Euro wrap-up

Overview

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- While final German inflation data for September provided no surprises, Bunds followed USTs lower.
- Gilts outperformed to end the day little changed as UK GDP data suggested a further softening of growth momentum in August.
- The coming week should bring an ECB rate cut while the dataflow will bring updates on UK and euro area inflation as well as the UK labour market.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.250	+0.022
OBL 2½ 10/29	2.129	+0.019
DBR 2.6 08/34	2.271	+0.016
UKT 4⅛ 01/27	4.167	-0.013
UKT 4⅛ 07/29	4.070	-0.007
UKT 4¼ 07/34	4.209	-

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

Euro area

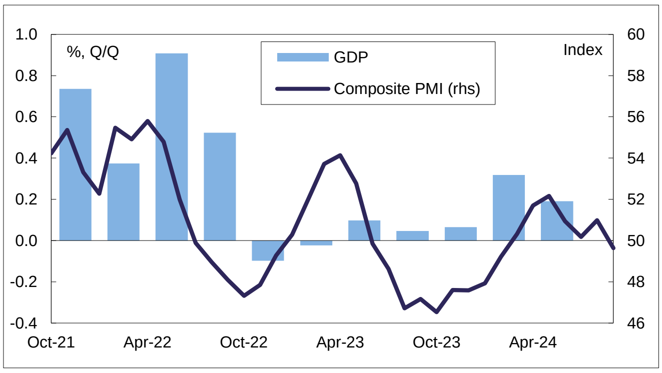
ECB poised to cut rates on Thursday as hawks wake up to downside risks

When its policy meeting concludes on Thursday, it would now be a huge surprise if the ECB did not cut rates by 25bps for a second successive month. But the prospect of such a move had initially appeared relatively low after the September rate announcement. Indeed, in her post-meeting press conference, President Lagarde had acknowledged that there were very few top-tier macroeconomic data to be released between the two meetings that might be able to justify an acceleration in the pace of monetary easing from 25bps per quarter to 25bps per meeting. But the account of that meeting, published yesterday, revealed that the balance of views on the Governing Council was already becoming more downbeat about the economic outlook, with members also more alert to the possibility that inflation might eventually undershoot the target over the medium term. And while not universally soft, the economic data published since the September policy meeting have suggested that the ECB's macroeconomic projections published just last month are overoptimistic. With recent comments from some of its members also pointing to greater urgency to reduce the restrictiveness of its monetary stance, market pricing for the coming week's policy decision has since late September shifted significantly towards anticipating back-to-back rate cuts.

Data underscore that current monetary stance is still highly restrictive

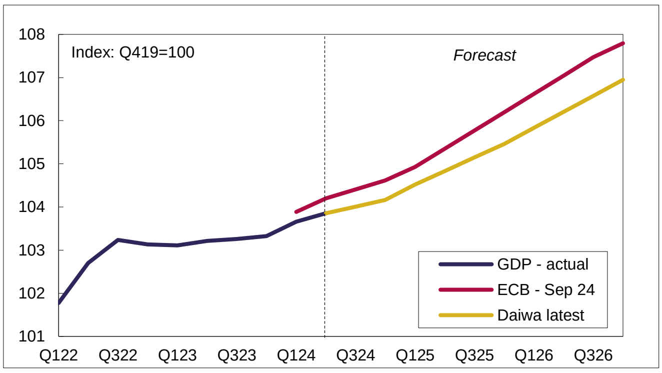
A rate cut in the coming week would be consistent with the Governing Council's forward guidance, which insists that policy decisions will remain data-dependent on a meeting-to-meeting basis. By the time of the last meeting, economic data had already suggested that domestic demand in Q2 was softer than the ECB's updated projections suggested. Since then, there have been a few upside surprises with respect to economic activity data. Most notably, yesterday's German retail sales figures signalled a possible welcome rebound in spending in goods this quarter. But, on balance, the data have been consistent with loss of growth momentum in Q3. The September PMIs reported no end to the gloom in manufacturing as well as softening in services. In addition, the Commission survey suggested persistent sub-par performance and a continued preference of consumers to save. Meanwhile, the flash September estimates of euro area inflation reported a drop in the headline rate below the 2% target for the first time since mid-2021 to undershoot the ECB's projection. In part thanks to a reversal of Olympics-related pressures in France, they also presented a welcome decline in the services component to allow a slight easing in the main core measure back to April's 2½-year low (2.7%Y/Y), similarly taking the Q3 average below the ECB's expectation. Finally, bank lending growth remains negative in real terms. And the ECB's quarterly bank lending survey due on Tuesday is likely to underscore that loan demand will remain subdued and credit conditions restrictive over the coming quarter. Certainly, overall, data are consistent with a policy stance that remains significantly restrictive and will continue to constrain economic growth and weigh on inflation even if the ECB cuts rates again on Thursday.

Euro area: GDP growth & composite PMI



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

Euro area: GDP levels



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

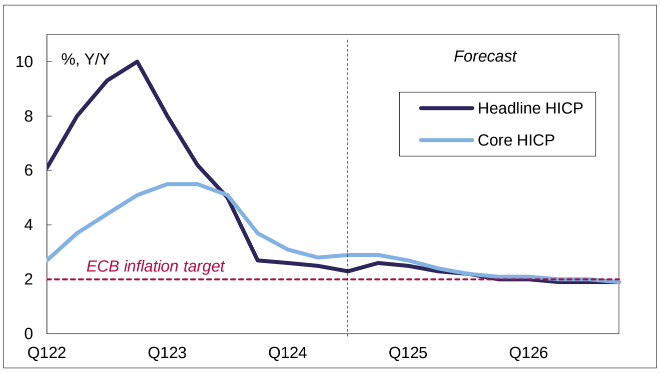
Balance of views on the Governing Council tilting in favour of the doves, for the time being

Of course, a wide range of views exist on the Governing Council. The representatives of the southern member states – which conspicuously remain the strongest-performing in terms of economic output – remain dovish, albeit diplomatically downplaying the case for a Fed-style jumbo cut of 50bps this month. More noteworthy, several of the Governing Council's hawks now also appear amenable to back-to-back rate cuts of 25bps apiece. In a speech on 2 October, Executive Board member Schnabel – who over recent years has been the most articulate advocate of the hawkish case – accepted that "Over the past 18 months, the recovery has repeatedly been weaker than anticipated" and argued that the ECB "cannot ignore the headwinds to growth". She added that "With signs of softening labour demand and further progress in disinflation, a sustainable fall of inflation back to our 2% target in a timely manner is becoming more likely". Amongst other members of the hawkish camp, in a Bloomberg interview on 1 October, Latvian Governor Kazaks judged that "recent data clearly point in the direction of a cut… The risks to the economy have become more pronounced and the risks of still sticky domestic, especially services, inflation and too-weak growth are increasingly balanced." The Bundesbank's Nagel and Slovenia's Vasle also made clear they were amenable to a cut this month, albeit one that would not then preclude a subsequent decision to leave rates unchanged in December.

October decision might not be unanimous but expect two cuts in Q4 & return to neutral by mid-2025

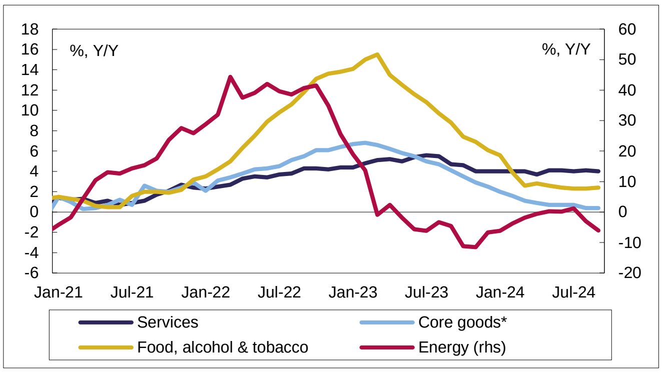
Nevertheless, it is possible that the ECB's forthcoming rate decision will not be unanimous. Holzmann, Governor of the National Bank of Austria – notably among the weakest-performing member states since the pandemic – was the sole Governing Council member to dissent from June's rate cut and might do so again. But we certainly place more weight on bell-whether members such as Finland's Rehn who judged that the flash September inflation data firmed the case for a cut this month. And we see no case to doubt Bank of France Governor Villeroy de Galhau, another bell-whether, who in a radio interview on 9 October stated that "A cut is very probable, and furthermore it won't be the last. The following pace will simply depend on the evolution of the fight against inflation". So, we fully expect the Governing Council on Thursday to rubber-stamp a third cut since June in the Deposit Rate of 25bps to a 16-month low of 3.25%. That level will remain highly restrictive, however. And we expect the euro area dataflow to continue to disappoint. Uncertainty about the trajectory of the US economy and events in the Middle East, among other things, mean that the ECB's forward guidance is bound to repeat that a data-dependent and meeting-by-meeting approach will be maintained. And Lagarde might again be frustratingly unenlightening in her press conference. But we continue to expect further easing to come in December and additional cuts to be enacted thereafter to return the Deposit Rate to a neutral level by mid-2025.

Euro area: ECB inflation projections



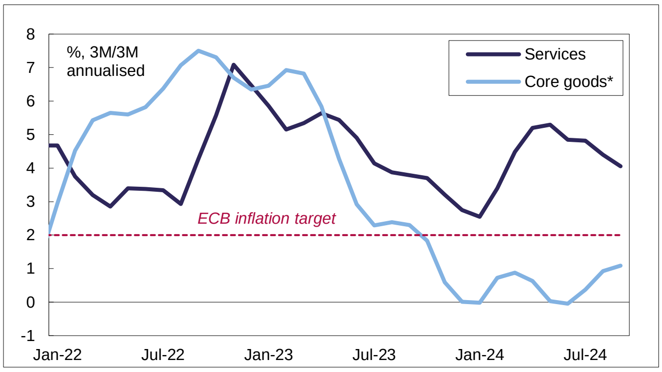
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Key HICP inflation components



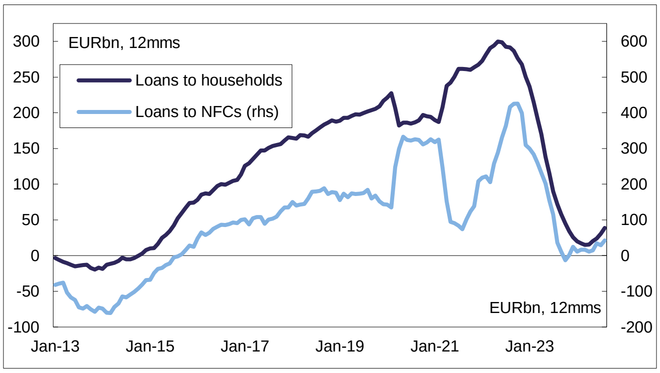
**Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Core inflation momentum



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

Euro area: Bank lending



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area for data

In addition to the ECB announcement, the coming week brings a handful of top-tier data releases including final euro area inflation figures for September (Thursday). The flash estimate showed headline HICP inflation moderating 0.4ppt to 1.8%Y/Y, the first sub-target reading since June 2021, due principally to a decline in energy prices. Core inflation dropped 0.1ppt to 2.7%Y/Y, as services inflation moderated slightly to a still-elevated 4.0%Y/Y. Final German HICP estimates today suggested that a moderation in inflation of transport services and communication offset a slightly uptick in insurance and package holiday costs. Within Germany's core goods detail, ongoing disinflation in clothing and deflation in furniture countered a pickup in inflation of motor vehicles. Final inflation figures from France and Spain (Tuesday) and Italy (Wednesday) are also due.

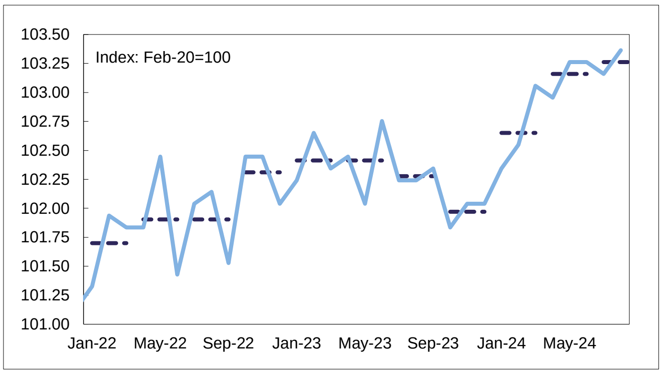
In terms of economic activity, the coming week will bring August figures for euro area industrial production (Tuesday), goods trade (Thursday) and construction activity (Friday). Based on member state figures so far, including strong growth in Germany, France and Ireland, we expect aggregate euro area IP to have risen around 1.8%M/M in August. The goods trade surplus is also expected to have widened somewhat, while construction activity is expected to have returned to modest growth in the middle of Q3 having stagnated in July. Meanwhile, the German ZEW investor survey (Tuesday) is likely to flag ongoing challenges in the largest member state at the start of Q4, albeit sentiment is expected to somewhat less gloomy than in September, echoing the message in the past week's Sentix release. In addition, the ECB's bank lending survey (Tuesday) will likely signal an easing in credit conditions over the past quarter as the Governing Council cut rates by a cumulative 50bps, but still suggest that high borrowing costs continues to restrain loan demand.

UK

GDP returned to expansion in August, but momentum is the softest since January

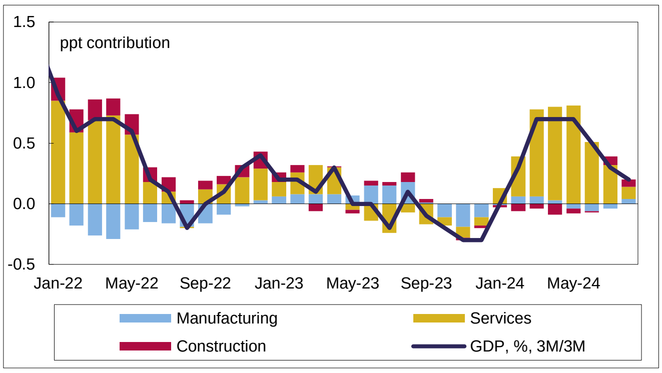
Today's monthly GDP figures broadly aligned with expectations, confirming that the UK economy returned to modest growth in August having stagnated in the previous two months. In particular, growth of 0.2%M/M left the level of economic output up 1.0%Y/Y and some 3.4% above the pre-pandemic benchmark in February 2020. But to two decimal places, growth of 0.16%M/M in August after -0.04%M/M in July was on the soft side of expectations. And having risen in just two of the past five months, growth momentum slowed in August to just 0.2%3M/3M, the softest pace since January and well below the rate of 0.7%3M/3M from March through to May. While we expect the economy to grow again in September, the PMIs implied a weaker pace of expansion that month. So, also given the detail of today's figures, we have revised down slightly our GDP growth forecast for Q3 as a whole, to 0.2%Q/Q, a touch below the MPC's most recent expectation of 0.3%Q/Q.

UK: GDP level*



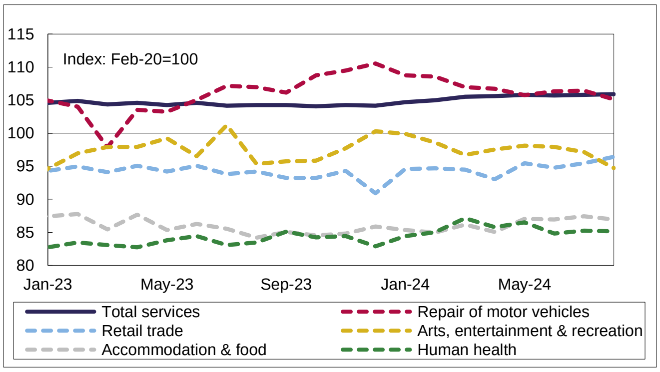
**Dashed dark blue line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: GDP growth



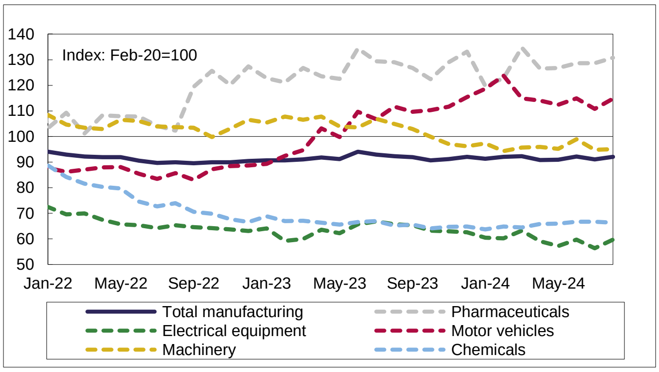
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services activity



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Services activity slowed to the softest three-month pace this year

Services activity underwhelmed expectations in August, rising for a second-successive month by just 0.1%M/M. So, while this left output in the sector up 1.5%Y/Y and almost 6% above the pre-pandemic level, growth on a three-month basis slowed 0.3ppt to just 0.1%3M/3M, the softest pace this year. Only four of the 14 services subsectors reported a rise in output in August, led by a rebound in professional, scientific and technical and personal services activities. In contrast, arts and entertainment fell sharply for a third consecutive month, while healthcare contracted for a third month out of five despite a reduction in the number of days lost to strike action. And a decline in wholesaling and motor vehicle repair more than offset the solid contribution from retail sales. Despite a deterioration in consumer confidence at the end of the quarter, retail surveys suggest that sales remained relatively firm, while car registrations might well rebound in September with the launch of new number plates. But while we would also expect some bounce back from some of the other seven subsectors that contracted in August, underlying momentum in the sector appears subdued.

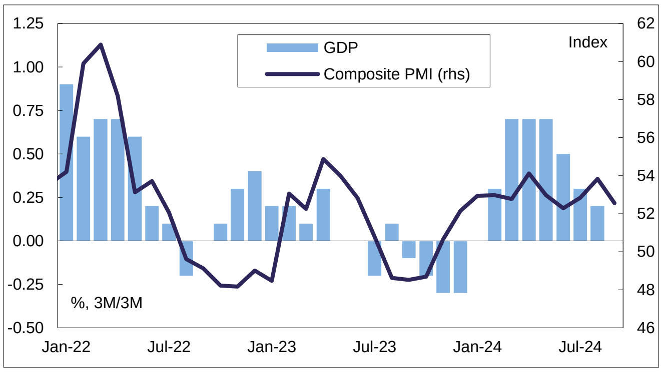
Manufacturing rebound driven by autos, but industrial production trending sideways

Despite a sizeable contraction in mining (-4.0%M/M), industrial production rose for a second month out of the past three in August, by 0.5%M/M, albeit leaving it flat on a three-month basis. Tallying with the more upbeat PMI survey that month, manufacturing output increased for a fifth month out of seven and by a larger 1.1%M/M and 0.5%3M/3M, with output rising in nine of the 13 subsectors. The rebound was driven by transport equipment, with motor vehicle production rising 3.6%M/M. But this still left output down -0.5%3M/3M. Notwithstanding monthly volatility, production of basic metals, electronics, electrical machinery and pharmaceuticals were up on a three-month basis providing some offset. But like the services PMIs, the manufacturing output component fell to a three-month low in September. Admittedly, the PMIs failed to signal a rebound in the construction sector in August, where activity rose for a third month out of the past four, by 0.4%M/M and 1.1%3M/3M, reflecting an increase in new building work (1.6%M/M).

Trade deficit narrows on surge in goods exports, but net trade still likely a drag in Q3

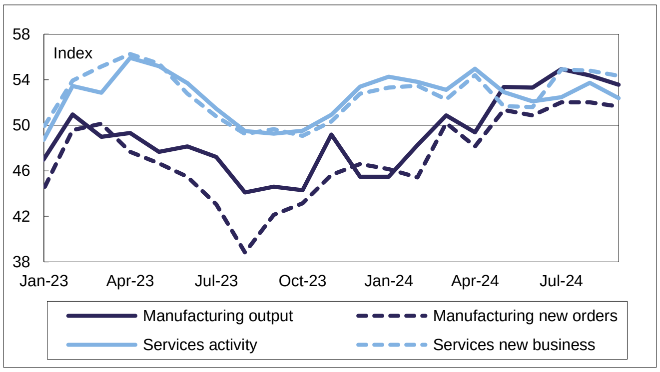
Tallying with the recent pickup in manufacturing, the latest trade figures reported a substantial narrowing in the deficit in August, by more than £3½bn to £0.96bn, the smallest since February. When excluding the distortion from precious metals, the deficit eased £3.0bn to a five-month low of £1.74bn, illustrating the extreme volatility in the underlying monthly figures too. This reflected a significant increase in exports (4.3%M/M) amid a surge in goods shipments (10.2%M/M, the most in 2½ years) related to a large-shipment of aircraft to Germany and pharmaceuticals to Belgium. Adjusting for prices, goods export volumes were stronger still, up 10.8%M/M in August, to be trending so far in Q3 some 1.9% higher than the Q2 average. When also including services, however, the upwards trend in export volumes so far in Q3 was more limited (1.1%). And a

UK: GDP growth & composite PMI



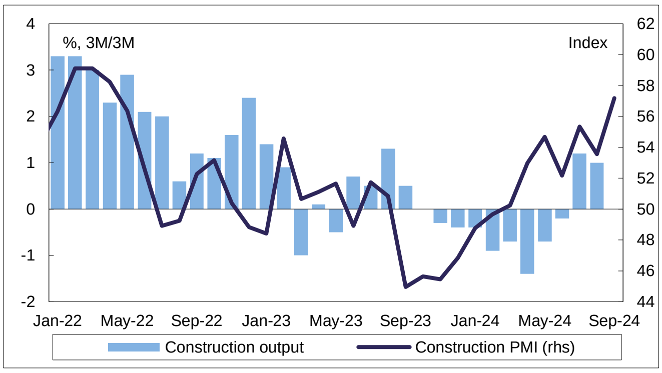
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Services & manufacturing PMIs



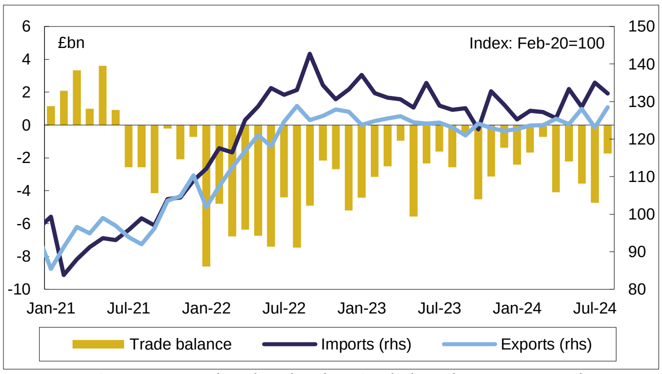
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Construction activity & PMI



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

UK: Trade balance, export & import values



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

stronger trend in import volumes (1.9%) compared with the Q2 level suggests that net trade will provide a further drag on GDP in Q3.

The week ahead in the UK

The week ahead will be a busy one for UK economic data, with a number of key releases of significant interest to BoE policymakers ahead of November's monetary policy meeting and updated macroeconomic projections. In particular, Wednesday's CPI inflation print for September will be watched closely for underlying price pressures. Having moved sideways in August, we forecast headline CPI to fall back below the Bank's 2% inflation target, easing 0.4ppt to 1.8%Y/Y, which would mark the lowest rate since April 2021. It would also come in well below the BoE's 2.1%Y/Y estimate for September in its August Monetary Policy Report. So, whilst inflation is expected to pick up again in Q4 not least in part due to the 10% increase in the Ofgem price cap from October, the MPC may be encouraged that inflation has undershot its forecast by 0.2ppt in Q3. The decline in September will in part also reflect falling petrol prices (down around 4.0%M/M). However, services price pressures should have eased too. So, we expect core inflation to soften to 3.3%Y/Y, which would further strengthen our expectation for a 25bps cut at the forthcoming MPC meeting.

A key contributor to the persistence in recent services inflation has been higher labour input costs. So, coming in ahead of the CPI release, Tuesday's labour market report will also have a bearing on the Bank's assessment of the risks to, and the path for, the inflation outlook. Despite the BoE's clearly communicated concerns about the quality of existing labour market data, recent months have encouragingly welcomed more signals of growing slack. Indeed, the vacancies-to-unemployment ratio – a proxy for workers' wage bargaining power – has continued to stabilise around its pre-pandemic level, while wages have also started to tip lower. Private sector regular wage growth further eased in July (4.9%3M/Y) to its slowest pace for more than two years, and just 0.1ppt above the BoE forecast for Q3. While the coming week's release is expected to show the unemployment rate steady at 4.1% in the three months to August and private regular wage growth little changed too, total pay growth will likely take a further significant drop down, perhaps by around 1/2ppt to around 3½%3M/Y from 4.0%3M/Y previously.

Abating price pressures are also expected to provide a boost in retail sales (Friday). Indeed, the past week's BRC retail monitor alluded to heavy discounting enticing consumers to the High Street. Alongside the impact of lower fuel costs, this hints at a third consecutive monthly uplift in retail sales volumes, following respective increases of 0.7%M/M and 1.0%M/M in July and August. Likewise, the ONS's house price index for August (Wednesday) should show a pickup in house price inflation after a temporary drop in July.

Daiwa economic forecasts

	2024			2025			2023	2024	2025
	Q2	Q3	Q4	Q1	Q2	Q3			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.2	0.2	0.2	0.3	0.3	0.3	0.5	0.7	1.0
UK	0.5	0.2	0.3	0.3	0.3	0.4	0.3	0.9	1.2
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.5	2.2	2.2	2.0	1.8	1.8	5.4	2.4	1.9
Core HICP	2.8	2.8	2.9	2.5	2.0	1.8	4.9	2.9	2.1
UK									
Headline CPI	2.1	2.1	2.6	2.5	2.0	2.2	7.3	2.6	2.2
Core CPI	3.6	3.4	3.5	3.3	2.2	2.0	6.2	3.8	2.4
Monetary policy, %									
ECB									
Deposit Rate	3.75	3.50	3.00	2.50	2.25	2.25	4.00	3.00	2.25
Refi Rate	4.25	3.65	3.15	2.65	2.40	2.40	4.50	3.15	2.40
BoE									
Bank Rate	5.25	5.00	4.50	4.00	3.50	3.00	5.25	4.50	3.00

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

Daiwa Capital Markets

The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <u>Daiwa forecast/</u>	Previous
		Monday 14 October 2024			
		- Nothing scheduled -			
		Tuesday 15 October 2024			
Euro area	10.00	Industrial production M/M% (Y/Y%)	Aug	1.8 (-1.0)	-0.3 (-2.2)
Germany	10.00	ZEW investor survey – current situation (expectations) balance %	Oct	-84.0 (10.0)	-84.5 (3.6)
France	07.45	Final HICP (CPI) Y/Y%	Sep	<u>1.5 (1.2)</u>	2.2 (1.8)
Spain	08.00	Final HICP (CPI) Y/Y%	Sep	<u>1.7 (1.5)</u>	2.4 (2.3)
UK	07.00	Average wages (excluding bonuses) 3M/Y%	Aug	3.7 (4.9)	4.0 (5.1)
	07.00	Unemployment rate 3M%	Aug	4.1	4.1
	07.00	Employment 3M/3M change 000s	Aug	250	265
	07.00	Payrolled employees M/M change 000s	Sep	-	-59
	07.00	Claimant count rate % (change 000s)	Sep	-	4.7 (23.7)
		Wednesday 16 October 2024			
Italy	09.00	Final HICP (CPI) Y/Y%	Sep	<u>0.8 (0.7)</u>	1.2 (1.1)
UK	07.00	CPI (core CPI) Y/Y%	Sep	<u>1.8 (3.3)</u>	2.2 (3.6)
	07.00	PPI – output (input) prices Y/Y%	Sep	-0.6 (-2.2)	0.2 (-1.2)
	09.30	House price index Y/Y%	Aug	-	2.2
		Thursday 17 October 2024			
Euro area	10.00	CPI (core CPI) Y/Y%	Sep	<u>1.8 (2.7)</u>	2.2 (2.8)
	10.00	Trade balance €bn	Aug	17.7	15.5
	13.15	ECB Deposit Rate (Refi Rate) %	Oct	<u>3.25 (3.40)</u>	3.50 (3.65)
		Friday 18 October 2024			
Euro area	09.00	Current account balance €bn	Aug	-	39.6
	10.00	Construction output M/M% (Y/Y%)	Aug	-	0.0 (-2.2)
UK	07.00	Retail sales – including auto fuel M/M% (Y/Y%)	Sep	-0.4 (3.2)	1.0 (2.5)
	07.00	Retail sales – excluding auto fuel M/M% (Y/Y%)	Sep	-0.3 (3.1)	1.1 (2.3)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
		Monday 14 October 2024
UK	09:30	MPC External Member Dhingra appears as a panellist at the Reserve Bank of India's 90th anniversary conference
		Tuesday 15 October
Euro area	09.00	ECB to publish Bank Lending Survey for Q324
UK	10.00	Auction: to sell £2.25bn of 4.375% 2054 bonds
		Wednesday 16 October 2024
Germany	10.30	Auction: to sell €1bn of 0% 2050 bonds
	10.30	Auction: to sell €1bn of 2.5% 2054 bonds
UK	10.00	Auction: to sell £3.5bn of 4% 2031 bonds
		Thursday 17 October 2024
Euro area	13.15	ECB monetary policy announcement
	13.45	ECB President Lagarde holds post Governing Council meeting press conference
France	09.50	Auction: to sell up to €12bn of 2.5% 2027, 0.75% 2028, 2.75% 2029 and 2.75% 2030 bonds
	10.50	Auction: to sell up to €2bn of 0.1% 2029, 0.6% 2034, 0.1% 2036 and 1.8% 2040 inflation-linked bonds
Spain	09.30	Auction: to sell 3.1% 2031, 3.45% 2034 and 2.7% 2048 bonds
		Friday 18 October 2024
Euro area	09.00	ECB to publish Survey of Professional Forecasters for Q424

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Final HICP (CPI) Y/Y%	Sep	**1.8 (1.6)**	*1.8 (1.6)*	2.0 (1.9)	-
UK		Monthly GDP M/M% (3M/3M%)	Aug	**0.2 (0.2)**	*0.2 (0.3)*	0.0 (0.5)	- (0.3)
		Services output M/M% (3M/3M%)	Aug	**0.1 (0.1)**	0.2 (0.3)	0.1 (0.6)	- (0.4)
		Industrial output M/M% (Y/Y%)	Aug	**0.5 (-1.6)**	0.2 (-0.5)	-0.8 (-1.2)	-0.7 (-2.2)
		Manufacturing output M/M% (Y/Y%)	Aug	**1.1 (-0.3)**	0.2 (-0.4)	-1.0 (-1.3)	-1.2 (-2.0)
		Construction output M/M% (Y/Y%)	Aug	**0.4 (0.3)**	0.5 (-0.2)	-0.4 (-1.6)	- (-1.4)
		Trade (goods trade) balance £bn	Aug	**-1.0 (-15.1)**	-5.9 (-18.9)	-7.5 (-20.0)	-4.7 (-18.9)

Auctions

Country		Auction
Italy		sold €1.5bn of 2.65% 2027 bonds at an average yield of 2.67%
		sold €2bn of 3.45% 2027 bonds at an average yield of 2.68%
		sold €3.5bn of 3.45% 2031 bonds at an average yield of 3.19%
		sold €1.25bn of 4.15% 2039 bonds at an average yield of 3.88%
		sold €1.25bn of 3.45% 2048 bonds at an average yield of 4.04%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 15 October 2024

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