

Euro wrap-up

Overview

- Bunds made very modest gains at the longer end of the curve despite a very weak German ifo business survey and a drop in the euro area trade surplus to a 15-month low.
- Gilts made big losses as UK private sector pay growth accelerated ahead of expectations.
- Wednesday will bring updates on UK and euro area inflation in November.

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Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.044	+0.001
OBL 2½ 10/29	2.063	-0.004
DBR 2.6 08/34	2.230	-0.014
UKT 4½ 01/27	4.446	+0.099
UKT 4½ 07/29	4.369	+0.092
UKT 4½ 07/34	4.523	+0.084

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

Source: Bloomberg

Euro area

Ifo survey ends year on a sour note as headline index drops to lowest since 1st wave of pandemic

Contrasting the modest uptick in the flash [German composite PMI](#) in December, today's ifo survey pointed to further deterioration in economic conditions at the end of the year. Indeed, the headline ifo business climate index ended the year on a sour note, dropping almost 1.0pt to 84.7, the lowest since the first wave of pandemic and a level only otherwise rivalled during the global financial crisis. The main culprit was a worsening of expectations for the coming six months, the index for which fell more than 2½pts – the most in 19 months – to an 11-month low. In contrast, the index for current conditions rose almost 1pt, but failed fully to reverse the decline in November to remain close to the bottom of the range of the past four years. Overall, the survey indicators remain consistent with a drop in German GDP in Q4.

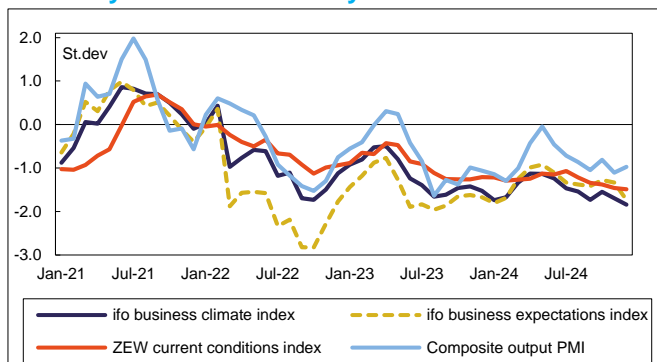
Conditions in manufacturing continue to deteriorate

Among the various sectors, the ifo survey tallied with the PMIs to suggest that manufacturing conditions continue to worsen and are dire by historical standards. Indeed, with both current conditions and expectations among factory firms judged to have deteriorated, and the production outlook revised down, the sector's business climate was also judged to be the worst since the first wave of Covid 19 and the global financial crisis before that. With certain exceptions (e.g. in hospitality), services were more pessimistic too, not least due to challenges among those subsectors (e.g. logistics and transport) whose fortunes are more closely related to those of manufacturers. Firms in wholesale and retail trade were also more downbeat. And while construction firms judged current conditions to have improved somewhat, they were also more pessimistic about the outlook.

German GDP growth likely to remain elusive in 2025

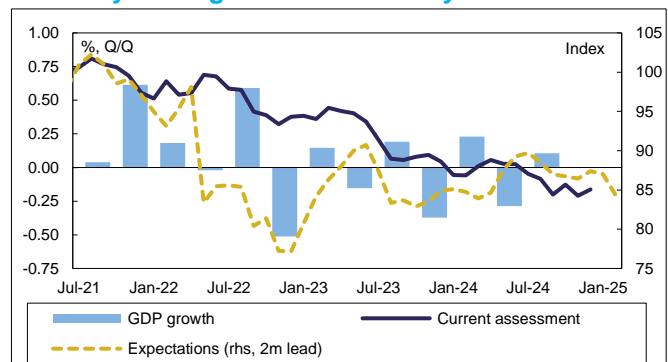
Admittedly, today's ZEW survey results point to a slight pickup in investor expectations for the coming six months. But that might in part simply reflect perceptions that things can't get more worse, with more than 93% of survey recipients – the highest share since the first wave of pandemic – judging conditions this month to be bad. Last week, the Bundesbank revised down its German GDP growth projection for 2025 by a chunky 0.9ppt to just 0.2%Y/Y. Given intensified competition at home and abroad, the risk of new US tariff barriers, and the persistence of high energy prices, the existential crisis in the manufacturing sector will certainly persist. The labour market now appears to be softening too. And with a more supportive fiscal policy unlikely to be forthcoming until late 2025 at the earliest, we fear that the Bundesbank's projection remains overly optimistic with growth likely to remain elusive despite the likelihood of further monetary easing.

Germany: Sentiment survey indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: GDP growth & ifo survey indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

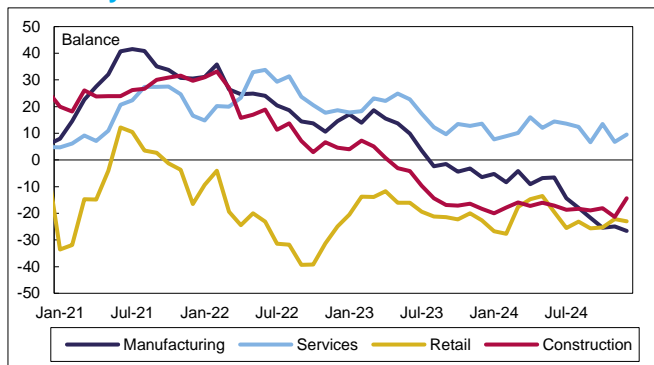
Although the [flash estimates](#) of euro area inflation in November showed inflation rising back above target to a four-month high of 2.3%Y/Y, tomorrow's detail should offer policymakers further reassurance that underlying inflation continues to moderate. Indeed, the majority of the increase in headline inflation last month was attributable to a smaller drag from energy prices. Core inflation was steady at 2.7%Y/Y. And importantly, services inflation fell back slightly as prices in that sector declined in seasonally adjusted terms for the first time in 3½ years. As ECB President Lagarde suggested during her post-Governing Council press conference, further evidence of a cooling of a range of measures of underlying inflation should provide policymakers with confidence to continue cutting rates at successive meetings. Chief Economist Lane, who is due to participate in a webinar on ECB policy tomorrow, might also be expected to comment on his interpretation of the data, and the scope they provide for ongoing monetary easing to a neutral stance or beyond.

UK

Pay growth exceeds expectations to reduce chance of surprise rate cut this week

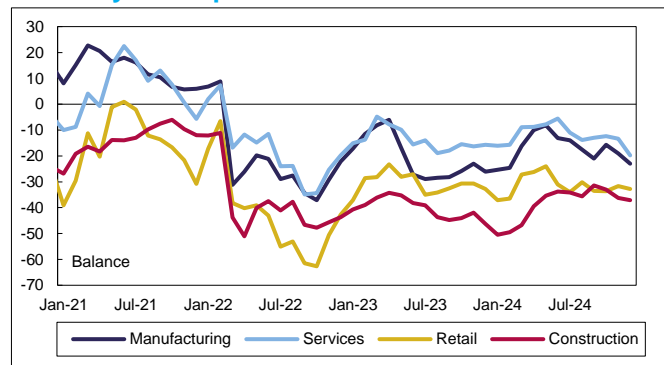
While Friday's [October GDP figures](#) and yesterday's [flash December PMIs](#) illustrated why easier monetary policy would be highly desirable to reboot UK economic growth, today's labour market data provided one reminder of why the BoE is unlikely to cut rates this week. In particular, wage growth almost certainly remains too strong for the comfort of the majority of MPC members. Private sector regular pay, which is monitored most closely by the BoE, accelerated in the three months to October, with growth up 0.5ppt to a five-month high of 5.4%3M/Y. While the jump in wage growth was greater than expected, it was consistent with the HMRC's PAYE median pay data published last month. Base effects and revisions played a role in the pickup in the annual rate of pay growth. But momentum was also firmer, with private regular wages rising 5.5%3M/3M annualised, up 0.8ppt from September, with a strengthening in finance, hospitality, other services and construction. As such, private regular pay looks at risk of exceeding the BoE's projection of 5.1%3M/Y in Q4. And, of course, it remains a long way above rates that would normally be considered consistent with the sustained achievement of the inflation target over the medium term. Adding bonuses and the public sector to the calculation, total pay growth was also significantly stronger in the three months to October, rising 0.8ppt to 5.2%3M/Y, also a five-month high. Real total pay was up 2.2%3M/Y, a five-month high and double the average growth rate in the five years before the pandemic, which the BoE would expect to support consumer spending.

Germany: ifo current situation indices



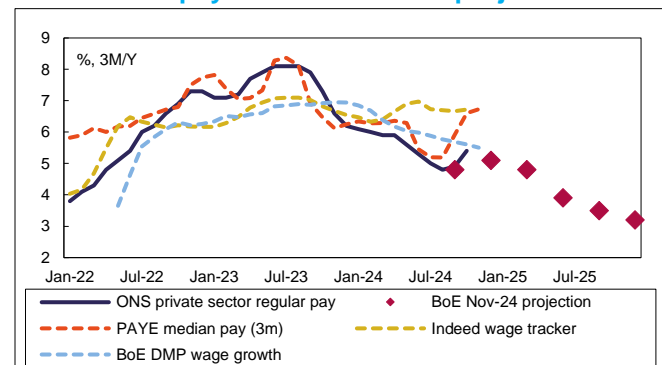
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ifo expectations indices



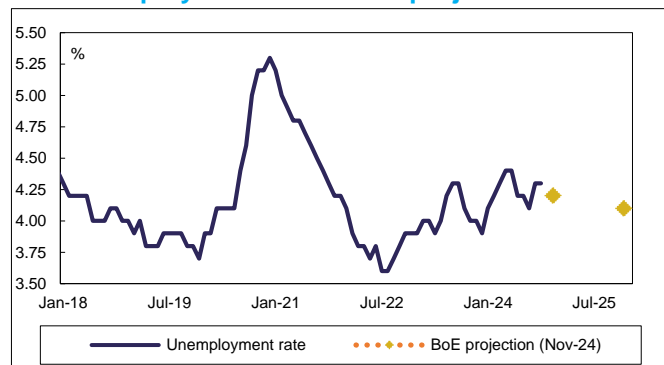
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected pay indicators & BoE projection



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

UK: Unemployment rate & BoE projection



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

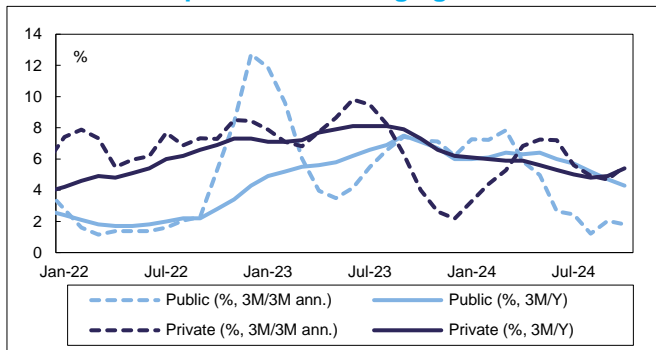
Labour demand continues to cool suggesting that pay growth should moderate again soon

Despite the strong rate of pay growth, the labour market appears to be continuing to soften. The preliminary estimate of payrolled employees fell a larger-than-expected 35k in November following a cumulative drop of 22k in the three months to October. The ILO unemployment rate was unchanged at 4.3% in the three months to October, up 0.3ppt from a year earlier and on track to exceed slightly the BoE's projection for Q4. The estimated number of vacancies fell 31k in the three months to November, extending the clear downtrend that has been in place for almost 2½ years to be almost 500k (and more than 37%) below the peak. And after the largest tax increase in the government's end-October Budget related to employer National Insurance Contributions (NICs), survey indicators point to a significant weakening of labour demand. The KPMG/REC report on jobs indicated the sharpest drop in worker demand in more than four years in November, with the fall for permanent employees most acute. And the flash composite employment PMI plunged in December to suggest the sharpest cuts to business headcount since January 2021 and, excluding the pandemic period, the global financial crisis in 2009. Admittedly, the number of redundancies remains low and there probably currently remains little slack in the labour market. But despite the big increase in the National Living Wage scheduled for April, cooling demand for workers should support the gradual slowing of pay over coming quarters anticipated by the BoE in its projections, particularly if firms seek to offset the increase in employer NICs by restraining future wage growth in an attempt to keep overall labour cost growth in check.

The day ahead in the UK

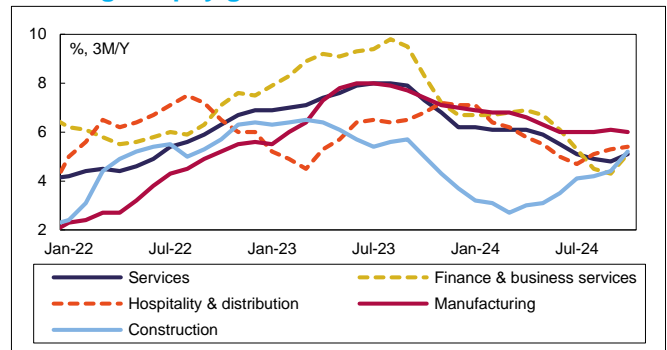
In view of today's strong private sector wage numbers, tomorrow's CPI report for November would need to surprise very significantly on the downside to prompt a rate cut when the MPC makes its monetary policy announcement on Thursday. Not least given diminishing energy base effects, the BoE forecast headline inflation to rise by 0.1ppt to 2.4%Y/Y in November. And we see the risks to that figure skewed to the upside. Indeed, in part due to higher petrol prices, we expect a larger increase of 0.3ppt to 2.6%Y/Y. Admittedly, services inflation is expected to be much more stable, with the BoE projecting that component to edge down to 4.9%Y/Y. Elsewhere, tomorrow's CBI industrial trends survey will be expected to flag a weak finish to the year, corroborating the deterioration in factory orders flagged by Monday's flash manufacturing PMIs.

UK: Private & public sector wage growth



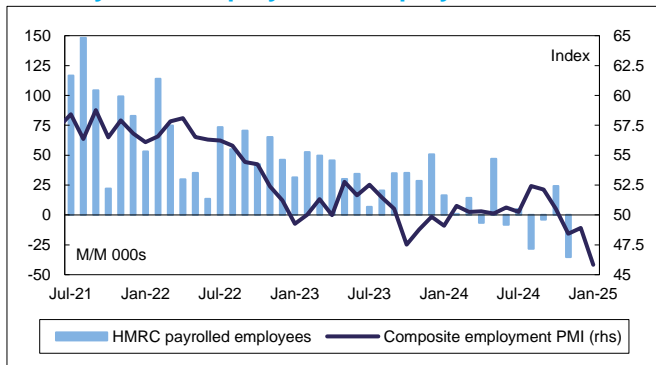
Source: Marcobond and Daiwa Capital Markets Europe Ltd.

UK: Regular pay growth



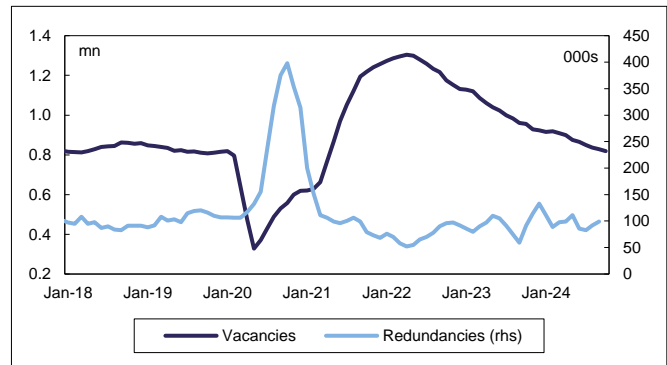
Source: Marcobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employees & employment PMI



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

UK: Job vacancies & redundancies












Source: Marcobond 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	 Trade balance €bn	Oct	6.1	11.6	13.6	12.6
Germany	 ifo business climate indicator	Dec	84.7	85.5	85.7	85.6
	 ifo current assessment (expectations) indicator	Dec	85.1 (84.4)	84.0 (87.5)	84.3 (87.2)	- (87.0)
	 ZEW investor survey – current situation (expectations) balance %	Dec	-93.1 (15.7)	-92.6 (6.9)	-91.4 (7.4)	-
UK	 Average wages (excluding bonuses) 3M/Y%	Oct	5.2 (5.2)	4.6 (5.0)	4.3 (4.8)	4.4 (4.9)
	 Unemployment rate 3M%	Oct	4.3	4.3	4.3	-
	 Employment 3M/3M change 000s	Oct	173	5	220	253
	 Payrolled employees M/M change 000s	Nov	-35	-10	-5	24
	 Claimant count rate % (change 000s)	Nov	4.6 (0.3)	-	4.7 (26.7)	4.6 (-10.9)







Auctions

Country	Auction
UK	 sold £3.75bn of 4.125% 2029 bonds at an average yield of 4.348%


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
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 (13)	-19 (11)

Auctions and events

Euro area	 09.00	ECB Chief Economist Lane participates in a fireside chat with MNI
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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