Euro wrap-up

Overview

Emily Nicol
+44 20 7597 8331

Edward Maling
+44 20 7597 8030

- Bunds followed the global trend higher despite a smaller than expected rebound in German industrial output in September, while euro area retail sales posted modest growth in Q3.
- Gilts also made gains as the BoE kept Bank Rate steady at 4.00%, but strongly signalled the likelihood of a December rate cut.
- Friday will bring September goods trade data from Germany and France.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/27	1.983	-0.017
OBL 2.2 10/30	2.245	-0.022
DBR 2.6 08/35	2.648	-0.023
UKT 3¾ 03/27	3.774	-0.016
UKT 4⅜ 03/30	3.894	-0.033
UKT 4½ 03/35	4.432	-0.029

*Change from close as at 5.00pm GMT.
Source: Bloomberg

Euro area

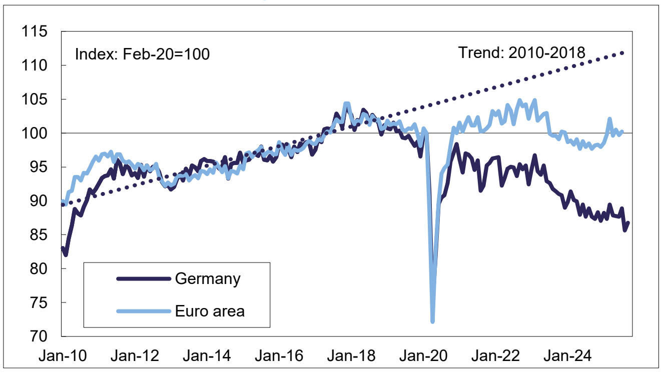
Bounce back in German IP in September fails to fully reverse autos retrenchment over the summer

Having fallen to the lowest level for more than 15 years outside of the first Covid-19 lockdown over the summer, German industrial output bounced back at the end of Q3 as car manufacturing resumed after the usual scheduled plant maintenance shutdowns. But the increase in production in September, at 1.3%M/M, was smaller than expected, only partially reversing the decline in August (-3.7%M/M). As such, the level of output contracted 0.8%Q/Q in Q3 – a similar pace to Q2, which saw payback for US tariff front-loading earlier in the year – to leave the sector a drag on GDP for a fifth quarter out of the past six. Regardless of a substantive rise in September (12.3%M/M), autos production fell more than 4%Q/Q over the third quarter, fully reversing the rise in Q2, to provide the largest drag on manufacturing last quarter. Despite a first monthly rise in four in production of other transport equipment, that component also fell in Q3 (-1.0%Q/Q) amid a decline in the aerospace subsector. And notwithstanding some bounce back in other export-oriented subsectors in September, including pharmaceuticals and computer, electronic and optical products, output in those subsectors was trending broadly sideways over the third quarter. Indeed, machinery and basic metals provided the only boost in Q3, albeit with output weakening in both subsectors in September. Finally, today's construction activity data also disappointed, reporting a second successive decline in September (-0.9%M/M) to be down more than ½%Q/Q in Q3.

Surveys tentatively point to pick up in manufacturing momentum

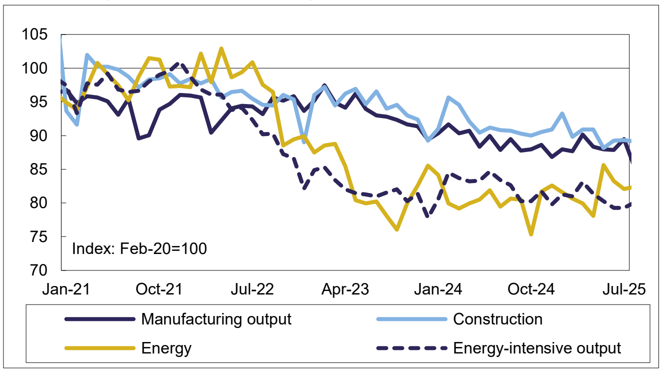
While factory orders suggest some stabilisation in underlying domestic demand for German goods, manufacturers continue to face significant external challenges, not least from higher US tariffs and intensified Chinese competition, particularly in terms of EVs and machinery. The latest signals from Germany's auto industry association (VDA) showed that domestic production fell 4%Y/Y last month, to leave production in the first 10 months of 2025 up just 1%Y/Y and still some 12% below the level in the pre-pandemic year in 2019. While incoming domestic car orders were up 2%Y/Y, there was a 10% decline in orders from overseas. So, it was no surprise that the ifo survey continued to flag difficulties in the autos industry current business situation at the start of Q4. Nevertheless, that survey in aggregate implied the strongest manufacturing production activity in 2½ years. And the quarterly expectations balance was the firmest since Russia's invasion of Ukraine, consistent with the signal from recent output PMIs. Admittedly, today's German construction PMI disappointed, with the headline activity index falling 3.4pts to a seven-month low in October (42.8). But this contrasted markedly with the steady improvement in the more comprehensive ifo construction survey. Indeed, this signalled the best current conditions in the sector for more than two years, supported not least by the highest optimism for the business climate in civil engineering. While services surveys have been mixed, they remain consistent with ongoing expansion. So, while risks are skewed to the downside, we still expect to see a pickup in economic momentum in Q4 before a steady acceleration through 2026.

Euro area & Germany: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing production

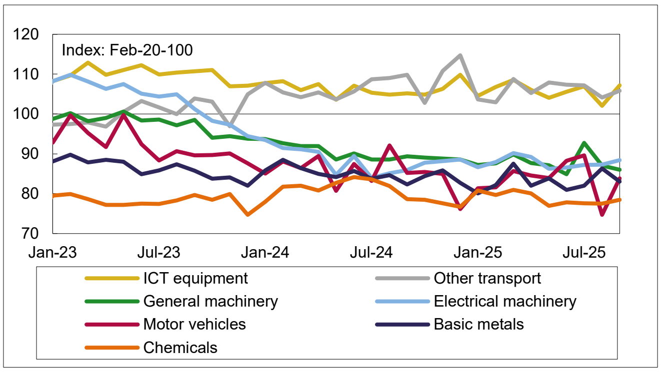


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Retail sales volumes rise modestly for an eighth consecutive quarter

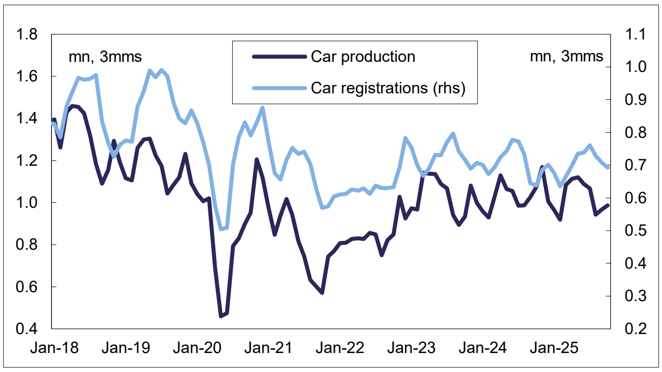
The preliminary estimate of euro area GDP in Q3 signalled a recovery in growth momentum over the summer (to 0.2%Q/Q, up 0.1ppt). And while we will have to wait until 5 December for a detailed expenditure breakdown, today's retail sales data was consistent with the view that consumer spending made a positive, albeit likely marginal, contribution to economic growth last quarter. Admittedly euro area retail sales volumes slipped back slightly in September (-0.1%M/M), a second in succession after revisions to the August figure. So having risen a sizable 0.8%Q/Q in Q2, sales volumes rose a more understated 0.2%Q/Q in Q3, consistent with the drag of prevailing uncertainty, moderating wage growth, and persistent preference to save. Nevertheless, the modest increase in Q3 marked the eighth consecutive quarter of retail sales growth, led by spending on core goods (i.e. sales of non-food and fuel). Indeed, core sales rose 0.7%Q/Q in Q3, a similar pace to Q2. In contrast, despite recent signs of stabilisation, sales of food declined slightly (-0.3%Q/Q). Among the key member states, retail sales volumes in Germany were flat on the quarter, mirroring GDP that quarter. Italian retail sales provided the main source of weakness (-0.6%Q/Q). But France provided some offset (0.5%Q/Q), while Spain – up 1.0%Q/Q – continued to outperform its peers. Recent improvement in consumer confidence and purchase intentions would suggest that the prospects for a rise in household consumption in Q4 remain broadly favourable too.

Germany: Manufacturing production, by subsector



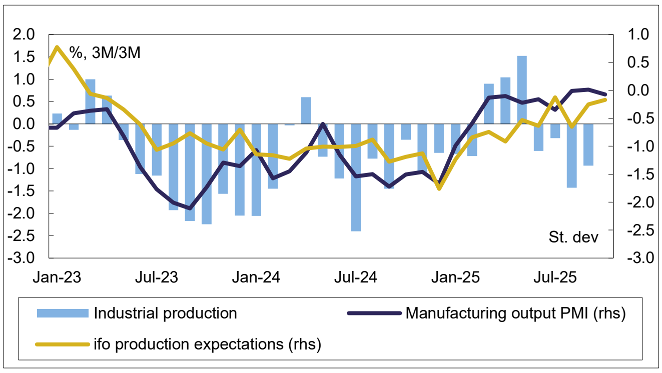
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Car production & registrations



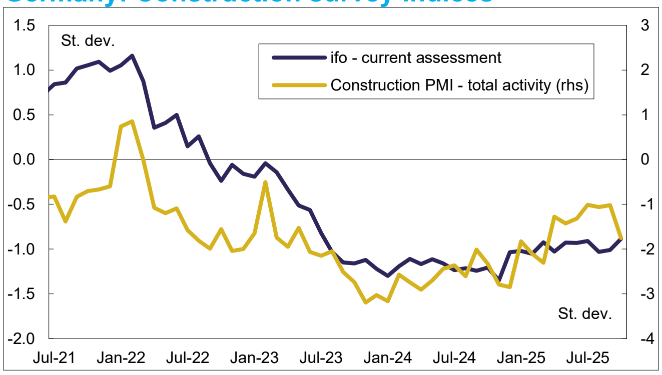
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industrial production & survey indices



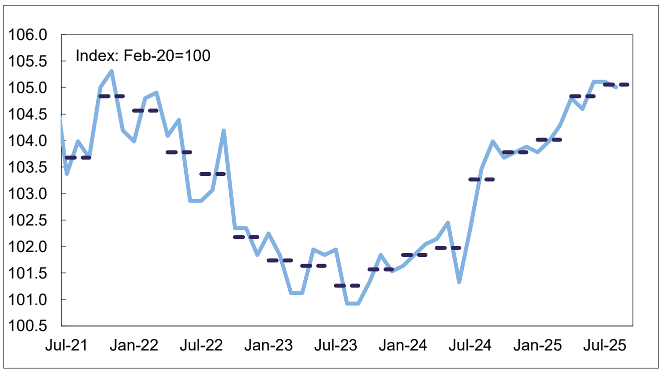
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Construction survey indices



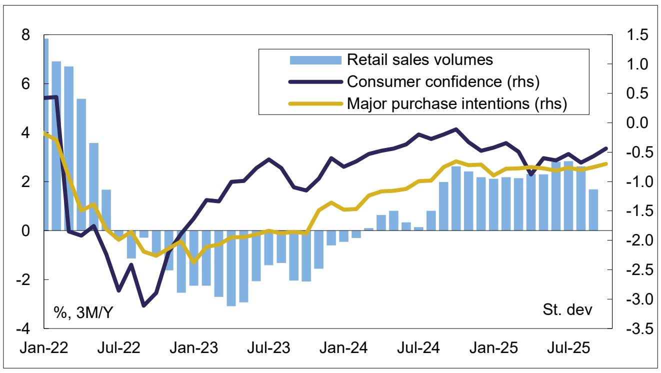
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales volumes*



**Dashed dark blue line represents quarterly averae.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sale & consumer confidence



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

The day ahead in the euro area

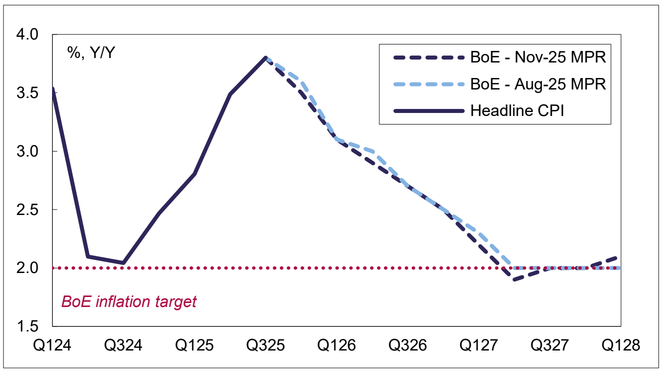
While the production data indicated, somewhat predictably, that German industry was a drag on GDP growth last quarter, we anticipate that tomorrow's German goods trade data will imply some form of positive contribution from net trade. Admittedly, that assumption stems from a relatively larger drop in import volumes since the start of Q3. In fact, German goods exports have contracted in four of the five months since March. And despite the trade framework fleshed out between the EU-US in August, the recent deterioration in German container freight to the US raises concerns about the prospects for an improvement in US-bound exports this quarter. Meanwhile, September's goods trade data from France are likely to confirm that exports provided a non-negligible boost to GDP growth in Q3.

UK

BoE keeps rates steady at 4%, but dovish policy stance strongly suggests a December cut

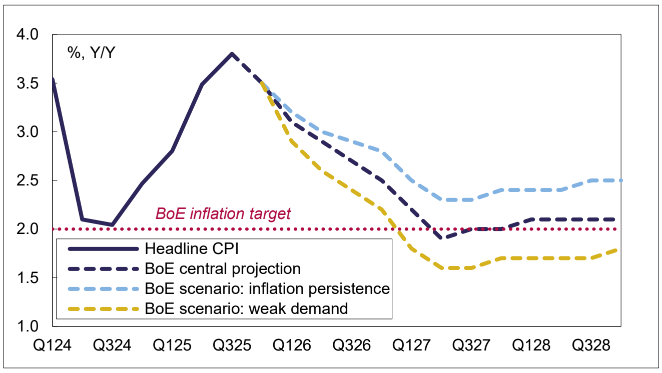
As we expected, the BoE today held Bank Rate unchanged at 4.00%. This marked the first time since August 2024 that the MPC didn't cut rates alongside updated macroeconomic projections. But the 5-4 vote to hold Bank Rate steady was closer than expected, with Deputy Governor Breeden joining the more predictable Deputy Governor Ramsden and external MPC members Dhingra and Taylor in voting to cut rates by 25bps. This reflected greater confidence that the "disinflation process remains on track and that upside risks to inflation are not materialising". Indeed, the policy summary held a more dovish tone this month, with the Committee judging overall risks to the inflation outlook to be "now more balanced", reflecting both less pronounced risks from greater inflation persistence and more apparent risks from weaker demand. So, the MPC left broadly unchanged its forward guidance that Bank Rate is likely to continue a gradual downward path if progress on disinflation continues. Of course, there remains a range of views on the Committee. But Governor Bailey, who had the decisive vote to hold this month, flagged that, in his opinion, upside risks to inflation have become less pressing, pointing to building slack in the economy and recent promising CPI data. But he also acknowledged that the inflation undershoot in September was just one data point and therefore wanted to see further evidence that the inflation peak had passed before pulling the trigger on a further rate cut. At the December policy-setting meeting, the MPC will have two more months of UK inflation, labour market and monthly GDP data to digest, in addition to the detailed measures in the 26 November Autumn budget, to factor into the inflation outlook. And given the expectation that fiscal policy will be tightened non-negligibly, we continue to expect the MPC to cut Bank Rate by 25bps to 3.75% next month.

UK: BoE inflation projections



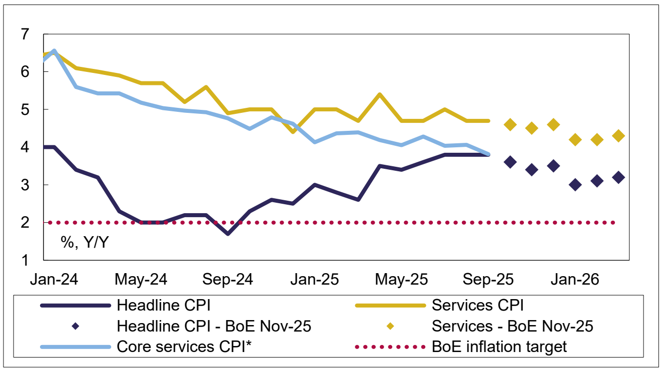
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BoE CPI inflation projections*



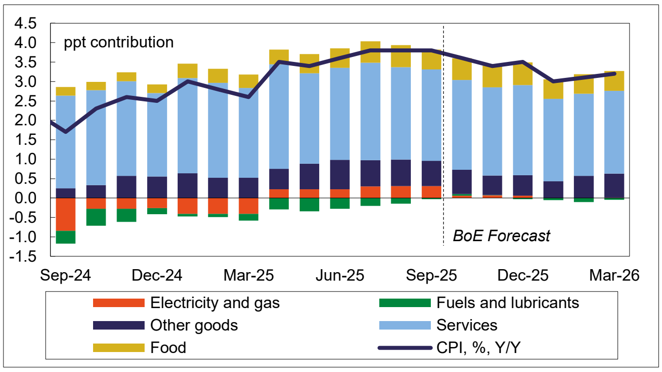
**Nov-25 MPR, based on market-implied path for Bank Rate.*
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Headline & services inflation



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

UK: Contributions to CPI inflation, BoE projections



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

Little change to BoE projections, with inflation expected to return to target in H127

The view that there remains further easing to come reflects the BoE's assessment that monetary policy is still broadly restrictive, albeit less so than a year ago. On the whole, the Bank continued to judge that the underlying services disinflation and recent undershoot in wages relative to its August forecast, as well as signals of continued wage moderation to come – all of which appears consistent with continued labour market loosening and emerging economic slack – means that CPI inflation remains on track to be close to the 2% target by the end of the projection horizon. Indeed, in part reflecting the undershoot of services and food inflation over recent months, the Bank's central projection – based on a market-implied path for Bank Rate that falls to 3.5% by H226 – now sees inflation returning to target in Q227, one quarter earlier than in August. The near-term inflation outlook – which anticipates a drop in headline inflation in the spring as effects of higher employer NICS and administered prices begin to fade – will in part depend on fiscal policy announcements later this month. And while inflation is currently expected to average a touch above target in 2028 at 2.1%Y/Y, we see risks to this forecast to be skewed to the downside due to the likely disinflationary effect of tighter fiscal policy. Indeed, although some members – Pill, Lombardelli, Mann and Greene – place greater weight on risks of inflation persistence, requiring more prolonged monetary restriction, Bailey noted that in his view the Bank's new downside 'weaker demand' scenario seems more likely.

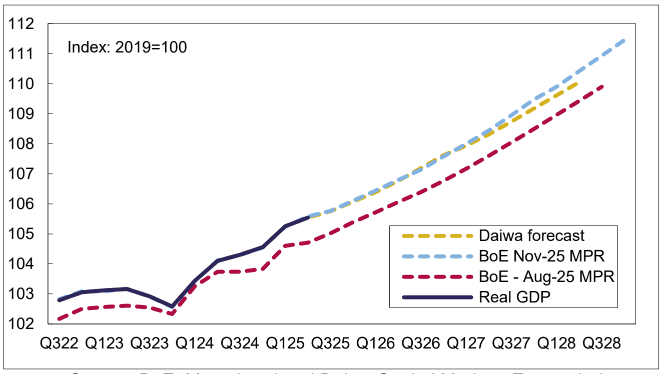
Bank flags concerns about household consumption

The Bank's projections for GDP were tweaked only slightly this month, with higher growth in 2025 (1.5%) to reflect stronger growth in H225. Growth in 2026 (1.2%Y/Y) is expected to remain below potential, before a pickup to 1.6%Y/Y in 2027 and 1.8%Y/Y in 2028, with the margin of spare capacity eroded fully by the end of the forecast period. But despite the firmest growth in the G7 in the first half of the year, the BoE continues to assess that underlying growth remains weak, with survey indicators pointing to only a slight recovery in the second half of the year. While the outlook for the labour market remains uncertain, survey suggestions of ongoing weaker labour demand underpinned its view that unemployment would rise more than previously expected in August. Against this backdrop, the outlook for household consumption remained a particular concern to policymakers, with still elevated savings ratios over recent years raising risks that ongoing caution among households and businesses could hold back demand and weigh on job prospects. As such, the downside scenario flagged the risk of an inflation-target undershoot over the forecast horizon. Overall, we maintain our view that, in addition to a cut in December, the MPC will reduce rates by a further 25bps in Q126 and Q226, taking Bank Rate to 3.25%.

The day ahead in the UK

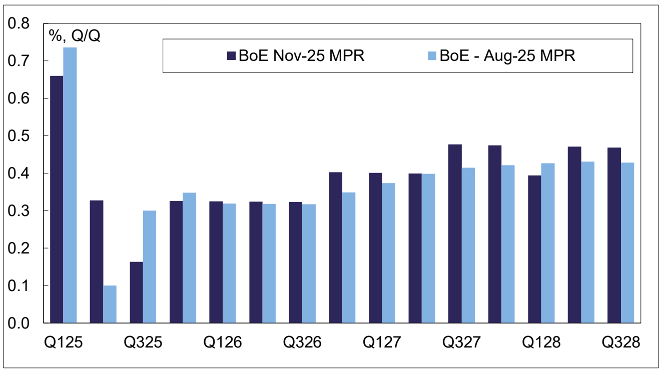
BoE Chief Economist Pill will recommunicate today's monetary policy decision to the Bank's Agents on Friday. But otherwise, with no economic data due, it should be a quiet end to the week for the UK.

UK: BoE projections – GDP levels



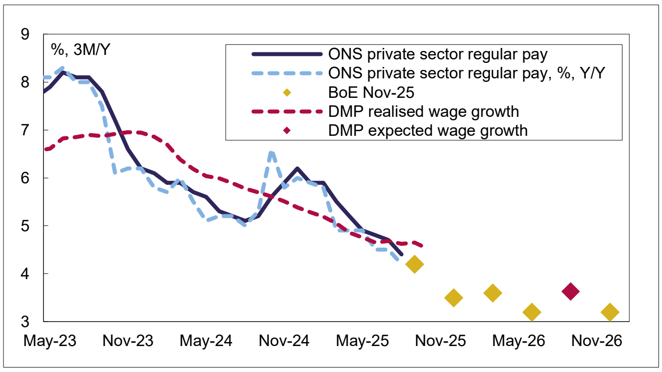
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BoE projections – GDP growth



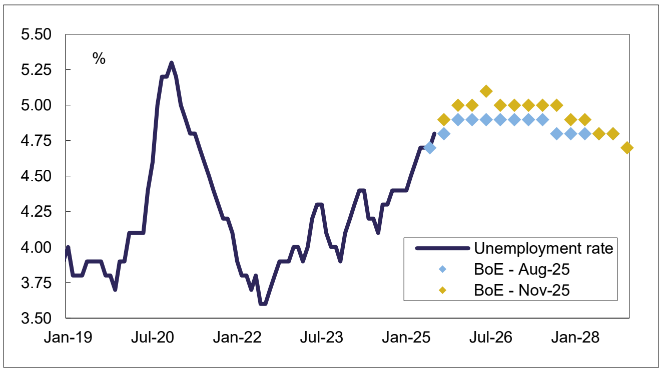
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private sector pay growth



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

UK: BoE unemployment rate projections



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
Euro area		Construction PMI	Oct	**44.0**	-	46.0	-
		Retail sales M/M% (Y/Y%)	Sep	**-0.1 (1.0)**	0.2 (0.9)	0.1 (1.0)	-0.1 (1.6)
Germany		Industrial production M/M% (Y/Y%)	Sep	**1.3 (-1.0)**	3.0 (0.1)	-4.3 (-3.9)	-3.7 (-3.6)
		Construction PMI	Oct	**42.8**	-	46.2	-
France		Preliminary private sector payrolls Q/Q%	Q3	**-0.3**	-	0.2	-
		Construction PMI	Oct	**39.8**	-	42.9	-
Italy		Construction PMI	Oct	**50.7**	-	49.8	-
Spain		Industrial production M/M% (Y/Y%)	Sep	**0.4 (1.7)**	0.2 (1.7)	-0.1 (3.4)	- (3.3)
UK		Construction PMI	Oct	**44.1**	46.9	46.2	-
		BoE Bank Rate %	Nov	**4.00**	*4.00*	4.00	-
		DMP 3M output price (1Y CPI) expectations Y/Y%	Oct	**3.7 (3.4)**	-	3.7 (3.4)	-

Auctions

Country		Auction
France		sold €7.2bn of 3.5% 2035 bonds at an average yield of 3.43%
		sold €2.257bn of 3.6% 2042 bonds at an average yield of 3.92%
		sold €1.526bn of 3% 2049 bonds at an average yield of 4.12%
Spain		sold €1.82bn of 3% 2033 bonds at an average yield of 2.848%
		sold €1.21bn of 1.85% 2035 bonds at an average yield of 3.111%
		sold €1.48bn of 3.5% 2041 bonds at an average yield of 3.616%
		sold €534mn of 1.15% 2036 inflation-linked bonds at an average yield of 1.392%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		07.00	Trade balance €bn	Sep	16.7	16.9
France		07.45	Trade balance €bn	Sep	-	-5.5
		07.45	Preliminary wages Q/Q%	Q3	-	0.5

Auctions and events

Country		GMT	Event
Germany		12.00	Bundesbank President & ECB Governing Council's Nagel in conversation with Fed Vice Chair Jefferson, Frankfurt
UK		15.15	BoE Chief Economist Pill to brief Bank's Agents on updated macroeconomic projections

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.