Euro wrap-up

Overview

- While European financial markets saw significant adjustments in early trading reflecting the US election shock, these were largely reversed during the day, with Bund yields closing the day only slightly lower.
- Gilt yields also closed marginally lower despite the latest UK trade report signalling that net trade made a positive contribution to Q3 GDP.
- Tomorrow brings French and Italian IP data for September, along with a UK housing market survey.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.635	-0.002
OBL 0 10/21	-0.423	-0.022
DBR 0 08/26	0.178	-0.011
UKT 1¼ 07/18	0.200	-0.023
UKT 3¾ 09/21	0.566	-0.007
UKT 1½ 07/26	1.235	-0.002

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

Euro area

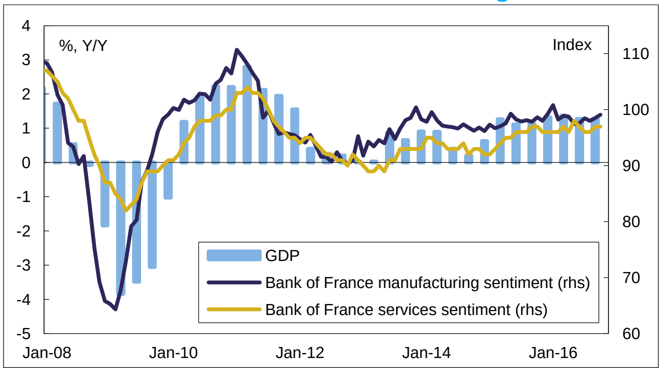
European markets driven by US election shock

European financial markets today were inevitably driven by the news that Donald Trump will become the next US President with a significant initial impact evident in the equity, forex and government bond markets. For example, the Euro Stoxx was almost 3% lower at the open, the euro jumped almost 3% spiking at $1.13 and 10Y Bund yields fell 8bps back through 10bps. While these adjustments were largely reversed through the morning session, the likelihood of significant uncertainty will remain a potential source of global volatility for some time to come. Certainly, the prospect of a Trump Presidency raises myriad issues about US policy across a whole range of areas with global implications – this is a man who has promised massive tax cuts and a significant increase in infrastructure and defence spending, implying a possible explosion in the US public borrowing, while also musing on the prospect of renegotiating the US's debt stock. And, of course, he has also talked about withdrawing from both NAFTA and the WTO, and questioned the actions of the Federal Reserve. Of course, persistent market volatility at the global level – which could have a notable impact on financial conditions in the Southern periphery of the euro area – might add to the list of factors justifying ongoing monetary accommodation by the ECB. Moreover, the US Presidential outcome flags the risks of similarly anti-establishment outcomes at the Italian referendum and Austrian Presidential election in early December and general elections in the Netherlands, France and Germany next year. So, while the ECB's current asset purchase programme is due to expire in March, with the ECB's updated forecasts in December already likely to push back the point at which the inflation target can be achieved on a sustainable basis to 2019 at the earliest, and given that a tapering of its asset purchases would risk an unhelpful tightening of financial conditions, Trump's election victory would seem to increase the likelihood that the Governing Council will next month announce an extension of the QE programme at the current monthly pace of €80bn for a further six months to at least September 2017.

French business conditions remain broadly favourable

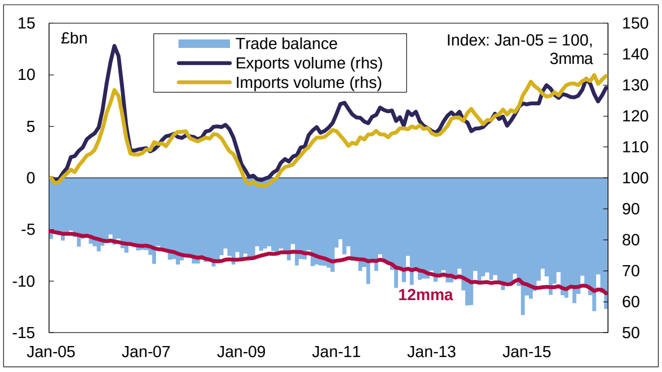
While the latest data were of secondary importance, the Bank of France's latest business sentiment survey suggested that conditions remained broadly favourable at the start of Q4. In particular, reflecting a moderate rise in output and fairly strong order books, the headline manufacturing indicator moved broadly sideways in October at 99, still slightly below the long-run average but nevertheless above the averages in Q2 and Q316. Meanwhile, with services activity having made further gains, the equivalent services sector index was similarly little changed in October at 97. And thanks to a rebound in construction output, as well as robust order books, the construction-related index rose 1pt to 99, the highest level since August 2011. So, based on the survey results, the central bank estimates that GDP growth will likely accelerate to 0.4%Q/Q in Q4, twice the rate seen in Q3. Admittedly, other business sentiment surveys – including the INSEE and Markit PMIs – have been slightly more downbeat at the start of Q4, suggesting that the French economy might well struggle to break out of the recent very subdued growth trend.

France: Business conditions and GDP growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Goods trade



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

The day ahead in the euro area and US

The flow of European manufacturing sector data continues tomorrow with the release of French and Italian IP for September. Similar to the German figures earlier in the week, industrial output in the second and third largest member states is expected to have fallen at the end of Q3 following significant growth in August of 2.1%M/M and 1.7%M/M respectively. In the US, meanwhile, tomorrow's data calendar brings just the weekly jobless claims figures and the Federal monthly budget statement for October. Supply-wise, the US Treasury will sell 30Y bonds.

UK

Trade supported GDP growth in Q3

Sterling depreciation since June's referendum – with the effective exchange rate down almost 15% – has made UK exporters more competitive in international markets. And while today's trade figures suggested that the UK's trade deficit increased significantly in September by £1.5bn to £5.2bn, the second highest level since the end of 2013, the outcome for the third quarter as a whole was much more upbeat. Indeed, the Q3 trade deficit fell by £1.6bn – the biggest quarterly improvement since Q214 – to £11.0bn, with goods trade fully accounting for the change. In terms of the geographical breakdown, the value of exports to non-EU countries increased by £2.3bn (5.9%Q/Q), while the value of imports rose only £0.4bn (0.8%Q/Q). In contrast, despite a notable pickup in the value of exports to the EU (6.2%Q/Q), the trade balance with the region deteriorated slightly last quarter. In terms of trade volumes, September saw a notable increase in imports by more than 4½%M/M, while exports were down by almost 1%M/M. Nevertheless, over the quarter as a whole, goods outflows were up by 1.7%Q/Q with goods inflows down 0.2%Q/Q, suggesting that net trade provided a positive contribution to the 0.5%Q/Q GDP growth in Q3.

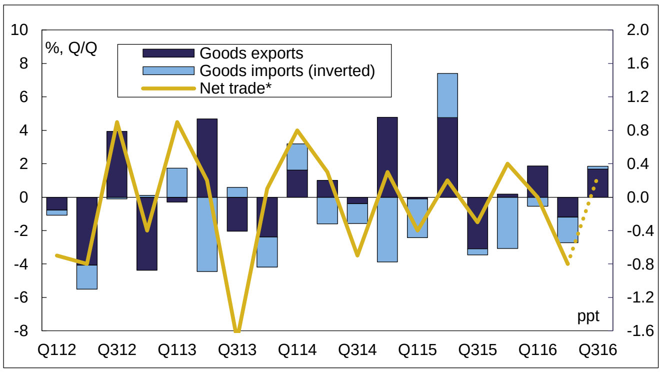
Investment outlook remains weak

Today also saw the BoE publish its latest business conditions indicators collected by its agents between late August and mid-October. Most notably, the survey suggested that overall business conditions had improved in both the services and manufacturing sectors, with activity growth having remained resilient. In contrast, however, construction output continued to fall despite the improvements seen in commercial real estate and housing markets. Meanwhile, consumer spending indicators were mixed: on the plus side, retail sales turnover was higher supported by increased demand for goods from overseas tourists on the back of weaker sterling. But the survey also suggested that domestic demand for new cars had continued to soften. The survey's forward looking indicators for business conditions were also less encouraging, with in particular the outlook for business investments over the coming twelve months remaining weak, as firms pointed to significant uncertainty about future demand and UK's trade arrangements. And this to a large extent reflects the BoE's concerns about the outlook for GDP growth over coming years, with last week's Inflation Report having revised down the GDP growth profile over the latter part of the forecast period – to about 1½%Y/Y throughout 2019, about ½ppt lower than previously projected.

The day ahead in the UK

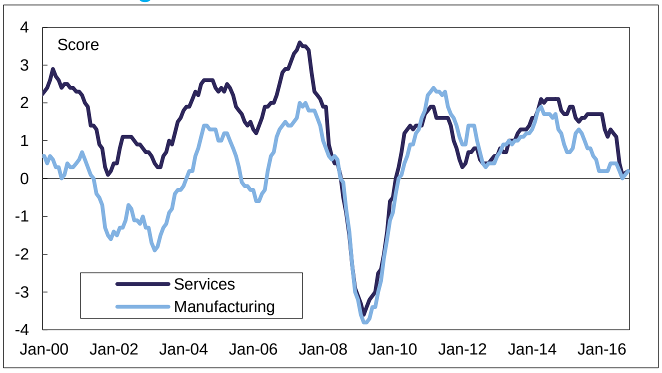
It should be a quiet day for new economic data releases in the UK on Thursday, with only the RICS Residential Market Survey due. The previous survey showed that upward pressure on house prices increased in September as housing demand improved, while supply continued to fall. Tomorrow's release for October is likely to paint a similar picture, with the net balance of survey respondents saying that prices are rising expected to remain little changed below 20%. Meanwhile, BoE Chief Economist Andy Haldane is scheduled to speak in Cambridge tomorrow.

UK: Trade indicators



**Net trade contribution to Q/Q GDP. Daiwa forecast for Q316.*
Source: ONS, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: BoE Agent scores - investment intentions



Source: BoE, 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**
France		Bank of France manufacturing sentiment indicator	Oct	**99**	99	98	**99**
UK		Visible trade balance £bn	Sep	**-12.7**	-11.4	-12.1	**-11.1**
		Total trade balance £bn	Sep	**-5.2**	-4.0	-4.7	**-3.8**

Country		Auction
Germany sold		€3.8bn of 2018 bonds (14-Dec-2018) at an average yield of -0.64%
UK		BoE APF operation purchased £1bn of 7-15Y Gilts (4.24 cover ratio)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
France		07:45	Industrial production M/M% (Y/Y%)	Sep	-0.3 (0.4)	2.1 (0.5)
		07:45	Manufacturing production M/M% (Y/Y%)	Sep	-0.1 (0.4)	2.2 (0.7)
Italy		09:00	Industrial production M/M% (Y/Y%)	Sep	-1.0 (2.2)	1.7 (4.1)
UK		00:01	RICS house price balance %	Oct	18	17
		15:00	BoE corporate bond purchases £mn	Weekly	-	2361

Auctions and events

Country		GMT	Auction / Event
EMU		14:50	ECB's Constancio scheduled to speak in Stockholm
UK		17:00	BoE's Haldane scheduled to speak in Cambridge

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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