Euro wrap-up

Overview

Emily Nicol
+44 20 7597 8331

Edward Maling
+44 20 7597 8030

- Longer-dated Bunds made modest losses while a survey suggested that investors remain broadly upbeat about the German economic outlook and euro area exports extended their recent upturn.
- Gilts were little changed, despite a soft UK labour market report showing private regular wage growth matching the lowest since 2020 and a further decline in headcount.
- Wednesday will bring euro area industrial production data for July and UK inflation figures for August.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	3.243	-0.013
OBL 2.9 10/31	3.343	+0.012
DBR 3 08/36	3.531	+0.016
UKT 4 05/29	4.881	-0.005
UKT 4⅛ 03/31	4.956	+0.003
UKT 4⅞ 07/36	5.380	+0.014

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

Euro area

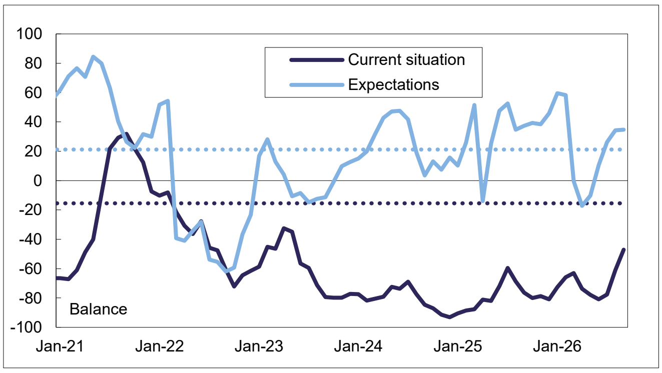
Investors remain broadly upbeat about German outlook, despite rising headwinds

Today's ZEW survey suggested that investors remained relatively optimistic about the German economic outlook at the end of Q3, with continued fiscal support and signs of strengthening demand seemingly outweighing concerns about tighter monetary policy and higher energy costs. The current conditions index rose for the third consecutive month in September, by a chunky 14pts to -47.1, the highest reading in more than three years. Nevertheless, this index remained well below the long-run average (-15.5), with around half of respondents still judging conditions to be 'bad'. Although the improvement in sentiment was slightly smaller than expected, investors remained broadly upbeat about prospects for the coming six months. Indeed, the expectations index edged up to its highest level since February, with almost 90% of respondents judging the outlook to be either 'normal' or 'improving'. Nevertheless, no doubt reflecting recent energy price developments, some caution emerged regarding the inflation outlook, with almost half of respondents expecting price pressures to intensify over the coming six months, up from around one quarter in August. And following last week's ECB rate hike, roughly 70% of investors anticipated further policy tightening over the same horizon. Against this backdrop, respondents expected the profit outlook for construction firms to deteriorate further in the near term. By contrast, banks and insurers were expected to benefit from a higher interest rate environment. Meanwhile, despite the recent surge in wholesale energy costs, profit expectations for utilities and chemical producers improved. And likely reflecting robust AI-related demand, respondents were also increasingly positive about earnings prospects in the IT, communications and electronics sectors.

Goods exports rise to highest level since March 2025 amid stronger demand from the US

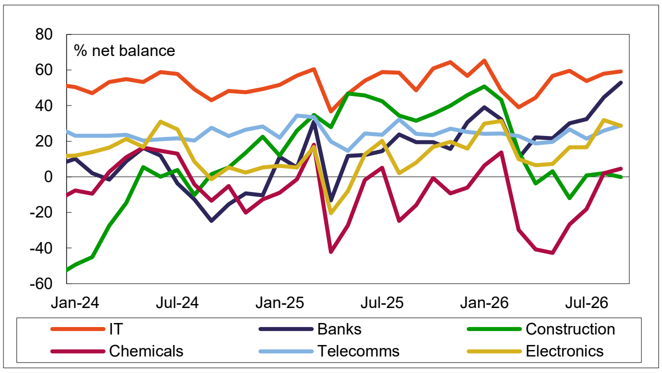
Today's euro area goods trade data gave further hints of strengthening external demand at the start of Q3. Export values rose for a sixth successive month in July, increasing 1.2%M/M to their highest level since March 2025 immediately before the jump in Trump's tariffs. With import values falling for a second successive month (-0.4%M/M), the headline trade surplus widened by €4.0bn to €5.0bn, its highest level since February. Encouragingly, the increase in exports reflected a further rebound in shipments to the US (6.0%M/M) to the highest level in ten months, driven largely by stronger demand for chemicals. Meanwhile, imports from the US fell to the lowest level since March due to a sharp drop in mineral fuels, likely reflecting the temporary fall in energy prices after the initial signing of the US-Iran MoU. So, the euro area's bilateral trade surplus with the US rose to €13.0bn, its highest level since last September. In contrast, exports to China fell to their lowest level since March after the prior month's figure had been flattered by a large French aerospace shipment. But stronger demand elsewhere in Asia helped offset that weakness, with exports to Japan rising 8½%M/M to a 14-month high. And import values from China fell back allowing the euro area's bilateral deficit with China to decline to a three-month low. While part of the increase in export values likely reflected higher prices, export volumes also appear to have risen again in July.

Germany: ZEW economic conditions indices*



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

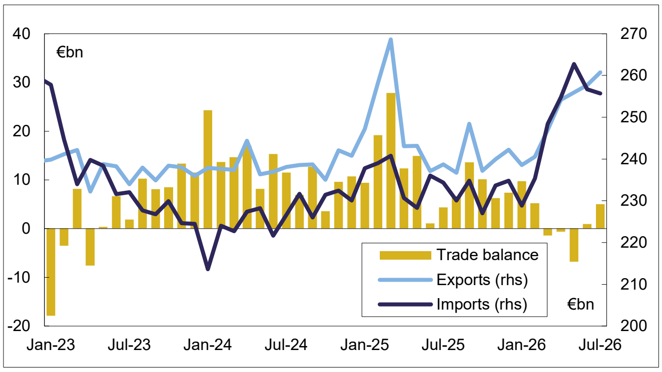
Germany: ZEW selected sectors' profit expectations



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

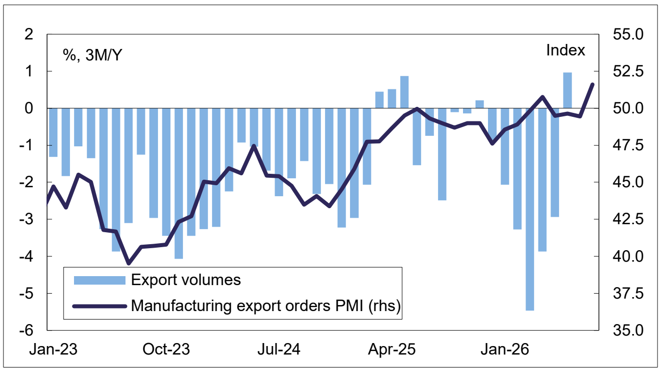
And with import volumes probably having fallen, today's data suggest that net goods trade likely supported GDP growth at the start of Q3.

Euro area: Goods trade balance, exports & imports*



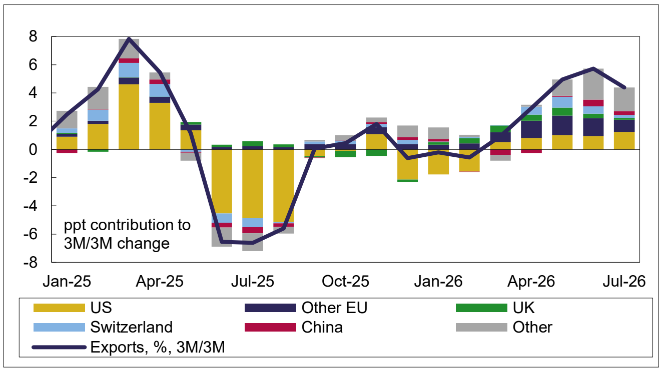
Values. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Export volumes & new export orders PMI



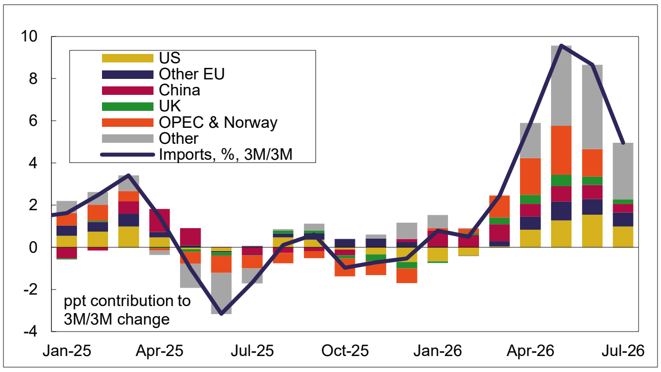
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods export values by destination



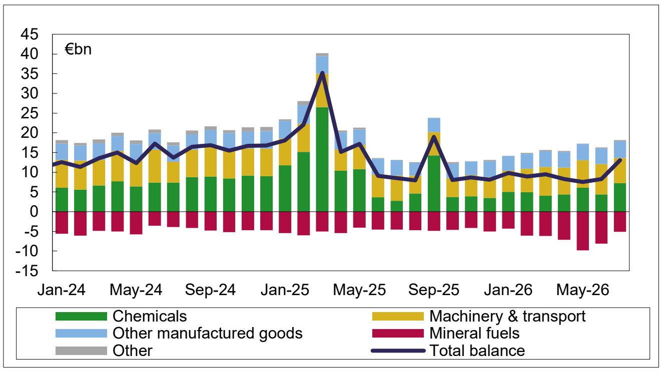
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods imports values by origin



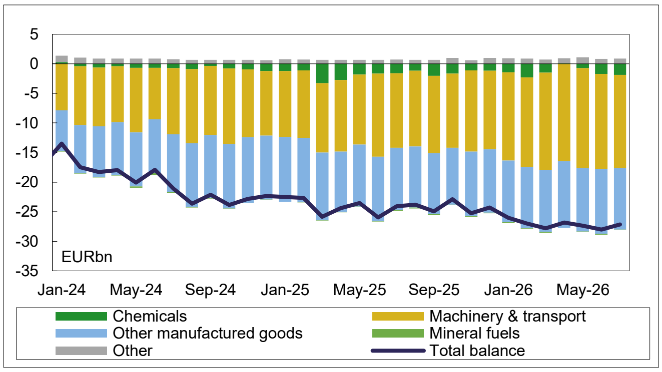
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade balance with the US



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade balance with China



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

The sudden drop in German industrial output imparts a downside skew to expectations for July's euro area IP figure. However, while energy-intensive production was also softer and disruption to river freight likely played a role, that decline in Germany was seemingly exaggerated by a temporary drop in autos production relating to retooling at a particular factory. And despite a modest downturn in France too, production across the wider euro area should only pare about 0.1%M/M with strength in the periphery and Ireland (2.6%M/M) and the Netherlands (1.8%M/M) also providing a counterbalance. If so, IP will be down only slightly on an annual basis and compared to its average level in Q2. Meanwhile, final August inflation data from Italy will provide a last preamble to Thursday's euro area detail. Today's releases confirmed a pickup in inflation last month in both France and Spain – owing principally to fuel and, contrasting with Germany, pressures in some fresh food categories – but they were nudged respectively lower and higher from their initial estimates. Given that the flash euro area HICP reading was 3.256% to 3 decimal places, those revisions may raise the likelihood of a downwards revision to one decimal place. However, they shouldn't affect the substance of Thursday's release, nor the reported softening in core inflation to 2.4%Y/Y. Consistent with that, Q2 labour cost data should confirm a moderation in growth to 3.1%Y/Y, a fifteen-quarter low. And more importantly for policymakers' assessments of second-round inflation risks, the latest update to the

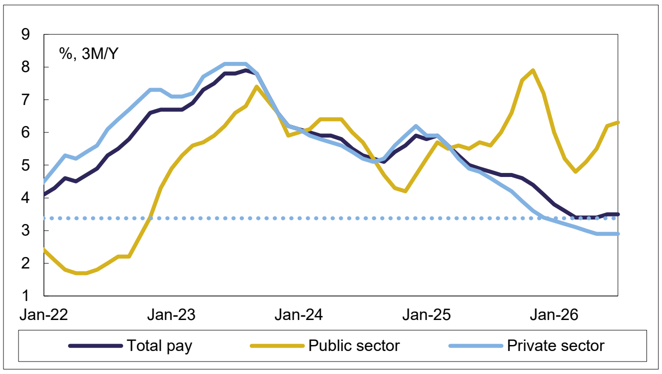
ECB's wage tracker tool will provide greater insights into arranged wage settlements through until Q227. The initial estimate for Q127, which admittedly seems likely to edge up as coverage improves, pointed towards relatively well-behaved settlements in the region of 2.7%Y/Y.

UK

No meaningful signs of pay pressures as private regular wage growth matches lowest since 2020

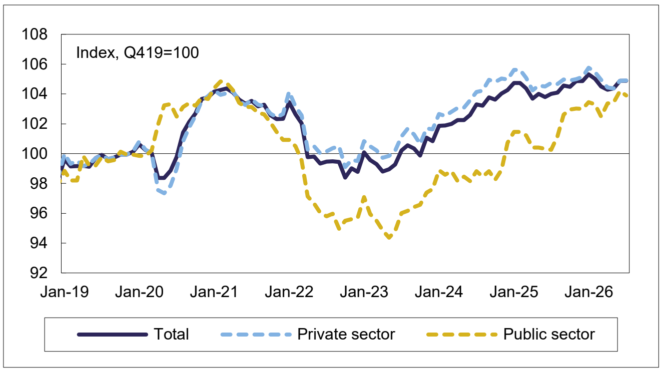
While the renewed surge in global energy prices means that Thursday's BoE monetary policy announcement will surely have a much more hawkish tone, today's soft labour market report reinforced our view that the majority of MPC members will vote to keep Bank Rate on hold until updated macroeconomic projections are available in early November. Indeed, today's data suggested that the stronger-than-expected economic growth seen so far this year has yet to translate into either a meaningful reduction in labour slack or firmer underlying wage pressures. Certainly, private sector wage growth moderated ½ppt to 3.2%3M/Y in July, the weakest rate since November 2020, while the BoE's preferred measure of private sector regular pay (excluding bonuses) moved sideways at 2.9%3M/Y for a third successive month. That pace was not only the slowest in almost six years, but also well below the long-run average and at a level which, other things equal, might be considered consistent with achievement of the inflation target on a sustained basis. While public sector regular pay accelerated in July to 6.3%3M/Y, the strongest rate in seven months, this partly reflected the timing of annual NHS settlements and continued catch-up for past weakness. As such, we are less concerned than some of the MPC's hawks that stronger public sector wages will fuel pressure in the private sector over coming quarters. Meanwhile, in real terms, regular pay rose 0.6%3M/Y while total pay slowed to 0.9%3M/Y. And with inflation set to rise notably further over coming months to around 4%Y/Y by the start of next year, the additional squeeze on real incomes will likely act as a meaningful restraint on consumer spending growth.

UK: Regular pay growth



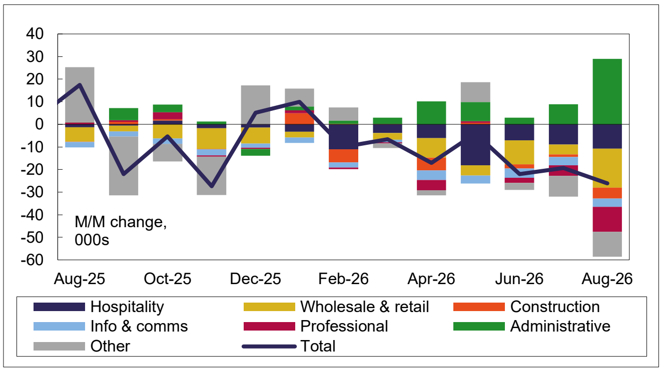
**Dotted line shows long-run average for private sector pay growth.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Real regular pay*



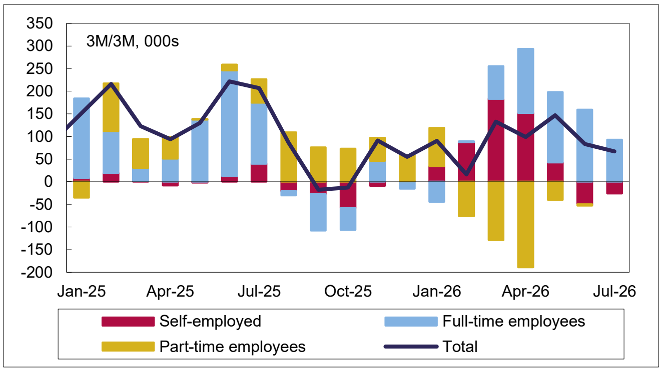
**Deflated by CPI, 3mma.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Change in payrolled employees by sector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Change in LFS employment



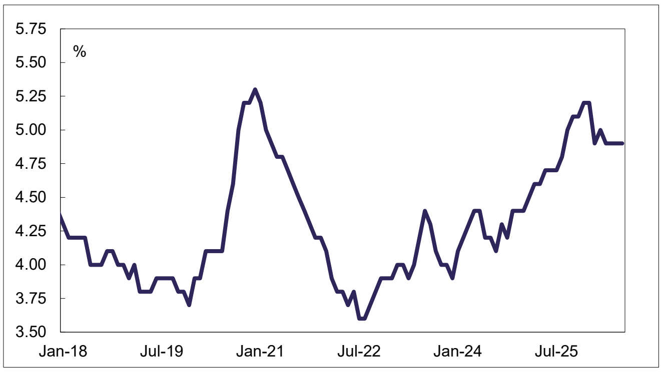
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Payroll & vacancy data suggest that labour demand remains soft amid persistent slack

While MPC members hold differing views on labour market conditions and measures of employment continue to send mixed messages, today's data overall pointed to a persistent excess of labour supply over demand. According to the preliminary estimate, the number of payrolled employees fell for a seventh successive month in August and by the largest amount since last November. With the July figure revised down too, payrolls fell 145k from a year earlier (-0.5%Y/Y) in August. In contrast, the Labour Force Survey showed employment up 243k in the year to July, including a 111k increase in the number of employees, although concerns about data quality concerns appear particularly strong with respect to that measure.

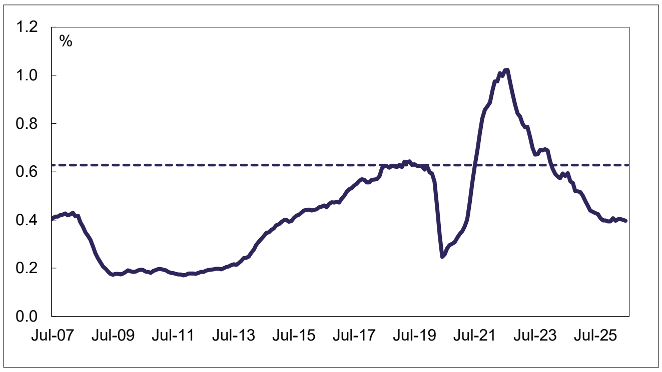
Nevertheless, the ILO unemployment rate in the three months to July was unchanged at 4.9%, 0.2ppt above the level a year earlier and more than 1ppt above the average in 2022 when inflation surged to a double-digit rate. Meanwhile, job vacancies edged down to the lowest level in more than five years and, excluding the pandemic period, the weakest since 2014. So, the vacancies-to-unemployment ratio – a useful gauge of labour market tightness – remained close to the bottom of its range over the past decade. Although some survey indicators, such as those of the REC report from employment agencies, have pointed to a stabilisation in labour demand over the summer, other indicators remain less encouraging. And given the likelihood that slack will persist over coming quarters, in assessing the case for a rate hike, many MPC members will continue to place weight on the DMP survey expectation of continued moderate pay growth 12 months ahead, which would suggest relatively modest second-round effects from the energy price shock.

UK: Unemployment rate



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Vacancies to unemployment ratio*



**Dashed line is 2019 average.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

In contrast to today's labour market report, August's inflation data – the highlight of the Wednesday's dataflow for the UK – will provide cause for consternation on the MPC as members meet before Thursday's policy announcement. Indeed, inflation seems bound to have risen further last month owing to a jump in energy prices, albeit on this occasion driven by rising auto fuel prices rather than regulated household energy bills. Overall, we see the headline CPI rate rising to a five-month high of 3.2%Y/Y, up 0.3ppt and 0.4ppt above the BoE's projection in July. In addition to the direct effects of higher energy prices, a survey from the BRC suggested that rising costs could have started to trickle into food inflation, which has been a recent source of softness. And we see the risks to core inflation skewed to the upside too, but principally due to ongoing pressures in AI-related goods and more pronounced indirect effects in services, as opposed to broader pressures. Still, those pressures could be sufficient to push up the core rate to 2.8%Y/Y, also a five-month high. PPI indices will also provide insights into how the latest spike in cost pressures is being transmitted to consumers by goods producers.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Trade balance €bn	Jul	**5.0**	-	1.8	1.0
	Final job vacancy rate %	Q2	**2.1**	*2.1*	2.3	-
Germany	ZEW current situation (expectations) balance	Sep	**-47.1 (34.7)**	-52.1 (40.0)	-61.1 (34.2)	-
	Wholesale prices M/M% (Y/Y%)	Aug	**0.9 (6.8)**	-	0.2 (5.3)	-
France	Final HICP (CPI) Y/Y%	Aug	**2.6 (2.4)**	*2.7 (2.4)*	2.4 (2.1)	-
Spain	Final HICP (CPI) Y/Y%	Aug	**4.6 (4.3)**	*4.5 (4.3)*	3.9 (3.6)	-
UK	Average wages (excluding bonuses) 3M/Y%	Jul	**3.9 (3.5)**	3.9 (3.5)	4.1 (3.5)	4.2 (-)
	Private sector wages 3M/Y%	Jul	**2.9**	2.8	2.8	2.9
	Unemployment rate 3M%	Jul	**4.9**	4.9	4.9	-
	Employment 3M/3M change 000s	Jul	**66**	67	84	-
	Payrolled employment M/M change 000s	Aug	**-26**	-5	-13	-19
	Claimant count rate % (change 000s)	Aug	**4.4 (27.8)**	-	4.3 (-11.0)	- (-11.8)

Auctions

Country	Auction
Germany	sold €3.817bn of 2.7% 2028 bonds at an average yield of 3.27%
UK	sold £1.25bn of 0.5% 2029 bonds at an average yield of 4.818%
	sold £750mn of 4.25% 2040 bonds at an average yield of 5.640%

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%)	Jul	*-0.1 (-0.2)*	0.0 (0.1)
	10.00	Final labour costs Y/Y%	Q2	*3.1*	3.2
Italy	09.00	Final HICP (CPI) Y/Y%	Aug	*3.2 (3.3)*	2.9 (2.9)
UK	07.00	Headline (core) CPI Y/Y%	Aug	*3.2 (2.8)*	2.9 (2.6)
	07.00	PPI – output (input) prices Y/Y%	Aug	3.3 (5.4)	3.1 (4.9)
	09.30	House price index Y/Y%	Jul	-	2.0

Auctions and events

Country	BST	Event
Euro area	09.00	ECB to publish wage tracker update
Germany	10.30	Auction: to sell up to €1bn of 3.4% 2047 bonds
	10.30	Auction: to sell up to €1.5bn of 2.9% 2056 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.