

Euro wrap-up

Overview

- Bunds made massive losses even as German inflation fell sharply to a two-year low and the Commission's sentiment indicator slipped further to suggest contraction in euro area GDP in Q3.
- Gilts made even larger losses despite a quiet day for UK economic news.
- Friday will bring the flash euro area inflation estimates, German and French consumer spending figures, as well as UK bank lending numbers and updated Q2 national accounts.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.289	+0.066
OBL 2.4 10/28	2.911	+0.108
DBR 2.6 08/33	2.963	+0.126
UKT 3½ 10/25	4.950	+0.106
UKT 4½ 06/28	4.614	+0.157
UKT 3¼ 01/33	4.524	+0.171

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

Source: Bloomberg

Euro area

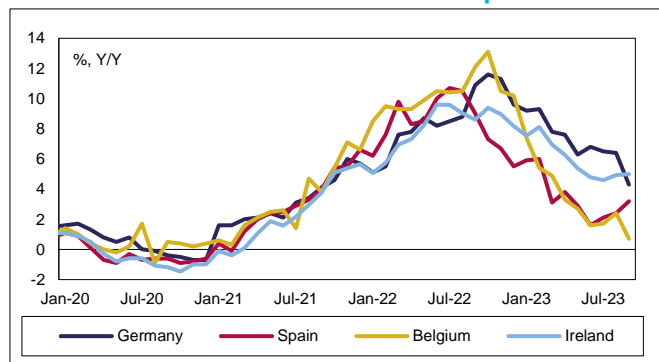
German inflation takes big step down in September with broad-based easing of pressures

German inflation took a big step down in September as prices across a range of items behaved more normally in marked contrast to the sharp increases a year earlier. In particular, with prices up just 0.2%M/M in contrast to the rise of 2.2%M/M a year earlier, which had been the second-highest monthly increase on the series, the headline EU-harmonised HICP inflation rate slowed a larger-than-expected 2.1ppts to a two-year low of 4.3%Y/Y. On the national CPI measure, inflation slowed 1.6ppts to 4.5%Y/Y, the lowest since the Russian invasion of Ukraine in February 2022 and also a touch below the consensus forecast. The CPI detail showed that the easing of German price pressures was broad-based. Despite higher prices of auto fuel, the base effect associated with the steep increase in household utility bills a year earlier meant that energy inflation slowed a huge 7.3ppts to just 1.0%Y/Y, the lowest since February 2021. While food prices rose on the month for the first time since March, the respective annual inflation rate slowed 1.5ppts to an 18-month low of 7.5%Y/Y. Among the core items, inflation of non-energy industrial goods appears to have moderated too. And most importantly, as the base effect from last year's super-discounted public transport prices fell out of the calculation, and prices of services overall fell for the first time in ten months, services inflation dropped 1.1ppts to a nine-month low of 4.0%Y/Y. As a result, German core CPI inflation (excluding all food and energy) fell 0.9ppt to a 12-month low of 4.6%Y/Y. And as the pass-through from past increases in prices of electricity, gas and food continues to fade, and margins come under pressure from weak demand, we expect German core inflation to fall significantly further by the end of the year and into 2024.

Headline inflation in Spain ticks slightly higher, but core inflation eases to 15-month low

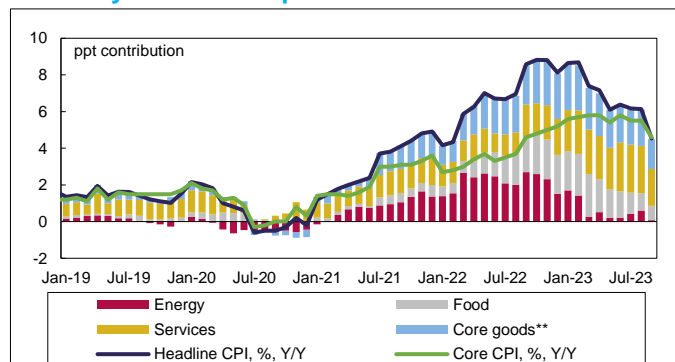
While also a touch below expectations, Spanish inflation once again ticked higher in September, with the HICP and national headline rates rising 0.8ppt to 3.2%Y/Y and 0.9ppt to 3.5%Y/Y respectively, both the highest for five months. Spain's statistical institute (INE) suggested that the increase principally reflected higher electricity prices, as well as the recent rise in auto fuel prices. As such, when excluding energy and unprocessed foods, INE's measure of core inflation fell more than expected in September, by 0.3ppt to a fifteen-month low of 5.8%Y/Y. While the Irish HICP rate also edged slightly higher (up 0.1ppt to 5.0%Y/Y), core inflation moderated again in September too, by 0.3ppt to 4.5%Y/Y. And there was a surprisingly large drop in the headline HICP rate in Belgium, which fell 1.7ppts to 0.7%Y/Y, the lowest since April 2021, with the core CPI rate (ex fresh food and energy) down a steep 0.75ppt to 6.95%Y/Y. Overall, based on today's figures – which account for almost 45% of the euro area – we continue to expect euro area inflation to drop by as much as 0.9ppt in September to 4.3%Y/Y, which would be a near-two-year low. This assumes a modest uptick in France and slight easing in Italy, as well as another sharp decline in the Netherlands. Euro area core inflation now looks set to drop by about 0.5ppt to 4.8%Y/Y.

Euro area member states: Consumer price inflation*



*HICP measure. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation*



*National measure. **Non-energy industrial goods inflation. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Consumer inflation expectations rise but firms' price expectations dampened by weaker demand

Despite the moderation in consumer price inflation this month, the European Commission's economic survey results today suggested that households' expectations for prices over the coming twelve months increased for a second successive month in September. We suspect that this was again driven by the steady increase in the price of auto fuel, which rose over the past week to its highest since July 2022 to take the cumulative increase since mid-May to more than 9½%. But while the aggregate euro area consumer price expectations index rose to a four-month high of 12.0, this remained well below the long-run average (24) and the peak in March 2022 (64). More encouragingly, selling price expectations for the coming three months in the services sector resumed a downwards trend this month, with the respective index falling to its lowest level in two years. While retail price expectations also remained well above average, they too fell to their lowest since May 2021. And although there was a further modest uptick in the survey's measure of industry and construction selling price expectations, they remained well below their long-run averages as input cost pressures continue to dissipate and weaker demand limits firm's capacity to pass on price increases to consumers

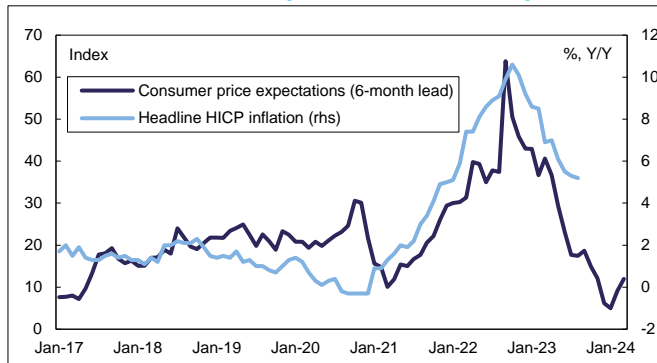
Economic sentiment continues to deteriorate, but signs that the trough might have been reached

Like last week's flash PMIs, the Commission's sentiment indices hinted that the trough in the current downturn might well be near. Admittedly, the headline economic sentiment index (ESI) fell for a fifth consecutive month in September to 93.3, the lowest level since November 2020 and some 6.7% below the long-run average. And with the quarterly index in Q3 some 3pts below the Q2 average, like the PMIs, today's survey strongly suggests that euro area GDP contracted this quarter. Nevertheless, the monthly drop in September (-0.3pt) was less than had been expected and the smallest of the past five months. Moreover, there were signs of stabilisation in economic conditions in the two largest member states, with the German ESI up for the first month in five by (an admittedly modest) 0.3pt to 89.0, while the French ESI jumped 2.7pts to 95.9. Indeed, the weakness at the end of Q3 largely reflected adjustments in Italy and Spain, where sentiment has largely remained above the long-run average since the start of the year, with the respective ESIs declining 2.2pts to an eleven-month low of 97.9 and 3.2pts to a ten-month low of 99.0.

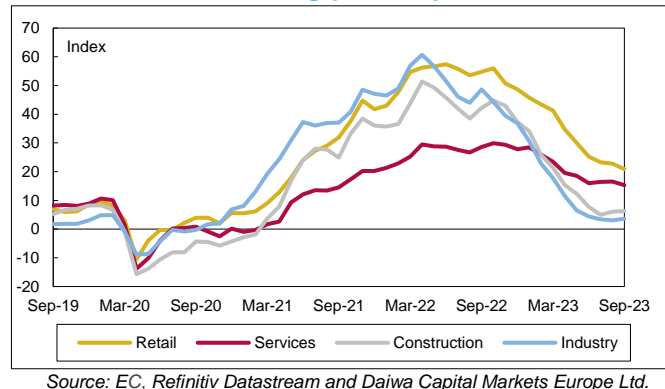
Broad-based weakness in sentiment, but services and manufacturers more upbeat about outlook

With the exception of manufacturing, which reported a slight easing in pessimism for the first time in eight months, the headline economic sentiment indices suggested a broad-based deterioration in confidence in September. Sentiment among retailers fell to the weakest in three months, with a ten-month low reached in services and a three-year low in construction. Much of this weakness, however, reflected assessments of past activity. Indeed, firms in services and retail were the most

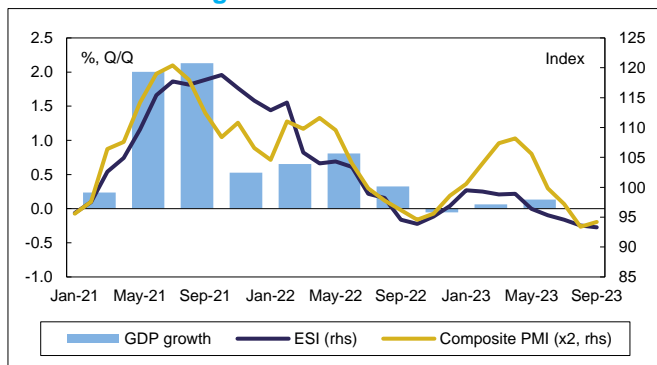
Euro area: Consumer price inflation & expectations



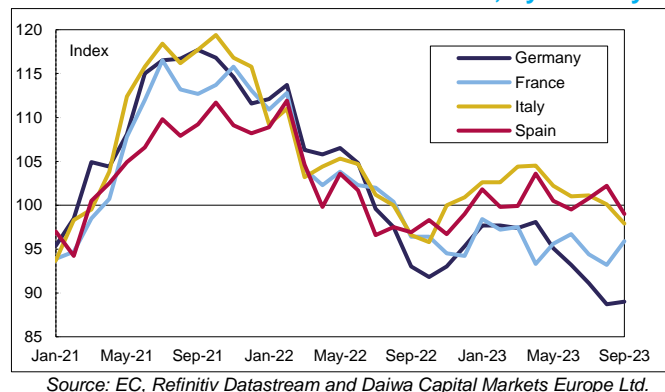
Euro area: Firms' selling-price expectations



Euro area: GDP growth & sentiment indices



Euro area: Headline sentiment indices, by country



upbeat about the outlook for demand in five and nineteen months respectively, with manufacturers also more optimistic about the production outlook amid some stabilisation in order books. But with construction more adversely impacted by the higher cost of borrowing, firms in that sector reported a drop in new business to the lowest in more than three years. The deterioration in consumer confidence to a six-month low amid worsening perceptions of the outlook for the economy and personal incomes also suggests that demand will remain relatively sluggish over the near term as households favour saving rather than spending. More encouragingly, the employment expectations index (EEI) rose for just the second time since February due to increased plans for hiring in services. Admittedly, this left the EEI at its second-lowest reading since April 2021, suggesting that job growth will be subdued. And overall, even assuming we have now reached the trough, we maintain our view that the recovery in economic momentum in the euro area will remain lacklustre over coming quarters.

The day ahead in the euro area

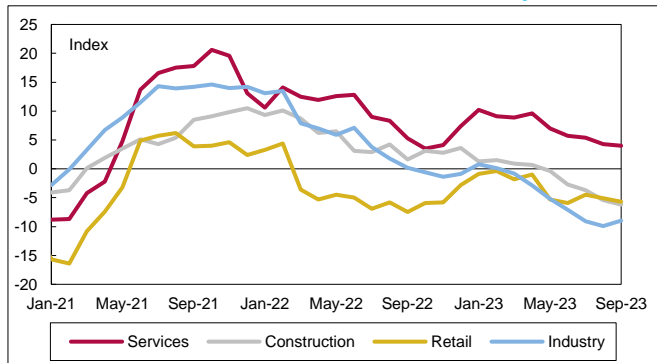
The main focus tomorrow will be the aforementioned euro area inflation estimates for September. Like in Germany, we expect the headline euro area HICP rate to fall sharply from 5.2%Y/Y in August, by as much as 0.9ppt to its lowest level since October 2021. Given that the moderation will in large part reflect a drop in transport services costs – as base effects with Germany's travel pass last year falling out of the calculation – core inflation is also expected to have declined around ½ppt to a twelve-month low of 4.8%Y/Y. Alongside preliminary inflation data from France, Italy and the Netherlands, national releases tomorrow will include German unemployment claims figures for September, as well as German retail sales and French consumer spending numbers for August. Household consumption of goods looks set to have remained subdued over the summer, with an anticipated modest increase in Germany (0.5%M/M) to reverse just half the drop in July, while spending in France is expected to have declined around ½%M/M.

UK

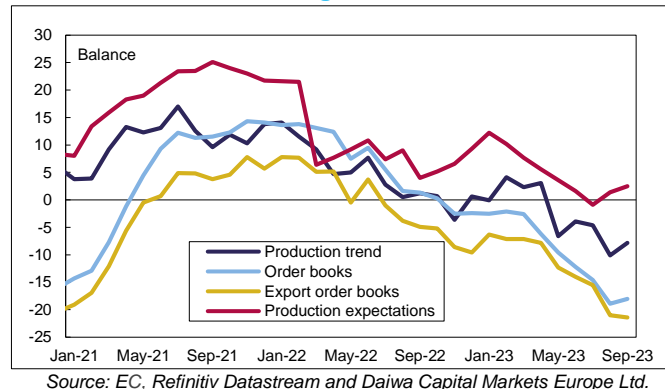
The day ahead in the UK

Following another day bereft of UK top-tier releases, it should be a busier end to the week, with arguably of most interest being the BoE's latest monetary data. 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. Tomorrow 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

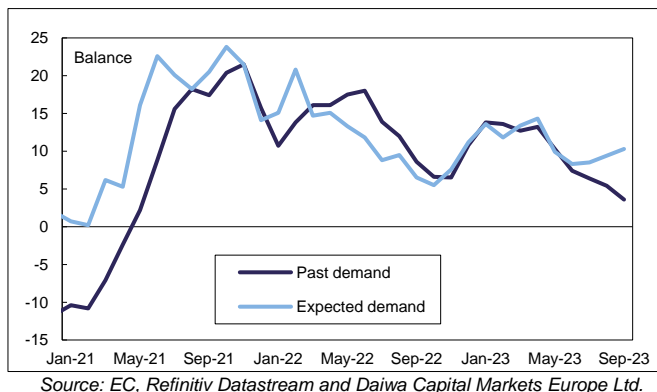
Euro area: Headline sentiment indices, by sector



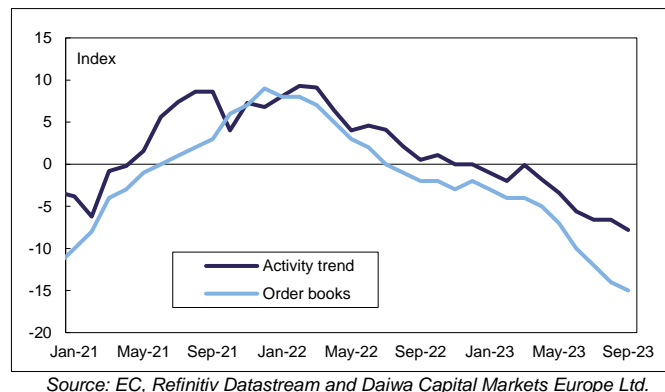
Euro area: Manufacturing sentiment indices



Euro area: Services sentiment indices

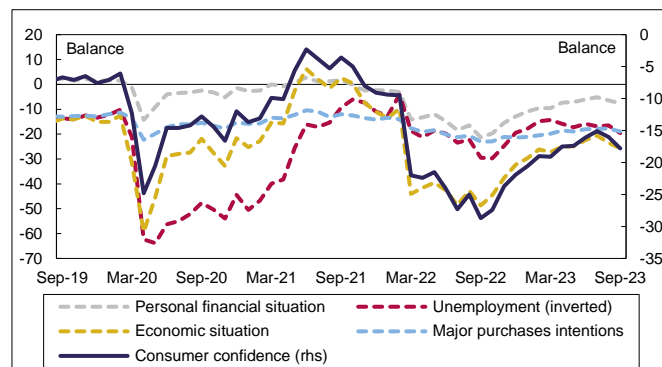


Euro area: Construction sentiment indices



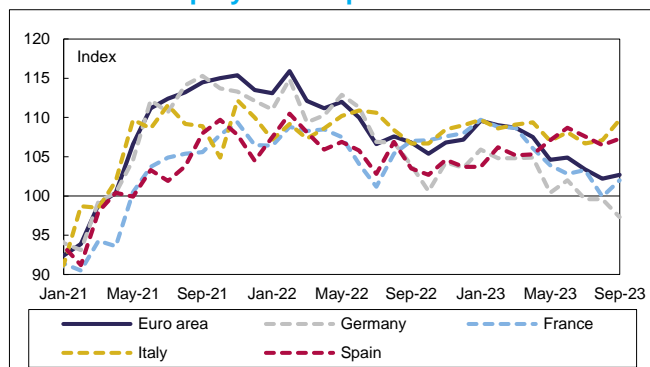
government spending and a pickup in business investment. However, the ONS might well make significant revisions to the level of GDP in 2022 reflecting the application of the methodological changes that earlier this month led to a [big upwards revision](#) to the estimate of growth in 2021. Meanwhile, 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.

Euro area: Consumer confidence indices



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

Euro area: Employment expectations indices



Source: EC, Refinitiv Datastream 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	European Commission's Economic Sentiment index	Sep	93.3	92.4	93.3	93.6
	European Commission's final consumer confidence index	Sep	-17.8	-17.8	-16.0	-
	European Commission's industrial (services) index	Sep	-9.0 (4.0)	-10.5 (3.4)	-10.3 (3.9)	-9.9 (4.3)
Germany	Preliminary HICP (CPI) Y/Y%	Sep	4.3 (4.5)	4.6 (4.6)	6.4 (6.1)	-
Italy	ISTAT business (manufacturing) confidence index	Sep	104.9 (96.4)	- (97.0)	106.8 (97.8)	106.7 (97.7)
	ISTAT consumer confidence index	Sep	105.4	105.5	106.5	-
Spain	Preliminary HICP (CPI) Y/Y%	Sep	3.2 (3.5)	3.3 (3.5)	2.4 (2.6)	-
	Retail sales Y/Y%	Aug	7.2	-	7.3	-

Auctions


Country	Auction
Italy	sold €5.00bn of 4.10% 2029 bonds at an average yield of 4.41%
	sold €3.00bn of 4.20% 2034 bonds at an average yield of 4.93%
	sold €750mn of 2026 floating-rate bonds at an average yield of 4.12%
	sold €750mn of 2030 floating-rate bonds at an average yield of 4.89%

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	HICP (core CPI) Y/Y%	Sep	<u>4.3 (4.8)</u>	5.2 (5.3)
Germany 	07.00	Retail sales M/M% (Y/Y%)	Aug	0.5 (-0.7)	-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	5.9 (5.1)	5.7 (4.9)
	07.45	Consumer spending M/M% (Y/Y%)	Aug	-0.5 (-1.9)	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 (47.4)	0.2 (49.4)
	09.30	M4 money supply Y/Y%	Aug	-	-0.9

Auctions and events

Euro area 	08.40	ECB President Lagarde scheduled to speak at event of energy transition
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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

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