

# Euro wrap-up

## Overview

- Bunds made gains as Merkel's CDU/CSU alliance underperformed expectations in Sunday's German election and the latest German Ifo business survey was also weaker than the consensus forecast.
- Gilts also made gains on a quiet day for economic news from the UK.
- Tuesday will bring a French business survey and UK bank lending data, with a French consumer survey and UK business survey following on Wednesday.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 09/19	-0.711	-0.028
OBL 0 10/22	-0.305	-0.047
DBR 0½ 08/27	0.401	-0.045
UKT 1½ 07/19	0.439	-0.008
UKT 0½ 07/22	0.755	-0.013
UKT 4½ 12/27	1.337	-0.020

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

## Euro area

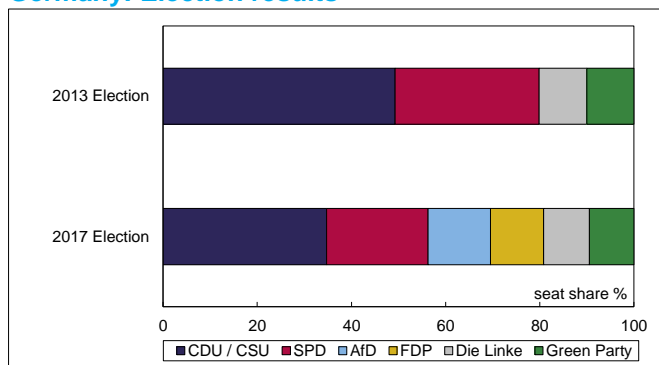
### Germany heading for an unstable coalition

The euro weakened and Bunds outperformed other euro area sovereigns today after yesterday's German general election saw Angela Merkel win a fourth term as Chancellor but left her authority diminished after her CDU/CSU alliance performed below expectations with about only one third of the vote, down from 41.5% at the previous election. With the SPD doing poorly, with barely more than one fifth of votes, the far-right AfD was the party to crow, outperforming expectations to gain a share of almost 13%. With the SPD unwilling now to reprise its role as junior partner in coalition with the CDU/CSU, Germany looks most likely now to be heading for a previously untested 'Jamaica' coalition with the pro-market FDP and Greens. However, there are significant differences of position between the parties on certain issues, not least those related to further development of the euro area's policy framework. So, discussions on a programme for government will be lengthy, probably at best taking at least a couple of months if not longer. We also still do not rule out the possibility that no coalition agreement will be reached, in which case Merkel could have to seek a 'confidence and supply' deal to back a minority CDU/CSU government with limited support from certain other parties on a case-by-case basis. Certainly, even if a Jamaican coalition is indeed formed, it could yet still prove unstable and ultimately short-lived.

### Bad news for future euro area policy integration?

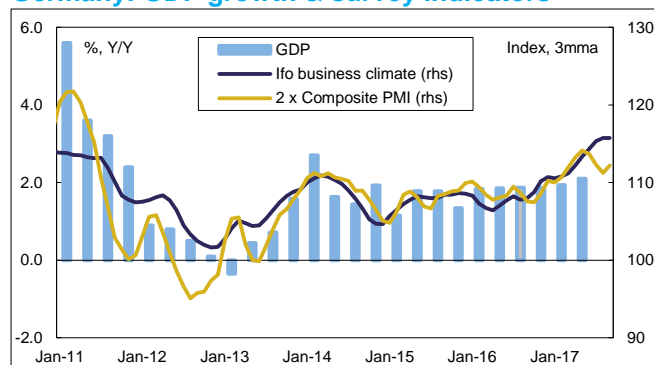
While in many respects, the German policy outlook is clouded by the election, there are many areas where little will change. Most notably, on fiscal policy, we certainly don't expect a significant deviation from current German fiscal policy-settings, with no dilution of the commitment to a balanced government budget. And regardless of the election, there was never any doubt that Germany under Merkel's leadership would take a continued cautious approach to further development of the euro area policy framework. Nevertheless, the rise of the AfD, as well as the FDP – which also opposes any significant further fiscal integration among euro area member states – could spell bad news for French President Macron, who recently proposed a suite of reforms to the euro area policy framework, including the creation of certain common euro area budgetary capacities and finance minister, and steps towards establishment of a European Monetary Fund. And Macron himself took an electoral blow on the weekend, as his La République en Marche (REM) party won less than 8% of the seats in the French Senate (upper house) elections yesterday while the centre-right Republicans maintained their majority. But while that illustrates how far Macron's star has fallen in France since he came to office earlier in the summer, it will not be a show-stopper for his economic reform agenda, not least as the National Assembly, where his coalition has a large majority, has the final say on most legislation. And, anyway, on Friday he already signed into law his key labour market reforms.

### Germany: Election results



Source: Deutscher Bundestag and Daiwa Capital Markets Europe Ltd.

### Germany: GDP growth & survey indicators



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



## Ifo survey points to firm expansion despite September setback

While the German election result appeared to be bad news for those, not least countries in the euro area's southern periphery, who have pinned their hopes on further euro area policy integration, today's economic data also disappointed. Contrasting with the message from last week's flash PMIs that the German economy regained some momentum at the end of this quarter, the headline Ifo business climate index fell in September to a three-month low, as firms felt a little less upbeat about both the current situation and the near-term economic outlook. Nevertheless, the deterioration signalled was not at all marked, and the headline Ifo index remains within reach of its series high. At the sectoral level, the Ifo survey suggested that, while their production plans remained consistent with ongoing expansion, manufacturers had become more cautious, and wholesalers were also less optimistic. However, retailers were more upbeat and signalled plans to increase prices, while construction firms suggested that conditions in their sector were the best since reunification. Certainly, overall, like the PMIs, the Ifo indices remain consistent with continued firm economic growth in Germany close to the 0.6%Q/Q rate of Q2.

## The coming two days in the euro area and US

The coming two days in the euro area will bring further economic survey results for September, with the French INSEE business conditions and consumer confidence indices due tomorrow and Wednesday respectively, and the Italian ISTAT economic sentiment indices also due Wednesday. In addition, French jobseeker data for August are due on Tuesday while euro area bank lending figures for the same month are due on Wednesday. In the bond markets, tomorrow Germany will sell 2Y notes and Italy will sell index-linked and 2Y zero-coupon bonds.

In the US, tomorrow financial market participants will watch closely Janet Yellen's speech on 'Inflation, Uncertainty and Monetary Policy' at the NABE conference, although whether she will offer further insights to those provided in her press conference last week remains to be seen. Data-wise, tomorrow will bring August new home sales and the July S&P CoreLogic Case-Shiller home price data along with the September Conference Board consumer confidence indices. On Wednesday preliminary durable goods data for August as well as pending home sales figures for the same month are due. In the bond markets, the Treasury will sell 2Y notes tomorrow, and 5Y notes and 2Y FRNs on Wednesday.

## UK

### The coming two days in the UK




The only economic data release of note tomorrow will be the latest BBA figures from the major High Street banks, which, ahead of the official BoE lending data release on Friday, are likely to confirm that consumer credit continued to grow rapidly in August. The Financial Policy Committee Statement from the latest meeting published today once again voiced policy makers' concerns about this type of lending. Although the Committee acknowledged that it should not represent a risk to economic growth as consumer credit is only 11% of total household debt, in the event of widespread defaults, losses could be significantly higher than banks themselves have estimated. Meanwhile, on Wednesday the CBI will release its Distributive Trades Survey for September. Last week's official retail sales figures for August were stronger than expected showing an increase of 1.0%M/M. However, while the CBI survey might point to another strong month, we expect the official data in due course to show slower growth in retail sales.

*In the absence of any significant developments, the next edition of the Euro wrap-up will be published on 27 September 2017.*

## European calendar

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 ECB public sector asset purchases €bn	Weekly	11.9	11.5	11.0	-
Germany	 Ifo business climate index	Sep	115.2	116.0	115.9	-
	 Ifo current assessment balance (expectations)	Sep	123.6 (107.4)	124.7 (108.0)	124.6 (107.9)	124.7 (107.8)



#### Auctions

Country	Auction
- Nothing to report-	





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's data releases

#### Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
France	 07:45	Manufacturing confidence (production outlook)	Sep	110 (-)	111 (20)
UK	 09:30	BBA mortgage approvals '000	Sep	41.7	41.6

#### Auctions

Country	BST	Auction / Event
Germany	 10:30	Auction: To sell €4bn of 0% 2019 bonds (13-Sep-2019)
Italy	 10:00	Auction: To sell up to €1.5bn of 0% 2019 bonds (30-May-2019)
	 10:00	Auction: To sell 0.1% 2022 index-linked bonds (15-May-2022)
	 10:00	Auction: To sell 1.25% 2032 index-linked bonds (15-Sep-2032)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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