Euro wrap-up

Overview

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- Longer-dated Bunds followed USTs higher, as data confirmed that euro area GDP and employment growth slowed in Q3, but Germany's ZEW investor survey surprised on the upside in November.
- Gilts also made gains despite UK data suggesting a very tight labour market amid rising inactivity and an acceleration in underlying wage growth.
- Wednesday will bring UK and Italian CPI inflation figures for October, while BoE MPC members will face questions from the Treasury Select Committee on November's Monetary Policy Report.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.124	+0.003
OBL 1.3 10/27	2.043	-0.030
DBR 1.7 08/32	2.091	-0.048
UKT 1 04/24	3.096	-0.041
UKT 1¼ 07/27	3.309	-0.044
UKT 4¼ 06/32	3.294	-0.070

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

Euro area

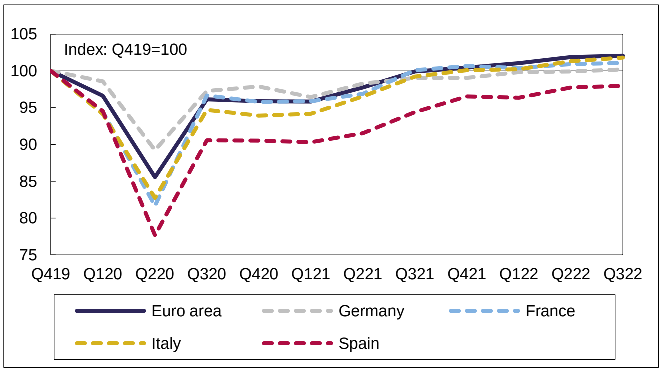
GDP growth slowed sharply in Q3 but remained positive in the four largest member states

Today's updated euro area Q3 GDP estimate saw growth unrevised at 0.2%Q/Q, a marked deceleration from the pace of recovery in the first half of the year when growth averaged 0.7%Q/Q but nevertheless stronger than had been anticipated by the ECB (0.1%Q/Q) and firmer than surveys had originally suggested. This left output 2.1% above the pre-pandemic level in Q419, lagging the recovery in the US (where output is more than 4% above the pre-Covid level) but compares favourably with the shortfall in the UK (-0.4% below the Q419 level). There were no changes to the preliminary estimates from the largest four member states either – Germany (0.3%Q/Q), France (0.2%Q/Q), Italy (0.5%Q/Q), and Spain (0.2%Q/Q). But five out of the fourteen member states to have reported data for Q3 saw their economies contract in Q3, including the Netherlands (-0.2%Q/Q), Belgium (-0.1%Q/Q) and Austria (-0.1%Q/Q). And with household budgets and firms' profit margins being increasingly squeezed by high inflation and rising borrowing costs, and concerns about energy supply and other supply-chain challenges remaining a constraint on production, various indicators point to likely contraction across the euro area as a whole in the fourth quarter, and beyond. Admittedly, today's German ZEW investor survey exceeded expectations in November, with the current conditions balance rising 7.7pts to -64.5 and the outlook component up 22.5pts to -36.7, amid expectations that inflation will fall sharply over coming quarters. However, the outlook balance still remains at an historically weak level and well below the long-run average. Moreover, other gauges including the ifo and PMI surveys that typically provide a more reliable guide to German activity still point to tough times ahead.

Employment growth slows despite rebound in Spain

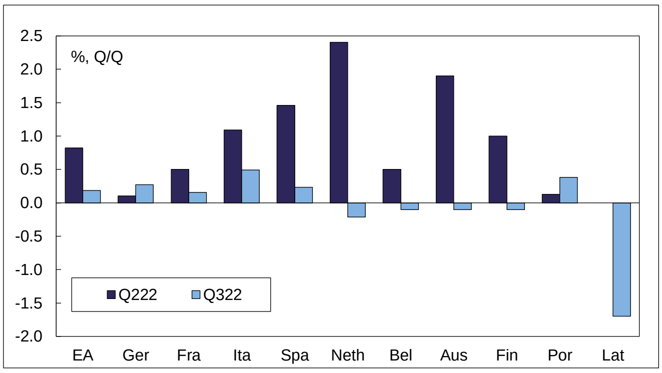
Consistent with the moderation in GDP growth, the pace of recovery in the labour market also slowed last quarter. Nevertheless, the number of employed persons rose for the sixth consecutive quarter, by 0.2%Q/Q (370k), to be up 2.4%Y/Y (2.79mn) and the level of employment above the pre-pandemic peak, by 1.9% or 3.07mn workers, to a new series high. Jobs growth last quarter was largely driven by a rebound in Spain, where employment rose 286k, with more modest increases in Germany (22k) and the Netherlands (49k). And while employment likely expanded in France and Italy too, given the worsening economic outlook, the aggregate level in Q3 might well mark the peak. Indeed, the Commission's latest sentiment survey signalled a further easing in firms' employment intentions at the start of the fourth quarter, to an eighteen-month low, with the softening most marked in Germany.

Euro area: GDP levels in selected member states



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth in selected member states



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

IP beat expectations in September, but energy-intensive subsectors continue to struggle

While we will have to wait until 7 December for the full breakdown of the Q3 national accounts, yesterday's euro area industrial production data suggested that, contrary to survey signals, the manufacturing sector made an unexpected, albeit modest, contribution to euro area GDP growth last quarter. In particular, IP rose for the fourth month out of the past five in September, by 0.9%M/M. This left industrial output up almost 5%Y/Y in September and up 0.5%Q/Q in Q3. But growth was driven by a surge in Ireland (11.9%M/M), which is notoriously volatile, and Belgium (7.1%M/M), excluding which production would have declined by around 0.2%M/M. And the strength in September in part reflected a 16.1%M/M (7.9%Q/Q) jump in pharmaceuticals output, with such output in Belgium surging more than 60%M/M. Autos production also accelerated 11.9%M/M in September (5.3%Q/Q) as supply bottlenecks eased. But energy-intensive subsectors continued to struggle. For example, chemicals production in the euro area fell in September for the ninth consecutive month to be more than 10½% lower than at the end of last year. Production in energy-intensive sectors in aggregate was down almost 1%M/M in September, by more than 3%Q/Q in Q3 and 6% below the level ahead of Russia's invasion of Ukraine. And given ongoing concerns about energy supply, production in these subsectors seems likely to have maintained a downtrend into the fourth quarter, with manufacturing output as a whole highly likely to be a drag on GDP growth.

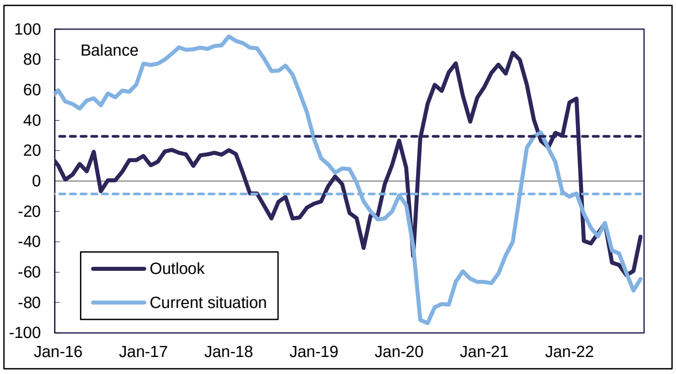
Goods trade deficit narrowed in September, but net trade likely a drag in Q3

While manufacturing provided modest support, net trade looks to have been a drag on growth last quarter. Admittedly, today's goods trade figures suggested that the deficit narrowed in September for the first time since May, by €9.8bn to €37.7bn, albeit still the third-largest on the series. Consistent with the pickup in production, the improvement in September in part reflected a second successive increase in the value of goods exports, by 1.6%M/M, to leave them up more than 2½%3M/3M in Q3. Within the country detail, there was a notable increase in shipments to Japan (19.0%M/M), with exports up to Korea (10.1%M/M) and Norway (9.5%M/M) too. But the narrowing in the deficit was also due to the first decline in the value of imports since January 2021 (-2.0%M/M), not least given the recent decline in prices of commodities. Nevertheless, this still left imports up 6%3M/3M in Q3, less than half the pace recorded in Q2 but more than double the pace of exports.

The day ahead in the euro area

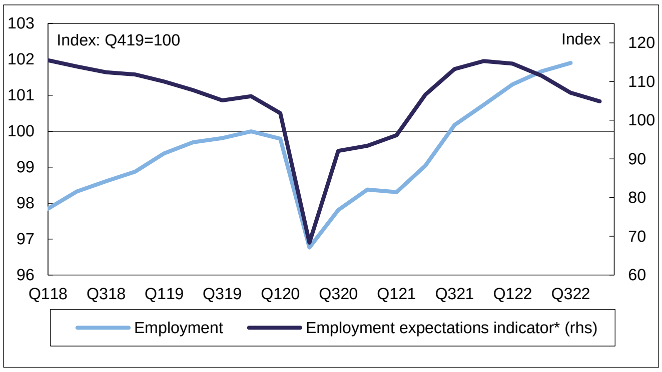
Tomorrow will be relatively quiet for euro area top-tier releases, with just final Italian CPI inflation figures due. The flash estimate surprised significantly on the upside, with the headline HICP rate accelerating 3.4ppts to 12.8%Y/Y in October, due largely to a surge in household energy bills. Equivalent figures from France and Spain published today aligned with the

Germany: ZEW investor survey indices*



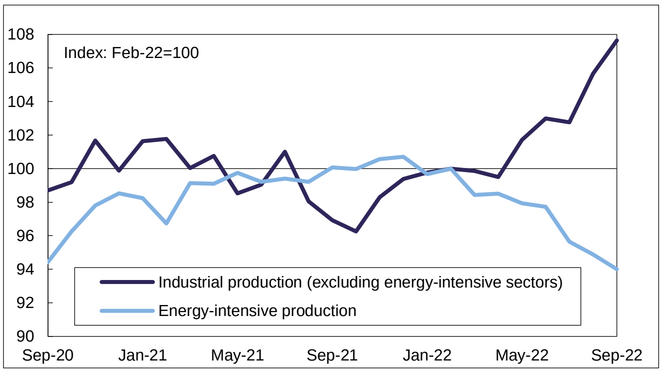
Dashed lines represent long-run averages. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Employment & EEI



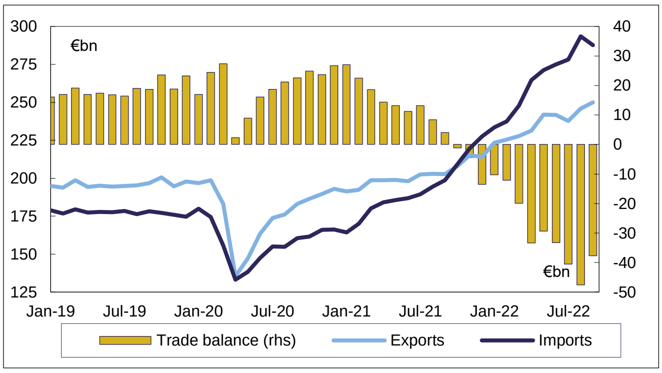
October survey result represents Q422 EEI. Source: Refinitiv, EC and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade balance*



Seasonally-adjusted values. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

preliminary figures that showed inflation rising 0.9ppt to 7.1%Y/Y in the former, but falling 1.7ppt to 7.3%Y/Y in the later as electricity and gas prices fell sharply (by 22½%M/M and 6½%M/M on the national measure). Separately, ECB President Lagarde and Executive Board member Panetta are due to speak on Wednesday, while the ECB's Financial Stability Review is scheduled to be published.

UK

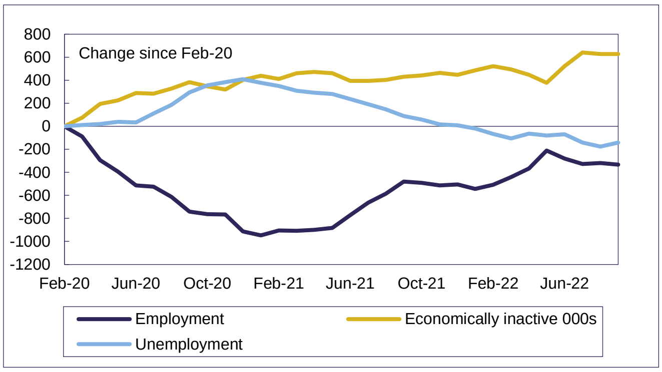
Employment declines in Q3 as economic inactivity rises

Today's UK labour market report suggested a still very tight jobs market with underlying wage growth continuing to exceed rates consistent with achieving its 2% inflation target over the medium term. Certainly, despite ticking slightly higher from August's 48-year low, the unemployment rate (3.6%) was still down 0.2ppt over the third quarter as a whole and 1.6ppt lower than the pandemic peak at the end of 2020. But looking at the admittedly volatile single-month figures, the unemployment rate jumped 0.4ppt to 3.8% in September, the highest since April. Moreover, the improvement over the quarter principally reflected a marked increase in economic inactivity, which rose by 108k in Q3, to be some 200k higher than a year ago and 629k higher since the start of the pandemic. While in part that was due to an increase in the number of students (70k), once again it also reflected a rise in the number of workers considered to suffer long-term sickness, which increased by a series high 133k in the third quarter, to account for roughly two-thirds of the total increase since February 2020. Consistent with the contraction in UK GDP in Q3, today's report confirmed a steeper-than-expected decline in employment (-52k) in the three months to September despite a surge in July, although this left the employment rate over the third quarter little changed at 75.5%, but nevertheless some 1.1ppt (334k workers) below the pre-Covid level. The weakening in economic activity last quarter was also evident in the fall in total hours worked, while the redundancy rate ticked higher. And consistent with survey indictors, vacancies fell to their lowest in almost a year, albeit remaining at an historically high level to leave the number of unemployed to job vacancy ratio still below 1%, illustrating the tightness in the labour market.

Wages remain too high for BoE comfort, but real wages continue to decline

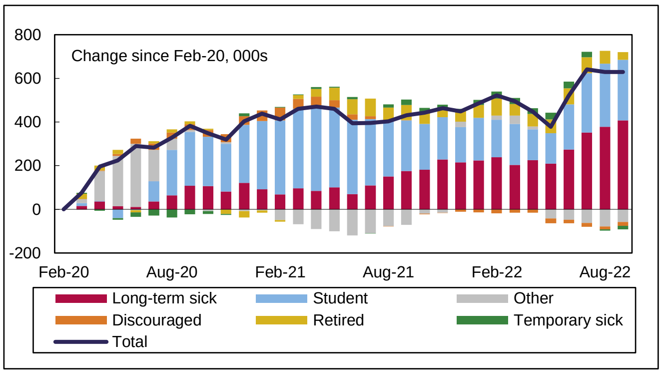
The tightness of the labour market was again also reflected in wage growth, the pace of which remains too high for the BoE's comfort. While growth in nominal wages moderated very slightly in the three months to September, by 0.1ppt to 6.0%3M/Y, regular wages accelerated 0.2ppt to 5.7%3M/Y, the fastest growth for more than a year and the strongest outside of the pandemic on the series. Regular private sector pay (6.6%3M/Y) was similarly at a series high outside of the height of the pandemic, with wage growth in hospitality, retail and wholesale sub-sectors remaining the strongest (7.3%3M/Y). Of course,

UK: Unemployment, employment & inactivity



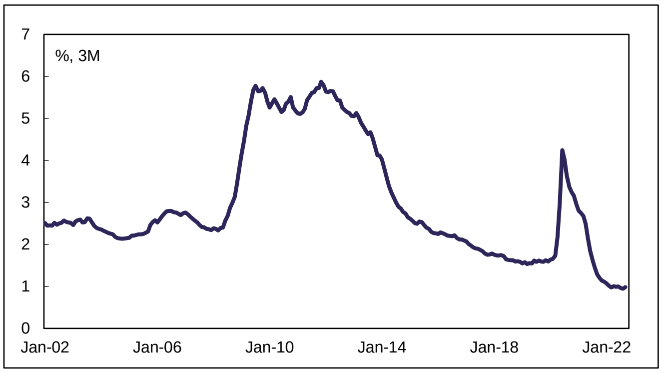
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Economic inactivity by cause



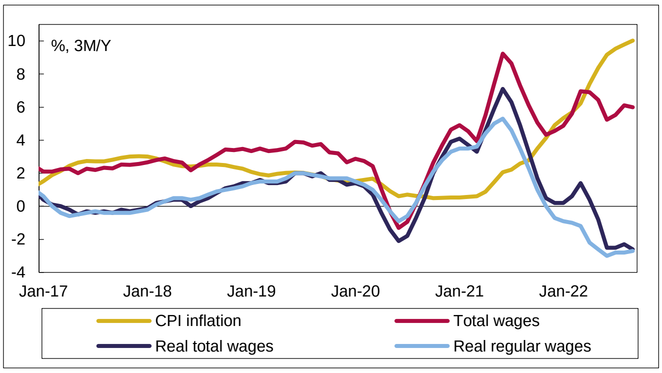
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Unemployment to job vacancy ratio



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: Wages and CPI inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

given high inflation, real wage growth remained firmly in negative territory, with total pay down 2.6%3M/Y, the most since April 2009, and regular earnings down 2.7%3M/Y. And with inflation set to rise further over the near term, declining real incomes will continue to reduce households' purchasing power.

The day ahead in the UK

The UK data highlight tomorrow will be the latest CPI figures, with the step-up in household energy bills last month likely to see headline inflation jump again in October: we forecast an above-consensus rise of 0.8ppt to 10.8%Y/Y. Indeed, when excluding food and energy, core inflation could have moved sideways at an admittedly still-elevated 6.5%Y/Y. The latest producer prices report will be watched for further signs of moderating price pressures at the factory gate. Meanwhile, the ONS house price index is expected to report a sizeable easing in the annual growth rate in September, in part reflecting base effects from the surge in September 2021 as the Stamp Duty discount concluded. Separately, BoE Governor Andrew Bailey and several MPC members, including the newest external member Swati Dhingra, will testify on November's Monetary Policy Report before the Treasury Select Committee.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	GDP – second estimate Q/Q% (Y/Y%)	Q3	**0.2 (2.1)**	0.2 (2.1)	0.8 (4.1)	**- (4.3)**
	Employment – first estimate Q/Q% (Y/Y%)	Q3	**0.2 (1.7)**	-	0.4 (2.7)	-
	Trade balance €bn	Sep	**-37.7**	-45.0	-47.3	**-47.6**
Germany	ZEW current assessment (expectations) balance	Nov	**-64.5 (-36.7)**	-68.1 (-50.0)	-72.2 (-59.7)	-
France	Final CPI M/M% (Y/Y%)	Oct	**1.0 (6.2)**	*1.0 (6.2)*	-0.6 (5.6)	-
	Final HICP M/M% (Y/Y%)	Oct	**1.2 (7.1)**	*1.3 (7.1)*	-0.5 (6.2)	-
Spain	Final CPI M/M% (Y/Y%)	Oct	**0.3 (7.3)**	*0.4 (7.3)*	-0.7 (8.9)	-
	Final HICP M/M% (Y/Y%)	Oct	**0.1 (7.3)**	*0.1 (7.3)*	-0.2 (9.0)	-
UK	Payrolled employees monthly change '000s	Oct	**74**	-	69	**94**
	Unemployment claimant count % (change '000s)	Oct	**3.9 (3.3)**	-	3.9 (25.5)	**- (3.9)**
	Average earnings including (excluding) bonuses 3M/Y%	Sep	**6.0 (5.7)**	5.9 (5.5)	6.0 (5.4)	**6.1 (5.5)**
	ILO unemployment rate 3M%	Sep	**3.6**	3.5	3.5	-
	Employment change 3M/3M '000s	Sep	**-52**	-30	-109	-

Auctions

Country	Auction
Germany	sold €3.11bn of 2.1% 2029 bonds at an average yield of 2.1%
UK	sold £3.25bn of 1% 2032 bonds at an average yield of 3.426%
	sold £2.25bn of 0.875% 2046 bonds at an average yield of 3.592%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Industrial production M/M% (Y/Y%)	Sep	**0.9 (4.9)**	*0.8 (3.5)*	1.5 (2.5)	**2.0 (2.8)**
UK		Rightmove house price index M/M% (Y/Y%)	Nov	**-1.1 (7.2)**	-1.1 (7.2)	0.9 (7.8)	-

Auctions

Country		Auction
UK		BoE sold £749.9mn of 2026-2029 gilts

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Italy		09.00	Final CPI M/M% (Y/Y%)	Oct	*3.5 (11.9)*	0.3 (8.9)
		09.00	Final HICP M/M% (Y/Y%)	Oct	4.0 (12.8)	1.6 (9.4)
UK		07.00	CPI M/M% (Y/Y%)	Oct	*1.8 (10.8)*	0.5 (10.1)
		07.00	Core CPI Y/Y%	Oct	*6.5*	6.5
		07.00	PPI output prices M/M% (Y/Y%)	Oct	0.5 (14.6)	0.2 (15.9)
		07.00	PPI input prices M/M% (Y/Y%)	Oct	0.2 (18.1)	0.4 (20.0)
		07.00	House price index Y/Y%	Sep	9.8	13.6

Auctions and events

Euro area		09.00	ECB publishes Financial Stability Review
		12.45	ECB's Villeroy scheduled to speak
		15.00	ECB President Lagarde scheduled to speak
Germany		10.30	Auction: €1.5bn of 1% 2038 bonds
UK		14.15	BoE Governor Bailey and MPC members testify on November's Monetary Policy Report before Treasury Select Committee

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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