Euro wrap-up

Overview

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- Shorter-dated Bunds made gains as the European Commission's sentiment indicator fell to its lowest level since early 2015, while French flash inflation for September fell short of expectations.
- Gilts made bigger gains after previously hawkish BoE MPC member Saunders hinted that a rate cut might be necessary even if a no-deal Brexit is avoided.
- The coming week will bring euro area flash inflation, unemployment and retail sales figures, while final PMIs for September are due the euro area and UK.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.779	-0.017
OBL 0 10/24	-0.774	-0.008
DBR 0 08/29	-0.577	+0.009
UKT 3¾ 09/21	0.396	-0.042
UKT 1 04/24	0.307	-0.050
UKT 0⅞ 10/29	0.499	-0.020

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

Euro area

Commission sentiment indices follow PMIs south

Like the flash PMIs released at the start of the week, today's European Commission business and consumer survey indices pointed to a significant further deterioration in economic momentum in September. Most notably, the headline euro area Economic Sentiment Indicator (ESI) fell a steep 1.4pts to 100.9, the lowest since February 2015. Among the large member states, the ESIs declined significantly in Germany (the lowest since May 2013), Italy (the lowest since February 2015), Spain and the Netherlands but only slightly in France. Also similar to the flash PMIs, the deterioration was led by the manufacturing sector, with the headline industrial confidence indicator down 3.0pts – the most since 2011 – to -8.8, the lowest since mid-2013. According to the survey, industrial production expectations and orders fell to the lowest since 2013.

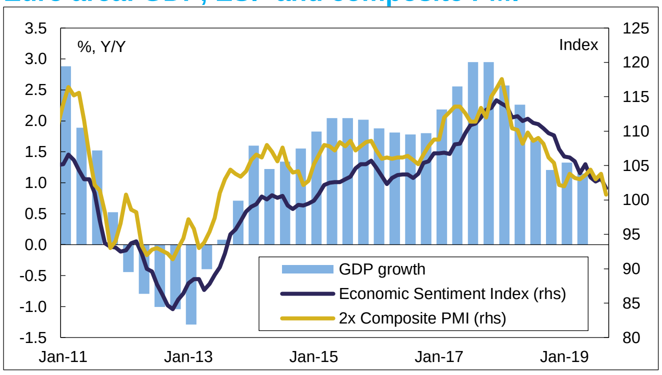
Weakness remains centred on the industrial sector

Among other detail, services firms were a touch happier, but that principally reflected an upgrade to their assessment of past demand while their expectations for the future were little changed. Sentiment among construction firms deteriorated only slightly, but still touched its lowest level since end-2017. Retailers were more downbeat than last month, but the relevant sentiment index remained well within the range of the past year. And the slight improvement in consumer confidence reported by the flash estimate was confirmed, but propensity to make major purchases was merely stable. Employment intentions were revised down in industry and retail, while household concerns about unemployment increased. And services selling price expectations fell to a two-year low, industrial selling price expectations declined to the second-lowest of the past three years, and consumer price expectations also slipped back close to the bottom of the range of the past two years. All in all, therefore, another disappointing survey which points to slower economic growth, a further moderation in job growth and diminishing price pressures heading into the fourth quarter.

French inflation posts surprise drop

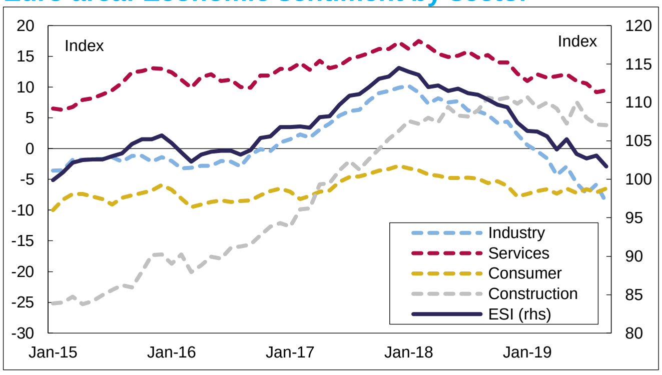
Like the Commission survey indices, today's other top-tier data, which principally came from France, also missed expectations, although the detail was not quite as bad as the headline numbers suggested. Certainly, the flash estimates of French inflation in September – the first such numbers to come from any member state – delivered a downside surprise. Contrary to expectations of no change, the CPI rate on the harmonised EU measure dropped 0.2ppt to 1.1%Y/Y, which matched the lowest rate of the past two years. However, while no breakdown on this measure was provided by INSEE, the detail on the national measure revealed that the downward pressure on inflation came from prices of food (down 1.0ppt to 2.1%Y/Y) and energy (down 0.6ppt to 0.2%Y/Y). In contrast, core components on that basis were higher, with inflation of manufactured products up 0.2ppt to (an admittedly still very weak) -0.7%Y/Y and services up by the same margin to 1.3%Y/Y.

Euro area: GDP, ESI* and composite PMI



*Economic Sentiment Index. Source: Markit, European Commission, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Economic sentiment by sector



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

French spending softer than expected too

The latest French figures for household consumption on goods were also weaker than expected with the level unchanged in August after rising 0.4%M/M the prior month. The impact of a further significant increase in spending on durable goods (1.6%M/M following a gain of 1.7%M/M in July) thanks not least to stronger (but likely temporary) growth in new car purchases, as well as clothing (up 1.6%M/M following a steeper dip previously), was offset by lower spending on food and energy. The sideways move in overall spending in August left it down 0.4%Y/Y but still up a steady 0.3%3M/3M. With consumer confidence in September up to its highest since January 2018, the moderately positive trend in consumption is likely to be broadly maintained going forward. The central government's draft budgetary plans for 2020 announced yesterday should provide further support. Indeed, these plans confirmed Macron's proposals for cuts in income tax for low earners and other sweeteners for more cash-constrained individuals, even though the headline budget deficit is forecast to drop by 0.9ppt to 2.2% of GDP back comfortable below the Stability and Growth Pact limit.

The day ahead in the euro area and US

The coming week brings a handful of top-tier euro area economic releases, kicking off on Monday with August unemployment figures that are likely to confirm the rate of unemployment remained at the lowest since mid-2008. Despite the tighter labour market, Tuesday's flash CPI estimate for September is expected to show that inflation pressures remained very subdued. Despite the recent jump in the oil price, headline inflation is forecast to fall below 1%Y/Y for the first time since November 2016, while core inflation might well tick higher to 1.0%Y/Y. That day will also bring the final manufacturing PMI for September, which seems bound to confirm the extremely disappointing flash release that showed the headline index declining 1.4pts to 45.6, the lowest in more than seven years. Final services and composite indices are due on Thursday and similarly expected to align with the preliminary readings, which reported a notable deterioration in the services sector. As such, the euro area composite PMI fell 1.5pts in September – the most since December – to just 50.4, the lowest since June 2013 and a level suggesting that economic growth has all but come to a halt. Thursday will also bring retail sales figures for August, which are expected to reverse only some of the decline recorded at the start of Q3.

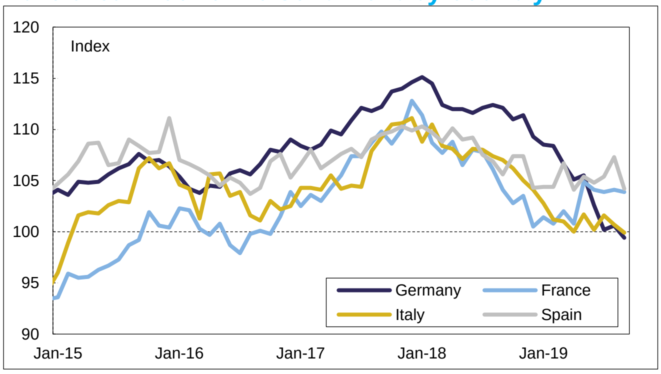
At the country level, meanwhile, Monday will bring flash inflation releases from Germany, Italy and Spain, as well as the latest labour market reports from Germany and Italy. And German retail sales are due sometime during the week.

In terms of politics, Monday evening will bring a key meeting of Italy's new Cabinet to discuss its draft budget for 2020. The Cabinet will seek to be compliant with EU rules while avoiding the automatic increase in VAT that is built into current legislation. Before then, Sunday will bring Austria's general election. With polls suggesting that the conservative Austrian People's party (ÖVP) will receive more than one third of the vote, its leader Sebastian Kurz is almost certain to remain Chancellor. Negotiations to form a coalition government will then get under way. After his previous coalition with the far-right Freedom Party collapsed in May when its leader was embroiled in a scandal related to illegal funding from Russia, the Greens –currently on the rise across much of Europe – and the liberal NEOS party would seem more likely partners.

Meanwhile, ECB policymakers set to speak publicly include Bundesbank President Weidman on Tuesday, ECB Vice President De Guindos and dovish Finnish Governor Rehn on Thursday. In the markets, Germany will sell 5Y Bunds on Wednesday, while France and Spain will sell bonds with various maturities on Thursday.

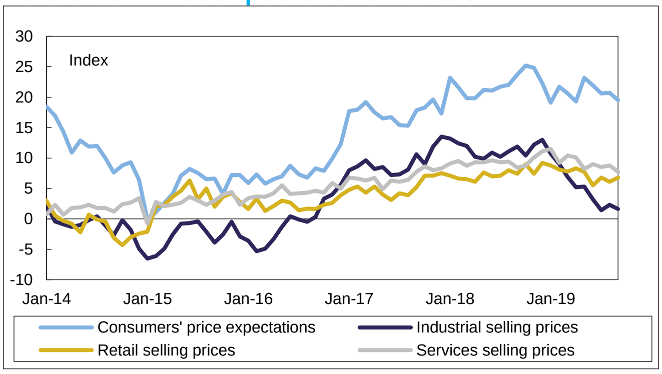
In the US, there are a number of top-tier releases in the coming week, including September's manufacturing and non-manufacturing ISMs on Tuesday and Thursday respectively. While the manufacturing survey is expected to signal ongoing weakness in the sector, the non-manufacturing index is likely to point to still-solid expansion at the end of Q3. Tuesday will also bring construction spending and vehicle sales figures, followed on Wednesday by the ADP employment report, on Thursday by factory orders data and on Friday by the full trade numbers. But most focus on Friday will be on the BLS employment report, with non-farm payrolls expected to have increased by 140k in September, slightly below the average for the year so far. As such, the unemployment rate is expected to be unchanged at 3.7%, while average earnings growth is also forecast to be unchanged at 3.2%Y/Y. In terms of Fed speak, various FOMC members are due to appear at conferences throughout the week, including Chair Powell at a 'Fed listens event' on Friday. Meanwhile, there are no UST auctions scheduled.

Euro area: Economic sentiment by country



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

Euro area: Price expectations indices



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

UK

Consumer confidence remains subdued

The meeting between UK Brexit Secretary Barclay and EU Chief Negotiator Barnier in Brussels today predictably saw nothing substantive emerge to suggest that the Brexit deadlock might be broken anytime soon. But while persistent political uncertainty is increasingly taking its toll on the UK economy, the latest GfK consumer survey indicated a surprising, albeit relatively modest, pickup in confidence. In particular, the headline index rose 2pts in September to -12, still comfortably within the recent range, 3pts lower than a year earlier and 11pts lower than the pre-referendum level. While there were improvements across the survey components, they still continued to suggest that consumers feel less than positive about the current and future economic situation – indeed the survey's index for expected economic conditions over the coming twelve months was still one of the lowest since the Global Financial Crisis. While the headline index remains some way above the record lows seen during that period, overall today's survey suggests little substantive improvement in household confidence. And with the component measuring consumers' willingness to make major purchases still below its level a year ago, we expect consumption growth to become increasingly subdued the longer political uncertainty persists.

BoE hawk becomes more dovish

While consumers have yet to markedly change their spending habits, ongoing political uncertainty continues to take a toll on firms' behaviour. Contrasting strikingly with the uptrend seen in other major economies, fixed investment in the UK has moved broadly sideways since the Brexit referendum. And business surveys signal a weakening trend in production, investment and employment ahead. The statement from the BoE's policy-setting meeting earlier this month had suggested that the MPC had lost confidence about the Brexit process too, and had also become more downbeat about the consequences for economic growth. Today's speech by MPC member Michael Saunders, who had previously been one of the most hawkish members of the Committee, expanded upon this pessimistic assessment, emphasising the risk of compounding adverse effects on the economy of persistent political uncertainty. Indeed, for as long as the current policy impasse persists, Saunders judged that firms and households alike will be increasingly likely to defer spending in the (perhaps naive) hope that a solution to Brexit might be on the cards over the near term.

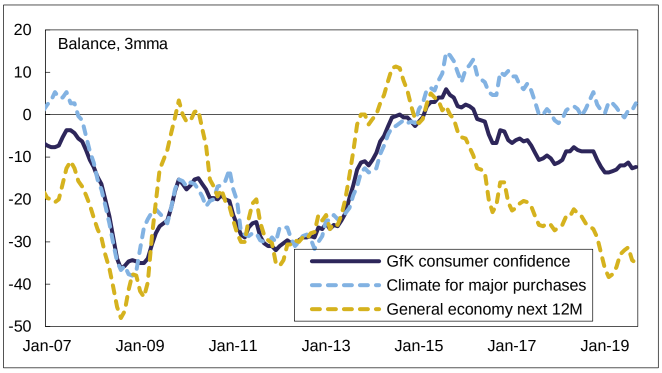
Strengthening case for a cut in Bank Rate

Brexit uncertainty is not the only reason why Saunders and other members of the MPC have become more dovish. Risks to the global outlook have become increasingly skewed to the downside. And given the slowing in GDP, capacity pressures are no longer increasing and may be starting to ease. Indeed, assuming recent weakness in business investment continues and export growth undershoots the BoE's forecast in August's Inflation Report, Saunders assessed that, even with a 25bp cut in Bank Rate, the level of real GDP would be roughly 2½% below the Bank's base-case forecast three years ahead. So, he noted that, even if a no-deal Brexit is avoided, persisting uncertainty surrounding the future relationship between the UK and EU might well eventually warrant an easing in monetary policy. Moreover, even if a Brexit deal is eventually reached, Saunders judged it plausible that the next move for the BoE would be to cut rates. This accords with our own view, and we currently forecast a 25bps cut in Bank Rate in May.

The coming week in the UK

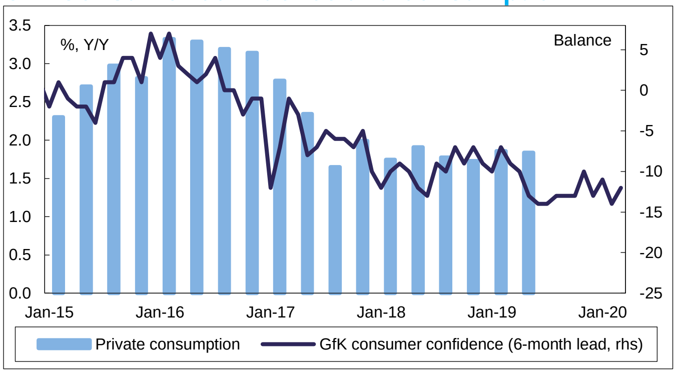
While focus in the first half of the coming week will be on the Conservative Party conference, where populist English nationalism will be in full effect, the most notable UK economic data will be the September PMIs, with the manufacturing, construction and services surveys due Tuesday, Wednesday and Thursday respectively. Having declined to the lowest level for more than six years in August (47.4) the headline manufacturing index is expected to fall further into contractionary territory in September as downside risks – domestic and external alike – intensified. And with the services PMI expected to have edged slightly lower again (from 50.6 in August), the composite PMI is forecast to fall to 50.0, which would leave the quarterly average in Q3 the lowest since Q412, consistent with contraction in underlying GDP growth. Ahead of these, the final estimate of Q2 GDP is due on Monday, and is expected to confirm that the economy contracted by 0.2%Q/Q. The accompanying balance of payments figures are likely to show the current account deficit narrowing in Q2 on the back of a smaller trade deficit that quarter. That day will also bring the BoE's latest bank lending figures for August, along with the Lloyds business barometer for September. Finally, the week will conclude with new car registrations numbers for September on Friday. In the markets, the DMO will sell 20Y Gilts on Tuesday.

UK: Consumer confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Consumer confidence and consumption



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Economic forecasts

	2019				2020						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2018	2019	2020
GDP forecasts %, Q/Q											
Euro area	0.4	0.2	0.1	0.2	0.2	0.2	0.2	0.1	1.9	1.1	0.8
Germany	0.4	-0.1	-0.1	0.1	0.1	0.2	0.1	0.1	1.5	0.5	0.4
France	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	1.7	1.3	1.2
Italy	0.1	0.0	0.0	0.0	0.0	0.1	-0.1	-0.1	0.7	0.0	0.1
Spain	0.7	0.5	0.4	0.4	0.4	0.4	0.4	0.3	2.4	2.2	1.6
UK	0.5	-0.2	0.2	-0.1	0.2	0.2	0.2	0.1	1.4	1.0	0.5
Inflation forecasts %, Y/Y											
Euro area											
Headline CPI	1.4	1.4	1.0	1.0	1.2	1.2	1.4	1.2	1.8	1.2	1.2
Core CPI	1.0	1.1	0.9	1.0	1.1	1.2	1.4	1.3	1.0	1.0	1.0
UK											
Headline CPI	1.9	2.0	1.9	1.7	2.0	1.7	1.5	1.5	2.5	1.9	1.7
Core CPI	1.9	1.7	1.7	1.6	1.7	1.8	1.7	1.7	2.1	1.7	1.7
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	0.00
Deposit Rate %	-0.40	-0.40	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.40	-0.50	-0.50
Net asset purchases*	0	0	0	20	20	20	20	20	15	20	20
BoE											
Bank Rate %	0.75	0.75	0.75	0.75	0.75	0.50	0.50	0.50	0.75	0.75	0.50
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.*

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	Economic sentiment (consumer confidence) indicator	Sep	**101.7 (-6.5)**	103.0 (-6.5)	103.1 (-7.1)	-
	Industrial confidence (services confidence) indicator	Sep	**-8.8 (9.5)**	-6.0 (9.4)	-5.9 (9.3)	-5.8 (9.2)
France	Preliminary CPI (EU-harmonised CPI) Y/Y%	Sep	**0.9 (1.1)**	1.0 (1.3)	1.0 (1.3)	-
	Consumer spending M/M% (Y/Y%)	Aug	**0.0 (-0.4)**	0.3 (-0.1)	0.4 (0.1)	-
Italy	Economic sentiment indicator	Sep	**98.5**	-	98.9	98.8
	Consumer confidence (manufacturing confidence) indicator	Sep	**112.2 (98.8)**	112.3 (100.0)	111.9 (99.7)	- (99.6)
Spain	Retail sales Y/Y%	Aug	**3.2**	3.0	3.2	3.3
UK	GfK consumer confidence indicator	Sep	**-12**	-14	-14	-

Auctions

Country	Auction
Italy	Auction: sold €3.75bn of 0.35% 2025 bonds at an average yield of 0.26%
	Auction: to sold €3bn of 1.35% 2030 bonds at an average yield of 0.88%
	Auction: to sold €0.75bn of floating rate 2025 bonds at an average yield of 0.52%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

The coming week's key data releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
			Monday 30 September 2019			
EMU		10.00	Unemployment rate %	Aug	7.5	7.5
Germany		08.55	Unemployment rate % (change '000s)	Sep	5.0 (5.0)	5.0 (4.0)
		13.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Sep	1.3 (1.0)	1.4 (1.0)
		-	Retail sales* M/M% (Y/Y%)	Aug	0.5 (2.7)	-1.6 (4.4)
Italy		09.00	Unemployment rate %	Aug	9.8	9.9
		10.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Sep	0.6 (0.5)	0.4 (0.5)
Spain		08.00	Preliminary CPI (EU harmonised CPI) Y/Y%	Sep	0.3 (0.3)	0.3 (0.4)
		08.00	Final GDP Q/Q% (Y/Y%)	Q2	0.5 (2.3)	0.7 (2.4)
UK		00.01	Lloyds buinness barometer	Sep	-	1
		09.30	Final GDP Q/Q% (Y/Y%)	Q2	-0.2 (1.2)	0.5 (1.8)
		09.30	Current account balance £bn	Q2	-19.0	-30.0
		09.30	Net consumer credit £bn (Y/Y%)	Aug	0.9 (5.5)	0.9 (5.5)
		09.30	Net mortgage lending £bn (mortgage approvals '000s)	Aug	4.2 (66.5)	4.6 (67.3)
		09.30	M4 money supply Y/Y%	Aug	-	2.7
			Tuesday 1 October 2019			
EMU		09.00	Final manufacturing PMI	Sep	45.6	47.0
		10.00	Flash CPI estimate (core CPI) Y/Y$	Sep	*0.9 (1.0)*	1.0 (0.9)
Germany		08.55	Final manufacturing PMI	Sep	41.4	43.5
France		08.50	Final manufacuturing PMI	Sep	50.3	51.1
Italy		08.45	Manufacturing PMI	Sep	48.1	48.7
Spain		08.15	Manufacturing PMI	Sep	48.2	48.8
UK		09.30	Manufacturing PMI	Sep	47.0	47.4
			Wednesday 2 October 2019			
Spain		08.00	Unemployment change '000s	Sep	-	54.4
UK		00.01	BRC shop price index Y/Y%	Sep	-	-0.4
		09.30	Construction PMI	Sep	45.0	45.0
			Thursday 3 October 2019			
EMU		09.00	Final services PMI (composite PMI)	Sep	52.0 (50.4)	53.5 (51.9)
		10.00	Retail sales M/M% (Y/Y%)	Aug	0.3 (2.1)	-0.6 (2.2)
		10.00	PPI Y/Y%	Aug	-0.5	0.2
Germany		08.55	Final services PMI (composite PMI)	Sep	52.5 (49.1)	54.8 (51.7)
France		08.50	Final services PMI (composite PMI)	Sep	51.6 (51.3)	53.4 (52.9)
Italy		08.45	Services PMI (composite PMI)	Sep	50.5 (50.0)	50.6 (50.3)
Spain		08.15	Services PMI (composite PMI)	Sep	53.8 (51.8)	54.3 (52.6)
UK		08.15	Services PMI (composite PMI)	Sep	50.3 (50.0)	50.6 (50.2)
			Friday 4 October 2019			
Germany		08.30	Construction PMI	Sep	-	46.3
UK		09.30	New car registrations Y/Y%	Sep	-	-1.6

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		BST	Event / Auction
			Monday 30 September 2019
UK		-	Conservative Party conference (29 September – 01 October)
			Tuesday 1 October August
EMU		02.00	ECB Chief Economist Lane due to speak in Los Angeles
		18.30	ECB's Weidmann due to speak in Vienna
UK		10.30	Auction: to sell 1.75% 2037 bonds
			Wednesday 2 October 2019
Germany		10.30	Auction: to sell €3bn of 0% % 2024 bonds
			Thursday 3 October 2019
EMU		08.45	ECB's de Guindos due to speak in Madrid
		09.00	ECB's Rehn due to speak in Helsinki
France		09.50	Auction: to sell 4% 2055 bonds
		09.50	Auction: to sell 1.5% 2050 bonds
Spain		09.45	Auction: to sell bonds
UK		15.00	BoE's Tenreyro due to speak in Washington
			Friday 4 October 2019
EMU		12.25	ECB's de Guindos due to speak in Sevilla

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs