Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds made gains as the ifo business survey added to evidence that German GDP growth has stalled and final euro area inflation data for November suggested that pressures were still not particularly broad-based.
- Gilts made modest losses as growth in UK retail sales in November was a little stronger than expected.
- The coming week will be relatively light on top-tier data from Europe, although updates on consumer confidence in the euro area and business sentiment in Italy and the UK are scheduled for release.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/23	-0.729	-0.020
OBL 0 10/26	-0.612	-0.017
DBR 0 08/31	-0.378	-0.021
UKT $0^1/_8$ 01/24	0.497	+0.014
UKT $0^3/_8$ 10/26	0.614	+0.015
UKT 0¼ 07/31	0.765	+0.012

*Change from close as at 4:00pm GMT.
Source: Bloomberg

Euro area

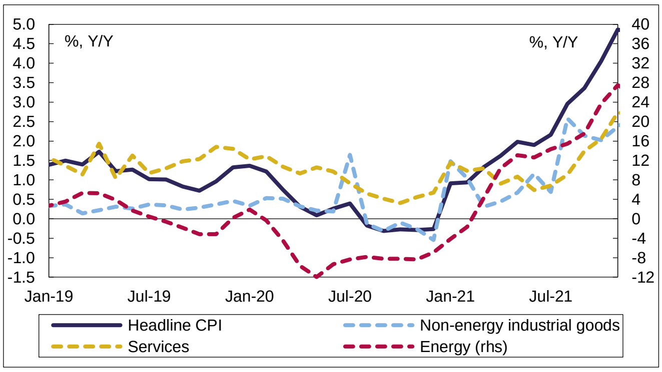
Euro area inflation confirmed at 30-year high but pressures still not broad-based

Despite some modest downwards revisions in Italy and Spain, today's final November euro area inflation numbers confirmed the headline CPI rate at the flash estimate of 4.9%Y/Y, up 0.8ppt from October and the highest for three decades. The detail of the report was unchanged from the flash too, with the largest contribution to the rise made by energy inflation (up 3.8ppts to 27.5%Y/Y), to account for a little more than half of the annual headline rate. Inflation of food increased 0.3ppt to a 17-month high of 2.2%Y/Y. Services inflation accelerated 0.6ppt to 2.7%Y/Y, the highest since 2008, in part reflecting a jump in the cost of package holidays (up 6ppts to 6.4%Y/Y, a three-year high) and air transport (up 2.5ppts to 18.7%Y/Y, a series high). And not least reflecting the impact of supply bottlenecks on certain items – e.g. inflation of new and used cars rose to fresh record highs – inflation of non-energy industrial goods rose 0.4ppt to a three-month high of 2.4%Y/Y, a rate only exceeded once since the introduction of the euro. As a result, core inflation rose 0.6ppt to a new series high of 2.6%Y/Y. Despite the increase in both headline and core inflation to multi-year highs, some of the pressures still stem from base effects following pandemic-related weakness last year. Indeed, the euro area's trimmed mean CPI – which excludes the top and bottom 7½% price moves – stood at a relatively moderate 2.9%Y/Y. While that was up 0.4ppt on the month and the highest since 2008, it was still well below the 4½%Y/Y rate on the equivalent Cleveland Fed US 16% trimmed mean CPI, suggesting that price pressures have broadened significantly less than on the other side of the Atlantic. The impact of the Omicron variant on global supply chains and new highs in wholesale gas prices raise uncertainty about the near-term price outlook. However, inflation will fall in January as base effects from Germany's VAT changes drop out of the calculation. And with wage growth modest, base effects from energy and other items affected by the pandemic should eventually establish a firm downwards trend by the end of 2022.

German ifo survey suggests GDP growth has stalled

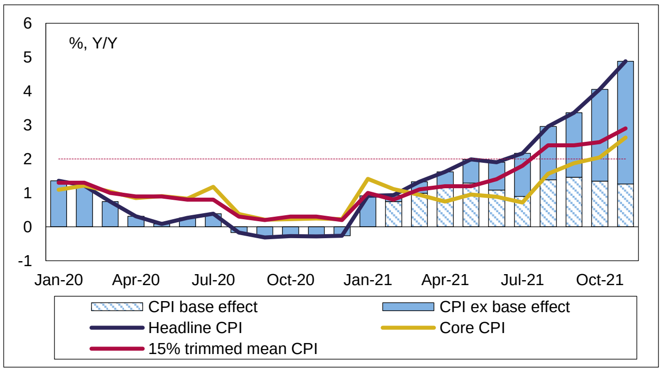
Like yesterday's flash PMIs, today's German ifo business survey suggested that economic growth has stalled in response to the latest wave of pandemic and ongoing supply bottlenecks. The survey assessment of current conditions deteriorated for the fourth successive month in December to the weakest since May. And the index of expectations for six months' time fell for the sixth consecutive month to the lowest since January. Overall, the headline business climate index dropped almost 2pts – the most in a losing streak dating back to July – to a ten-month low of 94.7, firmly below the long-run average. The assessment of current conditions was judged to have deteriorated in every major sector, with the weakening most marked among retailers, who were also the most pessimistic about the outlook. Faced with tightening pandemic restrictions, particularly on the unvaccinated, sentiment among services firms deteriorated the most since the first wave in April 2020.

Euro area: Consumer price inflation components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



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

And wholesalers and construction firms were also, on average, pessimistic about prospects for the coming six months. Only manufacturers were a little more upbeat about the outlook. While supply bottlenecks for intermediate goods and raw materials were judged to have intensified again, firms were encouraged by a big rise in orders. Consistent with the ifo indices and flash PMIs, the Bundesbank's updated economic projections published today suggested that GDP growth will pause in the current and next quarters. Overall, the Bundesbank revised down its GDP growth projection for 2021 by 1.2ppts from June to 2.5%Y/Y, and for 2022 by 1.0ppt to 4.2%Y/Y.

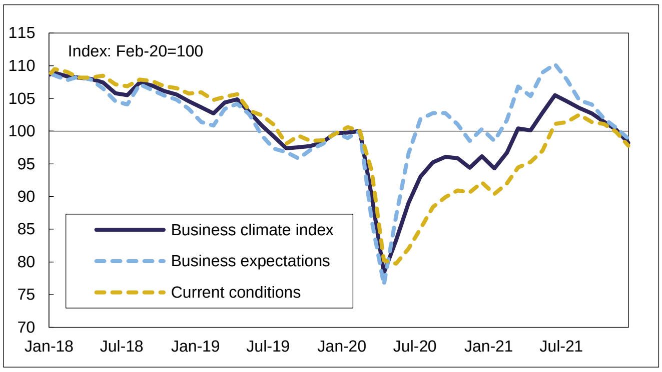
Euro area new car registrations see weakest November since survey began

Euro area new car registrations numbers published today suggested a modest improvement in November as production had increased with a slight easing of supply constraints. On a seasonally-adjusted basis, ECB data suggested that car sales rose for the second month out of the past five, by 1.5%M/M, with positive monthly growth registered in Germany (1.6%M/M), France (2.8%M/M) and Italy (3.7%M/M). But this still marked the lowest November outturn since the series began and left aggregate sales in October and November trending almost 1½% lower than the Q3 average and down more than 20%Y/Y. The unadjusted ACEA numbers showed new car registrations down 20.8%Y/Y in November despite the low base a year ago to leave cumulative sales in the year to date almost 1% lower than the first eleven months of 2020.

The festive period in the euro area

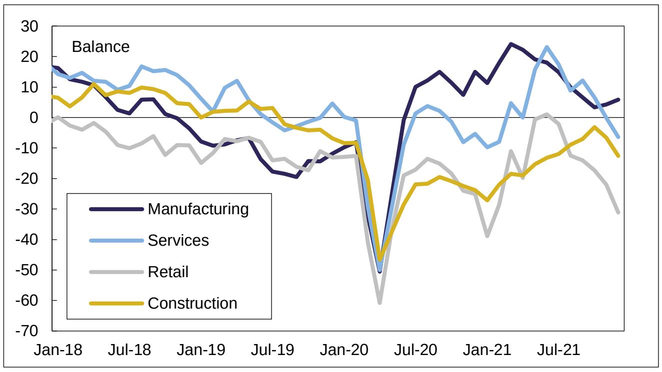
The coming week should be relatively uneventful for economic data from the euro area, although the European Commission's flash consumer confidence index for December is due on Tuesday and national confidence indicators include Germany's GfK consumer survey (21 December), and Italy's ISTAT business and consumer surveys (23 December). After a quiet festive period for top-tier euro area data, the first week of January will bring several releases of note, concluding with euro area flash December inflation, economic sentiment and November retail sales data on Friday 7 January. With energy inflation likely to have remained elevated, we expect the headline CPI rate to move broadly sideways in December. However, core inflation might well tick slightly higher on the back of non-energy industrial goods inflation. As suggested by yesterday's flash PMIs, the European Commission's economic surveys – arguably the best guide to euro area GDP growth – seem bound to offer a more downbeat assessment of conditions as the emergence of the Omicron variant and pandemic-related restrictions weigh on activity in the run up to Christmas. Euro area retail sales data for November seem likely to have been impacted to some extent by the resurgence of the pandemic. Other releases of note due early in the New Year include German factory orders and industrial production data for November on 6 and 7 January.

Germany: ifo business sentiment indicators



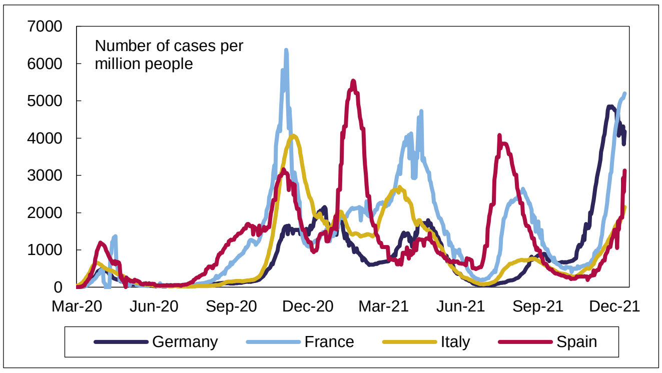
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ifo business expectations by sector



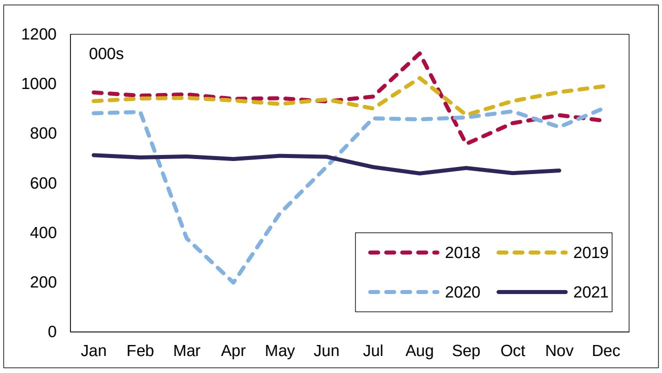
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

New coronavirus cases in selected countries



Source: OurWorldinData and Daiwa Capital Markets Europe Ltd.

Euro area: New car registrations*



**Seasonally adjusted. Source: ECB and Daiwa Capital Markets Europe Ltd.*

UK

Retail sales in November boosted by Black Friday deals and Christmas shopping

In light of the resurgence in the pandemic in the UK, yesterday's BoE decision to raise Bank Rate raised eyebrows. However, the decision was perhaps given additional justification by today's retail sales figures, which suggested that retailers had another strong month in November as consumers snapped up Black Friday deals and brought forward their Christmas shopping to avoid potential shortages during the festive period. In particular, total sales rose a stronger-than-expected 1.4%M/M following upwardly revised growth of 1.1%M/M in October. Excluding auto fuel, sales were 1.1% higher on the month, after a 2%M/M rise previously. So, total sales were 7.2% higher than their pre-pandemic level and were trending 1.4% higher than the Q3 average in the first two months of Q4. Growth was underpinned by a surge in spending on clothing (2.9%M/M) to surpass the pre-pandemic level for the first time and leave sales in October and November trending more than 11% higher than the Q3 average. Other non-food retailers, such as computer, toy and jewellery stores, also saw strong sales (2.8%M/M) supported by pre-Christmas discounting. The proportion of retail sales online fell again in November to 26.9%, its lowest proportion since March 2020 and down from February's peak (36.8%). But we would strongly expect to see this share rise again in December in light of the surge in coronavirus cases.

But consumer confidence worsens

Certainly, today's GfK consumer confidence survey predictably offered a more downbeat assessment of conditions heading into the festive period as concerns about the near-term outlook were heightened by the rapid spread of the Omicron strain. Admittedly, the headline sentiment index fell a smaller-than-expected 1pt in December to -15, 8pts lower than the summer peak but nevertheless 11pts higher than a year ago. Households were less upbeat about the economic outlook over the coming twelve months, with the index a steep 28pts lower than May's peak. And with disposable incomes being squeezed by higher prices, they were also less inclined to make major purchases in the run up to Christmas, although the relevant survey index (-6) was still considerably higher than a year ago (-22).

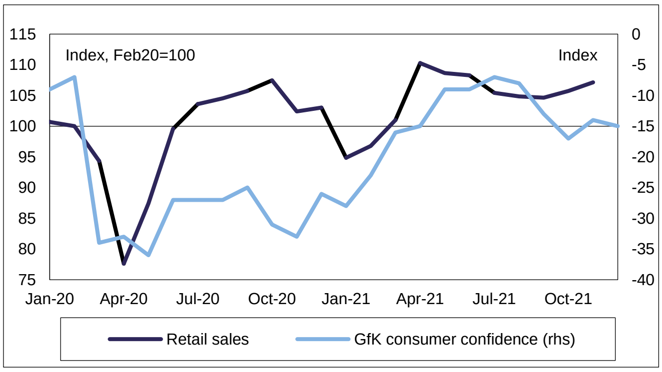
MPC likely to wait until May before raising Bank Rate again

While yesterday's vote to raise Bank Rate delivered a convincing 8-1 majority, the minutes suggested that the decision for all Committee members was finely balanced due to the uncertainty posed by the rapid spread of Covid-19. And the weakening in consumer sentiment reported today, following the more downbeat business assessment in yesterday's flash PMIs, should strengthen the case for the MPC to adopt a wait-and-see approach over the near term. Although the MPC will have updated Bank staff projections at the February meeting, it will not have received GDP data for the months most affected by the new pandemic wave. And while we can't rule out further fiscal support for the hospitality sector, particularly in light of increasing political pressures on PM Johnson, a tightening of restrictions in the New Year cannot be ruled out either. Importantly perhaps, the guidance in yesterday's policy statement that "some modest tightening of monetary policy over the forecast period" omitted November's statement that the "next rate hike would come in the coming months". So, that seemingly suggests less inclination to raise rates again at the next meeting. Moreover, if it waited until after the February meeting to raise Bank Rate to 0.50%, the BoE would reinvest the £28bn proceeds of its Gilt holdings due to mature at the start of March, avoiding an unpredictable impact on the yield curve. While it could alternatively choose to raise rates at the following meeting on 17 March, we think the MPC will wait for another set of updated economic forecasts in May, when it will have greater clarity on the economic impact of the Omicron variant both in the UK and more globally, before raising rates to 0.50%. And we pencil in a further 25bps hike in November to end the year at 0.75%.

The festive period in the UK

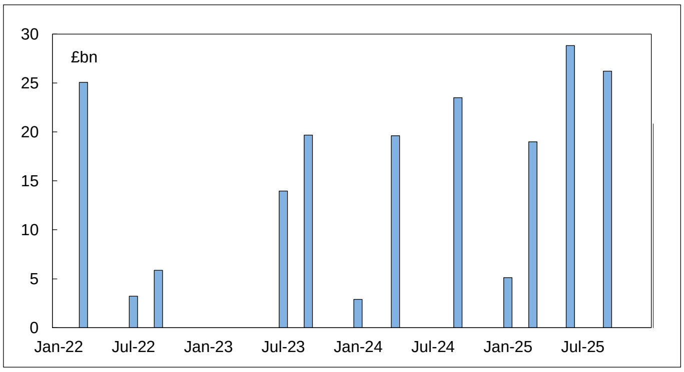
It should be a relatively quiet festive period for UK economic top-tier data, with December sentiment indicators of most note. The start of the coming week will bring the CBI's latest industrial trends and distributive trades surveys (Monday and

UK: Retail sales and consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: BoE gilt holdings by maturity date



Source: BoE and Daiwa Capital Markets Europe Ltd.

Tuesday respectively), along with the Lloyds business barometer (Tuesday), all of which are likely to flag heightened uncertainties amid the emergence of Omicron and reintroduction of certain restrictions on UK consumer-facing activities. Likewise, the final December PMIs – manufacturing and services reports due 4 and 6 January respectively – seem bound to reiterate the more downbeat findings from yesterday's flash estimates, while the construction PMIs (due 7 January) will likely flag ongoing supply chain disruption to activity. Supply bottlenecks will likely remain a restricting factor in the autos sector too, with November car production numbers (23 December) and December car registrations (7 January) expected to have remained subdued. November public finance (21 December) and bank lending figures (4 January), as well as final Q3 GDP and balance of payments data (22 December) are also due.

Daiwa economic forecasts

	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4	2021	2022	2023
GDP forecasts %, Q/Q									
Euro area	2.2	0.3	0.6	1.5	1.0	0.5	5.1	4.3	2.4
UK	1.3	0.6	0.6	1.0	0.6	0.6	6.8	4.3	1.9
Inflation forecasts %, Y/Y									
Euro area									
Headline CPI	2.8	4.6	3.7	3.7	2.9	1.5	2.6	2.9	1.3
Core CPI	1.4	2.4	2.0	2.7	2.3	1.6	1.5	2.2	1.3
UK									
Headline CPI	2.8	4.9	5.4	5.1	4.5	2.7	2.6	4.4	1.8
Core CPI	2.6	3.8	4.1	3.6	3.0	2.0	2.4	3.1	2.0
Monetary policy									
ECB									
Refi Rate %	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
PEPP envelope* (€bn)	1850	1850	1850	1850	1850	1850	1850	1850	1850
BoE									
Bank Rate %	0.10	0.25	0.25	0.50	0.50	0.75	0.25	0.75	1.00
Gilt purchases* (£bn)	875	875	875	875	866	866	875	866	833

**Target end of period. Source: Bloomberg, ECB, BoE 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	EU27 new car registrations Y/Y%	Nov	**-20.5**	-	-30.3	-
	Final CPI (core CPI) Y/Y%	Nov	**4.9 (2.6)**	*4.8 (2.6)*	4.1 (2.0)	-
	Construction output M/M% (Y/Y%)	Oct	**1.6 (4.4)**	-	0.9 (1.5)	**1.0 (2.0)**
Germany	PPI Y/Y%	Nov	**19.2**	20.0	18.4	-
	Ifo business climate	Dec	**94.7**	95.3	96.5	**96.6**
	Ifo current assessment (expectations)	Dec	**96.9 (92.6)**	97.5 (93.6)	99.0 (94.2)	-
UK	GfK consumer confidence	Dec	**-15**	-17	-14	-
	Retail sales incl. auto fuels M/M% (Y/Y%)	Nov	**1.4 (4.7)**	0.8 (4.2)	0.8 (-1.3)	**1.1 (-1.5)**
	Retail sales excl. auto fuels M/M% (Y/Y%)	Nov	**1.1 (2.7)**	0.8 (2.3)	1.6 (-1.9)	**2.0 (-2.1)**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

Key data releases – December/January 2022

20	21	22	23	24
EURO AREA ECB CURRENT ACCOUNT (OCT) **UK** CBI INDUSTRIAL TRENDS SURVEY (DEC)	**EURO AREA** CONSUMER CONFIDENCE (DEC P) **GERMANY** GFK CONSUMER CONFIDENCE (JAN) **ITALY** INDUSTRIAL SALES(OCT) PPI (DEC) **UK** LLOYDS BUSINESS BAROMETER (DEC) CBI DISTRIBUTIVE TRADES SURVEY (DEC) PUBLIC FINANCES (NOV)	**FRANCE** PPI (NOV) **SPAIN** PPI (NOV) **UK** GDP (Q3 F) CURRENT ACCOUNT (Q3)	**ITALY** ECONOMIC, CONSUMER & BUSINESS CONFIDENCE (DEC) **SPAIN** GDP (Q3 F) **UK** SMMT CAR PRODUCTION (NOV)	
27	**28**	**29**	**30**	**31**
GERMANY RETAIL SALES* (NOV)	**SPAIN** RETAIL SALES (NOV)	**EURO AREA** M3 MONEY SUPPLY (NOV) **UK** NATIONWIDE HOUSE PRICES* (DEC)	**SPAIN** CPI (DEC P) ECB PUBLISHES ECONOMIC BULLETIN	
03	**04**	**05**	**06**	**07**
EURO AREA MANUFACTURING PMI (DEC F) **GERMANY** MANUFACTURING PMI (DEC F) **FRANCE** MANUFACTURING PMI (DEC F) NEW CAR REGISTRATIONS* (DEC) **ITALY** CPI* (DEC P) MANUFACTURING PMI (DEC) NEW CAR REGISTRATIONS (DEC) **SPAIN** MANUFACTURING PMI (DEC) NEW CAR REGISTRATIONS* (DEC)	**GERMANY** UNEMPLOYMENT (DEC) **FRANCE** CPI (DEC P) **SPAIN** UNEMPLOYMENT (DEC) **UK** BRC SHOP PRICE INDEX (DEC) BANK LENDING (NOV) MANUFACTURING PMI (DEC F)	**EURO AREA** SERVICES & COMPOSITE PMIS (DEC F) **GERMANY** SERVICES & COMPOSITE PMIS (DEC F) NEW CAR REGISTRATIONS & PRODUCTION* (DEC) **FRANCE** CONSUMER CONFIDENCE (DEC) SERVICES & COMPOSITE PMIS (DEC F) **ITALY** SERVICES & COMPOSITE PMIS (DEC) **SPAIN** SERVICES & COMPOSITE PMIS (DEC)	**EURO AREA** PPI (NOV) CONSTRUCTION PMI (DEC) **GERMANY** CPI (DEC P) FACTORY ORDERS (NOV) CONSTRUCTION PMI (DEC) **FRANCE** CONSTRUCTION PMI (DEC) **ITALY** CONSTRUCTION PMI (DEC) **UK** NEW CAR REGISTRATIONS (DEC) SERVICES & COMPOSITE PMIS (DEC F)	**EURO AREA** CPI (DEC P) RETAIL SALES (NOV) EUROPEAN COMMISSION ECONOMIC CONFIDENCE SURVEYS (DEC) **GERMANY** INDUSTRIAL PRODUCTION (NOV) TRADE BALANCE (NOV) **FRANCE** CONSUMER SPENDING (NOV) INDUSTRIAL PRODUCTION (NOV) TRADE BALANCE (NOV) **UK** CONSTRUCTION PMI (DEC)

*UK public holiday. *Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

The next edition of the Euro wrap-up will be published on 4 January 2022

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