Euro wrap-up

Overview

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- Bunds made further gains as euro area retail sales remained subdued and German factory orders declined further than expected at the start of Q4 while a survey pointed to ongoing contraction in German construction.
- Gilts also largely made gains as the UK construction PMIs pointed to significant weakness in house-building as well as a notable cooling of input cost pressures in the sector.
- Thursday will bring German industrial production data for October as well as an updated estimate of euro area Q3 GDP and its expenditure breakdown.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.586	-0.006
OBL 2.4 10/28	2.157	-0.027
DBR 2.6 08/33	2.207	-0.036
UKT 3½ 10/25	4.480	+0.009
UKT 4½ 06/28	4.009	-0.032
UKT 3¼ 01/33	3.959	-0.060

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

Euro area

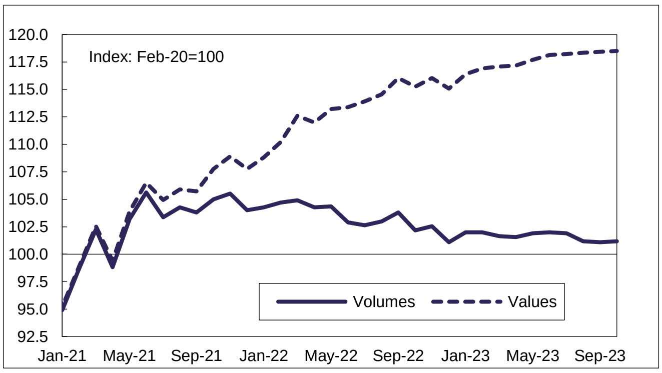
An underwhelming start to Q4 for retail sales following weak Q3

Retail sales volumes in the euro area rose in October for the first time in five months. But the increase of 0.1%M/M was paltry and merely reversed the drop the prior month. And it left sales down 0.8%3M/3M, the steepest such decline since February, and also down 1.2%Y/Y, albeit 1.3% above the pre-pandemic level. Within the detail, the volume of sales of food items and core (i.e. non-food and non-auto fuel) goods broadly also reversed their respective moves in September. But while food sales were down 1.1%M/M to be unchanged on a three-month basis, the rise of 0.8%M/M in core goods sales left them still down 1.1%3M/3M, highlighting their role as the key source of weakness. Additionally, while petrol prices fell steadily over the course of the month, sales of auto fuel were down 0.8%M/M and 2.6%3M/3M. The broadly flat reading in euro area retail sales came despite the rise of 1.1%M/M in Germany, which was the best in thirteen months. In contrast, sales fell for the second month in three in France (-1.0%M/M) and for the first time since February in Spain (-0.4%M/M). And while the Italian sales data were not published today, they also probably declined. With retail prices little changed, the value of euro area retail sales also rose in October by just 0.1%M/M, marking the fourth successive minimal increase, to be up 2.8%Y/Y. The sluggishness of sales in Q3 and at the start of Q4 tallies with the deterioration of consumer confidence over that period, with the Commission survey index having dropped in October to a seven-month low. And while that indicator rose back to a three-month high in November and consumers also signalled greater readiness to make major purchases, the Commission's index of retailer sentiment improved only marginally to be the second lowest in more than a year, with stock levels still judged to be undesirably high by historical standards.

Household spending in Q3 likely supported by outlays on cars and services

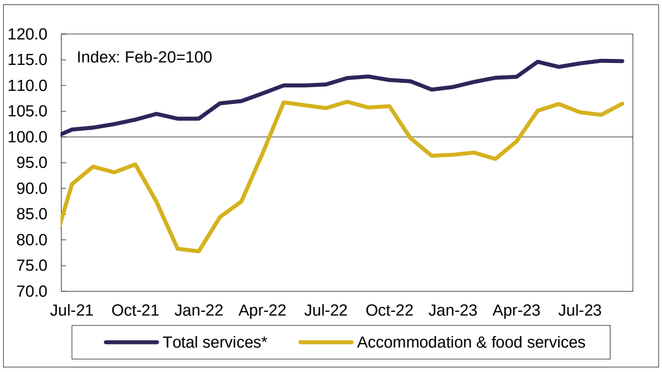
The subdued euro area retail sales in October raise the possibility of a further quarterly decline in Q4. Sales dropped 0.4%Q/Q in Q3, marking the sixth fall in the past seven quarters. Nevertheless, with new car registrations having risen 7.5%Q/Q on an adjusted basis, autos should have provided some offset in Q3. And spending on services should also have supported overall consumption. Indeed, other data published today showed that overall services activity rose 0.9%Q/Q in Q3 with food and accommodation services up 0.6%Q/Q. So, tomorrow's national accounts should show a return to modest positive growth in household consumption in Q3, supported by rising real disposable incomes, following the flat reading in Q2. Given in particular a significant negative contribution from inventories, however, the contraction in overall GDP will be confirmed, with the possibility that the size of decline was slightly larger than the initial estimate of -0.1%Q/Q.

Euro area: Retail sales



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Services activity



**Services of the business economy except trade and financial & insurance activities. Source: Macrobond and*

German orders start Q4 on the backfoot underscoring the weak manufacturing outlook

While recent surveys have hinted that the bottom in Germany's economic downturn might well be reached this quarter, they also remain consistent with ongoing contraction, not least in the manufacturing sector, amid soft domestic and external demand. Today's German factory orders data provided a reminder that the near-term production outlook remains subdued, with orders declining a steeper-than-expected 3.7%M/M in October to the lowest level since March. This left them down 4.6%3M/3M, more than 7% lower than a year ago, and 21% below the post-pandemic peak in July 2021. Admittedly, the weakness in October was driven by one-off bulk contracts, with orders excluding major items rising for the third month out of the past four, by 0.7%M/M, to be in line with the Q3 level. Encouragingly, domestic orders recorded the strongest monthly growth since June (2.4%M/M), but the decline in orders from non-euro area countries – driven by large items – was the largest since March (-7.4%M/M).

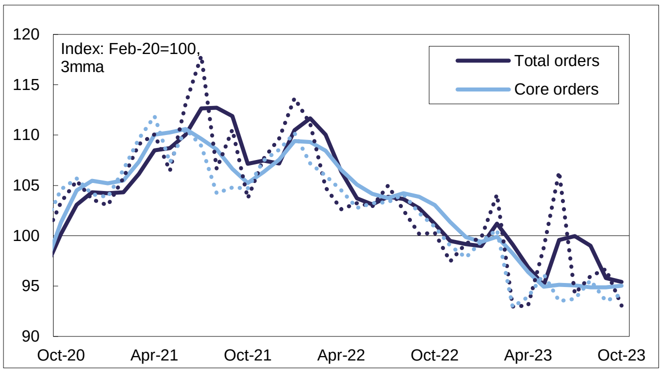
Broad-based weakness led by capital goods

Within the detail, orders for capital goods fell sharply in October (-6.0%M/M) to their lowest level since May 2020, reflecting a drop in external demand from both within and outside of the euro area. That, however, principally reflected a steep drop in orders for machinery and equipment (-13.5%M/M) due in part to payback for a jump in engine and turbine orders in September. But orders for electrical machinery and autos also fell, with the latter reaching its lowest level since March. And the fall in capital goods orders would have been even steeper in the absence of a jump in demand from the aerospace subsector. Meanwhile, following a pick up over the summer, demand for various energy-intensive items, including chemicals and basic metals, also fell back at the start of Q4. And so, overall, intermediate goods orders declined for the first month in three (-1.4%M/M), albeit remaining more than ½% above the Q3 average. However, despite a rebound in orders for consumer goods (2.8%M/M) amid a surge in the clothing sector, given the slump in September, they were still more than 1% below the Q3 average.

Decline in manufacturing turnover points to weak production in October

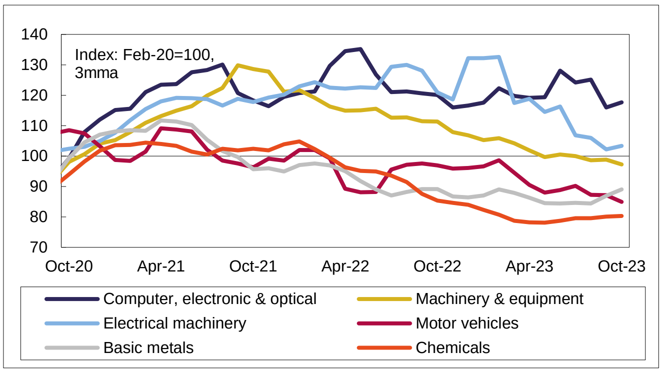
While the decline in new orders in part reflects rising global economic uncertainties, it also reflects a conscious effort by firms to reduce inventories. And with stock levels still looking relatively high, we suspect that the outlook for both orders and production will remain weak. Admittedly, order backlogs among certain subsectors, such as computers, electronic and optical products and electrical machinery remain elevated. And while they have fallen back steadily over the past year as improving supply chains allowed a rebound in production, backlogs in the autos sector should also support recovery in due course. But backlogs in other sectors have fallen back close to pre-pandemic levels. And although various sentiment surveys – including the manufacturing PMIs and ifo institute indices – suggest that Germany's manufacturing downturn might have finally

Germany: Factory orders*



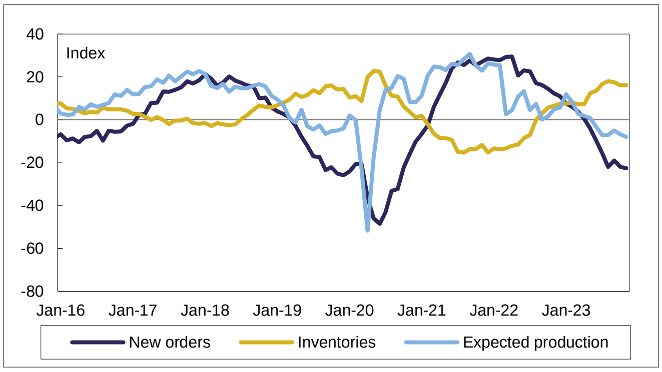
*Core orders excludes major items. Dotted lines are unsmoothed data.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders, by sub-sector



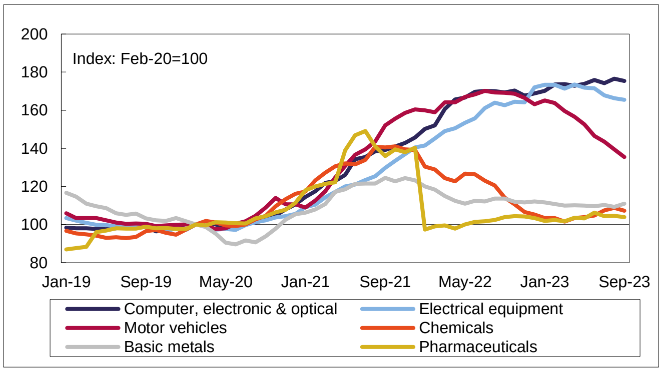
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Orders, inventories & production indices



Source: ifo, Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing order backlogs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

reached a bottom, they also imply that another contraction in production in Q4 is a good bet. This would certainly tally with today's figures for manufacturing turnover, which declined in October for a fifth successive month (-0.4%M/M) to a 17-month low, some 1½% below the Q3 average. Taken together with the latest truck toll mileage figures, today's turnover data pose notable downside risks to the Bloomberg survey consensus for tomorrow's production figures, which before today's release predicted that output rose 0.2%M/M in October.

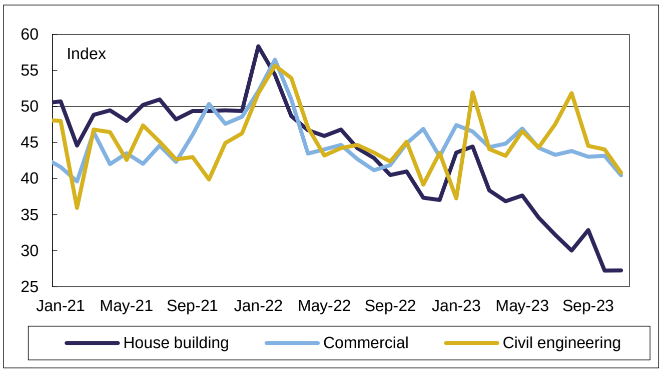
German construction PMI consistent with ongoing slump in house building

Today's construction PMIs also flagged significant challenges facing Germany's construction firms, with the survey signaling a further marked deterioration in the business climate in the middle of the fourth quarter. In particular, the headline index fell more than 2pts to 36.2 in November, suggesting that activity contracted at the steepest pace since the drop during the first Covid lockdown in April 2020 and the euro crisis in 2012 before that. Against the backdrop of rising borrowing costs and falling house prices, the downturn in German house-building remains most severe, with the respective index moving broadly sideways at a historically weak level (27.3). But the rate of contraction in commercial building and civil engineering activity also gathered pace. And with new orders declining sharply and building permits down almost 40% from last year's peak despite a pickup in September, the outlook for German construction remains exceptionally weak. According to the PMIs, French construction activity continued to contract in November too, albeit at a slightly softer pace than in the previous six months. The weakness in the largest member states was partially offset by ongoing growth in the sector in Italy, where the construction PMI rose more than 1pt to 52.9, its highest level since May 2022.

The day ahead in the euro area

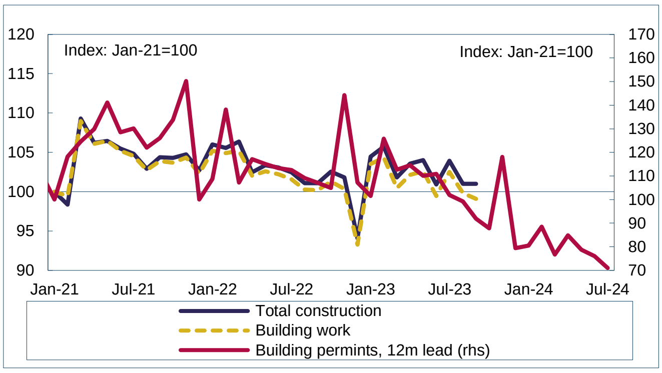
Aside from the aforementioned German IP figures, tomorrow also brings industrial output data from Italy, where production is forecast to fall for the first month in three, by 0.2%M/M in October. Also due to be published tomorrow are the euro area national accounts for Q3, which will give an update on GDP as well as the first expenditure breakdown. Given downward revisions to the estimates of French and Irish GDP, there is also a significant risk of a downwards revision to the initial estimate of euro area growth (-0.1%Q/Q). However, we suspect that the expenditure breakdown will confirm that household consumption provided modest support to GDP growth, fixed investment remained subdued due to the contraction in construction, both exports and imports declined, and adjustments to inventories subtracted significantly.

Germany: Construction PMIs by subsector



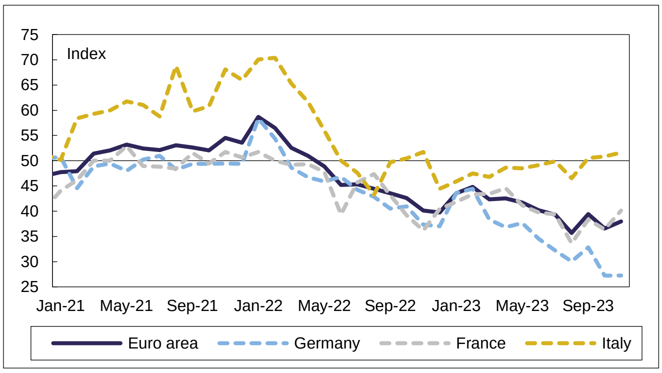
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Construction output & building permits



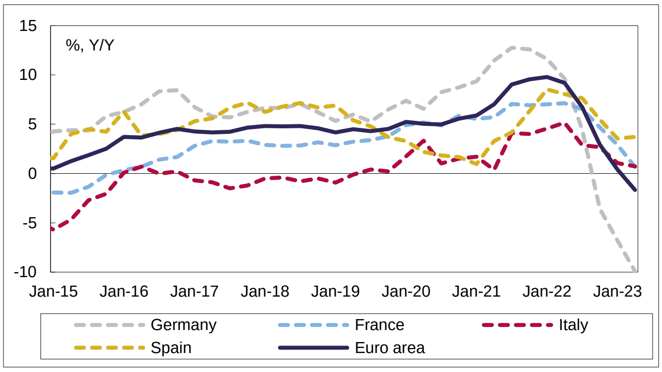
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction PMIs by member state



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: House prices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

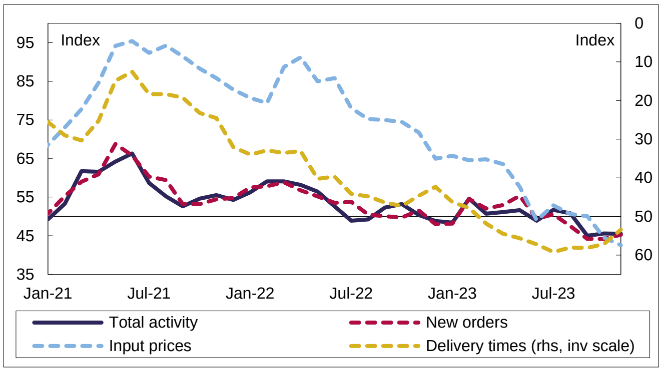
Construction PMIs signal substantive contraction led by house-builders

The final manufacturing and services PMIs for November suggested improved conditions in the middle of Q4, with yesterday's headline composite PMI up 2pts to a four-month high of 50.7, consistent with broad stability if not modest growth. However, today's construction PMIs pointed to ongoing and substantial contraction in the sector, with the survey's headline activity index down 0.1pt to 45.5, the second-lowest (after September this year) since the lockdowns of May 2020. While the respective index edged up slightly on the month, housing activity (39.2) was reportedly still the weakest subsector weighed by high borrowing costs and dim perceptions of the residential market outlook. But civil engineering (43.5) and commercial activity (48.1) were increasingly in reverse gear. And new orders (45.2) fell for a fourth successive month. Construction firms reported cuts in staff headcount for the first time in ten months, as well as a third successive cutback in purchasing activity. More happily for purchasers, the survey suggested that input costs fell for a second successive month and by the most since July 2009, reflecting falling prices of raw materials (not least timber and steel) and increased competition amid spare capacity among suppliers. Rates charged by subcontractors were broadly stable. Of course, the survey reports of weakness in the residential building sector comes as no surprise. Last month the OBR forecast that housing investment will drop 7.0%Y/Y this year and a further 6.0%Y/Y in 2024, while the BoE projects a decline of 5.75%Y/Y in 2023 followed by a steeper drop of 6.75%Y/Y next year.

The day ahead in the UK

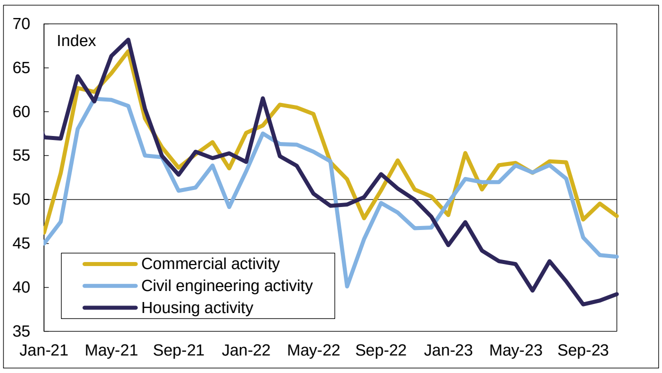
It will be a quiet day for economic news in the UK tomorrow with no key data releases to look out for.

UK: Construction PMI indices



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Construction PMIs by subsector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Construction PMI	Nov	**43.4**	-	42.7	-
		Retail sales M/M% (Y/Y%)	Oct	**0.1 (-1.2)**	0.2 (-1.1)	-0.3 (-2.9)	-0.1 (-)
Germany		Factory orders M/M% (Y/Y%)	Oct	**-3.7 (-7.3)**	0.0 (-3.9)	0.2 (-4.3)	0.7 (-3.8)
		Construction PMI	Nov	**36.2**	-	38.3	-
France		Construction PMI	Nov	**44.6**	-	41.0	-
Italy		Construction PMI	Nov	**52.9**	-	51.8	-
UK		Construction PMI	Nov	**45.5**	-	45.6	-
Auctions							
Country		Auction					
UK		sold £3.0bn of 0.875% 2033 bonds at an average yield of 4.091%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data						
Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	GDP – 3rd estimate Q/Q% (Y/Y%)	Q3	*-0.1 (0.1)*	0.2 (0.5)
		10.00	Employment – 2nd estimate Q/Q% (Y/Y%)	Q3	*0.3 (1.4)*	0.1 (1.3)
Germany		07.00	Industrial production M/M% (Y/Y%)	Oct	0.2 (-3.0)	-1.4 (-3.7)
France		07.45	Trade balance €bn	Oct	-	-8.9
Italy		10.00	Industrial production M/M% (Y/Y%)	Oct	-0.4 (-1.4)	0.0 (-2.0)
Auctions and events						
France		09.50	Auction: 2.75% 2027 bonds			
		09.50	Auction: 0.00% 2032 bonds			
		09.50	Auction: 1.25% 2034 bonds			
		09.50	Auction: 0.10% 2029 index-linked bonds			
Spain		09.30	Auction: 0.6% 2029 bonds			
		09.30	Auction: 3.9% 2039 bonds			
		09.30	Auction: 0.7% 2033 index-linked bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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