Euro wrap-up

Overview

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- Euro area govvies followed USTs lower even as Italian consumer price inflation and euro area producer goods prices fell.
- Gilts also made losses as a BoE survey reported a rise in firms' price and wage expectations.
- Friday will bring the flash euro area inflation estimates for December, as well as the Commission's economic survey results, euro area retail sales and German factory orders figures.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.621	+0.067
OBL 1.3 10/27	2.332	+0.052
DBR 1.7 08/32	2.300	+0.036
UKT 1 04/24	3.407	+0.077
UKT 1¼ 07/27	3.542	+0.063
UKT 4¼ 06/32	3.544	+0.055

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

Euro area

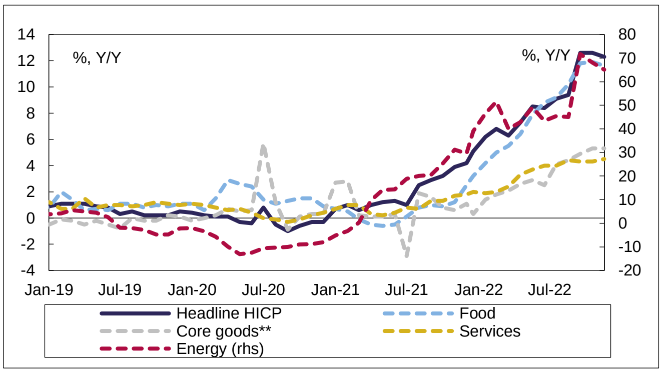
Italian consumer price inflation drops in December but key core rate edges higher

As in Germany, Spain and France, consumer price inflation in Italy fell in December. Today's flash Italian estimates reported declines in the EU-harmonised HICP rate, of 0.3ppt to 12.3%Y/Y, and national CPI rate, of 0.2ppt to 11.6%Y/Y. Both measures fell back from the multi-decade highs reached in October and November. As in the other member states, the cause for the decline in inflation was in non-core items. On the EU-harmonised measure, inflation of energy eased 3ppts to 65.1%Y/Y, while the component for food (including alcohol) slowed 0.3pt to 11.6%Y/Y. In contrast, inflation of non-energy industrial goods was unchanged at 5.3%Y/Y, while inflation of services rose 0.2ppt to 4.5%Y/Y. So, the core EU-harmonised measure excluding all energy and food items rose 0.1ppt to a new high of 4.8%Y/Y. Given today's data, we expect tomorrow's flash euro area figures to report a drop of 0.8ppt in the headline HICP rate to 9.3%Y/Y. But we also expect core inflation to rise 0.1ppt to 5.1%Y/Y due to an increase in the service sector.

Euro area producer goods price pressures moderated further in November

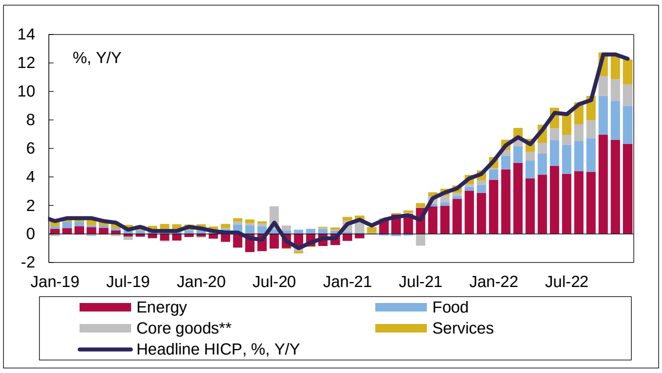
While services inflation will remain of concern to the ECB, today's industrial PPI figures for November added to evidence that goods price pressures are easing. Indeed, broadly in line with expectations, producer goods prices fell for the second successive month, dropping 0.9%M/M following a larger-than-previously thought decline of 3.0%M/M, which was the biggest on the series. As such, the annual PPI rate dropped for the third successive month and by more than 3ppts to an eleven-month low of 27.1%Y/Y. The decline was driven by energy, with prices falling more than 2%M/M to leave the annual energy inflation rate down almost 9ppts to 55.7%Y/Y, less than half August's peak. When excluding energy, producer prices rose just 0.1%M/M, the least in two years and well down from the average increase of almost 2%M/M from January to May. And so, the annual core PPI rate fell for a sixth successive month to a nine-month low of 13.1%Y/Y and almost 3ppts below May's peak. This in part reflected a first drop in intermediate goods prices since May 2020, down 0.4%M/M, to leave the respective annual rate down more than 2ppts to a fourteen-month low of 15.3%Y/Y. Capital goods prices rose just 0.3%M/M, the least in nineteen months, while consumer goods prices increased 0.6%M/M, the least in a year. And with this week's final manufacturing PMIs suggesting another notable drop in input costs in December, energy prices having fallen towards year-end, and demand soft, we expect euro area PPI to slow further, helping consumer goods inflation to moderate gradually in the New Year too.

Italy: Consumer price inflation*



*EU-harmonised measure. **Non-energy industrial goods inflation.
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Italy: Consumer price inflation*



*EU-harmonised measure. **Non-energy industrial goods inflation.
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

German trade surplus widens to 10-month high as import values fall sharply

Germany's goods trade surplus rose to €10.8bn, its biggest in ten months in November. The cause was a third successive drop in the value of goods imports, of 3.3%M/M, the most since January, to the lowest level since April. Imports from other euro area countries were particularly weak (down 6.5%M/M). The value of goods exports fell too, and for the second month in the three, albeit by just 0.3%M/M, with stronger shipments to the UK helping to offset weakness in US and Chinese demand. Compared to a year earlier, growth in the value of imports (14.7%Y/Y) still beat that of exports (13.3%Y/Y). However, over the first two months of Q4, the value of exports rose 1.2% above the Q3 average while the value of imports fell more than 3.5% on the same basis. That might suggest that net goods trade provided some welcome support to German GDP growth last quarter. However, the drop in the value of imports is highly likely in good part to have been driven by price effects, with data yesterday having reported the sharpest monthly drop in German import prices on the series (down 4.5%M/M) in November. Indeed, with German energy-intensive manufacturing output cut aggressively over recent months (down a whopping 12.6%Y/Y in October), import volumes of chemicals, metals and other goods produced in that sub-sector are likely to have picked up as a substitute for items previously produced domestically.

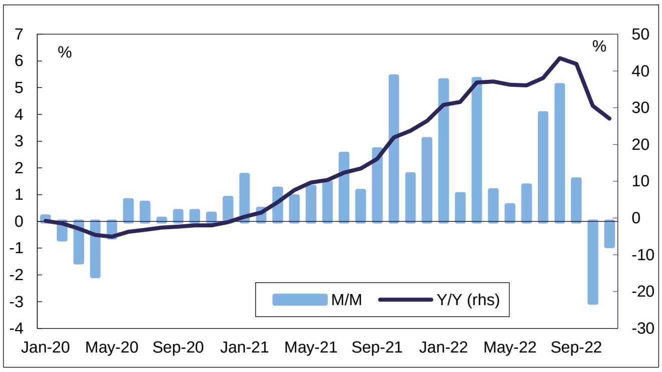
Construction PMIs signalling ongoing marked contraction at the end last year

Contrasting with a modest easing in struggles reported in the manufacturing and services PMIs at the end of last year, today's construction PMIs suggested that conditions in the sector remained extremely challenging. In particular, the headline euro area activity index fell in December for the tenth month out of the past eleven, by 1pt to 42.6, the weakest reading since May 2020. Weakness was led by the housing sector. Indeed, when excluding the initial Covid period, the housing activity PMI (39.8) implied the steepest contraction since March 2013, with the equivalent German index the lowest since February 2012. Overall, the German construction activity PMI edged marginally higher in December, albeit at 41.7 it remained firmly in contractionary territory, as did the equivalent French index (41.0). After a jump in November, the Italian PMI slumped 5pts to 47.0, a three-month low. And overall, despite support from the mild winter across the region and further easing of supply constraints, the outlook for the sector appears to remain bleak, with new orders declining at the sharpest pace since May 2020.

The day ahead in the euro area

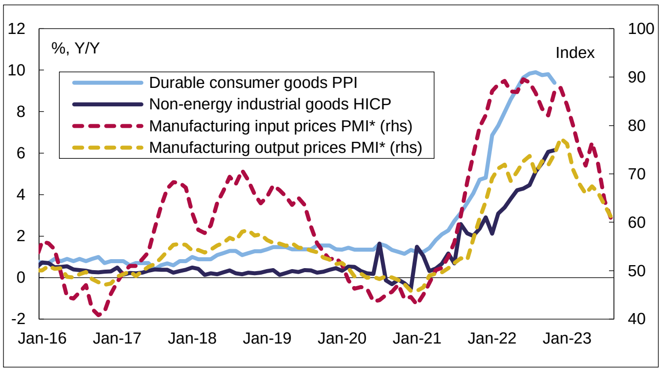
The economic data calendar concludes tomorrow with the aforementioned euro area flash December inflation estimate. With energy inflation likely to have fallen further, we expect the headline CPI rate to have eased by 0.8ppt to 9.3%Y/Y. However, with services inflation having risen in Germany and Italy, core inflation probably rose above 5.0%Y/Y for the first time.

Euro area: Producer goods price inflation



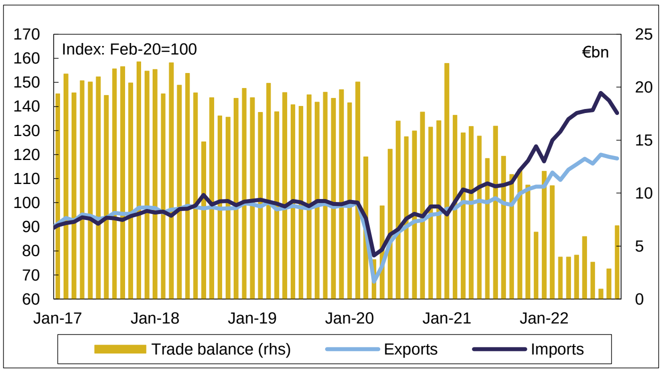
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Selected goods inflation indicators



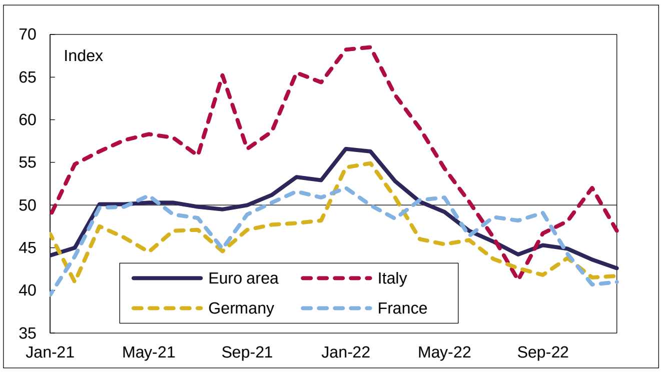
**PMIs have five-month leads. Source: S&P Global, Refinitiv and Daiwa Capital Markets Europe Ltd.*

Germany: Goods trade*



**Values terms. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

Euro area: Construction PMIs



Source: S&P Global, Refinitiv and Daiwa Capital Markets Europe Ltd.

Meanwhile, the European Commission's economic surveys will provide an update on business and consumer price expectations in December, as well as a wider assessment on economic activity. Euro area retail sales figures for November will likely report a modest rebound in spending following the sharp drop of 1.8%M/M in October, despite the ongoing squeeze on households' finances. In contrast, German factory orders data for November are likely to re-establish the downtrend in place since February after a temporary modest bounce the prior month. Beyond the data, later in the day, ECB Chief Economist Lane will speak on a panel discussion on the Global Economic Outlook.

UK

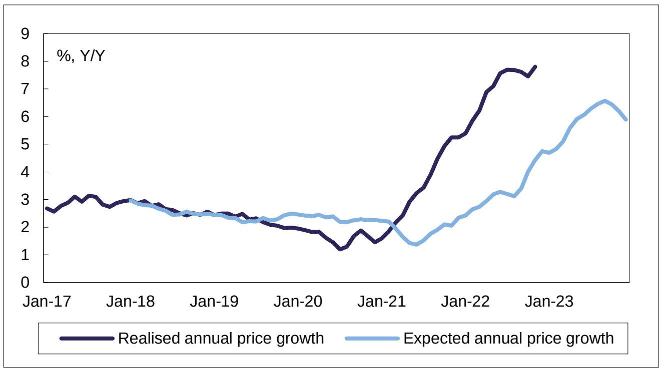
BoE survey reports a rise in firms' price and wage expectations

Given concerns about potential second-round effects on inflation from expectations, MPC members may have taken some relief from yesterday's reported decline in medium-term household inflation expectations. But today's results of the BoE Decision Maker Panel (DMP) survey for December suggested that businesses were less convinced about the cost outlook. Firms judged that annual private sector output price inflation jumped to a new high in the three-months to December, to 7.8%Y/Y. There was no further improvement in their expected year-ahead own-price inflation last month either (at 5.7%Y/Y). However, due to declines earlier in the quarter, the three-month average rate moderated to a seven-month low of 5.9%Y/Y. While well below September's peak, DMP members revised up slightly their expectation for CPI inflation one-year ahead by 0.2ppt to 7.4%Y/Y and their expectation for CPI inflation in three years' time by 0.1ppt to 4.0%Y/Y, double the Bank's target. Firms also reported a notable tick up in average wage growth to a new high of 6.6%Y/Y in the twelve months to December, with that rate expected to remain elevated at 6.3%Y/Y over the coming twelve months too.

PMIs suggest services activity stagnates, while price pressures moderate at year-end

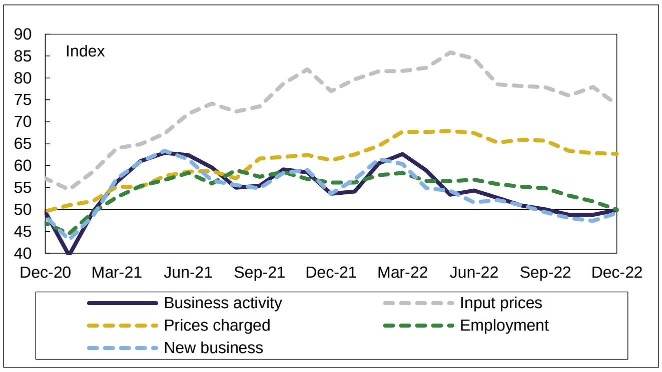
Other surveys, however, suggest that, amid a slowing economic backdrop, cost pressures are diminishing. For example, the services PMIs today showed that, while still at an elevated level, the input price PMI fell 4pts in December to 74.0, a fifteen-month low. Although upwardly revised from the flash estimate, the output price PMI also moderated slightly to 62.7, its lowest since last January. And there were further signs of diminishing labour market tightness last month too, with firms in the sector failing to add to their workforces for the first time since February 2021. This is hardly surprising given that activity in the sector was broadly stagnating at the end of last year – admittedly, the headline PMI was up 1.1pts in December at 49.9, a three-month high – and demand for new business continued to decline (49.2). Given also the weakness in manufacturing, the composite output PMI remained in contractionary territory in December (49.0), to leave it on average in Q4 (48.5) almost 2pts lower than in Q3 and consistent with the UK having entered a recession in the second half of last year.

UK: Firms' output price expectations



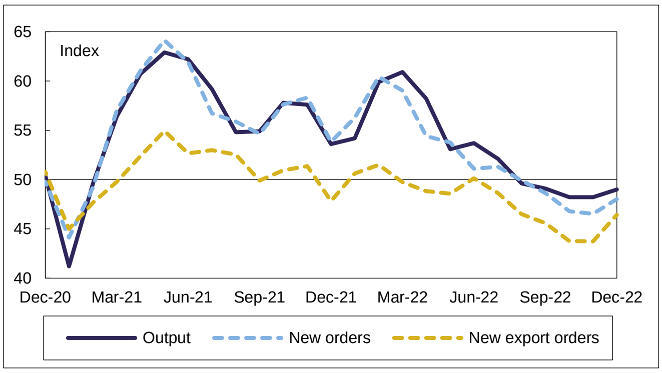
Source: BoE DMP survey and Daiwa Capital Markets Europe Ltd.

UK: Services PMIs



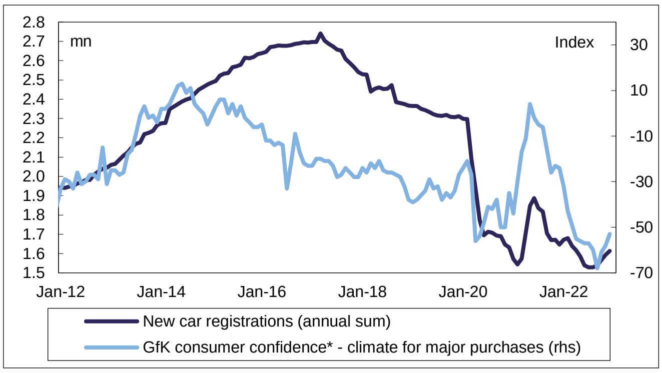
Source: S&P Global, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Composite PMIs



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: New car registrations & consumer confidence



**One-month lead. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

UK new car sales accelerate in December but growth flattered by pandemic weakness

While the overall UK economic outlook remains bleak, the Society of Motor Manufacturers and Traders (SMMT) today reported another increase in new car registrations in December. Indeed, consistent with a second successive pickup in UK car production in November (SMMT reported annual growth of 5.7%Y/Y), registrations were up 18.3%Y/Y at 128k units. But private car sales were down compared with a year earlier in December, by 7.4%Y/Y, with growth in total registrations last month driven by fleets and businesses, together accounting for around 60% of the market share. Moreover, growth was again flattered by a low base a year ago, with total sales still the second-lowest for any December since 2012. Indeed, despite positive annual growth in each month since August, full-year sales in 2022 were the lowest for three decades, down 2% from 2021, around 30% below the 2019 level and 40% below the peak in 2016. While pandemic-related backlogs might provide ongoing support to registrations over the near term, with consumer confidence near historically low levels and real disposable income declining, we do not expect to see a significant acceleration in car sales over coming quarters.

The day ahead in the UK

Tomorrow brings the release of the UK construction PMI survey for December, from which the headline index is expected to dip below the key 50 contraction/expansion level for the first time in four months, with activity likely to have been adversely impacted by snow and rail strikes.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Construction PMI	Dec	**42.6**	-	43.6	-
Germany	Trade balance €bn	Nov	**10.8**	7.5	6.9	**6.8**
	Construction PMI	Dec	**41.7**	-	41.5	-
France	Construction PMI	Dec	**41.0**		40.7	-
Italy	Preliminary CPI M/M% (Y/Y%)	Dec	**0.3 (11.6)**	- (11.6)	0.5 (11.8)	-
	Preliminary HICP M/M% (Y/Y%)	Dec	**0.2 (12.3)**	0.2 (12.3)	0.7 (12.6)	-
	Construction PMI	Dec	**47.0**		52.0	-
UK	Final services (composite) PMI	Dec	**49.9 (49.0)**	50.0 (49.0)	48.8 (48.2)	-
	New car registrations Y/Y%	Dec	**18.3**	-	23.5	-

Auctions

Country	Auction
France	sold €6.11bn of 2.00% 2032 bonds at an average yield of 2.77%
	sold €2.11bn of 1.25% 2038 bonds at an average yield of 3.02%
	sold €2.56bn of 0.75% 2053 bonds at an average yield of 2.95%
	sold €1.21bn of 1.75% 2066 bonds at an average yield of 2.79%
UK	sold £3.5bn of 4.125% 2027 bonds at an average yield of 3.665%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	Preliminary CPI M/M% (Y/Y%)	Dec	*-0.1 (9.3)*	-0.1 (10.1)
		10.00	Preliminary core CPI Y/Y%	Dec	*5.1*	5.0
		10.00	European Commission Economic sentiment indicator	Dec	94.5	93.7
		10.00	European Commission industrial (services) confidence	Dec	-1.3 (3.2)	-2.0 (2.3)
		10.00	European Commission final consumer confidence	Dec	-22.2	-23.9
		10.00	Retail sales M/M% (Y/Y%)	Nov	0.5 (-3.1)	-1.8 (-2.7)
Germany		07.00	Retail sales M/M% (Y/Y%)	Nov	1.5 (-5.9)	-2.7 (-6.5)
		07.00	Factory orders M/M% (Y/Y%)	Nov	-0.5 (-5.8)	0.8 (-3.2)
France		07.45	Consumer spending M/M% (Y/Y%)	Nov	1.1 (-5.1)	-2.8 (-5.9)
UK		09.30	Construction PMI	Dec	-	50.4

Auctions and events

Country		GMT	Event
Euro area		10.35	ECB's Centeno scheduled to speak at a conference
		16.15	ECB Chief Economist Lane scheduled to speak on a panel discussion on the Global Economic Outlook

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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