Euro wrap-up

Overview

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- Bunds made gains as the flash euro area PMIs flagged rising recession risks, German consumer confidence fell amid deteriorating income expectations and the ECB bank lending survey signalled a larger than expected decline in loan demand.
- Gilts also made gains as the flash UK PMIs remained consistent with modest contraction at the start of Q4, while employment declined over the summer.
- Wednesday will bring the latest ECB monthly monetary figures and the German ifo business survey.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	3.087	-0.033
OBL 2.4 10/28	2.725	-0.047
DBR 2.6 08/33	2.834	-0.035
UKT 3½ 10/25	4.768	-0.033
UKT 4½ 06/28	4.515	-0.049
UKT 3¼ 01/33	4.547	-0.046

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

Euro area

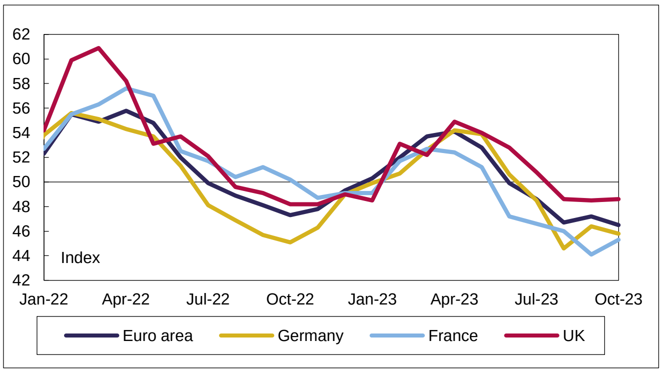
Flash PMIs flag rising recession risks as services slump & manufacturing downtrend persists

Over the past few months, the PMIs suggested strongly that euro area GDP contracted in Q3. And today's flash PMIs for October implied that the pace of contraction intensified at the start of Q4, indicating rising risks of recession. In particular, defying the consensus expectation of a rise, the euro area composite output PMI dropped 0.7pt from September to 46.5, 1.0pt below the Q3 average and the lowest level in almost three years. Indeed, barring the pandemic, this was the worst reading since the euro crisis in March 2013 and the weakness has become increasingly broad-based. Most notably, the services sector appears to have shifted into reverse in the autumn as the boost from tourism and travel over the spring and early summer faded and business-facing subsectors have been dragged down by the downtrend in industry, which remains marked. The euro area services activity PMI fell 0.9pt in October to 47.8, the lowest since the lockdowns of early 2021 and, once again, suggesting the sharpest contraction in the sector since the euro crisis when overlooking the initial pandemic phase. The pace of decline in manufacturing remains steeper, however, with the output PMI in that sector unchanged in October at 43.1, in line with the Q3 average, and pointing to a possible fifth successive quarterly drop in IP this quarter. Among the member states, the flash PMIs suggest that the deterioration in conditions in October was widespread, suggesting that activity in both manufacturing and services is falling in Germany, France and the rest of the euro area.

New orders and backlogs fall, jobs and purchases cut, but selling-price inflation thankfully slows

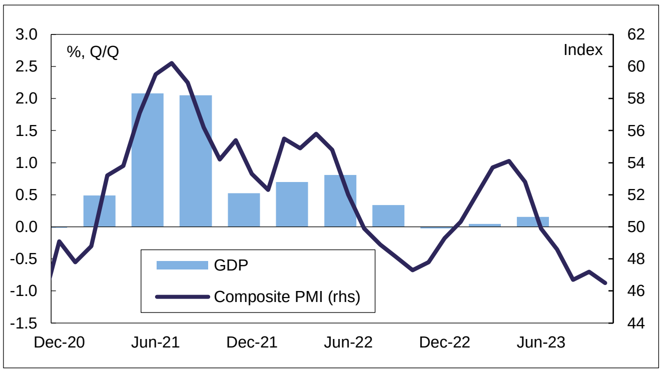
Much of the survey detail was as disheartening as the headline output PMIs. For example, the respective euro area indices suggest that new orders fell at a faster pace in both manufacturing (38.8) and services (45.5) in October, with external demand deteriorating further too. Backlogs of work reportedly fell at the quickest pace since the first wave of Covid-19, pointing to a worsening demand environment for both goods and services. While inventories of finished products were further run down, they remained elevated relative to new orders. Manufacturing purchasing activity fell at one of the sharpest rates since the global financial crisis. And most concerning perhaps, firms suggested the first aggregate fall in headcount since early 2021, as job cuts in manufacturing accelerated and recruitment in services slowed to a crawl. So, a slight improvement in optimism about the outlook for the year ahead offered little comfort. Nevertheless, the ECB will note that average prices charged for goods and services reportedly rose at a slower pace in October, with the composite output price index (52.1) implying the softest inflation rate in 32 months and below the average in the three years ahead of the pandemic (52.7). While factory output prices again fell sharply, more notably perhaps, service sector inflation slowed to the softest rate since May 2021 to underscore the impression that the weak demand environment is limiting the ability of firms in the sector to pass on increased costs related to higher oil prices or wages.

Europe: Composite PMIs



Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & composite output PMI



Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

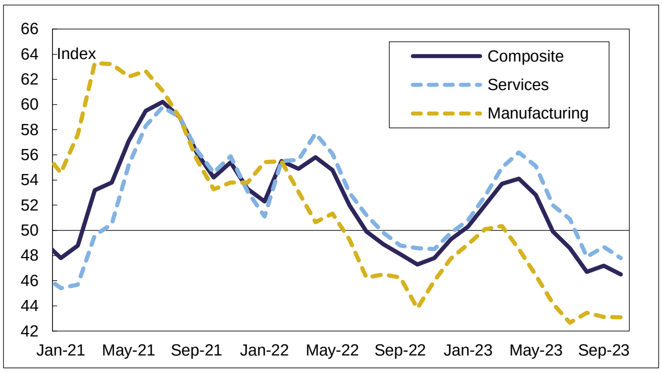
German consumer confidence deteriorates further on worsening income expectations

Notwithstanding risks of rising unemployment as firms adjust to falling demand, lower inflation should provide scope for a pickup in consumer spending over coming months as real disposable incomes pickup. However, households will first need to feel sufficiently confident to loosen their purse strings. And yesterday's flash Commission estimate of euro area consumer confidence reported no improvement in October, with the index edging down 0.1pt to -17.9, 1.6pts below the Q3 average and the lowest since March. Moreover, today's German GfK survey results reported a more marked worsening in household sentiment, with the headline index down 1.4pts in the latest month (presented as a forecast for November) similarly to a seven-month low, and 2.5pts below the average of the prior three months. Within the GfK survey detail, the deterioration this month reflected worsening income expectations, which suggests that households are aware of the challenges faced by business and also tallies with recent indications of moderating pay growth. And while consumer willingness to buy reportedly improved very marginally on the month, it remained down from the average of the previous three months and at a level consistent with falling spending.

Banks report ongoing tightening of credit standards & bigger than expected fall in loan demand

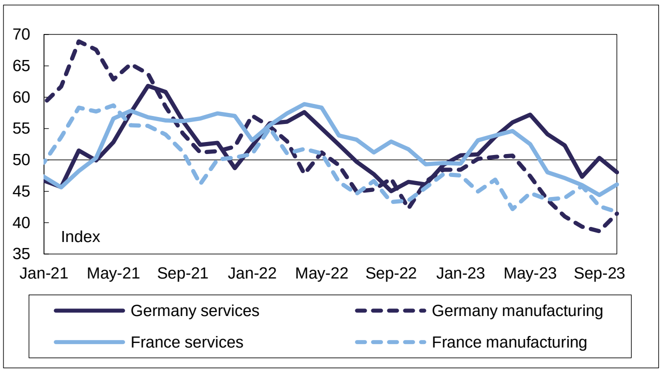
With the ECB having raised rates by the largest margin and at the fastest pace in the history of the single currency area, tighter financial conditions are an important factor suppressing spending by both firms and households. The ECB's bank lending survey reported a further larger-than-expected tightening of credit standards on loans to both firms and households last quarter following a marked tightening over the course of the preceding year. Among other things, increased risk aversion of banks in their lending was reflected in a higher share of rejected loan applications. And banks signalled the likelihood of a further tightening in standards on business loans and consumer credit in Q4 to suggest that the squeeze will continue for some time to come. At the same time as loan supply is becoming more restrictive, firms' net demand for loans also continued to drop at a faster pace than expected in Q3, and close to Q2's record rate. Banks cited reduced fixed investment plans and higher interest rates as the main drivers of lower loan demand. Likewise, banks reported a bigger-than-expected drop in demand for housing loans and consumer credit, with the deterioration in the outlook for the housing market and low consumer confidence key drivers. And banks expect business and household demand for loans to fall further in Q4, albeit at a slightly softer pace than last quarter. While banks welcomed the impact of higher interest rates on net interest margins, they suggested that beneficial impact was now likely peaking. And at the same time, they signalled an adverse impact on their liquidity and funding positions from quantitative tightening and the roll-off of TLTRO-iii loans.

Euro area: Output PMIs



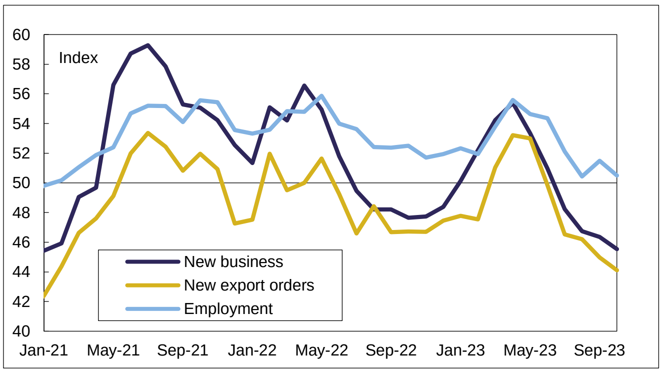
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Germany & France: Services & manufacturing PMIs



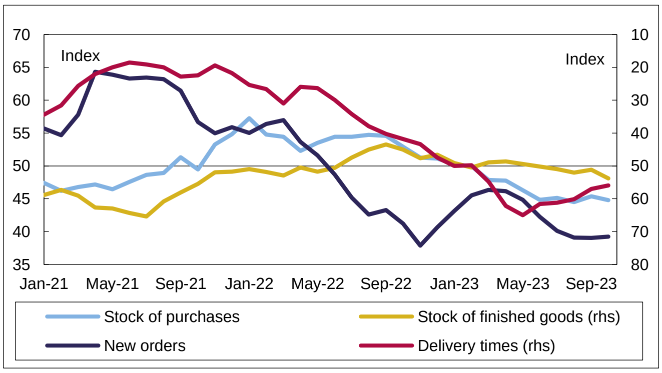
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Selected services PMI components



Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Selected manufacturing PMI components



Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Surveys highlight risks that the ECB has tightened too far

At the ECB's September monetary policy meeting, the doves cautioned that much of the pass-through of past rate hikes had yet to be felt in the euro area economy. So, they warned that the downside risks to the ECB's projections could be significant. Thus, they also cautioned that tightening again last month risked repeating the policy error of 2011, when the ECB's rate increases had to be reversed quickly in the face of growing evidence of the economic weakness. Overall, this week's data results – whether the PMIs, consumer confidence indices or the ECB's own bank lending survey results – all highlight that the monetary policy stance is now probably highly restrictive and taking an increasing toll on economic growth. If, as seems likely, there are still substantive lagged effects of past hikes still to be felt, there are big risks that the Governing Council has tightened too far. Certainly, the economic data underscore why the ECB will not raise rates further this week. Moreover, with inflation now trending steadily lower and mindful of the lessons of the past, if the expected pickup in consumer spending has failed to materialise by early 2024, the Governing Council ought to pivot swiftly to lower rates, sooner than mid-year as is currently priced by the markets.

The day ahead in the euro area

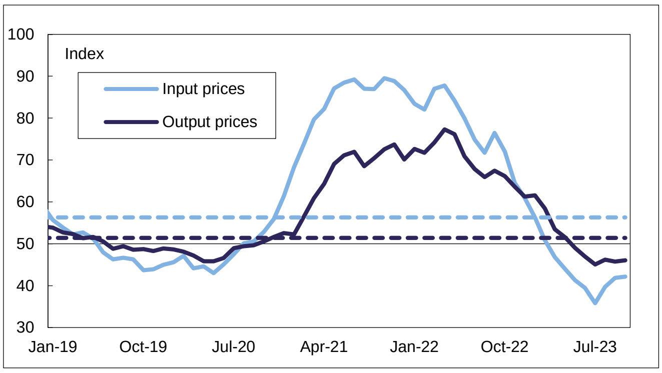
Wednesday will bring further insight into developments in the banking sector with the ECB's monthly monetary figures for September due. Against the backdrop of higher borrowing costs, falling house prices and an uncertain economic outlook, these are likely to report ongoing weakness in lending, while depositors will have continued to shift funds from overnight to higher-yielding time accounts. As such, M1 money supply is likely to have continued to fall at a record pace in September. Meanwhile, following today's flash PMIs, the German ifo institute business survey will provide an update on conditions in the manufacturing, services, retail and construction sectors at the start of Q4.

UK

UK flash PMIs consistent with ongoing modest contraction at the start of Q4

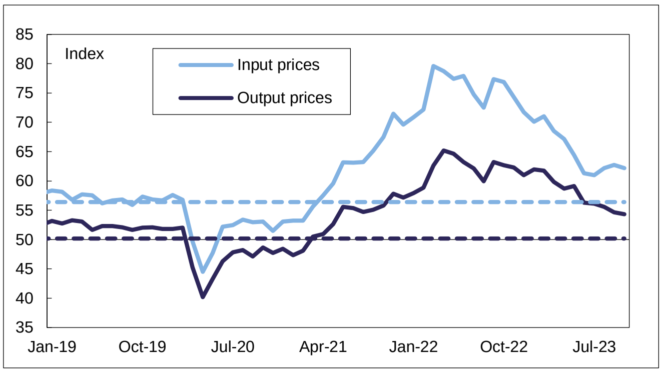
Unlike the euro area indicators, today's flash UK PMIs for October broadly aligned with expectations. But they still suggest ongoing modest contraction at the start of Q4, and that the risks to the near-term economic outlook are skewed to the downside. In particular, the headline composite output PMI edged only marginally higher in October, by 0.1pt to 48.6, the third successive sub-50 reading and a level consistent with a decline in GDP of around 0.1%Q/Q – the pace of contraction we think occurred in Q3. The slight improvement in the composite index this month reflected a second-successive increase in the manufacturing output PMI to 45.3, some 1.2pts above August's low. However, this marked the eighth consecutive

Euro area: Manufacturing price PMIs*



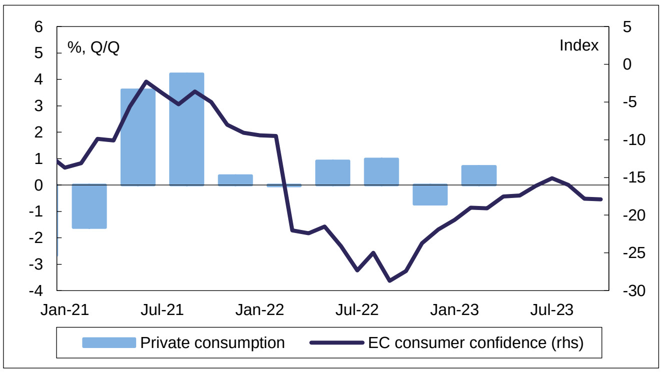
*Dashed lines represent long-run averages. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Services price PMIs*



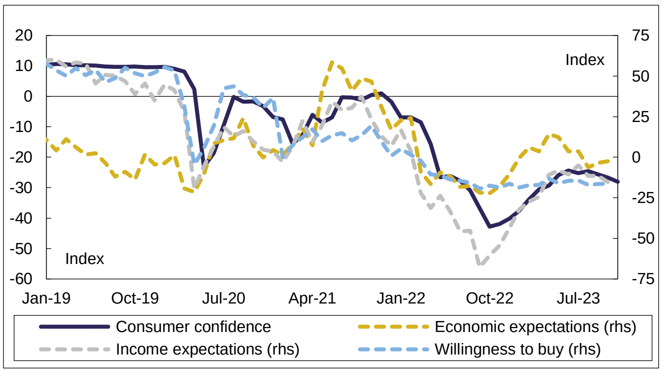
*Dashed lines represent long-run averages. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Consumption & consumer confidence



Source: EC, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Germany: Consumer confidence



Source: GfK, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

contractionary reading, to mark the longest such run since the global financial crisis. And while the PMIs still imply that the downturn in services activity has been less acute than in manufacturing, the respective index nevertheless fell for the sixth successive month in October, by 0.1pt to 49.2, the lowest since January.

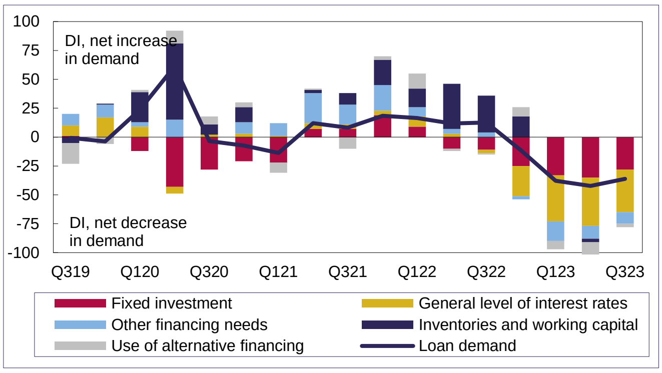
Firms more downbeat about year ahead as orders continue to decline

While household real disposable incomes have been boosted by relatively strong wage growth and the moderation in inflation, including this month's cut in the regulated cap on household energy bills, firms failed to report an upturn in spending. Indeed, they flagged that high borrowing costs and weak consumer confidence continue to weigh on new business in the services sector. Challenges seemingly remain most acute in real estate as falling house prices and higher mortgage rates sap demand. But the survey suggested that the only services subsectors to report any growth this month were linked to technology. Overall, the services new business PMI (48.7) fell for the fifth month out of the past six to its lowest level since last November, echoing the weakening in willingness to spend reported in last week's consumer confidence survey. Manufacturers also reported a further fall in orders (43.8), albeit at a slightly softer pace than in the previous three months, as overseas demand remained exceptionally weak. And with work backlogs still declining sharply, and firms the most downbeat so far this year about the 12-month production outlook, firms continued to cut headcount. Today's CBI industrial trends survey gave a similar message, with the net balance of manufacturers reporting 'normal' order levels (-26) falling to the lowest since the start of 2021 and business optimism the weakest in a year. So, while the CBI survey also suggested that manufacturers are more upbeat about the production outlook for the coming three months, firms' investment intentions for the coming twelve months were the weakest since Q121.

Input price pressures ease, but services output price PMI unexpectedly jumps in October

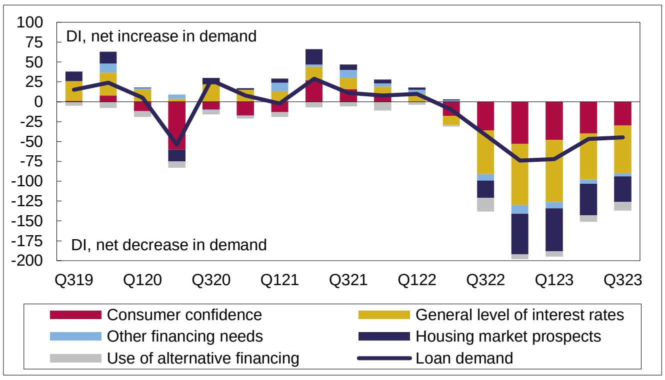
With inadequate demand having superseded supply shortages as the main constraint on economic output, today's surveys continued to point to disinflation in the UK's factory sector. Having temporarily jumped in September due to the spike in the oil price, the manufacturing output price PMI (48.6) dropped to its lowest since early-2016, while the CBI's measure of expected selling prices for the coming three months fell to its lowest since February 2021. But while the PMIs suggested that input costs in services moderated further in October, the MPC will note renewed upwards pressures in output prices charged in the sector as firms looked to pass on higher wage costs. Indeed, the respective PMI rose 1.2pts to a three-month high of 58.2, almost 10pts below the peak in May 2022 but still 5½pts above the long-run average.

Euro area: Factors affecting firms loan demand



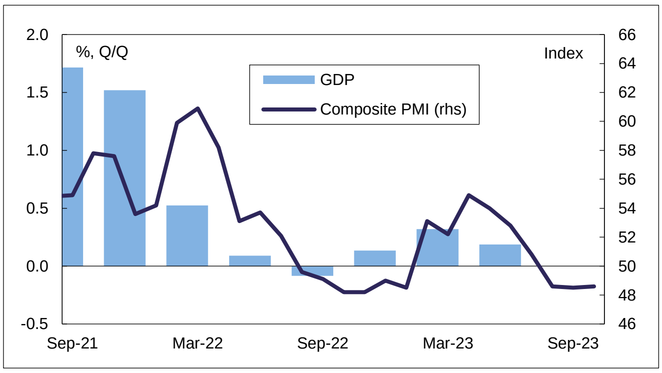
Source: ECB Bank Lending Survey and Daiwa Capital Markets Europe Ltd.

Euro area: Factors affecting mortgage loan demand



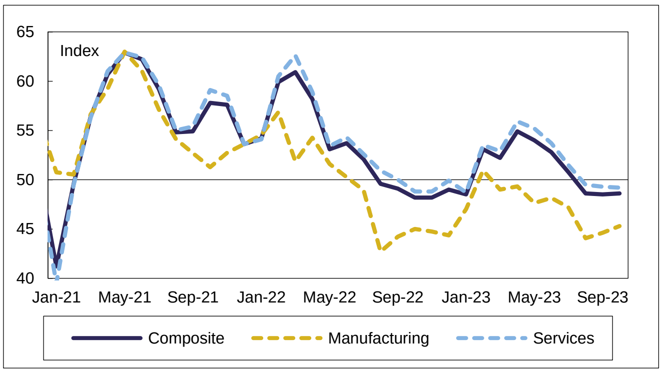
Source: ECB Bank Lending Survey and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & composite output PMI



Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Output PMIs



Source: Refinitiv Datastream, S&P GLobal and Daiwa Capital Markets Europe Ltd.

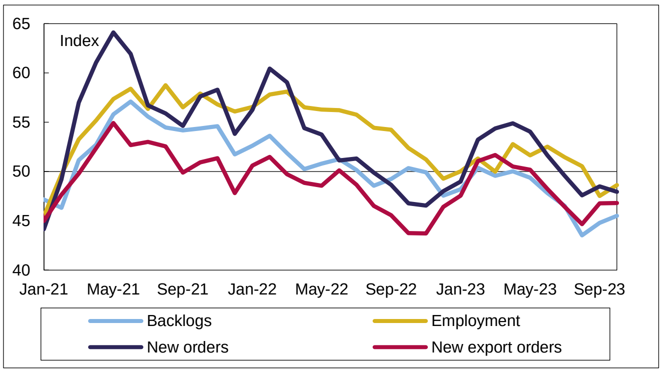
New ONS experimental series suggests employment declined over the summer

Consistent with the recent slowdown in economic activity, surveys including the PMIs, and the declines in the number of payroll employees and job vacancies reported last week, new employment and unemployment figures published today by the ONS also suggested that labour market conditions are weakening. In particular, an experimental series based on information from HMRC and the claimant count suggested that the number of people in employment fell for a third consecutive month and by 82k in the three months to August. Admittedly, this was a touch softer than the drop in the three months to July (-133k), which itself compared with the decline of 207k judged in the original Labour Force Survey (LFS) data for that period. As such, the shortfall in employment on the new experimental series compared with the pre-pandemic level was 103k (compared with 191k on the LFS measure in July). This contrasts with the figure for payrolled employees, which in September was still some 1.1mn above the February 2020 level. But all measures still point to a loss of momentum over recent months. And with labour force inactivity having reportedly risen in the three months to August for the first time in a year, the experimental LFS unemployment rate was up 0.2ppt from three months earlier to 4.2%, 0.7ppt above the low a year earlier. Notwithstanding the inconsistent messages about the amount of labour slack and concerns about data quality, the moderation in inflation in September, weakening economic activity and loss of momentum in the labour market, including signs that wage growth has peaked, will mean that the majority on the MPC will vote to keep Bank Rate unchanged at 5.25% next week.

The day ahead in the UK

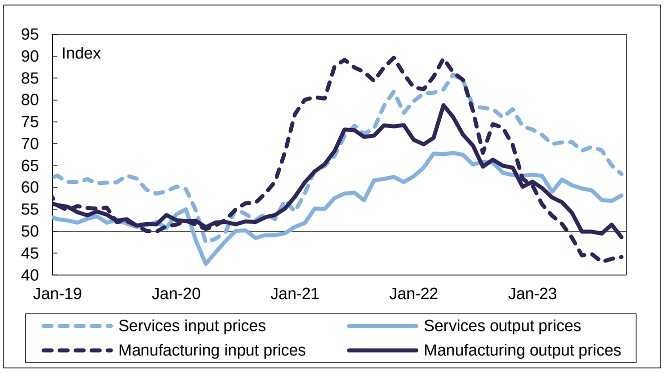
It should be a quiet day for UK economic news tomorrow with no top-tier releases due.

UK: Selected composite PMI components



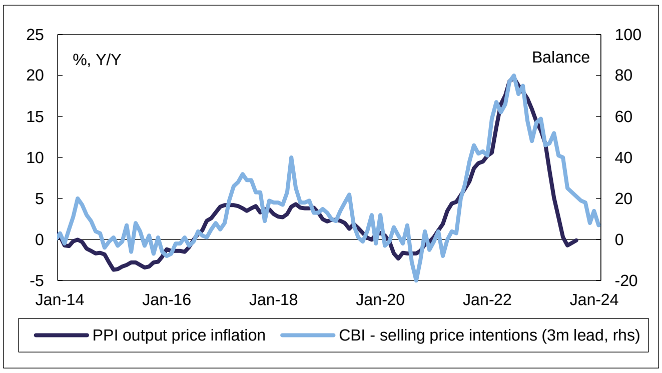
Source: Refinitiv, Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Input & output price PMIs



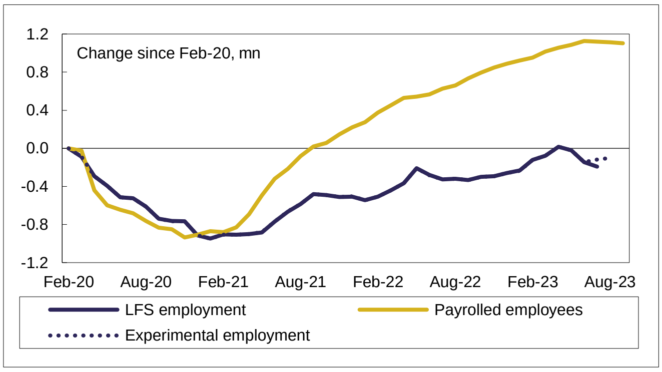
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: PPI & CBI selling price indicator



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

UK: Employment & payrolled employees



Source: ONS, Refinitiv Datastream, 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 manufacturing (services) PMIs	Oct	**43.0 (47.8)**	43.5 (48.7)	43.4 (48.7)	-
		Preliminary composite PMIs	Oct	**46.5**	47.5	47.2	-
Germany		GfK consumer confidence indicator	Nov	**-28.1**	-27.0	-26.5	-26.7
		Preliminary manufacturing (services) PMIs	Oct	**40.7 (48.0)**	40.0 (50.0)	39.6 (50.3)	-
		Preliminary composite PMIs	Oct	**45.8**	46.7	46.4	-
France		Preliminary manufacturing (services) PMIs	Oct	**42.6 (46.1)**	44.8 (44.8)	44.2 (44.4)	-
		Preliminary composite PMIs	Oct	**45.3**	44.3	44.1	-
UK		Adjusted experimental unemployment rate 3M%	Aug	**4.2**	4.3	4.2	-
		Claimant count rate % (change 000s)	Sep	**4.0 (20.4)**	-	4.0 (0.9)	3.9 (-9.0)
		Preliminary manufacturing (services) PMIs	Oct	**45.2 (49.2)**	44.8 (49.6)	44.3 (49.3)	-
		Preliminary composite PMIs	Oct	**48.6**	49.0	48.5	-
		CBI industrial trends survey – total orders (business optimism)	Oct	**-26 (-15)**	-	-18 (6)	-

Auctions		
Country		Auction
Germany		sold €3.26bn of 2.4% 2028 bonds at an average yield of 2.71%
UK		sold £1.5bn of 0.75% 2033 index-linked bonds at an average yield of 0.831%

Source: Bloomberg, ONS and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Preliminary consumer confidence indicator	Oct	**-17.9**	-18.3	-17.8	-

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	M3 money supply Y/Y%	Sep	-1.7	-1.3
Germany		09.00	ifo business climate index	Oct	85.8	85.7
		09.00	ifo current conditions (expectations) index	Oct	88.5 (83.2)	88.7 (82.9)
France		11.00	Total jobseekers mn	Q3	-	2.8

Auctions and events			
Germany		10.30	Auction: To sell 0% 2035 bonds
		10.30	Auction: To sell 1% 2038 bonds
Italy		10.00	Auction: €2.5bn of 3.6% 2025 bonds
		10.00	Auction: €1.5bn of 1.5% index-linked bonds
UK		10.00	Auction: £3bn of 3.75% 2038 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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