Euro wrap-up

Overview

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- Despite some softer euro area bank lending figures and a downbeat French consumer survey, Bunds fell as Spanish Q4 GDP beat expectations and markets looked ahead to next week's ECB policy announcements.
- Gilts also made losses on a quiet end to the week for UK economic news, as attention turned to the BoE policy decision and updated forecasts due on Thursday.
- In addition to the central bank announcements, the coming week's data highlights will be the flash estimates of euro area CPI inflation in January (Wednesday) and GDP in Q4 (Tuesday).

Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.567	+0.008
OBL 2.2 04/28	2.251	+0.032
DBR 2.3 02/33	2.237	+0.034
UKT 1 04/24	3.482	+0.027
UKT 1¼ 07/27	3.209	+0.019
UKT 4¼ 06/32	3.331	+0.014

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

Euro area

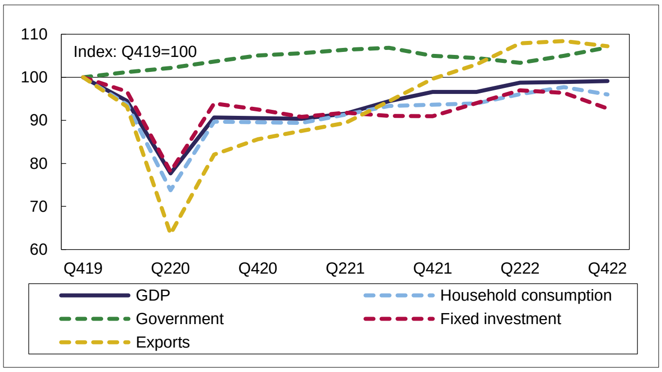
Spanish GDP up slightly in Q4 but domestic demand drops markedly

The first estimate of Q4 GDP from any of the member states, which came today from Spain, was a touch firmer than expected. Growth of 0.2%Q/Q was unchanged from an upwardly revised figure for Q3. That left Spanish GDP 0.9% below the pre-pandemic level but up 2.7%Y/Y. And over 2022 as a whole, it rose 5.5%Y/Y, which will be the fastest rate of all of the larger member states last year. The detail of the Q4 report, however, was significantly softer than the headline figure might suggest. Household consumption dropped for the first time since the start of 2021, and by a chunky 1.8%Q/Q, as purchasing power was eroded by high inflation and a drop in hours worked. Fixed investment also declined, down for a second successive quarter and by a steeper 3.8%Q/Q, with weakness in every category of capex including construction and machinery and equipment. So, despite a pickup in government spending, domestic demand dropped 0.9%Q/Q. And the only reason for the positive GDP growth in Q4 was that imports (-4.2%Q/Q) fell more sharply than exports (-1.1%Q/Q). INE, the Spanish statistical institute, also cautioned that the Q4 GDP estimate had been based on fewer data for December than would normally be the case, raising the likelihood of a (possibly significant) revision when the final estimate is published in March. And even if the estimate of growth last quarter remains positive, we expect growth in the current quarter to be negligible as consumer spending remains in reverse and net trade provides less support.

French consumer confidence fell further in January with purchase intentions lowered too

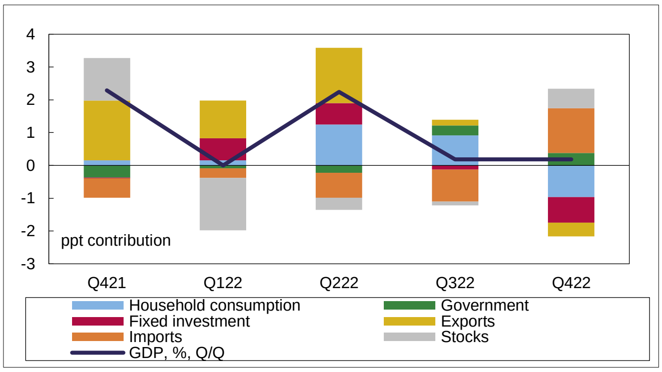
Contrasting with the reported improvement at the start of the year in German consumer sentiment and the Commission's flash euro area confidence indicator, today's INSEE survey results suggested that French households were more downbeat in January. Indeed, the headline sentiment index fell 1pt to 80, to be only marginally firmer than the more than nine-year low recorded in September (79) and well below the long-run average (100). While fears of near-term unemployment receded somewhat, households were more pessimistic about the outlook for their personal finances and the broader economic situation over the coming twelve months. More encouragingly perhaps, the share of households that expect prices to accelerate over the coming year fell. However, there was also a modest decline in the share that judged it a good time to make major purchases, with the respective index falling to its lowest since the initial pandemic slump. The government's new pension reform proposals, and associated widespread strike action which kicked off after the survey was conducted, is unlikely to have helped household sentiment. And so, with French inflation likely to have risen in January, the near-term outlook for French consumer spending looks very weak.

Spain: GDP and expenditure components



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Spain: Contributions to GDP growth



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

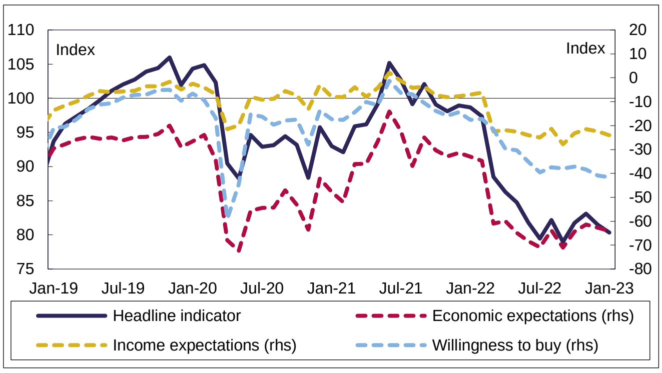
Italian business more upbeat, but consumer purchase intentions remain very weak

Likewise, yesterday's survey of Italian consumer confidence reported a deterioration in January, with the headline index down 1.6pts to 100.9. Admittedly, this was from a seven-month high in December, while households were seemingly less downbeat about their expectations for the year ahead. Nevertheless, amid still very high inflation (12.3%Y/Y in December), consumer purchase intentions fell to the second-lowest reading since the euro crisis in 2013. And so, it was perhaps unsurprising to see that ISTAT's business survey showed that retailers were less upbeat at the start of the year, with the respective index down to a three-month low. In contrast, however, sentiment among other business sectors again improved at the start of the year, consistent with the stabilisation seen in certain other leading indicators across the euro area. Indeed, the headline business composite index rose for the third consecutive month, by 1.6pts to 109.1, a five-month high. Services firms were similarly the most upbeat since August, with an improved production outlook registered by manufacturers too.

Bank lending to NFCs and households slows sharply at the end of last year

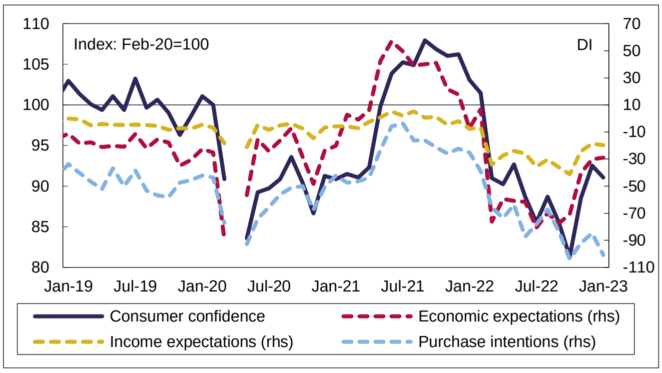
With economic momentum having slowed sharply in the final quarter of last year, incomes having been squeezed by high inflation and interest rates on loans having risen to the highest since 2014, today's ECB monetary data reported a further notable decline in bank lending growth in December. In particular, the flow of net lending to non-financial corporations (NFCs) fell for the second-successive month on an adjusted basis, by €15.5bn, the most since April 2021. There was a significant drop in short-dated loans (with a maturity of less than 1 year). And the decline in longer-dated loans (with a maturity of more than five years) – that typically relate to fixed investment intentions – was the largest since mid-2014. So, while the annual growth rate of lending to NFCs remained relatively elevated, it was down 2ppts at 6.3%Y/Y, a seven-month low. Consumer credit also slowed in December, with the net flow of lending (€0.5bn) the second-softest of the past year. And the flow of new mortgage loans (€4.5bn) was halved from November and markedly weaker than the peak in June (€30bn). Indeed, in the three months to December, net lending for house purchase slowed to €21.7bn, just one quarter of the amount seen in the summer and the lowest since mid-2017. Finally, the (typically more hawkish) national banks of the euro area, which in the past placed great importance on money supply as a guide to future inflation, might note the further marked moderation in M3 money supply growth in December, by 0.7ppt to 4.1%Y/Y. That represented the softest pace for almost four years, and was a level that the ECB in the past would have considered consistent with achievement of its price stability objective.

France: Consumer confidence indices



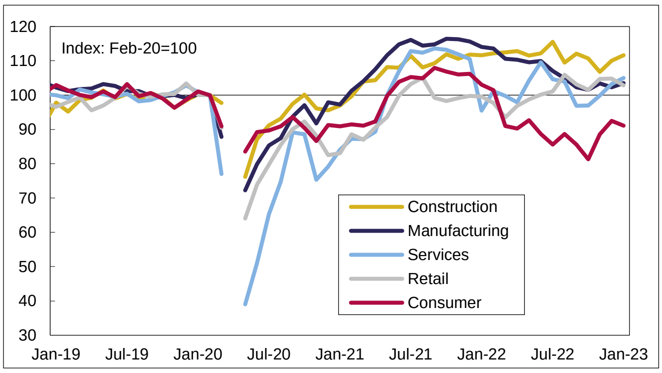
Source: INSEE, Refinitiv and Daiwa Capital Markets Europe Ltd.

Italy: Consumer confidence indices*



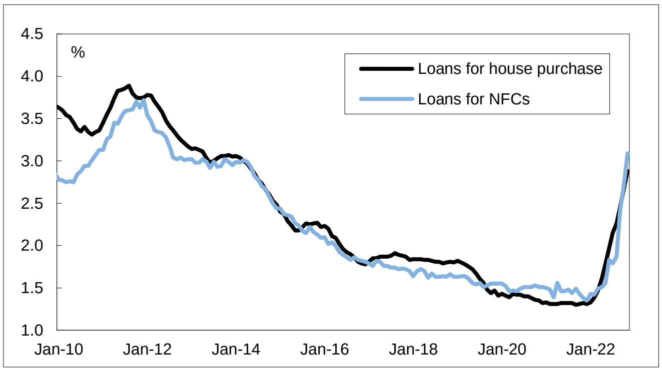
**No survey results for April 2020. Source: ISTAT, Refinitiv and Daiwa Capital Markets Europe Ltd.*

Italy: Business confidence indices*



**No survey results for April 2020. Source: ISTAT, Refinitiv and Daiwa Capital Markets Europe Ltd.*

Euro area: Interest rates on loans



Source: ECB and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

When the ECB's Governing Council meeting concludes on Thursday, the immediate interest rate policy decision seems easy to predict. After the December policy statement made clear that "interest rates will still have to rise significantly at a steady pace to reach levels that are sufficiently restrictive", the main policy interest rates will be hiked again by 50bps. That will take the deposit rate to 2.50% – a level that could reasonably be considered to be restrictive – and the cumulative tightening since July to a hefty 300bps. Meanwhile, the policy statement will probably repeat that "future policy rate decisions will continue to be data-dependent and follow a meeting-by-meeting approach". Apart from that, however, the Council's updated forward policy guidance, which will have an important bearing on the market mood, is uncertain.

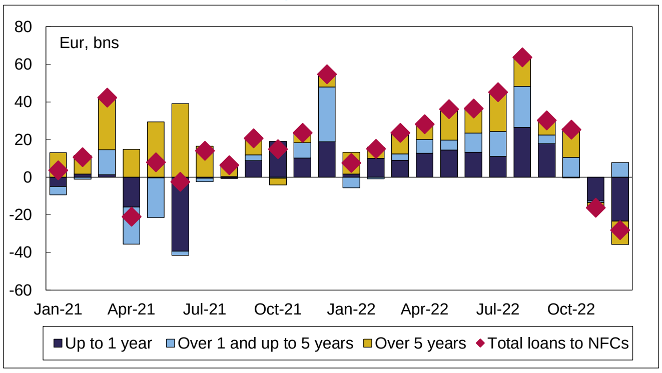
In our view, the Governing Council would be wise this month not to pre-commit to a particular path of tightening before considering the updated economic projections due in March. Economic activity looks to have been firmer than feared, and the labour market still appears tight. However, the significant drop in wholesale gas prices to well below levels a year ago, as well as a cooling of global goods inflation and shipping costs, the associated reduction in supply-chain challenges, and ongoing strengthening of the euro exchange rate, all means that the inflation outlook has improved since the December meeting. Bank of France Governor Villeroy recently suggested that inflation could be back to target before the end of 2024, compared to the current baseline projection that it will not reach that point before Q325. And we think 2% inflation could be reached sooner still.

Mindful also of the lagged effects of recent monetary policy tightening still to be felt, Executive Board member Panetta this week therefore insisted that the pace of rate hikes in March should not be pre-determined at the coming meeting. And dovish Bank of Italy Governor Visco highlighted the risks of over-tightening. However, the past week also some of the more balanced members of the Governing Council (such as Irish Governor Makhlouf) support the hawks in signalling their desire for a further 50bps hike in March. So, we see a significant risk that the coming meeting will similarly signal the likelihood of further "significant" tightening to come. And President Lagarde might also comment again on the appropriateness (or not) of the current market-implied path of rates.

Aside from the decision and updated guidance on rates, this meeting will also see the Governing Council provide more detail on how, from March, it plans to reduce its portfolio holdings under its regular Asset Purchase Programme (APP). We already know from the last policy announcement that the APP portfolio will shrink by €15bn per month on average until the end of Q2. Following this meeting, the ECB will provide more details related to the future composition of the portfolio, including with respect to the balance between various asset classes, and plans to "green" the remaining bond holdings. Among other things, the ECB's portfolio of private sector securities might be unwound at a faster pace than its holdings of government bonds. At the same time, however, an excessively rigid or aggressive plan to unwind government bonds might pose a particular risk to periphery government bond prices.

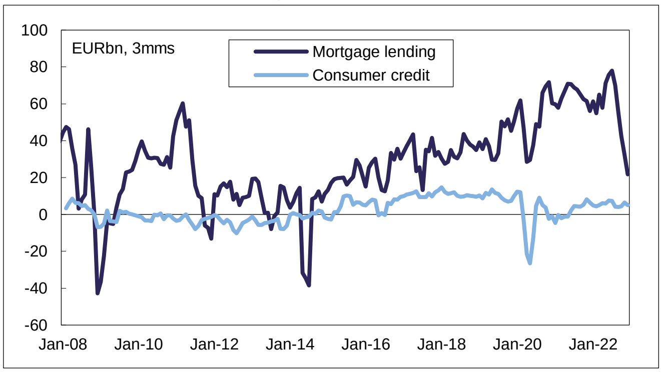
Meanwhile, it will be a busy week for top-tier economic data releases, with the flash estimates of euro area inflation for January (Wednesday) and GDP for Q4 (Tuesday) the highlights. The headline euro area HICP inflation rate is expected to have eased for a third consecutive month, and we forecast a drop of 0.4ppt from December's four-month low of 9.2%Y/Y. The decline will again principally reflect a moderation in energy inflation, particularly in Spain. But with prices of certain core items remaining sticky, core inflation is likely to have eased only very slightly from December's record high (5.2%Y/Y). We note, however, the very large degree of uncertainty with respect to these forecasts, not least as the inflation basket weights will be revised. The flash national inflation figures will offer a guide. The data from Spain – where inflation almost certainly fell – come first on Monday. And the data from Germany and France, where inflation likely increased in January due to lower government support, are scheduled for the following day. Separately, not least reflecting the impact of high inflation on consumer spending, the first estimate of Q4 GDP is likely to confirm a further slowing in economic activity in the final quarter of last year. We expect a modest contraction in the euro area (-0.1%Q/Q), with Italy weakest and Germany and France likely little changed. Among other data due, the Commission's business and consumer surveys (Monday) are likely to report a modest improvement in conditions at the start of the year consistent with the results of the flash PMIs. Meanwhile, unemployment figures (Wednesday) are expected to be consistent with ongoing tightness in the labour market, but euro area PPI data for December (Friday) should flag a cooling in goods price pressures ahead.

Euro area: Net lending to NFCs*



*Unadjusted for loan sales and securitisation. Source: *ECB and Daiwa Capital Markets Europe Ltd.*

Euro area: Net lending to households



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

UK

Survey suggests a challenging start to 2023 for UK retailers, car production continues to plunge

Following the disappointing flash manufacturing and services PMIs published earlier in the week, yesterday's CBI distributive trades survey suggested that spending was weak at the start to the year. In particular, the net balance of retailers that reported declining sales deteriorated 33pts to -23, the lowest reading since last April, and well below the long-run average (+17). Sales were unsurprisingly, therefore, judged to be softer than seasonal norms. Wholesale and auto traders' sales reportedly fell sharply compared with a year ago too. And amid still very weak consumer confidence, declining real incomes and still high inflation, total sales were forecast to decline further in February too. With retailers judging that the level of inventories relative to expected sales had risen further at the start of the year, by the most since August, discounting might be expected over coming months to encourage a loosen of purse strings.

Separately, the woes of the auto sector were highlighted by the SMMT production data for December, which reported a drop of almost 18%Y/Y to just 51.2k units, the lowest level for any December since the monthly series began in 1977. This left full-year output down almost 10%Y/Y in 2022, more than 40% below the level in 2019 and a whopping 55% lower than the pre-Brexit referendum peak in 2016, and at its lowest since 1956.

The week ahead in the UK

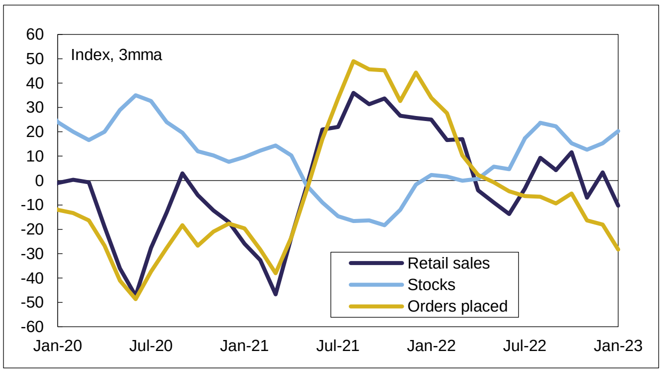
When the BoE makes its monetary policy announcement on Thursday, the MPC is widely expected to raise Bank Rate for the tenth consecutive meeting. But the decision is likely again to be split at least three ways, with external members Silvana Tenreyro and Swati Dhingra likely to vote once again for no change to policy. And analyst expectations, as well as market-implied pricing, for the pace of tightening this month are split between 25bps and 50bps. That uncertainty reflects the extremely unpredictable economic outlook. And the BoE's updated projections to be presented this week in its latest Monetary Policy Report (MPR) will play an important role in guiding the policy judgement.

Encouragingly, GDP in Q4 appears to have been a little more resilient than feared in November, albeit likely still down modestly from Q3. But the very tight labour market will remain a concern for the majority of MPC members. Indeed, the acceleration in wage growth in the three months to November (6.4%3M/Y), and jump in services inflation in December (6.8%Y/Y), will continue to stoke fears of second-round effects on future prices. Nevertheless, headline inflation in Q4 (10.7%Y/Y) came in a touch softer than the Bank's previous forecast (10.9%Y/Y). And BoE staff estimated in December that the revised Energy Price Guarantee would reduce the forecast for inflation in Q2 by ¾ppt. Since then we have also seen a further marked decline in wholesale natural gas prices, which in the fifteen-day period used to set the respective assumption in the BoE's February forecasts were more than 60% lower than in the equivalent period before the November MPR. Futures imply a significantly lower profile for gas prices across the forecast horizon too.

So, it should not have been a surprise that Governor Bailey noted this week that inflation is now on track to fall rapidly from the spring as supply-side pressures continue to recede. Indeed, the BoE's November forecast for 2024-25 was already extremely weak, with headline CPI expected to fall below 1%Y/Y at the end of the horizon, even if Bank Rate had been unchanged at 3.00%. Of course, this weakness also reflected the Bank's expectation that demand would fall steadily due to the record decline in household real disposable incomes. But while the anticipated downturn over the coming quarters might not be as deep as the November MPR baseline forecast suggested, recent indicators – including the past week's flash PMIs – suggest that economic activity weakened at the start of the year. And recession through the first half of 2023 will likely remain in the BoE's baseline projection.

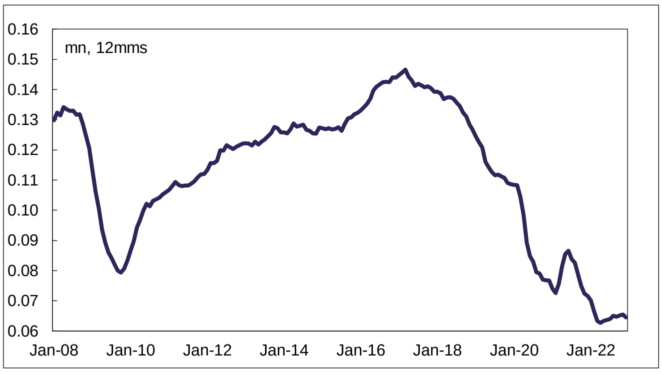
Given the tight labour market, and still relatively high business inflation expectations, on balance, we expect the majority on the Committee to favour a 50bps increase in Bank Rate this month. But we also recognise the non-negligible risk of a smaller hike. And while the Bank might well signal the likelihood of some additional tightening ahead, the forward guidance might be more equivocal than before.

UK: CBI retail survey indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Car production



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

In terms of the UK's data flow, the coming week will bring a few odds and sods, kicking off on Tuesday with the BoE's latest bank lending figures for December. Given higher borrowing costs, mortgage approvals are expected to have fallen further from November's more than two-year low (46.1k). Mortgage lending, however, is likely to have remained relatively robust in December, given that it will still reflect loan offers made before the Truss crisis. And there might well have been a pickup in credit card lending in the run up to the festive period. Wednesday will bring further insight into housing market developments at the start of the year, with the Nationwide house price index likely to report a fifth successive monthly drop in house prices in January. Separately, the BRC's shop price index might well report a slight moderation in inflation on the High Street in January. The final manufacturing and services PMIs are also due for release on Wednesday and Friday respectively.

Daiwa economic forecasts

	2022			2023			2022	2023	2024
	Q2	Q3	Q4	Q1	Q2	Q3			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.9	0.3	-0.1	0.0	0.1	0.1	3.4	0.5	1.0
UK	0.1	-0.3	-0.1	-0.2	-0.3	-0.1	4.1	-0.7	0.3
Inflation, %, Y/Y									
Euro area									
Headline HICP	8.0	9.3	10.0	7.9	6.0	4.3	8.4	5.1	1.8
Core HICP	3.7	4.4	5.1	4.9	4.1	3.2	3.9	3.6	2.0
UK									
Headline CPI	9.2	10.0	10.7	9.7	7.8	6.4	9.1	6.9	2.5
Core CPI	6.0	6.3	6.4	5.9	4.8	3.9	5.9	4.4	2.5
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.

Daiwa Capital Markets

The coming week's data calendar

The coming week's key data releases

Country		GMT	Release	Period	Market consensus/ _Daiwa forecast/actual_	Previous
			Monday 30 January 2023			
Euro area		10.00	EC's economic sentiment indicator	Jan	97.0	95.8
		10.00	EC's industrial (services) confidence	Jan	-0.9 (9.0)	-1.5 (6.3)
		10.00	EC's final consumer confidence	Jan	-20.9	-22.2
Germany		09.00	First estimate - GDP Q/Q% (Y/Y%)	Q4	_-0.1 (1.2)_	0.4 (1.3)
Spain		08.00	Preliminary CPI M/M% (Y/Y%)	Jan	-1.0 (5.0)	0.2 (5.7)
		08.00	Preliminary HICP M/M% (Y/Y%)	Jan	-1.9 (4.8)	0.0 (5.5)
		08.00	Retail sales Y/Y%	Dec	-	-0.6
UK		00.01	Lloyds business barometer	Jan	-	17
			Tuesday 31 January 2023			
Euro area		10.00	First estimate – GDP Q/Q% (Y/Y%)	Q4	_-0.1 (1.7)_	0.3 (2.3)
Germany		07.00	Retail sales M/M% (Y/Y%)	Dec	-0.2 (-2.6)	1.7 (-5.1)
		08.55	Unemployment rate % (change '000s)	Jan	5.5 (5.0)	5.5 (-13.0)
		13.00	Preliminary CPI M/M% (Y/Y%)	Jan	1.2 (9.4)	-0.8 (8.6)
		13.00	Preliminary HICP M/M% (Y/Y%)	Jan	1.4 (10.2)	-1.2 (9.6)
France		06.30	First estimate - GDP Q/Q% (Y/Y%)	Q4	_0.1 (0.6)_	0.2 (1.0)
		06.30	Consumer spending M/M% (Y/Y%)	Dec	0.2 (-4.2)	0.5 (-5.2)
		07.45	Preliminary CPI M/M% (Y/Y%)	Jan	0.5 (6.1)	-0.1 (5.9)
		07.45	Preliminary HICP M/M% (Y/Y%)	Jan	0.4 (7.0)	-0.1 (6.7)
Italy		10.00	First estimate – GDP Q/Q% (Y/Y%)	Q4	_-0.3 (1.5)_	0.5 (2.6)
UK		09.30	Net consumer credit £bn (Y/Y%)	Dec	1.3 (-)	1.5 (7.0)
		09.30	Net mortgage lending £bn (approvals '000s)	Dec	3.8 (43.0)	4.4 (46.1)
			Wednesday 01 February 2023			
Euro area		09.00	Final manufacturing PMI	Jan	_48.8_	47.8
		10.00	Preliminary HICP M/M% (Y/Y%)	Jan	_-0.1 (8.8)_	-0.4 (9.2)
		10.00	Preliminary core HICP M/M% (Y/Y%)	Jan	_-1.0 (5.0)_	0.6 (5.2)
		10.00	Unemployment rate %	Dec	6.5	6.5
Germany		08.55	Final manufacturing PMI	Jan	_47.0_	47.1
France		08.50	Final manufacturing PMI	Jan	_50.8_	49.2
Italy		08.45	Manufacturing PMI	Jan	49.6	48.5
Spain		08.15	Manufacturing PMI	Jan	48.0	46.4
UK		00.01	BRC shop price index Y/Y%	Jan	-	7.3
		07.00	Nationwide house price index M/M% (Y/Y%)	Jan	-0.5 (1.8)	-0.1 (2.8)
		09.30	Final manufacturing PMI	Jan	46.7	45.3
			Thursday 02 February 2023			
Euro area		13.15	ECB Deposit (Refi) Rate %	Feb	_2.50 (3.00)_	2.00 (2.50)
Germany		07.00	Trade balance £bn	Dec	8.0	10.9
UK		12.00	BoE Bank Rate %	Feb	_4.00_	3.50
			Friday 03 February 2023			
Euro area		09.00	Final services (composite) PMI	Jan	_50.7 (50.2)_	49.8 (49.3)
Germany		08.30	Final services (composite) PMI	Jan	_50.4 (49.7)_	49.2 (49.0)
France		07.45	Industrial production M/M% (Y/Y%)	Dec	0.2 (0.9)	2.0 (0.7)
		08.50	Final services (composite) PMI	Jan	_49.2 (49.0)_	49.5 (49.1)
Italy		08.45	Services (composite) PMI	Jan	50.9 (-)	49.9 (49.6)
Spain		08.15	Services (composite) PMI	Jan	52.5 (-)	51.6 (49.9)
UK		09.30	Final services (composite) PMI	Jan	_48.0 (47.8)_	49.9 (49.0)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 30 January 2023		
- Nothing scheduled -		
Tuesday 31 January 2023		
Germany	10.30	Auction: €6bn of 0% 2025 bonds
Italy	10.00	Auction: €4.0bn 3.4% 2028 bonds
	10.00	Auction: €3.5bn 4.4% 2033 bonds
	10.00	Auction: €1.5bn 2026 floating rate bonds
Wednesday 01 February 2023		
Germany	10.30	Auction: €5bn of 2.3% 2033 bonds
UK	10.00	Auction: £3bn 0.875% 2033 bonds
Thursday 02 February 2023		
Euro area	13:15	ECB monetary policy announcement
	13.45	ECB President Lagarde holds press conference following the Governing Council meeting
France	09.50	Auction: 0.00% 2031 bonds
	09.50	Auction: 2.00% 2032 bonds
	09.50	Auction: 0.50% 2044 bonds
Spain	09.30	Auction: 2.80% 2026 bonds
	09.30	Auction: 1.40% 2028 bonds
	09.30	Auction: 1.00% 2030 bonds
	09.30	Auction: 3.45% 2043 bonds
UK	12.00	BoE monetary policy announcement, statement, minutes and Monetary Policy Report to be published
	12.30	BoE Governor Bailey holds press conference on the BoE's latest Monetary Policy Report
	-	BoE publishes monthly decision maker panel data
Friday 03 February 2023		
Euro area	09.00	ECB publishes its survey of professional forecasters
UK	12.15	BoE Chief Economist Pill to give update on Monetary Policy Report at Bank's Agents briefing

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	M3 money supply Y/Y%	Dec	**4.1**	4.6	4.8	-
France	INSEE consumer confidence	Jan	**80**	83	82	**81**
Spain	Preliminary GDP Q/Q% (Y/Y%)	Q4	**0.2 (2.7)**	*0.1 (2.2)*	0.1 (4.4)	**0.2 (4.8)**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Italy	ISTAT business (manufacturing) sentiment indicator	Jan	**109.1 (102.7)**	-	107.8 (101.4)	**107.9 (101.5)**
	ISTAT consumer confidence	Jan	**100.9**	102.3	102.5	-
UK	CBI distributive trades survey, retailing reported sales	Jan	**-23**	-	11	-

Auctions

Country	Auction
Italy	sold €1.25bn 1.5% 2025 bonds at an average yield of 3.03%
	sold €2bn 2.5% 2025 bonds at an average yield of 3.1%
	sold €1.75bn 0.1% 2033 inflation-linked bonds at an average yield of 2.03%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs