Daiwa Capital Markets

Euro wrap-up

Overview

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- While the final euro area manufacturing PMIs were consistent with growth, Bunds made gains as further member states announced new restrictions on activity and car registrations remained weak.
- Gilts outperformed after Saturday's announcement of a new English lockdown from this Thursday.
- After a quiet day for European data on Tuesday, Wednesday will bring the final services PMIs and German new car registrations data October.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.812	-0.009
OBL 0 10/25	-0.827	-0.003
DBR 0 08/30	-0.641	-0.012
UKT 1¾ 09/22	-0.082	-0.039
UKT 0⅝ 06/25	-0.080	-0.038
UKT 4¾ 12/30	0.217	-0.042

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

Euro area

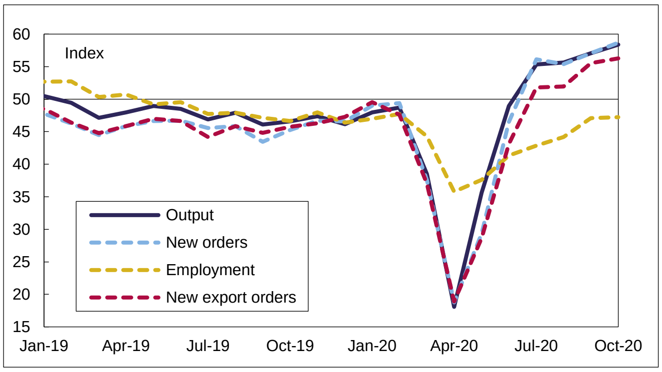
Italy the latest country to tighten restrictions to control spread of Covid-19

Data released at the end of last week reported stronger-than-expected GDP growth in Q3 in the euro area (+12.7%Q/Q) and most member states. But with more governments tightening restrictions on activity to try to restrain the pandemic, euro area GDP now looks bound to decline sharply in Q4, albeit with significant variation from country to country depending on the stringency of the measures concerned. Last week saw France and Belgium take the most aggressive action, closing non-essential retailing as well as most hospitality, leisure and personal services. In contrast, Germany was somewhat more laissez-faire, allowing all retailers to stay open, but closing restaurants, bars and cafes (except for takeaways), hotels (except for business customers), and indoor recreational and cultural services. The weekend saw Austria align itself with the German approach. But while Portugal also announced tighter controls (e.g. the closure of outdoor markets) affecting some 70% of the population, restaurants will be allowed to stay open on a reduced-hours basis. And Italy's PM Conte today announced his own three-tier system for regional restrictions, including the closure of shopping malls at weekends, and schools shifting to online teaching. But those countries with the least restrictive measures could yet be forced to tighten them over coming weeks if pressures on healthcare services become increasingly acute. And the full extent on GDP will also depend on the duration of the restrictions, with risks that enforcement will be required well into December if not beyond.

Final PMIs suggest manufacturing resilience to the second wave

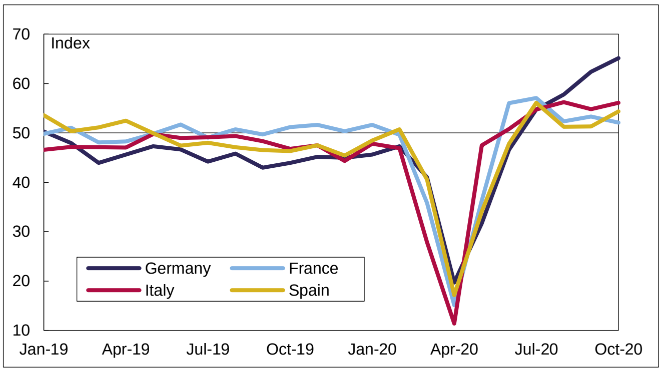
So far, member states have limited their new economic restrictions to services, encouraging firms in other sectors to continue to operate. So, while demand for big-ticket items might be affected by retail restrictions, uncertainty, weaker incomes and confidence, a major hit to the manufacturing sector such as that seen during the spring lockdown, when production in the euro area fell more than 27% between February and April, should be avoided. Indeed, conditions in the manufacturing appear to have been improving at the start of Q4, with the final PMIs for the sector today revised up from the initial estimates and rising in every member state. In particular, the headline euro area manufacturing PMI was revised up 0.4pt from the flash estimate to 54.8, up 1.1pts on the month to the highest since July 2018, with the region's output PMI even stronger at 57.8, the best in 32 months. Germany continued to lead the way, with the respective output PMI revised up to 65.1, a near-decade high and a level rarely beaten on the series. The German manufacturing orders (65.1) and backlog (63.9) PMIs were similarly revised up to point to the likelihood of strong growth in the sector over the remainder of Q4, despite signs of continued job-shedding. And while not as strong as in Germany, the manufacturing PMIs in France (revised up to 51.3), Italy (53.8) and Spain (52.5) also suggested resilience to the pandemic's second wave.

Euro area: Manufacturing PMIs



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

Euro area: Manufacturing ouput PMIs by country



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

Car registrations remain subdued in France, Italy and Spain

One sector to have become much more upbeat over recent months was autos, with the German ifo index of three-months ahead production expectations remaining highly elevated above 40 for a fifth successive month in October. However, judging from today's first indications from the member states, overall demand for cars in the euro area remained extremely subdued last month. In particular, new French car registrations fell 9.5%Y/Y in October, as the impact of government subsidies and dealer incentives waned. Domestic registrations were down 5.8%Y/Y with foreign registrations down a steeper 12.5%Y/Y. And that left total French car registrations in the first ten months of the year at about 1.3mn, down almost 27%Y/Y compared with the equivalent period in 2019 and the lowest number of units registered during that period since 1975. The decline in Spain was even steeper, falling 21%Y/Y, marking the ninth drop out of the past ten months, to be down more than 30%YTD/Y. And while Italian new car registrations fell just 0.2%Y/Y in October, that left still them down almost 24%YTD/Y Looking ahead, the closure of non-essential retailers, including car showrooms, in member states such as France will force far steeper declines this month.

The coming two days in the euro area

After an uneventful day for euro area data tomorrow, Wednesday should bring German new car registrations along with the final services PMIs for October. With hospitality and leisure activity weighed by the resurgence in the pandemic, the flash euro area services PMI dropped 1.8pts to a five-month low of 46.2. And the Italian and Spanish indices, to be released for the first time on Wednesday, are similarly likely to show significant deterioration.

UK

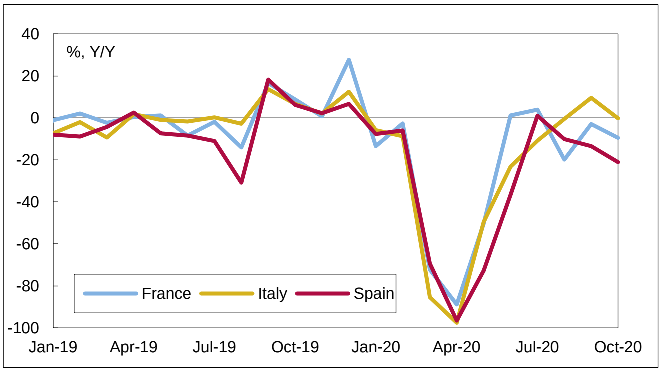
English lockdown 2.0 to kick in from Thursday

Given that it followed weeks of government insistence that such action was unnecessary and would be excessively damaging, Saturday's announcement by Boris Johnson of new English lockdown measures marked just the latest in a series of politically damaging U-turns for the PM. But, as in the UK's closest European neighbours, the case for protecting the health service proved overwhelming. So, from Thursday, as was already the case in Wales, non-essential retailing, including car showrooms, as well as hospitality and entertainment venues and personal care facilities, will close. And non-work related hotel stays and travel abroad will be banned. While the measures will be reviewed on 2 December, the unfavourable dynamics of the pandemic in the UK – not least the recent jump in hospital admissions and deaths due to the virus – means that an extension beyond then would be no surprise. So, while education facilities will remain open this time around, a double-digit percentage drop in services activity – which accounts for about 80% of UK GDP and fell by more than 24% between February and April and almost 20%Q/Q in Q1 when the first lockdown was imposed – is perfectly feasible.

GDP to drop sharply in Q4, so MPC bound to extend its asset purchases this week

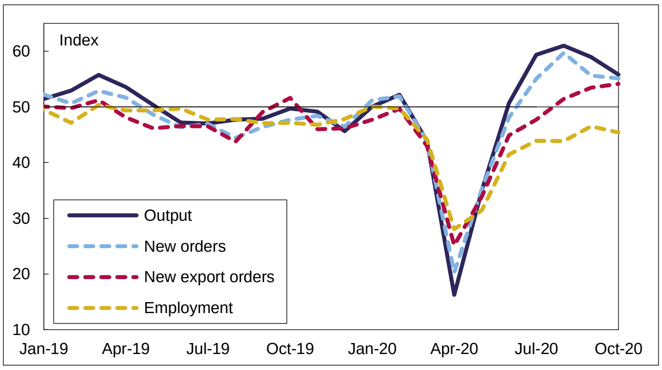
Like in the euro area, today's final manufacturing PMIs suggested that production should at least provide some support to GDP in Q4, even though momentum seems to be fading somewhat. Indeed, despite an upwards revision, the headline manufacturing PMI dropped for the second successive month to 53.7. And the survey detail suggested slightly softer growth in output and new orders as well as an accelerated pace of job cuts. Most importantly, as it accounts for only about one tenth of GVA, the positive contribution to growth from the sector will likely be modest. So, even though the government decided to increase its support for business and extend its Job Retention Scheme to support worker furloughs this month, a marked contraction in overall economic output in the current quarter is now inevitable. It remains to be seen how the BoE will reflect the new lockdown measures in its updated Monetary Policy Report forecasts on Thursday, But as – even before the new restrictions were announced – there was always a strong case for the MPC this week to extend the net purchases into 2021 in order to avoid an unwarranted tightening of financial conditions, the weekend's developments simply reinforce our expectation that the MPC will this week vote for an increase of £100bn in its target to £845bn. And, in terms of forward guidance, the MPC also seems bound to keep the door open to a possible eventual cut in Bank Rate to negative territory if economic conditions warrant such a move once the necessary technical preparations have concluded.

Euro area: New car registrations in member states



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing PMIs



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

The coming two days in the UK

Mirroring the euro area economic data calendar, a quiet day tomorrow devoid of any key UK releases, is followed on Wednesday by the release of the service sector and composite PMIs for October. According to the flash estimates, the headline services activity index, was down 3.8pts to 52.3, its weakest level since June, while the composite output PMI fell 3.6pts in October to 52.9, a four-month low. 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.

The next edition of the Euro wrap-up will be published on 4 November 2020

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Final manufacturing PMI	Oct	**54.8**	54.4	53.7	-
Germany	Final manufacturing PMI	Oct	**58.2**	58.0	56.4	-
France	Final manufacturing PMI	Oct	**51.3**	51.0	51.2	-
	New car registrations Y/Y%	Oct	**-9.5**	-	-3.0	-
Italy	Manufacturing PMI	Oct	**53.8**	-	53.2	-
	New car registrations Y/Y%	Oct	**-0.2**	-	9.6	-
Spain	Manufacturing PMI	Oct	**52.5**	-	50.8	-
	New car registrations Y/Y%	Oct	**-21.0**	-	-13.5	-
UK	Final manufacturing PMI	Oct	**53.7**	53.3	54.1	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
- Nothing scheduled -					

Auctions and events

Country	GMT	Event
Germany	10.30	Auction: €500mn of 0.5% 2030 index-linked bonds
UK	10.00	Auction: £2.75bn of 0.125% 2028 bonds
	10.00	Auction: £2bn of 1.25% 2041 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases						
Economic data						
Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		09.00	Final services (composite) PMI	Oct	46.2 (49.4)	48.0 (50.4)
		10.00	PPI Y/Y%	Sep	-2.4	-2.5
Germany		08.55	Final services (composite) PMI	Oct	48.9 (54.5)	50.6 (54.7)
		-	New car registrations* Y/Y%	Oct	-	8.4
France		08.50	Final services (composite) PMI	Oct	46.5 (47.3)	47.5 (48.5)
Italy		08.45	Services (composite) PMI	Oct	47.1 (49.3)	48.8 (50.4)
Spain		08.00	Unemployment change '000s	Oct	-	-26.3
		08.15	Services (composite) PMI	Oct	40.0 (43.0)	42.4 (44.3)
UK		09.30	Final services (composite) PMI	Oct	52.3 (52.9)	56.1 (56.5)
Auctions and events						
Germany		10.30	Auction: €5bn of 0% 2025 bonds			
UK		10.00	Auction: €3bn of 0.125% 2026 bonds			

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

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