Euro wrap-up

Overview

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- Ahead of this evening's leaders' teleconference, which appeared unlikely to resolve the impasse over the EU budget and recovery funds, Bunds made gains as data confirmed a drop in euro area construction output at end-Q3.
- While the EU-UK negotiations were suspended as one participant tested positive for coronavirus, Gilts made modest gains as business surveys pointed to a loss of recovery momentum in the UK.
- Friday will bring the Commission's flash euro area consumer confidence indicator for November and UK retail sales data for October.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/22	-0.747	-0.004
OBL 0 10/25	-0.751	-0.010
DBR 0 08/30	-0.572	-0.016
UKT 1¾ 09/22	-0.037	-0.002
UKT 0⅝ 06/25	0.006	-0.006
UKT 4¾ 12/30	0.323	-0.012

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

Euro area

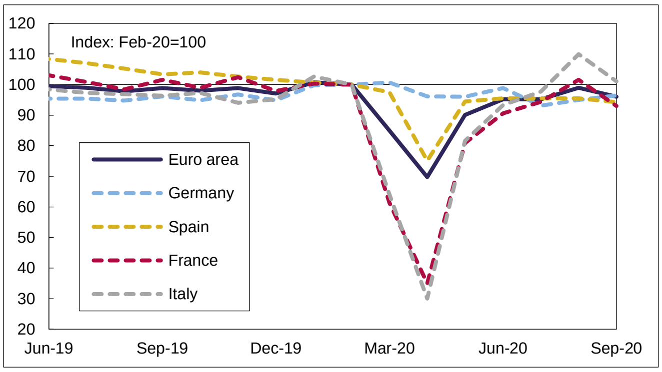
Construction output took step down at end-Q3

Ahead of this evening's main event – the European Council videoconference where leaders seemed unlikely to resolve the impasse over the forthcoming EU seven-year budget and recovery funds – today's new economic data focused on the construction sector and balance of payments. Having risen steadily since May and surpassed its level a year earlier in August, construction output in the euro area fell 2.9%M/M in September. That left it down 2.5%Y/Y and 4.7% below the pre-pandemic level in February. The weakness in September principally reflected new building work, which dropped 3.2%M/M to be down 3.0%Y/Y and 5% below February's level. In contrast, supported by fiscal policy, civil engineering output fell just 0.4%M/M to be up 0.2%Y/Y, albeit still 2.1% below February's level. Among the member states, there were significant differences too. Total construction output in Germany rose for a second successive month and by 1.5%M/M but was still 3.4% below February's level. It fell more than 8.0%M/M in France and by 1.3%M/M in Spain to be down 7.2% and 6.4% respectively below the pre-Covid level. And construction output also fell more than 8.0%M/M in Italy to fall back 1.6% below February's level.

Construction could slip back into reverse in Q4

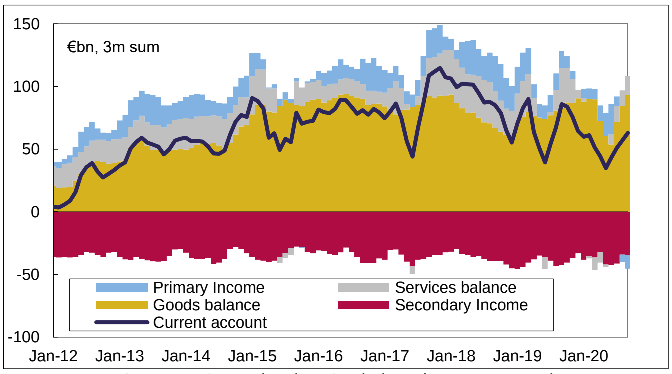
Over the past two quarters, euro area construction output has moved closely in line with GDP. Indeed, given the vigorous rebound from May to August, construction output in the region rose a record 12.5%Q/Q in Q3, just 0.1ppt softer than the increase in GDP. That followed a drop in construction output in Q2 of 11.8%Q/Q, which was just 0.2ppt steeper than the decline in total economic output. Germany – which had seen significant growth in the sector in Q2 due to more lenient lockdown rules – was the only one of the large member states to post a decline in construction output in Q3. But just as euro area GDP is likely to contract in Q4, so too might construction output fall back this quarter. Admittedly, while activity in many services sub-sectors is being hit by new lockdown measures, restrictions on construction activity are currently limited, providing scope for growth if demand picks up. Nevertheless, surveys suggest that sentiment in the sector remains well below pre-Covid levels. The construction PMIs fell in each of the large member states in October firmly below 50, with the euro area indices suggesting the weakest month for the sector since May. Indeed, the PMIs reported deterioration in both residential and civil engineering work, and new orders in the sector were down the most since June. Fundamentals appear relatively unfavourable too. Rising unemployment, downwards pressure on wages and tighter conditions on new mortgage loans are likely to weigh on demand for housing over coming months. And commercial work will be deterred by pandemic-related uncertainty about future demand for offices and city-centre retail, hospitality and leisure space.

Euro area: Construction output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Current account



Source: ECB and Daiwa Capital Markets Europe Ltd.

Largest current account surplus in twelve months

According to the ECB's latest balance of payments data, the euro area's current account surplus rose a further €4.3bn in September to €25.2bn, the largest in a year. That left the cumulative surplus in the twelve months to September at 1.9% of GDP, down 0.4ppt from a year earlier, but the improving near-term trend is unmistakable. With exports of goods outpacing those of imports, the merchandise surplus rose on the ECB measure to €32.7bn, the largest since December 2017. And the services trade surplus rose to a twelve-month high of €6.6bn. The primary income balance remained in deficit for a third month at -€2.2bn, but the positive net foreign asset position in fixed income should provide support over coming quarters as the US economic recovery gains traction. On the financial account, net portfolio inflows rose to €40.0bn, following near-balance the prior month. While euro area residents' holdings of foreign assets dropped €16bn, foreign investors added almost €24bn to their stock of euro area assets, with their holdings of euro area debt securities up more than €50bn amid expectations of further ECB monetary stimulus.

The day ahead in the euro area

The week's euro area dataflow concludes tomorrow with the Commission's flash estimate of consumer confidence in November. Due to the rising second wave of the pandemic, this indicator fell in October to its lowest level since May. And given that the spread of Covid-19 continued to intensify over the first half of this month, placing significant pressure on health services and forcing many member states to increase the stringency of restrictions on activity, a further fall in November is expected. Other data to be published tomorrow include German producer prices for October and Italian industrial orders and sales figures for September. We will also hear again from ECB President Lagarde and Vice President de Guindos.

UK

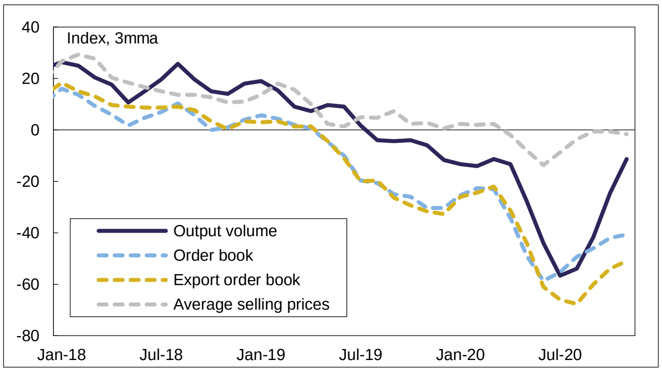
CBI survey suggests manufacturing outlook has weakened

According to the latest CBI Industrial Trends Survey, the manufacturing recovery continued over the three months to November, with the measure of output volumes down 6%Y/Y, the softest pace since September 2019. Production fell in 9 of 17 sub-sectors, although the headline decline was reportedly driven by the aerospace sub-sector. More of a concern, the near-term outlook weakened materially, with expectations for output over the coming three months now negative (down 25ppts to -10%). Stock adequacy rose back broadly in line with the long-run average to suggest that precautionary inventory accumulation related to uncertainty about the trading relationship with the EU at the end of the year remains less pronounced than that associated with previous no-deal Brexit deadlines. And order books – both in total (-40%) and from abroad (-51%) – deteriorated from last month and remained well below their long-run averages, suggesting that there will be no last-minute surge in production ahead of the New Year. Finally, the survey measure of firms' price expectations shifted into negative territory (down 12ppts to -8%).

Services adversely affected by the resurgence in the pandemic

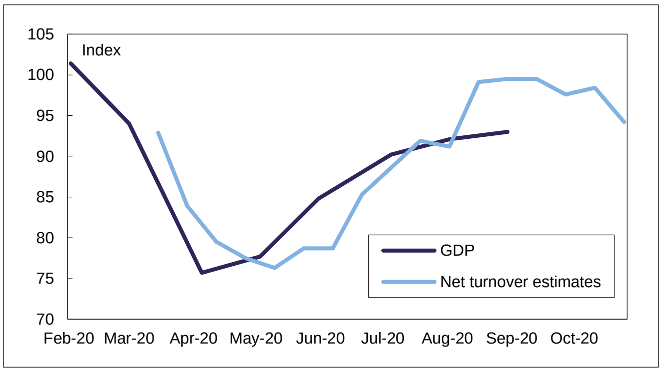
Of course, the intensification of the pandemic and the associated reintroduction of restrictions to try to control its spread is affecting many consumer-facing services far more profoundly than the manufacturing sector. The ONS's latest coronavirus business survey today reported that, in the two weeks to 1 November, hospitality firms were already struggling most financially, with 34% of food and accommodation businesses having no or low confidence that they would survive the next three months, compared to 14% of firms across all industries. In addition, more than one third of workers in the arts, entertainment and recreation industry were on partial or full-time furlough leave, compared to 9% across all industries. Given weakening demand for such services, as well as regional closures and early curfews, the share of firms reporting an increase in turnover reportedly deteriorated in the two weeks to 1 November to the lowest level since mid-August, suggesting that GDP already went into reverse last month. And, with non-essential retailing shut since early this month, overall shopping footfall dropped a steep 56%Y/Y in the week ending 15 November – more evidence, if it was needed, of a sharp drop in GDP this month.

UK: CBI industrial trends survey indicators



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

UK: Business turnover and GDP



Source: ONS Business Impact of Coronavirus survey and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

Tomorrow's UK data highlight will be the release of official retail sales figures for October. Surveys from the CBI and BRC point to a softer month for retail sales following five successive increases, which left the level of sales more than 5% above February's pre-pandemic level. Nevertheless, despite a drop in shopping centre footfall as the month went on, sales in October seem likely to benefit from renewed pandemic-related stock-building as well as the persisting shift in spending from services to goods. Also published tomorrow will be the GfK consumer confidence survey for November and October public finance figures.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	ECB current account balance €bn	Sep	**25.2**	-	19.9	**20.9**
	Construction output M/M% (Y/Y%)	Sep	**-2.9 (-2.5)**	-	2.6 (-0.9)	**3.9 (0.4)**
Spain	Total trade balance €bn	Sep	**-1.5**	-	-1.7	**-**
UK	CBI industrial trends survey, total orders	Nov	**-40**	-40	-34	**-**

Auctions

Country	Auction
France	sold €2.89bn of 1.75% 2023 bonds at an average yield of -0.71%
	sold €4.12bn of 0% 2026 bonds at an average yield of -0.62%
	sold €1.48bn of 2.75% 2027 bonds at an average yield of -0.57%
	sold €644mn of 0.1% Mar-26 index-linked bonds at an average yield of -1.29%
	sold €424mn 0.1% Jul-36 index-linked bonds at an average yield of -1.14%
Spain	sold €1.35bn of 0% 2026 bonds at an average yield of -0.414%
	sold €487.4mn of 0.8% 2027 bonds at an average yield of -0.273%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	15.00	European Commission's preliminary consumer confidence index	Nov	-17.7	-15.5
Germany	07.00	PPI Y/Y%	Oct	-0.8	-1.0
Italy	09.00	Industrial orders M/M% (Y/Y%)	Sep	-	15.1 (6.1)
	09.00	Industrial sales M/M% (Y/Y%)	Sep	-	5.9 (-3.8)
UK	00.01	GfK consumer confidence survey	Nov	-34	-31
	07.00	Retail sales including fuel M/M% (Y/Y%)	Oct	-0.3 (4.1)	1.5 (4.7)
	07.00	Retail sales excluding fuel M/M% (Y/Y%)	Oct	0.0 (5.9)	1.6 (6.4)
	07.00	Public sector net borrowing £bn	Oct	31.5	35.4

Auctions and events

Country	GMT	Event
EMU	08.15	ECB President Lagarde scheduled to speak
	09.45	ECB's de Guindos scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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