

Euro wrap-up

Overview

- Gilts outperformed as UK inflation in September undershot the BoE's projection to support the case for a further rate cut before year-end.
- Bunds followed USTs marginally lower on a quiet day for euro area economic news.
- October sentiment surveys will dominate the European dataflow over the remainder of the week, including euro area consumer confidence tomorrow and flash PMIs on Friday when UK retail sales are also due.

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Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.909	+0.007
OBL 2.2 10/30	2.164	+0.013
DBR 2.6 08/35	2.565	+0.015
UKT 3½ 03/27	3.754	-0.091
UKT 4% 03/30	3.866	-0.075
UKT 4½ 03/35	4.414	-0.062

*Change from close as at 4:00pm BST.
Source: Bloomberg

UK

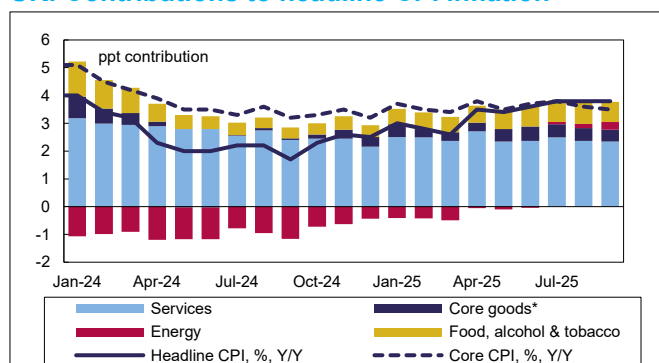
Inflation undershoots BoE projection to support case for a further rate cut before year-end

At the September MPC meeting, the BoE's policymakers had flagged concerns that upside risks to the medium-term inflation outlook remained "prominent" in their assessments of the outlook, suggesting that the bar to further easing over the near term had been raised somewhat. Since then, however, the UK's dataflow has softened, with the latest [labour market](#) report having pointed to a more meaningful moderation in pay growth and today's inflation print for September coming in below expectations. So, taken together with the likelihood that substantive fiscal tightening will be announced in the Budget on 26 November, we now expect the next BoE rate cut to come before the end of the year. On balance, we still expect rates to be left unchanged at the next meeting on 6 November with the next cut perhaps more likely to come in December. But next month's vote on the MPC will likely be close, with a non-negligible albeit outside chance that a 5-4 majority votes there and then to pull the trigger on a rate cut, taking Bank Rate to 3.75%. Certainly, as today's CPI report showed headline inflation moving sideways for a third successive month at 3.8%Y/Y, the peak in inflation this year appears to have been reached earlier and was lower than expected. Indeed, the September reading was 0.2ppt below the BoE's projection while core inflation also surprised to the downside, easing 0.1ppt to a four-month low of 3.5%Y/Y.

Underlying services inflation down to 4-year low, while food inflation also undershot BoE forecast

The detail in today's inflation data was also encouraging, suggesting a broad-based moderation in underlying price pressures in September. While headline services inflation merely moved sideways, at 4.7%Y/Y for a fourth month in five, it was 0.3ppt below the BoE's expectation. In particular, a drop in inflation of cultural services, which benefited from base effects in live music, was offset by a bounce in inflation of airfares and accommodation. But when excluding indexed and volatile components, which have represented a major source of pressures this year, the measure of underlying services inflation closely watched by policymakers fell 0.3ppt to 3.8%Y/Y, a four-year low. The MPC's hawks might flag that inflation rates of a significant share of services components remains more than 3ppts above their pre-pandemic averages. But this share has fallen sharply since the start of the year, suggesting welcome cooling in price pressures in this sector. Meanwhile, a below-average increase in prices of core goods pushed the respective inflation rate down to a five-month low (1.6%Y/Y). Downward pressures were evident in a range of goods including mobile phone equipment, new cars, household appliances and garden furniture. And an increase in clothing and sports equipment might simply reflect seasonal effects. Policymakers concerned about risks of second-round effects from high food inflation could take comfort from the significant undershoot in that component relative to the BoE's forecast, as it fell 0.5ppt to a four-month low (4.3%Y/Y). And while energy inflation jumped almost 2ppts to 4.3%Y/Y – the highest since May 2023 – this principally reflected an unfavourable base effect from the near-4%M/M decline in petrol prices a year ago and will likely mark the peak.

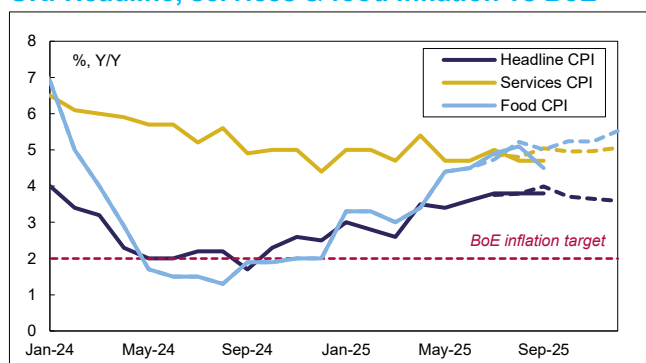
UK: Contributions to headline CPI inflation



*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Headline, services & food inflation vs BoE*

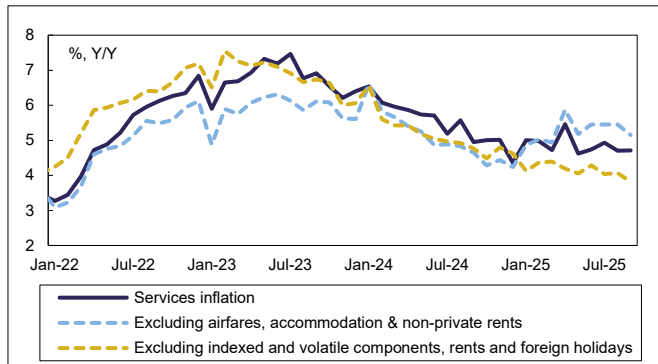


*Dashed lines represent BoE projections from August 2025 MPR.
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

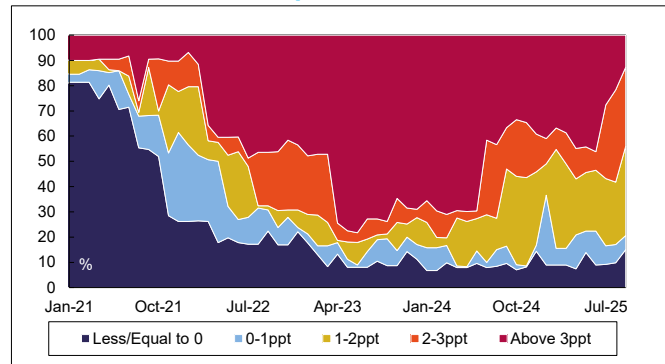
Inflation to take a step down in April and decline thereafter to below target in 2027

Despite the 2% increase in Ofgem's household energy price cap in October, the bigger hike a year ago should mean that energy inflation falls by more than half this month. And recent wholesale oil and gas pricing points to a modest cut in household utility tariffs at the start of 2026, which will then push energy inflation back into negative territory. While certain administered prices – including water bills and social housing rents – look set to rise further in the coming year, their price increases should be smaller than a year ago too. The impact of April's increase in employer NICs, which has likely contributed to the persistence of inflation in retail and hospitality, should also fall out of the annual calculation in the spring. As such, services inflation should take a step down in April. And we expect normalising pay growth thereafter to support a gradual moderation in that component to around 3½%Y/Y by year-end and just below 3%Y/Y in the second half of 2027. Core goods pressures are also expected to fade amid soft demand and a possible inflow of cheaper Chinese goods diverted away from the US. And signs of normalisation in pricing elsewhere in Europe also support our expectation that food inflation will maintain a downtrend going forward. So, while we expect headline inflation to move broadly sideways just below 3½%Y/Y in Q425, it should fall to 3.0%Y/Y or below at the start of 2026, before averaging just above the 2% target in the second half of next year and just below target in 2027. As such, in addition to a cut this quarter, we expect the BoE to ease policy at least once more in early 2026.

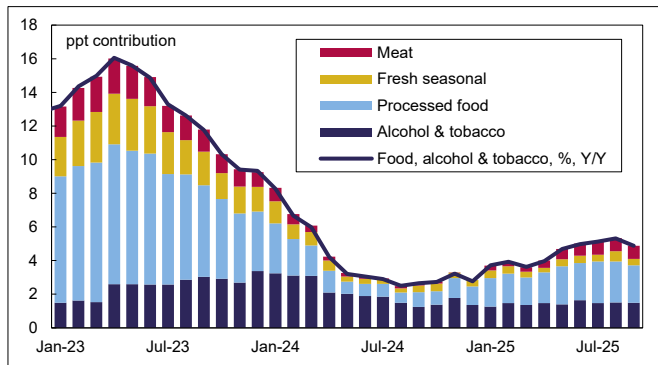
UK: Measures of services inflation



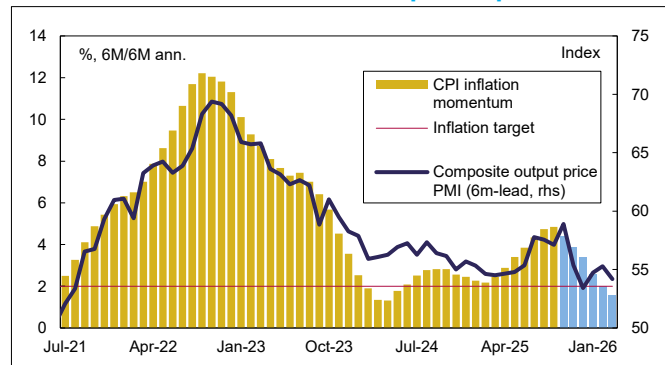
UK: Services inflation persistence*



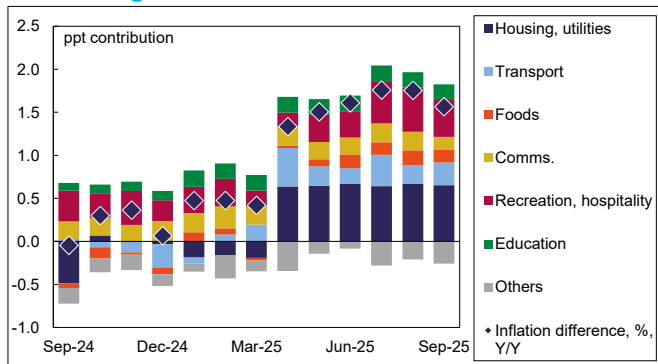
UK: Contributions to food inflation



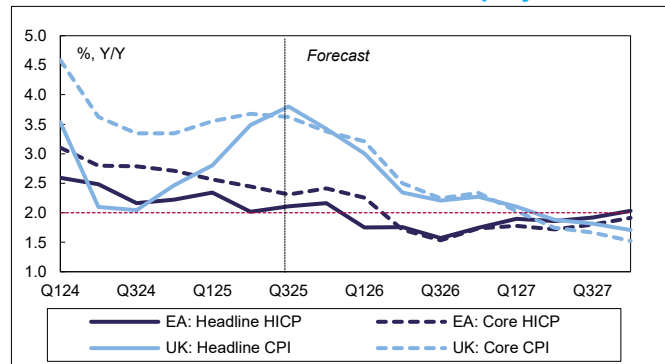
UK: Inflation momentum & composite price PMI*



UK: Divergence from euro area inflation



UK & euro area: Headline & core CPI projections*



The coming two days in the UK

Following today's inflation data, attention in the UK will quickly turn to Friday's release of October's flash PMIs. Their release will arguably provide the final top-tier data for the BoE ahead of November's MPC meeting. Policymakers will consider signals from the cost and price PMIs, as well as the employment PMIs, within their assessments. Crucially too, the PMIs will provide insights into the strength of private sector activity at the start of Q4. And having briefly risen to a 12-month high (53.5) in August, a repeat of September's stagnant composite PMI reading (50.1), or a contraction, would certainly support the case for a resumption of rate cuts next month. We would attach a relatively low probability to the latter, however. To the extent that last month's downturn in part reflected disruption at Jaguar Land Rover, the phased restart to production lines at that auto firm should benefit manufacturing output. And we might also expect some recovery in services, albeit to be consistent with merely modest expansion. Meanwhile, also in focus on Friday will be September's retail sales figures. Following three consecutive months of growth through to August, we expect to see some payback at the end of Q3, consistent with the deterioration in the PMIs referenced above, a downbeat BRC retail survey and also the effects of last month's strike action by tube staff in the capital. Moreover, consumer confidence also weakened in September, and Friday's release seems likely to suggest that it remained subdued in October amid intensifying speculation about forthcoming tax rises to be announced in next month's Budget.

The coming two days in the euro area

The principal focus in the euro area at the back end of the week will be October's flash PMIs, which are due on Friday. While the euro area composite activity PMI picked up to a 16-month high in September (51.2) – still demonstrating remarkable resilience, despite signs of waning overseas demand – we expect only a broadly sideways movement at the start of the current quarter, not least due to persistent weakness in US export demand as well as unease at the political turbulence in France. S&P's preemptive move last week to downgrade French debt from AA- to A+ might well have watered down the significance of Friday's scheduled rating decision by Moody's. However, there remains a decision for Moody's as to whether an outlook change to negative is more likely than a full downgrade. In any case, INSEE's business sentiment survey, due Thursday, will offer insights as to whether recent events have had any detrimental effect on French economic confidence ahead of the release of the PMIs. Not least thanks to its much larger survey sample, the INSEE survey arguably provides a more reliable guide to activity than the often-volatile PMIs, which deteriorated last month to a five-month low (48.1). Thursday's flash Commission consumer confidence indicator – and Friday's INSEE consumer sentiment indices – will also show whether political events in France have put the brakes on a pickup in consumer confidence in October.

The next Euro wrap-up will be published on Friday 24 October 2025

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
UK	 Headline (core) CPI Y/Y%	Sep	3.8 (3.5)	<u>4.0 (3.7)</u>	3.8 (3.6)	-
	 PPI – output (input) prices Y/Y%	Sep	3.4 (0.8)	3.6 (0.8)	2.9 (-0.1)	3.1 (0.2)
	 House price index Y/Y%	Aug	3.0	-	2.8	3.2
Auctions						
Country	Auction					
Germany	 sold €2.284bn of 2.5% 2032 bonds at an average yield of 2.33%					

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		15.00 Preliminary Commission consumer confidence indicator	Oct	-15.0	-14.9
France		07.45 INSEE business (manufacturing) confidence indicator	Oct	96 (96)	96 (96)
UK		11.00 CBI industrial trends survey – total orders (selling prices) % balance	Oct	-28 (5)	-27 (4)
		11.00 CBI industrial trends survey – business optimism % balance	Oct	-27	-27

Auctions and events

UK		10.00 Auction: to sell £4.75bn of 4.125% 2031 bonds			
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases
Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area		09.00 Preliminary services (manufacturing) PMI	Oct	51.2 (49.8)	51.3 (49.8)
		09.00 Preliminary composite PMI	Oct	51.1	51.2
Germany		08.30 Preliminary services (manufacturing) PMI	Oct	51.0 (49.5)	51.5 (49.5)
		08.30 Preliminary composite PMI	Oct	51.5	52.0
France		07.45 INSEE consumer confidence indicator	Oct	86	87
		08.15 Preliminary services (manufacturing) PMI	Oct	48.7 (48.2)	48.5 (48.2)
		08.15 Preliminary composite PMI	Oct	48.4	48.1
Spain		08.00 PPI Y/Y%	Sep	-	-1.5
		08.00 Unemployment rate %	Q3	-	10.29
UK		00.01 GfK consumer confidence indicator	Oct	-20	-19
		07.00 Retail sales – incl. auto fuels M/M% (Y/Y%)	Sep	-0.3 (0.4)	0.5 (0.7)
		07.00 Retail sales – excl. auto fuels M/M% (Y/Y%)	Sep	-0.6 (0.6)	0.8 (1.2)
		09.30 Preliminary services (manufacturing) PMI	Oct	51.0 (46.6)	50.8 (46.2)
		09.30 Preliminary composite PMI	Oct	50.5	50.1

Auctions and events

France		- Moody's to publish credit rating update			
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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