Euro wrap-up

Overview

- Gilts made losses as risks of a no-deal Brexit appeared minimal and expectations rose that Johnson's Withdrawal Agreement would gain the support of a majority of MPs in a key vote tomorrow.
- Bunds followed Gilts lower even as data confirmed a return to German factory price deflation.
- Tuesday's main focus will be the latest Brexit votes in the House of Commons while the latest ECB bank lending survey is also due.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.673	+0.010
OBL 0 10/24	-0.608	+0.018
DBR 0 08/29	-0.346	+0.040
UKT 3¾ 09/21	0.552	+0.015
UKT 1 04/24	0.536	+0.030
UKT 0⅞ 10/29	0.749	+0.041

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

Euro area

Germany factory gate deflation returns

On a very quiet day for economic data from the euro area, the most notable new release focused on German producer prices, which reported the first year-on-year drop in prices at the factory gate since 2016. Admittedly, following an increase of 0.3%Y/Y the previous month, the decline in PPI of 0.1%Y/Y was minimal. And it was explained largely by prices of energy, which fell -1.9%Y/Y following a drop of just 0.3%Y/Y the previous month. The fall in the energy component came from petroleum (down 7.6%Y/Y) and natural gas (down 6.8%Y/Y) while electricity prices rose 3.7%Y/Y. Most other main components were largely stable, e.g. inflation of capital goods was unchanged at 1.5%Y/Y for a fourth month, and inflation of durable goods was up 0.1ppt to 1.4%Y/Y, back in line with the average of the previous six months. Nevertheless, even excluding energy, PPI inflation slowed for a fifth successive month to just 0.5%Y/Y, the weakest in almost three years. So, in terms of consumer prices – both in Germany and in the euro area as a whole – today's data support our view that non-energy industrial goods inflation will remain highly subdued and energy prices are likely to subtract more significantly from inflation over the near term.

The day ahead in the euro area and US

Tuesday's most notable economic data from the euro area will come from the ECB, as it publishes the results of its latest Bank Lending Survey. These will no doubt be watched to judge any change in attitude at the region's banks in the wake of last month's ECB policy package, which included several measures with direct impact on the financial sector including a 10bp cut in the deposit rate, the restart of QE, more generous conditions on the TLTRO-III liquidity operations, and – perhaps most notable – the introduction of a new tiered framework of reserve remuneration to apply from 30 October.

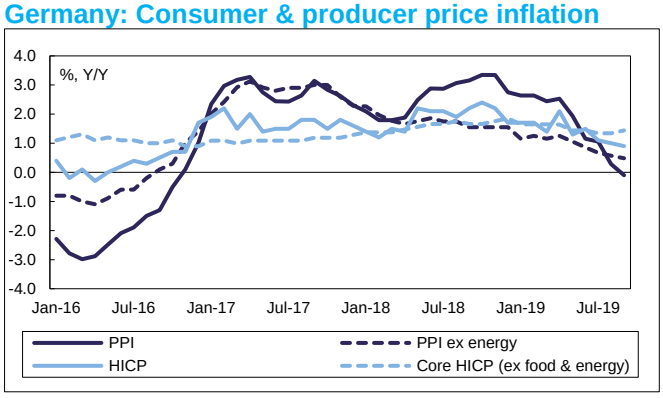
In the US, September's existing home sales data are due along with the October Richmond Fed manufacturing survey. In addition, the Treasury will sell 2Y Notes.

UK

Key days for Brexit

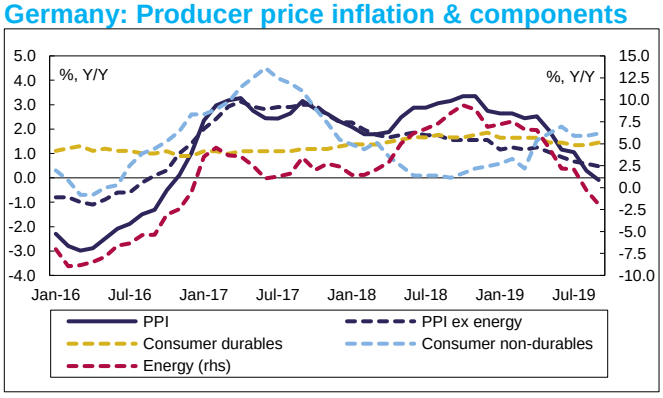
Saturday saw MPs in the House of Commons vote by 322 to 306 to refuse to endorse the UK-EU Withdrawal Agreement until the implementation legislation – the Withdrawal Agreement Bill (WAB) – has been approved. As such, they also forced UK PM Johnson to formally request an Article 50 extension beyond the end of the month. While the EU won't grant that

Germany: Consumer & producer price inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: Producer price inflation & components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

extension until the picture in Parliament is clearer, we fully expect events in the House of Commons over the coming couple of days to persuade the EU to do so. Quite what that extension will be used for, however, will be determined by the outcome of key votes likely to be held tomorrow. While Johnson was refused his wish for another 'meaningful vote' today, the Government was set this evening to present its WAB and will likely hold a 'second reading' vote – to test whether support exists in principle for that draft legislation – tomorrow. At the time of writing, Johnson appeared to have the numbers in Parliament required to win that vote and allow the WAB to move on to the committee stage. But votes on opposition party amendments, that might come in due course, could be close. Among other things, these would compel the Government to seek a customs union with the EU during the transition phase, prevent the UK from exiting the transition period at end-2020 straight to WTO rules, and/or call for a second referendum ahead of ratification.

Extension likely. But for what purpose?

Given the possible support of the Northern Irish DUP, which now feels betrayed by Johnson, and some ex-Conservative independents, the customs union amendment could be close. More importantly perhaps, given the need for MPs to be able to scrutinise properly the WAB, and amend it if required, a separate vote tomorrow on a so-called 'programme motion', proposing an accelerated timetable to pass the WAB by the end of the month, might well see Johnson defeated. Of course, if the WAB passed its second reading, the UK would be on track to leaving the EU whatever happened in the programme motion. But if the Government loses that second vote, further time beyond 31 October would be required for the WAB's ratification, and the EU would surely be willing to grant the necessary Article 50 extension. Moreover, if Johnson doesn't win any of tomorrow's key votes, the EU would similarly see the need to provide the extension, most likely of three months in line with the request in the letter to the EU, to allow for an early general election. For the time being, therefore, we maintain our baseline scenario of an Article 50 extension. But what that extension is for, and the likelihood of the UK leaving the EU before the next general election, will be determined in the coming days.

The day ahead in the UK

While all attention will be on the House of Commons for the aforementioned 'second reading' vote, Tuesday will also bring the week's most notable UK economic data. Public finances figures will show that net borrowing in September continued to trend higher than its level a year earlier on a trajectory incompatible with the Government's fiscal rules. And the CBI industrial trends survey will suggest that manufacturing activity remained weak this month with orders in retreat following renewed Brexit-related inventory accumulation. In the bond market, the DMO will sell 2025 Gilts.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	PPI Y/Y%	Sep	**-0.1**	-0.2	0.3	-
UK	Rightmove house price index M/M% (Y/Y%)	Oct	**0.6 (-0.2)**	0.6 (-0.2)	-0.2 (0.2)	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Spain	09.00	Trade balance €bn	Aug	-	-2.5
UK	09.30	Public sector net borrowing (ex banking groups)	Sep	8.9 (9.7)	5.8 (6.4)
	11.00	CBI industrial trends survey, total orders (selling prices)	Oct	-30	-28

Events & Auctions

Country	BST	Auction/Event
EMU	09.00	ECB to publish quarterly Bank Lending Survey
UK	10.30	Auction: to sell £3bn of 0.625% 2025 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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