

Euro wrap-up

Overview

- While French spreads narrowed and Bunds made losses except at the short end as euro area producer price inflation rose to the highest rate since early 2023.
- Gilts also made losses, while the final UK services activity PMI suggested a loss of momentum despite an upwards revision from the flash estimate.
- Tuesday will bring euro area retail sales and German factory orders data for August.

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Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	3.053	-0.014
OBL 2.9 10/31	3.244	+0.014
DBR 3 08/36	3.487	+0.029
UKT 4 05/29	4.848	+0.035
UKT 4% 03/31	4.956	+0.049
UKT 4% 07/36	5.422	+0.057

*Change from close as at 4:30pm BST.

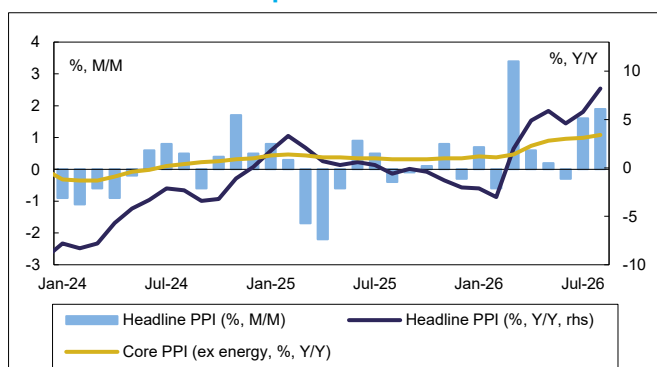
Source: Bloomberg

Euro area

Producer price inflation jumps to highest rate since early 2023 on energy price surge

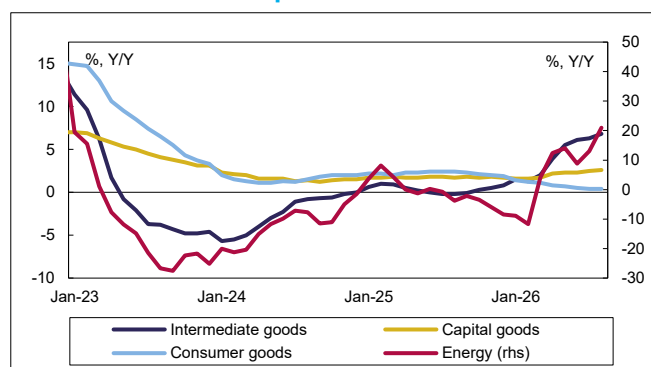
Following Friday's stronger-than-expected flash [HICP estimates](#), which reported that consumer price inflation rose in September to its highest level in three years, today's producer goods price data showed that pipeline pressures rose sharply over the summer, strengthening the case for further tightening before year-end. Producer prices jumped 1.9% M/M in August, the most since March, to push the annual rate up 2.4ppts to 8.2% Y/Y, the highest since February 2023. Inevitably, energy remained the principal driver, with such prices rising a further 5.6% M/M to stand 21% above their level before the start of the Iran conflict at end-February. In contrast, prices of non-energy goods were up just 0.2% M/M in August and 2.4% since February, suggesting relatively limited cost pass-through from the energy shock along the supply chain. Nevertheless, the annual rate of core PPI inflation (excluding energy) still rose for a sixth successive month to 3.4% Y/Y, the firmest in more than three years. Indeed, prices of intermediate goods were almost 7% higher than a year ago, while capital goods prices rose for an eighth month to be up 2.6% Y/Y, the most since end-2023. Predictably, there remained evidence of notable pressures in energy-intensive items, including chemicals and basic metals, as well as certain ICT goods benefiting from AI-related demand.

Euro area: Producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Producer price inflation

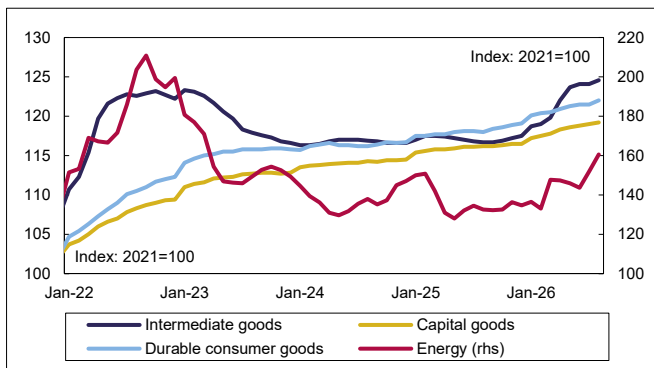


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Consumer goods pressures still relatively subdued, but signs of firmer services price pressures

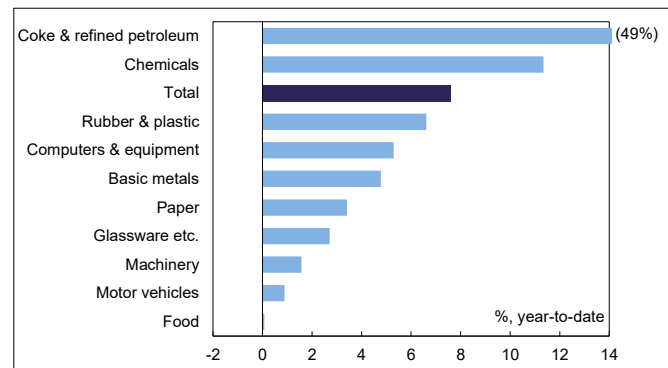
Encouragingly, despite rising cost pressures, pass-through to consumer goods prices appears to have remained limited, with producer prices of such items up just 0.5% since February and 0.4% Y/Y. But this figure is flattered by falling food prices (-0.8% Y/Y), excluding which producer price inflation of consumer goods rose to the highest rate since end-2023 (2.5% Y/Y). And surveys suggest that pipeline pressures are building in services as well as the goods sector. Indeed, today's final services PMIs suggested that such pressures were stronger than previously thought at the end of Q3. The input cost index rose to the highest level in almost 4½ years and, contrary to the equivalent signal from the Commission's business survey, the prices charged index suggested the strongest inflation in the sector since early 2024. Nevertheless, policymakers will continue to be mindful that labour market data suggest that second-round effects via wages remain largely absent. So, as ECB Chief Economist Philip Lane noted today, with higher energy prices eroding real purchasing power, they will also likely weigh on demand. While the profit share of non-financial corporations ticked up slightly in Q2, it remained close to the bottom of the range of the past five years. And the likely near-term softening of demand will limit the ability of firms to maintain margins in the face of ongoing cost pressures in Q3. So, given also the recent tightening in financial conditions illustrated by the marked widening in French sovereign spreads, we certainly expect the majority on the Governing Council to favour leaving monetary policy unchanged this month.

Euro area: Producer price levels



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Change in selected producer prices*

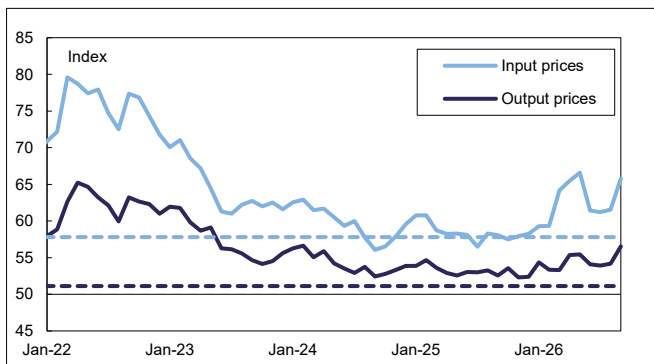


*Year to August. Source: Macrobond and Daiwa Capital Markets Europe Ltd.
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Services growth momentum accelerated, with ongoing Spanish outperformance (for now)

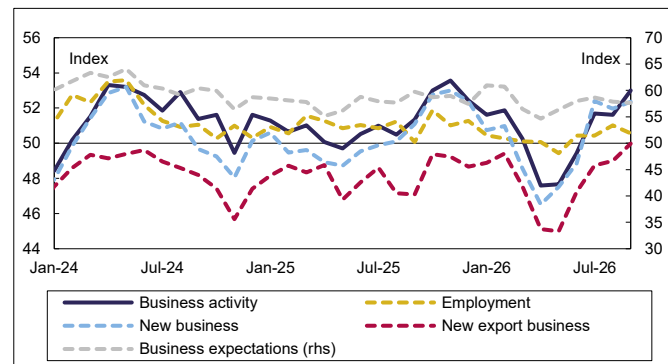
Admittedly, today's final services PMIs suggested that growth momentum in the sector strengthened further in September, with the euro area activity index rising to a ten-month high of 53.0. The improvement reflected recoveries in Germany (52.9) and France (51.2), where activity reportedly expanded at the fastest pace since last November. And Spain's services activity PMI (58.3) remained the strongest in the region, matching the highest level since early 2023. In contrast, the Italian services PMI dropped sharply from August, by 3.5pts to 51.7, albeit still a touch above the long-run average. Combined with a modest improvement in manufacturing, the euro area composite output index rose more than 1pt to 53.1, its highest level since April 2023. As a result, the Q3 average increased by more than 3pts to 52.1, consistent with a pickup in the underlying pace of economic expansion over the summer. Firms also remained broadly upbeat about the near-term outlook, with reported order backlogs rising to the highest level since mid-2023 as demand continued to recover. Nevertheless, the stronger PMIs will not be reflected in the Q3 GDP data, as growth was certainly softer than the 0.6%Q/Q rate in Q2. Spanish growth momentum seems unlikely to be significantly harmed by the heightened political uncertainty surrounding the snap general election called today for 29 November. But it is hard to believe that growth in France will be unscathed by the more marked recent tightening of financial conditions and election-related uncertainty, which will certainly extend into the first half of next year and most likely beyond.

Euro area: Services price PMIs*



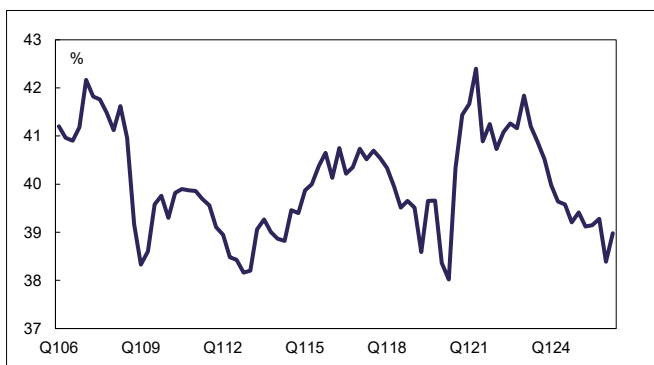
*Dashed lines represent long-run averages. Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected services PMIs



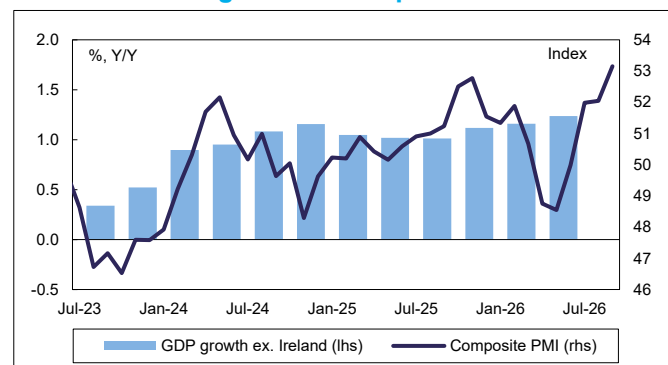
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Profit share of NFCs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & composite PMIs



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

The day ahead in the euro area

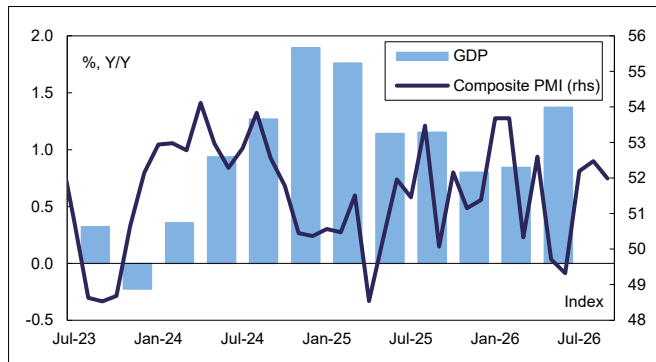
On Tuesday, euro retail sales figures are expected to suggest that goods consumption remained relatively subdued in August. Indeed, while German sales volumes rebounded in August (1.3%M/M) they continued to trend below the Q2 level. And sales in France fell sharply (-1.1%M/M) reflecting a marked decline in fuel sales. As such, we expect euro area sales volumes to rise only minimally to be similarly tracking slightly below their Q2 average. In Germany, August data for factory orders might have eased back after solid growth over the previous three months, although this would still leave orders substantially higher than a year earlier, consistent with positive industrial momentum. Meanwhile, French and Spanish industrial production data are expected to show that output remained subdued over the summer. And the construction PMIs will likely point to continued underperformance in the euro area despite stronger civil engineering activity in Germany.

UK

Services PMIs revised higher from the flash but still consistent with slower momentum

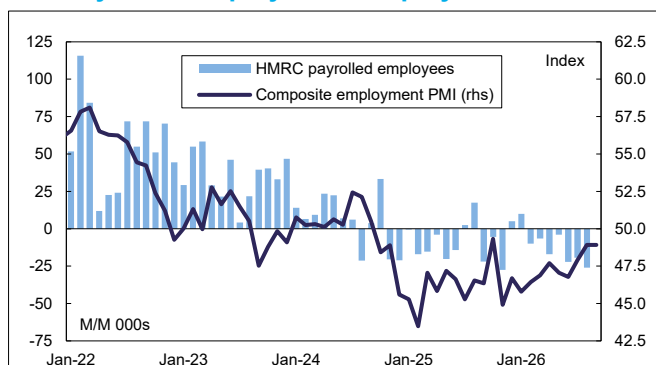
In contrast to the more upbeat euro area survey, today's final UK services PMIs pointed to a modest loss of momentum at the end of Q3. Nevertheless, the headline activity index for the sector was revised higher from the flash release, moderating just 0.4pt to 52.1 in September. So, while the composite output PMI similarly fell back, at 52.0, it matched July's level and left the quarterly average 2pts higher compared with the Q2 level, consistent with modest expansion. However, the broader tone of the survey remained relatively subdued. While backlogs were reported to be larger than initially estimated, firms in the services sector continued to reduce staffing amid concerns of a weaker demand outlook. Indeed, although the composite new orders index (50.4) was revised up from the flash reading, it remained broadly consistent with stagnation. As such, some policymakers are likely to argue that subdued demand conditions and persistent labour market slack will continue to contain domestic inflation pressures. At the same time, inflation signals remained less reassuring. While the price PMIs were revised marginally lower from the flash estimates, the services sector input and output price indices nevertheless rose to their highest levels since June and May respectively. And although firms reported that cost pressures were less intense than at the height of the US-Iran conflict, they remained well above their average over the past two years.

UK: GDP growth & composite PMIs



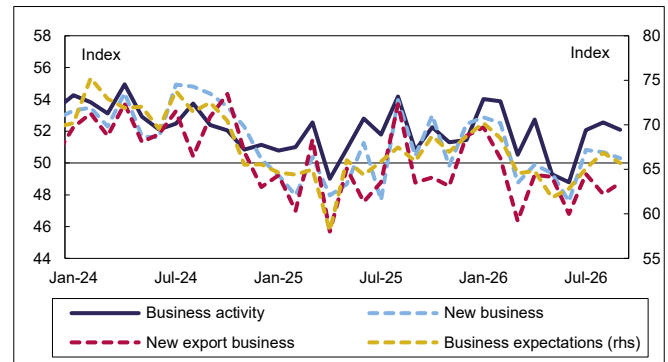
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employees & employment PMI



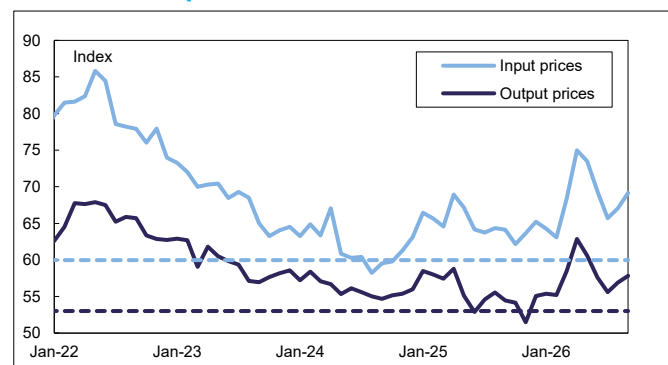
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected services PMIs



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

UK: Services price PMIs*



*Dashed lines represent long-run averages. Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

A relatively quiet day for UK data on Tuesday will bring the September construction PMIs. With rising materials costs and tighter financial conditions continuing to weigh on demand, these are likely to remain well below the key 50 mark, with the housebuilding index likely to signal the largest drag. Beyond the data, external MPC members Catherine Mann and Alan Taylor are expected to reiterate their contrasting views on the near-term policy outlook.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final composite (services) PMI	Sep	53.1 (53.0)	<u>53.1 (53.0)</u>	52.0 (51.6)	-
	 Sentix investor confidence indicator	Oct	2.7	4.5	5.1	-
	 PPI M/M% (Y/Y%)	Aug	1.9 (8.2)	1.8 (7.0)	1.6 (5.8)	-
Germany	 Final composite (services) PMI	Sep	53.8 (52.9)	<u>53.8 (52.9)</u>	51.8 (49.7)	-
France	 Final composite (services) PMI	Sep	51.1 (51.2)	<u>51.2 (51.4)</u>	48.5 (48.0)	-
Italy	 Composite (services) PMI	Sep	51.0 (51.7)	-	53.6 (55.2)	-
Spain	 Composite (services) PMI	Sep	56.8 (58.3)	-	55.8 (57.8)	-
UK	 New car registrations Y/Y%	Sep	12.0	-	13.7	-
	 Final composite (services) PMI	Sep	52.0 (52.1)	<u>51.7 (51.7)</u>	52.5 (52.5)	-

Auctions

Country	Auction
- Nothing to report -	

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	 08.30	Construction PMI	Sep	-	43.0
	 10.00	Retail sales M/M% (Y/Y%)	Aug	0.1 (1.0)	-0.6 (0.6)
Germany	 07.00	Factory orders M/M% (Y/Y%)	Aug	-1.0 (13.1)	2.5 (13.1)
	 08.30	Construction PMI	Sep	-	48.7
France	 07.45	Industrial production M/M% (Y/Y%)	Aug	0.3 (1.3)	-0.4 (-0.5)
	 08.30	Construction PMI	Sep	-	37.3
Italy	 08.30	Construction PMI	Sep	-	41.7
Spain	 08.00	Industrial production M/M% (Y/Y%)	Aug	-0.5 (2.4)	0.6 (2.3)
UK	 09.30	Construction PMI	Sep	-	44.3

Auctions and events

Euro area	 14.00	ECB's Cipollone scheduled to speak at MNI event
Germany	 10.30	Auction: to sell up to €6.0bn of 3.0% 2028 bonds
UK	 10.00	Auction: to sell up to £1.25bn of 1.125% 2035 linker bonds
	 10.00	MPC's Mann to participate in fireside chat in London
	 16.30	MPC's Taylor to deliver a lecture on "Expectations and the risk of inflation persistence" in London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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