Euro wrap-up

Overview

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- Bunds made losses as euro area bank lending ticked up and the final December manufacturing PMIs were revised up slightly.
- Gilts also made losses despite downward revisions to the UK manufacturing PMIs and a relatively subdued shop price survey.
- Wednesday will bring German and Spanish labour market data while Thursday will bring flash German and French inflation estimates.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.445	+0.065
OBL 2.4 10/28	1.992	+0.057
DBR 2.6 08/33	2.077	+0.058
UKT 3½ 10/25	4.034	+0.109
UKT 4½ 06/28	3.545	+0.103
UKT 3¼ 01/33	3.647	+0.125

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

Euro area

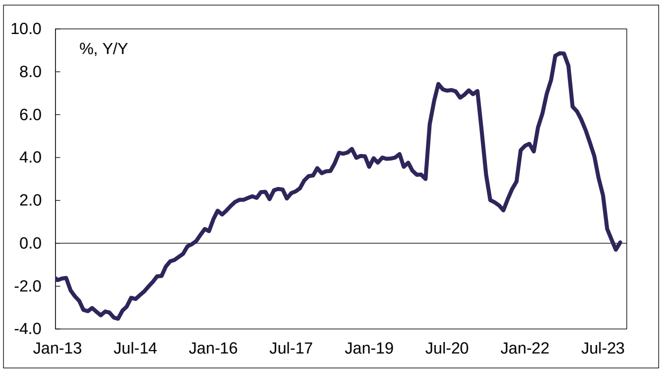
Bank lending flow picked up from low level in November

Having been sluggish throughout the prior twelve months amid higher interest rates, tighter credit conditions and subdued economic activity, euro area bank lending picked up in November. Indeed, excluding sales and securitisations, the flow of new loans to NFCs rose €20bn to €19.6bn, the highest since October 2022. That, however, merely pushed the annual growth rate in the stock of loans to NFCs back up 0.3ppt to 0.0%Y/Y, consistent with stagnation in credit creation. On an unadjusted basis, the pickup on the month was led by short-dated loans (i.e. those with a maturity of up to one year), which rose almost €15bn to €10.4bn, the most in 14 months. That took the net flow on a three-month basis to €6.3bn, the most in a year, suggestive of a pickup in inventories and working capital following an extended period of negative stock adjustments. In contrast, while the flow of long-term loans (i.e. those with a maturity of more than five years) was modestly positive in November at €2.0bn, it slowed on a three-month basis to a ten-month low of €0.7bn, raising doubts about the resilience of business fixed investment. Meanwhile, as for total lending to NFCs, the monthly flow of loans to households also picked up in November, to €5.9bn, the most since February. Nevertheless, the annual growth rate in the stock of loans to households slowed 0.1ppt to 0.5%Y/Y, the lowest since May 2015. Growth in loans for house purchase was unchanged at just 0.3%Y/Y, a mere 0.1ppt above September's six-year low, pointing to ongoing weakness in the residential property market. And growth in consumer credit moderated 0.1ppt to 2.6%Y/Y, just 0.1ppt above June's 16-month low.

Money supply data consistent with soft activity and inflation

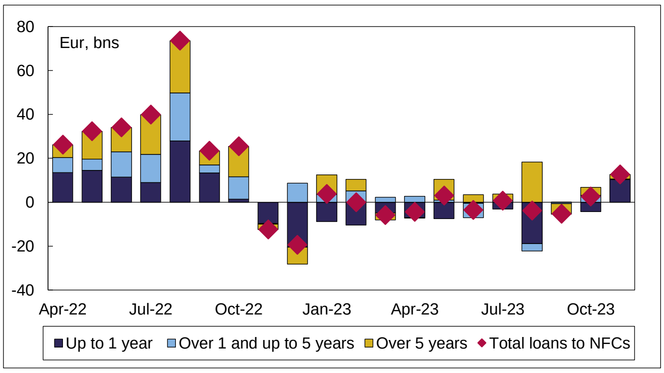
Given the higher interest rates available on other assets, the growth rate in total deposits at euro area banks remained negative for a seventh successive month in November. But the pace of decline moderated 0.4ppt to -1.8%Y/Y, thanks to a net inflow of €56bn, the most since August 2022, with NFCs, households, government entities and other financial corporations all increasing their deposits. Unsurprisingly, households and NFCs alike continued to shift funds into higher-yielding time deposits from sight deposits consistent with a preference for saving rather than spending. Nevertheless, the rate of decline in M3 money supply moderated for a third successive month, by 0.1ppt to -0.9%Y/Y. And the narrower M1 measure, which also excludes sight deposits, moderated 0.5ppt to a four-month high. At -9.5%Y/Y, however, that still represented one of the weakest readings on the series. And overall, the money supply data remain consistent with soft economic activity and inflation.

Euro area: Stock of loans to NFCs



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Flow of net bank loans to NFCs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

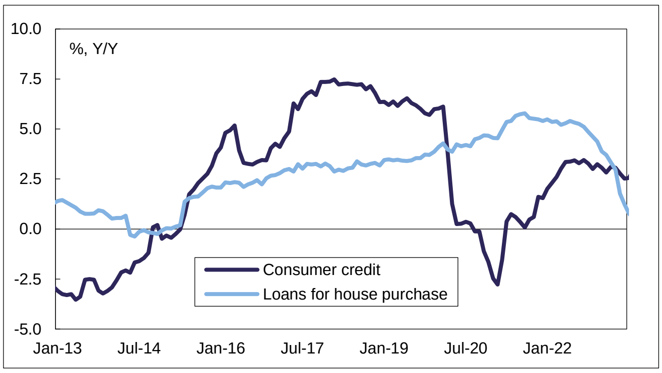
Manufacturing PMIs consistent with ongoing challenges at year-end

Today's final December euro area manufacturing PMIs provided no surprises, highlighting again that the sector remained firmly in contraction heading into year-end. Admittedly, the output PMI was revised up modestly from the flash estimate. But this still left it down 0.5pt from November at a very weak 44.1, with the challenges reportedly most acute among intermediate goods producers. As a result, while the quarterly average in Q4 was 1pt above that in Q3, at 44.0 it suggested that manufacturing production remained a non-negligible drag on GDP growth in the final quarter of 2023. While the survey detail suggests that the sharpest declines of the downturn might have been reached, there was little to suggest that an imminent rebound in activity is likely over the near term. Despite rising to the highest level in seven months, the new orders component (42.0) was still 10pts below the pre-pandemic average and consistent with a further fall in production ahead. And while the rate of decline in backlogs also moderated slightly, the destocking process appeared to remain in full swing, with firms' stocks of purchases falling by the most since the global financial crisis. Moreover, although manufacturers were reportedly the most confident about the production outlook since last April, perhaps reflecting the prospects of lower interest rates in the year ahead, the new orders-to-inventories ratio remained well below the pre-pandemic average, and firms continued to cut headcount. At the same time, cost burdens in the sector declined again. And given subdued demand, manufacturers' pricing power remained weak, with the output price PMI (49.0) still well below the pre-pandemic average despite rising to the highest since May.

Modest improvement in Italian and Spanish PMIs offsets a further deterioration in the French index

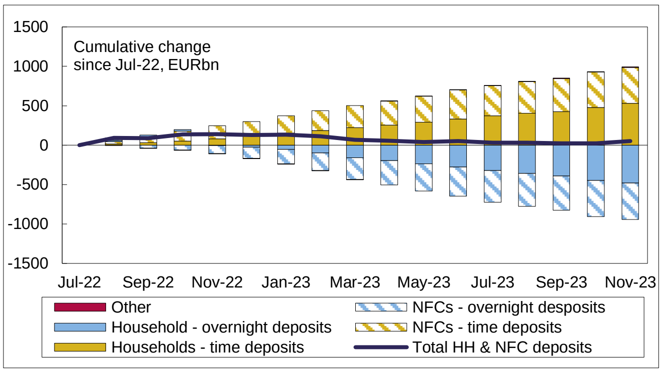
Within the country breakdown, today's final survey results suggested that the manufacturing weakness was broad based. However, despite declining on the month, the German output PMI in December (43.8) was still some 4pts above the average recorded in Q3 suggesting that the worst of the recession in the euro area's largest manufacturing sector might have passed. And the respective indices in Italy (up 1.2pt to 45.4) and Spain (up 0.9pt to 46.3) were the highest for the three months, although also consistent with contraction. Indeed, according to the PMIs, Greece was the only member state to signal growth in the manufacturing sector in December, with the respective PMI (53.3) having been in 'expansionary' territory in each month since February. In marked contrast, the French output PMI (40.7) suggested that manufacturing production was the weakest since the euro crisis when excluding the initial Covid-19 slump, leaving the quarterly index in Q4 almost 3pts below the Q3 average. But the PMIs have recently overstated the extent of the weakening in the French factory output, with the INSEE business indices having tended to provide a more reliable guide to current conditions. And the December INSEE survey reported a 1.4pt jump in the headline manufacturing sentiment index back to the long-run average of 100 for the first time since July.

Euro area: Stock of loans to households



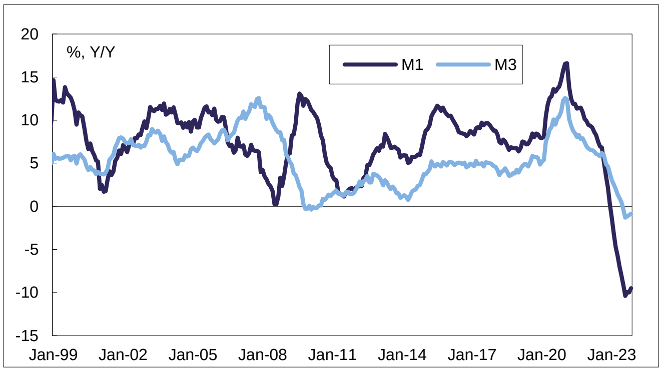
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Household & NFC deposits



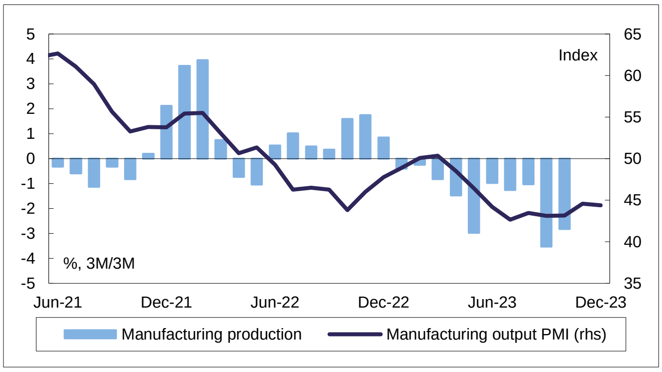
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Money supply



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output & PMI



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

The coming two days in the euro area

A relatively quiet day for economic releases tomorrow will bring German and Spanish national labour market reports for December. German jobless claims are expected to rise for the eleventh successive month, but the claimant count rate is expected to remain unchanged at 5.9%, up 0.4ppt from a year earlier. Meanwhile, ahead of Friday's release of the flash December euro area CPI estimates, Thursday will bring preliminary inflation figures from Germany and France. Due principally to base effects associated with the one-off energy subsidies in December 2022, headline German HICP inflation is expected jump temporarily by around 1½ppts from 2.3%Y/Y in November. In contrast, the equivalent French inflation rate is expected to edge only slightly higher, by 0.2ppt to 4.1%Y/Y. Thursday will also bring the final December services PMI survey results from the euro area and member states. The preliminary release saw the euro area's headline activity index disappointingly drop 0.6pt to 48.1, suggesting ongoing contraction at the end of last year, while the services output price PMI rose 1.3pt to a four-month high.

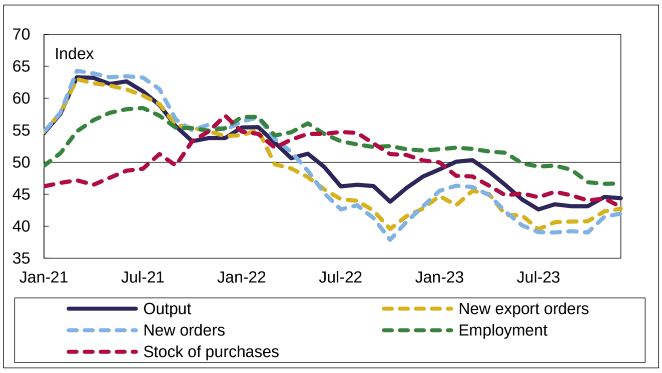
UK

Shop price inflation steady in February according to the BRC survey

The BRC survey measure of UK shop price inflation was unchanged in December at 4.3%Y/Y, matching the lowest rate since June 2022. Within the detail, food inflation slowed for an eighth successive month, down 1.1ppts to an 18-month low of 6.7%Y/Y, as the drop in producer output prices provided scope for discounting ahead of the festive period. In an attempt to attract customers amid subdued demand, special promotions also weighed on prices of certain types of goods such as health and beauty products, for which the BRC survey's measure of inflation fell to a 14-month low. However, following an extended period of significant discounting the prior month ahead of Black Friday, overall inflation of non-food goods rebounded 0.6ppt from its 17-month low to 3.1%Y/Y.

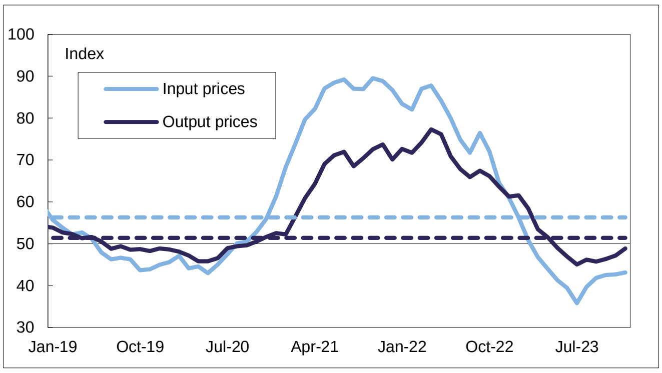
The BRC survey supports our forecast that broader consumer price inflation was also steady in December, with the CPI rate perhaps unchanged at November's 26-month low of 3.9%Y/Y. But we see the risks to that forecast to be skewed to the downside, not least due to components not captured by the BRC survey. For example, petrol prices were trending more than 4% below the November average over the first three weeks of December. And following a downside surprise to services inflation in the prior month, our forecast assumption of modest payback in December might be too cautious. Certainly, external MPC member Jonathan Haskel suggested that the broad-based nature of the easing in services inflation in

Euro area: Manufacturing PMIs



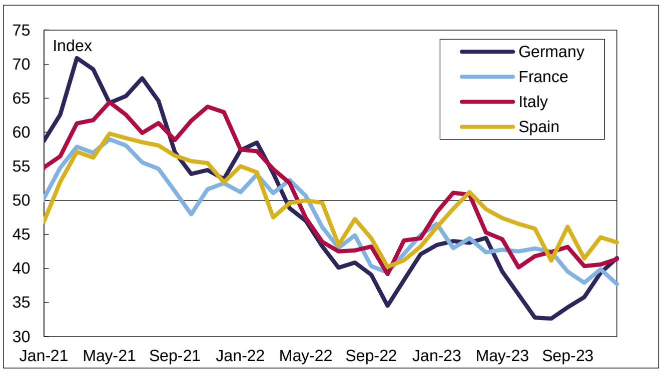
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing price PMIs



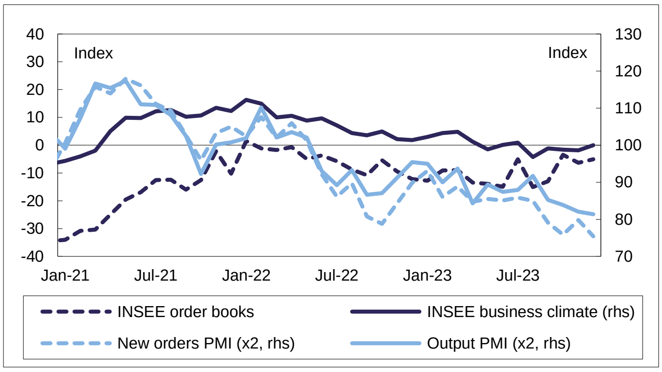
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output PMIs by country



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

France: Manufacturing sentiment indices



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

November represented significant news. Indeed, after he voted for a rate hike at the BoE's last monetary policy meeting on 14 December, that good news on services inflation seems likely to lead him to change his vote to unchanged rates at the next meeting on 1 February.

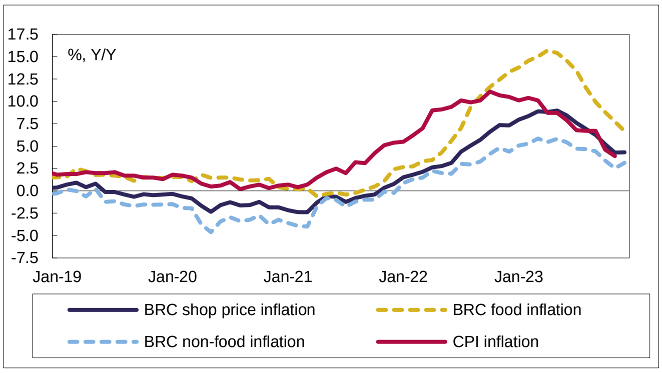
UK manufacturing PMI flagged ongoing challenges at the turn of the year

After updated national accounts figures released late last year saw GDP revised lower in Q2 (by 0.2ppt to 0.0%Q/Q) and Q3 (by 0.1ppt to -0.1%Q/Q) due in particular to a softer investment outturn than previously estimated, today's final UK manufacturing survey highlighted the persistent weakness in the factory sector heading towards year-end. Indeed, in contrast to the euro area, the final output PMI was revised lower in December, to 45.5, to leave it down a chunky 3.7pts on the month. Reportedly, a significant weakening in the consumer goods sub-sector and ongoing contraction in production of intermediate goods offset a modest expansion in the investment goods industry. But having risen 4.9pts to a seven-month high in November – thanks to a temporary surge in consumer goods output – the quarterly average in Q4 (46.0) was almost 2pts higher than the level in Q3, suggesting a slightly softer drag on GDP growth over the past quarter. But the output index nevertheless marked the tenth consecutive sub-50 monthly reading. And like in the euro area, the survey detail offered limited encouragement with respect to the near-term outlook. Admittedly, following significant inventory adjustment over the past year, with stocks of purchases having declined in each of the past fifteen months, and the pace of decline in new orders the softest for seven months, the new orders-to-inventories ratio rose to the highest since April. But the new business index remained in contractionary territory for the eighteenth month out of the past nineteen, with demand dampened by the uncertain economic outlook and elevated borrowing costs, as well as a further retrenchment in export orders from the EU, US and China. Given increased spare capacity and a drop in business confidence in the year ahead to the lowest in twelve months, manufacturers reduced headcount for the fifteenth successive month. And while some firms attempted to protect profit margins, the output price index (50.1) suggested limited price pressures in the sector, and input costs declined for an eighth consecutive month.

The coming two days in the UK

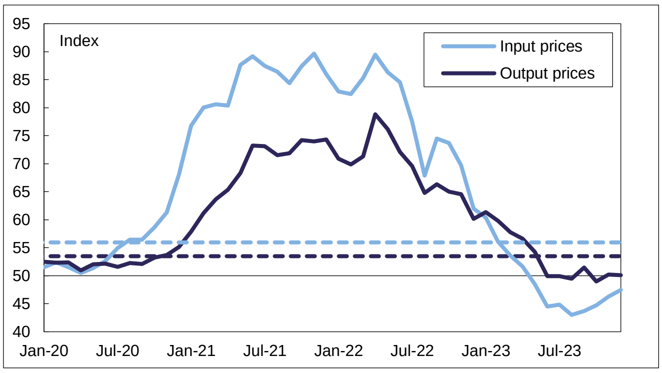
Following a day with no new economic data tomorrow, Thursday will bring the BoE's monetary figures for November. These are expected to show that net new mortgage lending remained near zero and new mortgage approvals continued to be well below levels seen before the pandemic as interest rates remained elevated despite moderating from the summer peak. Thursday will also bring the December results from the BoE's Decision Maker Panel survey, with particular focus on firms' expectations for inflation and wages over the coming year and beyond. The final services PMIs for December will also be published, with the flash release reporting an unexpected jump in the activity index, by 1.8ptst to a six-month high of 52.7.

UK: Selected inflation indicators



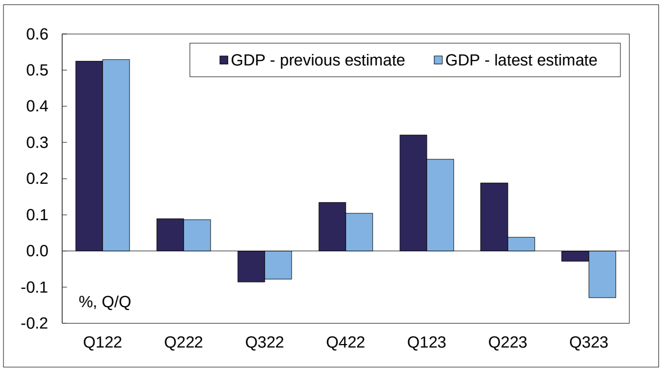
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing price PMIs



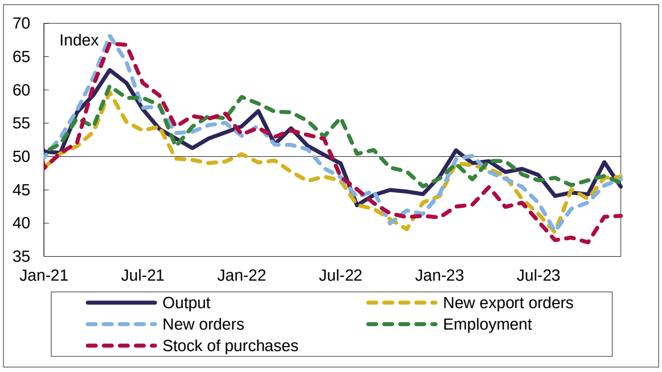
Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: GDP growth



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing PMIs



Source: Refinitiv Datastream, S&P Global 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	M3 money supply Y/Y%	Nov	**-0.9**	-	-1.0	-
	Final manufacturing PMI	Dec	**44.4**	*44.2*	44.2	-
Germany	Final manufacturing PMI	Dec	**43.3**	*43.1*	42.6	-
France	Final manufacturing PMI	Dec	**42.1**	*42.0*	42.9	-
Italy	Manufacturing PMI	Dec	**45.3**	-	44.4	-
Spain	Manufacturing PMI	Dec	**46.2**	-	46.3	-
UK	BRC shop price index Y/Y%	Dec	**4.3**	-	4.3	-
	Final manufacturing PMI	Dec	**46.2**	*46.4*	47.2	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Upcoming releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Wednesday 03 January 2024					
Germany	08.55	Unemployment change '000s (rate %)	Dec	20.0 (5.9)	22.0 (5.9)
Spain	08.00	Unemployment change '000s	Dec	-	-24.6
Thursday 04 January 2024					
Euro area	09.00	Final services (composite) PMI	Dec	*48.1 (47.0)*	48.7 (47.6)
Germany	08.55	Final services (composite) PMI	Dec	*48.4 (46.7)*	49.6 (47.8)
	13.00	Preliminary HICP (CPI) Y/Y%	Dec	3.9 (3.7)	2.3 (3.2)
France	08.50	Final services (composite) PMI	Dec	*44.3 (43.7)*	45.4 (44.6)
	07.45	Preliminary HICP (CPI) Y/Y%	Dec	4.1 (3.7)	3.9 (3.5)
Italy	08.45	Services (composite) PMI	Dec	50.0 (48.2)	49.5 (48.1)
Spain	08.15	Services (composite) PMI	Dec	51.2 (-)	51.0 (49.8)
UK	09.30	Final services (composite) PMI	Dec	*52.7 (51.7)*	50.9 (50.7)
	09.30	Net consumer credit £bn (Y/Y%)	Nov	1.4 (-)	1.3 (8.1)
	09.30	Net mortgage lending £bn (approvals '000s)	Nov	0.2 (48.5)	-0.1 (47.4)
	09.30	BoE's DMP 1Y CPI expectations Y/Y%	Dec	-	4.4

Auctions and events

Country	GMT	Auction
Wednesday 03 January 2024		
Germany	10.30	Auction: €4.5bn of 3.1% 2025 bonds
Thursday 04 January 2024		
France	10.30	Auction: To sell 3.5% of 2033 bonds
	10.30	Auction: To sell 1.25% of 2038 bonds
	10.30	Auction: To sell 3% of 2054 bonds
Spain	09.30	Auction: To sell 2.5% of 2027 bonds
	09.30	Auction: To sell 3.5% of 2029 bonds
	09.30	Auction: To sell 1.9% of 2052 bonds
	09.30	Auction: To sell 0.65% of 2027 index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 04 January 2024

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