Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made gains as the flash estimates of German inflation in January came in below expectations, despite also indicating the likelihood of a modest upwards revision to euro area inflation.
- Despite another downbeat UK housing market survey, Gilts made losses at the shorter end of the curve as BoE MPC members offered a range of views about the balance of risks to the economic outlook.
- Friday will bring data for UK GDP in Q4 and Italian IP in December.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	2.672	-0.026
OBL 2.2 04/28	2.326	-0.035
DBR 2.3 02/33	2.300	-0.057
UKT 1 04/24	3.456	+0.042
UKT 1¼ 07/27	3.218	+0.044
UKT 4¼ 06/32	3.301	-0.008

*Change from close as at 4:35pm GMT.
Source: Bloomberg

Euro area

Flash German estimate implies modest upwards revision to euro area inflation in January

The delayed flash estimates of German inflation in January point to the likelihood of an eventual modest upwards revision to the euro area headline rate when the region's final data are published on 23 February. On the national CPI measure, German inflation edged up 0.1ppt to 8.7%Y/Y, still 1.7ppts below last October's peak. And on the EU-harmonised HICP measure, German inflation fell for the third successive month, dropping 0.4ppt to 9.2%Y/Y, 2.4ppts below October's peak. That was well below the rise to 10.0%Y/Y suggested by the median forecast on the Bloomberg survey. But it was still about ½ppt above the rate implied by the flash euro area estimate published on 1 February. So, notwithstanding the possibility of forthcoming revisions to the estimates from Germany and the other member states, today's data suggest that euro area headline inflation will in due course be upwardly revised by up to 0.2ppt to 8.7%Y/Y. Unfortunately, the German statistics agency Destatis failed to provide the usual detail of major sub-components with today's flash CPI data. Therefore, it is impossible to judge whether the initial estimate of euro area core inflation (5.2%Y/Y) will also need to be upwardly revised. However, the government's electricity price cap appears to have facilitated the further decline in the HICP rate last month.

The day ahead in the euro area

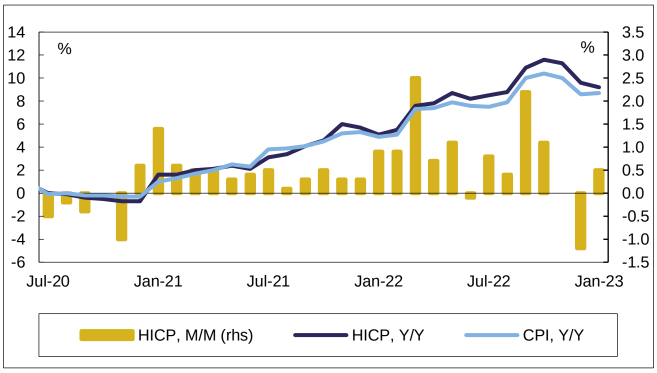
A quiet end to the week on the euro area economic data front brings Italian industrial production data for December. While Italian IP is forecast to edge higher in December (+0.2%M/M), that would follow drops in each of the previous three months. So, a result in line with expectations would still leave Italian IP down 1.2%Q/Q in Q4.

UK

RICS survey points to further house price falls ahead

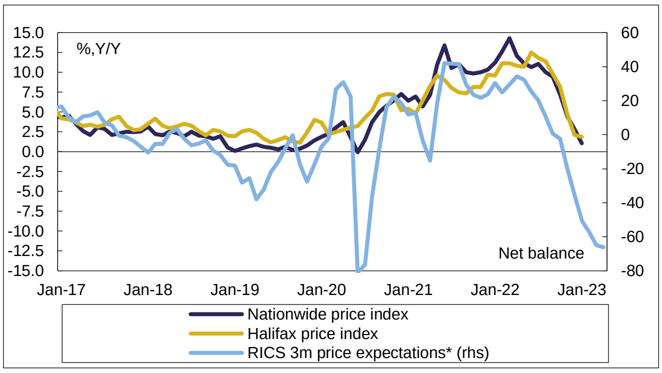
While Tuesday's Halifax house price index suggested a pause in the decline of house prices at the start of the year, today's RICS residential market survey results pointed to an ongoing steady downtrend ahead. A net balance of -47.0% of survey respondents – down a larger-than-expected 5pts to the lowest since April 2009 – judged that house prices were rising at the start of the year. More notably regarding the outlook, the index of new buyer enquiries weakened to its second lowest level since the global financial crisis (bar the first wave of Covid-19), only beating October's reading which had suffered from the marked impact of the Truss crisis on mortgage rates and availability. New vendor instructions also continued to fall. And so, the survey index of sales expectations remained weak. Expectations for residential prices three months ahead (-66.2) were the most negative on the series bar the first wave of Covid and initial aftermath of the collapse of Lehman Brothers in 2008. And while not quite as bad as the past few readings, price expectations twelve months ahead remained highly negative

Germany: Consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: House price indices



**RICS index has 3-month lead.*
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

(-39.6) at the second-lowest level on the series. Overall, we think the RICS survey was again consistent with a peak-to-trough decline in house prices of at least 10%, and note that significantly more than that will be required to offset the hit to affordability to first-time buyers caused by the rise in mortgage rates since the summer. So, with demand and selling prices falling, the outlook appears challenging for building firms, which continue to be squeezed by the shock to input prices over the past few years. While prices of construction materials for new housing in December had at least fallen more than 3ppts from their peak in July, they were still up 7.5%Y/Y and more than 35% above the level three years earlier ahead of the pandemic. And overall prices of construction materials – including those required for repair and maintenance – were up a larger 11.2%Y/Y to be still more than 42% above the level three years earlier.

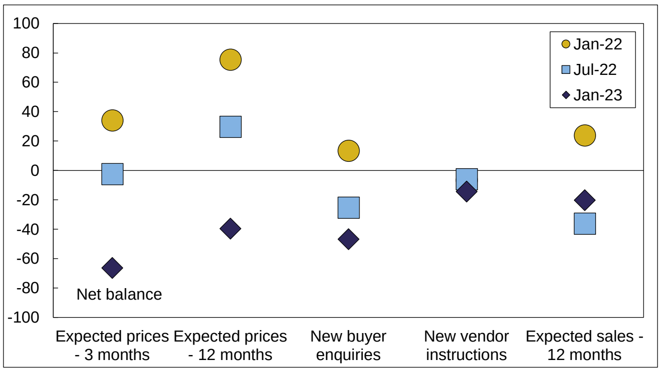
Labour market survey suggests loss of momentum but continued tightness

Last week's BoE MPC statement noted that the Committee would "monitor closely... the tightness of labour market conditions and the behaviour of wage growth" as it judges whether to tighten monetary policy further. Recent economic surveys have signalled a loss of momentum in the labour market, e.g. with the composite employment PMI dropping below 50 in December and January. Yesterday's KPMG/REC report on jobs also suggested a loosening of conditions in the jobs market at the start of 2023, although there remained evidence of a relatively tight balance between supply and demand by historical standards. In particular, recruitment consultants reported a fourth successive drop in new permanent hires in January. However, firms' reliance on temporary staff increased, with such positions rising the most since September. Moreover, the number of vacancies rose the most in three months, albeit similarly with openings for temporary staff outpacing those for permanent hires. While staff availability appeared to improve somewhat to the best since March 2021, candidate shortages persisted. And although the survey indicator for growth in starting salaries for new permanent staff edged down to the lowest since April 2021, it remained well above the long-run average. We suspect that next Tuesday's ONS labour market data will report a drop in employment in the three months to December and a 0.1ppt rise in the unemployment rate over the same period to 3.7%. But while private sector regular pay growth is likely to slow from 7.4%Y/Y in November, it also seems likely to remain well above the BoE's comfort zone, providing ammunition to the MPC's hawks.

The day ahead in the UK

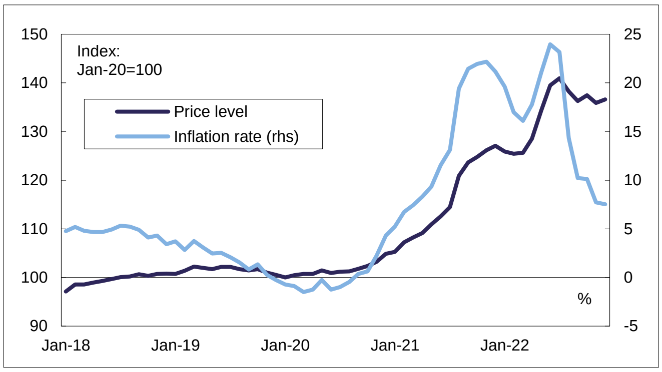
The week's UK data highlight comes tomorrow in the form of the first estimate of Q4 GDP and associated monthly output and trade figures for December. Not least reflecting the weakening in demand amid high inflation, rising borrowing costs and heightened economic uncertainties, we forecast a moderate decline of around ½%M/M in GDP in December. And that should leave GDP broadly flat in Q4, with consumer spending subtracting from growth, leaving the UK as the only G7 economy with output still below the pre-pandemic level at the end of 2022.

UK: RICS residential market survey indices



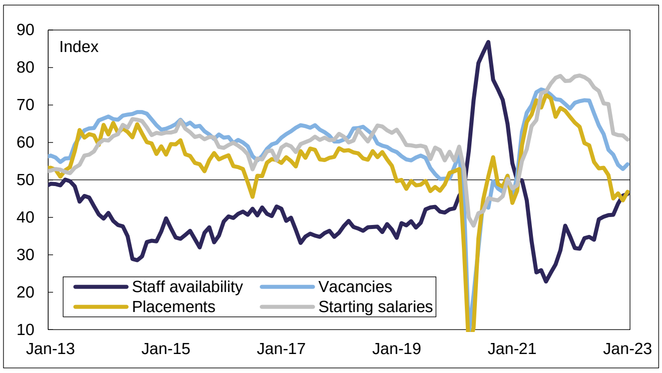
Source: Refinitiv & Daiwa Capital Markets Europe Ltd.

UK: Construction material prices for new housing



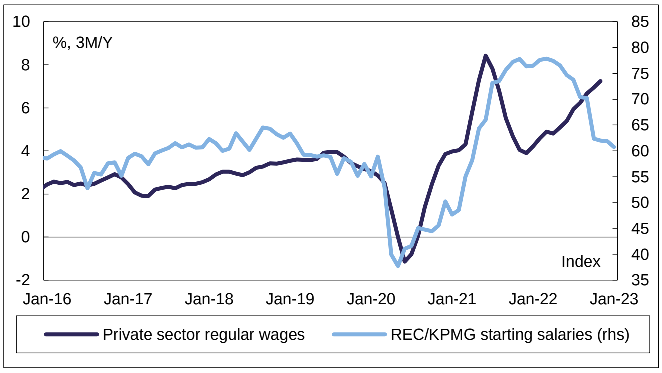
Source: DBEIS and Daiwa Capital Markets Europe Ltd.

UK: REC/KPMG report on jobs – selected indices



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

UK: Wage growth indicators



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

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK		RICS house price balance %	Jan	**-47**	-45	-42	-
Germany		Preliminary HICP (CPI) Y/Y%	Jan	**9.2 (8.7)**	10.1 (9.0)	9.6 (8.6)	-

Auctions

Country		Auction
UK		BoE sold £621.2mn of 2026-29 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Italy		Retail sales M/M% (Y/Y%)	Dec	**-0.2 (3.4)**	-	0.8 (4.4)	-

Auctions

Country		Auction
Germany		sold €3.38bn of 2.1% 2029 bonds at an average yield of 2.34%
UK		sold £2bn of 1.125% 2039 bonds at an average yield of 3.74%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Italy		09.00	Industrial production M/M% (Y/Y%)	Dec	0.2 (-)	-0.3 (-3.7)
UK		07.00	GDP Q/Q% (Y/Y%)	Q4	*0.0 (0.4)*	-0.3 (1.9)
		07.00	GDP M/M%	Dec	*-0.5*	0.1
		07.00	Industrial production M/M% (Y/Y%)	Dec	-0.2 (-5.2)	-0.2 (-5.1)
		07.00	Manufacturing production M/M% (Y/Y%)	Dec	-0.2 (-6.1)	-0.5 (-5.9)
		07.00	Index of services M/M% (Q/Q%)	Dec	-0.3 (0.1)	0.2 (-0.1)
		07.00	Construction output M/M% (Y/Y%)	Dec	-	0.0 (4.0)
		07.00	Goods trade balance (ex precious metals) £bn	Dec	-17.3 (-)	-15.6 (-21.0)

Auctions and events

UK		14.00	BoE Chief Economist Pill scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.