Euro wrap-up

Overview

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- While an ECB survey reported a pickup in household inflation expectations, Bunds made gains at the longer end of the curve as the Middle East conflict intensified and final German inflation data for September confirmed a significant and broad-based easing of price pressures.
- Gilts outperformed as a survey suggested that UK wage pressures are moderating.
- Thursday will bring the account of the ECB's September policy meeting as well as UK GDP data for August.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.087	+0.026
OBL 2.4 10/28	2.651	-0.007
DBR 2.6 08/33	2.715	-0.055
UKT 3½ 10/25	4.756	-0.011
UKT 4½ 06/28	4.365	-0.045
UKT 3¼ 01/33	4.322	-0.101

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

Euro area

Final German inflation data confirm sharp drop in pressure in part reflecting services base effect

Today's final German inflation figures for September confirmed the substantial and broad-based easing in pressure suggested by the flash estimates. In particular, with consumer prices on the EU-harmonised measure rising just 0.2%M/M compared with a jump of 2.2%M/M in September 2022, the annual HICP rate fell 2.1ppts to 4.3%Y/Y, the lowest in two years and 6.3ppts below last October's peak. The drop in the national measure was also unrevised at 1.6ppts to take the headline CPI rate to a nineteen-month low of 4.5%Y/Y. And core inflation fell 0.9ppt to a twelve-month low of 4.6%Y/Y. The detail confirmed that the decline was principally led by services, for which inflation fell 1.1ppts to a nine-month low of 4.0%Y/Y, as base effects of last summer's highly discounted €9 travel pass fell out of the calculation. Indeed, transport services costs fell 3.9%Y/Y in September, compared with a rise of almost 20%Y/Y in August. Accommodation inflation also moderated in September to the weakest in 20 months, while the catering component edged slightly lower and net rents continued to have a dampening effect.

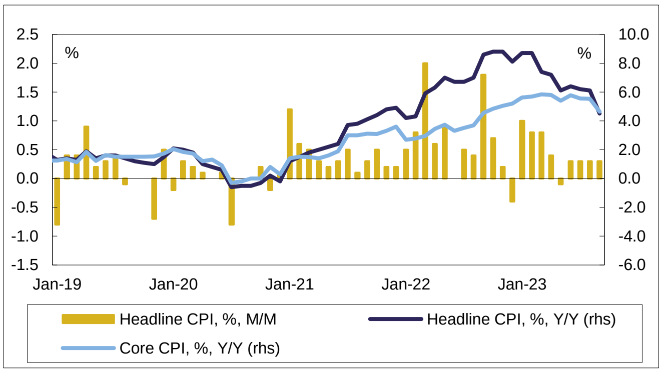
Broad-based disinflation trend in goods and energy components

The disinflationary trend was also evident across a range of core goods items, including furnishings and household appliances, motor vehicles and footwear. And while food prices rose for the first month in six, the magnitude of increase was still significantly smaller than a year earlier to push the annual inflation rate of that component down a further 1.5ppts to an eighteen-month low of 7.5%Y/Y. Given the surge in prices a year ago, energy inflation dropped sharply to 1.0%Y/Y, the lowest since February 2021. Indeed, despite the recent uptick in Brent crude oil prices, petrol prices were down 6.0%Y/Y with heating oil prices falling a much steeper 26.0%Y/Y. While the deflationary impulse from energy base effects will fade over coming months, base effects related to food prices will subtract significantly further from inflation into the New Year, while weak demand amid relaxed supply constraints will limit firms' pricing power in core goods and services. Indeed, according to an ifo institute survey, firms' selling price expectations for the three months ahead continued to moderate in September, with the composite index (12.2) falling to its lowest for more than 2½ years and well below the peak in April 2022 (65.3). In the absence of significant new shocks, we expect German CPI inflation to fall further to below 4.0%Y/Y in Q4 and below 3.0%Y/Y in Q124.

Households revise slightly higher their inflation expectations despite worsening economic outlook

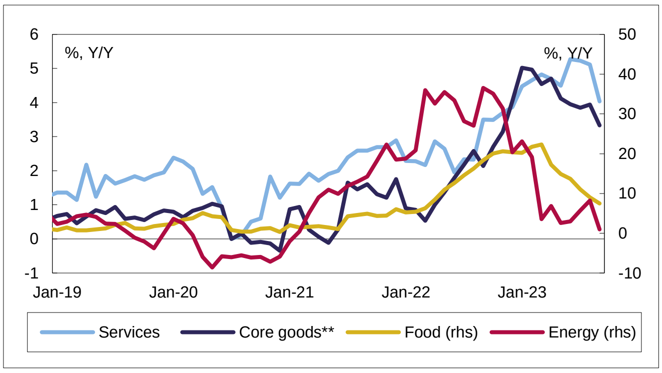
While headline inflation continues to moderate, the results from the ECB's August consumer expectations survey reported a modest uptick in households' inflation expectations over the summer, perhaps reflecting the rise in auto fuel prices. Indeed,

Germany: Consumer price inflation*



*National measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Key CPI components*



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

the median expectation for inflation twelve months ahead rose for the first month in five, by 0.1ppt to 3.5%Y/Y, with a jump in France to a three-month high and slightly firmer outturns in the Netherlands and Belgium too. The median consumer forecast for inflation three years ahead also rose for a second successive month, by 0.1ppt to 2.5%Y/Y. While the equivalent Italian measure rose to a ten-month high (3.2%Y/Y), medium-term expectations in Germany eased slightly (2.3%Y/Y), albeit still remaining slightly above the average so far this year and also modestly above the ECB's target. Beyond price concerns, the survey also suggested that households have become a touch more downbeat about the economic growth outlook for the coming twelve months, forecasting a decline in euro area GDP of 0.8%Y/Y as expectations for nominal household spending growth fell to the weakest since the Russian invasion of Ukraine. Among the member states, households in Italy and the Netherlands are particularly downbeat, expecting a notably sharper contraction in GDP.

The day ahead in the euro area

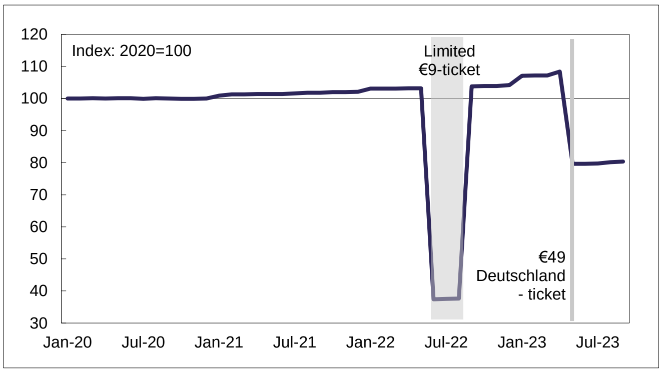
The focus in the euro area tomorrow will be the publication of the ECB's account from its September policy-setting meeting. On that occasion, the Governing Council raised interest rates by a further 25bps, taking the deposit rate to a record high of 4.00% and the cumulative tightening since July 2022 to 450bps. But the Governing Council also hinted that this will likely mark the peak for the current tightening cycle, with the statement noting that "interest rates have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to the target". President Lagarde also noted in her press conference that some members of the Governing Council had already wanted to pause rather than raise rates further in September. So, the account will continue to illustrate a range of opinions on the Governing Council, while also suggesting that the balance of risks has become much more balanced, justifying the more dovish stance.

UK

REC survey adds to evidence of a cooling in the labour market

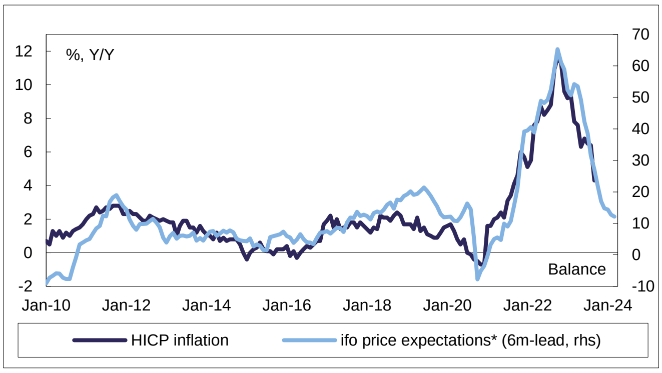
When it left rates unchanged at its September monetary policy meeting, the MPC downplayed concerns about the strength of private sector pay. While average weekly earnings (AWE) growth had accelerated well above the BoE's expectation to 8.1%Y/Y in the three months to July, the MPC noted evidence of a loosening of conditions in the labour market, including higher unemployment and a decline in job vacancies. They also considered the trend in AWE to be inconsistent with other indicators of pay growth. Among the signals on pay watched by the BoE are those from the REC report on jobs, based on a survey of recruitment and employment consultancies. And contrary to that recent trend in AWE, the results of the September REC survey, released today, suggested that pay growth continues to ease. In particular, the survey measure of permanent

Germany: Public transport consumer price index



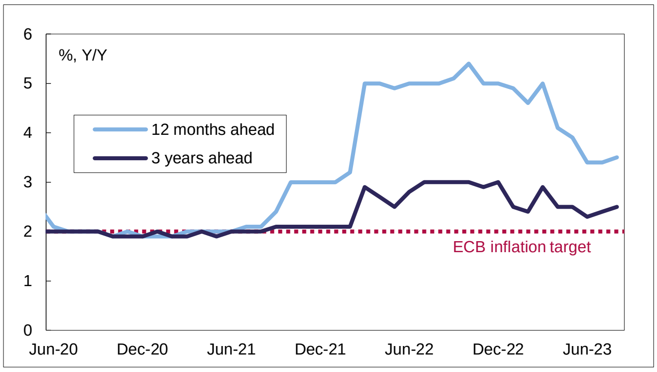
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: CPI & firms' selling price expectations



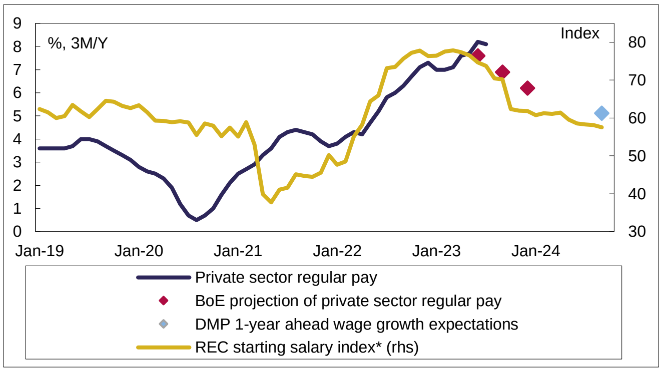
**Six-month lead. *Source: ifo, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.*

Euro area: Consumer price expectations



Source: ECB and Daiwa Capital Markets Europe Ltd.

UK: Private sector pay indicators



**Twelve-month lead. Source: BoE, S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.*

staff starting salaries fell for a fifth successive month to the lowest level since March 2021, and firmly below the average in the five years before the pandemic. And growth in wages for new temporary staff reportedly slowed to the softest in more than 2½ years. The weakening signals on pay tallied with last week's findings on business wage expectations from the BoE's DMP survey. And it reflected other evidence in the REC survey of a further improvement in the balance between labour supply and demand. For example, the REC reported a twelfth successive monthly decline in permanent staff placements, albeit at the softest pace in three months. It also flagged a drop in vacancies due to falling openings for permanent staff for the first time since February 2021, as firms signalled a preference for temporary staff instead. Moreover, with the supply of candidates for both permanent and temporary positions reportedly improved again at a historically high rate, notwithstanding persistent staff shortages in certain sectors (e.g. IT and healthcare), upwards pressure on pay should continue to dissipate.

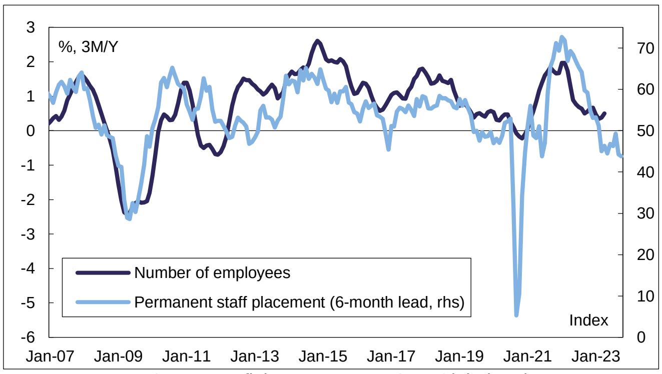
BRC survey adds to evidence that retail sales fell in Q3

Like today's REC survey, yesterday's BRC retail survey results for September suggested that UK economic momentum remains below potential, strengthening the case for the BoE to avoid further rate hikes this cycle. Certainly, demand on the high street remains very subdued, with the BRC's measure of the value of total sales slowing 0.9ppt to a ten-month low of 2.7%Y/Y. Growth in the value of like-for-like sales was down a larger 1.5ppts to 2.8%Y/Y, the second-softest rate since last autumn. With the average temperature in the UK for the month matching the series high, consumers postponed purchases of autumn clothing. Spending on big-ticket items was also reportedly weak as households remained uneasy about the economic outlook. Sales were supported, however, by the food and drink category as retailers took advantage of falling producer prices to implement price cuts and freezes on certain essential items. While inflation on the high street moderated, like-for-like sales deflated by the BRC's shop price index suggest that the pace of decline in the volume of sales accelerated 0.9ppt in September to -3.5%Y/Y, close to the average rate so far this year. And given the weak start to the quarter when sales were hit by exceptionally wet weather, total sales in real terms were down 4.2%3M/Y, some ½ppt steeper than the average in the year to-date. We note that the CBI distributive trades survey, released in late September, suggested that demand on the high street was not quite so underwhelming. However, it still reported a fifth consecutive drop in sales on an annual basis. And, with the average level of retail sales volumes in July and August on the official ONS measure down about ½% from the Q2 average, sales look to have fallen in Q3 for the first quarter since Q422. And we note that the unseasonably high temperatures that hit spending on clothing in September have been repeated in October, likely again weighing on total spending this month too.

The day ahead in the UK

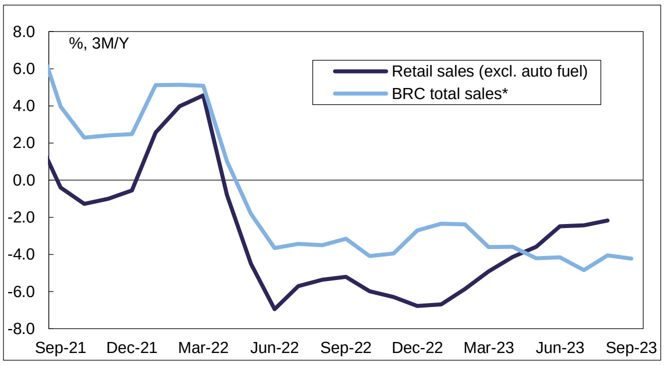
The UK's data highlight tomorrow will be the release of the monthly GDP report for August. Survey indicators, including the PMIs, signalled a deterioration in economic momentum over the summer, with the composite output index slumping more than 2pts to 48.6 in August, a level that in the five years before the pandemic would have been consistent with a substantive contraction in GDP. This notwithstanding, we expect some positive payback for the weather-associated weakness in July, which saw GDP decline 0.5%M/M. Certainly, retail sales in August (0.4%M/M) reversed some of the decline in July (-1.1%M/M). Overall, we expect GDP to have risen around 0.2%M/M in August, to leave growth on a three-month basis moderately positive at 0.3%3M/3M, which would be the firmest in thirteen months. Within the detail, we expect modest rebounds in services, manufacturing, and construction activity that month, which will be insufficient to fully reverse the contraction at the start of Q3. Meanwhile, amid weaker job prospects and high borrowing costs, the RICS residential survey for September is likely to imply an ongoing decline in house prices. And the BoE's quarterly Credit Conditions Survey will likely illustrate the impact of the MPC's aggressive monetary policy tightening on the demand for and supply of bank loans in Q3.

UK: Employment indicators



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

UK: Retail sales volumes



**Total sales deflated by BRC shop price index. Source Refinitv 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		ECB 1Y (3Y) CPI expectations Y/Y%	Aug	**3.5 (2.5)**	-	3.4 (2.4)	-
Germany		Final HICP (CPI) Y/Y%	Sep	**4.3 (4.5)**	*4.3 (4.5)*	6.4 (6.1)	-

Auctions

Country		Auction
Germany		sold €806mn of 1.25% 2048 bonds at an average yield of 2.89%
		sold €1.23bn of 0.00% 2052 bonds at an average yield of 2.87%
UK		sold £3.75bn of 4.625% 2034 bonds at an average yield of 4.444%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Italy		Industrial production M/M% (Y/Y%)	Aug	**0.2 (-4.2)**	-0.6 (-5.0)	-0.7 (-2.1)	-0.9 (-2.3)
UK		BRC retail sales monitor, like-for-like sales Y/Y%	Sep	**2.8**	-	4.3	-

Auctions

Country		Auction
Germany		sold €326mn of 0.100% 2033 index-linked bonds at an average yield of 0.42%
		sold €138mn of 0.100% 2046 index-linked bonds at an average yield of 0.56%
UK		sold £900mn of 0.125% 2039 index-linked bonds at an average yield of 1.265%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
UK		00.01	RICS house price balance %	Sep	-60	-68
		07.00	GDP M/M% (3M/3M%)	Aug	0.2 (0.3)	-0.5 (0.2)
		07.00	Industrial production M/M% (Y/Y%)	Aug	-0.1 (1.7)	-0.7 (0.4)
		07.00	Manufacturing production M/M% (Y/Y%)	Aug	-0.3 (3.5)	-0.8 (3.0)
		07.00	Index of services M/M% (3M/3M%)	Aug	0.3 (0.1)	-0.5 (0.1)
		07.00	Construction output M/M% (Y/Y%)	Aug	0.0 (2.4)	-0.5 (2.8)
		07.00	Total (goods) trade balance £bn	Aug	-3.7 (-15.0)	-3.4 (-14.1)

Auctions and events

Euro area		12.30	ECB publishes account of September meeting
Italy		10.00	Auction: €2.75bn of 3.85% 2026 bonds
		10.00	Auction: €2.75bn of 4.00% 2030 bonds
		10.00	Auction: €1.50bn of 4.00% 2035 bonds
		10.00	Auction: €1.00bn of 4.45% 2043 bonds
UK		09.30	BoE publishes its quarterly credit conditions survey
		10.00	BoE Chief Economist Pill scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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