Euro wrap-up

Overview

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- Bunds made modest losses as data suggested that Germany's labour market remains relatively resilient despite further evidence of a deterioration in business conditions and lower import prices.
- Ahead of Thursday's BoE's policy announcement, Gilts made sizeable gains despite a UK survey suggesting record high shop price inflation.
- The BoE is expected to raise Bank Rate by a further 75bps to 3.00% tomorrow, while euro area unemployment figures are due.

Daily bond market movements

Bond	Yield	Change
BKO 0.4 09/24	1.951	+0.029
OBL 1.3 10/27	1.999	+0.023
DBR 1.7 08/32	2.125	-0.001
UKT 1 04/24	3.051	-0.180
UKT 1¼ 07/27	3.360	-0.141
UKT 4¼ 06/32	3.400	-0.068

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

Euro area

German labour market remains relatively resilient

While German business and consumer sentiment is historically weak, the labour market remains relatively resilient. Admittedly, German jobless claims rose for a fifth successive month in October. But the increase of just 8k was less than expected and indeed the smallest amount over the period. It also meant that, contrary to expectations of a rise, the claimant count rate remained unchanged at 5.5% for a third month. That was 0.5ppt above the trough earlier in the year and the highest since June 2021. And barring the pandemic period, it was the highest since end-2017. However, it remains well below the average since the global financial crisis. And the rise in the claimant count rate continues in good part to reflect the inclusion of Ukrainian refugees into the labour force. Indeed, thanks in part to rising labour supply, German employment rose on an unadjusted basis in September to a record high close to 45.6mn, and was down just 4k on an adjusted basis. The clear upwards trend before the pandemic, however, remains in abeyance with a broad sideways trend evident over recent months on a seasonally-adjusted basis. Meanwhile, although the number of vacancies fell for a fifth month in October and by the most over that period (17k) to an eleven-month low of 820k, it also remained historically high, above the range in the series up to the end of last year.

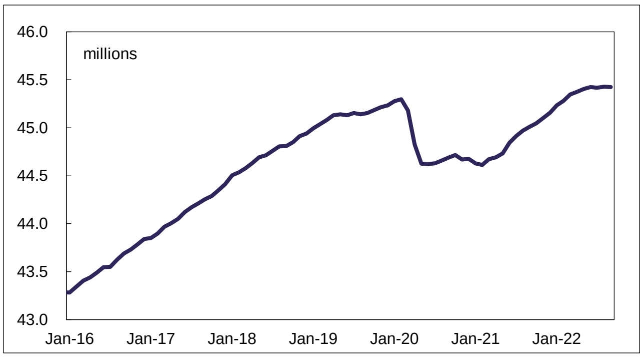
Goods trade surplus edges up from three-decade low as imports fall

Germany's goods trade data for September reported an unexpected drop in the value of exports, of 0.5%M/M. That, however, followed upwardly revised growth of 2.9%M/M in August. Over Q3 as a whole, goods exports rose 2.4%Q/Q, a slowdown from growth of 5.8%Q/Q in Q2 but better than might have been feared. Imports were also weaker than expected in September, dropping for the first time since January and by 2.4%M/M. As such, the goods trade surplus rose €2.5bn from the prior month's 31-year low to €3.7bn. By country, imports from the UK rose while those from Russia fell, likely reflecting a shift in the source of natural gas imports related to the shutdown of the NordStream pipeline early in the month. As for exports, German import growth in August was also revised up, to 4.9%M/M, the most since February. So, over Q3 as a whole, imports again outpaced exports, rising 3.8%Q/Q after 10.0%Q/Q in Q2, to leave the 3-month accumulated trade surplus in September at a new near-three-decade low of just €8.6bn.

Import prices drop for first time since first wave of Covid-19

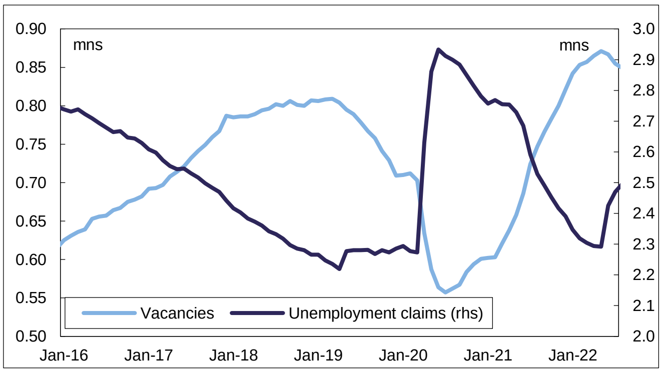
Of course, the drop in German export and import values on the month in September at least in part reflects changes in prices. Import prices that month fell 0.9%M/M – the first decline since the first wave of Covid-19 in April 2020 – due not least to developments in wholesale energy markets. Likewise, export prices also fell in September, dropping 0.6%M/M. Adjusting

Germany: Employment*



*Seasonally-adjusted basis.
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Unemployment claims & vacancies*



*Seasonally-adjusted basis.
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

for price effects, however, over Q3 as a whole, net trade volumes likely again subtracted from GDP growth, even when services trade is also accounted for. However, the likely continued softening of domestic demand, and lower natural gas prices in part due to higher natural gas inventories, raises the possibility of a further drop in imports and a positive contribution to growth from net trade in Q4.

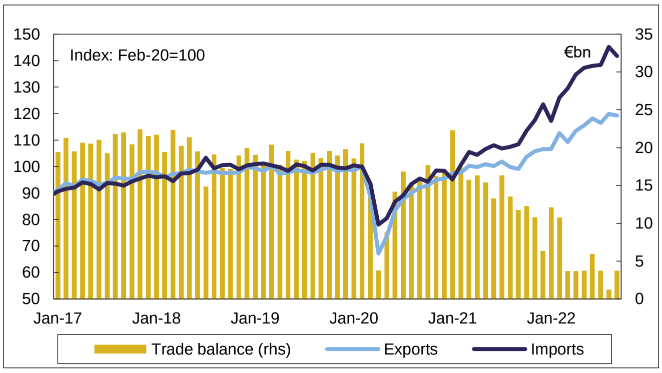
Despite a slightly easing in price pressures, manufacturing PMIs point to tough times ahead

Today's final euro area manufacturing PMIs made for even worse reading than the initial gloomy flash release, with the headline index revised down a further 0.2pt to 46.6 in October to leave it 2pts lower than in September and the weakest since May 2020. However, the revision in part reflected inflation in the sector, with the input price PMI down 0.9pt from the preliminary estimate to 72.0, the second-weakest reading since the start of 2021, albeit still well-above the long-run average. Likewise, the increase implied by the output price index was the second-softest in the past eighteen months as supply constraints continued to ease. Today's survey, nevertheless, also flagged a further loss of growth momentum, with producers reducing their purchases of inputs by the most since May 2020 amid rapidly declining production needs. Indeed, the output component fell 2½pts to 43.8, consistent with the largest contraction since mid-2012 outside of lockdown periods, with the new orders index slumping almost 3½pts to 37.9, which was the weakest reading in the survey's 25-year history outside of periods of extreme turbulence (i.e. the pandemic, and the euro and global financial crises). Among the member states, the deterioration was most striking in Germany and Spain, where the respective output components fell 4.7pts to 42.3 and 6.2pts to 41.6, signaling the steepest contractions since 2012 outside of lockdown periods. But while the equivalent French (43.5) and Italian PMIs (44.1) were little changed in October, they too implied a marked decline. Moreover, the new orders components in all four member states fell even further suggesting more challenging times ahead in the sector.

The day ahead in the euro area

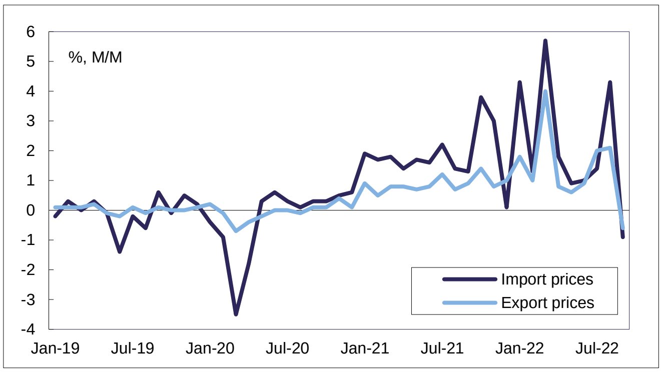
Thursday will bring September unemployment rates from the euro area and member states, with the aggregate jobless rate for the region expected to have moved sideways at the series low of 6.6%. The latest Spanish labour market numbers for October are likely to report a pickup in unemployment at the start of the fourth quarter as the peak tourist season comes to an end. Numerous Governing Council members are due to speak tomorrow, including President Lagarde at a Latvian central bank conference.

Germany: Goods trade*



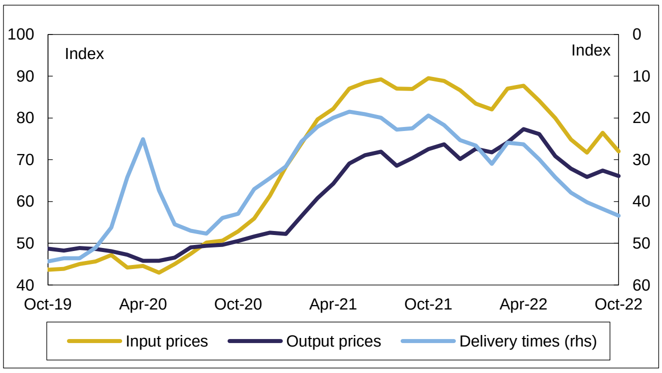
*Seasonally-adjusted basis.
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Export and import prices



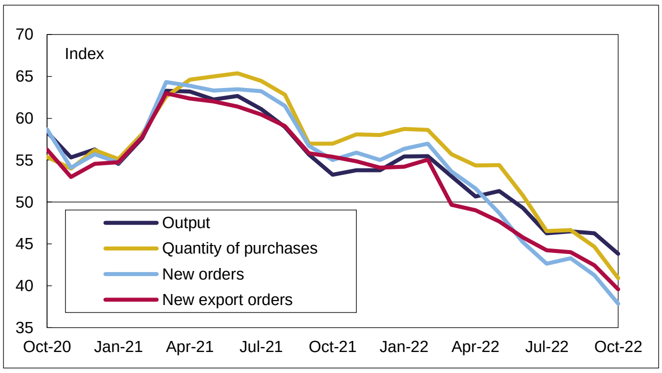
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Selected manufacturing PMIs



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

Euro area: Selected manufacturing PMIs



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

UK

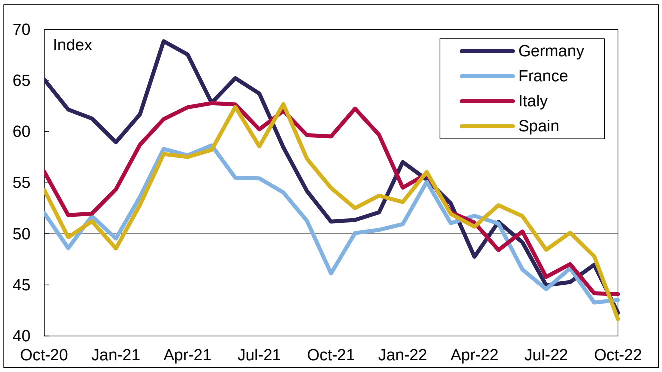
Manufacturers the most downbeat since April 2020 amid slump in new orders and elevated prices

Like the euro area PMIs, the final UK manufacturing indices published yesterday made for gloomy reading. Indeed, while the output component rose for the second successive month in October, the improvement was smaller than initially estimated, and at 45.0 the index remained firmly in contractionary territory. Admittedly, there was a marked improvement in the consumer goods sub-sector, with the respective output PMI rising 4pts to a six-month high (49.4). But this was countered by the steepest contraction in production of intermediate goods since the onset of the pandemic (and a pace of decline not seen since 2009 outside of lockdown periods), with new orders in the subsector slumping to their lowest since April 2020 – indeed, the respective PMI (30.6) was more than 11pts below the Q3 average. The deterioration in new orders was, however, widespread, with firms citing weaker domestic and external demand amid already high inventories, subdued confidence and persisting inflationary pressures. As such, just 43% of respondents expected production to be higher in a year's time. In response, manufacturers cut back purchases of inputs at the steepest rate since 2009 bar the initial wave of Covid-19, and reported job losses in the sector for the first time since 2020, reflecting redundancies as well as difficulties in recruiting appropriately skilled staff. While the rates of increase eased slightly in October, the survey suggested that price pressures in the sector remained extremely elevated and broad-based – indeed, while some way off April's peak (78.8), the output price PMI (65.0) was still more than 10pts above the long-run average. Taken with rising fears of recession, manufacturers were unsurprisingly their most downbeat since the onset of the pandemic.

UK shop prices increase at fastest monthly pace since the series began in 2005

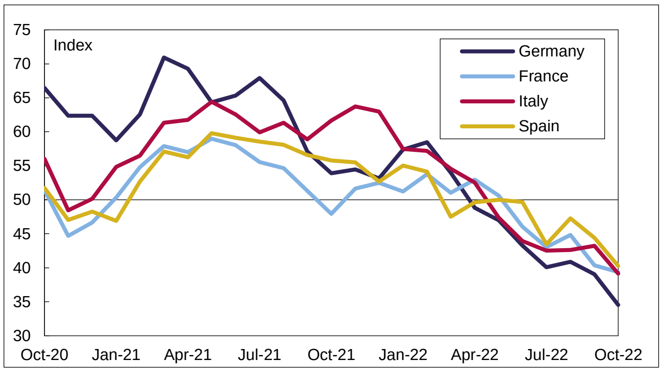
According to the BRC, UK shop price inflation jumped again at the start of Q4 as retailers continued to pass on some of their additional cost burdens amid ongoing supply-side pressures and significant energy expenses. This survey suggested that prices rose 1.3%M/M in October, the largest monthly increase since the series began in 2005, to leave the annual inflation rate up 0.9ppt to a series-high 6.6%Y/Y. Food inflation rose a further 1ppt to 11.6%Y/Y, with non-food inflation up more than 4%Y/Y, not least as prices of furniture and electrical products continued to be magnified by cost pressures amid supply-chain disruption. Of course, not least due to intense competition on the high street, as well as the exclusion of prices of energy, cars and services, the BRC survey measure of shop price inflation will continue to track well below CPI inflation. So, taken together with the step up in household energy bills last month and ongoing decline in household disposable income, today's release further highlights the likely significant hit to consumption this quarter (and coming quarters too).

Euro area: Manufacturing output PMIs



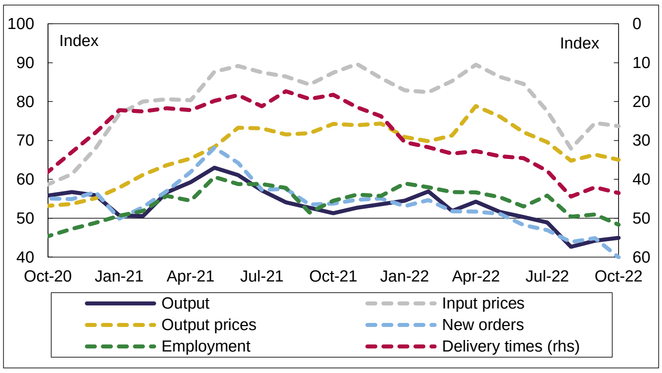
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing new orders PMIs



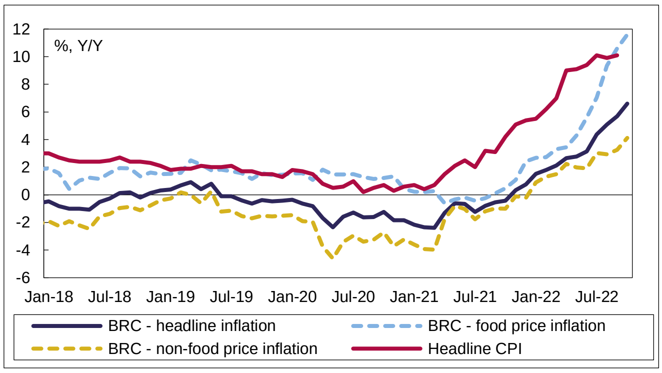
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Selected manufacturing PMIs



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

UK: BRC shop price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Nationwide house prices fall by the most since the start of the pandemic

Given households' diminishing purchasing power, the steady easing in new buyer enquiries since the summer and the surge in mortgage interest rates following September's mini-budget, yesterday's Nationwide house price index reported the first monthly drop in house prices since July 2021 and the largest since the start of the pandemic. This left the annual rate of increase in house prices down 2.3ppts to 7.2%Y/Y, the softest pace since April 2021 and almost half the peak recorded in March. While average mortgage rates have eased back somewhat from the recent peak, Nationwide highlighted the negative impact of higher borrowing costs on already stretched affordability – indeed, based on an average interest rate of 5.5% on an 80% LTV loan, Nationwide estimated that mortgage payments of first-time buyers as a share of their take-home pay would rise to around 45% from around 34% over the past quarter.

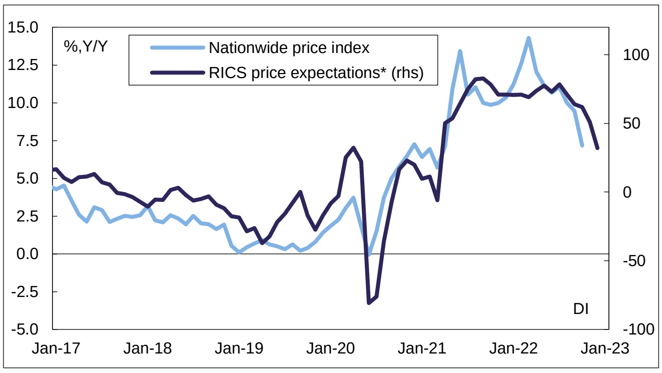
The day ahead in the UK

All eyes in the UK tomorrow will be on the BoE's latest policy announcement, where we expect to see the MPC raise Bank Rate by 75bps to 3.00%. However, with conditions in the Gilt market now stable, the BoE's first round of quantitative-tightening related Gilt sales having passed smoothly this week, sterling firmer than of late, and certain MPC members having cautioned that market pricing of future tightening was probably too aggressive, particularly in light of the tightening of financial conditions – not least via higher mortgage rates – since the mini-budget, the risks to that view are skewed to the downside. The size of the rate hike will, in good part, depend on the BoE's updated economic forecasts. Despite the recent rise in inflation to double-digits and continued evidence of a very tight labour market, the government's decision to cap the increase in household energy bills between October and April means that the near-term inflation forecast will be significantly lower than projected in August. Moreover, data also suggest the economy contracted in Q3 by more than the BoE previously expected (by as much as 0.5%Q/Q vs the BoE's forecast of -0.2%Q/Q), and high inflation will likely result in further contractions to come, which should help inflation fall back in due course.

But with the Sunak government having postponed its fiscal update until 17 November, there remains a lack of clarity surrounding the magnitude of further increases in household energy bills from April on, as well as the extent of forthcoming public spending restraint and tax measures that are likely ultimately to result in a tightening of the fiscal stance. And it remains to be seen what the BoE will assume in this respect for its projections. Nevertheless, given continued tightness in the labour market we continue to expect the MPC to flag concerns about domestically-generated inflation, justifying the hike of 75bps this week. And the BoE's updated forecasts will maintain expectations of further hikes to come, albeit perhaps suggesting a terminal rate below the current market-implied rate of 4.75%.

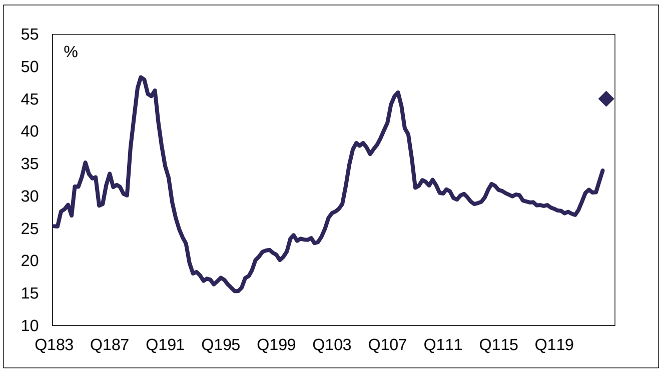
In terms of data, tomorrow will bring the final October services and composite PMIs. The flash release had signalled a marked deterioration in activity at the start of Q4, with the services index down 2½ pts to 47.5, the weakest since January. And while the modest upwards revision to the manufacturing output index might see the preliminary composite PMI (47.2) revised a touch higher it will still be consistent with a contracting economy.

UK: House price indices



*Three-months ahead. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Mortgage payments as a share of pay*



*First time buyer mortgage payments to take home pay, based on an 80% LTV mortgage. Source: Nationwide, Refinitiv and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Final manufacturing PMI	Oct	**46.4**	46.6	48.4	-
Germany	Goods trade balance €bn	Sep	**3.7**	1.4	1.2	-
	Final manufacturing PMI	Oct	**45.1**	45.7	47.8	-
	Unemployment claims rate % (change '000s)	Oct	**5.5 (8.0)**	5.5 (15.0)	5.5 (14.0)	**- (13.0)**
France	Final manufacturing PMI	Oct	**47.2**	47.4	47.7	-
Italy	Final manufacturing PMI	Oct	**46.5**	46.9	48.3	-
Spain	Final manufacturing PMI	Oct	**44.7**	47.5	49.0	-
UK	BRC shop price index Y/Y%	Oct	**6.6**	-	5.7	-

Auctions

Country	Auction
Germany	sold €923mn of 0% 2031 bonds at an average yield of 2.07%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK	Nationwide house price index M/M% (Y/Y%)	Oct	**-0.9 (7.2)**	-0.3 (8.2)	0.0 (9.5)	-
	Final manufacturing PMI	Oct	**46.2**	45.8	48.4	-

Auctions

Country	Auction
Germany	Auction: €260mn of 0.1% 2023 index-linked bonds at an average yield of -0.28%
	Auction: €171mn of 0.1% 2046 index-linked bonds at an average yield of -0.22%
UK	BoE sold £750mn of 2026-2029 gilts

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	Unemployment rate %	Sep	6.6	6.6
Spain		08.00	Unemployment change '000s	Oct	23.5	17.7
UK		09.30	Final services (composite) PMI	Oct	47.5 (47.2)	50.0 (49.1)
		12.00	BoE Bank Rate %	Nov	*3.00*	2.25

Auctions and events

Country		GMT	Event
Euro area		07.50	ECB President Lagarde scheduled to give opening remarks at Bank of Latvia conference
		08.00	ECB Executive Board member Panetta scheduled to give keynote speech at ECB Money Market conference
		09.50	ECB Executive Board member Elderson scheduled to speak at Bank of Latvia conference
France		09.50	Auction: To sell 2% 2032 bonds
		09.50	Auction: To sell 1.25% 2036 bonds
		09.50	Auction: To sell 0.75% 2053 bonds
Spain		09.30	Auction: To sell 0% 2027 bonds
		09.30	Auction: To sell 1% 2030 bonds
		09.30	Auction: To sell 2.55% 2032 bonds
		09.30	Auction: To sell 1% 2042 bonds
UK		12.00	BoE to publish MPC policy announcement, minutes and Monetary Policy Report
		12.30	BoE Governor Bailey post-meeting press conference to discuss Monetary Policy Report

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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