Euro wrap-up

Overview

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- With risk appetite strong and German labour market data resilient, Bunds sold off and the euro strengthened even as euro area inflation remained at a record low and new car registrations fell sharply.
- Gilts also made losses as UK house price inflation rose to the highest since early 2015.
- Wednesday will bring updates on euro area unemployment and German retail sales, while attention will remain on the EU-UK negotiations, which reports suggest have now entered the 'tunnel'.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/22	-0.730	+0.024
OBL 0 10/25	-0.723	+0.033
DBR 0 08/30	-0.531	+0.042
UKT 1¾ 09/22	-0.026	+0.011
UKT 0⅝ 06/25	0.029	+0.026
UKT 4¾ 12/30	0.345	+0.042

*Change from close as at 5.00pm GMT.
Source: Bloomberg

Euro area

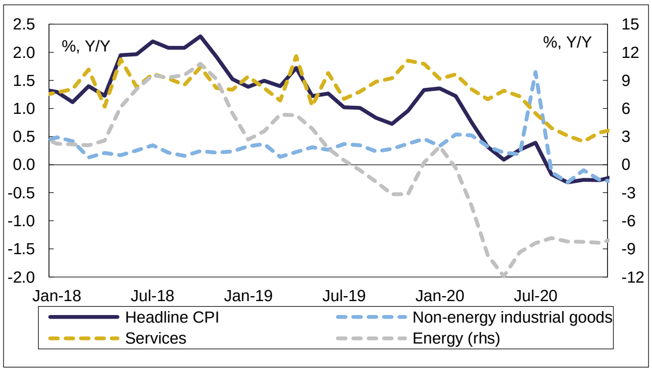
Euro area inflation steady in November

While the equivalent data from the large member states were mixed, with France and Italy posting increases but Germany recording a decline to match the series low, euro area inflation was steady in November according to today's flash estimates. So, headline inflation remained at -0.3%Y/Y, the lowest level since January 2015, for a third month. And core inflation remained at its record low of 0.2%Y/Y, also for a third month. Within the detail, inflation of non-energy goods dropped 0.2ppt to -0.3%Y/Y, also matching the series low. Inflation of energy (-8.4%Y/Y) and food (1.9%Y/Y) were very slightly softer. But services inflation edged up 0.2ppt from the prior month's record low to a three-month high of 0.6%/Y. We caution, however, that a large share of those services prices had to be imputed by the national statisticians due to the impact of Covid-19 containment measures. Looking ahead, the reversal of the 3ppt German VAT cut at year-end as well as base effects from past moves in energy prices will push inflation higher in the New Year. However, excess global supply as well as euro strength – today up more than 9%Y/Y against the USD to its strongest level since April 2018, and up about 7%Y/Y on a trade-weighted basis – will continue to weigh on prices of goods. And, until the pandemic is better under control and until a vaccine is successfully rolled out, services inflation will also likely remain highly subdued. So, despite the recent jump in oil prices which will support the near-term profile, there is a good chance that next week the ECB will nudge lower its inflation forecasts for 2022. Indeed, we expect core inflation to average no more than 1.0%Y/Y that year. And the ECB's projections for 2023, to be published for the first time, will likely suggest that both headline and core inflation will likely remain below target into the medium term.

German labour market resilient in face of the second wave of Covid-19

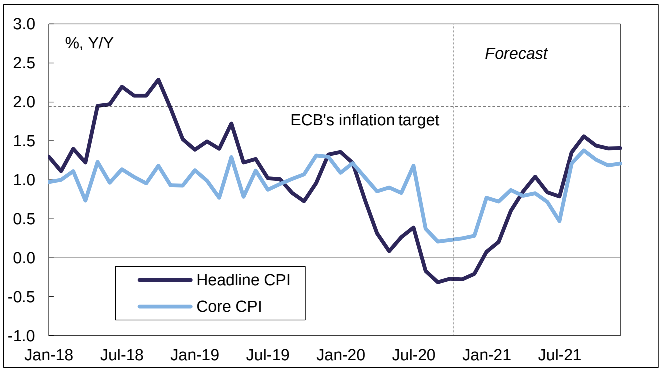
Contrary to expectations of an increase, German unemployment fell in November by a sizeable 39k, the most since 2008, to push the claimant count rate down 0.1ppt for a second successive month to 6.1%, the lowest since April. In addition, vacancies posted a second successive strong monthly increase, of 11k in November, to rise to the highest level in seven months. And lagging data showed that employment rose in October to reverse the decline the previous month and leave the annual growth rate unchanged at -1.3%Y/Y. So, at this stage, Germany's labour market appears resilient in the face of the second wave of Covid-19 and associated containment measures, including extended restrictions on the hospitality sector. Today's labour market data also tally with survey indicators, such as the ifo Employment Barometer, which suggested that job hiring in manufacturing and certain services (e.g. IT) might be more than offsetting weakness in the sub-sectors directly impacted by the containment measures. And, of course, the government's kurzarbeit short-term working scheme and other generous financial assistance programmes are providing important support to firms. Indeed, the ifo institute estimated that

Euro area: Inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

the share of businesses benefiting from the kurzarbeit scheme rose by 3.2ppts last month to 28%. Nevertheless, while the ifo business survey reported that the share of German firms concerned about their survival fell 6ppts last month, at 15% it remained elevated. And more than four-fifths of travel agents and tour operators felt threatened, as did more than three-quarters of hotels and 62% of restaurants. While the number of new German coronavirus cases recently stabilized, a further wave of pandemic in the New Year could well prove more damaging for the labour market.

Covid-19 restrictions hit new car registrations in November

Given the closure of car showrooms in some member states, and concerns about the spread of the pandemic widespread across the region, it was no surprise that the first countries to release data confirmed that new car registrations fell significantly last month. In France, registrations fell 27.0%Y/Y to be also down almost 27%YTD/Y in the first eleven months of the year. In Spain, registrations dropped 18.7%Y/Y to be down a little more than 35%YTD/Y. And in Italy, new car registrations fell 8.3%Y/Y to be down almost 30%YTD/Y. Over the past couple of weeks, new coronavirus cases have started to subside in some countries and, in France, showrooms have been able to reopen. So, as after the first wave lockdown, we could see a short-term rebound in registrations. However, with consumer confidence down in November to the lowest since May and at a level previously seen during the euro crisis, we do not expect car registrations to accelerate markedly for a number of quarters to come.

Final manufacturing PMIs suggest continued expansion

The final euro area manufacturing PMIs for November offered few surprises, reiterating the findings of the flash estimates to suggest that, overall, the sector continues to grow despite the renewed weakness in services. Admittedly, the euro area output PMI dropped a little further than previously thought, down 3.1pts to a four-month low. But, at 55.3, it was still consistent with expansion. And new orders are seemingly continuing to grow too, with the respective PMI revised up slightly to 54.1. There are, of course, significant differences among the member states. German manufacturing output growth appears to remain robust, as the respective PMI was revised down 0.5pt from the flash estimate to a still-elevated 62.2. But judging from the significant deterioration in the equivalent indices from the other large member states, growth in the sector appears to have weakened – or gone into reverse – in France (48.6), Italy (51.8) and Spain (49.7), where the survey's evidence on new orders was even more troubling. So, the PMIs arguably flagged the risk of a weakening in production in the New Year. More happily, however, likely supported by vaccine news, optimism regarding the coming twelve months was striking, with the future output indices up and highly elevated across the member states with the euro area PMI rising to 64.8, the best since March 2018.

The day ahead in the euro area

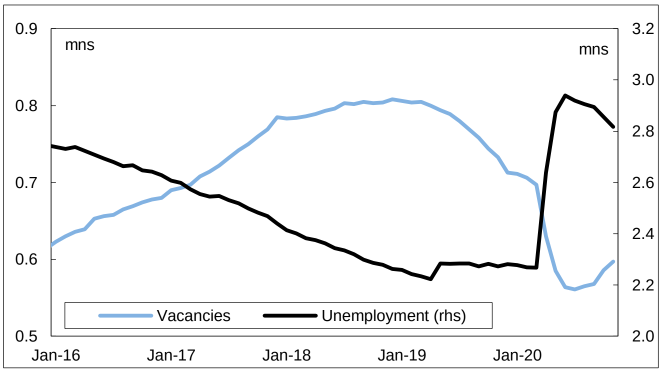
Ahead of the release of the equivalent euro area figures on Thursday, tomorrow will bring German retail sales data for October. After dropping 1.9%M/M in September, sales in Germany are expected to rebound by more than 1.0%M/M to be up about 6.0%Y/Y. In addition, euro area labour market data for October are expected to report a slight increase of 0.1ppt in the unemployment rate to 8.4% in October, the highest since March 2018.

UK

Manufacturing resilient to services weakness but end of Brexit transition poses new risk

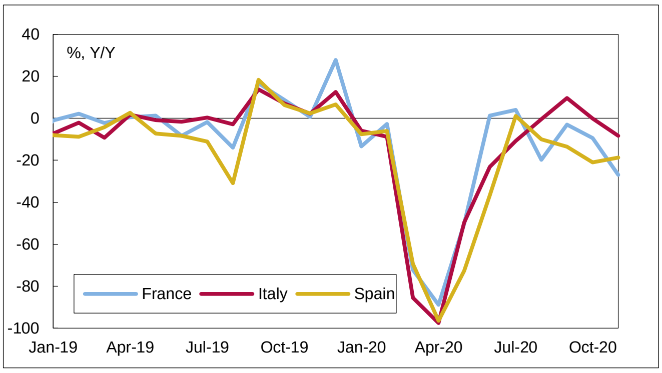
According to the final UK manufacturing PMIs, production accelerated in November, with the respective index revised up to 56.8, 1pt higher than in October albeit down from each month of Q3. Upwards revisions to the index for new orders (to 54.9, down only marginally from the previous month) also pointed to ongoing near-term growth in the sector. But while the headline manufacturing PMI was revised up to 55.6, the highest since 2017, that gives a misleading impression of current conditions, being in part due to a surge in the index for stocks of purchases and a decline in the index for suppliers' delivery times, suggesting that manufacturers are having to stockpile inputs and wait longer for imported components ahead of the

Germany: Labour market indicators



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: New car registrations



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

end to the Brexit transition period in January. While the delays to delivery times partly reflects disruption at UK ports, particularly Felixstowe, we expect such disruption to intensify significantly in January, whether or not the UK and EU agree a new FTA to avoid the imposition of new tariffs. And reflecting the likelihood of a softening of external demand due to the passing of that milestone, we expect UK manufacturing output to fall back in Q1.

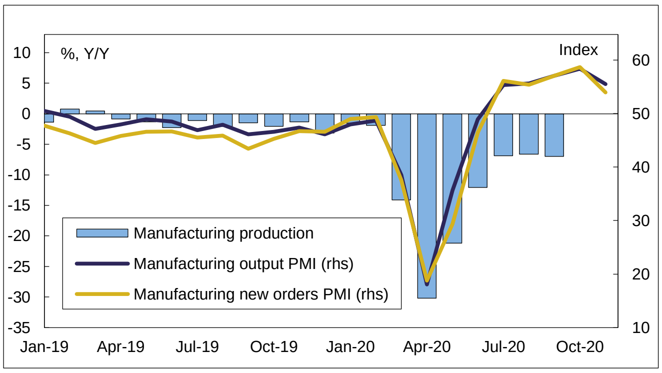
House prices rebounding at strongest pace in eleven years

UK house prices continue to accelerate, boosted by the temporary increase in the threshold for payment of stamp duty, from £125k to £500K, which kicked in from July and will last to next March. In particular, the Nationwide's house price index rose 0.9%M/M in November to take the annual pace of increase to 6.5%Y/Y, the highest since January 2015, and the three-month increase to 3.65%3M/3M, the highest in eleven years. With mortgage approvals up last month to the highest since 2007 and the RICS survey pointing to still-high levels of new buyer enquiry last month, further strength in house prices seems inevitable over the near term. The transformative impact of Covid-19 on preferences – with Nationwide reporting that nearly 30% of those considering a home move were doing so because they wanted a garden or to be near more outdoor space – will also likely continue to provide support to housing market transactions. But with mortgage interest rates having picked up (e.g. the rate on a five-year 75% LTV mortgage was 33bps higher in October than in June) and prices having leapt over recent months, the financial benefit to first-time buyers of the stamp duty holiday has already been wiped out. And with unemployment set to rise, unless the government adds to its support for the market, a slowdown looks to be inevitable in the spring. Certainly, housebuilders currently appear unconvinced of the outlook, with housing starts still trending at their lowest levels since the global financial crisis.

The day ahead in the UK

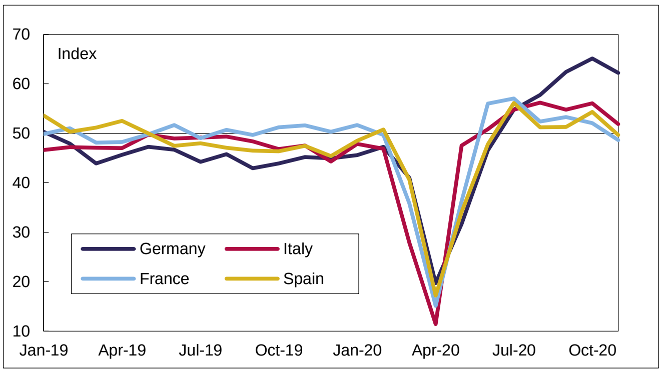
Attention tomorrow is bound to remain on the EU-UK negotiations, which reports late today suggested had now entered the so-called 'tunnel' phase during which both teams would make commitments to avoid media briefings and chief EU negotiator Barnier would also refrain from giving updates to the member states on progress. That news raised hopes that a deal might be reached by the end of this week, giving sterling an immediate boost. Data-wise, the BRC shop price index for November is unlikely to provide much distraction.

Euro area: Manufacturing output and PMIs



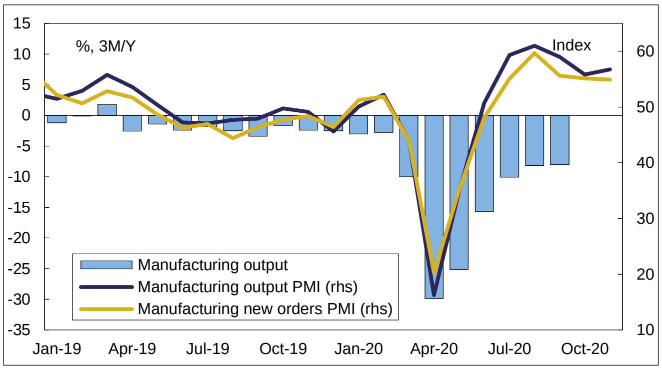
Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing PMIs by country



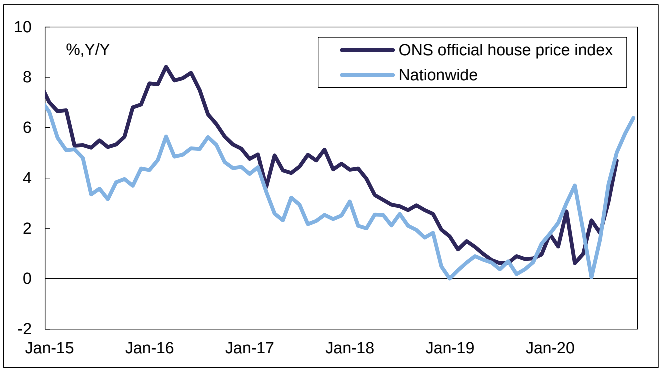
Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output and PMIs



Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: House prices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		Final manufacturing PMI	Nov	**53.8**	53.6	54.8	-
		Preliminary CPI (core CPI) Y/Y%	Nov	**-0.3 (0.2)**	*-0.3 (0.2)*	-0.3 (0.2)	-
Germany		Final manufacturing PMI	Nov	**57.8**	57.9	58.2	-
		Unemployment change '000s (rate %)	Nov	**-39.0 (6.1)**	8.0 (6.3)	-35.0 (6.2)	**-38.0 (-)**
France		Final manufacturing PMI	Nov	**49.6**	49.1	51.3	-
		New car registrations Y/Y%	Nov	**-27.0**	-	-9.5	-
Italy		Manufacturing PMI	Nov	**51.5**	52.0	53.8	-
		Final GDP Q/Q% (Y/Y%)	Q3	**15.9 (-5.0)**	16.1 (-4.7)	-12.8 (-17.7)	-
		New car registrations Y/Y%	Nov	**-8.3**	-	-0.2	
Spain		Manufacturing PMI	Nov	**49.8**	50.7	52.5	-
		New car registrations Y/Y%	Nov	**-18.7**	-	-21.0	-
UK		Final manufacturing PMI	Nov	**55.6**	55.2	53.7	-
		Nationwide house price index M/M% (Y/Y%)	Nov	**0.9 (6.5)**	0.2 (5.4)	0.8 (5.8)	-

Auctions

Country		Auction
UK		sold: £3bn of 0.125% 2026 bonds at an average yield of 0.072%
		sold £2.25bn of 1.25% 2041 bonds at an average yield of 0.802%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		10.00	PPI Y/Y%	Oct	-2.3	-2.4
		10.00	Unemployment rate %	Oct	8.4	8.3
Germany		07.00	Retail sales M/M% (Y/Y%)	Oct	1.2 (5.8)	-1.9 (7.0)
Italy		09.00	Preliminary unemployment rate %	Oct	9.9	9.6
Spain		08.00	Unemployment change '000s	Nov	-	49.6
UK		00.01	BRC shop price index Y/Y%	Nov	-1.3	-1.2

Auctions and events

Country		GMT	Event
EMU		14.00	ECB's Chief Economist Lane scheduled to speak
Germany		10.30	Auction: €2bn of 0% 2025 bonds
UK		10.00	Auction: £1bn of 0.125% 2028 index-linked bonds
		11.30	Auction: £2.75bn of 0.25% 2031 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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