Y/Y%	Jul	1.9 (1.0)	1.8 (0.9)	1.3 (1.3)	-

Auctions

Country	Auction
Germany	 sold €3.3bn of 2031 bonds at an average yield of -0.44%
UK	 sold £700mn of 0.125% 2039 index-linked bonds at an average yield of -2.633%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU	10.00	Trade balance €bn	Jun	10.8	9.4
France	07.45	Final CPI (EU-harmonised CPI) Y/Y%	Jul	1.2 (1.6)	1.5 (1.9)
Spain	08.00	Final CPI (EU-harmonised CPI) Y/Y%	Jul	2.9 (2.9)	2.7 (2.5)

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast/actual</i>	Previous
Monday 16 August 2021					
UK	00.01	Rightmove house prices M/M% (Y/Y%)	Aug	-	0.7 (5.7)
Tuesday 17 August 2021					
Euro area	10.00	GDP – 2 nd release Q/Q% (Y/Y%)	Q2	2.0 (13.7)	-0.3 (-1.3)
	10.00	Employment Q/Q% (Y/Y%)	Q2	-	-0.3 (-1.8)
	10.00	Construction output M/M% (Y/Y%)	Jun	-	0.9 (13.6)
UK	07.00	Employment 3M/3M 000	Jun	-	25
	07.00	Unemployment rate 3M%	Jun	-	4.8
	07.00	Claimant count rate % (change 000)	Jul	-	5.8 (-114.8)
	07.00	Average weekly earnings (excluding bonuses) 3M/Y%	Jun	-	7.3 (6.6)
	09.30	Output per hour Y/Y%	Q2	-	0.9
Wednesday 18 August 2021					
Euro area	10.00	Final CPI (core CPI) Y/Y%	Jul	<u>2.2 (0.7)</u>	1.9 (0.9)
UK	07.00	CPI (core CPI) Y/Y%	Jul	<u>2.3 (2.0)</u>	2.5 (2.3)
	07.00	PPI output prices (input prices) Y/Y%	Jul	-	4.3 (9.1)
	09.30	House price index Y/Y%	Jun	-	10.0
Thursday 19 August 2021					
EMU	09.00	Current account balance €bn	Jun	-	11.7
Spain	08.00	Trade balance €bn	Jun	-	0.1
Friday 20 August 2021					
Germany	07.00	PPI Y/Y%	Jul	-	8.5
UK	00.01	GfK consumer confidence	Aug	-	-7
	07.00	Retail sales including auto fuel M/M% (Y/Y%)	Jul	-	0.5 (9.7)
	07.00	Retail sales excluding auto fuel M/M% (Y/Y%)	Jul	-	0.3 (7.4)
	07.00	Public sector net borrowing £bn	Jul	-	22.8

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 16 August 2021		
- Nothing scheduled -		
Tuesday 17 August 2021		
Germany 	10.30	Auction: €6bn of 2023 bonds
UK 	10.00	Auction: £2bn of 0% 2046 bonds
Wednesday 18 August 2021		
Germany 	10.30	Auction: €1bn of 2050 bonds
Thursday 19 August 2021		
France 	09.50	Auction: to sell bonds
	10.50	Auction: to sell index linked bonds
Spain 	09.30	Auction: to sell bonds
Friday 20 August 2021		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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