Euro wrap-up

Overview

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- Gilts made losses as the BoE left rates unchanged but signalled gradual cuts ahead, while the MPC agreed to continue QT at the same annual pace of £100bn, implying fewer active Gilt sales.
- Shorter-dated Bunds followed USTs higher, while euro area new car registrations fell sharply in August.
- Friday will bring consumer confidence indicators from the euro area and UK, a French business survey and UK retail sales figures.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.207	-0.051
OBL 2½ 10/29	2.043	-0.026
DBR 2.6 08/34	2.188	-
UKT 4⅛ 01/27	3.910	+0.014
UKT 4⅛ 07/29	3.735	+0.022
UKT 4¼ 07/34	3.885	+0.041

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

UK

BoE leaves rates unchanged, signals gradual easing to come

Having eased policy in August, as expected the BoE left Bank Rate unchanged at 5.0%. Only one of the nine-member MPC – the uber-dove Dhingra – voted for a rate cut, with the others supporting the decision. Although the decision was announced today, it was taken yesterday before the FOMC delivered its 50bp rate cut, making clear that the BoE does not intend to be overly influenced by the Fed. Nevertheless, while it left its policy stance unchanged today, the MPC updated its forward guidance to suggest strongly that further easing is likely to come soon. In particular, it stated that ‘In the absence of material developments, a gradual approach to removing policy restraint remains appropriate’. This could imply the likelihood of one cut of 25bps per quarter or cuts of the same magnitude at each meeting into the New Year. Current market pricing suggests there is no consensus among investors that one path is more likely than the other.

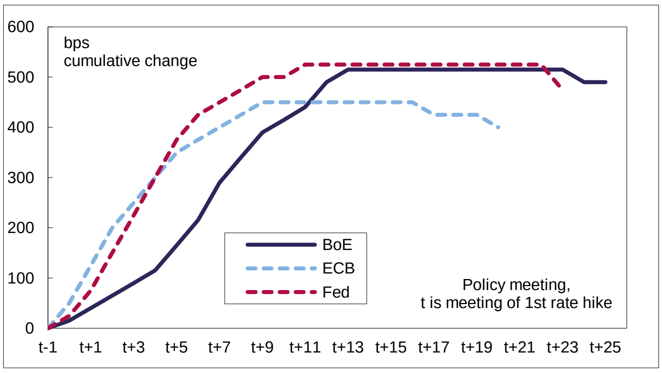
Softening of UK dataflow & sterling strength consistent with faster pace of cuts in Q4

While the MPC judged that there had ‘generally been limited news in UK economic indicators relative to the Committee’s expectations in the August Monetary Policy Report’, on balance, data have been a touch softer than its projections. Indeed, this month’s meeting minutes noted that Bank staff have now revised down their Q3 GDP growth forecast by 0.1ppt to 0.3%Q/Q. Nevertheless, they also suggested that Bank staff no longer expect any spare capacity to emerge by the end of the year. Regardless, inflation has started to undershoot the BoE’s projection, with the all-important services component easing a touch more than had been anticipated and petrol prices falling on the back of events in wholesale oil markets. Wage growth is clearly moderating too. Moreover, in the wake of yesterday evening’s jumbo US rate cut and today’s BoE announcement, sterling rallied to its strongest level against the dollar in 2½ years. And with the Fed likely to keep easing steadily into the New Year, the MPC might soon have to keep pace with the FOMC to avoid the risk that sterling strength injects an excessively disinflationary impulse and weighs too heavily on exports over coming quarters. So, while inflation will take a step-up in October and probably remain above-target for a while in the New Year, we currently expect cuts of 25bps at each policy meeting in Q4 and further easing at the same pace in 2025. Nevertheless, any significant shift in the fiscal policy stance resulting from the government’s Budget announcement on 30 October might yet temper the pace of easing ahead.

QT to continue at the same pace as past 12 months, implying fewer active Gilt sales

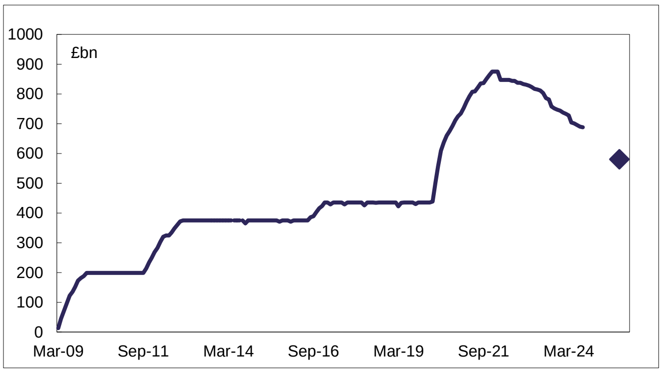
In line with our expectation, the MPC today also agreed to a 12-month extension of its quantitative tightening programme at the same annual pace of £100bn as over the past 12 months. Due to the increased share of that reduction to be accounted for by roll-off of maturing bonds (87%), the decision means that the amount and frequency of auctions of its Gilt holdings will

BoE, ECB & Fed: Change in rates since 1st hike



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

BoE: Asset Purchase Facility Gilt holdings



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

be reduced from the past 12 months. And given the choppy profile of redemptions, and to maintain a relatively even pace of QT across maturity sectors over the coming 12 months, the BoE also confirmed that the frequency and size of auctions by maturity will vary each quarter. With this next phase of QT likely to return the total stock of bank reserves close to levels it considers to be consistent with equilibrium, we expect the programme to be brought to an end in a year's time.

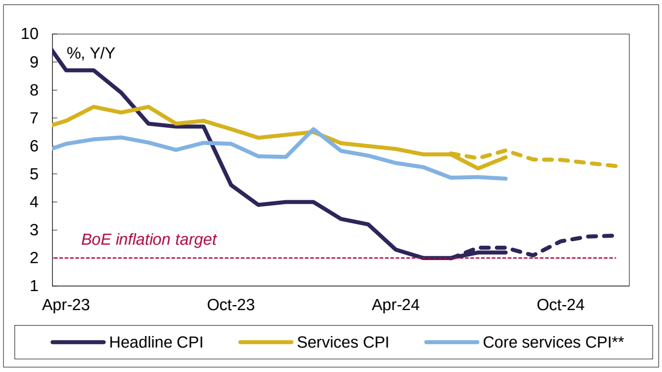
The day ahead in the UK

Friday's release of August retail sales figures and September's consumer confidence survey results will provide some insight into household spending in Q3. Following a modest rise in July (0.5%M/M), retail surveys point to a further increase in sales volumes last month as demand was boosted by an improvement in weather conditions. Auto fuel sales also likely benefitted from lower petrol prices. Expectations are for another rise of around ½%M/M, which would leave sales trending so far in Q3 almost 1% above the Q2 average. Consumer confidence might also receive a boost from the recent cut in interest rates, although purchase intentions are likely to remain very subdued as households still prefer to save than spend. Tomorrow will also bring the release of the latest monthly public finance figures for August, which are likely to illustrate the limited scope for supportive fiscal policy ahead of the Autumn Budget on 30 October unless the new government chooses to relax its public debt target via a revised accounting treatment for losses associated with the BoE's QE programme.

The day ahead in the euro area

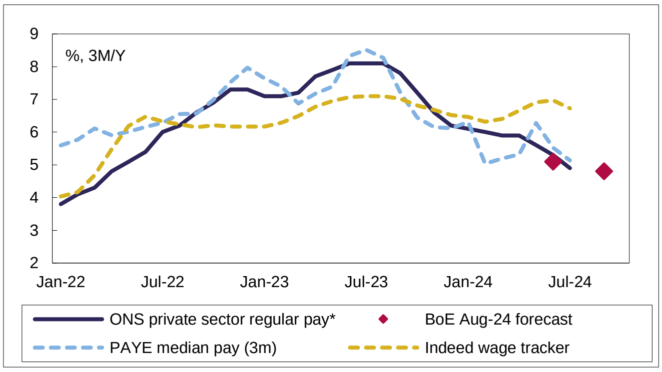
After a quiet day for top-tier releases today, Friday's release of the Commission's flash euro area consumer confidence indicator and the French INSEE business survey will provide updates on economic conditions at the end of Q3. While the headline consumer sentiment index slipped back in August (down 0.5pt to -13.5) it was still the second-highest since February 2022. Confidence might well be little changed this month as concerns about increasing downside risks to the economic outlook might offset any support from the cut in interest rates. Meanwhile, having been boosted by activity related to the Paris Olympics in August, French business sentiment is likely to moderate in September particularly in the services sector.

UK: Headline & services inflation*



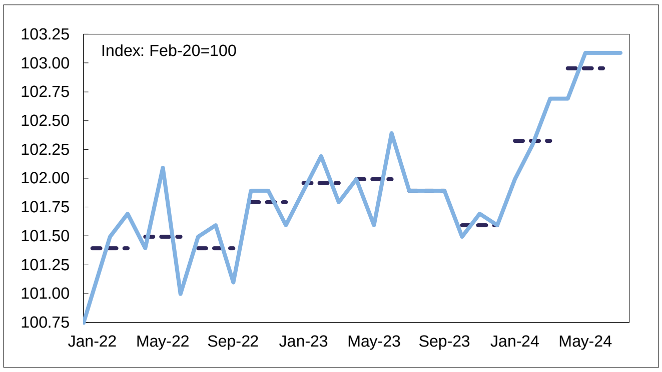
**Dashed lines represent BoE projections from August MPR. **Excluding airfares, accommodation & rents. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Pay growth & BoE projection



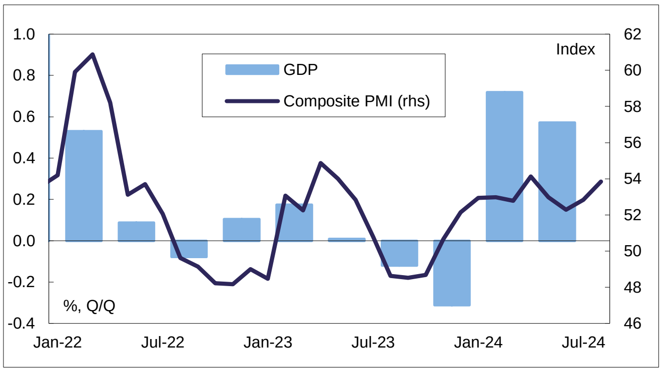
**Data between January 2022 and November 2022 are BoE staff estimates of underlying private sector regular pay growth. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: GDP level*



**Dashed dark blue line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: GDP growth & composite PMI



Source: Macrobond, 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
Euro area	New car registrations Y/Y%	Aug	**-19.9**	-	-1.0	-
	Current account balance €bn	Jul	**39.6**	-	50.5	-
UK	BoE Bank Rate %	Sep	**5.00**	*5.00*	5.00	-

Auctions

Country	Auction
France	sold €4.07bn of 2.5% 2027 bonds at an average yield of 2.45%
	sold €1.95bn of 0.75% 2028 bonds at an average yield of 2.46%
	sold €3.57bn of 2.75% 2030 bonds at an average yield of 2.62%
	sold €2.41bn of 2% 2032 bonds at an average yield of 2.77%
	sold €816mn of 0.1% 2032 inflation-linked bonds at an average yield of 0.92%
	sold €330mn of 3.15% 2032 inflation-linked bonds at an average yield of 0.76%
	sold €530mn of 1.8% 2040 inflation-linked bonds at an average yield of 1.13%
	sold €323mn of 0.1% 2053 inflation-linked bonds at an average yield of 1.1%
Spain	sold €1.40bn of 5.15% 2028 bonds at an average yield of 2.463%
	sold €2.38bn of 3.1% 2031 bonds at an average yield of 2.692%
	sold €1.77bn of 3.45% 2043 bonds at an average yield of 3.527%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	15.00	Preliminary Commission consumer confidence indicator	Sep	-13.2	-13.5
Germany	07.00	PPI Y/Y%	Aug	-1.0	-0.8
France	07.45	INSEE business (manufacturing) confidence indicator	Sep	98 (99)	97 (99)
	-	Retail sales Y/Y%	Aug	-	-0.5
UK	00.01	GfK consumer confidence indicator	Sep	-13	-13
	07.00	Retail sales – including auto fuel M/M% (Y/Y%)	Aug	0.4 (1.3)	0.5 (1.4)
	07.00	Retail sales – excluding auto fuel M/M% (Y/Y%)	Aug	0.5 (1.1)	0.7 (1.4)
	07.00	Public sector net borrowing £bn	Aug	12.6	3.1

Auctions and events

Country	BST	Event
Euro area	16.00	ECB President Lagarde delivers Michel Camdessus Central Banking Lecture at the IMF, New York.

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.