

Euro wrap-up

Overview

- Bunds made big gains, as the final manufacturing PMIs of all euro area members states were in contractionary territory at the end of Q3.
- Gilts made sizeable gains as the UK Chancellor announced a U-turn on his controversial top-rate tax-cut plans and the final UK manufacturing output PMI remained firmly below 50.
- Tuesday will bring euro area PPI data, while final services PMIs will be published on Wednesday.

Emily Nicol

+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	1.569	-0.166
OBL 1.3 10/27	1.739	-0.217
DBR 1.7 08/32	1.892	-0.210
UKT 1 04/24	4.007	-0.259
UKT 1¼ 07/27	4.197	-0.206
UKT 4¼ 06/32	3.397	-0.158

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

Source: Bloomberg

Euro area

Final manufacturing PMIs paint a gloomy picture amid falling demand and higher energy costs

The euro area's final manufacturing PMIs continued to paint a gloomy picture of conditions in the sector at the end of Q3. Despite being revised marginally higher from the flash release, the survey's output index was still down 0.2pt on the month to 46.3, leaving the quarterly PMI down more than 4pts in Q3 and consistent with marked contraction. The weakness was primarily linked to soft demand amid growing economic uncertainties, with the new orders component down a further 2pts in September to just 41.3, the lowest since the onset of the pandemic and before that the height of the global financial crisis. Firms continued to cite supply shortages as well as high energy prices as limiting factors on production, with some firms noting their efforts to curb energy usage. And with the rising cost of living and global economic uncertainties set to weigh further on demand, manufacturers again reduced their purchases of inputs for the third consecutive month. Taken with an intensification of cost burdens linked to elevated energy prices and growing concerns of recession ahead, manufacturers were the most pessimistic since May 2020.

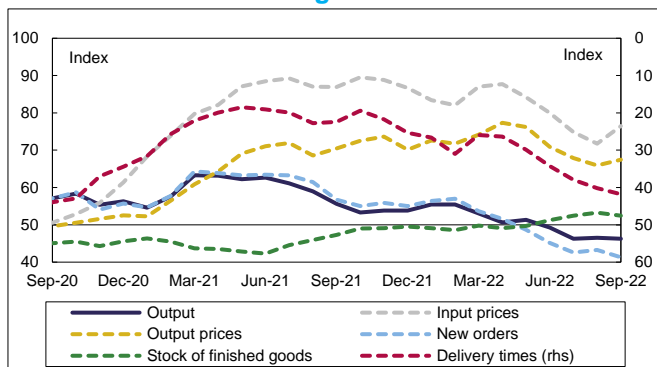
Manufacturing PMIs of all member states in contractionary territory

Admittedly, there was pickup Germany's output PMI in September, by 1.7pts to 47.0, perhaps reflecting a further easing in supply constraints last month, with the survey's measure of delivery times the shortest for two years. But this still marked the fourth consecutive contractionary reading and left the quarterly output index down more than 3½pts compared with Q2. Moreover, firms reported a steeper pace of decline in new orders, with the survey component falling to just 39.1, with domestic and overseas demand seemingly the weakest since May 2020. The output PMIs from the other larger member states, however, implied a marked steepening in the pace of contraction at the end of the third quarter. Indeed, the French output index slumped 3.3pts to 43.3, while roughly one third of firms reported declining new business. The equivalent Italian PMI declined 2.8pts on the month to 44.2, with the Spanish PMI down 2.3pts to 47.8 and the Dutch PMI down 3.1pts to 46.4. And while there were solid improvements in the respective indices in Ireland and Greece, they too remained in contractionary territory.

The coming two days in the euro area

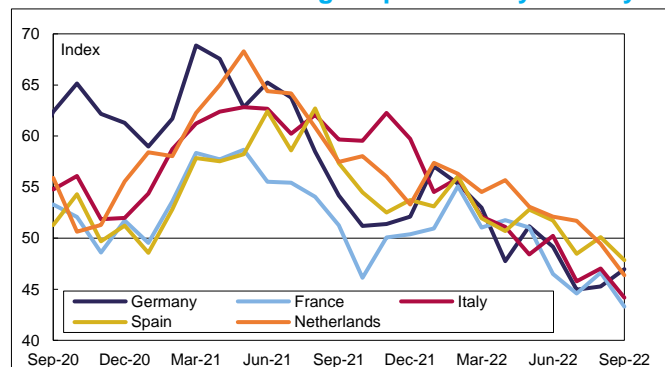
Looking ahead tomorrow brings the release of euro area producer price figures, which will provide an update on inflationary pressures at the factory gate in August. Given the surge in the German PPI rate to a new series high due to the energy shock, and higher PPI rates in France (29.5%Y/Y) and Italy (50.5%Y/Y), we expect the headline euro area producer inflation rate to jump to a new record from July's reading of 37.9%Y/Y to well above 40%Y/Y, although we might well see a further

Euro area: Manufacturing PMIs



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

Euro area: Manufacturing output PMIs by country



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

easing in the core PPI rate. On Wednesday we will get the final services and composite PMIs for September, which are expected to provide further evidence that activity has ground to a halt. According to the preliminary release, the euro area services activity index fell 0.9pt to 48.9 in September, the lowest since February 2021. This left the composite output index down for the fifth successive month, by 0.7pt to 48.2, the lowest since January 2021 and the third consecutive sub-50 reading, to leave the average for the third quarter (49.0) more than 5pts lower than in Q2 and consistent with contraction. Meanwhile, Germany's goods trade data and French IP figures for August, will provide an update on the likely extent to which the manufacturing sector will be a drag on GDP growth in the third quarter, reflecting not least slowing global demand.

UK

Government's U-turn on top-rate tax cut will do little to improve the UK's fiscal sustainability

The farce of the new UK government leadership continued at the start of the week. Following increasing backlash among the MPs of the ruling Conservative party, and while Prime Minister Truss had insisted over the weekend and again first-thing today that her plans would go ahead in full, new Chancellor Kwasi Kwarteng this morning announced a U-turn on his plans to scrap the 45% top income tax rate announced in his mini-budget just ten days ago. The news gave a boost to sterling, which rose back above \$1.12, while Gilts also made sizeable gains, particularly at the short end. But, on its own, today's announcement will do little to improve the medium-term fiscal outlook. Indeed, the reversal of the pledge to cut the top income tax rate will reduce the original £45bn package of unfunded tax cuts by just £2bn, and therefore have limited impact on fiscal sustainability, particularly when the cost of the energy support measures and higher debt costs will need to be accommodated. Indeed, market-implied pricing of Bank of England policy still implies that Bank Rate will need to peak at around 5½% next year, representing a nasty shock to real disposable incomes of many refinancing mortgage holders and a likely hit to house prices too. In the absence of the reversal or postponement of the other tax plans, the government will also still need to propose significant and highly unpopular cuts to public spending to ensure that public debt starts to decline as a share of GDP at some point over the medium-term horizon. And if the Conservative party's extraordinary slump in the opinion polls since the fiscal event persists, there is still a significant risk that the Finance Bill will fail to pass the two key legislative hurdles scheduled for late November. If so, that would not only add to the impression of a government lacking credibility and competence, but could also leave Truss's tax-cut package – and premiership as a whole – dead in the water.

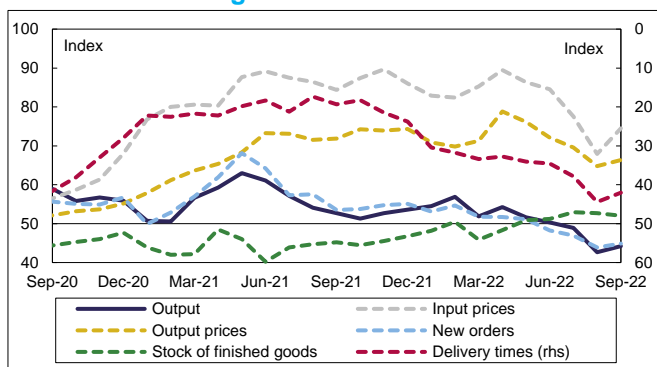
UK manufacturing PMIs point to marked contraction despite pickup in September

In terms of economic data, the final UK manufacturing PMIs offered no major surprises. Like in Germany, the survey suggested a modest improvement in the output index in September, albeit the 1.5pt increase came on the back of four consecutive declines to leave it at just 44.2, and the quarterly average almost 7pts lower in Q3 and therefore still pointing to marked contraction in the sector. While the weakness was broad-based in September, producers of intermediate goods recorded a steeper pace of decline – the output PMI fell to 40.2 – in part reflecting the lowest new orders in the sector since May 2020. So, although the overall manufacturing new business component ticked slightly higher in September, at 44.8 it too was some 3½pts lower than at the end of Q2, with firms noting a rise in cancelled and postponed orders amid rising uncertainties and the cost-of-living crisis. And with cost burdens on the rise once again, only around 50% of firms expected output to be higher in twelve months' time.

The coming two days in the UK

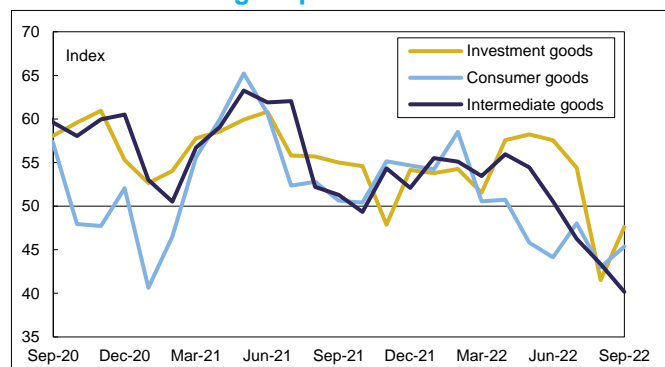
After a day bereft of top-tier UK data on Tuesday, Wednesday will bring the updated service sector and composite PMIs for September. The flash services activity index dropped 1.7pts to a 20-month low of 49.2. And so, despite the pickup in the manufacturing survey, the flash composite output PMI declined for a third successive month and by 1.2pts to 48.4, the lowest since the lockdowns of January 2021. That left the quarterly average at 50.0, which is arguably consistent with steady economic activity. But that was 5pts lower than the average in Q2 when GDP dropped 0.1%Q/Q, and was the lowest quarterly average since Q121 when GDP fell 1.2%Q/Q.

UK: Manufacturing PMIs



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











UK: Manufacturing output PMIs








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

The next edition of the Euro wrap-up will be published on 05 October 2022

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	48.4	48.5	49.6	-	
Germany	 Final manufacturing PMI	Sep	47.8	48.3	49.1	-	
France	 Final manufacturing PMI	Sep	47.7	47.8	50.6	-	
	 New car registrations Y/Y%	Sep	5.5	-	3.8	-	
Italy	 Manufacturing PMI	Sep	48.3	47.5	48.0	-	
	 New car registrations Y/Y%	Sep	-2.8	-	9.9	-	
Spain	 Manufacturing PMI	Sep	49.0	49.4	49.9	-	
	 New car registrations Y/Y%	Sep	12.7	-	9.1	-	
UK	 Final manufacturing PMI	Sep	48.4	48.5	47.3	-	
Auctions							
Country	Auction						
UK	 BoE buys £22.1mn special long-term gilt tender						














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	 10.00	PPI M/M% (Y/Y%)	Aug	4.9 (43.2)	4.0 (37.9)		
Spain	 08.00	Unemployment change '000s	Sep	-	40.4		
Auctions and events							
Euro area	 15.00	ECB President Lagarde due to speak at an event organised by Central Bank of Cyprus					
Germany	 10.30	Auction: €400mn of 2033 index-linked bonds					
UK	 10.00	Auction: 0.5% 2061 bonds					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area		09.00 Final services (composite) PMI	Sep	48.9 (48.2)	49.8 (48.9)
Germany		07.00 Trade balance €bn	Aug	4.7	5.4
		08.55 Final services (composite) PMI	Sep	45.4 (45.9)	47.7 (46.9)
France		07.45 Industrial production M/M% (Y/Y%)	Aug	0.0 (-1.5)	-1.6 (-1.2)
		07.45 Manufacturing production M/M% (Y/Y%)	Aug	-	-1.6 (0.2)
		08.50 Final services (composite) PMI	Sep	53.0 (51.2)	51.2 (50.4)
Italy		08.45 Services (composite) PMI	Sep	49.0 (48.4)	50.5 (49.6)
Spain		08.15 Services (composite) PMI	Sep	49.8 (49.8)	50.6 (50.5)
UK		09.00 New car registrations Y/Y%	Sep	-	1.2
		09.30 Final services (composite) PMI	Sep	49.2 (48.4)	50.9 (49.6)
Auctions and events					
Euro area		10.00 Non-monetary policy Governing Council meeting			
Germany		10.30 Auction: €1.5bn of 1.0% 2038 bonds			
UK		10.00 Auction: 1.0% 2032 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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