Daiwa Capital Markets

Euro wrap-up

Overview

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- The French National Assembly backed a no-confidence motion against the Barnier government.
- Ahead of the vote at European market close, Bunds had made very modest losses while OATs were little changed on the day.
- Gilts were also little changed as BoE Governor Bailey suggested that one BoE rate cut per quarter might still be the most likely scenario in 2025.
- Thursday will bring new data for German factory orders and euro area retail sales.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	1.943	+0.014
OBL 2½ 10/29	1.913	+0.016
DBR 2.6 08/34	2.057	+0.005
UKT 4⅛ 01/27	4.225	+0.008
UKT 4⅛ 07/29	4.104	+0.013
UKT 4¼ 07/34	4.246	+0.005

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

Euro area

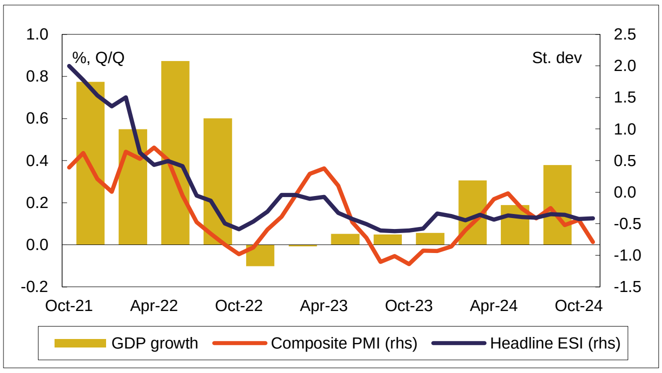
French National Assembly votes to censure Barnier government to intensify political crisis

As expected, a couple of hours after European markets closed this evening, the French National Assembly voted to back a censure motion against the Barnier government to intensify the political and fiscal crisis in the euro area's second-largest member state. With the first of two tabled motions of no confidence adopted by an absolute majority of MPs, Barnier's social security bill – which he had forced through the Assembly without a vote on Monday – was rejected. So, the government was obliged to submit its resignation to the President. The censure motion was the first in more than 60 years to pass, and only the second to do so since the Fifth Republic was established by De Gaulle in 1958, underscoring the historical nature of today's events. And with no new election permitted before next summer, President Macron is now in unchartered territory. He needs to find a new Prime Minister able to withstand a confidence vote in the National Assembly. But there is no obvious candidate, particularly one capable of passing a contractionary Budget through the divided parliament. And as Barnier himself suggested in this evening's parliamentary debate, France's fiscal challenges won't disappear simply evaporate with the appointment of a new Prime Minister.

Budget deficit likely to remain above 5% of GDP in 2025 even if spending is capped at 2024 levels

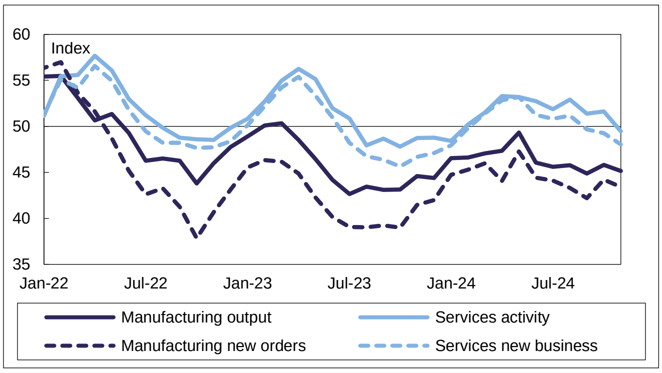
Over the near term, Barnier will likely remain in office as caretaker Prime Minister with minimal powers to govern on a day-to-day basis. With no time to design and adopt a new Budget for 2025, the Assembly will likely need to approve an emergency law to allow the state to finance itself over coming months. While that would cap much public expenditure in nominal terms at 2024 levels, implying real-terms cuts going forward, demand-driven welfare and public healthcare spending would still face upwards pressure. And with tax policy also left unchanged from 2024, Barnier's planned revenue-raising measures – which had been hoped to reduce the budget deficit by about 1ppt of GDP next year – would be eschewed. So, while new fiscal policies, if any, eventually adopted by a new government either before or after a likely summer election would have an influence if miraculously passed by the parliament, we currently expect the budget deficit as a share of GDP in 2025 to remain above Barnier's target of 5.0% of GDP. We see non-negligible upside risks in the likely event that persistent political uncertainty and the adverse impact of real-terms public spending cuts weighs heavily on economic growth and increases debt interest costs. Moreover, given the rejection of structural fiscal reforms today, and the likelihood that political paralysis persists or a populist government emerges after the summer, over coming years there would also seem likely to be minimal progress in reducing the deficit, which Barnier had aimed to cut below 3% of GDP by 2029. The absence of a credible and assertive government in Paris, coupled with uncertainty surrounding the German election in February, will also likely paralyse policymaking at the EU level throughout the first half of 2025 and probably beyond too.

Euro area: GDP growth & sentiment survey indices



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

Euro area: Services & manufacturing output PMIs



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

Final PMIs point to a notable loss of momentum in November despite modest upwards revision

Today's final euro area PMIs broadly aligned with the flash release that implied a notable loss of economic momentum in November amid heightened political uncertainties. Indeed, despite a very modest upwards tweak from the flash estimate, the headline composite PMI fell a chunky 1.8pts on the month – the most in 15 months – to 48.3, a 10-month low. This left the index trending in October and November some 1.3pts below the Q3 average and a level that ahead of the pandemic would have been consistent with a contraction of 0.1%Q/Q. The deterioration in November was led by services, with the activity index down 2.2pts to a 10-month low of 49.5. But the manufacturing output PMI (down 0.7pt to 45.1) recorded the twentieth successive contractionary reading, the longest such stretch on the survey's more than 2½-decade history. In contrast to the PMIs, the more comprehensive European Commission survey in November implied that economic conditions were broadly stable and consistent with (an admittedly lacklustre) expansion so far in Q4. And our current expectation is for euro area GDP growth to remain modestly positive at 0.1%Q/Q. But the PMIs highlight the loss of momentum and illustrate the downside risks to the near-term outlook. Certainly, with new private orders declining for a sixth successive month and by the most this year, firms were increasingly downbeat about the year ahead. They also reportedly cut headcount for a fourth consecutive month.

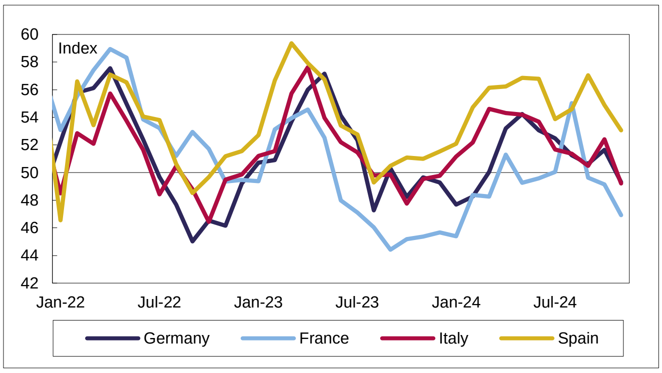
Survey suggests only modest uptick in services costs while producer goods inflation remains soft

Inflation-wise, today's final PMIs reported a modest uptick in services input costs and prices charged in November. But the respective index for the latter was still bang in line with the average in the previous six months (53.3) and still comfortably below the level a year ago, pointing to a continued moderation of price pressures in the sector. Elsewhere, today's corporate goods price data suggested that core producer prices (i.e. excluding energy) were unchanged for a second successive month in October. While this took the annual rate up to a 13-month high, it was still very subdued at 0.8%Y/Y, with durable consumer goods inflation of 0.7%Y/Y, suggesting an ongoing absence of any meaningful upwards pressures on consumer goods inflation. Overall, industrial producer prices rose 0.4%M/M to be still down a marked 3.2%Y/Y.

German, French & Italian PMIs firmly in contractionary territory

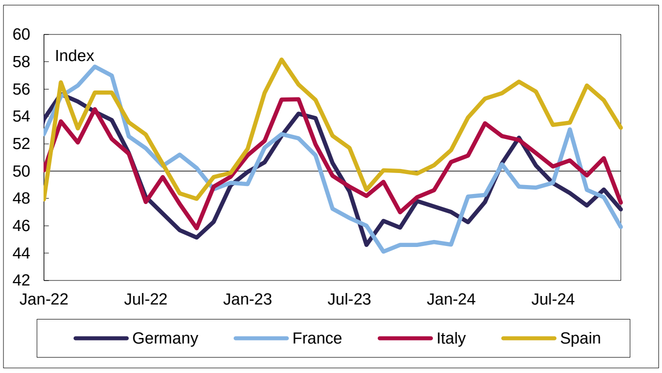
Like in the flash release, the economic weakness implied by the PMIs was most pronounced among the core member states. Germany's composite PMI was a touch softer than initially estimated, falling 1½pts on the month to 47.2, the softest in nine months. And despite an upwards revision from the flash estimate of more than 1pt, the French composite index (45.9) was still down more than 2pts to the lowest reading since January and also the lowest of all surveyed member states. But today's

Euro area: Services output PMIs



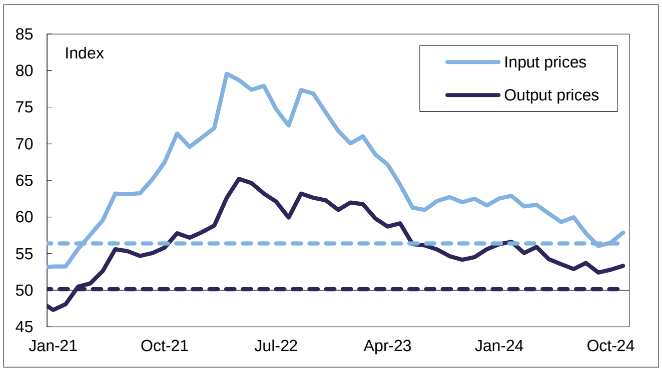
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Composite output PMIs



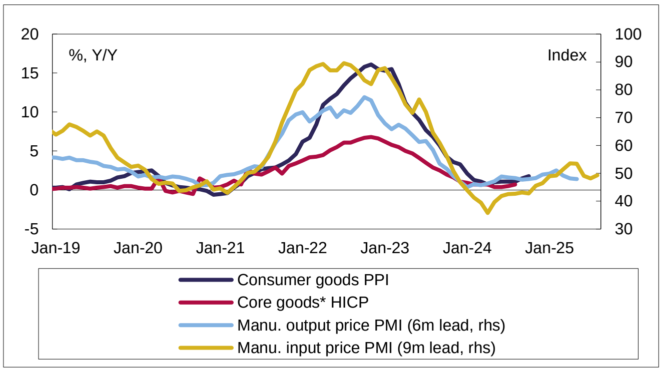
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Services price PMIs*



**Dashed lines represent pre-pandemic long-run average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Good price indicators



**Non-energy industrial goods. Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.*

survey also signalled a notable deterioration in Italian economic conditions, with the composite PMI down 3.3pts – the most in 18 months – to a 13-month low of 47.7. And while the equivalent Spanish index remained comfortably in expansionary territory, at 53.2 it was still down more than 3pts since September and the lowest level since January. The impact of the flash flooding in late October seemingly weighed heavily on tourism – indeed, the new services exports PMI fell a hefty 3.9pts to 48.5. While the overall macroeconomic impact of the extreme weather event remains uncertain, the Bank of Spain estimated last month that it could knock around 0.2ppt off GDP growth in Q4, and provide a modest drag over coming quarters too. This notwithstanding, both the PMI and Commission surveys suggest that Spain's economy will continue to outperform this quarter and likely in 2025 too. And while we expect modest growth in Italy in Q4, we think that GDP is moving sideways in France and contracting in Germany.

The day ahead in the euro area

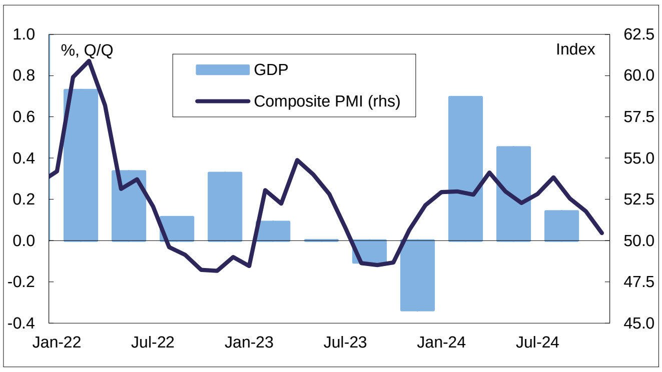
Thursday in the euro area will bring a handful of top-tier releases, including aggregate retail sales data for October. Consistent with October's softer releases from Germany (-1.5%M/M) and France and Spain (0.0%M/M), these figures should show that sales fell back at the start of Q4 following three months of consecutive growth in Q3. Tomorrow will also bring an update on the manufacturing sector. Ahead of Friday's German industrial production release, October's factory orders and turnover data will provide an important prelude. We expect factory orders to have fallen back in October, considering that September's step-up (4.2%M/M) was exaggerated by a likely temporary uptick in major transport equipment orders. By contrast, manufacturing turnover will likely report some payback for the weakness at the end of Q3. Similarly, tomorrow's French IP figures should start Q4 on a stronger footing following September's decline (-0.9%M/M). Thursday's construction PMIs are expected to point towards another subdued month of activity for the sector across the core of the euro area. Meanwhile, final estimates for Irish GDP in Q3 will also warrant attention ahead of Friday's third and final estimate for the euro area. Owing to the former's susceptibility to sizable revisions, and notable expansion in the first release – growth of 2.0%Q/Q in the first estimate appears too strong in light of the more than 3%Q/Q drop in manufacturing output – a significant revision could result in a downward adjustment to the euro area aggregate (0.4%Q/Q).

UK

Upwards revision to final PMIs consistent with modestly positive GDP growth in Q4

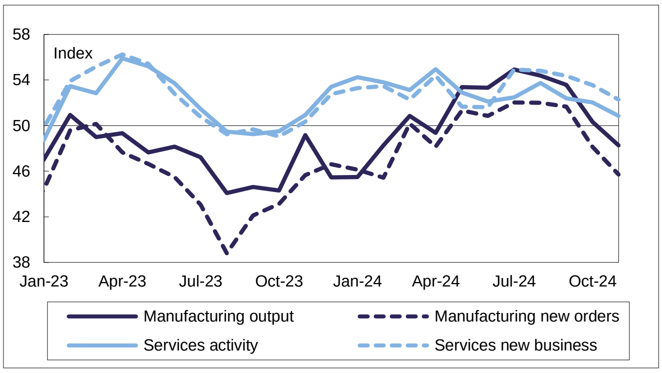
The final UK composite PMIs brought a larger upwards revision than the euro area survey. In particular, contrasting the downwards revision to the manufacturing output component earlier in the week, the services activity index was upwardly revised by 0.8pt to 50.8, to imply ongoing modest expansion. Admittedly, this still represented a third consecutive monthly

UK: GDP growth & composite output PMI



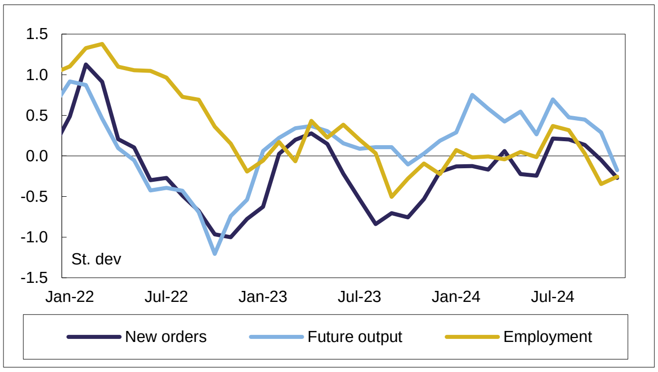
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services & manufacturing output PMIs



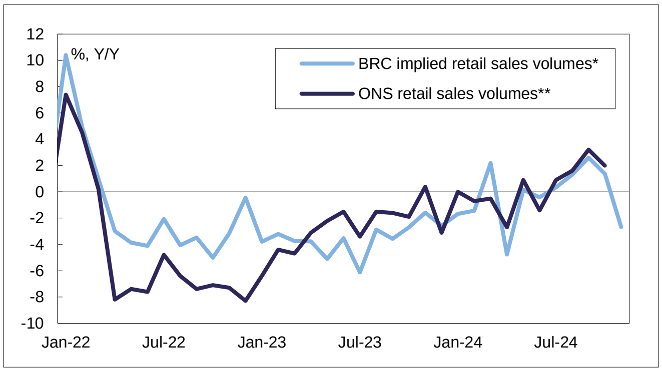
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected composite PMIs



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

UK: BRC retail sales monitor



**Deflated using BRC shop price inflation. **Excluding auto fuel.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

decline, by a non-negligible 1.2pts and the softest reading in 13 months. Unfortunately, the press release gave no insight into the factors underpinning the improvement in sentiment in the 19% of responses to be submitted in the additional two days of surveying reported in the final release. Nevertheless, while the composite PMI also fell 1.3pt in November to 50.5, this was some 0.6pt above the initial estimate. And although it continues to trend so far in Q4 some 2pts below the Q3 average, at 51.1 it remains consistent with ongoing modest expansion this quarter. Furthermore, the survey suggested that new business volumes increased for the thirteenth successive month in November – partly attributed to resilient consumer spending – which should continue to support moderate expansion into the New Year too.

Retail sales fell sharply in November due to timing of Black Friday discounting

It is worth noting that the PMIs have been a fairly unreliable guide to UK GDP growth since the start of the year. This in part likely reflects the exclusion of developments in the construction and retail sectors. And yesterday's BRC retail monitor reported a marked decline in sales in November, with like-for-like sales values down 3.4%Y/Y, the most since April this year and March 2020 before that. Sales at non-food stores fell for a 17th consecutive month, while online sales were down a whopping 10.3%Y/Y, the most since April 2022. When adjusting for price effects, like-for-like sales volumes fell a somewhat more moderate 2.8%Y/Y, with growth still marginally positive on a three-month basis (0.4%3M/Y). Moreover, the weakness principally reflected the exclusion of Black Friday discounting period from November's survey this year. As such, we would expect the survey to report a significant rebound in spending on goods in December. Overall, we continue to expect GDP growth in Q4 to accelerate slightly from 0.1%Q/Q in Q3 – which was distorted by a significant negative contribution from private inventories net of trade – albeit to a still relatively lacklustre 0.2%Q/Q.

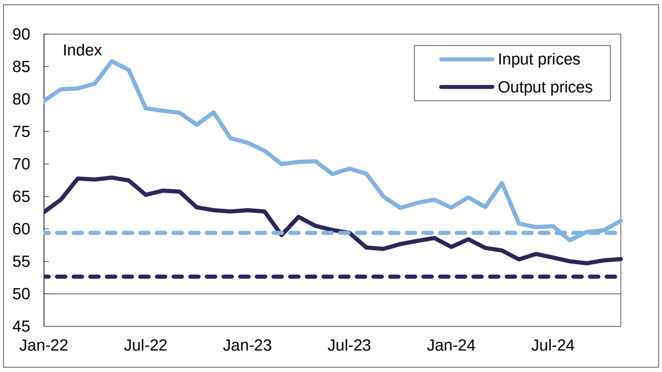
Bailey implies four BoE rate cuts still appropriate in 2025

Despite signals of a loss of economic momentum, today's final PMIs also brought an upwards revision to the services price PMIs, with input costs considered to be the highest since May (61.3) and still above the long-run average. This notwithstanding, the implied increase in prices charged in the sector remained broadly steady this month, close to the bottom of the range of the past 3½ years. And given diminished pricing powers in the face of declining demand, the manufacturing output price PMI moderated to a nine-month low, well below the long-run average. So, while services inflation might well remain sticky for several months to come – in part due to budget-related increases in private school fees and higher bus fares from the start of 2025 – an absence of any meaningful core goods inflationary pressures will likely persist. With services inflation set to take a step down from April due to base effects, we expect headline and core inflation to resume a gradual downwards path next year and perhaps returning to the 2% target in the second half of 2026, ahead of the MPC's current expectation. But with non-negligible uncertainties related to the inflationary impact of the government's budget measures – including the hike in the employers' NICS in April – as well as US President-elect Trump's fiscal and trade policies, the BoE will want to maintain a relatively cautious approach in its near-term monetary policy decisions. So, BoE Governor Bailey reiterated today that four interest rate cuts next year – that were assumed in the MPC's baseline November macroeconomic projections – might remain the most likely scenario.

The day ahead in the UK

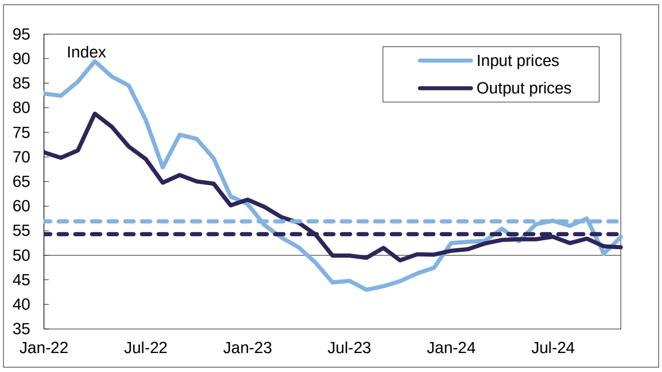
As with the euro area, the day ahead will bring UK construction PMIs for November, for which the headline index looks set to be consistent with a ninth consecutive month of expansion, supported by a pick up in house prices and mortgage lending. Meanwhile, after recent rounds of the survey pointed towards ongoing moderation in firms' price expectations - seemingly well-anchored close to the Bank's 2% target – November's BoE Decision Maker Panel survey should provide insights as to whether last month's government budget measures will have implications for firms' future price-setting behaviour and wage growth expectations.

UK: Services price PMIs*



**Dashed lines represent pre-pandemic long-run average.*
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing price PMIs*



**Dashed lines represent pre-pandemic long-run average.*
Source: S&P Global, 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		Final composite (services) PMI	Nov	**48.3 (49.5)**	*48.1 (49.2)*	50.0 (51.6)	-
		PPI Y/Y%	Oct	**-3.2**	-3.2	-3.4	-
Germany		Final composite (services) PMI	Nov	**47.2 (49.3)**	*47.3 (49.4)*	48.6 (51.6)	-
France		Final composite (services) PMI	Nov	**45.9 (46.9)**	*44.8 (45.7)*	48.1 (49.2)	-
Italy		Composite (services) PMI	Nov	**47.7 (49.2)**	49.6 (50.8)	51.0 (52.4)	-
Spain		Composite (services) PMI	Nov	**53.2 (53.1)**	53.8 (53.3)	55.2 (54.9)	-
UK		Final composite (services) PMI	Nov	**50.5 (50.8)**	*49.9 (50.0)*	51.8 (52.0)	-

Auctions

Country		Auction
Germany		sold €2.866bn of 2.6% 2034 bonds at an average yield of 2.07%
UK		sold £4bn of 4% 2031 bonds at an average yield of 4.155%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tuesday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
France		Budget balance YTD €bn	Oct	**-157.4**	-	-173.8	-
Spain		Unemployment change (net change) 000's	Nov	**-16.0 (13.1)**	-	26.8 (67.8)	-
UK		BRC retail sales monitor – like-for like sales Y/Y%	Nov	**-3.4**	0.6	0.3	-

Auctions

Country		Auction
Germany		sold €3.607bn of 2% 2026 bonds at an average yield of 1.94%
UK		sold £2.25bn of 4.375% 2054 bonds at an average yield of 4.747%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data					
Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	08.30	Construction PMI	Nov	-	43.0
	10.00	Retail sales M/M% (Y/Y%)	Oct	-0.3 (1.7)	0.5 (2.9)
Germany	07.00	Factory orders M/M% (Y/Y%)	Oct	-2.0 (1.8)	4.2 (1.0)
	08.30	Construction PMI	Nov	-	40.2
France	07.45	Industrial production M/M% (Y/Y%)	Oct	0.3 (-0.2)	-0.9 (-0.6)
	08.30	Construction PMI	Nov	-	42.2
Italy	08.30	Construction PMI	Nov	-	48.2
Spain	08.00	Industrial production M/M% (Y/Y%)	Oct	-0.1 (0.6)	0.5 (0.6)
	08.00	House price index Q/Q% (Y/Y%)	Q3	-	3.6 (7.8)
UK	09.30	DMP 3M output price (1Y CPI) expectations %	Nov	3.5 (2.6)	3.5 (2.5)
	09.30	Construction PMI	Nov	53.5	54.3

Auctions and events		
France	09.50	Auction: to sell up to €5bn of 4% 2038, 0.5% 2040, 1.5% 2050 & 0.5% 2072 bonds
Italy	11.00	ISTAT to publish economic outlook for 2024/25
Spain	09.30	Auction: to sell 2.7% 2030 & 3.45% 2034 bonds
UK	10.00	Auction: to sell up to £350m of 2073 inflation-linked bonds
	17.00	BoE external MPC member Greene speaks on panel at Financial Times conference

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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