

# Euro wrap-up

## Overview

- With the exception of the short end of the curve, Bunds made gains while euro area industrial production fell markedly in July.
- Gilts made gains across the curve as UK headline inflation fell back in August but the core measure edged higher.
- Thursday will bring updated euro area trade and labour cost data along with the BoE's Inflation Attitudes Survey.

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### Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	1.374	+0.006
OBL 1.3 10/27	1.549	-0.021
DBR 1.7 08/32	1.689	-0.034
UKT 1 04/24	3.008	-0.041
UKT 1½ 07/27	3.031	-0.047
UKT 4½ 06/32	3.111	-0.054

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

## Euro area

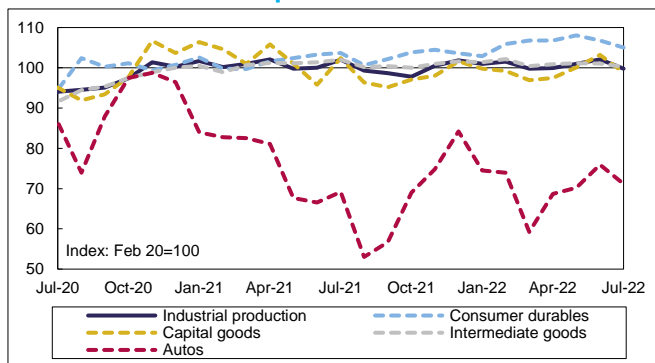
### Euro area IP in reverse at the start of Q3

The major survey indicators signalled strongly that conditions in the euro area manufacturing sector took a marked turn for the worse at the start of the summer, as supply constraints continued to limit production capacity while demand was hit by higher costs and heightened uncertainties about the outlook. And just as the PMIs signalled a substantive contraction in output in July, today's euro area industrial production figures confirmed such an outturn, with the 2.3%M/M drop the steepest for eleven months. That left IP 1.2% below the Q2 average, down 2.4%Y/Y, and a touch below the pre-pandemic level in February 2020. The weakness was led by a significant drop in output of computers and electronic parts (-10.4%M/M) to the lowest level since October 2020, although that left it still some 19% above the pre-Covid level. Having risen in the previous three months, auto production also went into reverse (-6.3%M/M), leaving it still 29% below the pre-pandemic level. And chemicals output fell for the seventh consecutive month (-1.1%M/M). Overall, capital goods output fell more than 4%M/M in July, with production of intermediate goods down for the second successive month (-0.8%M/M). But while consumer durables output also fell (-1.6%M/M), this was more than offset by a more than 1% increase in non-durables, reflecting not least a 7%M/M jump in pharmaceuticals.

### Broad-based decline and ongoing challenges point to industrial sector contraction in Q3

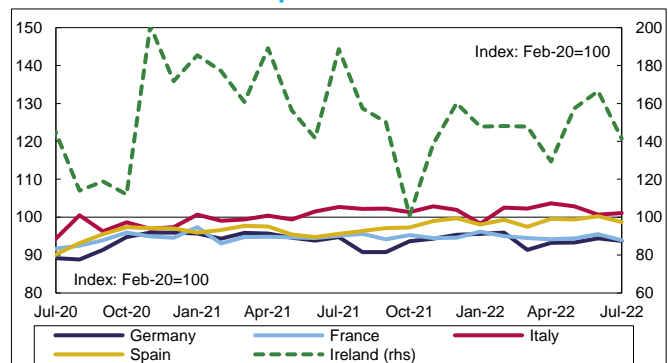
Among the various member states, the weakness was led by Ireland, whose data are typically extremely volatile due to the impact of the cross-border activities of multinational corporations, and where production was estimated to fall a whopping 18.9%M/M. Estonia also recorded its steepest monthly drop since April 2020 (-7.4%M/M). But with the exception of Italy and Belgium, all other member states were also either a drag on euro area IP growth or offered negligible support. So, for example, production on the EU-harmonised measure (i.e. excluding construction) dropped 0.7%M/M in Germany and 1.5%M/M in France. Surveys point to ongoing and widespread weakness ahead too, with the PMIs having implied another decline in output and new orders in August amid the significant weakening in client purchasing power, efforts by energy-intensive firms to reduce their dependency on natural gas ahead of possible rationing this winter, and concerns about additional supply-side obstacles from record-low water levels in the Rhine to French nuclear power generators being taken off-line. And so, we see a strong probability that euro area manufacturing output will be a non-negligible drag on GDP growth in Q3 as a whole.

### Euro area: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

## The day ahead in the euro area

Tomorrow will bring updates on euro area goods trade in July and labour costs in Q2. With export values still relatively subdued in line with the weakness in manufacturing output, tomorrow's euro area trade figures are expected to report a widening in the deficit back close to April's series high of €32.3bn due not least to high prices of imported energy. Separately, following a sharp pickup to 3.8%Y/Y in Q1 on special pandemic-related payments, euro area labour cost growth might well accelerate further in Q2. However, that would in part reflect the low base a year earlier, when costs fell 0.1%Y/Y marking the series low.

## UK

### Inflation drops slightly in August on lower petrol prices but core measure rises again

In line with our forecast, UK inflation eased back slightly in August, dropping 0.2ppt to 9.9%Y/Y. The principal cause of the decline was auto fuel, prices of which fell almost 7%M/M to push the respective annual rate down more than 11ppts to just over 32%Y/Y. That, however, was partly offset by a further rise in food inflation of 0.6ppt to a new high of 13.4%Y/Y. Meanwhile, the impact of higher prices of clothing back in line with the pre-Covid seasonal pattern was broadly offset by a decline in second-hand car inflation to below 5%Y/Y, having peaked above 30%Y/Y as recently as March. So, non-energy industrial goods price inflation was unchanged at 6.6%Y/Y, some 1.4ppts below the peak in the spring. But higher inflation of consumer-facing services – not least restaurants, where wage and other cost pressures are currently particularly acute, and package holidays – pushed services inflation up a further 0.2ppt to a new high of 5.9%Y/Y. So, core inflation rose 0.1ppt to a new high of 6.3%Y/Y.

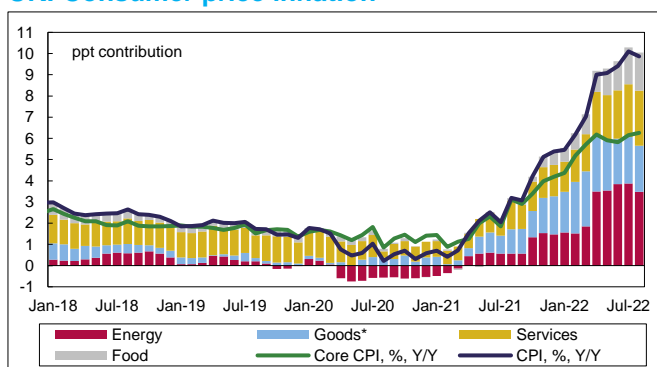
### Cap on household energy bills price transforms inflation outlook

The MPC will be relieved that today's data were consistent with the BoE's inflation forecast published last month. However, its projection for Q4 onwards – which showed a peak of 13.1%Y/Y next quarter – is now obsolete given the government's commitment to cap the rise in household energy bills next month at £2500, a little more than £1000 below the level previously set by the regulator Ofgem. Despite the further drop in petrol prices so far this month, we currently expect inflation to move back slightly above 10.0%Y/Y in September. And it could surpass 10½%Y/Y in October due to the aforementioned rise in prices of electricity and gas. But while charges on several services (e.g. mobile phone charges and social housing rents) will in due course be indexed in line with the past year's inflation, the hospitality and tourism components will fall back in October and April due to base effects associated with past changes in VAT. In addition, the as-yet-unspecified government measures to cap energy bills for businesses for six months from October should help to contain price pressures in a range of sub-sectors. So, with producer goods inflation past the peak – the input PPI measure fell more than 2ppts in August to 20.5%Y/Y, with the output price measure down 1ppt to 16.1%Y/Y – the recent retreat of prices of a range of commodities and shipping, and ongoing slowing of global demand, should help goods inflation to subside too.

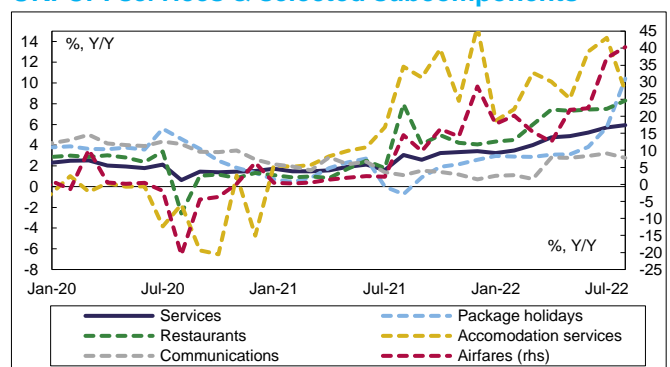
### Inflation to peak in October and fall steadily next year, but medium-term outlook unclear

We currently expect October to represent the peak in CPI inflation, which should then fall back below 10%Y/Y in Q1 and steadily further over subsequent quarters next year and into 2024. We also note that the BoE's August projections suggested a probability of more than 50% that inflation would be below 1%Y/Y by mid-2025. How fast and how far it eventually falls will depend in no small part on prices of petrol and food, for which base effects could pose significant downside risks. However, while core inflation will likely fall steadily too as the impact of external shocks subside, and a majority on the MPC will continue to judge that current domestically-generated pressures risk persistence of above-target inflation over the medium term. Yesterday's evidence of increased [labour market](#) tightness and associated wage pressures will likely reinforce that view. In addition, the government's energy market interventions might be judged to raise the risks that excess demand will persist over the monetary policy-relevant horizon, adding upside risks to the medium-term inflation outlook. The MPC will

#### UK: Consumer price inflation



#### UK: CPI services & selected subcomponents

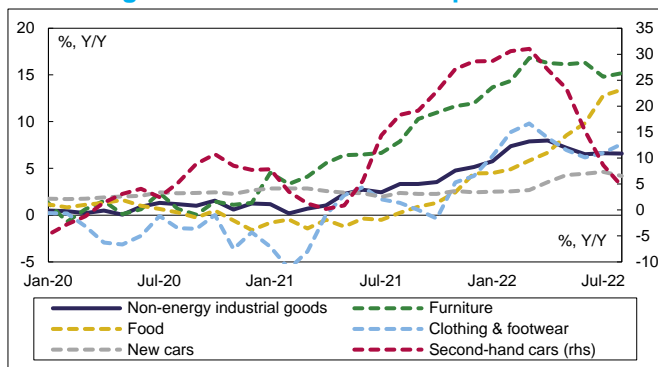


also be wary that the BoE’s Decision Maker Panel reported a further increase in firms’ expectations of year-ahead output price inflation in the three months to August of 0.2ppt from the prior survey to 6.5%Y/Y; an increase in firms’ expectations of CPI inflation one-year ahead of 1.1ppt to 8.4%; and an increase of 0.1ppt in their expectations of CPI inflation in three years’ time to 4.2%. The results of the BoE’s latest consumer inflation perceptions survey – due belatedly to be published tomorrow – might similarly report a further increase in expectations for the coming five years, from 3.5% in May, something that might further concern the MPC’s hawks.

**The day ahead in the UK**

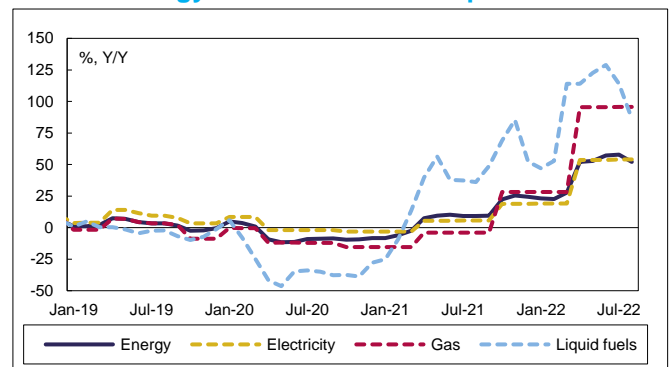
In the UK, tomorrow will bring the BoE’s postponed publication of its quarterly Inflation Attitudes Survey, which is highly likely to report a further rise in expectations for the coming twelve months from the series high of 4.6% registered three months ago. Expectations for inflation further ahead are also likely to have picked up, to add to concerns among some members of the MPC about potential second-round effects. Of course, the survey will have been conducted before the government made clear its readiness to cap household energy bills well below Ofgem’s recommended level over the coming two years.

**UK: CPI goods & selected subcomponents**



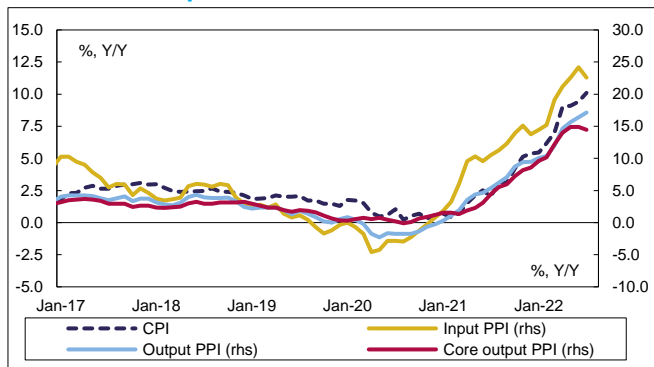
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

**UK: CPI energy & selected sub-components**



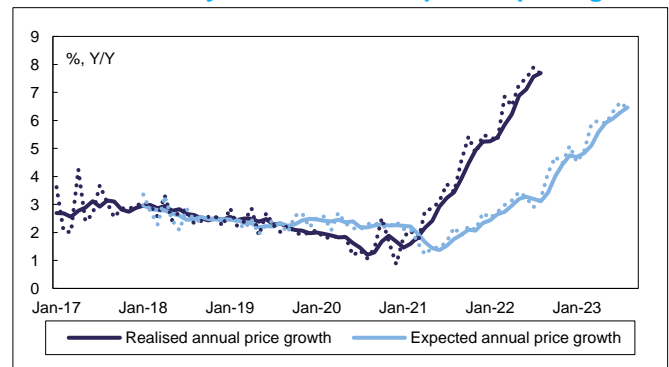
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

**UK: Producer price inflation**



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

**UK: DMP survey – Realised & expected price growth\***









\*Expected price growth relates to the coming twelve months. Dotted lines represent single-month figures. Unbroken lines represent three-month averages.  
Source: BoE 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	 Industrial production M/M% (Y/Y%)	Jul	<b>-2.3 (-2.4)</b>	<u>-1.0 (0.7)</u>	0.4 (2.4)	<b>1.1 (2.2)</b>
UK	 CPI M/M% (Y/Y%)	Aug	<b>0.5 (9.9)</b>	<u>0.5 (9.9)</u>	0.6 (10.1)	-
	 Core CPI Y/Y%	Aug	<b>6.3</b>	<u>6.3</u>	6.2	-
	 PPI output prices M/M% (Y/Y%)	Aug	<b>-0.1 (16.1)</b>	0.9 (17.6)	1.6 (17.1)	-
	 PPI input prices M/M% (Y/Y%)	Aug	<b>-1.2 (20.5)</b>	0.2 (22.9)	0.1 (22.6)	<b>0.0 (-)</b>
	 House price index Y/Y%	Jul	<b>15.5</b>	-	7.8	-

#### Auctions






Country Auction

Germany  sold €855mn of 2.5% 2044 bonds at an average yield of 1.79%











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	Labour costs Y/Y%	Q2	-	3.8
	 10.00	Trade balance €bn	Jul	-32.0	-30.8
France	 07.45	Final CPI M/M% (Y/Y%)	Aug	<u>0.4 (5.8)</u>	0.3 (6.1)
	 07.45	Final HICP M/M% (Y/Y%)	Aug	<u>0.4 (6.5)</u>	0.3 (6.8)
UK	 09.30	BoE/Ipsos inflation expectations over next 12 months Y/Y%	Aug	-	4.6

#### Auctions and events

Euro area	 10.15	ECB Vice President de Guindos scheduled to speak
France	 09.50	Auction: 0.00% 2027 bonds
	 09.50	Auction: 0.75% 2028 bonds
	 09.50	Auction: 0.00% 2029 bonds
	 10.50	Auction: 0.10% 2025 index-linked bonds
	 10.50	Auction: 0.10% 2038 index-linked bonds
	 10.50	Auction: 0.10% 2053 index-linked bonds
Spain	 09.30	Auction: 2.15% 2025 bonds
	 09.30	Auction: 0.00% 2027 bonds
	 09.30	Auction: 0.50% 2030 bonds

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