

Euro wrap-up

Overview

- Bunds made losses despite a drop in German consumer confidence to a six-month low.
- Gilts outperformed with gains at the long end as the Burnham government's first budget avoided major surprises with a modest fiscal loosening that left intact a downwards trajectory for borrowing over coming years.
- The ECB will leave rates unchanged on Thursday while the Commission economic sentiment survey and data for UK bank lending and Irish GDP are also due.

Chris Scicluna
+44-20-7597-8326

Edward Maling
+44-207597-8030

Daily bond market movements

Bond	Yield	Change
BKO 3 12/28	3.121	+0.041
OBL 2.9 10/31	3.202	+0.022
DBR 3 08/36	3.368	+0.012
UKT 4 05/29	4.940	-0.001
UKT 4½ 03/31	4.993	-0.010
UKT 4¾ 07/36	5.320	-0.025

*Change from close as at 5:00pm GMT.

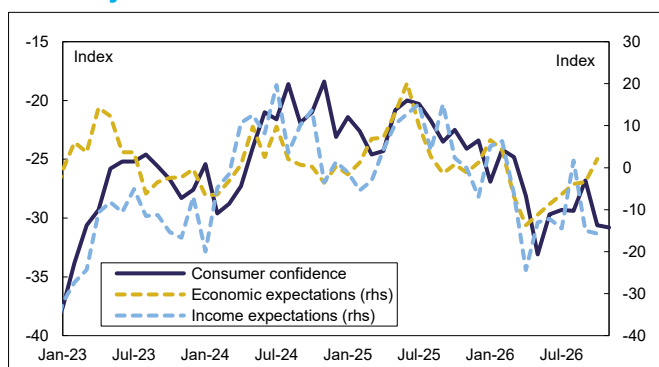
Source: Bloomberg

Euro area

German consumer confidence remains subdued despite brighter economic expectations

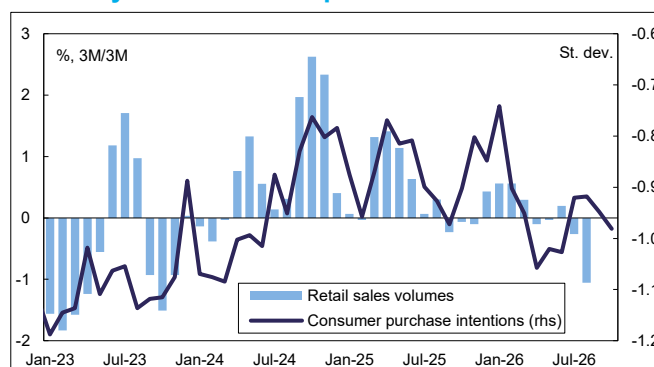
Unsurprisingly, today's GfK German consumer survey was unable to match this week's dramatic deterioration in [French household sentiment](#). But it confirmed that, like their Gallic neighbours, German consumers remain far from optimistic. Admittedly, consumer confidence edged down by only 0.2pts, to -30.8, and so contributed negligibly to the decline in October's Commission consumer confidence number. But given its weakness last month – when Germany was encountering its own flashpoint for political uncertainty in state elections – that reading remained subdued, marking a fresh six-month low and the second-worst in three-and-a-half years. Notably, consumers' income expectations failed to respond as they did in the spring to the reimposition of a temporary fuel tax cut. That likely reflects the diminished expectations for a timely normalisation in petrol prices, as well as the accumulation of more acute price pressures since that date. Expectations of weaker purchasing power also had a dampening effect on consumers' willingness to spend. And given the pullback in retail sales volumes since fuel relief was initially withdrawn at the end of June – down 2% in July-August against the Q2 average – it casts doubt on the potential for a subsequent rebound, particularly as real incomes are likely to be squeezed further by rising inflation at the start of next year. Reassuringly, however, consumers appear to agree with the sentiment conveyed in Monday's [ifo survey](#) regarding Germany's improving near-term growth prospects. Indeed, consumer expectations for the economic outlook rose back above the long-run average for the first time since February. And if that improvement does begin to be reflected in consumers' income expectations, household spending might also eventually gain traction too.

Germany: Consumer confidence indicators



Source: GfK, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales & purchase intentions



Source: GfK, Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

Having raised interest rates in September by a further 25bps – taking the Deposit Rate to 2.50%, the upper limits of its estimates for neutral – we expect the ECB to leave its key rates unchanged on Thursday. For their part, developments in euro area government bond markets have made that assertion considerably easier. Average sovereign yields up to the 10Y have risen between 40-50bps relative to the ECB's latest macroeconomic projections, which policymakers expect to lean against economic activity and cost pass-through. Despite the suggestions of surveys, Q3 GDP growth is also at risk of undershooting those forecasts, and while energy recently pushed headline inflation to a three-year high, warnings of ongoing persistence remain reassuringly absent. So, most Governing Council members have signalled their reluctance to tighten at this juncture – our table of comments can be found in [Friday's Euro wrap-up](#) – at least until they receive updated macroeconomic projections in December. Given the energy prices implied by current futures curves, we would be surprised if those did not justify a more restrictive stance. But, this week, President Lagarde will refrain from precommitting to a particular

rate path. And while she will reassert that the risks to the inflation outlook are skewed to the upside, on balance we might expect her to avoid an excessively hawkish tone.

Beyond monetary policy, Lagarde's press conference is likely to give significant weight to the implications of widening sovereign spreads, as well as the persistent rumours regarding her own potential early departure from the ECB. And if we follow the existing timetable, we could receive some news regarding the ECB's future treatment for its balance sheet too. To recap, excess liquidity has more than halved since 2022 as the passive roll-off of maturing securities held under the ECB's facilities has continued. A further €350bn of public sector bonds held under the Asset Purchase (APP) and Pandemic Emergency Purchase Programmes (PEPP) are due to mature by end-2027, reducing their cumulative holdings close to €3trn. And a potential increase in the ECB's unremunerated minimum reserve requirement, from 1% to 2%, would mechanically reduce excess liquidity further too, even as bank reserves now appear to be getting close to their equilibrium level. Previously, the ECB signalled the potential for it to introduce a new liquidity facility to meet future demand for reserves. But it also flagged the possibility of, at some point in the future, doing so via the creation of a new structural bond portfolio, which could give it plausible cover to start reinvesting some proceeds of maturing bonds, including OATs. Given the current conjuncture for France, and the churn of senior leadership on the ECB Executive Board, the Governing Council might also be reluctant to implement such before new leadership is in place.

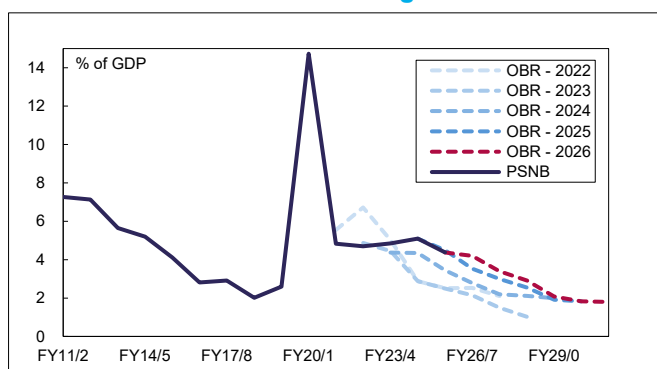
Data-wise, the Commission's economic sentiment indicators will provide a crosscheck for the French-induced moderation in growth momentum flagged by the October flash PMIs, while survey data from Istat will shine a spotlight on developments in Italy. Preliminary Irish GDP data will also highlight any surprises which might distort Friday's euro area estimates.

UK

Gilts unruffled by Burnham government's uneventful first budget

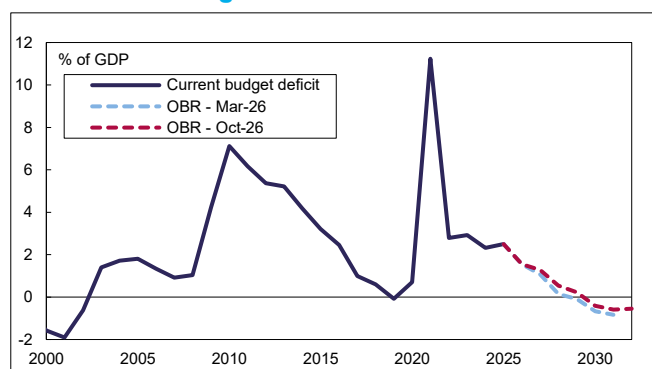
Today's first budget announcement of the new Burnham government was broadly in line with expectations. Chancellor Healey confirmed a modest easing of the fiscal stance, primarily of small measures aimed at easing the cost of living, as well as a little more spending on defence. The budgetary cost of those policies was offset in part by limited revenue-raising measures, including a smaller-than-expected temporary 3ppt increase in the banking levy. So, the overall cost of the measures was a net £6.3bn (0.2% of GDP) in the current fiscal year. Given recent market developments and the energy-driven rise in inflation, the Chancellor also had to budget for higher debt interest costs, which are on track to exceed the OBR's previous forecast by almost £15bn in FY26/7. As a result, the OBR revised up its forecasts of net public borrowing by about ½ppt of GDP this fiscal year and next to 4.2% and 3.4%. But the upwards revisions further ahead were more modest, so that net borrowing is projected to decline below 3% of GDP from FY28/9. And the government's targeted debt measure – public sector net financial liabilities – is projected to peak as a share of GDP at 83.8% in FY27/8 before declining from the end of the decade on. As expected, the government's 'fiscal headroom' within its binding fiscal constraint – to return the current budget to surplus by FY29/30 – was cut by about £10bn to £14.5bn, a shift that seems appropriate given the shock of higher energy prices. Overall, the fiscal measures will have little impact on the profile for economic growth and will knock only about 0.1ppt off inflation next year. And with the increases in the National Minimum Wage and National Living Wage from next April confirmed to be no more than expected at 3.9%Y/Y, with the former weaker than the Labour party's manifesto commitment, today's announcements seem unlikely to have a material impact on the BoE's forthcoming monetary policy decisions. Meanwhile, the DMO's plan for Gilt issuance this fiscal year was revised up by little more than £4bn to £250.6bn, close to expectations, with a slightly bigger increase in the cash requirement to be met with £3bn of extra bills. But the OBR's illustrative gross financing requirement for FY27/28 was more than £20bn below expectations at £312.6bn. So, while Gilts made very modest losses at the short end of the curve, they made modest gains at the longer end.

UK: Public sector net borrowing & OBR forecasts



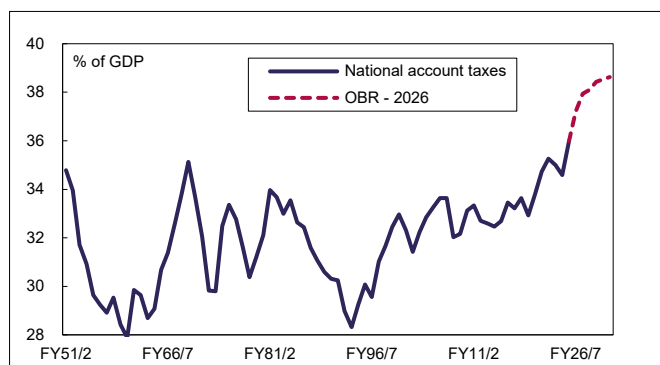
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Current budget deficit & OBR forecasts



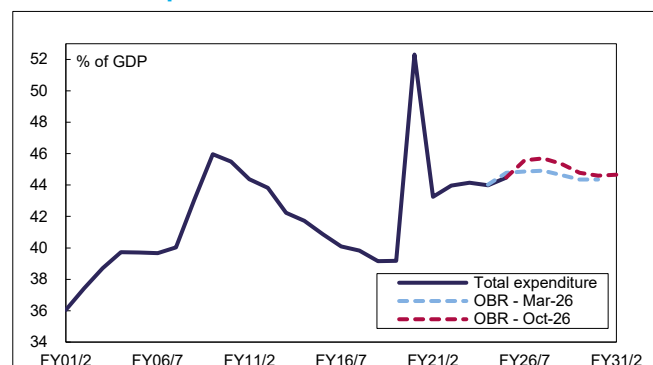
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Tax burden & OBR forecasts



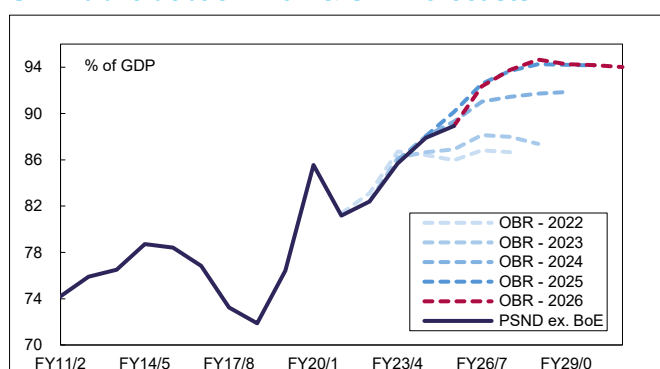
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Total expenditure & OBR forecasts



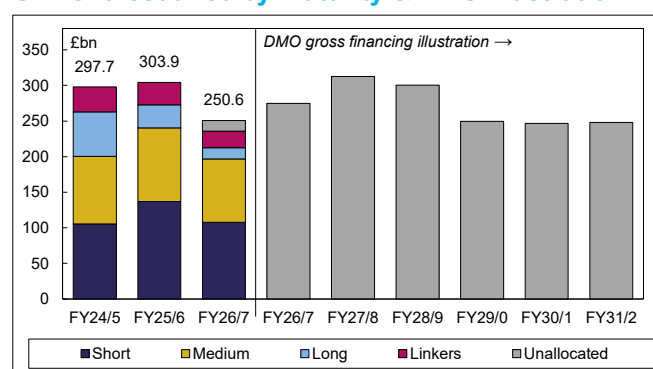
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Public debt ex. BoE & OBR forecasts



Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Gilt issuance by maturity & DMO illustration



Source: DMO and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

While inconsequential to the outcome of next week's monetary policy meeting, September's bank lending data will be the highlight of the UK dataflow on Thursday. Indeed, their release will show whether the further tightening in financial conditions last month dented the surprising resilience of business and consumer lending flows. However, we expect to see further evidence of softness in mortgage lending, not least considering the more pronounced increase in UK mortgage rates, slowing mortgage approvals numbers and pre-Budget apprehension.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	GfK consumer confidence indicator	Nov	-30.8	-30.3	-30.6	-
Italy	PPI Y/Y%	Sep	17.4	-	13.5	-

Auctions

Country	Auction
Germany	sold €3.89bn of 3% 2036 bonds at an average yield of 3.37%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases
Economic data

Country		GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area		10.00	Commission economic sentiment indicator	Oct	97.5	97.9
		10.00	Commission services (industrial) confidence indicator	Oct	5.8 (-3.8)	6.1 (-3.8)
		10.00	Final Commission consumer confidence indicator	Oct	<u>-17.9</u>	-16.5
		13.15	ECB Deposit (Refinancing) Rate %	Oct	<u>2.50 (2.65)</u>	2.50 (2.65)
Italy		09.00	Unemployment rate %	Sep	6.2	6.2
		11.00	Istat economic (manufacturing) confidence indicator	Oct	- (92.0)	95.9 (91.9)
		11.00	Istat consumer confidence indicator	Oct	91.0	91.2
Spain		08.00	Retail sales Y/Y%	Sep	-	-0.4
UK		09.30	Net consumer credit £bn (Y/Y%)	Sep	2.1 (-)	2.5 (9.6)
		09.30	Net mortgage lending £bn (approvals 000s)	Sep	4.2 (54.0)	4.4 (54.9)

Auctions and events

Euro area		13.15	ECB monetary policy announcement
		13.45	ECB President Lagarde to hold post-Governing Council meeting press conference
Italy		10.00	Auction: to sell €1.25bn of 3.5% 2031 bonds
		10.00	Auction: to sell €1.75bn of 3.95% 2032 bonds
		10.00	Auction: to sell €3.5bn of 4% 2036 bonds
		10.00	Auction: to sell €1.25bn of 2036 floating bonds
UK		10.00	Auction: to sell £1bn of 0.25% 2031 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research at:

<http://www.uk.daiwacm.com/ficc-research/research-reports>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited ("DCME"). DCME is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange. DCME and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or derivatives or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of DCME and its affiliates may have positions and effect transactions in such the Securities or derivatives or options thereof and may serve as Directors of such issuers. DCME may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended only for investors who are professional clients as defined in MiFID II and should not be distributed to retail clients as defined in MiFID II. Should you enter into investment business with DCME's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

DCME has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.blumatrix.com/sellside/Disclosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.