

Euro wrap-up

Overview

- While euro area wage data remained weak, Bunds made big losses as the flash euro area PMIs beat expectations and ECB Board member Schnabel judged the risks to the inflation outlook to be skewed to the upside and said that the PEPP net purchases would probably end next March.
- Gilts also made losses as the flash UK PMIs also beat expectations and external MPC member Haskel suggested that he could support a BoE rate hike over coming months if the labour market remained tight.
- Wednesday will further bring business survey results from Germany, France and the UK.

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Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.755	+0.006
OBL 0 10/26	-0.561	+0.045
DBR 0 08/31	-0.235	+0.071
UKT 0 ¹ / ₈ 01/24	0.561	+0.051
UKT 0 ³ / ₈ 10/26	0.726	+0.056
UKT 0 ¹ / ₄ 07/31	0.983	+0.053

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

Euro area

Flash German PMIs still consistent with growth despite worsening pandemic wave

The fourth wave of pandemic in Germany continues to worsen. The Robert Koch Institute today reported a new record high seven-day case count just a fraction below 400 per 100k people nationwide, with the state of Saxony worst off with a figure just shy of 1000 per 100k. Under the national rules agreed last week, restrictions on access to services for the unvaccinated look set to tighten even further in several states. It remains to be seen, however, quite how economically damaging such tightening of restrictions – in Germany, as well as the Netherlands, Austria and perhaps other member states too – will prove to be. In a notable interview with Bloomberg published today, ECB Executive Board member Schnabel acknowledged that the pandemic is likely to have a moderating effect on activity in the short run, in particular in the contact-intensive services sector. But she did not think that this will derail the overall recovery. Consistent with that view, today's flash German PMIs for November reported a rise in the composite output index of 0.8pt to 52.8, a level consistent with modest expansion albeit still well below the range (55.5 to 62.4) recorded throughout Q2 and Q3. The detail did, however, point to a near-stalling of new business in services and a modest drop in new services export demand, with both indices at seven-month lows.

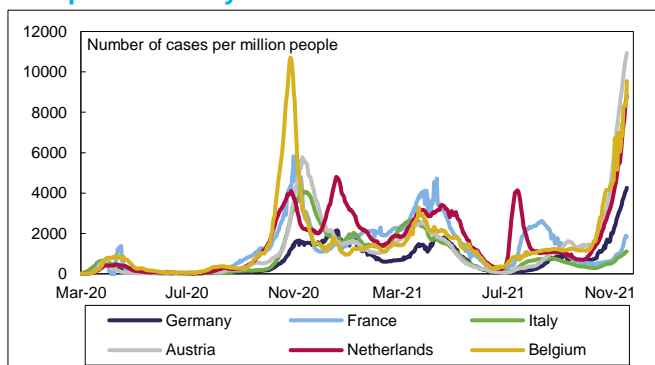
Manufacturing PMIs restrained by supply strains, but French services enjoy strong growth

While they suggested a modest impact so far from the fourth wave of pandemic, the flash German PMIs continued to highlight the significant restraining impact on growth and major cost pressures emanating from supply bottlenecks, which might yet be further aggravated by the renewed spread of Covid-19. Indeed, the German manufacturing output PMI (51.7) was again consistent with only minimal growth in the sector. The input cost PMI (92.6) and output price (77.3) indices for the sector reached new highs. And delivery times reportedly continued to rise at a near-unprecedented pace while backlogs of work remained substantive despite a softening of new demand. Meanwhile, in France, the November flash PMIs suggested that supply pressures might now be more damaging for manufacturers than in Germany. For a second month, the output index (48.0) pointed to contraction while input cost pressures were close to last month's 17-year high. But with the number of new coronavirus cases still well down on that in Germany, albeit admittedly also on a worsening path, the French services activity PMI (58.2) suggested the strongest pace of expansion in the sector for almost four years. And so, the French composite PMI rose to a four-month high (56.3) consistent with steady above-potential GDP growth.

Euro area PMIs signal acceleration in GDP for first time in four months

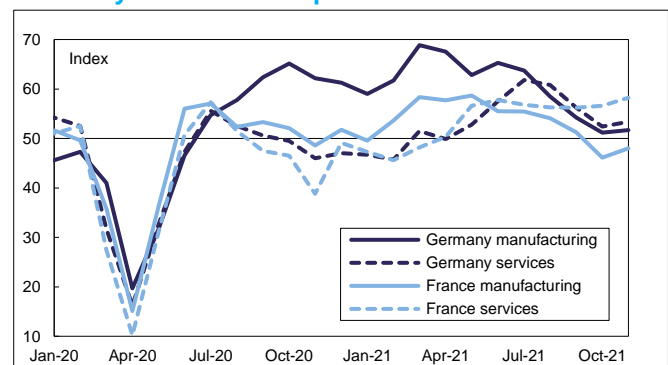
Without providing numerical detail, Markit reported that growth in the rest of the euro area was probably firmer in November than in Germany and France. So, overall, the flash euro area output PMIs for manufacturing (53.8) and services (56.6) both suggested an acceleration in activity. And by extension, for the first time in four months, the euro area composite output PMI

Europe: New daily Covid-19 cases



Source: Our World in Data and Daiwa Capital Markets Europe Ltd.

Germany & France: Output PMIs



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

was higher too (up 1.6pts to 55.8). Nevertheless, that was still the second-lowest reading since April. And while the composite employment PMI suggested the second-fastest pace of job creation in more than two decades, broader optimism about the outlook fell to a ten-month low as both Covid concerns and supply strains worsened. Regarding the latter, the composite PMIs reported a survey record increase in firms' input costs for a second consecutive month, with series highs in both manufacturing and services. And with many firms likely to have submitted their survey responses well before the latest intensification of the pandemic, we expect the final November PMIs, due in the first week of December, to make downwards revisions to the indices for services activity.

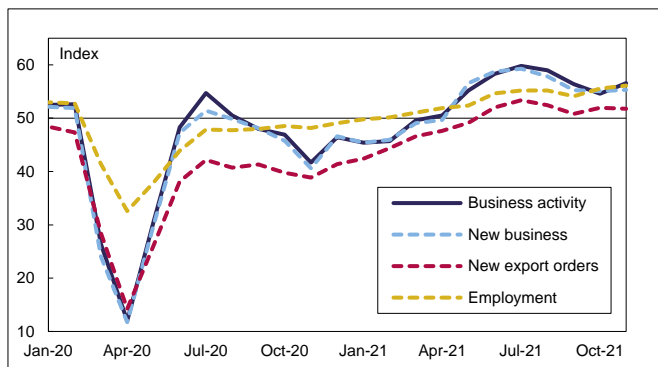
Drop in consumer confidence and soft wage settlements pose downside risks

While euro area economic growth might well have firmed a touch in the first half of November as suggested by the flash PMIs, on the whole indicators still point to a notable softening of momentum over recent months. Indeed, the Bundesbank yesterday judged that German economic output could "broadly stagnate" in the fourth quarter of the year. And the European Commission's preliminary euro area consumer confidence indicator for November flagged the likelihood of a softening in consumption growth over coming months, falling a larger-than-expected 2pts to a seven-month low of -6.8. That, however, was within the range in 2019 ahead of the pandemic, and still likely consistent with positive consumption growth. Early national survey indicators suggest that consumer sentiment in lockdown-affected Netherlands fell the most since the outbreak of the pandemic to a nine-month low. But the drop in Belgium – where coronavirus cases have also accelerated – was more measured, albeit falling to the lowest since April. If restrictions are tightened across several member states, we might still simply see a renewed shift in spending back away from services towards goods, rather than an outright decline in total private consumption. But with other data today reporting a slowdown in euro area negotiated wages in Q3 to a series low of just 1.35%Y/Y, falling real incomes pose an additional downside risk to the outlook for consumer spending and also suggest that concerns about second-round effects on the inflation outlook from current price pressures might be overdone.

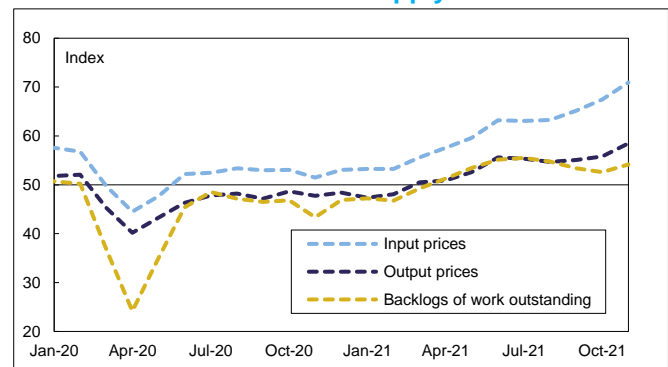
Schnabel sees inflation risks skewed to the upside and PEPP March end-date valid

In her Bloomberg interview, Isabel Schnabel suggested that the ECB had yet to study how the rebound in the pandemic might impact the balance of demand between goods and services and the associated possible implications for price pressures. But evidently not perturbed by the recent weakness of wage settlements, she emphasised that she saw the risks to the inflation outlook as skewed to the upside. And with the inflation outlook key for determining the future of the PEPP, she also judged that net purchases under that programme were "probably" going to end in March. However, with reinvestments under the programme to continue, she also suggested that the PEPP could be retained as a policy tool for possible use going forward, providing optionality for more flexible purchases to preserve the monetary transmission mechanism if

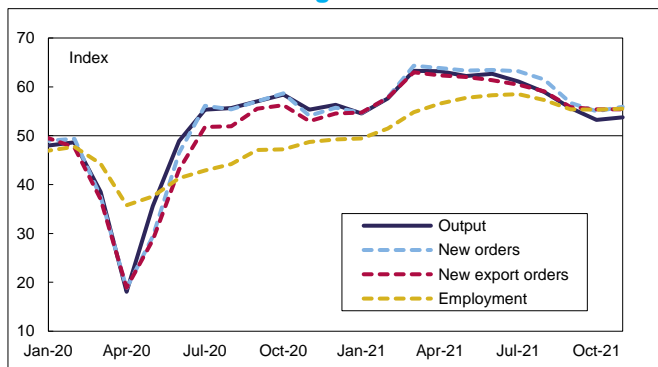
Euro area: Services PMIs – demand side



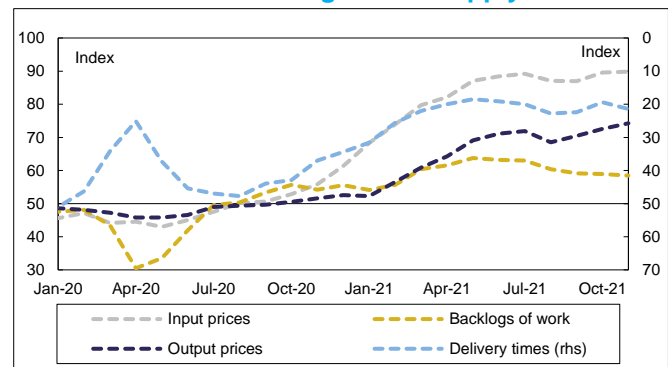
Euro area: Services PMIs – supply side



Euro area: Manufacturing PMIs – demand side



Euro area: Manufacturing PMIs – supply side



necessary in future. As such, she did not see any reason to transfer flexibility to the regular asset purchase programme (APP) from April on. Moreover, she didn't necessarily see reason to accelerate purchases under the APP, as she saw "diminishing returns to asset purchases and increasing side-effects". In her opinion, what was most important for the inflation outlook was the stock of purchases accumulated over recent years rather than the flow of new net purchases. Overall, therefore, Schnabel's comments today arguably reflected the most hawkish remarks from an Executive Board member for several months.

The day ahead in the euro area

Tomorrow's data flow could bring additional insight into business conditions in the two largest member states. Ahead of today's flash PMIs and consistent with persisting supply constraints, Germany's ifo survey was expected to report a further deterioration in both the current assessment and expectations balances, with the former forecast to fall to its lowest since May and the latter the lowest since January. Meanwhile, the French INSEE survey is similarly likely to flag challenges in the manufacturing sector, albeit the headline business sentiment index is forecast to have edged only slightly lower from October's reading, which was the joint-highest since mid-2007. Wednesday will also see ECB Executive Board members Schnabel and (the highly dovish) Panetta give speeches.

UK

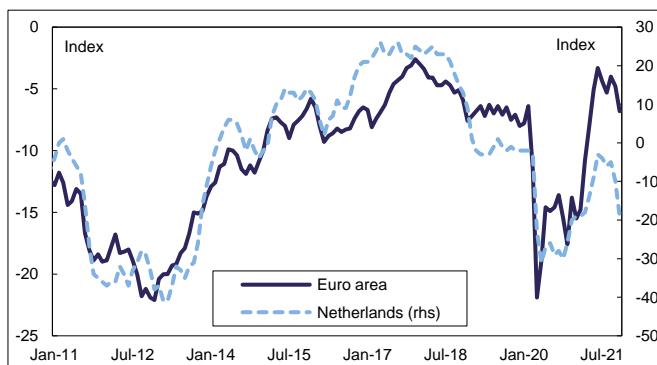
UK PMIs points to solid growth amid rising price pressures

The UK's flash PMIs also exceeded expectations in November, signalling another month of decent growth in output and jobs amid ongoing price pressures. As such, it might have lent further support to a Bank Rate hike before the end of the year. Admittedly, the headline services activity index fell back on the month, although at 58.6 it remained consistent with solid expansion and at a pace above the long-run average. Moreover, in the first two months of Q4, the services PMI was averaging (58.9) more than 2pts higher than the Q3 outturn, while the new business component (59.2) in November increased to its highest since June. This contrasted with the manufacturing sector, where the respective output index is currently trending in Q4 (52.1) more than 2½pts below the average in Q3 despite increasing in November (+1.6pts) for the first month in six. Manufacturers continued to note that pandemic-related shortages of key materials had led to production stoppages, while growth in new orders was being restricted in part by lengthy lead times and ongoing Brexit-related trade frictions. While today's survey suggested that job growth in the manufacturing sector accelerated in November, services firms cited ongoing challenges in recruiting and maintaining employees and increased pressure on wages. Against this backdrop, around 63% of firms surveyed reported an increase in their average cost burdens this month while the composite input price PMI rose to its highest since the series began in January 1998. In addition, the output price PMI in the manufacturing sector rose its highest in 20 years, while pressures on prices charged in the services sector remained extremely elevated.

MPC member Haskel open to rate hikes over coming months if labour market remains tight

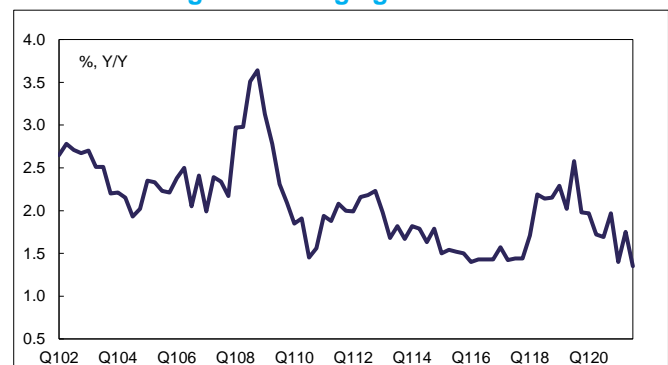
Of course, once supply-side constraints ease and base effects from the recent surge in energy and other commodity prices dissipate, much of these price pressures are likely to fall back. Indeed, external MPC member Jonathan Haskel today reaffirmed that he was in 'team transitory' when assessing the recent spike in inflation of energy and freight costs. But his comments were, on balance, less dovish than of late. In particular, he viewed risks to the inflation outlook now to be broadly balanced, having previously been skewed to the downside over the past eighteen months. As such, he was mindful of second-round effects on inflation emanating from the labour market, where the high level of vacancies suggested that there was significant tightness. The case for a rate hike, however, might diminish if there was evidence that the 360k workers who had left the labour market during the pandemic were starting to return to help ease pressures. And Haskel also suggested that he would want to see clearer evidence that economic recovery was firmly entrenched before raising rates. So, with the Q3 GDP numbers having fallen a little short of the BoE's forecast, we wouldn't be surprised if Haskel preferred to wait until

Euro area: Consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Negotiated wage growth



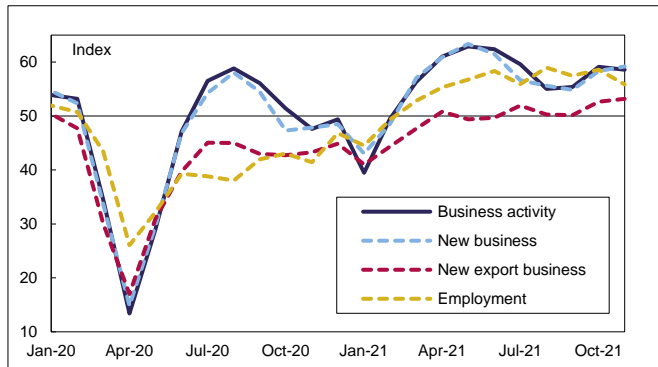
Source: ECB and Daiwa Capital Markets Europe Ltd.

the Bank's updated economic forecasts in February before pulling the rate-hike trigger, particularly if next month's labour market data report a further moderation in wage growth and a rebound in labour force participation.

The day ahead in the UK

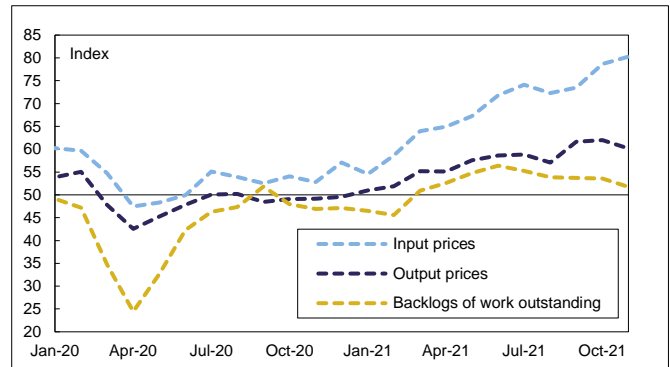
Tomorrow's CBI industrial trends survey is expected to report ongoing challenges faced by UK manufacturers related to material and labour shortages, softer export orders and higher input costs. In addition, dovish external MPC member Sylvia Tenreiro will speak publicly at the Oxford Economics Society.

UK: Services PMIs – demand side



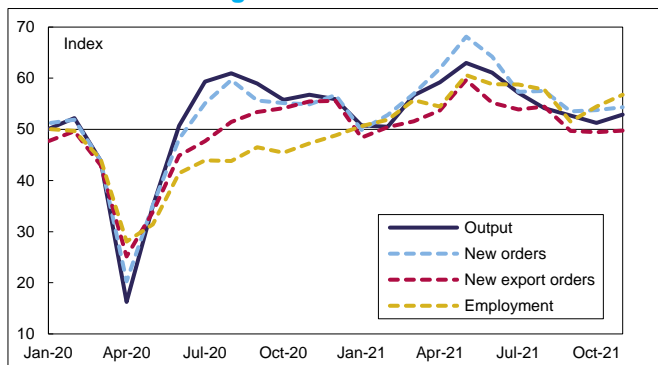
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

UK: Services PMIs – supply side



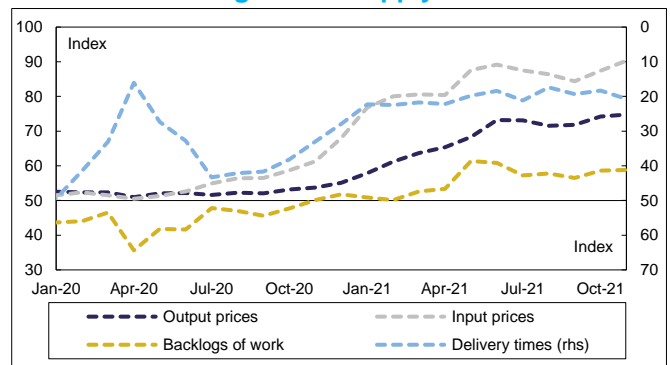
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing PMIs – demand side



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

UK: Manufacturing PMIs – supply side











Source: Refinitiv, Markit 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
Euro area	 Preliminary manufacturing (services) PMI	Nov	58.6 (56.6)	57.5 (53.5)	58.3 (54.6)	-
	 Preliminary composite PMI	Nov	55.8	53.3	54.2	-
Germany	 Preliminary manufacturing (services) PMI	Nov	57.6 (53.4)	57.0 (52.0)	57.8 (52.4)	-
	 Preliminary composite PMI	Nov	52.8	51.0	52.0	-
France	 Preliminary manufacturing (services) PMI	Nov	54.6 (58.2)	53.1 (54.2)	53.6 (56.6)	-
	 Preliminary composite PMI	Nov	56.3	53.3	54.7	-
UK	 Preliminary manufacturing (services) PMI	Nov	58.2 (58.6)	57.0 (58.0)	57.8 (59.1)	-
	 Preliminary composite PMI	Nov	57.7	57.2	57.8	-



Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 European Commission's preliminary consumer confidence	Nov	-6.8	-5.4	-4.8	-
Spain	 Trade balance €bn	Sep	-2.4	-	-3.9	-






Auctions

Country	Auction
- Nothing to report -	





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany		09.00 Ifo business climate	Nov	96.7	97.7
		09.00 Ifo current assessment balance (expectations)	Nov	99.0 (94.4)	100.1 (95.4)
France		07.45 INSEE business confidence	Nov	112	113
		07.45 INSEE manufacturing confidence (production outlook)	Nov	106 (-)	107 (21)
UK		11.00 CBI industrial trends survey, total orders (selling prices)	Nov	7 (-)	9 (59)

Auctions and events

Euro area		10.10 ECB's Panetta scheduled to speak
		16.00 ECB's Schnabel scheduled to speak at an event – 'New deals, markets and governance'
Germany		10.30 Auction: €2bn of 0% 2036 bonds
UK		14.30 BoE's Tenreyro scheduled to speak at Oxford Economics Society

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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