

# Euro wrap-up

## Overview

- Bund yields followed the global trend higher as German factory orders and turnover data pointed to a turnaround in the manufacturing sector, while German inflation appeared to have peaked.
- Gilt yields also made gains despite the final services PMIs and credit card data confirming a loss of momentum in December.
- Friday will bring the euro area's flash December CPI estimate, Commission sentiment survey and retail sales figures. German and French IP data also due.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 12/23	-0.613	+0.019
OBL 0 10/26	-0.406	+0.028
DBR 0 02/32	-0.067	+0.022
UKT 0 <sup>1</sup> / <sub>8</sub> 01/24	0.809	+0.045
UKT 0 <sup>3</sup> / <sub>8</sub> 10/26	0.968	+0.050
UKT 0 <sup>1</sup> / <sub>4</sub> 07/31	1.150	+0.063

\*Change from close as at 4:15pm GMT.

Source: Bloomberg

## Euro area

### German factory orders data support manufacturing turnaround

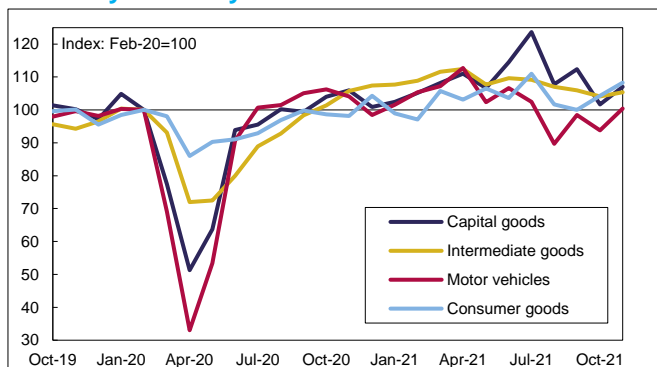
Consistent with certain other encouraging indicators, such as the December manufacturing PMIs and truck toll indices, today's German factory orders data offered further tentative signs of recovery in the sector. In particular, orders rose a stronger-than-expected 3.7%M/M in November. Admittedly, this only partially offset the weakness in October, although the drop that month (-5.8%M/M) was smaller than initially estimated. And the level was still merely the second-lowest since February. Nevertheless, orders were still a substantive 6.6% above the pre-pandemic level. The rebound in November was driven by overseas orders (8.0%M/M), with the strongest monthly increase (13.1%M/M) in orders from other euro area countries since August 2020, while domestic orders fell back (-2.5%M/M). The rise principally reflected an increase of 32%M/M in orders for other transport equipment – i.e. aircraft, ships, trains – while orders for autos rose 7%M/M to a four-month high and orders for machinery and equipment rose 2.0%M/M. Overall, orders for capital goods were up 5.3%M/M, while orders for intermediate and consumer goods rose 1.2%M/M and 3.8%M/M respectively.

Assuming a gradual easing in supply constraints, today's orders data bode well for the near-term production outlook. Indeed, the detail of today's release showed that manufacturing turnover rose for the second successive month in November and by a stronger-than-expected 4.1%M/M, the biggest monthly increase since July 2020, to the highest level since March. Admittedly, this still left turnover more than 6½% lower than the pre-pandemic level. Nevertheless, turnover was trending over the first two months of Q4 more than 3% above the Q3 average. And it suggests that the data for industrial production in November, due tomorrow, will easily exceed the Bloomberg consensus forecast rise of 1.0%M/M.

### German inflation now likely past its peak

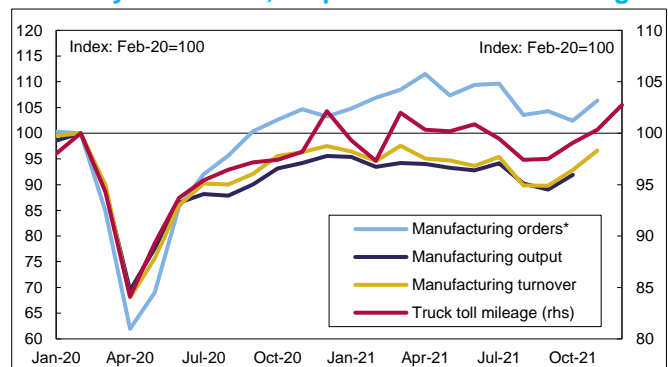
Today's flash estimates suggest that German inflation has now passed its peak. In particular, the headline rate on the EU harmonised HICP measure fell in December by 0.3ppt to 5.7%Y/Y, ahead of what will be a bigger drop in January as base effects associated with tax changes fall out of the calculation. Admittedly, the drop in December contrasted slightly with the national CPI rate, which rose 0.1ppt to 5.3%Y/Y. But the pickup was marginal and this will also fall significantly in January. Within the detail on the national measure, there was a notable easing in energy inflation last month, by 3.8ppts to 18.3%Y/Y, which, given the slightly larger energy weight in the harmonised measure, probably explains much of the discrepancy. In contrast, food inflation jumped 1.5ppts to 6.0%Y/Y, the highest for more than thirteen years. And non-energy industrial goods

### Germany: Factory orders



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany: Turnover, output and truck toll mileage\*\*



\*Excluding major orders. \*\*November toll mileage figure is based on daily data to 25 November. Source: Refinitiv, Bloomberg and Daiwa Capital Markets Europe Ltd.

inflation rose 0.5ppt to 2.7%Y/Y, the highest since the series began in the early 1990s. Services inflation rose 0.2ppt to 3.1%Y/Y, the highest since 1997. As such, core inflation also likely rose further in December, although this too will mark the peak. Looking ahead to tomorrow's euro area flash CPI estimate, today's figures support our forecast that the euro area's headline inflation rate fell back slightly in December, by 0.1ppt to 4.8%Y/Y, despite the surge in Spanish inflation at year-end. But core inflation is likely to have risen slightly further (by 0.1ppt to 2.7%Y/Y), before it drops back at the start of this year. Separately, euro area PPI inflation rose again in November, by 1.8ppts to 23.7%Y/Y, a fresh series high, but this too is set soon to turn lower.

## Construction PMIs point to mixed performances across the euro area

While manufacturing production appears to have picked up in November, surveys suggest that German construction output remained soft after falling 1.8%M/M in October. And today's construction PMIs suggest little improvement in conditions in the sector at the end of the year too. While it rose to a 22-month high, at 48.2 the German construction activity PMI was still consistent with contraction. In contrast, the French index remained consistent with expansion even though it slipped back in December, by 0.7pt to 50.9. And despite a more sizeable drop in the Italian construction activity PMI (down 1.1pts), at 64.4 it continued to suggest strong growth. Overall, this left the headline euro area construction PMI a touch weaker (-0.4pt) than November's more than 3½-year high, to suggest another month of solid growth in the sector. Within the detail, the survey implied sustained growth in housebuilding for a tenth consecutive month, albeit at a slightly softer pace than in November, while commercial construction work maintained a similar pace. And civil engineering activity broadly stabilised having been in contractionary territory since July 2019. Moreover, new business reportedly increased at the fastest pace since February 2019. Alongside a further significant increase in delivery times due to material shortages and associated higher costs, price pressures remained still very close to series highs too.

## The day ahead in the euro area

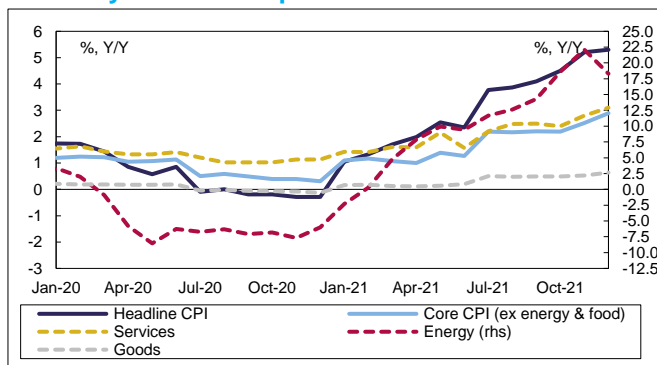
It will be a busy end to the week on the euro area economic data front. Aside from the aforementioned euro area inflation estimate, we will get euro area retail sales numbers for November and the European Commission's December economic confidence survey. Retail sales are expected to have fallen in the middle of Q4 (with a forecast fall of 0.5% more than reversing October's 0.2%M/M increase), as the Omicron coronavirus variant took hold across Europe forcing a number of member states to tighten restrictions. Given the new pandemic wave the final measure of the European Commission's December consumer confidence indicator is expected to confirm the sharp drop recorded in the flash release, down 1.5pts to -8.3. The Commission's sentiment survey is also expected to reveal a notable decline in services confidence, while the manufacturing sentiment indicator is expected to edge higher in December, tallying with the recent PMIs. At the country level, the aforementioned German IP numbers will be accompanied by the equivalent French figures, as well as November trade data from both countries.

## UK

### Services PMIs point to slump in demand at year-end, but still positive growth in Q4

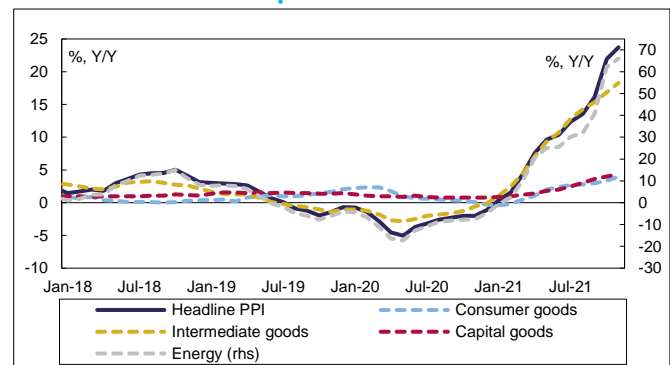
Despite an upwards revision from the flash survey, today's final UK services PMIs still suggested a notable (albeit not surprising) weakening of activity in the sector, particularly among consumer-facing firms, in the final month of last year as the Omicron variant hit demand and exacerbated labour shortages. Indeed, the headline activity PMI was still down 4.9pts on the month to 53.6, its lowest since February, more than 9pts lower than the summer peak and the first time it has not outpaced the equivalent manufacturing index since May. There was a similar slump (-5.4pts) reported in new business too, with tighter pandemic restrictions weighing particularly on leisure, hospitality and travel – the new export orders PMI fell an

### Germany: Consumer price inflation\*



\*National measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Producer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

even steeper 8pts to 46.2, the weakest since February. This broadly tallied with the BoE's Decision Maker Panel (DMP) results, published today, that suggested that overall sales might be around 7% lower in both Q421 and Q122 than they otherwise would have been without the pandemic, an impact some 2ppts larger than implied by the November survey. And experimental credit and debit card spending published by the ONS reported a notable drop in spending on social activities over the course of December, when the hospitality sector would normally be expected to be booming. Meanwhile, although firms continued to report solid jobs growth in the sector, they also cited persisting labour shortages, due to Covid-related absences and lack of available candidates, as well as difficulties retaining staff due not least to increased wage competition. In addition, while down from November's survey record high, Markit's measure of input costs remained extremely elevated. Overall, despite the sharp slowdown in the run up to Christmas, the services PMI remains consistent with expansion in the sector. And despite the near-4½pt monthly drop in the composite PMI (to 53.2, the lowest since March), the average index over the fourth quarter as a whole still stood at a healthy 56.1, just 0.1pt lower than the Q3 average.

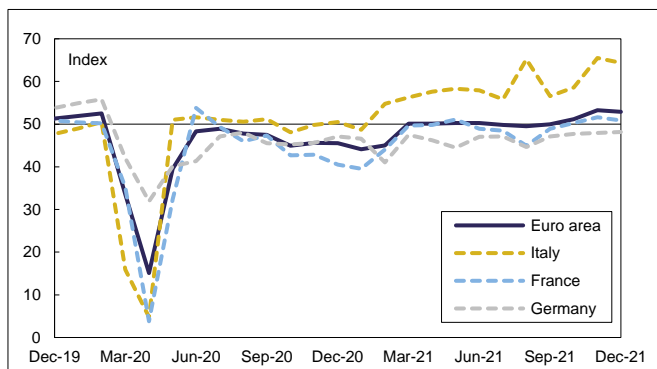
### Car registrations remain in the slow lane

The latest UK new car registrations numbers suggested a subdued end to the year too, with total sales down 18.2%Y/Y. But this principally reflected ongoing sharp declines in fleet and business-related registrations (-40.4%Y/Y and -13.1%Y/Y respectively), to leave associated full-year sales even lower than in 2020. Of course, that weakness in part reflects supply-side challenges. However, private car registrations were almost 20% higher than in December 2020, with full-year sales almost 7½% higher than in 2020 too. Admittedly, full-year private registrations were still down by more than a fifth compared with 2019, with total registrations 29% lower on an equivalent basis.

### The day ahead in the UK

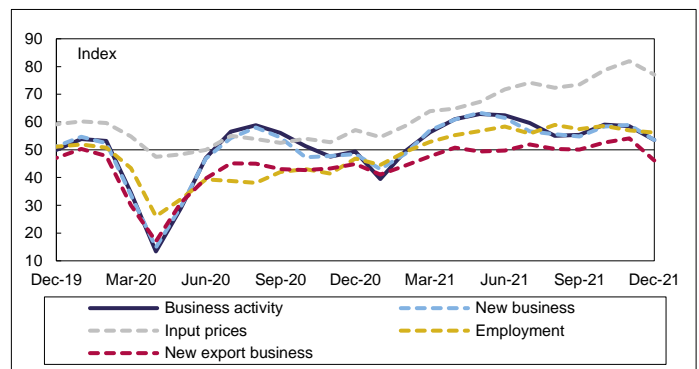
A fairly quiet end to the week in the UK brings only the construction PMI for December scheduled for release, which is expected to reveal a slowdown in the pace of expansion in the sector.

#### Euro area: Construction PMIs



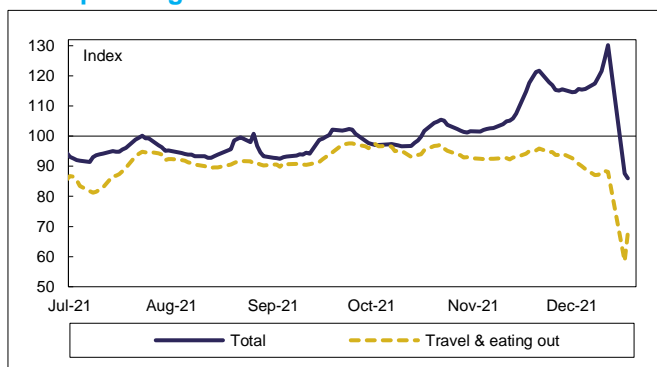
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

#### UK: Services PMIs



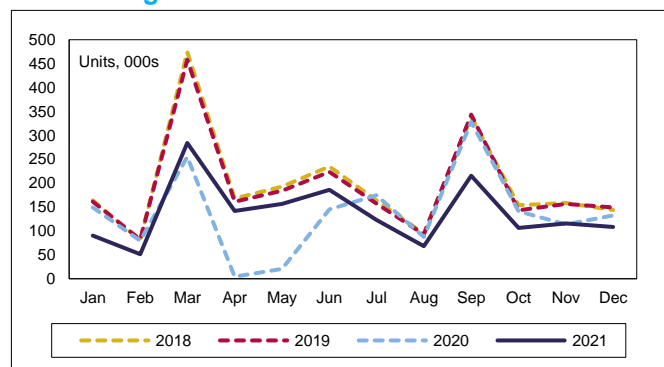
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

#### UK: Spending on credit and debit cards\*



\*Non-seasonally adjusted data. Source: Bank of England, ONS and Daiwa Capital Markets Europe Ltd.

#### UK: Car registrations












Source: Refinitiv 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	 Construction PMI	Dec	<b>52.9</b>	-	53.3	-
	 PPI Y/Y%	Nov	<b>23.7</b>	22.9	21.9	-
Germany	 Factory orders M/M% (Y/Y%)	Nov	<b>3.7 (1.3)</b>	2.2 (-1.1)	-6.9 (-1.0)	<b>-5.8 (0.1)</b>
	 Construction PMI	Dec	<b>48.2</b>	-	47.9	-
	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Dec	<b>5.3 (5.7)</b>	5.1 (5.6)	5.2 (6.0)	-
France	 Construction PMI	Dec	<b>50.9</b>	-	51.6	-
Italy	 Construction PMI	Dec	<b>64.4</b>	-	65.5	-
UK	 New car registrations Y/Y%	Dec	<b>-18.2</b>	-	1.7	-
	 Final services (composite) PMI	Dec	<b>53.6 (53.6)</b>	53.2 (53.2)	58.5 (57.6)	-













#### Auctions

Country	Auction
France	 sold €5.87bn of 0% 2032 bonds at an average yield of 0.3%
	 sold €1.80bn of 0.5% 2040 bonds at an average yield of 0.69%
	 sold €3.33bn of 0.75% 2053 bonds at an average yield of 0.99%


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	10.00	 Preliminary CPI (core CPI) Y/Y%	Dec	<u>4.8 (2.7)</u>	4.9 (2.6)
	10.00	 Retail sales M/M% (Y/Y%)	Nov	-0.5 (5.6)	0.2 (1.4)
	10.00	 European Commission's economic sentiment indicator	Dec	116.1	117.5
	10.00	 European Commission's final consumer confidence	Dec	-8.3	-6.8
	10.00	 European Commission's industrial (services) confidence	Dec	13.9 (16.6)	14.1 (18.4)
Germany	07.00	 Industrial production M/M% (Y/Y%)	Nov	1.0 (-0.8)	2.8 (-0.6)
	07.00	 Trade balance €bn	Nov	12.8	12.7
France	07.45	 Consumer spending M/M% (Y/Y%)	Nov	0.5 (13.9)	-0.4 (-5.3)
	07.45	 Industrial production M/M% (Y/Y%)	Nov	0.5 (0.6)	0.9 (-0.5)
	07.45	 Manufacturing production M/M% (Y/Y%)	Nov	-	0.9 (0.1)
	07.45	 Trade balance €bn	Nov	-7.2	-7.5
UK	09.30	 Construction PMI	Dec	54.0	55.5

#### Auctions and events

UK	17.15	 BoE's Mann speaks on a panel discussion on 'Will US growth be higher than in the previous decade after the pandemic?'
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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