Euro wrap-up

Overview

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- Bunds made gains as German producer price inflation fell to a new record low and German exports to non-EU countries posted the steepest annual drop for more than three years.
- Gilts also made more modest gains as UK retail sales fell further than expected in Q3 and consumer confidence deteriorated at the start of Q4.
- The main event in the coming week will be the ECB announcements on Thursday, but rates are widely expected to be left unchanged. October's flash PMIs and the ECB Q3 bank lending survey results are also due.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	3.107	-0.085
OBL 2.4 10/28	2.772	-0.069
DBR 2.6 08/33	2.881	-0.045
UKT 3½ 10/25	4.878	-0.104
UKT 4½ 06/28	4.627	-0.082
UKT 3¼ 01/33	4.646	-0.026

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

Euro area

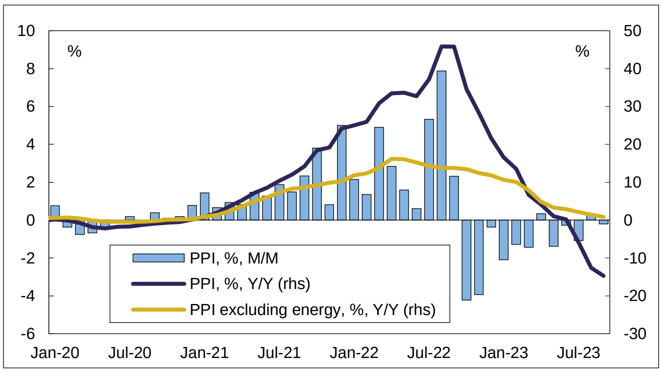
German producer price inflation at record low with broad-based declines

Today's German producer goods price data strongly suggested that consumer goods inflation should continue to fall over coming quarters. Indeed, having risen in August due to a pickup in energy prices, producer goods prices fell in September for tenth month out of the past twelve (-0.2%M/M), to leave them down a substantial 14.7%Y/Y, the steepest drop since data collection began in 1949. Admittedly, this partly reflected base effects associated with the extreme surge in natural gas prices last summer – indeed, despite a rise in natural gas prices of 8%M/M in September, the sharp rise of more than 33%M/M a year earlier left the annual rate of that component down almost 72%Y/Y. The decline in electricity prices was also striking (-41%Y/Y), leaving overall producer energy inflation further in negative territory (-35.3%Y/Y). Today's release highlighted a further moderation in underlying factory price pressures too reflecting the shift in the balance between supply and demand. Indeed, when excluding energy, producer prices fell for a fifth consecutive month (-0.1%M/M) to be up just 0.9%Y/Y, the softest rate since January 2021. Intermediate goods prices fell for a seventh consecutive month (-0.2%M/M) to be down 4.2%Y/Y, the most since the global financial crisis. With food prices down for a fourth month out of five, producer prices of non-durable consumer goods fell for a second successive month. That left the annual rate of increase down 1.6ppts to 5.3%Y/Y, the lowest since December 2021. And with producer prices of consumer durables down for the first month in more than a decade, the respective annual rate similarly fell to its lowest in ten months. Notwithstanding a recent modest uptick in measures of price expectations, surveys suggest that manufacturers are passing on lower costs on to customers, and so the disinflationary trend for consumer goods prices should continue well into 2024.

German exports and hospitality sales hit by weakening demand

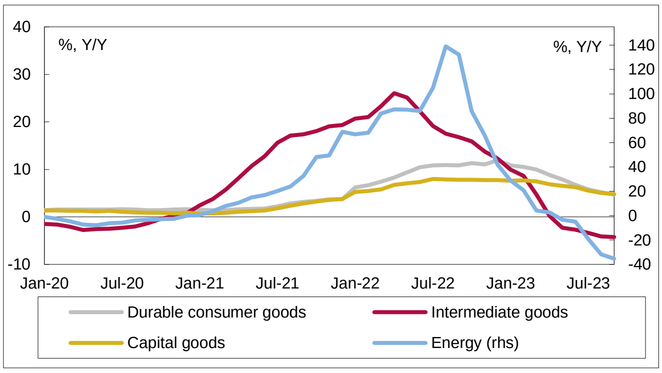
The dampening effect of weak global demand was illustrated in today's advance German data for exports outside of the EU in September. In particular, the value of exports fell for a third consecutive month, by 3.4%M/M, the most in nine months. This left them down almost 3%3M/3M and 12.1%Y/Y, the steepest annual drop for more than three years and more than seven years when excluding the initial Covid lockdown period. Weakness was broad-based, with double-digit annual percentage declines in shipments to the US, China and Korea. Separately, the latest German hospitality sales figures, published yesterday, suggested that demand – likely both domestic and from abroad – remained very subdued over the summer too. Turnover in the sector declined 2.1%M/M in August to the lowest level since March 2022, with weakness in both catering and accommodation. Compared with a year earlier, total hospitality sales were down 8.7%Y/Y. And in the first two months of Q3, they were trending some 1% below the Q2 average. Taken together the drop in spending on goods – retail sales in July and August were on average 0.8% below the level in Q2 – and a rising preference to save rather than spend, household consumption looks to have subtracted from German GDP growth in Q3 and might well do so in Q4 too.

Germany: Producer goods price inflation



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Germany: Producer goods inflation



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Rise in French retail sales in September fails to offset weakness earlier in Q3

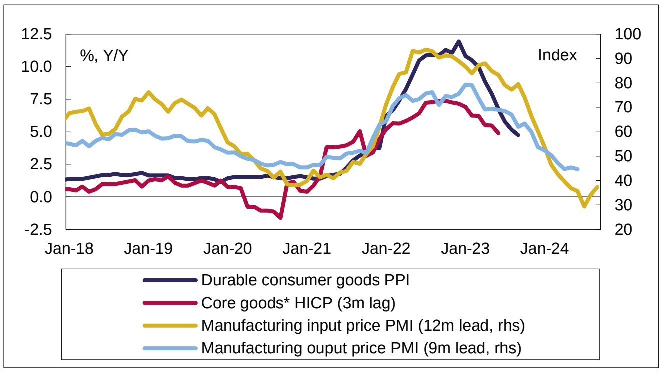
Today's Bank of France retail survey encouragingly reported a pickup in spending at the end of the third quarter, with an increase in sales of 1.1%M/M in September reversing the decline recorded in August. But with sales having declined in July and failed to grow in June too, this left them down ½%3M/3M and more than 4% lower than a year earlier. Within the detail, the improvement in September was led by a rebound in spending on consumer electronics (4.2%M/M) and new autos (4.2%M/M), although weakness earlier in the summer left car sales down by more than 2%3M/3M. Admittedly, the BoF's retail sales measure contrasts with the INSEE estimate of consumption of goods – for which the latter often provides a better guide to household consumption in the national accounts. Indeed, the INSEE data were trending some 1% above the Q2 average. Nevertheless, risks to the near-term spending outlook appear skewed to the downside, with yesterday's INSEE survey suggesting that retailers expect a steep drop in sales in Q4, despite the positive impact of lower inflation on real purchasing power.

The week ahead in the euro area

The main event in the euro area in the coming week will be the outcome of the latest ECB monetary policy meeting on Thursday. However, we, like the consensus, fully expect rates to be left unchanged. The statement issued following the September Governing Council meeting, when rates were raised for the tenth successive occasion to take the Deposit Rate to 4.00%, gave a strong indication that the terminal rate for the tightening cycle has probably now been reached. In particular, it noted that rates have now "reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to the target". In her post-meeting press conference, President Lagarde suggested that the focus of debate would now probably be more on the duration of high rates rather than their level. She also noted that some members of the Governing Council had already wanted to pause rather than raise rates further last month, while the account of the meeting subsequently revealed that for others the decision whether to hike or pause had been a close-run thing. While the account also stated that a "solid majority" backed the decision, we suspect that many Governing Council members did so without enthusiasm and only in order to avoid the impression of division.

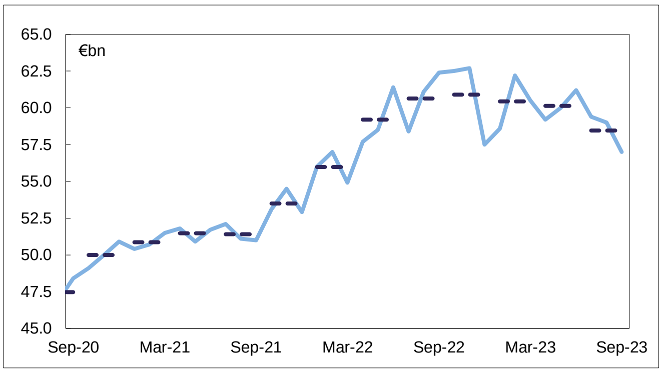
Of course, the September policy statement also repeated that the ECB's main rates will remain data dependent and "set at sufficiently restrictive levels for as long as necessary". But events since the last meeting have largely been unconducive to a further rate hike. After the ECB's updated projections acknowledged the non-negligible risk of recession, data and surveys have reinforced the likelihood that euro area GDP contracted in Q3 and that economic activity will be at best subdued in Q4. Moreover, inflation fell in September by the most in six months to the lowest level in almost two years, with a broad-based easing of pressures pointing to the likelihood of further significant declines to come. Recent increases in bond yields will

Germany: Goods inflation indicators



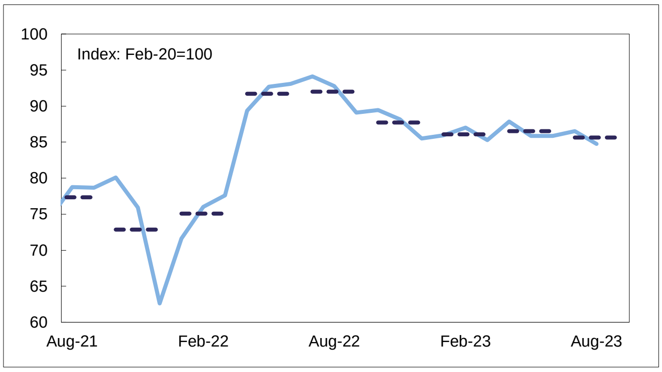
*Non-energy industrial goods. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd .

Germany: Exports to non-EU countries*



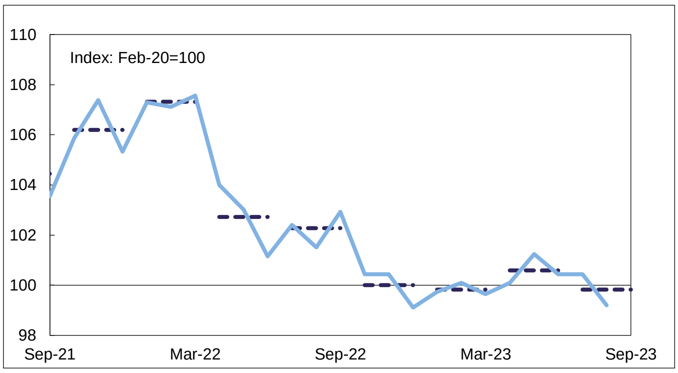
*Dashed lines represent quarterly averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Hospitality sales*



*Dashed lines represent quarterly averages. Source: Destatis and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales*



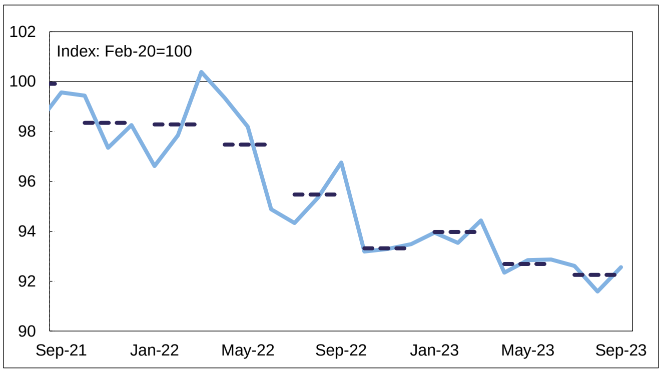
*Dashed lines represent quarterly averages. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

have strengthened further the transmission of the ECB’s recent policy tightening. And events in Israel and Gaza have increased geopolitical tensions and uncertainties. So, if many members of the Governing Council are tempted to argue for a further hike, we suspect they will wait to make the case at the following meeting in December, when data for GDP in Q3, as well as two further months of figures for inflation and economic surveys and additional information on the potency of the transmission mechanism will be available, and the economic consequences of events in the Middle East, including on oil prices, are likely to be clearer too.

With the decision to leave rates unchanged this month likely to be widely supported by the Governing Council, we suspect that members will also have discussions on its other policy instruments, including the future of its asset purchase programme and reserve remuneration. With respect to quantitative tightening, we doubt that the current elevated level of uncertainty and recent upwards shift in yields will encourage a majority to support yet an end to reinvestments of maturing PEPP securities before the end of 2024 as is currently envisaged. We also suspect that the Governing Council will not be ready this month to announce details on its plans for active greening of its corporate bond (CSPP) portfolio now that it has ceased reinvestments. And while the Governing Council agreed in July to reduce from September the remuneration of minimum reserves held by credit institutions at the ECB to 0%, an announcement of other possible related adjustments, such as an increase in the size of minimum required reserves – e.g. from 1% to 2% of deposits and certain other sources of funding – or a system of reverse tiering to reduce interest payments from the ECB to banks would seem more likely to come in December.

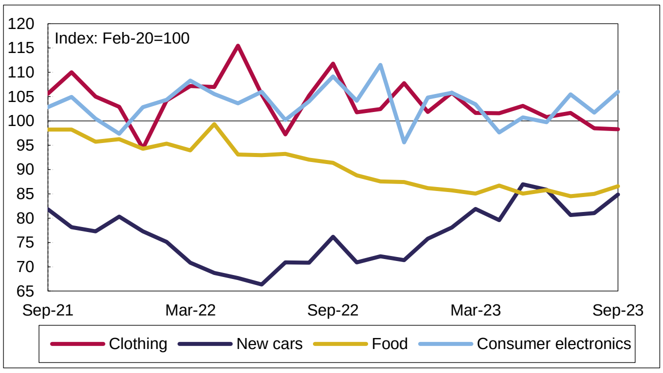
Ahead of the Governing Council announcement, the coming week’s data – including the October flash PMIs (Tuesday), ECB quarterly Bank Lending Survey (also Tuesday) and monthly monetary figures for September (Wednesday) – seem likely to further support the case for keeping interest rates unchanged. While the September PMIs saw the headline composite output index rise for the first month in five to suggest that the bottom might have been passed, at 47.2, it still remained consistent with contraction. And with demand lacklustre and uncertainties regarding the economic outlook arguably having increased due to geopolitical events, we might expect the index to do no better than move sideways at the start of Q4. And the services and manufacturing activity indices will likely remain firmly below the key-50 ‘unchanged growth’ level. Meanwhile, with the input cost PMI having ticked up in the previous two months due to the higher oil price, the survey’s inflation measures will also be watched closely. At the national level, the German ifo (Wednesday) and Italian ISTAT business surveys (Friday) will offer further insight into economic momentum (or lack of) in October. With respect to consumer confidence, the preliminary Commission euro area indicator (Monday) will be followed by the German GfK survey (Tuesday), and French INSEE and Italian ISTAT indices (Friday). Given the deterioration in the economic outlook over the summer, higher borrowing costs and falling house prices, the Bank Lending Survey is likely to highlight a further tightening in credit standards, while monetary figures will also illustrate ongoing weakness in demand for both secured and unsecured lending. Finally, Friday will also bring

France: Retail sales*



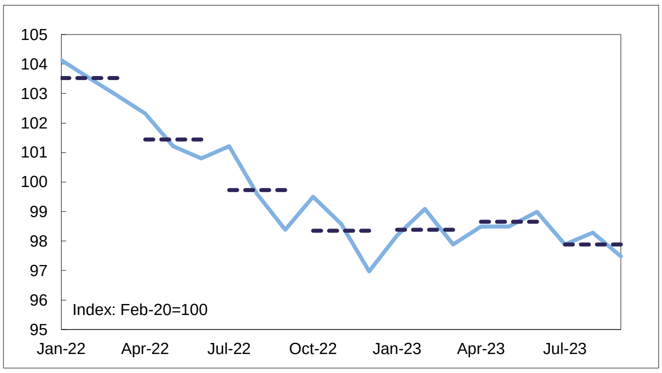
*Dashed lines represent quarterly averages. Source: BoF, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

France: Retail sales, selected goods



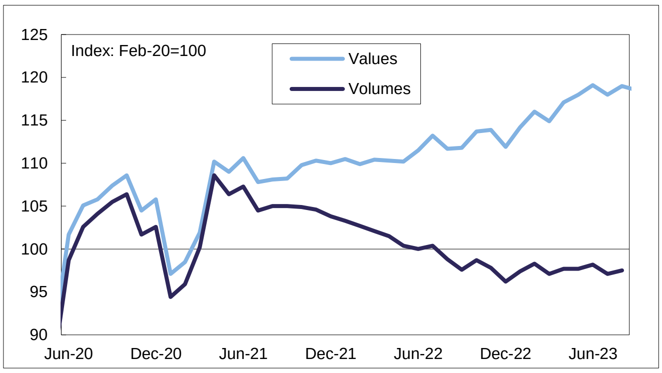
Source: BoF, Refinitv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Retail sales*



*Dashed lines represent quarterly averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales volumes vs values



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

the first estimate of Q3 GDP from Spain, which is expected to show that growth slowed from Q2, by around 0.3ppt to 0.2%Q/Q.

UK

Retail sales fall further than expected in September to be down in Q3 for the first quarter since Q422

Retail sales fell further than expected in September, and consumer confidence was much weaker than expected in October, underscoring the significant loss of momentum in private consumption growth since the first half of the year. In particular, retail sales volumes fell 0.8%M/M last month, more than reversing the rise of 0.4%M/M in August to hit the lowest level since last December. Given the sharp drop in July, that left sales volumes down 0.8%Q/Q in Q3, marking the first quarterly contraction since Q422. Sales in September were also down 1.0%Y/Y and 2.5% below the pre-pandemic level in February 2020. With prices up again, the drop in the value of sales last month was smaller at 0.2%M/M. And that left the value of sales up 0.3%3M/3M and 4.7%Y/Y despite the decline in volumes.

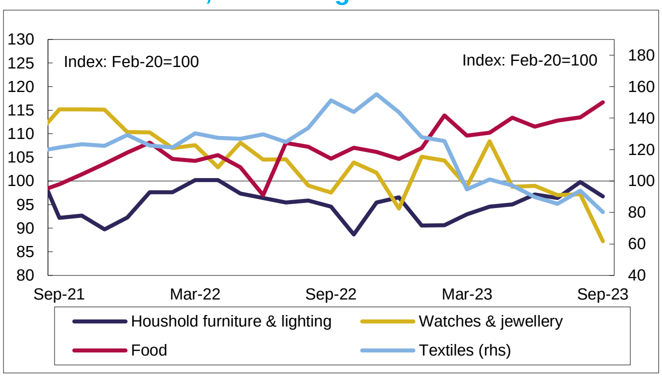
Warm weather and high cost of living weighed on sales last month

As in July, the significant weakness in sales last month was in part due to the weather. But while particularly high levels of rainfall deterred spending at the start of the quarter, unusually high temperatures, which matched the record for the month, weighed on sales at the end of Q3. Indeed, as households saw no pressing need to buy autumn apparel, sales at clothing and department stores fell 1.6%M/M. However, sales at non-food stores overall fell a steeper 1.9%M/M, the most since December. As shoppers eschewed spending on non-essentials due to continued concerns about the high cost of living, household goods store sales declined 2.3%M/M, with sales of furniture and lighting down 3.1%M/M and watches and jewelry down 10.3%M/M. In contrast, food store sales rose for a second month, up 0.2%M/M, as inflation in that category continued to ease. And while auto fuel sales volumes rose 0.8%M/M, that failed to reverse in full the drop in August, perhaps in part due to the significant rise in petrol prices over the course of the month.

Deterioration in consumer confidence indicates a weak near-term spending outlook

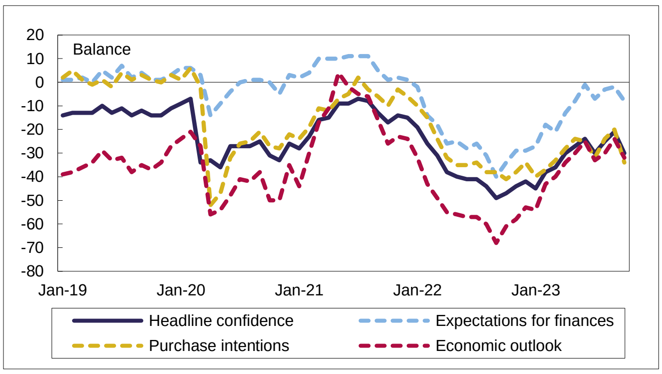
Spending on autos and services should have provided some offset to the weakness in retail sales of the past three months. Nevertheless, following the rise of 0.5%Q/Q in Q2, overall private consumption has certainly slowed very significantly in Q3, perhaps to zero or negative territory. Moreover, while retail sales might well have rebounded somewhat in October with the return of more normal autumn weather, the latest GfK consumer survey strongly suggested that the near-term outlook for household spending remains weak. Contrary to the consensus expectation of a third successive improvement, household sentiment deteriorated in October by the most since the first Covid lockdown in March 2020. In particular, GfK's headline confidence indicator fell 9pts this month to -30, matching the lows of the past six months albeit still 17pts above the level a year earlier. The survey detail reported worsening perceptions of both household finances and broader economic conditions. But strikingly, the largest downgrade was made with respect to willingness to spend, with survey recipients suggesting they were less inclined to make major purchases than any time since February. As many more households refinance mortgages at sharply higher interest rates over coming months, rising debt service costs will continue to erode aggregate spending power. Rapidly rising housing rents will do so too. However, thanks to the overall decline in inflation and rising wages, real disposable incomes in aggregate should still rise this quarter and next, which should hopefully allow for a modest pickup in consumer spending. Much, however, will likely depend on developments in the labour market where recent evidence is mixed but the Labour Force Survey previously pointed to a marked deterioration over the summer.

UK: Retail sales, selected goods



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Consumer confidence indices



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

The week ahead in the UK

Like in the euro area, a key economic focus in the UK in the coming week will be the release of the flash October PMIs (on Tuesday). Having fallen below the key-50 ‘no change’ level in August, and slipped to an eight-month low of 48.5 in September, the headline composite PMI is expected to move broadly sideways in October, consistent with ongoing modest contraction at the start of Q4. The survey’s price measures will be watched for evidence of an easing in price pressures in the services sector, while manufacturing cost burdens will continue to fall in line with the supply-demand rebalancing in the sector. And having dropped to the lowest level since the start of 2021, the employment component is likely to signal further cuts in headcount. Meanwhile, the postponed official Labour Force Survey results (also on Tuesday) are likely to report that employment remained well down on a three-month basis in August, probably close to the prior month’s fall of 207k – a magnitude always previously associated with recession. We also expect the unemployment rate to remain unchanged at July’s rate 4.3%, up 0.3ppt from the three months to May. Other releases in the coming week include the CBI industrial trends (Tuesday) and distributive trades surveys (Thursday), with the latter likely to suggest ongoing challenges in the retail sector at the start of Q4 after the drop in sales in Q3.

The next edition of the Euro wrap-up will be published on 24 October 2023

Daiwa economic forecasts

	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2	2024 Q3	2023	2024	2025
GDP								**%, Y/Y**	
Euro area	0.1	-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	0.5	0.2	0.7
Inflation, %, Y/Y									
Euro area									
Headline HICP	6.2	5.0	3.1	2.9	2.5	2.0	5.5	2.4	1.9
Core HICP	5.5	5.1	4.0	2.8	1.8	1.4	5.0	1.9	1.8
UK									
Headline CPI	8.4	6.7	4.6	4.2	2.5	2.6	7.4	2.9	1.8
Core CPI	6.9	6.4	5.7	5.1	3.2	2.6	6.3	3.2	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.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	EU new car registrations Y/Y%	Sep	**9.2**	-	21.0	-
Germany	PPI Y/Y%	Sep	**-14.7**	-14.2	-12.6	-
France	Bank of France retail sales index Y/Y%	Sep	**-4.3**	-	-4.0	-3.9
UK	GfK consumer confidence index	Oct	**-30**	-20	-21	-
	Retail sales incl. auto fuels M/M% (Y/Y%)	Sep	**-0.9 (-1.0)**	-0.2 (-0.1)	0.4 (-1.4)	- (-1.3)
	Retail sales excl. auto fuels M/M% (Y/Y%)	Sep	**-1.0 (-1.2)**	0.2 (0.0)	0.6 (-1.4)	- (-1.3)
	Public sector net borrowing excl. banks £bn	Sep	**14.3**	18.3	11.6	11.4

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg 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/ *Daiwa forecast/actual*	Previous
			Monday 23 October 2023			
Euro area		15.00	Preliminary consumer confidence indicator	Oct	-18.3	-17.8
			Tuesday 24 October 2023			
Euro area		09.00	Preliminary manufacturing (services) PMIs	Oct	43.5 (48.7)	43.4 (48.7)
		09.00	Preliminary composite PMIs	Oct	47.5	47.2
Germany		07.00	GfK consumer confidence indicator	Nov	-27.0	-26.5
		08.30	Preliminary manufacturing (services) PMIs	Oct	40.0 (50.0)	39.6 (50.3)
		08.30	Preliminary composite PMIs	Oct	46.7	46.4
France		08.15	Preliminary manufacturing (services) PMIs	Oct	44.8 (44.8)	44.2 (44.4)
		08.15	Preliminary composite PMIs	Oct	44.3	44.1
UK		07.00	ILO unemployment rate 3M%	Aug	4.3	4.3
		07.00	Employment change 3M/3M 000s	Aug	-200	-207
		07.00	Claimant count rate % (change 000s)	Sep	-	4.0 (0.9)
		09.30	Preliminary manufacturing (services) PMIs	Oct	44.8 (49.6)	44.3 (49.3)
		09.30	Preliminary composite PMIs	Oct	49.0	48.5
		11.00	CBI industrial trends survey – total orders (business optimism)	Oct	-	-18 (6)
			Wednesday 25 October 2023			
Euro area		09.00	M3 money supply Y/Y%	Sep	-1.7	-1.3
Germany		09.00	ifo business climate index	Oct	85.8	85.7
		09.00	ifo current conditions (expectations) index	Oct	88.5 (83.2)	88.7 (82.9)
France		11.00	Total jobseekers mn	Q3	-	2.8
			Thursday 26 October 2023			
Euro area		13.15	ECB Deposit Rate %	Oct	*4.00*	4.00
Spain		08.00	Unemployment rate %	Q3	11.5	11.6
UK		11.00	CBI distributive trades survey – reported retail sales	Oct	-	-14
			Friday 27 October 2023			
France		07.45	INSEE consumer confidence indicator	Oct	82	83
Italy		09.00	ISTAT business (manufacturing) confidence indicator	Oct	- (96.0)	104.9 (96.4)
		09.00	ISTAT consumer confidence indicator	Oct	105.0	105.4
Spain		08.00	GDP - preliminary estimate Q/Q% (Y/Y%)	Q3	*0.2 (1.5)*	0.5 (2.2)
		08.00	Retail sales Y/Y%	Sep	-	7.2

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
		Monday 23 October 2023
		- Nothing scheduled -
		Tuesday 24 October 2023
Euro area	09.00	ECB to publish Bank Lending Survey results for October
Germany	10.30	Auction: €4.0bn of 2.4% 2028 bonds
UK	10.00	Auction: £1.5bn of 0.75% 2033 index-linked bonds
		Wednesday 25 October 2023
Germany	10.30	Auction: To sell 0% 2035 bonds
	10.30	Auction: To sell 1% 2038 bonds
Italy	10.00	Auction: To sell fixed-rate and index-linked bonds
UK	10.00	Auction: £3bn of 3.75% 2038 bonds
		Thursday 26 October 2023
Euro area	13.15	ECB monetary policy announcement
	13.45	ECB President Lagarde holds post-meeting press conference
		Friday 27 October 2023
Euro area	13.15	ECB to publish Survey of Professional Forecasters results

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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