Euro wrap-up

Overview

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- Bunds made notable losses as euro area flash inflation in August surprised on the upside and ECB hawks called for asset purchases to be pared back.
- Despite some weak bank lending data, Gilts also made losses as a UK business survey suggested economic optimism was at its strongest for four years.
- Tomorrow will bring euro area labour market figures, final manufacturing PMIs and new car registrations numbers from several member states.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.731	+0.020
OBL 0 10/26	-0.681	+0.040
DBR 0 08/31	-0.384	+0.058
UKT 0 1/8 01/23	0.218	+0.029
UKT 0 3/8 10/26	0.384	+0.024
UKT 0¼ 07/31	0.716	+0.045

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

Euro area

Inflation rises above expectations to highest since 2011

Euro area inflation was always bound to rise significantly further in August to a multi-year high. However, today's flash estimate was even stronger than anticipated. In particular, the euro area headline HICP rate rose 0.8ppt to 3.0%Y/Y, the highest since November 2011 and some 0.3ppt above the consensus on the Bloomberg survey. In addition, core inflation (excluding energy, food, alcohol and tobacco) rose 0.9ppt to 1.6%Y/Y, a modest 0.1ppt above the Bloomberg consensus but still the highest since July 2012. Within the detail, euro area inflation was stronger among all main components, but particularly non-energy industrial goods (up 2.0ppts to 2.7%Y/Y, the highest since the introduction of the euro), energy (up 1.1ppts to 15.4%Y/Y, the highest since 2008 to account for almost half of all inflation) and food (up 0.4ppt to 2.0%Y/Y, the highest since last October). But inflation of services was still relatively subdued and within the recent range, up just 0.1ppt to 1.1%Y/Y. At the country level, while yesterday's German inflation data were in line with expectations, today's figures from France and Italy exceeded expectations as did yesterday's figures from Spain.

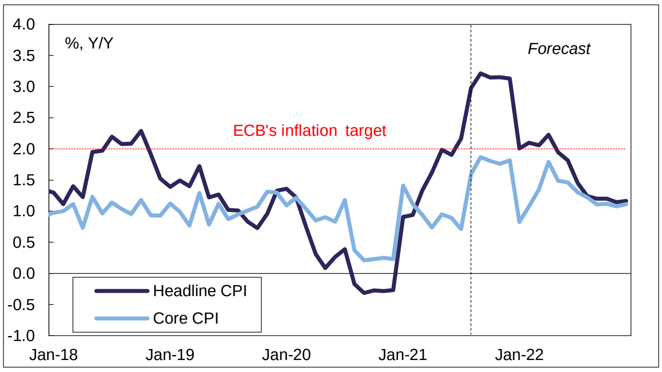
Still no evidence of second-round effects from recent inflation spike

On balance, with services inflation still subdued, today's figures suggest that the euro area's current high inflation readings will be temporary blips caused by base effects and temporary factors associated with the pandemic, including shifts in global oil and commodity prices, the reversal of Germany's VAT cut and – explaining much of today's high French and Italian data and some of the rise in inflation of non-energy industrial goods inflation – the timing of summer sales. The full data set (due on 17 September) will, however, provide additional insights into what extent this month's jump in goods inflation might also reflect supply-chain problems. Nevertheless, there still seems little reason to expect significant second-round effects on euro area inflation to emerge next year, when base effects will fall away and in some cases likely turn negative. For example, data released yesterday showed that German agreed labour earnings rose in nominal terms by just 1.9%Y/Y in Q2 – still in the lower half of the range of recent years, consistent with a drop in real earnings and far from the wage-price spiral required to shift inflation significantly higher over coming years. In addition, while yesterday's Commission survey suggested a further modest increase in inflation expectations of consumers, retailers and industrial firms, inflation expectations of services firms fell back within the pre-Covid range. Financial market inflation expectations remain inconsistent with the ECB's target too.

Outlook inconsistent with policy tightening but hawks argue for slower pace of purchase

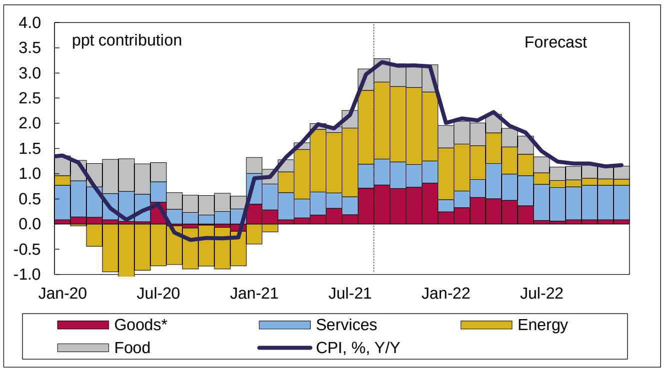
We expect headline inflation to remain at 3.0%Y/Y or above for the rest of the year, with core inflation probably rising closer to 2.0%Y/Y. However, as the impact of Germany's VAT change falls out of the calculation, headline inflation will take a step

Euro area: Inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation forecast and components



**Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

down to about 2%Y/Y from January. And we expect it to fall back below the ECB's target over the course of the year, and remain well below 2%Y/Y into the medium term too. So, while the ECB's updated projections due next week will revise up the near-term inflation outlook, the case for an upwards revision to the forecast for 2023 is weaker. With the ECB's updated forward policy guidance having signalled that rates are expected to remain at their present or lower levels until the Governing Council expects inflation to remain at 2%Y/Y "well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and it judges that …underlying inflation is …consistent with inflation stabilizing at 2%Y/Y over the medium term", this outlook would suggest no policy tightening over the horizon. That, however, did not prevent a couple of the hawkish Governing Council members (Holzmann and Knot) from arguing today that the pace of purchases should be slowed in Q4.

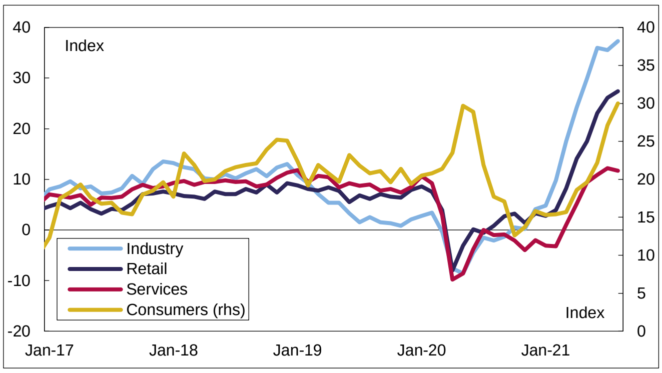
German unemployment falls again

While wage settlements in Germany remain subdued, conditions in the labour market continue to improve, with today's figures reporting a further notable decline in unemployment this month as employment was boosted by the extensive reopening of the economy. In particular, unemployment fell for the fourth consecutive month in August and by 53k to 2.54mn and taking the cumulative decline since April to 208k. This left the number of people unemployed down by around 377k compared with a year earlier, but still roughly 271k above the pre-pandemic level. As such, the claimant count rate of unemployment fell a further 0.1ppt on the month to 5.5%, down from the peak of 6.4% in July last year but still ½ppt above the rate in March 2020. Of course, Germany's labour market remains supported to some extent by the government's Kurzarbeit short-time work scheme, although participation in this scheme is expected to have declined notably further this month – in June, firms were estimated to have claimed for around 1.59mn employees, down from 3.36mn in February and the near-6mn peak at the start of the pandemic. And a further 22k new jobs were registered in August too, leaving the number of vacancies at 751k, comfortably higher than the pre-pandemic level (711k) but still some way off the peak in early 2019 (808k). Furthermore, yesterday's European Commission survey suggested a further notable increase in German business employment expectations, with the respective index (EEI) up to the highest since 2018. Overall, the EEI for the euro area also rose further to signal the strongest hiring intentions since November 2018.

The day ahead in the euro area

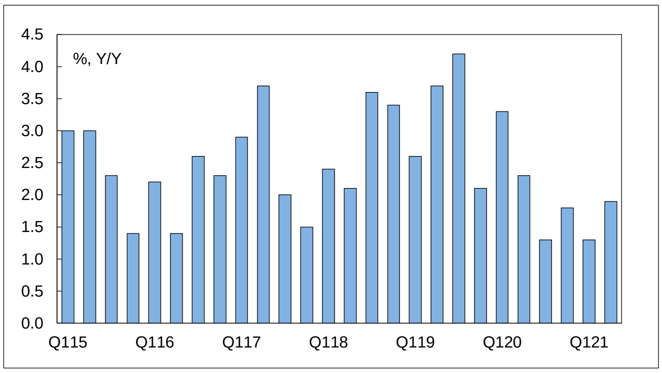
Tomorrow will bring euro area labour market figures for July, which, consistent with the continued re-opening of the services sector, are likely to report a further decline in the level of unemployment that month. Indeed, the unemployment rate is expected to decline by 0.1ppt to 7.6%, which would be the lowest rate since May 2020 but still ½ppt above the pre-pandemic low. Wednesday will also bring German retail sales figures for July, which, similar to today's weak French consumer

Euro area: Selling price expectations



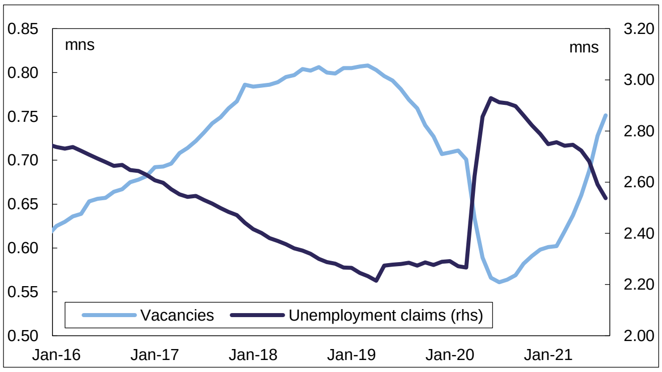
Source: European Commission, Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Wage settlements



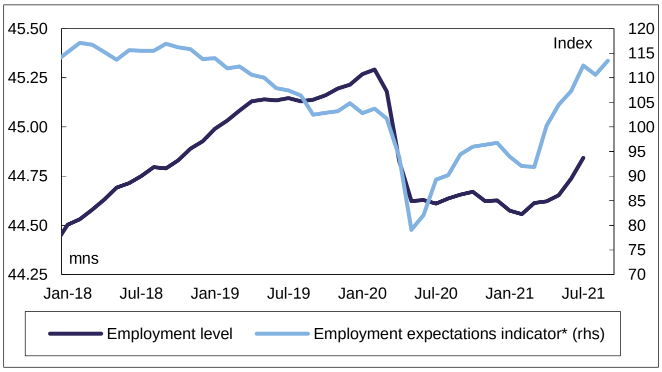
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: Unemployment and vacancies



Source: European Commission, Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Employment and expectations Indicator



**One-month lead. Source: European Commission, Refinitiv and Daiwa Capital Markets Europe Ltd.*

spending numbers (down 2.2%M/M) are likely to report a decline last month after two consecutive months of strong growth, as households pivot spending from goods to services. August's new car registration numbers from France, Italy and Spain are also due and likely to report that sales remain well below pre-pandemic levels due not least to ongoing supply constraints on the production line. Indeed, the final manufacturing PMIs – also due tomorrow – are likely to point to a further moderation in the sector's recovery in August, with the flash release seeing the output PMI decline 1.9pts to 59.2, a six-month low, amid ongoing disruption from global supply bottlenecks.

UK

Improved Lloyds business barometer at odds with the decline in the PMIs

Contrasting with the slowing momentum implied by the flash PMIs, today's Lloyds business barometer suggested an improvement in economic optimism in August to its highest in more than four years. Indeed, the headline indicator rose 6pts on the month to 36%, with firms' assessment of the current situation the most positive since mid-2016, while almost half of surveyed firms expected stronger business activity in the year ahead. Perhaps inevitably given the final easing of restrictions from mid-July, the improvement in confidence this month was most pronounced in the services sector, which rose to its highest since the start of 2018. Despite ongoing supply concerns, sentiment was also firmer in the construction and manufacturing sectors as firms were more upbeat about their trading prospects over the coming year, although headline manufacturing confidence was still below May's peak. While firms' hiring intentions were unchanged, given the improved economic backdrop and reported staff shortages, today's survey suggested that pay growth prospects rose to a near-three-year high, with roughly one-third of responding businesses predicting a rise in average pay growth of at least 2% over the coming twelve months. As such, almost half of firms were expecting to charge higher prices over the coming year, with overall companies' expectations for the prices charged for goods and services rising to the highest level since 2017.

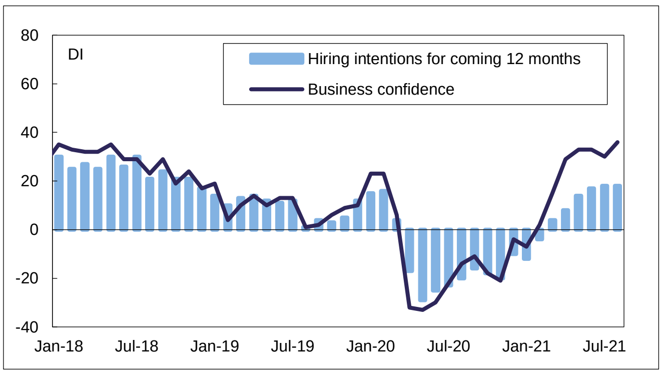
Consumer credit subdued and mortgage lending weaker as incentives scaled back

While consumers should continue to support the recovery over coming quarters, the latest bank lending figures published today by the Bank of England suggested that demand for consumer credit remained subdued in July. Indeed, there was no additional consumer credit borrowing in July for the first month in four, and compared with an average monthly increase of £1.2bn in the two years before the pandemic. As such, the annual pace of decline in consumer credit accelerated slightly in July to -2.7%Y/Y, albeit remaining considerably softer than the trough in February (-10%Y/Y). Instead, households' deposits increased by an additional £7.1bn in July, a touch below the average over the previous three months and down from the peak (£27.4bn) in May 2020, but nevertheless still well above the pre-pandemic norm, which in due course might feed through into stronger consumer spending. Finally, given the tapering of the government's stamp duty holiday from the start of July there was an inevitable slowdown in mortgage lending that month. With the amount of secured loans having risen a whopping £17.9bn in June, individuals actually repaid £1.4bn of mortgage debt in July, only the second net repayment in the past decade. And the number of mortgage approvals – an indicator of future borrowing – similarly fell back, by 5.1k to 75.2k, the lowest since July 2020. While this remains well above the pre-pandemic level, today's figures add to evidence of a likely further slowing of housing market activity over coming months, particularly once the stamp duty holiday is fully reversed in October.

The day ahead in the UK

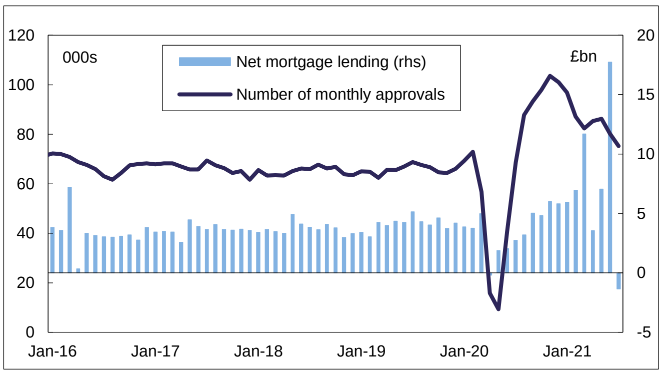
Tomorrow will bring the final UK manufacturing PMIs for August, which, similar to the euro area's survey, is likely to flag ongoing difficulties in the sector not least due to supply constraints. In particular, the flash release reported a 3pt decline in the output PMI to 54.1, a six-month low, with supplier delays having risen further last month to a level only exceeded once before (at the beginning of the pandemic) and therefore suggesting that input and output price pressures remain extremely high. Despite significantly higher operating costs, the BRC Shop Price Index – also due tomorrow – is likely to show still very subdued price pressures on the high street. The Nationwide house price index for August is also due for release.

UK: Lloyds business barometer



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending and approvals



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

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Preliminary CPI (core CPI) Y/Y%	Aug	**3.0 (1.5)**	*2.7 (1.4)*	2.2 (0.7)	-
Germany	Unemployment rate % (change '000s)	Aug	**5.5 (-53)**	5.6 (-40)	5.7 (-91)	**5.6 (-90)**
France	GDP – 2nd estimate Q/Q% (Y/Y%)	Q2	**1.1 (18.7)**	0.9 (18.7)	0.0 (1.7)	**- (1.5)**
	Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	**1.9 (2.4)**	1.7 (2.1)	1.2 (1.5)	-
	Consumer spending M/M% (Y/Y%)	Jul	**-2.2 (-4.6)**	0.8 (-1.4)	0.3 (-2.4)	-
Italy	GDP – 2nd estimate Q/Q% (Y/Y%)	Q2	**2.7 (17.3)**	2.7 (17.3)	0.2 (-0.7)	-
	Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	**2.1 (2.6)**	1.9 (2.1)	1.9 (1.0)	-
UK	Lloyds business barometer	Aug	**36**	-	30	-
	Net consumer credit £bn (Y/Y%)	Jul	**0.0 (-2.7**	0.4 (-)	0.3 (-2.2)	-
	Net mortgage lending £bn (mortgage approvals '000s)	Jul	**-1.4 (75.2)**	3.0 (78.5)	17.9 (81.3)	**17.7 (80.3)**
	M4 money supply Y/Y%	Jul	**6.0**	-	6.9	-

Auctions

Country	Auction
Italy sold	€2.5bn of 0% 2026 bonds at an average yield of -0.01%
	€3.25bn of 0.95% 2031 bonds at an average yield of 0.67%
	€2bn of 2029 floating rate bonds at an average yield of 0.03%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	European Commission economic sentiment indicator	Aug	**117.5**	118.0	119.0	-
	European Commission final consumer confidence	Aug	**-5.3**	-5.3	-4.4	-
	European Commission industrial (services) confidence	Aug	**13.7 (16.8)**	13.5 (19.0)	14.6 (19.3)	**14.5 (18.9)**
Germany	Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	**3.9 (3.4)**	3.9 (3.4)	3.8 (3.1)	-
Spain	Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	**3.3 (3.3)**	3.0 (2.9)	2.9 (2.9)	-
	Retail sales Y/Y%	Jul	**0.1**	0.6	1.4	**1.2**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
France	INSEE consumer confidence	Aug	**99**	100	101	**100**
Italy	ISTAT consumer confidence	Aug	**116.2**	116.3	116.6	-
	ISTAT business (manufacturing) confidence	Aug	**114.2 (113.4)**	- (115.0)	116.3 (115.7)	**115.9 (115.2)**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	09.00	Final manufacturing PMI	Aug	61.5	62.8
	10.00	Unemployment rate %	Jul	7.6	7.7
Germany	07.00	Retail sales M/M% (Y/Y%)	Jul	-1.0 (3.6)	4.5 (6.5)
	08.55	Final manufacturing PMI	Aug	62.7	65.9
France	08.50	Final manufacturing PMI	Aug	57.3	58.0
	-	New car registrations* Y/Y%	Aug	-	-35
Italy	08.45	Manufacturing PMI	Aug	60.1	60.3
	09.00	Unemployment rate %	Jul	9.6	9.7
	17.00	New car registrations Y/Y%	Aug	-	-19.36
Spain	08.15	Manufacturing PMI	Aug	59.0	59.0
	-	New car registrations* Y/Y%	Aug	-	-28.9
UK	00.01	BRC shop price index Y/Y%	Aug	-	-1.2
	07.00	Nationwide house price index M/M% (Y/Y%)	Aug	0.0 (8.6)	-0.5 (10.5)
	09.30	Final manufacturing PMI	Aug	60.1	60.4

Auctions and events

Country	BST	Event
Euro area	13.00	ECB's Wiedmann scheduled to speak
Germany	10.30	Auction: €4bn of 0% 2026 bonds
UK	10.00	Auction: £2.5bn of 0.5% 2029 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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