

Euro wrap-up

Overview

- Longer-dated Bunds followed USTs lower even as the flash euro area PMIs for December surprised on the downside.
- Gilts also made losses while the flash UK PMIs signalled significant economic weakness heading towards year-end.
- Tuesday will bring new data for euro area goods trade and new car registrations as well as the latest UK labour market figures.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.641	-0.008
OBL 0 10/24	-0.539	+0.001
DBR 0 08/29	-0.274	+0.020
UKT 3¼ 09/21	0.598	+0.057
UKT 1 04/24	0.634	+0.047
UKT 0% 10/29	0.823	+0.034

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

Euro area

Flash PMIs suggest weakness persists

The ECB's updated economic forecasts, published last week, showed that the Governing Council expects euro area economic growth to pick-up from Q1 onwards. The December flash PMIs, however, showed no meaningful improvement heading towards year-end. In particular, contrary to expectations of a second successive monthly increase, the euro area manufacturing PMI fully reversed November's gain to fall 1pt to 45.9, only 0.2pt above September's seven-year low, to suggest continued retrenchment in the sector. Within the detail, the manufacturing output component fell 1.5pts to the lowest since September 2012, while the indices for new orders and employment in the sector fell too. More encouragingly, the services PMI rose 0.5pt to a four-month high of 52.4, implying resilience to the manufacturing weakness and ongoing steady (if not vigorous) growth in the sector. Nevertheless, that still left the composite PMI stuck for a third month at 50.6, matching the second-lowest reading since mid-2013.

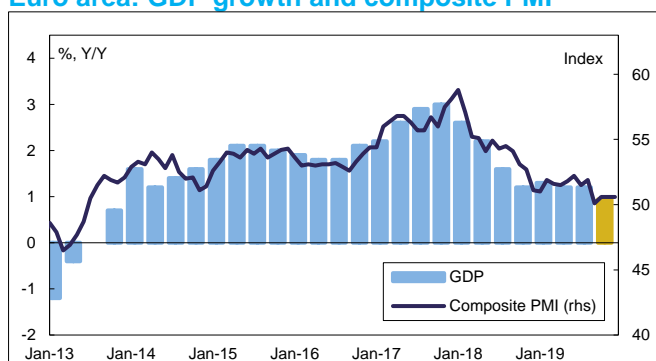
PMIs point slower growth in Q4

Given the renewed deterioration towards year-end, over Q4 as a whole the euro area manufacturing PMI (46.2) dropped to its lowest quarterly average in six years. And despite the improved reading for the sector in December, the services PMI in the fourth quarter (52.2) was the worst since Q414. So, the average composite PMI (50.6) fell to its lowest since the recovery from the sovereign debt crisis began in Q213, and a level consistent with euro area GDP growth in Q4 of just 0.1%Q/Q, 0.1ppt weaker than the two previous quarters. In addition, the survey suggested that employment growth slowed to a five-year low, new orders growth shifted into reverse for the first time since Q213, and underlying inflation pressures moderated further with the output price PMI down to its lowest in three years.

France still outperforming Germany

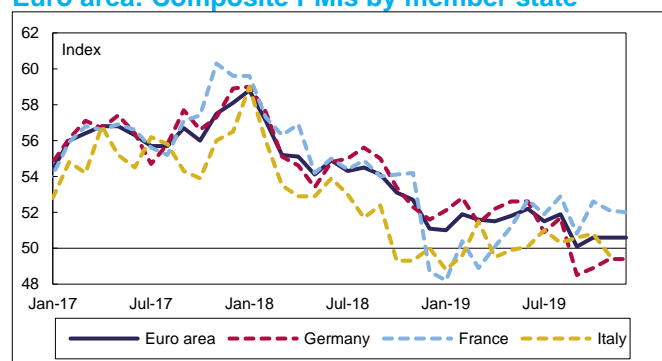
The flash PMIs at the country level for December matched the pattern of the aggregate euro area, with services firmer but manufacturing weaker and the composite PMIs little changed from the prior month. So, France's composite PMI in Q4 averaged 52.2, up 0.3pt from Q3 and a four-quarter high, to suggest ongoing economic growth of 0.3%Q/Q, the same pace as each of the first three quarters of 2019. In contrast, with its manufacturing PMIs suggesting ongoing contraction in the sector, Germany's composite PMI in Q4 averaged 49.2, down more than 1pt from Q3 and the lowest since Q412, to raise the prospect of another dip in GDP. While flash PMIs for other member states were not published, Markit stated that its survey suggested that growth remained at a six-year low in the remainder of the euro area.

Euro area: GDP growth and composite PMI*



*Flash composite PMI for December 2019. GDP forecast for Q419.
Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Composite PMIs by member state*



*Flash PMIs for December 2019 for euro area, Germany and France.
Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.



Labour cost growth levelling off

Beyond the flash PMIs, euro area private sector labour costs in Q3 rose 2.6%Y/Y, matching the average of the preceding four quarters. As the unemployment rate fell faster than expected, labour cost growth had picked up steadily over the two years to mid-2018. But since then, with the pace of improvement in the labour market slowing in line with weaker economic growth – the rise in employment in Q3 of less than 120k was the weakest in six years, while the unemployment rate has plateaued since the summer at around 7½% – labour cost growth levelled off. Despite the further decline in the employment PMIs in Q4, we do not expect labour market conditions to deteriorate significantly – indeed, job growth in October looks to have been the strongest since March while negotiated wage settlement growth, at 2.6%Y/Y in Q3, edged up slightly to the firmest in a decade. Nevertheless, with overall economic growth set to remain sub-potential and the unemployment rate likely to continue to trend sideways, we expect overall labour cost growth to remain broadly steady over coming quarters, suggesting no additional impetus to domestically generated inflation in 2020.

The day ahead in the euro area and US

Tuesday will bring euro area new car registration data for November along with the region's goods trade report for October. In the US, November figures for industrial production, housing starts and building permits are due. Most notably perhaps, manufacturing production is likely to have rebounded driven by the return of striking workers at General Motors. Housing starts are also likely to be stronger, buoyed by firmer sales over prior months.

UK

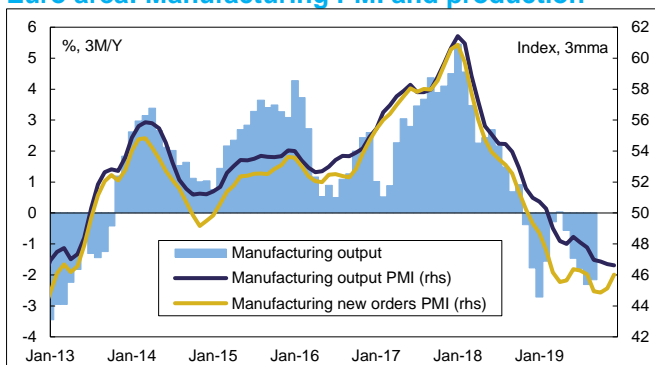
Economic activity weak ahead of General Election

As political uncertainty continued to take its toll ahead of the 12 December General Election, today's flash UK PMIs – which reflected survey responses during the week up to and including polling day – offered a particularly disappointing snapshot of economic activity heading towards year-end. Like in the euro area, the weakness was particularly striking in the manufacturing sector, for which the output index fell a sizeable 3.3pts to 45.8, the lowest reading since mid-2012. And with new orders reportedly declining for the eighth consecutive month, manufacturers also continued to scale back their workforces. But firms in the services sector were also more downbeat. Indeed, the headline PMI fell for the fourth month out of the past five in December to 49.0, with the latest two observations marking the first successive sub-50 readings in the sector for more than a decade. And despite a notable improvement in the survey's new orders component, this was merely consistent with stabilisation rather than growth.

PMIs point to contraction in Q4

So, overall, the composite PMI fell 0.8pt in December to 48.5, the second-lowest reading since the height of the Global Financial Crisis. That left the quarterly index at 49.3 in Q4, a drop of 0.8pt from Q3, the weakest since Q109 and consistent with GDP growth of -0.2%Q/Q. While our forecast is for a slightly smaller contraction in the final quarter of 2019 (-0.1%Q/Q), we remain broadly downbeat about the outlook heading into the New Year. Indeed, while the outcome of last week's election brought confirmation that the UK will leave the EU on 31 January, Johnson's current insistence that he will not apply for an extension of the transition period implies a non-negligible risk that the UK will leave at the end of next year under WTO rules, which would see large tariffs applied to UK manufacturers and a loss of market access for services. As such, we expect business investment in particular – which has flat-lined since the 2016 referendum – to remain very subdued.

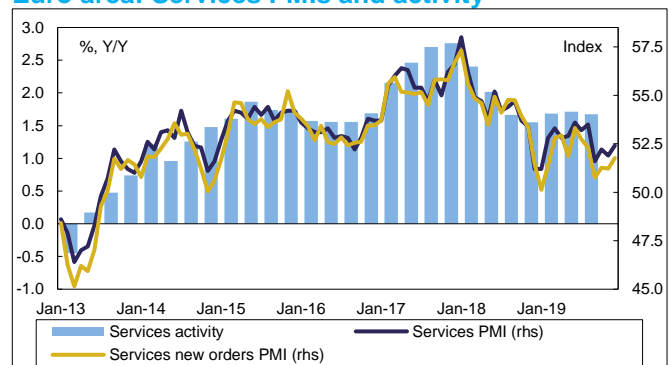
Euro area: Manufacturing PMI and production*



*Flash PMI for December 2019.

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

Euro area: Services PMIs and activity*



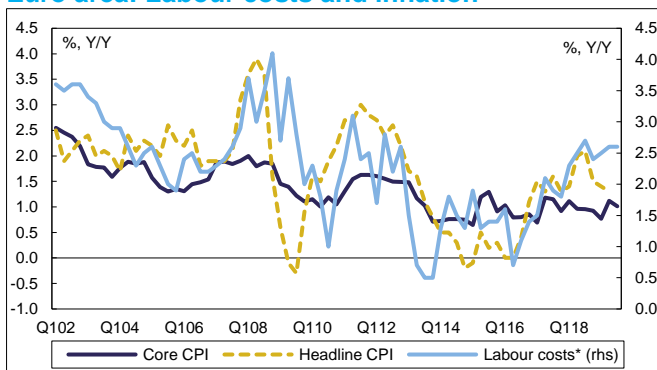
*Flash PMIs for December 2019

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

The day ahead in the UK

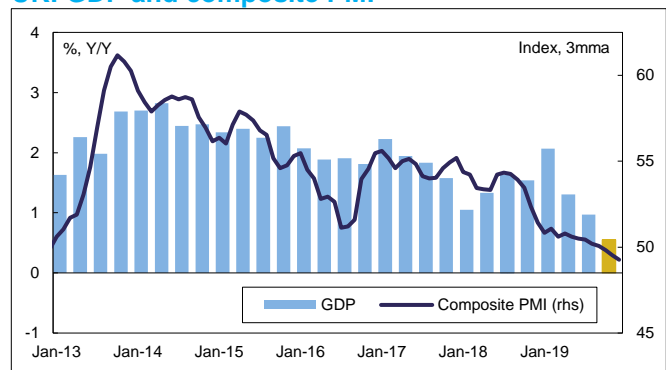
The main data focus in the UK tomorrow will be the latest labour market report, with figures likely to confirm that employment declined for the third consecutive month in the three months to October, to leave the unemployment rate edging slightly higher to 3.9%. Against this backdrop, wage growth is likely to have moderated further that month, with average weekly earnings growth set to fall to a five-month low of 3.4%3M/Y. Tomorrow will also bring the CBI's latest industrial trends survey, which is expected to confirm still significant weakness in manufacturing orders. In the markets, the DMO will sell 5Y Gilts.

Euro area: Labour costs and inflation



*Labour costs exclude public sector. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: GDP and composite PMI*














*Flash PMIs for December 2019. GDP forecast for Q4 19. Source: Markit, 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	 Preliminary manufacturing (services) PMI	Dec	45.9 (52.4)	47.4 (52.0)	46.9 (51.9)	-
	 Preliminary composite PMI	Dec	50.6	50.7	50.6	-
	 Labour costs Y/Y%	Q3	2.6	-	2.7	2.8
Germany	 Preliminary manufacturing (services) PMI	Dec	43.4 (52.0)	44.6 (52.0)	44.1 (51.7)	-
	 Preliminary composite PMI	Dec	49.4	49.9	49.4	-
France	 Preliminary manufacturing (services) PMI	Dec	50.3 (52.4)	51.5 (52.1)	51.7 (52.2)	-
	 Preliminary composite PMI	Dec	52.0	52.0	52.1	-
Italy	 Final CPI (EU-harmonised CPI) Y/Y%	Nov	0.2 (0.2)	0.4 (0.4)	0.2 (0.2)	-
UK	 Rightmove house price index M/M% (Y/Y%)	Dec	-0.9 (0.8)	-	-1.3 (0.3)	-
	 Preliminary manufacturing (services) PMI	Dec	47.4 (49.0)	49.2 (49.5)	48.9 (49.3)	-
	 Preliminary composite PMI	Dec	48.5	49.6	49.3	-

Auctions









Country	Auction
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- 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	 07.00	EU27 new car registrations Y/Y%	Nov	-	8.7
	 10.00	Trade balance €bn	Oct	-	18.3
Italy	 09.00	Trade balance €bn	Oct	-	2.8
UK	 09.30	ILO unemployment rate 3M%	Oct	3.9	3.8
	 09.30	Employment 3M/3M, '000s	Oct	-14	-58
	 09.30	Claimant count rate % (change '000s)	Nov	-	3.4 (33.0)
	 09.30	Average earnings (excluding bonuses) 3M/Y%	Oct	3.4 (3.4)	3.6 (3.6)
	 11.00	CBI industrial trends survey, total orders	Dec	-25	-26

Auctions and events

Country	GMT	Auction / Event
UK	 10.30	Auction: to sell £2.75bn of 2% 2025 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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