Euro wrap-up

Overview

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- Bunds followed USTs lower as a German business survey defied expectations of a further decline but remained consistent with unfavourable conditions, while lending to euro area firms and households continued to slow.
- Gilts also made losses on a day bereft of top-tier UK data.
- The main event on Thursday will be the ECB monetary policy announcements, but interest rates are expected to be left unchanged. A UK retail survey is also due.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	3.113	+0.033
OBL 2.4 10/28	2.765	+0.047
DBR 2.6 08/33	2.887	+0.064
UKT 3½ 10/25	4.827	+0.073
UKT 4½ 06/28	4.573	+0.072
UKT 3¼ 01/33	4.614	+0.080

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

Euro area

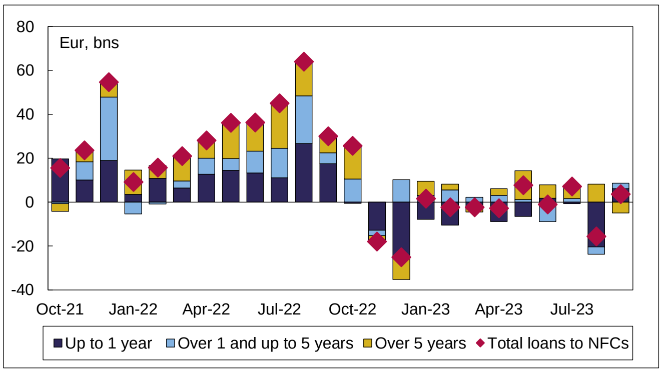
Lending to firms & households continues to slow

Broadly consistent with yesterday's ECB bank lending survey results, which reported a further larger-than-expected tightening of credit standards and drop in loan demand in Q3, today's monetary data showed that annual growth in lending to non-financial corporations (NFCs) and households slowed further in September. The outstanding stock of loans to NFCs adjusted for sales and securitisations slowed 0.5ppt to just 0.2%Y/Y, the weakest in eight years. Strikingly, despite a positive net flow last month, the pace of decline in the stock of short-dated loans outstanding (i.e. those with a maturity of up to one year) accelerated by 1ppt to -8.8%Y/Y, the steepest drop since the aftermath of the global financial crisis in 2010 when excluding the pandemic. That probably reflects declining needs over the past twelve months to finance inventories and working capital. In contrast, the annual growth rate in the stock outstanding of long-dated loans (i.e. those with a maturity of more than five years), which tends to relate to financing of fixed investment projects, remained positive at 1.4%Y/Y. That, however, was the softest pace in more than seven years while the net flow of such loans of -€4.9bn in September was the weakest in nine months and a drop that has been rarely exceeded in the past seven years. Meanwhile, on an adjusted basis, the outstanding stock of loans to households slowed to 0.8%Y/Y, the softest in more than eight years. Lending for house purchase slowed to a crawl at just 0.2%Y/Y, also the slowest since the first half of 2015. But perhaps reflecting strains on household finances, consumer credit growth edged up slightly to a five-month high of 3.1%Y/Y

Household deposits decline on an annual basis but contraction in money supply eases slightly

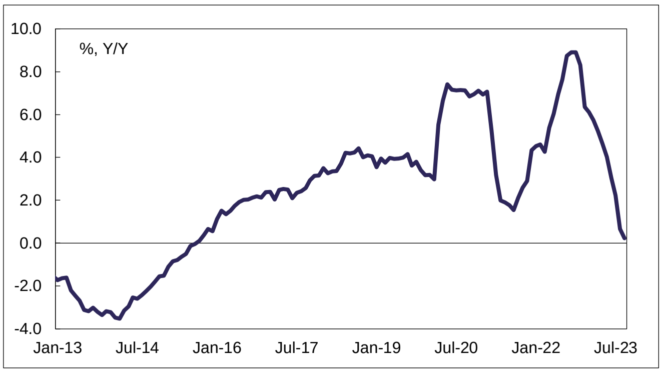
Meanwhile, the annual growth rate in household deposits slipped into negative territory for the first time on the series, which dates back to 2004, to -0.2%Y/Y. However, the overall stock of household deposits has been broadly stable since March. At the same time, the marked shift from low-yielding overnight deposits (-7.4%Y/Y) and those redeemable with a notice of up to three months (-3.2%Y/Y) to site deposits (up 127%Y/Y) has persisted. While a similar rebalancing towards higher-yielding deposits continued for NFCs, the annual pace of decline in their overall deposits slowed by 1.0ppt in September to -1.3%Y/Y thanks to the first positive monthly net flow in three months. And, as a result, growth in M1 money supply moderated 0.5ppt from the record drop in August to -9.9%Y/Y, while the pace of decline in M3 eased 0.1ppt to -1.2%Y/Y. While those figures both remain consistent with a marked easing in inflation and contraction in economic output over the near term, the moderation might be a hint that the trough in momentum has been reached.

Euro area: Net flow of lending to NFCs



Source: ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Stock of loans to NFCs



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

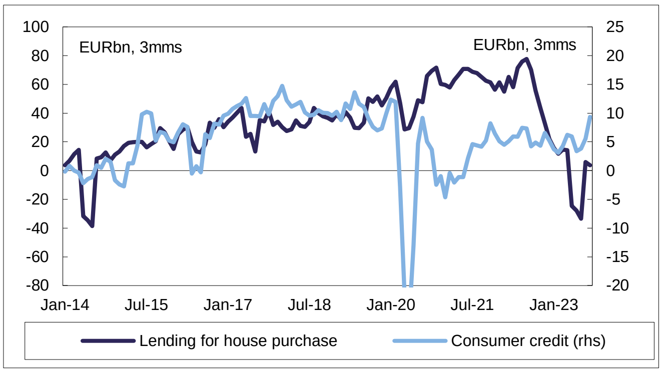
German ifo survey defies expectations but still points to unfavourable business conditions

Contrasting with the further deterioration in yesterday's flash German PMIs in October, today's ifo business indices beat very downbeat expectations to point to a slight improvement in sentiment at the start of Q4. In particular, the headline business climate index increased for the first month in six and by 1.1pts to a three-month high of 86.9. Admittedly, this still remained well below the peak earlier in the spring (93.2), almost 10pts below the long-run average, and a level that that has recently been consistent with a contraction in GDP. Moreover, the improvement this month was principally driven by an increase in the index for expectations for the coming six months – up 1.6pts to a five-month high of 84.7 – perhaps reflecting a sense that conditions can't be much worse than now once winter has passed, rather than signaling the likelihood of a firm near-term rebound in the economy. Indeed, the net share of firms anticipating an improvement in conditions over the coming six months remained firmly in negative territory (-22%). The rise in the current assessment index was more modest – up 0.5pt to 89.2 – to leave it still some 0.5pt below the Q3 average and one of the lowest readings since the global financial crisis barring the initial Covid lockdown. Overall, it is certainly still too early to conclude that Germany's economy has reached a turning point for the better at the start of Q4, and there remains a sizeable risk of recession in the euro area's largest member state as well as in the euro area as a whole.

Recovery in services sentiment contrasts with ongoing deterioration in other sectors

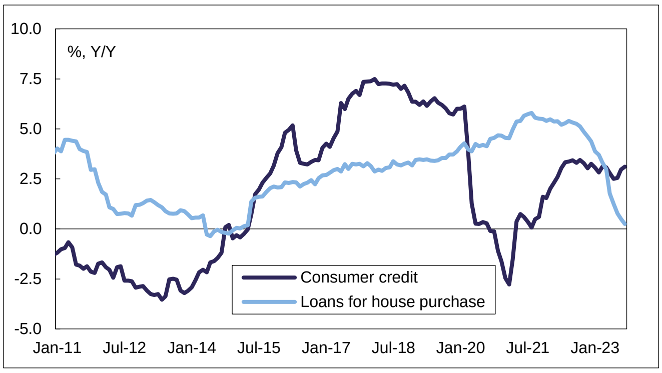
The detail in today's ifo survey suggested that the improvement in October largely reflected the reversal of the sharp deterioration in conditions in the services sector recorded in September, which had been considered to be the least favourable since April 2021. Of course, this contradicted the message from yesterday's PMIs, where the services activity index dropped more than 2pts to 48.0, the second-lowest reading since last November. Moreover, the improvement in services reported by the ifo institute contrasted with the further deterioration in sentiment registered in the survey across the other major subsectors at the start of Q4. Manufacturers assessed current conditions to be the weakest in three years, with the respective balance having previously been lower in the aftermath of the global financial crisis, as firms reported ongoing declines in new orders. Meanwhile, after the GfK survey yesterday suggested that German consumers are increasingly preferring to save than spend, retailers were also notably more downbeat in October, with the respective ifo index falling to its lowest in thirteen months and some 7pts below the Q3 level. Moreover, construction firms were the most pessimistic since the start of 2011 as declining house prices and higher borrowing costs deterred activity. Admittedly, according to other data released today, new construction orders rose by almost 10%M/M for the second successive month in August. But this principally reflected a surge in civil engineering (18.6%M/M), and appeared to be temporarily boosted by one-off large orders. In contrast, incoming orders for house building fell for a second successive month (-2.7%M/M) to be down more than

Euro area: Net flow of lending to Households



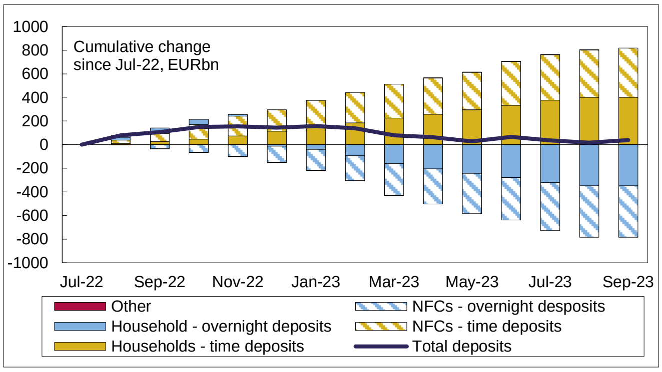
Source: ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Stock of loans to households



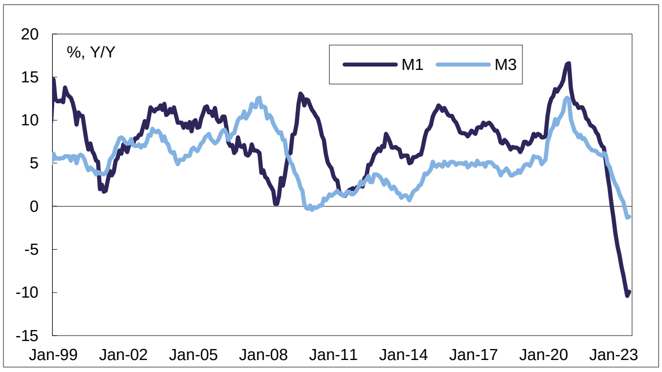
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Bank deposits



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Money supply



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

6½%Y/Y. And total construction orders in the first eight months of 2023 were still down 7.6%YTD/Y, illustrating the deterioration in the outlook for the sector seen this year.

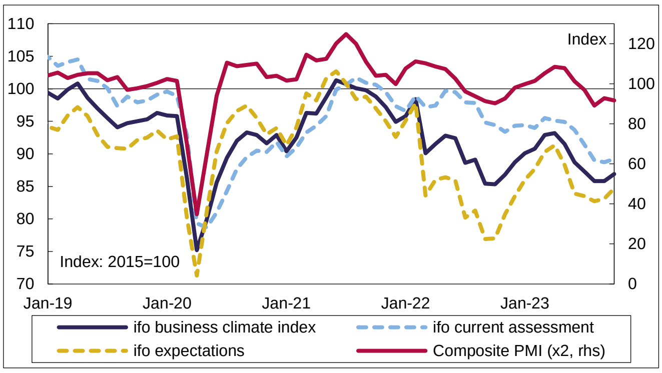
The day ahead in the euro area

The main focus tomorrow will be the outcome of the latest ECB monetary policy meeting. However, we, like the consensus, fully expect rates to be left unchanged. The statement issued following the September Governing Council meeting, when rates were raised for the tenth successive occasion to take the Deposit Rate to a record high of 4.00%, gave a strong indication that the terminal rate for the tightening cycle has probably now been reached. The account of the meeting subsequently revealed that for some members of the Governing Council the decision whether to hike or pause had been a close-run thing. And while the account also stated that a "solid majority" backed the decision, we suspect that many members did so without enthusiasm and only in order to avoid the impression of division.

Events since the last meeting have largely been unconducive to a further rate hike. After the ECB's updated projections acknowledged the non-negligible risk of recession, data and surveys – including yesterday's PMIs – have reinforced the likelihood that euro area GDP contracted in Q3 and that economic activity will be at best subdued in Q4. Moreover, inflation fell in September by the most in six months to the lowest level in almost two years, with a broad-based easing of pressures pointing to the likelihood of further significant declines to come. Recent increases in bond yields will have strengthened further the transmission of the ECB's recent policy tightening. And events in Israel and Gaza have increased geopolitical tensions and uncertainties. So, if many members of the Governing Council are tempted to argue for a further hike, we suspect they will wait to make the case at the following meeting in December, when data for GDP in Q3, as well as two further months of figures for inflation and economic surveys and additional information on the potency of the transmission mechanism will be available, and the economic consequences of events in the Middle East, including on oil prices, are likely to be clearer too.

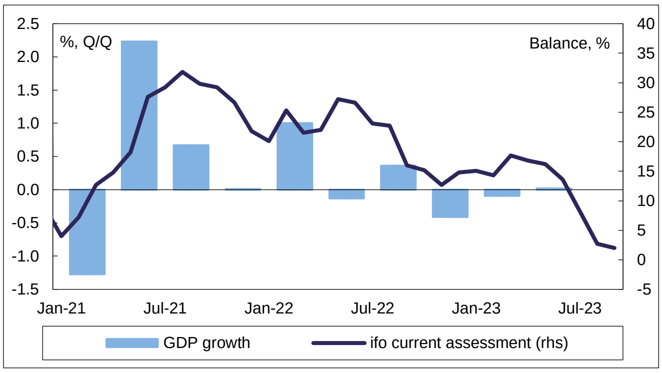
There is a good chance that the Governing Council will also have discussions on its other policy instruments, including the future of its asset purchase programme and reserve remuneration. With respect to quantitative tightening, we doubt that the current elevated level of uncertainty and recent upwards shift in yields will encourage a majority to support yet an end to reinvestments of maturing PEPP securities before the end of 2024 as is currently envisaged. We also suspect that the There is a good chance that the Governing Council will also have discussions on its other policy instruments, including the future of its asset purchase programme and reserve remuneration. With respect to quantitative tightening, we doubt that the current elevated level of uncertainty and recent upwards shift in yields will encourage a majority to support yet an end to reinvestments of maturing PEPP securities before the end of 2024 as is currently envisaged. We also suspect that the

Germany: Headline sentiment indices



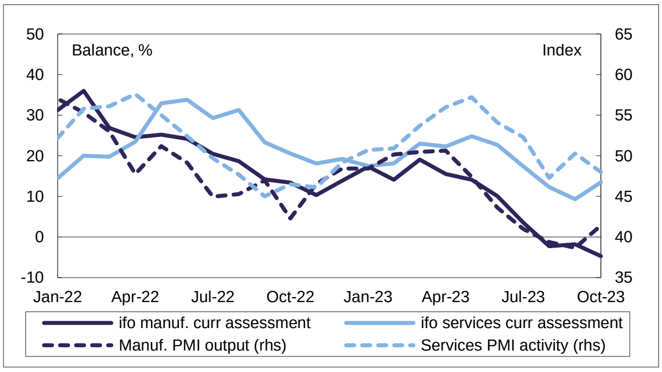
Source: ifo, S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Germany: GDP growth & ifo current assessment



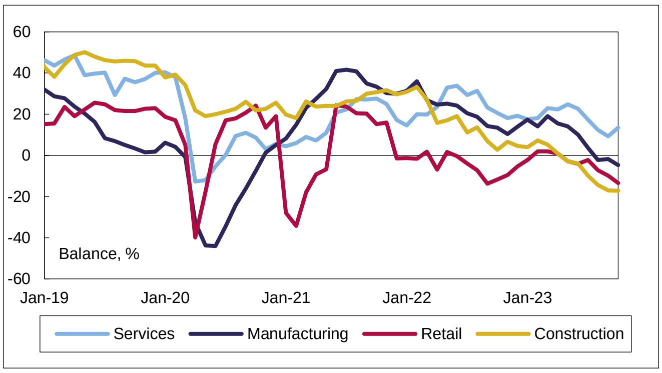
Source: ifo, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing & services indices



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

Germany: ifo current assessment indices



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

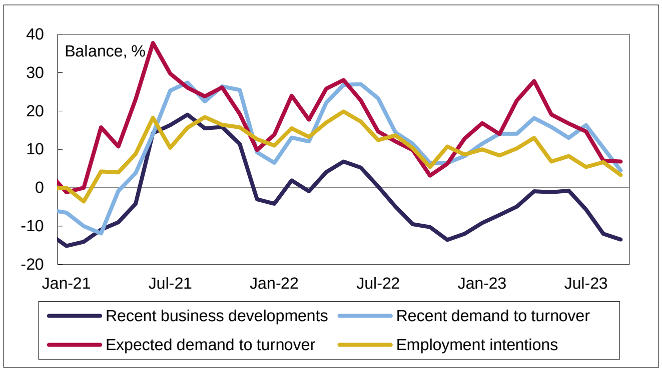
Governing Council will not be ready this month to announce details on its plans for active greening of its corporate bond (CSPP) portfolio now that it has ceased reinvestments. And while the Governing Council agreed in July to reduce from September the remuneration of minimum reserves held by credit institutions at the ECB to 0%, an announcement of other possible related adjustments, such as an increase in the size of minimum required reserves – e.g. from 1% to 2% of deposits and certain other sources of funding – or a system of reverse tiering to reduce interest payments from the ECB to banks would seem more likely to come in December.

UK

The day ahead in the UK

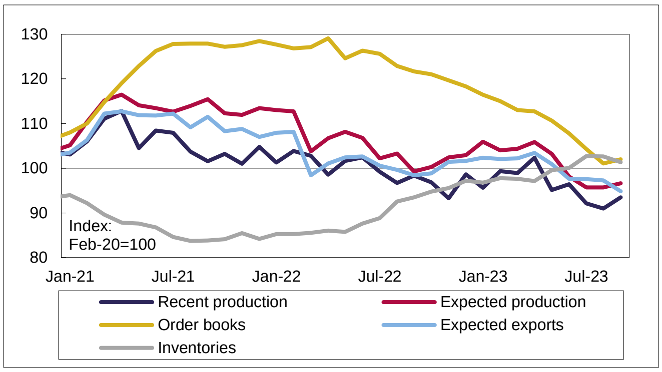
After a quiet day for economic news from the UK, tomorrow will bring the CBI distributive trade survey results for October. Retail sales disappointed in September, with clothing sales once again distorted by unseasonably warm weather that month. And while October has also brought a range of extreme weather conditions for the month, heavy rainfall and a sudden drop in temperature in the second half of the month might well have seen a rebound in spending on autumnal apparel. But while households will have received a boost to disposable incomes this month amid the drop in the cap on household energy bills, the latest consumer confidence survey signalled a deterioration in willingness to spend, suggesting that any rebound in the CBI retail sales indicator will be limited.

Germany: ifo services sector indices*



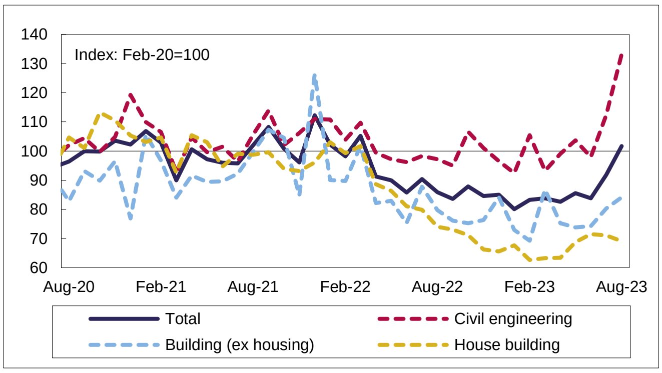
Latest observation is September 2023. Source: ifo, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ifo manufacturing sector indices*



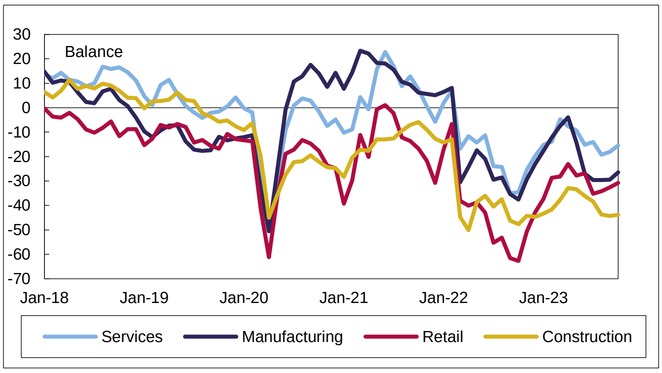
Latest observation is September 2023. Source: ifo, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: New construction orders



Source: Destatis, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ifo expectations indices



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

European calendar

Today's results

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Economic data							
Euro area		M3 money supply Y/Y%	Sep	**-1.2**	-1.7	-1.3	-
Germany		ifo business climate index	Oct	**86.9**	85.8	85.7	85.8
		ifo current conditions (expectations) index	Oct	**89.2 (84.7)**	88.5 (83.2)	88.7 (82.9)	- (83.1)
France		Total jobseekers mn	Q3	**2.81**	-	2.80	-
Auctions							
Country		Auction					
Germany		sold €602mn of 0% 2035 bonds at an average yield of 2.94%					
		sold €999mn of 1% 2038 bonds at an average yield of 3.05%					
Italy		sold €2.5bn of 3.6% 2025 bonds at an average yield of 3.99%					
		sold €1.5bn of 1.5% index-linked bonds at an average yield of 2.24%					
UK		sold £3bn of 3.75% 2038 bonds at an average yield of 4.871%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Economic data						
Euro area		13.15	ECB Deposit Rate %	Oct	*4.00*	4.00
Spain		08.00	Unemployment rate %	Q3	11.5	11.6
UK		11.00	CBI distributive trades survey – reported retail sales	Oct	-	-14
Auctions and events						
Euro area		13.15	ECB monetary policy announcement			
		13.45	ECB President Lagarde holds post-meeting press conference			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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