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## Headline inflation to rebound as energy drag starts to fade

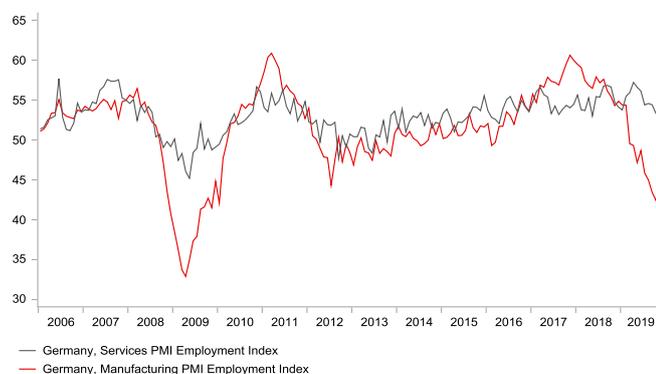
25 November 2019

### Surveys may also shed more light after last week's mixed bag PMI release

The key data releases this week are the flash estimates of inflation, with the figures for the euro area as a whole to be released on Friday. We expect the headline to increase from 0.7% YoY in October to 0.9% YoY in November as the drag from energy is set to fade (with a similar story for the individual national releases). The core measure may tick up again, to 1.2% YoY.

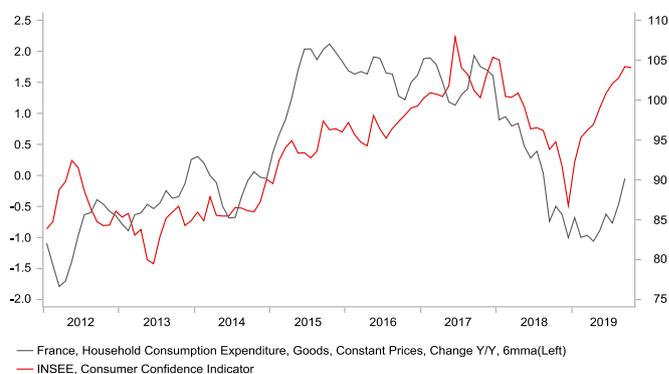
Turning to the surveys, while last week's flash PMI release did hint at improving conditions in the manufacturing sector, there were worrying signs of contagion as the services PMI fell to a 10-month low. There were also concerns about the rest of the euro area, excluding France and Germany, which slipped into contraction territory for the first time since 2013, according to IHS Markit. PMIs for other euro area countries are not released until 2 December, but this week's ISTAT business confidence indicator might be informative about the extent of any deterioration in Italy. The drag may have been from Spain, however, due to the political uncertainty there.

### DIVERGENCE IN GERMAN EMPLOYMENT OUTLOOK



Source: IHS Markit, MUFG Economic Research

### IMPROVED CONSUMER OUTLOOK IN FRANCE



Source: INSEE, MUFG Economic Research

In Germany, this week's Ifo survey will be interesting as a follow-up to the composite PMI which has (very) gradually improved for two consecutive months. We suspect there will be a small increase in the business climate index, and perhaps a stronger pick-up in the expectations after the improvement shown in the ZEW figure. However, there is likely to be some signs of deterioration in the German labour market data which could be reflected in the consumer confidence indicator.

Lastly, in France, higher household consumption contributed to resilient overall GDP growth of 0.3% QoQ in Q3 this year. French consumer confidence has recovered sharply after the gilets jaunes protests peaked at the end of 2018. We expect it will have remained above the long-term average in November.

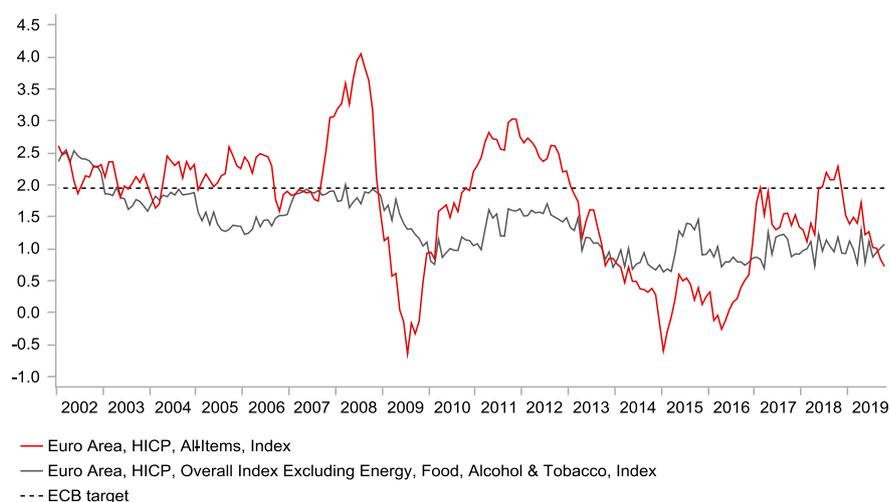
## KEY RELEASES AND MUFG FORECASTS – WEEK BEGINNING 25 NOVEMBER

Day	GMT	Region	Indicator/Event	Period	Previous	Cons.	MUFG
Mon 25 Nov	09:00	GE	IFO Business Climate	Nov	94.6	95.0	95.4
Mon 25 Nov	09:00	GE	IFO Expectations	Nov	91.5	92.5	93.2
Mon 25 Nov	09:00	GE	IFO Current Assessment	Nov	97.8	97.9	98.4
Tue 26 Nov	07:00	GE	GfK Consumer Confidence	Dec	9.6	9.6	9.4
Wed 27 Nov	07:45	FR	Consumer Confidence	Nov	104	103	104
Wed 27 Nov	09:00	IT	Manufacturing Confidence	Nov	99.6	99.9	99.1
Thu 28 Nov	09:00	EC	M3 Money Supply YoY	Oct	5.5	5.5	5.4
Thu 28 Nov	10:00	EC	Economic Confidence	Nov	100.8	101.0	100.7
Thu 28 Nov	13:00	GE	CPI YoY	Nov P	1.1	1.2	1.2
Fri 29 Nov	07:45	FR	CPI YoY	Nov P	0.8	0.9	0.9
Fri 29 Nov	08:55	GE	Unemployment Change (000's)	Nov	6.0k	5.0k	8.0k
Fri 29 Nov	08:55	GE	Unemployment Claims Rate SA	Nov	5.0	5.0	5.0
Fri 29 Nov	10:00	EC	Unemployment Rate	Oct	7.5	7.5	7.5
Fri 29 Nov	10:00	EC	CPI Estimate YoY	Nov P	0.7	0.9	0.9
Fri 29 Nov	10:00	EC	CPI Core YoY	Nov P	1.1	1.2	1.2

Source: Bloomberg

### Data focus 1: Euro area inflation

#### EURO AREA INFLATION REMAINS STUBBORNLY BELOW TARGET



Source: Eurostat, MUFG Economic Research

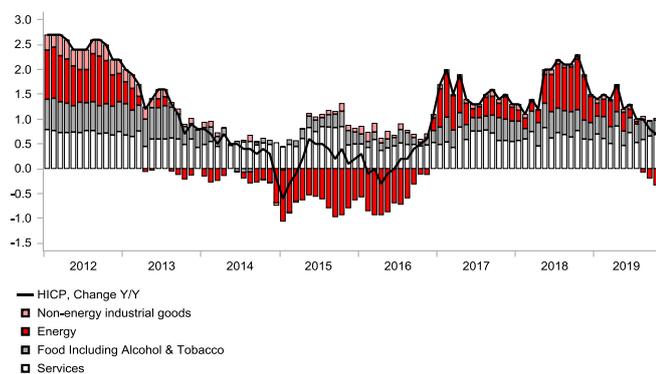
The recent euro area inflation story has been one of stubbornly low core rates with swings in the headline figure due to changing energy prices. This was the case in October, as core inflation edged slightly up to 1.1% while the headline rate slipped to 0.7%. The energy component has weighed on headline inflation for the last three months but, as the year ends, we expect that this drag will unwind fairly promptly as oil price base effects turn around. Headline HICP is likely to increase to 0.9% YoY in November.

The more important question, for the ECB at least, is whether or not core price pressures will ever start to show more signs of life. HICP inflation excluding energy, food, alcohol and tobacco has hovered in a very narrow range between 0.7% and 1.3% since November 2015 – well below the ECB's target of 2%. Wage pressure had slowly increased in the euro area, but pay increases seem to have stalled at through 2019. Current wage growth, at around 2.5% YoY, may still be enough to create

upward pressure on prices – eventually it will not be possible to absorb it into profit margins – so we expect core will edge slightly higher into next year, starting with another rise to 1.2% in October. But wage pressure is likely to remain relatively muted, at least by historical standards, against the current backdrop of weaker economic activity.

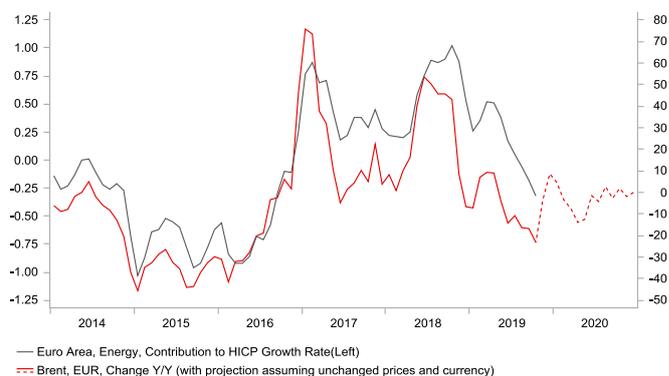
Despite the encouraging recent surge in the ECB's preferred measure of pay growth (negotiated wages), we note that the proportion of firms indicating that a lack of labour is limiting production has slumped in 2019. This points to weaker wage pressure. This may change through 2020 – we expect there might be signs of a manufacturing recovery from as early as H1 – but a continuation of below-target core inflation through next year seems most likely to our minds. Our overall HICP forecast for 2020 is 1.4%.

### ENERGY HAS DRAGGED ON HEADLINE INFLATION...



Source: Eurostat, Macrobond, MUFG Economic Research

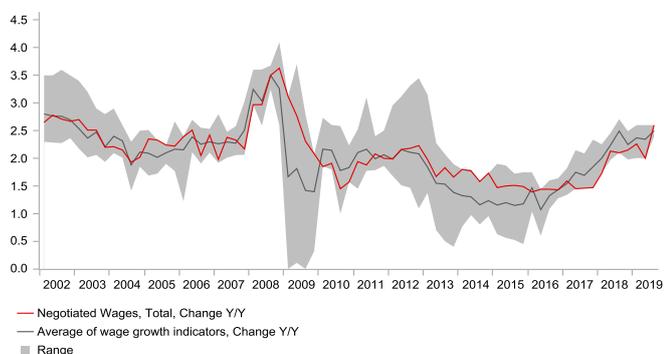
### ...BUT THIS IS SET TO FADE



Source: Eurostat, Macrobond, MUFG Economic Research

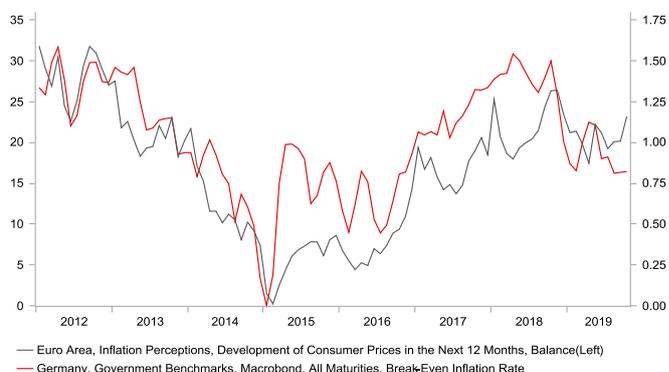
Meanwhile, the risk to inflation expectations has been brought even more sharply into focus as the energy component has dragged down the headline HICP rate. Well-anchored inflation expectations can become self-fulfilling by feeding back into the price setting process. Currently, market-based measures remain low, and the November Consensus forecast for core inflation in 2020 is just 1.2%. Consumer surveys are slightly more encouraging, but we suspect that the current situation of below-target expectations, well-anchored as they are, will continue to be a drag on actual inflation rates for some time.

### WAGE GROWTH MAY HAVE LOST SOME STEAM IN 2019



Source: Macrobond, MUFG Economic Research

### INFLATION EXPECTATIONS REMAIN MUTED



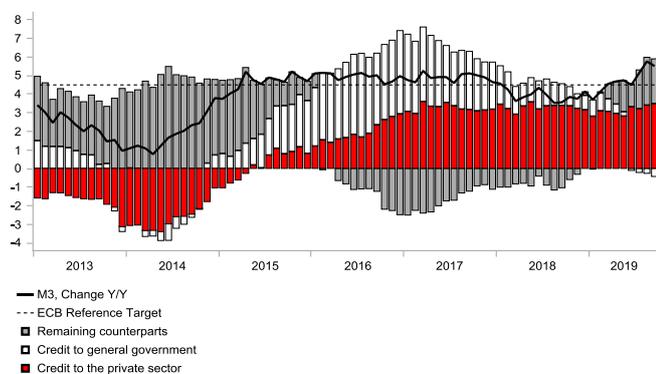
Source: Eurostat, Macrobond, MUFG Economic Research

## Data focus 2: Euro area money supply

Annual growth of broad money (M3) slowed to 5.5% YoY in September, from 5.8% in August. The headline figure has been bolstered by growth in credit to the private sector. Loan growth had steadily accelerated since 2014 but is now showing signs of stabilisation at around 3.6% YoY. We expect a similar figure of 5.4% for M3 growth in October. Further ahead, base effects are set to boost M3 growth in the new year. The figures will also start to reflect the ECB's renewed net asset purchases which resumed at a monthly pace of €20bn from 1 November this year. With this in mind, we think that broad money growth may approach 6% YoY in early 2020.

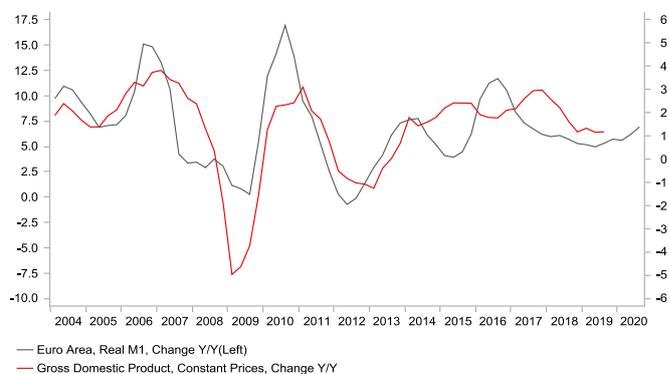
We will also watch the release for the M1 growth figure, which, when adjusted for inflation, is a reasonable leading indicator for growth in total economic activity. Despite a slowdown from 8.5% in August to 7.9% in September, the narrow money aggregate does seem suggest we may be approaching a turning point for euro area growth.

### PRIVATE SECTOR CREDIT SUPPORTS M3 GROWTH



Source: ECB, Macrobond, MUFG Economic Research

### REAL M1 GROWTH SUGGESTS A GROWTH RECOVERY



Source: Eurostat, Macrobond, MUFG Economic Research

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