Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds made losses despite some disappointing German factory orders data, which fell to a more than three-year low.
- Gilts ended the day little changed as UK labour productivity figures suggested that the woeful post-crisis performance continues.
- Thursday will bring euro area unemployment figures, German IP and trade data and a UK retail sector survey.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.631	+0.005
OBL 0 10/24	-0.541	+0.018
DBR 0 02/30	-0.229	+0.020
UKT 3¾ 09/21	0.608	+0.007
UKT 1 04/24	0.611	-0.001
UKT 0⅞ 10/29	0.795	+0.003

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

Euro area

German orders fall to new low

Germany's factory orders data for November were a big disappointment. Contrary to the consensus expectation of a rise, orders fell 1.3%M/M, the most since July, to be down a hefty 6.5%Y/Y at the lowest level since September 2016. The weakness in the latest month came from foreign orders, which followed two months of growth by dropping a steep 3.1%M/M, with orders from the euro area down 3.3%M/M and those from other countries down 2.8%M/M. In contrast, domestic orders, which had seen the steepest declines over the course of 2019, rose 1.6%M/M. By sector, the falls were concentrated in capital goods (down 2.1%M/M) while orders of intermediate and consumer items were little changed.

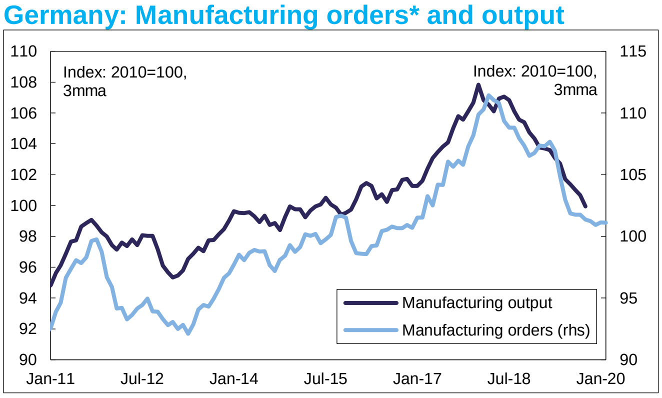
Detail suggests stabilisation

The picture is not quite as bad as the headline figures suggest. The October reading was nudged slightly higher to show growth of 0.2%M/M contrary to the previously estimated decline. (September's figure, however, was revised down). In addition, the drop in the latest month was explained by big-ticket items – excluding these, orders rose 1.0%M/M with those from abroad down a modest 0.4%M/M. And looking through the volatility, despite the new multi-year low, orders seem to be trending broadly sideways. On a three-month basis, total orders were down just 0.1%, with orders of capital goods flat and orders of autos and associated parts up 1.1%3M/3M. Admittedly, manufacturing turnover dropped 0.3%M/M in November to a 28-month low to suggest that tomorrow's production figure might well be another soft one. And VDA data showed that car production in December plummeted to the third lowest level in the past fifteen years. However, the overall impression is that the worst of the declines in German factory output are now behind us, even if recovery in the sector evidently remains elusive.

Euro area sentiment ticks slightly higher

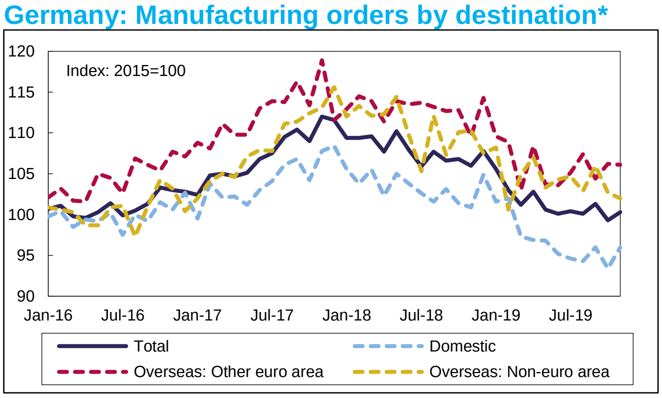
The European Commission's sentiment survey – which arguably provides the best guide to overall economic activity in the euro area – today also suggested that the loss of momentum over recent quarters might now have come to an end. In particular, the headline economic sentiment index (ESI) rose for the second successive month in December, by 0.3pt to 101.5. Admittedly, this still marked the third-lowest reading for almost five years. And over the fourth quarter as a whole, the index was on average more than 1pt lower than Q3, supporting our view that GDP growth slowed in Q4 by 0.1ppt to 0.1%Q/Q. But the detail of the report was certainly encouraging. Most notably, a significant improvement in services sentiment – the 2.2pt increase on the month was the largest since March 2014 – to a seven-month high suggests that the sector has shrugged off the weakness in the manufacturing sector. At the same time, the near-stability in the indicator for

Germany: Manufacturing orders* and output



*Orders have a three-month lead. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing orders by destination*



*Excludes major items. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

industrial confidence complemented the German orders data to suggest that the worst of the declines in production are behind us. Construction firms were also the most upbeat for seven months on the back of improved order books. In contrast, consumer confidence aligned with the deterioration reported in the flash release, reaching its lowest level since late 2017 as households were more concerned about the general economic outlook and their expected financial situation.

Mixed performance among member states

France was the only of the largest four member states to see a modest deterioration in overall sentiment in December, with that country's ESI down 0.2pt to 103, nevertheless still bang in line with the average for the year as a whole. Indeed, the decline was driven by weaker consumer confidence, likely reflecting the impact of the strikes among workers in transport and certain other sectors. Meanwhile, Germany's ESI edged slightly higher in December (up 0.4pt to 100.0, a four-month high) as services sentiment jumped to its highest since June. But while there were marked improvements in the ESIs in Italy (+1.7pts) and Spain (+1.3pts), these were from particularly weak levels. And over the fourth quarter as a whole, the headline indices of each of the large four member states were down compared with Q3.

The day ahead in the euro area and US

Tomorrow will bring the euro area's latest labour market figures, which are expected to show the unemployment rate moving sideways in November at 7.5%, the joint lowest since 2008. Thursday will also bring the aforementioned German IP release for November. Not least given the significant weakness seen in October – which might well have been exaggerated by special factors related to the timing of the German Unity Day holiday that might have seen many workers take an extra day's leave – we expect output to have increased in November, by almost 1%M/M. In contrast, the latest German trade figures are expected to show that exports fell back in November following two solid increases. Elsewhere, the ECB's Chief Economist Lane will speak at a BoE conference, while newly appointed Executive Board member Schnabel's speech in Germany will also be watched. In the markets, France and Spain will sell bonds with various maturities.

A quieter day for US releases brings just the weekly jobless claims figures. But there will be a number of FOMC voting members in action, including Vice Chair Williams, Clarida, Evans and Bullard. Supply-wise, the Treasury will sell 30Y bonds.

UK

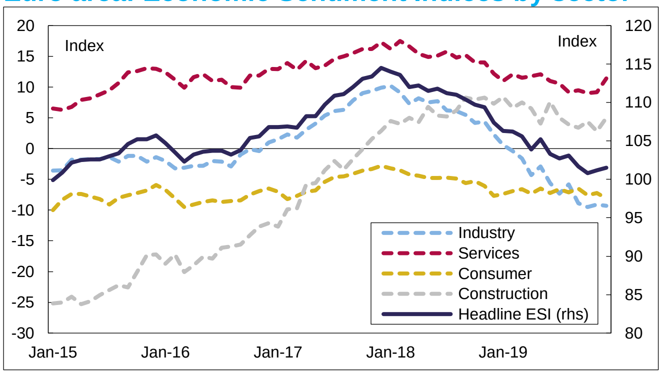
Productivity growth remains poor

Final UK productivity figures for Q3 published by the ONS today provided no surprises, confirming that the woeful post-crisis performance continues. In particular, labour productivity, measured by output per hour, rose just 0.4%Q/Q in Q3 following two quarters of decline, to leave it up just 0.1% compared with a year earlier. This left productivity in the latest quarter one fifth lower compared with the level it would have reached if the pre-crisis pace had been maintained. While services provided a modest positive contribution to productivity in Q3 thanks to financial services, this still left productivity in the sector as a whole little changed compared with a year earlier. Meanwhile, declines in manufacturing output in each month of Q3 left productivity in that sector almost 2% lower than a year earlier.

Unit labour cost growth remains firm

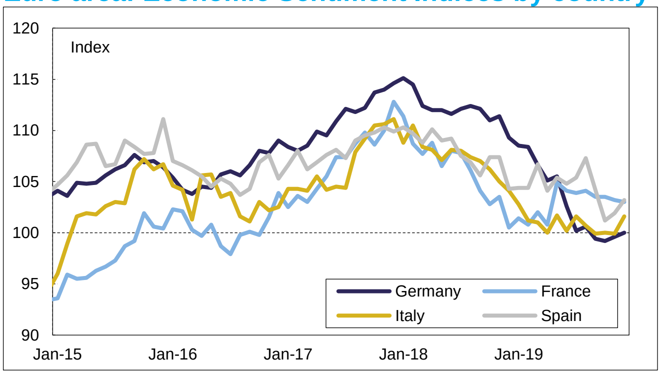
So, with wages having continued to outpace productivity, unit labour costs increased 3.6%Y/Y in Q3, down 0.4ppt from Q2 but still the third-fastest rate of the past five years. And while job creation and wage growth have moderated further into the fourth quarter, persistently weak productivity growth – which has likely been related at least in part to subdued investment, and might be expected to persist once the economic costs of Brexit crystallise – will likely see unit labour cost growth ease only marginally over coming quarters. As such, the BoE will likely remain reluctant to ease monetary policy further, even as GDP growth continues to disappoint expectations.

Euro area: Economic Sentiment Indices by sector



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Economic Sentiment Indices by country

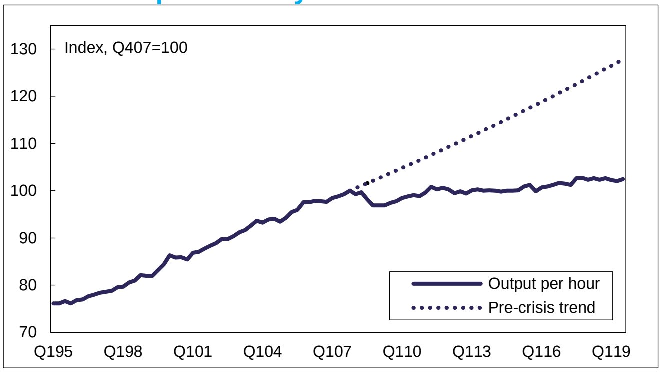


Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

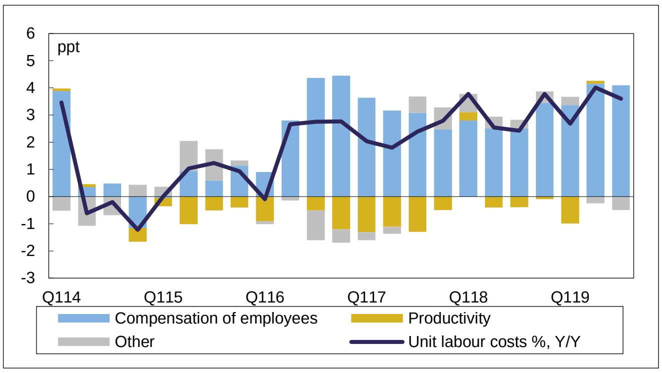
Tomorrow will bring the BRC's latest retail sales monitor for December. Not least given the inclusion of the Black Friday discounting period that month, we would expect to see a bounce back in sales growth at the end of 2019. But this will mask underlying weakness in consumption in the final quarter of the year, growth of which looks set to have moderated from Q3. Meanwhile, BoE Governor Carney will give opening remarks at the Bank's conference on the future of inflation targeting. In the markets, the DMO will sell 10Y index-linked Gilts.

UK: Labour productivity



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Unit labour costs



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		Economic confidence	Dec	**101.5**	101.4	101.3	**101.2**
		Industrial confidence (services)	Dec	**-9.3 (11.4)**	-9.0 (9.5)	-9.2 (9.3)	**-9.1 (9.2)**
		Final consumer confidence	Dec	**-8.1**	-8.1	-7.2	**-**
Germany		Factory orders M/M% (Y/Y%)	Nov	**-1.3 (-6.5)**	0.2 (-4.7)	-0.4 (-5.5)	**0.2 (-5.6)**
France		Consumer confidence	Dec	**102**	104	106	**105**
		Trade balance €bn	Nov	**-5.6**	-5.1	-4.7	**-4.9**
UK		Unit labour costs Y/Y%	Q3	**3.6**	-	3.6	**4.0**

Auctions

Country		Auction
Germany		sold €3.534bn of 0% 2030 bonds at an average yield of -0.25%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		10.00	Unemployment rate %	Nov	7.5	7.5
Germany		07.00	Industrial production M/M% (Y/Y%)	Nov	0.8 (-3.7)	-1.7 (-5.3)
		07.00	Trade balance €bn	Nov	21.3	21.3
Italy		09.00	Unemployment rate %	Nov	9.7	9.7
UK		00.01	BRC like-for-like retail sales Y/Y%	Dec	-0.5	-4.9

Auctions and events

Country		GMT	Auction / Event
France		09.50	Auction: to sell 0% 2029 bonds
		09.50	Auction: to sell 1.25% 2036 bonds
		09.50	Auction: to sell 1.50% 2050 bonds
Spain		09.45	Auction: to sell 0.05% 2021 bonds
		09.45	Auction: to sell 0.25% 2024 bonds
		09.45	Auction: to sell 1.85% 2035 bonds
		09.45	Auction: to sell 0.7% 2033 index-linked bonds
UK		10.30	Auction: to sell £1bn of 0.125% 2028 index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
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