

Euro wrap-up

Overview

- Bunds made gains as euro area retail sales volumes fell further than expected in August and the region's final services PMIs for September remained consistent with contraction in Q3.
- Gilts also largely made gains despite a sizeable upwards revision to the UK services PMI for September.
- Thursday will bring data for German trade and French IP, and surveys of European construction and UK business price expectations.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.181	-0.020
OBL 2.4 10/28	2.822	-0.016
DBR 2.6 08/33	2.935	-0.029
UKT 3½ 10/25	4.940	-0.021
UKT 4½ 06/28	4.261	-0.010
UKT 3¼ 01/33	4.603	+0.008

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

Euro area

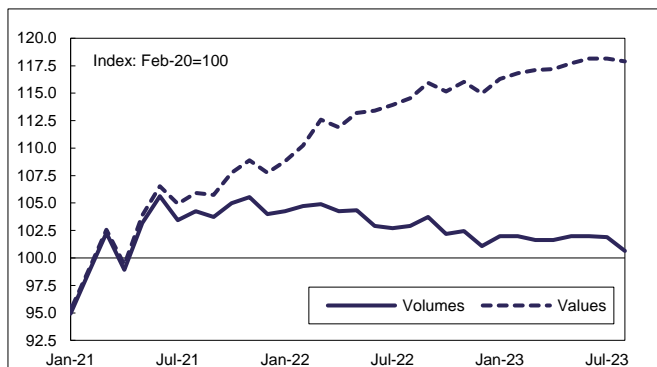
Retail sales volumes fell more than expected in August to be on track for Q3 decline

Euro area retail sales volumes fell a steeper-than-expected 1.2%M/M in August following a modestly revised drop of 0.1%M/M the prior month. That left sales volumes down 2.1%Y/Y, just 0.6% above the pre-pandemic level in February 2020 and at their lowest point since the final pandemic shutdowns in April 2021. And the average level in the first two months of Q3 was down 0.6% from Q2. So, a first quarterly contraction in retail sales volumes since Q422, following stagnation in both Q1 and Q2, now seems highly likely. The weakness in August was broad-based. Core (i.e. non-food and non-fuel) sales fell for the first time since March, and by 0.9%M/M as online sales dropped a steep 4.5%M/M. Sales of food and related items fell 1.2%M/M, likewise the first decline since March. And fuel sales fell for a third successive month and by 3.0%M/M, the most since late 2020. Among the member states, sales in August were particularly weak in France (-2.8%M/M and -3.7%Y/Y) and Portugal (-3.0%M/M and -0.4%Y/Y). German sales fell 1.2%M/M, the most so far this year, to be down 2.3%Y/Y. Bucking the trend in most other member states, however, Spanish sales rose a steady 0.4%M/M for a third successive month to be up a whopping 8.1%Y/Y. Of course, given rising prices, the value of euro area retail sales fell a more modest 0.2%M/M and were still up 2.9%Y/Y.

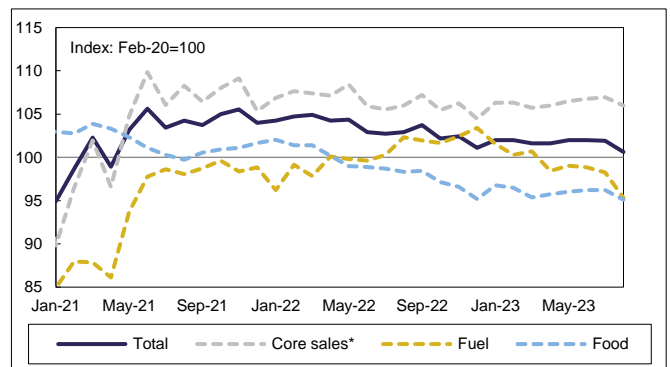
Stronger car registrations and international tourism likely provided some offset

Despite the weakness of retail sales volumes, certain other indicators point to relative resilience of household consumption in Q3 following two quarters of stagnation. For example, on a seasonally adjusted basis, new car registrations rose for a third successive month in August and by 4.0%M/M to be trending 6.8% above the Q2 average over the first two months of Q3. And as constraints on budgets eased somewhat thanks to firm wage growth and lower inflation, spending on services probably provided support too. Expenditure on tourism and hospitality appears to have remained relatively firm over the summer months. Among Europe's holiday hotspots, international tourist visitors to Spain were up 13.9%Y/Y in August, to be just 0.4% below the pre-pandemic level in the same month in 2019. While UK visitors (up 10.0%Y/Y) accounted for a significant amount of that growth, arrivals from Germany (5.8%Y/Y), France (17.9%Y/Y) and Italy (14.4%Y/Y) and other euro area member states also grew significantly. Tourist stays from guests from abroad in France were also higher than a year ago, and indeed back above the pre-pandemic level. However, as domestic residents looked increasingly to travel abroad, they were less likely to holiday in France than a year ago. And, perhaps reflecting squeezed real incomes, the number of French residents choosing to stay domestically in cheaper campsite accommodation rose while those staying in hotels fell.

Euro area: Retail sales



Euro area: Retail sales



Services PMI suggests contraction in the sector due to incongruous weakness in French survey

Looking at the sector overall, however, today's final services PMI for September (48.7) was still consistent with a contraction despite an upwards revision from the flash estimate and an increase from August. That left the Q3 average (49.2, down 1.2pts from Q2), which was the lowest since Q422, also consistent with contraction last quarter. But at the country level, the indices for Germany and Spain rose back slightly above the key 50 level in September, while that for Ireland was firmly in expansion territory (54.5). And for a second successive month the Italian index was consistent with stagnation (49.9) rather than a fall in activity. So, it was just the significant weakness in the French services PMI (44.4 in September, the lowest since end-2020) which explained the sub-50 figure for the euro area as a whole both last month and over Q3 as a whole. As we have previously noted, other French survey indicators, such as those published by INSEE and the Bank of France, point to greater resilience in sector last quarter. However, we also acknowledge that the PMIs reported a marked fall in new demand for services in Germany as well as France, which pushed the euro area new business PMI down in September to 44.1, its lowest level since autumn 2020, which likely foreshadows a subdued Q4.

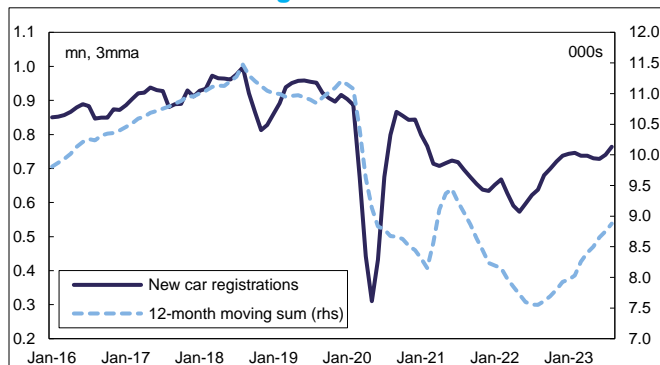
Composite PMI probably overstates extent of contraction in euro area GDP in Q3

Given the renewed weakness reported in the manufacturing output index (down 0.4pt to 43.1), the euro area composite PMI rose just 0.5pt in September to 47.2. That left the quarterly average at 47.5, the lowest since Q220 and a level that before the pandemic would have been consistent with a drop in GDP of about -0.3%Q/Q in Q3. The quarterly averages for Germany, France and Italy also pointed to declines in economic output last quarter. And the Spanish composite PMI suggested stagnation, with only Ireland's indicating positive growth in Q3. We agree that German and Italian GDP likely contracted last quarter. But we still look for modest growth in France, and a respectable expansion in Spain and Ireland.

PMIs suggest further cooling in selling-prices after PPI falls at a record pace

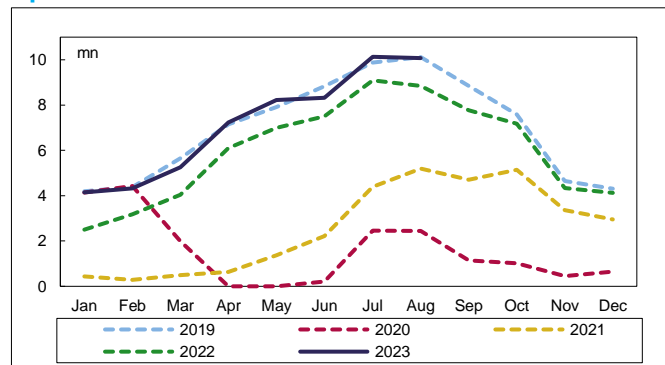
In terms of price pressures, the final PMIs reaffirmed the finding of the flash estimate that services input costs picked up in September at their strongest rate in four months (61.1) and well above the long-run average pace, likely driven by higher oil prices and wages. But perhaps reflecting softer demand, the services prices charged PMI fell to the lowest in more than two years (54.7). And earlier this week, the final manufacturing PMIs reported falls in input costs (41.9) and output prices (45.8), suggestive of a further decline in industrial PPI inflation last month following the record drop of 11.5%Y/Y in August reported today. So, while the euro area composite PMIs also reported the strongest rise in input costs since May (57.1), they also suggested the softest increase in whole economy output prices since February 2021 (52.2) and a rate below the average in the three years before the pandemic.

Euro area: New car registrations



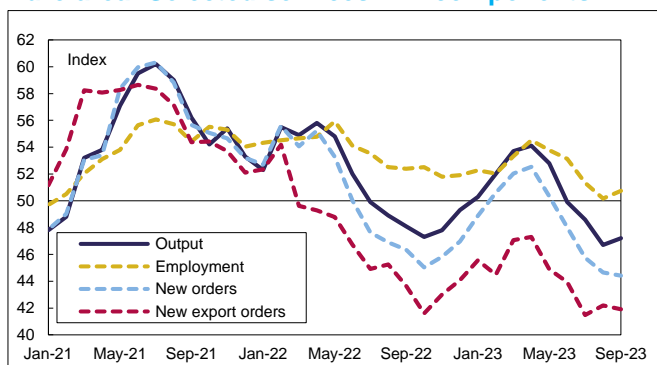
Source: ECB, Bloomberg and Daiwa Capital Markets Europe Ltd.

Spain: International tourist arrivals



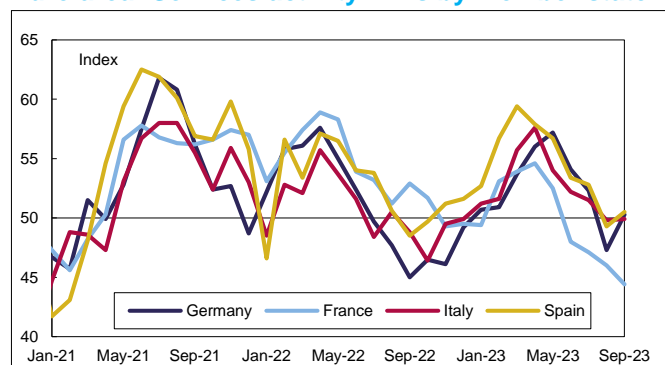
Source: INE and Daiwa Capital Markets Europe Ltd.

Euro area: Selected services PMI components



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

Euro area: Services activity PMIs by member state



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

The day ahead in the euro area

Tomorrow's construction PMI survey results will provide an update on sentiment in the sector at the end of Q3. Like the equivalent services and manufacturing indices, these are likely to signal ongoing contraction across euro area member state reflecting weakness in house building, with a more acute downturn in Germany and France against a backdrop of falling residential property prices. In terms of hard economic data, tomorrow will bring German goods trade figures, which are expected to report a slight narrowing in the surplus over the summer as the value of exports fell further but the value of imports rose in part due to higher oil prices. Thursday will also bring German new car registrations and production data for September, as well as French and Spanish industrial production numbers for August. Separately, ECB Chief Economist Lane will participate with BoE Deputy Governor Broadbent in a policy panel discussion at an academic conference hosted by the ECB.

UK

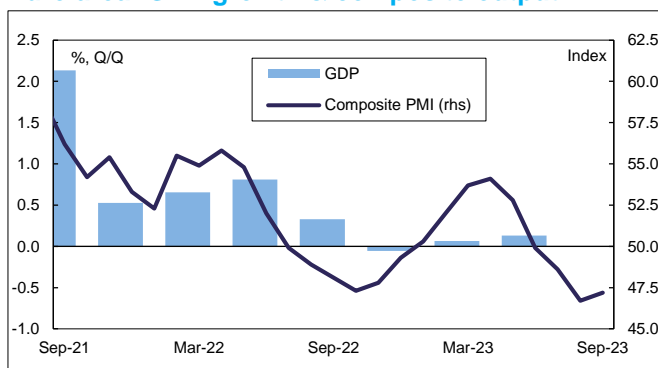
Despite big upwards revision from the flash, services PMI still consistent with marked slowdown

While today's final UK services PMI survey suggested that the economic performance in the sector was substantially better than initially estimated, it nevertheless implied a loss of momentum at the end of the third quarter. Despite being upwardly revised from the flash estimate by more than 2pts, at 49.3, the headline activity index was still the weakest since January and consistent with modest contraction. And the quarterly index in Q3 (50.1) was some 4.8pts below the Q2 average and consistent with stagnation. While the equivalent manufacturing output PMI edged slightly higher in September, at 44.6 it still suggested a significant drop in output and a steeper pace of decline in production of intermediate goods. Overall, while the magnitude of decline was much smaller than initially estimated, the headline composite output PMI fell for the fifth consecutive to a ten-month low of 48.5. This left the quarterly index in Q3 (49.3) down more than 4½pts from Q2 and a level that implies a modest contraction in GDP last quarter.

Firms cut headcount as economic uncertainties continue to dampen demand

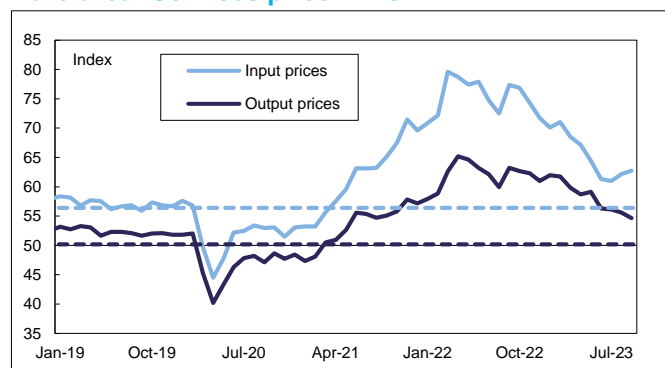
There were some tentative signs in the latest PMIs to suggest that the trough might be near, however, with the services new business component (49.7) and manufacturing new orders index (42.1) rising for the first month in five in September. Admittedly, both remained consistent with ongoing declines as clients reined in non-essential spending amid ongoing concerns about high borrowing costs and global economic uncertainties, with reports of lower demand from within Europe, the US, China and Brazil weighing on overseas orders. Against this backdrop, manufacturers continued to reduce their purchases of inputs, while stocks of finished goods also fell by the most in six months. Meanwhile, S&P Global reported that

Euro area: GDP growth & composite output PMI



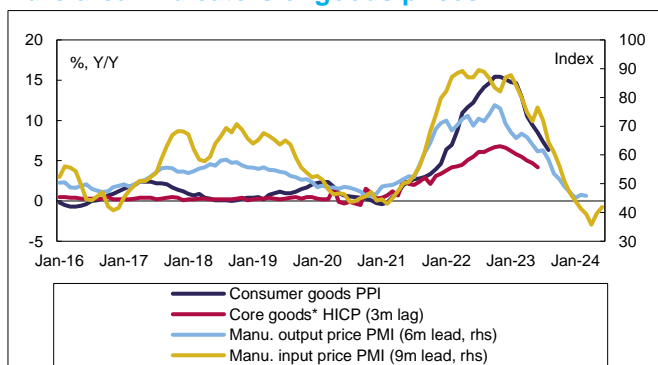
Source: S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Services price PMIs*



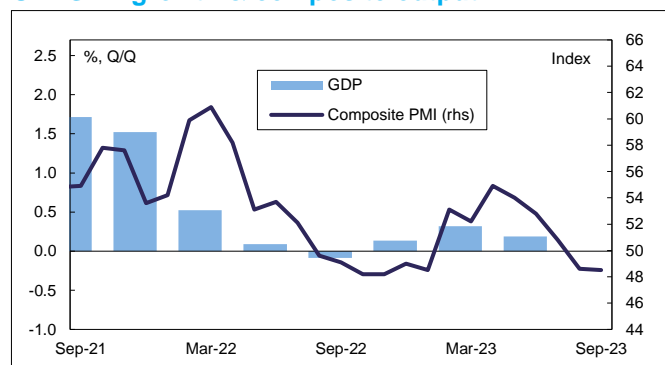
*Dashed lines represent long-run averages. Source: S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Indicators of goods prices



*Non-energy industrial goods. Source: S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & composite output PMI



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

only around half of respondent services firms expected activity to rise over the coming twelve months. As such, firms appear to have cut headcount in both sectors in September, with the pace of job-shedding among services businesses the steepest since the start of 2021. Some firms suggested that the non-replacement of voluntary leavers was linked to higher wage pressures.

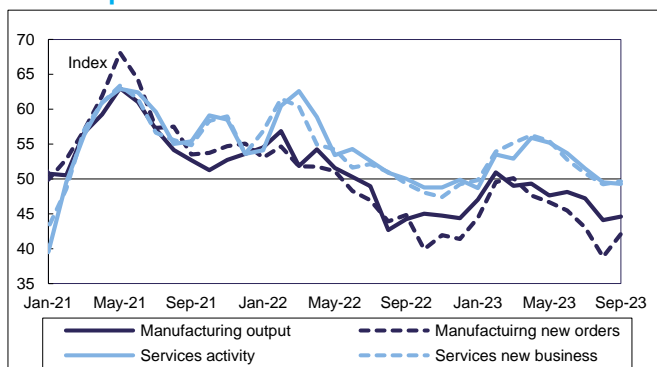
Services and shop price pressures continue to ease as input cost pressures moderate

Notwithstanding higher wage pressures and fuel prices, ongoing improvements in supply chains and weakening demand saw a further easing in input cost burdens in September. Certainly, the composite input price PMI fell 2.8pts to a 32-month low of 61.7, as a marked moderation in services costs (65.0) combined with ongoing deflationary pipeline pressures in the factory sector (43.7). And so, while still high by historical standards, prices charged among services firms continued to diminish, with the respective survey index (56.9) down to its lowest since April 2021. Admittedly, there was a pickup in the manufacturing output price PMI (51.5) as firms attempted to protect profit margins, although the index remained below the long-run average. Yesterday's BRC shop price survey also suggested that, amid lacklustre demand and fierce competition, price pressures on the high street continue to moderate. Indeed, according to the BRC, shop price inflation fell for the fourth consecutive month in September, by 0.5ppt to a twelve-month low of 6.2%Y/Y. This in part reflected the first decline in food prices (-0.1%M/M) for more than two years, leaving inflation of that component in single digits (9.9%Y/Y) for the first time since August last year. Non-food inflation (4.4%Y/Y) was also down to its lowest in nine months.

The day ahead in the UK

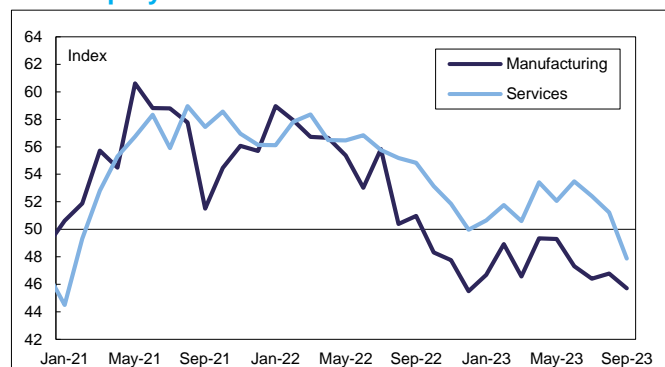
Thursday will bring the September results of the BoE's Decision Maker Panel (DMP) survey, with particular focus on firms' price and wage expectations. In August, one-year ahead CPI inflation expectations decreased 0.6ppt to 4.8%, while expected year-ahead wage growth moved sideways at 5.0%, with the three-month rate moderating 0.1ppt to 5.1%. Tomorrow will also bring the findings from the latest construction PMI survey. These are expected to flag further contraction in activity in September amid the ongoing downturn in the housing market as higher borrowing costs and rising economic uncertainties have weakened demand.

UK: Output & orders PMIs



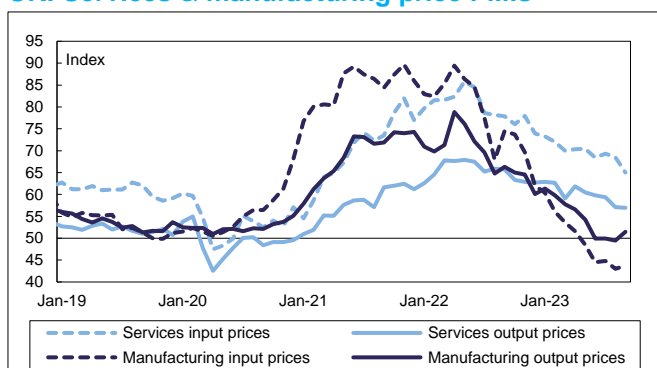
Source: S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Employment PMIs



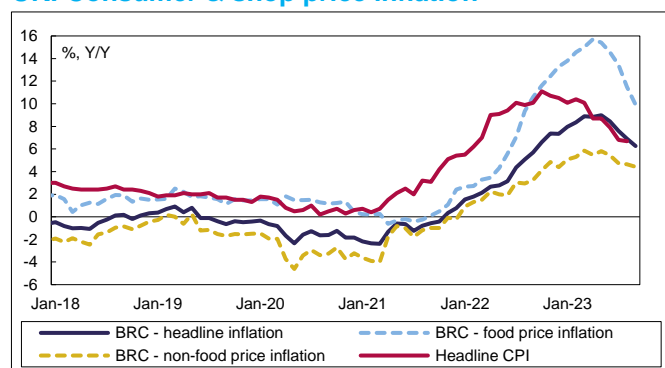
Source: S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Services & manufacturing price PMIs



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

UK: Consumer & shop price inflation









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



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area 	Final services (composite) PMI	Sep	48.7 (47.2)	<u>48.4 (47.1)</u>	47.9 (46.7)	-
	Retail sales M/M% (Y/Y%)	Aug	-1.2 (-2.1)	-0.3 (-0.5)	-0.2 (-1.0)	-0.1 (-)
	PPI Y/Y%	Aug	-11.5	-11.7	-7.6	-
Germany 	Final services (composite) PMI	Sep	50.3 (46.4)	<u>49.8 (46.2)</u>	47.3 (44.6)	-
France 	Final services (composite) PMI	Sep	44.4 (44.1)	<u>43.9 (43.5)</u>	46.0 (46.0)	-
Italy 	Services (composite) PMI	Sep	49.9 (49.2)	50.1 (49.0)	49.8 (48.2)	-
Spain 	Services (composite) PMI	Sep	50.5 (50.1)	49.7 (49.6)	49.3 (48.6)	-
UK 	Final services (composite) PMI	Sep	49.3 (48.5)	<u>47.2 (46.8)</u>	49.5 (48.6)	-



Auctions

Country	Auction
Germany 	sold €2.39bn of 2.4% 2030 bonds at an average yield of 2.890%
UK 	sold £4.25bn of 3.5% 2025 bonds at an average yield of 4.964%


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data













Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Spain 	Unemployment change 000s	Sep	19.8	-	24.8	-
UK 	BRC shop price index Y/Y%	Sep	6.2	-	6.9	-

Auctions









Country	Auction
UK 	sold £2.25bn of 1.5% 2053 green bonds at an average yield of 4.936%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases
Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area		08.30 Construction PMI	Sep	-	43.4
Germany		07.00 Trade balance €bn	Aug	15.0	17.7
		08.30 Construction PMI	Sep	-	41.5
France		- New car registrations (production)* Y/Y%	Sep	-	37.3
		07.45 Industrial production M/M% (Y/Y%)	Aug	-0.4 (-0.5)	0.8 (2.7)
		07.45 Manufacturing production M/M% (Y/Y%)	Aug	-	0.7 (2.7)
Italy		08.30 Construction PMI	Sep	-	42.4
		08.30 Construction PMI	Sep	-	47.7
Spain		08.00 Industrial production M/M% (Y/Y%)	Aug	-0.3 (-1.8)	0.2 (-1.8)
UK		09.00 New car registrations Y/Y%	Sep	-	24.4
		09.30 Construction PMI	Sep	50.0	50.8
		09.30 BoE's DMP 3M (1Y) output price expectations	Sep	-	4.9 (4.8)

Auctions and events

Euro area/UK		10.45 ECB Chief Economist Lane and BoE Deputy Governor Broadbent participate in panel discussion at ECB conference
France		09.50 Auction: 3.5% 2033 bonds
		09.50 Auction: 2.5% 2043 bonds
		09.50 Auction: 3.0% 2054 bonds
Spain		09.30 Auction: 3.5% 2029 bonds
		09.30 Auction: 2.35% 2033 bonds
		09.30 Auction: 1.0% 2042 bonds
UK		09.30 BoE to publish its monthly Decision Maker Panel survey results for September

*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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