Euro wrap-up

Overview

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- Bunds made losses as euro area consumer confidence beat expectations rising to the highest since February 2022.
- Gilts made losses as the UK Chancellor announced a modest easing of fiscal policy while the DMO revised down only very slightly its Gilt issuance plan for the current fiscal year.
- Thursday will bring the flash November PMIs and the ECB's account of its October policy-setting meeting.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	3.000	+0.038
OBL 2.4 10/28	2.535	+0.021
DBR 2.6 08/33	2.557	-0.007
UKT 3½ 10/25	4.573	+0.054
UKT 4½ 06/28	4.185	+0.059
UKT 3¼ 01/33	4.149	+0.050

*Change from close as at 5.00pm GMT.
Source: Bloomberg

Euro area

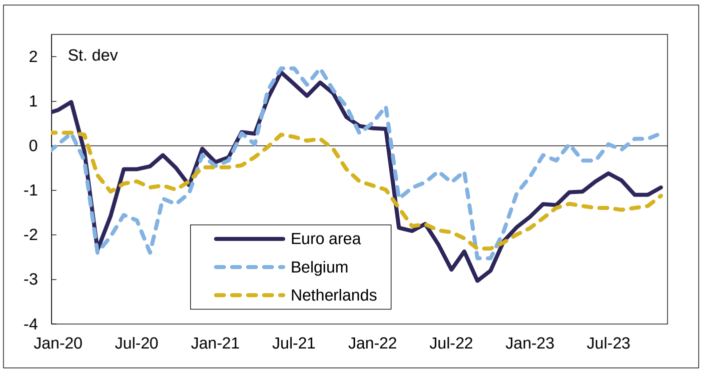
Consumers cautiously less pessimistic in November

Against the backdrop of falling inflation and improving real disposable incomes, today's flash Commission estimate of euro area consumer confidence in November beat expectations, with the index rising 0.9pt to -16.9, the highest since Russia's invasion of Ukraine in February 2022. Admittedly, this still left the average in the first two months of Q4 some 1pt below the Q3 average and still significantly closer to last September's trough (-28.7) than the average in the five years before the pandemic (5.6). Among the national surveys published, household sentiment also improved in the Netherlands and Belgium, with the respective headline indices rising 5pts to -33 and 1pt to -4, both at their highest levels since February 2022 and the latter above the long-run average. The detail of the Dutch survey suggested that consumers were less pessimistic about the economic outlook for the coming twelve months. And with expectations for their personal finances similarly less downbeat, perhaps buoyed by signals of stronger wage growth (see below), households assessed that the environment for making big-ticket purchases was somewhat more favourable than in October. But while the respective purchase intentions index rose to the highest for twenty months, it still remained closer to the recent trough than the long-run average. And with sentiment in the Netherlands, Belgium and the euro area as a whole still significantly worse than the average in the five years before the pandemic, today's survey remained consistent with restrained consumer spending across the region over the remainder of this year and into 2024.

Negotiated wage growth accelerated in Q3, but wage trackers gradually easing

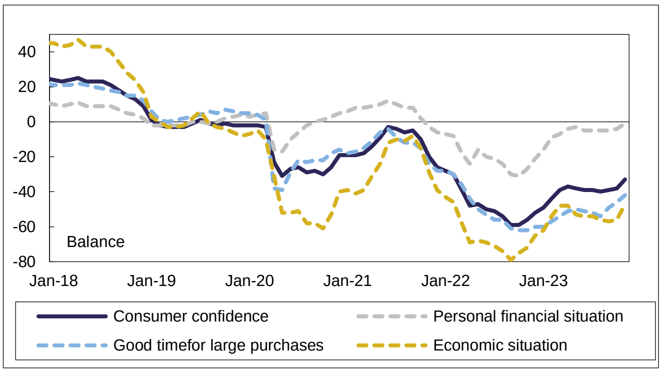
Despite weakening economic momentum, the euro area's labour market has shown remarkable resilience over recent quarters, with employment having risen for a tenth successive quarter in Q3. And with firms reporting staff shortages in many sectors, unions have remained in a relatively strong position to seek compensation for the high inflation of the past couple of years. Contrary to expectations, yesterday's ECB negotiated wage figures reported an uptick in pay settlement growth in Q3, rising 0.3ppt to a new series-high 4.7%Y/Y. Admittedly, this figure was boosted in part by one-off payments in Germany and Spain. And this contrasts with somewhat softer signals on employee compensation from other earnings indicators, including the Indeed wage tracker. In particular, this suggested that aggregate wage growth slowed for a third successive quarter in Q3, by 0.6ppt to 3.9%3M/Y, with sizeable declines in Germany (-1.4ppts to 4.5%3M/Y) and France (-0.4ppt to 4.3%Y/Y) offsetting an acceleration in Spain (+0.2ppt to 6.0%3M/Y) and the Netherlands (+0.1ppt to 5.2%3M/Y). And while the single-month growth rate in October ticked slightly higher, it remained below 4.0%Y/Y and maintained a downwards trend on a three-month basis.

Euro area: Consumer confidence



Source: EC, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Netherlands: Consumer confidence indices



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

New car registrations remain subdued at the start of Q4

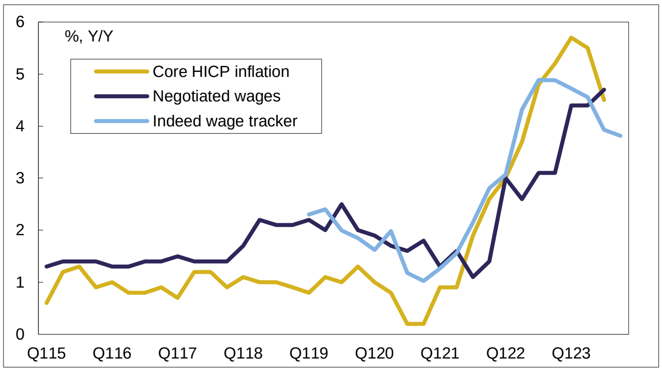
Aligning more closely with subdued consumer confidence and rising fears of unemployment amid a deteriorating economic backdrop, euro area new car registrations fell 2.2%M/M on a seasonally adjusted basis in October, suggesting that demand for big-ticket items remained subdued at the start of Q4. Admittedly, this followed strong growth in registrations in Q3 (8.2%Q/Q) which was boosted by increased demand in Germany ahead of the conclusion of tax incentives. And despite the monthly drop, sales were up around 8%Y/Y in October. However, registrations were still more than 14% below the equivalent month before the pandemic in 2019. The continued weakness in consumer spending in Q4 was also illustrated in the Bank of France retail survey, which suggested that sales fell for the third month out of the past four in October, by 0.9%M/M, to be trending some 0.6% below the Q3 average and at the joint-lowest level since April 2021.

The day ahead in the euro area

A key focus tomorrow will be the flash November PMIs from the euro area, Germany and France. Despite an anticipated modest improvement in sentiment, these are likely to be consistent with ongoing contraction in economic output in the middle of Q4 as new orders continue to decline. Indeed, the headline euro area composite output PMI already fell in October to 46.5, its lowest level for almost three years, with the respective German (45.9) and French indices (44.6) signalling a steeper pace of contraction. Admittedly, the French PMIs have overemphasised the deterioration in economic conditions in the euro area's second-largest member state. And so, the INSEE business survey (also due tomorrow) should be watched for an alternative guide to recent activity in France. Meanwhile, the price PMIs will also offer an update on recent inflationary pressures, with the manufacturing survey likely to be consistent with further declines in both input and output prices, while the services indices will signal inflation stickiness in the sector, despite having moderated from last year's peaks.

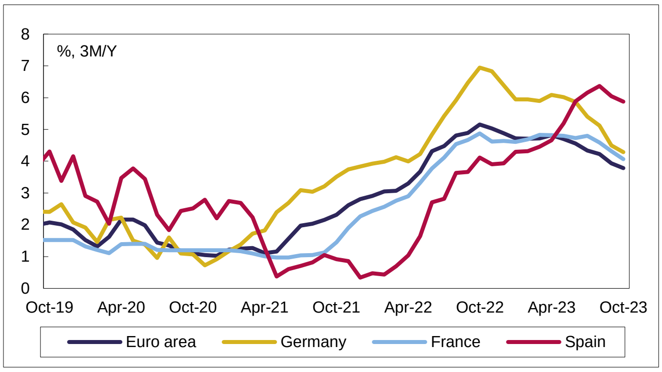
Separately, the ECB's account from its policy-setting meeting on 26 October will also be published tomorrow. While the Governing Council at this meeting maintained a 'higher-for-longer' stance, and recent commentary from members has pushed back on rate cut expectations, President Lagarde's tone in the post-meeting press conference was more dovish. And so, we might expect the minutes to flag increasing concerns on the Governing Council about the lagged impact of past rate hikes on the economy and intensifying downside risks to the near-term growth outlook.

Euro area: Wage growth* & core inflation



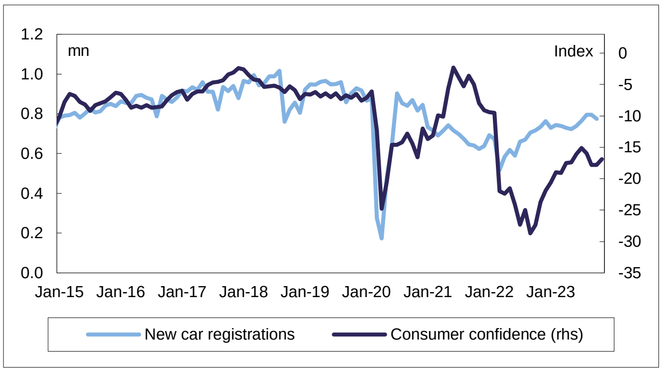
*Indeed wage tracker for Q423 is October figure. Source: ECB, Indeed, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Wage growth tracker



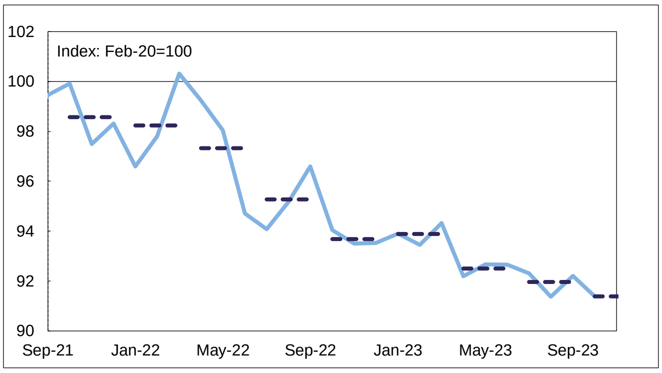
Source: Indeed, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence & car sales



Source: EC, ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

France: Retail sales*



*Dashed dark blue lines represent quarterly averages. Source: BoF, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK

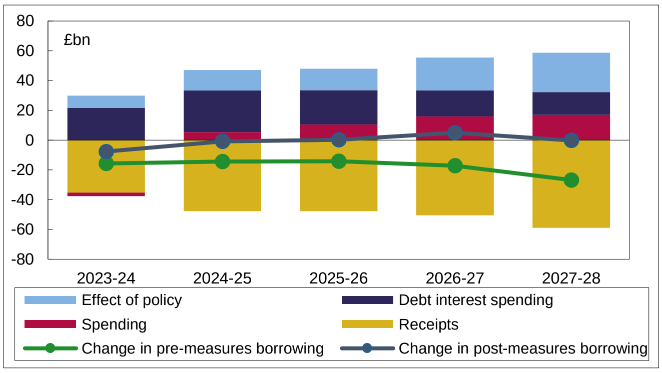
Government announces modest fiscal easing centered on tax cuts

Not least given the ruling Conservative party's extremely low popularity ratings ahead of the next general election, which is highly likely to come by next autumn at the latest, it should have been no surprise that Chancellor Hunt announced an easing of the fiscal stance in his autumn budget statement today. Most notably, with respect to personal taxation, the government will cut employee and self-employed National Insurance Contributions (NICs) from January. And with respect to business taxation, the government will make permanent the full-expensing capital allowance policy, which provides incentives for increased business investment, that was previously scheduled to end in 2026. In total, the tax policy decisions will cost the government in lost revenues some £10.7bn in the coming fiscal year (FY24/5) rising to a little more than £18bn in five years' time. The Chancellor also announced a more modest increase in public expenditure, amounting to £5.6bn in FY24/5 and peaking at £8.0bn in FY26/7. When incorporating the estimated indirect effects, today's fiscal loosening is estimated by the OBR to increase government borrowing by some £13.7bn, or about 0.5% of GDP, in the coming fiscal year.

Improvement in government borrowing due to higher inflation given away by Chancellor

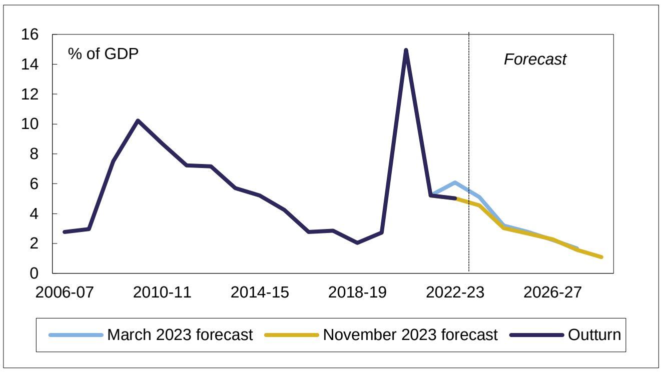
The government had scope to ease fiscal policy today as public sector net borrowing (PSNB) has been undershooting expectations. Over recent months, tax revenues have come in stronger than expected thanks principally to high inflation, while departmental spending has differed little from plan in cash terms. So, net borrowing in the first half of this fiscal year was almost £20bn lower than originally anticipated. And despite the NICs cut from January, the OBR expects PSNB over FY23/4 as a whole to be £7.7bn lower than its March forecast at £123.9bn (4.5% of GDP). While the government's public expenditure plans for coming years are unrealistically low and imply savage cuts to some public services, and the profile of public investment was also cut today, they also allow the OBR to project this year's improvement in the public finances to extend over the medium term. But almost all of the forecast reduction in underlying borrowing from FY24/5 to FY27/8 was offset by today's policy measures, leaving the profile for PSNB over coming years little changed from previous expectations. Overall, PSNB is expected to drop to 3.0% of GDP in the next fiscal year and 2.7% in FY25/6. Meanwhile, the DMO revised down its Gilt issuance target for this year by just £0.5bn – much less than the expected downwards revision of more than £13bn on last week's Bloomberg survey – to £237.3bn, with planned net bill sales instead reduced by £10bn and no change made to debt sales to retail investors.

UK: Change in public sector net borrowing forecast*



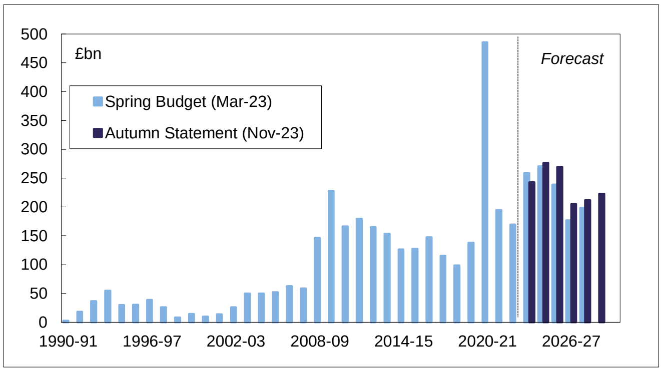
*Compared with Spring Budget in March 2023. Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Public sector net borrowing



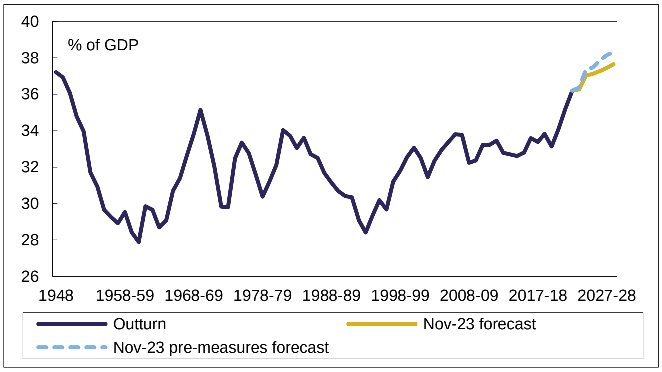
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Gross Gilt issuance



Source: DMO and Daiwa Capital Markets Europe Ltd.

UK: Tax revenues



Source: OBR and Daiwa Capital Markets Europe Ltd.

Budget boost to GDP growth to be small

Being worth just ½% of GDP in total, today's fiscal giveaway will have only a modest impact on economic growth. Indeed, as households will save some of their extra income, the OBR expects the NICs cut to boost GDP growth by less than 0.2ppt next fiscal year. And the OBR still expects real household disposable income to decline over FY24/5. As some firms will no longer feel the need to bring forward capital spending projects to before 2026 to take advantage of the full-expensing capital allowances, the decision to make that tax incentive permanent is likely to weigh on GDP growth over the near term. And despite today's measures, fiscal policy will still tighten over the coming fiscal year, with the cyclically-adjusted primary balance expected by the OBR to improve by some 1.6ppts to a surplus of 0.3% of GDP in FY24/25. Given the extremely tight monetary stance too, it is therefore no surprise that GDP growth next year is going to be subdued – the OBR expects growth of 0.1%Q/Q in the current quarter, rising to 0.2%Q/Q through H124 and 0.3%Q/Q in H224. That is a slightly stronger outlook than envisaged by the BoE and ourselves, but is hardly likely to make the electorate feel warmer towards the Conservatives.

Scope left for extra pre-election tax cuts next Spring

Indeed, the fundamentals of the UK economy and public finances remain extremely underwhelming. The OBR today revised down its estimate of medium-term potential growth by 0.2ppt to 1.6%Y/Y. Moreover, the tax burden as a share of GDP will still rise in every year of the projection to the highest level since the 1940s. And despite the unrealistic profile for public spending, which the OBR expects to fall more than 2ppts over the projection horizon to 42.7% of GDP, the expenditure share of GDP would still by FY28/9 exceed the pre-pandemic level by more than 3ppts. The good news for the government is that the updated OBR projections suggest that the Chancellor still has some £13.0bn of headroom in meeting his objective that the ratio of government debt to GDP should be falling in five years' time. Declining Gilt yields might boost that headroom a little further by March when we expect the next government Budget to be announced. As such, we expect the government then to announce a further easing of fiscal policy, via cuts to personal taxes. However, we certainly do not expect that to change the outcome of the general election when it is eventually called.

The day ahead in the UK

The main focus in the UK tomorrow will be the flash PMIs for November, which are likely to remain consistent with an ongoing modest downturn in economic activity in the middle of Q4 amid subdued domestic and external demand. In particular, the composite output PMI is expected to be little improved on October's level of 48.7, to mark the fourth successive sub-50 'contractionary' reading. Certainly, today's CBI industrial trends survey suggested that manufacturing conditions remained extremely challenging in November. In particular, this suggested that order books fell to their lowest level since January 2021 during the second pandemic lockdown, with manufacturers expecting output to fall further into the New Year, with the respective survey index the lowest for eleven months. And with consumer confidence still historically low, we expect tomorrow's PMIs to point to subdued demand for services in November too.

European calendar

Today's results

Economic data						
Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	European Commission's preliminary consumer confidence index	Nov	**-16.9**	-17.8	-17.9	-17.8
UK	CBI industrial trends, total orders (selling prices) balance %	Nov	**-35 (11)**	-	-26 (7)	-

Auctions

Country	Auction
Germany	sold €826mn of 1% 2038 bonds at an average yield of 2.77%
	sold €414mn of 0% 2035 bonds at an average yield of 2.65%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data						
Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	EU27 new car registrations Y/Y%	Oct	**14.6**	-	9.2	-
France	Bank of France retail sales Y/Y%	Oct	**-2.8**	-	-4.3	-4.5
UK	Public sector net borrowing (ex banks) £bn	Oct	**14.0 (14.9)**	10.7 (12.8)	13.5 (14.3)	13.7 (14.6)

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data					
Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	09.00	Preliminary manufacturing (services) PMI	Nov	43.5 (48.1)	43.1 (47.8)
	09.00	Preliminary composite PMI	Nov	46.8	46.5
Germany	08.30	Preliminary manufacturing (services) PMI	Nov	41.2 (48.5)	40.8 (48.2)
	08.30	Preliminary composite PMI	Nov	46.3	45.9
France	07.45	INSEE business (manufacturing) confidence index	Nov	98 (98)	98 (98)
	08.15	Preliminary manufacturing (services) PMI	Nov	43.3 (45.5)	42.8 (45.2)
	08.15	Preliminary composite PMI	Nov	44.9	44.6
UK	09.30	Preliminary manufacturing (services) PMI	Nov	45.0 (49.5)	44.8 (49.5)
	09.30	Preliminary composite PMI	Nov	48.7	48.7

Auctions and events

Country	GMT	Event
Euro area	12.30	ECB to publish account of October Governing Council monetary policy meeting
	21.30	ECB's Schnabel scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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