

Euro wrap-up

Overview

- While strong German retail sales suggested that consumer spending will provide some much-needed support to GDP in Q3, Bunds followed USTs higher at the short end as the account of the ECB's September monetary policy meeting reported an increasingly downbeat mood on the Governing Council.
- Longer-dated Gilts made modest losses as a UK housing survey signalled the strongest house price growth for more than two years.
- Friday will bring final German inflation figures for September and UK GDP numbers for August.

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Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.228	-0.026
OBL 2½ 10/29	2.109	-0.015
DBR 2.6 08/34	2.252	-0.004
UKT 4½ 01/27	4.183	+0.001
UKT 4½ 07/29	4.081	+0.020
UKT 4½ 07/34	4.211	+0.032

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

Euro area

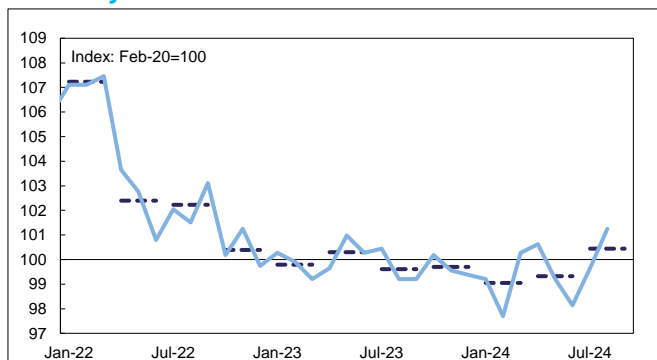
German retail sales on track to provide much-needed support to GDP in Q3

Long-awaited German retail sales figures – postponed since May due to technical issues – have provided some welcome hints that consumer spending might have provided some much-needed support to the economy last quarter. Indeed, retail sales rose for a second-successive month in August, by 1.6%/M/M to the highest level since November 2022, to be trending in the first two months of Q3 a little more than 1% above the Q2 average. Admittedly, given previous weakness, sales in the year to August were merely flat compared with the same period in 2023 with spending down notably on this basis in clothing and furniture stores. This notwithstanding, sales of both food (1.9%/M/M) and non-food items (1.1%/M/M) were firm in August, and higher than a year earlier, with the latter supported by a notable boost in auto fuel sales volumes amid the decline in petrol prices. Given usual monthly volatility in German retail sales data, we might expect to see some payback at the end of Q3. But a further fall in fuel prices should be supportive. And while still well below the long-run average, the GfK consumer confidence survey suggested that purchase intentions last month were the least downbeat since spring 2022. So, while retail accounts for just one-third of consumer spending, today's figures raise the likelihood that household consumption rose in Q3 for just the second quarter out of the past five.

German exports rise in August, but net trade still on track to subtract from GDP growth in Q3

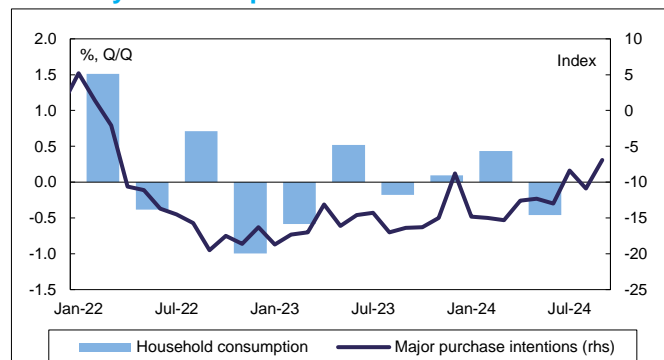
At face value, yesterday's German goods trade figures were also more encouraging. Against expectations of a further narrowing, the trade surplus rose €5.6bn in August to a three-month high of €22.5bn as the value of exports rose for a second successive month (1.3%/M/M) and the value of imports fell sharply (-3.4%/M/M). The improvement in exports was widespread across Germany's main trading partners, including increases of around 5½%/M/M to the US and UK. It also partly reflected a significant jump in shipments to Japan (37%/M/M), reflecting a likely one-off large-scale shipment of transport equipment. While exports to China also rose in August (1.2%/M/M), they remained close to July's more than four-year low amid lacklustre demand for German autos, machinery and equipment. When adjusting for price effects, export volumes in August were also up a cumulative 3.1% since June. But having declined sharply in Q2 (-2.0%/Q/Q), this still left them trending a little more than 1% below the Q2 average. Furthermore, with import volumes trending over the same period some 1.8% higher, these data strongly suggest that net trade will be a drag on GDP growth for a second consecutive quarter. Recent figures similarly suggest that manufacturing and construction output is also on track for a non-negligible decline last quarter. So, while household spending and services activity might provide some decent offset, on balance, we are not yet ready to adjust our view that Germany's economy contracted slightly in Q3 (-0.1%/Q/Q).

Germany: Retail sales*



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

Germany: Consumption & consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italian IP remains weak in August, but Ireland provides a further boost to euro area output

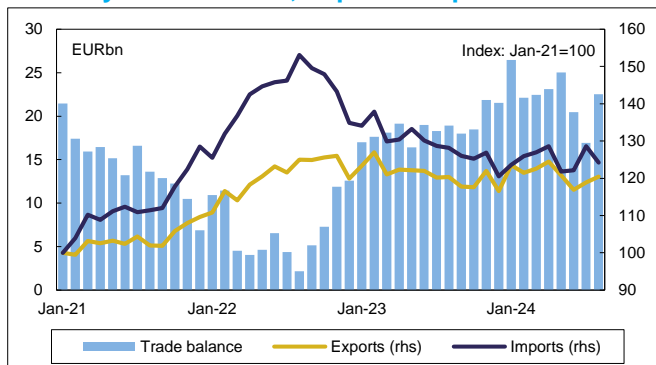
While August industrial production surprised to the upside in [Germany](#) and [France](#), today's Italian figures proved to be something of a damp squib, with IP rising just 0.1%M/M, bang in line with expectations. Having declined 1.0%M/M in July, this left output down 3.2%Y/Y and trending some 0.5% below the Q2 average. Moreover, in the absence of a more than 3%M/M jump in energy, output would have been much weaker. Indeed, manufacturing production fell for a second successive month, by 1.3%M/M – the steepest monthly drop since April 2023 – to be tracking so far in Q3 almost 1½% below the Q2 level. The weakness was led by a drop in intermediate goods (-2.8%M/M), where the level of output fell to its lowest since the global financial crisis outside of the initial pandemic slump due not least to the ongoing downtrend in basic metals and rubber and plastic products. Production of capital goods also fell (-2.5%M/M) to its lowest level for more than two years, led by a further decline in output of machinery and equipment. And while output of consumer goods was boosted by pharmaceuticals in August, it was still averaging a little more than ½% below the Q2 level.

Notwithstanding the weakness in Italy, aggregate euro area manufacturing output appears to have risen sharply in the middle of Q3. Certainly, Irish IP – which due to the activities of multinational corporations based there for tax reasons often impact the area-wide measure significantly – rose for the third month out of the past four, by 4.5%M/M. This left Irish production in July and August some 8.8% above the Q2 average. Overall, we expect euro area industrial output – data due on Tuesday – to increase a little more than 1½%M/M in August, to leave it on a broadly sideways trend in Q3.

ECB account highlights increasingly downbeat mood on the Governing Council

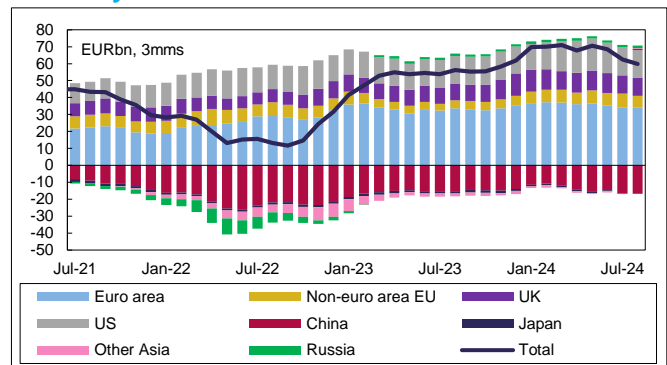
In her post-meeting press conference after the Governing Council eased policy last month, ECB President Lagarde appeared to downplay the chances of back-to-back rate cuts. Since then, however, September's PMIs and inflation data have come in on the soft side. And in the wake of those figures, commentary from ECB policymakers has become increasingly dovish, significantly raising the likelihood of further monetary easing next week. But the account from last month's policy meeting, published today, suggested that the mood on the Governing Council had by then already become more downbeat and more conducive to successive rate cuts. While the deposit rate was lowered to 3.50% at the September meeting, the account reported that Chief Economist Phillip Lane judged that new level to be "still clearly restrictive" while he also made judgment that downside risks to the economic outlook were rising. It was also noted that data published since the ECB's updated macroeconomic projections had been finalised pointed to a softer near-term path for domestic demand and inflation. And Lane cautioned that "if the incoming data indicated a sustained acceleration in the speed of disinflation or a material shortfall in the speed of economic recovery (with its implications for medium-term inflation), a faster pace of rate adjustment could be warranted".

Germany: Goods trade, import & export values



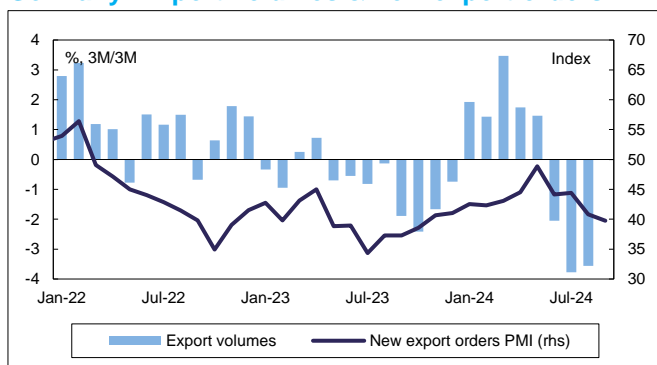
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Goods trade balance



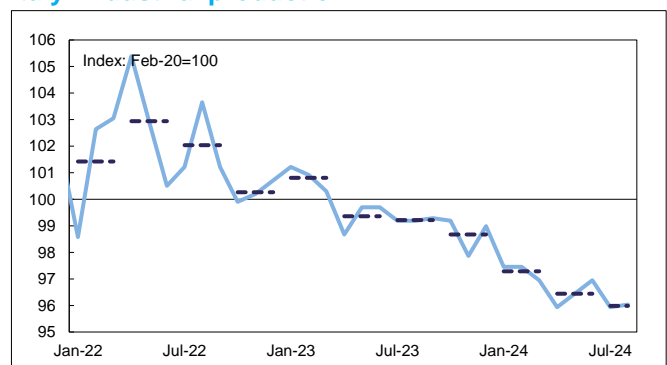
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Export volumes & new export orders PMI



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

Italy: Industrial production*



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

Other Governing Council members last month “concurred” with Lane’s assessment. Among things, it was noted that “the long-anticipated consumption-led recovery... had so far not materialised” with the level of interest rates cited as a possible cause. Likewise, particular concerns were also expressed about the weakness of investment. And it was flagged that “there was no indication that the manufacturing sector would recover anytime soon”. Notably too, it was remarked that “with inflation increasingly close to target, real economic activity should become more relevant for calibrating monetary policy”. Indeed, while there remained concerns about risks of inflation persistence in services, the account reported that “the risk of undershooting the target was now becoming non-negligible”. Given such a pessimistic mood last month and the subsequent soft data and dovish commentary from its members, it would certainly now be extraordinary if the Governing Council did not cut rates next week.

The day ahead in the euro area

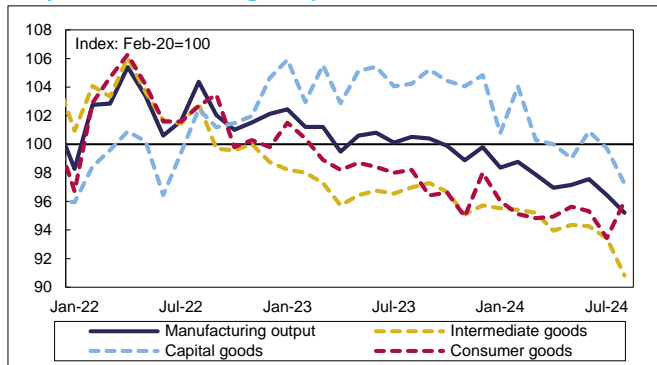
A fairly quiet end to the week for top-tier euro area data will bring final German inflation estimates for September. The preliminary figures saw headline HICP inflation ease below the 2% for the first time since February 2021, down 0.2ppt to 1.8%Y/Y. But this reflected a decline in energy prices, while core inflation – on the EU-harmonised measure – moved sideways at 3.0%Y/Y. Tomorrow’s release will provide more granular detail in the goods and services components.

UK

RICS house price balance up to near-2-year high, but mortgage supply to remain limited

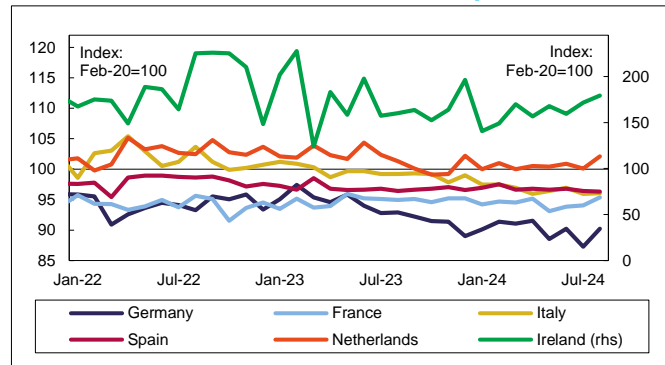
Tallying the improvements reported in the Nationwide and Halifax indices, today’s RICS residential survey pointed to the strongest house price growth since the Truss-related blowout in interest rates in October 2022. Indeed, the headline house price net balance jumped 11pts to +11% in September, some 23pts higher than average in the year-to-date, a whopping 80pts above the trough in August 2023, and only a touch below the pre-pandemic five-year average. Given the prospect of lower borrowing rates, surveyors reported a notable increase in new selling instructions last month. And while the respective net balance for new buyer enquiries slipped back slightly, it was still close to the top of the range of the past three years. And so, while sales expectations for the three months ahead fell back from August, they were still pointing to ongoing growth at an above-trend rate. But while today’s BoE credit conditions survey signalled a likely jump in mortgage demand over the coming three months, lenders suggested that the supply of secured credit would be unchanged from Q3, which might constrain the recovery momentum in the housing market over the near term.

Italy: Manufacturing output



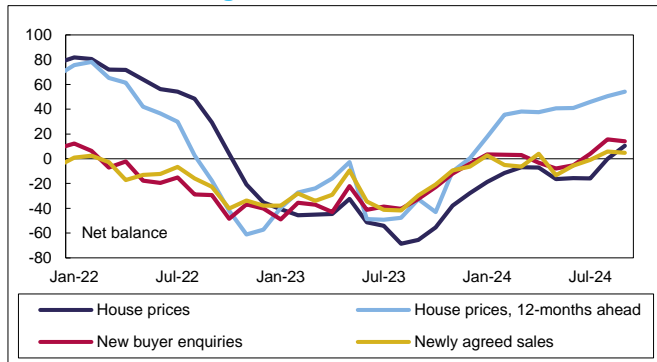
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Industrial production



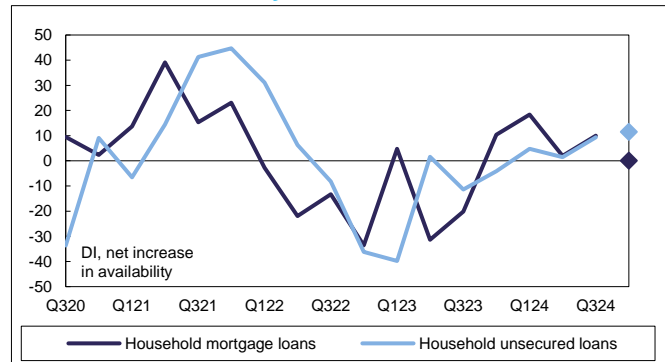
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: RICS housing market indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Credit availability*



*Diamonds represent survey forecast for Q424. Source: BoE credit conditions survey, Macrobond and Daiwa Capital Markets Europe Ltd.




The day ahead in the UK

A busy end to the week for UK data will bring the monthly GDP report for August, which will include the latest developments in services, industry, construction and trade. Following a downward revision to Q2 growth, by 0.1ppt to 0.5%Q/Q, the August release will provide a final reference for GDP ahead of both November's MPC decision and the Autumn budget. Our expectation is for a return to modest growth of 0.2%M/M that month, in part compensating for stagnation in June and July (0.0%M/M). The risks to that forecast looks skewed to the upside. Indeed, retail sales volumes – accounting for around 10% of the monthly GDP measure – rose a stronger than expected 1.0%M/M in August in a sign that waning inflation and less restrictive financial conditions may be feeding through to higher consumer spending. The manufacturing PMIs also buoyed hopes for some bounce back in the sector following the decline in industrial production in July.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Retail sales M/M% (Y/Y%)	Aug	1.6 (2.4)	-	1.5 (1.8)	-
Italy	 Industrial production M/M% (Y/Y%)	Aug	0.1 (-3.2)	0.2 (-3.1)	-0.9 (-3.3)	-1.0 (-)
UK	 RICS house price balance %	Sep	11	10	1	0


Auctions

Country	Auction
- Nothing to report -	




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Trade balance €bn	Aug	22.5	18.5	16.8	16.9




Auctions

Country	Auction
Germany	 sold €408mn of 0% 2036 bonds at an average yield of 2.34%
	 sold €846mn of 2.6% 2041 bonds at an average yield of 2.52%
UK	 sold £3.75bn of 4.25% 2034 bonds at an average yield of 4.17%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany 	07.00	Final HICP (CPI) Y/Y%	Sep	<u>1.8</u> (1.6)	2.0 (1.9)
UK 	07.00	Monthly GDP M/M% (3M/3M%)	Aug	<u>0.2</u> (0.3)	0.0 (0.5)
	07.00	Services output M/M% (3M/3M%)	Aug	0.2 (0.3)	0.1 (0.6)
	07.00	Industrial output M/M% (Y/Y%)	Aug	0.2 (-0.5)	-0.8 (-1.2)
	07.00	Manufacturing output M/M% (Y/Y%)	Aug	0.2 (-0.4)	-1.0 (-1.3)
	07.00	Construction output M/M% (Y/Y%)	Aug	0.5 (-0.2)	-0.4 (-1.6)
	07.00	Trade (goods trade) balance £bn	Aug	-5.9 (-18.9)	-7.5 (-20.0)
Auctions and events					
Italy 	10.00	Auction: to sell up to €1.5bn of 2.65% 2027 bonds			
	10.00	Auction: to sell up to €2bn of 3.45% 2027 bonds			
	10.00	Auction: to sell up to €3.5bn of 3.45% 2031 bonds			
	10.00	Auction: to sell up to €1.25bn of 4.15% 2039 bonds			
	10.00	Auction: to sell up to €1.25bn of 3.45% 2048 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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