# Euro wrap-up

## Overview

- Despite a slightly softer Ifo business survey, Bunds made losses as Draghi spoke of "a relatively vigorous pick-up in underlying inflation".
- Gilts followed Bunds lower despite an underwhelming CBI industrial trends survey.
- Tuesday will bring the latest French INSEE business survey and speakers from the ECB and BoE, while Wednesday will bring the equivalent French consumer survey and the UK CBI's latest distributive trade survey.

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**Daily bond market movements**

| Bond | Yield | Change* |
|---|---|---|
| BKO 0 06/20 | -0.531 | +0.026 |
| OBL 0 04/23 | -0.134 | +0.057 |
| DBR 0¼ 08/28 | 0.510 | +0.050 |
| UKT 2 07/20 | 0.826 | +0.016 |
| UKT 0¾ 07/23 | 1.183 | +0.038 |
| UKT 1⅝ 10/28 | 1.610 | +0.057 |

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

# Euro area

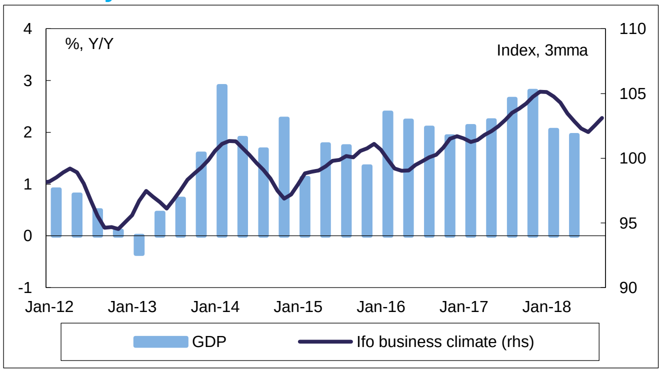
## Rates higher on Draghi inflation comments

Coming less than a fortnight after Mario Draghi's most recent post-policy meeting press conference, this afternoon's hearing at the European Parliament's Committee on Economic and Monetary Affairs might have been expected to be uneventful, simply offering the ECB President an opportunity to repeat his message to a new audience. However, during his introductory statement to the Committee, Draghi triggered an increase in euro rates across the curve, as he referred to "a relatively vigorous pick-up in underlying inflation". We do not, however, think the comments merited the market's response. Rather than referring to current conditions – regards which Draghi acknowledged that "Measures of underlying inflation remain generally muted" – he was describing the ECB's latest economic forecasts, which predict a rise in the average annual core CPI rate from 1.1%Y/Y this year to 1.5%Y/Y in 2019 and 1.8%Y/Y in 2020. While that would indeed represent a "vigorous" pick-up inflation, it would still be a softer profile than was anticipated in the ECB's previous forecasts published in June. And, just as the ECB repeatedly over recent years had to revise down its forecasts for core CPI, we think that these latest projections will also prove overoptimistic, with the recent subdued behavior of prices and the likelihood of a further slowing of economic growth suggesting to us a more gradual upwards drift in underlying inflation over the coming couple of years. One of the key purposes of Draghi's remarks today was to emphasise the ECB's forward guidance on rates, specifically that interest rates will remain at their present levels "well past the end" of the net asset purchases, "at least through the summer of 2019, and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with our current expectations of a sustained adjustment path". And, as such, despite the excitable response to Draghi's comments today, we maintain our view that the first ECB rate hike this cycle will come next September, but also that the Governing Council might struggle to achieve more than one hike after that before it has to pause for an extended period.

## German Ifo suggests steady growth momentum at end-Q3

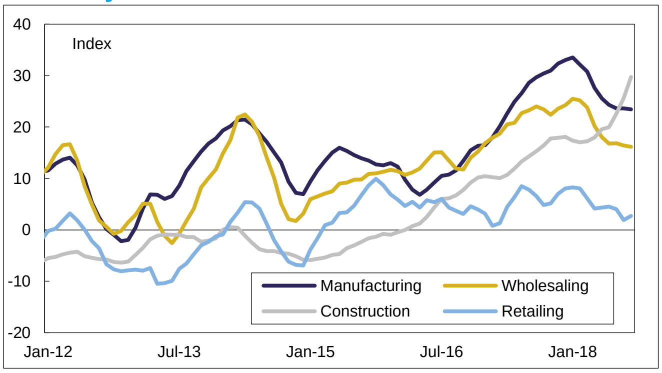
Like Friday's flash PMIs, today's Ifo indices for September suggested that German business sentiment deteriorated slightly over the past month but still remains firmer than in the first part of the summer. In particular, after rising more than 2pts to a six-month high in August, the headline German Ifo business climate index slipped back 0.2pt to 103.7, back in line with the average of the past twelve months. On average, companies assessed both current and future business conditions to have worsened slightly, albeit with significant variation between the various sectors. Manufacturers were more downbeat about current conditions, but by no means to the extent of the respective PMI which fell to a two-year low. And, all the more surprising perhaps, they were also more upbeat about the outlook than any time in the past six months. Meanwhile, the business climate in services was little changed, but retailers were significantly more upbeat, albeit with sentiment improving from a low level. And reporting ample order books, construction firms

**Germany: Ifo business climate index & GDP**




*Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

**Germany: Ifo business climate indices**




*Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

remained particularly optimistic, with the respective business climate index up to a new series high. Overall, the survey suggests German economic growth in Q3 close to the 0.4-0.5%Q/Q rates of Q1 and Q2, and a similar moderate growth rate in Q4, with construction leading the way but retail and manufacturing lagging behind.

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

Tuesday will bring the September INSEE French business sentiment survey. Last week's flash PMIs suggested a deterioration in conditions in both the services and manufacturing sectors at the end of Q3, with the composite index down to a twenty-month low, and so we anticipate a weakening in the INSEE indices too. Wednesday, meanwhile, will bring the INSEE French consumer confidence survey for September, with the headline index having over the past three months fallen to the lowest level since September 2016. ECB Executive Board members Praet and Cœuré will be speaking publicly on Tuesday. In the bond market, Italy will sell zero-coupon and inflation-linked bonds tomorrow while Germany will sell 5Y Bunds on Wednesday.

The main event of the coming two days is obviously the conclusion of the FOMC meeting on Wednesday. With a further 25bp hike in the FFR range (to 2.00-2.25%) seemingly 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. As well as a hike this week, the June dot-plots signalled the likelihood of a fourth hike this year – presumably in December – a further three in 2019, and one more in 2020, taking the FFR range by the end of that year to 3.25-3.50%, 50bps above the FOMC's median assessment of the long-run equilibrium level. Despite intensified trade-war risks and stresses in certain emerging markets, this week's dot-plots might signal stronger support for that tightening profile. Ahead of the FOMC announcements, tomorrow brings the results of the Conference Board's consumer survey and Richmond Fed's manufacturing indices for September, as well as the FHFA and S&P CoreLogic Case-Shiller home price data for July. August new home sales figures are due the following day. On Tuesday, the Treasury will sell 2Y FRNs and 5Y Notes.

# UK

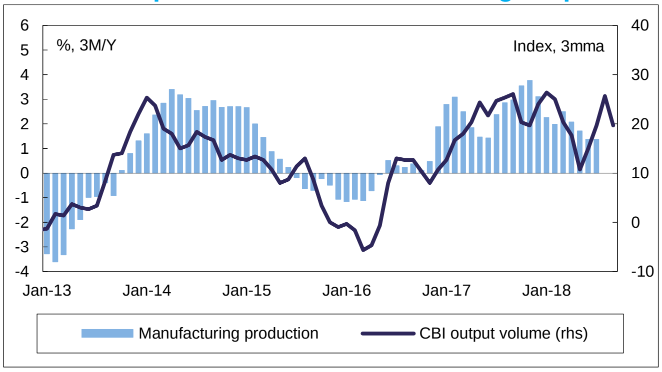
### An underwhelming industrial survey

Those expecting the depreciation of sterling in the aftermath of the Brexit referendum to provide a lasting boost to the competitiveness of UK manufacturers are likely to have been disappointed by the sector's performance this year. While production outpaced GDP for much of 2017, it subtracted from economic growth in each of the first two quarters of 2018. And today's CBI survey suggests that conditions remained underwhelming in Q3. Indeed, the survey's measure of industrial output volume fell 10pts in September to a net balance of 11, the second-lowest reading since 2016. Likewise, the index of order books fell close to the bottom of the range of the past twenty months, with export orders the weakest in more than a year. Additionally, the gauge of firms' selling prices slipped back to the bottom of the range of the past year. The CBI took comfort from the fact that these survey balances for output, orders, expected output and prices remained above their respective long-run averages on the survey, which dates back more than four decades. But since UK manufacturing production trended broadly sideways for much of that period, that's faint praise. Indeed, Brexit seems to have stymied what might otherwise have proved a welcome renaissance for UK manufacturing. Surveys and anecdotal evidence suggests that uncertainty about the UK's future trading relationship with the EU is already weighing on investment and new orders, and the CBI reported today that "fears of a 'no deal' Brexit have prompted some firms to move publicly from contingency planning to action" – reasons to believe that the government's shambolic handling of the negotiations will have long-lasting negative effects on manufacturing, whatever their eventual outcome.

### The coming two days in the UK

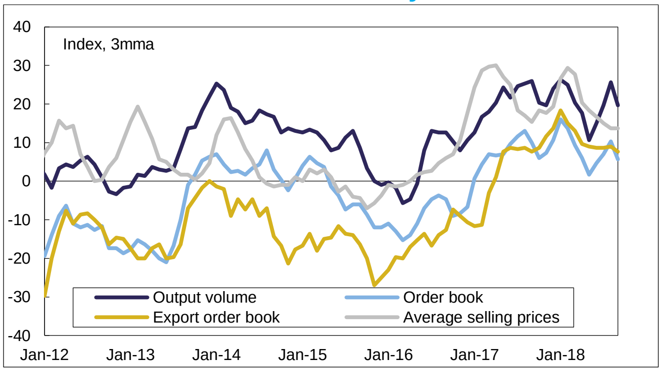
In the UK, Tuesday is set to be quiet for new economic data from the UK. But MPC member Vlieghe will speak publicly, and, in the bond markets, the DMO will sell 30Y index-linked Gilts. Wednesday, meanwhile, will bring insights into consumer activity at the end of Q3 in the shape of the CBI distributive trades survey for September. UK Finance data for lending in August by the major retail banks are also due that day.

**UK: CBI output volume & manufacturing output**




*Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

**UK: CBI Industrial Trends Survey indices**




*Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

***In the absence of significant news, the next edition of the Euro wrap-up will be published on 26 September 2018.***

# European calendar

## Today's results

**Economic data**

| Country | Release | Period | **Actual** | Market consensus/ *Daiwa forecast* | Previous | **Revised** |
|---|---|---|---|---|---|---|
| EMU | ECB public sector asset purchases €bn | Weekly | **5.2** | *4.9* | 3.3 | **-** |
| Germany | Ifo business climate index | Aug | **103.7** | 103.2 | 103.8 | **103.9** |
| | Ifo current assessment balance (expectations) | Aug | **106.4 (101.0)** | 106.1 (100.4) | 106.4 (101.2) | **106.5 (101.3)** |
| UK | CBI Industrial Trends Survey, total orders | Sep | **-1** | 4 | 7 | **-** |

| 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/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|
| France | 07:45 | Business sentiment indicator | Sep | 105 | 105 |
| | 07:45 | Manufacturing confidence (production outlook) indicator | Sep | 109 (-) | 110 (11) |

**Auctions and events**

| Country | BST | Auction / Event |
|---|---|---|
| EMU | 09:10 | ECB's Praet scheduled to speak in London |
| | 13:30 | ECB's Cœuré speaks in Frankfurt |
| 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) |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Wednesday's data releases

**Economic data**

| Country | BST | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|
| France | 07:45 | Consumer confidence indicator | Sep | 97 | 97 |
| UK | 09:30 | UK Finance mortgage approvals 000's | Aug | 39.5 | 39.6 |
| | 11:00 | CBI Distributive Trades survey, retail sales | Sep | 17 | 29 |

**Auctions and events**

| Country | BST | Auction / Event |
|---|---|---|
| Germany | 10:30 | Auction: to sell £3bn of 0% 2023 bonds (13-Oct-2023) |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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