Europe | Economic Research | 19 November 2024

Euro wrap-up

Overview

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- Bunds made gains as Governing Council members re-affirmed the likelihood of a further rate cut in December amid signs of a less tight labour market and softer wage growth in Q3.
- Gilts also made gains as BoE Governor Bailey reiterated that the economic outlook was consistent with gradual rate cuts, but the newest external MPC member Taylor signalled a more dovish stance.
- Wednesday will bring euro area negotiated wage figures for Q3 and UK inflation data for October.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.128	-0.031
OBL 2½ 10/29	2.166	-0.032
DBR 2.6 08/34	2.334	-0.034
UKT 4⅛ 01/27	4.401	-0.008
UKT 4⅛ 07/29	4.316	-0.015
UKT 4¼ 07/34	4.440	-0.023

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

Euro area

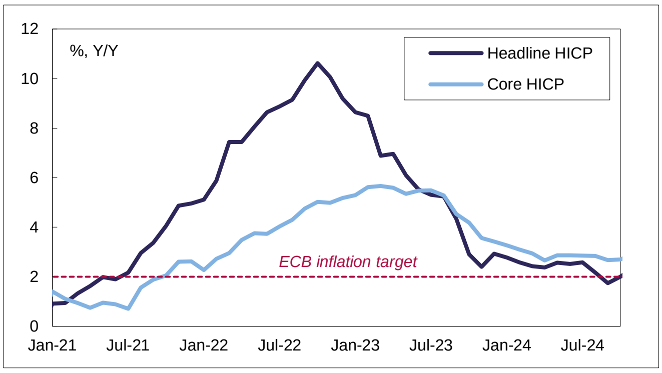
Euro area inflation back up to 2% target on energy and food prices

While the euro area's flash inflation estimates came in ahead of the market consensus in October, today's final figures provided no major surprises, with the headline rate unrevised at 2%Y/Y. This was up from 1.7%Y/Y in September, but nevertheless the second-softest reading since April 2021 and bang in line with the ECB's target. The uptick last month was widespread across member states, but largely underpinned by Germany (up 0.6ppt to a three-month high of 2.4%Y/Y). Indeed, inflation still remained below target in member states accounting for more than 50% of the region's GDP, including France, Italy and Spain. The detail of today's release also confirmed that the upwards impulse was principally driven by non-core components. Due to higher prices of auto fuel and heating gas oil, and falling prices a year earlier, energy inflation rose 1½ppts, albeit remaining firmly in negative territory (-4.6%Y/Y). Meanwhile, prices of food, alcohol and tobacco rose the most since January, taking the respective inflation rate up ½ppt to an eight-month high of 2.9%Y/Y.

Services inflation nudged higher, but recent momentum still slowing

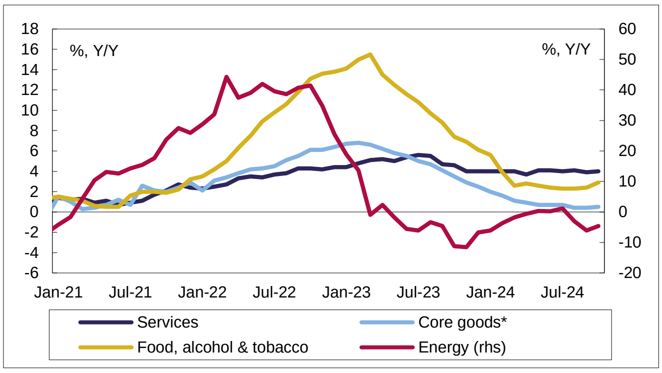
In terms of the core components, services inflation was nudged marginally higher from the flash release, by 0.1ppt to 4.0%Y/Y, maintaining the broadly sideways trend of the past year. This reflected a further rise in insurance costs (9.8%Y/Y) and higher package tour prices (7.7%Y/Y) compared with September, offsetting a further moderation in hospitality inflation, which fell to its lowest in more than 3½ years. But inflation of non-energy industrial goods was largely absent, at just 0.5%Y/Y, with ongoing disinflation in a range of components including second-hand cars, household furniture and major household appliances. Overall, the core HICP rate was unrevised at 2.7%Y/Y, matching the bottom of the range of the past 2½ years. Admittedly, other measures of underlying inflation ticked higher in October. For example, the 15% trimmed mean HICP rose 0.2ppt to a three-month high of 2.4%Y/Y, while the weighted median jumped 0.3ppt to 2.7%Y/Y, the highest since May. The principal common component estimate (PCCI), which ECB staff think often provides the best guide to underlying pressures, also ticked 0.1ppt higher to 2.0%%3M/Y. But this was still well down on the peak in mid-2022 (5.6%3M/Y). Moreover, when excluding food and energy, core PCCI moved sideways at 1.9%3M/Y, the seventh successive sub-target reading. And importantly, there was a welcome further easing of underlying inflation momentum. Indeed, with prices of services up in line with the average for the month in the decade before the financial crisis, and hence consistent with achievement of the ECB's target on a sustained basis, services inflation momentum fell for the fifth successive month by 0.4ppt to 3.5%3M/3M ann., almost 2ppts below May's peak.

Euro area: Headline & core HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Key HICP components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

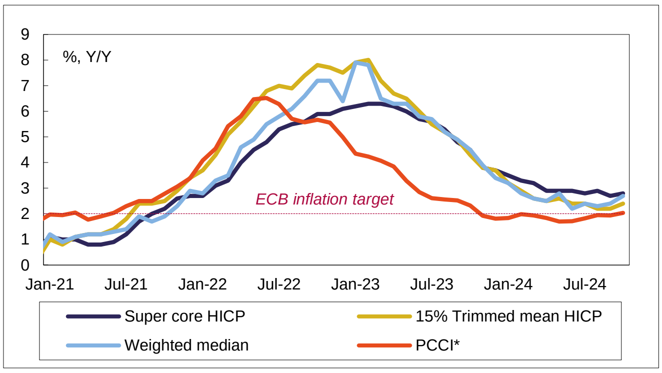
ECB to revise down its inflation projections despite expected pickup over coming months

Due in part to base effects in energy, inflation looks set to rise further over the remainder of Q4, perhaps ending the year at 2½%Y/Y. We also expect core goods and services inflation to tick slightly higher as the monthly price changes a year ago were soft. But with cost pressures being absorbed by profit margins, wage growth moderating (see below) and risks to economic activity skewed to the downside, we continue to expect both headline and core inflation to take a step down in spring 2025. Indeed, in the absence of new shocks, we expect the headline HICP rate to fall back to the 2.0%Y/Y target in Q125, with core inflation set to return to 2%Y/Y in Q225, roughly a year ahead of when the ECB had projected in September. As such, the ECB will revise down its inflation projections next month, which seems highly likely to coincide with a fourth rate cut this cycle. With some policymakers having flagged at the previous meeting in October some concerns about a potential inflation-target undershoot, we continue to expect the ECB to cut rates in January, March and June next year too.

Gradual labour market loosening to support disinflationary trend

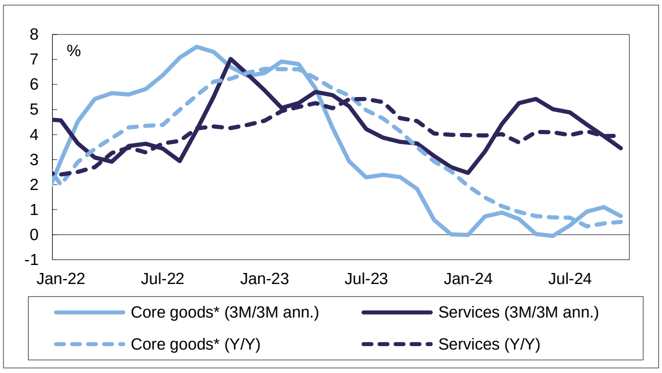
Policymakers should also take encouragement from the ongoing rebalancing of supply and demand in the labour market and associated recent developments in wage growth. Admittedly, at face value, the euro area's labour market still looks tight by historical standards, with the unemployment rate at a series low (6.3%) at the end of Q3. But employment growth slowed in Q3, while today's data also signalled a further fall in job openings in Q3. According to the flash release, the vacancy rate in the euro area softened to 2.5% in Q3, the lowest since Q221, some 0.8ppt below its peak in Q222, and only a touch above the pre-pandemic average in 2019. The reduction was also evident across sectors, with the services vacancy rate (2.8%) similarly the lowest in more than three years. And perhaps inevitably given the lacklustre economic recovery, Germany's vacancy rate was some 0.3ppt below the 2019 average. Meanwhile, the further steady decline in the vacancies-to-unemployment ratio (0.40%) to its softest in three years appears consistent with a gradual cooling in underlying inflation. And with a diminishing share of firms reporting labour shortages and surveys pointing to a further softening in firms' hiring intentions at the start of Q4, employee wage bargaining should be more restrained going forward. Certainly, today's flash labour costs estimates reported a further slowdown in growth in Q3, to 4.6%Y/Y from 5.0%Y/Y in Q2 and 5.4%Y/Y in Q1. The moderation in labour costs was broad based across sectors. But encouragingly for the inflation outlook in that sector, services labour costs growth slowed 0.2ppt to a three-quarter low of 4.6%Y/Y, with growth in the hospitality sector (2.2%Y/Y) notably the softest since Q421.

Euro area: Selected measures of inflation



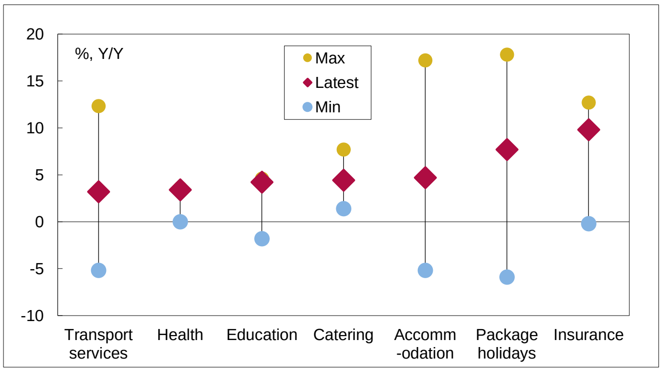
*Persistent and Common Component of inflation.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core inflation momentum



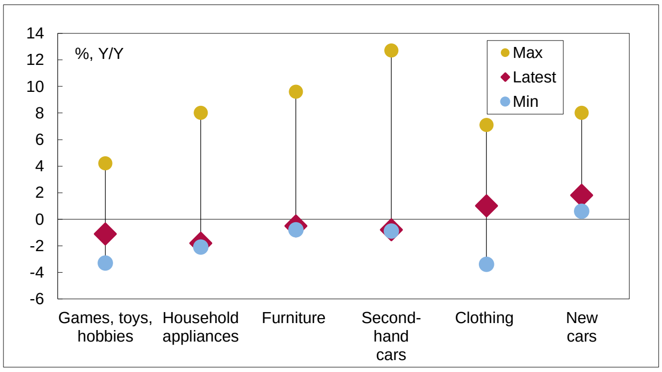
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected services HICP components*



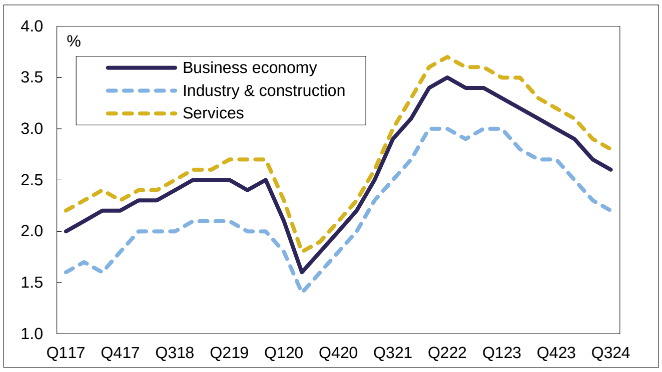
*Since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected goods HICP components*



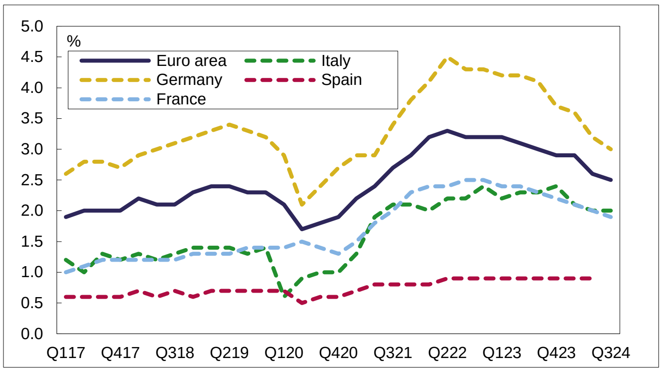
*Since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Job vacancy rates by sector



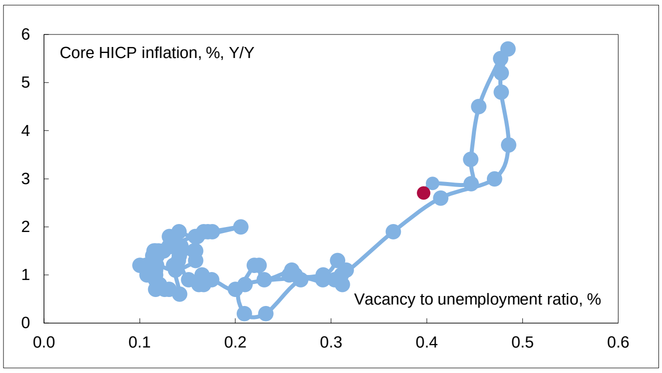
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Job vacancy rates by member state



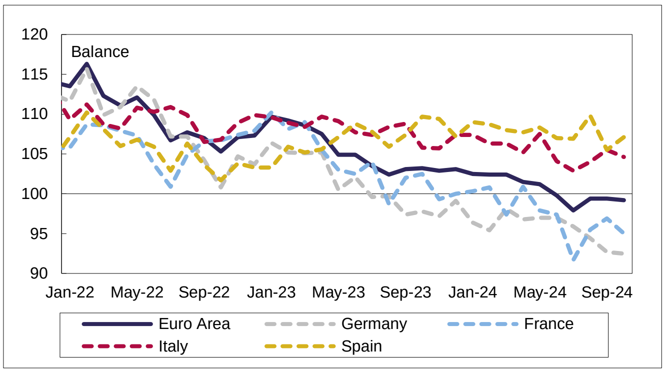
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Phillips curve*



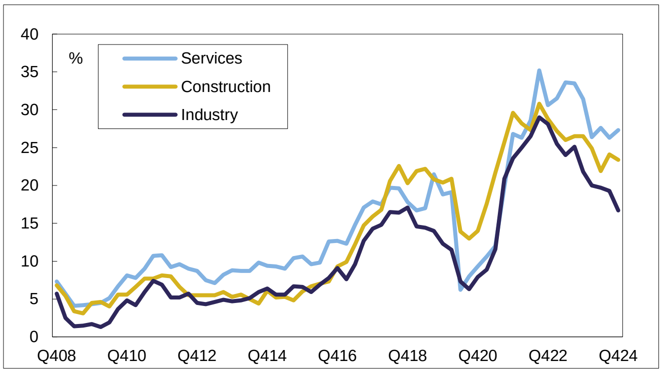
**Red dot represents latest observation for Q324. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Employment expectation indicators



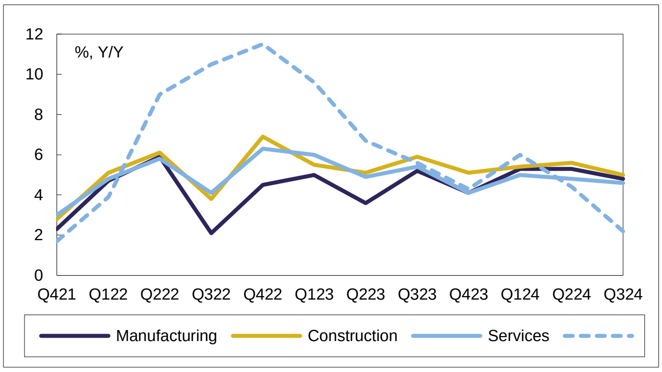
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Firms reporting labour shortages



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Labour costs by selected sectors



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

Tomorrow will bring further insight into recent wage developments, with the release of Q3 negotiated wage figures. But higher wage settlements in Germany (up 0.6ppt to 4.9%Y/Y on the national measure) are expected to skew the euro area results upwards in Q3. Meanwhile, tomorrow's euro area construction output data for September are likely to show that the sector contracted for a fifth quarter in six in Q3, consistent with the recent trend in Germany and France. In addition, German PPI data are also due and likely to show that factory pipeline pressures remain very subdued at the start of Q4.

UK

The day ahead in the UK

Following another quiet day for UK economic data, tomorrow's CPI release for October is expected to show that inflation bounced back from September's 3½ year low. This will predominantly reflect the impact of the increase in Ofgem's energy price cap, which rose by 9.5% last month, and stands to reduce the drag from energy disinflation by 6ppts to -10%Y/Y. So, we expect headline CPI to accelerate back to rise by 0.5ppt, to 2.2%Y/Y, in line with the BoE's own updated projections. In contrast, we expect core inflation to remain unchanged at 3.2%Y/Y, with core goods inflation set to remain largely absent. All-important services inflation is likely to tick only marginally higher (0.1ppt) to 5.0%Y/Y, also in line with the Bank's forecast. Meanwhile, energy base effects will likely continue to weigh on producer price inflation – also due tomorrow – suggesting that upwards pressure on consumer goods prices should stay muted over the near term. Finally, tomorrow's ONS house price index is expected to point towards continued recovery in house prices in September, in line with leading indicators.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Final headline (core) HICP Y/Y%	Oct	**2.0 (2.7)**	*2.0 (2.7)*	1.8 (2.7)	-
	Preliminary labour costs Y/Y%	Q3	**4.6**	-	5.0	-
	Preliminary job vacancy rate %	Q3	**2.5**	-	2.6	-
	Current account balance €bn	Sep	**37.0**	-	31.5	35.4

Auctions

Country	Auction
UK	sold £3.25bn of 3.75% 2038 bonds at an average yield of 4.558%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	10.00	Negotiated wages Y/Y%	Q3	-	3.6
	10.00	Construction output M/M% (Y/Y%)	Sep	-	0.1 (-2.5)
Germany	07.00	PPI Y/Y%	Oct	-1.0	-1.4
UK	07.00	CPI (core CPI) Y/Y%	Oct	*2.2 (3.2)*	1.7 (3.2)
	07.00	PPI – output (input) prices Y/Y%	Oct	-1.1 (-2.9)	-0.7 (-2.3)
	09.30	House price index Y/Y%	Sep	-	2.8

Auctions and events

Country	GMT	Event
Euro area	09.00	ECB to publish Financial Stability Review
Germany	10.30	Auction: to sell €1bn of 0% 2052 bonds
	10.30	Auction: to sell €1bn of 1.8% 2053 bonds
UK	16.00	BoE Deputy Governor Ramsden scheduled to speak about monetary policy

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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