

Euro wrap-up

Overview

- Bunds were little changed on the day as data confirmed that euro area industrial production is on track to contract again in Q3 and that the pickup in French services inflation in August was caused in part by temporary Olympic-related factors.
- Gilts were also little changed on a quiet end to the week for UK economic news.
- The coming week will bring BoE announcements on rates and QT as well as updates on inflation in the UK and euro area.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2.7 09/26 | 2.208 | -0.008 |
| OBL 2½ 10/29 | 2.023 | +0.003 |
| DBR 2.6 08/34 | 2.152 | +0.004 |
| UKT 4½ 01/27 | 3.801 | -0.012 |
| UKT 4½ 07/29 | 3.622 | -0.014 |
| UKT 4½ 07/34 | 3.770 | -0.010 |

*Change from close as at 4:00pm BST.
Source: Bloomberg

Euro area

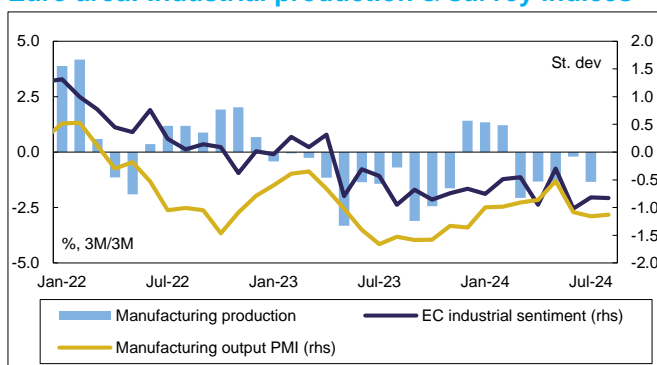
IP on track to contract in Q3 for sixth successive quarter

As flagged by the data from the large member states, euro area industrial production extended its dire trend in July. Excluding construction, IP contracted 0.3%M/M and 2.2%Y/Y in July. That meant that production has not registered positive growth in any single month since March. And as a result, it was some 2.6% below the pre-pandemic level and at its lowest point since September 2020. The weakness was relatively broad-based, but particularly acute in motor vehicles, output of which fell 13.4%M/M and more than 20%Y/Y to the lowest level since November 2022 and the lowest in more than fifteen years barring the pandemic and post-pandemic era. So, production of capital goods and consumer durables both fell disproportionately. And output of intermediate goods was also down by more than overall IP, weighed in part by renewed weakness in energy-intensive items. So, the only support came from consumer non-durables, which were buoyed by food products and pharmaceuticals, and energy. By country, IP fell by more than the euro area rate in each of the five largest member states, with Germany (-3.0%M/M) standing out again for its weakness. But the aggregate figure for the region was supported by extreme growth in Ireland (9.2%M/M) and Belgium (7.3%M/M), both countries whose data appear distorted by the activities of multinational corporation based there for tax purposes. The drop in euro area production in July left it a substantive 1.5% below the Q2 average. Survey indicators, such as the PMIs and Commission survey indices, point to continued weakness in August and probably ahead too. So, the factory sector appears firmly on track to contract in Q3 for the sixth successive quarter.

Rise in French core inflation underpinned by temporary Olympic-related pricing

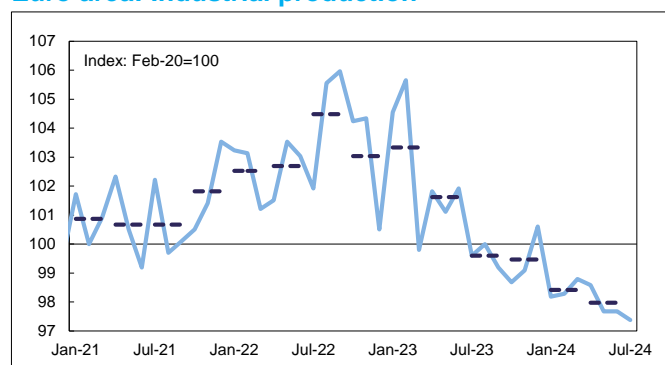
At yesterday's ECB press conference, President Lagarde noted that inflation will likely take a step down in September before rising temporarily again in Q4 due to base effects with respect to energy. The decline in September will in part reflect the reversal of certain upwards pressures on services prices in August, which were related to the Paris Olympics and confirmed in the detail of today's final French inflation figures for last month. Overall, headline French HICP inflation was unrevised from the flash estimate at 2.2%Y/Y, down 0.5ppt on the month due to lower energy prices. But the rise in French services inflation (up 0.6ppt to a 10-month high of 3.7%Y/Y) was a significant contributor to the increase in the equivalent indicator for the euro area (up 0.2ppt to 4.2%Y/Y). Today's French figures reported a second-successive sizeable monthly increase in accommodation prices, which pushed the annual rate of that component up 2½ppts to 4.0%Y/Y. Hotel inflation rose to a 10-month high of 6½%Y/Y. And transportation services inflation jumped more than 5ppts to 3.8%Y/Y, amid a surge in fares on the metro and trams (25%%Y/Y) and buses (7%Y/Y) as Paris's public transport authority temporarily hiked prices between 20 July and 8 September. Admittedly, education inflation rose to a new series high and the insurance component also ticked up, suggesting persisting stickiness in certain components. However, catering services prices remained well

Euro area: Industrial production & survey indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production*



*Dashed lines represent quarterly averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

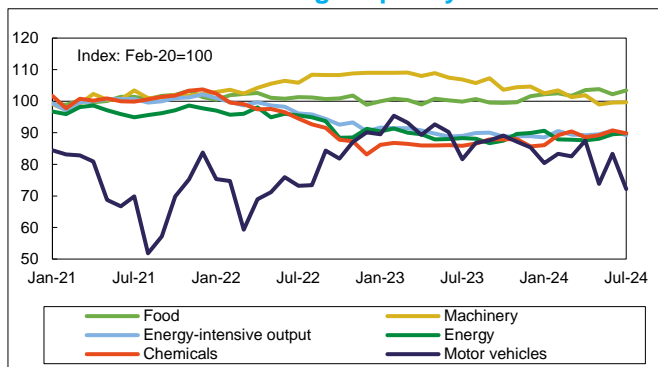
contained in August. And other tourism- and transport-related price pressures seem bound to ease this month. So, with core goods price pressures still very subdued (0.5%Y/Y) amid ongoing deflation in household appliances and second-hand cars, French core inflation this month should reverse the 0.4ppt increase in August to 2.7%Y/Y.

The week ahead in the euro area

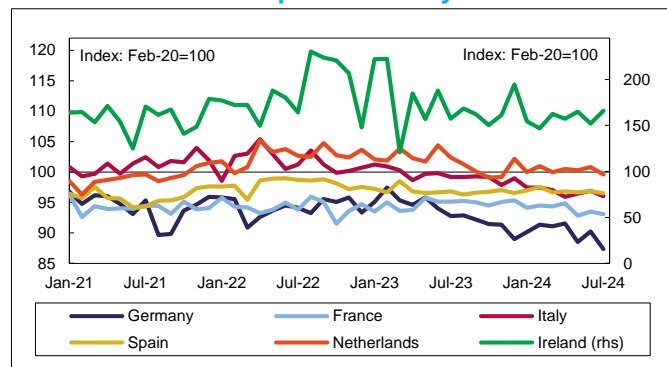
The coming week will bring the final estimates of euro area inflation in August. In the preliminary release, headline inflation fell 0.4ppt to 2.2%Y/Y, the softest rate in more than three years, due principally to a notable decline in the energy component. Consistent with the subdued global trend, core goods inflation also fell to the lowest since April 2021. And the detail will likely confirm ongoing disinflation in a range of items including clothing, motor vehicles, furniture and household goods. While services inflation rose to a 10-month high (3.7%Y/Y), today's French figures highlighted that many of those price pressures were concentrated in the hospitality, tourism and transport-related subsectors that are subject to significant volatility. Overall, in line with the flash estimate, core inflation likely edged only slightly lower, by 0.1ppt to 2.8%Y/Y. Final Italian consumer price inflation figures will be published Monday, while German producer price figures (Friday) are likely to suggest that factory pipeline pressures remain very subdued in line with the global trend. An updated estimate of euro area labour costs in Q2 will also be published on Monday. And in terms of economic activity, euro area goods trade and construction activity figures for August are due on Monday and Wednesday respectively.

In terms of economic surveys, the Commission's flash consumer confidence indicator, a French business survey (both due Friday) and the German ZEW investor survey (Tuesday) will provide updates on conditions at the end of Q3. While the headline consumer sentiment index slipped back in August (down 0.5pt to -13.5) it was still the second-highest since February 2022. Confidence might well be little changed this month as concerns about downside risks to the economic outlook might offset any support from the cut in interest rates. Meanwhile, having been boosted by activity related to the Paris Olympics in August, French business sentiment is likely to moderate in September particularly in the services sector. And tallying with the downbeat assessment in the past week's Sentix survey and decline in equity markets since the start of the month, we expect the ZEW survey to signal greater investor pessimism about the German economic outlook in particular.

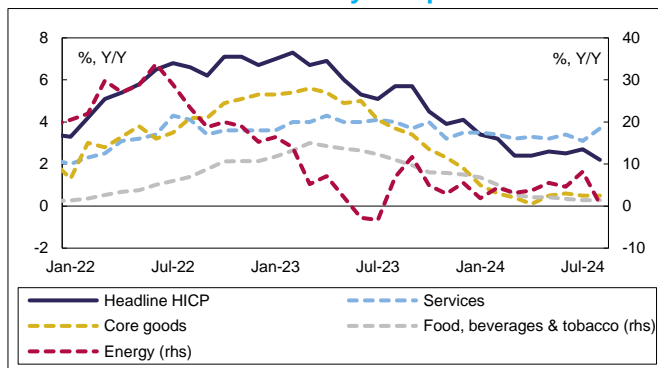
Euro area: Manufacturing output by selected sector



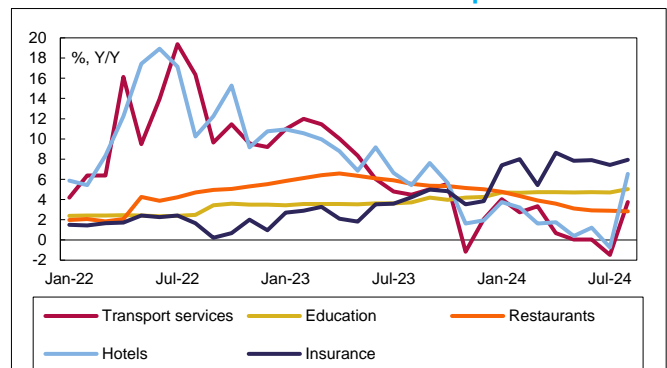
Euro area: Industrial production by member state



France: HICP inflation & key components



France: Selected services HICP components



UK

BoE likely to leave rates unchanged on Thursday but signal further cuts to come

The main event in the UK in the coming week will be the BoE's latest monetary policy announcement on Thursday, which will include confirmation of the Bank's QT plans for the coming year as well as its latest decision on rates. With respect to the latter, following the 5-4 vote in favour of a 25bps cut in August, Bank Rate is likely to be left unchanged at 5.0%. The MPC will likely repeat its guidance that policy "will need to continue to remain restrictive for sufficiently long until the risks to inflation returning sustainably to the 2% target in the medium term have dissipated further". It will also probably repeat that it will continue "to monitor closely the risks of inflation persistence and will decide the appropriate degree of monetary policy restrictiveness at each meeting." However, we also expect a signal that rates are likely to be cut again at the following meeting in November and probably also beyond if the underlying inflation outlook continues to improve in line with expectations. Indeed, we expect at least one MPC member (Swati Dhingra) to vote for another cut at this month's meeting. And the replacement of one of the MPC hawks (Jonathan Haskel) with a new member (Alan Taylor) whose views on rates are unclear adds further uncertainty about the extent of pressure for immediate easing.

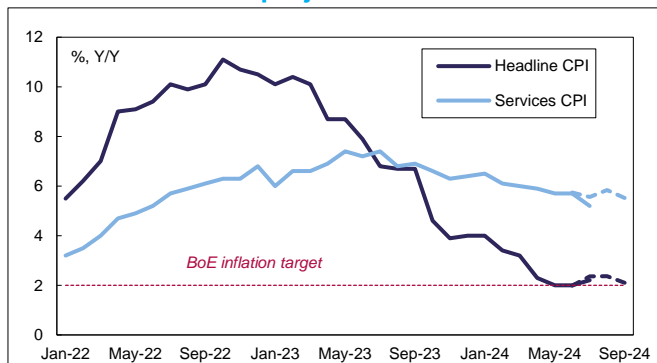
August inflation data should strengthen case for easing from Q4 on

Uncertainty about the MPC's stance on Thursday comes from the August inflation data, which are scheduled to be released on Wednesday. While CPI inflation rose back above the BoE's target in July, the 0.2ppt increase to 2.2%Y/Y was 0.2ppt less than the MPC had forecast. The core rate fell 0.2ppt to a near-three-year low of 3.3%Y/Y. And importantly, the key services component dropped a larger-than-expected 0.5ppt to a two-year low of 5.2%Y/Y, 0.4ppt below the MPC's projection. That decline in services was in part due to items that are typically highly volatile, including a marked drop in accommodation prices which the previous month had surprised significantly on the upside due in part to a sampling irregularity. So, we expect the services component to rebound in August, albeit to remain below the MPC's projection of 5.8%YY. And thanks also to lower petrol prices, we expect headline inflation to come in below the Bank's projection of 2.4%Y/Y. So, while inflation will still be on track to rise back above 2.5%Y/Y in October due to Ofgem's increase in the household energy price cap, the August inflation data should remain consistent with ongoing gradual dissipation of inflation persistence risks.

Moderation in pay & GDP growth also supports case for rate cuts to come

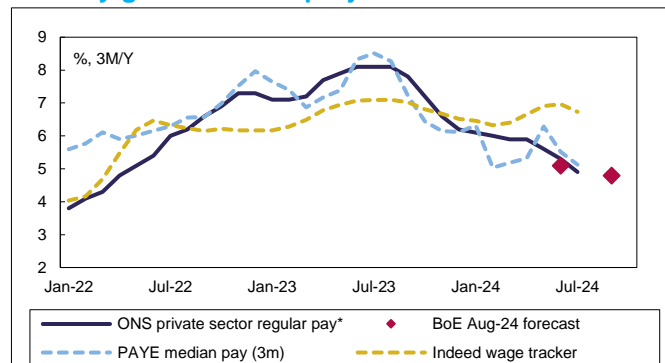
Beyond inflation, other recent UK macroeconomic data have been mixed. This week's [labour market](#) figures suggested that pay growth continues to decline in line with, or even below, the path projected by the BoE last month. Better anchored

UK: Inflation & BoE projection*



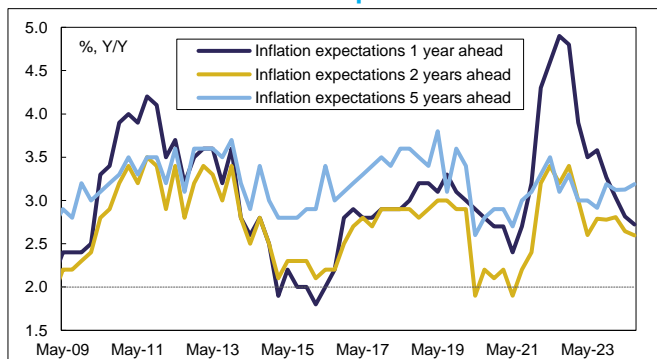
*Dashed lines represent BoE projection, August 2024. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Pay growth & BoE projection



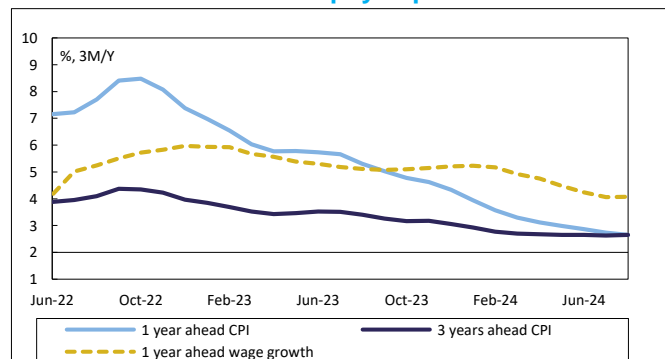
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Household inflation expectations*



*BoE Inflation Attitudes Survey results. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Business inflation & pay expectations*



*BoE DMP Survey results. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

inflation expectations of both households (as suggested by today's BoE survey) and firms (as implied by its DMP survey) should maintain confidence that pay growth will continue to moderate over coming quarters. Indeed, while the LFS unemployment rate has fallen well below the MPC's projection, the policymakers should have little faith in the accuracy of those figures as a guide to labour market tightness. They will also note that GDP was unchanged for a second successive month in July, so that their growth forecast of a slowdown in Q3 (0.4%Q/Q) from the relatively robust rates in the first half of the year remains valid. They will also be aware of increasing downside risks to external demand, not least from the EU. So, coupled with the signs of diminishing inflation persistence, those rising downside risks to the outlook for economic activity should prompt a strong signal that a rate cut is likely to come in November when the Bank will next update its projections, and also open the door to the possibility of accelerated easing further ahead. Of course, a very significant downside surprise to the August inflation data might even bring a further rate cut into play this month.

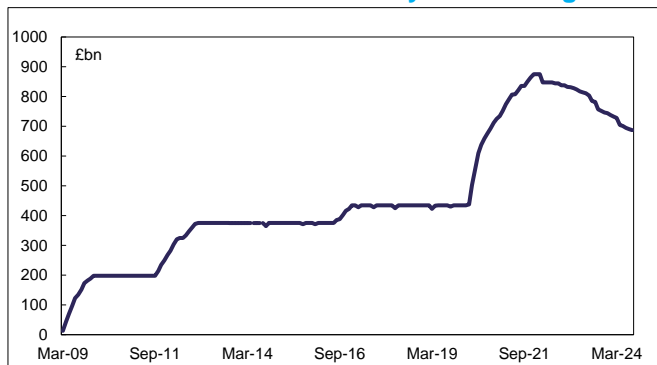
QT to be extended close to recent pace, implying a slower rate of active Gilt sales

In terms of quantitative tightening, we currently expect the BoE to aim to reduce its Asset Purchase Facility (APF) holdings, which currently amount to about £688bn, by roughly £100bn over the coming twelve months. That would broadly maintain the pace of balance sheet reduction of the past year. But it would also imply a slowdown in the pace of active Gilt sales offset by an increase in the pace of roll-off of maturing bonds. It would also push the total stock of bank reserves down close to levels that the BoE considers to be optimal. The MPC will continue to judge that QT has had only a modest impact on Gilt yields – indeed, the BoE thinks that the near £200bn reduction in the Bank's (APF) between February 2022 and June 2024 accounted for only about 10-20bps of the 75bps rise in the 10Y Gilt yield term premium that it estimated over that period. Given the recent marked uptrend in take-up of the Short-term Repo facility, however, we do not rule out that the BoE might slow the pace from March to mitigate any perceived risks of unintentional and possibly destabilizing bank reserve scarcity arising next year.

The week ahead for data in the UK

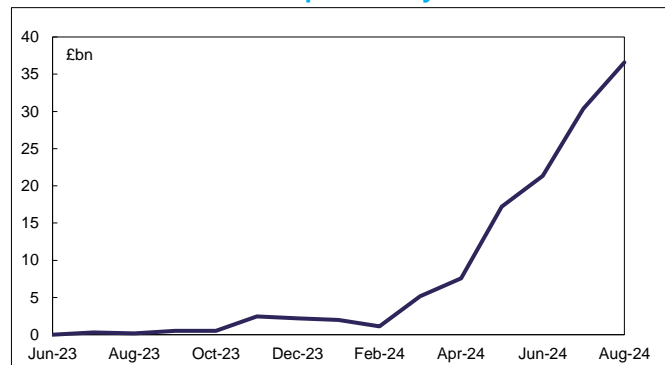
In addition to the aforementioned CPI release on Wednesday, the coming week will bring August retail sales figures and September's consumer confidence survey results on Friday. Following a modest rise in July (0.5%M/M), retail surveys point to a further increase in sales volumes last month as demand was boosted by an improvement in weather conditions and auto fuel sales likely benefitted from lower petrol prices. Expectations are for another rise of around ½%M/M, which would leave them trending so far in Q3 almost 1% above the Q2 average. Consumer confidence might also receive a boost from the recent cut in interest rates, although purchase intentions are likely to remain very subdued as households still prefer to save than spend. Finally, the latest monthly public finance figures for August (Friday) are likely to illustrate the limited scope for supportive fiscal policy ahead of the Autumn Budget on 30 October unless the new government chooses to relax its public debt target.

UK: BoE Asset Purchase Facility Gilt holdings



Source: Macrobond and Daiwa Capital Markets Europe Ltd.










UK: BoE Short-term Repo Facility allocation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.




The next edition of the Euro wrap-up will be published on 17 September 2024

Daiwa economic forecasts

| | 2024 | | | 2025 | | | 2023 | 2024 | 2025 |
|---|--------|------|------|------|------|------|--------|------|------|
| | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | | | |
| GDP | %, Q/Q | | | | | | %, Y/Y | | |
| Euro area  | 0.2 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.5 | 0.7 | 1.1 |
| UK  | 0.6 | 0.3 | 0.3 | 0.3 | 0.3 | 0.4 | 0.1 | 1.1 | 1.3 |
| Inflation, %, Y/Y | | | | | | | | | |
| Euro area | | | | | | | | | |
| Headline HICP  | 2.5 | 2.3 | 2.6 | 2.3 | 1.9 | 1.5 | 5.4 | 2.5 | 1.9 |
| Core HICP  | 2.8 | 2.9 | 3.1 | 2.7 | 1.9 | 1.3 | 4.9 | 3.0 | 1.9 |
| UK | | | | | | | | | |
| Headline CPI  | 2.1 | 2.2 | 2.8 | 2.7 | 2.2 | 2.3 | 7.3 | 2.6 | 2.3 |
| Core CPI  | 3.6 | 3.5 | 3.6 | 3.4 | 2.3 | 2.0 | 6.2 | 3.8 | 2.4 |
| Monetary policy, % | | | | | | | | | |
| ECB | | | | | | | | | |
| Deposit Rate  | 3.75 | 3.50 | 3.25 | 2.75 | 2.50 | 2.25 | 4.00 | 3.25 | 2.25 |
| Refi Rate  | 4.25 | 3.65 | 3.40 | 2.90 | 2.65 | 2.40 | 4.50 | 3.40 | 2.40 |
| BoE | | | | | | | | | |
| Bank Rate  | 5.25 | 5.00 | 4.50 | 4.00 | 3.50 | 3.00 | 5.25 | 4.50 | 3.00 |

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  | Industrial production M/M% (Y/Y%) | Jul | -0.3 (-2.2) | -0.3 (-2.3) | -0.1 (-3.9) | 0.0 (-4.1) | |
| France  | Final HICP (CPI) Y/Y% | Aug | 2.2 (1.9) | 2.2 (1.9) | 2.7 (2.3) | - | |
| | Final wages Q/Q% | Q2 | 0.6 | 0.6 | 1.3 | - | |
| UK  | BoE/Ipsos household inflation expectations 1Y ahead Y/Y% | Aug | 2.7 | - | 2.8 | - | |
| 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/ <i>Daiwa</i> forecast/actual | Previous |
|------------------------------------|---|---|--------|--|--------------|
| Monday 16 September 2024 | | | | | |
| Euro area |  | 10.00 Labour costs Y/Y% | Q2 | <u>4.0</u> | 5.1 |
| |  | 10.00 Trade balance €bn | Jul | 15.0 | 17.5 |
| Italy |  | 09.00 Final HICP (CPI) Y/Y% | Aug | 1.3 (1.1) | 1.6 (1.3) |
| |  | 10.00 Trade balance €bn | Jul | - | 5.1 |
| UK |  | 00.01 Rightmove house prices M/M% (Y/Y%) | Sep | - | -1.5 (0.8) |
| Tuesday 17 September 2024 | | | | | |
| Germany |  | 10.00 ZEW investor survey – current situations (expectations) balance % | Sep | 17.0 (-80.0) | -77.3 (19.2) |
| Wednesday 18 September 2024 | | | | | |
| Euro area |  | 10.00 Final HICP (core HICP) Y/Y% | Aug | <u>2.2 (2.8)</u> | 2.6 (2.9) |
| |  | 10.00 Construction output M/M% (Y/Y%) | Jul | - | 1.7 (1.0) |
| UK |  | 07.00 CPI (core CPI) Y/Y% | Aug | <u>2.3 (3.7)</u> | 2.2 (3.3) |
| |  | 07.00 PPI – output (input) prices Y/Y% | Aug | 0.5 (-0.9) | 0.8 (0.4) |
| |  | 09.30 House price index Y/Y% | Jul | - | 2.7 |
| Thursday 19 September 2024 | | | | | |
| Euro area |  | 05.00 New car registrations Y/Y% | Aug | - | -1.0 |
| |  | 09.00 Current account balance €bn | Jul | - | 50.5 |
| UK |  | 12.00 BoE Bank Rate % | Sep | <u>5.00</u> | 5.00 |
| Friday 20 September 2024 | | | | | |
| Euro area |  | 15.00 Preliminary Commission consumer confidence indicator | Sep | -13.2 | -13.5 |
| Germany |  | 07.00 PPI Y/Y% | Aug | -1.0 | -0.8 |
| France |  | 07.45 INSEE business (manufacturing) confidence indicator | Sep | 98 (99) | 97 (99) |
| |  | - Retail sales Y/Y% | Aug | - | -0.5 |
| UK |  | 00.01 GfK consumer confidence indicator | Sep | -13 | -13 |
| |  | 07.00 Retail sales – including auto fuel M/M% (Y/Y%) | Aug | 0.4 (1.3) | 0.5 (1.4) |
| |  | 07.00 Retail sales – excluding auto fuel M/M% (Y/Y%) | Aug | 0.5 (1.1) | 0.7 (1.4) |
| |  | 07.00 Public sector net borrowing £bn | Aug | 12.5 | 3.1 |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

| Country | BST | Event / Auction |
|------------------------------------|---|--|
| Monday 16 September 2024 | | |
| - Nothing scheduled - | | |
| Tuesday 17 September 2024 | | |
| UK |  | 10.00 Auction: to sell £2.25bn of 4.375% 2054 bonds |
| Wednesday 18 September 2024 | | |
| Germany |  | 10.30 Auction: to sell €1bn of 1.8% 2053 bonds |
| |  | 10.30 Auction: to sell €1bn of 2.5% 2054 bonds |
| UK |  | 10.00 Auction: to sell £2.75bn of 0.875% 2033 bonds |
| Thursday 19 September 2024 | | |
| France |  | 09.50 Auction: to sell up to €12bn of 2.5% 2027, 0.75% 2028, 2.75% 2030 & 2% 2032 bonds |
| |  | 10.50 Auction: to sell up to €2bn of 0.1% 2032, 3.15% 2032, 1.8% 2040 & 0.1% 2053 inflation-linked bonds |
| Spain |  | 09.30 Auction: to sell 5.15% 2028, 3.1% 2031 and 3.45% 2043 bonds |
| UK |  | 12.00 BoE monetary policy announcement and minutes to be published |
| Friday 20 September 2024 | | |
| Euro area |  | 16.00 ECB President Lagarde delivers Michel Camdessus Central Banking Lecture at the IMF, New York. |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

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