

Euro wrap-up

Overview

- While the flash estimate of euro area inflation in November significantly undershot expectations with a broad-based moderation in price pressures, Bunds made losses.
- Despite a moderation in UK business inflation expectations, Gilts also made losses as an external MPC member suggested that monetary policy was less restrictive than the BoE had previously thought.
- The coming week will bring new data on euro area retail sales, producer prices and consumer price expectations, and German industrial production and trade, as well as revised data for euro area Q3 GDP.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.809	+0.002
OBL 2.4 10/28	2.373	+0.016
DBR 2.6 08/33	2.444	+0.016
UKT 3½ 10/25	4.564	+0.035
UKT 4½ 06/28	4.152	+0.056
UKT 3¼ 01/33	4.162	+0.073

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

Euro area

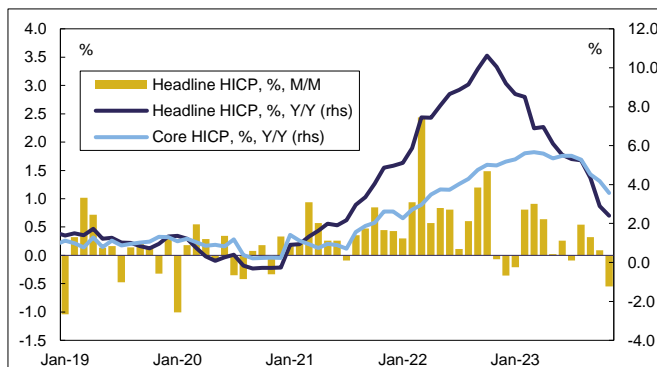
Inflation falls far further than expected in November suggesting a broad-based easing of pressure

The flash estimates of euro area inflation in November came in well below expectations, underscoring the likelihood that the next move in ECB rates will be down and that the first cut will come in the first half of 2024. The headline rate fell 0.5ppt to just 2.4%Y/Y, the lowest since July 2021 and 0.3ppt below the median forecast on the Bloomberg survey. Even more encouragingly, the core rate fell 0.6ppt to 3.6%Y/Y, the lowest since April 2022 and again 0.3ppt below the Bloomberg survey consensus. Indeed, all major inflation components declined in November to suggest a broad-based moderation of price pressures. Within the core items, given weak demand, and an ongoing easing of supply constraints and cost pressures in the industrial sector, it was not especially surprising that inflation of non-energy industrial goods fell 0.6ppt to 2.9%Y/Y, the lowest since January 2022 and almost 4ppts below February's peak. However, far more eye-catching and of most importance for the ECB, inflation of services also fell 0.6ppt, to a 15-month low of 4.0%Y/Y, 1.6ppts below the series high reached just four months ago. The data published by the member states also suggested that the decline in services inflation was seen in a range of sub-sectors, suggesting that the ECB's concerns about inflation stickiness related to strong wage growth are overdone. Meanwhile, beyond the core components, inflation of food, alcohol and tobacco fell 0.5ppt to 6.9%Y/Y, the lowest since April 2022 and 8.6ppts below the summer peak. And energy inflation edged down 0.3ppt to -11.5%Y/Y, the weakest since the first wave of Covid-19.

Core inflation momentum slows markedly to diminish significantly the chances of a further rate hike

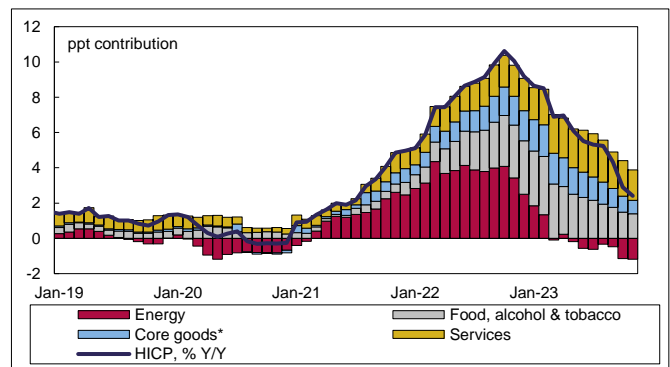
The declines in euro area headline and core inflation reported today were even steeper than implied by yesterday's weaker-than-expected German and Spanish data. On the EU-harmonised measure, today's data showed that inflation in France (down 0.7ppt to 3.8%Y/Y) and Italy (down 1.1ppt to just 0.7%Y/Y) also fell further than anticipated in November. And the drop in inflation this month was widespread across the region, with only the Netherlands and Belgium – where inflation had reached record lows in October due to sharply negative energy inflation – reporting increases. Most importantly, prices of core goods and services fell on a month-on-month basis far more than the pre-pandemic norm for November. Indeed, in seasonally-adjusted terms, both major core components fell 0.1%M/M. And on the same basis, core goods prices were up just 0.8%3M/3M annualised, the least since June 2021, while services prices were up 2.9%3M/3M ann., the least since April 2022. So, while the ECB will not jump to conclusions from just one month's data, core inflation momentum has clearly weakened significantly and is becoming far more consistent with a return of headline inflation to the 2% target over the coming couple of years. Admittedly, the less favourable base effect associated with energy prices will add more than ½ppt to headline inflation in December. And we expect energy to add a further ½ppt by April. But the Q423 averages are bound to undershoot the ECB's projections of both the headline (3.3%Y/Y) and core (4.1%) rates, probably by close to ½ppt. And in

Euro area: HICP inflation



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to HICP inflation



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

the absence of new shocks, both headline and core inflation should fall steadily further through the first three quarters of 2024. So, the ECB's updated economic projections on 14 December are likely to revise down the profiles for both inflation and GDP. As such, the threats of the ECB's hawks that rates might have to rise again look increasingly hollow.

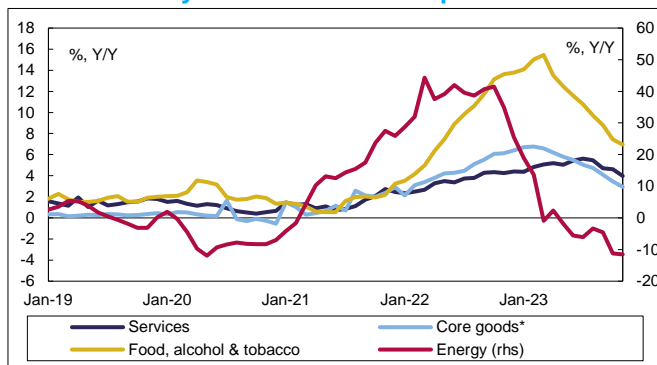
Unemployment rate remains at record low, but signs that labour market starting to cool

Despite the improving price outlook, the hawks on the Governing Council will continue to flag their concerns about inflation persistence in part due to the remarkable ongoing resilience in the labour market. Indeed, despite stagnant economic activity, today's figures showed that the euro area jobless rate moved sideways for an eighth consecutive month in October, at the revised series low of 6.5%. Among the larger member states, unemployment rates were similarly unchanged in Germany (3.1%), France (7.3%) and Spain (12.0%), and picked up only slightly in Italy (+0.2ppt to 7.8%). Surveys suggest that the labour market remains tight. For example, while the share of services firms reporting labour shortages as a constraint on activity moderated slightly in Q4, it remains elevated at 30%. And with workers taking advantage of labour market tightness to seek compensation for the high inflation of the past couple of years, negotiated wage growth accelerated in Q3 to 4.7%Y/Y, some 3ppts higher than the average in the five years before the pandemic. Nevertheless, surveys also suggest that labour shortages are becoming significantly less acute in industry. And the jobs market does appear to have lost momentum over recent months. The number of people unemployed rose for the third month out of the past four in October, to an eight-month high of 11.13mn. And German figures, also published today, indicated a further weakening in November, with the claimant count rising for a tenth successive month to take the equivalent rate up to a 2½-year high of 5.9%, while the number of job vacancies fell to the fewest since July 2021. Moreover, sentiment survey indicators, including last week's PMIs and yesterday's Commission indices, suggest that manufacturers continue to reduce headcount, while recruitment in services has slowed sharply.

German retail sales rebound but French consumption falls in October after Q3 GDP downgrade

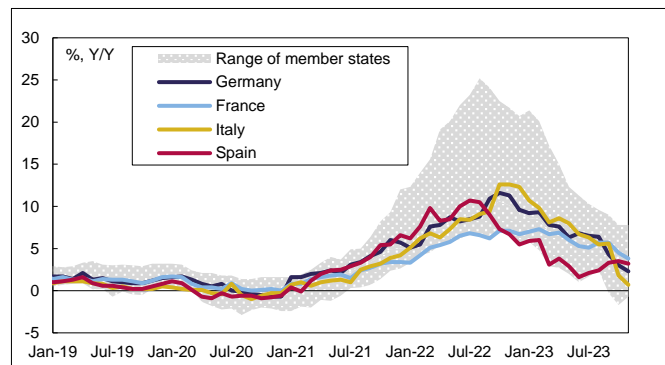
In terms of economic activity, today's data from the euro area's two largest member states were mixed. Unusually, the news from Germany was better than had been expected. Boosted by spending on non-food items and online, retail sales volumes rose 1.1%M/M in October while the revised drop of just 0.1%M/M in September was smaller than previously estimated. So, sales in October rose back slightly above the pre-pandemic level to a three-month high, and were also down just 0.1%Y/Y and 0.7% above the average in Q3 when sales fell 1.0%Q/Q. With prices down on the month, the value of German retail sales rose a more moderate 0.7%M/M in October but was still up 2.6%Y/Y. The rise in retail sales volumes at the start of the quarter, coupled with the modest uptick in consumer confidence this month, raises hopes that German household consumption will return to very modest growth in Q4 following the drop of 0.3%Q/Q in Q3.

Euro area: Key HICP inflation components



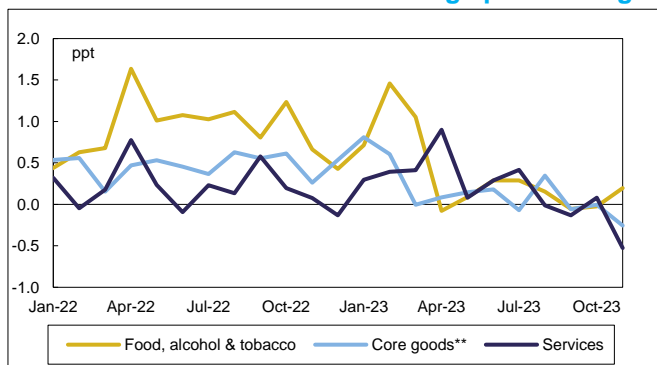
*Non-energy industrial goods. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area member states: HICP inflation



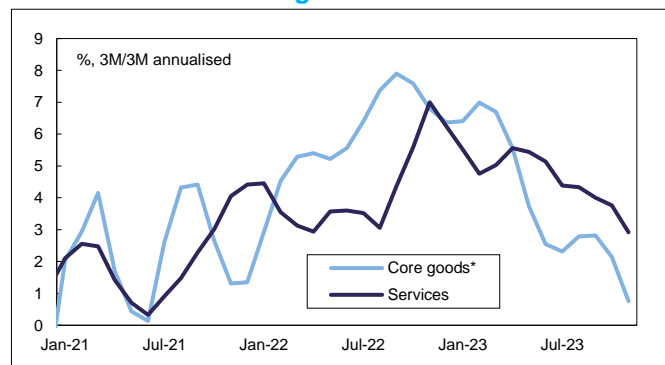
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Deviation from 1-r average price change*



*Deviation from pre-pandemic long-run average monthly price change. **Non-energy industrial goods. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Services & goods inflation momentum



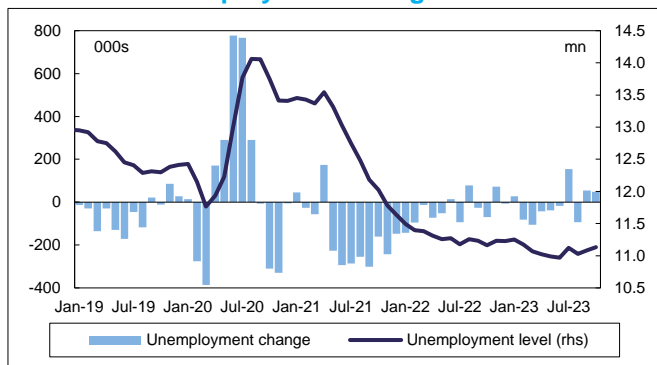
*Non-energy industrial goods. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

In France, however, having risen 0.6%Q/Q in Q3, household consumption of goods started Q4 on the back foot, falling 0.9%M/M in October following a flat September. That left it at a six-month low, down 1.3%Y/Y, 1.1% below the Q3 average and a hefty 5.7% below the pre-pandemic level. As in Germany, spending on food in October fell in France. And while spending on durables, including transport items, and clothing picked up, a sharp drop in the energy component left French consumption on goods down at the start of Q4. Today's updated French national accounts confirmed that total household consumption rose in Q3 by 0.6%Q/Q, just 0.1ppt less than earlier estimated, despite a 0.1%Q/Q drop in real disposable income. However, with housing investment down, growth in fixed capex was revised down by a more substantial 0.8ppt to just 0.2%Q/Q. And with imports now estimated to have risen in Q3 while exports fell sharply, net trade subtracted 0.4ppt, a touch more than previously thought. So, overall, contrary to the previous estimate of marginal growth in Q3, French GDP is now estimated to have contracted by 0.1%Q/Q last quarter. That raises the possibility that the drop in euro area GDP was a touch sharper than the initially estimated fall of 0.1%Q/Q. But much will depend on tomorrow's updated figures from Ireland, where GDP is currently thought to have contracted by a steep 1.8%Q/Q but subsequent revisions are often substantial.

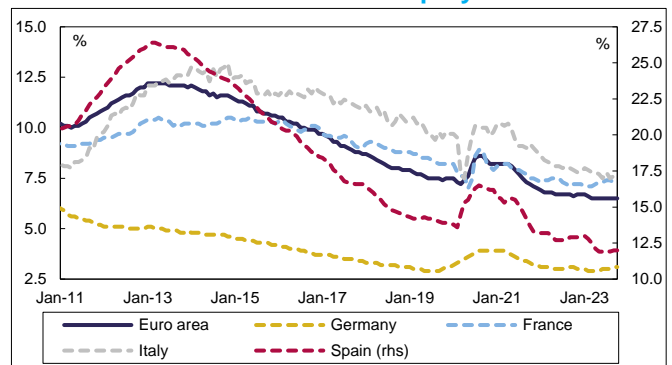
The week ahead in the euro area

The euro area data flow in the first half of the coming week, including producer price figures, the ECB's consumer expectations survey and the final services PMIs (all on Tuesday), will provide further insight into the outlook for inflation. Having hit a record low in September (-12.4%Y/Y), the headline PPI rate is expected to remain firmly in negative territory in October reflecting an ongoing drag from energy inflation as well as a further easing in underlying factory price pressures. Meanwhile, in line with the step down in headline inflation and renewed downwards momentum in the Commission's measure of household price expectations, the ECB's survey gauge for inflation expectations one year ahead might also reverse the uptick recorded in September (up 0.5ppt to 4.0%Y/Y). And having moved sideways at 2.5%Y/Y, inflation expectations for three years ahead might also have edged lower in October. But while today's figures reported a notable easing in services inflation, the final services PMIs are likely to suggest that price pressures remain sticky in the sector as cost pressures from wages remained strong. In terms of economic activity, updated euro area national accounts for Q3 (Thursday) will include the first official expenditure breakdown. While much will depend on the magnitude of any revisions in tomorrow's Irish GDP figures, risks to the advance estimate of aggregate euro area GDP in Q3 (-0.1%Q/Q) appear skewed to the downside. The expenditure breakdown will also likely confirm that household consumption was a drag on GDP growth in Q3, fixed investment remained subdued and net trade made a slight positive contribution. The release of euro area retail sales figures (Wednesday) will offer insight into consumer spending at the start of Q4, although these are likely to suggest little growth with a rise in Germany offset by a decline in France. Among the country releases, the main focus will be on Germany's manufacturing performance at the start of Q4, with October figures for goods trade (Monday), factory orders (Wednesday) and industrial production (Thursday) all due. French and Italian industrial production data are also scheduled (Tuesday and Thursday respectively).

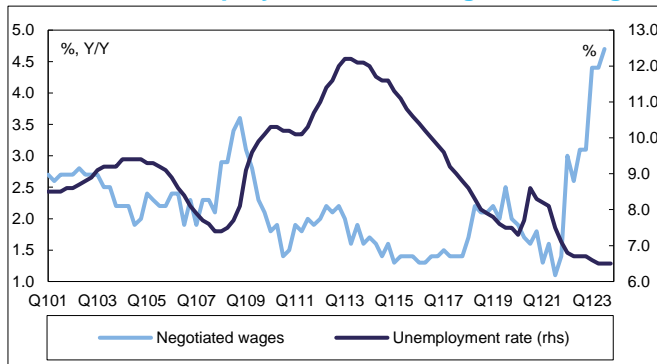
Euro area: Unemployment change & level



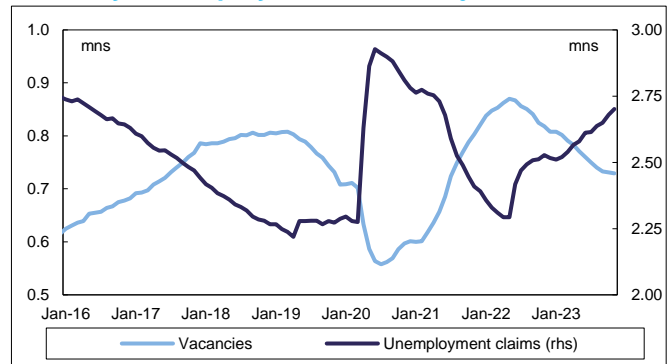
Euro area member states: Unemployment rate



Euro area: Unemployment rate & negotiated wages



Germany: Unemployment claims & job vacancies



UK

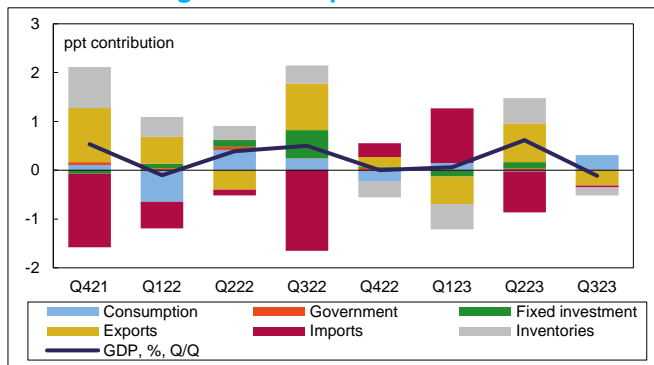
Firms' inflation and wage expectations remain stubbornly elevated

With the MPC still wary of persisting inflationary pressures, the results of the BoE's latest Decision Maker Panel (DMP) will have disappointed those hoping for a more convincing decline in firms' inflation expectations. Admittedly, respondents expected the disinflationary trend in their own prices charged to continue over the coming year as the global downtrend in goods price pressures and weak demand limited pricing power. Firms reported that the annual rise in their own output prices slowed 0.5ppt to 6.6%Y/Y in the three months to November, the lowest rate since April 2022, with a larger drop on the single-month figure, by 0.8ppt to a 21-month low of 6.0%Y/Y. And their expectation for the rate of increase in their own prices over the coming twelve months moderated for a seventh successive month to 4.4%Y/Y, down more than 2ppts from the peak last September, but nevertheless still 2ppts above the average in the two years before the pandemic. One-year ahead CPI inflation expectations also moderated in November, by 0.2ppt to 4.4%Y/Y, more than 5ppts below last year's peak. But the MPC will have been discouraged to see a slight increase in three-year ahead CPI inflation expectations in November, up 0.1ppt to 3.2%Y/Y, with firms' expectations for wage growth over the year ahead unchanged for a fourth consecutive month at 5.1%Y/Y. While this is almost 2ppt below survey respondents' estimate of realised wage growth in the three months to November, it remains well above rates that would be consistent with achievement of the BoE's 2% inflation target over the medium term.

The week ahead in the UK

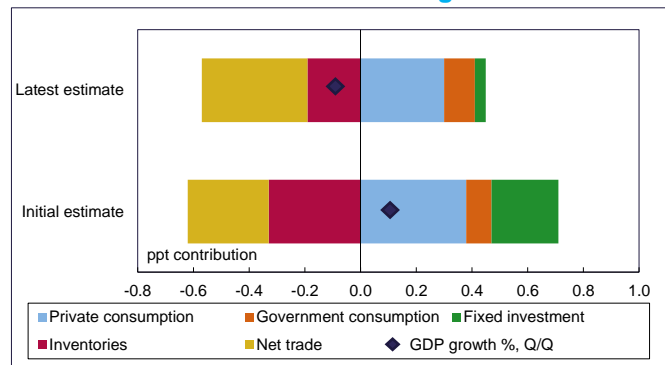
It will be a relatively quiet week ahead for top-tier UK economic releases, with the main focus on Friday's release of November's REC/KPMG report on jobs and BoE's household attitudes survey. Given the current suspension of the ONS's key Labour Force Survey (LFS) due to potential inaccuracies amid a steady decline in the response rate, survey indicators have become increasingly important for the MPC's assessment of the state of the labour market. And while the flash PMIs signalled some stabilisation in economic momentum in November, the REC survey might well continue to report a further decline in permanent placements for a fourteenth consecutive month, while the survey's measure of permanent staff starting salaries might well fall for a seventh successive month. Meanwhile, given the recent step-down in inflation, the BoE's inflation attitudes survey will likely report an easing in households' inflation expectations in twelve months' time, having ticked slightly higher in the previous survey in August (3.6%Y/Y). But longer-term expectations might also have edged lower from 2.9% in August to move further below the long-run average (3.2%) but nevertheless remain above the Bank's 2% target. The final results of November's services PMIs (Tuesday) will be followed by the construction PMIs (Wednesday), while the BoE will also publish its latest Financial Stability Report (Wednesday).

France: GDP growth & expenditure contributions



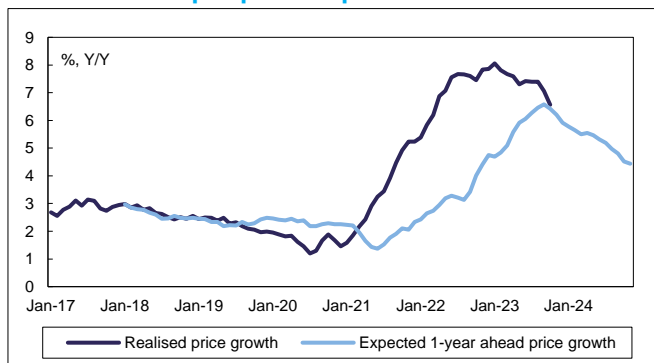
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Contributions to Q3 GDP growth



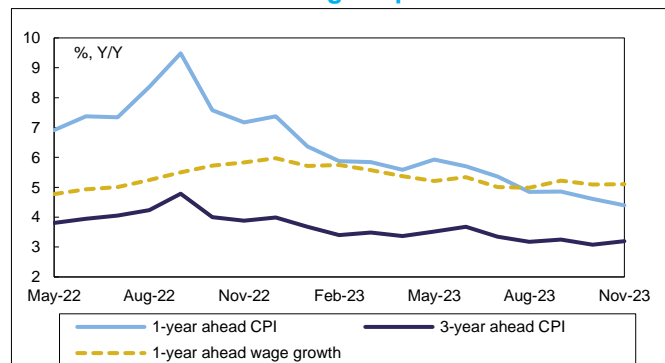
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Firms' output price expectations












Source: BoE DMP survey and Daiwa Capital Markets Europe Ltd.

UK: Firms' inflation & wage expectations














Source: BoE DMP survey and Daiwa Capital Markets Europe Ltd.

Daiwa economic forecasts

	2023			2024			2023	2024	2025
	Q2	Q3	Q4	Q1	Q2	Q3			
GDP	%, Y/Y								
Euro area 	0.2	-0.1	-0.1	0.1	0.2	0.2	0.5	0.3	1.4
UK 	0.2	-0.1	0.1	0.1	0.0	0.1	0.5	0.2	0.7
Inflation, %, Y/Y									
Euro area									
Headline HICP 	6.2	5.0	2.7	2.5	2.1	1.7	5.4	2.2	1.8
Core HICP 	5.5	5.1	3.7	2.7	1.8	1.5	4.9	1.9	1.6
UK									
Headline CPI 	8.4	6.7	4.5	4.1	2.5	2.8	7.4	3.1	2.1
Core CPI 	6.9	6.4	5.6	5.0	3.3	2.9	6.2	3.5	2.1
Monetary policy, %									
ECB									
Refi Rate 	4.00	4.50	4.50	4.50	4.25	4.00	4.50	3.75	3.00
Deposit Rate 	3.50	4.00	4.00	4.00	3.75	3.50	4.00	3.25	2.50
BoE									
Bank Rate 	5.00	5.25	5.25	5.25	5.25	5.00	5.25	4.50	2.75

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area 	Preliminary HICP (core HICP) Y/Y%	Nov	2.4 (3.6)	<u>2.6 (4.0)</u>	2.9 (4.2)	-
	Unemployment rate %	Oct	6.5	6.5	6.5	-
Germany 	Retail sales M/M% (Y/Y%)	Oct	1.1 (-0.1)	0.4 (-2.5)	-0.6 (-4.4)	-0.1 (-3.9)
	Unemployment change '000s (rate %)	Nov	22.0 (5.9)	22.5 (5.8)	30.0 (5.8)	31.0 (-)
France 	Preliminary HICP (CPI) Y/Y%	Nov	3.8 (3.4)	4.1 (3.7)	4.5 (4.0)	-
	Consumer spending M/M% (Y/Y%)	Oct	-0.9 (-1.3)	-0.2 (-0.2)	0.2 (-3.0)	0.0 (-3.2)
	PPI Y/Y%	Oct	-1.2	-	-1.7	-1.5
	Final GDP Q/Q% (Y/Y%)	Q3	-0.1 (0.6)	<u>0.1 (0.7)</u>	0.6 (1.1)	-
Italy 	Preliminary HICP (CPI) Y/Y%	Nov	0.7 (0.8)	1.1 (1.0)	1.8 (1.7)	-
UK 	Lloyds business barometer	Nov	42	35	39	-
	DMP 1 year ahead CPI expectations %	Nov	4.4	-	4.6	-
Auctions						
Country	Auction	- Nothing to report -				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 5 December 2023







The coming week's data calendar

The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous
Friday 01 December 2023					
Euro area	09.00	Final manufacturing PMI	Nov	<u>43.8</u>	43.1
Germany	08.55	Final manufacturing PMI	Nov	<u>42.3</u>	40.8
France	08.50	Final manufacturing PMI	Nov	<u>42.6</u>	42.8
	-	New car registrations* Y/Y%	Nov	-	21.9
Italy	08.45	Manufacturing PMI	Nov	45.5	44.9
	09.00	Final GDP Q/Q% (Y/Y%)	Q3	<u>0.0 (0.0)</u>	-0.4 (0.3)
	17.00	New car registrations Y/Y%	Nov	-	20.0
Spain	08.15	Manufacturing PMI	Nov	45.5	45.1
	-	New car registrations* Y/Y%	Nov	-	18.1
UK	07.00	Nationwide house price index M/M% (Y/Y%)	Nov	-0.4 (-2.3)	0.9 (-3.3)
	09.30	Final manufacturing PMI	Nov	<u>46.7</u>	44.8
Monday 04 December 2023					
Euro area	09.00	Sentix investor confidence index	Dec	-	-18.6
Germany	07.00	Goods trade balance €bn	Oct	-	16.7
Spain	08.00	Unemployment change, 000s	Nov	-	36.9
Tuesday 05 December 2023					
Euro area	09.00	ECB CPI expectations 1Y ahead (3Y ahead) Y/Y%	Oct	-	4.0 (2.5)
	09.00	Final services (composite) PMI	Nov	48.2 (47.1)	47.8 (46.5)
	10.00	PPI Y/Y%	Oct	-	-12.4
Germany	08.55	Final services (composite) PMI	Nov	48.7 (47.1)	48.2 (45.9)
France	08.50	Final services (composite) PMI	Nov	45.3 (44.5)	45.2 (44.6)
	07.45	Industrial production M/M% (Y/Y%)	Oct	-	-0.5 (-0.1)
Italy	08.45	Services (composite) PMI	Nov	-	47.7 (47.0)
Spain	08.15	Services (composite) PMI	Nov	-	51.1 (50.0)
	08.00	Industrial production M/M% (Y/Y%)	Oct	-	1.1 (-1.4)
UK	00.01	BRC retail sales monitor Y/Y%	Nov	-	2.6
	09.00	Car registrations Y/Y%	Nov	-	14.3
	09.30	Final services (composite) PMI	Nov	50.5 (50.1)	49.5 (48.7)
Wednesday 06 December 2023					
Euro area	08.30	Construction PMI	Nov	-	42.7
	10.00	Retail sales M/M% (Y/Y%)	Oct	-	-0.3 (-2.9)
Germany	07.00	Factory orders M/M% (Y/Y%)	Oct	-	0.2 (-4.3)
	08.30	Construction PMI	Nov	-	38.3
France	08.30	Construction PMI	Nov	-	41.0
Italy	08.30	Construction PMI	Nov	-	51.8
UK	09.30	Construction PMI	Nov	-	45.6
Thursday 07 December 2023					
Euro area	10.00	GDP – 3 rd estimate Q/Q% (Y/Y%)	Q3	-0.1 (0.1)	0.2 (0.5)
	10.00	Employment – 2 nd estimate Q/Q% (Y/Y%)	Q3	0.3 (1.4)	0.1 (1.3)
Germany	07.00	Industrial production M/M% (Y/Y%)	Oct	-	-1.4 (-3.7)
France	07.45	Trade balance €bn	Oct	-	-8.9
Italy	10.00	Industrial production M/M% (Y/Y%)	Oct	-	0.0 (-2.0)
Friday 08 December 2023					
Germany	07.00	Final HICP (CPI) Y/Y%	Nov	<u>2.3 (3.2)</u>	3.0 (3.8)
UK	09.30	BoE household inflation expectations 12M ahead, Y/Y%	Nov	-	3.6

*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Friday 01 December 2023		
- Nothing scheduled -		
Monday 04 December 2023		
- Nothing scheduled -		
Tuesday 05 December 2023		
Germany	 10.30	Auction: €4.5bn of 3.1% 2025 bonds
UK	 10.00	Auction: £1.5bn of 0.75% 2033 index-linked bonds
Wednesday 06 December 2023		
UK	 10.00	Auction: £3.0bn of 0.875% 2033 bonds
	 10.30	BoE to publish Financial Stability Report
Thursday 07 December 2023		
France	 09.50	Auction: To sell fixed-rate and index-linked bonds with various maturities
Spain	 09.30	Auction: To sell fixed-rate bonds with various maturities
Friday 08 December 2023		
UK	 00.01	REC/KPMG report on jobs

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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