

Euro wrap-up

Overview

- Bunds made sizeable gains as influential ECB hawk Schnabel pivoted to a more neutral stance, suggesting that a further rate hike was unlikely.
- Gilts also made large gains as a survey suggested that UK retail sales remained subdued in November despite heavy discounting.
- Wednesday will bring October figures for euro area retail sales and German factory orders, as well as the November construction PMIs.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.599	-0.067
OBL 2.4 10/28	2.177	-0.089
DBR 2.6 08/33	2.241	-0.109
UKT 3½ 10/25	4.466	-0.103
UKT 4½ 06/28	4.039	-0.132
UKT 3¼ 01/33	4.024	-0.163

*Change from close as at 4:00pm GMT.
Source: Bloomberg

Euro area

Schnabel pivots to increase the likelihood that the next move in rates will be down

Despite the marked recent tightening of credit conditions, weakening of economic activity and moderation in inflation, up to now the ECB's hawks have been maintaining the pretence that they are ready to tighten monetary policy further. But in an interview with Reuters published today, Executive Board member Isabel Schnabel – routinely the most eloquent advocate of the hawkish cause on the Governing Council – pivoted to a neutral, if not explicitly dovish, stance. We suspect that her views will be shared by the majority of ECB policymakers. And even if the Governing Council's updated forward guidance fails to offer an explicit easing bias, the Eurosystem's updated macroeconomic projections, to be published following next week's monetary policy meeting, will make it much clearer that the next move in rates is likely to be down.

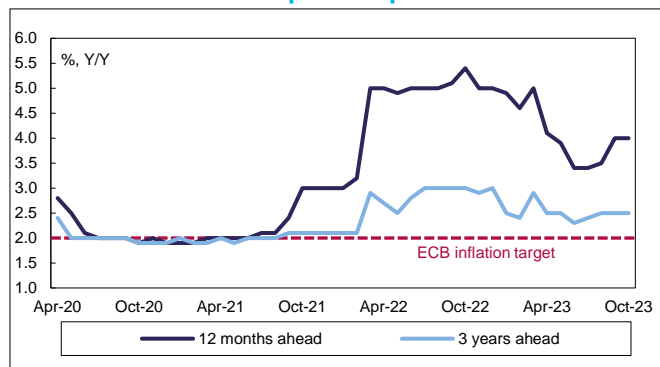
Hawks likely to focus on balance sheet rather than rates after softer November inflation data

Most notably in her Reuters interview, Schnabel acknowledged last week's big downside surprise in the [flash November consumer price data](#), judging that "The most recent inflation number has made a further rate increase rather unlikely." She added that she now has "more confidence that [inflation] will be able to come back to 2% no later than 2025". And when prompted, she would not rule out a rate cut before mid-2024, instead insisting that the Governing Council remained data dependent and should avoid "making statements about something that is going to happen in six months' time". With the case for rate hikes evidently significantly diminished, her comments also suggested that the focus of the ECB hawks would now be primarily on ensuring ongoing ECB balance sheet reduction. Indeed, she noted that the Governing Council will discuss PEPP reinvestments in the not-too-distant future and thought it would not be a "big deal" if they were terminated early. Of course, most of the national bank governors from Southern Europe would likely disagree. But the Governing Council will likely decide its next steps for managing its balance sheet in the spring, when a rate cut might also be on the table. That could provide the opportunity for a deal between hawks and doves encompassing both an easing of policy via interest rates as well as a (perhaps counterintuitive) modest tightening via an early end to PEPP reinvestments. Finally, on one niche issue at least, the hawks appear to be divided: Schnabel appeared unimpressed by proposals made by Bundesbank governor Nagel to increase bank reserve requirements given the possibly undesirable distributional effects from such a move.

Consumer price expectations stable but pessimism rising regards income and expenditure

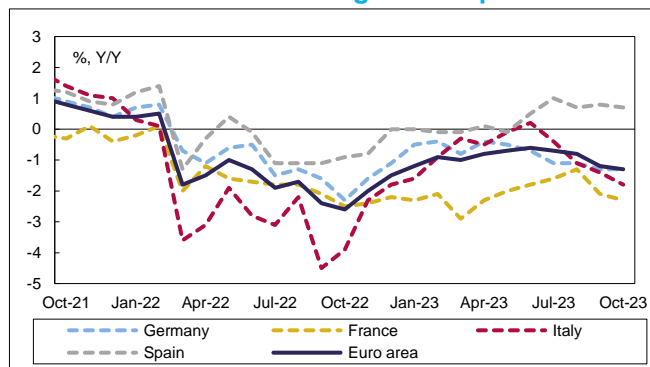
Compared to last week's consumer price figures, today's economic data will have done little to change minds one way or the other about the appropriateness of current monetary policy. The ECB's October consumer expectations survey results left unchanged the median consumer inflation expectation for the next 12 months (at 4.0%Y/Y) and for three years ahead

Euro area: Consumer price expectations



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

Euro area: Consumer GDP growth expectations*



*12 months ahead. Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

(2.5%Y/Y), with both measures only slightly below their respective averages for the past 12 months. Consumers revised down slightly their expectation for nominal income growth over the next 12 months by 0.1ppt to 1.1%Y/Y, thus still implying expectations of a significant drop in real incomes (which we think is unnecessarily downbeat). Their expectations for nominal spending growth and overall GDP growth over the next 12 months were also nudged lower by 0.1ppt to 3.3%Y/Y and -1.3%Y/Y, respectively the bottom of the ranges of the past 18 and 10 months. And with expectations for mortgage interest rates 12 months ahead remaining at the series high of 5.4%, and expectations for credit availability tightening further, consumers revised down again their 12-month expected increase in the price of their home, to 2.0%Y/Y.

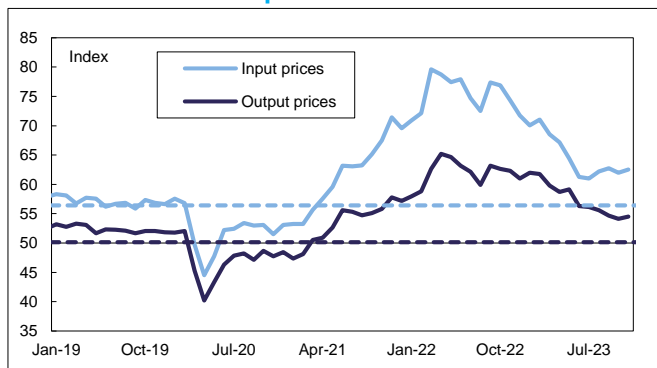
Services PMIs point to ongoing stickiness, but underlying goods prices pressures continue to ease

While the November inflation data were much improved, momentum in services prices remains significantly greater than that in core goods. And surveys continue to flag expectations of some persistence in services inflation over coming months. Last week's [Commission survey](#) results saw services firms' selling price expectations rise to their highest since May. And the final November services PMIs, published today, reported the first monthly rise in six in the services output prices charged component, as cost burdens ticked higher. And while this left the output price PMI (54.5) still more than 10pts below its peak last year, it remained 4.5pts above the pre-pandemic average. In contrast, the PMIs signalled that factory output prices fell sharply again in November, reflecting the ongoing easing in global goods prices due to improved supply chains and diminished pricing power amid the more acute weakening in demand in the manufacturing sector. Admittedly, the annual pace of decline in euro area producer prices moderated slightly in October from the prior month's record, by 3ppts to -9.4%Y/Y. But this reflected a smaller drag from producer energy inflation at the start of the fourth quarter, as electricity and gas prices jumped following the summer spike in wholesale prices. Indeed, when excluding energy, producer prices fell for a seventh consecutive month in October, to leave them down compared with a year earlier (-0.2%Y/Y) for the first time in three years. The downtrend in underlying price pressures was broad-based. Intermediate goods prices fell for the eleventh month out of the past twelve. And consumer goods prices were down for a third successive month, while capital goods prices were flat having risen in each month since November 2020. So, having fallen to a 22-month low in November, today's figures suggested that the disinflationary trend in consumer goods inflation should continue over coming months, even if the moderation in services inflation is more gradual.

The day ahead in the euro area

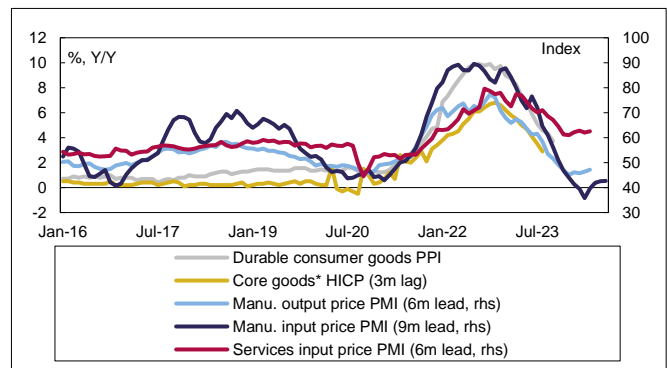
Tomorrow's release of euro area retail sales figures will offer insight into consumer spending at the start of Q4. But having contracted in Q3 for the sixth quarter out of the past seven, these are expected to report little growth in October, with a rise in Germany offset by a decline in France. The current Bloomberg consensus is for an increase of 0.2%M/M, following a decline of 0.3%M/M in September, which would leave sales down 1.1% compared to a year earlier. Meanwhile, Germany factory

Euro area: Services price PMIs*



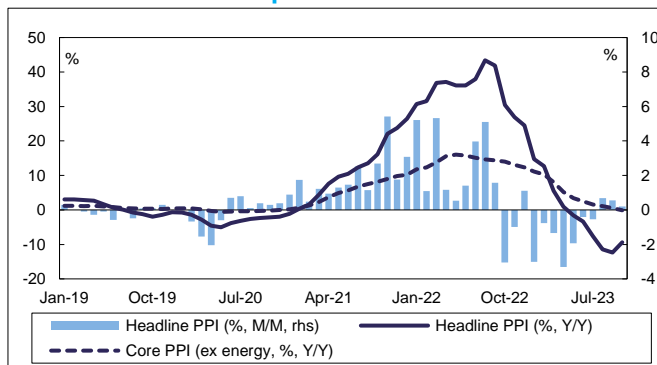
*Dashed lines represent pre-pandemic average. Source: S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Selected inflation indices



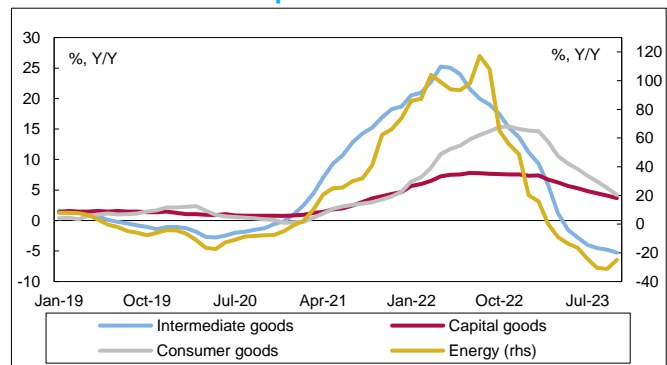
*Non-energy industrial goods inflation. Source: S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Producer price inflation



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Producer price inflation



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

orders data will provide further insight into the manufacturing performance at the start of Q4, while the latest construction PMIs for the euro area and three largest member states will likely point to ongoing contraction in the sector as higher borrowing costs weigh more acutely on demand.

UK

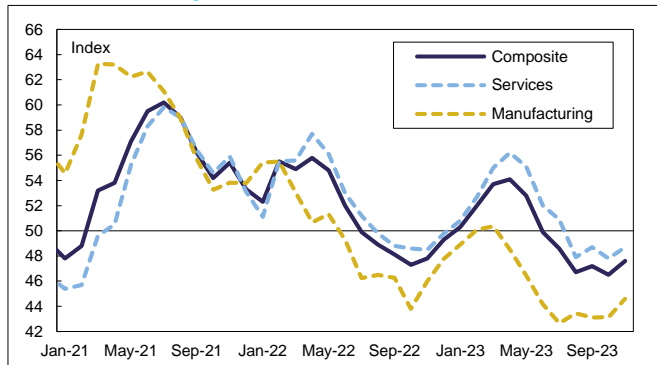
Retail sales remain subdued despite discounting, while private car sales continued to stall

Despite the improvement in household real disposable income after energy bills were cut in October, and widespread reports of discounting, retailers continue to report very cautious spending in the run up to Christmas. Certainly, today's BRC retail sales monitor tallied with last week's CBI distributive trade survey, suggesting that retail volumes continued to decline compared with a year earlier, with an initial boost in spending at the start of November fading as the month progressed. Admittedly, growth in the value of sales in November (2.7%Y/Y) was a touch firmer than in October (2.5%Y/Y) despite the moderation in shop price inflation (-0.9ppt to 4.3%Y/Y). Spending on health and beauty products was reportedly stronger, but sales of luxury items such as jewellery and watches reportedly declined at a steeper pace. So, when adjusting for price effects, the BRC's measure of annual growth in retail volumes remained in negative territory for the twentieth consecutive month (-1.6%Y/Y). Perhaps reflecting the spike in inflation this time last year, the average pace of decline in retail sales volumes in the first two months of Q4 (-2.1%Y/Y) was almost half that a year ago. But this still represented the second-steepest drop since the global financial crisis. And with the latest consumer confidence survey suggesting that households still appear more inclined to save than spend, we suspect that retailers hoping for a pre-Christmas splurge will be disappointed. Today's new car registrations figures also illustrated weak demand for big-ticket items, with private car sales down 5.9%Y/Y in November. And while new car registrations maintained an uptrend as fleets invested in the latest models, they merely returned back to the pre-pandemic level in November 2019 and were still 15% below the peak for the month in 2016.

Final PMIs revised higher, but still consistent with stagnation rather than growth

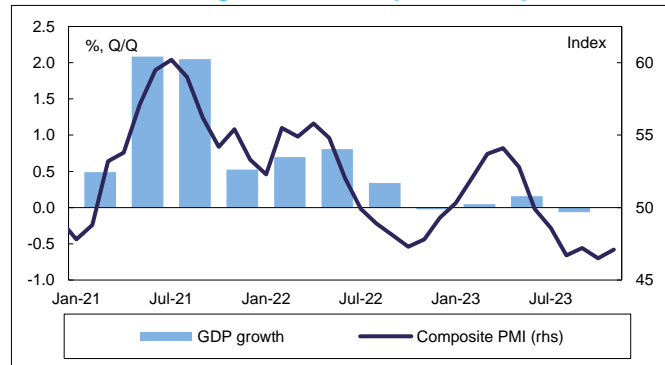
More encouragingly, however, the final November PMIs raised hopes that a contraction in UK GDP will again be avoided in Q4. Indeed, having already beaten expectations in the flash release, the headline services activity index was revised up 0.4pt from the initial estimate to a four-month high of 50.9, 1.6pts above September's low. Given also a more substantial revision to the final manufacturing output index, up almost 5pts from October to a seven-month high of 49.2, the composite PMI was also stronger than initially estimated, to be up 2pts on the month to a four-month high of 50.7. But while this left the composite index trending 0.4pt above the Q3 average, at 49.8, the survey was consistent with continued stagnation rather than a more meaningful recovery. And with new orders reportedly still declining, and firms having put a freeze on hiring, the near-term growth outlook appears to remain lacklustre, consistent with the BoE's most recent projections. Today's survey

Euro area: Output PMIs



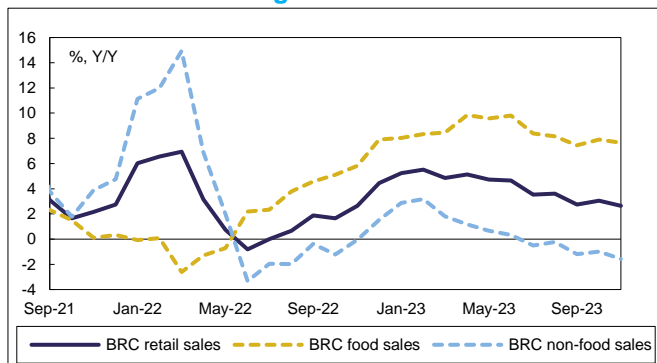
Source: S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & composite output PMI



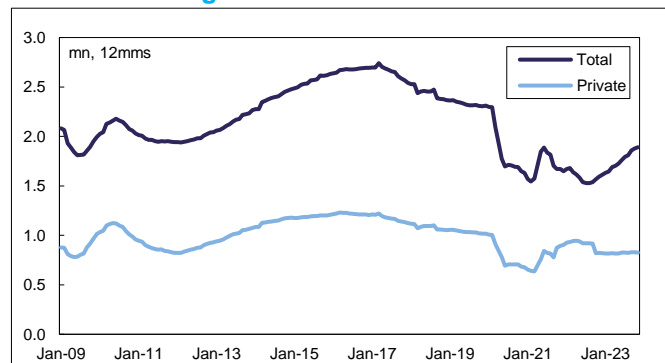
Source: S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: BRC retail sales growth*



*Retail sales values. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: New car registrations



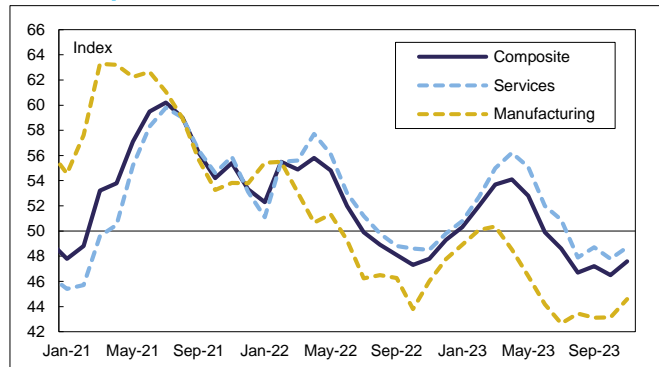
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

also provided further evidence of inflation persistence, with services firms seemingly keen to pass on the modest uptick in input cost burdens last month. In particular, the output prices charged index for the sector rose to a four-month high (58.2). And while this was well down on last year's peak, it was also still well above the long-run average, suggesting that when the MPC meets again in the coming week, its forward guidance tightening bias will be retained for the time being.

The day ahead in the UK

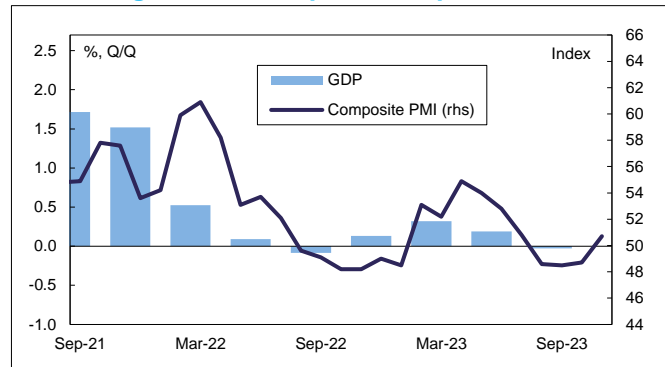
Like in the euro area, tomorrow will bring the UK's construction PMIs for November. This survey signalled a marked slowdown in activity towards the end of the summer, with the headline PMI falling sharply in September (45.0) to its lowest level since the slump during the first Covid lockdown. And while the respective index for commercial activity improved at the start of Q4, and the overall output index is forecast to rise again in November, it is also expected to remain in contractionary territory led by an ongoing downturn in house building. The BoE will also publish its latest Financial Stability Report.

UK: Output PMIs



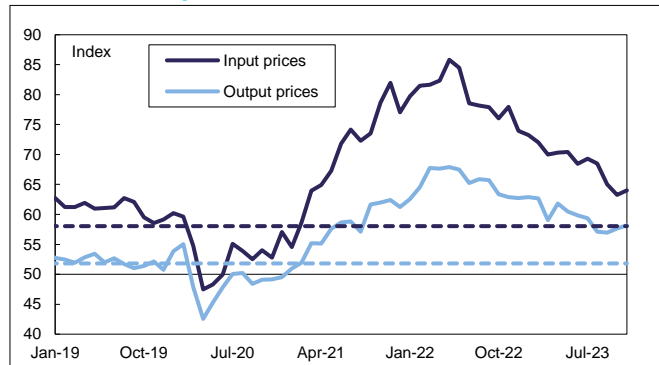
Source: S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & composite output PMI



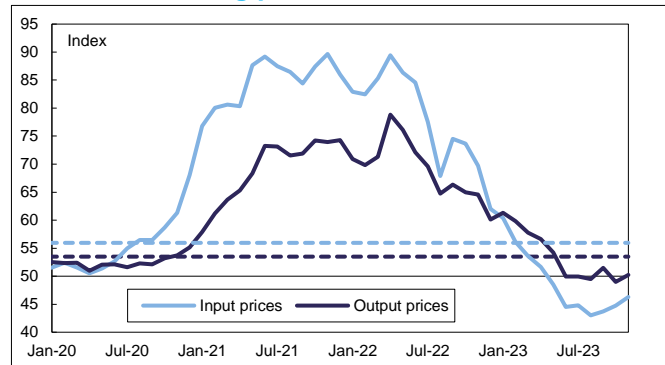
Source: S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Services price PMIs*



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

UK: Manufacturing price PMIs*















*Dashed lines represent pre-pandemic average. Source: S&P Global, Refinitiv Datastream 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	 ECB CPI expectations 1Y ahead (3Y ahead) Y/Y%	Oct	4.0 (2.5)	3.8 (2.5)	4.0 (2.5)	-
	 Final services (composite) PMI	Nov	48.7 (47.6)	48.2 (47.1)	47.8 (46.5)	-
	 PPI Y/Y%	Oct	-9.4	-	-12.4	-
Germany	 Final services (composite) PMI	Nov	49.6 (47.8)	48.7 (47.1)	48.2 (45.9)	-
France	 Final services (composite) PMI	Nov	45.4 (44.6)	45.3 (44.5)	45.2 (44.6)	-
	 Industrial production M/M% (Y/Y%)	Oct	-0.3 (1.8)	-	-0.5 (-0.1)	-0.6 (-0.3)
Italy	 Services (composite) PMI	Nov	49.5 (48.1)	48.3 (47.2)	47.7 (47.0)	-
Spain	 Services (composite) PMI	Nov	51.0 (49.8)	51.5 (50.5)	51.1 (50.0)	-
	 Industrial production M/M% (Y/Y%)	Oct	-0.5 (-1.5)	-0.5 (-1.7)	1.1 (-1.4)	- (-1.2)
UK	 BRC retail sales monitor Y/Y%	Nov	2.6	-	2.6	-
	 Car registrations Y/Y%	Nov	9.5	-	14.3	-
	 Final services (composite) PMI	Nov	50.9 (50.7)	50.5 (50.1)	49.5 (48.7)	-




Auctions

Country	Auction
Germany	 sold €3.66bn of 3.1% 2025 bonds at an average yield of 2.64%
UK	 sold £1.50bn of 0.75% 2033 index-linked bonds at an average yield of 0.724%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Sentix investor confidence index	Dec	-16.8	-15.6	-18.6	-
Germany	 Goods trade balance €bn	Oct	17.8	<u>17.8</u>	16.5	16.7
Spain	 Unemployment change, 000s	Nov	-24.6	<u>-24.6</u>	36.9	-








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/ <i>Daiwa forecast</i>	Previous
Euro area	 08.30	Construction PMI	Nov	-	42.7
	 10.00	Retail sales M/M% (Y/Y%)	Oct	0.2 (-1.1)	-0.3 (-2.9)
Germany	 07.00	Factory orders M/M% (Y/Y%)	Oct	0.2 (-3.9)	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	46.7	45.6

Auctions and events

UK	 10.00	Auction: £3.0bn of 0.875% 2033 bonds
	 10.30	BoE to publish Financial Stability Report

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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