

# Euro wrap-up

## Overview

- Bunds made gains even as euro area inflation was confirmed at a 13-year high in September and German retail sales returned to growth in August.
- Gilts were little changed as the final UK manufacturing PMIs underscored that supply constraints are constraining output and weighing on new orders.
- The coming week brings August retail sales from the euro area, IP and goods trade data from Germany and France, as well as the ECB's account of its September policy meeting.

**Chris Scicluna**  
+44 20 7597 8326

**Emily Nicol**  
+44 20 7597 8331

### Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.714	-0.014
OBL 0 10/26	-0.583	-0.022
DBR 0 08/31	-0.223	-0.021
UKT 0 1/8 01/24	0.400	-0.001
UKT 0 3/8 10/26	0.629	-0.001
UKT 0 4/8 07/31	1.011	-0.009

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

## Euro area

### Inflation up to 13-year high on energy and services prices

In line with our forecast, today's flash estimates of euro area inflation for September showed that the headline HICP rate rose 0.4ppt to 3.4%Y/Y, the highest in thirteen years. The largest contributor remained energy, prices of which accelerated 2.0pps from August to a new euro-era high of 17.4%Y/Y, to account for roughly half of all inflation last month. But services inflation accounted for the largest share of the increase in inflation, jumping 0.6ppt – the most in more than two years – to 1.7%Y/Y, the highest since December 2019. That reflected the smallest decline in services prices in any September since 2007. In contrast, prices of non-energy industrial goods rose by the least in any September since 2010, pushing the respective inflation rate down 0.5ppt from August's series high to 2.1%Y/Y. Nevertheless, core inflation (excluding energy and food, alcohol and tobacco) still rose 0.3ppt to 1.9%Y/Y, the highest since November 2008. The granular detail of the September inflation data will only be published with the final release on 20 October. However, it is highly likely that the pickup in core inflation continues largely to reflect a rebound in prices of goods and services that had initially been compressed by the pandemic. Indeed, looked at over the two years from September 2019, core prices were only cumulatively 2.1% higher. And the core CPI index was thus merely back on the trend that existed between the end of the euro crisis and the pandemic, which had delivered a subdued average core inflation rate close to 1.0%Y/Y.

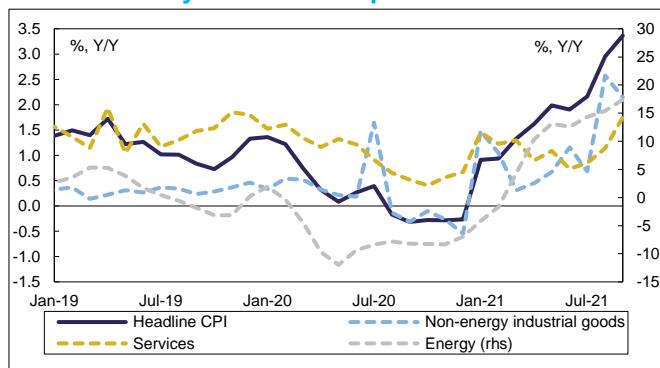
### Energy prices to fuel further price pressures over the near term

On top of this subdued underlying trend, headline inflation continues to be skewed higher by energy prices, of both fuel for transport and household utilities. Wholesale power prices have continued to rise. For example, German producer gas prices were already up more than 225%Y/Y in August. And with pressures on both supply and demand sides, Dutch natural gas futures touched a new record high today briefly up to €100 per megawatt-hour, marking a more than six-fold rise from a year ago. Oil prices recently gained a second wind too. Euro area governments continue to announce policies aimed at insulating consumers from some of the pressures, e.g. France's Prime Minister yesterday announced plans to block any new increase in regulated gas tariffs for households following a rise of 126% today, and also committed to a cut in taxes on electricity. But energy inflation looks set to rise further over the near term, with cold temperatures this winter risking more intense price pressures – and perhaps localized disruption to supplies – into the New Year.

### Expect further pass through to consumers but base effects will eventually wear off

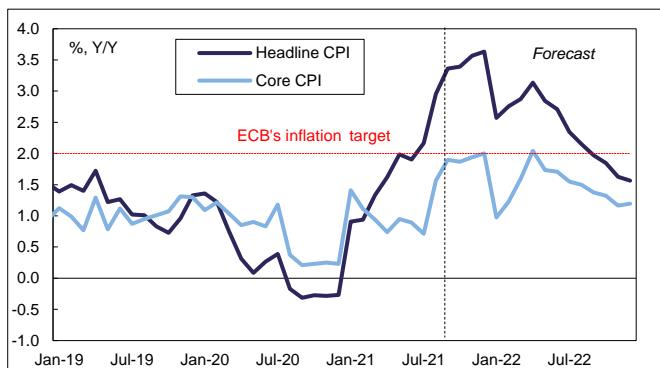
Headline and core inflation rates will take a step down in January as the impact of Germany's temporary VAT cut falls out of the calculation. However, like the increases in industrial energy prices, some of the pressures in producer intermediate

#### Euro area: Key inflation components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

prices, which rose more than 17%Y/Y in Germany in August, will likely be passed on to consumers over the coming six months. So, headline inflation is likely to edge up over the near term, and is likely to remain above the ECB's 2.0%Y/Y target throughout the first half of 2022. And we expect headline inflation to average about 2.3%Y/Y in both 2021 and 2022. We also expect core inflation to average 1.3-1.4%Y/Y in both 2021 and 2022 – somewhat stronger than the pre-pandemic trend. However, with wage demands still underwhelming by historical standards and scope for productivity gains – with the demands of Germany's IG Metall for a rise of 4.5% a case in point – the risks of persistent second-round effects on inflation from the current spike appear modest. Indeed, higher energy prices seem more likely to act as a restraint on consumer and business demand. So, we expect headline inflation to fall back more markedly in 2023 to average less than 1.5%Y/Y as base effects from current pressures wear off, with the core rate unlikely to gain further traction too.

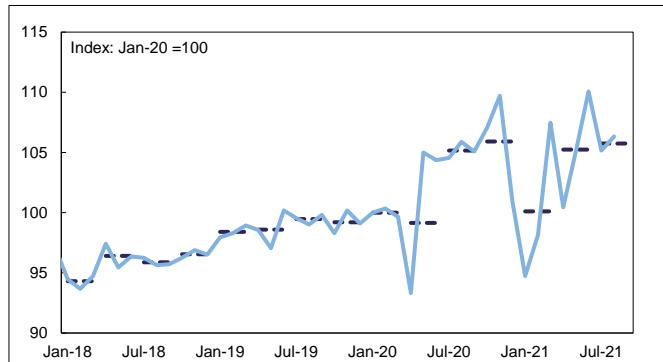
## German retail sales increase modestly, as spending on consumer-facing services resumes

While consumer confidence remains relatively buoyant and the recovery in the labour market continues, by eroding disposable income the higher cost of living seems likely to weigh on household spending over the near term. And today's German retail sales release signalled a moderation in the growth trend of expenditure on goods in the middle of the summer. Retail sales were up just 1.1%M/M in August, reversing only part of the 4.5%M/M slump in July. This left them up just 0.4%Y/Y, but nevertheless still 6% above the pre-pandemic level. Sales at non-food stores rose a more sizeable 4.9%M/M to leave them more than 12% higher than the pre-pandemic level. So the softness reflected lower spending at food stores, which dropped 3.4%M/M to be 5% below the pre-pandemic level. Overall, retail sales were trending in the first two months of Q3 some 0.4% above the Q2 average. But the monthly profile for German sales is always volatile, which leaves plenty of uncertainty regarding overall sales growth in Q3. Given the relaxation of restrictions, consumption of some goods – particularly food – has likely been at least in part substituted by increased spending on services. Certainly, turnover in the hospitality sector jumped at the start of the second quarter, with accommodation sales in July 140% higher than the average in Q2, while restaurant sales were similarly up 65%. And high-frequency data suggest that restaurant bookings in August were roughly 50% higher than the equivalent period in 2019 and up by more than a quarter on the same basis in September. So, we continue to expect household consumption to have supported an acceleration in GDP growth last quarter.

## Final manufacturing PMIs underscore struggles with supply constraints

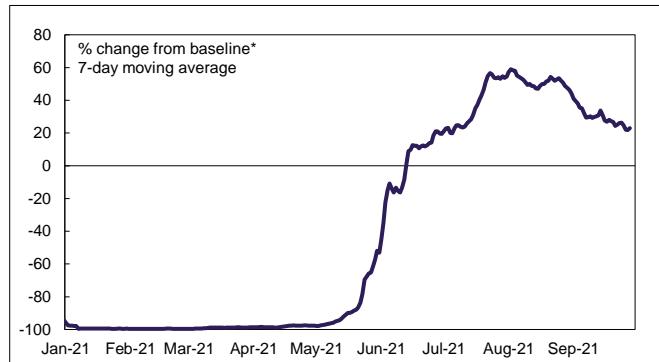
The final manufacturing PMIs for September underscored the message of the flash estimates that supply bottlenecks remain a significant impediment to growth in the sector. Indeed, the euro area output index dropped a touch further than the flash estimate, by 3.3pts, the most since the height of the first wave of pandemic in April 2020. At 58.6, that was also a seven-

### Germany: Retail sales



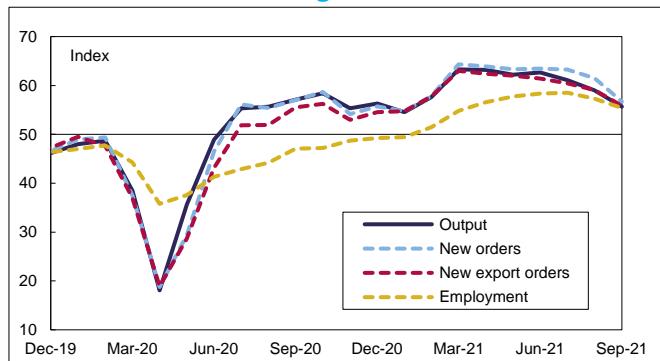
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany: Restaurant bookings



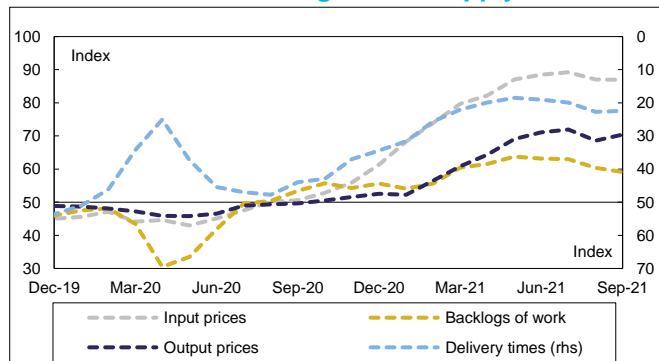
\*Value for the equivalent corresponding day of the week in 2019.  
Source: OpenTable and Daiwa Capital Markets Europe Ltd.

### Euro area: Manufacturing PMIs – demand side



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

### Euro area: Manufacturing PMIs – supply side



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

month low, albeit one still consistent with expansion. In addition, the new orders index dropped by almost 5pts, likewise the most in seventeen months, to an eight-month low (56.7). All indices of supply-side strains – including delivery times (down to just 22.5), input costs (86.9) and output prices (70.4) – remained near record levels, albeit not quite as extreme as the levels reached from May to July. Markit reported that survey respondents highlighted widespread shortages of electronic components and raw materials, and some noted poor availability of containers and other logistical problems related to securing inputs from parts of Asia. Demand for workers in the sector moderated amid the production constraints. Revisions to the PMIs of the large member states reinforced the narrative. Germany's output index dropped most, by more than 4pts to a fifteen-month low of 54.2, while France's fell to an eight-month low of just 51.3, the lowest of all member states to report. And today's Italian and Spanish survey results, published for the first time, suggested the softest growth rates in eight and seven months respectively – albeit still stronger than in the two largest member states – and new order growth also at multi-month lows. The price pressure gauges for all member states remained highly elevated too, with delivery times also near record levels everywhere.

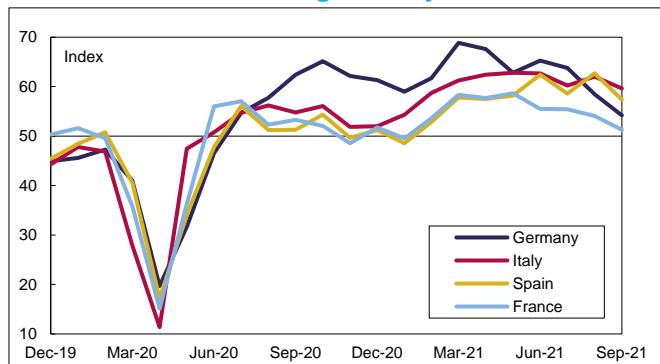
## Car registrations remained extremely weak in September

Within the manufacturing sector, the autos industry has been most acutely impacted by the persistent global semiconductor shortage. And today's national car registration figures underscored these ongoing challenges. While the French figures reported that more cars were registered in September than in August, at just 132k this was the lowest outturn for a September since 1997, and down 20.5%Y/Y and 23% compared with September 2019. So, while the number of new cars sold in the first nine months of the year was up by 8%YTD/Y, it was still down by 23% compared to the equivalent period in 2019. There were similar trends in Italy and Spain too. For example, the number of new cars registered in Italy was down 33% compared with September 2019. And while the cumulative amount sold so far this year was up 21%YTD/Y, it was still 21% lower than the equivalent period in 2019. The weakness was somewhat less striking in Spain, where new car registrations were down 'just' 15.7%Y/Y in September. But they were still down by more than one quarter from September 2019. And in the first nine months of the year, sales were still around one third lower than the equivalent period in 2019.

## The week ahead in the euro area

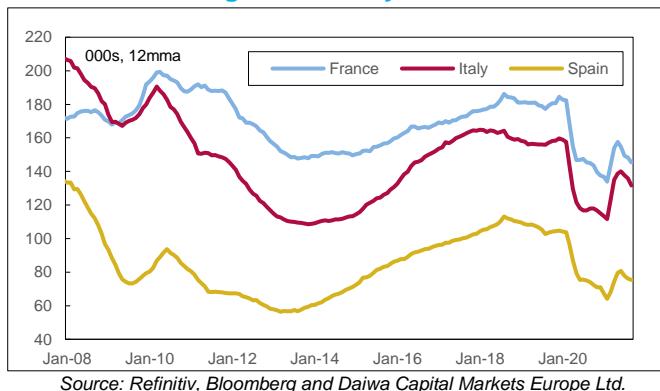
After today's flash CPI estimate, the coming week's release of euro area producer price data (Tuesday) will provide an insight into price pressures at the factory gate. After rising a hefty 2.3%M/M in July, the second-highest monthly increase in 36 years, to leave annual PPI inflation at 12.6%Y/Y, the highest level since the early 1980s, producer prices are expected to have risen notably further in August as wholesale gas prices took off. Euro area retail sales figures for August (Wednesday) are likely to report a modest rebound, following a marked decline in July. The coming week also sees the publication of

### Euro area: Manufacturing PMIs by member state



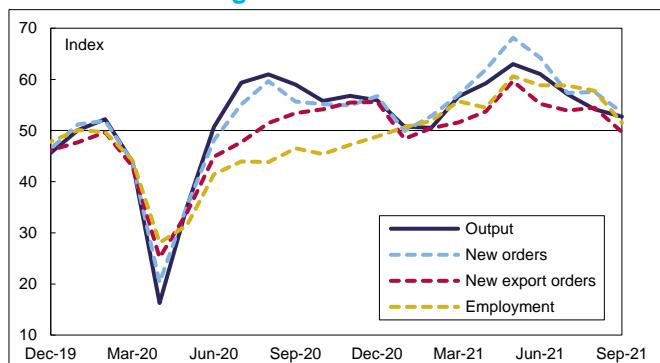
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

### Euro area: Car registrations by member state



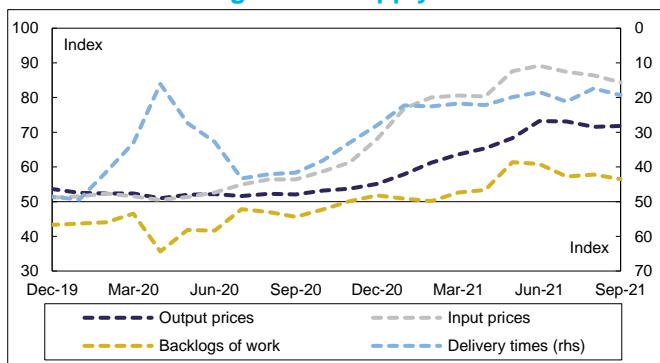
Source: Refinitiv, Bloomberg and Daiwa Capital Markets Europe Ltd.

### UK: Manufacturing PMIs – demand side



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

### UK: Manufacturing PMIs – supply side



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

national manufacturing data for August, with IP numbers from France (Tuesday), Spain (Wednesday) and Germany (Thursday) due alongside German factory orders data (Wednesday). These releases are highly likely to show that supply constraints continue to bite, particularly in the autos sector. Other monthly indicators due include French and German August trade numbers (Thursday and Friday respectively), together with German car registrations figures for September (Tuesday). Survey-wise, the euro area's Sentix investor confidence survey for October (Monday) will be followed by the release of the final September service sector and composite PMIs (Tuesday). The euro area preliminary services activity PMI declined 2.7pts to 56.3, a four-month low, while the composite PMI fell for the second successive month in September, by 2.9pts to 56.1, the lowest reading since April. The equivalent construction PMIs for the euro area and three largest euro area economies will be published on Wednesday. On the policy front, Thursday will bring the publication of the ECB's account from September's meeting, while ECB Chief Economist Lane will participate in a panel discussion on "The ECB strategy – the 2021 review and its future".

## UK

### Manufacturing output remains limited by supply chain disruption

A relatively quiet end to the week in the UK just brought the release of the final manufacturing PMIs for September. Admittedly, the headline index was upwardly revised from the flash survey, although the underlying message of persistent challenges to the sector was little changed. Indeed, while the output PMI was 0.9pt higher than the preliminary release, at 52.7 it was still 1.4pts lower than in August and its weakest since February, principally reflecting a marked moderation in production of consumer goods – the respective PMI declined 2.2pts to 50.6 – and an ongoing downturn among small-sized firms. Production remained disrupted by a range of factors, including a lack of key materials and skilled workers, lengthy supplier delivery times, and increased shipping delays, which have been exacerbated by the persistent shortage of HGV drivers. And potential power shortages add an additional risk to the near-term outlook. But manufacturers are also facing softer demand, particularly from overseas, as well as near-record high prices for inputs. And while today's survey implied still rapid growth in prices charged, manufacturers and retailers will continue to absorb some of these additional costs in their profit margins.

### The week ahead in the UK

The coming week's economic data calendar kicks off with the release on Tuesday of new car registrations figures for September, which are likely to echo the continued weakness amid supply bottlenecks reported in yesterday's car production numbers. Tuesday will also bring the final September services and composite PMIs. The preliminary services activity PMI moderated to a seven-month low (55.0), while the composite output PMI fell for a fourth successive month and by 0.7pt to a seven-month low of 54.1, with the respective indicator for new orders similarly falling to the lowest since February (down more than 2pts to 53.8). Construction PMI data follow on Wednesday, while the KPMG/REC Report on Jobs, which provides an update from recruitment consultants on permanent and temporary placements, as well as vacancies and earnings data, will be published on Friday.

*The next edition of the Euro wrap-up will be published on 5<sup>th</sup> October 2021*

## Daiwa economic forecasts

		2021				2022		2021	2022	2023
		Q1	Q2	Q3	Q4	Q1	Q2			
Euro area		-0.3	2.2	1.8	1.1	1.0	0.8	5.1	4.4	2.1
UK		-1.4	5.5	1.8	1.0	0.7	0.7	7.2	4.8	2.2
Euro area										
Headline CPI		1.1	1.8	2.8	3.5	2.7	2.9	2.3	2.4	1.3
Core CPI		1.2	0.9	1.4	1.9	1.3	1.8	1.3	1.4	1.2
UK										
Headline CPI		0.6	2.1	2.9	4.3	4.5	4.0	2.5	3.4	1.8
Core CPI		1.2	1.8	2.7	3.4	3.6	3.1	2.3	2.7	2.0
ECB										
Refi Rate %		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %		-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
PEPP envelope* (€bn)		1850	1850	1850	1850	1850	1850	1850	1850	1850
BoE										
Bank Rate %		0.10	0.10	0.10	0.10	0.10	0.25	0.10	0.25	0.75
Bond purchases* (£bn)		895	895	895	895	895	895	895	895	895

\*Target end of period. 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	Final manufacturing PMI	Sep	<b>58.6</b>	58.7	61.4	-
	Preliminary CPI (core CPI) Y/Y%	Sep	<b>3.4 (1.9)</b>	<u>3.4 (1.9)</u>	3.0 (1.6)	-
Germany	Retail sales M/M% (Y/Y%)	Aug	<b>1.1 (0.4)</b>	1.5 (0.9)	-5.1 (-0.3)	<b>-4.5 (0.4)</b>
	Final manufacturing PMI	Sep	<b>58.4</b>	58.5	62.6	-
France	Final manufacturing PMI	Sep	<b>55.0</b>	55.2	57.5	-
	New car registrations Y/Y%	Sep	<b>-20.5</b>	-	-15.4	-
Italy	Manufacturing PMI	Sep	<b>59.7</b>	59.5	60.9	-
	New car registrations Y/Y%	Sep	<b>-32.7</b>	-	-27.3	-
Spain	Manufacturing PMI	Sep	<b>58.1</b>	58.2	59.5	-
	New car registrations Y/Y%	Sep	<b>-15.7</b>	-	-28.9	-
UK	Final manufacturing PMI	Sep	<b>57.1</b>	56.3	60.3	-
Auctions						
Country	Auction	- Nothing to report -				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

# The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <u>Daiwa forecast/actual</u>	Previous
<b>Monday 04 October 2021</b>					
Euro area		09.30 Sentix investor confidence	Oct	18.8	19.6
Spain		08.00 Unemployment change '000s	Sep	-	-82.6
<b>Tuesday 05 October 2021</b>					
Euro area		09.00 Final services (composite) PMI	Sep	56.3 (56.1)	59.0 (59.0)
		10.00 PPI Y/Y%	Aug	13.5	12.1
Germany		08.30 Final services (composite) PMI	Sep	56.0 (55.3)	60.8 (60.0)
		- New car registrations* Y/Y%	Sep	-	-23.0
France		07.45 Industrial production M/M% (Y/Y%)	Aug	0.4 (3.3)	0.3 (4.0)
		07.45 Manufacturing production M/M% (Y/Y%)	Aug	-	0.6 (4.0)
		08.50 Final services (composite) PMI	Sep	56.0 (55.1)	56.3 (55.9)
Italy		08.45 Services (composite) PMI	Sep	56.5 (57.7)	58.0 (59.1)
Spain		08.15 Services (composite) PMI	Sep	58.3 (58.5)	60.1 (60.6)
UK		09.00 New car registrations Y/Y%	Sep	-	-22.0
		09.30 Final services (composite) PMI	Sep	54.6 (54.1)	55.0 (54.8)
<b>Wednesday 06 October 2021</b>					
Euro area		08.30 Construction PMI	Sep	-	49.5
		10.00 Retail sales M/M% (Y/Y%)	Aug	0.8 (0.4)	-2.3 (3.1)
Germany		07.00 Factory orders M/M% (Y/Y%)	Aug	-1.9 (16.5)	3.4 (24.4)
		08.30 Construction PMI	Sep	-	44.6
France		08.30 Construction PMI	Sep	-	44.9
Italy		08.30 Construction PMI	Sep	-	65.2
Spain		08.00 Industrial production M/M% (Y/Y%)	Aug	1.1 (3.5)	-1.1 (3.4)
UK		09.30 Construction PMI	Sep	54.0	55.2
<b>Thursday 07 October 2021</b>					
Germany		07.00 Industrial production M/M% (Y/Y%)	Aug	-0.5 (5.0)	1.0 (5.7)
France		07.45 Trade balance €bn	Aug	-	-7.0
Italy		09.00 Retail sales M/M% (Y/Y%)	Aug	0.5 (2.0)	-0.4 (6.7)
<b>Friday 08 October 2021</b>					
Germany		07.00 Trade balance €bn	Aug	15.5	17.9

\*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## The coming week's key events & auctions

Country	BST	Event / Auction
<b>Monday 04 October 2021</b>		
Euro area	11.45	ECB President Lagarde and Board Member Panetta participate in Eurogroup meeting
<b>Tuesday 05 October 2021</b>		
Euro area	16.00	ECB President Lagarde speaks at the annual general assembly of the Business Initiative Frankfurt
Germany	10.30	Auction: €500mn of 0.1% 2033 index-linked bonds
UK	10.30	Auction: €200mn of 0.1% 2046 index-linked bonds
UK	10.00	Auction: £3bn of 0.25% 2025 bonds
UK	11.30	Auction: £2.25bn of 1.125% 2039 bonds
<b>Wednesday 06 October 2021</b>		
Germany	10.30	Auction: €4bn of 0% 2026 bonds
UK	10.00	Auction: £2.5bn of 0.5% 2029 bonds
<b>Thursday 07 October 2021</b>		
Euro area	09.30	ECB Chief Economist Lane participates in discussion on The ECB Strategy: the 2021 review and its future
	12.30	Publication of the account of the ECB's monetary policy meeting held on 8-9 <sup>th</sup> September
	-	ECB Board Members Lane and Schnabel speak at joint ECB/Cleveland Fed conference on Inflation: Drivers and Dynamics
Euro area	14.00	ECB Chief Economist Lane takes part in webinar on The importance of data: statistics during the pandemic and beyond
France	09.50	Auction: 2.5% 2030 bonds
France	09.50	Auction: 0% 2031 bonds
France	09.50	Auction: 0.75% 2053 bonds
France	09.50	Auction: 1.75% 2066 bonds
Spain	09.30	Auction: 0% 2028 bonds
Spain	09.30	Auction: 0.5% 2031 bonds
Spain	09.30	Auction: 2.7% 2048 bonds
Spain	09.30	Auction: 0.7% 2033 index-linked bonds
<b>Friday 08 October 2021</b>		
UK	00.01	KPMG/REC report on jobs

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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