

Euro wrap-up

Overview

- While the Governor of the Bank of France broadly validated market pricing of several ECB rate cuts in 2025, and euro area IP stagnated and German exports fell sharply in October, Bunds followed the global trend lower as President Macron nominated centrist Francois Bayrou as new French PM.
- As UK consumer confidence rose to a four-month high, Gilts made losses despite an unexpected second successive monthly drop in GDP in October.
- The coming week will bring the flash December PMIs and updates on UK inflation and wages ahead of the latest BoE interest rates announcement.

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Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.047	+0.036
OBL 2½ 10/29	2.071	+0.039
DBR 2.6 08/34	2.246	+0.043
UKT 4½ 01/27	4.293	+0.027
UKT 4½ 07/29	4.226	+0.049
UKT 4½ 07/34	4.402	+0.042

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

Euro area

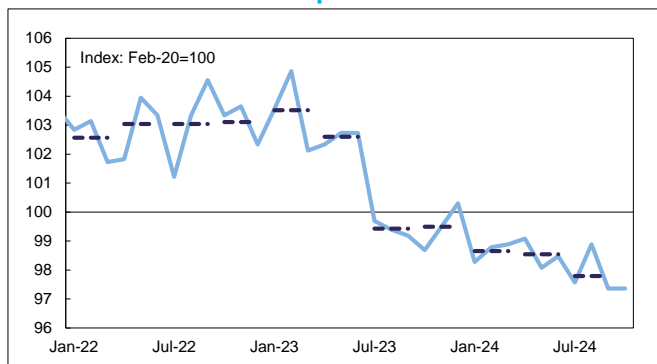
Euro area industrial production stagnates in October despite boost from Ireland

After declining sharply in September, euro area industrial production stagnated at the start of Q4. This left it at its joint-lowest level since September 2020 and July 2016 outside of the initial Covid-19 slump, almost 4% below the pre-pandemic benchmark in February 2020 and some 0.6% below the Q3 average. In the absence of the surge from Ireland (5.7%M/M), euro area industrial output would have declined some ½%M/M in October, led lower by the weather-driven drop in Germany (-1.1%M/M) and steep fall in Belgium (-6.2%M/M). Given the lack of wind in Germany and certain other member states, energy production fell 1.9%M/M to a 13-month low, some 12½% below the pre-pandemic level in February 2020. Output of consumer goods also declined sharply (-2.2%M/M) to a four-month low, led by a drop in pharmaceuticals (-5.9%M/M). Production of basic metals fell to the lowest level since the global financial crisis outside of the initial pandemic slump, while intermediate goods moved sideways at the joint-lowest level since June 2020. But despite a further fall in autos and general machinery, output of capital goods (1.7%M/M) was boosted by a partial rebound in electrical machinery and ICT equipment. Overall, manufacturing output eked out a very modest increase (0.1%M/M), albeit leaving it still more than ½% below the Q3 average. While the Commission survey reported an improvement in the production trend in November – with the respective index up to a six-month high – it continued to flag a lack of goods demand within the region and from overseas. And with ongoing structural adjustment required in Germany, intense competition not least from China, and threats of new tariffs on US imports in 2025, we continue to expect euro area industrial output to remain subdued well into the New Year.

German exports decline to a more than 2½-year low in October amid slump in shipments to US

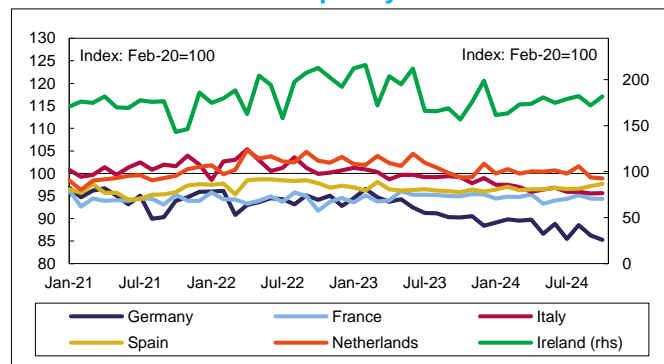
Tallying with the weakening trend in industrial output, today's German goods trade figures further illustrated the persisting challenges facing manufacturers at the start of Q4. In particular, the seasonally-adjusted trade surplus narrowed for a fourth month out of the past five in October, by €3.5bn to €13.4bn, the lowest in almost two years and €11.5bn below January's record high. The deterioration reflected a second-successive decline in the value of exports, by 2.8%M/M, the most since last December. While the drop in exports was broad-based, it was led by a marked fall in shipments to the US (-14.2%M/M). While this in part reflected payback for the increase in August and September – up a cumulative 9% – the level was the lowest since March 2022, suggesting no signs of front-loading in shipments ahead of potential tariff hikes next year. Exports to China also fell a chunky 3.8%M/M to the lowest level since March 2020. Total export values in October were the lowest since January 2022 and more than 3½% below the Q3 average. And with export prices having risen 0.3%M/M in October, the decline in export volumes appears to have been even steeper than the drop in values. Moreover, as the ifo survey signalled an even steeper pace of contraction in new foreign orders in November, goods exports look likely to remain a drag on German GDP growth in Q4 for a second successive quarter.

Euro area: Industrial output*



*Dashed dark blue lines represent quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial output by member state

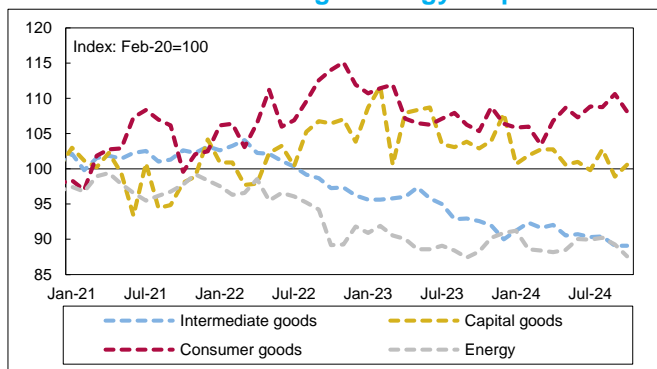


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

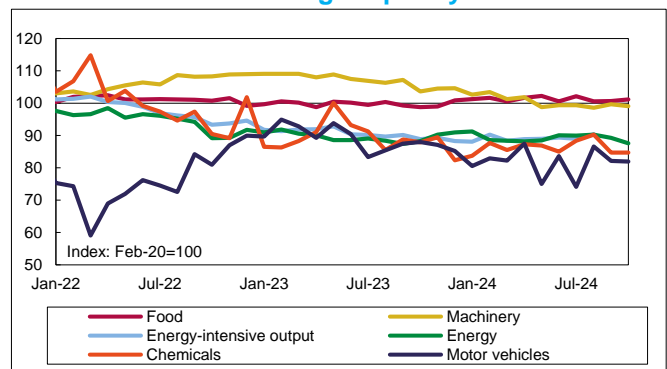
With the ECB gradually becoming more alert to the downside risks to the euro area’s economic outlook, to the extent that French Governor Villeroy de Galhau today suggested that he was “rather comfortable” with current market pricing of several rate cuts next year, the coming week’s business survey results will likely be of greatest interest, starting with December’s flash PMIs (Monday). We expect the euro area PMIs to remain broadly consistent with stagnation at best towards end Q4 after the composite index fell 1.7pts to a 10-month low (48.3) as a marked softening in services added to the protracted weakness in the manufacturing sector. Given the potential impact of the festive season on the survey’s sample, December’s results could be subject to a greater-than-normal dose of random volatility. So, as is often the case, the PMIs will need to be considered alongside business surveys from across the member states. The December German ifo (Tuesday) and French INSEE business surveys (Thursday) will be of especially close interest as complements to the PMIs. Friday will also bring the European Commission’s preliminary consumer confidence indicator for December, which fell back sharply last month – from a more than 2½-year high to a 5-month low (of -13.7) – in response to rising political uncertainty in France and Germany and concerns about events in the US. The German GfK consumer confidence survey (Thursday) should provide a guide as to whether the euro area figure will resume its upward trend or remain subdued. The ZEW investor sentiment survey (Tuesday) will offer another signpost for confidence in Germany.

Euro area: Manufacturing & energy output



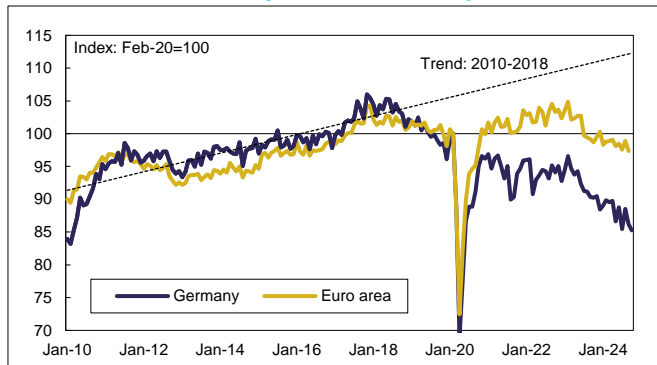
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output by subsector



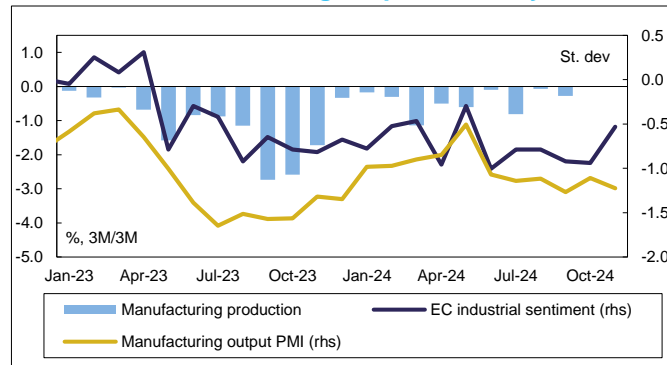
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area & Germany: Industrial output



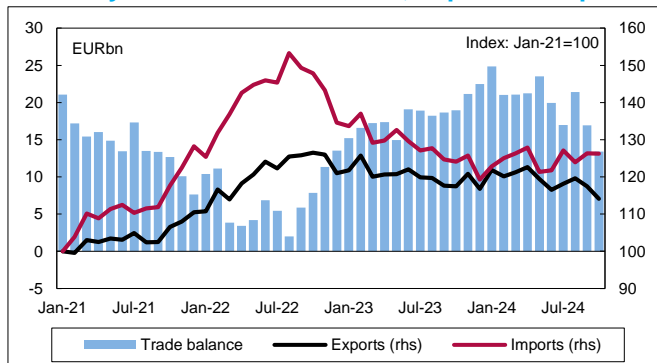
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output & survey indices



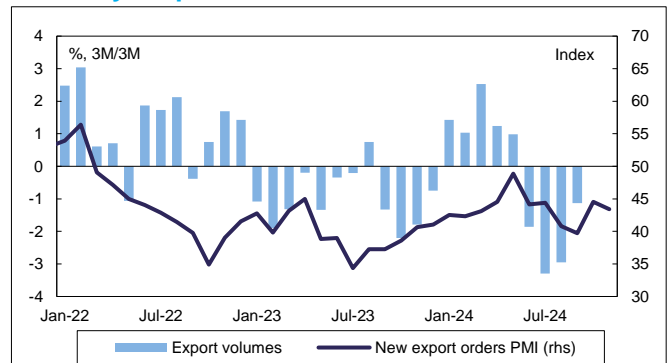
Source: EC, S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Goods trade balance, exports & imports*



*Seasonally-adjusted values. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Export volumes & orders



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

Meanwhile, the full detail of November's euro area inflation data (Wednesday) should offer further reassurance that the disinflationary trend in the euro area remains on track. ECB President Lagarde commented in Thursday's post-policy meeting press conference that further evidence of moderating inflation in more persistent categories – particularly services – would provide additional confidence to the Governing Council of the likelihood of a sustained return to target. Although the flash release predictably reported that headline inflation was driven back above target last month (2.3%Y/Y), underlying inflation measures were likely steady. Policymakers should also take comfort in the final estimates of labour costs and job vacancies in Q3 (Monday) – the latter of which, according to the flash release, fell to a more than 3-year low – for signs of gradually loosening conditions in the labour market. Furthermore, November's producer price data for Germany, France and Italy (Friday) would seem unlikely to flag a significant increase in input costs.

UK

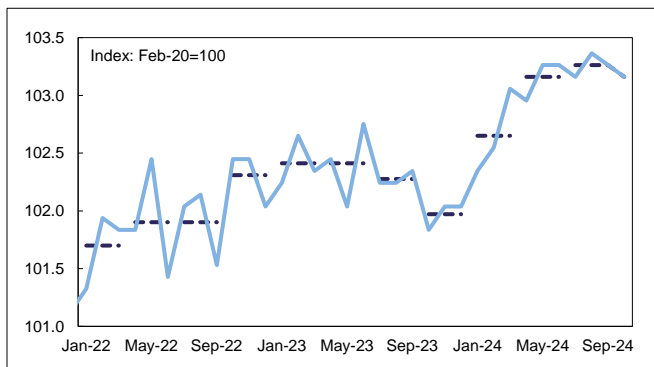
GDP unexpectedly declines at start of Q4 to raise outside possibility of pre-Xmas cut

Today's UK economic activity figures disappointed once again to raise the outside possibility of a BoE rate cut next Thursday, but only if incoming data – including the flash December PMIs and November inflation report – also surprise on the downside ahead of the MPC meeting. Contrary to the consensus expectation of a return to modest growth in October, GDP contracted 0.1%M/M for the second month in row, and the weakness was broad-based. Services output was flat for a second successive month, weighed by consumer-facing activities, such as retail, restaurants and pubs, arts and entertainments, which collectively declined 0.6%M/M. Due to sharp drops in chemicals, pharmaceuticals and machinery and equipment, manufacturing output declined 0.6%M/M in October after falling 1.0%M/M the prior month. Mining and quarrying dropped a steep 3.1%M/M to offset a pickup in utilities. And construction output more than fully reversed September's modest rise, falling 0.4%M/M at the start of Q4 due to a sharp pull-back in private housing repair and maintenance, which until the start of this year had been the principal source of growth in the sector. With respect to trade, goods export volumes (excluding precious metals) fell a steep 2.6%M/M due to particular weakness in shipments beyond the EU, while goods imports rose 2.9%M/M. So, although services export volumes rose 2.5%M/M while imports fell 2.0%M/M, net trade appears to have continued to weigh on GDP growth at the start of Q4.

Uncertainty surrounding end-October Budget announcement likely weighed at start of Q4

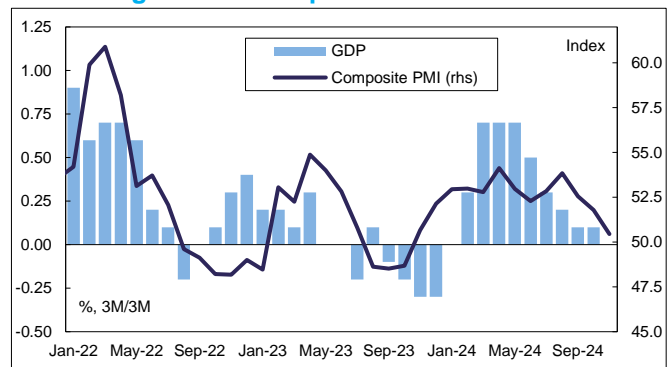
The ONS reported anecdotal evidence that uncertainty ahead of the government's Budget announcement on 30 October hit turnover in several sectors, including manufacturing, retail and professional services, as consumers and businesses alike refrained from spending. That tallies with findings from various sentiment survey indices, such as the headline GfK consumer

UK: GDP level*



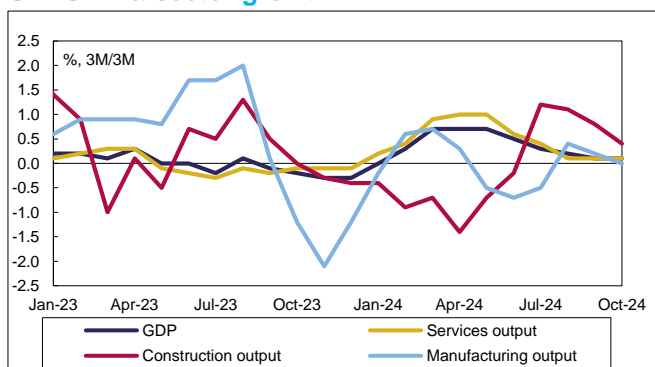
*Dashed dark blue line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & composite PMI



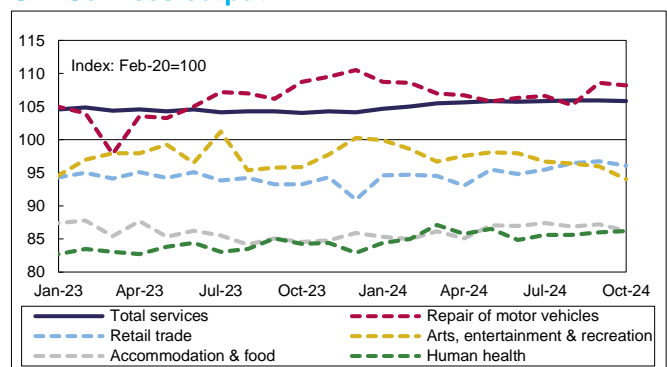
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP & sector growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

confidence index which dropped to a seven-month low that month. However, the ONS also suggested that firms in certain other sectors, including legal, accounting and real estate services, had brought forward activity to October in anticipation of the various policy announcements. So, the net effect of the timing of the Budget on GDP that month was probably relatively modest. As such, any positive payback in economic output in November will probably be small too.

Downbeat communication & concerns about fiscal policy hit growth momentum since the spring

The malaise in UK economic output now appears far too entrenched for the soft reading in October to be explained merely by the timing of the government's fiscal policy announcement. Repeatedly negative communications from government ministers over the summer undoubtedly heightened concerns about the economic outlook and state of the public finances, extinguishing any immediate post-election feelgood factor. Fueling dissatisfaction in advance over possible tax hikes to fund additional (arguably justifiable) public expenditure, the new administration appears to have arrested underlying growth momentum. So, structural challenges, including past underinvestment and Brexit-related impediments to trade, have now been compounded by cyclical weakness amid downbeat economic sentiment.

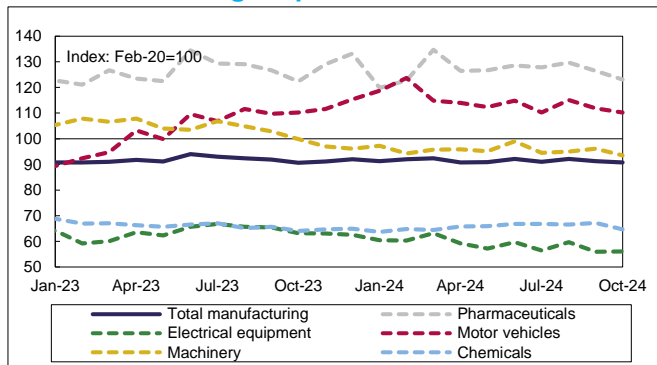
GDP likely to undershoot BoE projection again in Q4 despite modest bounce in consumer sentiment

Admittedly, with businesses rather than households having eventually borne the brunt of Budget revenue-raising measures, the GfK consumer confidence index edged up for a second successive month in December to a four-month high. And the climate for making major purchases was steady this month to match the best level since August. Nevertheless, both indicators remain well below their long-run averages and at levels unlikely to reboot underlying growth momentum. Indeed, the small drop in GDP in October left it up just 0.1%3M/3M, matching the rate in Q3, which fell a touch short of the BoE's projection (0.2%Q/Q). Three-month growth in services was similarly just 0.1%3M/3M in October, with declining production (-0.3%3M/3M) offsetting expansion in construction (0.4%3M/3M). And as the level of GDP was still slightly below the Q3 average, the chances that growth in Q4 will match the BoE's projection of 0.3%Q/Q now appear minimal. Indeed, economic output in October was still below the level in May and just 0.1% above the level seven months earlier. So, the underlying trend in economic activity now appears to be barely better than sideways.

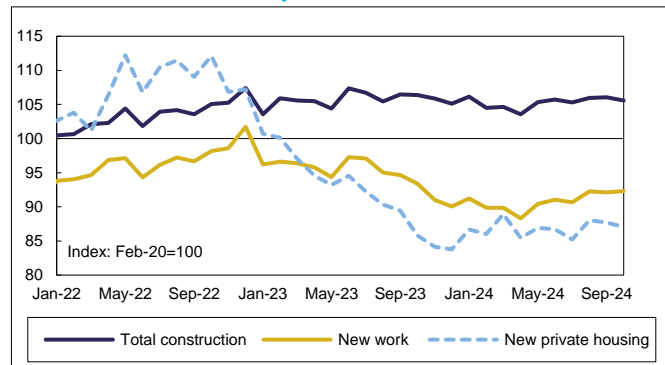
BoE policy response will depend on data due in the coming week

With GDP growth momentum appearing softer than it had anticipated, the coming week's monetary policy meeting provides a timely opportunity for the BoE to take stock and decide whether to respond. Assuming no further significant downside surprises in the data due in the coming week, however, we share the market consensus that Bank Rate will be left unchanged, at 4.75%. If so, the MPC would likely conclude that the GDP forecast error will not be sufficient to have a

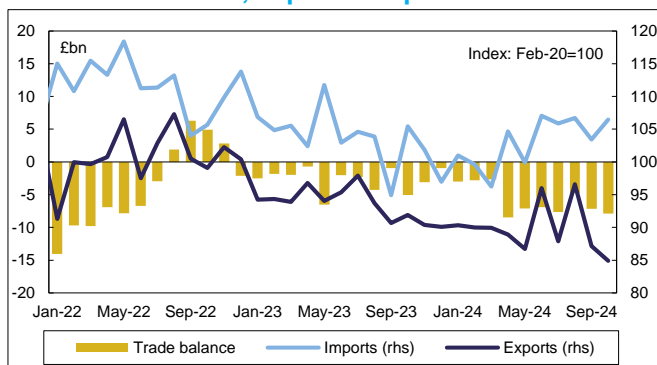
UK: Manufacturing output



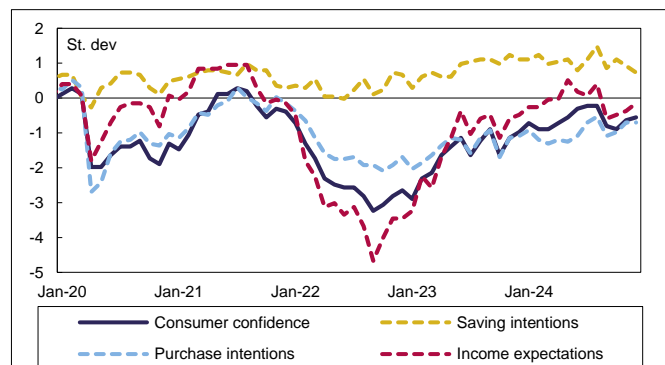
UK: Construction output



UK: Trade balance, export & import volumes



UK: Consumer confidence



material impact on its baseline inflation outlook. That projection was conditioned on four 25bp reductions in rates over the coming year, and foresaw inflation remaining around 2½%Y/Y over coming quarters before returning back to the 2.0% target by mid-2027. In part, that profile reflected the expectation that fiscal policy will boost both GDP and inflation over coming quarters, with the response of pay and prices to the Budget's increase in employer National Insurance Contributions an important source of uncertainty.

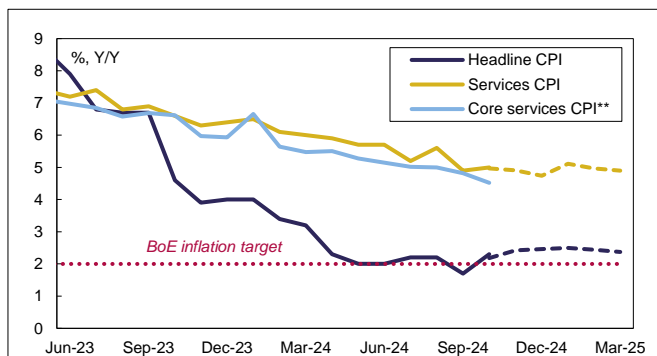
Majority of MPC likely to back unchanged rates in absence of further downside data surprises

Recent comments from Governor Bailey and several other MPC members have seemingly validated that four quarter-point rate cut path as the most likely scenario to unfold over the coming year. And unless new data persuade them otherwise, despite somewhat better-than-expected progress towards disinflation as well as mounting downside risks to the economic outlook, the persistence of services inflation and uncertainties surrounding labour market dynamics would seem likely to persuade the majority of MPC members to vote to leave policy unchanged this month. That might only be due to concerns that inflation persistence could – as suggested recently by Deputy Governor Lombardelli – “eventually require a more costly monetary policy response”. But, in the absence of downside surprises in the coming week's dataflow, we expect an 8-to-1 vote in favour of keeping rates steady – with perhaps only uber-dove Dhingra dissenting in favour of a reduction to 4.50%, and maybe only an outside chance that she will be joined by new external member Taylor or Deputy Governor Ramsden. Nevertheless, as the BoE's monetary stance is still significantly restrictive, weighing on economic output, and recent CPI data suggest that price-setting behaviour has normalized significantly to raise the likelihood that the MPC's more dovish alternative scenario will eventually unfold, we think the risks of inflation persistence are now overdone and would be sympathetic to a rate cut on Thursday.

Flash PMIs may signal further weakness but inflation & wages may be too strong for MPC's comfort

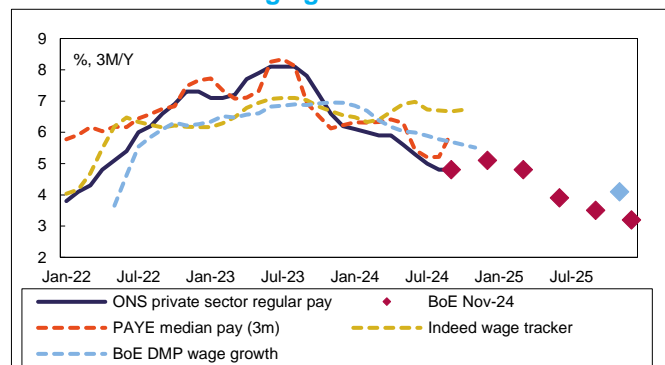
Further downside surprises in the coming week's data-flow might yet persuade a majority of MPC members that its baseline projection exaggerates the upside risks to the inflation outlook. After declining in November to a 14-month low of 50.5 consistent with stagnation, the flash composite PMI (Monday) would strengthen the likelihood of a rate cut if it fell significantly below 50. A big downwards surprise in November's CPI data (Wednesday) would be even more consequential. Diminishing energy base effects are expected to lead headline inflation higher in the coming months, with the BoE forecasting headline inflation to rise 0.1ppt to 2.4%Y/Y in November. In part due to higher petrol prices, we see the risks to that figure as skewed to the upside. But services inflation is expected to be broadly more stable, and the BoE projected a marginal softening in November, down 0.1ppt to 4.9%Y/Y. Meanwhile, the prospects of a significant moderation in private sector wage growth (Tuesday) appear relatively slim. After private sector regular pay growth moved sideways (4.8%3M/Y) in September, the strength of October's PAYE data (6.3%3M/Y) flags the potential for a moderate increase in October's ONS wage data, broadly in line with the BoE's projection. Admittedly, following the monetary policy announcement, November's retail sales data (Friday) are expected to flag a downturn in sales volumes in the lead up to Christmas. But, whilst consistent with downbeat surveys, weakness in November's figures downturn would be primarily attributed to the Black Friday discounting period falling into December's sampling period this year.

UK: Headline & services CPI inflation*












*Dashed lines are BoE projections from November MPR. **Excluding indexed and volatile components, rents & package holidays/ Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measures of wage growth








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

Daiwa economic forecasts

	2024			2025			2024	2025	2026
	Q2	Q3	Q4	Q1	Q2	Q3			
GDP	%, Q/Q						%, Y/Y		
Euro area 	0.2	0.4	0.1	0.2	0.2	0.2	0.7	0.9	1.2
UK 	0.5	0.1	0.1	0.2	0.3	0.3	0.8	0.9	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/ <i>Daiwa forecast</i>	Previous	Revised	
Euro area 	Industrial production M/M% (Y/Y%)	Oct	0.0 (-1.2)	0.0 (-1.9)	-2.0 (-2.8)	-1.5 (-2.2)	
Germany 	Trade balance €bn	Oct	13.4	15.7	16.9	-	
France 	Final HICP (CPI) Y/Y%	Nov	1.7 (1.3)	<u>1.7 (1.3)</u>	1.6 (1.2)	-	
	Wages – final estimate Q/Q%	Q3	0.4	<u>0.3</u>	0.6	-	
Spain 	Final HICP (CPI) Y/Y%	Nov	2.4 (2.4)	<u>2.4 (2.4)</u>	1.8 (1.8)	-	
UK 	Monthly GDP M/M% (3M/3M%)	Oct	-0.1 (0.1)	0.1 (0.1)	-0.1 (0.2)	-	
	Services output M/M% (3M/3M%)	Oct	0.0 (0.1)	0.1 (0.2)	0.0 (0.1)	-	
	Industrial output M/M% (Y/Y%)	Oct	-0.6 (-0.7)	0.3 (0.2)	-0.5 (-1.8)	-	
	Construction output M/M% (Y/Y%)	Oct	-0.4 (-0.7)	0.3 (0.0)	0.1 (-0.4)	-	
	Trade (goods trade) balance £bn	Oct	-3.7 (-19.0)	-3.5 (-16.0)	-3.5 (-16.3)	-	
	BoE/Ipsos household inflation expectations 1Y ahead Y/Y%	Nov	3.0	-	2.7	-	
	GfK consumer confidence indicator	Dec	-17	-18	-18	-	
Auctions							
Country	Auction						
- Nothing to report -							






Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Monday 16 December 2024						
Euro area		09.00	Preliminary manufacturing (services) PMI	Dec	45.3 (49.5)	45.2 (49.5)
		09.00	Preliminary composite PMI	Dec	48.2	48.3
		10.00	Labour costs Y/Y%	Q3	<u>4.6</u>	5.0
		10.00	Job vacancy rate %	Q3	<u>2.5</u>	2.6
Germany		08.30	Preliminary manufacturing (services) PMI	Dec	43.1 (49.4)	43.0 (49.3)
		08.30	Preliminary composite PMI	Dec	47.5	47.2
France		08.30	Preliminary manufacturing (services) PMI	Dec	43.1 (47.0)	43.1 (46.9)
		08.30	Preliminary composite PMI	Dec	46.0	45.9
Italy		10.00	Final HICP (CPI) Y/Y%	Nov	<u>1.6 (1.4)</u>	1.0 (0.9)
UK		00.01	Rightmove house prices M/M% (Y/Y%)	Dec	-	-1.4 (1.2)
		09.30	Preliminary manufacturing (services) PMI	Dec	48.5 (51.0)	48.0 (50.8)
		09.30	Preliminary composite PMI	Dec	50.6	50.5
Tuesday 17 December 2024						
Euro area		10.00	Trade balance €bn	Oct	12.0	13.6
Germany		09.00	ifo business climate indicator	Dec	85.5	85.7
		09.00	ifo current assessment (expectations) indicator	Dec	84.0 (87.5)	84.3 (87.2)
		10.00	ZEW investor survey – current situation (expectations) balance %	Dec	-93.0 (6.5)	-91.4 (7.4)
UK		07.00	Average wages (excluding bonuses) 3M/Y%	Oct	4.7 (5.0)	4.3 (4.8)
		07.00	Unemployment rate 3M%	Oct	4.3	4.3
		07.00	Employment 3M/3M change 000s	Oct	25	220
		07.00	Payrolled employees M/M change 000s	Nov	-10	-5
		07.00	Claimant count rate % (change 000s)	Nov	-	4.7 (26.7)
Wednesday 18 December 2024						
Euro area		10.00	Final headline (core) HICP Y/Y%	Nov	<u>2.3 (2.7)</u>	2.0 (2.7)
		10.00	Construction output M/M% (Y/Y%)	Oct	-	-0.1 (-1.6)
UK		07.00	CPI (core CPI) Y/Y%	Nov	<u>2.6 (3.6)</u>	2.3 (3.3)
		07.00	PPI – output (input) prices Y/Y%	Nov	-0.6 (-1.6)	-0.8 (-2.3)
		09.30	House price index Y/Y%	Oct	-	2.9
		11.00	CBI industrial trends survey – total orders (selling prices) balance %	Dec	-22 (-)	-19 (11)
Thursday 19 December 2024						
Euro area		05.00	New car registrations Y/Y%	Nov	-	-0.3
		09.00	Current account balance €bn	Oct	-	37.0
Germany		07.00	GfK consumer confidence indicator	Jan	-23.3	-23.3
France		07.45	INSEE business (manufacturing) confidence indicator	Dec	96 (97)	96 (97)
UK		12.00	BoE Bank Rate %	Dec	<u>4.75</u>	4.75
Friday 20 December 2024						
Euro area		15.00	Preliminary Commission consumer confidence indicator	Dec	-14.0	-13.7
Germany		07.00	PPI Y/Y%	Nov	-0.3	-1.1
France		07.45	PPI Y/Y%	Nov	-	-5.7
		-	Retail sales Y/Y%	Nov	-	-0.2
Italy		09.00	ISTAT consumer confidence indicator	Dec	97.0	96.6
		09.00	ISTAT business (manufacturing) confidence indicator	Dec	-	93.1 (86.5)
UK		11.00	PPI Y/Y%	Nov	-	-3.8
		07.00	Retail sales – including auto fuel M/M% (Y/Y%)	Nov	<u>-0.5 (0.5)</u>	-0.7 (2.4)
		07.00	Retail sales – excluding auto fuel M/M% (Y/Y%)	Nov	<u>-0.5 (0.7)</u>	-0.9 (2.0)
		07.00	Public sector net borrowing £bn	Nov	13.8	17.4
		11.00	CBI distributive trades survey – reported sales volumes %	Dec	-14	-18

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 16 December 2024		
Euro area	 08.15	ECB President Lagarde delivers keynote speech and appears on panel at a conference in Vilnius
	 16.30	ECB Executive Board Member Schnabel to deliver speech at CEPR Paris Symposium
Tuesday 17 December 2024		
UK	 10.00	Auction: to sell £3.75bn of 4.125% 2029 bonds
Wednesday 18 December 2024		
Euro area	 09.00	ECB Chief Economist Lane participates in a fireside chat with MNI
Thursday 19 December 2024		
UK	 12.00	BoE monetary policy announcement and minutes to be published
Friday 20 December 2024		
- Nothing to report -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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