

# Euro wrap-up

## Overview

- Bunds made modest gains as the flash euro area PMIs suggested further weakening in the manufacturing sector.
- Gilts made gains and sterling fell the most in ten months as PM May insisted she would not compromise with the EU on her Brexit policy.
- The coming week brings flash euro area inflation figures for September, further top-tier surveys, and the presentation of the Italian government's fiscal targets.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 06/20	-0.553	-0.003
OBL 0 04/23	-0.191	-0.010
DBR 0¼ 08/28	0.460	-0.010
UKT 2 07/20	0.810	-0.020
UKT 0¼ 07/23	1.145	-0.032
UKT 1½ 10/28	1.553	-0.032

\*Change from close as at 4.30pm BST.

Source: Bloomberg

## Euro area

### Manufacturing activity softens further

Having been on a downward trajectory through the first half of the year, euro area economic sentiment appeared to stabilise over the summer months. But the preliminary PMIs for September suggested renewed weakness mostly concentrated in the manufacturing. Indeed, that sector's PMI fell 1.3pts to a two-year low of 53.3, as demand from outside the euro area took another step down, with the relevant index falling to 50, the lowest in more than five years and a level consistent with zero growth. Total new orders were also notably weaker, with the respective PMI down to a two-year low of 51.4. And against this backdrop of weaker demand, the output PMI dropped by 2pts to 52.8, taking the decline in the index since the end of last year to more than 9pts.

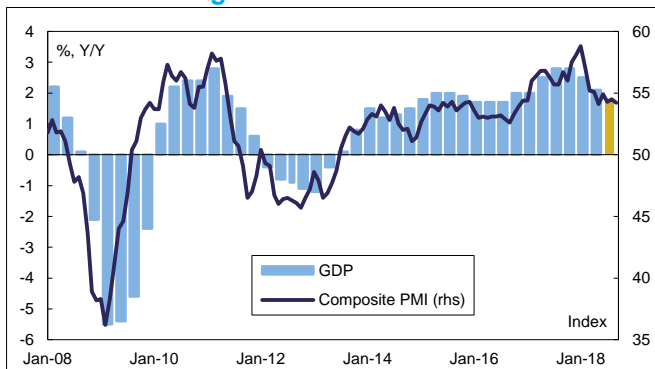
### No pickup in euro area GDP growth in Q3?

The signals from the services sector, which is less exposed to changes in global demand and rising protectionism, were more positive, with the headline activity index inching up to a three-month high of 54.7. In addition, the services employment PMI was stable and the new business gauge weakened only slightly. Nevertheless, the composite PMI fell 0.3pt to 54.2, representing the second-weakest month since the end of 2016. Over Q3 as a whole, the composite PMI averaged 54.3, a level that mechanistically would still be consistent with a slight pickup in GDP growth to 0.5%Q/Q. However, given that the average composite PMI for Q3 was down on the equivalent figures for Q1 and Q2 – indeed it was the lowest since Q416 – and components such as the PMIs for backlogs of work and new orders were also softer, we maintain our view that the economy is unlikely to expand by more than 0.4%Q/Q.

### Mixed Q3 PMIs from major member states

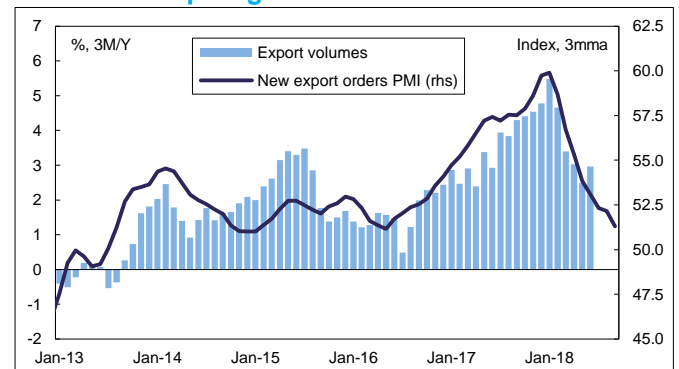
At the country level, the pictures from the German and French PMIs likewise suggested little changes from Q2. In the former country, having reached a record high in December 2017, the headline manufacturing index declined in eight of the past nine months, falling in September to 53.7, the lowest level in more than two years. That impact was partly offset by improvement in the services sector, to leave the German composite output PMI down by only 0.3pt, to 55.3. And given strength earlier in the quarter, its Q3 average was still up by 1.0pt on Q2, with the quarterly employment index also stronger. So, overall, the largest euro area member state appears to have maintained momentum despite the weaker global backdrop. But the detail of the French survey was more downbeat. Both the manufacturing and services sector PMIs declined in September by around 1.0pt and, on a quarterly basis, France's composite index was also down by a similar amount. So, following confirmation from the

### Euro area: GDP growth\* and PMI



\*Daiwa forecast for Q318. Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: Export growth and PMI



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



final Q2 GDP release today that the French economy expanded by 0.2%Q/Q, we do not expect firmer growth in France this quarter.

## The coming week in the euro area and US

It is set to be an important week for Italian politics, with the government presenting on Thursday its Economic and Financial Document, setting out its economic forecasts, fiscal targets and the broad structure of the budgetary package required to meet its goal over the coming year. Finance Minister Tria has repeatedly insisted that the budget will not breach the 3% deficit limit, and reports suggest that the target is likely to be below 2.5%. But tensions in the cabinet over economic policy remains high with Tria reportedly having threatened to resign over the content of the package. But with Deputy PM and 5-Star leader Di Maio insisting that the government make steps towards funding his party's flagship 'universal income' policy, the League's preferred tax reforms and reversal of past pension reforms, there is significant uncertainty as to whether the budgetary announcement will be sufficiently prudent and fit for purpose.

On the data front, the focus will be on the preliminary September inflation figures, due at the end of the week on Friday. We expect that both the headline and the core rates will have remained unchanged this month at respectively 2.0%Y/Y and 1.0%Y/Y. On Thursday, the European Commission will release its latest economic sentiment survey which will provide more insights into how the economy performed this month. Ahead of that we will get a preview from national survey releases from Germany, France and Italy – indeed, the Ifo indices are due on Monday, the INSEE business and consumer sentiment indices will be released on Tuesday and Wednesday, and the ISTAT surveys are out on Thursday. In the bond markets, Italy and Germany will issue bonds on Tuesday, Wednesday and Thursday.

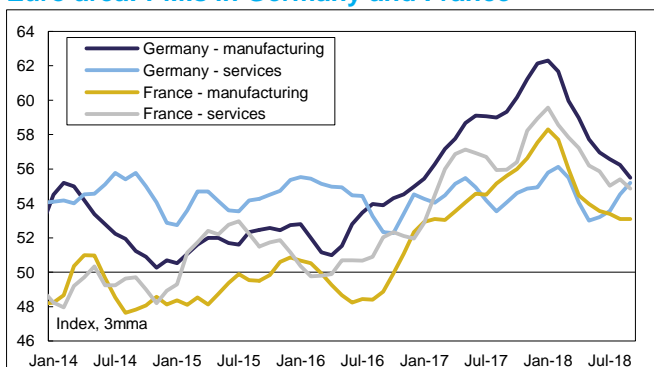
Turning to the US, the focus over the coming busy week will be on the two-day FOMC meeting that concludes on Wednesday. With a further 25bp rate hike viewed by the market as a done deal, the main focus for investors will be on the Fed's updated forecasts, and associated commentary, and what this implies for the likelihood of further policy action at future meetings. (The June median dot plot signalled two 25bps hikes by end-2018, a further three in 2019, and one more in 2020). On the data front we have more regional manufacturing surveys due early in the week. The Conference Board's latest consumer survey will be of some interest on Tuesday, while August new home sales are released on Wednesday. On Thursday we will receive a final reading on Q2 GDP growth, while advance trade, durable goods orders and inventory reports for August will cast some light on how GDP growth is shaping up in Q3. The durable goods orders report will also be of interest to see whether it verifies anecdotal stories – such as those in the Fed's Beige Book – which have pointed to some firms delaying investment decisions due to uncertainties about the global trading environment. On Friday further light on Q3 GDP growth will be cast by the personal spending and income report for August, while the latest development in the core PCE deflator will be analysed closely. The Chicago PMI and final University of Michigan consumer survey results for September complete a busy diary. In the bond market the US Treasury will auction 2-year notes on Monday, 5-year notes on Tuesday and 7-year notes on Thursday.

## UK

### Public net borrowing this fiscal year remains lower than expected

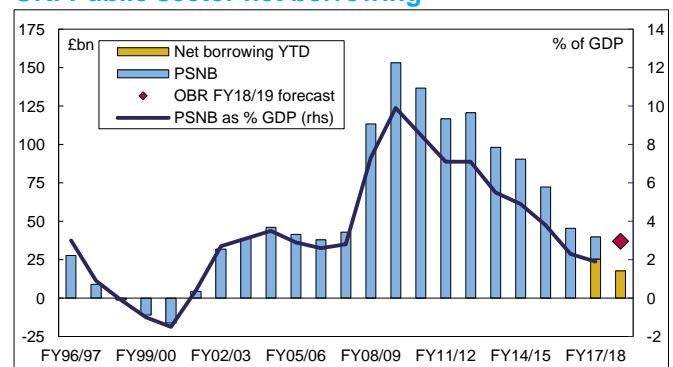
In July, when self-assessment income tax payments boosted tax receipts, the public finances reported a surplus of more than £3bn, the highest for that month in eighteen years. But the public sector balance returned to negative territory in August, with today's figures reporting a deficit of almost £7bn. Compared to the same month a year ago, that figure represented a deterioration of £2.5bn, accounted for mainly by an increase in central government spending. However, looking at the first five months of this fiscal year together, net borrowing was £8bn lower compared to the equivalent period last year. With the latest official OBR projections suggesting only a small decline in borrowing this fiscal year, the figures so far appear to suggest that the public finances are in a better shape than expected, with lower departmental spending and higher tax receipts, likely

### Euro area: PMIs in Germany and France



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

### UK: Public sector net borrowing\*


















\*Excluding public sector banks. Source: ONS

reflecting firm employment growth and elevated consumer spending over the summer months. Of course, this provides some better news for the UK government, currently bogged down in the Brexit negotiations. But after disparaging comments from EU leaders yesterday having highlighted the weakness of her position, Theresa May today insisted she would not change policy.

## The week ahead in the UK










With regards to hard economic data in the coming week, the Q2 national accounts, due on Friday, will be the most notable. The figures are set to confirm the recovery in GDP growth that quarter to 0.4%Q/Q after a slowdown to 0.2%Q/Q in Q1. Q2 current account data are also due on Friday, but otherwise, focus will be mostly on new survey indicators. The CBI surveys, out on Monday and Wednesday, will provide the latest insights into how manufacturing production and High Street activity developed this month. Meanwhile, alongside the GDP data on Friday, we will also receive the GfK consumer confidence and Lloyds Business Barometer surveys. The UK Finance lending data from the major retail banks are due on Wednesday. And, most notably perhaps, we are likely receive some new insights into the UK monetary policy outlook, as BoE governor Carney and other MPC member Vlieghe, Haldane and Ramsden are scheduled to speak. In the bond markets, the DMO will issue index-linked Gilts on Tuesday.

## Daiwa economic forecasts

	2018				2019				2017	2018	2019
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
<b>GDP forecasts %, Q/Q</b>											
Euro area 	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	2.5	2.0	1.6
Germany 	0.4	0.5	0.4	0.5	0.4	0.5	0.4	0.5	2.5	1.9	1.8
France 	0.2	0.2	0.3	0.3	0.4	0.3	0.4	0.4	2.3	1.5	1.2
Italy 	0.3	0.2	0.2	0.2	0.3	0.2	0.3	0.3	1.6	1.1	0.9
Spain 	0.7	0.6	0.6	0.5	0.5	0.5	0.5	0.5	3.1	2.7	2.1
UK 	0.2	0.4	0.4	0.3	0.3	0.3	0.3	0.3	1.7	1.3	1.3
<b>Inflation forecasts %, Y/Y</b>											
Euro area											
Headline CPI 	1.3	1.7	2.1	2.0	1.8	1.7	1.5	1.5	1.5	1.7	1.6
Core CPI 	1.0	0.9	1.0	1.1	1.1	1.2	1.3	1.3	1.0	1.0	1.2
UK											
Headline CPI 	2.7	2.4	2.4	2.3	2.3	2.3	1.9	1.8	2.7	2.5	2.1
Core CPI 	2.5	2.0	2.0	1.9	1.9	2.0	1.8	1.8	2.4	2.1	1.9
<b>Monetary policy</b>											
ECB											
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate % 	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.25	-0.25	-0.40	-0.40	-0.25
Net asset purchases* 	30	30	30	15	0	0	0	0	60	15	0
BoE											
Bank Rate % 	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.50	0.75	0.75
Net asset purchases** 	0	0	0	0	0	0	0	0	0	0	0































\*Monthly target €bn, end of period. \*\*Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

## European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
EMU	 Preliminary services PMI (preliminary composite PMI)	Sep	<b>54.7 (54.2)</b>	54.4 (54.5)	54.4 (54.5)	-	
	 Preliminary manufacturing PMI	Sep	<b>53.3</b>	54.5	54.6	-	
Germany	 Preliminary services PMI (preliminary composite PMI)	Sep	<b>56.5 (55.3)</b>	55.0 (55.4)	55.0 (55.6)	-	
	 Preliminary manufacturing PMI	Sep	<b>53.7</b>	55.7	55.9	-	
France	 GDP – final release Q/Q% (Y/Y%)	Q2	<b>0.2 (1.7)</b>	0.2 (1.7)	0.2 (2.1)	-	
	 Preliminary services PMI (preliminary composite PMI)	Sep	<b>54.3 (53.6)</b>	55.3 (54.6)	55.4 (54.9)	-	
	 Preliminary manufacturing PMI	Sep	<b>52.5</b>	53.3	53.5	-	
Spain	 Trade balance €bn	Jul	<b>-3.2</b>	-	-2.4	-	
UK	 Public sector net borrowing excluding interventions £bn	Aug	<b>6.8</b>	3.4	-2.0	<b>-3.1</b>	
Country	Auction	- Nothing to report -					














Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's data calendar

Key data releases					
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
<b>Monday 24 September 2018</b>					
EMU		14:55 ECB public sector asset purchases €bn	Weekly	<u>4.9</u>	3.3
Germany		09:00 Ifo business climate index	Aug	103.2	103.8
		09:00 Ifo current assessment balance (expectations)	Aug	106.1 (100.4)	106.4 (101.2)
UK		11:00 CBI Industrial Trends Survey, total orders	Sep	4	7
<b>Tuesday 25 September 2018</b>					
France		07:45 Business sentiment indicator	Sep	105	105
		07:45 Manufacturing confidence (production outlook) indicator	Sep	109 (-)	110 (11)
<b>Wednesday 26 September 2018</b>					
France		07:45 Consumer confidence indicator	Sep	97	97
UK		09:30 UK Finance mortgage approvals 000's	Aug	-	39.6
		11:00 CBI Distributive Trades survey, retail sales	Sep	17	29
<b>Thursday 27 September 2018</b>					
EMU		09:00 M3 money supply Y/Y%	Aug	3.9	4.0
		10:00 Economic sentiment indicator	Sep	111.2	111.6
		10:00 Services (industrial) confidence	Sep	14.6 (5.1)	14.7 (5.5)
		10:00 Final consumer confidence indicator	Sep	-2.9	-1.9
Germany		07:00 GfK consumer confidence indicator	Oct	10.5	10.5
		13:00 Preliminary EU-harmonised CPI Y/Y%	Sep	1.9	1.9
Italy		09:00 Consumer confidence indicator	Sep	114.9	115.2
		09:00 Manufacturing confidence indicator	Sep	104.5	104.8
		09:00 Economic sentiment indicator	Sep	-	103.8
<b>Friday 28 September 2018</b>					
EMU		10:00 CPI (core CPI) Y/Y%	Sep	<u>2.0 (1.0)</u>	2.0 (1.0)
Germany		08:55 Unemployment change 000s (rate %)	Sep	-8 (5.2)	-8 (5.2)
France		07:45 Consumer spending M/M% (Y/Y%)	Aug	0.3 (0.7)	0.1 (0.2)
		07:45 Preliminary EU-harmonised CPI Y/Y%	Sep	2.6	2.6
Italy		10:00 Preliminary EU-harmonised CPI Y/Y%	Sep	1.7	1.6
Spain		08:00 GDP – final estimate Q/Q% (Y/Y%)	Q2	<u>0.6 (2.7)</u>	0.7 (3.0)
		08:00 Preliminary EU-harmonised CPI Y/Y%	Sep	2.3	2.2
		09:00 Current account balance €bn	Jul	-	0.5
UK		00:01 GfK consumer confidence indicator	Sep	-8	-7
		00:01 Lloyds business barometer	Sep	-	23
		09:30 Current account balance £bn	Q2	-19.4	-17.7
		09:30 GDP – second estimate Q/Q% (Y/Y%)	Q2	0.4 (1.3)	0.4 (1.3)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's events/auctions calendar

Key events & auctions		
Country	BST	Event / Auction
<b>Monday 24 September 2018</b>		
- Nothing scheduled -		
<b>Tuesday 25 September 2018</b>		
EMU		09:10 ECB's Praet scheduled to speak in London
Italy		10:00 Auction: to sell €1.75bn of 2020 zero bonds (30-Mar-2020)
		10:00 Auction: to sell €1bn of 1.25% 2032 index-linked bonds (15-Sep-2032)
UK		09:40 BoE's Vlieghe scheduled to speak in London
		10:30 Auction: to sell £800mn of 0.125% 2048 index-linked bonds (10-Aug-2048)
<b>Wednesday 26 September 2018</b>		
Germany		10:30 Auction: to sell €3bn of 0% 2023 bonds (13-Oct-2023)
<b>Thursday 27 September 2018</b>		
EMU		14:30 ECB's Draghi scheduled to speak in Frankfurt
		18:00 ECB's Praet scheduled to speak in London
Italy		10:00 Auction: to sell bonds
UK		12:45 BoE's Haldane scheduled to speak in London
		15:00 BoE's Carney chairs panel in Frankfurt
<b>Friday 28 September 2018</b>		
EMU		13:35 ECB's Praet scheduled to speak in Frankfurt
UK		14:20 BoE's Ramsden scheduled to speak in London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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