

Euro wrap-up

Overview

- Bunds made gains as German GDP fell slightly in Q3 and German inflation took another big step down in October.
- Gilts followed US Treasuries lower despite some further weak UK mortgage lending and approvals data.
- Tuesday will bring the preliminary estimates of euro area GDP in Q3 and inflation in October as well as German retail sales figures for September.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	3.003	-0.021
OBL 2.4 10/28	2.667	-0.012
DBR 2.6 08/33	2.823	-0.006
UKT 3½ 10/25	4.753	+0.038
UKT 4½ 06/28	4.493	+0.024
UKT 3¼ 01/33	4.563	+0.023

*Change from close as at 4:45pm GMT.
Source: Bloomberg

Euro area

German GDP falls slightly in Q3 as private consumption contracts

Ahead of tomorrow's preliminary estimate of euro area GDP in Q3, today's initial estimates from a handful of member states were mixed but predictably consistent with subdued economic activity in the region as a whole. Most notably, German GDP dropped 0.1%Q/Q in Q3, a touch less than expected, following slightly upwardly revised growth of 0.1%Q/Q the prior quarter. That left GDP on a working-day adjusted basis down 0.3%Y/Y and just 0.3% above the pre-pandemic level in Q419. As usual, Germany's statistical agency Destatis failed to provide a detailed expenditure breakdown of GDP last quarter. However, it reported that household consumption fell in Q3, while fixed investment in machinery and equipment provided support. We also think that exports subtracted from GDP growth although weak imports might have left the contribution from net trade as broadly neutral. And thanks to a firm start to the quarter, construction investment might have avoided a second successive quarterly contraction despite subsequent weakness. Looking ahead, as higher interest rates take a greater toll on demand, we expect construction to subtract from GDP in Q4. Likewise, investment in machinery and equipment is likely to soften. And while a pickup in real disposable incomes offers scope for a pickup in private consumption, the recent deterioration in household sentiment raises risks of a second successive modest contraction in German GDP in the current quarter.

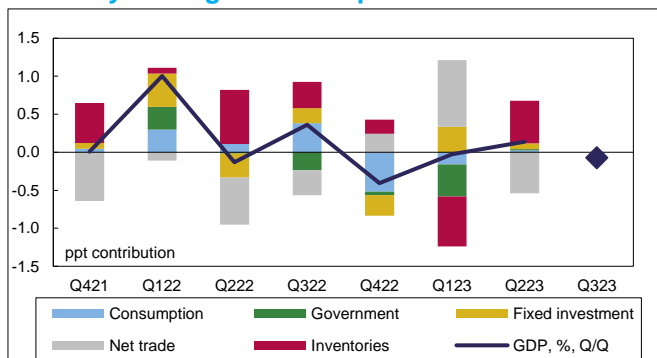
Euro area GDP on track for slight contraction or flat reading last quarter

Among the other member states to publish Q3 GDP data today, Austria's were weakest, with a contraction of 0.6%Q/Q following a drop of 0.8%Q/Q in Q2. However, that negative contribution to euro area aggregate growth was offset by growth of 0.5%Q/Q in Belgium, which is the slightly larger economy of the two. Latvian GDP rose a similar 0.6%Q/Q. So, after figures released on Friday reported that Spanish GDP rose 0.3%Q/Q but Ireland's contracted by 1.8%Q/Q, euro area GDP is currently on track to decline 0.1%Q/Q. Much, however, will depend on the figures from France and Italy, also due tomorrow. There is a non-negligible probability that GDP last quarter was merely unchanged from Q2, which would be bang in line with the ECB's projection.

German inflation falls further than expected in October to its lowest since June 2021

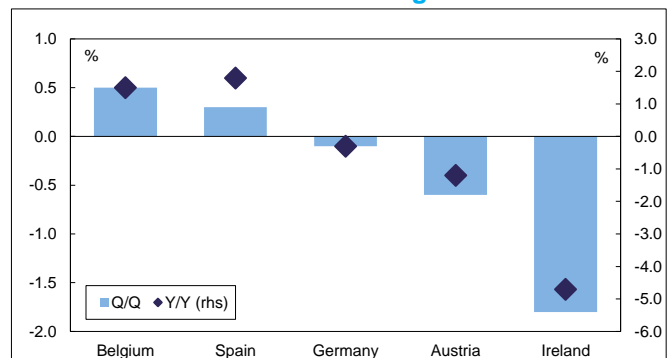
German inflation took another large step down in October as price movements – particularly in energy, food and core goods – were better aligned with the norm for the time of year, contrasting with the substantial increases this time a year ago. Indeed, with consumer prices having declined in October (-0.2%M/M) for the first time since 2017, compared to the increase of 1.1%M/M in October 2022, the headline harmonized HICP inflation rate fell a steeper-than-expected 1.3ppts to 3.0%Y/Y,

Germany: GDP growth & expenditure contributions*



*Diamond represents flash GDP estimate for Q3. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area member states: GDP growth in Q3



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

the lowest since June 2021 and more than 8½ppts below the record high reached a year ago. On the national CPI measure, inflation slowed 0.7ppt to 3.8%Y/Y, the lowest since August 2021, also below the consensus forecast. The limited detail published by Destatis on this basis showed that the easing of German price pressures was broad-based but again reflected large base effects. Indeed, with energy prices down this month (-1.7%M/M) not last reflecting lower auto fuel prices, while they had risen (2½%M/M) this month last year, that inflation component fell a further 4.2ppts to -3.2%YY, the steepest annual drop since December 2020. Meanwhile, with the rise in food prices (0.2%M/M) bang in line with the average for October in the five years before the pandemic, the respective annual inflation rate also moderated sharply, by 1.4ppts to a 20-month low of 6.1%Y/Y. Consistent with easing factory pipeline pressures due to improved supply and soft demand, inflation of non-energy industrial goods appears to have eased further to below 3%Y/Y for the first time in a year. So, while services inflation moderated only slightly, by 0.1ppt to 3.9%Y/Y as prices rose by an above-average 0.1%M/M, German core CPI inflation (excluding all food and energy) fell 0.3ppt to a 14-month low of 4.3%Y/Y.

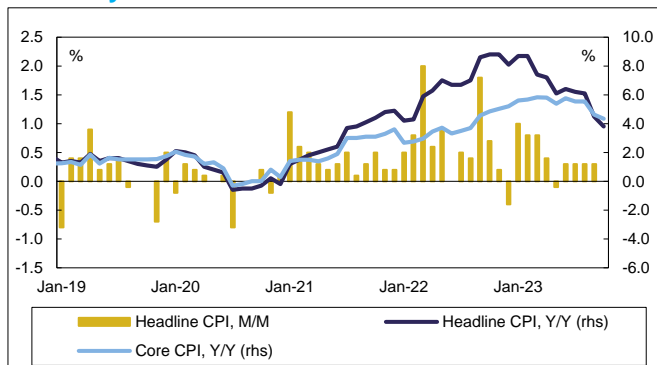
Spanish inflation rises less than expected, while Belgian inflation falls into negative territory

While Spanish HICP inflation rose in October, by 0.2ppt to a six-month high of 3.5%Y/Y, the increase was smaller than had been expected. And the national CPI rate moved sideways at 3.5%Y/Y. Admittedly, this was 1.6ppts above the summer trough, with the rise since then reflecting Spain's faster pass-through of wholesale energy market developments. Indeed, Spain's statistical office (INE) suggested that the upwards drift this month principally reflected electricity, with the decline in prices this month much smaller than the sharp drop of 22.5%M/M in October 2022. When excluding energy and fresh foods, the national core CPI rate fell sharply in October, by 0.6ppt to 5.2%Y/Y, the lowest since May 2022. Core inflation (excluding fresh food and energy) in Belgium also maintained a downwards trend this month, easing 0.3ppt to 6.6%Y/Y, the lowest in a year. And with base effects associated with last year's spike in energy and food prices extremely large this month, Belgium's headline HICP rate fell into negative territory, dropping 2.4ppts to -1.7%Y/Y, the lowest since July 2009. With French and Italian inflation also likely to have taken a marked step down in October due to more favourable energy base effects, we maintain our view that the flash euro area HICP estimate (due tomorrow) will report a substantial drop, of up to 1.4ppts to 2.9%Y/Y, with core inflation expected to have fallen 0.4ppt to 4.1%Y/Y.

Consumers' and retailers' price expectations ease in October

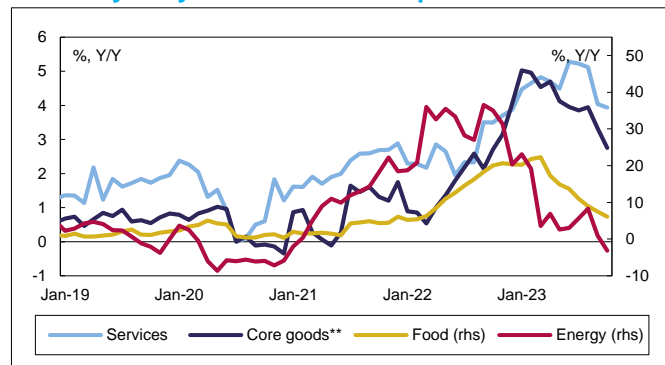
With consumer price inflation having more clearly moderated this month, the European Commission's economic survey results today suggested that household expectations for prices over the coming twelve months also declined in October after increasing over the prior two months when petrol prices were rising. However, the drop was relatively modest, and left the

Germany: Headline & core CPI inflation*



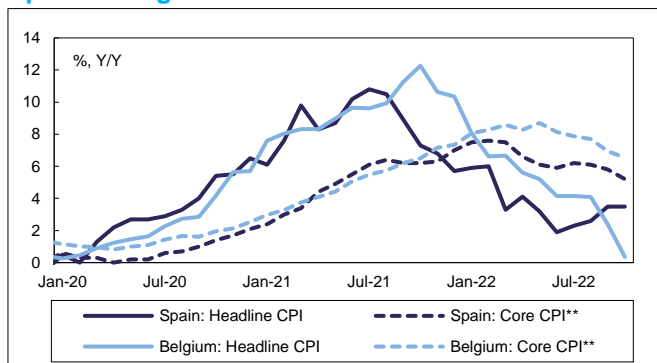
*National measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Key CPI inflation components*



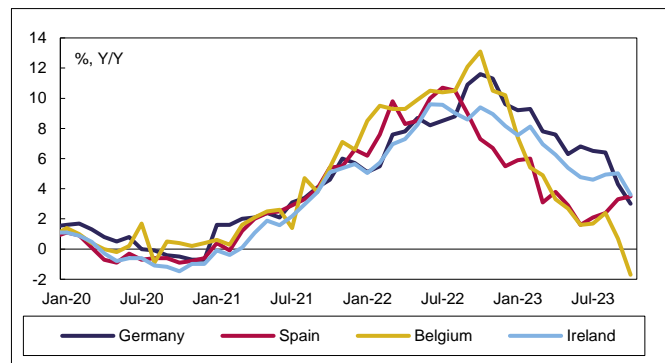
*National measure. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Spain & Belgium: Headline & core CPI inflation*



*National measures. **Excluding fresh foods and energy. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area member states: HICP inflation



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

euro area consumer price expectations index above the levels registered between June and August. Nevertheless, at 11.4 it remained well below the long-run average (24) and the peak in March 2022 (64). And the indices for each of the three largest member states fell back too. Moreover, retailers' selling price expectations for the coming three months extended their downwards trend, with the respective index falling to its lowest level since May 2021. Admittedly, in the other major sectors, selling price expectations ticked up, perhaps due to the bounce in crude oil prices related to events in the Middle East. Indeed, the survey's measures of industry and construction selling price expectations rose to four-month highs. However, they both remained well below their long-run averages, perhaps not least as weaker demand limited firms' capacity to pass on price increases to consumers. And while the equivalent services index edged up too, it was still the second-lowest level in more than two years, and consistent with a gradual moderation in pressures in the sector.

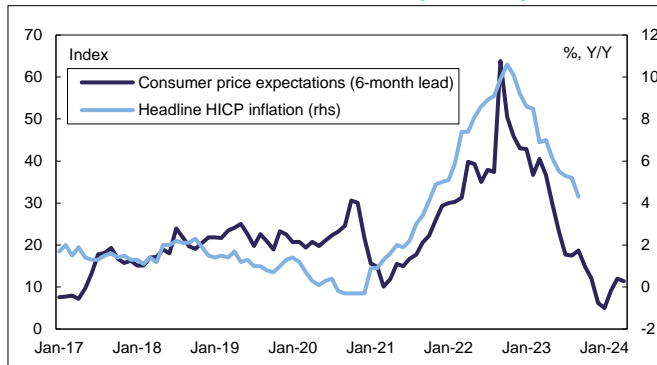
Economic sentiment continues to deteriorate, but signs that the trough might have been reached

Like last week's [flash PMIs](#), the Commission survey's sentiment indices suggested that the economic weakness of Q3 has extended into the start of Q4. Indeed, the headline economic sentiment index (ESI) fell for a sixth consecutive month in October to 93.3, the lowest level since November 2020 and some 6.7% below the long-run average. Admittedly, the size of the drop on the month was a minimal 0.1pt and left the index just 0.6pt below the Q3 average. But it was still more than 3% below the Q2 average and, like the PMIs, suggested that euro area GDP is contracting. Reflecting the minimal fall in the headline ESI, the detail was mixed, with certain indices giving hints that the trough might have been reached. Most notably, thanks to an improved assessment of the outlook for demand in the sector, particularly in Germany, the services ESI rose for the first time since April to the best since July. The construction index also ticked very slightly higher. But it still languished at its second-lowest level since 2020. Moreover, industrial sector sentiment worsened to the second-lowest level since August 2020, with firms taking a dim view of orders and the outlook for exports. And retailers' confidence was the weakest since the lockdowns of early 2021. That tallied with the deterioration in consumer confidence to a seven-month low well below the long-run average and a weakening in household willingness to spend back in line with the average since June. And while still consistent with increasing headcounts in aggregate, firms' employment expectations deteriorated back slightly below the Q3 average. At the country level, the German ESI rose for the second successive month, admittedly still firmly below the range in the three years to July and more than 10% below the long-run average. But sentiment deteriorated significantly in France and Italy, with the former back close to the lows of the past 2½ years, and the latter falling to the lowest in 12 months.

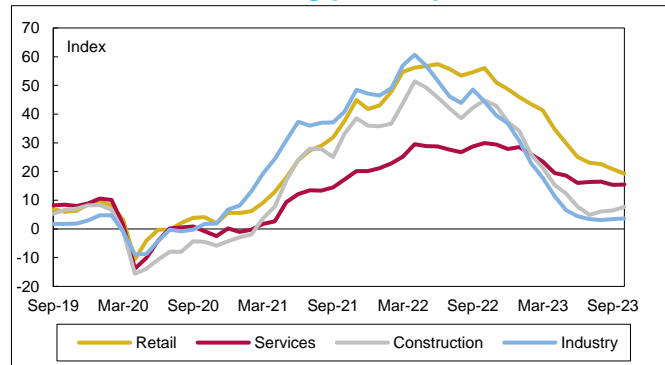
The day ahead in the euro area

Tomorrow will bring the aforementioned first estimates of euro area inflation in October and GDP in Q3. With respect to inflation, the national figures published so far support our view that euro area headline inflation took a further step down this

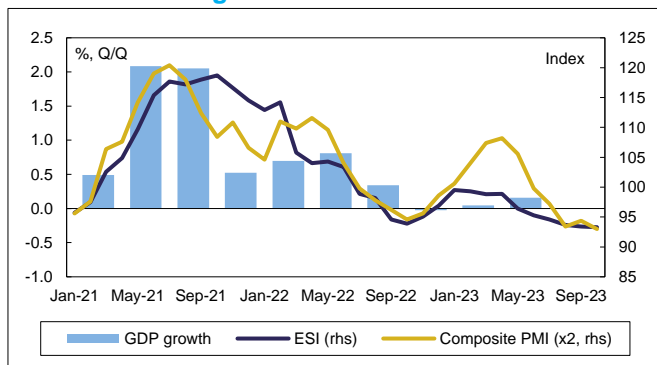
Euro area: Inflation & consumer price expectations



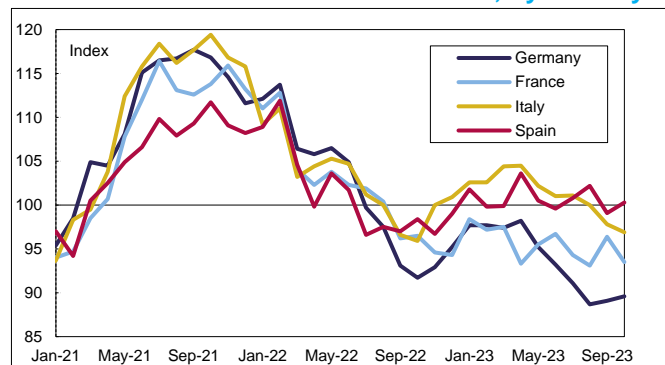
Euro area: Firms' selling-price expectations



Euro area: GDP growth & sentiment indices



Euro area: Headline sentiment indices, by country



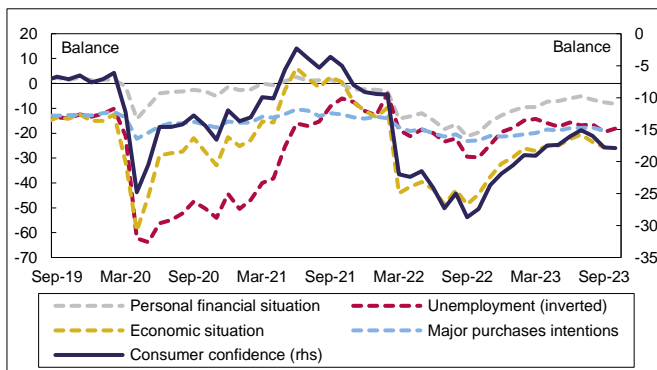
month, with our forecast for a big drop of 1.4ppt to 2.9%Y/Y. This will in part reflect a larger negative contribution from energy, while food and core goods inflation are also likely to have moderated further. So, while services inflation might well have moved broadly sideways this month, we expect core inflation to fall 0.4ppt to 4.1%Y/Y, which would be the lowest since July 2022. French and Italian inflation figures (also due tomorrow) are similarly expected to report a notable drop in October. In terms of economic activity, the performance across the member states has been mixed. While we expect modestly positive GDP growth in France, given our expectation that Italy's economy also contracted in Q3, we maintain our view that aggregate euro area GDP contracted very slightly in Q3, by 0.1%Q/Q. But although risks to this forecast appear skewed slightly to the upside, this would still leave the level of output only very slightly higher than a year earlier. In addition, tomorrow will bring German retail sales figures for September, which will provide greater insight into the weakness in household consumption in Q3.

UK

Mortgage lending declines for third month out of past six as higher borrowing costs hit demand

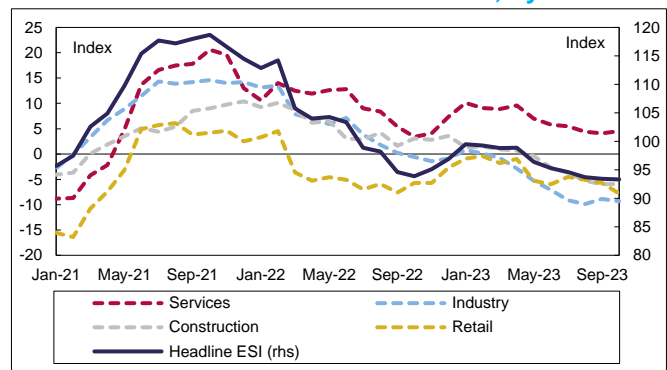
While the MPC's tightening cycle appears to have come to an end, the impact of past interest rate hikes – by a cumulative 515bps since November 2021 – will continue to weigh on economic activity over coming quarters. And consistent with the downbeat message of the latest Credit Conditions Survey, which flagged a further tightening in lending standards, decline in credit availability and weak loan demand, today's monthly monetary figures further illustrated the significant impact of higher borrowing costs on bank lending. Most striking, with the effective interest rates on new secured loans having risen above 5% in September, some 350bps higher than the trough in November 2021, new mortgage lending fell by a steeper-than-expected £0.9bn, marking the third net repayment in the past six months and the second-largest on the series when excluding pandemic-related disruption. This left the annual rate of increase in mortgage lending at just 0.8%Y/Y, down from 4%Y/Y at the end of last year and the softest since the summer of 2013. Mortgage approvals were down again in September too, by 2.1k to 43.3k, the lowest level since January, near the bottom of the range since the first wave of the pandemic, and roughly 23k below average in the five years before the pandemic, suggesting that mortgage lending will remain exceptionally weak for the foreseeable future. Indeed, while interest rates on new mortgage deals have fallen back from the summer peak, the average rate on two- and five-year fixed-rate deals – which according to Moneyfacts fell at the start of October to 6.47% and 5.97% respectively – remain extremely elevated and are likely to dampen demand for the time being.

Euro area: Consumer confidence indices



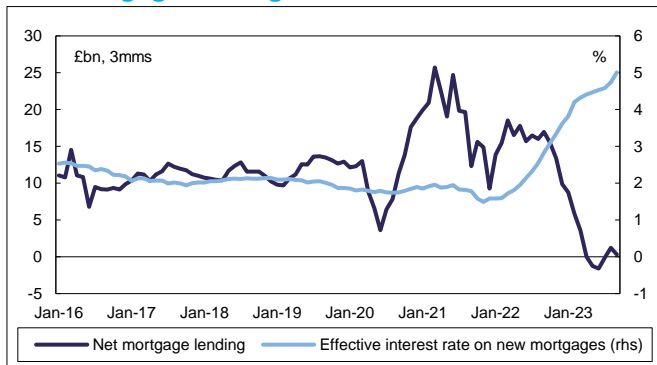
Source: EC, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Headline sentiment indices, by sector



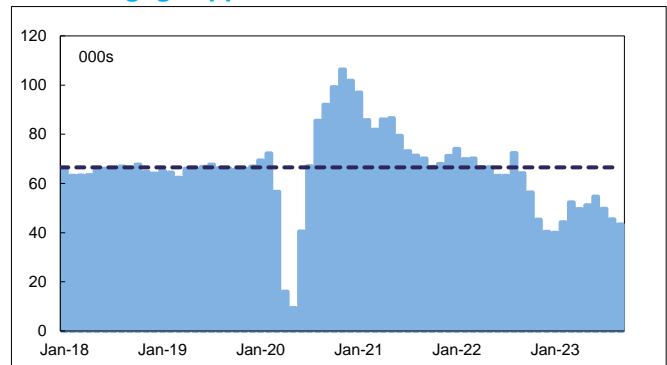
Source: EC, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending & interest rate



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

UK: Mortgage approvals



*Dashed line represents pre-pandemic five-year average. Source: BoE, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

Looking ahead to tomorrow, the UK data calendar brings the BRC shop price index for October, which should suggest that consumer goods price inflation continued to trend lower in October. We will also get the Lloyds business barometer indicator for October.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	EC economic sentiment index	Oct	93.3	93.0	93.3	93.4
	EC industry (services) sentiment indices	Oct	-9.3 (4.5)	-9.5 (3.4)	-9.0 (4.0)	-8.9 (4.1)
	Final EC consumer sentiment index	Oct	-17.9	-17.9	-17.8	-
Germany	GDP – first estimate Q/Q% (Y/Y%)	Q3	-0.1 (-0.8)	<u>-0.2 (-0.7)</u>	0.0 (-0.2)	0.1 (-0.4)
	Preliminary HICP (CPI) Y/Y%	Oct	3.0 (3.8)	3.3 (4.0)	4.3 (4.5)	-
Spain	Preliminary HICP (CPI) Y/Y%	Oct	3.5 (3.5)	3.8 (3.8)	3.3 (3.5)	-
UK	Net consumer credit £bn (Y/Y%)	Sep	1.4 (8.0)	1.4 (-)	1.6 (7.6)	1.7 (7.7)
	Net mortgage lending (mortgage approvals '000s)	Sep	-0.9 (43.3)	1.2 (44.5)	1.2 (45.4)	1.1 (-)

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	10.00	GDP – first estimate Q/Q% (Y/Y%)	Q3	<u>-0.1 (0.0)</u>	0.1 (0.5)
	10.00	Preliminary HICP (core HICP) Y/Y%	Oct	<u>2.9 (4.1)</u>	4.3 (4.5)
Germany	07.00	Retail sales M/M% (Y/Y%)	Sep	0.5 (-3.4)	-1.2 (-1.9)
France	06.30	GDP – first estimate Q/Q% (Y/Y%)	Q3	<u>0.1 (0.6)</u>	0.5 (1.0)
	06.30	Consumer spending M/M% (Y/Y%)	Sep	0.4 (-2.8)	-0.5 (-1.9)
	07.45	Preliminary HICP (CPI) Y/Y%	Oct	4.5 (4.0)	5.7 (4.9)
Italy	07.45	PPI Y/Y%	Sep	-	-1.4
	09.00	GDP – first estimate Q/Q% (Y/Y%)	Q3	<u>-0.1 (0.0)</u>	-0.4 (0.3)
	10.00	Preliminary HICP (CPI) Y/Y%	Oct	2.3 (2.4)	5.6 (5.3)
UK	11.00	PPI Y/Y%	Sep	-	-16.1
	00.01	Lloyds business barometer	Oct	-	36
	00.01	BRC shop price index Y/Y%	Oct	-	6.2

Auctions and events

Germany	10.30	Auction: €1.0bn of 1.8% 2053 green bonds
Italy	10.00	Auction: €1.5bn of 2.2% 2027 bonds
	10.00	Auction: €2.5bn of 4.1% 2029 bonds
	10.00	Auction: €3.5bn of 4.2% 2034 bonds
	10.00	Auction: €1.25bn of 2028 floating-rate bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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