Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds followed USTs lower, while a German investor sentiment survey pointed to some stabilisation in the outlook.
- Longer-dated Gilts also made losses as UK labour market figures reported a decline in payrolls and a very gradual moderation in wage pressures.
- Wednesday will bring updated September inflation estimates from the euro area and UK, as well as euro area construction activity data.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.238	+0.094
OBL 2.4 10/28	2.808	+0.103
DBR 2.6 08/33	2.879	+0.098
UKT 3½ 10/25	4.836	-0.042
UKT 4½ 06/28	4.532	+0.006
UKT 3¼ 01/33	4.508	+0.031

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

Euro area

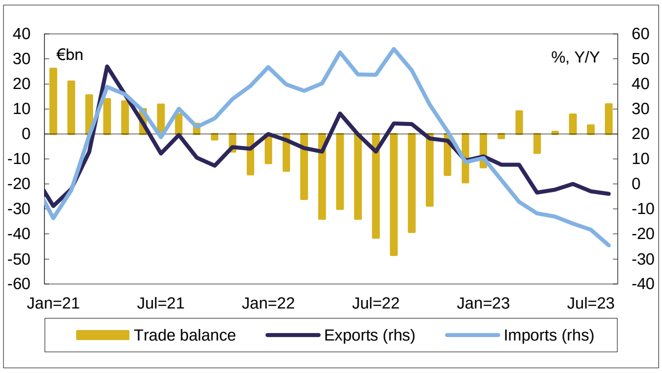
Euro area trade surplus jumps to its highest since May 2021

Despite subdued overseas demand, a significant (8.5%) appreciation of the nominal effective euro exchange rate over the prior twelve months, and increased tensions with China, which culminated earlier this month in the launch by the European Commission of an anti-subsidy investigation into imports of Chinese battery electric vehicles, euro area goods trade figures for August, published yesterday, were a little more encouraging than of late. In particular, the goods trade surplus rose €8.4bn in August to €11.9bn, the highest since May 2021 and more than €61bn above the record deficit hit a year earlier, albeit still some €6bn below the pre-pandemic five-year average. The improvement in August reflected a first rise in export values for three months (1.6%M/M) as well as renewed weakness in the value of imports (-2.0%M/M), which left them down 3.9%Y/Y and a whopping 24.6%Y/Y respectively. Admittedly, the rebalancing of the euro area's trade position over the past year in part reflects major relative price shifts, with import prices in August down a whopping 13.7%Y/Y in the euro area and an even steeper 16.4%Y/Y in Germany. While the equivalent figure for export prices is not yet available for the euro area, the drop in Germany was 'just' 5.1%Y/Y. But with euro area import prices having risen for the first month in twelve in August (0.6%M/M), import volumes also appear to have maintained a downwards trend over the summer. And while goods export volumes also appear to have fallen a little further on average over the first two months of Q3, with services exports likely boosted over the summer by tourism, net trade might yet have provided some modest support to GDP growth in Q3 following the sizeable drag in Q2.

Trade deficit with China at lowest in two years

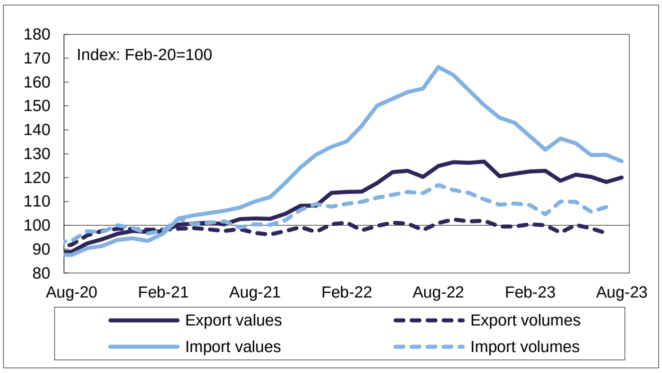
By destination, euro area exports to the US maintained a steady upwards trend in August, with values rising for a fourth consecutive month to their highest level since last November and up almost 5%Y/Y. Indeed, that left the euro area's bilateral trade surplus with the US at its second-highest level (€13.8bn) since the series began in 2002. Meanwhile, a double-digit rise in exports to Japan, reversing a slump in July, left them up almost 9½%Y/Y, helping broadly to balance the respective bilateral trade position. But while the value of exports to China was also still down around 6½%Y/Y, imports from China fell 8.8%M/M and around 31%Y/Y. So, having blown out to a record €28.2bn in September 2022, the euro area's trade deficit with China narrowed by €4bn on the month to €14.7bn, its lowest in two years and just €5bn above the average in the five years before the pandemic. While price shifts have played a role, the value of imports of chemicals from China was down by roughly two thirds from the peak in May last year, with the decline in volumes terms down a hefty 56% over the same period. Imports of machinery, transport equipment and other manufactured goods were down by roughly 30% from the respective peaks too.

Euro area: Trade balance, export & import values



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Exports & imports



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Goods imports likely to remain subdued amid lacklustre demand

Consistent with the Chinese trade data and steady manufacturing inventory destocking over recent quarters, total euro area imports of intermediate goods have been steadily declining since last September, to be down almost 23%Y/Y in July. When adjusting for prices, the drop in volumes terms was somewhat more modest at 7.6%Y/Y, albeit reaching their lowest level since October 2021. With manufacturing new orders still declining, we might well see a further weakening in imports of intermediate goods over the near term, while imports of capital and consumer goods are also likely to remain subdued. Exports of intermediate goods have also trended lower over the past year, to be down more than 8%Y/Y and at their lowest level since the start of 2022. Shipments of consumer goods have edged slightly lower over recent months, although remain up around 1%Y/Y. And, notwithstanding some monthly volatility, capital goods exports have moved broadly sideways recently to be some 7% higher than a year ago. Moreover, with the US economy seemingly holding up better than many observers had expected, and hints that momentum in China's economy might be turning for the better on the back of increased public investment, exports of capital and consumer goods from the euro area might well be supported over the near term in the absence of any retaliatory action against EU exporters taken by China.

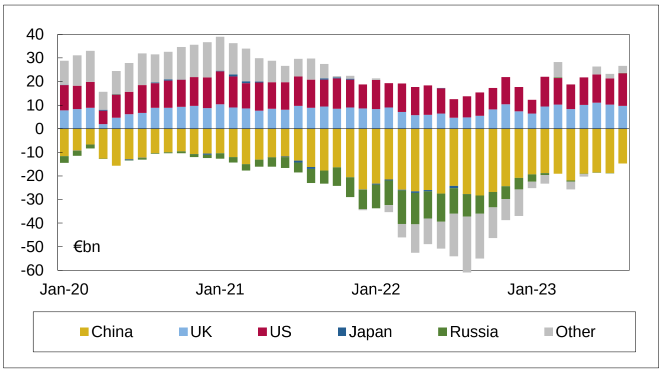
German investor survey points to stabilisation in the outlook

Like last week's euro area Sentix survey findings, today's German ZEW investor survey offered mixed messages about sentiment at the start of Q4. While investors assessed the current situation to have deteriorated very slightly in October, the decline in the respective index, by 0.4pt to -79.9, was the smallest in six months and notably less than had been expected. Admittedly, this marked the lowest reading since August 2020, still well down on the long-run average (-9.9) and consistent with levels that imply contraction in the largest member state. But the survey nevertheless suggests that the trough might have been reached. Certainly, financial market participants were again more upbeat about the outlook over the coming six months despite some citing negative factors associated with the conflict in Israel. In particular, the survey's expectations balance rose for a third consecutive month in October and by a larger-than-expected 10.3pts to -1.1, the highest for six months. While this still remained some 55pts below the level ahead of the Russian invasion of Ukraine, it was more than 60pts above the trough last September. Against this backdrop, firms from various sectors, including autos, steel, machinery, chemicals and retail, were less pessimistic about their expectations for profit growth over the coming six months.

The day ahead in the euro area

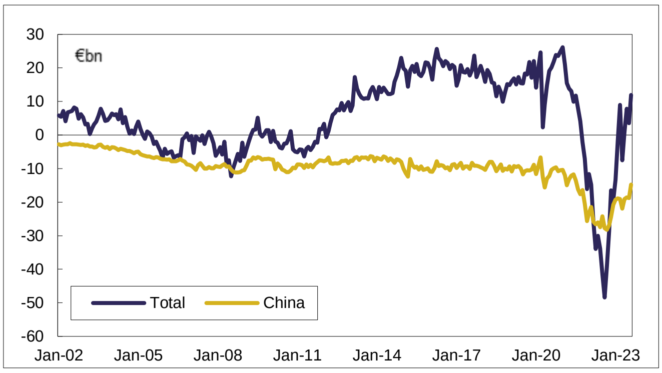
Tomorrow will bring updated euro area consumer price inflation figures for September, which will include the granular detail. Notwithstanding modest upwards revisions to the final French and Spanish HICP figures, the downwards revision to the

Euro area: Goods trade balance



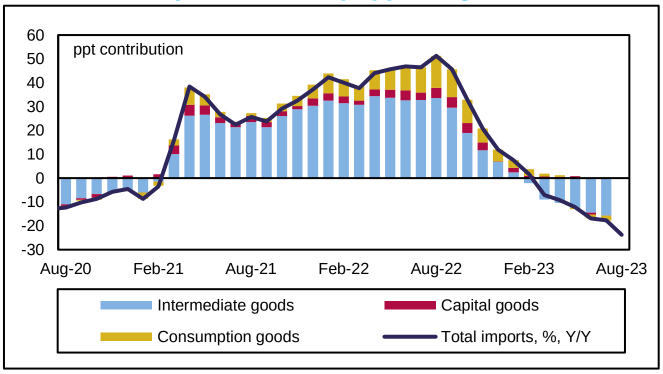
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade balance



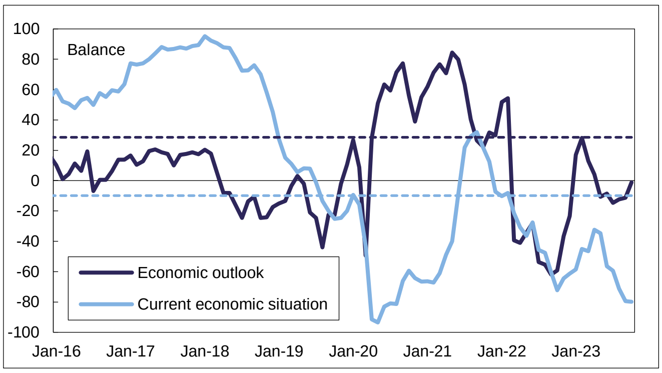
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Import values by type of good



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ZEW investor sentiment indices*



**Dashed lines represent long-run averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

equivalent Italian rate means that euro area inflation is likely to be unrevised from the flash estimates. The preliminary release saw the headline HICP rate fall 0.9ppt to a near-two-year low of 4.3%Y/Y, with the core rate down 0.8ppt to a twelve-month low of 4.5%Y/Y. The moderation principally reflected a sizeable easing in services inflation in part as last year's German highly discounted travel pass fell out of the calculation. But inflation of core goods, food and energy also moderated in September. In terms of economic activity, Wednesday will bring euro area construction output data for August. Based on figures published so far by the member states, including Germany (-2.4%M/M) and France (-1.5%M/M), euro area construction activity is likely to have fallen over the summer, possibly reversing the increase (0.8%M/M) recorded in July.

UK

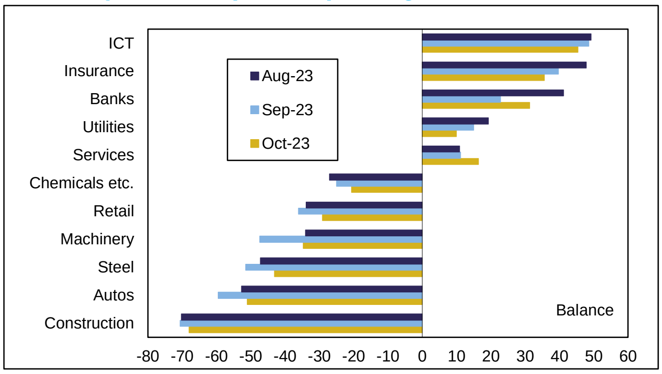
Incomplete labour market data suggest turning points in jobs and pay have been reached

For some time, the BoE's MPC has flagged the tightness of the labour market and the behaviour of wage growth as among the key indicators to be monitored when determining the path for monetary policy. However, the data have recently provided mixed messages, complicating the task of policymakers as they attempt to judge the risks of inflation persistence emanating from labour costs. For example, while the ONS's Labour Force Survey (LFS) had reported an extremely sharp drop in employment in the three months to July of 207k, a rate of decline previously exceeded only during the first wave of Covid-19 and the global financial crisis, experimental payrolls figures implied that the number of people in work was both much higher and far more resilient to the recent weakness of economic activity. Likewise, contrary to some other evidence including the KPMG/REC surveys of recruitment and employment consultancies, average weekly earnings data had suggested that pay pressures remained extremely strong over the summer. On balance, however, today's data – which included updates on payrolls, average earnings and vacancies, but unusually did not include the LFS indicators on employment and unemployment – were broadly consistent with a loss of momentum in the labour market, adding to evidence that turning points in the number of people in work and pay pressures have probably been reached. So, the figures were also consistent with expectations that the BoE will not tighten policy further this cycle.

Payrolls and vacancies fall but extent of labour market tightness obscured by data inconsistencies

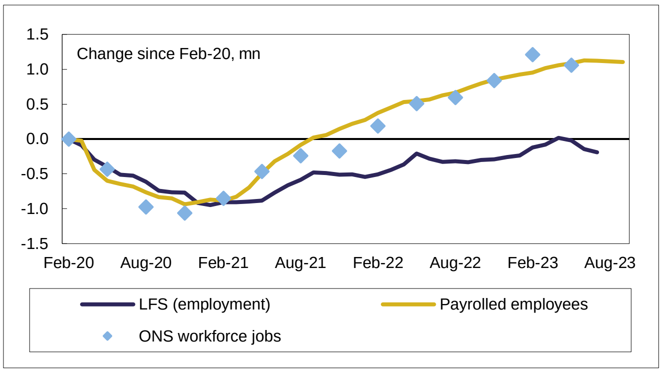
In terms of today's signals on employment, the initial estimate of the number of payrolled employees derived from HMRC data fell for a third successive month in September. But the size of the drop was relatively modest, at just 11k, taking the cumulative fall over the past three months to just 24k. And while it was the softest since June 2021, the annual rate of increase in September was still firmly in positive territory at 1.2%Y/Y (369k). Meanwhile, the ONS's estimate of the number

Germany: ZEW expected profit growth indices



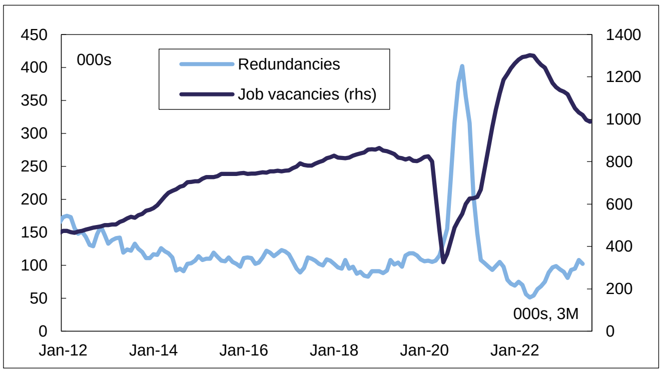
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Employment & payrolled employees



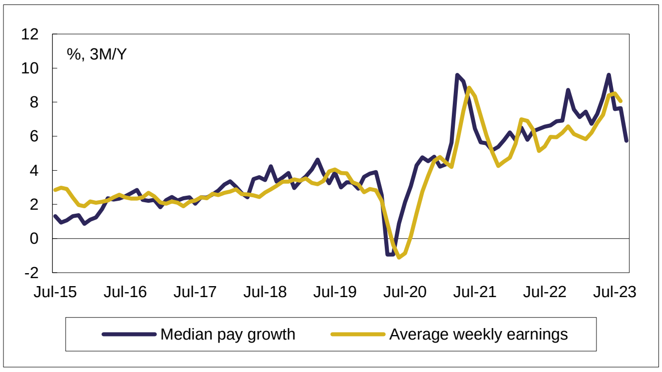
Source: ONS, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Vacancies and redundancies



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

UK: Measures of wage growth



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

of workforce jobs, derived in part from business surveys, fell 153k in the three months to June. But the decline was explained entirely by a drop in self-employment while the number of employee jobs rose to a new high. Overall, the number of workforce jobs was still some 995k above the pre-pandemic level, while the number of payrolled employees was a little more than 1.1mn above the pre-pandemic level. Those figures contrast markedly with the LFS estimate of total employment, which in August was still more than 100k below the pre-pandemic level. Meanwhile, although redundancy notifications remain low, the number of vacancies fell 988k in the three months to September, to be down more than 20%Y/Y and at the lowest level since the three months to July 2021. So, the MPC will still conclude that labour demand is weakening. And notwithstanding ongoing concerns about the steadily declining and now very low survey response rate, they will watch next week's release of the latest LFS employment and unemployment data – postponed from today – for further confirmation of that assessment. Sadly, however, given the continued differences in the estimates of the number of people in work and concerns about data quality, the full extent of tightness in the labour market will remain a matter of debate.

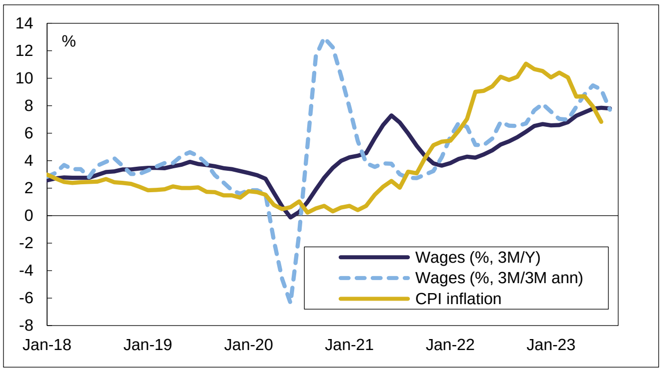
Signals on pay moderating gradually following extreme strength in spring and early summer

Of course, evidence on the extent of labour market tightness is provided by signals on pay, albeit with a lag. And the annual rate of average weekly earnings growth remained extremely high in the three months to August, albeit slowing 0.4ppt to a three-month low of 8.1%3M/Y. As a result, encouragingly from the perspective of household consumption growth, total real pay deflated by the ONS's preferred CPIH inflation measure rose 1.3%3M/Y in August, the highest in seventeen months. While total pay remains enhanced by special one-off payments over the summer to public sector workers, average regular pay (excluding bonuses) moderated just 0.1ppt from July's series high to 7.8%3M/Y. Public sector regular pay growth rose to a record 6.8%3M/Y. And still boosted by very strong growth in earnings in finance and business services (9.6%3M/Y), regular pay growth in the private sector moderated only marginally for a second month to a still historically high 8.0%3M/Y, some 1.1ppts above the BoE's projection for September. To some extent, however, that vigour reflects intense pressures in the spring and early summer, which itself likely reflects tightness in the labour market before then. Looking at the most recent trend on an annualised three-month basis, private sector regular pay slowed 1.7ppts in August to 7.8%3M/3M ann., still elevated and above levels that the BoE would tolerate if sustained over coming quarters but 2.7ppts down from June's series high. Moreover, real-time data from HMRC reinforce the impression that labour earnings growth is moderating in the face of broader economic weakness. In particular, having spiked at 9.6%3M/Y in June, growth in median pay slowed 1.9pts in September to 5.7%3M/Y, still firmly above pre-pandemic norms but the softest since the three months to November 2021. And the level of median pay fell on a month-on-month basis.

The day ahead in the UK

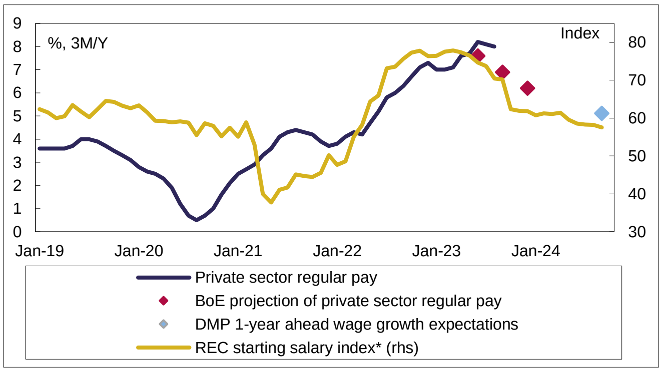
The focus in the UK tomorrow will be September's consumer price inflation data. We expect no change in the annual CPI rate in September from August's 18-month low of 6.7%Y/Y to be 0.2ppt below the BoE's forecast for the month. The stickiness of the headline inflation rate will principally reflect the sharp rise in prices of auto fuel over the course of the past month. In contrast, the BRC survey suggests that inflation of food should fall to a 12-month low and that pressures on non-energy industrial goods prices also continue to moderate. And despite the likelihood of a pickup in the education component, services inflation should slow in part due to base effects associated with hotel prices. So, we expect the core CPI rate to fall 0.2ppt to an eight-month low of 6.0%Y/Y. Meanwhile, producer price figures are likely to point to a mild deflationary trend further along the pipeline, with producer input prices forecast to fall 2½%Y/Y, and output prices forecast to have fallen from a year earlier for a third consecutive month, albeit by a marginal 0.1%Y/Y.

UK: Average weekly earnings & CPI inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Indicators of wage growth



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

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		ZEW current assessment (expectations) balance	Oct	**-79.9 (-1.1)**	-80.0 (-10.3)	-79.4 (-11.4)	-
UK		Payrolled employees, monthly change '000s	Sep	**8.1 (7.8)**	8.3 (7.8)	8.5 (7.8)	- (7.9)
		Average weekly earnings (excluding bonuses) 3M/Y%	Aug	**-11**	3	-1	-8

Auctions

Country		Auction
Germany		sold €4.02bn of 0% 2025 bonds at an average yield of 3.12%
UK		sold £2.75bn of 3.75% 2053 bonds at an average yield of 4.926%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Trade balance €bn	Aug	**11.9**	-	2.9	3.5
Italy		Final HICP (CPI) Y/Y%	Sep	**5.6 (5.3)**	*5.7 (5.3)*	5.5 (5.4)	-
UK		Rightmove house price index M/M% (Y/Y%)	Oct	**0.5 (-0.8)**	0.5 (-0.8)	0.4 (-0.4)	-

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	Final headline (core) HICP Y/Y%	Sep	*4.4 (4.5)*	5.2 (5.3)
		10.00	Construction output M/M% (Y/Y%)	Aug	-	0.8 (1.0)
Italy		09.00	Trade balance €bn	Aug	-	6.4
UK		07.00	Headline (core) CPI Y/Y%	Sep	*6.7 (6.0)*	6.7 (6.2)
		07.00	PPI (input) output prices Y/Y%	Sep	-0.2 (-2.6)	-0.4 (-2.3)
		09.30	House price index Y/Y%	Aug	-	0.6

Auctions and events

Germany		10.30 Auction: €4bn of 2.6% 2033 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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