Euro wrap-up

Overview

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- Bunds made gains as euro area bank lending to firms declined and banks reported a tightening of credit standards due to concerns about the economic impact of the pandemic.
- Gilts also rallied as a survey suggested a weakening of UK retail sales.
- After a quiet day for European economic news tomorrow, Thursday will bring the ECB's latest policy announcement and updates on German and Spanish inflation and euro area business sentiment, among other data.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.782	-0.017
OBL 0 10/25	-0.804	-0.027
DBR 0 08/30	-0.615	-0.034
UKT 1¾ 09/22	-0.054	-0.009
UKT 0⅝ 06/25	-0.053	-0.019
UKT 4¾ 12/30	0.234	-0.039

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

Euro area

Bank deposits continue to accumulate, illustrating pent-up demand

Ahead of the ECB's policy meeting on Thursday, today's economic data focus in the euro area was on the banking sector, with September monetary figures published alongside the Central Bank's latest quarterly bank lending survey (BLS). Among other things, the figures revealed a further substantive net inflow to bank deposits, which arguably represent pent-up demand that might in due course be unwound to give a boost to economic growth. Indeed, the net inflow of household deposits rose to €56bn, the highest since May, pushing the respective annual growth rate up 0.3ppt to 7.8%Y/Y, the highest since the Global Financial Crisis in early 2009. And while the net inflow of deposits placed by non-financial corporations slowed to €9.3bn, the lowest since January, it still increased the respective annual growth rate by 1.2ppt to a new series high of 21.0%Y/Y.

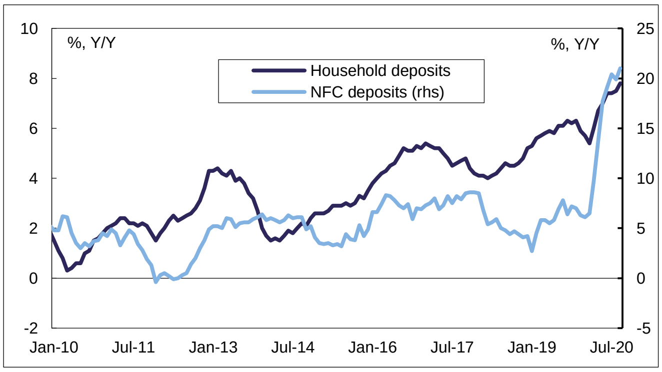
But lending to firms drops for the first time in a year

Meanwhile, on the lending side, adjusted for sales and securitisations, the flow of new loans to households rose in September to €21.5bn, the most since February. That reflected the biggest net monthly flow of loans for house purchase since early 2011, which contrasted with continued stagnant consumer credit. As a result, growth in total loans to households edged up 0.1ppt to 3.1%Y/Y, the most since March. On the same basis, however, loans to non-financial corporations fell for the first time in a year, dropping €10.6bn, with a steep fall in the monthly flow of short-term credit. Nevertheless, given strong net flows over recent months, growth in lending to firms was unchanged at a respectable 7.1%Y/Y. And it is too soon to judge whether the drop in September represents a clear turn for the worse.

Credit standards tighten on pandemic concerns

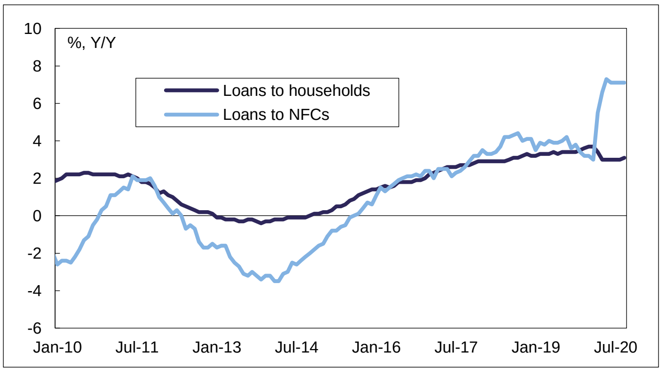
The BLS provided more colour on recent developments in bank lending. In line with earlier expectations, but tallying with the negative flow of lending in September, the survey reported a tightening of credit standards on loans to firms last quarter and expectations of a further tightening in the current quarter. That tightening reflected concerns of vulnerabilities in certain sectors due to the pandemic as well as uncertainties about the future of fiscal policy. It did not reflect banks' own cost of funds or balance sheet considerations. At the same time, while it remained robust in Germany and Italy where manufacturing production accelerated, firms' loan demand in the euro area overall fell last quarter reflecting lower emergency liquidity needs as well as diminished fixed investment plans. France and Spain appeared particularly weak in this respect. In the current quarter, however, banks expect to see a net increase in loan demand from firms, in particular SMEs. Meanwhile, credit standards for housing loans and consumer credit continued to tighten significantly last quarter, due principally to the

Bank deposits



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

Euro area: Bank loans



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

weakening of the economic outlook and diminished creditworthiness of consumers. But, having fallen significantly in Q2, net demand for housing loans and for consumer credit increased in Q3 following the lifting of lockdown measures. Banks expect to see a continued net tightening of credit standards for loans to households for house purchase and a fall in housing loan demand in the current quarter after the surge in such lending in September.

Survey responses suggest that all ECB policy tools continue to support lending

With the ECB likely to be looking soon to add further stimulus, the survey's findings about the impact of its various monetary policy tools were also of interest. And in light of the drop in lending to firms in September, they are likely to have provided some comfort to the policymakers. In particular, banks reported that, over the past six months, the ECB's various asset purchase programmes have had a positive impact on liquidity and market financing conditions. And they also judged that the purchases had contributed to an easing of the terms and conditions on their loans as well as positively impacting lending volumes. Likewise, banks considered that the ECB's negative deposit rate had supported lending and contributed to lower interest rates on loans despite the adverse impact on profitability. They also unsurprisingly welcomed the tiering system for reserve remuneration. But having loaded up on TLTRO-iii funds earlier in the summer to help support increased lending, a more limited percentage of banks expect to participate in the future operations, although a significant share of banks remains undecided.

PEPP purchases likely to remain ECB's preferred tool for action given banks' feedback

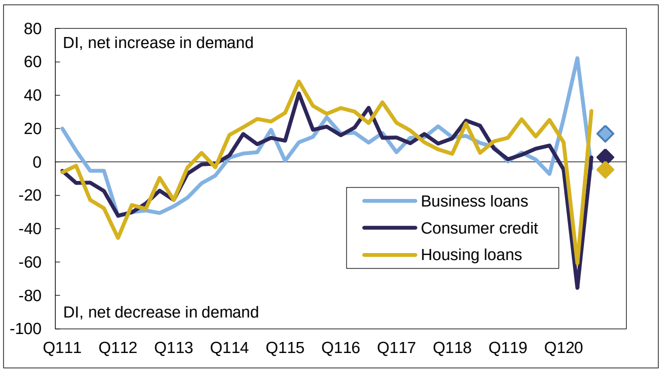
Given the banks' broadly favourable assessment of impact of the various policy tools on lending volumes, today's survey might support the ECB's judgement that an increase in the tiering multiplier is unnecessary. And while there might, in due course, be benefits from extending the TLTRO-iii programme – or indeed further enhancing the attractiveness of the loans under the programme – the survey responses will probably also reinforce the Governing Council's judgement that a further increase in its asset purchases would be the most effective means of adding further monetary accommodation if and when such action is judged appropriate.

The coming two days in the euro area

The key focus in the euro area over the coming two days will be the conclusion of the ECB's latest Governing Council meeting 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. And since then, core inflation has weakened further to a record low with the headline CPI rate dipping below the ECB's forecast. Meanwhile, although GDP growth in Q3 is likely to have been stronger than the ECB's baseline projection, the recent marked intensification of the pandemic and steady re-imposition of restrictions is increasingly taking its toll, particularly in the services sector. So, the ECB's GDP forecast for Q4 is looking too optimistic. And the risks to the near-term outlook appear to be becoming increasingly skewed to the downside. The ECB might also be frustrated that negotiations on the EU recovery fund appear to be bogged down and member states seem reluctant to take advantage of the loans under the scheme. And damaging uncertainty related to the EU-UK negotiations persists too.

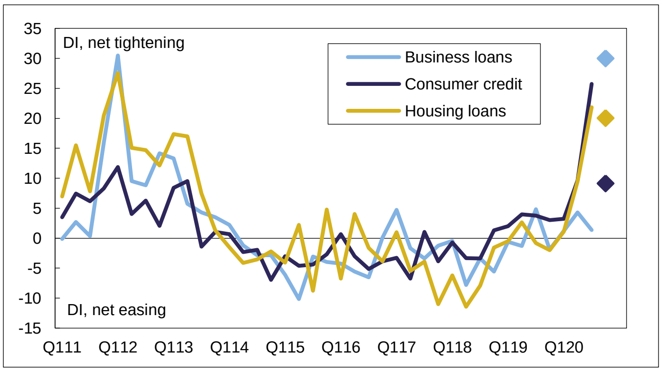
So, the tone of recent commentary from various Governing Council members has unsurprisingly become increasingly dovish. Indeed, even the hawks – e.g. Dutch Central Bank Governor Knot and soon-to-depart Executive Board member Mersch – have acknowledged that more stimulus might be merited in due course. Nevertheless, with a little less than half of the €1.35trn PEPP envelope filled, the Governing Council is unlikely to decide to add stimulus at this week's meeting. Instead, reports have suggested 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, the account of the September meeting – which had a more dovish tone than the press conference – made clear that the PEPP is currently the preferred tool for adding stimulus. And so, in her press conference on Thursday,

ECB Bank Lending Survey: Loan demand*



** Diamonds show expected growth in loan demand in Q420.*
Source: ECB, Refinitiv and Daiwa Capital Markets Europe Ltd.

ECB Bank Lending Survey: Credit standards*



**Diamonds show expected change to credit standards in Q420.*
Source: ECB, *Refinitiv and Daiwa Capital Markets Europe Ltd.*

Christine Lagarde might well give a strong hint that an increase in the PEPP envelope is likely in December.

Datawise, after a quiet day tomorrow, Thursday will bring the Commission's business and consumer confidence indices which are likely to point to a deterioration in conditions in the services sector in October as the resurgence of the pandemic became more widespread across the region. That day will also bring the first of the week's flash October inflation releases from Germany and Spain, as well as German labour market figures for October and the first Q3 GDP estimate from Belgium. German inflation on the EU measure is expected to remain unchanged at September's five-year low of -0.4%Y/Y while the equivalent Spanish figure is expected to decline 0.1ppt to -0.7%Y/Y.

UK

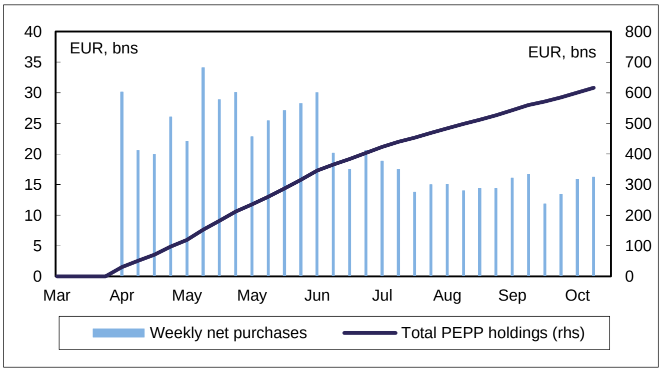
Survey signals drop in retail sales in Q4

Last week's retail sales figures showed ongoing solid demand for goods, with a fifth successive monthly increase pushing growth in sales excluding fuel up to 6.4%Y/Y, the strongest rate in almost four years. However, today's Distributive Trades Survey from the CBI signalled payback in October. According to the survey, the volume of sales fell sharply in the year to October, with a net balance of -23% down from +11% last month. Moreover, sales are expected to dropi at a similar pace in November (-26%). Consistent with that expected softening of demand, orders placed with suppliers were also down markedly (the respective net balance dropped to -39%) and are expected to fall further still next month (-48%). So, the only positive news on the CBI survey regarded internet sales, for which growth picked up to be broadly in line with the long-run average (balance of +47, from +35), with a similar pace of growth expected next month (+47). In light of the burgeoning second wave of pandemic – which once again is proving more deadly in the UK than in any other European country – the increase in online sales at the expense of spending on the high street seems unsurprising.

The coming two days in the UK

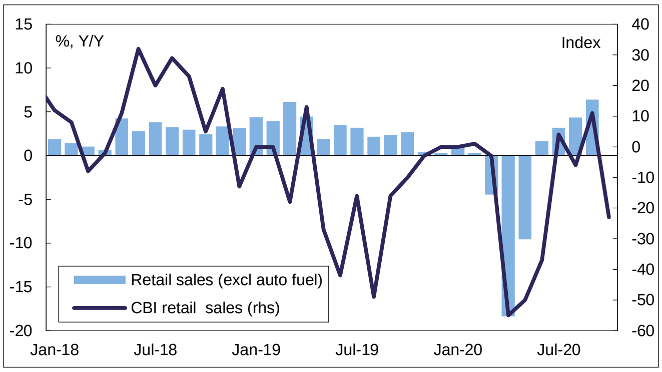
After a quiet day for UK economic releases tomorrow, Thursday will bring the BoE's bank lending figures for September. These are likely to show that demand for consumer credit remained weak last month. In contrast, mortgage lending is likely to have remained relatively robust, with mortgage approvals close to multi-year highs as the clearing of lockdown-related backlogs and the temporary Stamp Duty holiday boosted demand. Thursday will also see the release of the SMMT auto production figures for September.

ECB: PEPP Purchases



Source: ECB and Daiwa Capital Markets Europe Ltd.

UK: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 29 October 2020

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ _Daiwa forecast_	Previous	Revised
EMU		M3 money supply Y/Y%	Sep	**10.4**	9.6	9.5	
UK		CBI distributive trades survey, reported sales	Oct	**-23**	-2	11	

Auctions

Country		Auction
Italy		sold €2.5bn of 2022 zero-coupon bonds at an average yield of -0.26%
		sold €0.75bn of 0.65% 2026 index-linked bonds at an average yield of -0.15%
UK		sold £3.25bn of 2024 bonds at an average yield of -0.017%
		sold £1.0bn of 1.625% 2071 index-linked bonds at an average yield of 0.687%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ _Daiwa forecast_	Previous
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

Auctions and events

Country		GMT	Event
Germany		10.30	Auction: To sell up to €2bn of 2035 bonds
UK		10.00	Auction: To sell £2.5bn of 0.375% 2030 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data

Country		GMT	Release	Period	Market consensus/ _Daiwa forecast_	Previous
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 %	Nov	_0.00_	0.00
		12.45	ECB marginal lending rate %	Nov	_0.25_	0.25
		12.45	ECB deposit rate %	Nov	_-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		07.00	Nationwide house price index* M/M% (Y/Y%)	Sep	0.4 (5.2)	0.9 (5.0)
		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)

Auctions and events

Country		GMT	Event
EMU		12.45	ECB Governing Council monetary policy announcement
		13.30	ECB President Lagarde speaks at post-meeting press conference
Italy		10.00	Auction: To sell up to €2.3bn of 2026 0.5% bonds, up to €3bn of 2031 0.9% bonds and up to €1bn of 2023 floating-rate bonds

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

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