Euro wrap-up

Overview

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- Despite a rebound in euro area exports in November, Bunds made gains as the ECB account flagged that some Governing Council members noted a case for a 50bps rate cut in December.
- Gilts also made gains as UK GDP growth fell short of expectations in November to maintain a zero trend.
- Friday will bring final December euro area inflation estimates with the granular detail, along with UK retail sales figures for the same month.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.223	-0.029
OBL 2½ 10/29	2.340	-0.020
DBR 2½ 02/35	2.542	-0.015
UKT 4⅛ 01/27	4.369	-0.081
UKT 4⅛ 07/29	4.404	-0.057
UKT 4¼ 07/34	4.677	-0.051

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

Euro area

Goods exports rebound in November but net trade likely to subtract from GDP growth in Q4

Weak external demand has been a key cause of the ongoing downtrend in manufacturing production, which is on track for an eighth successive quarterly decline in Q4. On a seasonally adjusted basis, euro area goods export values fell in October to the lowest level in 2½ years while export volumes hit the lowest level since June 2020. As such, exports from the euro area continued significantly to underperform those of other major industrialised economies, extending the downtrend in the region's share of global imports. But today's data reported a rebound in export values in November of 3.2%M/M, the most since August 2022, suggestive of a welcome pickup in volume terms. That, however, still left export values down 1.6%Y/Y. Given the smaller rise in import values of 0.7%M/M, the seasonally adjusted goods trade surplus rose in November by almost €6bn to €12.9bn, which was nevertheless still about €1½bn below the average for the year to date. By type of good, a smaller deficit in energy (-€24.5bn) was accompanied by larger surpluses in chemicals and associated items (€23.4bn) and machinery and transport goods (€13.4bn), while the other categories continued to display a mix of much smaller surpluses or deficits. Despite the improved showing in November, however, goods exports were still trending slightly lower in the first two months of Q4 from the Q3 average, while imports were trending higher. So, net goods trade likely weighed on euro area GDP growth again in Q4 after subtracting a chunky 0.4ppt from growth in Q3. And survey indicators such as the new manufacturing orders PMIs and hard data on factory orders point to the likelihood of further export weakness in early 2025.

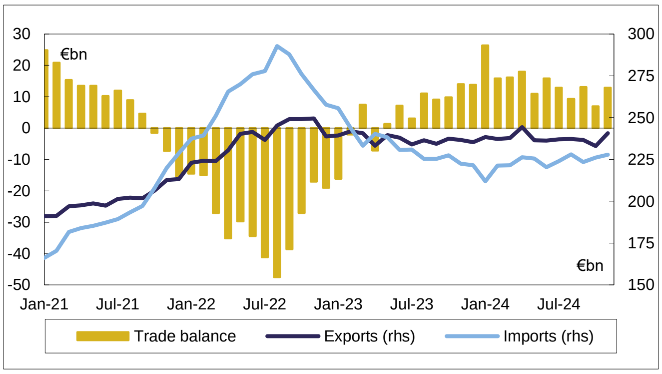
Trade deficit with China and surplus with the US remain well above pre-pandemic levels

Among the euro area's most important trading partners, goods export values to China were up more than 2%M/M in November. But they were still down about 8%Y/Y to be more than 22% below the peak at the start of 2023, highlighting the extent to which weaker demand from China has hit European manufacturers since the pandemic. And so, the euro area's bilateral trade deficit with China remained very large in November at €20.9bn, more than double the average in 2019 before the pandemic. Goods exports to the US – by far the euro area's most important export market, accounting for twice the share as China – rose to a series high to be up almost 6½%Y/Y. And with imports from that country softer, the euro area bilateral trade surplus with the US rose more than €1bn to €16.5bn, more than 50% higher than the average in the year before the pandemic.

Pharma, machinery & transport goods account for largest share of surplus with the US

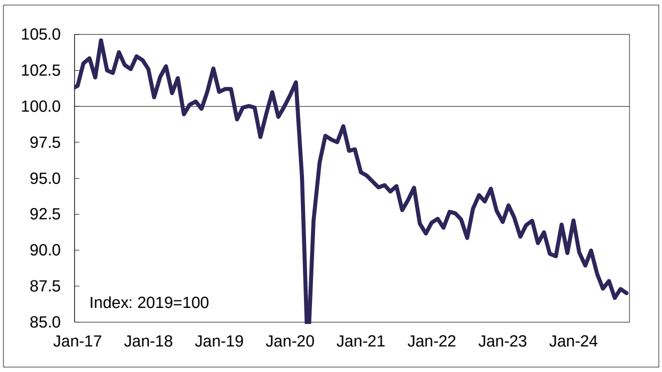
That large bilateral trade surplus with the US – which among the euro area member states is explained predominantly by surpluses from Germany and Ireland, and to a lesser extent Italy and France – is likely to be in the firing line of President-

Euro area: Goods trade balance & components*



Value terms. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Exports as share of global imports*



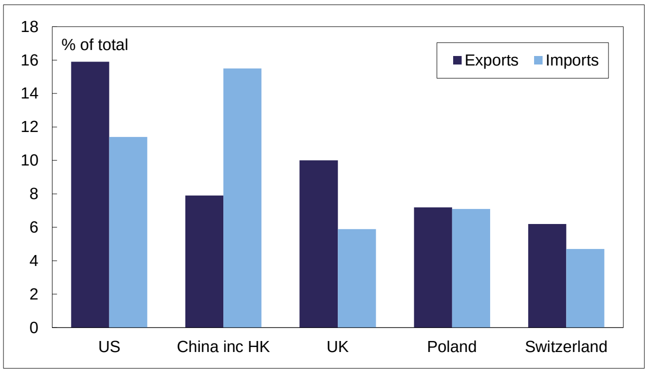
Volume terms. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

elect Trump as he considers whether and if so how he might implement the new tariff regimes threatened during his election campaign. Of course, the threat of new trade barriers might encourage European firms to front-load shipments to the US over the near term. But there was no evidence of that occurring in the November data. By type of good, pharmaceuticals represent more than one fifth of all exports to the US. They also represent the largest source of the trade surplus, accounting for some €80bn of that balance annually. Yet they currently face an average tariff paid of 0.001%. Non-electrical machinery, motor vehicles and organic chemicals, which typically have average tariffs paid from close to zero to up to 3%, also account for both large shares of euro area exports to the US and a large share of the trade surplus, suggesting they too might be considered – along with more politically sensitive items – for higher tariffs. The EU will, of course, be prepared to retaliate with its own tariff-increases against US-made items if necessary. But, ultimately, it is likely to make concessions to Trump, including commitments to buy American, to try to avoid an extremely damaging lasting trade war. Until such uncertainties are resolved, however, we expect many firms to place planned export-related investments on ice.

The day ahead in the euro area

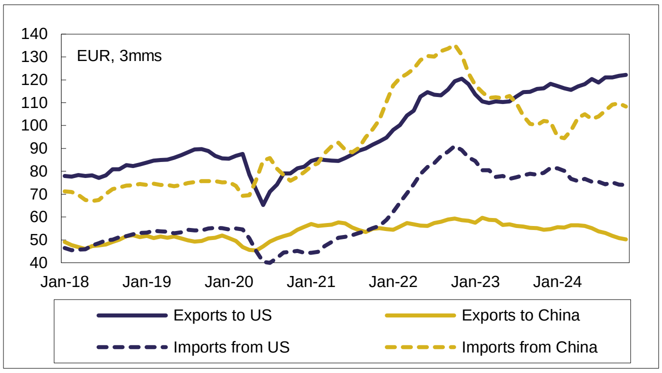
December's final HICP inflation detail for the euro area will be the highlight for euro area economic data on Friday. Last week's flash release reported a further 0.2ppt increase in headline inflation to 2.4%Y/Y, principally reflecting pressure in energy components. In contrast, the core rate remained steady at 2.7%Y/Y. Despite the high-side reading of the headline

Euro area: Goods trade by major partner



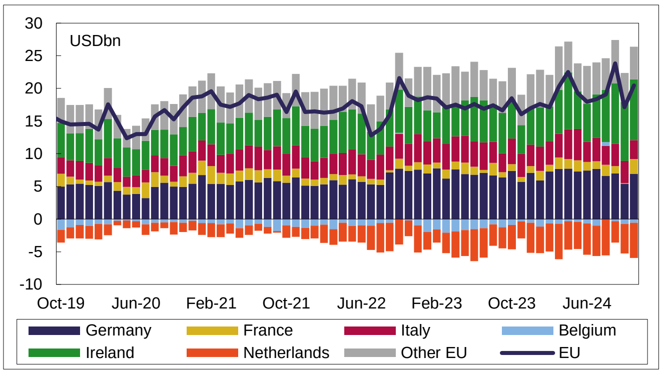
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Exports & imports to/from US & China



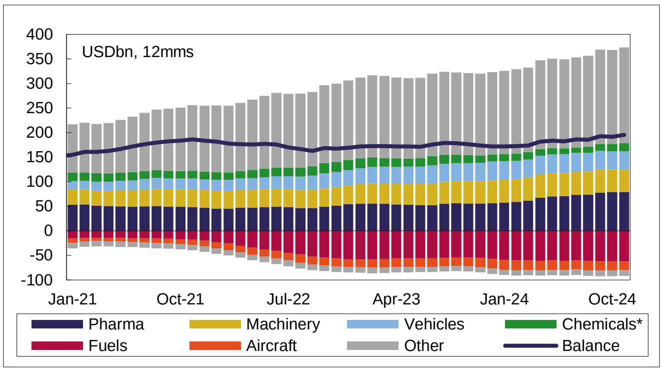
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Trade balance with US by member state



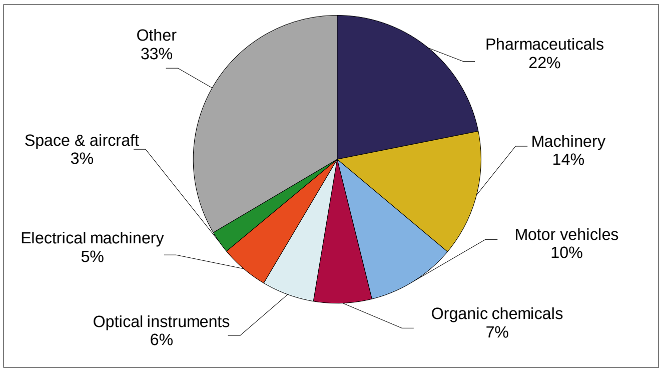
Source: US Census Bureau, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Trade balance with US by type of good



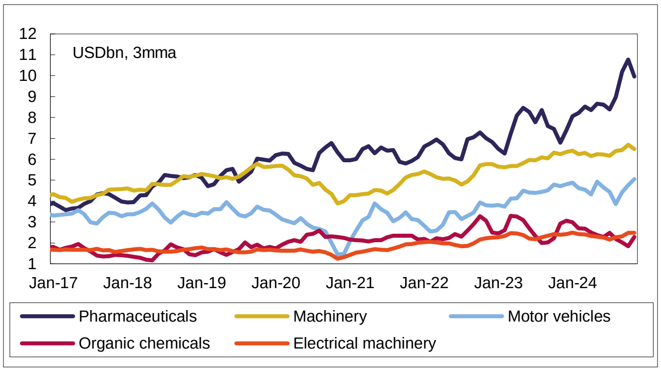
**Excluding pharma. Source: US Census Bureau, Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Share of total exports to the US by good*



**Based on 12-month average. Values terms. Source: US Census Bureau, Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Selected goods exports to the US*



**Values terms. Source: US Census Bureau, Macrobond and Daiwa Capital Markets Europe Ltd.*

flash rate to two decimal places (2.44%Y/Y), this week's final releases from the largest member states came in unrevised, suggesting tomorrow's headline readings will similarly be unchanged. Perhaps more significantly, the final detail will provide a granular breakdown to help explain the slight uptick (0.1ppt) in services inflation, back to 4.0%Y/Y, and allow calculation of various measures of underlying inflation. While elevated services inflation will remain a point of conjecture for some of the hawks on the Governing Council, we suspect the detail to show underlying inflation continuing to moderate, consistent with a return to the 2% target (or below) by mid-year, which should provide enough reassurance for policymakers to continue to loosen policy restrictiveness over the coming months.

UK

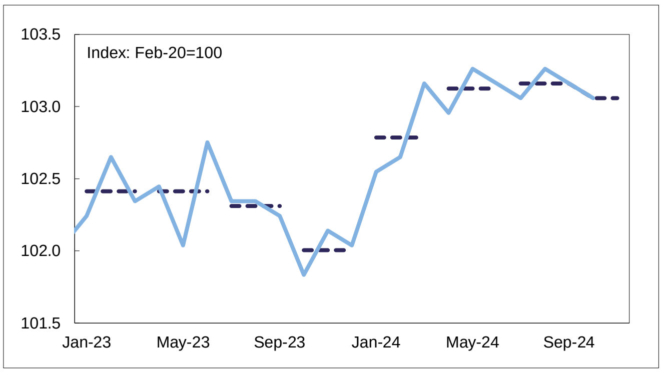
GDP growth falls short of expectations in November to maintain sideways trend

Following yesterday's softer inflation numbers, today's UK monthly GDP figures confirmed a persisting lack of economic momentum in the middle of Q4, further strengthening the case for the MPC to cut Bank Rate at its next policy meeting in February. Admittedly, economic output recorded a modest expansion in November (0.1%M/M) for the first time since August. But this rebound fell short of the Bloomberg survey consensus. And with downwards revisions to growth in June and July, the level of output was no higher than in March, and was less than 3% above the pre-pandemic benchmark in Q419. Moreover, growth was flat on a three-month basis for a fourth consecutive month. Looking ahead, with the composite PMI having edged marginally down in December (50.4) to its lowest level in 14 months, there is a non-negligible risk that GDP growth that month was no stronger than in November, which would result in a modest decline in economic activity over the fourth quarter as a whole. However, given the likely boost from the inclusion of the Black Friday discounting period in December's retail sales (data due for release tomorrow), we expect GDP to have just about avoided a contraction last quarter. Nevertheless, a second successive quarter of zero growth will be significantly softer than the 0.2%Q/Q and 0.3%Q/Q increases respectively in Q3 and Q4 projected by the BoE in the November Monetary Policy Report.

Despite growth in November, services and construction activity lacks any momentum

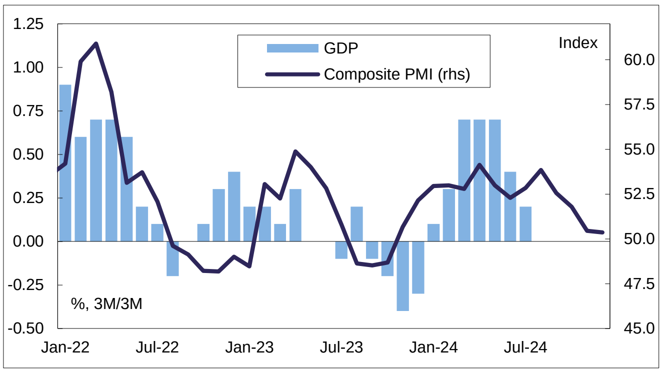
The largest contribution to GDP growth in November came from services, where activity rose (0.1%M/M) for the first month in three amid firmer growth in wholesale, hospitality and information and communications services. But business-related services maintained the sideways trend in place since April. And, overall, services activity on a three-month basis was flat for a fourth successive month. The services PMI suggested that output in the sector remained subdued heading into year-end too. While construction activity also rose the most in four months in November (0.4%M/M), this simply reversed the decline in October resulting in the softest three-month growth (0.2%3M/3M) since June. And despite recent signs of a recovery in the

UK: GDP level*



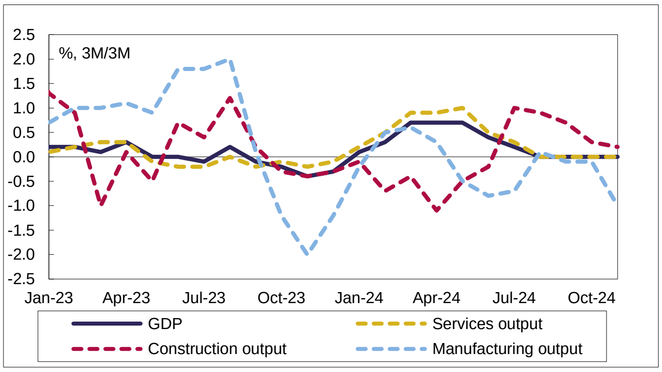
*Dashed dark blue line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & composite PMI



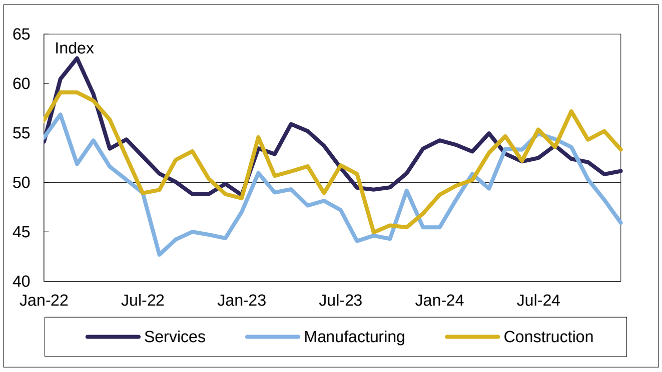
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: GDP growth by sector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output PMIs



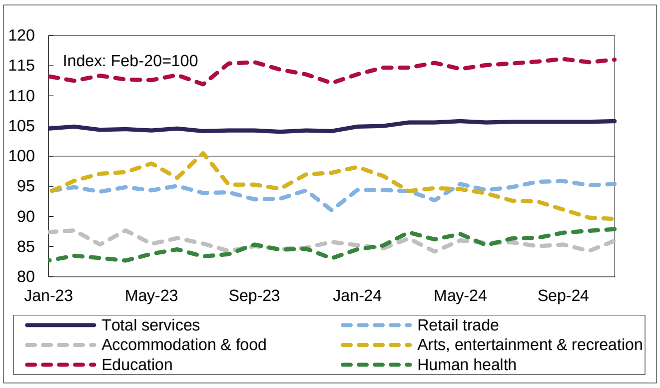
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

housing market, new private building work declined for a third consecutive month in November to be trending so far in Q4 some ½% below the Q3 average. While the latest RICS residential survey – also published today – signalled a further increase in house price growth in December to a more than two-year high, the number of surveyors reporting new sale instructions and new buyer enquiries fell back, with sales expectations three months ahead slipping to a seven-month low too. And likely reflecting the recent increase in swap rates, the BoE's latest Credit Conditions Survey reported that lenders expect demand for mortgage loans to decline over the coming three months for the first time since Q323, with higher swap rates also possibly set to weigh on house-building activity over the near term.

Downtrend in manufacturing exacerbated by heightened economic uncertainties

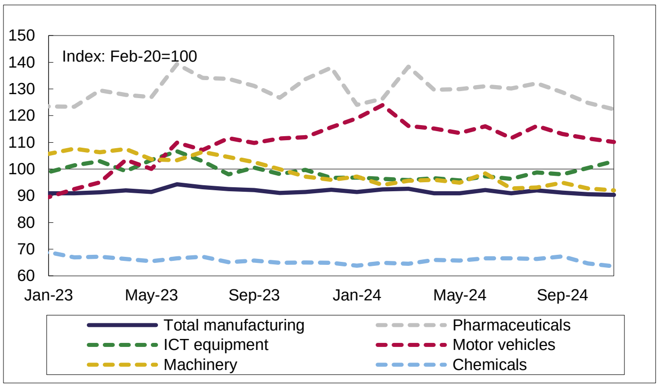
Reflecting ongoing challenges in the industrial sector, production fell for a third consecutive month in November (-0.4%M/M) to the lowest level since the first Covid-19 lockdown and early 2015 before that. While the ongoing weakness in part related to mining and quarrying, manufacturing output also fell for a third month to a two-year low to be trending in October and November some 1% below the Q3 average. Indeed, while there was a notable jump in output from the ICT equipment subsector to its highest level since mid-2023, there was a continued downtrend of pharmaceuticals, car and machinery manufacturing, with the latter reaching the lowest level since the first pandemic wave. And with the manufacturing PMIs pointing to a further notable contraction in December as demand remained weighed by heightened uncertainty both

UK: Services output – selected subsectors



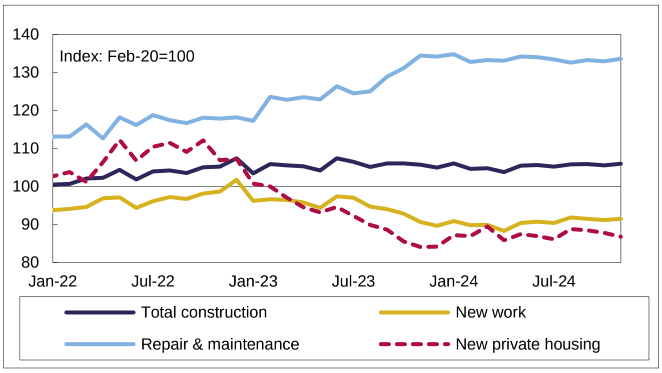
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output – selected subsectors



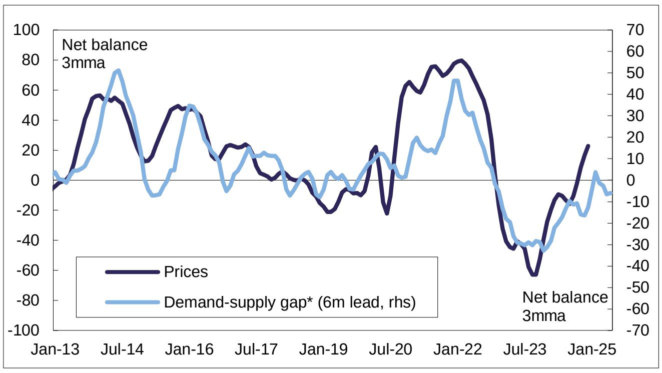
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Construction output



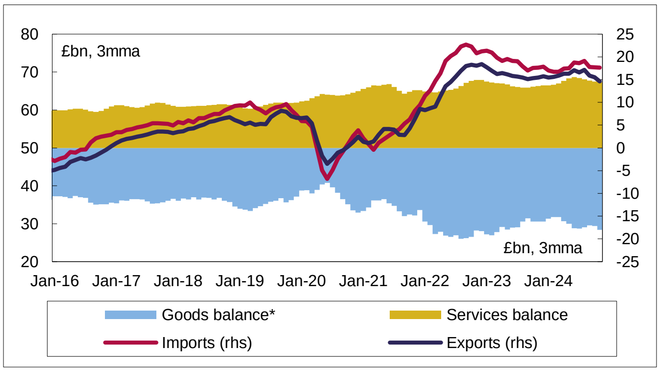
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: RICS residential market survey indices



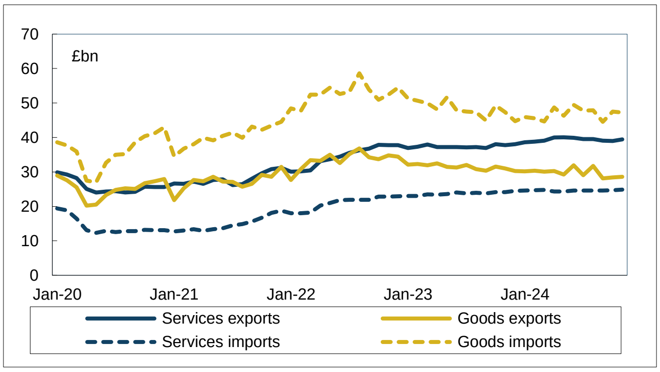
**Difference between new buyer enquiries and new instructions net balances*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Trade balances



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

UK: Goods & services exports/imports



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

domestic and overseas, we expect the manufacturing sector to remain a non-negligible drag on UK growth over Q4 as a whole and into 2025 too.

Net trade on track to subtract from GDP growth in Q4 as underlying deficit widens to 16-month high

Despite the weakness of manufacturing production in November, the value of goods exports (excluding precious metals) rose 0.8%M/M. Increased shipments to non-EU countries, particularly of machinery and transport equipment, offset weakness to the EU related to pharmaceuticals. However, adjusting for prices, goods export volumes fell 0.7%M/M to be trending over the first two months of Q4 some 5% below the Q3 average. In part due to the energy component, goods imports fell in November in both value (-0.6%M/M) and volume terms (-1.8%M/M). But in volume terms they were still trending 1.8% higher over the first two months of Q4 relative to Q3. Meanwhile, in the all-important services sector, exports volumes were trending 0.3% lower while services imports were trending 0.7% higher. So, having added a whopping 0.7ppt to GDP growth in Q3, net trade is (perhaps unsurprisingly) firmly on course to subtract from growth in Q4. And, excluding precious metals, the total goods and services trade deficit widened in the three months to November by £3.8bn from three months earlier to £10.8bn, the largest since July 2023.

The day ahead in the UK

Tomorrow's December's retail sales data will provide the first hard figures to feed into the monthly GDP report for the month. These are expected to show a rebound in sales volumes over the festive period boosted not least by the later timing of Black Friday discounting this year. But while this should inflate December's report, taken together with October and November's particularly dampened figures, tomorrow's release should also confirm that retail sales volumes declined on a three-month basis at the end of the year, following an increase of 1.4%3M/3M in Q3.

European calendar

Today's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Trade balance €bn	Nov	**12.9**	11.5	6.1	7.0
Germany		Final HICP (CPI) Y/Y%	Dec	**2.8 (2.6)**	*2.8 (2.6)*	2.4 (2.2)	-
Italy		Final HICP (CPI) Y/Y%	Dec	**1.4 (1.3)**	*1.4 (1.3)*	1.5 (1.4)	-
UK		Monthly GDP M/M% (3M/3M%)	Nov	**0.1 (0.0)**	0.2 (0.0)	-0.1 (0.1)	- (0.0)
		Services output M/M% (3M/3M%)	Nov	**0.1 (0.0)**	0.2 (0.1)	0.0 (0.1)	-0.1 (0.0)
		Industrial output M/M% (Y/Y%)	Nov	**-0.4 (-1.8)**	0.1 (-0.9)	-0.6 (-0.7)	- (-1.1)
		Construction output M/M% (Y/Y%)	Nov	**0.4 (0.2)**	0.4 (0.1)	-0.4 (-0.7)	-0.3 (-0.5)
		Trade (goods trade) balance £bn	Nov	**-4.8 (-19.3)**	-3.6 (-18.0)	-3.7 (-19.0)	-5.0 (-19.0)
		RICS house price balance %	Dec	**28**	28	25	24

Auctions

Country		Auction
Spain		sold €2.493bn of 2.7% 2030 bonds at an average yield of 2.763%
		sold €2.146bn of 0.85% 2037 bonds at an average yield of 3.452%
		sold €1.351bn of 1% 2050 bonds at an average yield of 3.727%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		09.00	Final headline (core) HICP Y/Y%	Dec	*2.4 (2.7)*	2.2 (2.7)
		10.00	Current account balance €bn	Nov	-	25.8
UK		07.00	Retail sales – including auto fuel M/M% (Y/Y%)	Dec	0.4 (4.8)	0.2 (0.5)
		07.00	Retail sales – excluding auto fuel M/M% (Y/Y%)	Dec	0.3 (3.8)	0.1 (0.3)

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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