Daiwa Capital Markets

Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- While flash estimates of Spanish and Belgian inflation surprised to the upside, Bunds made modest gains while the Commission's economic sentiment indicator fell slightly as consumer expectations deteriorated.
- Gilts also made modest gains as the BRC's measure of shop price inflation moderated and mortgage approvals slowed, but business lending and household credit flows remained robust.
- Wednesday will bring flash September inflation data from Germany, France and Italy, alongside updates on the German labour market and retail sales.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	3.286	-0.012
OBL 2.9 10/31	3.424	-0.015
DBR 3 08/36	3.623	-0.017
UKT 4 05/29	4.911	-0.012
UKT 4⅛ 03/31	4.983	-0.009
UKT 4⅞ 07/36	5.409	-0.010

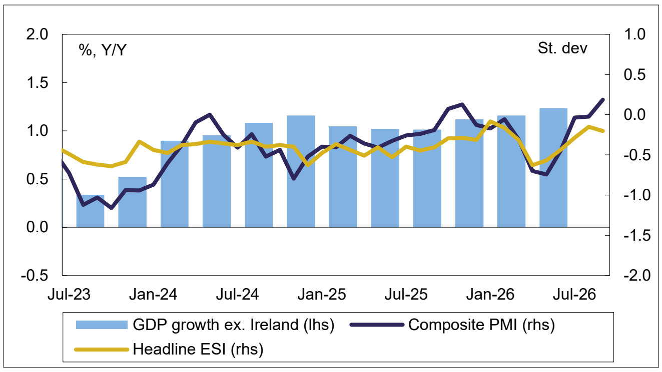
*Change from close as at 5:00pm BST.
Source: Bloomberg

Euro area

Commission sentiment indicator deteriorates despite improved confidence in industry & services

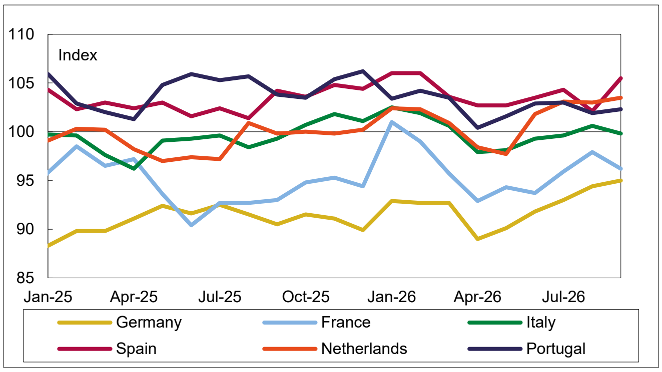
Unexpectedly, the Commission's headline Economic Sentiment Indicator (ESI) for the euro area slipped back in September, by 0.5pt to 97.9, more than 2% below the long-run average and more than 1% below January's near-three-year high. That appeared to contradict the upbeat signal from last week's flash composite PMI, which suggested the strongest underlying growth momentum in four years. But the weakness in the ESI reflected the 1pt drop to a three-month low in the consumer confidence index while its signals on business sentiment remained broadly upbeat. Households revised down their outlooks for their own incomes and the economy. And so, they reported a diminished appetite for making major purchases and an increased desire to save. In contrast, and consistent with the PMIs, the Commission survey reported improved confidence in both industry and services, and broadly unchanged sentiment in retail and construction. Among the member states, there was significant divergence. Economic sentiment was considered the best in Germany in more than three years and rose sharply back close to the top of the range of the past four years in Spain. But having risen to multi-month highs in August, confidence worsened in France and Italy.

Euro area: GDP growth & survey indices



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

Euro area: Economic sentiment by member state

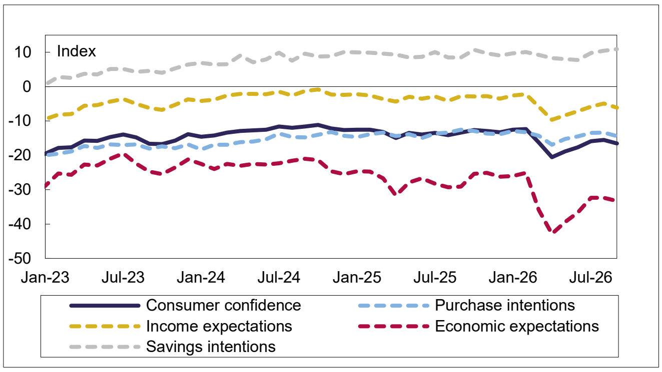


Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Manufacturers signal strongest production outlook since early 2022

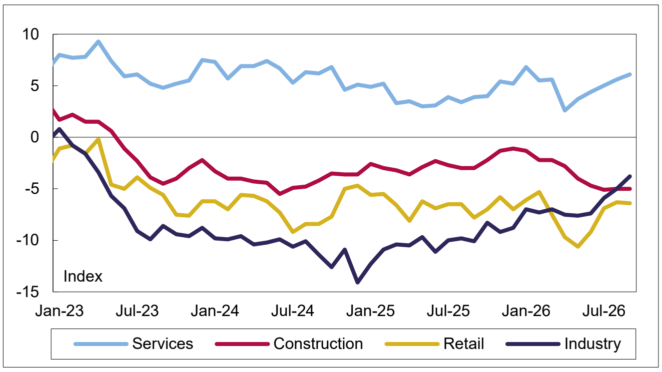
Most encouraging within the survey detail, sentiment among manufacturers rose to the highest level in more than three years. In part that reflected markedly improved production expectations, which were the strongest since before the Russian invasion of Ukraine in early 2022, as well as firmer order books and diminished stocks of finished items. The improvement in services confidence was somewhat less emphatic, however. And while firms in that sector were the most optimistic since January, that principally reflected an upwards revision to their assessment of recent activity, while the demand outlook was judged to have softened slightly. In addition, weaker labour demand from retailers largely explained a first decline in three months in the Commission's employment expectations indicator (EEI). Perhaps more notably and contrasting the message from the flash PMIs but consistent with softer expectations of demand, services firms and retailers also revised down a touch their selling-price expectations for the coming three months. In contrast, however, manufacturers and construction firms respectively revised up their selling-price expectations to three- and four-month highs. And given the recent jump in energy prices, consumer inflation expectations for the coming twelve months were also revised up to the highest level since May, no doubt one cause of their greater pessimism about the outlook.

Euro area: EC survey - consumer confidence indices



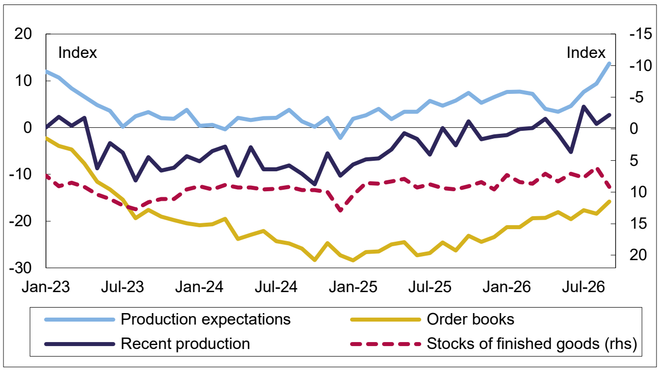
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: EC survey - business sentiment indices



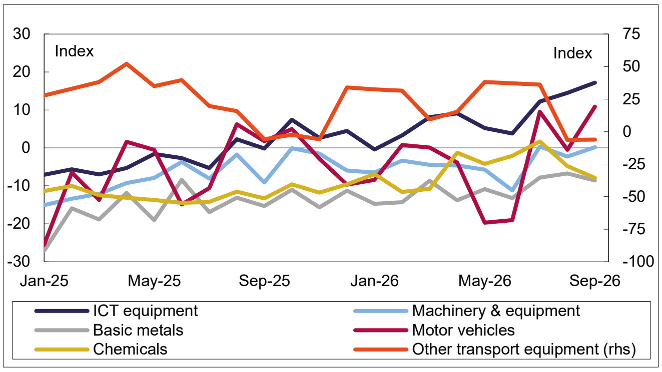
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: EC survey - selected industry indices



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

Euro area: EC survey - recent output by sector

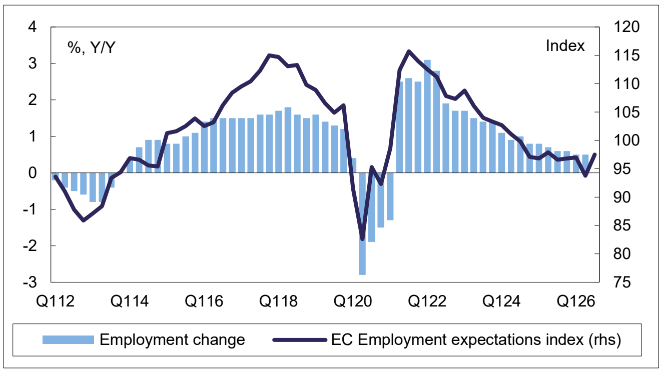


Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Inflation in Spain & Belgium surprises to the upside as energy costs surge

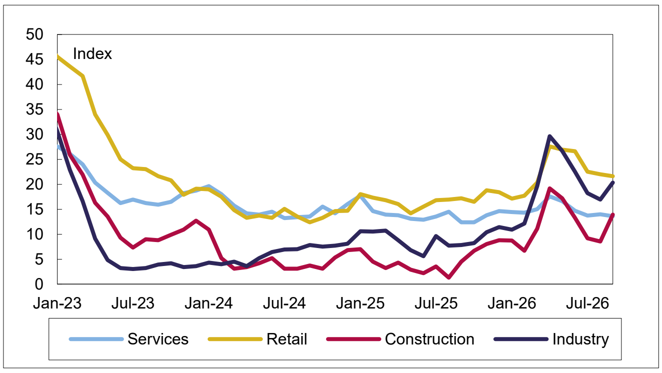
Consistent with increased household price expectations, the first national estimates of inflation in September were stronger than expected, underscoring the likelihood that the euro area HICP rate (due Friday) will rise to a three-year high and the Governing Council will at least consider a hike in the deposit rate again at its next meeting on 29 October. In Spain and Belgium, the EU-harmonised HICP rates rose 0.4ppt to 5.0%Y/Y and 4.6%Y/Y respectively, the highest since February 2023 and November 2024. However, as in recent months, the acceleration was driven predominantly by energy rather than a meaningful broadening of underlying price pressures. Prices of motor fuel played an important role in both countries, accounting for around half of the monthly increase in the Belgian headline rate. Natural gas and electricity prices also rose sharply in Belgium. Package holidays added to services inflation in both countries. In contrast, food inflation in Belgium fell deeper into negative territory. And overall, underlying price pressures appeared relatively contained. Indeed, the Belgian core CPI inflation measure (excluding fresh food and energy) was unchanged at 3.0%Y/Y while the Spanish core HICP measure, (excluding fresh food and energy) was unchanged at 3.2%Y/Y. So, while higher wholesale energy prices and their pass-through will push inflation higher into the new year, the evidence so far suggests that indirect effects from events in the Middle East remain manageable and second-round effects via wages negligible.

Euro area: Employment growth & EEI



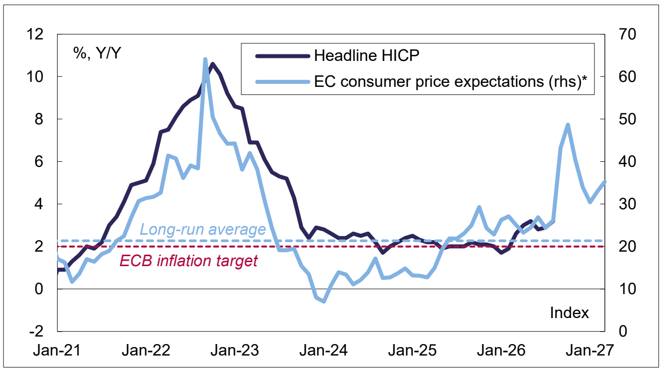
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Firms' selling price expectations*



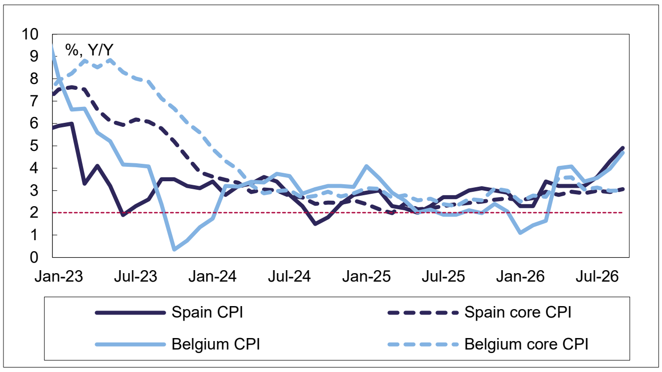
**3 months ahead. Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Consumer price expectations



*12 months ahead, with a 6-month lead. Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Spain & Belgium: Headline & core inflation*

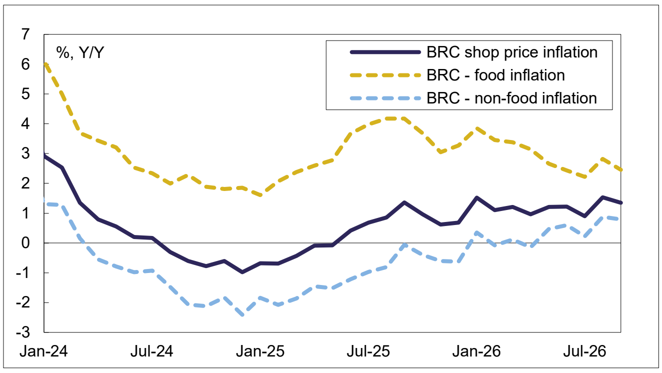


*National measures. Core inflation excludes fresh food & energy. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

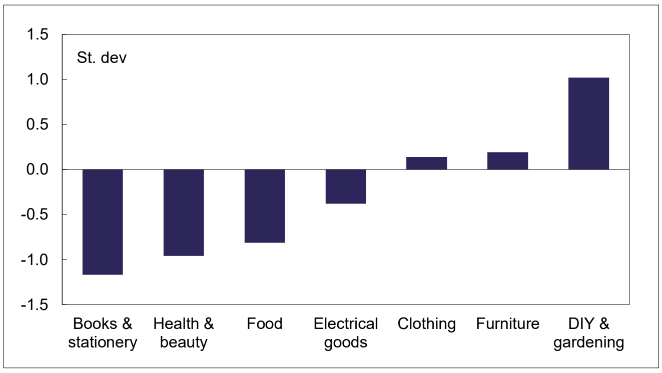
Ahead of Friday's euro area release, the data focus tomorrow will be the flash September CPI estimates from Germany, France and Italy. With auto fuel prices in Germany and France around 6% above their August averages, and heating oil prices posting double-digit increases, headline inflation is expected to accelerate markedly. In particular, the German and French HICP rates are forecast to rise above 3%Y/Y to their highest levels since early 2024, while the Italian rate is expected to rise ½ppt to 3.7%Y/Y, which would be the highest in three years. While the increase will be driven primarily by energy, given the persistence and intensification of the shock, the risks to other categories now appear skewed to the upside too. This notwithstanding, like in Spain and Belgium, any increase in core HICP inflation should be modest. Wednesday will also bring the latest German retail sales and labour market figures. While sales volumes are expected to have rebounded last month following the steep decline at the start of Q3, they will likely remain well below their Q2 average given subdued fuel consumption. Meanwhile, consistent with the latest ifo survey, German jobless claims numbers are expected to point to further stabilization in labour market conditions in September.

UK: BRC shop price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Monthly change in BRC shop prices*



*September 2026. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

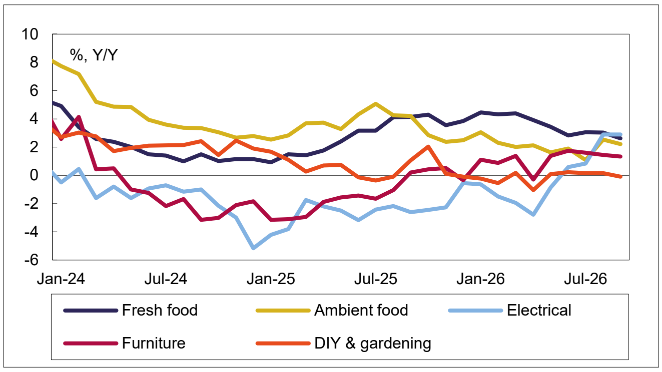
BRC shop price survey suggests limited pass-through from higher energy costs

The renewed surge in Brent crude prices has been evident in UK petrol prices, which rose a further 5%M/M this month to be almost one-third above their level before the Iran conflict. And diesel prices increased nearly 6%M/M to a new series high. Higher wholesale energy costs will further fuel inflation via higher household utility bills from next month and again in January. And higher input costs risk generating broader inflationary pressures in due course. But today's BRC survey offered little evidence that firms have yet begun to pass those costs on to consumers in any significant way. Indeed, the headline shop price index rose just 0.1%M/M in September, in line with the long-run average for that month, pushing shop price inflation down 0.1ppt to just 1.4%Y/Y. While the BRC noted that the summer heatwave pushed up prices of fresh fruit, a continued easing in producer food costs contributed to an unseasonable decline in the BRC's measure of consumer food prices in September (-0.2%M/M). As a result, food inflation fell 0.3ppt to 2.5%Y/Y, well below the average of recent years, with the rates for fresh food and ambient food inflation moderating alike. Meanwhile, non-food inflation (0.8%Y/Y) also edged lower from August's 2½-year high, with heavy discounting of back-to-school essentials reportedly helping to restrain price growth. Nevertheless, reflecting continued pressures on ICT-related input costs, inflation for electrical goods remained unchanged at a series high. And perhaps due to the persistence of unseasonably warm weather, prices of DIY and gardening products rose sharply for a second successive month, although inflation in that category remained slightly negative overall. Having remained at just 0.9%Y/Y in August, core goods CPI inflation is likely to remain close to 1%Y/Y in September before edging up close to 1½%Y/Y by year-end.

Business lending & consumer credit flows strong in August, but mortgage approvals now slowing

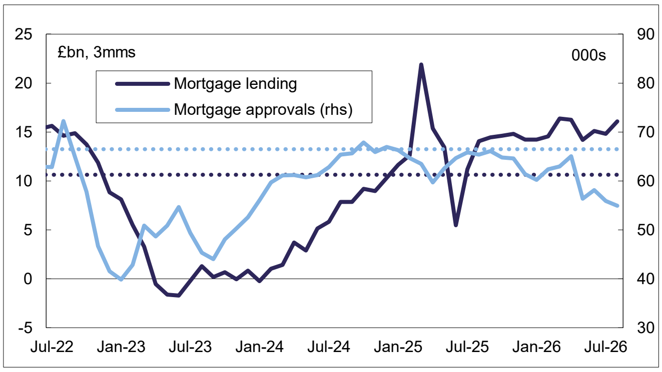
The significant tightening of financial conditions since the start of the Iran conflict has been a key restraint on the BoE as it mulled raising rates over past months. However, while the price of new borrowing has risen, lending volumes have not appeared excessively restrained. Indeed, while in July private non-financial corporations (PNFCs) had borrowed, on net, a negligible amount of finance, in August they raised £7.7bn, the most in almost 2½ years. Within that amount, bank lending accounted for £5.7bn, the most since the precautionary surge in March, to leave the stock of loans to PNFCs up 8.1%Y/Y. There appears to have been no significant rationing of loans to households either. Net borrowing of consumer credit rose in August to £2.5bn, the highest level on the series dating back more than three decades, with net lending via credit cards the most in any month of the series bar one (March 2004). That left the outstanding stock of consumer credit up 9.6%Y/Y, the strongest rate since 2018. And net mortgage lending rose slightly to £4.4bn, to leave the stock up 3.6%Y/Y, matching the top of the growth range since end-2022. However, net mortgage lending in July and August was down on the same months a year earlier. And the number of new mortgage approvals fell in August to 54.9k, the lowest level since end-2023. With interest rates on mortgage rates moving higher with rising swap rates, we expect mortgage approvals to continue to trend lower over coming months. On Saturday, PM Burnham announced plans for a new scheme (called “Your First Home”) to provide a 20% equity loan to first-time buyers who place a 2.5% deposit to purchase a new-build home. And the experience of the previous government’s similar “Help to Buy” had a material impact on demand. But unless and until mortgage rates stabilise, we would expect the current downtrend in mortgage approvals to persist and eventually feed through to a material slowdown in growth of outstanding mortgage loans.

UK: BRC shop price inflation, by good



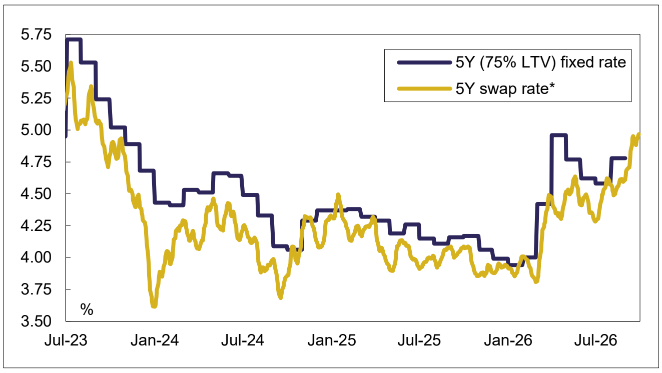
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending & approvals*



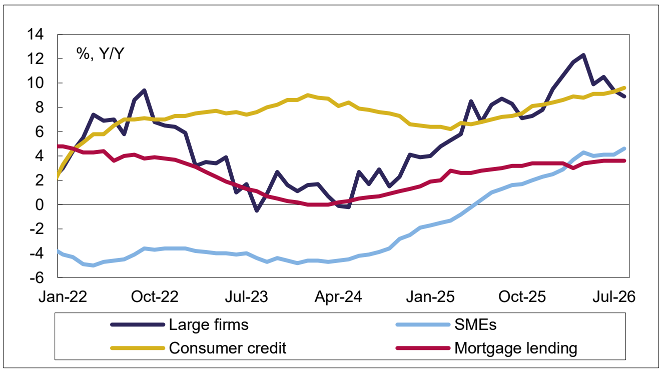
**Dotted lines represent pre-pandemic 5-year average. . Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: 5Y mortgage & swap rates



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Household & business lending growth



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

The day ahead in the UK

A relatively quiet day for UK data tomorrow will bring updated national accounts figures for Q2, which will include additional information on household and corporate income and savings, as well as balance of payments data. Preliminary estimates suggest that GDP growth slowed slightly to 0.4%Q/Q, with activity led higher by fixed investment while private consumption and inventories also contributed positively, offsetting a drag from government spending. While net trade was broadly neutral in Q2, the current account deficit likely widened slightly, albeit remaining firmly within the range of the past couple of years.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Commission economic sentiment indicator	Sep	**97.9**	98.8	98.4	-
		Commission services (industrial) confidence indicator	Sep	**6.1 (-3.8)**	6.5 (-4.8)	5.8 (-5.3)	5.6 (-5.0)
		Final Commission consumer confidence indicator	Sep	**-16.5**	*-16.5*	-15.5	-
Italy		PPI Y/Y%	Aug	**13.5**	-	9.3	-
Spain		Preliminary HICP (CPI) Y/Y%	Sep	**5.0 (4.9)**	4.9 (4.7)	4.6 (4.3)	-
		Retail sales Y/Y%	Aug	**-0.4**	-	-0.3	-0.4
UK		BRC shop price index Y/Y%	Sep	**1.4**	1.5	1.5	-
		Net consumer credit £bn (Y/Y%)	Aug	**2.5 (9.6)**	1.9 (-)	2.0 (9.2)	2.1 (9.3)
		Net mortgage lending £bn (approvals 000s)	Aug	**4.4 (54.9)**	4.4 (56.6)	4.3 (56.1)	4.1 (55.9)

Auctions

Country		Auction
Italy		sold €3.5bn of 3.95% 2032 bonds at an average yield of 4.08%
		sold €3.0bn of 4% 2036 bonds at an average yield of 4.58%
		sold €1.5bn of 2036 floating-rate bonds at an average yield of 3.38%
UK		sold £4.25bn of 4.875% 2036 bonds at an average yield of 5.383%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		07.00	Retail sales M/M% (Y/Y%)	Aug	1.5 (-1.2)	-3.4 (-2.4)
		07.00	Import prices M/M% (Y/Y%)	Aug	0.5 (7.8)	0.2 (6.8)
		08.55	Unemployment claims rate % (change 000s)	Sep	6.4 (2)	6.4 (4)
		13.00	Preliminary HICP (CPI) Y/Y%	Sep	3.2 (3.1)	2.9 (2.9)
France		07.45	Preliminary HICP (CPI) Y/Y%	Sep	3.1 (2.8)	2.6 (2.4)
		07.45	PPI Y/Y%	Aug	-	3.4
		07.45	Consumer spending M/M% (Y/Y%)	Aug	-	0.5 (1.4)
Italy		09.00	Istat consumer confidence indicator	Sep	94.4	94.5
		09.00	Istat economic (manufacturing) confidence indicator	Sep	-	96.9 (89.9)
		10.00	Preliminary HICP (CPI) Y/Y%	Sep	3.7 (3.7)	3.2 (3.3)
UK		07.00	GDP - final estimate Q/Q% (Y/Y%)	Q2	*0.4 (1.2)*	0.4 (1.2)
		07.00	GDP - private consumption Q/Q%	Q2	*0.3*	0.6
		07.00	GDP - government spending Q/Q%	Q2	*-0.3*	1.3
		07.00	GDP - fixed investment Q/Q%	Q2	*1.2*	0.4
		07.00	GDP – exports (imports) Q/Q%	Q2	*0.5 (0.5)*	0.2 (1.4)
		07.00	Current account balance £bn	Q2	-25.5	-22.1

Auctions and events

Euro area		16.45	ECB's Schnabel to deliver a keynote speech at a European capital markets seminar in Luxembourg
Germany		10.30	Auction: to sell up to €5.5bn of 3% 2036 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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