

Euro wrap-up

Overview

- Bunds made losses as euro area inflation rose back to the 2% target, the unemployment rate registered a series low and German retail sales posted the strongest quarterly growth in almost three years.
- Gilts continued to sell off as markets repriced the impact of yesterday's updated government borrowing plans.
- Despite the Gilt market turbulence, the BoE will still likely cut Bank Rate by 25bps on Thursday, while September figures for euro area retail sales, German IP and factory orders are also due in the coming week.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2 12/26 | 2.272 | +0.022 |
| OBL 2½ 10/29 | 2.262 | +0.007 |
| DBR 2.6 08/34 | 2.386 | -0.001 |
| UKT 4½ 01/27 | 4.416 | +0.125 |
| UKT 4½ 07/29 | 4.315 | +0.100 |
| UKT 4½ 07/34 | 4.442 | +0.095 |

*Change from close as at 5.00pm GMT.
Source: Bloomberg

Euro area

Inflation back up to 2.0% target on energy & food prices

Above the market consensus, but bang in line with our own forecast, the flash estimate of euro area inflation in October rose 0.3ppt back to 2.0%Y/Y. As expected, the upward impulse came from non-core items. Due to higher prices of auto fuel and heating gas oil, and falling prices in the category a year earlier, energy inflation rose 1½ppts. But it remained firmly in negative territory (-4.6%Y/Y). In addition, prices of food, alcohol and tobacco rose the most since January to push the respective inflation category up ½ppt to a nine-month high of 2.9%Y/Y. In contrast, services inflation was unchanged at 3.9%Y/Y, matching the lowest since April. And while inflation of non-energy industrial goods edged up slightly, at 0.5%Y/Y it remained very low. So, in line with our projection albeit also a touch above the consensus, core inflation was unchanged at 2.7%Y/Y, matching the bottom of the range of the past 2½ years.

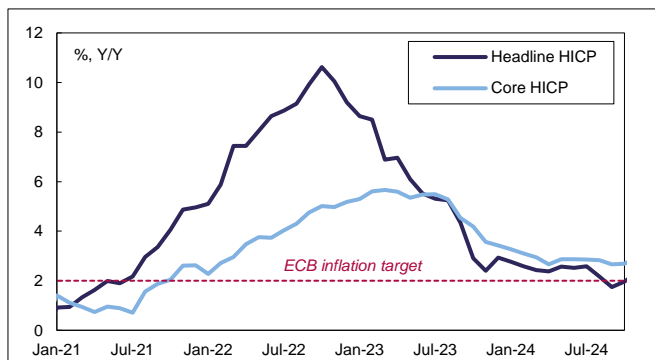
Steady core inflation masks further easing of underlying pressures

The steady core rate in October masked a welcome ongoing easing of underlying inflation momentum. Indeed, with prices of both core goods and services up in line with their averages for the month in the decade before the financial crisis, and hence consistent with achievement of the ECB's target on a sustained basis, core inflation momentum fell ½ppt to an eight-month low of 2.4%3M/3M annualised. Indeed, on a seasonally adjusted basis, core goods inflation momentum eased 0.3ppt to just 0.8%3M/3M ann. And most notably perhaps, despite still-firm wage growth, services inflation momentum fell for the fifth successive month by ½ppt to 3.4%3M/3M ann., some 2ppts below May's peak.

Inflation to rise further towards year-end before easing back to target in 2025

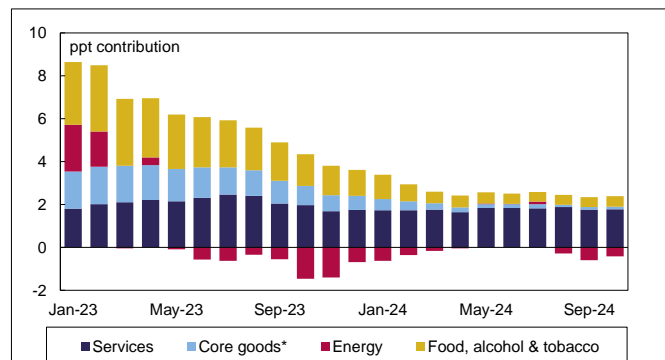
Inflation is set to rise further over the near term, perhaps as far as 2½%Y/Y by year-end. Base effects in energy will contribute, while the recent pickup in wholesale gas prices will likely push up domestic electricity prices offsetting likely falls in petrol prices. We also expect core goods and services inflation to tick higher as the monthly price changes a year earlier were particularly soft. But with cost pressures being absorbed by profit margins, and inflation expectations of consumers and businesses relatively well anchored, underlying momentum should continue to moderate. So, in the absence of new shocks, we expect inflation subsequently to ease back to the 2.0%Y/Y target or below in Q225. Of course, in such an uncertain geopolitical environment, the assumption of no new shocks might be a brave one to make. And certainly, the ECB's Governing Council will not be adjusting its meeting-by-meeting and data-dependent approach to policy-setting. However, despite yesterday's upside surprise to euro area Q3 GDP and the uptick in inflation in October, the signs of continued

Euro area: Headline & core HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to HICP inflation



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

underlying moderation in price pressure means that a December rate cut of 25bps and further easing in 2025 remains a strong likelihood.

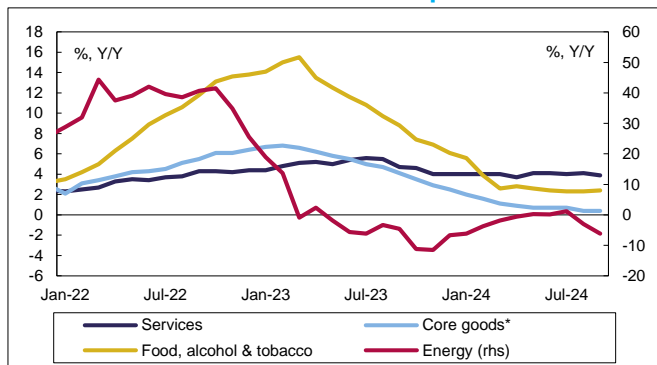
Unemployment rate steady at a series low, but uncertainties over jobs growth remain

Tallying with the upside surprise to Q3 GDP, an unexpected drop in the euro area unemployment rate in August and September further extinguished any case for a jumbo rate cut in December. Indeed, despite a marginal increase in the number of people out of work last month, the jobless rate held steady at August's series low of 6.3%, which was downwardly revised from the initial estimate. Perhaps unsurprisingly after the temporary boost from the Paris Olympics, the monthly rise in joblessness was led by France, which took the unemployment rate (7.6%) to the highest since May 2022. In contrast, the equivalent ILO rates were unchanged in Germany (3.5%) and Italy (6.1%, the joint-lowest since 2007). And they fell further in Spain (down 0.1ppt to 11.2%) and Greece (down 0.2ppt to 9.3%), which were both the lowest since the global financial crisis. But with surveys signalling a lack of momentum at the start of Q4, the near-term outlook for the labour market still looks somewhat less favourable. Certainly, the Germany claimant count rose in October to the highest level in more than four years. And while the number of job vacancies in Germany stabilised this month (at 680k), it was still almost 200k below the peak and well below the average in the three years before the pandemic. The Commission survey's employment intentions indices also signalled a desire among German and French firms to trim headcount at the start of Q4.

Solid German retail sales in September supported GDP rebound in Q3

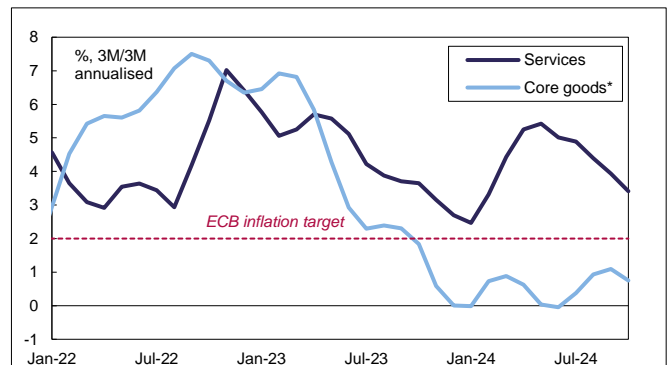
Destatis suggested that German GDP in Q3 was supported by household and government spending. And today's monthly retail sales figures confirmed a revival in spending on goods over the summer, as households benefitted from rising real disposable incomes. In particular, retail sales rose for a third consecutive month in September (1.2%M/M) to their highest level in two years. This left sales volumes up 1.3%3M/3M in Q3, the strongest quarterly growth rate since Q421. Within the detail, the rebound was led by core spending – i.e. non-food and non-fuel stores – which rose for a third successive month in September to the highest level for two years amid the strongest quarterly growth (1.7%3M/3M) for three years. Supported by declining prices, sales at petrol stations also rose for a third month to leave them up more than 2%3M/3M, the most since Q221. But sales at food stores slipped back in September to be up a more modest 0.7%3M/3M. We caution that German retail sales figures are often subject to very significant revisions – indeed, growth in July and August was downwardly revised in the latest release by 0.9ppt and 0.4ppt respectively. And while consumer confidence recently rose to its highest level since spring 2022, the level remains well below the long-run average, pointing to a more modest pace of sales growth. This notwithstanding, in the absence of significant revisions, today's release implies a non-negligible positive carryover of growth into the fourth quarter, which should help to offset persisting weakness in manufacturing output.

Euro area: Selected inflation components



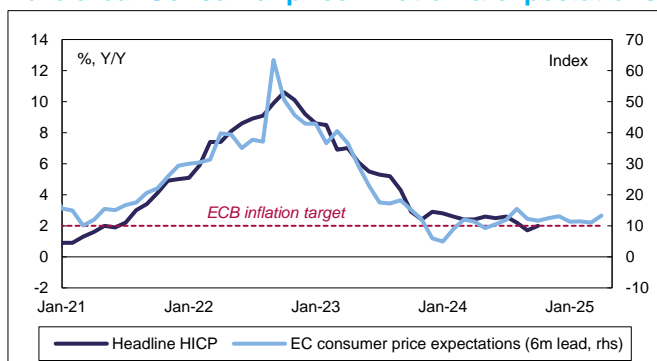
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core inflation momentum



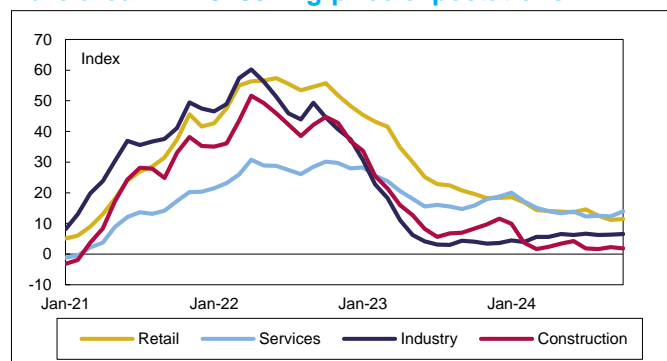
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation & expectations



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Firms' selling-price expectations*



*Three months ahead. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

Following the upside surprise to euro area GDP in Q3, the coming week's data releases will shed more light on economic momentum at the end of the summer. Thursday's euro area retail sales data for September will be watched for confirmation that consumption led the rebound in economic activity last quarter. Indeed, the recent upturn in consumer confidence and third consecutive month of solid growth in German retail sales (1.2%M/M) should provide optimism for a second successive month of sales growth for the euro area as a whole at the end of Q3. Given the inclusion of the German figures for the first month since April, this release may well include larger back revisions than normal.

September industrial production releases are also scheduled from the largest member states, including France (Tuesday), Germany (Thursday) and Italy and Ireland (both Friday), the latter of which often has a significant impact on aggregate euro area output. Euro area production in August saw the largest monthly rise in 18 months (1.8%M/M) owing to a sizable contribution from autos manufacturing. As such, a second consecutive month of growth in September seems highly unlikely. Certainly, we expect some payback in Germany, where autos production surged 19.3%M/M in August, not least given the ongoing downtrend in new orders, for which September data will also be published (Wednesday). The coming week's trade data for Germany (Thursday) and France (Friday) will provide a glance at external demand conditions in September.

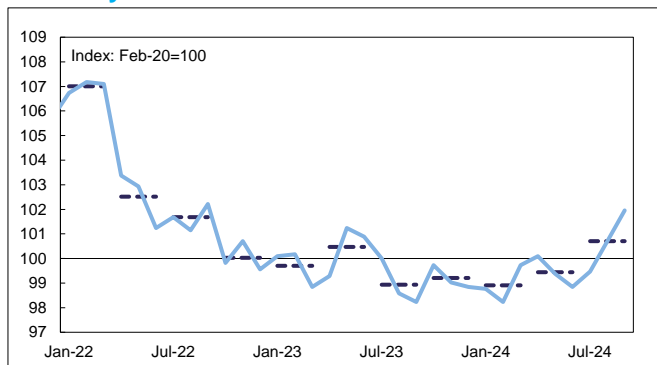
The final manufacturing PMIs (Monday) will likely confirm that the downbeat mood in euro area manufacturing extended into Q4. October's flash release suggested that manufacturing output remained in contractionary territory in the euro area and its two largest members. The final services and composite PMI results (Wednesday) will likely repeat the signal of stagnation too, while Thursday's construction PMIs will remain firmly in contractionary territory as the lags from restrictive monetary policy continue to serve as a headwind to activity.

UK

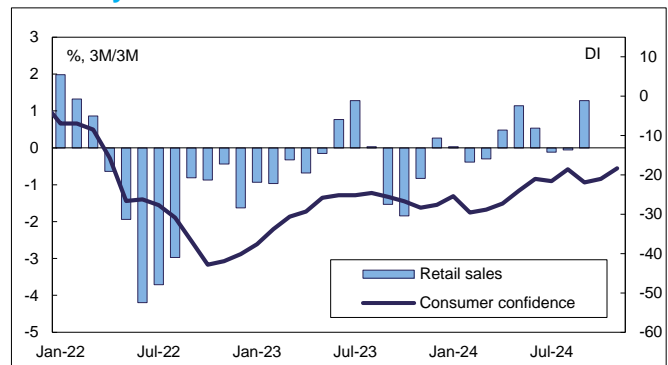
The week ahead in the UK

With the dust still settling after Wednesday's Budget statement, headlines in the UK will shift back towards monetary policy when the BoE announces its rate decision and publishes updated projections on Thursday. Having left policy unchanged at the preceding meeting in September, we expect the MPC to resume the loosening cycle it commenced in August and cut by 25bps, taking Bank Rate to 4.75%, its lowest level since June 2023. Although inflation is expected to bounce back above the BoE's 2% target from October not least due to the 9.7% increase in the Ofgem household energy price cap, over recent months it has significantly undershot the Bank's August projection. Indeed, headline inflation came in some 0.4ppt below the

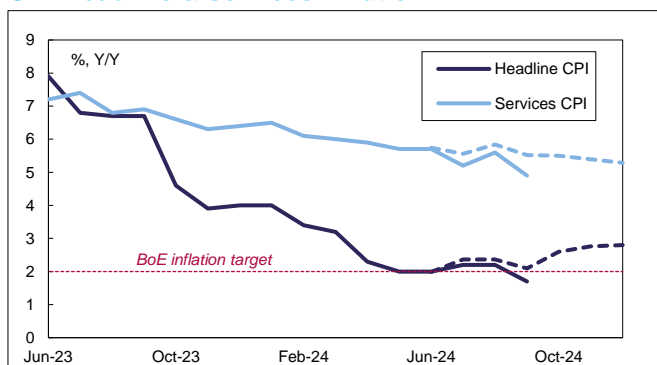
Germany: Retail sales*



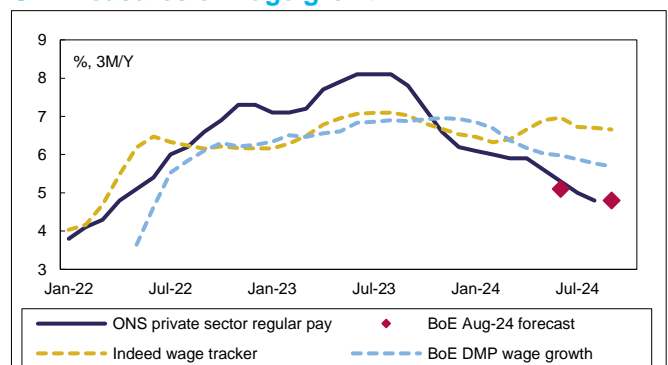
Germany: Retail sales & consumer confidence



UK: Headline & services inflation*



UK: Measures of wage growth



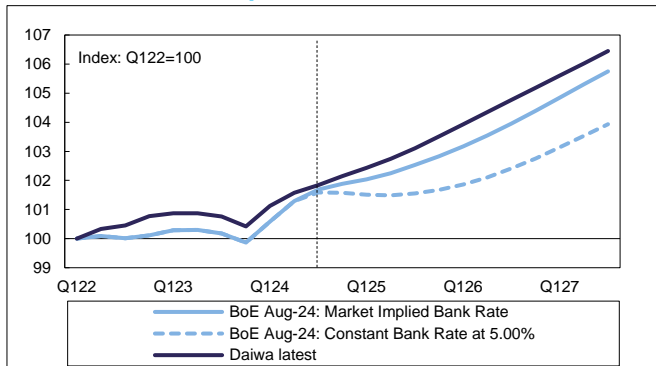
Bank's forecast in September, registering its first sub-target reading since April 2021 (1.7%Y/Y). Services inflation was some 0.6ppt below the projection (4.9%Y/Y), while private sector wage growth tracking slightly below expectations so far in Q3. Coupled with well-anchored inflation expectations, ahead of yesterday's Budget announcement, the disinflation trend below the Bank's projection should have provided the MPC with ample confidence to cut rates this month.

Nevertheless, there is significant uncertainty about how the MPC will interpret the impact of Wednesday's budget announcement on the future path for GDP and inflation. The magnitude of the government's proposed cumulative increase in government borrowing over the monetary policy horizon has led the market to temper its bets on the likely pace and eventual magnitude of future cuts to Bank Rate over coming quarters. Certainly, higher government spending in an economy with limited spare capacity would call for fewer rate cuts than might otherwise be anticipated. But higher employer National Insurance Contributions might weigh further on wage growth and hiring plans with other tax-raising measures set to sap demand from April on. Thursday's Monetary Policy Report and updated macroeconomic projections should impact the market's pricing of the future path of Bank Rate. However, while the BoE will attempt to reflect the planned changes to fiscal policy in its projections, we caution that the market assumptions used will have been set before the subsequent Gilt market sell-off. As a result, the projections might appear out of date already by the time of publication.

In terms of recent BoE-speak, Governor Bailey appeared likely to be an advocate for easing this time around, bearing in mind not only the MPC's updated forward guidance – which stated that 'in the absence of any material developments, a gradual approach to removing policy restraint remains appropriate' – but also his earlier (albeit potentially misquoted) suggestion that the BoE could get a 'bit more aggressive' on rate cuts. However, other (hawkish) members of the MPC have since come out emphasising the need for a cautious approach. For example, Chief Economist Pill warned against cutting 'too far or too fast'. There are also question marks about the respective reaction functions of the MPC's recent additions, Deputy Governor Lombardelli and external member Taylor, who have offered few clues to-date.

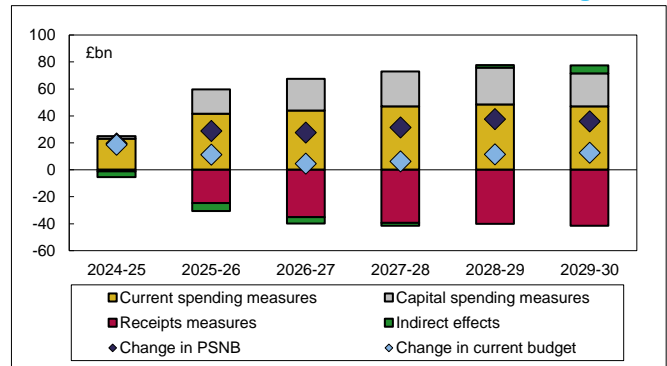
It should otherwise be a relatively quiet week ahead for UK data releases. Following tomorrow's manufacturing PMI release, Tuesday's final services and composite measures are also expected to underscore that pre-budget uncertainty weighed on sentiment, possibly leading output to expand at its slowest pace for 11 months. Budget jitters are also likely to have impacted the construction PMI (Thursday), which the previous month pointed to the fastest growth in the sector since April 2022. Meanwhile, the October iteration of the Bank of England's Decision Maker Panel survey arrives too late to factor into the MPC's decision on Thursday, though both price and wage expectations both sustained their broadly downward trends in Q3.

UK: GDP level comparisons



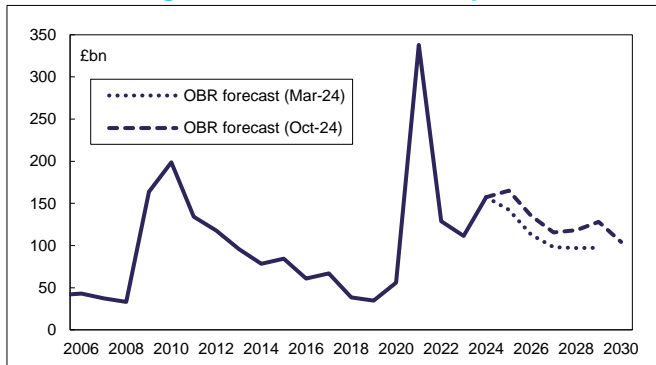
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Fiscal measures on PSNB & current budget*



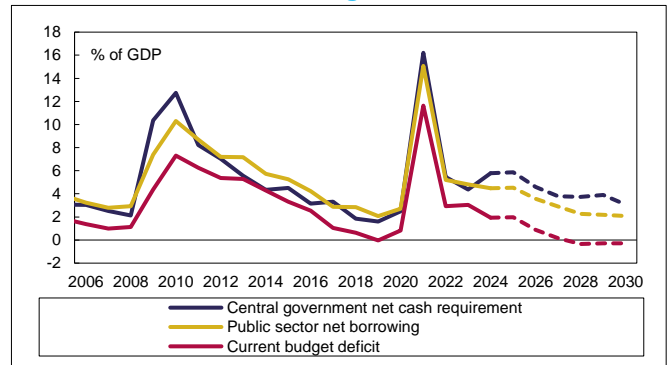
*Impact of fiscal measures announced in 30 October Budget. Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Central government net cash requirement



Source: OBR and Daiwa Capital Markets Europe Ltd.










UK: Government borrowing measures



Source: OBR and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 05 November 2024

Daiwa economic forecasts







| | 2024 | | | 2025 | | | 2023 | 2024 | 2025 |
|---|---------------|------|------|------|------|------|---------------|------|------|
| | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | | | |
| GDP | %, Q/Q | | | | | | %, Y/Y | | |
| Euro area  | 0.2 | 0.4 | 0.1 | 0.3 | 0.3 | 0.3 | 0.5 | 0.7 | 1.1 |
| UK  | 0.5 | 0.3 | 0.3 | 0.3 | 0.3 | 0.4 | 0.3 | 0.9 | 1.3 |
| Inflation, %, Y/Y | | | | | | | | | |
| Euro area | | | | | | | | | |
| Headline HICP  | 2.5 | 2.2 | 2.3 | 2.0 | 1.8 | 1.8 | 5.4 | 2.4 | 1.9 |
| Core HICP  | 2.8 | 2.8 | 2.8 | 2.5 | 2.0 | 1.8 | 4.9 | 2.9 | 2.1 |
| UK | | | | | | | | | |
| Headline CPI  | 2.1 | 2.0 | 2.3 | 2.3 | 2.1 | 2.3 | 7.3 | 2.5 | 2.2 |
| Core CPI  | 3.6 | 3.3 | 3.3 | 3.3 | 2.3 | 2.0 | 6.2 | 3.7 | 2.3 |
| 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 | 3.75 | 3.50 | 5.25 | 4.50 | 3.50 |

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


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% | Oct | 2.0 (2.7) | <u>2.0 (2.7)</u> | 1.8 (2.7) | - |
|  | Unemployment rate % | Sep | 6.3 | 6.4 | 6.4 | 6.3 |
| Germany  | Retail sales M/M% (Y/Y%) | Sep | 1.2 (0.9) | -0.6 (1.2) | 1.6 (2.4) | 1.2 (2.5) |
| France  | Preliminary HICP (CPI) Y/Y% | Oct | 1.5 (1.2) | 1.5 (1.1) | 1.4 (1.1) | - |
|  | PPI Y/Y% | Sep | -7.0 | - | -6.3 | - |
| Italy  | Preliminary HICP (CPI) Y/Y% | Oct | 1.0 (0.9) | 0.9 (0.8) | 0.7 (0.7) | - |



Auctions

| Country | Auction |
|--|---|
| UK  | sold £2.25bn of 1.5% 2053 green bonds at an average yield of 4.831% |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

| Country | GMT | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|--|-------|--|--------|--|-----------|
| UK  | 07.00 | Nationwide house price index M/M% (Y/Y%) | Oct | 0.3 (2.8) | 0.7 (3.2) |
|  | 09.30 | Final manufacturing PMI | Oct | 50.3 | 51.5 |

Auctions and events

- Nothing to report -













Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key data releases

| Country | GMT | Release | Period | Market consensus/ <i>Daiwa forecast/</i> | Previous | |
|----------------------------------|---|---------|---|---|-------------|-------------|
| Monday 4 November 2024 | | | | | | |
| Euro area |  | 09.00 | Final manufacturing PMI | Oct | 45.9 | 45.0 |
| |  | 09.30 | Sentix investor confidence index | Nov | -12.6 | -13.8 |
| Germany |  | 08.55 | Final manufacturing PMI | Oct | 42.6 | 40.6 |
| France |  | 08.50 | Final manufacturing PMI | Oct | 44.5 | 44.6 |
| Italy |  | 08.45 | Manufacturing PMI | Oct | - | 48.3 |
| Spain |  | 08.15 | Manufacturing PMI | Oct | - | 53.0 |
| Tuesday 5 November 2024 | | | | | | |
| France |  | 07.45 | Industrial production M/M% (Y/Y%) | Sep | -0.8 (-0.5) | 1.4 (0.5) |
| |  | 07.45 | Budget balance YTD €bn | Sep | - | -171.9 |
| Spain |  | 08.00 | Unemployment (employment) change 000s | Oct | - | 3.2 (22.2) |
| UK |  | 00.01 | BRC retail monitor – like-for-like sales Y/Y% | Oct | - | 1.7 |
| |  | 09.00 | New car registrations Y/Y% | Oct | - | 1.0 |
| |  | 09.30 | Final composite (services) PMI | Oct | 51.7 (51.8) | 52.6 (52.4) |
| Wednesday 6 November 2024 | | | | | | |
| Euro area |  | 09.00 | Final composite (services) PMI | Oct | 49.7 (51.2) | 49.6 (51.4) |
| |  | 10.00 | PPI Y/Y% | Sep | -3.4 | -2.3 |
| Germany |  | 07.00 | Factory orders M/M% (Y/Y%) | Sep | - | -5.8 (-3.9) |
| |  | 08.55 | Final composite (services) PMI | Oct | 48.4 (51.4) | 47.5 (50.6) |
| France |  | 08.50 | Final composite (services) PMI | Oct | 47.3 (48.3) | 48.6 (49.6) |
| Italy |  | 08.45 | Composite (services) PMI | Oct | - | 49.7 (50.5) |
| Spain |  | 08.15 | Composite (services) PMI | Oct | - | 56.3 (57.0) |
| UK |  | 09.30 | Construction PMI | Oct | - | 57.2 |
| Thursday 7 November 2024 | | | | | | |
| Euro area |  | 08.30 | Construction PMI | Oct | - | 42.1 |
| |  | 10.00 | Retail sales M/M% (Y/Y%) | Sep | 0.8 (1.5) | 0.2 (0.8) |
| Germany |  | 07.00 | Industrial production M/M% (Y/Y%) | Sep | -1.5 (-3.4) | 2.9 (-2.7) |
| |  | 07.00 | Trade balance €bn | Sep | - | 22.7 |
| |  | 08.30 | Construction PMI | Oct | - | 41.7 |
| France |  | 07.45 | Preliminary private sector wages Q/Q% | Q3 | - | -0.1 |
| |  | 08.30 | Construction PMI | Oct | - | 37.9 |
| Italy |  | 08.30 | Construction PMI | Oct | - | 47.8 |
| Spain |  | 08.00 | Industrial production M/M% (Y/Y%) | Sep | - | -0.1 (-0.1) |
| UK |  | 12.00 | BoE Bank Rate % | Nov | <u>4.75</u> | 5.00 |
| |  | 14.00 | DMP 3M output price (1Y CPI) expectations % | Oct | - | 3.6 (2.7) |
| Friday 8 November 2024 | | | | | | |
| France |  | 07.45 | Trade balance €bn | Sep | - | -7.4 |
| |  | 07.45 | Preliminary wages Q/Q% | Q3 | - | 0.6 |
| Italy |  | 09.00 | Industrial production M/M% (Y/Y%) | Sep | - | 0.1 (-3.2) |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

| Country | GMT | Event / Auction |
|----------------------------------|--|---|
| Monday 4 November 2024 | | |
| - Nothing to report - | | |
| Tuesday 5 November 2024 | | |
| UK |  10.00 | Auction: to sell £3.75bn of 4.25% 2034 bonds |
| Wednesday 6 November 2024 | | |
| Germany |  10.30 | Auction: to sell €1bn of 2.6% 2041 bonds |
| |  10.30 | Auction: to sell €500mn of 2.5% 2041 bonds |
| Thursday 7 November 2024 | | |
| Euro area |  08.10 | ECB Executive Board Member Schnabel gives opening remarks at ECB conference on money markets in Frankfurt |
| |  13.30 | ECB Chief Economist Lane speaks on panel at Bank of Greece conference on public debt in Athens |
| France |  09.50 | Auction: to sell bonds* |
| Spain |  09.30 | Auction: to sell 2.7% 2030 bonds, 0.7% inflation-linked bonds & 4% 2054 bonds |
| UK |  12.00 | BoE monetary policy announcement, minutes and Monetary Policy Report to be published |
| |  12.30 | Governor Bailey to present updated macroeconomic projections in press conference |
| Friday 8 November 2024 | | |
| Italy |  10.00 | ISTAT to publish monthly report on Italian economy |
| UK |  00.01 | KPMG, REC and S&P Global release UK report on jobs for October |
| |  12.15 | BoE Chief Economist Pill to brief Bank's Agents on updated macroeconomic projections |

**Further detail expected on Friday*

Access our research blog at:

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

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited ("DCME"). DCME is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange. DCME and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or derivatives or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of DCME and its affiliates may have positions and effect transactions in such the Securities or derivatives or options thereof and may serve as Directors of such issuers. DCME may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended only for investors who are professional clients as defined in MiFID II and should not be distributed to retail clients as defined in MiFID II. Should you enter into investment business with DCME's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

DCME has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at:

https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.