Euro wrap-up

Overview

- Bunds followed USTs lower as the euro area composite PMI exceeded expectations and markets reacted to reports that the ECB was considering tweaking its securities lending programme next month.
- Gilts also made losses as government borrowing in the UK over the next five years was forecast to be much higher than previously envisaged.
- Tomorrow brings sentiment surveys from Germany and France, while the second estimate of Q3 GDP from Germany and Spain are also due.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.701	+0.037
OBL 0 10/21	-0.382	+0.048
DBR 0 08/26	0.280	+0.059
UKT 1¼ 07/18	0.162	+0.018
UKT 3¾ 09/21	0.686	+0.058
UKT 1½ 07/26	1.471	+0.109

*Change from close as at 4.30pm GMT.
Source: Bloomberg

Euro area

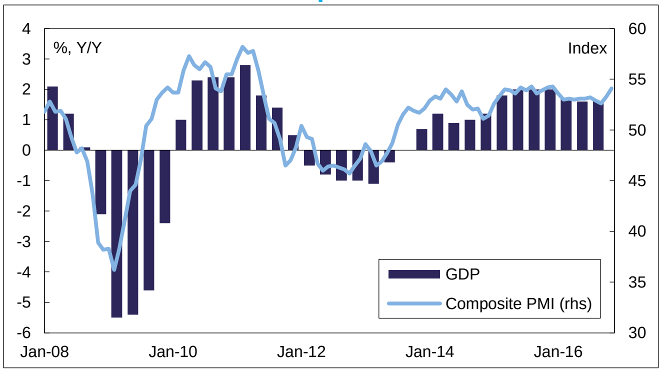
Euro area composite PMI at an 11-month high

After the Commission's flash estimate of euro area consumer confidence yesterday unexpectedly rose to its highest level this year, the November flash PMIs today also comfortably beat expectations. Most notably, the euro area composite PMI posted the strongest monthly increase since the start of 2015, with the 0.8pt gain taking the index to 54.1, the highest level for the year to date, driven by a more than 1pt increase in the headline services PMI to 54.1, similarly its highest since December. And while the manufacturing output PMI edged lower in November, at 54.1 it still marked the second highest reading in 2016. The survey detail was also encouraging, with, for example, the composite new orders index rising for the third consecutive month to the highest since December. That reportedly contributed to a further pickup in employment growth, with the respective index at its joint highest since February 2008. And with the composite output index on average so far in Q4 0.8pt higher than that in Q3, today's release raises cautious optimism that GDP growth in the fourth quarter might step up from the 0.3%Q/Q rate seen in Q2 and Q3. Moreover, the euro area composite input price index rose to the highest in eighteen months, while the composite output price PMI rose to the highest level since the summer of 2011, although at 50.3 that indicator hardly signals significant inflationary pressures.

French and German PMIs continues to signal expansion in Q4

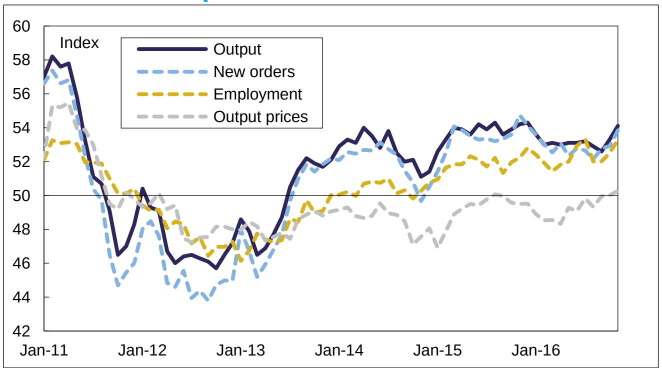
While we will have to wait until the final releases at the start of December for a detailed breakdown, today's survey suggested that business activity accelerated markedly in Italy and/or Spain in November. But the French flash composite PMI also rose 0.7pt on the month to 52.3, the second-highest level so far this year, reflecting a marked improvement in the services sector, with the relevant index up by more than 1pt to 52.6. And despite a notable drop in the manufacturing output PMI (-1.6pts) it still remained above the key-50 level for the third consecutive month. The euro area's recovery in the fourth quarter, however, continues to be principally supported by Germany, with today's survey showing that the composite PMI, despite a modest decline on the month, stood at a healthy 54.9 in November, well above the average for the year to date and leaving it on average so far in Q4 more than 1pt higher than the average in Q3. And there was a notable improvement in services sector output reported, with the respective PMI rising to a six-month high in November to leave it on average so far over the quarter more than 2pts higher than in Q3. So, despite a modest decline in the equivalent manufacturing output PMI, on the whole today's survey suggests that German GDP growth so far in Q4 has picked up notably from the 0.2%Q/Q rate in the third quarter.

Euro area: GDP and composite PMI



Source: Thomson Reuters, Markit and Daiwa Capital Markets Europe Ltd.

Euro area: Composite PMIs



Source: Thomson Reuters, Markit and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area and US

Tomorrow brings more sentiment surveys from the largest member states, with Germany's Ifo business sentiment and GfK consumer confidence indicators expected to show little change on the month. Last month, the respective headline indices provided conflicting messages, with the former suggesting that business sentiment rose in October to its highest level (110.5) for more than 2½ years, while the latter signalled a possible loss of confidence in November with the index falling to a six-month low of 9.7. Meanwhile, the French INSEE business confidence survey is similarly forecast to show conditions little changed in November. In addition, the second estimates of Q3 GDP from Germany and Spain are due to be published alongside the first official expenditure breakdowns. In the US, meanwhile, it should be a quiet day with markets closed for the Thanksgiving holiday.

UK

Fiscal rules rewritten (again)

Philip Hammond's first fiscal policy statement since becoming Chancellor was inevitably, given the uncertainty surrounding the economic outlook in the wake of the Brexit vote, a more downbeat one than George Osborne was able to provide in March. The Office for Budget Responsibility's (OBR) growth forecasts were revised down markedly, with growth in 2017 now expected to be 1.4%, 0.8ppt lower than forecast in March. And growth in 2018 is also expected to be lower than expected in March, by 0.4ppt, although, as the chart below shows, the OBR expects growth to rebound much more rapidly than the BoE does. And with lower growth comes lower tax receipts and higher government spending. Public sector net borrowing (PSNB) this year is now expected to be £13bn higher than expected in March, at £68bn. And deficits thereafter are expected to remain higher than previously forecast, by a cumulative £122bn over the next five years. Indeed, these forecasts meant that the Chancellor had to tear up his predecessor's fiscal rules, which were centred on balancing the budget by the end of the current Parliament (2019/20). Now, however, rather than a surplus of £10bn, a deficit of £22bn is expected. So, the Chancellor unveiled (yet another) set of fiscal rules, with the primary aim to deliver a fiscal surplus in the next Parliament and to have the government debt stock as a share of GDP falling by the end of the current Parliament.

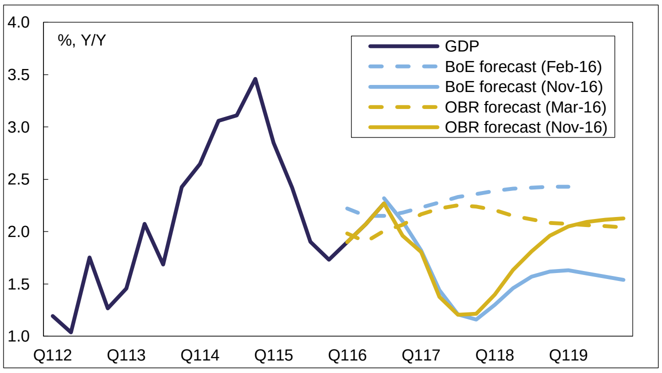
Fiscal policy will continue to tighten

Of course, in the immediate aftermath of the Brexit vote there was much talk of a fiscal stimulus at this Autumn Statement to support growth. But, with growth having subsequently been better than expected and with the fiscal outlook much worse, the Chancellor offered little new. There was the announcement of a £23bn investment fund over the next five years. But at just £5bn a year, the impact on growth will be negligible and will only return net investment as a share of GDP to the level it was in 2010. Indeed, rather than provide support to growth over coming years, fiscal policy is projected to continue to tighten each year for the next six years, by an average of 0.5% of GDP each year, a significant tightening that will weigh on growth at a time when the economy is slowing anyway.

OBR lays bare Brexit costs

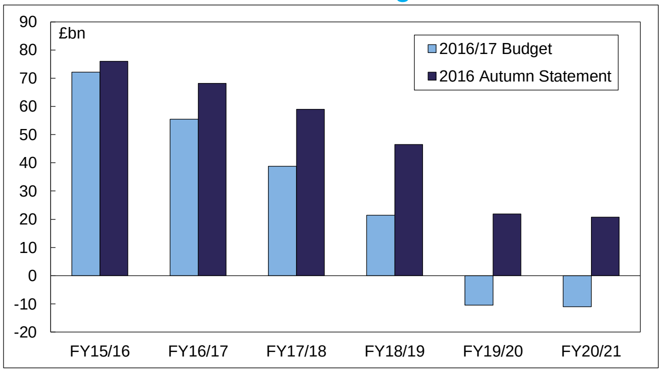
All fiscal and economic forecasts are, of course, subject to great uncertainty and are more likely to be wrong than right. But these forecasts are more uncertain than ever given the continued lack of clarity over what Brexit means. Indeed, in the absence of any information from the Government on what Brexit will entail, the OBR simply assumed that the UK leaves the EU in April 2019 and that a new trade deal is put in place that slows the pace of both import and export growth over the next 10 years. Net immigration, however, is assumed to remain significantly higher than the 'tens of thousands' that the Government says it is aiming for. Nevertheless, the OBR expects Brexit to blow a hole in the public finances. Of the cumulative £122bn additional borrowing by the Government it expects over the next five years, it puts £58.6bn of that

UK: GDP forecasts



Source: OBR, BoE, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Public sector net borrowing



Source: OBR and Daiwa Capital Markets Europe Ltd.

specifically down to the impact of Brexit. And, of course, if Brexit turns out to be harder than expected, or the OBR has underestimated the impact of even the soft Brexit it has assumed, then growth will be weaker, and deficits therefore larger, than even included here.

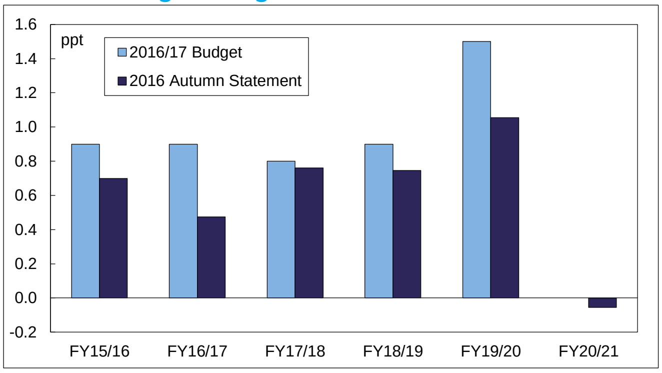
BoE the backstop for growth

All told, today's Autumn Statement can be seen as a holding operation by the Chancellor as he awaits more details on when and how Brexit will happen and the economic impact of that. By doing so he gives himself room to do more at the next major fiscal announcement (which will be in a year's time as the Chancellor announced today that the Budget will move to the Autumn) if required. But that is a long way off, while the suspicion has to be that a Chancellor that seemed initially to favour providing fiscal support in the face of lower growth has now got cold feet in the face of a political imperative within his own party to bring the deficit down. As such, if growth does end up slowing more than expected, expect the BoE to, as usual, be left to provide what support to growth it can while fiscal consolidation remains the over-riding consideration of the Government.

The day ahead in the UK

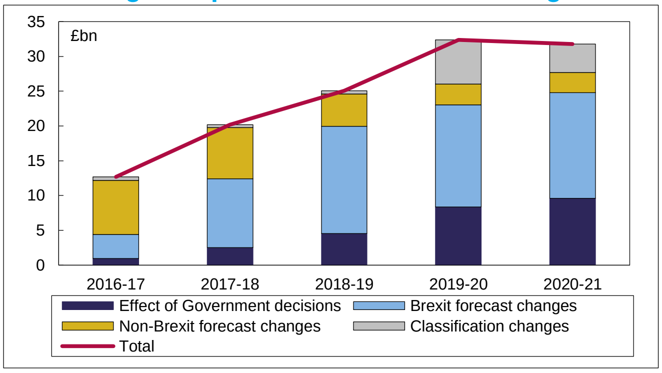
Tomorrow brings only the BBA lending figures from the major High Street banks.

UK: Fiscal tightening*



**Reduction in cyclically adjusted net borrowing as a share of GDP.*
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Changes to public sector net borrowing*



**Since the Budget announcement in March.*
Source: OBR and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Economic data							
EMU		Preliminary manufacturing PMI	Nov	**53.7**	53.3	53.5	-
		Preliminary services PMI (preliminary composite PMI)	Nov	**54.1 (54.1)**	52.9 (53.3)	52.8 (53.3)	-
Germany		Preliminary manufacturing PMI	Nov	**54.4**	54.8	55.0	-
		Preliminary services PMI (preliminary composite PMI)	Nov	**55.0 (54.9)**	54.0 (55.0)	54.2 (55.1)	-
France		Preliminary manufacturing PMI	Nov	**51.5**	51.5	51.8	-
		Preliminary services PMI (preliminary composite PMI)	Nov	**52.6 (52.3)**	51.9 (51.9)	51.4 (51.6)	-
Country		Auction					
Germany sold		€2.5bn of 0% 2026 bonds (15-Aug-2026) at an average yield of 0.21%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Economic data						
Germany		07:00	GDP – second release Q/Q% (Y/Y%)	Q3	*0.2 (1.7)*	0.4 (1.8)
		09:00	Ifo business climate index	Nov	110.5	110.5
		09:00	Ifo current assessment balance (expectations)	Nov	115.0 (106.0)	115.0 (106.1)
		12:00	GfK consumer confidence survey	Dec	9.7	9.7
France		07:45	Business confidence indicator (production outlook)	Nov	101 (2)	101 (2)
Spain		08:00	GDP – second release Q/Q% (Y/Y%)	Q3	*0.7 (3.2)*	0.8 (3.2)
UK		09:30	BBA loans for house purchase 000s	Oct	39.0	38.3
		15:00	BoE corporate bond purchases £mn	Weekly	-	3070
Auctions and events						
Country		GMT	Auction / Event			
EMU		16:10	ECB's Praet scheduled to speak in Vienna			
UK		14:50	BoE APF operation: To purchase 7-15Y Gilts			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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