

# Euro wrap-up

## Overview

- While Lagarde confirmed her early departure from the ECB but signalled that rates are likely to rise in December after today's pause, Bunds followed the global trend higher.
- Gilts also made gains as UK mortgage lending and approvals slowed, but business lending and consumer credit remained resilient.
- Friday will bring flash estimates of euro area GDP in Q3 and October inflation from the large member states.

## Economic Research Team

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### Daily bond market movements

| Bond          | Yield | Change |
|---------------|-------|--------|
| BKO 3 12/28   | 3.068 | -0.053 |
| OBL 2.9 10/31 | 3.170 | -0.032 |
| DBR 3 08/36   | 3.353 | -0.015 |
| UKT 4 05/29   | 4.893 | -0.046 |
| UKT 4½ 03/31  | 4.950 | -0.042 |
| UKT 4½ 07/36  | 5.293 | -0.027 |

\*Change from close as at 5:00pm GMT.

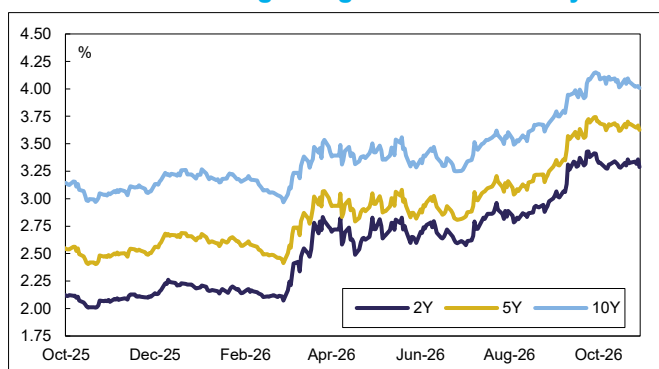
Source: Bloomberg

## Euro area

### ECB leaves rates unchanged but Lagarde warns “the direction of travel is quite clear”

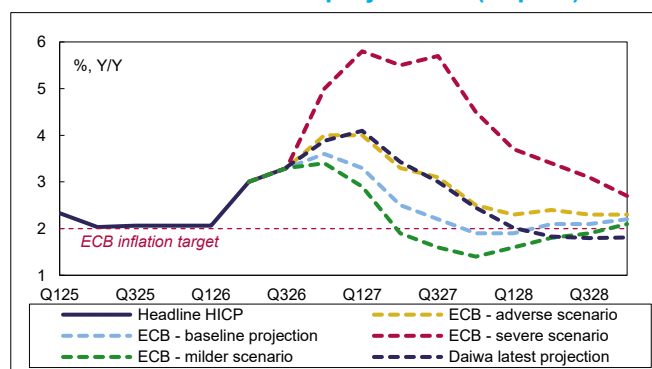
Having raised rates in June and September, as expected the ECB today left its monetary policy unchanged. So, the deposit rate was held at 2.50%, which before the energy shock was the upper end of its range of neutral estimates. And the Governing Council also maintained its quantitative tightening/normalisation policy, whereby its stock of APP and PEPP bond holdings continue to decline without reinvestment of the proceeds of maturing securities. The post-meeting statement appropriately flagged that the increased magnitude and duration of the energy price shock, which aligns much more closely to the ECB's 'adverse' scenario than its baseline projection, is likely to push inflation higher over the near term. And it also drew attention to the rising risks of indirect and second-round effects. But President Lagarde insisted in her press conference that there was no evidence yet of the latter effects crystallising to a material extent. The statement also cautioned that higher energy prices will weigh on growth. And Lagarde elaborated that the tightening of credit conditions reported in the ECB's Bank Lending Survey, as well as the significant rise in euro swap rates and average euro area govvie yields since its projections were finalised, not to mention the recent gapping out of French spreads, will also weigh on growth and inflation. So, while a possible rate hike was debated, the Governing Council's policy decision today was unanimous. Instead, all members preferred to await the December projections update and further information on activity, inflation and financial conditions before deciding whether to tighten again. Nevertheless, those projections and associated scenarios will likely confirm that inflation will rise above 4%Y/Y in Q1 and remain above target throughout 2028. And Lagarde noted today that “Unless there are major developments, the direction of travel is quite clear”. So, despite the recent widening of French spreads to Bunds close to euro crisis highs, we should still brace for a rate hike in December and possibly more tightening in Q127.

### Euro area: GDP-weighted government bond yields\*



\*Based on EA10. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Euro area: ECB inflation projections (Sep-26)



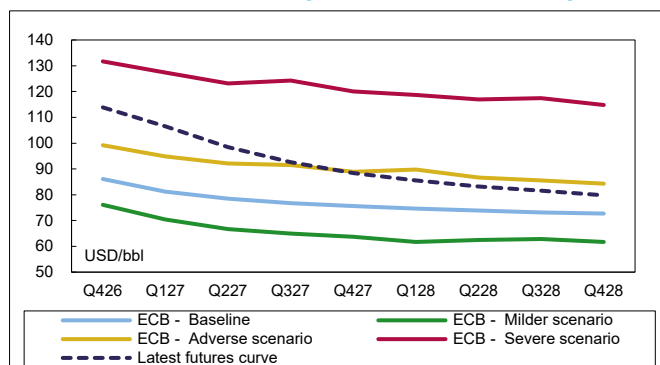
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

### Lagarde's departure in February unlikely to bring major changes to the ECB's reaction functions

While the policy announcement should have been today's focus, instead it was overlooked by the long-awaited confirmation by Lagarde that she will step down as ECB President immediately after the February Governing Council meeting, eight months before the end of her term. She confirmed that her decision reflected her desire to shed her obligation for neutrality and engage in the French political debate ahead of the Presidential elections in April and May. Certainly, the denial of leading candidates, particularly on either extreme of the political spectrum, to face up to the reality of the French fiscal position and the kind of policies required to correct it, merits a more forceful challenge. And, surprising as it might seem to some observers of recent events at the ECB, Lagarde herself ranks highly in opinion polls of the most popular French politicians.

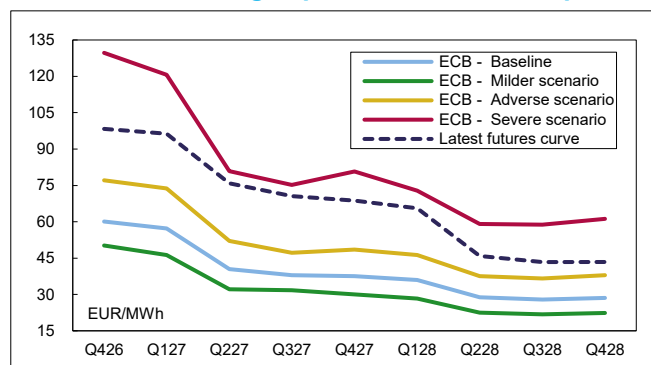
So, like certain other former ministers such as Dominique de Villepin, her contribution to the debate over coming months could be beneficial. In the meantime, successors to Lagarde and sooner-to-depart Executive Board member Schnabel, should be confirmed by EU Heads at the European Council meeting on 17-18 December. Our expectation is that the leaders' nod will be given to former Dutch National Bank Governor Klaas Knot, who recently set out his current views on ECB policy in a PIIE report that might reasonably be interpreted as his personal manifesto for the role. If so, he would be a credible choice and consistent with broad policy continuity. But the most likely alternative, BIS General Manager Pablo Hernández de Cos, would also be credible. And under the leadership of either candidate, additional tightening next year would be possible, while a reluctance to step into bond markets to support OATs without a further significant sell-off and marked shift in policy direction in France would be likely too.

### Euro area: Brent crude prices & ECB assumptions



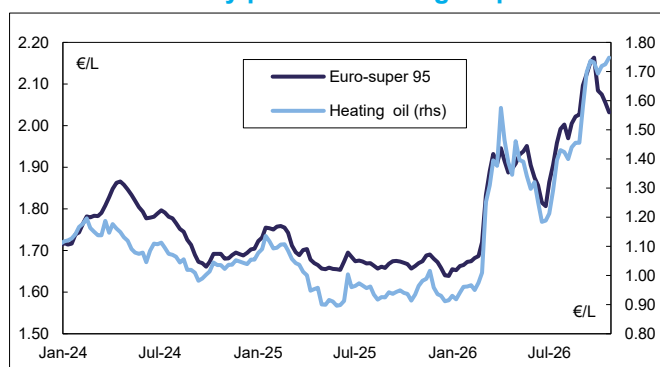
Source: ECB Sep-26 projections, Bloomberg and Daiwa Capital Markets Europe Ltd.

### Euro area: Natural gas prices & ECB assumptions



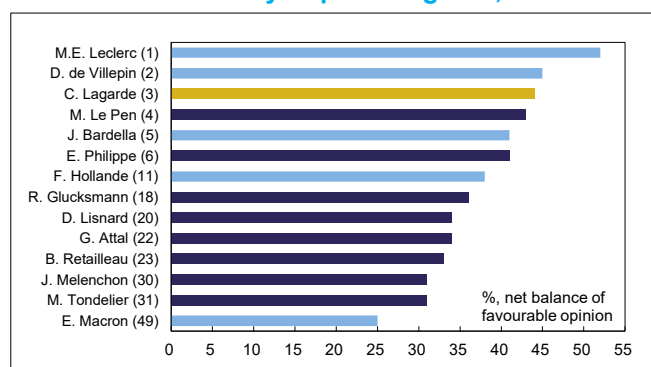
Source: ECB Sep-26 projections, Bloomberg and Daiwa Capital Markets Europe Ltd.

### Euro area: Weekly petrol & heating oil prices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### France: Favourability of public figures, Oct 2026

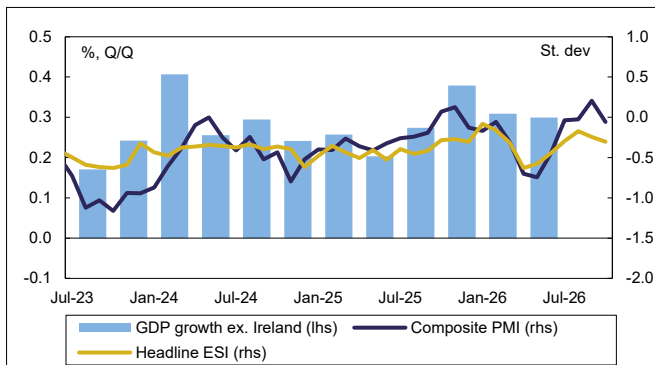


\*Bracketed numbers show ranking out of 50. Dark blue bars represent declared Presidential candidates. Light blue bars represent other public & political figures.  
 Source: ifop and Daiwa Capital Markets Europe Ltd.

## Euro area ESI falls to four-month low, with squeezed budget weighing on consumer demand

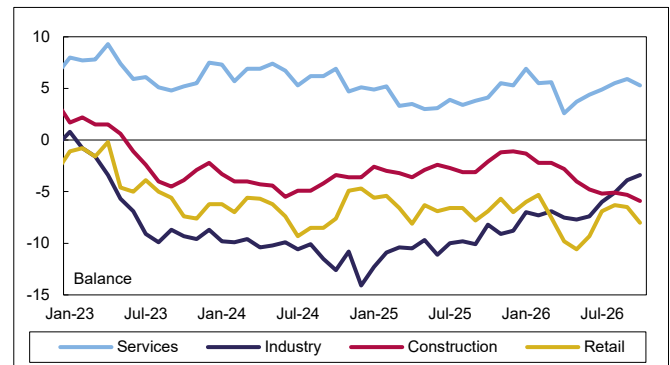
Consistent with last Friday's [flash PMIs](#), today's Commission survey results suggested that growth momentum in the euro area slowed at the start of Q4, as persistent geopolitical uncertainty, elevated energy prices and tighter financial conditions increasingly weighed on activity. The headline Economic Sentiment Indicator (ESI) fell for a second successive month in October to 96.9, the lowest level since June, leaving it 0.7pt below the Q3 level and some 3% below the long-run average. The deterioration partly reflected a weakening in consumer confidence to a five-month low, with a particularly marked decline in French household sentiment amid rising fuel prices, mounting concerns over fiscal sustainability and social unrest. But weakness in consumer confidence was widespread across the region. And while consumer price expectations eased slightly in October, they remained firmly above the long-run average. Moreover, firms signalled an intention to pass on higher costs over coming months. And expectations of a continued squeeze in household budgets left consumers' willingness to make major purchases at its lowest level since January 2024. Against this softer demand backdrop, retail confidence fell to its lowest level since June. Notwithstanding ongoing optimism in the information services subsector on continued AI-related activity, services firms assessed conditions to be the least favourable since July. And with higher borrowing and materials costs continuing to weigh on the sector, constructors were the most downbeat since 2020.

### Euro area: GDP growth & survey indices



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

### Euro area: Economic sentiment by sector

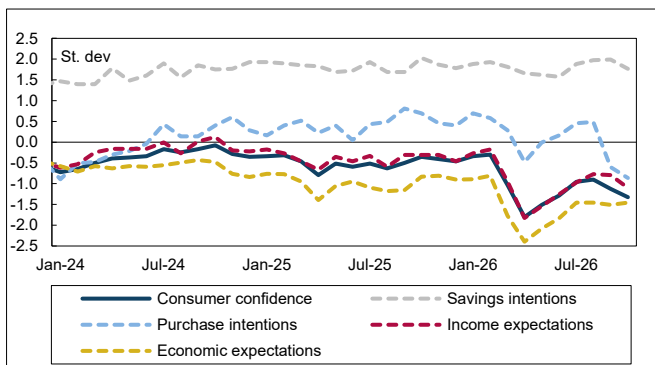


Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

## Manufacturers most upbeat in 3½ years, with autos rebound adding to AI- & defence-related boost

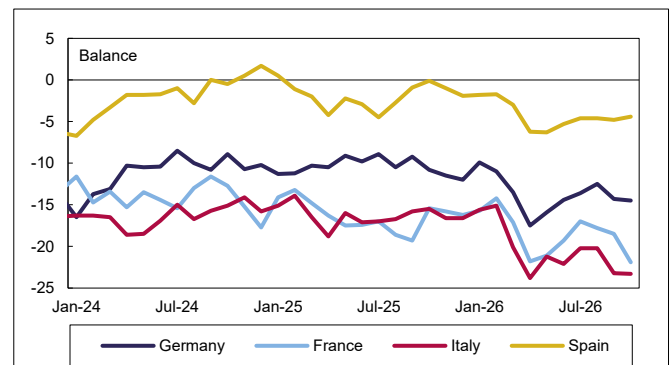
Today's survey, however, was not all doom and gloom. Partly reflecting signals of the strongest output growth since mid-2022, manufacturing confidence rose to its highest level in 3½ years and was broadly in line with its long-run average. Furthermore, the improvement was widespread across member states and industries, suggesting that the weakness in activity in the sector over the summer will prove temporary. Certainly, auto manufacturers reported production had recently picked up by the most in more than three years, pointing to a welcome rebound in a sector that has been a significant drag on manufacturing activity. The global AI drive continued to support outperformance in the ICT and electrical equipment sub-sectors, while metals remained underpinned by higher government spending on defence and infrastructure. And despite the ongoing energy price shock, chemicals firms reported the firmest recent output growth since Russia's invasion of Ukraine. Despite continued uncertainty surrounding the conflict in the Middle East, orders books strengthened further at the start of Q4. And with stocks of finished goods lower than in recent years, firms remained optimistic about the outlook for production over coming months. So, while manufacturing looks set to have provided a modest drag on euro area growth in Q3 – particularly in Germany, France and Belgium – today's survey points to a broad-based rebound in Q4 and continued growth into 2027 too.

### Euro area: Consumer confidence indices



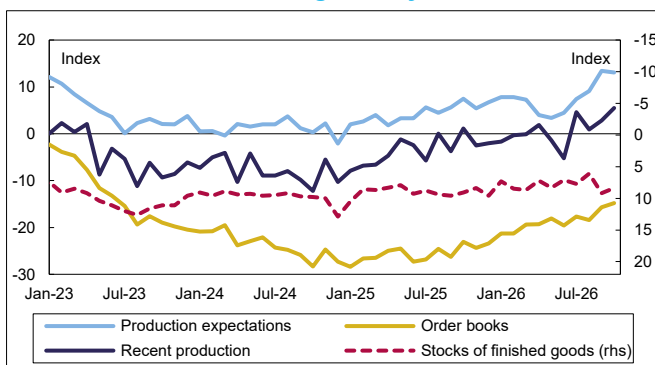
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: Consumer confidence by country



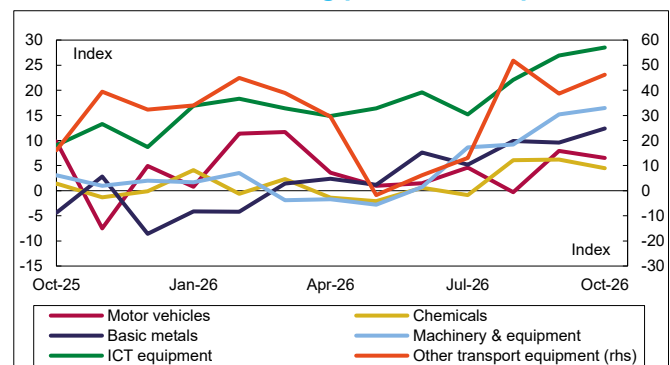
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: Manufacturing survey indices



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

### Euro area: Manufacturing production expectations



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

## The day ahead in the euro area

A busy end to the week for top-tier euro area economic data will include most notably the first estimates for Q3 GDP and preliminary October inflation estimates from the largest member states. Inflation has been driven indiscriminately higher over the past couple of months as rising oil prices and refiner margins pushed fuel prices towards record highs. But the October flash estimates are expected to show some divergence. German inflation should moderate from September's 33-month high of 3.3%Y/Y, and to a lesser extent Spanish inflation should ease too, in both cases thanks principally to the extension of tax relief measures for auto fuel. But larger energy contributions are more likely to push French and Italian inflation slightly higher. We expect those differences to be largely offsetting at the aggregate euro area level. And tomorrow's releases will be watched closely for further evidence of the impact of the summer drought and higher operating costs on food prices, as well as any indication of a more meaningful indirect impact on core goods and services prices.

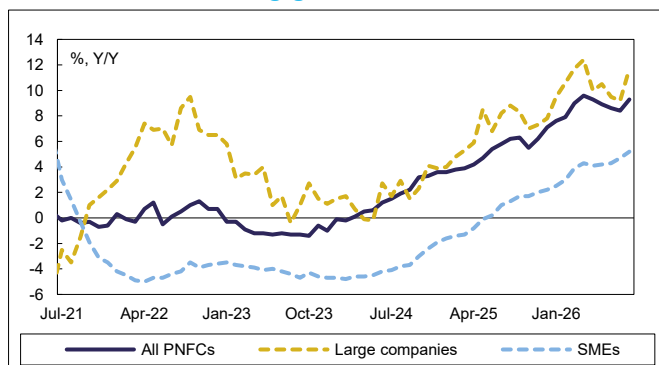
In terms of growth, contrary to the signals of firmer underlying growth momentum across most surveys last quarter, we expect euro area GDP growth to have slowed somewhat from Q2 (0.6%Q/Q). Indeed, while a recovery in services activity in France likely spurred a first increase in GDP (0.1%Q/Q) this year, German and Italian growth (also 0.1%Q/Q) seems unlikely to have sustained their strong performance from the first half of the year. And although we forecast continued Spanish outperformance, growth is likely to be softer than over recent years (perhaps as low as 0.4%Q/Q). This notwithstanding, another strong outturn in Ireland (5.5%Q/Q) suggests risks to the euro area figure are skewed to the upside. Indeed, we now expect aggregate GDP growth of (at least) 0.3%Q/Q, which would be in line with the ECB's forecast in September. Friday will also bring euro area unemployment figures for September, which are expected to show that the jobless rate held steady at 6.4% for an eighth successive month, although risks are skewed slightly to the upside after the uptick in today's Italian unemployment rate (6.3%). German labour market data for October, including the latest monthly negotiated wage numbers, are also due.

## UK

### Business and consumer credit volumes remain surprisingly resilient

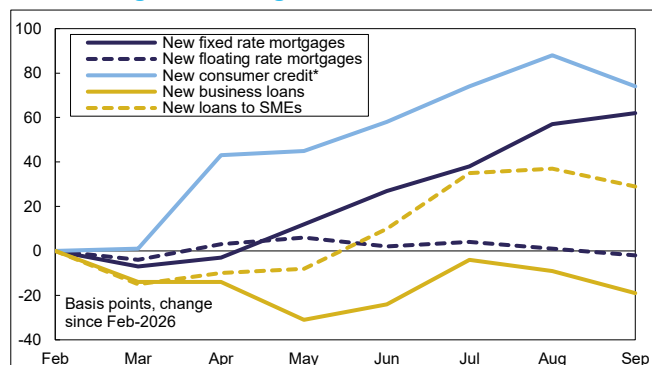
Despite a further tightening in financial conditions, September's UK monetary statistics continue to raise questions regarding the restrictiveness of monetary policy, with lending to businesses and consumer credit remaining surprisingly resilient. In particular, the flow of £7.2bn in new loans to private non-financial corporations (PNFCs) was its largest since June 2021, and more than twice the average in the year to date. While concentrated among larger firms (11.7%Y/Y), the rate of increase amongst SMEs (5.2%Y/Y) was notably the firmest since the wave of post-pandemic support. Meanwhile, consumer credit lending was broadly in line with its trend over the past 12 months. But courtesy of its strength over the prior two months, its growth rate (9.8%Y/Y) was similarly the strongest since April 2018. Perhaps most crucially, however, effective interest rates for both of those categories were reported as having fallen back last month. Together with still solid credit growth, this arguably suggests that financial conditions are not yet sufficiently restrictive and that there remains scope for the MPC to tighten monetary policy more proactively to lean against potential second-round effects.

### UK: Business lending growth rates



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Change in average interest rates



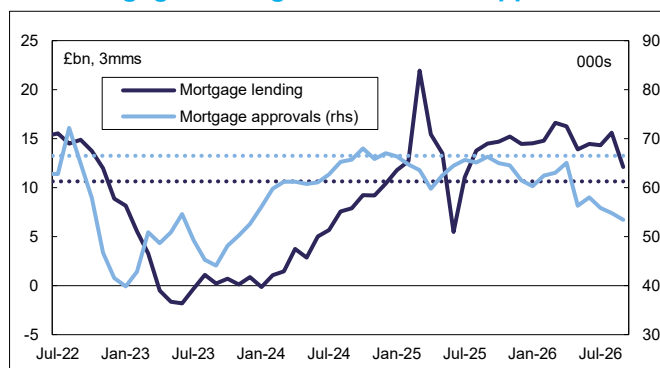
\*Excludes overdrafts. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Tightening financial conditions are most apparent for mortgages

By contrast, there remain signs that the tightening of financial conditions has weighed on mortgage demand. In particular, new mortgage lending flows in September were their lowest since May, some £0.8bn below last year's average. So, while exaggerated by a boost to mortgage lending in June, lending on a three-month annualised basis declined to the weakest level in 14 months. And to underscore the loss of momentum, new mortgage approvals (53.4k) fell for a third straight month to their lowest level since the 2023 tightening cycle. Average interest rates, by contrast, also continue to tighten, and

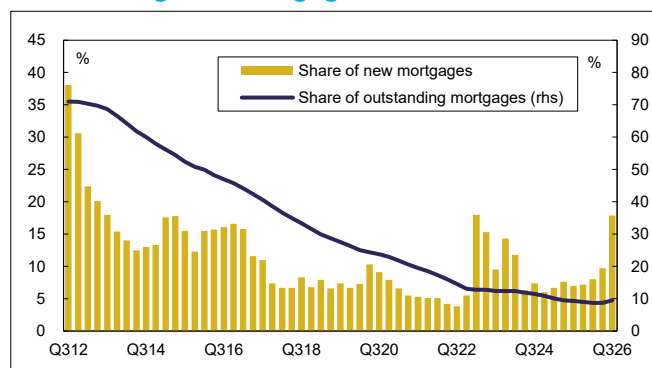
particularly so for the fixed-term mortgages which make up around 90% of the outstanding stock. Akin to the previous tightening cycle, last quarter also saw a spike in new floating-rate products, such as trackers, to a five-quarter high, which reflects the reluctance of some households to lock in the higher market rates embedded in fixed-rate products. But given that these make up just one-tenth of the outstanding stock, the immediate squeeze on household budgets generated by the likely hike at next week's BoE meeting will likely take time to feed through to consumer demand more broadly.

### UK: Mortgage lending flows and new approvals\*



\*Dashed lines represent pre-pandemic five-year averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Floating rate mortgages



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

## The day ahead in the UK

Ahead of the BoE's rate-setting meeting in the coming week, policymakers will have the latest DMP survey to digest, which will provide further insight into the risks of second-round inflation effects at the start of Q4. The survey has generally indicated that firms' price and wage expectations remain well-anchored and comfortably below their peaks earlier in the year. But due to the slightly hotter reading last month, the upside surprise to headline CPI inflation and elevated wholesale energy prices, risks around the trend appear skewed to the upside. Firms' year-ahead inflation expectations appear primed to tick higher as a result and greater pressures on firms' price- and wage-setting expectations cannot be discounted either. The more granular quarterly DMP results will provide insights as to how broad those pressures might be, while the concurrent Agents' summary of business conditions could provide a helpful signal on next year's pay settlements. Meanwhile, Friday will also bring the Nationwide house price report for October.

## European calendar

### Today's results

#### Economic data

| Country   | Release                                               | Period | Actual             | Market consensus/<br><i>Daiwa forecast</i> | Previous    | Revised    |
|-----------|-------------------------------------------------------|--------|--------------------|--------------------------------------------|-------------|------------|
| Euro area | ECB Deposit (Refinancing) Rate %                      | Oct    | <b>2.50 (2.65)</b> | <u>2.50 (2.65)</u>                         | 2.50 (2.65) | -          |
|           | Commission economic sentiment indicator               | Oct    | <b>96.9</b>        | 97.5                                       | 97.9        | 97.5       |
|           | Commission services (industrial) confidence indicator | Oct    | <b>5.3 (-3.4)</b>  | 5.6 (-3.8)                                 | 6.1 (-3.8)  | 5.9 (-3.9) |
|           | Final Commission consumer confidence indicator        | Oct    | <b>-17.9</b>       | <u>-17.9</u>                               | -16.5       | -          |
| Italy     | Istat economic (manufacturing) confidence indicator   | Oct    | <b>96.6 (91.9)</b> | - (92.0)                                   | 95.9 (91.9) | -          |
|           | Istat consumer confidence indicator                   | Oct    | <b>90.3</b>        | 91.0                                       | 91.2        | -          |
|           | Unemployment rate %                                   | Sep    | <b>6.3</b>         | 6.2                                        | 6.2         | -          |
| Spain     | Retail sales Y/Y%                                     | Sep    | <b>-1.4</b>        | -                                          | -0.4        | -0.5       |
| UK        | Net consumer credit £bn (Y/Y%)                        | Sep    | <b>1.9 (9.8)</b>   | 2.1 (-)                                    | 2.5 (9.6)   | -          |
|           | Net mortgage lending £bn (approvals 000s)             | Sep    | <b>3.9 (53.4)</b>  | 4.2 (54.0)                                 | 4.4 (54.9)  | -          |

#### Auctions

| Country | Auction                                                          |
|---------|------------------------------------------------------------------|
| Italy   | sold €1.25bn of 3.5% 2031 bonds at an average yield of 3.90%     |
|         | sold €1.75bn of 3.95% 2032 bonds at an average yield of 4.02%    |
|         | sold €3.5bn of 4% 2036 bonds at an average yield of 4.49%        |
|         | sold €1.25bn of 2036 floating bonds at an average yield of 4.02% |
| UK      | sold £1bn of 0.25% 2031 bonds at an average yield of 4.847%      |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

**Tomorrow's releases**
**Economic data**

| Country   | GMT   | Release                                                | Period | Market consensus/<br><i>Daiwa forecast</i> | Previous   |
|-----------|-------|--------------------------------------------------------|--------|--------------------------------------------|------------|
| Euro area | 10.00 | GDP – first estimate Q/Q% (Y/Y%)                       | Q3     | <u>0.3 (1.3)</u>                           | 0.6 (1.2)  |
|           | 10.00 | Unemployment rate %                                    | Sep    | 6.4                                        | 6.4        |
| Germany   | 07.00 | Import prices M/M% (Y/Y%)                              | Sep    | 2.0 (10.3)                                 | 1.0 (8.3)  |
|           | 08.55 | Unemployment claims rate % (change 000s)               | Oct    | 6.4 (5)                                    | 6.4 (12)   |
|           | 09.00 | GDP – first estimate Q/Q% (Y/Y%)                       | Q3     | <u>0.1 (1.1)</u>                           | 0.3 (1.0)  |
|           | 13.00 | Preliminary HICP (CPI) Y/Y%                            | Oct    | 3.1 (3.0)                                  | 3.3 (3.3)  |
| France    | 06.30 | GDP – first estimate Q/Q% (Y/Y%)                       | Q3     | <u>0.1 (0.3)</u>                           | 0.0 (0.5)  |
|           | 06.30 | Consumer spending M/M% (Y/Y%)                          | Sep    | 0.1 (0.4)                                  | -0.5 (0.8) |
|           | 07.45 | Preliminary HICP (CPI) Y/Y%                            | Oct    | 3.6 (3.3)                                  | 3.4 (3.1)  |
|           | 07.45 | PPI Y/Y%                                               | Sep    | -                                          | 4.8        |
|           | 07.45 | Preliminary private sector payrolls Q/Q%               | Q3     | -                                          | -0.1       |
| Italy     | 09.00 | GDP – first estimate Q/Q% (Y/Y%)                       | Q3     | <u>0.1 (0.9)</u>                           | 0.2 (1.0)  |
|           | 10.00 | Preliminary HICP (CPI) Y/Y%                            | Oct    | 4.6 (4.6)                                  | 4.2 (4.2)  |
|           | 11.00 | Hourly wages Y/Y%                                      | Q3     | -                                          | 2.4        |
| Spain     | 08.00 | GDP – first estimate Q/Q% (Y/Y%)                       | Q3     | <u>0.4 (2.5)</u>                           | 0.7 (2.6)  |
|           | 08.00 | Preliminary HICP (CPI) Y/Y%                            | Oct    | 4.9 (4.9)                                  | 5.0 (4.9)  |
| UK        | 07.00 | Nationwide house prices M/M% (Y/Y%)                    | Oct    | -0.2 (0.6)                                 | -0.2 (0.8) |
|           | 09.30 | DMP – year-ahead output price (CPI) expectations 3M/Y% | Oct    | 3.8 (3.3)                                  | 3.7 (3.1)  |

**Auctions and events**

|           |       |                                                                        |
|-----------|-------|------------------------------------------------------------------------|
| Euro area | 09.00 | ECB to publish quarterly Survey of Professional Forecasters (SPF)      |
| UK        | 09.30 | BoE to publish Bank Agents' summary of business conditions for October |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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