

# Euro wrap-up

## Overview

- Bunds made modest gains as the flash PMIs underscored the likelihood of contraction in euro area GDP in Q3.
- While UK retail sales and consumer confidence picked up, Gilts made gains as the flash PMIs signalled a more acute slowdown in services activity.
- The coming week will bring flash euro area inflation estimates, the Commission's economic survey results and bank lending figures from the euro area and UK.

Chris Scicluna

+44 20 7597 8326

Emily Nicol

+44 20 7597 8331

### Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.232	-0.017
OBL 2.4 10/28	2.735	-0.016
DBR 2.6 08/33	2.726	-0.006
UKT 3½ 10/25	4.798	-0.049
UKT 4½ 06/28	4.364	-0.060
UKT 3¼ 01/33	4.241	-0.056

\*Change from close as at 4:00pm BST.

Source: Bloomberg

## Euro area

### Flash September PMIs underscore likelihood of contraction in GDP in Q3

Judging from today's September flash PMIs, euro area GDP contracted in Q3 although a bottom might have been reached last month. In particular, the flash euro area composite output PMI beat expectations, rising 0.4pt in September from last month's nine-month low to 47.1. That nevertheless left the Q3 average at 47.5, representing the weakest quarterly figure since the first wave of pandemic in 2020 and a level which, before the pandemic, would have implied a drop in GDP of about 0.3%Q/Q. While we do think that GDP fell over the past quarter, we think the flash PMIs are currently somewhat exaggerating the extent of the contraction. Indeed, we note that the flash PMIs in the first half of the year had suggested that GDP growth was stronger than the eventual outcome, and we think that seasonal factors might be driving some of the volatility in the indices from one quarter to the next. We also note, in particular, that the PMIs present a significantly gloomier picture of conditions in France than other survey indicators such as those published yesterday by [INSEE and the Bank of France](#). Therefore, we maintain our forecast that euro area GDP will contract by a modest 0.1%Q/Q in Q3 before stabilising in Q4.

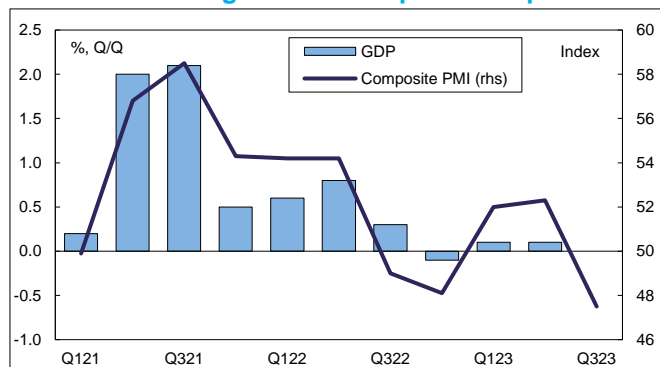
### Broad-based decline in new orders and backlogs point to a subdued near-term outlook

For a second successive month, the flash euro area PMIs suggested that the contraction in economic output was relatively broad-based. However, the drop in services activity was judged to be less marked than in August, with the respective index up 0.5pt to 48.4 to suggest only a modest decline in that sector and one that might still be concentrated in firms providing B2B services to the industrial sector. And while it remained the principal source of weakness and extended the run of sub-50 readings to 16 months, the manufacturing output PMI was stable at 43.4. Discouragingly, however, the euro area services new orders PMI fell more than 1pt to 46.8, the worst since the lockdowns in early 2021 while the equivalent index for manufacturing edged down to a 10-month low of 39.0. And backlogs of work reportedly dropped the most since the first wave of the pandemic. So, while the composite employment index was still consistent with stable headcount, the near-term outlook for output looks subdued in both major sectors.

### Euro area PMIs weighed by notable weakness in France, jarring with findings of other surveys

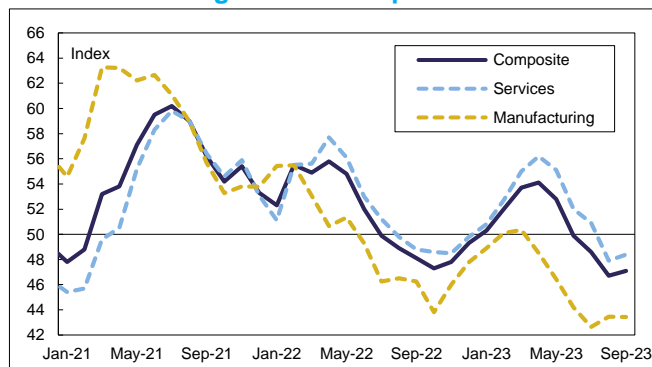
At the country level, the flash PMIs reinforced our expectation that German GDP contracted in Q3, with the respective composite index firmly below 50 for a third successive month. Nevertheless, it rose by 1.6pts to 46.2, suggesting an easing in the rate of decline towards the end of the quarter and raising hopes of more stable output in Q4. In particular, while the survey reported a further deterioration in German manufacturing output, and at the sharpest rate since the first wave of

#### Euro area: GDP growth & composite output PMI



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

#### Euro area: GDP growth & composite PMIs



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

pandemic, it also reported a welcome stabilisation in services activity. In contrast, with the respective composite PMI down 2.5pts to 43.5, the survey suggested the steepest drop in French GDP since late 2020, and indeed the worst performance beyond the pandemic since the euro crisis. According to the PMIs, French output in both manufacturing and services reportedly contracted rapidly this month. That contrasts markedly with the stability reported by the typically more reliable INSEE survey. And while there will be payback this quarter for the significant strength in net trade in Q2, we continue to forecast modestly positive French GDP growth in Q3. More reassuringly, the flash PMIs implied that activity was broadly stable in the rest of the euro area – not least Italy and Spain – in September. Indeed, manufacturing output beyond the two largest member states reportedly fell at the softest pace in five months while services activity increased at a slightly faster pace than last month.

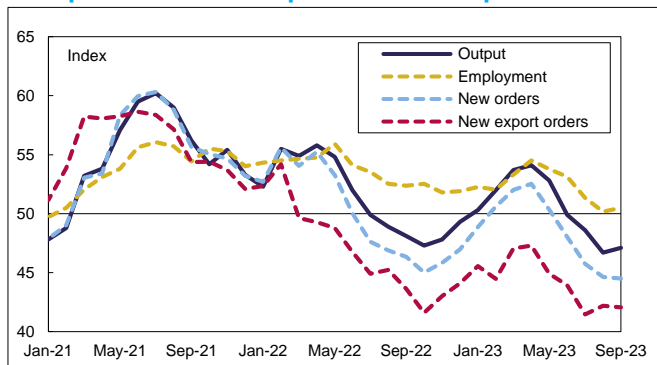
### Output price pressures continue to ease despite oil-driven pickup in input costs

Finally, the ECB will note that the September flash PMIs remained broadly consistent with disinflation. Admittedly, with oil prices rising significantly, the euro area input price indices increased in both manufacturing and services. However, the former was still consistent with falling costs and at one of the sharpest rates since the global financial crisis. Likewise, with demand faltering and inventories more than ample, the respective PMI suggested that factory output prices continued to fall at one of the fastest rates outside of the first wave of pandemic and global financial crisis. And most encouragingly perhaps, the survey suggested that output prices in services rose in September at the softest pace in two years. Overall, therefore, the flash PMIs underscored the likelihood that the ECB's interest rates have now reached their peak for this cycle.

### The week ahead in the euro area

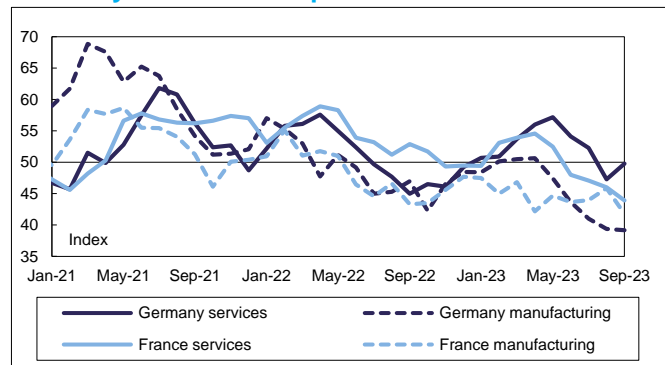
It will be a busy week ahead for top-tier euro economic releases, which include the flash September inflation estimates (Friday), European Commission economic sentiment survey results (Thursday) and bank lending numbers (Wednesday). Headline inflation will take a notable step down this month not least because base effects associated with last year's heavily discounted German travel pass will fall out of the calculation. And base effects related to last year's energy and food price shocks will more than offset the impact of the further rise in the price of auto fuel. In particular, we expect headline inflation to drop 0.9ppt to 4.3%Y/Y, which would be the lowest rate since October 2021. More importantly perhaps, we expect core inflation to moderate 0.4ppt to an eleven-month low of 4.9%Y/Y. Ahead of that release, the preliminary inflation estimates from Germany, Spain and Belgium are due for release on Thursday. The Commission's economic surveys, also due that day, will provide an update on price expectations, which ticked slightly higher in August most likely in response to the higher oil

#### Europe: Selected composite PMI components



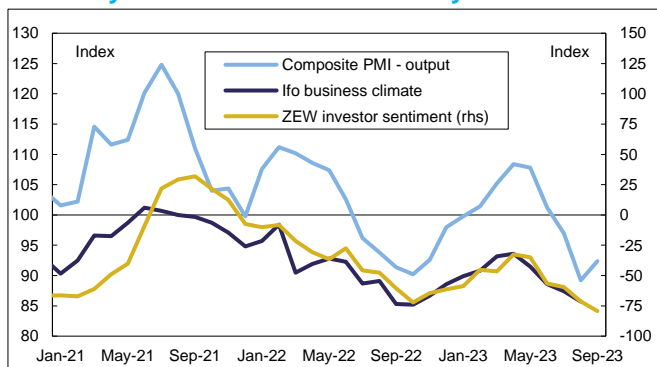
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

#### Germany & France: Output PMIs



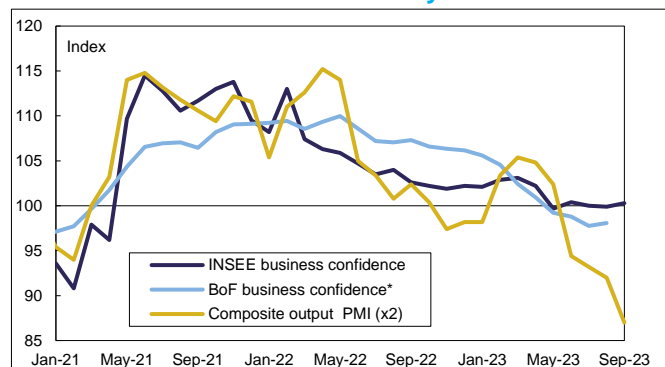
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

#### Germany: Selected business survey indices



Source: Refinitiv Datastream, Ifo institute, ZEW, S&P Global and Daiwa Capital Markets Europe Ltd.

#### France: Selected business survey indices



\*Weighted average of manufacturing, services and construction indices.  
 Source: Refinitiv Datastream, INSEE, BoF, S&P Global and Daiwa Capital Markets Europe Ltd.

price. Arguably of most interest will be the extent of the slowdown in GDP growth implied by the headline economic sentiment indicator, which in August declined to 93.3, the lowest since November 2020 and more than 6½% below the long-run average. Other key sentiment indicators due in the coming week include the German ifo business climate indices (Monday) and German and French consumer confidence survey results (Wednesday). Euro area monetary data (Wednesday) will illustrate the dampening impact of the ECB's aggressive tightening cycle on bank lending.

## UK

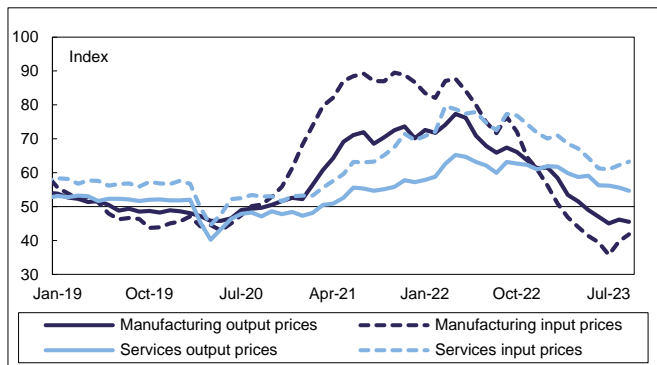
### Retail sales recover in August but still trending below the Q2 average

As expected, today's UK retail sales figures for August suggested some positive payback for the weather-dampened weakness in July. Nevertheless, the increase of 0.4%M/M fell slightly short of the Bloomberg survey consensus and only partially reversed the 1.1%M/M drop in July. Indeed, despite steady growth in the first half of the year, this left sales down 1.4%Y/Y. Admittedly, when excluding the decline in petrol station sales reflecting the jump in petrol prices that month, retail sales were up a slightly firmer 0.6%M/M in August. The increase was supported by a pickup in sales at food (1.2%M/M) and clothing stores (2.3%M/M), which partly reversed the steep declines in July when the inclement weather kept shoppers away. Sales at furniture and hardware stores posted a solid rise in August, perhaps reflecting the diminished disruption to supply and general disinflationary trend in global goods prices. But, on average so far in Q3, food, clothing and household goods store sales were still trending below the Q2 level. And while non-store retail sales were trending higher thanks in part to special promotions including Amazon Prime Day in July, total retail sales in the first two months of Q3 were running some ½% below the Q2 average.

### Consumer confidence improves in September

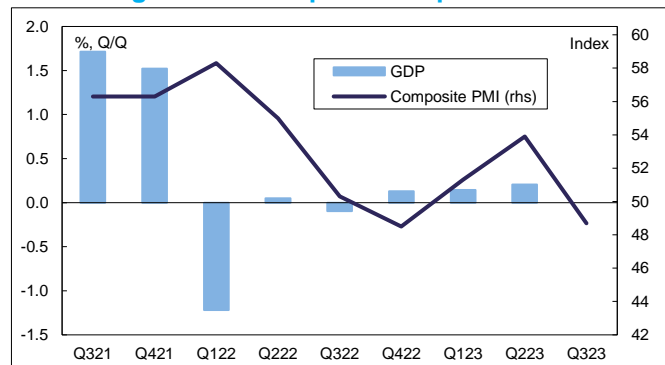
Today's consumer confidence survey offered some tentative encouragement regarding the near-term outlook for household spending. Indeed, against the backdrop of easing inflation, strong wage growth and a slight moderation in mortgage lending rates, the headline confidence indicator rose a larger-than-expected 4pts to -21, the highest level since January 2022. The improvement was broad-based, with households' expectations for the economic outlook over the coming twelve months the best since end-2021 and the respective index (-24) some 44pts higher than a year ago. With real disposable incomes set to receive a further boost from the drop in the energy price cap in October, households were somewhat more upbeat about their expected financial situation for the coming twelve months too, with the respective index just 5pts off the long-run average and 38pts higher than a year ago. As such, consumers' willingness to spend rose again in September, with the index up to its highest since February 2022. Admittedly, this partly reflects a rebound from the slump in July, with the

#### Euro area: Price PMIs



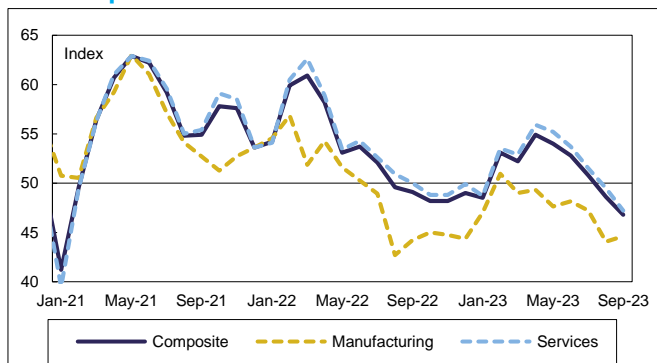
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

#### UK: GDP growth & composite output PMI



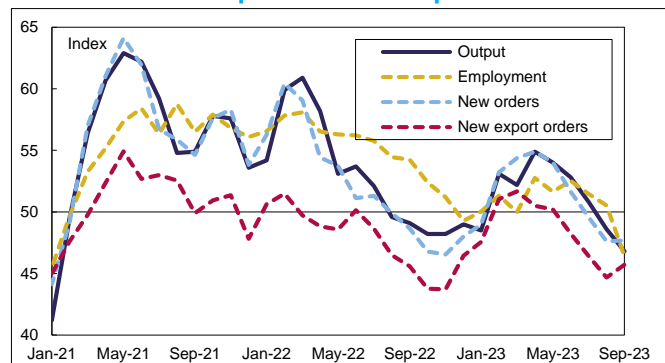
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

#### UK: Output PMIs



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

#### UK: Selected composite PMI components



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

quarterly average in Q3 little improved from Q2. Moreover, with purchase intentions still well below the long-run average, and some homeowners' budgets still set to be hit by significantly higher interest rates when remortgaging, consumer spending seems highly likely to remain relatively sluggish over coming quarters.

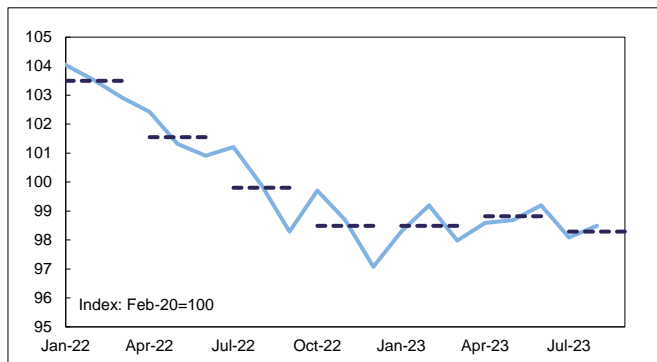
### But PMIs flag sharp weakening in services momentum

Contrasting with the improvement in household sentiment, but adding support to the [BoE's decision](#) yesterday to pause its tightening cycle, today's flash PMIs suggested a further deterioration in economic momentum at the end of Q3. Certainly, the composite output index fell more than expected in September, by 1.8pts to 46.8, the lowest since the start of 2021 and the global financial crisis when excluding lockdown periods. This left the quarterly index down more than 5pts at 48.7, a level that before the pandemic would have implied a contraction in GDP between -0.4% and -0.5%Q/Q. Admittedly, the implied decline seems overdone to us. But there is undoubtedly a significant risk that UK GDP contracted in Q3. And today's surveys provided evidence of a further substantial weakening in the all-important services sector, where the activity index fell for a fifth consecutive month, by 2.3pts to 47.2, the lowest since March 2009 when excluding the height of the pandemic. Respondents suggested the near-term outlook remained clouded by economic uncertainties, higher borrowing costs, constraints on non-essential spending and a notable downturn in overseas demand. As such, firms in the sector signalled a notable loosening in labour market conditions, reporting the first month of job cuts since February 2021 and at the steepest rate since the global financial crisis outside of lockdown periods. While slightly improved on August, the manufacturing survey continued to imply ongoing challenges too. Indeed, the output (44.6), new orders (42.2), employment (46.3) and stock of purchases (36.7) components were consistent with a more acute contraction than in the services sector. It is worth noting that this survey has underestimated the recent strength in the sector, where output actually increased in each of the three quarters to Q2. So, notwithstanding the clear slowdown in momentum over the summer, we maintain our view that the UK's economy more likely stagnated than contracted through the second half of 2023, albeit risks to our GDP forecast for growth of 0.1%Q/Q in Q3 appear skewed to the downside.

### Services price pressures continue to moderate gradually, but slight pickup in factory prices

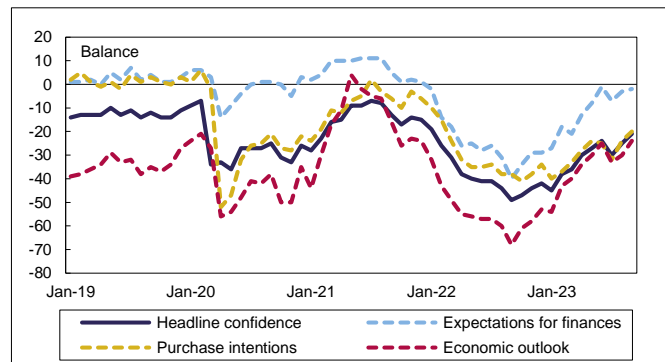
While the MPC maintained a tightening bias in its forward guidance, today's price PMIs suggested that, on balance, a disinflationary trend should continue. Indeed, despite strong wage growth and higher fuel bills, services firms suggested input cost burdens rose at the softest rate since March 2021, while the prices charged index (56.4) was notably closer to the long-run average (52.6) than the peak (67.9) in May 2022. But while manufacturing input costs continued to decline, there was a surprising increase in output prices in the manufacturing sector, albeit the respective index (51.9) remained below the long-run average. Today's CBI industrial trends survey also saw the net balance of firms expecting to raise prices over the

#### UK: Retail sales\*



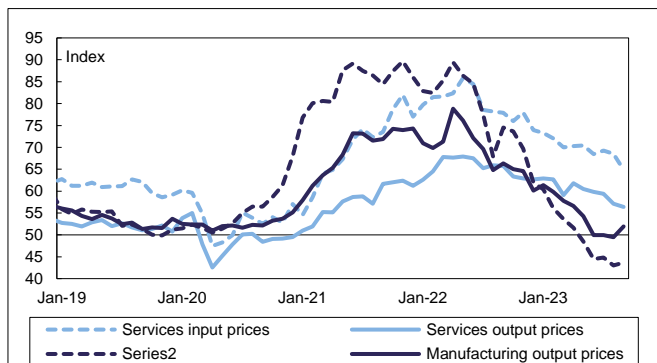
\*Dashed lines represent quarterly averages. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

#### UK: Consumer confidence



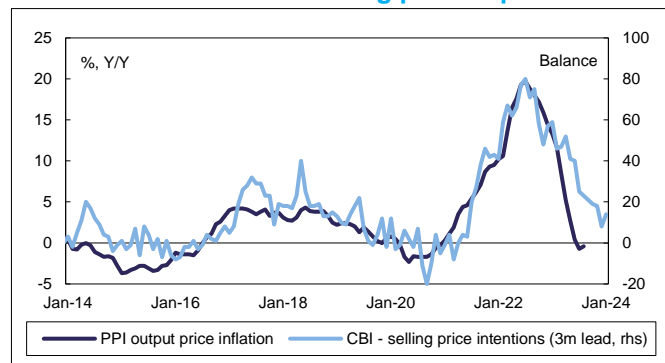
Source: Refinitiv Datastream, GfK and Daiwa Capital Markets Europe Ltd.

#### UK: Price PMIs



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

#### UK: PPI inflation & CBI selling price expectations












Source: Refinitiv Datastream, CBI and Daiwa Capital Markets Europe Ltd.

next three months increase to 14%, from a 2½-year low of 8% in August, albeit remaining well below the average over the past two years (50%). Given the weakness in demand, we suspect that this pickup might prove temporary, with firms' pricing power likely to remain diminished over the near term.

### The week ahead in the UK

In a relatively quiet week ahead for UK economic data, the main releases will come on Friday, with the BoE's latest monetary data arguably of most interest. While the average mortgage rate edged slightly lower in August, with mortgage approvals having weakened sharply in July and surveys suggesting that housing market activity slowed over the summer, we expect new mortgage lending to have remained very weak in August. Concerns about the economic outlook and higher borrowing rates might also limit demand for consumer credit. And we expect to continue to see households further shift deposits from lower-yielding overnight accounts to higher-yielding products. Friday will also bring updated national accounts figures for Q2. These are expected to confirm GDP growth of 0.2%Q/Q, supported by firmer household and government spending and a pickup in business investment. However, the ONS might well make significant revisions to the level of GDP in 2022 reflecting the application of the methodological changes that earlier this month led to a [big upwards revision](#) to the estimate of growth in 2021. Meanwhile, the latest balance of payments figures are expected to report a modest widening in the current account deficit amid a deterioration in the trade balance.

## Daiwa economic forecasts





























		2023			2024			2023	2024	2025
		Q2	Q3	Q4	Q1	Q2	Q3			
GDP					%, Y/Y					
Euro area		0.2	-0.1	0.0	0.2	0.2	0.3	0.4	0.6	1.5
UK		0.2	0.1	0.1	0.1	0.0	0.1	0.4	0.3	0.7
Inflation, %, Y/Y										
Euro area										
Headline HICP		6.2	5.0	3.3	3.2	2.7	2.3	5.6	2.6	1.9
Core HICP		5.5	5.2	4.4	3.2	2.1	1.6	5.1	2.2	1.8
UK										
Headline CPI		8.4	6.7	4.7	4.4	2.7	2.8	7.4	3.1	1.8
Core CPI		6.9	6.4	5.7	5.3	3.4	2.8	6.3	3.4	1.7
Monetary policy, %										
ECB										
Refi Rate		4.00	4.50	4.50	4.50	4.50	4.25	4.50	4.00	3.00
Deposit Rate		3.50	4.00	4.00	4.00	4.00	3.75	4.00	3.50	2.50
BoE										
Bank Rate		5.00	5.25	5.25	5.25	5.25	5.00	5.25	4.50	2.75

Source: Bloomberg, ECB, BoE 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/ <i>Daiwa</i> <i>forecast/actual</i>	Previous
<b>Monday 25 September 2023</b>					
Germany 	09.00	Ifo business climate balance	Sep	85.1	85.7
	09.00	Ifo current assessment (expectations) balance	Sep	87.9 (82.8)	89.0 (82.6)
UK 	11.00	CBI distributive trades, reported sales	Sep	-35	-44
<b>Tuesday 26 September 2023</b>					
- Nothing scheduled -					
<b>Wednesday 27 September 2023</b>					
Euro area 	09.00	M3 money supply Y/Y%	Aug	-1.1	-0.4
Germany 	07.00	GfK consumer confidence index	Oct	-25.5	-25.5
France 	07.45	INSEE consumer confidence index	Sep	84	85
<b>Thursday 28 September 2023</b>					
Euro area 	10.00	European Commission's Economic Sentiment index	Sep	92.1	93.3
	10.00	European Commission's final consumer confidence index	Sep	<u>-17.8</u>	-16.0
	10.00	European Commission's industrial (services) index	Sep	-10.5 (3.4)	-10.3 (3.9)
Germany 	13.00	Preliminary HICP (CPI) Y/Y%	Sep	4.6 (4.6)	6.4 (6.1)
Italy 	09.00	ISTAT business (manufacturing) confidence index	Sep	-	106.8 (97.8)
	09.00	ISTAT consumer confidence index	Sep	-	106.5
Spain 	08.00	Preliminary HICP (CPI) Y/Y%	Sep	3.1 (3.5)	2.4 (2.6)
	08.00	Retail sales Y/Y%	Aug	-	7.3
UK 	-	Nationwide house price index* M/M% (Y/Y%)	Sep	-0.5 (-5.8)	-0.8 (-5.3)
<b>Friday 29 September 2023</b>					
Euro area 	10.00	HICP (core CPI) Y/Y%	Sep	<u>4.3 (4.9)</u>	5.3 (5.3)
Germany 	07.00	Retail sales M/M% (Y/Y%)	Aug	0.5 (-1.0)	-1.0 (-2.6)
	08.55	Unemployment change '000s (rate %)	Sep	15.0 (5.7)	18.0 (5.7)
France 	07.45	Preliminary HICP (CPI) Y/Y%	Sep	6.0 (5.2)	5.7 (4.9)
	07.45	Consumer spending M/M% (Y/Y%)	Aug	-0.3 (-1.7)	0.3 (-1.1)
	07.45	PPI Y/Y%	Aug	-	0.9
Italy 	10.00	Preliminary HICP (CPI) Y/Y%	Sep	5.3 (5.4)	5.5 (5.4)
	11.00	Industrial sales M/M% (Y/Y%)	Jul	-	0.4 (1.3)
UK 	00.01	Lloyds business barometer	Sep	-	41
	07.00	Final GDP Q/Q% (Y/Y%)	Q2	<u>0.2 (0.4)</u>	0.1 (0.2)
	09.30	Net consumer credit £bn (Y/Y%)	Aug	1.3 (-)	1.2 (7.3)
	09.30	Net mortgage lending £bn (mortgage approvals '000s)	Aug	0.2 (48.0)	0.2 (49.4)
	09.30	M4 money supply Y/Y%	Aug	-	-0.9

\*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 25 September 2023</b>		
Euro area	 08.00	ECB's Villeroy scheduled to speak on monetary policy and macroeconomics
	 14.00	ECB President Lagarde speaks at hearing before the Committee on Economic and Monetary Affairs
	 14.00	ECB's Schnabel scheduled to speak at University event
<b>Tuesday 26 September 2023</b>		
Euro area	 08.00	ECB's Chief Economist Lane scheduled to speak on "monetary policy challenges for European macroeconomics"
Germany	 10.30	Auction: €4bn of 2.40% 2028 bonds
Italy	 10.00	Auction: €3bn of 3.60% 2025 bonds
	 10.00	Auction: 1.50% 2029 index-linked bonds
	 10.00	Auction: 2.55% 2041 index-linked bonds
UK	 10.00	Auction: £3.0bn of 0.875% 2033 green bonds
<b>Wednesday 27 September 2023</b>		
Germany	 10.30	Auction: €4bn of 2.60% 2033 bonds
UK	 10.00	Auction: 1.125% 2073 bonds
<b>Thursday 28 September 2023</b>		
Euro area	 09.00	ECB publishes Economic Bulletin
	 17.30	ECB's de Cos scheduled to speak on globalisation
Italy	 10.00	Auction: 5Y and 10Y bonds
<b>Friday 29 September 2023</b>		
Euro area	 08.40	ECB President Lagarde scheduled to speak at event of energy transition

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Preliminary manufacturing (services) PMI	Sep	<b>43.4 (48.4)</b>	44.0 (47.6)	43.5 (47.9)	-
	 Preliminary composite PMI	Sep	<b>47.1</b>	46.5	46.7	-
Germany	 Preliminary manufacturing (services) PMI	Sep	<b>39.8 (49.8)</b>	39.5 (47.1)	39.1 (47.3)	-
	 Preliminary composite PMI	Sep	<b>46.2</b>	44.7	44.6	-
France	 Preliminary manufacturing (services) PMI	Sep	<b>43.6 (43.9)</b>	46.1 (46.0)	46.0 (46.0)	-
	 Preliminary composite PMI	Sep	<b>43.5</b>	46.0	46.0	-
Spain	 Final GDP Q/Q% (Y/Y%)	Q2	<b>0.5 (2.2)</b>	<u>0.4 (1.8)</u>	0.5 (4.2)	-
UK	 GfK consumer confidence	Sep	<b>-21</b>	-26	-25	-
	 Retail sales including auto fuels M/M% (Y/Y%)	Aug	<b>0.4 (-1.4)</b>	0.5 (-1.2)	-1.2 (-3.2)	-1.1 (-3.1)
	 Retail sales excluding auto fuels M/M% (Y/Y%)	Aug	<b>0.6 (-1.4)</b>	0.7 (-1.3)	-1.4 (-3.4)	- (-3.3)
	 Preliminary manufacturing (services) PMI	Sep	<b>44.2 (47.2)</b>	43.2 (49.4)	43.0 (49.5)	-
	 Preliminary composite PMI	Sep	<b>46.8</b>	48.7	48.6	-
	 CBI industrial trends, total orders (selling prices)	Sep	<b>-18 (14)</b>	-17 (-)	-15 (8)	-

#### Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited ("DCME"). DCME is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange. DCME and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or derivatives or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of DCME and its affiliates may have positions and effect transactions in such the Securities or derivatives or options thereof and may serve as Directors of such issuers. DCME may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended only for investors who are professional clients as defined in MiFID II and should not be distributed to retail clients as defined in MiFID II. Should you enter into investment business with DCME's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

DCME has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

#### **Explanatory Document of Unregistered Credit Ratings**

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: <https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>

#### **IMPORTANT**

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.