

Euro wrap-up

Overview

- Bunds followed USTs lower, while euro area industrial output moved broadly sideways in September to provide a neutral contribution to GDP in Q3.
- Gilts also made losses even as UK GDP surprised to the downside in Q3 as a predictable slump in car production dragged on economic activity in September.
- Friday will bring updated estimates of euro area GDP in Q3 and French and Spanish inflation in October.

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Daily bond market movements

Bond	Yield	Change
BKO 2 12/27	2.023	+0.029
OBL 2.2 10/30	2.290	+0.045
DBR 2.6 08/35	2.685	+0.044
UKT 3½ 03/27	3.754	+0.035
UKT 4½ 03/30	3.897	+0.033
UKT 4½ 03/35	4.434	+0.037

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

Euro area

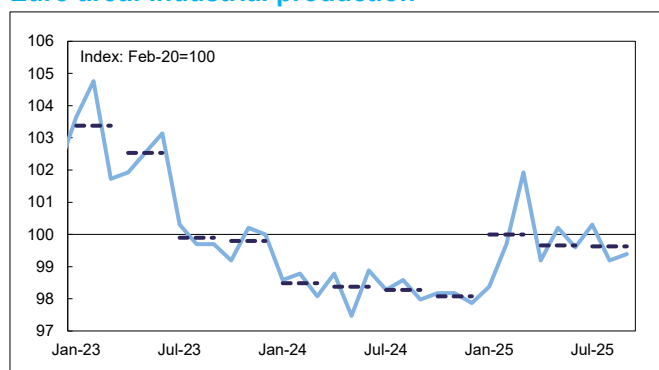
Despite subdued September bounce back & tariff headwinds, euro area IP moved sideways in Q3

Given that the considerable contraction in euro area industrial production in August (-1.1%M/M) related in part to seasonal maintenance shutdowns, there was a strong expectation for some payback in September. In the event, the 'bounce' amounted to a meagre 0.2%M/M, broadly in line with our expectations but well below the Bloomberg consensus. This left the level of output some 2½% below the March's pre-tariff acceleration. While IP rebounded in France (0.8%M/M), Italy (2.8%M/M) and partially in Germany (1.9%M/M), a predictable decline in Ireland (-9.4%M/M) significantly dampened the core member states' impact on the headline number. Nevertheless, with the drop in August a touch smaller than initially thought, today's release suggested that euro area IP was flat last quarter, consistent with a neutral contribution to GDP in Q3. Germany and Italy – which account for roughly half of aggregate euro area industrial capacity and are relatively more exposed to US demand than most of their peers – unsurprisingly contracted by 0.8%Q/Q and 0.5%Q/Q respectively. The decline in the former owed in no small part to the weakness of autos production, exaggerated by [summer maintenance](#). And so there was a near-equivalent pullback (-3.8%Q/Q) in the aggregate euro area, despite growth of 7.1%M/M in September. But in spite of a sharp decline on the month, pharma production rose (2.4%Q/Q) in Q3, while general and electrical machinery output also increased in Q3, with the later to the highest level for six months. While production in the core manufacturing states will have to weather the adjustment to higher tariffs a while longer, business surveys cautiously point to near-term stabilisation in the sector. Indeed, the Commission's survey reported the strongest production growth in October for 2½ years, while the PMIs signalled the greatest optimism about future output for 3½ years, tentatively suggesting that a pickup in manufacturing activity in Q4 might be on the cards.

The day ahead in the euro area

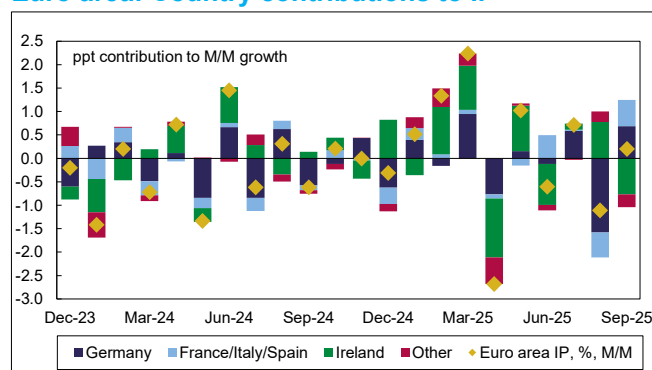
Anticipating a slightly narrower euro area goods trade surplus in September – to mirror last week's German data – we expect Friday's trade data to perhaps imply a broadly neutral contribution from net trade to Q3 GDP in the euro area. Taken alongside the sideways movement in industrial output, Friday's second estimate of euro area Q3 GDP seems bound to be left unchanged at 0.2%Q/Q. Of course, a breakdown by expenditure components won't be published until the final release on 5 December. Nonetheless, tomorrow's release will include preliminary estimates for employment growth in Q3. That number, however, will inevitably reflect its trend so far this year; ongoing positive growth in Spain compensating for the weakness in the core bloc of member states, including negative growth in Germany. As such, we expect employment growth to be maintained the same pace as Q2 (0.1%Q/Q), while slowing slightly on an annual basis to around 0.5%Y/Y.

Euro area: Industrial production*



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Country contributions to IP



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

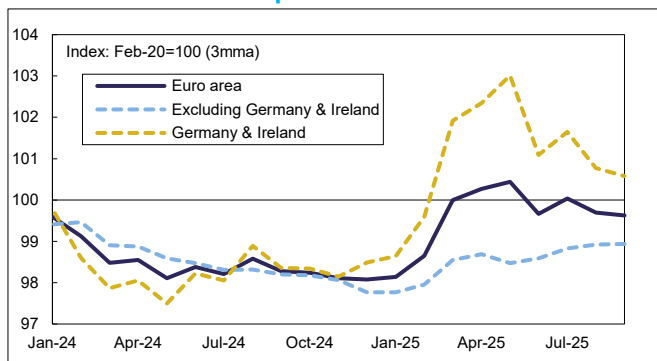
French and Spanish inflation detail are also due on Friday, although much like Wednesday's German release, we wouldn't expect any surprises. The German detail confirmed that the moderation in the headline reading (down 0.1ppt to 2.3%Y/Y) owed principally to a base effect-assisted drop in food inflation. The flash release for French inflation (down 0.2ppt to 0.9%Y/Y), similarly benefitted from easing food inflation and a predictable drop in energy prices (also flattered by base effects). Meanwhile, in Germany, upwards pressure from transport services – chiefly rail prices and the often-volatile airfares categories – provided the upwards impulse for a pick up in services inflation to a five-month high (3.6%Y/Y). Transport services, in addition to electricity inflation, are expected to have driven the surprise uptick in Spain too, assuming that its final release aligns with the flash reading of 3.2%Y/Y. Nonetheless, underlying services prices in Germany still look to be gradually easing, particularly in more persistent, slow moving components such as insurance, which supports expectations that inflation will resume its downtrend at the end of the year.

UK

Q3 GDP growth slows more than expected, strengthening case for a December rate cut

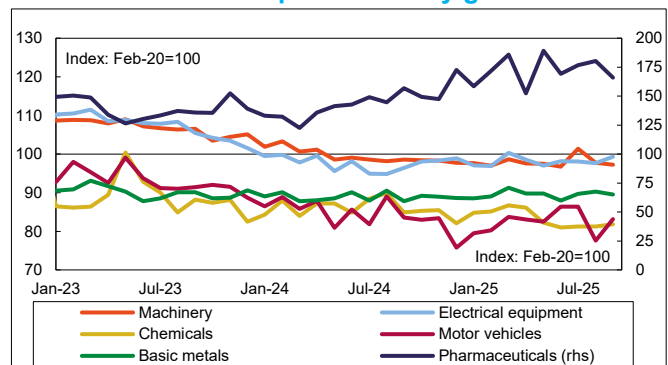
UK GDP growth in Q3 fell short of expectations, slowing to 0.1%Q/Q, the softest in seven quarters and 0.1ppt below the Bloomberg survey consensus and BoE projections. While this left economic output up 1.3%Y/Y – arguably close to potential – and more than 5% above the Q419 level, it also marked a significant moderation from the first half of the year when annualised growth of 1.9% was the strongest of the G7 countries. Moreover, the positive outturn last quarter merely reflected the strong carry over from June. When adjusting for population, a sideways move in GDP per capita in Q3 reinforced the lacklustre underlying performance in the economy of recent years – indeed, output on this measure was still less than 1% above the pre-pandemic benchmark almost six years ago. Undoubtedly, the slowdown last quarter in part reflected one-offs, such as the prolonged hit to production during the cyber-attack on Jaguar Land Rover (see below) and a further notable inventory adjustment. And it might also partly reflect the pattern of recent years, perhaps due to inadequate seasonal adjustment. While recent surveys point to a rebound in manufacturing in October, there will be a negative carry over into Q4. And with businesses and consumers likely more hesitant in anticipation of higher taxes to be announced in the Autumn Budget, we expect only a modest increase in GDP growth this quarter. Overall, coming on the back of the past week's soft [labour market](#) report, today's data illustrates building slack in the economy, further strengthening the case for a rate cut at the next BoE policy-setting meeting in December.

Euro area: Industrial production



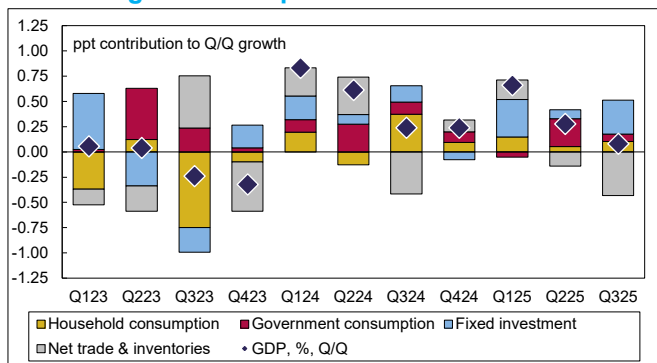
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production by good



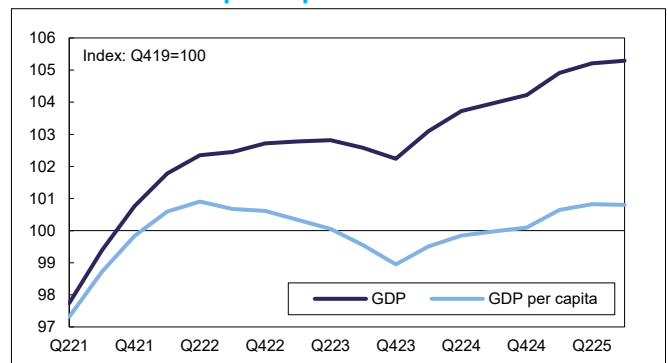
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & expenditure contributions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP & GDP per capita



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

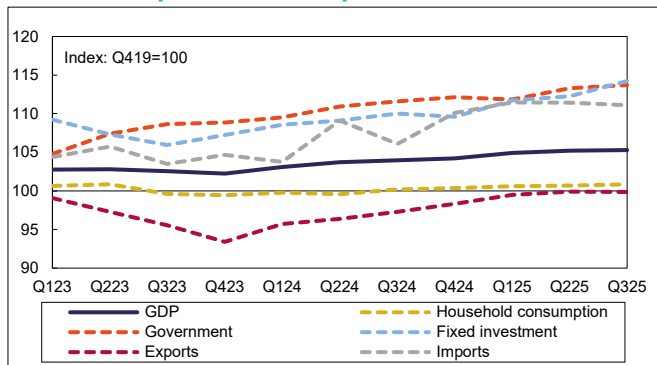
Fixed investment boosted by fiscal policy, but household consumption and exports remain weak

The expenditure breakdown was arguably more encouraging than the headline rate, suggesting solid growth in final domestic demand around $\frac{1}{2}\%$ Q/Q for a third consecutive quarter. This reflected a notable contribution from fixed investment, which jumped 1.8%Q/Q to add 0.3ppt to GDP growth, due to sharp increases in spending on ICT and other machinery equipment, housebuilding and intellectual property. That was underpinned by stronger government investment as last year's fiscal policy decisions continued to feed through. In contrast, however, business fixed capex fell for a third quarter out of four, likely reflecting persisting uncertainties relating to global trade and heightened caution ahead of the Autumn Budget announcements. Growth in government consumption also slowed in Q3 as the vaccination boost in Q2 faded. Meanwhile, private consumption growth remained subdued, rising just 0.2%Q/Q in Q3, thus contributing minimally to GDP growth as consumers preferred to build savings in the face of persisting uncertainties. And while net trade added 0.1ppt to GDP growth in Q3, this reflected a greater decline in imports last quarter, illustrating weak domestic demand. Export volumes also fell slightly (-0.1%Q/Q) for the first quarter in seven reflecting a fall in shipments of machinery, transport equipment and chemicals. While adjustments in trade are often counterbalanced by private inventories, the ONS estimated they knocked 0.5ppt off GDP, the most in four quarters.

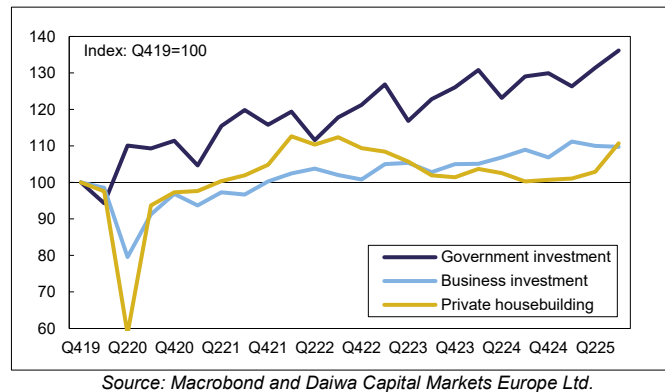
Weakness in September production driven by halt at JLR, but services returned to modest growth

The softer-than-expected outturn in Q3 is hardly surprising given that economic output failed to grow in any month last quarter. In addition to a downward revision to the figure for August (by 0.1ppt to 0.0%M/M), today's monthly GDP data showed that output fell 0.1%M/M in September to a four-month low. As expected, this was driven by a temporary retrenchment in the autos industry, where production fell a whopping 28.6%M/M – a series-record outside the plunge in first Covid-19 lockdown – amid the production halt at Jaguar Land Rover and its associated impact on supply chains. Overall, car production (or lack thereof) knocked 0.17ppt off monthly GDP in September, leaving output in the subsector down more than 10%Q/Q in Q3. Production of pharmaceuticals, chemicals and iron and steel products also fell back. So, despite strong growth in ICT and electrical equipment, total industrial production contracted 2.0%M/M in September – the most since January 2021 – and 0.5%Q/Q in Q3. More encouragingly, services activity returned to growth in September for the first month in three, to record the seventh consecutive quarterly rise (0.2%Q/Q), albeit the softest for a year. Growth was led by the arts and entertainment, real estate and public administration and defence sectors. But despite a boost from retail, consumer-facing services edged lower in Q3. And despite a rise in private housing repair and maintenance, growth in construction activity slowed sharply to provide no support to GDP last quarter.

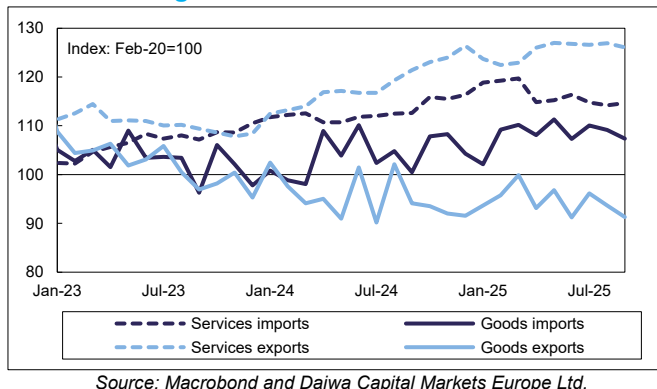
UK: GDP expenditure components



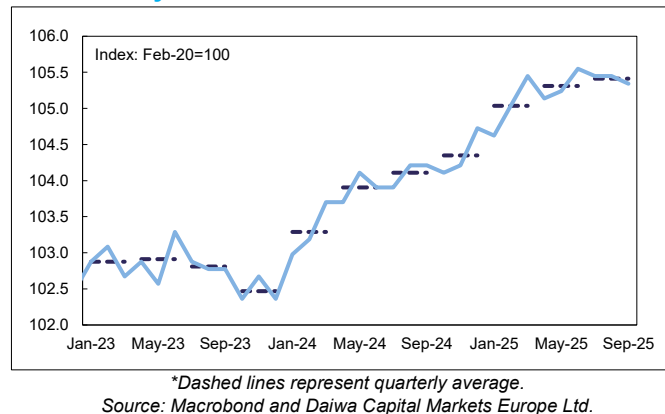
UK: Fixed investment



UK: Trade in goods & services



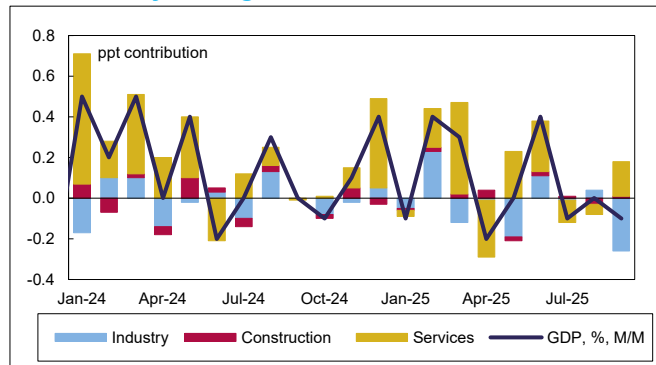
UK: Monthly GDP*



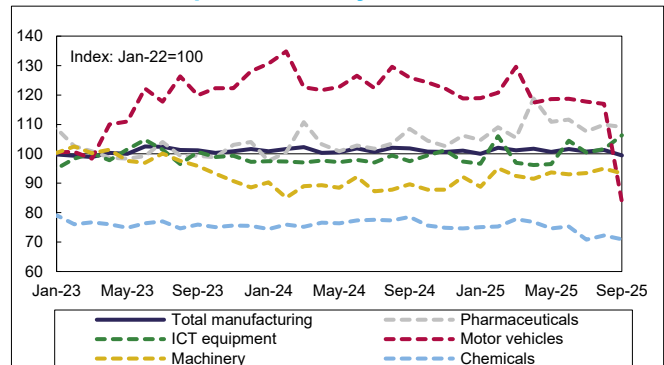
The day ahead in the UK

Following this week's distinctively soft labour market report, the most significant economic news from the UK on Friday will likely come from the REC's jobs report for October. Forward-looking indicators of labour market conditions have been broadly downbeat, supporting expectations for a continued downtrend in wage growth to year-end. But reflective of the conflicting views on the MPC, there have recently been some contrasting signals about the extent to which the labour market continues to loosen, like the latest divergence between October's improvement in the composite employment PMI and the still-weak hiring intentions signalled in the BoE's DMP. As such, the REC report will provide another valuable input for those assessments.

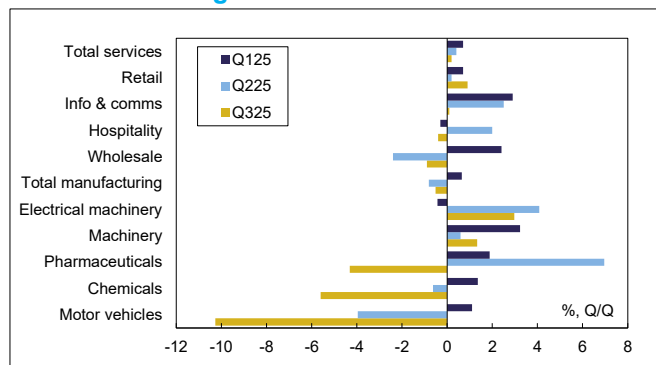
UK: Monthly GDP growth & contributions



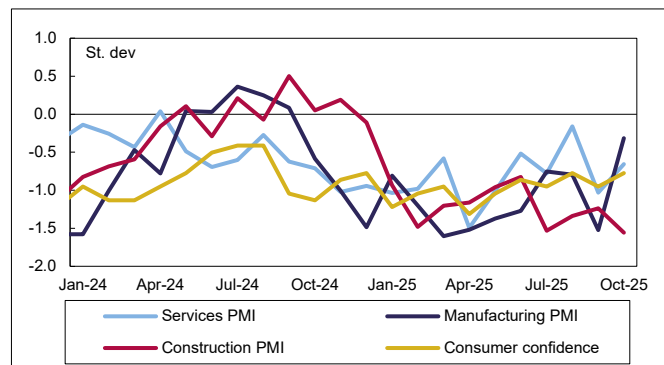
UK: Industrial production by selected subsector



UK: Production growth in selected subsectors



UK: Business & consumer sentiment indices



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	Industrial production M/M% (Y/Y%)	Sep	0.2 (1.2)	0.7 (2.0)	-1.2 (1.1)	-1.1 (1.2)
France	ILO unemployment rate (mainland) %	Q3	7.7 (7.5)	7.6 (7.3)	7.5 (7.3)	7.6 (7.4)
UK	GDP – first estimate Q/Q% (Y/Y%)	Q3	0.1 (1.3)	<u>0.2 (1.4)</u>	0.3 (1.4)	-
	Preliminary output per hour Y/Y%	Q3	1.1	-	-0.8	-
	Monthly GDP M/M% (3M/3M%)	Sep	-0.1 (0.1)	0.0 (0.2)	0.1 (0.3)	0.0 (0.2)
	Services output M/M% (3M/3M%)	Sep	0.2 (0.2)	0.1 (0.3)	0.0 (0.4)	-0.1 (0.3)
	Industrial output M/M% (Y/Y%)	Sep	-2.0 (-2.5)	-0.2 (-1.3)	0.4 (-0.7)	0.3 (-0.5)
	Construction output M/M% (Y/Y%)	Sep	0.2 (1.3)	0.0 (1.0)	-0.3 (1.0)	-0.5 (1.1)
	Trade (goods trade) balance £bn	Sep	-1.1 (-18.9)	-3.1 (-20.8)	-3.4 (-21.2)	-1.3 (-19.5)
	RICS house price balance %	Oct	-19	-14	-15	-17

Auctions

Country	Auction
Italy	sold €3.5bn of 2.35% Jan 2029 bonds at an average yield of 2.38% sold €1.5bn of 3.25% Jul 2032 bonds at an average yield of 2.95% sold €1.5bn of 3.25% Nov 2032 bonds at an average yield of 3% sold €1.5bn of 4.65% Oct 2055 bonds at an average yield of 4.3%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	Final HICP (CPI) Y/Y%	Oct	2.3 (2.3)	<u>2.3 (2.3)</u>	2.4 (2.4)	-
Italy	Industrial production M/M% (Y/Y%)	Sep	2.8 (1.5)	1.5 (-0.5)	-2.4 (-2.7)	-2.7 (-3.0)

Auctions

Country	Auction
Germany	sold €898mn of 2.5% 2046 bonds at an average yield of 3.15% sold €1.14bn of 2.9% 2056 bonds at an average yield of 3.26%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	10.00	GDP – second estimate Q/Q% (Y/Y%)	Q3	<u>0.2 (1.3)</u>	0.1 (1.5)
	10.00	Employment – first estimate Q/Q% (Y/Y%)	Q3	<u>0.1 (0.5)</u>	0.1 (0.6)
	10.00	Trade balance €bn	Sep	-	9.7
France	07.45	Final HICP (CPI) Y/Y%	Oct	<u>0.9 (1.0)</u>	1.1 (1.2)
Spain	08.00	Final HICP (CPI) Y/Y%	Oct	<u>3.2 (3.1)</u>	3.0 (3.0)

Auctions and events

Euro area	15.00	ECB Chief Economist Lane speaks on policy panel hosted by SNB, Zurich
UK	00.01	REC, KPMG & S&P Global UK Report on Jobs for October

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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