

Euro wrap-up

Overview

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- While euro area stocks fell and BTPs made losses, Bunds were little changed as the latest German and French business surveys suggested that economic recovery in the euro area continues.
- Gilts were also little changed as the UK Government announced more support for jobs and businesses while a survey suggested ongoing growth in retail sales.
- Friday will bring new data for euro area bank lending and the UK public finances, as well as new Italian and UK economic sentiment survey results.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.711	+0.004
OBL 0 10/25	-0.711	+0.004
DBR 0 08/30	-0.510	-0.003
UKT 1¼ 09/22	-0.062	-0.002
UKT 0% 06/25	-0.076	-0.001
UKT 4¾ 12/30	0.214	-0.003

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

Source: Bloomberg

Euro area

ifo and INSEE surveys more upbeat than flash PMIs

Contrary to yesterday's downbeat [flash PMIs](#), which suggested that a notable weakening in the services sector might have caused the economic recovery to grind to a halt this month, more reassuringly today's German and French national business surveys pointed to ongoing growth. Indeed, the German ifo survey reported a fourth successive monthly increase in the survey measure of current conditions, up 1.3pts to 89.2, to suggest that a little more than half of the initial peak-to-trough deterioration following the lockdown had been reversed. Firms' expectations were also very slightly improved, with the 0.5pt increase to 97.7 in the respective index representing the most upbeat reading since November 2018. As such, the headline business climate index rose 0.9pts to 93.4, down just 2.5pts from February, to suggest further normalisation in the economy despite the revival of the pandemic.

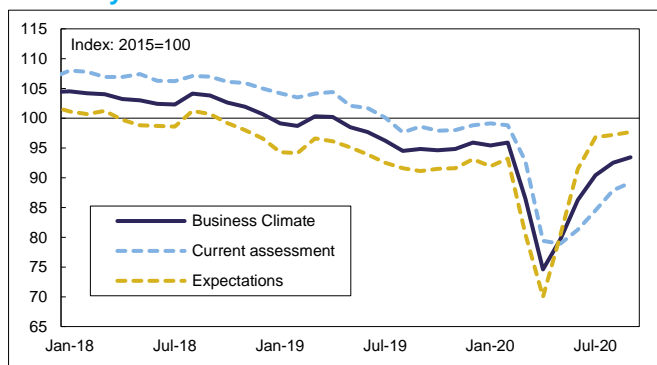
Further evidence that German manufacturers are in finer fettle

As with the German flash PMIs, the ifo survey suggested that the manufacturing sector is driving the recovery in the euro area's largest member state, with fewer firms expressing concern about current conditions and expectations the most upbeat since late 2017. While last month autos firms appeared to leading the way, this month the ifo institute noted that electrical and electronics firms in particular were particularly more upbeat. Retail and construction firms were also happier about business conditions this month. But they were still relatively downbeat about the outlook. And while services suggested that conditions had improved in September, they were less optimistic about prospects for the coming six months, with the growing unease about the impact of the pandemic weakening overall sentiment in the sector.

But both surveys flag wariness about the outlook for services

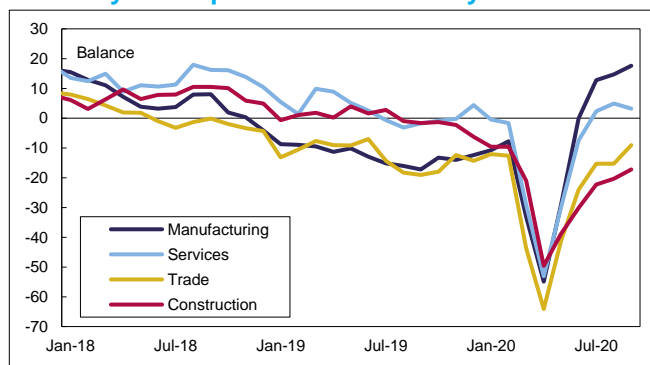
The French flash PMIs were significantly weaker than the German indices, suggesting that economic activity in the euro area had started to contract again at the end of Q3. However, like the German ifo survey, today's INSEE business survey also suggested ongoing French recovery in the current month. Perhaps inevitably given the vigour of the recent rebound and the renewed pandemic, the INSEE survey did suggest a moderation of growth, with the headline business climate index rising a modest 2pts to 92. But it pointed to ongoing improvement in all main sectors nonetheless, e.g. with the headline indices for services and manufacturing up 2 and 3pts respectively to 95 and 96. Admittedly, the headline INSEE business climate index, and the main sectoral indices, remain well below their long-term averages (100) and thus also well below the rather elevated pre-lockdown levels (105 for the headline index). And the rise in the headline business climate figure was thanks in no small part to improved perceptions of recent growth over the past three months in services, manufacturing and construction. Most notably perhaps, the general outlook for activity in services was judged to have deteriorated. Similarly, while the employment

Germany: ifo business climate indices



Source: ifo Institute, Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ifo expectations indices by sector



Source: ifo Institute, Refinitiv and Daiwa Capital Markets Europe Ltd.

climate was judged to have improved, the positive news on jobs was not seen in every sector, e.g. with retailers signalling plans to scale back. And with new restrictions on activity in hospitality and leisure announced yesterday for Paris and Marseille, we anticipate a weakening in the INSEE survey next month.

TLTRO-iii take-up at upper end of expectations

Having borrowed a whopping €1.31trn at the previous operation in June, and with excess liquidity already above €2.9trn, euro area banks were bound to seek a much smaller amount in the latest quarterly TLTRO-iii operation this week. Today's announcement confirmed that the ECB allotted €174.5bn to 388 banks (down from 742 banks last time around), an amount that was still at the upper end of expectations. Net of recent repayments, that represented a new injection of liquidity of €158bn, a non-negligible amount. Clearly, euro area banks no longer fear being stigmatized for maximising their take-up of TLTRO funds. And, as suggested by the ECB's recent bank lending survey, they are likely to use the funds for sustaining increased lending volumes – which rose at a record pace following the national lockdowns – thus also enabling them to benefit from an interest rate as low as -1.0% on the borrowings until at least June 2021 and probably beyond. Over the near term at least, many banks in the region – not least in Italy and Spain – will use a portion of the funds for carry-trade activity, helping to keep periphery bond yields compressed.

The day ahead in the euro area

Following today's business sentiment surveys from Germany and France, the focus tomorrow turns to Italy, where manufacturing and consumer confidence data for September are scheduled for release. While the spread of Covid-19 in Italy appears much better under control than in most other European countries, consumer confidence is expected to have moved broadly sideways, after regaining some ground in recent months. Following the trend in Germany and France, manufacturing confidence is expected to rise further, leading the recovery. Also due to be published tomorrow are euro area M3 money supply figures for August, which are likely to report continued solid growth in bank lending.

UK

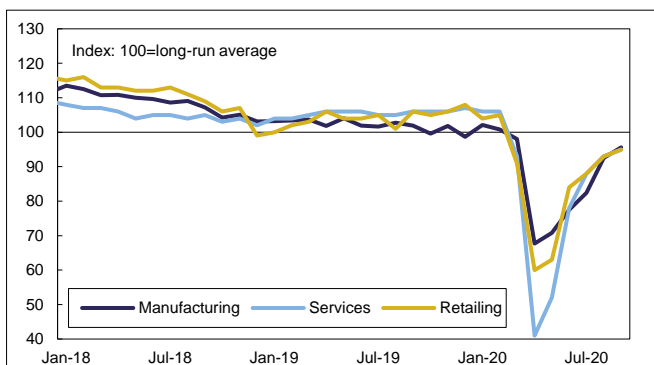
CBI survey signals ongoing retail sales growth in September

Following four months of decent growth to above the pre-lockdown level, retail sales might have been expected to pause for breath in September. However, today's Distributive Trades Survey from the CBI suggested ongoing growth, and at the fastest year-on-year rate since April 2019. In particular, the headline survey balance rose 17pts to +11%, driven by solid growth at grocery stores, even though online sales were judged to have moderated further (down 1ppts to +35%). And despite the acceleration in the spread of Covid-19 over the past few weeks, total sales were expected to be broadly flat in October (a survey balance of 0%). While improved, retailers responding to the CBI survey judged that sales were about 8% lower than they might otherwise had been in 'normal' conditions without the pandemic. And the pattern evident in the [official sales data](#) since lockdown was judged to have continued into the autumn. In particular, sales of household furniture (+39%), DIY items & hardware (+20%) and groceries (+10%) were judged to be stronger than 'normal' thanks not least to ongoing working from home. But sales of clothing (-40%) and at department stores (-23%) were still considered to be well below the pre-pandemic trend.

New job support scheme to slow but not stop rise in unemployment

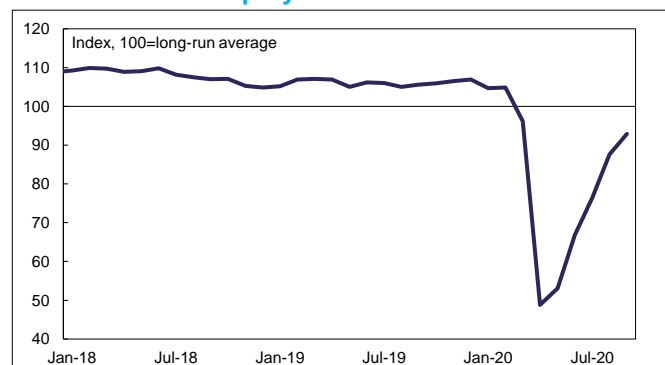
With the Government having encouraged greater home working in the face of the renewed spread of Covid-19, we expect those spending trends to continue over coming months too. Today the Government also announced extra fiscal support for the economy, including an extension of the temporary VAT cut for the hospitality sector through to end-March 2021 and a lengthening of the period for businesses to repay the government-backed 'bounce-back' loans and deferred tax bills. The Government also confirmed that it would launch a new job support scheme, modelled on the German *kurzarbeit* scheme, to top up the incomes of part-time workers from the start of November in lieu of the current Job Retention Scheme subsidies.

France: INSEE business confidence indicators



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: INSEE employment climate index



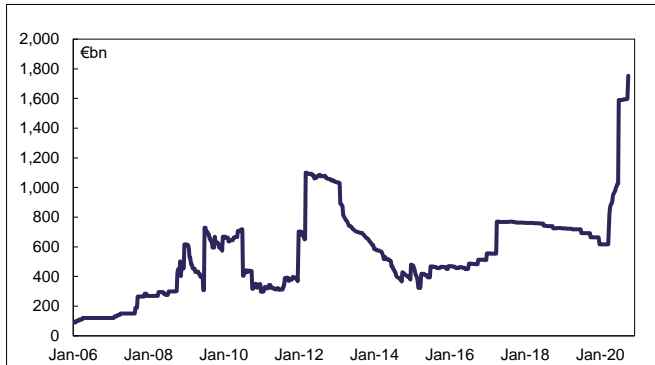
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

These measures should help to slow the rate of redundancies somewhat over coming months and reduce risks of a double-dip in spending into the New Year. However, the new labour market support will be far less generous than the current Job Retention Scheme – not least as workers subsidized will have to work at least one-third of normal hours with employers footing a significant share of the total wage bill – and so the unemployment rate still seems bound to increase significantly before year-end as many of the near-3 million workers still furloughed lose their jobs. And that might be expected to weigh somewhat on total retail sales too.

The day ahead in the UK

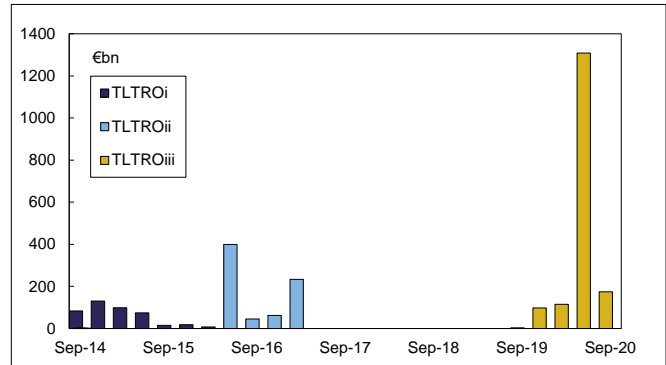
Turning to tomorrow, the UK calendar sees the release of public finances data for August and the GfK consumer confidence survey, for which the headline indicator is expected to remain unchanged at -27 in September, still some way (20pts) below the peak seen earlier in the year. In other news, the Bank of England will release its Q3 Quarterly Bulletin.

ECB: Outstanding long-term loan operations*



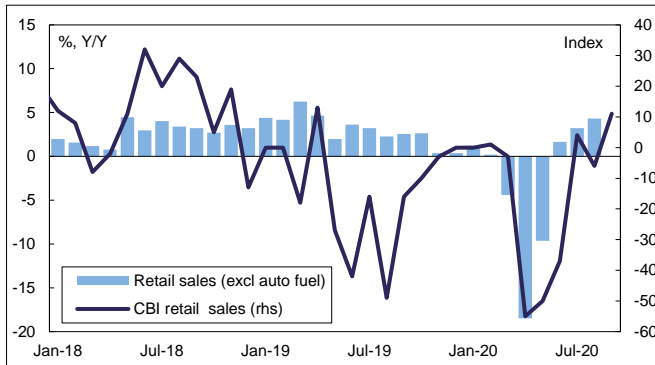
*Includes all TLTRO and LTRO funds. Forecast for end-September 2020. Source: ECB and Daiwa Capital Markets Europe Ltd.

ECB: TLTRO take up



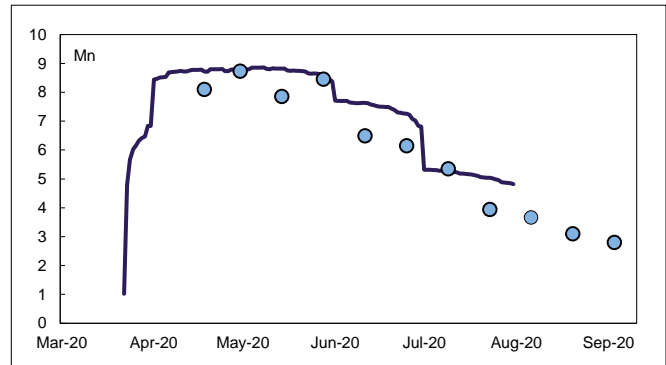
Source: ECB and Daiwa Capital Markets Europe Ltd.

UK: Retail sales












Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Workers on furlough*











*Light blue dots represent estimated number of furloughed workers based on ONS' Business Impact of COVID-19 survey (BICs) results. Source: HMRC, ONS 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	 Ifo business climate	Sep	93.4	93.8	92.6	92.5	
	 Ifo current assessment (expectations)	Sep	89.2 (97.7)	89.7 (98.0)	87.9 (97.5)	- (97.2)	
France	 INSEE business confidence	Sep	92	94	91	90	
	 INSEE manufacturing confidence (production outlook)	Sep	96 (-2)	96 (2)	93 (-3)	92 (-4)	
UK	 CBI distributive trades survey, reported sales	Sep	-7	-15	-9	-	
Auctions							
Country	Auction						
Italy	 sold €3.75bn of 0% 2022 bonds at an average yield of -0.118%						
	 sold €750mn of 0.4% 2030 index-linked bonds at an average yield of 0.37%						
UK	 sold £3bn of 0.125% 2026 bonds at an average yield of -0.009%						
	 Auction: sold £1.2bn of 0.125% 2028 index-linked bonds at an average yield of -2.977%						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's results							
Economic data							
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous		
EMU	 09.00	M3 money supply Y/Y%	Aug	10.1	10.2		
Italy	 09.00	ISTAT business (manufacturing) confidence	Sep	- (87.4)	80.8 (86.1)		
	 09.00	ISTAT consumer confidence	Sep	100.8	100.8		
Spain	 08.00	PPI Y/Y%	Aug	-	-4.8		
UK	 07.00	Public sector net borrowing £bn	Aug	38.0	26.7		
	 00.01	GfK consumer confidence	Sep	-27	-27		
Auctions and events							
Country	BST	Auction / Event					
UK	 12.00	BoE publishes its Q3 Quarterly Bulletin					
	 -	UK sovereign debt rating update by Fitch					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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