

Euro wrap-up

Overview

- Bunds followed USTs higher, while BTP spreads widened slightly as concerns about the Italian budget remained to the fore.
- Gilts also followed the global trend, despite UK GDP growth accelerating to a seven-quarter high.
- As Brexit negotiations remain ongoing, the coming week will bring Q3 GDP releases from the euro area and Germany, as well as inflation and labour market data from the euro area and UK.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 09/20	-0.599	-0.014
OBL 0 10/23	-0.176	-0.035
DBR 0¼ 08/28	0.410	-0.046
UKT 2 07/20	0.794	-0.045
UKT 0¼ 07/23	1.084	-0.058
UKT 1½ 10/28	1.504	-0.061

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

Euro area

French IP slumps in September, but up in Q3

Ahead of next week's euro area industrial production release, member state production figures have provided mixed messages in September. While German IP posted a modest rise on the month, Spanish figures published yesterday reported a decline of 0.7% M/M, more than reversing the rise in August. And today's French release was disappointing, with industrial production declining 1.8% M/M in September, following downwardly revised growth of 0.2% M/M in August. And the manufacturing performance was even more disappointing, with output down more than 2% M/M, thanks in part to a more-than 6% M/M decline in production of consumer durable goods, while production of intermediate and capital goods also fell that month. Nevertheless, given the strength at the start of the quarter, this still left manufacturing production up ½% over the third quarter as a whole, with total IP up 0.7% Q/Q. Of course, this contrasted markedly with the quarterly IP outturns from Germany and Spain, down 0.9% Q/Q up 0.1% Q/Q. So, overall, while we still await Italy's release on Monday, when the euro area aggregate production figure is published next Wednesday, we could well see a monthly decline of more than ½% M/M in September, partly reversing August's increase. And this would leave industrial output broadly flat over the third quarter as whole.

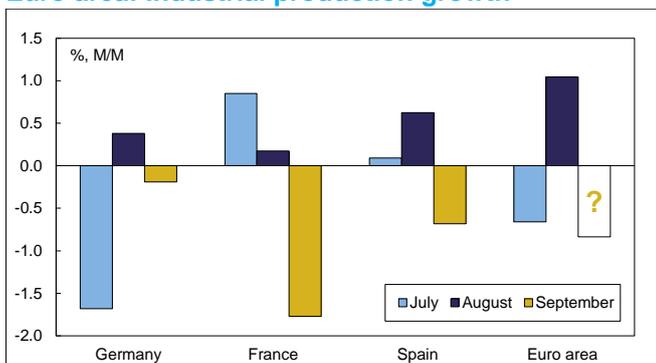
Italy's budget continues to weigh on sentiment

As the deadline (13 November) for Italy's government to re-submit its revenue and spending projections to the Commission approaches, Italian markets remained on edge – 10Y BTP spreads rose above 300bps today – as government officials continued to suggest that the key points of its budget would remain unchanged. This followed the publication yesterday of the European Commission's latest economic forecasts showing that the general government deficit in Italy is set to rise to 2.9% of GDP in 2019, much higher than the 2.4% predicted by the Italian government itself. And in marked contrast to the Italian government's expected decline (to 2.1%) in 2020, the Commission forecasts that the deficit will widen to 3.1% of GDP the following year, above the level consistent with EU rules. Of course, this is not overly surprisingly given that the Italian government's projections were based on overly optimistic growth forecasts. Indeed, the Commission expects Italian GDP growth of 1.2% Y/Y next year, the slowest pace in the euro area. And even this looks too upbeat – our forecast for growth is just half that for 2019 and a touch weaker in 2020.

The coming week in the euro area and US

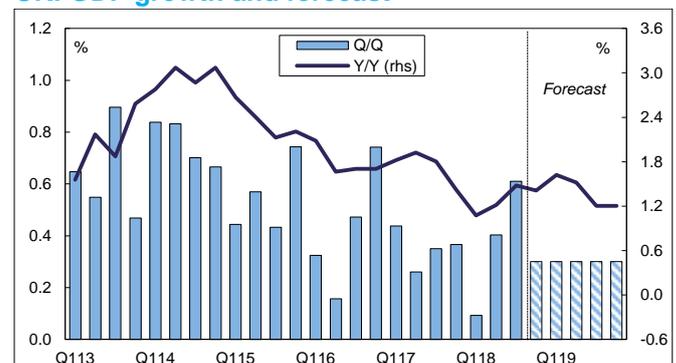
Aside from the aforementioned IP release, Wednesday will also bring a handful of other notable reports, including euro area and German GDP, as well as euro area employment, all for Q3. While euro area GDP growth is expected to align with the flash estimate of 0.2% Q/Q, given the preliminary reading's proximity to the rounding range, however, there is a risk of a downwards revision. Germany will also announce its Q3 GDP data for the first time – with most activity indicators having weakened significantly last

Euro area: Industrial production growth*



*German IP excludes construction. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: GDP growth and forecast



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



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quarter, we expect the economy to have moved sideways, which would mark the first non-positive growth in 3½ years. Against a backdrop of slowing growth, euro area labour market figures might also show a limited rise in employment over the third quarter. Thursday will bring euro area trade figures for September, as well as new car registrations data for October. And Friday will see the final release of euro area inflation figures for October, which are expected to confirm that headline CPI rose 0.1ppt to 2.2%Y/Y, a near-6-year high, while core CPI rose 0.2ppt to 1.1%Y/Y. With respect to national releases, the latest surveys from the Bank of France and ZEW are due on Monday and Tuesday respectively, while final inflation numbers are due from Germany (Tuesday), France and Spain (Thursday). Also due are Italian September industrial production data (Monday) and orders and sales figures (Friday). In the markets, Germany will sell 2Y and 30Y bonds on Tuesday and Wednesday respectively, while Italy will also auction bonds on Tuesday.

The holiday shortened week in the US – on Monday the country marks Veterans' Day – brings a number of top-tier releases, including the latest CPI, retail sales and IP figures for October (on Wednesday, Thursday and Friday respectively). With respect to inflation, the headline index is expected to rise 0.3%M/M in October, breaking out of the recent range. This should leave the annual pace increasing for the first time since June, by 0.2ppt to 2.5%Y/Y. The rise in core prices should be a touch softer 0.2%M/M, to leave the year-on-year rate unchanged at 2.2%. The latest retail sales figures, meanwhile, are expected to report a steeper rise than of late, by around ½%M/M. October industrial production data should remain positive too, reporting the fifth consecutive monthly increase at the start of Q4. Ahead of these, we will see the release of the NFIB small business optimism index and the federal budget (Tuesday), as well as the Empire manufacturing and the Philly Fed activity indicators (Thursday). Supply-wise, the US Treasury will auction 10Y notes on Tuesday and 30Y bonds on Wednesday.

UK

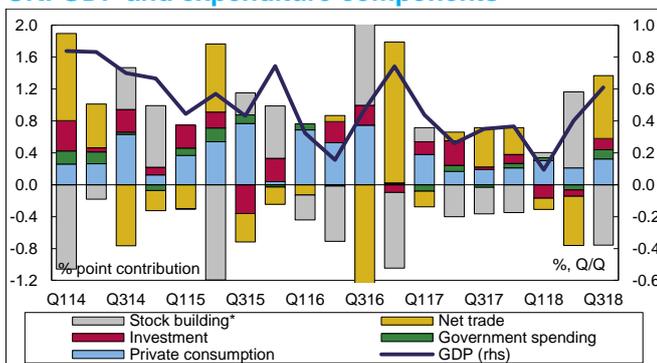
Economy expanded more vigorously in Q3

Contrasting with the abrupt slowdown in euro area GDP in Q3, UK GDP figures released today showed that growth picked up last quarter, from 0.4%Q/Q to 0.6%Q/Q, the fastest pace since the end of 2016 and in line with the latest BoE forecasts. Following the weather-induced weakness at the start of the year, the acceleration in Q3 pushed GDP back up to a level in line with its recent trend. Indeed, the annual pace of 1.5%Y/Y, up from 1.2%Y/Y, matched the average since the start of last year. Within the expenditure breakdown, household consumption growth rose from 0.3%Q/Q to 0.5%Q/Q and accounted for half of the increase in GDP. Meanwhile, having fallen in the previous two quarters, fixed investment recovered, rising by 0.8%Q/Q. However, this was more than accounted for by the public sector, while business investment fell 1.2%Q/Q, the worst reading since the start of 2016 and the third consecutive decline – no doubt related to ongoing uncertainty associated with Brexit. In contrast, trade was the most positive spot in today's figures – indeed, the contribution of 0.8ppt to GDP growth from net exports was one of the strongest in recent years. It was accounted for by exports, which rose 2.7%Q/Q, with shipments of fuels and transport equipment standing out as the strongest categories, while imports were merely flat. Offsetting that, stock building and the acquisitions less valuables categories made the largest negative contribution since the start of 2014.

Monthly activity data signal weakening trend through Q3

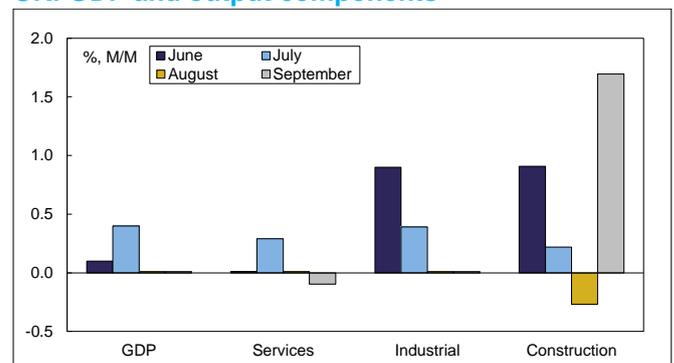
Despite the positive headline GDP figure, the monthly profile provided a more downbeat assessment of recent economic activity. Indeed, while GDP was reportedly boosted in July by the summer heat wave and World Cup effect, overall output merely moved sideways in August and September. This in part reflected weakening in the services sector, with output down 0.1% on the month in September, the first decline for seven months, following a flat reading previously. While retail trade provided a drag in September, the deceleration was principally driven by a more-than 6%M/M decline in the motor trade industry as new emission testing rules came into effect. Although this drag on growth should not be repeated in the fourth quarter, recent service sector surveys have hardly been encouraging for the near-term outlook. Meanwhile, the industrial sector fared little better at the end of the third quarter either, with output unchanged in both August and September. There was a modest pickup in manufacturing production (0.2%M/M), but this followed declines in July and August. And if the manufacturing PMI is to be believed production in the sector is likely to take a

UK: GDP and expenditure components



*Includes acquisitions less disposal of valuables category and alignment adjustment). Source: ONS, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: GDP and output components



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

further step down over coming months. Surveys also suggest that against the backdrop of Brexit uncertainty, the workflow from abroad has diminished at the start of Q4 too – indeed, the manufacturing new exports PMI returned to contractionary territory in October, for just the second month in the past 2½ years. So looking ahead, we do not expect a similar pace of GDP growth to be maintained. For now, we maintain a view that GDP growth will probably moderate to 0.3%Q/Q in Q4. But the longer the Brexit negotiations drag on, the more businesses will delay or cancel their investment plans. And so if we see no progress in the Brexit talks soon, risks to the UK outlook will certainly shift further to the downside.

The week ahead in the UK

As we await any further progress on the Brexit discussions, the flow of key UK economic data releases will continue in the coming week with the latest labour market, inflation and retail sales figures out on Tuesday, Wednesday and Thursday respectively. Headline wage growth picked up in the three months to August, and further increases are on the cards in September, with headline average weekly earnings set to reach 3.0%3M/Y% for the first time in three years. Excluding bonuses, growth will probably be a touch stronger at 3.1%3M/Y, unchanged from August. This notwithstanding, this report is likely to show that the period of subdued employment growth continued. The headline three month pace dropped to around zero in the last two months, and while we will probably see somewhat higher reading for September, it should be far from the triple-digit increases often seen in the first half of the year. The weaker employment growth should leave the headline unemployment rate unchanged at 4%. With regard to inflation data, we expect little change, with headline and core rate remaining at 2.4%Y/Y and 1.9%Y/Y. Risks to the former appear to be skewed to the upside given that energy inflation should take another step up due rises in auto fuel prices as well as gas and electricity tariffs. Finally, the figures from the retail sector will be of no less interest. After a period of strong growth over the summer months in September the annual pace eased to a four-month low of 3.0%Y/Y and it appears likely that we will see a further moderation in October. In the bond markets, the DMO will issue long-term Gilt on Thursday.

In the absence of significant news, the next edition of the Euro wrap-up will be published on 13 November 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%)	Sep	-1.8 (-1.1)	-0.3 (1.1)	0.3 (1.6)	0.2 (1.5)
	 Manufacturing production M/M% (Y/Y%)	Sep	-2.1 (-1.0)	-0.2 (1.8)	0.6 (1.9)	0.4 (1.8)
UK	 GDP – first estimate Q/Q% (Y/Y%)	Q3	0.6 (1.5)	<u>0.5 (1.4)</u>	0.4 (1.2)	-
	 Monthly GDP estimate M/M%	Sep	0.0	<u>-0.2</u>	0.0	-
	 Services output M/M% (3M/3M%)	Sep	-0.1 (0.4)	0.1 (0.5)	0.0 (0.5)	-
	 Industrial production M/M% (Y/Y%)	Sep	0.0 (0.0)	-0.1 (0.4)	0.2 (1.3)	0.0 (1.0)
	 Manufacturing Production M/M% (Y/Y%)	Sep	0.2 (0.5)	0.1 (0.4)	-0.2 (1.3)	-0.1 (-)
	 Construction output M/M% (Y/Y%)	Sep	1.7 (3.0)	0.1 (1.3)	-0.7 (0.3)	-0.3 (0.5)
	 Trade (goods trade) balance £bn	Sep	-0.03 (-9.7)	-1.5 (-11.4)	-1.3 (-11.2)	-2.1 (-11.7)
	Country	Auction	- Nothing to report -			

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 balance €bn	Sep	18.4	20.0	17.2	17.1
	 Current account €bn	Sep	21.1	21.0	15.3	-
	 Exports (imports) M/M%	Sep	-0.8 (-0.4)	0.4 (0.8)	-0.1 (-2.7)	0.1 (-2.4)
France	 Trade balance €bn	Sep	-5.7	-5.8	-5.6	-5.7
	 Current account balance €bn	Sep	-1.9	-	-1.6	-2.0
Spain	 Industrial production M/M% (Y/Y%)	Sep	-0.7 (-0.1)	-0.5 (0.8)	0.7 (1.2)	0.6 (1.0)
UK	 RICS house price balance %	Oct	-10	-2	-2	-
Country	Auction					
France sold	 €1.7bn of 0.25% 2026 bonds (25-Nov-2026) at an average yield of 0.54%					
	 €3.8bn of 0.75% 2028 bonds (25-Nov-2028) at an average yield of 0.82%					
	 €1.5bn of 2.5% 2030 bonds (25-May-2030) at an average yield of 0.92%					
	 €1.9bn of 4.5% 2041 bonds (25-Apr-2041) at an average yield of 1.43%					
Spain sold	 €1.42bn of 0.35% 2023 bonds (30-Jul-2023) at an average yield of 0.565%					
	 €800mn of 3.45% 2066 bonds (30-Jul-2066) at an average yield of 3.03%					
	 €553.2mn of 4.2% 2037 bonds (31-Jan-2037) at an average yield of 2.224%					
	 €1.2bn of 0.05 of 2021 bonds (31-Oct-2021) at an average yield of 0.102%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

Daiwa economic forecasts

	2018				2019				2018	2019	2020
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP forecasts %, Q/Q											
Euro area 	0.4	0.4	0.2	0.3	0.3	0.3	0.3	0.3	1.9	1.3	1.2
Germany 	0.4	0.5	0.0	0.4	0.4	0.5	0.4	0.4	1.7	1.5	1.5
France 	0.2	0.2	0.4	0.3	0.4	0.3	0.3	0.3	1.6	1.3	0.9
Italy 	0.3	0.2	0.0	0.2	0.2	0.2	0.2	0.2	1.0	0.6	0.5
Spain 	0.6	0.6	0.6	0.5	0.5	0.4	0.4	0.4	2.5	1.8	1.6
UK 	0.1	0.4	0.6	0.3	0.3	0.3	0.3	0.3	1.3	1.4	1.2
Inflation forecasts %, Y/Y											
Euro area											
Headline CPI 	1.3	1.7	2.1	2.1	1.8	1.6	1.5	1.4	1.8	1.6	1.5
Core CPI 	1.0	0.9	1.0	1.1	1.1	1.2	1.3	1.3	1.0	1.2	1.4
UK											
Headline CPI 	2.7	2.4	2.5	2.3	2.1	2.2	1.9	1.9	2.5	2.0	1.9
Core CPI 	2.5	2.0	2.0	1.9	1.9	2.0	1.9	2.0	2.1	2.0	2.0
Monetary policy											
ECB											
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25
Deposit Rate % 	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.25	-0.25	-0.40	-0.25	0.00
Net asset purchases* 	30	30	30	15	0	0	0	0	15	0	0
BoE											
Bank Rate % 	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	0.75	1.00	1.25
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.

Coming week's data calendar

Key data releases						
Country		GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 12 November 2018						
EMU		14:55	ECB public sector asset purchases €bn	Weekly	-	-1.4
France		07:30	Bank of France industrial sentiment	Oct	104	105
Italy		09:00	Industrial production M/M% (Y/Y%)	Sep	-0.5 (0.6)	1.7 (-0.8)
Tuesday 13 November 2018						
EMU		10:00	ZEW expectations indicator	Nov	-	-19.4
Germany		07:00	Final EU-harmonised CPI Y/Y%	Oct	2.4	2.2
		10:00	ZEW current situation (expectations) indicator	Nov	65.0 (-25.0)	70.1 (-24.7)
UK		09:30	Claimant count rate % (change '000s)	Oct	-	2.6 (18.5)
		09:30	Average weekly earnings (excl. bonuses) 3M/Y%	Sep	3.0 (3.1)	2.7 (3.1)
		09:30	ILO Unemployment rate 3M%	Sep	4.0	4.0
		09:30	Employment change 3M/3M '000s	Sep	23	-5
Wednesday 14 November 2018						
EMU		10:00	GDP - second estimate Q/Q% (Y/Y)	Q3	0.2 (1.7)	0.4 (2.2)
		10:00	Industrial production M/M% (Y/Y%)	Sep	-0.4 (0.4)	1.0 (0.9)
		10:00	Employment Q/Q% (Y/Y%)	Q3	-	0.4 (1.5)
Germany		07:00	GDP - first estimate Q/Q% (Y/Y)	Q3	0.0 (1.4)	0.5 (2.3)
France		07:45	Final EU-harmonised CPI Y/Y%	Oct	2.5	2.5
Spain		08:00	Final EU-harmonised CPI Y/Y%	Oct	2.3	2.3
UK		09:30	CPI (core CPI) Y/Y%	Oct	2.5 (1.9)	2.4 (1.9)
		09:30	Input (output) PPI Y/Y%	Oct	9.6 (3.1)	10.3 (3.1)
		09:30	UK House Price Index Y/Y%	Sep	3.3	3.2
Thursday 15 November 2018						
EMU		07:00	EU27 new car registrations Y/Y%	Oct	-	-23.5
		10:00	Trade balance €bn	Sep	16.7	16.6
UK		09:30	Retail sales excluding auto fuel M/M% (Y/Y%)	Oct	0.2 (3.3)	-0.8 (3.2)
		09:30	Retail sales including auto fuel M/M% (Y/Y%)	Oct	0.1 (2.8)	-0.8 (3.0)
Friday 16 November 2018						
EMU		10:00	Final CPI (core CPI) Y/Y%	Oct	2.2 (1.1)	2.1 (0.9)
Italy		10:00	Final EU-harmonised CPI Y/Y%	Oct	1.7	1.5
		11:00	Trade balance €bn	Sep	-	2.6

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

Key events & auctions			
Country	GMT	Event / Auction	
Monday 12 November 2018			
EMU	 10:00	ECB's Vice President De Guindos scheduled to speak in Frankfurt	
Tuesday 13 November 2018			
EMU	 08:00	ECB's Praet scheduled to speak in London	
	 08:45	ECB's Lautenschlaeger sscheduled to speak in Frankfurt	
	 19:00	ECB's Vice President de Guindos scheduled to speak in Frankfurt	
Germany	 10:30	Auction: to sell €4bn of 2020 bonds (11-Dec-2020)	
Italy	 10:00	Auction: to sell up to €2.5bn of 2.3% 2021 bonds (15-Oct-2021)	
	 10:00	Auction: to sell up to €1.8bn of 2.5% 2025 bonds (15-Nov-2025)	
	 10:00	Auction: to sell up to €1.3bn of 2.95% 2038 bonds (01-Sep-2038)	
Wednesday 14 November 2018			
Germany	 10:30	Auction: to sell €1.5bn of 1.25% of 2048 bonds (15-Aug-2048)	
Thursday 15 November 2018			
EMU	 12:15	ECB's Coeure scheduled to speak in Basel	
	 13:10	ECB's Praet scheduled to speak in Brussels	
UK	 10:30	Auction: to sell £2bn of 1.75% 2037 bonds (07-Sep-2037)	
Friday 16 November 2018			
- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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