

# Euro wrap-up

## Overview

- As certain hawkish ECB Governing Council members tried to downplay the prospect of rate cuts before the summer, Bunds made losses even as data reported a fifth drop in euro area IP in six months in November and a decline in German GDP in Q4.
- Gilts made smaller losses on a quiet day for UK economic news.
- Tuesday will bring the latest official UK labour market data, as well as final German inflation figures and the results of surveys of euro area households and investors.

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### Daily bond market movements

| Bond          | Yield | Change |
|---------------|-------|--------|
| BKO 3.1 12/25 | 2.571 | +0.064 |
| OBL 2.4 10/28 | 2.132 | +0.058 |
| DBR 2.2 02/34 | 2.229 | +0.047 |
| UKT 4½ 10/25  | 4.140 | +0.005 |
| UKT 4½ 06/28  | 3.670 | +0.019 |
| UKT 3¼ 01/33  | 3.798 | +0.010 |

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

## Euro area

### Euro area industrial sector remains in recession

Euro area industrial production dropped in November for the fifth month out of the past six, by 0.3%M/M, to be firmly on track for a fifth successive quarterly contraction in Q4. Indeed, this left production some 1.2% below the Q3 average, down 6.8%Y/Y and at the lowest level since October 2020. And while the performance was mixed across the member states in November, IP was trending below the Q3 level in Germany (-1.2%), France (-0.5%), Italy (-0.9%) and Ireland (a striking -6.0%). By sub-sector, manufacturing output in the euro area fell 0.2%M/M in November, similarly to the lowest level for more than three years and 1% below the Q3 average. The weakness was again led by capital goods production (-0.8%M/M), which fell to an eight-month low, as a drop in output of motor vehicles and electrical equipment offset a partial rebound in other machinery and equipment. Meanwhile, production of intermediate goods fell for a fourth successive month (-0.6%M/M) to its lowest level since July 2020. In contrast, production of non-durable consumer items rose for a second successive month (1.2%M/M). And production in energy-intensive sectors (0.3%M/M) rose for the first month in three and energy generation (0.6%M/M) was the firmest since July, albeit both were still more than 10% below the pre-pandemic level.

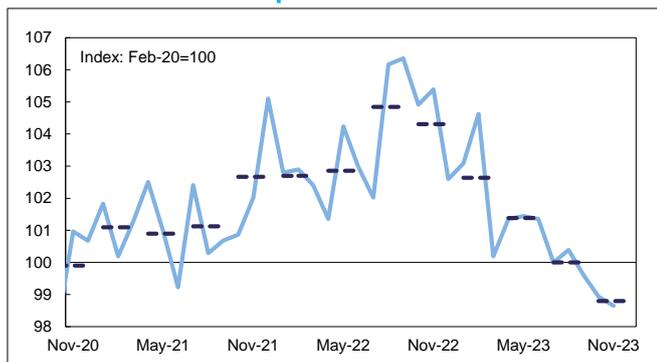
### Surveys point to ongoing manufacturing weakness at turn of the year

Surveys on the whole suggest that factory output remained lacklustre heading into year end. Indeed, while the euro area manufacturing PMI in Q4 (44.0) was firmer than in Q3, it merely suggested a moderation in the pace of contraction rather than a return to positive growth. And while the Commission survey indicator of industrial production rose to a five-month high in December, it remained on average in Q4 below the Q3 level. Furthermore, manufacturers reported a further deterioration in orders to a more than three-year low, weighed by falling demand from abroad. And while surveys point to a further cut in inventories in December, they remain historically elevated, suggesting that stock adjustments will continue for some time and risking an extension of the industrial sector recession into the first quarter of this year.

### Euro area trade surplus the largest since March 2021

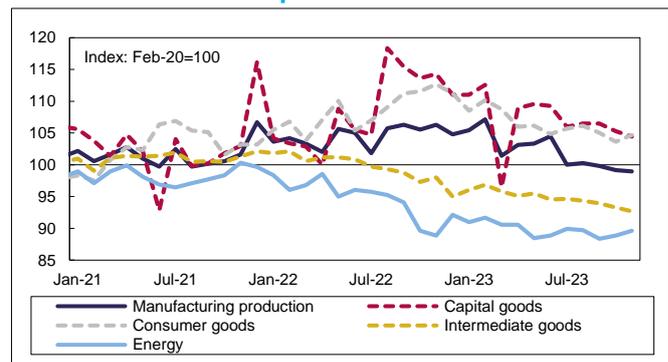
While surveys suggest that export orders continue to decline significantly, today's euro area trade figures suggested that net trade provided a second successive positive contribution to GDP growth in Q4, even if only because weak domestic demand meant that imports underperformed exports. In particular, the value of exports rose for the third month out of the past four, by 1.0%M/M in November, with increases of shipments to the US, China and UK of between 2-3%M/M more than offsetting a decline to Japan (-5.2%M/M). So, while the total value of exports was still down 4.7%Y/Y, it was trending in the first two months of Q4 some 0.7% above the Q3 average. And with the value of imports falling for the third month out of the past four

### Euro area: Industrial production\*



\*Dashed dark blue line represents quarterly averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

(-0.6%M/M), to be trending almost 1½% below the Q3 average, the goods trade surplus widened further in November, by €3.6bn to €14.8bn, the largest since March 2021 and a whopping €63.2bn above the trough in August 2022 caused by the blowout in energy prices after Russia's invasion of Ukraine. While we will need to wait for volumes data to be published next month for a better guide to the impact on GDP growth, equivalent figures published Germany suggested that relative price shifts had limited impact on the big picture in November. And the drop in euro area import volumes in October compared with the Q3 average (-2.2%) exceeded that of export volumes (-0.7%). While net trade appears on track provided support to euro area economic growth last quarter, however, we doubt that this will be sufficient to avoid a mild contraction in euro area GDP.

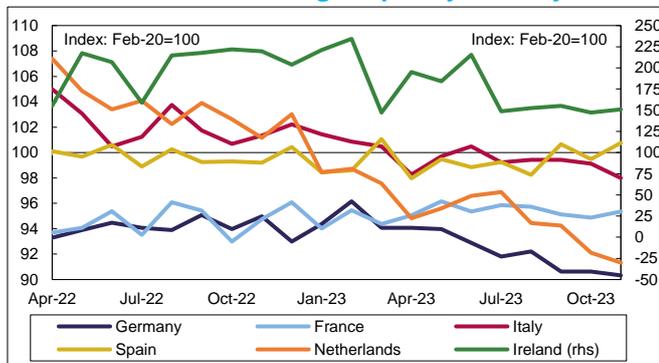
### Germany's economy contracted 0.3%Q/Q in Q4 according to initial estimate

The first official indication of GDP growth in Q4 came today from Germany and was disappointingly soft. According to Destatis, the information available to-date suggests that German GDP contracted 0.3%Q/Q in Q4, 0.1ppt weaker than the consensus expectation. So, while growth in Q3 was revised up slightly to zero from -0.1%Q/Q in the previous estimate, momentum heading into 2024 appears slightly more negative than previously anticipated, weighed not least by household consumption and construction investment. Due in part to the drop in the final quarter, German GDP contracted 0.3%Y/Y over 2023 as a whole, a notable setback from growth of 1.8% in 2022, to be just 0.7% above the pre-pandemic level in 2019. Given fewer working days, on a calendar-adjusted basis, GDP fell a more modest 0.1%Y/Y in 2023 but was just 0.5% above the level in 2019.

### Fiscal policy could have provided more support as budget deficit came in well below initial plan

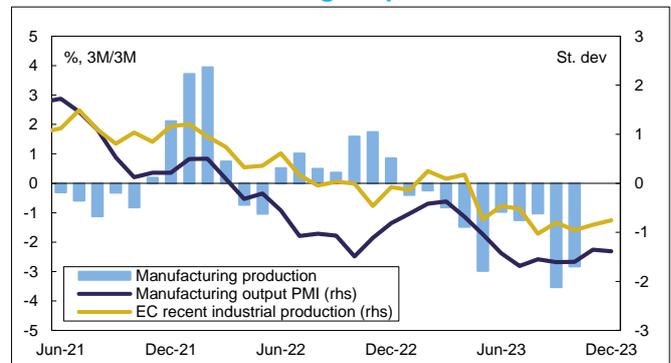
With disposable incomes down in real terms, household consumption fell 0.8%Y/Y (on an unadjusted basis) in 2023 to be some 1½% below the 2019 level. And while equipment capex rose 3.0%Y/Y, higher interest rates contributed to a drop in construction investment of 2.1%Y/Y leaving total fixed investment down 0.3%Y/Y and almost 3% below the 2019 level. Given the retrenchment in final domestic demand, the decline in import volumes (-3.0%Y/Y) outpaced that of exports (-1.8%Y/Y) so that net trade provided some support. In contrast, government consumption fell 1.7%Y/Y, subtracting from German GDP growth for the first time in 20 years as pandemic-related support was withdrawn. As a result, the general government budget deficit fell 0.5ppt in 2023 to 2.0% of GDP, the smallest since 2019 and some 2¼ppts lower than expected as recently as April. The weakness of GDP suggests that German fiscal policy was excessively tight last year. And while the government has yet to make a final decision on whether once again to suspend the legislated debt brake this year, the revenue-raising and expenditure-cutting measures proposed by the government to offset the Constitutional Court's decision against the use of off-budget funds raise risks that fiscal policy will once again stifle economic growth this year. Indeed, we currently expect full-year German GDP growth to be little better than zero in 2024.

#### Euro area: Manufacturing output by country



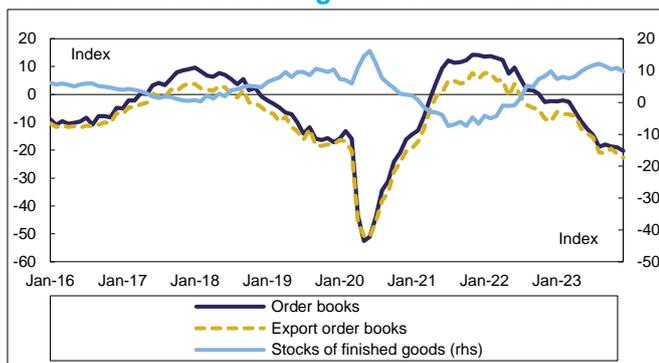
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### Euro area: Manufacturing output & confidence



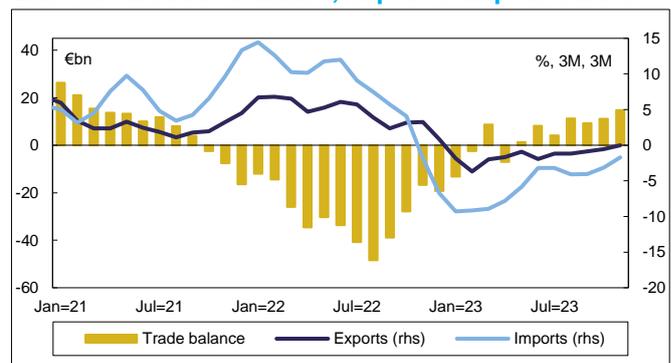
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

#### Euro area: Manufacturing orders & inventories



Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

#### Euro area: Trade balance, export & import values



Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

### The day ahead in the euro area

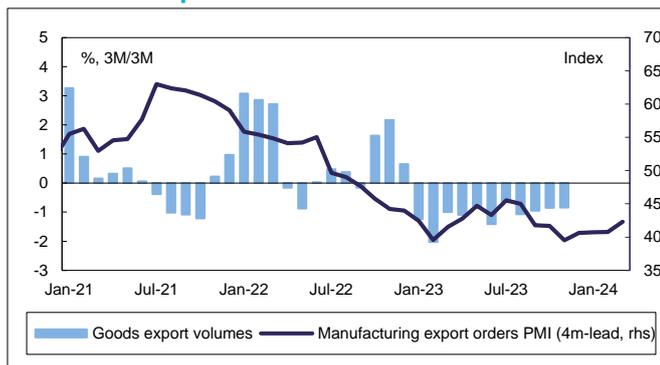
Tomorrow's release of the German ZEW survey results will likely flag continued investor concerns about the lack of economic momentum at the start of the New Year. While last week's similar Sentix survey results reported a modest improvement in perceptions of the euro area as a whole, the equivalent German indices slipped back slightly in January. Separately, final German inflation figures will likely confirm the 1.5ppt pickup in the headline HICP rate in December to 3.8%Y/Y due principally to energy base effects associated with last year's government one-off energy payments. In contrast, additional granular detail to be released for the first time will likely illustrate a further easing in underlying price pressures. Meanwhile, the results of the ECB's consumer survey for November will be watched for progress in reducing medium-term inflation expectations, which had previously moved sideways at 2.5%Y/Y for three consecutive months.

## UK

### The day ahead in the UK

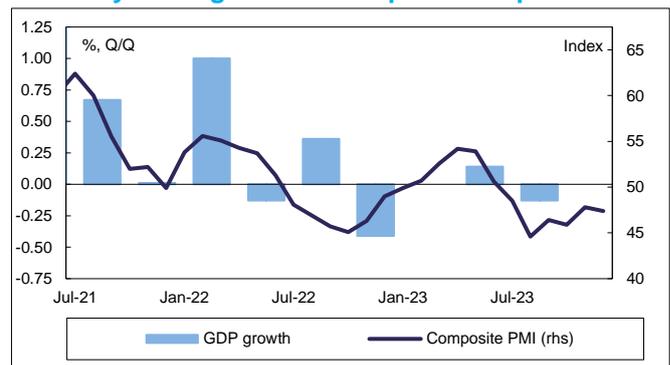
After a quiet start to the week for top-tier UK economic releases, tomorrow will bring the latest ONS labour market data. November's labour earnings figures should provide some encouragement that domestically generated inflationary pressures are dissipating. Indeed, with single-month wage growth in October down to a seven-month low, while PAYE data suggested that median pay growth in November moderated to its weakest rate for more than two years, total wage growth is forecast to drop 0.4ppt to a seven-month low of 6.8%3M/Y. In the absence of the official Labour Market Survey, the claimant count and HMRC payrolled employee figures will provide a further guide to the current tightness of the labour market.

#### Euro area: Exports volumes & orders PMI



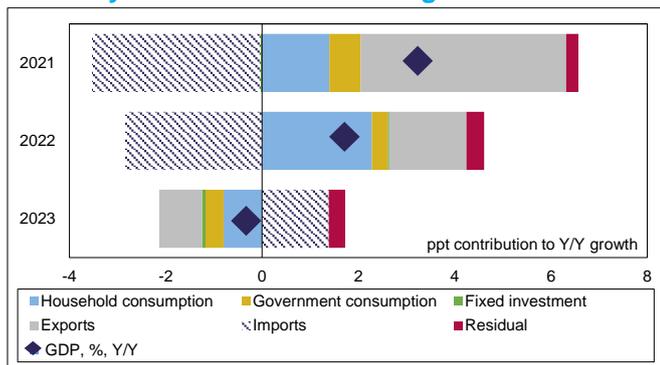
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

#### Germany: GDP growth & composite output PMI



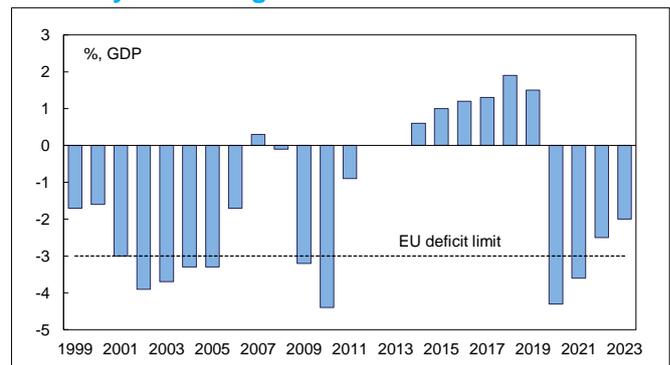
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

#### Germany: Contributions to GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### Germany: General government fiscal balance



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## European calendar

### Today's results

#### Economic data

| Country   | Release   | Period | Actual      | Market consensus/<br><i>Daiwa forecast</i> | Previous    | Revised |
|-----------|---|--------|-------------|--|-------------|---------|
| Euro area |  Trade balance €bn                       | Nov    | 14.8        | -  | 10.9        | 11.1    |
|           |  Industrial production M/M% (Y/Y%)       | Nov    | -0.3 (-6.8) | -0.3 (-5.9)                                | -0.7 (-6.6) | -       |
| Germany   |  GDP Y/Y%                                | 2023   | -0.3        | -0.3                                       | 1.8         | -       |
| Italy     |  Trade balance €bn                       | Nov    | 3.9         | -  | 4.7         | -       |
| UK        |  Rightmove house price index M/M% (Y/Y%) | Jan    | 1.3 (-0.7)  | -  | -1.9 (-1.1) | -       |

#### Auctions

| Country               | Auction |
|-----------------------|---------|
| - Nothing to report - |         |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's releases

#### Economic data

| Country   | GMT   | Release   | Period | Market consensus/<br><i>Daiwa forecast</i> | Previous     |
|-----------|---|---|--------|--|--------------|
| Euro area |  09.00   | ECB 1Y (3Y) ahead CPI expectations Y/Y%                     | Nov    | -  | 4.0 (2.5)    |
| Germany   |  07.00  | Final HICP (CPI) Y/Y%                                       | Dec    | 3.8 (3.7)                                  | 2.3 (3.2)    |
|           |  10.00 | ZEW current assessment (expectations) balance               | Jan    | -77.0 (11.7)                               | -77.1 (12.8) |
| Italy     |  09.00 | Final HICP (CPI) Y/Y%                                       | Dec    | 0.5 (0.6)                                  | 0.6 (0.7)    |
| UK        |  07.00 | Payrolled employees monthly change '000s                    | Dec    | -13  | -13          |
|           |  07.00 | Average weekly earnings including (excluding) bonuses 3M/Y% | Nov    | 6.8 (6.6)                                  | 7.2 (7.3)    |

#### Auctions and events

|         |   |   |
|---------|---|---|
| Germany |  10.30 | Auction: €4bn of 2029 bonds   |
| UK      |  10.00 | Auction: £1.5bn of 0.75% 2033 index-linked bonds                                    |
|         |  15.00 | BoE Governor Bailey testifies before the House of Lords' Economic Affairs Committee |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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