

Euro wrap-up

Overview

- While euro area inflation rose to a five-month high, Lagarde suggested that risks to consumer prices were quite contained allowing Bunds to follow USTs slightly higher.
- Gilts also made modest gains on a quiet day for UK economic news.
- Thursday will bring euro area unemployment data for August and a BoE business survey.

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Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	2.010	-0.007
OBL 2.2 10/30	2.302	-0.005
DBR 2.6 08/35	2.712	+0.003
UKT 3½ 03/27	3.963	-0.013
UKT 4½ 03/30	4.116	-0.016
UKT 4½ 03/35	4.698	+0.001

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

Source: Bloomberg

Euro area

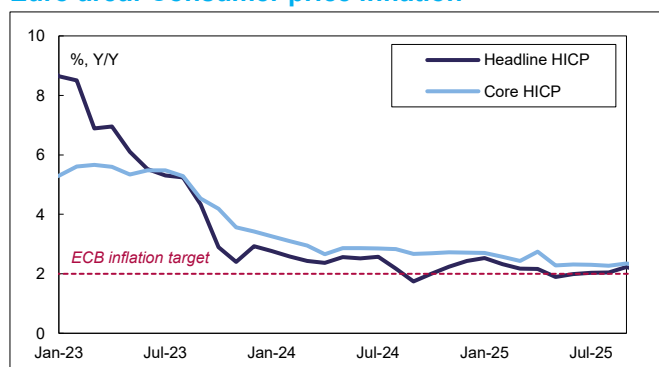
Euro area inflation up to a five-month high, but in line with the ECB's projections

Despite the upside surprise in yesterday's German numbers, the flash estimate of euro area inflation in September came in line with the Bloomberg survey consensus. This showed the headline HICP rate rising 0.2ppt to 2.2%Y/Y, the first above-target reading since April. But this was bang in line with the ECB's September projection update. Moreover, the upwards impulses in today's report look to be largely driven by base effects and suggest no new need for concern. Given a much larger decline in prices a year ago, energy inflation rose 1.6ppts to -0.4%Y/Y, the least negative for seven months, to account fully for the increase in the headline rate. In contrast, core inflation moved sideways at 2.3%Y/Y for a fifth consecutive month. Admittedly, both the headline and core rates would have been higher had it not been for steep declines in Greece. And that core rate (2.347%Y/Y to three decimal places) was exceptionally close to being nudged up as the services component edged a touch higher (3.2%Y/Y). But as flagged in yesterday's German regional data, we suspect that volatility in airfares at the start of the new season played a significant role, with prices having fallen much more than usual a year earlier (-17.2%M/M). Indeed, seasonally adjusted data suggest that, overall, services pricing was better behaved this month, with momentum edging down to an eight-month low (2.8%3M/3M annualised). Moreover, core goods inflation remained very low, moving sideways at just 0.8%Y/Y. And policymakers concerned about second-round effects from elevated food prices should take some comfort from the moderation in inflation of that component last month to a five-month low (3.0%Y/Y).

Inflation to move a touch higher in Q4, but fall back below target in 2026

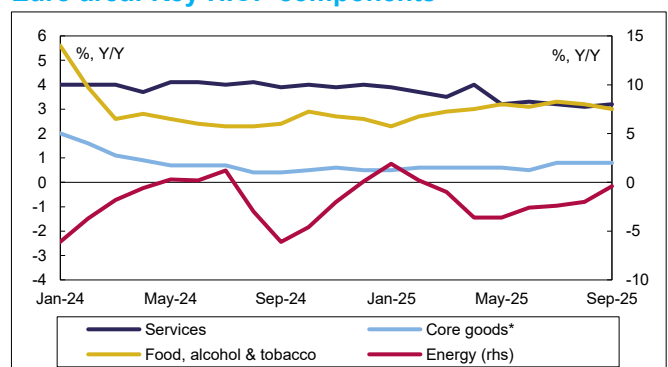
Despite signs of subdued economic growth momentum, services inflation is likely to tick higher over the fourth quarter close to 3½%Y/Y due to unfavourable base effects. But for the same reason, we expect it to take a step down in the spring, with moderating pay pressures supporting a broadly sideways trend thereafter between 2-2½%Y/Y. Core goods price pressures will also remain largely absent as soft demand, euro strength and a possible influx of cheaper Chinese goods redirected from the US weigh. Certainly, today's manufacturing PMIs implied continued moderate downward pressure on input costs (49.6) and output prices (49.7) in the factory sector. September will also likely mark the peak for energy inflation for the next six months, with a step down to come in January thanks in part to German government policies aimed at cutting electricity prices. So, while our forecasts for Q4 – of headline inflation at 2.1%Y/Y and core inflation at 2.4%Y/Y – are a touch above the ECB's expectations, headline inflation should fall back below 2.0%Y/Y from the start of 2026 and remain sub-target throughout next year. We also expect core inflation to fall marginally below 2.0%Y/Y from Q226 but end the policy horizon back close to target. In a speech today, ECB President Lagarde suggested that risks to consumer prices were 'quite contained in both directions'. And with the Governing Council also having assessed policy to be 'in a good place', we maintain our view that the ECB's rate-cutting cycle has now concluded.

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Key HICP components



*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

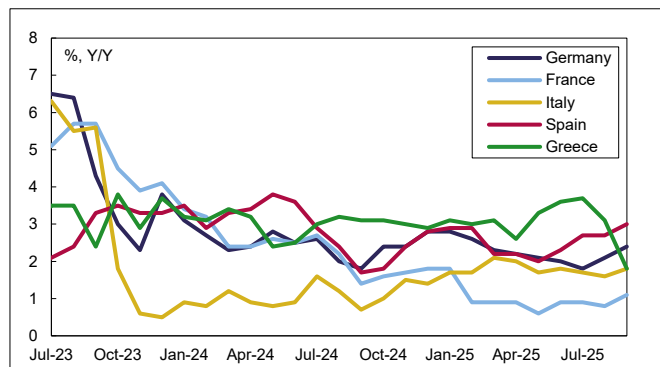
The day ahead in the euro area

Thursday's euro area economic data will focus on the labour market, headlined by the euro area's August unemployment release. In the absence of revisions, the unemployment rate should stick close to its historical low of 6.2%. Indeed, that argument is helped by the less downbeat German claims data that month, which suggested that, while labour demand remains subdued, the loosening of the jobs market has probably slowed somewhat. Recent progress in reducing joblessness has been driven especially by capacity absorption in southern Europe, and particularly Spain, for which tomorrow's employment figures will provide a timelier assessment of the scope for a further reduction in unemployment at the aggregate euro level.

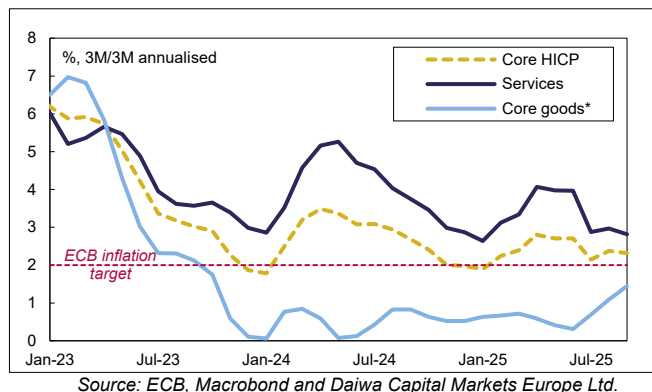
The day ahead in the UK

September's all-important update to the BoE's Decision Maker Panel survey will provide the main event for the UK's dataflow tomorrow. However, with its release unlikely to present a meaningful change from its recent trend, we expect it will do little more than reinforce the conflicting perspectives on the MPC. Indeed, a further modest upwards drift in inflation expectations – cited by external MPC member Mann today – seems likely to maintain the MPC hawks' concerns about inflation persistence. We also expect the more dovish rate-setters, who have been placing more weight on developments in the labour market, to be able to cite ongoing gradual moderation in wage growth expectations.

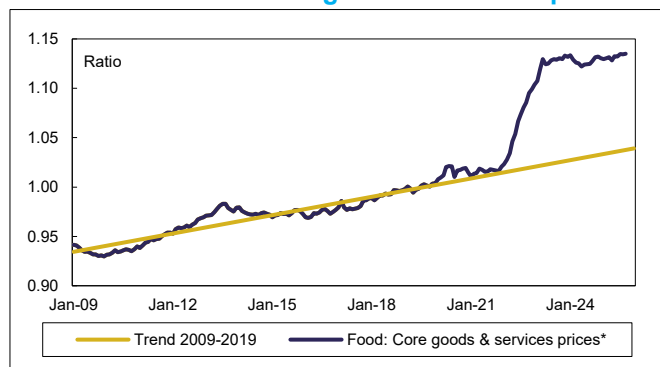
Euro area member states: Headline HICP inflation



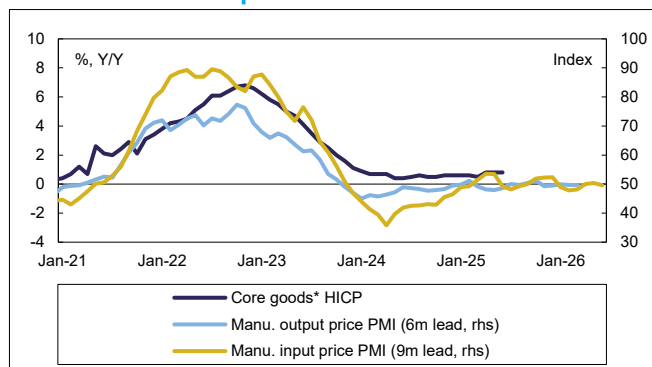
Euro area: Core inflation momentum



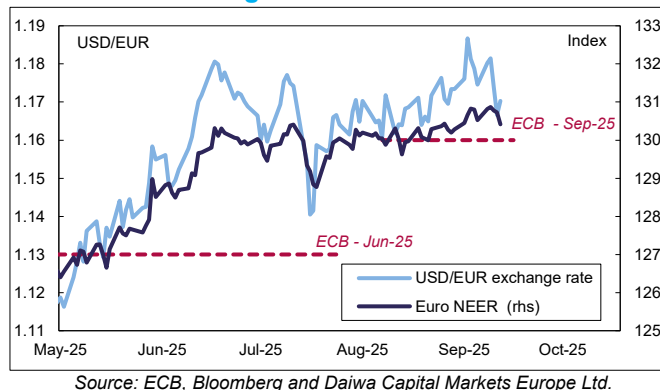
Euro area: Food vs core goods & services prices*



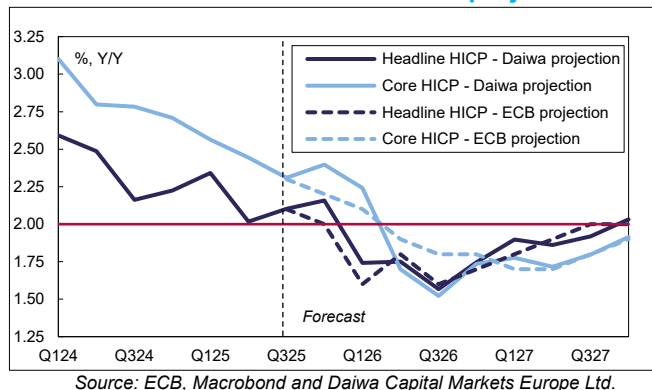
Euro area: Goods price indices



Euro area: Exchange rates



Euro area: Headline & core inflation projections



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%	Sep	2.2 (2.3)	<u>2.3 (2.4)</u>	2.0 (2.3)	-
	Final manufacturing PMI	Sep	49.8	<u>49.5</u>	50.7	-
Germany	Final manufacturing PMI	Sep	49.5	<u>48.5</u>	49.8	-
France	Final manufacturing PMI	Sep	48.2	<u>48.1</u>	50.4	-
Italy	Manufacturing PMI	Sep	49.0	49.9	50.4	-
Spain	Manufacturing PMI	Sep	51.5	53.8	54.3	-
UK	Final manufacturing PMI	Sep	46.2	<u>46.2</u>	47.0	-
	Nationwide house prices M/M% (Y/Y%)	Sep	0.5 (2.2)	0.2 (1.8)	-0.1 (2.1)	-

Auctions

Country	Auction
Germany	sold €3.807bn of 2.6% 2035 bonds at an average yield of 2.72%
UK	sold £1.6bn of 1.125% 2035 inflation-linked bonds at an average yield of 1.673%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	10.00	Unemployment rate %	Aug	<u>6.2</u>	6.2
Spain	08.00	Unemployment (net employment) change 000s	Sep	-	21.9 (29.8)
UK	12.00	DMP 3M output price (1Y CPI) expectations Y/Y%	Sep	3.7 (3.4)	3.7 (3.4)

Auctions and events

France	09.50	Auction: to sell up to €11.5bn of 3.5% 2035, 1.25% 2036, 0.5% 2044 & 4% 2060 bonds
Spain	09.30	Auction: to sell 2.7% 2030, 3% 2033, 1% 2042 bonds and 1.15% 2036 inflation-linked bonds
UK	10.00	Auction: to sell £4.5bn of 4.75% 2035 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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