Euro wrap-up

Overview

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- Bunds made further gains even as new euro area data reported significant growth in jobs and falling labour market slack in Q3.
- Gilts also made gains as a UK labour market survey reported firm employee demand and strong growth in starting salaries, albeit diminished labour shortages.
- Friday will bring data for UK GDP and euro area goods trade in November as well as full-year German GDP growth in 2021.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/23	-0.615	-0.009
OBL 0 10/26	-0.409	-0.024
DBR 0 02/32	-0.095	-0.032
UKT 0$^{1}/_{8}$ 01/24	0.751	-0.038
UKT 0$^{3}/_{8}$ 10/26	0.932	-0.037
UKT 0¼ 07/31	1.107	-0.028

*Change from close as at 4:20pm GMT.
Source: Bloomberg

Euro area

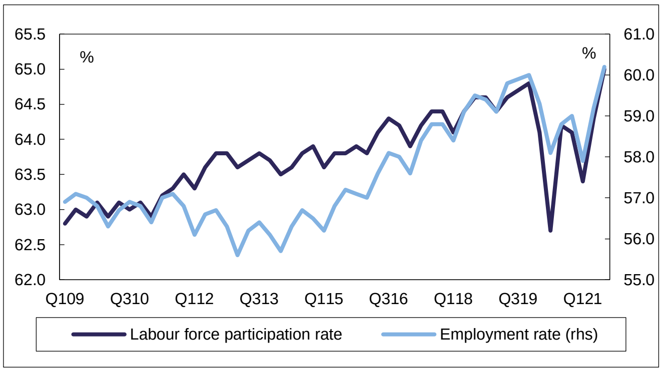
Strong growth in employment in Q321 as labour force participation reached a series high

On a relatively quiet day for economic data from the euro area, today's labour force survey results provided an update on the extent of slack in the labour market, which will have a bearing on growth in wages and hence domestically generated inflation over coming quarters. We already knew from Monday's data that the euro area unemployment rate declined in November to 7.2%, only marginally above the series low reached in March 2020. However, those figures are influenced by changes in labour force participation. Indeed, the increase in inactivity during the early stage of the pandemic – in part due to the difficulty of job search during lockdowns, as well as factors such as early retirement and sickness – weighed on the number of jobless workers classified as unemployed. Following solid growth the prior quarter, today's figures suggest that labour force participation continued to rebound in Q321. Notably, the activity rate for people aged 15-74 years rose to a series high, up 0.7ppt on the quarter to 65.0%, some 2.3ppts above the trough during the first lockdowns in Q220 and 0.2ppt above the previous peak in Q419. Remarkably too, activity rates reached series highs for all age groups bar those over 70 years, suggesting that the marked increase in early retirement seen in the US over the course of the pandemic has not been mimicked in the euro area, probably in part reflecting the success of government furlough schemes in keeping workers attached to their firms. So, the decline in the unemployment rate in Q321 of 0.4ppt to 7.6% (down more than 550k to 12.5mns, slightly more than 200k above the Q419 level) was all the more impressive, and was accompanied by an increase of 0.6ppt in the employment rate to 59.8%, just 0.2ppt below the pre-pandemic peak. That represented an increase of 1.45mn to 151.98mn, fewer than 600k below the pre-pandemic peak.

Labour market slack declines close to series low

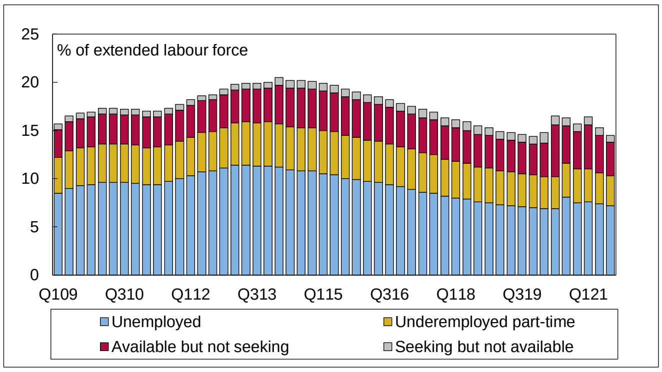
Looking at the population aged 20-64 years only, overall labour market slack – which includes workers who would like to work longer hours as well as all those available for work, job seeking and classified unemployed – fell significantly in the middle of 2021. In particular, following a drop of 1.0ppt in Q2, euro area labour market slack declined a further 0.9ppt in Q3 to 14.5%, just 0.1ppt above the series low in Q419. Among the member states, there remained major differences. For example, while slack in Germany (6.8%) and France (15.0%) recorded series lows, the equivalent figures in Italy (22.0%) and Spain (23.2%) remained more than 1.0ppt above the pre-pandemic rates. Within the detail, the share of the labour force involuntarily working part-time edged down 0.1ppt to a series low of 3.1% while there were also declines in the share seeking work but not immediately available and also those available for work but not actively seeking. Looking ahead, employment, labour market slack and participation will likely have been affected by the latest wave of pandemic. However, unemployment and overall labour market slack seem likely to decline to series lows over coming quarters. That should push wage growth somewhat higher. But as slack – particularly in Italy and Spain – will remain sizeable, and based on past relationships, on

Euro area: Labour participation and employment*



*Ages 15-74 years. Source: Refinitiv, Eurostat and Daiwa Capital Markets Europe Ltd.

Euro area: Labour market slack*



*Ages 20-64 years. Source: Eurostat and Daiwa Capital Markets Europe Ltd.

average that wage growth seems likely to be insufficient to compensate for high inflation and maintain purchasing power. By the same token, increased wage costs seem unlikely to be passed on to consumers in terms of higher prices – particularly in services – to the extent required to keep inflation above 2%Y/Y in 2023.

The day ahead in the euro area

The end of the week will bring euro area goods trade numbers for November. After falling to an eighteen-month low in October the trade surplus is expected to have narrowed further not least on the back of higher import prices. Tomorrow's release will also include export and import volumes numbers for October. Friday will also bring updated French and Spanish inflation data for December – for which the preliminary readings showed the headline HICP rate unchanged at 3.4%Y/Y in the former but increased 1.2ppts to 6.7%Y/Y in the latter – as well as Germany's full-year GDP figures for 2021, which are expected to report disappointing growth of 2.7%Y/Y (consistent with little if any growth at all in Q4) following the drop of 5.0%Y/Y in 2020. Elsewhere, ECB President Lagarde is scheduled to speak publicly.

UK

Survey suggests very slight easing of labour demand amid improving staff availability

Despite the spread of the Omicron variant and hit to services activity at the end of last year, the latest REC/KPMG Report on Jobs implied that the UK labour market remains tight. Certainly, demand for workers remained strong in December with the survey reporting robust growth in permanent and temporary placements alike, with the former continuing to outpace the latter, and at a pace only marginally softer than the rates seen during the summer peak. A separate ONS survey today suggested that roughly 3% of the workforce was estimated to be on leave or not working due to coronavirus at the end of the year, the largest share since comparable estimates began in June 2020. So, it was perhaps not surprising to see healthcare topping temporary vacancy requirements, while retail saw the softest demand. This notwithstanding, growth in private sector vacancies remained stronger than in the public sector overall, with both still close to recent record highs. Nevertheless, the survey reported an easing in labour supply constraints in December, with recruitment consultants considering candidate shortages to be the least severe since April. However, recruiters remained concerned about the outlook for labour supply given low unemployment and the reduced availability of foreign workers since Brexit. And starting salaries reportedly continued to rise rapidly in December as competition for scarce workers remained extremely high.

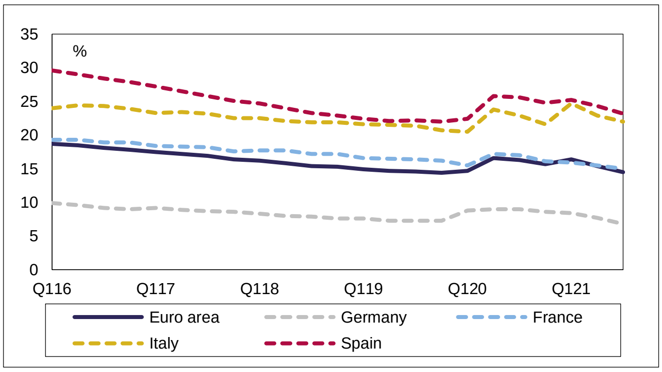
Household finances squeezed by rising living costs

As in the euro area, it remains to be seen whether growth in UK labour incomes will accelerate to compensate workers adequately for higher inflation. Certainly, underlying wage growth had appeared to be moderating slightly towards the end of last year. And reflecting the jump in living costs, a Scottish Widows survey yesterday suggested that its measure of household financial wellbeing had fallen at the steepest pace since Q220, as household savings were squeezed to the greatest extent since 2013 and cash availability was judged to have fallen the most since 2014. With the prospect of still higher energy bills to coincide with an increase in National Insurance Contributions in April, households were unsurprisingly more downbeat about their expected financial situation for the coming year. Indeed, in the absence of government action to reduce energy bills, and a renewed acceleration in wage growth, real household disposable income will fall significantly this year and perhaps also in 2023, which will inevitably weigh on private consumption growth.

The day ahead in the UK

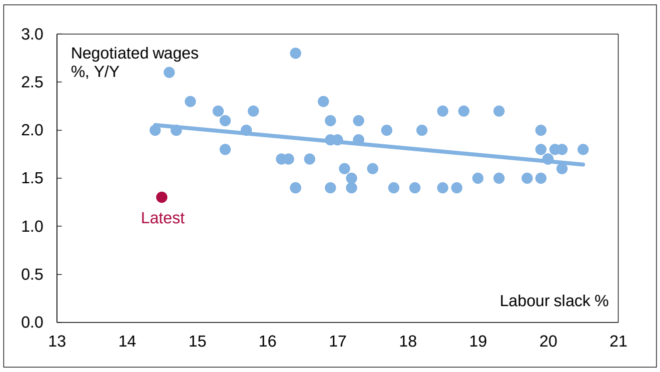
It will be a busy end to the week for top-tier UK data, with most notable being the release of November's GDP report. High frequency data suggest that private sector services activity picked up that month, while retail sales recorded another month of strong growth. Additionally, a surge in the provision of booster vaccinations seems likely to have supported the heath sector again. And with a modest pickup in manufacturing output also anticipated, an acceleration in GDP from the

Euro area: Labour market slack by member state*



Ages 20-64 years. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

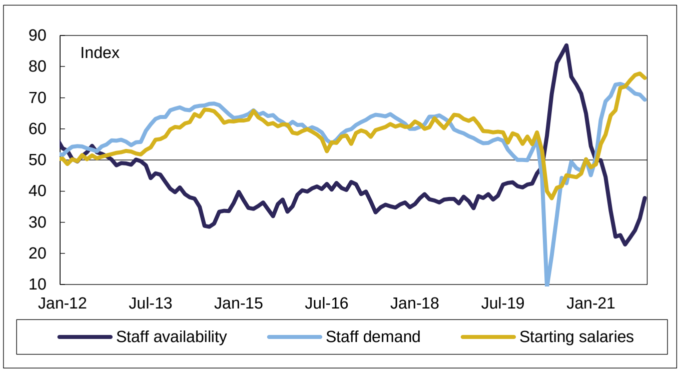
Euro area: Wage growth and labour market slack*



Data from Q109 to Q321. Source: Refinitiv, Eurostat and Daiwa Capital Markets Europe Ltd.

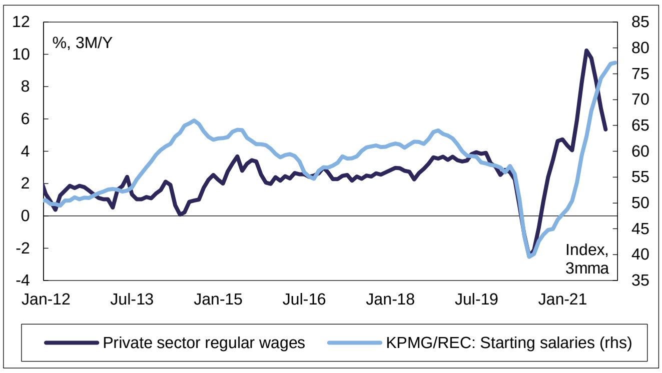
disappointing 0.1%M/M rate recorded in October is likely, with growth of 0.5%M/M to be sufficient to return output back to its pre-pandemic level. Tomorrow will also bring November's trade data.

UK: REC labour market indicators



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

UK: Wages and starting salaries



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

European calendar

Today's results							
Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Italy		Industrial production M/M% (Y/Y%)	Nov	1.9 (6.3)	0.5 (3.7)	-0.6 (2.0)	**-0.5 (1.9)**
Auctions							
Country		Auction					
Italy		sold €3.5bn of 0% 2024 bonds at an average yield of 0.14%					
		sold €3.5bn of 0.45% 2029 bonds at an average yield of 0.89%					

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	Trade balance €bn	Nov	1.5	2.4
Germany		09.00	GDP Y/Y%	2021	2.7	-5.0
France		07.45	Final CPI (EU-harmonised CPI) Y/Y%	Dec	2.8 (3.4)	2.8 (3.4)
Spain		08.00	Final CPI (EU-harmonised CPI) Y/Y%	Dec	6.7 (6.7)	5.5 (5.5)
UK		07.00	GDP M/M% (3M/3M%)	Nov	0.4 (0.8)	0.1 (0.9)
		07.00	Industrial production M/M% (Y/Y%)	Nov	0.2 (0.6)	-0.6 (0.4)
		07.00	Manufacturing production M/M% (Y/Y%)	Nov	0.2 (-0.3)	0.0 (1.3)
		07.00	Index of services M/M% (3M/3M)	Nov	0.5 (1.1)	0.4 (1.1)
		07.00	Construction output M/M% (Y/Y%)	Nov	0.3 (2.7)	-1.8 (3.3)
		07.00	Goods trade balance £bn	Nov	-14.2	-13.9
Auctions and events						
Euro area		13.30	ECB President Lagarde scheduled to speak			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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