Euro wrap-up

Overview

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- Bunds made losses as euro area equities fared better, while the latest ifo survey suggested that German firms were more upbeat about the outlook at the start of the year.
- Gilts also made losses despite a slightly softer UK manufacturing survey and some lower-than-expected public borrowing numbers.
- Wednesday will bring the latest French consumer confidence survey results, with the equivalent data from Germany due Thursday along with a UK retail sales survey.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/23	-0.666	+0.003
OBL 0 10/26	-0.366	+0.019
DBR 0 08/31	-0.086	+0.024
UKT $0^1/_8$ 01/24	0.882	+0.025
UKT $0^3/_8$ 10/26	0.987	+0.027
UKT 0¼ 07/31	1.160	+0.036

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

Euro area

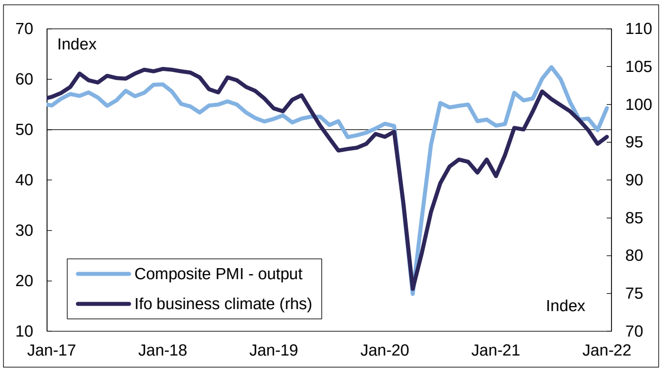
German ifo indices suggest a soft start to 2022

Consistent with the more upbeat message from yesterday's flash PMIs, today's German ifo survey suggested that businesses in the largest member state are on the whole slightly more upbeat than they were at the end of last year. Indeed, the survey's headline business climate index rose in January for the first time since June, by 0.9pt to 95.7, albeit leaving it still some 6pts below the summer peak. Admittedly, firms were a little more downbeat about the current situation, with the respective index falling for the fifth consecutive month, by 0.8pt to 96.1, an eight-month low. That tallies with certain other high-frequency indicators, including the truck toll mileage index and mobility indicators, which suggest that German economic activity might well have contracted again at the start of the year. But the weakness in the ifo survey largely reflected a more downbeat assessment of current conditions among services, not least hospitality. And the survey suggested that retailers and construction firms are somewhat more satisfied with their current situation, with the latter citing a further easing in material shortages. Improving supply bottlenecks similarly gave a boost to manufacturers at the start of the year, with the respective current conditions balance rising to a three-month high.

Firms more optimistic about the outlook, notwithstanding risks such as Russia

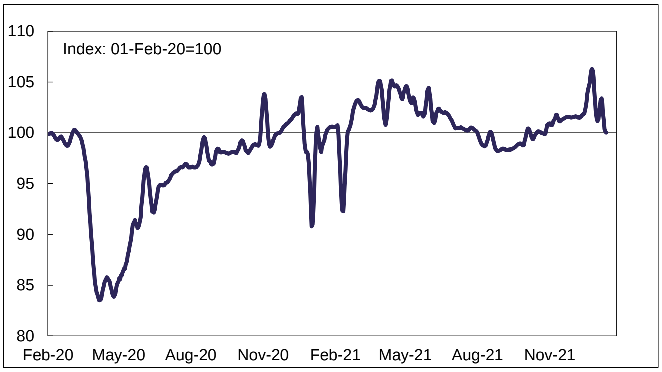
While pandemic-related restrictions will remain in place for the time being, firms across all sectors expressed greater optimism about the outlook for the coming six months. Manufacturers were the most upbeat since August, while the overall ifo expectations balance jumped 2.5pts to 95.2, a three-month high. So, all surveys suggest that the current weakness of economic activity should prove temporary and that Germany's economic recovery should regather pace as and when pandemic restrictions and supply bottlenecks ease. Of course, the outlook remains highly uncertain with plenty of downside risks, including renewed intensification of supply bottlenecks or events at the Russia-Ukraine border. While military hostilities do not represent our base case, it would trigger a sudden imposition of tough new economic sanctions against Russia. And they would represent a highly adverse new shock for the euro area economy, not least via disruption to supplies of energy and other commodities, and sharply higher prices of natural gas, metals and other items. Indeed, Russia is the primary supplier of natural gas and oil to the EU, typically providing up to one half and one quarter of imports respectively of each item from beyond the Union. And of all the large member states, Germany is most exposed, reliant on Russia for between 50-75% of its natural gas imports.

Germany: ifo and PMI sentiment indicators



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

Germany: Truck toll mileage



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming two days in the euro area

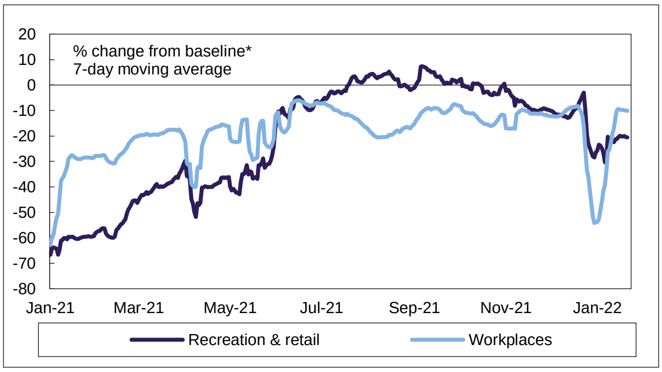
The flow of sentiment indicators continues over the coming few days, with French and German consumer surveys for January due tomorrow and Thursday respectively. Given the rapidly rising number of coronavirus cases in France we would expect households in the second-largest member state to be more downbeat about conditions since the start of the year. In contrast, in Germany, with consumer confidence having previously fallen sharply to its lowest level since June, households in the largest member state might well report greater optimism about the near-term outlook as economic conditions look brighter and the number of coronavirus cases remains lower than in other euro area countries.

UK

Manufacturing survey pointed to slightly softer growth amid ongoing supply constraints

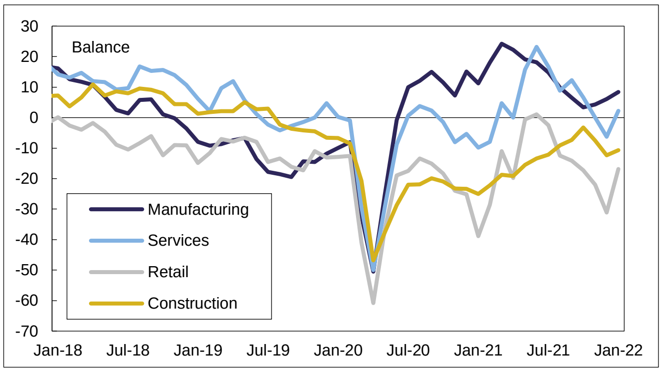
Given the emergence of the Omicron variant and additional Brexit-related customs checks since the start of the year, today's CBI industrial trends quarterly survey perhaps unsurprisingly suggested that business optimism among UK manufacturers had deteriorated compared with three months ago, to its lowest level in a year, with a more striking decline in sentiment regarding exports. And contrasting with yesterday's flash PMIs, today's monthly survey suggested that factory output growth in the three months to January had slowed slightly, with the relevant index slipping to its lowest for nine months, albeit remaining above its long-run average. Nevertheless, manufacturers suggested that output had risen compared with a year earlier in 10 out of 17 sub-sectors, underpinned by strong growth in food, drink and tobacco. And with order books at one of the highest levels since the series began, manufacturers were broadly upbeat about the production outlook for the coming three months. Against this backdrop, firms' capex intentions for the year ahead rose to the strongest since April 1988 and they also intended to increase headcount at a faster pace over the coming three months. This notwithstanding, the share of firms citing a lack of skilled labour as a factor expected to limit production rose to 42%, the highest since October 1973. And while the proportion of firms noting a shortage of key materials likely to limit output fell from a multi-decade high of 64%, it remained at a still historically elevated 55%. Persistent supply-chain challenges continued to push up manufacturers' costs at the fastest rate since the start of the 1980s. And so it was unsurprising to see that firms planned to pass on these higher price pressures to consumers over the coming three months.

Germany: Google mobility indices



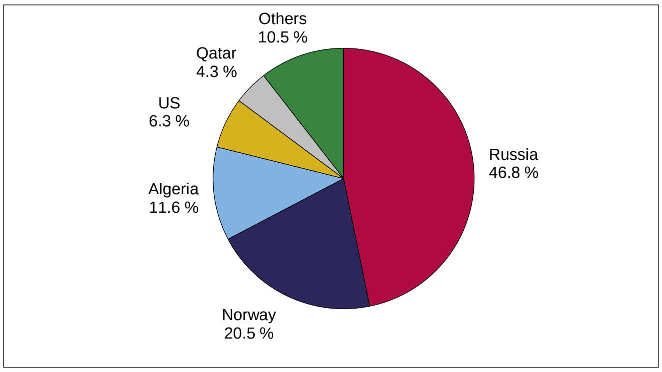
*The baseline is the median value, for the corresponding day of the week, during the five week period 3 Jan – 6 Feb 2020.Source: Google mobility and Daiwa Capital Markets Europe Ltd.

Germany: ifo expectations, by sector



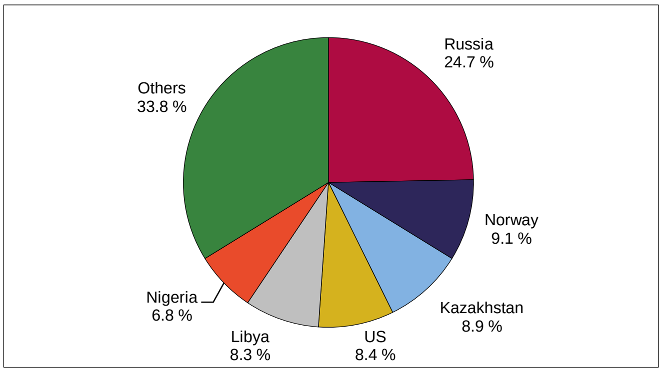
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

EU: Imports of natural gas by country, H121



Source: Eurostat

EU: Imports of oil by country, H121



Source: Eurostat

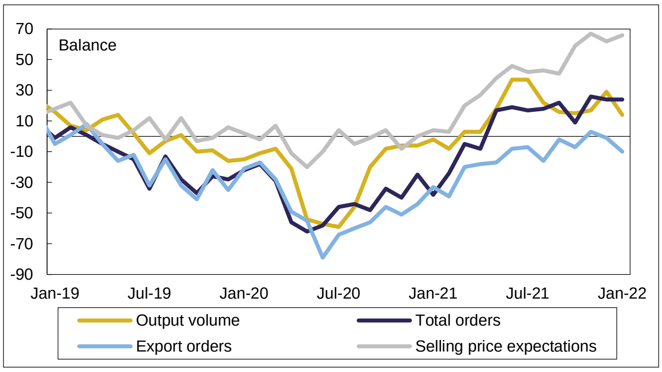
UK public finances suggest some limited room for fiscal giveaways

Amid widespread calls for the UK government to tackle the impact of high inflation on real disposable incomes, today's public finance figures suggested there should be some room for fiscal policy maneuver over the near term. Admittedly, today's release suggested that public sector net borrowing (excluding public sector banks) reached a still substantial £16.8bn in December, the fourth-highest December reading. But this was notably lower than in 2020 (£24.4bn). And while it was £11bn higher than the equivalent level in December 2019, today's figure was smaller than the consensus expectation. Reflecting the ongoing recovery in the labour market and stronger business profits, central government receipts (£68.5bn) were up 10%Y/Y. But while public spending (£84.7bn) in December was a touch softer than a year earlier there was another notable rise in interest payments – which doubled from a year ago and reached a record high for the month of December – due to the rise in inflation. There was also higher than expected spending on public services related to the pandemic. Overall, so far this fiscal year, cumulative public spending has come in a little stronger than was forecast by the OBR in October. But with tax revenues having been much stronger, cumulative public borrowing in the fiscal year to December stood at £146.8bn, £129.3bn less than in the same period a year ago and some £13bn less than the OBR's forecast. So, while government spending seems likely to continue to exceed the OBR's forecast over coming months, there still appears to be scope for some modest (or temporary) fiscal relaxation when Chancellor Sunak presents his Spring Statement on 23 March, if not sooner. Given PM Johnson's waning popularity and refusal yesterday to confirm whether the national insurance hike would go ahead, we see a high chance that the planned £12bn NIC increase will be postponed for a year from April with other support to be offered for the lowest-income households to cope with increased household energy bills.

The coming two days in the UK

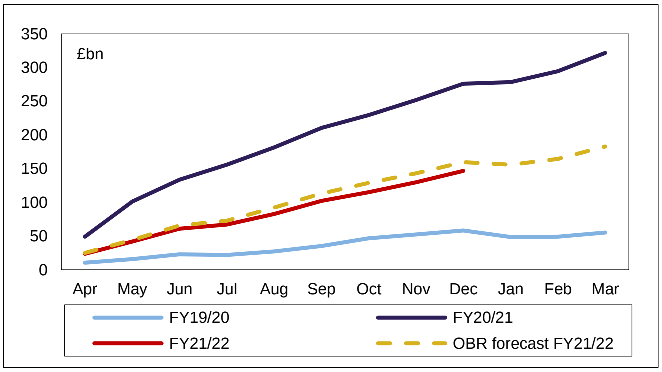
After a day bereft of new UK data releases tomorrow, Thursday will bring the CBI's latest distributive trades survey for January. After Friday's official retail sales figures reported a significantly weaker-than-expected outturn in December, high-frequency data suggest that travel for recreation and retail has remained subdued at the start of the year. And so, while the CBI survey might well suggest that sales remained above their level a year earlier (when the UK was operating under more stringent pandemic restrictions), it seems unlikely to signal significant recovery in the sector in January.

UK: CBI industrial trends survey



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Public sector net borrowing



Source: ONS, OBR and Daiwa Capital Markets Europe Ltd.

In the absence of significant news, the next edition of the Euro wrap-up will be published on 27 January 2022

European calendar

Today's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		ifo business climate	Jan	**95.7**	94.5	94.7	**94.8**
		ifo current assessment (expectations)	Jan	**96.1 (95.2)**	95.1 (93.0)	96.9 (92.6)	**- (92.7)**
Spain		PPI M/M% (Y/Y%)	Dec	**3.8 (35.9)**	-	1.8 (33.1)	**1.3 (32.2)**
UK		Public sector net borrowing, excluding banks £bn	Dec	**16.4**	18.5	17.4	**14.7**
		CBI industrial trends, total orders (business optimism)	Jan	**24 (-9)**	22 (8)	24 (2)	**-**
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/ *Daiwa forecast*	Previous
France		07.45	INSEE consumer confidence	Jan	99	100
		11.00	Total jobseekers '000s	Q4	-	3307
Auctions and events						
Euro area		07.00	ECB Research Bulletin published			
Germany		10.30	Auction: €4bn of 0% 2032 bonds			
Italy		10.00	Auction: €3.75bn of 0% 2023 bonds			
		10.00	Auction: €1.0bn of 0.65% 2026 inflation-linked bonds			
		10.00	Auction: €1.0bn of 2.55% 2041 inflation-linked bonds			
UK		10.00	Auction: £600mn of 0.125% 2051 inflation-linked bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data						
Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
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
Auctions and events						
- Nothing scheduled -						

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