

Euro wrap-up

Overview

- Bunds followed Treasuries higher as the ECB account flagged concerns about the downside risks to the inflation outlook.
- Gilts also made more modest gains, as a UK housing survey showed its headline price balance rising to the strongest since mid-2002.
- Friday will bring UK monthly GDP figures for August, as well as IP data from France, Italy and the Netherlands.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.715	-0.012
OBL 0 10/25	-0.721	-0.023
DBR 0 08/30	-0.522	-0.026
UKT 1½ 09/22	-0.016	-0.002
UKT 0% 06/25	-0.023	-0.001
UKT 4% 12/30	0.293	-0.010

*Change from close as at 4:00pm BST.
Source: Bloomberg

Euro area

Meeting account maintains dovish tone of recent ECB communication

In her press conference following the ECB's most recent monetary policy meeting on 9-10 September, President Lagarde appeared somewhat complacent about the inflation outlook, which was still extremely weak despite an upward revision since June. She also appeared to downplay certain risks, including those posed by recent euro strength. Since then, however, various ECB officials, including Chief Economist Lane the following day and Lagarde herself last week, have sought to counter the immediate impression that the ECB was broadly satisfied with the economic outlook while Executive Board member Panetta argued that the risks of providing insufficient stimulus were larger than providing too much. While it acknowledged a range of views on the Governing Council, the account of the 9-10 September, published today, largely maintained the more recent dovish tone of communication, among other things noting that "There was broad agreement among members that there was no room for complacency", not least as inflation expectations remained "very depressed" and were at risk of deteriorating further. And the concerns about exchange rate developments were also underscored.

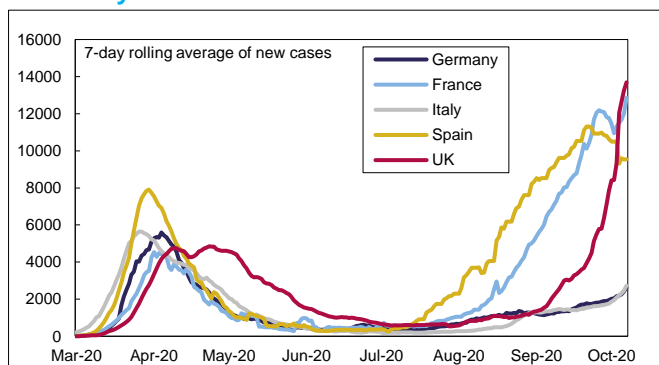
PEPP still the primary policy tool if and when more easing is needed

So, while the Governing Council agreed to leave the monetary stance unchanged last month, the case was made "to maintain flexibility in taking appropriate policy action if and when needed." The account suggested that, as well as the exchange rate, news on the pandemic, the negotiations between the EU and UK on post-transition arrangements, the outcome of the US election, and fiscal plans in the member states would have an impact on the economic outlook and hence also the case for amending monetary policy in future. With the ECB's September projections suggesting that inflation would remain well below the pre-pandemic path over the horizon, it was reiterated that the current overall €1.35trn PEPP envelope was likely to be used in full. Moreover, ahead of a discussion on the Governing Council about the various asset purchase programmes that will reportedly be conducted later this month, the account restated that the PEPP was "seen as the primary instrument for providing additional monetary policy accommodation ... [although] further cuts in policy rates and changes to the conditions of the TLTROs were also [still] part of the toolkit". Given today's release, we maintain our expectation that the PEPP envelope will be increased by a further €650bn to €2trn at the December Governing Council meeting.

German exports maintained upwards trend, but outpaced by imports in August

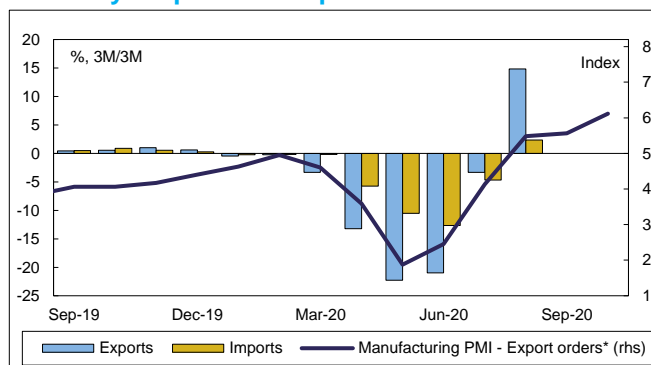
While yesterday's German IP release came in on the soft side of expectations, today's trade report suggested that demand from abroad maintained an upwards trend in August. In particular, the value of German exports rose for the fourth consecutive month and by a stronger-than-expected 2.4%M/M, albeit unsurprisingly softer than the rate of growth during the

New daily coronavirus cases



Source: ECDC and Daiwa Capital Markets Europe Ltd.

Germany: Export and import volumes



*Export orders PMI has 1-month lead. Source: Refinitiv. Markit and Daiwa Capital Markets Europe Ltd.

initial rebound. But despite having recovered more than two-thirds of the post-pandemic plunge, exports were still 10% below their February peak and their level a year earlier. This in part reflected ongoing significant weakness in demand from the US, with shipments to that country down 21%Y/Y, while exports to other euro area countries and the UK fell 8.3%Y/Y and 7.3%Y/Y respectively. In contrast, the drop in exports to China continued to moderate to just -1.1%Y/Y. Overall, Germany's trade surplus narrowed in August as the value of imports jumped a stronger 5.8%M/M. But this still left them almost 6½% lower than their pre-pandemic peak. Adjusting for changes in prices, growth in import volumes (5.6%M/M) also exceeded that of exports (2.4%M/M) in August. However, exports had significantly outperformed imports in July. And so, while import volumes were up on average in the first two months of Q3 by 8.5% compared with the Q2 average, this compared with an 18.9% increase in exports on the same basis. So, today's data suggest that net trade is on track to provide a significant contribution to GDP growth in Q3 having subtracted 2.8ppts in Q2.

Bank of France survey implied no growth in September

The Bank of France's (BoF's) latest monthly economic update – incorporating the results from its latest business sentiment survey – implied that activity in the euro area's second-largest member state likely moved broadly sideways in September to leave it still roughly 5% below the pre-pandemic level. This notwithstanding, like INSEE earlier in the week, the BoF maintained its Q3 GDP growth forecast of 16%Q/Q. But this might well mark the high point for now. Indeed, respondents to the survey on the whole suggested that activity was expected to be merely broadly stable in October. And there were inevitably ongoing divergences between sectors, with activity in autos, hospitality and recreational services still depressed. Indeed, accommodation services were assessed to have recovered to just 56% of normal activity levels in September, with restaurants now at 75%, while auto manufacturers output was at 86% on the same basis. And the sharp rise in new coronavirus cases and reintroduction of stricter containment measures (including the closure of Parisian bars, gyms and swimming pools from Tuesday) will further weigh on activity. Indeed, the BoF noted that the expectation for broad stability in activity in October could partly reflect a lack of visibility among business leaders regarding the outlook – so the eventual outturn could well prove significantly worse. INSEE earlier this week also suggested that French GDP growth could be zero or negative in the current quarter.

The day ahead in the euro area

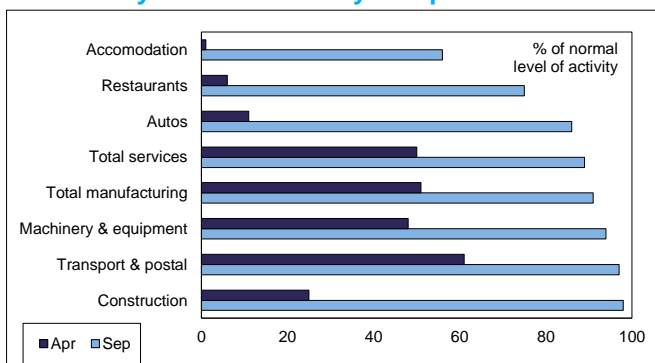
Looking ahead to tomorrow, the euro area economic data calendar sees the release of French, Italian and Dutch industrial production figures for August. IP is expected to have risen by around 1½% on the month, although given the softer outturns in Germany and Spain earlier in the week, we may well also see weaker than expected output numbers tomorrow.

UK

UK house prices at multi-year high for now

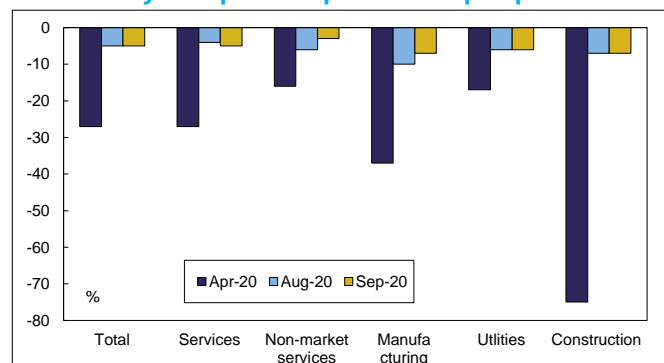
While yesterday's ONS figures suggested a moderation in house price growth in July (down 0.6ppts to 2.9%Y/Y), today's release of the RICS survey provided a broader and more timely assessment of conditions in the housing market. And this painted a starkly different picture, with the Chancellor's announcement of the Stamp Duty holiday in July and release of pent-up demand following the lockdown helping to boost prices significantly over recent months. Indeed, the headline RICS house price balance – the net share of surveyors reporting rising house prices – jumped 17ppts in September to 61%, its highest reading since mid-2002. This broadly tallied with the Nationwide price index (published last week) that saw prices jump 5%Y/Y in September, and yesterday's Halifax release suggesting growth accelerated to 7.3%Y/Y, both the strongest readings in three years. But while buyer enquiries and new instructions remained strong last month, the survey's relevant indices were still down slightly from August. Surveyors were somewhat less upbeat about price expectations too, with sales expectations for the year ahead also more negative, noting increasing concerns about the ending of certain fiscal policy initiatives – not least the Government's Job Retention Scheme at the end of this month as well as the Stamp Duty holiday in early 2021. And the recent spike in coronavirus cases across the UK will also likely have an adverse impact on the market's

BoF survey: Level of activity compared with normal



Source: BoF and Daiwa Capital Markets Europe Ltd.

BoF survey: Output compared with pre-pandemic



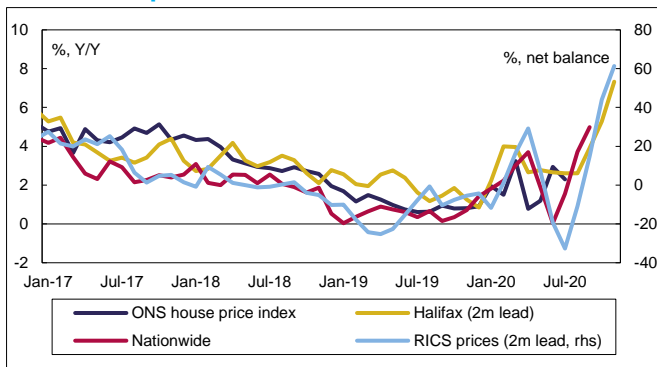
Source: BoF and Daiwa Capital Markets Europe Ltd.

dynamics. So, while PM Johnson this week pledged to promote the reintroduction of 95% mortgages, with a new mortgage guarantee scheme to help first-time buyers under consideration, risks to the outlook over the coming year still look skewed to the downside.

The day ahead in the UK

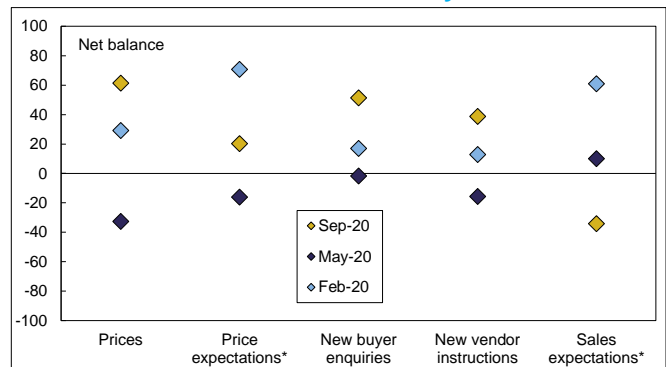
The UK economic data calendar ends the week with some interesting data in the form of the August GDP release, which is expected to report further substantive growth (4.6%M/M) having risen 6.6%M/M in July. Growth is expected to be widespread across the sectors, with services most notably supported by the Government’s “Eat out to help out” subsidy and hospitality VAT cut. However, GDP as a whole will likely remain more than 5% below the February level and the outlook for growth remains highly uncertain given the revival in the pandemic and – most importantly – the marked labour market shake-out now firmly underway. Separately, we will also hear from BoE Chief Economist Haldane, who is due to speak at an OECD conference on ‘New tools and techniques emerging from Covid-19’.

UK: House price indicators






Source: Refinitive and Daiwa Capital Markets Europe Ltd.

UK: RICS residential market survey














*12 months ahead. Source: Refinitiv 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
Germany	 Current account (trade) balance €bn	Aug	16.5 (12.8)	16.2 (16.0)	20.0 (19.2)	21.0 (-)
France	 Bank of France industrial sentiment	Sep	101	105	106	105
UK	 RICS house price balance %	Sep	61	40	44	-
Auctions						
Country	Auction					
- Nothing to report -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases							
Economic data							
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous		
France		07.45	Industrial production M/M% (Y/Y%)	Aug	1.7 (-5.7)	3.8 (-8.3)	
		07.45	Manufacturing production M/M% (Y/Y%)	Aug	2.4 (-5.5)	4.5 (-8.5)	
Italy		09.00	Industrial production M/M% (Y/Y%)	Aug	1.4 (-6.4)	7.4 (-8.0)	
UK		07.00	Monthly GDP M/M% (3M/3M%)	Aug	4.6 (8.2)	6.6 (-7.6)	
		07.00	Industrial production M/M% (Y/Y%)	Aug	3.0 (-5.9)	5.2 (-7.8)	
		07.00	Manufacturing production M/M% (Y/Y%)	Aug	3.0 (-5.9)	6.3 (-9.4)	
		07.00	Construction output M/M% (Y/Y%)	Aug	5.0 (-9.2)	17.6 (-12.7)	
		07.00	Index of services M/M% (3M/3M%)	Aug	5.0 (7.0)	6.1 (-8.1)	
		07.00	Total trade (goods trade) balance £bn	Aug	0.0 (-9.1)	1.1 (-8.6)	
		07.00					
Auctions and events							
Country	BST	Auction / Event					
UK		09.30	BoE's Chief Economist Haldane scheduled to speak at an OECD conference				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FCA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.