

# Euro wrap-up

## Overview

- Bunds followed US10s lower despite today's data confirming the further retrenchment in euro area energy-intensive manufacturing production, as well as a slump in goods exports at the end of 2022.
- Gilts made sizeable gains as UK inflation surprised on the downside at the start of 2023, with core inflation down to the lowest rate since June.
- On Thursday the ECB and BoE Chief Economists will speak publicly, while Friday will bring January figures for German PPI, final French CPI and UK retail sales.

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### Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	2.853	+0.016
OBL 2.2 04/28	2.519	+0.025
DBR 2.3 02/33	2.470	+0.039
UKT 1 04/24	3.778	-0.062
UKT 1¼ 07/27	3.423	-0.082
UKT 4¼ 06/32	3.482	-0.038

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

Source: Bloomberg

## Euro area

### Euro area manufacturing slips back further as energy-intensive production slumps

There were no major surprises from today's euro area industrial production release, which confirmed a weak end to the year for the manufacturing sector despite an easing in pandemic-related supply constraints. In particular, output fell 1.1%M/M in December, largely reversing upwardly revised growth in November (1.4%M/M), to leave output down 1.7%Y/Y and 0.2%Q/Q lower in Q4. While the weakness was exacerbated by Ireland – for which output slumped 8.5%M/M – aggregate euro area IP excluding that country was still down 0.8%M/M in December, with Germany (-2.1%M/M) leading the decline. While the overall drop in Q4 was smaller than had been implied by various survey indicators, the detail in today's release reported significant declines in production of energy-intensive items, which fell more than 3%M/M in December to its lowest level since June 2020 to leave the quarterly average some 4½% lower. Within that component, the drop in output of chemicals was most striking (-4.8%M/M), to leave the level some 19½% below the peak in December 2021 and at its weakest since the global financial crisis. And with production of basic metals also down 4%M/M, output of intermediate goods overall dropped 2.8%M/M, the most since the initial pandemic plunge in April 2020. But while autos production accelerated in December (7.0%M/M) to be up some 14%Q/Q in Q4, capital goods production also fell 0.4%M/M in December. Meanwhile, output of consumer durables fell for the fourth consecutive month, to its lowest level since September 2021.

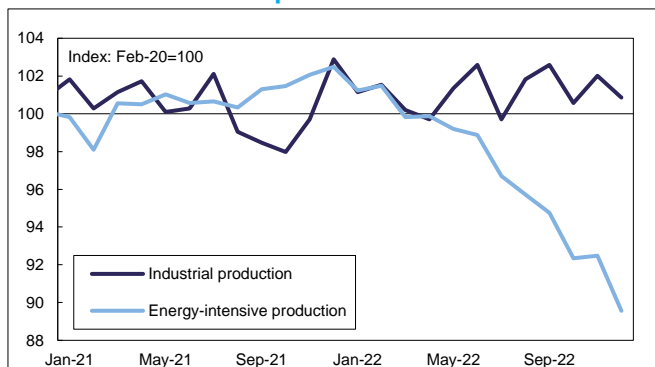
### Euro area export values decline sharply in December

While manufacturing surveys have signalled some stabilisation in the sector at the start of the year, the outlook remains uncertain including with respect to global demand. Today's euro area goods trade figures flagged a challenging end to last year, with the value of exports declining 4.6%M/M in December, the most since April 2020. So, while growth in exports remained positive in Q4, at 0.9%Q/Q it was some 1½ppts softer than in Q3 and almost 5½ppts weaker than the rebound in Q122. Meanwhile, in part likely due to the drop in commodity prices over recent months as well as soft domestic demand, the downtrend in the value of imports was maintained in December, down 2.9%M/M to be almost 12% below August's peak. As a result, the euro area's goods trade deficit in December, of €18.1bn, was just half the level at the end of Q3 and some €28bn off August's record high. And when the expenditure breakdown of Q4 GDP is published on 8 March, the figures are highly likely to confirm that net trade provided the main source of economic growth in Q4.

### The coming two days in the euro area

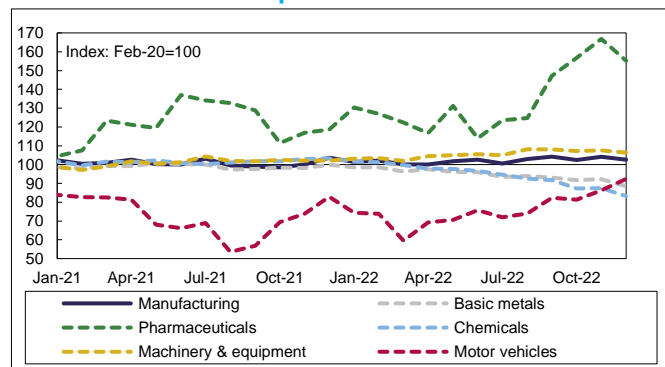
The remainder of the week will be quiet on the euro area data front, with the release of German PPI numbers for January on Friday. These are likely to report a further moderation in headline producer price inflation, reflecting not least the decline in

#### Euro area: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

energy prices since the start of the year. Friday will also bring revised French CPI inflation numbers, for which the flash estimate saw the headline HICP rate rise 0.3ppt to 7.0%Y/Y. Separately, ECB Chief Economist Lane will take stock of the euro area's hiking cycle at a lecture at NIESR (tomorrow), while Executive Board member Panetta and BoF Governor Villeroy are due to discuss monetary policy at separate events tomorrow and Friday respectively.

## UK

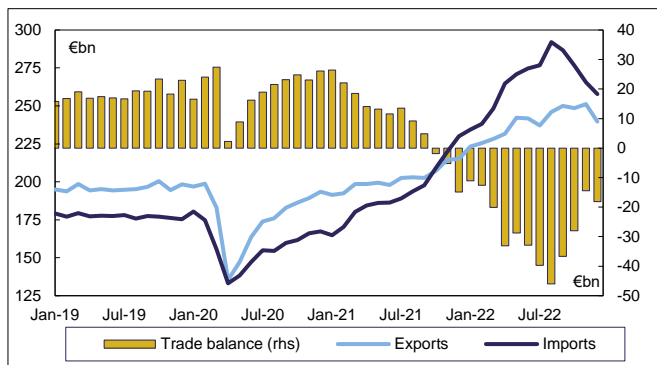
### Headline and core CPI surprise on the downside in January

Today's UK CPI inflation figures confirmed a third consecutive moderation in January and by a larger degree than the Bloomberg survey consensus. Indeed, the monthly drop in consumer prices of 0.6%M/M in January was the first for a year and the steepest for four years, although this was in line with the pre-pandemic ten-year average for that month (as well as our own estimate). As such, the headline inflation rate fell 0.4ppt to 10.1%Y/Y, a full percentage point below the October peak and bang in line with the BoE's latest forecast. Having exceeded the pre-pandemic average monthly price change for twenty months through to December, prices of core items fell a steeper-than-normal 0.9%M/M in January, to leave the annual rate similarly down 0.5ppt to 5.8%Y/Y, the lowest rate since June. Contrary to expectations, services drove the weakness last month, for which the inflation rate dropped 0.8ppt to 6.0%Y/Y. This principally reflected a record drop in airfares (-42%M/M), to leave the annual rate down 25ppts to 18.4%Y/Y, with the impact of this price change on overall inflation exaggerated by an increase in the weight in the CPI basket. Most encouragingly perhaps, the BoE's preferred measure of core services inflation (excluding airfares, package holidays and education) also moderated in January, by ½ppt to 6.0%Y/Y, well below the Bank staff forecast of a rise of 0.2ppt to 6.7%Y/Y in this month's Monetary Policy Report.

### Contribution from energy inflation revised higher on CPI basket adjustment

In contrast to the improved services figures, core goods inflation fell less than expected at the start of the year (down 0.1ppt to 5.6%Y/Y), as a jump in the games and hobbies component (up 13ppts to 1.4%Y/Y) largely offset another moderation in furniture to its lowest in a year, as well as a steeper decline in prices of second-hand cars as supply-side pressures eased further. The uptrend in food prices was also maintained in January, with inflation (13.2%Y/Y) matching October's series high. But while petrol prices fell sharply further (-3.8%M/M), and energy inflation moderated 1½ppts to a four-month low of 51.2%Y/Y, an upwards revision to the weight in the CPI basket for energy saw the contribution to overall inflation rise by 0.6ppt to more than 4ppts – indeed, had today's figures been based on 2022 weights the contribution from energy would have fallen to 3.4ppts and headline inflation dropped back into single digits. Looking ahead, inflation should indeed return to

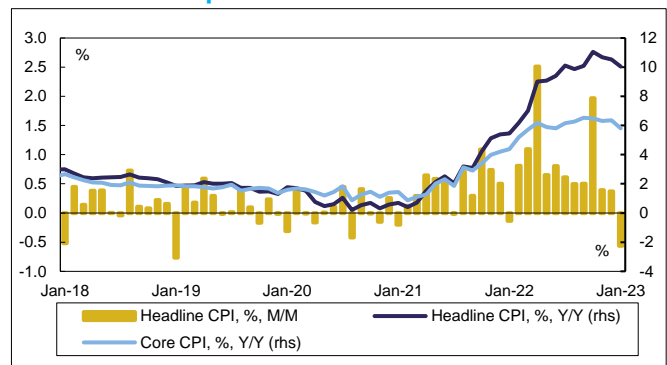
#### Euro area: Goods trade balance\*



\*Seasonally-adjusted values.

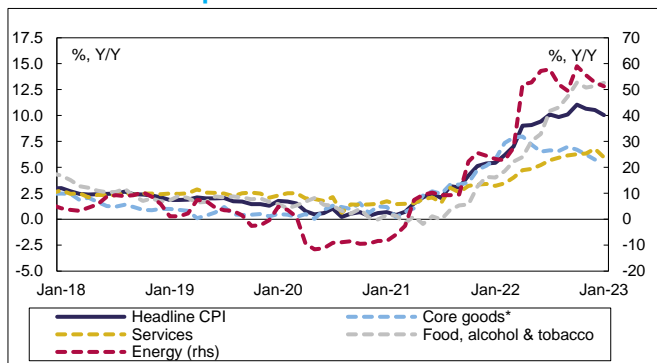
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

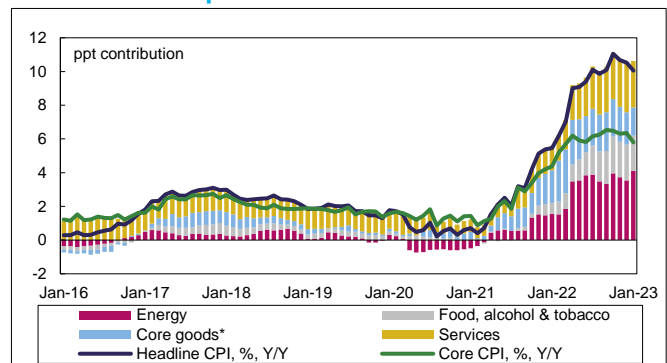
#### UK: Consumer price inflation



\*Core goods excluding energy, food, alcohol and tobacco.

Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

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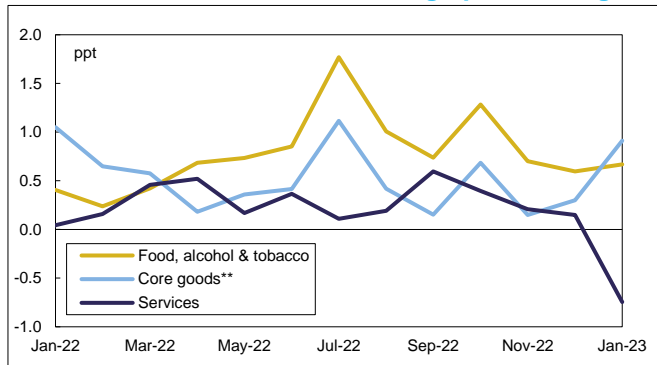
single digits in February and maintain a steady downwards trend over the remainder of the year, not least thanks to a steady moderation in energy inflation. Certainly, petrol prices have edged slightly lower in the first half of February, and today's PPI release suggested a further significant fall in input prices of crude oil in January. Moreover, in the absence of upside price pressures that might emerge later this year from shortages in the UK's gas storage capacity, the larger basket share of energy should mean that the fall in headline CPI inflation will in due course be slightly faster than previously anticipated. Given still-strong wage growth, we maintain our view that the majority on the MPC will favour additional tightening in March. Nevertheless, with the economic outlook weak and inflation set to fall below target through the second half of 2024, the pace of tightening will moderate in March to 25bps and that hike in Bank Rate to 4.25% should mark the last in the current tightening cycle.

### The coming two days in the UK

In the UK, after a day bereft of economic releases tomorrow, Friday will bring retail sales figures for January, which are likely to have maintained a downwards trend at the start of the year. Retail sales are expected to fall 0.3%M/M in January, and a little further than that excluding petrol, leaving both measures down around 5½%Y/Y. Meanwhile, BoE Chief Economist Pill will participate on Thursday in a fireside chat on recent monetary policy developments.

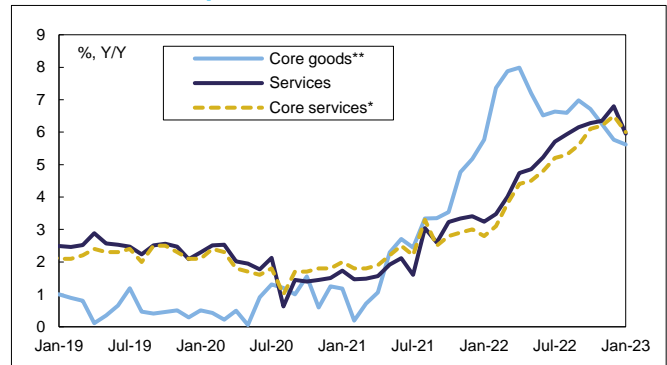
*The next edition of the Euro wrap-up will be published on 17 February 2023*

#### UK: CPI deviations from l-r average price change\*



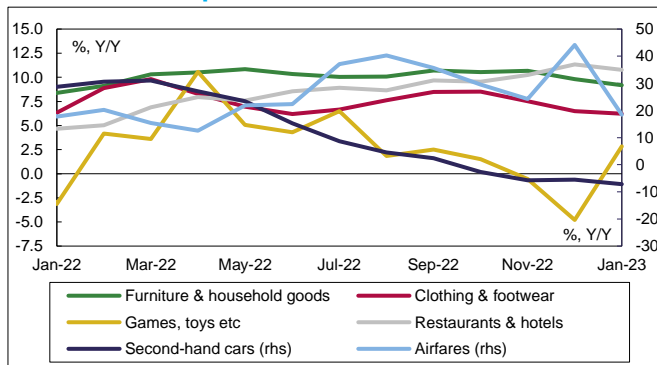
\*Difference in monthly consumer price change from pre-pandemic long-run average \*\*Core goods excluding energy, food, alcohol and tobacco. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Consumer price inflation



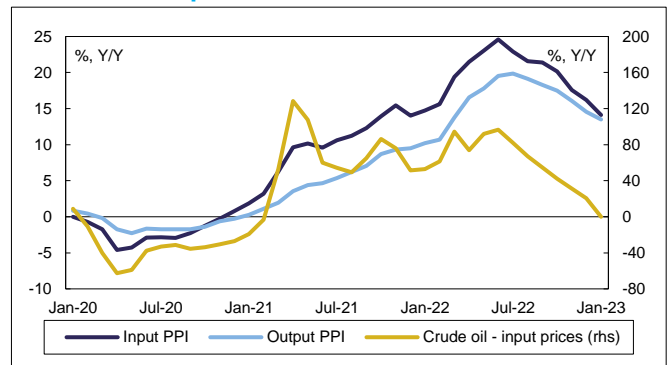
\*Core services excluding airfares, package holidays and education. \*\*Core goods excluding energy, food, alcohol and tobacco. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.









#### UK: Producer price inflation





Source: Refinitiv 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	 Industrial production M/M% (Y/Y%)	Dec	<b>-1.1 (-1.7)</b>	<i>-1.0 (-)</i>	1.0 (2.0)	<b>1.4 (2.8)</b>
	 Trade balance €bn	Dec	<b>-18.1</b>	-16.0	-15.2	<b>-14.4</b>
Spain	 Final HICP (CPI) Y/Y%	Jan	<b>5.9 (5.9)</b>	<i>5.8 (5.8)</i>	5.5 (5.7)	-
	 Final core CPI Y/Y%	Jan	<b>7.5</b>	<i>7.5</i>	7.0	-
UK	 CPI Y/Y%	Jan	<b>10.1</b>	<i>10.1</i>	10.5	-
	 Core CPI Y/Y%	Jan	<b>5.8</b>	<i>(6.2)</i>	6.3	-
	 PPI output (input) prices Y/Y%	Jan	<b>13.5 (14.1)</b>	13.3 (14.7)	14.7 (16.5)	<b>14.6 (16.2)</b>
	 House price index Y/Y%	Dec	<b>9.8</b>	-	10.3	<b>10.6</b>














Auctions	
Country	Auction
Germany	 sold €808mn of 1.25% 2048 bonds at an average yield of 2.30%
	 sold €1.2bn of 0.00% 2052 bonds at an average yield of 2.26%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's releases

Economic data						
Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Italy		09.00 Total trade balance €bn	Dec	-	1.4	
Spain		09.00 Total trade balance €bn	Dec	-	-3.3	






  

Auctions and events						
Euro area		09.40 ECB's Panetta scheduled to speak – 'Monetary policy after the energy shock'				
		09.00 ECB publishes its Economic Bulletin				
		15.00 ECB's Chief Economist Lane scheduled to speak – 'The euro area hiking cycle: An interim assessment'				
France		09.50 Auction: 2.50% 2026 bonds				
		09.50 Auction: 0.75% 2028 bonds				
		09.50 Auction: 2.50% 2030 bonds				
		10.50 Auction: 0.10% 2029 index-linked bonds				
		10.50 Auction: 0.10% 2032 index-linked bonds				
		10.50 Auction: 0.10% 2038 index-linked bonds				
Spain		09.30 Auction: 0.80% 2027 bonds				
		09.30 Auction: 0.80% 2029 bonds				
		09.30 Auction: 2.55% 2032 bonds				
UK		17.00 BoE Chief Economist Pill participates in a fireside chat on the UK economy				


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Friday's releases

## Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area 	09.00	ECB current account balance €bn	Dec	-	13.6
Germany 	07.00	PPI Y/Y%	Jan	-	21.6
France 	07.45	Final HICP (CPI) Y/Y%	Jan	<u>7.0</u> (6.0)	6.7 (5.9)
UK 	07.00	Retail sales including auto fuels M/M% (Y/Y%)	Jan	-0.3 (-5.6)	-1.0 (-5.8)
	07.00	Retail sales excluding auto fuels M/M% (Y/Y%)	Jan	-0.4 (-5.4)	-1.1 (-6.1)

## Auctions and events

Euro area 	11.30	ECB's Villeroy scheduled to speak on monetary policy and inflation			
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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