

Euro wrap-up

Overview

- Bunds made losses as the pace of decline in German producer prices eased, while euro area construction activity contracted in Q3.
- Gilts also made modest losses on reports that the UK government is likely to announce tax cuts later in the week.
- Wednesday will bring the flash euro area Commission consumer confidence indicator, as well as an update on UK fiscal policy with the Chancellor's Autumn Statement.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.995	+0.042
OBL 2.4 10/28	2.570	+0.043
DBR 2.6 08/33	2.617	+0.032
UKT 3½ 10/25	4.511	-0.004
UKT 4½ 06/28	4.115	+0.014
UKT 3¼ 01/33	4.127	+0.029

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

Source: Bloomberg

Euro area

Euro area construction output a drag on GDP in Q3 despite pickup in September

Unsurprisingly, the euro area's construction sector has been acutely impacted by the ECB's aggressive monetary tightening, with more stringent lending conditions and higher rates on loans to households and non-financial corporations weighing heavily on demand. And while today's activity data reported a modest pickup in September, the trend remains negative. And leading indicators suggest that the adjustment, particularly in new building work, still has significantly further to play out. Indeed, although construction output rose 0.4%M/M in September, this still left it down for a second successive quarter in Q3 (-0.4%Q/Q). The pickup in September was principally underpinned by civil engineering (1.5%M/M), while building work remained very subdued (0.2%M/M). And in Germany, where total output was flat in September, building work declined for the third month out of the past four (-0.7%M/M) to the lowest level since December and spring 2018 before that. Despite a more substantial rise in activity in France in September (1.8%M/M), it was still down more than 1%Q/Q in Q3. And so, of the larger member states, it appears that Italy (whose September data will be published with a lag) was the only country to avoid a contraction in Q3.

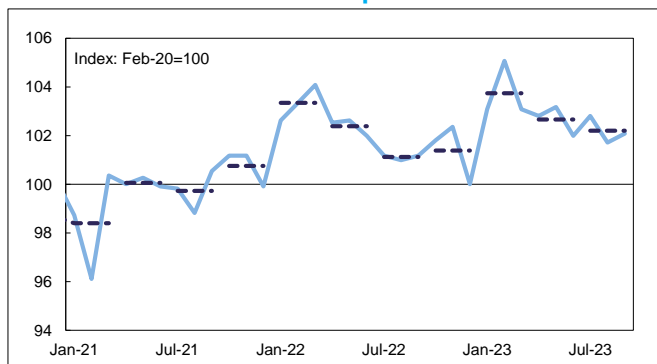
Outlook for construction remains fragile as number of building permits collapse

Surveys point to an extension of the downtrend in the euro area as a whole at the start of Q4 too. Certainly, the construction PMIs remain consistent with a steeper pace of contraction in Germany (38.3) and France (41.0), with new orders falling sharply. The Commission survey reported that insufficient demand was a limiting factor on activity in October for almost 30% of respondent construction firms, the highest share in roughly six years. And with new borrowing costs rising to their highest since the euro crisis in 2013, house prices now falling on average in the euro area and sharply in Germany, and consumer confidence still historically low, the outlook for the construction sector looks gloomy. Indeed, while the number of building permits in the euro area edged slightly higher in July (2.7%M/M), they were still almost 22% below the peak in March 2022. Moreover, the number of residential building permits fell almost 5% that month to the lowest level since the slump at the start of the pandemic and some 35% below last year's peak. And German building permits in August were just half the peak in early 2022. So, despite an easing in constraints on the supply of building materials, activity seems highly likely to remain very subdued over coming quarters.

Underlying German producer price pressures continue to ease

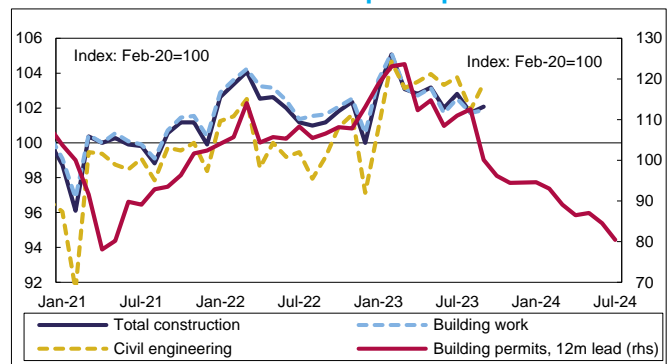
In terms of inflation, today's German producer price figures for October added to the evidence that, against the backdrop of softer demand and improved supply bottlenecks, consumer goods inflation should maintain a downwards trend over coming

Euro area: Construction output*



*Dashed line represents quarterly average. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output & permits



Source: Eurostat, Bloomberg and Daiwa Capital Markets Europe Ltd.

quarters. Admittedly, the annual pace of decline in producer prices moderated in October to -11.0%Y/Y from the record low of -14.7%Y/Y in September. This reflected developments in the energy component, where prices were still down a hefty 27.9%Y/Y, but less than the drop in September (-35.3%Y/Y) when the base effect related to the spike in energy prices last year was more pronounced. But when excluding energy, producer prices fell for a sixth successive month (-0.2%M/M), to leave them up just 0.2%Y/Y, the lowest since November 2020 and more than 16ppts below the peak in May 2022. And the easing in underlying price pressures in the factory sector was seemingly broad-based, with intermediate goods prices down for an eighth successive month to leave them down 4.5%Y/Y, the steepest such decline since 2009. Producer capital goods inflation (4.4%Y/Y) also eased to its softest rate since the start of 2021, while prices of consumer goods fell for a third consecutive month in October, to leave the annual increase of that component down 1.3ppts to 3.9%Y/Y, a near-two year low. While base effects associated with energy prices will continue to fade, surveys such as the manufacturing PMIs suggest that manufacturers should continue to pass on lower cost burdens to customers over coming months and into the New Year. And against the backdrop of weakening demand, retailers might well in due course start to lower prices for consumers too.

The coming two days in the euro area

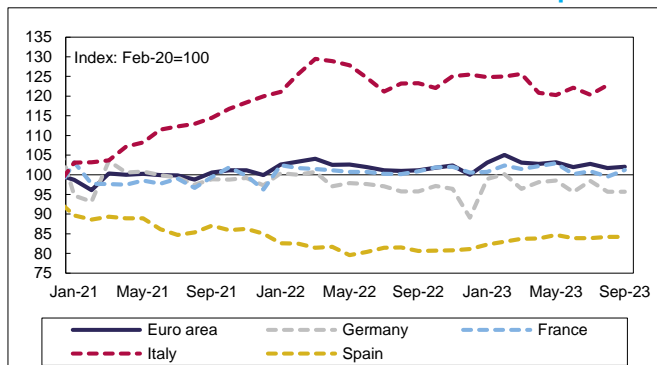
Ahead of Thursday's flash PMIs for November, Wednesday will provide an update on consumer sentiment in the middle of Q4. But despite the recent moderation in inflation, the European Commission's preliminary confidence indicator is likely to suggest little improvement in November as household purchase intentions remain dampened by higher borrowing costs and rising concerns of unemployment. Despite low confidence, tomorrow's euro area new car registrations figures for November are likely to report an acceleration in year-on-year growth in October from a rise of 8.9%Y/Y in September, supported by firmer growth in Germany (4.9%Y/Y), France (21.9%Y/Y), Italy (20.0%Y/Y) and Spain (18.1%Y/Y).

UK

The coming two days in the UK

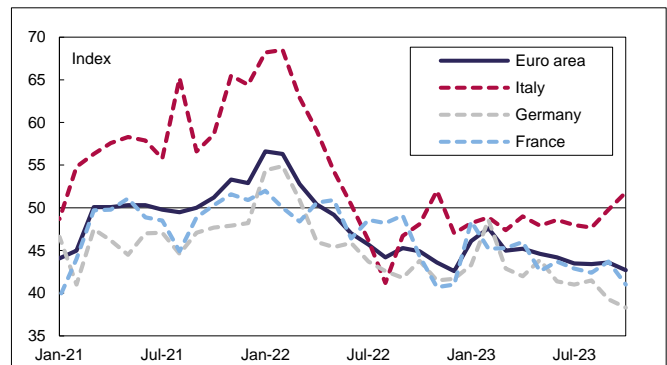
After a quiet start to the week for economic news, the focus in the UK over the coming two days turns to fiscal policy, with Chancellor Hunt expected to present his Autumn Statement on Wednesday alongside updated economic and fiscal forecasts from the Office for Budget Responsibility (OBR). Ahead of this, tomorrow will bring public finance figures for October, which are likely to show that public sector borrowing continued to trend below the OBR's March projection thanks not least to the flattering impact of high inflation on tax revenues. With the government's public expenditure commitments for coming years currently set at unrealistically low levels in cash terms in light of the high inflation of the past couple of years, the OBR's

Euro area member states: Construction output



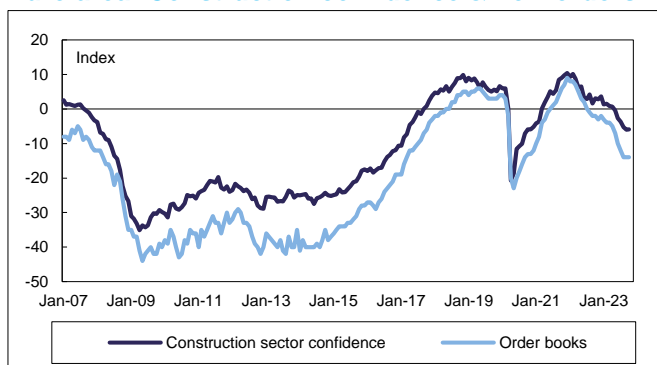
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area member states: Construction PMIs



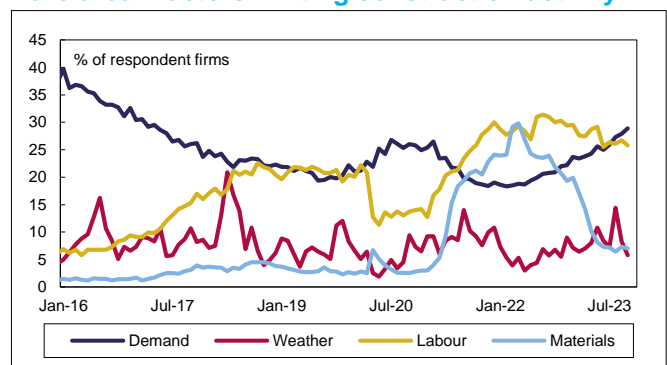
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Construction confidence & new orders



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

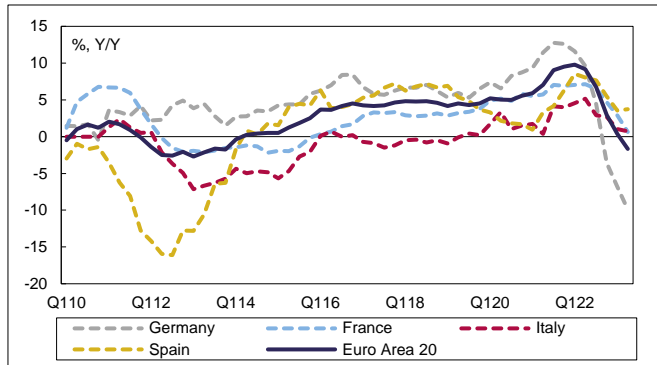
Euro area: Factors limiting construction activity



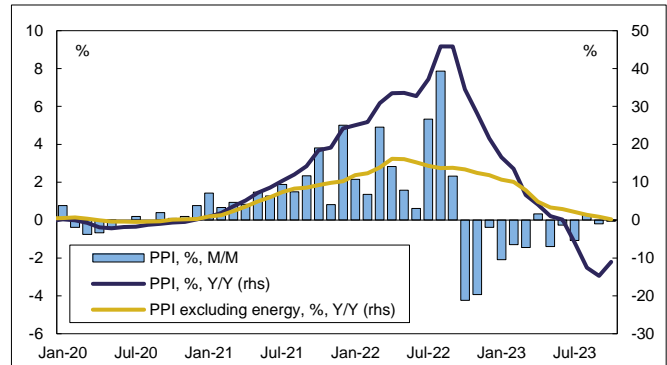
Source: EC, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

updated projections are likely to provide cover for some fiscal easing within the constraint of the government's stated public debt objective. Reports suggest that Hunt will announce some tax giveaways, including perhaps a modest cut to personal income and/or inheritance taxes, an extension of the full-expensing capital allowance policy to provide incentives for increased business investment, as well as an overhaul of tax-free individual savings accounts (ISAs). This will probably be accompanied by policies aimed at restraining the rise in the welfare bill, including perhaps by uprating inflation-linked benefits below the rate of CPI inflation in September 2023 which would normally be the convention. Meanwhile, given the recent deterioration in economic momentum and associated need for downwards revisions to be made to the OBR's previous GDP forecasts, any fiscal giveaway might be judged to offer relatively little boost to economic growth ahead of the next general election, which currently appears most likely to be held next autumn. In terms of economic data, Wednesday will bring the CBI's industrial trends survey for November, which is expected to report ongoing challenges in the manufacturing sector amid weak domestic and overseas demand.

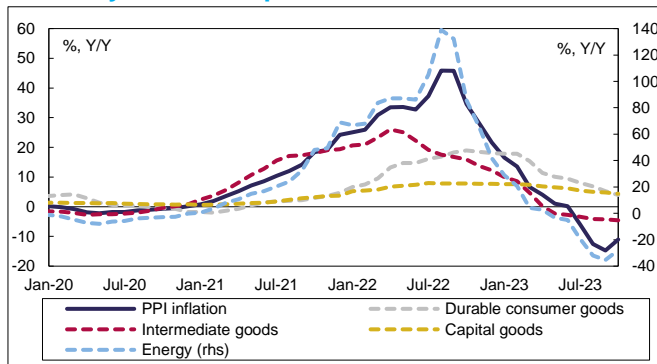
Euro area member states: House prices



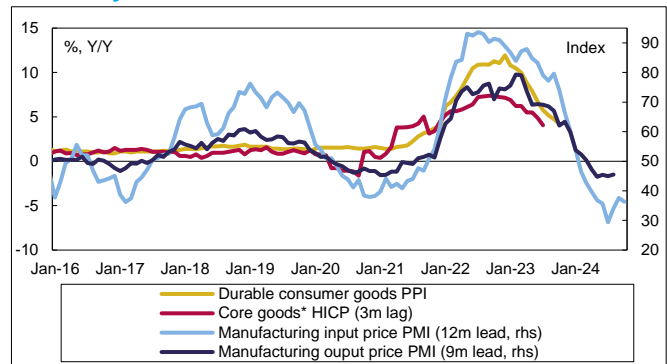
Germany: Producer price inflation



Germany: Producer price inflation



Germany: Goods inflation indices





The next edition of the Euro wrap-up will be published on 22 November 2023

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Construction output M/M% (Y/Y%)	Sep	0.4 (-0.3)	-	-1.1 (-0.1)	- (0.0)
Germany	 PPI Y/Y%	Oct	-11.0	-11.0	-14.7	-




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	 07.00	EU27 new car registrations Y/Y%	Oct	-	9.2
France	 -	Bank of France retail sales Y/Y%	Oct	-	-4.3
UK	 07.00	Public sector net borrowing (ex banks) £bn	Oct	17.8 (13.7)	13.5 (14.3)



Auctions and events

Euro area	 16.00	ECB President Lagarde scheduled to speak
	 17.00	ECB's Schnabel scheduled to speak
Germany	 10.30	Auction: €3.5bn of 2.4% 2028 bonds





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	 15.00	European Commission's preliminary consumer confidence index	Nov	-17.8	-17.9
UK	 11.00	CBI industrial trends, total orders (selling prices) balance %	Nov	-23 (5)	-26 (7)

Auctions and events

Euro area	 09.00	ECB to publish Financial Stability Report
Germany	 10.30	Auction: €1bn of 1% 2038 bonds
	 10.30	Auction: €500mn of 0% 2035 bonds
UK	 12.30	Chancellor of the Exchequer presents the Autumn Statement

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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