

Euro wrap-up

Overview

- Sterling continued to strengthen and Gilts made significant losses as the EU agreed to intensify negotiations with the UK on a Brexit deal.
- Bunds made losses at the longer end of the curve as final German inflation data for September provided no surprises.
- Brexit will remain centre-stage in the coming week, with the summit on Thursday and Friday key. New data on UK inflation, employment and retail sales and euro area inflation and IP are due.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.736	-0.009
OBL 0 10/24	-0.700	-
DBR 0 08/29	-0.441	+0.032
UKT 3¼ 09/21	0.542	+0.083
UKT 1 04/24	0.501	+0.126
UKT 0¾ 10/29	0.714	+0.126

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

UK

Sterling rallies as negotiations enter intensive phase

After being boosted yesterday by the joint statement from UK Prime Minister Boris Johnson and Irish Taoiseach Leo Varadkar that they “could see a pathway to a possible deal”, sterling continued to appreciate today as the probability of a Brexit deal appeared to rise further. After a breakfast meeting between UK Brexit Secretary Stephen Barclay and EU chief negotiator Michel Barnier was described as constructive, it was confirmed in the afternoon that the negotiations would now enter an intensive and secretive phase from which an agreement might feasibly eventually emerge.

But how far has Johnson moved?

It remains very uncertain whether an agreement can ultimately be reached. Yesterday’s statement from the Irish and UK leaders offered little reason to believe that they were much closer to agreement on the knottiest of issues: how to allow for Northern Irish consent to a deal and what should be the customs arrangements between Northern Ireland and the Irish Republic. Admittedly, the Taoiseach’s press conference yesterday and subsequent anonymous media briefings from Irish officials suggested that Johnson might have significantly shifted his position in these respects. But Barclay reportedly failed to provide substantive new detail at his breakfast meeting. And quite what Johnson is proposing is unclear.

Are the negotiations a charade?

Indeed, while Varadkar might have been led to believe that Johnson has become more constructive, there is frequently a mismatch between the UK PM’s words and deeds. He also has a habit of saying one thing to one audience and the opposite to another. Moreover, with reports suggesting that ahead of the meeting Johnson might have cleared his position with Arlene Foster, leader of the hard-line DUP, the shift in UK position might be modest. It is also possible that the developments of yesterday and today have been designed merely to allow the UK and Irish leaders to give the impression of flexibility and avoid the blame if and when talks eventually collapse. Alternatively, the suggestion of a ‘pathway’ to a deal might have been made to allow Johnson to avoid losing too much face if and when he is forced to write a letter to the EU requesting an Article 50 extension after next week’s EU summit.

Variant of May’s Customs Partnership possibly in contention

We do not, however, discount the possibility that Johnson has made a substantive shift on the issues of consent and customs. On consent, Johnson might have conceded that a simple majority in Northern Ireland could suffice to endorse the new regulatory proposals. And in terms of customs, the UK PM might be suggesting an amended version of one of Theresa May’s maligned proposals (which Johnson himself previously opposed) – the so-called Customs Partnership – albeit limited only to Northern Ireland. According to this approach, while Northern Ireland would leave the EU Customs Union, the border for administrative purposes, like that for regulatory purposes under Johnson’s proposals, would run down the Irish Sea. So, the UK would agree to enforce EU customs rules and tariffs on goods moving from Great Britain to Northern Ireland. But if the EU tariff was higher than the UK tariff on the goods concerned, Northern Irish firms would subsequently receive a rebate.

Major obstacles to a deal remain

Previously, the European Commission rejected Theresa May’s version of the Customs Partnership, judging it to be unworkable. So, an agreement between the UK and EU might well remain elusive, particularly by the time of the leaders’ summit on 17-18 October. Moreover, even if the EU agreed to them, Johnson’s new proposals on consent and customs could struggle to gain the support of the DUP and more nationalist members of the Conservative ERG, making it difficult to find a majority in favour in the House of Commons. Indeed, if the DUP and most members of the ERG failed to back his proposals, Johnson would be reliant on the backing of several Labour Party MPs, many of whom might only give their approval if the deal was subject to confirmation in a second Brexit referendum. So, a full range of eventual Brexit scenarios



and outcomes remains feasible. And, in our view, the probability that a deal will be reached at the summit and endorsed in the House of Commons on 19 October remains significantly less than 50%.

The coming week in the UK

So, intensive negotiations between the EU and UK are set to be held over coming days ahead of the key summit on Thursday and Friday. Whatever happens at the summit, the UK House of Commons is set to meet on Saturday (19th October) to determine what to do next. If there is an agreement between the EU and UK, MPs will be asked to vote on it, with the likely outcome uncertain given the wide range of views among MPs. And if an agreement is not reached, Johnson might seek a Parliamentary vote on whether to press ahead with a no-deal Brexit. If, as we would expect, a no-deal Brexit was rejected, Johnson would then be legally compelled to write to the EU requesting an extension of the Article 50 deadline beyond end-October.

While Brexit will rightly dominate the headlines, the coming week will also be a busy one for economic data from the UK, with several key releases. The latest labour market data are due on Tuesday. While employment is likely to have slowed to its weakest rate in a year in the three months to August, the unemployment rate is expected to remain unchanged at 3.8%. Meanwhile, average labour earnings growth (excluding bonuses) seems likely to remain elevated close to the multi-year high of 4.0%3M/Y reached previously. Meanwhile, we expect the inflation numbers due the following day to report an uptick in the headline rate of CPI of 0.1ppt to 1.8%Y/Y and a similar 0.1ppt rise in the core rate to 1.6%Y/Y. Finally, the September retail sales report on Thursday is likely to show a second successive weak month with a modest decline in the headline monthly rate. However, that would still sales up over the third quarter as a whole. Meanwhile, BoE Deputy Governor Cunliffe will speak on monetary policy on Monday while external MPC member Vlieghe will speak on the same topic on Tuesday, when Governor Carney will testify on financial stability to the House of Commons Treasury Committee. Carney might be more likely to touch on monetary policy issues when speaks at an event at Harvard's Kennedy School on Wednesday. In the bond market, finally, the DMO will sell 10Y Gilts on Tuesday.

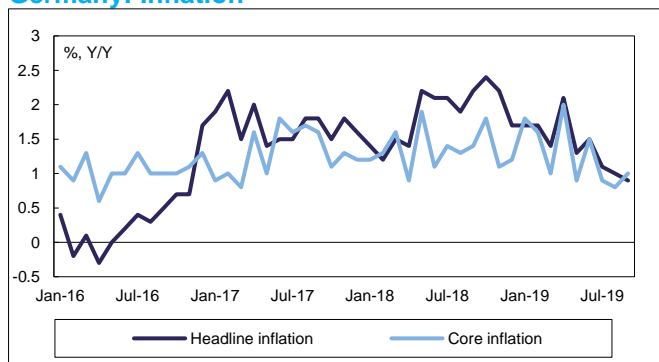
Euro area

No surprises from national inflation numbers

A relatively quiet end to the week for euro area economic news brought final German and Spain inflation figures for September, which provided no surprises, aligning with the respective preliminary estimates. So, headline German CPI on the EU-harmonised measure declined 0.1ppt to 0.9%Y/Y, the lowest since November 2016. The downward pressure principally reflected weaker energy price inflation, which posted the first negative reading since mid-2017, while food inflation also moderated. But while non-energy industrial goods inflation also slipped back to a six-month low (down 0.2ppt to 0.9%Y/Y), services inflation ticked higher (up 0.5ppt to 1.2%Y/Y). As such, core inflation took a step up in September, up 0.2ppt to 1.0%Y/Y, nevertheless remaining below the average of the past two years and suggesting still very subdued underlying inflationary pressures.

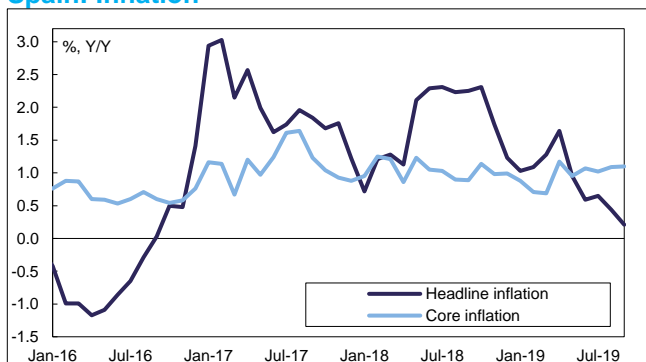
Similarly in line with the flash data, Spanish headline inflation on the EU measure fell 0.2ppt in September to 0.4%Y/Y. Like in Germany, the weakness largely reflected a steeper decline in energy inflation, with the 6.5%Y/Y drop the steepest for more than three years. Having recently edged up to the highest since the start of 2017 in August, non-energy industrial goods inflation also slipped back (down 0.1ppt to 0.5%Y/Y). But with services inflation up 0.2ppt to a five-month high of 1.7%Y/Y, core inflation was unchanged at 1.1%Y/Y, suggesting that underlying inflation in Spain remains subdued but not quite as weak as the headline index might imply.

Germany: Inflation*



*Harmonised EU measures. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Spain: Inflation*



*Harmonised EU measures. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.
















The coming week in the euro area and US

The coming week will bring a few noteworthy euro area economic releases. First up on Monday will be aggregate IP data for August, which are likely to show a modest increase in output, insufficient to fully reverse the 0.4%M/M decline in July and will thus leave output still down more than 2½% compared with a year earlier. These will be followed on Wednesday by final euro area CPI figures for September. Like today's figures from Germany and Spain, headline inflation is likely to align with the preliminary readings showing a drop of 0.1ppt to 0.9%Y/Y, the lowest since November 2016. Core inflation was nudged higher in the flash estimate by 0.1ppt to 1.0%Y/Y, although rounding issues raise the risk of a downwards revision. That day will also bring new car registrations figures from the euro area, which – like national figures for the largest member states – are likely to report a double-digit annual rate of growth at the end of Q3, flattered to some extent by the low base the previous year as new emissions testing came into effect. The euro area's trade report (Wednesday) is likely to show a narrowing in the trade surplus in August on the back of subdued external demand, and will be followed by the latest balance of payments figures (Friday). At the country level, final French and Italian CPI numbers are due Tuesday and Wednesday respectively, while Germany's ZEW sentiment survey for October is due Tuesday.

Elsewhere, various ECB Governing Council members will speak at the IMF Annual Meetings in the coming week, including Chief Economist Lane, as well as Knot, Weidmann, and Villeroy (all opposed to the latest round of QE). In the markets, Germany will sell 2Y bonds on Tuesday and 20Y bonds on Wednesday, while France and Spain will issue bonds with various maturities on Thursday.



In the US, it should be a quiet start to the coming week for economic releases with markets closed on Monday for a national holiday and just the Empire Manufacturing index for October on Tuesday. Wednesday's release of September retail sales figures will provide an insight into household consumption in the third quarter. That day will also bring business inventories numbers for August, the Fed's latest beige book and the NAHB housing market index for October. These will be followed on Thursday by industrial production numbers for September, which are expected to show renewed manufacturing weakness at the end of the quarter, albeit not fully reversing the increase in August. That day will also bring September housing starts data, October's Philly Fed index and weekly claims figures, followed on Friday by the Conference Board's latest leading indicators. In terms of Fed Speak, a number of voting FOMC members will be in action in the coming week including Bullard and George (Tuesday), Evans and Brainard (Wednesday), Evans, Bowman and Williams (Thursday) and Clarida (Friday). In the markets, the Treasury will sell 5Y TIPS on Thursday.

Economic forecasts

		2019				2020				2018	2019	2020
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
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		0.5	0.4	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	0.50	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	
Germany	 Final CPI (EU-harmonised CPI) Y/Y%	Sep	1.2 (0.9)	1.2 (0.9)	1.4 (1.0)	-	
Spain	 Final CPI (EU-harmonised CPI) Y/Y%	Sep	0.1 (0.2)	0.1 (0.2)	0.3 (0.4)	-	
Auctions							
Country	Auction	- Nothing scheduled -					























Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 14 October 2019					
EMU		10.00 Industrial production M/M% (Y/Y%)	Aug	0.3 (-2.5)	-0.4 (-2.0)
Tuesday 15 October 2019					
Germany		10.00 ZEW current situation balance (expectations)	Oct	-25.0 (-27.0)	-19.9 (-22.5)
France		07.45 Final CPI (EU-harmonised CPI) Y/Y%	Sep	0.9 (1.1)	1.0 (1.3)
UK		09.30 ILO unemployment rate %	Aug	3.8	3.8
		09.30 Employment 3M/3M, '000s	Aug	20	31
		09.30 Claimant count rate % (change '000s)	Sep	-	3.3 (28.2)
		09.30 Average earnings (excluding bonuses) 3M/Y%	Aug	4.0 (3.7)	4.0 (3.8)
Wednesday 16 October 2019					
EMU		07.00 EU27 new car registrations Y/Y%	Sep	-	8.4%
		 10.00 Trade balance €bn	Aug	17.5	19.0
		 10.00 Final CPI (core CPI) Y/Y%	Sep	1.0 (1.0)	1.0 (0.9)
Italy		09.00 Industrial sales (orders) Y/Y%	Aug	-	-0.6 (-1.0)
		10.00 Final CPI (EU-harmonised CPI) Y/Y%	Sep	0.3	0.5
UK		09.30 CPI (core CPI) Y/Y%	Sep	1.8 (1.7)	1.7 (1.5)
		09.30 PPI input prices (output prices) Y/Y%	Sep	-1.8 (1.2)	-0.8 (1.6)
		09.30 House price index Y/Y%	Aug	-	0.7
Thursday 17 October 2019					
EMU		10.00 Construction output M/M% (Y/Y%)	Aug	-	-0.7 (1.1)
Italy		09.00 Total trade balance (EU balance) €bn	Aug	-	7.6 (3.6)
UK		09.30 Retail sales including fuel M/M% (Y/Y%)	Sep	-0.2 (3.2)	-0.2 (2.7)
		09.30 Retail sales excluding fuel Y/Y%	Sep	0.0 (2.9)	-0.3 (2.2)
Friday 18 October 2019					
EMU		09.00 Current account balance €bn	Aug	-	20.5
Italy		09.00 Current account balance €bn	Aug	-	8.4

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 14 October 2019		
EMU	 08.15	ECB's De Guindos and Hernandez de Cos speak in Madrid
UK	 13.10	BoE's Cunliffe speaks on monetary policy in London
Tuesday 15 October August		
Germany	 10.30	Auction: €4bn of 0% 2021 bonds
UK	 09.30	BoE Governor Carney speaks at Treasury Select Committee on Financial Stability Report
	 10.30	Auction: £2.75bn of 0.875% 2029 bonds
	 13.30	BoE's Vlieghe speaks on monetary policy in London
Wednesday 16 October 2019		
EMU	 13.30	ECB's Knot speaks in New York
	 16.00	ECB's Lane speaks in Washington
	 18.00	ECB's Weidmann and Villeroy De Galhau speak in New York
Germany	 10.30	Auction: €1bn of 1.25% 2048 bonds
UK	 14.00	BoE Governor Carney takes part in a panel session at IMF event
Thursday 17 October 2019		
EMU	 18.30	ECB's Villeroy De Galhau, Visco, Knot, Hernandez de Cos all speak in Washington
France	 09.50	Auction: up to €750mn of 0% 2022 bonds
	 09.50	Auction: 0% 2025 bonds
	 09.50	Auction: 0.5% 2026 bonds
	 10.50	Auction: 0.25% 2024 index-linked bonds
	 10.50	Auction: 0.1% 2025 index-linked bonds
	 10.50	Auction: 3.4% 2029 index-linked bonds
Spain	 09.45	Auction: 0.05% 2021 bonds
	 09.45	Auction: 0.25% 2024 bonds
	 09.45	Auction: 0.6\$ 2029 bonds
Friday 18 October 2019		
UK	 -	UK sovereign debt to be rated by Fitch

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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