

Euro wrap-up

Overview

- Bunds made further losses at the longer end of the curve as the euro area unemployment rate fell to a series low and German retail sales rebounded moderately in July following significant weakness in Q2.
- Gilts underperformed significantly yet again as markets appeared to remain extremely uneasy about policies advocated by Liz Truss, who remains highly likely to become UK Prime Minister next week.
- Friday will bring new data for euro area producer price inflation and German goods trade.

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Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	1.152	-0.015
OBL 1.3 10/27	1.363	-0.012
DBR 1.7 08/32	1.558	+0.025
UKT 1 04/24	3.050	+0.082
UKT 1½ 07/27	2.809	+0.068
UKT 4½ 06/32	2.881	+0.086

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

Source: Bloomberg

Euro area

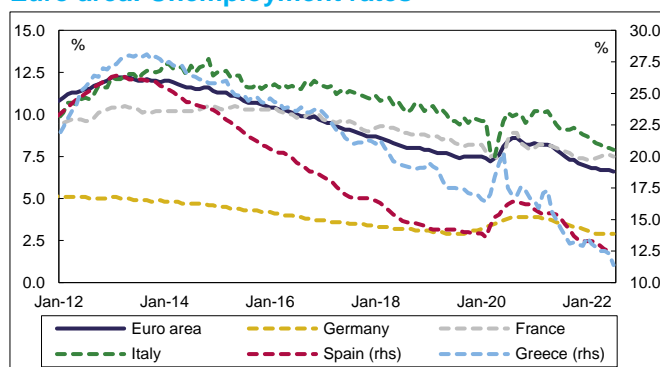
Unemployment rate down to series low in July thanks to rebound in tourism

At the ECB's most recent monetary policy meeting in July, the Governing Council took comfort from the continued strength of the labour market, noting the historically low rate of unemployment, elevated level of vacancies and evidence of a pick-up in wage growth. Today's figures revealed that the unemployment rate fell to a series low at the start of Q3, although the decline of 0.1ppt came from an upwardly revised prior month, and so the rate of 6.6% was no lower than previously thought to be the case in May. The rebound in services activity, not least tourism, supported further declines in joblessness in several holiday hotspots. Indeed, the biggest improvement was recorded in Greece (down a marked 0.9ppt to 11.4%, the lowest since 2010), with marginal further declines in Italy (7.9%, where the number of jobless workers fell below 2mn for the first time in eleven years), France (7.5%) and Portugal (5.9%). However, in contrast, most labour markets in northern European showed no improvement or indeed weakened (e.g. the Netherlands' unemployment rate rose for a third month to 3.6% with the number of jobless workers up to the highest since January). And we expect the trend in Southern Europe to turn for the worse once the summer holiday season comes to an end too.

While recession beckons, tight job market will support hawks' case for a jumbo rate hike

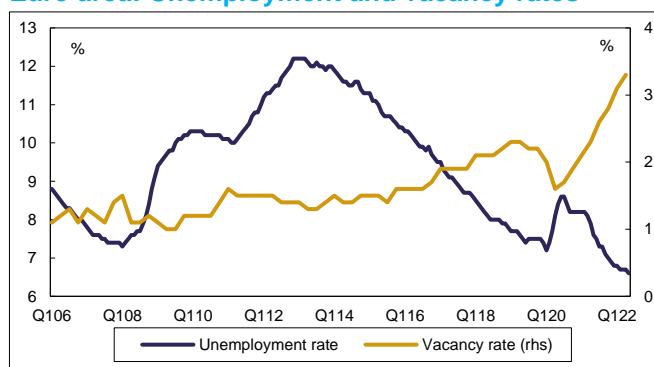
Admittedly, earlier in the summer, the labour market had undeniably become tight, with survey evidence of skill shortages tallying with a rise in the number of job vacancies in Q2 to a series high. However, upwards pressure on nominal wage growth in most countries was still relatively modest, suggesting still limited second-round effects on prices from the labour market and leaving real pay growth firmly in negative territory. So, despite evidence of stronger pricing power for firms, workers still appeared hesitant to demand higher pay. Surveys suggest that labour shortages persist in certain sectors, e.g. construction. But others, e.g. wholesale and retail trade, are flagging the likelihood of redundancies. Today's final euro area manufacturing PMIs left the output (46.5) and new orders (43.3) indices firmly in contractionary territory. And while the employment index (52.8) remained consistent with rising headcounts for the time being, it was also the lowest since the lockdowns at the start of 2021. With increasing likelihood of a broad-based downturn over coming months, the jobs market seems likely to soften from now on. That, however, is unlikely to deter the ECB's hawks from pressing ahead with a jumbo 75bps rate hike next week, and perhaps in October too. Indeed, the historically low unemployment rate will provide sufficient cover for substantive tightening. And they will also argue that, while the flattening of the Phillips curve over recent decades allowed the ECB to run the economy above its potential level before inflationary pressures emerged, it would also now require a significant economic contraction and increase in unemployment to reduce inflation back to target.

Euro area: Unemployment rates



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

Euro area: Unemployment and vacancy rates*



*Vacancy rate is the number of vacancies as a share of the sum of occupied posts and vacancies. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

German retail sales volumes up at start of Q3, but trend still weak as inflation erodes real incomes

Having dropped a steep 3.6%Q/Q in Q2, German retail sales volumes rebounded somewhat at the start of Q3. Growth of 1.9%M/M took the level of retail sales 1.3% above the Q2 average, and was led by sales of food items, with non-food sales little changed on the month. Nevertheless, retail sales volumes were still down 3.5% from March's high for the year to-date, and also fell 5.5%Y/Y to be almost 7% below the pandemic peak in June 2021. And with the volume of sales also down 1.9%3M/3M, and consumer confidence having hit a new series low last month with households reporting a marked increase in desire to save rather than spend, growth in July seems likely to represent a mere pause in the downtrend rather than a sudden turn for the better. Of course, with real disposable incomes eroded by high inflation, household saving looks increasingly challenging. Indeed, rapid price increases mean that nominal retail sales growth was again strong in July, up 2.4%M/M and 6.1%Y/Y to match the series high recorded in March. And with inflation set to rise further over coming months, consumers are likely to spend more to buy less.

The day ahead in the euro area

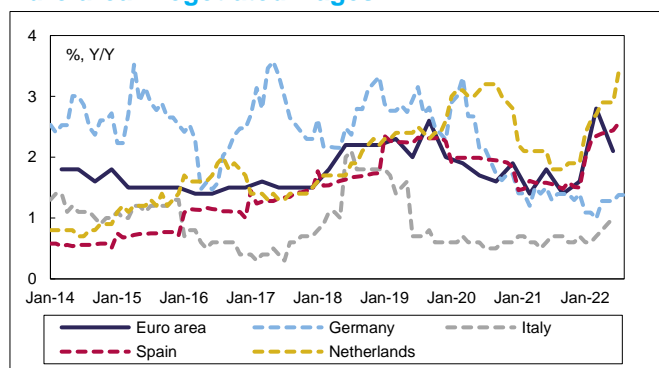
Looking ahead to tomorrow, euro area PPI data for July will offer further insight into producer price pressures. The massive upside surprise to the [German figures](#), related to gas and electricity market strains, points to a further rise in the euro area rate from 35.8%Y/Y in June. That would suggest the likelihood that firms will continue to seek to pass on to consumers their increased costs over coming months. However, Tuesday's [Commission survey](#) suggested that firms in all major sectors had moderated their inflation expectations for the coming year, likely reflecting some easing of supply challenges, expectations of softer demand and a reduced capacity of customers to tolerate higher prices. Meanwhile, Germany's latest goods trade data are likely to report a fall in the value of exports in July for the first time in four months. With imports probably up again, that will likely narrow the goods trade surplus by about €1.7bn to €4.6bn.

UK

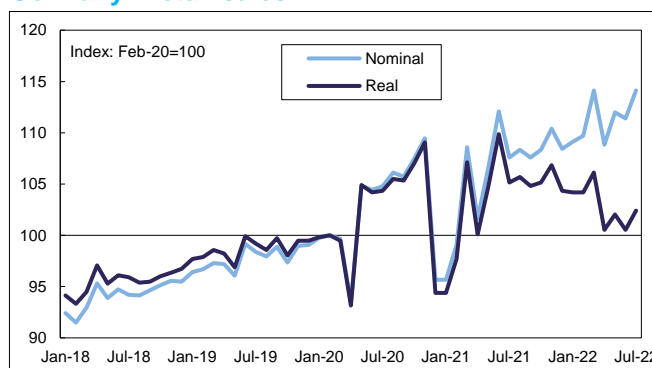
The day ahead in the UK

The week ends on a quiet note in the UK, with no key economic data scheduled for release tomorrow.

Euro area: Negotiated wages

















Germany: Retail sales











European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final manufacturing PMI	Aug	49.6	<u>49.7</u>	49.8	-
	 Unemployment rate %	Jul	6.6	6.6	6.6	6.7
Germany	 Retail sales M/M% (Y/Y%)	Jul	1.9 (-5.5)	-0.1 (-6.5)	-1.5 (-9.6)	-1.5 (-9.6)
	 Final manufacturing PMI	Aug	49.1	<u>49.8</u>	49.3	-
France	 Final manufacturing PMI	Aug	50.6	<u>49.0</u>	49.5	-
	 New car registrations Y/Y%	Aug	3.8	-	-7.1	-
Italy	 Manufacturing PMI	Aug	48.0	48.1	48.5	-
	 Unemployment rate %	Jul	7.9	8.1	8.1	8.0
	 Final GDP Q/Q% (Y/Y%)	Q2	1.1 (4.7)	<u>1.0 (4.6)</u>	0.1 (6.2)	-
	 New car registrations Y/Y%	Aug	9.9	-	-0.9	-
Spain	 Manufacturing PMI	Aug	49.9	48.5	48.7	-
	 New car registrations Y/Y%	Aug	9.1	-	-12.5	-
UK	 Nationwide house price index M/M% (Y/Y%)	Aug	0.8 (10.0)	0.1 (8.9)	0.1 (11.0)	0.2 (-)
	 Final manufacturing PMI	Aug	47.3	<u>46.0</u>	52.1	-




Auctions

Country	Auction
France	 sold €4.41bn of 1.50% 2031 bonds at an average yield of 1.94%  sold €3.50bn of 2.00% 2032 bonds at an average yield of 2.21%  sold €2.10bn of 1.25% 2038 bonds at an average yield of 2.52%
Spain	 sold €1.70bn of 0.00% 2025 bonds at an average yield of 1.81%  sold €1.68bn of 2.55% 2032 bonds at an average yield of 2.81%  sold €1.59bn of 1.90% 2052 bonds at an average yield of 3.33%  sold €415mn of 0.70% 2033 index-linked bonds at an average yield of 0.61%
UK	 sold £2.00bn of 0.875% 2046 bonds at an average yield of 3.22%

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	 10.00	PPI M/M% (Y/Y%)	Jul	2.6 (35.9)	1.1 (35.8)
Germany	 07.00	Trade balance €bn	Jul	4.6	6.3
Spain	 08.00	Unemployment change '000s	Aug	-	3.2

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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