

Euro wrap-up

Overview

- Bunds were little changed as final euro area inflation data for October aligned with the flash estimate, with the modest uptick relating to likely temporary price pressures in volatile services components.
- While UK inflation fell for the first month in five in October, Gilts made losses as uncertainty about fiscal policy ahead of next week's budget persisted.
- Thursday will bring the flash Commission consumer confidence indicator for November, euro area construction activity for September and a UK manufacturing survey.

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Daily bond market movements

Bond	Yield	Change
BKO 2 12/27	2.010	-0.005
OBL 2.2 10/30	2.289	-0.002
DBR 2.6 08/35	2.709	-0.004
UKT 3% 03/27	3.798	+0.008
UKT 4% 03/30	4.002	+0.033
UKT 4½ 03/35	4.605	+0.054

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

Euro area

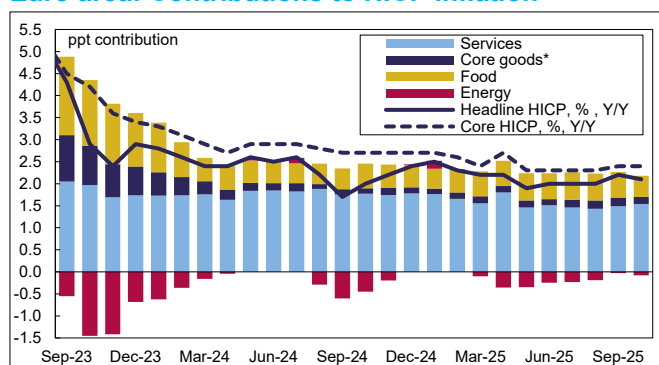
Euro area inflation just above target in October, despite six-month high in services inflation

As expected, October's final inflation print affirmed its flash release. Having taken a predictable step-up on unfavourable energy base effects in September, headline inflation moderated 0.1ppt to 2.1%Y/Y, in line with the Q3 average and just a touch above the ECB's inflation target. The energy component, however, had a more muted impact this time around. Indeed, while that still declined ½ppt to slightly increase its drag on the headline rate, the drop in food inflation – by a similar ½ppt to a nine-month low of 2.5%Y/Y – applied the most downward pressure to headline inflation. Within the food category, softer butter (down 9.3ppts to -3.7%Y/Y) and vegetables inflation offset a further increase in meat prices. Core inflation, meanwhile, held steady at 2.4%Y/Y for a second month, despite a weaker contribution from core goods (down 0.2ppt to 0.6%Y/Y). So, services inflation provided the principal source of upwards pressure, rising 0.2ppt to a six-month high of 3.4%Y/Y. While admittedly an unpleasant headline, however, we would note that the increase to two decimal places (0.12ppt to 3.36%Y/Y) was not particularly alarming. And the single largest cause for that increase can be attributed to transport services, mostly related to typical monthly volatility in airfares. Reassuringly, other recently persistent services components showed further signs of gradual softening. Insurance, for example, fell to a 22-month low (5.3%Y/Y) amid slower growth in home and car insurance premiums. Consequently, measures of underlying inflation were also encouragingly stable.

Uptick in services inflation to be temporary, with inflation to dropping below target in 2026

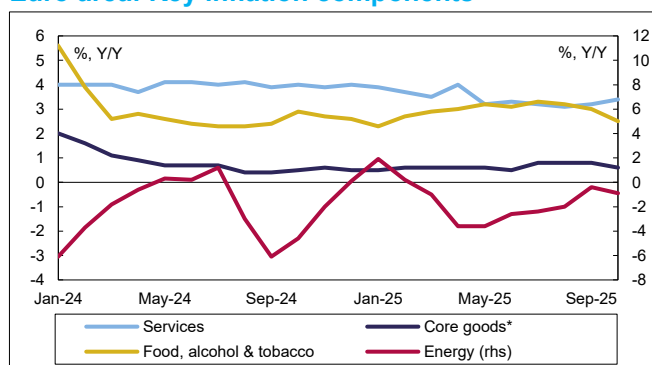
Despite October's minimal relief, we expect headline and core euro area inflation to tick up gradually over the last two months of the year, averaging 2.2%Y/Y in Q4. That predominantly reflects our expectation for an uptick in services inflation, which itself is more reflective of unfavourable base effects. But we expect a greater drag from energy inflation to bring the headline rate back below the 2% target thereafter, while services will resume a more pronounced disinflationary trend due in part to events in the labour market. Indeed, while the euro area unemployment rate remains close to its historic lows (6.3%), that in part reflects the absorption of slack in southern Europe. The labour market in the core member states, by comparison, continues to show signs of gradual loosening. Today's flash labour market statistics for Q3 suggested that the euro area job vacancy rate eased 0.1ppt to 2.2%, its lowest since Q121 and below its pre-pandemic level in Q419. Predictably, the reduction was led by fewer openings in Germany and France. And labour cost growth also showed signs of moderation, albeit, at 3.5%Y/Y, only 0.1ppt lower than in Q225. Friday's negotiated wages release seems likely to signal a more pronounced slowdown in wage settlements, consistent with that signalled by the ECB's forward-looking wage tracker. Indeed, additional to a further sharp slowdown in the current quarter, the wage tracker has pointed towards a more gradual rate of increase in wage settlements through to Q326 (2-2½%Y/Y), consistent with our view for moderating services inflation over the course of next year. And as a result, like the ECB, we see headline inflation at averaging just 1.7% throughout 2026.

Euro area: Contributions to HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Key inflation components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

The day ahead in the euro area will bring a handful of notable economic data releases, of which the Commission's flash consumer confidence reading for November will perhaps garner most attention following a second consecutive monthly rise in October to an eight-month high of -14.2. Otherwise, September's construction production figures are also due. With output contracting in both Germany (-0.9%M/M) and France (-1.3%M/M), we expect a negative outturn for the euro area of around ½M/M. Predictably, that result would also imply a continued drag from the sector on GDP growth last quarter, albeit more modest than the downwardly revised contraction in Q2. German PPI data for October will also provide a first view to underlying pipeline price pressures in the euro area.

UK

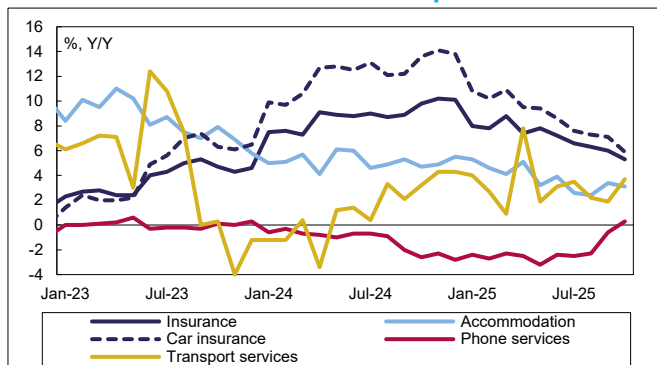
Inflation declines for first month in five, reinforcing our expectation for a December rate cut

At the November MPC meeting, the BoE's policymakers judged that risks to the inflation outlook had become more balanced. This notwithstanding, a small majority of MPC members voted to keep Bank Rate steady, with Governor Bailey – who seemingly cast the decisive vote – requiring more evidence that inflation had peaked before pulling the trigger on a further rate cut. But coming on the back of last week's soft [labour market](#) and [GDP](#) reports, today's inflation data further supported our expectation that the MPC will cut Bank Rate in December by 25bps to 3.75%. Indeed, the headline CPI rate fell for the first month in five in October, by 0.2ppt to 3.6%Y/Y, bang in line with the Bank's expectation. Admittedly, this remains a full percentage point above the March reading ahead of the policy- and energy-related leap in April. But to two decimal places, the headline rate (3.56%Y/Y) was on the soft side. And core inflation moderated for a fourth successive month, by 0.1ppt to 3.4%Y/Y, the joint softest rate so far in 2025, suggesting that underlying price pressures continue gradually to recede.

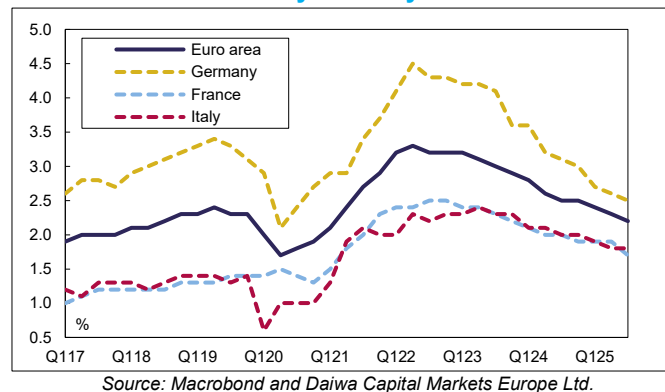
Inflation moderation led by energy and services, offsetting a rebound in food

Admittedly, the main source of downwards pressure in October came from energy, whose decline was flattered by base effects related to Ofgem's household energy price cap. Indeed, despite a pickup in petrol prices, the increase in overall energy prices in October (1.3%M/M) was just one third of the rise a year ago, to push down inflation of that component by 2.5ppts to 1.8%Y/Y, a three-month low. More importantly perhaps, services inflation also surprised to the downside compared with the BoE's projection, easing 0.2ppt to 4.5%Y/Y, a ten-month low. But this in part reflected a moderation in volatile components such as airfares, package holidays and accommodation services. The hawks on the MPC might also

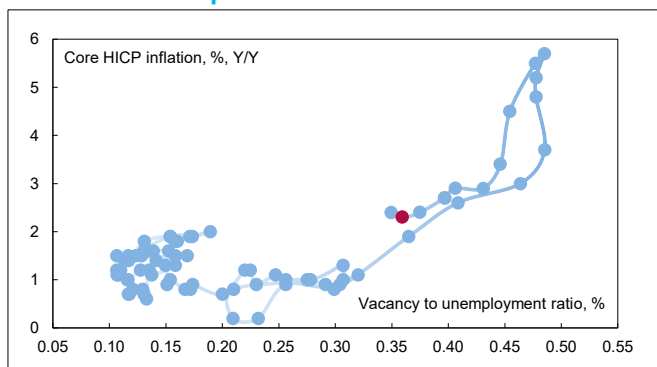
Euro area: Selected services components inflation



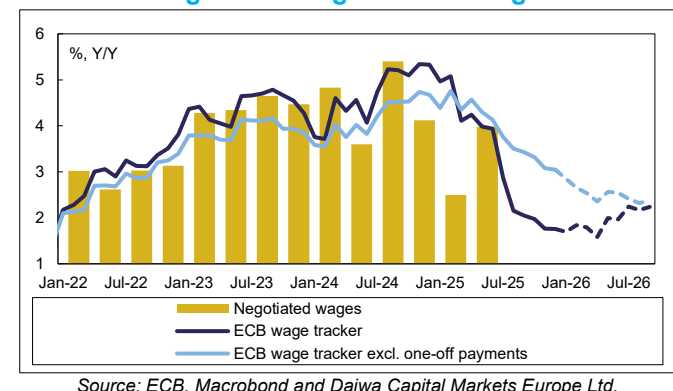
Euro area: Job vacancy rates by member state



Euro area: Phillips curve*



Euro area: Negotiated wages & ECB wage tracker

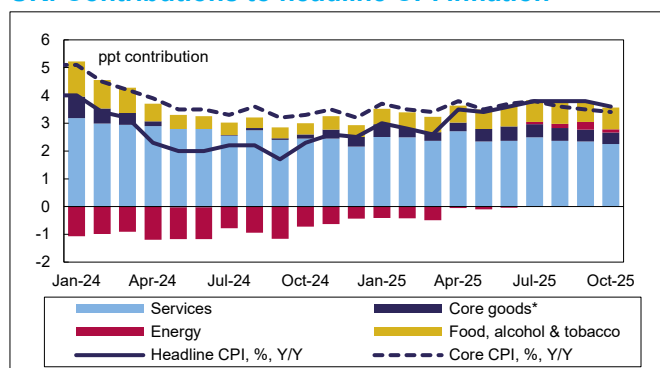


caution that inflation rates of more than one third of services components remain more than 2ppts above their pre-pandemic averages. This notwithstanding, a measure of underlying services excluding indexed and volatile components – which is watched by policymakers – edged only slightly higher in October, remaining below 4%Y/Y and still close to September's four-year low. Meanwhile, core goods inflation held steady at just 1.5%Y/Y, with modest downward pressures in clothing, household appliances and sports equipment offsetting modest upwards pressures from new cars and medical equipment. Policymakers concerned about risks of second-round effects via expectations might point to the rebound in food inflation (up 0.5ppt to 4.8%Y/Y). But the uptick related to a rise in prices of sugar- and chocolate-coated cereals, rather than a broader-based pick up. Moreover, food inflation undershot slightly relative to the BoE's forecast.

Inflation outlook subject to uncertainty, but likely supportive of additional monetary easing

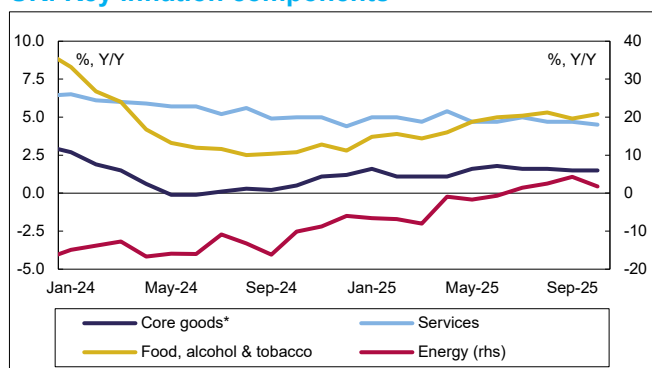
The UK inflation outlook remains subject to significant uncertainty, not least due to a range of government policy measures to be announced in next week's Budget which could have contrasting impacts on prices. Many administered and regulated prices, including water bills and social housing rents, look set to rise less in the coming year than in 2025. But the opposite might be true for rail fares. And while VAT and green levies might be cut on electricity bills, a new tax might be introduced on electric vehicles. At least, however, the inflationary impact of April's increase in employer NICs should soon have fully dissipated. The more hawkish BoE policymakers might well look through the impact of one-off Budget-related effects that temporarily dampen inflation. But the rising amount of slack in the economy, which will likely be exacerbated by the net tightening of the fiscal stance, will weigh more heavily on underlying inflation. Indeed, after a policy-related drop in services inflation in April, the continued slowing of pay growth should support a gradual further moderation in price pressures thereafter. Core goods pressures are also expected to fade over coming months amid soft demand and a possible inflow of cheaper Chinese goods diverted away from the US. And with the Ofgem household energy price cap likely to be cut in January (the exact tariff will be confirmed on 25 November), energy inflation should fall back into negative territory in early 2026. So, while we expect headline inflation to move broadly sideways close to 3½%Y/Y in Q425 due not least to sticky food inflation, it should fall close to 3.0%Y/Y by end-Q126 and around 2½%Y/Y at the start of Q2. And with inflation expected to be back at the 2% target in 2027, after the cut next month, we expect the BoE to ease policy at least once more in early 2026.

UK: Contributions to headline CPI inflation



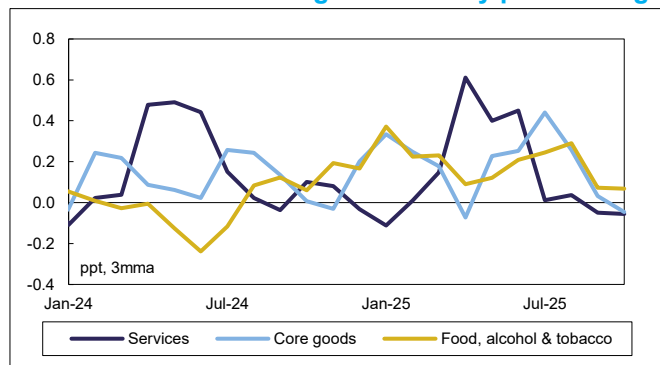
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Key inflation components



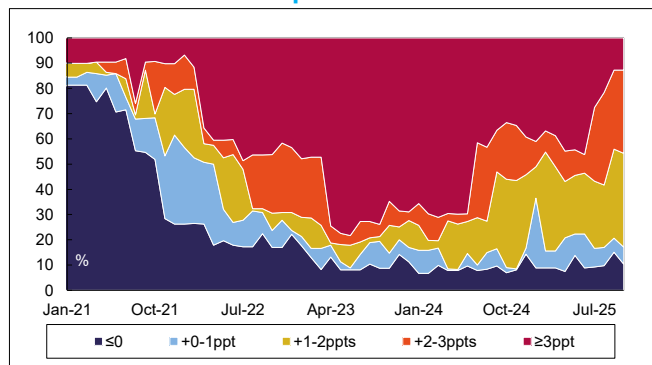
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Deviations from long-run monthly price change*



*Monthly change in prices relative to average for the month in the decade before the pandemic. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services inflation persistence*

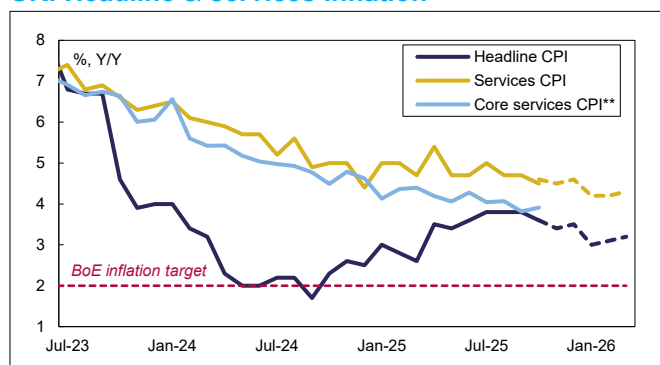


*Weighted share of services inflation relative to the respective averages from 2012-2019. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

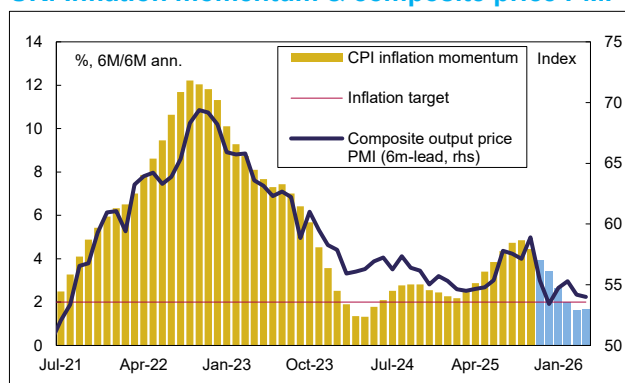
With a host of top-tier economic data due at the end of the week – most notably featuring November's flash PMIs and retail sales figures for October – Thursday looks set to be a quieter day for UK economic news. On the data front, the CBI's industrial trends survey for November will provide the sole release. And while that survey last month was comparably unperturbed by the phased restart of production at Jaguar Land Rover, it may provide a signal as to the prospects for a sustained improvement in the manufacturing PMIs ahead of their release. MPC external member Swati Dhingra – a long-established member of the MPC's dovish camp, and one of the four dissenting votes for a cut in November – is also due to deliver a speech on trade.

UK: Headline & services inflation*



*Dashed lines represent BoE projections from the Nov-25 MPR. **Services excluding indexed and volatile components. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

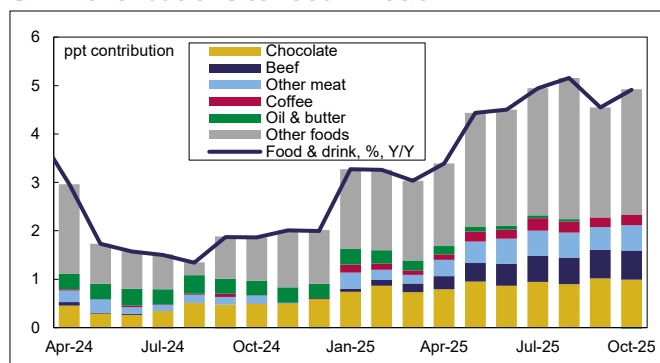
UK: Inflation momentum & composite price PMI*



*Non-energy industrial goods.

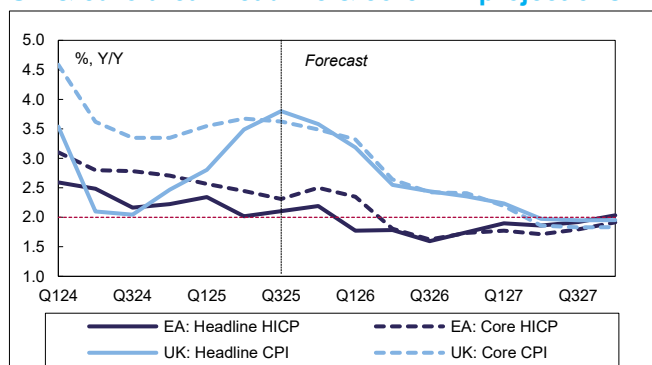
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Contributions to food inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK & euro area: Headline & core CPI projections*



*Daiwa forecast. 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	Final headline (core) HICP Y/Y%	Oct	2.1 (2.4)	2.1 (2.4)	2.2 (2.4)	-
	Preliminary labour costs Y/Y%	Q3	3.5	-	3.6	-
	Preliminary job vacancy rate %	Q3	2.2	-	2.3	-
	ECB current account balance €bn	Sep	23.1	-	11.9	22.2
UK	Headline (core) CPI Y/Y%	Oct	3.6 (3.4)	3.4 (3.4)	3.8 (3.5)	-
	PPI – output (input) prices Y/Y%	Oct	3.6 (0.5)	3.4 (0.6)	3.4 (0.8)	3.5 (0.7)
	House price index Y/Y%	Sep	2.6	-	3.0	3.1

Auctions

Country	Auction
UK	sold £4.5bn of 4.75% 2035 bonds at an average yield of 4.608%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tuesday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
- Nothing to report -						

Auctions

Country	Auction
UK 	sold £1.25bn of 4.75% 2030 bonds at an average yield of 3.896%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Italy 	Final HICP (CPI) Y/Y%	Oct	1.3 (1.2)	<u>1.3 (1.2)</u>	1.8 (1.6)	-
UK 	Rightmove house prices M/M% (Y/Y%)	Nov	-1.8 (-0.5)	-	0.3 (-0.1)	-

Auctions

Country	Auction
- Nothing to report -	

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	Construction output M/M% (Y/Y%)	Sep	-	-0.1 (0.1)
	15.00	Preliminary Commission consumer confidence indicator	Nov	-14.0	-14.2
Germany 	07.00	PPI Y/Y%	Oct	-1.7	-1.7
UK 	11.00	CBI industrial trends survey – total orders (selling prices) balance %	Nov	-	-38 (16)

Auctions and events

France 	09.50	Auction: to sell up to €12bn of 2.4% 2028, 2.7% 2031, 1.5% 2031 & 3.5% 2033 bonds			
	10.50	Auction: to sell up to €1bn of 0.1% 2036, 1.8% 2040 & 0.1% 2053 inflation-linked bonds			
Spain 	09.30	Auction: to sell 3% 2033, 3.2% 2035 & 4% 2054 bonds			
UK 	10.00	Auction: to sell £300mn of 0.25% 2052 inflation-linked bonds			
	12.00	MPC external member Dhingra gives speech on 'navigating the future of trade and tariffs' in lecture at the University of Bristol			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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