Euro wrap-up

Overview

- Bunds made modest losses today as euro area Q3 GDP growth was confirmed at 0.3%Q/Q and German factory orders exceeded expectations.
- Gilts also made modest losses as the Commission's Chief Brexit negotiator highlighted the weakness in the UK's bargaining position.
- Tomorrow brings October's industrial production releases from Germany and the UK, as well as French trade figures for the same month.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.700	+0.011
OBL 0 10/21	-0.341	+0.037
DBR 0 08/26	0.377	+0.044
UKT 1¼ 07/18	0.135	+0.024
UKT 3¾ 09/21	0.608	+0.027
UKT 1½ 07/26	1.418	+0.014

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

Euro area

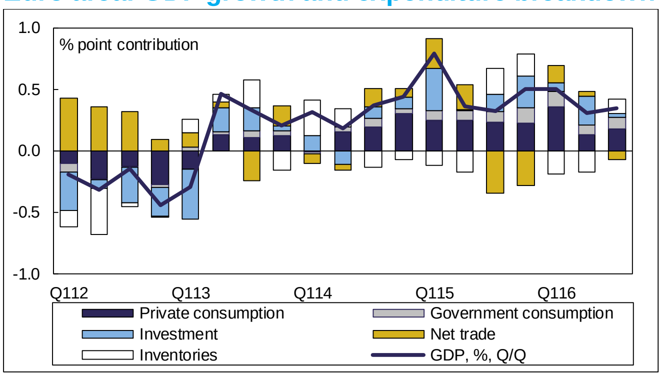
Euro area Q3 GDP growth confirmed at 0.3%Q/Q

Today's revised euro area GDP figures for Q316 were as expected, confirming that growth was unchanged at 0.3%Q/Q for the second successive quarter. But with growth downwardly revised in Q315, by 0.1ppt to 0.3%Q/Q, the year-on-year rate was revised up slightly from the preliminary release to 1.7% for the third consecutive quarter. The expenditure breakdown unveiled nothing overly surprising either. GDP growth in the euro area was overwhelmingly supported by domestic demand, with private consumption growth of 0.3%Q/Q a touch firmer than in Q2, albeit still less than half the rate in the first quarter of the year. Government spending growth of 0.5%Q/Q provided a modest boost to growth for the seventh consecutive quarter, while private sector inventories similarly added 0.1ppt to quarterly GDP growth. But investment came in a touch weaker than expected with an increase of 0.2%Q/Q providing a negligible contribution to growth, albeit from an upwardly revised increase of 1.2%Q/Q previously. Also, contrasting markedly with the second quarter, exports broadly flatlined in Q3 with growth of 0.1%Q/Q the weakest since Q412. And with imports up 0.2%Q/Q, net trade subtracted 0.1ppt from growth in Q3.

Germany's manufacturing output to bounce back in Q4

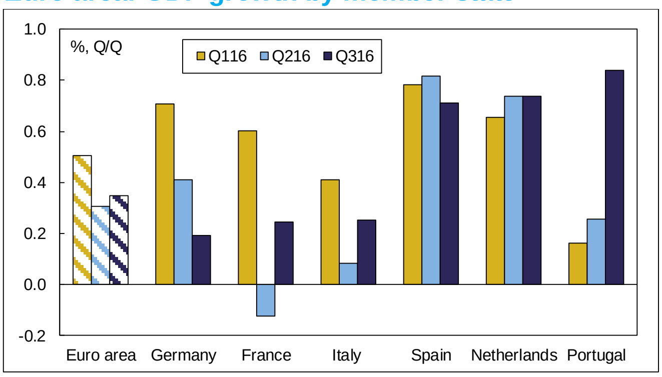
There were no surprises in the country breakdown either, with the outperformance of Spain (0.7%Q/Q) contrasting markedly with that of the other larger member states: today's release confirmed only modest growth in Germany (0.2%Q/Q), France (0.2%Q/Q) and Italy (0.3%Q/Q), albeit the latter two were stronger than in Q2. But there are reasons to be cautiously optimistic that economic conditions in Germany have improved in Q4. Certainly, business and consumer sentiment indicators have so far been consistent with an acceleration in economic growth in the current quarter. And today's German factory orders for October brought a significant upside surprise, with total orders up 4.9% on the month, the strongest reading since mid-2014 and the second-strongest since the series began in 1990. And the improvement was driven by a more than 6%M/M increase in domestic orders, as well as a more than 6%M/M increase in new orders from overseas, excluding other member states, with a more than 7%M/M increase in orders for capital goods perhaps more positive for the near-term capex outlook. While we would expect to see some payback for this strength over coming months, the near-2½% increase in orders on a three-month basis was the firmest such pace since August 2013 and bodes well for German manufacturing output growth in the fourth quarter. And this further supports our view that the largest member state's economy expanded at a much faster pace than last quarter.

Euro area: GDP growth and expenditure breakdown



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

Euro area: GDP growth by member state



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

The day ahead in the euro area and US

Tomorrow brings Germany's industrial production data for October, which, in line with recent positive manufacturing sentiment surveys and today's orders releases, are expected to show that output rose at the start of Q4, by almost 1%M/M, following a notable decline at the end of last quarter. The latest French trade figures for October are also due. In the markets, Germany will sell 2Y bonds. In the US, meanwhile, Wednesday brings just consumer credit figures for October.

UK

Barnier highlights weakness of UK's position

Today saw Michel Barnier, the European Commission's Chief Negotiator on Brexit, hold his first press conference in his new role. And his message, while hardly surprising to anyone with more than a passing knowledge of the EU or who has listened to the consistent messages coming out of EU capitals since the referendum, highlighted the weakness of the UK's negotiating position. In particular, he stated that the UK will not be able to "cherry-pick" what elements of EU membership it wanted to keep (e.g. single market access) without abiding by the obligations of membership (e.g. free movement of people). He was also at pains to spell out that the actual time that will be available for Article 50 negotiations is not in reality 2 years, but closer to 18 months given the need to ratify any agreement through the EU Parliament (and possibly other national Parliaments). And given that those 18 months will be focussed on discussing the terms of the divorce, rather than necessarily the terms of the post-Brexit relationship between the UK and the EU, this highlighted the significant risk that the UK ends up leaving under a 'hard' Brexit scenario, with no post-Brexit agreement in place. As such, there was nothing in Barnier's comments to suggest a softening in attitudes among the European Commission at least. And with Barnier insisting that there will be no discussions on Brexit until the UK triggers Article 50 (a pledge that EU leaders have stuck to religiously so far) we are unlikely to get any more detail on the EU's thinking until the end of March, by which time Theresa May hopes to have triggered Article 50.

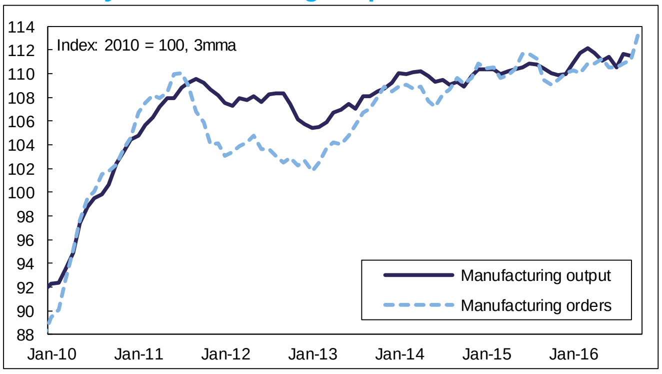
Consumer spending remains the key source of growth in Q4

In a wide-ranging speech last night Mark Carney reiterated that the MPC is prepared to tolerate a period of above-target inflation without raising rates, albeit not without limits. However, he struck a cautious tone on the economy noting that while recent economic data continue to suggest solid growth ahead, with consumption having accounted for the largest share of the GDP growth in recent quarters, he also expressed some concern that "episodes of consumption-led growth tends to be both slower and less durable". And the BRC Retail Sales monitor released today suggested that consumer spending remains the key driver of growth so far in Q4. Total sales growth moderated in November from 2.4%Y/Y, which was the highest pace in nine months, to a still-robust and above-average rate of 1.3%Y/Y, while same store sales increased by 0.6%Y/Y. Within the details, despite the boost in the last week of the month from Black Friday discounting, it would appear that food sales provided the largest contribution to the headline rate.

The day ahead in the UK

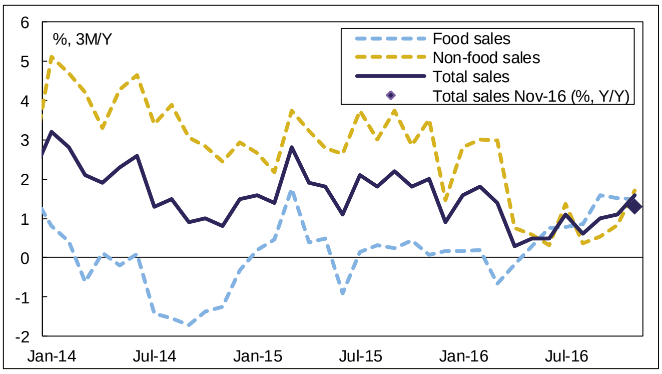
UK exporters should be the main beneficiaries of the sharp drop in the value of sterling following the Brexit vote. However, while a boost to exports and output can be seen in survey data, it is yet to show up in the hard economic indicators. And while tomorrow's release of industrial production figures are expected to show an increase in manufacturing output in October, this is set to leave the three-month on three-month pace only slightly above zero and the annual rate of growth below 1%.

Germany: Manufacturing output and orders



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: BRC Retail Sales monitor



Source: 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
EMU		GDP – third release Q/Q% (Y/Y%)	Q3	**0.3 (1.7)**	*0.3 (1.6)*	0.3 (1.6)	-
Germany		Factory orders M/M% (Y/Y%)	Oct	**4.9 (6.3)**	0.6 (1.6)	-0.6 (2.6)	**-0.3 (2.9)**
UK		BRC Sales like-for-like Y/Y%	Nov	**0.6**	1.7	1.7	-
Country		Auction					
UK sold		£2.5bn of 1.5% 2026 bonds (22-Jul-2026) at an average yield of 1.394%					
		BoE APF operation purchased £1bn of 15Y+ Gilts (3.00 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
Germany		07:00	Industrial production M/M% (Y/Y%)	Oct	0.8 (1.6)	-1.8 (1.2)
France		07:45	Trade balance €bn	Oct	-4.4	-4.8
		07:45	Current account balance €bn	Oct	-	-3.4
Italy		09:00	Unemployment rate %	Q3	11.6	11.5
UK		08:30	Halifax house price index M/M% (3M/Y%)	Nov	0.2 (5.9)	1.4 (5.2)
		09:30	Industrial production M/M% (Y/Y%)	Oct	0.2 (0.5)	-0.4 (0.3)
		09:30	Manufacturing production M/M% (Y/Y%)	Oct	0.2 (0.7)	0.6 (0.2)
		15:00	NIESR GDP 3M/3M%	Nov	0.4	0.4

Auctions and events

Country		GMT	Auction / Event
Germany		10:30	Auction: To sell €3bn of 0% 2018 bonds (14-Dec-2018)
UK		10:30	Auction: To sell £2.25bn of 1.5% 2047 bond (22-Jul-2047)
		14:50	BoE APF operation: To purchase 7-15Y Gilts

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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