

Euro wrap-up

Overview

- Bunds made modest losses as final euro area inflation data met expectations.
- Gilts made losses as UK inflation data came in above expectations.
- Thursday brings a videoconference of EU leaders to discuss the pandemic, as well as new data on euro area construction activity and the balance of payments, and a UK industrial sector survey.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.739	+0.005
OBL 0 10/25	-0.742	+0.005
DBR 0 08/30	-0.556	+0.008
UKT 1½ 09/22	-0.036	+0.008
UKT 0% 06/25	0.012	+0.009
UKT 4% 12/30	0.333	+0.011

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

Source: Bloomberg

Euro area

Inflation steady in October, with services inflation at a record low

Despite upwards revisions last week from France and Spain, today's final euro area inflation data suggested no improvement in October, with the headline CPI rate unchanged at -0.3%Y/Y, matching the lowest rate since February 2015. There were also no meaningful revisions to the detail. So, for example, the modest increase in food inflation (up 0.2ppt to 2.0%Y/Y was confirmed) while energy inflation was unchanged from September at -8.2%Y/Y). Moreover, as suggested by the preliminary estimates, the moderation in the pace of decline in non-energy industrial goods prices was confirmed (by 0.2ppt to -0.1%Y/Y), while – most striking – services inflation hit a record low of just 0.4%Y/Y. So, core inflation was unchanged at the series low of 0.2%Y/Y. Headline inflation will remain negative over the near term, partly due to the German VAT cut – which will expire at year-end – and past declines in energy prices. But the intensification of the pandemic will also mean that services inflation, particularly in the travel, tourism, recreation and cultural sectors, will remain very weak well into 2021. And further ahead, the impact of past euro appreciation as well as downwards pressure on wage growth will likely keep core inflation highly subdued. So, we expect inflation to remain some way below target over the coming couple of years at least, meriting additional stimulus from the ECB throughout next year.

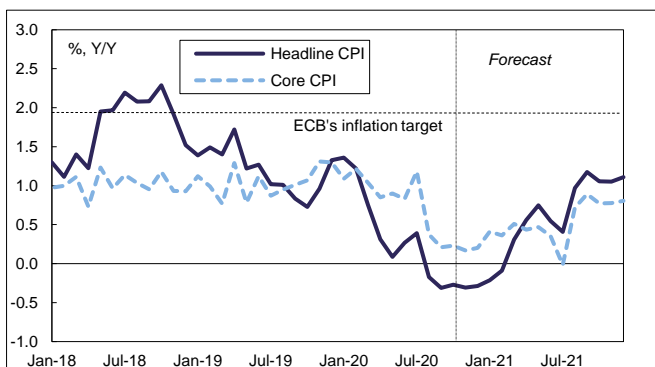
French retail sales accelerated ahead of store closures

Data released today from the Bank of France (which had been postponed from yesterday) suggested that French retail sales remained strong in October ahead of the closure of non-essential retailing this month. On the Bank's measure, sales rose 6.0%Y/Y, up 2.7ppts from September, with strength in sales of food (5.3%Y/Y) and non-food items (6.2%Y/Y) alike. Sales of consumer electronics, DIY-related items, and games and toys were all particularly strong, with the Bank speculating that Christmas-related demand for such items was brought forward in light of concerns that the new lockdown arrangements might extend well into the festive season. A slightly more favourable trend in the number of new coronavirus cases, however, suggests that non-essential retailing will be reopened next month. Restaurants, bars and cafes in France, however, face remaining closed until mid-January.

Euro area car registrations remain subdued

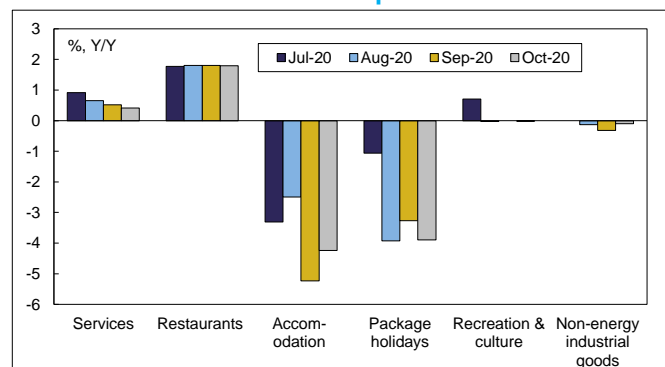
Meanwhile, the European Automobile Manufacturers Association (ACEA) confirmed that the level of new car registrations in the euro area was relatively subdued in October, falling 7.4%Y/Y to be down 27.3%YTD/Y. Despite government incentives and discounting, the intensification of the pandemic likely continued to deter consumers from visiting showrooms. At the country level, new registrations were down more than 9.0%Y/Y in France (-26.9%YTD/Y) and Belgium (-22.8%YTD/Y), and

Euro area: CPI inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Selected CPI components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

fell 21.0%Y/Y and 36.8%YTD/Y in Spain. New car registrations also fell from a year earlier in Germany (-3.6%Y/Y) but were down a negligible 0.2%Y/Y in Italy. On a seasonally adjusted basis, ECB data suggest that new car registrations in the euro area still increased 2.9%M/M last month to the best level since Covid-19 reached Europe. However, there has been no catch-up in registrations to compensate for the lull during the first wave of pandemic. And the current second wave of the pandemic and new restrictions on economic activity – not least in France – seems bound to result in a significant new drop this month.

The day ahead in the euro area

The main event on Thursday will be the EU leaders' teleconference, called ostensibly to coordinate the response to the pandemic. However, it is possible that the leaders' discussions will address the EU's €1.8trn long-term budget for 2021-27 (the multi-annual financial framework, or MFF) and associated Recovery Plan (Next Generation EU), which Hungary and Poland indicated earlier this week that they would veto in protest at moves to allow the suspension of funding for countries where there are concerns about the rule of law. In due course, we do expect a solution to be found, to allow the key EU Recovery and Resilience Facility – under which the EU would seek to borrow up to €672.5bn to pass on to the member states in the form of grants and loans – to be established in the course of 2021. If Hungary and Poland do not back down, those funds would likely need to be raised by a new SPV established, like the ESM, by intergovernmental treaty, rather than the European Commission. On balance, however, we expect the two Central European member states to concede and remove their vetoes – perhaps in return for some kind of non-binding political declaration – if only because their government budgets will be the biggest losers (at the cost of about 11% of GDP each) if the other member states press ahead with the Recovery and Resilience Facility without them. We suspect, however, that the agreement will not be reached until the next leaders' summit on 10 December.

Meanwhile, on the data front, Thursday will bring euro area construction output data for September – following four successive months of growth, output will likely post a sizeable decline due not least to a plunge of 8.4%M/M already reported in France. The ECB's balance of payments data for the same month are also due, and seem set to report a further increase in the current account surplus on account of the increased [goods trade surplus](#), as exports continue to outpace imports.

UK

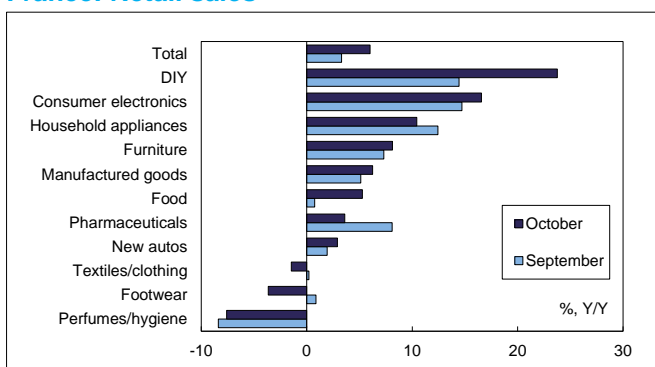
Inflation up in October on higher clothes prices

UK inflation in October beat expectations, rising in both headline and core terms, contrary to the median expectation on the Bloomberg survey of no change to either figure. In particular, headline CPI inflation rose 0.2ppt to a three-month high of 0.7%Y/Y, while core inflation also rose 0.2ppt to 1.5%Y/Y, likewise the highest since July. Within the detail, the pressure came from goods inflation, which rose 0.3ppt to 0.0%Y/Y. And that was due principally to higher inflation of clothes, up 1.5ppts also to 0.0%Y/Y, the highest since February, as prices in this category continued to buck the usual seasonal pattern due to the disruption of the pandemic. In contrast, services inflation was unchanged at 1.4%Y/Y. Firmer inflation of transport services to 1.2%Y/Y, the highest since March, and a slightly more moderate pace of decline of prices in restaurants and hotels (-0.5%Y/Y), was countered by softer inflation of prices of recreation and entertainment (down to a five-month low of 2.0%Y/Y). Among non-core items, food inflation rose 0.8ppt to a three-month high of 0.5%Y/Y, but inflation of electricity, gas and other fuels fell 2.0ppts to -8.8%Y/Y, reflecting the latest reduction in the domestic energy price cap by the regulator Ofgem.

Inflation to jump in 2021, negotiations with EU to determine how far

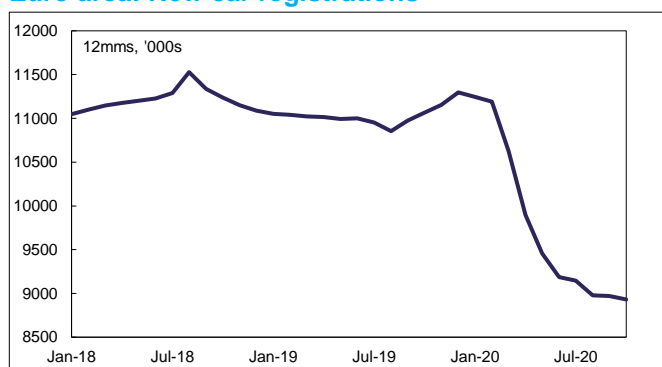
Looking ahead, we expect UK inflation to fall back close to ½%Y/Y in November and December, not least reflecting the intensification of the pandemic, although the closure of non-essential retailing and many services will mean that prices of many items will need to be imputed by the ONS. However, base effects from shifts in oil prices, as well as the end of the

France: Retail sales



Source: Bank of France and Daiwa Capital Markets Europe Ltd.

Euro area: New car registrations



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

hospitality VAT cut at end-March, will push inflation significantly higher from Q2 on, when we expect the headline CPI rate to rise above 1½%Y/Y. Indeed, from the start of the year, there will also likely be some upwards pressure on prices emanating from the increased costs of trade with the EU due to the end of the Brexit transition period. Of course, the extent will depend on whether the UK concludes an FTA with the EU – failure to agree and ratify such a deal would generate very significant upwards pressure, not least through the imposition of tariffs and weaker sterling.

GDP to be hit, even if UK and EU reach a deal

As UK PM Johnson sought only a ‘skinny’ Canada-style trade deal with the EU, even with a new FTA the UK will still leave the Single Market and Customs Union at the end of the year, bringing new burdens for firms that trade between the two blocs related to customs, rules of origin and regulatory checks. And business readiness for those new burdens is low – e.g. the BoE’s DMP Survey suggested that more than 40% of firms in wholesale and retail, manufacturing, transport and storage are either only partially prepared or not prepared at all for the end of the transition period. So, as well as generating higher prices, the new arrangements for trade will highly likely disrupt economic activity at the start of the year – the BoE estimates that the resulting hit to exports, and the associated impact to domestic supply chains, will reduce projected GDP directly by about 1% in Q121. And, even when the initial disruption subsides, trade is likely to be lower, weighing on investment, productivity and demand over the horizon. Indeed, the UK government itself estimated that UK GDP could be reduced by 5% over 15 years compared with what would have happened had EU membership been retained.

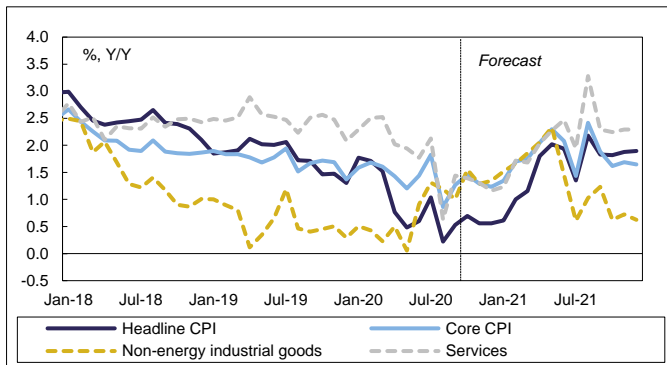
Will agreement be reached next week?

Media reports over the past couple of days suggested that a trade deal with the EU might be reached “early next week”, perhaps as soon as Tuesday. While hopes of a deal this week have faded, the European Parliament might have insufficient time to ratify any deal by the end of the year if negotiations drifted into December, particularly if it becomes preoccupied with resolving the political problems related to the EU budget and recovery funds. So, next week appears a credible time to expect a deal. Such an agreement would likely see the UK sign up to new level playing field commitments (e.g. on state aid, labour and environmental standards) to be overseen by a new independent authority (albeit under UK not EU jurisdiction), in return for somewhat greater control over its fisheries territory.

The day ahead in the UK

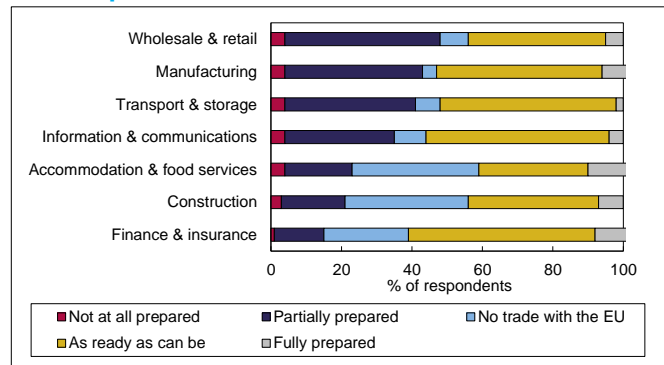
In the UK, Thursday will bring the CBI’s latest industrial trends survey, which is expected to report a weakening in new factory orders on account of continued uncertainty about the UK’s trade arrangements with the EU at the start of 2021.

UK: CPI Inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Preparedness for new EU-UK trade rules









Source: Bank of England Monetary DMP Survey 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	 EU27 new car registrations Y/Y%	Oct	-7.8	-	3.1	-
	 Final CPI (Core CPI) Y/Y%	Oct	-0.3 (0.2)	-0.3 (0.2)	-0.3 (0.2)	-
France	 Bank of France retail sales M/M% (Y/Y%)	Oct	2.8 (6.0)	-	0.1 (2.7)	-0.7 (3.3)
UK	 CPI (Core CPI) Y/Y%	Oct	0.7 (1.5)	0.5 (1.3)	0.5 (1.3)	-
	 PPI input prices (output prices) Y/Y%	Oct	-1.3 (-1.3)	-2.6 (-0.7)	-3.7 (-0.9)	-2.2 (-1.6)
	 House price index Y/Y%	Sep	4.7	2.9	2.5	3.0


Auctions

Country	Auction
Germany	 sold €2.4bn of 0% 2030 bonds at an average yield of -0.57%
UK	 sold £2.5bn of 0.625% 2035 bonds at an average yield of 0.676%




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Italy	 Total trade balance €bn	Sep	5.8	-	3.9	-



Auctions

Country	Auction
Germany	 sold €4.1bn of 0% 2022 bonds at an average yield of -0.74%
UK	 sold £3.25bn of 0.125% 2024 bonds at an average yield of 0.025%
	 sold £2bn of 0.625% 2050 bonds at an average yield of 0.92%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Italy	 Final CPI (EU-harmonised CPI) Y/Y%	Oct	-0.3 (-0.6)	-0.3 (-0.6)	-0.6 (-1.0)	-
UK	 Rightmove house price index M/M% (Y/Y%)	Nov	-0.5 (1.1)	-	1.1 (5.5)	-





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/ <i>Daiwa forecast</i>	Previous
EMU		09.00 ECB current account balance €bn	Sep	-	19.9
		10.00 Construction output M/M% (Y/Y%)	Sep	-	2.6 (-0.9)
Spain		09.00 Total trade balance €bn	Sep	-	-1.7
UK		11.00 CBI industrial trends survey, total orders	Nov	-40	-34

Auctions and events

EMU		08.00 ECB President Lagarde gives introductory statement at European Parliament Hearing			
		15.15 ECB President Lagarde scheduled to speak			
		16.00 ECB's Schnabel scheduled to speak			
		17.00 Video conference of the members of the European Council			
France		09.50 Auction: 1.75% 2023 bonds			
		09.50 Auction: 0% 2026 bonds			
		09.50 Auction: 2.75% 2027 bonds			
		09.50 Auction: 0.1% 2036 index-linked bonds			
		09.50 Auction: 0.1% 2026 index-linked bonds			
Spain		09.45 Auction: 0% 2026 bonds			
		09.45 Auction: 0.8% 2027 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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