

Euro wrap-up

Overview

- Bunds made losses as data showed that German manufacturing production rose the most in six years in August.
- Gilts made further significant losses following sterling's flash crash while UK trade and industrial production figures disappointed expectations.
- The coming week should be relatively uneventful for European economic data with euro area industrial production and goods trade data arguably most notable.

Chris Scicluna
+44 20 7597 8326

Mantas Vanagas
+44 20 7597 8318

Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.667	+0.006
OBL 0 10/21	-0.493	+0.024
DBR 0 08/26	0.027	+0.045
UKT 1½ 07/18	0.179	+0.056
UKT 3½ 09/21	0.359	+0.079
UKT 1½ 07/26	0.971	+0.100

*Change from close as at 4.30pm BST.
Source: Bloomberg

Euro area

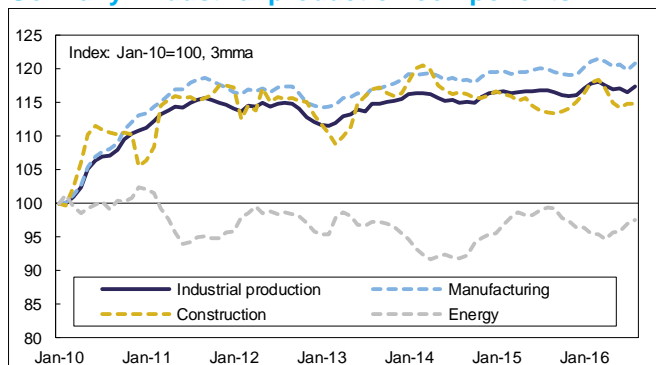
German manufacturing output jumps most in six years

Germany's industrial production figures for August significantly beat expectations with growth of 2½%M/M, the strongest monthly increase since January, to leave output almost 2% higher compared with a year earlier. While construction activity dropped more than 1%M/M, manufacturing output increased 3.3%M/M – the strongest rise for more than six years – as production of capital and consumer durable goods surged (up 4.7%M/M and 6.5%Y/Y respectively). But while undeniably strong, growth in the latest month followed particular weakness in July, when manufacturing output dropped almost 2½%M/M. Indeed, on average over the first two months of Q3, manufacturing output was still marginally lower than the average Q2. Nevertheless, given the solid factory orders figures for August (up 1%M/M, the strongest rise since March) as well as marked improvements in German manufacturing surveys in September, with the Ifo business climate index for the sector having risen to a seventeen-month high and the manufacturing PMI also having risen to the second highest level in more than two years, conditions in the sector appear far more favourable than of late. So, following a contraction in the second quarter, Germany's manufacturing sector looks to have returned to positive growth in Q3 with further expansion likely over the near term too.

French and Spanish production rebounds too

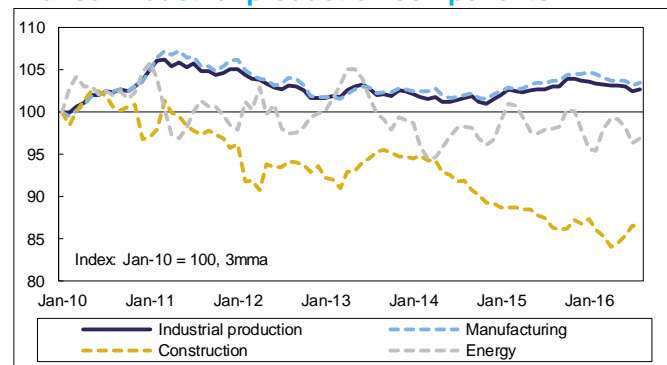
The strong performance of manufacturing production in August was not confined to Germany. Most notably, following three consecutive months of decline, French output from the sector jumped 2.2%M/M, the most since December 2014, with particularly vigorous growth in production of consumer durables. Like in Germany, however, given the weakness over the preceding months, on average in the first two months of the third quarter French manufacturing output was still slightly lower than the average for Q2, and it was still only 0.6% higher than a year earlier in the latest month. In addition, Spanish manufacturing production in August posted the strongest gain in eleven months, up 2.0%M/M following a drop of 0.3%M/M in July to stand more than 4½% higher than a year earlier and remain comfortably on track for an eighth consecutive quarter of expansion. Elsewhere, while there was drop in output in the Netherlands and Portugal, and the Italian figures have yet to be released, overall euro area industrial production (excluding construction) looks set to have risen in August by about 1¼%M/M, the strongest rate since January. Given recent weakness, that would still leave output so far in Q3 little different to the average for the second quarter and only about 1½% higher than a year earlier – broadly in line with the average of the past two years. And with the euro area manufacturing PMI having increased in September but remaining well within the recent range, the sector still appears to be following nothing stronger than an ongoing moderate growth trend.

Germany: Industrial production components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

France: Industrial production components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



The week ahead in the euro area and US

The coming week in the euro area brings a handful of top-tier releases, although there will probably be little that will have a material impact on the debate of the ECB Governing Council at its next monetary policy meeting, which concludes on 20 October. Monday brings German trade figures for August, which seem likely to show a vigorous rebound in exports following a drop in excess of 2½%M/M in July. In addition, Italian industrial output data for the same month and the Bank of France September business sentiment survey are due the same day. Tuesday brings only the German ZEW investor sentiment survey, while Wednesday brings the euro area industrial production figures for August: given the strong growth registered in Germany, France and Spain, we expect overall euro area IP to have risen about 1.7%M/M, the most since January. Also due on Wednesday are the final French inflation figures for September, with the equivalent German numbers out the following day. And the Italian and Spanish numbers are due on Friday, along with the August euro area goods trade report and September new car registrations figures. In the markets, meanwhile, Italy will sell 3Y bonds on Thursday.

In the US, the second televised Presidential Debate will be held on Sunday evening while financial markets will be closed on Monday for a national holiday. Meanwhile, the first of the week's economic releases come on Wednesday with the minutes from the FOMC's most recent policy-setting meeting arguably the most noteworthy. Wednesday also brings the latest JOLTS data for September, followed by weekly initial claims figures on Thursday. The data focus on Friday, meanwhile, will be September's retail sales figures and October's University of Michigan's consumer sentiment survey. Also due that day will be August business inventories figures, September PPI data and the latest monthly Federal budget statement. Policy-wise, Fed Chair Yellen is due to speak at a conference on Friday, while FOMC members Evans, George, Harker and Rosegren will also give speeches during the week. Supply-wise, the Treasury will sell 3Y and 10Y notes on Wednesday, followed by a 30Y bond auction on Thursday.

UK

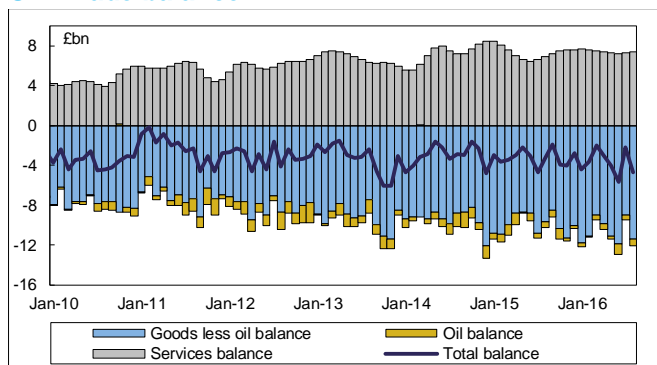
Sterling plunge fully justified by fundamentals

The overnight flash crash in sterling, which saw it briefly fall more than 10 cents against the dollar to trade momentarily around \$1.15 before bouncing back to around \$1.24, was attributed in various quarters to algorithmic trading and/or fat fingers. But the depreciation trend resumed in London trading, leaving the currency down more than 15% since the referendum. And, make no mistake, there's no shortage of reasons why such a large depreciation is justified and also probably has further to go. Most notably, at almost 6% of GDP in Q2, the UK's current account deficit is by far the largest of any major economy – developed or emerging market alike. Strip out the large surpluses currently generated by financial services – which seem particularly vulnerable to Brexit if and when firms lose 'passporting' rights – and the current account deficit would look far worse still, closer to 10% of GDP – more than double the size of those of countries like South Africa and Turkey typically considered more vulnerable to the gyrations of global risk aversion. Moreover, the capital inflows from abroad required to finance the UK's current account – not least the large-scale FDI inflows typically associated in the past with UK participation in the EU single market – seem bound to be less forthcoming in a world in which significant doubts about the UK's economic future have been raised by the prospect of hard Brexit, not to mention the unpleasant and self-defeating rhetoric of Theresa May and some of her Ministers in the past week demonising foreign workers and global capital. (For further analysis of the case for continued sterling weakness see our blog article [Sterling – far from flash](#)).

No boost to exports?

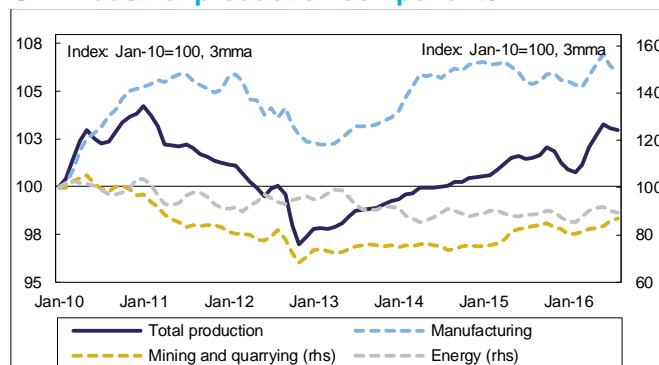
While sterling has been falling since the referendum, it is really too soon for the effects to have been felt in the wider economy. For example, in contrast to expectations, today's release of the latest trade data showed that the UK deficit increased in

UK: Trade balance



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Industrial production components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

August, to £4.7bn, the second highest level since the start of 2015. And after a significant downward revision to the previous month's deficit, this was more than double the level seen in July. The deterioration mainly reflected a weaker goods trade balance, and in particular higher goods imports, while the services balance was little changed. Indeed, in volume terms, goods imports increased by more than 6%M/M reversing a fall of a similar magnitude in July, while exports decreased by 1.4%M/M. And even when smoothing out the monthly volatility, exports were still down 3.8%3M/3M. As such, net exports seem unlikely to have provided any significant support to GDP growth in Q3.













Manufacturing disappointing too

Contrasting with the latest manufacturing PMIs, which dropped initially after the Brexit vote before recovering sharply in subsequent months, today's figures showed that manufacturing growth remained weak in August. Despite a small increase of 0.2%M/M, the first after three consecutive months of declines, manufacturing output was only 0.5% higher than a year earlier, having risen by 0.7%Y/Y in July. And it was only thanks to a recovery in the pharmaceuticals and transport equipment sectors, perhaps where sterling depreciation did provide some support through stronger demand from abroad, that the growth rates were not even lower. Meanwhile, growth in other sub-sectors was unimpressive as well, leaving total industrial output down by 0.4%M/M, the steepest in eight months. Overall, a significant increase of more than 1%M/M is required in September to prevent total industrial output from falling in Q3. Industrial output therefore looks to have been a drag on GDP growth that quarter. Nevertheless, the NIESR estimate of Q3 GDP, also published today, suggested that economic growth was as strong at 0.4%Q/Q.

The week ahead in the UK







Data-wise, it should be a relatively quiet week with only a few second-tier data releases due. Most notably, construction figures, due on Friday, are likely to show that output rose slightly in August to take the annual pace of growth back above zero from -1.5%Y/Y in July. On Thursday, the RICS Residential Market survey will provide an update on sentiment in the housing market. And ahead of that, on Tuesday, the BRC Retail Sales Monitor looks set to suggest that spending on the High Street remained firm in September. Meanwhile, on Thursday the High Court of Justice will begin a hearing on whether the government has the right to invoke Article 50 without the approval of the Parliament. With regard to monetary policy, MPC members Michael Saunders and Jon Cunliffe will be speaking at Parliament on Tuesday and Wednesday respectively, while Governor Mark Carney and other BoE officials are due to appear in public on Friday.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Industrial production M/M% (Y/Y%)	Aug	2.5 (1.9)	1.0 (0.4)	-1.5 (-1.2)	- (-1.3)
France	 Trade balance €bn	Aug	-4.3	-3.9	-4.5	-4.3
	 Current account balance €bn	Aug	-2.1	-	-2.6	-2.9
	 Industrial production M/M% (Y/Y%)	Aug	2.1 (0.5)	0.6 (-1.3)	-0.6 (-0.1)	-0.5 (-)
	 Manufacturing production M/M% (Y/Y%)	Aug	2.2 (0.7)	0.3 (-1.4)	-0.3 (0.4)	-0.2 (-)
Spain	 Industrial production M/M% (Y/Y%)	Aug	1.4 (4.0)	-0.1 (1.6)	0.2 (0.3)	0.1 (0.4)
UK	 Halifax house price index M/M% (3M/Y%)	Sep	0.1 (5.8)	0.0 (5.9)	-0.2 (6.9)	-0.3 (-)
	 Industrial production M/M% (Y/Y%)	Aug	-0.4 (0.7)	0.1 (1.3)	0.1 (2.1)	-
	 Manufacturing production M/M% (Y/Y%)	Aug	0.2 (0.5)	0.4 (0.8)	-0.9 (0.8)	- (0.7)
	 Visible trade balance £bn	Aug	-12.1	-11.3	-11.8	-9.5
	 Total trade balance £bn	Aug	-4.7	-4.0	-4.5	-2.2
	 NIESR GDP 3M/3M%	Sep	0.4	-	0.3	0.5
Auctions						
Country	Auction					
- Nothing scheduled -						












Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

Key data releases						
Country		BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 10 October 2016						
EMU		14:45	ECB public sector asset purchases €bn	Weekly	<u>14.0</u>	11.5
Germany		07:00	Trade balance €bn	Aug	19.8	19.5
		07:00	Current account balance €bn	Aug	15.0	18.6
		07:00	Imports (exports) M/M%	Aug	0.7 (2.2)	-0.7 (-2.6)
		07:00	Imports (exports) Y/Y%	Aug	0.7 (2.2)	-0.7 (-2.6)
France		07:30	Bank of France manufacturing sentiment indicator	Sep	99	98
Italy		09:00	Industrial production M/M% (Y/Y%)	Aug	-0.1 (-0.3)	0.4 (-0.3)
Tuesday 11 October 2016						
EMU		10:00	ZEW expectations balance	Oct	-	5.4
Germany		10:00	ZEW current assessment balance (expectations)	Oct	55.5 (4.0)	55.1 (0.5)
UK		00:01	BRC Sales like-for-like Y/Y%	Sep	-0.3	-0.9
Wednesday 12 October 2016						
EMU		10:00	Industrial production M/M% (Y/Y%)	Aug	1.5 (1.0)	-1.1 (0.5)
France		07:45	Final EU-harmonised CPI Y/Y%	Sep	<u>0.5</u>	0.4
Thursday 13 October 2016						
Germany		07:00	Final EU-harmonised CPI Y/Y%	Sep	<u>0.5</u>	0.3
UK		00:01	RICS house price balance %	Sep	14	12
		15:00	BoE corporate bond purchases £mn	Weekly	-	507
Friday 14 October 2016						
EMU		07:00	EU27 new car registrations	Sep	-	10.0
		10:00	Trade balance €bn	Aug	20.5	20.0
Italy		09:00	Final EU-harmonised CPI Y/Y%	Sep	<u>0.1</u>	-0.1
Spain		08:00	Final EU-harmonised CPI Y/Y%	Sep	<u>0.1</u>	-0.3
UK		09:30	Construction output M/M% (Y/Y%)	Aug	0.0 (1.3)	0.0 (-1.5)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

Key events & auctions			
Country		BST	Event / Auction
Monday 10 October 2016			
UK		14:50	BoE APF operation: To purchase 3-7Y Gilts
Tuesday 11 October 2016			
Germany		10:30	Auction: To sell €500mn of 0.1% 2046 index-linked bonds (15-Apr-2046)
UK		10:00	BoE's Saunders scheduled to speak at a hearing of Parliament's Treasury Select Committee
		14:50	BoE APF operation: To purchase 15Y+ Gilts
Wednesday 12 October 2016			
UK		10:00	BoE's Cunliffe scheduled to speak in Parliament
		10:30	Auction: To sell 0.125% 2036 index-linked bonds
		14:50	BoE APF operation: To purchase 7-15Y Gilts
Thursday 13 October 2016			
Italy		10:00	Auction: To sell bonds
UK		-	Hearing at the High Court of Justice regarding the right of the government to invoke Article 50
Friday 14 October 2016			
UK		09:30	BoE Q3 Credit Conditions Survey
		12:45	BoE's Forbes scheduled to speak in Warsaw

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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