Euro wrap-up

Overview

- Bunds made losses as ECB President Lagarde noted in an interview that a cut in interest rates was unlikely in the next couple of quarters.
- Gilts made losses as UK GDP data exceeded downbeat expectations, but merely suggested that the economy moved sideways in Q3.
- The coming week will bring updated euro area Q3 GDP and October inflation figures, as well as UK labour market, CPI and retail sales data.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	3.045	+0.050
OBL 2.4 10/28	2.644	+0.073
DBR 2.6 08/33	2.707	+0.064
UKT 3½ 10/25	4.620	+0.034
UKT 4½ 06/28	4.308	+0.060
UKT 3¼ 01/33	4.325	+0.059

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

UK

UK economy narrowly avoided a contraction in Q3 as GDP rises in September

The first estimate of Q3 GDP published today suggested that the UK's economy narrowly avoided contraction last quarter. In particular, this suggested that output moved sideways over the summer period, bang in line with the BoE's forecast published in its Monetary Policy Report earlier this month, as a second successive monthly rise in output in September (0.2%M/M) helped to offset the weather-dampened decline in July. This left the annual growth rate in Q3 unchanged at 0.6%Y/Y – admittedly flattered by the additional bank holiday in September 2022 – and the level of GDP some 1.8% above the pre-pandemic benchmark in Q419. While this was ahead of the lacklustre post-pandemic recovery in Germany (0.3%) and in line with the performance of France, it lags significantly behind that of the US, where the economy in Q3 was some 7.4% higher than before the pandemic. Moreover, to two decimal places, UK GDP fell 0.03%Q/Q, with the expenditure breakdown suggesting a particularly weak performance in domestic demand.

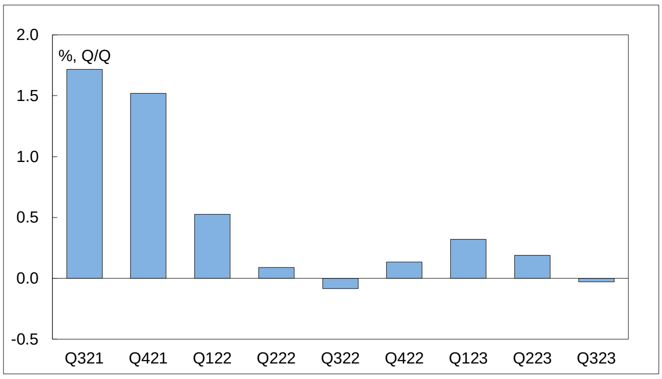
Domestic demand declines sharply as higher borrowing costs bite

The decline in domestic demand was led by fixed investment, which fell (-2.0%Q/Q) for the first time in two years and by the most since Q121, with a more sizeable drop in business investment (-4.2%Q/Q). Admittedly, this follows two quarters of strong growth in H123, with the decline in spending on transport equipment in Q3 (-20.3%Q/Q) payback for the surge in spending on aircraft in Q2. But the downtrend in dwellings investment was maintained for a fourth consecutive quarter, to be down almost 7%Y/Y, as the impact of rising borrowing costs and heightened economic uncertainty dampened demand for new projects. The impact of higher interest rates, low confidence and rising risk aversion saw households tighten their purse strings in Q3 too, with consumption falling (-0.4%Q/Q) for the first quarter in four as spending on food and drink, clothing, healthcare, transport and hospitality declined. So, while household consumption was still up 0.7%Y/Y it remained some 1½% below the Q419 benchmark. Government consumption also slipped back in Q3 (-0.5%Q/Q) due principally to a decline in spending on healthcare and education amid industrial action in the subsectors across the quarter. Indeed, Q3 marked the first quarter when household, government and business capital spending simultaneously provided a drag on GDP growth since Q220, and the largest (-0.8ppt) since Q113 when excluding the initial Covid-19 slump.

Net trade boosted by a (likely temporary) rise in exports and drop in imports

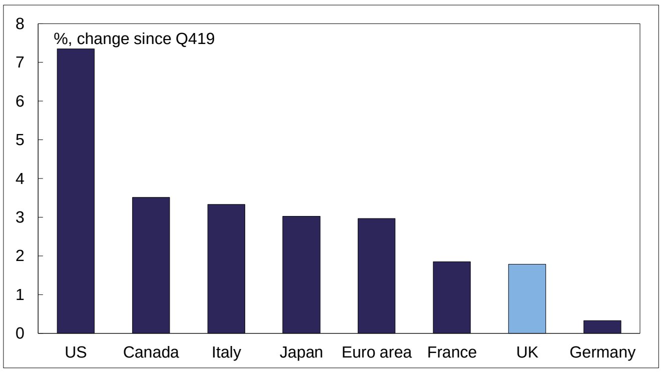
This was in part offset by a fourth consecutive positive contribution from (likely involuntary) stock building (0.3ppt). GDP growth was also supported by a sizeable contribution from net trade (0.5ppt) for the first quarter in four. This was partly supported by stronger services exports (+2.8%Q/Q) which rose to a new series high and more than offset a third consecutive

UK: GDP growth



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Major economies: GDP level compared with Q419*



**Latest data comparison is Q323 except Japan and Canada which is Q223.*
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

decline in goods exports (-2.0%Q/Q) to their lowest level since Q122, with shipments to outside of the EU falling more steeply. Net trade was also boosted by a drop in imports (-0.8%Q/Q) following the jump in Q2 related to the import of aircraft parts from the US. But the latest monthly figures showing that import volumes declined sharply in September (-3.4%M/M) to the lowest level in eleven months, suggest a negative carry over into Q4. Equally, export volumes also weakened in September, declining (-2%M/M) to the lowest level since June 2022.

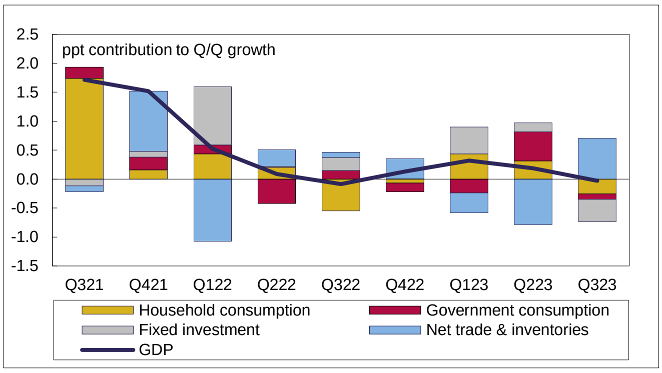
Services output boosted in September by Covid vaccinations and fewer strike days

With activity in consumer-facing services having declined (-0.7%Q/Q) in Q3 to remain almost 5% below the pre-pandemic level, total services output fell (-0.1%Q/Q) for the first quarter since Q121. But this principally reflected a retreat at the start of the summer. Indeed, despite a drop in retail sales and real estate activities, services activity rose for a second successive month in September (+0.2%M/M), boosted not least by stronger heath care sector growth amid the latest Covid-19 vaccination campaign and fewer NHS strikes days than in August. In contrast, industrial production merely moved sideways in September (and over Q3 as a whole) as a pickup in output of ICT and machinery equipment offset renewed weakness in car production. Meanwhile, output from the construction sector in September (0.4%M/M) was underpinned by an increase in repair and maintenance to leave total activity in the sector up an eighth consecutive quarter (+0.1%Q/Q). But this marked the softest growth in the sequence, with a sixth monthly decline out of seven in new private sector housing work leaving it down 2½%Q/Q in Q3 and at its lowest level since October 2021.

GDP growth to remain subdued, but likely avoid a contraction over coming quarters

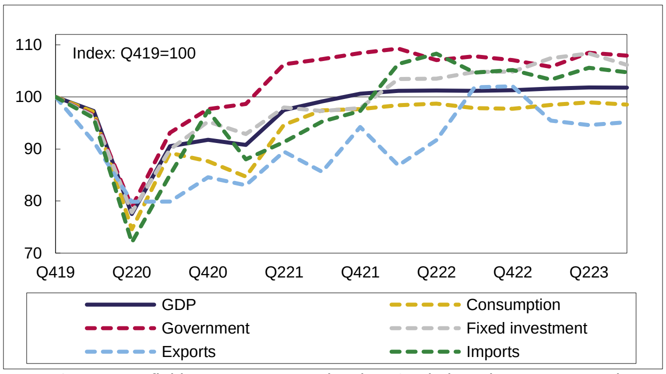
Survey indicators suggest that UK economic activity remained very subdued at the start of Q4. For example, with the services sector PMI having declined to an eleven-month low in October, the composite output PMI (48.6) remained at a level consistent with mild contraction, with the output indices from the services, manufacturing and construction surveys below the key-50 level. Admittedly, the PMIs underestimated GDP growth in Q3 having overestimated it in Q2. Nevertheless, while households' real disposable incomes were given a boost in October by a decline in energy bills, retail surveys suggest that spending remained weak for the time of the year. And with yesterday's RICS residential survey suggesting that house prices will continue to fall over coming months, while indicators imply a further slowdown in the jobs market and point to a moderation in wage growth, households might well be more inclined to add to their savings than spend on big-ticket items. Furthermore, with elevated interest rates also set to weigh further on investment, not least in construction, and global demand for manufactured goods softening, we expect GDP growth to remain very subdued in Q4, with another quarter of zero growth. And while we might well see a modest fiscal giveaway before next general election (to be held by January 2025) a broadly flat profile for GDP looks likely to persist throughout 2024.

UK: GDP growth & expenditure contributions



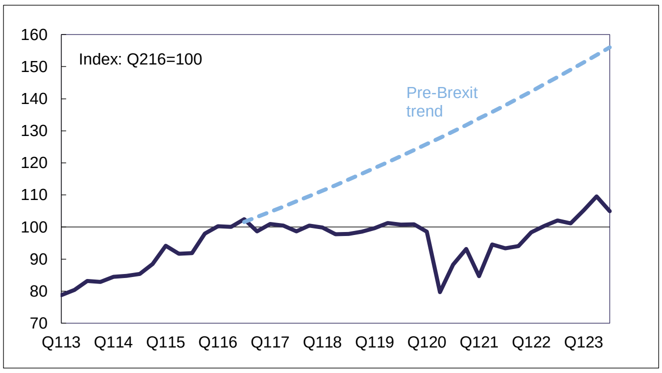
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: GDP & expenditure levels



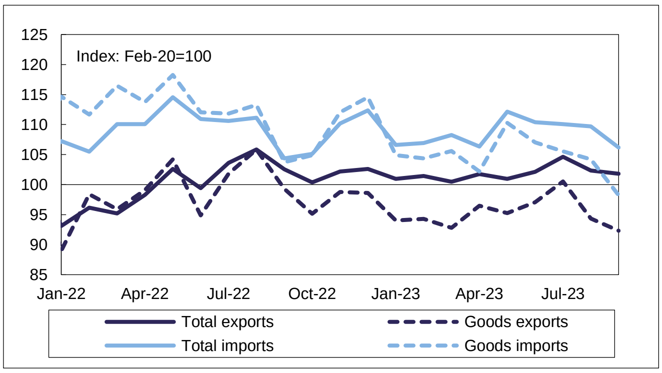
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Business investment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Export & import volumes



Source: ONS and Daiwa Capital Markets Europe Ltd.

The week ahead in the UK

It will be a busy week ahead for top-tier UK releases, including the latest labour market figures (Tuesday), inflation data (Wednesday) and retail sales (Friday). Given the suspension of the Labour Force Survey, the ONS' new experimental unemployment and employment figures – based on HMRC Pay as You Earn figures and the claimant count – will be viewed with some skepticism. But these should nevertheless signal a further loosening in the labour market in September. Indeed, with the claimant count having risen by around 20k that month and the number of payrolled employees having declined for a third successive month, we would expect to see employment on the experimental measure to fall in the three months to September, and a possible uptick in the unemployment rate from 4.2% previously. Despite evidence of a looser labour market and surveys – like the past week's REC report on jobs – suggesting slowing wage growth, average weekly earnings growth is forecast to have remained elevated in the three months to September, with regular pay growth expected to have moved sideways at 7.8%3M/Y. Total wage growth, however, is forecast to have taken a step down in September, to a four-month low of 7.4%3M/Y.

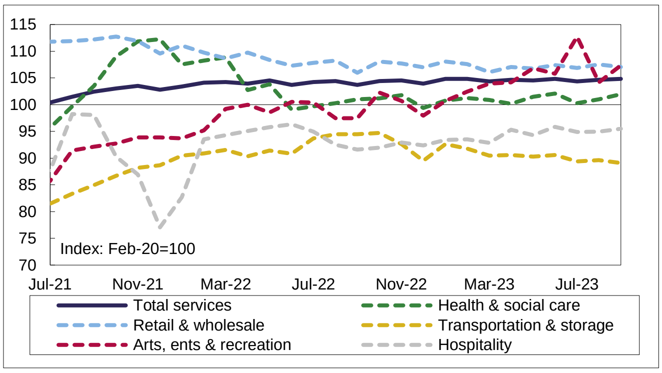
In terms of inflation, this week's October CPI release will report a notable drop in the headline rate due principally to the decline in Ofgem's household energy bill cap. Indeed, with consumer prices expected to have increased in October at just a fraction of the 2%M/M jump this time last year, we forecast headline inflation to decline around 2ppts to 4.7%Y/Y, which would mark the lowest for two years. While energy will provide the principal drag and food inflation is expected to fall for a sixth successive month, we also expect an ongoing disinflationary trend in non-energy industrial goods inflation to a two-year low as well as a modest easing in services inflation (albeit still at an elevated level of 6.7%Y/Y). As such, we forecast core inflation to decline a further 0.4ppt to a 19-month low of 5.7%Y/Y. Given the improvement in households disposable incomes and the weakness reported over the summer, we might expect to see some payback in retail spending in October. But surveys suggest that, against the backdrop of historically low confidence and purchase intentions, sales remained weak for the time of the year at the start of Q4. And so, any bounce back last month will lack vigour.

Euro area

The week ahead in the euro area

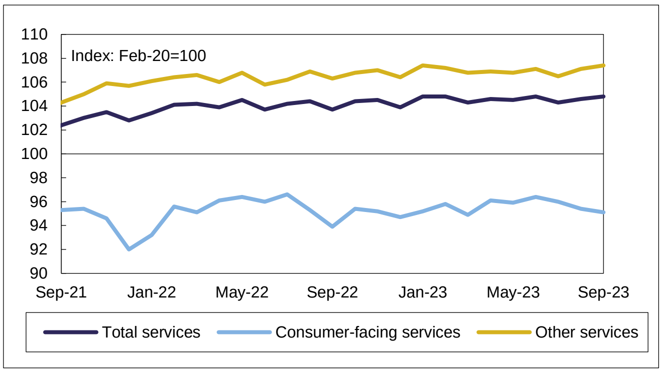
The coming week's data calendar kicks off with an updated estimate for euro area Q3 GDP. In the absence of a significant downside surprise to Dutch GDP (preliminary data are due for release the same day), this is likely to confirm a slight contraction in euro area GDP of 0.1%Q/Q in Q3. Admittedly, euro area industrial production data (Wednesday) might well suggest a downwards revision to Q3 GDP in due course. Figures published so far by the larger member states have been

UK: Services output



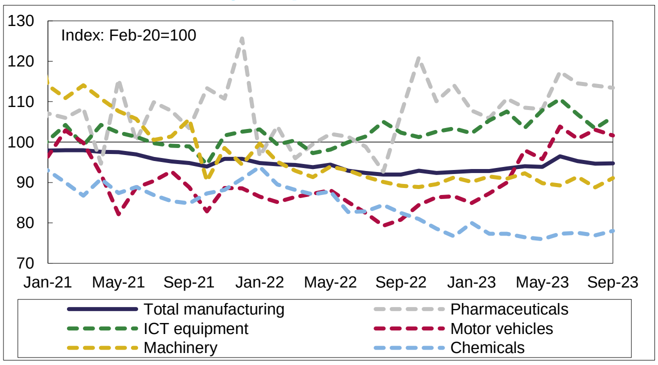
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Services output



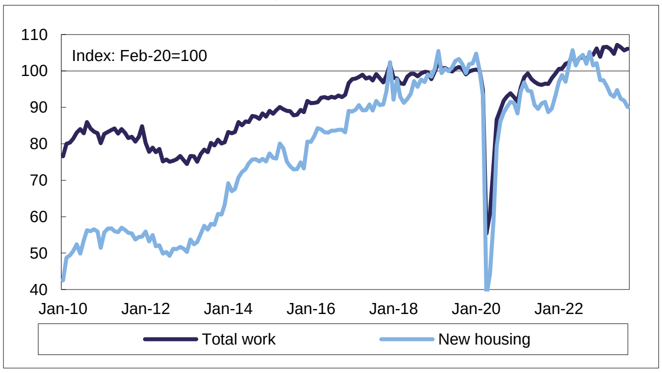
Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Construction output



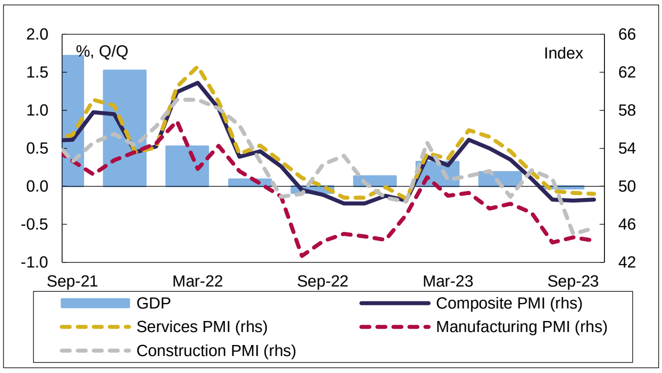
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

mixed, with declines in Germany (-1.4%M/M) and France (-0.5%M/M) and no growth in Italy contrasting with a rise in Spain (1.1%M/M). But with today's releases also suggesting contraction in September in the Netherlands, Ireland and Austria, we expect aggregate euro area output to have declined by more than 1.0%M/M in September, which would leave it down 1.2%Q/Q in Q3. Euro area goods trade figures for September (also due Wednesday) will offer further insight into the contribution of net trade to GDP in Q3. According to the German numbers, the decline in export values outpaced the drop in imports in September, to suggest a broadly neutral contribution from net trade last quarter. Despite weaker economic activity, the latest employment data (Tuesday) are likely to report another modest increase over the third quarter, albeit growth will be notable softer than the average pace of 0.4%Q/Q seen since the start of 2022. Separately, Germany's ZEW investor survey (Tuesday) will offer an update on economic conditions in November. This is likely to echo the findings of the past week's Sentix indicators, that reported an improvement in investor expectations for the outlook but implied still very challenging conditions in the middle of Q4.

The data calendar will conclude on Friday with the release of updated euro area HICP figures for October. In the absence of revisions to the French, Italian and Spanish estimates (due Tuesday and Wednesday), these are expected to confirm findings from the flash release that saw headline inflation drop 1.4ppts to a 27-month low of 2.9%Y/Y and core inflation decline 0.3ppt to a 15-month low of 4.2%Y/Y. While the drop was driven by base effects associated with last year's energy price spike, the granular detail will also likely suggest a broad-based easing in underlying price pressures.

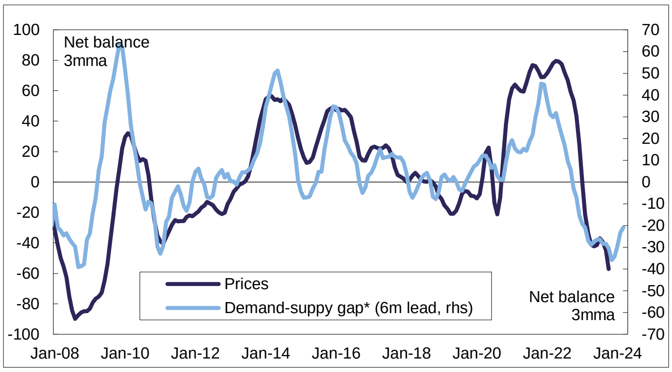
The next edition of the Euro wrap-up will be published 14th November 2023

UK: GDP growth & composite PMI



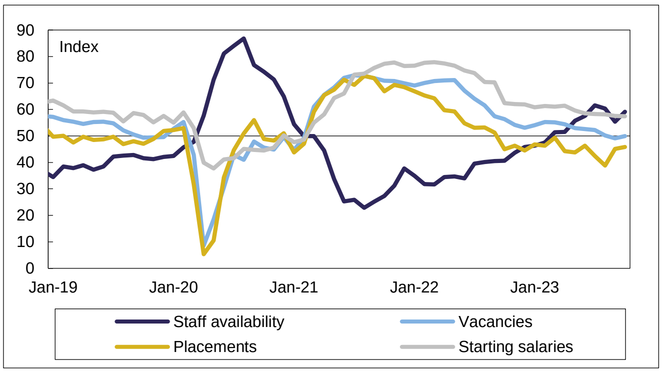
Source: Refinitiv Datastream S&P Global and Daiwa Capital Markets Europe Ltd.

UK: RICS residential survey indices



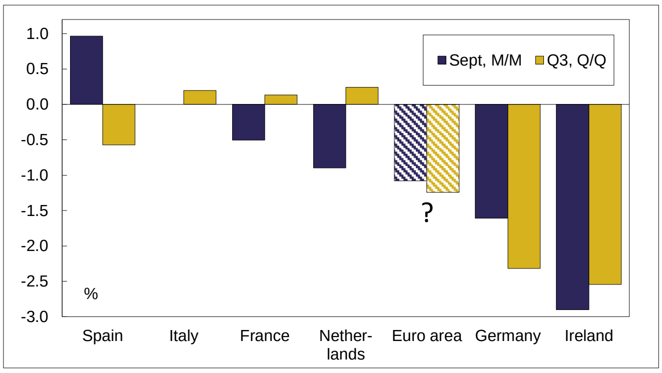
**New buyer enquiries minus new instructions. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: REC report on jobs indices*



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

Euro area member states: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Daiwa economic forecasts

	2023		2024				2023	2024	2025
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP			%, Q/Q					%, Y/Y	
Euro area	-0.1	-0.1	0.1	0.2	0.3	0.3	0.4	0.3	1.4
UK	0.0	0.0	0.0	0.0	0.1	0.2	0.5	0.1	0.6
Inflation, %, Y/Y									
Euro area									
Headline HICP	5.0	3.1	3.0	2.4	1.9	2.1	5.5	2.3	1.8
Core HICP	5.1	4.1	3.1	1.9	1.5	1.7	5.0	2.0	1.7
UK									
Headline CPI	6.7	4.7	4.2	2.7	3.0	2.8	7.4	3.2	2.1
Core CPI	6.4	5.7	5.1	3.3	2.9	2.7	6.3	3.5	2.0
Monetary policy, %									
ECB									
Refi Rate	4.50	4.50	4.50	4.25	4.00	3.75	4.50	3.75	3.25
Deposit Rate	4.00	4.00	4.00	3.75	3.50	3.25	4.00	3.25	2.75
BoE									
Bank Rate	5.25	5.25	5.25	5.25	5.00	4.75	5.25	4.75	3.00

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
Italy	Industrial production M/M% (Y/Y%)	Sep	**0.0 (-2.0)**	-0.2 (-)	0.2 (-4.2)	0.3 (-)
UK	GDP – first estimate Q/Q% (Y/Y%)	Q3	**0.0 (0.6)**	*-0.1 (0.5)*	0.2 (0.6)	-
	GDP M/M%	Sep	**0.2**	0.0	0.2	0.1
	Industrial production M/M% (Y/Y%)	Sep	**0.0 (1.5)**	0.0 (1.1)	-0.7 (1.3)	-0.5 (1.5)
	Manufacturing production M/M% (Y/Y%)	Sep	**0.1 (3.0)**	0.2 (3.0)	-0.8 (2.8)	-0.7 (3.0)
	Index of services M/M% (3M/3M%)	Sep	**0.2 (-0.1)**	0.0 (-0.2)	0.4 (0.1)	0.3 (-)
	Construction output M/M% (Y/Y%)	Sep	**0.4 (2.8)**	-0.5 (2.7)	-0.5 (2.3)	-0.8 (1.8)
	Trade (goods) balance £bn	Sep	**-1.6 (-14.3)**	-2.5 (-15.3)	-3.4 (-16.0)	-2.7 (-15.5)

Auctions

Country	Auction
Italy	sold €3.0bn of 3.85% 2026 bonds at an average yield of 3.75%
	sold €1.5bn of 3.50% 2030 bonds at an average yield of 4.07%
	sold €2.0bn of 4.00% 2030 bonds at an average yield of 4.21%
	sold €1.5bn of 3.25% 2038 bonds at an average yield of 4.84%
	sold €1.0bn of 4.50% 2053 bonds at an average yield of 5.05%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK	RICS house price balance %	Oct	**-63**	-65	-69	-67

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		GMT	Release	Period	Market consensus/ *Daiwa forecast/actual*	Previous
			Monday 13 November 2023			
UK		00.01	Rightmove house price index M/M% (Y/Y%)	Nov	-	0.5 (-0.8)
			Tuesday 14 November 2023			
Euro area		10.00	GDP – second estimate Q/Q% (Y/Y%)	Q3	*-0.1 (0.1)*	0.1 (0.5)
		10.00	Preliminary employment Q/Q% (Y/Y%)	Q3	-	0.2 (1.3)
Germany		10.00	ZEW current assessment (expectations) balance	Nov	-76.9 (5.0)	-79.9 (-1.1)
Spain		08.00	Final HICP (CPI) Y/Y%	Oct	*3.5 (3.5)*	3.3 (3.5)
UK		07.00	Payrolled employees, monthly change '000s	Oct	-18	-11
		07.00	Unemployment claimant count rate % (change '000s)	Oct	-	4.0 (20.4)
		07.00	Average weekly earnings (excluding bonuses) 3M/Y%	Sep	7.4 (7.7)	8.1 (7.8)
			Wednesday 15 November 2023			
Euro area		10.00	Industrial production M/M% (Y/Y%)	Sep	*-1.1 (-6.2)*	0.6 (-5.1)
		10.00	Trade balance €bn	Sep	-	11.9
France		06.30	Unemployment rate %	Q3	-	6.9
		07.45	Final HICP (CPI) Y/Y%	Oct	*4.5 (4.0)*	5.7 (4.9)
Italy		09.00	Final HICP (CPI) Y/Y%	Oct	*1.9 (1.8)*	5.6 (5.3)
UK		07.00	CPI (core) Y/Y%	Oct	*4.7 (5.7)*	6.7 (6.1)
		07.00	Output (input) PPI Y/Y%	Oct	-1.0 (-3.3)	-0.1 (-2.6)
		09.30	House price index Y/Y%	Sep	-	0.2
			Thursday 16 November 2023			
Italy		09.00	Trade balance €bn	Sep	-	2.1
			Friday 17 November 2023			
Euro area		09.00	ECB current account balance €bn	Sep	-	27.7
		10.00	Final HICP (core HICP) Y/Y%	Oct	*2.9 (4.2)*	4.3 (4.5)
Spain		09.00	Trade balance €bn	Sep	-	-4.4
UK		07.00	Retail sales incl. auto fuels M/M% (Y/Y%)	Oct	0.3 (-1.6)	-0.9 (-1.0)
		07.00	Retail sales excl. auto fuels M/M% (Y/Y%)	Oct	0.4 (-1.6)	-1.0 (-1.0)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		GMT	Event / Auction
			Monday 13 November 2023
Euro area		08.15	ECB's de Guindos scheduled to speak at conference
			Tuesday 14 November 2023
Euro area		09.00	ECB Chief Economist Lane scheduled to speak at conference on 'Global risk, uncertainty and volatility'
Germany		10.30	Auction: €5bn of 3.1% 2025 bonds
UK		07.00	ONS publishes experimental employment/unemployment data
			Wednesday 15 November 2023
Euro area		10.00	EU Commission publishes economic forecasts
Germany		10.30	Auction: 0.0% 2052 bonds
		10.30	Auction: 1.8% 2053 bonds
			Thursday 16 November 2023
France		09.50	Auction: 2.50% 2026 bonds
		09.50	Auction: 2.75% 2029 bonds
		09.50	Auction: 0.75% 2028 bonds
		10.50	Auction: 0.1% 2029 index-linked bonds
		10.50	Auction: 0.1% 2036 index-linked bonds
		10.50	Auction: 0.1% 2053 index-linked bonds
Spain		09.30	Auction: 2.80% 2026 bonds
		09.30	Auction: 3.55% 2033 bonds
		09.30	Auction: 3.45% 2043 bonds
			Friday 17 November 2023
Euro area		08.00	ECB President Lagarde scheduled to speak – 'Navigating in a world at risk of fragmentation'
UK		13.10	BoE Deputy Governor Ramsden scheduled to speak at the Society of professional economists

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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