Euro wrap-up

Overview

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- While the flash euro area PMIs pointed to further stabilisation of economic activity and some continued pressures on output prices at the start of 2023, Bunds made gains as Bank of France Governor Villeroy said that inflation will likely be back at the 2% target by the end of 2024 or early 2025.
- Gilts outperformed as the flash UK PMIs suggested the steepest pace of contraction in two years as well as moderating input cost and output price pressures.
- Wednesday will bring the German ifo business survey for January as well as UK producer price inflation data for November and December.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.527	-0.044
OBL 2.2 04/28	2.180	-0.049
DBR 2.3 02/33	2.150	-0.047
UKT 1 04/24	3.376	-0.089
UKT 1¼ 07/27	3.175	-0.096
UKT 4¼ 06/32	3.280	-0.081

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

Euro area

Flash PMIs suggest a return to growth in services and easing challenges for manufacturers

The flash euro area PMIs for January came in a touch firmer than expected, implying further stabilisation in economic conditions at the start of the New Year and further adding to cautious optimism that the region might well avoid recession. In particular, the headline composite PMI rose for the third consecutive month, by 0.9pt to 50.2, the first non-contractionary reading since June, albeit one that is merely consistent with stagnation of output. The improvement was driven by an implied return to growth in services for which the activity index increased 0.9pt to a six-month high of 50.7. There was also a softer pace of decline in manufacturing output, for which the respective index rose 1.2pts to an eight-month high of 49.0, as firms reported that supplier delivery times failed to rise for just the second month since the start of the pandemic. S&P Global suggested that growth in January was driven by technology, healthcare and pharmaceuticals subsectors, while there was an easing in the downturn in real estate, and consumer-facing services including tourism and recreation had shown signs of stabilisation. Amid a softer pace of decline in new orders, services and manufacturing firms alike were more upbeat about the outlook for output over the coming twelve months, with the respective composite index posting the strongest monthly rise (4.3pts) since June 2020. Firms reported a pickup in job growth too.

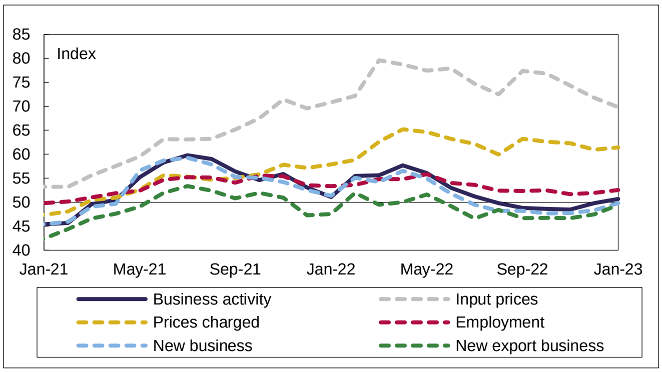
Input costs continue to moderate, but firms' prices charged accelerate in January

With supply pressures easing and wholesale energy prices having declined further around the turn of the year, firms reported another notable moderation in input costs in January, with the composite input price PMI declining for the ninth month out of the past ten, to 66.0, the lowest since April 2021 and some 15½pts below last year's peak. This largely reflected a drop of more than 5pts in the manufacturing cost index to 55.8, back below the pre-pandemic average for the first time since November 2020. Disappointingly, however, output prices charged in manufacturing and services reportedly accelerated slightly in January, with the respective composite PMI edging up to 61.4 to remain well above the pre-pandemic average (50.3). That index is still down significantly from the peak (81.6) reached earlier last year. But given the ongoing tightness in the labour market and persisting concerns of second-round effects on wages, as well as signs of a less severe economic downturn, today's survey might, on balance, be cited by those Governing Council members – including President Lagarde – who are arguing that "significant" interest rate hikes beyond the February policy meeting are still likely to be required.

PMIs suggest stabilisation in Germany's economy, but slight deterioration in France

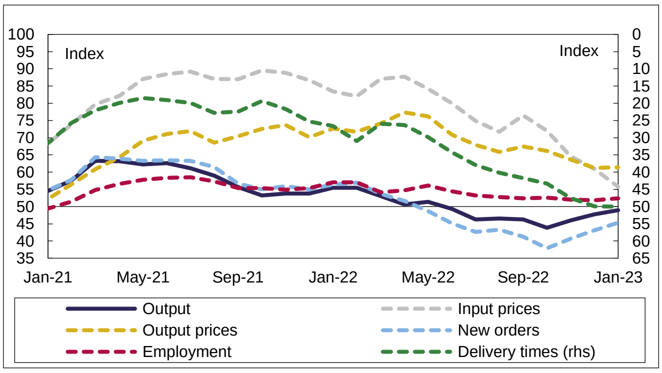
At the country level, today's PMIs suggested that Germany's services sector returned to modest growth at the start of the year, with the activity index rising 1.2pts to 50.4, a seven-month high. But the manufacturing output index (unchanged at

Euro area: Services PMIs



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

Euro area: Manufacturing PMIs



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

48.4) remained consistent with contraction. As such, while Germany's composite output PMI rose for the third consecutive month, by 0.7pt to 49.7, it continued to suggest that the euro area's largest economy remained sluggish at best. And while the pace of decline in new business again moderated, at 46.4 the respective PMI implied extremely lacklustre demand. Contrasting with the German survey, the French PMIs signalled the steepest drop in services activity (49.2) since lockdown measures in March 2021. So, despite a modest increase in the manufacturing index (48.0, an eight-month high), the composite PMI moved broadly sideways at 49.0. This tallied with today's INSEE survey that saw the headline business composite indicator down just 1pt to 102, from an upwardly revised reading in December, reflecting weaker conditions in the wholesale trade and construction sectors. Meanwhile, beyond the two largest member states, the PMIs implied a return to modestly positive growth across the rest of the euro area, driven by a rise in services and stabilisation in manufacturing.

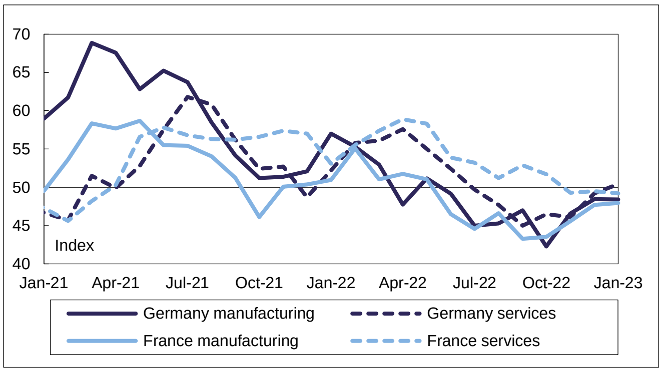
German consumers more optimistic but still highly unwilling to make major purchases

Yesterday's flash Commission estimate of euro area consumer confidence in January reported a fourth successive improvement in sentiment to an eleven-month high of -20.9. As such, while it still pointed to a drop in private consumption, roughly half of the deterioration in consumer sentiment between February and September last year has now been reversed. Today's German GfK consumer confidence survey results also indicated greater optimism among households. However, while the headline index – reported as a forecast for February – rose for the fourth successive month to a six-month high of -33.9, the improvement was less than signalled by the median expectation on the Bloomberg survey. Moreover, in Germany, less than one quarter of the deterioration in consumer confidence between the late 2021 peak and October's trough has been reversed. The headline German index also remains firmly in negative territory and a long way below the long-run average (4.1). And the detail of the survey was also inconsistent with a pickup in private consumption at the start of the year. Admittedly, it reported a significant improvement in expectations of the economic outlook and personal incomes, as well as a big drop in inflation expectations to the lowest since February 2021. But apart from last September's reading, the GfK index of German consumer willingness to make purchases was the lowest since the Global Financial Crisis in 2008.

The day ahead in the euro area

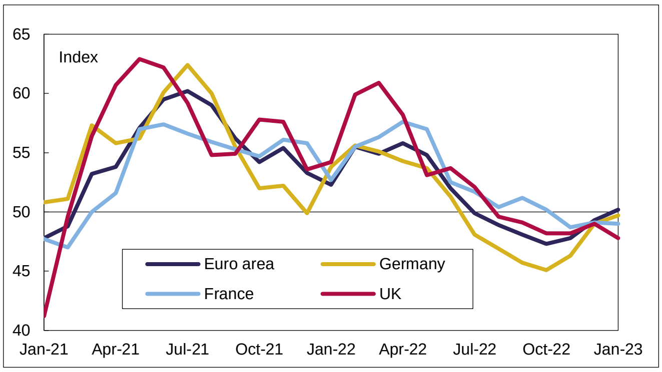
The flow of January sentiment indicators continues tomorrow, with the release of the German ifo institute survey. This is expected to align with today's flash PMIs and point to some further stabilisation in economic conditions. In particular, German businesses are expected to be increasingly optimistic about future conditions, with the expectations index forecast to rise 2.3 points to 85.5, which would be the highest since June 2022. The measure of current conditions is expected to edge up ½ point to 94.9, the highest since August 2022.

Germany & France: Output PMIs



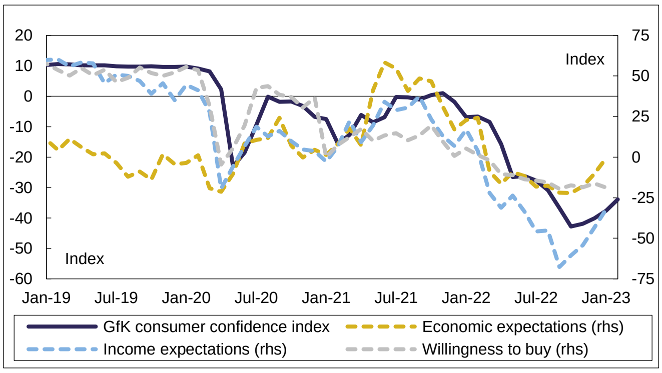
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Europe: Composite output PMIs



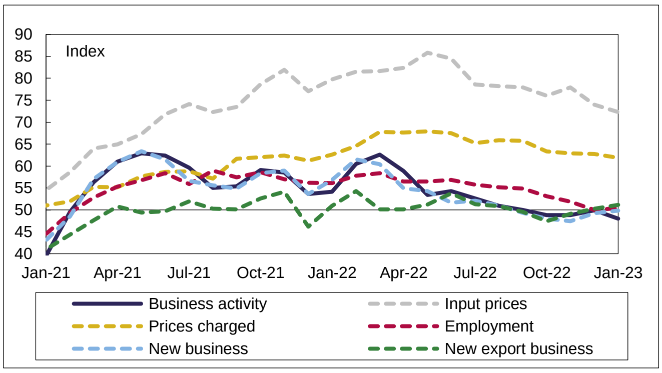
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Germany: Consumer confidence



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

UK: Services PMIs



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

UK

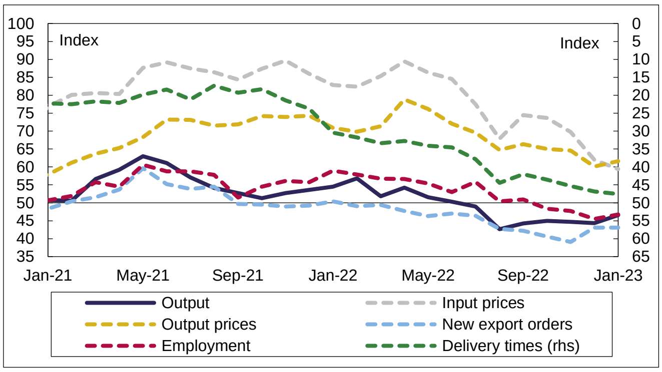
Flash UK PMIs signal a steeper pace of contraction at the start of the year amid weak demand

The flash PMIs today reaffirmed the impression that, from a macroeconomic perspective at least, the UK is now very much the sick man of Europe. In particular, bucking the regional trend of stabilisation or gradual improvement, the headline composite index fell a bigger-than-expected 1.2pts in January to 47.8, implying the steepest pace of contraction for two years. This principally reflected a marked deterioration in services, for which the activity index slumped 1.9pts to 48.0, similarly the lowest since the pandemic-related lockdown in January 2021. But while there was an easing in the deterioration in manufacturing output, the respective PMI (up 2.2pts to 46.6) was still consistent with marked contraction. Amid squeezed budgets and increasing concerns about the economic outlook, new demand reportedly continued to decline in January, albeit the respective composite index rose to its highest since August. According to the PMIs, new factory orders remained extremely weak, tallying with today's CBI industrial survey that suggested the share of firms (57%) reporting demand-side factors as a key limit on output reached the highest since April 2021. At the same time, the share reporting labour and material shortages eased to 38% and 44% respectively. As such, despite reports of pressures from wage demands, today's surveys suggested a further moderation in cost burdens at the start of the year. In the PMI survey, this was particularly evident in the manufacturing sector where the input price index dropped a further 2.6pts to 59.4, the lowest since October 2020. Overall, the composite input price index fell to its weakest since April 2021. And reflecting somewhat more constrained pricing power, the output price PMI edged down to its lowest in seventeen months, albeit at 61.8 it was still almost 10pts above the pre-pandemic average.

Record UK public borrowing in December, but full-year figure should undershoot OBR forecast

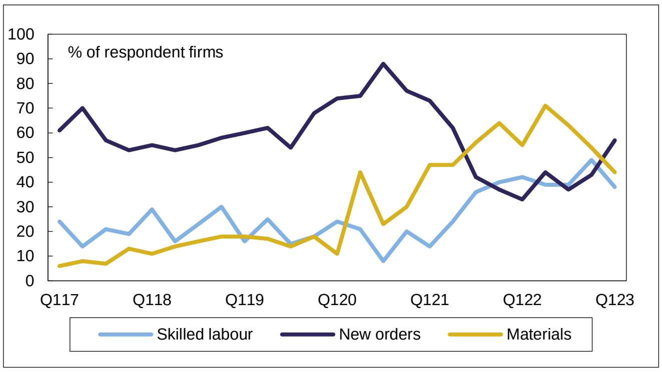
UK public sector net borrowing excluding banks (PSNB ex) in December reached £27.4bn, up from £10.7bn in the same month of 2021 and the highest for the month on the series. That in part reflected the impact of high inflation on index-linked Gilt interest, which drove central government debt interest payments to the highest for the month on the series (£17.3bn, more than double the amount one year earlier). It also reflected recent fiscal policy decisions to support real disposable incomes, most notably government support for household energy bills and the Truss/Kwarteng decision – subsequently retained by Sunak/Hunt – to reverse April's National Insurance hike. Perhaps strikingly, net borrowing was almost £10bn above the OBR's forecast for the month. That discrepancy, however, largely reflected different assumptions for the outstanding value of student loans, with the ONS awaiting further information before making a one-off reduction to the estimate of borrowing in a similar way to the OBR. Nevertheless, in the first nine months of the fiscal year, public borrowing totalled £128.1bn, still some £2.7bn below the OBR's most recent forecast produced in November, suggesting that full-year

UK: Manufacturing PMIs



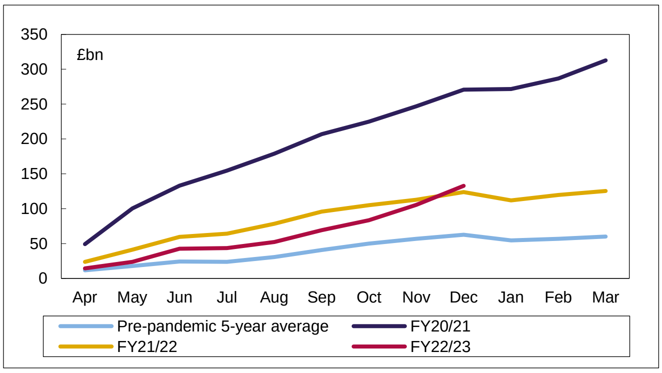
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Factors limiting manufacturing output



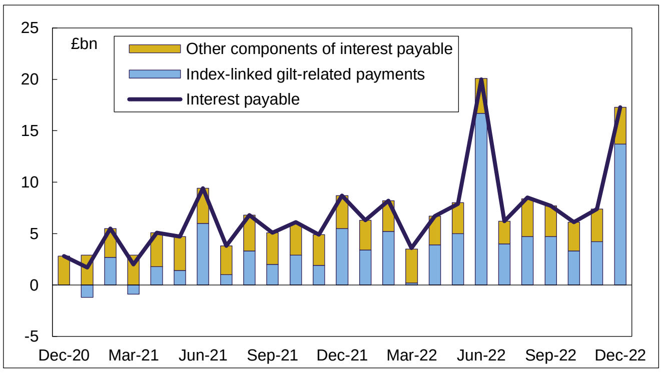
Source: CBI, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Cumulative public sector net borrowing*



**Excluding public banks.*
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Central government debt interest



Source: ONS and Daiwa Capital Markets Europe Ltd.

borrowing might significantly undershoot the watchdog's expectations. Indeed, compared to that OBR forecast, a less hawkish path of Bank Rate than had been assumed, as well as lower Gilt yields and the recent drop in natural gas prices, should provide the Chancellor with scope for modest fiscal loosening – perhaps including enhanced support for household energy bills from April – when he presents his Spring Budget on 15 March.

The day ahead in the UK

Tomorrow will bring the postponed release of UK PPI figures for November and December. In October, producer input price inflation eased for the fourth consecutive month (19.5%Y/Y), with output price inflation at a six-month low (17.1%Y/Y), although tomorrow's release might well bring significant revisions to past data following quality checks.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Preliminary manufacturing (services) PMI	Jan	**48.8 (50.7)**	48.5 (50.2)	47.8 (49.8)	-
	Preliminary composite PMI	Jan	**50.2**	49.9	49.3	-
Germany	GfK consumer confidence	Feb	**-33.9**	-33.0	-37.8	**-37.6**
	Preliminary manufacturing (services) PMI	Jan	**47.0 (50.4)**	48.0 (49.7)	47.1 (49.2)	-
	Preliminary composite PMI	Jan	**49.7**	49.6	49.0	-
France	INSEE business (manufacturing) confidence	Jan	**102 (103)**	103 (102)	102 (101)	**103 (102)**
	Preliminary manufacturing (services) PMI	Jan	**50.8 (49.2)**	49.7 (49.7)	49.2 (49.5)	-
	Preliminary composite PMI	Jan	**49.0**	49.7	49.1	-
UK	Public sector net borrowing excl. banks £bn	Dec	**27.4**	18.0	22.0	**19.6**
	Preliminary manufacturing (services) PMI	Jan	**46.7 (48.0)**	45.7 (49.7)	45.3 (49.9)	-
	Preliminary composite PMI	Jan	**47.8**	49.3	49.0	-
	CBI industrial trends, total orders (selling prices)	Jan	**-17 (41)**	-	-6 (52)	-

Auctions

Country	Auction
Germany	sold €1.43bn 0.0% 2025 bonds at an average yield of 2.29%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	European Commission preliminary consumer confidence	Jan	**-20.9**	-20.0	-22.2	**-22.0**

Auctions

Country	Auction
UK	BoE sold £650mn of 2026-2028 gilts

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Economic data						
Germany		09.00	ifo business climate	Jan	90.3	88.6
		09.00	ifo current assessment (expectations)	Jan	94.9 (85.5)	94.4 (83.2)
France		11.00	Total jobseekers '000s	Q4	-	2946
Spain		08.00	PPI M/M% (Y/Y%)	Dec	-	-2.2 (20.7)
UK		07.00	PPI output prices M/M% (Y/Y%)	Nov & Dec	0.3 (16.4)	0.9 (17.1)
		07.00	PPI input prices M/M% (Y/Y%)	Nov & Dec	0.2 (17.9)	0.7 (19.5)
Auctions and events						
Germany		10.30	Auction: €1.5bn 1.0% 2038 bonds			
		10.30	Auction: €1.0bn 2.5% 2044 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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