Daiwa Capital Markets

Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

- As the US dollar weakened further, Bunds made gains despite stronger-than-expected data for euro area retail sales, firm German car production figures, and a Germany composite PMI that was consistent with growth.
- While reports on the state of play in the Brexit negotiations remained confused, Gilts also made gains despite an upwards revision to the UK services PMI.
- Friday will bring October data for German factory orders and the November construction PMIs.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/22	-0.745	-0.018
OBL 0 10/25	-0.748	-0.028
DBR 0 08/30	-0.550	-0.029
UKT 1¾ 09/22	-0.047	-0.008
UKT 0⅝ 06/25	0.010	-0.010
UKT 4¾ 12/30	0.331	-0.020

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

Euro area

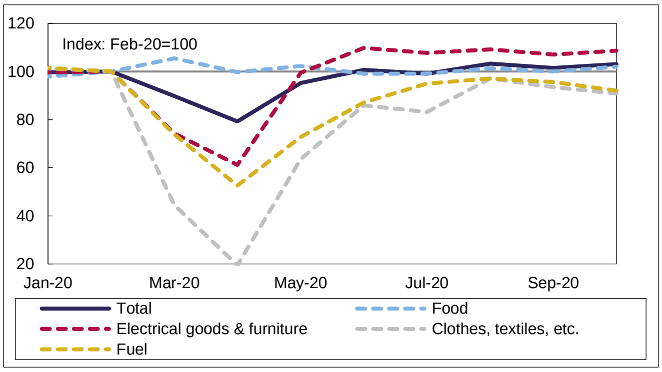
Retail sales beat expectations at start of Q4

Euro area retail sales in October comfortably beat the Bloomberg consensus, rising 1.5%M/M to all but reverse the drop in September. As a result, sales were 3.1% above February's pre-pandemic level and up a robust 4.3%Y/Y from an upwardly revised 2.5%Y/Y in September. Growth was driven by Germany (2.6%M/M) and France (2.8%M/M), the latter seemingly partly reflecting stock-piling ahead of the closure of non-essential retailing last month. Elsewhere, sales in Spain rose by 0.6%M/M to reverse the drop the prior month, while the other member states largely posted a mix of modest gains and losses. Within the detail, growth in euro area sales was relatively broad-based and led by strong gains in online sales (up 6.1%M/M, also effectively reversing September's drop). Growth in core (i.e. non-food, non-fuel) items was up 2.0%M/M following the fall of 1.9%M/M previously. Sales of electrical goods and furniture partly reversed the previous month's decline, rising 1.5%M/M, but sales of clothing and textiles fell for a second month and by a sizeable 2.8%M/M. Food sales rose 2.0%M/M to move back close to May's series high. But with mobility falling in response to the jump in new coronavirus cases and tightening of restrictions on activity, sales of fuel fell for the second month in a row and by a steeper 3.7%M/M. Given the additional containment measures – not least the closure of a large share of French stores – overall sales seem likely to have fallen back last month. That should not prevent positive growth in sales over Q4 as a whole. But with spending on many services more significantly inhibited, household consumption seems highly likely to account for the largest share of the decline in GDP this quarter.

German car registrations weaken slightly, production rises to 20-month high, but outlook softens

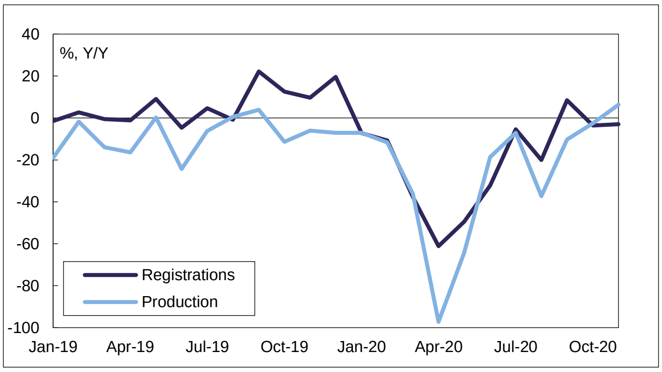
Compared to its peers in the other large member states, November was a satisfactory month for German auto manufacturers. While new car registrations in France and Italy fell at a steep double-digit percentage pace as the pandemic took its toll, they were up on the month and down just 3%Y/Y in Germany, with support from foreign registrations (up 10%Y/Y) offsetting some of the domestic weakness (down 8%Y/Y).Given major weakness earlier in the year, German new car registrations were still, however, down 22%YTD/Y in the first eleven months of the year, and on track for the worst year since reunification. Meanwhile, car production was strong, rising 6.3%Y/Y to a 20-month high. That, however, left it down 26%YTD/Y. And, unfortunately, the ifo institute yesterday reported that expectations of German automakers and their suppliers for the coming months had turned sour, with the respective business survey index falling for the fourth consecutive month in a row in November, and by more than 20pts to -4.0. Within the detail, the manufacturers stated that they intended to cut car production over coming months, export expectations had worsened, growth in new orders had weakened, and they also intended to cut jobs.

Euro area: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Car production and registrations



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

After Germany extends restrictions, final services PMIs illustrate weakening in sector

In terms of the services sector, yesterday's confirmation of the extension of Germany's pandemic containment measures came as no surprise. After all, the day also brought confirmation of Germany's highest single-day death toll (487) from Covid-19. The measures, which had previously been scheduled to conclude on 20 December, were extended to 10 January at the earliest and will thus mean that hotels (for non-business visitors), restaurants, bars and many leisure and entertainment facilities will have to remain closed into the New Year, meaning a soft start to 2021 for overall German economic activity.

With similar – and sometimes tougher – restrictions in other member states last month, the final euro area services PMIs for November underscored the findings of the flash estimates to suggest strongly that the sector is contracting again. Admittedly, the euro area services activity PMI was revised up from the initial estimate, by 0.4pt, but that left it down more than 5pts on the month at a six-month low of 41.7. And new business weakened further, with the respective PMI also down more than 5pts to 40.6, similarly the lowest since May. Among the member states, the headline services PMIs for Italy (39.4) and Spain (39.5), which were released for the first time, came in only modestly above the upwardly revised final estimate for France (38.8), where restrictions were most draconian. And at 46.0 Germany's also inevitably still signalled contraction and was a touch softer than initially thought.

Given the strength in Tuesday's final manufacturing indices, Germany's composite PMI was the only one of the member states to be above 50 in November to flag the possibility that – supported by the aforementioned growth in auto production – its economy might possibly still avoid a contraction in Q4. However, we still expect GDP in all of the large member states to contract in Q4, with the pace of decline ranging from 1.5%Q/Q in Germany to 4.5%Q/Q in France. And with the composite PMI in the euro area a clearly contractionary 45.3, we expect economic activity in the euro area as a whole to fall 2.7%Q/Q, with the rebound in Q121 unlikely to be strong enough to return to the level in Q320.

The day ahead in the euro area

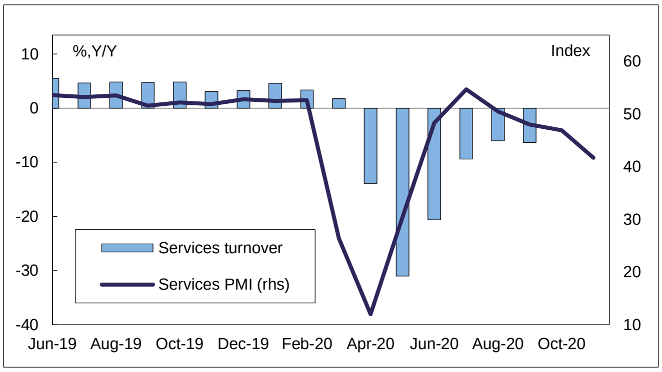
The week's euro area data-flow will end tomorrow with German factory orders data for October. Consistent with ongoing recovery in the sector, these are expected to post a sixth successive monthly increase to rise above the level a year earlier for the first time since February. In addition, the November construction PMIs are likely to point to ongoing weakness in the sector, while Italian retail sales data for October are also due.

UK

Brexit headlines continue to dictate moves in sterling

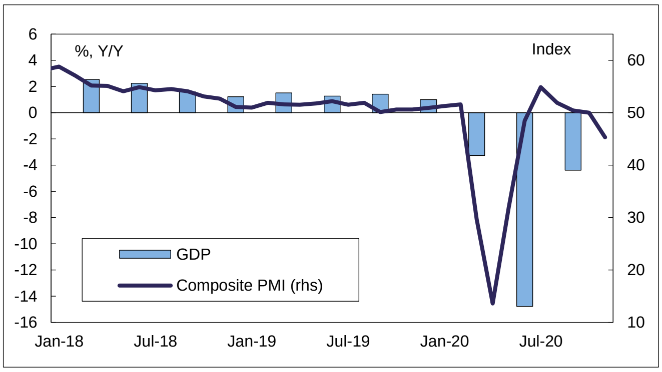
Brexit negotiation headlines continue to drive movements in sterling, which yesterday weakened as reports suggested increased risks of no deal ahead of the end of the transition period. While there has supposedly been some progress on certain issues, inertia remains the case for many others. To some extent, this might reflect the fact that UK PM Johnson has been distracted by other political matters this week, not least his struggle to convince his own party's backbenchers of the merits of his new Covid-19 containment measures. But his lack of consistent principles and fundamental beliefs arguably leaves him ill-equipped to take the tough decisions required about the future of the UK's relationship with by far its largest trade partner. Indeed, he might well be continuing to equivocate. To force the pace, Irish reports today suggested that the EU side wanted to set a deadline of tomorrow (or perhaps this weekend) for a deal. At the same time, the UK government's plans to present on Monday draft Internal Market and Finance Bill text that would be inconsistent with the Withdrawal Agreement appear unhelpful provocation. There might yet be progress over coming days, although a bilateral between Johnson and Commission President Von Der Leyen would seem likely to be required. Whether we get that before the next EU Summit, which kicks off one week today, remains to be seen.

Euro area: Services PMI and turnover



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

Euro area: GDP and composite PMI



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

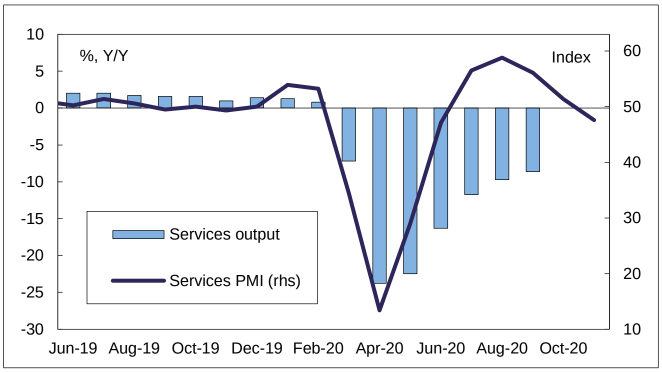
Services PMI revised up to stir hopes that drop in GDP might be avoided

According to the final UK services PMIs for November, the drop in activity in the sector was not as marked as previously thought, with an upwards revision from the flash estimate of 1.8pts to 47.6. That, however, still represented the third consecutive decline in the index and left it at its lowest level since July. According to Markit, survey respondents associated the decline to the government's containment measures, which forced the closure of firms in hospitality, leisure and non-essential retail in England last month. At the same time, some firms also cited resilient spending among businesses in sectors that had remained open. And while firms reportedly cut jobs at the fastest pace in three months, the drop in new business suggested by the survey was relatively modest. Indeed, from yesterday, the English national restrictions were replaced with new localized containment measures, allowing the reopening of firms in a large share of the country, albeit with various levels of controls on activity. While the new restrictions are still much-disliked by businesses, and for many firms Brexit uncertainty remains a concern, positive vaccine news supported an improvement in the outlook for the year ahead to the best since February. Indeed, according to Markit, around 60% of firms surveyed expect business activity to rise over the coming twelve months, while only 15% forecast a drop. Given the sizeable upwards revision to the services PMI, the UK's composite PMI was also revised higher, by 1.6pts, to 49.0. While that is a five-month low, it would also suggest that a drop in GDP in Q4 might yet avoided. However, for now, we continue to forecast a decline of as much as 2.5%Q/Q.

The day ahead in the UK

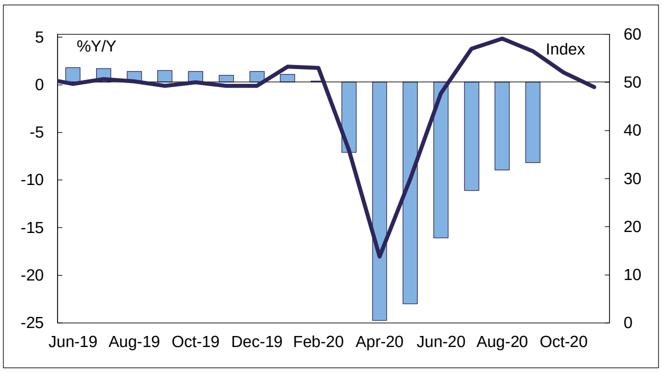
While the headlines from the EU-UK negotiations will continue to be the main focus, like in the euro area Friday will bring the UK construction PMIs for November. In addition, new car registrations figures for the same month are due and seem bound to show an accelerated decline as car showrooms were closed due to pandemic containment restrictions.

UK: Services output and PMI



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

UK: GDP and composite PMI



Source: Markit, 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 services (composite) PMI	Nov	**41.7 (45.3)**	41.3 (45.1)	46.9 (50.0)	-
	Retail sales M/M% (Y/Y%)	Oct	**1.5 (4.3)**	0.7 (2.6)	-2.0 (2.2)	**-1.7 (2.5)**
Germany	Final services (composite) PMI	Nov	**46.0 (51.7)**	46.2 (52.0)	49.5 (55.0)	-
	New car registrations Y/Y%	Nov	**-3.0**	-	-3.6	-
France	Final services (composite) PMI	Nov	**38.8 (40.6)**	38.0 (39.9)	46.5 (47.5)	-
Italy	Services (composite) PMI	Nov	**39.4 (42.7)**	40.8 (43.5)	46.7 (49.2)	-
Spain	Services (composite) PMI	Nov	**39.5 (41.7)**	36.6 (40.2)	41.4 (44.1)	-
UK	Final services (composite) PMI	Nov	**47.6 (49.0)**	45.8 (47.4)	51.4 (52.1)	-

Auctions

Country	Auction
France	sold €1.59bn of 5.75% 2032 bonds at an average yield of -0.26%
	sold €1.99bn of 1.25% 2036 bonds at an average yield of -0.04%
	sold €1.83bn of 2% 2048 bonds at an average yield of 0.29%
	sold €1.08bn of 4.5% 2041 bonds at an average yield of 0.1%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	08.30	Construction PMI	Nov	-	44.9
Germany	07.00	Factory orders M/M% (Y/Y%)	Oct	1.5 (0.2)	0.5 (-1.9)
	08.30	Construction PMI	Nov	-	45.2
France	08.30	Construction PMI	Nov	-	42.7
Italy	08.30	Construction PMI	Nov	-	48.1
	09.00	Retail sales M/M% (Y/Y%)	Oct	0.3 (0.7)	-0.8 (1.3)
UK	09.30	Construction PMI	Nov	-	53.1
	09.00	New car registrations Y/Y%	Nov	-	-1.6

Auctions and events

Country	GMT	Event
Germany	-	German sovereign debt rated by DBRS
Italy	-	Italian sovereign debt rated by Fitch
UK	09.30	BoE's Tenreyro scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs