Euro wrap-up

Overview

- Shorter-dated Bunds followed their UST counterparts higher, while the European Commission's consumer confidence index remained close to a series low despite ticking slightly higher in October.
- Despite another poor UK retail sales report, Gilts made large losses as former Prime Minister Boris Johnson appeared to receive greater support, maintaining uncertainty regarding the outcome of next week's Tory leadership vote.
- Along with UK politics, focus in the coming week will be on Thursday's ECB policy announcement, while flash PMIs, inflation and GDP data are due from Germany and France.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	2.021	-0.066
OBL 1.3 10/27	2.210	-0.015
DBR 1.7 08/32	2.433	+0.039
UKT 1 04/24	3.761	+0.185
UKT 1¼ 07/27	4.150	+0.195
UKT 4¼ 06/32	4.082	+0.174

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

Euro area

Euro area consumer confidence ticks higher, but remains close to record low

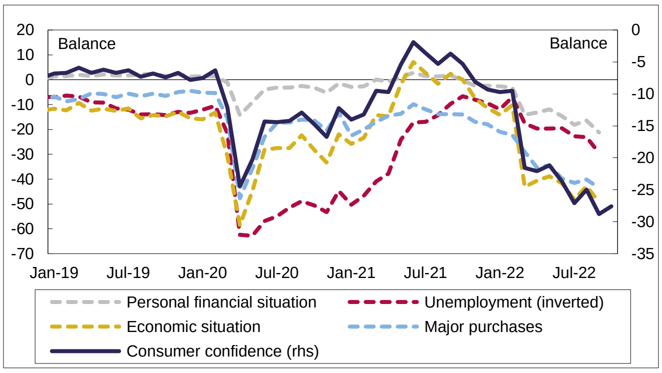
After yesterday's INSEE survey suggested some resilience in French business conditions at the start of Q4, today's European Commission consumer confidence indicator surprisingly signalled a modest uptick in sentiment in October too. Admittedly, the 1.1pt monthly increase still left the index (-27.6) at its second-lowest on record, down more than ½pt on the Q3 average and more than 18pts lower than at the start of the year. Sentiment might well have been given a moderate boost by declining energy prices. However, with double-digit inflation in many member states, borrowing costs set to rise further and recession risks on the up, it is hardly surprising that households remain close to their most pessimistic since the launch of the euro. And while consumer surveys from Belgium and the Netherlands suggested that households were slightly less downbeat about expectations for the economic outlook over the coming twelve months, their respective measures of willingness to spend declined further, suggesting that household consumption will likely weaken at the start of the fourth quarter.

Look ahead to the ECB

The main event of the coming week in the euro area will be Thursday's conclusion of the ECB's monetary policy meeting when another sizeable rate hike is inevitable. Technical adjustments to address issues related to the huge amount of excess liquidity in an environment of positive and rapidly normalising interest rates are also likely.

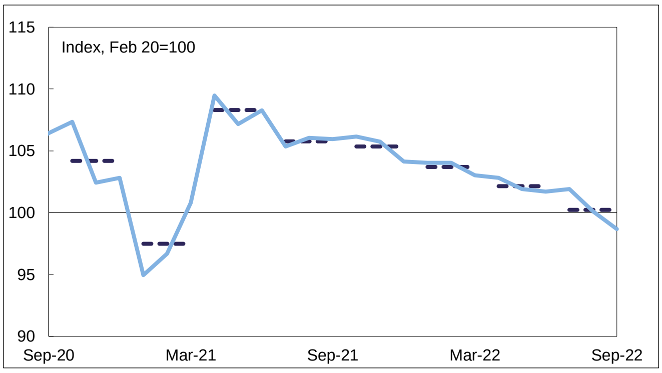
In terms of the main policy stance, for the second successive meeting, we expect the ECB to raise each of its three main policy rates by 75bps. So, in line with the consensus expectation, the deposit rate will rise to 1.50% while the refi rate will reach 2.0%. Admittedly, some members of the Governing Council last month had originally preferred a 50bps hike. But they were all eventually happy to join a consensus for 75bps. And with euro area inflation in September having again exceeded the ECB's forecast, rising to within a whisker of 10%Y/Y, and the euro having depreciated significantly below parity against the dollar since the last monetary policy meeting, all members of the Governing Council will likely agree that real short-term rates are still far from the neutral stance that they hope to achieve by year-end. So, while a dovish minority will still be mindful of rising recession risks, another hike of 75bps this month is likely to be uncontroversial and agreed without dissent. Moreover, while the post-meeting policy statement will likely repeat that future policy decisions will continue to be data-dependent and made on a meeting-by-meeting basis, it will also likely make clear that the Governing Council expects rates to rise again before year-end. And President Lagarde might make clear that the ECB will consider reducing its bond holdings (i.e. quantitative tightening) once interest rate normalisation has been completed.

Euro area: Consumer confidence



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

UK: Retail sales*



**Dashed dark blue line represents quarterly average. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

In terms of technical policy adjustments to address issues related to excess liquidity amid normalising interest rates, a range of measures is possible. Excess liquidity currently exceeds €4trn due to the cumulative effect of past net asset purchases and the TLTRO loans. While the ECB might in the New Year start reducing some of its bond holdings acquired via its regular asset purchase programme (APP), a large share will remain on its balance sheet over the coming couple of years, and the proceeds of maturing PEPP bonds are set to be reinvested at least until the end of 2024. In addition, the last of the TLTRO loans will not mature until December 2024. So, large-scale excess liquidity will likely persist over the coming couple of years. Against that backdrop, certain Governing Council members, including French Governor Villeroy de Galhau, are concerned that positive and rapidly rising rates will offer banks significant risk-free income while also representing a big cost to the Eurosystem. They also fear that the incentives provided to banks might impair the monetary policy transmission mechanism. As such, several policy options appear to have been under consideration. In particular, to sharpen banks' incentives to repay their TLTRO loans without undue delay, it is possible that the Governing Council might decide retrospectively to amend the terms of that long-term liquidity. That, however, might have a reputational cost for the ECB. Alternatively, the ECB might simply introduce a 'reverse-tiering' system to reduce interest paid on deposits above a certain threshold. Whatever precise measure is agreed upon, it will likely reduce total net income for euro area banks by tens of billions of euros in the coming year.

The data week ahead in the euro area

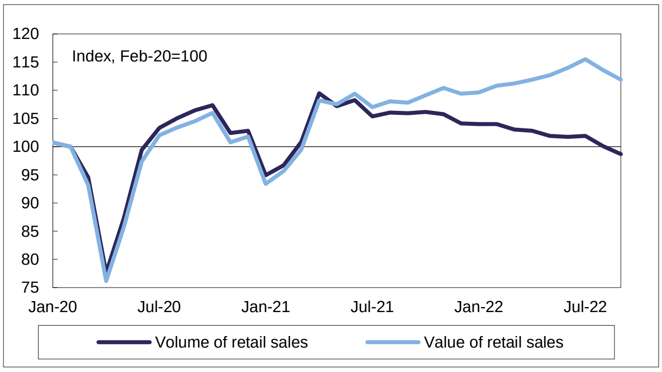
On the data front, it will be a busy week for top-tier releases, including a raft of October sentiment surveys throughout the week, along with the first estimates of Q3 GDP and October inflation from the larger member states (Friday). Sentiment indicators have implied a significant deterioration in conditions over the summer, with the flash PMIs in September suggesting the worst performance in more than two years. The weakness has been particularly evident in Germany, which might report a contraction in Q3 (our forecast is for a slight drop of 0.1%Q/Q), following only a modest increase (0.1%Q/Q) in Q2. Growth is also expected to have slowed in France and Spain, albeit remaining in positive territory at 0.2%Q/Q and 0.3%Q/Q respectively. The flow of economic sentiment indicators continues throughout the week, kicking off with the preliminary PMIs on Monday and concluding with the Commission survey indices on Friday. On balance, the surveys will likely point to a worsening in the economic outlook heading into the final quarter of the year. However, indicators of price pressures and inflation expectations might well ease amid weakening demand. But in terms of actual inflation, we expect Friday's HICP data from the four largest euro area economies to reveal underlying price pressures remained elevated, albeit perhaps hinting that the euro area headline rate of inflation (due for release on 31 October) is close to its peak. Other releases in the coming week include the ECB's latest quarterly Bank Lending Survey (Tuesday) and monthly bank lending numbers for September (Wednesday).

UK

UK retail sales maintain downtrend in September, falling almost 10% below Spring 2021 peak

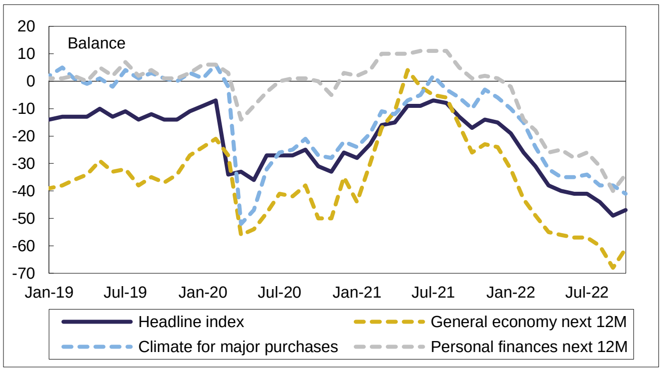
UK retail sales maintained their downtrend in September, as households struggled with falling real incomes and shops were shut for the Queen's funeral. Indeed, retail sales volumes dropped a larger-than-expected 1.4%M/M to be almost 10% below the peak in April 2021 and 1.3% below the pre-pandemic level in February 2020. In addition, with sales in August having dropped an even larger 1.7%M/M, the volume of sales was down 2.0%3M/3M, representing the fifth consecutive quarterly decline. Within the detail, food store sales volumes declined 1.8%M/M in September to be 3.2% below the pre-pandemic level while non-food store sales were down 0.6%M/M and 2.7% below the pre-pandemic level. The extra bank holiday also likely weighed on automotive fuel sales, which dropped 1.3%M/M to be more than 10.2% below the February 2020 level. In nominal terms, the total value of sales was also down 1.4%M/M in September. But given high inflation, it was up 3.8%Y/Y compared to the drop of 6.9%Y/Y in volumes, illustrating again how households are having to spend more to buy less.

UK: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Consumer confidence



Source: Refinitiv. GfK and Daiwa Capital Markets Europe Ltd.

Consumer willingness to spend fell even before government's major fiscal volte face

Looking ahead, the weak trend in sales looks set to continue. Indeed, while it ticked higher in October, the GfK headline measure of consumer confidence was up just 2pts from September's reading of -49, which was the lowest on the series dating back to 1974. Within the detail, households judged that the climate for making major purchases deteriorated to a level that has rarely been worse on the survey – only at the worst point of the Global Financial Crisis and the initial wave of Covid-19. And while expectations for personal finances and the general economic situation over the coming twelve months were not quite as bad as last month, it is notable that the survey was conducted before the government's announcement of a massive U-turn on its proposed tax cuts, with the additional subsequent prospect of less generous support to cope with energy bills and renewed austerity – as well as the disturbing wider political dysfunction – likely to push consumer confidence lower again next month.

The week ahead in the UK

Politics will remain the key focus in the UK in the coming week, with the nomination process for a new Conservative Party leader to close at 14.00BST on Monday. The identity of the next Prime Minister remains uncertain, with just Penny Mordaunt having formally put her hat into the ring at the time of writing. If only one candidate meets the demanding pre-requisite of 100 nominations from Conservative MPs, that person will be appointed as new leader and Prime Minister on Monday. But in the event that more than two are put forward, an initial vote among Conservative MPs will be held on Monday afternoon, with the candidate with the fewest votes eliminated. If and when the field is reduced to two candidates, an unbinding vote among Tory lawmakers will precede an online ballot of party members, with the result then due to be announced on Friday.

At the time of writing, former Chancellor Rishi Sunak reportedly had around half of the 100 MPs required for endorsement and remained the bookies' favourite, although the implied probability of his victory had fallen back to close to 50%* following increased betting momentum behind former disgraced PM Boris Johnson. While Sunak still looks highly likely to receive the backing of a much larger share of MPs than Johnson, the latter might become favourite if he manages to qualify for the vote among party members. However, with Johnson still scheduled to appear before the House of Commons Privileges Committee in November for misleading Parliament, and thus at risk of severe sanction including a possible recall election, his return as Prime Minister would hardly restore credibility or stability to the Government or Tory party. Nevertheless, we will have to wait until Monday to see whether Johnson is able to receive 100 nominations from MPs or will fail to make the cut. And Penny Mordaunt might yet make it to the final two as a compromise candidate.

The coming week's UK economic data calendar focuses on the latest sentiment releases, beginning with the preliminary October PMIs on Monday, followed by the CBI's industrial trends (Tuesday) and retail sales surveys (Thursday), which will provide a first look at economic conditions at the start of Q4. Like in the euro area, we expect to see a further deterioration in manufacturing, services and retail sector sentiment. And the composite output PMI is forecast to point to a faster pace of contraction in October, after falling to a twenty-month low of 49.1 in September.

Daiwa economic forecasts

	2022			2023			2022	2023	2024
	Q2	Q3	Q4	Q1	Q2	Q3			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.8	0.0	-0.2	-0.3	-0.1	0.1	3.2	-0.2	0.8
UK	0.2	-0.5	-0.3	-0.3	-0.5	-0.3	4.2	-1.2	0.1
Inflation, %, Y/Y									
Euro area									
Headline HICP	8.0	9.3	9.8	8.6	6.7	5.1	8.3	5.9	2.0
Core HICP	3.7	4.4	5.0	4.7	3.9	3.2	3.9	3.5	2.0
UK									
Headline CPI	9.2	10.0	10.9	10.2	9.9	8.9	9.1	9.0	4.2
Core CPI	6.0	6.3	6.6	6.2	5.1	4.6	6.0	5.0	3.9
Monetary policy, %									
ECB									
Refi Rate	0.00	1.25	2.50	3.00	3.00	3.00	2.50	3.00	2.25
Deposit Rate	-0.50	0.75	2.00	2.50	2.50	2.50	2.00	2.50	1.75
BoE									
Bank Rate	1.25	2.25	4.00	4.75	4.75	4.75	4.00	4.75	3.75

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

**In yesterday's Euro wrap-up we erroneously typed that the probability of a Sunak victory implied by the bookies' odds was more than 90% at the time of writing; instead, it was more than 60%.*

Daiwa Capital Markets

The coming week's data calendar

The coming week's key data releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast/actual*	Previous
			Monday 24 October 2022			
Euro area		09.00	Preliminary manufacturing (services) PMI	Oct	48.0 (48.3)	48.4 (48.8)
		09.00	Preliminary composite PMI	Oct	47.7	48.1
Germany		08.30	Preliminary manufacturing (services) PMI	Oct	47.0 (45.0)	47.8 (45.0)
		08.30	Preliminary composite PMI	Oct	45.5	45.7
France		08.15	Preliminary manufacturing (services) PMI	Oct	47.0 (51.5)	47.7 (52.9)
		08.15	Preliminary composite PMI	Oct	49.5	51.2
UK		09.30	Preliminary manufacturing (services) PMI	Oct	48.0 (48.0)	48.4 (50.0)
		09.30	Preliminary composite PMI	Oct	48.2	49.1
			Tuesday 25 October 2022			
Germany		09.00	Ifo business climate	Oct	83.8	84.3
		09.00	Ifo current assessment (expectations) balance	Oct	92.7 (75.0)	94.5 (75.2)
UK		11.00	CBI trends, total orders (selling prices)	Oct	-	-2 (59)
			Wednesday 26 October 2022			
Euro area		09.00	M3 money supply Y/Y%	Sep	6.1	6.1
France		07.45	INSEE consumer confidence	Oct	78	79
		11.00	Total jobseekers, '000s	Q3	-	2945
			Thursday 27 October 2022			
Euro area		13.15	ECB deposit (refinancing) rate %	Sep	*1.50 (2.00)*	0.75 (1.25)
Germany		07.00	GfK consumer confidence	Nov	-41.5	-42.5
Italy		09.00	ISTAT business (manufacturing) sentiment indicator	Oct	- (100.0)	105.2 (101.3)
		09.00	ISTAT consumer confidence	Oct	93.0	94.8
UK		11.00	CBI distributive trades survey, reported sales	Oct	-	-26
			Friday 28 October 2022			
Euro area		10.00	EC Economic Sentiment Indicator	Oct	92.5	93.7
		10.00	EC industrial (services) confidence	Oct	-1.0 (3.0)	-0.4 (4.9)
		10.00	EC final consumer confidence	Oct		-28.8
Germany		09.00	Preliminary GDP Q/Q% (Y/Y%)	Q3	*-0.1 (0.9)*	0.1 (1.7)
		13.00	Preliminary CPI M/M% (Y/Y%)	Oct	0.6 (10.1)	1.9 (10.0)
		13.00	Preliminary HICP M/M% (Y/Y%)	Oct	0.4 (10.8)	2.2 (10.9)
France		06.30	Preliminary GDP Q/Q% (Y/Y%)	Q3	*0.2 (1.1)*	0.5 (4.2)
		06.30	Consumer spending M/M% (Y/Y%)	Sep	-	0.0 (-3.8)
		07.45	Preliminary CPI M/M% (Y/Y%)	Oct	0.5 (5.6)	-0.6 (5.6)
		07.45	Preliminary HICP M/M% (Y/Y%)	Oct	0.6 (6.4)	-0.5 (6.2)
		07.45	PPI M/M% (Y/Y%)	Sep	-	2.7 (29.5)
Italy		09.00	PPI M/M% (Y/Y%)	Sep	-	3.5 (50.5)
		10.00	Preliminary CPI M/M% (Y/Y%)	Oct	-	0.3 (8.9)
		10.00	Preliminary HICP M/M% (Y/Y%)	Oct	1.4 (9.7)	1.6 (9.4)
Spain		08.00	Preliminary GDP Q/Q% (Y/Y%)	Q3	0.3 (3.9)	1.5 (6.8)
		08.00	Preliminary CPI M/M% (Y/Y%)	Oct	-	-0.7 (8.9)
		08.00	Preliminary HICP M/M% (Y/Y%)	Oct	-	-0.2 (9.0)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 24 October 2022		
- Nothing scheduled -		
Tuesday 25 October 2022		
Euro area	09.00	ECB publishes its Bank Lending Survey
Germany	10.30	Auction: €4bn of 1.3% 2027 bonds
UK	09.55	BoE Chief Economist Pill speaks at the ONS – 'Understanding the cost of living through statistics'
	10.00	Auction: £800mn of 0.125% 2039 index-linked bonds
Wednesday 26 October 2022		
Italy	10.00	Auction: 2Y fixed-rate bonds and inflation-linked bonds
UK	10.00	Auction: £3.5bn of 0.50% 2029 bonds
Thursday 27 October 2022		
Euro area	13:15	ECB monetary policy announcement
	13.45	ECB President Lagarde holds press conference following the Governing Council meeting
	16.55	ECB's Villeroy speaks at climate finance conference
Friday 28 October 2022		
Euro area	09.00	ECB publishes survey of professional forecasters
Italy	10.00	Auction: 5Y and 10Y fixed-rate bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Government debt/GDP ratio	2021	**95.4**	-	95.6	**-**
	Preliminary EC consumer confidence	Oct	**-27.6**	-30.0	-28.8	**-**
UK	GfK consumer confidence	Oct	**-47**	-52	-49	**-**
	Retail sales including autos fuel M/M% (Y/Y%)	Sep	**-1.4 (-6.9)**	-0.5 (-5.0)	-1.6 (-5.4)	**-1.7 (-5.6)**
	Retail sales excluding autos fuel M/M% (Y/Y%)	Sep	**-1.5 (-6.2)**	-0.4 (-4.0)	-1.6 (-5.0)	**-1.7 (-5.3)**
	Public sector net borrowing, excluding banks £bn	Sep	**20.0**	-	11.8	**9.3**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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