Daiwa Capital Markets

Euro wrap-up

Overview

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- Shorter-dated Bunds made modest losses after Estonian Governing Council member Muller joined the group of more hawkish members to suggest there is no strong case to resume QE.
- Gilts made gains as UK MPs took first action to try to prevent a no-deal Brexit.
- Politics in the UK will remain a key focus tomorrow, while final services and composite PMIs from the euro area and UK, and euro area retail sales data are due.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.924	+0.016
OBL 0 10/24	-0.928	+0.009
DBR 0 08/29	-0.720	-0.014
UKT 3¾ 09/21	0.322	-0.010
UKT 1 04/24	0.260	-0.007
UKT 0⅞ 10/29	0.393	-0.022

*Change from close as at 4:30pm BST.
Source: Bloomberg

UK

MPs set to free up time to pass anti-no-deal legislation

As had seemed likely for some time, a cross-party group of MPs today launched their attempt to legislate to prevent the UK from leaving the EU at the end of October without a deal. In particular, the MPs, who crucially included several senior Conservatives, were set this evening to vote on a motion to take control of the order of business of the House of Commons through to Wednesday evening away from the Government. If, as we strongly expect, they are successful, they will aim tomorrow to force through draft legislation, presented yesterday evening, which would compel the Prime Minister to request a three-month extension of the Article 50 deadline, i.e. to 31 January, if a deal with the EU has not been agreed by 19 October. The legislation would also provide for possible further extensions of the Article 50 deadline beyond that date, as well as regular reporting by the Government on the progress in its negotiations with the EU. While PM Johnson had threatened to prevent any rebel MPs from standing as Conservative MPs at the next general election if they vote against the Government, between fifteen and twenty prominent Tories seemed likely to do so, more than sufficient to allow the anti-no-deal legislation to pass the House of Commons tomorrow. Indeed, with today's defection to the Liberal Democrats of Conservative MP Phillip Lee, Johnson's government now formally has no majority in the House of Commons.

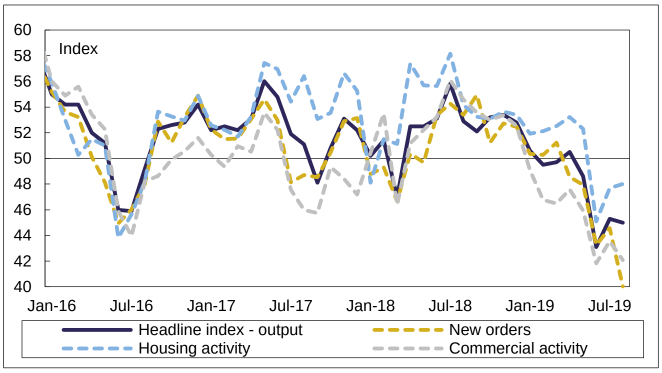
House of Commons set to back anti-no-deal legislation

If the House of Commons approves that draft legislation tomorrow, PM Johnson is expected to propose an early general election, with his preferred date now seemingly 14 October. That would be just three days ahead of the next key EU summit and 17 days before the Article 50 deadline, providing insufficient time to negotiate and pass a new deal, not least since Johnson has still failed to make any meaningful proposed amendments to the draft Withdrawal Agreement. Under the Fixed-Term Parliaments Act (FTPA), however, two thirds of all MPs would have to approve Johnson's motion calling an early general election. And, all indications today were that opposition MPs will not vote in favour of such an early election unless and until the anti-no-deal legislation has received Royal Assent. As such, the focus would still shift to the House of Lords, which might have to sit over the weekend to give sufficient time for the legislation to gain upper house approval before the planned prorogation of Parliament early next week.

Construction PMI consistent with contraction

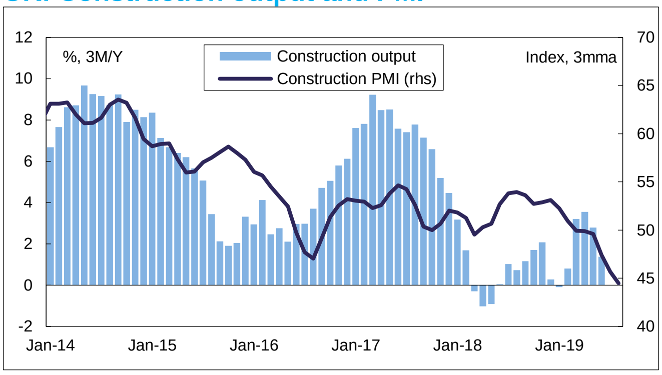
Unsurprisingly, Brexit uncertainty continues to weigh on confidence and economic growth. After yesterday's dire manufacturing PMI flagged the likelihood of a further contraction in production in Q3, today's construction PMI similarly suggested a significant pace of decline in activity as Brexit-related uncertainty and tighter budgets caused clients to delay

UK: Construction PMI



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

UK: Construction output and PMI



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

their decision making. In particular, the headline activity index slipped back in August, down 0.3pt to just 45.0, the second-lowest reading for a decade, to leave it on average in July and August more than 2pts lower than the average in Q2. While housing and civil engineering activity reportedly declined at a slightly softer pace last month, there was a further notable contraction in commercial activity. As a result, so far in Q3, all three sub-sectors have seen their respective indices on average notably weaker than in Q2. Against this backdrop, it might have been somewhat surprising to see construction firms indicating a smaller drop in employment in August, with the rate of decline the slowest since the downtrend started in April. Certainly, construction firms remained extremely gloomy about the near-term outlook. Indeed, new orders fell at an accelerated rate in August – the relevant PMI fell 4½pts to just 40.0, the lowest since March 2009 – while business expectations were at the weakest since 2008 at the height of the global financial crisis.

BRC survey signals retail sales weakness

The latest BRC retail sales monitor highlighted the likelihood of a weak quarter on the High Street too. In particular, total sales on the survey measure were unchanged from a year ago in August, with like-for-like sales down 0.5%Y/Y. Food sales (up 0.5%3M/Y) continued to provide support to the trend as the warmer weather in the second half of the month provided a boost, but non-food sales were down 1.2%3M/Y. And while growth in online non-food sales remained positive, at 2.2%Y/Y this was the second-softest reading on the series, which dates back more than a decade. While some of the weakness last month reflected summer discounting, even adjusting for price effects, total sales growth on a three-month basis was still down compared with a year earlier for the fifth month out of the past six. And with consumer confidence having dipped last month, we see little prospect of a meaningful acceleration in household spending at the end of the third quarter either.

The day ahead in the UK

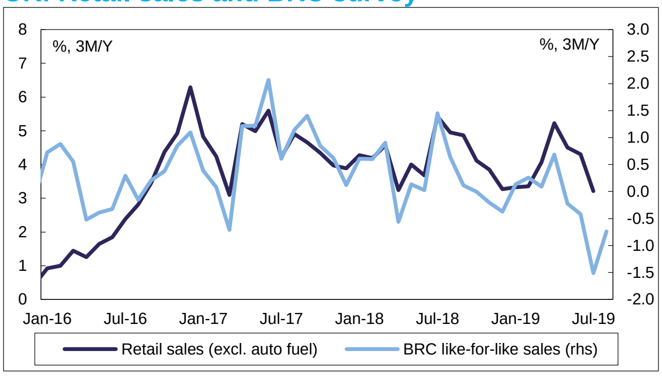
Political developments will of course continue to attract most attention tomorrow as a cross-party group of MPs seeks the House of Commons' approval of draft legislation demanding the Prime Minister takes action to avoid a no-deal Brexit. But also of interest will be the services PMI for August. The headline index might well reverse some of the 1.2pts increase in July (to 51.4) to signal very subdued growth in the sector in August. While the headline manufacturing PMI fell to its lowest for more than six years there was a modest pickup in the manufacturing output PMI (up 0.7pt to 47.7), as such the composite PMI might well remain little changed from the 50.7 reading in July, nevertheless a level Markit considers to be consistent with ongoing contraction. Elsewhere, BoE policy makers, including Carney, Haldane, Haskel and Vlieghe, are due to appear before the Treasury Select Committee to testify on the most recent Inflation Report and provide an update on the Bank's assessment of the possible impact of a no-deal Brexit.

Euro area

Euro area PPI highlights disinflationary pressures

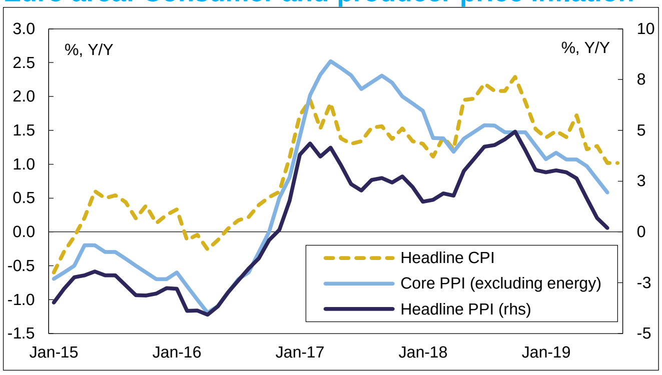
After the flash estimate of euro area inflation last week week showed the headline CPI rate unchanged in August at its lowest since November 2016, at just 1.0%Y/Y, today's producer price inflation figures cast light on further disinflationary pressures in the pipeline. Despite a monthly rise in producer prices for the first month in five, the year-on-year inflation rate fell for the fifth consecutive month in July, by a further 0.5ppt to 0.2%Y/Y, the lowest rate since November 2016. This principally reflected a drop in energy price inflation, down 1.5ppts to -1.7%Y/Y, further supporting our view that energy prices will provide an increasing drag on consumer price inflation over coming months. But with prices of intermediate goods also falling (down 0.4ppt to -0.2%Y/Y), the core PPI rate (excluding energy) also fell 0.2ppt to 0.6%Y/Y, similarly its lowest rate since 2016, suggesting that underlying pipeline pressures are also waning too.

UK: Retail sales and BRC survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer and producer price inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area and US

Tomorrow will bring a several top-tier euro area releases, which will provide more information about the extent of economic growth in Q3. In particular, retail sales figures for July are likely to indicate a soft start to the third quarter after a surge at the end of Q2, not least reflecting a notable decline in Germany where sales fell more than 2%M/M in July. The final services PMIs are also due and expected to align with the preliminary release showing a modest improvement in the headline index by 0.2pt to 53.4. But despite the very slight upwards revision to the manufacturing output PMI, the composite PMI is expected to be confirmed at 51.8, an increase of 0.3pt on the month but merely in line with the average in Q2, and therefore consistent with still-subdued GDP growth.

Italian financial markets, meanwhile, will respond to the outcome of today's vote of Five Star Movement members on the draft programme for a coalition with the Democratic Party, which includes the replacement of the automatic VAT increase with offsetting consolidation measures, lower labour taxes, the introduction of a minimum wage, and revisions to the previous government's migration measures. Assuming the deal is approved, Prime Minister-designate Giuseppe Conte will present a list of Ministers to President Mattarella on Wednesday ahead of confidence votes in parliament at the back end of the week.

In the US, tomorrow's data highlights will be July's full trade report and vehicle sales figures for August, while the Fed's Beige Book is also due.

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European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		PPI M/M% (Y/Y%)	Jul	**0.2 (0.2)**	0.2 (0.2)	-0.6 (0.7)	
Spain		Unemployment change '000s	Aug	**54.4**	-	-4.3	-
UK		BRC retail sales monitor - like-for-like sales Y/Y%	Aug	**-0.5**	0.5	0.1	-
		Construction PMI	Aug	**45.0**	46.6	45.3	-

Auctions

Country		Auction
UK sold		£3.0bn of the 0.625% 2025 bonds at an average yield of 0.225%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		09.00	Final services PMI (composite PMI)	Aug	53.4 (51.8)	53.2 (51.5)
		10.00	Retail sales M/M% (Y/Y%)	Jul	-0.5 (2.3)	1.1 (2.6)
Germany		08.55	Final services PMI (composite PMI)	Aug	54.4 (51.4)	54.5 (50.9)
France		08.50	Final services PMI (composite PMI)	Aug	53.3 (52.7)	52.6 (51.9)
Italy		08.45	Services PMI (composite PMI)	Aug	51.6 (50.6)	51.7 (51.0)
Spain		08.15	Services PMI (composite PMI)	Aug	53.0 (52.0)	52.9 (51.7)
UK		09.30	Services PMI (composite PMI)	Aug	51.5 (50.5)	51.4 (50.7)

Auctions

Country		BST	Auction/Event
EMU		12.00	ECB's Lane due to speak in London
Germany		10.30	Auction: to sell €3bn of the 0% 2024 bonds
UK		14.15	BoE's Carney, Haldane, Haskel and Vlieghe to testify before the Treasury Select Committee

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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