Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Edward Maling
+44 20 7597 8030

- Gilts outperformed as the UK budget raised taxes to keep public borrowing on a downtrend and added significantly to headroom relative to the government's principal fiscal target.
- Bunds were little changed on a quiet day for euro area economic data.
- Thursday will bring the Commission's latest sentiment survey, euro area bank lending data and the ECB's account of its October policy-setting meeting.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/27	2.014	+0.003
OBL 2.2 10/30	2.266	-0.002
DBR 2.6 08/35	2.408	-0.001
UKT 3¾ 03/27	3.717	-0.029
UKT 4⅜ 03/30	3.873	-0.054
UKT 4½ 03/35	4.422	-0.070

*Change from close as at 5:00pm GMT.
Source: Bloomberg

UK

Budget pushes tax burden to record high to keep borrowing on downtrend & add to headroom

As had been clear following the past days' media leaks, today's Budget announcement proposed – for a second successive year – a substantive increase in the tax burden to restore recent slippage and maintain UK public net borrowing as a share of GDP on a steady downwards path. Unlike last year's Budget when the burden fell squarely (and damagingly) on business, the larger share of tax hikes this time around fell on households. Revenue-raising measures included an extension of the freeze to personal tax thresholds from FY28/9, as well as the application of National Insurance Contributions to salary-sacrificed pension contributions, increased income tax rates on property, savings and dividends, higher taxes on gambling and a new mileage-based charge on EVs. While she added to public spending relative to previous plans, the Chancellor also set policy to increase headroom relative to the government's binding 'balanced current budget' rule. And while much of the extra adjustment was backloaded as many of the tax hikes will necessarily require time to prepare the ground for implementation, the policies appeared broadly deliverable and the total planned fiscal tightening of sufficient magnitude to give Gilts a boost, especially at the longer end of the curve, while sterling benefited too.

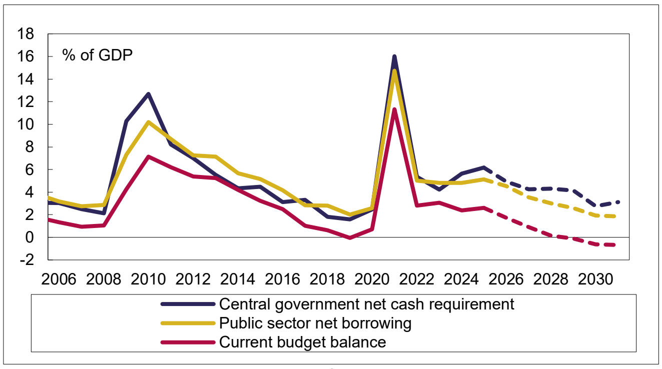
Despite welfare U-turns, government spending as % of GDP to edge down slightly over the horizon

According to the OBR's updated arithmetic, having increased taxation by about £40bn over four years last October, the Chancellor proposed today to raise taxation by a further £26bn by the end of the current parliament in FY29/30. That will push the tax take as a share of GDP up from less than 35% last fiscal year to a record high slightly above 38%, hardly something to benefit growth potential. Meanwhile, largely due to welfare measures including recent U-turns relative to winter fuel payments and disability reforms, as well as today's confirmation of the removal of the two-child limit within Universal Credit, public spending was set by the Chancellor to rise by about £11bn relative to plan over the same period. But as a share of GDP, central government spending was still set to edge down slightly over the horizon.

Fiscal arithmetic more credible than recent years due to more realistic productivity assumption

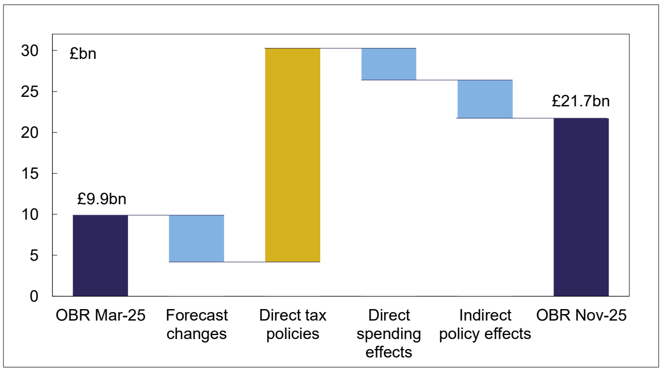
As a result of today's new policy measures as well as some forecast revisions, the current budget balance (i.e. borrowing excluding investment) is now forecast to move close to zero by FY27/8. And the Chancellor increased her buffer above her target to balance the current budget by FY29/30 by about £12bn to a more ample £22bn, to provide somewhat greater insulation to shocks. While the plans for increased investment over the horizon were maintained – which, unlike the tax hikes, should be GDP growth-positive – total public sector net borrowing is still expected to maintain a steady downward

UK: Public sector borrowing measures*



**Dashed lines show OBR Nov-25 projection.*
Source: OBR, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: OBR estimated change to fiscal headroom



Source: OBR and Daiwa Capital Markets Europe Ltd.

path, falling from 5.1% of GDP last fiscal year to 4.5% this fiscal year, 3.0% by FY27/8 and slightly below 2.0% by the end of the decade. Unlike the Budget arithmetic of recent years, these figures are based on a credible OBR assumption for trend productivity growth – down 0.3ppt to 1.0%Y/Y – because of which GDP is forecast to grow close to this year's rate of 1½%Y/Y over the horizon. And while there might be some question marks about the potential revenue take from certain measures, the plans also appear more politically deliverable than those of the past few years, further adding to confidence that – unlike other major industrialised economies – UK government borrowing will be maintained on a steady downwards path over the horizon. Nevertheless, public sector net financial liabilities are forecast to edge slightly higher to 83.7% of GDP before falling slightly by the end of the parliament to maintain compliance with the government's debt rule, albeit only just.

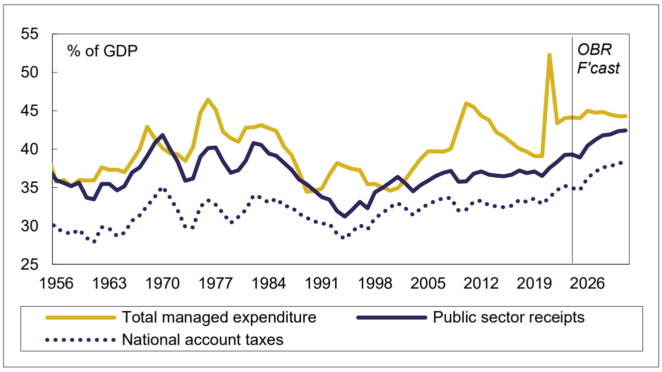
Longer-term Gilt issuance cut this fiscal year & total issuance to fall FY26/7

Given the slippage relative to the past year's fiscal plans, the DMO revised up its planned Gilt issuance for the current fiscal year by £4.6bn – at the lower end of expectations – to £303.7bn. The extra issuance was inevitably skewed to the shorter end of the curve and the DMO will consult on a further deepening of the Bill market. It also cancelled three longer-dated auctions and reduced its planned issuance of index-linked Gilts. With the central government net cash requirement set to decline some £16bn in FY26/7, the DMO's illustrative gross financing requirement is projected to decline close to £275bn next fiscal year. While in part reflecting lower redemptions, that also illustrates the steady net fiscal tightening underway since last year's Budget. Indeed, the cyclically adjusted primary deficit is forecast to decline by 1ppt this fiscal year, by a further ¾ ppt in the next fiscal year and close to ½ ppt in each of the subsequent fiscal years.

Measures to suppress inflation from Q226, BoE likely to cut rates in December & further next year

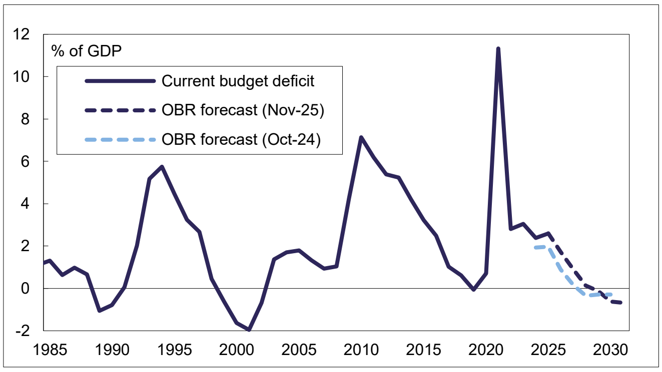
Overall, given the near-term increases to public spending and with some tax hikes backloaded, the new fiscal measures announced today nevertheless will add to borrowing over the near term before reducing borrowing by almost £15bn in FY29/30 and more beyond. But measures to reduce household energy bills, cap regulated rail and bus fares and freeze fuel duty are estimated to reduce CPI inflation in the next fiscal year by 0.3ppt, with the peak reduction of 0.5ppt in Q226. And while inflation is still unlikely to return to the BoE's 2% target until FY27 when the Budget measures will add slightly to inflation, the lower near-term profile for prices should help further to allay MPC concerns that inflation expectations will become de-anchored. Indeed, the Budget announcement helped push the market-implied probability of a December BoE rate cut to above 90%. And it also increased somewhat market expectations that – in line with our own view – the MPC will be able cut rates twice further next year.

UK: Public sector tax & expenditure



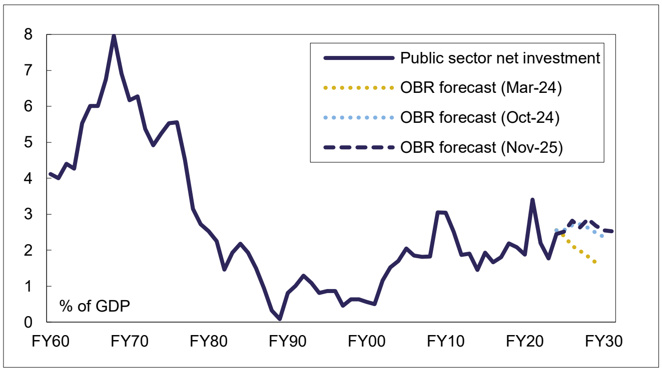
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Current budget deficit



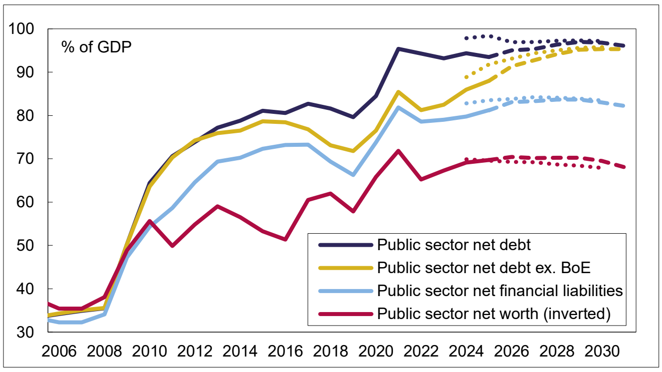
Source: OBR, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Public sector net investment



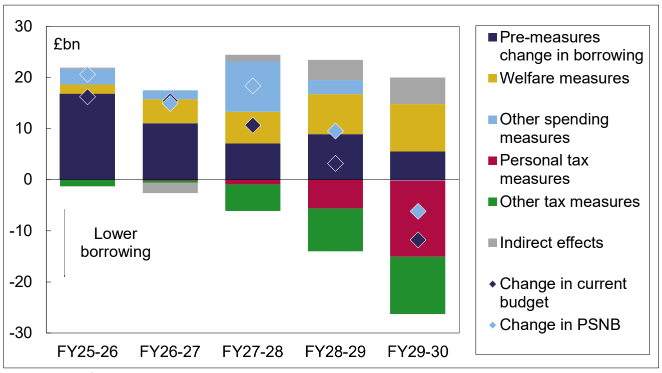
Source: OBR, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Public sector debt measures*



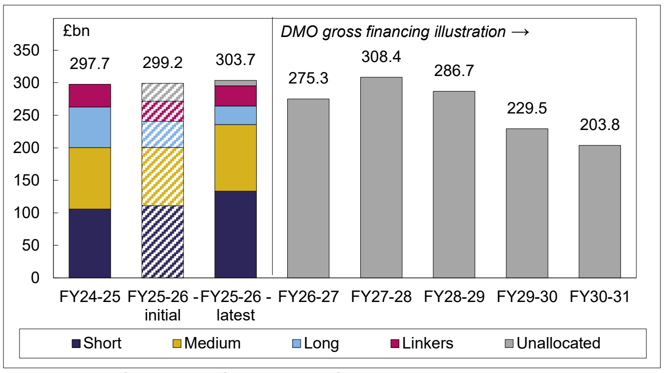
**Dotted lines show Oct-24 OBR projections; dashed lines show Nov-25 OBR projections. Source: OBR, Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Changes to OBR public net borrowing forecast*



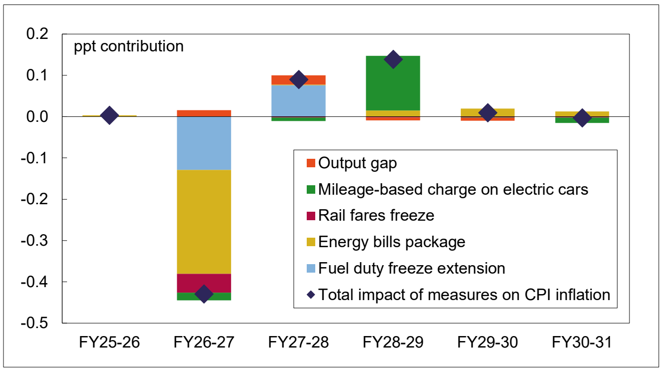
*Change to November 2025 projections relative to March 2025.
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Gilt issuance by maturity & DMO illustration



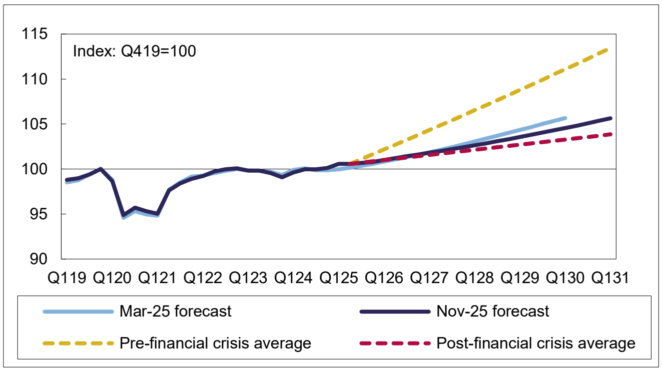
Source: DMO and Daiwa Capital Markets Europe Ltd.

UK: Impact of Budget measures on inflation



Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: OBR trend productivity level projections



Source: OBR and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

With no top-tier UK economic data releases or events scheduled on Thursday, markets will likely continue to digest today's Budget announcements.

The day ahead in the euro area

Thursday will bring a handful of noteworthy survey releases from the euro area. Among those will be the Commission sentiment surveys which, like the PMIs, have signalled a modest pickup in growth momentum into the start of Q4, with the headline economic sentiment index rising to a 2½-year high (96.8) in October. The November release will provide a crosscheck to the flash PMIs, which showed the composite output index edging slightly lower on the month but remaining consistent with an improvement in economic momentum this quarter. The ISTAT business and consumer confidence surveys will also provide a view towards Italian GDP growth in Q4. The latter of those, as well as the German GfK consumer confidence measure (which is presented as a forecast for December) will provide additional context to a sidestep reported in the Commission's flash consumer sentiment indicator for the euro area. Like the modest decline in French consumer confidence this month, we see the risks to those national releases to be skewed to the downside. The ECB's latest monetary data for October are also due for release.

Besides the economic data, the ECB will also publish its monetary policy account of the 29-30 October Governing Council meeting. While the ECB left rates and its forward guidance unchanged, President Lagarde signalled that the Governing Council had become relatively less concerned about certain downside risks to the outlook. The account seems bound to convey a similar message – reflecting the more optimistic signals of business surveys and moderating concerns relating to tariffs – albeit with the risks to the outlook still likely to be seen as two-sided. While the account is likely to confirm that policymakers remain confident in their projection that shows inflation remaining close to the 2% target over the medium term, we note the recent postponement of the EU's ETS2 carbon tax measures beyond the ECB's forecast horizon presents an additional downside risk in 2027.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
- Nothing to report -						

Auctions

Country	Auction
Germany	sold €2.34bn of 2.6% 2035 bonds at an average yield of 2.67%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	09.00	M3 money supply Y/Y%	Oct	2.8	2.8
	10.00	Commission economic sentiment indicator	Nov	97.0	96.8
	10.00	Commission services (industrial) confidence indicator	Nov	4.4 (-8.3)	4.0 (-8.2)
	10.00	Final Commission consumer confidence indicator	Nov	*-14.2*	-14.2
	07.00	GfK consumer confidence indicator	Dec	-23.5	-24.1
Italy	09.00	ISTAT consumer confidence indicator	Nov	97.6	97.6
	09.00	ISTAT business (manufacturing) confidence indicator	Nov	-	94.3 (88.3)

Auctions and events

Country	GMT	Event
Euro area	12.30	ECB to publish monetary policy account of October 29-30 Governing Council meeting
Italy	10.00	Auction: to sell up to €2.75bn of 2.85% 2031 bonds
	10.00	Auction: to sell up to €2.75bn of 3.45% 2036 bonds
	10.00	Auction: to sell up to €4bn of floating-rate 2035 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs