

Euro wrap-up

Overview

- Despite increased political uncertainty in Germany, Bunds made large losses as the euro area manufacturing PMIs were revised up from their flash estimates.
- Gilts made somewhat smaller losses despite an upwards revision to the UK flash manufacturing PMIs.
- Tuesday will bring euro area PPI data and the UK construction PMIs, while Wednesday will bring final services PMIs from the euro area and UK.

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Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.624	+0.021
OBL 0 10/24	-0.533	+0.055
DBR 0 08/29	-0.282	+0.082
UKT 3% 09/21	0.543	-0.002
UKT 1 04/24	0.537	+0.025
UKT 0% 10/29	0.735	+0.037

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

Euro area

Future of Germany's coalition in doubt

A dose of political uncertainty has returned to the euro area, with tensions within Italy's ruling coalition emerging over reforms to the ESM, and the future of Germany's Grand Coalition (GroKo) government in doubt. In terms of the latter, Saturday brought the announcement that the left-leaning Norbert Walter-Borjans (former Finance Minister of North Rhine-Westphalia) and his running mate, the GroKo critic Saskia Esken, had won the Social Democrat Party's (SPD) leadership contest against expectations. The margin of victory was relatively large, with 53% in favour of the winning candidates against 45% for the defeated federal Finance Minister Olaf Scholz and his partner Klara Geywitz, who would have represented continuity in government. By contrast, Esken subsequently called for a renegotiation of the 2018 coalition government agreement – to include a significant fiscal stimulus, lashings of infrastructure spending and a more aggressive anti-climate change agenda – something that Chancellor Merkel's CDU/CSU alliance seems unwilling to countenance. The future of the coalition might well be determined over the coming week at the SPD's conference, which kicks off on Friday.

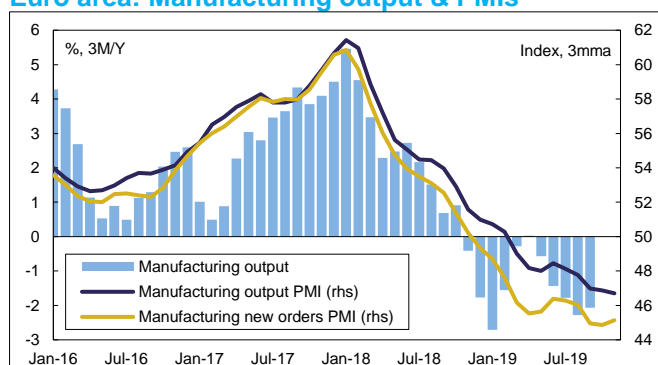
SPD ill-placed for an early General Election

Should the SPD choose to withdraw from government, we would expect the CDU/CSU to continue with a minority administration for the time being. That would not be particularly disruptive: after all, the 2020 Budget has now been ratified. It would, however, be a recipe for policy drift, although we note that the coalition to-date has hardly been assertive in policymaking. Indeed, despite the strong fiscal position, once again the 2020 Budget lacked the invention and ambition required to shift the German economy onto a stronger economic growth trajectory. Nevertheless, if and when the SPD withdraws from government, the chances of an early General Election before the middle of next year would clearly rise. But since we doubt that the SPD's ratings will see a particularly transformative bounce from the new leadership, an early election is unlikely to be in its interests – polls suggest that it has lost about one third of its support since the 2017 election, which itself represented the worst showing in the party's history. As a result, the SPD is currently neck-and-neck with the far-right Alternative for Germany (AfD) in a tussle for third place, well behind the CDU/CSU and second-placed Greens who are very well-placed to participate in the federal government after the next General Election.

Manufacturing PMIs revised up

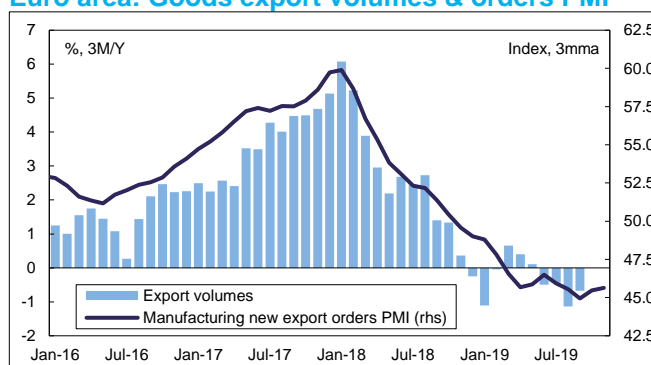
The final manufacturing PMIs for November reported slight upwards revisions from the flash estimates, which had already provided hints that the pace of deterioration in the sector has eased. In particular, the headline euro area manufacturing PMI was upwardly revised by 0.3pt to 46.9, up 1.0pt from October and 1.2pts from the trough in September. The indices for

Euro area: Manufacturing output & PMIs



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

Euro area: Goods export volumes & orders PMI



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



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output and new orders were revised up too, as were the headline figures for Germany (44.1, 2.0pts higher than in October) and France (51.7, 0.4pt higher than in October). Of course, the manufacturing sector has for more than a year been the prime source of weakness in the euro area, with production having trended steadily lower since the summer of 2018. And despite the upwards revision, the average euro area headline manufacturing PMI for the first two months of Q4 was still firmly in contraction territory and no better than the Q3 average (46.4). So, while today's figures were more encouraging than of late, any conclusion that a meaningful recovery in the sector is now underway would be premature.

The coming two days in the euro area and US

Tuesday will be a quiet day for economic data from the euro area, with just PPI data for October due. Expect a further decline in the annual rate to -1.8%Y/Y, the lowest in more than three years, not least due to lower energy inflation. The final services and composite PMIs, for which the flash estimates suggested further weakening of momentum despite the better showing in manufacturing, are due on Wednesday. In particular, the flash services PMI fell 0.7pt to the lowest level since January. Beyond the economic data, the European Parliament committee hearings into the ECB Executive Board nominees Isabel Schnabel and Fabio Panetta will be held tomorrow when departing Board member Benoît Cœuré will also speak publicly. French National Bank Governor Villeroy will give a speech on Wednesday. In the markets, Germany will sell 10Y Bunds on Wednesday.

In the US, Tuesday will bring November vehicle sales data. Wednesday will bring ADP employment report as well as the non-manufacturing ISM and Markit services PMI surveys.

UK

Manufacturing PMI signals ongoing contraction

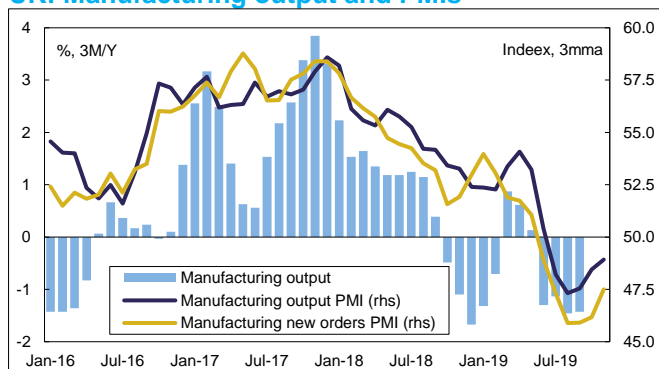
While the UK's final manufacturing PMI today saw widespread upwards revisions from the flash release, it still offered a poor assessment of conditions in the sector. Against the backdrop of continued political uncertainty, it suggested that firms continued to scale back production in November and remained downbeat about the near-term outlook too. In particular, despite coming in 0.6pt higher than the flash estimate, the headline index stood at 48.9, a decline of 0.7pt from October and the seventh consecutive sub-50 reading. This in part reflected the reversal of the precautionary stock building ahead of the end-October Brexit deadline, with the relevant index down 6.6pts to a more-than 2½-year low. But the output component was 0.6pt lower at a still-weak 49.1. And while producers of consumer goods suggested that output ticked slightly higher last month, the survey signalled renewed weakness in production of intermediate goods. Furthermore, the outlook for manufacturers of investment goods remained more downbeat, with the relevant indices for production, new orders and employment implying a steeper pace of contraction than other sub-sectors.

Perhaps unsurprisingly, manufacturers across all subsectors remained gloomy about the near-term outlook, with notable pessimism with respect to external demand – indeed, the new export orders PMI for all manufacturers declined 5.6pts to 46.0, the second-lowest reading since 2012. Against this backdrop, the survey implied a further cut back in the number of people employed in the sector for the eighth straight month and by the most for more than seven years. And today's survey suggested little upward inflationary pressures in the sector, with the output price PMI falling to its second lowest level since mid-2016 and the input price index recording the first sub-50 reading for 3½ years.

The coming two days in the UK

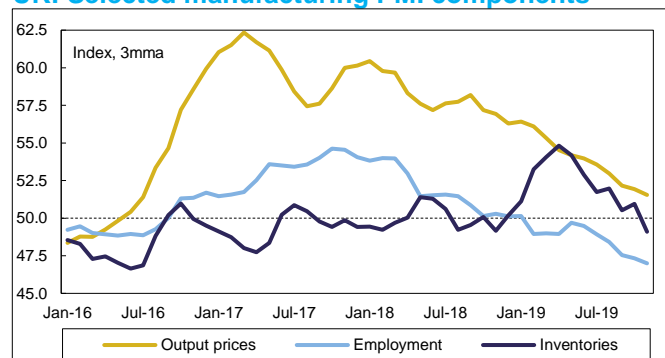
Sentiment surveys will continue to dominate the data flow over coming days, with the construction PMI (due tomorrow) and services PMI (Wednesday). The headline construction index is expected to remain considerably below the 50-level, signalling ongoing significant weakness this month. The flash services survey surprised on the downside, with the headline index declining 1.4pts to 48.6. So, despite the modest upwards revision to today's manufacturing survey, the final composite

UK: Manufacturing output and PMIs



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

UK: Selected manufacturing PMI components



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







PMI will likely remain firmly in contractionary territory (albeit a touch firmer than the flash estimate of 48.5), at its second-lowest level since the Global Financial Crisis. Tomorrow will also bring the BRC's latest retail sales monitor for November, which is expected to show that year-on-year growth in like-for-like sales fell back into negative territory for the third month out of the past four. In the markets, the DMO will sell 10Y Gilts tomorrow.

In the absence of significant news, the next edition of the Euro wrap-up will be published on 4 December 2019

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Final manufacturing PMI	Nov	46.9	46.6	45.9	-
Germany	 Final manufacturing PMI	Nov	44.1	43.8	42.1	-
France	 Final manufacturing PMI	Nov	51.7	51.6	50.7	-
Italy	 Manufacturing PMI	Nov	47.6	47.7	47.7	-
Spain	 Manufacturing PMI	Nov	47.5	47.0	46.8	-
UK	 Final manufacturing PMI	Nov	48.9	48.3	49.6	-





Auctions

Country	Auction
- Nothing to report -	


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	 10.00	PPI Y/Y%	Oct	-1.8	-1.2
Spain	 08.00	Unemployment 000s	Npv	-	97.9
UK	 00.01	BRC retail sales monitor, like-for-like sales Y/Y%	Nov	-0.4	0.1
	 09.30	Construction PMI	Nov	44.5	44.2







Auctions and events

Country	GMT	Auction / Event
UK	 10.30	Auction: 0.875% 2029 bonds


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's data releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU	 09.00	Final services (composite) PMI	Nov	51.5 (50.3)	52.2 (50.6)
Germany	 08.55	Final services (composite) PMI	Nov	51.3 (49.2)	51.6 (48.9)
France	 08.50	Final services (composite) PMI	Nov	52.9 (52.7)	52.9 (52.6)
Italy	 08.45	Services (composite) PMI	Nov	51.2 (50.6)	52.2 (50.8)
Spain	 08.15	Services (composite) PMI	Nov	51.9 (50.7)	52.7 (51.2)
UK	 09.30	Final services (composite) PMI	Nov	48.6 (48.5)	50.0 (50.0)

Auctions and events

Country	GMT	Auction / Event
Germany	 10.30	Auction: €3bn of 0% 2029 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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