Euro wrap-up

Overview

Emily Nicol
+44 20 7597 8331

Edward Maling
+44 20 7597 8030

- Bunds made gains and OAT spreads narrowed as French PM Lecornu proposed postponing the 2023 pension reform to gain cross-party support to pass next year's budget.
- Gilts rallied as UK pay growth fell below the BoE's forecast and a survey suggested that consumers were reluctant to spend at end-Q3.
- Tomorrow will bring euro area industrial production data for August and final September inflation estimates from France and Spain.

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.924	-0.012
OBL 2.2 10/30	2.193	-0.021
DBR 2.6 08/35	2.605	-0.030
UKT 3¾ 03/27	3.889	-0.047
UKT 4⅜ 03/30	4.032	-0.063
UKT 4½ 03/35	4.587	-0.069

*Change from close as at 4:35pm BST.
Source: Bloomberg

Euro area

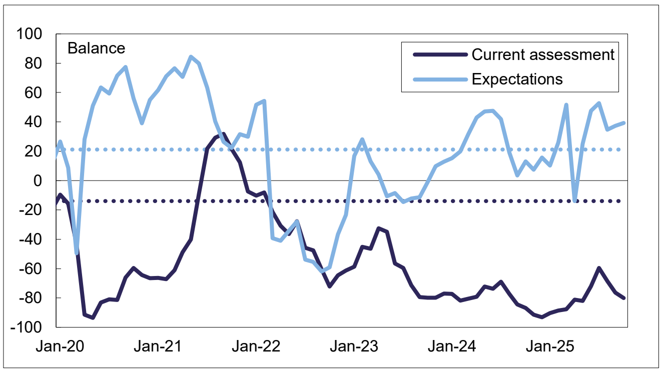
German investors cautious about current economic conditions, but remain upbeat about outlook

Amid renewed US-China trade tensions and heightened political uncertainties in France, today's ZEW survey results suggested that investor perceptions of the state of the German economy remain mixed. Probably influenced by the declines in global equity markets during the latter part of the survey period, investors judged Germany's current economic situation to be the weakest since May, with the respective net balance (-80) no better than the average of the past two years and well below the long-run average (-14). Indeed, just 2% of respondents assessed conditions to be "good". Nevertheless, the ZEW survey also indicated that investors remain broadly upbeat about the outlook, with around half judging the economic outlook for the coming six months to be "improving", and just 11% considering it to be "bad". Certainly, investors remain seemingly unconcerned about inflation, with some 80% of respondents expecting it to fall or move sideways over the coming six months. And almost three-quarters anticipate ECB rates being left unchanged at the current low level, which likely in part is supporting optimism about the profit outlook for the construction sector. Investors also remain upbeat about profits in IT services, no doubt in part relating to the push for AI. And while still negative, investors were the least downbeat about profits in the steel sector since March, after the EU announced new safeguarding proposals on steel imports.

German inflation picked up on energy base effects & certain services

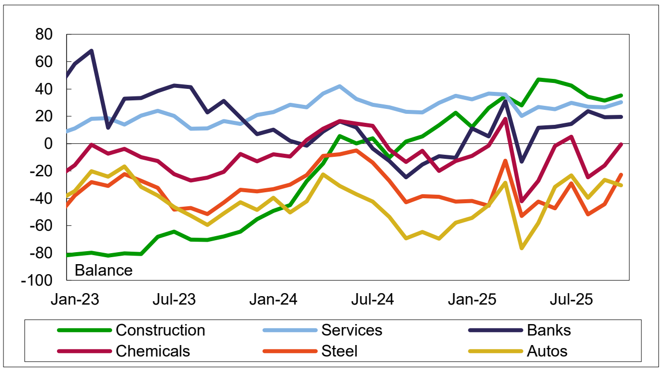
As expected, September's final German inflation print offered little surprise. In line with the flash estimate, headline inflation was confirmed to have ticked 0.3ppt higher for a second consecutive month on the HICP measure, to a seven-month high of 2.4%Y/Y. That rate was also matched by the national CPI rate, which rose to a nine-month high. Predictably, as the drag from energy components continues to gradually fade, base effects explained around half of that rise in headline inflation, with auto fuel prices seeing a first year-over-year increase since May 2024, up 3.6ppts to 1.1%Y/Y. But having reached a four-year low in August, core inflation also picked up 0.2ppt to 2.6%Y/Y, led by services components. Absent any principal drivers, transport services and seasonally variable accommodation and package holidays all offered modestly larger contributions. And categories exhibiting greater persistence – including insurance, social protection and housing services – were also otherwise stubborn. So, services HICP inflation picked up 0.5ppt to 3.5%Y/Y, a three-month high. But, on a brighter note, the drop in food inflation to 2.1%Y/Y, and below the headline rate for the first time since January, should help temper concerns about second-round effects on consumer price expectations. And while next year's minimum wage hikes (8.4%) and rising government spending pose upside risks to the German inflation outlook, we still expect services disinflation in those more persistent areas to regather pace this quarter, supported not least by the sluggishness of present economic activity.

Germany: ZEW survey – investor sentiment*



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

Germany: ZEW survey – profit growth expectations



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

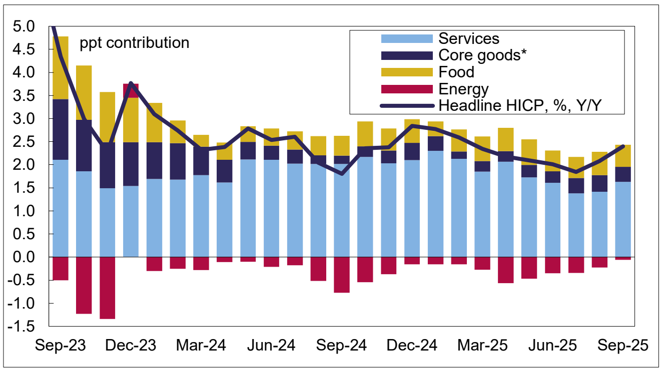
Consistent with today's German detail, Wednesday's final releases of French and Spanish inflation in September are expected to follow a familiar pattern. Indeed, their respective 0.3ppt increases (to 1.1%Y/Y in France, and 3.0%Y/Y in Spain, according to the preliminary estimates) were likely driven by a combination of unfavorable energy base effects and pressure in certain services components. In France, for example, transport services are likely to have made a larger contribution relating to the end of Olympics-related public transport fares increases. Meanwhile, Wednesday's data highlight will be the release of aggregate euro area industrial output for August. Considering the data from the member states – with a substantial increase in Ireland (9.8%M/M) tempered by declines in Germany (-5.2%M/M) and Italy (-2.5%M/M) – we expect euro area IP declined a little more than 1%M/M. Such would leave euro IP trending 0.4% below its Q2 average, consistent with our view that industry provided little support to GDP growth last quarter.

UK

Private regular pay continues to moderate leaving door open to further easing in due course

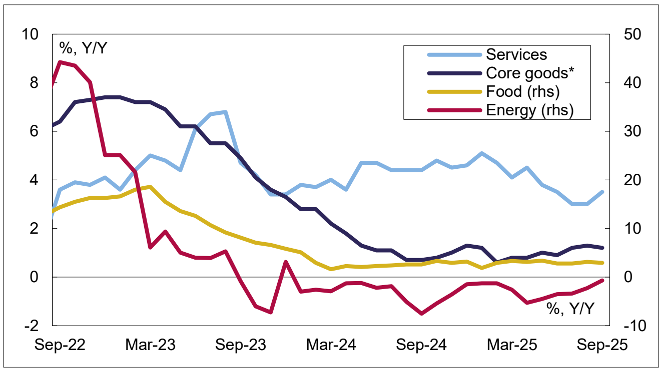
With UK inflation set to rise to roughly double the 2% target in September and the hawks on the MPC remaining more concerned about upside risks to the price outlook, we continue to expect Bank Rate to remain on hold at 4.00% at the next meeting in November. But some members on the Committee – including Governor Bailey – continue to place significant weight on the state of the labour market. And ahead of Bailey's fireside chat in Washington DC this evening, today's labour market report again flagged rising slack and moderating pay growth, arguably leaving open the possibility of a rate cut before the end of the year. Admittedly, total pay growth edged higher again in the three months to August, by 0.2ppt to 5.0%3M/Y. But, when excluding bonus payments, regular pay growth moderated 0.1ppt to 4.7%3M/Y, the softest since May 2022. Moreover, the pickup principally reflected the timing of annual pay rises in the public sector (up 0.4ppt to a 14-month high of 6.0%3M/Y). More encouragingly, however, the BoE's preferred measure of private regular wage growth moderated for a sixth successive month to 4.4%3M/Y, the lowest since end-2021, with growth notably softer in hospitality and distribution services. The single-month measure for total private regular pay fell to just 4.2%Y/Y, with momentum on a three-month annualised basis down to just 3.6%3M/3M, suggesting that pay growth will undershoot the BoE's forecast in September (4.6%3M/Y) for a second successive quarter.

Germany: Contributions to HICP inflation



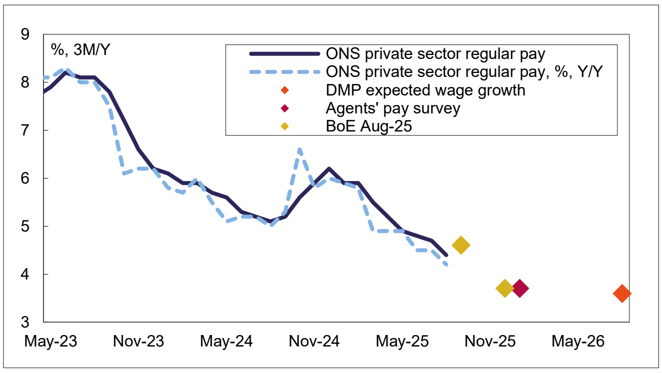
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: HICP inflation by component



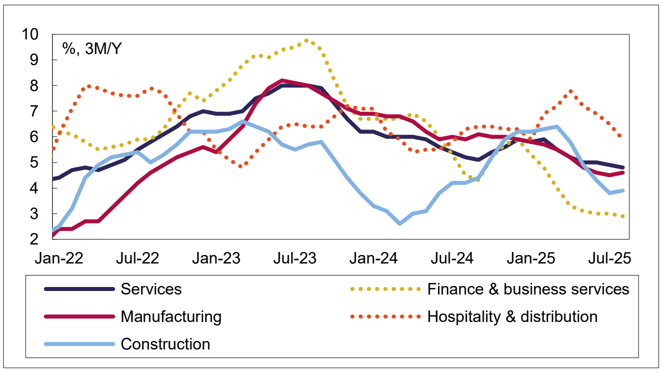
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private regular pay growth



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

UK: Private regular pay growth, by sector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Signs of stabilisation in payrolls, but labour demand continues to soften

One source of divergence of views on the MPC relates to uncertainty about the balance of supply and demand in the labour market, not least due to data inadequacies. But, on the whole, today's report was consistent with the findings of surveys such as the PMIs and REC report on jobs that point to an increase in labour slack over the past year or so. The flash estimate of payrolled employees fell for a ninth month out of the past twelve in September, by a further 10k, taking the cumulative drop over the past year to 100k. Admittedly, payrolled employees have moved broadly sideways over the past three months suggesting some recent stabilisation. And past revisions to these data imply that the drop since last October was smaller than initially estimated. But having pointed to a marked increase in the three months to July (232k), the Labour Force Survey (LFS) measure of employment fell in August for just the second month out of the past 18, taking the increase over the past three months to just 91k. This pushed the unemployment rate in the three months to August up 0.1ppt to 4.8%, the highest since May 2021 and 0.8ppt higher than a year earlier. And with the number of job vacancies similarly falling to the lowest since early 2021, the ratio of vacancies to jobless workers was the weakest in over a decade outside of the pandemic period.

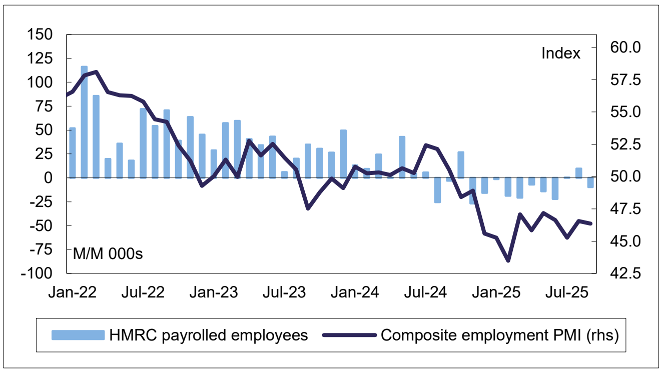
Survey suggests consumers remain reluctant to spend at end-Q3

With firms more reluctant to hire, households facing higher energy tariffs from 1 October and the government set to announce tax hikes in the November Budget, today's BRC retail monitor suggested that consumers remained cautious with their spending at the end of Q3. This showed that growth in sales values slowed from 3.1%Y/Y to 2.3%Y/Y in September, a four-month low. When smoothing for monthly volatility, sales growth (2.6%3M/Y) remained firmly above the average for the past twelve months, albeit down more than 1ppt from Q2. Despite strong growth in sales of electrical goods – supported reportedly by the release of new mobile phone models – sales of non-food goods slowed from Q2 (down more than 1ppt to 1.2%3M/Y). And while the value of food sales growth continued to outpace that of non-food items, this largely reflects price effects. Indeed, adjusting for the BRC shop price inflation measure, growth in food sales volumes in September was negligible. And while total sales volumes growth remained positive (0.9%3M/Y), it was down almost 2ppts from Q2 and the softest since last November.

The day ahead in the UK

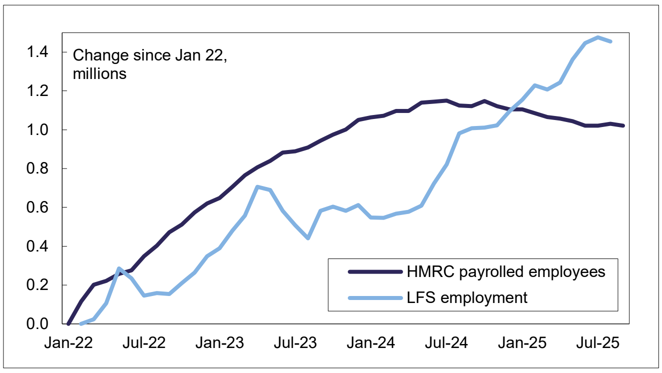
With no economic data or Bank speak scheduled until Thursday, it should be a quiet day ahead for the UK.

UK: Payrolled employees & employment PMI



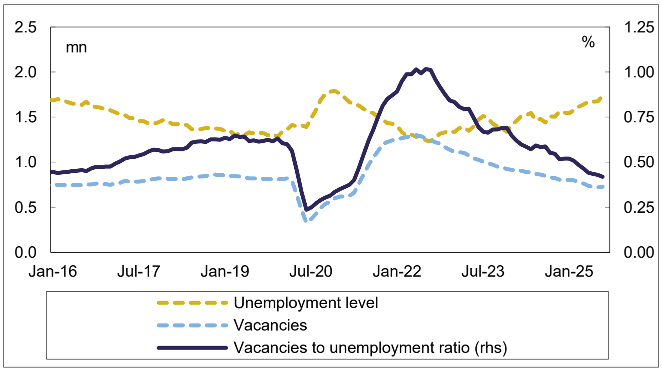
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measure of employment



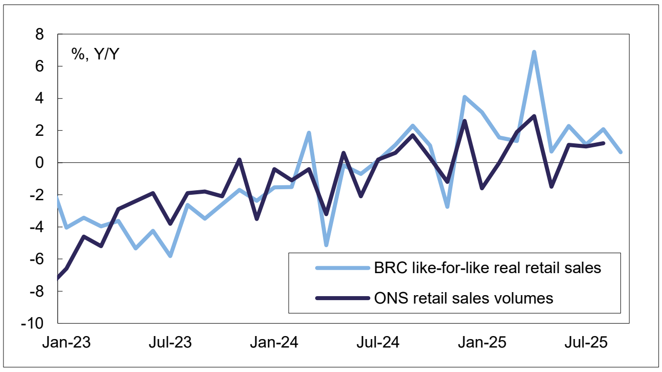
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Unemployment & job vacancies



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales volumes



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Final HICP (CPI) Y/Y%	Sep	**2.4 (2.4)**	*2.4 (2.4)*	2.1 (2.2)	-
		ZEW current situation (expectations) balance	Oct	**-80.0 (39.3)**	-74.2 (41.1)	-76.4 (37.3)	-
UK		Average wages (excluding bonuses) 3M/Y%	Aug	**5.0 (4.7)**	*4.7 (4.8)*	4.7 (4.8)	4.8 (-)
		Private sector regular wages 3M/Y%	Aug	**4.4**	*4.5*	4.7	-
		Unemployment rate 3M%	Aug	**4.8**	*4.7*	4.7	-
		Employment 3M/3M change 000s	Aug	**91**	125	232	-
		Payrolled employees M/M change 000s	Sep	**-10**	-10	-8	10
		Claimant count rate % (change 000s)	Sep	**4.4 (25.8)**	-	4.4 (17.4)	4.3 (-2.0)
		BRC retail monitor – like-for-like sales Y/Y%	Sep	**2.0**	2.5	2.9	-

Auctions

Country		Auction
Germany		sold €4.25bn of 2% 2027 bonds at an average yield of 1.91%
Italy		sold €1.25bn of 2.8% 2028 bonds at an average yield of 2.23%
		sold €2bn of 2.35% 2029 bonds at an average yield of 2.36%
		sold €3.5bn of 3.25% 2032 bonds at an average yield of 3.05%
		sold €1.75bn of 3.85% 2040 bonds at an average yield of 3.87%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	Industrial production M/M% (Y/Y%)	Aug	*-1.2 (0.3)*	0.3 (1.8)
France		07.45	Final HICP (CPI) Y/Y%	Sep	*1.1 (1.2)*	0.8 (0.9)
Spain		08.00	Final HICP (CPI) Y/Y%	Sep	*3.0 (2.9)*	2.7 (2.7)

Auctions and events

Country		BST	Event
Euro area		16.50	BdF Governor and ECB Governing Council member Villeroy speaks at IIF annual membership meeting, Washington
Germany		10.30	Auction: to sell up to €1bn of 0% 2050 bonds
		10.30	Auction: to sell up to €1.5bn of 2.9% 2056 bonds
UK		10.00	Auction: to sell £1.5bn of 0.125% 2031 inflation-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

https://www.uk.daiwacm.com/ficc-research/recent-blogs