

Euro wrap-up

Overview

- While the ECB left interest rates unchanged, Bunds made gains as President Lagarde's tone in her post-meeting press conference was more dovish than of late, acknowledging that recent hikes are being increasingly felt in the real economy.
- Gilts also made gains as a survey suggested that UK retail sales were weak at the start of Q4.
- Friday will bring Q3 GDP estimates from Spain and Ireland, along with October consumer and business survey results from France and Italy.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	3.070	-0.055
OBL 2.4 10/28	2.723	-0.049
DBR 2.6 08/33	2.854	-0.035
UKT 3½ 10/25	4.824	-0.020
UKT 4½ 06/28	4.548	-0.029
UKT 3¼ 01/33	4.601	-0.010

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

Euro area

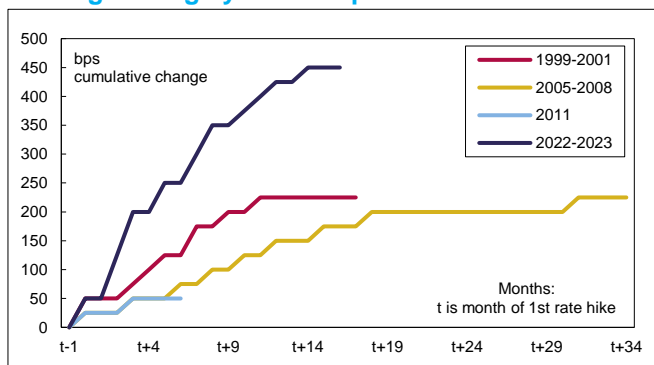
ECB predictably leaves rates & 'high for long' guidance unchanged

As expected, the ECB left its main interest rates unchanged when its monetary policy meeting concluded today. So, in particular, the deposit rate was maintained at the series high of 4.00%, up 450bps from the series low that was still in place until early summer 2022. The guidance in its policy statement was also almost identical to that issued at its previous meeting in September. It reiterated that rates are now considered to be "at levels that, maintained for a sufficiently long duration, will make a substantial contribution" to returning inflation to target. It also repeated that "future decisions will ensure that its policy rates will be set at sufficiently restrictive levels for as long as necessary". So, while the Governing Council insisted again that future rate decisions will be data dependent, it maintained its implicit "high for long" message about the probable rate outlook. Nevertheless, after rate hikes at each of the ECB's ten previous policy meetings represented the most aggressive tightening of the central bank's lifetime, today confirmed the start of a new phase for monetary policy. Indeed, there were even hints in the press conference of rising concerns about the impact that recent rate hikes are having on the real economy.

Lagarde's tone more dovish as transmission mechanism becomes more potent

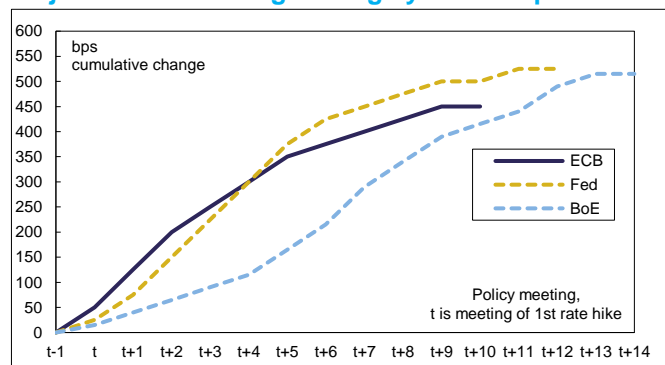
The Governing Council's policy statement reiterated its assessment that inflation is set to remain too high for too long. So, in her press conference, President Lagarde inevitably insisted that the ECB might yet raise rates further this cycle. But she appeared half-hearted in doing so. And her tone, if not her explicit forward guidance, was more dovish than of late. Emboldened by the broad-based easing of price pressures reported in the September data, Lagarde appeared more confident that inflation is now heading back to 2% over the medium term. And she was warier of the downside risks to economic activity. Among other things, she flagged the spread of the downturn from the manufacturing sector to services, the slowdown in job growth, and evidence from this week's [Bank Lending Survey](#) – which Lagarde considered "striking" – that the transmission of high rates to the real economy is now significant. She also considered the recent upwards shift in longer-dated global bond yields to represent an additional tightening of financial conditions in the euro area. Ominously perhaps, Lagarde warned that the transmission of recent rate hikes would be felt even more firmly in the real economy in the current quarter and into the New Year. And contrary to speculation ahead of the meeting, she confirmed that the Governing Council did not discuss this month either an acceleration of QT or a further adjustment to bank reserve remuneration, perhaps mindful of recent developments in bond markets and the banking sector. Indeed, an unattributed Reuters report published after the press conference suggested that the Governing Council decided not to discuss PEPP reinvestments until early

ECB tightening cycles compared



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

Major central bank tightening cycles compared



Source: ECB, Fed, BoE, Bloomberg and Daiwa Capital Markets Europe Ltd.

2024, and that the debate on reserve requirements would be conducted in the context of a broader review of the policy framework in the spring.

December macroeconomic projections could prompt a shift in guidance to an easing bias

Of course, in her press conference, Lagarde was bound to insist that it is far too soon to consider the case for cutting rates. But if evidence continues to mount over coming weeks that the euro area economy has slipped into recession, while – as we expect – inflation falls to around 3.0% or even below in October, the ECB's updated macroeconomic projections in December could yet prompt a shift in the Governing Council's forward guidance to an explicit easing bias. And given the risk that recent rate hikes will be felt even more forcefully in Q1, if there is no sign of a turnaround in momentum of consumer spending and/or exports during the first quarter of 2024, the policymakers might yet be discussing a possible rate cut as soon as March.

The day ahead in the euro area

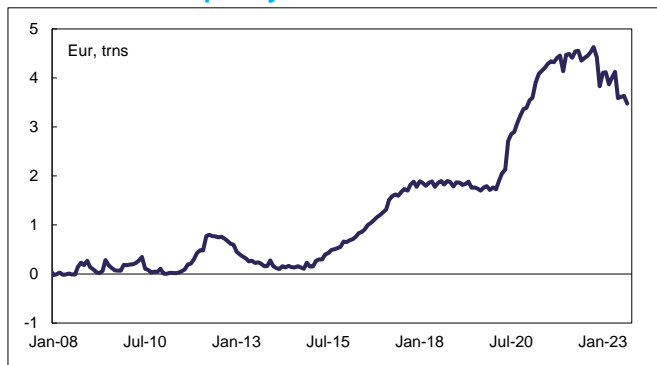
A key data focus from the euro area tomorrow will be the first estimates of Q3 GDP from member states, including Spain and Ireland. The Spanish figures are expected to show that growth slowed from Q2, by around 0.3ppt to 0.2%Q/Q. The Irish figures are notoriously volatile due to activities of several large multinational corporations and therefore difficult to forecast with an accuracy. But given the weakness in manufacturing production during the first two months of Q3 (trending some 22% below the Q2 average), we expect GDP to have contracted last quarter, likely more than fully reversing growth of 0.5%Q/Q in Q2. The first of the October flash HICP estimates will also be published from Ireland. Meanwhile, the latest French INSEE consumer and Italian ISTAT consumer and business surveys will provide an insight into economic momentum at the start of Q4.

UK

CBI survey signals further weakness in retail spending at the start of Q4

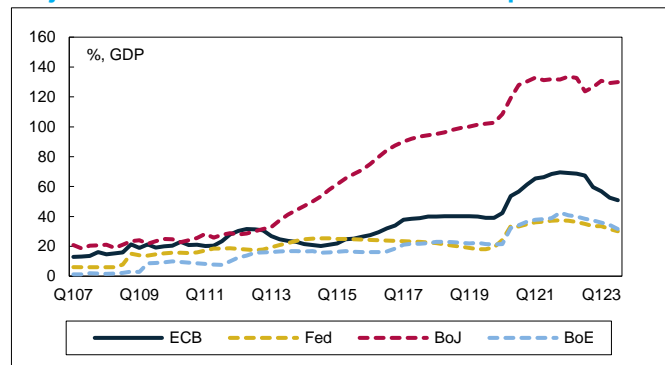
After UK retail sales disappointed in September, suggesting a drag on GDP in Q3 for the first quarter in four, today's CBI distributive trades survey offered little encouragement about spending at the start of Q4 despite the boost to disposable incomes from this month's cut in household energy prices. Certainly, the headline balance of annual sales growth fell sharply in October, by 22ppts to -36%, the second-lowest since March 2021 and the joint-weakest for the month of October since the series began four decades ago. Moreover, half of retailers signalled that sales had decreased from a year ago. When

ECB: Excess liquidity



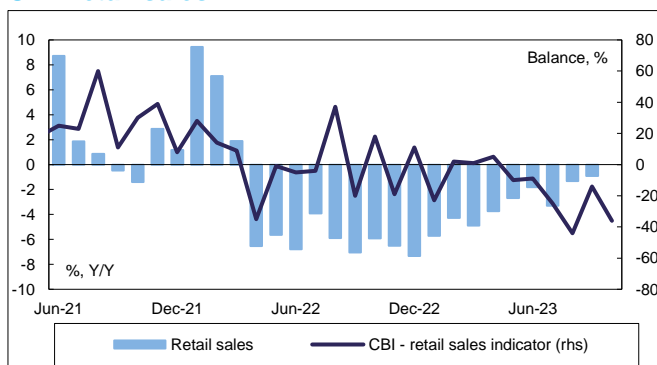
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Major central bank balance sheets compared



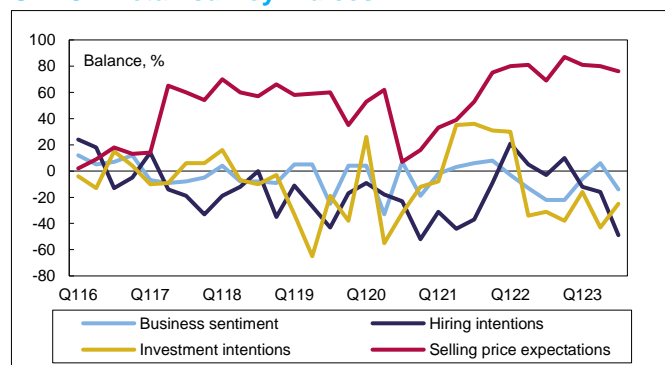
Source: ECB, Fed, BoE, BoJ, Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: Retail sales



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

UK: CBI retail survey indices



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

smoothing for monthly volatility, the retail sales balance (-28%) was the worst since spring 2021 when spending on services resumed after lockdown, and well below the long-run average (+17). Within the detail, online sales fell the most since the series began in August 2009. Reflecting signals of a deterioration in household willingness to spend, retailers expected sales to remain exceptionally weak in November. And given their downbeat outlook, they again signalled plans to scale back investment and headcount over the coming twelve months.

Admittedly, the CBI survey has not provided a particularly reliable guide to official retail sales over the past year or so. And above-average inventory levels might yet encourage more substantial discounting in the run-up to Christmas to give a temporary boost to spending. But while the index of selling prices moderated to the lowest level in two years in Q3, it was still well above the long-run average in October. And given the uncertain economic outlook, we expect household consumption, of goods and services alike, to remain very subdued this quarter and into 2024.




The day ahead in the UK

There are no top-tier UK data due for release tomorrow.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area 	ECB Deposit Rate %	Oct	4.00	4.00	4.00	-
Spain 	Unemployment rate %	Q3	11.84	11.45	11.60	-
UK 	CBI distributive trades survey – reported retail sales	Oct	-36	-	-14	-




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
France 	07.45	INSEE consumer confidence indicator	Oct	82	83
Italy 	09.00	ISTAT business (manufacturing) confidence indicator	Oct	- (96.0)	104.9 (96.4)
	09.00	ISTAT consumer confidence indicator	Oct	105.0	105.4
Spain 	08.00	GDP - preliminary estimate Q/Q% (Y/Y%)	Q3	0.2 (1.5)	0.5 (2.2)
	08.00	Retail sales Y/Y%	Sep	-	7.2

Auctions and events

Euro area 	13.15	ECB to publish Survey of Professional Forecasters results
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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

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