Euro wrap-up

Overview

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- Bunds made losses as a survey suggested ongoing gradual improvement in euro area consumer confidence, but BTPs rose as the outcomes of a referendum and regional elections reduced near-term Italian political risks.
- Gilts made losses, particularly at the short end of the curve, as BoE Governor Bailey downplayed the likelihood of a near-term move to negative rates.
- Wednesday will bring the September flash PMIs from the euro area, its largest member states and the UK, and an update on German consumer confidence.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.726	+0.008
OBL 0 10/25	-0.723	+0.011
DBR 0 08/30	-0.517	+0.014
UKT 1¾ 09/22	-0.068	+0.053
UKT 0⅝ 06/25	-0.092	+0.045
UKT 4¾ 12/30	0.187	+0.031

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

Euro area

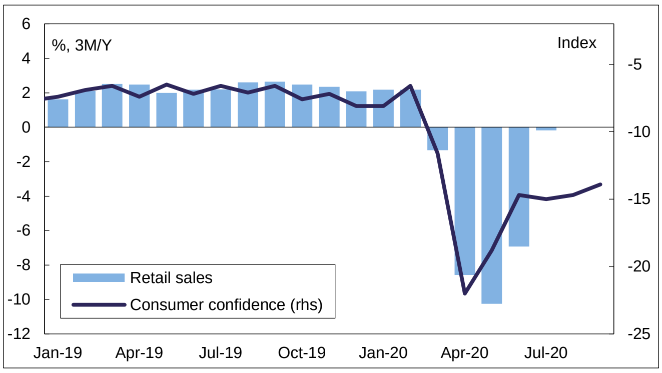
Euro area consumer confidence edges higher despite uptrend in new Covid-19 cases

In a quiet start to the week for top-tier economic data from the euro area, today's flash estimate of consumer confidence in September was arguably most noteworthy. The past month has seen a significant pick-up in new cases of Covid-19 in many countries, particularly France and Spain, bringing new local restrictions to activity in large cities such as Madrid and Lyon. Nevertheless, overall, that has seemingly not prevented a further modest improvement in consumer confidence, with the Commission's flash estimate rising for the second successive month in September, up 0.8pt to -13.9, the highest since March. That, however, still suggested that little more than half the peak-to-trough deterioration in sentiment following the initial lockdown has been reversed. The extension of job support programmes in many member states might have provided comfort to some households. However, unemployment is still rising nonetheless. And the steady increase in cases of Covid-19, and the hit to activity and incomes from the imposition of selective new restrictions might all suggest the likelihood of a renewed deterioration in consumer confidence over the near term.

A satisfactory start to the week for Italy's ruling parties

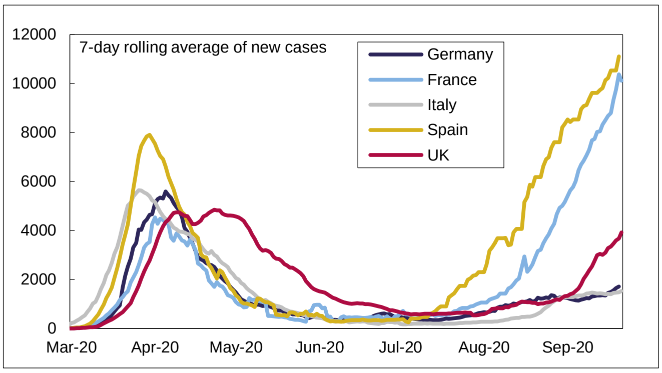
Perhaps the most notable news from the euro area at the start of the week came from Italy, where the two parties making up the national coalition government were able to take comfort from events at the ballot box. In particular, the Five Star Movement (M5S) bolstered its political capital in the referendum on whether to shrink both lower and upper houses of parliament, while the centre-left Democrats (PD) largely resisted the challenges from Salvini's League and its right-wing populist partners in regional elections. In particular, almost 70% of voters approved of the plans, which had been a Five Star flagship policy, to reduce the number of seats in parliament by more than one third. And in the regional elections, the Democrats retained their Tuscan bastion against the right-wing challenger hand-picked by Salvini, winning almost half of the vote there. They also retained two further regions (Puglia and Campania) out of the seven contested. The Eastern region of Marche was the only one where the right, under the guise of the populist Brothers of Italy, took control from the Democrats. While not unambiguous triumphs for either, the results should be enough to strengthen, at least for a while, the leaderships of both Five Star and the Democrats. So, they can now refocus on preparations for next year's budget and plans for spending Italy's share of the EU's recovery funds, which will see Italy receive €44.7bn in grants from the Commission over the next two years and probably more than €20bn in 2023 too. And, thanks to the reduced near-term political risks, BTPs outperformed other euro area government bonds today.

Euro area: Retail sales and consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Daily new coronavirus cases



Source: ECDC and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

The focus in the euro area tomorrow remains on sentiment surveys with the flash September PMIs scheduled for release. Having fallen back in August as concerns about a resurgence in coronavirus cases weighed on confidence, the headline composite PMI is expected to have moved broadly sideways (from 51.9 in August) this month implying a moderation in the pace of recovery at the end of Q3. Separately, however, Germany's forward-looking GfK consumer survey is expected to suggest a further improvement in sentiment. Final Q2 GDP data for Spain and the Netherlands are expected to confirm the sharp falls (-18.5%Q/Q and -8.5%Q/Q respectively) in output previously recorded.

UK

New Covid restrictions to weigh on economic activity

With the number of new UK cases of Covid-19 having risen significantly, to a moving average of more than 4k per day from fewer than 1.5k at end-August, PM Johnson today announced new restrictions on activity, including a 10pm curfew for pubs and restaurants. And, once again, he promoted greater recourse to home-working having just last month actively encouraged workers to return to their offices. So, while recent data suggested that economic activity in Q3 had been stronger than anticipated by the BoE, the downside risks to the outlook from the pandemic appear to have increased. That might be expected to add to expectations of near-term policy easing from the BoE. However, we continue to expect the next move by the MPC to be another £100bn increase in the asset purchase target from November, rather than a further cut in Bank Rate. And that expectation was reinforced by comments today from BoE Governor Andrew Bailey at a webinar hosted by the British Chambers of Commerce (BCC).

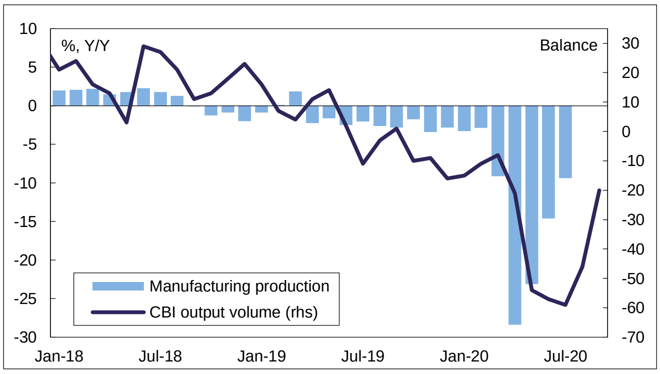
Bailey counters speculation of a near-term move to negative rates

After the MPC left policy, in terms of rates, asset purchases and forward guidance unchanged last week, a mention in the minutes of its technical preparations for a possible future move to negative rates had caused a stir, pushing Gilt yields significantly lower at the short end of the curve. However, responding to questions at the BCC webinar, Bailey today seemingly sought to calm speculation about the MPC's work in this area. In particular, he emphasised the technical nature of the preparations, which were focused on ensuring that computer systems in the financial sector would be able to cope with any shift to a negative (or zero) Bank Rate should the MPC ever decide that such a move was desirable at some point in the future. And he emphasised that such technical work would take time, implying that there would be no decision to implement negative rates over the near term even if the MPC thought such a move might theoretically support growth and inflation. He also noted again that experience of negative rates in other major economies had been mixed. And he cited evidence that such a move might be more beneficial in bolstering an economic recovery that was already underway rather than mitigating the impact of any major new shock, such as might emanate from more stringent lockdown measures or a failure of the UK Government to agree a new FTA with the EU by the end of the year. By calming speculation of an imminent move to negative rates, Bailey's comments saw Gilts today make losses across the curve, and particularly at the short end.

Manufacturing conditions remain challenging as new orders fall back

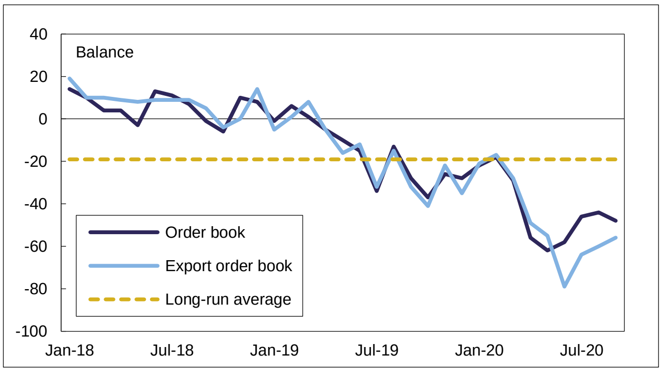
Despite the BoE's assessment that the recent pace of recovery has been slightly faster than previously anticipated, today's CBI industrial trends survey implied ongoing challenges for the manufacturing sector ahead. Perhaps inevitably however, the survey reported a notable improvement in manufacturing output volumes in the three months to September, with the respective balance up 26pts to -20, the highest since March. Moreover, the share of firms reporting a decline in output compared with a year earlier also narrowed for the second consecutive month, with just 10 of the 17 subsectors reporting a fall, compared with 16 in August, and the motor vehicle and transport sub-sector accounting for the largest share of the weakness. But while manufacturers on the whole expect further growth in output over the coming three months, the overall

UK: Manufacturing output and CBI survey



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: CBI industrial trends survey – order books



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

volume was still forecast to be lower than a year earlier. Indeed, order books reportedly remain extremely depressed – the relevant balance fell 4pts to -48 – reflecting ongoing subdued demand both at home and abroad. And not least due to ongoing concerns about the lack of progress in the EU-UK trade negotiations, orders seem likely to remain muted heading into year-end too.

The day ahead in the UK

Like in the euro area, the flash September PMIs will be the UK's data focus tomorrow and will provide greater colour on wider economic conditions. We expect the surveys to point to ongoing solid growth across the sectors, although the conclusion of the government's "Eat out to help out" scheme at the end of August might well see the headline services activity index slip back.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Preliminary consumer confidence	Sep	**-13.9**	-14.7	-14.7	-
UK	CBI industrial trends survey, total orders	Sep	**-48**	-40	-44	-

Auctions

Country	Auction
Germany	sold €4bn of 0% 2022 bonds at an average yield of -0.73%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Spain	Trade balance €bn	Jul	**-0.3**	-	1.5	-
UK	Rightmove house price index M/M% (Y/Y%)	Sep	**0.2 (5.0)**	-	-0.2 (4.6)	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's results

Economic data

Country		BST	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		09.00	Preliminary manufacturing (services) PMI	Sep		51.9 (50.5)	51.7 (50.5)	
		09.00	Preliminary composite PMI	Sep		51.9	51.9	
Germany		07.00	GfK consumer confidence	Oct		-0.8	-1.8	
		08.30	Preliminary manufacturing (services) PMI	Sep		52.5 (53.0)	52.2 (52.5)	
		08.30	Preliminary composite PMI	Sep		54.1	54.4	
France		08.15	Preliminary manufacturing (services) PMI	Sep		50.7 (51.9)	49.8 (51.5)	
		08.15	Preliminary composite PMI	Sep		51.9	51.6	
Spain		08.00	Final GDP Q/Q% (Y/Y%)	Q2		-18.5 (-22.1)	-5.2 (-4.1)	
UK		09.30	Preliminary manufacturing (services) PMI	Sep		54.0 (55.9)	55.2 (58.8)	
		09.30	Preliminary composite PMI	Sep		56.3	59.1	

Auctions and events

Country		BST	Auction/Event
Germany		10.30	Auction: €3.5bn of 0% 2035 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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