

Euro wrap-up

Overview

- Bunds made losses and the curve flattened significantly as the euro area trade deficit hit a new record high, euro area labour cost growth remained firm and the estimates of French inflation were revised up.
- Gilts also made losses across the curve but outperformed Bunds at the short end as a BoE survey suggested that medium-term inflation expectations of UK consumers fell significantly last month.
- Friday will bring updated estimates of euro area inflation in August and UK retail sales data.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	1.480	+0.094
OBL 1.3 10/27	1.613	+0.045
DBR 1.7 08/32	1.732	+0.023
UKT 1 04/24	3.057	+0.037
UKT 1½ 07/27	3.082	+0.035
UKT 4¼ 06/32	3.140	+0.014

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

Euro area

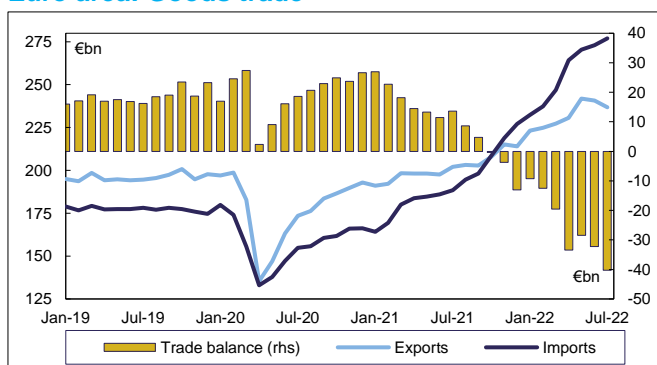
Trade deficit hits a new high as fuel prices and export weakness continue to take toll

The euro area's goods trade deficit widened significantly further than expected in July by more than €8bn to a new series high of €40.3bn. In part, the deterioration reflected the continued disappointing performance of goods exports. Tallying with the weakness of [industrial production](#) at the start of Q3, the value of exports fell for a second successive month and by 1.7%M/M, the most since the first wave of Covid-19 in April 2020, to be almost ½% below the Q2 average. In contrast, the value of imports rose for the nineteenth successive month and by 1.5%M/M to be almost 3% above the Q2 average. In part, that reflected the ongoing terms of trade shock related to energy prices, with the fuels deficit rising to a new record high of €54.6bn, almost three times the level a year earlier, more than three times the level ahead of the pandemic in February 2020 and about seven times the level during the first wave of Covid-19. However, excluding fuels, the euro area's trade performance was also extremely disappointing, with the non-fuels surplus declining to €14.3bn, the smallest since the first wave of Covid-19 in April 2020 and a level rarely lower in the past two decades, suggesting that weak external demand and severe supply-side challenges continue to weigh on growth despite the boost to competitiveness from euro depreciation. Exports in July fell to most major destinations including the US (-5.0%M/M), the UK (-3.4%M/M) and Japan (-11.2%M/M), with exports to China (+4.2%M/M) as well as OPEC countries and some non-euro area EU member states bucking the trend. Survey evidence of falling foreign orders points to continued export weakness over the remainder of the year.

Labour cost growth well above average in Q2 but limited signs of second-round inflation effects

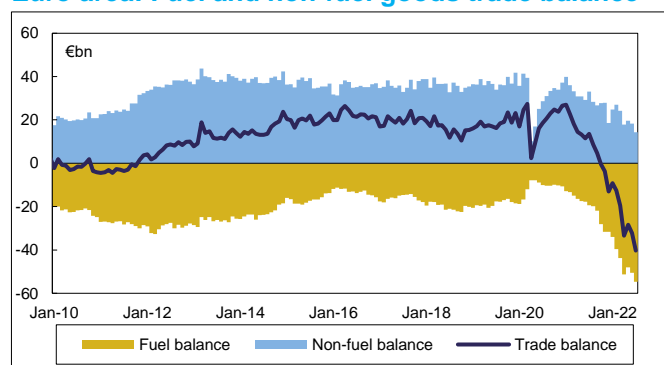
Euro area labour cost growth moderated very slightly in Q2. But the slowdown of 0.2ppt came from a significantly upwardly-revised estimate for Q1, leaving it at 4.0%Y/Y, almost twice the average pace since 2008. Among the member states, labour cost growth eased somewhat in Germany (4.7%Y/Y), France (3.1%Y/Y), Spain (2.1%Y/Y) and the Netherlands (4.1%Y/Y). But it picked up in Italy (3.0%Y/Y) and strikingly so in Ireland (10.6%Y/Y). In the business sector, labour costs slowed 0.6ppt to 3.9%Y/Y largely due to slowing non-wage costs (down more than 2ppts to 3.0%Y/Y) while wage growth eased minimally to 4.2%Y/Y. That, of course, was well below the rate of consumer price inflation in Q2, suggesting that wages declined significantly in real terms. And while we expect pay growth to pick up over coming quarters as workers try to keep pace with cost-of-living pressures, negotiated wage growth of just 2.1%Y/Y in Q2 suggests that settlements are yet to display any meaningful signs of second-round effects from current high inflation. We note, however, that with employment growth firm over the past year, total employee compensation in the national accounts rose 7.7%Y/Y in Q2, down only 0.2ppt from Q1 and still above the 6.4%Y/Y rate of increase in the household consumption expenditure deflator. And wage growth was particularly strong in certain sectors, e.g. accommodation and food services (9.9%Y/Y), where labour shortages are acute. The wage share of national income, however, continued to decline in Q2 and thus remained below the long-run average,

Euro area: Goods trade*



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

Euro area: Fuel and non-fuel goods trade balance*



*Seasonally adjusted values.
Source: Eurostat and Daiwa Capital Markets Europe Ltd.

again providing evidence of an absence of significant worker bargaining power and the likelihood of only limited second-round effects on inflation.

French inflation revised higher, maintaining chance of upwards revision to euro area data

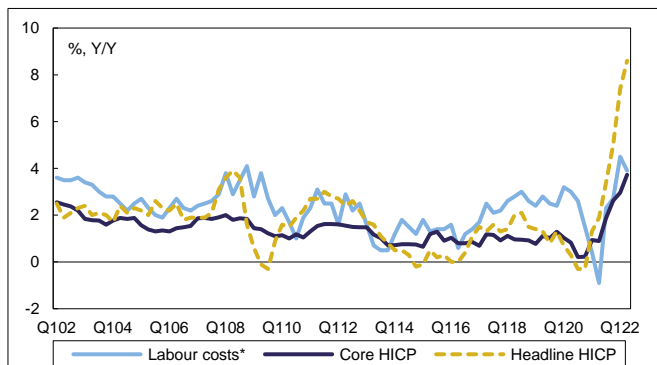
The chances of an upwards revision to the estimate of euro area inflation in August, when the final data are published tomorrow, have increased further. Following the publication of increased estimates of [Spanish](#) inflation on Tuesday, French inflation was revised up today, by 0.1ppt, taking the EU-harmonised HICP rate to 6.6%Y/Y (down from 6.8%Y/Y in July) and the national CPI measure to 5.9%Y/Y (from 6.1%Y/Y the prior month). Within the detail, inflation of both food (7.8%Y/Y) and energy (22.7%Y/Y) in August were stronger than previously thought, although the decline in the latter rate from July explained the decrease in headline inflation. In contrast, the core CPI measure was left unrevised at 4.7%Y/Y, nevertheless 0.4ppt higher than in July and the highest on the series dating back more than three decades. Pressure on the core measure in August came in particular from non-energy industrial goods, for which inflation jumped 0.8ppt to 3.5%Y/Y in part due to shifts in the timing of summer discounting. Within that category, inflation of clothing, furniture, household utensils and cars all accelerated significantly. Elsewhere, inflation in Portugal was revised down 0.1ppt from the flash estimate to 8.9%Y/Y. Nevertheless, the more significant upwards revisions from France and Spain mean that a modest upwards revision from Italy will be required tomorrow for the euro area headline inflation rate to be nudged up 0.1ppt from the flash estimate to 9.2%Y/Y.

The day ahead in the euro area

Friday will bring the aforementioned updated euro area HICP inflation figures for August. While there is a non-negligible risk that due to higher energy and food prices the euro area's flash estimate of headline inflation is nudged higher in August by 0.1ppt to 9.2%Y/Y to leave it 0.3ppt higher than July's reading and a new record high, we expect the core HICP rate to align with the flash estimate of 4.3%Y/Y, up from 4.0%Y/Y in July. The latest euro area new car registrations figures for August are also due and expected to have remained weak, not least reflecting still subdued production. Separately, ECB President Lagarde and BoF Governor Villeroiy de Galhau are scheduled to speak at an event in Paris.

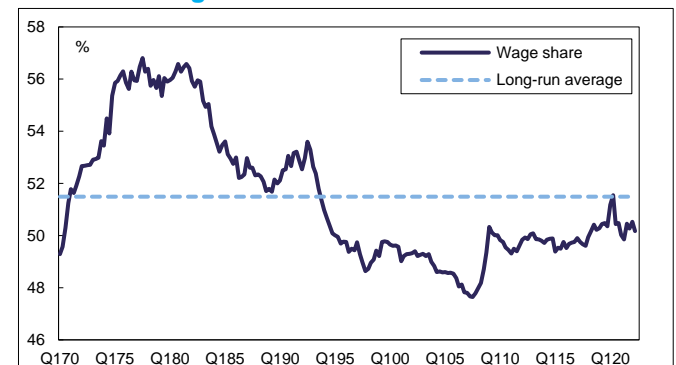
UK

Euro area: Labour costs & inflation



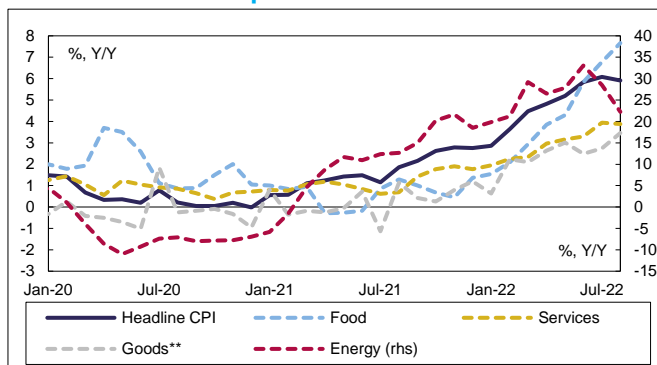
*Total labour costs in the business economy.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Wage share of national income*



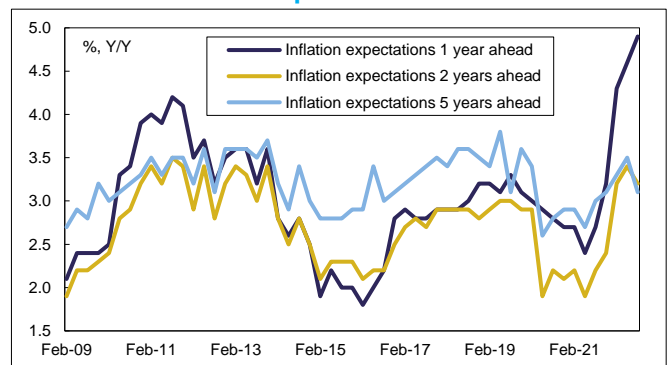
*Compensation of employees adjusted by the employed people to employee ratio as a share of GDP. Source: Refinitiv, Eurostat, ECB Area Wide Model database and Daiwa Capital Markets Europe Ltd.

France: Consumer price inflation*



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

UK: Public inflation expectations



Source: BoE and Daiwa Capital Markets Europe Ltd.

BoE survey reports fall in medium-term household inflation expectations

With CPI inflation having reached double-digits in July, and slipped back only slightly to [9.9%Y/Y in August](#), the BoE is unsurprisingly fearful about second-round effects from wages and firms' price-setting behavior. Those concerns might have been exacerbated by ongoing [labour market](#) tightness related not least to rising inactivity. However, while financial market measures of expected inflation, such as the 5Y5Y inflation forward swap rate, and business inflation expectations remain elevated, today's BoE Inflation Attitudes Survey for August suggests that medium-term household inflation expectations remain well anchored. Admittedly, median expectations for inflation over the coming year rose 0.3ppt from May to a new series high of 4.9%Y/Y. However, expected inflation two years ahead dropped 0.2ppt to 3.2%Y/Y. And while that remained 0.5ppt above the long-run average, expected inflation five years ahead fell a larger 0.4ppt to 3.1%Y/Y, a touch below the long-run average.















Survey softens case for jumbo rate hike

Notably, the latest Inflation Attitudes Survey was conducted from 5-8 August, when new PM Liz Truss – at that time the clear favourite to succeed Boris Johnson – was still refusing to countenance interventions to limit the massive rise in household energy bills signalled by the regulator Ofgem. But her subsequent plans to fix the “typical” household bill at £2500 for two years, announced last week, will significantly reduce the profile of inflation over the coming two years. And so, household inflation expectations over that horizon should now be significantly lower than suggested by the Inflation Attitudes Survey. The impact of Truss's announcement on medium-term inflation expectations remains to be seen. But, for the time being, the evidence in today's survey that such expectations are well anchored should soften the case for a jumbo hike of 75bps at next week's rescheduled BoE monetary policy meeting. Instead, coupled with the increased likelihood of a second-successive quarterly contraction in GDP in Q3 following the death of Queen Elizabeth II, overall the past week's events suggest that the majority of MPC members will vote for a hike of 50bps.

The day ahead in the UK

In the UK, Friday will bring the release of August retail sales figures. While the CBI distributive trades survey suggested that sales held up well last month, the BRC monitor implied a much weaker outturn. And with household purchasing power diminishing, prices continuing to rise, and some payback likely after July's surprising increase, we expect to see retail sales fall back in August, with the Bloomberg consensus for a drop of around ½%M/M.









European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
Euro area	 Labour costs Y/Y%	Q2	4.0	-	3.2	4.2	
	 Trade balance €bn	Jul	-40.3	-32.0	-30.8	-32.2	
France	 Final CPI M/M% (Y/Y%)	Aug	0.5 (5.9)	<u>0.4 (5.8)</u>	0.3 (6.1)	-	
	 Final HICP M/M% (Y/Y%)	Aug	0.5 (6.6)	<u>0.4 (6.5)</u>	0.3 (6.8)	-	
UK	 BoE inflation expectations, next 12 months	Aug	4.9	-	4.6	-	
Auctions							
Country	Auction						
France	 sold €2.70bn of 0.00% 2027 bonds at an average yield of 1.84%						
	 sold €4.52bn of 0.75% 2028 bonds at an average yield of 1.96%						
	 sold €2.78bn of 0.00% 2029 bonds at an average yield of 2.01%						
	 sold €655mn of 0.10% 2025 index-linked bonds at an average yield of -1.14%						
	 sold €417mn of 0.10% 2038 index-linked bonds at an average yield of 0.15%						
	 sold €178mn of 0.10% 2053 index-linked bonds at an average yield of 0.12%						
Spain	 sold €863mn of 2.15% 2025 bonds at an average yield of 1.875%						
	 sold €2.07bn of 0.00% 2027 bonds at an average yield of 2.228%						
	 sold €1.25bn of 0.50% 2030 bonds at an average yield of 2.510%						



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		07.00	EU27 new car registrations Y/Y%	Aug	-	-15.4
		10.00	Final HICP M/M% (Y/Y%)	Aug	<u>0.5 (9.1)</u>	0.1 (8.9)
Italy		10.00	Final core HICP Y/Y%	Aug	<u>4.3</u>	4.0
		09.00	Total trade balance €bn	Jul	-	-2.2
		10.00	Final CPI M/M% (Y/Y%)	Aug	<u>0.8 (8.4)</u>	0.4 (7.9)
UK		10.00	Final HICP M/M% (Y/Y%)	Aug	<u>0.8 (9.0)</u>	-1.1 (8.4)
		07.00	Retail sales including autos fuel M/M% (Y/Y%)	Aug	-0.5 (-3.7)	0.3 (-3.4)
		07.00	Retail sales excluding autos fuel M/M% (Y/Y%)	Aug	-0.7 (-3.5)	0.4 (-3.0)

Auctions and events

Euro area		09.00	ECB's Rehn scheduled to speak
		09.30	ECB's Lagarde and Villeroy de Galhau scheduled to speak at an event in Paris

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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

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