

Euro wrap-up

Overview

- Bunds ended the day little changed but periphery bonds made further gains, as the flash euro area PMIs reported a significant loss of momentum in the services sector.
- As the UK Government signalled new support for the labour market, Gilts made losses while the flash UK PMIs pointed to a moderation of economic growth.
- Thursday will bring the German ifo and French INSEE business surveys, alongside a UK retail survey. The ECB will also publish the take-up of its latest TLTRO-III operation.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.714	+0.008
OBL 0 10/25	-0.712	+0.005
DBR 0 08/30	-0.504	+0.002
UKT 1½ 09/22	-0.058	+0.002
UKT 0% 06/25	-0.074	+0.008
UKT 4% 12/30	0.218	+0.017

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

Euro area

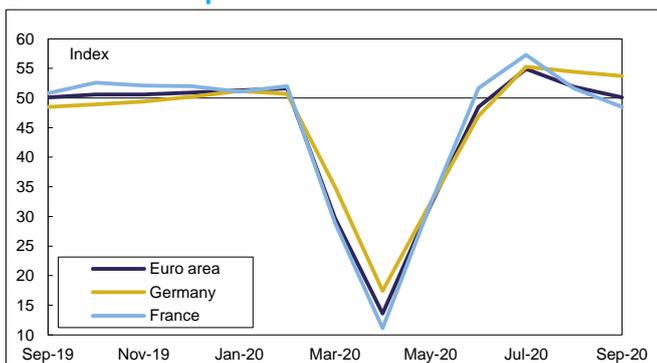
Flash PMIs suggest significant loss of momentum in services

The euro area's flash September PMIs suggested a notable loss of overall economic growth momentum at the end of the fourth quarter. As with much recent data, however, the headline figures masked significant variation between sectors and countries. In particular, the resurgence in the pandemic in many member states appears to have weighed heavily on services. Indeed, the respective euro area PMI fell almost 3pts in September to a four-month low of 47.6 to suggest that the level of activity in the sector has fallen back this month, with the flow of new business reportedly down too. In contrast, growth in the manufacturing sector appears to have stepped up a gear, with the headline euro area PMI for the sector rising 2pts in September to a two-year high of 53.7, with the respective indices for output and new orders (from both at home and abroad) higher still to their best readings since early 2018. Nevertheless, given the weakness in services, the euro area composite PMI fell 1.8pts to a three-month low of 50.1. We would not interpret this indicator strictly to conclude that GDP growth has stalled completely in the current month. But it tallies with other high-frequency data suggestive of a levelling-out in activity. And given the increased number of cities being subject to tighter restrictions in an attempt to contain the spread of Covid-19, there is certainly the risk of a further weakening in services in the coming quarter, which might in due course take its toll on the manufacturing sector too. Perhaps encouragingly, however, the survey also reported that business expectations for the coming twelve months rose to the highest since February as firms anticipate that disruption from the pandemic will eventually ease once again.

Germany faring better than the rest of the euro area

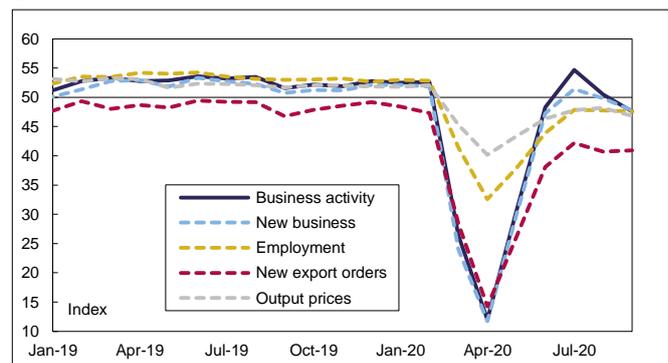
Like the differences in conditions between the sectors, the September flash PMIs reported growing divergences between the member states. Germany continued to lead the recovery, with the manufacturing output PMI suggestive of the strongest growth since January 2018. But even there, the survey pointed to a modest drop in services activity for the first time since June and so the composite PMI moderated to a three-month low of 53.7. In France, where new Covid-19 cases have trended over 10k per day, the PMIs signalled a more marked deterioration in services activity, whose impact on overall economic output was not offset by a modest increase in manufacturing production to leave the composite PMI at 48.5, and thus in contractionary territory for the first month since May. And Markit reported that overall business activity elsewhere in the euro area fell for a second successive month in September, with an increased rate of contraction in services – almost certainly led by Spain, which recently recorded more than 15k new Covid-19 cases in a day – accompanied by slower manufacturing output growth. Meanwhile, the survey suggested that employment fell again, with a more moderate pace of decline in Germany and France partly offset by an accelerated decline in the rest of the euro area. And output prices for

Euro area: Composite PMIs*



*September 2020 figures are flash estimates. Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Euro area: Services PMIs*



*September 2020 figures are flash estimates. Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

goods and services fell the most in three months despite increased input costs. All in all, therefore, the flash PMIs will have provided cause for concern about the economic outlook at the ECB.

German consumer confidence flattening out below pre-Covid level

Meanwhile, after yesterday's Commission flash [euro area consumer confidence](#) indicator reported only a modest improvement in sentiment, today's German GfK survey added to the impression of a loss of recovery momentum, suggesting that the consumer climate in the euro area's largest member state was little changed this month. The headline GfK survey index – presented as a forecast for October – rose just 0.1pt to -1.6, leaving it still some way down from August's post-Covid high of -0.2, which itself was well down from the levels close to +10 at the start of the year. Within the details, consumer income expectations improved as did broader expectations for the economic outlook, for which the respective indicator rose to a two-year high, supported by evidence of a gradually improving labour market amid diminished short-time working. But while still favourable, willingness to buy fell back to a three-month low, suggesting a fading boost from the temporary VAT cut and perhaps wariness over the impact of the renewed rise in the number of coronavirus cases. And, overall, the GfK survey suggested that consumer sentiment in Germany is now levelling off after reversing only a little less than two-thirds of the post-lockdown deterioration.

The day ahead in the euro area

The flow of September sentiment surveys continues tomorrow with the release of the German ifo business climate as well as the French INSEE business indicators. In line with today's flash PMIs these might well paint a mixed picture, flagging divergences in conditions between sectors in the two largest member states with the recent resurgence in COVID-19 cases in France hitting activity more severely. Separately, the ECB will announce the take-up of its latest TLTRO-III operation. Following the extremely high level of participation at the prior operation in June, when 742 banks borrowed €1.31trn, we expect a significantly lower level of take-up from fewer banks this time around. In addition, ECB Chief Economist Lane will participate in a twitter Q&A session and the ECB's latest Economic Bulletin will be published.

UK

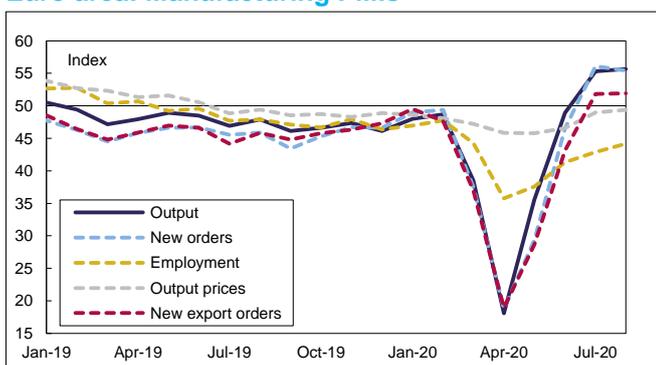
Services PMI points to a moderation of growth

With the number of daily new coronavirus infections having taken a step up over the past month, localised restrictions reintroduced and the government's "Eat out to help out" concluding at the end of August, the pace of recovery in the UK's consumer-facing services sector was widely anticipated to have moderated this month. And today's flash services PMI implied just that, with the headline index declining 3.7pts to 55.1, a three-month low, as firms in transport services, international travel and hospitality continued to cite severely impacted operating conditions. Today's survey also suggested that, even before new national restrictions were announced yesterday, including the closing of pubs and restaurants at 10pm and working from home where possible, firms were seemingly less upbeat about the near-term outlook, with expectations about the year ahead falling to their lowest since May. And with the Government's Job Retention Scheme being phased out, firms in the sector continued to scale back their workforces at a considerable pace.

Manufacturing PMI held up relatively well

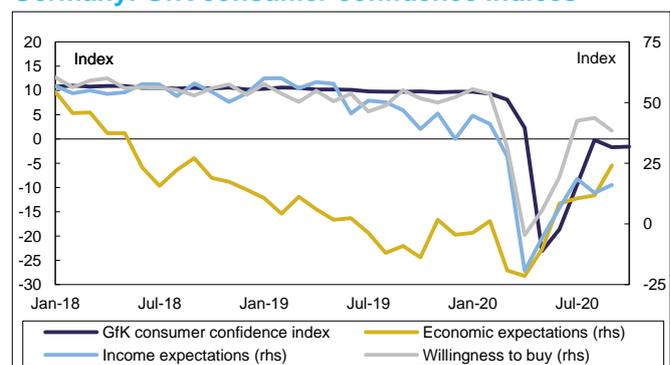
The moderation in growth reported in the manufacturing sector PMI was less marked, with the headline index down 0.9pt to 54.3, while the output component merely reversed the increase in August to leave the index at 59.3, its second-highest reading for almost six years. But while there was a welcome improvement in demand from overseas – the new export orders PMI rose to 54.7, the highest since February 2018 – overall new business supposedly grew at a softer pace in September. And notwithstanding downside risks related not least to the trade negotiations between the UK and EU, production

Euro area: Manufacturing PMIs*



*September 2020 figures are flash estimates. Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Germany: GfK consumer confidence indices*



*October 2020 figure is survey forecast. Source: Refinitiv, GfK and Daiwa Capital Markets Europe Ltd.

expectations for the year ahead remained steady in September, with roughly 60% of respondents forecasting a rise and just 11% expecting a decline. As such, the scaling back in manufacturing employment eased considerably this month.

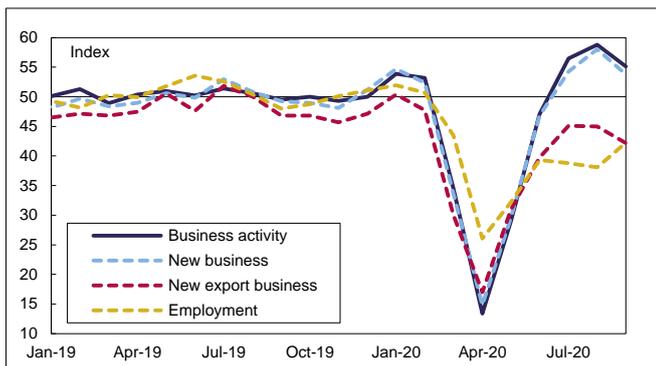
Outlook for Q4 deteriorating

While reports today suggest that the Chancellor is considering new labour market support schemes to replace the Jobs Retention Scheme which is due to conclude at the end of October – perhaps similar to the wage-subsidy programmes in place in Germany and France – we still anticipate unemployment across sectors to rise over coming months. Higher frequency data already suggest a fallback in spending and socialising over recent weeks. And the September composite PMI, for which the flash estimate was down 3.4pts to 55.7, implied a notable slowing in the recovery. Indeed, in reality, output might well have slipped back in September after rapid growth in July and August. Of course, this would not prevent a notable rebound in GDP growth in Q3. But with new containment measures set to be in place for the next quarter or two, we would expect to see surveys weaken further over coming months, as in those euro area countries that have recently seen a spike in Covid-19 cases, suggesting the outlook for UK GDP growth in Q4 remains highly uncertain.

The day ahead in the UK

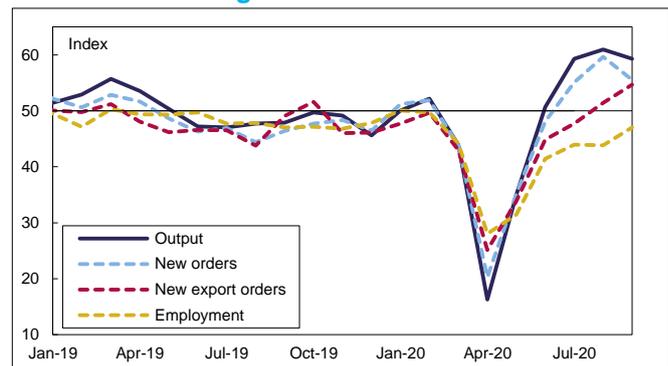
On the data front tomorrow, the CBI will publish tomorrow its September distributive trades survey, which is expected to show a fall back in the headline retail sales balance to -15, from -9 in August to suggest a drop in spending on the high street this month. In addition, Chancellor of the Exchequer Sunak will likely announce new policy support for the labour market. And in the afternoon, BoE Governor Bailey is due to speak at a webinar hosted by the North East England Chamber of Commerce, although he might see unlikely to diverge from his views on [policy](#), including negative rates, voiced at the BCC webinar yesterday.

UK: Services PMIs*



*September 2020 figures are flash estimates. Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing PMIs*



*September 2020 figures are flash estimates. Source: Refinitiv, Markit 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	 Preliminary manufacturing (services) PMI	Sep	53.7 (47.6)	51.9 (50.5)	51.7 (50.5)	-
	 Preliminary composite PMI	Sep	50.1	51.9	51.9	-
Germany	 GfK consumer confidence	Oct	-1.6	-0.8	-1.8	-1.7
	 Preliminary manufacturing (services) PMI	Sep	56.6 (49.1)	52.5 (53.0)	52.2 (52.5)	-
	 Preliminary composite PMI	Sep	53.7	54.1	54.4	-
France	 Preliminary manufacturing (services) PMI	Sep	50.9 (47.5)	50.6 (51.5)	49.8 (51.5)	-
	 Preliminary composite PMI	Sep	48.5	51.9	51.6	-
Spain	 Final GDP Q/Q% (Y/Y%)	Q2	-17.8 (-21.5)	-18.5 (-22.1)	-5.2 (-4.1)	-
UK	 Preliminary manufacturing (services) PMI	Sep	54.3 (55.1)	54.0 (55.9)	55.2 (58.8)	-
	 Preliminary composite PMI	Sep	55.7	56.3	59.1	-

Auctions

Country	Auction
Germany	 sold €3.0bn of 0% 2035 bonds at an average yield of -0.31%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's results

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany	 09.00	Ifo business climate	Sep	93.8	92.6
	 09.00	Ifo current assessment (expectations)	Sep	89.7 (98.0)	87.9 (97.5)
France	 07.45	INSEE business confidence	Sep	94	91
	 07.45	INSEE manufacturing confidence (production outlook)	Sep	96 (2)	93 (-3)
UK	 11.00	CBI distributive trades survey, reported sales	Sep	-15	-9

Auctions and events

Country	BST	Auction / Event
EMU	 09.00	ECB publishes its latest Economic Bulletin
	 -	ECB to publish TLTRO-III operation allotment
Italy	 10.00	Auction: fixed rate and index-linked bonds
UK	 10.00	Auction: £3bn of 0.125% 2026 bonds
	 11.30	Auction: £1.2bn of 0.125% 2028 index-linked bonds
	 15.00	BoE Governor Bailey scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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