Euro wrap-up

Overview

Emily Nicol
+44 20 7597 8331

Edward Maling
+44 20 7597 8030

- Longer-dated Bunds followed JGBs lower while euro area construction output fell in November but remained on track for growth in Q4.
- Gilts also followed the global trend lower despite a soft UK labour market report signalling the weakest private pay growth in five years.
- Wednesday will bring UK inflation estimates for December.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/27	2.067	-0.010
OBL 2½ 04/31	2.438	+0.005
DBR 2.9 02/36	2.861	+0.023
UKT 3¾ 03/27	3.668	+0.006
UKT 4⅜ 03/30	3.913	+0.031
UKT 4½ 03/35	4.461	+0.048

*Change from close as at 4:15pm GMT.
Source: Bloomberg

Euro area

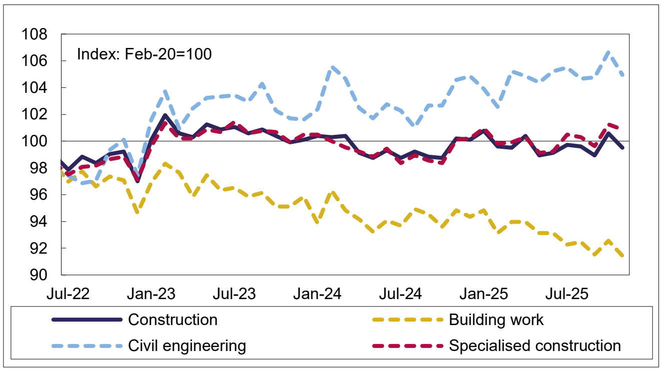
Despite falling back in November, construction sector remains on track to expand in Q4

Given the extent of the declines in Germany (-0.8%M/M), France (-1%M/M) and Spain (-1.1%M/M), a drop in euro area construction output in November was inevitable. But, at -1.1%M/M, the contraction was still perhaps slightly larger than expected. Softness was also broad based across subsectors, and pronounced in housebuilding (-1.2%M/M) and civil engineering (-1.6%M/M). Yet with output in October firmer than initially reported (1.7%M/M), construction production in the euro area was continuing to trend some 0.6% above its average level in Q3, consistent with a return to growth in the sector last quarter underpinned by 'specialised' activities and, to a lesser extent, civil engineering. Progress at the member state level, however, has remained disjointed. Activity in France – currently 1.7% lower in October and November versus Q3, remained particularly weak. But Germany and the Netherlands, each some 2.3% higher, provided offset. Unsurprisingly, the former has been driven by a noticeable rise in civil engineering activity. And with funding for public investment in Germany to continue scaling up this year, growth in that subsector looks likely to support a broader upturn. While slower to pickup, a tentative upswing in building permits in Germany and the lagged effects of monetary policy loosening also raise the likelihood of a cyclical upturn for housebuilders. Survey indicators such as the construction PMIs have already signalled firmer growth momentum at the start of this year. In similar vein, today's ZEW survey implied that investor expectations of German constructor profits were the best since April 2018. And while the bullishness of the broader survey – optimism in the wider German economy rose to a five-year high in January – failed adequately to recognise the new downside risks posed by the latest Greenland-related US tariff threats, the construction sector's lesser exposure to those threats means that its outlook, at least, is relatively less likely to be knocked.

The day ahead in the euro area

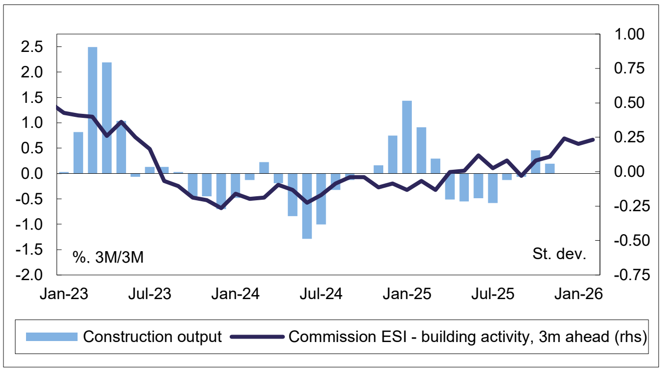
At face value, it should be a quieter day ahead for euro area economic news. December retail sales numbers from the Banque de France will provide the sole data release of note. But any relevant developments emerging from the World Economic Forum meetings in Davos should take precedence. Indeed, besides talks between politicians, senior ECB policymakers – including President Lagarde and Governing Council members Villeroy and Nagel – are scheduled to appear on panels.

Euro area: Construction output by subsector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output & Commission ESI



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

UK

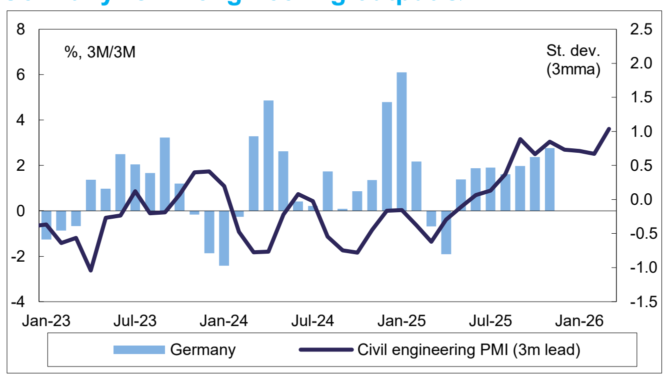
Total wage growth a touch above expectations, but private regular pay maintains steady downtrend

Today's UK labour market data once again provided mixed signals on labour demand and pay growth, which will therefore fail to reconcile differences in the views of the doves and hawks on the MPC. Overall, however, we considered the report to be on the soft side, consistent with continued loosening of the labour market and a further easing of underlying price pressures. But it was highly unlikely to have been weak enough to persuade a majority of MPC members to pull the trigger on another rate cut at the February policy meeting, particularly with uncertainty so high amid Trump's threat of new trade barriers against the UK and associated market volatility. In terms of the headline numbers, total pay growth exceeded expectations slightly in November, slowing by only 0.1ppt from an upwardly revised figure in the prior month to 4.7%3M/Y, still some 2ppts above the pre-pandemic five-year average. But that was again distorted by strength in the public sector (7.8%3M/Y) associated with a base effect, which should fade over the coming three months. More importantly, in the private sector, total pay growth moderated a further 0.9ppt from three months earlier to 3.9%3M/Y. And excluding bonuses, private sector regular pay – the BoE's preferred measure – slowed to a five-year low of 3.6%3M/Y. That suggests that private regular pay is firmly on track to match and possibly undershoot the BoE's projection for end-2025 (3.5%3M/Y). Despite concerns from certain MPC members regarding the still-elevated nature of forward-looking wage indicators, various measures – including the Indeed wage tracker and HMRC PAYE figures – took a further step down in December, to the lowest rates in four and five years respectively. While the Bank's DMP survey recently signalled a slight pickup in expected wage growth in 12 months' time, Bank Agents suggest that pay settlements point to a slowdown to around 3½% in 2026. Given persisting slack and subdued economic activity, a further moderation in private regular pay growth closer to the long-run average of 3.0%Y/Y – more consistent with the 2% inflation target over the medium term – looks likely by mid-year.

Payrolled employee growth down to 2½-year low, loosest labour market in over a decade

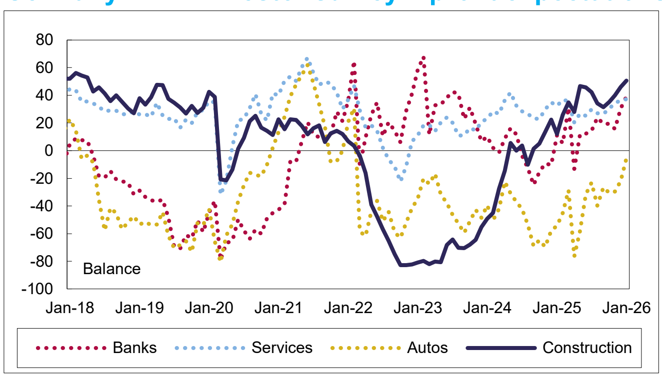
Admittedly, signals on labour demand from the latest data again were mixed. According to the ONS' official data, the LFS measure of total employment rose for the first month in the three in November, by 82k3M/3M, and up more than ½mn over the past year. But this was more than fully accounted for by part-timers. In contrast, full-time employment fell for a third month to be up a more moderate 163k on a year earlier. And with inactivity down to a four-year low, the unemployment rate nevertheless held steady at 5.1%, the joint-highest since January 2021 and a touch above the BoE's projection for end-2025. Moreover, the provisional HMRC PAYE estimate of jobs growth – which the ONS judges to be the more reliable measure of employee numbers despite improvements in the LFS response rate – fell in December for a fourth successive month and by 43k, the most in five years, taking the number of payrolled employees down 184k over the past year. This broadly tallies with

Germany: Civil engineering output & PMI



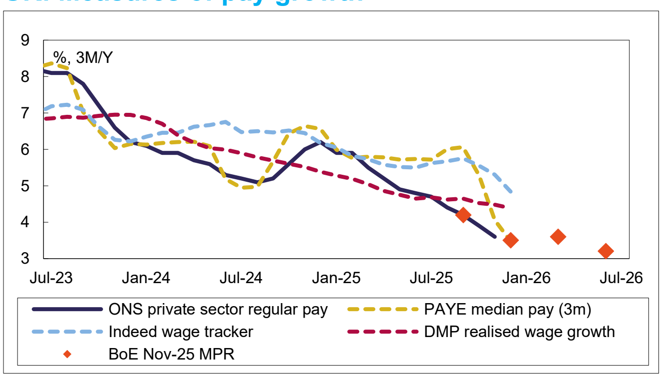
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ZEW investor survey – profit expectations



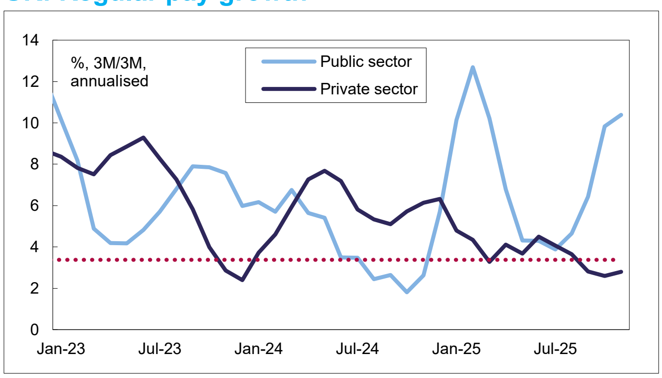
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measures of pay growth



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

UK: Regular pay growth*



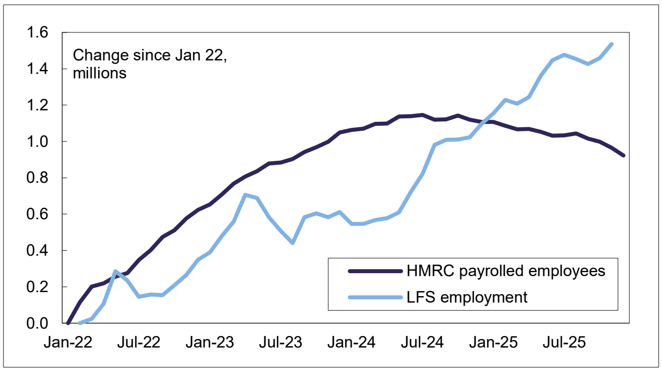
**Dotted red line represents 20-year average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

the employment PMI signalling ongoing cuts to headcount at the end of last year. Admittedly, this is somewhat at odds with recent signs of stabilisation in job vacancies, the number of which rose to a six month high in December. Nevertheless, this still left the ratio of vacancies to unemployed unchanged at 0.40, well below the long-run average and suggesting the largest amount of labour slack in over a decade outside of the pandemic period.

The day ahead in the UK

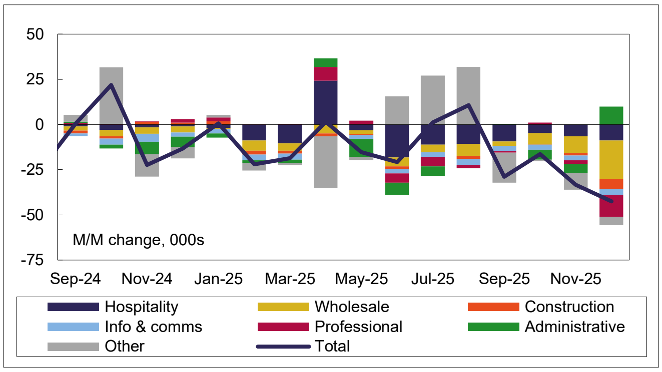
December's UK inflation report will provide the highlight of Wednesday's dataflow. While concerns about the persistence of underlying inflation have not wholly abated, recent months have offered more encouragement about the disinflation process. Having already fallen from its peak in Q3 (3.8%Y/Y), November's CPI print was surprisingly soft at 3.2%Y/Y, undershooting the BoE's forecast by 0.2ppt. Before a more pronounced easing in Q1, we expect to see modest payback for that weakness, with the headline rate edging up to 3.3%Y/Y in December. But as reflected by the range of estimates around that figure (±0.3ppt), uncertainty about this print is considerably higher than usual. That owes in no small part to the speculation about the sampling period chosen by the ONS for airfares – a more-volatile services component at the best of times – which could capture a larger share of pre-Christmas fare increases. In such a case, we would expect that upside to be temporary. But our forecast assumes that the sample will avoid that volatility anyway. So, we expect a moderate uptick in services inflation (4.5%Y/Y), which alongside the likelihood of some post-Black Friday payback in select goods means that the risks to our baseline for a side-step in core inflation (3.2%Y/Y) are certainly skewed to the upside. Nonetheless, new tobacco duties implemented in the Budget are likely to restore their higher contribution, while the BRC also signalled broader upside risks to food prices, after moderating a full 0.8ppt in November to 4%Y/Y. Energy inflation, by contrast, should provide some offset, owing to base effects for auto fuels. Meanwhile, the CBI's industrial trends survey will also provide a preliminary assessment of manufacturing sentiment in January ahead of Friday's flash PMIs. Moreover, that survey will also feature a quarterly update on business trends and investment intentions, which will be of particular interest.

UK: Measures of employment



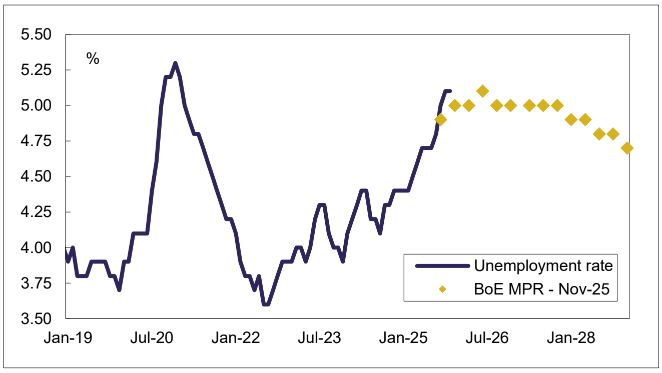
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Change in payrolled employees by sector



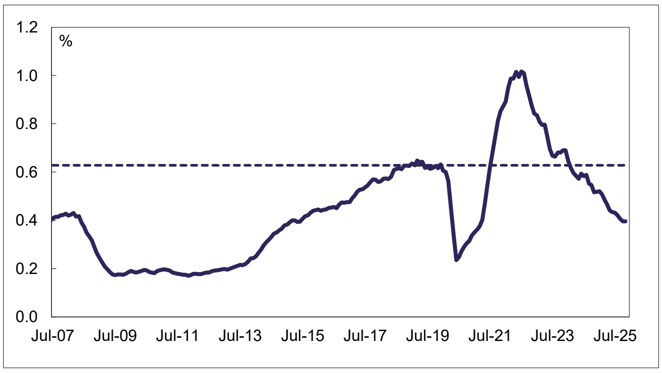
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Unemployment rate



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

UK: Vacancies to unemployment ratio



Source: Macrobond 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		Construction output M/M% (Y/Y%)	Nov	**-1.1 (-0.8)**	*-0.6 (-0.8)*	0.9 (0.5)	1.7 (1.9)
		ECB current account balance €bn	Nov	**8.6**	-	25.7	26.7
Germany		PPI Y/Y%	Dec	**-2.5**	-2.4	-2.3	-
		ZEW current situation (expectations) balance	Jan	**-72.7 (59.6)**	-76.0 (50.0)	-81.0 (45.8)	-
UK		Average wages (excluding bonuses) 3M/Y%	Nov	**4.7 (4.5)**	4.6 (4.5)	4.7 (4.6)	4.8 (-)
		Private sector regular wages 3M/Y%	Nov	**3.6**	3.7	3.9	-
		Unemployment rate 3M%	Nov	**5.1**	5.1	5.1	-
		Employment 3M/3M change 000s	Nov	**82**	31	-16	-
		Payrolled employees M/M change 000s	Dec	**-43**	-20	-38	-33
		Claimant count rate % (change 000s)	Dec	**4.4 (17.9)**	-	4.4 (20.1)	4.3 (-3.3)

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
France		-	Retail sales Y/Y%	Dec	-	0.7
UK		07.00	Headline (core) CPI Y/Y%	Dec	*3.3 (3.2)*	3.2 (3.2)
		07.00	PPI – output (input) prices Y/Y%	Dec	3.4 (1.0)	3.4 (1.1)
		09.30	House price index Y/Y%	Nov	-	1.7
		11.00	CBI industrial trends survey – total orders (selling prices) net balance %	Jan	-33 (16)	-32 (19)
		11.00	CBI industrial trends survey – business optimism net balance %	Jan	-	-31

Auctions and events

Country		GMT	Event
Germany		10.30	Auction: to sell up to €1bn of 2.6% 2041 bonds
		10.30	Auction: to sell up to €1bn of 2.9% 2056 bonds
		18.30	Bundesbank President Nagel speaks on European growth on a panel at the WEF in Davos
UK		10.00	Auction: to sell £4.75bn of 4% 2029 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.