

Euro wrap-up

Overview

- Bunds made large losses as German producer price inflation smashed expectations and jumped to a new series high, while the euro area's current account balance registered a record deficit.
- Ahead of the BoE's MPC meeting, on a quiet day for top-tier UK economic data, Gilts declined sharply after the Riksbank hiked its policy rate by 100bps.
- Wednesday brings the latest UK public finance figures alongside a manufacturing sentiment survey.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	1.696	+0.110
OBL 1.3 10/27	1.828	+0.131
DBR 1.7 08/32	1.934	+0.129
UKT 1 04/24	3.331	+0.195
UKT 1½ 07/27	3.311	+0.189
UKT 4½ 06/32	3.298	+0.162

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

Euro area

German producer prices smash records again in August due to energy shock

Price pressures on German industry intensified markedly to a new record last month, illustrating the energy shock which even the Bundesbank now acknowledges seems bound to push the economy into marked recession by the end of the year. Overall, industrial producer prices rose 7.9%/M/M and 45.8%/Y/Y in August, with both the monthly and annual rates marking series highs. The additional impetus last month came almost entirely from energy prices, which rose 20.4%/M/M to be up about 35% since June and 139%/Y/Y, with prices of electricity and natural gas at certain stages of the supply chain more than tripling from a year earlier as prices in wholesale natural gas and power markets spiked to record highs. It is something of a relief, therefore, that benchmark European wholesale natural gas prices have moderated significantly over the past few weeks in response to government actions, with the one-month forward Dutch TTF contract below €200/MWh, the lowest levels since late July, from a peak around €340 late last month.

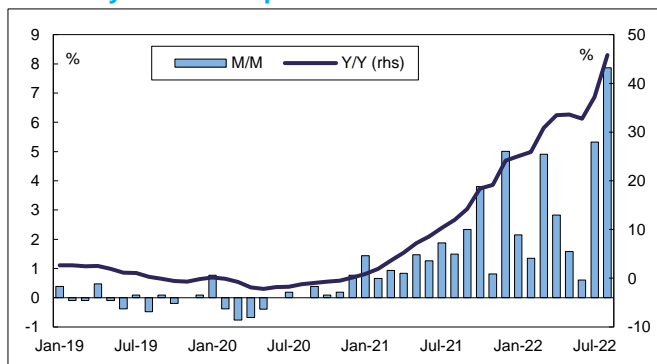
But hints of cooling price pressures elsewhere

In contrast to the pressures in electricity and markets, German industrial producer prices of mineral oil products fell for a second successive month in August to be up 37%/Y/Y, the least since February. Moreover, excluding energy, the annual core rate of industrial PPI inflation slowed for a third successive month, down to 13.8%/Y/Y. That was due to a fourth successive monthly moderation in pressures in prices of intermediate goods, which rose just 0.1%/M/M to be up 17.5%/Y/Y, the least in eleven months, reflecting recent falls in prices of various commodities. Among other items, wood prices fell 13%/Y/Y and prices for metal secondary raw materials fell 12.3%/Y/Y. Capital goods inflation also slowed a touch, down 0.2ppt from July's series high to 7.8%/Y/Y. However, while their monthly rates of increase were well down from recent highs, producer price inflation of consumer goods remained elevated on an annual basis, matching July's series high of 10.9%/Y/Y for durables and rising to a new series high of 16.9%/Y/Y for non-durables on higher food prices. The moderation in prices of intermediate goods, however, raises some hopes that inflation of many consumer goods will soon start to ease, as long as governments can get a much greater grip on the energy market.

Energy price shock and export weakness results in record current account deficit

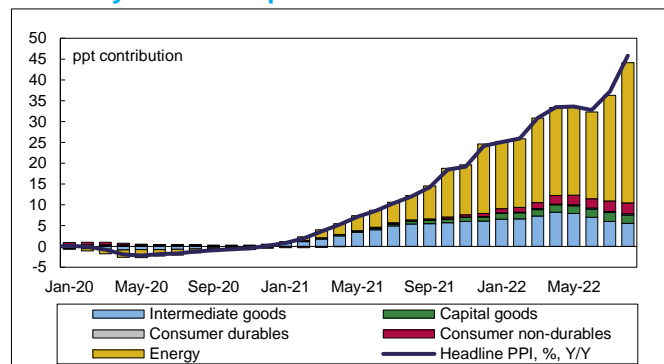
The marked impact of the energy price shock was also clear in today's ECB balance of payments data. After last week's euro area goods export and import data from Eurostat reported a [record trade deficit](#) in July, today's figures duly reported a record current account deficit that month. Indeed, having briefly returned to surplus in June following three months of deficit, the euro area's external current account balance deteriorated by a little more than €24bn – the second most on the series –

Germany: Producer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Producer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

to a deficit of €19.9bn. That meant that the cumulative surplus over the twelve months to July dropped to just 0.5% of GDP, from a surplus of 3.1% of GDP over the same period in 2022. And despite the boost to competitiveness provided by this year's euro depreciation, given the marked deterioration in the euro area's terms of trade, likely persistence of high energy prices and soft external demand well into 2023, and the "J-curve" effect that will boost the value of imports before exports can benefit from the exchange rate adjustment, the euro area is likely to run a full-year current account deficit in 2022 for the first time since 2011. And, on average, we expect it to run monthly current account deficits well into next year too. Within the detail of the ECB's figures, the goods deficit was estimated to have leapt €18.0bn to €18.3bn, by far the largest on the series. In addition, the services surplus shrank €8.2bn to €10.2bn, the smallest so far this year. But while the surplus on primary income was little changed (€3.4bn), the secondary income deficit – primarily related to remittances and foreign aid – narrowed €2.3bn (to €15.1bn) to offer a modest offset to the marked deterioration in trade flows.

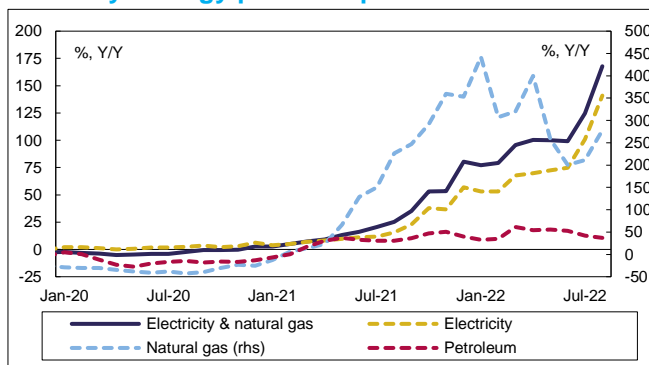
Euro area construction rises slightly in July, but the outlook remains clouded by weakening demand

Yesterday's euro area construction data for the start of Q3 were somewhat underwhelming. At face value, these suggested some stabilisation in the sector, with activity rising in July for the first month in five, by 0.3%M/M to be up 1.5%Y/Y. Within the detail, a rise in building construction (0.3%M/M) offset another decline in civil engineering (-0.6%M/M). Among the larger member states, the strongest growth was recorded in Spain (6.7%M/M) and Germany (1.4%M/M). But while this left construction activity in Spain some 5½% above the Q2 average, it was still almost 14% lower than the pre-Covid level in February 2020 reflecting the steady downtrend from end-2020 through to early summer 2022. And although German construction was trending marginally higher than the Q2 average (0.4%), aggregate euro area output was 0.7% lower. Moreover, surveys point to a deterioration in conditions in the sector. Despite edging slightly higher on the month in August, the Commission's headline sentiment indicator was still the third lowest for fifteen months and was also trending more than 2pts lower than in Q2, with the measure of order books turning negative for the first time since April 2021. The PMIs were even more striking, with the activity index (44.2) signaling the steepest contraction since the start of 2021, with new orders reportedly declining by the most since the onset of the pandemic. While the weakness in part likely continues to reflect supply bottlenecks, the share of firms stating that activity was constrained by demand rose to its highest since February 2021. So, with real incomes of both firms and households squeezed by higher prices, and rising interest rates further limiting affordability, the euro area's construction sector looks set to remain a drag on GDP in Q3.

The day ahead in the euro area

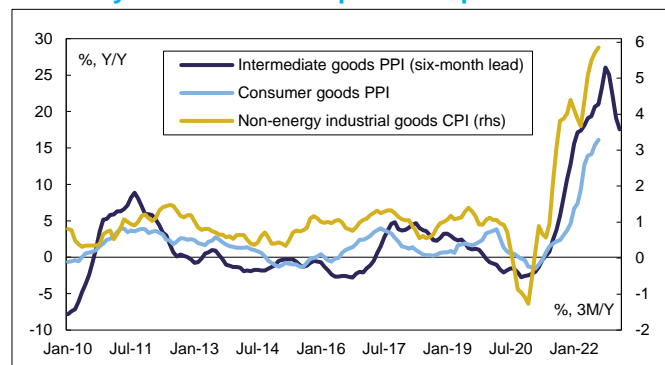
There are no top-tier euro area data scheduled for release on Wednesday.

Germany: Energy producer price inflation



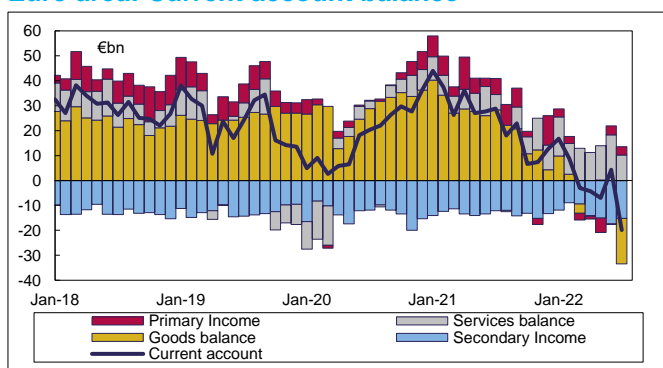
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Consumer and producer price inflation



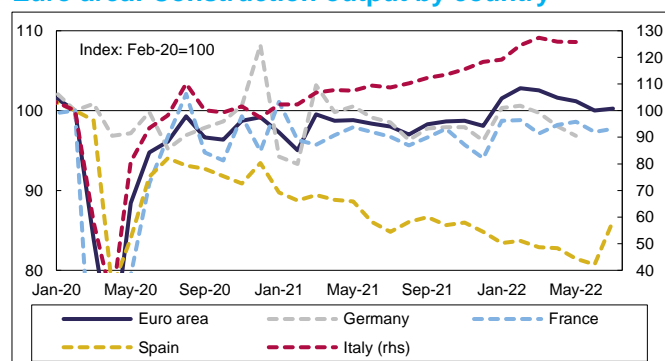
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Current account balance



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output by country*



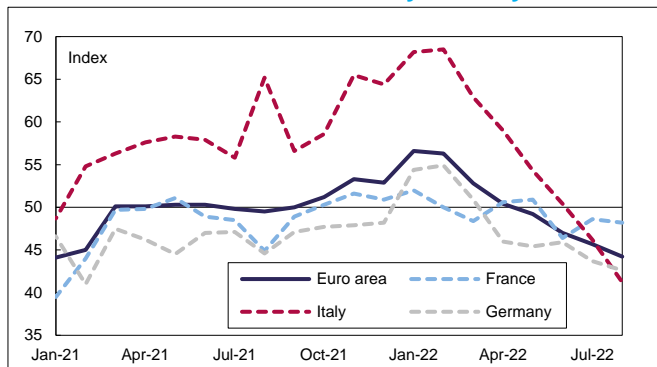
*Latest data-point for Italy is May 2022. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK

The day ahead in the UK

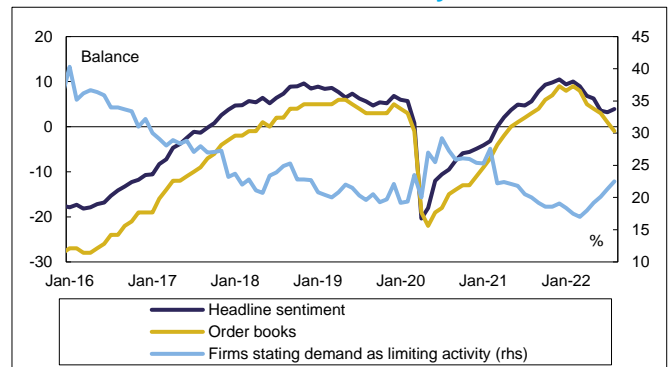
After another day bereft of UK data today, and ahead of Friday’s mini-budget statement, Wednesday brings the latest monthly public finance figures. These are expected to show an increase in net public sector borrowing in August to £8.5bn, significantly lower than in August 2020 and 2021, but above equivalent borrowing in the two years ahead of the pandemic not least due to higher debt interest payments. Tomorrow will also see the release of the CBI’s latest industrial trends survey, which will provide an update on manufacturing conditions, including output over the past three months, new orders and firms’ assessments of selling prices over the year ahead. The latter indicator will probably be of most interest to the BoE as the MPC meets to decide rates ahead of the announcement on Thursday.

Euro area: Construction PMIs by country



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

Euro area: EC construction survey indices





Source: Refinitiv, European Commission 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 	ECB current account balance €bn	Jul	-19.9	-	4.2	-
Germany 	PPI M/M% (Y/Y%)	Aug	7.9 (45.8)	1.6 (36.4)	5.3 (37.2)	-


Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area 	Construction output M/M% (Y/Y%)	Jul	0.3 (1.5)	-	-1.3 (0.1)	-1.2 (1.3)


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
UK 	07.00	Public sector net borrowing (excluding banks) £bn	Aug	7.5 (8.8)	4.2 (4.9)
	11.00	CBI industrial trends, total orders (selling prices)	Sep	-13 (52)	-7 (57)

Auctions and events

Euro area 	08.00	ECB Vice President de Guindos scheduled to speak			
Germany 	10.30	Auction: €4bn of 1.7% 2032 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are MiFID 2 Professional (or equivalent) Clients and should not therefore be distributed to such Retail Clients. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: <https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Opinions [and/or estimates] reflect a judgment as at the date of publication and are subject to change without notice. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.