Euro wrap-up

Overview

- Bunds made losses as German inflation rose above 4%Y/Y, while unemployment in the euro area continued to fall.
- Gilts made more sizeable losses as a significant upwards revision to UK GDP suggested there was less spare capacity in the economy than previously estimated.
- Friday will bring the flash euro area inflation estimate for September, along with German retail sales figures for August.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.632	+0.002
OBL 0 10/26	-0.557	+0.006
DBR 0 08/31	-0.195	+0.019
UKT 0⅛ 01/24	0.425	+0.022
UKT 0⅜ 10/26	0.645	+0.025
UKT 0¼ 07/31	1.037	+0.046

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

Euro area

Inflation surpasses 4% in Germany, reaches 3% in Italy, and also rises in France

After yesterday's upside surprise to Spanish inflation, the equivalent numbers from the three largest member states inevitably made clear that overall euro area inflation took another sizeable step up this month. Most strikingly, broadly in line with expectations, German inflation on both the national and EU-harmonised measures rose to 4.1%Y/Y. While the national measure rose 0.2ppt to the highest rate since 1993, the latter jumped a larger 0.7ppt, partly reflecting a different treatment of package tour prices, to a series high. 4.1%Y/Y is a rate that will make the Bundesbank and many in the German media feel queasy. However, it is in part due to German VAT and carbon pricing policies, the impact of which will fall out of the calculation in January. And it is also due to shifts in wholesale energy markets, post-pandemic adjustments, and supply bottlenecks – effects that will persist into 2022 but will eventually likely prove temporary – that were also fully evident in the other large member states. Indeed, while the French figures were a fraction softer than expected, the EU-harmonised measure of inflation rose 0.3ppt to 2.7%Y/Y, the highest in almost a decade. And in line with the consensus forecast, Italian HICP inflation rose 0.5ppt to a nine-year high of 3.0%Y/Y.

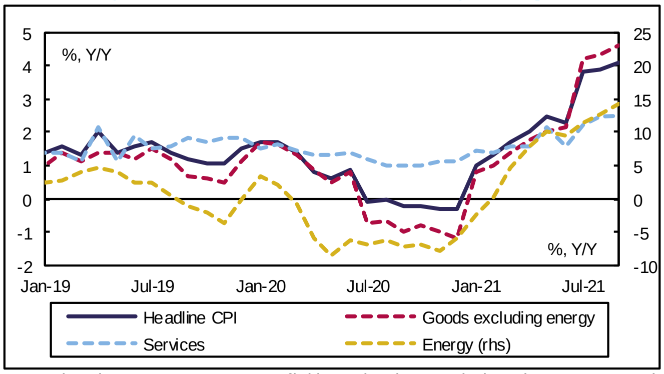
Euro area inflation likely rose to 13-year high in September

Within the detail, on the respective national measures, energy inflation was again the strongest component in each member state, rising to 14.3%Y/Y in Germany, a similar 14.4%Y/Y in France, and an even higher 20.2%Y/Y in Italy. Indeed, reflecting increased household utility bills, Italian regulated energy prices rose more than 34%Y/Y. However, due to the associated higher costs of transportation, as well as increased prices in hospitality, tourism and recreation due to economic reopening, services inflation accelerated in France and Italy too. And in part likely due to intensified cost pressures, increases in non-energy industrial goods inflation were also reported in Italy. Indeed, in Italy – the sole member state to publish such a figure at this stage – core inflation on the EU measure (excluding energy, food and tobacco) rose a steep 0.7ppt to 1.5%Y/Y. Overall, the estimates from the four largest member states support our forecasts for tomorrow's euro area data. We expect the headline rate of inflation to rise 0.4ppt to 3.4%Y/Y, with the core measure rising 0.3ppt to 1.9%Y/Y, and both rates being the highest since 2008.

Unemployment continues to fall

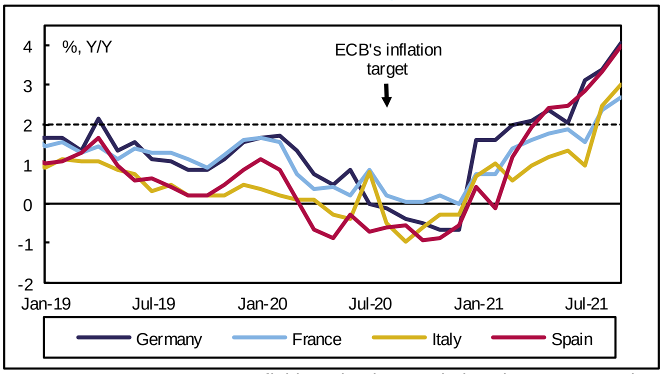
Consistent with ongoing economic recovery, today's labour market data reported another sizeable drop in euro area unemployment in August. Thanks not least to ongoing reopening in the services sector, the number of people out of work fell a further 226k on the month, taking the cumulative decline since April to almost 1.2mn and the level slightly below that in the

Germany: Headline inflation and key components*



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

Euro area: Headline inflation by member state*



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

same month of 2019 ahead of the pandemic. And this left the euro area's unemployment rate down 0.1ppt to 7.5%, a fifteen-month low. Of course, the number of workers unemployed would be much higher in the absence of the various national job support schemes, most of which remained in operation last month but some of which (e.g. in Spain) concluded today. Germany's labour market data for September were also again encouraging, with the number of people unemployed down for the fifth consecutive month (by 30k), taking the cumulative decline since April to 238k, while the number of job vacancies continued to rise. Admittedly, this still left the number of people out of work 238k higher than the pre-pandemic level, despite the support provided by the government's Kurzabeit short-time work scheme. But Germany's Federal Employment Agency noted another decline in the number of firms reporting the need to claim under that scheme in September, from 88k to 70k, with roughly three quarters of these in the manufacturing and construction industries, partly due to the impact of supply shortages in these sectors. The most recent figures show that 927k employees were receiving such benefits in July.

The day ahead in the euro area

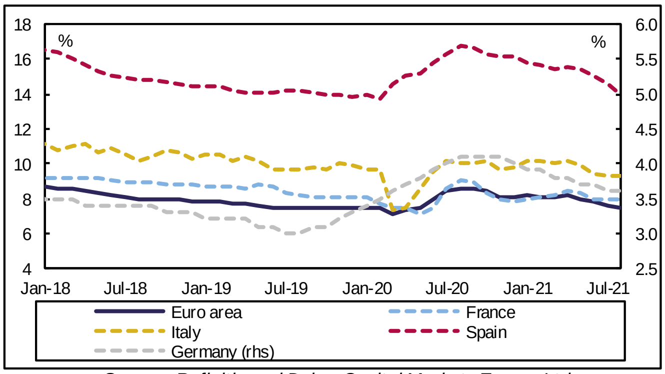
Alongside the aforementioned euro area flash inflation, tomorrow will bring German retail sales figures for August. These are expected to report modest growth (1.5%M/M), albeit not enough to offset the slump (-4.5%M/M) recorded in July. French, Italian and Spanish new car registrations data for September are also due and likely to have remained weak as supply constraints limit production. The final manufacturing PMIs for the euro area, Germany and France as well as new manufacturing PMI results for Italy and Spain are also due and likely to signal ongoing challenges. Indeed, the preliminary manufacturing PMIs for September came in softer than expected, pointing to a further easing of recovery momentum as firms continue to face supply difficulties and price pressures – the euro area manufacturing output PMI fell 3.3pts on the month to 55.7, the lowest since January.

UK

GDP revised significantly higher in Q2 suggesting less spare capacity

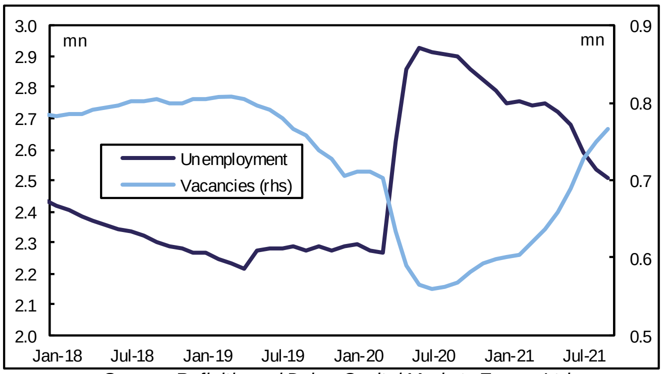
Today was busy for UK economic releases. Most notably, while the updated estimate of GDP and Lloyds business survey are not normally considered to be of top-tier significance, on balance they strengthened the case for a near-term tightening in monetary policy. Most significant was the sizeable upwards revision to GDP, with activity last quarter now estimated to have accelerated 5.5%Q/Q, 0.7ppt stronger than previously measured. Within the detail in Q2, growth was revised higher for production, construction and services, while on the expenditure side the upwards revision reflected firmer investment, government spending and net trade. In contrast, inventories are now considered to have provided a significant drag. Taken together with previous revisions – including a slightly softer contraction in Q121 and Q220 and a stronger rebound in Q320 –

Euro area: Unemployment rates in member states



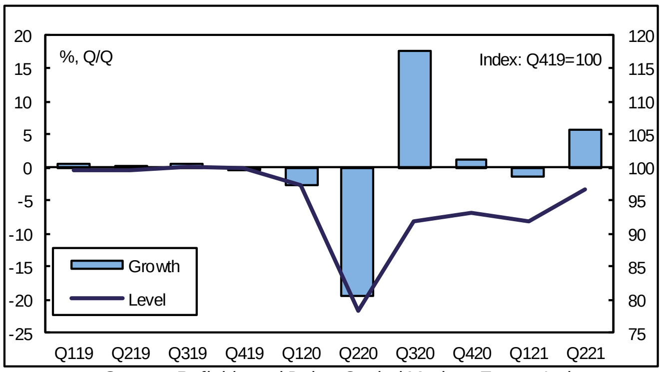
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Unemployment and job vacancies



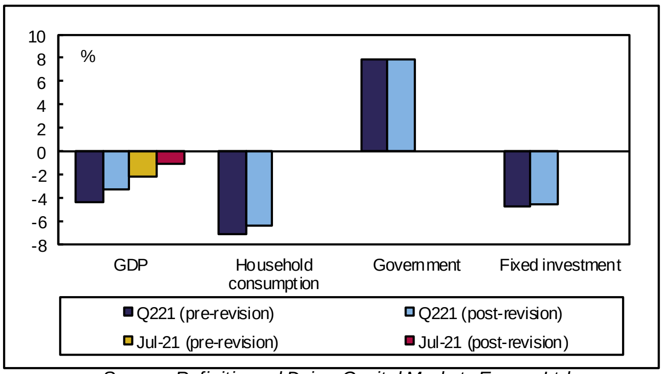
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: GDP growth and level



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: GDP compared with pre-pandemic level



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

GDP was up a stronger 23.6%Y/Y in Q2. More importantly, the level of output in Q221 is now estimated to be 'just' 3.3% below the pre-pandemic peak, compared with a shortfall of 4.4% judged previously. And the revised monthly profile suggests that, despite subdued growth in July (0.1%M/M), GDP at the start of the third quarter was just 1.0% below the pre-pandemic level (compared with 2.1% before today's revision), suggesting a significantly reduced amount of spare capacity in the economy.

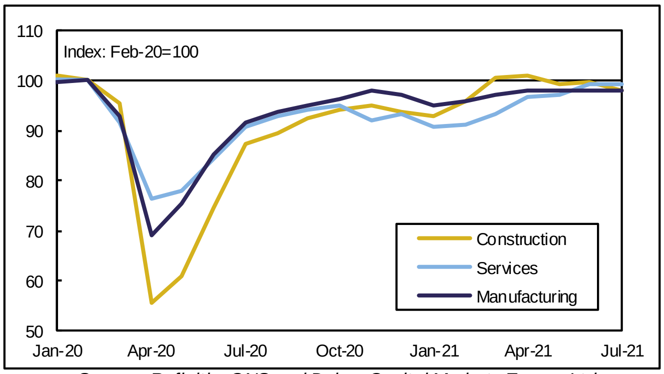
Lloyds business barometer points to further improvement

In addition to the GDP figures, the hawks on the MPC will note the findings of today's Lloyds Business Barometer, which suggested that business confidence continued to improve in the first half of this month, with the headline survey measure (46%) reaching its highest since April 2017. The increase on the month (+14%) was the biggest since April, and was attributed to greater confidence about the wider economy, which reached the highest since 2015. Perhaps most notably, firms' employment expectations jumped to the highest in more than four years, with more than half of surveyed businesses expecting to increase their workforce in the coming year. But the survey also flagged recruiting difficulties due to a lack of applicants and candidates with an appropriate skillset, which was most acute in the services sector, with roughly one third of respondent firms suggesting that it was impacting their ability to meet demand. So, more firms signalled stronger wage growth expectations. One caveat, however, is that the survey was conducted before the current bout of disruption to petrol supplies, which seems highly likely to have hurt sentiment (although might also add to expectations of stronger wage growth). And even before this event, firms continued to cite supply chain disruption as the biggest constraint on activity overall, especially in manufacturing.

GDP likely to return to pre-pandemic level this year

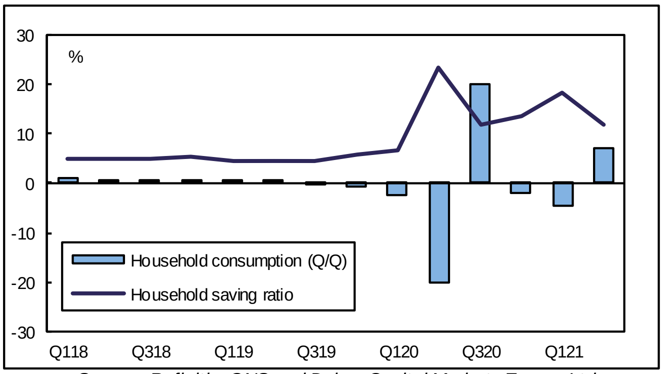
Despite the buoyant business sentiment suggested by the Lloyds survey, recent data – including August retail sales and the September flash PMIs – provided further evidence of a slowing of economic activity over the summer. And with the government furlough scheme (which the ONS estimates has been subsidising roughly 1mn employees this month) and support for the housing market coming to an end today, Universal Credit welfare payments being cut next month, and household energy bills increasing sharply next month too, risks to near-term demand appear skewed to the downside. Today's national accounts data reported that the household savings ratio fell sharply in Q2, from 18.7% in Q1 to 11.7%. But that level remained well above the pre-pandemic average below 10%. So, a further, albeit more modest, decline in the savings ratio should support growth in spending over the near term. And given today's upwards revision, and our expectation for positive GDP growth this quarter and next (albeit at a markedly softer rate than in Q2), GDP should return to its pre-pandemic level before the end of the year with spare capacity in the economy to further diminish in early 2022. So, while we

UK: GDP – key output components



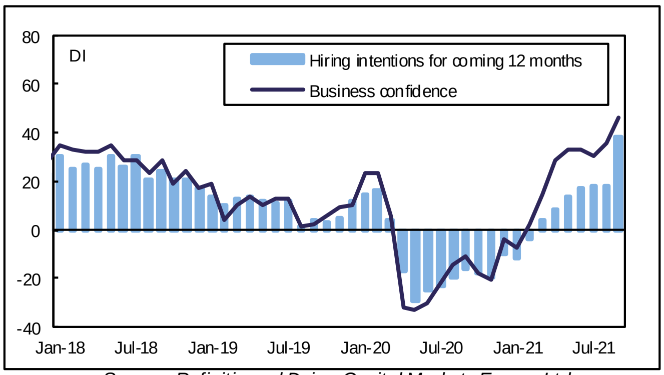
Source: Refinitiv, ONS and Daiwa Capital Markets Europe Ltd.

UK: Household consumption and saving ratio



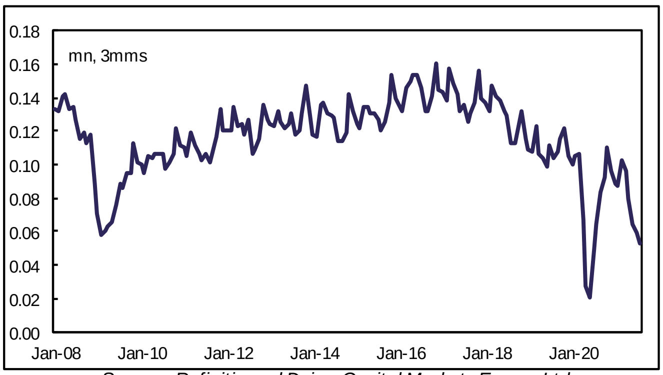
Source: Refinitiv, ONS and Daiwa Capital Markets Europe Ltd.

UK: Lloyds business barometer



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Car production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

think the BoE will act more cautiously than what is currently priced into the market, we have now brought forward our central expectation for the first increase in Bank Rate, by 15bps to 0.25%, to May, to be followed by a further 25bps increase to 0.5% in February 2023.

Car production remains dented by supply bottlenecks

Challenges caused by supply bottlenecks – and the global semiconductor shortage in particular – have been particularly acute in the autos sector. And today's car production figures published by the SMMT continued to emphasise the hit, producing just 37,246 units in August, a drop of 27% compared with August 2020, which itself was a relatively low base. Indeed, output was down a whopping 60% compared with August 2019 and was the lowest for the month since the survey began in the 1970s. So, while the number of cars produced in the first eight months of 2021 was up 13.8%YTD/Y, they were still down by almost one third compared with the equivalent period in 2019 and by almost 43% compared with the average corresponding period in the five years before the pandemic (equivalent to 440k cars). And with supply bottlenecks expected to continue through to at least early 2022, SMMT remained extremely downbeat about the near-term outlook for the industry.

The day ahead in the UK

The week ends on a quiet note in the UK with only the final manufacturing PMI survey for September scheduled for release. The preliminary data indicated a further marked moderation in manufacturing, with the output PMI falling more than 2pts to 51.8. The primary driver of the slowdown was supply-chain disruption, although there was also evidence of a softening of demand for manufactured items, with growth in new export orders reportedly grinding almost to a halt.

European calendar

Today's results						
Economic data						
Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Unemployment rate %	Aug	**7.5**	7.5	7.6	-
Germany	Unemployment rate % (change '000s)	Sep	**5.5 (-30.0)**	5.5 (-37.0)	5.5 (-53.0)	-
	Preliminary CPI (EU-harmonised CPI) Y/Y%	Sep	**4.1 (4.1)**	4.2 (4.0)	3.9 (3.4)	-
France	Preliminary CPI (EU-harmonised CPI) Y/Y%	Sep	**2.1 (2.7)**	2.2 (2.8)	1.9 (2.4)	-
	PPI Y/Y%	Aug	**10.0**	-	8.6	**9.0**
	Consumer spending M/M% (Y/Y%)	Aug	**1.0 (-5.4)**	0.0 (-5.4)	-2.2 (-4.6)	**-2.4 (-)**
Italy	Unemployment rate %	Aug	**9.3**	9.2	9.3	-
	Preliminary CPI (EU-harmonised CPI) Y/Y%	Sep	**2.6 (3.0)**	2.4 (3.0)	2.1 (2.5)	**2.0 (-)**
Spain	Retail sales Y/Y%	Aug	**-0.9**	0.1	0.1	-
UK	Lloyds business barometer	Sep	**46**	-	36	-
	SMMT car production Y/Y%	Aug	**-27.0**	-	-37.6	-
	Final GDP Q/Q% (Y/Y%)	Q2	**5.5 (23.6)**	4.8 (22.2)	-1.6 (-6.1)	**-1.4 (-5.8)**
	Nationwide house price index M/M% (Y/Y%)	Sep	**0.1 (10.0)**	0.6 (10.7)	2.1 (11.0)	**2.0 (-)**
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	Sep	58.7	61.4
	10.00	Preliminary CPI (core CPI) Y/Y%	Sep	*3.4 (1.9)*	3.0 (1.6)
Germany	07.00	Retail sales M/M% (Y/Y%)	Aug	1.5 (0.9)	-4.5 (0.4)
	08.55	Final manufacturing PMI	Sep	58.5	62.6
France	08.50	Final manufacturing PMI	Sep	55.2	57.5
	-	New car registrations* Y/Y%	Sep	-	-15.4
Italy	08.45	Manufacturing PMI	Sep	59.5	60.9
	17.00	New car registrations Y/Y%	Sep	-	-27.3
Spain	08.15	Manufacturing PMI	Sep	58.2	59.5
	-	New car registrations* Y/Y%	Sep	-	-28.9
UK	09.30	Final manufacturing PMI	Sep	56.3	60.3

Auctions and events

Country	BST	Event
Euro area	16.30	ECB's Schnabel scheduled to speak at Fed Conference on Lessons for the future

**Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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