

Euro wrap-up

Overview

- While German producer price inflation jumped more than expected and euro area construction data showed output rising to a 10-month high, Bunds made gains on optimism regarding Middle East peace talks.
- Gilts were mixed with shorter-dated maturities making losses as the UK labour market showed signs of stabilisation.
- Wednesday will bring UK CPI inflation and public finance figures.

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Daily bond market movements

Bond	Yield	Change
BKO 3.0 12/28	3.072	-0.032
OBL 2.9 10/31	3.194	-0.044
DBR 3 08/36	3.397	-0.055
UKT 4 05/29	4.954	+0.031
UKT 4½ 03/31	5.030	+0.022
UKT 4¾ 07/36	5.409	-0.022

*Change from close as of 5.00pm BST.

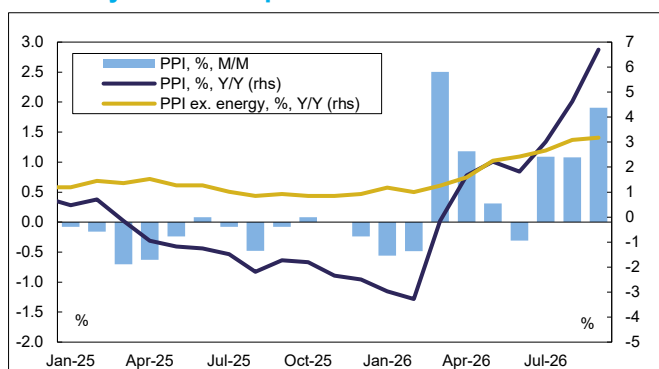
Source: Bloomberg

Euro area

German producer prices jump on renewed energy cost pressures

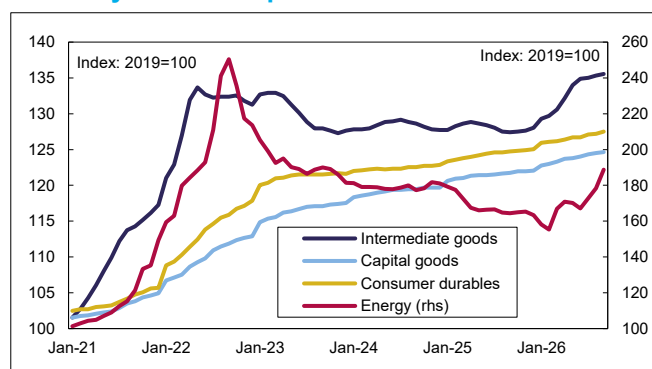
With German consumer price inflation already at its highest level in almost three years, today's producer price figures offered a further warning of mounting pipeline pressures as the renewed surge in wholesale energy costs over the summer fed through to manufacturers. Factory prices rose a steeper-than-expected 1.9%M/M in September, to be up 6.7%Y/Y, the most since March 2023, and 8% since the start of the conflict at end-February. Producer energy prices rose a further 5.8%M/M to be 22% higher than at the start of the conflict. And refined petroleum product prices were up almost 50% over the same period. For now, however, evidence of broader pass-through of these energy pressures remained relatively limited. Indeed, the monthly rise in non-energy producer prices was modest at just 0.1%M/M, to leave core PPI inflation (excluding energy) at 3.1%Y/Y, less than half the headline rate. Admittedly, while they rose just 0.2%M/M, intermediate goods prices were still up 6.4%Y/Y, the strongest rate since February 2023, providing evidence of spillovers from higher energy costs. While much of this reflected pressure in energy-intensive sectors such as chemicals and basic metals, ICT-related price pressures also remained notably firm, with such prices rising for a 16th successive month and producer prices of electronic integrated circuits up 25%Y/Y.

Germany: Producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Producer price levels

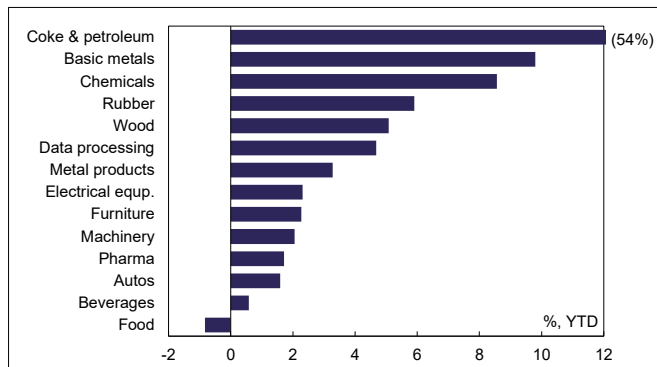


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Underlying price pressures remain contained for now, but food prices starting to turn higher

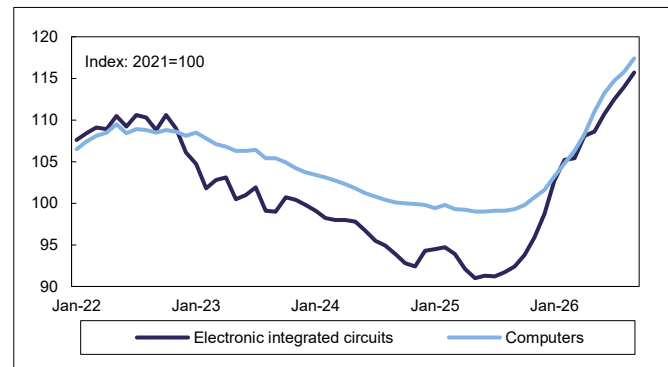
Among the other major categories, capital goods prices remained relatively well-behaved, rising 0.1%M/M in September and just 1.3% cumulatively since February. While this left the annual rate unchanged at 2.4%Y/Y, there was also further evidence of AI-related price pressures, with producer prices of computers rising 18%Y/Y respectively. Meanwhile, producer prices of consumer durables were up just 1.1% since February and 2.2%Y/Y. And encouragingly for households, producer prices of consumer non-durables were still down almost 2%Y/Y, thanks to a substantive ongoing drag from food (-3.5%Y/Y). But there were tentative signs that this disinflationary impulse is beginning to fade. Food prices rose for a second successive month in September (0.3%M/M), due not least to higher meat prices, potentially reflecting increased costs for prepared animal feed. And with the effects of the summer drought and higher energy costs likely to feed through only gradually, we expect food inflation to turn increasingly higher towards the new year. Indeed, while the impact will vary across the region, ECB staff estimate that higher energy and weather-related costs could add between 0.3-0.8ppt to euro area consumer food inflation over the next year.

Germany: YTD change in producer prices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: AI-related producer prices

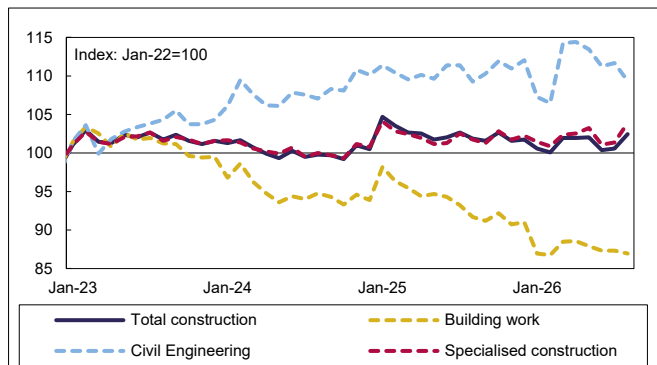


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area construction rose to a 10-month high in August, but merely tracking sideways in Q3

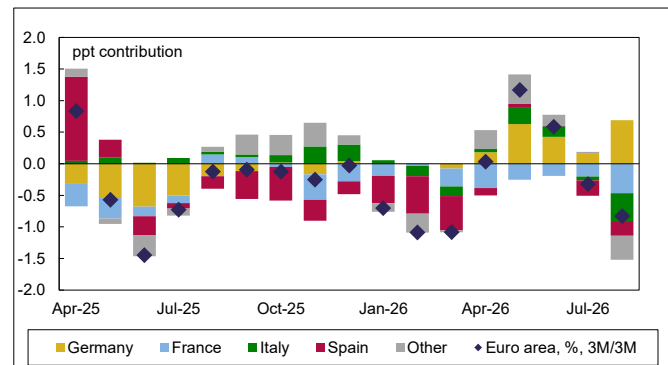
Despite higher costs of materials and borrowing, today's euro area construction data suggested that output in the sector held up relatively well in the middle of Q3. Total activity rose a stronger-than-expected 1.8%M/M in August, the most since March, to reach the highest level in ten months. But there remains significant contrasts between countries and subsectors. Indeed, the strong growth in August principally reflected a surge in German specialised work (13.2%M/M) to the highest level since end-2020. As a result, total German construction output rose 9.3%M/M. But reflecting weakness in the Netherlands, Belgium and possibly Italy, building work in the euro area as a whole failed to grow for a fourth consecutive month (-0.4%M/M). And due to a substantial decline in Spain and Austria, civil engineering activity in the euro area fell (-2.1%M/M) to the lowest level since February despite a further increase in Germany to a new record high in August. And notwithstanding a marked deterioration in the construction PMIs in September, the construction sector in the largest member state appears on track to provide a meaningful boost to GDP growth in Q3. In contrast, given the negative carryover from weakness in June, quarterly construction growth elsewhere in the region looks to have been weak. Indeed, total euro area construction activity fell 0.8%3M/3M in August and likely provided a negligible contribution to GDP growth in Q3.

Euro area: Construction output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output by member state



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

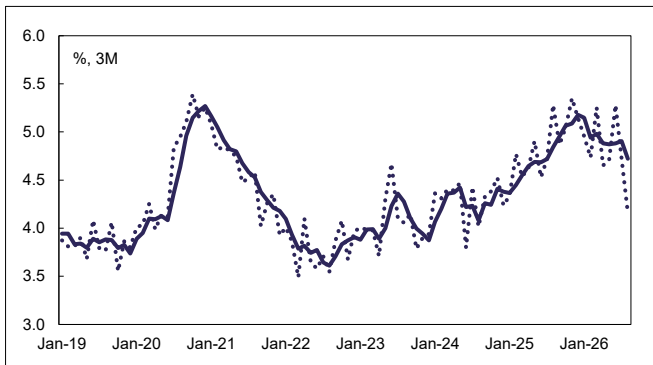
ECB President Lagarde and Chief Economist Lane will be among the senior ECB figures with public appearances on Wednesday. Meanwhile, quarterly government debt and deficit statistics for Q2 might also be of interest given the heightened attention on France's woeful fiscal situation. However, with no timelier data otherwise due, it should be a relatively quiet day ahead for the euro area.

UK

Signs of stabilisation in labour market support case for a BoE rate hike

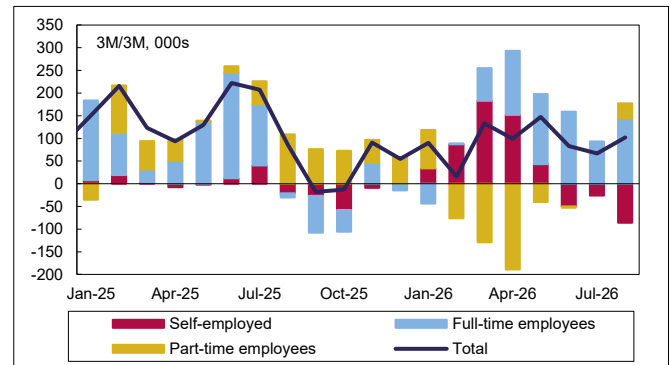
Today's labour market report provided further evidence that stronger economic growth since the start of the year is supporting a stabilisation in the jobs market, giving further cover to the BoE to raise rates in November. Most strikingly, having risen close to its pandemic peak in December 2025, the unemployment rate fell 0.2ppt in the three months to August to a 14-month low of 4.7%, some 0.3ppt below the BoE's late-July projection. And, while notoriously volatile, the single-month rate dropped a sharp 0.5ppt to a two-year low of 4.2%. Some of this reflected workers leaving the labour force over the summer. But the LFS also reported another sizeable increase in employment in the three months to August (102k), while full-time employment rose by the most in 14 months (170k). Admittedly, the HMRC payroll measure remained weaker, cumulatively falling by 111k over the same period. But here too there were signs that the worst may have passed. Indeed, the initially reported decline in August (-27k) was revised away to mark the first rise in seven months, and preliminary figures for September brought the largest increase in payrolls in more than a year (12.7k). And while job vacancies fell again in September to suggest that labour demand remains relatively subdued, the weakness was disproportionately concentrated among smaller firms, many of which have faced greater pressures on margins from the current energy shock than their larger counterparts. Nevertheless, the vacancies-to-unemployment ratio remained close to the bottom of its range of the past decade to suggest persisting slack in the labour market.

UK: Unemployment rate*



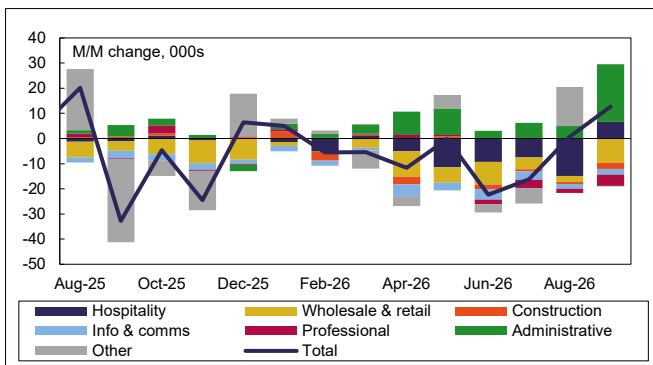
*Dotted line represents single-month series. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Employment growth



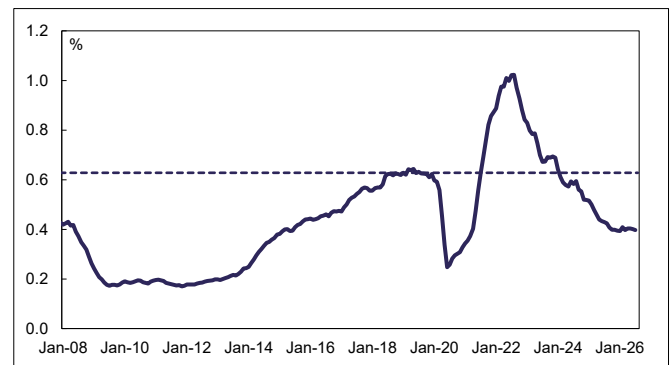
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employees



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Vacancies to unemployment ratio*



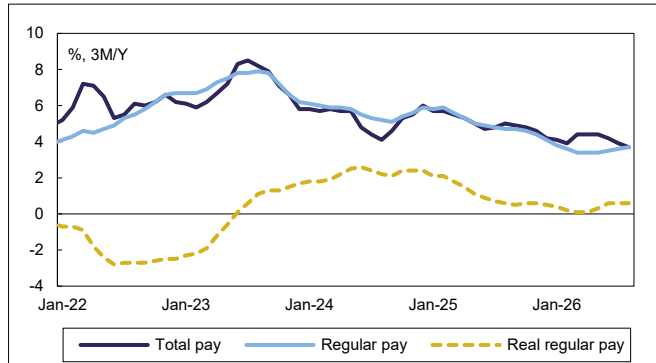
*Dashed line is 2019 average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Pay growth softest since November 2020, but underlying pay pressures starting to re-emerge?

At face value, today's figures suggested that the steady moderation in pay growth continued over the summer. Total wage growth fell a larger-than-expected 0.7ppt over the quarter to 3.7%3M/Y in August, the weakest rate since November 2020. However, the underlying picture was somewhat firmer. Excluding bonuses, regular pay growth rose for a third consecutive month to a seven-month high of 3.7%3M/Y. And while this uptrend over recent months principally reflected the impact on public sector pay from the timing of annual NHS settlements, private sector regular pay growth ticked higher for the first time since late-2024, albeit by just 0.1ppt to 3.0%3M/Y to be in line with the BoE's forecast for Q3. This rate remains well below its long-run average and at a level which, if sustained, might be consistent with an eventual return of inflation to target. Nevertheless, today's data also suggested that private sector pay momentum strengthened materially over the summer. Private sector regular wage growth accelerated to 4.5%3M/3M annualised, its strongest pace in 18 months, while total pay

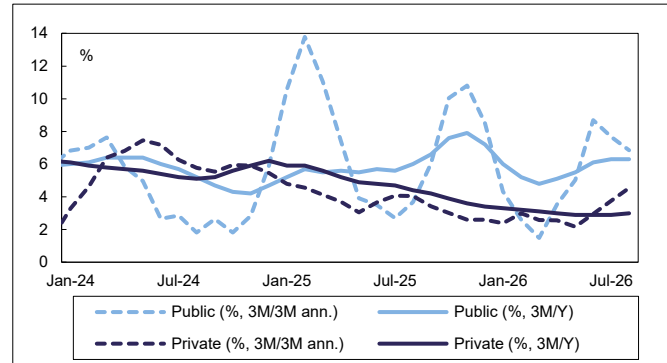
growth exceeded 5% on the same basis. Meanwhile, the squeeze on real incomes intensified, with total real pay growth slowing to a six-month low of 0.7%3M/Y and real wages falling 1.2%3M/3M annualised. With inflation also set to rise above 4%Y/Y by the start of next year, and signs that labour-market slack is starting to diminish, policymakers will be wary of the risk that workers will soon seek compensation for the renewed erosion of purchasing power.

UK: Nominal & real pay growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private & public regular pay growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

September's UK inflation report will provide the highlight of Wednesday's economic calendar. Perhaps unsurprisingly given the continued increase in retail fuel prices last month, a hotter CPI print is widely expected. Indeed, like Bloomberg's median forecast, we expect headline inflation to have risen for the third month in a row, to 3.4%Y/Y, up 0.3ppt from August. Such a reading would take inflation to a nine-month high, placing last quarter's rate in line with the BoE's adverse scenario which, alongside today's jobs data, will strengthen the argument of the MPC to tighten in November. Admittedly, most of September's jump should again be attributed to energy prices, with inflation in that category likely to report a 3½-year high. And we expect food inflation to rise from its near-five-year low to around 2%Y/Y, reflecting higher input costs and weather effects as already seen in the euro area. On the other hand, the stabilisation in the labour market will not have precipitated broader inflationary pressures in September. So, provided that AI-related pressures and indirect energy effects on certain volatile holiday-related services remain muted, we expect core inflation to merely move sideways at 2.6%Y/Y for a fifth consecutive month. But of course, given the persistence of the current energy shock, we suspect that BoE Governor Bailey – who is due to participate in a fireside chat on Wednesday – will continue to acknowledge that it is getting harder for the BoE to look through the high energy prices. Otherwise, September's public finances statistics will provide an update on this year's borrowing overshoot relative to the OBR's forecast, in part owing to higher debt interest costs, as well as a prelude for speculation ahead of next week's Budget announcement.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 ECB current account €bn	Aug	8.7	-	27.6	27.2
	 Construction output M/M% (Y/Y%)	Aug	1.8 (1.4)	-	0.0 (-2.0)	0.2 (-1.7)
Germany	 ZEW current situation (expectations) balance	Oct	-35.9 (28.1)	-44.5 (30.0)	-47.1 (34.7)	-
	 PPI M/M% (Y/Y%)	Sep	1.9 (6.7)	1.6 (6.3)	1.1 (4.6)	-
UK	 Average wages (excluding bonuses) 3M/Y%	Aug	3.7 (3.7)	3.8 (3.6)	3.9 (3.5)	- (3.6)
	 Private sector wages 3M/Y%	Aug	3.0	3.0	2.9	-
	 Unemployment rate 3M%	Aug	4.7	4.9	4.9	-
	 Employment 3M/3M change 000s	Aug	102	5	66	-
	 Payrolled employment M/M change 000s	Sep	13	-8	-26	1
	 Claimant count rate % (change 000s)	Sep	4.4 (30.3)	-	4.4 (27.8)	- (7.0)

Auctions

Country	Auction
Germany	 sold €498mn of 2.1% 2029 green bonds at an average yield of 3.08%
	 sold €494mn of 1.8% 2053 green bonds at an average yield of 3.79%
UK	 sold £4.25bn of 4.875% 2036 bonds at an average yield of 5.418%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
UK	 07.00	Headline (core) CPI Y/Y%	Sep	3.4 (2.6)	3.1 (2.6)
	 07.00	PPI – output (input) prices Y/Y%	Sep	4.4 (7.6)	3.7 (6.1)
	 07.00	Public sector net borrowing £bn	Sep	24.0	18.3
	 09.30	House price index Y/Y%	Aug	-	1.4

Auctions and events

Euro area	 10.00	Eurostat to publish Government financial accounts for Q226 and final deficit-debt statistics for 2025
UK	 14.00	BoE Governor Bailey to participate in a fireside chat on central bank independence in London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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