

# Euro wrap-up

## Overview

- Despite an unexpected big improvement in the German survey, Bunds made gains and euro area stocks fell the most since June 2020 as the euro area flash PMIs suggested softening economic growth in the region and concerns persisted over events on the Russia-Ukraine border.
- Gilts also made gains as the UK flash PMIs suggested broadly stable economic activity but rising price pressures in the services sector.
- Tuesday will bring the latest German ifo business survey and UK CBI industrial trends survey and public borrowing data.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 12/23	-0.663	-0.031
OBL 0 10/26	-0.378	-0.041
DBR 0 02/32	-0.104	-0.035
UKT 0 <sup>7</sup> / <sub>8</sub> 01/24	0.869	-0.001
UKT 0 <sup>7</sup> / <sub>8</sub> 10/26	0.972	-0.018
UKT 0 <sup>1</sup> / <sub>4</sub> 07/31	1.135	-0.033

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

## Euro area

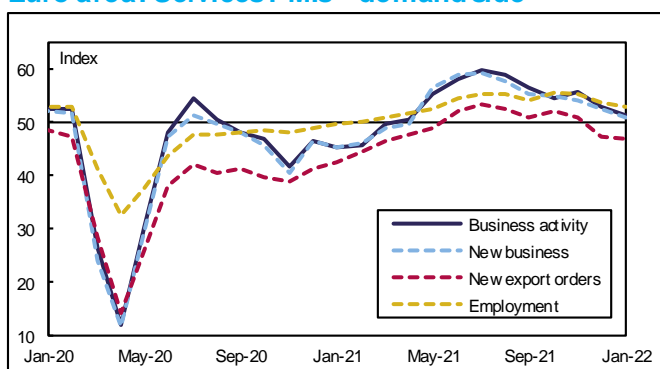
### Flash PMIs suggest softest euro area growth in eleven months

Broadly in line with expectations, the flash PMIs suggested that euro area economic activity slowed for a second successive month in January as the latest wave of coronavirus weighed on services activity. In particular, the euro area composite output PMI dropped 0.9pt in January to an eleven-month low of 52.4 with the fall entirely due to a near-2pt decline in the services activity index to a nine-month low of 51.2. Moreover, the PMI for new business in services dropped for a sixth successive month while employment in the sector reportedly grew at the softest pace since May. Markit reported that firms in consumer- and hospitality-oriented businesses bemoaned the impact of pandemic restrictions while businesses also cited problems of staff absenteeism due to illness or the need to self-isolate as a restraint on activity. Contrasting the struggles in services, however, the manufacturing output PMI rose by 2pts to a five-month high of 55.8 with the detail suggesting an easing of supply bottlenecks. Delivery times lengthened by the least in a year, with survey respondents reporting fewer items in short supply and an easing of shipping delays. In addition backlogs of work increased by the least in eleven months. Nevertheless, while input prices rose the least in nine months, factory output prices accelerated the most on the series bar November, suggesting a greater willingness to pass on price pressures.

### Economic activity picks up in Germany but slows in France and the rest of the region

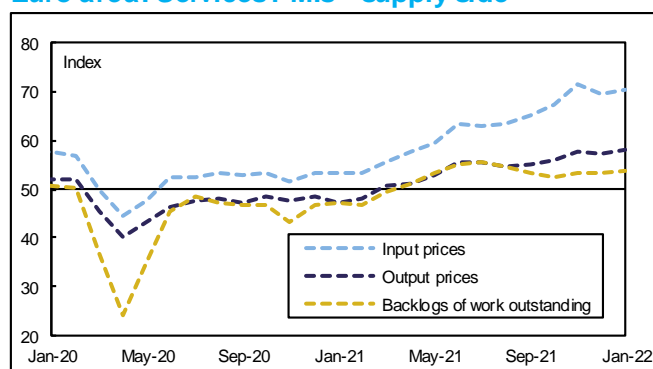
With respect to the member states, the German flash PMIs comfortably beat expectations pointing to a pickup in economic activity at the start of 2022. Indeed, having fallen into contractionary territory in December and by the most in ten months, Germany's services activity PMI rebounded 3.5pts to 52.2, the second-lowest since April but sufficient to imply improved resilience to the latest coronavirus wave. Moreover, the manufacturing output PMI leapt more than 6pts to a five-month high of 58.4, suggestive of strong growth in the sector on a slight easing of supply challenges. As such, the German composite PMI jumped more than 4pts to a four-month high of 54.3, 3pts above the average in Q4 when GDP probably declined by as much as 0.5%Q/Q albeit still well down on the range in Q2 and Q3 last year when GDP rose 2.0%Q/Q and 1.7%Q/Q respectively. In contrast, the French composite PMI implied a notable slowdown in economic activity in the New Year, falling more than 3pts to a nine-month low of 52.7. Unlike in Germany, the French manufacturing output PMI saw only very modest improvement from December to suggest minimal growth in the sector (50.8). And the French services activity PMI fell almost 4pts to a nine-month low of 53.1 indicating a very subdued pace of expansion. Beyond Germany and France, while Markit provided no detail, it stated that its survey suggested that economic growth "ground almost to a halt across the rest of the region" due to a renewed contraction of activity in services.

### Euro area: Services PMIs – demand side



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

### Euro area: Services PMIs – supply side



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

## The day ahead in the euro area

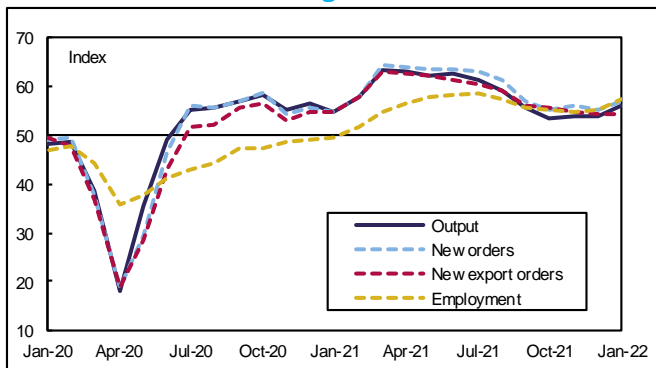
The flow of economic sentiment data continues tomorrow, with the release of the German ifo business sentiment survey for January. Ahead of today's big jump in the German composite PMI to a four-month high, the headline ifo business climate index was forecast to move broadly sideways as deterioration in the current balance offsets an improvement in expectations reflecting an easing in supply constraints. Elsewhere, the news flow from Italy will be watched for any indication of the likely eventual outcome in the Presidential election process that got underway today.

## UK

### Flash PMIs suggest some stabilisation in economic activity in January

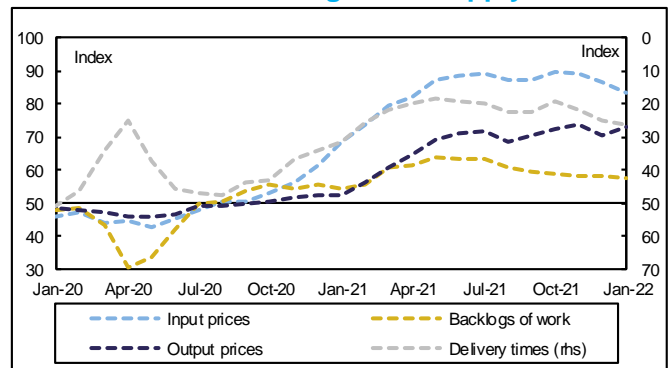
With the number of new coronavirus cases in the UK having fallen back over the past couple of weeks, today's flash PMIs also suggested some stabilisation in activity at the start of the year. Indeed, while it hit an eleven-month low, the composite output PMI fell just 0.2pt in January to 53.4, a level still consistent with expansion. Admittedly, with certain pandemic-related restrictions in place throughout most of the month, consumer-facing sectors such as hospitality and travel reported extremely challenging conditions. But other sub-sectors, such as financial and business services, fared better. So, the overall services activity index edged down just 0.3pt to 53.3, similarly the lowest reading since February 2021. And with travel restrictions having been eased and most remaining English restrictions ending this week, services firms were more upbeat about the near-term outlook than they were in December, while optimism about the year ahead was the highest since August. At face value, the manufacturing surveys suggested worsening conditions in the sector at the start of the year, with the headline PMI down 1pt to 56.9, its lowest reading since February last year. This in part reflected a notable drop in new business – the relevant index fell 2.9pts to 52.1, similarly an eleven-month low – as manufacturers indicated that firms had previously brought forward their orders to avoid higher prices. But it was also due to a marked improvement in supply chain performance, with supplier delivery times their least severe since November 2020, which counterintuitively contributed negatively to the headline index. Indeed, the manufacturing output index rose for the third consecutive month in January, albeit by just 0.2pt on the month, to 53.8, a five-month high. Survey respondents suggested that output would have been stronger still in the absence of persistent staff shortages.

### Euro area: Manufacturing PMIs – demand side



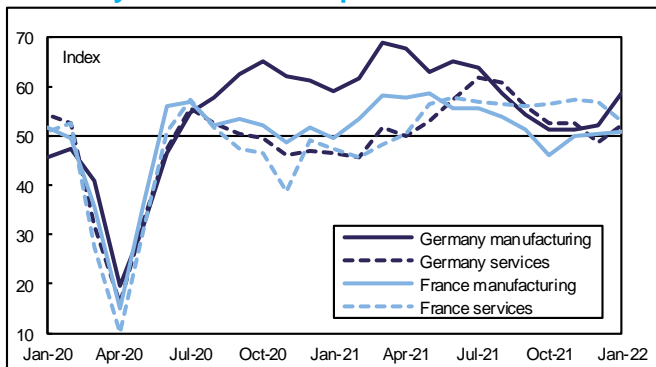
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

### Euro area: Manufacturing PMIs – supply side



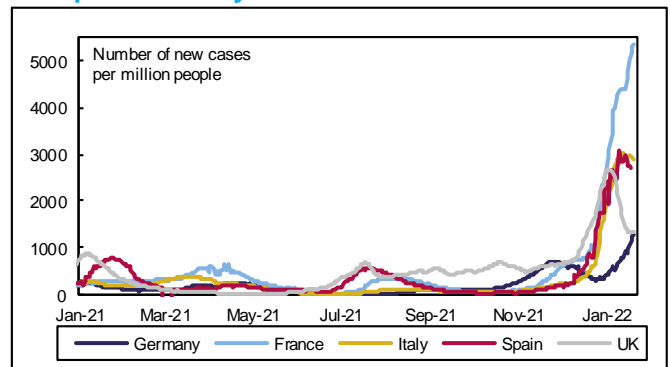
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

### Germany and France: Output PMIs



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

### Europe: New daily coronavirus cases



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

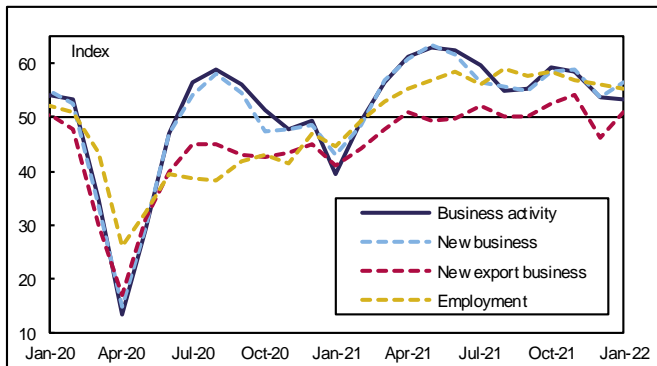
## Rising inflationary pressures in services add to case for rate hike next week

In terms of prices, manufacturers reported another moderation in the input and output price PMIs from admittedly extremely high levels. However, stronger inflationary pressures were reported in the services sector at the start of the year reflecting higher costs of raw materials, staff wages and energy bills. As such, the composite input and output price PMIs rose to signal the second-fastest increases in prices since the survey began 24 years ago. So, added to last week's upside surprise in December's inflation data as well as survey evidence that firms intend to raise both wages and prices significantly further this year, today's PMIs are likely to reinforce MPC members' determination to vote for a further 25bps hike in Bank Rate when they meet to set policy next week.

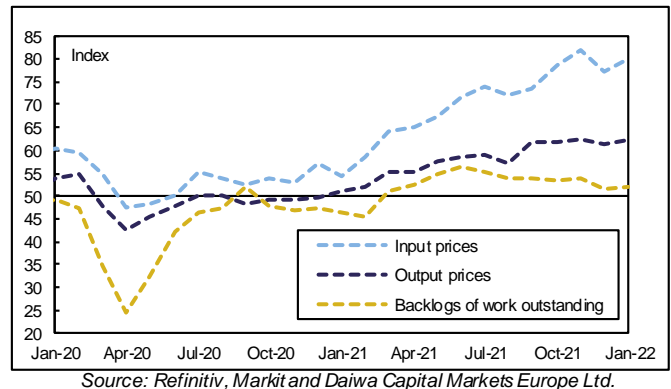
## The day ahead in the UK

Today's PMIs will be followed tomorrow by the CBI industrial trends survey, which is expected to reveal that manufacturers are more optimistic about the coming six months, reflecting falling coronavirus cases in the UK, the easing of restrictions and supply constraints, and elevated new orders. Tomorrow also brings the release of the latest UK public finance figures for December. As was the case in each month of 2021, November's release reported the second-highest level of government borrowing for that month since the series began, only falling short of the equivalent level in 2020. And tomorrow's release will again do likewise, with public sector net borrowing excluding public sector banks expected to reach £18.5bn in December 2021, down from £24.4bn a year earlier but almost £13bn more than the equivalent level in December 2019. This release might be of increased interest amid widespread calls, reportedly including from within the Cabinet, for the government to postpone its planned increases in National Insurance Contributions planned for April and take action to tackle the impact of further rises in household energy bills. In the fiscal year to November, cumulative public borrowing (excluding banks) was still some £7bn below the OBR's forecast, suggesting scope for some modest (or temporary) fiscal relaxation from April.

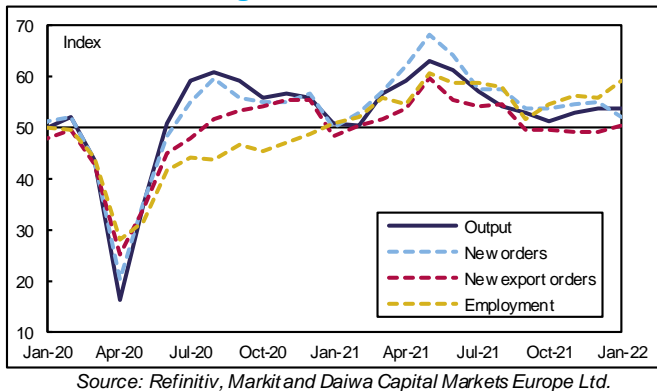
### UK: Services PMIs – demand side



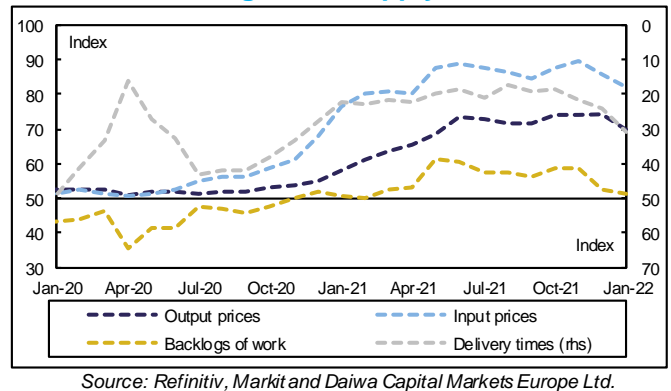
### UK: Services PMIs – supply side











### UK: Manufacturing PMIs – demand side









### UK: Manufacturing PMIs – supply side



## European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Preliminary manufacturing (services) PMI	Jan	<b>59.0 (51.2)</b>	57.8 (52.2)	58.0 (53.1)	-
	 Preliminary composite PMI	Jan	<b>52.4</b>	52.9	53.3	-
Germany	 Preliminary manufacturing (services) PMI	Jan	<b>60.5 (52.2)</b>	57.2 (48.0)	57.4 (48.7)	-
	 Preliminary composite PMI	Jan	<b>54.3</b>	49.5	49.9	-
France	 Preliminary manufacturing (services) PMI	Jan	<b>55.5 (53.1)</b>	55.0 (55.5)	57.0 (55.6)	-
	 Preliminary composite PMI	Jan	<b>52.7</b>	54.7	55.8	-
UK	 Preliminary manufacturing (services) PMI	Jan	<b>56.9 (53.3)</b>	57.5 (54.3)	57.9 (53.6)	-
	 Preliminary composite PMI	Jan	<b>53.4</b>	55.0	53.6	-
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/ <i>Daiwa forecast</i>	Previous	
Germany	 09.00	ifo business climate	Jan	94.5	94.7	
	 09.00	ifo current assessment (expectations)	Jan	95.1 (93.0)	96.9 (92.6)	
Spain	 08.00	PPI Y/Y%	Dec	-	33.1	
UK	 07.00	Public sector net borrowing, excluding banks £bn	Dec	18.5	17.4	
	 11.00	CBI industrial trends, total orders (business optimism)	Jan	22 (8)	24 (2)	
Auctions and events						
Euro area	 09.00	Eurostat publishes quarterly government deficit/debt data				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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