

# Euro wrap-up

## Overview

- Bunds made losses as the flash estimates of euro area inflation in August surprised on the upside, with a notable rise in the core measure, to increase the likelihood that the ECB will raise rates by 75bps next week.
- Gilts made substantive further losses as a survey suggested an intensification of UK price pressures while the ONS ruled that government support to reduce household energy bills would not subtract from inflation.
- Thursday will bring new data for euro area unemployment, German retail sales and UK home prices.

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### Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	1.161	+0.036
OBL 1.3 10/27	1.366	+0.040
DBR 1.7 08/32	1.527	+0.022
UKT 1 04/24	2.977	+0.097
UKT 1½ 07/27	2.749	+0.098
UKT 4¼ 06/32	2.795	+0.096

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

## Euro area

### Euro area inflation again exceeds expectations

Euro area inflation once again exceeded expectations in August, with prices rising 0.5%M/M to push the headline HICP rate up 0.2ppt to a new series high of 9.1%Y/Y. This was in spite of a drag from declining petrol prices, which resulted in a further modest easing in energy inflation, by 1.3ppts to 38.3%Y/Y. While that represented a three-month low, energy nevertheless still accounted for more than 40% of total inflation. Among other key drivers, another big rise in food prices (1.0%M/M), related to drought across Europe as well as the impact of the Ukraine war, resulted in a tenth consecutive monthly increase in the annual rate to double digits (10.6%Y/Y) for the first time. As summer discounting came to an end, non-energy industrial goods prices rose the most in any August (0.8%M/M), increasing the annual rate by 0.5ppt to a series high of 5.0%Y/Y. And despite the continued negative influence of Germany's discounted travel pass, services inflation similarly rose (0.1ppt) to a series high of 3.8%Y/Y likely due to higher prices in hospitality, tourism and leisure. As a result, core inflation rose a stronger-than-expected 0.3ppt to 4.3%Y/Y, suggesting a further increase in domestically-generated pressures.

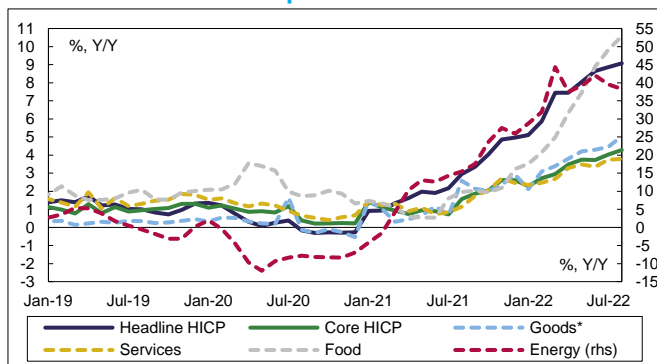
### Inflation outlook remains highly uncertain not least due to energy market dysfunction

So far in the third quarter, headline inflation is averaging 9.0%Y/Y, 1.7ppts above the ECB's baseline forecast published in June. And not least as the German travel pass and fuel duty discounts are set to elapse this month, inflation looks set to rise again in September, with a new gas levy also to provide an additional impetus in the largest member state from October. Most importantly perhaps, recent dysfunctional developments in wholesale markets for natural gas and electricity – which propelled forward power prices to eye-wateringly high levels – are set to push up energy inflation once more in most member states over the near term. However, in some countries, temporary government support measures will subtract from inflation – e.g. Spain will introduce a discounted travel pass from September through to the end of the year – and France will maintain its cap on electricity prices until year end. And importantly, the EU is expected to introduce new emergency measures to reduce the near-term burden of higher energy costs on households and businesses, including via amendments to the pricing mechanism related to wholesale gas and electricity prices – EU energy ministers are set to discuss options on 9 September. All this, of course, means that, while it likely has further to rise, the inflation outlook is extremely uncertain.

### Two-sided risks to domestically-generated inflation

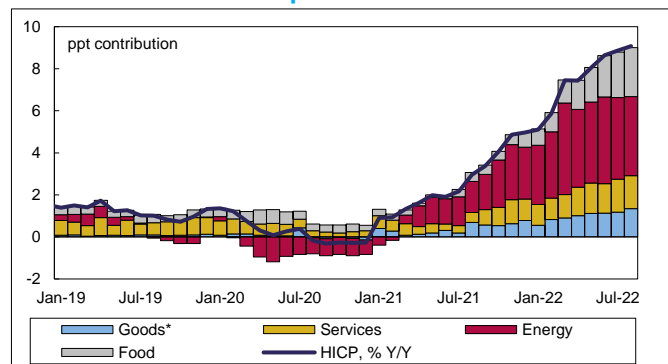
In terms of other components, food inflation will remain higher for longer than previously anticipated due to the European drought. And the weaker euro represents a further source of unpredictability and concern at the ECB. But while the risks to the inflation outlook certainly appear to remain skewed to the upside not least due to external events, the risks are two-sided.

### Euro area: Consumer price inflation



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

### Euro area: Consumer price inflation



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

While to some extent the moderation reflected the passing of one-off German payments at the start of the year, the slowing in euro area negotiated wage growth in Q2, by 0.7ppt to 2.1%Y/Y, would suggest still limited signs of second-round effects from the tightening labour market. And yesterday's Commission survey reported an easing in household inflation expectations as well as a moderation in selling-price expectations in every main business sector, as firms reported some further easing of supply constraints, a replenishment of inventories and a notable drop in new orders amid faltering demand. So, while domestically generated price pressures appear to have risen further over the summer, they might soon start to dissipate, particularly if and when the economy slides into recession.

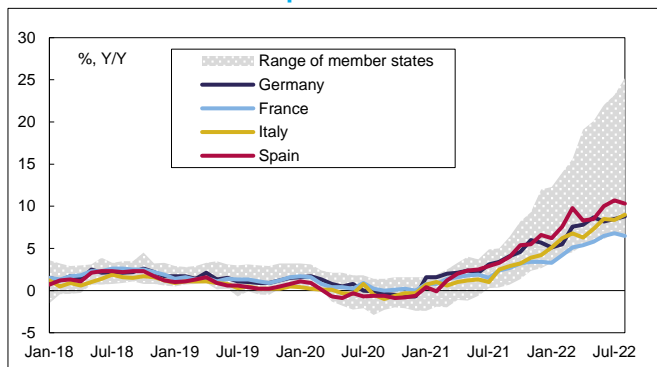
## ECB to revise inflation forecast higher, increasing likelihood of a jumbo hike

Regardless of the uncertainties, next week the ECB seems bound to revise significantly higher its near-term outlook for both headline and core HICP inflation, having previously forecast it to peak in Q222. Indeed, we currently expect the headline rate to rise to above 9½%Y/Y – and perhaps above 10%Y/Y – in Q4 before easing gradually through 2023 to end next year at around 4%Y/Y. And as most Governing Council members will share the view of key Executive Board member Schnabel that the ECB should now place relatively more weight on actual inflation outcomes than its own projections given the current difficulties in forecasting, today's figures underscore the inevitability of another large rate hike at next week's policy meeting. But while many of the usual suspects on the Council clearly now favour a jumbo hike of 75bps, others will share the view of Chief Economist Lane that tightening should be conducted at a "steady pace" with a "multi-step calibrated series", not least given uncertainty about the transmission mechanism, the likelihood that supply bottlenecks will continue to ease, and the possible need to pivot policy if and when recession emerges. On balance, however, as in recent meetings, the doves are likely to be in the minority. With the Governing Council likely to be unanimous in the view that real interest rates remain too far below a neutral level for comfort, we now expect the ECB to increase interest rates by a further 75bps next week, taking the deposit rate to 0.75% and refi rate to 1.00%, with further tightening to come in Q4 too.

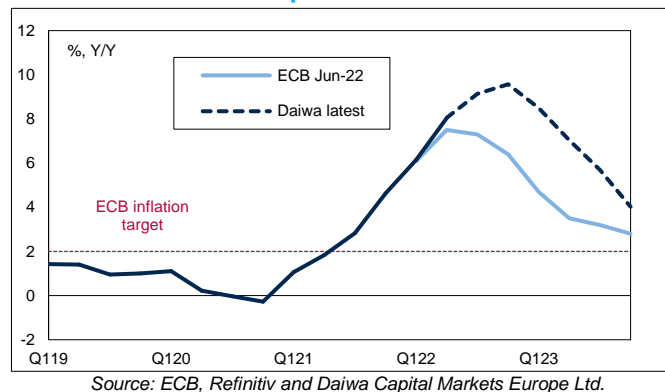
## German unemployment rises as Ukraine refugees join the workforce

Today's German labour market figures showed the number of unemployment claimants continuing to creep higher in August, with the 28k increase on the month stronger than the seasonal norm, to 2.497mn, the highest level for a year. As such, the unemployment claimant rate rose 0.1ppt to 5.5%. But the employment agency continued to attribute the increase to the registration of Ukrainian refugees, suggesting that, despite the economic uncertainties, Germany's labour market remained robust. This notwithstanding, the number of job vacancies, while still historically high, edged lower for a third month in August. And surveys suggest that firms are becoming more cautious in their hiring intentions amid rising uncertainties ahead, with the flash composite employment PMI down to its lowest since the lockdowns in 2021 and the Commission's employment expectations indicator the lowest since May 2021.

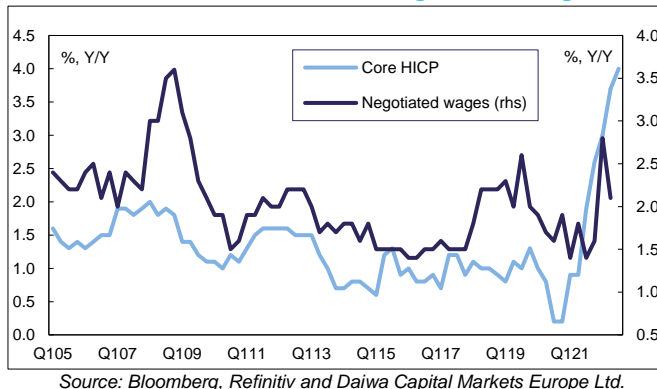
### Euro area: Consumer price inflation



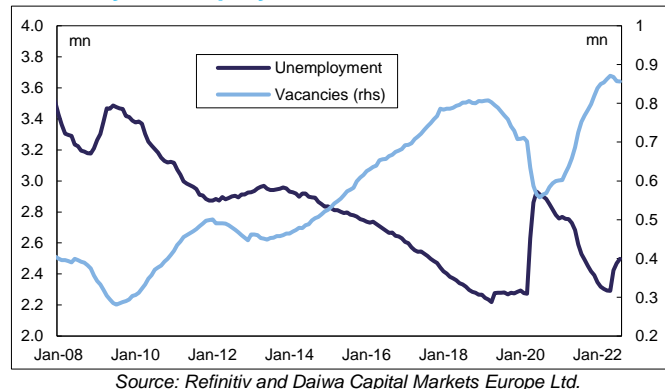
### Euro area: Consumer price inflation forecast



### Euro area: Core inflation and negotiated wages



### Germany: Unemployment and vacancies



## French consumer spending on goods maintained a downwards trend

While household consumption was a key driver of euro area GDP growth in Q2, spending on goods fell as the relaxation of pandemic restrictions offered greater opportunities to spend on services. And today's French consumer spending numbers for July suggest that demand for goods remained weak at the start of Q3 amid sharply rising prices. In particular, spending on goods fell a steeper-than-expected 0.8%M/M, to be down 4.3%Y/Y. The weakness was relatively broad-based, although there was a sizeable decline in purchases of new and used cars to leave consumption of transport equipment down 1½%M/M to be still some 13% below the pre-Covid level. Spending on clothing and textiles also fell more than 3½%M/M, while spending on food fell for the eighth month out of the past nine.

## The day ahead in the euro area

Looking ahead, Thursday will bring a number of releases, including the latest euro area labour market figures, which are expected to show that the unemployment rate moved sideways at a record-low 6.6% in July. Despite the still somewhat favourable conditions in the labour market, households unsurprisingly remain reluctant to spend. And following today's weaker French consumer spending numbers, German retail sales data tomorrow are expected to post the third monthly decline out of the past four. Meanwhile, we will get the final manufacturing PMIs for August, which are expected confirm the flash release that showed the euro area manufacturing output index edging very slightly higher in August, albeit to 46.5 implying ongoing marked contraction. New car registrations numbers for August from France, Italy and Spain are also due.

## UK

### BRC shop price survey suggests intensification of inflation on the UK high street in August

The latest BRC shop price survey results suggest that inflation on the UK high street intensified significantly in August, with the headline index rising a further 0.7ppt to a series high of 5.1%Y/Y. Food prices caused the damage in the latest month, accelerating a record 2.3%M/M and 9.3%Y/Y as increased costs of energy, animal feed, fertiliser, wheat and oils – all related to the war in Ukraine – combined with the effects of drought conditions across much of Europe. Prices of non-food items were better behaved, up 0.5%M/M (admittedly still the strongest in six months) to slow 0.1ppt in annual terms to 2.9%Y/Y.

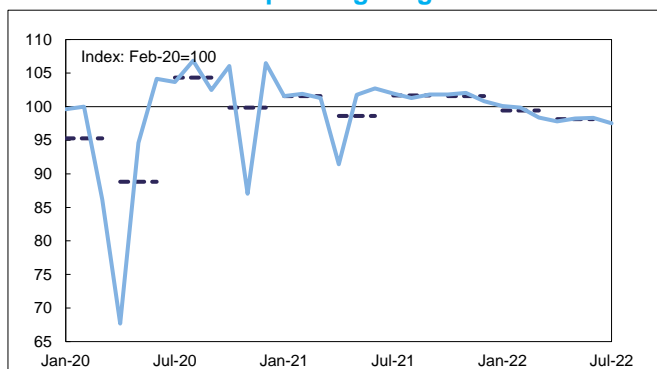
### ONS rules that UK government payments to reduce household energy bills won't reduce inflation

With respect to the UK's near-term inflation outlook, the ONS today cleared up one source of uncertainty, ruling that forthcoming payments from the government to households under the Energy Bills Support Scheme (EBSS) – whereby domestic energy customers in Great Britain will receive a £400 discount on their bills from October – should be treated statistically as current transfers to households and not lower energy prices. As such, the payments – which might possibly be increased once the new Prime Minister takes over next month – will have no impact on inflation. Had the ONS ruled the other way, the impact could have reduced inflation by 2ppts or more, with huge consequences not least for UK government debt interest payments on index-linked gilts. In the absence of far more aggressive government interventions in the energy market, UK consumer price inflation is thus now bound to accelerate markedly in October in response to the 80% hike in the regulator's household energy price cap from that month, while a share of the increased energy costs for businesses will also be passed on to consumers of non-energy items.

## The day ahead in the UK

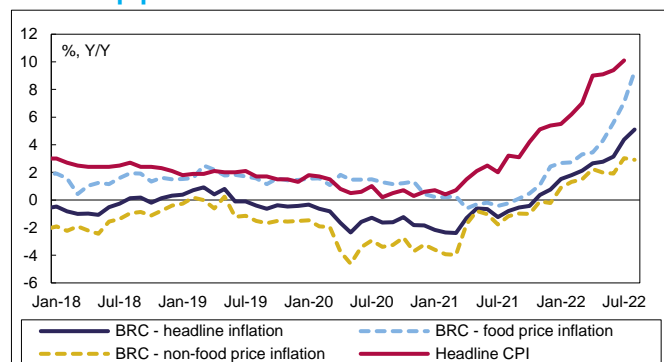
Tomorrow sees the release of the final UK manufacturing PMIs for August. The flash data revealed a marked slump in the manufacturing output index, down a whopping 6.5pts – the most since the initial pandemic slump in April 2020 – to 42.4, the lowest in more than two years, as firms cited weak demand as well as shortages of both labour and materials. Indeed, excluding the onset of the pandemic, the output PMI implied the weakest production since the start of 2009. We will also get the latest Nationwide house price index, which is expected to report a further modest monthly increase in August (0.1%M/M), albeit this would leave the annual growth rate easing 2.1ppts to 8.9%Y/Y, a sixteen-month low.

### France: Consumer spending on goods\*















\*Dashed dark blue lines are quarterly averages. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: Shop price inflation



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
Euro area	 Preliminary HICP M/M% (Y/Y%)	Aug	0.5 (9.1)	0.4 (9.0)	0.1 (8.9)	-
	 Core HICP Y/Y%	Aug	4.3	4.1	4.0	-
Germany	 Unemployment change '000s (rate %)	Aug	28.0 (5.5)	28.5 (5.5)	48.0 (5.4)	45.0 (-)
France	 Preliminary CPI M/M% (Y/Y%)	Aug	0.4 (5.8)	0.6 (6.1)	0.3 (6.1)	-
	 Preliminary HICP M/M% (Y/Y%)	Aug	0.4 (6.5)	-	0.3 (6.8)	-
	 Final GDP Q/Q% (Y/Y%)	Q2	0.5 (4.2)	0.5 (4.2)	-0.2 (4.8)	-
	 Consumer spending M/M% (Y/Y%)	Jul	-0.8 (-4.3)	-	0.2 (-4.4)	0.1 (-4.3)
Italy	 PPI M/M% (Y/Y%)	Jul	1.6 (27.2)	-	1.3 (27.0)	-(27.2)
	 Preliminary CPI M/M% (Y/Y%)	Aug	0.8 (8.4)	-	0.4 (7.9)	-
UK	 Preliminary HICP M/M% (Y/Y%)	Aug	0.8 (9.0)	-	-1.1 (8.4)	-
	 Lloyds business barometer	Aug	16	-	25	-
	 BRC shop price index Y/Y%	Aug	5.1	-	4.4	-
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/ <i>Daiwa forecast</i>	Previous	
Euro area		09.00	Final manufacturing PMI	Aug	<u>49.7</u>	49.8
		10.00	Unemployment rate %	Jul	6.6	6.6
Germany		07.00	Retail sales M/M% (Y/Y%)	Jul	-0.1 (-6.5)	-1.5 (-9.6)
		08.55	Final manufacturing PMI	Aug	<u>49.8</u>	49.3
France		08.50	Final manufacturing PMI	Aug	<u>49.0</u>	49.5
		-	New car registrations* Y/Y%	Aug	-	-7.1
Italy		08.45	Manufacturing PMI	Aug	48.1	48.5
		09.00	Unemployment rate %	Jul	8.1	8.1
		10.00	Final GDP Q/Q% (Y/Y%)	Q2	<u>1.0 (4.6)</u>	0.1 (6.2)
Spain		08.15	Manufacturing PMI	Aug	48.5	48.7
		-	New car registrations* Y/Y%	Aug	-	-12.5
UK		07.00	Nationwide house price index M/M% (Y/Y%)	Aug	0.1 (8.9)	0.1 (11.0)
		09.30	Final manufacturing PMI	Aug	<u>46.0</u>	52.1

### Auctions and events

Euro area		11.30	ECB's Centeno scheduled to take part in a panel discussion about 'financial capitalism and sustainability'		
France		09.50	Auction: 1.50% 2031 bonds		
		09.50	Auction: 2.00% 2032 bonds		
		09.50	Auction: 1.25% 2038 bonds		
Spain		09.30	Auction: 0.00% 2025 bonds		
		09.30	Auction: 2.55% 2032 bonds		
		09.30	Auction: 1.90% 2052 bonds		
		09.30	Auction: 0.70% 2033 index-linked bonds		
UK		09.30	BoE publishes Decision Maker panel data for July		
		10.00	Auction: 0.875% 2046 bonds		

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

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