Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds made sizeable losses despite a downbeat German ZEW investor sentiment survey that signalled growing fears of recession, while the euro area's goods trade deficit widened as exports slipped back.
- Gilts made bigger losses across the curve as UK basic pay accelerated in nominal terms but fell at a record rate in real terms.
- Wednesday will bring updated estimates of euro area Q2 GDP and employment growth, while the UK focus will be July's inflation data.

Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	0.555	+0.051
OBL 1.3 10/27	0.736	+0.064
DBR 1.7 08/32	0.969	+0.067
UKT 1 04/24	2.121	+0.126
UKT 1¼ 07/27	1.961	+0.120
UKT 4¼ 06/32	2.130	+0.117

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

Euro area

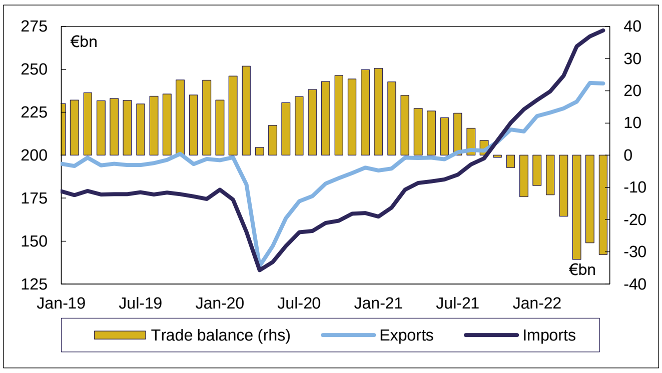
Euro area goods trade deficit widens in June as exports fall back

While euro area GDP growth accelerated in Q2, today's goods trade figures suggested that the acceleration had nothing to do with exports. Indeed, the euro area's goods trade deficit widened in June, by €3.7bn to €30.8bn, a level exceeded on the series only in April. The deterioration in part reflected the first fall in the value of goods exports in six months. However, that decline was a mere 0.1%M/M, leaving the value of exports up 20%Y/Y in June and almost 6%3M/3M in Q2. Within the country detail, the weakness on the month was caused principally by a decline in shipments to the US (-3.7%M/M), with exports also weaker to China (-2.6%M/M), Japan (-3.7%M/M), UK (-0.3%M/M) and Norway (-7.3%M/M). And while shipments to Russia rose for the second successive month (9.2%M/M), they were still down 36%Y/Y. Unsurprisingly, the widening in the deficit also reflected the seventeenth consecutive increase in the value of imports in June, which despite the slowing pace (to 1.3%M/M), left them up 44%Y/Y in June and 12½%Q/Q in Q2. Of course, this largely reflects the marked deterioration in the terms of trade over the past year or so. Indeed, since spring 2021, import values have risen by more than 50% compared with a rise of around 9% in import volumes. In the first two months of Q2, import volumes were trending 3.2% higher than in Q1, just a little more than one quarter of the equivalent rise in the value of imports. And with export volumes up a more modest 1.3% so far in Q2, net goods trade looks likely to have been a drag on GDP growth in the second quarter.

German ZEW survey flags rising recession fears as gas levy and drought compound downside risks

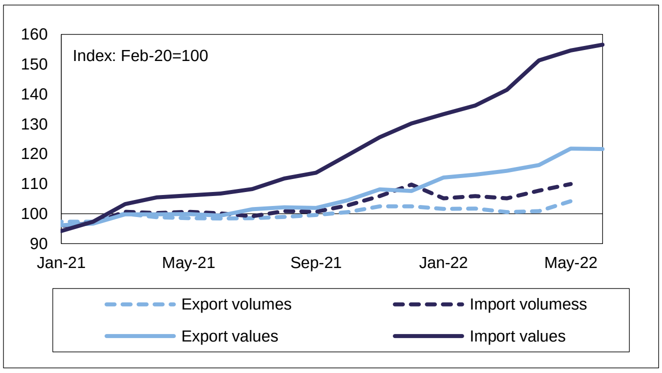
Germany's ZEW investor survey painted a predictably gloomy picture of sentiment this month. Admittedly, the survey's gauge of current conditions remained well above the initial pandemic low (-93.5), but at -47.6 it was nevertheless the weakest for sixteen months and still well below the long-run average (-8.0). And faced with persisting concerns about higher prices, supply disruption and the global economic outlook, investors remained extremely downbeat about prospects for the coming six months. Indeed, the ZEW expectations balance fell a further 1.7pts to -55.3, some 140pts lower than the pandemic peak last May, 77pts below the long-run average and the weakest reading since the global financial crisis, to signal growing fears of recession. Certainly, the outlook for domestic demand in Germany has weakened in light of recent wholesale energy price movements and the new gas levy, which will spread some of the burden of higher prices from utilities to households and businesses from October. While the government plans to seek permission from the European Commission to scrap the sales tax on that surcharge, it is still on average estimated to cost an additional €480 per year for a four-person household. So, among other things, the ZEW survey saw investors revise significantly lower their profit expectations for consumer-facing sectors. The survey's indicator for retailers' profits declined to its lowest for almost fourteen years, with the equivalent index for services the weakest since the onset of the pandemic. Of course, notwithstanding with higher energy costs, disruption to energy supply remains a key downside supply-side risk to the outlook for the winter

Euro area: Goods trade, exports and imports*



*Seasonal adjusted values. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Exports and imports*



*Seasonally adjusted figures. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

months – while German gas storage has risen to more than 75% of capacity, the inflow of Russian gas through the Nord Stream 1 pipeline remains just 6% of its level this time last year. And before those risks might crystallise, some industrial sectors face additional supply challenges from near-record low water levels on the Rhine, with the key marker point at Kaub today only just above the low recorded during the drought in 2018, when deliveries of materials and production in the chemicals, steel and pharmaceuticals sectors was impeded.

The day ahead in the euro area

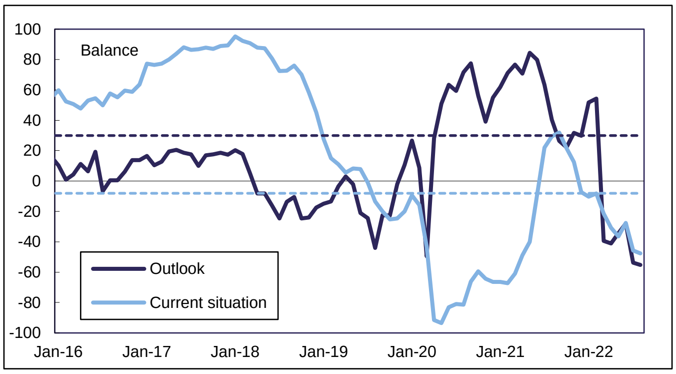
Tomorrow will bring an updated reading for euro area Q2 GDP, which is expected to confirm the flash estimate of growth of 0.7%Q/Q, to leave output 1½% above the pre-pandemic level. This release will be accompanied by euro area employment figures for the second quarter, which are also likely to report job growth for a fifth successive quarter to a new series high, albeit at the slowest rate over that period.

UK

Labour market conditions loosen only slightly despite drop in GDP in Q2

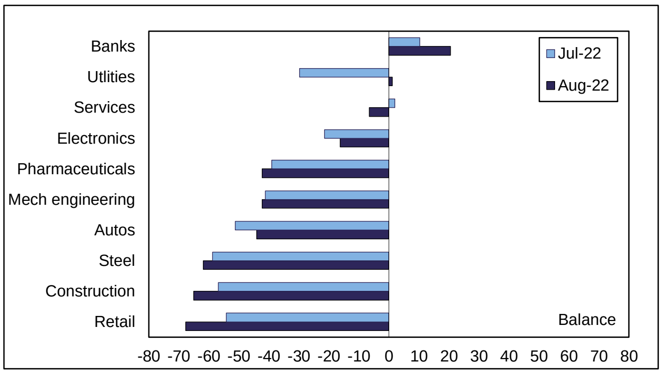
The tightness of the UK's labour market has been one of several factors contributing to the increased hawkishness of the BoE over recent quarters. And despite the contraction in GDP in Q2, conditions in the labour market loosened only very slightly around the middle of the year. Indeed, while the headline ILO unemployment rate edged up over the second quarter, that increase of just 0.1ppt occurred at the start of Q2. So, the unemployment rate was still just 3.8% in the three months to June, in line with the level at the end of 2019 ahead of the pandemic. That slight rise in the jobless rate from Q1 reflected a modest drop in the employment rate over the quarter, of just 0.1ppt to be 1.0ppt (281k workers) below the pre-pandemic level. Meanwhile, the inactivity rate – one of the UK's key structural weaknesses since the start of the pandemic – was unchanged over the same period, still some 1.2ppt (521k workers) above the pre-Covid level. The number of potential workers judged to be long-term sick was up again to account for more than half of the rise in inactivity since the onset of the pandemic. The softening of economic activity was also reflected in a modest drop in the total number of hours worked, which thus remained below the pre-Covid level. But while the number of job vacancies in the three months to July also fell slightly for the first time in almost two years to add to evidence that the labour market is turning, the decline was modest (a little less than 20k) and left the total (1.274mn) at an extremely high level and broadly in line with the total number of jobless workers. Moreover, the redundancy rate remained close to the record low.

Germany: ZEW investor sentiment indicators*



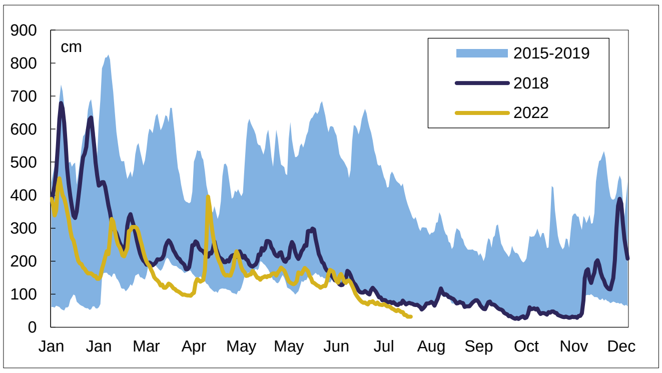
Dashed lines represent long-run averages. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ZEW investor profit expectations



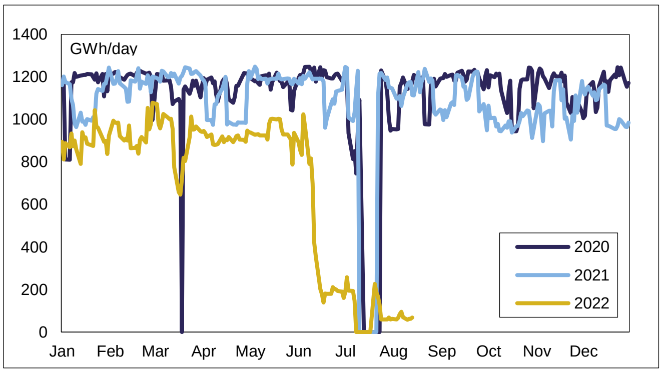
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: River Rhine water level*



**At Kaub marker. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

Germany: Russia gas inflows – Nord Stream 1



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

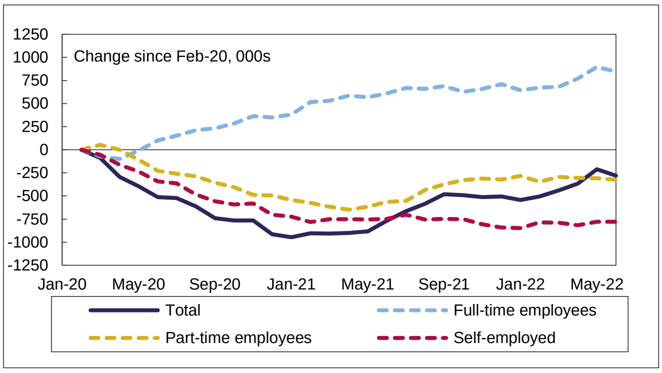
Regular pay accelerates in nominal terms but falls at a record rate in real terms

Over recent months, the tightness of the labour market has been reflected in underlying pay growth that the BoE has judged to be above levels consistent with the achievement of the inflation target over the medium term. And while growth in average total labour earnings (including bonuses) slowed almost 2ppts over the second quarter to 5.1%3M/Y in June, that reflected volatility in bonus payments. Excluding special payments, regular wage growth picked up 0.5ppt over the quarter to 4.7%3M/Y in June, a nine-month high and a rate still likely to be too high for comfort for some MPC members. Indeed, the BoE expects underlying pay growth to pick up further over the near term to around 5½%Y/Y, while its Agents' surveys showed that respondent firms expect average pay settlements to be close to 6%Y/Y over the coming twelve months, up from around 5%Y/Y in January. Moreover, around a quarter of respondents have already given or were considering awarding one-off payments to compensate staff for recent price pressures. Nevertheless, given high inflation, pay growth remains far too low for comfort among households. Indeed, in real terms in June, total pay fell 2.5%3M/Y and regular pay was down a record 3.0%3M/Y. And with inflation set to rise higher still – to above 13%Y/Y – over the autumn, real pay looks set to fall significantly further. So, in the absence of significant new fiscal support, household spending seems bound to drop towards year-end and beyond.

The day ahead in the UK

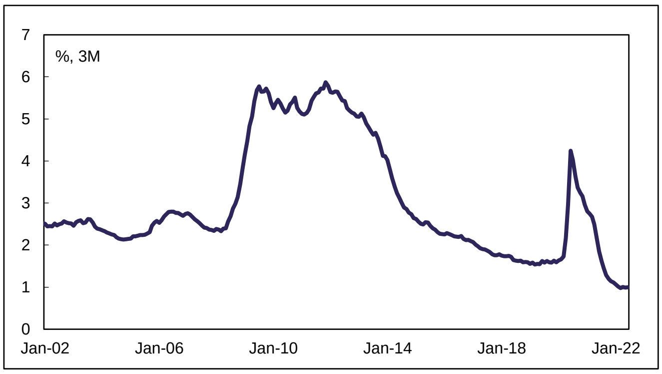
The data focus tomorrow in the UK will be on the latest inflation figures. In particular, the headline CPI rate could rise 0.6ppt to an eye-catching 10.0%Y/Y in July, driven not least by an increase in the food component, as well as an uptick in non-energy industrial goods and services inflation. As such we could also see the core inflation rate rise above 6.0%Y/Y. Also to be published tomorrow are the latest PPI data, which are likely to reveal continued price pressures at the factory gate, especially amongst food manufacturers. And the Land Registry's measure of house prices is also expected to reveal that prices remained elevated in June, likely recording the third consecutive double-digit rise, albeit at a softer pace to that seen in May (12.8%Y/Y).

UK: Change in employment since start of pandemic



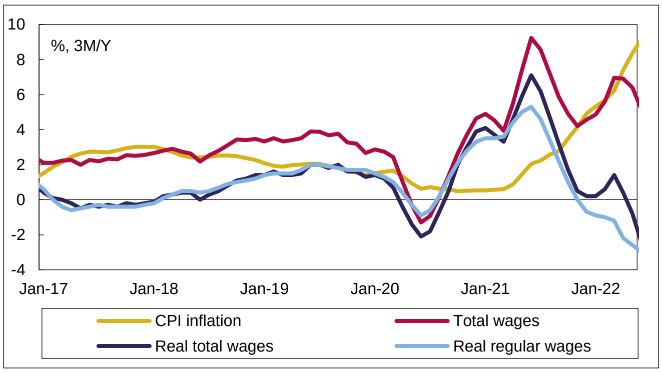
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Unemployment-to-vacancies ratio



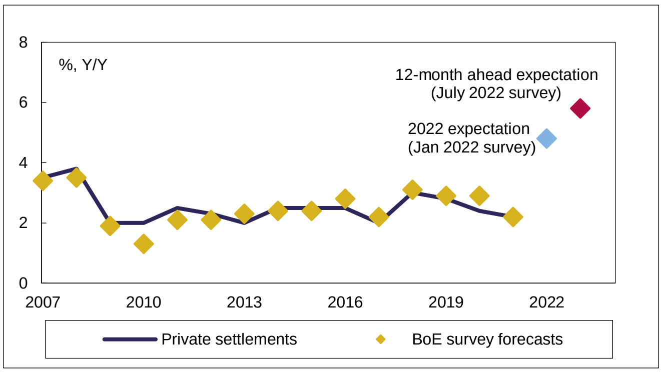
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Wages and inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Wage settlements



Source: Bank of England MPR and Agents' Surveys, 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		Trade balance €bn	Jun	**-30.8**	-	-26.0	**-27.2**
Germany		ZEW current situation (expectations) balance	Aug	**-47.6 (-55.3)**	-49.8 (-53.8)	-45.8 (-53.8)	**-**
UK		Payrolled employees, change '000s	Jul	**73**	25	31	**48**
		Unemployment claimant count rate % (change '000s)	Jul	**3.9 (-10.6)**	-	3.9 (-20.0)	**- (-26.8)**
		Average earnings including (excluding) bonuses 3M/Y%	Jun	**5.1 (4.7)**	4.6 (4.5)	6.2 (4.3)	**6.4 (4.4)**
		ILO unemployment rate 3M%	Jun	**3.8**	3.8	3.8	**-**
		Employment, change 3M/3M '000s	Jun	**160**	250	296	**-**

Auctions

Country		Auction
Germany		sold €3.24bn of 1.3% 2027 bonds at an average yield of 0.71%
UK		sold £2.75bn of 0.5% 2029 bonds at an average yield of 1.955%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK		Rightmove house price index M/M% (Y/Y%)	Aug	**-1.3 (8.2)**	-	0.4 (9.3)	**-**

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		10.00	GDP – second estimate Q/Q% (Y/Y%)	Q2	*0.7 (4.0)*	0.5 (5.4)
		10.00	Employment – first estimate Q/Q% (Y/Y%)	Q2	-	0.6 (2.9)
UK		07.00	CPI M/M% (Y/Y%)	Jul	*0.5 (10.0)*	0.8 (9.4)
		07.00	Core CPI Y/Y%	Jul	*6.3*	5.8
		07.00	PPI output prices M/M% (Y/Y%)	Jul	1.0 (16.7)	1.4 (16.5)
		07.00	PPI input prices M/M% (Y/Y%)	Jul	0.7 (23.1)	1.8 (24.0)
		09.30	House prices Y/Y%	Jun	-	12.8

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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