

Euro wrap-up

Overview

- With risk appetite benefiting from a de-escalation of tensions on the Russia/Ukraine border, Bunds made losses while euro area employment returned to its pre-pandemic level and investors were more upbeat about the near-term German economic outlook.
- Shorter-dated Gilts also made modest losses as the latest UK economic data implied a tight labour market despite a drop in employment.
- Tomorrow brings euro area industrial production data for December and UK inflation numbers for January.

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Daily bond market movements

| Bond | Yield | Change |
|---|--------|--------|
| BKO 0 03/24 | -0.361 | +0.014 |
| OBL 0 04/27 | 0.056 | +0.017 |
| DBR 0 02/32 | 0.310 | +0.031 |
| UKT 0 ¹ / ₈ 01/24 | 1.524 | +0.027 |
| UKT 0 ³ / ₈ 10/26 | 1.522 | +0.024 |
| UKT 0 ¹ / ₂ 07/31 | 1.582 | -0.005 |

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

Euro area

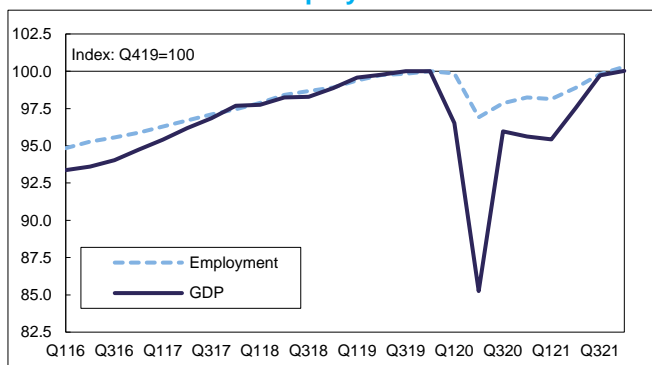
Euro area employment moved above pre-pandemic level in Q4

European financial markets were buoyed today by early reports of a de-escalation of tensions on the Russia-Ukraine border. In particular, with Russia moving some of its troops back from the Ukrainian border, President Putin subsequently stated that he was ready for “dialogue” with the west on security issues. Against that backdrop, the day’s economic data releases were of secondary importance. Indeed, the latest estimate of euro area GDP growth in Q421 merely confirmed the initial flash estimate of 0.3%Q/Q, marking a slowdown from 2.3%Q/Q in Q3 as the latest wave of coronavirus impeded activity. That still left GDP up 4.6%Y/Y and a fraction above the pre-pandemic level in Q419. No additional detail was provided on the composition of demand. However, notably, today’s release confirmed a further quarter of solid job growth in Q421, with employment up 0.5%Q/Q (782k) and 2.1%Y/Y (3.32mn). Like GDP, that meant that the level of employment rose back above the pre-pandemic level, by 0.3% or 489k workers. Unlike in the US and UK, that benchmark appears to have been reached without a decline in labour force participation. While that suggests that longer-term scarring from the pandemic might be limited and thus is positive from the perspective of future euro area growth potential, the recovery in labour force participation is likely to be contributing to the ongoing subdued growth of wages. Continued recourse to government short-term working programmes is also likely still be distorting the picture, likely having reduced unemployment by close to 2ppts in the fourth quarter.

Trade deficit blows out to largest since 2008

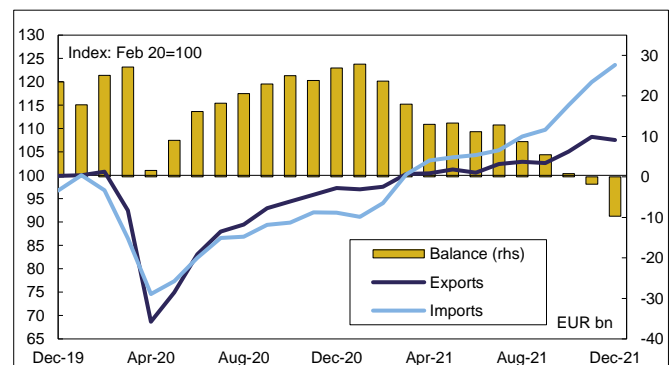
As had seemed inevitable following the release of the data from the largest member states [last week](#), the euro area’s goods trade balance deteriorated markedly at the end of 2021 having the prior month fallen into deficit on a seasonally adjusted basis for the first time since 2011. Indeed, in December the deficit blew out by almost €7.9bn to a €9.69bn, the largest since mid-2008. Export values dropped 0.6%M/M to be up 4.2%Q/Q in Q4 while imports jumped 3.1%M/M to be up 10.9%Q/Q. On an unadjusted basis, goods exports rose 14.1%Y/Y in December, far outpaced by the leap of 36.7%Y/Y in imports. The main cause, of course, was a surge in the value of imported energy, largely due to higher prices. Indeed, overall producer import prices rose 22.7%Y/Y in December, with prices of imported electricity and gas up more than 200%Y/Y and total imported energy prices up more than 100%Y/Y. But prices of imported manufactured goods were also up a marked 12.3%Y/Y. So, by trading partner, the euro area deficits with both Russia and China widened significantly. Adjusting for price shifts, net trade likely had a minimal impact on GDP growth in Q4. And while the trade deficit might well widen further in Q1, export volumes should outpace import volumes.

Euro area: GDP and employment



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade*



*Seasonally adjusted nominal figures. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

German ZEW survey indicates improved investor sentiment

Finally, the German ZEW survey for February tallied with last week's Sentix survey to report improved investor perceptions of both current conditions and expectations for the coming six months. Admittedly, having dropped to an eight-month low in January, the index of current conditions rose just 2.1pts to -8.1, remaining the second-lowest level since June. But while the increase in the expectations index was similarly modest at 2.6pts, it still took it to 54.3, the highest since July and well above the long-run average. So, investors were evidently happy to overlook risks from Ukraine, instead focusing on the prospect that coronavirus restrictions might soon be lifted. Having the prior month dropped to the lowest level of the pandemic, however, inflation expectations rose somewhat but remained consistent with widespread expectations of declining price pressures ahead (-37.5). In addition, long-term interest rates were expected to continue to pick up, with the associated balance (74.2) rising to the highest since 2011. That is judged to benefit the profit outlook for banks, for which the respective survey index rose to the highest since 2006. And the improved outlook for supply chains gave a boost to profit expectations in several other sectors including autos, machinery and electronics.

The day ahead in the euro area

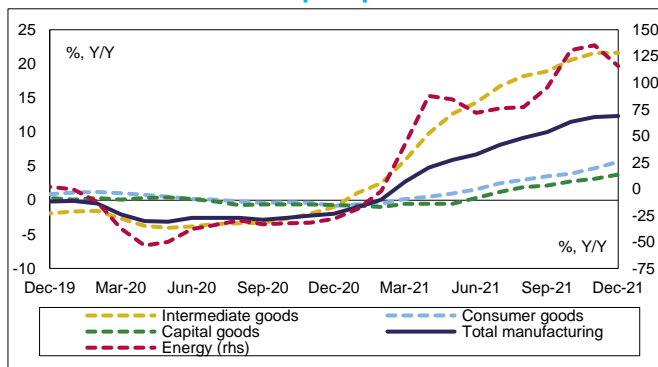
Tomorrow will bring further insight into the euro area's manufacturing sector at the end of last year, with aggregate industrial production data for December. National figures already published revealed hefty declines in Spain and Italy, and smaller decreases in activity in Germany and France. But not least given a surge in Irish output, we expect aggregate euro area production to post an increase of around ½% M/M in December, although this would leave it almost ½% lower on the quarter.

UK

Labour market tightens further despite drop in employment as inactivity rises

While a softening of economic growth momentum amid the spread of Omicron coincided with a fall in the number of people in work at the end of 2021, the UK labour market appears to have remained very tight. Employment dropped 38k in the three months to December, the first such decline in ten months, to leave the employment rate (75.5%) still 1.0ppt lower than before the pandemic. Additionally, inactivity continued to edge higher, up 31k 3M/3M over the same period to take the rate (21.1%) 1.0ppt above that ahead of the pandemic. The rise in inactivity was again driven by long-term sickness – seemingly an unwelcome legacy of the pandemic. As a result, the unemployment rate was unchanged at 4.1% in the three months to December, still matching the lowest rate in eighteen months albeit up 0.3ppt from the end of 2019. And against the backdrop of the highly elevated quit rate, despite a record low redundancy rate, the number of job vacancies hit a new high in the three

Euro area: Producer import prices



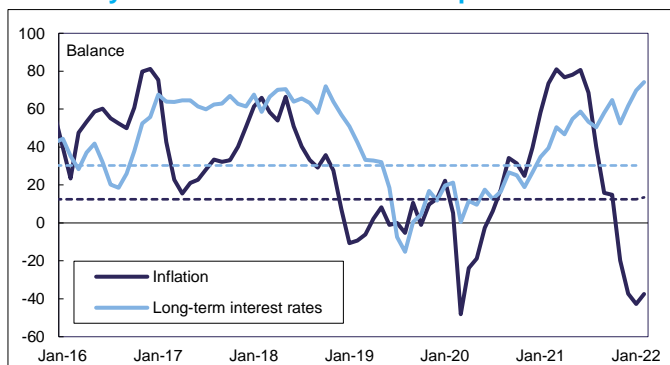
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ZEW investor survey indicators*



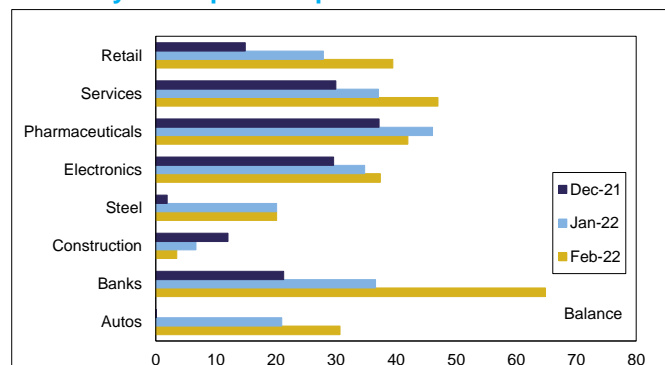
*Dashed lines represent long-run average. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ZEW inflation and rate expectations*



*Dashed lines represent long-run average. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ZEW profit expectations



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

months to January despite a slowing in the rate of their growth. So, the ratio of unemployed workers to vacancies dropped to the lowest in at least fifty years. Renewed positive momentum might have been reflected in the further rise, of 108k, in the number of payrolled employees to a new high in January. However, with workers continuing to eschew self-employment, and these data routinely downwardly revised in subsequent months, we place less emphasis on them as a guide to near-term momentum.

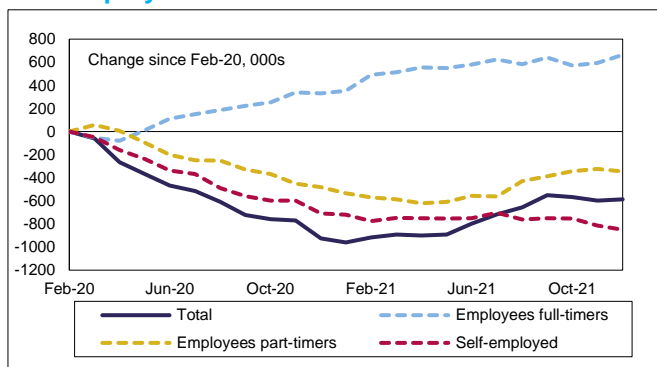
Regular wages falling sharply in real terms

In terms of wages, the latest data were mixed, making it difficult to conclude that increased labour market tightness is fueling domestically generated inflation. Average total pay edged up 0.1ppt to 4.3%3M/Y in December (with financial services strongest at 8.1%3M/Y) to be down 0.1%3M/Y in real terms. The pickup in nominal terms reflected bonuses, excluding which regular pay slowed a further 0.1ppt to 3.7%3M/Y, as the temporary distortions associated with composition and base effects continued to pass. And that left regular pay down a steep 0.8%3M/Y in real terms, with an even sharper drop on a single-month basis of 1.2%Y/Y, the most since 2014 – further evidence of the marked squeeze in living standards underway even before taxes and household energy bills go up in April and mortgage payments rise in response to the BoE's latest rate hike. At face value, therefore, the data might also suggest that recent BoE concerns of pay pressures have been overdone. However, the 3M/3M annualised rate of nominal regular pay rose to 4.5%, the highest since February 2021, suggesting some new momentum. And business survey evidence of very strong pay expectations for the coming year will likely sustain MPC worries of significant second-round effects from current high inflation over coming quarters. So, today's data won't deter the MPC from hiking Bank Rate again next month, although an increment of 25bps seems to us as more likely than one of 50bps.

The day ahead in the UK

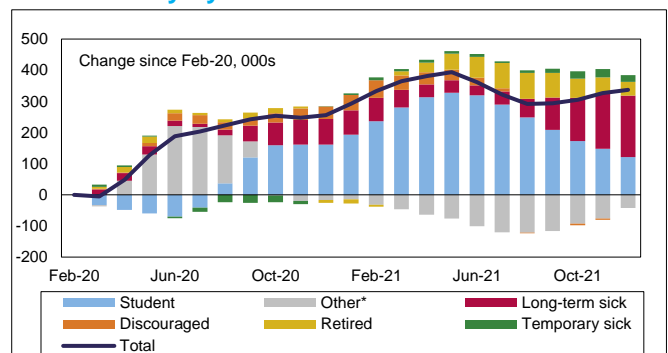
Focus in the UK tomorrow turns to the latest inflation data. While petrol prices on average fell slightly in January, energy inflation will have remained elevated and food price pressures likely remained firm. Meanwhile, persisting supply constraints likely pushed non-energy industrial goods inflation higher at the start of the year. So, despite the possibility of some pandemic-related weakness in services inflation, overall we expect headline CPI inflation to have remained broadly unchanged from the 30-year high (5.4%Y/Y) recorded in December. And we think that core inflation might have eased only marginally in January from 4.3%Y/Y previously. Meanwhile, the latest PPI numbers are also likely to show that price pressures at the factory gate also remained elevated at the start of the year, with only very modest declines anticipated from the rates of 9.3%Y/Y for output prices and 13.5%Y/Y for input prices in December.

UK: Employment



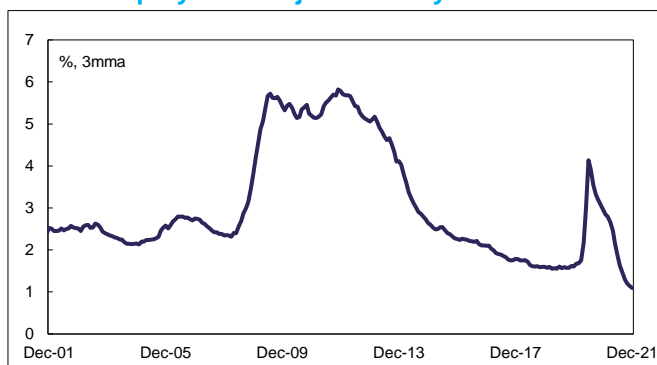
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Inactivity by reason



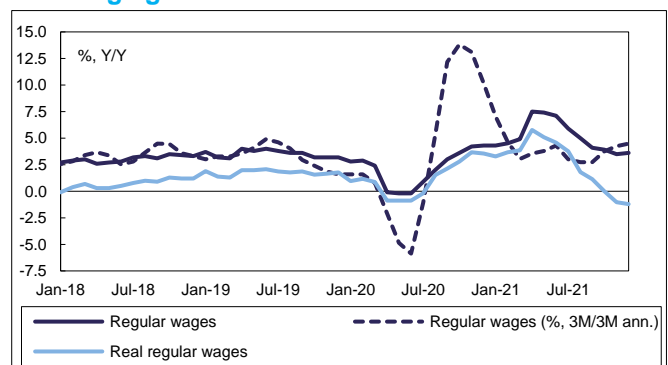
*Includes looking after family/home. 3mma. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Unemployment to job vacancy



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Wage growth













Source: Refinitiv 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 |  GDP Q/Q% (Y/Y%) | Q4 | 0.3 (4.6) | 0.3 (4.6) | 2.3 (3.9) | - |
| |  Preliminary employment Q/Q% (Y/Y%) | Q4 | 0.5 (2.1) | - | 0.9 (2.1) | 1.0 (-) |
| |  Trade balance €bn | Dec | -9.7 | -4.4 | -1.3 | -1.8 |
| Germany |  ZEW current situation (expectations) | Feb | -8.1 (54.3) | -7.0 (54.3) | -10.2 (51.7) | - |
| Spain |  Final CPI (EU-harmonised CPI) Y/Y% | Jan | 6.1 (6.2) | 6.0 (6.1) | 6.5 (6.6) | - |
| UK |  Unemployment claimant count rate % (change '000s) | Jan | 4.6 (-31.9) | - | 4.7 (-43.3) | 4.6 (-51.6) |
| |  Average weekly earnings (excluding bonuses) 3M/Y% | Dec | 4.3 (3.7) | 3.8 (3.6) | 4.2 (3.8) | - |
| |  ILO unemployment rate 3M % | Dec | 4.1 | 4.1 | 4.1 | - |
| |  Employment change 3M/3M '000s | Dec | -38 | -66 | 60 | - |
| |  Payrolled employees monthly change '000s | Jan | 108 | - | 184 | 131 |






Auctions

| Country | Auction |
|---------|---|
| Germany |  sold €3.25bn of 0% 2027 bonds at an average yield of 0.04% |
| UK |  sold £2.25bn of 1% 2032 bonds at an average yield of 1.598% |


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

| Country | GMT | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|-----------|-------|---|--------|--|-------------|
| Euro area | 10.00 |  Industrial production M/M% (Y/Y%) | Dec | 0.3 (-0.7) | 2.3 (-1.5) |
| UK | 07.00 |  CPI (core CPI) Y/Y% | Jan | 5.4 (4.2) | 5.4 (4.2) |
| | 07.00 |  PPI input prices M/M% (Y/Y%) | Jan | 1.0 (13.4) | -0.2 (13.5) |
| | 07.00 |  PPI output prices M/M% (Y/Y%) | Jan | 0.6 (9.1) | 0.3 (9.3) |
| | 09.30 |  House price index Y/Y% | Dec | 9.4 | 10.0 |

Auctions and events

| | |
|---------|---|
| Germany |  10.30 Auction: €4bn of 2032 bonds |
|---------|---|

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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