Euro wrap-up

Overview

- Bunds were little changed as the latest euro area GDP and inflation figures broadly aligned with expectations.
- Gilts made modest gains as Mark Carney was expected to lengthen his term as BoE Governor.
- Tuesday will bring the UK manufacturing PMI for October while many euro area member states will enjoy national holidays.

Economic Research Team
+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.617	+0.001
OBL 0 10/21	-0.399	-0.006
DBR 0 08/26	0.162	-0.006
UKT 1¼ 07/18	0.261	-0.028
UKT 3¾ 09/21	0.590	-0.019
UKT 1½ 07/26	1.241	-0.019

*Change from close as at 4.15pm GMT.
Source: Bloomberg

Euro area

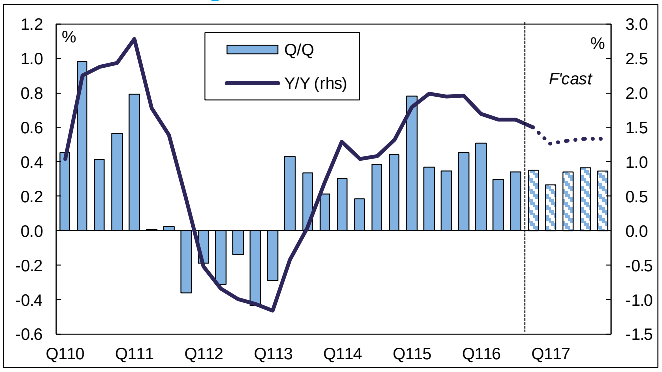
Euro area GDP growth in Q3 little changed from Q2

Broadly in line with the consensus expectation, today's preliminary estimate suggested that euro area GDP in the third quarter of 2016 rose 0.34%Q/Q, a marginal improvement from the 0.29%Q/Q rate in Q216 and close to the average rate of the economic recovery to date. Although there was no detail on the expenditure breakdown released today, monthly data suggest that growth was driven by domestic demand, with consumption and investment likely providing support, while net trade subtracted from growth. Today's figure implies that the euro area economy lost some vigour in the middle of the year after GDP rose close to 0.5%Q/Q in Q415 and Q116. However, the strong October survey results released last week suggest that growth will be firmer in the final quarter of this year not least thanks to an acceleration in Germany. On an annual basis, euro area GDP in Q316 was up 1.6%Y/Y, in line with the average of the past couple of years and a touch stronger than the equivalent rate achieved in the US for the fourth consecutive quarter. And we expect this annual rate to be sustained over coming quarters too.

Core inflation remains stubbornly weak

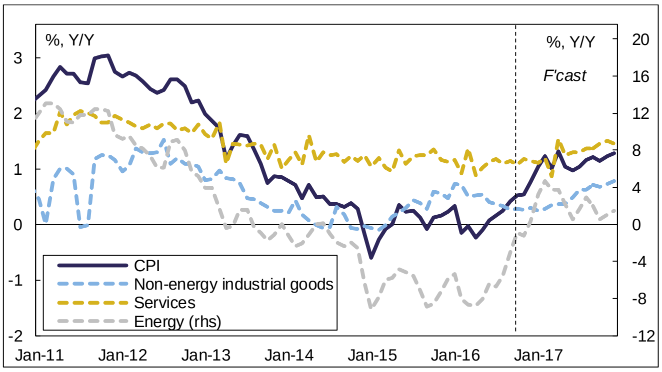
As far as the ECB is concerned, today's euro area flash inflation figures for October are likely to have been no less important than the GDP estimate and illustrated the case for ongoing monetary policy support. While headline CPI rose to the highest rate in more than two years, at 0.5%Y/Y it was only 0.1ppt higher than in September and meant that inflation has now remained below 1%Y/Y for more than three years. Moreover, the pickup in the latest month was due only to the smaller drag from energy prices, which fell less than 1%Y/Y, the least since June 2014. In contrast, food inflation weakened to just 0.4%Y/Y, the lowest since January 2015. And with inflation of non-energy industrial goods (0.3%Y/Y) and services (1.1%Y/Y) unchanged from September, as expected the core measure remained unchanged at 0.8%Y/Y for the third consecutive month, no higher than the average of the past two years and arguably about ½ppt below the levels that might lead the ECB to feel sufficiently confident to start tapering its asset purchases. Looking ahead, we expect headline CPI to remain unchanged at 0.5%Y/Y in November before rising to 0.8%Y/Y in December and 1.0%Y/Y in January as energy prices start to add to inflation. However, we also forecast core CPI to remain at 0.8%Y/Y over those months, and to rise only gradually throughout 2017. And with its own inflation projection likely to be nudged down to suggest that CPI will remain below target through at least to end-2018, we expect the ECB in December to extend its asset purchase programme for a further six months to at least September 2017, initially at the current rate of €80bn per month.

Euro area: GDP growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: CPI inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area and US

Given national holidays in many member states for All Saints' Day, Tuesday will be relatively quiet on the data front with the Greek and Irish manufacturing PMIs for October most notable. In the US, the ISM manufacturing indices for October are due along with September's construction spending figures.

UK

Carney under attack

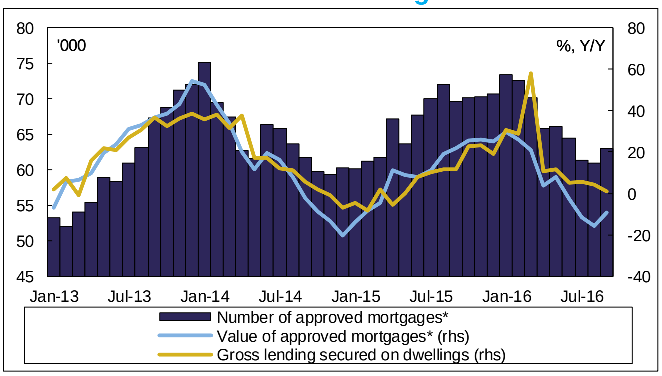
When George Osborne appointed Mark Carney as Governor of the Bank of England he described him as "the outstanding central banker of his generation". And, while hyperbole for sure, his record since he took office has been pretty impressive, with the forward guidance regime he instigated on his arrival helping to lay the foundations for what has been a job-rich (although wage-growth-poor) economic recovery. But his relationship with some in the ruling Conservative Party took a sharp turn for the worse during the referendum campaign when Carney warned of the potential economic consequences of the UK leaving the EU. None of these warnings were controversial – they aligned with all mainstream economic theory and the views of the overwhelming majority of economists. But they were obviously inconvenient to the Leave campaigners who only had a very small rag-tag band of economists on their side willing to suspend economic theory to meet their political priorities. And with no coherent economic arguments to attack Carney with, they decided instead to attack the man, accusing him of "politicising" his office.

These attacks have grown increasingly loud over recent weeks. Theresa May's speech at the Tory Party conference, in which she appeared to criticise the MPC's QE policy, while possibly just clumsy drafting, appeared to give the green light for Carney's opponents to up their attacks. Further confusion over whether the Chancellor would be willing to approve further QE automatically, if the MPC requested it, was cleared up only belatedly and merely served to give the impression of a Governor under pressure from the Government, further undermining the perception of the quality of economic policymaking in the UK, adding to the pressure on sterling and Gilts. This pressure ratcheted up further over the weekend, with explicit calls for Carney to resign from high-profile Leave campaigners and press reports suggesting that he was on the brink of confirming that he would indeed depart in 2018, as originally planned, rather than extend his stay, as he had hinted he may do earlier in the year.

But is set to stay on beyond 2018

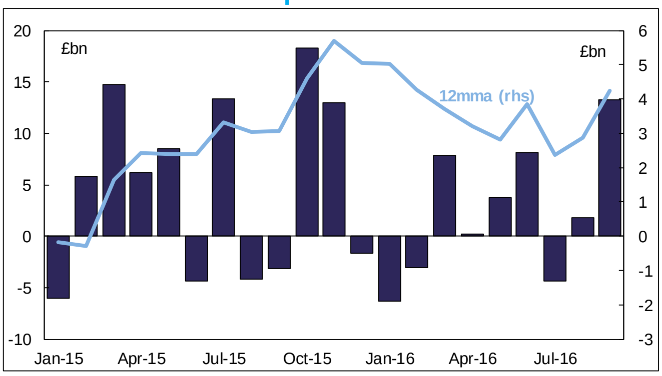
But Carney appears to have moved quickly to quash those rumours, with an apparently well-sourced story in the Financial Times suggesting that he might stay on beyond 2018, with the announcement of this news to probably come this week, and probably before Thursday's press conference following the MPC meeting. That Carney is set to stay on to guide the BoE through the period of the UK's departure from the EU is good news. Carney's assured press conference on the morning of 24th of June, at a time when the rest of the government was in total meltdown, was a key factor in helping to calm markets in the wake of the vote. And there's going to be plenty more tough times ahead for the MPC as, first, Article 50 is triggered, and then Brexit itself draws ever closer. But don't expect the criticism to stop. Indeed, expect Carney and the MPC to come in for more criticism in the wake of this Thursday's MPC meeting. Of course, the fact that last week's flash Q3 GDP reading showed growth of 0.5%Q/Q, well above the 0.1%Q/Q the MPC forecast back in August, is a little embarrassing. But, more importantly, Theresa May's announcement that she intends to trigger Article 50 before the end of March next year means that the UK is set to leave the EU within the MPC's three-year forecast horizon. That means that this week's forecast will have to directly address the issue of the potential consequences of the UK's departure from the EU. And, given that we have no idea what Brexit will look like, the MPC may well present a much wider forecast range for GDP and inflation to reflect the possible

UK: Indicators of secured lending to individuals



*For house purchase.
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Non-resident Gilt purchases



Source: BoE, Bloomberg and Daiwa Capital Markets Europe Ltd.

economic consequences of the various forms of Brexit. Those judgments, which should make it clear that the 'harder' the Brexit the more damaging the economic consequences, will further fuel the wrath of the Leavers. But, thankfully, Carney appears not to care and his decision to extend his term means that there will be at least one grown up in a key economic policy making role over the period of Brexit.

Housing market holds steady

The signals from the UK housing market, including the latest ONS/Land Registry house price index and the survey data from RICS, suggested that confidence after the referendum held up better than expected. And today's mortgage figures from the BoE confirmed that. Consistent with the previous decreases in mortgage approvals new gross lending fell to the lowest level in twelve months. However, the stock of net lending increased by £3.2bn, representing the steepest rise in three months. And the number of approved mortgages also picked up, having been on a downward trend since the start of the year, signaling that transaction levels and prices might receive some support from higher buyer interest in the final quarter of the year. In other data, the BoE reported that Gilt purchases by overseas investors surged in September to the highest level in almost a year. But with sterling having subsequently fallen sharply and yields having spiked, the October numbers might make less promising reading.

The day ahead in the UK

The flow of October PMIs in the UK starts tomorrow with the release of the manufacturing survey. Following a sharp increase in the previous month, when it rose by 2pt to 55.4, the headline indicator is expected to have eased to about 54½, which would still be above the levels seen before the referendum.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
EMU	GDP – preliminary release Q/Q% (Y/Y%)	Q3	**0.3 (1.6)**	*0.4 (1.6)*	0.3 (1.6)	-
	Flash CPI estimate Y/Y%	Oct	**0.5**	*0.6*	0.4	-
	Flash core CPI estimate Y/Y%	Oct	**0.8**	*0.8*	0.8	-
	ECB public sector asset purchases €bn	Weekly	**17.2**	*16.2*	16.5	-
Germany	Retail sales M/M% (Y/Y%)	Sep	**-1.4 (0.4)**	0.2 (1.5)	-0.4 (3.7)	**-0.3 (3.8)**
Italy	Preliminary EU-harmonised CPI Y/Y%	Oct	**-0.1**	0.1	0.1	-
Spain	Retail sales Y/Y%	Sep	**3.2**	3.3	3.4	**3.3**
	Current account balance €bn	Aug	**2.9**	-	3.0	-
UK	Lloyds business barometer	Oct	**37**	-	24	-
	Mortgage approvals `000s	Sep	**62.9**	61.5	60.1	**61.0**
	Net consumer credit (net lending secured on dwellings) £bn	Sep	**1.4 (3.2)**	1.5 (3.0)	1.6 (2.9)	**- (3.1)**
Country	Auction					
UK	BoE APF operation purchased £1.17bn of 3-7Y Gilts (3.30 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
UK		09:30	Manufacturing PMI	Oct	54.5	55.4
Auctions and events						
Country		BST	Auction / Event			
UK		10:30	Auction: To sell £2.75bn of 0.5% 2022 bonds (22-Jul-2022)			
		14:50	BoE APF operation: To purchase 15Y+ Gilts			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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