

Euro wrap-up

Overview

- Bunds followed US10s higher as updated German inflation data confirmed an easing in underlying price pressures in August while IP fell in each of the euro area's four largest member states in July.
- Despite a fall in the UK unemployment rate firmly below the BoE's projection, Gilts also made gains as pay growth continued to moderate.
- Wednesday will bring UK GDP data for July.

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Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.191	-0.015
OBL 2½ 10/29	2.008	-0.021
DBR 2.6 08/34	2.145	-0.021
UKT 4½ 01/27	3.866	-0.015
UKT 4½ 07/29	3.693	-0.023
UKT 4½ 07/34	3.830	-0.024

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

Source: Bloomberg

Euro area

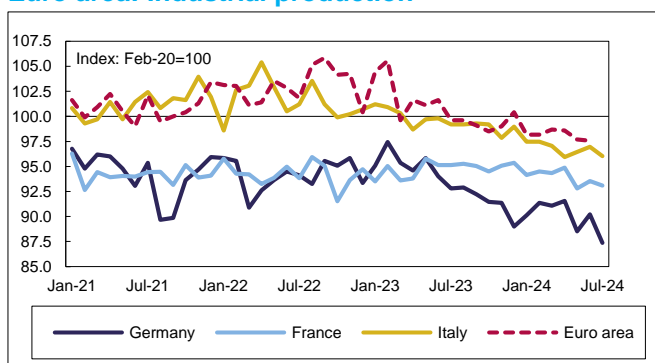
Italian & Spanish data confirm weak start to Q3 for factory sector in the euro area Big 4

Figures published last week revealed a particularly weak start to Q3 for manufacturing output in Germany (-3.2%M/M) and France (-0.9%M/M). Today's data showed that industrial production also contracted in Italy and Spain in July. In Italy, overall IP (excluding construction) fell 0.9%M/M while manufacturing output dropped a larger 1.2%M/M, the most since January to be down 3.8%Y/Y and 1.5%3M/3M. That left it 0.4% below the Q2 average level and 3.5% below the pre-pandemic level. Declines were registered in all main sub-sectors in July, with negative momentum relatively broad-based too. Consumer goods output was down 2.0%3M/3M, with intermediate (-1.0%3M/3M) and capital goods (-1.6%3M/3M) faring little better. Survey indicators point to the likelihood of a ninth successive quarterly decline in Italian manufacturing production in Q3, as new orders remain weak amid sluggish external demand, particularly from elsewhere in the EU. In Spain, overall IP (excluding construction) dropped 0.4%M/M to be down 0.4%Y/Y and 0.5%3M/3M. As in Italy, production was down modestly from the Q2 average level and 3.5% below the pre-pandemic level. But while momentum in Spanish capital and consumer goods sectors was similarly negative, the trend in intermediate goods remained moderately positive for the time being. The significantly negative results for production in the euro area's largest member states in July mean that IP in the euro area almost certainly also dropped that month and might also be expected to drop over Q3 as a whole. The extraordinarily volatile Irish data distort the picture somewhat via the activities of multinational enterprises based there for tax purposes. Indeed, data yesterday reported a scarcely credible jump of 9.2%M/M in Irish IP in July, which left it up 5.6%Y/Y. However, based on the data published so far, euro area IP still likely dropped about 0.6%M/M to be 0.4% below the Q2 average.

Final German data confirm further easing of price pressures in August

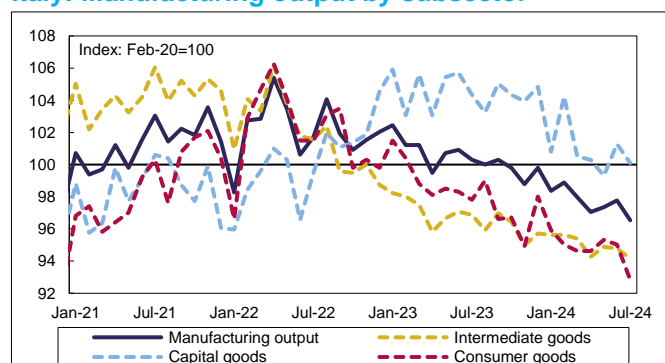
The final German consumer price inflation data for August provided no major surprises, confirming a continued easing of underlying pressures, particularly from the energy and goods sectors. The headline rates aligned with the flash estimates, which had dropped to the lowest levels in more than three years. Prices on the EU-harmonised HICP measure fell for the first month in seven in August (by 0.2%M/M), pushing the annual rate down a chunky 0.6ppt to 2.0%Y/Y, bang in line with the ECB's target for the first time since March 2021. The national headline CPI rate fell 0.4ppt to 1.9%Y/Y. On the EU-harmonised measure, energy prices fell for the third month out of the past four (-1.5%M/M) and by the most since December due to a sizeable drop in prices of petrol and heating oil and a much more modest fall in prices of electricity and gas. So, given the big monthly increase in such prices in August last year, energy inflation dropped more than 3ppts to -5.1%Y/Y, the weakest since December 2020. Prices of food, beverages and tobacco were unchanged on the month, which was enough to push up the respective category up 0.2ppt to 2.6%Y/Y. But core goods HICP inflation fell 0.4ppt to a three-year low of just 0.7%Y/Y, thanks to ongoing disinflation in a range of items including clothing, motor vehicles, furniture and household goods.

Euro area: Industrial production*



*Excluding construction. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: Manufacturing output by subsector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

In contrast, services inflation moved sideways at 4.4%Y/Y on the EU-harmonised measure. The detail reported a pickup in volatile items such as transport and accommodation, which offset a welcome moderation in insurance and deflation in communications. Overall, the German core HICP rate (excluding energy, food, alcohol and tobacco) eased 0.3ppt to a four-month low of 3.0%Y/Y, the second-softest since February 2022.

The day ahead in the euro area

Ahead of Thursday’s ECB monetary policy announcement, which seems bound to bring a further cut in the deposit rate of 25bps to 3.50% but no pre-commitments to any further easing in future, Wednesday should be a quiet day for economic news from the euro area with no top-tier releases due.

UK

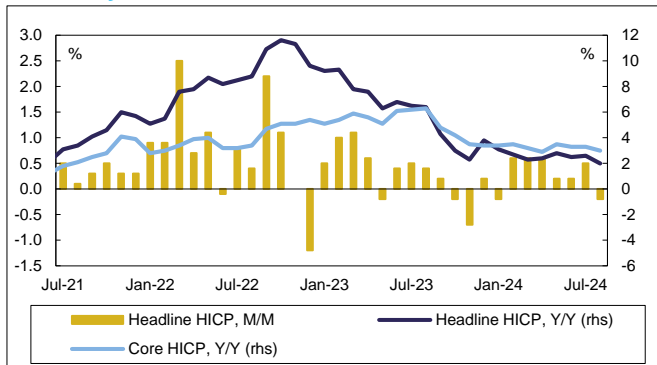
Pay growth moderates to softest in more than 2 years to keep MPC on track for November rate cut

While the unemployment rate fell firmly below the path expected last month by the BoE, today’s UK labour market data remained broadly consistent with its pay projection and hence failed to shift expectations that the MPC will next cut rates in November. Last month, the Committee expected lower inflation and better anchored inflation expectations to contribute to weaker pay dynamics. And private sector total pay (including bonuses) slowed in July by a further 0.3ppt to 4.8%3M/Y, the softest rate since November 2021. Private sector regular wages (i.e. excluding bonuses) also slowed, by 0.4ppt to 4.9%3M/Y, the weakest since April 2022, with softer momentum suggesting that the BoE’s projection for September (4.8%) will be undershot. All major business sectors bar construction – which has this year reported the lowest pay rises – reported wage growth at multi-quarter lows, with the slowdown in finance most marked (down 0.7ppt to 5.4%3M/Y) and services far cooler than earlier in the year. Public sector regular pay growth also moderated to the lowest in over a year (5.7%3M/Y). Real wages in manufacturing, construction and the public sector remained below their respective pre-pandemic levels but the opposite remained the case for most private services. Adding together private and public sector pay, growth slowed 0.6ppt to 4.0%3M/Y, the lowest since late 2020. Given the government’s ‘triple lock’ policy, that rate will mark the increase in the UK state pension next year, representing another significant real-terms increase in incomes for many older people.

LFS unemployment rate falls firmly below BoE projection but doubts over data quality remain

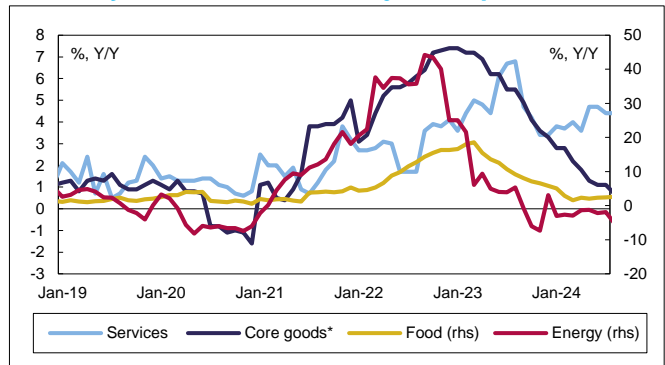
In terms of the overall tightness of the labour market, the evidence remains mixed, with the ability to draw firm conclusions impeded by low data quality. Judging from today’s Labour Force Survey (LFS) figures, the jobs market has benefited from

Germany: HICP inflation



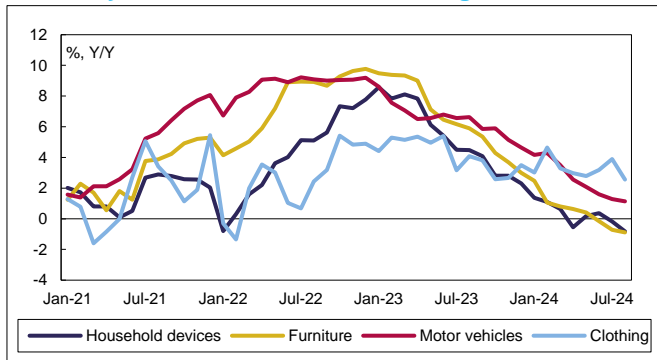
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: HICP inflation – major components



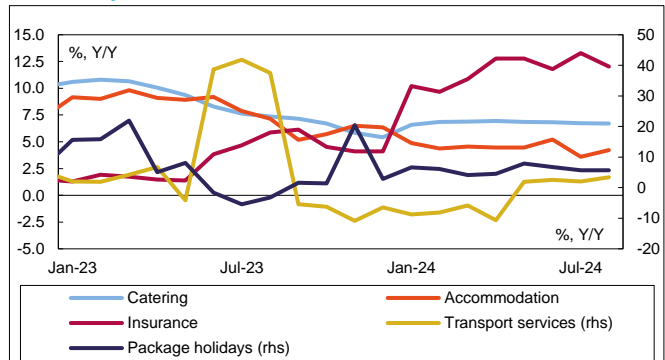
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: HICP inflation – selected goods



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: HICP inflation – selected services



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

surprisingly firm GDP growth in Q1 and Q2 and still-positive momentum in Q3. Indeed, the LFS measure of employment jumped 265k in the three months to July, the biggest rise in more than two years, with more than three quarters of the increase accounted for by full-time positions. That pushed LFS employment back above the level a year ago and above the pre-pandemic level. And the LFS unemployment rate dropped 0.2ppt from three months earlier to 4.1%, the lowest since the three months to January and 0.3ppt below the BoE's projection, albeit 0.3ppt above the rate at the end of last year. Supporting labour supply, however, inactivity reportedly fell to the lowest level since December, due principally to an outflow from education and a third successive decline in the number of people reporting long-term sickness. But due to the low survey response rate, all of these LFS data are presented with very wide confidence intervals, diminishing their usefulness.

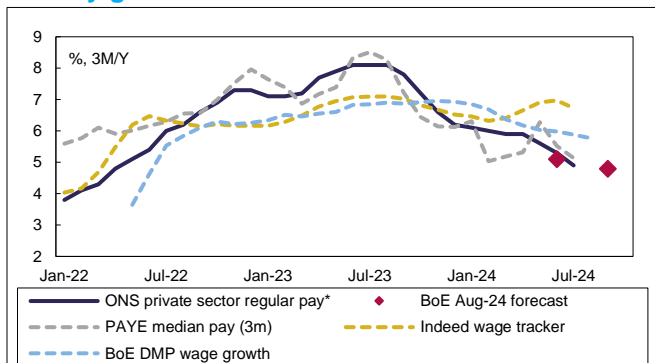
Job vacancies continue to decline suggesting labour market is becoming gradually less tight

Figures from alternative sources provided different messages, including a slight decline in payrolled employees in July and a larger fall in the preliminary estimate for August. A rise in claimant count unemployment likely in part reflected policy changes. While the number of redundancies fell to a nine-month low in July, it is likely to pickup in the autumn due not least to steel plant closures. Most importantly perhaps, in line with the trend in other major economies, softer labour demand was reflected in a further drop in the number of vacancies in the three months to August to be down 4.7%Q/Q and 14.3%3M/Y, and also marginally below the pre-pandemic peak. Job openings were also down in all major sectors, and not least in consumer-facing services such as hospitality and retail trade. And the vacancy-to-unemployment ratio – which arguably provides the best guide to labour market slack – was broadly in line with the pre-pandemic level. Overall, the MPC is likely to continue to judge that the labour market remains tight by historical standards but is very gradually becoming looser not least due to the restrictiveness of monetary policy.

The day ahead in the UK

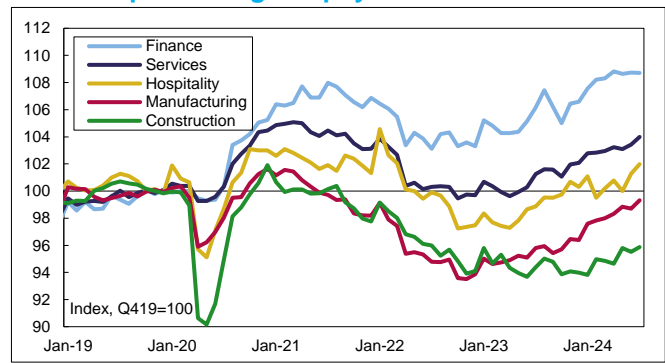
Wednesday will bring monthly GDP data for July. After economic output moved sideways in June, we expect a return to expansion in July with growth of 0.3%M/M, which would leave the three-month growth rate unchanged at a solid 0.6%3M/3M. Growth will in part reflect the pickup in retail sales of 0.5%M/M that month, when a long-awaited improvement in the weather boosted demand. Surveys also pointed to growth across the services sector as well as construction, while the manufacturing output PMI rose to the highest level in more than two years. So, although factory production grew in June by the most in four months, we expect the expansion in GDP in July to be broad-based.

UK: Pay growth – selected measures



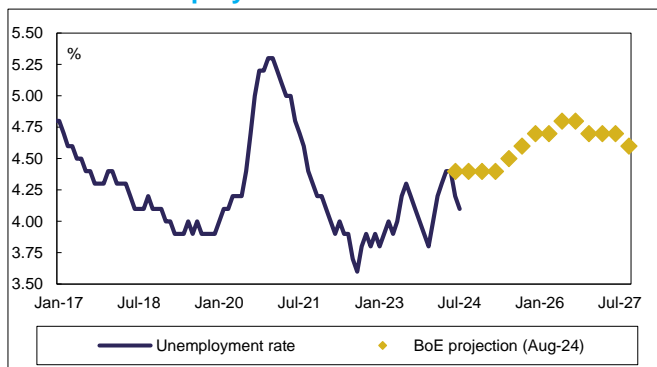
*Data between January 2022 and November 2022 are BoE staff estimates of underlying private sector regular pay growth. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Real private regular pay – selected measures



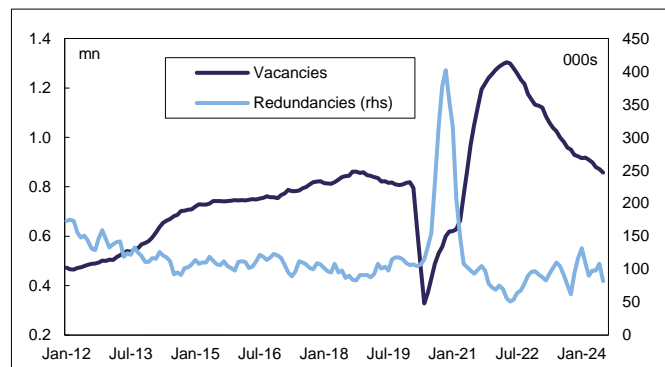
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: LFS unemployment rate



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

UK: Job vacancies & redundancies











Source: Macrobond 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
Germany	 Final HICP (CPI) Y/Y%	Aug	2.0 (1.9)	2.0 (1.9)	2.6 (2.3)	-
Italy	 Industrial production M/M% (Y/Y%)	Jul	-0.9 (-3.3)	-0.2 (-1.8)	0.5 (-2.6)	-
Spain	 Industrial production M/M% (Y/Y%)	Jul	-0.4 (-0.4)	-0.2 (0.4)	0.3 (0.6)	0.2 (0.2)
UK	 Unemployment rate 3M%	Jul	4.1	4.1	4.2	-
	 Employment 3M/3M change 000s	Jul	265	123	97	-
	 Payrolled employees M/M change 000s	Aug	-59	25	24	-6
	 Average wages (excluding bonuses) 3M/Y%	Jul	4.0 (5.1)	4.1 (5.1)	4.5 (5.6)	4.6 (-)
	 Claimant count rate % (change 000s)	Aug	4.7 (23.7)	-	4.7 (135.0)	4.6 (102.3)


Auctions

Country	Auction
Germany	 sold €462mn of 2.1% 2029 bonds at an average yield of 2.02%
	 sold €485mn of 0% 2050 bonds at an average yield of 2.41%
UK	 sold £900mn of 0.625% 2045 inflation-linked bonds at an average yield of 1.2%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Sentix investor confidence index	Sep	-15.4	-12.2	-13.9	-







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	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	0.5 (-0.7)	0.5 (-1.7)
	 07.00	Trade (goods trade) balance £bn	Jul	-5.1 (-18.0)	-5.3 (-18.9)

Auctions and events

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

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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