

# Euro wrap-up

## Overview

- Bunds made gains as the flash PMIs implied a continued lack of momentum in the euro area economy and Draghi's final Governing Council meeting press conference provided no significant new policy insights.
- Gilts made substantive gains ahead of reports that Boris Johnson is proposing a general election for 12 December.
- Friday will probably bring the EU's decision on the Article 50 extension as well as the latest German ifo survey.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.681	-0.009
OBL 0 10/24	-0.636	-0.012
DBR 0 08/29	-0.408	-0.012
UKT 3¼ 09/21	0.476	-0.054
UKT 1 04/24	0.430	-0.052
UKT 0% 10/29	0.625	-0.061

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

## Euro area

### Draghi's swansong offers no new insights

Today's ECB press conference was a momentous occasion, being the last to be conducted by Mario Draghi before Christine Lagarde, who attended this week's policy meeting as an observer, takes over as President. From a market perspective, however, it was largely a non-event, with Draghi offering no new insights into policy. Unsurprisingly, he emphasised ongoing weakness in the euro area manufacturing sector, referring among things to the subdued PMIs (see below). And he repeated that the risks to the economic outlook remain skewed to the downside. Also predictably, he was keen to downplay the differences in opinion among the members of the Governing Council. And he suggested that the market response to the September package revealed that the various measures had been well understood by investors.

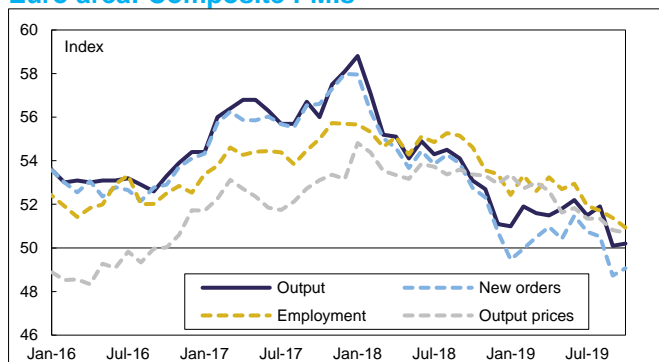
### Still scope for extra stimulus

But while Draghi insisted that the time now was for implementation of the September package rather than further easing, he made clear that there was scope for further stimulus in future if necessary. For example, he judged the economic impact of negative rates so far to have been strongly positive. And by noting how it mitigated the adverse impact on banks, he implied that tiering would give scope for further rate cuts. Likewise, he reiterated that the issue and issuer limits on the QE programme need not represent an obstacle to ongoing asset purchases, particularly if Governments increased issuance via appropriate easing of fiscal policy.

### Fiscal inadequacies to prompt further easing under Lagarde

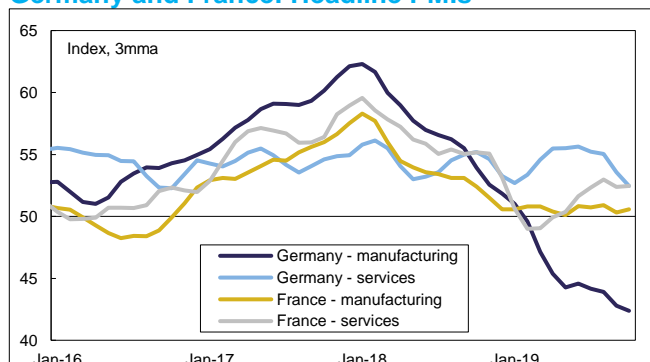
Indeed, Draghi's parting shot was at Governments, for having often failed to provide appropriate fiscal policy at the member state level and a more potent central fiscal capacity for the euro area as a whole. Of course, his calls to Governments in this respect have fallen on deaf ears for some time. German fiscal policy remains too tight. And euro area Finance Ministers only last week failed to agree major enhancement to the forthcoming planned Budgetary Instrument for Convergence and Competitiveness (BICC), whose size is currently expected to reach a paltry €17bn over a seven-year period – wholly inadequate to provide a meaningful source of fiscal support in the event of a sharper macroeconomic downturn. When she takes over as President, Lagarde's first task will likely be to review and possibly amend the ECB's interpretation of its price stability objective, perhaps specifying explicitly a symmetrical 2.0% target. But in due course, the subdued economic outlook, coupled with the inadequacy of euro area fiscal policy, seems likely to force the Governing Council to provide further easing, most likely via another rate cut.

### Euro area: Composite PMIs\*



\*October figures are flash estimates. Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Germany and France: Headline PMIs\*



\*October figures are flash estimates. Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.



## PMIs point to continued stagnation

Concerns about the near-term economic outlook were reinforced by today's flash PMIs, which suggested no meaningful improvement in economic momentum in the euro area at the start of Q4 and were consistent with output moving merely sideways in October. Indeed, the composite PMI was just 0.1pt higher on the month at 50.2, the second lowest since mid-2013. If sustained over coming months, this might suggest economic growth of at most 0.1%Q/Q in Q4, comparing unfavourably to the ECB's forecast of 0.2%Q/Q for this quarter. Given the challenging external environment, manufacturers remained particularly gloomy about conditions, with the headline index unchanged (45.7) at its weakest for more than six years. But while consistent with ongoing growth, the services PMI remained subdued, up just 0.2pt at 51.8, the second-lowest reading in nine months. And the survey offered little prospect of a significant acceleration in either sector over the near term too. Indeed, the composite new orders component remained in contractionary territory for the second successive month. As a consequence, firms reported the softest jobs growth for almost five years. And the PMIs also implied a further softening of inflationary pressures, as average prices for goods and services reportedly rose at the weakest rate for over three years.

## Germany's PMIs signal continued contraction

At the country level, despite a modest improvement in October, the PMIs implied that Germany's manufacturing sector remains very weak. In particular, the 0.2pt increase in the headline index left it in deeply contractionary territory at 41.9. While the monthly increases in the output (up 0.7pt) and new orders (up 3.6pts) PMIs were somewhat more convincing, they still signalled steep declines at the start of Q4. And there were increasing signs of a negative spillover from the troubles in manufacturing to the services sector, with the headline PMI down 0.2pt to 51.2, a more than three-year low. So, the German composite output PMI (48.6) remained consistent with contraction and the employment component implied the first fall in six years. In contrast, the French PMIs were better in October, particularly in services where the index increased 1.8pts to 52.9. The manufacturing output PMI also posted a sizeable gain (1.3pts to 51.0) to leave the composite PMI up 1.8pts to 52.6. However, this was not quite enough to fully reverse the weakness seen in September, with the index having oscillated around a broadly sideways trend since June. And we note that the flash French PMIs are often significantly revised in due course. Finally, today's survey also suggested that the rest of the region slowed closer to stagnation at the start of Q4. So, overall, the PMIs provided little cause for optimism.

## The day ahead in the euro area and US

Friday will bring more sentiment indicators from Germany, with the ifo business survey likely to echo the downbeat tone of the flash PMIs and emphasise the downside risks to the near-term economic outlook in the euro area's largest member state. The GfK consumer confidence survey, meanwhile, is expected to confirm a modest pickup in the headline gauge in October but indicate an anticipated deterioration over the coming month close to the bottom of the range of the past 2½ years. Elsewhere, the ECB's Villeroy will speak in Paris, while in the markets Italy is due to sell 2Y bonds.

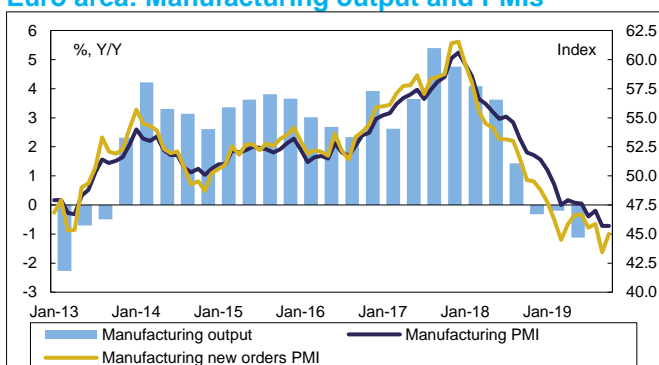
In the US, the week will conclude with just the revised University of Michigan consumer sentiment survey for October.

## UK

### Johnson proposes 12 December election

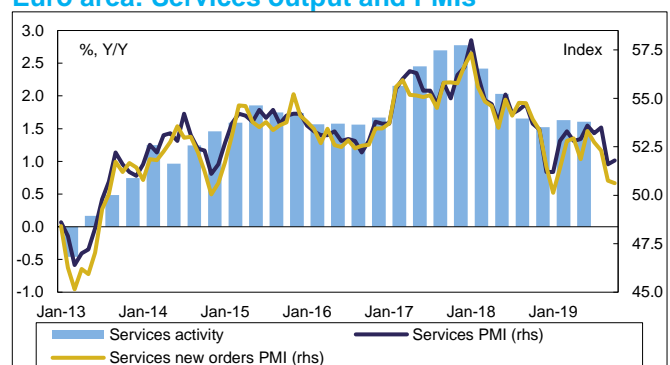
Just after market close, UK PM Johnson published a letter to Labour Party leader Corbyn calling for a general election on 12 December. A formal legislative proposal will be presented to Parliament on Monday. While Johnson stated that Parliament would continue to sit until 6 November to try to pass his Withdrawal Agreement Bill, we doubt that he will succeed in getting his legislation passed. If the proposal for the election is brought under the Fixed Term Parliaments Act, the agreement of most Labour MPs will be required to confirm the election for 12 December. That can't be guaranteed, although on balance

### Euro area: Manufacturing output and PMIs\*



\*October PMI figures are flash estimates. Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: Services output and PMIs\*



\*October PMI figures are flash estimates. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

we do expect it to happen. While opinion polls currently suggest that Johnson's Conservative Party would win a large majority, the outcome is difficult to predict, as Theresa May discovered to her cost when she lost her majority in 2017. Indeed, there is a good probability that it would merely deliver another hung parliament.

Separately, at the time of writing, there had been no meaningful news with respect to the EU's decision how to extend the Article 50 deadline. Perhaps inevitably, reports suggested that all EU member states agreed that there should be an Article 50 extension. But while most key players – Tusk, Merkel and Varadkar – concur that the new deadline should be 31 January in line with Johnson's formal request, Macron had reportedly continued to press for a short deadline of 15 November unless a new general election was called and confirmed. A decision one way or the other is likely to come on Friday.











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

Friday should bring the decision of the EU on the Article 50 extension. But the fallout from Johnson's proposal for a general election will dominate. No new UK economic data are scheduled for release.

# European calendar

## Today's results

### Economic data






Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Preliminary manufacturing PMI (services)	Oct	<b>45.7 (51.8)</b>	46.0 (51.9)	45.7 (51.6)	-
	 Preliminary composite PMI	Oct	<b>50.2</b>	50.3	50.1	-
	 ECB main refinancing rate %	Oct	<b>0.00</b>	0.00	0.00	-
	 ECB marginal lending facility %	Oct	<b>0.25</b>	0.25	0.25	-
	 ECB deposit facility rate %	Oct	<b>-0.50</b>	-0.50	-0.50	-
Germany	 Preliminary manufacturing PMI (services)	Oct	<b>41.9 (51.2)</b>	42.0 (52.0)	41.7 (51.4)	-
	 Preliminary composite PMI	Oct	<b>48.6</b>	48.8	48.5	-
France	 Preliminary manufacturing PMI (services)	Oct	<b>50.5 (52.9)</b>	50.2 (51.6)	50.1 (51.1)	-
	 Preliminary composite PMI	Oct	<b>52.6</b>	51.0	50.8	-
UK	 UK Finance loans approved for house purchase '000s	Sep	<b>42.3</b>	42.4	42.6	-

### 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	GfK consumer confidence indicator	Nov	9.8	9.9
	 09.00	Ifo business climate index	Oct	94.5	94.6
	 09.00	Ifo current assessment balance (expectations)	Oct	98.0 (91.0)	98.5 (90.8)
France	 07.45	PPI Y/Y%	Sep	-	-0.7
Spain	 08.00	PPI Y/Y%	Sep	-	-2.5

### Events & Auctions

Country	BST	Auction/Event
EMU	 09.00	ECB to publish its Survey of Professional Forecasters
	 -	ECB's Villeroy speaks in Paris
France	 -	French sovereign debt to be rated by Moody's
Italy	 -	Italian sovereign debt to be rated by S&P
UK	 10.00	Auction: to sell zero coupon 2021 bonds
	 -	UK sovereign debt to be rated by S&P

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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