

Euro wrap-up

Overview

- Bunds and other euro area government bonds made losses as the euro area's Q3 data significantly beat expectations.
- Gilts followed other major government bonds lower as a measure of UK house price growth rose to the highest since early 2015.
- The coming week will bring September data for euro area retail sales, German IP and factory orders, October new car registrations, and the final October PMIs.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.806	+0.009
OBL 0 10/25	-0.823	+0.013
DBR 0 08/30	-0.627	+0.013
UKT 1% 09/22	-0.040	+0.026
UKT 0% 06/25	-0.040	+0.031
UKT 4% 12/30	0.261	+0.041

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

Source: Bloomberg

Euro area

Record Q3 GDP growth beats expectations across the board, but Spain is the laggard

Faced with the resurgence in the pandemic and the reimposition of restrictions on activity in several member states, economic conditions in the euro area are now undeniably deteriorating. However, today's preliminary Q3 data significantly beat expectations, with rebounds much stronger than expected in the euro area as a whole as well as in each of the large member states. In particular, euro area GDP rose a record 12.7%Q/Q in Q3 to be down 4.3%Y/Y and also 4.3% below the level before the pandemic in Q4. In Germany, where the initial contraction in the first half of the year was somewhat less severe than in the other large member states, quarterly growth was inevitably softer than the figure for the region as a whole. Nevertheless it was still very vigorous at 8.2%Q/Q, also leaving GDP down 4.3%Y/Y. Growth in France (18.2%Q/Q) and Italy (16.1%Q/Q) was extremely strong, leaving French GDP down the same 4.3%Y/Y rate as the euro area and Germany, and Italian output down only slightly more on the same basis (-4.7%Y/Y). However, despite similarly strong growth of 16.7%Q/Q in Q3, given the much sharper shock in the first half of the year, the recovery in GDP in Spain still lagged those elsewhere, with the annual decline of 8.7%Y/Y double that of the euro area average and the two largest member states.

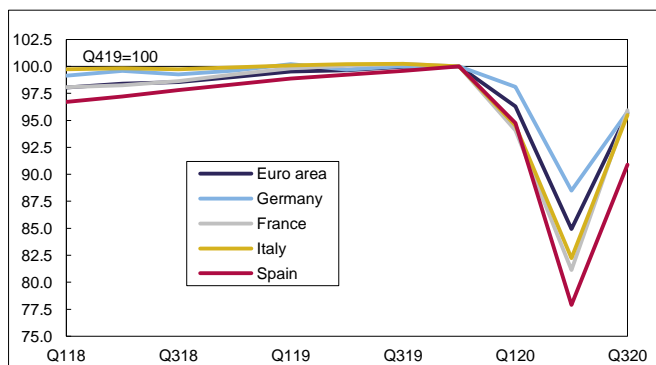
Broad-based rebound from lockdown, but capex and trade lags consumption

Eurostat provided no detail to elaborate its headline euro area GDP figures. But while it also provided no additional data, Germany's statistical institute explained that, unsurprisingly, growth in the euro area's largest member state was broad-based, as consumption, investment and trade volumes rebounded as lockdown restrictions eased. And the detail provided by other member states tallied with that assessment. For example, in France household consumption leapt 17.3%Q/Q to be down only 2.1%Y/Y. And household spending on manufactured goods was particularly strong, rising by almost 39%Q/Q to rise well above the pre-pandemic level and be up a strong 4.2%Y/Y. But while consumer spending on services rose a little more than 20%Q/Q it was still down 5.0%Y/Y as demand for hospitality, leisure and other face-to-face services remained well below pre-pandemic levels. Total capex similarly jumped 23.3%Q/Q, but was still down 5.1%Y/Y as uncertainty about the future weighed. Government spending was up 15.1% to be up 0.4%Y/Y. And net trade contributed positively to French GDP growth, with exports (up 23.2%Q/Q but still down 15.2%Y/Y) stronger than imports (up 16.0%Q/Q but down 9.9%Y/Y).

Q3 much stronger than ECB expected, but signs of weakening in September

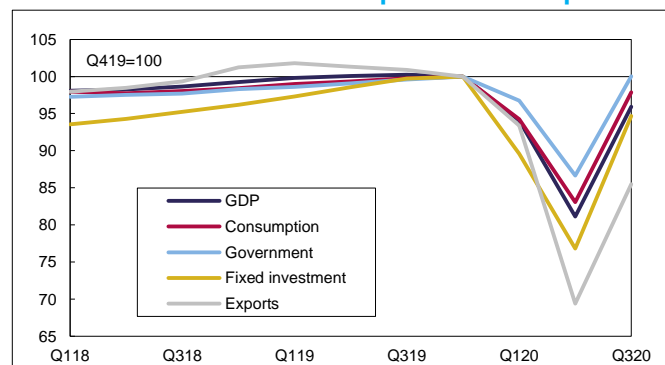
The rebound in euro area GDP in Q3 was several percentage points stronger than the 8.4%Q/Q rate forecast by the ECB in its most recent projections. And despite an increase in French joblessness at the end of the quarter (up to 7.9% in September following the third successive monthly rise of at least 0.4ppt), it might have been reassuring that the aggregate

Euro area: GDP levels



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: GDP and selected expenditure components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

euro area unemployment rate stabilised at 8.3% in September having risen in each of the previous five months. While it was primarily thanks to the extension of government job support schemes, that stabilisation partly reflected welcome declines in the rates in Italy (down 0.1ppt to 9.6%) and Spain (down 0.2ppt to 16.5%). Nevertheless, today's data also provided further evidence that momentum had already weakened significantly by the end of the quarter. German retail sales dropped 2.2%M/M in September, more than reversing growth in August. And the decline in French consumer spending on goods that month was even steeper, falling a marked 5.1%M/M to the lowest level since June. So, Q4 in France was looking weak even before the new lockdown hit.

GDP to fall sharply in Q4 due to intensified pandemic and new lockdowns

With the pandemic most acute and new restrictions most stringent, French GDP now looks set to drop back markedly in Q4. Indeed, despite the much stronger-than-expected growth in Q3, French Finance Minister Le Maire today revised down the government's full-year GDP forecast by 1ppt, now anticipating a drop of 11%Y/Y, implying a fall of more than 10%Q/Q in GDP in Q4. Based on current restrictions, the declines in economic activity elsewhere should be more modest – Germany's government today suggested that GDP might fall 5.5%Y/Y in 2020, somewhat less than previously expected, implying a drop of roughly 1%Q/Q in Q4. But much will depend on the evolution of the pandemic and the duration and severity of restrictions in place over coming months. The range of credible outcomes for Q4 GDP – in individual member states and the euro area as a whole – is very wide indeed. And the outlook will still likely be highly uncertain when the ECB next updates its projections ahead of the Governing Council's key 10 December meeting, when monetary policy will be "recalibrated".

Services inflation drops to record low in October

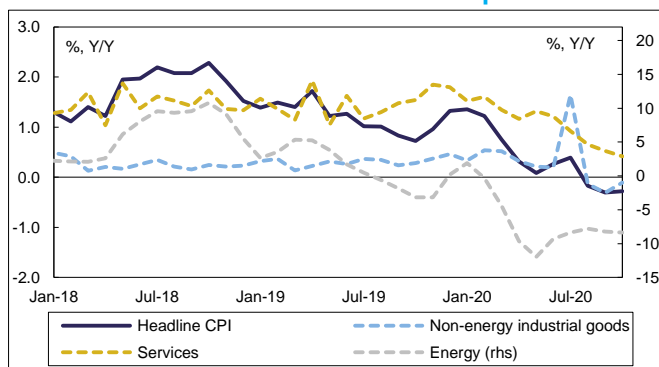
Of course, the ECB will re-set monetary policy primarily with the inflation outlook in mind. Back in September, its projections suggested that the headline CPI rate would still be less than 1½%Y/Y by the end of 2022, and that core inflation would average little more than 1% that year. Today's flash inflation data suggested no improvement in October, with the headline CPI rate unchanged at -0.3%Y/Y, matching the lowest rate since February 2015. And with food inflation slightly firmer (up 0.2ppt to 2.0%Y/Y) but energy inflation slightly weaker (down 0.2ppt to -8.4%Y/Y), core inflation was unchanged at the series low of 0.2%Y/Y. Moreover, although the pace of decline in non-energy industrial goods prices eased slightly (by 0.2ppt to -0.1%Y/Y), services inflation hit a record low of just 0.4%Y/Y. As suggested yesterday by Christine Lagarde, headline inflation will remain negative over coming months, partly due to the German VAT cut – which will expire at year-end – and past declines in energy prices. But the intensification of the pandemic will mean that services inflation, particularly in the travel and tourism sectors, will remain very weak well into 2021. And further ahead, the impact of past euro appreciation as well as downwards pressure on wage growth will keep core inflation highly subdued. While the ECB will update its projections to include 2023 for the first time, and the Governing Council will hope that progress towards development and dissemination of an effective vaccine will provide some upside risks to the outlook, we expect inflation to remain some way below target by the end of the projection horizon, meriting additional stimulus throughout next year.

The coming week in the euro area

With global attention set to be firmly focused on the US elections, and the continued spread of Covid-19 across Europe pushing up the daily rate of fatalities, placing health services under pressure and leading more governments to tighten restrictions on activity, the economic news-flow from the euro area is unlikely to be in the spotlight in the coming week. Nevertheless, updates on the strength of activity in the industrial sector will be of interest, as will further sentiment survey results. The data calendar starts on Monday with the final manufacturing PMIs for October. Thanks to a big jump in the German index, the flash headline euro area manufacturing PMI rose 0.7pt to a two-year high of 54.4. While that might well be confirmed, the equivalent indices from Italy and Spain, to be released for the first time might be of greater interest. New car registration data for October from France, Italy and Spain should also be released at the start of the week.

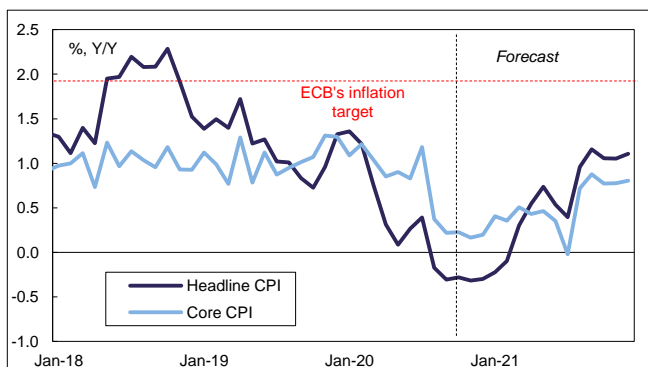
After an uneventful day for euro area data on Tuesday, the following day should bring German new car registrations along

Euro area: Inflation and selected components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

with the final services PMIs for October. With hospitality and leisure activity weighed by the resurgence in the pandemic, the flash euro area services PMI dropped 1.8pts to a five-month low of 46.2. And the Italian and Spanish indices, to be released for the first time on Wednesday, are similarly likely to show significant deterioration. Meanwhile, Thursday will bring the October construction PMIs along with euro area retail sales and German factory orders figures for September. Given the weakness reported in today's German and French spending figures for that month, euro area sales are likely to have fallen back by 1½%M/M or more. Finally, German and Spanish industrial production data for the same month will come on Friday with another month of positive growth of more than 1%M/M expected in both countries.

UK

The coming week in the UK

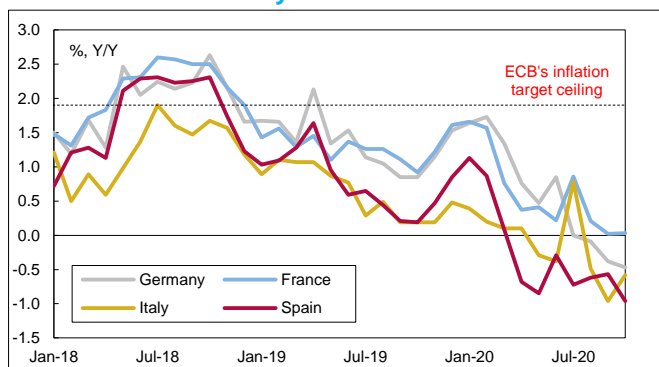
The main event in the UK in the coming week will be Thursday's BoE policy announcement, which will also be accompanied by the Bank's latest Monetary Policy Report. Since the previous meeting in September, the UK's economic data have been mixed. Inflation, for example, has come in above the BoE's central forecast of 0.2%Y/Y in Q3. But, given the disappointingly soft increase in August, Q3 GDP growth looks likely to come in slightly below the BoE's median forecast close to 18%Q/Q. Crucially, the resurgence in the pandemic over recent weeks, and associated localized re-imposition of restrictions on activity, appears increasingly to be weighing on activity. While the government has so far eschewed the far more stringent national lockdown measures now underway in France, restrictions are steadily tightening in an ever increasing number of regions of the UK. Meanwhile, although the government recently announced additional fiscal support for businesses, and increased the generosity of the new Job Support Scheme to encourage firms to retain workers, redundancies have been rising at a record pace. And the now-likely double-dip in GDP in the euro area in Q4 seems bound to imply a hit to UK external demand. At the same time, significant uncertainty persists regarding the nature of trade relations between the EU and UK from the end of the year, acting as a continued disincentive to business investment. And a no-deal end to the transition period would significantly impede economic activity while also boosting inflation over the near term.

Even if it maintains the assumption that an FTA is agreed by the end of the year, we expect the BoE to cut its GDP forecast for 2020 and 2021. In addition, while the near-term profile for inflation might well be nudged higher, the BoE might also continue to forecast inflation barely above target two years ahead. And the risks to the outlook for both growth and inflation will be judged to be significantly skewed to the downside. Therefore, the economic projections in the Monetary Policy Report will still likely merit additional stimulus. Indeed, based on the current rate of asset purchases, the £745bn target would be reached by the end of the year.

So, there is a strong case for the BoE to extend its purchases into 2021 in order to avoid an unwarranted tightening of financial conditions. And, consistent with the recent public comments of most MPC members, we strongly expect the Committee to vote for an increase of £100bn in that target to £845bn. Indeed, out of the nine members, only Chief Economist Haldane, who voted against the previous increase in asset purchases, might be expected to vote against such an increase on Thursday. But judging from his recent comments, even he might be swayed to vote for the extra purchases this time around. Finally, in terms of forward guidance, the MPC will likely keep the door open to a possible eventual cut in Bank Rate to negative territory if economic conditions warrant such a move. But, for the time being there will be no rate cut, as preparations that might facilitate such a move in future still need to be completed.

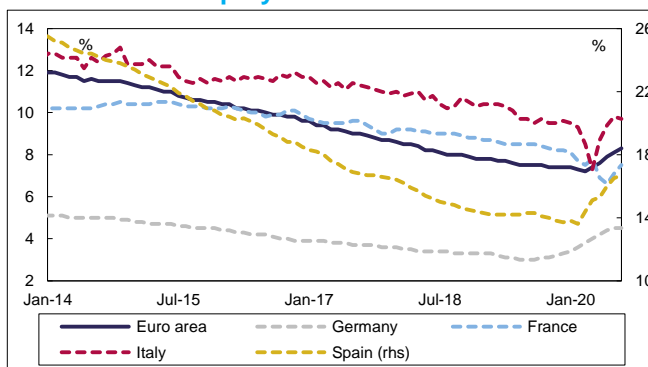
As in the euro area, the coming week's UK dataflow includes the October PMIs, with the final manufacturing and services indices due Monday and Wednesday respectively, and the construction survey results to be released for the first time on Thursday. According to the flash estimates, the headline manufacturing and services PMIs both weakened in October, to 53.3 and 52.3 respectively. And we expect the construction PMI similarly to suggest a moderation in growth in the sector, dropping from 56.8 in September. Beyond the PMIs, the other data of note due in the coming week will be October new car registrations, which will also come on Thursday.

Euro area: Inflation by member state
















Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment rates



Source: Refinitiv 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 GDP Q/Q% (Y/Y%)	Q3	12.7 (-4.3)	10.5 (-6.1)	-11.8 (-14.7)	- (-14.8)
		Preliminary CPI (core CPI) Y/Y%	Oct	-0.2 (0.2)	-0.2 (0.3)	-0.3 (0.2)	-
		Unemployment rate (%)	Sep	8.3	8.2	8.1	8.3
Germany		Preliminary GDP Q/Q% (Y/Y%)	Q3	8.2 (-4.3)	7.5 (-4.9)	-9.7 (-11.3)	-
		Retail sales M/M% (Y/Y%)	Sep	-2.2 (6.5)	-0.6 (2.8)	1.8 (3.0)	1.8 (3.0)
France		Preliminary GDP Q/Q% (Y/Y%)	Q3	18.2 (-4.3)	16.0 (-6.1)	-13.8 (-18.9)	-13.7 (-18.9)
		Consumer spending M/M% (Y/Y%)	Sep	-5.1 (-1.3)	-0.5 (2.2)	2.3 (2.4)	2.2 (3.6)
		Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	0.0 (0.0)	0.1 (0.1)	0.0 (0.0)	-
Italy		Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	-0.3 (-0.6)	-0.4 (-0.8)	-0.6 (-1.0)	-
		Preliminary GDP Q/Q% (Y/Y%)	Q3	16.1 (-4.7)	12.0 (-7.9)	-12.8 (-17.7)	-13.0 (-17.9)
Spain		Preliminary GDP Q/Q% (Y/Y%)	Q3	16.7 (-8.7)	15.0 (-10.1)	-17.8 (-21.5)	-
UK		Lloyds business barometer	Oct	-18	-	-11	-
		Nationwide House Price Index M/M% (Y/Y%)	Oct	0.8 (5.8)	-	0.9 (5.0)	-
Auctions							
Country	Auction						
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.









Coming week's data calendar

The coming week's key data releases

Country		GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 2 November 2020						
EMU		09.00	Final manufacturing PMI	Oct	54.4	53.7
Germany		08.55	Final manufacturing PMI	Oct	58.0	56.4
France		08.50	Final manufacturing PMI	Oct	51.0	51.2
		-	New car registrations* Y/Y%	Oct	-	-3.0
Italy		08.45	Manufacturing PMI	Oct	53.7	53.2
		17.00	New car registrations Y/Y%	Oct	-	9.5
Spain		08.15	Manufacturing PMI	Oct	51.0	50.8
		-	New car registrations* Y/Y%	Oct	-	-13.5
UK		09.30	Final manufacturing PMI	Oct	53.3	54.1
Tuesday 3 November 2020						
- Nothing scheduled -						
Wednesday 4 November 2020						
EMU		09.00	Final services (composite) PMI	Oct	46.2 (49.4)	48.0 (50.4)
		10.00	PPI Y/Y%	Sep	-2.4	-2.5
Germany		08.55	Final services (composite) PMI	Oct	48.9 (54.5)	50.6 (54.7)
		-	New car registrations* Y/Y%	Oct	-	8.4
France		08.50	Final services (composite) PMI	Oct	46.5 (47.3)	47.5 (48.5)
Italy		08.45	Services (composite) PMI	Oct	47.1 (49.3)	48.8 (50.4)
Spain		08.00	Unemployment change 000s	Oct	-	-26.3
		08.15	Services (composite) PMI	Oct	40.0 (43.0)	42.4 (44.3)
UK		09.30	Final services (composite) PMI	Oct	52.3 (52.9)	56.1 (56.5)
Thursday 5 November 2020						
EMU		08.30	Construction PMI	Oct	-	47.5
		10.00	Retail sales M/M% (Y/Y%)	Sep	-1.5 (2.8)	4.4 (3.7)
Germany		07.00	Factory orders M/M% (Y/Y%)	Sep	2.0 (-1.2)	4.5 (-2.2)
		08.30	Construction PMI	Oct	-	45.5
France		08.30	Construction PMI	Oct	-	47.3
Italy		08.30	Construction PMI	Oct	-	51.2
UK		09.00	New car registrations Y/Y%	Oct	-	-4.4
		09.30	Construction PMI	Oct	55.0	56.8
		12.00	BoE Bank Rate %	Nov	<u>0.10</u>	0.10
		12.00	BoE asset purchase target £bn	Nov	<u>845</u>	745
Friday 6 November 2020						
Germany		07.00	Industrial production M/M% (Y/Y%)	Sep	2.5 (-6.5)	-0.2 (-9.6)
France		07.45	Trade balance €bn	Sep	-6.8	-7.7
		07.45	Private sector payrolls	Q3	0.7	-0.8
Italy		09.00	Retail sales M/M% (Y/Y%)	Sep	-1.5 (1.2)	8.2 (0.8)
Spain		08.00	Industrial production M/M% (Y/Y%)	Sep	1.3 (-3.8)	0.4 (-5.7)

*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 2 November 2020		
- Nothing scheduled -		
Tuesday 3 November 2020		
Germany 	10.30	Auction: To sell index-linked bonds
UK 	10.00	Auction: To sell £2.75bn of 0.125% 2028 bonds
	10.00	Auction: To sell £2.0bn of 1.25% 2041 bonds
Wednesday 4 November 2020		
Germany 	10.30	Auction: To sell €5bn of 2025 bonds
UK 	10.00	Auction: To sell £3.0bn of 0.125% 2026 bonds
Thursday 5 November 2020		
France 	09.50	Auction: To sell fixed-rate and index-linked bonds with various maturities
Spain 	09.45	Auction: To sell bonds with various maturities
UK 	12.00	BoE monetary policy announcement and publication of Monetary Policy Report
	12.30	BoE Governor Bailey to speak at MPC press conference
Friday 6 November 2020		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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