Euro wrap-up

Overview

- Despite a pickup in households' inflation expectations, Bunds largely made gains as euro area retail sales contracted in Q3 and households remained gloomy about the economic outlook.
- Gilts also made gains as a UK labour market survey provided further evidence of a looser labour market.
- The main economic data due over the remainder of the week will be Friday's release of the UK's Q3 GDP estimate.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.977	+0.004
OBL 2.4 10/28	2.557	-0.015
DBR 2.6 08/33	2.612	-0.077
UKT 3½ 10/25	4.580	-0.020
UKT 4½ 06/28	4.227	-0.011
UKT 3¼ 01/33	4.226	-0.043

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

Euro area

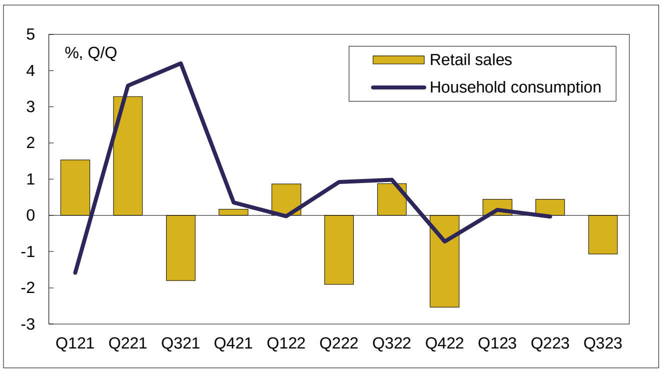
Retail sales fell for a third consecutive month in September

While last week's flash estimate of euro area Q3 GDP – which reported a modest contraction of 0.1%Q/Q – was published with just the headline growth figures, today's euro area retail sales data for September offered some insight into the strength (or lack) of consumer spending at the end of the summer. Indeed, the numbers came in softer than expected, with sales volumes falling for a third consecutive month, by 0.3%M/M. And while the decline in August was smaller than initially estimated, sales were still down more than 2%Y/Y and on average over the quarter some 0.5% below the Q2 level, suggesting a modest drag on GDP growth in Q3 for the first time since Q422. Among the larger member states, retail sales contracted on the quarter in Germany, Italy, the Netherlands and Ireland, each declining by 1.2%Q/Q. But following modest increases in September, sales volumes in France and Spain rose over the quarter as a whole, by 0.4%Q/Q and 0.9%Q/Q respectively. The weakness in the euro area in September was led by core sales (i.e. non-food and non-fuel), which fell for a second successive month (-1.9%M/M) and by the most since June 2022 to be down 0.7%Q/Q in Q3, the steepest quarterly decline since Q121. The jump in petrol prices also continued to dampen fuel sales, which fell for an eighth month out of the past nine to their lowest level since May 2021. But with food prices having fallen back, sales at food stores rose (+1.4%M/M) by the most in eight months. A jump in new car registrations (7.7%Q/Q) will have provided some offset to private consumption in Q3, while services activity in August was trending some 1.0% above the Q2 average. But with consumer confidence having dipped lower over recent months, and households' purchase intentions still historically low, spending on big-ticket items is likely to remain very subdued this quarter, and possibly into the New Year too.

Households inflation expectations jump despite a more downbeat assessment of economic outlook

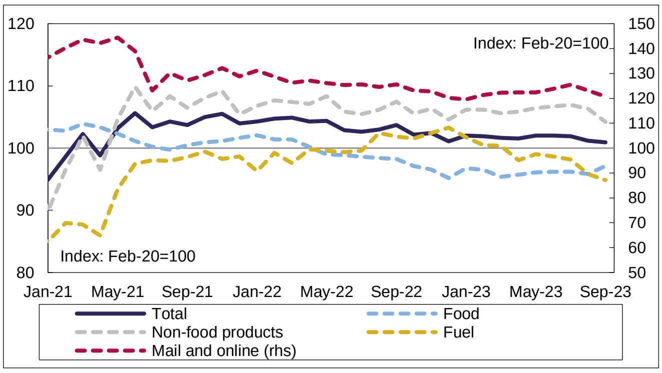
The downbeat spending outlook over the near term reflects increasing unease about broader economic prospects. Certainly, today's ECB consumer expectations survey results suggested that households are becoming increasingly gloomy about the growth outlook for the next twelve months and therefore more mindful of potential job losses. Indeed, the mean forecast for GDP growth in the year ahead fell 0.4ppt to -1.2%Y/Y, with less than a quarter of respondents expecting an increase in economic activity, and households notably more downbeat about the outlook for French GDP growth. Perhaps reflecting the rise in auto fuel prices, today's survey also reported a noticeable uptick in households' inflation expectations in September, with the median expectation for inflation twelve months ahead rising 0.5ppt to 4.0%Y/Y, a five-month high, with a striking increase in Spain (up 1.7ppt to 4.8%Y/Y). Admittedly, the median consumer forecast for inflation three years ahead moved sideways at 2.5%Y/Y, with a pickup in Spain (up 0.4ppt to 2.5%Y/Y) offset by the downtrend in Germany (2.2%Y/Y), Italy (3.1%Y/Y) and the Netherlands (2.5%Y/Y). But while expectations remain above the ECB's 2% target in each member state, they were well down on the average in the second half of 2022, with the euro area forecast some ½ppt lower.

Euro area: Retail sales & household consumption



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

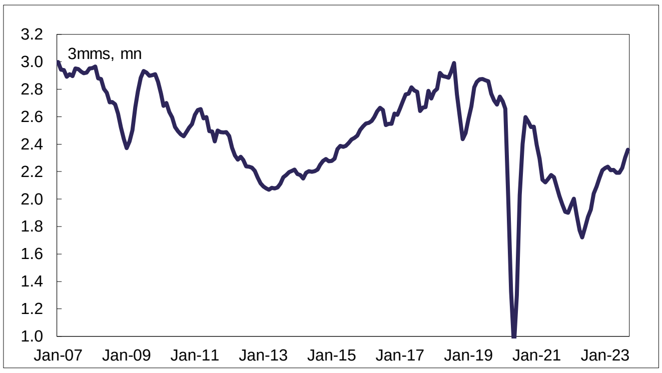
German inflation confirms broad-based easing in prices pressures in October

Notwithstanding the pickup in household inflation expectations, the latest data for consumer prices suggest that the disinflationary cycle is well underway. Certainly, the final German inflation figures for October confirmed the further broad-based easing in pressures suggested by the flash estimates. In particular, with consumer prices on the EU-harmonised measure falling for the first month in five (-0.2%M/M) compared with a rise of 1.1%M/M in October 2022, the annual HICP rate fell a further 1.3ppts to 3.0%Y/Y, the lowest since June 2021 and 8.3ppts below the peak a year ago. The detail confirmed that the decline was principally led by energy, for which prices fell 1.8%M/M to leave the annual rate of that component down 5.2ppts to -6.0%Y/Y. Food price inflation also fell 1ppt to 7.1%Y/Y, an eighteen-month low. The downtrend was also evident in a range of core goods items, including furnishings, household appliances and clothing, to leave non-energy industrial goods inflation down 0.8ppt to a twenty-month low of 4.1%Y/Y in October, some 3.3ppts below January's peak. And while the magnitude of the moderation was significantly smaller than in September, when developments were influenced by base effects associated with last year's discounted travel pass, services inflation still fell 0.5ppt to 4.2%Y/Y, the lowest since January, as transport services costs continued to ease and catering inflation fell to an eighteen-month low. As such, core HICP inflation fell 0.6ppt to 4.2%Y/Y, a fourteen-month low. While the deflationary impulse from energy will fade over coming months, base effects related to food prices will subtract further from inflation into the New Year, while weak demand will limit firms' pricing power in core goods and services too. Indeed, according to an ifo institute survey, firms' selling price expectations for the three months ahead continued to moderate very slightly in October, with the composite index (12.1) falling to its lowest for more than 2½ years and well below the peak in April 2022 (65.5).

The coming two days in the euro area

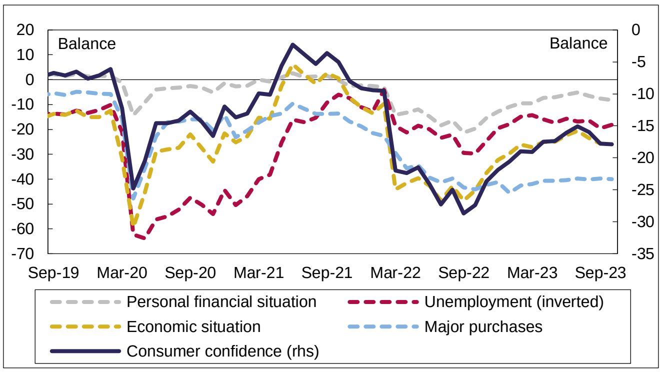
It will be a relatively quiet end to the week for euro area economic data, with the main focus coming on Friday in the form of the September industrial production figures from various member states including Italy, the Netherlands and Ireland. Italian output is expected to have reversed the modest increase (0.2%M/M) reported in August, to leave it unchanged over the third quarter as a whole. But, as is often the case, the outturn from Ireland is likely to have a greater bearing on aggregate euro area output (figures due for release on 15 November). Indeed, while we might expect to see some further payback from the slump in activity in July (-28.6%M/M), Irish manufacturing production would need to surge by more than 80%M/M in September to avoid a contraction over the third quarter as a whole. Beyond the data, Friday will see ECB President Lagarde participate in a fireside chat with the Financial Times' Martin Wolf.

Euro area: New car registrations



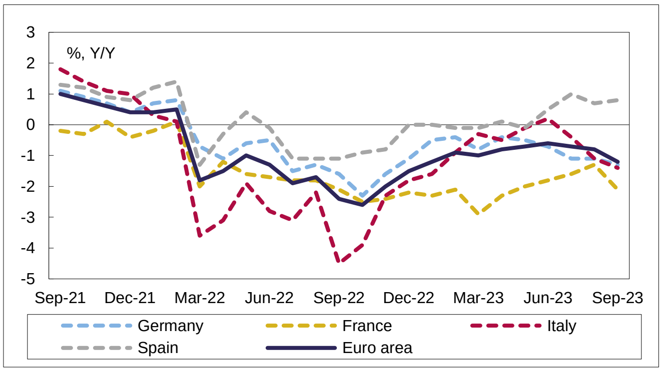
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence indices



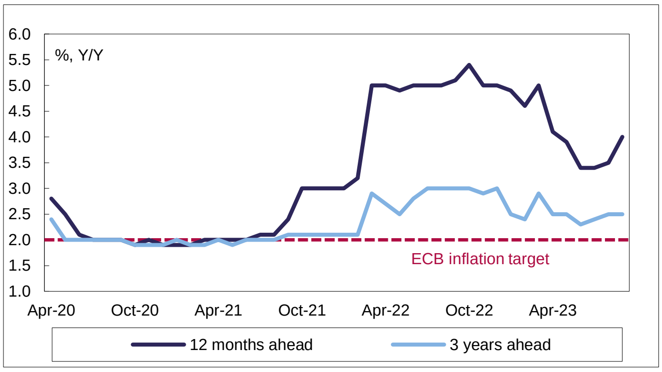
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Households' GDP growth expectations*



**Mean forecast over coming twelve months. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Households' inflation expectations*



**Median forecast. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK

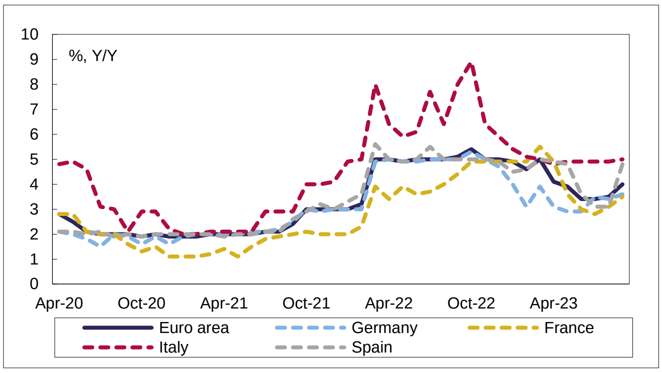
REC survey provides further evidence of a looser labour market

Given the importance of labour market conditions in the BoE's monetary policy reaction function and the current suspension of the ONS's key Labour Force Survey (LFS) due to potential inaccuracies amid a steady decline in the response rate, the MPC will need to place greater trust over coming months in other survey measures. While the ONS' new experimental series suggested that a turning point in the labour market was likely reached over the summer, the findings of the KPMG/REC report on jobs, based on a survey of recruitment and employment consultancies, has for some time pointed to a marked moderation in employment and wage growth. The latest results, published today, also implied a further loosening in the labour market at the start of Q4, with an improved supply-demand imbalance continuing to diminish pay pressures. In particular, the REC survey suggested that permanent placements fell for a thirteenth consecutive month in October, albeit at a slightly softer pace than in the previous three months. But rather than reflecting a lack of available candidates as was the case through the second half of 2021 and in 2022, today's survey suggested that there was an accelerated and above-average rise in the candidate pool for permanent work, amid frequent reports of redundancies, while demand remained subdued due to rising economic uncertainties. So, while there remains evidence that a skills mismatch in the labour market continues to inflate starting salaries, today's survey also showed that its measure of permanent staff starting salaries fell for a sixth successive month to the lowest level since March 2021, and firmly below the average in the five years before the pandemic. And while growth in wages for new temporary staff edged slightly higher as firms reportedly favoured temporary billings to enable greater flexibility, the measure was also well below the pre-pandemic average.

The coming two days in the UK

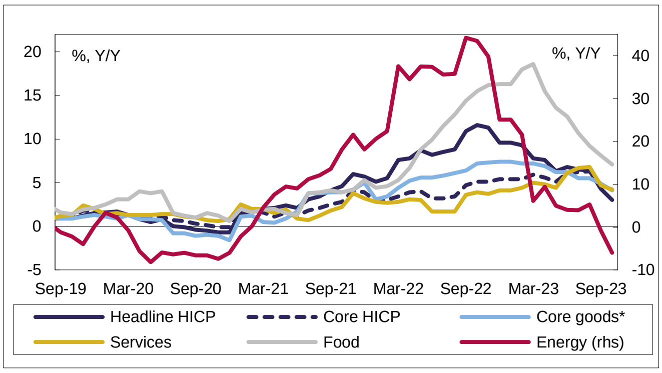
The main event in the UK's economic calendar over the remainder of the week will be Friday's release of the Q3 GDP estimate and monthly activity figures for September. Various indicators have signalled a marked slowdown in economic momentum over the summer, with the PMIs pointing to a mild contraction over the quarter as a whole. Indeed, while the construction sector has benefitted from a positive carry-over effect following the strong end to the second quarter, industrial production was trending in August merely flat compared with Q2. Certain services sectors – i.e. healthcare, education and transport – have been impacted by industrial action. Retail sales have been hit by inclement weather, weak consumer confidence, higher borrowing costs and economic uncertainties. So, while hospitality and leisure activities might well have benefitted from the joint-hottest September on record, NHS strikes are likely to have weighed on activity. So, with total output having likely moved sideways (at best) in September, over the third quarter as a whole, we forecast a modest contraction in GDP of 0.1%Q/Q. Against the backdrop of the economic slowdown and the impact of the significant increase in borrowing

Euro area: Households' inflation expectations*



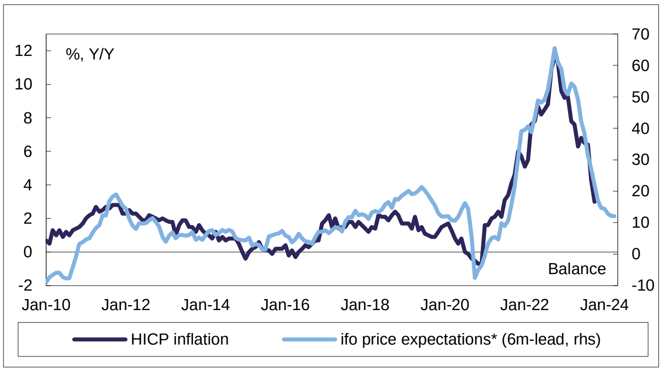
Median forecast three years ahead. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: HICP inflation



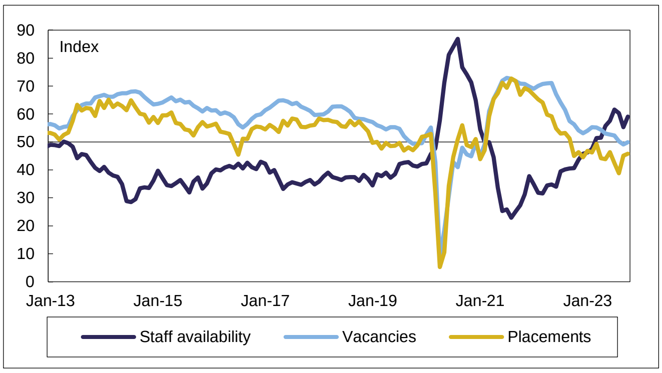
Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: HICP inflation & ifo selling price indices



Unweighted average of services, manufacturing, construction and retail indices. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

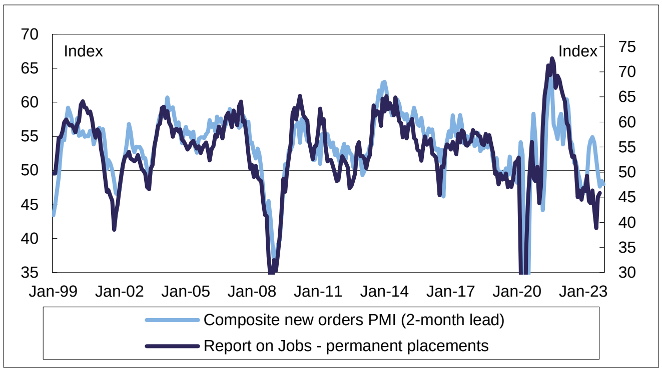
UK: REC permanent jobs market indices



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

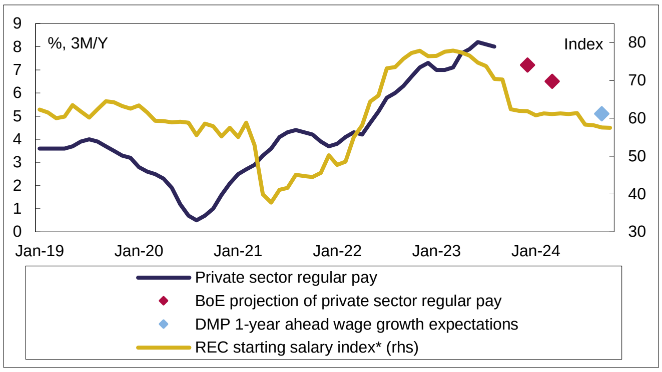
costs, tomorrow's RICS residential survey for October will continue to underscore meaningful challenges facing the UK's housing market. Indeed, despite an ongoing lack of supply, the RICS house price balance is forecast to remain close to September's 14½-year low of -69%.

UK: New orders & permanent job placements



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

UK: Measures of pay growth



**12-month lead. Source: BoE, REC/KPMG, S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.*

The next edition of the Euro wrap-up will be published on 10 November 2023

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	ECB 1 (3) year inflation expectations Y/Y%	Sep	**4.0 (2.5)**	-	3.5 (2.5)	-
	Retail sales M/M% (Y/Y%)	Sep	**-0.3 (-2.9)**	-0.2 (-2.9)	-1.2 (-2.1)	-0.7 (-1.8)
Germany	Final HICP (CPI) Y/Y%	Oct	**3.0 (3.8)**	*3.0 (3.8)*	4.3 (4.5)	-
France	Trade balance €bn	Sep	**-8.9**	-	-8.2	-8.3
Italy	Retail sales M/M% (Y/Y%)	Sep	**-0.3 (-2.9)**	-	-0.4 (2.4)	-0.7 (-1.8)

Auctions

Country	Auction
Germany	sold: €3.3bn of 2.6% 2033 bonds at an average yield of 2.64%
UK	sold: £900mn of 0.125% 2051 index-linked bonds at an average yield of 1.314%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
UK	00.01	RICS house price balance %	Oct	-65	-69

Auctions and events

Country	GMT	Event
Euro area	08.10	ECB Chief Economist Lane scheduled to give opening remarks at ECB conference on money markets
	09.00	ECB publishes Economic Bulletin
UK	08.30	BoE Chief Economist Pill scheduled to speak at a conference

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Italy	09.00	Industrial production M/M% (Y/Y%)	Sep	-0.2 (-)	0.2 (-4.2)
UK	07.00	GDP – first estimate Q/Q% (Y/Y%)	Q3	*-0.1 (0.5)*	0.2 (0.6)
	07.00	GDP M/M%	Sep	0.0	0.2
	07.00	Industrial production M/M% (Y/Y%)	Sep	0.0 (1.1)	-0.7 (1.3)
	07.00	Manufacturing production M/M% (Y/Y%)	Sep	0.2 (3.0)	-0.8 (2.8)
	07.00	Index of services M/M% (3M/3M%)	Sep	0.0 (-0.2)	0.4 (0.1)
	07.00	Construction output M/M% (Y/Y%)	Sep	-0.5 (2.7)	-0.5 (2.3)
	07.00	Trade (goods) balance £bn	Sep	-2.5 (-15.3)	-3.4 (-16.0)

Auctions and events

Country	GMT	Event
Euro area	12.30	ECB President Lagarde to hold a fireside chat with the FT's Martin Wolf
Italy	10.00	Auction: €3.0bn of 3.85% 2026 bonds
	10.00	Auction: €1.5bn of 3.50% 2030 bonds
	10.00	Auction: €2.0bn of 4.00% 2030 bonds
	10.00	Auction: €1.5bn of 3.25% 2038 bonds
	10.00	Auction: €1.0bn of 4.50% 2053 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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