Euro wrap-up

Overview

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- Bunds made losses as data confirmed another firm rise in euro area employment in Q4 and ECB hawks continued to flag the possibility of another "significant" rate hike in March.
- Gilts made sizeable losses as strong growth in UK regular wages increased expectations of further near-term BoE monetary tightening.
- Wednesday will bring new data for UK inflation and euro area IP and goods trade.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	2.837	+0.070
OBL 2.2 04/28	2.494	+0.078
DBR 2.3 02/33	2.431	+0.065
UKT 1 04/24	3.761	+0.176
UKT 1¼ 07/27	3.493	+0.154
UKT 4¼ 06/32	3.515	+0.118

*Change from close as at 5:00pm GMT.
Source: Bloomberg

Euro area

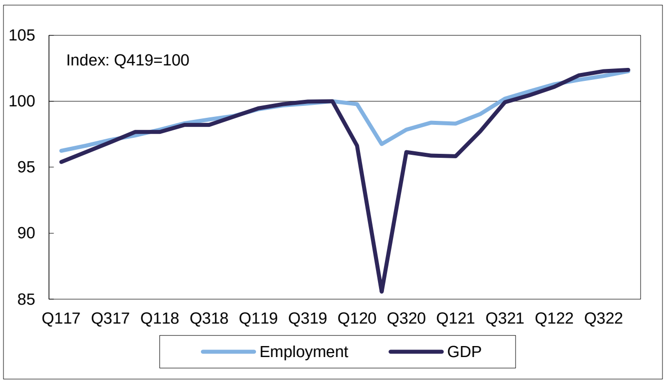
No surprise from second estimate of GDP in Q4, while job growth remains firm

Today's second estimate of euro area Q4 GDP provided no surprises, reaffirming the initial growth estimate of 0.1%Q/Q, the softest rate in seven quarters and 0.2ppt softer than in Q3, albeit stronger than most forecasts at the start of the quarter. The expenditure breakdown will not be available until the release of the third estimate, due in early March. But monthly data and the limited figures available from the member states strongly suggest that domestic demand – and particularly household consumption – subtracted from GDP growth. Net trade appears to have provided the boost to keep GDP growth positive, albeit perhaps only because imports fell at a faster pace than exports. At the country level, growth was fully accounted for by the extraordinary jump in Irish GDP, while among the large member states, contractions in Germany and Italy broadly offset growth in France and Spain. Meanwhile, just as survey indicators had suggested that euro area demand for labour remained resilient in the fourth quarter despite the slowdown in economic output, today's data confirmed a seventh successive steady quarterly rise in employment. Indeed, the pace of job growth stepped up 0.1ppt to a three-quarter high of 0.4%Q/Q, implying a slowing of labour productivity growth at the end of last year. National data highlight ongoing notable job growth in Germany (despite its contraction in GDP) and Spain. Looking ahead, while business survey indicators point to improved confidence at the start of the year, weak December data have led us to expect stagnation in GDP at best in the euro area in Q1. And while surveys also point to a pickup in employment intentions, we also look for a moderation in job growth – albeit still remaining in positive territory – this quarter.

The day ahead in the euro area

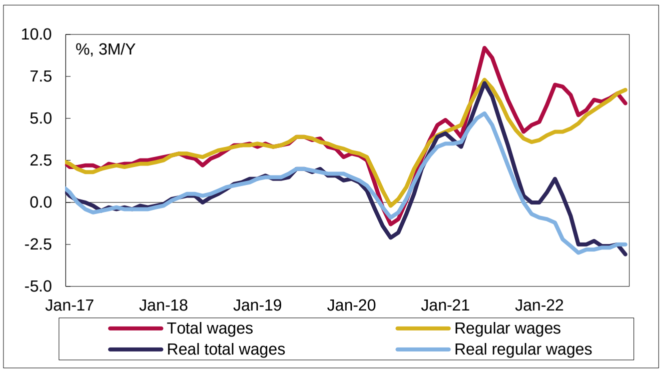
Tomorrow brings the release of euro area industrial production and goods trade figures for December, which will no doubt again highlight the weak end to 2022. While production (excluding construction) declined sharply in Germany (-2.1%M/M) and especially Ireland (-8.5%M/M), we expect aggregate euro area IP to have fallen more moderately, by a little less than 1%M/M. That, however, would fully reverse the increase in November, and leave it down around ½%Q/Q in Q4. The goods trade figures, meanwhile, are likely to report declines in both exports and imports in December.

Euro area: GDP and employment



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

UK: Wage growth*



**Real wages deflated by the CPI.*
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK

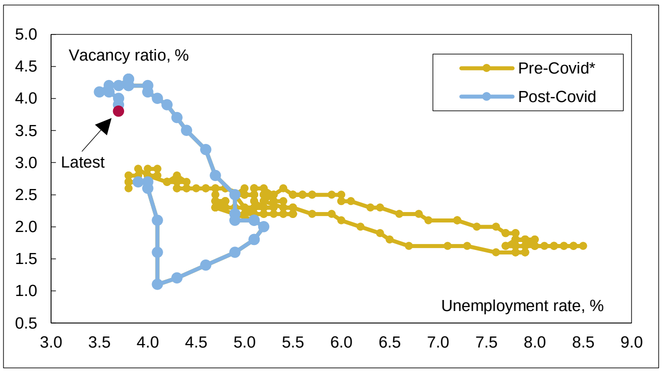
Strong growth in regular wages keeps further rate hike on the table…

Ahead of tomorrow's CPI inflation data, today's labour market figures increased the likelihood that the BoE will raise Bank Rate again in March. Most importantly, after the MPC earlier this month flagged wage growth as a key variable that would determine whether further monetary tightening would be required, regular pay accelerated in the three months to December to 6.7%3M/Y, up 0.9ppt from the three months to September and indeed a series high outside of the initial pandemic period. Private sector regular pay growth accelerated 0.7ppt from the prior three-month period to 7.3%3M/Y, led by financial and business services and construction. And public sector regular pay growth rose 2.0ppts to 4.2%3M/Y. Admittedly, there were hints of a slight softening in the private sector, where the quarterly rate of regular pay growth moderated slightly, by 0.2ppt to 1.7%3M/3M. But against the backdrop of ongoing staff shortages and industrial action – 843k working days were lost to strikes in December, the most in eleven years – the equivalent pace in the public sector also jumped more than 2.0ppts to 2.7%3M/3M. With bonuses in the private sector weaker, total pay slowed 0.1ppt from the prior three-month-period to 5.9%3M/Y from October to December. Moreover, in real terms, deflated by the ONS's preferred CPIH index, total pay fell 3.1%3M/Y, the most since the three months to April 2009. And real total pay deflated by the CPI fell a record 4.6%3M/Y, underscoring the likelihood of continued weakness in household spending. Nevertheless, the strengthening of overall regular pay growth is likely to be a red flag for the MPC as it weighs the need to respond to signs of second-round inflationary effects from wages.

…but balance between supply and demand for labour becoming gradually less tight

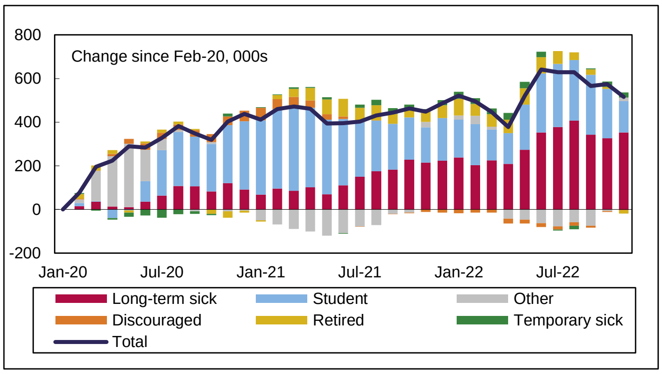
Of course, the strong rate of nominal pay growth in part reflects the tight balance of supply and demand in the labour market. However, the latest data brought further evidence of a loosening in labour market conditions. Most welcome was the further fall in the inactivity rate, of 0.3ppt on the quarter to a six-month low of 21.4% in the three months to December. That reflected a decline in economic inactivity among students, the retired and long-term sick – perhaps a response to the cost-of-living pressures. But while there was a record flow from the economically inactive into employment, the unemployment rate increased 0.1ppt on the quarter to 3.7%. The number of people seeking extra working hours also picked up, while the number of Zero Hours Contracts reached a record high, suggesting that the rise of 0.2ppt in the employment rate over the quarter (to 75.6%, still 0.9ppt lower than before the pandemic) was not centred on high-quality jobs. Moreover, a softening of labour demand was also reflected in a seventh successive quarterly decline in the number of job vacancies in the three months to January. And the redundancy rate continued to rise over the quarter in the three months to December, albeit

UK: Beveridge curve



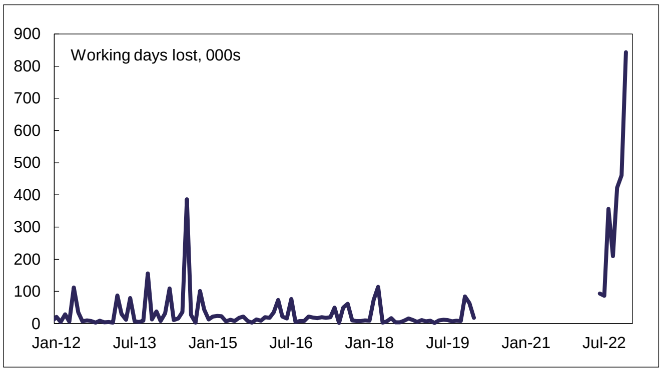
** Pre-Covid period represents data between 2001 and 2019. Red circle represents December 2022 observation. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

UK: Economically inactive workers



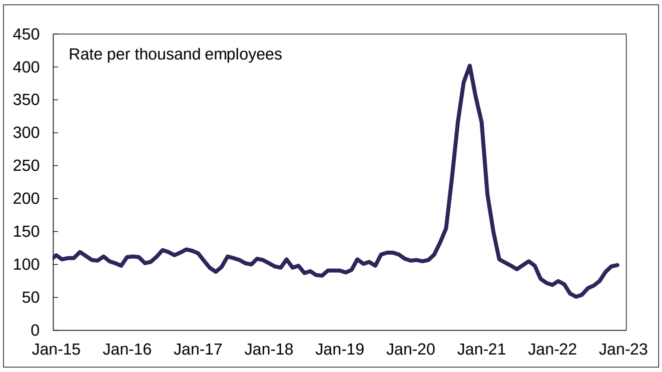
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Working days lost due to industrial action



Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Redundancies



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

remaining low by historical standards. Admittedly, the unemployment rate remains firmly below the BoE's estimate of the equilibrium rate, which is also expected to pick up as the downturn persists. And the ratio of unemployed to vacancies remains close to historical lows. But various indicators – including the sub-50 composite employment PMI and REC survey indices – point to a softening of labour market conditions around the turn of the year. Indeed, the Bank's December Decision-Maker Panel survey reported a softening in business wage growth expectations for this year, down 0.6ppt in January to a five-month low of 5.7%Y/Y. And given the weak economic outlook, the loosening of the labour market is likely to continue over coming months, helping pay growth eventually to subside to rates within the BoE's comfort zone. In our view, that should help to justify an end to the BoE's tightening cycle in Q2.

The day ahead in the UK

The focus in the UK tomorrow, will be the latest inflation data. We expect the headline CPI rate to have eased for third consecutive month in January, by 0.4ppt to 10.1%Y/Y, a full percentage point below the October peak. The drop will principally reflect a further moderation in energy inflation amid a sharp decline in petrol prices. But while services inflation is expected to have remained at a series high, a drop in core goods inflation should see the core CPI rate edge slightly lower too.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	GDP – second estimate Q/Q% (Y/Y%)	Q4	**0.1 (1.9)**	*0.1 (1.9)*	0.3 (2.3)	-
	Preliminary employment Q/Q% (Y/Y%)	Q4	**0.4 (1.5)**	-	0.3 (1.8)	-
France	ILO unemployment rate %	Q4	**7.0**	7.1	7.1	-
UK	Unemployment claimant count rate % (change '000s)	Jan	**3.9 (-121.9)**	-	4.0 (19.7)	3.9 (-3.2)
	Payrolled employees monthly change, '000s	Jan	**102**	15	28	47
	ILO unemployment rate %, 3M	Dec	**3.7**	3.7	3.7	-
	Average earnings including (excluding) bonuses 3M/Y%	Dec	**5.9 (6.7)**	6.2 (6.5)	6.4 (6.4)	6.5 (6.5)
	Employment change '000s, 3M/3M	Dec	**74**	43	27	-

Auctions

Country	Auction
Italy	sold €3.5bn of 3.50% 2026 bonds at an average yield of 3.37%
	sold €3.5bn of 3.85% 2029 bonds at an average yield of 3.80%
	sold €1.5bn of 3.25% 2038 bonds at an average yield of 4.28%
UK	sold £3.0bn of 3.25% 2033 bonds at an average yield of 3.53%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
			- Nothing to report -			

Auctions

Country	Auction
UK	BoE sold £650mn of 2044-71 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data					
Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	10.00	Industrial production M/M% (Y/Y%)	Dec	*-0.9 (-0.9)*	1.0 (2.0)
	10.00	Trade balance €bn	Dec	-16.0	-15.2
Spain	08.00	Final HICP (CPI) Y/Y%	Jan	*5.8 (5.8)*	5.5 (5.7)
	08.00	Final core CPI Y/Y%	Jan	*7.5*	7.0
UK	07.00	CPI M/M% (Y/Y%)	Jan	*-0.5 (10.1)*	0.4 (10.5)
	07.00	Core CPI Y/Y%	Jan	*(6.2)*	6.3
	07.00	PPI output prices M/M% (Y/Y%)	Jan	0.1 (13.3)	-0.9 (14.7)
	07.00	PPI input prices M/M% (Y/Y%)	Jan	0.2 (14.7)	-1.2 (16.5)
	09.30	House price index Y/Y%	Dec	9.2	10.3
Auctions and events					
Euro area	14.00	ECB President Lagarde participates in a debate on the ECB Annual Report 2021			
Germany	10.30	Auction: €1.0bn of 1.25% 2048 bonds			
	11.30	Auction: €1.5bn of 0.00% 2052 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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