

Euro wrap-up

Overview

- Bunds made gains as euro area consumer confidence fell to a 10-month low and Christine Lagarde repeated that economic conditions in the euro area were very different from those in the US.
- While an MPC member argued that the BoE needed to act to restrain wage and price expectations, Gilts also made gains as UK retail sales fell sharply and consumer confidence deteriorated.
- The coming week brings the flash PMIs for January, first estimates of Q4 GDP from Germany and France, and Italy's Presidential election.

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Daily bond market movements

Bond	Yield	Change
BKO 0 12/23	-0.623	-0.035
OBL 0 10/26	-0.333	-0.030
DBR 0 02/32	-0.066	-0.037
UKT 0 ¹ / ₈ 01/24	0.887	-0.010
UKT 0 ³ / ₈ 10/26	1.002	-0.039
UKT 0 ¹ / ₄ 07/31	1.172	-0.053

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

Euro area

Consumer confidence weakens slightly while Lagarde reiterates expectation of no hike in 2022

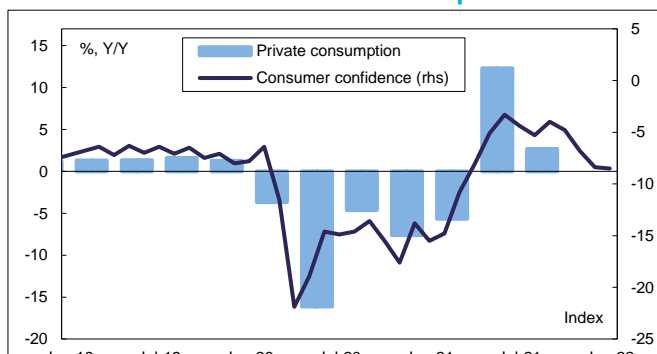
On a relatively quiet end to the week for euro area economic news, the sole new data release of note was the Commission's flash euro area consumer confidence index for January. With the spread of Covid-19 having accelerated in the large member states over recent weeks, it was no surprise that the index dropped for a fourth successive month. However, the decline was minimal, just 1bp from a slightly downwardly revised reading for December, to a better-than-feared -8.5. Admittedly, this marks a ten-month low and suggests that consumer spending remains subdued at the start of 2022 after likely weakening towards year-end. However, with Omicron less threatening to public health than the receding Delta variant, the French government looks set to lift some pandemic restrictions from 2 February, while Spain's government is leading calls to treat Covid-19 as endemic and return to normality as soon as possible. So, while high inflation is eroding real incomes, we expect confidence and consumer spending to firm from next month on. That, however, will not prevent the euro area economy from continuing significantly to lag the US, a point again underscored today by ECB President Christine Lagarde in her comments to the Davos Forum. And so, she reiterated that the pre-conditions for ECB rate hikes were still not expected to be met this year.

The week ahead in the euro area

Ahead of the forthcoming ECB meeting on 3 February, the coming week brings some top-tier data releases, including the first estimates of Q4 GDP from certain member states (Friday), as well as various January sentiment indicators including the flash PMIs (Monday) and Commission's economic sentiment indices (Friday). With the increased spread of the pandemic in the final months of 2021 resulting in tighter restrictions in various member states, and persisting supply bottlenecks limiting production, growth seems bound to have slowed sharply. Among the larger member states, this will be most pronounced in Germany, where we expect output contracted by about ½%Q/Q. Surveys suggest France (and Italy, whose data come the following week) fared better, with growth of roughly ½%Q/Q or more. And given the recent strength in retail sales and industrial output, Spanish GDP is forecast to have expanded by more than 1%Q/Q.

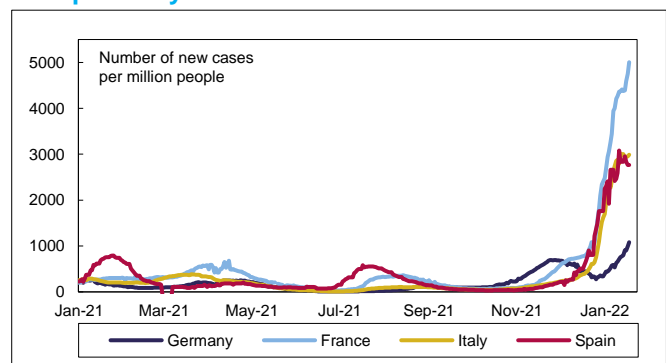
The coming week's raft of economic sentiment surveys will be watched closely for further evidence of weak activity in the face of the acceleration in coronavirus cases across the region. In particular, Monday's preliminary PMIs for the euro area and two largest member states are expected to suggest a notable deterioration in services activity at the start of the year. But reflecting a modest easing in supply constraints, expectations are for a modest improvement in manufacturing conditions. Meanwhile, the Commission's detailed sectorial confidence survey will be published on Friday. At the country level, Germany's ifo business sentiment survey will be published on Tuesday, followed by consumer confidence surveys for

Euro area: Confidence and consumption



Source: European Commission, Refinitiv and Daiwa Capital Markets Europe Ltd.

Europe: Daily coronavirus cases



Source: Our World in Data and Daiwa Capital Markets Europe Ltd.

France, Germany and Italy. Other data to be published in the coming week include the euro area's latest bank lending numbers (Friday), as well as French, Spanish (Tuesday) and Italian (Friday) PPI figures for December.

Beyond the economic data, a special joint session of Italy's parliament, with more than 1000 participants, will on Monday afternoon begin voting to elect a new national President for a seven-year term – a process likely one way or the other to have an impact on BTPs. Italy's President is head of state and guardian of the national Constitution, with important powers – including the ability to dissolve Parliament and provide mandates to form a government – that seek to support stability in the otherwise political volatile country. In the first three rounds of voting, a two-thirds majority is required to win the Presidency. If no one has succeeded by then, only a simple majority is required. The process could take several days, with the aim to conclude the election by 3 February when the term of current President, the respected Sergio Mattarella, expires.

As an extraordinary person in terms of domestic and international credibility and skill-set, and possibly the only one capable of securing the support of all of the parties currently backing the government, the favourite to be elected President is Prime Minister Mario Draghi, who has hinted at his willingness to move roles. His appointment as head of state would obviously leave a vacancy as head of government. So, under such a scenario, a deal to appoint a new technocrat PM – perhaps current Minister of Justice Marta Cartabia, Minister of Finance Daniele Franco or Minister of Public Administration Renato Brunetta – would also likely be required to provide reassurance to investors that the country's Recovery and Resilience Plan would continue to be implemented this year to unlock further sizeable disbursements of EU funds. Without such a deal, the risks of a period of renewed uncertainty and inertia in government, and perhaps an early general election – which might be expected to deliver a majority for the centre-right led by the populist and Eurosceptic Brothers of Italy and League – would seem likely to unsettle investors and push BTP spreads significantly higher.

Should Draghi not be appointed President, he might be expected to continue to lead the government through to 2023, when the next general election is due. And Brunetta or Cartabia might be feasible credible alternatives as President. Mattarella might also be re-elected as President although he has indicated his lack of desire for a second term. Despite his latest campaign, however, we attach a very low probability to former Prime Minister Silvio Berlusconi winning the election, although such an appointment would be highly negative for Italy's credibility and deserve to trigger a BTP sell-off.

UK

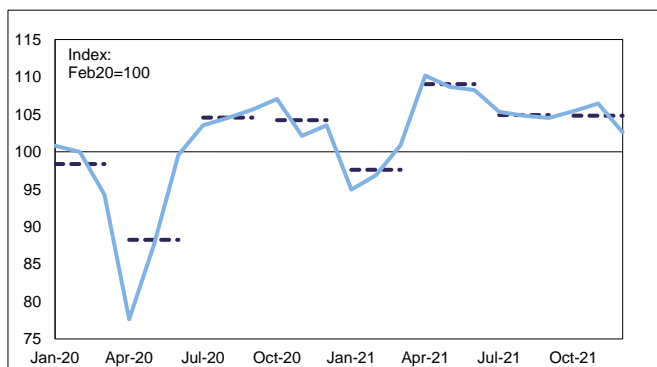
Retail sales drop more than expected at year-end as Covid, inflation and supply shortages bite

UK retail sales fell far more sharply than expected at the end of last year. In particular, sales in December dropped 3.7%M/M in real terms, the most in eleven months to a nine-month low. That compared with the Bloomberg median forecast decline of just 0.6%M/M. It also left sales still some 2.6% above the pre-pandemic level in February 2020 but 6.9% below last April's peak, suggesting a slight downwards trend since then. Indeed, despite firm growth in October and November, the sharp drop in December meant that sales edged down 0.2%Q/Q in Q4. The weakness in sales in December reflected several factors, including the accelerated spread of Covid-19, payback for strength in the prior two months when shoppers appear to have brought forward festive spending to try to dodge supply shortages, and the erosion of real disposable incomes by high inflation (nominal sales fell 3.1%M/M in December but were up 1.9%Q/Q in Q4).

Every category of sales weaker in December

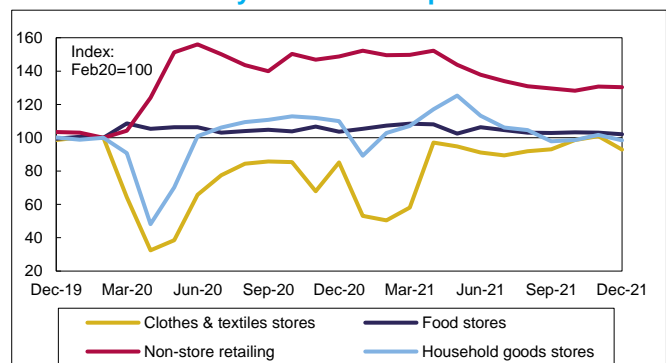
Within the detail, sales volumes at non-food stores plunged 7.1%M/M in December, with declines in all major categories as footfall fell. Auto fuel sales dropped 4.7%M/M as increased working from home reduced travel. But food store sales fell a relatively modest 1.0%M/M as many consumers reduced their spending at restaurants. While the reporting period for the December data included Cyber Monday shopping (which took place on 29 November), the share of sales online increased only 0.3ppt to 26.6%, suggesting that the impact of Omicron on footfall was only a small part of the explanation for the weakness in sales at the end of the year.

UK: Retail sales*



*Dashed dark blue line represents quarterly average.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Retail sales by selected component



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Consumer confidence drops in January on cost-of-living concerns

While pandemic restrictions are coming to an end, the near-term outlook for spending hardly appears strong. Indeed, according to the latest GfK survey, UK consumer confidence deteriorated at the start of the year with the headline index dropping 4pts to an eleven-month low of -19, well below the long-run average but still well above the range throughout the first phase of the pandemic in 2020. All major categories weakened in the survey, with expectations for the economic outlook for the coming twelve months falling to the weakest in a year and expectations regarding personal finances down to a 14-month low as concerns mount about the “cost-of-living crisis”. The climate for making major purchases was also judged to have worsened, albeit merely matching October’s level, which was the lowest since last April. With real disposable incomes set to be eroded more significantly from April, when household energy bills will rise again along with National Insurance Contributions, and likely to decline this year by the most since fiscal austerity in 2011, retail sales might do well to move broadly sideways throughout the first half of 2022.

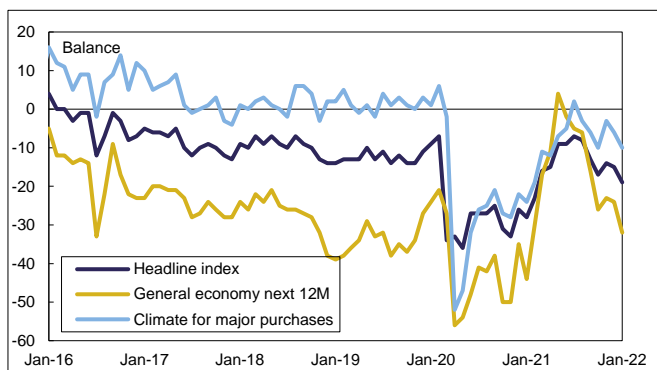
MPC member Mann makes case for prompt BoE action to temper expectations

In a speech today, MPC external member Catherine Mann highlighted such downside risks to demand from eroded purchasing power as representing a potential headwind to inflation this year. However, she also noted BoE survey findings that firms’ wage and price expectations for the coming year are high and flagged concerns that these risk keeping inflation “strong for longer” into 2023 and beyond. We think such concerns are widely shared on the Committee. And so, in light of the MPC’s resulting desire to temper wage and inflation expectations, we maintain our expectation that the BoE will raise Bank Rate in February by 25bps to 0.50% and also expect two further hikes by year-end.

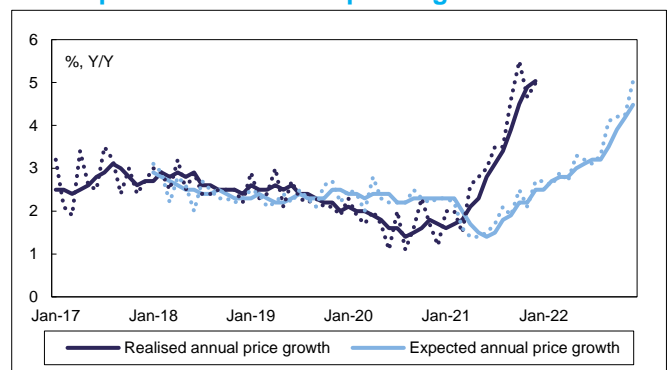
The week ahead in the UK

Like in the euro area, the coming week’s UK economic data calendar will be dominated by sentiment surveys, kicking off on Monday with the preliminary manufacturing and services PMIs for January. The December PMIs indicated a slump in services activity at year-end, as the Omicron variant hit demand at consumer-facing firms and exacerbated labour shortages. Indeed, the headline activity PMI fell 4.9pts on the month to 53.6, its lowest since February. While the number of reported new infections has eased back over recent weeks, it still remains considerably higher than during much of December and so we anticipate little improvement in the services PMI this month. However, with restrictions being eased, forward-looking indicators should be brighter. Tuesday brings the release of the CBI’s industrial trends survey, which will be followed on Thursday by the CBI’s retail sales survey. Tuesday will also bring the latest public finance figures for December. In November, the government borrowed £17.4bn, outstripping expectations. The week ends on a quiet note, with only the Nationwide house price index for January due on Friday.










UK: Consumer confidence



UK: Expectations of sales prices growth*







Daiwa economic forecasts

	2021		2022				2021	2022	2023
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP forecasts %, Q/Q									
Euro area 	2.2	0.3	0.2	1.5	1.0	0.7	5.1	3.9	2.7
UK 	1.1	0.9	0.3	0.8	0.8	0.6	7.2	4.0	1.9
Inflation forecasts %, Y/Y									
Euro area									
Headline CPI 	2.8	4.6	4.3	4.4	3.6	2.1	2.6	3.6	1.9
Core CPI 	1.4	2.4	2.3	2.9	2.5	1.9	1.5	2.4	1.8
UK									
Headline CPI 	2.8	4.9	5.6	5.7	5.0	3.3	2.6	4.9	2.0
Core CPI 	2.6	3.9	4.5	4.3	3.7	2.6	2.4	3.8	2.1
Monetary policy									
ECB									
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate % 	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.25
BoE									
Bank Rate % 	0.10	0.25	0.50	0.75	0.75	1.00	0.25	1.00	1.25

*Target end of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

































European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised	
Euro area 	Commission's preliminary consumer confidence	Jan	-8.5	-9.0	-8.3	-8.4	
UK 	GfK consumer confidence	Jan	-19	-15	-15	-	
	Retail sales M/M% (Y/Y%)	Dec	-3.7 (-0.9)	-0.6 (3.4)	1.4 (4.7)	1.0 (4.3)	
	Retail sales, excluding auto fuel M/M% (Y/Y%)	Dec	-3.6 (-3.0)	-0.8 (1.1)	1.1 (2.7)	0.7 (2.2)	
Auctions							
Country	Auction						
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.



The coming week's data calendar

The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous	
Monday 24 January 2022						
Euro area		09.00	Preliminary manufacturing (services) PMI	Jan	57.8 (52.2)	58.0 (53.1)
		09.00	Preliminary composite PMI	Jan	52.9	53.3
Germany		08.30	Preliminary manufacturing (services) PMI	Jan	57.2 (48.0)	57.4 (48.7)
		08.30	Preliminary composite PMI	Jan	49.5	49.9
France		08.15	Preliminary manufacturing (services) PMI	Jan	55.0 (55.5)	57.0 (55.6)
		08.15	Preliminary composite PMI	Jan	54.7	55.8
UK		09.30	Preliminary manufacturing (services) PMI	Jan	57.5 (54.3)	57.9 (53.6)
		09.30	Preliminary composite PMI	Jan	55.0	53.6
Tuesday 25 January 2022						
Germany		09.00	ifo business climate	Jan	94.0	94.7
		09.00	ifo current assessment (expectations)	Jan	95.7 (92.9)	96.9 (92.6)
Spain		08.00	PPI Y/Y%	Dec	-	33.1
UK		07.00	Public sector net borrowing, excluding banks £bn	Dec	15.8	17.4
		11.00	CBI industrial trends, total orders (business optimism)	Jan	22 (-)	24 (2)
Wednesday 26 January 2022						
France		07.45	INSEE consumer confidence	Jan	99	100
		11.00	Total jobseekers '000s	Q4	-	3307
Thursday 27 January 2022						
Germany		07.00	GfK consumer confidence	Feb	-8.0	-6.8
Italy		09.00	Industrial sales M/M% (Y/Y%)	Nov	-	2.8 (16.9)
Spain		08.00	Unemployment rate %	Q4	14.2	14.6
UK		11.00	CBI distributive sales, reported retail sales	Jan	10	8
Friday 28 January 2022						
Euro area		09.00	M3 money supply Y/Y%	Dec	7.0	7.3
		10.00	Commission's Economic Sentiment Indicator	Jan	114.5	115.3
		10.00	Commission's industrial (services) confidence	Jan	15.0 (10.3)	14.9 (11.2)
		10.00	Commission's final consumer confidence	Jan	-8.5	-8.3
Germany		09.00	Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>-0.5 (1.3)</u>	1.7 (2.6)
France		06.30	Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>0.6 (4.9)</u>	3.0 (3.3)
		06.30	Consumer spending M/M% (Y/Y%)	Dec	-	0.8 (14.8)
		07.45	PPI Y/Y%	Dec	-	17.4
Italy		09.00	ISTAT consumer (manufacturing) confidence	Jan	116.0 (115.0)	117.7 (115.2)
		09.00	ISTAT economic sentiment	Jan	-	113.1
		10.00	PPI Y/Y%	Dec	-	27.1
Spain		08.00	Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>1.2 (4.4)</u>	2.6 (3.4)
UK		-	Nationwide house price index* M/M% (Y/Y%)	Jan	-	1.0 (10.4)

*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 24 January 2022		
UK		09.30 BoE Asset purchase facility report Q421 published
Tuesday 25 January 2022		
Euro area		09.00 Eurostat publishes quarterly government deficit/debt data
Wednesday 26 January 2022		
Euro area		07.00 ECB Research Bulletin published
Germany		10.30 Auction: €4bn of 0% 2032 bonds
Italy		10.00 Auction: Fixed rate and index-linked bonds
UK		10.00 Auction: £600mn of 0.125% 2051 inflation-linked bonds
Thursday 27 January 2022		
- Nothing scheduled -		
Friday 28 January 2022		
Italy		10.00 Auction: 5Y and 10Y bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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