Daiwa Capital Markets

Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Edward Maling
+44 20 7597 8030

- Bund yields were little changed on the day, making modest gains at the short end after German IP data dampened hopes of a reversal to industrial sector fortunes in Q4.
- Gilts made slight losses on a quiet day for UK economic news.
- The main event next week will be Thursday's ECB monetary policy announcement. We expect a cut of 25bps, lowering the Deposit Rate to 3.00%.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.001	-0.006
OBL 2½ 10/29	1.974	-0.007
DBR 2.6 08/34	2.112	+0.004
UKT 4⅛ 01/27	4.264	-0.002
UKT 4⅛ 07/29	4.141	-0.001
UKT 4¼ 07/34	4.284	+0.004

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

Euro area

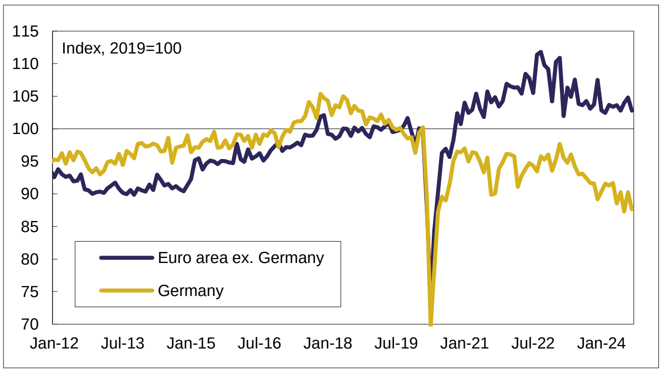
German industrial production falls again as Dunkelflaute depresses energy output

German industrial production extended its downtrend in October, unexpectedly falling 1.0%M/M in marked contrast to the Bloomberg consensus forecast of expansion of the same rate. That left IP at its lowest level since 2010 bar just two months during the first wave of Covid-19. Indeed, it was some 13.5% below the pre-pandemic level in February 2020 and almost 17% below its peak in 2017. And being 1.5% below the Q3 average, the October figure raises the likelihood that German industrial production will fall for a third successive quarter in Q4. The weakness in October was broad-based, but particularly acute in energy, where the Dunkelflaute (dark doldrums) of windless cloudy weather hit power generation by renewables. Indeed, wind-generated electricity output fell 26%Y/Y to push total electricity generation down 8.6%Y/Y. As a result, energy output fell 8.9%M/M to a post-reunification low 8.5% below the Q3 average. Among other major components, manufacturing output dropped 0.4%M/M to be just 0.1% above July's 4-year low and almost 13% below the pre-pandemic level. The struggles in the power sector were a contributing factor, as energy-intensive output – including production of chemicals, metals and related items – fell 0.9%M/M in part in response to increased wholesale power prices, which reached year-to-date highs. In addition, autos production fell for a second successive month (1.9%M/M) while other transport equipment, including aerospace, fell 8.7%M/M. Machinery also dropped 1.1%M/M. Consumer durables, in particular electrical equipment, provided some positive offset (0.7%M/M). Finally, construction output was unchanged in October to remain 0.4% below the Q3 average level and at a level that has been lower only in a few isolated months over the past eight years.

IP on track for broad-based decline for third successive quarter in Q4

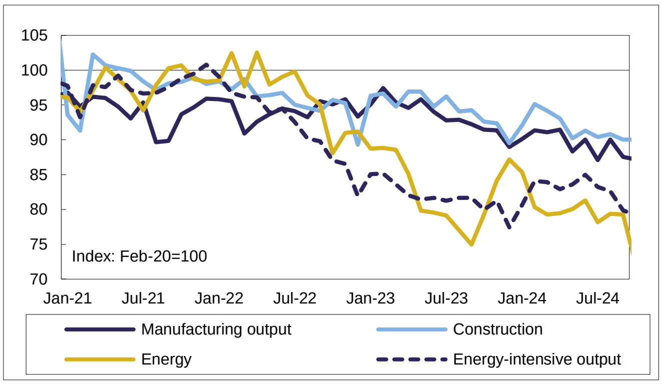
The extension of the Dunkelflaute into November continued to hit wind-generated electricity output (-25%Y/Y) last month. While increased gas-generated power eventually provided some offset, total electricity generation remained at the bottom of the range of recent years to be down 8.4%Y/Y. So, we do not expect to see a marked rebound in energy production in seasonally adjusted terms in the November IP data. Moreover, with wholesale gas prices having continued to trend higher to 12-month highs last month, energy-intensive manufacturing output likely remained subdued too. In addition, according to the VDA, the trend in German auto output was broadly flat last month, as the annual rate of growth slowed to a five-month low (0.9%Y/Y) and new car registrations fell from a year earlier. Truck toll mileage data for November point to ongoing stagnation too while core factory orders have been trending broadly sideways. And recent survey data, such as the PMIs and ifo indices, also point to likelihood of a third successive quarterly drop in IP in Q4 amid heightened political uncertainty at home and in key export markets, increased competition from China, and broader competitiveness challenges such as those posed by the lasting energy price shock, years of underinvestment in public infrastructure, and complacency in private and public sectors alike.

Euro area & Germany: Industrial production*



*Excluding construction Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: IP by selected component



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Firm euro area GDP growth in Q3 driven by consumption & flattered by Irish-based MNC activity

More positively, the euro area national accounts for Q3 confirmed the initial estimate of 0.4%Q/Q, which was twice as firm as the ECB's projection and the strongest in two years. The principal driver was a long overdue jump in private consumption, which rose 0.7%Q/Q, also the most since Q322 and 0.3ppt above the ECB projection, benefitting from recent strong growth in real disposable income. Strikingly, fixed investment surged 2.0%Q/Q, the best since Q421 and 1.5ppts above the ECB projection, to make the same contribution (0.4ppt) to GDP growth as private consumption. But the capex components for machinery, equipment, transport goods and construction all declined in Q3, with investment growth entirely driven by intellectual property (up 14.8%Q/Q). At face value, that might appear welcome, not least as it pushed R&D investments back closer to the pre-pandemic 2019 average. However, as in prior quarters, that growth was severely distorted by activities of multinational corporations based in Ireland for tax purposes. Indeed, due to a rebound from earlier unusual weakness, capital formation in Ireland rose a scarcely credible 212%Q/Q in Q3, contributing to outsized Irish GDP growth of 3.5%Q/Q. Excluding Ireland – which the ECB will be inclined to do given its distortions – euro area GDP rose 0.3%Q/Q in Q3, still nevertheless slightly firmer than in Q2. The activities of Irish-based multinationals also contributed to a drop in euro area services export volumes of 0.5%Q/Q in Q3. And with goods exports down for the first quarter in four (-0.3%Q/Q), trade net of inventories subtracted a whopping 0.4ppt from euro area GDP growth last quarter.

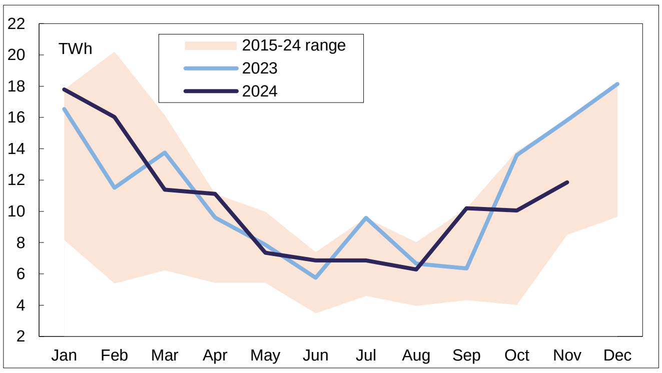
Strength of consumption in Q3 kills off any chance of a pre-Xmas jumbo rate cut

Despite the confirmation of a pickup in euro area GDP growth in Q3 back close to potential, on Thursday the ECB will still cut rates for the third successive policy-setting meeting and fourth time this year. Having eased the monetary stance by 25bps in June, September and October, certain Governing Council members, such as Banca d'Italia Governor Panetta, might articulate the case for an increment of 50bps this month. But the strength of private consumption in Q3, coupled with ongoing employment growth (0.2%Q/Q) and record-low unemployment (6.3%), will reinforce ECB expectations that an underlying recovery just about remains intact. And with inflation set to tick up over the near term, a pre-Xmas jumbo rate cut now looks a non-starter. Indeed, even had household spending stagnated and employment faltered in Q3, the inherent conservatism of a majority of Governing Council members, and a continued emphasis on backward-looking inflation metrics in their decision-making, meant the ECB would still likely have cut rates again by just 25bps this month, to take the deposit rate to 3.00%.

Forward guidance should give clearer signal of need to adjust stance to neutral & possibly beyond

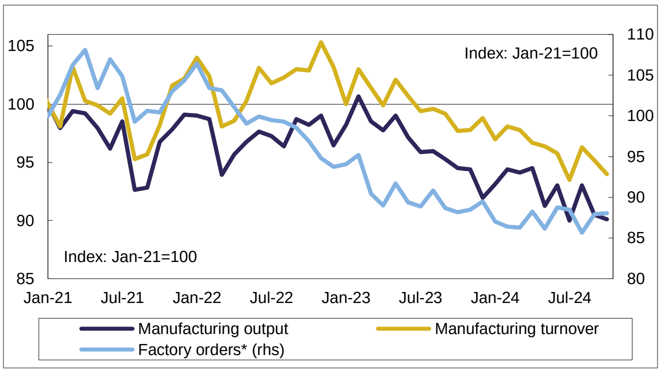
Nevertheless, while the size of rate cut this month will again be conservative, we expect the Governing Council to adjust its forward guidance to give a clearer sense of the likely future path of policy. Given the uncertainty of the economic outlook, it is

Germany: Wind-generated electricity output



Source: Ember and Daiwa Capital Markets Europe Ltd.

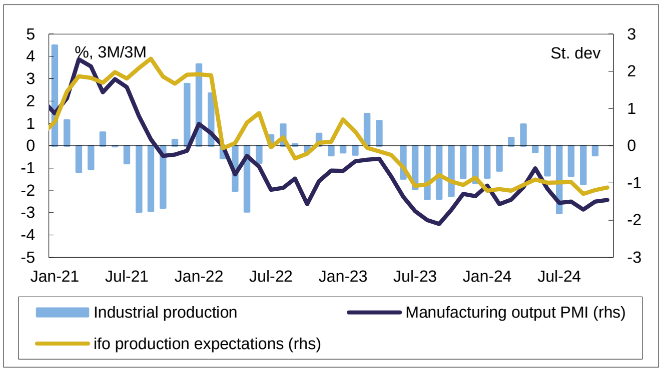
Germany: Manufacturing output, turnover & orders



*Core factory orders

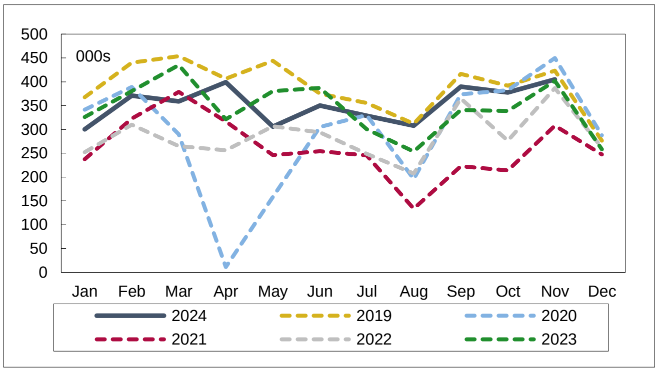
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: IP & survey indicators



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

Germany: Car production



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

likely to reiterate that it will continue to follow a data-dependent and meeting-by-meeting approach. But we also think it will acknowledge the increasingly two-sided nature of risks to inflation over the medium term, and that a greater emphasis on forward-looking indicators will be required from now on. Indeed, there is a non-negligible risk that inflation will undershoot 2% on a sustained basis, particularly if economic growth weakens. So, the statement also ought to suggest that, in the absence of new shocks, the Governing Council expects to return rates to a broadly neutral stance over coming meetings. In her press conference, ECB President Lagarde should also make clear that the magnitude of future rate cuts should remain open for debate. And she should not reject the possibility that rates might eventually move into accommodative territory.

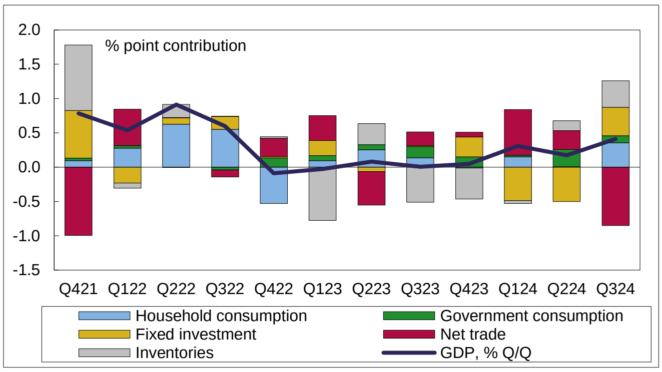
Inflation outlook to be lowered to suggest target met in mid-2025 & increased undershooting risk

More dovish forward guidance should be justified by the ECB's updated projections, also due on Thursday, which will likely revise down the inflation outlook. According to the flash estimates, headline euro area inflation rose back above 2.0%Y/Y in November while the core rate was unchanged at 2.7%Y/Y for a third month. Nevertheless, the details were soft. Services prices on a seasonally-adjusted basis fell on the month for the first time in more than 3½ years to suggest that price-setting behaviour has become more target-consistent. And there is now a strong likelihood that both headline and core inflation in Q4 will undershoot the ECB's September projection. Indeed, while the euro effective exchange rate has weakened since the summer, and wholesale gas and electricity prices are higher, with employee compensation having moderated in Q3 to a two-year low of 4.4%Y/Y slightly below the ECB's forecast, and labour cost pressures still absorbed by unit profits (down 1.0%Y/Y in Q3), the ECB's updated projections will likely bring forward from Q425 to mid-year the date at which inflation is expected to return to target. They should also retain a sub-2.0% full-year inflation projection for 2026. And in our view, there is a case for the inflation projection for 2027 – to be published for the first time – also to be slightly below 2.0%.

ECB's GDP projection likely to be little changed, albeit with a significant downwards skew to risks

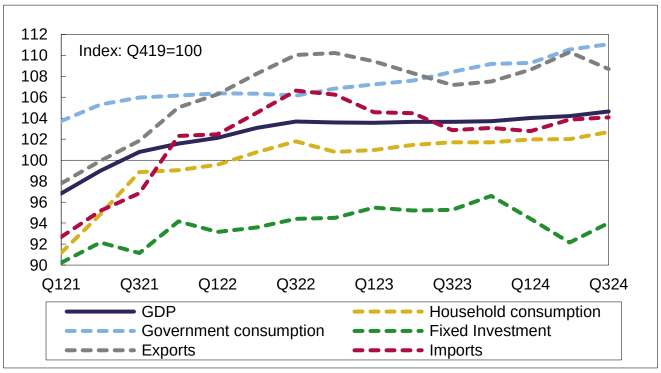
In terms of GDP, despite the upside surprise in Q3, data point to the likelihood of a softer pace of expansion in Q4 and early 2025 than the ECB previously projected. As illustrated by today's IP data, the challenges of Germany's manufacturing sector persist. A turn for the better in business capex (beyond Ireland-based multi-nationals) and construction remains elusive. And sluggish credit growth suggests that restrictive monetary policy is impeding a cyclical acceleration in economic activity. But given the pickup in household spending and continued labour market resilience despite the plans of German manufacturers to slash headcount, the ECB will continue to expect private consumption to lead a recovery in economic activity in 2025 and 2026. So, despite an increasing downside skew to risks – such as those posed by political uncertainty in Germany, France and the US – the ECB's full-year GDP growth projections will likely be little changed from 1.3% in 2025 and 1.5% in 2026, with a similar projection close to estimates of the potential rate likely to be penciled-in for 2027.

Euro area: GDP growth & contributions



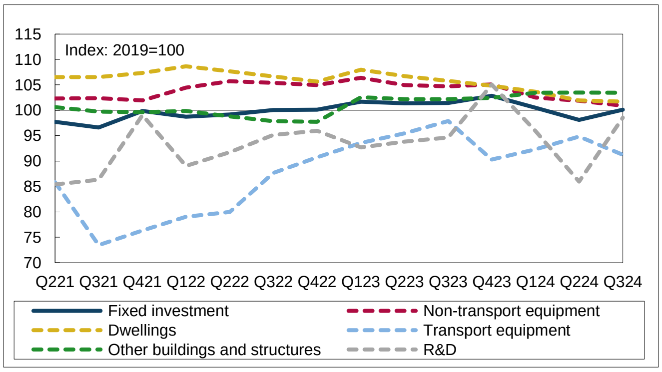
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP levels by expenditure component



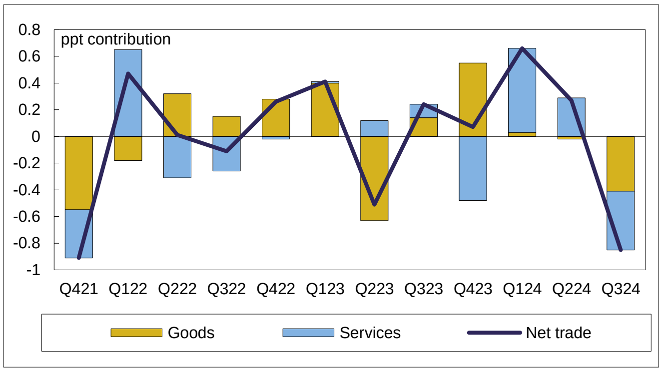
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Fixed investment by component



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Net trade contribution to GDP



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

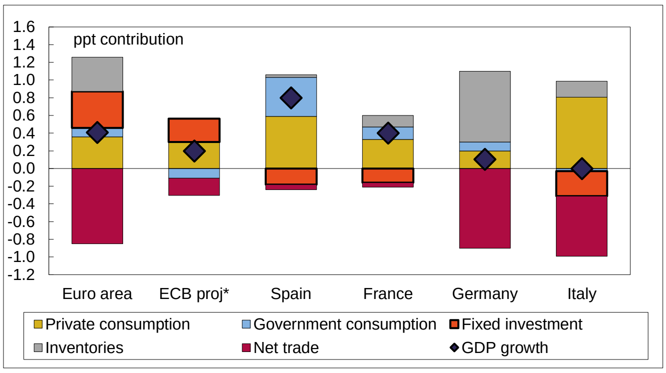
Thursday's Governing Council meeting aside, it looks set to be a relatively quiet week for euro area economic news. October's aggregate industrial production data (Friday) – arguably the highlight among next week's releases – should show some positive payback from September's weakness (-2.0%M/M). But the downside surprises to both German (-1.0%M/M) and French (-0.1%M/M) IP this week elevates the scenario that euro area production fell back further at the start of Q4. Ahead of the Governing Council meeting, policymakers will receive a more detailed assessment of price developments in the euro area with final German inflation estimates for November due on Tuesday. After the flash release signalled that headline inflation moved sideways in the euro area's largest member state last month, the final release should offer more encouragement that underlying inflation continues to soften. Notwithstanding the upward effects of energy-base effects to the headline measures, the final French and Spanish inflation estimates (Friday) should also reaffirm this more benign trend. Elsewhere, Monday's Sentix confidence survey will provide insights into investor sentiment in December.

UK

The week ahead in the UK

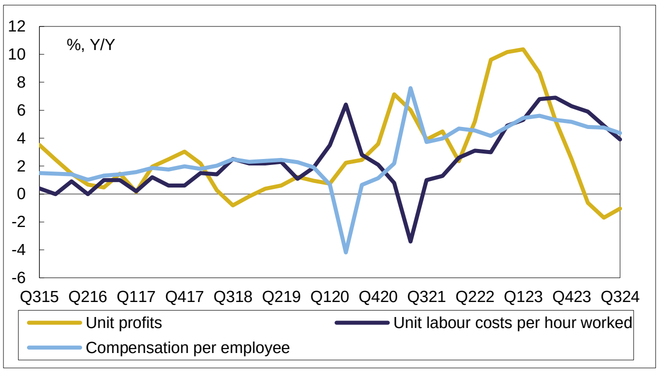
With the Bank of England's last monetary policy meeting of the year still a couple of weeks' away, it will be a relatively quiet week for UK economic news. The main release will be October's monthly GDP data (Friday), which will provide the first official signpost for Q4 growth after the first estimates for GDP last quarter surprised to the downside (0.1%Q/Q). A significant proportion of this weakness was apportioned to the negative contribution from inventories while final domestic demand remained relatively firm. But overall economic activity softened notably in September (-0.1%M/M). And softer retail sales (-0.7%M/M) and less optimistic PMIs data point to the likelihood of only a modest rebound in October (0.2%M/M) to maintain the three-month growth at just 0.1%3M/3M. Elsewhere, the week ahead will also bring December's GfK consumer confidence indices (Friday), while the BoE's quarterly consumer survey (also due Friday) will provide a timely update on consumers' inflation expectations. Following the budget-led upward revisions to headline inflation in the Bank's latest forecasts, now due to peak in Q325, policymakers will hope to see some confirmation that expectations remain well anchored. Finally, and after the Nationwide housing indices pointed towards a release of pre-budget pent-up activity and acceleration in home price growth in November, the RICS survey of surveyors (Thursday) will provide further update on housing market developments.

Euro area: Q/Q GDP growth & contributions in Q3



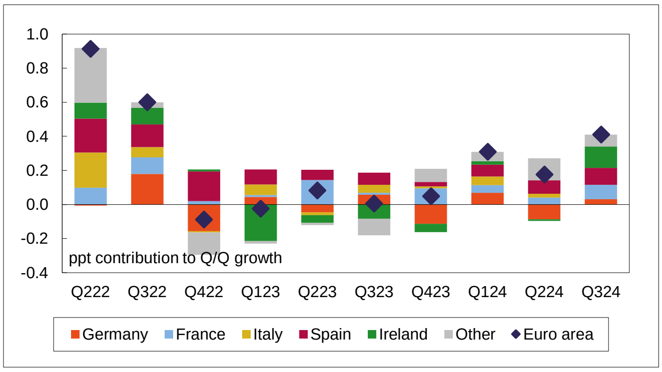
*ECB staff projections, September 2024
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Unit labour costs, profits & wages



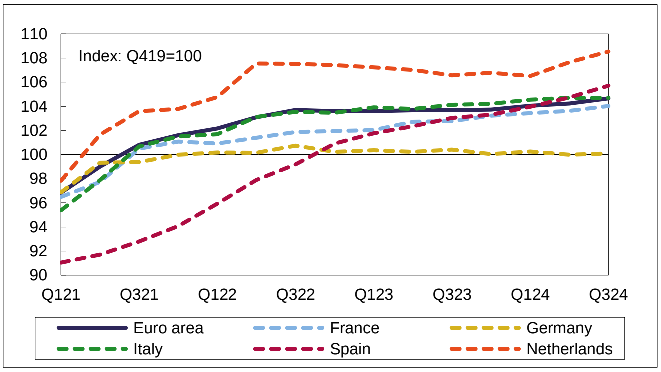
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Member state GDP growth contributions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP levels by member state



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on Tuesday 10 December 2024

Daiwa economic forecast

	2024 Q2	2024 Q3	2024 Q4	2025 Q1	2025 Q2	2025 Q3	2024	2025	2026
GDP	%, Q/Q						%, Y/Y		
Euro area	0.2	0.4	0.1	0.2	0.2	0.2	0.8	0.9	1.2
UK	0.5	0.1	0.2	0.3	0.3	0.3	0.9	1.1	1.3
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.5	2.2	2.3	2.0	1.8	1.8	2.4	1.9	1.9
Core HICP	2.8	2.8	2.7	2.3	1.8	1.6	2.8	1.9	1.8
UK									
Headline CPI	2.1	2.0	2.5	2.5	2.3	2.6	2.5	2.4	2.1
Core CPI	3.6	3.3	3.4	3.5	2.5	2.3	3.7	2.6	2.0
Monetary policy, %									
ECB									
Deposit Rate	3.75	3.50	3.00	2.50	2.25	2.00	3.00	2.00	2.00
Refi Rate	4.25	3.65	3.15	2.65	2.40	2.15	3.15	2.15	2.15
BoE									
Bank Rate	5.25	5.00	4.75	4.50	4.25	4.00	4.75	3.75	3.25

Source: Bloomberg, ECB, BoE 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	GDP – final estimate Q/Q% (Y/Y%)	Q3	**0.4 (0.9)**	*0.4 (0.9)*	0.2 (0.6)	-
	GDP – household consumption Q/Q%	Q3	**0.7**	0.6	-0.1	0.0
	GDP – government expenditure Q/Q%	Q3	**0.5**	0.5	0.6	1.2
	GDP – fixed investment Q/Q%	Q3	**2.0**	-0.5	-2.2	-2.5
	Final employment Q/Q% (Y/Y%)	Q3	**0.2 (1.0)**	*0.2 (1.0)*	0.1 (0.9)	-
Germany	Industrial production M/M% (Y/Y%)	Oct	**-1.0 (-4.5)**	1.0 (-3.3)	-2.5 (-4.6)	-2.0 (-4.3)
France	Trade balance €bn	Oct	**-7.7**	-	-8.3	-8.4

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases					
Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Monday 9 December 2024					
Euro area	09.30	Sentix investor confidence index	Dec	-12.3	-12.8
Tuesday 10 December 2024					
Germany	07.00	Final HICP (CPI) Y/Y%	Nov	*2.4 (2.2)*	2.4 (2.0)
Italy	09.00	Industrial production M/M% (Y/Y%)	Oct	-0.1 (-3.6)	-0.4 (-4.0)
Wednesday 11 December 2024					
- Nothing to report -					
Thursday 12 December 2024					
Euro area	13.15	ECB Deposit Rate (Refi Rate) %	Dec	*3.00 (3.15)*	3.25 (3.40)
UK	00.01	RICS house price balance	Nov	19	16
Friday 13 December 2024					
Euro area	10.00	Industrial production M/M% (Y/Y%)	Oct	-0.1 (-2.3)	-2.0 (-2.8)
Germany	07.00	Trade balance €bn	Oct	15.7	16.9
France	07.45	Final HICP (CPI) Y/Y%	Nov	*1.7 (1.3)*	1.6 (1.2)
	07.45	Wages – final estimate Q/Q%	Q3	*0.3*	0.6
Spain	08.00	Final HICP (CPI) Y/Y%	Nov	*2.4 (2.4)*	1.8 (1.8)
UK	00.01	GfK consumer confidence indicator	Dec	-18	-18
	07.00	Monthly GDP M/M% (3M/3M%)	Oct	0.1 (0.1)	-0.1 (0.2)
	07.00	Services output M/M% (3M/3M%)	Oct	0.1 (0.2)	0.0 (0.1)
	07.00	Industrial output M/M% (Y/Y%)	Oct	0.3 (0.2)	-0.5 (-1.8)
	07.00	Construction output M/M% (Y/Y%)	Oct	0.3 (0.0)	0.1 (-0.4)
	07.00	Trade (goods trade) balance £bn	Oct	-3.3 (-16.2)	-3.4 (-16.3)
	09.30	BoE/Ipsos household inflation expectations 1Y ahead Y/Y%	Nov	-	2.7

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions		
Country	GMT	Event / Auction
Monday 9 December 2024		
UK	00.01	KPMG/REC UK Report on Jobs for December
Tuesday 10 December 2024		
UK	10.00	Auction: to sell £1.5bn of 0.75% 2033 inflation-linked bonds
Wednesday 11 December 2024		
UK	10.00	Auction: to sell £4bn of 4.25% 2034 bonds
Thursday 12 December 2024		
Euro area	13.15	ECB monetary policy announcement
	13.45	ECB President Lagarde holds post Governing Council meeting press conference
Italy	10.00	Auction: to sell bonds*
Spain	09.30	Auction: to sell bonds*
Friday 13 December 2024		
Germany	10.00	Bundesbank to publish biannual economic forecasts

**Details to be announced. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs