Euro wrap-up

Overview

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- Despite data showing continued steady growth in euro area bank lending, Bunds made modest gains today as concerns about Deutsche Bank continued to weigh on sentiment.
- Gilts ended the day little changed despite a disappointing UK retail sales survey.
- Tomorrow's European data focus will be September's consumer confidence surveys from the largest three euro area member states.

Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.699	-0.018
OBL 0 10/21	-0.596	-0.021
DBR 0 08/26	-0.139	-0.023
UKT 1¼ 07/18	0.086	+0.006
UKT 3¾ 09/21	0.183	-0.001
UKT 1½ 07/26	0.680	-0.017

*Change from close as at 4.30pm BST.
Source: Bloomberg

Euro area

Lending growth remains at multi-year highs

While concerns about Deutsche Bank remain at the forefront of investors' minds, the release of the ECB's latest bank lending figures nevertheless provided a reminder how credit conditions have improved across the euro area over recent quarters. For example, net new lending to households in the euro area on an adjusted basis rose for the twenty-fourth consecutive month in August and by €7bn, to leave the stock of outstanding loans 1.9% higher compared with a year earlier, unchanged from the growth rate seen in July. While net new lending to non-financial corporations (NFCs) slipped back slightly last month by just €1bn, this followed four months of notable increases to leave the annual rate of growth in the outstanding stock of loans up 1.8%Y/Y, matching the near-five-year high seen in the previous two months. Credit growth to households and firms alike continued to be driven by the two largest member states. In particular, lending to firms in Germany was up almost 3%Y/Y, unchanged from the more than seven-year high hit in July, while lending to French corporates increased by almost 5½%Y/Y, the highest rate since 2011 despite a drop in net new lending. And while net new lending to much of the periphery slipped back again in August, the annual rate of growth in the outstanding stock of loans remained well above rates seen in recent years (see chart below).

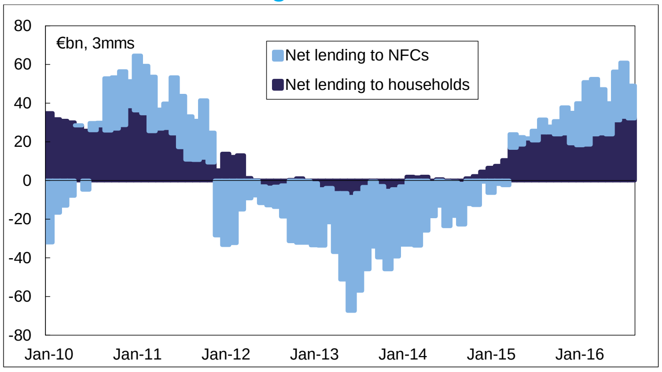
Lending supported by lower borrowing costs

Against this backdrop, in his testimony yesterday to the European Parliament, Draghi again trumpeted the success of the ECB's recent easing measures in repairing the monetary transmission mechanism. Among other things, he again asserted that cuts in the ECB's policy interest rates to record lows had been a driving force behind the significant easing in lending conditions over recent years and also helped to reduce fragmented funding costs across various euro area member states. Indeed, from the peak at end-2011 to July 2016, the composite cost-of-borrowing indicator for new loans to NFCs declined by 355bps in Portugal and 242bps in Italy, compared with 185bps for the euro area as a whole. Draghi also drew attention to the marked narrowing in the spread between lending rates for small and large loans – an indicator of the improvement in borrowing conditions for SMEs – which is currently at similar levels in core and periphery euro area countries for the first time since early 2011. And, overall, there seems little firm evidence that the ECB's negative deposit rate is harming financial intermediation.

ECB policy to remain highly supportive to financial conditions

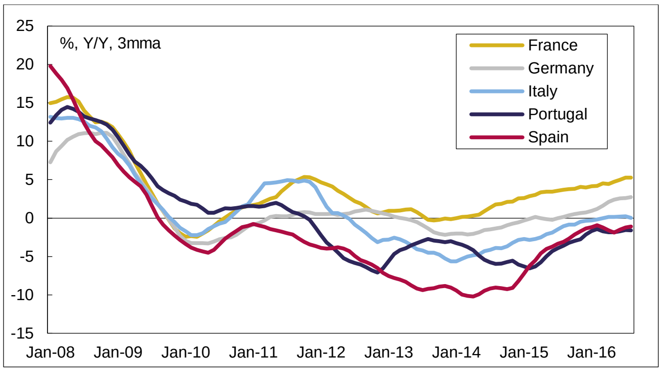
In terms of future policy signals, Draghi adopted a similarly dovish tone (and often the precise same language) as was used in his press conference after the Governing Council's most recent policy-setting meeting. Indeed, emphasising the importance of maintaining highly supportive financial conditions, Draghi stated again that the ECB will 'preserve the very substantial

Euro area: Net lending to households and NFCs



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

Euro area countries: Loans to NFCs



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

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amount of monetary support' embedded in its forecast, implying that – unless we see a marked further easing of financial conditions over the near term, we should fully expect the asset purchase programme to be extended beyond next Spring. And so, when the ECB concludes its current review of 'options to ensure a smooth implementation' of the asset purchase programme, most likely at the 8 December policy meeting, we expect it to confirm the extension of QE beyond next March.

The day ahead in the euro area and US

Ahead of Thursday's release of the Commission's economic sentiment indicator – which arguably provides the most reliable guide to euro area GDP growth – tomorrow's focus will be the September consumer confidences surveys from the three largest member states. In particular, the headline German GfK index is expected to remain unchanged at the series high of 10.2. Meanwhile, the French INSEE consumer index is forecast to be little changed from the average level seen so far this year. In contrast, the Italian index is expected to have edged slightly lower at the end of Q3, to 109, the lowest level since July and well below the more than decade-high registered in January. The Italian ISTAT business sentiment survey for September is also due. Elsewhere, Draghi will address policymakers at the Bundestag in a private session, while Germany will sell 2Y Bunds.

In the US, tomorrow brings durable goods orders data for August, which are expected to align with other subdued indicators of manufacturing sector activity that month. Meanwhile, Fed Chair Yellen will testify on banking supervision to the House Panel, while Bullard and Evans will also speak at a conference on community banking. Supply-wise, the Treasury will sell 2Y floating-rate notes and 7Y notes.

UK

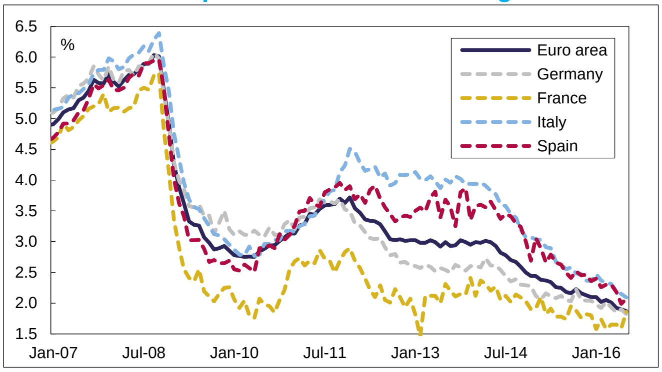
Is Brexit starting to weigh on retail sales?

While the UK economy certainly appears to have lost some momentum after the Brexit vote, economic growth so far seems to have held up much better than expected, with firm consumer spending seemingly remaining the main driver. However, the latest CBI distributive trades survey, arguably the most timely indicator of consumption, signalled that the trend in spending growth might be weakening. Indeed, the survey's retail sales volume index reversed the gain of the previous month declining back below zero in September. This left the average for the third quarter as a whole at the lowest level since Q112. Other details of the survey, however, were little changed, while responses from wholesalers and motor traders were relatively upbeat. But although some of the forward-looking indicators also suggest that the survey's October readings should be stronger, the orders index remained negative for the sixth consecutive month. Indeed, overall, UK retailers seem likely to face a challenging operating environment in the months ahead, as real household incomes are eroded by higher inflation while weaker sterling and intense competition on the High Street weigh on their own profits too.

The day ahead in the UK

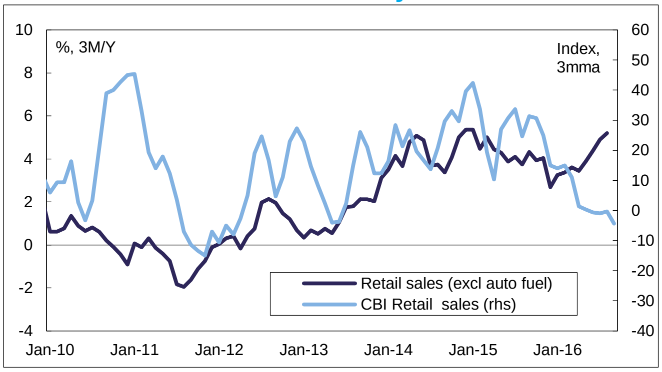
On an otherwise quiet day for major economic news in the UK, BoE Deputy Governor Minouche Shafik, who has recently announced that she will be leaving the central bank next year, is scheduled to speak.

Euro area: Composite cost of borrowing to NFCs



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

UK: Retail sales and CBI Survey



Source: ONS, CBI, 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		M3 money supply Y/Y%	Aug	**5.1**	4.9	4.8	**4.9**
Italy		Industrial sales M/M% (Y/Y%)	Jul	**2.1 (-0.7)**	-	-1.1 (-2.7)	**-**
		Industrial orders M/M% (Y/Y%)	Jul	**-10.8 (-11.8)**	-	-2.8 (-4.2)	**-**
UK		CBI Distributive Trades survey, retail sales	Sep	**-8**	5	9	**-**

Auctions

Country		Auction
Italy sold		€2.5bn of 2018 zero-coupon bonds (28-Mar-2018) at an average yield of -0.216%
		€0.9bn of 1.25% 2032 index-linked bonds (15-Sep-2032) at an average yield of 0.63%
UK sold		£400mn of 0.25% 2052 index-linked bonds (22-Mar-2052) at an average yield of -1.77%
		BoE APF operation purchased £1.17bn of 15Y+ Gilts (2.38 cover ratio)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		07:00	GfK consumer confidence survey	Oct	10.2	10.2
France		07:45	Consumer confidence survey	Sep	97	97
Italy		09:00	Consumer confidence indicator	Sep	109.0	109.2
		09:00	Manufacturing (economic) confidence	Sep	100.9 (-)	101.1 (99.4)

Auctions and events

Country		BST	Auction / Event
EMU		-	ECB's Draghi scheduled to speak in Berlin
Germany		10:30	Auction: To sell €4bn of 2018 zero-coupon bonds (14-Sep-2018)
UK		09.05	BoE's Shafik is scheduled to speak in London
		14:50	BoE APF operation: To purchase 7-15Y Gilts

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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