Euro wrap-up

Overview

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- Bunds made losses as a survey suggested that German consumers were the least downbeat since April 2022.
- Ahead of tomorrow's Budget announcements, Gilts also made losses as UK mortgage approvals rose to the highest level for more than two years.
- Wednesday will bring flash estimates of euro area GDP in Q3 and German and Spanish inflation in October.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.133	+0.041
OBL 2½ 10/29	2.155	+0.055
DBR 2.6 08/34	2.336	+0.051
UKT 4⅛ 01/27	4.246	+0.049
UKT 4⅛ 07/29	4.184	+0.056
UKT 4¼ 07/34	4.311	+0.059

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

Euro area

German consumer confidence highest since April 2022

Last week's flash Commission estimate suggested that euro area consumer confidence improved in October for the eighth time in the past nine months to return close to the long-run average. While the respective national surveys suggested that household sentiment deteriorated in France and Italy this month, today's GfK indices suggested that German confidence extended its uptrend into the autumn. Indeed, the headline German consumer confidence index – presented as a forecast for November – rose for the second successive month to -1.7, the highest level since April 2022. Within the detail for October, major purchase intentions rose to the highest level since March 2022 to point to a long-awaited pickup in spending. That likely reflected firmer income expectations, which improved to the second-highest level since early 2022. And German consumers' propensity to save fell to a five-month low.

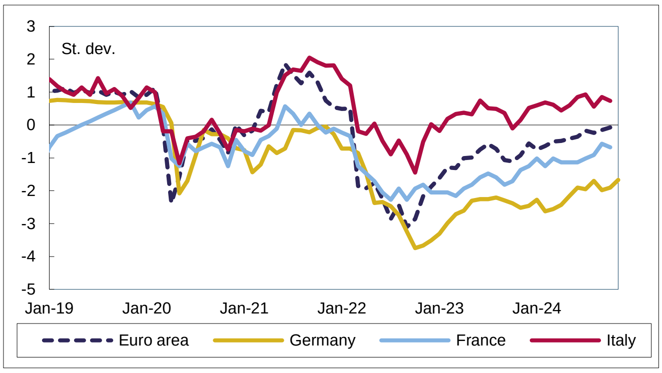
Sentiment likely to remain low by historical standards as political & industrial relations sour

We caution, however, that German household savings intentions remain very high by historical standards. Moreover, the GfK survey's measure of consumer expectations for the economic outlook weakened in October to a seven-month low. Despite signs of a pickup in retail sales in Q3 and a slight improvement in the German flash PMIs and ifo survey indices this month, GDP looks likely to have contracted in Q3 and seems unlikely to rise in Q4. Evidence points to a non-negligible softening of conditions in the labour market as businesses remain under pressure from soft demand, greater competition at home and abroad, and still-high prices of energy and commodities. And the broader economic news-flow from Germany remains predominantly downbeat, with a turbulent political backdrop now matched by greater tensions between struggling corporates and demands from staff for higher pay to compensate for the erosion of real incomes over recent years. Notably, according to the head of its works council this week, VW is reportedly considering the closure of at least three of its German factories and 10% reductions in worker pay. And Germany's largest union IG Metall has called for strikes in the electrical engineering and metal industries as it seeks stronger pay growth. Against such a negative backdrop, we suspect that the German consumer confidence will soften again before year-end and remain firmly below the long-run average over coming quarters.

The day ahead in the euro area

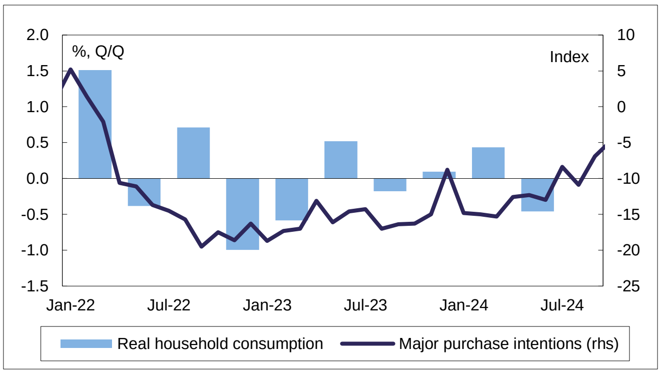
In a congested day for top-tier data releases, Wednesday's preliminary estimates of economic output in Q3 are likely to confirm another mixed performance across the member states. Survey indicators like the PMIs suggest that industrial output almost certainly remained a drag last quarter, though services will likely provide some offset. For the euro area as a whole, we expect GDP growth of 0.2%Q/Q in Q3, unchanged from Q2 and bang in line with the ECB's September projection and

Euro area: Consumer confidence by country



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumption & purchase intentions



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

market consensus. Confidence in that forecast was boosted by today's results from Ireland (2.0%Q/Q to add 0.07ppt to the euro area figure) and Belgium (0.2%Q/Q). However, in Germany, 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 sector 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).

Tomorrow's flash inflation releases for Germany and Spain will also provide an important yardstick for price developments in the member states ahead of Thursday's euro area print. Last month, lower petrol prices lent a disinflationary impetus to both countries, contributing to the first sub-2% readings on the harmonised figure in Germany (1.8%Y/Y) and Spain (1.7%Y/Y) since February 2021 and June 2023 respectively. Fuel price base effects should be less favourable in October. And with food inflation expected to tick marginally higher for a second successive month, a moderate increase in headline inflation should follow. But these forces are not expected to significantly alter the steady downward trajectory in core inflation.

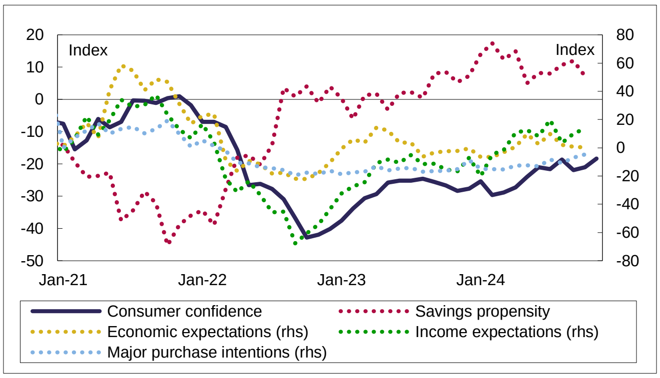
Also coming in ahead of the Thursday's euro area labour market report for September, tomorrow's German employment numbers are expected to show that the unemployment rate ticked up at the start of Q4 for the first time in four months. Meanwhile, the Commission's economic sentiment indices will provide an alternative perspective of economic sentiment following the weakness displayed in the flash PMIs, in view of the signals of further improvement in consumer confidence from last week's flash release.

UK

BRC shop price inflation falls to lowest in more than three year amid subdued demand

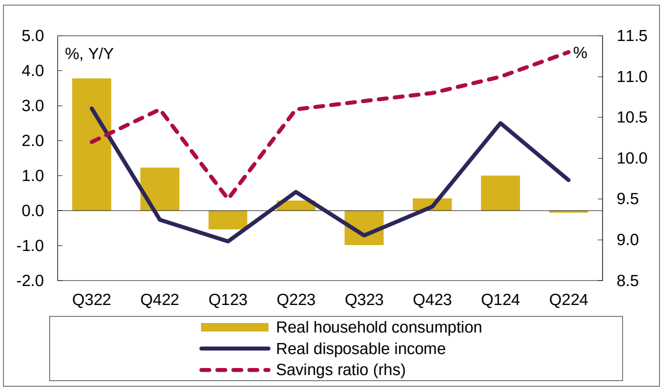
According to the BRC, shop prices rose for the first month in five in October (0.1%M/M). But this nevertheless left the annual rate of shop price inflation maintaining a downwards trend at the start of Q4 – falling 0.2ppt to a more than three-year low of -0.8%Y/Y – as strong competition and soft demand continued to limit pricing power. The drop this month reflected the softest food inflation (down 0.4ppt to 1.9%Y/Y) since November 2021. Non-food inflation also remained firmly in negative territory in October, steady at -2.1%Y/Y, the joint-lowest since March 2021. According to the BRC, retailers again resorted to heavy discounting to shift stock, especially for DIY and gardening products – where prices fell for a second successive month and by the most in almost four years – clothing and electricals. The heavy discounting would tally with yesterday's CBI

Germany: Consumer confidence by category



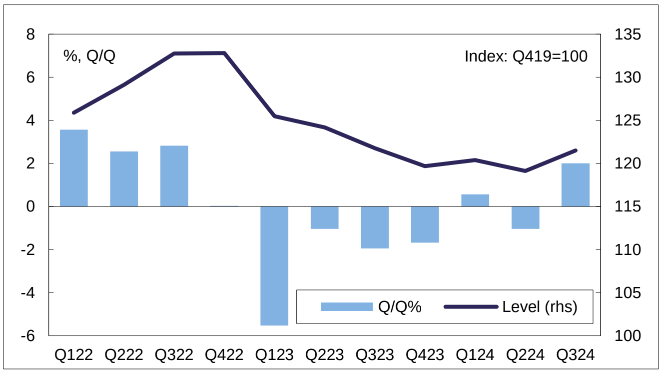
Source:GfK, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumption, income & savings



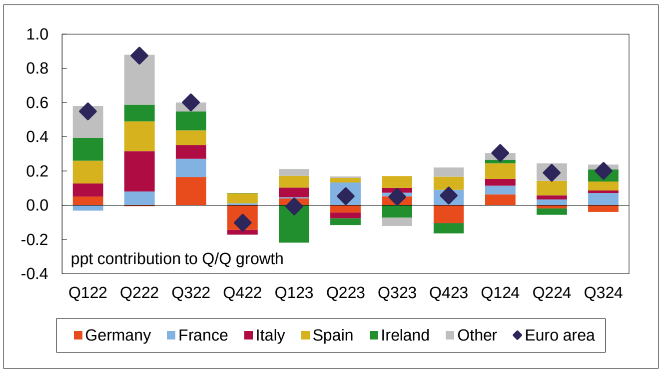
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Ireland: GDP growth & level



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to GDP growth*



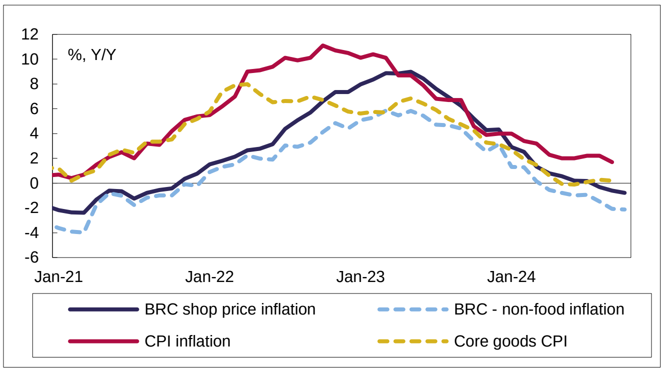
**Figures for Q324 are Daiwa forecasts, except Ireland which are preliminary estimates. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

distributive trades survey, which suggested that retail sales were particularly weak for the time of the year at the start of Q4, with roughly 40% of respondents reporting that volumes were down compared with a year earlier. The BRC's shop price survey suggests that the CPI components for core goods should remain well-behaved in October. But headline CPI inflation will take a step up this month due to the 9½% hike in the Ofgem energy price cap at the start of the month. Indeed, we expect headline CPI to reverse September's 0.5ppt decline, rising back to 2.2%Y/Y in October. Nevertheless, this would still leave it some 0.4ppt below the BoE's projection from the August Monetary Policy Report. And so, we maintain our view that the MPC will cut Bank Rate for the second time this cycle at its meeting next week, by 25bps to 4.75%.

Mortgage approvals highest in 2 years, but consumer credit and business lending still subdued

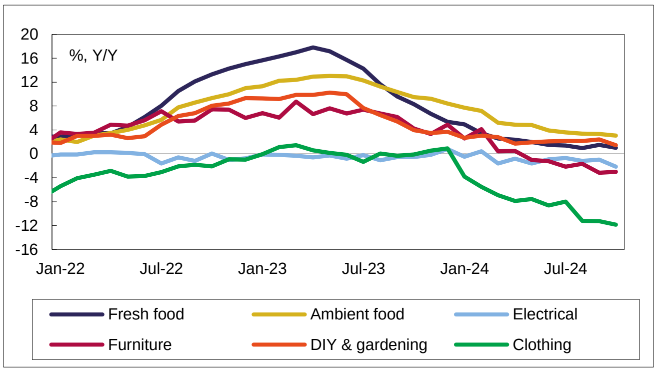
With mortgage rates having taken a further step down after the BoE cut rates in the summer – the average rate on a new 2Y mortgage with a 75% LTV ratio in September was down 60bps from May, and 160bps below the peak in July 2023 – and amid improving prospects for the housing market, today's BoE lending figures raised the possibility of a more sustained pickup in mortgage lending over coming months. In particular, the number of mortgages approved for new house purchases rose for a third consecutive month in September to a more than two-year high of 65.7k, up some 50% (21.7k) compared with a year earlier and in line with the average in the year before the pandemic. According to the latest Credit Conditions Survey, lenders anticipate a notable rise in demand for secured lending in Q4 too. Admittedly, today's figures showed that the net

UK: CPI & BRC shop price inflation



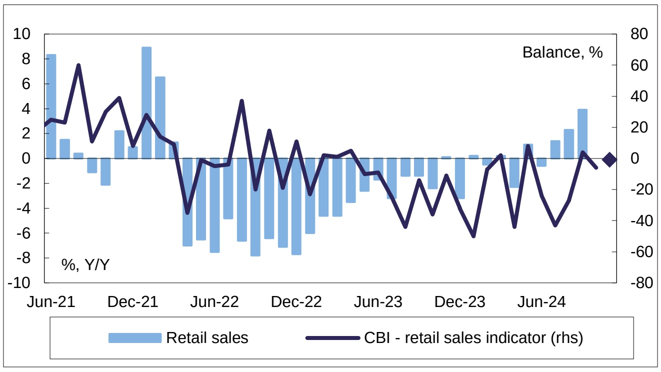
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BRC shop price inflation



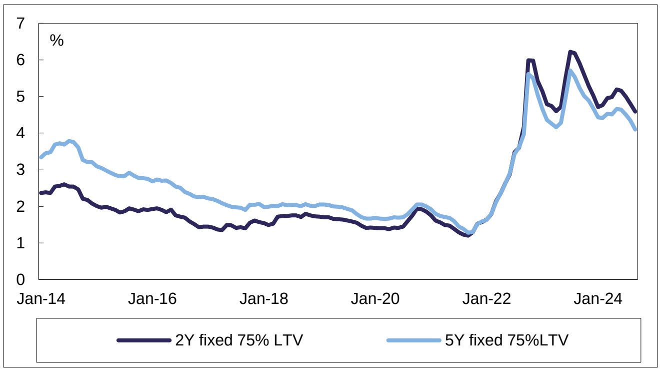
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales



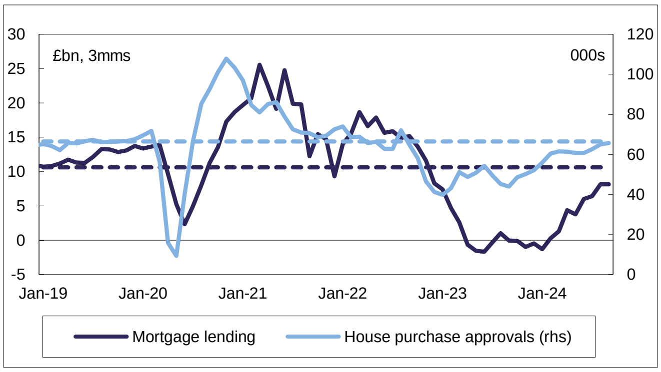
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage interest rates



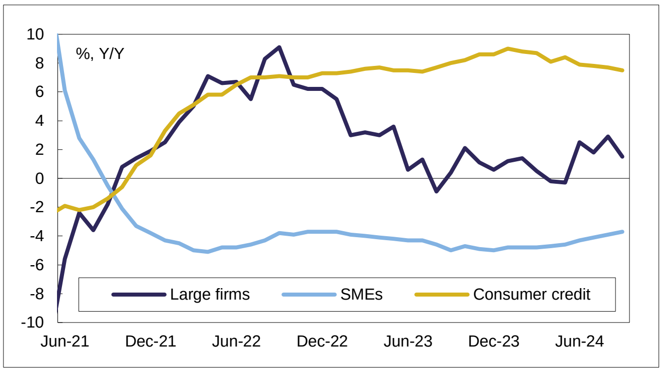
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending & approvals



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Loan growth to households & firms



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

increase in mortgage lending in September (£2.5bn) remained some way below the pre-pandemic long-run average (£3.6bn) and up just 0.9%Y/Y. But this still left net lending on a three-month basis (£8.1bn) at the joint-highest level since December 2022. Recent momentum in consumer credit (£3.9bn 3mms) has been more subdued, leaving the annual growth in such lending (7.5%Y/Y) at its softest rate since July 2023. Indeed, today's figures again suggested that households continued to add to their savings at an above-average pace, tallying with the GfK confidence survey which suggested that consumers still prefer to save rather than spend. Meanwhile, with the balance of firms preferring to raise finance through net bond issuance for a third month out of the past four, business demand for bank loans remained relatively subdued at the end of Q3, with a modest net increase in loans to large firms offsetting an eighth consecutive net repayment by SMEs.

The day ahead in the UK

While no top-tier data releases are scheduled for the UK until Friday, tomorrow's eagerly-anticipated Budget announcement – the first of the new Labour government – would nevertheless eclipse any regular release. Indeed, while much of what will be announced to Parliament has already 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. Chancellor Rachel Reeves is expected to confirm the detail of a range of tax hikes intended to balance the current budget, which registered a deficit from 1.9% of GDP in the last fiscal year, over coming years. Alongside those plans for higher revenues, she will also announce an increase in current government expenditure to provide more resources for healthcare, avoid the real-terms cuts in several departments' spending planned by the last government, and address the latest overshoot from the OBR's projection.

Chancellor Reeves will also commit to extra public borrowing to top-up public investment, requiring a recalibration of the government's fiscal rules. Like its predecessor, the new government will continue to target a decline in public debt by the end of the OBR projection period (FY28/9). 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 is 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 change to the debt target would 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 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. While episodes of recent Gilt underperformance have frequently been associated with media speculation about the additional public borrowing to be announced, a more moderate and deliverable plan for borrowing could equally provide the conditions for Gilts to outperform, particularly when compared against the current fiscal policy challenges in the euro area and election-related budgetary risks in the US. Indeed, while in nominal terms annual total gilt issuance in excess of £250bn per year over the medium term appears large, Reeves will hope that the transparency of her plans and commitment to balance the current budget will boost the credibility of the announcement and avoid a Truss-style gilt-market sell-off.

The implication of tomorrow's announcement 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. With the current policy stance restrictive and the inflation outlook improved, however, that 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.

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, which were supposed to raise an additional £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, could possibly also be in store. As ever, however, the devil of the tax-raising measures will be in the detail.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		GfK consumer confidence indicator	Nov	**-18.3**	-20.5	-21.2	-21.0
Italy		Hourly wages Y/Y%	Sep	**3.7**	-	3.6	-
UK		BRC shop price index Y/Y%	Oct	**-0.8**	-0.5	-0.6	-
		Net consumer credit £bn (Y/Y%)	Sep	**1.2 (7.5)**	1.3 (-)	1.3 (7.6)	1.4 (7.7)
		Net mortgage lending £bn (mortgage approvals 000s)	Sep	**2.5 (65.6)**	2.8 (64.4)	2.9 (64.9)	- (65.0)

Auctions

Country		Auction
Germany		sold €3.29bn of 2.5% 2029 bonds at an average yield of 2.13%
UK		sold £4bn of 4.125% 2029 bonds at an average yield of 4.148%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Spain		Retail sales Y/Y%	Sep	**4.1**	2.1	2.3	2.4
UK		Lloyds business barometer (own price expectations)	Oct	**44 (61)**		47 (65)	-
		CBI distributive trades survey – reported sales volumes %	Oct	**-6**	-10	4	-

Auctions

Country		Auction
		- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
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 (6.6)	-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)

Auctions and events

Country		GMT	Event
Euro area		15.00	ECB Executive Board Member Schnabel speaks at the CEPR Frankfurt Hub Conference
Italy		10.00	Auction: to sell up to €2bn of 3% 2029 bonds
		10.00	Auction: to sell up to €3.5bn of 2033 floating bonds
		10.00	Auction: to sell up to €3.5bn of 3.85% 2035 bonds
UK		12.30	Chancellor of the Exchequer Reeves presents UK Budget to Parliament

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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