

Euro wrap-up

Overview

- Bunds made gains despite a modest improvement in German consumer confidence, and an acceleration in euro area bank lending.
- Gilts made modest gains as UK car production figures indicated a continuing weakening trend.
- A busy end to the week will bring the European Commission's economic sentiment survey, national confidence surveys from Italy and the UK and flash inflation figures from France.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.762	-0.016
OBL 0 10/24	-0.766	-0.011
DBR 0 08/29	-0.584	-0.005
UKT 3¼ 09/21	0.442	-0.025
UKT 1 04/24	0.360	-0.019
UKT 0% 10/29	0.523	-0.008

*Change from close as at 4:30pm BST.
Source: Bloomberg

Euro area

Bank lending accelerates to signal upturn in activity ahead?

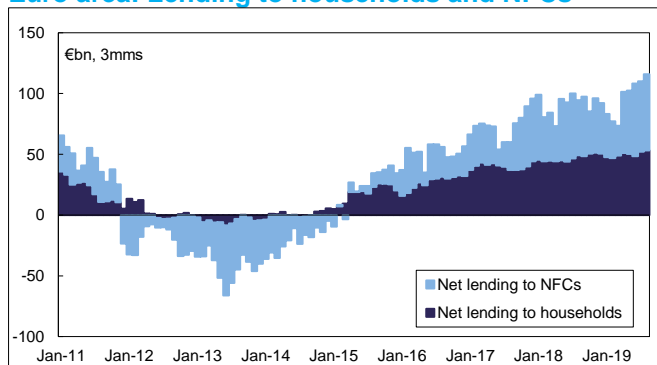
Despite ever-increasing concerns about the euro area economic outlook, the ECB's latest bank lending data reported another solid rise in lending to consumers and businesses alike, which might point to firmer GDP growth ahead. In particular, following the largest increase for more than eleven years the prior month, net lending to households (adjusted for sales and securitisations) was €17.8bn in August, leaving cumulative lending on a three-month basis at a very healthy €53bn and growth in the outstanding stock of loans at 3.4%Y/Y, matching the strongest pace since the start of 2009. Meanwhile, new lending to non-financial corporations (NFCs) accelerated in August to €24.0bn, close to the top of the range of the past decade. That took cumulative new lending to NFCs on a three-month basis to €62.8bn, the most since end-2008, and growth in the stock of such loans to an eleven-month high of 4.3%Y/Y.

At the country level, the growth in the stock of loans to NFCs remained particularly strong in France, up 0.5ppt to a decade high of 8.3%Y/Y, and in Germany, up 0.2ppt to 6.8%Y/Y. Of course, banks in Germany and France account for the lion's share of euro area excess liquidity and have been disproportionately hit by the ECB's negative rate on excess reserves. Going forward they will gain relief from the -0.50% deposit facility rate via the new tiered reserve remuneration framework. However, today's data suggest that the direct adverse impact of that negative deposit rate on financial conditions might have been negligible – indeed the evidence might imply that the policy spurred lending.

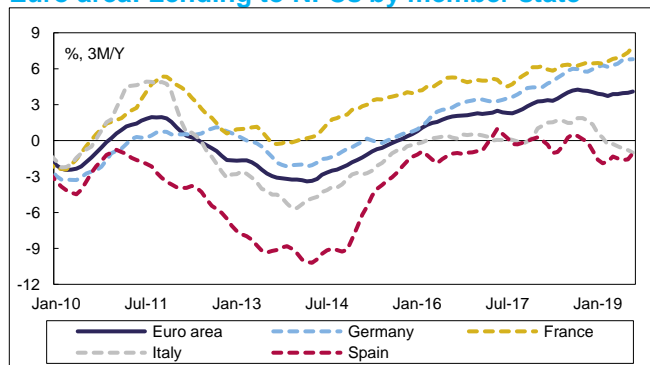
German consumers less downbeat

In marked contrast to the country's downbeat business sentiment surveys released earlier this week, Germany's GfK consumer confidence survey today suggested that households expect a turn for the better at the start of Q4. Contrasting with the anticipated fall, the headline index was forecast to rise 0.2pt to 9.9 in October, a four-month high, nevertheless still well below its level a year ago. The detail for September was somewhat mixed too. While there was a modest improvement in the index of households' assessment of the economic outlook, this was nevertheless the second-lowest reading since the start of 2013. And income expectations fell back again in September. So, while the survey's component for households' willingness to buy jumped in September to an eight-month high, an acceleration in consumer spending over coming months seems highly unlikely. Indeed, we caution that the correlation between the GfK consumer confidence indices and German private consumption is not at all strong.

Euro area: Lending to households and NFCs



Euro area: Lending to NFCs by member state



Hawks to be replaced by doves at the ECB?

The turnover at the top of the ECB continues. Somewhat unexpectedly, ahead of Mario Draghi's replacement by Christine Lagarde at the start of November, yesterday saw Sabine Lautenschläger announce her resignation as a member of the Executive Board more than two years before the end of her term. Since taking up her post in 2014, Lautenschläger has repeatedly been one of the most hawkish members on the Governing Council, advocating stereotypical Bundesbank views and seemingly indifferent to persistently sub-target inflation. Predictably, she was one of several members to oppose the latest round of QE. And given her track record, her departure is unlikely to be considered a great loss by Lagarde.

Lautenschläger will inevitably be replaced on the Executive Board by another German, and probably another woman too. Claudia Buch, the current Bundesbank Vice President, will likely be one candidate, and she would also be likely to advocate the traditional German line, instinctively opposed to easing and particularly opposed to unconventional measures. However, Isabel Schnabel, Financial Economics Professor at the University of Bonn and member of Germany's Council of Economic Experts, would be a more imaginative choice. She would add value to discussions on the Governing Council and also play a more effective role in communicating ECB policies to sceptics in Germany and other Northern European member states. In recent years, Schnabel has been a constructive advocate of euro area reform, including the development of a banking union, and has defended Draghi's OMT policy as well as the latest round of monetary easing against the knee-jerk criticism from German media and politicians.

Meanwhile, Fabio Panetta, Senior Deputy Governor at the Banca d'Italia with significant experience of the work of the Governing Council as well as G7, G20 and BIS workstreams, is the sole candidate to replace Benoît Cœuré on the Executive Board at the end of the year. While Cœuré joined Lautenschläger in dissenting to the latest round of ECB QE, Panetta can be expected to take a typically dovish Italian viewpoint, thus supporting open-ended asset purchases for as long as core inflation is expected to remain sub-target.

The day ahead in the euro area and US

It will be a busy end to the week for euro area economic data releases, with perhaps most noteworthy the European Commission's September business and consumer surveys, which arguably offer the most comprehensive guide to economic activity in the euro area. While the flash consumer confidence survey reversed the decline seen in August, the flash PMIs earlier this week suggest that business confidence took a notable turn for the worse in September. So, the headline economic sentiment indicator is likely to weaken in September, to leave the quarterly average at its lowest since Q215. Italy's ISTAT business and consumer sentiment surveys are also due tomorrow, while flash inflation figures for September from France will be published alongside consumer spending figures for August from the same country. Elsewhere, ECB Chief Economist Lane is due to speak in New York, while Governing Council members de Guindos, Knot and Hernández de Cos will speak at the ESRB conference in Frankfurt.

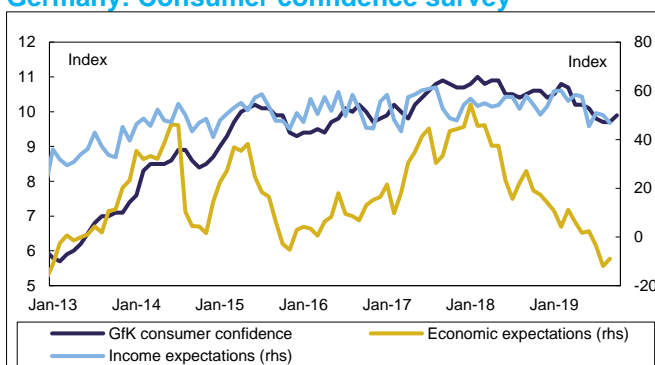
In the US, tomorrow will bring the release of preliminary durable goods orders data for August, along with personal income and spending numbers for the same month, including the monthly deflators.

UK

Trumpian Johnson further dims prospect of a Brexit deal

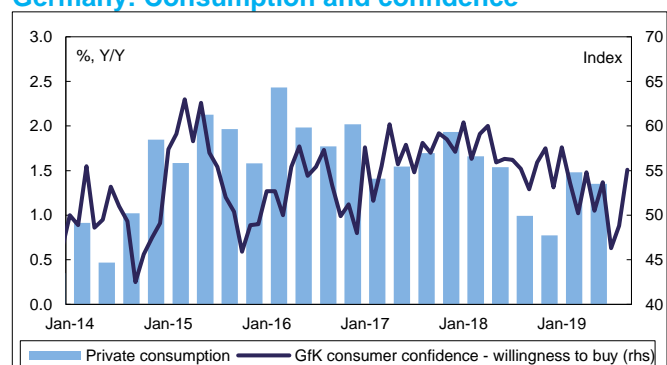
The resumption of Parliament yesterday was a truly unedifying spectacle with Prime Minister Johnson's behavior offensive in every sense. He and his cabinet were dismissive of the Supreme Court, which earlier in the week ruled his advice to the Queen as unlawful. And they were belligerent, economical with the truth, and calculatingly provocative when responding to

Germany: Consumer confidence survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: Consumption and confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

charges across a range of issues, from the Government's forced publication of its damning assessment of the likely severe damage to be caused by a no-deal Brexit, to questions of impropriety related to his recently uncovered actions as London Mayor.

Before too long, Johnson's time as Prime Minister will – for this term at least – come to an end, if and when MPs vote for an early General Election, or if and when they agree to replace him with an alternative figure. But the bottom line is that the chances that a Brexit deal will be agreed with the EU and endorsed by Parliament by end-October must now be minimal. The UK Government 'non-papers' on issues related to the Irish border, sent to the European Commission over recent days, were reportedly derisory, adding to evidence that Johnson has no legally operable proposals to make. By mimicking Donald Trump's bluster and stoking of division with inflammatory language, Johnson made it far more difficult to see how he could possibly compromise with the EU. And, even if he was able to reach a deal with the EU, it seems near-impossible to envisage how many opposition MPs – upon whose support he would rely – could dare vote for it in the House of Commons. So, with the recent Benn-Burt Act limiting significantly the chances of a no-deal Brexit, we continue to attach a very high probability to an extension of the Article 50 deadline at end-October, with a General Election then most likely to be held on 28 November or 5 December.

Weak trend in car production continues

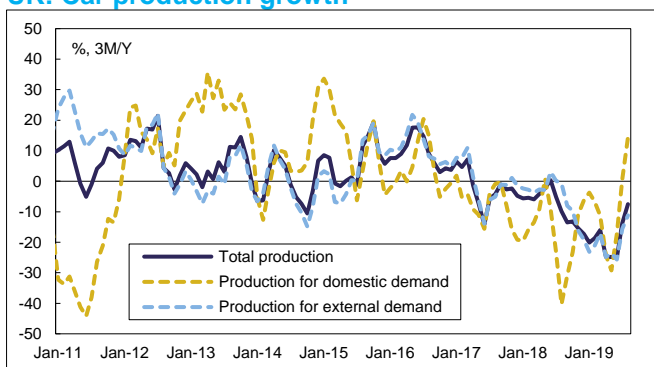
While political noise in the UK continues to rise towards a crescendo, the UK dataflow continues to play second fiddle. But, at face value, today's UK car production figures for August appeared to offer some relief for manufacturers, with total autos output up 3.3%Y/Y – the first annual increase in fifteen months. Output for the domestic market was up more than 15%Y/Y. But production for the export market (which accounts for roughly 80% of total production) was up just 0.6%Y/Y. And the outturn in August was flattered by the timing of summer shutdowns at certain key car manufacturers, which had been brought forward to April as part of the initial Brexit deadline preparations, as well as base effects following a weak outturn in August 2018 when production was hit by several factors including preparation for new EU-wide testing regulations.

Moreover, the increase in August was far from sufficient to offset the marked drop in production in April. In the first eight months of the year, the number of cars produced fell below 1mn units for the first time since 2014, to be down a whopping 17%YTD/Y, the steepest such decline since 2011. And the fall in production for the export market was down an even sharper 18.4%YTD/Y in August, the largest drop since 2009. Production for China was down 43.8%YTD/Y, the EU down 13.7%YTD/Y and the US down 9.1%YTD/Y. Although we still expect car production to provide a modest boost to GDP growth in Q3, today's release further illustrates the steady downward trend in output from the sector since the Brexit referendum. And with several car manufacturers having indicated their intentions for an additional shutdown around the current end-October Brexit deadline, like the BoE we expect to see the contribution to GDP growth in Q3 more than reversed in Q4.

The day ahead in the UK

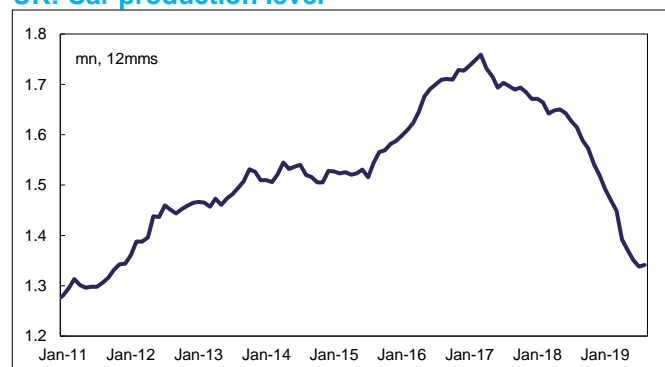
The end of the week will see UK Brexit Secretary Barclay meet EU Chief Negotiator Barnier in Brussels. However, we do not expect anything substantive to emerge. Data-wise, the GfK consumer confidence survey is expected to show that households remained downbeat at the end of the third quarter – the index is forecast to be unchanged at -14 matching the multi-year low hit earlier in the year – not least reflecting heightened political uncertainty. Elsewhere, MPC member Saunders is due to speak publicly.

UK: Car production growth



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

UK: Car production level






Source: SMMT, 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%	Aug	5.7	5.1	5.2	5.1
Germany	 GfK consumer confidence indicator	Oct	9.9	9.6	9.7	-
UK	 Car production Y/Y%	Aug	3.3	-	-10.6	-

Auctions






Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU	 10.00	Economic sentiment (consumer confidence) indicator	Sep	103.0 (-6.5)	103.1 (-7.1)
	 10.00	Industrial confidence (services confidence) indicator	Sep	-6.0 (9.4)	-5.9 (9.3)
France	 07.45	Preliminary CPI (EU-harmonised CPI) Y/Y%	Sep	1.0 (1.3)	1.0 (1.3)
	 07.45	Consumer spending M/M% (Y/Y%)	Aug	0.3 (-0.1)	0.4 (0.1)
Italy	 09.00	Economic sentiment indicator	Sep	-	98.9
	 09.00	Consumer confidence (manufacturing confidence) indicator	Sep	112.3 (100.0)	111.9 (99.7)
Spain	 08.00	Retail sales Y/Y%	Aug	3.0	3.2
UK	 00.01	GfK consumer confidence indicator	Sep	-14	-14

Auctions

Country	BST	Auction/Event
EMU	 08.15	ECB's De Guindos and Knot scheduled to speak in Frankfurt
Italy	 10.00	Auction: to sell €3.75bn of 0.35% 2025 bonds
	 10.00	Auction: to sell €3bn of 1.35% 2030 bonds
	 10.00	Auction: to sell €0.75bn of floating rate 2025 bonds
UK	 08.00	BoE's Saunders scheduled to make a speech

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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