

Euro wrap-up

Overview

- Shorter-dated Bunds followed USTs lower, even as German industrial producer prices fell again.
- Gilts ended little changed on the day at the short end of the curve but made gains at the long end as UK retail sales fell at the sharpest rate since pandemic restrictions were imposed at the start of 2021.
- The outlook for ECB interest rates will be the focus of President Lagarde's press conference on Thursday while the coming week will also bring the January flash PMIs and latest ECB Bank Lending Survey results.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.721	+0.045
OBL 2.1 04/29	2.270	+0.019
DBR 2.2 02/34	2.335	-0.011
UKT 3½ 10/25	4.274	+0.003
UKT 4½ 06/28	3.829	+0.008
UKT 3¼ 01/33	3.913	-0.013

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

Source: Bloomberg

Euro area

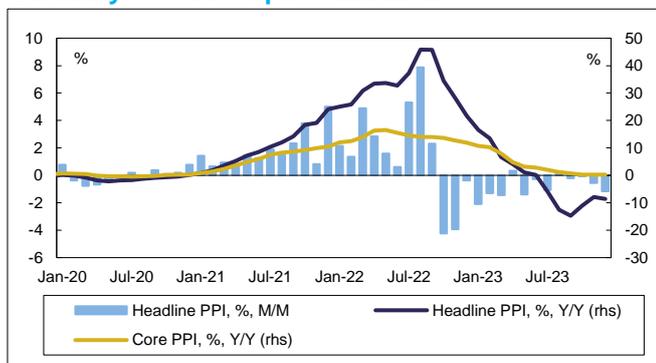
German producer prices again down sharply at end-2023 with broad-based lack of pressure

On a quiet end to the week for euro area economic data, the latest German producer price data flagged the continuing easing of price pressures in the goods sector at the end of 2023. In particular, industrial producer prices fell in December for the seventh month in the past eight and by a larger-than-expected 1.2%M/M to be down 8.6%Y/Y. The further drop was due to energy prices, which fell 3.7%M/M, the most in nine months, not least thanks to lower prices of natural gas, oil and motor fuel. As a result, energy prices fell 23.5%Y/Y to a 22-month low. Excluding energy, producer prices were unchanged on the month to be up 0.3%Y/Y. Indeed, reflecting subdued demand and lower wholesale prices at the global level, there was a broad-based lack of pressure with no major component posting a rise in prices on the month. Having dropped in each of the prior months, prices of intermediate goods were flat in December to be down 3.7%Y/Y, a touch less than over recent months, with the year-on-year weakness concentrated in chemicals, metals and related items. Prices of capital goods, including transport items, were also unchanged on the month for a second successive month to be up 3.9%Y/Y, the softest annual increase in two years. Prices of consumer durables fell 0.1%M/M to be up 3.0%Y/Y. And those of consumer non-durables including food were unchanged to be up 3.2%Y/Y, the lowest since October 2021.

Upside risks to prices from fiscal policy and events in the Red Sea should be limited

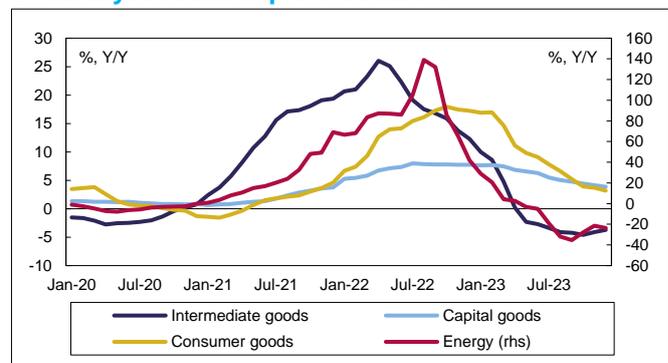
Looking ahead, the withdrawal of government pandemic support, as well as additional fiscal tightening related in part to the Constitutional Court's judgement on the government's use of off-budget funds, will push up many producer prices directly and indirectly. Measures include a higher carbon price, as well as a plastics levy, and a kerosene tax on domestic flights. However, given the weakness of wholesale prices, the impact of the end to the energy price brakes, which capped some electricity and gas bills looks, set to be relatively modest. And increased truck tolls from the start of December evidently had a minimal impact on today's producer price data. Surveys suggest no significant new inflationary impulse. For example, according to the Commission's survey, German manufacturing selling price intentions for the coming three months only edged slightly higher in December with the respective index still close to the bottom of last year's range and well below the long-run average. Of course, since then, the escalation of events in the Red Sea in the New Year poses an additional upside risk to producer and consumer goods inflation via disruption to supplies as well as higher freight shipping costs on deliveries of goods from Asia. However, so far, shipping freight costs remain well down on the peaks of the past few years.

Germany: Producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

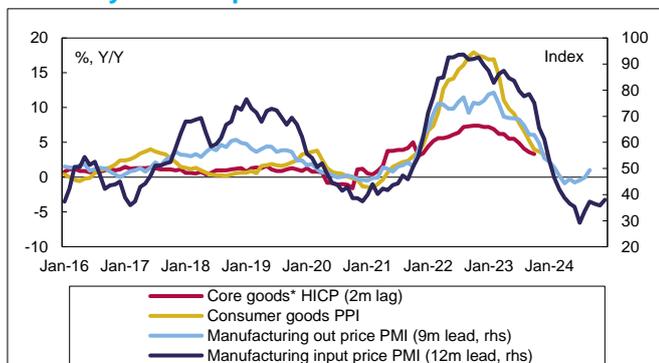
The week ahead in the euro area

The ECB's Governing Council meeting will be the main event of the coming week, but the greatest interest will be in the press conference rather than the policy statement. At last month's meeting, the policymakers left unchanged the ECB's main interest rates and forward guidance. So, the Governing Council reaffirmed its intention to keep rates at a sufficiently restrictive level for as long as necessary, maintaining the "higher for longer" message of previous policy meetings. In her press conference, President Lagarde implied that rates would now probably be unchanged for a while to come. But she reiterated that policy would be data-dependent with a meeting-by-meeting approach to rate-setting. Meanwhile, the Governing Council clarified this year's path for its bond holdings, deciding to accelerate the pace of quantitative tightening (QT) by halving reinvestments of maturing PEPP proceeds over the second half of 2024.

With rates bound to be left unchanged, and no decisions to take with respect to the balance sheet, the forthcoming meeting will be uneventful with respect to policy decisions. However, having forecast positive GDP growth in Q4 and a pickup in the pace of expansion this quarter, the ECB's macroeconomic projections, published last month, already look a little too optimistic regarding economic activity. Moreover, headline and core inflation slightly undershot the ECB's forecast for Q4 and shifts in wholesale market prices suggest that inflation will further undershoot its projections from the current quarter on. There are, of course, significant uncertainties with respect to the inflation outlook, including the impact of fiscal measures as the subsidies and indirect tax cuts of recent years are reversed and possible supply disruption due to events in the Red Sea. The Governing Council will also want to see further evidence that wage growth has moderated before deciding that the time is ripe for a rate cut.

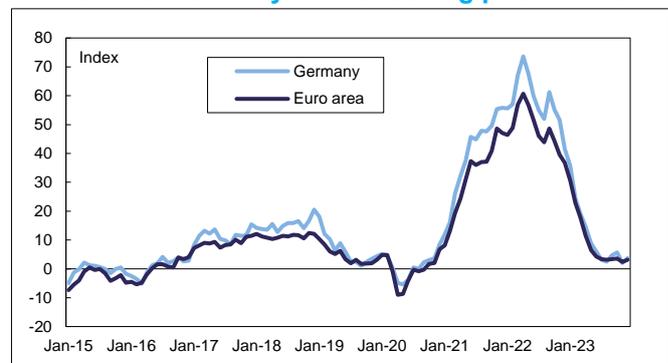
The likely timing of the first rate cut, however, seems bound to be a focus of the press conference. Lagarde will reiterate that the ECB's interest rate decisions will remain data dependent. And despite the decent possibility that the ECB's inflation projections will be revised significantly lower in March, she will push back on any suggestions that rates could be cut as early as that month. Indeed, consistent with the concerns reported yesterday in the [account of the December Governing Council meeting](#), Lagarde stated in her Bloomberg interview earlier this week that "it is not helping our fight against inflation if the anticipation [of future rate cuts] is such that they are way too high compared with what's likely to happen". In an interview with CNBC earlier this week, Dutch Governor Klaas Knot similarly suggested that "markets are getting ahead of themselves...and the problem for us is that might become self-defeating" as the ECB's inflation projection assumes an outlook for interest rates with "significantly less easing than is currently embedded in market pricing". Nevertheless, earlier this week, Chief Economist Lane suggested that sufficient evidence might in due course be available to justify a first rate cut

Germany: Goods price indicators



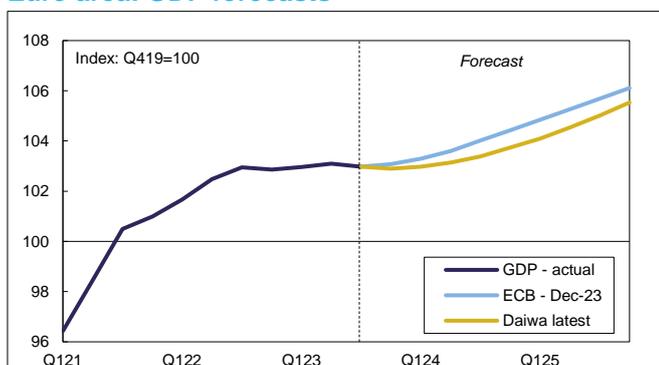
*Non-energy industrial goods. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area & Germany: Firms' selling price intentions



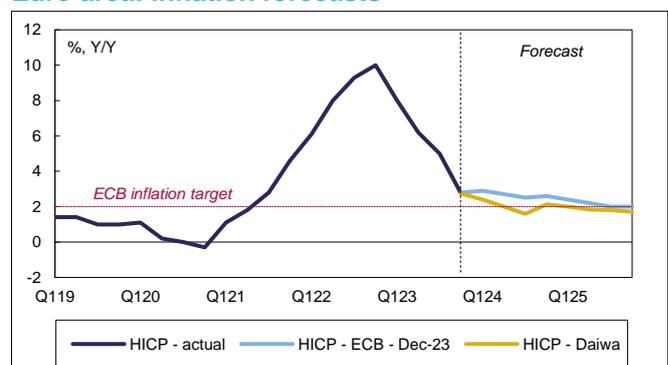
Source: Macrobond, EC and Daiwa Capital Markets Europe Ltd.

Euro area: GDP forecasts



Source: Refinitiv Datastream, ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation forecasts



Source: Refinitiv Datastream, ECB and Daiwa Capital Markets Europe Ltd.

in June. And Lagarde acknowledged to Bloomberg that a first cut by or in the summer looks “likely” to her. She seems likely to be asked to clarify that comment at the forthcoming press comment.

Data-wise, the most notable release of the coming week will be the January flash PMIs on Wednesday. After the composite PMI moved sideways at 47.6 in December, we expect to see a modest improvement in January to a six-month high, albeit remaining in contractionary territory. The services PMI, which edged up marginally in December to a four-month high of 48.8, will likely point to only modest contraction. The manufacturing output PMI is likely to remain much weaker at less than 45 for an eight successive month. And the composite PMIs will be consistent with negative growth in both Germany and France. The ifo and INSEE business survey results due the following day will provide a cross-check on the findings of the German and French PMIs. Among other new data of note in the coming week, Tuesday will bring the preliminary European Commission consumer confidence index for January, which should report a third successive monthly increase to the highest level since the Russian invasion of Ukraine, albeit remaining well below the long-run average. The same day will bring the ECB’s Bank Lending Survey results for Q4, giving insight on the transmission of the ECB’s rate hikes, which currently appears to have been more powerful than the Governing Council had anticipated. December’s monetary data on Friday will likely suggest that bank lending to firms and households remained very subdued at year-end.

UK

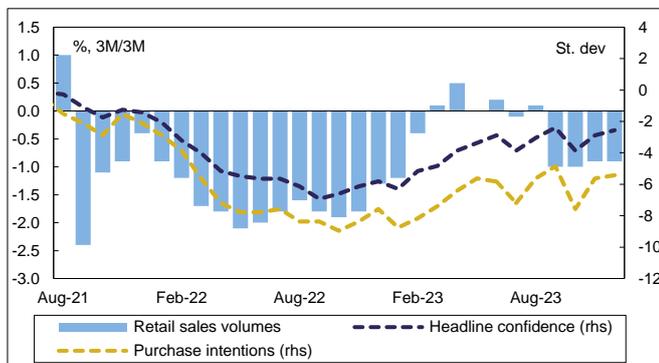
Retail sales plunge most since Covid restrictions

Business surveys had already suggested that retail sales fell towards the end of the year. But the decline reported today in the official ONS data was much larger than expected, with sales volumes down a whopping 3.2%M/M, marking the steepest fall since pandemic restrictions were imposed in January 2021. The fall in December followed revised growth of 1.4%M/M to a six-month high in November, when sales were boosted by widespread discounting ahead of Black Friday. But it left the level of sales volumes down 2.4%Y/Y and at its lowest since the first Covid lockdown in May 2020. All major categories fell, with sales volumes excluding auto fuel down 3.3%M/M, sales at food stores down 3.1%M/M and non-food store sales down 3.9%M/M. Sales at department stores fell a whopping 7.1%M/M, while those at household goods stores fell 3.0%M/M, and clothing and textiles got off lightly with a drop of 1.5%M/M. Moreover, with prices falling a touch further in December following November’s sales, the value of retail sales was down a steeper 3.6%M/M to be up just 0.6%Y/Y.

Sales slump increases probability that GDP fell in Q4

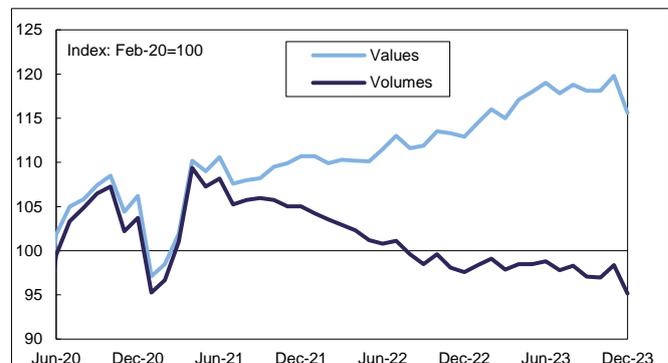
The strength in November followed by weakness in December appears in part to have reflected a behavioural shift, as consumers increasingly bring forward Christmas shopping in the hope of making savings from special discounts. Indeed, the steep decline in sales volumes at the end of the year left the underlying trend unchanged, with sales down 0.9%3M/3M in December – unchanged from November on that basis – to mark the second successive quarterly drop at broadly the same pace. So, although many consumer-facing services such as hospitality appear to have had a better end to the year, today’s figures increase the likelihood that GDP contracted slightly for a second successive quarter in Q4. The steep drop in December also capped a poor year for retailers, with full-year sales volumes down for a second successive year and by 2.8%Y/Y in 2023 to a five-year low. While consumer confidence improved somewhat in the second half of the year and households signalled somewhat greater willingness to spend, we expect retail sales to pick up in Q1 as real disposable incomes rise. But we caution that sentiment and purchase intentions remain well below their long-run average. And recent increases in interest rates will remain a restraint on big-ticket purchases. So, any growth in sales over Q1 as a whole seems likely to be moderate at best.

UK: Retail sales & consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales volumes & values



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the UK

Sentiment surveys will dominate the UK data flow in the coming week, with the most noteworthy being the flash January PMIs (Wednesday). Following a rebound at the end of last year to a seven-month high (52.1), the composite output PMI is expected to edge slightly higher at the start of the New Year suggesting a further modest recovery in economic momentum. This will largely reflect ongoing modest growth in the services (excluding retail), while the pace of contraction in manufacturing production is expected to ease slightly. The CBI's industrial trends survey (Wednesday) will also provide insight into manufacturing conditions, while the distributive trades survey (Thursday) will give an update on retail sales at the start of the year. Finally, the GfK consumer confidence indices (Friday) are likely to suggest only modest improvement in sentiment. While household incomes are benefiting from the cut to National Insurance Contributions at the start of the year, they are also getting squeezed by the increase in the regulated cap on household utility tariffs. So, consumer confidence is bound to remain well below the long-run average.

The next edition of the Euro wrap-up will be published on 23 January 2024

Daiwa economic forecasts

	2023		2024				2023	2024	2025
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	%, Y/Y								
Euro area 	-0.1	-0.1	0.1	0.2	0.2	0.3	0.5	0.3	1.4
UK 	-0.1	-0.1	0.1	0.1	0.1	0.2	0.3	0.1	0.7
Inflation, %, Y/Y									
Euro area									
Headline HICP 	5.0	2.7	2.4	2.0	1.6	2.1	5.4	2.0	1.8
Core HICP 	5.1	3.7	2.9	1.9	1.6	2.0	4.9	2.1	1.6
UK									
Headline CPI 	6.7	4.2	3.6	1.8	2.1	2.3	7.3	2.5	1.8
Core CPI 	6.4	5.3	4.6	2.9	2.5	2.5	6.2	3.1	1.7
Monetary policy, %									
ECB									
Refi Rate 	4.50	4.50	4.50	4.25	4.00	3.75	4.50	3.75	2.75
Deposit Rate 	4.00	4.00	4.00	3.75	3.50	3.25	4.00	3.25	2.25
BoE									
Bank Rate 	5.25	5.25	5.25	5.00	4.50	4.00	5.25	4.00	2.50

Source: Bloomberg, ECB, BoE 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	
Germany 	PPI Y/Y%	Dec	-8.6	-8.0	-7.9	-	
UK 	Retail sales including auto fuels M/M% (Y/Y%)	Dec	-3.2 (-2.4)	-0.5 (1.1)	1.3 (0.1)	1.4 (0.2)	
	Retail sales excluding auto fuels M/M% (Y/Y%)	Dec	-3.3 (-2.1)	-0.6 (1.4)	1.3 (0.3)	1.5 (0.5)	
Auctions							
Country	Auction						
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming few week's key data releases

Country	GMT	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous
Monday 22 January 2024					
France		Bank of France retail sales* Y/Y%	Dec	-	-3.8
Tuesday 23 January 2024					
Euro area	15.00	European Commission's preliminary consumer confidence index	Jan	-14.3	-15.0
UK	07.00	Public sector net borrowing (excl. banks) £bn	Dec	11.4 (13.4)	13.4 (14.3)
Wednesday 24 January 2024					
Euro area	09.00	Preliminary manufacturing (services) PMI	Jan	44.8 (49.0)	44.4 (48.8)
	09.00	Preliminary composite PMI	Jan	48.0	47.6
Germany	08.30	Preliminary manufacturing (services) PMI	Jan	43.5 (49.3)	43.3 (49.3)
	08.30	Preliminary composite PMI	Jan	47.8	47.4
France	08.15	Preliminary manufacturing (services) PMI	Jan	42.4 (46.0)	42.1 (45.7)
	08.15	Composite PMI	Jan	45.2	44.8
UK	09.30	Preliminary manufacturing (services) PMI	Jan	46.8 (53.5)	46.2 (53.4)
	09.30	Preliminary composite PMI	Jan	52.5	52.1
	11.00	CBI industrial trends, total orders (selling prices)	Jan	-	-23 (7)
Thursday 25 January 2024					
Euro area	13.15	ECB deposit rate %	Jan	<u>4.00</u>	4.00
Germany	09.00	Ifo business climate index	Jan	86.6	86.4
	09.00	Ifo current assessment (expectations) index	Jan	88.5 (84.8)	88.5 (84.3)
France	07.45	INSEE business (manufacturing) confidence index	Jan	99 (100)	98 (100)
Spain	08.00	PPI Y/Y%	Dec	-	-7.4
UK	11.00	CBI distributive trades survey, reported retail sales balance	Jan	-	-32
Friday 26 January 2024					
Euro area	09.00	M3 money supply Y/Y%	Dec	-0.7	-0.9
Germany	07.00	GfK consumer confidence index	Feb	-24.7	-25.1
France	07.45	INSEE consumer confidence index	Jan	90	89
UK	00.01	GfK consumer confidence index	Jan	-20	-22

*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 22 January 2024		
- Nothing scheduled -		
Tuesday 23 January 2024		
Euro area	 09.00	ECB publishes its Bank Lending survey
Germany	 10.30	Auction: €1bn of 1.3% 2027 green bonds
	 10.30	Auction: €1bn of 1.8% 2053 green bonds
Wednesday 24 January 2024		
Germany	 10.30	Auction: €1.5bn of 1.0% 2038 bonds
	 10.30	Auction: €1.0bn of 2.5% 2046 bonds
UK	 10.00	Auction: £4bn of 4.5% 2028 bonds
Thursday 25 January 2024		
Euro area	 13.15	ECB monetary policy announcement
	 13.45	ECB President Lagarde holds post-meeting press conference
Italy	 10.00	Auction: Fixed rate and index-linked 2Y bonds
Friday 26 January 2024		
Euro area	 09.00	ECB publishes survey of professional forecasters

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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