# Euro wrap-up

## Overview

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- While euro area inflation rose to a 30-year high, longer-dated Bunds made gains as Vice President de Guindos noted that he expected ECB net asset purchases to continue throughout 2022.
- Despite an upbeat UK business survey, Gilts also rose as BoE MPC external member Catherine Mann judged that the Omicron variant had increased uncertainty and might adversely impact confidence and demand.
- Wednesday will bring data for German retail sales, French and Italian new car registrations, and UK house prices, as well as the final manufacturing PMIs.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 0 12/23 | -0.757 | +0.011 |
| OBL 0 10/26 | -0.626 | +0.005 |
| DBR 0 08/31 | -0.347 | -0.025 |
| UKT 0¹/₈ 01/24 | 0.464 | -0.013 |
| UKT 0³/₈ 10/26 | 0.619 | -0.023 |
| UKT 0¼ 07/31 | 0.812 | -0.045 |

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

# Euro area

### Headline inflation exceeds expectations again rising to 30-year high

The flash euro area inflation data for November exceeded expectations that would already have been revised up following yesterday's upside surprises from Germany, Spain and Belgium. In particular, headline HICP inflation jumped 0.8ppt – the most since January – to 4.9%Y/Y, the highest for three decades. Once again, the largest contribution to the rise was energy inflation, which accelerated 3.7ppts to a series high of 27.4%Y/Y. That accounted for more than half (2.6ppts) of the annual headline rate and a little less than half of the increase on the month. But the pressures this month were broad-based. Inflation of food, alcohol and tobacco increased 0.3ppt to a 17-month high of 2.2%Y/Y. Likely in part reflecting higher prices of transport and package holidays as well as Covid-sensitive face-to-face activities, services inflation accelerated 0.6ppt to 2.7%Y/Y, the highest since 2008. And inflation of non-energy industrial goods rose 0.4ppt to a three-month high of 2.4%Y/Y – a rate only exceeded once since the introduction of the euro – suggesting that pressures further up the supply chain associated with bottlenecks and energy prices are increasingly being passed on to consumers. As a result, core inflation rose 0.6ppt to a new series high of 2.6%Y/Y.

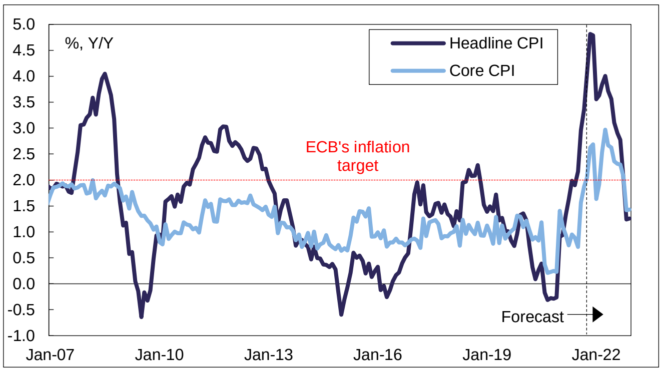
### Inflation still highly likely to fall significantly next year

With wholesale gas prices having risen back to their highest levels since mid-October on cold weather, but oil prices down more than 10% from the October average to their lowest levels since late August on Omicron concerns, the near-term profile for energy prices remains difficult to define. Renewed pandemic restrictions in Austria, the Netherlands, Slovakia and Germany, and heightened worries about the pandemic elsewhere, could also soften pressures on prices of consumer-facing services. However, we might yet see both headline and core inflation touch new highs next month as further upstream pressures are passed on to consumers. Nevertheless, the still-substantive base effects associated with German VAT and index re-weighting will shift significantly in January (headline inflation rose from -0.3%Y/Y in December 2020 to 0.9%Y/Y in January 2021). So, headline inflation is highly likely to drop back below 4.0%Y/Y at the start of 2022 while core inflation will likely fall back below 2.0%Y/Y. And as energy pressures fade and supply bottlenecks ease steadily, and associated prices risk overshooting on the downside, we expect both headline and core measures to be well below 2.0%Y/Y by end-2022.

### ECB VP expects net asset purchases to last throughout 2022

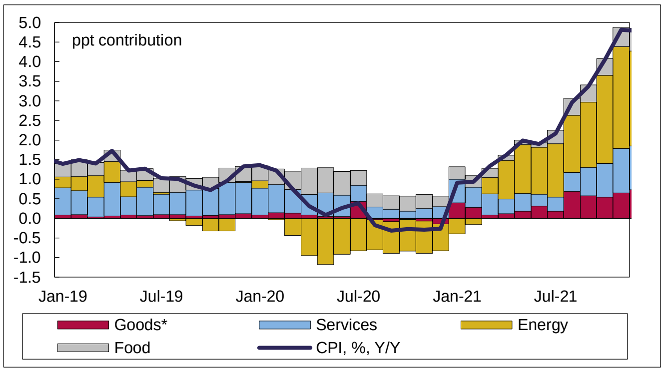
While the uncertainty surrounding that price outlook is inevitably wide, the possible dampening effect of economic confidence and activity from the Omicron variant might reduce upside risks to inflation somewhat. On the other hand, as suggested by ECB Vice President Luis de Guindos in an interview published today by Les Echos, supply bottlenecks may now last longer than expected, keeping inflation higher for longer than the ECB predicted. He also cautioned that many wage bargaining

**Euro area: Headline and core CPI inflation**




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

**Euro area: Contributions to CPI inflation**




**Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

negotiations had been postponed to the end of the year and early next year, raising the risks of a pickup in labour costs in 2022. Nevertheless, while he also acknowledged that the ECB had signalled that net PEPP purchases are likely to end in March, he added that they could be resumed if necessary. And, in his opinion, continued net purchases under the regular APP will be required over the course of 2022 even if the net PEPP purchases are brought to an end. Moreover, as the ECB's forward guidance makes clear that rates will not be raised until the net asset purchases have ceased, the VP's comments signalled that he did not expect the ECB to raise rates next year. Most members of the Governing Council will share that view, just as they will also likely share the view of Executive Board member Schnabel that some policy "optionality" should be allowed to allow a tighter stance in the event that inflation continues to exceed ECB expectations into the medium term.

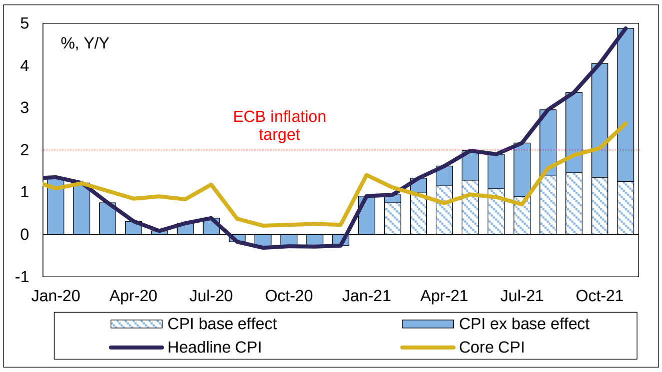
## German labour market maintains steady recovery

Despite the resurgence of coronavirus case in Germany since the middle of October and the recent reintroduction of certain restrictions, today's labour market report suggested that for now at least a steady recovery has been maintained. In particular, the number of people in employment rose a further 34k in October to a little more than 45mn. While this was still below the pre-pandemic level by some 368k (0.8%), this was half the shortfall recorded in February this year. And according to the German Federal Employment Agency, the number of jobless people declined by a further 34k in November, to be 382k lower than a year earlier. Of course, the number of people out of work would be higher in the absence of the government's job support scheme. Indeed, the most recent figures show that in September 751k employees were still being supported on the Kurzarbeit short-time work scheme. While this is down from 794k employees in August and more than 1mn in July, and the number of vacancies rose in November to the highest since May 2019, the current pandemic wave might well see greater recourse to the Kurzarbeit scheme over the near term.

## French and Spanish goods consumption weakens

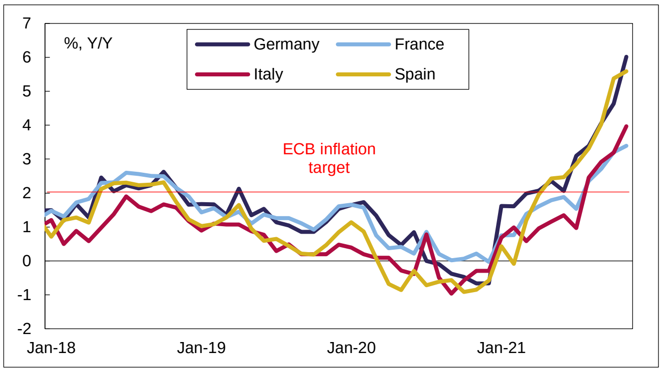
The October figures for French consumer spending on goods also released today suggested that households remained cautious at the start of the fourth quarter. Tallying with the BoF retail sales survey, the INSEE measure of consumption of goods fell 0.4%M/M to leave it down by more than 5%Y/Y and merely back at the pre-pandemic level. Within the detail, purchases of durable goods fell sharply as sales of new autos remained extremely weak, while spending on furniture also declined. Clothing purchases also reversed some of the marked increase seen in September. So, in the absence of increased spending on food (0.7%M/M) and energy (1.0%M/M), the drop in spending last month would have been even steeper. Spanish retail sales were similarly subdued in October, falling 0.1%M/M to be down 0.7%YY. The drop in sales of non-food products (-1.2%M/M) principally reflected a decline in household appliances. And headline sales were boosted by increased spending at service stations and on food products. Indeed, excluding fuel, sales were down 0.4%M/M.

### Euro area: CPI inflation



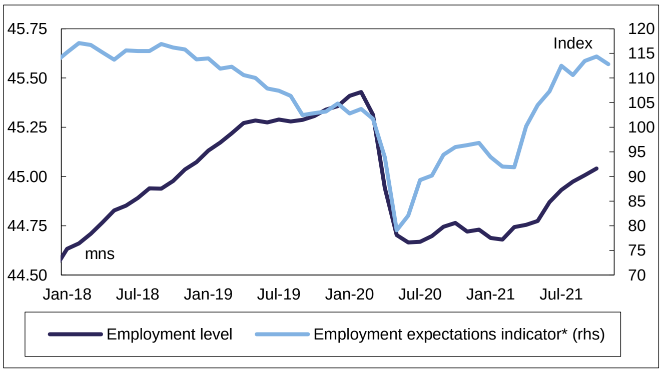

*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: CPI inflation in selected member states



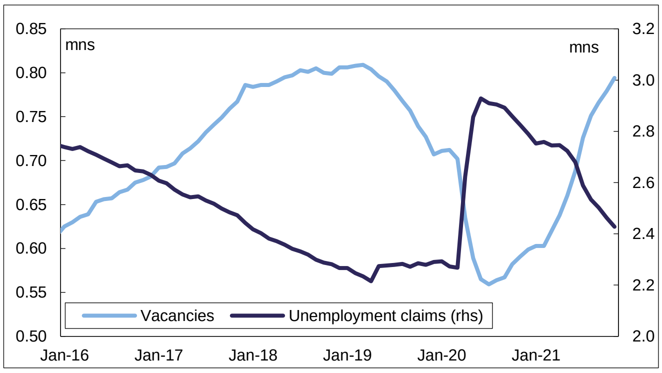

*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Germany: Employment and expectations




**European Commission survey index. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Germany: Unemployment and job vacancies




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### The day ahead in the euro area

Tomorrow brings an update on German consumption at the start of Q4, with retail sales forecast to have risen 0.9%M/M in October following a cumulative decline of more than 5% in Q3 when spending on services surged as restrictions relaxed. This would leave them down by more than 1½%Y/Y but still more than 4½% higher than the pre-pandemic level. In contrast, due not least to persistent supply bottlenecks, November new car registration numbers from France, Italy and Spain are likely to have remained well down on levels seen a year earlier despite the pandemic-related low base. Final November manufacturing PMIs from the euro area and member states are also due. While the preliminary release reported the headline euro area PMI index rising for the first month in five, by 0.3pt to 58.6, this might well be revised lower on the back of the resurgence of coronavirus cases and reintroduction of certain restrictions across member states.

## UK

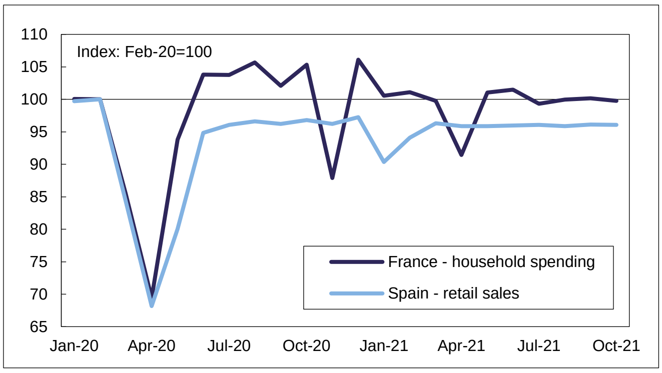
### UK business survey suggests slight softening of sentiment

Broadly consistent with the flash PMIs, which suggested that activity remained firm in November, the Lloyds business barometer released overnight suggested that UK corporate sentiment remains relatively elevated, albeit slightly softer for a second successive month. As last month, the headline sentiment index fell 3pts, but at 40 it was still above the long-run average (28). The index for firms' trading expectations for the coming twelve months also fell 3pts to a three-month low (39), with 52% of firms expecting stronger trading conditions and 13% expecting a deterioration. A series high of 50% of firms expect to raise prices while 6% plan to cut prices. The survey index of hiring intentions fell 7pts to 30%, with still almost half of all firms expecting to increase headcount over the coming year. Pay growth expectations remained broadly steady from October, with one quarter of firms expecting to offer average wage growth of 3% or more, but 9% of firms anticipating a pay freeze.

### The day ahead in the UK

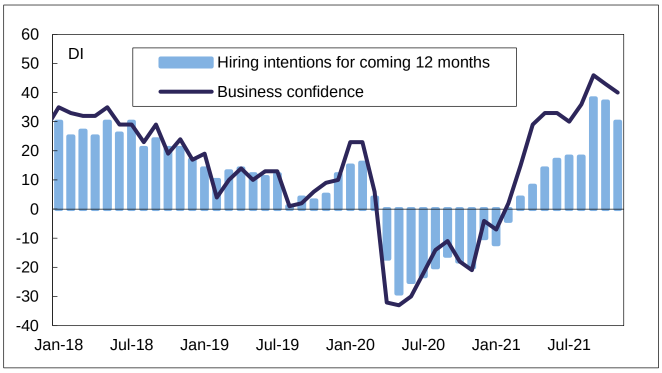
Tomorrow will bring the latest BRC shop price index, which will provide an update on price pressures on the High Street in November. While retail price inflation was still in negative territory in October (-0.4%Y/Y), this was the softest pace of decline since January 2020, while three in five retailers had expected prices to increase in the run up to Christmas. Nationwide house price data for October (the first release since the conclusion of the government's Stamp Duty holiday) will also be published alongside the final UK manufacturing PMIs. The flash estimates showed the headline PMI rising 0.4pt to 58.2, a three-month high, with the output index up for the first month in six and price pressures at a series high.

**France and Spain: Spending on goods**




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

**UK: Lloyds business barometer indices**




*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 |
|---|---|---|---|---|---|---|
| Euro area | Preliminary CPI (core CPI) Y/Y% | Nov | **4.9 (2.6)** | *4.7 (2.3)* | 4.1 (2.0) | - |
| Germany | Unemployment rate % (change '000s) | Nov | **5.3 (-34.0)** | 5.4 (-25.0) | 5.4 (-39.0) | **- (-40.0)** |
| France | Preliminary CPI (EU-harmonised CPI) Y/Y% | Nov | **2.8 (3.4)** | 2.6 (3.2) | 2.6 (3.2) | - |
| | PPI Y/Y% | Oct | **14.9** | - | 11.6 | **11.7** |
| | Final GDP Q/Q% (Y/Y%) | Q3 | **3.0 (3.3)** | 3.0 (3.3) | 1.1 (18.7) | **1.3 (18.8)** |
| | Consumer spending M/M% (Y/Y%) | Oct | **-0.4 (-5.3)** | 0.0 (-5.2) | -0.2 (-2.3) | **0.2 (-1.9)** |
| Italy | Final GDP Q/Q% (Y/Y%) | Q3 | **2.6 (3.9)** | 2.6 (3.8) | 2.7 (17.3) | **- (17.1)** |
| | Preliminary CPI (EU-harmonised CPI) Y/Y% | Nov | **3.8 (4.0)** | 3.2 (3.3) | 3.0 (3.2) | - |
| Spain | Retail sales Y/Y% | Oct | **-0.7** | - | -0.1 | - |
| UK | Lloyds business barometer | Nov | **40** | - | 43 | - |

**Auctions**

| Country | Auction |
|---|---|
| Germany | sold €2.3bn of 0% 2028 bonds at an average yield of -0.53% |
| Italy | sold €2bn of 0% 2026 bonds at an average yield of 0.19% |
| | sold €2.25bn of 0.95% 2032 bonds at an average yield of 1.02% |
| | sold €1.5bn of 2029 floating rate bonds at an average yield of 0.02% |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Tomorrow's releases

**Economic data**

| Country | GMT | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|
| Euro area | 09.00 | Final manufacturing PMI | Nov | 58.6 | 58.3 |
| Germany | 07.00 | Retail sales M/M% (Y/Y%) | Oct | 0.9 (-1.7) | -1.9 (-0.6) |
| | 08.55 | Final manufacturing PMI | Nov | 57.6 | 57.8 |
| France | 08.50 | Final manufacturing PMI | Nov | 54.6 | 53.6 |
| | - | New car registrations* Y/Y% | Nov | - | -30.7 |
| Italy | 08.45 | Manufacturing PMI | Nov | 61.0 | 61.1 |
| | 17.00 | New car registrations Y/Y% | Nov | - | -35.7 |
| Spain | 08.15 | Manufacturing PMI | Nov | 57.8 | 57.4 |
| | - | New car registrations* Y/Y% | Nov | - | -20.5 |
| UK | 00.01 | BRC shop price index Y/Y% | Nov | - | -0.4 |
| | 07.00 | Nationwide home price index M/M% (Y/Y%) | Oct | 0.4 (9.3) | 0.7 (9.9) |
| | 09.30 | Final manufacturing PMI | Nov | 58.2 | 57.8 |

**Auctions and events**

| Country | GMT | Event |
|---|---|---|
| Euro area | 10.00 | OECD publishes latest Economic Outlook report |
| Germany | 10.30 | Auction: €3bn of 0% 2026 bonds |
| UK | 10.00 | Auction: £2.25bn of 1% 2032 bonds |
| | 14.00 | BoE Governor Bailey scheduled to speak on insurance regulation |

**Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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