Euro wrap-up

Overview

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- Bunds made notable gains as euro area GDP growth remained subdued in Q3 and headline inflation fell to a near-three-year low in October.
- Gilts also followed the global trend higher as UK car production remained weak at the end of Q3, while consumer confidence deteriorated at the start of Q4.
- While the US labour market and manufacturing ISM will attract attention, the UK's manufacturing PMI survey for October is also likely to suggest the sector remained firmly in contractionary territory at the start of Q4.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.675	-0.030
OBL 0 10/24	-0.628	-0.040
DBR 0 08/29	-0.407	-0.049
UKT 3¾ 09/21	0.502	-0.016
UKT 1 04/24	0.436	-0.044
UKT 0⅞ 10/29	0.629	-0.057

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

Euro area

Euro area GDP growth unchanged at 0.2%Q/Q

While the first estimate of euro area GDP in Q3 today exceeded expectations, the growth rate was nevertheless still underwhelming. Indeed, growth of 0.2%Q/Q was merely unchanged from the pace in Q2, which itself was half that seen in Q1. As such, the annual rate fell a further 0.1ppt to 1.1%Y/Y, the weakest since Q413. No detail was provided on the expenditure breakdown, but the results so far from the member states suggest that household consumption and private investment was firmer in Q3, while private inventories also provided a boost. But not least due to stronger imports, net trade looks set to have provided a drag for a sixth quarter out of the past seven. And with the external environment still posing a significant downside risk to the near-term growth outlook, the deterioration in economic surveys at the start of Q4 – including yesterday's disappointing European Commission ESI – imply a possible slowdown in euro area GDP growth in the final quarter of the year.

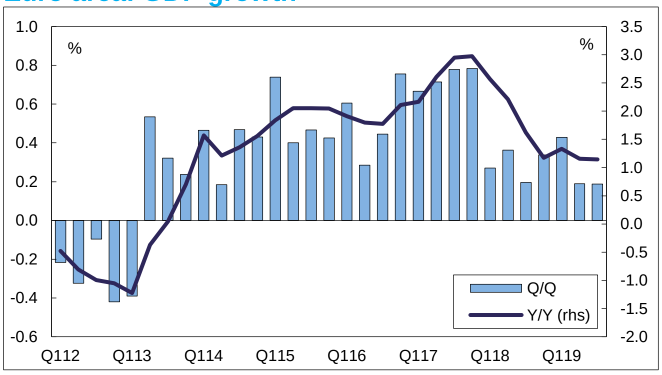
Growth little changed among member states

At the country level, after French economic growth yesterday aligned with our forecast of 0.3%Q/Q, today's figures from Spain also showed growth unchanged from the pace in Q2, at 0.4%Q/Q. This marked the twenty-fourth consecutive quarterly expansion, but left output up 2.0%Y/Y, the softest annual rate in five years. While Italy's economic performance beat expectations, growth was still weak at just 0.1%Q/Q. So despite having been revised marginally higher in the previous quarter, this left output up a paltry 0.3%Y/Y, nevertheless the firmest annual pace for a year. No Q3 GDP data were provided for Germany. But while today's German retail sales suggested only modest growth in September, with the 0.1%M/M increase merely reversing the drop in August, they were still up 0.6%Q/Q in Q3, an acceleration from the 0.1%Q/Q increase in Q2. So, while manufacturing output likely remained a significant drag in the third quarter, today's euro area GDP figures imply that Germany might well have avoided a technical recession, with a non-negligible possibility that the euro area's largest member state might well have returned to very modest positive growth.

Euro area CPI declines to near-3-year low

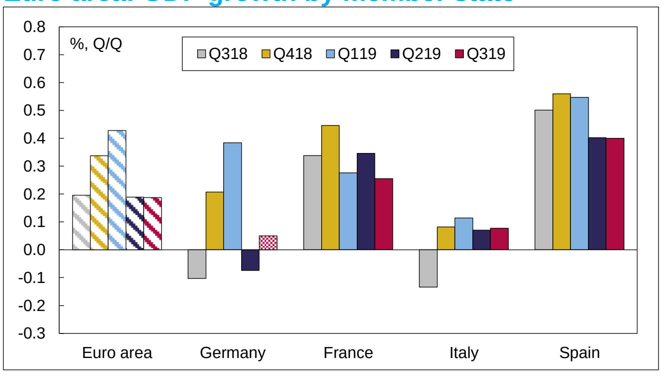
Against the backdrop of subdued economic growth, the first estimate of euro area inflation in October aligned with expectations, showing headline CPI declining 0.1ppt to 0.7%Y/Y, the lowest for almost three years. But the weakness was more than fully accounted for by energy prices, which fell a steeper 3.2%Y/Y. While food price inflation was unchanged at 1.6%Y/Y, there was a modest pickup in non-energy industrial goods inflation, by 0.1ppt to 0.3%Y/Y, with a similar increase in services inflation too, to 1.6%Y/Y. As such, the core CPI rate was a touch stronger than expected in October, rising 0.1ppt to

Euro area: GDP growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth by member state*



**Q319 GDP figure for Germany is Daiwa forecast.*
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

1.1%Y/Y, a four-month high. To two decimal places, the headline rate was within a smidgen of being unrevised at 0.8%Y/Y at the start of Q4. Moreover, this looks set to mark the trough, with the drag from energy inflation set to diminish over coming months and services inflation expected to edge slightly higher. This notwithstanding, with risks to the near-term economic outlook firmly to the downside, we also think headline and core inflation will shift only slightly higher over coming months, and on average remain only a little stronger than 1%Y/Y over the coming year too.

Euro area unemployment rate nudges slightly higher

Over the past year or so, the euro area's labour market recovery has remained remarkably resilient in the face of slowing economic momentum. And while today's figures showed a modest increase in the number of people unemployed in September, this marked only the third monthly rise in the past two years, to leave the cumulative drop over the past year at a still-healthy 738k. So, the unemployment rate was unchanged at 7.5% in September (from an upwardly revised reading in August), the joint-lowest since mid-2008. Germany's unemployment rate remained at a record-low of 3.1%, while there were further improvements in France and Spain, where the rates fell 0.1ppt a piece to 8.4% and 14.2% respectively, with the former the lowest for more than a decade. In contrast, the Italian unemployment rate edged higher to 9.9%, although this was still 0.4ppt below its level a year ago.

The day ahead in the euro area and US

With many European markets closed for All Saints Day, tomorrow should be relatively quiet for euro area data, with just Italian new car registrations figures for September due for release.

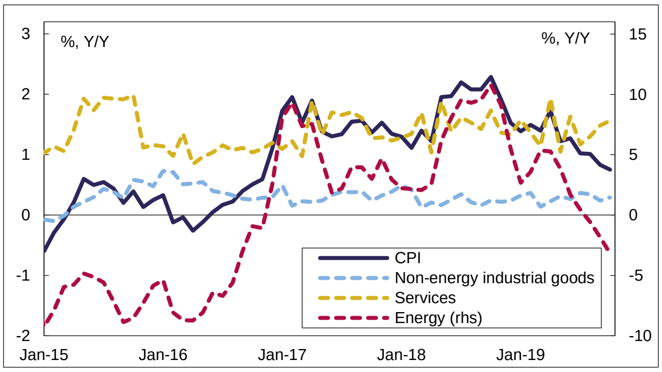
Of course, most attention will be on the US, with top-tier releases including October's labour market report and manufacturing ISM. The increase in non-farm payrolls at the start of Q4 is also expected to be much softer than of late, with a forecast increase of 95k likely to see the unemployment rate nudged slightly higher to 3.6%. And while the headline manufacturing ISM is expected to largely reverse September's decline it is still expected to remain in contractionary territory for the third consecutive month. Tomorrow will also bring the latest construction spending and vehicle sales data. A number of Fed Governors will also be in action, including Vice Chair Williams, Clarida, Quarles, Kaplan and Daly.

UK

Car production maintains a downward trend

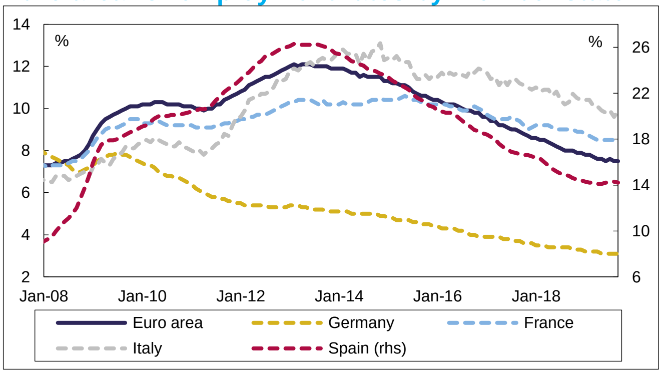
While the decision to hold an early General Election in December represents an opportunity to bring to an end persistent political paralysis, today's car production figures, published by SMMT, illustrated how the ongoing Brexit uncertainty continues to have a negative impact on UK manufacturers. In particular, total autos output resumed its downward trend in September, with the 3.8%Y/Y drop the fifteenth annual decline out of the past sixteen months. Output for the domestic market was down a steeper 5.1%Y/Y, while production for the export market (which accounts for roughly 80% of total production) was down almost 3½%Y/Y. As such, in the first nine months of the year, the number of cars produced was the lowest since 2011, to leave them down a whopping 15.6%YTD/Y, the steepest such decline for a decade. And the fall in production for the export market was down an even sharper 16.8%YTD/Y in September, similarly the largest drop since 2009. Moreover, with several car manufacturers having temporarily shut their factories at the end of October as a precaution around the former Brexit deadline, we expect to see further weakness over coming months too.

Euro area: CPI inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment rates by member state



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

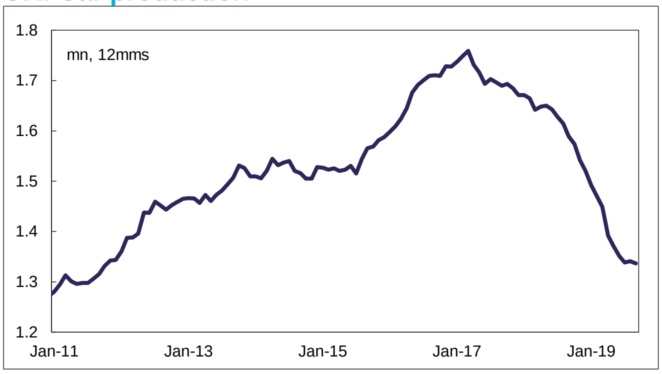
Consumer confidence at lowest since mid-2013

While the weakness in demand for autos in part reflects the challenging external environment more generally, the latest GfK consumer confidence survey also suggested that domestic demand will likely remain subdued in the final quarter of the year. In particular, the headline index fell 2pts in October to -14, reversing the increase seen in September and matching the weakest reading since mid-2013. Households were unsurprisingly downbeat about general economic conditions, with expectations for the next twelve months among the most downbeat since the Global Financial Crisis and notably lower than a year ago. As such, consumers were also more concerned about their own financial situation and therefore suggested that their willingness to make major purchases had fallen further, indicating the likelihood of more subdued consumption growth in the fourth quarter. And with it far from certain that the snap election will restore some form of political stability, we expect this pattern of weak consumer confidence and spending to continue to hamper the UK's economic recovery into the New Year on beyond.

The day ahead in the UK

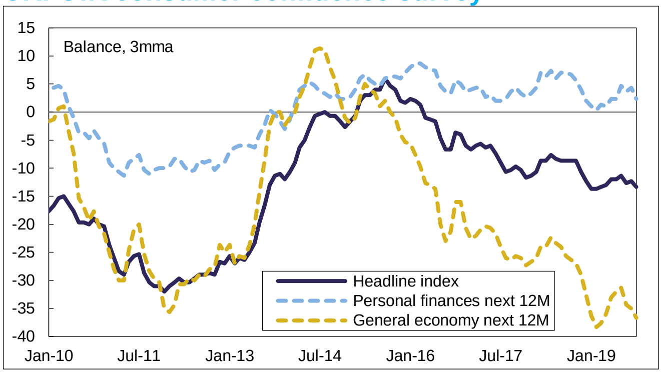
Tomorrow will bring arguably the most noteworthy UK economic release of the week, with the manufacturing PMI survey for October. Despite a modest pickup in September, the headline index remained below the key-50 mark for the fifth consecutive month. And while the risk of a no-deal Brexit at the end of the month was eventually effectively taken off the table, persistent political uncertainty and soft global demand will have continued to hamper conditions in the sector, with the headline index likely to have remained firmly in contractionary territory at the start of Q4.

UK: Car production



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

UK: GfK consumer confidence survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data						
Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	GDP Q/Q% (Y/Y%)	Q3	**0.2 (1.1)**	0.1 (1.1)	0.2 (1.2)	-
	Preliminary CPI (core CPI) Y/Y%	Oct	**0.7 (1.1)**	0.7 (1.0)	0.9 (1.0)	0.8 (-)
	Unemployment rate %	Sep	**7.5**	7.4	7.4	7.5
Germany	Retail sales M/M% (Y/Y%)	Sep	**0.1 (3.4)**	0.3 (3.5)	0.5 (3.2)	-0.1 (3.1)
France	Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	**0.7 (0.9)**	0.9 (1.1)	0.9 (1.1)	-
Italy	Unemployment rate %	Sep	**9.9**	9.6	9.5	9.6
	Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	**0.3 (0.2)**	0.3 (0.2)	0.4 (0.2)	0.3 (-)
	Preliminary GDP Q/Q% (Y/Y%)	Q3	**0.1 (0.3)**	0.0 (0.2)	0.0 (-0.1)	0.1 (0.1)
Spain	Preliminary GDP Q/Q% (Y/Y%)	Oct	**0.4 (2.0)**	0.4 (2.0)	0.4 (2.0)	-
UK	GfK consumer confidence indicator	Oct	**-14**	-13	-12	-
	SMMT car manufacturing Y/Y%	Sep	**-3.8**	-	3.3	-

Auctions	
Country	Auction
- Nothing scheduled -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
UK	09.30	Manufacturing PMI	Oct	48.2	48.3

Events & Auctions		
Country	GMT	Auction/Event
EMU	-	All Saints' Day public holiday

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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