Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds followed USTs lower but the final estimates of German inflation in November confirmed a broad-based easing of price pressures.
- Gilts also made losses despite survey evidence of a significant softening of conditions in the UK labour market.
- The coming week will bring monetary policy announcements from the ECB and BoE, as well as the flash December PMIs and new data for UK GDP, jobs and vacancies and euro area IP.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.673	+0.090
OBL 2.4 10/28	2.222	+0.092
DBR 2.6 08/33	2.264	+0.078
UKT 3½ 10/25	4.520	+0.040
UKT 4½ 06/28	4.062	+0.051
UKT 3¼ 01/33	4.011	+0.050

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

Euro area

German inflation confirmed at 29-month low with broad-based moderation

On a quiet end to the week for economic data from the euro area, the final figures for German inflation in November confirmed the flash estimates, which had provided a welcome downside surprise when they were published at the end of last month. So, the EU-harmonised HICP rate fell 0.7ppt to 2.3%Y/Y, the lowest since June 2021 and 0.2ppt below the original median forecast on the Bloomberg survey. And the national CPI measure fell 0.6ppt to 3.2%Y/Y, also a 29-month low and 0.3ppt below the initial consensus. But, most encouragingly, the final figures confirmed that the drop in German inflation last month was broad-based.

Services prices significantly weaker than normal while core goods prices were steady

On the HICP inflation measure, services prices fell 1.3%M/M – 0.3ppt below the average change for the month in the decade before the pandemic – to push the annual rate down 0.8ppt to a 15-month low of 3.4%Y/Y. In this category, while inflation of package tours was much stronger due to a base effect, the categories for restaurants and accommodation, as well as airfares, were significantly softer. On the same basis, core goods prices were unchanged on the month, bang in line with the average of the decade before the pandemic. So, their annual rate of increase moderated 0.4ppt to a 21-month low of 3.6%Y/Y. The components of vehicles and furniture both fell to 2½-year lows, and clothing was the lowest in 15 months. So, German core HICP inflation (excluding all food and energy) fell 0.7ppt to 3.5%Y/Y, the softest since August 2022.

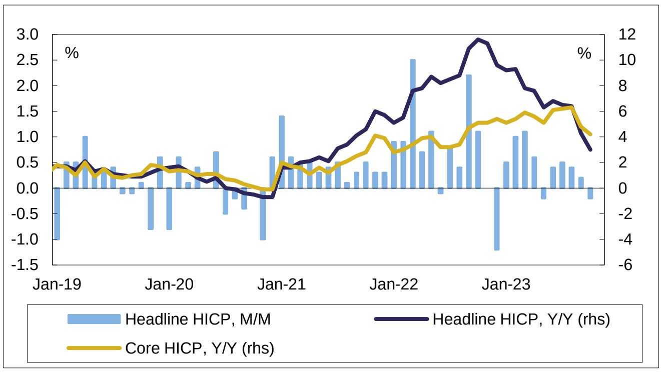
Inflation will rebound in December on energy base effect before renewing downtrend in New Year

In the non-core components, as petrol prices fell 2.6%M/M and electricity and gas prices fell 1.7%M/M, energy inflation on the national HICP measure fell 1.3ppts to -7.3%Y/Y, marking the steepest year-on-year fall in three years. And while food prices rose for a third successive month, the respective inflation rate moderated 0.5ppt to a 20-month low of 6.6%Y/Y. Given the steep drop in energy prices a year ago thanks to the special government gas and heating bill rebates for that month only, German inflation is bound rebound in December. However, we expect core inflation to be little changed this month. And the downtrend in both headline and core inflation in Germany should be clear again from February on.

ECB set to revise down its projections for GDP and inflation

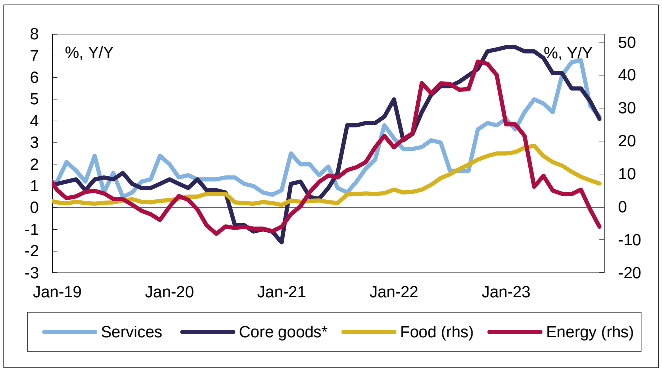
Of course, the steeper-than-expected decline in inflation in November was not limited to Germany, with the flash estimates from France, Italy and Spain also lower than anticipated. And we expect the drop of 0.5ppt in euro area inflation last month to

Germany: HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: HICP inflation – major components



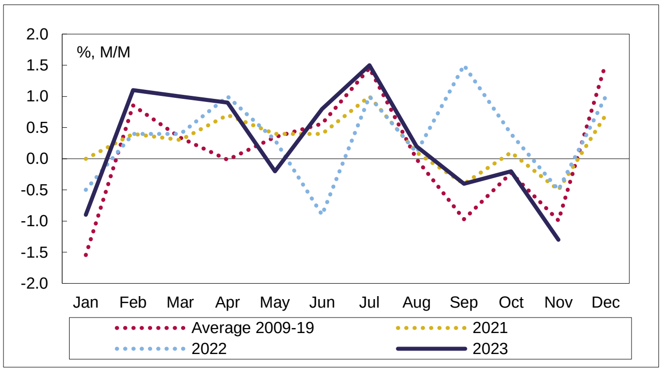
**Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

2.4%Y/Y to be confirmed when the final figures are published on 19 December. So, while headline inflation will pick up again in December due to energy base effects, both headline and core rates will undershoot the ECB's current forecasts for Q4 – 3.3%Y/Y and 4.1%Y/Y respectively – by roughly ½ppt. Yesterday's revised national accounts data confirmed that euro area GDP growth of 0.1%Q/Q and -0.1%Q/Q in Q2 and Q3 respectively was similarly below the rates projected by the ECB's projection. Surveys also suggest no immediate pickup in economic or price momentum. And despite the recent drop in the yield curve and recent market shifts, given the cut-off date last month, the technical assumptions will not be hugely different to those used previously. So, the updated Eurosystem macroeconomic projections, to be published on Thursday following the Governing Council's monetary policy meeting, are bound to nudge down the profiles for both GDP and inflation. Admittedly, the expenditure breakdown of Q3 GDP suggested that growth should resume in the New Year once inventory adjustments come to an end. But the Eurosystem will likely revise down the projection of full-year GDP growth in 2023 by 0.2ppt to 0.5%Y/Y, and also revise down its GDP projection for 2024 to below 1.0%Y/Y. More importantly for monetary policy, the revised projections should suggest that headline inflation will average less than 3.0%Y/Y in 2024 and return to the 2.0% target by mid-2025. And they are likely to suggest that headline inflation will average 2.0%Y/Y or less that year, down from 2.1%Y/Y in the current projections.

ECB guidance should signal that the next move in rates is highly likely to be down

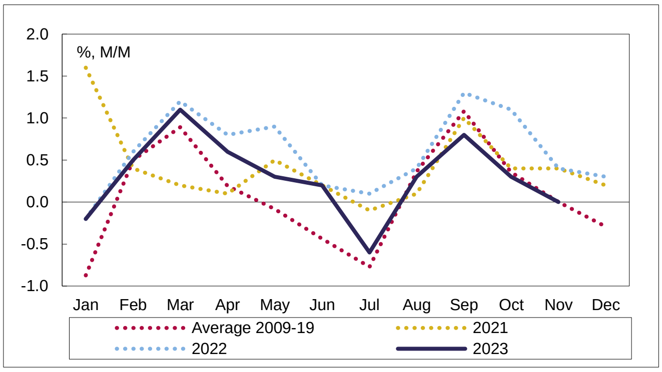
Given the downwardly revised inflation projections, we suspect that President Lagarde will echo the recent comments of Executive Board member Schnabel – who has typically been the most eloquent advocate of the hawks – that a further rate hike is now "unlikely". However, the policy statement will repeat that future policy will be data dependent. And with core inflation still well above the 2.0% target at 3.6%Y/Y in November and likely to remain above 3.0%Y/Y until February at the earliest, and unit labour costs having risen at a record rate in Q3, she will be reluctant to suggest that a rate cut could come as soon as the first quarter of 2024. Indeed, given the likely discomfort of many Governing Council members to recent market moves, she might well try to push back somewhat against the marked downward shift in expectations of future rates, which has priced in five cuts of 25bps apiece over the course of next year. The monetary policy statement is also likely to repeat that "future decisions will ensure that its policy rates will be set at sufficiently restrictive levels for as long as necessary". And the updated forward guidance might fail to offer an explicit easing bias. Moreover, in her press conference, Lagarde might remind that the Governing Council will soon discuss the possibility of an early end to PEPP reinvestments, which would tighten financial conditions somewhat even as the ECB pivots towards lower policy rates.

Germany: Services prices*



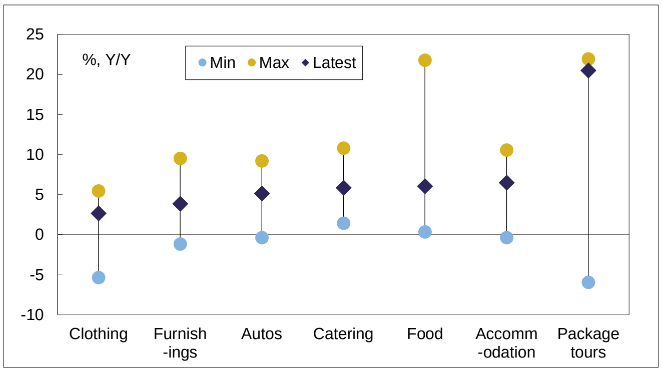
*HICP measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Core goods prices*



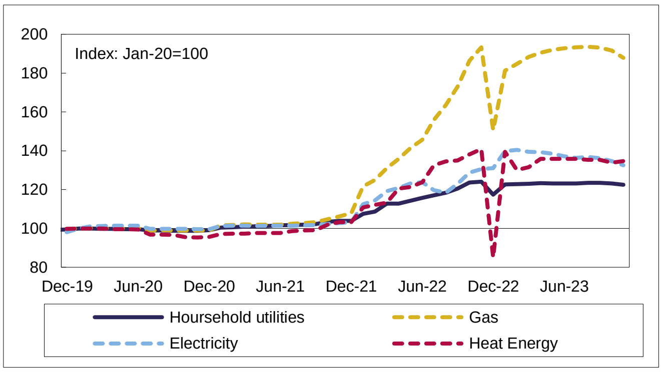
*Non-energy industrial goods prices, HICP measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: HICP inflation – selected components*



*Data range since start of 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: HICP – energy components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

Data-wise, the principal focus in the coming week will be Friday's flash December PMIs. While we expect to see a second successive rise in the euro area composite output PMI from October's three-year low, it is likely to remain firmly below 50, suggesting ongoing contraction. The weakness will be led by the manufacturing sector but the survey is also likely to suggest that services remain subdued. An unchanged reading in the composite PMI from 47.6 in November would leave the Q4 average down 0.6pt from Q3 when GDP declined 0.1%Q/Q. Ahead of that release, euro area IP data for October due on Wednesday will likely report a further drop in output at the start of Q4. The data published so far from the member states suggest a decline of around ½%M/M. Other notable releases due in the coming week include the German ZEW investor sentiment survey for December (Tuesday), final Spanish and French inflation for November (Thursday and Friday respectively), and euro area goods trade and updated labour cost figures (also Friday).

UK

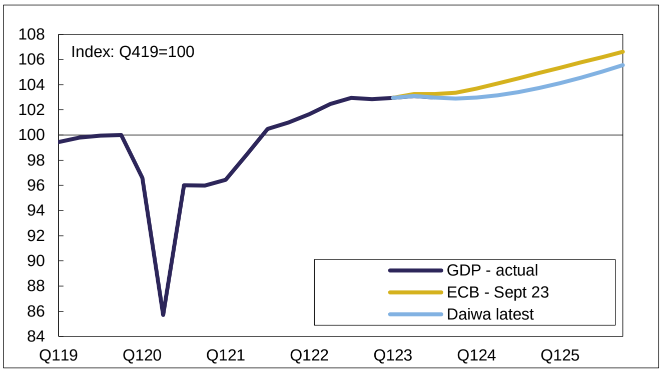
Survey signals significant softening of labour market conditions in Q4

Together with developments in services prices, conditions in the UK's labour market – specifically, the extent of underlying tightness and wage growth – are currently the key variables in the BoE's policy reaction function. Unfortunately, however, given the suspension of the ONS's key Labour Force Survey (LFS) due to potential inaccuracies related to the steady decline in the response rate, current labour market conditions are especially difficult to assess. So, the MPC is having to place more weight than usual on survey indicators such as today's REC/KPMG report on jobs, which is based on information provided by recruitment and employment consultancies. For some time, this survey has pointed to a significant moderation in employment and wage growth. And the November survey results, published today, implied a further loosening in the labour market in Q4, with a significantly improved supply-demand imbalance continuing to diminish pay pressures.

Pay growth moderating as staff availability continues to rise and demand for workers falls

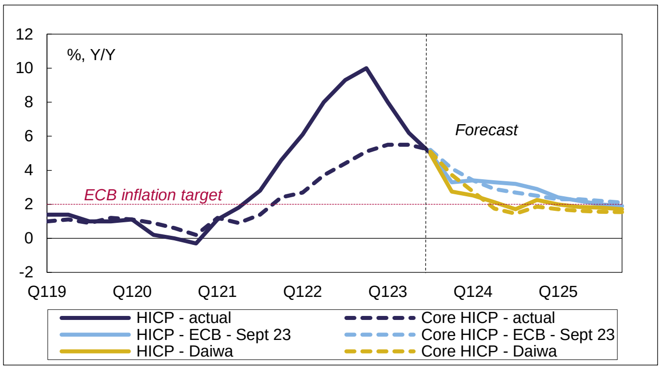
In particular, the REC survey suggested that permanent placements fell for a fourteenth consecutive month in November, and at the second fastest pace during that losing streak. And strikingly, staff availability improved for the eleventh successive month to the best since end-2020. That implied a significant easing in the balance between demand for and supply of workers, amid reports of increased redundancies and broader job insecurity as well as a reluctance of employers to hire new staff. Indeed, the survey reported a third successive month of falling staff demand, albeit at a very modest rate. So, while firms continued to suggest that skills shortages were supporting wage growth somewhat, the survey measure of permanent staff starting salaries – which is a good leading indicator for private sector pay twelve months ahead – fell for a seventh

Euro area: GDP projections



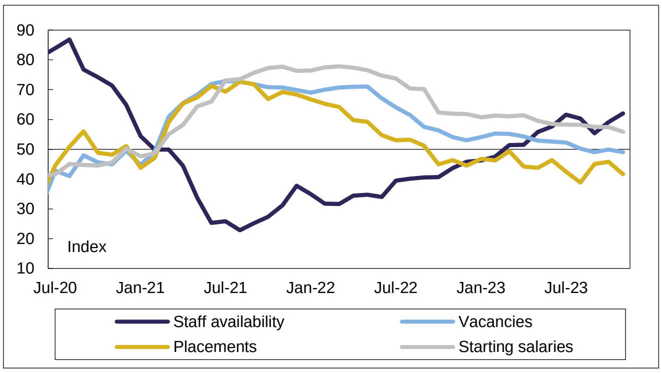
Source: ECB, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation projections



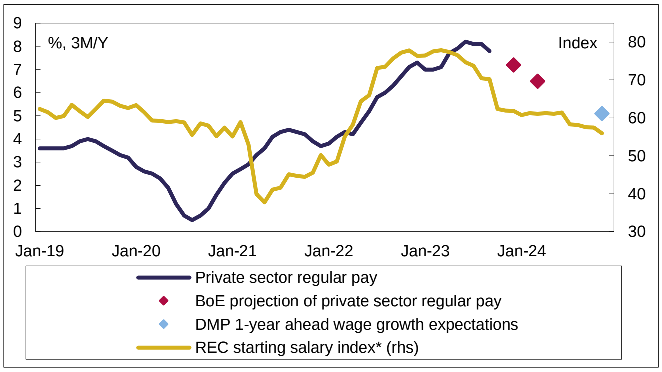
Source: ECB, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: REC report on jobs – selected indicators*



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

UK: Selected pay growth indicators



**12-month lead. Source: BoE, S&P Global, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.*

successive month to the lowest level since March 2021, and well below the average in the five years before the pandemic. Moreover, growth in wages of new temporary staff slowed to a 33-month low. The official ONS labour market data, minus the usual LFS figures, due on Tuesday should similarly report an easing in pay growth (albeit from a very high level) amid falling job vacancies and rising jobless claims.

REC survey should bolster BoE's confidence in its labour market judgements

Today's REC survey should bolster confidence at the BoE in its judgement last month that, against the backdrop of subdued economic activity, employment growth is likely to have softened over the second half of the year, and to a greater extent than it had anticipated during the summer. The BoE will also therefore retain faith in its forecast that wage growth will decline steadily over coming quarters. And it will certainly have welcomed the big drop in inflation in October of 2.1ppts to 4.6%Y/Y, 0.2ppt below the MPC's projection. However, while services inflation was also softer than the BoE had expected, at 6.6%Y/Y it remained highly elevated. Likewise, while core CPI fell to the softest rate since March 2022, at 5.7%Y/Y it still suggested that the UK has a much greater problem of inflation persistence than the other major economies. And importantly, since the last MPC meeting, the sharp drop in market pricing of future rates – which has continued to be reflected in lower mortgage rates – suggests that the monetary policy stance is not as tight as it previously thought. And the government has also loosened the fiscal stance.

MPC likely to maintain tightening bias on Thursday

When it meets for its latest monetary policy meeting in the coming week, given the recent market shifts and fiscal policy easing, the MPC might well judge that economic growth over coming quarters is likely to be somewhat firmer than previously anticipated. And, in its policy statement to be issued on Thursday after the forthcoming policy meeting, it will surely repeat its concerns that the risks to the inflation outlook remain skewed to the upside. It will therefore also again underscore that "monetary policy is likely to need to be restrictive for an extended period of time". And so, pushing back against market pricing, which is now consistent with a first rate cut next June, it will maintain a tightening bias, restating that "Further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures." Indeed, as in November, we suspect that three MPC members will again vote for a hike this month.

The week ahead in the UK

On the data front, several top-tier releases, including the latest labour market report (Tuesday), monthly GDP figures (Wednesday) and preliminary PMIs (Friday), are due. The suspension of the ONS's Labour Force Survey, due to the marked decline in the response rate, means that the information provided by the labour market report will be less comprehensive than normal. But those figures to be published – including payroll jobs, the claimant count and vacancies – will be watched for evidence of a further softening of the balance between supply and demand, as suggested by survey results such as today's REC report. And although the annual rates of average earnings growth will remain very elevated, they are likely to imply a notable slowing of momentum. Meanwhile, we expect the October GDP data to report a third successive very modest monthly increase in growth, which would suggest that a contraction should be avoided in Q4. Friday's flash PMIs for December will also likely be more consistent with stagnation or modest growth rather than recession after the composite index rose 2.0pts to a four-month high of 50.7. Among other releases due, while the GfK consumer confidence survey (Friday) is likely to be consistent with cautious household spending, we expect a further modest rise close to September's 20-month high. Finally, the RICS residential market survey (Thursday) is likely to signal ongoing challenges in the housing sector amid high borrowing costs and a low level of transactions, albeit with price expectations likely to be more consistent with stabilisation than of late.

The next edition of the Euro wrap-up will be published 12 December 2023

Daiwa Capital Markets

Daiwa economic forecasts

	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2	2024 Q3	2023	2024	2025
GDP								%, Y/Y	
Euro area	0.1	-0.1	-0.1	0.1	0.2	0.3	0.5	0.3	1.4
UK	0.2	0.0	0.1	0.1	0.1	0.1	0.5	0.3	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/ *Daiwa forecast*	Previous	Revised
Germany	Final HICP (CPI) Y/Y%	Nov	**2.3 (3.2)**	*2.3 (3.2)*	3.0 (3.8)	-
UK	BoE household inflation expectations 12M ahead, Y/Y%	Nov	**3.3**	-	3.6	-
Auctions						
Country	Auction					
- Nothing to report -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

The coming week's data calendar

The coming week's key data releases

Country		GMT	Release	Period	Market consensus/ _Daiwa forecast/actual_	Previous
			Monday 11 December 2023			
UK		00.01	Rightmove house price index M/M% (Y/Y%)	Dec	-	-1.7 (-1.3)
			Tuesday 12 December 2023			
Germany		10.00	ZEW current assessment (expectations) balance	Dec	-75.5 (8.8)	-79.8 (9.8)
UK		07.00	Payrolled employees, monthly change '000s	Nov	-	33
		07.00	Unemployment claimant count rate % (change '000s)	Nov	-	4.0 (17.8)
		07.00	Average weekly earnings (excluding bonuses) 3M/Y%	Oct	7.6 (7.4)	7.9 (7.7)
			Wednesday 13 December 2023			
Euro area		10.00	Industrial production M/M% (Y/Y%)	Oct	_-0.5 (-4.7)_	-1.1 (-6.9)
UK		07.00	GDP M/M% (3M/3M/)	Oct	-0.1 (0.1)	0.2 (0.3)
		07.00	Industrial production M/M% (Y/Y%)	Oct	-0.1 (1.1)	0.0 (1.5)
		07.00	Manufacturing production M/M% (Y/Y%)	Oct	0.0 (1.9)	0.1 (3.0)
		07.00	Index of services M/M% (3M/3M%)	Oct	-0.1 (0.2)	0.2 (-0.1)
		07.00	Construction output M/M% (Y/Y%)	Oct	-0.2 (1.4)	0.4 (2.8)
		07.00	Trade (goods) balance £bn	Oct	- (-14.1)	-1.6 (-14.3)
			Thursday 14 December 2023			
Euro area		13:15	ECB Deposit Rate %	Dec	_4.00_	4.00
Spain		08.00	Final HICP (CPI) Y/Y%	Nov	_3.2 (3.2)_	3.5 (3.5)
UK		00.01	RICS house price balance %	Nov	-58	-63
		12.00	BoE Bank Rate %	Dec	_5.25_	5.25
			Friday 15 December 2023			
Euro area		09.00	Preliminary manufacturing (services) PMI	Dec	44.5 (49.2)	44.2 (48.7)
		09.00	Preliminary composite PMI	Dec	48.0	47.6
		10.00	Labour costs Y/Y%	Q3	-	4.5
		10.00	Trade balance €bn	Oct	-	9.2
Germany		08.30	Preliminary manufacturing (services) PMI	Dec	43.0 (49.9)	42.6 (49.6)
		08.30	Preliminary composite PMI	Dec	48.0	47.8
France		07.45	Final HICP (CPI) Y/Y%	Nov	3.8 (3.4)	4.5 (4.0)
		08.15	Preliminary manufacturing (services) PMI	Dec	43.2 (46.0)	42.9 (45.4)
		08.15	Preliminary composite PMI	Dec	45.0	44.6
Italy		09.00	Final HICP (CPI) Y/Y%	Nov	_0.7 (0.8)_	1.8 (1.7)
UK		00.01	GfK consumer confidence	Dec	-23	-24
		09.30	Preliminary manufacturing (services) PMI	Dec	47.5 (51.0)	47.2 (50.9)
		09.30	Preliminary composite PMI	Dec	50.9	50.7

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions			
Country		GMT	Event / Auction
Monday 11 December 2023			
- Nothing scheduled -			
Tuesday 12 December 2023			
UK		10.00	Auction: £3.75bn of 4.5% 2028 bonds
Wednesday 13 December 2023			
Italy		10.00	Auction: €3bn of 3.85% 2026 bonds
		10.00	Auction: €3bn of 4.00% 2030 bonds
UK		10.00	Auction: £2bn of 3.75% 2053 bonds
Thursday 14 December 2023			
Euro area		13.15	ECB monetary policy announcement
		13.45	ECB President Lagarde holds post-meeting press conference
UK		12.00	BoE monetary policy decision, statement and minutes published
		12.00	BoE Agents' summary of business conditions – Q423
Friday 15 December 2023			
- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.