

Euro wrap-up

Overview

- While euro area inflation rose above expectations to a three-year high and French and Italian bonds initially extended their sell-off, all euro area govies ended the day higher on news of a release of strategic European diesel reserves.
- Gilts also made gains as a BoE survey reported that business inflation and wage expectations remain relatively well anchored.
- The coming week will bring updates on euro area retail sales and German factory orders and production.

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Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	3.046	-0.011
OBL 2.9 10/31	3.213	-0.042
DBR 3 08/36	3.447	-0.058
UKT 4 05/29	4.804	+0.005
UKT 4½ 03/31	4.898	-0.011
UKT 4¾ 07/36	5.356	-0.040

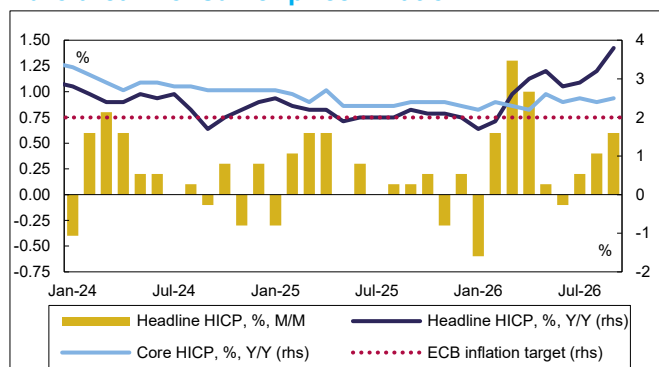
*Change from close as at 4:30pm BST.
Source: Bloomberg

Euro area

Headline inflation rises above expectations to 3-year high

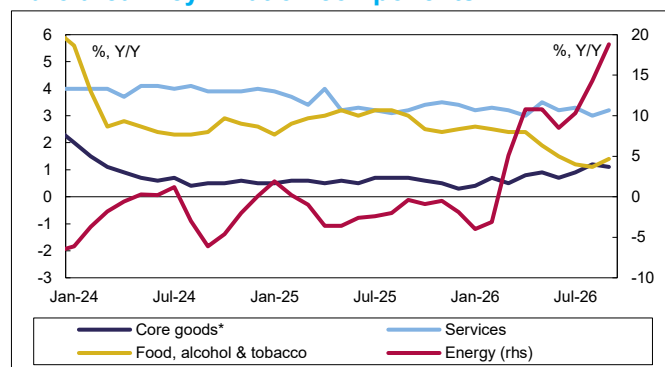
Like the [figures](#) from the largest member states, the flash estimate of euro area inflation in September beat expectations, with the headline HICP rate rising 0.6ppt to a three-year high of 3.8%Y/Y. Four fifths of the increase was due to higher energy prices, which rose the most in any month since March at the onset of the war in Iran to be up 18.8%Y/Y, as household utility bills increased alongside a surge in auto fuel prices. However, having surprised on the downside over recent months, prices of unprocessed food responded to the summer drought and higher input costs, rising the most since January and in any September since 2022. So, while prices of processed items remained well-behaved, the broader category of food, alcohol and tobacco rose 0.3ppt to a three-month high (1.4%Y/Y). Meanwhile, having surprised on the downside the prior month in part due to softness in the volatile holiday-related items, services inflation rose 0.2ppt to 3.2%Y/Y, still nevertheless 0.3ppt below the year's high for the category. Reassuringly, core goods inflation eased back slightly from the prior month's 2½-year high to remain relatively subdued (1.1%Y/Y). Nevertheless, core inflation rose 0.1ppt to 2.5%Y/Y, just below May's peak for the year. And we expect it to edge up a little further by year-end. More significantly, while European wholesale diesel prices fell back today on the planned release of strategic reserves, continued increases in energy and food inflation are now highly likely to push headline inflation up to 4.0%Y/Y or above this quarter.

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Key inflation components



*Non-energy industrial goods.

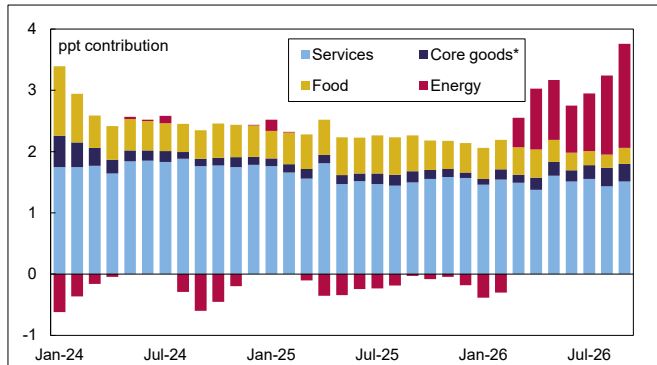
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

ECB won't raise rates this month as French turmoil provides significant tightening

With wholesale energy futures curves close to its adverse scenario, the ECB's September projections suggested that inflation might remain above target over the horizon in the absence of policy adjustment or new shocks. But since those projections were published little more than three weeks ago, bond markets have indeed delivered a shock to certain member states via a tightening of financial conditions. At one stage today, 2Y and 10Y French sovereign yields rose more than 55bps and 60bps respectively over their levels ahead of the ECB's rate hike last month, with their spreads over equivalent Bunds briefly above 80bps at the 2Y maturity and 150bps at the 10Y maturity. Thankfully, the announcement of the release of diesel reserves calmed nerves somewhat, allowing all euro govies to make gains before the close. But absent a substantive peace deal in the Middle East, there appears little chance of a lasting reversal of the adverse momentum. The ECB will not adjust its quantitative normalisation policy, whereby its sovereign debt holdings acquired for monetary policy purposes are redeemed at maturity without reinvestment. And the use of the ECB's Transmission Protection Instrument (TPI) or Outright Monetary Transactions, which could provide temporary secondary market purchases, would require the agreement and implementation of a more ambitious French fiscal adjustment programme than announced in yesterday's [budget plan](#). With the negotiation and legislation of any new French fiscal policy complicated by the populist-dominated and split National

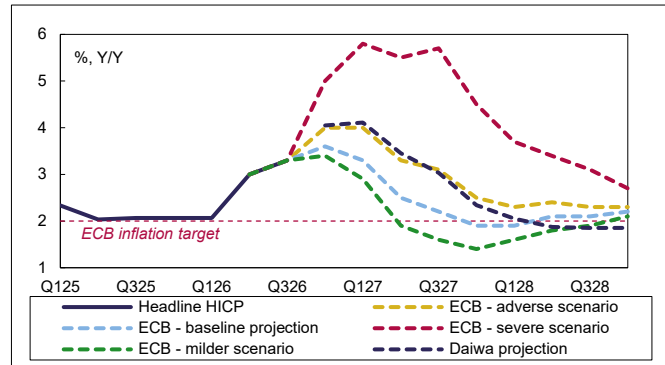
Assembly as well as the approaching Presidential election – not to mention the credibility challenge posed by Lagarde's nationality and determination to leave her post early – the ECB will not come to rescue the OAT market unless and until spreads of France and several other member states are much wider than current levels. Nevertheless, given the recent tightening of financial conditions, the Governing Council will likely refrain from raising rates again this month despite the upside surprise to the September inflation print. Instead, they will wait to see how events unfold in European markets and in the Middle East, and also consider updated projections in December before deciding whether to tighten once more.

Euro area: Contribution to headline inflation



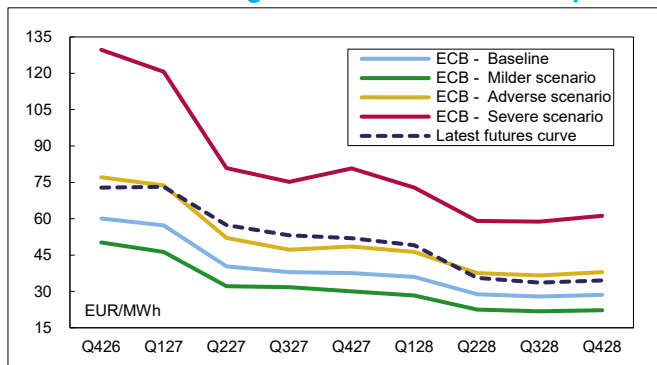
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB inflation projections



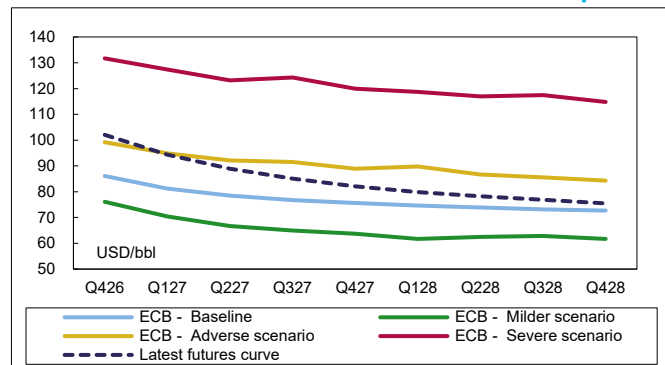
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Natural gas futures & ECB assumptions



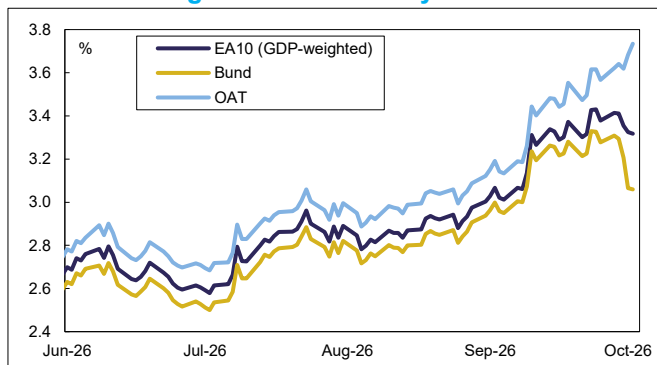
Source: ECB Sep-26, Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Brent crude futures & ECB assumptions



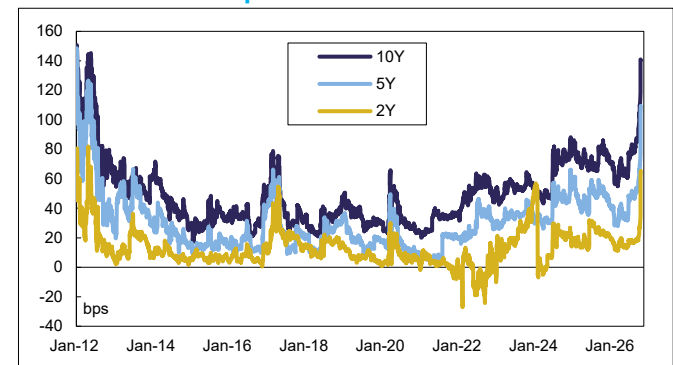
Source: ECB Sep-26, Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: 2Y government bond yields



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

Euro area: OATs spreads to Bunds



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

While French and Italian bond markets are likely to remain in focus, the coming week's euro area data releases should shed further light on how economic activity fared over the summer as cost pressures intensified. Euro area retail sales figures (Tuesday) are expected to suggest that goods consumption remained relatively subdued in August. Indeed, while German sales volumes rebounded in August (1.3% M/M) they continued to trend below the Q2 level. And sales in France fell sharply (-1.1% M/M) reflecting a marked decline in fuel sales. As such, we expect euro area sales volumes to rise only minimally to be similarly tracking slightly below their Q2 average. In Germany, August data for factory orders (Tuesday), manufacturing and construction output (Wednesday) and goods trade (Thursday) will provide an update on industrial momentum. While new factory orders may have eased back after solid growth over the previous three months, industrial production is expected to rise for the first time in three months. Nevertheless, we expect higher energy costs and low Rhine water levels to have

weighed on output in certain subsectors. French and Spanish industrial production data (both Tuesday) and the Italian release (Friday) are also due.

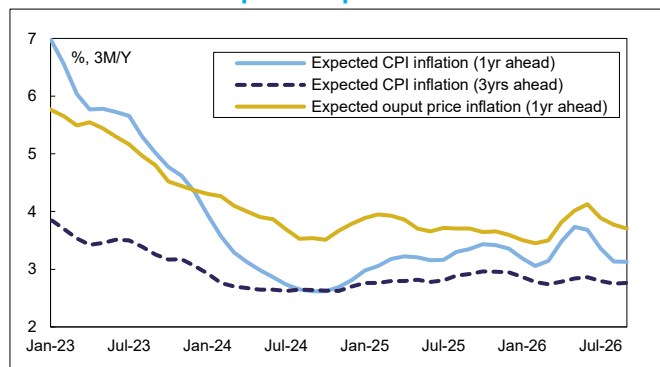
Survey-wise, the final services PMIs for September (Monday) will provide an update on economic momentum at quarter-end. The flash results signalled an acceleration, with the services activity index jumping to a 10-month high (53.0). And given the ongoing uptrend in manufacturing, the composite output index rose more than 1pt to 53.1, the highest level since April 2023. Moreover, the composite new orders index suggested the strongest demand growth in more than four years. In contrast, the construction PMIs (Tuesday) will likely point to continued underperformance despite stronger civil engineering activity in Germany. And the Sentix investor indices (Monday) may signal a deterioration in sentiment at the start of Q4 as heightened geopolitical uncertainty and French market stress weighed. Finally, in terms of inflation, euro area PPI data for August (Monday) will show that energy-related cost pressures continued to build, but broader pass-through along the supply chain is likely to have remained limited.

UK

Firms' inflation and wage expectations remain well anchored despite spike in energy prices

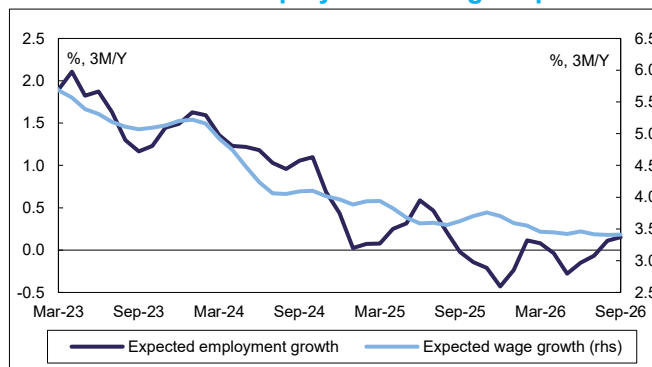
While the BoE left Bank Rate unchanged at 3.75% in September, its communication struck a much more hawkish tone, leaving the door firmly open to a rate hike at the November meeting. Several MPC members who voted to keep policy on hold, including Governor Bailey, have since cautioned that the Committee will not be able to wait for clear evidence of second-round effects to materialise before deciding whether further tightening is required. And external MPC member Catherine Mann, who backed a 25bps rate hike at each of the past two meetings, today reiterated her view that the tightening in financial conditions since the start of the Iran conflict – with 2Y Gilt yields up almost 125bps since end-February – is insufficient on its own to contain inflationary risks. Nevertheless, policymakers might take some comfort from the latest BoE Decision Maker Panel survey, which suggested that firms' inflation and wage expectations remained relatively well anchored despite the renewed spike in wholesale energy prices. Indeed, business expectations for output price inflation over the coming year moderated again in the three months to September to the lowest in six months (3.7%3M/Y), while expectations for CPI inflation 12 months ahead held steady to match the lowest rate since February (3.1%3M/Y). Moreover, while inflation expectations at the three-year horizon – which arguably matter more for policy making – edged higher in September (by 0.2ppt to 2.9%Y/Y), this was merely in line with the average in the 12 months before the onset of the Iran war. And with firms reporting ongoing declines in headcount and profit margins remaining under pressure, forward-looking wage expectations moved sideways in the three months to September (3.4%3M/Y), suggesting that the risks of second-round effects via pay remain contained.

UK: DMP – Firms' price expectations



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

UK: DMP – Firms' employment & wage expectations*



*1yr ahead. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the UK

It should be a relatively quiet week for top-tier UK economic releases, kicking off on Monday with the final services PMIs for September. The flash survey showed the headline activity index (51.7) moderating to a three-month low as domestic and overseas demand softened. Together with the slowdown in manufacturing, the composite output index (51.7) was also the lowest since June, consistent with a modest loss of momentum heading into quarter-end as cost pressures intensified. While unseasonably warm weather may have provided some support to activity in September, the construction PMI (Tuesday) is expected to remain well below the key 50 mark, with rising material costs and tighter financial conditions continuing to weigh on demand. The latest RICS residential survey (Thursday) is also expected to confirm that homebuyer demand remained subdued at the end of Q3, with limited new supply and ongoing downward pressure on house prices. With swap rates having risen sharply over recent months and geopolitical uncertainty remaining elevated, the BoE's quarterly credit conditions survey (Thursday) is expected to show that lending standards tightened further in Q3 and are set to tighten again in Q4. And while credit flows to households and businesses have held up over the summer, lenders may anticipate weaker demand over coming months. The coming week will also bring September new car registration figures and the REC/KPMG report on jobs.

Daiwa economic forecast

		2026				2027		2026	2027	2028
		Q1	Q2	Q3	Q4	Q1	Q2			
GDP		%, Q/Q						%, Y/Y		
Euro area		0.0	0.6	0.2	0.3	0.3	0.4	1.0	1.3	1.4
UK		0.6	0.5	0.5	0.2	0.5	0.3	1.4	1.5	1.4
Inflation, %, Y/Y										
Euro area										
Headline HICP		2.0	3.0	3.3	4.0	4.0	3.4	3.1	3.2	1.9
Core HICP		2.3	2.4	2.4	2.6	2.8	2.7	2.4	2.7	2.2
UK										
Headline CPI		3.1	2.8	3.1	3.6	3.9	3.4	3.1	3.2	1.7
Core CPI		3.2	2.5	2.6	2.8	3.0	3.0	2.8	2.9	2.4
Monetary policy, %										
ECB										
Deposit Rate		2.00	2.25	2.50	2.75	3.00	3.00	2.75	3.00	2.50
Refi Rate		2.15	2.40	2.65	2.90	3.15	3.15	2.90	3.15	2.65
BoE										
Bank Rate		3.75	3.75	3.75	4.00	4.00	4.00	4.00	4.00	3.50

Source: Bloomberg, ECB, BoE 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
Euro area		Preliminary headline (core) HICP Y/Y%	Sep	3.8 (2.5)	<u>3.7 (2.5)</u>	3.2 (2.4)	-
Italy		Retail sales M/M% (Y/Y%)	Aug	0.3 (0.3)	-	-0.4 (0.8)	- (1.0)
Spain		Unemployment change (employment net change) 000s	Sep	23.6 (108.8)	-	44.4 (83.8)	-
UK		DMP – 1Y ahead output price (CPI) expectations 3M/Y%	Sep	3.7 (3.1)	3.7 (3.2)	3.8 (3.1)	-
Auctions							
Country		Auction					
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's calendars

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 5 October 2026					
Euro area		09.00 Final composite (services) PMI	Sep	<u>53.1 (53.0)</u>	52.0 (51.6)
		09.30 Sentix investor confidence indicator	Oct	4.5	5.1
		10.00 PPI M/M% (Y/Y%)	Aug	1.8 (7.0)	1.6 (5.8)
Germany		08.55 Final composite (services) PMI	Sep	<u>53.8 (52.9)</u>	51.8 (49.7)
France		08.50 Final composite (services) PMI	Sep	<u>51.2 (51.4)</u>	48.5 (48.0)
Italy		08.45 Composite (services) PMI	Sep	-	53.6 (55.2)
Spain		08.15 Composite (services) PMI	Sep	-	55.8 (57.8)
UK		09.00 New car registrations Y/Y%	Sep	-	13.7
		09.30 Final composite (services) PMI	Sep	<u>51.7 (51.7)</u>	52.5 (52.5)
Tuesday 6 October 2026					
Euro area		08.30 Construction PMI	Sep	-	43.0
		10.00 Retail sales M/M% (Y/Y%)	Aug	0.1 (1.0)	-0.6 (0.6)
Germany		07.00 Factory orders M/M% (Y/Y%)	Aug	-1.0 (13.1)	2.5 (13.1)
		08.30 Construction PMI	Sep	-	48.7
France		07.45 Industrial production M/M% (Y/Y%)	Aug	0.3 (1.3)	-0.4 (-0.5)
		08.30 Construction PMI	Sep	-	37.3
Italy		08.30 Construction PMI	Sep	-	41.7
Spain		08.00 Industrial production M/M% (Y/Y%)	Aug	-0.5 (2.4)	0.6 (2.3)
UK		09.30 Construction PMI	Sep	-	44.3
Wednesday 7 October 2026					
Germany		07.00 Industrial production M/M% (Y/Y%)	Aug	0.4 (0.7)	-1.1 (-1.6)
France		07.45 Trade balance €bn	Aug	-	-6.7
Thursday 8 October 2026					
Germany		07.00 Trade balance €bn	Aug	19.0	21.1
UK		00.01 RICS house price balance %	Sep	-30	-28
Friday 9 October 2026					
Italy		09.00 Industrial production M/M% (Y/Y%)	Aug	-	0.7 (0.0)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 5 October 2026		
- Nothing scheduled -		
Tuesday 6 October 2026		
Euro area		14.00 ECB's Cipollone scheduled to speak at MNI event
Germany		10.30 Auction: to sell up to €6.0bn of 2028 bonds
UK		10.00 Auction: to sell up to £1.25bn of 1.125% 2035 linker bonds
		10.00 MPC's Mann to participate in fireside chat in London
		16.30 MPC's Taylor to deliver a lecture on "Expectations and the risk of inflation persistence" in London
Wednesday 7 October 2026		
Germany		10.30 Auction: to sell up to €4.0bn of 2033 bonds
UK		10.00 Auction: to sell up to £1.0bn of 0.125% 2028 bonds
Thursday 8 October 2026		
Euro area		12.30 ECB to publish monetary policy account of 09-10 September meeting
UK		00.01 REC/KMPG Report on Jobs
		09.30 BoE to publish quarterly Credit Conditions Survey
		10.15 BoE's Green scheduled to give speech in South Africa
		11.30 BoE Chief Economist Pill scheduled to give speech in London
		13.15 BoE Governor Bailey scheduled to give speech in Turkey
		14.00 BoE Deputy Governor Lombardelli scheduled to give speech in Coventry
Friday 9 October 2026		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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