Euro wrap-up

Overview

Emly Nicol +44 20 7597 8331
Edward Maling +44 20 7597 8030

- Bunds made modest gains, while the dataflow remained consistent with an absence of German GDP growth in Q3.
- Longer-dated Gilts made gains as the overshoot in UK public borrowing compared with the OBR forecast was a little less than previously thought.
- Wednesday's release of UK inflation data for September is expected to see the headline CPI rate rise to 4.0%Y/Y.

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.902	-0.002
OBL 2.2 10/30	2.154	-0.012
DBR 2.6 08/35	2.552	-0.024
UKT 3¾ 03/27	3.848	+0.004
UKT 4⅜ 03/30	3.942	-0.008
UKT 4½ 03/35	4.477	-0.027

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

Euro area

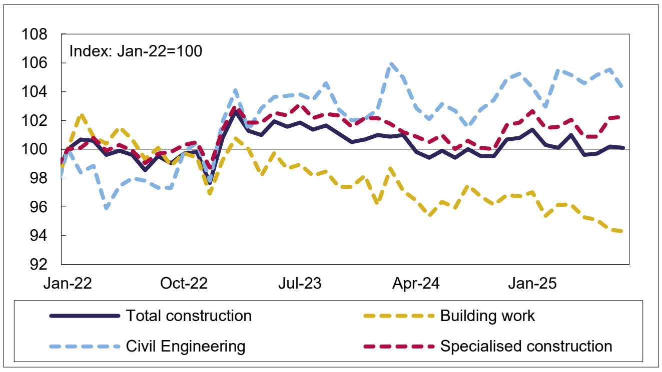
Weakness in euro area construction activity in August follows downward revision to Q2 growth

With manufacturing output having declined sharply in August, yesterday's euro area construction activity data for the same month raised concerns about a loss of momentum in the region over the summer. Despite growth in Germany, France and Spain, euro area construction output fell slightly (-0.1%M/M) due principally to a third decline in four in Italy (-1.6%M/M). As a result, euro area construction activity was flat compared with a year earlier and trending broadly sideways in Q3. Yesterday's data also brought a notable downward revision to the estimate of construction output in Q2 to correct for the erroneous surge previously recorded in Spanish housebuilding in April. Aggregate euro area growth in the sector is now estimated to have peaked at 0.9%M/M that month compared with the spike of 4.5%M/M initially calculated. While the subsequent pullback was also somewhat smaller, activity in the sector in Q2 is now judged to have contracted 0.5%Q/Q, considerably weaker than the growth of 2.4%Q/Q previously reported. The adjustment in August was led by building work, which fell for a fourth successive month to the lowest level since February 2021, tracking more than 1% below the Q2 average. Civil engineering dropped to a six-month low to be trending broadly sideways in Q3. In contrast, specialised construction work rose to an eight-month high, averaging some 1% above the Q2 level. There are certain reasons to be cautiously optimistic about a return to growth in the sector as a whole in Q4. According to the latest Commission survey, the share of constructors reporting demand as a factor limiting output fell to a near-two-year low in September. Builders also judged recent activity to have been the firmest for almost three years. Building permits in Germany recently rose to the highest level in 18 months. And while much of the detail on the survey was negative, the German construction PMIs last month pointed to a third month of growth in civil engineering in four, seemingly benefiting from the government's infrastructure programme.

German hospitality and French retail weaken over the summer, but Spain providing some offset

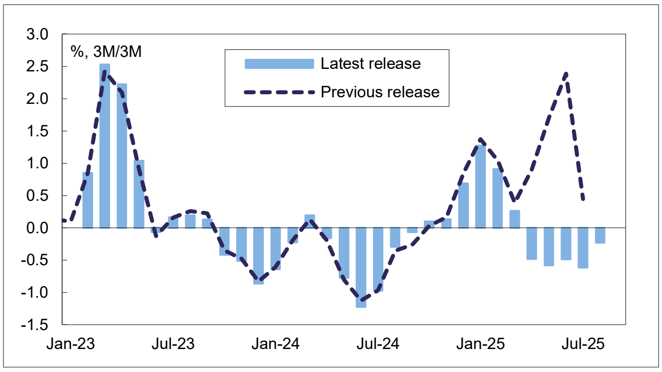
While services should have provided some offset to lacklustre industrial and construction output, today's German hospitality data flagged downside risks to estimates of GDP growth in Q3. Turnover in the subsector fell for a third month out of four in August (-1.8%M/M) to the lowest level for 3½ years to be tracking almost 2% below the Q2 average. Weakness was evident in accommodation and food services. With the fall in German retail sales a touch larger than initially reported (-0.5%M/M), they too were on track to be a modest drag on growth. Appropriately, the Bundesbank thinks that GDP moved sideways "at best" in Q3, with a non-negligible risk that the largest member state slipped into a mild technical recession over the summer. In France, retail sales maintained a moderate downtrend in September, to be down almost ½%Q/Q over the third quarter. But the Bank of France remains relatively upbeat about services activity more generally and thinks that GDP grew in Q3 at a similar pace to Q2 (0.3%Q/Q). And while Spanish services output was soft (-0.1%M/M) in August, it was trending ½% above the Q2 level. Overall, we expect euro area GDP growth of 0.1%Q/Q, albeit with risks skewed to the downside.

Euro area: Construction output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

Wednesday will bring a pause to the economic dataflow in the euro area. And while ECB President Lagarde is due to speak at a conference in Frankfurt, the pre-Governing Council meeting quiet period means that her comments are unlikely to be relevant to the current monetary policy debate, so it should be a quieter day ahead.

UK

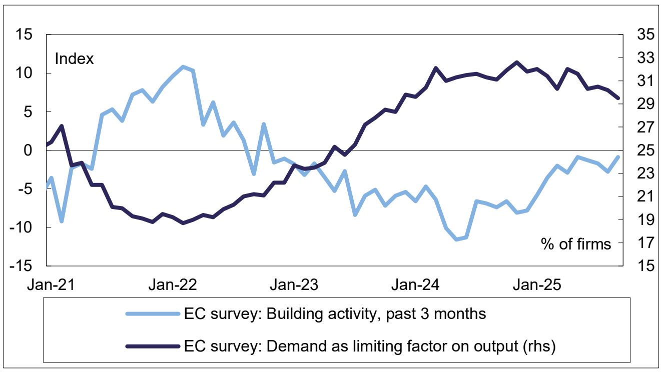
Fiscal tightening inevitable despite downwards revision to public borrowing through September

With the Autumn Budget (26 November) looming into view, today's monthly public finances release provided the opportunity for a mid-financial year stocktake. Thankfully, September's data were arguably less downbeat than of late. Indeed, public sector borrowing at £20.2bn was broadly in line with the OBR's forecast for that month. Thanks in part to HMRCs correction to its previous estimate of VAT receipts, tax revenues were revised higher for the year-to-date. While inflation also continued to boost spending, including with respect to debt interest payments, the OBR noted those were contributing only modestly to a slight overshoot of central government spending. So, while local authorities continued to push public sector borrowing higher – and at £99.8bn, some £11.5bn higher than the first six months of last year – the overshoot of £7.2bn relative to the OBR forecast was £4.2bn less than suggested in August. Such a revision ultimately has little bearing on our expectations for the Autumn budget. Namely, that in order to restore compliance with her fiscal rules – that day-to-day government spending will be in surplus come FY29/30 – Chancellor Reeves will need to tighten policy. While a smaller shortfall today will be welcomed, the cumulative effects of policy reversals and (especially) the expected downgrade to the OBR's productivity and GDP assumptions will likely imply the need to find roughly £25-30bn, assuming that the Chancellor looks to simply restore the slim headroom (£10bn) allocated last year, and does not seek to build a buffer to future deviations in the data.

The day ahead in the UK

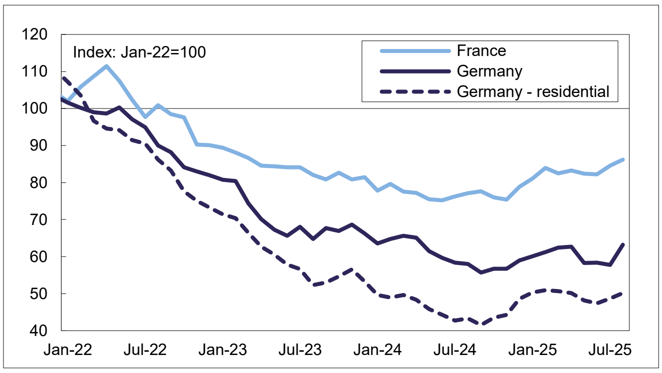
Unsurprisingly, September's inflation data will occupy UK markets' focus on Wednesday. Indeed, the BoE has long expected September to mark the peak of the UK's recent inflation episode, principally since unfavourable base effects related to a steeper decline in petrol prices one year prior are due to add to the headline rate. So, in line with both the BoE and Bloomberg consensus estimate, we expect CPI to rise to 4%Y/Y, up 0.2ppt from August. Also matching the consensus, we expect the core rate to edge back slightly higher, up 0.1ppt to 3.7%Y/Y. Though reflective of slight pressure in both core

Euro area: Construction survey indices



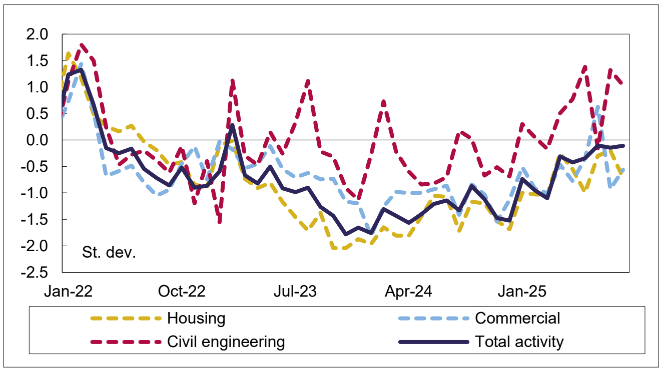
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany & France: Building permits



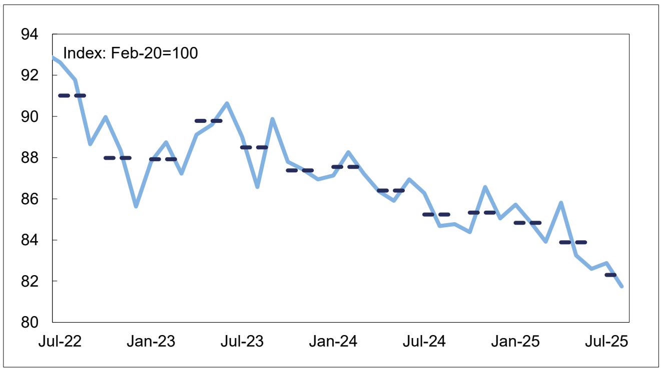
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Construction PMIs



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

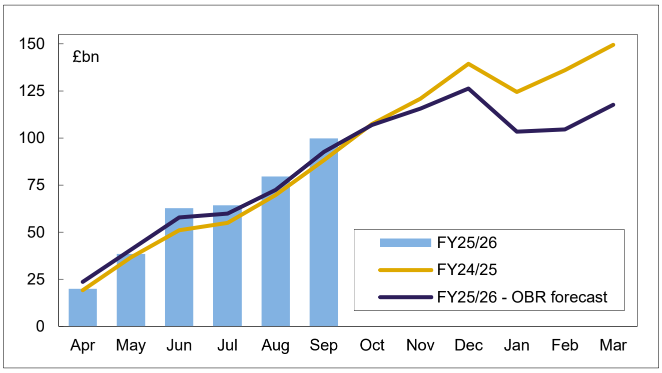
Germany: Hospitality services turnover*



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

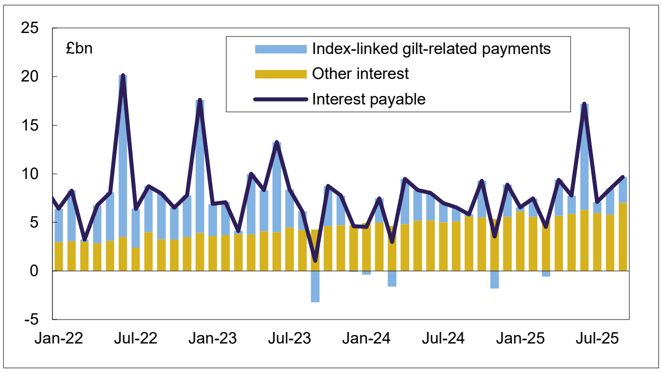
goods and services components, our expectations for the latter remain slightly more modest than the rise predicted by the BoE's latest projection (for 5.0%Y/Y) although we note upside risks from the London Transport strikes that month. On a more encouraging note, given the concerns of some policymakers about second order effects on household expectations, we also expect food price inflation to begin showing signs of stabilisation. The inflation report will also bring a first regular PPI update since publication of that series was suspended seven months ago over data quality concerns.

UK: Public sector net borrowing



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

UK: Central government debt interest



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
France		Retail sales Y/Y%	Sep	**-1.2**	-	-0.9	-1.0
UK		Public sector net borrowing £bn	Sep	**20.2**	-	17.7	15.3

Auctions

Country		Auction
Germany		sold €733mn of 1.3% 2027 green bonds at an average yield of 1.86%
		sold €718mn of 2.5% 2035 green bonds at an average yield of 2.52%
UK		sold £1.5bn of 1.5% 2053 green bonds at an average yield of 5.294%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		ECB current account balance €bn	Aug	**11.9**	-	27.7	29.8
		Construction output M/M% (Y/Y%)	Aug	**-0.1 (0.1)**	*0.4 (0.7)*	0.5 (3.2)	0.5 (0.7)
Germany		PPI Y/Y%	Sep	**-1.7**	-1.5	-2.2	-
UK		Rightmove house prices M/M% (Y/Y%)	Oct	**0.3 (-0.1)**	-	0.4 (-0.1)	-

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
UK		07.00	Headline (core) CPI Y/Y%	Sep	*4.0 (3.7)*	3.8 (3.6)
		07.00	PPI – output (input) prices Y/Y%	Sep	3.6 (0.8)	2.9 (-0.1)
		09.30	House price index Y/Y%	Aug	-	2.8

Auctions and events

Country		BST	Event
Euro area		13.25	ECB President Lagarde to give keynote speech at Frankfurt Finance and Future Summit, Frankfurt
Germany		10.30	Auction: to sell up to €3bn of 2.5% 2032 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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