

# Euro wrap-up

## Overview

- Bunds followed USTs higher as euro area GDP growth in Q2 was revised down, unit labour costs and unit profits slowed, and German IP fell further than expected.
- Gilts also made gains on a quiet end to the week for UK economic news.
- The ECB will cut rates again on Thursday while UK monthly GDP and labour market data are also due in the coming week.

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### Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.222	-0.066
OBL 2½ 10/29	2.042	-0.047
DBR 2.6 08/34	2.169	-0.035
UKT 4½ 01/27	3.948	-0.037
UKT 4½ 07/29	3.768	-0.034
UKT 4½ 07/34	3.886	-0.025

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

Source: Bloomberg

## Euro area

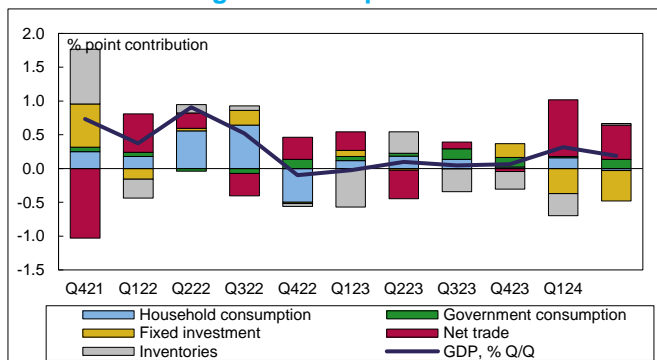
### ECB set to deliver another 25bp rate cut as downside risks to outlook appear to be increasing

Having eased policy in June but left its stance unchanged in July, the Governing Council looks firmly set to agree a further cut of 25bps in the Deposit Rate to 3.50% at its forthcoming policy meeting on Thursday. (While the pre-agreed narrowing of the rate corridor from 18 September will also be confirmed, the resulting 60bps cut in the Refi Rate to 3.65% will be far less significant.) Recent comments suggest that most of the hawks broadly accept the case for easing policy this month. The ECB staff's updated projections will reaffirm its expectations that inflation is on track to return to target on a sustained basis by end-2025. And the past month's economic data underscore that the monetary stance is highly restrictive – and perhaps increasingly so now inflation is closer to target. Chief Economist Lane, who makes the policy recommendation to the Governing Council, has rightly warned of the dangers of keeping rates too high for too long, cautioning that the ECB would risk unnecessarily restraining growth, weakening the labour market and pushing inflation well below target over the horizon. We hope that President Lagarde will echo such warnings in her press conference. Indeed, in our view, there is growing evidence (including in today's releases discussed below) that the euro area economy might already be slipping towards such a damaging path. But for the time being, the ECB's hawks remain preoccupied with the lingering upside risks to inflation. So, they will continue to insist that the policy statement repeats that rates will be restrictive for as long as necessary, and that decisions must remain data dependent and hence relatively backward-looking. The hawks will also likely reaffirm their intention for policy easing to remain gradual, which might imply still no more than one cut of 25bps per quarter. But further deterioration in the economic dataflow might in due course force the Governing Council to cut rates more aggressively.

### ECB should revise down its GDP outlook as Q2 growth estimate is cut & domestic demand drops

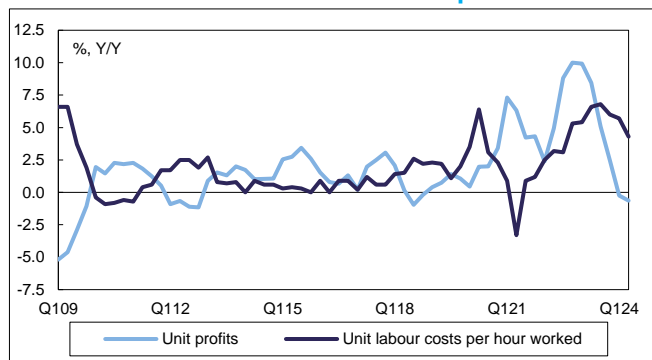
The ECB's updated projections will need to nudge down its outlook for economic activity. Reflecting yesterday's updated Irish estimates, euro area GDP growth in Q2 was today revised down by 0.1ppt to 0.2%Q/Q, half the rate forecast by the Eurosystem in June. Surveys, such as the PMIs and Commission indices, as well as hard data such as today's woeful German IP figures, suggest that the ECB's projection of growth of 0.4%Q/Q in the current and next quarters is also too upbeat. So, its full-year GDP growth forecast of 0.9%Y/Y in 2024 needs trimming back. Moreover, due in part to lower investment in intellectual property by Irish-based multinationals, fixed investment contracted sharply for a second successive quarter in Q2, by 2.2%Q/Q, in marked contrast to the Eurosystem's forecast of positive capex growth. With private consumption also unexpectedly falling slightly, principally due to German weakness and in marked contrast to the ECB's projection of moderate growth buoyed by higher real incomes, the Governing Council ought to take a more hard-headed view of the outlook for private domestic demand particularly as surveys suggest that households want to keep saving. So, with export growth soft in Q2 and likely to remain subdued given events in the US and China, we think ECB staff should

### Euro area: GDP growth & expenditure contributions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: Unit labour costs & unit profits



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

revise down its projection of GDP growth in 2025 of 1.4%Y/Y. The Governing Council should also therefore judge that more significant spare capacity opens up over the next 18 months to weigh more significantly on underlying inflation.

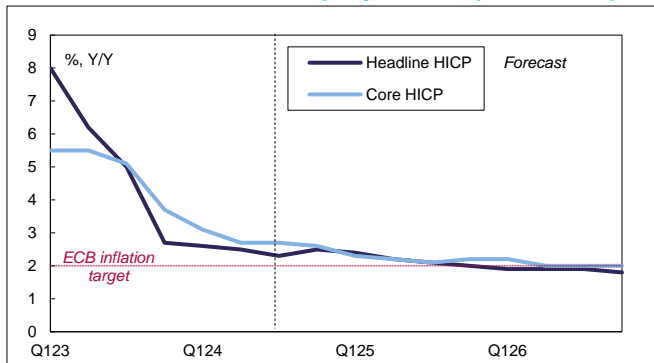
### Disinflation on track as employee compensation slows & unit profits fall

Other detail in today's updated national accounts also suggested that underlying price pressures continue to dissipate. The euro area GDP deflator fell further than the ECB projected to a 12-quarter low of 3.0%Y/Y. In part, that reflected softer pay pressures than anticipated, with growth in compensation per employee moderating 0.5ppt to a seven-quarter low of 4.4%Y/Y and unit labour costs per hour worked slowing a marked 1.4ppts to 4.3%Y/Y, also the lowest since Q322. While those rates remain above levels consistent with the achievement of the inflation over the medium term, unit profits again absorbed much of the impact on prices, dropping 0.6%Y/Y, the most since the euro crisis in 2012. After consumer price inflation slowed in August to a 3-year low of 2.2%Y/Y, the ECB's projection for Q3 of 2.3%Y/Y remains on track, despite a slight overshoot in the core rate related to persistence in services. And so, with oil prices down and the euro exchange rate stronger, GDP growth surprising on the downside and pay pressures on track to slow significantly next year, the ECB's can maintain its projection that headline inflation will be back to 2.0%Y/Y on average by end-2025 and slightly below target by the end of the horizon. We also see a case for nudging down its projections for core inflation in both 2025 and 2026 by 0.2ppt apiece to be fully consistent with its target too.

### German IP declined to the lowest level since the initial pandemic slump

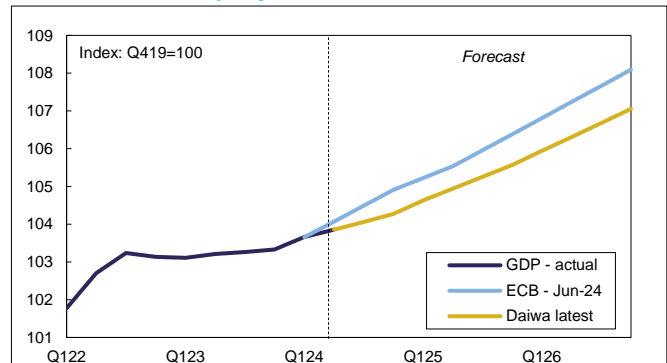
Today's German IP data should have provided a reminder to the Governing Council hawks that economic recovery in the euro area's largest member state cannot be taken for granted. While yesterday's manufacturing turnover had already suggested that industrial production was soft in July, today's figures still disappointed, raising a non-negligible risk that Germany's manufacturing sector will provide a drag on GDP for a fifth quarter out of the past six this quarter. Indeed, total industrial production fell a much steeper-than-expected 2.4%M/M in July to the lowest level since the global financial crisis aside from the initial slump at the onset of the pandemic. While this in part reflected payback for a strong increase in June, it still left output down 2.7%3M/3M – the most since May 2022 – and some 12½% below the pre-pandemic level. The decline in manufacturing (-3.2%M/M) was the second sharpest since March 2022 following the Russian invasion of Ukraine, to leave it down 2.9%3M/3M. Meanwhile, the decline in energy output (-1.9%M/M) was the first in four months. But while construction activity eked out a modest increase in July (0.3%M/M), it was still down 3.3%3M/3M, the most in seven months.

#### Euro area: ECB inflation projections (June 2024)



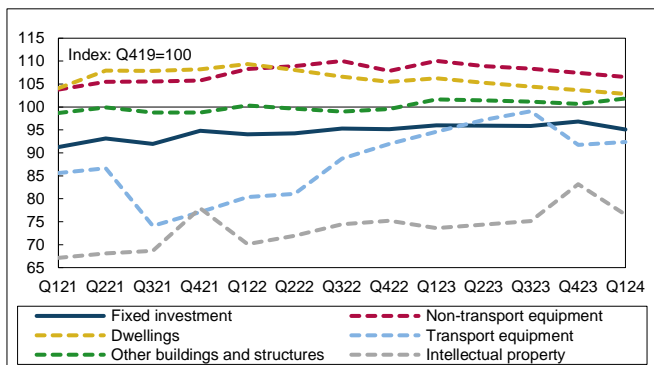
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### Euro area: GDP projections



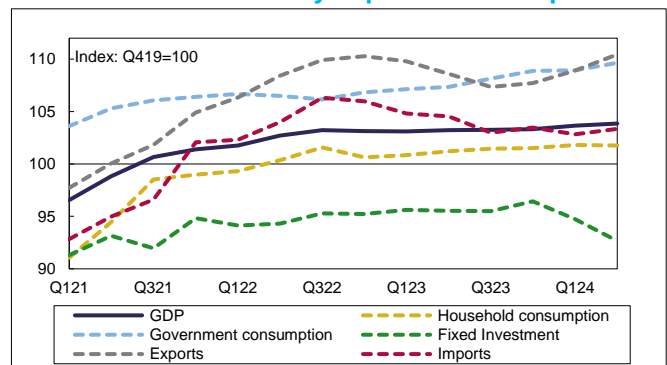
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### Euro area: Fixed investment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### Euro area: GDP levels by expenditure component



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

## Widespread manufacturing weakness in July driven by autos sector

While the decline in manufacturing was broad-based in July, it was led by a more than 8%M/M drop in the autos sector. And while this follows notable volatility in the sector over recent months – including a near-8%M/M rise in June – the level of production in the subsector was the lowest for almost two years and more than 18% below the pre-pandemic level. Production of electrical equipment also fell to the lowest for more than four years, while production of pharmaceutical products was the lowest for more than three years. And while output from the more energy-intensive sub-sectors – including chemicals, basic metals, coke and petroleum – had risen in recent months to suggest that structural adjustments in the sector since the start of the energy crisis might be nearing an end, this too slipped back in July (-1.8%M/M) to remain some 14% below the level ahead of Russia's invasion of Ukraine.

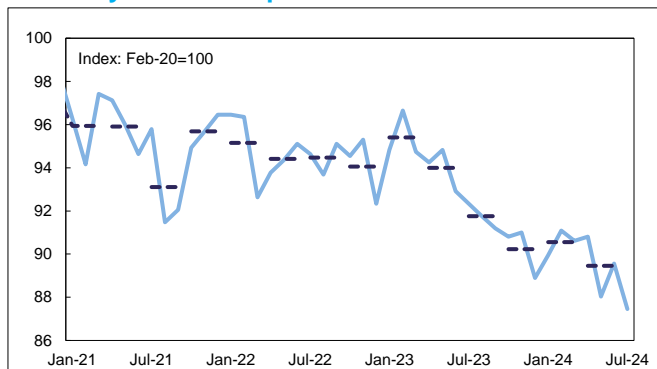
## Manufacturers remains downbeat about near-term outlook

The near-term manufacturing outlook remains uncertain. Indeed, while order backlogs remain elevated in certain sectors such as electrical machinery and computer, electronic and optical products, backlogs of car orders have fallen back to the pre-pandemic level. Car production numbers published by the German autos association (VDA) suggest a marked acceleration in August, up 23.7%Y/Y. But any rebound seems unlikely to be durable. Certainly, the latest ifo survey suggested that sentiment in the auto industry had worsened again that month due a lack of new orders, particularly from overseas, with expectations for the coming six months close to the bottom of the post-pandemic range. Indeed, while the pickup in factory orders in July offered some cautious optimism about the near-term production outlook, surveys point to renewed weakness in August, with a deterioration in the order-inventory ratio suggesting that, notwithstanding some monthly volatility, the underlying trend in manufacturing will remain lacklustre for the time being.

## French manufacturing production down to its lowest for more than two years

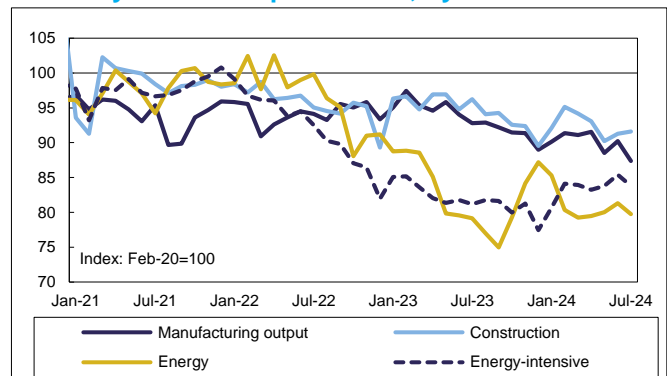
Today's French IP figures also fell short of expectations. In particular, total production fell 0.5%M/M in July, to the second-lowest level since October 2022. This left output down 2.2%YY and 1.5%3M/3M, the most since December 2022. Like in Germany, the decline in manufacturing was steeper (-0.9%M/M) to its lowest level since April 2022. And while the weakness was widespread across industries, it was led by the transport sector. Indeed, autos production fell 4.6%M/M to its lowest level for more than two years, while other transport equipment fell 4.9%M/M amid a fall in the ship-building and aerospace subsectors. So, while a rise in machinery and equipment provided some offset, output of capital goods fell for the second month out of three (-0.8%M/M), while production of intermediate goods was down for the third month of four (-0.9%M/M) to its lowest level for more than four years. In contrast, production of consumer durables rose for second successive month,

### Germany: Industrial production\*



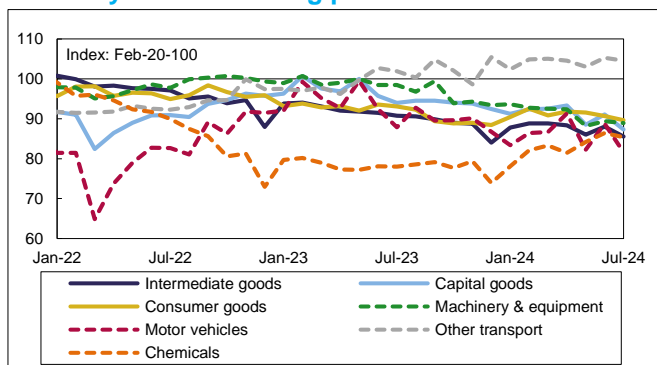
\*Dashed dark blue line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Germany: Industrial production, by sector



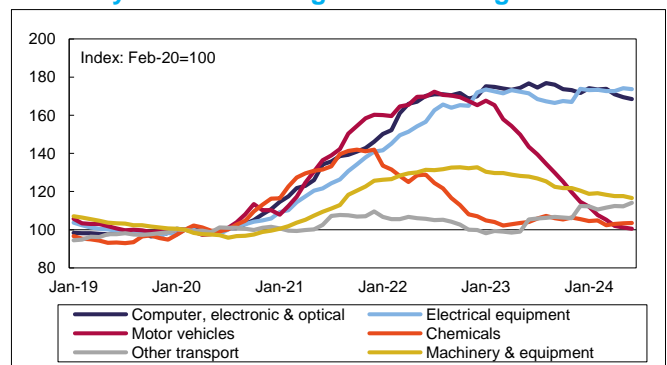
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Germany: Manufacturing production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Germany: Manufacturing order backlogs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

while construction activity was also up slightly for fifth success month. Moreover, any weakness in manufacturing in Q3 looks to have been offset by the services sector, where the Paris Olympics appears to have provided a notable boost to demand in the hospitality sector in the capital.

## The data week ahead in the euro area

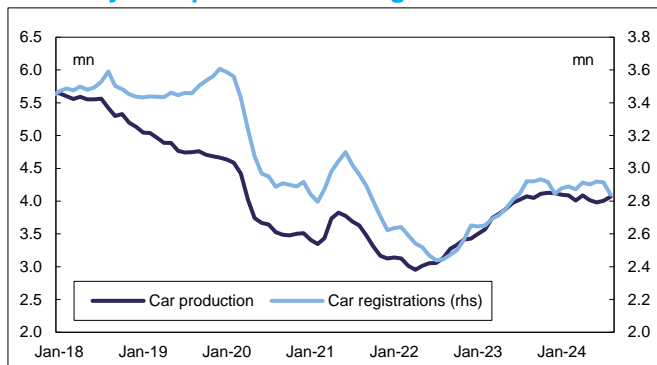
Aside from Thursday's ECB announcements it should be a relatively quiet week for top-tier euro area data, with the main focus on final August inflation figures from Germany (Tuesday), France (Friday) and Spain (Thursday). The preliminary estimates recorded a notable drop in headline inflation last month due principally to lower energy prices. In contrast, on the national measure, services inflation remained steady in Germany and ticked higher in France, with the coming week's figures likely to confirm that this principally reflected opportunistic pricing by firms in the accommodation and restaurant sectors during the Paris Olympics. The coming week will also bring the euro area Sentix investor survey (Monday) which will provide a first insight into sentiment in September and might be expected to signal a further deterioration in line with the recent decline in equity markets. July industrial production figures from Ireland (Monday) and Italy (Tuesday) are also due.

## UK

### The week ahead in the UK

The coming week will be busy for top-tier UK data, bringing an update on labour market conditions (Tuesday) and economic activity (Wednesday) at the start of Q3. Having unexpectedly fallen in the three months to June by 0.2ppt to 4.2%, the ILO unemployment rate is expected to edge slightly lower in July to a six-month low of 4.1%, still some ½ppt above the low reached almost two years ago. This will coincide with another increase in employment in the three months to July, by more than 100k. But despite signs that the labour market remains tight, average wage growth is expected to moderate notably further in July, by 0.4ppt to 4.1%3M/Y, which would be the softest since November 2021. When excluding bonus payments, regular pay growth is also expected to ease to a two-year low, albeit a full percentage point higher than headline wage growth. Meanwhile, after GDP moved sideways in June, we expect a return to expansion in July with growth of 0.3%M/M, which would leave the three-month rate unchanged at 0.6%3M/3M. Growth will in part reflect a pickup in retail sales (0.5%M/M) that month as the improvement in weather gave a boost to demand. The PMIs also pointed to an improvement in services activity, while the manufacturing output index rose to the highest in more than two years. So, despite a strong increase in manufacturing output in June, we expect growth in July to be widespread across the main subsectors. Among other data due, Friday will bring the results of the BoE's latest household inflation expectations survey for Q3.

### Germany: Car production & registrations\*



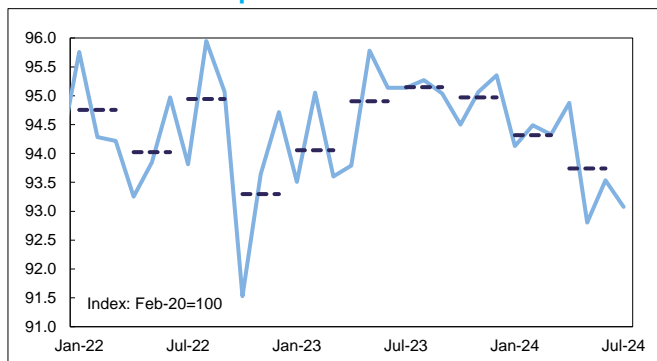
\*12-month moving sums. Source: Macrobond, VDA and Daiwa Capital Markets Europe Ltd.

### Germany: Manufacturing inventories & orders



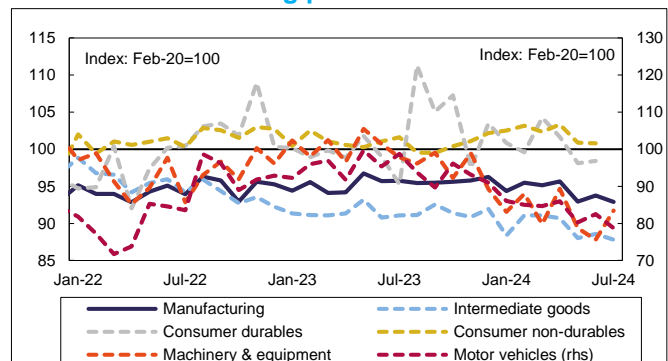
Source: Macrobond, ifo and Daiwa Capital Markets Europe Ltd.

### France: Industrial production\*












\*Dashed dark blue line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### France: Manufacturing production










Source: Macrobond and Daiwa Capital Markets Europe Ltd.

## Daiwa economic forecasts

	2024				2025		2023	2024	2025
	Q1	Q2	Q3	Q4	Q1	Q2			
<b>GDP</b>	<b>%, Q/Q</b>						<b>%, Y/Y</b>		
Euro area 	0.3	0.2	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
<b>Inflation, %, Y/Y</b>									
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	2.6	2.3	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
<b>Monetary policy, %</b>									
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/ <i>Daiwa forecast</i>	Previous	Revised	
Euro area 	GDP – final estimate Q/Q% (Y/Y%)	Q2	<b>0.2 (0.6)</b>	<u>0.3 (0.6)</u>	0.3 (0.5)	-	
	Employment – 2 <sup>nd</sup> estimate Q/Q% (Y/Y%)	Q2	<b>0.2 (0.8)</b>	0.2 (0.8)	0.3 (1.0)	-	
Germany 	Industrial production M/M% (Y/Y%)	Jul	<b>-2.4 (-5.3)</b>	-0.5 (-3.5)	1.4 (-4.1)	1.7 (-3.7)	
	Trade balance €bn	Jul	<b>16.8</b>	20.9	20.4	-	
France 	Industrial production M/M% (Y/Y%)	Jul	<b>-0.5 (-2.2)</b>	-0.3 (-0.9)	0.8 (-1.6)	- (-1.7)	
	Trade balance €bn	Jul	<b>-5.9</b>	-	-6.1	-6.0	
Italy 	Retail sales M/M% (Y/Y%)	Jun	<b>0.5 (1.0)</b>	-	-0.2 (-1.0)	- (-1.1)	
Auctions							
Country	Auction						
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

**The next edition of the Euro wrap-up will be published on 10 September 2024**

## The coming week's data calendar

### The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous
<b>Monday 9 September 2024</b>					
Euro area		09.30 Sentix investor confidence index	Sep	-12.2	-13.9
<b>Tuesday 10 September 2024</b>					
Germany		07.00 Final HICP (CPI) Y/Y%	Aug	2.0 (1.9)	2.6 (2.3)
Italy		09.00 Industrial production M/M% (Y/Y%)	Jul	-0.2 (-1.8)	0.5 (-2.6)
Spain		08.00 Industrial production M/M% (Y/Y%)	Jul	-	0.3 (0.6)
UK		07.00 Unemployment rate 3M%	Jul	4.1	4.2
		07.00 Employment 3M/3M change 000s	Jul	120	97
		07.00 Payrolled employees M/M change 000s	Aug	15	24
		07.00 Average wages (excluding bonuses) 3M/Y%	Jul	4.1 (5.1)	4.5 (5.4)
		07.00 Claimant count rate % (change 000s)	Aug	-	4.7 (135.0)
<b>Wednesday 11 September 2024</b>					
UK		07.00 Monthly GDP M/M% (3M/3M%)	Jul	0.2 (0.6)	0.0 (0.9)
		07.00 Services output M/M% (3M/3M%)	Jul	0.2 (0.6)	-0.1 (0.8)
		07.00 Industrial output M/M% (Y/Y%)	Jul	0.3 (-0.1)	0.8 (-1.4)
		07.00 Manufacturing output M/M% (Y/Y%)	Jul	0.2 (-0.1)	1.1 (-1.5)
		07.00 Construction output M/M% (Y/Y%)	Jul	0.2 (-0.8)	0.5 (-1.7)
		07.00 Trade (goods trade) balance £bn	Jul	-4.7 (-18.0)	-5.3 (-18.9)
<b>Thursday 12 September 2024</b>					
Euro area		13.15 ECB Deposit Rate (Refi Rate) %	Sep	<u>3.50 (3.65)</u>	3.75 (4.25)
Italy		09.00 Unemployment rate Q/Q%	Q2	-	7.2
Spain		08.00 Final HICP (CPI) Y/Y%	Aug	2.4 (2.2)	2.9 (2.8)
UK		00.01 RICS house price balance %	Aug	-14	-19
<b>Friday 13 September 2024</b>					
Euro area		10.00 Industrial production M/M% (Y/Y%)	Jul	-0.4 (-2.7)	-0.1 (-3.9)
France		07.45 Final HICP (CPI) Y/Y%	Aug	2.2 (1.9)	2.7 (2.2)
		07.45 Final wages Q/Q%	Q2	0.6	1.3
UK		09.30 BoE/Ipsos household inflation expectations 1Y ahead Y/Y%	Aug	-	2.8

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### The coming week's key events & auctions

Country	BST	Event / Auction
<b>Monday 9 September 2024</b>		
UK 	00.01	KPMG, REC and S&P release Monthly Report on Jobs (Aug)
<b>Tuesday 10 September 2024</b>		
Germany 	10.00	Auction: to sell €500mn of 0% 2050 bonds
	10.30	Auction: to sell €500mn of 2.1% 2029 bonds
UK 	10.00	Auction: to sell £900mn of 0.625% 2045 inflation-linked bonds
Italy 	10.00	ISTAT releases Report on the Italian Economy (Jul-Aug)
<b>Wednesday 11 September 2024</b>		
Germany 	10.30	Auction: to sell €4.5bn of 2.6% 2034 bonds
UK 	10.00	Auction: to sell £3.75bn of 4.25% 2034 bonds
<b>Thursday 12 September 2024</b>		
Euro area 	13.15	ECB monetary policy announcement
	13.45	ECB President Lagarde holds post Governing Council meeting press conference
	-	ECB to reduce spread between deposit and main refinancing rates to 15bps
Italy 	10.00	Auction: to sell 3- and 7-year bonds
<b>Friday 13 September 2024</b>		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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