Euro wrap-up

Overview

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- Bunds followed USTs higher, while German inflation was confirmed to have declined in November and an investor survey suggested that inflation expectations fell sharply in December.
- Gilts made losses as underlying UK wage growth accelerated in October amid a still very tight labour market.
- Wednesday will bring the release of euro area IP and UK inflation figures.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.112	-0.066
OBL 1.3 10/27	1.909	-0.056
DBR 1.7 08/32	1.897	-0.033
UKT 1 04/24	3.516	+0.035
UKT 1¼ 07/27	3.332	+0.051
UKT 4¼ 06/32	3.281	+0.082

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

Euro area

Final German figures saw headline CPI fall back in November, but core inflation remain sticky

There were no surprises from today's final German inflation figures for November. These confirmed that consumer prices fell for the first time in a year (-0.5%M/M), to leave the annual national inflation rate down 0.4ppt to 10.0%Y/Y. The EU harmonised inflation rate fell 0.3ppt to 11.3%Y/Y. The decline in part reflected a drop in energy prices (-1.3%M/M on the national measure), as the price of heating oil fell 13½%M/M and petrol was down 3½%M/M. But while energy inflation was down some 5ppts from the peak, it remained at a lofty 38.7%Y/Y. And this downwards impulse was in part offset by a further increase in food inflation, by 0.8ppt to 21.1%Y/Y a new series high. Today's release also suggested a further rise in prices of other goods, with our estimate of non-energy industrial goods inflation up 0.4ppt to a new post-reunification high of 8.1%Y/Y. So, while services prices dropped by the most in two years (-1.2%M/M) due to a sharp decline in package holiday deals (-25.7%M/M), there were further price increases in hospitality. And overall, core inflation remained sticky at a series high 5.0%Y/Y.

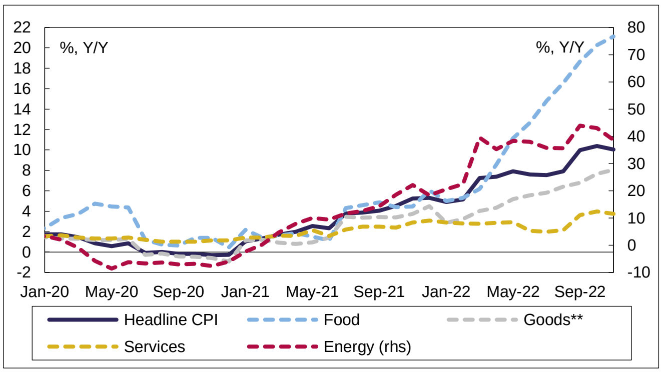
German investors expect a decline in inflation and economic conditions to improve (slightly)

While the outlook remains highly uncertain, we continue to think that German inflation has reached its peak. Certainly, the energy price cap coming into effect at the start of next year will further weigh on headline CPI, while price pressures of non-essential core items are likely to come under downwards pressures as demand continues to wane. Today's ZEW survey suggested that the vast majority of financial investors expect the inflation rate to fall back in the coming months too, with the relevant survey diffusion index (-78.1) at its lowest since 1994. Against this backdrop, the survey reported a modest improvement in current economic conditions in December, although the index (-61.4) was still at a historically low level and some 54pts lower than at the end of 2021. And while there was a smaller degree of pessimism among investors about the economic outlook, despite rising 13.4pts to -23.3, the survey index was also more than 50pts lower from a year ago and well below the long-run average (21.4). So, while Germany might well avoid a severe slump this winter, today's survey was still consistent with recession in the euro area's largest member state.

The day ahead in the euro area

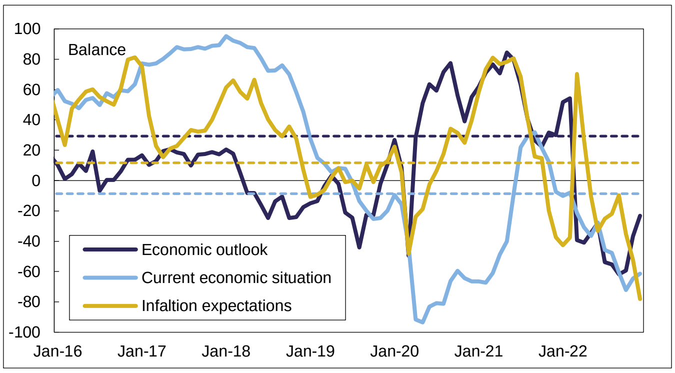
Wednesday will bring an update on the euro area's manufacturing sector at the start of Q4, with October's IP figures due for release. Today's Italian IP data reported a drop of 1.0%M/M, to leave output down more than 1½%Y/Y. And taken with declines in Germany (-0.4%M/M), France (-2.6%M/M), Spain (-0.4%M/M) and Ireland (-10.7%M/M), aggregate euro area production is likely to fall around 1.8%M/M to leave it still almost 3½% higher than a year ago but ½% lower than the Q3

Germany: Consumer price inflation*



*National measure. **Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ZEW investor survey indices*



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

average. Tomorrow will also bring updated Spanish CPI estimates for November. Preliminary data revealed that headline inflation on the national measure moderated for the fourth consecutive month, by 0.5ppt to 6.8%Y/Y, but that core inflation edged slightly higher, by 0.1ppt to 6.3%Y/Y.

UK

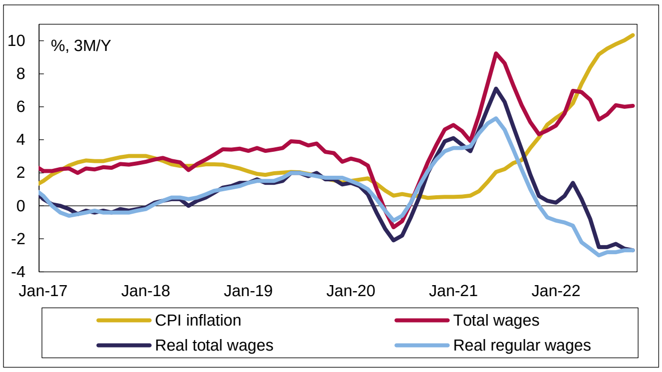
Stronger regular pay growth will remain a concern for BoE ahead of rate decision

Ahead of the BoE's latest monetary policy announcement on Thursday, today's UK labour market data strengthened the case for further policy tightening, with aspects of the report likely to add to the case for those MPC members considering another large hike in Bank Rate this week. Certainly, those members concerned about potential second-round effects from the tight labour market will be wary of the uptick in underlying wage growth in October to well above rates consistent with achieving its 2% inflation target over the medium term. Indeed, growth in nominal wages was above 6%3M/Y for the fifth month out of the past nine, while regular wages accelerated 0.3ppt to 6.1%3M/Y, the fastest growth for fifteen months and the strongest outside of the pandemic on the series. While the pickup reflected an increase in public sector pay growth (2.7%3M/Y), this continued to lag significantly rates of growth in the private sector, where regular pay (6.9%3M/Y) was similarly at a series high outside of the height of the pandemic. And the more timely HMRC estimates of median pay growth based on PAYE figures accelerated more than 1ppt to 7.9%Y/Y in November. Of course, given high inflation, real wage growth remained firmly in negative territory, with total pay down 2.7%3M/Y in October, the most since April 2009, and regular earnings down 2.7%3M/Y.

Employment unexpectedly rises in October, but signs that jobs growth will slow ahead

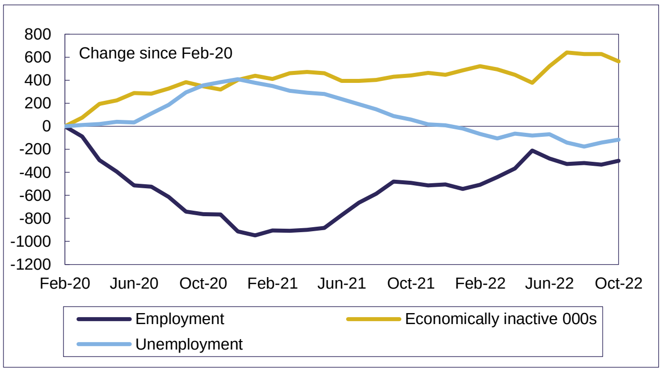
Employment also exceeded expectations, rising 27k in the three months to October, with the more timely (but more volatile and often revised) estimate of payrolled employees up 107k in November, the most since August 2021. And while the ILO unemployment rate edged slightly higher in the three months to October, by 0.1ppt to 3.7%, this remained low by historical standards and 1½ppt below the pandemic peak. Moreover, the uptick reflected a decline in inactivity over the same period (-64k), with the number of people taken out of the labour force due to long-term sickness and early retirement having encouragingly fallen back. Admittedly, this still left those economically inactive up more than 120k from a year ago and still 565k higher than before the pandemic, with employment roughly 300k lower than in February 2020 too. And there were components of today's report that reinforced the deterioration in labour market conditions flagged in recent surveys. For example, short-term unemployment rose to the highest since June 2021, with a more modest increase in unemployment

UK: Wages and CPI inflation



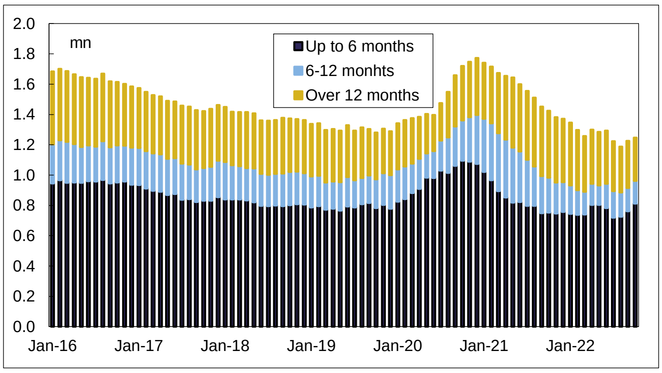
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Unemployment, employment & inactivity



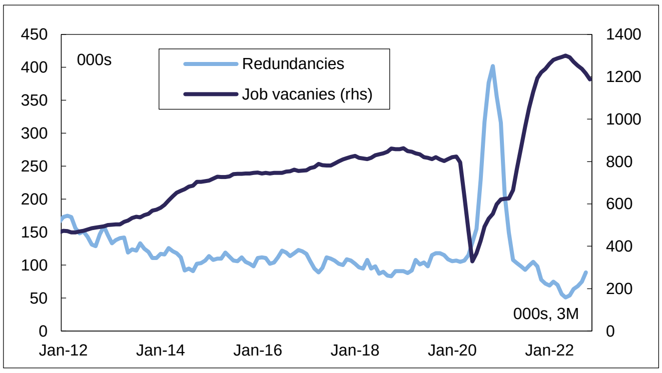
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Unemployment by duration



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Job vacancies & redundancies



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

flattered by a slight drop in longer-term joblessness. And while still also historically low, the number of redundancies in the three months to October rose by the most for a year (24k). The near-term jobs outlook remains highly uncertain, with the number of vacancies falling for the fifth consecutive month, to their lowest for fourteen months and around 9% below the summer peak. So with the economy having entered a likely prolonged recession, we expect to see a renewed downtrend in employment and a steady increase in the unemployment rate over coming quarters, which should limit any further upwards pressure on wages. On balance, therefore, we continue to expect the majority on the MPC to vote to raise rates by 50bps on Thursday, taking Bank Rate to 3.50%.

The day ahead in the UK

Focus in the UK tomorrow will be firmly on November's CPI inflation estimate. Headline CPI inflation is expected to have edged slightly lower in November due principally to an easing in energy inflation. But, in line with the Bloomberg consensus, we forecast inflation to fall only marginally below 11%Y/Y, with core inflation likely to remain sticky at 6.5%Y/Y. The latest ONS house price index for October is likely to see the annual rate of growth rise due principally to base effects associated with the ending of the Stamp Duty holiday last year.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Final CPI M/M% (Y/Y%)	Nov	**-0.5 (10.0)**	*-0.5 (10.0)*	0.9 (10.4)	-
	Final HICP M/M% (Y/Y%)	Nov	**0.0 (11.3)**	*0.0 (11.3)*	1.1 (11.6)	-
	ZEW current assessment (expectations)	Dec	**-61.4 (-23.3)**	-57.0 (-26.4)	-64.5 (-36.7)	-
Italy	Industrial production M/M% (Y/Y%)	Oct	**-1.0 (-1.6)**	-	-1.8 (-0.5)	**-1.7 (-)**
UK	Unemployment claimant count rate %, change '000s	Nov	**3.9 (30.5)**	-	3.9 (3.3)	**- (-6.4)**
	ILO unemployment rate %, 3M	Oct	**3.7**	3.7	3.6	-
	Employment change '000s, 3M/3M	Oct	**27**	-19	-52	-
	Average earnings including (excluding) bonuses 3M/Y%	Oct	**6.1 (6.1)**	6.2 (5.9)	6.0 (5.7)	**- (5.8)**

Auctions

Country	Auction
Italy	sold €1.5bn of 0% 2024 bonds at an average yield of 2.62%
	sold €2.0bn of 3.5% 2026 bonds at an average yield of 3.07%
	sold €3.5bn of 3.85% 2029 bonds at an average yield of 3.61%
UK	sold £3.0bn of 1% 2032 bonds at an average yield of 3.333%
	BoE sold £2.31bn of gilts in its financial stability portfolio

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMTT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	10.00	Industrial production M/M% (Y/Y%)	Oct	*-1.5 (3.6)*	0.9 (4.9)
Spain	08.00	Final CPI M/M% (Y/Y%)	Nov	*-0.1 (6.8)*	0.3 (7.3)
	08.00	Final HICP M/M% (Y/Y%)	Nov	*-0.5 (6.6)*	0.1 (7.3)
UK	07.00	CPI M/M% (Y/Y%)	Nov	*0.5 (10.9)*	2.0 (11.1)
	07.00	Core CPI Y/Y%	Nov	*6.5*	6.5
	09.30	House price index Y/Y%	Oct	11.2	9.5

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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