

Euro wrap-up

Overview

- While German industrial output dropped to its lowest level since the first Covid-19 lockdown, Bunds made losses as the euro area unemployment rate fell back to match its record low.
- Gilts also made losses even as a survey suggested that UK retail sales declined back at the end of last year.
- Ahead of Friday's UK GDP report, the coming two days will bring data from France and Italy.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.595	+0.056
OBL 2.4 10/28	2.133	+0.065
DBR 2.6 08/33	2.191	+0.058
UKT 3½ 10/25	4.203	+0.018
UKT 4½ 06/28	3.734	+0.015
UKT 3¼ 01/33	3.792	+0.025

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

Source: Bloomberg

Euro area

German manufacturing remains in recession, while construction downturn gathers pace

Consistent with yesterday's downbeat manufacturing turnover data, today's German industrial production figures confirmed a sixth successive monthly decline in output in November. In particular, total IP fell 0.7%M/M to the lowest level since July 2020 and 2010 when excluding the initial Covid-19 slump. This left output down 4.8%Y/Y, 9½% below the pre-pandemic level and trending some 1.6% below the Q3 average, strongly suggesting that the sector remained a drag on GDP for a third consecutive quarter in Q4. The drop would have been even steeper without a second successive jump in energy production (3.9%M/M), albeit still leaving it down 11.2%Y/Y and 18% below the pre-pandemic level having reached a new post-reunification low in September. Consistent with various surveys, construction activity fell for a fourth month out of the past six in November, by a steeper 2.9%M/M to an eleven-month low, to be trending 3½% below the Q3 average. The steady downwards trend in building permits over recent quarters suggests that the downturn in that sector still has further to play out. Meanwhile, manufacturing output contracted for the fifth month out of the past six (-0.4%M/M), to leave it more than 1½% below the Q3 average and therefore also suggestive of a third consecutive quarterly contraction in Q4.

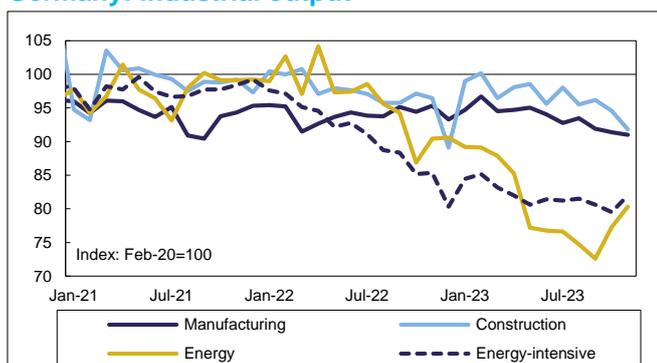
Broad-based weakness in manufacturing

Within the manufacturing detail, the weakness was broad based. Production of intermediate goods declined for the seventh month out of the past nine (-0.5%M/M) to be trending some 1.6% below the Q3 average and more than 10% below the pre-pandemic level. Despite a modest increase in machinery and equipment, a drop in production of cars and other transport equipment left capital goods output down for the fifth month out of the past six (-0.7%M/M) and at the lowest level since August 2022. And while the monthly fall in consumer goods production (-0.1%M/M) was modest in November, it was trending more than 3% below the Q3 average. Somewhat more positively, production in the energy-intensive subsectors rose 3.1%M/M to a seven-month high as chemical output jumped more than 5%M/M. But this still left output in energy-intensive sub-sectors trending below the Q3 level so far in Q4 and still a whopping 18% below the pre-pandemic level as firms continued to limit their use of gas.

Little improvement in German output on the horizon

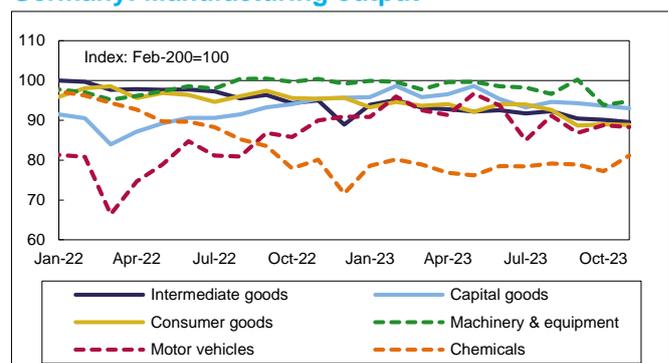
Survey indicators – including the PMIs and ifo institute business climate indices – suggest that the sharpest declines in Germany's manufacturing downturn might have been passed. But they also remain consistent with ongoing contraction. Yesterday's factory orders data also suggested that demand remained exceptionally weak at the end of last year, while truck toll mileage fell in December at the steepest pace in twelve months (-3.5%M/M) to hit the lowest level since May 2020.

Germany: Industrial output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Admittedly, manufacturing order backlogs in several subsectors are still elevated, which should support production in certain subsectors such as ICT and electrical equipment. But the steady fall in autos backlogs suggests that output in that sector will remain subdued. With global demand at risk of fading further, we see little reason to expect a sudden rebound in German manufacturing over the near term.

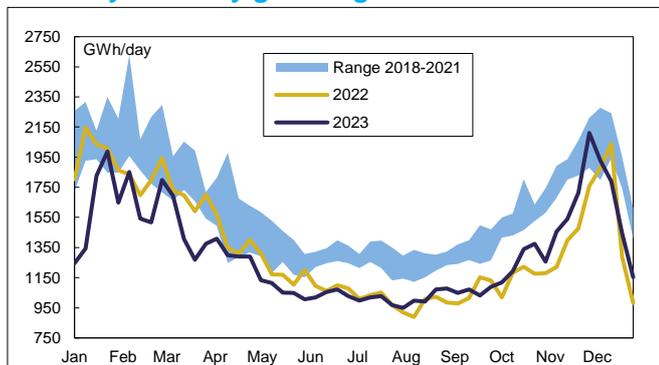
Euro area unemployment rate at record low as firms continue to hoard labour

Despite weakening economic momentum through the second half of last year, the euro area's labour market continues to hold up remarkably well as firms appear prepared to hoard rather than lay off workers in the hope that the current downturn will prove temporary. Indeed, November's jobless figures beat expectations, with the number of unemployed people falling for the first month in three and by 99k to 10.97mn, taking the unemployment rate down 0.1ppt to 6.4%, matching June's record low. Roughly two thirds of the drop in the latest month was accounted for by Italy, where the data are often volatile. There were also notable declines in Spain and Greece, with the latter rate at its lowest level since the global financial crisis. In contrast, having fallen in the previous three months, French unemployment edged slightly higher in November, while the number of people out of work in Germany rose for the eighth consecutive month and by a cumulative 68k, albeit leaving the respective unemployment rates unchanged at 3.1% and 7.3%. More timely data show that German jobless claims rose further in December, but Spanish unemployment continued to decline. The Commission survey's employment expectations indicator also improved slightly at the end of last year, reflecting greater optimism in Germany, France and Italy, while hiring plans remained firmest in Spain. And the share of firms willing to hoard labour despite declining output (11.7%) remained above the long-run average, with the share highest in Germany and France, suggesting that the labour market should remain broadly stable over coming months.

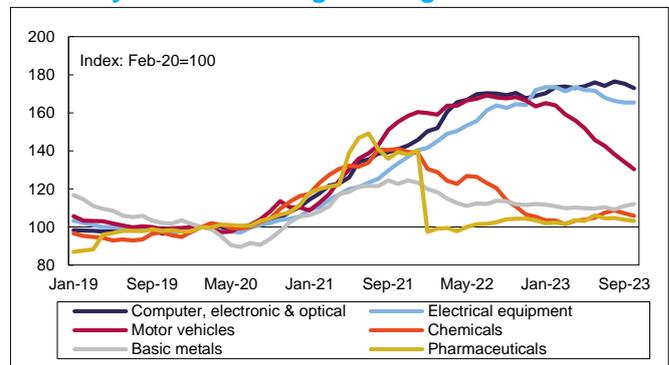
The coming few days in the euro area

The European data flow will be relatively thin over coming days with November industrial production numbers due from France and Netherlands (tomorrow), as well as Italy and Spain (Thursday). Meanwhile, ahead of next week's final December estimates of euro area inflation, the equivalent figures will be published from the Netherlands (Thursday), France and Spain (Friday).

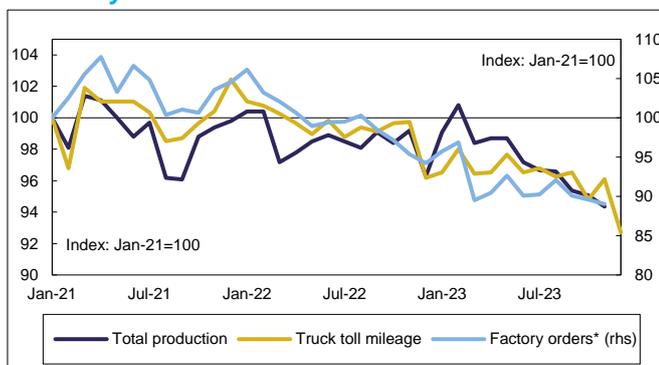
Germany: Industry gas usage



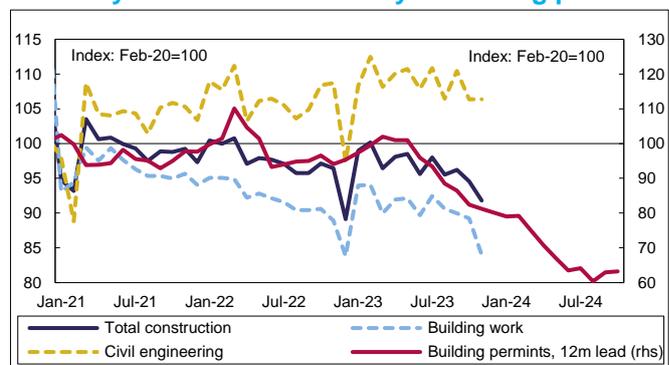
Germany: Manufacturing backlogs



Germany: Selected industrial indicators



Germany: Construction activity & building permits



UK

Retail sales fall back in December according to the BRC survey

Data published by the ONS just before Christmas showed that retail sales volumes rebounded 1.3%M/M in November, seemingly benefiting from extended discounting ahead of Black Friday. That, however, left the three-month rate firmly in negative territory, at -0.8%3M/3M. And survey indicators strongly suggest that retail sales fell back once again in December. Today's BRC survey results reported a slowdown of 1.0ppt in total sales growth in December to a five-month low of 1.7%Y/Y with like-for-like sales growth down 0.7ppt to 1.9%Y/Y, also a five-month low. Food sales growth moderated 0.8ppt to a 13-month low of 6.8%Y/Y while the pace of contraction of sales of non-food items eased just 0.1ppt from November's 15-month low to -1.5%Y/Y. According to the BRC, among non-food items, sales of beauty, health and personal care products firmed at the expense of clothing, jewellery and technology goods. With the BRC survey measure of shop price inflation steady at 4.3%Y/Y in December, the implied measure of retail sales volume growth dropped 1.0ppt to -2.6%Y/Y.

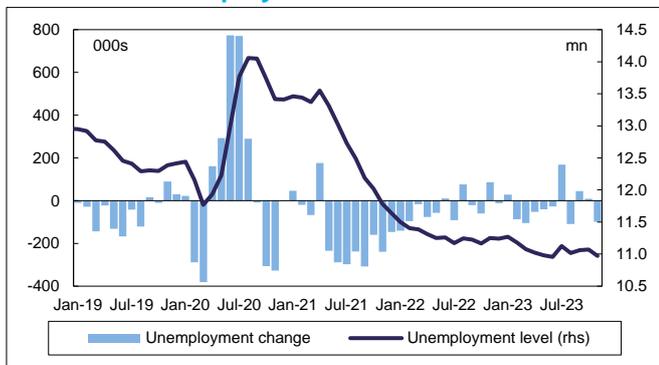
Other surveys underscore weakness at the turn of the year

While the BRC survey has not been the most reliable guide to the ONS sales data over recent quarters, the CBI Distributive Trades Survey sales volumes index fell 21pts to -32 in December. And the BDO High Street Tracker reported a decline in total like-for-like sales of 2.7%Y/Y, representing the first negative reading for the month on the series since 2020. The BRC cautioned that post-Christmas sales had failed to encourage increased spending of many types of durable goods. And the CBI survey reported that retailers expect sales to fall at a faster pace in January and thus be well below normal for the time of year. So, despite the easing of downwards pressure on real disposable incomes, demand appears set to remain subdued for a while yet. At the same time, due to activity by Yemeni Houthis near the Bab el Mandeb Strait, new supply disruption to the import of goods from Asia shipped via the Red Sea, and possible related additional price pressure, represents a further headache for retailers.

The coming few days in the UK

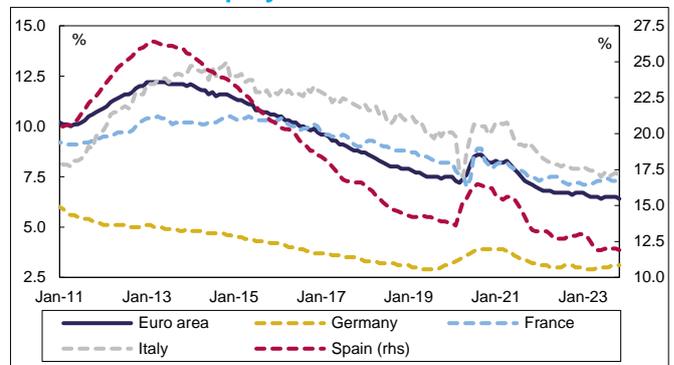
While the next couple of days will bring no top-tier economic data, the UK focus at the end of the week will be the release of the November GDP report, including the monthly services, industrial, construction and trade figures. Retail sales came in much stronger than expected in November (1.3%M/M), while the ONS's business insights survey suggested that the share of firms affected by strikes was the lowest since June 2022. Taken together with a rebound in the composite PMI that month

Euro area: Unemployment level



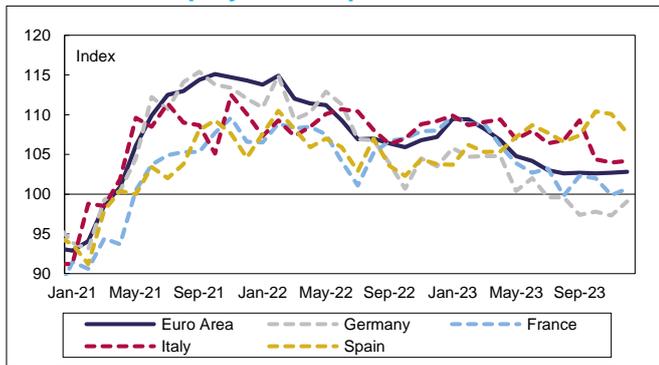
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment rates



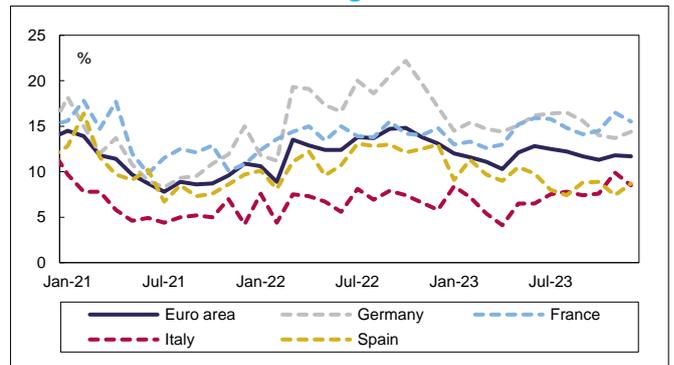
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Employment Expectations Indicators



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

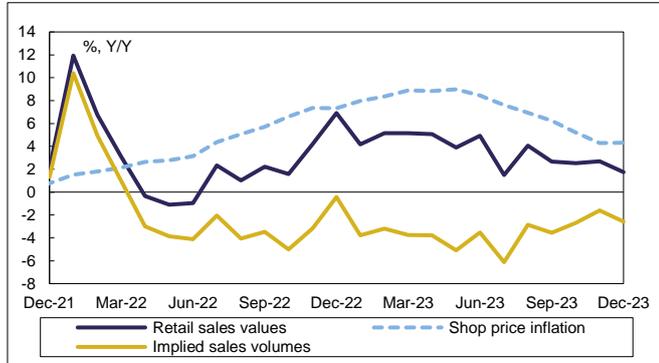
Euro area: Labour hoarding indicators*



*Share of firms which expect their output to decrease but their employment to increase or remain unchanged. Source: EC and Daiwa Capital Markets Europe Ltd.

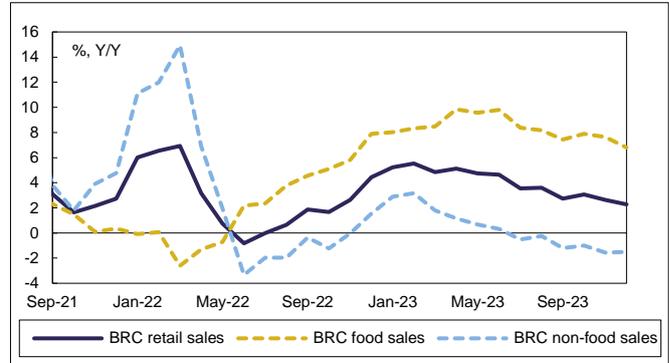
to a four-month high (50.7), we expect GDP growth in November to be a touch firmer than the Bloomberg survey consensus of 0.2%M/M to fully reverse the 0.3%M/M contraction recorded in October and leave output unchanged on a three-month basis. Beyond the economic data, BoE Governor Bailey will appear before the Treasury Select Committee (tomorrow) to discuss the findings of the Bank's Financial Stability Report published in December.

UK: BRC retail survey indices



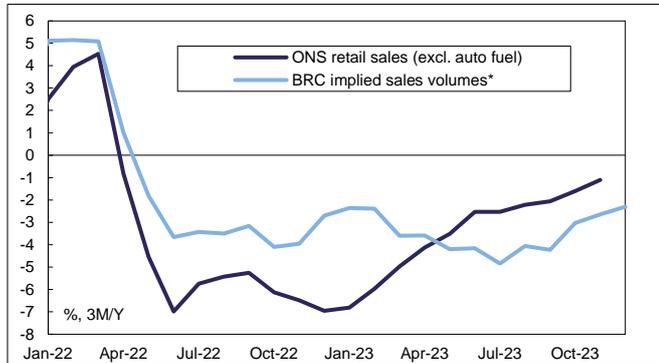
Source: Refinitiv Datastream BRC and Daiwa Capital Markets Europe Ltd.

UK: BRC retail sales values



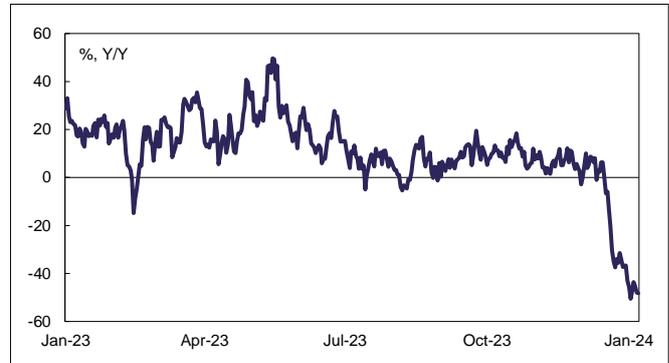
Source: Macrobond, BRC and Daiwa Capital Markets Europe Ltd.

UK: ONS & BRC retail sales volumes



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

Transit trade volume via Bab el-Mandeb Strait



Source: IMF Portwatch and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 12th January 2024

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area 	Unemployment rate %	Nov	6.4	6.6	6.5	
Germany 	Industrial production M/M% (Y/Y%)	Nov	-0.7 (-4.8)	-0.3 (-4.0)	-0.4 (-3.5)	-0.3 (-3.4)
France 	Trade balance €bn	Nov	-5.9	-	-8.6	
UK 	BRC retail sales monitor, like-for-like sales Y/Y%	Dec	1.9	2.4	2.6	

Auctions

Country	Auction
UK 	sold £2.25bn of 4.75% 2043 bonds at an average yield of 4.391%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
France 	07.45	Industrial production M/M% (Y/Y%)	Nov	0.1 (0.7)	-0.3 (1.8)
Italy 	09.00	Retail sales M/M% (Y/Y%)	Nov	-	0.4 (0.3)

Auctions and events

Euro area 	08.00	ECB's de Guindos scheduled to speak
Germany 	10.30	Auction: €5bn of 2034 bonds
UK 	10.00	Auction: £4bn of 3.75% 2027 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Upcoming releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Thursday 11 January 2024					
Italy 	09.00	Industrial production M/M% (Y/Y%)	Nov	-	-0.2 (-1.1)
Spain 	08.00	Industrial production M/M% (Y/Y%)	Nov	-	-0.5 (-1.5)
Friday 12 January 2024					
France 	07.45	Final HICP (CPI) Y/Y%	Dec	4.1 (3.7)	3.9 (3.5)
	07.45	Consumer spending M/M% (Y/Y%)	Nov	0.0 (-1.4)	-0.9 (-1.3)
Spain 	08.00	Final HICP (CPI) Y/Y%	Dec	3.3 (3.1)	3.3 (3.2)
UK 	07.00	GDP M/M% (3M/3M%)	Nov	0.3 (0.0)	-0.3 (0.0)
	07.00	Industrial production M/M% (Y/Y%)	Nov	0.3 (0.8)	-0.8 (0.4)
	07.00	Index of services M/M% (Y/Y%)	Nov	0.2 (0.4)	-0.2 (0.1)
	07.00	Construction output M/M% (Y/Y%)	Nov	0.4 (1.5)	-0.5 (1.1)
	07.00	Trade balance (goods trade balance) £bn	Nov	- (-15.7)	-4.7 (-17.0)

Auctions and events

Thursday 11 January 2024					
Euro area 	09.00	ECB publishes Economic Bulletin			
Italy 	10.00	Auction: €4bn of 2.95% 2027 bonds			
Friday 12 January 2024					
Euro area 	12.30	ECB Chief Economist Lane scheduled to speak at conference on post-pandemic governance and Next Generation EU			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited ("DCME"). DCME is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange. DCME and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or derivatives or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of DCME and its affiliates may have positions and effect transactions in such the Securities or derivatives or options thereof and may serve as Directors of such issuers. DCME may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended only for investors who are professional clients as defined in MiFID II and should not be distributed to retail clients as defined in MiFID II. Should you enter into investment business with DCME's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

DCME has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at:

https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.