

Euro wrap-up

Overview

- Bunds made gains at the short end but losses further along the curve while German factory orders extended their losing streak and a survey signalled contraction in the euro area construction sector.
- The Gilt curve also steepened as the detail of new UK PM Truss's plans to freeze energy bills, to be announced on Thursday and have a big bearing on the outlook for inflation and rates, remained subject to speculation.
- Wednesday will bring new data for German industrial production as well as updated estimates of euro area GDP and jobs in Q2.

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Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	1.067	-0.025
OBL 1.3 10/27	1.380	+0.036
DBR 1.7 08/32	1.600	+0.044
UKT 1 04/24	3.136	-0.058
UKT 1½ 07/27	2.974	+0.061
UKT 4¼ 06/32	3.050	+0.110

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

Euro area

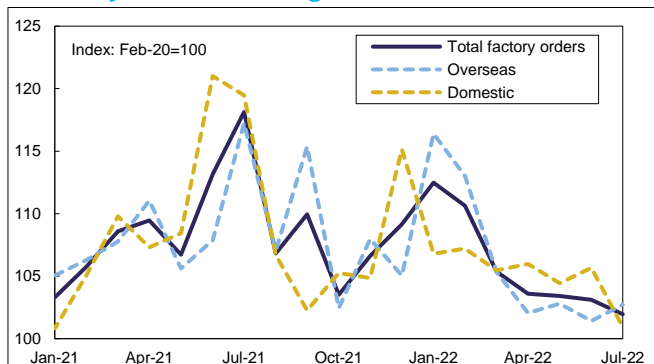
German factory orders fall for sixth successive month

Momentum in Germany's manufacturing sector appears to have remained in reverse at the start of the third quarter, with new factory orders dropping for the sixth successive month and by 1.1%/M/M, a touch more than had been expected. That left them down a whopping 13.6% from the post-pandemic peak, which occurred one year earlier, 1.4% below the Q2 average, and at the lowest level since September 2020. New factory orders were still, however, about 2% above the pre-pandemic level in February 2020. Weakness in the latest month came from domestic orders, which dropped 4.5%/M/M, and orders from the euro area, which dropped 6.4%/M/M, perhaps adding to concerns that the region's economy might be slipping into recession. In contrast, orders from beyond the euro area rose 6.5%/M/M. By type of good, the detail suggested that one-off factors were at play. Indeed, weakness was extremely pronounced in orders of consumer goods, down 16.9%/M/M due not least to a drop of more than 23%/M/M in orders of pharmaceuticals, which had seen double-digit growth the previous month. In contrast, orders of capital goods were little changed (-0.2%/M/M) with new demand for motor vehicles only slightly weaker too (-0.3%/M/M). And orders of intermediate goods were up 1.5%/M/M despite a drop of more than 10%/M/M for chemicals. Survey indicators, such as the relevant PMIs and ifo indices, suggest that the downtrend in new factory orders remained firmly in place in August.

Manufacturing turnover signals drop in output in July, as gas usage was well below recent range

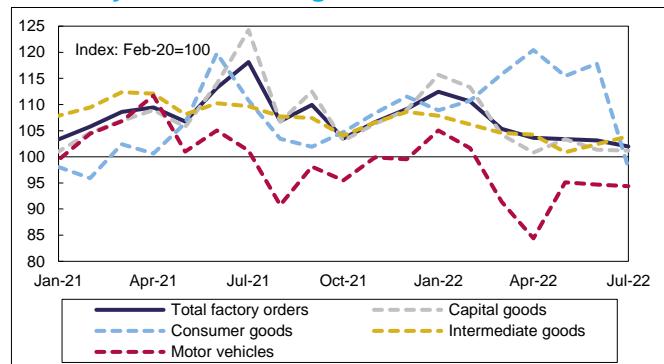
Having risen in each of the previous three months, real turnover in German manufacturing fell 1.8%/M/M in July to tally with survey evidence of weakness in production at the start of Q3. So, tomorrow's IP data are expected to report a decline in factory output at the start of Q3 of at least ½%/M/M following three consecutive monthly increases in Q2. While those increases in production were achieved despite a notable reduction in gas usage in the sector, the more marked cut in gas consumption by industrial users in July and August, to almost 20% below the bottom of the range of the same period in the prior four years, is likely to have taken a greater toll in Q3. As manufacturers continue to try to reduce their dependence on energy, in particular gas, through the winter months, yesterday's decision by the government to retain two of its nuclear power stations on stand-by as a possible "emergency reserve" helped wholesale natural gas prices fall back somewhat today. But it is unlikely to be a game-changer for growth. Indeed, despite the weekend announcement by Chancellor Scholz of plans for a €65bn (2% of GDP) package of [new fiscal support](#) to cushion the impact of high energy prices on households and business, we maintain our baseline forecast of German recession.

Germany: Manufacturing orders



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing orders



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

German and Italian construction PMIs signal marked contraction in Q3

Today's PMI surveys suggested that Germany's construction sector will be a drag on economic growth in the third quarter. In particular, the headline activity index fell for the fifth month out of the past six in August, by 1.1pts to 42.6, the weakest reading since February 2021 and trending more than 2½pts lower than the Q2 average. While supply-side constraints continued to ease and input costs moderated to an eighteen-month low, firms reported another steep decline in orders as high prices, increased interest rates and economic uncertainty all weighed on demand. But the most striking aspect of today's construction PMIs was the ongoing marked turn for the worse in Italy's construction sector, for which the activity index fell a further 5pts in August to just 41.2, trending some 11pts below the Q2 average, 27pts below February's peak and the weakest since the first wave of Covid-19 in April 2020. Reflecting economic uncertainty, supply bottlenecks and issues surrounding delayed payments under the government superbonus scheme of support for housing renovations, new orders continued to fall sharply. So, expectations for future output remained extremely subdued resulting in firms in the sector cutting jobs for the first time since the start of 2021. While the French construction PMI was more resilient in August, down just 0.4pt to 48.2, this still marked the third consecutive contractionary reading. Overall, the aggregate euro area activity PMI fell for the seventh successive month, by 1.5pts to a nineteen-month low of 44.2, while the new orders component (42.5) implied the steepest pace of decline in new business since May 2020.

The day ahead in the euro area

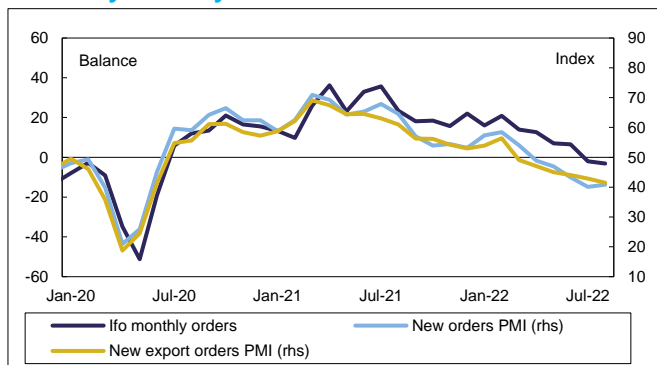
Aside from the aforementioned German industrial production release – expected to report a drop in output of at least ½M/M – Wednesday will bring updated euro area Q2 GDP growth numbers, which will include an official expenditure breakdown for the first time. These are expected to confirm that the economy expanded 0.6%Q/Q last quarter, underpinned by increased opportunities to spend on services. Employment numbers for Q2 will confirm a moderation in job growth to 0.3%Q/Q, the softest pace in five quarters and hence consistent with an improvement in productivity. The full country breakdown will be published for the first time.

UK

UK construction PMI points to contraction in Q3

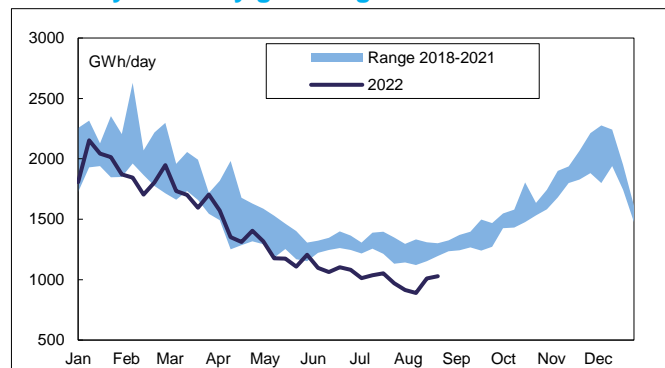
Since late last year, the UK's construction sector has benefitted from a robust housing market and easing in supply constraints, with activity rising for seven consecutive months between November and May by a cumulative 7.0%. But output fell back in June (-1.4%M/M) and surveys suggest a steady downtrend over the summer. Indeed, while today's headline construction PMI posted a modest rise in August, at 49.2 the index still marked the second successive contractionary reading

Germany: Survey measures of new orders



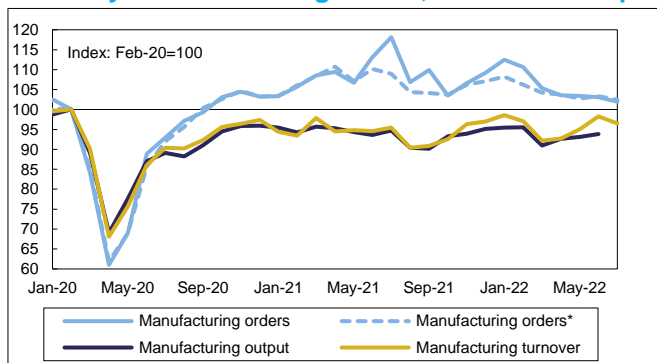
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Germany: Industry gas usage



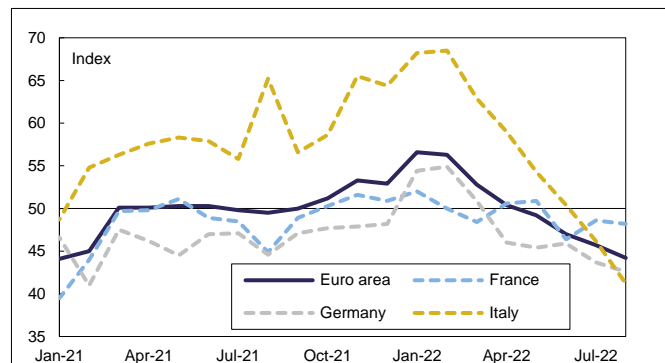
Source: German Federal Network Agency and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing orders, turnover & output



*Excluding bulk orders. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Construction PMIs



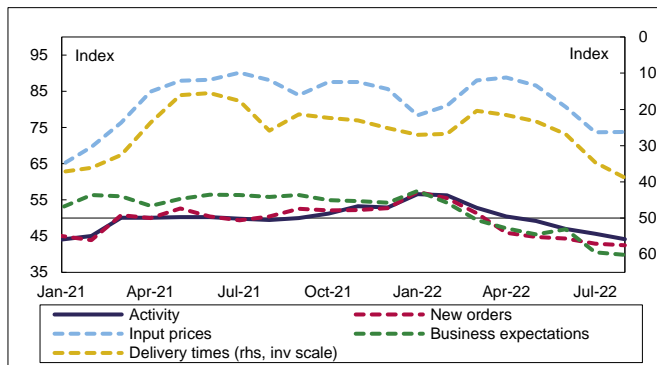
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

to be trending more than 6½pts below the Q2 average. Within the sector, civil engineering posted a substantial decline, with commercial activity continuing to contract and housing broadly stagnating. And with cost pressures still elevated, interest rates rising and the cost-of-living crisis eroding budgets, new orders were the softest for more than two years. As such, construction firms scaled back their material purchases for the first time since the first wave of the pandemic, while also reporting the softest jobs growth since March 2021. And overall expectations for the year ahead remained well below the long-run average.

The day ahead in the UK

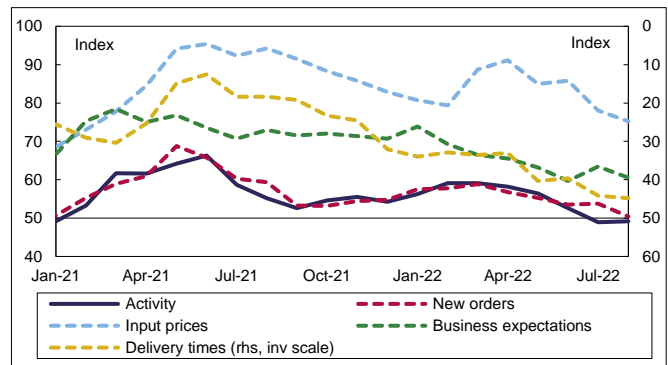
While politics will remain the focus in the UK, Wednesday will also see BoE Governor Andrew Bailey, along with Chief Economist Huw Pill, Catherine Mann (the most hawkish MPC member) and Silvana Tenreyro (the only member to vote for a smaller 25bps hike in August) appear before the Treasury Select Committee to discuss the Bank's most recent economic forecasts published in August's Monetary Policy Report. But the Committee members will likely also be pressed for their views on the likely impact on the outlook for inflation and monetary policy of possible new fiscal policy initiatives to freeze household and business energy bills. The intention of new PM Truss to review the BoE's monetary policy mandate is also likely to be discussed, as will the BoE's possible reaction function to sterling weakness.

Euro area: Construction PMIs



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Construction PMIs










Source: Refinitiv, S&P Global 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	 Construction PMI	Aug	44.2	-	45.7	-
Germany	 Factory orders M/M% (Y/Y%)	Jul	-1.1 (-13.6)	-0.7 (-13.5)	-0.4 (-9.0)	-0.3 (-)
	 Construction PMI	Aug	42.6	-	43.7	-
France	 Construction PMI	Aug	48.2	-	48.6	-
Italy	 Construction PMI	Aug	41.2	-	46.2	-
UK	 BRC retail sales like-for-like Y/Y%	Aug	0.5	-	1.6	-
	 Construction PMI	Aug	49.2	48.1	48.9	-





Auctions

Country	Auction
Germany	 sold €322mn of 0.1% 2026 index-linked bonds at an average yield of -1.45%
	 sold €190mn of 0.1% 2046 index-linked bonds at an average yield of -0.61%
UK	 sold £3.50bn of 0.25% 2025 bonds at an average yield of 3.182%




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	Final GDP Q/Q% (Y/Y%)	Q2	0.6 (3.9)	0.5 (5.4)
	 10.00	Final employment Q/Q% (Y/Y%)	Q2	0.3 (2.4)	0.6 (2.9)
Germany	 07.00	Industrial production M/M% (Y/Y%)	Jul	-0.6 (-2.1)	0.4 (-0.5)
Italy	 09.00	Retail sales M/M% (Y/Y%)	Jul	0.2 (-)	-1.1 (1.4)

Auctions and events

Germany	 10.30	Auction: €1.5bn of 1.00% 2038 bonds
UK	 10.00	BoE Governor Bailey and MPC members Pill, Mann and Tenreiro testify to Parliament's Treasury Select Committee
	 10.00	Auction: £2.75bn of 1% 2032 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

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