

Euro wrap-up

Overview

Chris Scicluna

+44 20 7597 8326

- Bunds were little changed as the ifo survey suggested a deterioration in the German business outlook but BTPs made further gains following Friday evening's favourable revision to Italy's sovereign rating outlook by S&P.
- Gilts were also little changed following weekend reports that the UK government will finalise its Brexit negotiation strategy only once the US election results are clear.
- Tuesday will bring the ECB's latest quarterly bank lending survey along with September's euro area credit data and a UK retail survey.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.765	+0.002
OBL 0 10/25	-0.771	+0.007
DBR 0 08/30	-0.575	+0.004
UKT 1½ 09/22	-0.039	+0.005
UKT 0% 06/25	-0.029	+0.006
UKT 4% 12/30	0.277	-

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

Euro area

ifo indices suggest a gradual turn for the worse in the German business climate

Friday's [flash PMIs](#) for October suggested a significant weakening of economic activity in the region at the start of Q4, with the composite euro area PMI falling below 50 for the first time since June. However, Germany appeared still to be faring relatively well, with the deterioration in the country's composite PMI modest (down just 0.2pt to a still-respectable 54.5), as notable strength in manufacturing largely offset a softening of momentum in services. Today's German ifo business survey findings broadly echoed the PMIs, with the headline business climate index dropping in October for the first time since April, albeit by just 0.5pt to 92.7. However, the survey did suggest that a turning point in the recovery might have been met. Current conditions were reported to have improved in October, with the respective survey index rising a larger-than-expected 1.1pts to 90.3. That, however, remained below the range seen for almost a decade ahead of the arrival of the pandemic earlier this year. And the clouding of the outlook for the coming six months was reflected in a drop in the survey's expectations index of 2.4pts to a four-month low of 95.0, back below the range prevailing over the five years following the euro area crisis in 2012.

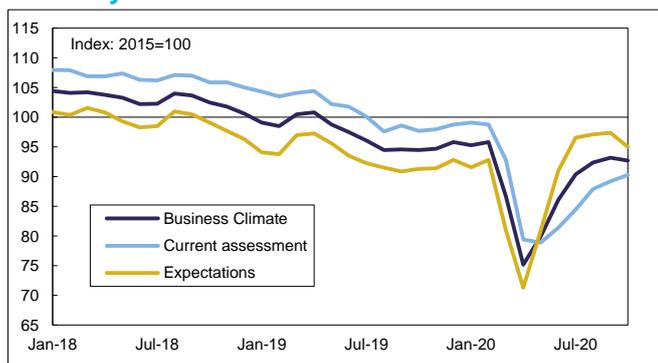
Expectations softer in all German business sectors

As implied by the flash PMIs, the ifo indices suggested a notable improvement in conditions in the manufacturing sector in the current month, with a rise of 8.5pts in the respective indicator to 8.1, the highest since March. The wholesale and retail sectors also reported improvements in current conditions to the best since before Covid-19 arrived. However, the intensified spread of the virus over the past month, and tighter restrictions on activity in certain regions, was reflected in a deterioration in current conditions in the services sector to a three-month low. And the equivalent index for the construction sector also fell back. Moreover, the deterioration in the outlook for the coming six months was reported in all sectors. Indeed, contrasting the improvement in the German manufacturing PMIs, the ifo manufacturing expectations index dropped from September's near-three-year high by a substantive 5.2pts to a three-month low. That, however, remained relatively high by recent standards, and above the equivalent expectations indices for other sectors. In addition, according to the ifo survey, expectations for wholesale and retail trade, as well as construction, remain weaker even than in services.

Intensified spread of Covid-19 and tightening restrictions bound to weigh on growth in Q4

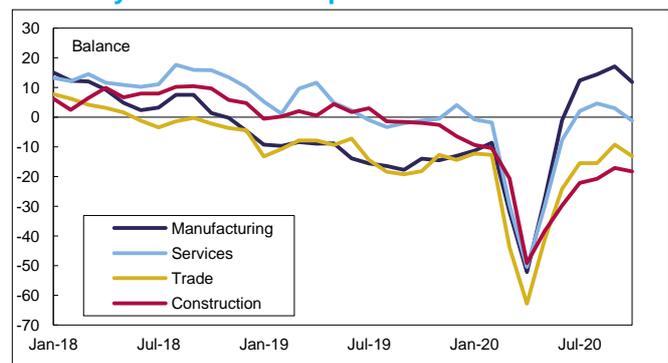
Data to be published at the end of this week are likely to show that German GDP rose about 7½%Q/Q in Q3 to reverse a little more than half of the cumulative decline over the first half of the year. That, however, will still likely leave German economic output about 5% below the level in Q419. Meanwhile, the weakening in the ifo expectations indices tallies with the

Germany: Headline ifo business climate indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Sectoral ifo expectations indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

recent levelling off in certain other high-frequency data, including truck-toll mileage and other mobility indicators, to suggest a loss of momentum in the German economy in Q4. And with the intensification of the pandemic and associated tightening restrictions on activity increasingly likely to affect spending decisions, it was no surprise today that the Bundesbank stated that it expected Germany's economic recovery to continue at a "considerably slower" pace in the current quarter. That seems all the more likely after reports today suggested that Chancellor Merkel is now planning additional 'lockdown light' measures, with discussions at cabinet level expected on Wednesday.

ECB's Q4 baseline growth forecast now looking too optimistic

In euro area member states such as France, where yesterday brought a new record score for daily coronavirus cases above 52k, far more stringent restrictions than those seen in Germany might yet see GDP growth return to negative territory in Q4. Indeed, reports today suggested that the French government is now examining a range of further restrictions that might be implemented on top of its current curfews. Similarly, new 'partial lockdown' measures announced yesterday in Italy – including a 6pm closing time for bars and restaurants, and the complete closure of cinemas, gyms and swimming pools – will crimp growth in the services sector in the euro area's third-largest member state even as manufacturing provides support. And the reintroduction of a national state of emergency, which brought new night-time curfews and allows for tighter restrictions at the regional level, increases the probability of negative growth in Spain's services-dominated economy this quarter. So, while euro area GDP growth in Q3 will be at least 1ppt stronger than the ECB's September baseline forecast of 8.4%Q/Q, growth in Q4 is highly likely to be more than 2ppts weaker than its equivalent projection for Q4 (3.1%Q/Q).

The day ahead in the euro area

Tomorrow will bring the release of the ECB's latest monthly euro area bank lending figures for September, which are likely to show that credit growth remained strong at the end of Q3 in part reflecting ongoing loan guarantee schemes provided by member state governments as well as the incentives provided by the TLTRO-iii scheme and regulatory relief measures. The ECB's quarterly Bank Lending Survey will also be published, which should suggest that financial conditions remain favourable and supportive of economic recovery in the current quarter despite the second pandemic wave.

UK

The day ahead in the UK

After a quiet start to the week for UK economic releases, Tuesday will bring the CBI's latest distributive trades survey for October. While last week's retail sales figures showed ongoing solid demand for goods, with new Covid containment restrictions in place and consumer confidence having weakened significantly, growth in sales of non-essentials might be expected to have slowed at the start of Q4. By the same token, household stockpiling of essentials might well provide additional support.

Beyond the economic data, the EU-UK negotiations on a new FTA will continue in London. However, we certainly do not expect a meaningful breakthrough at this stage. Certainly, we found credible the weekend's reports that the UK will not finalise its strategy until after the result of the US Presidential election is clear, not least since a Biden victory would diminish even further the political attractions of a no-deal outcome. Moreover, we think that the current round of official-level negotiations will simply be unable to broker an agreement on an FTA. So, a further round of political negotiations at the highest level – no doubt involving more political drama – will eventually likely be required, most likely in the second week of November, to determine whether or not an FTA can be agreed.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Ifo business climate index	Oct	92.7	93.0	93.4	93.2
	 Ifo current assessment (expectations) balance	Oct	90.3 (95.0)	89.6 (96.5)	89.2 (97.7)	-(97.4)

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU	 09.00	M3 money supply Y/Y%	Sep	9.6	9.5
UK	 11.00	CBI distributive trades survey, reported sales	Oct	-2	11

Auctions and events

EMU	 09.30	ECB bank lending survey for Q3
Italy	 10.00	Auction: To sell up to €2.5bn of 2022 zero-coupon bonds
	 10.00	Auction: To sell 0.65% 2026 index-linked bonds
UK	 10.00	Auction: To sell £3.25bn of 0.125% 2024 bonds
	 11.30	Auction: To sell £1bn of 1.625% 2071 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FCA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.