Euro wrap-up

Overview

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- Euro area government bonds made further losses as flash October inflation data surprised on the upside while Q3 GDP was close to expectations.
- Gilts also made losses while UK consumer credit remained weak and UK businesses made net loan repayments.
- The coming week will likely bring a rate hike from the BoE while data for euro area retail sales and German factory orders and industrial production are due.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.595	+0.035
OBL 0 10/26	-0.389	+0.052
DBR 0 08/31	-0.104	+0.034
UKT 0⅞ 01/24	0.680	+0.051
UKT 0⅜ 10/26	0.815	+0.061
UKT 0¼ 07/31	1.024	+0.022

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

Euro area

Another big upside surprise to inflation, but again driven by energy prices

In her post-policy meeting press conference yesterday, ECB President Lagarde acknowledged that the Governing Council expected inflation to increase further than it had expected just last month and to remain higher for longer. But she also repeated that the policymakers still expected inflation to fall back over the course of 2022 and, in line with its September projections, to be below the ECB's 2% target in 2023. Despite another big upside surprise to the flash estimate of euro area inflation in October, there was nothing in the detail of today's data to force the ECB to shift that view. The headline inflation rate rose an extremely sharp 0.7ppt to match the series high of 4.1%Y/Y. Once again, however, almost all action was in terms of energy prices, which posted their biggest monthly increase on the series (5.5%M/M) to be up a whopping record high annual rate of 23.5%Y/Y and contribute more than half (2.24ppts) of headline inflation. All other components were exceptionally close to the ECB's 2% target. Indeed, food inflation was stable, bang on 2.0%Y/Y. But while non-energy industrial goods inflation fell 0.1ppt, also exactly to 2.0%Y/Y, services inflation rose 0.4ppt to 2.1%Y/Y, the highest since 2009. That increase, however, can also almost certainly be attributed to higher fuel prices (e.g. due to their impact on prices of transport services).

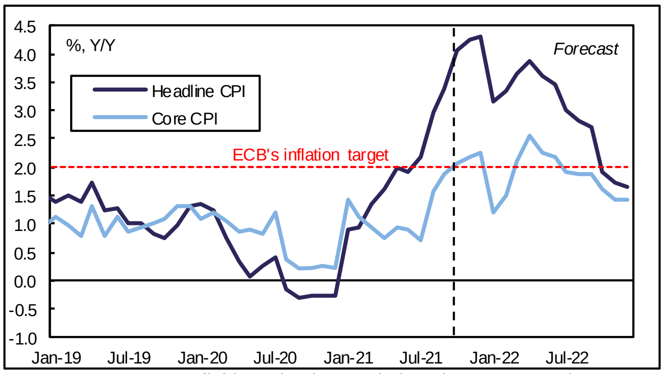
Inflation picture to shift significantly in 2022

We expect inflation to edge up a little further before year-end. However, base effects from the German tax changes and basket revisions will fall out of the calculation from January, pushing headline and core measures significantly lower, with the latter certain to drop back well below 2% then. Moreover, while there remains scope for further pass-through of producer cost pressures to consumers, it is highly likely that energy prices will make a diminishing contribution to inflation once winter has passed and, presumably, gas in the new Nord Stream 2 pipeline is flowing. Indeed, at some point over the next year or two energy prices are likely to be subtracting from inflation once again. But if energy prices did maintain their recent trajectory, then it's also inconceivable that economic recovery would be sustained, and so core inflation would likely fall back sharply instead. So, like the ECB we maintain our view that both headline and core inflation will be below 2.0%Y/Y in the second half of 2022. And as global supply chains are likely increasingly to respond to current bottlenecks, and wage growth is highly likely to be no stronger than the pre-pandemic norms, our baseline projection foresees inflation below 1.5%Y/Y in 2023.

Euro area GDP recovery sustained in Q3

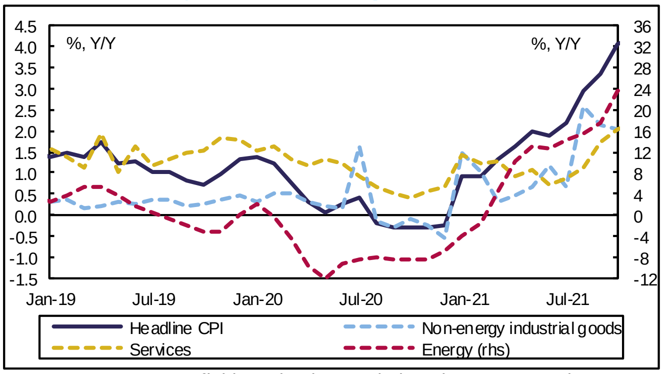
In contrast to inflation, there was no major surprise from the preliminary reading of euro area GDP in Q3. Growth of 2.2%Q/Q was only a touch firmer than the consensus forecast and the outturn in Q2, which was downwardly revised to 2.1%Q/Q.

Euro area: Headline and core inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Key inflation components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Today's release provided no additional detail on the national accounts. But country level reports suggest that the recovery last quarter was principally driven by increased household spending on services as restrictions were relaxed, while net trade also provided a modest boost. Overall, the level of output in Q3 was up 3.7% compared with a year earlier, 4.0% compared with Q420 and just 0.5% below the pre-pandemic. So, although the euro area recovery continues to lag behind the US, where GDP in Q3 was 1.4% above the Q419 level despite a marked slowdown, it remains broadly in line with the profile assumed in the ECB's September macroeconomic projections. Nevertheless, while the euro area appears on track to return to the pre-Covid level of output by the end of the year, as in the US growth seems bound to moderate from now on. Indeed, persistent supply-chain disruption, labour shortages, surging prices of energy and intermediate goods, and a rise in coronavirus cases in certain member states (including Belgium, Austria and the Netherlands and the Baltic States, and to a lesser extent Germany) suggest that risks to the near-term outlook are now skewed to the downside.

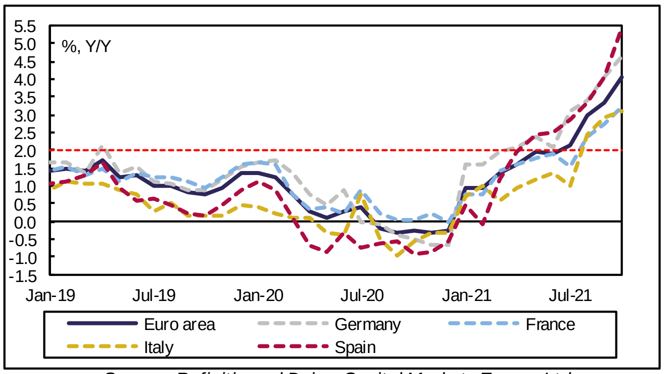
France leads the recovery, with Spain still lagging behind

The ongoing recovery in Q3 was reassuringly evident in each of the euro area's largest member states, albeit to varying degrees. German growth of 1.8%Q/Q broadly aligned with our forecast and followed upwardly revised growth of 1.9%Q/Q in Q2. But, not least reflecting the ongoing challenges German manufacturers continue to face from supply bottlenecks, the pace of recovery so far in 2021 has been the softest of the larger member states (up 1.8% compared with Q420), to leave output still 1.1% below its pre-Covid level. This contrasted with France, where growth firmly beat expectations at 3.0%Q/Q in Q3 and left output within a whisker of the Q419 level. In Southern Europe, Italian growth also beat expectations at 2.6%Q/Q, to leave the country the fastest-growing so far in 2021, with output up more than 5½% since Q420. This leaves a shortfall in Italian GDP of 1.4% from the pre-Covid level. Spanish growth aligned with our own forecast of 2.0%Q/Q, but was well short of the consensus expectation to be still down a whopping 6.6% from the pre-pandemic level. The Spanish detail perhaps raises some questions over the quality of these data – e.g. household consumption was estimated to have fallen 0.5%Q/Q in Q3 despite the easing of restrictions. By comparison, French household consumption was up a whopping 5½%Q/Q, with spending on services up more than 9%Q/Q. And while we will have to wait for an official breakdown in a later release, Destatis also suggested that Germany's growth was driven by household expenditure.

The week ahead in the euro area

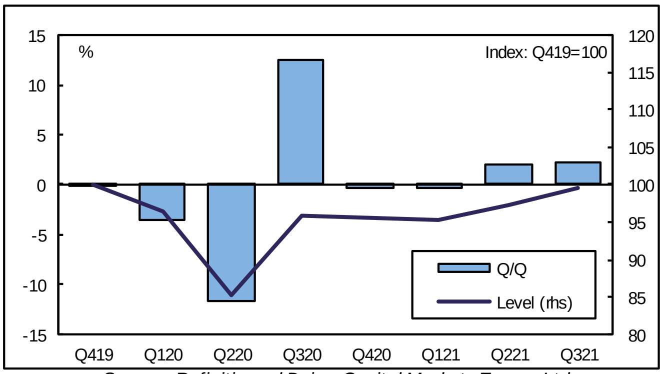
The coming week will bring a number of top-tier releases from the euro area and member states, concluding on Friday with September's retail sales figures for the region as a whole, which will provide some insight into household consumption at the end of the third quarter. These are expected to report further moderate growth in September, albeit this would still leave sales down over the third quarter as a whole as spending on consumer-facing services continued to recover. New car

Euro area: Headline inflation by member state



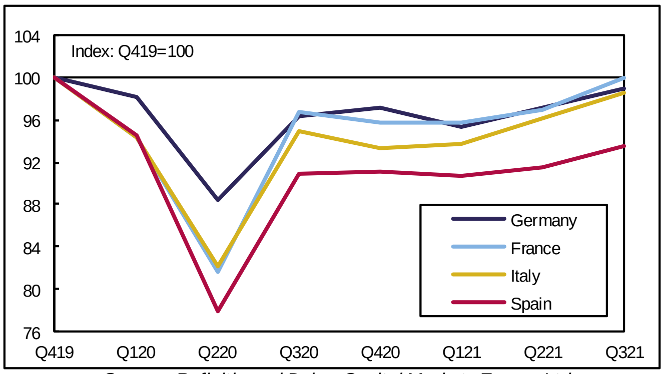
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth and level



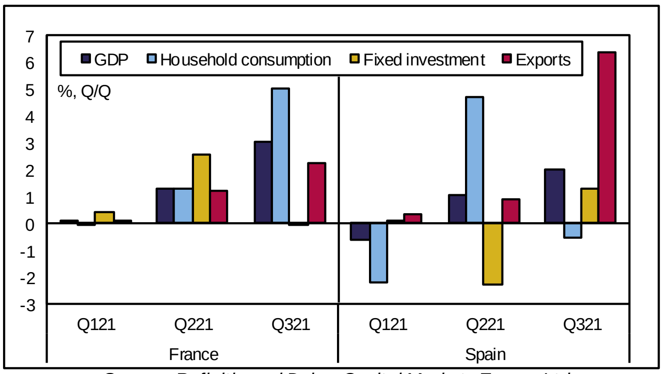
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: GDP levels by member state



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France and Spain: GDP expenditure breakdown



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

registrations data from France, Italy and Spain (Monday) and Germany (Wednesday) will continue to remain subdued at the start of the fourth quarter, with sales still well below levels seen a year earlier despite the low base associated with the pandemic. Of course, this in part reflects ongoing supply-related disruption to production in the manufacturing sector. And this will be further illustrated in the final manufacturing PMIs (Monday) – the flash release saw the euro area output index decline 3.3pts to 53.3, a sixteen-month low. The back end of the week will bring an update on manufacturing conditions at the country level too, with September's German factory orders (Thursday) and IP (Friday) releases likely to confirm a softening in new demand and contraction in production over the third quarter as a whole. French and Spanish IP numbers will also be published on Friday. Meanwhile, the final services PMIs (Wednesday) are also expected to confirm a loss of recovery momentum at the start of the fourth quarter – the preliminary activity index fell 2.6pts to 54.7, a six-month low – while the latest construction PMIs (Thursday) will likely flag ongoing supply-related challenges in the sector. And all three PMI surveys are likely to indicate still extremely elevated price pressures as well as ongoing struggles with respect to labour shortages. Against this backdrop, euro area unemployment figures for September are due on Wednesday, with the latest PPI data – which are set to report a notable further jump in cost pressures due to energy prices – to be published on Thursday.

UK

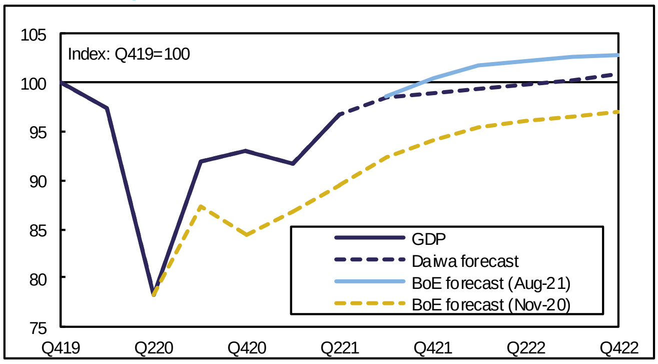
Mortgage lending boosted by tapering of stamp duty holiday, but consumer credit remains weak

A relatively quiet end to the week for UK economic news brought the release of the BoE's latest bank lending data. While striking, the pickup in mortgage lending last month was hardly surprising as house buyers rushed to complete before the tapering of the government's stamp duty holiday was completed. Indeed, net lending secured on dwellings jumped £9.5bn in September, £2.9bn above the average in the year to June when mortgage borrowing hit a record (£17.1bn). But the number of mortgage approvals eased in September to 72.6k, the lowest since July 2020 signalling an inevitable slowdown in housing market activity. Against the backdrop of heightened concerns about the near-term outlook, demand for consumer credit also remained subdued, with individuals borrowing just a net £0.2bn last month. This in part reflected a net repayment on other forms of credit, such as car dealership finance and personal loans, while net borrowing on credit cards (£0.6bn) was the strongest since July last year. Overall, consumer credit remained well down on a year earlier (-1.8%Y/Y). Meanwhile, given a second successive monthly net repayment of loans to non-financial corporations, and of £2.7bn, total loans to businesses were down 1.2%Y/Y, with loans to SMEs (-0.4%Y/Y) and large corporations (-1.6%Y/Y) both lower. Overall, M4 money growth (excluding the deposits of intermediate other financial corporations, IOFCs) slowed to 5.5% 3M/3M annualised, back firmly within the range of the five years ahead of the pandemic having leapt in the first phase of the pandemic last year and again throughout the second wave around the turn of the year.

The week ahead in the UK

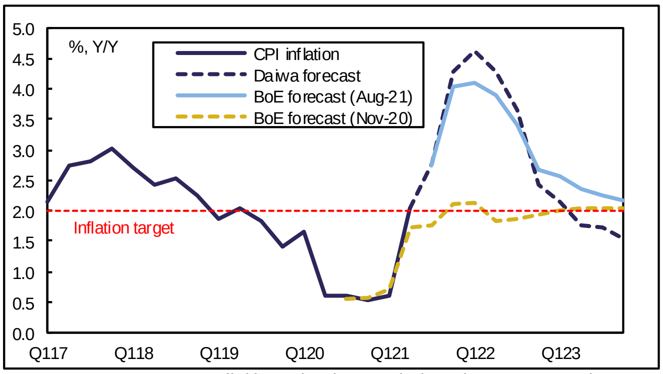
All eyes in the coming week will be on Thursday's BoE announcements. In the run up to this meeting, key MPC members – including most notably Governor Bailey and Chief Economist Pill – have raised concerns about the near-term outlook for inflation and signalled that rates will likely need to be raised over the near term to reduce the risks of potential second-round effects on inflation expectations and wages. And with the Bank's updated economic forecasts likely to suggest that spare capacity in the economy is considerably smaller than assumed in its previous projections in August, near-term unemployment will rise less than previously thought and inflation will peak noticeably higher and remain above target for longer than previously expected, it would seem odd for those recently adopting a hawkish tone not to vote for a rate hike at this meeting. The news from this week's Budget, which implied a less severe profile for near-term fiscal tightening than previously, will provide further justification for those itching to raise rates. But some on the MPC have adopted a more cautious approach, suggesting the desire to await further information on the labour market after the conclusion of the government's furlough scheme last month. As such, Thursday's decision is unlikely to be unanimous. Nevertheless, with the BoE staff members of the MPC all likely on board for tighter policy now, we think the majority will vote to raise rates by 15bps to 0.25%, by 6-3 in favour. The MPC will also likely vote to bring an end to its QE programme one month early, thus reducing its target by £20bn to £875bn (of which £855bn would comprise Gilts).

UK: GDP growth forecasts



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

UK: Inflation forecasts



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

As Pill recently noted, of course, a 15bps increase in Bank Rate would merely remove the emergency settings of policy that were introduced after the intensification of the pandemic. So, next week's policy statement and Bailey's press conference should also be watched for further signals on the near-term future path of policy and the conditions required to justify additional tightening. We suspect that the BoE's updated economic projections will imply that the expected tightening currently priced into money markets, of almost four additional hikes in 2022, would likely push inflation back below the 2.0%Y/Y target by the end of the horizon.

Ahead of the BoE's announcements, October sentiment surveys will dominate the UK's dataflow, with the final manufacturing, services and construction PMIs due on Monday, Wednesday and Thursday respectively. The flash releases suggested a surprise acceleration in services activity at the start of Q4, with the headline index up 2.6pts to 58.0, a three-month high. But manufacturing output – the relevant index fell 2.1pts to 50.6, an eight-month low – reportedly continued to struggle amid persistent supply challenges, which are similarly likely to have remained a drag on activity in the construction sector this month too. With autos production particularly hampered by supply bottlenecks, the latest new car registrations numbers for October (Thursday) are expected to remain well down on their pre-pandemic levels. Meanwhile, the Lloyds Business Barometer (Monday) will be watched for further insights into labour market developments – the previous survey saw the indicator for expected wage growth rise to the highest since 2018 – as will the REC/KPMG report on UK jobs (Friday).

Daiwa economic forecasts

	2021		2022				2021	2022	2023
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP forecasts %, Q/Q									
Euro area	1.8	1.0	0.8	0.7	0.7	0.6	5.0	4.1	2.1
UK	1.8	0.5	0.4	0.4	0.4	0.7	7.0	3.7	1.9
Inflation forecasts %, Y/Y									
Euro area									
Headline CPI	2.8	4.2	3.4	3.6	2.8	1.8	2.5	2.9	1.4
Core CPI	1.4	1.9	1.6	2.3	1.9	1.5	1.4	1.8	1.3
UK									
Headline CPI	2.8	4.3	4.6	4.3	3.7	2.4	2.4	3.7	1.8
Core CPI	2.6	3.3	3.7	3.2	2.6	2.0	2.2	2.9	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	0.25	0.25	0.50	0.50	0.50	0.25	0.50	0.75
Gilt purchases* (£bn)	875	855	855	855	846	846	855	846	813

**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 CPI (core CPI) Y/Y%	Oct	**4.1 (2.1)**	*3.6 (1.9)*	3.4 (1.9)	**-**
	Preliminary GDP Q/Q% (Y/Y%)	Q3	**2.2 (3.7)**	*1.8 (3.3)*	2.2 (14.3)	**2.1 (14.2)**
Germany	Preliminary GDP Q/Q% (Y/Y%)	Q3	**1.8 (2.5)**	*1.7 (1.9)*	1.6 (9.4)	**1.9 (9.8)**
France	Consumer spending M/M% (Y/Y%)	Sep	**-0.2 (-2.3)**	0.4 (-1.7)	1.0 (-5.4)	**0.7 (-)**
	Preliminary GDP Q/Q% (Y/Y%)	Q3	**3.0 (3.3)**	*2.0 (2.1)*	1.1 (18.7)	**1.3 (18.8)**
	Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	**2.6 (3.2)**	2.5 (3.2)	2.2 (2.7)	**-**
Italy	Preliminary GDP Q/Q% (Y/Y%)	Q3	**2.6 (3.8)**	*1.5 (2.6)*	2.7 (17.3)	**- (17.0)**
	Preliminary CPI (EU-harmonised CPI) Y/Y%	Oct	**2.9 (3.1)**	2.9 (3.2)	2.5 (2.9)	**-**
Spain	Preliminary GDP Q/Q% (Y/Y%)	Q3	**2.0 (2.7)**	*2.0 (2.7)*	1.1 (17.5)	**-**
	Retail sales Y/Y%	Sep	**-0.1**	0.0	-0.9	**-0.7**
UK	Net consumer credit £bn (Y/Y%)	Sep	**0.2 (-1.8)**	0.5 (-)	0.4 (-2.4)	**0.5 (-)**
	Net mortgage lending £bn (approvals 000s)	Sep	**9.5 (72.6)**	5.7 (72.0)	5.3 (74.5)	**4.4 (74.2)**
	M4 money supply Y/Y%	Sep	**7.0**	-	7.0	**7.1**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

The coming week's data calendar

The coming week's key data releases

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast/actual*	Previous
Monday 1 November 2021						
Euro area		09.00	Final manufacturing PMI	Oct	58.5	58.6
Germany		-	Retail sales* M/M% (Y/Y%)	Sep	0.5 (1.9)	1.2 (0.9)
		08.55	Final manufacturing PMI	Oct	58.2	58.4
France		08.50	Final manufacturing PMI	Oct	53.5	55.0
		-	New car registrations Y/Y%	Oct	-	-20.5
Italy		08.45	Manufacturing PMI	Oct	59.5	59.7
		17.00	New car registrations Y/Y%	Oct	-	-32.7
Spain		08.15	Manufacturing PMI	Oct	58.0	58.1
		-	New car registrations Y/Y%	Oct	-	-15.7
UK		00.01	Lloyds business barometer	Oct	-	46
		09.30	Final manufacturing PMI	Oct	57.7	57.1
Tuesday 2 November 2021						
- Nothing scheduled -						
Wednesday 3 November 2021						
Euro area		09.00	Final services (composite) PMI	Oct	54.7 (54.3)	56.4 (56.2)
		10.00	Unemployment rate %	Sep	7.4	7.5
Germany		08.55	Final services (composite) PMI	Oct	52.4 (52.0)	56.2 (55.5)
		-	New car registrations Y/Y%	Oct	-	-25.7
France		08.50	Final services (composite) PMI	Oct	56.6 (54.7)	56.2 (55.3)
Italy		08.45	Services (composite) PMI	Oct	54.5 (55.8)	55.5 (56.6)
		09.00	Unemployment rate %	Oct	9.3	9.3
Spain		08.00	Unemployment change 000s	Oct	-	-76.1
		08.15	Services (composite) PMI	Oct	56.0 (56.2)	56.9 (57.0)
UK		07.00	Nationwide house price index M/M% (Y/Y%)	Oct	0.3 (9.2)	0.1 (10.0)
		09.30	Final services (composite) PMI	Oct	58.0 (56.8)	55.4 (54.9)
Thursday 4 November 2021						
Euro area		08.30	Construction PMI	Oct	-	50.0
		10.00	PPI M/M% (Y/Y%)	Sep	- (15.2)	1.1 (12.4)
Germany		07.00	Factory orders M/M% (Y/Y%)	Sep	0.4 (7.5)	-7.7 (11.7)
		08.30	Construction PMI	Oct	-	47.1
France		08.30	Construction PMI	Oct	-	48.9
Italy		09.00	Construction PMI	Oct	-	56.6
UK		09.00	New car registrations Y/Y%	Oct	-	-34.4
		09.30	Construction PMI	Oct	52.0	52.6
		12.00	BoE Bank Rate %	Nov	*0.25*	0.10
		12.00	BoE Gilt purchase target £bn	Nov	*875*	875
		12.00	BoE Corporate bond target £bn	Nov	*20*	20
Friday 5 November 2021						
Euro area		10.00	Retail sales M/M% (Y/Y%)	Sep	0.3 (1.6)	0.3 (0.0)
Germany		07.00	Industrial production M/M% (Y/Y%)	Sep	-0.8 (-0.9)	-4.0 (1.7)
France		07.45	Industrial production M/M% (Y/Y%)	Sep	-0.1 (2.2)	1.0 (3.9)
		07.45	Wages Q/Q%	Q3	0.5	0.3
Spain		08.00	Industrial production M/M% (Y/Y%)	Sep	0.3 (1.5)	-0.3 (1.8)

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

The coming week's key events & auctions			
Country		GMT	Event / Auction
			Monday 1 November 2021
			- Nothing scheduled -
			Tuesday 2 November 2021
Germany		10.30	Auction: €400mn of 2030 index-linked bonds
		10.30	Auction: €400mn of 2033 index-linked bonds
UK		10.00	Auction: £3.0bn of 0.25% 2025 bonds
		11.00	Auction: £3.0bn of 1.625% 2017 bonds
			Wednesday 3 November 2021
Euro area		09.15	ECB President Lagarde speaks at event marking 175th anniversary of the Bank of Portugal
Germany		10.30	Auction: €4.0bn of 0% 2026 bonds
UK		10.00	Auction: £2.5bn of 0.5% 2029 bonds
			Thursday 4 November 2021
France		09.50	Auction: to sell 2031, 2039 and 2053 bonds
Spain		09.30	Auction: to sell 2028, 2030, 2031 and 2046 bonds
UK		12.00	BoE publishes monetary policy statement, minutes and Monetary Policy Report
		12.30	BoE Governor Bailey holds press conference
Euro area		13.00	ECB President Lagarde speaks at ECB-CEPR Women in Economics Conference
		18.15	ECB Executive Board member Schnabel speaks at ECB-CEPR Women in Economics Conference
			Friday 5 November 2021
Euro area		11.00	ECB Executive Board member Panetta speaks publicly in Madrid
UK		12.15	BoE Deputy Governor Ramsden and Chief Economist Pill to deliver Monetary Policy Report National Agency briefing
		13.00	BoE's Tenreryo due to speak on "Uncertainty and restoring confidence following the pandemic"

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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