Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made gains despite confirmation of a pickup in German and euro area job growth in Q3.
- Despite a moderation in UK pay growth, Gilts made losses as payrolls and job vacancies continued to rise after the end of the furlough scheme.
- Wednesday will bring updated inflation figures from the UK and euro area as well as data on euro area construction output.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.748	-0.044
OBL 0 10/26	-0.567	-0.039
DBR 0 08/31	-0.249	-0.018
UKT 0⅛ 01/24	0.574	+0.025
UKT 0⅜ 10/26	0.731	+0.024
UKT 0¼ 07/31	0.973	+0.012

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

Euro area

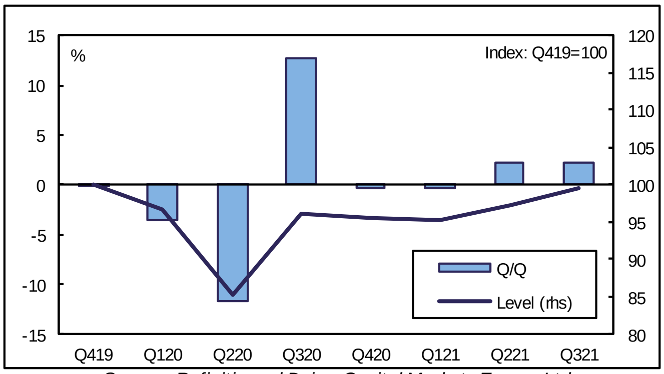
GDP growth in Q3 confirmed at 2.2%Q/Q, as employment accelerates

There were no surprises whatsoever from today's updated euro area GDP data for Q321, which left growth unchanged from the initial estimate at 2.2%Q/Q, marking a very slight acceleration of 0.1ppt from the previous quarter. This left output just 0.5% below the pre-pandemic level in Q419, a significantly smaller shortfall than in the UK (-2.1%) but still lagging the recovery in the US where the pre-pandemic level was surpassed in Q2. We will have to wait until the final release on 7 December for the official expenditure breakdown, which we suspect might yet bring an upwards revision to GDP growth. The data released so far from the member states imply that private consumption was the main driver in Q3 as opportunities to spend on services increased as restrictions were relaxed and the spread of Covid-19 subsided. Stronger domestic demand and increased services activity supported another solid increase in employment in the euro area, with today's data reporting net job creation of 0.9%Q/Q (or 1.5mn) in Q3, marking an acceleration of 0.2ppt from Q2, to be up 2.0%Y/Y or 2.9mn from the level one year earlier. But while this left employment almost 4½mn above the pandemic trough, there is still a little more than 500k (0.3%) fewer people in work than before the arrival of Covid-19.

German employment edges higher in Q3, but still firmly below Q419 level

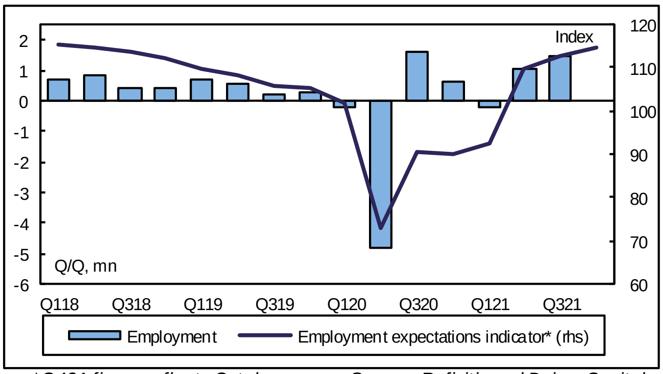
While there was no detail released with today's employment figures, figures previously published suggested that Spain led the way in job creation in Q3, with employment up 502k (2.6%Q/Q) following a drop in Q2. German labour market data for last quarter – also published today – reported an increase in employment of 196k (0.4%Q/Q), more than double the increase in Q2 to be up 267k (0.6%Y/Y). That, however, merely represented the largest year-on-year increase since Q419 just ahead of the pandemic. With the normalisation of economic activity over the summer, employment growth in Germany was strongest in the services sector (303k, 0.9%Y/Y), of which the public sector – and healthcare in particular – remained a key source of growth (up 261k from Q320). Job creation was particularly vigorous in hospitality, retail and transport, although collectively employment in those sub-sectors was still down by 106k from a year earlier and more than 400k lower than the pre-pandemic level. Perhaps unsurprisingly given persistent weakness in production amid shortages of components, employment in the manufacturing sector remained subdued in Q3 to be more than 250k lower than Q419. In contrast, despite similar struggles among firms in sourcing materials and skilled labour, the construction sector reported net job creation for the fifth quarter out of the past six to be among a select few to have returned above the pre-pandemic level. Overall, however, while Germany's government continues to support the labour market through its short-term work kurzarbeit scheme, the number of people in employment in Q3 was still 688k (1.5%) less than in Q419.

Euro area: GDP growth and level



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Employment and EEI



*Q421 figure reflects October survey. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Job growth to be maintained, but spare capacity to persist

While the recent jump in the number of new coronavirus cases in certain member states, as well as the erosion of real disposable incomes by high inflation, raises downside risks to the near-term growth outlook, surveys continue to signal that firms intend to continue to add to headcount – indeed, the Commission's Employment Expectations Indicator rose in October to its highest level since May 2018. However, despite persistent skill mismatches and labour shortages in certain sectors, there remains significant spare capacity in the labour market. Indeed, overall slack in the labour market – including underemployment part-time workers, persons available to work but not seeking employment, and persons seeking work but not immediately available, as well as the unemployed – is likely to have remained above 13% of the labour force last quarter. Of course, as and when government support is phased out from all member states, redundancies might be expected to pick up for a while too. And with wage settlements still not out of line with the subdued pre-pandemic norms, while wage growth might firm a little next year as a lagged response to higher prices in 2021, overall cost pressures from the labour market seem unlikely to provide major second-round effects to inflation over the forecast horizon.

The day ahead in the euro area

Tomorrow will bring updated euro area CPI figures for October, which are likely to align with the flash estimate that showed headline inflation rising 0.7ppt to 4.1%Y/Y, a euro-era high, as energy prices surged. Certainly, there were no surprises from today's final French figures, which confirmed the initially reported increase of 0.4ppt in the HICP rate to 3.2%Y/Y, driven principally by energy inflation. And last week's downwards revision to the equivalent Spanish numbers (down 0.1ppt to 5.4%Y/Y) appears to have been offset by a modest upwards revision to the Italian headline CPI rate, by 0.1ppt to 3.2%Y/Y, leaving it 0.3ppt higher than September. The Italian revision reflected a stronger outturn for energy inflation (up 1.9ppts from the flash release to 25.3%Y/Y), while services inflation was unchanged at 1.3%Y/Y and non-energy goods inflation nudged a touch lower by 0.1ppt to 0.8%Y/Y. So, the harmonised Italian core measure was also a touch softer than initially assumed at 1.2%Y/Y, from 1.4%Y/Y in September. As such, there is a risk that the euro area core CPI rate will be revised slightly lower from the flash estimate of 2.1%Y/Y (which was merely 0.2ppt higher than in September), with the trimmed mean estimate likely to have ticked only slightly higher too. Wednesday will also bring construction output numbers for September, which are likely to report a rebound in activity following the sharp drop in August, while the ECB will also publish its latest Financial Stability Review.

UK

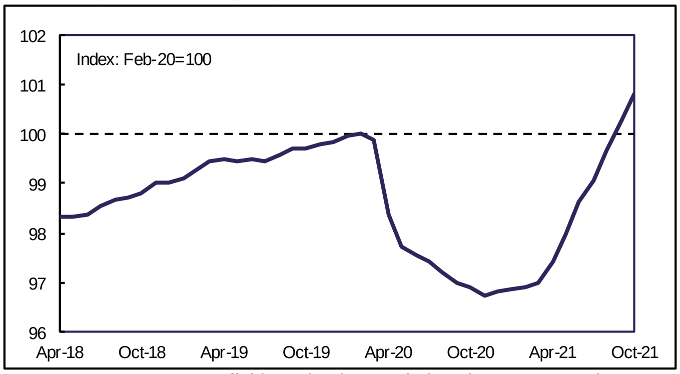
Solid jobs data but December BoE rate decision still in the balance

Since failing to raise rates at its policy meeting earlier this month, the BoE has made clear that its near-term policy decisions will be determined primarily by assessments of developments in the jobs market, and specifically the impact of the end of the furlough schemes on unemployment and pay. So, today's labour market data were closely watched. And overall, the figures were largely firm, tallying with Governor Bailey's assertion yesterday that there appears so far to have been little additional unemployment caused by the end of the Government's support schemes. But it's not clear yet whether most of the workers on furlough returned to work on a full- or merely part-time basis (the latter seems most likely). And wage growth moderated, with the underlying rate of pay growth – which might be expected to have a non-negligible bearing on the inflation outlook – remaining very unclear. On balance, the figures probably take us a further step closer to BoE tightening. However, the pay data suggest this is no done deal and December's policy decision still remains in the balance.

Payrolled employment and job vacancies rise to new highs

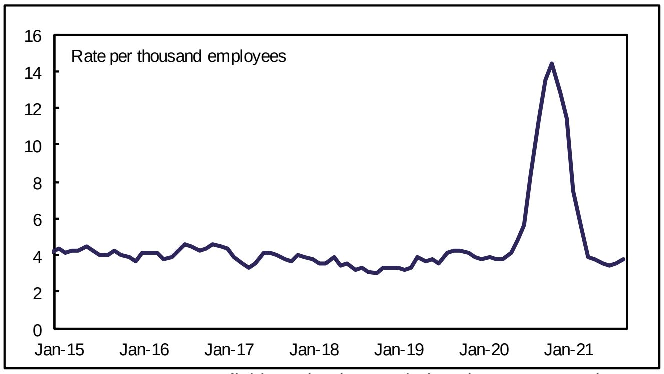
With the furlough schemes having concluded at the end of September with 1.14mn jobs still supported, most notable today were the data for October. Payrolled employees rose 160k last month to be up 1.14mn (4.0%) from a year earlier and 235k (0.8%) from the pre-pandemic level in February 2020. Admittedly, the increase over the past year is likely to have been flattered by a shift from self-

UK: Payrolled employees



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

UK: Redundancy rate



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

employed status to payroll employment associated with the IR35 tax changes. Indeed, in the three months to September the number of self-employed workers was more than 750k down from the pre-pandemic level. More importantly perhaps, the October payroll figure likely includes employees who were working out their notice period after being made redundant. However, data on redundancies and surveys suggest that only a small share of those on furlough (perhaps just 3% according to the most recent ONS survey) have since lost their jobs. Moreover, labour demand appears to remain strong – the number of job vacancies in the three months to October hit a new high of 1.172mn, up 388k from the pre-pandemic level, with 15 of the 18 sectors at record levels. And the ratio of unemployed persons per vacancy fell to a record low of 1.3. The rate of increase of vacancies moderated, however, and only for certain types of job (e.g. HGV drivers) do firms appear to be struggling to hire once positions are advertised. Meanwhile, the claimant count rate, which includes workers on very low incomes as well as those unemployed, fell 0.1ppt to 5.1%, 2.0ppts above the pre-pandemic level. The number of claims was down for the eighth successive month in October, albeit by just 14.9k, the lowest drop of the sequence.

Job turnover at record high, but long-term unemployment and long-term sickness up too

Most data for the three months to September, just ahead of the end of furlough, were unsurprisingly firm too. For example, the employment rate increased 0.4ppt on the quarter, to 75.4%. Notably, there was a record high net flow from unemployment into work. Consistent with the recent rise to a record high in the US quits rate, the ONS reported a record high in job-to-job moves in the UK driven by resignations rather than dismissals, suggesting greater confidence among workers about job security. But more than 80% of the overall increase in employment (208k out of an increase of 247k) came from part-time workers, including those on zero-hour contracts. It remains to be seen whether the end of furlough has translated principally into a big rise in involuntary part-time working, which would likely see such workers face a drop in overall income. In addition, the ILO unemployment rate fell 0.5ppt in Q3 to 4.3%, just 0.5ppt below the pre-pandemic trough at the end of 2019. However, long-term unemployment continued to rise, with the number out of work for more than 12 months up to 434k, a rise of more than 140k from before the pandemic. And the inactivity rate remained unchanged at 21.1%, 0.9ppt and 364k above the pre-pandemic level. A fall in the numbers of inactive due to being in education was offset by a record increase in those inactive due to long-term sickness to 2.26mn, up almost 200k since the end of 2019, representing a possible lasting impact from the pandemic.

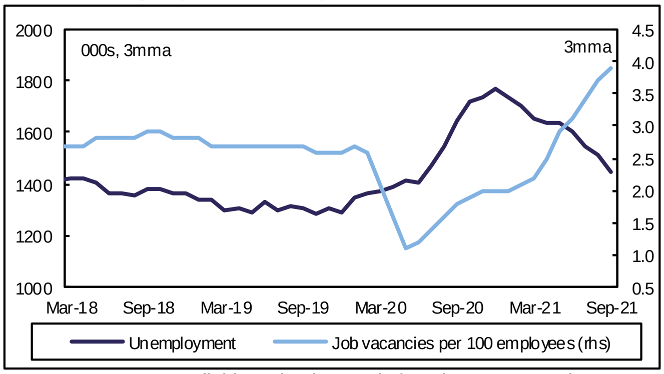
Wage growth moderating on base and compositional factors

Of course, to the extent that the BoE is primarily concerned about second-round effects from current price pressures on the inflation outlook, the wage data are as important as the jobs figures to December's rate decision. The headline annual growth rate in average total pay (including bonuses) slowed 1.4ppts to 5.8%Y/Y while regular pay (excluding bonuses) slowed 1.1ppts, broadly in line with expectations, to 4.9%Y/Y. These declines in large part reflected an easing of base and composition effects that exaggerated the increases of recent months. But the annualised quarterly growth rate of regular pay slowed 0.6ppt to 2.2%, the softest in fourteen months, further suggesting a loss of momentum and perhaps reflecting the normalisation of activity as well as downwards pressure provided by the phasing out of the furlough scheme. Moreover, while the true underlying rate of wage growth remains impossible to calculate with any accuracy, the ONS suggests that it could be as low of 3.4%Y/Y, which would be close to the bottom of the range in 2019 and a rate that is unlikely to generate significant inflation further ahead. If so, that would seem to call for no change in rates just yet. Earlier this month in the Monetary Policy Report, BoE staff estimated that underlying wage growth had risen above 4%Y/Y, a rate more likely to prompt action from the MPC. But the members of the Committee will likely wait for this week's October inflation and retail sales figures, the October GDP numbers (due 10 December), as well as the next round of wage and jobs data – due two days ahead of the December policy announcement – before coming to their own view on underlying pay growth and hence whether or not to hike rates.

The day ahead in the UK

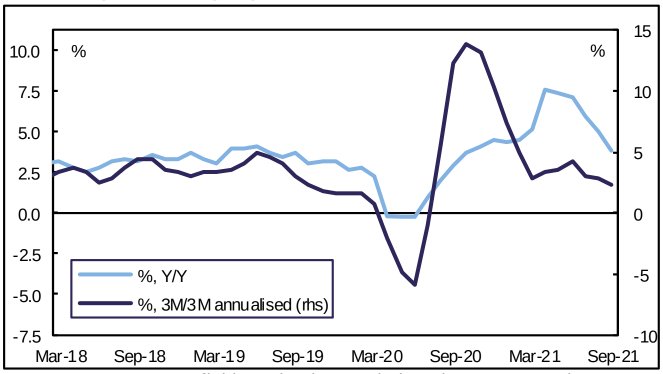
Focus now turns to tomorrow's release of October inflation data. These seem highly likely to see headline UK inflation jump from 3.1%Y/Y in September to close to 4%Y/Y, principally due to the increase in the regulated household energy price cap and higher petrol prices. Indeed, despite an anticipated pickup up in services inflation to its highest since mid-2013, core inflation is likely to have risen just 0.1ppt to 3.0%Y/Y.

UK: Unemployment and job vacancies



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Regular wage growth



Source: Refinitiv 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		Second estimate of GDP Q/Q% (Y/Y%)	Q3	**2.2 (3.7)**	2.2 (3.7)	2.1 (14.2)	-
		Preliminary employment Q/Q% (Y/Y%)	Q3	**0.9 (2.0)**	-	0.7 (1.8)	-
France		Final CPI (EU-harmonised CPI) Y/Y%	Oct	**2.6 (3.2)**	2.6 (3.2)	2.2 (2.7)	-
Italy		Final CPI (EU-harmonised CPI) Y/Y%	Oct	**(3.2)**	2.9 (3.1)	2.5 (2.9)	-
UK		Preliminary output per hour Y/Y	Q3	**-4.8**	-	4.3	
		Claimant count rate % (jobless claims change '000s)	Oct	**5.1 (-15.9)**	-	5.2 (-51.1)	**- (-85.9)**
		Average earnings including bonuses (excluding bonuses) 3M/Y%	Sep	**5.8 (4.9)**	5.9 (5.0)	7.2 (6.0)	-
		ILO unemployment rate %	Q3	**4.3**	4.5	4.5	-
		Employment change '000s	Q3	**247**	-	235	-

Auctions

Country		Auction
UK		sold £1.75bn of 0.875% 2046 bonds at an average yield of 1.178%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ _Daiwa forecast_	Previous
Euro area		10.00	Final CPI (core CPI) Y/Y%	Oct	_4.1 (2.0)_	3.4 (1.9)
		10.00	Construction output M/M% (Y/Y%)	Oct	-	-1.3 (-1.6)
Italy		09.00	Total trade balance €bn	Sep	-	1.3
UK		07.00	CPI (core CPI) Y/Y%	Oct	_3.9 (3.0)_	3.1 (2.9)
		07.00	PPI input (output) prices Y/Y%	Oct	12.1 (7.3)	11.4 (6.7)
		09.30	House price index Y/Y%	Sep	-	10.6

Auctions and events

Country		GMT	Event
Euro area		-	ECB publishes its Financial Stability Review
		12.00	ECB's Schnabel takes part in Q&A session on the euro area's economic and monetary policy outlook
Germany		10.30	Auction: €1bn of 0% 2052 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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