Daiwa Capital Markets

Euro wrap-up

Overview

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- Gilts made notable gains as UK-EU Brexit deal was met with condemnation from both sides of the Brexit argument and triggered the resignation of several ministers from the UK Cabinet.
- Bunds followed Gilts higher, while euro area trade figures implied that net trade was a drag on GDP growth in Q3.
- Focus tomorrow will no doubt remain on UK political developments, while final euro area inflation figures for October are due.

Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-0.593	-0.019
OBL 0 10/23	-0.235	-0.038
DBR 0¼ 08/28	0.360	-0.037
UKT 2 07/20	0.712	-0.076
UKT 0¾ 07/23	0.929	-0.136
UKT 1⅝ 10/28	1.379	-0.135

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

UK

May's final countdown?

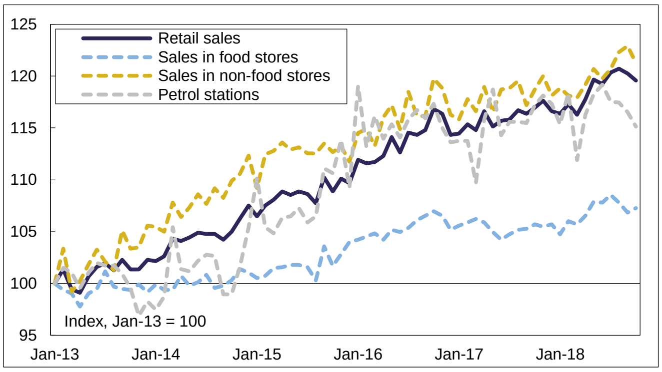
When UK PM Theresa May announced last night that she had secured Cabinet approval of the Brexit deal struck between EU and UK negotiators she might have thought she had guaranteed a small amount of breathing space. But, true to form in the Brexit process, things have not turned out like that. Indeed they have gone from bad to worse.

Unsurprisingly, the Irish backstop (and the backstop to the backstop) reportedly caused the most heated debates among Cabinet members, while the publication of the 585-page Withdrawal Agreement was met with widespread condemnation from both sides of the Brexit argument. To top it all, this morning saw the resignation of several ministers, including, most significantly, Brexit Secretary Dominic Raab.

The criticism of the withdrawal agreement was certainly understandable. The backstop mechanism would leave the UK in a potentially-indefinite customs union with the EU (the UK government will not be in a position to unilaterally leave the backstop without leaving Northern Ireland in a separate arrangement with the EU). Additionally, the UK will have to commit to continuing to follow EU rules on labour and environmental standards, among others, with ECJ oversight over large swathes of the UK. This is therefore a deal that tries to protect UK manufacturing, but does nothing for the service sector while leaving the country tied to many EU rules and regulations. It does indeed seem a high price to pay for ending free movement.

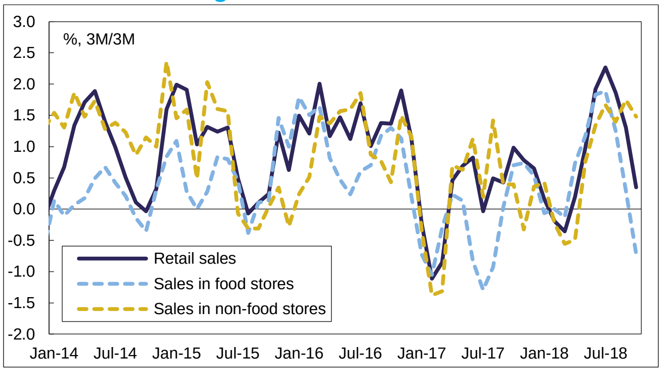
While May might have expected to lose some Cabinet ministers, the loss of Raab is a particular blow. And with several MPs reportedly submitting letters to seek a no confidence vote in her leadership of the Conservative Party, political instability looks set to intensify from here. Indeed, while she might be able to win any no confidence vote within her party over the near term, allowing her to sign-off the deal at the special EU leaders' summit scheduled on 25 November, it looks increasingly unlikely that she will get the Withdrawal Agreement through UK parliament in December. At that point May will be faced with total crisis. With her deal dead (and the EU unwilling to reopen negotiations in any meaningful sense) the choice facing the UK will come down to heading for a no deal Brexit, which will not have the support of parliament, or, perhaps, look to put the decision back to a referendum, giving a choice between her deal or remain. So, with today's news having weighed heavily on sentiment – sterling was down almost 2% against the euro today back through 1.13, while 10Y Gilt yields were down around 15bps – we expect financial markets to remain volatile through to year-end.

UK: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Retail sales growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Retail sector in decline after a summer boost

The latest retail sales data for October were also consistent with weaker sentiment in financial markets. Following very rapid growth over the summer months, retail sector activity declined in September (albeit by less than originally thought), and today's figures brought a further downward surprise with a decline of 0.6%M/M. Grocery stores saw sales rising modestly, by 0.4%M/M, so the weakness was accounted for by sales in the non-food sector. Clothing sales declined by 1%M/M, with retailers suggesting that shoppers were not particularly interested in their winter ranges given the mild weather last month. Meanwhile, results from household goods stores were the most disappointing showing a sharp drop of 3%M/M, although that followed a very strong increase in the previous two months. So, overall, despite the weakness in the housing market, household good sales appear to have remained on an upward trend. When stripping out monthly volatility, total retail sales were also up on a three month basis by 0.4%3M/3M and compared with a year earlier by 2.2%Y/Y. However, this compares to of increase of more than 2%3M/3M and around 4%Y/Y seen in the preceding months, suggesting a notable slowdown in consumer spending, perhaps to a level more consistent with subdued consumer confidence. And while somewhat higher real wage growth should provide some support over coming months, ongoing uncertainty with regards to the Brexit outcome will likely weigh on consumer spending.

The day ahead in the UK

With no new economic data releases in the UK at the end of the week, political and Brexit developments will remain in the limelight.

Euro area

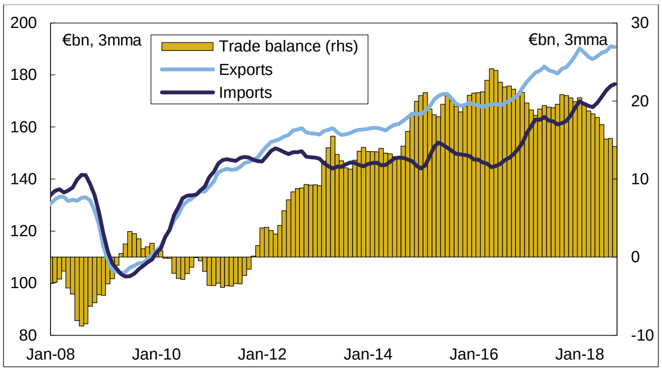
Euro area trade surplus narrowed in Q3

While euro area GDP growth was confirmed earlier this week at 0.2%Q/Q in Q3, we will have to wait until the final release on 7 December for the official expenditure breakdown. However, today's release of September's trade figures support our view that net trade played its role in the slowdown last quarter. While the headline trade surplus (on an unadjusted basis) widened slightly in September (up €1.4bn to €13.1bn), the seasonally adjusted surplus recorded a notable decline by €3.4bn to €13.4bn, to leave the surplus in Q3 (€42.6bn) at a more-than four-year low. This in part reflected weakness in the value of exports in September, down 1.6%M/M, with notable declines in shipments to the US and Turkey – exports to the latter were down a whopping 27% compared with a year earlier. Nevertheless, this still left total exports up a little more than 1%Q/Q in Q3, and 2½%Y/Y. However, the value of imports rose in September to leave them up 2.9%Q/Q in Q3, 9.6%Y/Y. So, while it is difficult to assess the full impact of price movements, today's report strongly suggests that net trade was a drag on growth in Q3.

Car registrations remained subdued in October

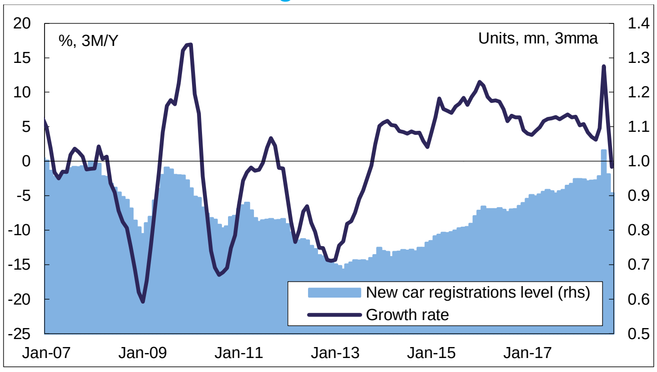
With private consumption appearing to have slowed in the third quarter, headline figures for new car registrations signalled another subdued showing at the start of Q4. In particular, new car registrations in the euro area were down 7.3%Y/Y, following a more-than 24%Y/Y decline in September. And even stripping out some month-to-month volatility, registrations over the past three months were almost 3% lower than the same period a year ago. Admittedly, recent weakness has been driven by the introduction of new 'WLTP' (Worldwide Harmonised Light Vehicle Test Procedure) emission-testing standards. So, when looking through this distortion, on a year-to-date basis growth was still relatively strong, at 2.9%YTD/Y, about 1ppt below the equivalent rate in the first half of the year. Meanwhile, seasonally adjusted data showed an increase of 9.1%M/M in October, following the 37%M/M decline previously. But while the increase in car registrations in the year-to-date were still strong in France (5.7%YTD/Y) and Spain (9.8%YTD/Y), it slowed again in Germany (1.4%YTD/Y) and was down in Italy (-3.4%YTD/Y).

Euro area: Trade



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: New car registrations



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area and US

Tomorrow will bring euro area final inflation figures for October. The final inflation data from Germany, France and Spain earlier this week brought no surprises, confirming the initial estimates of 2.4%Y/Y, 2.5%Y/Y and 2.3%Y/Y on the respective EU-harmonised measures. So, we expect the euro area figures to confirm the flash estimates showing headline CPI rising0.1ppt to 2.2%Y/Y, a near-6-year high, and core CPI rising 0.2ppt to 1.1%Y/Y. In addition, ECB President Draghi will speak at a conference in Frankfurt.

In the US, tomorrow's data focus will be October's industrial production release, which is expected to show that output rose for the fifth consecutive month. The Kansas City Fed's Manufacturing Activity Index for November, as well as capital inflows figures for September are also due for release.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
EMU		EU27 new car registrations Y/Y%	Oct	**-7.3**	-	-23.5	**-**
		Trade balance €bn	Sep	**13.4**	16.3	16.6	**16.8**
UK		Retail sales excluding auto fuel M/M% (Y/Y%)	Oct	**-0.4 (2.7)**	0.2 (3.4)	-0.8 (3.2)	**-0.3 (3.6)**
		Retail sales including auto fuel M/M% (Y/Y%)	Oct	**-0.5 (2.2)**	0.2 (2.8)	-0.8 (3.0)	**-0.4 (3.3)**
Country		Auction					
UK sold		£2bn of 1.75% 2037 bonds (07-Sep-2037) at an average yield of 1.918%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

Tomorrow's data releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
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
Country		GMT	Auction / Event			
			- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

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