

# Euro wrap-up

## Overview

- Bunds made modest losses at the short end of the curve but gains at the long end as euro area IP posted a modest gain in August.
- Gilts made significant gains as investor expectations of a Brexit deal at this week's EU summit receded somewhat.
- Tuesday will bring UK labour market data, the ZEW investor sentiment survey and further Brexit negotiations between the UK and EU.

**Chris Scicluna**

+44 20 7597 8326

### Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.719	+0.018
OBL 0 10/24	-0.693	+0.008
DBR 0 08/29	-0.462	-0.016
UKT 3¼ 09/21	0.501	-0.041
UKT 1 04/24	0.440	-0.057
UKT 0% 10/29	0.636	-0.068

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

Source: Bloomberg

## Euro area

### IP trend likely to remain down despite uptick in August

Close to expectations, euro area industrial production rose 0.4%/M/M in August, an increase that was only enough to reverse the drop the previous month which followed a steep decline of 1.5%/M/M in June. Production of consumer goods and energy declined again in August. And while output of intermediate and capital goods increased, we strongly doubt that this will represent a turning point in the downwards trends in those items. Likewise, although production rose in Germany, Italy and the Netherlands, surveys and orders data suggest that renewed declines there lie ahead while the trends in France and Spain might be little better than flat. Overall, the modest increase in August left total industrial production in the euro area down 2.8%Y/Y. And with the average in July and August about 1.0% below the average monthly level in Q2, total IP seems bound to have declined for a sixth successive quarter in Q3. Moreover, surveys strongly suggest that a seventh successive quarterly drop should be expected in Q4, with output continuing to decline at an annual rate close to 3%.

### The day ahead in the euro area and US

Tuesday will bring the ZEW investor analyst survey for October, which seems likely to show a further deterioration in perceptions of the German economic outlook. In addition, ahead of the release on Wednesday of the equivalent euro area figures, the final estimates of French inflation in September are due. The flash French figures saw the EU-harmonised measure of inflation drop 0.2ppt to 1.1%Y/Y. In the bond markets, Germany will sell 2Y Schatz.

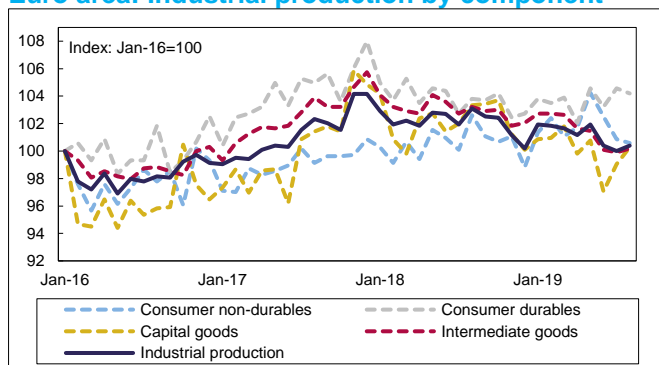
In the US, the Empire manufacturing survey results for October represent the only economic data certain to be released on Tuesday although the federal government's monthly budget statement for September might also be released. FOMC members Bullard and Daly are speaking public on matters that could touch on Fed policy. Meanwhile, the NY Fed will start its T-bill purchases, at a monthly rate of \$60bn, under the new programme announced at the end of last week.

## UK

### Expectations of Brexit deal recede

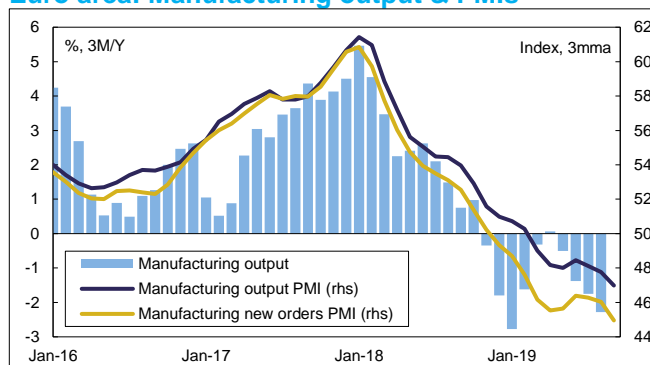
Gilts rallied and sterling reversed some of Friday's appreciation today as expectations of a Brexit deal at the EU leaders' meeting on Thursday and Friday appeared to recede. After weekend technical-level Brexit talks, chief EU negotiator Barnier commented merely that "a lot of work remains to be done". But while negotiations continued today, and Barnier signalled a willingness to continue discussions through to Wednesday, it was clear that UK PM Johnson would have to amend further

### Euro area: Industrial production by component



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: Manufacturing output & PMIs



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



his position if there was to be a chance of a deal this week or at a further special summit that might subsequently be arranged for a fortnight's time.

### **Johnson's proposals predictably half-baked**

The implication of Barnier's understated assessment – that there remains a significant gap between the UK and EU positions – shouldn't have come as a surprise. Johnson's proposals always seemed more likely than not to be half-baked and presented too late to be able to be considered a realistic basis for an agreement at this week's summit. And as we suspected [last week](#), reports over the weekend seemed to confirm that he had merely resurrected Theresa May's proposals for a Customs Partnership – which had previously been rejected by the EU as unworkable and derided by Johnson himself and his allies – albeit applied only to Northern Ireland rather than the whole of the UK. According to these plans, Northern Ireland would leave the EU Customs Union. But the border for administrative purposes, like that for regulation 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, firms would subsequently be able to receive a rebate on items that were not ultimately destined for the Republic or elsewhere in the EU.

### **Heading for an Article 50 extension**

With arrangements such as those proposed by Johnson being unprecedented, there simply won't be sufficient time to implement them before the end of the transition period at end-2020. More importantly, the arrangements would seem to pose a very high risk of fraud, and thus could undermine the integrity and credibility of the EU's Single Market and Customs Union. So, the EU would seem highly likely to reject them. Of course, Johnson might shift his position again over the coming couple of days to try to strike a deal, e.g. by adopting the EU's previous proposals for a Northern Ireland-only backstop in all but name. But if he did so, the chances of that proposal subsequently being approved by the House of Commons would seem relatively slim, unless it was subsequently submitted for a confirmatory referendum. So, our baseline expectation remains an Article 50 extension at the end of the month. But whether that is used to provide time for an early general election or a second referendum remains uncertain.


### **The day ahead in the UK**

A busy week for UK economic data gets underway tomorrow with the latest labour market report. 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%. Average labour earnings growth seems likely to remain elevated close to the more than decade high of 4.0%3M/Y reached in July. Meanwhile, BoE Governor Carney will testify to Parliament on the Bank's latest Financial Stability Report while MPC external member will speak publicly on monetary policy. In addition, the DMO will sell 10Y Gilts.

# European calendar

## Today's results

### Economic data




Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Industrial production M/M% (Y/Y%)	Aug	<b>0.4 (-2.8)</b>	0.3 (-2.5)	-0.4 (-2.0)	-0.4 (-2.1)

### 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	 10.00	ZEW current situation balance (expectations)	Oct	-23.6 (-26.4)	-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)

### Events & Auctions

Country	BST	Auction/Event	
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

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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