

Euro wrap-up

Overview

- Bunds made gains as data for German goods trade, and French and Spanish IP, as well as a euro area construction sector survey, were all consistent with weak economic momentum.
- Despite some hints of stickiness in business price and wage expectations, Gilts also made gains as the UK construction PMIs suggested a sudden significant deterioration in conditions in the sector.
- Friday will bring German factory orders data.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.132	-0.038
OBL 2.4 10/28	2.766	-0.042
DBR 2.6 08/33	2.883	-0.032
UKT 3½ 10/25	4.859	-0.057
UKT 4½ 06/28	4.542	-0.059
UKT 3¼ 01/33	4.541	-0.034

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

Euro area

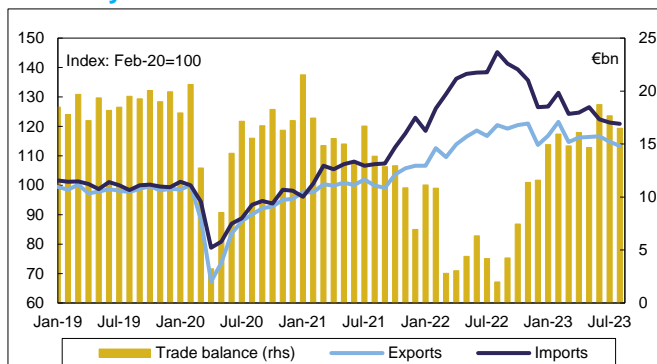
German goods exports decline more than expected over the summer

Germany's latest goods trade figures suggested that net exports offered little support to GDP growth in Q3. Indeed, the seasonally adjusted surplus narrowed in August by €1.1bn to a three-month low of €16.6bn. This reflected a steeper-than-expected decline in the value of exports (-1.2%M/M), which fell for a second successive month to their lowest level since March 2022 to be down 5.8%Y/Y. In terms of export markets, weakness was relatively widespread with the value of shipments down to other euro area member states (-2.6%M/M), the UK (-4.2%M/M) and US (-1.3%M/M), while shipments to China increased (1.2%M/M). In the year to date, however, exports were up 0.6%YTD/Y to the rest of the euro area, 6.7%YTD/Y to the UK and 5.0%YTD/Y to the US, but still down almost 7.9%YTD/Y to China. Meanwhile, the value of imports fell for a third successive month (-0.4%M/M) to leave them down a steep 16.8%Y/Y, as import prices fell a similar 16.4%Y/Y despite rising in August for the first time in twelve months. So, adjusting for price changes, goods import volumes were trending in the first two months of Q3 some 1.4% below the Q2 average. At the same time, while export prices also rose on the month and were down just 5.1%Y/Y, the ongoing improvement in Germany's terms of trade paused in August. Moreover, goods export volumes were trending a steeper 1.7% below the Q2 average, consistent with recent downbeat surveys and ongoing weakness in new export orders, as well as a modest drag on GDP growth in Q3.

French and Spanish industrial production slip back in August

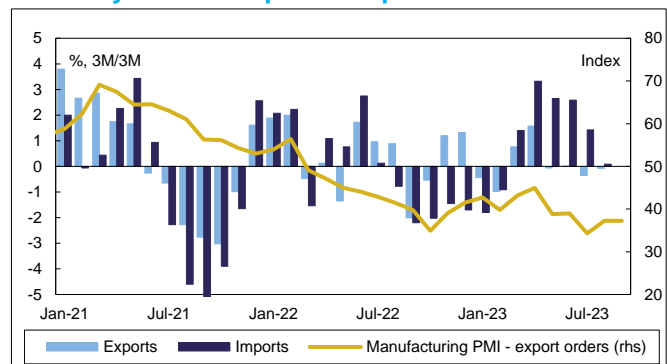
Challenging conditions in some subsectors of the manufacturing sector were also illustrated in today's industrial production releases from France and Spain. In particular, French IP fell 0.3%M/M in August following downwardly revised growth of 0.5%M/M in July. The drop in manufacturing output (-0.4%M/M) fully reversed the increase in July, with a jump in other transport equipment – in particular aerospace – and clothing more than offset by declines in autos, food, and machinery and equipment, with the latter down to its lowest level in ten months. Production in energy-intensive industries also remained lacklustre amid a steep drop in glassware to be trending some 2½% below the Q2 average. Indeed, French energy-intensive production is now more than 18% below the pre-pandemic level, broadly in line with the scale of adjustment in the same subsectors in Germany. More happily, however, given previous strength in the autos, coke and pharmaceutical sectors, manufacturing output was still trending broadly sideways in the first two months of Q3. And while construction activity fell in August (-1.4%M/M) to its lowest level since December 2021, a further increase in energy production to a sixteen-month high left total industrial production trending so far in Q3 marginally higher than in Q2. In contrast, Spanish industrial production in July and August was averaging 1.0% below Q2 and suggesting the sector was on track to provide a drag on GDP growth in Q3. We think that negative impact will, however, be more than offset by continued growth in services.

Germany: Goods trade values



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Germany: Goods export & import volumes



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

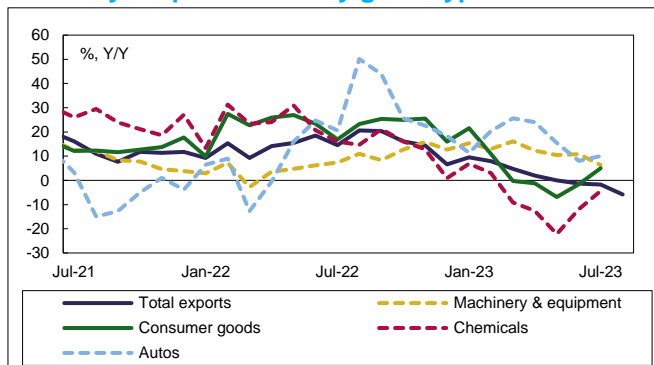
Construction PMIs point to significant contraction amid marked drop in demand

Having weakened heading into the summer months, the business climate in the construction sector continues to deteriorate as higher interest rates inevitably sap demand. According to the most recent hard data, euro area construction output fell 1.1%3M/3M in July. And subsequent survey indicators point to ongoing contraction through to the autumn. Indeed, today's construction PMI survey reported a further drop in production in September at a similar pace to the prior two months, with the headline euro area index up just 0.2pt from August's eight-month low to 43.6. New orders in the sector reportedly fell at the fastest pace since the first wave of Covid-19, with the respective PMI down more than 3pts to 38.9. So, business expectations for the coming twelve months deteriorated to the lowest so far this year. And firms signalled a desire to cut headcount even though input costs appeared broadly stable. Among the largest member states, the survey suggested that German output in the sector continues to decline at the steepest rate, with the country's headline index down to 39.3, the lowest since April 2020. But the equivalent French PMI (43.7) was also consistent with falling production. More happily, the Italian index rose to a ten-month high (49.8) to suggest some stabilisation after a period of contraction related not least to the dilution of the government's Superbonus green tax credit incentive.

Housebuilding responds to rising rates as house prices post first annual decline since Q114

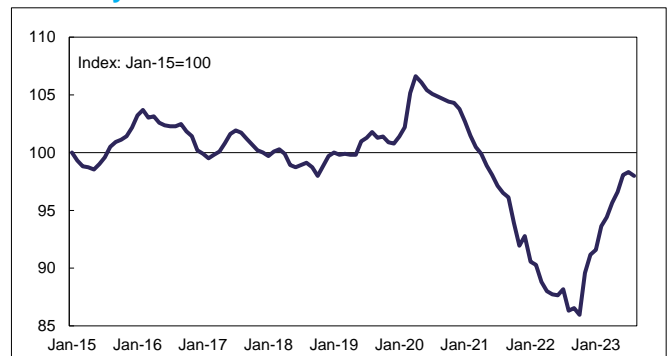
Within the detail of the euro area survey, civil engineering activity declined at a steeper pace in September with commercial work also in retreat. But housing remained the weakest subsector, as new demand continued to be hit by rising interest rates, subdued household confidence, squeezed disposable incomes and falling residential property prices in several member states. Indeed, the euro area housing activity PMI (39.4) remained below 40 for a third successive month for the first time since 2010, with the German and French indices weaker than the regional figure but Italy's rising to a ten-month high of 50.5. Mortgage rates continue to rise across the euro area, with the average cost of borrowing on a new loan for home purchase up in August to 3.85%, the highest since the euro crisis in 2011. So, following significant gains over recent years, on average house prices have gone into reverse, dropping in the euro area by 1.7%Y/Y in Q2 to mark the first annual decline since Q114. But the aggregate euro area figure masks significant differences between the countries. House prices were down sharply in Germany (-9.9%Y/Y), the Netherlands (-4.3%Y/Y) and Finland (-5.6%Y/Y), where past increases had been particularly marked when interest rates had been very low. But they were still up slightly on a year earlier in France and Italy (both 0.7%Y/Y), and significantly in Spain (3.7%Y/Y) where previous price rises had been more limited. And they continued to roar ahead in Portugal (8.7%Y/Y).

Germany: Export values by good-type



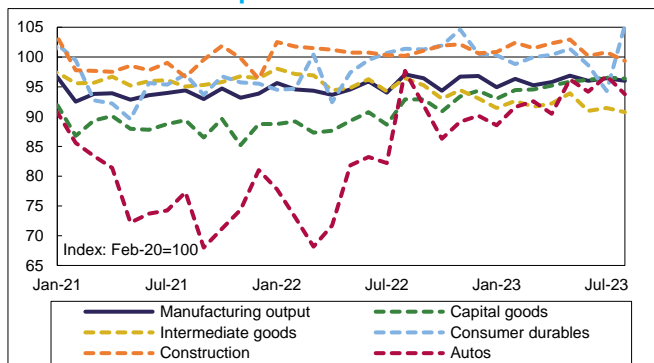
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Germany: Terms of trade*



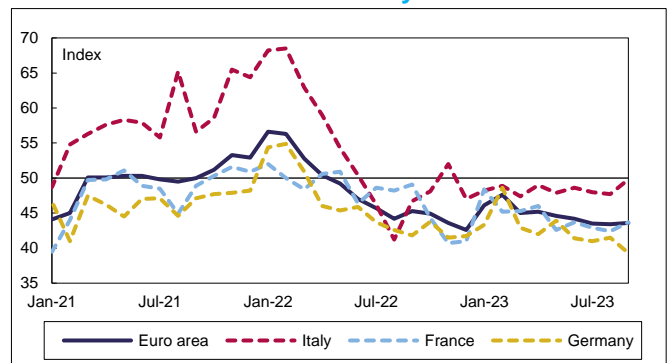
*Ratio of goods export prices to import prices. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

France: Industrial production



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Construction activity PMIs



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

The day ahead in the euro area

The main focus in the euro area tomorrow will be the release of German factory orders data for August. Orders have been particularly volatile over recent months, falling a steep 11.7%M/M in July, following cumulative growth of more than 14% in the previous two months. So, while the median forecast on the Bloomberg survey is for an increase of 1.5%M/M in August, there are significant uncertainties surrounding this estimate. Meanwhile, the latest French trade numbers are expected to show that the deficit remained close to July's level of €8bn.

UK

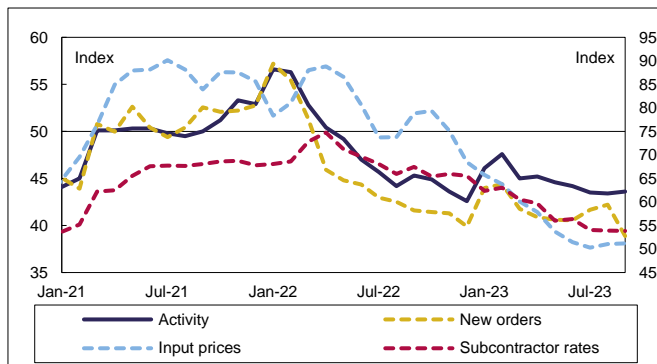
Firms' inflation & wage expectations maintain downtrend despite some temporary stickiness

According to the BoE's latest Decision Maker Panel (DMP), the trend in business inflation expectations appears to remain favourable despite some stickiness in the latest single-month figures. Firms reported that their own output prices rose by an average annual rate of 7.4% in the three months to September, unchanged for a third consecutive month. But their expectation for the rate of increase in their own prices over the coming twelve months fell to 4.8%Y/Y, down 0.2ppt from the three months to August. One-year ahead CPI inflation expectations increased slightly to 4.9% in September, up from 4.8% in August. However, the three-month moving average fell by 0.3ppt to 5.0%. And three-year ahead CPI inflation expectations remained unchanged at 3.2%Y/Y in September, to push the three-month average down 0.2ppt to the same level, which is the lowest on the (admittedly short) series. Of course, the MPC is also concerned about the outlook for wage growth. And the single-month expectation for wage growth for the year ahead ticked up 0.2ppt to 5.2%Y/Y. That, however, left the three-month average wage growth expectation unchanged at a 14-month low of 5.1%Y/Y, 1.8ppt below survey respondents' estimate of realised wage growth in the three months to September. Of course, that would still be above levels consistent with the achievement of the BoE's inflation target over the medium term.

PMIs flag sudden downturn in construction in September

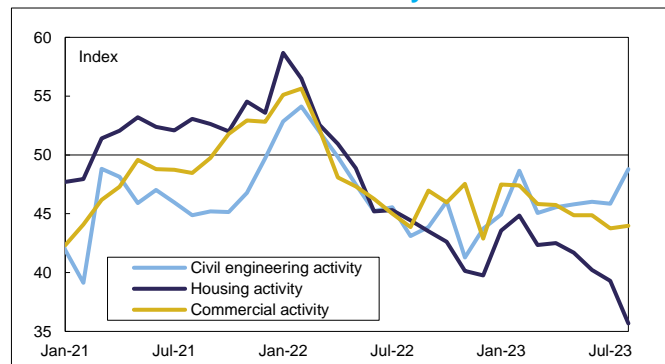
Like the euro area survey, the UK construction PMIs suggested a significant deterioration in conditions in the sector at the end of Q3. Indeed, the headline construction activity PMI dropped more than 5pts in September to 45.0, the lowest since the first wave of Covid-19 in May 2020. All major subsectors reported falling activity, with the sudden turnaround in fortunes in commercial work and civil engineering particularly marked. Indeed, the respective indices both dropped more than 6pts to signal contraction for the first time since January. But, as in the euro area, housebuilding remained weakest, with the respective PMI falling 2.7pts to 38.1, also the lowest since May 2020. While mortgage rates have fallen back somewhat from their summer highs, house prices continue to trend lower – down in both August and September by 5.3%Y/Y, the most since

Euro area: Construction PMIs



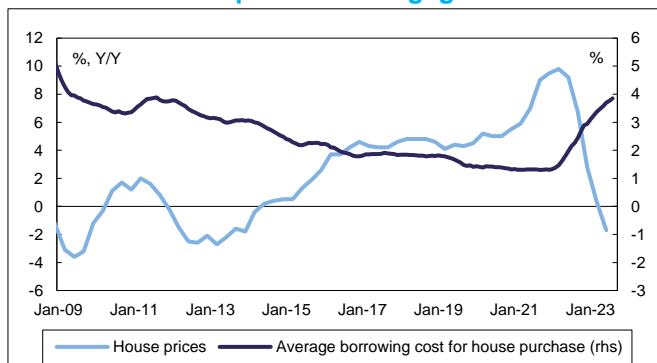
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Construction PMIs by sub-sector



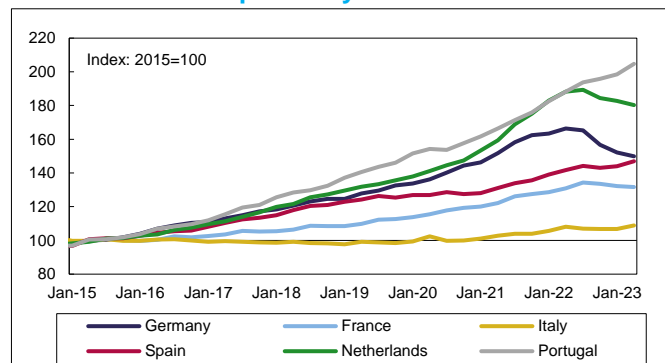
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: House prices & mortgage rates



Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: House prices by member state



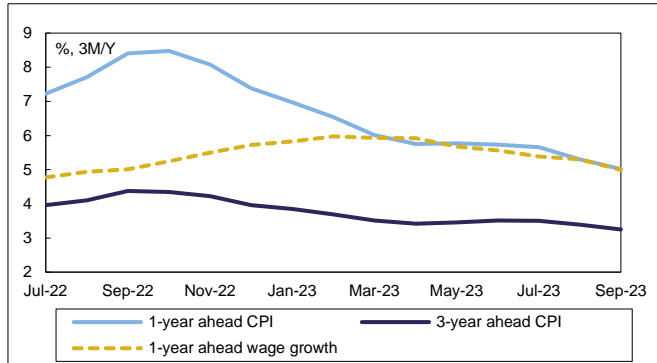
Source: Eurostat, Macrobond and Daiwa Capital Markets Europe Ltd.

2009, according to the Nationwide index – and are highly likely to have further to fall. So, with new orders reportedly declining the most since the first wave of pandemic due particularly to weakness in the residential construction subsector, firms were the least upbeat about the outlook for the coming twelve months so far this year. More happily, however, a majority of firms still anticipated output eventually to pick up. And with input costs stable, they also signalled a desire to increase headcount in the sector.

The day ahead in the UK

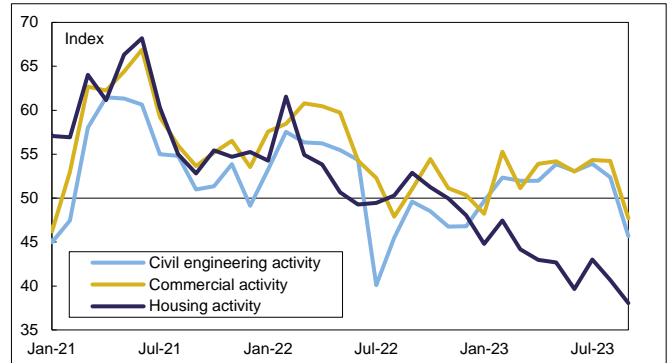
It should be a quiet end to the week for UK economic news, with no data releases scheduled tomorrow.

UK: Firms' price and wage expectations



Source: BoE DMP survey and Daiwa Capital Markets Europe Ltd.

UK: Construction PMIs by sub-sector














Source: Refinitiv Datastream, S&P Global 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	 Construction PMI	Sep	43.6	-	43.4	-
Germany	 Trade balance €bn	Aug	16.6	15.0	15.9	17.7
	 Construction PMI	Sep	39.3	-	41.5	-
France	 Industrial production M/M% (Y/Y%)	Aug	-0.3 (-0.5)	-0.4 (-0.5)	0.8 (2.7)	0.5 (2.5)
	 Manufacturing production M/M% (Y/Y%)	Aug	-0.4 (-1.1)	-	0.7 (2.7)	0.4 (2.6)
	 Construction PMI	Sep	43.7	-	42.4	-
Italy	 Construction PMI	Sep	49.8	-	47.7	-
Spain	 Industrial production M/M% (Y/Y%)	Aug	-0.8 (-3.4)	-0.3 (-1.8)	0.2 (-1.8)	0.1 (-2.2)
UK	 New car registrations Y/Y%	Sep	21.0	-	24.4	-
	 Construction PMI	Sep	45.0	50.0	50.8	-
	 BoE's DMP 3M (1Y) output price expectations	Sep	4.8 (4.9)	-	4.9 (4.8)	5.0 (-)




Auctions

Country	Auction
France	 sold €6.40bn of 3.50% 2033 bonds at an average yield of 3.56%
	 sold €1.67bn of 2.50% 2043 bonds at an average yield of 3.96%
	 sold €1.87bn of 3.00% 2054 bonds at an average yield of 4.06%
Spain	 sold €3.55bn of 3.50% 2029 bonds at an average yield of 3.644%
	 sold €1.29bn of 2.35% 2033 bonds at an average yield of 3.980%
	 sold €1.60bn of 1.00% 2042 bonds at an average yield of 4.479%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Germany		07.00	Factory orders M/M% (Y/Y%)	Aug	1.5 (-7.9)	-11.7 (-10.5)
France		07.45	Trade balance €bn	Aug	-	-8.1
Italy		09.00	Retail sales M/M% (Y/Y%)	Aug	0.0 (-)	0.4 (2.7)

Auctions and events

- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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