

Euro wrap-up

Overview

- Bunds made modest losses, while euro area periphery government bonds underperformed as Spain's election over the weekend saw the Socialist party fall well short of a majority and a significant increase in the share of the far-right Vox party.
- Gilts also made modest losses, even as UK GDP posted a smaller than expected increase in Q3 to leave annual growth at its softest since Q110.
- Tomorrow will bring a German and French business sentiment survey, as well as the UK's latest labour market report.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.624	+0.001
OBL 0 10/24	-0.524	+0.009
DBR 0 08/29	-0.252	+0.013
UKT 3% 09/21	0.567	+0.007
UKT 1 04/24	0.557	+0.024
UKT 0% 10/29	0.809	+0.019

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

Source: Bloomberg

Euro area

Spain's political stalemate to persist

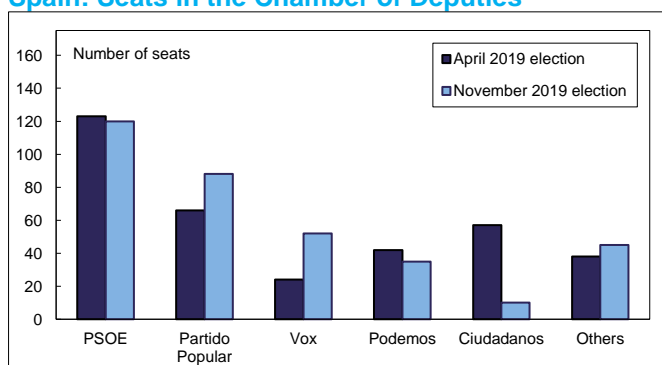
The outcome of yesterday's Spanish election – the fourth in as many years – predictably delivered an even more hung parliament. As had been expected, the Socialist party (PSOE) of acting Prime Minister Pedro Sánchez once again took the largest number of seats. But like in the previous vote in April, its share fell well short of a majority, with only 120 of the 350-seat Congress of Deputies (and three less than it previously held). While the right-wing establishment Partido Popular (PP) saw its share rise, with its tally up by 22 to 88, the big surprise and headline grabber from yesterday's vote was the significant increase in the share of the ultra-nationalist/traditionalist Vox party, which took 52 seats this time around (up 28 from April) to become the third largest party in Parliament. This was at the expense of the centre-right Ciudadanos (C's), which saw a collapse in its seat count by 47 to just 10, to leave it only the sixth largest party in Parliament. Meanwhile, the anti-austerity populist left-wing Podemos also lost votes as the number of seats won fell back to just 35 (from 42 previously). Talks to try to form a government will now get underway. But with neither the left-wing nor right-wing blocs having the 176 seats needed for an absolute majority, there remains significant uncertainties as to whether a working coalition can eventually be found. Indeed, while Podemos has expressed willingness to work with PSOE, a coalition would still require the support of other left-wing and nationalist parties. Sánchez could also seek the abstention of PP. But both options will likely prove problematic in achieving a stable government. And overall, we see a significant probability of continued broad policy inertia ahead of yet another election in 2020.

The day ahead in the euro area and US

Tomorrow will bring national sentiment surveys from the euro area's two largest member states, which will provide an update on business conditions in Q4. In particular, Germany's ZEW survey will offer the first insight into conditions in November, with a modest improvement expected in financial experts' assessment of the current and future situations, albeit from a particularly low level. The Bank of France's business sentiment survey will provide an insight into conditions in October. Elsewhere, the ECB's Cœuré and Mersch will speak at ECB workshops on money markets and central bank independence. And in the markets, Germany will sell 2Y Schatz.

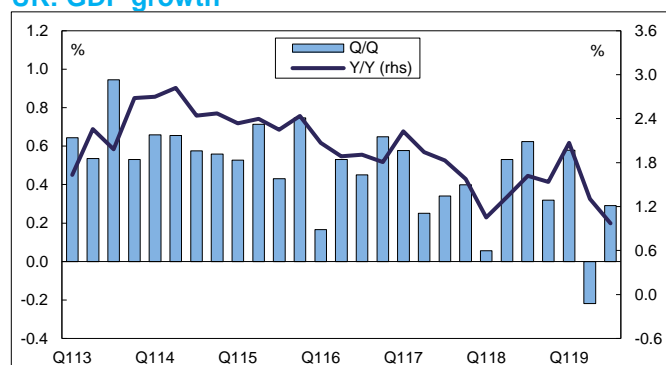
In the US, tomorrow will bring the NFIB small business optimism indicator for October, which despite an anticipated improvement is likely to remain close to the bottom of the recent range. In addition, the Fed's Clarida is due to speak on monetary policy and price stability, while on-voting members Harker and Kashkari are also scheduled to speak publicly.

Spain: Seats in the Chamber of Deputies



Source: Ministry of the Interior and Daiwa Capital Markets Europe Ltd.

UK: GDP growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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UK

GDP growth back in positive territory (for now)

The first estimate of Q3 GDP showed the UK's economy returning to expansion last quarter. But growth of 0.3%Q/Q fell short of the BoE's and market expectations, and left the annual rate of growth moderating 0.3ppt to 1.0%Y/Y, the softest such pace since the start of 2010. There was another solid contribution from net trade in Q3, with the more than 5%Q/Q increase in exports largely reversing the sharp decline seen in Q2. And with imports having risen by less than 1%Q/Q, net trade contributed 1.2ppts to GDP growth in Q3. But this was fully offset by a fall in inventories, as firms appeared to be continuing to run down stock levels in spite of the previous end-October Brexit deadline. In terms of final domestic demand, the recent trends were maintained. For example, households appeared relatively immune to heightened political uncertainties, with private consumption growth unchanged at 0.4%Q/Q. But persistent Brexit uncertainties continued to take their toll on business investment, which failed to grow in Q3 for the sixth quarter out of the past seven.

Economic momentum weakened over the quarter

At the sectoral level, services and construction posted modest growth, with output up 0.4%Q/Q and 0.6%Q/Q respectively. But despite a surge in car production in Q3 – the 11%Q/Q increase followed an 8½%Q/Q drop in Q2 when car factories brought forward their summer maintenance shutdown to April – total manufacturing output was merely flat in Q3, leaving it almost 1½% lower than a year earlier. And today's monthly output releases illustrated a further slowing in economic momentum towards the end of the third quarter. For example, manufacturing output fell for a second successive month in September (-0.4%M/M), to leave it 1.8% lower than a year earlier. While energy production and mining reversed some of the weakness seen in the previous two quarters, this left total industrial production down 0.2%M/M (-1.4%Y/Y). Construction activity also slipped back in September (-0.2%M/M). But services output was also weak, with output flat on the month following a drop of 0.1%M/M in August. And so, monthly GDP contracted for a second successive month (-0.1%M/M) for the first time since December 2013.

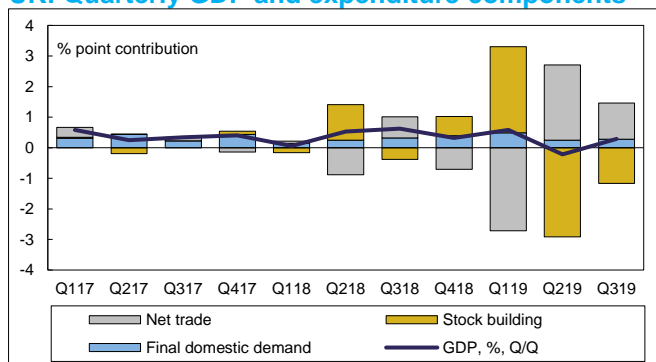
Outlook remains clouded by political uncertainty

Looking ahead, not least given the recent monthly GDP profile, we expect growth to return to negative territory in Q4. While the Article 50 deadline has been extended to the end of January, December's general election adds another source of political uncertainty. Business surveys continue to point to a further deterioration in conditions at the start of the quarter, implying another quarter of weak business capex. Indicators also suggest that consumer spending is unlikely to accelerate too. And against the backdrop of a still challenging external environment, net trade seems unlikely to provide a similar boost to growth. Overall, we currently expect GDP to fall in Q4, likely reversing the growth seen in Q3. Of course, the outlook further ahead will largely depend on the outcome of next month's election, not least due to the wide range of fiscal policies being proposed by the various parties. However, there is a significant risk that lack of clarity with respect to Brexit will drag on regardless of the outcome. And this will no doubt keep the underlying pace of the UK's economic growth subdued for some time to come.

The day ahead in the UK

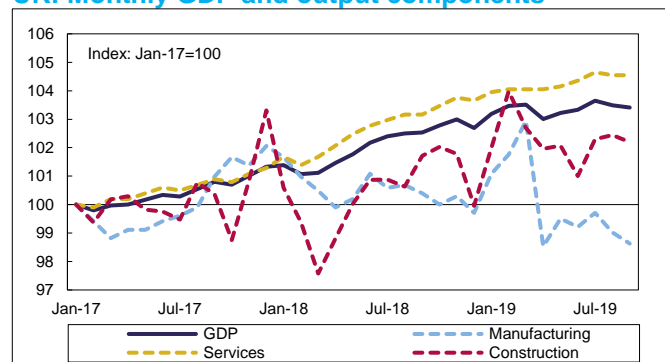
Tomorrow will bring more top-tier UK data, with the latest labour market report expected to reveal a steeper pace of decline in employment in the three months to September, albeit leaving the unemployment rate unchanged at 3.9%. Average earnings growth is also expected to remain close to the near-4%3M/Y growth seen over recent months.

UK: Quarterly GDP and expenditure components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Monthly GDP and output components











Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data







Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Italy	 Industrial production M/M% (Y/Y%)	Sep	-0.4 (-2.1)	-0.4 (-2.1)	0.3 (-1.8)	0.4 (-1.7)
UK	 Preliminary GDP Q/Q% (Y/Y%)	Q3	0.3 (1.0)	0.4 (1.1)	-0.2 (1.3)	-
	 GDP M/M%	Sep	-0.1	-0.1	-0.1	-0.2
	 Services output M/M% (3M/3M)	Sep	0.0 (0.4)	0.1 (0.4)	0.0 (0.4)	-0.1 (-)
	 Industrial production M/M% (Y/Y%)	Sep	-0.3 (-1.4)	-0.1 (-1.2)	-0.6 (-0.7)	-0.7 (-)
	 Manufacturing production M/M% (Y/Y%)	Sep	-0.4 (-1.8)	-0.2 (-1.3)	-0.7 (-1.7)	- (-1.6)
	 Construction output M/M% (Y/Y%)	Sep	-0.2 (0.5)	-0.3 (1.2)	0.2 (2.4)	0.1 (1.8)
	 Trade balance (goods trade balance) £bn	Sep	-3.4 (-12.5)	-2.0 (-10.1)	-1.5 (-9.8)	-1.8 (-10.8)

Auctions



Country	Auction
- Nothing scheduled -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany	 10.00	ZEW current situation balance (expectations)	Nov	-24.0 (-14.0)	-25.3 (-22.8)
France	 07.30	Bank of France industry sentiment indicator	Oct	97	96
UK	 09.30	Claimant count rate % (change '000s)	Oct	-	3.3 (21.1)
	 09.30	Average weekly earnings (excl. bonuses) 3M/Y%	Sep	3.8 (3.8)	3.8 (3.8)
	 09.30	ILO unemployment rate 3M%	Sep	3.9	3.9
	 09.30	Employment change 3M/3M '000s	Sep	-102	-56

Events & Auctions

Country	GMT	Auction/Event
EMU	 -	ECB's Coeure, Mersch and Enria are scheduled to speak
Germany	 10.30	Auction: to sell €5bn of 0% 2021 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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