

# Euro wrap-up

## Overview

- While the latest ifo survey signalled that the German economy is slipping into recession, Bunds made losses, while BTPs underperformed after the right-wing bloc won majorities in both of Italy's houses of parliament.
- Gilts again got smashed after sterling hit a record low, forcing the BoE to issue a statement late in the day that it stands ready to change policy if necessary to meet its inflation target.
- Tuesday will bring euro area bank lending and deposit data while the BoE's Chief Economist will speak publicly.

**Chris Scicluna**  
+44 20 7597 8326

**Emily Nicol**  
+44 20 7597 8331

### Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	1.913	+0.031
OBL 1.3 10/27	2.083	+0.076
DBR 1.7 08/32	2.108	+0.091
UKT 1 04/24	4.390	+0.497
UKT 1½ 07/27	4.521	+0.478
UKT 4¼ 06/32	4.236	+0.417

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

## Euro area

### ifo survey paints a particularly gloomy picture as the German economy slips into recession

Following Friday's [downbeat PMIs](#), today's German ifo survey underscored the impression that the euro area's largest economy weakened significantly over the summer, with high inflation, exorbitant energy prices and rising borrowing costs reducing purchasing power, supply constraints still binding in key sectors, and concerns about possible natural gas and electricity rationing, events in Ukraine and the broader global outlook having intensified. Certainly, the headline business climate index fell a steeper-than-expected 4.3pts in September to 84.3, the weakest reading since the first wave of Covid-19 in May 2020 and, before that, the global financial crisis in 2009. Firms were clearly more gloomy about their current situation, with the relevant survey index (94.5) the lowest since April 2021. And the outlook for the coming six months appeared increasingly bleak – the expectations index declined more than 5pts to 75.2, some 22pts below the long-run average and the second-weakest reading on the series dating back to 2005, merely 3.3pts above the initial pandemic trough in April 2020.

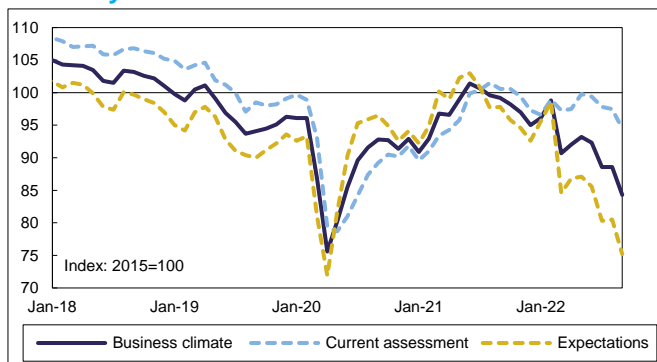
### German retailers the most downbeat on the survey, but pessimism widespread

Within the detail of the survey, with consumer confidence at a record low and household budgets being squeezed, retailers were the most negative about the outlook on record. But increasing pessimism was widespread. As the post-pandemic rebound in services activity over the summer faded, firms in the sector assessed that conditions had worsened significantly at the end of Q3, with hospitality seemingly facing particularly challenging times ahead. Indeed, only at the start of the pandemic in April 2020 was the balance of expectations in services so weak. Amid a further decline in order books and ongoing concerns about energy supply, manufacturers were also the most pessimistic about the coming six months since April 2020, with the mood in almost every subsector having taken a turn for the worse. The weakening in construction was also noticeable, with firms' assessment of current conditions the worst since April 2016. Overall, therefore, no one should be surprised that the ifo institute concluded that the German economy is now slipping into recession. We see a decent chance that GDP will be lower in Q3 than in Q2, with a steeper pace of contraction expected in the final quarter of the year and at the start of 2023 too.

### Italian election result broadly as expected

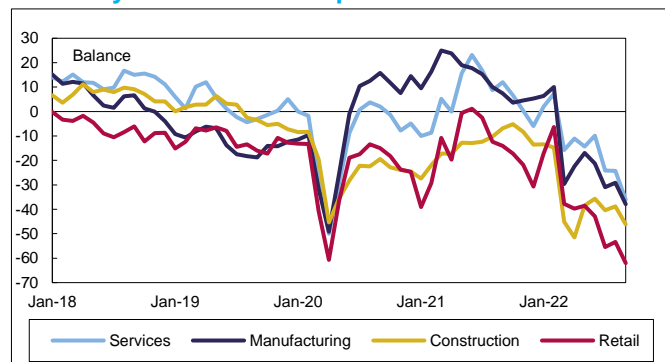
With major government bond yields higher, spreads of BTPs over Bunds widened today. But the results of yesterday's Italian general election probably did not have a significant impact, as they were broadly in line with the findings of the opinion polls. The record low turnout was also in line with expectations. Most notably, with the right-wing coalition securing about 44% of the vote, ahead of the centre-left bloc's share of just 26%, it won comfortable majorities in both houses of parliament, but fell

### Germany: ifo business climate indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany: ifo business expectations indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

short of the two-thirds majorities that would have facilitated constitutional reform. Moreover, within the right-wing bloc, the nationalist Brothers of Italy (FdI) managed somewhat to outperform expectations, with a little more than one quarter of the vote, up from just 4% at the last election in 2018. That was significantly more than the combined share of the vote of its two main partners – Salvini's Lega, with just 9%, and Berlusconi's Forza Italia with just 8% of the vote, with the former performing below expectations as it continued to suffer from its previous support for Draghi's government.

## Focus to shift to cabinet nominations

So, while discussions on a coalition government programme will probably take a few weeks, FdI leader Georgia Meloni is firmly set to succeed Mario Draghi as Italian Prime Minister. To maintain Italian eligibility for the NextGeneration EU funds, she is likely to signal once again her commitment to many of the key elements of Draghi's reform plans, as well as a broadly prudent fiscal stance. In that respect, the strong showing of the FdI in the election should enable her to face down Salvini, who has called for another big fiscal package, of about €30bn, to help households and businesses cope with higher energy bills. Of course, her commitment to fiscal rectitude might soon wane in the face of the deteriorating economic outlook. A key focus over the near term will be the nominations for key Cabinet positions. BTP investors will be hoping for a credible Minister Finance to succeed the incumbent technocrat Daniele Franco, and also for a Minister of Foreign Affairs that maintains Italian commitments to NATO and EU membership.

## The coming two days in the euro area

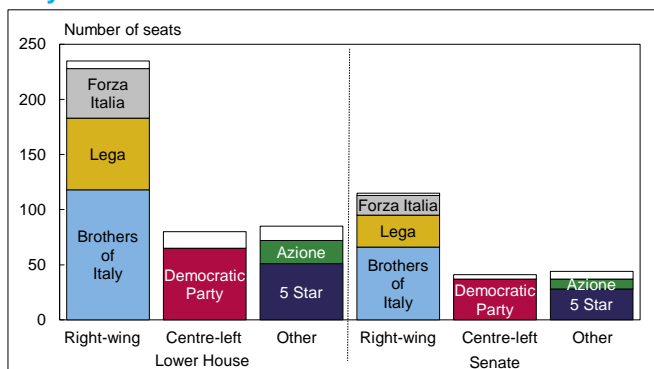
Tomorrow is set to be relatively quiet on the euro area economic data front with the ECB's bank lending figures for August due to be published. These might well show that, given rising interest rates, demand for consumer credit eased again, while households might well have reduced the amount they saved due to the rising cost of living. On Wednesday, the focus will be on national sentiment data, with Germany's GfK consumer confidence and Italy's ISTAT consumer and business sentiment surveys due. We expect these to echo the deterioration in last week's flash [Commission's consumer confidence](#) indicator and [flash PMIs](#) at the end of the third quarter. In terms of ECB-speak, Vice President de Guindos is in action tomorrow, followed by President Lagarde on Wednesday.

## UK

### BoE and Treasury issue statement after weekend suggestions of more tax cuts extend rout

After Friday's government announcement of large-scale unfunded tax cuts was followed on the weekend by promises of further generous tax cuts to come in the New Year, the depreciation of sterling to a record low of \$1.035 in Asian time today

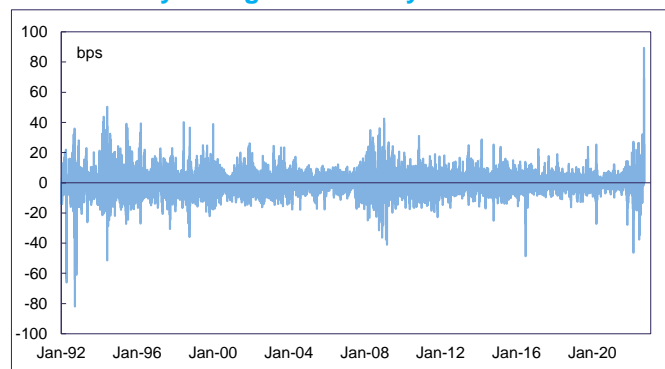
#### Italy: General election results\*



\*Based on 95% of vote. White represents other parties.

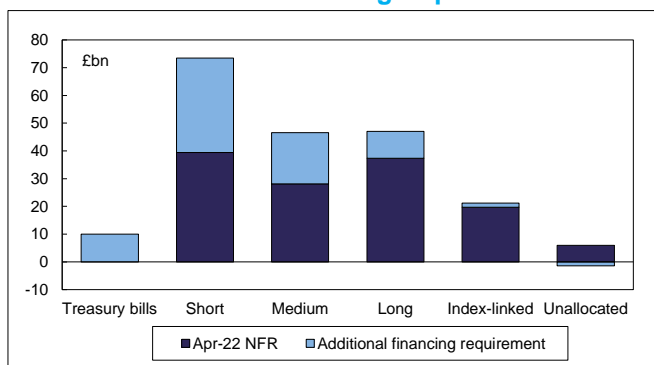
Source: Elezioni.internor.gov.it and Daiwa Capital Markets Europe Ltd.

#### UK: Two-day change in 5Y Gilt yield



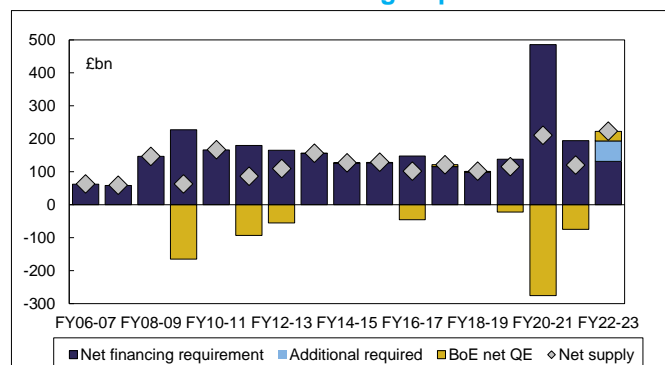
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

#### UK: Government net financing requirement



Source: DMO and Daiwa Capital Markets Europe Ltd.

#### UK: Government net financing requirement



Source: DMO, BoE, ONS and Daiwa Capital Markets Europe Ltd.

was not undeserved. While the pound subsequently recovered the lost ground from Friday's close over the course of the day, that reflected revised expectations of more aggressive BoE policy to come and the associated second successive trading day's leap in Gilt yields. Indeed, market pricing today suggested a non-negligible probability that the MPC will decide to raise rates significantly before its next scheduled monetary policy meeting on 3 November, and deliver cumulative hikes of some 225bps by that date. And after much market and media speculation over the course of the day that something was afoot, just before London market close, the BoE and HM Treasury issued statements attempting to allay the markets' immediate concerns. Whether or not they have done enough to draw a line under the pound and Gilts, however, must be in doubt. Certainly, the initial market response was not overwhelmingly favourable, with sterling edging lower and longer-date yields rising to new highs.

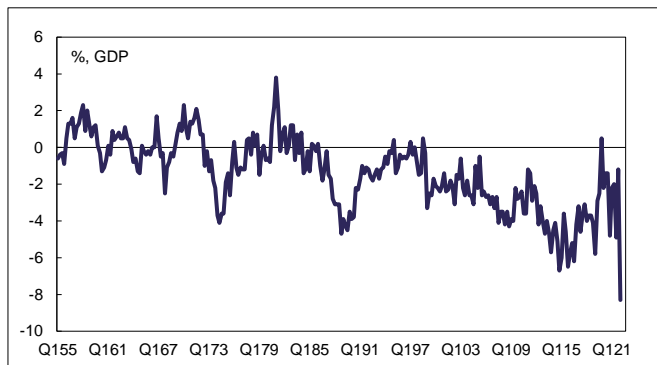
### BoE flags possibility of intra-meeting hike if sterling fails to stabilise

Most notably, the BoE statement alluded to the possibility of an intra-meeting hike, stating that "the MPC will not hesitate to change interest rates as necessary to return inflation to the 2% target sustainably in the medium term". However, Governor Bailey is clearly keeping his fingers crossed that such an exceptional hike will not be required, noting also that the MPC will not produce a full assessment of the Government's fiscal announcements until the next scheduled monetary policy meeting on 3 November. Even then, the BoE will still merely be partially sighted on the government's intentions, with HM Treasury stating that a new medium-term fiscal strategy and independent OBR forecasts will be presented no sooner than 23 November. With UK forex reserves being paltry and inadequate for market intervention purposes, and the MPC unlikely to want to change course on its quantitative tightening plans, an exceptional inter-meeting rate hike will remain the only credible tool at the BoE's disposal should the downwards pressure on sterling and upwards pressure on yields – which remains merited in light of the government's reckless fiscal policy, increased borrowing needs and disregard for transparency – continue over coming days. In that respect, this afternoon's statements certainly do not lessen the likelihood that substantial monetary tightening will be required before long, and perhaps before the week is out.

### The coming two days ahead in the UK

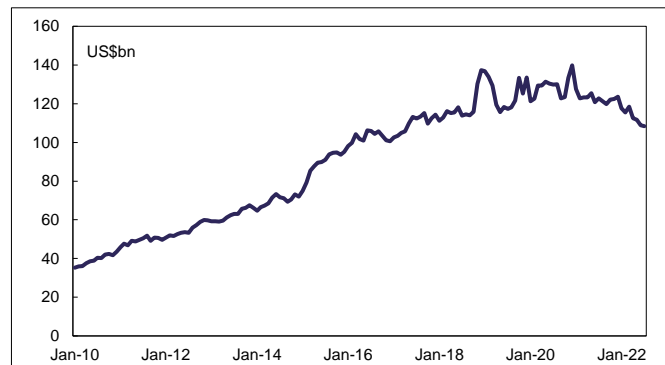
Following today's statement from the BoE, comments tomorrow afternoon from Chief Economist Pill will be watched closely for any further insights into the readiness of the MPC to take action to stem pressure on sterling and Gilts. Looking further ahead, on Wednesday, BoE Deputy Governor Jon Cunliffe and new external MPC member Dingra will also speak publicly. Data-wise the same day, the BRC's shop price index seems bound to flag elevated price pressures on the High Street, not least due to higher global food prices, with the headline rate likely to have risen further from August's series high of 5.1%Y/Y.

#### UK: Current account balance



Source: ONS and Daiwa Capital Markets Europe Ltd.

#### UK: Forex reserves







Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

**The next edition of the Euro wrap-up will be published on 28 September 2022**

## European calendar

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 ifo business climate index	Sep	<b>84.3</b>	87.0	88.5	<b>88.6</b>
	 ifo current assessment (expectations) balance	Sep	<b>94.5 (75.2)</b>	96.0 (79.0)	97.5 (80.3)	<b>- (80.5)</b>
Spain	 PPI M/M% (Y/Y%)	Aug	<b>2.8 (41.8)</b>	-	0.0 (40.4)	<b>0.1 (40.5)</b>
UK	 Rightmove house price index M/M% (Y/Y%)	Sep	<b>0.7 (8.7)</b>	-	-1.3 (8.2)	-


#### 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/ <i>Daiwa forecast</i>	Previous
Euro area	 09.00	M3 money supply Y/Y%	Aug	5.4	5.5







#### Auctions and events

Euro area	 14.15	ECB Vice President de Guindos scheduled to speak
Germany	 10.30	Auction: €3bn of 0% 2027 bonds
Italy	 10.00	Auction: €2.5bn of 1.75% 2024 bonds
	 10.00	Auction: €1.25bn of 0.10% 2033 index-linked bonds
UK	 10.00	Auction: £1.2bn of 0.125% 2031 index-linked bonds
	 14.35	BoE Chief Economist Pill to speak at a conference


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Wednesday's releases

#### Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany	 07.00	GfK consumer confidence index	Oct	-39.0	-36.5
France	 07.45	INSEE consumer confidence index	Sep	80	82
Italy	 09.00	ISTAT business (manufacturing) sentiment indicator	Sep	-(102.2)	109.4 (104.3)
	 09.00	ISTAT consumer confidence index	Sep	95.0	98.3
UK	 00.01	BRC shop price index Y/Y%	Sep	-	5.1
	 -	Nationwide house price index* M/M% (Y/Y%)	Sep	0.3 (9.9)	0.8 (10.0)

#### Auctions and events

Euro area	 08.15	ECB President Lagarde scheduled to speak
-----------	---	--

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

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are MiFID 2 Professional (or equivalent) Clients and should not therefore be distributed to such Retail Clients. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

#### **Explanatory Document of Unregistered Credit Ratings**

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at:

<https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>

#### **IMPORTANT**

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Opinions [and/or estimates] reflect a judgment as at the date of publication and are subject to change without notice. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.