

Euro wrap-up

Overview

- Another poor day for government bond markets saw Bund yields hit their highest level since the end of May.
- Gilts also saw sharp losses, with the 10Y yield approaching its pre-referendum level. The selloff was helped by stronger-than-expected Q3 GDP data.
- Tomorrow sees first Q3 GDP estimates from France and Spain and the Commission's economic sentiment survey.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.619	+0.015
OBL 0 10/21	-0.393	+0.042
DBR 0 08/26	0.175	+0.089
UKT 1¼ 07/18	0.298	+0.022
UKT 3¾ 09/21	0.610	+0.066
UKT 1½ 07/26	1.256	+0.104

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

Euro area

Bank lending continues to improve

The message of Draghi's speech earlier in the week was clear – the ECB's monetary policy is working as expected. Of course one of the most important channels it works through is via a loosening in financial conditions, evident in the rapidly falling cost of borrowing in major economies, tightening sovereign spreads and the gradual pick up in lending flows. And the ECB bank lending figures, released today, confirmed that credit to euro area households and businesses remain on a steady upward trend. Although the net flow of new credit to non-financial corporations was actually very close to zero in September, this was due to large repayments of short-term loans, while loans of over 1 year maturity actually rose to leave overall growth in lending to NFCs unchanged for the third consecutive month, at 1.9%Y/Y, which is the highest pace since 2011. Meanwhile, with regard to lending to households, mainly thanks to a notable increase in mortgage lending, the total flow of credit reached €11bn, the second-highest level since early 2012, and the growth rate of the total lending stock was 1.8%Y/Y, also the joint highest since 2011. In general, while these bank lending figures probably remain below the levels the ECB would like them to be, they demonstrate the improvement made in repairing the euro area financial flows in recent years.

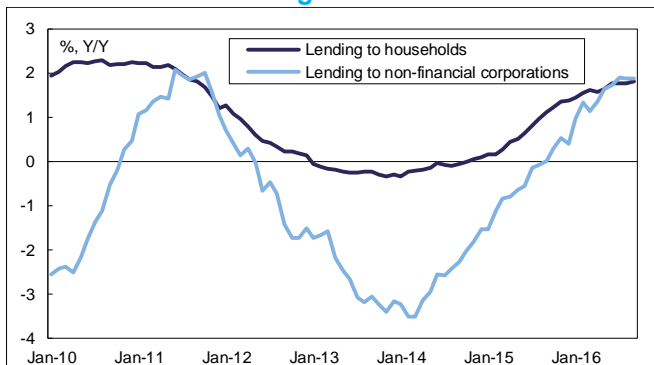
Firm economic indicators from Italy and Spain

The most recent German economic surveys were consistent with slightly stronger GDP growth in the largest euro area economy in Q4, and today's economic sentiment survey from Italy was also positive. The headline index increased in October, from 101.2 to 102.4, a level 1pt higher than the average seen in Q3. While it remains unlikely that we are going to see a notable increase in GDP growth over coming quarters, not least given that the consumer confidence indicator fell to the lowest level in more than a year, perhaps reflecting heightened political uncertainty around the constitutional referendum due in early December, stronger business confidence supports our view that GDP growth is likely to rise at a trend pace of around 0.2%Q/Q in H216. Meanwhile, today's news from the Spanish labour market did not disappoint either, with the unemployment rate falling by more than expected in Q3, from 20.0% to 18.9%, the lowest level since 2009.

The day ahead in the euro area and US

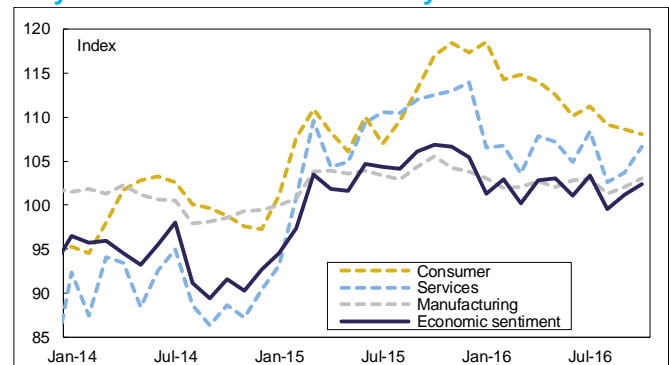
It is a particularly busy day for new economic data releases tomorrow, with the first estimates of French and Spanish GDP growth in Q3 out. French GDP is expected to have returned to growth of around 0.3%Q/Q following a drop of 0.1%Q/Q in Q2, while Spanish GDP growth is expected to have slowed slightly by 0.1ppt to a still-robust 0.7%Q/Q. The flash inflation figures from Germany, France and Spain, which are likely to rise further from their levels in September as past energy price declines continue to fall out of the calculation, will also be noteworthy. And perhaps even more important for the assessment of how the

Euro area: Bank lending



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

Italy: Economic sentiment survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



euro area economy is performing at the moment, the European Commission's economic sentiment survey for October is also due tomorrow. The flash consumer confidence estimate suggested that consumer sentiment improved for the second consecutive month, with the headline index rising from -8.2 to -8.0, and tomorrow's figures will most likely confirm that estimate.

The focus in the US will also be on the first release of Q3 GDP figures. Growth is expected to have picked up to a five-quarter high of 2.5%Q/Q annualised after the 1.4%Q/Q increase in the previous quarter, with household consumption, net trade and business investment all likely to have made positive contributions. The employment cost index for Q3 is also released.

UK

Referendum hit growth a little

According to the preliminary Q3 GDP figures released today, the UK economy held up relatively well in the aftermath of the referendum, with growth slowing by only 0.2ppt to 0.5%Q/Q, above expectations of growth of 0.3%. The data once again highlighted the importance of services to the UK economy, with the increase in output of 0.8%Q/Q in this sector more than fully accounting for the increase in GDP. Output in all other major sectors fell, with agriculture output dropping 0.7%Q/Q, construction output falling 1.4%Q/Q and manufacturing production declining 1.0%Q/Q.

But further slowdown and more easing to come

If growth of 0.5%Q/Q is confirmed in subsequent releases (today's estimate only contained about 50% of the data that will be incorporated in the final number) then these data almost certainly put pay to a further rate reduction at the MPC's November meeting – the MPC had expected growth of 0.2%Q/Q in Q3 in its most recent forecast. However, with expectations of a "hard" Brexit, whereby the UK leaves the world's largest single market, now firmly entrenched following the Conservative Party conference, and the impact of the resulting drop in sterling on inflation (and hence real earnings) yet to be fully felt, the MPC will no doubt continue to expect a further slowing in the economy, led by investment and then followed by slower consumer spending. As such, a rate reduction in February, which would most likely be accompanied by a further extension to its asset purchase programme, remains on the cards.

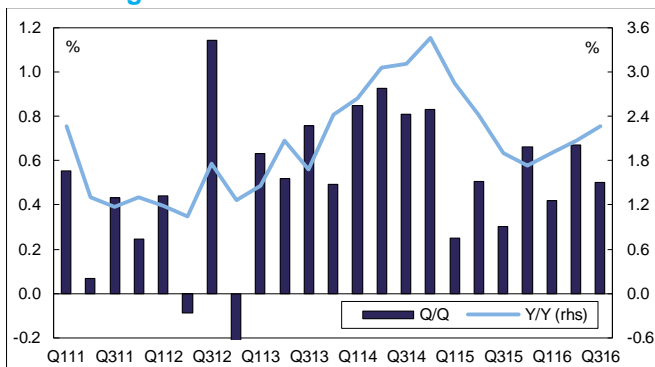
Retailers reported positive results for October

Having grown particularly strongly in July and August, retail sales appeared to have lost some steam in September. But today's CBI survey suggested that sales picked up again in October. Retailers reported the steepest rise in sales in more than a year, with clothing, furniture and hardware categories providing the largest contributions. Orders placed with wholesalers also improved, while sales adjusted for seasonal factors remained above average levels, suggesting that retailers are in a relatively strong position, despite the fact that the operating environment ahead looks challenging as a weaker currency and continued high competition look set to squeeze profit margins.

The day ahead in the UK

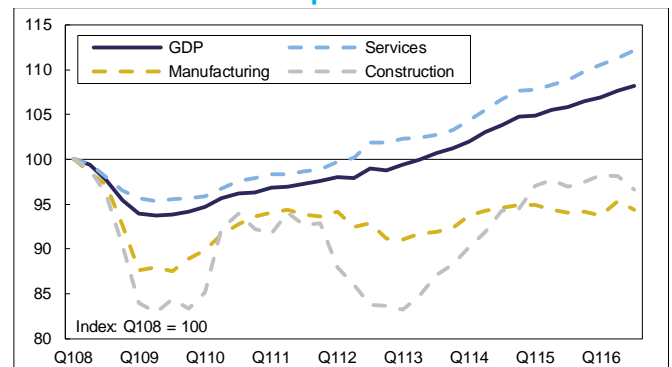
The end of the week in the UK brings the GfK consumer confidence survey for October. Having fallen sharply in July, the headline indicator recovered in August and September, returning to levels seen before the referendum. However, tomorrow's data seems likely to show that consumer sentiment has weakened again.

UK: GDP growth











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

UK: GDP level and components

















Source: ONS, 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
EMU	 M3 money supply Y/Y%	Sep	5.0	5.1	5.1	-
Italy	 Consumer confidence indicator	Oct	108.0	108.6	108.7	108.6
	 Manufacturing (economic) confidence	Oct	103.0 (102.4)	102.2 (-)	101.9 (101.0)	102.1 (101.2)
Spain	 Unemployment rate %	Q3	18.9	19.3	20.0	-
UK	 GDP – preliminary release Q/Q% (Y/Y%)	Q3	0.5 (2.3)	<u>0.4 (2.2)</u>	0.7 (2.1)	-
	 Index of services M/M% (3M/3M%)	Aug	0.2 (0.8)	0.1 (0.8)	0.4 (0.6)	-
	 CBI Distributive Trades survey, retail sales	Oct	21	-2	-8	-
	 BoE corporate bond purchases £mn	Weekly	1994	-	1559	-
Country	Auction	- Nothing to report -				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases						
Economic data						
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
EMU		10:00 Economic sentiment indicator	Oct	104.9	104.9	
		10:00 Services (industrial) sentiment	Oct	10.0 (-1.6)	10.0 (-1.7)	
		10:00 Final consumer confidence	Oct	<u>-8.0</u>	-8.2	
Germany		13:00 Preliminary EU-harmonised CPI Y/Y%	Oct	0.7	0.5	
France		07:45 GDP – preliminary release Q/Q% (Y/Y%)	Q3	<u>0.2 (1.3)</u>	-0.1 (1.3)	
		07:45 Preliminary EU-harmonised CPI Y/Y%	Oct	0.6	0.5	
		07:45 Consumer spending M/M% (Y/Y%)	Sep	0.3 (1.1)	0.7 (1.0)	
Spain		08:00 Preliminary EU-harmonised CPI Y/Y%	Oct	0.3	0.0	
		08:00 GDP – preliminary release Q/Q% (Y/Y%)	Q3	<u>0.7 (3.1)</u>	0.8 (3.2)	
UK		00:01 GfK consumer confidence survey	Oct	-3	-1	
Auctions and events						
Country	BST	Auction / Event				
EMU		08:30 ECB's Coeure scheduled to speak in Frankfurt				
Italy		10:00 Auction: To sell up to €2.75bn of 0.35% 2021 bonds (01-Nov-2021)				
		10:00 Auction: To sell up to €2.5bn of 1.25% 2026 bonds (01-Dec-2026)				
		10:00 Auction: To sell up to €3.25bn of floating-rate 2024 bonds (15-Feb-2024)				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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