

Euro wrap-up

Overview

- Bunds were little changed as the flash PMIs signalled strong euro area GDP growth in Q4.
- Gilts made gains as Q3 GDP data reinforced the impression from yesterday's budget that the UK economy is now stuck in the slow lane.
- A quiet end of the week will bring only the German Ifo business survey and the latest UK bank lending data.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 09/19	-0.720	+0.002
OBL 0 10/22	-0.329	+0.005
DBR 0½ 08/27	0.347	-0.001
UKT 1¾ 07/19	0.456	-0.009
UKT 0½ 07/22	0.730	-0.024
UKT 4¼ 12/27	1.252	-0.023

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

Euro area

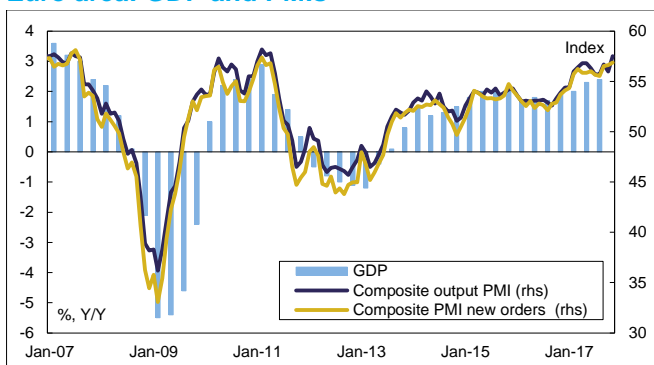
Flash PMIs suggest strong growth towards year-end

After data yesterday suggested that euro area consumer optimism is now well above average at the highest level since January 2001, today's flash PMIs for the current month suggested that businesses in the euro area are very upbeat too. Having slipped back last month to 56.0, close to the average for the year to-date, the euro area composite PMI leapt a larger-than-expected 1.5pts in November to 57.5, the highest since April 2011 and a level consistent with an acceleration in GDP growth in the current quarter from 0.6%Q/Q in Q3. Manufacturing appears to be leading the way, with that sector's headline PMI up 1.5pts to 60.0, a level beaten only once since the inception of the euro, thanks not least to record growth in new export orders. Meanwhile, the services PMI also rose more than 1pt, to 56.2, just shy of the six-year highs reached in the spring. With other survey detail suggesting that employment is rising at the fastest rate in sixteen years, and that order books across the economy as a whole are the thickest in more than six years, the PMIs suggest that firm economic growth momentum should be maintained into the New Year. The ECB will also have been pleased to see the PMIs for both input and output prices likewise rising to their highest in six years, suggesting that underlying cost pressures might also be starting to stir.

Robust momentum in Germany and France

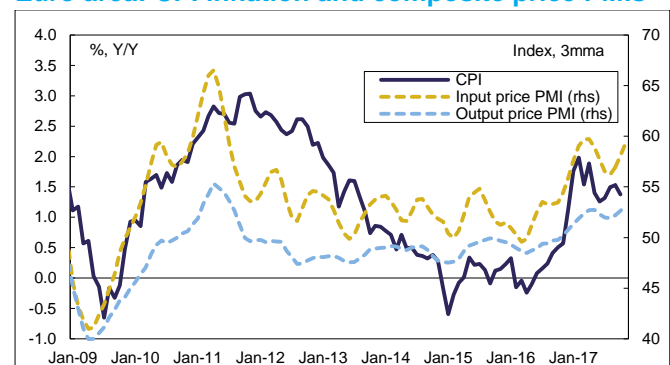
At the country level, the flash PMIs suggested strong economic growth momentum in Germany and France. In particular, the French composite PMI rose a whopping 2.7pts to a six-and-a-half-year high of 60.1, with strong gains registered in the manufacturing and services PMIs alike which similarly reached the highest since 2011. Those results tallied with an improved INSEE business survey, so all evidence from the corporate sector appears to point to a pickup in French economic growth in Q4 from 0.5%Q/Q in Q3. In addition, the German flash composite PMI rose 1pt in November principally thanks to a better showing in the manufacturing sector to a near seven-year high, to suggest that GDP growth in Q4 could match the 0.8%Q/Q rate of Q3, which was confirmed today. That growth in Q3 saw the level of German output compared to a year earlier rise a robust 2.8%Y/Y, the strongest such rate in six years. The detail of the expenditure breakdown, released for the first time today, showed that, while consumer confidence remains exceptionally strong, private consumption actually slipped back by 0.1%Q/Q to represent the first decline since the end of 2013. And around one half of all growth on the quarter was accounted for by inventory accumulation. But fixed investment also rose thanks to a vigorous 1.5%Q/Q (4.6%Y/Y) increase in machinery and equipment capex. German GDP also benefited from improved global demand, with net trade adding 0.4ppt to GDP growth, with exports up 1.7%Q/Q and imports up a more moderate 0.9%Q/Q. In contrast to Q3, we expect German growth in Q4 to be driven by consumer spending and construction investment, with capex on machinery and equipment, as well as exports, remaining firm too.

Euro area: GDP and PMIs



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

Euro area: CPI inflation and composite price PMIs



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



Private-sector bonds to account for larger share as ECB QE slows

Policy-wise, the account of the ECB's October Governing Council meeting, where the asset purchase programme was extended from January through to September at the slower rate of €30bn per month with a broad consensus, shone further light on the range of members' views on the decision to keep the QE programme open-ended. Indeed, while that decision was taken so to avoid a sudden tightening of financial conditions via market developments, the account made clear that some officials were concerned not to raise expectations of further asset purchases beyond next September. That view tallies with the opinion expressed in an interview published yesterday by Executive Board member Cœuré that additional asset purchases might be unnecessary by next autumn – we suspect, however, that other key Board members, not least President Draghi, will favour a gradual taper to zero over the final quarter of 2018, and so that remains our baseline forecast for the programme. Separately, ahead of the ECB's next monetary policy announcement on 14 December, at which the precise detail of the €30bn per month of purchases from January will be unveiled, the account confirmed our assumption that the purchases of private sector securities – covered and corporate bonds – will not drop proportionately with the overall decline in QE.

The day ahead in the euro area and US

Friday will bring the German Ifo business survey results for November. While political uncertainty might weigh slightly on the expectations index, today's upbeat PMIs point to improvement in the current conditions index, which could well rise above the post-reunification high of 125.7 reached in July. September sales and new orders data from the Italian industrial sector, which is also currently seeing a solid expansion, are also due. Black Friday in the US will see only the preliminary November PMIs released.

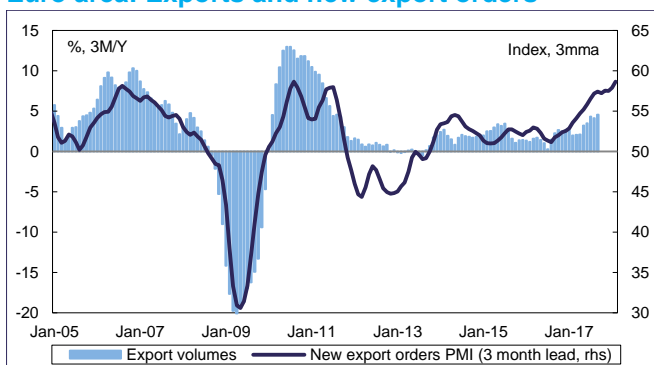
UK

GDP growth continues to lag

There were no surprises in today's second release of the Q3 UK GDP growth figures, with the headline rates of 0.4%Q/Q and 1.5%Y/Y fully aligning with the flash estimates. So, the most interesting news was the expenditure breakdown. Most notably, it showed that private consumption rose by 0.6%Q/Q, up from 0.2%Q/Q in Q2. It appears that this pattern was at least partly driven by changes in the new car market, which was suppressed in Q2 after an increase in Vehicle Exercise Duty, and then recovered to some extent in Q3. And so looking through this distortion, the average growth in consumption in these two quarters was broadly similar to the pace seen in Q117 and Q416. Meanwhile, after yesterday's UK budget provided a reminder of the UK's woeful productivity, today's figures highlighted that, against a backdrop of intense business uncertainty around Brexit, investment growth remains anaemic. Total investment rose by only 0.2%Q/Q, the slowest pace in almost two years, leaving it up only 1.8% compared to a year earlier, and only around 7% higher than its level in Q107. While business investment was somewhat higher relative to its pre-crisis level, in Q317 it increased at the same subdued 0.2%Q/Q pace. Housing investment also provided only a very small positive contribution.

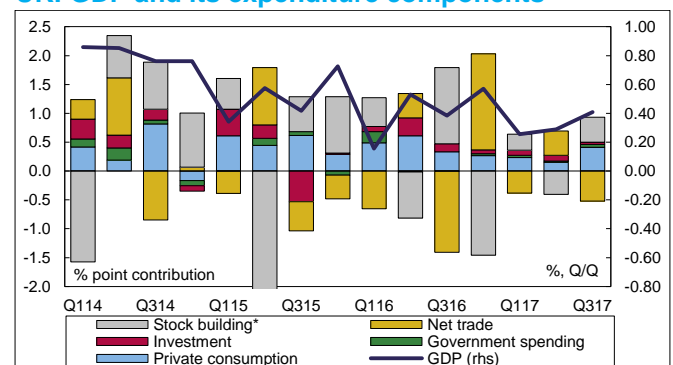
With regard to trade, the figures were broadly as expected, with exports falling by 0.7%Q/Q and imports rising by 1.1%Q/Q with net exports providing a negative growth contribution of 0.5ppt. So, despite a significant pickup in global economic momentum, including in the UK's main trading partners, and the significantly weaker exchange rate, this left the total cumulative net trade contribution to GDP growth over the five quarters since the Brexit referendum at -0.2ppt. Overall, while today's figures confirmed that the pace of GDP growth was marginally faster compared to previous quarters, they were hardly encouraging. In terms of annual growth, the UK remained at the back of the pack among the G7 and almost all other EU countries. And with most other economies seemingly on track to maintain the elevated momentum this quarter and possibly beyond, the UK looks set to continue to lag behind for many quarters to come.

Euro area: Exports and new export orders



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

UK: GDP and its expenditure components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

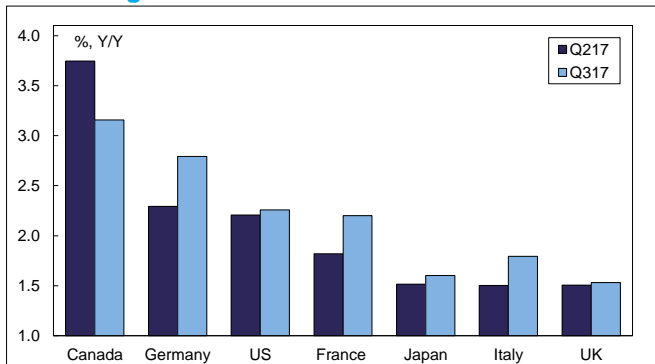
Decent demand on the High Street despite rising prices

Today's CBI Distributive Trades survey signaled that November might have been a better month for UK retailers. A net 26% of survey respondents, significantly higher than the recent average and up from -36% in October, which was the lowest level since early 2009, reported a pick-up in sales relative to a year ago. And this was despite a particularly sharp increase in average sale prices, the indicator for which rose to the highest level in more than twenty-six years. Orders also recovered notably, while stock levels eased slightly. So, while demand this month appears to have been firmer, which is encouraging ahead of the peak festive season sales, it remains to be seen if that will be maintained going forward, a key factor for the outlook for household spending in Q4, with the average figures suggesting that retail sales growth in Q4 so far is behind that in Q2 and Q3.

The day ahead in the UK

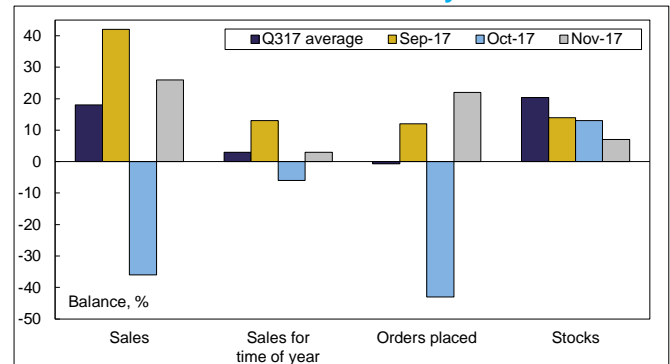
The end of the week brings only the latest BBA lending figures from major retail banks, which are expected to show that mortgage approvals moderated in October.

UK: GDP growth in G7 economies*



*Q317 forecast for Canada. Source: Thomson Reuters, Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: CBI Distributive Trades Survey - retail sales













Source: CBI, 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	 Preliminary manufacturing PMI	Nov	60.0	58.2	58.5	-
	 Preliminary services PMI (preliminary composite PMI)	Nov	56.2 (57.5)	55.2 (56.0)	55.0 (56.0)	-
Germany	 GDP – final release Q/Q% (Y/Y%)	Q3	0.8 (2.8)	<u>0.8 (2.8)</u>	0.6 (2.3)	-
	 Preliminary manufacturing PMI	Nov	62.5	60.4	60.6	-
	 Preliminary services PMI (preliminary composite PMI)	Nov	54.9 (57.6)	55.0 (56.7)	54.7 (56.6)	-
France	 Manufacturing confidence (production outlook)	Nov	112 (31)	111 (33)	111 (31)	- (30)
	 Preliminary manufacturing PMI	Nov	57.5	55.9	56.1	-
	 Preliminary services PMI (preliminary composite PMI)	Nov	60.2 (60.1)	57.0 (57.2)	57.3 (57.4)	-
UK	 GDP – second release Q/Q% (Y/Y%)	Q3	0.4 (1.5)	<u>0.4 (1.5)</u>	0.4 (1.5)	-
	 CBI Distributive Trades survey, retail sales	Nov	26	3	-36	-




Auctions

Country	Auction
- Nothing to report -	



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany	 09:00	Ifo business climate index	Nov	116.7	116.7
	 09:00	Ifo current assessment balance (expectations)	Nov	125.0 (108.8)	124.8 (109.1)
UK	 09:30	BBA mortgage approvals '000	Oct	40.7	41.6

Auctions

Country	GMT	Auction / Event
EMU	 12:30	ECB's Constâncio scheduled to speak in Madrid
	 18:15	ECB's Cœuré scheduled to speak in Paris

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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