

Euro wrap-up

Overview

- Bunds followed major bond markets lower as data confirmed a rebound in euro area industrial output following recent weakness.
- Gilts also made further losses as PM May continued to resist attempts to give the UK Parliament any substantive role in the Brexit process.
- Thursday will bring final German inflation figures for September, the latest UK housing market survey, and a UK High Court hearing seeking to clarify the procedures for launching Brexit.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.656	+0.014
OBL 0 10/21	-0.467	+0.024
DBR 0 08/26	0.066	+0.041
UKT 1¼ 07/18	0.197	+0.012
UKT 3¾ 09/21	0.413	+0.039
UKT 1½ 07/26	1.034	+0.056

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

Euro area

Industrial output rebound confirmed after a weak start to Q3

Following upside surprises in the data from the largest member states, the aggregate euro area industrial production figures for August released today broadly aligned with subsequent upwardly revised expectations, with the rise of 1.6%/M/M representing the biggest gain since April. Growth in August took the level of output in the sector to the highest since January, up almost 2% from a year earlier. And perhaps encouragingly, it was propelled by stronger production of capital goods, up about 3½%/M/M, the most since January. However, these data are typically highly volatile. And the strength in August followed weakness in July, when overall production fell 0.7%/M/M and output of capital goods fell almost 2%/M/M. As a result, the average level of industrial output in the first two months of Q3 was still just 0.1% higher than the average for the second quarter, with production of capital goods little firmer than other items. And on a similar basis, country-wise, only Italy and Spain appear clearly to have stepped up a gear in Q3.

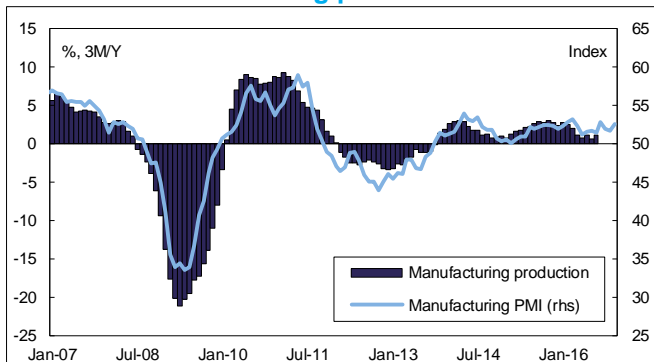
Expansion trend should be maintained in coming quarters

Nevertheless, there is cause for cautious optimism about the near-term outlook for the industrial sector, with several recent surveys having signalled an improvement in conditions at the end of the third quarter. For example, the euro area manufacturing PMI rose back close to the top of the range of the past two years, the German Ifo business climate index for the sector rose to a sixteen-month high, and, most striking perhaps, the Commission's industrial confidence index rose to a five-year high. Moreover, with hopes that the inventory adjustments, which subtracted from euro area GDP growth in the first two quarters of the year, are now well advanced, euro area manufacturing output likely returned to positive growth in the third quarter following a contraction in Q2. And while we still expect the trend in consumption to slow due to weaker growth in real disposable incomes, and investment growth to remain subdued not least due to persistent political risks, we expect to see steady expansion in the industrial sector over coming quarters close to the 1½%Y/Y average trend of the past couple of years.

The day ahead in the euro area and US

After today saw the final estimate of French inflation in September confirm the preliminary figure on the EU-harmonised measure of 0.5%Y/Y, up 0.1ppt on the month at a near-two-year high, Thursday brings the equivalent data from Germany. According to the flash estimate, the EU measure of headline German CPI rose 0.2ppt to a sixteen-month high of 0.5%Y/Y. The limited detail produced on the national definition suggested that the increase in inflation was caused principally by a moderation in the pace of decline of energy prices to the slowest rate since 2014. And so 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. In the bond markets, Italy will sell 3Y, 7Y and 15Y bonds.

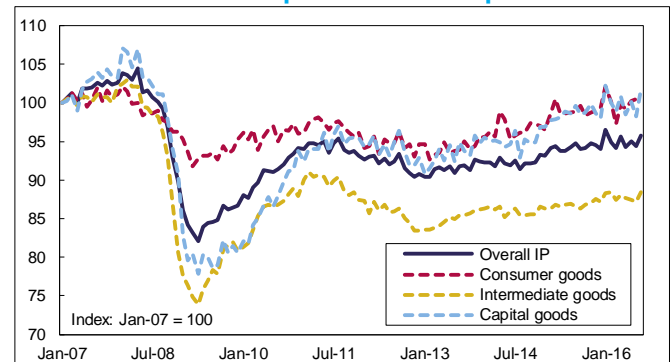
Euro area: Manufacturing production and PMI*



*PMI has 3-month lead.

Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



In the US, September figures for import prices, a persistent source of downwards pressure on inflation over the past couple of years, are due along with the usual weekly claims numbers. In addition, Philadelphia Fed President Harker, who will be a voting member of the FOMC in 2017, will speak on the economic outlook. Supply-wise, the US Treasury will sell 30Y bonds.

UK



The day ahead in the UK

The RICS Residential Market survey, due tomorrow, will provide an update on the latest developments in the housing market. Having fallen steadily in the first half of the year, the survey's headline indicator for price growth inched back up at the end of summer and is expected to have continued rising in September. Meanwhile, the BoE will publish an updated figure for the amount of its corporate bond purchases. The central bank started the scheme vigorously purchasing £507mn of bonds in the first week, however that pace will not be maintained going forward. And on the Brexit front, while today Theresa May refused to allow Parliament to vote on the timing of Article 50, or in fact influence any other aspects of the process of leaving the EU, a hearing at the High Court on this matter will take place tomorrow.



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	 Industrial production M/M% (Y/Y%)	Aug	1.6 (1.8)	1.5 (1.5)	-1.1 (0.5)	-0.7 (-)
France	 Final EU-harmonised CPI Y/Y%	Sep	0.5	<u>0.5</u>	0.4	-




Auctions

Country	Auction
UK sold	 £850mn of 0.125% 2036 index-linked bonds (22-Nov-2036) at an average yield of -1.847%
	 BoE APF operation purchased £1.17bn of 7-15Y Gilts (3.72 cover ratio)





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous
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

Auctions and events

Country	BST	Auction / Event
Italy		10:00 Auction: To sell up to €4bn of 0.05% 2019 bonds (15-Oct-2019)
		10:00 Auction: To sell up to €2.5bn of 0.65% 2023 bonds (15-Oct-2023)
		10:00 Auction: To sell up to €2bn of 1.65% 2032 bonds (01-Mar-2032)
UK		- Hearing at the High Court of Justice regarding the right of the government to invoke Article 50

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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