Daiwa Capital Markets

Euro wrap-up

Overview

- Bunds made notable losses as government bond markets sold off.
- Gilts also fell as they too were caught up in the sell off.
- The focus tomorrow will be on the first estimate of Q3 GDP in the UK. In the euro area, the ECB's bank lending numbers are the highlight.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.637	+0.010
OBL 0 10/21	-0.435	+0.039
DBR 0 08/26	0.088	+0.058
UKT 1¼ 07/18	0.271	+0.024
UKT 3¾ 09/21	0.543	+0.048
UKT 1½ 07/26	1.157	+0.068

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

Euro area

End of year economic outlook improved in Germany

In contrast to the strong flash PMIs released earlier in the week, which saw the German composite index rise to its highest level since the end of last year, and the stronger-than-expected Ifo business survey, the GfK consumer confidence released today was a touch disappointing. The headline indicator declined by 0.3ppt to 9.7, the lowest level since May. And some survey components were weaker too, with the income expectations and willingness to buy indices down notably to the lowest levels this year. But despite a somewhat more downbeat outlook for personal finances, consumers' assessed that economic prospects had improved, with the relevant indicator rising to the highest level in more than a year. We have a similar view and expect German GDP to increase by 0.5%Q/Q in Q4 from what we expect should be about a 0.3%Q/Q rise in Q3.

French GDP is set to pick up after weaker Q2

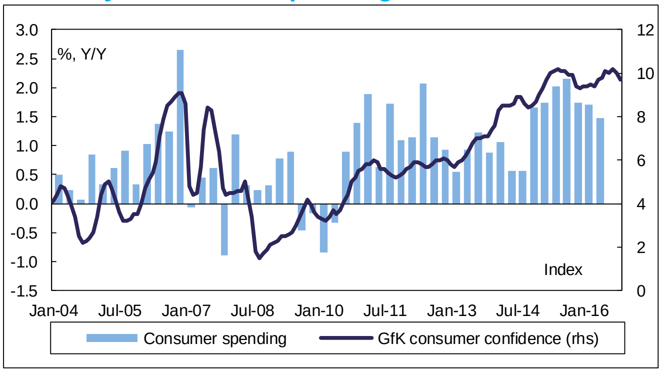
Meanwhile, in France, in line with the positive tone of yesterday's labour market figures, which showed that the number of jobseekers in September declined to the lowest level since January 2015, today's consumer confidence survey was also relatively upbeat. The headline indicator inched up in October to a joint multi-year high of 98, while the assessment of personal finances reached the highest level this year. Against this backdrop, we might see consumer spending providing more notable support to the economy in Q3 and Q4, and with government spending set to remain firm ahead of the presidential election next year, GDP in both quarters in H216 looks likely to increase by about 0.2-0.3%Q/Q, which is in line with its average pace over the last few years.

The day ahead in the euro area and US

The most notable data in the euro area tomorrow will be the ECB lending figures, which will most likely show that credit conditions in most major euro area economies continued to improve in September. Among other data, economic sentiment survey numbers in Italy and Spanish labour market figures, which are expected to show a notable drop in the headline unemployment rate in Q3, are also due.

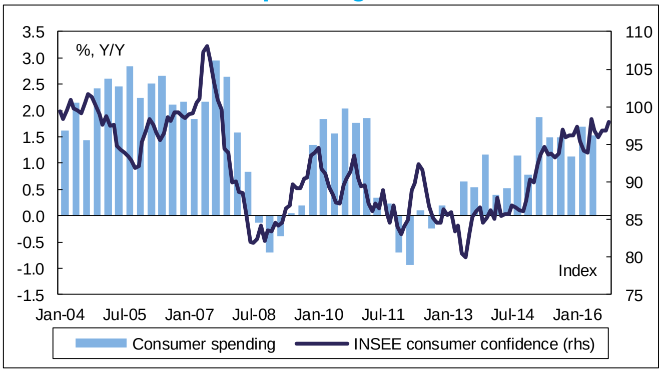
In the US, the dataflow brings September durable goods orders and pending home sales figures, while the usual weekly initial jobless claims are also due.

Germany: Consumer spending and confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

France: Consumer spending and confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK

Treasury will not obstruct QE

Rumours had been circulating that the Chancellor, Philip Hammond, had indicated to some market participants that he was not inclined to indemnify any further asset purchases by the BoE. The indemnification of the Bank's purchases of (mainly) Gilts by the Treasury, whereby any losses incurred by the BoE as a result of its asset purchases are covered by the Treasury, is something of an oddity in the world of QE, and means that the MPC has to request the permission of the Chancellor when it wants to increase its asset purchases. It was always assumed that such requests were merely a formality and that the Chancellor would always agree to any increases deemed necessary by the independent MPC. But that assumption was directly challenged by the rumours, which if true would have meant that the MPC faced the prospect of either deciding to go ahead with further QE without the Treasury's permission, or have its ability to operate as it wanted curtailed by politicians. Neither outcome would have been particularly good for the perception of the UK's economic policymaking framework; a framework that has already been severely damaged in the eyes of many in the aftermath of the Brexit vote and the apparent willingness of the Government to sacrifice economic wellbeing in return for greater control over immigration. It was therefore good news yesterday when Hammond put the rumours to bed, saying that he could see no reason why the BoE's request to indemnify the central bank against losses arising from any additional QE purchases, if and when they are announced in the future, would be rejected by the Treasury.

Is Carney leaving?

The rumours about the indemnification process had come hot on the heels of a sustained campaign of criticism from senior Conservative politicians against the policies being pursued by the MPC, with much of the criticism aimed directly at Mark Carney, who of course had annoyed many high-profile Leave campaigners with his (so far largely-vindicated) economic warnings about the economic costs of a vote to leave the EU. Speaking yesterday, Carney suggested that further easing from the MPC remained in the pipeline, although as we expect, February rather than November looks the more likely timing for this. Carney also alluded to his own future, given that he has indicated that he will decide whether or not to extend his tenure at the Bank to 2021 by the end of this year. And while he refused to be explicit, the answer he did give, saying that if he did decide to go in 2018 it would be the result of personal reasons only, suggested to many that he may be considering getting out before Brexit occurs. And, indeed, knowing the storm that is coming, and given the recent political briefings against him, whether he will want to hang around for much longer is unclear. If he does indeed decide later this year that he would prefer to move on in 2018, as was his original intention, expect markets to react with horror as one of the few grown-ups left in UK economic policymaking departs the scene.

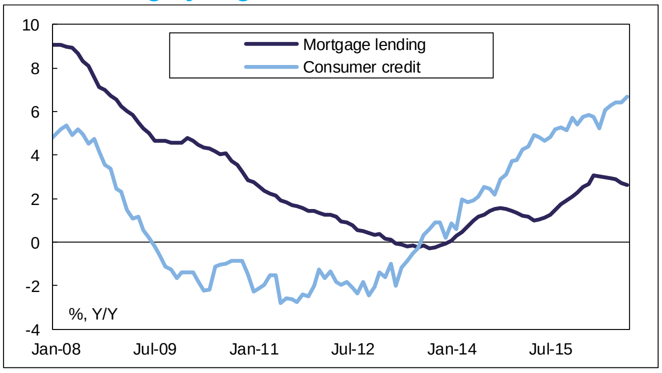
Mortgage lending set to pick up over the coming months

The only release of note today was the BBA data from the major retail banks, which continued to highlight the differences in behavior between mortgage and consumer lending. While mortgage lending growth unexpectedly eased for a third consecutive month in September, with the gross new lending falling to the lowest level since mid-2015, annual consumer credit growth hit 6.7%, the fastest pace since December 2006. However, the number of approved loans for house purchase increased for the first time in four months, hinting that activity in the mortgage market might be starting to rise after a quiet period due to recent changes to the Stamp Duty Tax regime and uncertainty around the EU referendum.

The day ahead in the UK

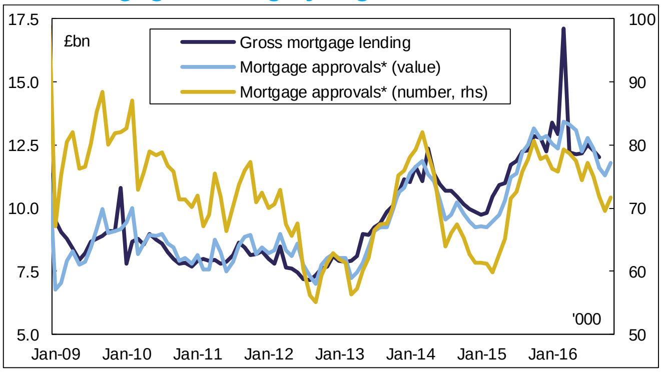
All eyes tomorrow will be on the preliminary UK GDP estimate for Q3, the first official estimate into how the economy reacted to the Brexit shock. In terms of the output components, output in both the manufacturing and construction sectors looks set to have fallen notably that quarter. However, momentum in the service sector seems to have been much stronger after the referendum. On balance, we think GDP growth slowed to about half the pace of 0.7%Q/Q in Q2. Also due tomorrow is the CBI Distributive Trades survey.

UK: Lending by High Street banks



Source: BBA and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending by High Street Banks



**2M lead. The figures include loans for house purchase, remortgaging and other secured lending.*
Source: BBA, Thomson Reiters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
Germany		GfK consumer confidence survey	Nov	**9.7**	10.0	10.0	**-**
France		Consumer confidence survey	Oct	**98**	98	97	**-**
Italy		Retail sales M/M% (Y/Y%)	Aug	**-0.1 (-0.2)**	0.4 (0.5)	-0.3 (-0.2)	**-0.2 (-0.3)**
UK		BBA loans for house purchase 000s	Sep	**38.3**	37.4	37.0	**37.2**

Country		Auction
Germany sold		€2.4bn of 0% 2021 bonds (8-Oct-2021) at an average yield of -0.46%
Italy sold		€669mn of 2.35% 2024 index-linked bonds (15-Sep-2024) at an average yield of 0.29%
		€832mn of 3.1% 2026 index-linked bonds (15-Sep-2026) at an average yield of 0.51%
UK		BoE APF operation purchased £1.17bn of 7-15Y Gilts (3.80 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
EMU		09:00	M3 money supply Y/Y%	Sep	5.1	5.1
Italy		09:00	Consumer confidence indicator	Oct	108.6	108.7
		09:00	Manufacturing (economic) confidence	Oct	102.2 (-)	101.9 (101.0)
Spain		08:00	Unemployment rate %	Q3	19.3	20.0
UK		09:30	GDP – preliminary release Q/Q% (Y/Y%)	Q3	*0.4 (2.2)*	0.7 (2.1)
		09:30	Index of services M/M% (3M/3M%)	Aug	0.1 (0.8)	0.4 (0.6)
		11:00	CBI Distributive Trades survey, retail sales	Oct	-2	-8
		15:00	BoE corporate bond purchases £mn	Weekly	-	1559

Auctions and events

Country	BST	Auction / Event
		- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.