Euro wrap-up

Overview

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- Shorter-dated Bunds made modest gains despite a surge in euro area negotiated wage growth in Q3.
- While the jump in UK inflation was a touch larger than expected, shorter-dated Gilts ended the day little changed as BoE Deputy Governor Ramsden suggested that he sees a case for 'less gradual' easing if uncertainty fades.
- Thursday will bring November sentiment surveys of euro area consumer confidence, French business and UK manufacturing sentiment.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.115	-0.013
OBL 2½ 10/29	2.168	+0.001
DBR 2.6 08/34	2.341	+0.008
UKT 4⅛ 01/27	4.392	-0.009
UKT 4⅛ 07/29	4.315	-0.001
UKT 4¼ 07/34	4.464	+0.024

*Change from close as at 4:45pm GMT.
Source: Bloomberg

Euro area

Surge in negotiated wages in Q3 driven by temporary inflation-related compensation in Germany

At face value, today's euro area negotiated wage figures for Q3 looked alarming. Having taken a step down in Q2 to a six-quarter low of 3.5%Y/Y, the ECB's composite measure of pay settlement growth jumped to 5.4%Y/Y, the highest in more than three decades. But this was largely expected by ECB policymakers. And it was driven by an exceptional jump in German negotiated pay settlements last quarter. Indeed, while negotiated wage growth was slightly softer in Q3 in France and little changed in Italy, it surged 8.8%Y/Y in Germany – the most since the summer of 1993 – amid substantial growth in the retail and wholesale sectors. The strength reflected a mix of higher regular pay, back payments and inflation-related compensation, the latter of which will remain tax free until the end of the year. When excluding such special payments, negotiated wage growth in Germany accelerated a somewhat softer 5.3%Y/Y, albeit also the firmest since Q493.

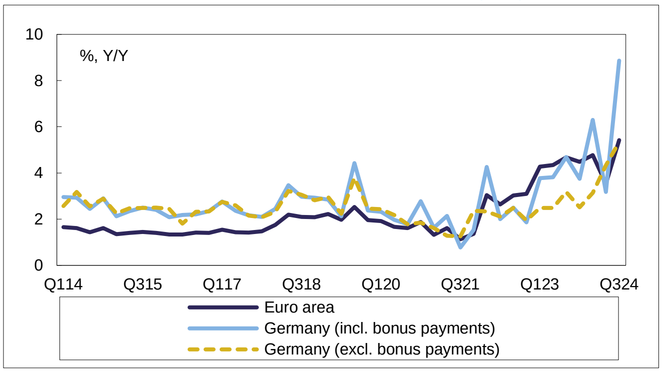
IG Metall deal flags moderation in Germany pay pressures heading into 2025

Notably, key German wage settlements in Q4 so far have been restrained as unions have moderated demands in the face of deepening economic challenges. In particular, Germany's largest union IG Metall this month agreed a wage increase for 3.9mn workers at certain firms in the autos and engineering industries (including Mercedes-Benz, BMW, Siemens and Thyssenkrupp) worth a mere 2.0% from April 2025 and 3.1% from April 2026. A separate deal negotiated for troubled carmaker Volkswagen also appears to be prioritising job security over higher pay. Given signs of softening in the Germany labour market, as firms seek to cut costs amid stagnant economic activity and a downside skew to risks to the outlook, we expect pay-demand pressures to fade significantly over coming quarters. Certainly, the latest Indeed wage tracker for October reported the softest pay growth (3.4%3M/Y) since March 2022. As such, the Governing Council seems highly likely to look through today's data and cut rates again by 25bps in December, ahead of further easing in Q1 and Q2 next year.

Construction declined for a fifth quarter in six, though conditions set to improve from next year

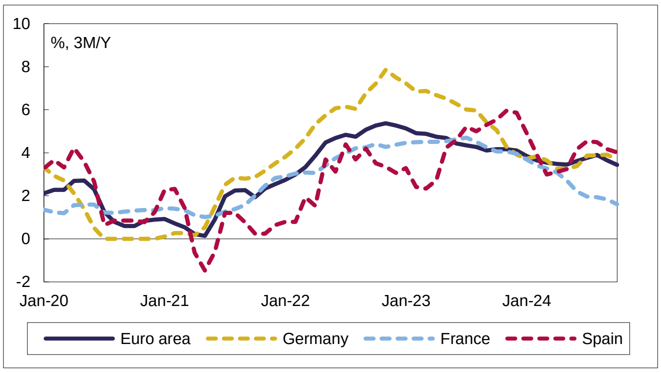
Consistent with recent surveys, euro area construction activity remained weak at the end of Q3. Output in the sector fell marginally in September (-0.1%M/M) to confirm the fifth quarterly decline in the past six (-0.4%3M/3M). While this marked a relatively softer decline than in Q2, production was still down some -1.6%Y/Y and at its joint-lowest level since the end of 2022. Unsurprisingly perhaps, the weakness in Q3 was centred on Germany (-1.4%3M/3M) and France (-1.2%3M/3M), with stronger production in Italy, Spain and the Netherlands unable to offset the euro area's two largest member states. And while some leading indicators, such as the Commission sentiment survey and the PMIs, might suggest that the lull in construction is bottoming out, order books remain subdued. Importantly, surveys also show little evidence of a recovery in housebuilding,

Euro area & Germany: Negotiated wage growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Indeed wage tracker



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

while German and French residential building permits continued to find new lows last quarter, suggesting that weakness in those two countries will likely serve as a headwind to euro area construction again in Q4. With building construction some 8.2% below its January 2020 peak, the subsector has been the main drag on euro area construction output over past quarters and so far unresponsive to the ECB's monetary easing. However, the central bank's most recent quarterly Bank Lending Survey signalled that less restrictive interest rates and rising consumer sentiment are starting to encourage a gradual pickup in mortgage demand. And while this will undoubtably take time to feed through to housebuilders' activity, continued easing should support an eventual recovery of housing market activity over the coming year.

The day ahead in the euro area

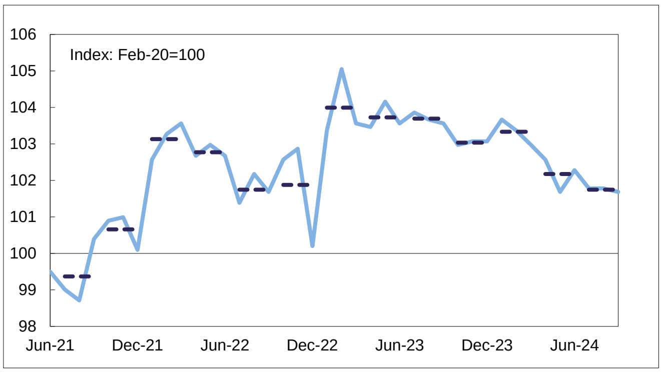
Ahead of the closely-watched flash PMIs (Friday), tomorrow will bring the Commission's flash November consumer confidence indicator for the euro area. Supported by the recovery in real disposable income and lower borrowing costs, consumer confidence rose close to its long-run average in October and might well signal a further modest improvement this month too. Meanwhile, tomorrow's INSEE business survey – which often provides a more reliable guide to French business sentiment than the PMIs – will be closely watched for developments in manufacturing sentiment after reporting last month the steepest monthly drop since the global financial crisis. Overall, however, business sentiment was broadly stable in October reflecting a pickup in services.

UK

Headline inflation principally boosted by energy price cap hike

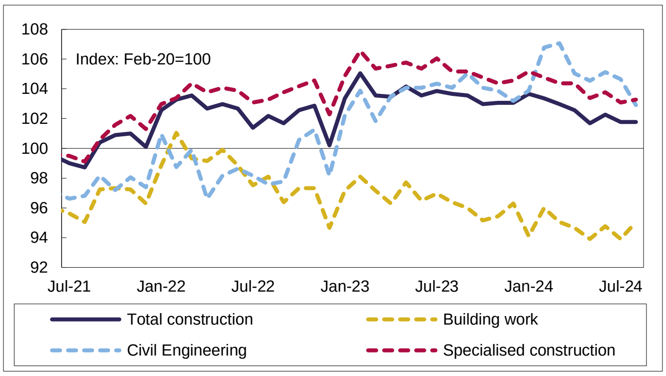
After falling sharply in September to its lowest rate since April 2021, UK inflation was widely anticipated to bounce back in October due to the near-10% hike in Ofgem's energy tariff cap. In the event, headline inflation rose a slightly firmer-than-expected 0.6ppt to a six-month high 2.3%Y/Y, 0.1ppt above the Bloomberg consensus and BoE projection. Inevitably, the upwards impulse principally reflected a leap in electricity (7.7%M/M) and gas prices (11.7%M/M), contrasting the sharp decline a year earlier. So, despite cheaper petrol, energy prices rose the most in two years, pushing the annual rate of that component up 6ppts in October to -10.1%Y/Y, adding 0.6ppt to headline inflation. But with the monthly increase in prices of non-energy industrial goods also some ½ppt higher than the norm for the month, core goods inflation unexpectedly rose 0.3ppt to (a still-subdued) 0.5%Y/Y, the firmest for six months, reflecting a slower pace of deflation in a range of goods, including second-hand cars, furniture and computer games. Meanwhile, in line with our own and the BoE's expectations, services inflation ticked only marginally higher, by 0.1ppt to 5.0%Y/Y, to leave core CPI inflation also up 0.1ppt to 3.3%Y/Y.

Euro area: Construction output*



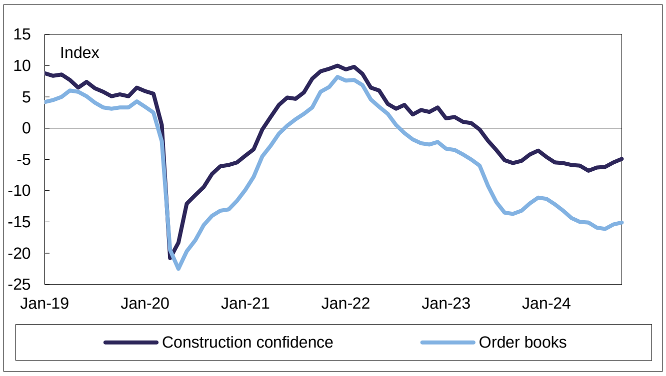
**Dashed lines denote quarterly average*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output by sector



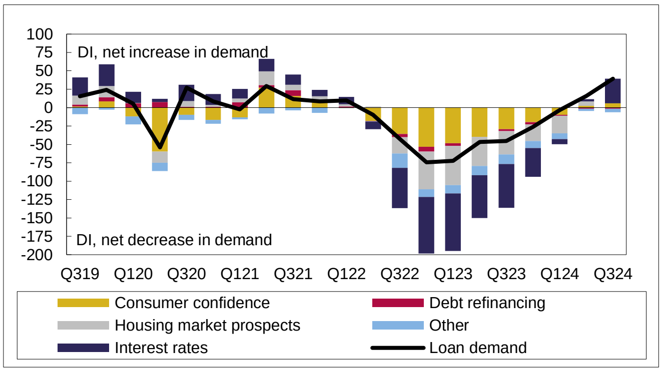
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction confidence & order books



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

Euro area: Loan demand for house purchase



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

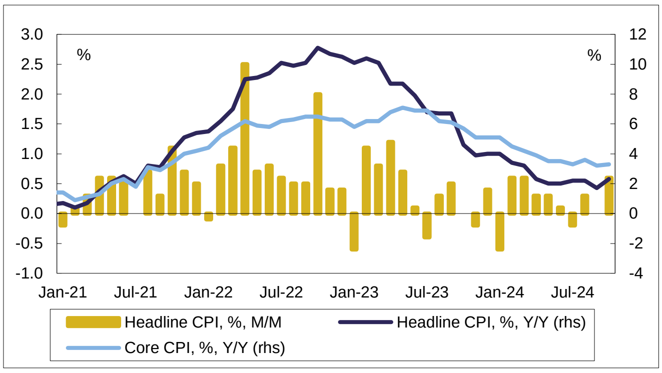
Uptick in services inflation underpinned by higher airfares

Despite the rise in October, headline and core inflation were still well down on the respective peaks of 11.1%Y/Y two years ago and 7.1%Y/Y in May 2023. And while services inflation remained elevated by historical standards, it was still more than ½ppt lower than the average in the first nine months of the year. The monthly price increase was also broadly in line with the norm ahead of the financial crisis for the third consecutive month, suggesting better-behaved pricing in the sector. The modest rise in services inflation in October was largely due to a significant increase in airfares (6.3%M/M), which rose the most in any October since the series began in 2001 in contrast to their fall (-5.4%M/M) in October 2023. Inflation in accommodation also rose to a four-month high (5.5%Y/Y), but was partly offset by a further moderation in the catering component to the lowest for more than three years (4.0%Y/Y). When excluding additional volatile items – such as package holidays, rents and education – underlying services inflation moved sideways at 4.5%Y/Y, the joint-softest since March 2022. And the BoE's closely watched series – excluding indexed and volatile components, rents and foreign holidays – fell 0.3ppt, also to 4.5%Y/Y, the lowest since February 2022. The share of items in the basket with above-target inflation also fell to just 44%, the lowest since mid-2021. And when excluding the highest and lowest 5%, NIESR's trimmed mean CPI measure fell to just 1.3%Y/Y, the lowest for almost three years.

Inflation likely to take a step down in Q2 on base effects and return to target in H226

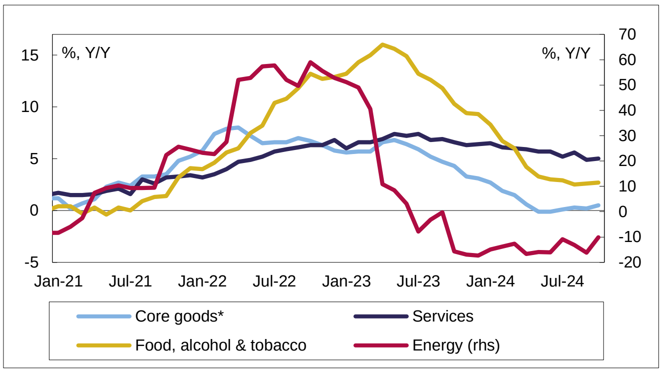
Inflation is expected to rise further over coming months, possibly to above 2½%Y/Y in November before moving broadly sideways through to February. But this will in part reflect base effects in energy and core goods inflation as prices fell sharply a year earlier, while a further modest rise in the Ofgem energy price cap might be expected in January. Services inflation is likely to move broadly sideways through to spring, before taking a step down in April due to base effects. But diminishing pay pressures will also support further gradual services disinflation thereafter. And with non-energy industrial goods inflation set to remain relatively subdued as pipeline pressures remain largely absent – input PPI inflation fell in October to a seven-month low of -2.3%Y/Y – core inflation will also ease sharply in Q225. While we have pushed higher our inflation projection over coming quarters to reflect the somewhat firmer growth outlook following the government's budget announcement, we still expect inflation to return to the 2% target in H226. As such, we continue to forecast the BoE to ease policy gradually further over the coming year, with one 25bps rate cut each quarter to coincide with updated macroeconomic projections in February, May, August and November.

UK: Headline & core inflation



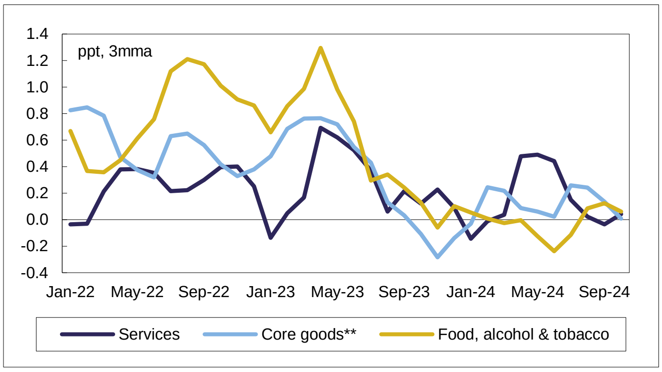
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Key inflation components



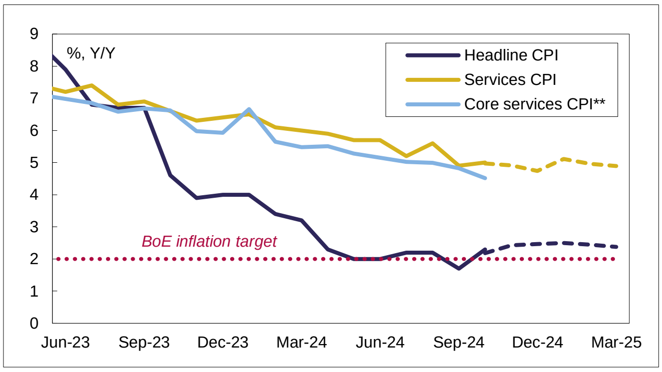
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Deviations from long-run average price change*



**Monthly change in prices compared to average for the month in the decade before the pandemic. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Headline & services inflation*

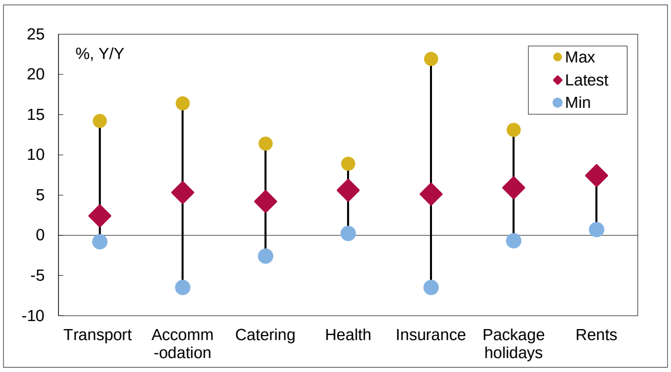


**Dashed lines represent BoE projections from November MPR. **Excluding indexed and volatile components, rents and foreign holidays' measure. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

The day ahead in the UK

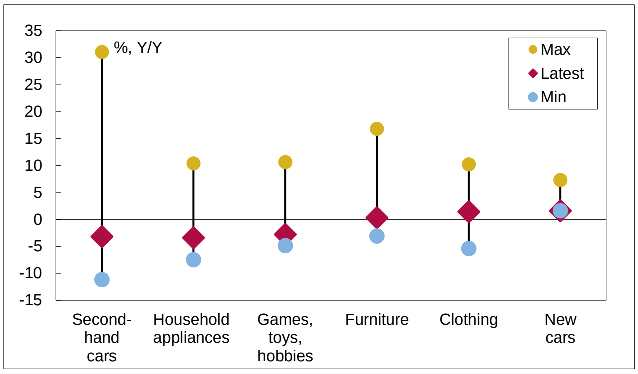
On a relatively quiet day for economic news in the UK, tomorrow's release of the CBI industrial trends survey will provide a prelude to Friday's PMI release, and a first look at how the industrial sector has digested October's budget announcement. Meanwhile, Thursday will also bring an update on public sector finances in October.

UK: Selected services inflation components



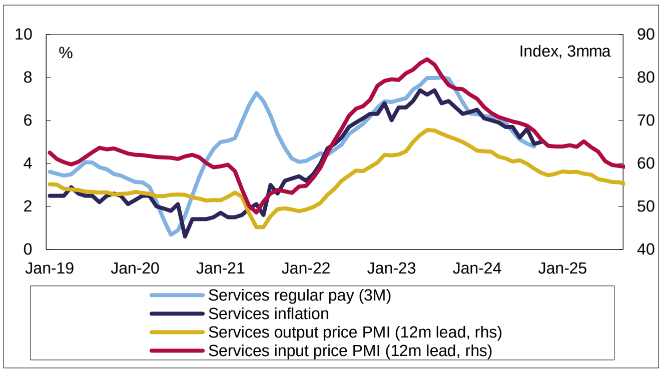
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected goods inflation components



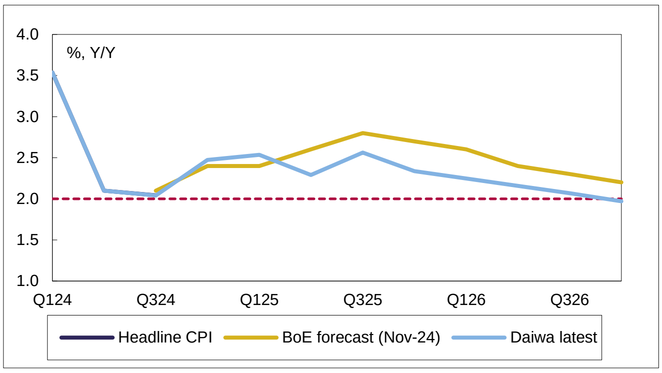
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services inflation & regular pay growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Inflation projections



Source: BoE, Macrobond 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		Negotiated wages Y/Y%	Q3	**5.4**	-	3.6	3.5
		Construction output M/M% (Y/Y%)	Sep	**-0.1 (-1.6)**	-	0.1 (-2.5)	0.0 (-)
Germany		PPI Y/Y%	Oct	**-1.1**	-1.0	-1.4	-
UK		CPI (core CPI) Y/Y%	Oct	**2.3 (3.3)**	*2.2 (3.2)*	1.7 (3.2)	-
		PPI – output (input) prices Y/Y%	Oct	**-0.8 (-2.3)**	-1.1 (-2.9)	-0.7 (-2.3)	-0.6 (-1.9)
		House price index Y/Y%	Sep	**2.9**	-	2.8	2.7

Auctions

Country		Auction
Germany		sold €818mn of 0% 2052 bonds at an average yield of 2.51%
		sold €804mn of 1.8% 2053 bonds at an average yield of 2.55%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data					
Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	05.00	New car registrations Y/Y%	Oct	-	-7.1
	15.00	Preliminary Commission consumer confidence indicator	Nov	-12.4	-12.5
France	07.45	INSEE business (manufacturing) confidence indicator	Nov	97 (94)	97 (92)
UK	07.00	Public sector net borrowing £bn	Oct	13.3	16.6
	11.00	CBI industrial trends survey – total orders (selling prices) balance %	Nov	-25 (5)	-27 (0)

Auctions and events		
Euro area	15.30	ECB Chief Economist Lane to participate in a panel discussion on 'The macroeconomic effects of geopolitical uncertainty'
France	09.50	Auction: to sell up to €11bn 2.5% 2027, 0.75% 2028, 0% 2030 & 2.75% 2030 bonds
	10.50	Auction: to sell up to €2.25bn 3.15% 2032, 0.6% 2034, 0.1% 2036 & 1.8% 2040 inflation-linked bonds
Spain	09.30	Auction: to sell 3.1% 2031, 4.2% 2037 & 1% 2042 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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