

# Euro wrap-up

## Overview

- Having initially made losses when a Brexit deal was reached between the EU and UK, Gilts closed higher on the day after the Northern Irish DUP refused to support it.
- Bunds followed Gilts higher at the longer end of the curve as euro area construction output fell again.
- With no top-tier data due from the euro area or UK, Brexit will remain the principle focus on Friday as UK MPs manoeuvre ahead of Saturday's key vote on the new deal.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.682	+0.008
OBL 0 10/24	-0.644	-
DBR 0 08/29	-0.412	-0.022
UKT 3¼ 09/21	0.509	-0.050
UKT 1 04/24	0.466	-0.028
UKT 0% 10/29	0.677	-0.033

\*Change from close as at 5.00pm BST.

Source: Bloomberg

## Euro area

### Construction output down again

Having reached a series high at the start of the year, sentiment among euro area construction firms has subsequently been on a downward trend. Indeed, the European Commission's index of confidence in the sector edged down in September for the fourth successive month to reach its lowest level since December 2017. Consistent with that softening of sentiment, activity in the sector has weakened too. Today's data showed that construction output fell in August for the fifth month out of six, with the drop of 0.5%M/M following a revised drop of 0.2%M/M the previous month to leave the level at its joint-lowest since January. Additionally, the annual rate of growth slowed 0.6ppt to 1.2%Y/Y, similarly the weakest since the start of the year.

Within the detail, both building work (-0.2%M/M) and civil engineering (-0.5%M/M) declined for a second successive month in August. However, at the country level, the decline in overall construction output was attributed largely to Germany, where production fell 1.5%M/M, the most since May. But having fallen a sharp 2.8%M/M in July due to the extreme heat-wave, the rebound in France of 0.3%M/M was negligible. Nevertheless, with the euro area level in July some 0.5% below the Q2 average, the risk of a second successive quarterly contraction in construction output in Q3 is non-negligible. Overall, the drop in August left the average level of euro area construction output in the first two months of Q3 down 0.1% on the Q2 average, currently suggesting that the sector made a negligible contribution to GDP growth last quarter.

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

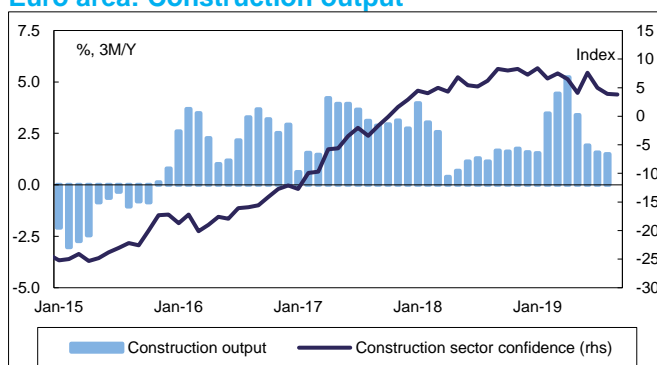
It should be a relatively uneventful end to the week for economic news from the euro area with the ECB's balance of payments for August the most notable new data due for release. It should be similarly uneventful in the US, with just the Conference Board coincident and leading indices due. However, FOMC members Kaplan, George and Clarida are set to speak publicly.

## UK

### At last a Brexit deal is reached

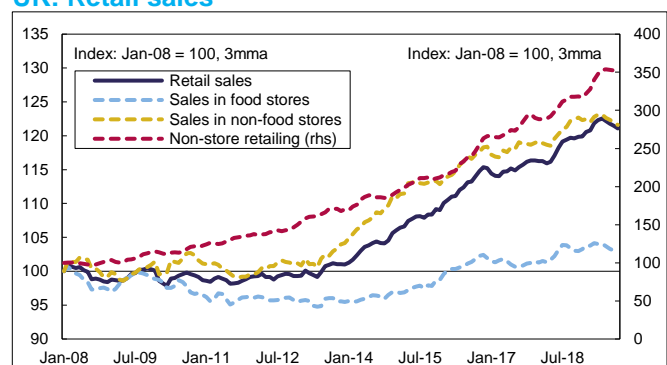
So, ahead of the two-day Summit which kicked off this afternoon, the UK and EU negotiators finally reached agreement on a draft Brexit deal. The bulk of the new Withdrawal Agreement was unchanged from that agreed previously by Theresa May in November 2018, particularly in terms of the financial settlement, a transition period that will last at least to end-2020, and

### Euro area: Construction output



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### UK: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



citizens' rights. But, as had long become clear would be the case in any deal agreed by Boris Johnson, the arrangements related to Northern Ireland were completely different to those envisaged by Theresa May. Rather than keeping Northern Ireland fully integrated with the rest of the UK as May had proposed (and Johnson and his allies had previously insisted must be the case), the new Withdrawal Agreement places an administrative border down the Irish Sea for regulatory, customs and VAT purposes, thus separating the Province from the rest of the UK. It also seeks to give the opportunity to representatives of the Northern Ireland Assembly to vote every four years on whether to maintain or reject the new arrangements. In addition, beyond Northern Ireland, the (non-binding) Political Declaration on the future relationship between the UK and EU was also amended to make clear that the future model would be based on a Free Trade Agreement (FTA). However, ambitions for zero tariffs in the FTA would have to be met by commitments to ensure a level playing field on regulation and competition. And, even with zero tariffs, the FTA would represent a more distant relationship than those previously envisaged by Theresa May's Political Declaration.

### **No more than 50% chance that deal will pass the House of Commons**

EU leaders endorsed the new Withdrawal Agreement later in the afternoon. But it is highly uncertain that the deal will find the necessary support in the House of Commons when it is submitted for a vote on Saturday. Johnson's chances of success took a significant hit this morning when the Northern Irish DUP stated unambiguously that its 10 MPs would vote against the deal, given what the Party judged to be the adverse constitutional and economic implications for the Province. And with the Conservatives having just 288 MPs, some of those (from the hardline ERG) likely to follow the DUP in voting against, and 319 votes required to win a majority, the PM will need several independent MPs (many of whom he recently expelled from the parliamentary Conservative Party) and a handful of Labour MPs (who will be 'whipped' by the party leadership to vote against) to vote in favour of the deal for it to be approved. That looks quite a tall order, with the probability of success no more than 50% in our view. But if the deal is rejected completely out of hand, that could pave the way to a general election in late November or early December, where Johnson's deal would act as the main plank of the Conservative manifesto and a Conservative majority might now be the most likely outcome. Alternatively, whatever happens in Saturday's votes, opposition MPs might still try at a future date to push for a second referendum on the deal. So, a wide range of scenarios remains possible. Whatever happens in Saturday's votes, however, we think an Article 50 extension will be requested as will be required under the Benn Act. And while Commission President Juncker otherwise today, we expect that extension to be granted.

### **Soft end to Q3 for retail sales**

As surveys had suggested, UK retail sales had a soft end to the third quarter, with the volume unchanged compared to August. And given a negative deflator, the value of sales fell 0.2%M/M. Excluding auto fuel sales were only a touch stronger, up 0.2%M/M in both volume and value terms. While the volume of sales in food stores and non-food stores rose on the month, sales in department stores fell for a second successive month. And most strikingly, non-store sales (largely over the internet) fell a steep 1.6%M/M following a drop of 3.2%M/M the prior month. Of course, retail sales can be volatile, particularly within the components. And given solid sales in June and July thanks to hot weather, the volume of sales was up 0.6%Q/Q in Q3, similar to the pace in Q2, suggesting another positive contribution to GDP growth last quarter. Looking ahead, however, the weak September figures suggest a loss of momentum, and we expect consumption growth to be softer, albeit still positive, in Q4.





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

There are no UK economic data of note due tomorrow so all attention can focus on assessing the prospects for the Brexit deal to be approved in a vote in the House of Commons on Saturday. Later in the day, however, BoE Governor Carney will once again speak publicly in Washington DC.










# European calendar

## Today's results

### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Construction output M/M% (Y/Y%)	Aug	<b>-0.5 (1.2)</b>	-	-0.7 (1.1)	-0.2 (1.8)
Italy	 Total trade balance (EU balance) €bn	Aug	<b>2.6 (0.3)</b>	-	7.6 (3.6)	-
UK	 Retail sales including fuel M/M% (Y/Y%)	Sep	<b>0.0 (3.1)</b>	-0.2 (3.1)	-0.2 (2.7)	-0.3 (2.6)
	 Retail sales excluding fuel M/M% (Y/Y%)	Sep	<b>0.2 (3.0)</b>	-0.1 (2.9)	-0.3 (2.2)	-

### Auctions


Country	Auction
France	 sold €2.6bn of 0% 2022 bonds at an average yield of -0.63%
	 sold €4.1bn of 0% 2025 bonds at an average yield of -0.43%
	 sold €2.3bn of 0.5% 2026 bonds at an average yield of -0.37%
	 sold €0.6bn of 0.25% 2024 index-linked bonds at an average yield of -1.36%
	 sold €0.2bn of 0.1% 2025 index-linked bonds at an average yield of -1.09%
	 sold €0.4bn of 3.4% 2029 index-linked bonds at an average yield of -1.03%
Spain	 sold €1.1bn 0.05% 2021 bonds at an average yield of -0.447%
	 sold: €0.8bn 0.25% 2024 bonds at an average yield of -0.221%
	 sold €1.152bn 0.6% 2029 bonds at an average yield of 0.253%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Tomorrow's releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU		09.00 Current account balance €bn	Aug	-	20.5
Italy		09.00 Current account balance €bn	Aug	-	8.4

### Events & Auctions

Country	BST	Auction/Event
UK		- UK sovereign debt to be rated by Fitch

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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