Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made losses as the ifo survey suggested that German firms were a touch less downbeat in October while some ECB hawks tried to push back against suggestions that rates should be cut by 50bps in December.
- Gilts made losses at the short end of the curve but gains at the long end as UK consumer confidence dropped to a nine-month low.
- The coming week will bring euro area flash estimates of inflation in October and GDP in Q3 as well as the UK government's Budget announcement.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.107	+0.039
OBL 2½ 10/29	2.111	+0.038
DBR 2.6 08/34	2.290	+0.025
UKT 4⅛ 01/27	4.157	+0.020
UKT 4⅛ 07/29	4.099	+0.013
UKT 4¼ 07/34	4.231	-0.004

*Change from close as at 5:00pm BST.
Source: Bloomberg

Euro area

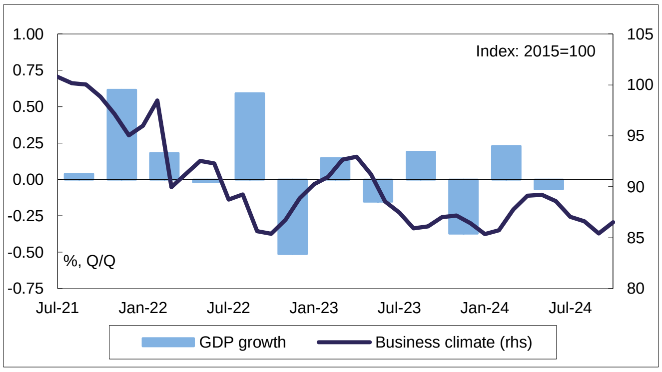
Modest improvement in German ifo survey masks ongoing downtrend in manufacturing

Like yesterday's flash PMIs, today's ifo business survey raised the tentative possibility that the bottom in Germany's economic downturn might finally be within reach. Indeed, the headline ifo business climate index rose for the first month in five in October, by 1.1pts to 86.5. Firms signalled a modest improvement in the current business situation, for which the respective index increased for the first month in six. They also revised up their expectations for the coming six months to a four-month high. But German economic activity still likely contracted for a second successive quarter in Q3. And consistent with the downbeat message in the Bundesbank's latest monthly report, the ifo indices suggest that the economy is likely to move sideways, rather than bounce back, in Q4. The detail of the October survey also flagged that the improvement was far from broad-based across sectors. Services, particularly in logistics, tourism and IT, were more satisfied with conditions in October. In contrast, however, manufacturers considered the current business situation to have worsened considerably at the start of Q4 due to a persisting lack of orders. And while they were less pessimistic about the outlook for the coming six months, sentiment in the sector still remained well below the long-run average, suggesting that the sector will remain a drag on the German economy over coming quarters. Meanwhile, retailers and constructors reported little improvement in conditions despite rising real incomes, lower interest rates and the recent associated pickup in consumer confidence.

French and Italian consumer confidence little changed, but Italian businesses more downbeat

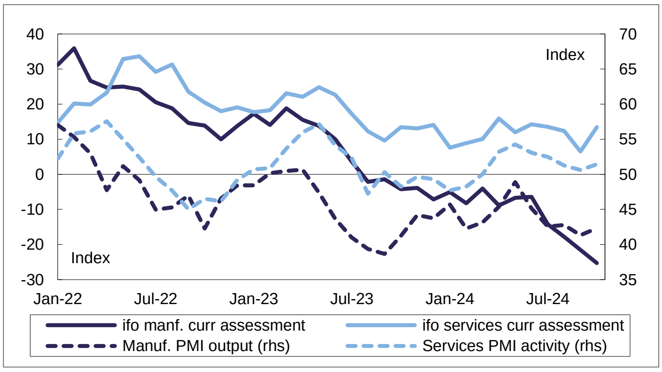
Despite the further rise in the Commission's flash euro area consumer confidence index in October close to the long-run average, today's INSEE survey suggested little change in French household sentiment at the start of Q4 as concerns surrounding fiscal consolidation offset the boost from lower inflation and rates. Indeed, having jumped to a 2½-year high in September, the headline confidence index edged down 1pt to 94, leaving it slightly above the Q3 average but nevertheless still some 6% below the long-run average. With fears of unemployment the highest for almost 3½ years, households were somewhat more downbeat about future incomes. Savings intentions remained close to historical highs. And the share of households considering it a good time to make major purchases remained well below the long-run average. According to ISTAT, Italian consumers were also somewhat less upbeat at the start of Q4, with the headline index also down 1pt to 97.4. Contrasting France, however, this index remained comfortably above the long-run average. While Italian consumers were less upbeat about the economic outlook, purchase intentions were little changed broadly in line with long-run average and consistent with ongoing modest consumer spending. Italian business confidence also slipped back slightly in October, with the headline composite index down 1pt to 97. But despite greater optimism among services firms, the respective manufacturing sentiment index slumped to its lowest since November 2020, to be some 5% below the long-run average and suggestive of a marked decline in Italian industrial production at the start of Q4.

Germany: GDP growth & ifo business climate index



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Business survey indices



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

Lending to firms picks up only gradually in response to lower rates

With the ECB's rate-cutting cycle underway and expected to continue through the first half of next year, lending is gradually picking up from low levels. Tallying with reports in the ECB's Bank Lending Survey (BLS) of a moderate increase in loan demand in Q3, the monthly flow of bank lending to non-financial corporations (NFCs) on an adjusted basis in September was the highest in more than two years. But that followed two months of negative flow. So, the three-month cumulative sum was little changed from August and down from earlier in the summer. Nevertheless, growth in the adjusted stock of loans to NFCs rose 0.3ppt to 1.1%Y/Y, the highest since July 2023, albeit still more than 2½ppts below the average in two years before the pandemic and firmly negative in real terms. Recent growth in lending to NFCs has been concentrated in shorter-term maturities, which often correspond with demand for working capital. In contrast, the net flow of longer-term loans, which corresponds more closely with fixed investment, has remained subdued within the range of the past two years.

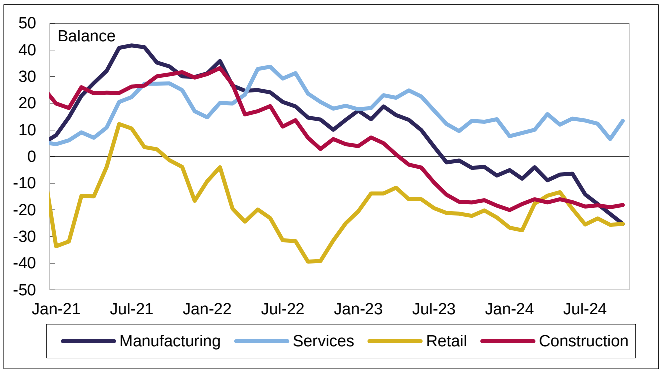
Consumer lending growth also remains tepid

Meanwhile, also consistent with the BLS, the net flow of lending to households of €9.5bn in September was the strongest since January 2023. But the respective annual growth rate merely edged up 0.1ppt to 0.7%Y/Y, almost 2.5ppts below the average in the two years before the pandemic. Consumer credit growth moderated slightly to 2.8%Y/Y, while growth in the stock of loans for house purchase was unchanged at just 0.6%Y/Y. So, the pickup in the overall growth in loans to households reflecting a slower pace of decline in the 'other' category, which includes loans granted for debt consolidation and education (-2.1%Y/Y). Finally, having reached historical lows in the second half of 2023 as ECB rates finally hit their terminal levels for the cycle, money supply growth continues to normalise. The pace of decline in the narrow M1 aggregate moderated to -1.2%Y/Y while M3 broad money growth picked up 0.3ppt to 3.2%Y/Y, the highest since December 2022 albeit still below the range considered consistent with achievement of the inflation target over the medium term albeit.

The week ahead in the euro area

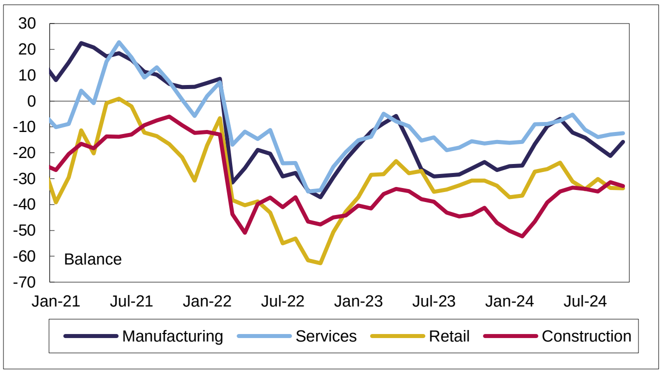
In a busy week ahead for top-tier economic data releases, the highlights include flash estimates of euro area inflation in October (Thursday) and GDP growth in Q3 (Wednesday). While headline euro area inflation fell a chunky 0.5ppt to 1.7%Y/Y in September – the first sub-target reading since mid-2021 – this principally reflected the energy component, which fell more than 3ppts to an eight-month low of -6.1%Y/Y. With heating gas oil prices having subsequently risen sharply and food inflation expected to tick marginally higher for a second successive month, we expect some bounce back this month. Indeed, we forecast headline inflation to rise back to the 2.0%Y/Y target in October. But having previously slipped back to a five-month low of 2.7%Y/Y, we expect core inflation to move sideways this month, with the services and non-energy industrial

Germany: ifo current assessment indices



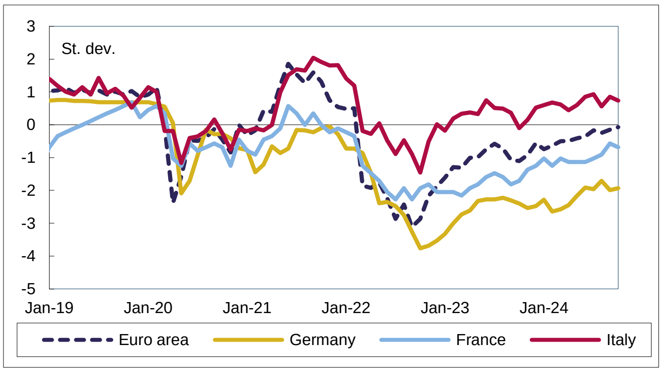
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ifo expectations indices



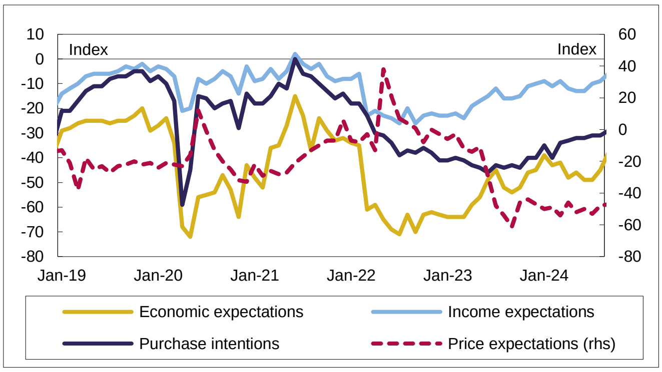
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Consumer confidence indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

goods components little changed at 3.9%Y/Y and 0.5%Y/Y respectively. The preliminary inflation estimates from Germany, Spain, Belgium and Ireland (Tuesday) will provide an initial guide to the euro area data.

The preliminary estimates of economic output in Q3 are likely to confirm another mixed performance across the member states. Survey indicators like the PMIs suggest that industrial output almost certainly remained a drag last quarter. But services will provide some offset, not least due to the boost from the Paris Olympics over the summer. Overall, we expect euro area GDP growth of 0.2%Q/Q in Q3, unchanged from Q2 and bang in line with the ECB's September projection and market consensus. But risks to that forecast appear skewed to the downside, not least reflecting ongoing weakness in Germany, where we expect the economy to have contracted slightly for a second successive quarter (-0.1%Q/Q). We also think that growth in Italy will have slowed in Q3 to just 0.1%Q/Q, as support from the construction continues to fade. But we expect growth in France to have accelerated temporarily last quarter, by 0.2ppt to 0.4%Q/Q, due not least to a boost from the Paris Olympics to certain services. And while growth in Spain might have moderated from 0.8%Q/Q in Q2, we continue to expect it to significantly outperform the other larger member states (0.5%Q/Q). While the preliminary figures for the four largest member states will be published on Wednesday, the data from Belgium and Ireland – the latter of which often has a significant impact on the euro area figure – will be published on Tuesday.

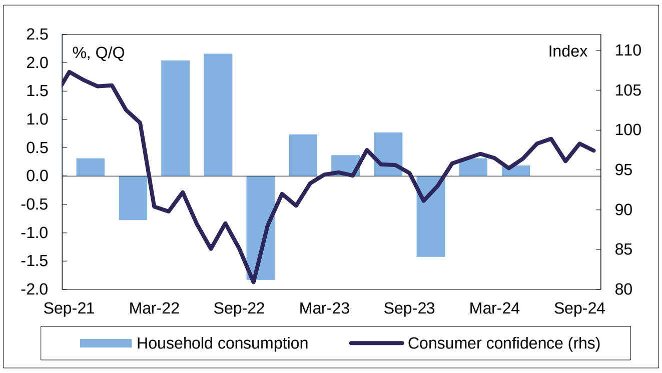
Among other notable data due in the coming week, the Commission's economic sentiment indices (also due Wednesday) will provide a cross-check on yesterday's flash PMIs, which suggested that economic growth stagnated at the start of Q4 despite a further improvement in consumer confidence. Labour market data from Germany (for October on Wednesday) and the euro area (for September on Thursday) might well point to a modest pickup in unemployment, although the latter will remain very close to August's series low (6.4%).

UK

Consumer confidence falls to a nine-month low

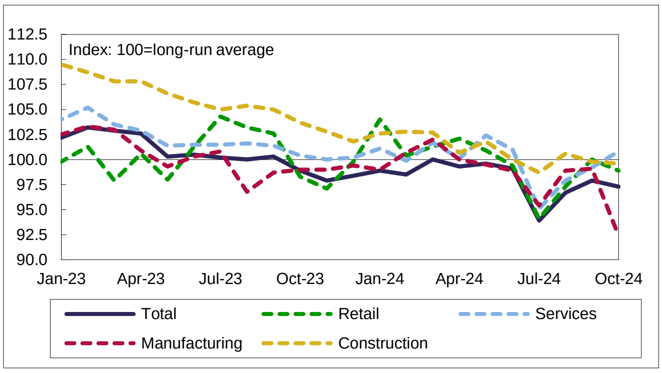
Despite the recent downtrend in headline inflation to below the 2% target and a gradual easing in borrowing rates, today's GfK consumer survey suggested that households remained apprehensive about the extent and nature of tax hikes to be announced in next week's government Budget, while the near-10% hike in household energy prices at the start of this month also hit real incomes. Overall, the decline in the headline confidence indicator in October was modest, but this followed a more sizeable drop in September, to leave it at -21, some 8pts below August's near-two-year high and matching the lowest reading since December. Admittedly, the decline this month principally related to the backwards looking components. But

Italy: Consumption & consumer confidence



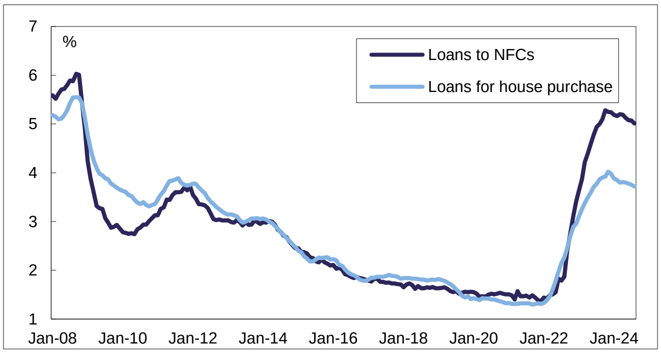
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: ISTAT business survey indices



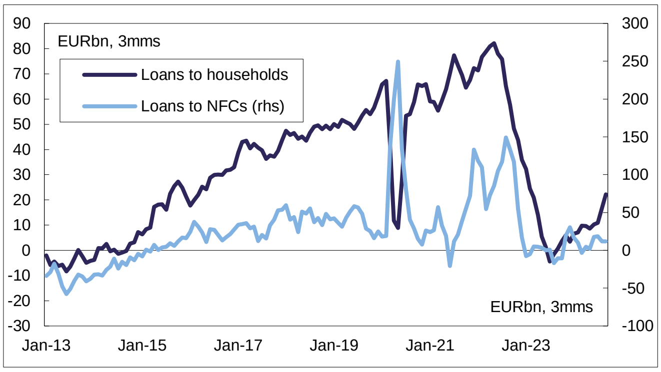
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Composite cost of borrowing



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Loans to NFCs & households



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

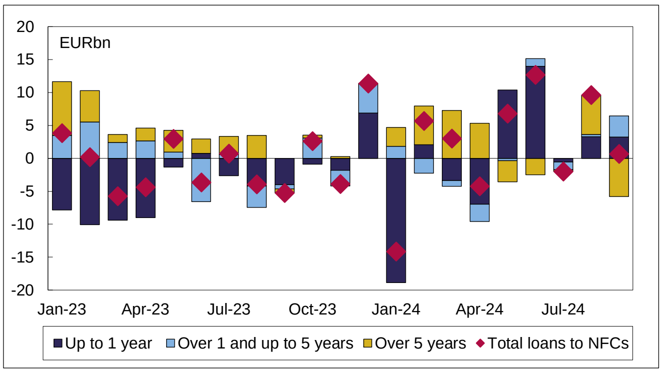
households were also the most downbeat about the economic outlook in a year. And while the respective indices for income expectations and purchase intentions ticked higher in October, they were still below the summer peaks and well below the long-run average, suggesting that spending on big-ticket items will remain subdued for the time being. Indeed, today's survey again flagged an ongoing preference to save amid ongoing economic and political uncertainties, which will likely act as a restraint on economic growth momentum going forward.

The week ahead in the UK

The main event of the coming week will be Wednesday's Budget announcement, which will be the first of the new Labour government. Chancellor Rachel Reeves will confirm the detail of a range of tax hikes intended to balance the current budget (i.e. net borrowing excluding investment) from 1.9% of GDP last fiscal year. She will also announce an increase in current government expenditure to provide more resources for healthcare, avoid the real-terms cuts in departmental spending planned by the last government, meet new spending demands not previously adequately budgeted and address the recent (in part related) overshoot from the OBR's projection. She will also commit to extra public borrowing to fund additional public investment. And to allow for that extra borrowing, she will also recalibrate the government's fiscal rules. While much of what will be announced to Parliament has been trailed in the media, the precise detail is bound to impact Gilts, sterling and UK equities, as well as the outlook for BoE policy. Indeed, episodes of recent Gilt underperformance have frequently been associated with media speculation about the additional public borrowing to be announced.

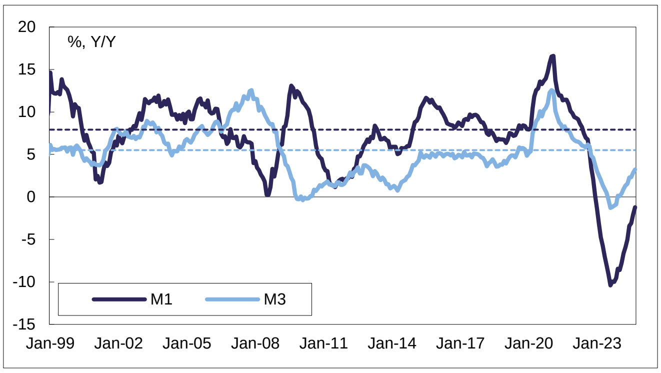
As for its predecessor, the new government will continue to target a decline in public debt by the end of the OBR projection period. Perhaps arbitrarily, the last government constrained its fiscal plans significantly by targeting a reduction in the stock of public sector net debt excluding the BoE, which was projected by the OBR in March to drop just 0.3ppt of GDP in FY28/9 from the previous year to 92.9%, 3.6ppts above last year's level. Instead, to provide greater flexibility, Reeves appears set to target a decline in public sector net financial liabilities, which the OBR in March projected to decline by almost 2ppts from the previous year in FY28/9 to 78.7% of GDP, 4.5ppts below last year's level. In principle, that would seem to allow for extra cumulative borrowing of more than £50bn in five years' time. But in practice, Reeves seems likely to commit to a much smaller increase in borrowing just enough to keep net public investment broadly stable around last year's ratio of 2.6% of GDP and thus avoid the steady decline to 1.7% of GDP in FY28/9 pencilled-in by the previous government. The implication could nevertheless be extra public investment and extra borrowing of about 1% of GDP in 2-3 years' time at the end of the current monetary policy horizon. That could mean that Bank Rate will need to be 25-50bps higher than it otherwise would have needed to be for the BoE to meet its inflation target. That, however, will only slow the downwards path in Bank Rate over the coming 12 months. And, for the time being, we expect Bank Rate to be cut to 3.50% by the end of 2025.

Euro area: Loans to NFCs



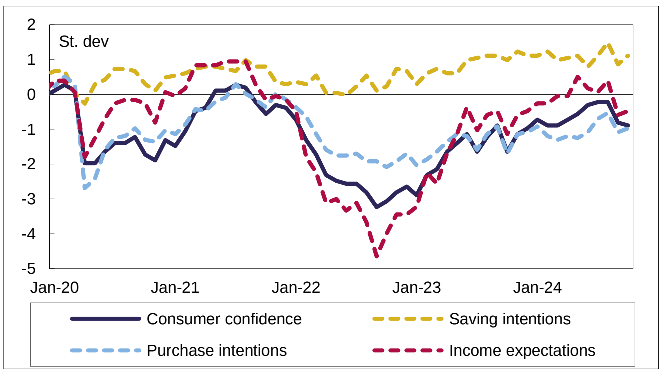
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Money supply*



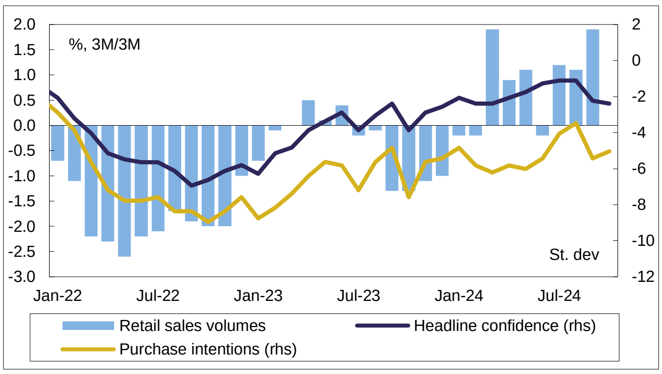
**Dashed lines represent long-run average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Consumer confidence indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales & consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Meanwhile, although in FY22/23 the tax burden reached its highest level in more than seven decades, Reeves' tax hikes could reach as much as £40bn (between 1¼-1½% of GDP) over the coming five years. The Labour Party manifesto already pledged revenue-raising measures such as charging VAT on private school fees, and reforming the non-domiciled tax regime and taxation of carried interest, amounting to about £7.5bn by FY29. To make her sums add up without breaking manifesto pledges, a hike of employer NICs now seems likely, as does a freezing of personal income tax thresholds, higher capital gains tax and the closing of inheritance tax loopholes. Other revenue-raising measures, such as higher fuel duty and even a windfall levy on banks to reflect QE-related profits, might possibly also be in store.

The coming week will be relatively quiet for top-tier economic data, with releases including October's results from the CBI's distributive trades survey (Monday), BRC shop price monitor (Tuesday), and Nationwide house price report (Friday), as well as the BoE's bank lending figures for September (Tuesday). Given unseasonably mild temperatures but heavy rainfall over the past month, the CBI survey might well report a decline in retail sales volumes at the start of Q4 as consumers stayed away from the high street. Indeed, while the BRC's shop price index is likely to imply ongoing price-cutting amid fierce competition among retailers, we expect some payback for the strength in retail sales in Q3. Meanwhile, the BoE's lending figures might well report a further improvement in mortgage lending at the end of Q3 in line with the recent pickup in mortgage approvals, signs of revival in the housing market and a further decline in mortgage rates.

The next edition of the Euro wrap-up will be published on 29 October 2024

Daiwa economic forecasts

	2024			2025			2023	2024	2025
	Q2	Q3	Q4	Q1	Q2	Q3			
GDP	**%, Q/Q**						**%, Y/Y**		
Euro area	0.2	0.2	0.2	0.3	0.3	0.3	0.5	0.7	1.0
UK	0.5	0.3	0.3	0.3	0.3	0.4	0.3	0.9	1.3
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.5	2.2	2.2	2.0	1.8	1.8	5.4	2.4	1.9
Core HICP	2.8	2.8	2.8	2.5	2.0	1.8	4.9	2.9	2.1
UK									
Headline CPI	2.1	2.0	2.4	2.3	2.1	2.3	7.3	2.5	2.2
Core CPI	3.6	3.3	3.3	3.3	2.3	2.0	6.2	3.7	2.3
Monetary policy, %									
ECB									
Deposit Rate	3.75	3.50	3.00	2.50	2.25	2.25	4.00	3.00	2.25
Refi Rate	4.25	3.65	3.15	2.65	2.40	2.40	4.50	3.15	2.40
BoE									
Bank Rate	5.25	5.00	4.50	4.00	3.75	3.50	5.25	4.50	3.50

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

Economic calendars

The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast/*	Previous
		Monday 28 October 2024			
Spain	08.00	Retail sales Y/Y%	Sep	2.1	2.3
UK	00.01	Lloyds business barometer (own price expectations)	Oct	-	47 (65)
	11.00	CBI distributive trades survey – reported sales volumes %	Oct	-10	4
		Tuesday 29 October 2024			
Germany	07.00	GfK consumer confidence indicator	Nov	-20.5	-21.2
Italy	09.00	Hourly wages Y/Y%	Sep	-	3.6
UK	00.01	BRC shop price index Y/Y%	Oct	-0.5	-0.6%
	09.30	Net consumer credit £bn (Y/Y%)	Sep	1.3 (-)	1.3 (7.6)
	09.30	Net mortgage lending £bn (mortgage approvals 000s)	Sep	2.8 (65.2)	2.9 (64.9)
		Wednesday 30 October 2024			
Euro area	10.00	GDP – first estimate Q/Q% (Y/Y%)	Q3	*0.2 (0.7)*	0.2 (0.6)
	10.00	Final Commission consumer confidence indicator	Oct	-12.5	-12.9
	10.00	Commission economic sentiment indicator	Oct	96.3	96.2
	10.00	Commission industrial (services) confidence indicator	Oct	-10.5 (6.5)	-10.9 (6.7)
Germany	08.55	Unemployment rate % (change 000s)	Oct	6.1 (15.0)	6.0 (17.0)
	09.00	GDP – first estimate Q/Q% (Y/Y%)	Q3	*-0.1 (-0.3)*	-0.1 (0.0)
	13.00	Preliminary HICP (CPI) Y/Y%	Oct	2.1 (1.8)	1.8 (1.6)
France	06.30	GDP – first estimate Q/Q% (Y/Y%)	Q3	*0.4 (1.2)*	0.2 (1.0)
	06.30	Consumer spending M/M% (Y/Y%)	Sep	0.1 (0.0)	0.2 (0.0)
Italy	09.00	GDP – first estimate Q/Q% (Y/Y%)	Q3	*0.1 (0.7)*	0.2 (0.9)
	10.00	PPI Y/Y%	Sep	-	-1.1
Spain	08.00	GDP – first estimate Q/Q% (Y/Y%)	Q3	*0.5 (2.8)*	0.8 (3.1)
	08.00	Preliminary HICP (CPI) Y/Y%	Oct	1.8 (1.7)	1.7 (1.5)
		Thursday 31 October 2024			
Euro area	10.00	Preliminary headline (core) HICP Y/Y%	Oct	*2.0 (2.7)*	1.8 (2.7)
	10.00	Unemployment rate %	Sep	6.2	6.4
Germany	07.00	Retail sales M/M% (Y/Y%)	Sep	-0.8 (1.2)	1.6 (2.4)
France	07.45	Preliminary HICP (CPI) Y/Y%	Oct	1.5 (1.1)	1.4 (1.1)
	07.45	PPI Y/Y%	Sep	-	-6.3
Italy	10.00	Preliminary HICP (CPI) Y/Y%	Oct	0.9 (0.9)	0.7 (0.7)
		Friday 1 November 2024			
UK	07.00	Nationwide house price index M/M% (Y/Y%)	Oct	0.3 (2.8)	0.7 (3.2)
	09.30	Final manufacturing PMI	Oct	50.3	51.5

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 28 October 2024		
- Nothing to report -		
Tuesday 29 October 2024		
Germany	10.30	Auction: to sell €4bn of 2.5% 2029 bonds
UK	10.00	Auction: to sell £4bn of 4.125% 2029 bonds
Wednesday 30 October 2024		
Euro area	15.00	ECB Executive Board Member Schnabel speaks at the CEPR Frankfurt Hub Conference
Italy	10.00	Auction: to sell bonds*
UK	11.00	Chancellor of the Exchequer Reeves presents UK budget to Parliament
Thursday 31 October 2024		
Euro area	09.00	ECB to publish Economic Bulletin
UK	10.00	Auction: to sell £2.25bn of 1.5% 2053 green bonds
Friday 1 November 2024		
- Nothing to report -		

**Details to be announced next week. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	ECB consumer expectations survey – 1Y CPI (3Y CPI) Y/Y%	Sep	**2.4 (2.1)**	2.6 (2.2)	2.7 (2.3)	-
	M3 money supply Y/Y%	Sep	**3.2**	2.9	2.9	-
Germany	ifo business climate indicator	Oct	**86.5**	85.6	85.4	-
	ifo current assessment (expectations) indicator	Oct	**85.7 (87.3)**	84.4 (86.9)	84.4 (86.3)	- (86.4)
France	INSEE consumer confidence indicator	Oct	**94**	95	95	-
	Total jobseekers mn	Q3	**2.8**	-	2.8	-
Italy	ISTAT consumer confidence indicator	Oct	**97.4**	98.5	98.3	-
	ISTAT business (manufacturing) confidence indicator	Oct	**93.4 (85.8)**	- (87.0)	95.7 (86.7)	95.6 (86.6)
Spain	PPI Y/Y%	Sep	**-5.2**	-	-1.3	-1.4
	Unemployment rate %	Q3	**11.21**	11.35	11.27	-
UK	GfK consumer confidence indicator	Oct	**-21**	-20	-20	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs