Euro wrap-up

Overview

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- Bunds followed USTs lower even as the euro area services PMIs pointed to weakening activity in September, with France and Spain particularly suffering from the accelerated spread of Covid-19.
- While BoE external MPC member Haskel stated that he stands ready to vote for more stimulus and UK new car registration data were weak, Gilts also made losses as the UK services PMIs were revised up.
- Tuesday will bring German factory orders data for August and the European construction PMIs for September.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.711	+0.012
OBL 0 10/25	-0.713	+0.019
DBR 0 08/30	-0.517	+0.022
UKT 1¾ 09/22	-0.026	+0.012
UKT 0⅝ 06/25	-0.039	+0.021
UKT 4¾ 12/30	0.284	+0.038

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

Euro area

Euro area services PMI at four-month low

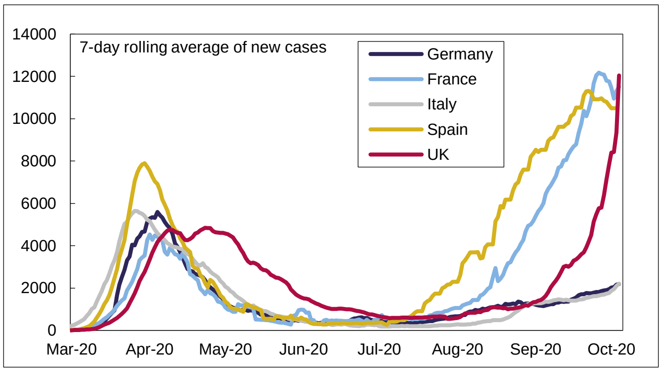
Given the resurgence in coronavirus cases over the past month, today's final euro area services PMI posted a somewhat surprising upwards revision from the flash estimate. Nevertheless, the headline business activity index was still down for the second successive month with the 2½pt drop leaving it at 48.0, the lowest reading since May and consistent with a loss of momentum in the sector. Firms reported a decline in the flow of new business too, with services exports still extremely weak due to ongoing travel restrictions. And so, firms in the sector reportedly continued to scale back their workforces as profit margins remained squeezed by rising operating costs but falling output prices. Despite the upwards revision to both manufacturing and services indices, the euro area composite PMI fell 1.5pts to a three-month low of 50.4. We would not interpret this indicator strictly to conclude that GDP growth has stalled completely last month. But it tallies with other high-frequency data suggestive of a levelling-out in activity.

French and Spanish services severely impacted

There was greater evidence in the PMIs of the diverging fortunes among member states. And inevitably given the surge in coronavirus cases and re-introduction of stricter containment measures in France and Spain, activity in the services sectors in these member states was reportedly more severely impacted. Certainly, the final French services PMI was confirmed at 47.5, a drop of 4pts on the month and almost 10pts lower than July's high. And new business reportedly declined at the fastest pace since May, resulting in firms continuing to cut back staffing, particularly in hospitality. But the decline was even steeper in Spain, where the services PMI fell 5.3pts to 42.4, as a lack of new business related in part to quarantine restrictions on travelers from abroad weighed. As such, the composite PMIs in both countries also fell sharply, down 3.1pts to 48.5 in France and 4.1pts to 44.3 in Spain.

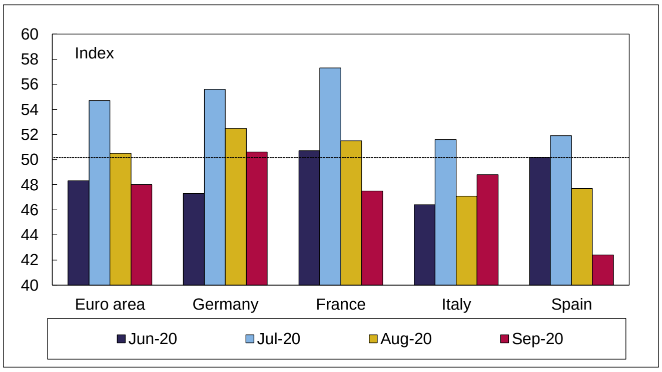
Like with the manufacturing sector, Germany's services firms fared slightly better than previously thought in September, with the final headline index revised up by 1½pts from the flash to 50.6, the strongest reading of all member states, but nevertheless still suggesting a loss of momentum from August (the index was down 1.9pts). But firms continued to signal ongoing recovery in new business. Meanwhile, Italy's services PMI bucked the trend this month, rising 1.7pts from August. But this still remained in contractionary territory (48.8). So, with the exception of Germany, the PMIs suggested that labour market conditions remain pretty bleak, with services firms across member states continuing to cut back employment despite the continuation of government support schemes. And when including manufacturing, Germany's composite employment PMI similarly suggested ongoing redundancies.

New daily coronavirus cases*



*UK figures between 25 September and 2 October relate to the date at which the tests were conducted. Source: ECDC and Daiwa Capital Markets Europe Ltd.

Euro area: Services PMIs by member states



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

Retail sales growth vigorous in August

In addition to the weakening of the services PMIs in September, there was no shortage of evidence of a loss of economic growth momentum in national high frequency data – from declining Spanish credit card spending to flat-lining German truck toll mileage – at the end of Q3. And new restrictions on economic activity in various member states (including the closure of Parisian bars from tomorrow) will further impede growth at the start of Q4. Against that backdrop, the relatively vigorous growth reported in today's euro area retail sales data for August offered relatively little comfort. Having dropped 1.8%M/M in July, euro area retail sales rose 4.4%M/M in August to be 3.1% above February's pre-lockdown level and up 3.7%Y/Y. And that left the average level of sales in July and August more than 10% above the Q2 average. Among the member states, sales were particularly strong in France (6.2%M/M) and Belgium (9.6%M/M) as summer discounting belatedly got underway, with growth in Germany (3.1%M/M) and Spain (1.5%M/M) also positive. While the data have yet to be published, growth in sales in Italy similarly seems likely to have been firm.

Sales likely to slow over the near term

Within the euro area detail, sales of core items (i.e. sales excluding food and fuel) rose a stronger 6.1%M/M to be almost 5% above February's level and up 5.9%Y/Y. Supported by the aforementioned summer sales, purchases of textiles and clothing etc. rose 7.7%M/M but remained more than 10% below their pre-lockdown level. In contrast, following vigorous growth in May and June, sales of electrical goods and furniture fell for a second successive month but were still more than 4% above February's level. Renewed online spending saw non-store sales rise 12.4%M/M to be more than 18% above the pre-lockdown level and up 23.8%Y/Y. Meanwhile, sales of food rose 2.4%M/M to be up 1.4% from February. Sales of auto fuel rose a similar 2.1%M/M, but were still 3.5% below the pre-lockdown level. Given the diversion of spending towards retail items from other services (e.g. spending in bars and restaurants and commuter transport), we expect retail sales to remain above the February level over coming months. Nevertheless, with consumer confidence still some way below pre-Covid levels and the labour market outlook highly uncertain, sales seem bound to slow significantly in Q4 following vigorous growth in Q3.

German car registrations and orders advance

At face value, there was some more positive news with respect to German car registrations, which were up 8%Y/Y in September, the first year-on-year increase since December. But this in part reflected an additional working day than a year earlier as well as comparatively low demand last year due to regulatory changes. Indeed, in the first nine months of the year, the number of cars registered was still down 25%YTD/Y. But while production was still down 11%Y/Y in September, the VDA suggested that new orders were up on a year earlier (4%Y/Y) perhaps boosted by the prospect of the ending of the VAT tax cut at the end of the year.

The day ahead in the euro area

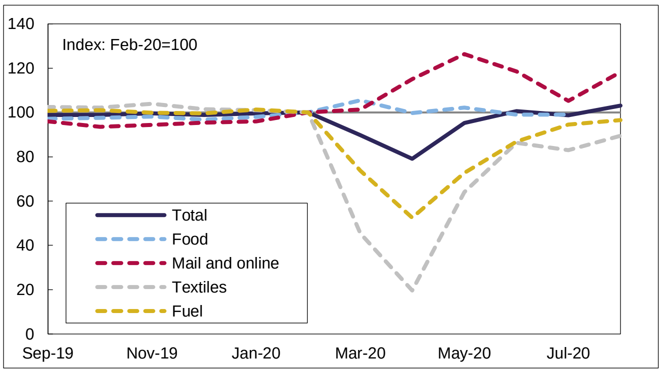
Looking ahead to tomorrow, the euro area economic data calendar includes the release of German factory orders for August, which are expected to show a further rise of 2.5%M/M, illustrating the ongoing recovery in the manufacturing sector. But this would still leave orders well below their pre-pandemic level. Meanwhile, construction PMIs for September, also due to be published tomorrow, are expected to point to a slowdown in activity across the euro area. In addition, we will hear from ECB President Lagarde and Chief Economist Lane, who are both scheduled to speak publicly tomorrow.

UK

Services PMI points to slight loss on momentum

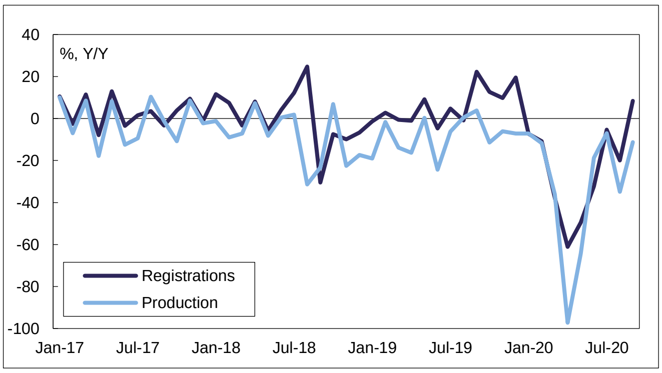
While the number of new daily Covid-19 cases continues to trend higher – with new data published on the weekend suggesting a faster pace than previously estimated last week due to problems with an excel spreadsheet – and has brought the reintroduction of somewhat stricter containment measures over recent weeks in certain consumer-facing sectors, today's final UK services PMI was stronger than initially estimated. In particular, the headline index was revised higher by 1pt to

Euro area: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Car registrations and production



Source: Bloomberg, VDA and Daiwa Capital Markets Europe Ltd.

56.1, nevertheless still leaving it down 2.7pts on the month and at a three-month low. And the survey suggested that those sectors subject to heightened restrictions and more greatly impacted by the conclusion of the 'Eat out to help out' scheme – i.e. hotels, restaurants and catering – saw a downturn in business last month. The recovery in new business also moderated from August. While respondents reported a further rise in operating costs due to the purchase of PPE, employment costs again fell back as firms continued to cut their workforces. And due to competitive pressures, firms in the sector continued to cut output prices. Overall, despite being revised up from the flash release, the final composite output PMI (56.5, a three-month low) still suggested a loss of momentum in the recovery in September. And in reality output might well have slipped back that month 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 the near term.

Car registrations remain in reverse

Today's car registration figures for September certainly suggested that this sector continues to struggle. Indeed, new registrations were down a further 4.4%Y/Y, the weakest reading for a September (when new number plates are released) since 1999. And this followed particularly weak readings in the previous two years due to regulatory changes associated with emissions testing. The weakness was in part driven by subdued demand from businesses. But private registrations were also down a further 1.1%Y/Y in September, to leave them at just 596k units in the first nine months of the year, a drop of 28.9%Y/Y on the equivalent period in 2019. And the near-term outlook for the sector remains subject to significant downside risks, not least due to rising unemployment due to the end of the Government's Jobs Retention Scheme, soft consumer confidence and Brexit uncertainties.

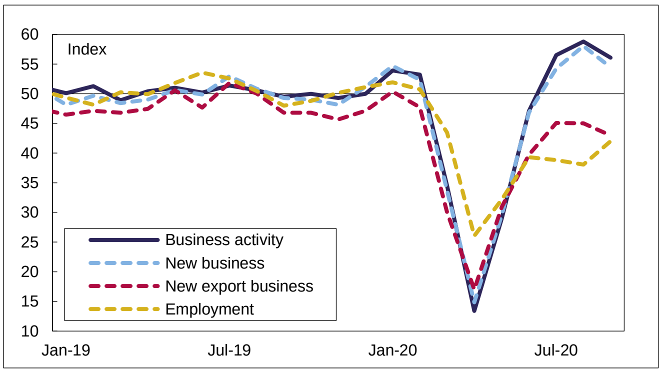
Brexit talks to continue but deal more likely next month than this

Saturday's talks between Commission President von der Leyen and UK PM Johnson concluded with the leaders noting progress in many areas of the post-Brexit relationship, including trade in goods and services. But they also stated that significant gaps remain "notably but not only in the areas of fisheries, the level playing field [i.e. state aid rules] and governance". With the main parameters of an eventual deal on a free trade agreement (FTA) now clear, however, they agreed to shift negotiations into a new "intensified" phase, and it is against that backdrop that the two sides' chief negotiators – Barnier and Frost – will reconvene for new talks in a restricted format with fewer officials on Wednesday. However, at the political level, neither the EU nor the UK is likely to be ready to make meaningful concessions on the remaining issues. So, neither negotiator will receive a political mandate to compromise. And therefore, no matter how intensively the officials negotiate, it is highly improbable that a deal on a new Free Trade Agreement (FTA) will be reached by the time of the next European Council meeting, on 15-16 October. Indeed, such a deal will need to be reached by leaders, not official-level negotiators. And while, on balance, we still expect an FTA to be agreed, we think that milestone will not be reached before the start of next month, when the time pressures associated with the need for ratification by year-end – and hence political needs for a deal – will be much more significant.

The day ahead in the UK

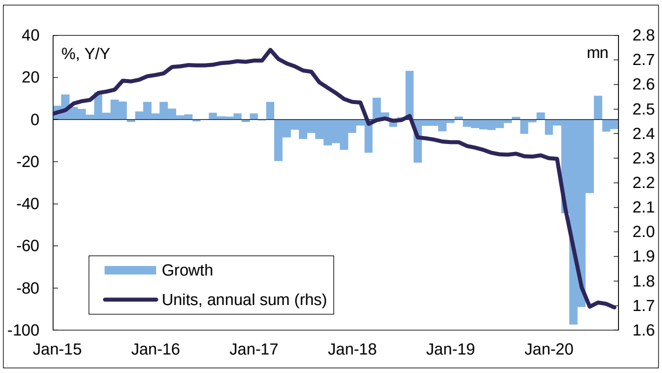
Tomorrow's UK economic data calendar sees the release of the construction PMI for September, which is expected to point to continued growth in the sector.

UK: Services PMIs



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

UK: Car registrations



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Final services (composite) PMI	Sep	**48.0 (50.4)**	47.6 (50.1)	50.5 (51.9)	-
	Sentix investor confidence	Oct	**-8.3**	-9.3	-8.0	-
	Retail sales M/M% (Y/Y%)	Aug	**4.4 (3.7)**	2.3 (2.4)	-1.3 (0.4)	**-1.8 (-0.1)**
Germany	Final services (composite) PMI	Sep	**50.6 (54.7)**	49.1 (53.7)	52.5 (54.4)	-
	New car registrations Y/Y%	Sep	**8.0**	-	-20.0	-
France	Final services (composite) PMI	Sep	**47.5 (48.5)**	47.5 (48.5)	51.5 (51.6)	-
Italy	Services (composite) PMI	Sep	**48.8 (50.4)**	46.6 (49.5)	47.1 (49.5)	-
Spain	Services (composite) PMI	Sep	**42.4 (44.3)**	46.3 (-)	47.7 (48.4)	-
UK	New car registrations Y/Y%	Sep	**-4.4**	-	-5.8	-
	Final services (composite) PMI	Sep	**56.1 (56.5)**	55.1 (55.7)	58.8 (59.1)	-

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	08.30	Construction PMI	Sep	-	47.8
Germany	07.00	Factory orders M/M% (Y/Y%)	Aug	2.8 (-3.8)	2.8 (-7.3)
	08.30	Construction PMI	Sep	-	48.0
France	08.30	Construction PMI	Sep	-	46.0
Italy	08.30	Construction PMI	Sep	-	50.6
UK	09.30	Construction PMI	Sep	54.0	54.6

Auctions and events

Country	BST	Auction / Event
EMU	-	ECB President Lagarde and Chief Economist Lane scheduled to speak
Germany	10.30	Auction: €250mn of 0.1% 2046 index-linked bonds
	10.30	Auction: €500mn of 0.5% 2030 index-linked bonds
UK	10.00	Auction: £3.25bn of 0.125% 2024 bonds
	11.30	Auction: £2bn of 1.75% 2049 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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