Euro wrap-up

Overview

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- Bunds were little changed as the euro area flash PMIs signalled a loss of recovery momentum but ongoing price pressures due to supply constraints.
- While BoE Chief Economist Pill stated the case for an imminent rate hike, and the flash UK PMIs beat expectations, Gilts made gains as retail sales and consumer confidence came in weaker than expected.
- The main events in the coming week will be the ECB's Governing Council announcement (Thursday) and flash euro area Q3 GDP and October inflation estimates (Friday). In the UK, the Chancellor will present his Budget and Spending Review (Wednesday).

Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.656	-0.001
OBL 0 10/26	-0.430	+0.006
DBR 0 08/31	-0.106	-0.003
UKT 0¹/₈ 01/24	0.662	-0.034
UKT 0³/₈ 10/26	0.830	-0.026
UKT 0¼ 07/31	1.148	-0.050

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

Euro area

Flash PMIs signal loss of growth momentum

Ahead of next week's ECB monetary policy meeting, the euro area flash PMIs for October gave a snapshot of economic conditions at the start of Q4. A moderation in growth momentum in the autumn had always been expected after the firm rebound in activity over the summer associated with the easing of pandemic restrictions. Indeed, in its projections published last month, the ECB predicted that GDP growth in Q4 of 1.2%Q/Q would be half the pace in Q3. However, the flash PMIs suggested that the slowdown underway is rather more marked than it had anticipated, with supply constraints and historically elevated cost pressures acting as a brake. In particular, while it remained consistent with growth, the euro area manufacturing output PMI fell to a 16-month low (53.2). If the PMIs are to be believed, French manufacturers were particularly severely hit this month, with the output PMI down more than 5pts to a 17-month low and a highly contractionary level (46.2). Germany's manufacturing output PMI also fell to a 16-month low, albeit at a level consistent with modest expansion (51.1). With the euro area services activity index (54.7), and those for Germany and France, the lowest in six months, the euro area composite output PMI (54.3) was also the lowest since April when pandemic restrictions were still pretty widespread.

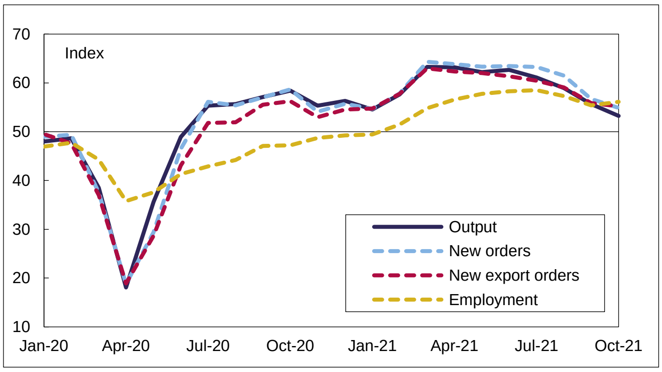
Supply bottlenecks worsen, price pressures intensify

On the demand side, growth of new orders in services was reportedly a touch stronger this month. But that boost was more than negated by additional weakness in manufacturing orders. So, overall growth in new orders was judged to be the slowest since April. Unsurprisingly, the main cause of the slowdown in output and demand was an intensification of supply-side bottlenecks. Suppliers' delivery times lengthened to an extent exceeded only once on the survey dating back more than two decades. Backlogs of work continued to rise at a firm pace. And with firms' input costs judged to be rising at a record pace, selling price inflation also intensified to the strongest almost 20 years as firms felt better able to pass higher costs on to customers. With supply difficulties and price pressures up again, expectations about future output moderated for a fourth successive month and to the lowest since the winter wave of pandemic in February.

ECB projections now out of date, outlook highly uncertain

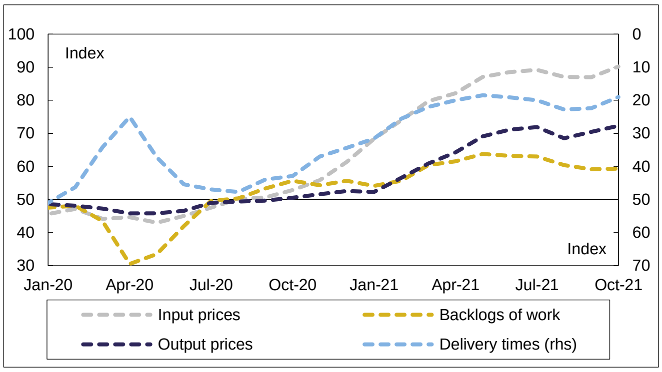
So, while the October flash PMIs suggested that the ECB's near-term growth outlook is overoptimistic, it also suggests that its near-term inflation outlook is too low. Indeed, not least due to higher energy costs, HICP inflation could rise close to 4.0%Y/Y in November and average above 3.5%Y/Y in Q4, well above the ECB's expectation of 3.1%Y/Y for the current quarter. Such pressures are bound to enliven the hawks on the Governing Council, whose concerns about upside risks from

Euro area: Manufacturing PMIs – demand side



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

Euro area: Manufacturing PMIs – supply side



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

current pressures were already aired at the September Governing Council meeting. However, the detail of September's inflation figures continued to suggest that underlying price pressures remain moderate. While market-based measures of inflation expectations have risen significantly to be more consistent with the ECB's inflation target – indeed the 5Y5Y inflation swap forward rate today rose above 2.0% for the first time since 2014 – recent wage settlements remain inconsistent with meaningful second-round effects. So, the majority of the Governing Council will still expect inflation to fall back over the course of 2022 to below 2.0%Y/Y by year-end. And they will also be concerned about the downside risks to demand posed by the current shock to energy prices – notwithstanding various new government support programmes, such as France's decision to make payments of €100 to 38mn lower-income citizens to help cushion the blow. Moreover, the risks of negative price base effects, as and when supply chains and energy pipelines respond to high prices, suggests significant downside risks to inflation in 2023. With no updated projections to be published at the coming meeting, however, the ECB might continue to judge the risks to the economic outlook as broadly balanced albeit noting the significant uncertainty posed by the ongoing supply-side shocks.

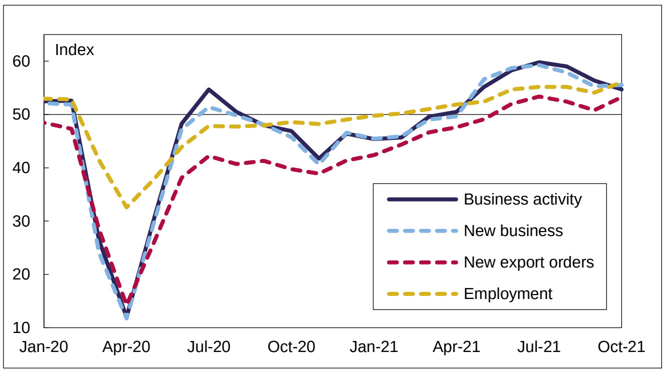
Lagarde to refrain from insights into future ECB policy

Of course, financial conditions are also a key determinant of current ECB policy, particularly the pace of net asset purchases. And over recent weeks, conditions in bond markets have tightened significantly. Since the September monetary policy meeting, the average 5Y sovereign yield has risen about 25bps to -0.22%, while the 10Y yield has risen almost 30bps to 0.29%, the highest since May and near the top of the range of the past 18 months. In her press conference, President Lagarde will be asked about the future pace of net asset purchases from Q1 on, and the nature of purchases following the end of the PEPP programme. However, she seems highly likely to deflect questions on such issues, not least as they are unlikely to be discussed thoroughly, let alone agreed, by the Governing Council until the December meeting. If the Governing Council is concerned about the recent jump in yields, however, it is possible that she might flag the possibility of an accelerated pace of net purchases if the bond market sell-off continues.

The week ahead in the euro area

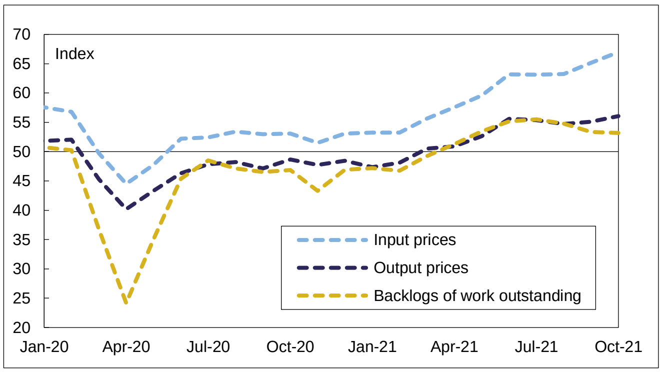
Alongside the ECB announcement, the coming week will also bring a number of key top-tier economic releases concluding with the first estimates of euro area Q3 GDP and October CPI data on Friday. We expect to see another quarter of solid GDP growth in the euro area of 1.8%Q/Q in Q3 (following growth of 2.2%Q/Q in Q2), thanks to a strong contribution from services as Covid restrictions were relaxed. At the country level, we expect growth to have accelerated in France and Spain (from 1.1%Q/Q in Q2), be a little stronger in Germany (from 1.6%Q/Q in Q2) and have moderated in Italy (from 2.7%Q/Q previously). In terms of inflation, we expect the euro area's headline measure of inflation to have taken a step up from September's thirteen-year high of 3.4%Y/Y, driven by a further jump in energy inflation following the surge in wholesale gas

Euro area: Services PMIs – demand side



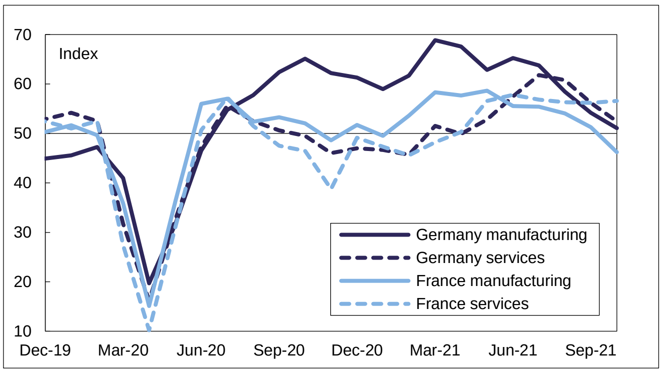
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Euro area: Services PMIs – supply side



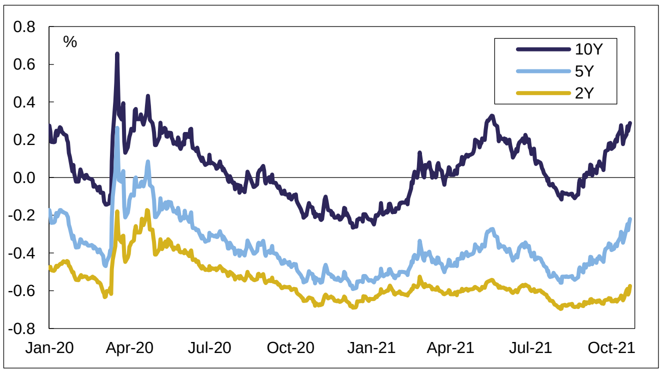
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Germany and France: Output PMIs



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

Euro area: GDP-weighted government bond yields



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

prices. In contrast, we expect the core measure to have moved sideways at 1.9%Y/Y this month. Ahead of the euro area figures, Thursday brings the equivalent German and Spanish CPI numbers, followed on Friday with the French and Italian numbers.

The coming week also brings a number of sentiment surveys, which are expected to suggest a further moderation in recovery momentum at the start of Q4. Among these will be the European Commission's business and consumer indicators (Thursday), which are expected to show the headline economic sentiment index fall to a five-month low. Germany's ifo business climate index for October is also due on Monday. Other releases include the ECB's quarterly bank lending survey (Tuesday), euro area bank lending figures for September (Wednesday), as well as French jobseeker data for Q3 and German unemployment numbers for October (Thursday).

UK

BoE Chief Economist signals November is 'live' for a hike but notes restrictive stance not needed

The flow of hawkish commentary from BoE staff members continued yesterday evening with Chief Economist Huw Pill telling the FT that the 4 November MPC meeting is "live" for a possible rate hike. Stating that he "would not be shocked" if inflation rose "close to or even slightly above 5%" early next year, he noted that such an increase would be "uncomfortable" for the BoE. And while inflation would also likely come down later in the year, he considered the labour market to be "quite tight" even after the end of the government's furlough scheme. Importantly, he also judged that "we don't need the emergency settings of policy that we saw after the intensification of the pandemic". So, while he said that next month's policy decision will be "finely balanced", and he did not see "a need to go to a restrictive [policy] stance", it seems that he is itching to raise rates. Given recent comments from Governor Bailey and Pill, it would now seem absurd if the BoE did not hike Bank Rate by 15bps to 0.25% in November. We suspect that what comes after that, however, will be less hawkish than is currently priced into the markets. Indeed, in 2022, we currently pencil in only one more 25bps hike, to 0.50%, most likely in May.

Services PMI rises to a three-month high, but manufacturing weakens due to supply bottlenecks

Today's flash PMIs probably provided further support to those on the MPC in favour of an early rate hike. Certainly, the services PMI suggested that activity in the sector accelerated at the start of the fourth quarter underpinned by buoyant consumer spending. In particular, the headline index rose 2.8pts in October to 58.0, a three-month high, with the new business PMI (56.9) also at a four-month high as new export sales recorded the second-best month since the pandemic as tourism picked up. But today's surveys also flagged the increasing divergence between the services and manufacturing sectors as persisting supply constraints remained more acute in the latter. Indeed, despite an increase in domestic orders, the manufacturing output PMI fell in October to an eight-month low of 50.6, leaving the widest margin between the respective activity indices since February 2009. Certainly, the headline manufacturing PMI (up 0.6pt to 57.7) was flattered by mounting backlogs and lengthened delivery times – indeed, Markit reported that almost two-thirds of manufacturers cited worsening supplier delivery times, while only 1% saw an improvement. Production capacity was also reportedly being limited by recruitment difficulties across the manufacturing and services sectors alike despite the end of the Job Retention Scheme. As such, input costs continued to rise rapidly, by the most since the series began. And while firms continued to absorb much of these pressures, there was a further increase in the output price PMIs, similarly to the highest on record. Overall, given the dominance of the services sector in the UK economy, the composite PMI rose 1.9pts in October to 56.8, a three-month high and consistent with solid expansion, albeit still down from the highs recorded earlier in the summer.

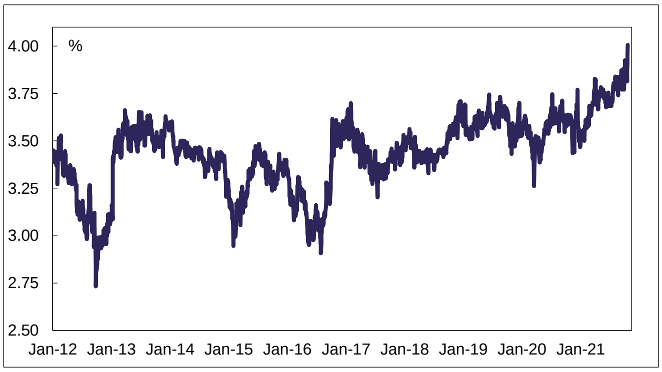
Retail sales on longest losing streak

The upbeat services PMI was somewhat at odds with the more downbeat message from today's other UK releases, which suggested that recovery momentum continues to fade. Indeed, retail sales once again came in weaker than expected, with

Euro area: 5Y5Y inflation swap forward rate

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: 5Y5Y inflation swap forward rate



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

the volume down for the fifth consecutive month in September (-0.2%M/M) to mark the longest losing streak since the series began in early 1996. And that figure was flattered by the surge in spending at petrol stations (2.9%M/M) amid panic-buying at the end of the month. Excluding that impact, the decline in retail sales was even steeper (-0.6%M/M). Within the detail, the drop in sales in September was driven by notable falls in spending at household goods stores (-9.3%M/M) and other non-food stores (-1.7%M/M) as demand for furniture and sporting goods continued to wane following strength throughout the pandemic. Spending at clothing stores improved (+4.3%M/M), but this level was still roughly 5½% lower than before the arrival of Covid-19 and down more than 3½%Q/Q. Overall, there was a marked decline in the volume of total sales over the third quarter as a whole, by a whopping 3.9%Q/Q (-4.9%Q/Q when excluding auto fuels). Admittedly, this followed growth of almost 12%Q/Q in Q2, and the September level was still more than 4% higher than before the pandemic. Meanwhile, significant price increases saw the retail sales deflator rise to an elevated 3.4%Y/Y. Nevertheless, the value of retail sales still fell for the fourth month in the past five, dropping 0.2%M/M in September to be down a chunky 2.3%Q/Q in Q3.

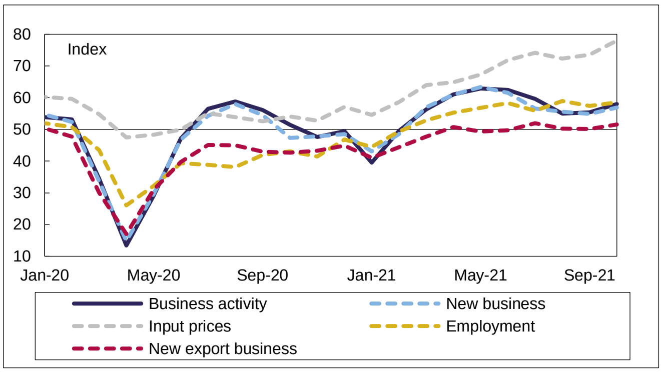
Consumer confidence falls to eight-month low

Of course, part of the weakness last quarter reflects the increased opportunities to spend on consumer-facing services as Covid-related restrictions eased. But a deterioration in consumer confidence might also have played a role amid rising prices and squeezed household budgets, as well as perhaps the recent jump in Covid cases. And the overnight release of October's GfK consumer confidence survey showed the headline sentiment index falling for the third consecutive month and by a further 3pts to -17, the lowest level since February. Perhaps inevitably, there was a sizeable decline in households' expectations for the economic outlook over the coming twelve months (down 10pts on the month), while their expectations for their personal finances over the year ahead also dropped (-4pts) to the lowest since November. And so, there was a further decline in household intentions to make major purchases to the lowest level since April, suggesting that the outlook for retailers remains soft.

The week ahead in the UK

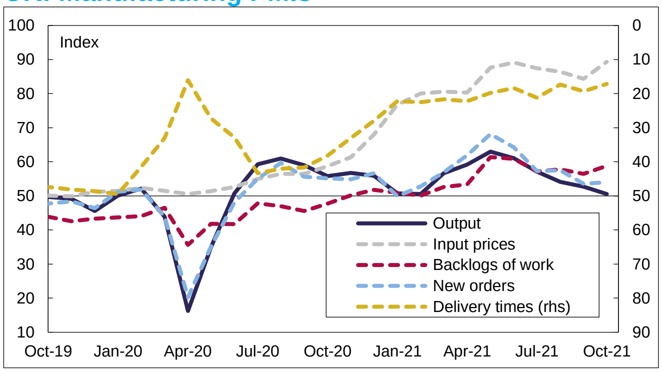
Ahead of the BoE's MPC meeting on 4 November, much focus in the coming week will be on the Chancellor's Budget and Spending Review on Wednesday. While the past week's public finance figures suggested greater scope for fiscal giveaways, the OBR's updated economic forecasts will be based on national accounts numbers that were published before the recent significant upwards revisions and therefore suggest more limited opportunity for fiscal loosening. Nevertheless, we would expect some government support for lower-income households to cope with increased household energy bills as well as additional government spending on public services affected by the continuing pandemic. However, overall, for now at least, we expect the Chancellor to maintain the impression that the fiscal stance will be tightened over the coming few years.

UK: Services PMIs



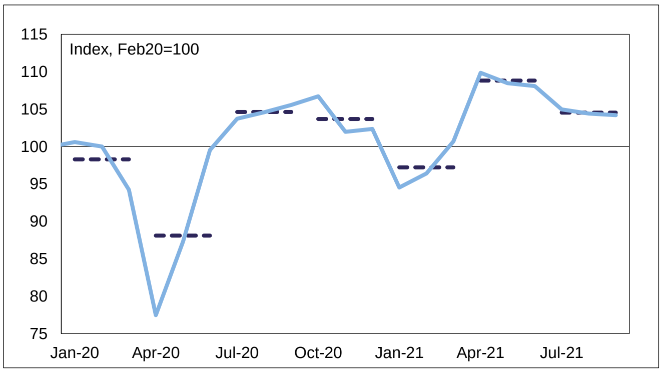
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing PMIs



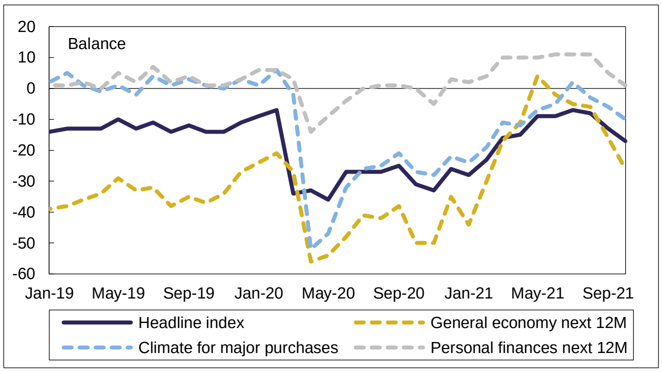
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

UK: Retail sales*



**Dashed dark blue lines are quarterly averages. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

UK: Consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Datawise, the UK economic data calendar kicks off on Tuesday with the release of the CBI distributive trades survey for October, which will provide the first look at retail sales growth this month and likely to further highlight the challenges facing the distribution sector. Meanwhile, Wednesday's BRC shop price index for October will reveal how supply chain issues are also affecting shop prices. On Friday, the Lloyds business barometer for October will be published, along with the Bank of England's lending figures for September. The latter half of the week might also see Nationwide publish its October house price index.

Daiwa economic forecasts

	2021				2022		2021	2022	2023
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP forecasts %, Q/Q									
Euro area	-0.3	2.2	1.8	1.0	0.8	0.7	5.0	4.1	2.1
UK	-1.4	5.5	1.8	0.5	0.4	0.4	7.0	3.7	1.9
Inflation forecasts %, Y/Y									
Euro area									
Headline CPI	1.1	1.8	2.8	3.5	2.7	2.9	2.3	2.4	1.3
Core CPI	1.2	0.9	1.4	1.9	1.3	1.8	1.3	1.4	1.2
UK									
Headline CPI	0.6	2.1	2.9	4.3	4.5	4.0	2.5	3.4	1.8
Core CPI	1.2	1.8	2.7	3.4	3.6	3.1	2.3	2.7	2.0
Monetary policy									
ECB									
Refi Rate %	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
PEPP envelope* (€bn)	1850	1850	1850	1850	1850	1850	1850	1850	1850
BoE									
Bank Rate %	0.10	0.10	0.10	0.25	0.25	0.50	0.25	0.50	0.75
Bond purchases* (£bn)	895	895	895	870	870	860	870	860	825

**Target end of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.*

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Preliminary manufacturing (services) PMI	Oct	**58.5 (54.7)**	57.1 (55.4)	58.6 (56.4)	-
	Preliminary composite PMI	Oct	**54.3**	55.2	56.2	-
Germany	Preliminary manufacturing (services) PMI	Oct	**58.2 (52.4)**	56.6 (55.2)	58.4 (56.2)	-
	Preliminary composite PMI	Oct	**52.0**	54.3	55.5	-
France	Preliminary manufacturing (services) PMI	Oct	**53.5 (56.6)**	54.0 (55.5)	55.0 (56.2)	-
	Preliminary composite PMI	Oct	**54.7**	54.7	55.3	-
UK	GfK consumer confidence	Oct	**-17**	-16	-13	-
	Retail sales including auto fuels M/M% (Y/Y%)	Sep	**-0.2 (-1.3)**	0.6 (-0.4)	-0.9 (0.0)	**-0.6 (-0.2)**
	Retail sales excluding auto fuels M/M% (Y/Y%)	Sep	**-0.6 (-2.6)**	0.3 (-1.6)	-1.2 (-0.9)	**-0.7 (-1.1)**
	Preliminary manufacturing (services) PMI	Oct	**57.7 (58.0)**	56.0 (54.5)	57.1 (55.4)	-
	Preliminary composite PMI	Oct	**56.8**	54.0	54.9	-

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ Daiwa forecast/actual	Previous
Monday 25 October 2021					
Germany	09.00	Ifo business climate index	Oct	96.5	98.8
	09.00	Ifo current assessment (expectations)	Oct	99.4 (98.0)	100.4 (97.3)
Tuesday 26 October 2021					
Spain	08.00	PPI Y/Y%	Sep	-	18.0
UK	11.00	CBI distributive trades survey, reported retail sales	Oct	13	11
Wednesday 27 October 2021					
Euro area	09.00	M3 money supply Y/Y%	Sep	7.5	7.9
Germany	07.00	GfK consumer confidence	Nov	-0.5	0.3
France	07.45	INSEE consumer confidence	Oct	101	102
	07.45	PPI Y/Y%	Sep	-	10.0
	11.00	Jobseekers, mn	Q3	-	3.5
UK	00.01	BRC shop price index Y/Y%	Oct	-	-0.5
Thursday 28 October 2021					
Euro area	10.00	European Commission's economic sentiment index	Oct	116.6	117.8
	10.00	European Commission's final consumer confidence	Oct	-4.8	-4.0
	10.00	European Commission's industrial (services) confidence	Oct	13.0 (14.6)	14.1 (15.1)
	12.45	ECB refinancing rate %	Oct	0.00	0.00
	12.45	ECB marginal lending facility rate %	Oct	0.25	0.25
	12.45	ECB deposit rate %	Oct	-0.50	-0.50
Germany	08.55	Unemployment rate % (change '000s)	Oct	5.4 (-20.0)	5.5 (-30.0)
	13.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	4.4 (4.5)	4.1 (4.1)
Italy	09.00	ISTAT consumer (manufacturing) confidence index	Oct	118.5 (112.3)	119.6 (113.0)
	09.00	ISTAT economic sentiment indicator	Oct	-	113.8
	10.00	Hourly wages Y/Y%	Sep	-	0.6
	11.00	PPI Y/Y%	Sep	-	13.8
Spain	08.00	Preliminary CPI (EU-harmonised CPI)	Oct	4.4 (4.6)	4.0 (4.0)
Friday 29 October 2021					
Euro area	10.00	Preliminary CPI (core CPI) Y/Y%	Oct	3.6 (1.9)	3.4 (1.9)
	10.00	Preliminary GDP Q/Q% (Y/Y%)	Q3	1.8 (3.3)	2.2 (14.3)
Germany	09.00	Preliminary GDP Q/Q% (Y/Y%)	Q3	1.5 (1.8)	1.6 (9.4)
France	06.30	Consumer spending M/M% (Y/Y%)	Sep	0.4 (-1.7)	1.0 (-5.4)
	06.30	Preliminary GDP Q/Q% (Y/Y%)	Q3	2.0 (2.1)	1.1 (18.7)
	07.45	Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	2.5 (3.2)	2.2 (2.7)
Italy	09.00	Preliminary GDP Q/Q% (Y/Y%)	Q3	1.5 (2.6)	2.7 (17.3)
	10.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	2.9 (3.2)	2.5 (2.9)
Spain	08.00	Preliminary GDP Q/Q% (Y/Y%)	Q3	2.0 (2.7)	1.1 (17.5)
	08.00	Retail sales Y/Y%	Sep	0.0	-0.9
UK	09.30	Net consumer credit £bn (Y/Y%)	Sep	0.5 (-)	0.4 (-2.4)
	09.30	Net mortgage lending £bn (approvals '000s)	Sep	5.7 (72.0)	5.3 (74.5)
	09.30	M4 money supply Y/Y%	Sep	-	7.0

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions			
Country		BST	Event / Auction
			Monday 25 October 2021
Euro area		-	European Commission publishes latest economic forecasts
UK		14.00	BoE's Tenreyro scheduled to speak: International trade, global supply chains and monetary policy
			Tuesday 26 October 2021
Germany		10.30	Auction: €3bn of 0% 2028 bonds
Italy		10.00	Auction: €2.25bn of 0% 2024 bonds
		10.00	Auction: €750mn of 0.15% 2051 inflation-linked bonds
UK		10.00	Auction: £2.75bn of 0.375% 2026 bonds
			Wednesday 27 October 2021
Germany		10.30	Auction: €2bn of 0% 2036 bonds
UK		12.30	Chancellor Sunak presents UK Budget and Spending Review
			Thursday 28 October 2021
Euro area		12.45	ECB monetary policy announcement
		13.30	ECB President Lagarde speaks at post-Governing Council press conference
Italy		10.00	Auction: 5Y and 10Y bonds
			Friday 29 October 2021
			- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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