Daiwa Capital Markets

Euro wrap-up

Overview

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- Longer dated Bunds followed USTs lower, while shorter-dated Bunds made gains as an investor survey reported a notable deterioration in perceptions for German's economic outlook amid heighted political uncertainties.
- Gilts also followed USTs lower, even as the UK's labour market report showed a further moderation in regular pay growth.
- Following no European data releases tomorrow, Thursday will bring updated estimates of euro area GDP and employment in Q3 and September's industrial production figures.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.110	-0.018
OBL 2½ 10/29	2.180	+0.028
DBR 2.6 08/34	2.358	+0.035
UKT 4⅛ 01/27	4.489	+0.085
UKT 4⅛ 07/29	4.400	+0.089
UKT 4¼ 07/34	4.498	+0.074

*Change from close as at 5.00pm GMT.
Source: Bloomberg

Euro area

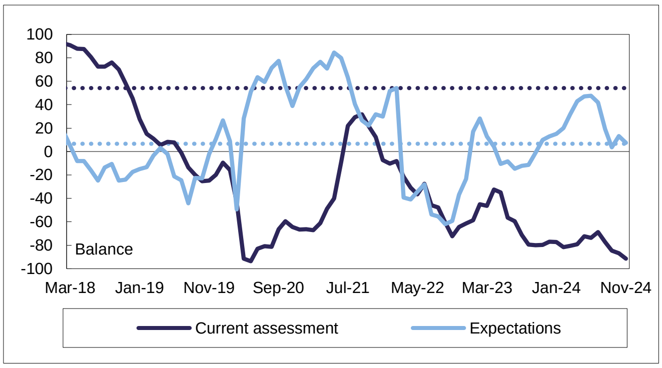
Political uncertainty weighs on German investor sentiment

Amid the collapse of the ruling German coalition last week and in the wake of the re-election of US President Trump – with the uncertainty associated with the potential imposition of higher tariffs on goods exports to the US likely to weigh on near-term investment intentions – investor confidence about Germany's economic outlook unsurprisingly deteriorated at the start of November. Indeed, the results of today's ZEW investor survey saw assessments of the current situation decline sharply, with the respective balance (-91.4) down to the lowest level in more than four years and the global financial crisis when excluding the pandemic. Expectations for the coming six months also fell back (7.4), well below the recent high at the start of the summer (47.5), with just one-quarter of respondents expecting conditions to be 'good' over the near term. Admittedly, the survey's press release noted that greater optimism was expressed towards the end of the response period, with expectations for improved economic prospects with snap elections on the horizon. Indeed, it has today been reported that Chancellor Scholz and opposition lawmakers have reached a resolution regarding the timeline for an election early next year, with opposition parties seemingly prepared to support the vote on this year's supplementary budget as a result. A procedural no-confidence vote will likely be held on 16 December, with a proposed date for a federal election on 23 February, some seven months earlier than previously scheduled. Given the latest polls, we would assume a CDU-led coalition to be the most likely outcome at this time.

Food, energy and volatile services pushed German inflation back above target in October

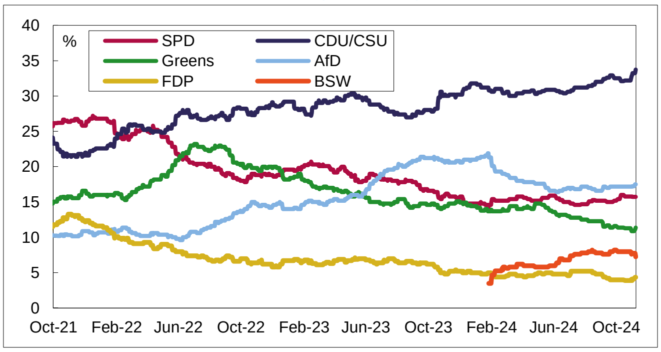
After German headline HICP inflation in September fell back below target (1.8%Y/Y) for the first time in 3½ years, inflation had been widely expected to rise back above 2% over the course of Q4 as lower energy base effects rolled out of the annual comparison. But the bounce back in October's EU-harmonised inflation to 2.4%Y/Y (2.0%Y/Y on the national measure) was slightly larger than most had anticipated. This steeper rise was in part a result of higher food price inflation, which jumped 0.7ppt to nine-month high of 3.1%Y/Y, driven primarily by the notable increase in prices of oils and fats (23.8%Y/Y). And while energy prices continued to weigh on headline inflation (-5.4%Y/Y), a pick-up in petrol and heating oil prices, as well as unfavourable base effects meant that this was dampened relative to September (-7.5%Y/Y). Contrasting the aggregate euro area figures, Germany's core inflation also increased a notable 0.3ppt to 3.3%Y/Y, with services inflation – having moved sideways throughout Q3 at 4.4%Y/Y – rising to a 14-month high of 4.8%Y/Y. However, a large proportion of this rise reflected an upturn in some of the more volatile services components. In particular, transport services inflation ticked up 1.9ppts to a 14-month high of 4.2%Y/Y in October, while there was also a larger contribution from package holidays (up 0.9ppt to 7.7%Y/Y), in spite of a second consecutive price decline on a monthly basis. Arguably more concerning was the steady

Germany: ZEW investor sentiment indices*



*Dotted lines show pre-pandemic 5Y average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Political polling averages*



*Rolling average of latest polls by Kantar, YouGov, Allensbach, Infratest & Forschungsgruppe.(As of Nov 8)
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

uptrend in insurance costs, which strengthened to 14.4%Y/Y, up 2.2ppts to a new series high. In contrast, there was ongoing gradual disinflation in catering and accommodation inflation.

The coming two days in the euro area

With Wednesday set to be a relatively quiet day for the euro area in terms of economic news, Thursday will bring a second (and penultimate) estimate for euro area GDP for Q3, accompanied by flash estimates for employment growth and September's industrial production figures. With limited additional information since the previous release, we expect GDP growth to be confirmed at 0.4%Q/Q, up from 0.2%Q/Q and double the rate projected by the ECB in September. Despite the acceleration in headline GDP growth, the rate of employment growth likely eased slightly in Q3 as firms responded to a softening in underlying growth momentum. Indeed, Thursday's euro area IP will almost certainly point to another quarter of stagnation (at best) for manufacturers. Production is highly likely to have dropped in September, consistent with lower output in Germany (-2.5%M/M), France (-0.9%M/M) and Italy (-0.4%M/M), while a notable decline in Irish IP (-10.7%M/M) will also have a non-negligible effect. Overall, we expect aggregate euro area output to drop almost 2%M/M, more than reversing the strong increase in August (1.8%M/M), which might well also be revised, in line with developments in the aforementioned member states that month.

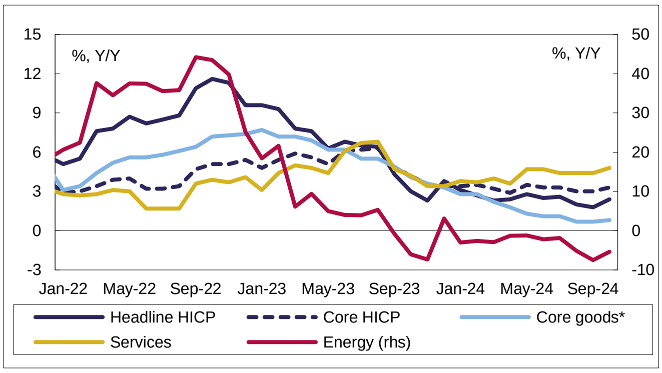
Aside from the data, attention will also turn to the release of the ECB account from the 17 October monetary policy meeting, at which the Governing Council lowered the Deposit Rate by 25bps for a second-consecutive meeting and the third time this cycle. While the policy statement remained non-committal to future policy decisions, it acknowledged that disinflation is now well on track and that economic activity has recently surprised on the downside. In her press conference, President Lagarde noted that the that decision to cut was unanimous. So, we expect the account to highlight that policy discussions erred on the dovish side, with certain members likely flagging the downside risks to overly restrictive policy on near-term economic growth and therefore a growing possibility that inflation will undershoot the 2% target over the policy horizon, suggesting that a third-consecutive rate cut will be likely in December.

UK

Uptick in total pay growth related to public sector pay settlements

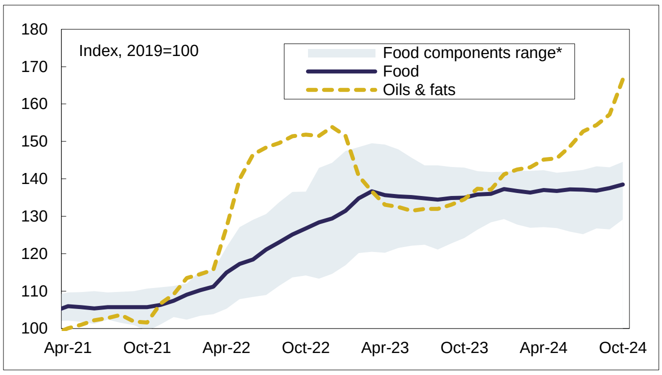
Today's UK labour market figures were, on the whole, suggestive that slowing labour demand should support a further gradual easing in pay growth, which in turn should offer scope for further gradual cuts to Bank Rate in due course. This notwithstanding, BoE Chief Economist Pill – arguably the most hawkish of the internal MPC members – today cautioned that

Germany: HICP inflation components



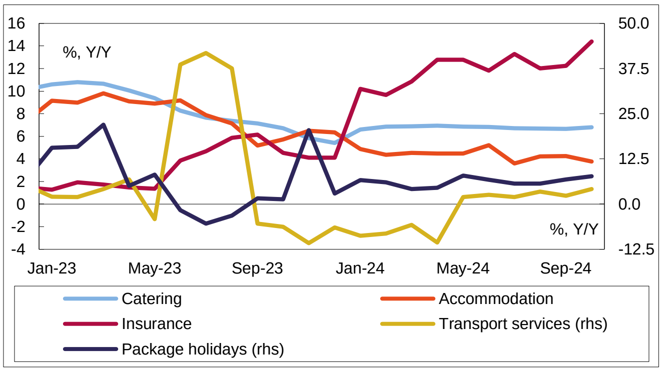
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: HICP food price inflation



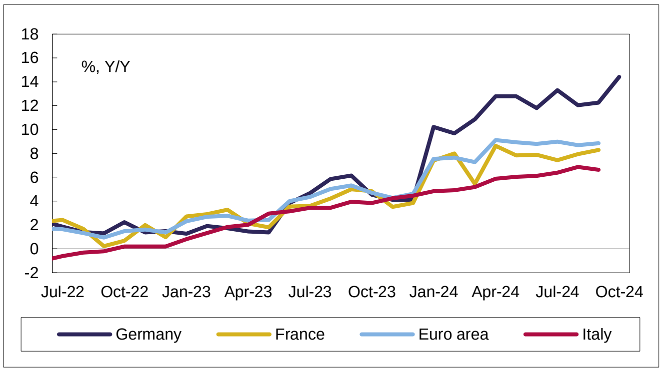
*Non-energy industrial goods
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Selected services HICP components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Insurance services HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

for now at least "pay growth remained at elevated levels that, given the outlook for productivity growth in the UK, are hard to reconcile with the UK inflation target". And today's figures saw total wage growth tick slightly higher in the three months to September, by 0.4ppt to a three-month high of 4.3%3M/Y. But this was again in part distorted by public sector pay settlements, which rose for the armed forces and police, while the one-off payment to NHS workers last year dropped out of the annual calculation. The impact of the pay settlement to NHS staff last month was also evident in the HRMC PAYE figures, which suggested that total median pay growth jumped 0.9ppt to a 14-month high of 7.0%Y/Y in October. Indeed, median pay in the health and social work sector accelerated 15½%Y/Y, contrasting with a further moderation in retail, administration and recreation subsectors, with the latter the softest for two years.

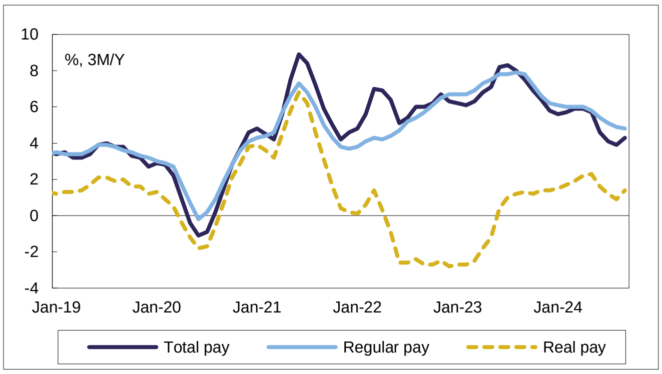
Private regular pay growth in line with BoE's expectations, with momentum slowing

When excluding special & bonus payments, total regular pay growth maintained a gradual downtrend, by 0.1ppt to 4.8%3M/Y, the lowest since June 2022, with public sector regular pay growth down ½ppt to a 21-month low of 4.7%Y/Y. And while private sector regular pay – the measure closely followed by policymakers for signals on underlying inflation pressures – held steady at 4.8%3M/Y, this was bang in line with the BoE's projection and a rate that was last lower in February 2022. Notably too, with respect to the inflation outlook for that subsector, regular pay in services slowed to a 28-month low (4.8%3M/Y). And private regular pay growth on a three-month annualised basis fell to a seven-month low of 4.5%3M/3M, more than 5ppts below the peak in July 2023, suggesting an ongoing easing in recent momentum. Admittedly, the BoE's updated macroeconomic projections expected private regular pay growth to edge slightly higher in Q4 (5.1%3M/Y) before resuming a downwards trend to end next year close to 3%Y/Y, bang in line with the long-run average. Of course, the outlook remains clouded by uncertainties surrounding the impact of the various measures announced in the Budget. But while the increase in employers' National Insurance Contributions (NICs) represents an increase in labour costs – and will likely be passed on in higher on firms' selling-prices – the MPC also assumes that it might well transmit to a small downward impact on wages over coming years.

Job vacancies maintain downtrend, employment growth slowing & recruitment difficulties easing

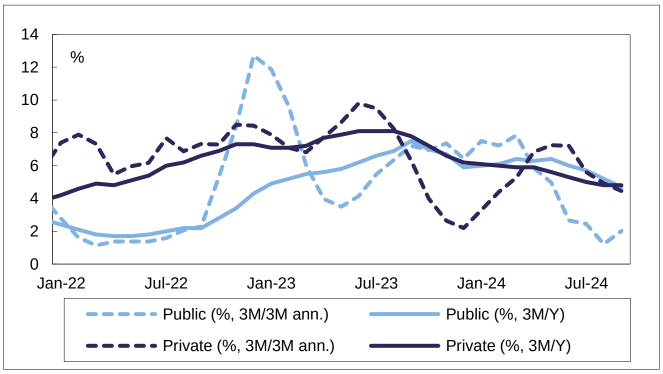
Today's report also suggested a further easing in the jobs market, which should also help constrain wage bargaining over coming quarters. Indeed, the number of vacancies maintained the steady downtrend of the past two years, dropping in the three months to October to 831k, the lowest since April 2021, and falling in more than 80% of all sectors. That left them down 13.8%Y/Y and just 3k above the average in the year ahead of the pandemic, with the ratio of vacancies to unemployed people in September (0.57) the lowest since June 2021 and back below the 2019 level. In addition, according to provisional data the number of payrolled employees fell in October for the fourth month out of the past five to be down almost 50k since

UK: Nominal & real pay growth



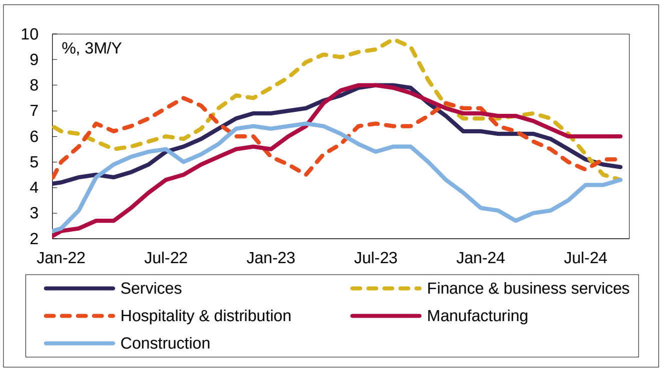
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private & public regular pay growth



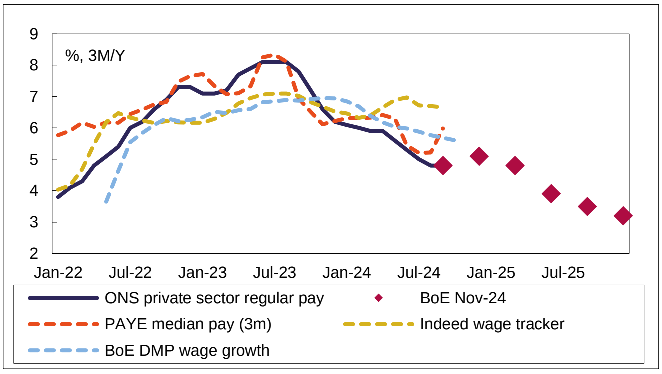
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private regular pay growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measures of pay growth



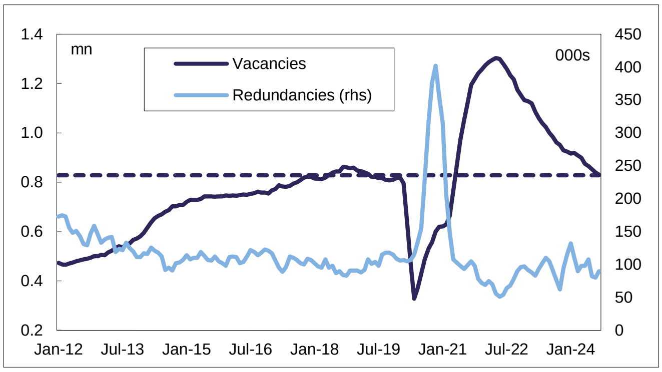
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

May and leave the annual growth rate (0.3%Y/Y) the softest since April 2021. The Labour Force Survey (LFS) measure of employment also fell back in September – following the unbelievable spike in August – although the ONS continues to caution the reliability of these data due to the survey's low response rate. And so, the LFS measure of the unemployment rate rose in the three months to September to a four-month high of 4.3%. Admittedly, despite edging slightly higher, the number redundancies remain well down on the historical average, suggesting that most firms are not actively cutting headcount. Nevertheless, the Bank's Agents' suggest that recruitment difficulties have fallen back to levels last seen in 2017, which might also limit the capacity for higher pay demands going forward.

The coming two days in the UK

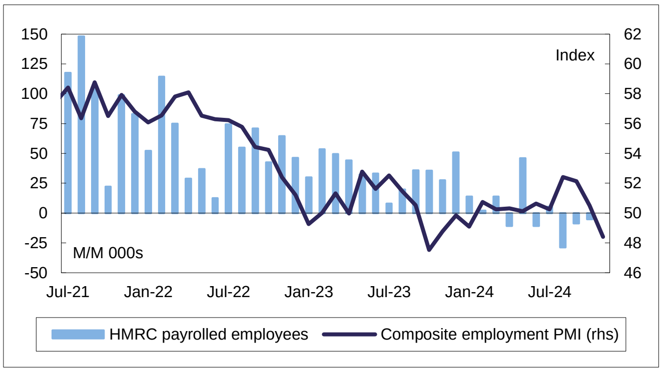
It should be a relatively quiet couple of days for UK data releases, with no top-tier data scheduled for tomorrow. Thursday will bring the RICS residential market survey will provide an update on October's housing market conditions. Consistent with other indicators – such as the Nationwide and Halifax – recent RICS surveys have seen steady recovery in house prices and market activity, as mortgage rates fall in tow with the cut in Bank Rate and real incomes continue to pick up. But as was hinted in the BoE's Monetary Policy Report, October's figures may also report that activity slowed in the run-up to the Budget announcements. Aside from data releases, BoE Governor Bailey will deliver his Mansion House speech on Thursday evening.

UK: Job vacancies* & redundancies



**Dashed dark blue line represents 2019 average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Payrolled employees & employment PMI



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

The next edition of the Euro wrap-up will be published on Thursday 14 November

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Final HICP (CPI) Y/Y%	Oct	**2.4 (2.0)**	2.4 (2.0)	1.8 (1.6)	-
		ZEW investor survey – current situation (expectations) balance %	Nov	**-91.4 (7.4)**	-85.0 (13.2)	-86.9 (13.1)	-
UK		Average wages (excluding bonuses) 3M/Y%	Sep	**4.3 (4.8)**	3.9 (4.7)	3.8 (4.9)	3.9 (-)
		Unemployment rate 3M%	Sep	**4.3**	4.1	4.0	-
		Employment 3M/3M change 000s	Sep	**220**	287	373	-
		Payrolled employees M/M change 000s	Oct	**-5**	-20	-15	-9
		Claimant count rate % (change 000s)	Oct	**4.7 (26.7)**	-	4.7 (27.9)	- (10.1)

Auctions

Country		Auction
Germany		sold €4.02bn of 2% 2026 bonds at an average yield of 2.11%
UK		sold £2.25bn of 4.75% 2043 bonds at an average yield of 4.836%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
			- Nothing scheduled -			

Auctions and events

Country		GMT	
Germany		10.30	Auction: to sell €4bn of 2.6% 2034 bonds
Italy		10.00	Auction: to sell up to €4bn of 2.7% 2027 bonds
		10.00	Auction: to sell up to €1.5bn of 3.5% 2031 bonds
		10.00	Auction: to sell €1.5bn of 2.5% 2032 bonds
		10.00	Auction: to sell €1.25bn of 4.15% 2039 bonds
UK		10.00	Auction: to sell £4bn of 4.375% 2028 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	GDP – second estimate Q/Q% (Y/Y%)	Q3	0.4 (0.9)	0.2 (0.6)
		10.00	Industrial production M/M% (Y/Y%)	Sep	-1.4 (-2.0)	1.8 (0.1)
		10.00	Employment – first estimate Q/Q% (Y/Y%)	Q3	-	0.2 (0.8)
Spain		08.00	Final HICP (CPI) Y/Y%	Oct	1.8 (1.8)	1.7 (1.5)
UK		00.01	RICS house price balance %	Oct	11	11

Auctions and events

Country		GMT	
Euro area		12.30	ECB publishes monetary policy account of October Governing Council meeting
UK		21.00	BoE Governor Bailey delivers speech to Mansion House annual financial and professional services dinner

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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