

Euro wrap-up

Overview

- Bunds made losses as the account of the September ECB policy meeting confirmed there was greater support for a rate cut than new QE.
- Gilts also made losses, while sterling was given a boost as a joint statement from the UK PM and Irish Taoiseach opened the door for further discussions regarding a Brexit deal ahead of next week's EU Summit.
- Tomorrow will see EU Brexit negotiator Barnier meet with UK Brexit Secretary Barclay, while final German and Spanish inflation figures are due.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.735	+0.034
OBL 0 10/24	-0.713	+0.055
DBR 0 08/29	-0.491	+0.061
UKT 3¼ 09/21	0.439	+0.072
UKT 1 04/24	0.350	+0.089
UKT 0% 10/29	0.557	+0.096

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

Source: Bloomberg

Euro area

ECB account confirms broad support for easing package

It was always clear that the full detail of the ECB's easing package announced at the September Governing Council meeting was not unanimously agreed. Ahead of the meeting, several members stated their opposition to restarting QE. Following the meeting, some of those – including the German (Weidmann), French (Villeroy de Galhau) and Dutch (Knot) Central Bank Presidents – confirmed their dissent, and Executive Board member Lautenschläger announced her resignation. Moreover, a document leaked to the FT suggested that the ECB's Monetary Policy Committee, which prepares the Governing Council discussions, had also advised against restarting net asset purchases last month. Nevertheless, the official account of the meeting, released today, confirmed that "all members agreed that a further easing was warranted" and that there was "broad agreement with most of the monetary policy proposals" made by Chief Economist Lane. And the detail of the account provided far more detail than ever before about the arguments for and against individual measures, as well as information about the strength of support for each part of the policy package.

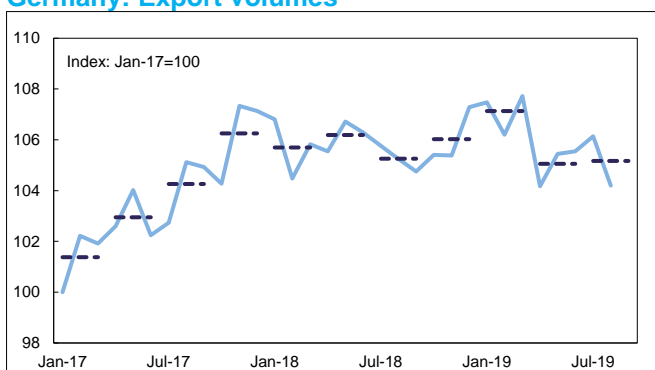
Tiering saw less support than QE

Among other things, the account noted that "most members" backed the announcement of a package of measures as "individual policy measures were facing some limitations and the impact of each measure on its own was uncertain and difficult to assess". Unsurprisingly given the numerous measures taken, however, the account also noted that "members assessed the case for specific elements differently" and some members saw "trade-offs between elements of the package", for instance between the TLTRO-III operations and tiering. But it reported a "very large majority" in favour of the 10bps rate cut, as well as "clear majority" (perhaps 17 out of the 25 members) in favour of restarting QE at €20bn per month on an open-ended basis. Given the modest pace of net asset purchases, it also noted that a discussion to raise the issue and issuer limits would not be required for "a significant period of time". Judging from the account, the tiering framework appeared to find the smallest majority in favour, not least as the transmission mechanism of monetary policy was judged still "to be functioning well". In contrast, the account confirmed that all members agreed that "governments with fiscal space" (i.e. Germany and the Netherlands) should act in an effective and timely manner with new stimulus to boost growth and inflation. Nevertheless, the overall message of the account must surely be that, if and when the ECB needs to ease policy again, a further rate cut would seem likely, while an increase in monthly net asset purchases (as well as an increase in the issue and issuer limits) can also still not be ruled out.

German exports retreat in August

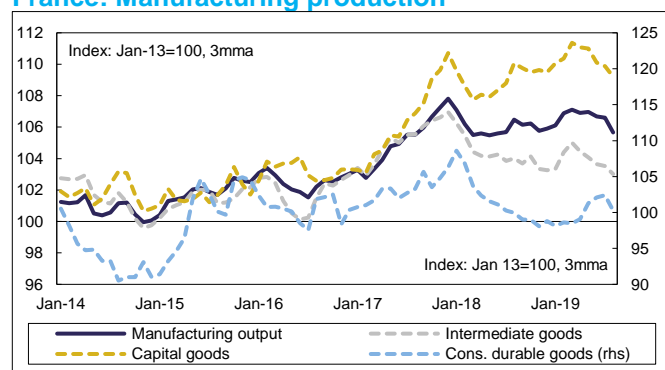
The bad news from the euro area's manufacturing sector resumed today with underwhelming data from each of the three largest member states. For a start, German export values dropped 1.8%M/M in August, the most since April, to reach a four-month low.

Germany: Export volumes*



*Dashed lines represent quarterly averages. Source: Bundesbank, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

France: Manufacturing production



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



That left them 3.9% lower than a year earlier. In contrast, imports rose 0.5%M/M following a steep 2.4%M/M the prior month to be down 3.1%Y/Y. Stripping out the impact of price changes, the picture was little different: export volumes fell 1.8%M/M while import growth was a firmer 0.9%M/M. Looking through the monthly volatility, however, export volumes in the first two months of Q3 were on average 0.1% higher than in Q2, while imports were trending 0.2% below their Q2 average level. So, it is still possible that net goods trade provided a positive contribution to German GDP growth in Q3 for only the second quarter in six.

Manufacturing output set for Q3 decline in France and Italy

In France, contrary to the expected increase, manufacturing output fell 0.8%M/M in August, weighed notably by production of autos (down for a third successive month and by 1.0%M/M) and consumer durables (down 3.2%M/M). With utility and energy output down but construction up slightly, total industrial production dropped 0.9%M/M. As a result, manufacturing output and IP were down 1.6%Y/Y and 1.4%Y/Y respectively, and were both trending about 1.0% below the Q2 average over the first two months of Q3. Contrary to the findings of recent surveys, that strongly suggests a negative contribution to French GDP growth from the industrial sector over the third quarter as a whole.

Italian manufacturing production also fell in August, albeit by a minimal 0.1%M/M following a larger 0.8%M/M drop the prior month. A rebound in production of machinery and clothing was offset by declines in most other categories, including transport goods, chemicals and other pharmaceuticals. Given the weak start to the quarter, the average level of manufacturing output over the first two months of Q3 was 0.8% below the Q2 average. So, like in German and France, Italian production also looks to have declined over the third quarter as a whole. And survey indicators, such as the new orders PMI which fell to just 45.7 in September, would suggest little new momentum in the sector in Italy in Q4.

The day ahead in the euro area and US

It should be a relatively quiet end to the week for euro area economic releases, with just September's final inflation figures from Germany and Spain scheduled for release. These should align with the flash readings that showed the respective headline harmonised CPI rates decline 0.1ppt to 0.9%Y/Y and 0.2ppt to 0.2%Y/Y. But given that the downwards shift largely reflected energy prices that month, core inflation rates are likely to have remained little changed in September, nevertheless at a still subdued level. Elsewhere, ECB Governing Council members de Guindos and Hernández de Cos will speak at an event in Madrid.

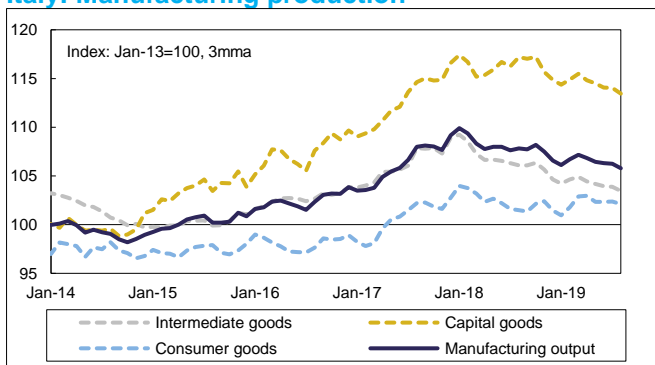
In the US, tomorrow will bring the import and export price indices for September, as well as the preliminary University of Michigan consumer sentiment survey for October. With respect to Fed-speak, Kashkari, Rosengren and Kaplan are due to speak publicly.

UK

Monthly GDP contracts in August

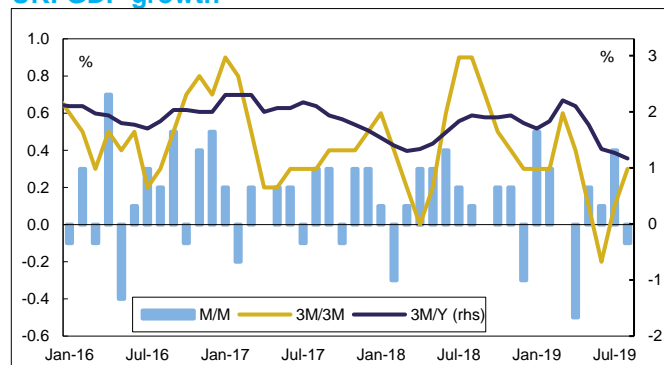
After the UK's economy contracted in Q2 for the first quarter since 2012, today's monthly GDP figures for August fell short of expectations, with output declining (0.1%M/M) for the first month in four. But with growth having been revised higher in June and July, by 0.1ppt apiece, to 0.1%M/M and 0.4%M/M respectively, output on a three-month basis in August accelerated to 0.3%3M/3M. This was more than fully accounted for by the services sector, with activity up 0.4%3M/3M and once again boosted by the motion pictures industry – indeed, output from that subsector has risen by almost 30% over the past year compared with a more moderate increase of 1½%Y/Y in the services sector as a whole. Construction eked out a modest increase in August (0.2%M/M, 0.1%3M/3M) too. But contrary to an expected rise, industrial production fell 0.6%M/M, with manufacturing a key weakness. Certainly, the increase in autos production (0.7%M/M) proved smaller than had been hoped for as certain firms went ahead with their usual

Italy: Manufacturing production



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: GDP growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

summer maintenance shutdown, to leave output from the sector more than 7½% lower than a year earlier. And with eleven of the thirteen subsectors reporting a drop in production in August, manufacturing output fell 0.7%M/M, the second-steepest decline since 2016.

GDP growth on track for positive Q3

Surveys have implied a significant deterioration in economic conditions at the end of the third quarter too. For example, the all-sector PMI fell to just 48.8 in September, the second successive sub-50 reading and the second-lowest since the Global Financial Crisis. But we would need to see a monthly contraction in GDP of more than 1½%M/M in September – which would mark the steepest drop since mid-2002 and seems highly unlikely – to see a decline over the third quarter as a whole. Indeed, given the recent monthly profile, risks to our quarterly GDP growth forecast of 0.2%Q/Q are skewed slightly to the upside. But with several auto manufacturers having already signalled their intentions to close factories again around the current end-October Brexit deadline, and ongoing political uncertainty likely to weigh more heavily on wider business sentiment, we continue to expect the economy to contract again in Q4.

Net trade likely to boost growth in Q3

Despite ongoing struggles at UK manufacturers and the challenging external environment, today's monthly trade report suggested that exports maintained a steady upward trend in the middle of the third quarter. In particular, export volumes rose for the fourth consecutive month in August (1.9%M/M) to leave them almost 2½% higher on a three-month basis, the first positive such rate for five months. The pickup largely reflected stronger goods exports (1.7%M/M, 4.2%3M/3M) on the back of robust demand from non-EU countries. Indeed, the 11½%3M/3M increase in exports to such countries contrasted markedly with ongoing weakness in demand from within the EU, where goods exports were down more than 3½%3M/3M in August. But weak underlying domestic demand continues to impact imports too, which were down more than 5½%3M/3M. Admittedly, September might well see a notable increase in goods imports as firms step up their no-deal Brexit preparations ahead of October's deadline. Nevertheless, on current trends, today's report still suggests that net trade will provide a solid contribution to GDP growth in Q3.

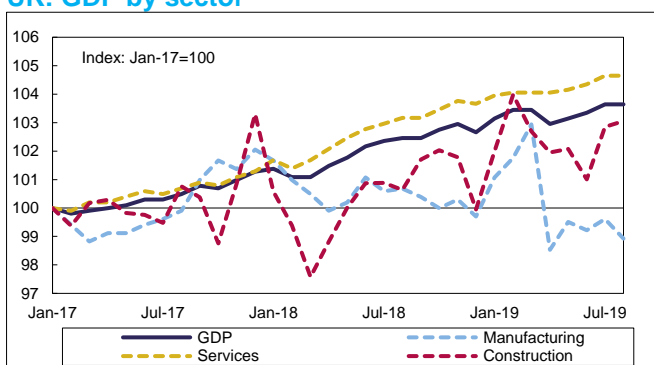
Housing market weakness persists

The impact of persistent political uncertainty on the housing market was further evident in today's RICS house price survey. Admittedly, the headline price balance exceeded expectations in September, rising 2pts to -2. But this reflected a marked pickup in only certain regions – for example, the net price balance for the East was up a whopping 56pts, while the equivalent index for the North was up 46pts – while most edged lower last month. Moreover, it still signalled a slight decline in national prices compared with a year earlier. And the detail of the survey was more downbeat. For example, the survey suggested that the number of new instructions fell to the lowest in three years, with a drop in new buyer enquiries too. Against this backdrop, the surveys newly agreed sales component fell sharply in September, with expectations for near-term sales also weaker last month.

The day ahead in the UK

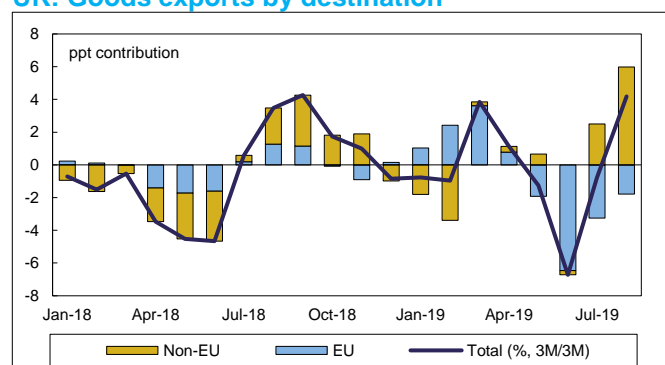
The focus in the UK tomorrow will remain firmly on Brexit. While the joint statement from today's tête-à-tête between UK Prime Minister Johnson and the Irish Taoiseach Leo Varadkar insisted that "they could see a pathway to a possible deal", the statement was predictably light on substance. Certainly there was no suggestion that there had been any headway on the two most troublesome issues raised by Johnson's proposals: how to allow for Northern Irish consent and what should be the customs arrangements between Northern Ireland and the Irish Republic. So, while the statement also confirmed that Brexit Secretary Stephen Barclay will meet with the EU's Brexit negotiator Michel Barnier tomorrow morning, we still think agreement on a Brexit deal at next week's Summit remains highly unlikely.

UK: GDP by sector



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Goods exports by destination















Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Trade balance €bn	Aug	16.2	18.8	21.4	21.6
	 Exports (imports) M/M%	Aug	-1.8 (0.5)	-1.0 (0.5)	0.7 (-1.5)	0.8 (-2.4)
France	 Industrial production M/M% (Y/Y%)	Aug	-0.9 (-1.4)	0.2 (0.2)	0.3 (-0.2)	- (0.0)
	 Manufacturing production M/M% (Y/Y%)	Aug	-0.8 (-1.6)	0.3 (-0.2)	0.3 (-0.3)	0.4 (-0.1)
Italy	 Industrial production M/M% (Y/Y%)	Aug	0.3 (-1.8)	0.1 (-1.8)	-0.7 (-0.7)	-0.8 (-)
UK	 RICS house price balance	Sep	-2	-7	-4	-
	 Monthly GDP M/M% (3M/3M%)	Aug	-0.1 (0.3)	0.0 (0.1)	0.3 (0.0)	0.4 (0.1)
	 Industrial production M/M% (Y/Y%)	Aug	-0.6 (-1.8)	0.1 (-0.8)	0.1 (-0.9)	- (-1.1)
	 Manufacturing production M/M% (Y/Y%)	Aug	-0.7 (-1.7)	0.2 (-0.4)	0.3 (-0.6)	0.4 (-0.9)
	 Index of services M/M% (3M/3M%)	Aug	0.0 (0.4)	-0.1 (0.2)	0.3 (0.2)	- (0.3)
	 Construction output M/M% (Y/Y%)	Aug	0.2 (2.4)	-0.4 (-0.2)	0.5 (0.3)	1.8 (1.9)
	 Total trade balance (goods trade balance) £bn	Aug	-1.5 (-9.8)	-1.0 (-10.0)	-0.2 (-9.1)	-1.7 (-9.6)


Auctions

Country	Auction
- Nothing to report -	

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
France	 Bank of France survey - industrial sentiment	Sep	96	99	99	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany	 07.00	Final CPI (EU-harmonised CPI) Y/Y%	Sep	1.2 (0.9)	1.4 (1.0)
Spain	 08.00	Final CPI (EU-harmonised CPI) Y/Y%	Sep	0.1 (0.2)	0.3 (0.4)
Country	BST	Auction/Event			
Italy	 10.00	Auction: to sell up to €2.75bn of 0.05% 2023 bonds			
	 10.00	Auction: to sell up to €2.25bn of 2.1% 2026 bonds			
	 10.00	Auction: to sell up to €1.5bn of 3.1% 2040 bonds			
	 10.00	Auction: to sell up to €1.5bn of 3.85% 2049 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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