Euro wrap-up

Overview

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- Bunds made losses as the flash euro area PMIs for November reported a modest improvement while the account of the ECB's October policy meeting underscored its intention to maintain a "higher for longer" stance.
- Gilts made bigger losses as the flash UK PMIs significantly beat expectations.
- Friday will bring the German ifo business survey and UK GfK consumer confidence survey results for November as well as an updated estimate of German GDP in Q3.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	3.028	+0.028
OBL 2.4 10/28	2.590	+0.055
DBR 2.6 08/33	2.619	+0.062
UKT 3½ 10/25	4.669	+0.096
UKT 4½ 06/28	4.298	+0.113
UKT 3¼ 01/33	4.246	+0.097

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

Euro area

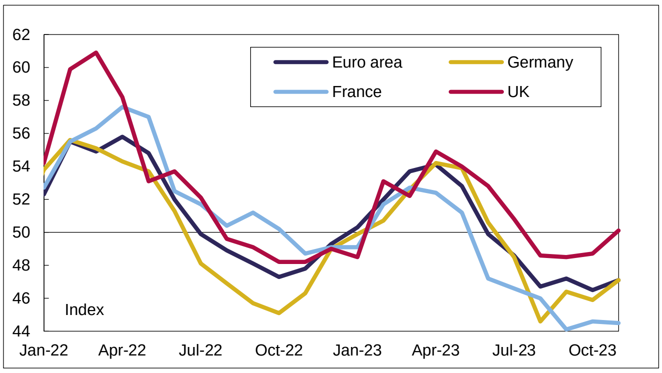
Euro area flash PMIs improve in November, but still consistent with weak economic momentum

Coming on the back of yesterday's improvement in the Commission's consumer confidence estimate, today's flash November PMIs signalled some stabilisation in business conditions in the middle of November, suggesting that the trough in the euro area's economic downturn may have been reached. Admittedly, the survey findings still pointed to a lack of momentum in the fourth quarter and remained consistent with our expectation that the economy slipped into a very mild technical recession in the second half of the year. Indeed, despite rising a stronger-than-expected 0.6pt in November, the headline composite PMI (47.1) marked the sixth successive sub-50 contractionary reading and was trending in the first two months of Q4 some 0.7pt below the Q3 average. The improvement in the output component in November was broad-based across the services (up 0.4pt to 48.2) and manufacturing sectors (up 1.2pts to a six-month high of 44.3), although both suggested contraction in Q4, with a steeper pace of decline in services compared with Q3. And while the PMIs suggested that the drop in new orders (45.1) was the smallest since July, this still marked the sixth successive decline, and backlogs were down for an eighth consecutive month. Given increased spare capacity, firms signalled the first aggregate fall in headcount since the start of 2021, as job cuts in manufacturing accelerated and recruitment in services slowed to a crawl. And while manufacturers were slightly less downbeat about the outlook for the coming twelve months, services firms were marginally less optimistic.

German PMIs consistent with contraction in Q4, but suggest the trough in the downturn has passed

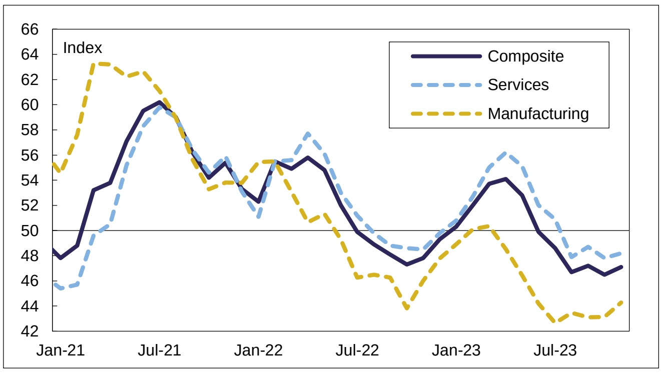
Today's PMIs continued to suggest that the downturn remains driven principally by the euro area's core member states. Nevertheless, the German survey was more encouraging than of late, with the composite output index unexpectedly rising 1.2pts to a four-month high of 47.1, amid a less marked weakening in manufacturing (up 2.9pts to 44.0) and slight improvement in services (up 0.5pt to 48.7). Of course, the underlying message from today's PMIs was ongoing retrenchment in the euro area's largest member state. But the implied decline in new orders in both manufacturing and services was notably softer in November, raising cautious optimism regarding the near-term outlook. And with German exports to non-EU countries having risen for the first month in four in October (1.7%M/M), recent developments in external demand have been perhaps a little stronger than initially feared. So, with the composite output PMI so far in Q4 unchanged from the average in Q3, the economy might yet avoid a steeper pace of contraction this quarter. However, the risks to the initially estimated decline in German GDP in Q3 of -0.1%Q/Q appear skewed to the downside (see day ahead).

Europe: Composite output PMIs



Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Output PMIs



Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

French PMIs signal steeper downturn, but INSEE survey points to more moderate deterioration

In contrast, the French PMIs suggested that the economy has taken a more pronounced step down in the current quarter. Indeed, the composite PMI fell (an admittedly modest) 0.1pt in November to 44.5, the second-lowest reading in three years to be trending some 1pt below the Q3 average, with demand for French goods and services declining at the steepest pace since the second pandemic wave in November 2020. But as has been the case over recent quarters, the message from the PMIs remained significantly more downbeat than the INSEE business survey. Admittedly, this reported a further deterioration in sentiment in November, with the headline index down 1pt to 97, the lowest since April 2021 and below the long-run average (100). The drop principally reflected a worsening business climate in the retail sector, for which the respective sentiment index fell to its lowest since July 2022 on the back of a substantial decline in recent sales. Perhaps inevitably given the acute impact of higher borrowing costs on construction, firms in the sector considered conditions to be the least favourable since end-2020 too, albeit still just above the long-run average. But while sentiment among manufacturers and services moved sideways at the bottom of the recent range, it was broadly in line with the long-run average, providing cautious support to our view that the French economy might well again avoid a contraction in the current quarter.

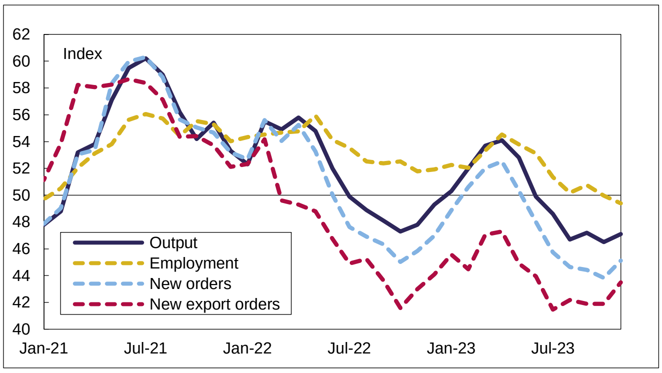
PMIs suggest sticky services inflation to resonate with ECB concerns

Against the backdrop of subdued demand, the flash euro area price PMIs were, at face value, consistent with a further easing in inflationary pressures in November. Certainly, the composite input price index (56.7) reversed the modest uptick reported in October to be broadly in line with the pre-pandemic long-run average and well below the peak recorded in March 2022 (81.6). And the output price PMI similarly resumed a gradual downwards trend (down 0.6pt to 52.1). But the ECB will note that average prices charged for services reportedly accelerated in November, with the respective index (54.9) up to a three-month high and well above the average in the three years before the pandemic (52.2). So, while factory output prices again fell sharply, suggesting that core goods inflation should maintain a disinflationary trend over coming months, services inflation is likely to remain sticky over the near term, underscoring recent push back from ECB Governing Council members against market expectations of rate cuts from the first half of 2024.

ECB account underscored "higher for longer" stance despite recognition of increased uncertainty

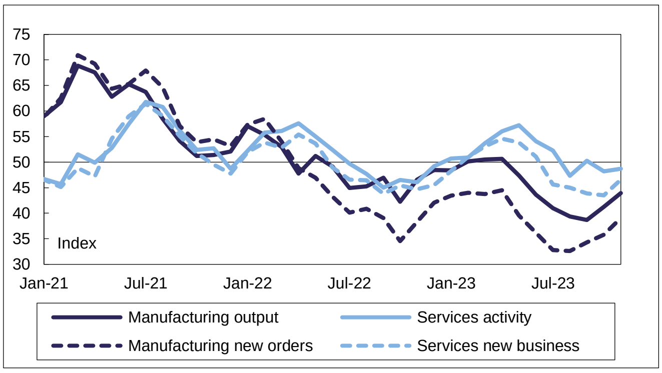
The account from the ECB's policy-setting meeting on 26 October, published today, reinforced the view that, while the tightening cycle has probably come to an end, the Governing Council intends to be "patient" and "persistent" in maintaining a restrictive stance for a while to come. While the general consensus appears to be that the current policy setting should help to bring inflation back to the 2% target in due course, the hawks insisted on keeping the door open to further rate hikes. On

Euro area: Composite PMIs



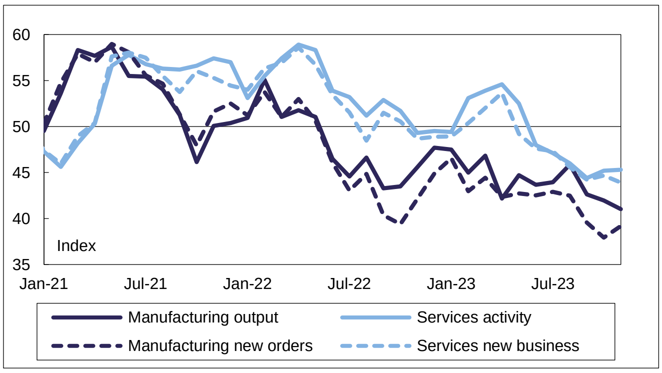
Source: Refinitiv Datastream,, S&P Global and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing & services PMIs



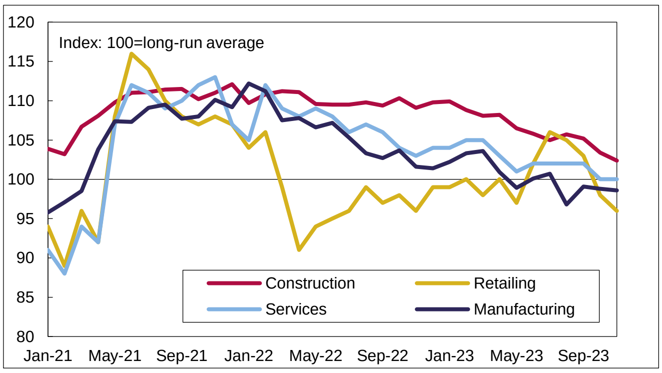
Source: Refinitiv Datastream,, S&P Global and Daiwa Capital Markets Europe Ltd.

France: Manufacturing & services PMIs



Source: Refinitiv Datastream,, S&P Global and Daiwa Capital Markets Europe Ltd.

France: INSEE business climate indices



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

the whole, the policy-makers largely agreed that the disinflation process has been developing broadly in line with expectations. And with uncertainty surrounding the economic outlook having increased, the monetary policy transmission arguably stronger than had been previously anticipated and set to intensify over coming months, the account suggested that Governing Council members are aware of the potential risks for undershooting the inflation target. Nevertheless, there remain concerns at the ECB about the persistence of underlying price pressures in services, associated not least with strong wage growth and the sector's lesser sensitivity to higher interest rates. And members of the Governing Council generally share the view widely espoused by hawkish Executive Board member Schnabel that the "last mile" in bringing inflation back to target will be the most challenging. So, while inflation has taken a further notable step down since the Governing Council last met, the stickiness of services inflation illustrated in today's PMIs as well as hints of an easing in the region's economic downturn might well bolster support for the ECB's "higher-for-longer" policy stance.

The day ahead in the euro area

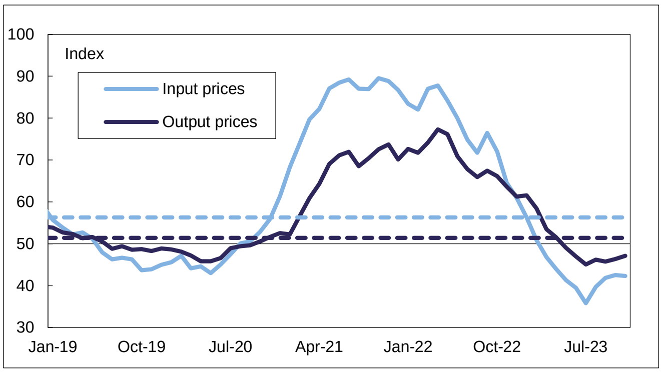
Tomorrow brings more sentiment survey results with the release of the German ifo business indices, which will provide an update on sentiment in retail and construction as well as services and manufacturing in November. Overall, the headline business climate index is forecast to edge a little higher for a second successive month, to a five-month high of 87.5. That would still leave it below the average in the first half of the year (91.2) and consistent with stagnation or modest contraction in economic output. Moreover, the improvement will likely largely reflect a pickup in firms' expectations for the outlook over the coming six months, while the current assessment balance is expected to have moved broadly sideways. We will also get updated German Q3 GDP figures, which will include, for the first time, an official expenditure breakdown. Given the weakness in September activity figures, there is a risk that the contraction in GDP will be slightly larger than initially estimated (-0.1%Q/Q). When it released the preliminary estimate, Destatis stated that household consumption fell in Q3 but that investment in equipment and machinery provided support.

UK

Flash PMIs consistent with continued stagnation in economic activity in Q4

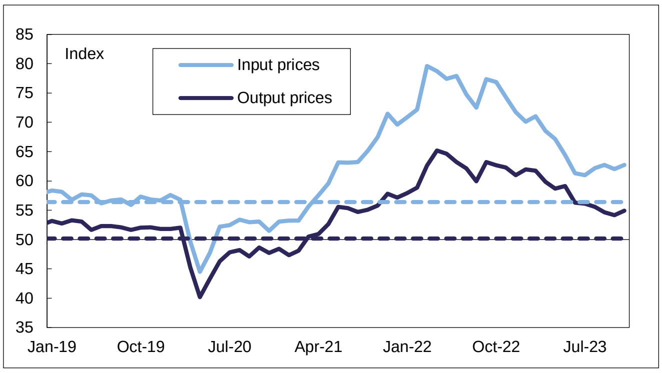
The UK's flash PMIs for November beat expectations to suggest that a contraction in GDP should be avoided in Q4 but also that stagnation rather than growth remains the main theme. In particular, the headline composite PMI rose 1.4pts to a four-month high of 50.1, consistent with broad stability in overall economic output in the middle of the quarter. And it brought the average composite PMI for the first two months of Q4 back close to that of Q3, when GDP was unchanged from Q2. Improvement in November was seen in the surveys for services and manufacturing alike. In services, the 1.0pt rise in the

Euro area: Manufacturing price PMIs*



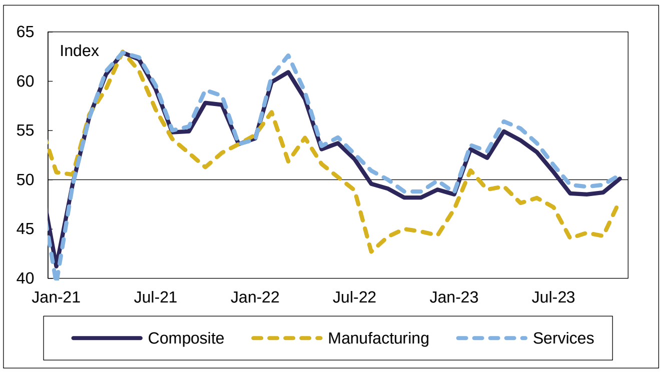
*Dashed lines represent pre-pandemic averages. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Services price PMIs*



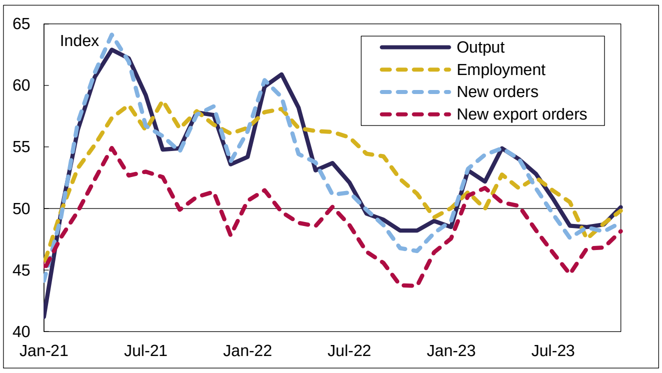
*Dashed lines represent pre-pandemic averages. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Output PMIs



Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Composite PMIs



Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

headline PMI to a four-month high of 50.5 was consistent with marginal growth in the sector for the first time since July, with S&P Global reporting increased support from business-facing activity. And in the factory sector, the output PMI rose a larger 3.6pts to a five-month high, buoyed somewhat by high-tech investment. But at 47.9, this indicator is still consistent with falling manufacturing production in aggregate.

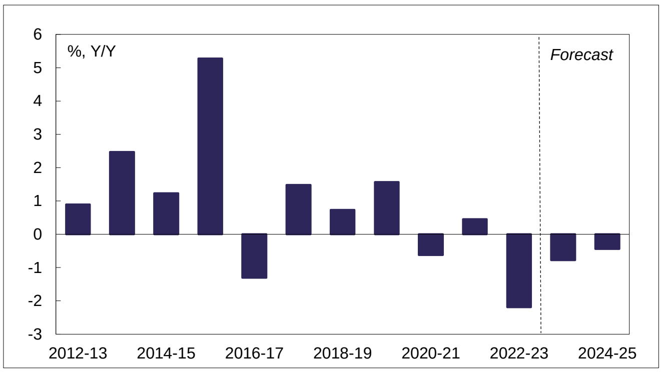
Weak demand from consumers and the construction sector likely to continue to weigh on output

According to the flash PMIs, firms in services and manufacturing reported that the pace of decline in new orders moderated somewhat in November while firms continued to work through backlogs and reduce inventories. However, external demand remained subdued and domestic demand from consumers and the construction sector reportedly also remained weak, weighed by the impact of high inflation and interest rates. And yesterday's CBI industrial trends survey suggested that factory orders have dropped to the lowest level since the lockdowns of early 2021. Moreover, we do not anticipate a more significant turn for the better over coming months. Notably, the lagged effects of the BoE's monetary tightening will take a greater toll on household budgets over the coming year due to increased remortgaging at higher rates. Indeed, despite yesterday's cut to National Insurance Contributions, real household disposable incomes (RHDI) are still expected by the OBR to fall again in 2024 by almost 1.0%Y/Y. That would take the peak-to-trough drop in RHDI per person in the five years to FY24-25 to 3.5%, marking the biggest reduction in real living standards on the series dating back to the 1950s. Moreover, residential and commercial property prices and transactions are also expected to fall further over the coming year. Perhaps unsurprisingly, therefore, the PMI for business activity expectations remained down on levels registered through the first three quarters of the year and below the long-run average.

BoE unlikely to relax tightening bias as PMIs report slight pickup in cost and price pressures

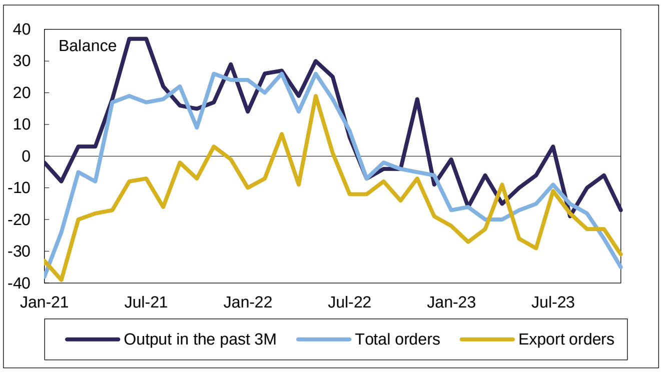
The BoE will not be surprised that the PMIs are suggestive of stagnation in economic activity. Indeed, that is the main theme of its own projections. But it will also note that the survey implied an uptick in input cost pressures and output price inflation in November. Services firms reportedly remained particularly keen to pass on those increased costs to customers, with their output prices reportedly rising the most in four months and at a pace well above the long-run average. Manufacturers also reported a very slight increase in their output prices for the second month in the past three. With services firms also reportedly looking to add to headcount, the composite employment PMI rose back above 50 for the first month in three. As such, as it suggested that GDP is no weaker, price pressures are arguably a touch stronger, and the labour market is perhaps no looser, today's flash PMIs will not cause the BoE to relax the monetary tightening bias, which Governor Bailey and some of his MPC colleagues reiterated to the Treasury Select Committee earlier this week.

UK: Real household disposable income



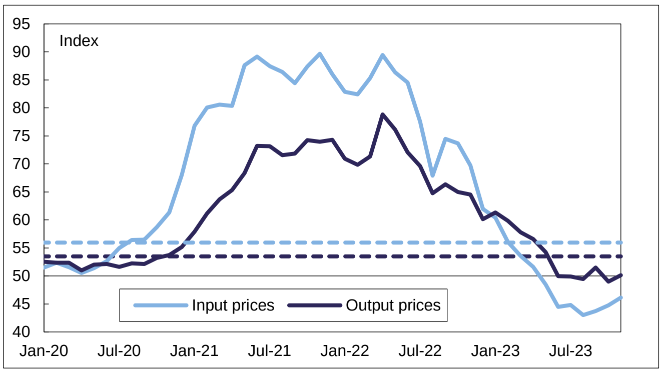
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: CBI industrial trends survey indices



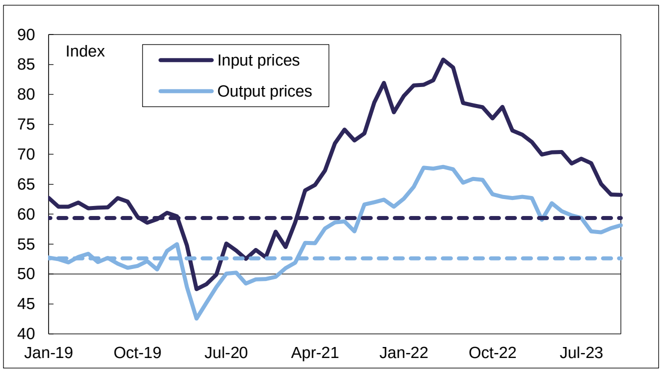
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing price PMIs*



**Dashed lines represent pre-pandemic averages. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.*

UK: Services price PMIs*



**Dashed lines represent pre-pandemic averages. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.*

The day ahead in the UK

Tomorrow brings the release of the GfK consumer survey, which will offer an update on household sentiment in November. In October the headline confidence index fell 9pts to -30, matching the bottom of the range of the past six months. And despite strong wage growth and falling inflation, persistent concerns about the high cost of living and job insecurity will likely keep confidence relatively low by historical standards and purchasing intentions subdued.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Preliminary manufacturing (services) PMI	Nov	**43.8 (48.2)**	43.5 (48.1)	43.1 (47.8)	-
	Preliminary composite PMI	Nov	**47.1**	46.8	46.5	-
Germany	Preliminary manufacturing (services) PMI	Nov	**42.3 (48.7)**	41.2 (48.5)	40.8 (48.2)	-
	Preliminary composite PMI	Nov	**47.1**	46.3	45.9	-
France	INSEE business (manufacturing) confidence index	Nov	**97 (99)**	98 (98)	98 (98)	-
	Preliminary manufacturing (services) PMI	Nov	**42.6 (45.3)**	43.3 (45.5)	42.8 (45.2)	-
	Preliminary composite PMI	Nov	**44.5**	44.9	44.6	-
UK	Preliminary manufacturing (services) PMI	Nov	**46.7 (50.5)**	45.0 (49.5)	44.8 (49.5)	-
	Preliminary composite PMI	Nov	**50.1**	48.7	48.7	-

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
Germany	07.00	GDP – second estimate Q/Q% (Y/Y%)	Q3	*-0.1 (-0.3)*	0.1 (0.0)
	09.00	Ifo business climate index	Nov	87.5	86.9
	09.00	Ifo current assessment (expectations) index	Nov	89.5 (85.9)	89.2 (84.7)
Spain	08.00	PPI Y/Y%	Oct	-	-8.6
UK	00.01	GfK consumer confidence index	Nov	-28	-30

Auctions and events

Country	GMT	Event
Euro area	10.00	ECB's Lagarde scheduled to speak
	13.00	ECB's de Guindos scheduled to speak
Italy	10.00	Auction: Fixed rate and index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs