Daiwa Capital Markets

Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Despite a sharp deterioration in German consumer confidence, Bunds followed USTs lower as euro area bank lending picked up slightly.
- Gilts made gains despite an improvement in UK consumer confidence to a two-year high.
- The coming week will likely see the BoE revise down its inflation projection significantly, while the euro area flash estimates of inflation in January and GDP in Q4 will be the data highlights.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.621	+0.012
OBL 2.1 04/29	2.189	+0.006
DBR 2.2 02/34	2.295	+0.008
UKT 3½ 10/25	4.321	-0.034
UKT 4½ 06/28	3.885	-0.020
UKT 3¼ 01/33	3.962	-0.015

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

Euro area

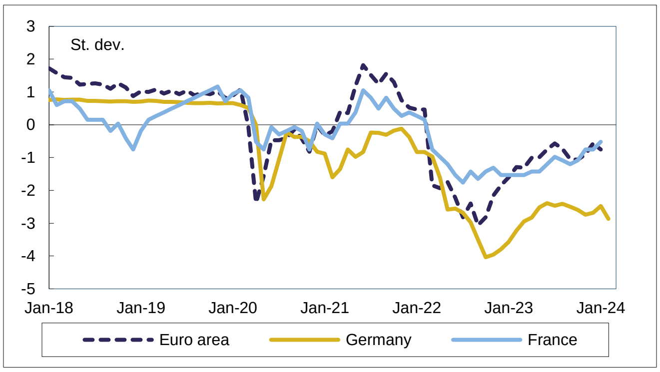
German consumers more downbeat as income expectations deteriorate

After the flash PMIs and ifo surveys earlier this week suggested that the euro area's largest member state is stuck in recession, the flow of disappointing German economic news continued today. Like businesses, households are also evidently more downbeat against an unsettling backdrop including strikes by train drivers, demonstrations by farmers, public protests against the rise of the far-right AfD, the hasty recalibration of fiscal policy due to the Constitutional Court's judgement on the use of off-budget funds, high interest rates, falling property prices, structural adjustments in heavy industry and a temporary shutdown of Tesla's Berlin factory due to events in the Red Sea. Indeed, today's GfK German consumer survey reported a notable decline in the headline confidence indicator – presented as a forecast for February – to an eleven-month low (-29.7). Admittedly, this followed a moderate festive-fuelled recovery at the end of last year, to leave confidence trending broadly sideways compared with Q4. But the level remains well below the long-run average (+2.3) and the size of the decline (4.3pts) was the sharpest in 17 months. The detail suggested that consumers aimed to tighten their purse strings at the start of the year amid a marked worsening of income expectations following the temporary pickup in inflation in December and further withdrawal of government support for energy bills in January. Consumers were also more pessimistic about the general economic outlook – for which the respective index fell to a thirteen-month low – to underscore that policymakers should not pin their hopes on any near-term recovery in household spending despite the prospect of rising real disposable incomes over coming quarters. Certainly, the Bundesbank's latest monthly report, published today, acknowledged that that the economic backdrop was weaker than it previously anticipated, reflecting in part its recognition of cautious household consumption as well as declining external demand. Indeed, the Bundesbank optimistically concluded that the economy may well "stagnate at best" in the first quarter, and we expect another modest quarterly contraction in GDP in Q1.

French consumers more upbeat amid more favourable growth and inflation expectations

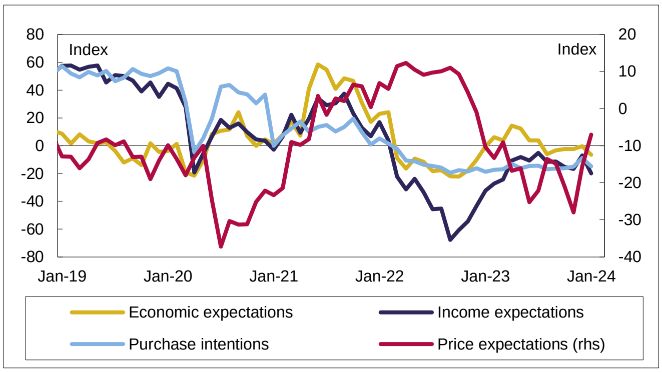
In contrast, the gradual improvement in French consumer confidence seen over the past eighteen months was extended at the start of the year, with the headline index rising for the third month out of the past four in January, by 2pts to 91. Admittedly, this remains some 9% below the long-run average and well below the highs enjoyed during the pandemic rebound in summer 2021. Nevertheless, it was the highest since Russia's invasion of Ukraine in spring 2022 and 9pts above its level a year ago. The detail suggested that the improvement was broad-based, with expectations about the general economic outlook and personal financial positions the most favourable since February 2022, supported by a further marked decline in inflation expectations over the coming twelve months. So, while the share of households planning to save more rose to its highest since May 2021, the proportion considering it a good time to make major purchases also rose to a

Euro area: Consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumer confidence indices



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

nineteen-month high. This notwithstanding, purchase intentions remain well below the long-run average suggesting only a gradual pickup in private consumption at the start of the year.

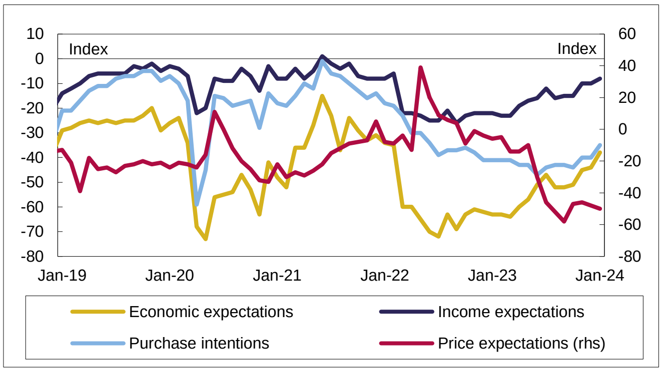
Bank lending to firms picks up but detail consistent with weak business fixed investment

Broadly consistent with this week's ECB Bank Lending Survey, which reported a moderation in the pace of decline in business loan demand last quarter, today's monetary data reported a second successive pickup in lending to non-financial corporations (NFCs) in December. Excluding sales and securitisations, the flow of new loans to NFCs rose €2.5bn from November (the figure for which was admittedly downwardly revised) to €15.8bn, the highest since October 2022. As a result, having been in negative territory in October and zero in November, annual growth in the stock of loans to NFCs picked up to 0.4%Y/Y in December. Of course, with inflation well above target, growth was still firmly negative in real terms. On an unadjusted basis, the pickup on the month was again led by short-dated loans (i.e. those with a maturity of up to one year), which rose to €12.5bn, the most in 15 months. That took the net flow on a three-month basis to €15.7bn, also the most since October 2022, suggestive of a pickup in spending on stocks and working capital following an extended period of negative inventory adjustments throughout much of last year. In contrast, the flow of long-term loans (i.e. those with a maturity of more than five years) slipped back into negative territory at -€6.3bn, the worst in a year, pointing to additional weakness in business fixed investment. Meanwhile, in contrast to total lending to NFCs, the monthly flow of loans to households on an adjusted basis also reverted to negative territory in December at -€2.9bn, the steepest decline in five months. As a result, the annual growth rate in the stock of loans to households slowed a further 0.2ppt to 0.3%Y/Y, the lowest since March 2015. Growth in loans for house purchase moderated to just 0.2%Y/Y, matching September's six-year low, tallying with continued weakness in the residential property market. But growth in consumer credit was steady at (an upwardly revised) 2.7%Y/Y, 0.2ppt above June's 16-month low.

Money supply picks up but still consistent with weak economic growth and inflation

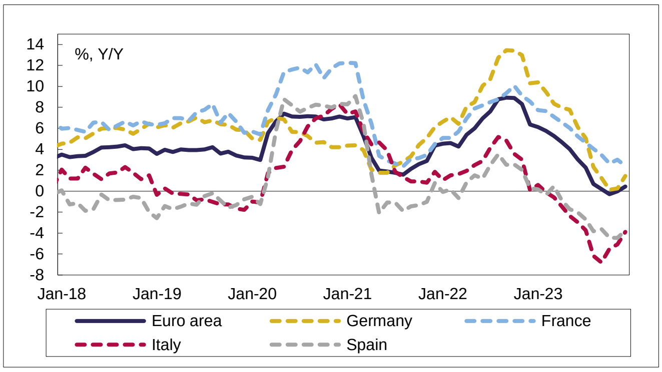
Meanwhile, despite the higher interest rates available on other assets, the pace of decline in euro area bank deposits moderated for a fourth successive month in December to -0.7%Y/Y, the softest in six months. That reflected a net inflow of €100bn, the most since August 2022, with NFCs, households, government entities and other financial corporations all increasing their deposits for a second successive month. Unsurprisingly, households continued to shift funds into higher-yielding time deposits from sight deposits consistent with a preference for saving rather than spending. However, the opposite was the case in December for NFCs. Given the pickup in deposits, the annual growth in M3 money supply snapped back into positive territory for the first time since June, jumping 1.0ppt to an admittedly minimal 0.1%Y/Y. And the pace of

France: Consumer confidence indices



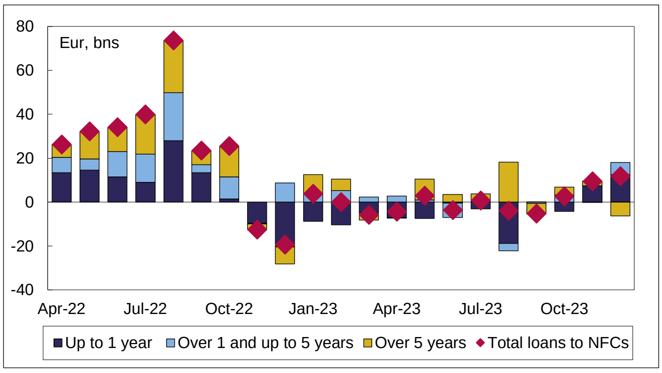
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Stock of loans to NFCs



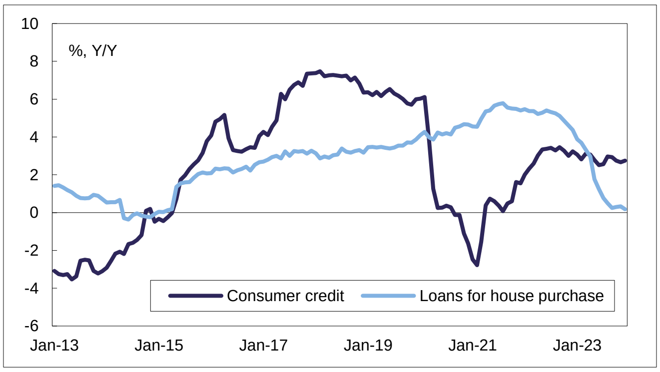
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Flow of net bank loans to NFCs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Stock of loans to households



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

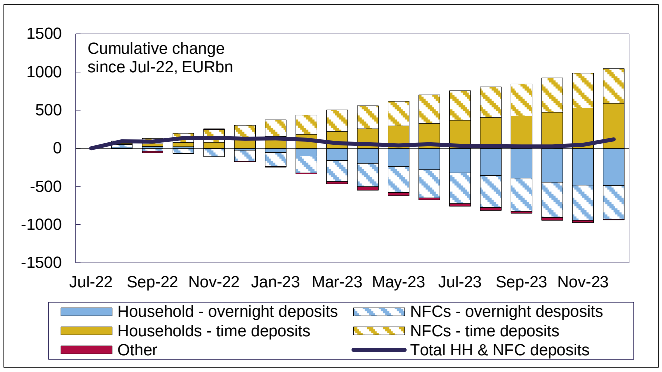
decline in the narrower M1 measure, which excludes sight deposits, moderated 1.0ppt to a six-month high. But at -8.5%Y/Y, that remained extremely weak by historical standards. And despite the improvement towards year-end, the money supply data remain consistent with soft economic activity and inflation.

The week ahead in the euro area: January inflation and Q4 GDP in focus

The coming week will bring plenty of top-tier euro area data, including the flash January inflation estimates and preliminary estimates of Q4 GDP. The near-term inflation profile remains highly uncertain, not least given a range of tax and subsidy changes at the start of the year as governments continued to withdraw policy support to consumers and businesses, as well as a reweighting of the inflation basket to reflect the shift in consumption patterns last year. In line with the consensus, our expectation is for headline euro area inflation (due Thursday) to ease slightly, albeit not fully reverse December's pickup, taking the HICP rate down 0.2ppt to 2.7%Y/Y. Given an anticipated further drop in non-energy industrial goods inflation, we also forecast core inflation to maintain a moderate downwards trajectory, by 0.1ppt to 3.3%Y/Y, which would be the lowest since March 2022. We see the risks to those forecasts as skewed to the downside, but the figures from Germany and France (Wednesday) and Spain (Tuesday) will offer some guidance ahead of the euro area figures.

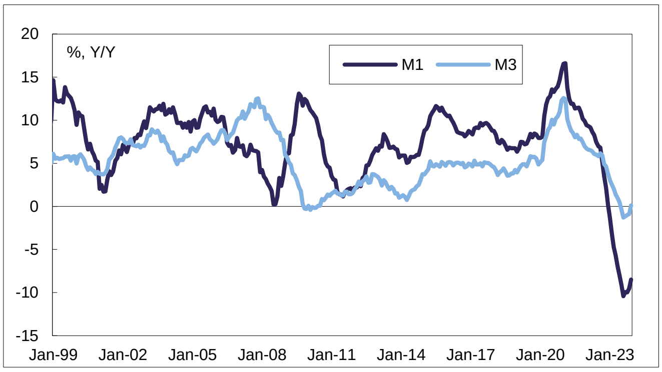
In terms of economic activity, the first estimates of Q4 GDP (Tuesday) will be downbeat. In line with the Bloomberg consensus, we forecast euro area GDP to contract by 0.1%Q/Q for a second successive quarter. The economic performances of the member states will likely be mixed. Destatis already reported with its advance full-year estimate that German GDP likely declined by 0.3%Q/Q while today's Irish figures reported a drop of 0.7%Q/Q to represent a fifth consecutive quarterly fall in GDP. Among the larger member states still to report, we also expect a modest contraction in Italy (-0.1%Q/Q), but positive growth in France (0.1%Q/Q) and Spain (0.2%Q/Q). Among other data due in the coming week, the European Commission's latest business and consumer surveys (Tuesday) will also flag a lack of economic momentum at the start of the year, with the headline economic sentiment indicator likely to be little changed in January to remain more than 3½% below the long-run average. Euro area unemployment figures for December (Thursday) are expected to report that the headline rate was unchanged at the series low of 6.4%. Beyond the economic data, ECB Chief Economist Lane is due to speak on "Monetary Policy and inflation" on Thursday.

Euro area: Household & NFC deposits



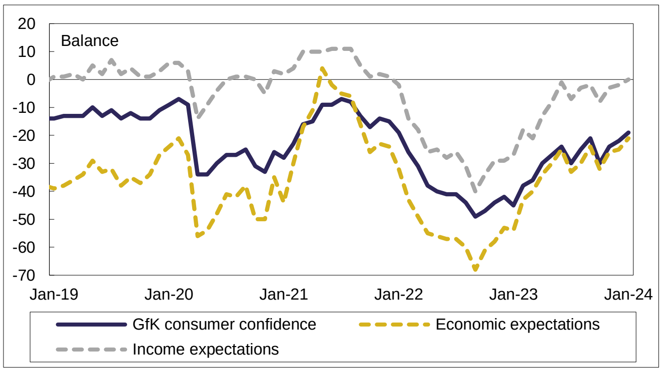
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Money supply



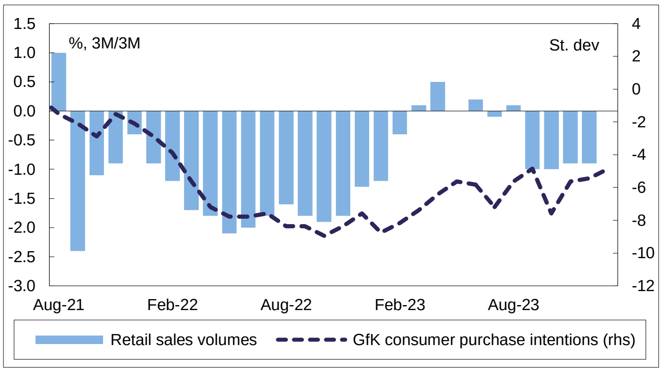
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Consumer confidence indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Consumer confidence & retail sales



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

UK consumer confidence benefitting from more favourable income expectations

Contrasting with the equivalent German release, but consistent with the improved growth momentum signalled in the flash PMIs, today's GfK consumer survey suggested that household sentiment in the UK was the highest in two years in January. In particular, the headline index rose for a third consecutive month and by a stronger-than-expected 3pts to -19, to be more than 6pts above the Q4 average and more than 30pts above the trough in September 2022 when Liz Truss took over as Prime Minister and interest rates surged in response to her reckless fiscal policy proposals. The improvement in sentiment was broad based. Consumers assessed the economic outlook over the coming twelve months to be the most favourable since September 2021 supported not least by the prospect of interest rate cuts later this year. And household income expectations were the most favourable since the start of 2021, benefitting from the recent moderation in inflation and cut to National Insurance Contributions at the start of this year. As such, households' purchase intentions also improved slightly in January, with the respective index matching the nineteen-month high recorded in September. However, this still remained well below the long-run average, suggesting the private consumption will remain relatively subdued. Indeed, if yesterday's gloomy CBI distributive trades survey is to be believed, consumer spending was particularly weak in January. And a noticeable pick up consumption might be unlikely to materialise until Q2, after personal taxes are likely to have been cut in the Spring Budget on 6 March and household energy tariffs are likely to have been significantly reduced on 1 April.

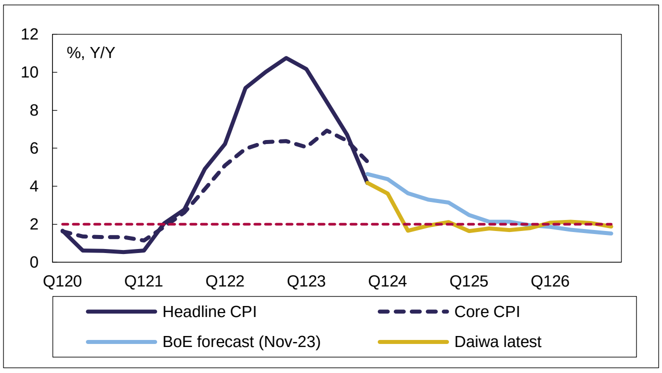
The week ahead in the UK: All eyes on the BoE

Thursday will bring the BoE's latest monetary policy announcement and updated macroeconomic projections, which will steer the MPC's rate decision and forward guidance. At its last policy meeting, the MPC left Bank Rate unchanged at 5.25% for a third successive meeting, with six members voting in favour of the decision but three external members – Greene, Haskel and Mann – still voting for a further hike of 25bps. And while the BoE revised down its expectation of GDP in Q4, and acknowledged that the latest CPI and wage prints had also surprised on the downside, it continued to see the risks to the inflation outlook as skewed to the upside. As such, the MPC's forward guidance and subsequent comments from Governor Bailey sought to downplay the possibility that rates might soon be cut. Indeed, the MPC retained a hiking bias, reiterating that "Further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures".

Recent data for GDP, inflation and pay has undershot the MPC's expectations

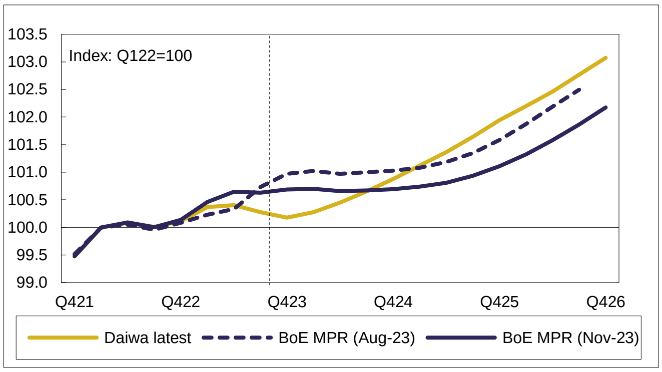
Since that meeting, the November CPI inflation data surprised significantly on the downside. And while the December CPI figure was above the market consensus at 4.0%Y/Y, it was still 0.6ppt below the BoE's projection for the month. Importantly too, at 6.4%Y/Y, services inflation – which is currently one of the key variables in its policy reaction function – undershot the BoE's forecast by 0.5ppt. Likewise, the November labour market data reported a steeper-than-expected drop in another key variable – average weekly private sector regular pay – to 6.5%3M/Y to be trending well below the path anticipated by the BoE. Indeed, pay momentum over the past few months has arguably slowed to levels in line with rates consistent with the achievement of the inflation target over the medium term. Moreover, while the ONS's latest experimental estimate of the unemployment rate remains below the BoE's estimate of the long-run equilibrium rate, the third key variable for the MPC – labour market tightness – also appears to have become less of a concern, with job vacancies down for the eighteenth successive month in December to the lowest level since June 2021. In addition, GDP growth in Q2 and Q3 was revised down by a cumulative 0.3ppt to 0.0%Q/Q and -0.1%Q/Q respectively. And while the PMIs suggested that GDP might have increased last quarter, hard data, including retail sales and output in manufacturing and construction, point to a possible second successive slight contraction in Q4.

UK: Inflation forecasts



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

UK: GDP forecasts



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

BoE likely to revise up its GDP growth outlook

Despite the weakness of GDP since Q223, the economic outlook for 2024 appears to have brightened somewhat since the publication of the November Monetary Policy Report. While the CBI distributive trades survey suggests that retail sales were again weak in January, the flash PMIs for that month pointed to GDP growth momentum around 0.1-0.2%Q/Q. Fiscal policy was loosened by the Government, not least via a cut in National Insurance Contributions from the start of the year. In addition, the 5.0% increase in the regulated household energy price cap in January was already 2.0ppts less than the BoE had expected, and recent market pricing points to a reduction in the cap by 15% or more in April. Oil prices are also down significantly across the curve, e.g. some 10% lower for the April contract compared to the respective forward price three months ago. And households who have to remortgage their housing loans will benefit from reductions in mortgage rates over the past few months, which have reflected the significant downwards shift in the sterling swap curve over that period. So, the BoE will see a significant improvement in real household disposable income compared to its previous forecast, and accordingly revise up its projection for private consumption and GDP.

Downward revision to inflation projection should prompt more dovish rate guidance

In its previous forecast, the BoE expected GDP to contract 0.1%Q/Q in each quarter of 2024 on an assumption of constant Bank Rate, or to remain unchanged in each quarter on an assumption of a market-implied path for rates. Given recent economic news, as well as the downwards shift in the market-implied path of rates, the BoE should forecast a resumption of positive economic growth this quarter, and a steady modest expansion – perhaps at an average quarterly pace of 0.2%Q/Q – over the course of the year, particularly on the market-implied rate assumption. And while firmer activity will mean that less economic slack accumulates over the course of the year, the recent softening of momentum in services inflation and private pay growth, as well as a lower path for household energy and petrol prices, will allow for a significant downwards shift to the BoE's inflation forecast. On both assumptions for the path of interest rates, the Bank previously expected inflation to fall below 2.0%Y/Y in 2025. We now expect inflation to fall below 2.0%Y/Y in Q224, return to about 2.0%Y/Y through the second half of the year, but then fall back close to but below 2.0%Y/Y in 2025. If the BoE shifts its view closer to ours, given the uncertainties and persisting upside risks it will still probably be too soon to consider a rate cut. But we would not be surprised if one MPC member (Swati Dhingra) voted to ease policy at this meeting, and expect at most only one member (Catherine Mann) to continue to vote for a hike. More importantly, the MPC statement should certainly drop its rate-hike bias and acknowledge that, if inflation follows the path assumed in its projection, the next move in rates is likely to be down.

Business inflation and pay expectations the main data focus

Data-wise, most notable for the BoE in the coming week will probably be the January results of its Decision-Maker Panel business survey, which will be released the same day as the MPC meeting. The December survey reported a welcome decline in firms' inflation expectations for the coming year (to 4.0%Y/Y) and the medium term (2.9%Y/Y). But the survey also reported a pickup in 12-month wage-growth expectations to the highest in nine months (5.4%Y/Y). Other new data due in the coming week from the UK include December's bank lending figures and the January BRC shop price survey (Tuesday), the Nationwide house price index for January (Wednesday), and the final January manufacturing PMIs (also Thursday). According to the flash estimates, the manufacturing sector had a disappointing start to the year, with the output PMI falling 0.5pt to a three-month low of 45.0, marking the eighteenth sub-50 "contractionary" reading out of the past nineteen months, and leaving the index some 1.3pts below the Q4 average. The flash PMIs also reported a further decline in domestic orders as well as a weakening in export demand.

The next edition of the Euro wrap-up will be published on 30 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	0.2	0.2	0.2	0.3	0.3	0.9
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	4.1	3.5	1.7	1.9	2.3	7.3	2.3	2.1
Core CPI	6.4	5.3	4.5	2.7	2.3	2.5	6.2	3.0	2.1
Monetary policy, %									
ECB									
Refi Rate	4.50	4.50	4.50	4.25	3.75	3.25	4.50	3.25	2.75
Deposit Rate	4.00	4.00	4.00	3.75	3.25	2.75	4.00	2.75	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/ *Daiwa forecast*	Previous	Revised
Euro area	M3 money supply Y/Y%	Dec	**0.1**	-0.7	-0.9	-
Germany	GfK consumer confidence index	Feb	**-29.7**	-24.6	-25.1	-25.4
France	INSEE consumer confidence index	Jan	**91**	90	89	-
UK	GfK consumer confidence index	Jan	**-19**	-21	-22	-

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/ *Daiwa forecast/actual*	Previous
		Monday 29 January 2024			
		- Nothing scheduled -			
		Tuesday 30 January 2024			
Euro area	10.00	GDP – first estimate Q/Q% (Y/Y%)	Q4	*-0.1 (0.0)*	-0.1 (0.0)
	10.00	European Commission's Economic Sentiment Indicator	Jan	96.4	96.4
	10.00	European Commission's final consumer confidence indicator	Jan	*-16.1*	-15.0
	10.00	European Commission's industrial (services) confidence indicator	Jan	-9.0 (8.1)	-9.2 (8.4)
Germany	09.00	GDP – first estimate Q/Q% (Y/Y%)	Q4	*-0.3 (-0.3)*	0.0 (-0.4)
France	06.30	GDP – first estimate Q/Q% (Y/Y%)	Q4	*0.1 (0.7)*	-0.1 (0.6)
	06.30	Consumer spending M/M% (Y/Y%)	Dec	0.0 (1.1)	0.7 (-1.1)
Italy	09.00	GDP – first estimate Q/Q% (Y/Y%)	Q4	*-0.1 (0.2)*	0.1 (0.1)
Spain	08.00	GDP – first estimate Q/Q% (Y/Y%)	Q4	*0.2 (1.5)*	0.3 (1.8)
	08.00	Preliminary HICP (CPI) Y/Y%	Jan	3.1 (2.7)	3.3 (3.1)
UK	00.01	BRC shop price index Y/Y%	Jan	-	4.3
	09.30	Net consumer credit £bn (Y/Y%)	Dec	-	2.0 (8.6)
	09.30	Net mortgage lending £bn (approvals '000s)	Dec	-	0.0 (50.1)
	09.30	M4 money supply M/M% (Y/Y%)	Dec	-	-0.1 (-2.3)
		Wednesday 31 January 2024			
Germany	07.00	Retail sales M/M% (Y/Y%)	Dec	0.5 (-1.2)	-2.2 (-1.5)
	08.55	Unemployment change '000s (rate %)	Jan	12.5 (5.9)	5.0 (5.9)
	13.00	Preliminary HICP (CPI) Y/Y%	Jan	3.2 (3.0)	3.8 (3.7)
France	07.45	Preliminary HICP (CPI) Y/Y%	Jan	3.6 (3.2)	4.1 (3.7)
Spain	08.00	Retail sales Y/Y%	Dec	-	5.2
UK	00.01	Lloyds business barometer	Jan	-	35
	07.00	Nationwide house price index M/M% (Y/Y%)	Jan	-	0.0 (-1.8)
		Thursday 01 February 2024			
Euro area	09.00	Final manufacturing PMI	Jan	*46.6*	44.4
	10.00	Preliminary HICP (core CPI) Y/Y%	Jan	*2.7 (3.3)*	2.9 (3.4)
	10.00	Unemployment rate %	Dec	6.4	6.4
Germany	08.55	Final manufacturing PMI	Jan	*45.4*	43.3
France	08.50	Final manufacturing PMI	Jan	*43.2*	42.1
Italy	08.45	Manufacturing PMI	Jan	*46.6*	45.3
	10.00	Preliminary HICP (CPI) Y/Y%	Jan	0.8 (0.9)	0.5 (0.6)
Spain	08.15	Manufacturing PMI	Jan	*47.6*	46.2
UK	09.30	Final manufacturing PMI	Jan	*47.3*	46.2
	12.00	BoE Bank Rate %	Feb	*5.25*	5.25
	14.00	BoE's DMP 1Y ahead inflation expectations %	Jan	-	4.0
		Friday 02 February 2024			
France	07.45	Industrial production M/M% (Y/Y%)	Dec	0.1 (-)	0.5 (0.6)
Spain	08.00	Unemployment change '000s	Jan	-	-27.4

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
		Monday 29 January 2024
Euro area	10.30	ECB Vice President de Guindos scheduled to speak
		Tuesday 30 January 2024
Germany	10.30	Auction: €5bn of zero-coupon 2026 bonds
	10.30	Auction: €4.5bn of 2.2% 2034 bonds
Italy	10.00	Auction: €3.5bn of 4.1% 2029 bonds
	10.00	Auction: €1.5bn of 4.35% 2033 bonds
	10.00	Auction: €2.0bn of 3.35% 2035 bonds
	10.00	Auction: €2.0bn of 2031 floating-rate bonds
UK	10.00	Auction: £900mn of 0.125% 2051 index-linked bonds
		Wednesday 31 January 2024
Germany	10.30	Auction: €4.5bn of 2.2% 2034 bonds
		Thursday 01 February 2024
Euro area	09.00	ECB's Centeno scheduled to speak
	11.30	ECB's Chief Economist Lane scheduled to speak
France	09.50	Auction: 3.5% 2033 bonds
	09.50	Auction: 2.5% 2043 bonds
	09.50	Auction: 0.5% 2040 bonds
	09.50	Auction: 3.0% 2054 bonds
Spain	09.30	Auction: Fixed-rate bond auction
UK	12.00	BoE monetary policy statement, minutes and Monetary Policy Report (MPR) published
	12.30	BoE Governor Bailey speaks at post MPR press conference
	14.00	BoE's Decision Maker Panel data published
		Friday 02 February 2024
UK	12.15	BoE Chief Economist Pill scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs