Euro wrap-up

Overview

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- Bunds made gains as flash data from certain member states were consistent with a modest drop in euro area GDP in Q3 and a substantive step down in euro area inflation in October.
- Gilts also made gains on a quiet end to the week for UK economic data.
- The coming week should see the BoE leave Bank Rate unchanged while it will also publish updated economic projections. Euro area unemployment figures are also due along with the aforementioned GDP and inflation data.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	3.03	-0.036
OBL 2.4 10/28	2.682	-0.035
DBR 2.6 08/33	2.835	-0.023
UKT 3½ 10/25	4.726	-0.079
UKT 4½ 06/28	4.470	-0.067
UKT 3¼ 01/33	4.541	-0.054

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

Euro area

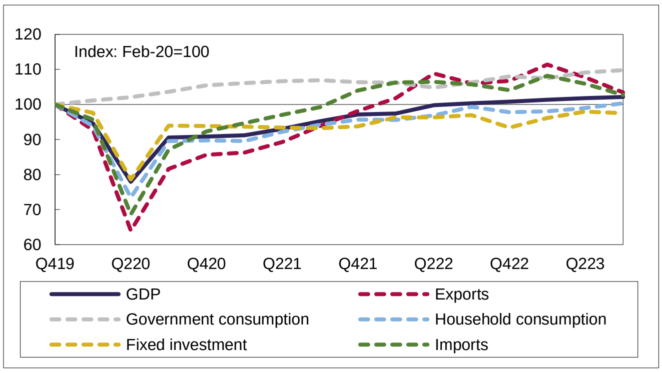
Spanish GDP beat expectations as household consumption offset weak external demand

Ahead of the release of the initial estimate of euro area Q3 GDP on Tuesday, today's flash figures from Spain and Ireland were a mixed bag, although they reinforced the view that economic activity in the region softened last quarter. Encouragingly, Spain's GDP estimate beat expectations, with growth of 0.3%Q/Q in Q3 marking the thirteenth consecutive quarter of expansion. So, while growth was revised a touch lower in Q2 (by 0.1ppt to 0.4%Q/Q), this left output up 1.8%Y/Y and 2.1% above the pre-pandemic benchmark. With household disposable incomes supported by strong employee compensation growth (8.2%Y/Y) and a moderation in inflation, the expansion was led by a jump in household consumption, which accelerated 0.5ppt to 1.4%Q/Q to contribute 0.7ppt to GDP growth. This supported a further surge in recreational services activity. In contrast, activity in trade, transport and accommodation services was broadly unchanged over the quarter, while falling house prices and rising borrowing costs saw real estate services contract for the first quarter in six. Moreover, construction investment contracted sharply (-2.2%Q/Q). There was also some payback for the double-digit jump in spending on transport equipment in Q2. And so, despite a rise in spending on other machinery, equipment and intellectual property, total fixed investment fell for the first quarter in three (-0.4%Q/Q). Meanwhile, amid weaker external demand for both goods and services, exports declined (-4.0%Q/Q) by the most since the global financial crisis when excluding the initial Covid lockdown. So, while this negative impact was partially offset by a drop in import volumes, net trade knocked around 0.4ppt off GDP growth.

Irish GDP contracts sharply amid weakness in multinational activity

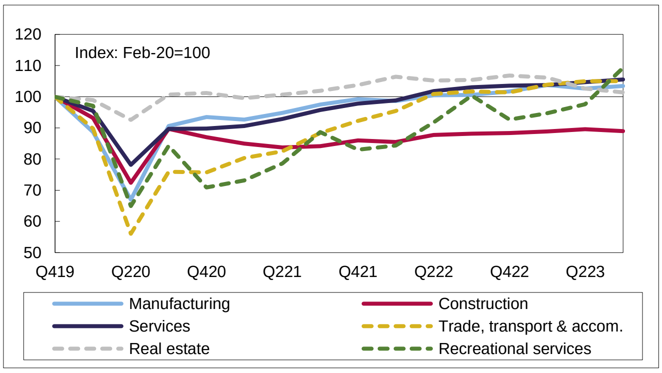
Contrasting the ongoing moderate expansion in Spain last quarter, Irish GDP contracted a steep 1.8%Q/Q in Q3. That marked the third quarterly decline out of the past four, leaving output down a striking 4.7%Y/Y. Admittedly, this was a relatively small adjustment compared with the exceptionally strong growth during the first two years of the pandemic, with output still some 26% higher than the Q419 benchmark. While there was no detailed breakdown of GDP published, Ireland's statistical office noted that the weakness unsurprisingly related to multinational-dominated subsectors. Of course, due to the outsized contribution of such activities, the Irish GDP data are typically highly volatile and subject to significant revisions. For example, in Q2, growth was initially estimated at 3.3%Q/Q before being revised down to 0.5%Q/Q. Nevertheless, based on today's figures, Irish GDP will subtract around 0.07ppt from euro area GDP growth in Q3, more than offsetting the positive contribution from Spain (0.03ppt). And given that we also expect GDP to have declined in Germany and Italy, it seems highly likely that euro area economic output contracted in Q3 for the first quarter since Q220, probably by no more than ¼%Q/Q.

Spain: GDP & expenditure components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Spain: Output by selected sector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

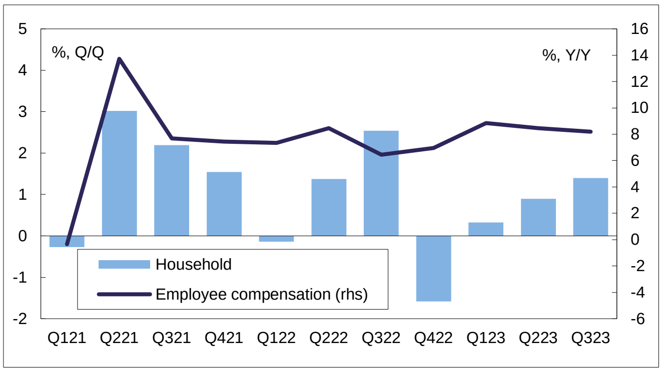
Italian business confidence falls to its lowest since April 2021

Recent surveys – including the past week's flash PMIs – suggest that momentum remained unfavourable at the start of Q4. Consistent with the trend, today's Italian business indices signalled a further deterioration in October, with the headline sentiment index falling for the fifth month out of the past six, by 1pt to 103.9, the lowest since April 2021. The deterioration was led by services, for which the respective sentiment index dropped to its weakest in a year as firms assessed a notable worsening in both current business conditions and order books. And with the number of overseas visitors having disappointed over the summer (trending in July and August some 3½% below the Q2 average), firms in the tourism sub-sector were notably more downbeat about the outlook for demand over the coming three months. After sales fell in August to the lowest level since the start of 2021 and appear to have done little better in September, confidence in the retail sector similarly maintained a downwards trend at the start of Q4, dropping to its lowest in seventeen months. And with factory output on track to record its fifth consecutive quarterly decline in Q3, and external demand weak, sentiment among manufacturers unsurprisingly fell further in October, with the respective index at its lowest since November 2020. So, it was only due to a surprising improvement in confidence in the construction sector that overall sentiment didn't fall further.

Consumer confidence slumps in Italy and remains near historical low in France

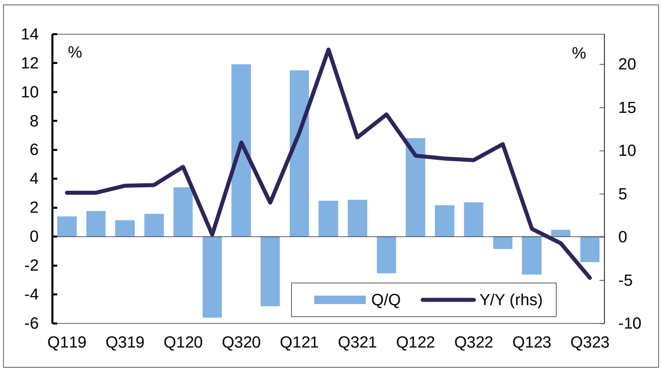
Despite unemployment being the lowest since the global financial crisis, the impact of higher interest rates and uncertain economic outlook saw confidence among Italian consumers fall sharply in October. In particular, the headline ISTAT sentiment index recorded the largest monthly drop (-3.8pts) in a year to 101.6, similarly the lowest reading since November last year. While this was broadly in line with the long-run average, it was nevertheless some 18pts below the peak in 2021. And with households more downbeat about the prospects for their own incomes over the coming year, they once again appeared less willing to spend, with the respective index the lowest for nine months and well below the long-run average. This tallied with the French INSEE consumer confidence survey, in which the share of households judging it to be a good time to make major purchases slipped back in October. Admittedly, consumers were marginally less pessimistic about income expectations in the twelve months ahead, while concerns about unemployment also receded. As such, contrary to expectations, the headline consumer confidence index increased for the first month in five, by 2pts to 84. But, this was still well below the long-run average (100) and indeed still close to the series low (80) recorded in July last year, suggesting that consumer spending is likely to remain very subdued over coming months and probably into 2024 too.

Spain: Household consumption & income



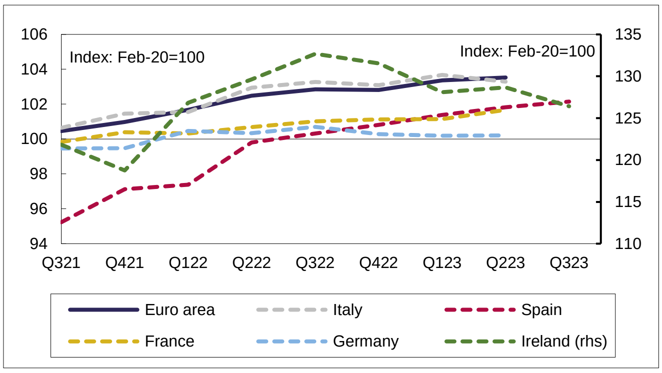
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Ireland: GDP growth



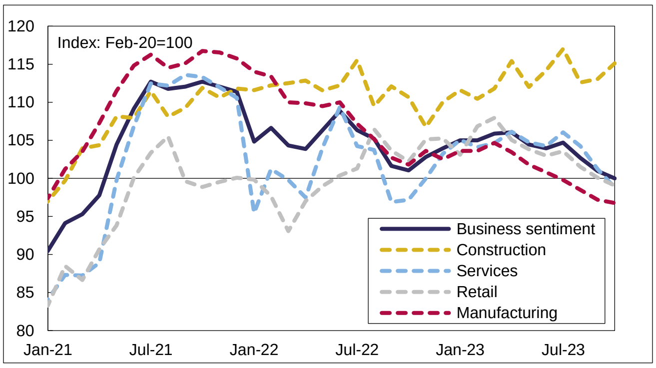
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: GDP levels



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Italy: Business sentiment indices



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

The coming week will be a busy one for top-tier euro area data, including the release of the European Commission confidence survey (Monday), flash estimates for October inflation and Q3 GDP (Tuesday), and unemployment figures (Friday). In terms of inflation, having declined to a nineteen-month low in September, the euro area's headline HICP rate is bound to take a further step down this month, with our forecast for a big drop of 1.4ppt to 2.9%Y/Y. This will in part reflect a larger negative contribution from energy, as lower prices this October compared with a jump of more than 6%M/M this time last year. Food and core goods inflation are also likely to have moderated further. So, while services inflation might well merely have moved broadly sideways this month, we expect core inflation to fall to 4.1%Y/Y, from 4.5%Y/Y in September, which would be the lowest since July 2022. Certainly, the early release today of figures from Germany's Brandenburg and Berlin states saw the headline CPI rates fall 1ppt to 4.6%Y/Y and 0.9ppt to 4.2%Y/Y respectively. Moreover, Irish HICP inflation fell 1.4ppts to 3.6%Y/Y. Preliminary inflation figures from Germany – which are expected to report a drop of about 1ppt in the HICP rate – Spain and Belgium will offer further guidance on Monday.

With ECB President Lagarde having acknowledged yesterday the growing downside risks to economic activity, euro area GDP looks already to have contracted in Q3, probably by 0.1-0.2%Q/Q, to leave the level of output unchanged from a year ago. In addition to the drag from Ireland, Germany's economy is highly likely to have shrunk in Q3 (data due Monday), with our expectation for a decline in output of at least 0.2%Q/Q to mark the third quarterly contraction out of the past four. Italian GDP (Tuesday) looks set to have contracted for a second successive quarter too, and at a similar rate to Germany. But while French GDP growth (Tuesday) will have slowed sharply from the pace of expansion in Q2 (0.5%Q/Q), we expect it to remain slightly positive in Q3 (0.1%Q/Q). With respect to the near-term outlook, the Commission surveys will provide an update on economic momentum at the start of Q4. National business survey results from Germany, France and Italy have provided mixed signals, while the flash PMIs flagged rising recession risks. The Commission's headline economic sentiment indicator (ESI) is expected to move sideways in October (93.3), which would leave it more than 6½% below the long-run average and suggestive of a continued absence of growth.

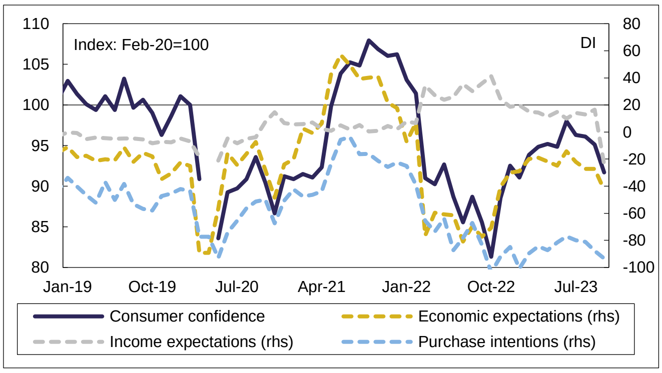
Despite the slowdown in economic activity, the latest unemployment figures are likely to point to ongoing resilience in the labour market in September, with the unemployment rate to remain close to the series low of 6.4% recorded in June and August. German and Spanish figures for October are also due (Thursday and Friday respectively). Other national data releases include September German retail sales (Tuesday) and goods trade figures (Friday), as well as French industrial production (Friday).

UK

November MPC meeting and MPR projections the UK highlight in the coming week

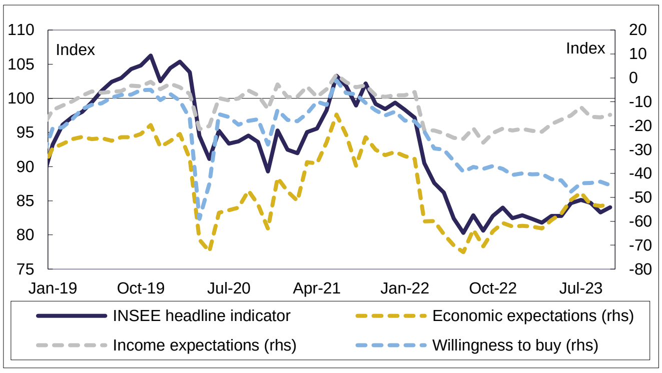
The main event in the coming week will be the BoE's monetary policy announcement on Thursday, which will be accompanied by its updated macroeconomic projections in its Monetary Policy Report. At the previous policy meeting last month, the MPC left Bank Rate unchanged at 5.25%. But the decision was close-run, with four out of nine members voting for a hike. Moreover, the Committee's policy statement retained a tightening bias, repeating the message from previous meetings that "Further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressure". And the MPC also echoed the "higher for longer" theme of the ECB, insisting that "Monetary policy will need to be sufficiently restrictive for sufficiently long to return inflation to the 2% target sustainably in the medium term". Nevertheless, the decision to pause tightening reflected the softening evident in various key economic indicators – including with respect to GDP, employment and services inflation – which had suggested that the BoE's August projections were already out of date.

Italy: Consumer confidence indices



Source: ISTAT, Refinitv Datastream and Daiwa Capital Markets Europe Ltd.

France: Consumer confidence indices



Source: INSEE, Refinitv Datastream and Daiwa Capital Markets Europe Ltd.

As such, the majority decided to leave rates steady, seemingly perhaps for an extended period (akin to Chief Economist Huw Pill's now oft-cited Table Mountain analogy), rather than tighten further at the risk of probably having to cut rates again shortly thereafter (Pill's Matterhorn analogy).

Expect Bank Rate to be left unchanged again, probably with a larger majority

Recent economic data and likely revisions to the BoE's projections in its Monetary Policy Report (see below) arguably further diminish the case for a rate hike at the coming meeting. Moreover, departing Deputy Governor Jon Cunliffe, one of the four MPC members to vote for a hike last month and only Bank staff member to do so, has now been replaced on the Committee by Sarah Breeden. At her first monetary policy meeting, we suspect that Breeden might be more inclined than Cunliffe to tow the line of the other staff members including Governor Bailey. So, we fully expect Bank Rate again to be left unchanged on Thursday, and with a larger majority in favour of the decision than in September. Moreover, it is possible that one member (the uber-dove Swati Dhingra) will vote for a rate cut.

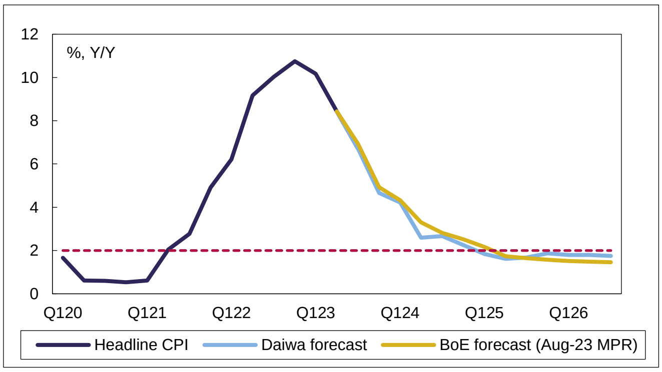
Expect near-term growth profile to be nudged down but little changes to projected annual rates

Since the last meeting, data for August economic output, September retail sales, and survey indicators, all point to the likelihood of a slight contraction in GDP of 0.1%Q/Q in Q3, contrary to the BoE's August projection of growth of 0.4%Q/Q. And the October flash PMIs and other surveys point to no recovery in momentum since then, raising the risks of a weaker performance in Q4 than the BoE's forecast of 0.2%Q/Q. So, the November MPR will certainly revise down the BoE's expected near-term path of GDP growth. Moreover, despite the decline in sterling swap rates since the summer and (notwithstanding contrasting evidence from various indicators) firmer pay growth than the Bank expected, it might only modestly revise up its view that GDP will be broadly flat throughout most of 2024 and into early 2025 as the lagged effects of past rate hikes still erode real disposable incomes of remortgaging households and hit fixed investment and unemployment picks up. Notably, however, since the August MPR was finalised, the post-pandemic profile of GDP, including growth in the first half of this year, has been revised up. Overall, given offsetting influences, we suspect that the Bank will maintain its full-year growth projections on market-based rate assumptions for both 2023 and 2024 at about ½%Y/Y. Nevertheless, given the drop in the market-implied path of Bank Rate that year, we see the possibility of an upwards revision to its 2025 growth forecast from ¼%Y/Y in August.

Inflation projection to be little changed, albeit with scope for modest near-term downwards revision

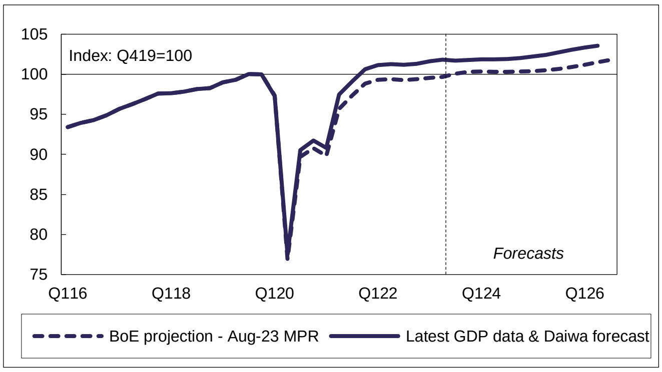
In term of inflation, although the headline CPI rate was disappointingly unchanged in September at 6.7%Y/Y, that was still 0.2ppt below the BoE's Monetary Policy Report projection for the month. The principal reason for the stickiness was higher prices of petrol. But core goods inflation continued to fall significantly in September. And while the more important services component increased from August due to higher private school fees and holiday-related components, it was still 0.1ppt below the BoE's forecast. Despite a further increase in auto fuel prices, headline inflation is bound to take a big step down in October – by around 2ppts – due to the regulated cut in household energy bills. And we think the BoE should nudge down slightly its projection for headline inflation in Q4 from 4.9%Y/Y. In 2024, the inflation profile, particularly for services, will depend significantly on developments in the labour market. Unfortunately, the quality of the LFS employment and unemployment data – which pointed to a significant deterioration in conditions over the summer – now appears poor given the marked decline in the survey response rate. And other indicators – such as HMRC payrolls and the claimant count – have limitations too. So, the BoE will feel unsighted about the true condition of the labour market. Nevertheless, on balance, all of the recent evidence suggests that the labour market has become less tight over recent months and pay growth should moderate over coming months. So, despite the rise in auto fuel prices summer, as well as the drop in market expectations for Bank Rate, we expect the broad profile of its inflation forecast for 2024 or 2025 to be maintained. So, the mode inflation projection would still be close to 2.5%Y/Y by end-2024 and below the 2.0% target by Q225. And, despite an upside skew, the mean rate would also still be back on target by Q225, supporting the decision to leave Bank Rate unchanged at this meeting.

UK: Inflation forecasts*



**Modal forecast. Source: BoE, Refinitv Datastream and Daiwa Capital Markets Europe Ltd.*

UK: GDP forecasts



Source: BoE, Refinitv Datastream and Daiwa Capital Markets Europe Ltd.

The data week ahead in the UK

In terms of economic data, the coming week kicks off on Monday with the BoE's latest monetary figures for September, which are likely to illustrate the ongoing impact of the MPC's aggressive policy tightening. Indeed, while the average new mortgage interest rate edged slightly lower in September, after mortgage approvals declined significantly over the summer and surveys having suggested that housing market activity remains slow, new mortgage lending is highly likely to have remained very subdued in September. Concerns about the economic outlook and high borrowing rates might also limit demand for consumer credit although stretched household finances might well have boosted demand. The weakening residential property market will be emphasised by the Nationwide house price index (Tuesday), which is expected see prices resume a downwards trend this month. In addition, final manufacturing and services PMI survey results for October (Wednesday and Friday respectively) are likely to align with the flash estimates that showed the output indices little changed from September and still consistent with contraction.

Daiwa economic forecasts

	2023			2024					
	Q2	Q3	Q4	Q1	Q2	Q3	2023	2024	2025
GDP								%, Y/Y	
Euro area	0.1	-0.1	0.0	0.2	0.2	0.3	0.4	0.6	1.5
UK	0.2	-0.1	0.1	0.1	0.0	0.1	0.5	0.2	0.7
Inflation, %, Y/Y									
Euro area									
Headline HICP	6.2	5.0	3.1	2.9	2.5	2.0	5.5	2.4	1.9
Core HICP	5.5	5.1	4.0	2.8	1.8	1.4	5.0	1.9	1.8
UK									
Headline CPI	8.4	6.7	4.7	4.2	2.5	2.6	7.4	2.9	1.8
Core CPI	6.9	6.4	5.7	5.1	3.2	2.6	6.3	3.2	1.7
Monetary policy, %									
ECB									
Refi Rate	4.00	4.50	4.50	4.50	4.25	4.00	4.50	3.75	3.00
Deposit Rate	3.50	4.00	4.00	4.00	3.75	3.50	4.00	3.25	2.50
BoE									
Bank Rate	5.00	5.25	5.25	5.25	5.25	5.00	5.25	4.50	2.75

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

The coming week's data calendar

The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast/actual*	Previous
Monday 30 October 2023					
Euro area	10.00	EC economic sentiment index	Oct	93.0	93.3
	10.00	EC industry (services) sentiment indices	Oct	-9.5 (4.0)	-9.0 (4.0)
	10.00	Final EC consumer sentiment index	Oct	-17.9	-17.8
Germany	09.00	GDP – first estimate Q/Q% (Y/Y%)	Q3	*-0.2 (-0.7)*	0.0 (-0.2)
	13.00	Preliminary HICP (CPI) Y/Y%	Oct	3.3 (4.0)	4.3 (4.5)
Spain	08.00	Preliminary HICP (CPI) Y/Y%	Oct	3.8 (3.8)	3.3 (3.5)
UK	09.30	Net consumer credit £bn (Y/Y%)	Sep	1.4 -	1.6 (7.6)
	09.30	Net mortgage lending (mortgage approvals '000s)	Sep	1.0 (45.0)	1.2 (45.4)
Tuesday 31 October 2023					
Euro area	10.00	GDP – first estimate Q/Q% (Y/Y%)	Q3	*-0.1 (0.0)*	0.1 (0.5)
	10.00	Preliminary HICP (core HICP) Y/Y%	Oct	*2.9 (4.1)*	4.3 (4.5)
Germany	07.00	Retail sales M/M% (Y/Y%)	Sep	-	-1.2 (-1.9)
France	06.30	GDP – first estimate Q/Q% (Y/Y%)	Q3	*0.1 (0.6)*	0.5 (1.0)
	06.30	Consumer spending M/M% (Y/Y%)	Sep	0.4 (-2.8)	-0.5 (-1.9)
	07.45	Preliminary HICP (CPI) Y/Y%	Oct	4.5 (4.0)	5.7 (4.9)
	07.45	PPI Y/Y%	Sep	-	-1.4
Italy	09.00	GDP – first estimate Q/Q% (Y/Y%)	Q3	*-0.1 (0.0)*	-0.4 (0.3)
	10.00	Preliminary HICP (CPI) Y/Y%	Oct	2.3 (2.4)	5.6 (5.3)
	11.00	PPI Y/Y%	Sep	-	-16.1
UK	00.01	Lloyds business barometer	Oct	-	36
	00.01	BRC shop price index Y/Y%	Oct	-	6.2
Wednesday 01 November 2023					
UK	09.30	Final manufacturing PMI	Oct	*45.2*	44.3
	09.30	Nationwide house prices M/M% (Y/Y%)	Oct	-0.4 (-4.8)	0.0 (-5.3)
Thursday 02 November 2023					
Euro area	09.00	Final manufacturing PMI	Oct	*43.0*	43.4
Germany	08.55	Final manufacturing PMI	Oct	*40.7*	39.6
	08.55	Unemployment change '000s (rate %)	Oct	15.0 (5.8)	10.0 (5.7)
France	08.50	Final manufacturing PMI	Oct	*42.6*	44.2
Italy	08.45	Manufacturing PMI	Oct	46.5	46.8
Spain	08.15	Manufacturing PMI	Oct	47.3	47.7
UK	12.00	BoE Bank rate %	Nov	*5.25*	5.25
	12.30	DMP 1-year ahead CPI (output price) expectations Y/Y%	Oct	-	4.9 (4.8)
Friday 03 November 2023					
Euro area	10.00	Unemployment rate %	Sep	6.4	6.4
Germany	07.00	Trade balance €bn	Sep	16.3	16.5
France	07.45	Industrial production M/M% (Y/Y%)	Sep	0.0 (0.1)	-0.3 (-0.5)
Italy	09.00	Unemployment rate %	Sep	7.4	7.3
Spain	08.00	Unemployment change '000s	Oct	-	19.8
UK	09.30	Final services (composite) PMI	Oct	49.2 (48.6)	49.3 (48.5)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions			
Country		GMT	Event / Auction
Monday 30 October 2023			
- Nothing scheduled -			
Tuesday 31 October 2023			
Germany		10.30	Auction: €1.0bn of 1.8% 2053 green bonds
Italy		10.00	Auction: €1.5bn of 2.2% 2027 bonds
		10.00	Auction: €2.5bn of 4.1% 2029 bonds
		10.00	Auction: €3.5bn of 4.2% 2034 bonds
		10.00	Auction: €1.25bn of 2028 floating-rate bonds
Wednesday 01 November 2023			
Germany		10.30	Auction: €3.0bn of 2.4% 2030 bonds
UK		10.00	Auction: £4.0bn of 4.5% 2028 bonds
Thursday 02 November 2023			
France		09.30	Auction: To sell 2033, 2044, 20544 and 2072 fixed-rate bonds
Spain		09.30	Auction: To sell 2029, 2032 and 2052 fixed-rate bonds, and 2033 index-linked bonds
UK		12.00	BoE monetary policy decision, statement and Monetary Policy Report published
		12.30	BoE Governor Bailey to speak at press conference about the Monetary Policy Report
		12.30	BoE to publish Decision Maker Panel survey results
Friday 03 November 2023			
UK		12.15	BoE Chief Economist Pill to speak to regional agents about the Monetary Policy Report
		16.00	BoE MPC member Haskel to speak on a panel about labour market dynamics at BoE Watchers' Conference

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results							
Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
France		INSEE consumer confidence indicator	Oct	**84**	82	83	-
Italy		ISTAT business (manufacturing) confidence indicator	Oct	**103.9 (96.0)**	- (96.0)	104.9 (96.4)	-
		ISTAT consumer confidence indicator	Oct	**101.6**	105.0	105.4	-
Spain		GDP - preliminary estimate Q/Q% (Y/Y%)	Q3	**0.3 (1.8)**	*0.2 (1.5)*	0.5 (2.2)	0.4 (2.0)
		Retail sales Y/Y%	Sep	**6.5**	-	7.2	7.1
Auctions							
Country		Auction					
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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