

Euro wrap-up

Overview

- Despite weak German IP data, Bunds made notable losses after the ECB announced it will adjust the interest rate ceiling paid on government deposits within the Eurosystem from 1 May, while Bundesbank President Nagel stated that further significant ECB rate hikes were likely after March.
- Gilts made more significant losses even as UK surveys on retail sales and house prices disappointed.
- Wednesday will bring a UK jobs survey, followed on Thursday by the delayed flash estimates of German inflation in January.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	2.677	+0.082
OBL 2.2 04/28	2.363	+0.070
DBR 2.3 02/33	2.339	+0.052
UKT 1 04/24	3.511	+0.071
UKT 1¼ 07/27	3.217	+0.087
UKT 4¼ 06/32	3.317	+0.074

*Change from close as at 5.00pm GMT.
Source: Bloomberg

Euro area

German IP ends 2022 firmly in reverse as efforts to cut energy use were maintained

German industrial production (including construction) fell more than expected at the end of 2022, dropping 3.1%M/M, more than three times the median forecast decline on the Bloomberg forecast. That left it down 3.9%Y/Y, more than 8½% below the pre-pandemic level in February 2020, and at the lowest level since August 2020. Production in Q4 was therefore down for the third successive quarter and by 0.7%Q/Q, consistent with the weakening that had been signalled clearly by the industrial sector survey indicators. Indeed, the data were very weak in several sectors. Manufacturing and mining output fell 2.1%M/M to a nine-month low, dragged down by a further steep decline in production of energy-intensive items, which fell 6.1%M/M to be down almost 20%Y/Y. Most notably within that component, output of chemical products fell 11.2%M/M to be down almost 30%Y/Y and 12%Q/Q to the lowest level since 1993. As a result, production of intermediate goods overall dropped 5.8%M/M to the lowest since July 2020 to be down 4.0%Q/Q in Q4.

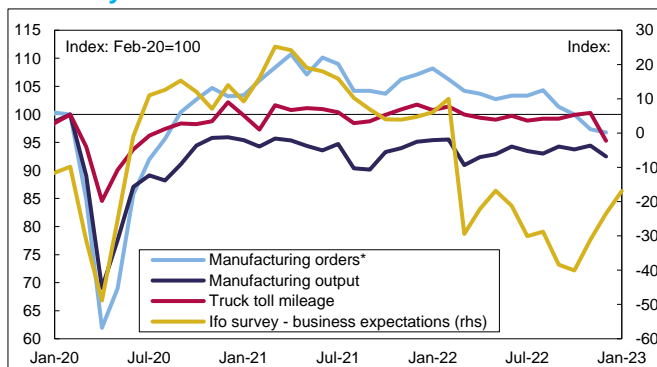
Auto output maintains recovery but construction plunges on cold snap

In contrast, supported by a further rise in autos and related parts to the highest level since the end of 2020, capital goods output was unchanged on the month to be up a firm 3.9%Q/Q in Q4. And consumer goods output rose 0.3%M/M, although that was not enough to prevent a drop of 1.2%Q/Q in Q4. Beyond manufacturing, energy production fell 2.3%M/M in December to be down for a third successive quarter and by a marked 7.8%Q/Q in Q4. And in part due to a cold snap in the weather, construction output in December fell a steep 8.0%M/M – the most since January 2021 and to the lowest level since January 2017 – to be down 1.8%Q/Q in Q4. Looking ahead, surveys point to slightly improved confidence in Germany's industrial sector at the start of the year not least due to a moderation in cost pressures, the easing of concerns about energy supply, and ongoing healing in supply chains. But the continued downtrend in new orders, persisting adverse risks to future domestic and external demand, as well as the negative carry-over from the end of Q4, all point to the likelihood of a further decline in German IP in Q1.

Spanish IP ticks up in December but also subtracts from GDP growth in Q4

In contrast to Germany, Spanish industrial production (excluding construction) rose at the end of 2022, rising 0.8%M/M in December to be marginally above the level in February 2020 ahead of the pandemic. That, however, followed three successive months of declines. And so, Spanish IP dropped for the second successive quarter in Q4, by 0.6%Q/Q, consistent with the decline in both domestic demand and exports. Within the detail, Spanish production at the end of the year was supported by the auto sector, helping capital goods output to rise 2.8%M/M in December and 0.8%Q/Q in Q4. Output of

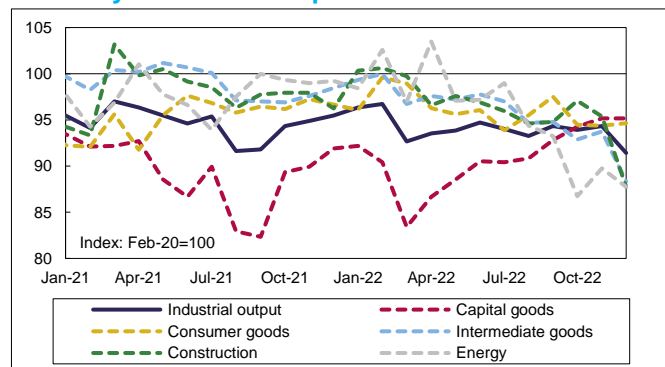
Germany: Selected industrial sector indices



*Excluding major orders.

Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Industrial output & selected sub-sectors



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

consumer goods also rose in December to be up 1.5%Q/Q in Q4. So, as in Germany, output of intermediate goods was the key source of weakness in Spain, down 1.6%M/M and 1.4%Q/Q. As in Germany, survey indicators suggest a slight improvement in conditions in the Spanish industrial sector so far in Q1, albeit with the trend in production likely still down.

The coming two days in the euro area

It will be relatively quiet for top-tier releases tomorrow, with just Italian retail sales figures for December due. Of more interest will be Thursday's release of the delayed German preliminary inflation estimates for January, with a very wide range of analyst forecasts. While the median forecast on the Bloomberg survey is for a rise in the EU-harmonised measure of 0.4ppt to 10.0%Y/Y, last week's flash euro area figure implied a drop in German inflation.

UK

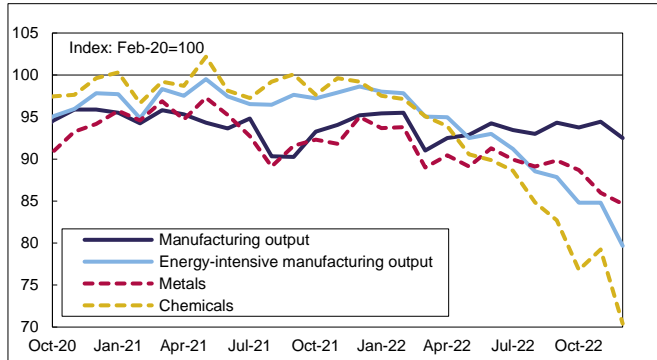
UK retail survey suggests a weak start to the year

According to today's BRC retail sales monitor, and tallying with the recent [CBI survey](#), spending on the UK high street disappointed at the start of the year. Indeed, total sales growth in nominal terms slowed 2.7ppts to 4.2%Y/Y in January, with like-for-like sales down to 3.9%Y/Y. This was in spite of a reported pickup in inflation on the high street at the start of the year. Indeed, when adjusting for the BRC's shop price inflation measure, retail sales volumes were down 3.8%Y/Y in January, the tenth consecutive year-on-year drop. While retailers suggested that demand for own-brand items remained popular, and discounting provided support to clothing sales, spending on big-ticket items was reportedly down. And with [consumer confidence](#) still historically weak, households increasingly pessimistic about the climate for making major purchases, real disposable incomes declining sharply, borrowing costs rising and the economic outlook still highly uncertain, household expenditure seems bound to remain extremely subdued in Q1 and probably the coming couple of quarters too.

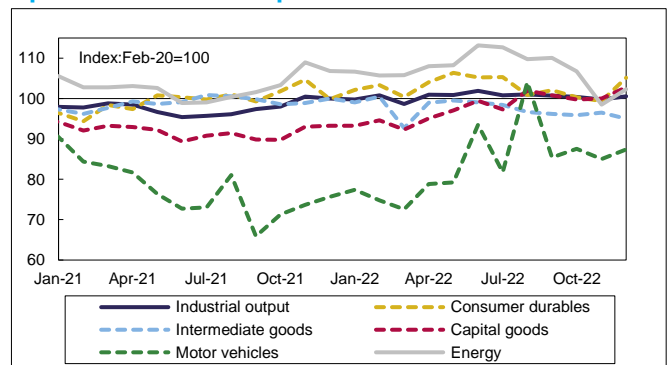
UK house price inflation continues to slow

Given the surge in mortgage rates since the summer, the housing market remains a key downside risk to the UK economic outlook. And while today's Halifax house price index suggested some stability in January, with prices unchanged on the month, this followed significant weakening at the end of last year. Indeed, the average UK house price was down 3.6%3M/3M in January to be more than 4% below its August peak. As a result, the annual increase slowed to just 1.9%Y/Y, from the peak of 12½%Y/Y in June. The slowdown was widespread across regions, but was more significant in the South West (down 3.2ppts to 2.7%Y/Y) and London (down 2.9ppts to 0.0%Y/Y), with prices declining 2.0%M/M in the capital.

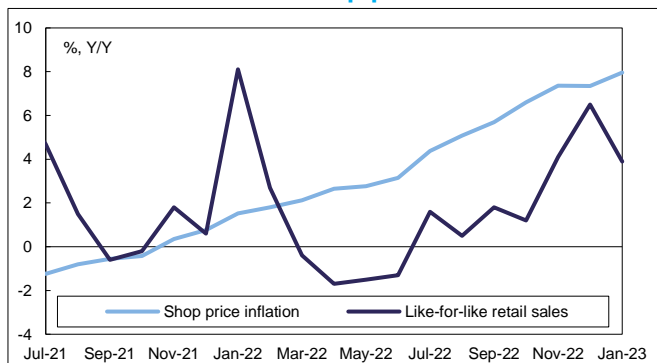
Germany: Energy-intensive manufacturing output



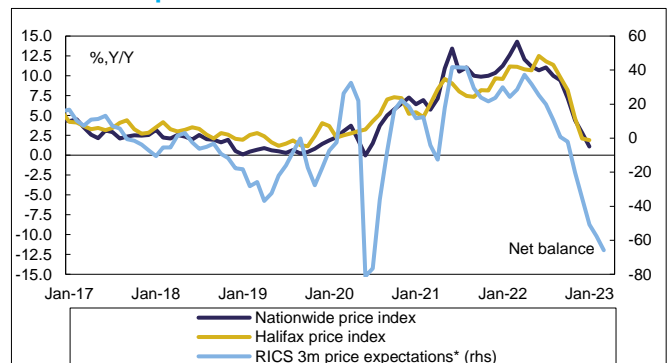
Spain: Industrial output & selected sub-sectors



UK: BRC retail sales & shop price inflation



UK: House price indicators



Today's release broadly aligns with the Nationwide figures, which in January extended the declining streak to the longest since the global financial crisis. And while Rightmove suggested some stabilisation in asking prices in January, they were also almost 2½% below the October peak, with a drop of 4% in London. Taken together with the slump in [mortgage approvals](#) in December, and the extremely downbeat expectations of future sales and prices in the [RICS survey](#), which is likely to be reaffirmed in the January results this week, we expect to see a further fall in house prices over coming months, probably taking the peak-to-trough decline to 10% or more.

The coming two days in the UK





Given the BoE's keen focus on the labour market, the data highlight in the UK tomorrow will be the REC report on jobs, which will be watched for further signs of weakening at the start of the year. Indeed, the December survey suggested that permanent placements fell for a third consecutive month and at the fastest pace since the start of 2021, while demand for workers also eased amid increasing economic uncertainties. And having softened at the end of last year, particular focus will be on wage pressures. Tomorrow's REC report will be followed on Thursday by the RICS residential market indicators, which are likely to report a further drop in the headline price balance, as well as worsening expectations for sales and prices over the coming three months too.

The next edition of the Euro wrap-up will be published on 09 February 2023




European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany 	Industrial production M/M% (Y/Y%)	Dec	-3.1 (-3.9)	-2.0 (-1.9)	0.2 (-0.4)	0.4 (-0.5)
France 	Trade balance €bn	Dec	-14.9	-	-13.8	-13.6
Spain 	Industrial production M/M% (Y/Y%)	Dec	0.8 (0.6)	-	-0.7 (-1.1)	-0.6 (-1.5)
UK 	BRC retail monitor like-for-like sales Y/Y%	Jan	3.9	-	6.5	-




Auctions

Country	Auction
Germany 	sold €375mn of 0.1% 2026 index-linked bonds at an average yield of 0.19%
	sold €198mn of 0.1% 2046 index-linked bonds at an average yield of -0.07%
UK 	sold £3.5bn 4.125% 2027 bonds at an average yield of 3.351%




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Upcoming releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Wednesday 08 February 2023					
Italy 	09.00	Retail sales M/M% (Y/Y%)	Dec	-	0.8 (4.4)
Thursday 09 February 2023					
Germany 	07.00	Preliminary HICP (CPII) Y/Y%	Jan	10.0 (8.9)-	9.6 (8.6)
UK 	00.01	RICS house price balance %	Jan	-45	-42

Auctions and events

Wednesday 08 February 2023					
Germany 	10.30	Auction: €4bn of 2.1% 2029 bonds			
UK 	01.01	KPMG/REC report on jobs			
	10.00	Auction: £2bn of 1.125% 2039 bonds			
Thursday 09 February 2023					
- Nothing scheduled -					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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