

Euro wrap-up

Overview

- While euro area inflation fell back below 1%Y/Y and the final manufacturing PMIs signalled marked contraction in the sector, despite following Treasuries higher, longer-dated Bunds ended the day slightly lower.
- Gilts also followed USTs higher as the UK manufacturing PMI implied ongoing weakness.
- After a quiet day for data tomorrow, Thursday will bring final services PMIs from the euro area and UK, along with euro area retail sales figures. Thursday will also see UK PM Johnson present his Brexit plan to the House of Commons.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.782	-0.002
OBL 0 10/24	-0.777	-0.001
DBR 0 08/29	-0.564	+0.012
UKT 3% 09/21	0.347	-0.019
UKT 1 04/24	0.257	-0.021
UKT 0% 10/29	0.478	-0.003

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

Source: Bloomberg

Euro area

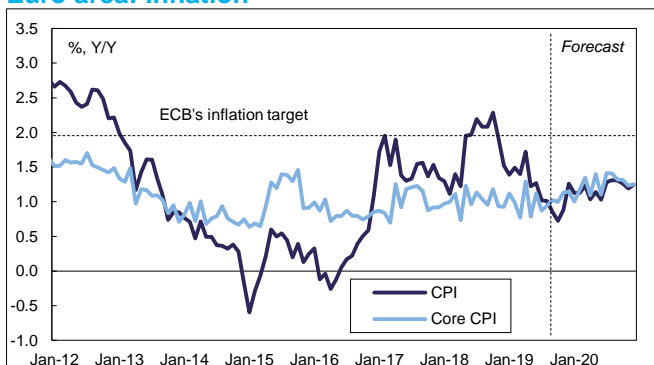
Inflation back below one percent

After the flash figures from the four largest member states posted declines, there were no major surprises from today's preliminary estimates of euro area inflation in September. The headline CPI rate declined 0.1ppt to 0.9%Y/Y (or by 0.157ppt to 0.852%Y/Y to three decimal places), the lowest since November 2016. The cause of the drop last month, however, was food and fuel. Indeed, lower food prices saw the respective inflation rate drop 0.5ppt to a three-month low of 1.6%Y/Y. And while, on average, energy prices were unchanged from August, base effects saw the inflation rate drop 1.2ppts to -1.8%Y/Y, the sharpest annual pace of decline in three years. In contrast, inflation of non-energy industrial goods was unchanged at 0.3%Y/Y, while services inflation rose 0.2ppt to a three-month high of 1.5%Y/Y. As a result, core inflation rose 0.1ppt to 1.0%Y/Y (up 0.074ppt to 1.023%Y/Y to three decimal places), in line with the average of the past two years. Not least due to energy price base effects, we expect headline inflation to remain below 1.0%Y/Y in October and November before rising to about 1.1%Y/Y in December. Thereafter, with continued sub-trend growth likely to restrain any rise in core inflation associated with a weaker euro and stronger wage growth, we expect euro area headline CPI inflation to oscillate in a range between 1.0-1.3%Y/Y next year.

Final manufacturing PMIs little better than dire flash figures

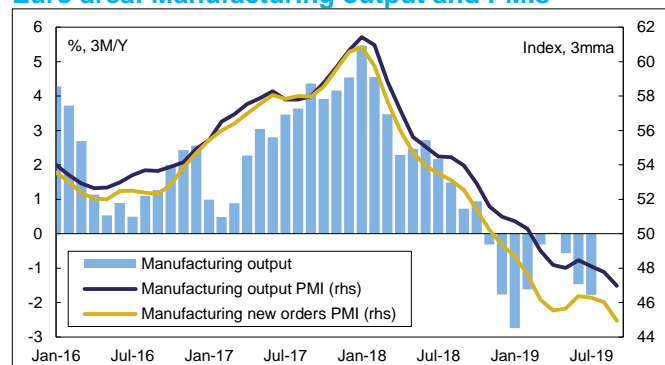
While the final euro area and German manufacturing PMIs for September saw slight upwards revisions from the preliminary estimates, they were still dire and continued to suggest marked contractionary forces in the sector. Indeed, the euro area headline manufacturing index was revised up just 0.1pt to 45.7, which still marked the lowest since 2012. And while they were also a touch firmer than previously thought, the euro area output and new orders indices were likewise still well below 50 at the respective lowest levels in about seven years. Likewise, although the German manufacturing PMI was revised up 0.3pt from the flash, at 41.7 it was at a level that has only been lower in 2009 during the aftermath of the Global Financial Crisis while the new orders index was still strikingly weak at just 38.2. Elsewhere, the French manufacturing PMI was revised down from the flash estimate to 50.1, down 1.0pt from August and close to the bottom of the range of the past three years. And the Italian and Spanish figures, published for the first time today, suggested a further notable deterioration in Southern Europe in September. The headline PMIs respectively fell 0.9pt to a six-month low of 47.8 and 1.1pts to 47.7, the worst since April 2013, while the new orders indices signalled further retrenchment in the sector over the near term. All in all, therefore, today's manufacturing PMIs suggest that the sector's struggles are becoming more widespread and seem likely to persist into Q4 and probably into the New Year too.

Euro area: Inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output and PMIs



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



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The coming two days in the euro area and US

After a quieter day for euro area economic data tomorrow, with just Spanish labour market figures for September due, Thursday will bring the euro area retail sales report for August and the final services PMIs for September. After the more upbeat [German retail figures](#) yesterday, euro area retail sales are expected to have reversed some of the 0.6%M/M decline recorded at the start of Q3 – and if the German release is anything to go by July's decline will be smaller than initially estimated too. But the final September services and composite indices are expected to broadly align with the preliminary readings, which reported a notable deterioration in conditions in services. As such, the euro area composite PMI will likely confirm a sizeable decline to around 50.5, the lowest since June 2013 and a level suggesting that economic growth has all but come to a halt.

Elsewhere, Thursday will see ECB Vice President de Guindos speak in Madrid, while Governing Council member Hernández de Cos will give a speech in Barcelona and dovish Finnish Governor Rehn will speak in Helsinki on Thursday. In the markets, Germany will sell 5Y Bunds tomorrow, while France and Spain will sell bonds with various maturities on Thursday.

In the US, tomorrow will bring just the ADP employment report for September. But Thursday's data calendar will be more noteworthy with the non-manufacturing ISM likely to signal ongoing solid expansion at the end of the third quarter. That day will also bring factory orders figures for August, Challenger job cuts data for September and the weekly jobless claims numbers. In terms of Fed Speak, voting member Williams and non-voting member Harker are due to speak publicly tomorrow, while voting members Clarida, Evans and Quarles, as well as non-voting members Kaplan and Mester, are due to speak on Thursday.

UK

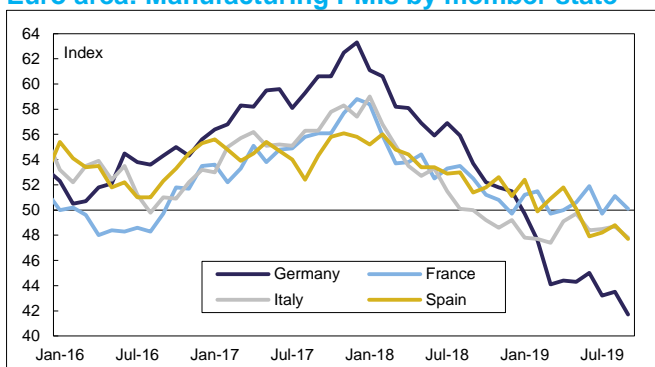
Johnson soon to present Brexit proposals

Once his Conservative Party conference speech is out of the way tomorrow, Boris Johnson will present his first substantive Brexit proposals since becoming Prime Minister more than two months ago, with a statement to the House of Commons and associated document now expected on Thursday. After much speculation about how he might meet his pledge to replace the Irish backstop with alternative legally operable arrangements, Johnson's proposals will reportedly aim to keep Northern Ireland within UK territory for customs purposes after Brexit while envisaging mechanisms to reduce the intrusiveness of customs procedures for goods crossing the border. There remains significant uncertainty about what the proposals might involve. But whatever form they might take, we have significant doubts that they will be acceptable to the EU.

Proposals will require new customs infrastructure

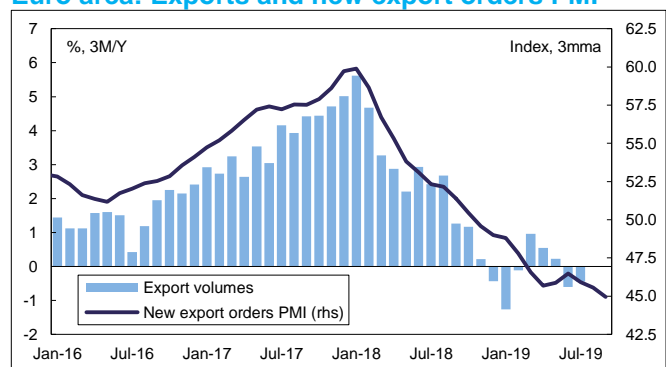
In terms of the detail, Johnson today denied reports by Irish broadcaster RTÉ that he will propose new "customs clearance zones" involving "a string of customs posts perhaps five to ten miles away from the frontier" which would certainly be a non-starter for the Irish Government and EU. Regardless of the precise terminology to be used by Johnson, however, the proposals seem bound to require some form of customs infrastructure that would represent the re-imposition of a form of hard border and – as occurred with previous customs infrastructure on the island of Ireland before the UK and Irish Republic were members of the Customs Union – would re-establish a target for republican paramilitaries and hence risk reigniting the Troubles. The proposals would also seem likely to add significantly to the costs faced by businesses (particularly small and medium-sized firms) trading across the border. Moreover, Johnson's proposals might also incorporate technological and/or procedural wheezes previously advocated by Theresa May but rejected by the EU. Even if the EU suddenly became more sympathetic to such ideas now, they would seem unlikely to be workable for a long time to come, if ever, suggesting the continued need for some form of backstop arrangement.

Euro area: Manufacturing PMIs by member state



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

Euro area: Exports and new export orders PMI



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

Proposals won't address EU concerns

If only for presentational reasons – not least as they wish to avoid being blamed in the event of a no-deal Brexit – the EU seem unlikely to reject Johnson's proposals completely out of hand when they are formally presented. Instead, they will propose further discussions with the European Commission. Nevertheless, for both political and practical reasons, we continue to expect that Johnson's proposals will fail to form the basis of an agreement, leaving a no-deal Brexit or an Article 50 extension as the only paths forward on 31 October. We continue to take comfort from the Benn-Burt anti-no-deal legislation and maintain an extension of the Article 50 deadline as our baseline forecast.

Manufacturing PMI points to ongoing contraction

At face value, today's UK manufacturing PMI survey was somewhat more encouraging, with the headline index unexpectedly rising 0.9pt in September to a four-month high. But, at 48.3, the index remained firmly in contractionary territory for the fifth consecutive month to leave the quarterly average more than 2pts lower than the average in Q2 and the weakest for more than a decade. And overall the detail of the report offered little encouragement. For example, despite rising for the second successive month, the output component (47.9) signalled still significant declines at the end of the third quarter to leave the quarterly index at its lowest since the height of the Global Financial Crisis. This weakness was particularly evident in the investment goods sub-sector, as clients were reportedly reluctant to commit to capex in the face of continued Brexit and political uncertainty – indeed, the production PMI plunged 7.2pts to 40.5, the lowest for more than seven years, while the new orders index fell to a more-than decade low of 41.3. And production of intermediate and consumers goods reportedly fared only slightly better in September, with the respective PMIs still at below-average levels of 51.0 and 50.0.

Manufacturing orders continue to decline, as do jobs

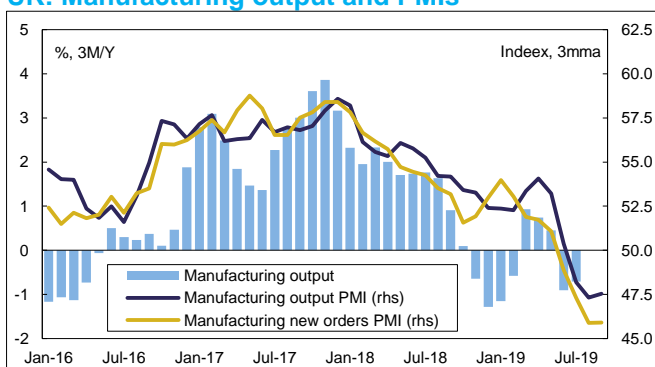
While some manufacturers referenced increased inventory accumulation ahead of the end-October Brexit deadline, the survey's PMI for the stock of finished goods showed a marked drop in September to a ten-month low (47.7). And while the new orders PMI reversed some of August's 2.5pts decline, at 46.4 it still indicated a sharp decline last month. So, over the third quarter as a whole it was more than 3pts lower than the average in Q2, suggesting a further weakening in demand, and therefore production ahead. As such, manufacturers reportedly continued to scale back their workforces at the end of the quarter by the most since early 2013, with cuts widespread across the sector and at SMEs and large firms alike. Today's survey also implied diminishing inflationary pressures in the sector with the output price PMI declining 1.5pts to 51.3, the weakest for three years.

The coming two days in the UK

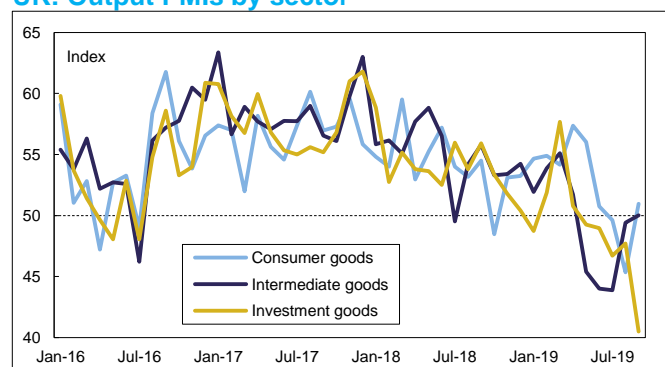
September PMI surveys will continue to dominate the UK's data flow over the coming two days, with tomorrow's construction PMI for September expected to imply continued contraction in the sector at the end of the third quarter, with the headline index forecast to be unchanged at 45.0. Thursday's services PMI will also likely signal very subdued growth in the sector in September, with the index forecast to fall to 50.3. But given the modest pickup in the output PMI, the composite PMI might well move sideways at 50.2, nevertheless leaving the quarterly average in Q3 the lowest since Q412 and consistent with contraction in underlying GDP growth. In addition, the BRC's shop price index for September is due on Wednesday, while BoE MPC external member Tenreyro is due to speak in Washington.

In the absence of significant news, the next edition of the Euro wrap-up will be published on 03 October 2019

UK: Manufacturing output and PMIs











UK: Output PMIs by sector




European calendar

Today's results

Economic data





Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Final manufacturing PMI	Sep	45.7	45.6	47.0	-
	 Flash CPI estimate (core CPI) Y/Y\$	Sep	0.9 (1.0)	<u>0.8 (1.0)</u>	1.0 (0.9)	-
Germany	 Final manufacturing PMI	Sep	41.7	41.4	43.5	-
France	 Final manufacturing PMI	Sep	50.1	50.3	51.1	-
Italy	 Manufacturing PMI	Sep	47.8	48.1	48.7	-
Spain	 Manufacturing PMI	Sep	47.7	48.2	48.8	-
UK	 Nationwide house price index Y/Y%	Sep	-0.2	0.4	0.6	-
	 Manufacturing PMI	Sep	48.3	47.0	47.4	-

Auctions

Country	Auction
UK	 sold £2.25bn of 1.75% 2037 bonds at an average yield of 0.938%


















Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
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
Country	BST	Auction/Event			
Germany		10.30 Auction: to sell €3bn of 0% % 2024 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
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)
Country	BST	Auction/Event				
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 0%2029 bonds			
		09.50	Auction: to sell 1.5% 2050 bonds			
		09.50	Auction: to sell 4% 2055 bonds			
Spain		09.45	Auction: to sell 0.6% 2029 bonds			
		09.45	Auction: to sell 2.7% 2048 bonds			
		09.45	Auction: to sell 0.65% 2027 index-linked bonds			
UK		15.00	BoE's Tenreyro due to speak in Washington			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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