

Euro wrap-up

Overview

- Bunds made gains as data confirmed a subdued start to Q4 for euro area industrial output.
- Gilts also made gains as data suggested that the UK's labour market is starting to weaken.
- Thursday brings the latest BoE monetary policy announcements along with the euro area flash PMIs for December and latest UK retail sales figures.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.768	-0.016
OBL 0 10/21	-0.465	-0.030
DBR 0 08/26	0.306	-0.053
UKT 1¼ 07/18	0.118	-0.024
UKT 3¾ 09/21	0.556	-0.041
UKT 1½ 07/26	1.387	-0.056

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

Euro area

IP set to pick up following a limp start to Q4

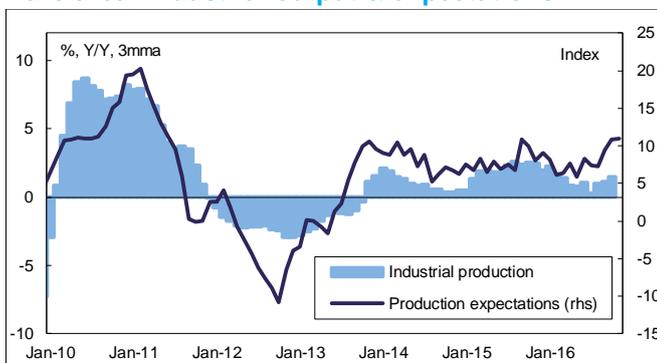
Having dropped at the end of the third quarter, euro area industrial output was also limp at the start of Q4, declining a further 0.1%M/M to stand just 0.6% higher than a year earlier. Total production of goods fell too, with higher capital goods output (up 1%M/M following a drop of more than 2%M/M the previous month) more than offset by declines in other items, while the overall IP figure was also supported by a weather-related increase in energy output. This drop in the overall euro area figure was no surprise, with national data having already revealed at best minimal growth in each of the five largest member states. Looking ahead, however, there seems every reason to expect an acceleration in production over the remainder of the fourth quarter. Certainly, surveys suggest that manufacturers are increasingly optimistic, with the euro area manufacturing PMI up in November to the highest level since January 2014 and the European Commission survey index of manufacturing production expectations up last month to the highest since 2011. And following the near-5%M/M surge in German manufacturing orders in October, and after the Ifo business climate index for the sector also reached its highest level in more than two years that month, we expect the euro area's largest member state to lead the way into the New Year.

The day ahead in the euro area and US

Thursday will bring December's flash PMIs from the euro area, Germany and France. These are expected to remain close to their respective levels in November when the euro area composite PMI rose to 53.9, the highest so far in 2016. EU new car registration figures for November are also due for release. In the markets, Spain will sell 5Y and 10Y bonds. In Brussels, meanwhile, EU leaders will meet for their latest summit covering issues related to migration, security, Russia and Ukraine, and (over dinner without UK Prime Minister May) Brexit.

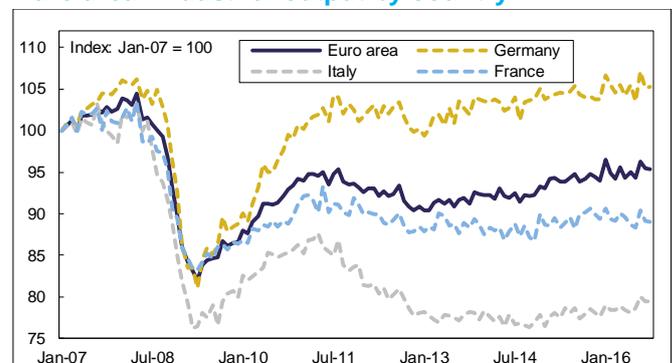
In the US, as the dust settles on the Fed's announcements, Thursday will bring November's CPI inflation figures along with the December NAHB housing and Philly Fed business indices, October TIC capital flow data and the usual weekly claims numbers.

Euro area: Industrial output & expectations*



*European Commission manufacturing production intentions index.
Source: EC, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial output by country



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



UK

Labour market starting to weaken?

In many ways, conditions in the UK labour market remained relatively firm in the aftermath of the Brexit vote. However, today's data revealed a drop of 6k in the number of people in work in the three months to October, the first decline in sixteen months, with a drop in the employment rate from the previous month's series high. While the headline unemployment rate on the ILO measure remained unchanged over the same three-month period at 4.8%, the lowest in eleven years, that stability partly reflected an increase in the number of inactive people of working age. In addition, the single-month figures for October suggested a more abrupt deterioration at the start of the fourth quarter, with a sharper decline in the employment rate to a six-month low and a rise of 0.3ppt in the unemployment rate to 4.9%. It is, of course, too soon to tell if this deterioration represents the start of a new trend in the labour market. However, as noted by the BoE in its November Inflation Report, some surveys have already pointed towards a slowdown in employment growth as firms respond to the more subdued economic outlook and heightened Brexit-related uncertainty. Moreover, the number of vacancies dropped in the three months to November back below the average of the past year, albeit still remaining elevated compared to the norms of the period since the financial crisis.

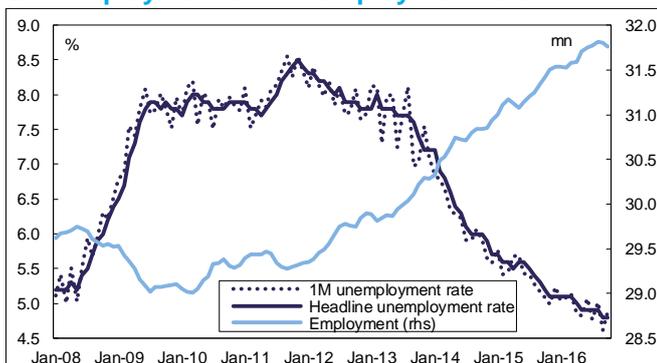
Real wage growth stable, for the time being

With inflation set to rise significantly over coming months on the back of the post-referendum depreciation of sterling, the MPC has made it clear that it will be watching wage developments particularly closely for risks of second-round effects on domestic costs. Despite the evidence of a weakening of labour demand, average real wage growth remained unchanged in the three months to October, at 1.7%Y/Y, as the increase in inflation over that period was matched by an increase in nominal pay growth. Indeed, excluding bonus payments, average earnings rose 2.6%Y/Y, the most in fourteen months. But if, as we expect, labour demand weakens more significantly, unless labour supply also declines (e.g. in response to an exodus of migrant workers), nominal wage growth seems highly unlikely to compensate anywhere near fully for the rise in headline inflation, which we expect to reach around 3%Y/Y by end-2017.

The day ahead in the UK

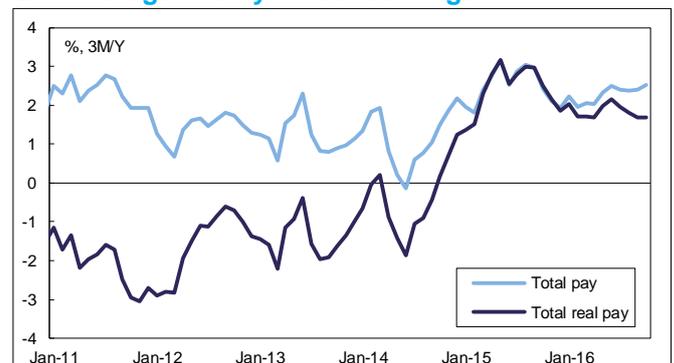
Thursday will bring the latest policy announcement from the BoE's Monetary Policy Committee, although this is likely to be a non-event. Data since the November meeting, at which the MPC removed its bias towards a possible further reduction in Bank Rate, have been broadly in line with the BoE's forecast. And with sterling having appreciated over the past month, upward pressure on inflation might prove slightly less than previously anticipated. Ahead of the MPC announcement, November's retail sales figures are due. These are expected to show that the annual rate of sales growth eased last month from the fourteen-year high of 7.4% reached in October despite the efforts of retailers to attract customers via the Black Friday sales.

UK: Employment and unemployment rate



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Average weekly labour earnings



Source: Thomson Reuters 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
EMU	 Industrial production M/M% (Y/Y%)	Oct	-0.1 (0.6)	0.1 (0.8)	-0.8 (1.2)	-0.9 (1.3)
France	 Final EU-harmonised CPI Y/Y%	Nov	0.7	0.7	0.5	-
Italy	 Final EU-harmonised CPI Y/Y%	Nov	0.1	0.1	-0.1	-
UK	 Average earnings incl. bonuses (excl. bonuses) 3M/Y%	Oct	2.5 (2.6)	2.3 (2.6)	2.3 (2.4)	2.4 (-)
	 ILO unemployment rate 3M%	Oct	4.8	<u>4.8</u>	4.8	-
	 Employment change 3M/3M '000s	Oct	-6	<u>70</u>	49	-
	 Claimant count rate % (change 000s)	Nov	2.3 (2.4)	2.3 (6.5)	2.3 (9.8)	- (13.3)
Country	Auction					
UK sold	 £800mn of 0.125% 2036 index-linked bonds (22-Nov-2036) at an average yield of -1.518%					
	 BoE APF operation purchased £1bn of 7-15Y Gilts (2.64 cover ratio)					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases						
Economic data						
Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
EMU	07:00	 EU27 new car registrations	Nov	-	0.0	
	09:00	 Preliminary manufacturing PMI	Dec	53.7	53.7	
	09:00	 Preliminary services PMI (preliminary composite PMI)	Dec	53.8 (53.9)	53.8 (53.9)	
Germany	08:30	 Preliminary manufacturing PMI	Dec	54.5	54.3	
	08:30	 Preliminary services PMI (preliminary composite PMI)	Dec	54.9 (54.9)	55.1 (55.0)	
France	08:00	 Preliminary manufacturing PMI	Dec	51.8	51.7	
	08:00	 Preliminary services PMI (preliminary composite PMI)	Dec	51.9 (51.6)	51.6 (51.4)	
UK	09:30	 Retail sales excluding petrol M/M% (Y/Y%)	Nov	0.0 (6.0)	2.0 (7.6)	
	09:30	 Retail sales including petrol M/M% (Y/Y%)	Nov	0.0 (5.9)	1.9 (7.4)	
	12:00	 BoE bank rate %	Dec	<u>0.25</u>	0.25	
	12:00	 BoE asset purchase target £bn	Dec	<u>435</u>	435	
	15:00	 BoE corporate bond purchases £mn	Weekly	-	4447	
Auctions and events						
Country	GMT	Auction / Event				
Spain	09:30	 Auction: To sell 0.75% 2021 bonds (30-Jul-2021)				
	09:30	 Auction: To sell 1.3% 2026 bonds (31-Oct-2026)				
UK	12:00	 Monetary policy announcement and MPC minutes				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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