Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made losses as German factory orders significantly beat expectations, while the Commission survey was consistent with steady growth in euro area GDP in Q4.
- Gilts were little changed as the BoE's DMP survey suggested stubbornly high business wage expectations.
- Friday will bring November data for euro area retail sales, German and French industrial production and German trade.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/27	2.093	+0.006
OBL 2.2 10/30	2.410	+0.014
DBR 2.6 08/35	2.864	+0.016
UKT 3¾ 03/27	3.657	-0.009
UKT 4⅜ 03/30	3.855	-0.003
UKT 4½ 03/35	4.409	-0.006

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

Euro area

German factory orders surge in November to benefit from jump in defence expenditure

Today's German factory orders data added to evidence that the government's significant fiscal loosening is starting to bear fruit. In particular, new factory orders rose for a third consecutive month in November – the longest run of growth in almost three years – and by a much stronger-than-expected 5.6%M/M, the most in eleven months. As a result, new orders rose to their highest level in two years, up a whopping 10.5%Y/Y and tracking almost 6% above the Q3 average. Admittedly, the strength in November was in good part attributed to substantial one-off orders in certain subsectors. Notably in light of the government's plans to increase expenditure on defence markedly, there was a more than six-fold increase in new orders of weapons and ammunition. And there was a fourth successive increase in orders of 'other transport equipment', a category that includes military vehicles as well as aircraft, ships and trains. Indeed, the average level of orders in this subsector in October and November was more than double that in Q3.

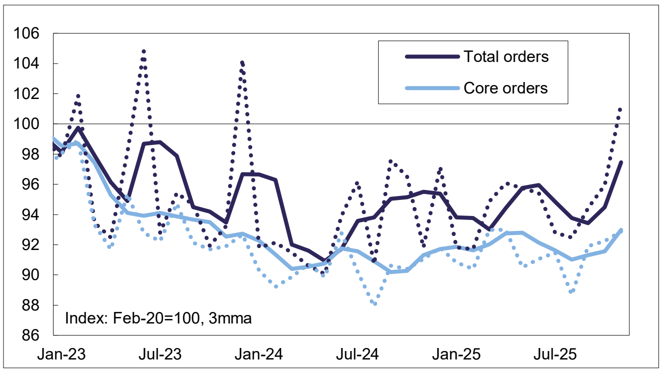
Core orders up to 7-month high suggesting broader recovery in manufacturing output ahead

Encouragingly too, today's data reported solid orders growth for general and electrical machinery and ICT equipment, pointing to an additional boost from plans to increase infrastructure and other capex. And when excluding bulk items, core orders still rose for a third successive month in November, by 0.7%M/M, to be trending more than 2% above the Q3 average and pointing to a pickup in both manufacturing output and fixed investment this year. Offering further evidence of the new impetus from fiscal policy, domestic orders leapt 6.5%M/M in November to be trending 14% higher in Q4. There was also strong growth in orders from the euro area (8.2%M/M). But while there was also a pickup in orders from outside of the euro area (2.9%M/M), they were still trending below the average level in Q3. Nevertheless, there are signs that overseas demand improved into year-end. And overall, today's data tally with yesterday's much stronger civil engineering PMI and uptrend in certain ifo manufacturing expectations indices to suggest that a range of German subsectors will see firmer activity in 2026.

Manufacturing & construction conditions improve at end-2025, services more upbeat about Q126

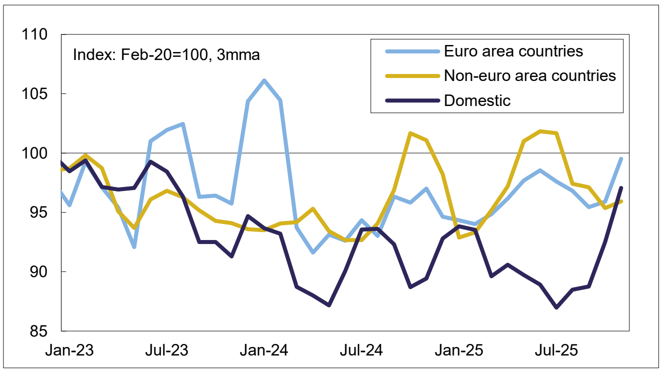
At first glance, however, today's Commission survey was less encouraging, signalling a decline in manufacturing production in the euro area in the three months to December, and led by a deterioration in Germany. But firms were more upbeat about the near-term outlook, not least in production of transport equipment, metals and chemicals. As such, overall manufacturing confidence rose slightly in December to the second highest level for two years. Constructors also judged conditions to be the most favourable in 2½ years and well above the long-run trend, reporting firmer civil engineering activity and a pickup in new orders. While services sentiment weakened slightly from November's 13-month high, there was greater optimism in

Germany: New factory orders*



Dotted lines represent unsmoothed data. Core orders exclude major items.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Domestic & foreign new factory orders



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

hospitality and advertising, as firms expected demand in Q126 to be the strongest in more than a year. And while retailers were seemingly disappointed by Christmas sales, sentiment in the sector was still above the long-run average. A modest deterioration in consumer confidence to a three-month low on a revised series also wasn't overly concerning, not least as it reflected a softening in Spain where sentiment remains comfortably above the long-run average. Moreover, today's results suggested that recent spending on big-ticket items was the strongest for almost four years, reinforcing expectations that private consumption gave a boost to GDP growth in Q4.

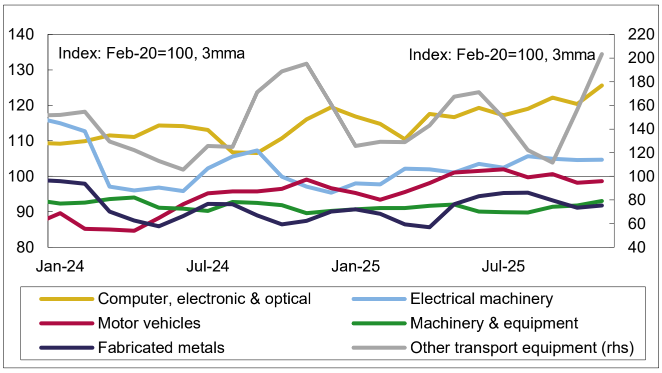
Economic sentiment signals firming GDP growth in Q4 despite softer momentum in December

Overall, the euro area Economic Sentiment Indicator (ESI) fell to a three-month low (96.7) in December to imply a slight slowing of economic momentum into year-end. But the average in Q4 was still up more than 1pt from Q3 to tally with the PMIs and suggest a slight acceleration in euro area GDP growth last quarter, from 0.26%Q/Q in Q3. Despite a relatively broad-based drop in sentiment in December across the larger member states, the respective quarterly ESIs for France (94.7), Italy (101.1) and Spain (104.5) in Q4 were similarly up around 1½-2pts from Q3, pointing to positive GDP growth in each country and continued Iberian outperformance. In contrast, the German ESI (90.9) in Q4 was little improved over the quarter and still the weakest of the member states. But this differed markedly from the increase in the German composite PMI, which rose to a 2½-year high firmly in expansionary territory, and we maintain our expectation of a very modest rise in German GDP in Q4.

Labour market broadly stable towards year-end with ongoing improvement in Southern Europe

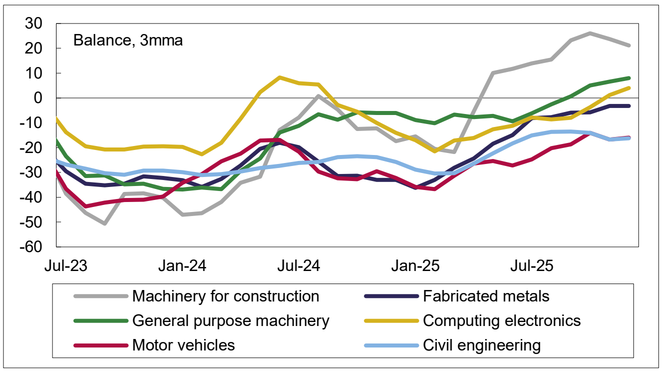
With respect to the labour market, today's other top-tier economic data pointed to broad stability towards year-end albeit with continued variation between member states and sectors. Encouragingly, the euro area unemployment rate edged down 0.1ppt in November to a seven-month low of 6.3%, just 10bps above the series low reached in autumn 2024. And the number of people out of work fell the most since April (-71k) to back below 11mn, similarly a seven-month low. The decline in joblessness was fully explained by Southern European member states. Indeed, the unemployment rates in Spain (10.4%) and Greece (8.2%) fell to their lowest levels since 2008, while the equivalent Italian rate (5.7%) was the lowest on the series dating back to 1983. Admittedly, the Commission survey's euro area Employment Expectations Index softened a touch in December to a three-month low. It also suggested that services firms looked to cut headcount for the first time since early 2021. However, overall, the survey pointed to another quarter of modestly positive job growth in Q4, a touch firmer than in Q3, with labour demand still particularly strong across Southern Europe.

Germany: New factory orders, by subsector



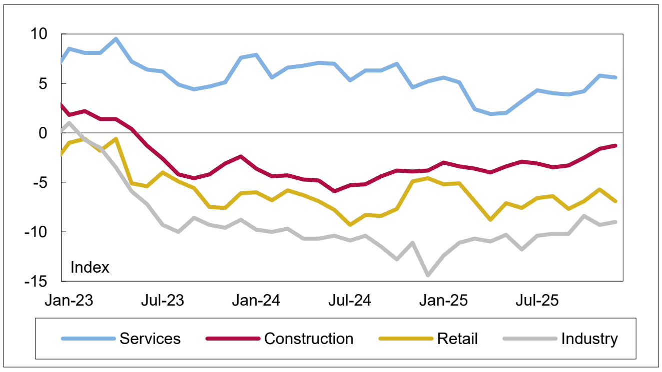
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ifo survey – expectations indices



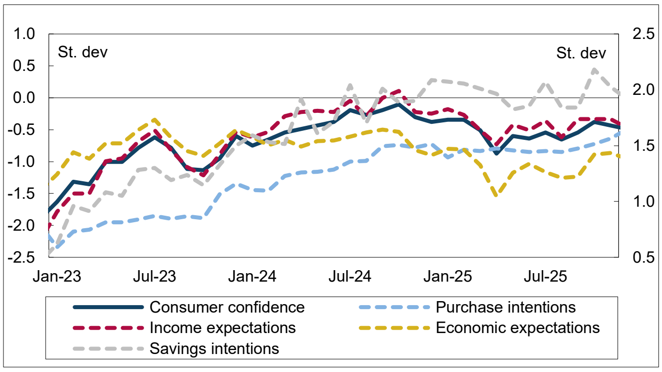
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ESIs by sector



Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence indices



Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

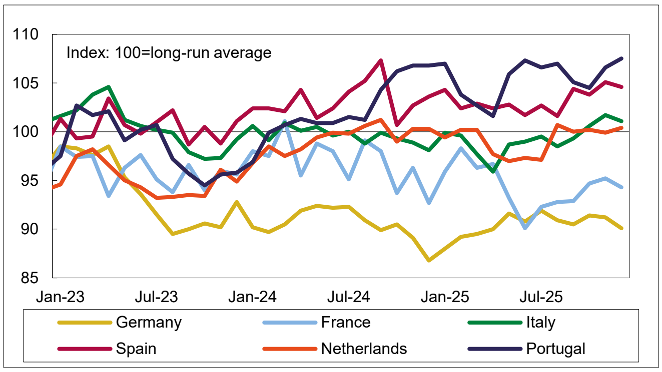
Factory output price pressures still largely absent, inflation expectations broadly anchored

Finally, after yesterday's flash euro area consumer price figures for December reported a drop in core goods inflation to a 16-month low of just 0.4%Y/Y, euro area producer price data for the prior month added further evidence that price pressures in the factory sector remain largely (if not entirely) absent. As expected, the headline euro area industrial PPI rate fell more deeply into deflation, down 1.2ppts to a 13-month low of -1.7%Y/Y. Despite higher prices on the month in that component, due to a favourable base effect, energy PPI inflation plummeted to -7.4%Y/Y, also the lowest since October 2024. Thanks to significant easing in food, producer non-durable goods inflation also slowed to the softest in more than a year (1.1%Y/Y). And the intermediate (0.4%Y/Y) and capital goods (1.8%Y/Y) components remained within last year's ranges. But durable goods PPI inflation rose 0.5ppt to a near-two-year high, albeit remaining target-consistent at 2.0%Y/Y. Meanwhile, with the exception of the retail sector, the Commission survey flagged a slight pickup in short-term output price expectations in all major business sectors in December. And consumer 12-month inflation expectations edged up to a four-month high. But none of these indices look particularly inconsistent with the ECB's target. And the ECB's own consumer survey today suggested that inflation expectations remain well-anchored towards year-end, with no changes to median expectations in November over the 12-month, 3-year and 5-year horizons, and the latter still close to target at 2.2%Y/Y.

The day ahead in the euro area

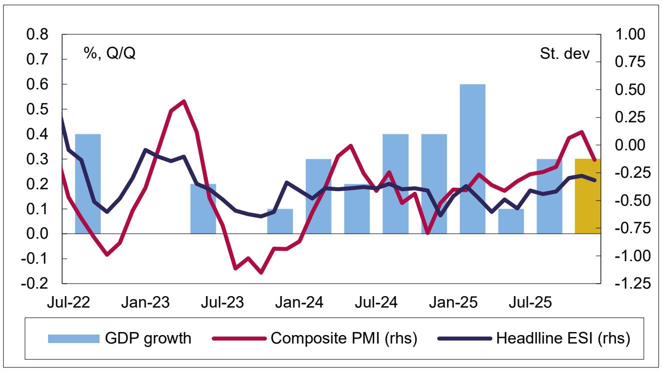
The focus on Friday in the euro area will stay with November's activity data, which will include euro area retail sales and industrial production data from certain member states. As reported in October, we expect retail sales volumes to be little changed in the latest month as gains in France (0.5%M/M) and Spain (1.0%M/M) offset a decline from yesterday's German release (-0.6%M/M). However, the member state data also lead us to expect upwards revisions to the series which, in net, should leave retail sales volumes trending slightly above their Q3 level, flagging the likelihood of a ninth consecutive quarterly advance. With respect to industrial output, data from Germany, France and Spain – which together account for more than half of the aggregate euro area figure – are also due at the end of the week. Having failed to add to GDP growth in Q3, German industry started last quarter on a strong footing (1.8%M/M) to boost expectations for a return to expansion in Q4. The extent of October's rise, however, implies that at least modest payback in November is more than likely. Indeed, that would corroborate with the drop in the truck toll index that month. And while today's manufacturing turnover data were more upbeat, it has been a poor predictor of IP more recently. The German release will also be accompanied by November's goods trade figures, while provisional Irish IP data – which are often volatile and have an outsized effect on euro area output – will also be closely watched.

Euro area: ESIs by member state



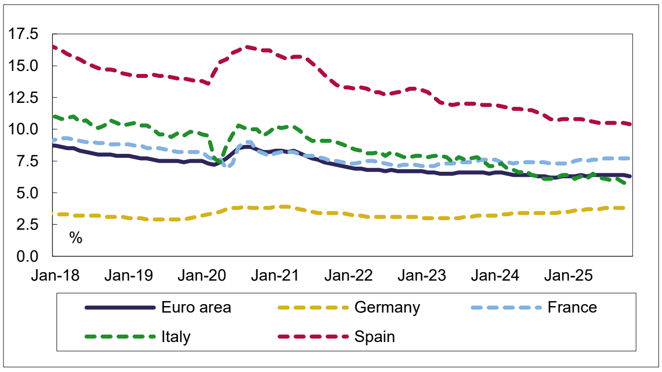
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Survey indices & GDP growth*



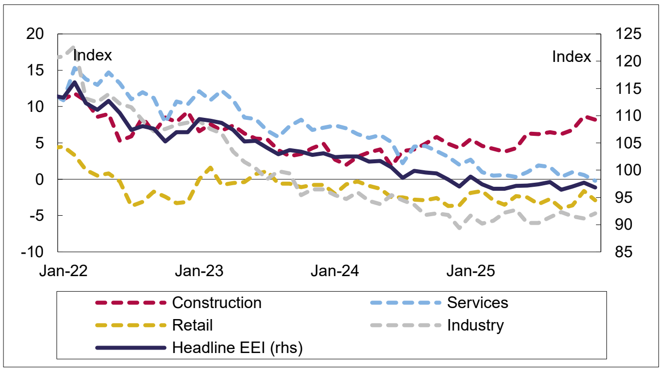
**Gold bar represents Daiwa forecast for Q425. Source: S&P Global, EC, Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Unemployment rates



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Employment expectations indices



Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

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UK

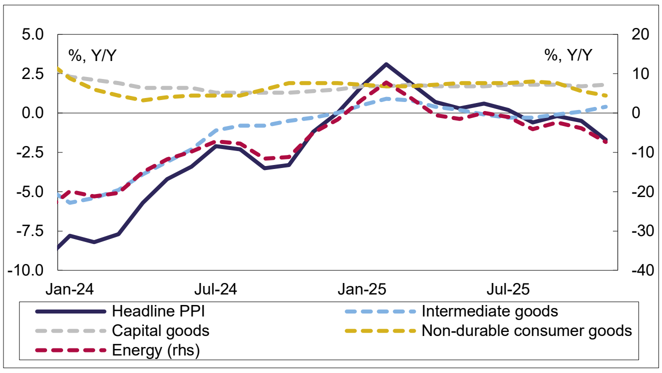
Stubborn DMP wage expectations support a case for temporary caution in rate cuts

Policy splits aside, MPC members agree that the BoE's DMP survey is relevant to its decision-making. Indeed, in the minutes of December's monetary policy meeting, most of those who voted to hold rates cited concerns about forward-looking business wage and price expectations, which are monitored by the survey. More significant, however, was the more cautious tone struck some of the doves – Governor Bailey and Deputy Governors Breeden and Ramsden – with regards to the strength of forward-looking pay indicators. On balance, today's DMP survey will likely have done little to alleviate those concerns. On the one hand, some members might be reassured by evidence of cooling business inflation expectations. Though still elevated, year-ahead CPI expectations (3.2%Y/Y) declined for a second successive month and to a five-month low. Own output price expectations moderated slightly back close to levels before the inflationary 2024 Budget announcement. But evidence of moderation in wage expectations has been scarcer. At 3.7%Y/Y, that measure remains elevated, in line with the average last year. That should resonate with those MPC hawks concerned that elevated labour cost growth reflects structural issues, such as big hikes to national minimum wages. And to the extent that still-elevated pay growth heralds the risk of more persistent inflationary pressures, we expect some of the doves also to prefer to wait for more evidence of a cooling labour market before voting for further cuts to Bank Rate too. For what it's worth, the DMP also suggested that firms' hiring intentions, though stabilising, remained weak in the aftermath of the budget. In turn, we expect incoming data on wages and inflation to continue to soften over the coming months. So, following a pause to policy in Q1, we see that as justifying at least two more cuts to Bank Rate this year (in April and July).

The day ahead in the UK

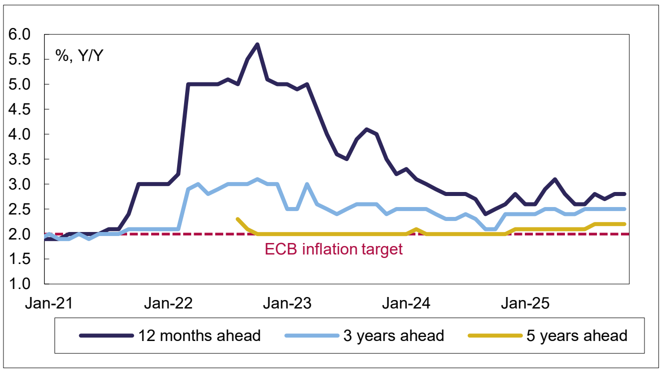
The REC's monthly jobs report will provide a first indicator of conditions in the UK labour market at the start of the new year. But otherwise, it should be a relatively quiet end to the week for UK economic news.

Euro area: Producer price inflation



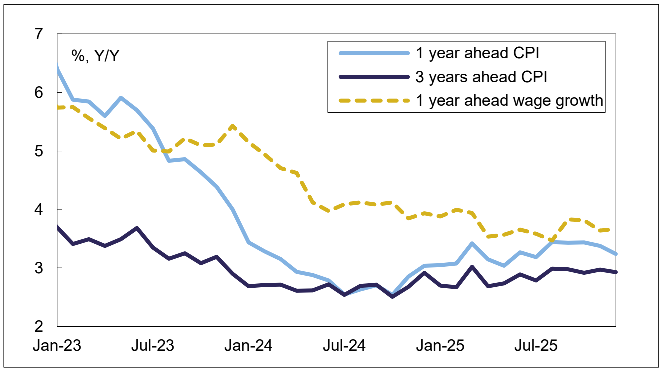
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB consumer inflation expectations



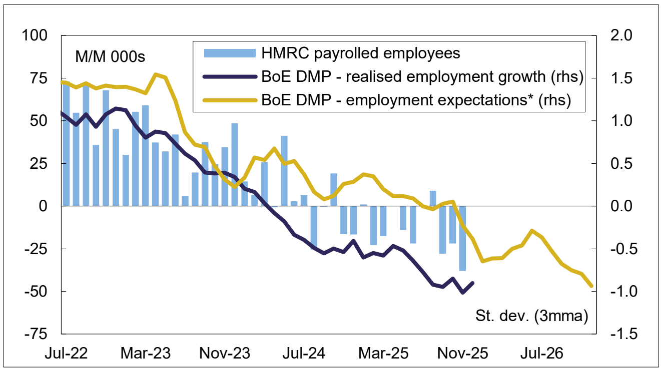
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: DMP survey - firms' CPI & wage expectations



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employment & DMP indicators



**Year-ahead employment expectations index has a 12-month lead.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

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European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ _Daiwa forecast_	Previous	Revised
Euro area	Commission economic sentiment indicator	Dec	**96.7**	97.1	97.0	97.1
	Commission services (industrial) confidence indicator	Dec	**5.6 (-9.0)**	6.0 (-9.1)	5.7 (-9.3)	5.8 (-)
	Final Commission consumer confidence indicator	Dec	**-13.1**	_-14.6_	-14.2	-12.8
	Unemployment rate %	Nov	**6.3**	6.4	6.4	-
	PPI Y/Y%	Nov	**-1.7**	-1.7	-0.5	-
	ECB consumer survey – 1Y (3Y) ahead CPI expectations Y/Y%	Nov	**2.8 (2.5)**	2.7 (2.5)	2.8 (2.5)	-
Germany	Factory orders M/M% (Y/Y%)	Nov	**5.6 (10.5)**	-1.0 (2.9)	1.5 (-0.7)	1.6 (-)
France	Trade balance €bn	Nov	**-4.2**	-	-3.9	-3.5
UK	DMP 3M output price (1Y CPI) expectations Y/Y%	Dec	**3.6 (3.2)**	3.6 (3.3)	3.7 (3.4)	-

Auctions

Country	Auction
France	sold €6.866bn of 3% 2035 bonds at an average yield of 3.53%
	sold €2.757bn of 0.5% 2040 bonds at an average yield of 3.95%
	sold €2.679bn of 3.6% 2042 bonds at an average yield of 4.05%
	sold €1.198bn of 3.75% 2056 bonds at an average yield of 4.46%
Spain	sold €2.81bn of 2.7% 2030 bonds at an average yield of 2.508%
	sold €2.01bn of 3% 2033 bonds at an average yield of 2.938%
	sold €1.46bn of 3.45% 2043 bonds at an average yield of 3.806%
	sold €726mn of 1.15% 2036 inflation-linked bonds at an average yield of 1.508%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ _Daiwa forecast_	Previous
Euro area	10.00	Retail sales M/M% (Y/Y%)	Nov	_0.0 (1.7)_	0.0 (1.5)
Germany	07.00	Industrial production M/M% (Y/Y%)	Nov	-0.7 (-1.0)	1.8 (0.8)
	07.00	Trade balance €bn	Nov	16.4	16.9
France	07.45	Industrial production M/M% (Y/Y%)	Nov	-0.2 (1.6)	0.2 (1.7)
	07.45	Consumer spending M/M% (Y/Y%)	Nov	-0.1 (0.2)	0.4 (0.4)
Italy	09.00	Retail sales M/M% (Y/Y%)	Nov	-	0.5 (1.3)
Spain	08.00	Industrial production M/M% (Y/Y%)	Nov	-	0.7 (1.2)

Auctions and events

Country	GMT	Event
UK	00.01	REC, KPMG & S&P Global Report on Jobs for January

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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