

Euro wrap-up

Overview

- Bunds followed the global trend lower as German factory orders beat expectations, but euro area retail sales fell sharply in December.
- Gilts made large losses as MPC hawk Catherine Mann noted that risks to the BoE's inflation forecast are skewed significantly to the upside, and reiterated that the next step in Bank Rate is more likely to be a hike than a cut.
- Tuesday will bring German IP data for December and a UK retail survey for January.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	2.587	+0.058
OBL 2.2 04/28	2.286	+0.096
DBR 2.3 02/33	2.276	+0.092
UKT 1 04/24	3.435	+0.221
UKT 1¼ 07/27	3.113	+0.206
UKT 4¼ 06/32	3.229	+0.175

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

Euro area

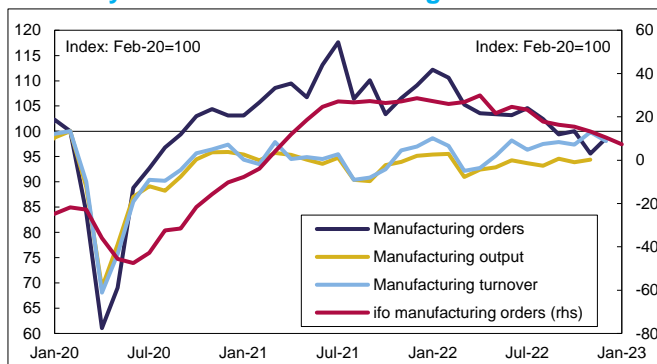
German new factory orders rebound in December but still down significantly in Q4

German factory orders rebounded a little firmer than expected at the end of 2022, rising 3.2%M/M in December. Domestic orders rose 5.7%M/M, while orders from elsewhere in the euro area were up almost 10%M/M but orders from the rest of the world fell 3.8%M/M. Despite the seemingly strong growth in December, total new factory orders were still down 10.1%Y/Y, more than 16% below the peak in July 2021, and about 1½% below the level in February 2020 ahead of the pandemic. The firm rebound in December reflected payback for the marked weakness the prior month, when orders fell (a revised) 4.4%M/M. The exaggerated month-to-month volatility was associated with large-scale orders, particularly in electricity distribution equipment, engines, turbines and the aerospace subsector. Indeed, excluding such items, new factory orders fell for a fourth successive month and by 0.6%M/M. Over the fourth quarter as a whole, total orders dropped for the third successive quarter and by a chunky 4.0%Q/Q (and 4.8%Q/Q excluding bulk orders), with declines in orders of consumer, intermediate and (particularly) capital goods. With other figures today reporting that manufacturing turnover dropped 1.7%M/M in December, data due for release tomorrow seem bound to report a soft end to the year for industrial output. And surveys suggest that new orders continued to decline in January, flagging risks of a subdued start to 2023 for production too.

Retail sales down sharply in December, Sentix survey signals stagnation in Q1

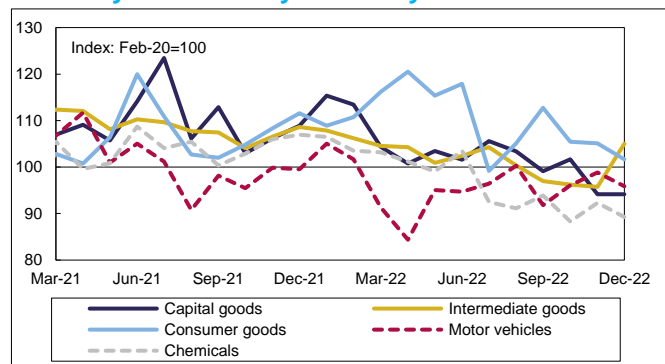
Broadly as expected, euro area retail sales volumes ended 2022 in reverse, with the decline of 2.7%M/M in December the biggest in twenty months. Falls of a similar magnitude were recorded in sales of both food and core goods (i.e. non-food and non-fuel). Sales fell in most member states, but were weakest in the Netherlands (-6.3%M/M) and Germany (-5.3%M/M). The drop in December took retail sales volumes to their lowest level since April 2021, down 2.8%Y/Y and more than 5% below the peak in November 2021, but still slightly above the pre-pandemic level in February 2020. They also fell for the fourth successive quarter in Q4 and by 1.1%Q/Q, highlighting the strong likelihood that private consumption subtracted from GDP growth as households cut spending in the face of falling disposable incomes. Indeed, in nominal terms, the value of retail sales fell 2.0%M/M in December but was still up 0.3%Q/Q in Q4. While the Commission's euro area consumer confidence indicator rose in January to an eleven-month high, it remained historically low and well below the level last February, with the climate for making major purchases judged to have deteriorated to the second-worst on the series. The Commission's retail trade confidence indicator also rose to an eleven-month high but also remained in negative territory, suggestive of continued softness in sales at the start of the year. Today's Sentix survey implied that investors are also becoming less downbeat about economic conditions, with the headline index rising for a fourth successive month in February to an eleven-month high, with improvements judged in current conditions and expectations. However, all of those survey indicators remained in negative territory and consistent with stagnation at best.

Germany: Selected manufacturing indicators



Source: ifo institute, Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: New factory orders by sub-sector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Construction PMIs signal easing challenges at start of year, but still consistent with contraction

Consistent with the improvements signalled by several surveys, including the manufacturing and services PMIs, today's construction PMIs reported an easing in challenges in the sector at the start of the year. In particular, the headline euro area activity PMI jumped 3.5pts in January – the most for a year – to 46.1, the highest reading since June. Admittedly, this contrasted with the deterioration recorded in the Commission's construction confidence index, which in January fell to its joint-lowest level since February 2021. Moreover, the PMIs still implied contraction for the ninth consecutive month, with incoming business remaining restrained by supply-side pressures and rising interest rates. But firms reported a further easing in cost burdens in January – the input price PMI fell to its lowest for two years – and perhaps as a result were also reportedly the least pessimistic about the year ahead for seven months. Within the country breakdown, the improvement was most marked in France, where the activity PMI jumped 7.4pts to 48.4, reflecting a significant easing in the pace of decline in commercial and civil engineering activity. But French housing activity remained very weak (41.8). While the headline German activity PMI rose for a second successive month (up 1.6pts), at 43.3 it also remained consistent with still marked contraction. And given soft underlying demand, the equivalent Italian index (48.2) pointed to ongoing weakness too.

The day ahead in the euro area

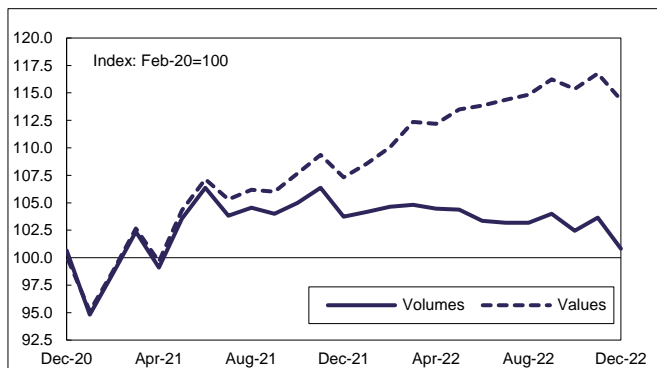
As suggested by today's manufacturing turnover data, tomorrow's German IP figures are likely to confirm that manufacturing output dropped in December. That decline will likely leave it little changed in Q4, as a boost from easing supply-chain disruption was offset by further retrenchment in energy-intensive sub-sectors. Overall German industrial production is forecast to fall 0.8%M/M, leaving it down 0.2%Q/Q in Q4. And while Spanish IP is expected to rise 0.2%M/M in December, that would still leave it down 1.1%Q/Q in Q4. Beyond the economic data, Executive Board member Schnabel will speak publicly tomorrow – expect the main messages from [Thursday's policy-meeting](#) press conference to be repeated.

UK

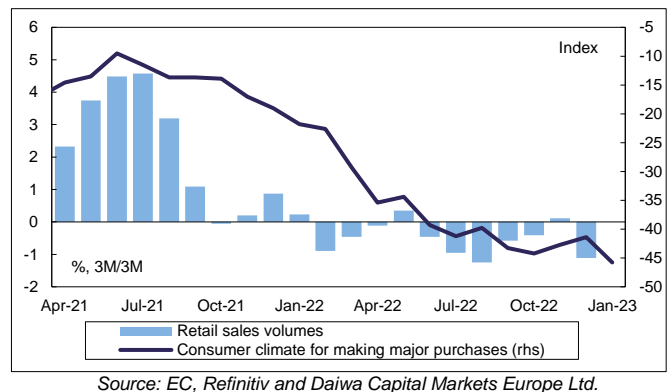
UK car registrations remain in the slow lane

At face value, today's UK new car registrations numbers published by the Society of Motor Manufacturers and Traders (SMMT) suggested a positive start to the year, as the easing in pandemic backlogs continued to support recovery. Indeed, total car sales rose 14.7%Y/Y in January to 132k units, marking the sixth consecutive annual increase, with petrol-fuelled vehicles similarly increasing 14½%Y/Y. Sales of electric vehicles rose more than 22%Y/Y, to account for roughly one-third of the total increase. But growth was again flattered by a low base a year ago, with the total amount of cars registered in January still some 20% below the pre-pandemic five-year average. Moreover, private sales in January (59.6k) were down

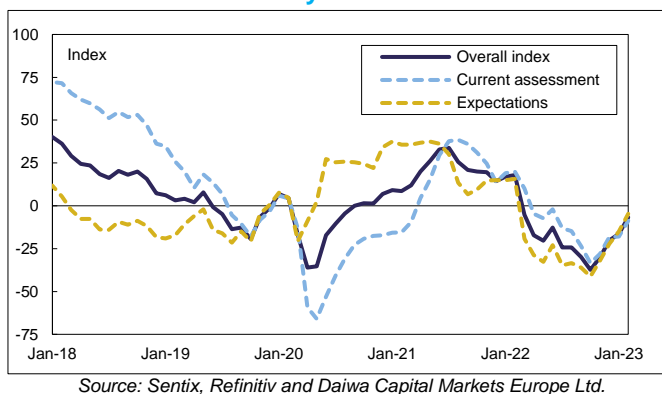
Euro area: Retail sales volumes & values



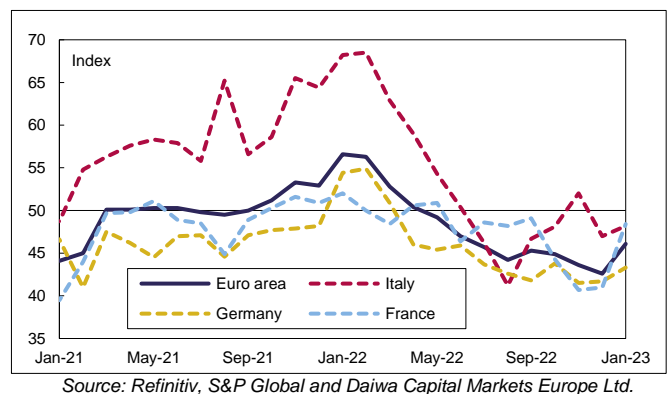
Euro area: Retail sales & consumer climate



Euro area: Sentix survey – Economic indices



Euro area: Construction PMIs



compared with a year earlier, by 4.3% Y/Y, illustrating subdued consumer demand in the face of heightened economic uncertainty, rising borrowing costs, declining disposable incomes and extremely subdued household confidence. So, while the easing of pandemic-related backlogs might provide ongoing support to registrations over the near term, we do not expect to see a significant acceleration in car sales over coming quarters.

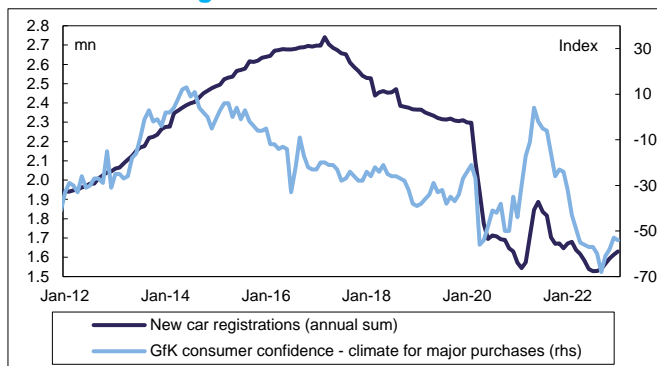
UK construction PMIs signal significant weakening in housing market activity

The impact of higher borrowing costs and weaker demand was also evident in today's UK construction PMI surveys. In particular, the headline activity index fell for the third consecutive month, by 0.4pt to 48.4, implying the steepest drop since May 2020. Perhaps inevitably given the slowdown in the housing market amid significantly higher borrowing rates, today's survey suggested that the weakness was most striking in residential activity, with the respective PMI down 3.2pts in January to 44.8. This took the cumulative decline since October to more than 8pts and the index to its lowest since the initial pandemic slump in April and May 2020, and before that the Brexit referendum in June 2016. But the survey also implied a contraction in commercial activity (48.2) for the first time in five months. Although the pace of decline in new business was little changed in January, respondents cited particularly weak demand in the housing sector. So, just 43% of firms expected activity to rise over the coming twelve months. As such, firms supposedly scaled back their workforces for a second successive month and by the most for two years. The survey also reported the sharpest fall in input-buying in the sector since May 2020. Admittedly, this helped reduce cost pressures, with the input price index implying the second-slowest increase since December 2020.

The day ahead in the UK

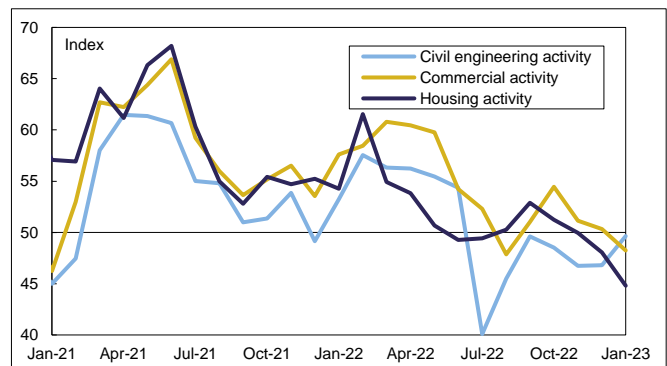
Tomorrow will bring the BRC retail sales monitor for January, which will provide further insight into spending on the UK high street at the start of the year. The recent CBI distributive sales survey reported a deterioration in the net balance of retailers reporting falling sales to the worst since April 2021, with sales unsurprisingly judged to be soft for the time of year. Ongoing declines in real disposable incomes as well as continued disruption from strikes look set to continue to weigh on household spending. Meanwhile, Chief Economist Pill and Deputy Governor Ramsden are due to speak tomorrow.

UK: New car registrations & consumer climate



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Constructions PMIs












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


European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Construction PMI	Jan	46.1	-	42.6	-
	 Sentix investor confidence	Feb	-8.0	-12.0	-17.5	-
	 Retail sales M/M% (Y/Y%)	Dec	-2.7 (-2.8)	-2.5 (-2.9)	0.8 (-2.8)	1.2 (-2.5)
Germany	 Factory orders M/M% (Y/Y%)	Dec	3.2 (-10.1)	2.0 (-11.6)	-5.3 (-11.0)	-4.4 (-10.2)
	 Construction PMI	Jan	43.3	-	41.7	-
France	 Construction PMI	Jan	48.4	-	41.0	-
Italy	 Construction PMI	Jan	48.2	-	47.0	-
UK	 New car registrations Y/Y%	Jan	14.7	-	18.3	-
	 Construction PMI	Jan	48.4	48.5	48.8	-





Auctions

Country	Auction
UK	 BoE sold £650mn of 2030-36 gilts







Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany	 07.00	Industrial production M/M% (Y/Y%)	Dec	-0.8 (-1.6)	0.2 (-0.4)
France	 07.45	Trade balance €bn	Dec	-12.0	-13.8
Spain	 08.00	Industrial production M/M% (Y/Y%)	Dec	0.2 (-0.6)	-0.7 (-1.1)
UK	 00.01	BRC retail sales monitor like-for-like Y/Y%	Jan	-	6.5

Auctions and events

Euro area	 10.00	ECB's Villeroy scheduled to speak
	 17.00	ECB's Schnabel scheduled to speak
Germany	 10.30	Auction: €500mn of 0.1% 2026 index-linked bonds
	 10.30	Auction: €200mn of 0.1% 2046 index-linked bonds
UK	 09.00	BoE Deputy Governor Ramsden and Chief Economist Pill scheduled to speak
	 10.00	Auction: £3.5bn 4.125% 2027 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are MiFID 2 Professional (or equivalent) Clients and should not therefore be distributed to such Retail Clients. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Dislosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: <https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Opinions [and/or estimates] reflect a judgment as at the date of publication and are subject to change without notice. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.