Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

- Bunds made gains as national consumer surveys signalled a deterioration of sentiment, euro area bank lending to NFCs remained subdued, and the ECB's flagged growing concerns about the outlook.
- Although late reports hinted that a breakthrough on fisheries might be close, Gilts made gains as reports for much of the day suggested that little progress had been made in the EU-UK negotiations.
- Friday will bring the Commission's economic sentiment survey and the first estimate of French inflation in November.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/22	-0.768	-0.006
OBL 0 10/25	-0.770	-0.012
DBR 0 08/30	-0.589	-0.020
UKT 1¾ 09/22	-0.055	-0.017
UKT 0⅝ 06/25	-0.015	-0.024
UKT 4¾ 12/30	0.278	-0.037

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

Euro area

German and French consumer confidence deteriorates on second wave concerns

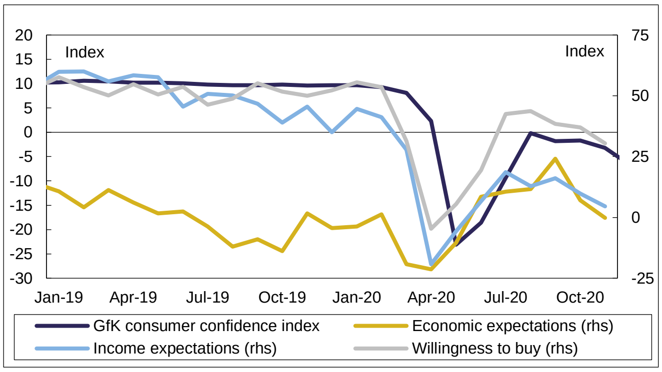
The second wave of the pandemic in the euro area is increasingly taking its toll on consumer confidence, with the latest surveys from Germany and France reporting notable deterioration. With German daily coronavirus cases spiking at a new high and related deaths up to the highest since April, it was no surprise that Chancellor Merkel yesterday confirmed an extension of the country's lockdown-light containment measures – including the continued closure of restaurants, bars and gyms – up to 20 December. And commensurate with the increased concerns about the pandemic and its impact on livelihoods, the GfK survey forecast index for German consumer confidence in December dropped 3.5pts – the most since May – to -6.7, the lowest since July. All main survey components deteriorated, with willingness to buy down to the lowest since June and income expectations falling to the lowest since May.

Likewise, while President Macron earlier this week announced a gradual easing of his (far more stringent) lockdown measures, but extended the closure of restaurants and bars to 20 January, the INSEE survey of French consumer confidence also reported a more downbeat mood among shoppers. Indeed, the 4pt decline in the survey's headline measure was the steepest since April and left the level at 90, the weakest in almost two years and a marked 10pts below the long-run average. Within the survey detail, concerns about unemployment rose to the highest since the euro crisis, perceptions of personal financial situations were considered the least favourable since May, and current conditions were also judged the least suitable for making significant purchases since May.

Bank deposits continue to accumulate, highlighting pent-up demand

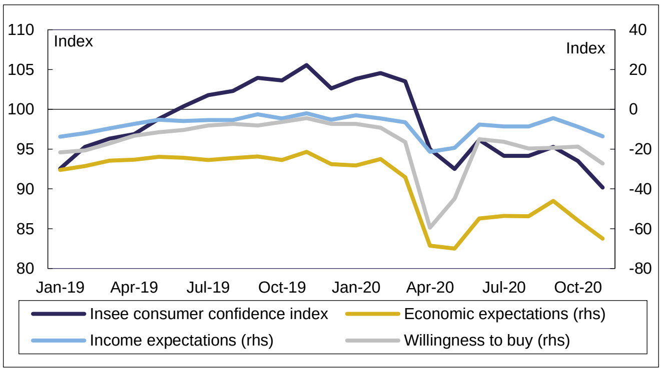
The German and French sentiment surveys affirmed an increased willingness among consumers to save. And today's monetary data from the ECB highlighted the ongoing substantive net inflow to bank deposits associated with such saving, which arguably represents pent-up demand that might in due course be unwound to give a boost to economic growth once the pandemic subsides. In particular, there was a further strong net inflow of euro area household deposits of €43bn in October to take the stock above €7.5trn for the first time, with the annual growth rate up 0.2ppt to 7.9%Y/Y, the highest since the Global Financial Crisis in early 2009. Meanwhile, the net inflow of deposits placed by non-financial corporations in the euro area slowed to €9bn, the lowest since January. However, the annual growth rate remained elevated just below the prior month's series high at 20.5%Y/Y, with the total stock of such deposits of €2.97trn was similarly a record high, reflecting large liquidity buffers at many firms.

Germany: Consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Lending for house purchase remains solid, lending to firms more subdued

Meanwhile, on the lending side, adjusted for sales and securitisations, the flow of new loans to households rose in October to €25bn, the most since February 2008. That reflected continued strong net lending for house purchase, which again contrasted with stagnant consumer credit. As a result, growth in total loans to households remained steady at 3.1%Y/Y, matching the strongest rate since March. On the same basis, having fallen for the first time in a year the previous month, net lending to euro area non-financial corporations rose just €2bn, with the annual growth rate in the stock of such loans dropping 0.3ppt to 6.8%Y/Y, and the recent slowdown broad-based across the member states. Given elevated uncertainty related to the second wave of the pandemic, lower emergency liquidity needs, cautious fixed investment plans as well as a tightening of credit conditions – which ECB Chief Economist Lane today described as "worrying" – we expect firms' loan demand to remain subdued over coming months, and at least until large-scale vaccination programmes are well under way.

Dovish ECB account underscores likelihood of extension to PEPP and TLTROs next month

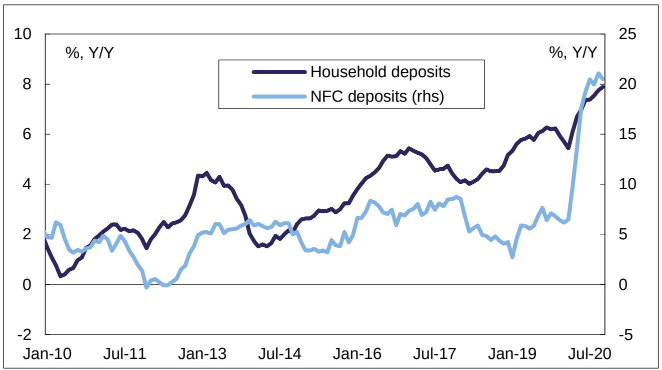
The account of the October Governing Council meeting, when Lagarde announced that policy would be recalibrated in December, provided no major surprises. However, the tone was undeniably dovish, highlighting the increased concern of the ECB about the economic outlook. While GDP growth in Q3 had been stronger than anticipated, Chief Economist Lane acknowledged that some member states, and indeed the euro area as a whole, might experience a double-dip recession due to the pandemic's second wave and associated containment measures. Indeed, restrictions on activity were expected to become more stringent and longer-lasting than during the first wave. Members recognised the uncertainty as to whether the liquidity buffers that firms and households had built up would be sufficient to withstand a renewed deterioration in economic conditions. And they were more concerned about lasting impacts on both demand and supply that might reduce potential growth ahead. It was also noted that headline inflation was now likely to remain negative for longer than forecast in September. Moreover, the view was expressed that, even if there were no further negative surprises, the probability "was increasing" that inflation would be closer to the "severe" forecast scenario whereby inflation remained below 1%Y/Y throughout 2020.

So, there was "wide agreement" among members of the Governing Council on the need to signal the necessity of recalibrating the ECB's monetary policy instruments at the December monetary policy meeting. And while there was a desire to avoid pre-committing to any measures, the account reinforced the recent messages from Governing Council members – hawks as well as doves – that an extension of the PEPP purchases and TLTRO-iii operations is most likely next month. Indeed, the account underscored the view that the TLTROs were effective at providing funding to banks at favourable rates, were thus contributing to low interest rates for bank lending, and had so far successfully averted a credit crunch. Meanwhile, the PEPP was judged to be successful in stabilising market conditions and reducing fragmentation, as well as easing the monetary policy stance, with the in-built flexibility (unlike the regular asset purchases) seen as key to their success. Indeed, with Lane today having emphasised the need to avoid premature steepening of the yield curve even when a successful vaccine programme is being rolled out and recovery is underway, an increase in the PEPP envelope seems certain.

The day ahead in the euro area

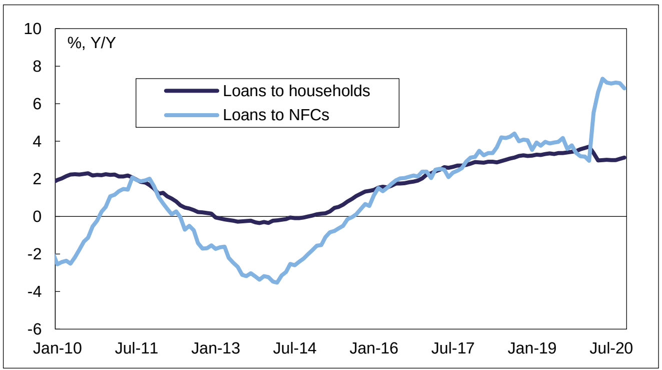
The week will end with a busy day for euro area economic data, with the comprehensive sentiment survey results from the European Commission highly likely to highlight a deterioration in conditions in November to add to expectations of a reversal in euro area GDP in Q4 and continued weakness into the New Year. Italy's Istat will also publish domestic confidence indicators. In France, final Q3 GDP data will confirm that activity bounced back at a record pace close to the current estimate of 18.2%Q/Q, while the country's flash estimates of inflation in October – the first to be published by any of the large member states – are expected to show a drop of 0.1ppt in the EU-harmonised measure back to 0.0%Y/Y, matching September's near 4½ year low. Beyond the economic data, ECB Executive Board members Panetta and Schnabel are due to speak at separate events.

Euro area: Bank deposits



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Bank loans



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK

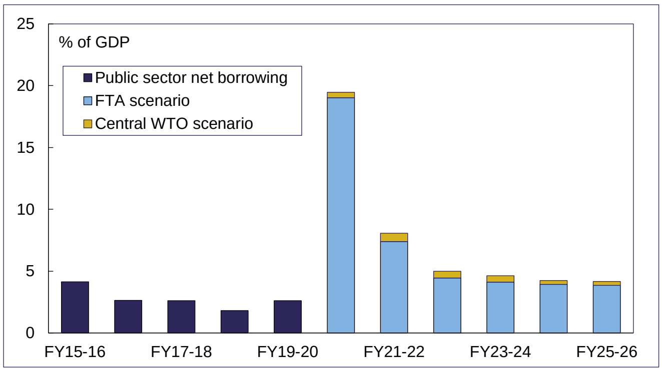
While OBR highlights big hit from no deal, negotiations with the EU appear to make little progress

While there were late hints of a sudden breakthrough on fish – with chief EU negotiator Barnier reportedly having called for a meeting with certain fishery ministers tomorrow – for much of the day the mood surrounding the UK's negotiations with the EU on the post-transition Brexit arrangements was downbeat, suggesting little further progress. Indeed, chief EU negotiator Michel Barnier reportedly told his opposite number that, unless new compromises are offered by tomorrow, he would cancel plans to visit London this weekend to continue talks. Yet, alongside yesterday's announcements from the UK government of new public spending plans and economic and fiscal forecasts, the independent OBR updated its view of the sharply negative impact of a failure to reach a deal. In particular, the fiscal watchdog judged that a default to WTO trading terms from 1 January would leave UK GDP about 2% lower next year than it otherwise would be if an FTA was implemented, with the point at which output regains its pre-virus peak thus pushed back by up to a year. The potential hit from disruption to many sectors – including manufacturing, professional, technical, scientific and financial services – was judged to be greater than for Covid-19. The unemployment rate would peak around 8.3%, 3.5ppts above its current level and almost 1ppt higher than with an FTA. And inflation next year would be about 1ppt higher, peaking above 2.5%Y/Y, due to the imposition of tariffs on imports from the EU and associated weakening of sterling. Moreover, over the longer term, the UK economy would suffer from lower business investment, lower productivity and higher structural unemployment. As such, WTO arrangements would take their toll on the longer-term level of output, with an additional 1½% impact on GDP over the forecast horizon, on top of the 4% hit that is already estimated to result from the UK's departure from the EU if a new FTA is reached. And public sector net borrowing would remain significantly higher over the horizon that it otherwise would be.

Government likely to push ahead with tax rises once pandemic has passed

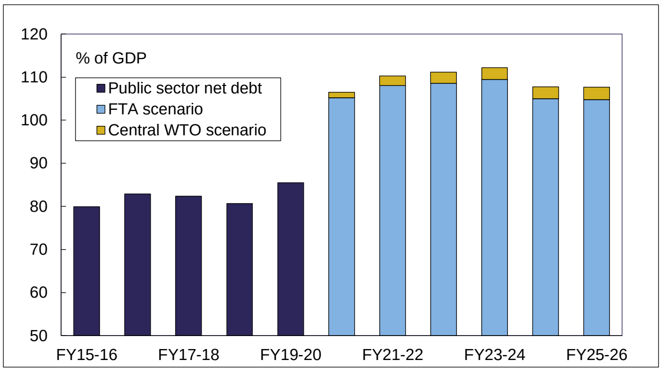
Of course, the OBR's baseline projection, which assumed that an FTA will be implemented, was already downbeat. A contraction in GDP of 11.3% this year is forecast to be followed by growth of 5.5% and 6.6% in the coming two years, so that the pre-Covid peak is not reached until Q422. Scarring from the impact of the pandemic means that the long-run level of GDP is estimated to remain about 3% below that it would have been without the spread of Covid-19. Over the immediate term, a contraction of 2.7%Q/Q in the current quarter is not expected to be fully reversed before Q221. Meanwhile, largely due to the dramatic increase in public spending – which as a share of GDP is estimated to be higher than all other developed economies bar Canada – public sector net borrowing is estimated to rise to 19% of GDP, the highest since 1944-5, this fiscal year, before falling back to 7.4% of GDP next fiscal year and 4.1% of GDP by the end of the parliament in FY2023-4. Public net debt as a share of GDP is forecast to rise by almost 25ppts from last fiscal year to 109.4% of GDP in 2023-4. With the government's current public spending commitments looking too tight to achieve, and two out of the government's three existing fiscal objectives set to be missed, tax rises are likely to be on the agenda as and when a vaccine programme has been successfully rolled out, the pandemic is under control, and sustainable economy recovery appears underway. However,

UK: Public sector net borrowing



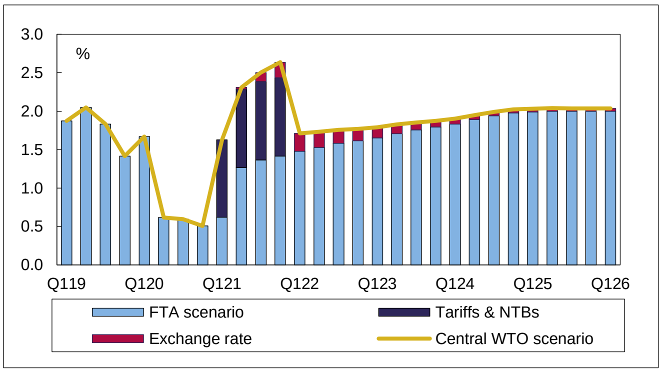
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Public sector net debt



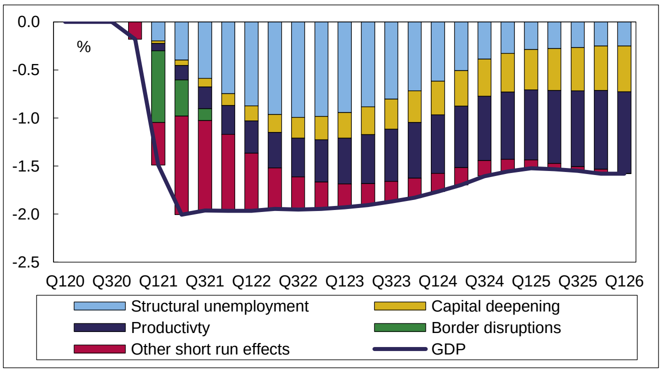
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Inflation forecast under a WTO Brexit



Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Impact of WTO Brexit on GDP



Source: OBR and Daiwa Capital Markets Europe Ltd.

that fiscal tightening is likely to weigh on activity, requiring monetary policy to remain highly accommodative for the foreseeable future.

The day ahead in the UK

In another day bereft of any UK economic data, the focus tomorrow remains firmly on the ongoing Brexit negotiations, with the EU's chief negotiator Michel Barnier expected to brief the 27 member states in the morning about the state of play.

European calendar

Today's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		M3 money supply Y/Y%	Oct	**10.5**	10.4	10.4	-
Germany		GfK consumer confidence	Dec	**-6.7**	-4.9	-3.1	**-3.2**
France		Insee consumer confidence	Nov	**90**	92	94	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Spain		PPI Y/Y%	Oct	**-4.1**	-	-3.3	-

Auctions

Country		Auction
Italy		sold €2bn of 0% 2022 bonds at an average yield of -0.369%
		sold €1.25bn of 0.1% 2023 index-linked bonds at an average yield of -0.84%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		10.00	European Commission economic confidence	Nov	86.0	90.9
		10.00	European Commission industrial (services) confidence	Nov	-10.7 (-15.5)	-9.6 (-11.8)
		10.00	European Commission final consumer confidence	Nov	-18.0	-15.5
France		07.45	Final GDP Q/Q% (Y/Y%)	Q3	18.2 (-4.3)	-13.8 (-18.9)
		07.45	Preliminary CPI (EU-harmonised CPI) Y/Y%	Nov	0.1 (0.0)	0.0 (0.1)
		07.45	PPI Y/Y%	Oct	-	-2.4
		07.45	Consumer spending M/M% (Y/Y%)	Oct	3.5 (1.8)	-5.1 (-1.3)
Italy		09.00	Istat economic sentiment	Nov	-	92.9
		09.00	Istat consumer (manufacturing) confidence	Nov	99.5	102 (95.6)
		10.00	PPI Y/Y%	Oct	-	-3.8
Spain		08.00	Retail sales Y/Y%	Oct	-3.9	-3.3

Auctions and events

EMU		09.30	ECB's Panetta scheduled to speak
		10.00	ECB's Schnabel scheduled to speak
Italy		10.00	Auction: €2.5bn of 0.5% 2026 bonds
		10.00	Auction: €3bn of 0.9% 0.9% 2031 bonds
		10.00	Auction: €2.5bn of 2026 floating-rate bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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