

# Euro wrap-up

## Overview

- Euro area govies followed USTs higher as euro area headline inflation fell to a four-month low, the Commission's price expectations indices moderated and German factory orders plunged.
- Gilts also made large gains as the UK construction PMIs signalled the steepest contraction in the sector since May 2020.
- The coming week brings euro area labour market figures, an ECB consumer expectations survey and UK GDP figures for November.

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### Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.566	-0.046
OBL 1.3 10/27	2.242	-0.095
DBR 1.7 08/32	2.220	-0.107
UKT 1 04/24	3.425	-0.103
UKT 1¼ 07/27	3.445	-0.110
UKT 4¼ 06/32	3.471	-0.080

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

## Euro area

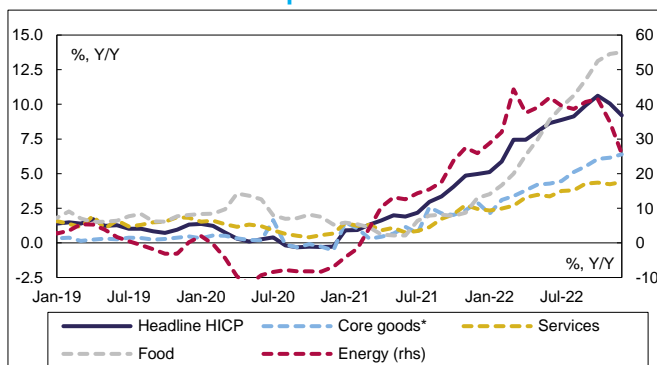
### Inflation drops to a 4-month low in December, but core rate up to new series high

According to the flash data, euro area consumer price inflation slowed 0.9ppt in December to a four-month low of 9.2%Y/Y, firmly below the consensus forecast ahead of the release of the national figures, albeit broadly in line with expectations following the successive downside surprises from the member states. The detail confirmed that the drop in inflation was driven by lower energy inflation, thanks to government interventions including the German government's special payments towards household bills, as well as lower petrol prices. Indeed, energy prices fell 6.5%M/M, the steepest monthly drop on the series, pushing the respective annual rate down more than 9ppts to a fourteen-month low of 25.7%Y/Y. In contrast, inflation of the other major items increased. In particular, the food, alcohol and tobacco component rose 0.2ppt to a new high of 13.8%Y/Y, thus accounting for roughly one third of all inflation, a larger share than energy prices for the first time since February 2021. Nevertheless, the monthly increase in food prices of 0.7%M/M was the lowest in one year. Within the core items, non-energy industrial goods inflation rose 0.3ppt to 6.4%Y/Y, with the monthly increase of 0.4%M/M the biggest in any December on the series. But while services inflation also rose, up 0.2ppt to a series high of 4.4%Y/Y, that principally reflected the unusually weak figure in December 2021. Indeed, the monthly increase in services prices of 0.7%M/M was below the long-run average for the respective month for the first time since June. However, with both services and non-energy industrial goods inflation higher, core inflation rose 0.2ppt to 5.2%Y/Y, a new series high.

### Business and consumer price expectations moderate

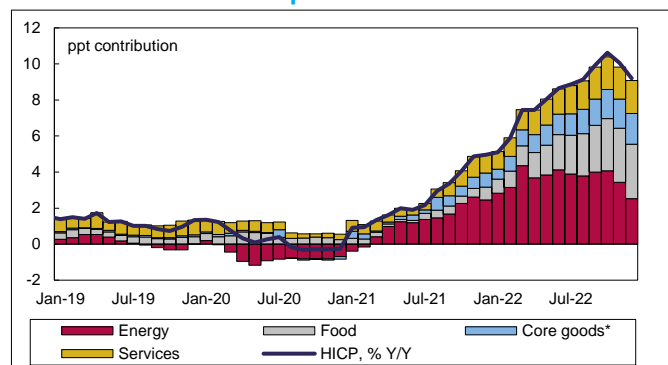
Given the rise in core inflation in December, the hawks on the Governing Council are likely to continue to insist on a further rate hike of 50bps at the next policy meeting in early February. However, while the re-weighting of the inflation basket raises some uncertainty, and household energy bills will increase in some member states this month, we expect both headline and core inflation to fall steadily from January on. Certainly, wholesale, producer and import price data suggest that pipeline pressures in the core goods sector are moderating. After services prices were better behaved in December, wage data do not point to further major pressure on this component over coming months. Moreover, today's Commission survey results for last month suggest that risks of second-round effects via inflation expectations are abating somewhat. While still firmly above the respective long-run averages, selling price expectations for the coming three months declined in every sector, with the indices for retailers and industrial firms down to the lowest in ten and fourteen months respectively. Moreover, the index of consumer price expectations for the coming twelve months fell for the third successive month to the lowest since April 2021 and a level close to the long-run average. Overall, the evidence strongly suggests that the ECB's inflation projection will be revised down, perhaps significantly, when it is updated in March.

### Euro area: Consumer price inflation



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

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

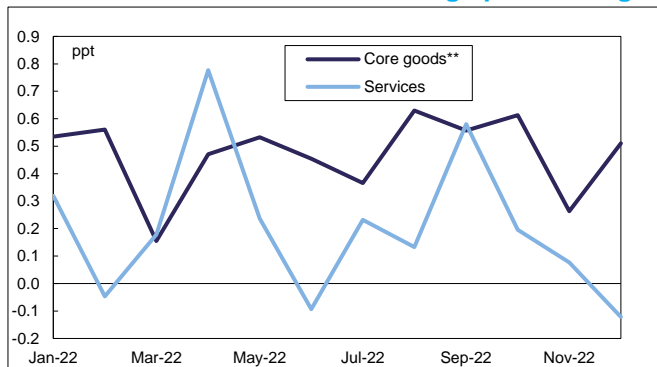
## Economic sentiment improves as price pressures pass their peak

With price pressures seemingly passing their peak, the Commission survey suggested that economic confidence improved for a second successive month in December, adding to expectations that the downturn in activity will be relatively shallow. In particular, the headline euro area economic sentiment index (ESI) rose 1.8pts to a four-month high of 95.8, still nevertheless firmly below the long-run average (100). Among the large member states, only France registered a deterioration in sentiment in December, although only in Italy was the respective index close to the long-run average. All major sectors registered an improvement. Confidence in industry rose for the first month in ten thanks to improved production expectations. Confidence in services and retail rose to the highest in four and nine months respectively, with both reporting higher demand expectations. Construction firms were also slightly more upbeat, encouraged by diminished concerns about shortages of labour, material and equipment, although a larger share reported inadequate demand. As suggested by the flash estimate, having reached a record low in September, consumer confidence rose for a third successive month. However, while expectations for households' financial situation and the economic outlook improved somewhat, their readiness to make major purchases over the coming twelve months worsened slightly. Consumer fears of unemployment diminished to a six-month low, although firms' own employment expectations were merely stable, admittedly with the respective index still above the long-run average.

## Euro area retail sales rise in November, but still on track for contraction in Q4

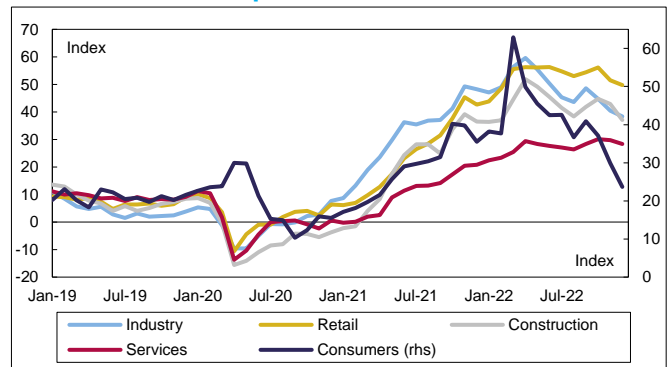
Despite the squeeze on household finances by high inflation and still very weak consumer confidence, today's euro area retail sales figures reported a modest rebound in spending on goods in November. In particular, sales in real terms rose a firmer-than-expected 0.8%M/M amid solid increases in Germany (1.1%M/M), Spain (3.6%M/M) and the Netherlands (1.5%M/M) that more than offset another decline in France (-1.0%M/M). Despite the hit to real disposable income, spending on core items – excluding food and energy – rebounded 1.6%M/M (following a drop of 1.9%M/M in October), with consumers perhaps taking advantage of Black Friday discounting. Meanwhile, auto fuel sales volumes increased (1.0%M/M) as petrol prices fell further. But food store sales fell for the third month out of the past four (-0.9%M/M) to the lowest level since mid-2019 as particularly steep price rises in the sector continued to dampen spending. Overall, retail sales volumes were down 2.8%Y/Y in November, contrasting markedly with the increase of more than 6½%Y/Y in the value of sales. And while the decline in sales volumes in October was slightly smaller than initially estimated (-1.5%M/M), this still left them trending more than ½% lower than the Q3 average.

### Euro area: Deviation from I-r average price change\*



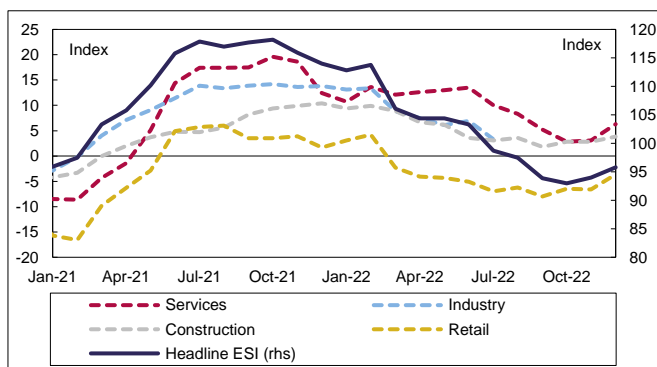
\*Difference in monthly consumer price change from pre-pandemic long-run average. \*\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Price expectations indices



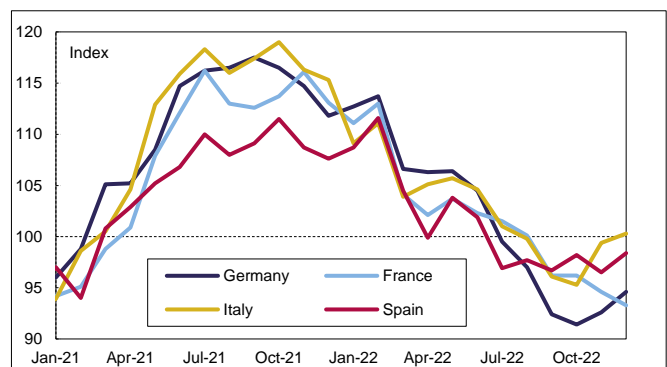
Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Economic sentiment indices



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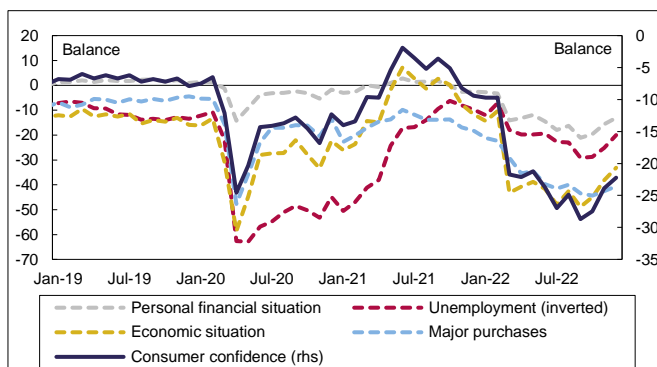
## German new factory orders plunge in November to lowest level since July 2020

German new factory orders in November fell a whopping 5.3%M/M, the most in more than a year. With growth in October revised down to 0.6%M/M, that left orders down a steep 11.0%Y/Y, more than 5% below the pre-pandemic level in February 2020, roughly 20% below the peak in July 2021, and at the lowest level since July 2020. Over the first two months of Q4, orders were trending more than 4½% below the Q3 level, underscoring the likelihood of a third successive big quarterly fall in orders ahead of the New Year. To some extent, the magnitude of the drop in orders reflected bulk items, excluding which orders nevertheless dropped a marked 2.9%M/M. The decline in new orders was led by foreign orders (down 8.1%M/M), particularly from the rest of the euro area (down 10.3%M/M). Orders of capital goods dropped 8.5%M/M, reflecting marked declines in machinery and certain transport items, raising concerns about the weakness of fixed investment in the euro area in Q4. However, new auto orders rose for a second successive month (up 1.1%M/M) while the declines in orders of consumer goods (0.7%M/M) and intermediate items (-0.9%M/M) were moderate. Despite the exceptionally weak figures for new orders, manufacturing turnover rose 2.1%M/M in November, suggesting upside risks to the consensus forecast for Monday's German industrial production data (currently +0.1%M/M). However, survey indicators and the precipitous drop in orders point to the likelihood of subdued output in December and into the New Year. Indeed, the Commission survey suggested that German industrial sentiment remained close to a two-year low in December, with the component for order books falling further.

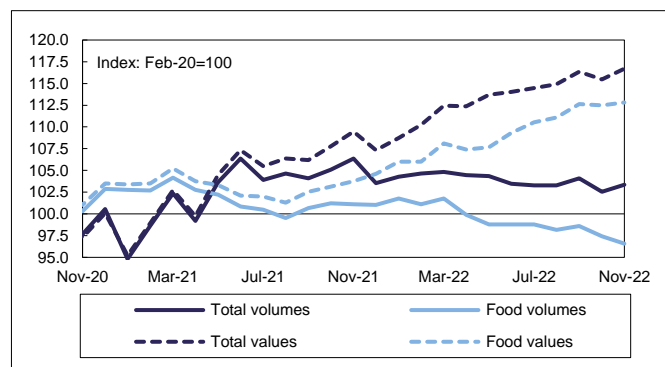
## The week ahead in the euro area

Given the uptick in core inflation and concerns on the ECB Governing Council about the risks of second-round effects related to the tight labour market, the coming week's unemployment figures for November (Monday) will be of note. Despite slowing economic activity, labour market resilience is likely to have continued in the middle of last quarter, with the jobless rate expected to have moved sideways at the series low of 6.5%. The ECB's consumer expectations survey for November (Thursday) will also be watched for further signs of de-anchoring – in October the median household forecast for inflation twelve months ahead rose 0.4ppt to 5.4%Y/Y, and the median forecast for inflation three years ahead moved sideways at 3.0%Y/Y. In addition, the coming week brings the release of November industrial production numbers, with German and Irish data (Monday), and French and Spanish figures (Tuesday) ahead of the Italian and euro area IP numbers (Friday). Following a disappointing start to the fourth quarter, euro area industrial output is expected to rise around ½%M/M, albeit failing to fully reverse the 2.0%M/M drop in October. Euro area goods trade data for November are also due to be published on Friday. Among other releases, the coming week also brings the euro area Sentix investor sentiment survey for January (Monday), and German full-year GDP growth figures for 2022 and final December inflation figures from France and Spain (all Friday).

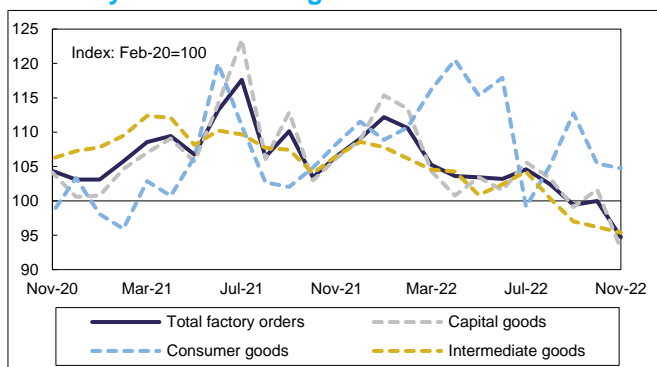
### Euro area: Consumer sentiment indices



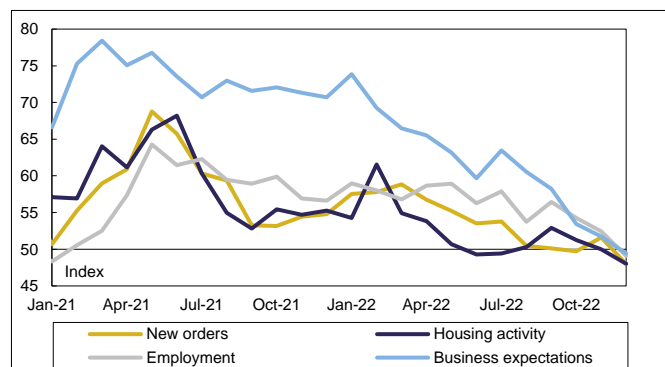
### Euro area: Retail sales



### Germany: Manufacturing orders



### UK: Construction PMIs



## UK










### Construction PMI contracts at the end of 2022 as housing activity slumped

As with the manufacturing and services sector indices, the UK construction PMI survey today suggested that activity in the sector contracted at the end of the year. In particular, the headline index fell for the second successive month in December, by 1.6pts to 48.8, the weakest reading since May 2020. While snow and rail strikes probably played a role, the further steep drop in housing activity – the relevant PMI fell for the third consecutive month and by 1.9pts to 48.0 – seems bound to be related to the ongoing adjustment in the residential market amid significantly higher borrowing costs and weaker demand. Indeed, given the slump in new business at the end of last year – the index fell 3.6pts to 48.0 – construction firms cut their workforces for the first time since the start of 2021. And given risks of a prolonged recession and still elevated cost burdens, despite a drop in the input price PMI to the lowest level since 2020, firms in the sector were the most downbeat about the coming twelve months since the start of the pandemic, and before that the start of the Global Financial Crisis in 2008.

### The week ahead in the UK

The main data focus in the UK in the coming week will be Friday's GDP report for November. While October saw a moderate rebound – with GDP up 0.5%M/M – as the UK returned to regular working days following the Queen's funeral in September, we expect growth to have returned to negative territory in November as high inflation and rising interest rates hit business and household spending. Retail sales were down 0.4%M/M in November, while high frequency data suggest a notable decline in restaurant bookings that month too. Survey indicators such as the PMIs suggest that economic activity in manufacturing and services alike contracted that month too. Overall, we think GDP might well have reversed much of the increase in October to leave it down as much as ½%3M/3M. Ahead of the GDP release, the week is set to be very quiet on the data front with only the BRC retail sales monitor for December (Tuesday), which will provide an insight into consumer spending in the final month of Q4. Despite disruption from snow and rail strikes, the BRC suggest that footfall was around 15% higher than in December 2021 as the High Street benefitted from postal strikes, which likely hit internet shopping.



























## Daiwa economic forecasts

	2022			2023			2022	2023	2024
	Q2	Q3	Q4	Q1	Q2	Q3			
<b>GDP</b>	<b>%, Q/Q</b>						<b>%, Y/Y</b>		
Euro area 	0.8	0.3	-0.3	-0.3	-0.1	0.1	3.3	-0.1	1.0
UK 	0.1	-0.3	-0.3	-0.3	-0.5	-0.3	4.0	-1.2	0.1
<b>Inflation, %, Y/Y</b>									
Euro area									
Headline HICP 	8.0	9.3	10.0	7.9	6.0	4.3	8.4	5.1	1.9
Core HICP 	3.7	4.4	5.1	4.9	4.1	3.2	3.9	3.6	1.9
UK									
Headline CPI 	9.2	10.0	10.7	9.8	7.9	6.7	9.1	7.3	3.2
Core CPI 	6.0	6.3	6.3	5.8	4.6	3.9	5.9	4.5	3.0
<b>Monetary policy, %</b>									
ECB									
Refi Rate 	0.00	1.25	2.50	3.50	3.50	3.50	2.50	3.50	3.00
Deposit Rate 	-0.50	0.75	2.00	3.00	3.00	3.00	2.00	3.00	2.50
BoE									
Bank Rate 	1.25	2.25	3.50	4.25	4.25	4.25	3.50	4.25	3.25

Source: Bloomberg, ECB, BoE 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> <i>forecast/actual</i>	Previous
<b>Monday 09 January 2023</b>					
Euro area	 09.30	Sentix investor confidence	Jan	-16.5	-21.0
	 10.00	Unemployment rate %	Nov	6.5	6.5
Germany	 07.00	Industrial production M/M% (Y/Y%)	Nov	0.2 (0.1)	-0.1 (0.0)
France	 07.45	Trade balance €bn	Nov	-	-12.2
Italy	 09.00	Unemployment rate %	Nov	7.8	7.8
<b>Tuesday 10 January 2023</b>					
France	 07.45	Industrial production M/M% (Y/Y%)	Nov	0.8 (-1.3)	-2.6 (-2.7)
	 07.45	Manufacturing production M/M% (Y/Y%)	Nov	-	-2.0 (0.0)
Spain	 08.00	Industrial production M/M% (Y/Y%)	Nov	-0.4 (0.1)	-0.4 (2.5)
UK	 00.01	BRC retail sales monitor, like-for-like sales Y/Y%	Dec	-	4.1
<b>Wednesday 11 January 2023</b>					
Italy	 09.00	Retail sales M/M% (Y/Y%)	Nov	-	-0.4 (1.3)
<b>Thursday 12 January 2023</b>					
- Nothing scheduled -					
<b>Friday 13 January 2023</b>					
Euro area	 10.00	Industrial production M/M% (Y/Y%)	Nov	0.5 (0.5)	-2.0 (3.4)
	 10.00	Trade balance €bn	Nov	-20.0	-28.3
Germany	 09.00	GDP Y/Y% (Budget maasticht % of GDP)	2022	1.8 (-)	2.6 (-3.7)
France	 07.45	Final CPI M/M% (Y/Y%)	Dec	<u>-0.1 (5.9)</u>	0.3 (6.2)
	 07.45	Final HICP M/M% (Y/Y%)	Dec	<u>-0.1 (6.7)</u>	0.4 (7.1)
Italy	 09.00	Industrial production M/M% (Y/Y%)	Nov	0.2 (-)	-1.0 (-1.6)
Spain	 08.00	Final CPI M/M% (Y/Y%)	Dec	<u>0.3 (5.8)</u>	-0.1 (6.8)
	 08.00	Final HICP M/M% (Y/Y%)	Dec	<u>0.1 (5.6)</u>	-0.3 (6.7)
UK	 07.00	GDP M/M% (3M/3M)	Nov	-0.3 (-0.3)	0.5 (-0.3)
	 07.00	Industrial production M/M% (Y/Y%)	Nov	-0.3 (3.1)	0.0 (-2.4)
	 07.00	Manufacturing production M/M% (Y/Y%)	Nov	-0.3 (-5.3)	0.7 (-4.6)
	 07.00	Index of services M/M% (3M/3M%)	Nov	-0.2 (-0.2)	0.6 (-0.1)
	 07.00	Construction output M/M% (Y/Y%)	Nov	-0.3 (5.7)	0.8 (7.4)
	 07.00	Goods trade balance (excluding precious metals) £bn	Nov	-14.9 (-)	-14.5 (-19.7)
	 -	PPI output prices* M/M% (Y/Y%)	Nov	0.3 (16.4)	0.9 (17.1)
	 -	PPI input prices* M/M% (Y/Y%)	Nov	0.2 (18.0)	0.7 (19.5)











\*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### The coming week's key events & auctions

Country	GMT	Event / Auction
<b>Monday 09 January 2023</b>		
UK 	15.30	BoE's Chief Economist Pill set to speak on the UK economic and monetary policy outlook
<b>Tuesday 10 January 2023</b>		
Euro area 	09.30	ECB's Schnabel. BoE Governor Bailey and US Fed Chair Powel scheduled to speak on Central Bank independence
Germany 	10.30	Auction: €500mn of 0.10% 2033 index-linked bonds
UK 	10.00	Auction: £3bn of 3.25% 2033 bonds
<b>Wednesday 11 January 2023</b>		
Germany 	10.30	Auction: €5bn of 0.00% 2033 bonds
<b>Thursday 12 January 2023</b>		
Euro area 	09.00	ECB publishes its Economic Bulletin
Euro area 	09.00	ECB publishes Consumer Expectations Survey results for November
Italy 	10.00	Auction: 3Y and 7Y bonds
Spain 	09.30	Auction: 2.80% 2026 bonds
Spain 	09.30	Auction: 0.80% 2029 bonds
Spain 	09.30	Auction: 2.90% 2046 bonds
Spain 	09.30	Auction: 0.70% 2033 index-linked bonds
UK 	17.00	BoE's Mann scheduled to speak on the challenges facing the UK economy and monetary policy
<b>Friday 13 January 2023</b>		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Today's results

Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area 	Preliminary CPI M/M% (Y/Y%)	Dec	<b>-0.3 (9.2)</b>	<u>-0.1 (9.3)</u>	-0.1 (10.1)	-
Euro area 	Preliminary core CPI Y/Y%	Dec	<b>5.2</b>	<u>5.1</u>	5.0	-
Euro area 	European Commission Economic sentiment indicator	Dec	<b>95.8</b>	94.7	93.7	<b>94.0</b>
Euro area 	European Commission industrial (services) confidence	Dec	<b>-1.5 (6.3)</b>	-1.3 (3.3)	-2.0 (2.3)	<b>-1.9 (3.1)</b>
Euro area 	European Commission final consumer confidence	Dec	<b>-22.2</b>	-22.2	-23.9	-
Euro area 	Retail sales M/M% (Y/Y%)	Nov	<b>0.8 (-2.8)</b>	0.6 (-3.1)	-1.8 (-2.7)	<b>-1.5 (-2.6)</b>
Germany 	Retail sales M/M% (Y/Y%)	Nov	<b>1.1 (-5.7)</b>	1.5 (-5.9)	-2.8 (-6.6)	<b>- (-6.5)</b>
Germany 	Factory orders M/M% (Y/Y%)	Nov	<b>-5.3 (-11.0)</b>	-0.5 (-5.8)	0.8 (-3.2)	<b>0.6 (-3.3)</b>
France 	Consumer spending M/M% (Y/Y%)	Nov	<b>0.5 (-5.2)</b>	1.1 (-5.1)	-2.8 (-5.9)	<b>-2.7 (-5.4)</b>
UK 	Construction PMI	Dec	<b>48.8</b>	-	50.4	-
Auctions						
Country	Auction					
- Nothing scheduled -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.



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