Euro wrap-up

Overview

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- Gilts made huge gains and the curve flattened as the BoE announced a programme of long-dated bond purchases as it judged recent market moves to be a material risk to financial stability.
- Bunds followed Gilts higher as German and French consumer confidence slumped to record lows.
- Thursday will bring flash German and Spanish inflation data for September, and the Commission's latest sentiment survey results.

Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	1.807	-0.137
OBL 1.3 10/27	2.033	-0.125
DBR 1.7 08/32	2.139	-0.083
UKT 1 04/24	4.327	-0.353
UKT 1¼ 07/27	4.350	-0.368
UKT 4¼ 06/32	4.067	-0.443

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

UK

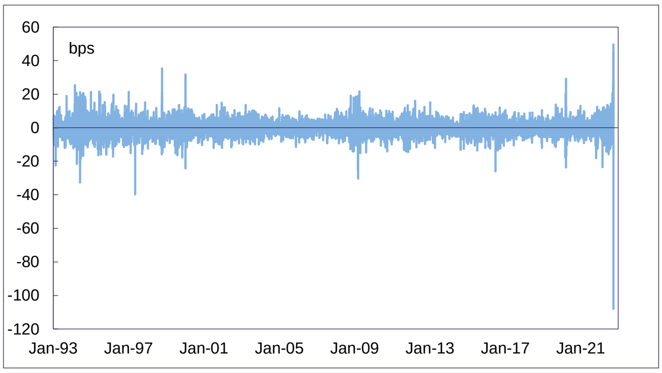
BoE restarts Gilt purchases as it judges markets pose "material risk to financial stability"

While the government's fiscal policy announcement on Friday, and subsequent sharp market moves, will have a substantive impact on the inflation outlook, BoE Chief Economist Huw Pill yesterday reiterated that the Monetary Policy Committee did not intend to announce a change in monetary policy until its next scheduled meeting on 3 November. That likely reflects a fear that, even if Bank Rate was hiked sufficiently high to validate or exceed market expectations, it might still not suffice to establish a floor for sterling, while it would certainly increase significantly the likelihood of deep recession ahead. Nevertheless, given that it judged yesterday's further marked sell-off in the long-dated Gilt market to represent "dysfunction" which posed a "material risk to UK financial stability", the BoE's Financial Policy Committee today saw the need for intervention in the market. So, while only last Thursday the MPC had decided to launch a programme of active Gilt sales from 3 October, today the BoE conducted an abrupt U-turn and started a programme of temporary purchases of long-dated Gilts to try to restore orderly market conditions. Indeed, echoing Mario Draghi during the euro crisis, the BoE stated that purchases would be "carried out on whatever scale is necessary", albeit with the government's balance sheet bearing the risks of future losses.

Gilt purchases concentrated on bonds with a residual maturity of more than 20 years

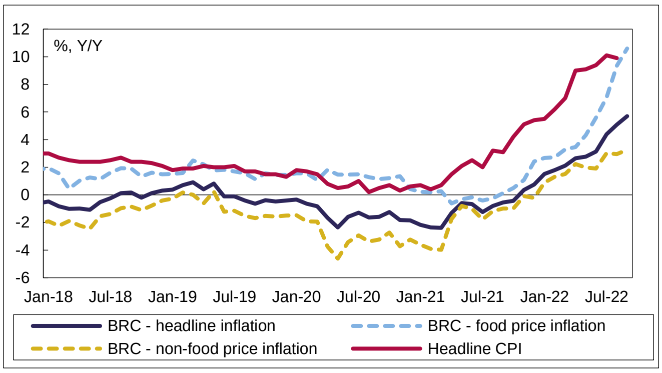
At this stage, the BoE will buy only conventional Gilts with a residual maturity of more than 20 years, and only in the secondary market, at a rate of up to £5bn per auction, which will be held every week day until 14 October. Its decision to focus on the very long end of the curve reflects concerns about the damaging impact of recent events on pension funds, which faced substantive margin calls on interest rate derivatives related to Liability Driven Investment (LDI) strategies, exaggerating the sell-off and risking a vicious cycle. The decision not to conduct purchases of short-term Gilts presumably also reflects a desire to limit the magnitude of its Gilt market interventions, and also perhaps a hope to gain information about market expectations from that part of the curve. But while they failed materially to change the fortunes of sterling, the purchases today gave a boost to all Gilts, albeit with the curve flattening significantly. Notably too, the BoE's announcement came shortly after the DMO's syndicated tap of its 2053-dated Green Gilt, giving bond-buyers an immediate massive windfall and leaving taxpayers with a debt interest bill that would have been significantly lower had the sale been held just hours later as 30Y yields closed down more than 100bps on the day – a record daily move.

UK: Daily change in 30Y Gilt yields



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: BRC shop price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

QT plans might have to be postponed once again, unless the Chancellor changes tax-cut plans

Admittedly, the BoE insisted that its new round of Gilt purchases will be time-limited, and the Bank only felt the need to purchase a little more than £1.0bn of bonds today. After 14 October, the BoE then intends to unwind the purchases in a smooth and orderly fashion as long as risks to market functioning are judged to have subsided. And it also plans to conduct the first Gilt sale operations under its active QT programme as soon as 31 October, supposedly maintaining the objective to reduce its holdings by some £80bn over the coming twelve months. However, that plan assumes that market conditions will have entirely stabilised over the next few weeks. Yet the MPC does not intend to announce its change in monetary policy until 3 November. And, crucially, the government will not announce its medium-term fiscal plans until 23 November. So, unless the Chancellor Kwasi Kwarteng heeds yesterday's blunt advice from the IMF and signals a sudden U-turn on his most egregious tax-cut plans, the BoE might still struggle to cease completely its Gilt purchases by the middle of next month, and/or be unable to get its active QT plans underway at the end of October. And that would further raise fears of fiscal dominance and an erosion of BoE credibility and independence.

UK shop prices up at fastest pace on the BRC series

The dire inflationary backdrop to the UK government's misguided fiscal plans was illustrated by the latest BRC shop price survey results released overnight. On the BRC's headline measure, prices on the UK high street accelerated at a record rate this month, with pressures becoming increasingly broad-based. The headline survey measure rose a further 0.6ppt to 5.7%Y/Y, having on average been firmly negative in the decade before the start of this year due to the intensity of competition within the UK retail sector. While pressures remained strongest in food prices, up 1.3%M/M and 10.6%Y/Y, prices of non-food items were also higher, rising 0.4%M/M to be similarly up at a series high of 3.3%Y/Y. Of course, the marked depreciation of sterling over the course of this month is bound to add a further significant inflationary impulse, perhaps adding a further 2% to the price level over the coming two years.

The day ahead in the UK

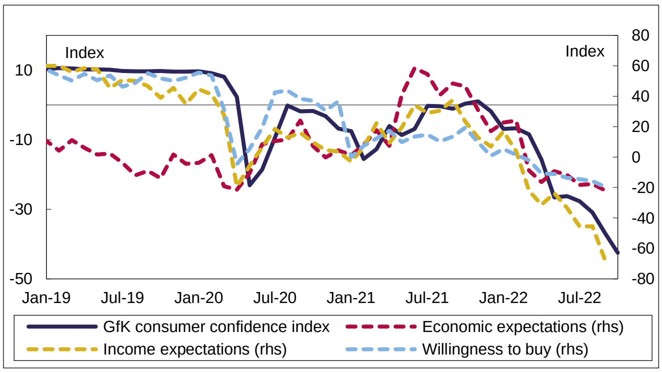
With only second-tier UK data due for release in the form of SMMT auto production numbers for September, the focus will remain firmly on the financial markets and policymakers. We are scheduled to hear from BoE Deputy Governor Ramsden, who is due to take part in a panel discussion on central banking.

Euro area

German consumer income expectations slump counters ECB fears of a wage-price spiral

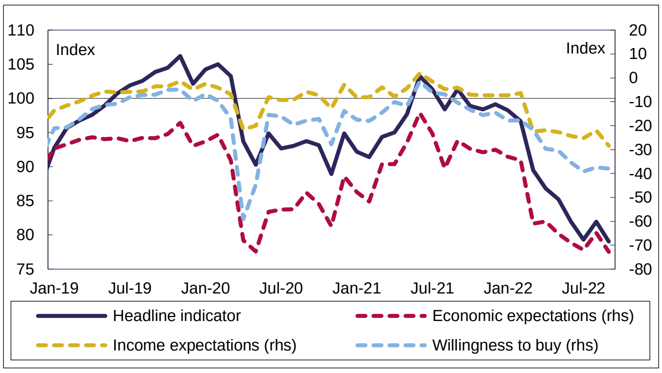
Given the deterioration reported in last week's flash euro area consumer confidence indicator to a fresh record low at the end of Q3, today's German GfK consumer survey was predictably extremely downbeat, similarly registering a series low and reinforcing expectations that the euro area's largest member state is slipping into recession. Given the expiration of the summer travel discounts at the end of August, the likely marked rebound in inflation this month, and a higher proportion of income being spent on (and put aside for) energy, households were especially downbeat in their expectations for incomes – indeed, the relevant survey index slumped a whopping 22.4pts in September to -67.7, the lowest since the series began in 1991 and some 48pts lower than the initial pandemic trough. That might suggest that ECB fears of a possible wage-price spiral are well wide of the mark. And against this backdrop it was perhaps somewhat surprising that households' willingness to buy didn't deteriorate by a greater extent, although the survey gauge was still down for the eighth consecutive month to -19.5, the lowest since the global financial crisis in 2008. Overall, the headline confidence index fell 5.9pts in September to -36.8, with the survey's forecast for October down another 5.7pts at -42.5, more than 10pts below the Q3 average and a new survey low.

Germany: Consumer confidence indices



Source: Refinitiv, Gfk< and Daiwa Capital Markets Europe Ltd.

France: Consumer confidence indices



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

French confidence at survey low, amid rising concerns about financial situations & unemployment

French consumers similarly have never been more downbeat over the past five decades. INSEE's headline sentiment index fell a steeper-than-expected 3pts in September to 79, well below the long-run average (100) and some 10pts below the initial pandemic trough, to match the survey lows previously recorded in July this year and May 2013. Like in Germany, French households were markedly more concerned about their future financial situation, with the relevant survey index (-28.4) the second-lowest on record and well below the long-run average (-6). As such, the share of households judging it a good time to make major purchases edged further below the long-run average, with the respective index on average some 6pts lower in Q3 and implying a decline in spending. The outlook for consumption seems bound to remain weak, with consumers reporting rising fears of unemployment in the current uncertain economic environment and a lack of opportunities to save.

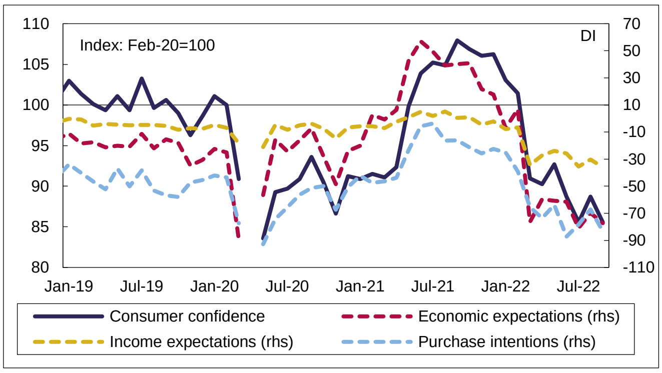
Italian consumer confidence at its lowest since the start of the pandemic

According to ISTAT, Italian consumer confidence weakened at the end of Q3 too. The headline index reversed the surprising 3.5pts increase in August to leave it back at 94.8, a level last lower at the start of the pandemic. Households were more despondent about both current and future economic conditions, with income expectations the weakest since the euro crisis in 2012, unemployment fears the highest for 18 months and major-purchase intentions close to historical lows. Despite that backdrop of weak consumer sentiment, however, retailer confidence held up relatively well, with the relevant index recording the second-highest reading in the past year despite dropping almost 3pts on the month. The downwards trend in business sentiment was more marked in services, reflecting not least the fading impact of the post-pandemic rebound in tourism, to take the respective index to its lowest since the start of the year. And manufacturers were the most pessimistic since the start of 2021 amid a worsening in order books and future production expectations.

The day ahead in the euro area

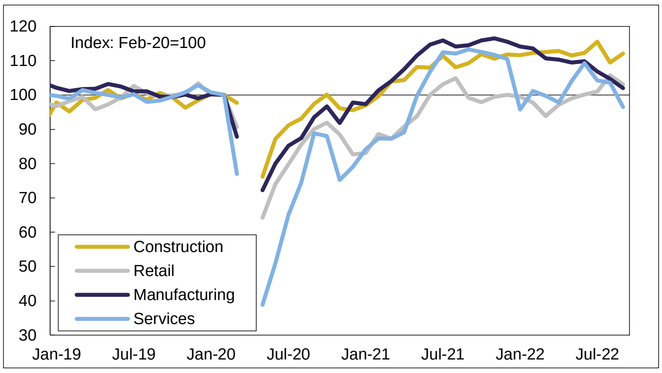
The flow of sentiment surveys continues tomorrow with the Commission's comprehensive business and consumer surveys, which we expect to echo the deterioration in the flash PMIs and various national sentiment indicators and confirm the record low in consumer confidence. The headline ESI is expected to fall 1.7pts to 96.0, a near two-year low. The price expectations measures will also be watched closely. However, arguably of most interest tomorrow will be the release of German and Spanish inflation numbers for September, ahead of Friday's euro area aggregate estimates. The German data are expected to reveal a big jump in prices of 1.5%M/M this month, due to the expiration of the discounted travel pass and fuel duty cut. That would push the annual HICP inflation rate to a new record high of 10.2%Y/Y, from 8.8%Y/Y in August. The Spanish HICP rate is expected to remain elevated, albeit easing somewhat to 10.0%Y/Y, from 10.5%Y/Y previously, in part due to lower petrol prices. We will also hear from the ECB's Chief Economist Lane tomorrow, as well as dovish Executive Board member Panetta.

Italy: Consumer confidence indices*



*No survey results in April 2020. Source: Refinitiv, ISTAT and Daiwa Capital Markets Europe Ltd.

Italy: Business confidence indices*



*No survey results in April 2020. Source: Refinitiv, ISTAT and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	GfK consumer confidence index	Oct	**-42.5**	-39.0	-36.5	**-36.8**
France	INSEE consumer confidence index	Sep	**79**	80	82	-
Italy	ISTAT business (manufacturing) sentiment indicator	Sep	**105.2 (101.3)**	- (102.2)	109.4 (104.3)	**109.2 (104.0)**
	ISTAT consumer confidence index	Sep	**94.8**	95.0	98.3	-
UK	BRC shop price index Y/Y%	Sep	**5.7**	-	5.1	-

Auctions

Country	Auction
UK	BoE accepted £1.025bn of £2.587bn offers in special long-term gilt tender

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	M3 money supply Y/Y%	Aug	**6.1**	5.4	5.5	**5.7**

Auctions

Country	Auction
Germany	sold €2.42bn of 1.300% 2027 bonds at an average yield of 2.08%
Italy	sold €2.50bn of 1.750% 2024 bonds at an average yield of 3.27%
	sold €1.25bn of 0.100% 2033 index-linked bonds at an average yield of 2.45%
UK	sold £1.20bn of 0.125% 2031 index-linked bonds at an average yield of 0.277%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	10.00	EC economic sentiment indicator	Sep	96.0	97.6
	10.00	EC industrial (services) confidence	Sep	-0.7 (7.0)	1.2 (8.7)
	10.00	EC final consumer confidence	Sep	-28.8	-24.9
Germany	13.00	Preliminary CPI M/M% (Y/Y%)	Sep	1.5 (9.54)	0.3 (7.9)
	13.00	Preliminary HICP M/M% (Y/Y%)	Sep	1.5 (10.2)	0.4 (8.8)
Italy	09.00	PPI M/M% (Y/Y%)	Aug	-	6.5 (45.9)
Spain	08.00	Preliminary CPI M/M% (Y/Y%)	Sep	-	0.3 (10.5)
	08.00	Preliminary HICP M/M% (Y/Y%)	Sep	0.6 (10.0)	0.3 (10.5)

Auctions and events

Country	BST	Event
Euro area	08.00	ECB's Panetta scheduled to speak
	18.00	ECB Chief Economist Lane scheduled to speak
Italy	10.00	Auction: €2.75bn of 2.65% 2027 bonds
	10.00	Auction: €2.5bn of 2.5% 2032 bonds
	10.00	Auction: €1bn of 2029 floating-rate bonds
UK	12.30	BoE Deputy Governor Ramsden takes part in a panel discussion on central banking

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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