

# Euro wrap-up

## Overview

- Gilts rallied as UK inflation fell significantly below the BoE's projection in September.
- Euro area government bonds also made gains as Italian inflation data for September were revised down following the similar downwards revision to the equivalent French figures yesterday.
- Thursday will bring the latest ECB policy announcement which seems bound to bring a further 25bps cut to the Deposit Rate.

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### Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.162	-0.042
OBL 2½ 10/29	2.036	-0.042
DBR 2.6 08/34	2.179	-0.042
UKT 4½ 01/27	4.017	-0.106
UKT 4½ 07/29	3.927	-0.102
UKT 4½ 07/34	4.065	-0.095

\*Change from close as at 4:00pm BST.

Source: Bloomberg

## UK

### Inflation significantly undershoots BoE projection to raise likelihood of back-to-back rate cuts in Q4

Following yesterday's softer [wage data](#), today's downside surprises in the September inflation figures underscored the near-inevitability that the BoE will cut Bank Rate in November and will probably cut rates again in December. The headline CPI rate fell 0.5ppt – the most in five months – to 1.7%Y/Y, marking the first sub-target reading and lowest since April 2021. That was 0.2ppt below the consensus forecast, 0.1ppt below our own forecast, and, most importantly, 0.4ppt below the BoE's projection published in August. Crucially too, the services component, which is seen by the Bank as a barometer of persistence risks, fell 0.7ppt – the most in 13 months – to 4.9%Y/Y, the lowest since May 2022. That was 0.3ppt below the consensus forecast, just 0.1ppt below our own forecast but a whopping 0.6ppt below the BoE's projection. The decline in services accounted for roughly half of the drop in the headline inflation rate. Much of the remainder was explained by the energy component, which fell 3.0ppts to a five-month low (-16.2%Y/Y) thanks to lower petrol prices. In contrast, the food, alcohol and tobacco component edged slightly higher (2.6%Y/Y). But core goods inflation was a touch lower (just 0.2%Y/Y) as the clothing category fell to a near-three-year low. So, the core CPI rate fell 0.4ppt to 3.2%Y/Y, the lowest since September 2021 and 0.3ppt below the level implied by the BoE's projection.

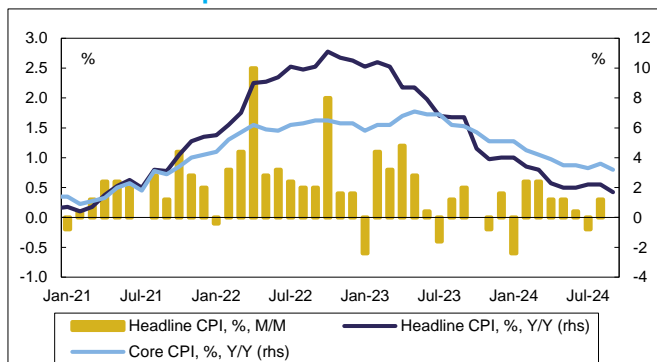
### Services component flattered by airfares but underlying disinflation in that component continues

The main cause of the drop in services inflation was airfares, which fell almost 35%M/M, the most in any September in more than two decades, to be down 5.0%Y/Y. Airfares will reverse in due course. However, the detail confirmed that pressures continue to dissipate in several other services components. Among others, inflation of accommodation fell to a 3½-year low while the categories for restaurants and car insurance fell to the lowest in more than 2½ years. A measure of underlying services inflation watched by the BoE, which excludes airfares, package holidays, education and rents, fell 0.3ppt to 4.2%Y/Y, the lowest since March 2022. An alternative core services measure, also excluding accommodation, fell to a 2½-year low. And over the past three months, services prices overall have moved broadly in line with their long-run average, suggesting that the risks of inflation persistence in that category have now faded as wage growth has moderated. In contrast, monthly price increases of core goods and food have been trending over recent quarters somewhat above their respective long-run averages, suggesting that disinflation in those categories is close to an end.

### Inflation to rise above 2% in October & remain above-target into 2025

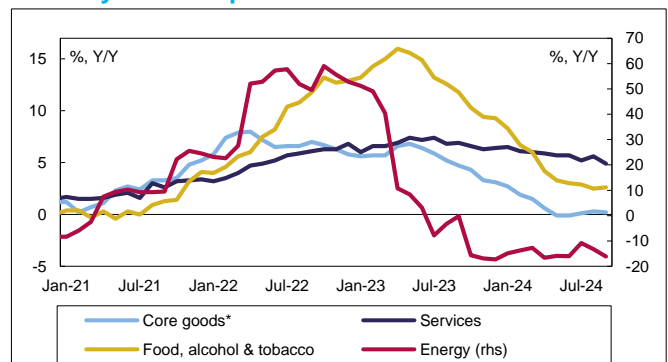
While inflation fell further than expected in September, it is poised to rebound back above 2.0%Y/Y in October. That will be not least due to the near-10% increase in Ofgem's regulated household energy price cap this month, which contrasts with

#### UK: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

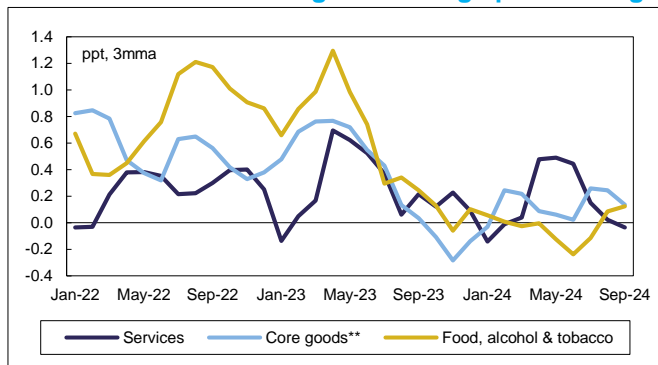
#### UK: Key CPI components



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

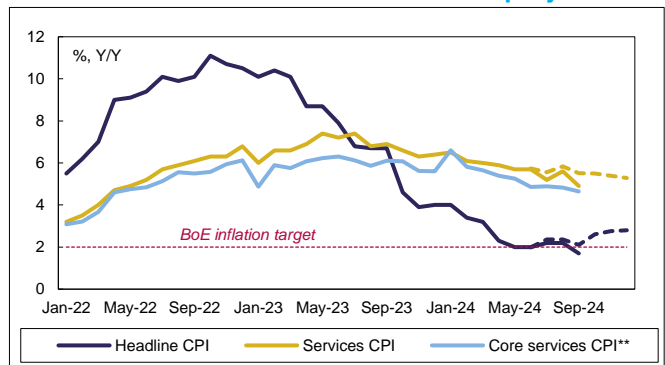
the cut of more than 7% a year earlier. Airfares and accommodation prices might be expected to rebound too, limiting scope for further near-term declines in the services component. Consistent with the slightly firmer underlying recent trend, and with the equivalent producer price inflation rate up in September to a 13-month high (1.4%Y/Y), core goods inflation is likely to move higher over the coming quarter too. But for the headline inflation profile, much will depend on movements in sterling and crude oil prices. Important too will be the detail of the government's budget announcement on 30 October. Increases in excise duty will likely boost alcohol and tobacco inflation, while the addition of VAT to private school fees from January and a possible increase in fuel duty in April would also add to the headline CPI rate. This could all mean that headline CPI inflation will remain above 2% through to the second half of next year. But with wage growth likely to continue to moderate, fiscal policy unlikely to be significantly expansionary over the near term, and so economic growth likely to remain sub-potential and hence to weigh further on margins, we currently expect inflation to return broadly in line with the BoE's target from Q3 next year and remain thereabouts thereafter. And that should allow for steady monetary easing, with rate cuts of 25bps apiece at successive MPC meetings, until policy returns to a broadly neutral stance by the end of next year.

**UK: Deviations from long-run average price change\***



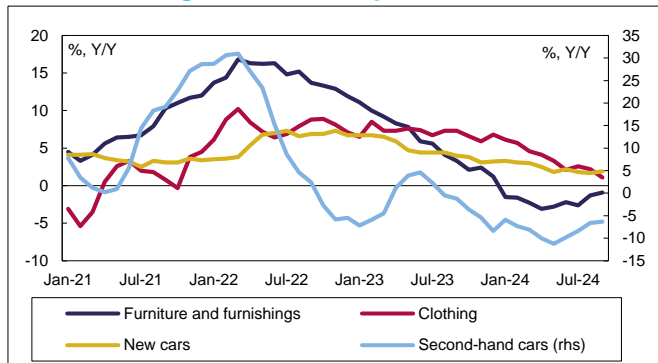
\*Monthly change in prices compared to average for the month in the decade before the pandemic. \*\*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**UK: Headline & services inflation: BoE projection\***



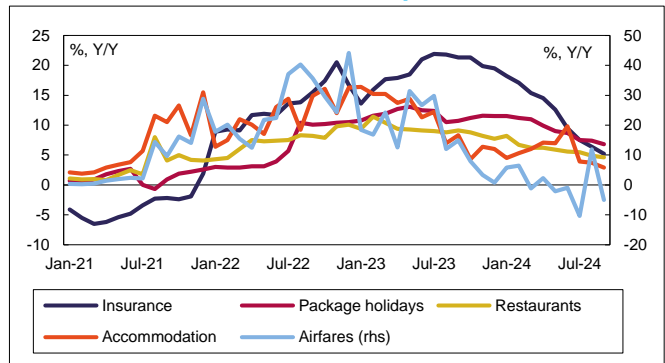
\*Dashed lines represent BoE projection in the August MPR. \*\*Core services excludes airfares, accommodation & rents. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**UK: Selected goods CPI components**



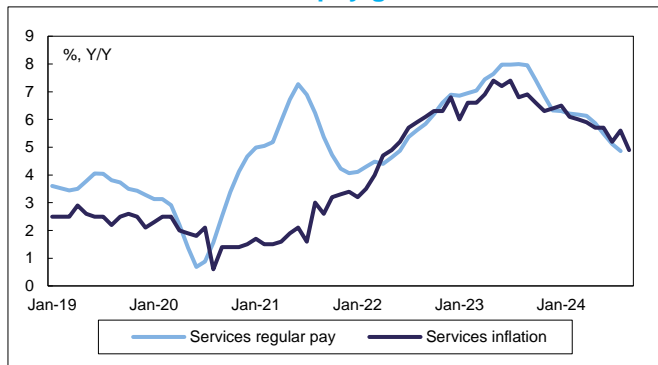
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**UK: Selected services CPI components**



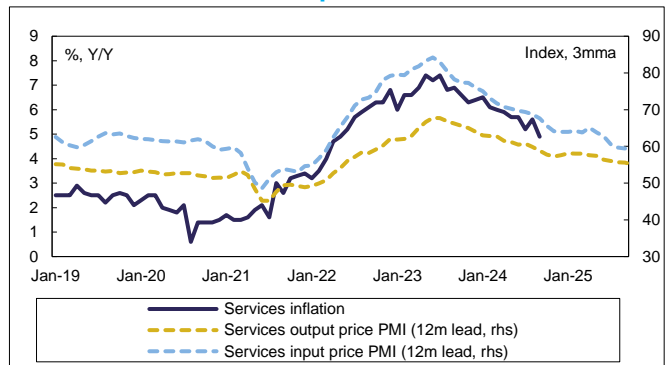
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**UK: Services inflation & pay growth**



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**UK: Services inflation & price PMIs**



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

## The day ahead in the UK

It should be a quiet day ahead, with no top-tier UK economic data scheduled.

## The day ahead in the euro area

The main event in the euro area tomorrow will be the ECB's monetary policy announcement, although it would be a huge surprise if the ECB did not cut rates by 25bps for a second successive meeting and a third time since June. As such, we expect the Deposit Rate to be cut to a 16-month low of 3.25%. [The account](#) of the previous policy meeting in September revealed that the balance of views on the Governing Council was already becoming more downbeat about the economic outlook, with members also more alert to the possibility that inflation might eventually undershoot the target over the medium term. And while not universally soft, the economic data published since this meeting have suggested that the ECB's macroeconomic projections published just last month are overoptimistic.

Certainly, the September PMIs pointed to a further loss of economic growth momentum at the end of Q3. The flash September inflation estimates also surprised to the downside, with the headline rate falling below the 2% target for the first time since mid-2021, to leave the quarterly rate (2.2%Y/Y) 0.1ppt below the ECB's September projection. Both the headline (1.77%Y/Y) and core (2.68%Y/Y) HICP rates came in on the low side in September. So, subsequent downwards revisions to the French (yesterday) and Italian HICP inflation rates (today), by 0.1ppt apiece to 1.4%Y/Y and 0.7%Y/Y respectively, suggest that downwards revisions to the euro area figures are possible when the final data are published tomorrow.





Of course, a [wide range of views](#) exists on the Governing Council. And so, tomorrow's rate decision might not be unanimous. And countless uncertainties surrounding the economic outlook, including those related to the trajectory of the US economy and events in the Middle East as well as labour cost and profit growth in the euro area, mean that the ECB's forward guidance is bound to repeat that a data-dependent and meeting-by-meeting approach will be maintained. Moreover, we suspect that President Lagarde will again be frustratingly unenlightening in her press conference.

In addition to the ECB announcement and final September inflation figures, tomorrow will also bring euro area goods trade data for August. Consistent with the equivalent German figures, the aggregate seasonally adjusted trade surplus is expected to have widened to a four-month high of €17.6bn, albeit remaining some €9bn below the series high recorded at the start of the year.




## European calendar

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Italy	 Final HICP (CPI) Y/Y%	Sep	<b>0.7 (0.7)</b>	<u>0.8 (0.7)</u>	1.2 (1.1)	-
UK	 CPI (core CPI) Y/Y%	Sep	<b>1.7 (3.2)</b>	<u>1.8 (3.3)</u>	2.2 (3.6)	-
	 PPI – output (input) prices Y/Y%	Sep	<b>-0.7 (-2.3)</b>	-0.6 (-2.2)	0.2 (-1.2)	0.3 (-1.0)
	 House price index Y/Y%	Aug	<b>2.8</b>	2.3	2.2	1.8




#### Auctions

Country	Auction
Germany	 sold €822mn of 0% 2050 bonds at an average yield of 2.46%
	 sold €854mn of 2.5% 2054 bonds at an average yield of 2.49%
UK	 sold £3.5bn of 4% 2031 bonds at an average yield of 3.988%






Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Wednesday's releases

#### Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	 10.00	CPI (core CPI) Y/Y%	Sep	<u>1.8 (2.7)</u>	2.2 (2.8)
	 10.00	Trade balance €bn	Aug	17.6	15.5
	 13.15	ECB Deposit Rate (Refi Rate) %	Oct	<u>3.25 (3.40)</u>	3.50 (3.65)

#### Auctions and events

Euro area	 13.15	ECB monetary policy announcement
	 13.45	ECB President Lagarde holds post Governing Council meeting press conference
France	 09.50	Auction: to sell up to €12bn of 2.5% 2027, 0.75% 2028, 2.75% 2029 and 2.75% 2030 bonds
	 10.50	Auction: to sell up to €2bn of 0.1% 2029, 0.6% 2034, 0.1% 2036 and 1.8% 2040 inflation-linked bonds
Spain	 10.00	Auction: to sell 3.1% 2031, 3.45% 2034 and 2.7% 2048 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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