Daiwa Capital Markets

Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds made losses despite a weakening in euro area and German consumer confidence and a deterioration in French business sentiment.
- As the EU-UK negotiations resumed, Gilts made significant losses for a second day while a survey illustrated ongoing struggles in consumer-facing services but the Chancellor announced more support for UK businesses.
- Friday will bring the flash October PMIs and UK retail sales data.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.778	+0.007
OBL 0 10/25	-0.781	+0.013
DBR 0 08/30	-0.573	+0.018
UKT 1¾ 09/22	-0.030	+0.020
UKT 0⅝ 06/25	-0.028	+0.024
UKT 4¾ 12/30	0.277	+0.036

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

Euro area

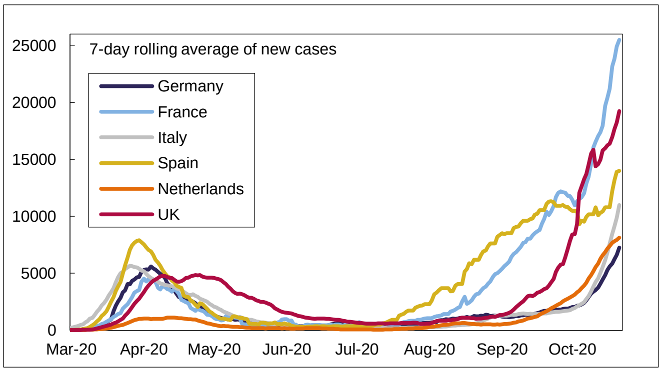
Consumer confidence drops to 5-month low

Given the resurgence of the pandemic across Europe and reintroduction of containment measures in a number of member states, the Commission's flash euro area consumer confidence indicator for October today predictably reported a deterioration in sentiment. In particular, the index fell 1.6pts to -15.5, the lowest since May. Pessimism seems bound to have increased in countries, such as France, Italy, Belgium and the Netherlands, that have seen the steepest recent increase in coronavirus cases. But even those countries that to-date have avoided the worst of the second wave have seen a pick-up in cases recently – e.g. the number of new daily coronavirus cases in Germany surged yesterday to a new high above 12k. And the October German GfK survey results, also released today, suggested that concerns about the pandemic have been increasingly taking their toll on sentiment. Indeed, GfK suggested that around three-quarters of German consumers feel that Covid-19 poses a 'major or very major threat', with roughly half 'concerned or very concerned' about their personal future outlook. Indeed, GfK today stated that these weekly readings have never been more negative since they began in April. Within the other detail of the German monthly report, there was a notable decline in households' economic expectations (the relevant index fell 17pts to 7.1) as income expectations also fell back to a four-month low and thus remained well below the level seen a year ago. But, for now at least, there were only mild losses in consumers' willingness to buy goods, with the survey component still well above levels seen earlier in the year. This notwithstanding, the overall headline confidence index was forecast to decline 1.4pts in November to a four-month low of -3.1, although this might well be revised down should the rise in infections steepen and containment measures tighten over coming weeks.

INSEE flags new hit to French services from the pandemic

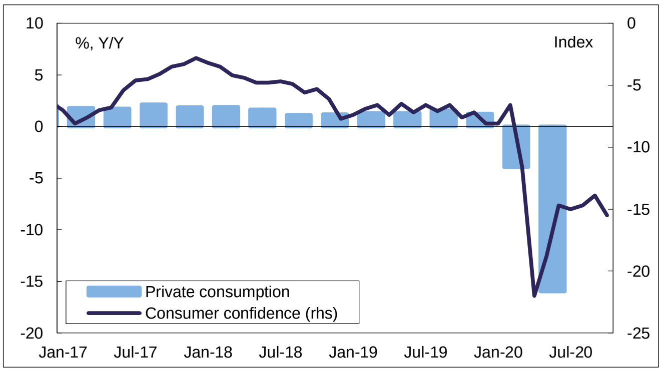
Today's INSEE business confidence survey flagged the notable deterioration in French economic conditions over the past month as the pandemic intensified. Most notably, the survey reported a particularly marked (but nevertheless predictable) decline in services sentiment as the hospitality sector was further hit by tighter containment measures, including night-time curfews in Paris and several other large cities. Indeed, the survey's measure of the business climate in services declined a hefty 5pts to just 89 (well below the long-run average of 100) with significant drops in services firms' expectations for activity and demand over the coming three months, for which the indices fell to their weakest since May. And while overall confidence among retailers reportedly moved broadly sideways, the survey detail flagged concerns about expectations for future sales. As such, the survey indicated that the employment climate had deteriorated, particularly in the tertiary sector. The recent improvement in the business climate also reportedly stalled in the manufacturing sector at the start of Q4 (the respective index dropped 1pt to 93), with firms seemingly much more downbeat about their production expectations – the relevant index fell 9pts to -12 the lowest since June – and weakening order books. Overall, the INSEE business climate

New daily coronavirus cases



Source: ECDC and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence and consumption



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

index dropped 2pts to a three-month low of 90.

The day ahead in the euro area

The main focus in the euro area tomorrow will be the October preliminary PMIs. Given the revival in the pandemic, the services PMIs weakened significantly last month. And as a result of the further intensification in the spread of Covid-19 over recent weeks, we expect to see ongoing deterioration in October, particularly in France, where additional restrictions on activity in the sector have recently been imposed. That would certainly be consistent with today's INSEE survey, which also flagged the possibility of a slight softening in the manufacturing PMIs. So, we expect the euro area composite PMI to slip back from 50.4 in September, and fall below the key 50 level for the first time since June.

UK

FTA negotiations resume, but leaders will eventually have to make the final deal

After several days of political posturing, yesterday evening the EU and UK confirmed that they would start from today a new phase of formal negotiations for a post-transition FTA. The plan, which is based on ten new 'organising principles', is that the talks will from now on take place on a daily basis, including weekends, and will for the first time be able to discuss proposed legal texts. A small joint secretariat will be established that might, if things proceed constructively, eventually facilitate the iteration of the new Treaty. And, importantly, there is recognition that the most difficult political issues, including the Level Playing Field (including state aid rules), governance, fisheries, energy, and goods and services provisions, will all now need to be considered. So, to some extent, the plan re-opens the door to finding a compromise. If it is to be agreed, however, the final Treaty will in due course also require far more intensive engagement at the highest level, i.e. the European Council of EU leaders and Boris Johnson, to commit to the extremely political compromises required. So, while yesterday's developments tallied with our expectation that a deal will eventually be reached, and the firming of sterling and the associated Gilt sell-off was thus arguably merited, there will still likely be significant political noise and theatrics – most likely in early November – to endure before we know one way or the other whether an FTA can actually be agreed.

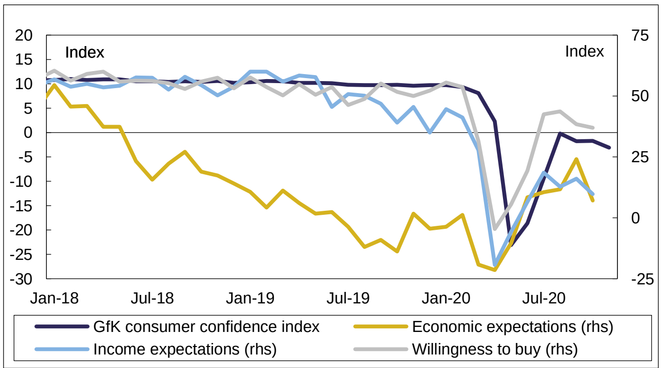
Manufacturers slightly less downbeat

In terms of the UK data flow, today's CBI industrial trends survey for October beat expectations, with manufacturers once again less downbeat about production over the past three months, signaling the softest pace of annual decline since March, with 7 output of 17 subsectors reporting positive growth. They were also notably more upbeat about their expectations for output over the coming three months too, perhaps reflecting reduced pessimism with respect to order books. Admittedly, the CBI's quarterly survey suggested that optimism regarding the export outlook had deteriorated slightly. And there was also limited improvement in overall business optimism compared with the July survey – the relevant index rose just 1pt to 0, albeit markedly higher than the -87 reading in April – with almost one third of manufacturers expressing concerns about their ability to access materials or components for production over the quarter ahead. So while firms suggested that they would stop cutting jobs over the coming three months, manufacturers were still expecting investment to fall back over the coming year, albeit to a lesser extent than in the previous two surveys.

Services more adversely affected by the resurgence in the pandemic

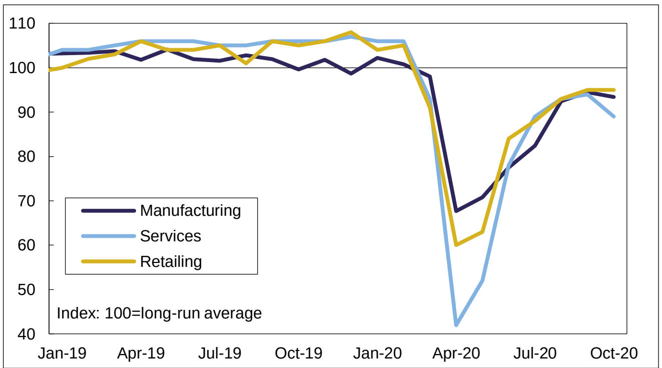
Of course, the intensification of the pandemic and the associated reintroduction of tighter restrictions to try to control its spread seem bound to affect consumer-facing services far more acutely than the manufacturing sector. The ONS's latest coronavirus business survey today reported that, in the two weeks to 4 October, hospitality firms were already struggling most financially, with 17% stating they were at severe risk of insolvency compared to 5% of firms across all industries. In addition, 30% of firms in the arts, entertainment and leisure industry – more than in any other sub-sector – were still not trading due to the pandemic, compared to 14% across the private sector as a whole. More than two thirds of firms in

Germany: GfK consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: INSEE business confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

hospitality and leisure – compared with 48% of firms overall – reported that turnover was still down on levels a year ago. And having moved broadly sideways for several weeks, overall turnover reportedly fell back in the two weeks to 4 October, suggesting a contraction in overall economic activity. Changing behavior was also reflected in the survey's findings on transportation, which suggested that the proportion of adults who travelled to work fell by 5ppts last week, to 60%, while the share who worked from home rose to 25%, the highest since the beginning of August.

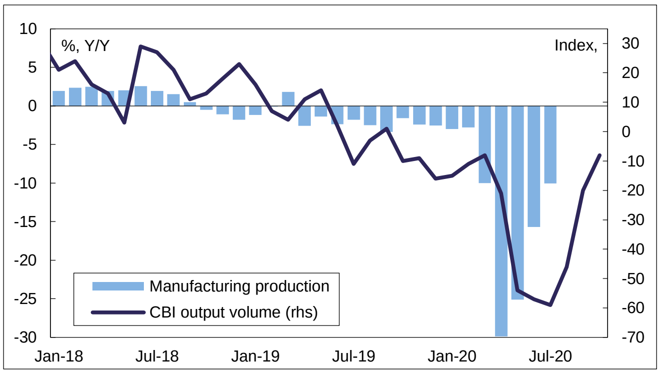
Chancellor Sunak announces increased support for firms affected by the pandemic

Against this gloomier backdrop for services, and the related increased risk of further financial distress and redundancies ahead, Chancellor Sunak today increased fiscal support for businesses. Most notably, only a month after announcing its details, he significantly reformed the new 'Job Support Scheme' programme, which will come into force from 1 November. In particular, by lowering the employer contributions and employee hours required to qualify for support, the new changes should reduce incentives for firms to make redundancies. Sunak also offered additional funding to local authorities to support businesses primarily in the hospitality and leisure sectors in 'high-alert' areas. For many firms and workers, however, the changes are likely to have come too late.

The day ahead in the UK

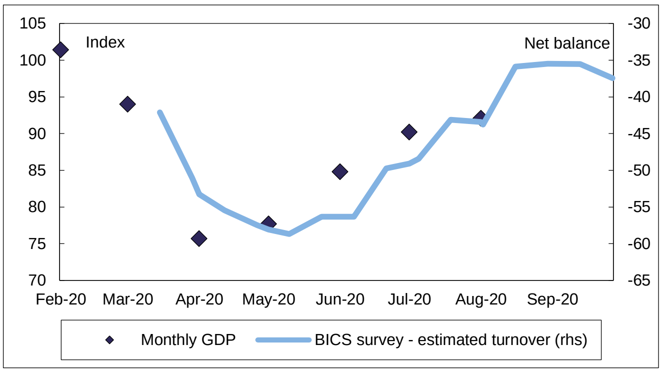
It will be a busy end to the week for UK economic releases. Like in the euro area, a key focus will be the release of the flash PMIs. We expect to see some softening in the UK services indices in response to the revival in the pandemic and tighter restrictions on consumer-facing industries. Nevertheless, with activity in the manufacturing sector seemingly holding up, the UK's composite PMI is likely to remain above the key 50 mark, albeit probably falling to a four-month low from 56.5 in September. Also of interest tomorrow will be September's retail sales data for September, which might well show signs of stock piling of essentials as Covid-related concerns heightened. Indeed, a rise of ½%M/M would leave sales up by more than 17%Q/Q in Q3, probably a touch firmer than the rate of growth in GDP. Whilst we expect retail sales to remain above the pre-pandemic levels over coming months, as households maintain an increased level of spending on goods at the expense of spending on many face-to-face services, rising joblessness will in due course take a toll on spending. Indeed, the latest GfK consumer confidence survey, also due tomorrow, will likely imply extremely subdued sentiment at the start of Q3.

UK: Manufacturing output and CBI survey



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Monthly GDP and BICS turnover estimate*



**Weighted net balance of firms reporting a decline and increase in turnover.*
Source: ONS and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Preliminary consumer confidence	Oct	**-15.5**	-15.0	-13.9	-
Germany	GfK consumer confidence	Nov	**-3.1**	-3.0	-1.6	**-1.7**
France	INSEE business confidence	Oct	**90**	91	92	-
	INSEE manufacturing confidence (production outlook)	Oct	**93 (-12)**	96 (-)	96 (-2)	**94 (-3)**
UK	CBI industrial trends, total orders (business optimism)	Oct	**-34 (0)**	-	-48 (-1)	

Auctions

Country	Auction
UK	sold £2.25bn of 0.625% 2035 bonds at an average yield of 0.618%
	sold £1.75bn of 0.625% 2050 bonds at an average yield of 0.842%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	09.00	Preliminary manufacturing (services) PMI	Oct	53.0 (47.0)	53.7 (48.0)
	09.00	Preliminary composite PMI	Oct	49.5	50.4
Germany	08.30	Preliminary manufacturing (services) PMI	Oct	55.0 (49.5)	56.4 (50.6)
	08.30	Preliminary composite PMI	Oct	53.5	54.7
France	08.15	Preliminary manufacturing (services) PMI	Oct	51.3 (47.0)	51.2 (47.5)
	08.15	Preliminary composite PMI	Oct	48.1	48.5
UK	00.01	GfK consumer confidence	Oct	-28	-25
	07.00	Retail sales including fuel M/M% (Y/Y%)	Sep	0.0 (3.8)	0.8 (2.8)
	07.00	Retail sales excluding fuel M/M% (Y/Y%)	Sep	0.5 (4.9)	0.6 (4.3)
	09.30	Preliminary manufacturing (services) PMI	Oct	53.1 (53.3)	54.1 (56.1)
	09.30	Preliminary composite PMI	Oct	53.4	56.5

Auctions and events

Country	BST	Event
Italy	-	Italy's sovereign debt rating update by S&P
UK	-	UK's sovereign debt rating update by S&P

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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