Daiwa Capital Markets

Euro wrap-up

Overview

- Gilts made losses as the rebound in UK GDP in October was a touch firmer than expected, albeit still suggesting that the economy is probably in recession.
- Bunds made modest losses on a quiet day for euro area economic data releases.
- Tuesday will bring final German inflation figures for November, and the UK's latest labour market report.

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Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.176	+0.055
OBL 1.3 10/27	1.965	+0.032
DBR 1.7 08/32	1.930	+0.008
UKT 1 04/24	3.482	+0.048
UKT 1¼ 07/27	3.286	+0.046
UKT 4¼ 06/32	3.206	+0.026

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

UK

Rebound in UK GDP in October a touch firmer than expected

While the rebound in UK GDP at the start of the fourth quarter was a touch firmer than had been expected, it nevertheless remained consistent with a downwards trend and reaffirmed that the economy is now probably in recession. GDP growth of 0.5%M/M in October was principally supported by expansion in the services sector (0.6%M/M), with wholesale trade, retail and auto repair reporting a firm bounce (1.9%M/M), while healthcare (1.3%M/M) was supported by the autumn vaccination booster campaign. But while output from consumer-facing services grew 1.2%M/M in October, this followed two consecutive declines of more than 1½%M/M to be still almost 9% below the pre-pandemic level. And only five out of the fourteen services subsectors reported positive growth. Construction also rose for the fourth consecutive month (0.8%M/M), while a pickup in manufacturing (0.7%M/M) was driven by another acceleration in autos (6.1%M/M) and pharmaceuticals (8.3%M/M). But these were offset by a negative contribution from energy supply to leave total industrial production broadly flat on the month.

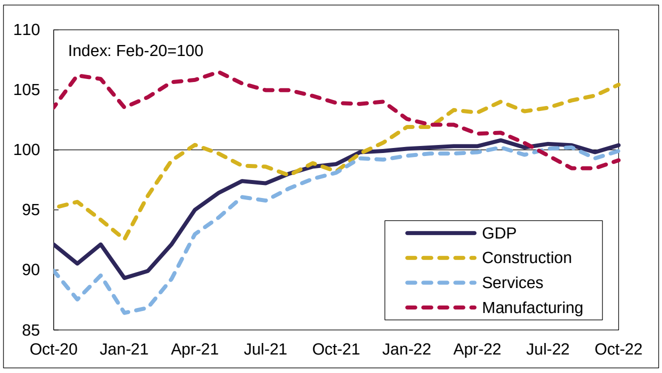
But downwards trend remains and economy probably in recession

Overall, the level of GDP in October was a touch higher than the Q3 average (0.2%). But it was still 0.1% below the pre-pandemic peak in January 2020. Smoothing out monthly volatility, GDP reported the third consecutive decline on a three-month basis and the steepest in this sequence at -0.3%3M/3M. And there is little reason to expect that a significant improvement in GDP is on the horizon. Certainly, the PMI surveys provided a bleak assessment of conditions in November, with the composite PMI (48.2) signalling the fastest pace of contraction since the start of 2021 and, outside of Covid lockdown periods, mid-2016 at the time of the Brexit referendum. The increasing squeeze on household budgets from high inflation and rising borrowing costs, as well as the deteriorating housing market will continue to weigh on household spending too. Indeed, the Rightmove house price index showed that the average asking price fell 2.1%M/M in December, the steepest monthly drop for four years and more than the average for the time of the year, to leave the annual rate (5.6%Y/Y) at a sixteen-month low. The current cold snap and rail strikes will certainly add further challenges to services activity in the run up to Christmas. As such, we maintain our view that GDP growth will contract in Q4, by around 0.2%Q/Q, with a return to positive quarterly growth unlikely in the first half of 2023 too.

Trade deficit narrows amid a steep drop in imported price of energy

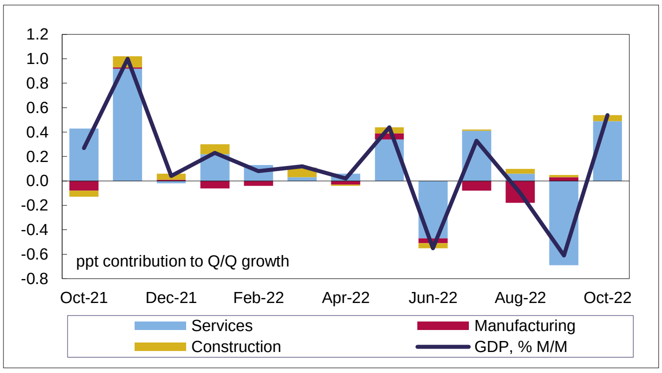
Today's monthly trade figures were at face value more encouraging, with the total trade deficit narrowing £1.4bn to £1.8bn in October, the smallest deficit this year but nevertheless still larger than the long-run average (£1.2bn). This reflected both an improvement in the services surplus (£12.7bn), and a narrowing in the goods deficit (£14.9bn). But when excluding precious

UK: GDP and selected production components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Contributions to GDP growth



Source: ONS and Daiwa Capital Markets Europe Ltd.

metals, which are extremely volatile, the improvement in the trade deficit was less pronounced, down £0.8bn to a still-hefty £7.0bn, within the range seen over the previous nine months and significantly higher than the series average (£2.1bn). Moreover, the improvement principally reflected the impact of lower prices, with the value of total imports down 2%M/M, with a striking drop of around one third in the value of imported fuel from non-EU countries. Indeed, when excluding price effects and erratic items, import volumes rose more than 4%M/M. Meanwhile, export volumes were broadly unchanged on the month, despite a near-4½% drop in goods exports. Of course, given the surge in exports in Q3, the decline might have been even steeper at the start of Q4. Certainly, given waning external demand, we expect net trade to weigh heavily on GDP growth in Q4, reversing some the support seen in Q3 when it added more than 3ppts to GDP growth.

The day ahead in the UK

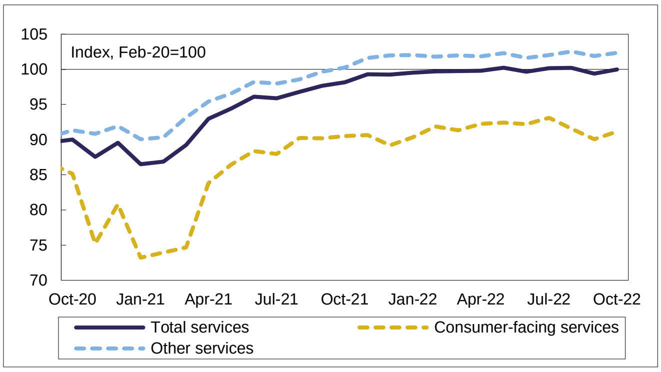
The data highlight in the UK tomorrow will be the latest labour market report. Despite expectations of another decline in employment in the three months to October, elevated inactivity and a lack of skilled workers will ensure that the labour market remained extremely tight, with the unemployment rate forecast to have risen just 0.1ppt to 3.7% over the same period. Against this backdrop, wages seem bound to have remained under upwards pressure in the private sector, with total regular wage growth forecast to have risen further above September's rate of 5.7%3M/Y, which was a series high when excluding the height of the pandemic disruption. Separately, the Bank of England's Financial Stability Report will also be published tomorrow, with the impact of the financial instability caused by Trussenomics in the autumn and the deterioration in the housing market likely to be of key focus.

Euro area

The day ahead in the euro area

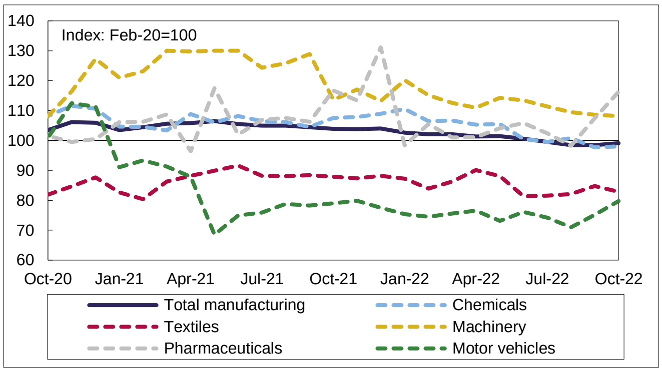
After a quiet start to the week for euro area economic news, tomorrow brings the release of updated German consumer price inflation estimates for November. Preliminary data revealed that consumer prices (on the national measure) fell for the first time in a year (-0.5%M/M), compared with an average increase of 0.9%M/M in the previous eleven months, to leave the annual CPI rate down 0.4ppt to 10.0%Y/Y. This principally reflected a fall in energy prices, for which the annual rate declined 4.7ppts to a three-month low of 38.4%Y/Y due to a near-4%M/M drop in petrol prices. On the EU-harmonised basis, German inflation stood at a firmer 11.3%Y/Y, nevertheless down 0.3ppt from October. Meanwhile, the German ZEW investor sentiment survey is expected to report an improvement in opinion about the current and future situation, although both indices are likely to remain close to recent lows, and well down on their pre-pandemic levels. Elsewhere, Italian IP is expected to fall 0.4%M/M in October, in line with the weakness reported last week across other member states.

UK: Services output



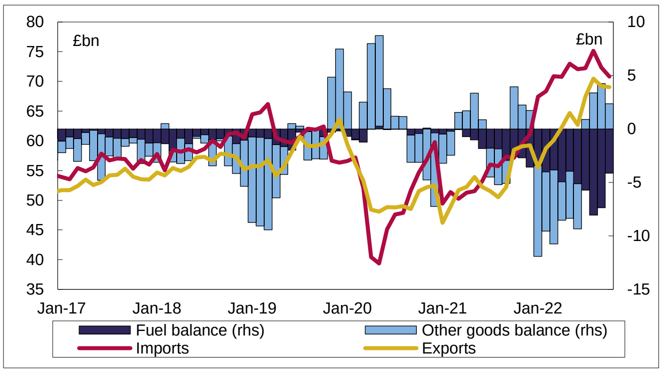
Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing production



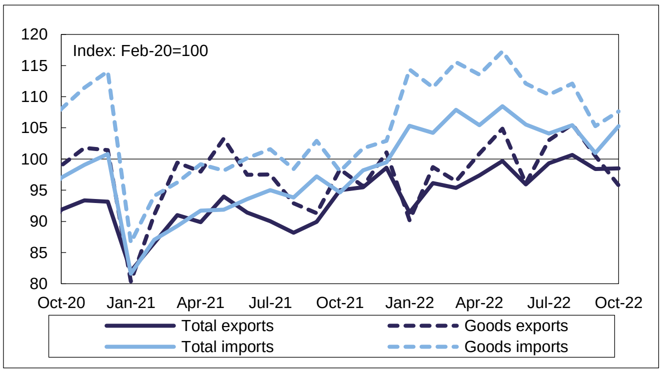
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Trade balance, export and import values



Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Export and import volumes



Source: ONS and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK		Rightmove house prices M/M% (Y/Y%)	Dec	-2.1 (5.6)	-	-1.1 (7.2)	-
		GDP M/M% (3M/3M%)	Oct	0.5 (-0.3)	0.4 (-0.4)	-0.6 (-0.2)	-
		Industrial production M/M% (Y/Y%)	Oct	0.0 (-2.4)	0.0 (-2.5)	0.2 (-3.1)	-
		Manufacturing production M/M% (Y/Y%)	Oct	0.7 (-4.6)	0.0 (-5.2)	0.0 (-5.8)	-
		Index of services M/M% (3M/3M%)	Oct	0.6 (-0.1)	0.5 (-0.1)	-0.8 (0.0)	-
		Construction output M/M% (Y/Y%)	Oct	0.8 (7.4)	0.1 (6.5)	0.4 (5.7)	-
		Trade balance (goods trade excl. precious metals) £bn	Oct	-1.8 (-19.7)	-3.5 (-)	-3.1 (-20.4)	-

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
Germany		07.00	Final CPI M/M% (Y/Y%)	Nov	-0.5 (10.0)	0.9 (10.4)
		07.00	Final HICP M/M% (Y/Y%)	Nov	0.0 (11.3)	1.1 (11.6)
		10.00	ZEW current assessment (expectations)	Dec	-57.0 (-26.4)	-64.5 (-36.7)
Italy		09.00	Industrial production M/M% (Y/Y%)	Oct	-	-1.8 (-0.5)
UK		07.00	Unemployment claimant count rate %, change '000s	Nov	-	3.9 (3.3)
		07.00	ILO unemployment rate %, 3M	Oct	3.7	3.6
		07.00	Employment change '000s, 3M/3M	Oct	-17	-52
		07.00	Average earnings including (excluding) bonuses 3M/Y%	Oct	6.1 (5.9)	6.0 (5.7)

Auctions and events

Country		GMT	Event
UK		10.00	Auction: £3bn of 1% 2032 bonds
		10.30	BoE publishes Financial Stability Report

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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