# Euro wrap-up

## Overview

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- Bunds made losses as the ECB cut rates by 25bps and signalled that restrictive policy is unlikely to be maintained for long but failed to suggest that an accommodative stance might eventually be required.
- Gilts made more modest losses as a survey indicated a pickup in momentum in the residential property market.
- Friday will bring new data for UK GDP and euro area industrial production in October.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 2 12/26 | 2.012 | +0.069 |
| OBL 2½ 10/29 | 2.032 | +0.082 |
| DBR 2.6 08/34 | 2.203 | +0.078 |
| UKT 4⅛ 01/27 | 4.266 | +0.024 |
| UKT 4⅛ 07/29 | 4.177 | +0.049 |
| UKT 4¼ 07/34 | 4.360 | +0.046 |

*Change from close as at 5:00pm GMT.
Source: Bloomberg

## Euro area

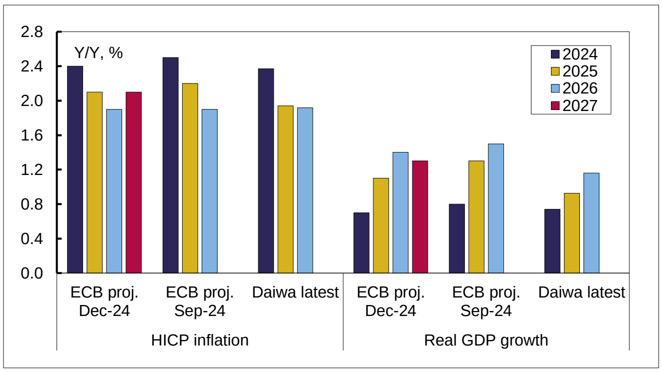
### ECB cuts rates again by 25bps & drops pledge to keep policy “restrictive for as long as necessary”

As expected, the ECB cut its key deposit rate by 25bps for the third successive policy meeting and fourth time since June. That took it to 3.00%, the lowest since May 2023. But as acknowledged by the Governing Council in its statement, that level remains restrictive. And while President Lagarde noted in her press conference that some members had proposed that the Council should consider a 50bp cut today, she added that the 25bp increment had been unanimously agreed, suggesting that conservatism and risk aversion continues to dominate thinking among the ECB’s policymakers. The statement also repeated that policy decisions would continue to be take on a meeting-by-meeting basis and remain data dependant, and that there remains no pre-determined path for rates going forward. Nevertheless, it was still somewhat more dovish than over recent months. In particular, the Governing Council no longer pledged to “keep policy rates sufficiently restrictive for as long as possible”. And Lagarde appeared to concede that the ongoing downward direction of travel for rates is now clear and also failed to rule out the possibility of a 50bp cut at the next meeting in January. But the pace of further easing and terminal rate will only be determined in due course as the evidence unfolds. Notably, while she recalled that past ECB studies had suggested that a neutral deposit rate might lie somewhere in the range of 1.75-2.50%, she added that the Governing Council had not recently discussed the matter. And even if updated analysis reaffirmed that wide range of estimates, it would still remain to be seen whether the monetary stance would merely be returned to neutral, or whether accommodative policy would eventually be implemented to prevent inflation undershooting the target over the medium term. Certainly, there is likely to be significant disagreement amongst members about where the terminal rate ought to eventually end up.

### Inflation projected to return to target in 2025, with core rate a touch below target by 2027

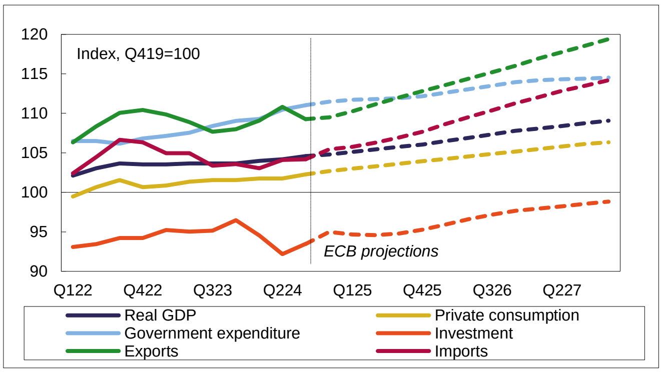
Appropriately, the Governing Council reiterated that disinflation remains well on track. And the policy statement noted for the first time this cycle that “most” underlying measures “suggest that inflation will settle at around the Governing Council’s 2% medium-term target on a sustained basis”, justifying a shift in policy stance towards neutral. Indeed, the staff’s projections for both headline and core inflation in the euro area were nudged slightly lower over most coming quarters through to mid-2026. Despite a slight pickup in the energy and food components, HICP inflation is now projected to “hover around the target” by the middle of 2025, averaging just 2.1%Y/Y in both Q2 and Q3 next year as services inflation moderates, before dropping to target by year-end and falling slightly below 2.0%Y/Y in 2026. That headline rate is projected to tick slightly higher in 2027 in part due to the introduction of the EU ETS2 carbon pricing scheme, which will cover emissions from building heating and transport fuels, adding to inflation of energy and other items. ECB staff judge that could add up to 0.4ppt to headline inflation that year. However, core inflation in 2027 is projected to fall to 1.9%Y/Y, remaining broadly consistent with the ECB’s target.

**Euro area: GDP & inflation projections compared**




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

**Euro area: GDP & components – ECB projection**




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

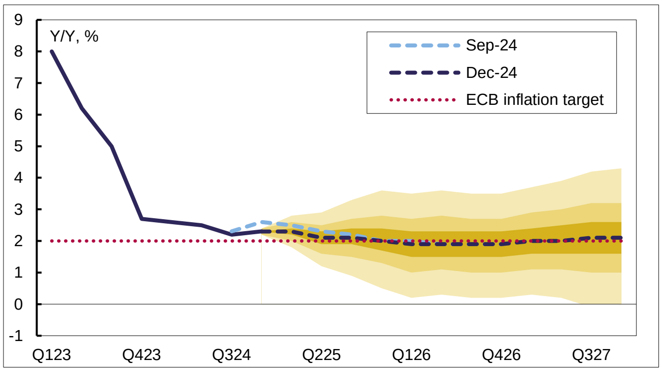
## ECB nudges down GDP outlook, downside risks suggest accommodative stance might be needed

While euro area GDP growth in Q3 was double the ECB's previous forecast at 0.4%Q/Q, the projections for the current quarter and Q125 were left unchanged at 0.2%Q/Q and 0.3%Q/Q respectively. And the staff still expect rising real incomes and the resilient labour market to support stronger household consumption over coming quarters, with the fading lagged effects of past monetary tightening also allowing for a gradual pick up in business capex. However, given recent downbeat survey indicators for both manufacturing and services, the ECB nudged lower its growth projection between Q2 and Q4 next year. So, its full-year growth projections were nudged modestly lower to 0.7%Y/Y in 2024, 1.1%Y/Y in 2025 and 1.4%Y/Y in 2026, with the first projection for 2027 (1.3%Y/Y) aligning with the ECB's view of potential growth. If economic outturns come in broadly in line with, or (as we expect) only a touch softer than its baseline forecast, then rates will likely be cut to neutral territory in the first half of next year, with a terminal rate of around 2.0% probably reached by Q325 at the latest. But, whether due to domestic sentiment and uncertainty, politics or geopolitics, the risks to GDP growth are skewed clearly to the downside suggesting no-negligible risks that inflation might undershoot the ECB's target over the medium term. And in the event that those downside risks crystallise in a significant way over coming quarters, the ECB should be expected to continue to ease policy into accommodative territory by the end of next year.

## The day ahead in the euro area

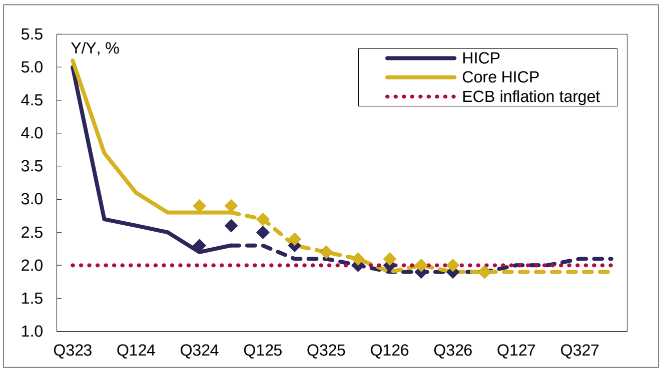
Aggregate industrial production in October will be the main data focus in the euro area tomorrow. After declining by a steep 2.0%M/M in September, Monday's bumper Irish IP results (+5.2%M/M) have raised the likelihood of a rebound in this month's euro area figures – albeit perhaps by no more than ½%M/M – as well as an upwards revision to September's result. Nonetheless, policymakers should look past the Irish distortion, focusing instead on the prevailing weakness in core euro area manufacturing output after German (-1.0%M/M), French and Italian (-0.1%M/M respectively) all slid at the start of Q4. Likewise, as tomorrow's final French and Spanish inflation data are expected to confirm that most of the uptick in November was driven by energy base effects, the focus in the underlying detail will be on the more persistent services components of inflation. The final estimates for French wage growth in Q3, barring major revisions, should confirm that pay pressures continued to soften in Q3. German trade data for October are also due tomorrow and are expected to report a second successive non-negligible monthly drop in exports.

### Euro area: HICP inflation – ECB projections*



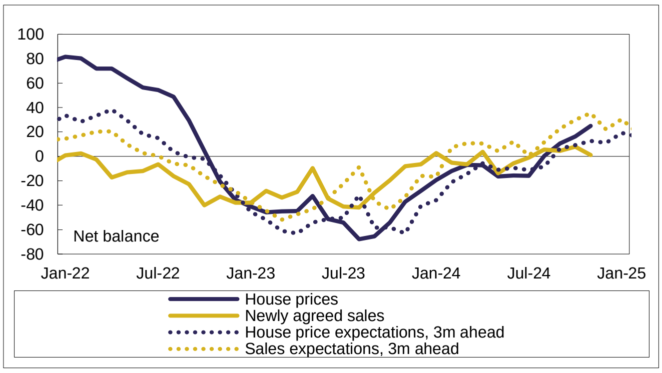

*Shaded areas denote 30%, 60% & 90% probabilities for HICP inflation, ECB Dec-24 projections. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: Inflation measures – ECB projections*



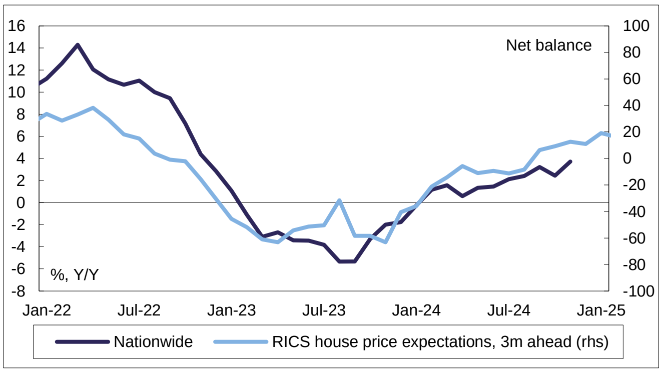

*Dashed lines show Dec-24 ECB staff projections; diamonds show Sep-24 staff projections. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: RICS residential market survey indices




Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Selected house price indicators




Source: Macrobond and Daiwa Capital Markets Europe Ltd.

# UK

## RICS survey points to firmer momentum in residential property market

Nationwide data reported last week that average home prices rose in November by 1.2%M/M, the most since April 2022, to be up 3.7%Y/Y, the strongest annual rate in two years. And today's RICS survey results provided further evidence that the residential property market continues to gain momentum. Tallying with the Nationwide data, the RICS national house price index rose in November for the fourth successive month to a net balance of +25%, the highest since late 2022. With real disposable income rising, new buyer enquiries continue to grow close to 3-year highs to point to a steady pickup in demand. As new selling instructions rose for a fifth successive month too, transactions are still expected to rise over the coming year despite reports of broadly flat sales in November. Meanwhile, demand in the letting market reportedly softened marginally. But supply of properties to let fell more significantly to maintain upwards pressure on rental prices.

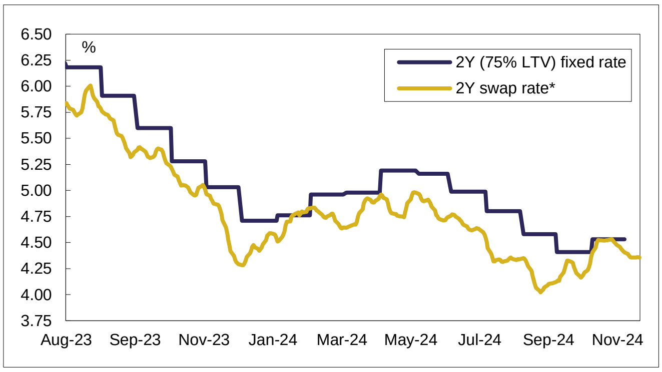
## House price expectations remain relatively firm despite recent uptick in mortgage rates

Looking ahead, surveyors' house price expectations for three (+16%) and twelve months ahead (+47%) remained above the respective long-run averages and near the top of the respective ranges of the past 2½ years to signal, if anything, the likelihood of a further pickup in the Nationwide price rate over coming months. However, they were a touch softer than in October, reportedly due to an uptick in available mortgage rates over recent weeks with OIS rates up significantly (e.g. about 40bps for 2Y maturities) from their mid-September lows. And the residential market trajectory will therefore continue to be influenced significantly by further shifts in interest rates to impact affordability, particularly for first-time buyers who in recent months have accounted for more than half of all new mortgages. However, the full impact of the increases in Bank Rate of the past few years has still not yet been passed through to all existing mortgagors. Despite market pricing of falling interest rates over the coming year, last month the BoE estimated that around half (4.4mn) of all mortgagors will have to refinance onto higher interest rates over the next three years, with the increase in monthly mortgage payments projected to rise by 22% (around £146). Only around a quarter of mortgagors – the largest share of whom borrow on variable rates – were judged likely to be able to refinance at lower rates over that period.

## The day ahead in the UK

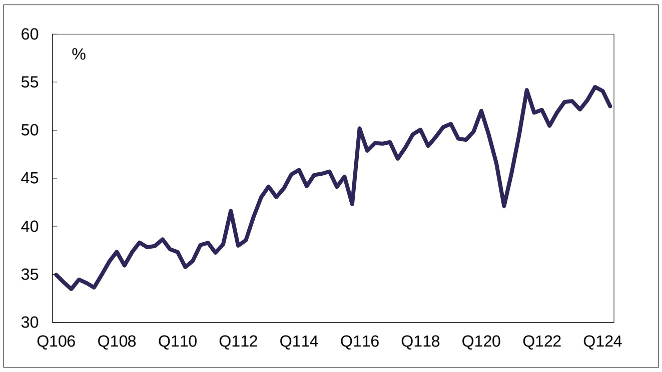
With the BoE's MPC due to convene next week, tomorrow's monthly GDP report will mark the start of a run of top-tier UK data releases in the build-up to Thursday's policy announcement. After the first estimates for quarterly GDP in Q3 surprised to the downside, with softer growth of 0.1%Q/Q attributed to a sizable negative contribution from inventories, October's monthly economic output release will provide a first official signpost for Q4. Activity finished Q3 on a downbeat note, edging down in September (-0.1%M/M). But softer retail sales (-0.7%M/M) and less optimistic PMIs imply that any rebound in October is likely to be modest. We expect growth of 0.2%M/M, which would maintain the three-month growth at just 0.1%3M/3M. Among Friday's other releases, policymakers will also look towards the BoE's quarterly consumer survey for some reassurance that expectations remain broadly target-consistent, after the BoE's latest DMP survey flagged a slight uptick in firms' CPI and output price expectations following October's budget announcements. Tomorrow will also bring December's GfK consumer sentiment survey results.

### UK: 2Y mortgage & swap rates*




**5-day moving averages.*
*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### UK: New mortgages – First-time buyer share




*Source: 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 | | ECB Deposit Rate (Refi Rate) % | Dec | **3.00 (3.15)** | *3.00 (3.15)* | 3.25 (3.40) | - |
| UK | | RICS house price balance | Nov | **25** | 19 | 16 | - |

**Auctions**

| Country | | Auction |
|---|---|---|
| Italy | | sold €3bn of 2.7% 2027 bonds at an average yield of 2.35% |
| | | sold €3bn of 3.15% 2031 bonds at an average yield of 2.92% |
| | | sold €1.5bn of 3.35% 2035 bonds at an average yield of 3.19% |
| | | sold €1bn of 4.3% 2054 bonds at an average yield of 3.94% |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Tomorrow's releases

**Economic data**

| Country | | GMT | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|---|
| Euro area | | 10.00 | Industrial production M/M% (Y/Y%) | Oct | 0.0 (-1.9) | -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 | -3.5 (-16.0) | -3.5 (-16.3) |
| | | 09.30 | BoE/Ipsos household inflation expectations 1Y ahead Y/Y% | Nov | - | 2.7 |

**Auctions and events**

| Country | | GMT | Event |
|---|---|---|---|
| Germany | | 10.00 | Bundesbank to publish biannual economic forecasts |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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