Euro wrap-up

Overview

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- Despite a major sell-off in USTs in the wake of Tuesday's US election results, Bunds made notable gains at the short end even as German factory orders also bounced back in September.
- Gilts made losses ahead of Thursday's BoE monetary policy announcement and updated macroeconomic projections.
- Alongside updated macroeconomic projections, we expect the BoE to cut Bank Rate by 25bps tomorrow, while September figures for euro retail sales and German IP are also due.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.173	-0.114
OBL 2½ 10/29	2.205	-0.077
DBR 2.6 08/34	2.401	-0.022
UKT 4⅛ 01/27	4.504	+0.006
UKT 4⅛ 07/29	4.441	+0.016
UKT 4¼ 07/34	4.563	+0.037

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

Euro area

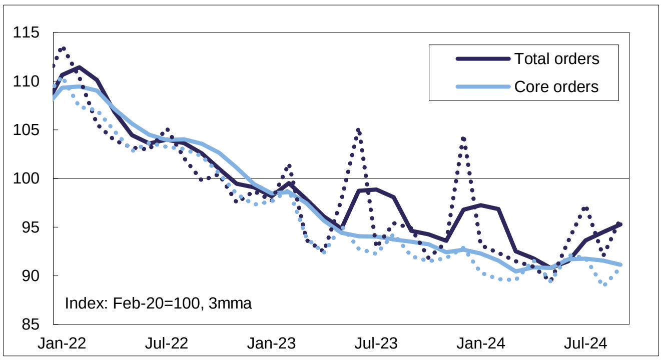
German orders bounce back in September amid a surge in one-off bulk transport orders

With German factory orders having declined sharply in August and given the normal monthly volatility in the series, a bounce back in September was always likely – indeed, total orders rose a stronger-than-expected 4.2%M/M. This left orders up a sizeable 4.4%Q/Q in Q3, the first quarter of positive growth in three and the strongest since Q221. The pickup was due to a third consecutive rise in overseas orders, while domestic orders fell for the first month in five. Admittedly, a significant share of the increase in September reflected a more than doubling of orders of other transport equipment, including a substantial order in the aerospace and luxury boat subsectors. New auto-related orders also rose for a fifth month out of the past seven (2.9%M/M), to their highest level since February 2023 and up more than 12½%Q/Q in Q3. Orders of ICT equipment also rose for the first month in four. In contrast, there were sizeable declines in orders from a range of other manufacturing subsectors, including general and electrical machinery, chemicals and basic metals. Moreover, when excluding major items, core orders rose a more modest 2.2%M/M in September. This left them down 0.6%Q/Q in Q3, maintaining a broadly sideways trend in place since March and suggesting that underlying demand still remains very subdued. And while surveys have provided mixed messages about demand at the start of Q4, the new orders components of the ifo and PMI surveys still point to persisting weakness. Like the orders numbers, the recent manufacturing output profile has also been choppy. So, having risen sharply in August (1.8%M/M) thanks to a surge in autos production, we expect some payback in September. Indeed, today's turnover data – which provide a guide to IP – reported a decline of 1.4%M/M, to leave it also down 1.4%Q/Q in Q3, matching the pace of decline in Q2 and marking the seventh consecutive quarterly drop.

Final euro area composite PMIs points to ongoing economic stagnation at the start of Q4

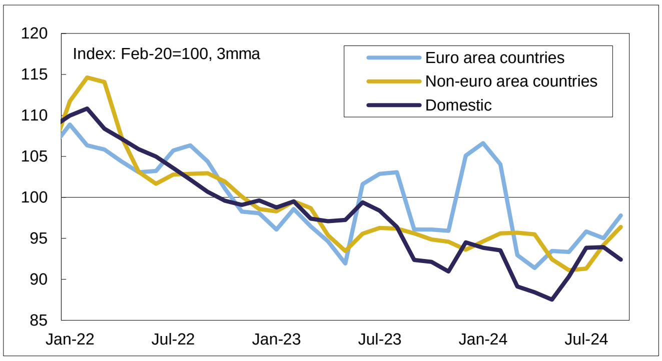
After the flash release had signalled a second consecutive month of very modest contraction for euro area GDP, upwards revisions to October's final manufacturing and services output PMIs meant that the final composite output PMI instead settled at 50.0, nevertheless signaling ongoing economic stagnation at the start of Q4. Weakness in the euro area continues to be centred in France and Germany, where the respective composite output indices remain consistent with ongoing contraction in output (48.1 and 48.6 respectively). And while the services sector in both countries has, to a large degree, partially offset the significant shortfall from manufacturing industries, falling demand for new business in recent months – particularly in France, where new business index fell most sharply to 45.3, for a fourth contractionary reading in five months – poses a downside risks for future services activity in the euro area as a whole. For the time being, the PMIs suggest that services output in the euro area remained broadly consistent with slow growth (51.6), owing primarily to the support from the

Germany: Factory orders*



*Core orders excluding major items. Dotted lines represent unsmoothed data.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Germany: Factory orders – domestic vs overseas



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

remainder of member states, including Spain (54.9), Ireland (53.8) and Italy, where the respective component (52.4) was the strongest for four months.

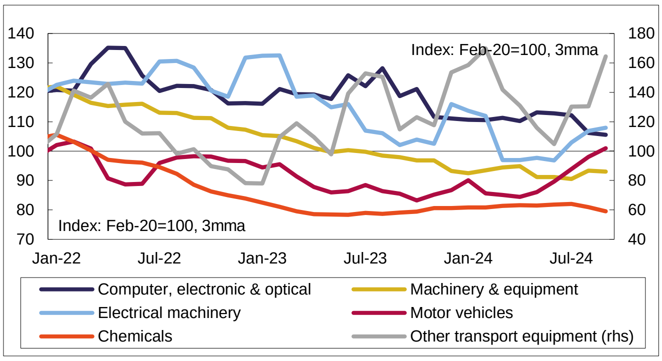
Producer prices fell for first month in four as energy costs decline

The flash October's HICP estimates suggested that euro area consumer core goods price inflation remained very subdued at the start of Q4, rising to just ½%Y/Y. And today's producer price inflation figures implied that pipeline pressures in the factory sector remained well contained too. Admittedly, producer prices had risen in the three months to August, by a cumulative 1.9% as the spike in shipping freight costs earlier in the year and pickup in the oil price fed through. However, producer prices fell back in September (-0.6%M/M) to leave the annual rate firmly in negative territory, down 1.1ppts to a four-month low of -3.4%Y/Y. As energy prices were the driver behind the upwards shift over recent month, they also led the drop in the latest month (-1.9%M/M). This left the annual rate of that component down 11.6%Y/Y and down by more than a third since the peak, the level of energy prices was still roughly 60% above the 2019 average. Meanwhile, underlying price pressures in the factory sector remain muted. For example, non-energy industrial producer prices merely moved sideways in September, to leave the core PPI inflation rate up to just 0.6%Y/Y. Intermediate goods prices also failed to grow for a third successive month, while capital goods prices fell (-0.1%M/M) for the first month in ten to leave the annual rate (1.3%Y/Y) the joint-softest for 3½ years. And despite a rise in producer prices of consumer durables rose for the first month in four in September, inflation of that category remained extremely subdued at just 0.5%Y/Y. Also, with survey measures of producer price pressures – such as the manufacturing price PMIs – still below the long-run average, there seemingly remains an ongoing absence of any meaningful upwards pressures on consumer goods inflation.

The day ahead in the euro area

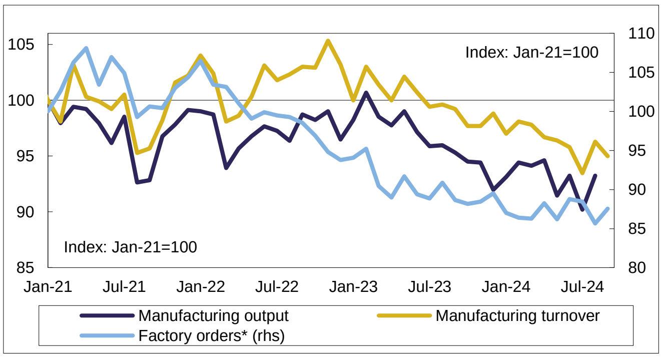
Following the upside surprise to euro area GDP in Q3, tomorrow's data releases will shed more light on economic momentum at the end of the summer. In particular, euro area retail sales data for September will be watched for confirmation that consumption led the rebound in economic activity last quarter. 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. Meanwhile, German industrial production figures for September are expected to report a notable payback for the strength recorded in August, when autos production surged 19.3%M/M. Today's manufacturing turnover figures suggested a drop of almost 1½%M/M in September. This would leave output down around 1½%Q/Q in Q3. In addition, the October construction PMIs are also due.

Germany: Factory orders – selected subsectors



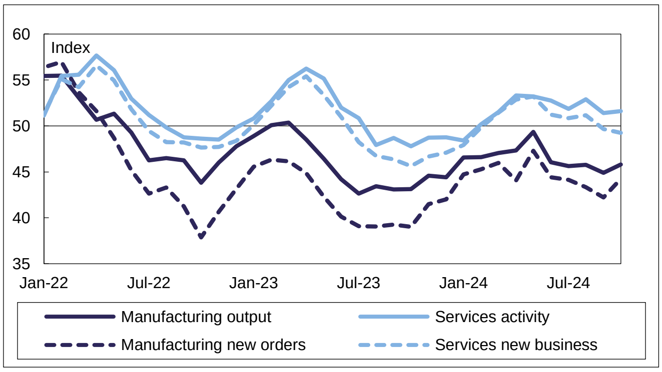
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing orders, output & turnover



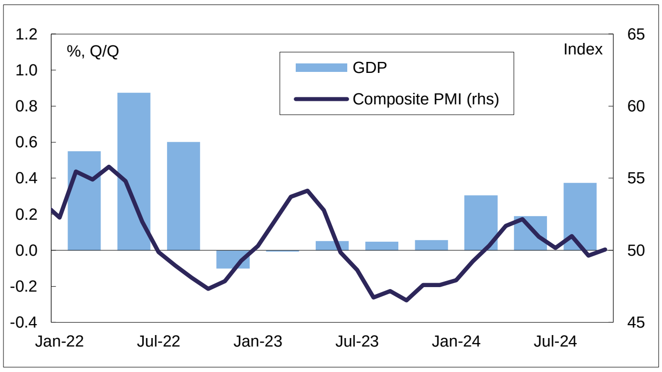
**Core orders excluding major items. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Manufacturing & services PMIs



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

Euro area: GDP growth & composite PMI



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

UK

Construction PMI signals an eighth-consecutive month of growth despite budget uncertainty

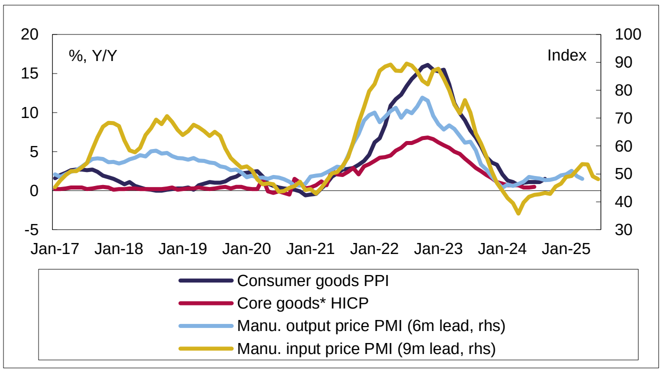
Having signalled the fastest pace of expansion in almost 2½ years in September (57.2), the UK construction activity PMI fell back in October to 54.3, albeit still marking an eighth consecutive month of expansion. The deterioration was in line with the trend observed in both the final manufacturing and services PMIs, as elevated uncertainty ahead of the new Labour government's budget weighed on October's business sentiment. Indeed, last week's final manufacturing output PMI decline by 3.3pts to a six-month low of 50.3. The effect on services confidence was less stark by contrast, with the activity index falling only 0.4pt to 52.0 and still consistent with healthy expansion in the sector, although this too marked the slowest pace for 12-months. Within the construction detail, although growth was reported to have eased across each subsector in October, commercial (54.7) and civil engineering (56.2) activity remained particularly robust, with the latter reportedly boosted by strong demand for energy infrastructure projects. By contrast, house builders were the most downbeat, with the respective index falling by a relatively large 4.9pts and slip marginally into contractionary territory (49,4) for the first time since June. However, with house price growth on an upward trajectory and lower interest rates on the horizon, housebuilding activity might soon reverse this drop.

The day ahead in the UK

The main event in the UK tomorrow will be the BoE's monetary policy announcement and the publication of updated macroeconomic projections in its latest Monetary Policy Report. 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. Indeed, inflation and wage developments have continued to point to reduced risks of inflation persistence over recent months. And the MPC will be encouraged to see that headline inflation in September (1.7%Y/Y) registered its first below-target reading since April 2021, some 0.4ppt below the Bank's expectations in August, while the all-important services inflation was 0.6ppt below its projection (4.9%Y/Y). So, whilst the uplift in the regulated household energy cap is expected to lead inflation back above the 2% target in October and possibly temporarily higher over the coming months, we continue to expect the BoE to projection a return to target next year. We expect that Governor Bailey will be amongst the advocates for easing this time around, bearing in mind the MPC's forward guidance that 'in the absence of any material developments, a gradual approach to removing policy restraint remains appropriate', as well as suggestion that the BoE could get a 'bit more aggressive' on rate cuts. However, the decision might not be unanimous, with other (hawkish) members of the MPC emphasising the need for a cautious approach, even before the recent wobble in the Gilt market following last week's Budget announcement.

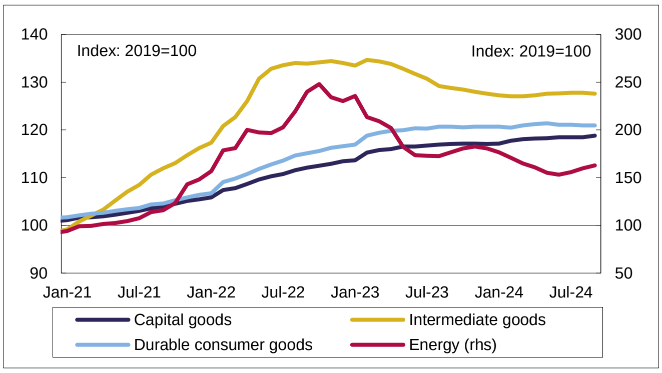
Of course, there is significant uncertainty about how the MPC will interpret the impact of the budget announcement on the future path for GDP and inflation. The magnitude of the government's proposed cumulative increase in government borrowing over the monetary policy horizon has led the market to temper its bets on the likely pace and 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. However, higher employer National Insurance Contributions might weigh further on wage growth and hiring plans, while other tax-raising measures are likely to weaken demand from April on. The BoE will attempt to reflect the cumulative effects of these changes in its projections, however we would caution that the market assumptions used will have been set before Gilts sold-off in the wake of the announcement of higher Gilt issuance. As a result, the projections might appear out of date already by the time of publication.

Euro area: Goods price indicators



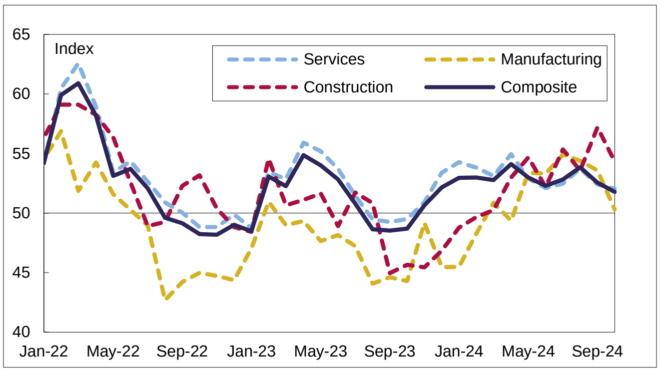
**Non-energy industrial goods. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

Euro area: Producer price indices



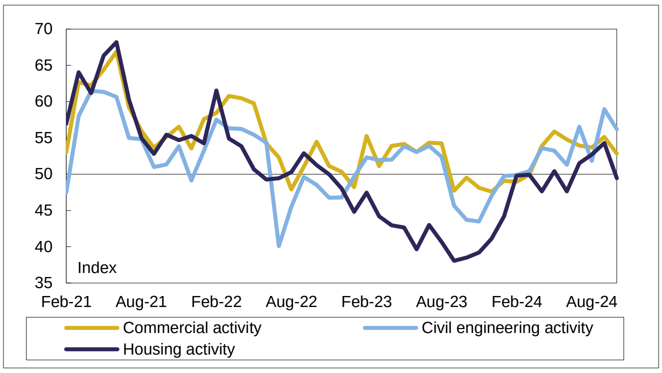
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Industry output PMIs



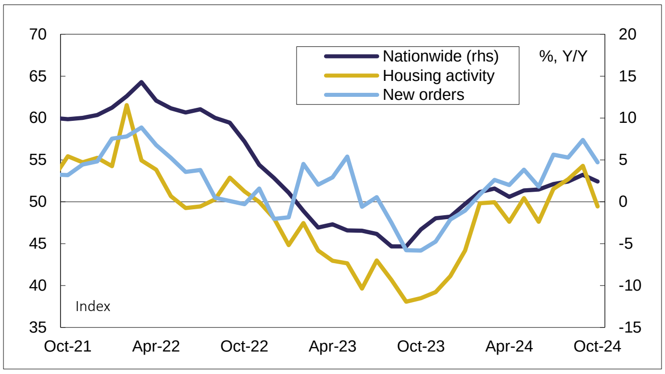
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Construction sector PMIs



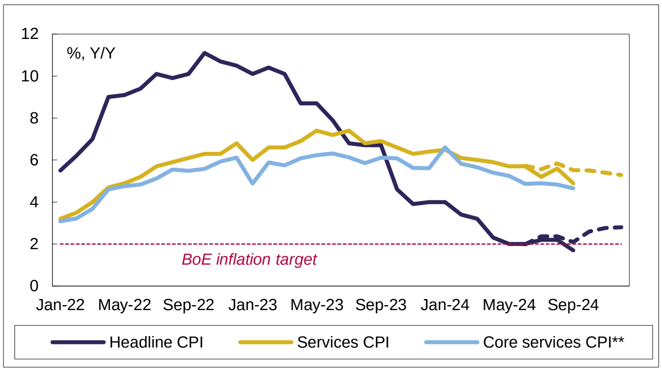
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Construction PMIs & house prices



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

UK: Headline & services inflation*



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

European calendar

Today's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Final composite (services) PMI	Oct	**50.0 (51.6)**	49.7 (51.2)	49.6 (51.4)	-
		PPI Y/Y%	Sep	**-3.4**	-3.4	-2.3	-
Germany		Factory orders M/M% (Y/Y%)	Sep	**4.2 (1.0)**	1.6 (-2.6)	-5.8 (-3.9)	-5.4 (-3.4)
		Final composite (services) PMI	Oct	**48.6 (51.6)**	48.4 (51.4)	47.5 (50.6)	-
France		Final composite (services) PMI	Oct	**48.1 (49.2)**	47.3 (48.3)	48.6 (49.6)	-
Italy		Composite (services) PMI	Oct	**51.0 (52.4)**	50.0 (50.4)	49.7 (50.5)	-
Spain		Composite (services) PMI	Oct	**55.2 (54.9)**	56.4 (56.6)	56.3 (57.0)	-
UK		Construction PMI	Oct	**54.3**	55.1	57.2	-

Auctions

Country		Auction
Germany		sold €804.7mn of 2.6% 2041 bonds at an average yield of 2.64%
		sold €409.4mn of 2.5% 2046 bonds at an average yield of 2.63%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data						
Country	**GMT**	**Release**	**Period**	**Market consensus/ *Daiwa forecast***	**Previous**
Euro area	08.30	Construction PMI	Oct	-	42.1
	10.00	Retail sales M/M% (Y/Y%)	Sep	0.4 (1.3)	0.2 (0.8)
Germany	07.00	Industrial production M/M% (Y/Y%)	Sep	-1.0 (-3.0)	2.9 (-2.7)
	07.00	Trade balance €bn	Sep	20.9	22.7
	08.30	Construction PMI	Oct	-	41.7
France	07.45	Preliminary private sector wages Q/Q%	Q3	0.0	-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	-0.4 (-0.2)	-0.1 (-0.1)
UK	12.00	BoE Bank Rate %	Nov	***4.75***	5.00
	14.00	DMP 3M output price (1Y CPI) expectations %	Oct	-	3.6 (2.7)

Auctions and events		
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 up to €12.5bn of 3% 2034, 4.75% 2035, 0.5% 2044 & 3.25% 2055 bonds
Spain	09.30	Auction: to sell 2.7% 2030 bonds, 0.7% inflation-linked 2033 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

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs