

# Euro wrap-up

## Overview

- Bunds made gains at the shorter end of the curve as Mario Draghi once again highlighted concerns about the weakness of underlying inflation in the euro area.
- Gilts followed Treasuries lower on a quiet day for UK economic news.
- This weekend brings the first Presidential primary for the French Republican party, while the coming week brings the UK Chancellor's fiscal Autumn Statement and the flash euro area PMIs for November.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.665	-0.026
OBL 0 10/21	-0.359	-0.016
DBR 0 08/26	0.281	+0.001
UKT 1¼ 07/18	0.217	+0.011
UKT 3¾ 09/21	0.710	+0.031
UKT 1½ 07/26	1.473	+0.064

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

## Euro area

### Draghi again signals concerns about weak core inflation

On a relatively quiet end to the week for euro area economic news, in a speech in Frankfurt Mario Draghi maintained his recent dovish tone, most notably once again emphasising his concerns about the continued weakness of core inflation. Echoing comments earlier this week from ECB Vice President Constâncio, Draghi noted that the ECB did not 'yet see a consistent strengthening of underlying price dynamics' and that achieving 'a sustained adjustment in the path of inflation still relies on the continuation of the current, unprecedented financing conditions'. Indeed, acknowledging also that the 'the euro area recovery still relies to a considerable degree on accommodative monetary policy', in our opinion Draghi's comments provided further reason to expect the Governing Council to extend the asset purchase programme beyond next March at the current rate of €80bn per month when it meets next month.

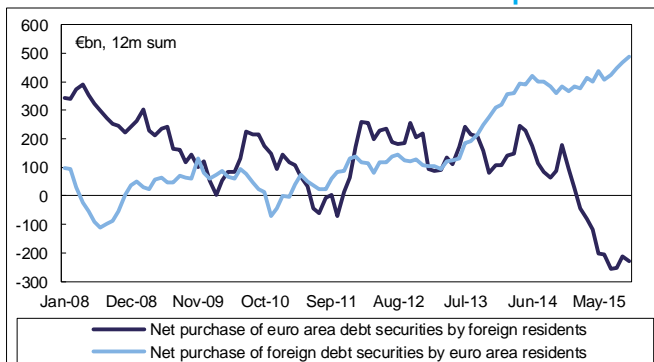
### Huge current account surplus remains symbol of structural weakness

Data-wise, the latest euro area balance of payments statistics revealed that the euro area current account surplus fell in September to its lowest level of the year so far, down more than €3½bn in seasonally adjusted terms to a nevertheless still large €25.3bn. While the goods trade surplus declined only slightly below the average of the year to-date, to a touch above €30bn, and the services trade surplus rose close to the 2016 average, the narrowing in the headline balance principally reflected a widening in the income deficit. Looking through the recent volatility, the cumulative 12-month surplus slipped back to a six-month low, although at €337bn (3.2% of GDP) it was still a touch higher than the equivalent figure one year earlier. And a counterpart of the large current account surpluses has been a continued strengthening of the euro area's international investment position – cumulative net purchases by euro area residents of foreign debt securities rose to more than €480bn in the twelve months to September, while non-residents reduced their holdings of euro area debt securities over that period by almost €230bn. The euro area current account surplus remains on track to remain the world's largest in nominal terms this year. And, if the recent weakening of the euro against the dollar to below \$1.06, the lowest in more than a year, is sustained or extended, the surplus seems likely to remain close to the present level in 2017 too – a persistent symbol of euro area structural weakness, reflecting the low level of investment relative to domestic savings and a factor contributing the region's ultra-low interest-rate environment.

### French Republican primary a three-horse race

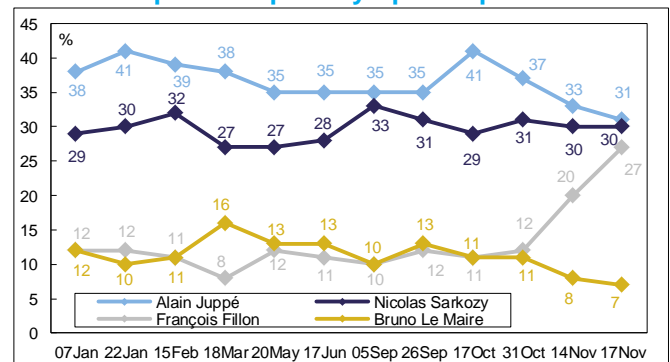
Perhaps the most significant event of the coming week will come on the political front, with the French centre-right Republican party set to hold its primaries to select its candidate for the 2017 presidential election. Although the independent former Economy Minister Emmanuel Macron might yet make a significant challenge, whoever wins the Republican primaries would

### Euro area: Financial account – net debt purchases



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

### France: Republican primary opinion poll results



Source: Ifop and Daiwa Capital Markets Europe Ltd.



seem most likely to face the far-right Front National leader Marine Le Pen in the run-off for the Presidency next May and – while we would certainly not be complacent about the ultimate outcome following the populist surges that led to Brexit and victory for Trump – would thus become bookmakers' favourite to become Head of State. The first Republican primary will be held this Sunday 20 November, with a run-off to be held a week later in the likely event that no candidate wins at least 50% of the vote in the first round.

The outcome of the Republican primaries looks incredibly difficult to predict. Opinion polls conducted in the past week reported a sizeable shift in support towards former Prime Minister François Fillon who advocates Thatcherite market-friendly reforms for the French economy – with a notable focus on the labour market – as well as (more controversially) closer ties with Russia. Before that shift had become evident, Alain Juppé, likewise a former Prime Minister, had seemed to be the clear favourite to win the Republican candidature. Also in favour of market-based economic reforms, including an end to the 35-hour working week, abolition of the wealth tax and significant cuts to public spending, but more conventional from a foreign policy perspective, Juppé's age (71 years, almost a decade older than Fillon) might possibly now be working against him. And since former President Nicolas Sarkozy, who has sought to share some of the Front National's anti-immigration rhetoric as well as some of the economic reform priorities of his Republican competitors, also cannot be ruled out, this looks to be a finely-balanced three-horse race.

## The week ahead in the euro area and US

The coming week's euro area economic data-flow will be dominated by the first notable survey results for November, which are expected to remain consistent with ongoing moderate economic growth in the euro area as a whole and a pickup in the pace of expansion in Germany in the current quarter. In particular, while Monday will be relatively uneventful for new releases, Tuesday will bring the Commission's preliminary estimate of euro area consumer confidence, while the flash PMIs are due the following day. Meanwhile, Thursday will bring the German Ifo business climate indices and GfK consumer confidence survey, as well as the French INSEE business survey, with the French consumer confidence indices due on Friday. Other data due in the coming week include the second estimates of German and Spanish GDP growth in Q3, as well as the expenditure breakdowns (both due Thursday) and Italian September retail and industrial sales figures (Friday). In addition, ECB President Draghi will speak at the European Parliament on Monday. And, in the bond markets, Germany will sell 10Y Bunds on Wednesday and Italy is scheduled to sell a range of bonds on Friday.

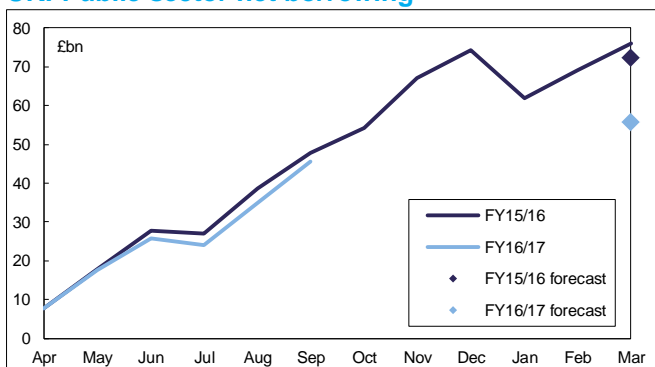
In the US, the coming week brings an assortment of new economic data including October's preliminary durable goods orders figures and November's flash University of Michigan consumer confidence survey (both Wednesday) and October's advance goods trade report (Friday). In addition, figures from the housing market will include October's existing home sales numbers (Tuesday) and new home sales figures for the same month and FHFA home price figures for September (Wednesday). And there might be further clues regarding the outlook for monetary policy as the minutes of the November FOMC meeting will be released on Wednesday. In the bond markets, the Treasury will sell 2Y Notes on Monday, 5Y Notes and 2Y FRNs on Tuesday, and 7Y Notes on Wednesday.

## UK

### Expectations of fiscal stimulus being played down...

In the immediate aftermath of the EU referendum, with concerns about the near-term economic outlook at their height, the prospect of a sizeable fiscal stimulus package being included in the Chancellor's Autumn Statement looked odds on. Certainly, Philip Hammond made all the right noises in the immediate aftermath of taking office, abandoning George Osborne's previous target of balancing the budget by 2019-20. But the subsequent performance of the economy, which grew by 0.5%Q/Q in Q3, well above most expectations, as well as an apparent desire by both the Chancellor and the Prime Minister to maintain at least the pretence of a commitment to fiscal rectitude, has seen repeated attempts to rein in expectations of a substantial stimulus package when the Autumn Statement is presented next Wednesday. Instead, a programme of infrastructure spending in the "low billions of pounds a year" is the line the media is now being fed.

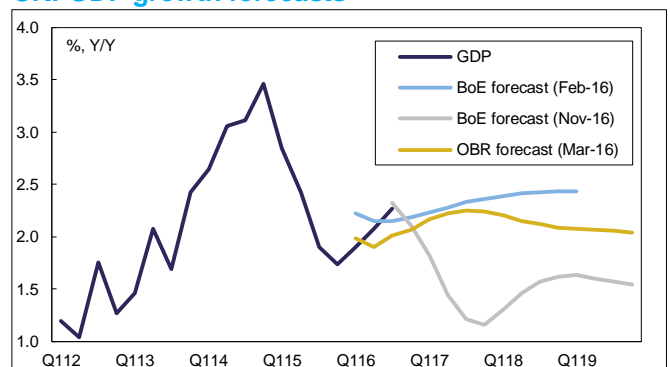
#### UK: Public sector net borrowing\*



\*Excluding public sector banks.

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

#### UK: GDP growth forecasts



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

## ...in part because of much-worse fiscal position

Notwithstanding that the Chancellor is set to be more cautious than he initially indicated, the position of the UK's public finances is significantly worse than anticipated at the time of the March Budget. For the first six months of the year public sector net borrowing was £45.5bn, well behind the improvement anticipated by the Office for Budget Responsibility (OBR) in its March forecast, and implying (if the trend of the first half of the year continues into the second) that the deficit will be a full £17bn above that expected. And, looking further ahead, the position of the public finances is set to remain much weaker than expected before the EU referendum. While the economy has performed better than expected, there is no denying that Brexit has had a downward impact on growth, and one that is likely to intensify as (a) rising inflation increasingly eats into real income growth and (b) Brexit itself moves closer. Certainly, the BoE expects a significant slowdown in growth over coming months, something that the OBR will also have to do to a greater or lesser extent. Slower growth, of course, means lower tax receipts and higher spending, with the upward pressure on expenditure compounded by higher inflation. The OBR will also have to take a longer-term view of growth than the BoE, forecasting out to 2022. This will force it to make assumptions about both the nature of Brexit (hard, soft, something in between) and its impact on the potential growth rate of the economy, not least as a result of the anticipated impact on net migration following Brexit. So there is no doubt that the OBR will forecast a significantly larger deficit, by up to £25bn, in 2019-20 than it did in March, with the debt stock falling (if indeed it is forecast to fall at all) at a much slower rate than previously expected. This will highlight both the damage to the public finances from Brexit and the Chancellor's limited room for manoeuvre.

## If growth slows, up to BoE to act



And it is this limited room for manoeuvre that will ultimately be driving his reticence to launch any meaningful fiscal stimulus. Indeed, fiscal policy, in aggregate, will continue to tighten over the next five years – the Chancellor will be willing to do little more than let the automatic stabilisers operate (whereby tax receipts fall and government spending on welfare automatically rises) as the economy slows. This, of course, will lessen the impact of the fiscal tightening, but will not fully mitigate it. As such, as the economic uncertainty surrounding Brexit intensifies with the triggering of Article 50, fiscal policy will be working to dampen, not boost, growth, whatever minor infrastructure spending Hammond announces next week. That, in turn, will put the pressure back on the BoE to act if growth slows more precipitously than it anticipates.

## The week ahead in the UK

Data-wise, the most notable releases in the coming week are due on Friday with the second estimate of Q3 GDP. The initial release showed growth of 0.5%Q/Q, significantly higher than expected, but still 0.2ppt lower than Q2. The coming week's figures will most likely leave that estimate unrevised, with the first information on the expenditure breakdown to almost certainly show that private consumption drove growth, while investment growth fell notably on the back of a rise in uncertainty in the wake of the Brexit vote. Meanwhile, ahead of the Chancellor's Autumn Statement the ONS will publish the latest public finance figures for October on Tuesday. Among other new economic data in the coming week are the BBA lending figures from major retail banks and the CBI surveys – the Distributive Trades survey is due on Tuesday and the Industrial Trends survey is out on Friday.






















**The next edition of Euro wrap-up will be published on 22 November 2016.**

## European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Current account balance €bn	Sep	25.3	-	29.7	29.1
Italy	 Current account balance €bn	Sep	2.8	-	3.4	-
Country	Auction	- Nothing to report -				













Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's data calendar

Key data releases						
Country		GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
<b>Monday 21 November 2016</b>						
EMU		14:45	ECB public sector asset purchases €bn	Weekly	<u>16.5</u>	16.8
Spain		09:00	Trade balance €bn	Sep	-	-2.6
<b>Tuesday 22 November 2016</b>						
EMU		15:00	Preliminary consumer confidence	Nov	-7.8	-8.0
UK		09:30	Public sector net borrowing excluding interventions £bn	Oct	6.0	10.6
		11:00	CBI Industrial Trends survey, total orders	Nov	-8	-17
<b>Wednesday 23 November 2016</b>						
EMU		09:00	Preliminary manufacturing PMI	Nov	53.3	53.5
		09:00	Preliminary services PMI (preliminary composite PMI)	Nov	52.9 (53.3)	52.8 (53.3)
Germany		08:30	Preliminary manufacturing PMI	Nov	54.9	55.0
		08:30	Preliminary services PMI (preliminary composite PMI)	Nov	54.0 (55.1)	54.2 (55.1)
France		08:00	Preliminary manufacturing PMI	Nov	51.5	51.8
		08:00	Preliminary services PMI (preliminary composite PMI)	Nov	52.0 (52.0)	51.4 (51.6)
<b>Thursday 24 November 2016</b>						
Germany		07:00	GDP – second release Q/Q% (Y/Y%)	Q3	<u>0.2 (1.7)</u>	0.4 (1.8)
		09:00	Ifo business climate index	Nov	110.5	110.5
		09:00	Ifo current assessment balance (expectations)	Nov	115.0 (106.1)	115.0 (106.1)
		07:00	GfK consumer confidence survey	Dec	9.7	9.7
France		07:45	Business confidence indicator (production outlook)	Nov	101 (-)	101 (2)
Spain		08:00	GDP – second release Q/Q% (Y/Y%)	Q3	<u>0.7 (3.2)</u>	0.8 (3.2)
UK		09:30	BBA loans for house purchase 000s	Oct	39.0	38.3
		15:00	BoE corporate bond purchases £mn	Weekly	-	3070
<b>Friday 25 November 2016</b>						
France		07:45	Consumer confidence survey	Nov	98	98
Italy		09:00	Industrial sales M/M% (Y/Y%)	Sep	-	4.1 (6.8)
		09:00	Industrial orders M/M% (Y/Y%)	Sep	-	10.2 (15.9)
		09:00	Retail sales M/M% (Y/Y%)	Sep	0.2 (-0.1)	-0.1 (-0.2)
UK		09:30	GDP – second release Q/Q% (Y/Y%)	Q3	<u>0.5 (2.3)</u>	0.7 (2.1)
		09:30	Index of services M/M% (3M/3M%)	Sep	0.2 (0.8)	0.2 (0.8)
		11:00	CBI Distributive Trades survey, retail sales	Nov	12	21

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's events/auctions calendar

Key events & auctions			
Country		GMT	Event / Auction
<b>Monday 21 November 2016</b>			
EMU		16:00	ECB's Cœuré scheduled to speak in Munich
		16:30	ECB's Draghi scheduled to speak at European Parliament in Strasbourg
		17:00	ECB's Nouy scheduled to speak in Rome
UK		14:50	BoE APF operation: To purchase 3-7Y Gilts
<b>Tuesday 22 November 2016</b>			
UK		10:30	Auction: To sell £2.5bn of 1.5% 2026 bonds (22-Jul-2026)
		14:50	BoE APF operation: To purchase 15Y+ Gilts
<b>Wednesday 23 November 2016</b>			
Germany		10:30	Auction: To sell €3bn of 0% 2026 bonds (15-Aug-2026)
UK		12:30	Chancellor Philip Hammond to deliver Autumn Statement 2016
		14:50	BoE APF operation: To purchase 7-15Y Gilts
<b>Thursday 24 November 2016</b>			
EMU		16:10	ECB's Praet scheduled to speak in Vienna
<b>Friday 25 November 2016</b>			
Italy		10:00	Auction: To sell bonds
		10:00	Auction: To sell index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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