

Euro wrap-up

Overview

- While the sharp rise in German inflation at the start of the year was confirmed, Bunds were little changed as Christine Lagarde insisted that the ECB was “very far away” from meeting its inflation target and French production data disappointed.
- Gilts made losses on an uneventful day for UK economic news.
- While Thursday will be a quiet day data-wise, Friday will bring the first estimates of UK GDP in Q4.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.723	-0.002
OBL 0 04/26	-0.695	-0.001
DBR 0 02/31	-0.441	+0.008
UKT 1½ 09/22	-0.045	+0.002
UKT 0% 06/25	0.074	+0.010
UKT 4% 12/30	0.482	+0.022

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

Source: Bloomberg

Euro area

French factory output ended 2020 on a softer note after seven months of growth

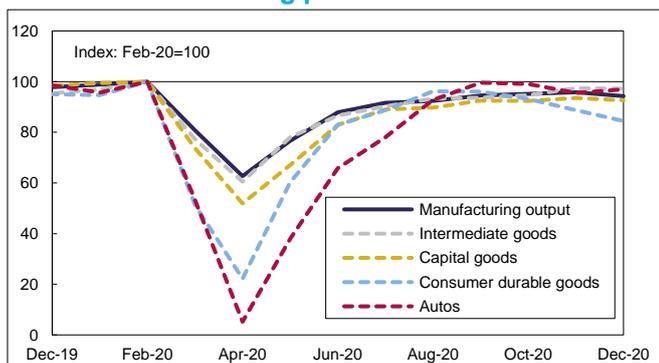
French manufacturing production dropped at the end of last year for the first time since April and by a steeper-than-expected 1.7%M/M to be down 4.4%Y/Y and 5.7% below last February’s pre-pandemic level. The drop came despite an increase in the transport goods sector, where production rose 2.2%M/M albeit still down 10.0% from last February. Within that category, autos output rose 1.4%M/M to be down 3.1% from February with other items (notably aircraft) stronger too. Other main categories, however, saw output drop at the end of last year, with production of coke and petrol down by almost one third due to the shutdown of several refineries and production of machinery and equipment falling 3.5%M/M. Meanwhile, energy output rose 2.5%M/M in December to be down just 1.5% below the pre-pandemic level. But construction output fell a steep 8.7%M/M in December to be down 10.9% from last February. Overall, total industrial production dropped 0.8%M/M at the end of 2020 to be down almost 5% from the pre-pandemic level. Nevertheless, over the fourth quarter as a whole French production rose 2.4%Q/Q with total IP up at roughly the same rate. In contrast, construction output fell 2.9%Q/Q in Q4. Looking ahead, while output from the petroleum refineries will rebound, we expect far more modest growth in manufacturing in Q1. And surveys point to ongoing weakness in construction.

Among the other largest euro area member states in December, production (excluding construction) rose in [Germany and Spain](#) and slid only slightly in Italy. Nevertheless, due to a drop of roughly one quarter in Ireland (where production had jumped more than 50% in November), we expect the euro area figure, due for release on Monday, to report a drop of roughly ½%M/M in December. But that will still likely leave production up about 4%Q/Q in Q4, confirming that the manufacturing sector provided helpful support to offset some of the impact of renewed weakness in services.

BoF survey suggests little change to French output in early 2021

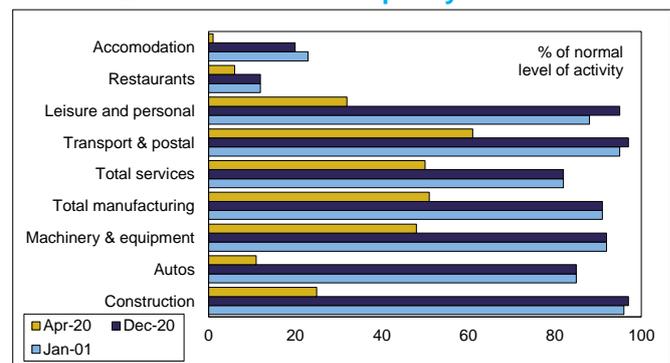
The weakening in the industrial sector at the end of 2020 contrasted with a broader improvement in the French economy as lockdown restrictions were eased, e.g. with the reopening of non-essential stores. So, having been down about 7% from the pre-pandemic norm in November, the Bank of France (BoF) estimates that the level of activity in December was down just 5% on the same basis. And based on its January survey published yesterday, the BoF judged that economic activity last month was little changed from December, even though the government brought forward its curfew by two hours to 6pm and tightened certain other restrictions too. Indeed, overall, the BoF saw little change last month in capacity utilization in industry, services and construction, and underscored the significant weakness in hospitality. Respondents to the BoF survey also expected to see little change to activity in industry and construction and a modest drop in services this month, but signalled

France: Manufacturing production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Estimated level of capacity utilisation*



*Compared to pre-pandemic level.

Source: Bank of France and Daiwa Capital Markets Europe Ltd.

increased uncertainty about the outlook. We recall, however, that the BoF survey exaggerated the extent of the weakness in French GDP in Q4, anticipating a drop of 4.0%Q/Q in contrast to the initial estimate of a decline of 1.3%Q/Q.

Lagarde downplays short-term price pressures as record jump in German inflation is confirmed

Beyond the production data, the record jump in German inflation in January was confirmed in today's final estimates. In particular, on the EU HICP measure inflation jumped a whopping 2.3ppts to an eleven-month high of 1.6%Y/Y. And the national CPI measure rose 1.3ppts to 1.0%Y/Y while the core measure on that basis rose 1ppt to 1.4%Y/Y. The main driver of the rise on all measures was the reversal of last summer's temporary VAT cut as well as higher energy prices, in part due to Germany's new carbon charge as well as higher oil prices. But all main components increased in line with the flash estimates. So, for example, on the national measure, inflation of services (including rents) rose 0.4ppt to an eleven-month high of 1.5%Y/Y, with a jump in administered prices in part reflecting an increased identity card fee. In addition, non-energy goods inflation rose 2ppts to 0.8%Y/Y. However, more than half of prices for clothing, recreation and culture – all of which were sources of upwards pressure – were imputed by the statisticians, suggesting that the true picture is far more uncertain than today's data suggest. In addition, changes in basket weights explain the steeper rise on the HICP measure. While German inflation is likely to rise further over the course of 2021, the preponderance of temporary issues explaining the rise last month suggests that it will take a significant step down in a year's time. So, it was no surprise that Christine Lagarde today insisted that the ECB would "see through" such short-term price rises and asserted that inflation was "certainly not robustly converging toward our aim at all."

The coming two days in the euro area

The remainder of the week in the euro area will be extremely quiet for economic data with no further top-tier releases due.

UK

Contrasting impressions of the drop in spending in January

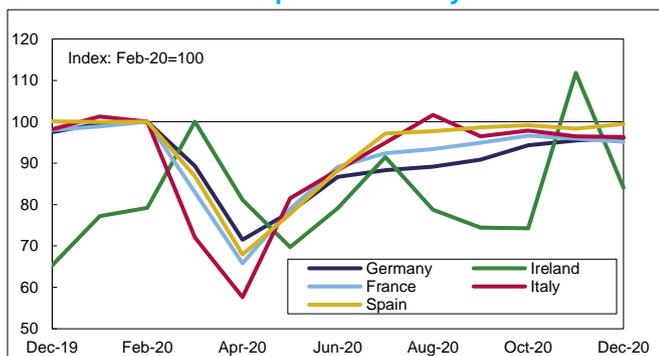
While today was again a quiet day for UK economic data, a couple of reports released yesterday gave somewhat contrasting impressions of the extent of the hit to consumer spending at the start of the year in response to the tightening of lockdown restrictions nationwide. According to Barclaycard, consumer spending fell 16.3%Y/Y in January as spending on non-essential items fell 24.2%Y/Y while spending on essentials rose 3.9%Y/Y. As people stayed home, spending on fuel dropped by about one third and spending in restaurants fell by more than four fifths. And spending at travel agents and with airlines also fell by more than 80%Y/Y. But online retail rose by almost three-quarters from a year earlier and accounted for more than half of all retail spend tracked by Barclaycard last month. Broadly tallying with those data, the BRC reported sales at high-street stores fell the most on a year-on-year basis since May, albeit by just 1.3%Y/Y as strong sales of food and durable goods for the home (including IT equipment to support home-schooling) helped to offset much of the weakness in other categories.

The coming two days in the UK

Tomorrow will bring an update on the UK housing market in January with the latest monthly RICS residential market survey. The December survey flagged a fifth successive moderation in new buyer demand, a negative reading for near-term sales expectations (the weakest since April) and a drop into negative territory (a net balance of -13%, the softest since May) in three-month price expectations. And with prices on the Nationwide index having dropped in January for the first time since June, albeit to be still up a firm 6.4%Y/Y, the RICS survey for last month might be expected to point to a further softening of momentum in the market ahead of the end of the stamp duty holiday at end-March.

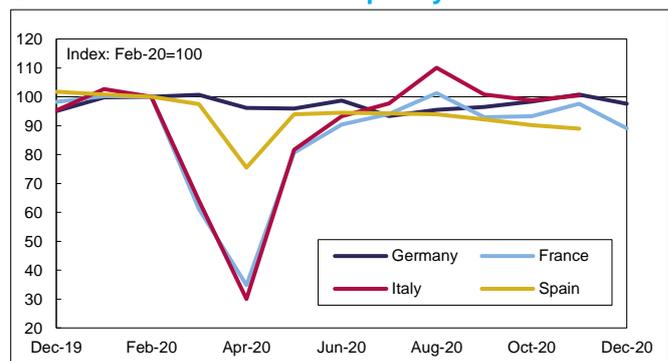
This week's most notable UK data this week will all come on Friday when the first estimates of Q4 GDP and its components are due. With December set to have seen a return to positive growth supported by manufacturing, services and construction

Euro area: Industrial production* by member state



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

Euro area: Construction output by member state



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

alike, we now expect GDP to have grown by about 0.5%Q/Q following the jump of 16.0%Q/Q in Q3. That, however, will still leave GDP down about 8.2%Y/Y. Among the components, private consumption and private investment are likely to have slipped back following growth in Q3, but government spending, inventory accumulation ahead of the end of the Brexit transition should have provided support. Given that stock-building, however, net trade might subtract from growth as imports outpaced the nevertheless strong growth in exports. Of course, not least given the tightening of pandemic containment measures as well as the disrupting impact of Brexit on trade with the EU, Q1 is highly likely to see a non-negligible drop in UK GDP.

The next edition of the Euro wrap-up will be published on 12 February 2021

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Final CPI (EU-harmonised CPI) Y/Y%	Jan	1.0 (1.6)	1.0 (1.6)	-0.3 (-0.7)	-
France	 Industrial production M/M% (Y/Y%)	Dec	-0.8 (-3.6)	0.4 (-1.7)	-0.9 (-4.6)	0.7 (-4.1)
	 Manufacturing production M/M% (Y/Y%)	Dec	-1.7 (-3.6)	-	0.5 (-4.3)	0.7 (-4.1)

Auctions

Country	Auction
Germany	 sold €3.27bn of 0% 2026 bonds at an average yield of -0.69%
UK	 sold £2bn of 1.25% 2041 bonds at an average yield of 0.987%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Trade balance, €bn	Dec	14.8	14.8	17.2	16.7
France	 Bank of France industrial sentiment	Jan	98	98	97	98
Italy	 Industrial production M/M% (Y/Y%)	Dec	-0.2 (-2.0)	0.3 (-1.4)	-1.4 (-4.2)	-
UK	 BRC retail sales monitor, like-for-like sales Y/Y%	Jan	7.1	-	4.8	-

Auctions

Country	Auction
Germany	 sold €1.1bn of 0.1% 2033 index-linked bonds at an average yield of -1.51%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
UK	 00.01	RICS house price balance, %	Jan	60	65

Auctions and events

EMU	 07.45	ECB's Villeroy scheduled to speak
	 08.00	ECB's de Guindos scheduled to speak
	 10.00	European Commission publishes economic forecasts
	 11.00	ECB's Knot scheduled to speak
Italy	 10.00	Auction: €3bn of 0% 2024 bonds
	 10.00	Auction: €4bn of 0.25% 2028 bonds
	 10.00	Auction: €2bn of 1.8% 2041 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Spain		08.00 Final CPI (EU-harmonised CPI) Y/Y%	Jan	0.6 (0.6)	-0.5 (-0.6)
UK		07.00 Preliminary GDP Q/Q% (Y/Y%)	Dec	<u>0.5 (-8.1)</u>	16.0 (-8.6)
		07.00 Monthly GDP M/M%	Dec	1.0	-2.6
		07.00 Industrial production M/M% (Y/Y%)	Dec	0.5 (-3.7)	-0.1 (-4.7)
		07.00 Manufacturing production M/M% (Y/Y%)	Dec	0.7 (-3.2)	0.7 (-3.8)
		07.00 Construction output M/M% (Y/Y%)	Dec	0.5 (-0.2)	1.9 (-1.4)
		07.00 Index of services M/M% (3M/3M%)	Dec	1.0 (0.0)	-3.4 (3.7)
		07.00 Goods trade balance, £bn	Dec	-15.0	-16.0
	Auctions and events				
- Nothing scheduled -					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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