

Euro wrap-up

Overview

- Bunds made notable gains as euro area inflation fell below the ECB's 2% target for the first time since mid-2021, raising expectations for an October rate cut.
- Gilts also made gains as a UK survey suggested that shop price inflation was the lowest for more than three years.
- Wednesday will bring euro area unemployment figures for August.

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Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.021	-0.038
OBL 2½ 10/29	1.880	-0.061
DBR 2.6 08/34	2.040	-0.081
UKT 4½ 01/27	3.949	-0.024
UKT 4½ 07/29	3.815	-0.040
UKT 4½ 07/34	3.941	-0.060

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

Source: Bloomberg

Euro area

Headline inflation falls below 2% target for the first time since June 2021

In line with expectations, euro area consumer price inflation took a notable step down in September, easing below the 2% target for the first time since June 2021. Inflation rose in just three of the euro area's twenty member states in September. And encouragingly, twelve member states – totalling 84% of the region's GDP and including the largest four – recorded sub-2% inflation. Furthermore, given the decline in September, the headline and core inflation rates for Q3 were both 0.1ppt below the ECB's respective projections, bolstering our expectation that it will cut rates again later this month. In particular, today's release reported the first monthly decline in consumer prices (-0.1%M/M) for seven months in September, taking the annual HICP inflation rate down 0.4ppt to 1.8%Y/Y, the lowest since March 2021. Admittedly, the decline in headline inflation in September largely reflected a sharp drop of 3.0ppts in the energy component to an eight-month low of -6.0%Y/Y, as fuel and heating gas oil prices fell significantly in contrast to a rise a year earlier. In contrast, inflation of food, alcohol and tobacco ticked up 0.1ppt to 2.4%Y/Y, while inflation of non-energy industrial goods moved sideways, albeit at a very subdued 0.4%Y/Y. And while the services component eased 0.1ppt to 4.0%Y/Y, this was merely bang in line with the average rate in the year-to-date. As a result, core inflation edged down just 0.1ppt to 2.7%Y/Y, matching April's 2½-year low. To two decimal places, however, both the headline (1.77%Y/Y) and core (2.68%Y/Y) rates came in on the low side.

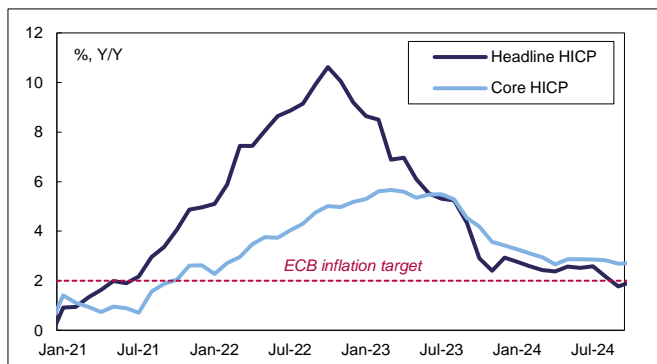
Services inflation momentum eases to a seven-month low

Amid the recent decline in costs of fuel and shipping freight, and given still subdued global demand and ample supply, the core goods prices were unchanged for a second successive month in September on a seasonally adjusted basis. So, inflation momentum in core goods remained subdued at just 1.1%3M/3M annualised. Moreover, of greater interest for ECB policymakers, services prices rose just 0.1%M/M on a seasonally adjusted basis, the least in ten months. Admittedly, this in part reflected payback for the increase in August associated with higher prices of public transport and accommodation during the Paris Olympics. So, services inflation momentum (4.1%3M/3M) was still more than double the ECB's 2% target, which won't dispel concerns about persistent stickiness in this category. Nevertheless, that was still a seven-month low, down 1.2ppts from the recent high in May and some 3ppts below the November 2022 peak. And services momentum should continue to moderate in Q4 and into 2025.

Inflation outlook to justify a faster pace of rate cuts from the ECB

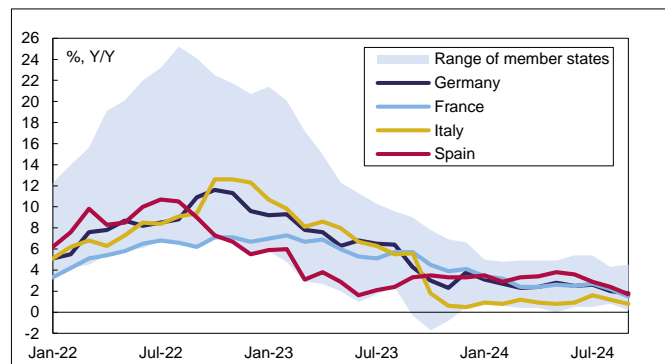
As flagged by ECB President Lagarde yesterday, we expect inflation to rise temporarily over coming months due to base effects in energy prices. Food inflation might also drift slightly higher as inclement weather conditions hampered harvests.

Euro area: Headline & core inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: HICP inflation



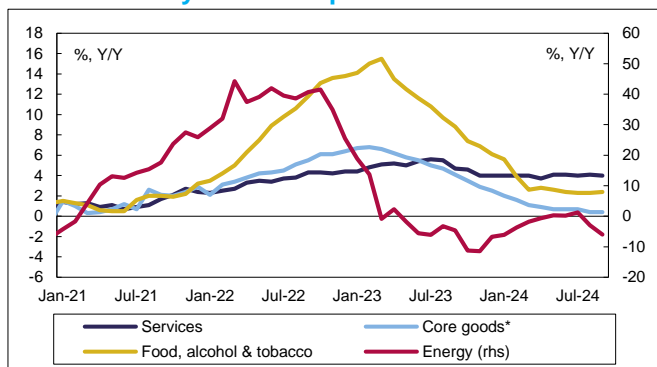
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Indeed, we expect headline inflation to rise back to 2.0%Y/Y in October and a little further above target in November and December. But this would leave inflation merely moving sideways on a quarterly basis in Q4 at 2.2%Y/Y, some 0.4ppt below the ECB's projection. Admittedly, given base effects, core inflation might tick back up slightly in Q4 to 2.9%Y/Y. But as economic recovery momentum appears to have slowed over the summer and firms are likely to continue to absorb wage and other cost pressures in their profit margins, we continue to expect headline inflation to fall back below the 2% target again by Q225, two quarters earlier than the ECB currently projects. Moreover, while the ECB in September expected core inflation to only return to target by the end of the forecast horizon in Q426, we also expect it to drop back to 2% by the middle of next year, a profile that should support our view that the ECB will cut interest rates by 25bp at each meeting in Q424 and Q125, with a final rate cut this cycle to coincide with updated macroeconomic projections in June next year.

The day ahead in the euro area

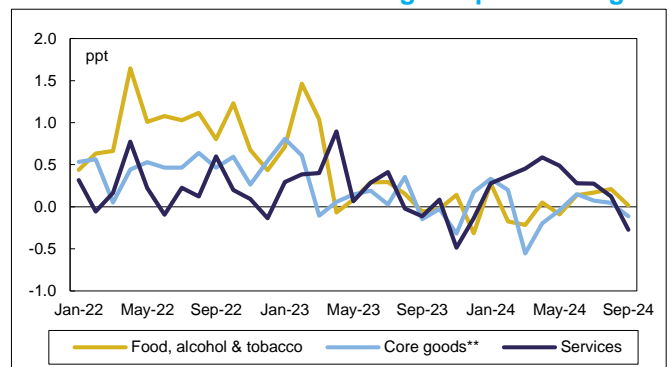
Wednesday will bring euro area unemployment figures for August. While the jobless rate is expected to remain steady at July's series low of 6.4%, the risks are skewed to the upside. Meanwhile, Spanish national figures will provide an update on labour market conditions in September.

Euro area: Key HICP components



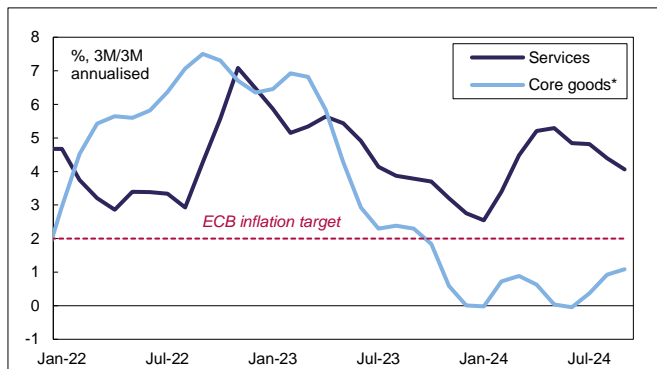
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Deviations from long-run price change*



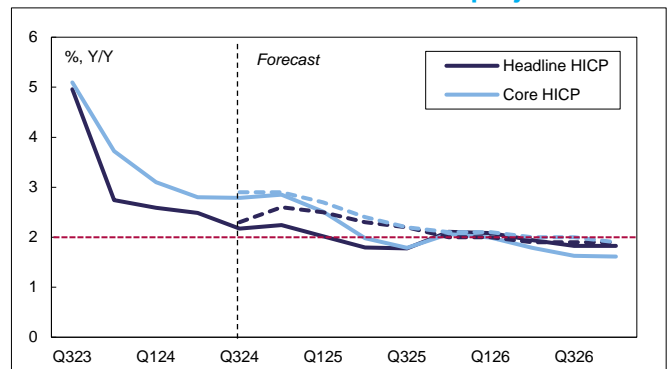
*Monthly change in prices compared with average for the month in the decade before the pandemic. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core inflation momentum



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

Euro area: Headline & core inflation projections*



*Dashed lines represent ECB projections, Sep-24. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

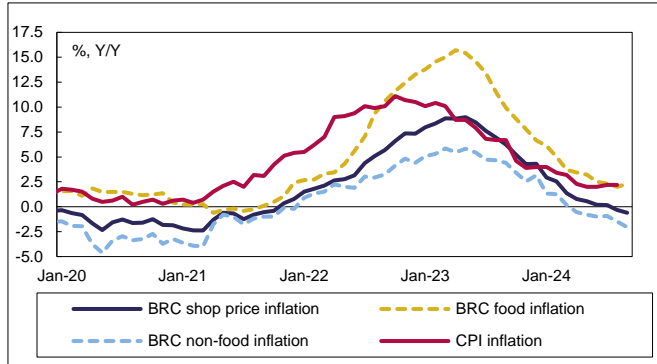
UK

BRC shop price deflation intensifies as firms offer heavy discounting to shift stock

According to the British Retail Consortium (BRC), UK shop prices maintained a downwards trend in September as strong competition continued to weigh on pricing powers. In particular, prices fell for a third month out of the past four in September – by 0.25%M/M, the most since April – to leave the annual rate of decline (-0.6%Y/Y) the steepest in more than three years. The negative print again reflected non-food prices, which reportedly declined for the sixth month out of the past seven to be down on the survey measure by 2.1%Y/Y, the most since March 2021. According to the BRC, retailers again resorted to heavy discounting to shift seasonal stock, particularly for clothing – where prices fell for a ninth successive month – and furniture – where prices fell the most in more than three years. In contrast, food prices rose for a third consecutive month as poor harvests pushed prices of cooking oil and sugary products higher, although the BRC's measure of food inflation

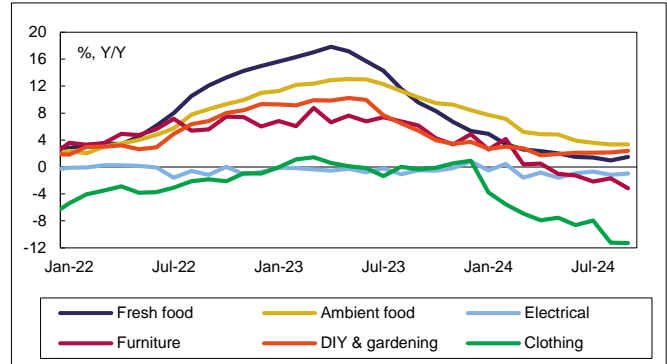
(2.3%Y/Y) remained some way below the average so far this year and well down on last year's peak. While today's release might suggest some renewed upward pressure in the equivalent food CPI measure at the end of Q3, the CPI components for core goods should remain well-behaved in September. And while today's manufacturing PMIs pointed to a pickup in costs in the factory sector, output prices charged remained below average as manufacturers' pricing power seemingly remained diminished by still sub-par demand.

UK: BRC shop price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BRC shop price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.









The day ahead in the UK

It should be a quiet day for UK economic news with no top-tier releases due.



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Preliminary headline (core) HICP Y/Y%	Sep	1.8 (2.7)	<u>1.8 (2.7)</u>	2.2 (2.8)	-
	 Final manufacturing PMI	Sep	45.0	44.8	45.8	-
Germany	 Final manufacturing PMI	Sep	40.6	40.3	42.4	-
France	 Final manufacturing PMI	Sep	44.6	44.0	43.9	-
Italy	 Manufacturing PMI	Sep	48.3	49.0	49.4	-
Spain	 Manufacturing PMI	Sep	53.0	50.2	50.5	-
UK	 Final manufacturing PMI	Sep	51.5	51.5	52.5	-
	 BRC shop price index Y/Y%	Sep	-0.6	-0.3	-0.3	-




Auctions

Country	Auction
Germany	 sold €3.3bn of 2.5% 2029 bonds at an average yield of 1.9%
UK	 sold £2.25bn of 4.75% 2043 bonds at an average yield of 4.421%



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	10.00	 Unemployment rate %	Aug	6.4	6.4
France	07.45	 Budget balance YTD €bn	Aug	-	-156.9
Spain	08.00	 Unemployment (employment) change 000s	Sep	12.0 (-)	21.9 (30.2)

Auctions and events

Germany	 10.30	Auction: to sell €4.5bn of 2.6% 2034 bonds
UK	 10.00	Auction: to sell £4bn of 4.125% 2029 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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