Euro wrap-up

Overview

- Bunds were little changed, despite an upside surprise to German inflation, which rose to a 7-month high on prices of fuel and services
- Gilts closed the day little changed while updated national accounts data suggested that the UK economy was larger than previously estimated and a survey showed shop price inflation up to an 18-month high.
- Wednesday will bring the flash September estimate of euro area inflation, final manufacturing PMIs and the UK Nationwide house price index.

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Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	2.013	-0.003
OBL 2.2 10/30	2.308	-
DBR 2.6 08/35	2.713	+0.007
UKT 3¾ 03/27	3.986	+0.007
UKT 4⅜ 03/30	4.139	-0.003
UKT 4½ 03/35	4.705	+0.006

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

Euro area

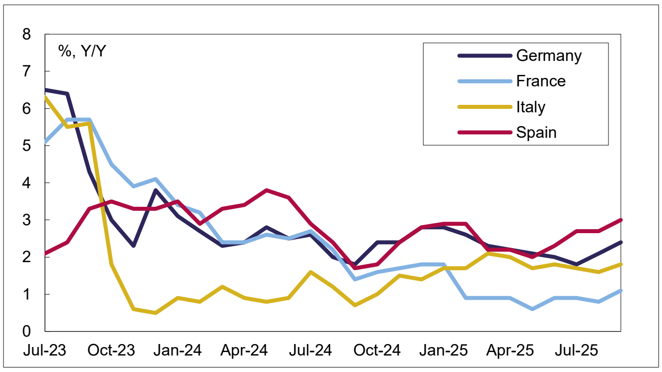
German inflation exceeds expectations rising to 7-month high on prices of fuel & services

According to today's flash estimate, German inflation rose further than expected in September, up 0.3ppt on the EU-harmonised measure to a six-month high of 2.4%Y/Y. The national CPI rate was up 0.2ppt, which also took it to 2.4%Y/Y, the highest so far this year. An increase in German inflation had been expected in part as fuel prices had fallen sharply a year earlier compared to the more modest decline this September. And largely due to that base effect, energy inflation on the national measure rose 1.7ppt to -0.7%Y/Y, the least negative since 2023. However, strikingly, the services CPI rate rose 0.3ppt to a four-month high of 3.4%Y/Y. The data from the German states suggest that was likely in part due to an increase in transport services, including airfares. And package holidays and hotels, which are similarly often volatile, were also seemingly higher. So, that increase in German services inflation need not be a great concern for the ECB. However, while non-energy industrial goods inflation fell back, core CPI inflation rose for the first time since April, ticking up 0.1ppt to 2.8%Y/Y. More happily, inflation of food and non-alcoholic beverages, which some policymakers believe is particularly important for household inflation expectations, provided modest offset, with the respective CPI rate down 0.4ppt to a three-month low of 2.1%Y/Y.

Inflation also up in France & Italy, so euro area headline & core rates also likely picked up

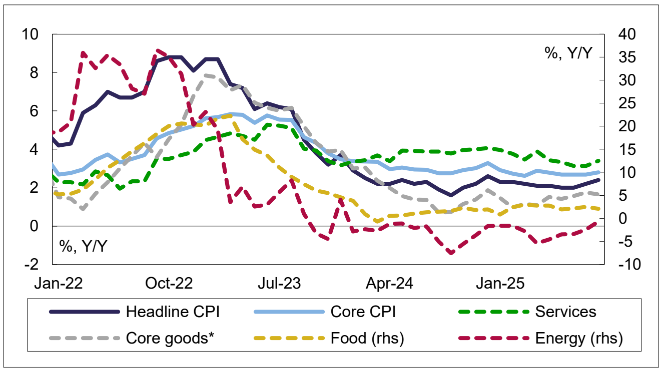
As in Germany, the flash estimates of inflation in the other large member states rose in September in part due to the base effect in fuel prices. Reassuringly, however, the increase of 0.3ppt in the French headline HICP inflation rate was smaller than expected. Nevertheless, at 1.1%Y/Y, that rate was still the highest since January. And as in Germany, the rise in France was also in part due to services inflation, which INSEE attributed to communication and healthcare components. So, while manufactured goods inflation was a touch softer, core French inflation also appears to have firmed about 0.2ppt in September. Elsewhere, as in Germany, the Italian September flash estimates also beat expectations, with the EU-harmonised measure up 0.2ppt to a three-month high of 1.8%Y/Y. While services inflation was steady, seasonal clothes inflation pushed the goods component higher. And so, Italian core inflation (excluding energy, food, alcohol and tobacco) edged up 0.1ppt to 2.1%Y/Y. Given the data from the other member states, including increases in Spain, Belgium and Ireland and a drop in Portugal, the flash estimate of euro area headline inflation (due tomorrow) now looks set to rise 0.3ppt to 2.3%Y/Y, matching our forecast but 0.1ppt above the consensus and the highest since February. And core inflation also looks likely to tick higher, up to 2.4%Y/Y after four months steady at 2.3%Y/Y.

Euro area member states: Headline HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: CPI inflation components



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

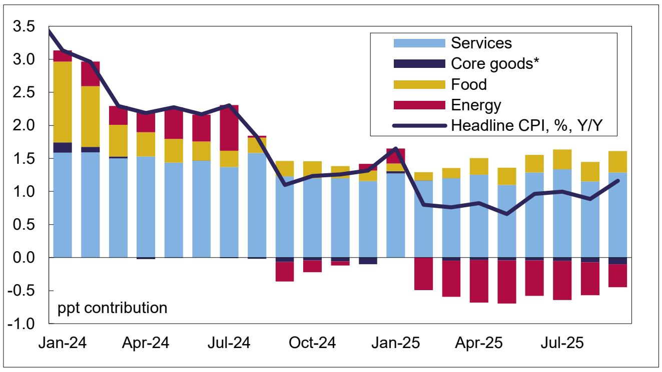
German retail sales down for second successive month in August but by less than feared

Consistent with an increasingly downbeat crop of German consumer sentiment surveys, August's retail sales figures disappointed with volumes falling (-0.2%M/M) for a second consecutive month. Contrasting a slight improvement in sales of food (0.6%M/M), which remained down on an annual basis, the reduction that month was most pronounced in non-food stores (-1.0%M/M). However, with the drop in July not as dramatic as initially feared – with the decline revised to just ½%M/M, from an initial 1½%M/M – retail sales in the first two months of the quarter were trending merely 0.2% below the Q2 average. So, while still flagging risks of a marginal contraction in household consumption in Q3, the likelihood of a notable drag on GDP growth this quarter would appear diminished. And while further moderation in real income growth and tepid labour demand are likely to weigh on household spending to the end of the year, we see retail sales turning the corner in the new year as labour market stabilisation offers support to consumer confidence. Admittedly, having fallen last month by the most since April 2022 (-7k, with revisions), jobless claims resumed a familiar uptrend this month (14k). But the increase in claims would seem to be on a downtrend, and with the jobless rate sticking at 6.3% for a sixth successive month, the labour market increasingly looks to be coming into balance. Increased public investment and improving prospects for the factory sector should support domestic activity further ahead.

The day ahead in the euro area

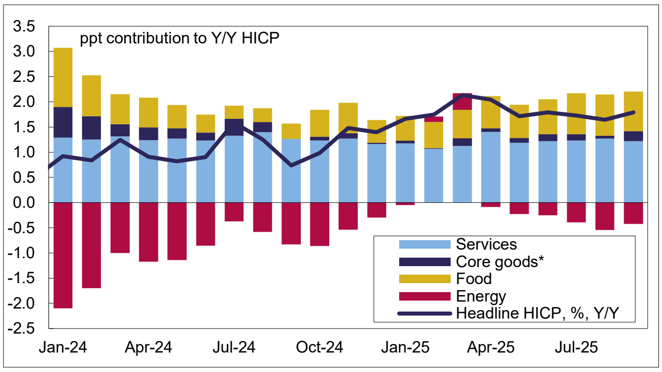
As noted above, Wednesday will bring the preliminary euro area inflation data for September. Following today's flash releases from the member states, we now expect the headline euro area HICP rate to rise 0.3ppt to 2.3%Y/Y, marking a first above-target print since April. Despite the large rise, that should remain consistent with the ECB's projection published earlier this month. Unfavourable base effects relating to lower fuel prices in the same month last year will be the principal driver of that change. By comparison, core inflation should be more stable. But the increases displayed by today's flash German, French and Italian releases point to a rise of 0.1ppt to 2.4%Y/Y. Beyond the inflation data, September's final euro area manufacturing PMIs will look to verify their less upbeat flash release, which reported a reversal of August's pickup in output amid reports of an allegedly sharp contraction in France and the weakest demand signals for six months. The final euro area release will be accompanied by the first manufacturing PMIs from Italy and Spain.

France: CPI inflation & contributions**



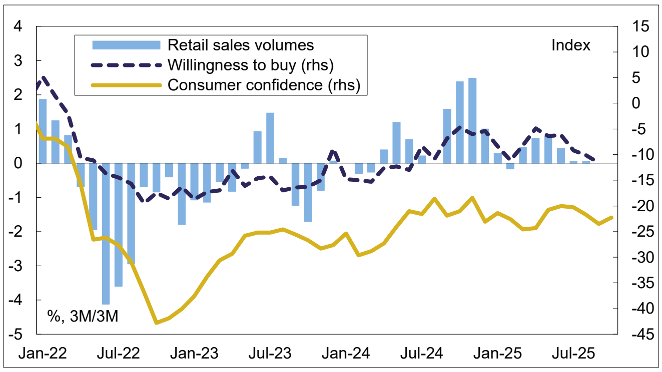
*Non-energy industrial goods. **National CPI measure.
Source: INSEE, Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: HICP inflation & contributions



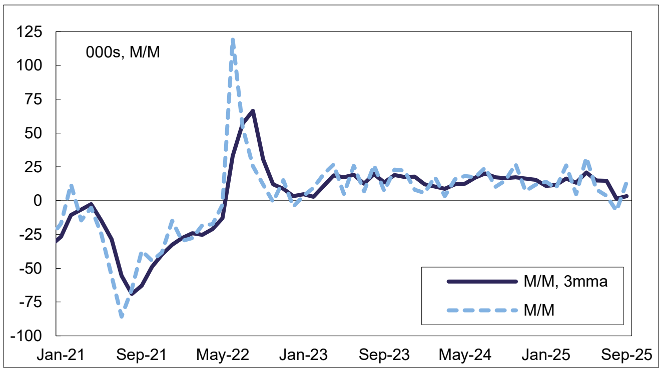
*Non-energy industrial goods. **EU-harmonised HICP measure.
Source: ISTAT, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales & consumer confidence



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

Germany: Change in unemployment claims



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

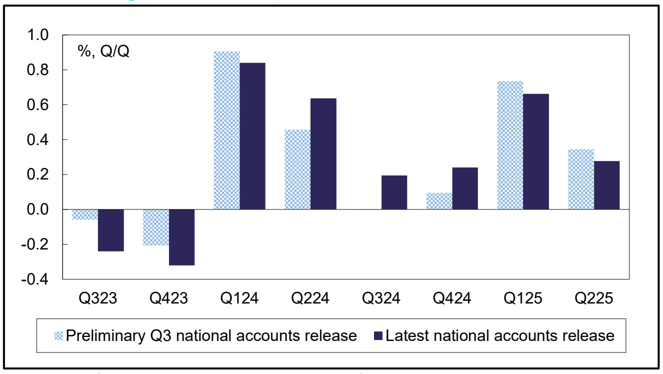
Updated national accounts data suggest UK economy larger than previously estimated

Today's updated UK national accounts data confirmed that, after front-running of US tariff and Stamp Duty hikes boosted activity at the start of the year, GDP growth slowed 0.4ppt in Q2 to 0.3%Q/Q, matching the previous estimate. To two decimal places, the quarterly growth rates were revised down by 0.07ppt apiece to 0.66%Q/Q and 0.28%Q/Q respectively. But this still left the UK economy as the best performing of the G7 countries in the first half of 2025, with output up almost 2% annualised compared with the second half of 2024. And given an upwards revision to the profile for GDP in H224, the year-on-year growth rate was upwardly revised by 0.2ppt to 1.4%Y/Y. Moreover, the level of output is now estimated to be more than 5% above the pre-pandemic benchmark in Q419, 0.7ppt higher than before. While this still lags the equivalent post-pandemic recoveries in the US and euro area, it nevertheless suggests a slightly better productivity performance than previously thought. In per capita terms, GDP is now estimated to have risen (albeit modestly) for six consecutive quarters for the first time since 2017 to be up 0.9%Y/Y. Admittedly, GDP per capita is still barely higher than in Q419, a performance only worse in Germany (-1.6%) among the major economies.

Domestic demand firmer than initially estimated in Q2 on boost to fixed investment

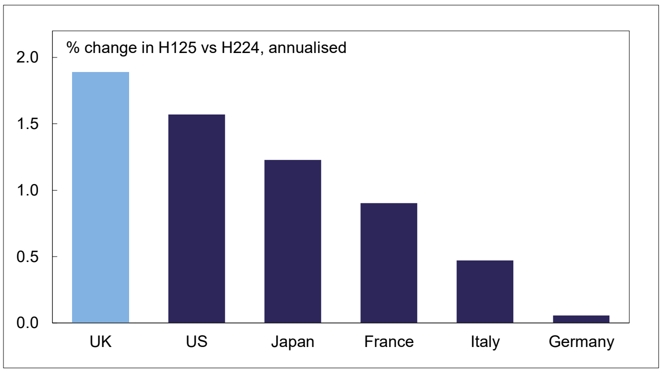
The detail in today's report on the composition of growth in Q2 was also more positive than previously estimated. As in the preliminary release, the strongest growth was in government spending (1.3%Q/Q) including on healthcare and defence. But there was also a marked upwards revision to total fixed investment, up 1.6ppts to 0.5%Q/Q. The drop in business capex was less marked than previously estimated at 1.1%Q/Q to leave that category of investment up 3%Y/Y and some 10% above the pre-pandemic level. Transport equipment and intellectual property slipped back following strong growth earlier in the year, partly offset by a surge in dwellings and other buildings and structures. Meanwhile, despite a rise in real incomes, the moderation in household consumption growth (0.1%Q/Q) was confirmed as spending on consumer-facing services remained lacklustre weighed by net tourism, excluding which domestic consumption grew a more respectable 0.4%Q/Q. But the household savings ratio also picked up slightly (10.7%). And while this was down on the recent peak in Q4 (11.7%) it was still more than 5ppts above the average of the four years before the pandemic, suggesting scope to boost expenditure if and when consumer confidence is restored. Finally, as is often the case, there were sizeable revisions to the trade data, with exports now estimated to have contracted slightly in Q2 (-0.2%Q/Q) in contrast to the growth initially estimated. But net trade provided only a modest drag on GDP growth, as a rise in the services surplus partly offset a widening in the goods deficit. Nevertheless, the current account deficit rose by £7.3bn to £23.8bn (3.2% of GDP) as higher payments to foreign investors on portfolio investments pushed the primary income deficit to a two-year high.

UK: GDP growth comparison



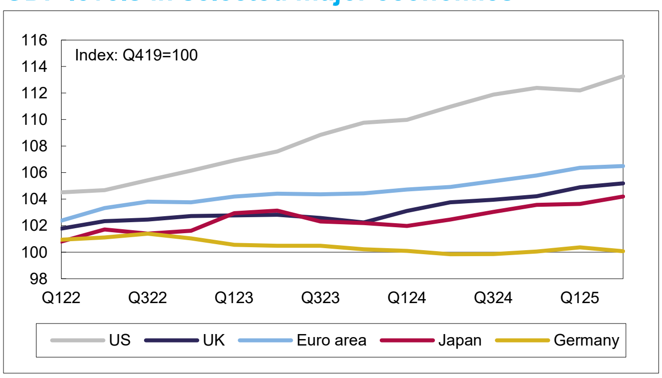
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Change in GDP in H125 in selected major economies



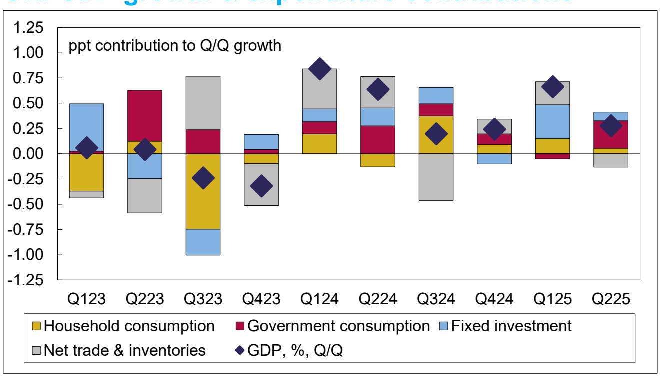
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

GDP levels in selected major economies



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & expenditure contributions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

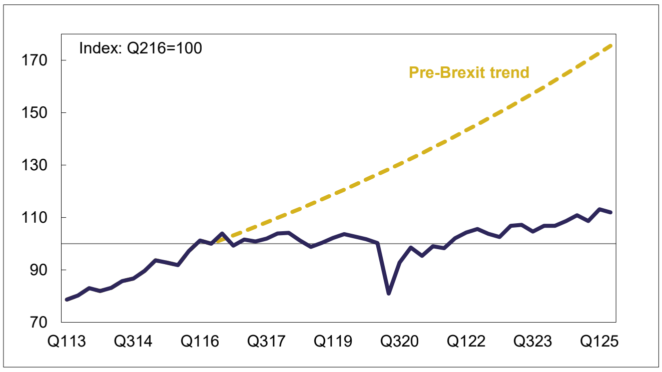
Shop price inflation rises to an 18-month high despite steady food inflation

Today's BRC shop price survey illustrated why households remain downbeat as its measure of high street inflation jumped 0.5ppt in September to an 18-month high of 1.4%Y/Y. The pickup reflected the softest rate of deflation in non-food items (-0.2Y/Y) since March 2024. In part, this was due to larger contributions from DIY goods, gardening supplies and furniture, reflecting steeper discounting a year ago. In contrast, prices of electrical items were down significantly as retailers offered promotions on items such as laptops ahead of the new academic year. And, while still elevated, the BRC's estimate of food inflation held steady (4.2%Y/Y) for the first month in eight. Not least given the likely rise in energy, we expect consumer price inflation to edge higher in September to a 20-month high of 3.9%Y/Y. But, like the BoE, we also expect this to mark the peak in the current upswing. Certainly, despite today's suggestion of stronger pressures in non-food items, we see the risks to the outlook for core goods prices to be skewed to the downside due to past sterling appreciation and the prospect of additional cheap imports diverted away from the US. And thanks to easing pay growth, services inflation should take a step down next spring and gradually moderate thereafter. So, while today's data support our expectation that the MPC will keep Bank Rate steady for the remainder of this year, we continue to expect it to resume its easing cycle in the New Year.

The day ahead in the UK

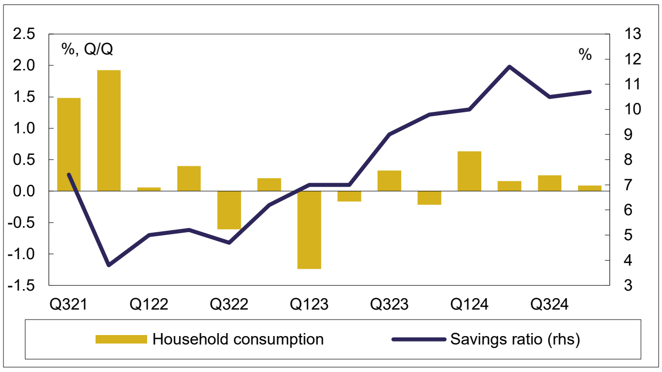
With respect to Wednesday's economic data flow, the day ahead will bring final UK manufacturing PMIs and Nationwide's house price indicator for September. While the decline in the UK flash composite PMI at the end of Q3 principally reflected a loss of momentum in the dominant services sector, the deterioration in the manufacturing output index was especially dramatic, paring 3.9pts to a six-month low of 45.4. That decline likely reflects the consequences of the cyberattack which halted production at Jaguar Land Rover this month. And with a phased-in resumption of JLR production lines only set to begin on 6 October, we expect the final survey will affirm that downcast reading. With respect to BoE-speak, comments from external MPC member Catherine Mann at a Bloomberg conference should echo her cautious tone this afternoon, further reinforcing predictions that she will vote again to hold rates in November amid upside risks to the inflation outlook.

UK: Business investment



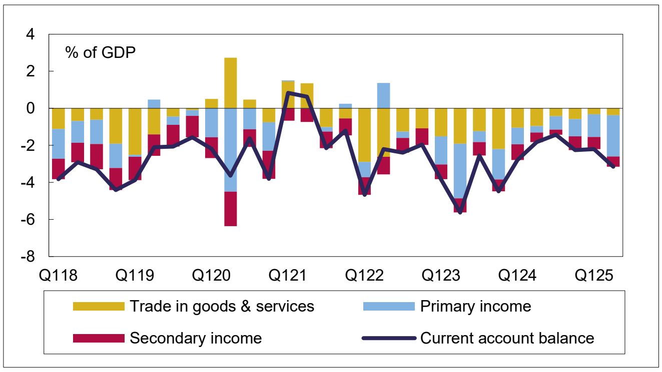
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Household consumption & savings ratio



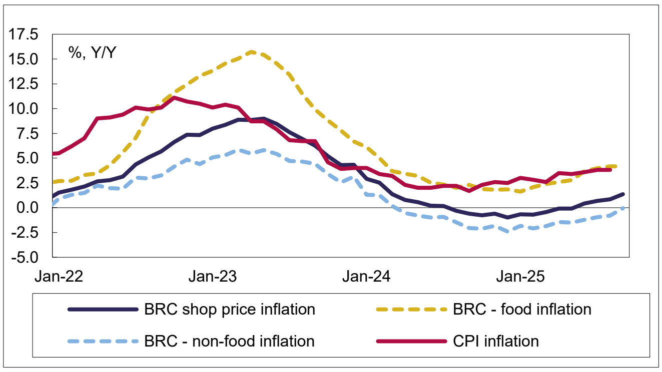
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Current account balance



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Consumer & shop price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Preliminary HICP (CPI) Y/Y%	Sep	**2.4 (2.4)**	2.2 (2.3)	2.1 (2.2)	-
		Retail sales M/M% (Y/Y%)	Aug	**-0.2 (-1.1)**	0.6 (2.3)	-1.5 (2.3)	-0.5 (3.3)
		Unemployment claims rate % (change 000s)	Sep	**6.3 (14)**	6.3 (8)	6.3 (-9)	- (-7)
		Import prices M/M% (Y/Y%)	Aug	**-0.5 (-1.5)**	-0.2 (-1.4)	-0.4 (-1.4)	-
France		Preliminary HICP (CPI) Y/Y%	Sep	**1.1 (1.2)**	1.3 (1.3)	0.8 (0.9)	-
		Consumer spending M/M% (Y/Y%)	Aug	**0.1 (-0.8)**	0.2 (-0.3)	-0.3 (-0.1)	-0.6 (-0.4)
Italy		Preliminary HICP (CPI) Y/Y%	Sep	**1.8 (1.6)**	1.7 (1.6)	1.6 (1.6)	-
UK		GDP – final estimate Q/Q% (Y/Y%)	Q2	**0.3 (1.4)**	*0.3 (1.2)*	0.7 (1.3)	-
		GDP – private consumption Q/Q%	Q2	**0.1**	*0.1*	0.4	-
		GDP – government consumption Q/Q%	Q2	**1.3**	*1.2*	-0.4	-
		GDP – gross fixed capital formation Q/Q%	Q2	**0.5**	*-1.1*	2.0	-
		Current account balance £bn	Q2	**-28.9**	-25.0	-23.5	-21.2
		BRC shop price index Y/Y%	Sep	**1.4**	1.2	0.9	-
		Lloyds business barometer (own price expectations) % balance	Sep	**42 (63)**	-	54 (65)	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		09.00	Final manufacturing PMI	Sep	*49.5*	50.7
		10.00	Preliminary headline (core) HICP Y/Y%	Sep	*2.3 (2.4)*	2.0 (2.3)
Germany		08.55	Final manufacturing PMI	Sep	*48.5*	49.8
France		08.50	Final manufacturing PMI	Sep	*48.1*	50.4
Italy		08.45	Manufacturing PMI	Sep	50.0	50.4
Spain		08.15	Manufacturing PMI	Sep	53.9	54.3
UK		07.00	Nationwide house prices M/M% (Y/Y%)	Sep	0.2 (1.8)	-0.1 (2.1)
		09.30	Final manufacturing PMI	Sep	*46.2*	47.0

Auctions and events

Country		BST	Event
Germany		10.30	Auction: to sell up to €5bn of 2.6% 2035 bonds
UK		10.00	Auction: to sell £1.6bn of 1.125% 2035 inflation-linked bonds
		10.55	MPC external member Mann to speak in interview at Bloomberg's Women, Money and Power conference, London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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