

Euro wrap-up

Overview

- Bunds made very modest gains as euro area goods trade figures showed shipments to the US and China remaining firmly in reverse.
- Gilts outperformed as UK economic growth momentum slowed in the first two months of Q3 as services activity stagnated.
- Friday will bring final euro area inflation estimates for September.

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Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.903	-0.013
OBL 2.2 10/30	2.155	-0.007
DBR 2.6 08/35	2.569	-
UKT 3¾ 03/27	3.843	-0.038
UKT 4¾ 03/30	3.949	-0.048
UKT 4½ 03/35	4.499	-0.042

*Change from close as at 5.00pm BST.
Source: Bloomberg

Euro area

Trade surplus widens on weak imports, but exports to the US & China remain firmly in reverse

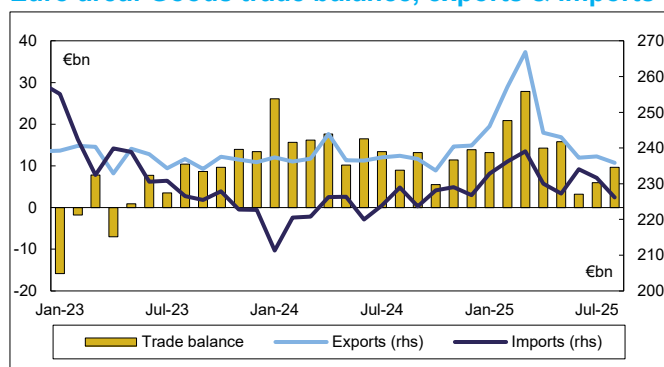
Having narrowed in June to the lowest level in almost two years, the euro area goods trade surplus widened in August for a second successive month. But at €9.7bn, that was still down more than €4bn on last year's average and more than €18bn below the record high reached in March. Moreover, the reason for the increase in the surplus in August was a broad-based drop in the value of goods imports, which fell for the fourth month in five (-2.4%M/M and -3.8%Y/Y) to an eleven-month low. Goods exports also fell for the fourth month in five, albeit by just 0.8%M/M. That, however, left them down 4.7%Y/Y at a 10-month low more than 11½% below March's series high. It also left them trending 2.0% below the average in Q2, when they fell almost 6%Q/Q. Just as front-running of US tariffs drove the near-8%Q/Q surge in exports in Q1, the subsequent weakness relates to payback in shipments across the Atlantic. Indeed, euro area exports to the US fell more than 8½%M/M in August to the lowest level since February 2022. That left them more than 45% below March's peak and trending more than 12% below the Q2 level. While all major categories have fallen since April, chemicals (including pharmaceuticals) account for by far the largest share of that decline in shipments to the US, having dropped almost two-thirds from the peak. Machinery and transport goods, by contrast, were down a little less than one quarter on the same basis.

In terms of other major markets, weakness in exports to China also persisted in August, falling for a second successive month to be trending about 2% below the Q2 average. Indeed, exports to China hit the lowest level since April 2020, with shipments of machinery and transport flatlining at the lowest since the first wave of Covid-19. And while imports from China fell in August so that the bilateral trade deficit narrowed to the smallest since January, political pressures within the EU for anti-dumping and other protectionist remedies will continue to mount, particularly due to the likelihood of increasing diversion of shipments away from the US to Europe over coming months. Elsewhere, despite a soft August, exports to the UK appear to be trending broadly sideways. And shipments to the rest of the EU and Switzerland are providing some welcome support in Q3. Nevertheless, the challenges faced by exporters to the US and China remain substantive, with data on container ship traffic and weak survey signals on new orders suggesting strongly that a meaningful pickup in euro area goods exports will not materialise before next year.

The day ahead in the euro area

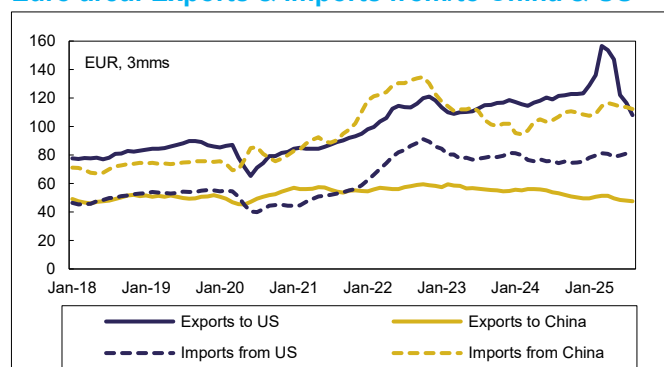
The survival of French PM Lecornu's government in Thursday's no-confidence votes should bring a reprieve from European political turbulence for at least the remainder of the week. So, September's final euro area inflation detail will provide Friday's focus. The preliminary estimates showed that headline inflation rose above the ECB's inflation target for only the first month since April, up 0.2ppt to 2.2%Y/Y. Predictably, given the more pronounced decline in fuel prices one year ago, higher energy

Euro area: Goods trade balance, exports & imports



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Exports & imports from/to China & US



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

inflation was the common denominator across the majority of the member states, principally leading the increase at the aggregate euro area level. But the final estimates from the member states also showed that services inflation ticked up in Germany and France, contributing to modestly higher core inflation in those member states. And today's Italian release confirmed a jump in core goods inflation to a 14-month high (albeit, a still-tame 0.7%Y/Y) on hotter seasonal price changes in clothing. So, while the flash estimates suggested that core euro area HICP stayed at 2.3%Y/Y for a fifth consecutive month, at 2.347%Y/Y to 3 decimal places, there remains an almost even probability that minor revisions throughout the member states will see the final core inflation figure rounded higher.

UK

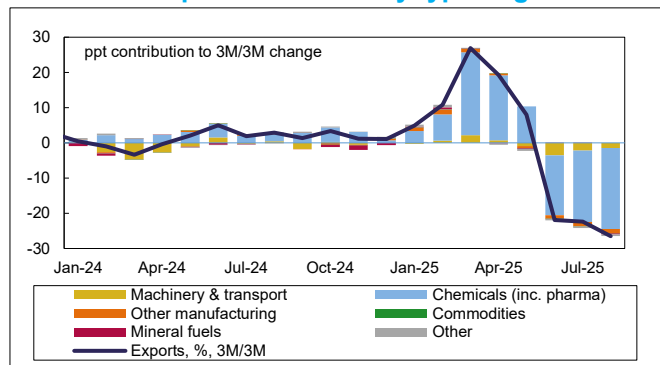
Subdued GDP growth tracking below the BoE's forecast

Today's UK GDP report broadly aligned with expectations, suggesting at face value that the economy continued to expand at a steady pace in the three months to August, by 0.3%3M/3M, in line with the rate of growth in Q2. But the monthly profile over the summer was on the soft side, with economic output rising just 0.1%M/M in August after a modest contraction in July. Indeed, in the first two months of Q3, GDP was trending just 0.2% above the Q2 average, a touch softer than the rate projected for the quarter in the BoE's Monetary Policy Report in August and half the pace assumed by Bank Staff at the September MPC meeting. The trajectory follows the seasonal pattern of recent years, whereby growth accelerates in the first half of the year before moderating in the second half. As such, it may simply reflect inappropriate seasonal adjustment. And if so, the slowdown in the data for recent months might not come as a surprise to many MPC members. Certainly, the Committee had flagged that surveys – including the PMIs – implied a more subdued pace of underlying growth in the first half of the year. And more recently, despite a marked deterioration in September, the average composite PMI in Q3 was almost 1½pts higher than in Q2. Nevertheless, the soft growth performance in July and August follows Tuesday's soft [labour market](#) data and dovish comments from Governor Bailey. And with a significant fiscal tightening to be announced in the government's 26 November Budget, a further Bank Rate cut before the end of this year – while not our base case – cannot be ruled out.

Services activity stagnates over the summer, while bounce in manufacturing will be temporary

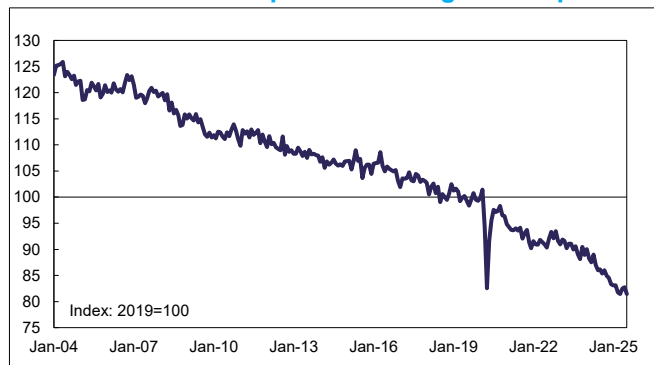
The sectoral detail of the GDP report was also somewhat disappointing, with the all-important services sector failing to grow in both July and August despite a non-negligible boost from retail and hospitality and a ninth consecutive increase in rental and leasing activity. Strikingly, despite modest growth in August, consumer-facing services were down 0.6%3M/3M, thanks in part to weakness in travel agencies and recreation. But not least due to a positive carryover from Q2 and firmness in

Euro area: Exports to the US by type of good



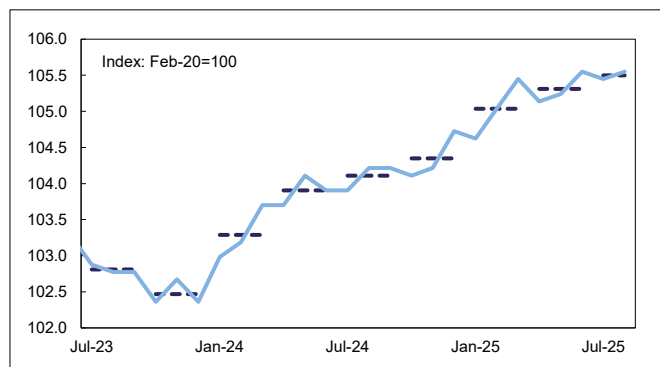
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods export share of global imports



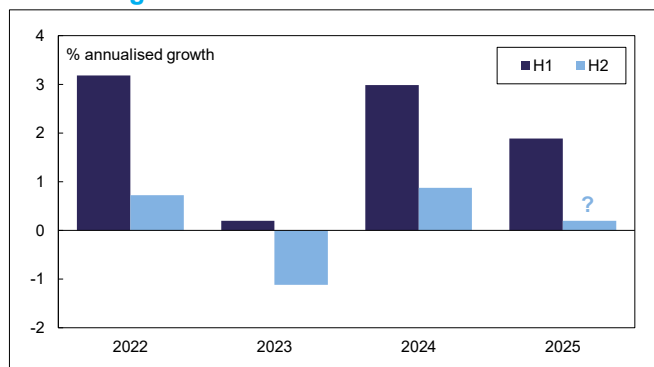
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP level*



*Dashed dark blue lines represent quarterly average.
 Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth*



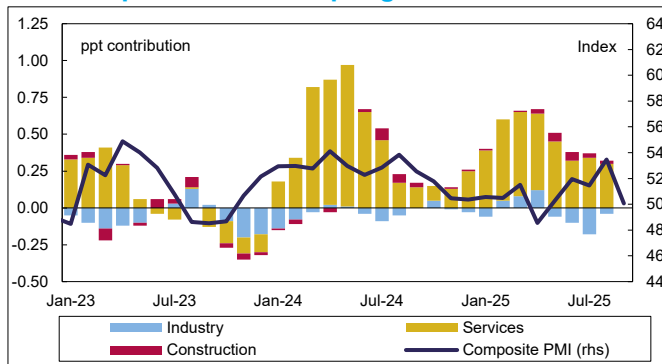
*H1 is change in GDP level in Q2 compared with Q4 of previous year. H2 is change in GDP level in Q4 compared with Q2. H225 is 2M/2M annualised.
 Source: Macrobond and Daiwa Capital Markets Europe Ltd.

business services, overall activity in the sector was still up 0.4%3M/3M, matching the rate in Q2 and therefore supportive to Q3 GDP growth. In contrast, construction output contracted in August (-0.3%M/M) following no growth in July, perhaps as payback for previous strength in private housing repair and maintenance work. As such, the sector looks to have provided no support to GDP growth in Q3. And while there was a rebound in industrial production in August (0.4%M/M), it continued to track below the Q2 average. While car production rose more than 1%M/M to a five-month high in August, this growth seems bound to be more than reversed in September after the prolonged cyberattack-related outage at [Jaguar Land Rover](#). Meanwhile, despite a bounce back in August, output of chemicals and pharmaceuticals was also trending between 4-5% below the Q2 average. So, while machinery output rose to a near-two-year high, total manufacturing output seems likely have provided a non-negligible drag on GDP growth in Q3.

2nd largest underlying goods trade deficit on record as shipments to Germany & US fall

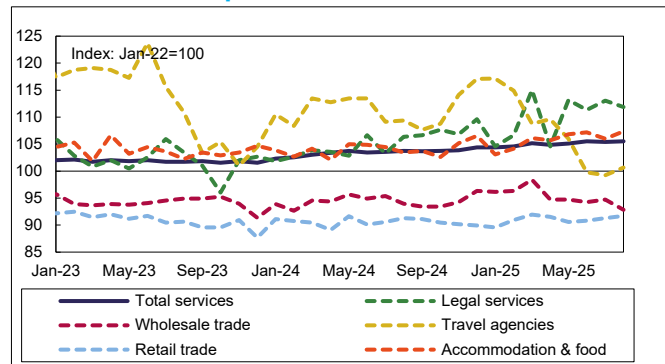
The continued downtrend in manufacturing over the past quarter unsurprisingly tallies with deterioration in the UK goods trade balance. Admittedly, the overall trade deficit widened just £0.3bn in August to £3.4bn. But this was in part flattered by shipments of precious metals including non-monetary gold. Excluding such items, the underlying trade deficit rose to a six-month high (£2.5bn). And the goods deficit (£21.2) on the same basis rose to the highest level since January 2022 and the second largest on record. The worsening of the underlying deficit was led by a decline in goods exports in both value

UK: Composite PMI & output growth



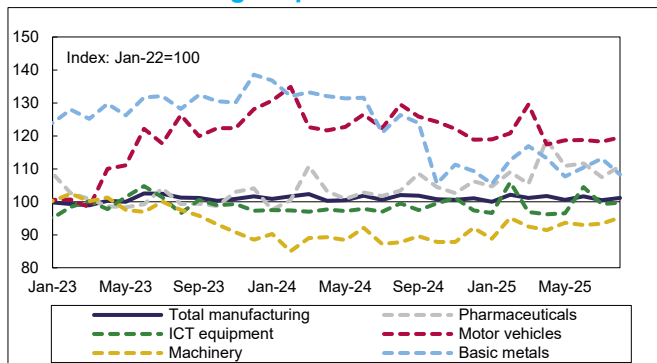
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services output



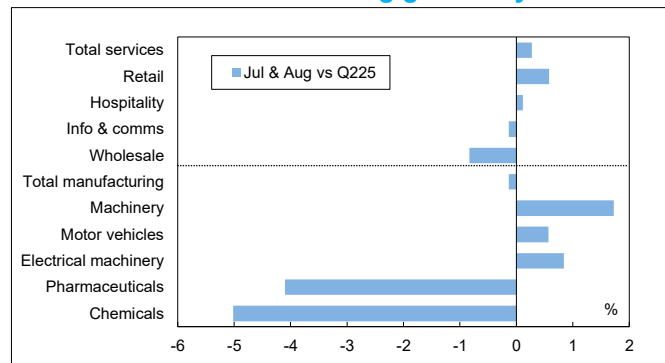
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output



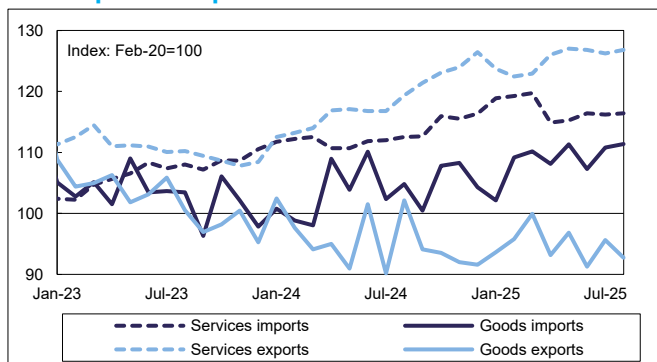
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services & manufacturing growth by subsector



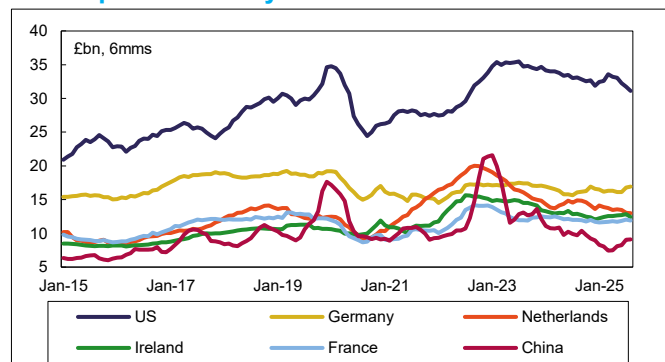
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Export & import volumes



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

UK: Export values by destination



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

(-3.3%M/M) and volume terms (-2.7%M/M). The weakness was most pronounced in the value of goods exports to the EU (-5.3%M/M) due to lower exports of aircraft, power generators and medical and pharmaceuticals products to Germany. Shipments to the US also fell back, led by pharmaceuticals, machinery and transport equipment. But while they remained well down on levels in Q1, they were trending a little more than 5% above the Q2 average. Meanwhile, services exports, which account for roughly 60% of total exports, were trending broadly sideways in the first two months of Q3. And although total export volumes (excluding precious metals) were trending more than ½% higher, this was roughly half the pace of import growth, suggesting that net trade was a drag on GDP growth in Q3 for a third quarter out of the past four.

The day ahead in the UK

It's set to be a quiet end to the week on the data front in the UK, which should push additional focus onto Friday's speeches from BoE Chief Economist Huw Pill and fellow MPC hawk Megan Greene. While certainly of interest, their respective speeches are bound to bolster bets that both will vote to hold rates at November's MPC meeting and thus should not alter the consensus about the (fine) balance of views on the MPC. Indeed, echoing Pill's well-documented concerns about the supply capacity of the UK economy, Greene earlier this week hinted at her intention to vote for a 'skip' to cuts, arguing that the Bank should maintain policy restrictiveness for longer amid her concerns about the slow pace of disinflation.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	Trade balance €bn	Aug	9.7	7.0	5.3	6.0
Italy	Final HICP (CPI) Y/Y%	Sep	1.8 (1.6)	<u>1.8 (1.6)</u>	1.6 (1.6)	-
UK	Monthly GDP M/M% (3M/3M%)	Aug	0.1 (0.3)	<u>0.2 (0.3)</u>	0.0 (0.2)	-0.1 (0.2)
	Services output M/M% (3M/3M%)	Aug	0.0 (0.4)	0.1 (0.4)	0.1 (0.4)	0.0 (0.4)
	Industrial output M/M% (Y/Y%)	Aug	0.4 (-0.7)	0.2 (-0.8)	-0.9 (0.1)	-0.4 (-0.1)
	Construction output M/M% (Y/Y%)	Aug	-0.3 (1.0)	-0.2 (1.5)	0.2 (2.4)	0.0 (1.8)
	Trade (goods trade) balance £bn	Aug	-3.4 (-21.2)	-4.8 (-22.0)	-5.3 (-22.2)	-3.0 (-20.6)

Auctions

Country	Auction
France	sold €4.707bn of 2.4% 2028 bonds at an average yield of 2.22% sold €2.403bn of 2.5% 2030 bonds at an average yield of 2.48% sold €2.65bn of 2.7% 2031 bonds at an average yield of 2.63% sold €1.739bn of 0% 2031 bonds at an average yield of 2.74% sold €650mn of 0.6% 2034 inflation-linked bonds at an average yield of 1.25% sold €177mn of 1.8% 2040 inflation-linked bonds at an average yield of 1.68% sold €327mn of 0.1% 2053 inflation-linked bonds at an average yield of 1.92%
Spain	sold €1.13bn of 1.25% 2030 bonds at an average yield of 2.443% sold €1.23bn of 2.55% 2032 bonds at an average yield of 2.716% sold €2.07bn of 3.2% 2035 bonds at an average yield of 3.085%

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	10.00	Final headline (core) HICP Y/Y%	Sep	<u>2.2 (2.3)</u>	2.0 (2.3)

Auctions and events

Italy	14.00	ISTAT to publish quarterly economic bulletin
UK	10.35	BoE Chief Economist Pill to speak at the ICAEW annual conference, London
	17.00	External MPC member Greene to speak in Atlantic Council webinar on 'inflation, tariffs and currency markets'

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

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