

Euro wrap-up

Overview

- Bunds were little changed on the day after ECB President Lagarde tried again to push back on market expectations of a rate hike next year, and as German car production and sales data remained very weak.
- Gilts made losses after surprising significant upwards revisions to the UK's services PMIs.
- Thursday will bring the BoE's latest policy announcement, which is expected to bring a rate hike, as well as new data on euro area producer prices and German factory orders.

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Daily bond market movements

| Bond | Yield | Change |
|---|--------|--------|
| BKO 0 09/23 | -0.668 | +0.013 |
| OBL 0 10/26 | -0.479 | +0.002 |
| DBR 0 08/31 | -0.170 | -0.003 |
| UKT 0 ⁷ / ₈ 01/24 | 0.672 | +0.027 |
| UKT 0 ⁷ / ₈ 10/26 | 0.831 | +0.034 |
| UKT 0 ¹ / ₄ 07/31 | 1.069 | +0.037 |

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

Source: Bloomberg

Euro area

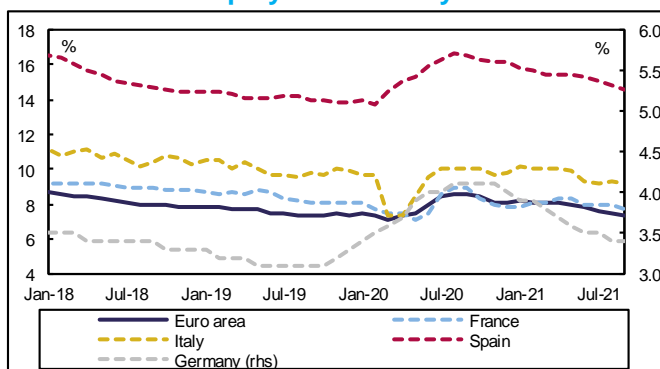
Lagarde tries (again) to push back on market rates expectations

In response to questions at her [press conference on Thursday](#), ECB President Lagarde tried to push back on market pricing of ECB rate hikes from next year. Among other things, she suggested that, judging from the ECB's current projections, the preconditions for such tightening simply were not likely to be met in the timeframe expected by the markets "nor any time soon thereafter". While such comments on market pricing by ECB officials were unusual, some observers judged her comments to be half-hearted, and euro rates markets had continued to sell off. Nevertheless, in a speech today in Lisbon, Lagarde tried again. Restating that the medium-term inflation outlook remains subdued, she repeated a little more forcefully that the conditions that need to be met before the ECB starts to raise rates "are very unlikely to be satisfied next year". She reminded that "An undue tightening of financing conditions is not desirable at a time when purchasing power is already being squeezed by higher energy and fuel bills". Moreover, having on Thursday given the clearest indication yet that the PEPP programme will likely be concluded at the end of March, today Lagarde emphasised that "after the expected end of the pandemic emergency, it will still be important that monetary policy – including the appropriate calibration of asset purchases – supports the recovery and the sustainable return of inflation to our target of 2%". So, we maintain our expectation of an increase in the volume and flexibility of regular APP net purchases from April next year to compensate for the end of the PEPP, and anticipate no ECB rate hike before late 2023 at the earliest. And investors today appeared to be more convinced by the ECB President's comments as, unlike Thursday, euro area government bonds initially gained on Lagarde's remarks.

Euro area unemployment continues to fall

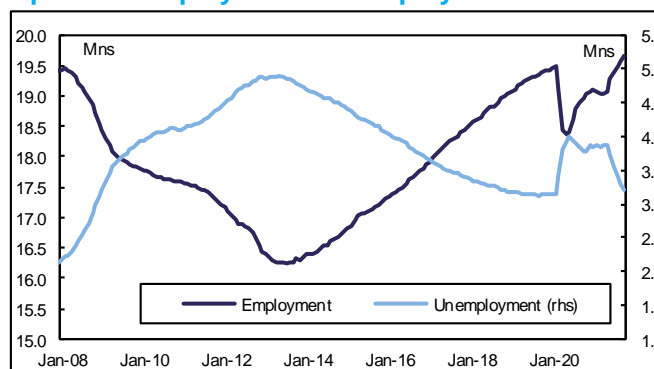
Turning to today's data, consistent with ongoing economic recovery, the latest labour market figures reported another sizeable drop in euro area unemployment in September. Not least reflecting the ongoing reopening of the services sector, the number of people out of work fell a further 255k on the month, the most since July and the thirteenth consecutive decline. This took the cumulative drop in euro area unemployment over the past year to more than 1.9mn and left the level now almost 170k below that in December 2019 ahead of the pandemic. And this also left the euro area's unemployment rate down 0.1ppt to 7.4%, a seventeen-month low. Among the country breakdown, the drop in September was underpinned by a substantial fall in France (-101k), as well as more modest declines in Germany (-16k), Italy (-27k) and Spain (-41k), with Spain the only of the larger member states to still have unemployment considerably higher than the pre-pandemic level.

Euro area: Unemployment rates by member states



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Spain: Unemployment and employment



Source: Refinitiv, Bloomberg and Daiwa Capital Markets Europe Ltd.

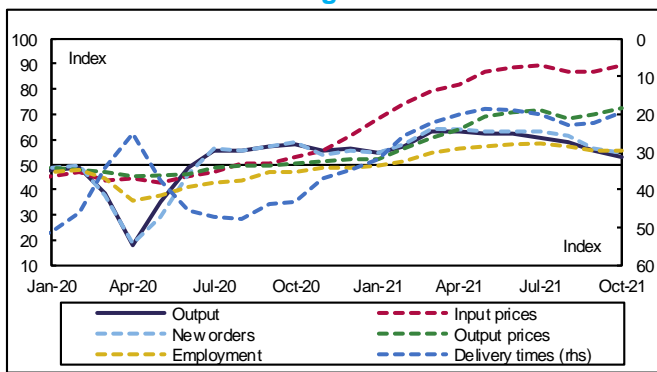
Spanish employment further above pre-pandemic level

But there were further improvements in Spain’s labour market conditions at the start of the fourth quarter. According to the Spanish Labour Ministry, unemployment (on a non-seasonally adjusted basis) fell (-0.7k) for the first time in any October since the start of the series in 1975. On a seasonally adjusted basis, unemployment fell 80k in October, taking the cumulative decline since April to more than 660k. And this left the number of people employed at 19.7mn, a little more than 180k above the pre-pandemic level. Of course, the number of workers out of work in the euro area would be higher in the absence of the various national job support schemes, most of which remain in operation. The most recent figures out of Germany show that in August 760k employees were still being supported on the government’s Kurzarbeit short-time work scheme, down from 927k the previous month. In France, 480k had been in partial activity in August down from 600k previously. And in Spain, the number of furloughed workers on the government’s ERTE scheme fell almost 50k over the month to 191k. The respective support schemes are currently due to conclude at the end of the year in Germany, France and Italy, and next February in Spain.

Final manufacturing PMI flag ongoing supply disruption

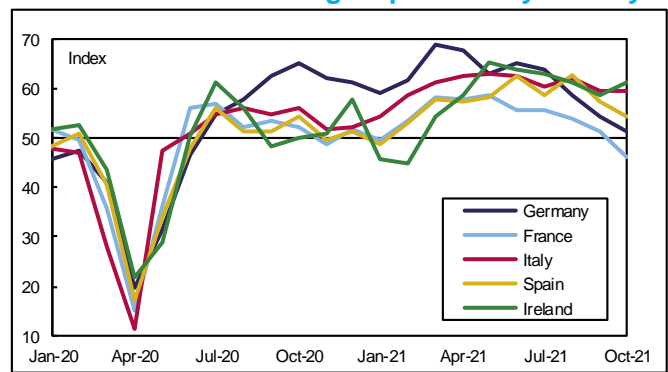
Despite some modest tweaks to the numbers between the flash and final release, the underlying message from yesterday’s euro area manufacturing PMI survey – that output growth had moderated further while supply-side challenges continued to intensify – was little changed. In particular, the output index was unrevised at 53.3 in October, down 2.4pts from September and the weakest reading since July 2020. While the rise in new orders was the softest since January, manufacturers continued to contend with supply constraints as shipping container availability remained low and widespread shortages of key materials and a lack of transportation led supplier delivery times to lengthen by the third most on the series. Against this backdrop, price pressures continued to mount, with the input and output indices both rising to series highs. At the country level, steep declines in the output PMIs were seen in Germany (-3.0pts to 51.2, a 16-month low), France (-5.1pts to 46.1, a 17-month low) and Spain (-2.8pts to 54.5, an 8-month low). In contrast, Italy’s output PMI held up relatively well (down just 0.1pt to 59.5, albeit an 8-month low), while the equivalent indicators rose in the Netherlands and Ireland. But across all member states, with supply-side challenges evident, the survey measures of input and output price pressures continued to trend higher.

Euro area: Manufacturing PMIs



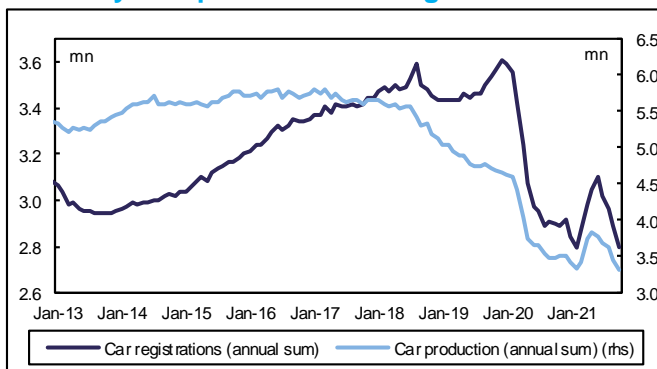
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output PMIs by country



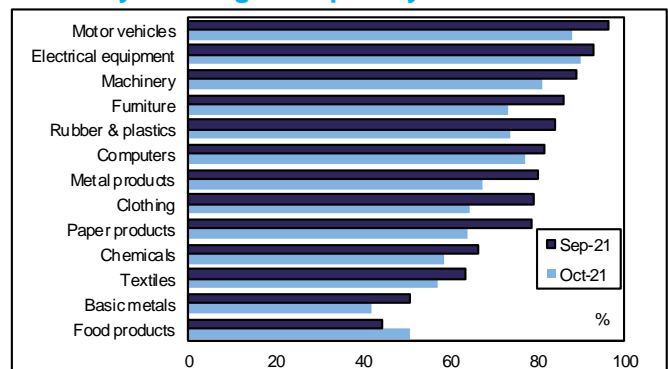
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Germany: Car production and registrations



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: Shortage of inputs by subsector



Source: ifo and Daiwa Capital Markets Europe Ltd.

Supply bottlenecks putting the brakes on car registrations

The impact of these supply bottlenecks continue to be most acutely evident in the autos sector. According to the autos association VDA, German car production fell for the fifth consecutive month in October and by a further 38% Y/Y despite the low base a year ago. Indeed, compared with the average in the five years before the pandemic, production in October was down by almost half. So, in the first ten months of 2021, auto output was down by 8% YTD/Y and by a whopping 38% compared with the equivalent period in 2019. So, tallying with the weak registration figures from France (-30.2), Italy (-35.7% Y/Y) and Spain (-20.5% Y/Y) published earlier this week, today's German sales numbers were similarly striking. In particular, German car registrations stood at just 178k units in October, the weakest outturn for any October since 1982 and down 34.9% from October 2020 despite the low base a year earlier. While a survey published by the ifo institute today suggested that the shortage of key inputs among German manufacturers has lessened slightly from September, they still remained a key factor limiting production. Indeed, almost 90% of auto firms were still reporting difficulties procuring materials last month, with an ever greater share of electrical equipment manufacturers indicating problems. Moreover, businesses on average expect these problems to persist for another eight months, with an even longer forecast backlog among auto producers.

The day ahead in the euro area

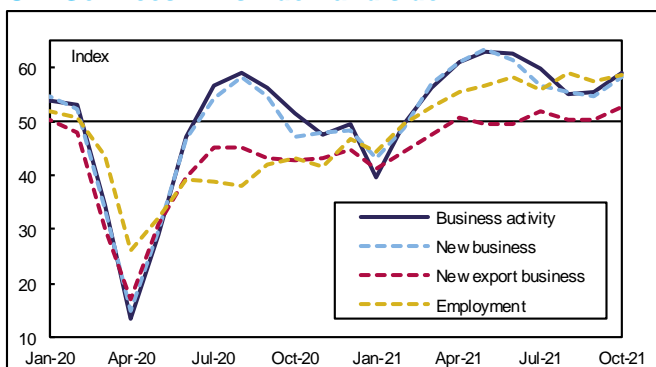
After the flash [euro area CPI estimate](#) last week saw headline inflation jump to a joint-series high 4.1% Y/Y in October, tomorrow's PPI release will be watched for any signs that increased energy and raw material costs are being increasingly passed through to other categories along the producer chain. The final October services PMIs will also likely confirm record high input and output price gauges seen in the preliminary release, while the flash euro area headline activity index fell 2.6pts to 54.7, a six-month low. Perhaps of most interest in tomorrow's release will be the first breakdown for the Italian and Spanish PMIs, with Markit having previously eluded to a moderating expansion in the sector among the periphery countries. Turning to the manufacturing sector, Thursday will also bring German factory orders for September, which are likely to report a modest bounce back following the more than 7½% slump in August, while the turnover figure will be watched closely for insight into Friday's IP data.

UK

Final services PMI revised even higher in October

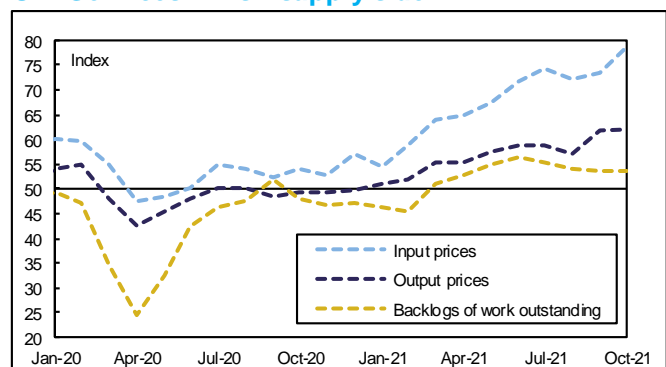
Ahead of tomorrow's BoE policy announcements, today's final UK services PMIs – which suggested an even greater improvement in conditions in the sector at the start of Q4 than initially implied – will have provided further support to those in favour of monetary tightening. In particular, the headline activity index was upwardly revised by 1.1pts from the flash reading to 59.1, leaving it 3.7pts higher than September and its highest since July when the final pandemic restrictions were relaxed. This principally reflected stronger demand, with the new business PMI accelerating for the first time in five months, while the new exports business indicator rose to its highest since June 2018 as international travel restrictions eased. While the survey's employment index pointed to the second-fastest rise in workforce levels since mid-2014, firms in the sector continued to flag ongoing recruitment challenges amid unusually high turnover due to rising wage competition. Indeed, with around 60% of survey respondents indicating higher cost burdens not least from higher wage growth, operating expenses increased at the steepest rates since the survey began in July 1996. And prices charged were similarly at a series high. Taken together with the upwards revision in the manufacturing survey at the start of the week, the composite output PMI was 2.9pts higher in October at 57.8, a three-month high, with the new orders, employment and prices indices all rising at the start of Q4.

UK: Services PMIs – demand side



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Services PMIs – supply side











Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK












An eventful day in the UK tomorrow will bring the BoE's policy announcements and updated economic forecasts at midday. While the policy decision from the MPC seems unlikely to be unanimous, the BoE staff members of the Committee are all likely to be on board for tighter policy. So, we think the majority will vote to raise rates by 15bps to 0.25%, with just three external members (Tenreyro, Mann and Haskel) likely to vote against. The MPC will also likely vote to bring an end to its QE programme one month early, thus reducing its asset purchase target by £20bn to £875bn (of which £855bn would comprise Gilts). Of course, the expected moves would merely reverse the emergency setting of policy that was introduced after the intensification of the pandemic. So, the BoE's forecasts, MPC policy statement and Bailey's press conference should also be watched for further signals on the near-term future path of policy and the conditions required to justify additional tightening. We suspect that the BoE's updated economic projections will imply that the expected tightening currently priced into money markets, of almost four additional hikes in 2022, would be excessive, pushing inflation back below the 2.0% Y/Y target by the end of the horizon.

On the data front, tomorrow's UK new car registrations figures for October are likely to remain extremely weak as supply-chain disruption continues to impact production. Persistent supply bottlenecks are likely to be the underlying message from the construction PMI survey at the start of the fourth quarter too.

European calendar













| Today's results | | | | | | |
|-----------------|--|--------|-------------|--|-------------|---------|
| Economic data | | | | | | |
| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
| Euro area |  Unemployment rate % | Sep | 7.4 | 7.4 | 7.5 | - |
| Germany |  New car registrations Y/Y% | Oct | -38.0 | - | -25.7 | - |
| Italy |  Unemployment rate % | Sep | 9.2 | 9.3 | 9.3 | - |
| Spain |  Unemployment change 000s | Oct | -0.7 | - | -76.1 | - |
| UK |  Nationwide house price index M/M% (Y/Y%) | Oct | 0.7 (9.9) | 0.3 (9.2) | 0.1 (10.0) | 0.2 (-) |
| |  Final services (composite) PMI | Oct | 59.1 (57.8) | 58.0 (56.8) | 55.4 (54.9) | - |
| Auctions | | | | | | |
| Country | Auction | | | | | |
| Germany |  sold €3.27bn of 0% 2026 bonds at an average yield of -0.5% | | | | | |
| UK |  sold £2.5bn of 0.5% 2029 bonds at an average yield of 0.887% | | | | | |

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 |
| Euro area |  Final manufacturing PMI | Oct | 58.3 | 58.5 | 58.6 | - |
| Germany |  Final manufacturing PMI | Oct | 57.8 | 58.2 | 58.4 | - |
| France |  Final manufacturing PMI | Oct | 53.6 | 53.5 | 55.0 | - |
| Italy |  Manufacturing PMI | Oct | 61.1 | 59.5 | 59.7 | - |
| |  New car registrations Y/Y% | Oct | -35.7 | - | -32.7 | - |
| Spain |  Manufacturing PMI | Oct | 57.4 | 58.0 | 58.1 | - |
| |  New car registrations | Oct | -20.5 | - | -15.7 | - |
| Auctions | | | | | | |
| Country | Auction | | | | | |
| Germany |  sold €344mn of 2030 index-linked bonds at an average yield of -2.03% | | | | | |
| |  sold €274mn of 2033 index-linked bonds at an average yield of -1.857% | | | | | |
| UK |  sold £3.0bn of 0.25% 2025 bonds at an average yield of 0.69% | | | | | |
| |  sold £1.25bn of 1.625% 2017 bonds at an average yield of 0.921% | | | | | |

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 |  | 09.00 Final services (composite) PMI | Oct | 54.7 (54.3) | 56.4 (56.2) |
| |  | 10.00 PPI M/M% (Y/Y%) | Sep | - (15.2) | 1.1 (12.4) |
| Germany |  | 07.00 Factory orders M/M% (Y/Y%) | Sep | 0.4 (7.5) | -7.7 (11.7) |
| |  | 08.55 Final services (composite) PMI | Oct | 52.4 (52.0) | 56.2 (55.5) |
| France |  | 08.50 Final services (composite) PMI | Oct | 56.6 (54.7) | 56.2 (55.3) |
| Italy |  | 08.45 Services (composite) PMI | Oct | 54.5 (55.8) | 55.5 (56.6) |
| Spain |  | 08.15 Services (composite) PMI | Oct | 56.0 (56.2) | 56.9 (57.0) |
| UK |  | 09.00 New car registrations Y/Y% | Oct | - | -34.4 |
| |  | 09.30 Construction PMI | Oct | 52.0 | 52.6 |
| |  | 12.00 BoE Bank Rate % | Nov | <u>0.25</u> | 0.10 |
| |  | 12.00 BoE Gilt purchase target £bn | Nov | <u>855</u> | 875 |
| |  | 12.00 BoE Corporate bond target £bn | Nov | <u>20</u> | 20 |

Auctions and events

| | | |
|-----------|---|--|
| Euro area |  | 13.00 ECB President Lagarde speaks at ECB-CEPR Women in Economics Conference |
| |  | 18.15 ECB Executive Board member Schnabel speaks at ECB-CEPR Women in Economics Conference |
| France |  | 09.50 Auction: 0% 2031 bonds |
| |  | 09.50 Auction: 1.75% 2039 bonds |
| |  | 09.50 Auction: 0.75% 2053 bonds |
| Spain |  | 09.30 Auction: 0% 2028 bonds |
| |  | 09.30 Auction: 0.5% 2031 bonds |
| |  | 09.30 Auction: 1% 2031 index-linked bonds |
| UK |  | 12.00 BoE publishes monetary policy statement, minutes and Monetary Policy Report |
| |  | 12.30 BoE Governor Bailey holds press conference |

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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