

Euro wrap-up

Overview

- Bunds made modest losses even as data confirmed a contraction in German GDP in Q4 and the Commission's economic sentiment indicator deteriorated more than expected.
- Gilts also made modest losses at the long end of the curve on a quiet end to the week for UK economic news.
- The coming week will bring the latest policy announcements from the ECB and BoE, as well as the first estimates of euro area GDP in Q4 and inflation in January.

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Daily bond market movements

Bond	Yield	Change
BKO 0 12/23	-0.622	+0.009
OBL 0 10/26	-0.312	+0.012
DBR 0 02/32	-0.050	+0.012
UKT 0 ¹ / ₈ 01/24	0.953	+0.002
UKT 0 ³ / ₈ 10/26	1.059	-0.002
UKT 0 ¹ / ₄ 07/31	1.236	+0.010

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

Euro area

Germany's contraction confirmed as tighter restrictions weighed on spending

With a new wave of coronavirus sweeping across the euro area in the final months of 2021 prompting tighter restrictions in various member states, and persisting supply bottlenecks limiting production, the first estimates of Q4 GDP published today inevitably confirmed that growth slowed last quarter. But there were also marked differences among the large member states. This was most striking in Germany, where output contracted 0.7%Q/Q in Q4, following growth of 1.7%Q/Q in Q3, to be still 1.5% below the pre-pandemic level of Q419. Germany's statistical office Destatis noted that the weakness principally reflected a drop in private consumption due to more stringent pandemic measures, with investment in construction also slipping back, likely due to supply constraints. In the absence of increased government spending the drop in Q4 would have been steeper. Overall, after a decline of 4.9%Y/Y in 2020, this left full-year German growth in 2021 at a disappointing 2.8%Y/Y, fractionally stronger than initially estimated but well down on forecasts made earlier in the year.

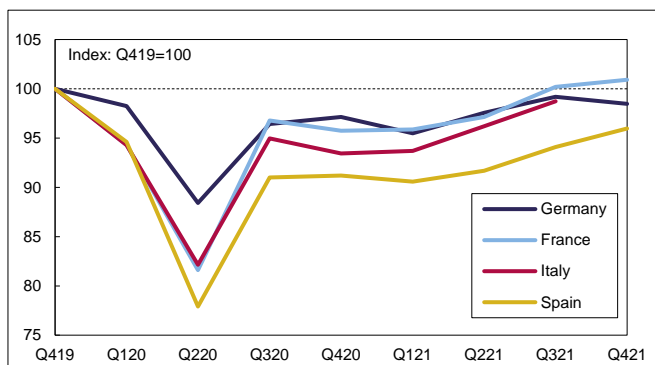
French growth remained respectable, underpinned by domestic demand

In contrast to the contraction in Germany last quarter, French GDP growth remained respectable at 0.7%Q/Q, albeit down 2.4ppts from Q3 after earlier restrictions were relaxed. So, in light of some favourable prior revisions, GDP last quarter rose 0.9% above the pre-pandemic level. French growth in Q4 was led by domestic demand, with household consumption up 0.4%Q/Q and fixed investment up a similar 0.5%Q/Q. And inventory accumulation added 0.4ppt to growth having subtracted 0.7ppt in Q3. In contrast, with imports (up 3.6%Q/Q) accelerating faster than exports (up 3.2%Q/Q), net trade subtracted 0.2ppt from GDP growth having contributed positively by the same amount in the prior quarter. Overall, the growth in the final quarter meant that French GDP in 2021 rose 7.0%Y/Y having dropped 8.0%Y/Y in 2020.

Spain's economy grew vigorously, outpacing other member states in Q4

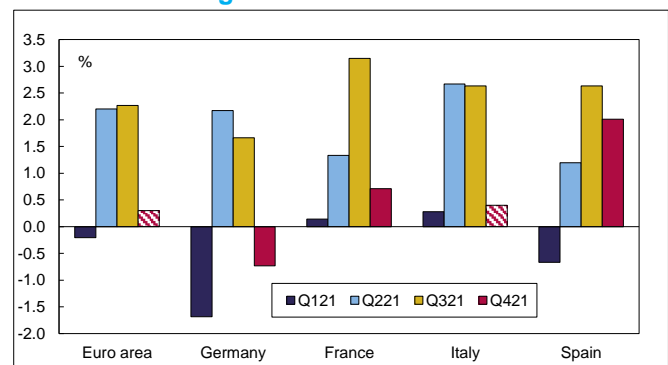
Of the large member states, Spain chalked up by far the strongest growth at the end of last year, with GDP rising a faster-than-expected 2.0%Q/Q after growth of 2.6%Q/Q the prior quarter. But with Spain's initial contraction having been far deeper than elsewhere in the euro area, economic output was still almost 4% lower than the pre-pandemic level of Q419, a significantly larger shortfall than any other member state. In contrast to France, Spanish household consumption appears to have been hampered by renewed restrictions at the end of last year, with the 1.2%Q/Q decline reversing the increase in Q3, and leaving it still almost 8% lower than the Q419 level, while government consumption fell (-0.4%Q/Q) for the first quarter in five years. But private capex was up by almost 5%Q/Q, with private inventories having also contributed positively to GDP growth (0.7ppt) for the second successive quarter. Solid spending by overseas visitors also gave a welcome boost to

Euro area: GDP level in selected member states



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth in selected member states*



*Euro area and Italy Q4 GDP figures are Daiwa estimates.
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

services exports (33%Q/Q). And so, with the rise in overall exports (6.5%Q/Q) outpacing a sizeable increase in imports (3.5%Q/Q), net trade also added 1.1ppt to growth. Overall, Spain's GDP rose 5.0%Y/Y in 2021 following a contraction of 10.8%Y/Y in 2020. Based on today's releases from the member states, we maintain our view that Monday's initial estimate for the euro area as a whole will report growth of 0.3%Q/Q, marking a significant deceleration from growth of 2.2%Q/Q in Q3, but still 0.1ppt above the ECB's December forecast and enough to take output back to its pre-pandemic level.

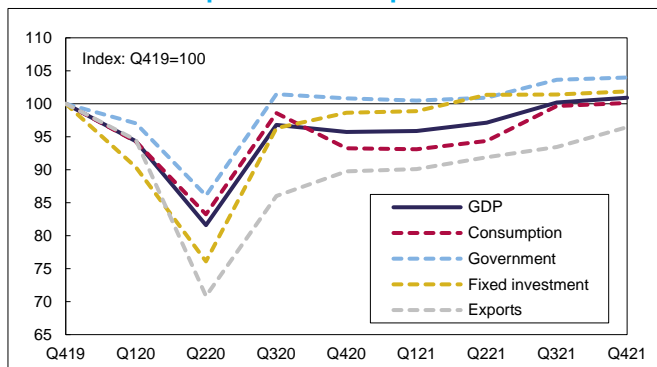
Commission survey flags broad-based softening of sentiment as supply restraints persist

Coming up to date, the Commission's economic sentiment indicator for January was much weaker than expected, dropping more than 1pt from a downwardly revised prior reading to a nine-month low of 112.7. That level, however, remains elevated by historical standards, and consistent with positive underlying growth momentum despite the current restraints of supply bottlenecks and Omicron. Among the large member states, sentiment was judged to have improved slightly in Germany and Spain. But it deteriorated in France, Italy and the Netherlands to the lowest levels in eight, nine and ten months respectively. The softening of confidence at the euro area level, however, appeared broad-based, with a deterioration in all major sectors bar retail. Weaker services sentiment to a nine-month low tallied with the softening in the PMI for the sector, and reflected a less positive assessment of recent demand while expectations improved. Less expected was the fall in the industrial sector sentiment index to a five-month low. In part, this reflected a statistical anomaly, with a welcome pickup in inventories contributing negatively to the headline index but hinting at a possible slight easing of supply bottlenecks. The Commission's survey nevertheless suggested that orders outstanding would assure manufacturing production for a series high of five months to come. In addition, more than half of firms in the sector (up 4ppt on the quarter to a new high of 54%) reported that materials and equipment shortages are limiting production, with a record share of firms in construction (29%) doing likewise. And exporters judged their external competitiveness to have deteriorated to a four-quarter low.

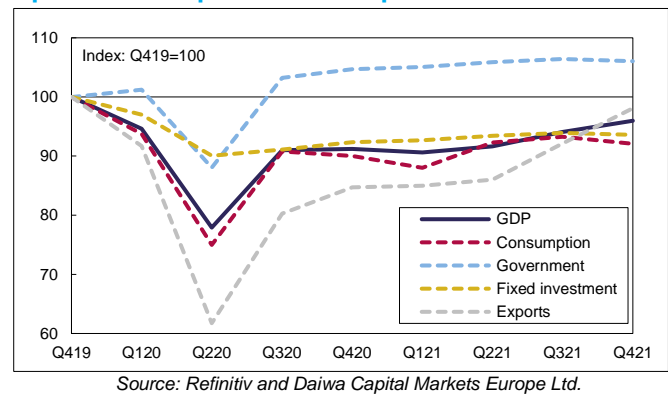
Price expectations up again for consumers and most business sectors

The Commission's survey confirmed the modest deterioration in consumer confidence to a ten-month low flagged by the preliminary estimate. While households signalled a greater readiness to make major purchases, they were more downbeat about the outlook for the economy and their own financial situation. That accorded with a renewed increase in consumers' price expectations, which rebounded from the prior month's three-month low. And while industrial sector selling-price expectations edged down to a three-month low but still remained exceptionally high, the ECB will be wary that the equivalent indices for retail, construction and services prices rose once again, the latter to a new series high.

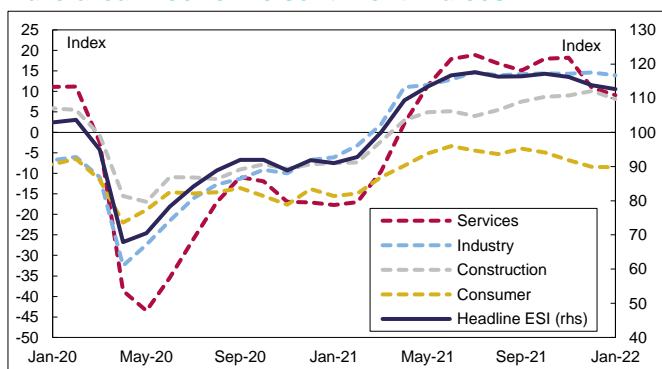
France: GDP expenditure components



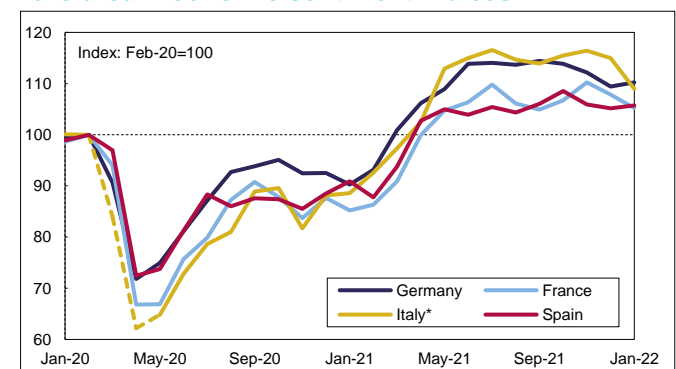
Spain: GDP expenditure components



Euro area: Economic sentiment indices



Euro area: Economic sentiment indices



Economic outlook still broadly in line with ECB's December projections

The coming week brings the latest ECB monetary policy meeting, which will conclude on Thursday. In marked contrast to the [previous meeting](#) in December, the announcements look set to be uneventful. First, there is no pressing need for the Governing Council to change its overall assessment of economic conditions. While economic activity slowed towards the end of last year, the ECB's GDP projections remain credible. Indeed, if anything, GDP is more likely to exceed the growth of 0.2%Q/Q and 0.4%Q/Q it predicted for Q4 and Q1. The ECB will also still expect a rebound in growth to above-potential rates in Q2 and Q3 as the latest coronavirus wave fades, supply bottlenecks ease, and so firms are better able to invest and consumers able to spend some of their excess savings accumulated over the past couple of years. Moreover, while the near-term profile of inflation might well exceed the path set out by the ECB in Q1 and Q2 due to higher prices of energy, food and other goods, the annual CPI rate still likely peaked at 5.0%Y/Y in December. And as projected by the ECB, inflation should be close to (or below) the 2.0%Y/Y target by year-end. The Governing Council will probably also continue to see the risks to the economic outlook as broadly balanced, while acknowledging the very large degree of uncertainty. Indeed, since the last meeting, geopolitical risks have undeniably increased significantly, with events on the Russia/Ukraine border representing additional downside risks to the near-term profile for GDP but also extra upside risks to the near-term profile for inflation.

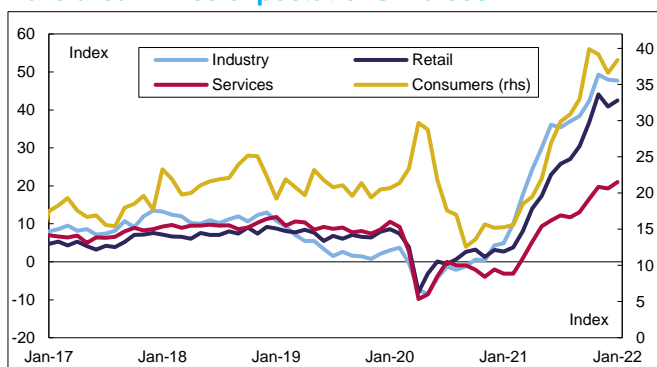
Policy outlook to be reaffirmed by Governing Council at forthcoming meeting

With a broadly unchanged assessment of the most likely path ahead for GDP and inflation, and financial conditions still to be considered favourable despite recent increases in sovereign yields and equity market volatility, at its forthcoming meeting the Governing Council will also see no need to change its assessment of the policy outlook. So, it will reaffirm the expected profile for QE up to October at the earliest. Net PEPP purchases will still conclude at the end of March. And while net APP purchases will double to €40bn per month in Q2, they will slow to €30bn per month in Q3 and further to €20bn per month from October. In her press conference, President Lagarde will likely reiterate that economic conditions in the euro area differ markedly from those in the US, and that the preconditions for rate hikes set out in the ECB's forward guidance are unlikely to be met before the end of the year. She will also likely repeat that the Governing Council stands ready to adjust policy if and when the inflation outlook differs significantly from the path currently set out in the ECB's projections. But she should echo comments made earlier this week by ECB Chief Economist Lane that the Bank's asset purchases would be reduced further to zero before any increase in interest rates.

The data week ahead in the euro area

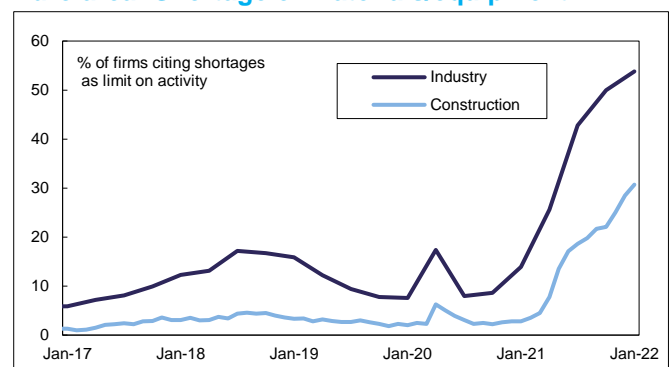
The coming week will also bring plenty of top-tier euro area economic data, kicking off with the aforementioned Q4 GDP estimate on Monday. Given the data from the member states released so far, we maintain our expectation that euro area economic activity slowed sharply at the end of last year, to 0.3%Q/Q, the softest pace for a year. Despite the slowing

Euro area: Price expectations indices



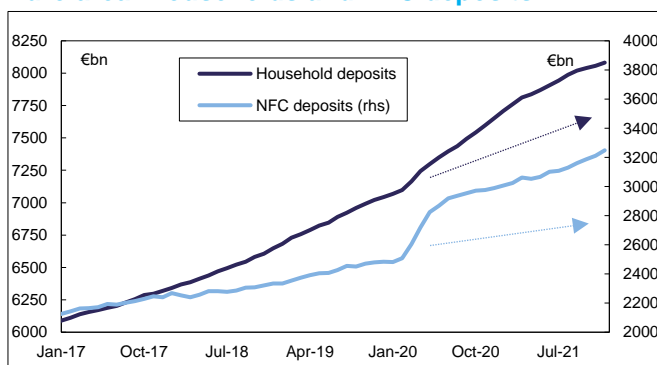
Source: European Commission, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Shortage of materials/equipment



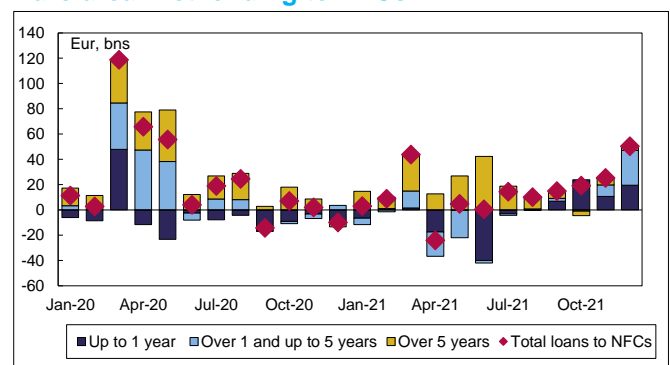
Source: European Commission and Daiwa Capital Markets Europe Ltd.

Euro area: Households and NFC deposits



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

Euro area: Net lending to NFCs



Source: ECB and Daiwa Capital Markets Europe Ltd.

economic recovery, the latest labour market data (Tuesday) are expected to report a further decline in euro area unemployment in December. The euro area's flash January inflation estimate is due on Wednesday and expected to report a marked drop at the start of the year in part due to the impact of past German tax changes. We expect the headline CPI rate to have fallen 0.8ppt to 4.1%Y/Y, with the core measure down 0.7ppt to 1.9%Y/Y – preliminary estimates from Germany and Spain (Monday) and France (Tuesday) will offer greater insight. The end of the week will bring euro area retail sales numbers for December, which are expected to have fallen sharply amid more stringent pandemic-related restrictions and following strong growth in November. Other releases in the coming week include German factory orders and French industrial production data for December (Friday), January new car registrations numbers from the larger member states (Tuesday and Thursday respectively), as well as the final January manufacturing, services and construction PMIs (Tuesday, Thursday and Friday respectively).

UK

Bank of England to raise rates again and start quantitative tightening

Unlike the ECB, the forthcoming meeting of the BoE's MPC looks firmly set to bring a change in policy on Thursday. Bank Rate is highly likely to be hiked by 25bps to 0.50%. And assuming that threshold for Bank Rate is reached, the BoE's guidance means that policymakers should also agree to start quantitative tightening, ceasing reinvestments of the proceeds of maturing bonds from its holdings starting with the redemption of £25bn of Gilts in March. With a rate hike this time around fully expected and priced by the markets, the policy decisions on their own should have minimal impact on Gilts. However, if the experience of previous meetings is anything to go by, the BoE's assessment of the economic outlook in the Monetary Policy Report and Governor Bailey's comments in the post-meeting press conference could yet generate some market volatility.

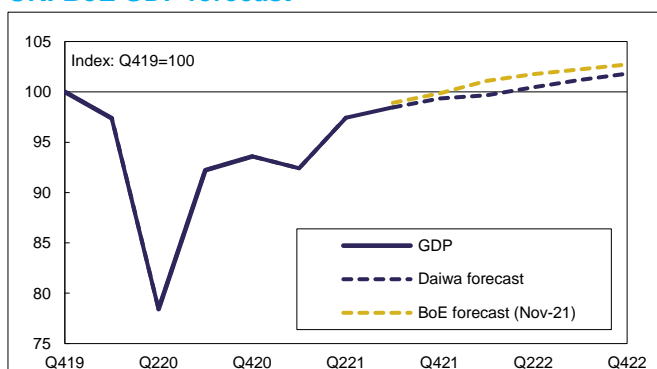
Near-term GDP forecast to be revised down but inflation forecast to be revised up

The MPC will justify its decision to raise rates on the basis of its updated projections. Admittedly, the BoE's forecasts for GDP in Q4 and Q1 will be revised down on account of the latest wave of coronavirus and associated restrictions in place over the festive period. And the Bank will be wary about the downside risks to growth of likely declines in real disposable incomes on private consumption over coming quarters. But the MPC will continue to judge that there remains excess demand at present and that a period of softer demand growth is appropriate, particularly given that inflation has continued significantly to exceed expectations. CPI inflation rose in December to 5.4%Y/Y, well above the profile expected by the MPC in November, when it forecast it to average just 4.3%Y/Y in Q4 and peak at around 5%Y/Y in the spring. Additional pressures to come from prices of energy, food and other goods are likely to push inflation up to around 6%Y/Y at the start of Q2. And concerns about the tightness of the labour market and fears of elevated wage and price expectations – the BoE's own survey measures of which are arguably inconsistent with the achievement of the inflation target – will persuade that the risks to the inflation outlook are skewed to the upside too. So, the BoE will certainly revise up its forecast for inflation throughout this year.

MPC to signal likelihood of further tightening to come

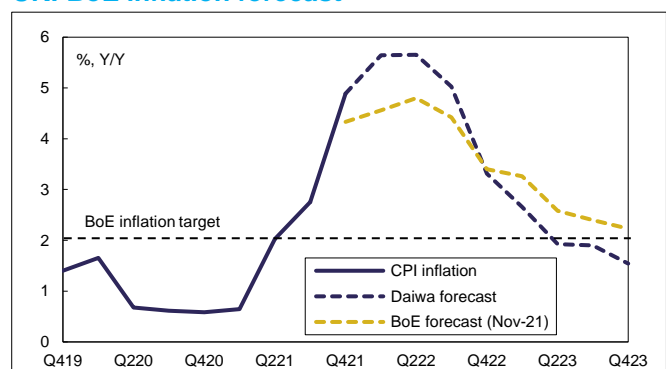
Before the end of the policy horizon, however, base effects are likely to have become more favourable. In addition, the Bank will assume that energy inflation will have fallen back close to zero. And given also the upwards shift in the sterling forward swap curve since November – with the implied Bank Rate in three years' time now more than 25bps higher than previously assumed – the BoE's updated forecast based on market-implied interest rates might suggest that inflation would be back close to or even below target in the course of 2023 or 2024. However, the BoE's projections based on no changes to policy are still likely to suggest that inflation would be more likely than not to exceed 2% at that point. So, the vast majority (if not all members) of the MPC will vote for a rate hike this time around. And the Committee will likely repeat that it continues to expect some further "modest tightening of monetary policy over the forecast period" to be necessary.

UK: BoE GDP forecast



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

UK: BoE inflation forecast












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

The data week ahead in the UK







Turning to the data, the coming week will provide an update on household lending in December (Tuesday), with demand for consumer credit likely to have weakened as the rise in coronavirus cases and reintroduction of certain pandemic restrictions limited consumption of services, while [retail sales](#) fell sharply at the end of the year. January sentiment surveys due include the Lloyds business barometer (Monday), final manufacturing, services and construction PMIs (Tuesday, Wednesday and Friday respectively). Meanwhile, January's Nationwide house price data will be published (Tuesday), alongside the BRC shop price index (Wednesday) and new car registrations figures (Friday).

Daiwa economic forecasts

	2021		2022				2021	2022	2023
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP forecasts %, Q/Q									
Euro area 	2.3	0.3	0.3	1.3	1.0	0.7	5.2	3.9	2.6
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	1.50

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.




































European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area 	M3 money supply Y/Y%	Dec	6.9	6.8	7.3	7.4
	Commission's Economic Sentiment Indicator	Jan	112.7	114.5	115.3	113.8
	Commission's industrial (services) confidence	Jan	13.9 (9.1)	15.0 (9.6)	14.9 (11.2)	14.6 (10.9)
	Commission's final consumer confidence	Jan	-8.5	-8.5	-8.3	-
Germany 	Preliminary GDP Q/Q% (Y/Y%)	Q4	-0.7 (1.4)	<u>-0.5 (1.3)</u>	1.7 (2.6)	- (2.9)
France 	Preliminary GDP Q/Q% (Y/Y%)	Q4	0.7 (5.4)	<u>0.6 (4.9)</u>	3.0 (3.3)	3.1 (3.5)
	Consumer spending M/M% (Y/Y%)	Dec	0.2 (-5.1)	0.0 (-5.2)	0.8 (14.8)	0.9 (-)
Italy 	PPI Y/Y%	Dec	17.7	-	17.4	17.9
	ISTAT consumer (manufacturing) confidence	Jan	114.2 (113.9)	116.5 (115.0)	117.7 (115.2)	- (115.0)
	ISTAT economic sentiment	Jan	105.4	-	113.1	112.7
Spain 	PPI Y/Y%	Dec	27.8	-	27.1	27.3
	Preliminary GDP Q/Q% (Y/Y%)	Q4	2.0 (5.2)	<u>1.2 (4.4)</u>	2.6 (3.4)	-
Auctions						
Country	Auction					
Italy 	sold €3bn of 0% 2026 bonds at an average yield of 0.5%					
	sold €3.5bn of 0.95% 2032 bonds at an average yield of 1.39%					
	sold €1.5bn of 0.126% 2029 floating rate bonds at an average yield of 0.08%					

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> forecast/actual	Previous	
Monday 31 January 2022						
Euro area		10.00	Preliminary GDP Q/Q (Y/Y%)	Q4	<u>0.3 (4.5)</u>	2.2 (3.9)
Germany		13.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	4.3 (4.3)	5.3 (5.7)
Italy		10.00	Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>0.4 (6.1)</u>	2.6 (3.9)
Spain		08.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	5.4 (5.5)	6.5 (6.6)
Tuesday 01 February 2022						
Euro area		09.00	Final manufacturing PMI	Jan	59.0	58.0
		10.00	Unemployment rate %	Dec	7.1	7.2
Germany		07.00	Retail sales M/M% (Y/Y%)	Dec	-1.4 (4.0)	0.8 (0.5)
		08.55	Unemployment rate % (change '000s)	Jan	5.2 (-10.0)	5.2 (-23.0)
		08.55	Final manufacturing PMI	Jan	60.5	57.4
France		07.45	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	2.5 (2.8)	2.8 (3.4)
		08.50	Final manufacturing PMI	Jan	55.5	55.6
Italy		08.45	Manufacturing PMI	Jan	61.5	62.0
		09.00	Unemployment rate %	Dec	9.1	9.2
Spain		08.15	Manufacturing PMI	Jan	56.0	56.2
UK		07.00	Nationwide house price index M/M% (Y/Y%)	Jan	0.6 (11.0)	1.0 (10.4)
		09.30	Net consumer credit £bn (Y/Y%)	Dec	0.6 (-)	1.2 (0.4)
		09.30	Net mortgage lending £bn (approvals '000s)	Dec	3.5 (65.9)	3.7 (67.0)
		09.30	Final manufacturing PMI	Jan	56.9	57.9
Wednesday 02 February 2022						
Euro area		10.00	Preliminary CPI (core CPI) Y/Y%	Jan	<u>4.1 (1.9)</u>	5.0 (2.6)
Italy		10.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	3.5 (3.6)	3.9 (4.2)
UK		00.01	BRC shop price index Y/Y%	Jan	-	0.8
Thursday 03 February 2022						
Euro area		09.00	Final services (composite) PMI	Jan	51.2 (52.4)	53.1 (53.3)
		10.00	PPI M/M% (Y/Y%)	Dec	2.0 (26.1)	1.8 (23.7)
		12.45	ECB refinancing rate %	Dec	<u>0.00</u>	0.00
		12.45	ECB deposit rate %	Dec	<u>-0.50</u>	-0.50
Germany		08.55	Final services (composite) PMI	Jan	52.2 (54.3)	48.7 (49.9)
France		08.50	Final services (composite) PMI	Jan	53.1 (52.7)	57.0 (55.8)
		08.45	Services (composite) PMI	Jan	50.6 (-)	53.0 (54.7)
Spain		08.15	Services (composite) PMI	Jan	52.0 (-)	55.8 (55.4)
UK		09.30	Final services (composite) PMI	Jan	53.3 (53.4)	53.6 (53.6)
		12.00	BoE Bank Rate %	Feb	<u>0.50</u>	0.25
Friday 04 February 2022						
Euro area		08.30	Construction PMI	Jan	-	52.9
Euro area		10.00	Retail sales M/M% (Y/Y%)	Dec	-0.5 (5.0)	1.0 (7.8)
Germany		07.00	Factory orders M/M% (Y/Y%)	Dec	0.3 (2.4)	3.7 (1.3)
France		07.45	Preliminary private sector payrolls (wages) Q/Q%	Q4	-	0.5 (0.3)
		07.45	Industrial production M/M% (Y/Y%)	Dec	0.5 (-)	-0.4 (-0.5)
UK		09.30	Construction PMI	Jan	54.3	54.3

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 31 January 2022		
- Nothing to report -		
Tuesday 01 February 2022		
Germany 	10.30	Auction: €6bn of 0% 2024 bonds
Wednesday 02 February 2022		
- Nothing to report -		
Thursday 03 February 2022		
Euro area 	12.45	ECB monetary policy announcement
	13.30	ECB President Lagarde speaks at post-Governing Council press conference
France 	09.50	Auction: 0% 2030 bonds
	09.50	Auction: 0% 2032 bonds
	09.50	Auction: 0.5% 2044 bonds
	09.50	Auction: 0.75% 2053 bonds
UK 	12.00	BoE monetary policy announcement, publication of MPC meeting summary, minutes and Monetary Policy Report (MPR)
	12.30	BoE Governor Bailey speaks at post-MPC press conference to discuss the MPR
	-	BoE publishes monthly Decision Maker Panel data for January 2022
Friday 04 February 2022		
Euro area 	09.00	ECB publishes its survey of professional forecasters
	16.00	ECB's Villeroy scheduled to speak at an online event
UK 	12.15	BoE Deputy Governor Broadbent and Chief Economist Pill brief BoE's agents about MPR and policy decision

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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