

Euro wrap-up

Overview

- While OATs continued to sell off and flash German, French and Italian inflation surprised to the upside, Bunds made sizeable gains.
- Shorter-dated Gilts made modest gains despite an upwards revision to UK GDP in Q2 to confirm the strongest growth of the G7 in H126.
- Thursday will bring euro area unemployment data alongside the final manufacturing PMIs.

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Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	3.199	-0.087
OBL 2.9 10/31	3.353	-0.071
DBR 3 08/36	3.593	-0.039
UKT 4 05/29	4.883	-0.027
UKT 4½ 03/31	4.972	-0.011
UKT 4¾ 07/36	5.423	+0.014

*Change from close as at 5.00pm BST.

Source: Bloomberg

Euro area

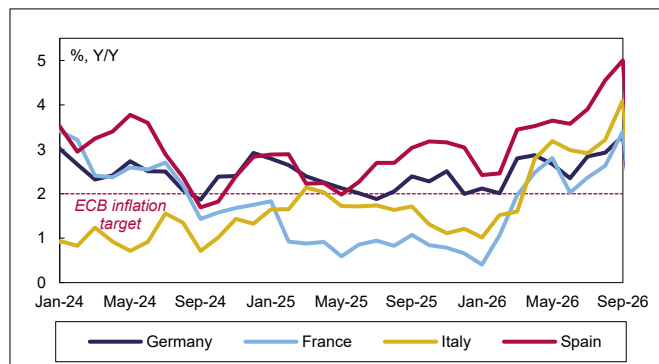
German inflation highest since December 2023, but price pressures largely confined to energy

Today's flash September inflation estimates from the largest three member states exceeded expectations, underscoring the likelihood that euro area inflation rose to a three-year high and keeping the door open to a further ECB rate hike next month. In Germany, the headline EU-harmonised HICP rate rose 0.4ppt to 3.3%Y/Y, the highest since December 2023 and 1.3ppts above its level at the onset of the US-Iran conflict. But the acceleration remained largely driven by the direct impact of the energy shock, suggesting that policymakers need not panic. Prices of motor fuels rose sharply for a third consecutive month to a series high, while a double-digit jump in heating oil prices took them to their highest level since March 2022. As a result, energy CPI inflation jumped 4.4ppts to 14.9%Y/Y, the highest rate since early 2023. By contrast, while food prices rose the most in four months, the increase was only marginally higher than the norm for September, leaving food inflation still very low at 0.4%Y/Y. Reflecting the continued rise in producer import prices (up 8.3%Y/Y in August), non-energy industrial goods inflation appears to have reached 2.3%Y/Y, the highest level in more than two years. Among other things, regional data reported higher telephone prices, perhaps due in part to the new iPhone. But services inflation moderated to the softest in more than four years, leaving core CPI inflation (excluding food and energy) unchanged at 2.4%Y/Y for a third month, just 0.1ppt above April's five-year low.

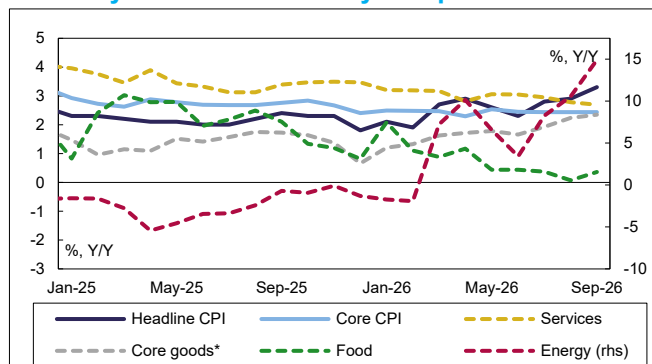
French & Italian inflation surprise significantly to the upside amid higher energy & fresh food prices

Inflation in France and Italy surprised more significantly to the upside in September, with the HICP rates jumping 0.8ppt to 3.4%Y/Y and 0.9ppt to 4.1%Y/Y, respectively their highest levels since January 2024 and September 2023. Like in Germany, energy predictably remained the principal impulse, accounting for around half of the monthly increase in the French headline rate and some three-quarters of the Italian increase. But today's data also hinted at a broadening of price pressures this month. Most strikingly, higher input costs and the effects of the summer heatwave pushed up inflation of fresh foods in France to a three-year high (9.9%Y/Y). The equivalent rise in Italy was somewhat more measured, merely to a four-month high (5.1%Y/Y). And while services inflation edged higher in both countries in part due to rising transportation costs (particularly airfares), it remained firmly within the recent range. Moreover, non-energy goods inflation remained very soft, remaining in negative territory in France for a nineteenth successive month. So, overall, underlying price pressures appeared relatively contained in both France and Italy. Based on the figures published so far by the member states, we expect the euro area headline HICP rate to rise 0.4ppt to 3.6%Y/Y. Reassuringly, however, we only expect core inflation to edge back up to 2.5%Y/Y, remaining within its range since the onset of the energy price shock and with limited evidence of more substantive and broader inflation persistence under the bonnet.

Euro area member states: HICP inflation



Germany: CPI inflation & key components

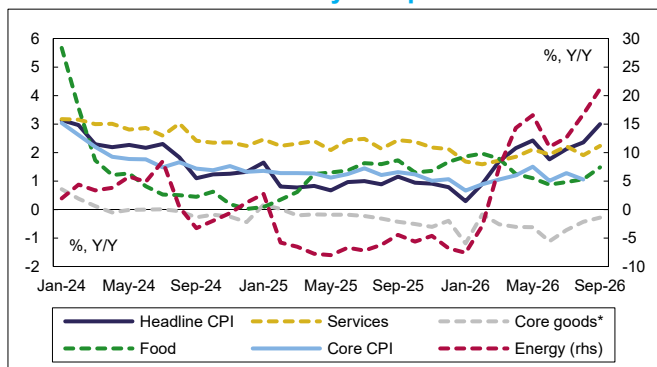


*Non-energy industrial goods.

German retail sales rebound in August, but on track to contract in Q3 as energy prices bite

The impact of the energy price shock has been evident in German retail sales volumes in recent months. While the government's temporary fuel tax cuts helped cushion the initial hit to households, their expiry at the end of June triggered the steepest monthly decline in auto fuel sales since September 2022, with volumes falling 8.1% M/M in July. Today's data suggested that sales at petrol stations merely stagnated in August, leaving volumes almost 9% Y/Y lower and contrasting the substantial growth in such sales values of nearly 11% Y/Y. So, while there was a rebound in food and core (i.e. non-food and non-fuel) items in August, growth in total sales volumes of 1.4% M/M only partially offset the drop in July (-3.2% M/M). As a result, sales in the first two months of Q3 were running more than 2% below the Q2 average, reinforcing expectations that household consumption and GDP growth slowed this quarter. While fuel sales volumes likely remained subdued in September due to a further surge in prices, the reintroduction of fuel tax cuts from 1 October until year-end should then provide some support to household spending. Moreover, while today's labour market figures showed jobless claims rising for a fourth consecutive month, up 12k to their highest level since March 2011, the claimant count rate was unchanged at 6.4%. And a slight increase in vacancies also pointed to a stabilisation in labour market conditions. Indeed, if the latest PMIs are to be believed, firms increased headcount for a second successive month in September, and at the fastest pace in more than three years.

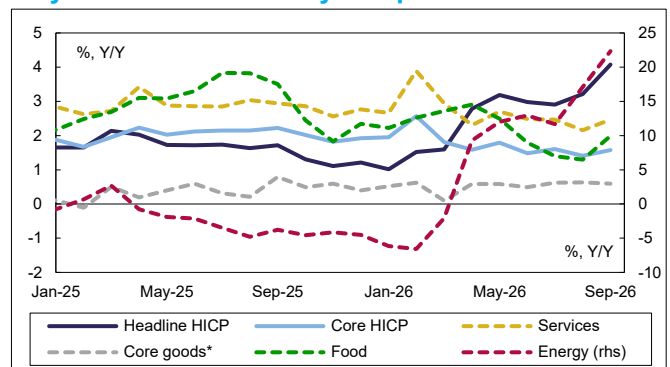
France: CPI inflation & key components



*Non-energy industrial goods.

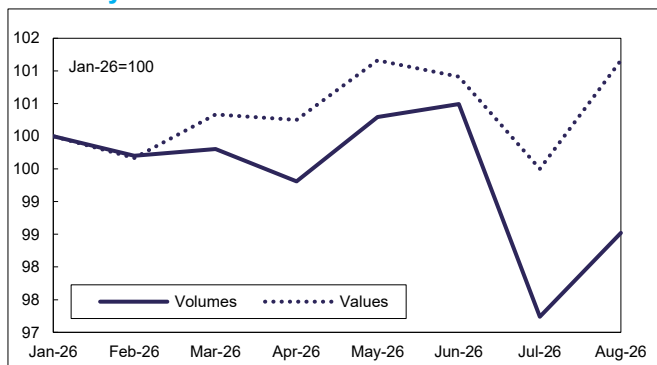
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: HICP inflation & key components



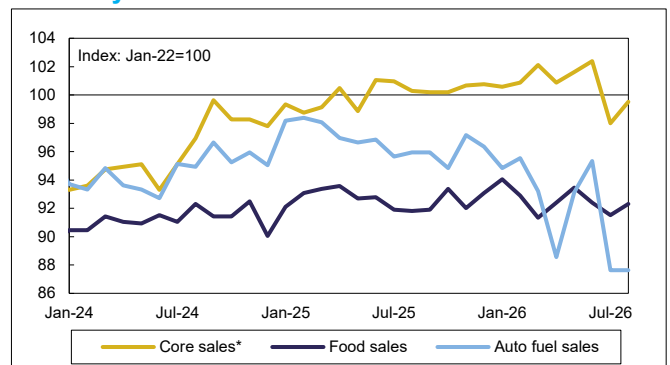
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales volumes & values



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales volumes



*Non-food and non-fuel.
 Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

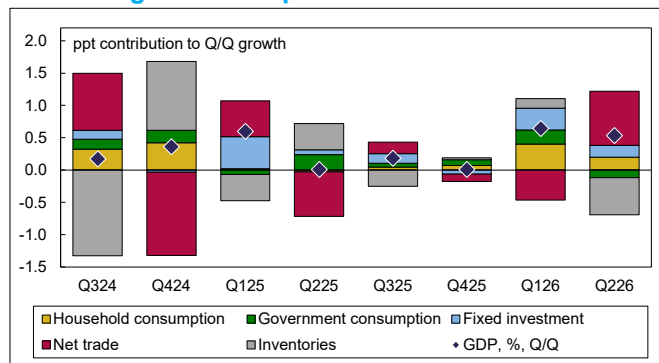
Thursday will bring euro area labour market figures for August. We expect the unemployment rate to hold steady at 6.4%, just 20bps above the series low. Tomorrow will also bring the final manufacturing PMIs for September. The flash release saw the euro area manufacturing output index rise to 53.4, its highest level since February 2022, with growth in new orders similarly the strongest in 4½ years. The pickup in the euro area figure this month reflected improvements beyond the two largest member states, with tomorrow's survey to provide additional detail on Italy, Spain and the Netherlands. Despite edging slightly lower from August, the flash German PMIs pointed to one of the strongest expansions in manufacturing activity since early 2022, contrasting still subdued conditions in France. In terms of inflationary pressures, the final survey is expected to reaffirm signals of a marked increase in input cost inflation but only a modest rise in output price inflation.

UK

GDP growth in Q2 revised up with welcome strength in exports & business capex

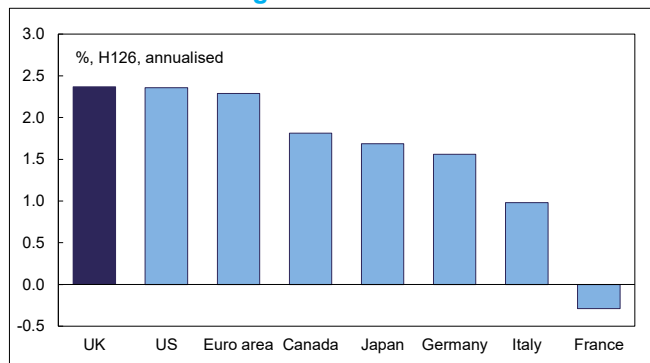
Today's updated national accounts revised up GDP growth in Q2 by 0.1ppt to 0.5%Q/Q (2.1%Q/Q annualised). While that rate was 0.1ppt softer than in Q1, it confirmed that the UK was (by an admittedly slight margin) the strongest growing of all G7 nations over the first half of the year. While first-quarter growth was driven by domestic demand, last quarter's expansion was led by net trade, which made its largest contribution (+0.8ppt) since Q324. As a result, the underlying trade deficit (i.e. excluding precious metals) narrowed to just 0.5% of GDP. Import volumes were effectively unchanged on the quarter. But with solid growth in shipments of goods (3.7%Q/Q, up from the flat initial estimate) and services (2.0%Q/Q), total export volumes rose the most in five quarters (2.8%Q/Q). Given repeated weakness over recent years, however, goods exports remained below their level at the time of the Brexit referendum in Q216, while services exports were more than 38% above their equivalent benchmark, illustrating the wide gulf in relative trade performance of the two sectors over the past decade. Meanwhile, despite higher energy prices, final private domestic demand was also firm (+0.4ppt). Supported by a pickup in real disposable incomes, household consumption rose for a fourth successive quarter. And business capex jumped 1.8%Q/Q to be up 5.2%Y/Y, the strongest annual rate in five quarters. The vigorous upwards trend in business capex of the past two years now contrasts markedly with the persistent lull of the eight years following the Brexit referendum. Finally, government consumption and particularly inventories subtracted from growth in Q2. On the output side, growth was driven by services (0.6%Q/Q) particularly in ICT-related activities suggestive of a boost from AI-related activity. Construction, manufacturing and mining also made a positive contribution, but utilities contracted. Given the strength in the monthly data published so far, we currently forecast another quarter of GDP growth of 0.5%Q/Q in Q3 before a moderation in Q4. That, however, should take full-year GDP growth in 2026 to about 1.4%Y/Y, which would mark the best year since 2022.

UK: GDP growth & expenditure contributions



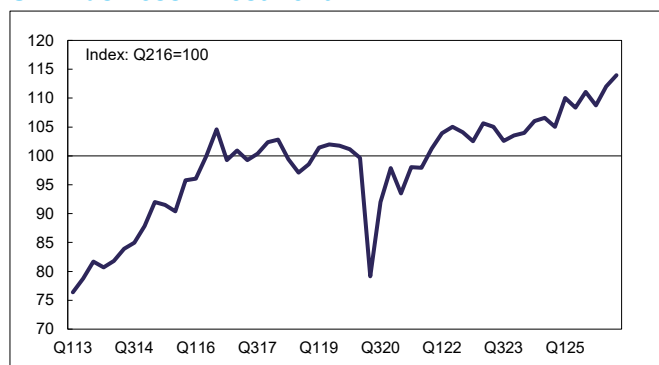
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

G7 members: GDP growth in 1st half of 2026



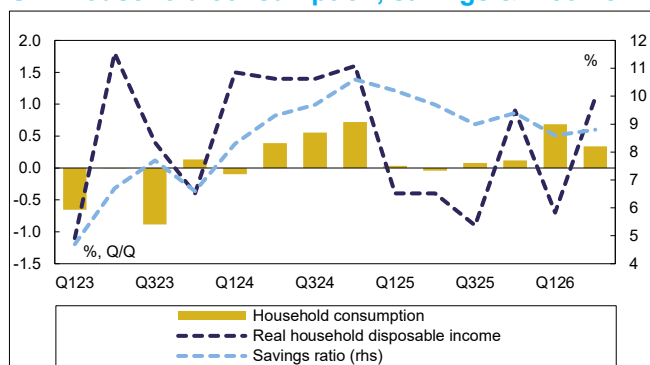
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Business investment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Household consumption, savings & income

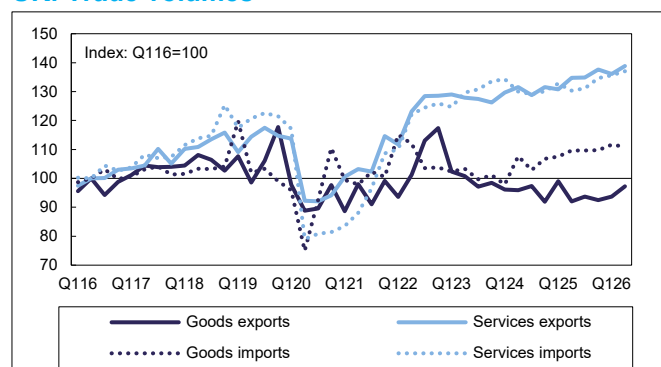


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

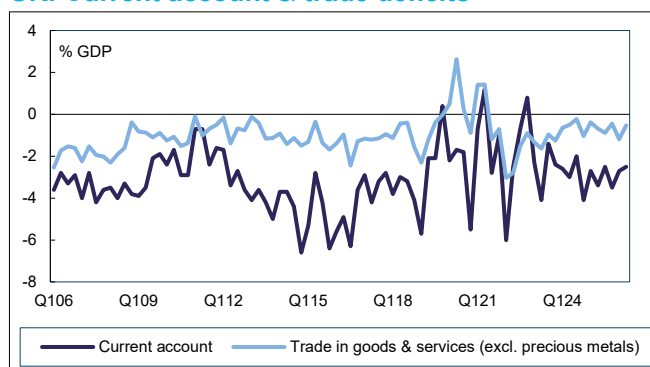
Thursday will bring the Nationwide house price index for September. With surveys suggesting weakening buyer demand in the face of higher borrowing costs and persisting uncertainty, prices are expected to have moved sideways (at best), which would push the annual rate down to 1.3%Y/Y, the softest since February. Meanwhile, in contrast to the euro area but in line with the flash estimate, the final UK manufacturing PMIs are expected to point to the slowest pace of expansion in the sector for six months in September (51.4). Nevertheless, the preliminary release suggested that order backlogs rose to their highest level since the start of 2022, while new orders continued to increase modestly amid resilient domestic demand. Meanwhile, although the preliminary release indicated little change in cost pressures this month, persistently elevated wholesale energy prices might suggest upside risks to the signals on selling prices.

UK: Trade volumes



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Current account & trade deficits



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	Retail sales M/M% (Y/Y%)	Aug	1.3 (-0.4)	1.5 (-1.2)	-3.4 (-2.4)	-3.2 (-2.2)
	Import prices M/M% (Y/Y%)	Aug	1.0 (8.3)	0.5 (7.8)	0.2 (6.8)	-
	Unemployment claims rate % (change 000s)	Sep	6.4 (12)	6.4 (2)	6.4 (4)	- (5)
	Preliminary HICP (CPI) Y/Y%	Sep	3.3 (3.3)	3.2 (3.1)	2.9 (2.9)	-
France	Preliminary HICP (CPI) Y/Y%	Sep	3.4 (3.0)	3.1 (2.8)	2.6 (2.4)	-
	PPI Y/Y%	Aug	4.8	-	3.4	3.5
	Consumer spending M/M% (Y/Y%)	Aug	-0.5 (0.8)	-	0.5 (1.4)	0.4 (1.3)
Italy	Istat consumer confidence indicator	Sep	91.2	94.4	94.5	-
	Istat economic (manufacturing) confidence indicator	Sep	95.9 (91.9)	-	96.9 (89.9)	97.0 (90.2)
	Preliminary HICP (CPI) Y/Y%	Sep	4.1 (4.2)	3.7 (3.7)	3.2 (3.3)	-
UK	GDP - final estimate Q/Q% (Y/Y%)	Q2	0.5 (1.4)	<u>0.4 (1.2)</u>	0.6 (0.8)	-
	GDP - private consumption Q/Q%	Q2	0.3	<u>0.3</u>	0.6	-
	GDP - government spending Q/Q%	Q2	-0.5	<u>-0.3</u>	1.3	-
	GDP - fixed investment Q/Q%	Q2	0.9	<u>1.2</u>	0.4	-
	GDP - exports (imports) Q/Q%	Q2	2.8 (0.0)	<u>0.5 (0.5)</u>	0.2 (1.4)	-
	Current account balance £bn	Q2	-19.9	-25.5	-22.1	-21.1

Auctions

Country	Auction
Germany	sold €4.18bn of 3% 2036 bonds at an average yield of 3.58%

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		09.00	Final manufacturing PMI	Sep	<u>52.7</u>	52.7
		10.00	Unemployment rate %	Aug	6.4	6.4
Germany		08.55	Final manufacturing PMI	Sep	<u>53.8</u>	54.3
France		08.50	Final manufacturing PMI	Sep	<u>50.3</u>	51.1
Italy		08.45	Manufacturing PMI	Sep	50.0	49.6
Spain		08.15	Manufacturing PMI	Sep	50.2	49.5
UK		07.00	Nationwide house prices M/M% (Y/Y%)	Sep	0.0 (1.3)	0.2 (1.6)
		09.30	Final manufacturing PMI	Sep	<u>52.0</u>	51.7

Auctions and events

Euro area		10.30	Bundesbank President Nagel & former Banque de France Governor Villeroy to speak at an event in London		
		14.30	ECB President Lagarde to deliver opening remarks and chair panel at the ESRB's 10 th annual conference in Frankfurt		
France		09.50	Auction: to sell up to €12bn of 3.7% 2036, 3.8% 2037, 1.25% 2038 & 2% 2048 bonds		
Spain		09.30	Auction: to sell bonds 1.45% 2029, 3.4% 2036, 2.9% 2046 bonds & 1.15% 2036 inflation-linked bonds		
UK		09.00	BoE Governor Bailey to give opening remarks to a BoE conference on the Future of Money in London		
		13.00	MPC's Mann to deliver a speech in London		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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