Euro wrap-up

Overview

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- As governments in several euro area member states further tightened restrictions on activity in response to the intensification of the pandemic, European equities fell, Bunds made big gains and BTPs sold off.
- Gilts rallied as the UK government announced new restrictions in London and other English regions.
- Friday will bring updated euro area data on goods trade, car registrations and inflation, while UK PM Johnson will respond to the EU summit discussions on the Brexit post-transition negotiations.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.785	-0.030
OBL 0 10/25	-0.801	-0.031
DBR 0 08/30	-0.622	-0.038
UKT 1¾ 09/22	-0.069	-0.013
UKT 0⅝ 06/25	-0.086	-0.024
UKT 4¾ 12/30	0.169	-0.048

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

Euro area

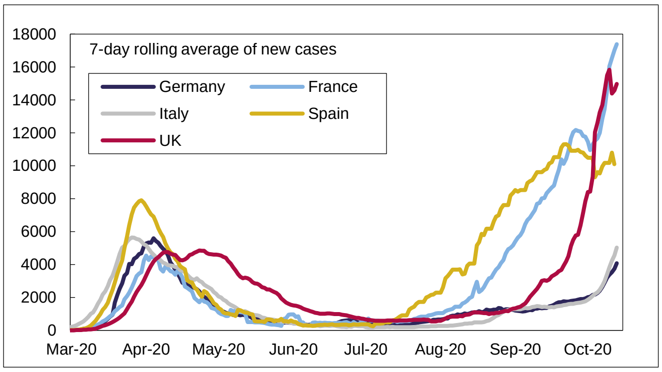
Tightening of restrictions to push recovery momentum back into reverse

While the week has been a relatively quiet one for new economic data from the euro area, it has been significant in terms of the pandemic, with several governments tightening restrictions on activity in an attempt to reverse the jump in new Covid-19 cases. Following the announcement earlier in the week that the Netherlands would close all bars and restaurants for at least four weeks, yesterday evening saw French President Macron announce a night-time curfew (from 21.00 to 06.00), affecting Paris and eight other cities accounting for about 28% of the national population, similarly for at least four weeks. Germany also announced new restrictions in additional 'hotspots', limiting social gatherings and extending a (less draconian) curfew for pubs and restaurants (from 23.00). With the exception of the Netherlands, the measures do not seem sufficiently stringent to have a large-scale impact on growth. Indeed, in France, drinking places account for only about 0.1% of GDP. But they represent a renewed blow to confidence in the hospitality sector, which had been struggling to recover from the initial lockdown. And the Parisian curfew will hit a region which – not least due to the shock tourism – was already harder hit than most in France and had subsequently seen a slower recovery. Given the broader impact on sentiment, the flash October PMIs, due on 23 October, seem bound to report further deterioration in services, with the euro area composite PMI likely to fall back below the key 50 level for the first time since June suggesting a reversal of momentum at the start of Q4.

Intensified pandemic strengthens case for more stimulus in December

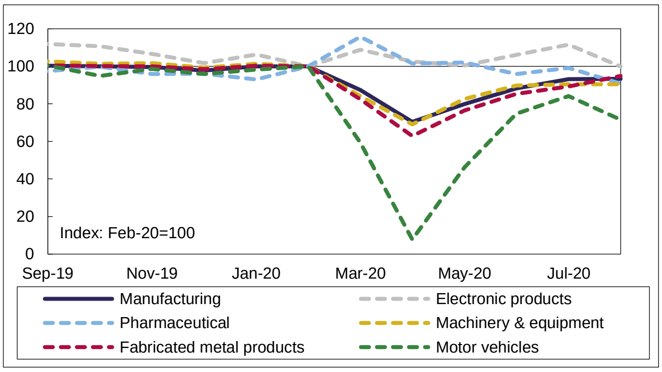
As the ECB continues to mull the appropriateness of whether, and if so when and how, to add further stimulus, even one of the more hawkish Governing Council members – Dutch Governor Knot – this week acknowledged that the recent surge in coronavirus cases, and associated new restrictions, "will flatten the recovery". And with other members of the Executive Board – including Chief Economist Lane and Italian representative Panetta – having emphasised that the ECB's most recent inflation projection was inconsistent with its target, the deterioration in the economic outlook clearly strengthens further the case for more stimulus. In order to be able to calibrate the policy response most effectively, and give enough time to reach a consensus too, the Governing Council will likely wait for updated economic projections in December before amending policy again. Indeed, comments from Lagarde and Lane earlier this week both suggested that, while an unattributed report on Bloomberg today also underscored that impression. But while some members (e.g. the relatively marginalized and soon-to-depart Mersch) have reminded that the ECB's forward guidance leaves open the possibility of further rate cuts, Lane's weekend WSJ interview made clear that near-term rate cuts were unlikely to be desirable. And with the account of the September policy meeting having stated unambiguously that extra asset purchases under the PEPP programme remained the preferred tool for further action, we continue to expect an increase in the PEPP envelope of about €650bn to €2trn at the December Governing Council meeting.

Euro area and UK: Coronavirus cases



Source: ECDC and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Manufacturing sector slowed in August, but revival in Italian orders offers encouragement

While activity in many services – not least transport, tourism and leisure activities as well as hospitality – remains a long way from the pre-pandemic level, industrial output has made somewhat greater progress in narrowing the gap. Indeed, the rise of 0.7%M/M in euro area industrial production (excluding construction) in August, reported yesterday, left it some 5.7% below February's level, thus reversing about four-fifths of the initial peak-to-trough decline due to the first-wave lockdown. The detail of the report was disappointing, however. With overall production buoyed by increased energy generation, which returned to its pre-pandemic level, manufacturing output rose just 0.2%M/M to be still 6.6% below February's level. Declines in output in autos, pharmaceuticals and computers and electronics largely offset gains in consumer durables, metals and associated products, and electrical machinery. And growth would have been negative had it not been for the 7.7%M/M surge in Italy to above the pre-pandemic level, led by increased production of transport items to a two-year high. Today's Italian industrial sector data for the same month reported a surge in orders of 15.1%M/M to be up 6.1%Y/Y in nominal terms, with double-digit percentage growth in transport goods, electrical items and domestic appliances, and clothing. The recovery in external orders, up 5.3%Y/Y in volume terms, was firm, with demand from China evidently providing an important source of growth. Indeed, Chinese imports from Italy rose almost 40%Y/Y in September. But encouragingly, domestic industrial orders were up 6.8%Y/Y, suggesting that Italy's manufacturing sector recovery is running on more than one engine.

The day ahead in the euro area

Turning to the day ahead, euro area goods trade figures are expected to reflect improving demand at home and abroad in August. But consistent with the more recent slowing of momentum, euro area new car registrations numbers for September, also to be published tomorrow, will confirm that auto sales remained extremely subdued. Tomorrow also brings the release of the Bank of France's latest retail sales estimates for September. Meanwhile, final CPI releases for September will conclude with the release of Italian and euro area inflation data tomorrow. According to the preliminary estimate, euro area inflation fell 0.1ppt to -0.3%Y/Y, the weakest reading since early 2015. While that in part reflect a steeper pace of decline in energy inflation, core inflation fell 0.2ppt to a series low of 0.2%Y/Y. The final figures from Germany, France and Spain confirmed the respective flash estimates.

UK

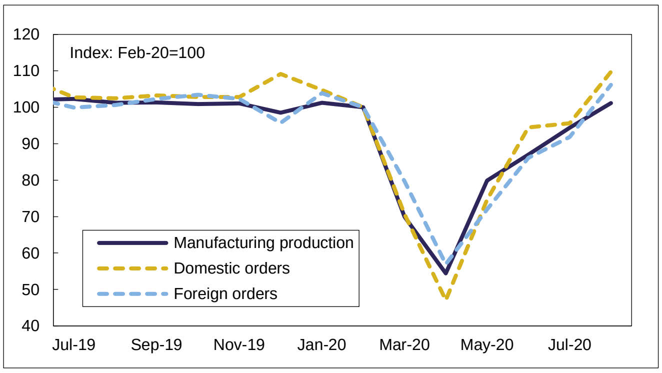
Increased restrictions to be imposed on London and other cities

Just as in the EU, tighter localised restrictions are being imposed on activity in several English regions in a belated attempt to regain control of the pandemic. London, Essex, York and other areas face bans on households mixing in restaurants and pubs from Saturday. Moreover, tougher restrictions will be placed on Manchester and Liverpool, which are currently more severely impacted. With less generous financial support on offer from the government for businesses most affected by the restrictions, however, the moves might accelerate the labour market shakeout already underway, and accentuate a levelling off of the UK economic recovery that has been evident in many recent data series, including transport use (see chart).

Loan supply and demand evolving as expected to changing economic circumstances

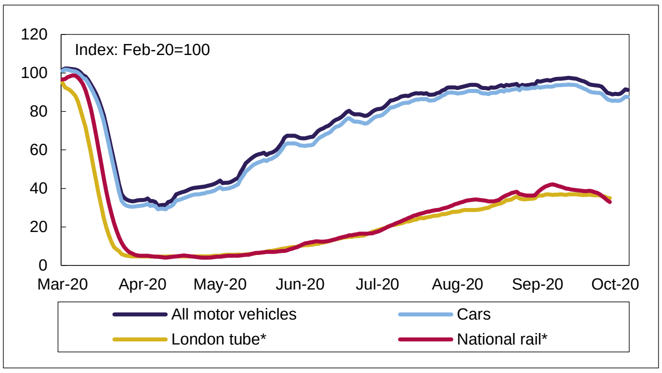
The BoE's latest quarterly credit conditions survey provided no major surprises, with loan supply and demand responding in the expected way to changing economic circumstances. Banks reported that the availability of secured credit to households increased slightly in the three months to end-August 2020 to meet increased demand for loans for house purchase as the housing market rebounded from the lockdown-related lull. Lenders expected the availability of secured credit and the demand for house purchase to remain unchanged over the three months to end-November. But demand for re-mortgages was expected to take advantage of lower interest rates. With redundancies up at a record pace, credit scoring criteria for secured loans to households had unsurprisingly tightened last quarter and were expected to tighten slightly further in the current quarter. Banks also reported a decline in the availability of unsecured credit to households over the past quarter and

Euro area: Italian manufacturing output and orders



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

UK: Transport use



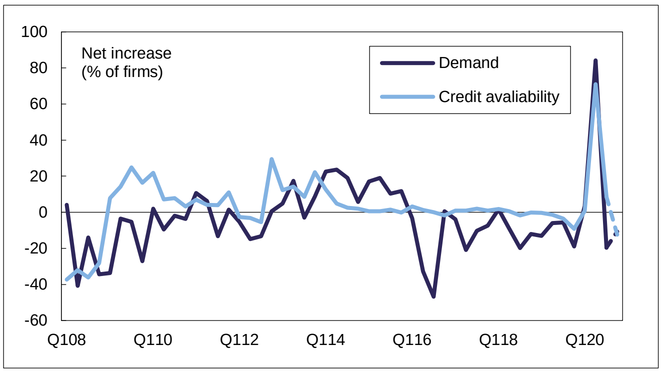
**Compared to a year ago. Source: Department for Transport and Daiwa Capital Markets Europe Ltd.*

suggested that this trend was likely to continue slightly in Q4, with credit scoring criteria for such lending on a tightening trend too. Lenders reported that the overall availability of credit to the corporate sector increased slightly in Q3, helping to meet increased demand from SMEs. But overall availability was expected to decrease in Q4, as was demand from small and large firms. In terms of loan pricing, banks reported wider spreads on secured and unsecured loans to households in Q3, with the trend expected to continue this quarter. And spreads had also widened on loans to medium-sized and large firms, with spreads on loans to small firms expected to widen in Q4.

The day ahead in the UK

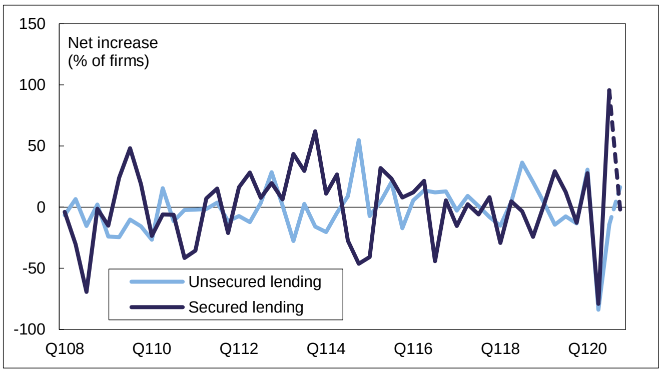
The UK economic data calendar for the week ends quietly with no key releases scheduled for tomorrow. So, attention will be on Brexit and how UK PM Johnson responds to the discussions of EU leaders at their latest two-day summit, which started this afternoon with the early departure of Commission President Von Der Leyen after a member of her team tested positive for coronavirus. Johnson previously suggested that he would walk away from the negotiations if there was no new free trade agreement reached by the time of the summit. However, the EU never recognized this deadline. And following their summit stock-take on the negotiations, they are likely simply to note progress so far, bemoan the lack of progress, but also state that they are willing to continue negotiations. They will also likely call for the UK to make the next move to make an agreement possible, and insist that the UK government will need to amend its controversial Internal Market Bill to be consistent with the Brexit Withdrawal Agreement before any FTA can be agreed. Finally, they will also likely increase their preparations for no deal, calling on the European Commission to make concrete proposals for contingency measures. It will then be for Johnson to decide how to respond tomorrow. We suspect that he will agree to continue negotiating while also insisting that the EU needs to move its position if a deal is eventually to be reached.

UK: Demand and availability of corporate lending*



*Dashed line represents expectations for Q420. Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Demand for household lending*



*Dashed line represents expectations for Q420. Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
France	Final CPI (EU-harmonised CPI) Y/Y%	Sep	**0.0 (0.0)**	0.1 (0.0)	0.2 (0.2)	-
Italy	Industrial sales M/M% (Y/Y%)	Aug	**5.9 (-3.8)**	-	8.1 (-8.1)	**8.0 (-8.1)**
	Industrial orders M/M% (Y/Y%)	Aug	**15.1 (6.1)**	-	3.7 (-7.2)	**3.4 (-7.6)**

Auctions

Country	Auction
France	sold €1.9bn of 0.5% 2025 bonds at an average yield of -0.7%
	sold: €3.15bn of 0% 2026 bonds an average yield of -0.64%
	sold €2.18bn of 2.75% 2027 bonds at an average yield of -0.59%
	sold: €570mn of 0.7% 2030 index-linked bonds at an average yield of -1.2%
	sold:€430mn of 0.1% 2036 index-linked bonds at an average yield of -0.91%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterdays results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Industrial production M/M% (Y/Y%)	Aug	**0.7 (-7.2)**	0.8 (-7.0)	4.1 (-7.7)	**5.0 (-7.1)**
Spain	Final CPI (EU-harmonised CPI) Y/Y%	Sep	**-0.4 (-0.6)**	-0.4 (-0.6)	-0.5 (-0.6)	-

Auctions

Country	Auction
Germany	sold €897mn of 0% 2050 bonds at an average yield of -0.16%
UK	sold £2.5bn of 0.875% 2029 bonds at an average yield of 0.166%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	07.00	EU27 new car registrations Y/Y%	Sep	-	-18.9
	10.00	Final CPI (core CPI) Y/Y%	Sep	-0.3 (0.2)	-0.2 (0.4)
	10.00	Trade balance €bn	Aug	18.0	20.3
France	-	Bank of France retail sales M/M% (Y/Y%)	Sep	-	-0.4 (1.4)
Italy	09.00	Final CPI (EU-harmonised CPI) Y/Y%	Sep	-0.5 (-0.9)	-0.5 (-0.5)
	10.00	Trade balance €bn	Aug	-	9.7

Auctions and events

Country	BST	Auction / Event
France	-	French sovereign debt to be rated by DBRS
UK	-	UK sovereign debt to be rated by Moody's

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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