

Euro wrap-up

Overview

- Bunds made further gains after the flash December composite PMIs unexpectedly fell, raising recession risks in the euro area.
- Gilts also made significant gains despite an upside surprise to the UK flash PMIs, which signalled a pickup in economic activity and persistence in inflationary pressures in the services sector.
- The coming week will bring November inflation figures from the euro area and UK, as well as various sentiment surveys for December.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.493	-0.033
OBL 2.4 10/28	1.996	-0.071
DBR 2.6 08/33	2.014	-0.091
UKT 3½ 10/25	4.256	-0.035
UKT 4½ 06/28	3.725	-0.069
UKT 3¼ 01/33	3.689	-0.090

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

Euro area

Flash December PMIs unexpectedly fall, raising recession risks in the euro area

While the ECB's updated GDP projections yesterday anticipated a return to marginally positive growth in Q4, today's flash December PMIs raised the risk that the euro area's economy slipped into a mild technical recession in the second half of the year. Indeed, contrasting with expectations of a further modest improvement, the headline composite index fell 0.6pt to 47.0, the third-lowest reading since the second Covid wave in November 2020 and a level that before the pandemic would have been consistent with a contraction in GDP of between 0.3-0.4%Q/Q. Admittedly, the flash December survey is based on a smaller sample due to a shorter collection period and therefore might be subject to more significant revisions when the final releases are published early in the New Year. And while we think the PMI-implied contraction overestimates the current weakness in the euro area's economy, the quarterly composite PMI in Q4 (47.0) was 0.5pt below the level in Q3 when GDP contracted 0.1%Q/Q, and the weakest quarterly reading since the euro crisis in Q412 excluding the first two quarters of the pandemic. Today's survey also implied ongoing marked contraction in Germany (46.7) and France (43.7), with S&P Global reporting a more modest decline in GDP elsewhere in the euro area.

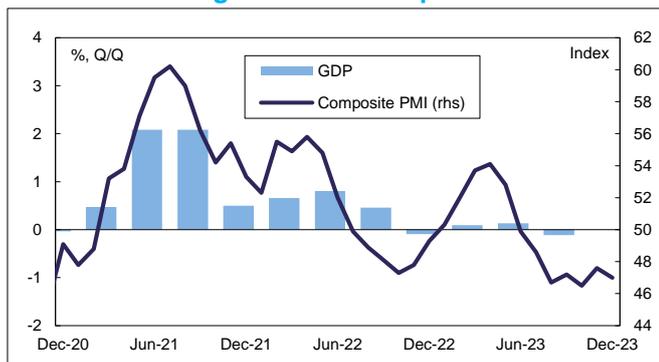
Firms cut headcount as backlogs and orders continue to decline

The deterioration in euro area economic activity in December was evident across both the services (down 0.6pt to 48.1) and manufacturing sectors (down a similar 0.5pt to 44.1). Over the fourth quarter as a whole, the manufacturing output index was a touch firmer than in Q3 (up 0.9pt to 43.9), but still very weak. And the services PMI fell to its lowest quarterly level since Q121 (down 1pt to 48.2). Moreover, despite a recent improvement in household purchasing power, both sectors reported ongoing steep falls in new business, suggesting that any near-term recovery will lack vigour. So, with backlogs falling at the steepest rate since the start of the pandemic and the euro crisis before that, manufacturers cut their purchasing activity at one of the fastest rates since the global financial crisis. Given increased spare capacity, firms in aggregate also signalled a second successive fall in headcount, with recruitment in services slowing to a crawl.

Services PMIs points to persisting price stickiness

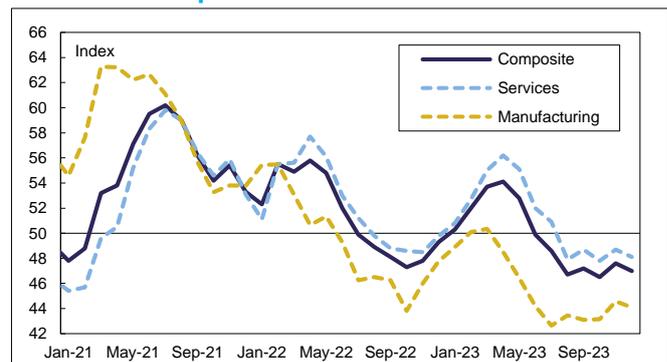
While the weak economic backdrop arguably might justify an earlier rate cut from the ECB in the Spring, today's price PMIs might be cited by the more hawkish members of the Governing Council as they push back against increasingly dovish market expectations. Certainly, the services output price index further illustrated the stickiness of inflation in the sector, rising 1.3pts to a seven-month high (55.8) and remaining well above the pre-pandemic average (50.8). In part, that reflected a substantial rise in Germany (up 2.9pts to 58.8). Admittedly, input cost pressures continued to moderate in the sector to their

Euro area: GDP growth and composite PMI



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

Euro area: Output PMI indices



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

lowest in five months. And with services firms relatively gloomy about the near-term demand outlook, we suspect pricing powers in the sector will continue to diminish. Moreover, with cost burdens having fallen significantly in the factory sector, today's survey suggested that core goods inflation should maintain a disinflationary trend over coming months.

The week ahead in the euro area

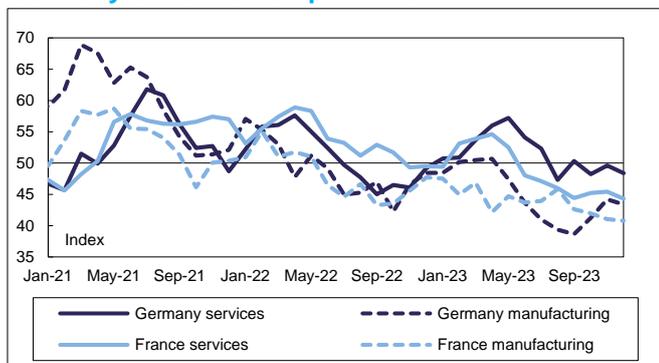
The data highlight in the coming week will be the publication on Tuesday of final euro area consumer price inflation figures for November. While there were modest upwards revisions made to the flash French and Spanish HICP rates (by 0.1ppt a piece to 3.9%Y/Y and 3.3%Y/Y respectively), the final estimate from Germany (2.3%Y/Y) was unrevised from the preliminary reading, while the Italian figure was revised lower (by 0.1ppt to a 32-month low of 0.7%Y/Y). As such, we expect the euro area data to similarly confirm the flash release, which saw headline inflation fall a steeper-than-expected 0.5ppt to just 2.4%Y/Y, the lowest rate since July 2021. The core HICP rate also fell 0.6ppt to a 19-month low of 3.6%Y/Y, with the granular detail published in the coming week's release likely to confirm a broad-based easing in underlying price pressures. Meanwhile, Wednesday will bring the European Commission's preliminary consumer confidence indicator, which is likely to signal a further modest recovery in sentiment at the end of the year, albeit leaving the index still well below levels seen before Russia's invasion of Ukraine. In addition, national sentiment indicators – the German ifo (Monday), French INSEE (Thursday) and Italian ISTAT (Friday) indices – will offer more insight into business conditions heading into year-end, including in the construction and retail sectors. Other releases due include euro area construction output figures for October (Wednesday) and the Bank of France's measure of retail sales for November (Thursday).

UK

Flash PMIs point to surprise uptick in activity towards year-end driven by services

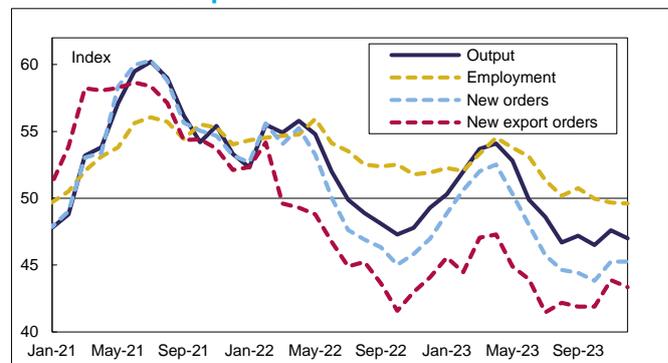
In marked contrast to the euro area, the UK flash PMIs indicated a firming of economic growth in December. In particular, the composite output PMI rose a larger-than-expected 1.0pt to a six-month high of 51.7. Given the weakness at the start of the quarter, however, that left the Q4 average at 50.4, consistent with our forecast that GDP was unchanged this quarter from Q3. According to the survey, growth was again reliant on services activity, for which the respective PMI rose 1.8pts, the most since April, to 52.7, also a six-month high. S&P Global reported that the improvement reflected increased demand for technology services as well as the impact of lower interest rate expectations on financial services activity. In contrast, the manufacturing survey reported a tenth successive month of falling output, with the respective PMI dropping 3.3pts – the most in sixteen months – to 45.9. New orders from home and abroad continued to decline, albeit not as markedly as in recent months. Manufacturers continued to cut stocks of finished items. But reflecting a broad-based retrenchment, they also again

Germany & France: Output PMIs



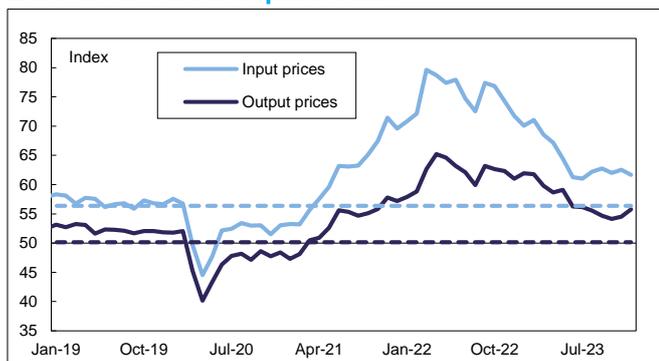
Source: Refinitiv Datastream S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Composite PMIs



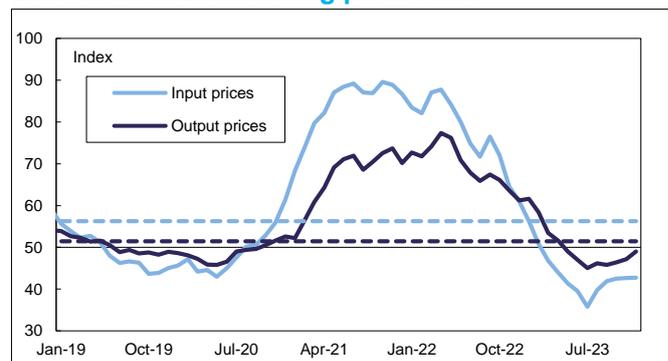
Source: Refinitiv Datastream S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Services price PMIs*



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

Euro area: Manufacturing price PMIs*



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

reduced significantly their purchases of inputs, made further inroads into work backlogs, and also looked to cut headcount in the sector for the fifteenth successive month.

Survey signals further decline in factory price pressures but inflation persistence in services

The flash PMIs also continued to highlight a significant divergence in price pressures between services and manufacturing firms. In the factory sector, input costs reportedly fell at a non-negligible rate for an eighth successive month, while output prices fell marginally for the second month in three. In contrast, in services, growth in both input costs and selling prices reportedly remained strong and well above the respective long-run averages. S&P Global attributed that pressure not least to elevated wage growth. And so, today's survey arguably tallied with concerns on the BoE's MPC that a further rate hike might yet be required to steer inflation back to target over the horizon.

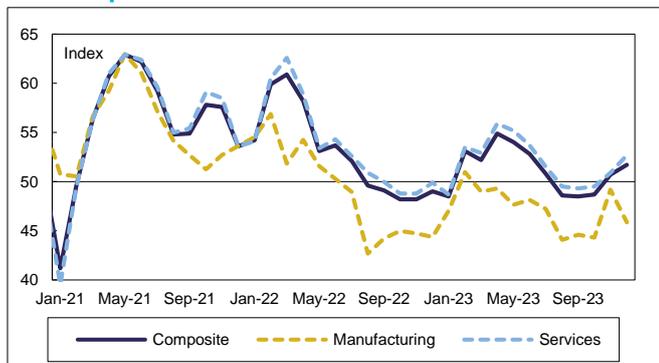
Consumer confidence remains historically weak, with no signs of a pre-Christmas splurge

Like the flash PMIs, according to the GfK's latest household survey, a gradual recovery in consumer confidence was also maintained heading into year-end. Indeed, the headline index rose for a fourth month out of the past five in December, by 2pts to -22, some 20pts above its level a year ago. However, this was merely its highest level since September, and left the quarterly index (-25) unchanged from Q3 and still well below the pre-pandemic average (-6), therefore hardly consistent with a pre-Christmas splurge in spending. Indeed, while households were marginally less pessimistic about expectations for their personal finances over the coming twelve months, the respective survey index was no better than in September. And given ongoing uncertainties about the economic outlook and still-elevated saving intentions as a result, consumer spending plans remained underwhelming. Indeed, despite rising for a second successive month, the survey's major purchases index (-23) was still below the level in September and well off the average in the five years before the pandemic (+7), to be trending in Q4 more than 1½pts below the Q3 level, suggesting no loosening of purse strings this quarter.

The week ahead in the UK

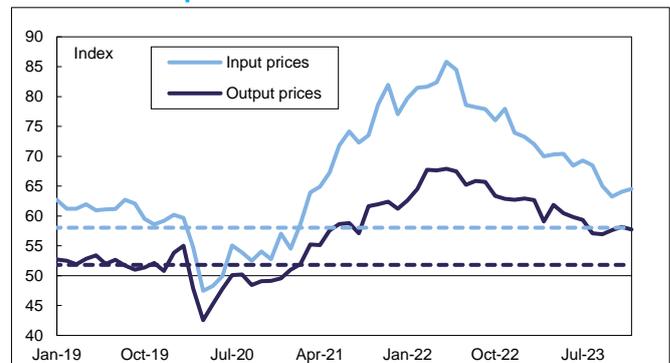
Like in the euro area, the main focus in the UK in the coming week will be November's CPI release on Wednesday. Having taken a significant step down in October due to the cut in the regulated household energy price cap, we expect headline inflation to have moderated slightly further last month, by 0.2ppt to 4.4%Y/Y, the lowest since October 2021 and 6.7ppts below last year's peak. The easing will again in part reflect a larger drag from energy thanks to a drop in petrol prices. But while we expect services inflation to have moved sideways, a further decline in non-energy industrial goods inflation will likely see core inflation ease for a fourth consecutive month, by 0.1ppt to a 21-month low of 5.6%Y/Y. In terms of activity

UK: Output PMI indices



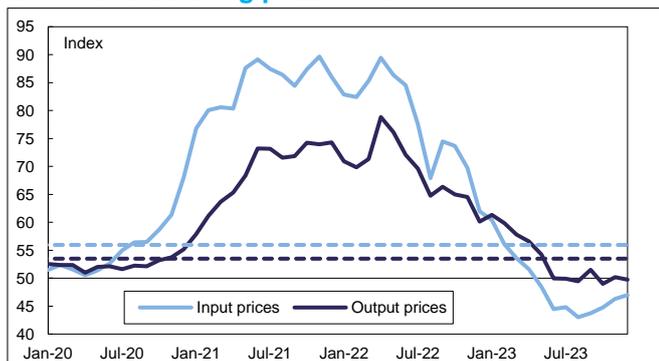
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Services price PMIs*



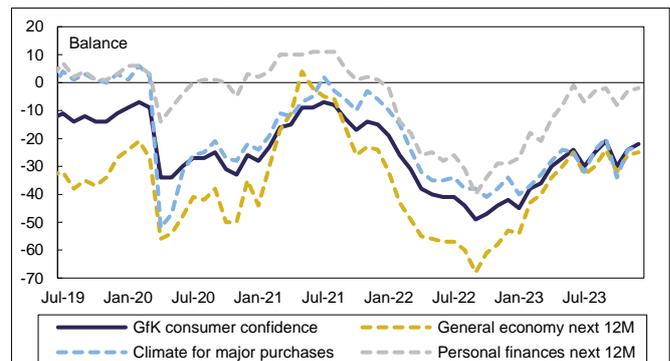
*Dashed lines represent pre-pandemic averages. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing price PMIs*



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

UK: Consumer confidence indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

data, the end of the week will bring retail sales figures for November. Having declined in three out of the previous four months, sales might well have risen last month amid a modest recovery in consumer confidence. This notwithstanding, surveys conducted by the CBI and BRC suggest that sales remained weak for the time of the year despite extended Black Friday discounting among retailers. Friday will also bring updated national accounts figures for Q3, which are expected to confirm that GDP moved sideways last quarter. The latest balance of payments figures for Q3 are also due.

The next edition of the Euro wrap-up will be published on 19 December 2023

Daiwa economic forecasts

	2023		2024				2023	2024	2025
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	%, Y/Y								
Euro area 	-0.1	-0.1	0.1	0.2	0.3	0.3	0.5	0.3	1.4
UK 	0.0	0.1	0.1	0.1	0.1	0.2	0.5	0.3	0.7
Inflation, %, Y/Y									
Euro area									
Headline HICP 	5.0	2.7	2.5	2.1	1.7	2.3	5.4	2.2	1.8
Core HICP 	5.1	3.7	2.7	1.8	1.5	1.9	4.9	1.9	1.6
UK									
Headline CPI 	6.7	4.5	4.1	2.5	2.8	2.8	7.4	3.1	2.1
Core CPI 	6.4	5.6	5.0	3.3	2.9	2.8	6.2	3.5	2.1
Monetary policy, %									
ECB									
Refi Rate 	4.50	4.50	4.25	4.00	3.75	3.50	4.50	3.50	2.75
Deposit Rate 	4.00	4.00	3.75	3.50	3.25	3.00	4.00	3.00	2.25
BoE									
Bank Rate 	5.25	5.25	5.25	5.25	5.00	4.50	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	
Euro area 	Preliminary manufacturing (services) PMI	Dec	44.2 (48.1)	44.6 (49.0)	44.2 (48.7)	-	
	Preliminary composite PMI	Dec	47.0	48.0	47.6	-	
	Labour costs Y/Y%	Q3	5.3	-	4.5	-	
	Trade balance €bn	Oct	10.9	10.0	9.2	8.7	
Germany 	Preliminary manufacturing (services) PMI	Dec	43.1 (48.4)	43.2 (49.8)	42.6 (49.6)	-	
	Preliminary composite PMI	Dec	46.7	48.2	47.8	-	
France 	Final HICP (CPI) Y/Y%	Nov	3.9 (3.5)	<u>3.8 (3.4)</u>	4.5 (4.0)	-	
	Preliminary manufacturing (services) PMI	Dec	42.0 (44.3)	43.3 (46.0)	42.9 (45.4)	-	
	Preliminary composite PMI	Dec	43.7	45.0	44.6	-	
Italy 	Final HICP (CPI) Y/Y%	Nov	0.6 (0.7)	<u>0.7 (0.8)</u>	1.8 (1.7)	-	
UK 	GfK consumer confidence	Dec	-22	-22	-24	-	
	Preliminary manufacturing (services) PMI	Dec	46.4 (52.7)	47.5 (51.0)	47.2 (50.9)	-	
	Preliminary composite PMI	Dec	51.7	51.0	50.7	-	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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
Monday 18 December 2023					
Germany	 09.00	Ifo business climate indicator	Dec	87.8	87.3
	 09.00	Ifo current assessment (expectations) balance	Dec	89.5 (86.0)	89.4 (85.2)
Tuesday 19 December 2023					
Euro area	 10.00	Final headline (core) HICP Y/Y%	Nov	<u>2.4 (3.6)</u>	2.9 (4.2)
UK	 11.00	CBI industrial trends, total orders (selling prices) balance	Dec	-30 (-)	-35 (11)
Wednesday 20 December 2023					
Euro area	 07.00	EU27 new car registrations Y/Y%	Nov	-	14.6
	 15.00	Preliminary consumer confidence index	Dec	-16.3	-16.9
	 10.00	Construction output M/M% (Y/Y%)	Oct	-	0.4 (-0.3)
Germany	 07.00	PPI Y/Y%	No	-27.0	-11.0
	 07.00	GfK consumer confidence index	Jan	-27.0	-27.8
UK	 07.00	Headline CPI (core CPI) Y/Y%	Nov	<u>4.4 (5.6)</u>	4.6 (5.7)
	 07.00	PPI output (input) Y/Y%	Nov	-0.5 (-3.0)	-0.6 (-2.6)
	 09.30	House price index Y/Y%	Oct	-	-0.1
Thursday 21 December 2023					
France	 07.45	INSEE business sentiment indicator	Dec	97	97
	 07.45	INSEE manufacturing confidence (production outlook)	Dec	98 (-)	99 (-11)
	-	Bank of France retail sales* Y/Y%	Nov	-	-2.8
Italy	 10.00	PPI Y/Y%	Nov	-	-12.4
UK	 00.01	Lloyds business barometer	Dec	-	42
	 07.00	Public sector net borrowing (excl banks) £bn	Nov	13.1 (12.9)	14.0 (14.9)
	 11.00	CBI reported retail sales balance	Dec	-	-11
Friday 22 December 2023					
France	 07.45	PPI Y/Y%	Nov	-	-1.2
Italy	 09.00	ISTAT business (manufacturing) sentiment indicator	Dec	- (96.9)	103.4 (96.6)
	 09.00	ISTAT consumer confidence index	Dec	104.0	103.6
Spain	 08.00	Final GDP Q/Q% (Y/Y%)	Q3	<u>0.3 (1.8)</u>	0.5 (2.0)
UK	 07.00	Final GDP Q/Q% (Y/Y%)	Q3	0.0 (0.6)	0.2 (0.6)
	 07.00	Retail sales including auto fuels M/M% (Y/Y%)	Nov	0.4 (-1.3)	-0.3 (-2.7)
	 07.00	Retail sales excluding auto fuels M/M% (Y/Y%)	Nov	0.3 (-1.5)	-0.1 (-2.4)

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

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 18 December 2023		
Euro area	 13.30	ECB's Schnabel chairs panel at conference on fiscal policy and EMU governance
	 15.00	ECB Chief Economist Lane chairs panel at conference on fiscal policy and EMU governance
UK	 10.30	BoE Deputy Governor Broadbent scheduled to speak at London Business School
Tuesday 19 December 2023		
UK	 10.00	Auction: £3bn 4.625% 2034 bonds
	 13.00	BoE Deputy Governor Breeden scheduled to speak
Wednesday 20 December 2023		
UK	 14.00	ECB Chief Economist Lane scheduled to speak – 'The euro area outlook'
Thursday 21 December 2023		
- Nothing scheduled -		
Friday 22 December 2023		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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