Euro wrap-up

Overview

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- Bunds made losses as German producer price inflation remained at a record high and the euro area's nominal current account deficit also reached the highest on the series.
- While a BoE Deputy Governor suggested strongly that market-implied expectations of rate hikes to come were overdone, Gilts made losses at the shorter end of the curve as Liz Truss announced her intention to resign as Prime Minister.
- Friday will bring data for UK retail sales and survey results for consumer confidence in the UK and euro area.

Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	2.078	+0.020
OBL 1.3 10/27	2.216	+0.021
DBR 1.7 08/32	2.388	+0.021
UKT 1 04/24	3.429	+0.042
UKT 1¼ 07/27	3.870	+0.043
UKT 4¼ 06/32	3.853	-0.012

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

Euro area

French business survey suggests resilience at the start of Q4

Some French business survey results published today were a touch better than expected, suggesting welcome resilience in the euro area's second-largest member state despite ongoing pressure on household budgets and concerns about energy prices and energy supply. Indeed, the latest INSEE business survey reported broadly stable conditions at the start of the fourth quarter, with the headline business climate index unchanged above its long-run average at 102. Conditions in services were judged to have deteriorated only slightly, led by a post-summer weakening in hospitality. But despite a weakening in foreign demand, conditions in manufacturing were judged to have improved a touch following three successive months of weakness and firms in the sector pointed to a continued desire to invest. However, contrary to indications from other surveys, industrial firms also reported a deterioration of supply bottlenecks, with almost half of businesses in the sector suggesting that they would not be able to increase production if orders picked up. Indeed, expectations for future production deteriorated. Meanwhile, despite rising interest rates, construction firms were decidedly upbeat.

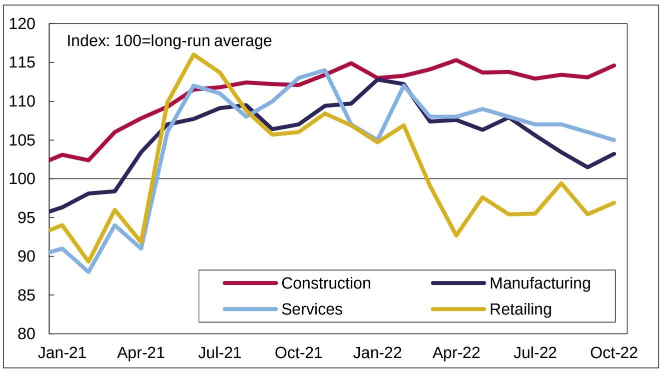
French retailers remain downbeat despite a pickup in sales in September

According to the INSEE survey, however, confidence in the French retail sector remains weak, albeit also a touch improved from September. Certainly, the outlook for sales is still judged to be firmly negative while selling price expectations rebounded on cost concerns. Admittedly, the INSEE survey suggested that retailers had revised up their assessment of past sales. And the Bank of France's latest retail survey, also published this morning, suggested that sales picked up at the end of Q3. Indeed, the BoF survey measure of sales rose an impressive-looking 2.2%M/M, benefiting from a surge in sales of new cars (10.3%M/M), consumer electronic items (9.0%M/M), furniture (8.8%M/M) and clothing and textiles (4.6%M/M). However, that growth followed weakness at the end of Q2 and early in Q3. So, over the third quarter as a whole, the BoF estimated that sales fell 1.4%Q/Q, with sales of manufactured goods still down a chunky 2.7%Q/Q but food sales down a much smaller 0.4%Q/Q. Nevertheless, the BoF estimates that GDP rose about ¼%Q/Q in Q3, which is consistent with our own forecast too.

German PPI inflation remains at series high, as producer inflation of consumer goods rises further

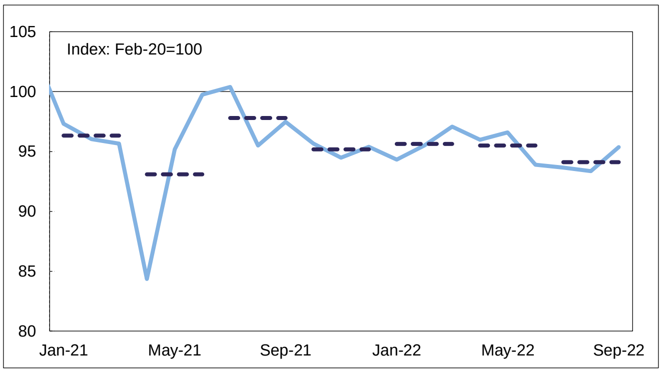
While today's German PPI release reported another strong increase in manufacturers' prices in September, the 2.3%M/M rise was roughly a quarter of the surge in August. And so, the annual rate of PPI inflation moved sideways last month at a series high of 45.8%Y/Y. Despite easing slightly from August, more than two-thirds of the annual rate continues to be accounted for by energy, with industrial firms paying more than two and a half times the amount for natural gas than they did

France: INSEE business sentiment indices



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

France: BoF retail sales*



**Dashed line represents quarterly average. Source: Refinitiv, BoF and Daiwa Capital Markets Europe Ltd.*

a year ago. But at the start of the EU leaders' two-day summit that will discuss proposals to cap prices in wholesale markets and possible coordination of purchases, benchmark natural gas futures remain well down on the summer highs. So, in the absence of new shocks, energy PPI inflation should slow over coming quarters. Today's data also reported a further moderation in pressures in prices of intermediate goods, with the annual rate down 0.7ppt to 16.8%Y/Y in September, a fourteen-month low and more than 9ppts below April's peak. Indeed, while still high, producer inflation of metals (18%Y/Y) was down some 20ppts from May. Admittedly, prices of chemicals, fertilisers and nitrogen compounds (33½%Y/Y) remained elevated by ongoing supply issues associated with Russia's invasion of Ukraine. And while capital goods inflation moved sideways in September, producer price inflation of consumer goods rose to a new series high (17.3%Y/Y), as manufacturers continue to pass on higher cost burdens despite a slowing in demand.

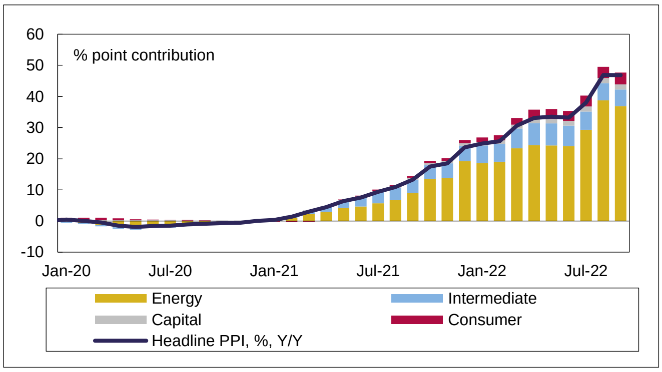
Another record current account deficit in August

The marked impact of the energy price shock was also evident again in today's ECB balance of payments data. After Eurostat last week reported a record trade deficit in August, the ECB reported a record current account deficit that month. Indeed, following a deterioration of €10bn in July the current account deficit widened by a further €6bn in August to €26bn. As a result, the current account registered a deficit on a twelve-month basis for the first time in a decade, marking a significant turnaround from the surplus of 2.8% of GDP over the same period in 2020-21. And despite the boost to competitiveness provided by this year's euro depreciation, given the marked deterioration in the euro area's terms of trade, likely persistence of high energy prices and soft external demand well into 2023, and the "J-curve" effect that will boost the value of imports before exports can benefit from the exchange rate adjustment, the euro area is bound to run a full-year current account deficit in 2022 for the first time since 2011. On average, we expect the euro area to run monthly current account deficits averaging more than €20bn well into next year too. Within the detail of the ECB's figures, the goods deficit was estimated to have risen €2.4bn to €21.2bn. But the services surplus deteriorated by more than to €4bn to €7.2bn, the smallest in a year. And while the surplus on primary income increased somewhat, that was almost fully offset by a widening in the secondary income deficit, which is primarily related to remittances and foreign aid.

The day ahead in the euro area

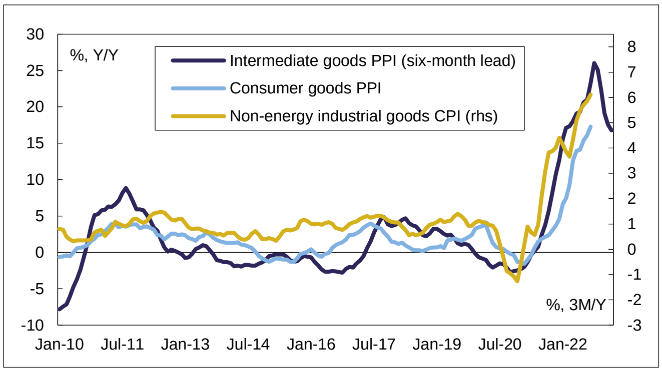
Friday brings the release of the European Commission's flash consumer confidence index for October. Amid record high inflation, rising borrowing costs and increasing recessionary risks, a further deterioration in household sentiment at the start of Q4 is expected, with the index forecast to fall to a new record low from -28.8 in September.

Germany: PPI inflation



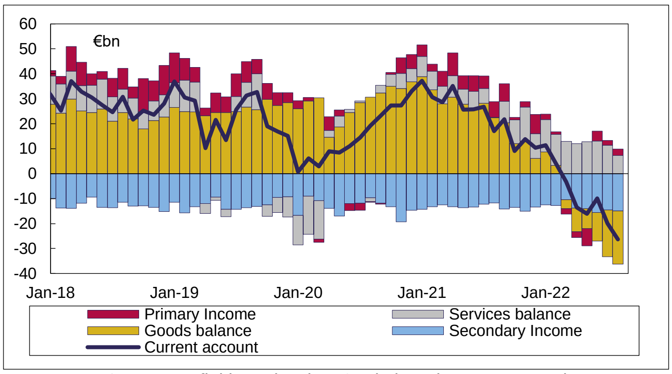
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: CPI & PPI inflation



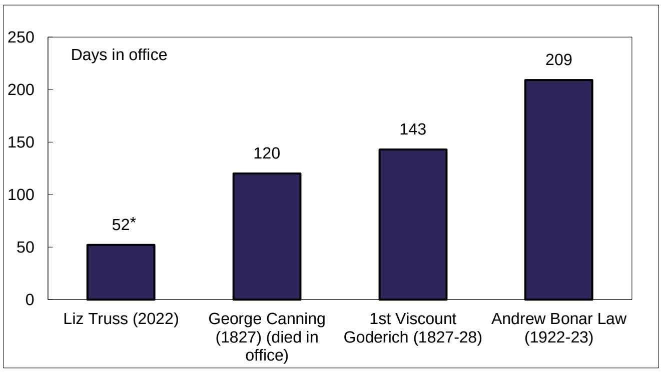
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Current account balance



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Shortest Prime Ministerial Terms



**Truss term is set to end on 28 October. Source: UK Government and Daiwa Capital Markets Europe Ltd.*

UK

Truss brings an end to her sorry Premiership before new fiscal plan is finalised

So, having triggered a wild selloff in the Gilt market that required BoE intervention to avoid a systemic crisis, and thus subsequently been forced to U-turn on the majority of her policy platform that got her elected as Conservative leader just 44 days ago, today Liz Truss announced her intention to resign as Prime Minister. Her announcement followed chaos in the House of Commons last night on a vote related to fracking, which underscored that she had completely lost authority among her own MPs. Truss will remain in office in Downing Street until 28 October, when the winner of yet another Conservative Party leadership election will be announced. So, her term as Prime Minister will be the shortest ever. And importantly, the next Prime Minister will be in place before the government's budget and medium-term fiscal plan is finalised and announced.

Will fiscal plan be postponed to after the next BoE monetary policy meeting?

Whether the new Prime Minister will be willing to endorse the new fiscal plan as soon as 31 October, when it is currently scheduled to be presented, is currently unclear. Certainly, that timetable would appear to give the new Prime Minister relatively little involvement in its preparation. Of course, a postponement of the announcement of the plan would also give the BoE's MPC little or no opportunity to reflect the new fiscal policy in its updated economic projections and monetary policy decision on 3 November. However, BoE Deputy Governor Broadbent today strongly suggested that eventual rate hikes are likely to fall short of what has recently been priced by the markets. And so, the OBR's fiscal arithmetic should at least benefit from an assumption of a lower path for Bank Rate and lower gilt yields than would have been the case had the projections been finalised in the past week. Given the current ungovernability of the Conservative party, however, it will also remain to be seen whether the politically difficult tax and public spending decisions to be unveiled in the fiscal plan will be able to pass the House of Commons or whether the new Prime Minister's term will be brought to an early end by Tory in-fighting.

Bookies' favourite will hope to avoid members' vote

The identity of the next Prime Minister remains uncertain too. Former Chancellor Sunak, who warned of the folly of Truss's fiscal policy platform during her election campaign, is bookies' favourite, with an implied probability of more than 90%, and also looks most likely to us too. But not least given reports of his prior holding of a US Green Card, as well as his Indian wife's tax affairs, he is a divisive figure among the public, and he clearly failed to appeal to party members in the summer. So, while he will likely have the backing of the majority of MPs, he will hope that the members will have no role in the process for determining Truss's successor. Of course, if MPs can agree among themselves on a single preferred candidate, there will be no need to consult the membership. So, Sunak might need to try to buy off his main rival Penny Mordaunt with a promise of a top job in his cabinet. And he will hope that Boris Johnson – who appears the preferred candidate of the party members – fails to make it to the MPs' choice of the final two candidates too.

The day ahead in the UK

After a quiet day for UK data releases, tomorrow brings the official retail sales numbers for September, which seem likely to report a further drop last month not least as most retailers shut or reduced opening times on the additional bank holiday for the Queen's funeral. But these data are also likely to illustrate the deterioration in households' purchasing power, with reduced spending on non-essentials and big ticket items. While online purchases will provide some support, excluding auto fuels, sales are expected to fall 0.4%M/M. A result in line with expectations would leave retail sales 1.0% lower on the quarter in Q3 and down 4.2%Y/Y. The latest GfK consumer confidence survey, also due tomorrow, seems bound to offer a gloomy outlook for near-term spending prospects too. And as the Chancellor puts together a new Budget and medium-term fiscal plan, public finance figures for September are also due. Public sector net borrowing is expected to come in at £17.5bn in September, compared with a pre-pandemic level of £10.2bn in the same month of 2019. This would leave cumulative spending in the first half of the financial year at almost £78bn, well down on the equivalent periods in FY21/22 and FY20/21 (by £22bn and £132bn respectively) but a touch larger than that assumed by the OBR in March and still roughly £35bn above the pre-pandemic five-year average.

European calendar

Today's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Current account balance €bn	Aug	**-26.3**	-	-19.9	**-20.0**
Germany		PPI M/M% (Y/Y%)	Sep	**2.3 (45.8)**	1.5 (45.4)	7.9 (45.8)	**-**
France		INSEE business confidence indicator	Oct	**102**	101	102	**-**
		INSEE manufacturing (production outlook) indicator	Oct	**103 (-8)**	101 (-8)	102 (-6)	**-**

Auctions

Country		Auction
France		sold €3.27bn of 0.00% 2025 bonds at an average yield of 2.38%
		sold €2.30bn of 0.50% 2026 bonds at an average yield of 2.46%
		sold €4.43bn of 0.75% 2028 bonds at an average yield of 2.65%
		sold €509mn of 0.10% 2036 index-linked bonds at an average yield of 0.61%
		sold €646mn of 0.10% 2036 index-linked bonds at an average yield of 0.76%
		sold €345mn of 0.10% 2053 index-linked bonds at an average yield of 0.61%
Spain		sold €1.75bn of 0.00% 2025 bonds at an average yield of 2.663%
		sold €1.22bn of 1.95% 2026 bonds at an average yield of 2.669%
		sold €2.46bn of 0.80% 2029 bonds at an average yield of 3.247%

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	Government debt/GDP ratio	2021	-	95.6
		15.00	Preliminary EC consumer confidence	Oct	-30.0	-28.8
UK		00.01	GfK consumer confidence	Oct	-52	-49
		07.00	Retail sales including autos fuel M/M% (Y/Y%)	Sep	-0.3 (-5.0)	-1.6 (-5.4)
		07.00	Retail sales excluding autos fuel M/M% (Y/Y%)	Sep	-0.4 (-4.0)	-1.6 (-5.0)
		07.00	Public sector net borrowing, excluding banks £bn	Sep	-17.5	11.8

Auctions and events

Country		BST	Event
EU		-	EU leaders summit to discuss energy markets

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.