

Euro wrap-up

Overview

- Bunds followed Treasuries higher despite a very modest upwards surprise to German IP in August.
- Gilts also made gains as Brexit talks between the EU and UK appeared close to collapse, while UK labour productivity fell at the steepest pace for five years.
- Wednesday will be quiet for new European data, but Thursday will bring the account of the September ECB policy meeting, as well as UK monthly GDP data. Brexit will no doubt remain in focus too.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.796	-0.008
OBL 0 10/24	-0.808	-0.019
DBR 0 08/29	-0.600	-0.023
UKT 3% 09/21	0.310	-0.035
UKT 1 04/24	0.209	-0.033
UKT 0% 10/29	0.407	-0.041

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

Euro area

German IP beats expectations with very modest rise

For a welcome change, Germany's latest industrial production data beat expectations, posting a rise for the first month in three in August. The increase, however, was a relatively paltry 0.3%M/M, insufficient to reverse the drop in July. Within the detail, output of manufacturing and mining also rose for the first time since May, up a stronger 0.7%M/M. Production of capital goods and intermediate goods both rose close to 1%M/M, although these headline figures masked significant variation among the components. For example, output of autos rose 2.7%M/M, but that followed a sharp 5.0%M/M drop the prior month and left it still down a huge 19% from its level two years earlier. Production of chemicals fell for a third successive month, down 3.0%M/M and 13.0%Y/Y. In addition, output of consumer goods fell for a third consecutive month and by 1.0%M/M to reach the lowest level since January 2017, down almost 9% from the high reached last year. Meanwhile, production of construction and energy both fell by about 1½%M/M, with the latter thus declining to a new post-reunification low and down 16.1%Y/Y as Germany's phase-out of coal-fired power generation continues.

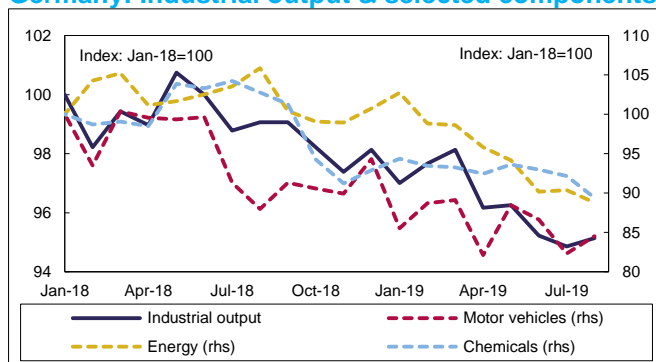
On track for 5th successive quarterly decline

Despite rising in August, manufacturing and total industrial output were both still down a hefty 4.0%Y/Y. And with the average level of manufacturing output in the first two months of Q3 down 0.7% on the Q2 average (and IP down 0.9% on the same basis), a fifth consecutive quarterly decline in production in the third quarter seems odds on. Certainly, yesterday's factory orders data offered little cause for optimism with a decline of 0.6%M/M in August led by weakness in domestic orders of consumer goods, following a revised drop of 2.1%M/M the prior month. That left them down a hefty 6.7%Y/Y, at the lowest level since September 2016, and trending 1.3% lower than the Q2 average in Q3. And downbeat sentiment indices also suggest that Q4 might be little better. Indeed, the manufacturing new orders PMI plunged in September to a decade-low of just 38.2 last month. Increased car production related to new models, as well as a bounce back in construction where orders remain elevated, however, might just about conspire to bring to an end the ignominious run of quarterly declines in total IP in Q4.

The coming two days in the euro area and US

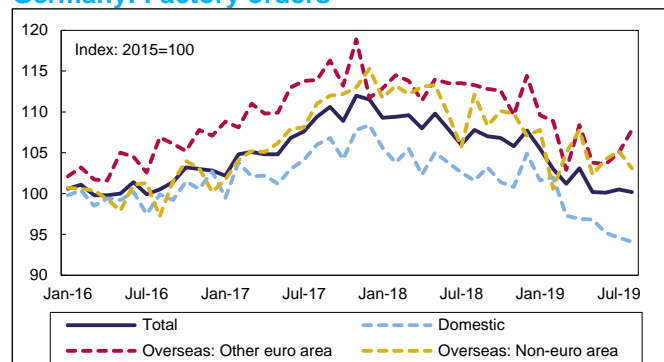
Focus in the euro area over the coming few days will remain on the manufacturing sector, with August industrial production from France and Italy due on Thursday. Like today's German figures, these are expected to report modest increases that month, although this would leave French IP up just 0.1%Y/Y and Italian IP down more than 1½%Y/Y. Ahead of this, the Bank of France's business sentiment survey for France is due tomorrow. Meanwhile, Germany's trade report for August, also due

Germany: Industrial output & selected components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders*



*Excluding major orders.

Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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Thursday, is expected to report a narrowing in the trade surplus on the back of weak exports.

Thursday will also bring the account from the ECB's September Governing Council meeting, which will be of interest not least given the well-publicised split in opinions of various members on last month's stimulus package. In addition, the Banca d'Italia's Panetta – the proposed candidate to replace outgoing ECB Executive Board member Cœuré at the end of the year – will speak in Rome tomorrow.

In the US, the main focus on Wednesday will be the minutes from the September FOMC meeting, while Fed Chair Powell is due to take part in a Kansas City Fed event, both of which will be watched closely for further insights in near-term Fed policy. Data-wise, tomorrow will bring the August JOLTS job report and wholesale trade and inventories figures for the same month, followed on Thursday by the weekly jobless claims numbers. But the highlight will likely be Thursday's CPI figures. While food prices will likely remain subdued, given the jump in the oil price earlier in the month headline inflation is expected to edge slightly higher to 1.8%Y/Y. Meanwhile, core CPI is forecast to move sideways at 2.4%Y/Y. Elsewhere, the US and Chinese trade delegations are set to meet again on Thursday, while in the markets, the Treasury will sell 10Y notes on Wednesday and 30Y bonds on Thursday.

UK

Brexit talks approach collapse

Perhaps unsurprisingly given the numerous flaws in Boris [Johnson's proposals](#), all indications today were that the Brexit negotiations were approaching collapse. Certainly, anonymous briefings from Downing Street suggested so, as they sought to place the blame firmly on the EU. But, in many ways, Johnson's suggestions had always appeared designed to fail. The proposal for the Northern Irish Assembly to be granted a veto on regulatory arrangements, and half-baked plans for customs checks between Northern Ireland and the Irish Republic, had never seemed likely to be endorsed by the EU. So, reports that the UK Government was unwilling this week to revise its proposals on these points implied that an agreement at next week's Summit would be impossible to reach. EU leaders will now presumably focus on preparations for either an Article 50 extension or a no-deal Brexit.

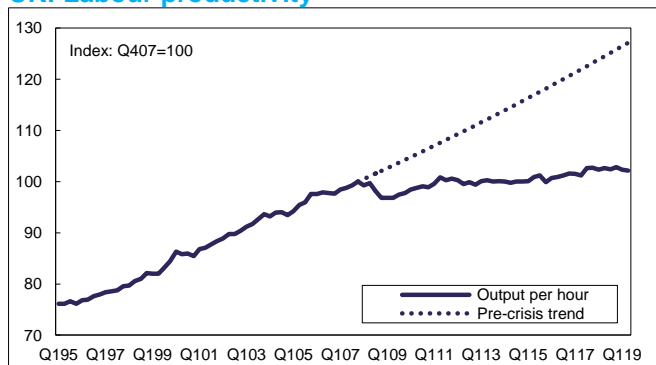
Article 50 extension remains our expectation

The UK Government will now insist its preference is for a no-deal Brexit. Indeed, today it published its revised draft tariff schedule to apply under such a damaging outcome, announcing – much to the annoyance of farmers' groups and certain other producer interests which will be suddenly exposed to a marked increase competition – that 88% of total imports would be eligible for tariff-free access. (Of course, UK exporters would face new tariff barriers into the EU in the event of a no-deal Brexit.) We strongly expect, however, that the anti-no-deal legislation (the Benn Act) will force the Government to request an Article 50 extension, and that this will in due course be agreed. So, a General Election later in the autumn (most likely on 28 November or 5 December) would then determine the future path for Brexit, with a no-deal scenario or second referendum the most likely outcomes depending on the result.

Poor productivity performance persists

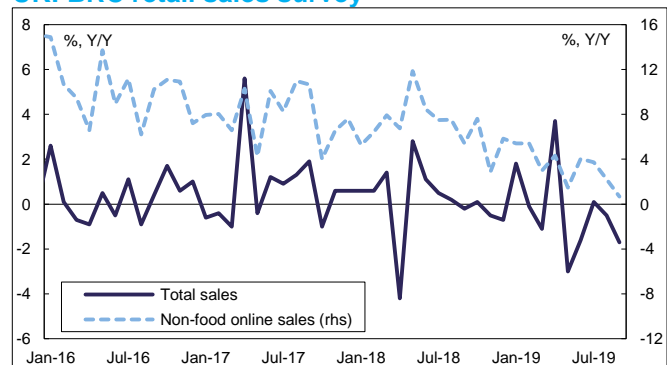
Against the backdrop of continued Brexit uncertainty, the UK's woeful productivity performance continues. Indeed, today's figures published by the ONS suggested that labour productivity, measured by output per hour, declined for the third quarter out of the past four in Q2, to leave it down 0.5% compared with a year earlier, the steepest annual drop for five years. So, following two consecutive quarters of zero annual growth, this left productivity in the latest quarter almost one fifth lower compared with the level it would have reached if the pre-crisis pace had been maintained. And there was no growth in output per job, down from 1.1%Y/Y in Q1. While non-manufacturing production and construction provided a positive contribution to

UK: Labour productivity



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: BRC retail sales survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

productivity in Q2, other sectors provided a drag. Perhaps unsurprisingly given the weakness in output in the sector, manufacturing productivity declined for the fifth quarter out of the past six (-1.6%Q/Q), to leave it almost 2% lower compared with a year earlier and a whopping 28% lower than the pre-crisis trend. And services sector productivity was also weaker, down 0.3%Q/Q and 0.8%Y/Y, the first annual drop since Q316 and the largest for five years.

While the official labour costs figures will be published later in November, the recent jump in wage growth and ongoing job creation suggests that we will see a notable increase in unit labour costs in Q2. But having fallen to 2.1%Y/Y in Q1, we still expect growth in unit labour costs to have remained below the long-run average. And given more recent survey evidence of a loss of momentum in the labour market, domestic cost pressures seem likely to moderate over the near term supporting our view that the BoE's next move in Bank Rate is likely to be down, regardless of what happens with respect to Brexit. Indeed, given the weaker growth outlook associated with heightened domestic and global uncertainty, we expect a 25bps cut at the MPC's January policy-setting meeting, which would take Bank Rate to 0.50%.

Survey suggests retail sales slumped at end-Q3

After last week's PMIs signalled contraction in the services, manufacturing and construction sectors at the end of the third quarter, yesterday's BRC survey suggested a further deterioration in conditions in the retail sector too. In particular, the survey's measure of total sales posted the first year-on-year decline for three months in September, by 1.3%Y/Y. Moreover, on a like-for-like basis, retail sales fell 1.7%Y/Y, the steepest annual drop since April 2018. When smoothing out monthly volatility, the outlook remained weak, with total sales down 0.4%3M/Y. While food sales continued to rise (1.2%3M/Y), spending at non-food stores declined for the ninth month out of the past ten (-1.7%3M/Y). And while sales from online stores remained positive, the 0.7%Y/Y increase was the softest since the series began in 2008. Admittedly, the BRC's survey has proved more downbeat than the official retail sales figures over recent months. Nevertheless, with consumer confidence near the bottom of the recent range, and concerns about the political and economic outlook coming more into focus as the end-October Brexit deadline approaches, we continue to expect a more marked slowdown in the official retail sales around the turn of the quarter.

The coming two days in the UK






After a day bereft of UK economic data tomorrow, Thursday will be a busy one for top-tier releases, with the August production figures, including monthly GDP, due. With some car plants missing their usual maintenance shutdowns that month, manufacturing output might post a second monthly gain. However, we expect output in services and construction to decline, and so also expect a small drop of 0.1%M/M in GDP. Given the rise of 0.3%M/M in July, however, that would still leave overall economic output on track for a modest gain in Q3 following the fall of 0.2%Q/Q in Q2. The August trade data, however, seem likely to show a widening in the deficit and ongoing weakness in exports. And finally, the RICS house price survey for September is also due.

In the absence of significant news, the next edition of the Euro wrap-up will be published on 10 October 2019



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Industrial production M/M% (Y/Y%)	Aug	0.3 (-4.0)	-0.2 (-4.2)	-0.6 (-4.2)	-0.4 (-3.9)
France	 Trade balance €bn	Aug	-5.0	-	-4.6	-4.5
Italy	 Retail sales M/M% (Y/Y%)	Aug	-0.6 (0.7)	-	-0.5 (2.6)	-0.6 (2.4)
Spain	 Industrial production M/M% (Y/Y%)	Aug	0.9 (1.7)	0.1 (0.4)	-0.4 (0.8)	-0.2 (1.2)
UK	 Labour productivity Y/Y%	Q2	-0.5	-	0.0	-



Auctions

Country	Auction
Germany	 sold €385mnn of 0.50% 2030 index-linked bonds at an average yield of -1.4%
UK	 sold £800mnn of 0.125% index-linked bonds at an average yield of -2.566%

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	 Factory orders M/M% (Y/Y%)	Aug	-0.6 (-6.7)	-0.4 (-6.9)	-2.7 (-5.6)	-2.1 (-5.0)
UK	 BRC retail monitor, like-for-like sales Y/Y%	Sep	-1.7	-0.8	-0.5	-


Auctions and events

- Nothing scheduled -


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data













Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
France	 07.30	Bank of France business survey – industry sentiment	Sep	99	99

Auctions and events



Country	BST	Auction / Event
UK	 09.30	Summary and record of BoE's FPC meeting to be published

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's data releases
Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany		07.00 Trade balance €bn	Aug	18.6	21.6
		07.00 Exports (imports) M/M%	Aug	-1.0 (0.5)	0.8 (-1.6)
France		07.45 Industrial production M/M% (Y/Y%)	Aug	0.2 (0.2)	0.3 (-0.2)
		07.45 Manufacturing production M/M% (Y/Y%)	Aug	0.3 (-0.2)	0.3 (-0.3)
Italy		09.00 Industrial production M/M% (Y/Y%)	Aug	0.1 (-1.8)	-0.7 (-0.7)
UK		00.01 RICS house price balance	Sep	-7	-4
		09.30 Monthly GDP M/M% (3M/3M%)	Aug	0.0 (0.1)	0.3 (0.0)
		09.30 Industrial production M/M% (Y/Y%)	Aug	0.0 (-0.9)	0.1 (-0.9)
		09.30 Manufacturing production M/M% (Y/Y%)	Aug	0.2 (-0.7)	0.3 (-0.6)
		09.30 Index of services M/M% (3M/3M%)	Aug	-0.1 (0.2)	0.3 (0.2)
		09.30 Construction output M/M% (Y/Y%)	Aug	-0.4 (-0.1)	0.5 (0.3)
		09.30 Total trade balance (goods trade balance) £bn	Aug	-1.0 (-10.0)	-0.2 (-9.1)

Auctions and events

Country	BST	Auction / Event
EMU		12.30 ECB's account from 12 September Governing Council meeting
EMU		18.30 ECB's Lane speaks in Frankfurt

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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