

# Euro wrap-up

## Overview

- Bunds rallied as the ECB's policy statement had a dovish tone and President Lagarde refused to rule out a rate cut in April, while the latest ifo survey signalled a deterioration in German business conditions.
- Gilts also made gains as a survey suggested that UK retail sales were extremely weak in January.
- Friday will bring updates on bank lending in the euro area and consumer confidence in Germany, France and UK.

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### Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.606	-0.097
OBL 2.1 04/29	2.176	-0.076
DBR 2.2 02/34	2.281	-0.058
UKT 3½ 10/25	4.342	-0.047
UKT 4½ 06/28	3.894	-0.056
UKT 3¼ 01/33	3.965	-0.041

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

Source: Bloomberg

## Euro area

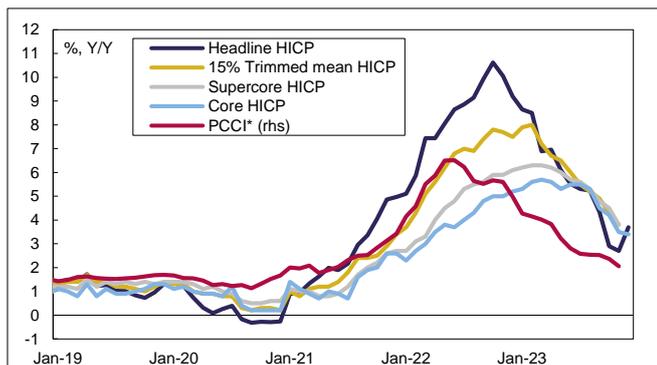
### ECB inevitably leaves rates unchanged, but tone of statement and press conference more dovish

Inevitably, the ECB today left its main interest rates unchanged. So, for example, the deposit rate was maintained at 4.0%, its level in place since September. The Governing Council also predictably retained its forward guidance, reaffirming its intention to keep rates at a sufficiently restrictive level for as long as necessary. And it reiterated that the appropriate level and duration of restriction depend on incoming data. But the policy statement and President Lagarde's press conference were, if anything, more dovish than last month. For example, Lagarde noted that the pickup in inflation in December had been softer than the ECB had expected. The statement acknowledged that the rise had been related to an adverse energy-price base effect and also emphasised that the declining trend in underlying inflation had continued. And, unlike last month, the Governing Council's statement no longer included a judgement that "domestic price pressures remain elevated, primarily owing to strong unit labour costs". Indeed, Lagarde added that firmer labour cost growth was being absorbed by lower profit margins, seemingly intimating that the upside risks to inflation have diminished. The statement also recognised that past interest rate increases keep being transmitted forcefully into financing conditions and that tight financing conditions continue to dampen demand. And Lagarde acknowledged that the euro area economy had been weak in Q4 and, while some leading indicators had improved, the risks to the growth outlook are skewed to the downside.

### ECB's March projections will be key and April now looks live for a rate cut

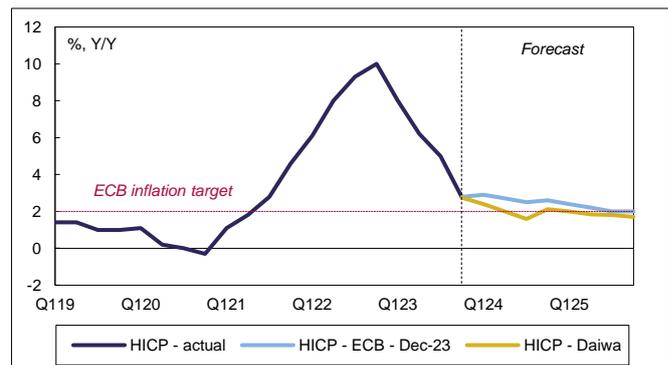
Unsurprisingly, the main focus of Lagarde's press conference was the likely timing of the first rate cut. While she predictably stated that it would have been premature to discuss rate cuts at the current meeting, and she was never going to endorse a specific date today, she did not push back against market pricing. Instead, Lagarde stood by her comments last week that a cut "by or in the summer" looks "likely". Moreover, when pressed, she did not rule out a first cut as soon as April, suggesting that month's meeting could be live for a first easing of policy. Lagarde was also at pains to downplay the importance of any single indicator in determining the timing of the first cut. Indeed, as some of the upside risks from pay have diminished, she appeared to downplay the importance of the national accounts wage data, due at the end of April, which Chief Economist Lane last week suggested might be significant. Instead, she insisted that a wide range of information related to inflation will play a role, and added that the ECB's macroeconomic projections in March would represent "a big set of information" to guide decision-making. Admittedly, she noted upside risks to inflation from disruption to shipping freight in the Red Sea. But she also highlighted the relevance of energy prices. And given Europe's success in stock-piling gas ahead of the winter and the increased contribution to electricity generation from renewables, these are currently well below the path assumed in the December projections, with significant implications for the likely profile of inflation over months. Overall, therefore, on the present economic trajectory, and given today's communication from the ECB, rates look set to be cut by June at the latest.

### Euro area: Measures of inflation



\*Persistent and Common Component of Inflation. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: Inflation forecast



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

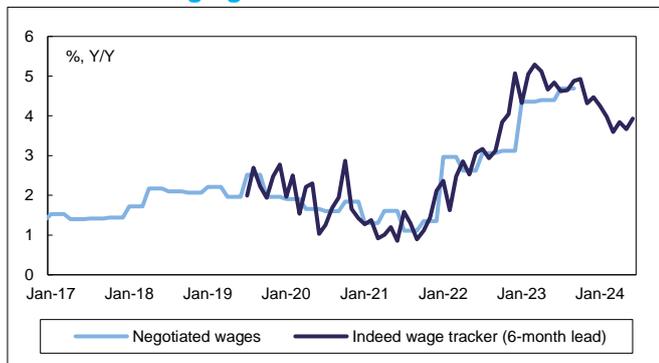
## German ifo echoes downbeat flash PMIs, suggesting the economy is in recession

Tallying with yesterday's [flash PMIs](#), today's German ifo business survey offered a pretty bleak assessment of economic conditions at the start of 2024. In particular, the headline business climate index fell for the second successive month in January and by a steeper-than-expected 1.1pts to 85.2, consistent with recession and the lowest reading since the first wave of Covid-19 in May 2020. The deterioration was led by a worsening in the assessment of current conditions, for which the respective index fell for the ninth month out of the past twelve, by 1.5pts to 87.0, the lowest since July 2020 and some 2pts below the Q4 average. Despite the recent improvement in household disposable incomes, the business situation for services and retail firms reportedly deteriorated markedly in January, with the respective indices at their lowest levels since spring 2021. Given also the more acute impact of high borrowing costs on construction, firms in that sector considered the current backdrop to be the least favourable since 2010. Although manufacturers were reportedly somewhat less downbeat at the start of the year, order books were assessed to be still declining suggesting that the outlook for the coming six months is little improved. Moreover, with retailers and construction firms even gloomier about the near-term outlook, today's survey will flag the non-negligible risks that the contraction in Germany's economy will persist over coming months. Indeed, contrary to expectations of an improvement, the aggregate expectations dropped for a second successive month to a four-month low (83.5).

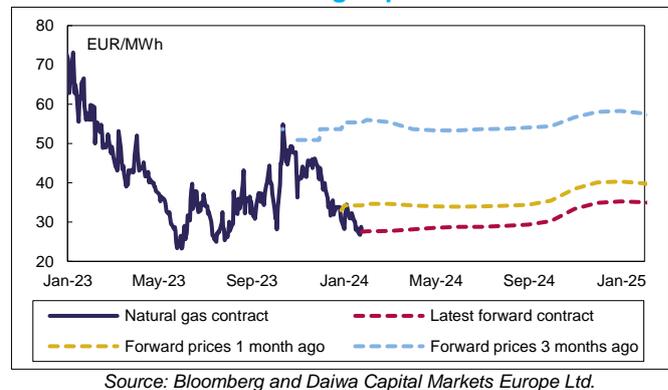
## French INSEE survey points to broadly stable conditions, with a pickup in services and retail

While the French PMIs yesterday signalled a further deterioration in sentiment in January and implied that the economy is now the worst performing of the large member states, today's INSEE business survey results pointed to broad stabilisation at the start of the year. In particular, the headline composite index moved sideways at 98, to be some ½pt above the Q4 average albeit 2pts below the long-run average (100). While it was weighed by a drop in output at the start of the year and lacklustre demand continued to hit orders, manufacturing sentiment was steady just below the long-run average (99) as the ongoing rundown of excess inventory seemingly boosted production expectations to a four-month high and the share of firms reporting supply constraints moderated slightly further. Moreover, conditions in services were considered to be the most favourable for three months (101), with recent activity assessed to be the strongest for eight months. Retailers also benefitted from a pickup in sales at the start of the year, with the respective composite sentiment index up 4pts to a four-month high of 104. And the construction sentiment index (103) edged up slightly from December's three-year low, suggesting that the bottom in the downturn in the sector might well have been reached. Overall, today's survey suggests that French GDP will accelerate slightly in Q1 and that the economy will continue to outperform Germany. In terms of prices, the message was somewhat mixed. Perhaps unsurprisingly given more robust demand and higher wage growth, expected

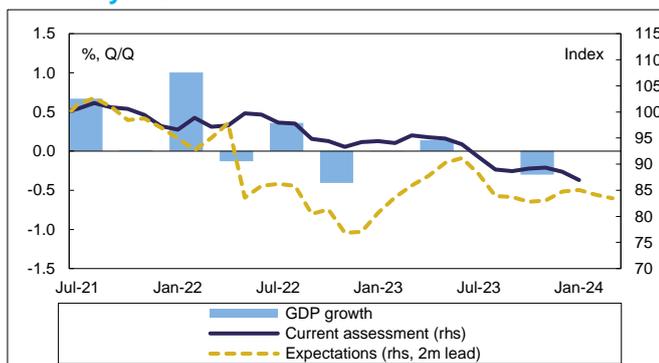
### Euro area: Wage growth



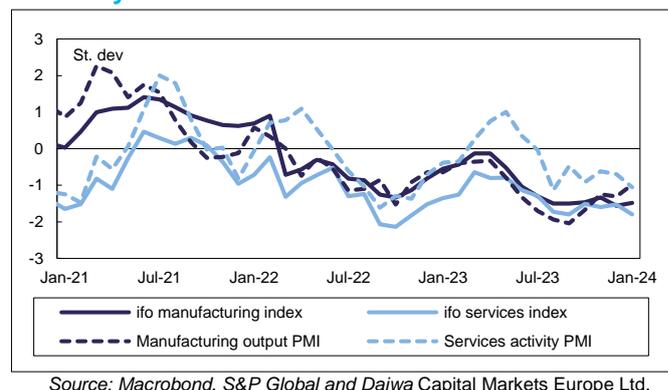
### Euro area: Dutch natural gas price



### Germany: GDP & ifo business climate indices



### Germany: ifo & PMI business sentiment



selling prices in services ticked up to four-month high. But selling-price expectations at retailers fell to the lowest since spring 2021. And having cut prices in Q4 for the first time since Q220, manufacturers intended to keep prices broadly stable in Q1.

## The day ahead in the euro area

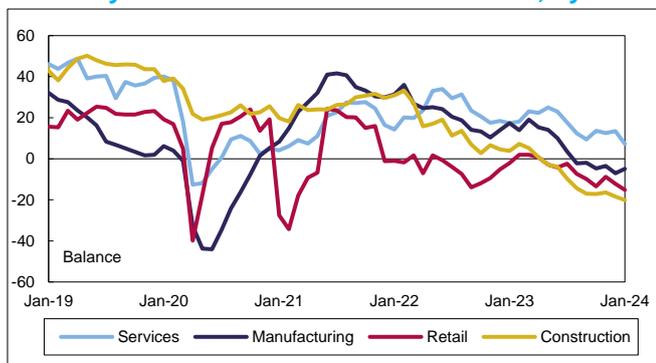
Looking ahead, tomorrow will bring euro area bank lending figures for December. Consistent with the ECB's [Bank Lending Survey](#) published earlier this week, these will likely suggest that lending to firms and households remained subdued at year-end. Friday will also bring the latest consumer confidence survey results from Germany and France, which are both expected to point to a modest improvement at the start of the year. In particular, Germany's GfK forward-looking headline index is expected to rise for the third successive month in February, while the INSEE measure of French consumer confidence is also expected to edge higher for the fourth consecutive month. But the unexpected decline in the Commission's flash euro area consumer confidence index suggests that risks are skewed to the downside.

## UK

### Retail survey points to a further slump in sales at the start of the year

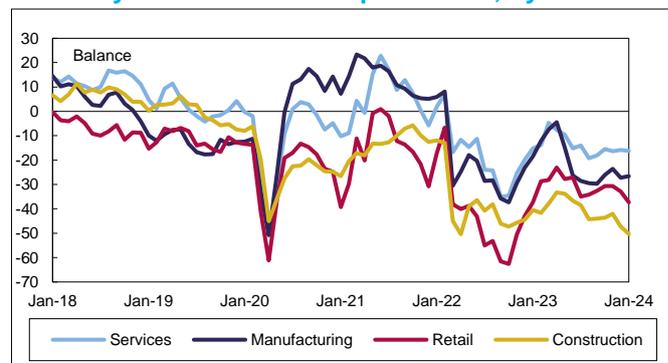
The findings of today's CBI distributive trade survey might have dashed any hopes of a significant rebound in spending at the start of the year following the plunge in sales in December. Indeed, the survey's headline sales balance unexpectedly slumped 18pts to -50 in January, matching the low recorded during the second Covid lockdown at the start of 2021 and a level only weaker in April 2020 and December 2008. Indeed, almost two-thirds of respondents reported that sales were down compared with a year earlier, with roughly 60% considering them to be below the norm for the time of year. Moreover, retailers expected sales to remain extremely weak in February too. Spending on big-ticket items also reported a marked decline, with the survey's gauge for car sales down 71pts to -15, the lowest since July. The extent of deterioration in the CBI survey might in part reflect the strength of sales a year ago, which recorded back-to-back increases of 0.8%M/M in January and February. This notwithstanding, with consumer confidence still historically weak and household incomes squeezed by the increase in the regulated cap on household utility tariffs this month, we expect household demand for goods to remain subdued despite the cut to National Insurance Contributions at the start of the year.

### Germany: ifo – current business situation, by sector



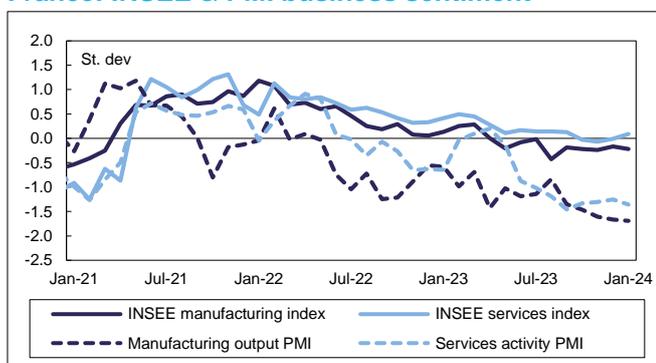
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Germany: ifo – business expectations, by sector



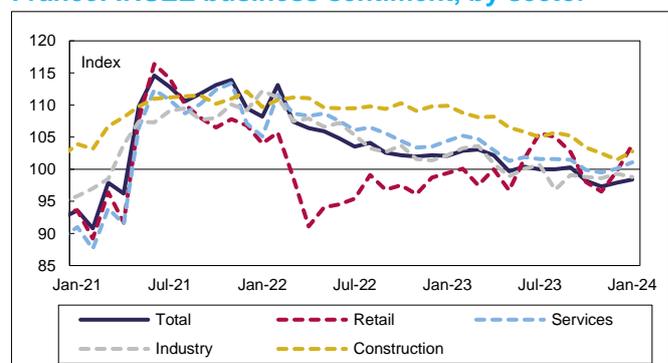
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### France: INSEE & PMI business sentiment



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

### France: INSEE business sentiment, by sector

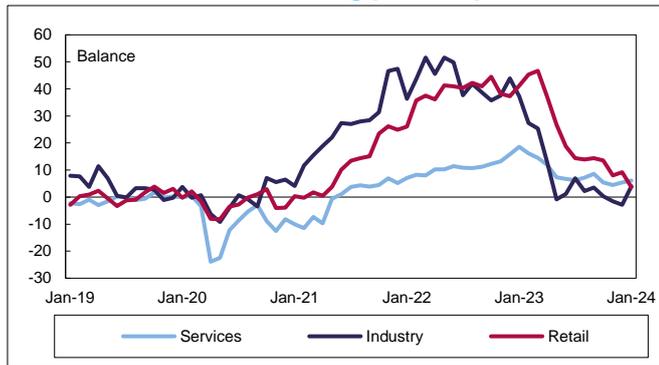


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### The day ahead in the UK

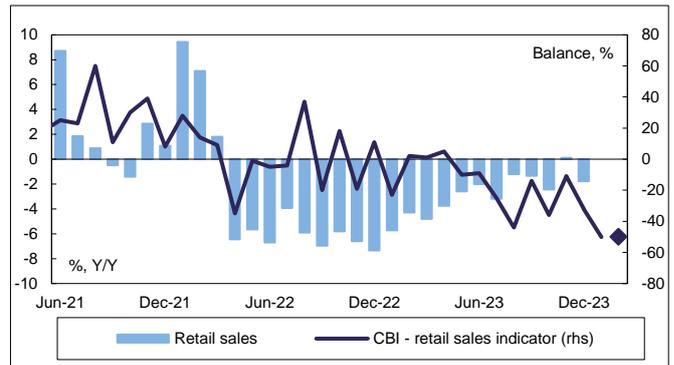
Like in Germany, tomorrow will bring the publication of the UK's GfK consumer confidence survey results, which are expected to report a modest increase in headline sentiment in January, albeit remaining below its long-run average. And in line with today's poor retail survey results, households' willingness to spend on durable goods is likely to have remained extremely muted.

#### France: INSEE firms' selling price expectations



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### UK: Retail sales\*



\*Diamond represents survey forecast for month ahead. Source: Macrobond 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	 ECB deposit rate %	Jan	4.00	4.00	4.00	-
Germany	 Ifo business climate index	Jan	85.2	86.6	86.4	86.3
	 Ifo current assessment (expectations) index	Jan	87.0 (83.5)	88.5 (84.8)	88.5 (84.3)	-(84.2)
France	 INSEE business (manufacturing) confidence index	Jan	98 (99)	98 (100)	98 (100)	-(99)
Spain	 PPI Y/Y%	Dec	-6.3	-	-7.4	-7.6
UK	 CBI distributive trades survey, reported retail sales balance	Jan	-50	-20	-32	-

#### Auctions

Country	Auction
Italy	 sold €2.5bn of 3.6% 2025 bonds at an average yield of 3.21%
	 sold €1.0bn of 1.5% 2029 index-linked bonds at an average yield of 1.61%
	 sold €1.5bn of 2.4% 2039 index-linked bonds at an average yield of 2.32%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's releases

#### Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
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

#### Auctions and events

Euro area	 09.00	ECB publishes survey of professional forecasters
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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