Euro wrap-up

Overview

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- Bunds made losses with 10Y yields flirting with 2.00% despite a further deterioration in euro area consumer confidence to a new record low.
- As the BoE raised rates by 50bps, left the door open to larger hikes ahead, and the UK Treasury confirmed the reversal of April's National Insurance increase, Gilts made sizeable losses with 10Y yields surpassing 3.50%.
- Friday brings the flash European PMIs for September, while the UK government will confirm its new tax-cut plans in a mini budget statement.

Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	1.821	+0.092
OBL 1.3 10/27	1.946	+0.118
DBR 1.7 08/32	1.980	+0.095
UKT 1 04/24	3.545	+0.127
UKT 1¼ 07/27	3.581	+0.201
UKT 4¼ 06/32	3.512	+0.200

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

Euro area

Euro area consumer confidence slumps to a new record low

Euro area consumer confidence took a further turn for the worse at the end of Q3, as high inflation, rising interest rates and persisting concerns about the energy crisis took their toll. Indeed, the headline indicator fell a steeper-than-expected 3.9pts to -28.8, a new series low. The weakness had already been flagged in yesterday's Dutch release, which similarly saw confidence fall to a record low, while today's survey results from the National Bank of Belgium (NBB) suggested a significant worsening. In particular, the headline NBB sentiment gauge dropped a whopping 16pts in September – almost matching the size of the slumps at the onset of the pandemic and Russian invasion of Ukraine – to -27, a record low. The weakness was broad-based, with pessimism about the future financial situation and economic outlook over the coming twelve months having never been greater, in part reflecting increased fears of unemployment and lack of opportunities to save. Overall, today's surveys imply the likelihood of a weakening in household spending as the summer progressed and little prospect for a pick up over the near term.

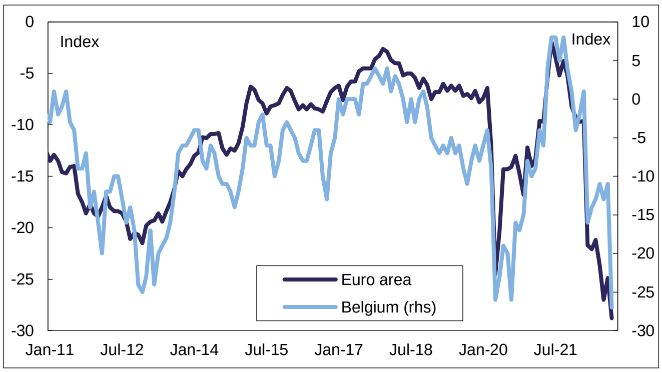
French business sentiment eases to a 17-month low

Ahead of Friday's flash PMIs, today's French INSEE business survey also pointed to a deterioration in confidence, with the headline indicator falling to a seventeen-month low. However, at 102, this remained just above the long-run average (100) and firmly above the post-pandemic low of 47.4 in April 2020. The reported deterioration in the business climate was nevertheless broad-based at the end of Q3, with the exception of the construction sector which was considered to have remained stable. Indeed, retailers continued to report the most challenging conditions, with the headline sentiment index (96) below the long-run average as firms in the sector were more downbeat about expected sales, while ordering intentions were the weakest since November 2020. Meanwhile, manufacturers reported the third consecutive deterioration in their order books and therefore saw notably weaker production prospects over the coming three months. Services sentiment similarly maintained a modest downtrend, with the synthetic business climate indicator falling to an eight-month low (106), albeit still comfortably above the long-run average.

ECB's Schnabel recognises likelihood of German recession and sees no signs of wage-price spiral

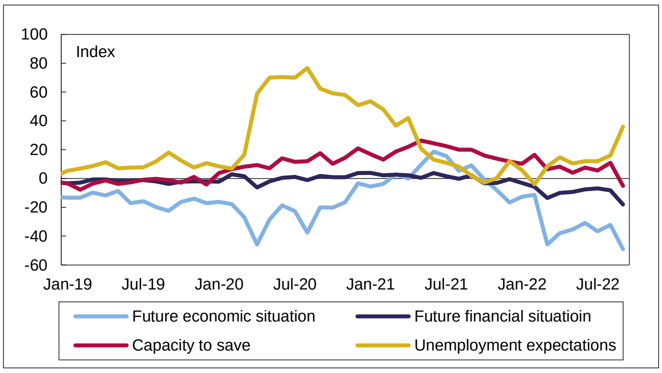
In an interview with t-online published today, one of the ECB's key hawks, Executive Board member Isabel Schnabel, unsurprisingly reiterated that rates are going to rise again at the Governing Council's next meeting at end-October. But she gave no clues as to the likely magnitude of that hike. And some of her comments were a little less hawkish than of late. Among other things, while for the euro area as a whole, the ECB was expecting economic stagnation over coming quarters,

Euro area: Consumer confidence indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Belgium: Consumer confidence indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

she noted that a German recession may be unavoidable due to the strong dependency on Russian gas. Of course, she also insisted that what matters for ECB policy is the outlook for inflation not GDP. But in that respect, while she reiterated concerns about possible increases in medium-term inflation expectations, she also admitted that there were no signs "at present" of a wage-price spiral. Indeed, she noted that wage agreements are "nowhere near keeping pace with inflation" and acknowledged that "purchasing power is declining". She insisted that the ECB was, however, closely monitoring wage dynamics. And at this stage, with the hawks still dominating the Governing Council, we maintain our expectation of a further hike of 75bps in rates at the next monetary policy meeting in late October.

The day ahead in the euro area

Looking ahead to tomorrow, the euro area economic data calendar remains focused on sentiment indicators, with the key flash PMIs for the euro area, Germany and France to be published. Like today's survey indicators, these are expected to point to a further deterioration in business conditions at the end of Q3, with the euro area composite output index forecast to record the third consecutive contractionary reading in September, and to fall below the 18-month low of 48.9 logged in August.

UK

BoE hikes Bank Rate by 50bps, launches active Gilt sales programme

In line with the expectation of most economists, but less than implied by market pricing ahead of the announcement, the BoE today hiked Bank Rate by 50bps to 2.25%. Also, as we suspected, the MPC's vote was split three ways. While five members voted for 50bps, three members (two externals, Mann and Haskel, as well as one BoE staffer, Ramsden) voted for 75bps, while the other (new external member Dhingra) voted for a hike of just 25bps. The MPC was unanimous, however, in voting to launch a programme of active Gilt sales in line with the plan published last month. The BoE will therefore aim to reduce the stock of its Gilt holdings by £80bn over the next twelve months, in part via sales of £10bn per quarter. Looking ahead, the BoE is highly likely to continue raising rates for a while yet. Indeed, its updated guidance left the door open to hikes of bigger increments in future, stating that "should the outlook suggest more persistent inflationary pressures, including from stronger demand, the Committee will respond forcefully, as necessary".

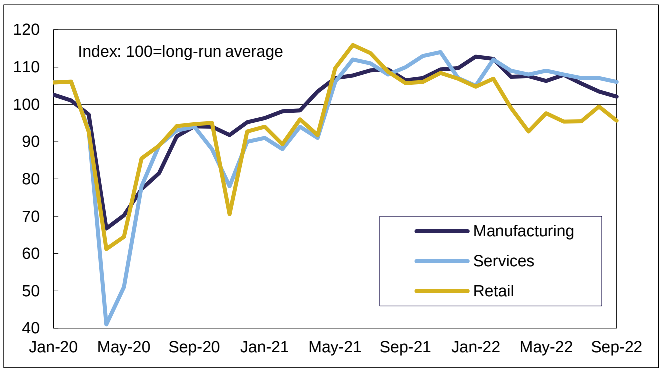
New fiscal policy initiatives judged to add to medium-term inflation pressures

The MPC's statement made clear the continued huge level of uncertainty about the economic outlook, including that related to UK government policy, which meant that the outlook for monetary policy remained extremely uncertain too. Indeed, while it acknowledged that risks related to UK retail energy prices had fallen thanks to the government's interventions in the market, the broader fiscal "Growth Plan", seemingly largely comprising unfunded tax cuts and due to be fully unveiled tomorrow, raised new question marks about the outlook for both GDP and inflation. Notably, the MPC thought that government policies were likely to add to inflation pressures over the medium term. So, while recent data suggested that GDP would contract slightly for the second successive quarter in Q3, and the peak in inflation – at just below 11%Y/Y in October – would be significantly lower than previously feared, risks of persistent price and wage pressures were still judged to be material, not least also as the labour market remained very tight and sterling continues to depreciate.

Sterling weakness also likely to pose upside risks to Bank Rate over coming quarters

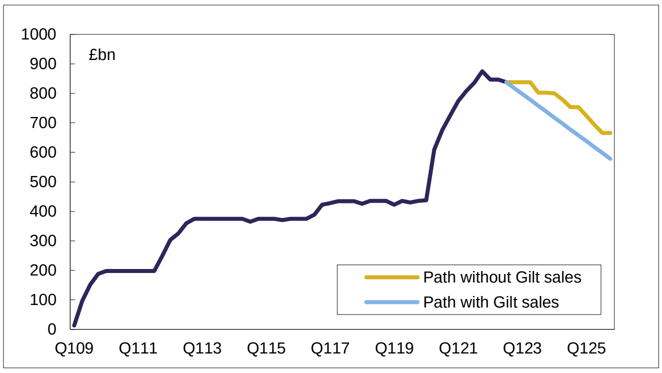
Given that the BoE's projections last month pointed to the likelihood of a deep recession, sharp increase in unemployment, and an eventual drop in inflation to below 1%Y/Y by the end of the forecast horizon, concerns about the inflationary impact of a somewhat stronger GDP outlook than was previously anticipated should perhaps not be exaggerated. However, fiscal stimulus – the full extent of which is only likely to become clear tomorrow – now seems bound to result in a higher path for Bank Rate than otherwise would have been the case. Likewise, given the additional inflationary risks posed by sterling weakness, the further that the Fed hikes, the greater will be the need for the BoE to keep tightening too. We continue to look

France: INSEE business sentiment indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: BoE Gilt holdings



Source: BoE and Daiwa Capital Markets Europe Ltd.

for an additional hike of 50bps in Bank Rate in November, with the risks to that view skewed to the upside. Likewise, the risks to our forecast terminal rate for the current cycle, of 3.50%, look skewed to the upside too.

The day ahead in the UK

Following today's BoE policy announcement, the focus tomorrow shifts to fiscal policy, with the government's new Chancellor Kwasi Kwarteng set to deliver a mini-budget and present his new growth strategy. In addition to the government's pre-announced energy support proposals and today's commitment to reverse April's hike in National Insurance Contributions from November and cancel the forthcoming Health and Social Care Levy, the previously planned corporation tax hike will be cancelled and housing stamp duty will reportedly be cut. The assumption is that the tax cuts will be financed by higher bond issuance. But the lack of updated fiscal forecasts and objective scrutiny from the OBR will likely leave plenty of uncertainty about the full implications for the Gilt market.

Data-wise, Friday brings a number of interesting sentiment surveys, including the preliminary September PMIs, GfK consumer confidence and CBI distributive trades indices. With the manufacturing PMI expected to signal a steeper pace of contraction and the services PMI expected to imply stagnation, the composite output PMI is currently forecast to fall further below the key-50 expansion level to its lowest level since January 2021. Meanwhile the CBI's retail trade survey for September will provide the first look at spending in the final month of Q3, following the larger than expected decline in August. And while the cap on household energy bills might well give a temporary boost, the ongoing squeeze on household budgets from rising inflation and interest rates seems bound to see consumer confidence remain close to recent record lows.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Preliminary EC preliminary consumer confidence	Sep	**-28.8**	-25.1	-24.9	**-25.0**
France	INSEE business confidence	Sep	**102**	102	103	**104**
	INSEE manufacturing confidence (production outlook)	Sep	**102 (-6)**	102 (-5)	104 (-2)	**103 (-)**
UK	BoE Bank Rate %	Sep	**2.25**	*2.25*	1.75	**-**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	09.00	Preliminary manufacturing (services) PMI	Sep	48.8 (49.1)	49.6 (49.8)
	09.00	Preliminary composite PMI	Sep	48.2	48.9
Germany	08.30	Preliminary manufacturing (services) PMI	Sep	48.3 (47.2)	49.1 (47.7)
	08.30	Preliminary composite PMI	Sep	46.1	46.9
France	08.15	Preliminary manufacturing (services) PMI	Sep	49.8 (50.5)	50.6 (51.2)
	08.15	Preliminary composite PMI	Sep	49.9	50.4
Spain	08.00	Final GDP Q/Q% (Y/Y%)	Q2	*1.1 (6.3)*	0.2 (6.3)
UK	00.01	GfK consumer confidence	Sep	-42	-44
	09.30	Preliminary manufacturing (services) PMI	Sep	47.5 (50.0)	47.3 (50.9)
	09.30	Preliminary composite PMI	Sep	49.0	49.6
	11.00	CBI reported retail sales	Sep	-	11

Auctions and events

Country	BST	Event
UK	Tbc	UK government's fiscal announcements

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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