

Euro wrap-up

Overview

- Bunds were little changed today, while the latest French and Italian IP data surprised on the upside.
- Gilts were also unchanged despite some reported positive momentum in the Brexit negotiations, while UK data indicated solid GDP growth in Q3.
- The coming few days will bring the ECB's account of its mid-September Governing Council meeting, as well as euro area IP figures. In the UK, a housing survey and the BoE's Credit Conditions Survey are due.

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Daily bond market movements

| Bond | Yield | Change* |
|--------------|--------|---------|
| BKO 0 06/20 | -0.563 | -0.005 |
| OBL 0 04/23 | -0.126 | +0.004 |
| DBR 0¼ 08/28 | 0.550 | +0.002 |
| UKT 2 07/20 | 0.907 | -0.007 |
| UKT 0¼ 07/23 | 1.284 | +0.004 |
| UKT 1½ 10/28 | 1.723 | +0.007 |

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

French and Italian IP surprise on the upside in August

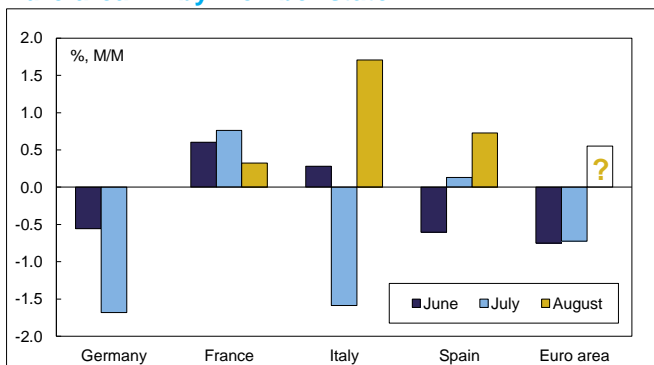
Ahead of Friday's euro area industrial production release and following the disappointing German IP release at the start of this week, there was a welcome upwards surprise to the equivalent French and Italian figures today. Certainly, the French industrial sector appears to be faring much better than Germany in the third quarter, with output rising for the third consecutive month in August, by 0.3%M/M, to leave it up more than 1½% compared with a year earlier. The improvement was underpinned by another solid showing from the manufacturing sector (with output up 0.6%M/M), as production of intermediate and consumer goods recovered. And despite a modest drop in production of capital goods in August, it was still on average in the first two months of Q3 more than 2% higher than the average in Q2. So, on the same basis, manufacturing output was also more than 1% higher, while total output was up 1.3% compared with the average in Q2 to suggest that the sector was well on track for positive growth in Q3.

The news from Italy's manufacturing sector was, at face value, more positive too, with industrial production posting a much stronger-than-expected rebound in August, up 1.7%M/M, the strongest increase in eight months as the manufacturing sector was supported by a more-than 3½%M/M rise in production of capital goods, which itself was the firmest growth for two years. But the improvement in August merely offset weakness in July to leave industrial output 0.8% lower compared with a year earlier and on average in the first two months 0.3% below the average in Q2. So, today's data suggest that, similar to Germany, the sector is on track for a contraction in Q3. Overall, despite the weakness in Germany in August, the indicators from the largest member states so far suggest that euro area industrial production – data due for release on Friday – is likely to have risen by a little more than ½%M/M in August, to leave output broadly flat over the first two months of Q3.

The coming two days in the euro area and US

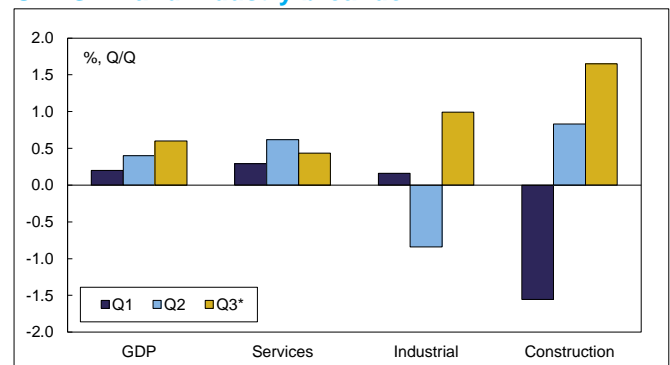
The most noteworthy release in the euro area tomorrow will be the publication of the ECB's account from the 13 September Governing Council meeting, when the reduction in the rate of net asset purchases from the start of October was confirmed and the staff forecasts for GDP growth and core inflation were nudged lower. The account might just provide further insight into the monetary policy debate, including prospects for possible shifts in reinvestment policy, but the post-meeting press conference was largely uneventful. Data-wise, aside from the aforementioned euro area industrial production release on Friday – with output forecast to rise by more than ½%M/M – the coming two days will see final inflation numbers for September from Germany (Friday), France and Spain (tomorrow). These are expected to confirm the flash estimates which

Euro area: IP by member state*



*Euro area forecast for August based on member state figures.
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: GDP and industry breakdown



*Q3 figures are based on the average of July and August compared with the average in Q2. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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brought an upside surprise to the German EU-harmonised rate, rising 0.3ppt to 2.2%Y/Y, while the equivalent French figure unexpectedly fell 0.1ppt to 2.5%Y/Y and the Spanish number was unchanged at 2.2%Y/Y. In the markets, Italy is scheduled tomorrow to sell bonds with various maturities.

In the US, aside from the usual weekly jobless claims figures, the data focus tomorrow will be the latest CPI figures for September. Consumer prices are expected to have risen 0.2%M/M last month, to leave the year-on-year rate moderating 0.3ppt to 2.4%Y/Y. Friday, meanwhile, will see the preliminary reading of the University of Michigan's consumer sentiment survey for October, alongside import price figures for September.

UK

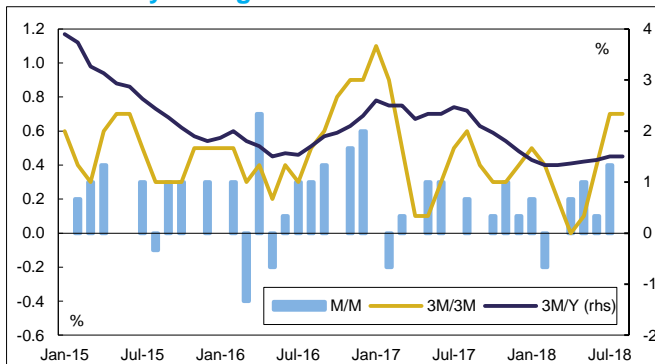
Some positive momentum in Brexit negotiations?

With the EU Council meeting kicking off a week today, there appears to have been some meaningful progress made between Theresa May's chief negotiator Olly Robbins and EU chief negotiator Michel Barnier, with reports suggesting that the EU was close to agreeing that the contentious Irish "backstop" would apply to the whole UK rather than just Northern Ireland. This backstop would see the UK remaining in the customs union for as long as it takes to create mechanisms to deliver a frictionless border in Ireland. But that in itself creates domestic political difficulties for Theresa May, with Brexiteer MPs concerned that this will keep the UK in a customs union with the EU indefinitely. At the same time the DUP, which provides Theresa May with her majority in Parliament, is not going to be happy with the additional checks that may be required between Northern Ireland and the rest of the UK to deal with the fact that the backstop will see Northern Ireland effectively remain in the Single Market for goods, but the rest of the UK not. So, even if a deal can be hammered out, Theresa May will face a significant challenge getting approval in the House of Commons (and, indeed, may face Parliamentary difficulties before that, with the DUP also threatening to vote down the impending Budget). She is likely to face opposition from hardline Brexiteers and DUP members, while the bulk of the Labour Party will almost certainly vote against the deal. But it is unclear to what extent Brexiteer and DUP opposition will translate into votes, while there appears to be a large number (potentially 30) of Labour MPs who may vote with the Government. On balance, we continue to judge its eventual endorsement as the most likely scenario, even though there remain non-negligible probabilities of a 'People's Vote' second referendum or disorderly no-deal Brexit too. And sterling's relatively muted reaction to the more positive noises coming out of the talks indicates that markets continue to see significant risks of significant political turbulence ahead.

Activity reports point to solid GDP growth

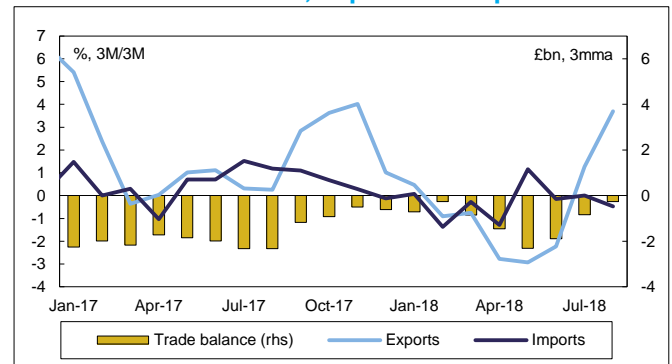
In terms of the latest data, today's monthly GDP figures came in a touch weaker than expected, with output flat on the month in August. But this followed stronger-than-previously-estimated growth in July (0.4%) to leave GDP on a three-month basis unchanged from July's upwardly revised rate of 0.7%3M/3M, which was the strongest since February 2017. Despite moving sideways in August, services activity accounted for the lion's share of the three-month increase, rising 0.5%3M/3M, underpinned by another strong showing in the retail subsector (1.7%3M/3M) as the warm weather continued to provide a boost, while motor trade reportedly received a lift in August ahead of regulatory changes the following month. And the prolonged summer heat wave appears to have benefited homebuilding too – although monthly growth in construction activity slipped back in August, this followed three months of solid expansion to leave it almost 3% higher on a three-month basis with new housing activity up 5½%3M/3M. Turning to the manufacturing sector, output was also softer in August (-0.2%M/M) driven by a notable drop in production of chemical products. But with a pickup in electricity and gas supply and mining and quarrying, total industrial output increased for the third consecutive month in August and by 0.3%M/M. When smoothing out monthly volatility, all subsectors continued to trend higher, with manufacturing output up 0.8%3M/3M and total IP up 0.7%3M/3M – the latter the strongest such increase for nine months.

UK: Monthly GDP growth



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

UK: Real trade balance, export and import volumes



Source: ONS and Daiwa Capital Markets Europe Ltd.

Exports on track to boost GDP growth in Q3

Against the backdrop of the recent upward trend in manufacturing output, the trade performance has also been more positive of late. Admittedly, the monthly figures in August were somewhat softer than had been expected, with the nominal trade deficit widening by £0.7bn to £1.3bn as the rise in the value of imports (2.4%M/M) outpaced the value of exports (1.1%M/M). Looking through monthly volatility, the picture was more positive, with the trade deficit narrowing by £4.6bn in the three months to August to £2.8bn. And when excluding price effects, the improvement was even more marked, by £6.1bn taking the deficit to just £0.8bn. The main contribution to that improvement came from goods exports, which in real terms were up by 4.9%3M/3M, while the equivalent measure of import volumes was down 1.0%3M/3M. When services were included, the positive export story was maintained. So, on average in the first two months of Q3, total export volumes were 4% higher than the average in Q2, while import volumes were broadly flat on the same basis. So despite a notable weakening in the new exports orders PMI over the third quarter, today's report suggests that net trade likely made a substantial contribution to GDP growth in Q3, having subtracted from growth in the first two quarters of the year. Indeed, given the overall positive tone to today's new figures, we have revised up our forecast for GDP growth in Q3 by 0.1ppt to 0.5%Q/Q.

The coming two days in the UK










Aside from additional information on the Brexit negotiations, the coming two days should be relatively quiet for top-tier economic data, with the RICS house price balance for September due tomorrow, along with the BoE's latest Credit Conditions Survey.

In the absence of significant news, the next edition of the Euro wrap-up will be published on 12 October 2018.


European calendar

Today's results

Economic data

| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|---------|---|--------|--------------------|--|--------------|--------------------|
| France |  Industrial production M/M% (Y/Y%) | Aug | 0.3 (1.6) | 0.1 (1.5) | 0.7 (1.8) | 0.8 (1.9) |
| |  Manufacturing production M/M% (Y/Y%) | Aug | 0.6 (1.9) | 0.1 (1.7) | 0.5 (1.9) | - (2.0) |
| Italy |  Industrial production M/M% (Y/Y%) | Aug | 1.7 (-0.8) | 0.8 (-1.5) | -1.8 (-1.3) | -1.6 (-) |
| UK |  Monthly GDP estimate M/M% (3M/3M%) | Aug | 0.0 (0.7) | 0.1 (0.6) | 0.3 (0.6) | 0.4 (0.7) |
| |  Services activity M/M% (3M/3M%) | Aug | 0.0 (0.5) | 0.1 (0.5) | 0.3 (0.6) | - (0.7) |
| |  Industrial production M/M% (Y/Y%) | Aug | 0.2 (1.3) | 0.1 (1.0) | 0.1 (0.9) | 0.4 (1.0) |
| |  Manufacturing production M/M% (Y/Y%) | Aug | -0.2 (1.3) | 0.1 (1.1) | -0.2 (1.1) | 0.0 (1.4) |
| |  Construction output M/M% (Y/Y%) | Aug | -0.7 (0.3) | -0.5 (1.2) | 0.5 (3.5) | - (2.8) |
| |  Trade balance (goods trade balance) £bn | Aug | -1.3 (11.2) | -1.2 (-10.9) | -0.1 (-10.0) | -0.5 (10.3) |




Auction

Germany sold  €2.41bn of 0.25% 2028 bonds (15-Aug-2028) at an average yield of 0.55%


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|---------|---|--------|--------------------|--|-------------|-----------------|
| Germany |  Trade (current account) balance €bn | Aug | 17.2 (15.3) | 16.2 (16.2) | 16.5 (15.3) | - (15.1) |
| |  Exports (Imports) M/M% | Aug | -0.1 (-2.7) | 0.4 (-0.1) | -0.9 (2.8) | - |
| UK |  BRC retail sales like-for-like Y/Y% | Sep | -0.2 | 0.1 | 0.2 | - |




Auction

Germany sold  €399mn of 0.1% index-linked bonds (15 Apr-2026) at an average yield of -1.12%




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 | Final EU-harmonised CPI Y/Y% | Sep | 2.5 | 2.6 |
| Spain  | 08:00 | Final EU-harmonised CPI Y/Y% | Sep | 2.2 | 2.2 |
| UK  | 00:01 | RICS house price balance % | Sep | 1 | 2 |



Auctions and events

| Country | BST | Auction / Event |
|---|-------|--|
| EMU  | 12:30 | ECB account to be published for the 13 September meeting |
| Italy  | 10:00 | Auction: to sell up to €3.5bn of 2.3% 2021 bonds (15-Oct-2021) |
| | 10:00 | Auction: to sell up to €1.5bn of 2.5% 2025 bonds (15-Nov-2025) |
| | 10:00 | Auction: to sell 2.45% 2033 bonds (01-Sep-2033) |
| | 10:00 | Auction: to sell 4% 2037 bonds (01-Feb-2037) |
| UK  | 15:00 | Italy's Lower House to debate and vote on the government's fiscal outline. |
| | 09:30 | BoE to publish quarterly Credit Conditions Survey |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

Friday's data releases

Economic data

| Country | BST | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|---|-------|-----------------------------------|--------|--|-------------|
| EMU  | 10:00 | Industrial production M/M% (Y/Y%) | Aug | 0.6 (-0.2) | -0.8 (-0.1) |
| Germany  | 07:00 | Final EU-harmonised CPI Y/Y% | Sep | 2.2 | 1.9 |

Auctions and events

| Country | BST | Auction / Event |
|-----------------------|-----|-----------------|
| - Nothing scheduled - | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

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