

Euro wrap-up

Overview

- Bunds were mixed as euro area inflation was confirmed at a three-year high, but underlying price pressures remained contained and the goods trade balance returned to deficit.
- Gilts made very modest gains after BoE Governor Bailey reiterated that evidence of second-round inflation effects remained limited and suggested that a rate hike next month was not assured.
- The coming week will bring the flash October PMIs, as well as UK inflation, labour market and public finance figures.

Emily Nicol
+44-20-7597-8331

Edward Maling
+44-207597-8030

Daily bond market movements

Bond	Yield	Change
BKO 3.0 12/28	3.085	-0.009
OBL 2.9 10/31	3.212	+0.005
DBR 3 08/36	3.423	+0.013
UKT 4 05/29	4.872	-0.009
UKT 4½ 03/31	4.958	-0.005
UKT 4¾ 07/36	5.370	-0.002

*Change from close as at 5.00pm BST.

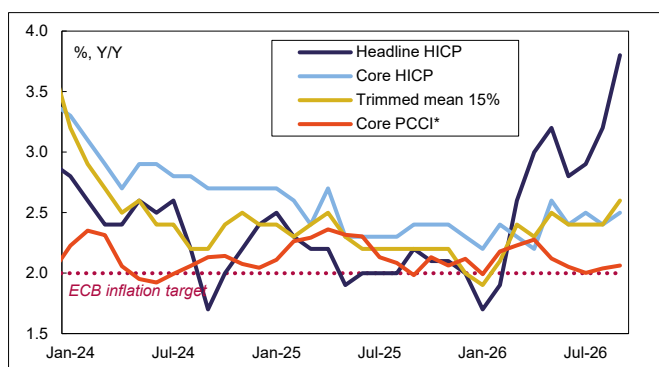
Source: Bloomberg

Euro area

Euro area inflation up to a three-year high, but underlying price pressures still contained

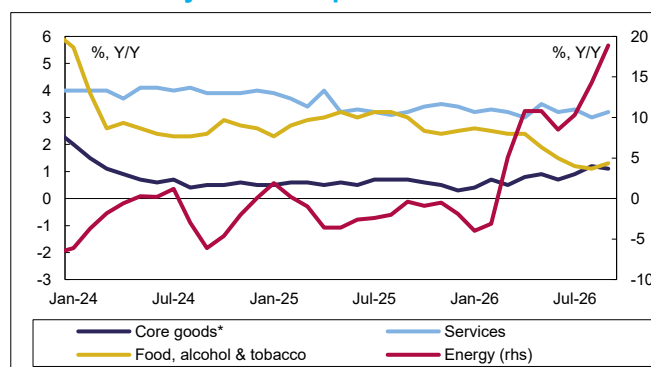
The final euro area inflation data for September brought no major revisions, with headline HICP inflation confirmed at a three-year high of 3.8%Y/Y. As in recent months, energy provided the main upwards impetus, accounting for four-fifths of the increase in headline inflation. Indeed, prices rose the most in any month since March to be up more than initially estimated at 18.9%Y/Y, as household utility bills increased alongside a surge in auto fuel prices. Prices of unprocessed food also responded to higher input costs and the summer drought, rising the most in any September since 2022, with vegetable prices jumping 6.4%Y/Y, the most since January 2024. But with prices of processed items well behaved, inflation in the broader category of food, alcohol and tobacco rose just 0.2ppt to 1.3%Y/Y. Meanwhile, today's detail confirmed that the rise in services inflation, up 0.2ppt to 3.2%Y/Y, principally reflected a rebound in the volatile tourism-related items, including package holidays, accommodation and airfares, following softness in August. And while some cost pressures persisted in web-based storage services, information and communications services inflation edged lower in September. Admittedly, demand pressures related to AI appeared more evident in ICT equipment, where inflation rose to a new series high (3.6%Y/Y). But with furniture and household appliances still exerting a drag and clothing easing back, non-energy industrial goods inflation moderated slightly from the prior month's 2½-year high to a still relatively subdued 1.1%Y/Y. Overall, therefore, the underlying inflation picture remains more benign than the headline rate would suggest, with core inflation rising just 0.1ppt to 2.5%Y/Y, still a touch below May's peak for the year. And the ECB's measure of the underlying persistent and common component of inflation (PCCI) – a measure that Chief Economist Lane has previously noted as one of the better gauges for predicting future inflation – edged up to just 2.1%Y/Y, still seemingly consistent with an eventual return to target.

Euro area: Measures of HICP inflation



*Persistent and common components of inflation. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Key HICP components



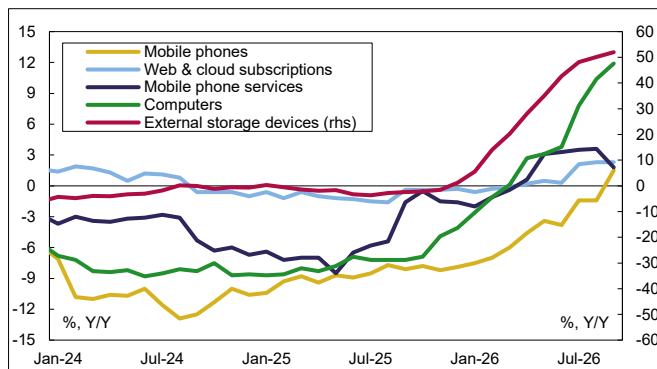
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Risks to inflation outlook to upside, but financial tightening might reduce need for rate hikes

Nevertheless, risks to the near-term inflation outlook remain firmly tilted to the upside, with wholesale energy prices tracking closer to the ECB's adverse scenario. Admittedly, declining auto fuel prices in the first two weeks of October, thanks in part to the cut in German fuel duties, provided some temporary relief at the start of Q4. But persistent supply concerns and high costs of diesel suggest that the broader pressure from energy prices is unlikely to fade over the near term. Moreover, while producers have so far absorbed much of the increase in costs, the longer the energy crisis persists, the greater the risk that pipeline pressures are passed through the supply chain to consumers. Certainly, we expect food and core goods inflation to pick up towards the end of the year and into 2027. So, while services inflation should remain broadly stable in the near term

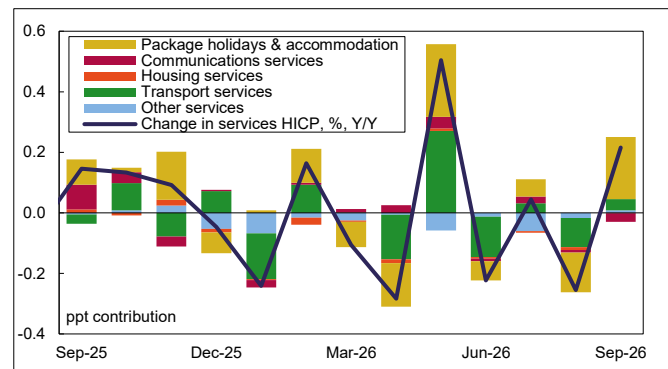
and below its 3.5%Y/Y high of earlier this year, we expect headline HICP inflation to peak above 4½%Y/Y in January and average 4%Y/Y in Q127, some 0.7ppt above the ECB's September baseline projection. For now, as conditions in the labour market suggest that risks of second-round effects are relatively limited, we expect the peak in core inflation to be more modest, remaining below 3%Y/Y but nevertheless above target through to the end of our forecast horizon. That said, if (as we expect) the recent significant tightening in financial conditions persists, it will additionally weigh on demand and further restrain any second-round inflationary pressures. Indeed, with higher market interest rates already doing some of the ECB's work, the tone among some policymakers has recently become less forceful, suggesting that the bar for significant further policy tightening is rising and that, at most, only one additional rate hike might ultimately be required this cycle.

Euro area: ICT equipment & services inflation



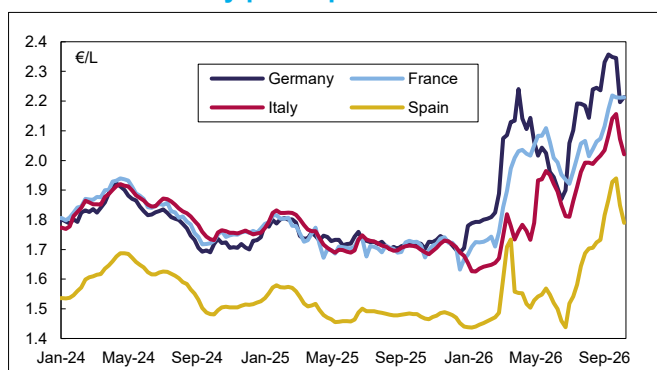
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Monthly change in services inflation



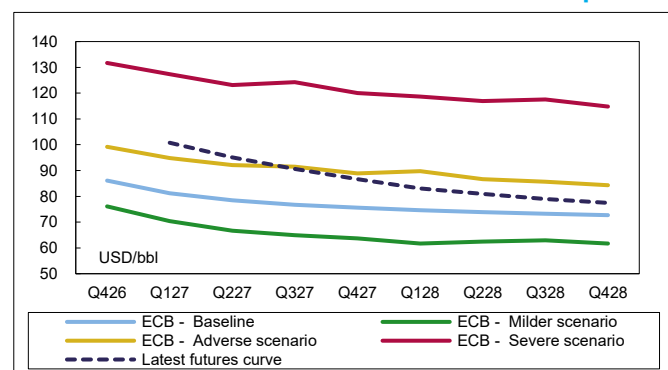
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Weekly petrol prices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Brent crude futures & ECB assumptions



Source: ECB Sep-26 projections, Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area goods trade balance slips into deficit as export values fall for the first month in seven

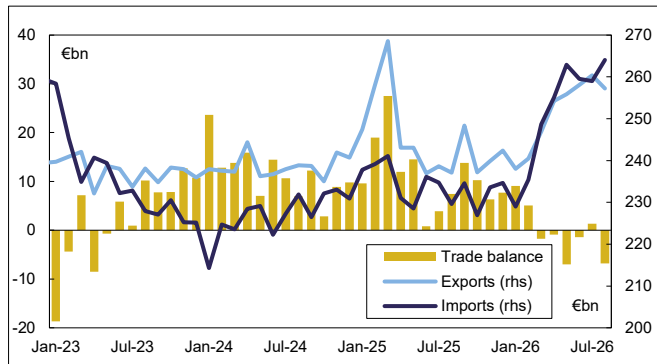
In part due to the uptrend in global energy prices over the second half of the summer, today's euro area goods trade data flagged a worsening picture. July's goods trade surplus was revised down considerably (by more than €3bn to €1.4bn). And the balance slipped back into deficit in August (-€6.8bn) for a fifth month in the past six, and to its widest level since May. The deterioration reflected a divergence in the direction of exports and imports. Among other things, higher energy prices pushed up the latter (2%M/M) via costlier mineral fuel and commodity imports. But export values softened for the first time since January (-1.2%M/M). While a decline in machinery and transport (-2.1%M/M) contributed, payback for recent strength in chemicals exports (-7.5%M/M), principally to the US, was the most significant driver of that decline and so too the modest drop in the euro area's bilateral trade surplus. Considering the sharp rise in energy prices towards the end of Q3, the euro area goods trade deficit overall appears likely to have widened further still in September. However, while net goods trade is unlikely to repeat its positive contribution to GDP growth in Q2, we equally do not expect significant payback either. Indeed, the price effects suggest that, in real terms, the increase in imports in August was somewhat smaller. And most business surveys – most notably the PMIs and Commission ESIs – all point towards an improving outlook for exports, with the respective indices in September at their highest since February 2022 and September 2023 respectively.

EU-China deal to limit EV imports belatedly aims to trim record bilateral goods trade deficit

The huge competitive challenge from Chinese manufacturing was also clearly evident in today's data. Despite a partial rebound in euro area goods exports to China in August, which left shipments almost 6% higher than a year earlier, imports from China surged 18%Y/Y, back close to their record high level in mid-2022. As a result, the bilateral trade deficit widened to a record €29.5bn in August and €223bn in the year to date, in marked contrast to the euro area's sizeable year-to-date

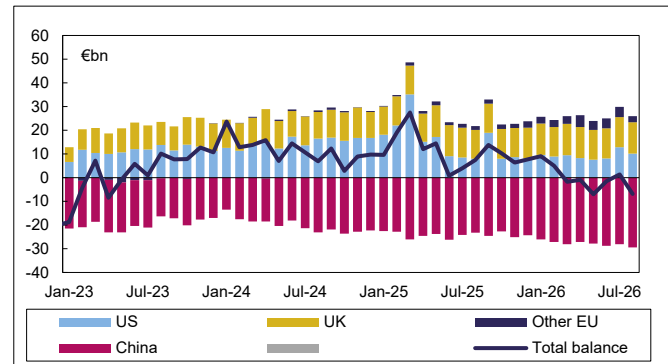
surpluses with the US (€75bn) and UK (€103bn). More than half of the deficit with China relates to machinery and transport equipment, imports of which have risen by around one quarter over the past year. And the influx of comparatively cheap Chinese electric vehicles (EVs) has increased threefold over the same period. But this week, the pressure on Europe's automotive sector finally prompted a more protectionist policy response. The tentative EU-China deal announced at the start of the week would cap Chinese EV imports at 350k vehicles in 2027, less than half the expected amount this year, with that quota subsequently rising 6% annually for the remainder of the four-year arrangement. Similar arrangements are expected to be agreed for other sectors, including machinery and chemicals. At the same time, Germany and France agreed a broader compromise on EU car policy aimed at providing greater flexibility for the sector in its transition to net zero while strengthening incentives for European production. In particular, the agreement would soften the existing 2035 emissions requirement from 100% to 90%, leaving some scope for new combustion-engine vehicles beyond that date, while access to "Made in Europe" subsidies would be more tightly focused on European production.

Euro area: Goods trade balance, exports & imports*



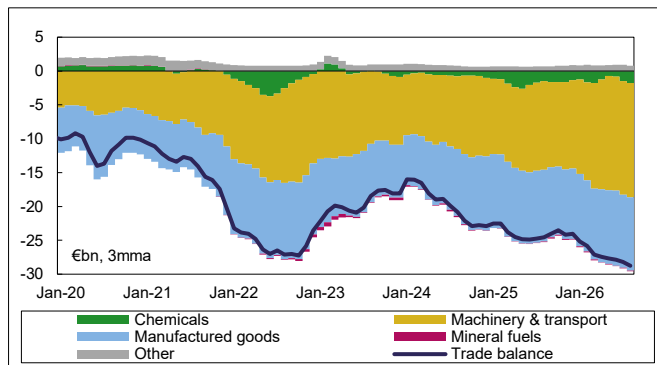
*Values terms. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Bilateral goods trade balances



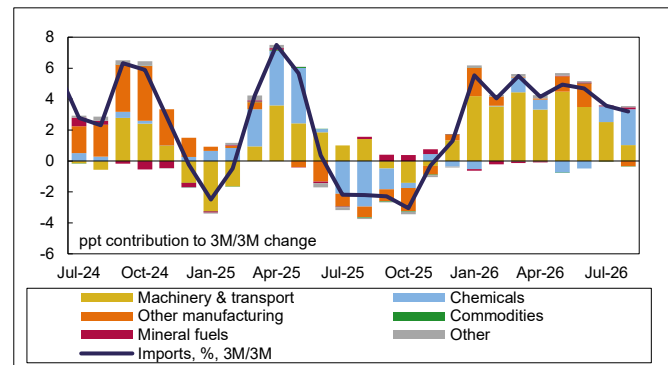
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Bilateral goods trade balance with China



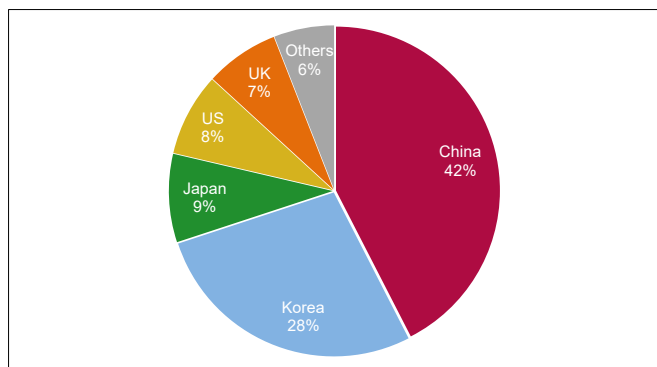
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods import values from China



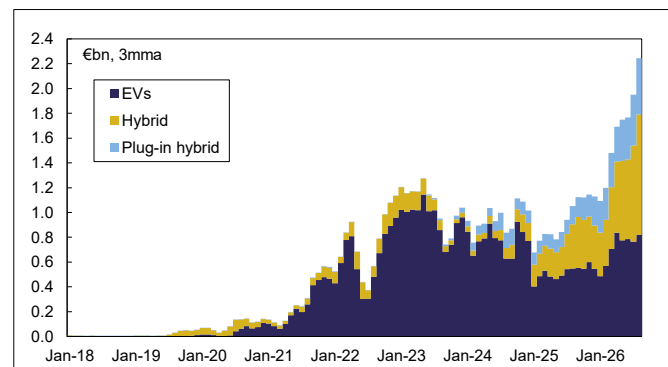
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

EU: Share of imported EVs, by trading partner*



*In value terms. Source: Eurostat and Daiwa Capital Markets Europe Ltd.

EU: Imports of Chinese EVs & hybrid vehicles



Source: Eurostat and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

The coming week's dataflow will be primarily focused on survey data, most notable of which being October's flash euro area PMIs (Friday). That survey will provide the first indication as to whether the encouraging pickup in growth momentum last quarter was sustained into the start of Q4, with the composite output PMI in [September](#) suggesting the fastest expansion in 3½ years (53.1) following a recovery in both German and French services activity. Order books were similarly stronger, still underpinned by defence and AI-related demand, which meant backlogs rose for the first time since mid-2022. However, it would not be surprising if political uncertainty in France, and perhaps also Spain, were to have dented that trend. INSEE's more comprehensive national survey (Thursday) will provide a guide to the French PMIs, as well as a more accurate gauge for GDP growth in that member state. Events in France also infer a further downside risk to the Commission's flash consumer confidence reading (also Thursday). And amplified political concerns, as well as persistently high energy prices are likely to weigh on investor sentiment in Germany too (Tuesday). Certainly, German PPI data (Tuesday) are likely to confirm another energy-led pickup in input cost inflation last month, and show how those pipeline pressures are feeding through into other subsectors. And not least given today's inflation numbers, ECB policymakers will be particularly attentive to the degree of upwards pressure in consumers' inflation expectations (Friday). While year-ahead CPI expectations remained well below their levels at the start of the energy shock, rising 0.1ppt to 3.0%Y/Y, they rose 0.2ppt at the three-year horizon to 2.9%Y/Y, just shy of March's 3-year high.

The week ahead in the UK

The coming week will be a busy one for UK data. In addition to the flash PMIs (Friday), the week ahead will bring the last updates on inflation (Wednesday), the labour market (Tuesday) and retail sales (also Friday) before November's monetary policy announcement. Unsurprisingly, a hotter UK CPI print is widely expected. We forecast the headline rate to rise for a third consecutive month, to 3.4%Y/Y, its highest rate since December and up 0.3ppt from August. Such a reading would place inflation last quarter in line with the BoE's adverse scenario, strengthening the argument for the MPC to tighten in November. Of course, like today's euro area release, the latest jump in inflation will be attributed to rising energy prices – in this instance fuel – likely pushing inflation in that category up to a 3½-year high. Rising input costs infer an upside risk to other categories too. On top of summer drought effects already seen in the euro area data, those costs could push food inflation up from its near-five year low to around 2%Y/Y. However, provided that the indirect effects on certain volatile holiday-related services and the impacts of AI-related demand are relatively muted, we expect the core rate to move sideways at 2.6%Y/Y for a fifth consecutive month, with little evidence of broadening inflation pressures.

On that front, the labour market data should also be of some reassurance. Private sector regular pay growth – the BoE's preferred measure – is likely to remain close to the Bank's Q3 forecast of 3%3M/Y. And while surveys have recently hinted at a slower pace of labour market loosening, hiring sentiment remains weak. So, a further drop in payrolled employment, as well as an increase in the unemployment rate, would not be surprising. October's flash PMIs will provide a timelier gauge of firms' labour demand, as well as firms' cost and prices pressures. Most important, however, will be the signal the flash PMIs send regarding economic activity at the start of Q4. Although firmer services activity supported a modest rebound in the composite output PMI last quarter, the survey has remained relatively weak, contrasting with the strength of the [GDP](#) data. Indeed, the signal on new orders was broadly neutral last quarter, while the headline index slipped to a three-month low (52.0). Given the backdrop of a persistent and more acute price shock, and further tightening in financial conditions, we expect growth momentum to have slowed into October.

Moreover, expectations for a modest fiscal tightening and broader uncertainty ahead of the Budget on 28 October could serve a headwind. September's public finances statistics (Wednesday) will provide a potential flashpoint for scrutiny of potential tax- and spend-initiatives, such as reversing the previous government's cut to the bank surcharge, as well as an update on the extent of the existing borrowing overshoot relative to the OBR's forecast as debt interest costs continue to rise. Lastly, September's retail sales figures appear well positioned to confirm a third consecutive quarter of positive retail sales growth, likely in the region of ¼-½%Q/Q. Still, we see the risks to September skewed slightly to the downside, not least owing to the dampening effect of recent inflationary pressures. And some [retail surveys](#) have corroborated that weakness. But generally, those have failed to account for the resilience of retail sector performance over recent quarters. And, notably, consumer confidence (October data also due Friday) sent a more positive signal, rising to a 2-year high last month. So, further resilience supported not least by back-to-school sales, cannot be totally discounted.

The next Euro wrap-up will be published on Tuesday 20 October 2026

Daiwa economic forecast

		2026			2027			2026	2027	2028
		Q2	Q3	Q4	Q1	Q2	Q3			
GDP		%, Q/Q						%, Y/Y		
Euro area		0.6	0.0	0.3	0.2	0.3	0.2	0.9	0.9	1.2
UK		0.5	0.7	0.2	0.5	0.3	0.3	1.5	1.5	1.4
Inflation, %, Y/Y										
Euro area										
Headline HICP		3.0	3.3	3.9	4.0	3.3	2.9	3.1	3.2	1.9
Core HICP		2.4	2.5	2.6	2.8	2.8	2.7	2.4	2.7	2.2
UK										
Headline CPI		2.8	3.1	3.6	4.0	3.4	3.1	3.2	3.3	1.7
Core CPI		2.5	2.6	2.8	3.0	3.0	2.9	2.8	2.9	2.4
Monetary policy, %										
ECB										
Deposit Rate		2.25	2.50	2.75	2.75	2.75	2.75	2.75	2.75	2.50
Refi Rate		2.40	2.65	2.90	2.90	2.90	2.90	2.90	2.90	2.65
BoE										
Bank Rate		3.75	3.75	4.00	4.00	4.00	4.00	4.00	4.00	3.50

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results							
Economic data							
Country	Release		Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area		Final headline (core) HICP Y/Y%	Sep	3.8 (2.5)	<u>3.8 (2.5)</u>	3.2 (2.4)	-
		Trade balance €bn	Aug	-6.8	-	5.0	-1.4
Italy		Final HICP (CPI) Y/Y%	Sep	4.2 (4.2)	<u>4.1 (4.2)</u>	3.2 (3.3)	-
Auctions							
Country	Auction						
- Nothing scheduled -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 19 October 2026					
UK		00.01 Rightmove house prices M/M% (Y/Y%)	Oct	-	0.7 (-0.8)
Tuesday 20 October 2026					
Euro area		09.00 ECB current account €bn	Aug	-	27.6
		10.00 Construction output M/M% (Y/Y%)	Aug	-	0.0 (-2.0)
Germany		07.00 PPI M/M% (Y/Y%)	Sep	1.6 (6.3)	1.1 (4.6)
		10.00 ZEW current situation (expectations) balance	Oct	-44.5 (30.0)	-47.1 (34.7)
UK		07.00 Average wages (excluding bonuses) 3M/Y%	Aug	3.8 (3.6)	3.9 (3.5)
		07.00 Private sector wages 3M/Y%	Aug	3.0	2.9
		07.00 Unemployment rate 3M%	Aug	-5.0	4.9
		07.00 Employment 3M/3M change 000s	Aug	0	66
		07.00 Payrolled employment M/M change 000s	Sep	-10	-26
		07.00 Claimant count rate % (change 000s)	Sep	-	4.4 (27.8)
Wednesday 21 October 2026					
UK		07.00 Headline (core) CPI Y/Y%	Sep	<u>3.4 (2.6)</u>	3.1 (2.6)
		07.00 PPI – output (input) prices Y/Y%	Sep	4.2 (7.4)	3.7 (6.1)
		07.00 Public sector net borrowing £bn	Sep	24.0	18.3
		09.30 House price index Y/Y%	Aug	-	1.4
Thursday 22 October 2026					
Euro area		05.00 New car registrations Y/Y%	Sep	-	4.5
		15.00 Preliminary Commission consumer confidence indicator	Oct	-17.0	-16.5
France		07.45 INSEE business (manufacturing) confidence indicator	Oct	96 (101)	96 (101)
		07.45 INSEE production (own-company production) outlook indicator	Oct	-	-9 (15)
UK		11.00 CBI industrial trends - total orders (selling prices) net % balance	Oct	-	-9 (12)
		11.00 CBI industrial trends - business optimism % net balance	Q4	-	-36
Friday 23 October 2026					
Euro area		09.00 Preliminary services (manufacturing) PMI	Oct	52.5 (52.7)	53.0 (52.9)
		09.00 Preliminary composite PMI	Oct	52.7	53.1
		09.00 ECB consumer expectations survey - 1Y- (3Y-) ahead CPI Y/Y%	Sep	3.2 (2.9)	3.0 (2.9)
Germany		08.30 Preliminary services (manufacturing) PMI	Oct	52.5 (53.6)	52.9 (53.9)
		08.30 Preliminary composite PMI	Oct	53.5	53.8
France		08.15 Preliminary services (manufacturing) PMI	Oct	50.9 (50.5)	51.2 (50.6)
		08.15 Preliminary composite PMI	Oct	50.5	51.1
UK		00.01 GfK consumer confidence indicator	Oct	-15	-13
		07.00 Retail sales - incl. auto fuels M/M% (Y/Y%)	Sep	-0.2 (1.0)	0.5 (2.4)
		07.00 Retail sales - excl. auto fuels M/M% (Y/Y%)	Sep	-0.1 (1.4)	0.6 (2.7)
		09.30 Preliminary services (manufacturing) PMI	Oct	51.8 (51.7)	52.1 (51.9)
		09.30 Preliminary composite PMI	Oct	51.7	52.0

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 19 October 2026		
- Nothing scheduled -		
Tuesday 20 October 2026		
Germany		10.30 Auction: to sell up to €500mn of 2.1% 2029 green bonds
		10.30 Auction: to sell up to €500mn of 1.8% 2053 green bonds
UK		10.00 Auction: to sell £4.25bn of 4.875% 2036 bonds
		18.00 External MPC member Greene to deliver a speech to the LSE Economics Society in London
Wednesday 21 October 2026		
Euro area		10.00 Eurostat to publish Government financial accounts for Q226 and final deficit-debt statistics for 2025
UK		14.00 BoE Governor Bailey to participate in a fireside chat on central bank independence in London
Thursday 22 October 2026		
UK		10.00 Auction: to sell £1bn of 0.125% 2031 inflation-linked bonds
Friday 23 October 2026		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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