

Euro wrap-up

Overview

- Bunds ended the day little changed, even as the German ifo business survey implied a gradual recovery over coming quarters, and further ECB Governing Council members called for at least two further hikes of 50bps.
- Longer-dated Gilts made modest gains as UK producer input prices declined the most since April 2020, while services PPI inflation fell back too.
- Thursday will bring surveys of Italian businesses and consumers and UK retailers, while Friday brings the first estimate of Q4 GDP from Spain.

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Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.514	-0.008
OBL 2.2 04/28	2.167	-0.010
DBR 2.3 02/33	2.151	+0.006
UKT 1 04/24	3.419	+0.024
UKT 1½ 07/27	3.144	-0.035
UKT 4¼ 06/32	3.253	-0.023

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

Source: Bloomberg

Euro area

German ifo business climate index rises, but current conditions reportedly deteriorate

Consistent with the firmer outlook suggested by yesterday's [flash PMIs](#), today's ifo survey reported a further modest improvement in the German business climate at the start of the year. In particular, the headline ifo indicator rose for the fourth consecutive month in January, by 1.6pts to 90.2, the highest reading since June. However, this reflected a pickup in expectations for the coming six months, for which the respective index rose to the best since May. In contrast, the ifo's current conditions index fell 0.3pt in January to the second-lowest level since the lockdowns of early 2021. That reflected a further deterioration in services – the respective index fell to the lowest since May 2021, with particular weakness related to transport and logistics and hospitality – and construction. We note, however, the contrast with the PMIs, which suggested that services activity returned to modest growth in January. Also opposing the findings of the PMIs, the ifo survey suggested that manufacturers assessed conditions to have improved in January, to the best since August, while retailers were the least downbeat since June.

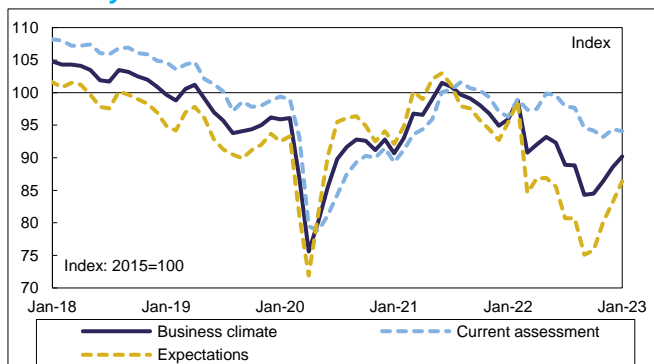
A gradual recovery expected amid easing supply bottlenecks and lower cost pressures

According to the ifo survey, manufacturers and retailers alike were notably more optimistic about the near-term outlook, with services firms seemingly less pessimistic too. This likely in part reflects manufacturers' improved expectations for production over coming quarters, as supply bottlenecks and energy adequacy concerns continue to recede. Indeed, the ifo institute noted that the share of respondent firms reporting a shortage of materials fell below 50% for the first time April 2021. Of course, sentiment in all sub-sectors remains well down on levels seen during the post-lockdown recovery in 2021. And so, while today's survey adds to evidence that the euro area's largest member state might well avoid a recession this year, it is still consistent with subdued growth at best. Indeed, reflecting in part a drop in demand for autos following the reduction in the government's electric car subsidies from the start of the year, the ifo institute forecasts that German GDP will contract this quarter. More encouragingly, however, amid soft demand and lower input cost burdens, it also reported that the net balance of firms planning to increase prices fell almost 5pts in January to 35.4, the lowest since April 2021, further suggesting that consumer price inflation in Germany, as well as the euro area as a whole, should maintain a steady downtrend over coming quarters.

The coming two days in the euro area

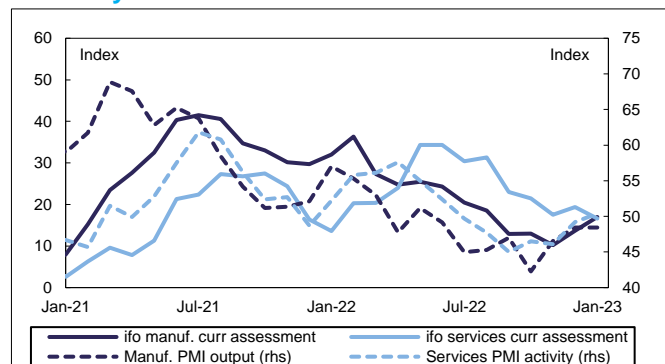
The flow of January economic sentiment indicators continues over the remainder of the week, with Italian business and consumer confidence indices from ISTAT due tomorrow, followed by the French INSEE consumer sentiment survey on

Germany: Headline ifo business sentiment indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ifo & PMI sentiment indices



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

Friday. These surveys are expected to align with the implied modest improvement in conditions recorded in other surveys this week. Friday also brings euro area bank lending data for December as well as a first look at Q4 GDP in the shape of the initial estimate from Spain, which is likely to be little better than flat on the quarter.

UK

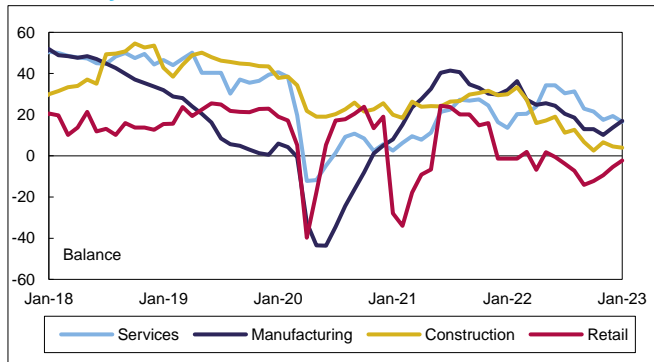
UK producer input prices decline by the most since April 2020 on lower energy prices

Last week's [UK CPI](#) data suggested a further moderation in core goods inflation at the end of last year, to its lowest level in eleven months. And today's postponed PPI inflation figures suggest easing goods price pressures at the factory gate too. Admittedly, due to corrections to the item weights, the profile for headline input price inflation was slightly higher than initially thought from March 2021, with the peak now estimated at 24.6%Y/Y in June. Similarly, the peak in output price inflation was marginally higher than previously thought, at 19.9%Y/Y in July. But today's release reported a notable step down in cost pressures in December, with input prices falling for the second successive month and by 1.1%M/M, the most since April 2020. This pushed the annual input PPI rate down a further 1.5ppts to 16.5%Y/Y, the softest since May. The drop largely reflected another marked decline in crude oil prices (-10.0%M/M). Core input prices (i.e. all items excluding energy) also fell in December (-0.4%M/M). And the food component moderated last month to the slowest since September 2021 (0.5%M/M), to leave the respective annual rate down 2ppts to 17.2%Y/Y. So, while producer output food inflation continued to trend higher in December – up 0.2ppt to 17.1%Y/Y to account for the largest share of annual output PPI inflation at more than 4.0ppts – this might well mark the peak in this component. Moreover, overall goods output PPI inflation moderated in December, by 1.5ppt to 14.7%Y/Y, the lowest since last March. And while this drop was again driven by petroleum products, for which prices fell almost 12%M/M and the annual rate fell some 15ppts to 31.1%Y/Y, core output PPI inflation eased a further 0.6ppt to 12.4%Y/Y.

Services PPI inflation fell back at the end of last year too

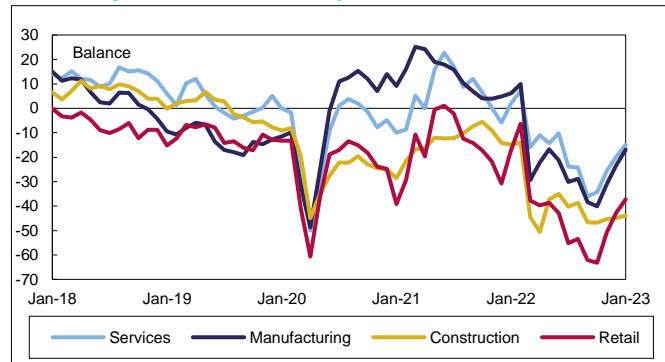
With surveys – including yesterday's flash PMIs and CBI indicators – suggesting a further drop producer cost burdens since the start of the year, we expect consumer non-energy industrial goods inflation to maintain a downwards trend over coming quarters. To some extent, this might be countered by price pressures in services. But in that respect, today's producer price figures were also more encouraging, with services prices up just 0.1%Q/Q in Q4, down from an average increase of 1.7%Q/Q over the previous three quarters. As such, the annual rate of services PPI fell 1ppt to 5.2%Y/Y. While this in part reflects base effects from a year ago, transportation and storage costs fell for the first quarter in nine (-0.3%Q/Q), to leave

Germany: ifo business current conditions indices



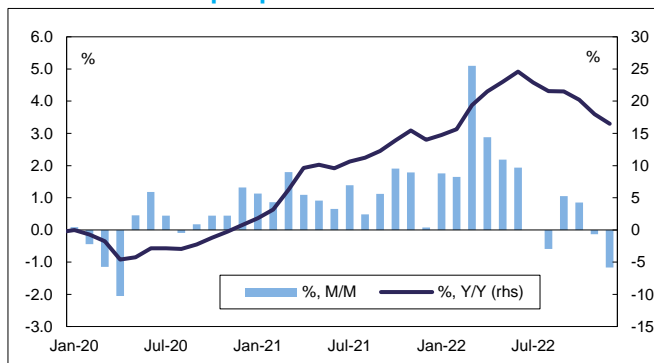
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ifo business expectations indices



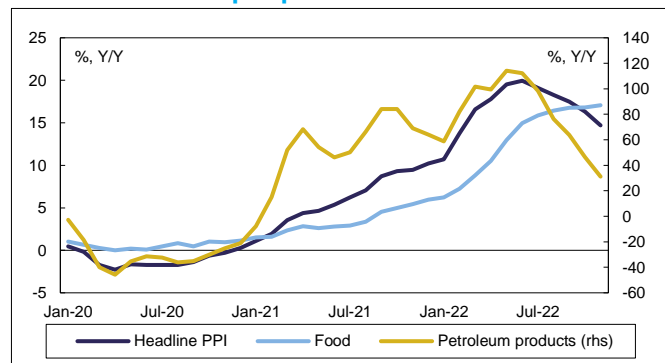
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Producer input price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Producer output price inflation



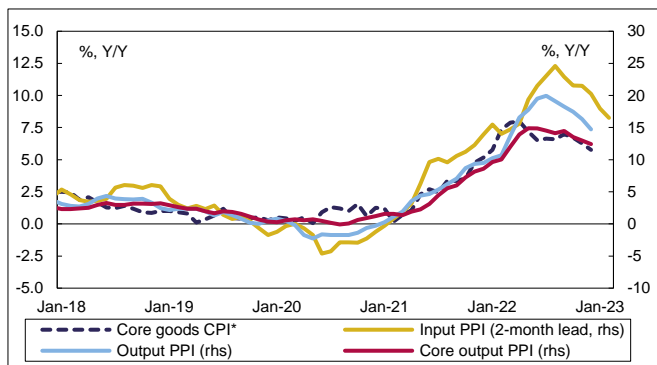
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

the annual rate down more than 3½ppts at 9.8%Y/Y. And hospitality costs fell 2ppts to 4.5%Y/Y, a four-quarter low. Of course, not least due to annual indexed adjustments to prices of certain services (e.g. mobile phone charges and social housing rents), we expect services CPI to remain stubbornly high in the first quarter of this year. And for now at least, most MPC members will remain concerned about underlying price pressures in the sector due to the ongoing tightness of the labour market.

The coming two days in the UK

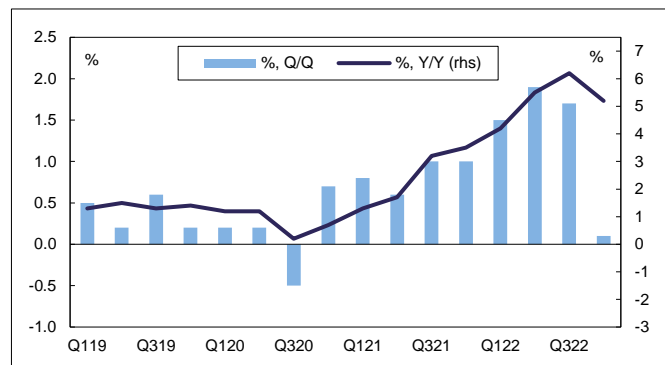
The remainder of the week will be relatively quiet for UK economic data, with only the CBI's distributive trades survey for January due for release tomorrow. The December survey revealed that retailers expected a fall in sales at the start of the year, adding to the poor outlook for the UK's retailing sector following last week's disappointing [retail sales](#) figures.

UK: Goods PPI and CPI inflation



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

UK: Services PPI inflation



Source: ONS and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 27 January 2023

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	ifo business climate	Jan	90.2	90.3	88.6	-
Germany	ifo current assessment (expectations)	Jan	94.1 (86.4)	94.9 (85.3)	94.4 (83.2)	-
France	Total jobseekers '000s	Q4	2834	-	2946	-
Spain	PPI M/M% (Y/Y%)	Dec	-1.7 (14.7)	-	-2.2 (20.7)	-2.4 (20.5)
UK	PPI output prices M/M% (Y/Y%)	Dec	-0.8 (14.7)	-	-0.1 (16.2)	-
UK	PPI input prices M/M% (Y/Y%)	Dec	-1.1 (16.5)	-	-0.2 (18.0)	-




Auctions

Country	Auction
Germany	sold €1.19bn of 1.0% 2038 bonds at an average yield of 2.19%
Germany	sold €831mn of 2.5% 2044 bonds at an average yield of 2.10%




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Italy		09.00 ISTAT business (manufacturing) sentiment indicator	Jan	- (101.8)	107.8 (101.4)
		09.00 ISTAT consumer confidence	Jan	102.5	102.5
UK		11.00 CBI distributive trades survey, retailing reported sales	Jan	-	11




Auctions and events

Italy		10.00 Auction: €2.00bn of 2.5% 2025 bonds
		10.00 Auction: €1.25bn of 1.5% 2025 bonds
		10.00 Auction: €1.75bn of 0.1% 2033 index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area		09.00 M3 money supply Y/Y%	Dec	4.6	4.8
France		07.45 INSEE consumer confidence	Jan	83	82
Spain		08.00 Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>0.0</u> (2.1)	0.1 (4.4)

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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