Daiwa Capital Markets

Euro wrap-up

Overview

- In line with other major bond markets, Bunds made gains as German inflation figures aligned with expectations.
- Gilts similarly made gains while the inflationary impact of recent sterling weakness became a major media focus in the UK.
- Friday brings trade and new car registration data from the euro area and construction output from the UK, while BoE Governor Carney is scheduled to give a speech.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.658	-0.005
OBL 0 10/21	-0.484	-0.018
DBR 0 08/26	0.040	-0.027
UKT 1¼ 07/18	0.209	+0.001
UKT 3¾ 09/21	0.412	-0.011
UKT 1½ 07/26	1.027	-0.016

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

Euro area

No surprises from Germany's inflation figures

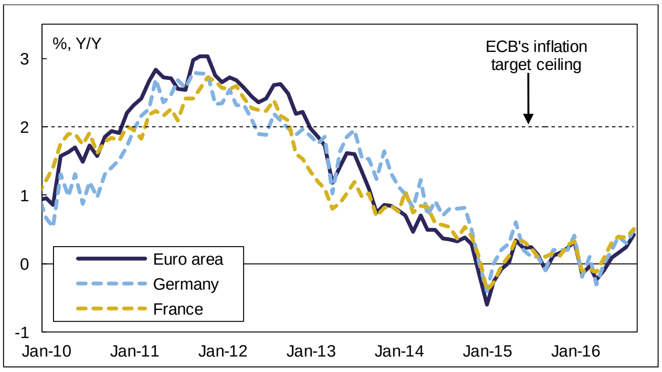
On a relatively uneventful day for economic news from the euro area, the only notable data release brought the final figures for German inflation in September. There were no surprises, however, with the report confirming the preliminary estimate of the EU-harmonised measure of 0.5%Y/Y, up 0.2ppt on the month to a sixteen-month high. The national CPI measure also aligned with the preliminary release, with the headline rate up 0.3ppt to 0.7%Y/Y. Within the detail of the national release, the increase in inflation was caused principally by a further moderation in the pace of decline of energy prices, by 2.3ppts to -3.6%Y/Y, the slowest rate since November 2014. But while the decline in goods price inflation also moderated to a near-two-year low of -0.1%Y/Y, services inflation was unchanged at just 1.3%Y/Y. And so, on the national definition, core CPI (excluding prices of food and energy) was unchanged at 1.2%Y/Y, within the middle of the range of the past couple of years. With the equivalent French figures published yesterday having also aligned with the flash estimates, most notably with the EU-harmonised measure of CPI rising to a two-year high of 0.5%Y/Y, we expect the final data for euro area inflation in September – due Monday – to confirm that the headline rate rose 0.2ppt to a two-year high of 0.4%Y/Y, while core CPI remained disappointingly subdued at 0.8%Y/Y for the second successive month.

The day ahead in the euro area and US

Friday brings the August trade report for the euro area, which – not least given the improvement already reported in Germany – is likely to show an increase in the trade surplus thanks particularly to a rebound in exports following a weak July. Also due are new car registration figures for September and the final inflation numbers for the same month from Italy (for which the flash estimate on the EU measure rose 0.2ppt to 0.1%Y/Y) and Spain (for which flash estimate on the EU measure rose 0.4ppt, also to 0.1%Y/Y).

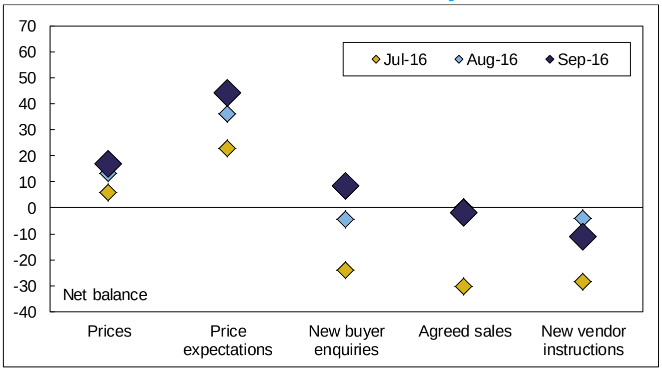
In the US, Friday brings the most notable new economic data of the week in the shape of September's advance retail sales report. A rebound in sales is anticipated following a decline in August. Also due is the preliminary University of Michigan consumer sentiment survey for October, as well as the monthly Federal government budget statement and producer price numbers for September, and business inventory data for August. Perhaps most notable, however, will be the keynote speech by Fed Chair Yellen at the Boston Fed's annual economics conference. And FOMC members Rosengren and Kashkari are also due to speak publicly.

Euro area: Inflation*



*September 2016 flash estimate for the euro area.
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: RICS Residential Market Survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

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UK

Prices on the rise while sterling continues to fall

The Brexit mess continues to take its toll. With sterling's effective exchange rate having fallen to a new record low yesterday, the inflationary consequences of the slide in the pound have been illustrated by the dispute between retailer Tesco and Unilever, which has reportedly sought an across-the-board 10% increase in prices of the hundreds of products it supplies to compensate for the exchange rate shift. And with the disagreement played out in the media, and currently leading to shortages of some of the UK's best-known food and household goods at the UK's largest supermarket chain, few consumers now should be unaware that Brexit will cost them. With sterling's depreciation likely to have further to go, and retailers needing to pass on a good deal of the higher associated costs, we fully expect UK CPI to rise above the BoE's 2%Y/Y target in Q2 next year, and to continue to rise to above 2½%Y/Y by end-2017, complicating the MPC's decision-making. However, given that higher inflation will erode real disposable incomes, it will also cause consumer spending to slow, accentuating the weakness in GDP from weaker investment. And so, while it will also feel uneasy about the recent rise in financial market measures of inflation expectations, as it did in 2009 we expect the BoE to look through the near-term increase in CPI and ease monetary policy further to support activity over coming quarters.

Legal challenge might slow separation from the EU

With PM Theresa May continuing to refuse to allow the UK Parliament to vote on the invoking of Article 50, or indeed influence any other aspects of the process of leaving the EU in a substantive way, a hearing at the High Court of Justice on this matter commenced today. The hearing is currently scheduled to last for two and a half days, with the judgment will be announced within the coming three weeks. However, this seems unlikely to settle matters, with a final verdict by the Supreme Court – already pencilled in for December – likely to be required to determine whether Parliament has a say in launching the formal proceedings to leave the EU. And credible estimates suggest that the final settlement will be more costly for the public purse than Brexiteers would like to admit. An FT study estimates that the divorce bill for the UK as it meets outstanding liabilities with the EU could reach as much as €20bn (a little less than 1% of GDP) – an unhelpful extra burden when the authorities will be concerned about a notable deterioration in the fiscal position for both cyclical and structural reasons, and will also be looking to provide some support to demand through higher public investment.

Confidence returns to the housing market

With respect to economic activity, the RICS Residential Market Survey suggested that the housing market continued to stabilise after June's referendum, with the headline price indicator rising for the second consecutive month in September to 17, up from the three-year low of 6 in July but still almost half the average of the past year. Against the backdrop of a lack of a new supply, the recovery in prices is reportedly being supported by a pick-up in demand. Indeed, the 'new buyer enquiries' indicator in September returned to a positive territory for the first time in six months. Within the breakdown by region, however, London maintained a downward trajectory. And with the indicator for the near-term expectations back below zero and about 60% of respondents judging that prices are above fair value, the outlook for the housing market in the capital remains less optimistic than in any other region.

The day ahead in the UK

The end of the week brings the latest construction sector figures, which will probably show that output in August was little changed from the previous month. But given that it fell particularly sharply a year ago, the output level would be consistent with a sharp increase in the annual pace of growth to above 1%Y/Y from -1.5%Y/Y in July. Also notable will be the release of the BoE Credit Conditions Survey for Q3. Meanwhile, there should be some headlines on the monetary policy front tomorrow given that Governor Mark Carney and other BoE officials are scheduled to meet with members of public and speak at the bank's own Future Forum.

European calendar

Today's results							
Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
Germany		Final EU-harmonised CPI Y/Y%	Sep	**0.5**	*0.5*	0.3	**-**
UK		RICS house price balance %	Sep	**17**	14	12	**13**
		BoE corporate bond purchases £mn	Weekly	**1042**	-	507	**-**
Country		Auction					
Italy sold		€4bn of 0.05% 2019 bonds (15-Oct-2019) at an average yield of 0.03%					
		€2.5bn of 0.65% 2023 bonds (15-Oct-2023) at an average yield of 0.83%					
		€2bn of 1.65% 2032 bonds (01-Mar-2032) at an average yield of 1.77%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases						
Economic data						
Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		07.00	EU27 new car registrations	Sep	-	10.0
		10.00	Trade balance €bn	Aug	20.4	20.0
Italy		09:00	Final EU-harmonised CPI Y/Y%	Sep	*0.1*	-0.1
Spain		08:00	Final EU-harmonised CPI Y/Y%	Sep	*0.1*	-0.3
UK		09:30	Construction output M/M% (Y/Y%)	Aug	0.0 (1.2)	0.0 (-1.5)
Auctions and events						
Country		BST	Auction / Event			
UK		09:30	BoE Q3 Credit Conditions Survey			
		12:45	BoE's Forbes scheduled to speak in Warsaw			
		-	BoE's Carney and deputy governors scheduled to speak at Future Forum			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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