Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds were little changed as a rebound in euro area IP in November was confirmed, while German full-year GDP data pointed to resilience in Q4.
- Gilts made losses as UK GDP beat expectations in November, eking out a second-successive month of growth.
- The coming week brings the ECB's account from its December policy-setting meeting, updated euro area and UK December inflation estimates, and UK labour market and retail sales reports.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.552	+0.013
OBL 1.3 10/27	2.172	-0.003
DBR 1.7 08/32	2.143	-0.005
UKT 1 04/24	3.469	+0.029
UKT 1¼ 07/27	3.284	+0.045
UKT 4¼ 06/32	3.349	+0.017

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

Euro area

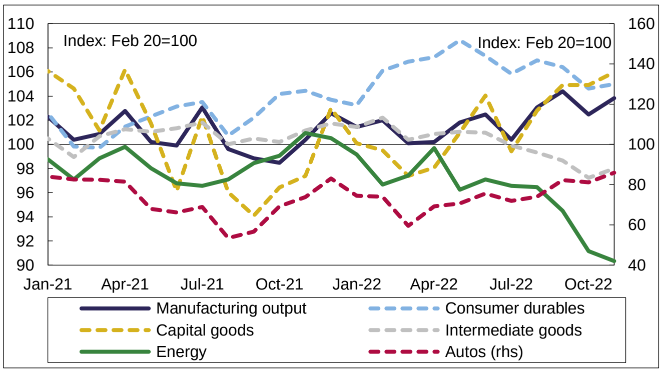
Euro area IP rose in November, driven by a rebound in autos as supply constraints ease

Consistent with the moderate easing in supply-side challenges signalled in recent manufacturing sector surveys, and the rebound in production reported by several member states over the past week, euro area industrial production rose in November for the third month out of the past four and by 1%M/M, to leave production up 0.3%3M/3M. Admittedly, given the plunge in October (-1.9%M/M), the level of output was trending in the first two months of Q4 some 0.3% below the Q3 average, suggesting that industry was a modest drag on GDP growth last quarter. But this principally reflected weaker energy production, which in November was down for the fifth consecutive month, with the 0.9%M/M drop taking it to a new euro-era low with the exception the initial pandemic trough in April 2020. In contrast, manufacturing output was up a firmer 1.3%M/M and 1.6%3M/3M, therefore maintaining the upwards trend in place since the summer. Growth in November was driven by a further rebound in the autos sector, with car production up 5.9%M/M and 12.5%3M/3M to its highest since December 2020, albeit still remaining some 14% below the pre-pandemic level. There was also the first increase in intermediate goods production in six months (0.8%M/M), related not least to modest growth in energy-intensive subsectors including the first rise in chemicals output this year (0.2%M/M). And while production of consumer non-durables fell back in November (-1.3%M/M) this was down from a series high in September to be still trending some 2% above the Q3 average.

Euro area trade deficit narrows thanks to a pickup in exports and drop in import values

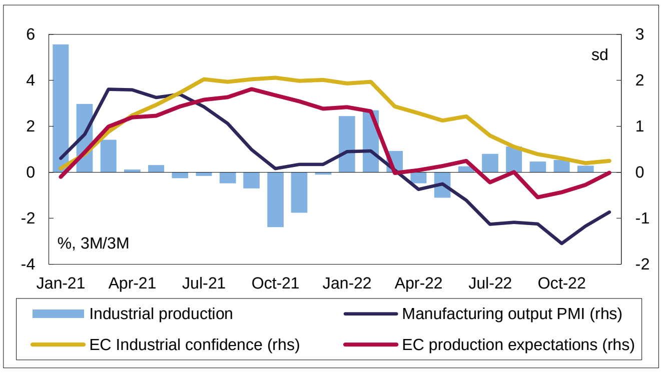
While ample backlogs should support ongoing growth in output over the near term, and the easing in Covid restrictions in China might in due course further ease supply constraints and provide additional impetus to demand, many manufacturers will be concerned about the recent marked downtrend in new orders, particularly from overseas. Indeed, the respective European Commission survey index fell in December to its lowest level since March 2021. Nevertheless, the latest goods trade report showed that the improvement in manufacturing output in November was accompanied by a pickup in shipments. In particular, the value of exports rose for the third month out of the past four, by 1.0%M/M, with increases of shipments to the US, Japan and UK of between 2-3%M/M offsetting a further decline to China (-3.5%M/M). This left the total value of exports in the first two months of Q4 some 2½% above the Q3 average. And with the value of imports falling (-3.8%M/M) for the third consecutive month, to be trending more than 4½% below the Q3 average, the goods trade deficit narrowed significantly further in November, by €12.9bn to €15.2bn, the smallest for nine months. Of course, the improving trade performance will in no small part reflect the marked decline in energy and commodity prices over recent months. But with the drop in import volumes (-2.9%M/M) exceeding that of export volumes (-2.2%M/M) in October, today's report adds to evidence that net trade provided welcome support to euro area GDP last quarter.

Euro area: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production & sentiment indices



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

Full-year German GDP figure suggests Q4 contraction might have been avoided

The first estimate of German full-year GDP for 2022 reported growth of 1.9%Y/Y, down from 2.6%Y/Y in 2021. That was a touch stronger than expected, about 0.5ppt above the average of the two decades ahead of the pandemic, and enough to take GDP 0.7% above the level in 2019. Given fewer working days in 2022, on a calendar-adjusted basis GDP was up 2.0%Y/Y. On a quarterly basis, growth in 2022 peaked in Q1 at 0.8%Q/Q. And given the energy-price shock, momentum weakened significantly in Q4 after growth of 0.4%Q/Q in Q3. The first estimate of GDP in Q4 will not be published until 31 January. And given issues related to seasonal adjustment, possible revisions and rounding, today's full-year GDP figures cannot tell us with any precision the extent of the slowdown at the end of the year. But encouragingly, given the range of possible outcomes consistent with today's full-year growth figures, they suggest that German GDP might have avoided a contraction in Q4. Nevertheless, for the time being, in part due to the weakness in retail activity, we maintain our forecast of a modest decline in Q4, although at 0.1%Q/Q this would be a much smaller drop than was initially feared.

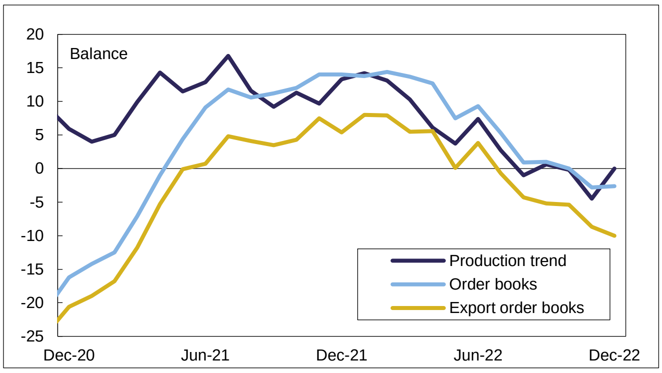
ECB survey reports easing in backward- and forward-looking inflation indicators

With inflation expectations seemingly having risen steadily over much of the past year, and ECB Governing Council members concerned about risks of a lasting de-anchoring, yesterday's results from its November consumer survey provided some better news. Indeed, consistent with the recent downtrend in the Commission survey measures of price expectations, and moderating cost pressures reported in the PMIs, all of the ECB survey price gauges fell back, with declines in backward- and forward-looking indicators alike. For example, while highly elevated, the mean perception of inflation over the previous twelve months eased 0.3ppt to 11.2%Y/Y in November, with the mean expectation for inflation twelve months ahead down 0.6ppt to 7.3%Y/Y, and the median forecast over that timeframe down 0.4ppt to a four-month low of 5.0%Y/Y. Also encouragingly, inflation expectations three years ahead fell for the first time in six months, with the mean forecast down 0.3ppt to 4.6%Y/Y and the median down 0.1ppt to 2.9%Y/Y, with a notable drop in Germany's median expectation of 0.5ppt to 2.4%Y/Y. Moreover, given the lagged publication of these results, and the subsequent decline in oil and commodity prices in December and the current month, we expect to see a further sizeable downwards adjustment in price expectations in coming surveys too.

The week ahead in the euro area

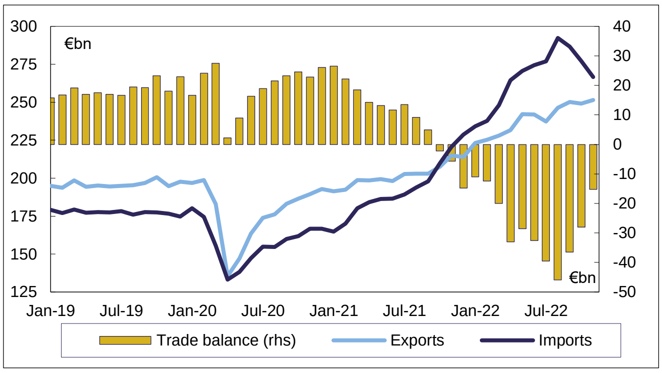
The euro area focus in the coming week will be the publication on Thursday of the ECB account from the [December monetary policy meeting]. While that saw the Governing Council moderate the pace of tightening to 50bps, taking the deposit rate to a broadly neutral level of 2.00% and the cumulative tightening since July to 250bps, the ECB's message was unambiguously hawkish. At the same time, the Governing Council announced that quantitative tightening will start from March onwards, with its APP portfolio to be reduced at a "measured and predictable pace", limiting the amount of principal payments from maturing bonds that will be reinvested. Further details on the debate between the doves and the hawks

Euro area: Commission industrial survey indices



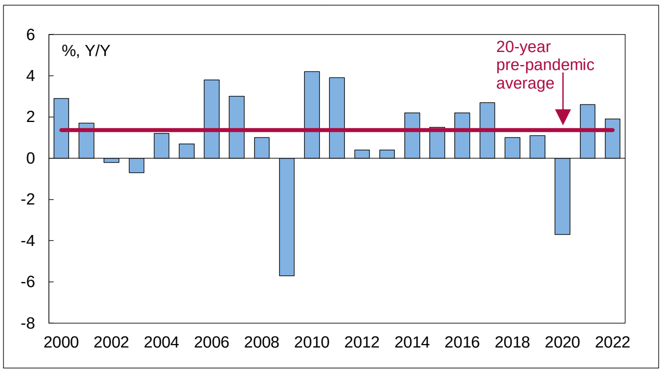
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade balance*



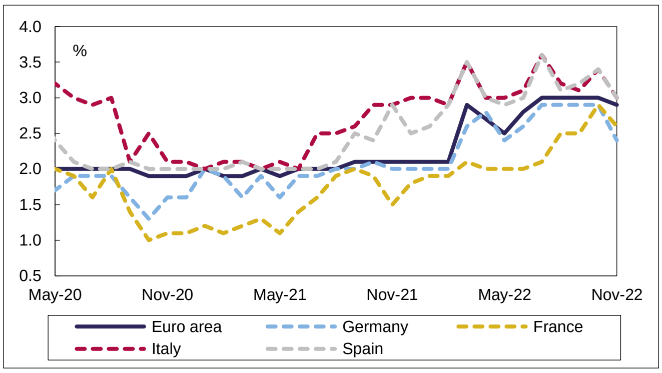
*Seasonally adjusted values. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Full-year GDP growth



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price expectations*



*Median inflation expectations three-years ahead. Source: ECB and Daiwa Capital Markets Europe Ltd.

surrounding these decisions will be closely analysed, as well as any additional clarity on members' expectations for how much further interest rates might need to rise this cycle.

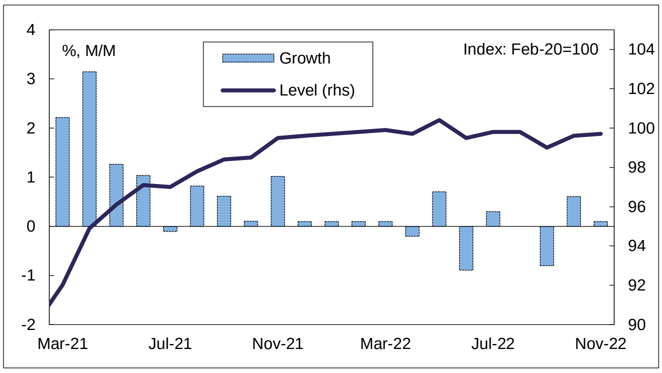
Data-wise, the coming week is set to be relatively quiet for euro area releases, with just final December inflation figures, new car registrations numbers for the same month, and construction output data for November all due on Wednesday. According to the flash data, euro area consumer price inflation slowed 0.9ppt in December to a four-month low of 9.2%Y/Y. 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. But core inflation ticked higher last month, to a new record 5.2%Y/Y, as core goods and services inflation rose. This release will offer more granular detail. Final inflation figures from Germany and Italy will be published on Tuesday. Also due that day is the German ZEW investor sentiment survey for January, which will shed some light on investors' inflation expectations, as well as the general economic outlook. And German PPI figures (Friday) will be watched for price pressures in the manufacturing sector.

UK

GDP edges up in November thanks to increased services activity

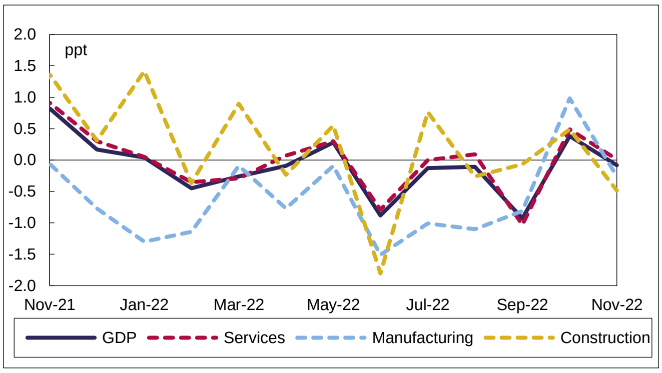
Contrary to expectations of a drop, UK GDP eked out modest growth of 0.1%M/M in November following the rebound of 0.5%M/M the prior month. Growth in November came largely from the services sector, where activity increased 0.2%M/M following growth of 0.7%M/M in October. While administrative and support services, as well as ICT, made the biggest contributions, hospitality also provided a positive impetus, seemingly buoyed by the start of the FIFA World Cup. However, despite the increase in November, overall output in consumer-facing services remained some 8.5% below the pre-pandemic level, with other services up 2.0% on that basis, illustrating the persistent impact of the coronavirus on spending behaviour. Beyond the services sector, UK economic activity was more predictably underwhelming in November. Manufacturing output dropped 0.5%M/M, marking the fifth decline in six months, despite a third successive increase in auto production as supply-chain disruption eased. While increased extraction of oil and gas provided some offset, overall industrial production fell 0.2%M/M after a drop of 0.1%M/M in October. And construction output was unchanged in November following downwardly revised growth of 0.4%M/M the prior month.

UK: Monthly GDP growth and level



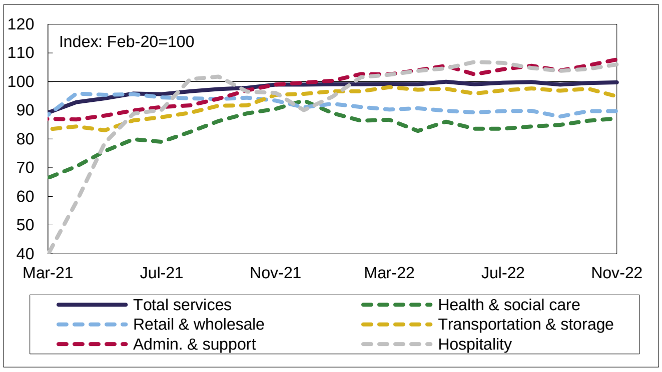
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Output – deviation from l-r average*



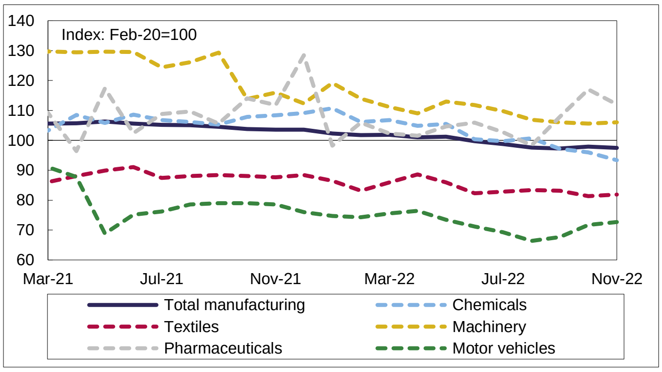
**Difference in monthly growth from 2010-2019 average. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

UK: Services output – selected subsectors



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Industrial output – selected subsectors



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Decline in Q4 might be avoided but contraction still likely in the first half of 2023

Given the steep drop of 0.8%M/M in September, GDP was still down 0.3%3M/3M in November and also 0.3% below the pre-pandemic level in February 2020. However, the average level of GDP in the first two months of Q4 was broadly in line with the Q3 average, raising the possibility that a second successive quarterly decline was avoided. Nevertheless, harsh winter weather and increased rail and postal strike activity in December will have weighed more heavily on several sectors, including transport and storage, wholesaling and particularly construction. So, we think that GDP still probably declined last quarter, but only by about 0.1%Q/Q – bang in line with the BoE's forecast in its November Monetary Policy Report – following the drop of 0.3%Q/Q in Q3. Looking ahead, however, we still expect GDP to decline in the first half of 2023, not least as energy bills and taxes are set to rise further in April, mortgage payments are rising sharply for many households, and so real pay set will fall again close to the record pace of 2022. Higher debt interest payments will weigh on business spending too. But with scope for household energy bills to be cut from October if wholesale gas prices remain close to current levels, private consumption and GDP now appear to have greater scope to return to growth by the end of the year than had previously appeared to be the case last autumn. So, we expect the BoE's GDP projection to be revised up when it publishes an updated Monetary Policy Report in February.

The week ahead in the UK

It is set to be a busy week ahead for top-tier UK economic releases, with the latest labour market and CPI inflation numbers (on Tuesday and Wednesday respectively) of particular interest. Recent leading indicators – including the softer REC/KPMG survey indices and decline in online job adverts to below the pre-pandemic level for the first time since April 2021 – point to a weakening in labour demand over recent months. We expect the coming week's figures to report a drop in employment in the three months to November to push the unemployment rate up to a five-month high of 3.8%. Much might depend on what happens to inactivity, which is likely to remain elevated. And wage growth is expected to remain strong at above 6.0%3M/Y, albeit this would still leave real wage growth firmly in negative territory. Indeed, despite being off the peak, inflation in November remained firmly in double-digit territory (10.7%Y/Y). We expect inflation to have eased further in December, with the headline CPI rate down 0.3ppt to 10.4%Y/Y, due principally to declining energy prices. Core is likely to remain stickier, with our expectation for a drop of just 0.1ppt to 6.2%Y/Y. Amid declining real disposable incomes, Friday's retail sales data look set to show that the trend in household spending remained very weak, with the latest GfK consumer survey likely to show that sentiment remained historically subdued at the start of 2023 too. In addition, the RICS residential and BoE credit conditions surveys (both due Thursday) will provide an update on the housing market and lending conditions amid the sharp rise in borrowing costs in the fourth quarter of last year.

The next edition of the Euro wrap-up will be published on 17 January 2023

Daiwa economic forecasts

	2022			2023					
	Q2	Q3	Q4	Q1	Q2	Q3	2022	2023	2024
GDP	%, Q/Q						%, Y/Y		
Euro area	0.8	0.3	0.0	0.0	0.1	0.1	3.4	0.5	1.0
UK	0.1	-0.3	-0.1	-0.2	-0.3	-0.2	4.1	-0.7	0.4
Inflation, %, Y/Y									
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	9.7	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
Monetary policy, %									
ECB									
Refi Rate	0.00	1.25	2.50	3.25	3.50	3.50	2.50	3.50	3.00
Deposit Rate	-0.50	0.75	2.00	2.75	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/ *Daiwa forecast/actual*	Previous
			Monday 16 January 2023			
			- Nothing scheduled -			
			Tuesday 17 January 2023			
Germany		07.00	Final CPI M/M% (Y/Y%)	Dec	*-0.8 (8.6)*	-0.5 (10.0)
		07.00	Final HICP M/M% (Y/Y%	Dec	*-1.2 (9.6)*	0.0 (11.3)
		10.00	ZEW current situation (expectations) balance	Jan	-58.5 (-15.0)	-61.4 (-23.3)
Italy		09.00	Final CPI M/M% (Y/Y%)	Dec	*0.3 (11.6)*	0.5 (11.8)
		09.00	Final HICP M/M% (Y/Y%	Dec	*0.2 (12.3)*	0.7 (12.6)
UK		07.00	Unemployment claimant count rate % (change '000s)	Dec	-	3.9 (30.5)
		07.00	Payrolled employees, change '000s	Dec	63	107
		07.00	ILO unemployment rate %, 3M	Nov	3.7	3.7
		07.00	Employment change, 3M/3M '000s	Nov	5	27
		07.00	Average weekly earnings (excluding bonuses) 3M/Y%	Nov	6.1 (6.3)	6.1 (6.1)
			Wednesday 18 January 2023			
Euro area		07.00	EU27 new car registrations Y/Y%	Dec	-	16.3
		10.00	Final CPI M/M% (Y/Y%)	Dec	*-0.3 (9.2)*	-0.1 (10.1)
		10.00	Final core CPI Y/Y%	Dec	*5.2*	5.0
		10.00	Construction output M/M% (Y/Y%)	Nov	-	1.3 (2.2)
Italy		09.00	Trade balance €bn	Nov	-	-2.1
UK		07.00	CPI M/M% (Y/Y%)	Dec	*0.3 (10.4)*	0.4 (10.7)
		07.00	Core CPI Y/Y%	Dec	*6.2*	6.3
		09.30	House price index Y/Y%	Nov	-	12.6
		09.30	Final output per hour Y/Y%	Q3	1.4	0.4
			Thursday 19 January 2023			
Euro area		09.00	Current account balance €bn	Nov	-	-0.4
Spain		09.00	Trade balance €bn	Nov	-	-6.9
UK		00.01	RICS house price balance %	Dec	-30	-25
			Friday 20 January 2023			
Germany		07.00	PPI M/M% (Y/Y%)	Dec	-1.1 (20.9)	-3.9 (28.2)
France		-	Retail sales Y/Y%	Dec	-	-3.1
UK		00.01	GfK consumer confidence	Jan	-42	-42
		07.00	Retail sales including auto fuels M/M% (Y/Y%)	Dec	0.5 (-4.2)	-0.4 (-5.9)
		07.00	Retail sales excluding auto fuels M/M% (Y/Y%)	Dec	0.3 (-4.6)	-0.3 (-5.9)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
		Monday 16 January 2023
Euro area	-	ECB President Lagarde and Board Member Panetta attend Eurogroup meeting
UK	15.00	BoE Governor to testify before Treasury Select Committee on financial stability
		Tuesday 17 January 2023
Germany	10.30	Auction: €5bn of 0% 2028 bonds
UK	10.00	Auction: £4bn of 3.5% 2025 bonds
		Wednesday 18 January 2023
Germany	10.30	Auction: €1.5bn of 1.8% 2053 bonds
	10.30	Auction: €1.0bn of 2050 bonds
		Thursday 19 January 2023
Euro area	12.30	ECB publishes account of 14-15th December monetary policy meeting
	12.30	ECB President Lagarde in panel discussion 'Finding Europe's new growth' at the World Economic Forum in Davos
	17.00	ECB's Schnabel scheduled to speak on "Monetary policy in times of pandemic and war"
France	09.50	Auction: 0.00% 2025 bonds
	09.50	Auction: 0.75% 2028 bonds
	09.50	Auction: 0.50% 2029 bonds
	10.50	Auction: 0.10% 2029 index-linked bonds
	10.50	Auction: 0.10% 2032 index-linked bonds
	10.50	Auction: 0.10% 2036 index-linked bonds
Spain	09.30	Auction: 0.0% 2028 bonds
	09.30	Auction: 0.5% 2030 bonds
	09.30	Auction: 4.9% 2040 bonds
UK	09.30	BoE to publish credit conditions survey results for Q422
	11.30	Auction: £1.1bn of 0.125% 2031 index-linked bonds
		Friday 20 January 2023
Euro area	12.00	ECB President Lagarde in panel discussion on 'Global economic outlook' at the World Economic Forum in Davos

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Industrial production M/M% (Y/Y%)	Nov	**1.0 (2.0)**	0.5 (0.5)	-2.0 (3.4)	**-1.9 (-)**
	Trade balance €bn	Nov	**-15.2**	-20.0	-28.3	**-28.1**
Germany	GDP Y/Y% (Budget maastricht % of GDP)	2022	**1.9 (-2.6)**	1.8 (-2.6)	2.6 (-3.7)	-
France	Final CPI M/M% (Y/Y%)	Dec	**-0.1 (5.9)**	*-0.1 (5.9)*	0.3 (6.2)	-
	Final HICP M/M% (Y/Y%)	Dec	**-0.1 (6.7)**	*-0.1 (6.7)*	0.4 (7.1)	-
Italy	Industrial production M/M% (Y/Y%)	Nov	**-0.3 (-3.7)**	0.4 (-)	-1.0 (-1.6)	**-1.1 (-)**
Spain	Final CPI M/M% (Y/Y%)	Dec	**0.2 (5.7)**	*0.3 (5.8)*	-0.1 (6.8)	-
	Final HICP M/M% (Y/Y%)	Dec	**0.0 (5.5)**	*0.1 (5.6)*	-0.3 (6.7)	-
UK	GDP M/M% (3M/3M)	Nov	**0.1 (-0.3)**	-0.2 (-0.3)	0.5 (-0.3)	**- (-0.4)**
	Industrial production M/M% (Y/Y%)	Nov	**-0.2 (-5.1)**	-0.2 (-2.8)	0.0 (-2.4)	**-0.1 (-4.7)**
	Manufacturing production M/M% (Y/Y%)	Nov	**-0.5 (-5.9)**	-0.2 (-4.8)	0.7 (-4.6)	**- (-5.7)**
	Index of services M/M% (3M/3M%)	Nov	**0.2 (-0.1)**	-0.1 (0.0)	0.6 (-0.1)	**0.7 (-)**
	Construction output M/M% (Y/Y%)	Nov	**0.0 (4.0)**	-0.3 (5.4)	0.8 (7.4)	**0.4 (5.9)**
	Goods trade balance (excluding precious metals) £bn	Nov	**-15.6 (-21.0)**	-14.9 (-)	-14.5 (-19.7)	**-12.3 (-19.5)**

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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