Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds were little changed but BTPs made gains as the euro area flash PMIs suggested that services activity in the region is contracting but German manufacturing output has strengthened.
- Gilts also were also little changed even as the UK flash PMIs remained consistent with growth while retail sales rose further above the pre-pandemic level.
- The coming week brings the latest ECB policy announcement, where we expect Lagarde to be more dovish, while the first estimates of euro area Q3 GDP and October inflation are also due.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.767	+0.008
OBL 0 10/25	-0.774	+0.004
DBR 0 08/30	-0.571	-0.001
UKT 1¾ 09/22	-0.034	-0.007
UKT 0⅝ 06/25	-0.030	-0.004
UKT 4¾ 12/30	0.285	+0.002

*Change from close as at 4:00pm BST.
Source: Bloomberg

Euro area

Flash PMIs suggest that euro area recovery has gone into reverse

With concerns about the pandemic having increased significantly over the past month prompting tighter restrictions in several member states, today's flash October PMIs inevitably pointed to a weakening in economic activity. Indeed, broadly in line with expectations, the euro area composite PMI fell 1.0pt to a four-month low of 49.4, representing the first sub-50 reading since June. With the new orders PMI dropping 2.0pts to 48.4 – also the lowest since June – the survey flagged risks of a contraction in GDP over the fourth quarter as a whole. In addition, the composite employment index remained firmly below the key 50 reading at 48.1 to suggest ongoing job-shedding. And while it picked up from September, at 48.8 the composite output price PMI remained consistent with disinflation. So, ahead of next week's ECB policy meeting, the survey should have added to fears on the Governing Council that its latest economic projections, released last month, were too optimistic, with the second wave of Covid having increased further the likelihood that inflation will return sub-target for the foreseeable future.

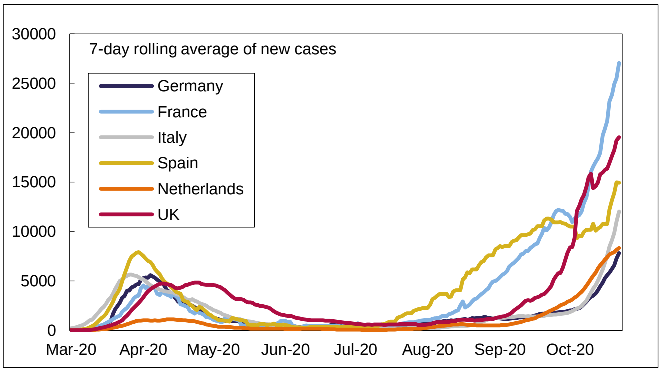
Deterioration centered on services

Perhaps inevitably, the deterioration in the PMIs was led by the services sector, for which the euro area activity index fell 1.8pts to a five-month low of 46.2 with Markit citing particular new weakness in the hard-hit hospitality sector. Within the detail, the indices for both new and outstanding business fell further below 50, as did new export orders, to suggest a weak near-term outlook too. At the country level, it was no surprise that the French services activity PMI fell further below 50, dropping 1.0pt to a five-month low of 46.5. After all, the second wave has been particularly severe in the euro area's second-largest member state, with the daily number of new cases rising above 41k yesterday. And with restrictions on activity, particularly affecting hospitality and leisure, having already been steadily tightened over recent weeks, curfew restrictions between 21.00 and 06.00 were extended yesterday to affect some 46 million people. While significantly less severe than in France, the number of new cases in Germany has nevertheless also been rising steadily, reaching a new record yesterday above 11k. And with more widespread localized restrictions on activity there too, the German services PMI fell a steeper 1.7pts to a four-month low of 48.9 with the leading indicators similarly signaling further weakening over coming months.

German manufacturing races ahead

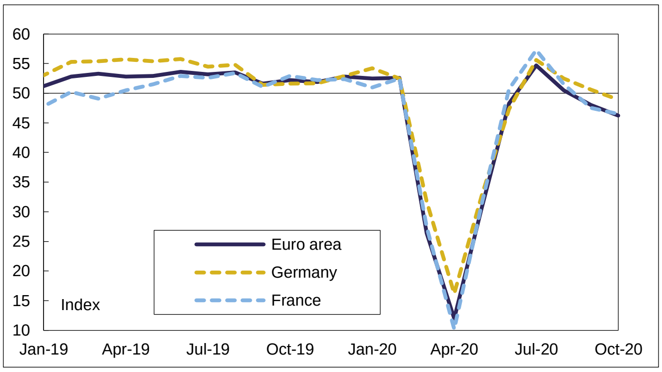
The picture in the manufacturing sector, however, was much less concerning. The euro area manufacturing output PMI rose 0.7pt to 57.8, the highest in 32 months and consistent with solid ongoing recovery. Admittedly, that masked significant variation among the member states. The French PMI for the sector edged down 0.2pt to a relatively subdued 51.0, with the

New daily coronavirus cases



Source: ECDC and Daiwa Capital Markets Europe Ltd.

Euro area: Services PMIs



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

orders indices pointing to an absence of growth ahead. But, in marked contrast, German firms in the sector appeared in rude health, with the output index rising 2.5pts to 64.9, remarkably the highest in almost a decade. The German manufacturing order and backlog PMIs also pointed to stronger growth ahead, remaining firmly above 60. But a drop in the respective employment index, to just 43.8, implied that firms in the sector are still aiming to cut jobs, suggesting that confidence in the outlook beyond the near term might not be particularly high. Nevertheless, the strength of the manufacturing output PMI meant that Germany's composite PMI fell just 0.2pt in October to 54.5, indicating ongoing positive GDP growth at the start of Q4. In contrast, the French composite PMI fell 1.2pts to a five-month low of 47.3 suggestive of a contraction in overall economic output. And while no indices were published for other member states, Markit reported that its survey suggested a contraction in the rest of the euro area at the sharpest pace since early-2013 barring the height of the pandemic.

The coming week in the euro area

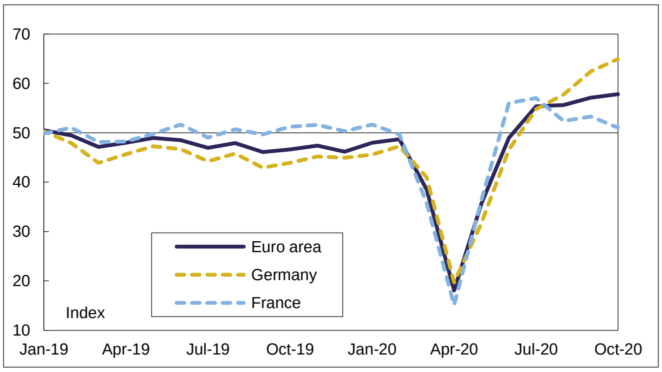
The main event of the coming week will be the policy meeting of the ECB's Governing Council on Thursday. Following the previous meeting in early September, the ECB revised up its baseline economic projections, giving Christine Lagarde cause to be more upbeat. Those projections, however, still suggested that inflation was highly likely to remain well below target over the horizon. Moreover, since then, core inflation has weakened further to a record low. And, as illustrated by today's flash PMIs, the intensification of the pandemic and re-imposition of restrictions on activity has seemingly taken its toll on the economic recovery in the services sector. In addition, member state draft budgetary plans suggest that the overall euro area fiscal stance might be broadly neutral next year, with governments reluctant to tap loans under the EU's Recovery and Resilience Facility due to concerns about conditionality and the bureaucratic approvals process. So, the tone of recent commentary from various Governing Council members has been increasingly dovish. Indeed, even the more hawkish – e.g. Dutch Central Bank Governor Knot and soon-to-depart Executive Board member Mersch – have acknowledged that more stimulus might be merited in due course.

Nevertheless, with a little less than half of the €1.35trn PEPP envelope filled, the Governing Council will see no need to add stimulus at this month's meeting. Instead, reports suggest that the members will discuss the effectiveness of all of its asset purchase programmes, perhaps as a first step to deciding with which policy tool to add further accommodation at the final meeting of the year in December. However, with the account of the September meeting – which had a more dovish tone than the press conference – having made clear that the PEPP is currently the preferred tool, and the pandemic is becoming increasingly rife, we expect the envelope for that programme to be increased by about €650bn to €2trn at the December meeting. In her press conference, therefore, Lagarde might well signal the likelihood of additional easing by the end of the year if conditions do not improve.

The coming week will also be a busy one for top-tier economic data, with the most noteworthy releases the first estimates for Q3 GDP and October inflation. Despite a recent slowing in the recovery, with activity having posted significant growth during the summer after lockdown measures were initially relaxed, euro area GDP – due for release on Friday – is expected to have risen at a historical magnitude this quarter, with our forecast for growth of 10½%Q/Q. Of course, this would mean that just 60% of the pandemic-related slump had been reversed, with output still more than 6% below its Q419 level. The country releases – the largest four member states will also publish figures on Friday – are all are expected to show that GDP rebounded vigorously in Q3. We expect German GDP to have risen by around 7½%Q/Q, while data from France, Italy and Spain will reveal significantly stronger rates of growth following significant double-digit rates of decline in Q2.

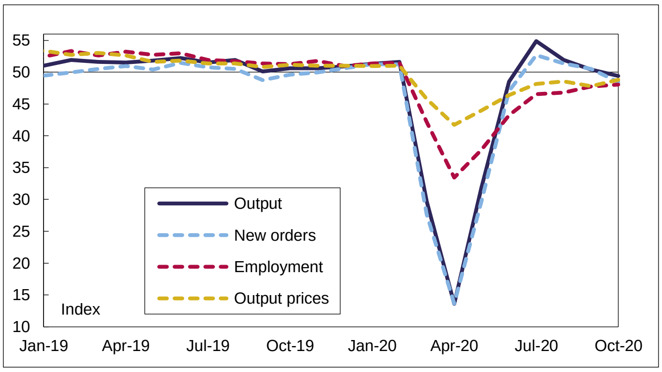
Meanwhile, given the still significant amounts of spare capacity, as well as temporary Covid-related disruption to demand, October's inflation release will continue to show that underlying price pressures remain subdued. But likely reflecting a pickup in clothing inflation as the impact of delayed summer discounting plays out, we expect the euro area's headline and core CPI rates to rise, perhaps ticking up to -0.2%Y/Y and 0.3%Y/Y respectively. Friday also brings euro area labour market figures for September, which are expected to show a further uptick in the headline unemployment rate from 8.1% in August, although this will remain limited by the various government employment and wage-support schemes in place across the

Euro area: Manufacturing PMIs



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Euro area: Composite PMIs



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

region. Ahead of this, the European Commission's sentiment survey for October – on Thursday – is likely to add to evidence of weakening services activity at the start of Q4. By the same token, Germany's ifo business climate survey (on Monday) should highlight the favourable conditions in that country's manufacturing sector. Finally, the ECB's monthly bank lending figures and quarterly bank lending survey (Tuesday) should continue to suggest that financial conditions remain favourable and supportive of economic recovery.

UK

UK services PMI predictably plunges in October but manufacturers still report growth

Like in the euro area, the revival of the pandemic in the UK is clearly taking its toll on services, with today's flash October PMIs reporting a notable decline in that sector's headline activity index, down 3.8pts to 52.3, its weakest level since June. And with tighter restrictions affecting the hospitality, leisure and travel sub-sectors, the new business index slumped an even steeper 6.6pts to 47.8. Perhaps inevitably, the manufacturing survey suggested that firms in the sector appear to be faring a little better. However, the headline index still fell 0.8pt to 53.3, a three-month low, while the output PMI fell 2.6pts to 56.4. This in part reportedly reflected rising demand from the US and China, while there was also some anecdotal evidence of Brexit-related stock building. Perhaps surprisingly, therefore, manufacturers were also reportedly the most optimistic for six years about prospects for production growth over the year ahead. Of course, this contrasted markedly with the services sector, where expectations for the outlook fell in October and seem bound to be further dented by widening containment measures – notably across Wales and the north of England – from this weekend.

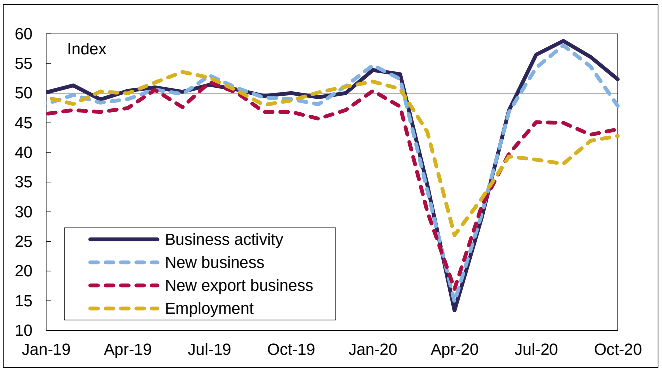
Composite PMI points to an overall loss of momentum

Overall, the UK's composite output PMI fell 3.6pts in October to 52.9, a four-month low. And the new orders index (48.8) slid into 'contractionary' territory for the first time since June, while firms across both sectors reportedly continuing to cut jobs at a significant pace. Of course, given the nature of the PMI survey, it is difficult to interpret with any accuracy what today's surveys imply for GDP growth at the start of Q4. But taken together with a softening in higher-frequency data over recent weeks, today's report adds to evidence of a slowing in the pace of recovery. And with the resurgence in the pandemic in the UK seemingly lagging that seen in the euro area, we would expect to see the uptrend in coronavirus cases and weakening in recovery momentum to continue across the UK over the near term too.

Retail sales maintain uptrend as spending diverts away from services

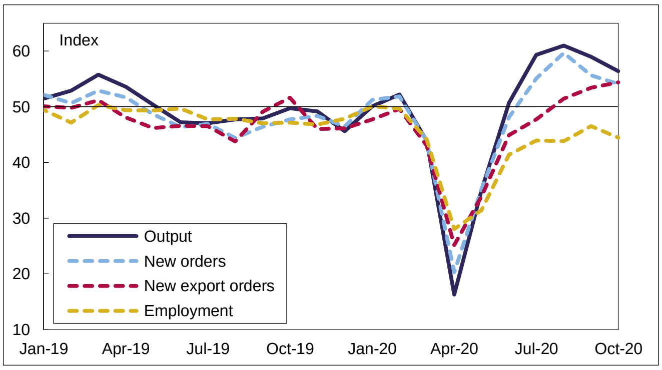
While the PMIs had already pointed to a moderation in the recovery towards the end of Q3, the survey excludes retailers, which have recently fared relatively well. And today's retail sales release maintained that trend, posting a fifth consecutive month of firm growth in September, beating the market consensus forecast by rising 1.5%M/M in volume terms, to be up 4.7%Y/Y and 5.5% above February's pre-pandemic level. As a result, sales volumes were also up 17.4%Q/Q in Q3, perhaps unsurprisingly the most on record and probably slightly above the growth rate in GDP last quarter. Almost all categories of sales rose in September, as consumers continued to divert spending from face-to-face services to goods. So, for example, sales at food stores rose 0.7%M/M to be 3.7% above the pre-pandemic level, anecdotally benefiting from some renewed stockpiling of essentials as the second wave of pandemic developed momentum. And sales at non-food stores were vigorous, rising 4.0%M/M to move 1.7% above their February levels. Within that rather broad category, sales at household goods stores rose 0.9%M/M to rise 11.0% above the pre-pandemic level, boosted by demand for home improvements and electrical goods amid increased working from home. But while clothing store sales rose for a fifth successive month and by a firm 3.6%M/M, they were still down 12.7% from February. And non-store sales slipped back for a third successive month, dropping 1.9%M/M. Nevertheless, online sales were still 36.6% above the pre-pandemic level, accounting for 27.5% of all sales compared with 20.1% in February. Fuel sales were little changed on the month to remain 8.6% below the pre-pandemic level.

UK: Services PMIs



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing PMIs



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

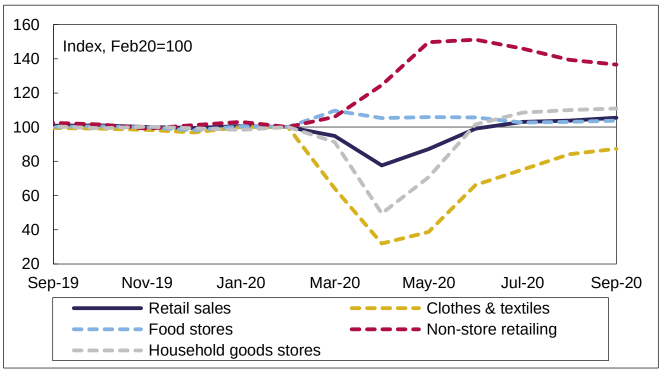
Consumers express increased pessimism

Whilst we expect retail sales to remain firmly above the pre-pandemic levels over coming months, as households maintain an increased level of spending on goods at the expense of spending on hospitality, leisure and transportation, increased joblessness and unease about the future will in due course likely take a toll on spending. Indeed, the latest GfK consumer confidence survey offered a predictably gloomy assessment of conditions at the start of Q4, with the headline balance declining 6pts to -31, its lowest reading since May and just 3pts above the post-pandemic trough. There was widespread deterioration reported within the detail of the survey too, with consumers reporting a notable deterioration in their expectations for the economic outlook. As such, households' willingness to buy durable goods fell further in October, with the survey component at its weakest since May. And while the Chancellor yesterday announced a substantive increase in fiscal support to business, including a more generous 'Job Support Scheme' to enhance incentives to firms to retain staff, consumer sentiment seems likely to remain subdued, weighing on total spending over coming months.

The coming week in the UK

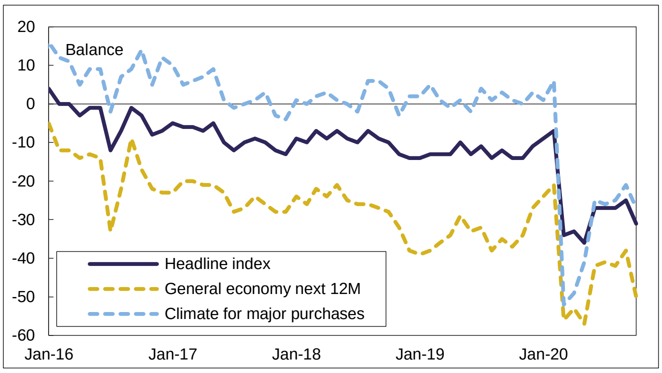
In contrast to the euro area, the coming week will be very quiet for UK economic releases. Tuesday's CBI distributive trades survey for October will be of most interest in the first half of the week. With new Covid containment restrictions in place and consumer confidence having weakened significantly, retail sales growth might be expected to have slowed at the start of Q4. However, stock-piling of essentials might provide additional support. In addition, the Bank of England's latest lending figures (due Thursday) are likely to show that demand for consumer credit remained weak in September. In contrast, mortgage lending is likely to have remained relatively robust, with mortgage approvals close to multi-year highs as the impact of lockdown-related backlogs and Stamp Duty holiday boosted demand. Thursday will also see the release of the SMMT auto production figures for September.

UK: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Daiwa economic forecasts

	2020				2021		2020	2021	2022
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP growth, %, Q/Q									
Euro area	-3.7	-11.8	10.5	0.8	0.8	1.0	-7.4	4.9	3.7
Germany	-2.0	-9.7	7.5	1.5	1.0	1.0	-5.5	4.6	2.4
France	-5.9	-13.8	16.0	0.0	0.5	1.0	-9.1	5.9	3.5
Italy	-5.5	-12.8	11.5	0.5	1.0	1.0	-9.8	5.1	3.7
Spain	-5.2	-17.8	15.0	0.5	0.5	2.0	-11.4	6.0	5.1
UK	-2.2	-19.8	15.5	0.5	1.0	2.0	-10.6	5.4	4.6
Inflation, %, Y/Y									
Euro area									
Headline CPI	1.1	0.2	0.0	-0.3	0.1	0.7	0.3	0.7	1.1
Core CPI	1.1	0.9	0.6	0.3	0.6	0.5	0.7	0.7	0.8
UK									
Headline CPI	1.7	0.6	0.7	0.4	0.5	1.6	0.8	1.4	1.6
Core CPI	1.6	1.4	1.2	0.7	0.8	1.5	1.2	1.3	1.4
Monetary policy									
ECB									
Refi Rate %	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
Net asset purchases*	20	140	95	120	120	100	100	100	20
BoE									
Bank Rate %	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Net asset purchases**	36	40	17	17	17	17	17	0	0

**Monthly target €bn, end of period. **Monthly target £bn, end of period.*
Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	Preliminary manufacturing (services) PMI	Oct	**54.4 (46.2)**	53.0 (47.0)	53.7 (48.0)	-
	Preliminary composite PMI	Oct	**49.4**	49.5	50.4	-
Germany	Preliminary manufacturing (services) PMI	Oct	**58.0 (48.9)**	55.0 (49.5)	56.4 (50.6)	-
	Preliminary composite PMI	Oct	**54.5**	53.5	54.7	-
France	Preliminary manufacturing (services) PMI	Oct	**51.0 (46.5)**	51.3 (47.0)	51.2 (47.5)	-
	Preliminary composite PMI	Oct	**47.3**	48.1	48.5	-
UK	GfK consumer confidence	Oct	**-31**	-28	-25	-
	Retail sales including fuel M/M% (Y/Y%)	Sep	**1.5 (4.7)**	0.0 (3.8)	0.8 (2.8)	**0.9 (2.7)**
	Retail sales excluding fuel M/M% (Y/Y%)	Sep	**1.6 (6.4)**	0.5 (4.9)	0.6 (4.3)	-
	Preliminary manufacturing (services) PMI	Oct	**53.3 (52.3)**	53.1 (53.3)	54.1 (56.1)	-
	Preliminary composite PMI	Oct	**52.9**	53.4	56.5	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

Coming week's data calendar

The coming week's key data releases

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
			Monday 26 October 2020			
Germany		09.00	Ifo business climate index	Oct	93.0	93.4
		09.00	Ifo current assessment (expectations) balance	Oct	89.6 (96.5)	89.2 (97.7)
			Tuesday 27 October 2020			
EMU		09.00	M3 money supply Y/Y%	Sep	9.6	9.5
UK		11.00	CBI distributive trades survey, reported sales	Oct	-2	11
			Wednesday 28 October 2020			
France		07.45	INSEE consumer confidence indicator	Oct	93	95
Spain		08.00	Retail sales Y/Y%	Sep	-3.4	-2.4
UK		00.01	BRC shop price index Y/Y%	Oct	-	-1.6
		-	Nationwide house price index* M/M% (Y/Y%)	Oct	-	0.9 (5.0)
			Thursday 29 October 2020			
EMU		10.00	EC economic sentiment indicator	Oct	89.6	91.1
		10.00	EC industrial (services) confidence indicator	Oct	-10.9 (-14.2)	-11.1 (-11.1)
		10.00	Final EC consumer confidence indicator	Oct	-15.5	-13.9
		12.45	ECB main refinancing rate %	Oct	*0.00*	0.00
		12.45	ECB marginal lending rate %	Oct	*0.25*	0.25
		12.45	ECB deposit rate %	Oct	*-0.50*	-0.50
Germany		08.55	Unemployment claims rate % (change 000s)	Oct	6.3 (-5.0)	6.3 (-8.0)
		13.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	-0.3 (-0.4)	-0.2 (-0.4)
Italy		09.00	ISTAT consumer confidence indicator	Oct	102.0	103.4
		09.00	ISTAT business (manufacturing) confidence indicator	Oct	-	91.1 (92.1)
Spain		08.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	-0.4 (-0.7)	-0.4 (-0.6)
UK		09.00	SMMT auto production Y/Y%	Sep	-	-44.6
		09.30	Net consumer credit £bn (Y/Y%)	Sep	-	0.3 (-3.9)
		09.30	Mortgage lending £bn (approvals 000s)	Sep	-	3.1 (84.7)
			Friday 30 October 2020			
EMU		10.00	Preliminary GDP Q/Q% (Y/Y%)	Q3	*10.5 (-6.1)*	-11.8 (-14.7)
		10.00	Preliminary CPI (core CPI) Y/Y%	Oct	*-0.2 (0.3)*	-0.3 (0.2)
Germany		07.00	Prelminary GDP Q/Q% (Y/Y%)	Q3	*7.5 (-4.9)*	-9.7 (-11.3)
		07.00	Retail sales M/M% (Y/Y%)	Sep	-0.6 (2.8)	1.8 (3.0)
France		06.30	Preliminary GDP Q/Q% (Y/Y%)	Q3	*16.0 (-6.1)*	-13.8 (-18.9)
		06.30	Consumer spending M/M% (Y/Y%)	Sep	-0.5 (2.2)	2.3 (2.4)
		07.45	Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	0.1 (0.1)	-0.5 (-0.6)
Italy		10.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	-0.4 (-0.8)	-0.6 (-1.0)
		11.00	Preliminary GDP Q/Q% (Y/Y%)	Q3	*12.0 (-7.9)*	-12.8 (-17.7)
Spain		08.00	Preliminary GDP Q/Q% (Y/Y%)	Q3	*15.0 (-10.1)*	-17.8 (-21.5)
UK		00.01	Lloyds business barometer	Oct	-	-11

**Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

Daiwa Capital Markets

The coming week's key events & auctions			
Country		GMT	Event / Auction
			Monday 26 October 2020
			- Nothing scheduled -
			Tuesday 27 October 2020
EMU		09.30	ECB bank lending survey for Q3
Italy		10.00	Auction: To sell up to €2.5bn of 2022 zero-coupon bonds
		10.00	Auction: To sell 0.65% 2026 index-linked bonds
UK		10.00	Auction: To sell £3.25bn of 0.125% 2024 bonds
		11.30	Auction: To sell £1bn of 1.625% 2071 bonds
			Wednesday 28 October 2020
Germany		10.30	Auction: To sell up to €2bn of 0% 2035 bonds
UK		10.00	Auction: To sell £2.5bn of 0.375% 2030 bonds
			Thursday 29 October 2020
EMU		12.45	ECB monetary policy announcement
		13.30	ECB President Lagarde speaks at post-meeting press conference
Italy		10.00	Auction: To sell bonds
			Friday 30 October 2020
EMU		09.00	ECB to publish Survey of Professional Forecasters

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs