Daiwa Capital Markets

Euro wrap-up

Overview

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- While euro area inflation fell to a 3-year low and ECB Executive Board member Schnabel acknowledged the case for further rate cuts, Bunds made modest losses as euro area unemployment eased to a new series low.
- Gilts made modest gains even as UK mortgage lending rose by the most since November 2022.
- The coming week will bring updated euro area national accounts estimates for Q2, as well as July data for euro area retail sales and German factory orders and industrial production.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.376	+0.028
OBL 2½ 10/29	2.176	+0.025
DBR 2.6 08/34	2.288	+0.018
UKT 4⅛ 01/27	4.099	-0.007
UKT 4⅛ 07/29	3.905	-0.010
UKT 4¼ 07/34	4.011	-0.006

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

Euro area

Headline inflation takes big step down to 3-year low to underscore case for rate cut

In line with expectations, euro area consumer price inflation fell 0.4ppt in August to a three-year low of 2.2%Y/Y. Inflation rose in only a quarter of the euro area's twenty member states, and declined in all of the others including the eight largest. With the headline euro area rate now more than 8ppts below the peak and just 0.2ppt above the ECB's target, disinflation is now clearly well advanced across the region. And given also the moderation in wages in Q2, still-subdued bank lending and evidence of a softening of economic growth momentum in Q3, today's data should make a further ECB rate cut in September inevitable despite a drop in unemployment in July. In part, the decline in headline inflation in August reflected a sharp drop of 4.2ppts in the energy component to a six-month low of -3.0%Y/Y, as fuel prices fell significantly in contrast to the sharp rise a year earlier. But it was also due to a further 0.3ppt fall in inflation of non-energy industrial goods to just 0.4%Y/Y, the lowest since April 2021. In contrast, inflation of food, drink and tobacco ticked up 0.1ppt to 2.4%Y/Y. And most notable for the hawks on the Governing Council, the services component increased 0.2ppt to a ten-month high of 4.2%Y/Y. As a result, core inflation edged down to 2.8%Y/Y, still 0.1ppt above April's 2½-year low.

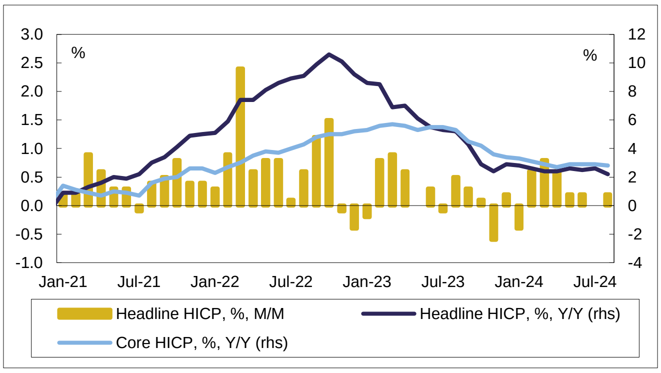
Core goods inflation momentum remains low, services prices boosted by Paris Olympics

The increase in core goods prices in August was in line with the pre-pandemic norm for the month. That suggests that ample global supply (including from China) and subdued demand continue to offset pressures from higher shipping freight costs related to the crisis in the Middle East. As a result, while it ticked up to a five-month high, inflation momentum in core goods remained low at just 0.9%3M/3M annualised. In contrast, on a seasonally adjusted basis, services prices rose the most in three months in August. The increase was in part due to higher prices of transport and accommodation related to the Paris Olympics. And other detail published by the member states suggesting that elevated wage growth continues to be absorbed by profit margins in labour-intensive subsectors. Nevertheless, given the pickup in August, services momentum remained very high at 4.5%3M/3M annualised, suggesting continued significant stickiness in this category.

Unemployment edges down to series low, but labour market not materially tighter

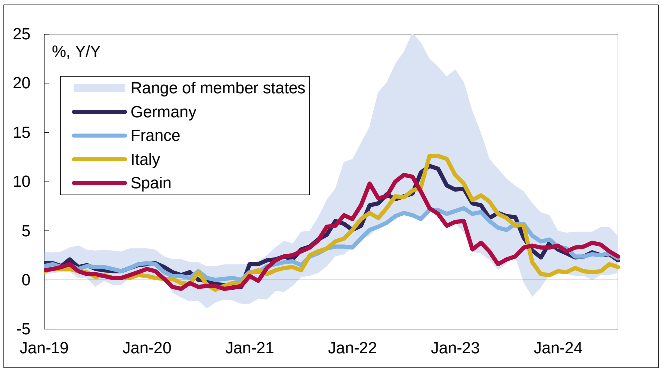
Admittedly, today's labour market figures were better than expected, with the number of jobless people in the euro area declining a sizeable 114k in July – the largest drop in 17 months – to 10.99mn. So, having moved sideways in the previous seven months, the unemployment rate fell 0.1ppt to a new low of 6.4%, suggesting that the labour market remains extremely resilient and arguably very tight. But we certainly do not see this as an obstacle to further monetary easing. The decline in July largely reflected the steepest drop in Italian unemployment for more than two years (-107k), which took the respective

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

jobless rate down 0.4ppt to 6.5%, the lowest in more than 16 years. In contrast, the equivalent rates were unchanged in Germany (3.4%), France (7.5%) and Spain (11.5%). Other German national data reported that the claimant count rate moved sideways at 6.0% in August for a third consecutive month, 1ppt above the low in May 2022. And surveys suggest that German firms in manufacturing and retail aim to accelerate cuts to headcount as their challenges persist. Indeed, job vacancies in Germany continued to decline this month to 670k, some 200k below the peak in 2022 and 100k below the pre-pandemic average in 2019. The steady decline in job openings across the euro area as a whole over recent quarters tally with various survey indicators to suggest that the labour market is becoming gradually less tight amid falling demand and increasing supply of workers. Nevertheless, German pay growth is likely to tick higher through the second half of the year to reflect the staggering of multi-year wage settlements. Indeed, growth in German negotiated wages (excluding one-off payments) picked up in August to 4.5%Y/Y, a three-month high but also the second-highest rate on the series.

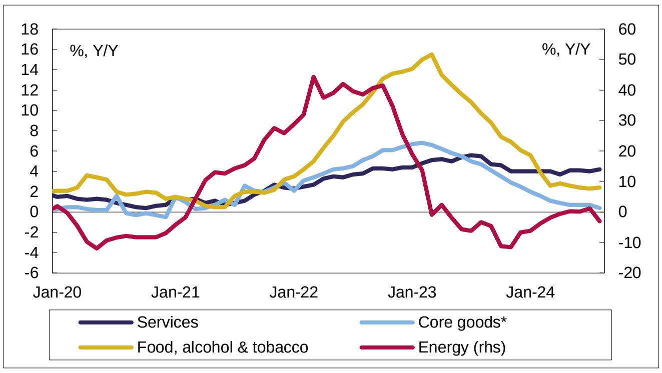
Schnabel acknowledges case for cuts with inflation on track to return sustainably to target in 2025

With Parisian transport fares and certain other Olympics- and tourism-related pressures set to reverse this month, services inflation should fall back in September. But it will remain high and sticky, and probably above 4.0%Y/Y, into the New Year. As a result, despite its drop in August, core inflation is on track to exceed the ECB's June projection for Q3 (2.7%Y/Y) and Q4 (2.6%Y/Y). However, thanks to lower energy prices and a stronger euro, the ECB's projection remains valid for headline inflation in Q3 (2.3%Y/Y) and Q4 (2.5%Y/Y). While wage growth in the euro area as a whole is likely to tick higher in the second half of the year due to developments in Germany, it should moderate very significantly from Q125 on thanks to anchored inflation expectations and a diminished need for catch-up to past price rises. And that should support a non-negligible moderation in services inflation by Q2. As such, as acknowledged today by leading Executive Board hawk Isabel Schnabel, the ECB's baseline scenario of a return of inflation to target on a sustained basis by the end of 2025 remains valid. And as a result, most if not all of the Governing Council hawks appear set to rubber-stamp a rate cut in September. Moreover, with policy judged still to be significantly restrictive, Schnabel's comments also implied that they are likely to support further gradual easing – presumably no more than one cut per quarter – until rates get close to the range of estimates of neutral, for as long as the economic data remain well behaved.

The week ahead in the euro area

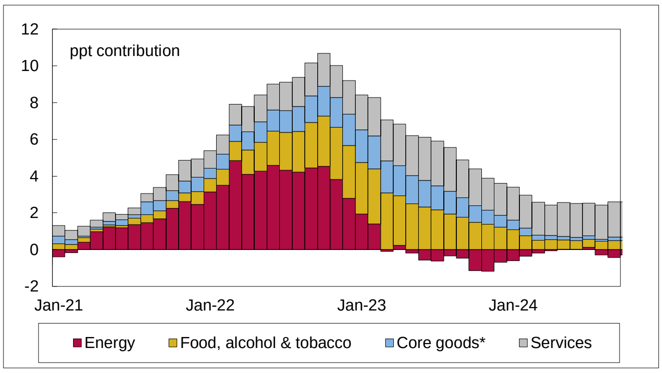
The coming week's data flow will be largely focussed on economic activity. Updated national accounts figures from the euro area (Friday) will include the first publication of the expenditure breakdown in Q2. The preliminary estimate saw GDP growth move sideways at 0.3%Q/Q in Q2, 0.1ppt below the ECB's latest projection. While the modest contraction in Germany (-0.1%Q/Q) was confirmed, data published today brought a downward revision to French GDP growth, by 0.1ppt to

Euro area: Key HICP components



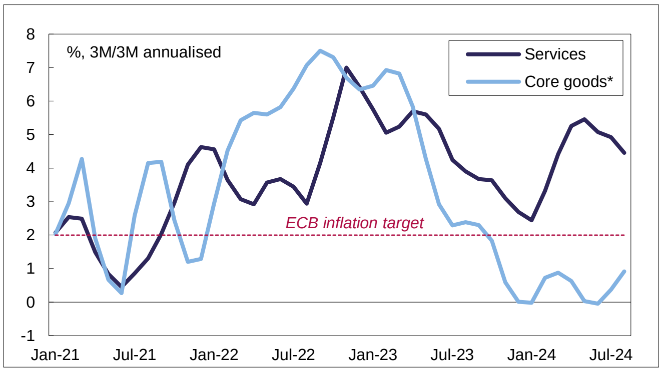
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Contribution to HICP inflation



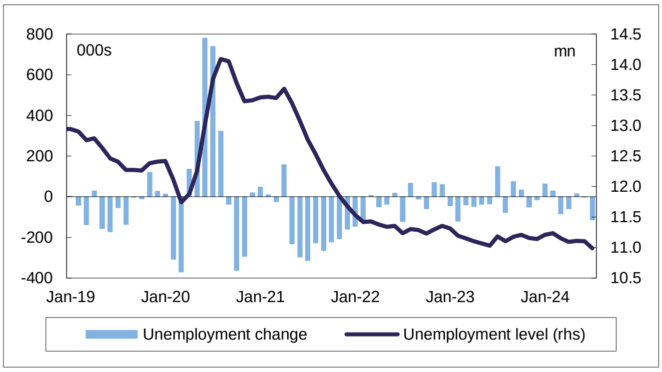
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core HICP momentum



*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

0.2%Q/Q. The updated estimate of euro area growth will also in part depend the Irish figures (due Thursday), where data revisions are often very significant. The flash Irish GDP estimate in Q2 recorded growth of 1.2%Q/Q, accounting for roughly 0.1ppt of euro area growth. The coming week will also bring updated GDP figures from Italy (Monday). In terms of the euro area expenditure breakdown, we expect fixed investment to provide a non-negligible boost, not least due to the anticipated contribution from Ireland, while government spending and net trade will also likely have expanded. This release will also bring an updated estimate of unit labour costs and insight into unit profits, with the latter expected to show that wage pressures were again largely absorbed by profit margins.

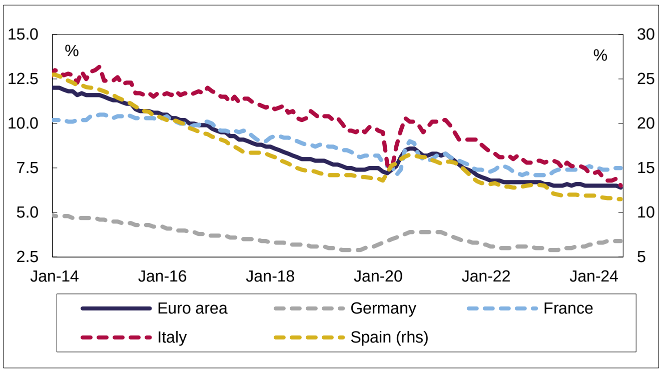
Looking to developments at the start of Q3, data for euro area retail sales in July (Thursday) should report a modest increase in sales following the drop in June (-0.3%M/M), tallying with the improvement in consumer purchase intentions that month. While today's figures for French consumption of goods rose 0.3%M/M in July, this reversed just half the drop in June. The back end of the week will also focus on the manufacturing sector, with the release of German factory orders and industrial production data for July (Thursday and Friday respectively). Following the first monthly rise in six in June, surveys suggest renewed weakness in orders at the start of Q3. Indicators provide mixed messages about production in July, with truck toll mileage having inched slightly higher, but surveys signalling a notable decline. Expectations are for a modest decline following the increase in June (1.4%M/M). French July IP numbers (Friday), and the final manufacturing (Monday), services (Wednesday) and construction PMI surveys (Thursday) for August are also due. In addition, euro area producer prices data for July (Wednesday) will provide an update on factory pipeline pressures.

UK

Mortgage lending rises the most since November 2022

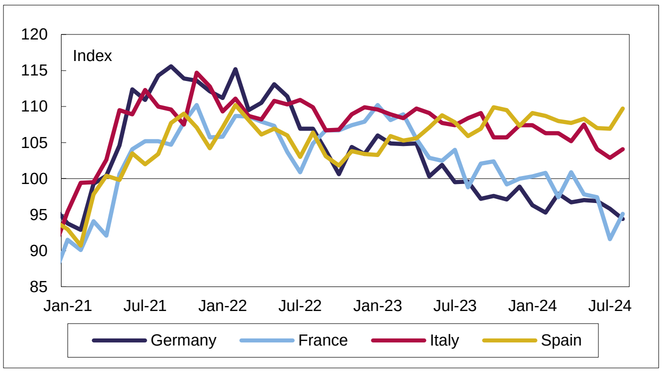
Today's BoE figures suggested that the restrictiveness of monetary policy continued to restrain loan demand in the UK. This notwithstanding, with mortgage rates having moderated at the start of Q3 in anticipation of the August cut in Bank Rate, mortgage lending picked up in July, with the net monthly increase of £2.8bn the strongest since November 2022, just after the Truss-related blowout in interest rates. Admittedly, this remained some way below the long-run average and left the stock of such lending up just 0.6%Y/Y. But encouragingly, the amount of new mortgage approvals rose to a 22-month high of 62.0k in July pointing to a moderate recovery in mortgage lending over coming months. So, while today's Nationwide figures reported an unexpected decline in house prices in August (-0.2%M/M), we continue to expect the ongoing demand-supply imbalance in the market to push prices gradually higher over coming quarters. Consumer credit growth also improved slightly in July, although the £1.2bn increase remained below the pre-pandemic five-year average and the annual growth rate slowed

Euro area member states: Unemployment rates



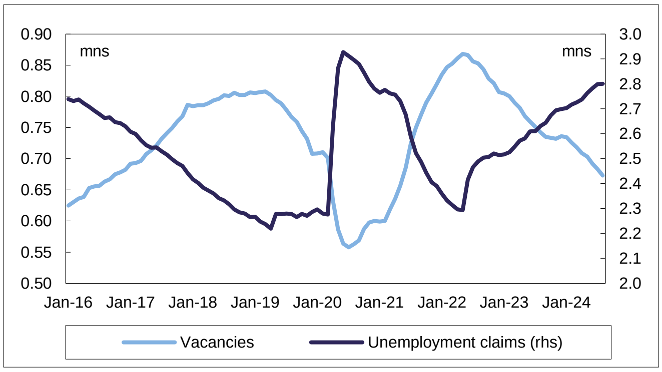
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Employment intentions indices



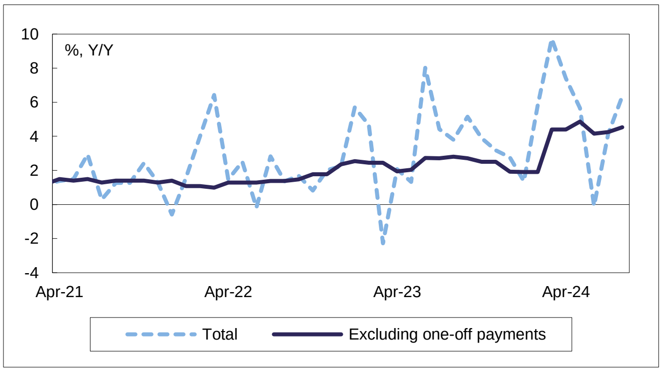
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Claimant count & job vacancies



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Negotiated wages



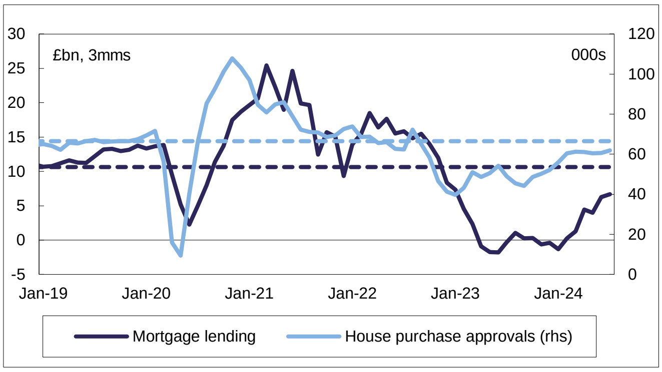
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

to an eleven-month low of 7.8%Y/Y. Today's figures also reported a smaller increase in household deposits at the start of Q3, by £5.7bn. But it remained above the pre-pandemic average, suggesting that consumers maintain a preference for saving rather than spending while interest rates remain elevated. In terms of lending to businesses, a further modest net repayment (£0.2bn) left the annual stock outstanding down 0.4%Y/Y, with a decline of more than 4%Y/Y in the stock of loans to SMEs.

The week ahead in the UK

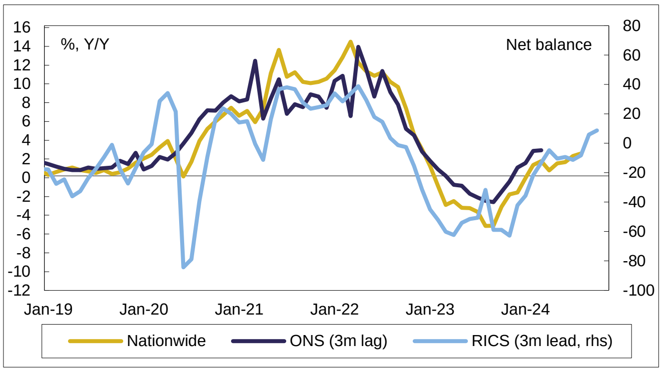
Surveys will dominate the UK dataflow in the coming week. Arguably most noteworthy in terms of monetary policy will be the results of the BoE's Decision Maker Panel survey on Thursday, which will provide an update on firms' inflation and wage growth expectations. In July, the median forecast for the headline CPI rate one year and three years ahead eased to 2.5%Y/Y, suggesting that inflation expectations remain well anchored. And while expectations for wage growth ticked slightly higher (4.1%Y/Y), this still marked the second-lowest reading for more than two years and was more than 2ppts below the peak. Meanwhile, the final August PMI surveys for the manufacturing (Monday) and services sectors (Wednesday) are likely to repeat the signal of a notable easing in services price pressures flagged in the flash releases. The latest construction PMI (Thursday) and BRC retail sales monitor (Tuesday) will also provide an update on growth momentum over the summer.

UK: Mortgage lending & approvals



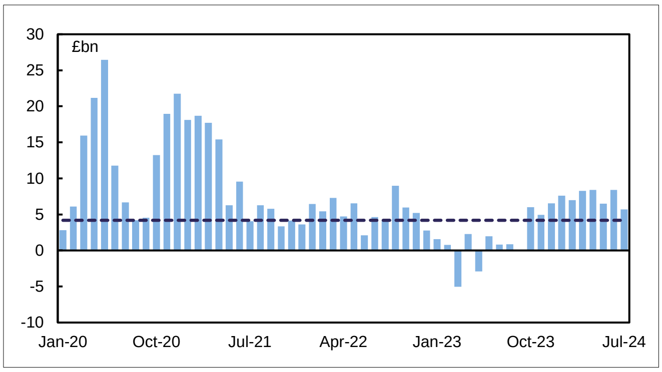
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: House price indices



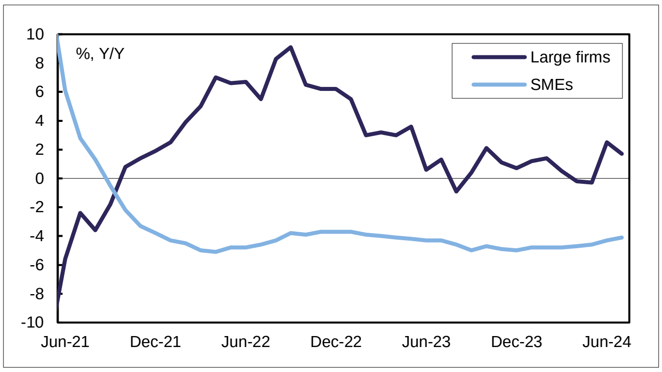
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Change in household deposits*



**Dashed dark blue line represents pre-pandemic average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Lending to businesses



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on date 04 September 2024

Daiwa economic forecasts

	2024				2025		2023	2024	2025
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.3	0.3	0.2	0.2	0.3	0.3	0.5	0.7	1.1
UK	0.7	0.6	0.3	0.3	0.3	0.3	0.1	1.1	1.3
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.6	2.5	2.4	2.7	2.4	2.0	5.4	2.5	1.9
Core HICP	3.1	2.8	2.9	3.1	2.7	1.9	4.9	3.0	1.8
UK									
Headline CPI	3.5	2.1	2.2	2.8	2.7	2.2	7.3	2.6	2.3
Core CPI	4.6	3.6	3.4	3.5	3.3	2.2	6.2	3.8	2.4
Monetary policy, %									
ECB									
Deposit Rate	4.00	3.75	3.50	3.25	3.00	2.75	4.00	3.25	2.25
Refi Rate	4.50	4.25	3.65	3.40	3.15	2.90	4.50	3.40	2.40
BoE									
Bank Rate	5.25	5.25	5.00	4.75	4.50	4.25	5.25	4.75	3.75

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Preliminary headline (core) HICP (Y/Y%)	Aug	**2.2 (2.8)**	*2.2 (2.9)*	2.6 (2.9)	-
	Unemployment rate %	Jul	**6.4**	6.5	6.5	-
Germany	Unemployment rate % (change 000's)	Aug	**6.0 (2.0)**	6.0 (16.0)	6.0 (18.0)	- (17.0)
France	GDP – final estimate Q/Q% (Y/Y%)	Q2	**0.2 (1.0)**	*0.3 (1.1)*	0.3 (1.5)	-
	Preliminary HICP (CPI) Y/Y%	Aug	**2.2 (1.9)**	2.1 (1.8)	2.7 (2.3)	-
	Consumer spending M/M% (Y/Y%)	Jul	**0.3 (-0.6)**	0.3 (-0.9)	-0.5 (-1.0)	-0.6 (-1.1)
	PPI Y/Y%	Jul	**-5.4**	-	-6.0	-5.9
	Total payrolls (final private sector) Q/Q%	Q2	**0.0 (-0.1)**	- (0.0)	0.3 (0.3)	-
Italy	Preliminary HICP (CPI) Y/Y%	Aug	**1.3 (1.1)**	1.3 (1.2)	1.6 (1.3)	-
	ISTAT consumer confidence indicator	Aug	**96.1**	99.0	98.9	-
	ISTAT business (manufacturing) confidence indicator	Aug	**94.7 (87.1)**	- (87.0)	94.2 (87.6)	94.3 (-)
Spain	Retail sales Y/Y%	Jul	**2.8**	0.3	0.3	-1.4
UK	Lloyds business barometer (own price expectations)	Aug	**50 (54)**	46 (-)	50 (57)	-
	Nationwide house price index M/M% (Y/Y%)	Aug	**-0.2 (2.4)**	0.2 (2.9)	0.3 (2.1)	-
	Net consumer credit £bn (Y/Y%)	Jul	**1.2 (7.8)**	1.3 (-)	1.2 (8.0)	0.9 (7.9)
	Net mortgage lending £bn (approvals 000s)	Jul	**2.8 (62.0)**	2.4 (60.5)	2.7 (60.0)	2.6 (60.6)

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast/actual*	Previous
			Monday 2 September 2024			
Euro area		09.00	Final manufacturing PMI	Aug	45.6	45.8
Germany		08.55	Final manufacturing PMI	Aug	42.1	43.2
France		08.50	Final manufacturing PMI	Aug	42.1	44.0
Italy		08.45	Manufacturing PMI	Aug	47.8	47.4
		09.00	GDP – final estimate Q/Q% (Y/Y%)	Q2	0.2 (0.9)	0.3 (0.6)
		10.00	PPI Y/Y%	Jul	-	-3.5
Spain		08.15	Manufacturing PMI	Aug	51.4	51.0
UK		09.30	Final manufacturing PMI	Aug	52.5	52.1
			Tuesday 3 September 2024			
France		07.45	Budget balance YTD €bn	Jul	-	-103.5
Spain		08.00	Unemployment (employment) change 000s	Aug	-	-10.8 (1.3)
UK		00.01	BRC retail monitor – like-for-like sales Y/Y%	Aug	-	0.3
			Wednesday 4 September 2024			
Euro area		09.00	Final services (composite) PMI	Aug	53.3 (51.2)	51.9 (50.2)
		10.00	PPI Y/Y%	Jul	-2.5	-3.2
Germany		08.55	Final services (composite) PMI	Aug	51.4 (48.5)	52.5 (49.1)
France		08.50	Final services (composite) PMI	Aug	55.0 (52.7)	50.1 (49.1)
Italy		08.45	Services (composite) PMI	Aug	-	51.7 (50.3)
Spain		08.15	Services (composite) PMI	Aug	-	53.9 (53.4)
UK		09.30	Final services (composite) PMI	Aug	53.3 (53.4)	52.5 (52.8)
			Thursday 5 September 2024			
Euro area		08.30	Construction PMI	Aug	-	41.4
		10.00	Retail sales M/M% (Y/Y%)	Jul	0.1 (0.2)	-0.3 (-0.3)
Germany		07.00	Factory orders M/M% (Y/Y%)	Jul	-1.5 (-2.4)	3.9 (-11.8)
		08.30	Construction PMI	Aug	-	40.0
France		08.30	Construction PMI	Aug	-	39.7
Italy		08.30	Construction PMI	Aug	-	45.0
Spain		08.00	House price index Q/Q% (Y/Y%)	Q2	-	2.6 (6.3)
UK		09.30	Construction PMI	Aug	54.8	55.3
		09.30	DMP 3M output price (1Y CPI) expectations Y/Y%	Aug	-	3.7 (2.5)
		09.00	New car registrations Y/Y%	Aug	-	2.5
			Friday 6 September 2024			
Euro area		10.00	GDP – final estimate Q/Q% (Y/Y%)	Q2	*0.3 (0.6)*	0.3 (0.5)
		10.00	Employment – 2nd estimate Q/Q% (Y/Y%)	Q2	0.2 (0.8)	0.3 (1.0)
Germany		07.00	Industrial production M/M% (Y/Y%)	Jul	-0.5 (-3.6)	1.4 (-4.1)
		07.00	Trade balance €bn	Jul	20.9	20.4
France		07.45	Industrial production M/M% (Y/Y%)	Jul	-0.3 (-0.9)	0.8 (1.6)
		07.45	Manufacturing production M/M% (Y/Y%)	Jul	-	0.8 (-2.0)
		07.45	Trade balance €bn	Jul	-	-6.1
Italy		09.00	Retail sales M/M% (Y/Y%)	Jun	-	-0.2 (-1.0)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions			
Country		BST	Event / Auction
			Monday 2 September 2024
			- Nothing scheduled -
			Tuesday 3 September 2024
Germany		10.30	Auction: to sell €4.5bn of 2.7% 2026 bonds
			Wednesday 4 September 2024
Germany		10.30	Auction: to sell €500mn of 1% 2038 bonds
		10.30	Auction: to sell €1bn of 2.6% 2041 bonds
			Thursday 5 September 2024
France		09.50	Auction: to sell up to €12bn of 3% 2034, 1.25% 2036, 0.5% 2040 and 3.25% 2055 bonds
Spain		09.30	Auction: to sell 2.5% 2027, 3.5% 2029, 3.45% 2034 bonds and 1% 2030 inflation-linked bonds
UK		10.00	Auction: to sell £4bn of 4.125% 2029 bonds
			Friday 6 September 2024
			- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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