Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made losses as a survey signalled an improvement in euro area economic sentiment and German inflation jumped to a sixteen-month high.
- Gilts also made losses as banking sector data suggested that the BoE's August rate easing package was supporting the housing market.
- Friday brings the flash estimate of euro area inflation in September along with new figures for euro area unemployment, German retail sales and UK consumer confidence, and revised Q2 UK GDP data.

Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.686	+0.014
OBL 0 10/21	-0.577	+0.022
DBR 0 08/26	-0.118	+0.028
UKT 1¼ 07/18	0.069	+0.001
UKT 3¾ 09/21	0.194	+0.016
UKT 1½ 07/26	0.715	+0.036

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

Euro area

Sentiment survey signals steady growth

Recent economic surveys have provided rather mixed messages about growth momentum in the euro area economy in the third quarter. So, the significant upside surprise in today's Commission's economic sentiment survey – which arguably provides the most reliable guide to GDP growth – was reassuring. In particular, contrary to expectations of a flat reading, the headline euro area economic sentiment index (ESI) posted its biggest gain in one year to rise to 104.9, the highest level since January. Within the survey detail, the ESIs rose in each of the five largest member states in September, with the German index up to a twelve-month high. At the sectoral level, the euro area industrial sector index rose to a more than five-year high, thanks not least to reported improvements in order books, while retailers and construction firms also appeared more upbeat but services sentiment was little changed. Additionally, the slight improvement in consumer confidence flagged in the flash estimate was confirmed. The survey also signalled a firming of employment intentions, and slightly higher selling price expectations in industry, construction and services as well as a rise in consumer price expectations. Therefore, the September Commission survey contained plenty of cause for cautious optimism at the ECB. However, given the weakness in the euro area ESI over recent months, the Q3 average of 104.3 still merely matched the level of Q2, to suggest another quarter of moderate economic growth of around 0.3%Q/Q in the past quarter – certainly nothing to get particularly excited about.

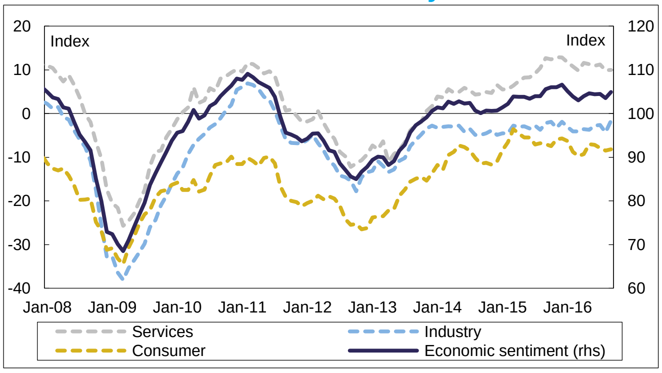
German inflation up to sixteen-month high

As past declines in energy prices fall out of the arithmetic, euro area inflation is set to move gradually higher, a process which was already evident in today's first estimates of CPI in September. As expected, Germany's EU-harmonised measure of inflation rose 0.2ppt to a sixteen-month high of 0.5%Y/Y. The limited detail produced on the national definition showed that energy prices declined at the slowest rate since 2014 seemingly accounting fully for the rise in the headline measure, and core inflation on the EU measure appears likely to have remained little changed from the rate of 1.1%Y/Y recorded in each of the previous three months. Although Spanish inflation on the EU measure fell slightly short of expectations, it nevertheless still rose 0.4ppt to 0.1%Y/Y, the highest rate in more than two years. And while no detail was published with the headline rate, higher fuel costs are again likely to explain the jump. So, we suspect that Spanish core CPI on the EU measure remained at 0.7%Y/Y, no higher than the average of the past twelve months.

The day ahead in the euro area and US

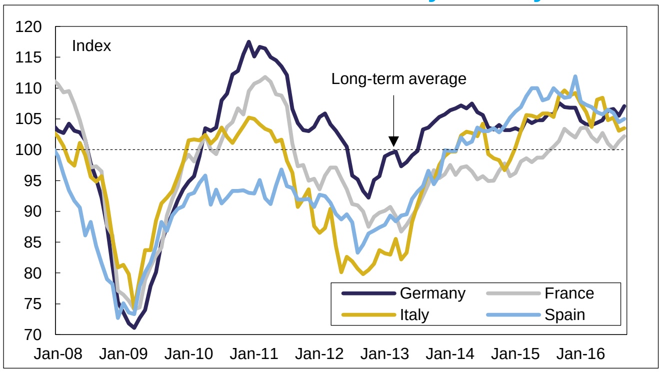
Friday brings the flash estimates of euro area inflation in September. Following today's German and Spanish figures, euro area CPI now looks set to rise 0.2ppt to 0.4%Y/Y with the core measure stubbornly remaining unchanged at just 0.8%Y/Y. Also due tomorrow are euro area unemployment data for August, which are expected to show a further 0.1ppt decline in the headline rate to a five-year low of 10.0%. In addition, August figures for German retail sales and French consumer spending are scheduled for release.

Euro area: Economic sentiment by sector*



*European Commission economic sentiment indicator.
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Economic sentiment by country*



*European Commission economic sentiment indicator.
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

In the US, August personal spending and income numbers are due along with the associated key PCE deflator inflation figures. Most notably, the Fed's preferred core PCE deflator indicator is expected to edge up to 0.2%M/M, 1.7%Y/Y, towards the top of the range of the year so far. The September Chicago PMI and final Michigan consumer confidence figures are also due.

UK

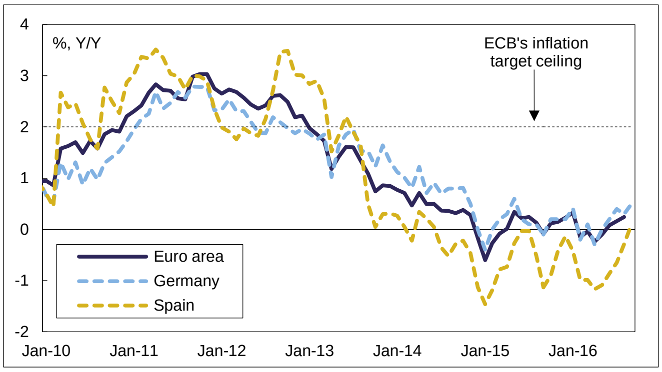
Lower interest rates supported mortgage lending

Figures released by the BoE today suggested that the MPC decision to ease monetary policy contributed to lower interest rates for UK households. Indeed, new floating rate mortgages were on average 13bps cheaper in August compared to July. And while fixed-rate mortgage rates actually headed slightly higher that month, a large fall had been registered in the previous month in anticipation of the MPC action to leave them still 7bps lower than in June. Lower rates seem to have provided some support to lending flows: after a fall in July to £2.6bn, net mortgage lending was slightly stronger in August, at £2.9bn, while gross lending inched up once again to the highest level since the surge in activity ahead of the Stamp Duty tax change in April. Nevertheless, although the number of housing market transactions has gradually recovered since April, mortgage approvals have been moving in the opposite direction, falling to 60.1k in August, the lowest level since November 2014. Overall, we expect momentum in the housing market to remain broadly unchanged over coming months as concerns about the impact of Brexit on prices will be balanced against lower mortgage rates and somewhat stronger than previously expected economic growth. Meanwhile, today's figures also suggested that unsecured lending remained particularly strong in August, with the amount outstanding growing at an annual rate in excess of 10% to the highest level in more than seven years.

The day ahead in the UK

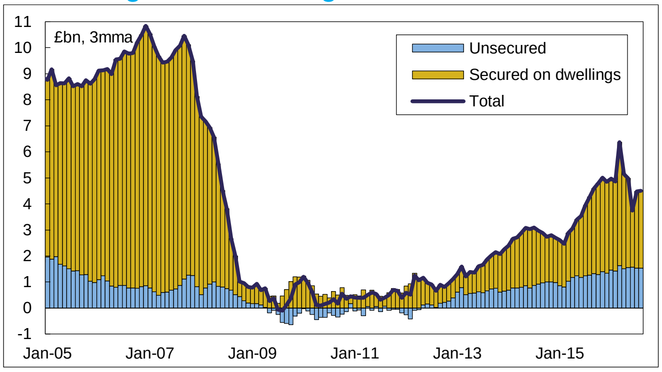
Data-wise, it should be a busy end of the week bringing the final estimate of Q2 GDP, which will most likely confirm the previous estimates of 0.6%Q/Q growth. Additionally, the current account deficit looks set to have remained particularly large by historical standards despite an expected small improvement that quarter. Among the more up-to-date indicators due tomorrow, the most noteworthy perhaps will be the services activity index for July. This will give the first hard data on growth in the services sector in the aftermath of the referendum, and, while it is likely to show that activity in the sector continued to expand, it is also expected to show a slowdown from the pre-referendum period. Meanwhile, the September Lloyds Business Barometer and GfK consumer confidence surveys will also be released tomorrow. The latter is expected to have risen for the second consecutive month in September, albeit still not recovering fully from the sharp fall seen immediately after the referendum.

Euro area: CPI* inflation



**EU-harmonised measure.*
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Change in net lending to individuals



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
EMU	Economic sentiment indicator	Sep	**104.9**	103.5	103.5	**-**
	Services (industrial) sentiment	Sep	**10.0 (-1.7)**	10.0 (-4.2)	10.0 (-4.4)	**9.9 (-4.3)**
	Final consumer confidence	Sep	**-8.2**	-8.2	-8.5	**-**
Germany	Unemployment change `000s (rate %)	Sep	**1 (6.1)**	-5 (6.1)	-7 (6.1)	**-6 (-)**
	Preliminary EU-harmonised CPI Y/Y%	Sep	**0.5**	0.5	0.3	**-**
Spain	Retail sales Y/Y%	Aug	**3.4**	4.5	4.9	**5.1**
	Preliminary EU-harmonised CPI Y/Y%	Sep	**0.1**	0.2	-0.3	**-**
UK	Mortgage approvals `000s	Aug	**60.1**	60.2	60.9	**-**
	Net consumer credit (net lending secured on dwellings) £bn	Aug	**1.6 (2.9)**	1.4 (2.6)	1.2 (2.7)	**- (2.6)**

Auctions

Country	Auction
Italy sold	€4bn of 0.35% 2021 bonds (01-Nov-2021) at an average yield of 0.28%
	€2.5bn of 1.25% 2026 bonds (01-Dec-2026) at an average yield of 1.21%
	€2bn of 2023 floating-rate bonds (15-Jul-2023) at an average yield of 0.33%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	10.00	Unemployment rate %	Aug	10.0	10.1
	10.00	Flash CPI estimate Y/Y%	Sep	*0.4*	0.2
	10.00	Flash core CPI estimate Y/Y%	Sep	*0.8*	0.8
Germany	07.00	l sales M/M% (Y/Y%)	Aug	-0.2 (1.8)	0.6 (-1.5)
France	07:45	Preliminary EU-harmonised CPI Y/Y%	Sep	0.5	0.4
	07:45	Consumer spending M/M% (Y/Y%)	Aug	0.5 (0.9)	-0.2 (0.5)
Italy	09:00	Unemployment rate %	Aug	11.4	11.4
	10:00	Preliminary EU-harmonised CPI Y/Y%	Sep	0.1	-0.1
Spain	09:00	Current account balance €bn	Jul	-	2.0
UK	00:01	Lloyds business barometer	Sep	-	16
	00:01	GfK consumer confidence survey	Sep	-5	-7
	07.00	Nationwide house price index M/M% (Y/Y%)	Sep	0.3 (5.0)	0.6 (5.6)
	09:30	GDP – second release Q/Q% (Y/Y%)	Q2	0.6 (2.2)	0.4 (2.0)
	09:30	Index of services M/M% (3M/3M%)	Jul	0.1 (0.3)	0.2 (0.5)
	09:30	Current account balance £bn	Q2	-30.6	-32.6

Auctions and events

Country	BST	Auction / Event
		- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.