Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds followed USTs lower as data confirmed a return to growth in euro area industrial production at the start of Q4.
- While UK wage growth moderated, Gilts also made losses as employment continued to rise and the level of vacancies remained very high following the end of the government's furlough scheme.
- Wednesday will bring new data for UK inflation in November along with updated estimates of the equivalent figures from France, Italy and Spain.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/23	-0.701	+0.018
OBL 0 10/26	-0.598	+0.015
DBR 0 08/31	-0.371	+0.015
UKT 0⅛ 01/24	0.423	+0.049
UKT 0⅜ 10/26	0.554	+0.041
UKT 0¼ 07/31	0.721	+0.028

*Change from close as at 4:00pm GMT.
Source: Bloomberg

Euro area

Euro area IP growth driven by autos acceleration

There were no major surprises from today's euro area industrial production numbers, which suggested a more encouraging manufacturing performance at the start of the fourth quarter. In particular, aggregate industrial output rose for the first month in three in October and by 1.1%M/M, to leave it more than 1% higher than the Q3 average and just 0.7% lower than the pre-pandemic level. The rebound was driven by an 18%M/M increase in the production of autos, the strongest growth in the sub-sector since June 2020. However, this still left autos output roughly one-third lower than the post-pandemic peak almost a year ago and almost 40% below its pre-pandemic level. Machinery equipment (2.0%) and pharmaceuticals (2.5%) also reported solid growth, and supported the rebound in overall production of capital (3.0%) and consumer goods (0.5%), with the latter some 3.7% above the pre-pandemic level. In contrast, energy output moved broadly sideways, while production of intermediate goods fell for the third consecutive month (-0.6%), likely reflecting persisting supply-chain disruption.

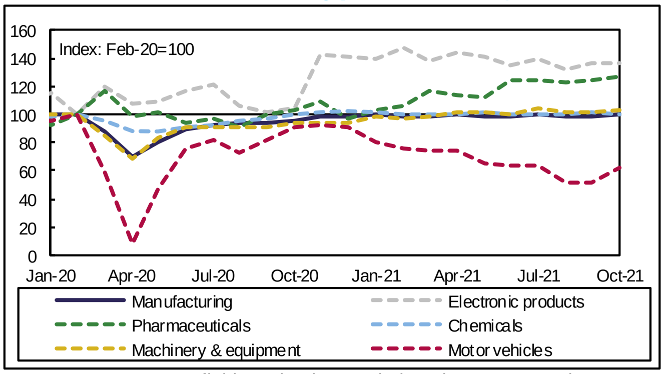
Germany led the recovery in October, Irish numbers suggest possible downwards revision

At the country level, the rebound on the month was led by Germany (3.0%), which reported the strongest monthly growth in a year, Greece (2.5%) and France (0.9%), which more than offset subdued outturns from Italy (-0.6%), Spain (-0.6%) and the Netherlands (-0.9%). However, today's aggregate euro area figures failed to incorporate the Irish numbers for October, which are currently subject to a review of the seasonal adjustment methodology used. According to yesterday's national release, Irish industrial output fell for the seventh month out of the past eight and by a whopping 34.5%M/M to its lowest level since mid-2018. Had those figures been included, euro area IP would have fallen roughly 1½%M/M. While that Irish figure certainly exaggerates the extent of the decline in October, we wouldn't be surprised to see a downwards revision to aggregate euro area IP growth in due course once a credible Irish estimate is included. And while German manufacturing output appears to have continued to grow in November, given the revival of the pandemic across various member states, and the emergence of the Omicron strain in Asia likely to further impede supply chains, overall growth in the euro area industrial sector in Q4 and Q1 seems more likely to be moderate than vigorous.

The day ahead in the euro area

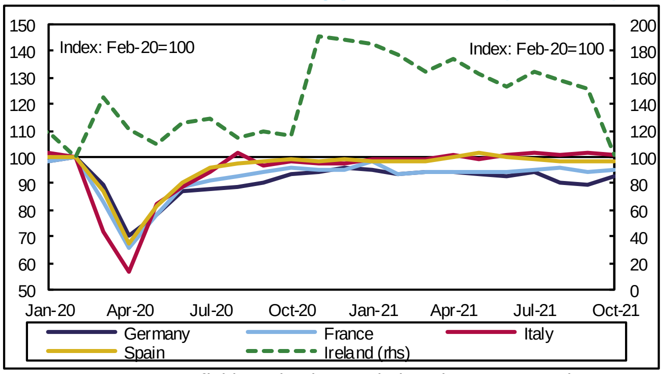
Ahead of Friday's release of final euro area November CPI numbers, tomorrow brings the equivalent inflation figures from France, Italy and Spain. The preliminary national releases showed that, on the EU-harmonised basis, headline HICP inflation rose in France by 0.2pt to 3.4%Y/Y, in Italy by 0.8pt to 3.2%Y/Y, and in Spain by 0.2ppt to 5.6%Y/Y. While the upwards move principally reflected higher energy price inflation, these releases should confirm that core inflation ticked higher too.

Euro area: Manufacturing production by sector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing production by country



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK

Labour market not yet fully recovered despite few signs of adverse impact from end of furlough

Ahead of Thursday's BoE monetary policy announcement, the latest data on the UK labour market – a key current focus for the MPC – suggested that the conclusion of the furlough scheme at the end of September has so far had a minimal adverse impact. Overall, the number of people in work continued to rise, although the detail also suggested that the labour market has yet to recover fully from the pandemic. According to the timeliest figures, the number of payrolled employees continued to rise in November, up 257k on the month to be 424k (1.5%) above the pre-pandemic level in February 2020 and 1.35mn (4.8%) above the level a year earlier. And in the three months to October, the Labour Force Survey suggested that the employment rate rose by 0.2ppt (149k) on the quarter, to 75.5%. That, however, was still 1.1ppts (567k) below the pre-pandemic level in the three months to February 2020. And the increase was again driven by part-time workers rather than full-time workers, with the latter falling slightly albeit from above the pre-pandemic level. By age, the improvement was driven by younger workers, who nevertheless remain more adversely impacted by the Covid shock. And while the number of employees rose, the number of self-employed workers continued to drop, declining 51k on the quarter to be down more than 750k from end-2019. And while total hours worked continued to recover, the pace of improvement slowed to 17.6mn on the quarter, to be still 27.8mn (2.2%) below the pre-pandemic level despite the end of furlough.

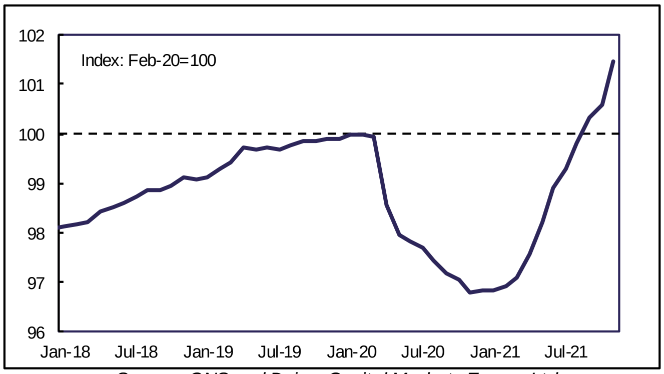
Unemployment near pre-pandemic rate, redundancies still low, but inactivity suggests scarring

Given the rise in the number of people in work, the unemployment rate decreased by 0.4ppt in the three months to October to 4.2%, just 0.2ppt (59k) above the pre-pandemic level. That, however, masked a rise of 0.3ppt to 4.2% in the (admittedly volatile) single-month unemployment rate in October. Moreover, the inactivity rate among people of working age increased by 0.1ppt on the quarter to 21.2%, 1.0ppt (377k) above the pre-pandemic level to hint at longer-term economic scarring from the pandemic. Nevertheless, despite the end of furlough, the redundancy rate rose just 0.1pt per thousand in the three months to October to be still more than 10pts lower than a year earlier and 0.4pt lower than the pre-pandemic rate. And the claimant count – which includes workers on low incomes as well as those out of work – continued to decline in November, down 0.1ppt to 4.9%.

Job vacancies rise to new high suggesting significant mismatches

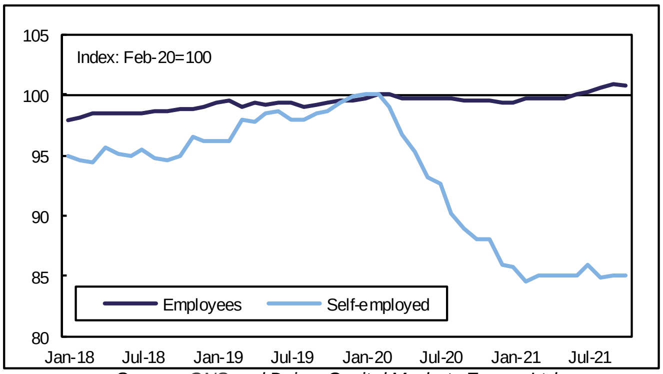
Beyond the headline numbers of people in and out of work, labour shortages appear to remain high. The number of job vacancies continued to rise in the three months to November, reaching a new record high of 1.219mn, up 434.5k from the

UK: Payrolled employees



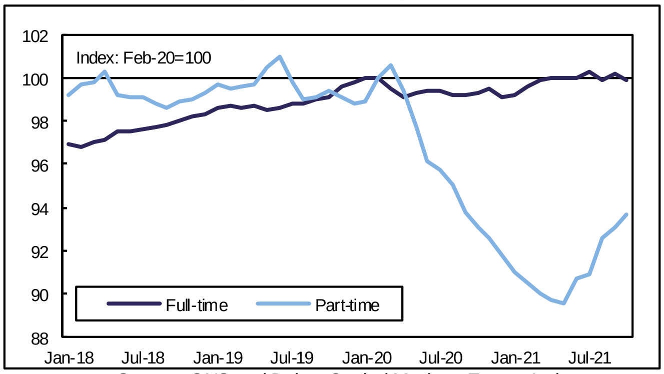
Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Employees and self-employed



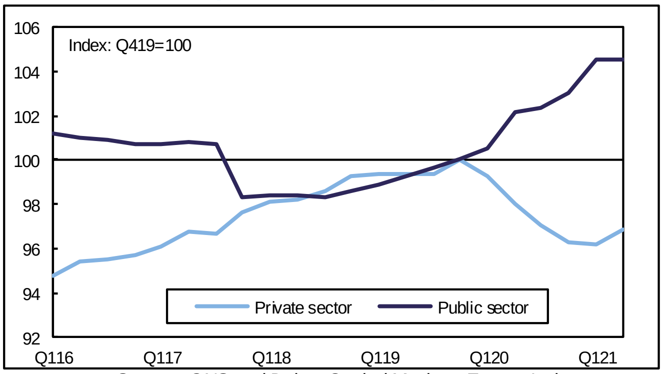
Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Full-time and part-time employees



Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Private and public sector employment



Source: ONS and Daiwa Capital Markets Europe Ltd.

pre-pandemic level, with 13 of the 18 industry sectors showing record highs. Admittedly, the rate of growth in vacancies continued to slow over the quarter – indeed, the ONS single-month estimate suggested a drop on the month in November for the first time in nine months. However, the high level of job openings compared to the unemployment rate (an upwards shift in the Beveridge curve) points to a rise in labour and skills mismatches – across and within sectors – as the economy continues to struggle to adjust to earlier economic reopening and the end of furlough.

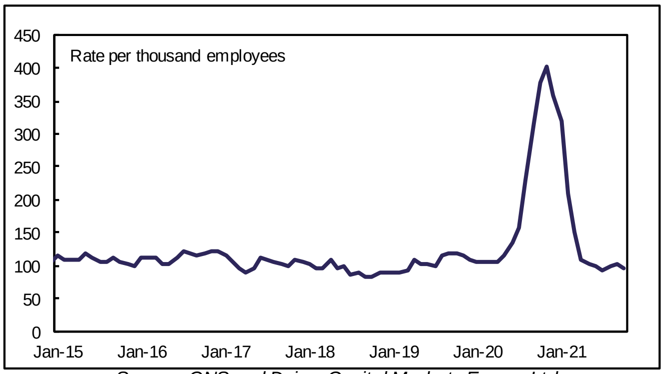
Wage growth continues to moderate from high rates as base and composition effects fade

Despite the high level of vacancies, wage growth continues to moderate as base and composition effects fade. In the three months to October, average total pay (including bonuses) slowed 1.0ppt to 4.9%Y/Y and regular pay (excluding bonuses) eased 0.7ppt to 4.3%Y/Y. As base and composition effects have now largely worked their way out of the system, that might suggest that underlying wage growth remains somewhat above the (sub-4.0%Y/Y) pre-pandemic norms and rates judged consistent with the achievement of the BoE's inflation target on a sustainable basis. However, on a single-month basis, regular wages slowed to 3.8%Y/Y in October. Moreover, having peaked late last year, regular wage growth on a three-month annualized basis has moderated for some time, with the rate of 3.5% in October within the pre-pandemic range and suggesting no need for the MPC to panic about cost pressures from the labour market. In addition, with CPI inflation likely to have jumped well above 4½%Y/Y in November (our forecast for the headline rate, due tomorrow, is 4.9%Y/Y), real wage growth is now negative, which is likely to weigh on demand over coming months. Therefore, while today's data suggest that the labour market remains tight despite the end of furlough, they do not make an overly compelling case for a rate hike. And given the tightening of Covid restrictions last week and concerns of worse disruption to economic activity in the New Year from the Omicron wave, the MPC would seem highly likely to await new forecasts in February before tightening monetary policy for the first time this cycle.

The day ahead in the UK

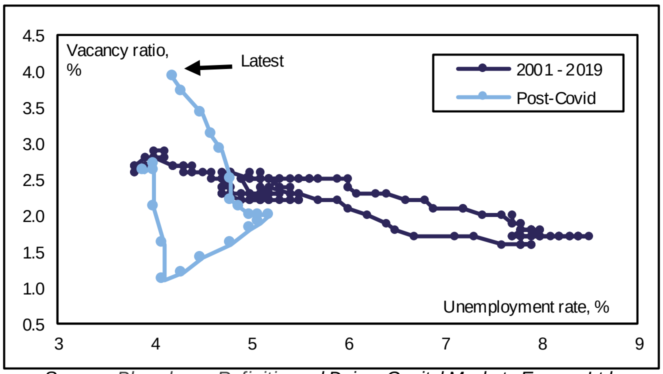
The UK's data focus tomorrow will be the release of November's inflation figures, which seem bound to report a further jump in the annual CPI rate. Not least given higher petrol prices, we expect headline CPI inflation to increase 0.7ppt to 4.9%Y/Y, which would be the highest since 2011. But core CPI inflation is also likely to rise too – we forecast an increase of 0.3ppt to 3.7%Y/Y, which would also be the highest since 2011 when the standard VAT rate was increased. And PPI figures, also published tomorrow, are expected to reveal ongoing price pressures at the factory gate. With producer input costs having risen rapidly over recent months, producer output price inflation is also expected to have risen to its highest in a decade in November, above 8%Y/Y. The official measure of house price inflation, however, is expected to moderate 0.6ppt to a still rapid 11.2%Y/Y in October.

UK: Redundancies



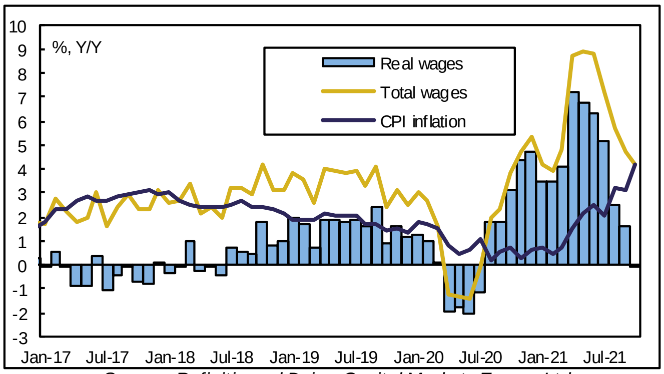
Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Vacancy ratio and unemployment rate



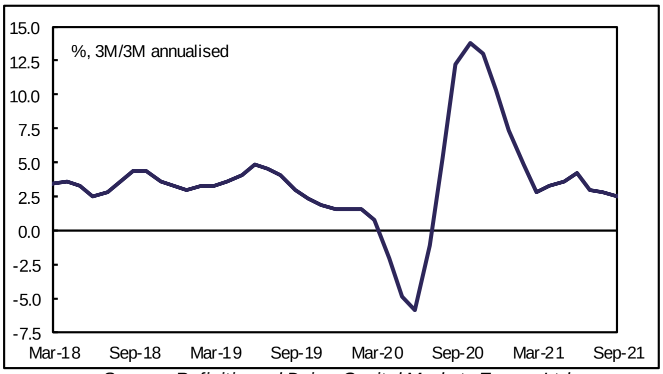
Source: Bloomberg, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Wage growth and CPI inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Regular wage growth



Source: Refinitiv 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
Euro area		Industrial production M/M% (Y/Y%)	Oct	**1.1 (3.3)**	1.2 (3.2)	-0.2 (5.2)	**- (5.1)**
UK		Unemployment claimant count rate % (change '000s)	Nov	**4.9 (-49.8)**	-	5.1 (-14.9)	**5.0 (-58.5)**
		Average earnings incl. bonuses (excl. bonuses) 3M/Y%	Oct	**4.9 (4.3)**	4.6 (4.0)	5.8 (4.9)	**5.9 (5.0)**
		ILO unemployment rate 3M%	Oct	**4.2**	4.3	4.3	-
		Employment change, '000s 3M/3M	Oct	**149**	220	247	-

Auctions

Country		Auction
Italy		sold €3.5bn of 0% 2024 bonds at an average yield of -0.1%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
UK		Rightmove house price index M/M% (Y/Y%)	Dec	**-0.7 (6.3)**	-	-0.6 (6.3)	-

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/ *Daiwa forecast*	Previous
France		07.45	Final CPI (EU-harmonised CPI) Y/Y%	Nov	2.8 (3.4)	2.6 (3.2)
Italy		09.00	Final CPI (EU-harmonised CPI) Y/Y%	Nov	3.8 (4.0)	3.0 (3.2)
Spain		08.00	Final CPI (EU-harmonised CPI) Y/Y%	Nov	5.6 (5.6)	5.4 (5.4)
UK		07.00	CPI (core CPI) Y/Y%	Nov	*4.9 (3.7)*	4.2 (3.4)
		07.00	PPI input prices (output prices) Y/Y%	Nov	13.1 (8.1)	13.0 (8.0)
		09.30	House price index Y/Y%	Oct	11.2	11.8

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.