# Euro wrap-up

## Overview

**Chris Scicluna**
+44 20 7597 8326

**Emily Nicol**
+44 20 7597 8331

- Bunds followed USTs sharply higher as the flash January German and French inflation estimates moderated a touch more than expected, while German retail sales fell to the lowest level since February 2021.
- Gilts also followed the global trend higher, even as the UK Nationwide house price report pointed to further stabilisation at the start of 2024.
- Thursday will bring euro area flash January inflation estimates, while the BoE will publish its latest monetary policy decision and updated macroeconomic projections.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 3.1 12/25 | 2.398 | -0.105 |
| OBL 2.1 04/29 | 2.036 | -0.124 |
| DBR 2.2 02/34 | 2.158 | -0.108 |
| UKT 3½ 10/25 | 4.207 | -0.107 |
| UKT 4½ 06/28 | 3.714 | -0.135 |
| UKT 3¼ 01/33 | 3.781 | -0.118 |

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

# Euro area

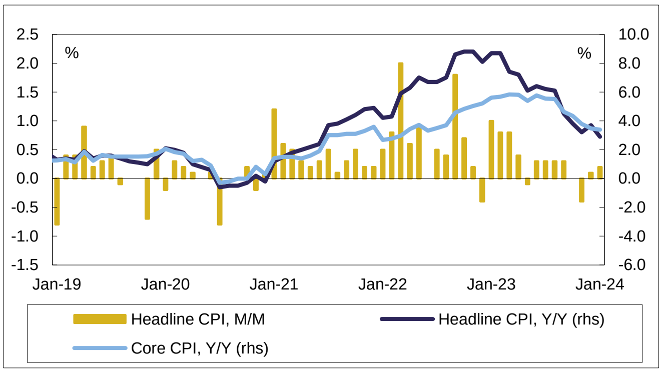
### German inflation falls a touch further than expected in January on lower goods price pressures

Based on the data published so far by the member states – including today's figures from Germany and France – the flash estimates of euro area inflation in January due tomorrow look set to report a modest decline in both the headline and core rates. In particular, having jumped in December due to a base effect associated with one-off government support for household energy bills a year earlier, German consumer price inflation fell back a touch further than expected in January. On the EU-harmonised HICP rate, German inflation fell 0.7ppt to 3.1%Y/Y. That was 0.1ppt below the median forecast on the Bloomberg survey, 8.5ppts below the peak, albeit still 0.8ppt above November's rate. And the national CPI rate fell 0.8ppt to 2.9%Y/Y, 0.3ppt below November's level and thus the lowest since June 2021. Within the detail on the German national measure, the energy component fell back into negative territory in January falling a steep 6.9ppts to -2.8%Y/Y. That, however, was still some 1.7ppts above the November level, as energy prices rose on the month for the first time since September due in part to the expiration of the government's so-called 'price brake' at the end of 2023 and increased carbon prices. Meanwhile, reflecting developments in wholesale and producer prices as well as a significant base effect, inflation of food and non-alcoholic beverages slowed 0.8ppt to 3.8%Y/Y, the lowest since June 2021. Within the core components, services inflation rose 0.2ppt to 3.4%Y/Y, as prices in the sector unusually rose at the start of the year likely in large part due to the expiration of a discounted VAT rate on restaurant meals. However, according to our calculation, inflation of core goods fell a steep 1.0ppt, the most since September and one of the sharpest declines on the series, to 3.0%Y/Y, the lowest since June 2022, as firms intensified discounting at the start of the year. And with core prices overall unchanged on the month in January, the annual core CPI rate fell for a fifth successive month, edging down 0.1ppt to 3.4%Y/Y, also a 19-month low. German headline and core inflation should fall steadily over coming quarters.

### French inflation eases to a 2-year low as base effects and discounting on selected goods

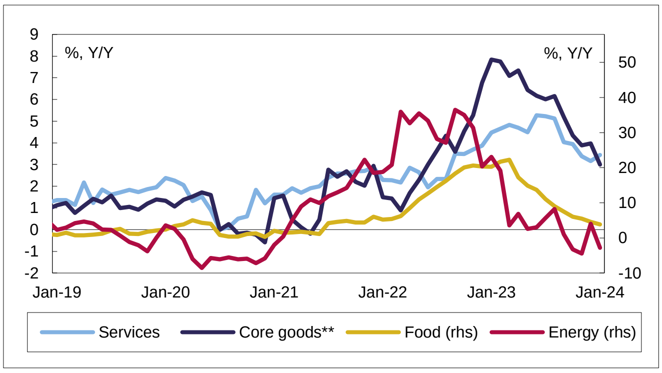
French inflation also fell a little further than expected at the start of the year, with the headline harmonised HICP rate declining 0.7ppt to 3.4%Y/Y, the lowest for two years and 3.9ppts below the peak last February. On the national measure, headline inflation also eased 0.6ppt to a two-year low of 3.1%Y/Y, with the limited detail published by INSEE suggesting that food, energy and core goods inflation benefitted from a mix of base effects, increased supply and seasonal discounting amid soft domestic demand. In particular, energy prices were little changed in January, compared with the near-4%M/M increase a year ago related to a jump in petrol prices as the government withdrew policy support. This left energy inflation down almost 4ppts at 1.8%Y/Y to account for roughly half the drop in the headline rate. The monthly rise in food prices was also a fraction of that a year ago too, leaving inflation of that component down 1½ppts at a nineteen-month low of 5.7%Y/Y. And this helped to offset the impact of a policy-driven rise in tobacco prices (up 7ppts to 16.8%Y/Y). There was also a larger-than-norm

**Germany: Consumer price inflation***




**National measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

**Germany: Key CPI components***




**National measure. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

decline in non-energy industrial goods prices in January (-1.7%M/M) due in part to heavy discounting among clothing retailers at the start of the year. And so, core goods inflation halved to just 0.7%Y/Y, the softest for two years. In contrast, services inflation edged higher for a second successive month, by 0.1ppt to 3.2%Y/Y, although the magnitude is unlikely to prevent a modest drop in core inflation this month. The slightly higher weighting of services in the inflation basket this year (up 2ppts to 52%) also added 0.1ppt to the contribution from that component. As in many other member states, the near-term profile of French inflation remains uncertain, not least due to the government's steady withdrawal of policy support. However, the near-10% rise in electricity prices scheduled in February should have limited impact on energy inflation given the 9.4%M/M rise in February 2023. And, as in Germany, inflation in France is also likely to maintain a steady downtrend over the course of the year.

## German retail sales fall to lowest level since February 2021 but labour market remains steady

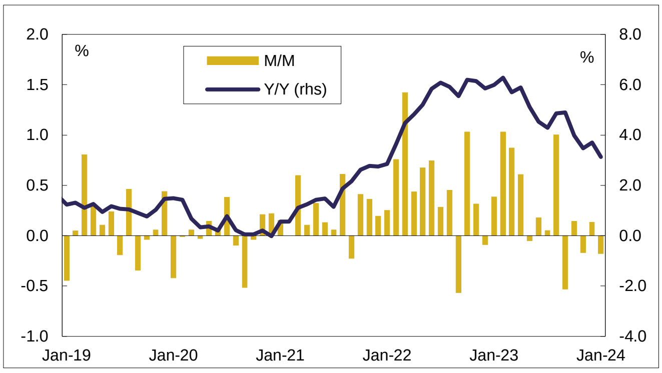
After yesterday's preliminary data reported that German GDP contracted 0.3%Q/Q in Q4, today's updated retail sales figures predictably suggested that private consumption similarly fell last quarter. Indeed, contrary to expectations of a modest rebound in December, retail sales volumes fell 1.6%M/M that month. The extent of the decline in November was revised to just 0.8%M/M, 1.7ppts less than originally estimated. However, that still left retail sales in December down 4.4%Y/Y and at the lowest level since the lockdowns of February 2021, some 2.0% below the pre-pandemic level in February 2020. Over Q4 as a whole, sales volumes were down 0.4%Q/Q, somewhat less than the decline of 0.7%Q/Q in Q3. In nominal terms, the value of retail sales fell 1.2%M/M in December to be still up 0.8%Y/Y that month but down 0.5%Q/Q over Q4 as a whole.

Surveys suggest no improvement in German economic growth momentum at the start of 2024. However, the labour market remains relatively resilient. Indeed, today's figures for January reported the first drop in German jobless claims in one year. While that fall was an admittedly negligible 2k, the increase in claims in December was revised down, also to just 2k. So, the claimant count rate was steady in January at the prior month's downwardly revised rate of 5.8%, its level since October. And consistent with continued labour hoarding across most sectors, that was just 0.3ppt above the level a year earlier, albeit 0.8ppt above the trough in the first half of 2022. Meanwhile, the number of vacancies on a seasonally-adjusted basis edged up in January to a five-month high of 738k, still 28k (or almost 4%) above the level in February 2020, albeit below the average in the two years ahead of the pandemic.

## The day ahead in the euro area

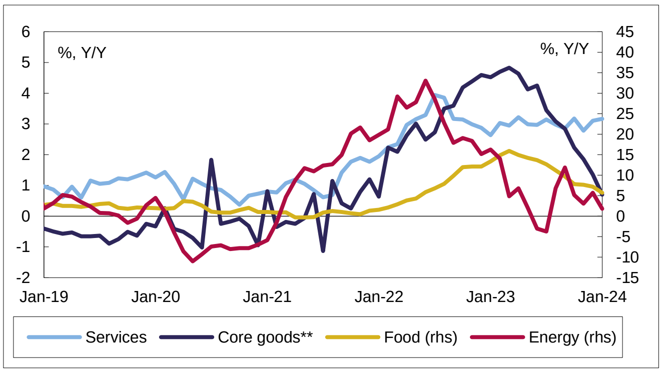
The data highlight tomorrow will be the aforementioned flash estimates of euro area inflation in January. Given a range of tax and subsidy changes at the start of the year as governments continued to withdraw policy support to consumers and

### France: Consumer price inflation*



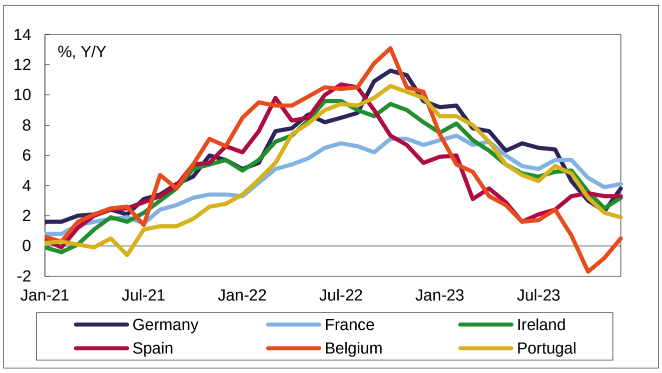

*National measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### France: Key CPI components*



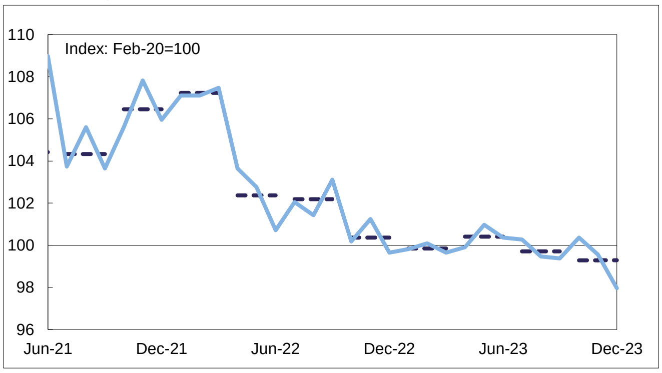

*National measure. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: HICP inflation in selected member states




Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Germany: Retail sales volumes*




*Dashed dark blue lines represent quarterly averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

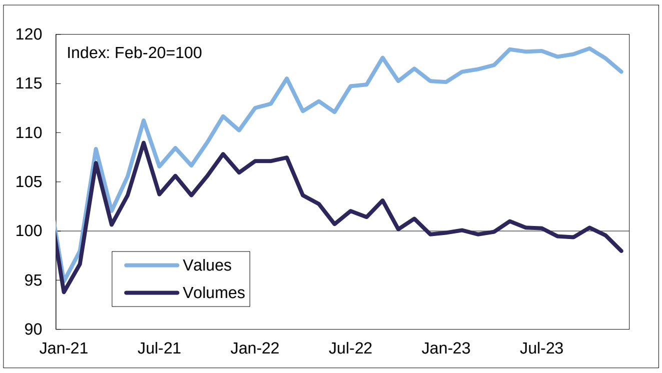
businesses, as well as a reweighting of the inflation basket to reflect the shift in consumption patterns last year, the near-term profile is subject to greater uncertainties than normal. Figures published by member states so far have been mixed, with the declines in Germany and France reported today contrasting increases in Spain (up 0.2ppt to 3.5%Y/Y) and Belgium (up 1ppt to +1.5%Y/Y). Like the consensus, we maintain our expectation that headline euro area inflation eased slightly, albeit not fully reversing 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. Meanwhile, Thursday will also bring euro area unemployment figures for December. In light of the downside surprise to today's (admittedly volatile) Italian figure (down 0.2ppt to 7.2%), the euro area jobless rate might well edge down from 6.4% to a fresh series low. The final readings for the January manufacturing PMIs are also due. According to the flash estimates, the manufacturing output PMI rose to a nine-month high of 46.6, still thus consistent with ongoing contraction in the sector. And at 48.6, the output price index remained consistent with ongoing disinflation in non-energy industrial goods prices. Aside from the data, ECB Chief Economist Lane will give a speech on "Monetary policy and inflation".

# UK

## Nationwide house price report points to further stabilisation, but outlook remains underwhelming

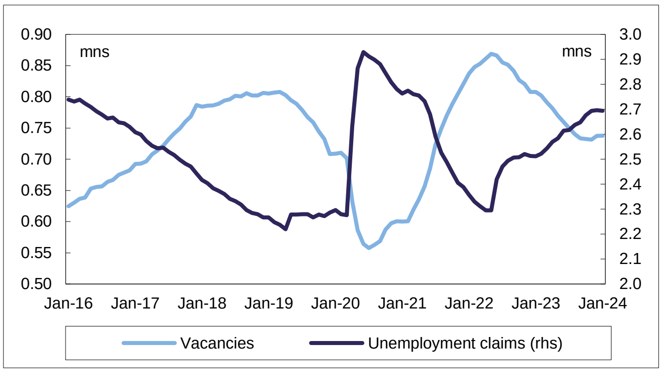
Consistent with the findings of the latest RICS residential survey, today's Nationwide house price report pointed to some further stabilisation in the housing market at the start of 2024. According to Nationwide, house prices rose a stronger-than-expected 0.7%M/M in January, to mark the third monthly increase out of the past four and leave prices some 2% above the summer low. So, the year-on-year growth rate was the firmest in a year, albeit at a paltry 0.0%Y/Y. With yesterday's lending figures reporting that households made the sixth net repayment of mortgage debt (-£0.8bn) in the past ten months in December, while mortgage approvals remained considerably weaker than the pre-pandemic five-year average, we expect subdued demand to remain a restraining influence on house prices. Furthermore, while rising wages and recent easing in new mortgage rates has slightly improved affordability pressures, the ratio of first-time buyer mortgage payments to earnings remains historically high at 37.8% in Q4, roughly 8ppts above the long-run average, with pressures in London even more acute (63%). So, while surveyors are more upbeat about the outlook for sales over the coming twelve months, with interest rates still considerably higher than two years ago we expect minimal growth in house prices for several quarters to come.

### Germany: Retail sales volumes & values



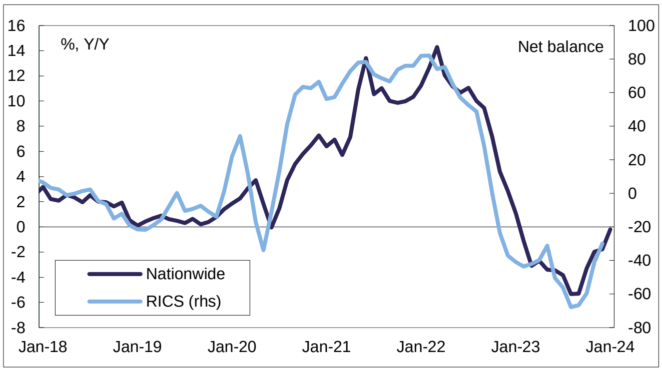

*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Germany: Unemployment claims & vacancies



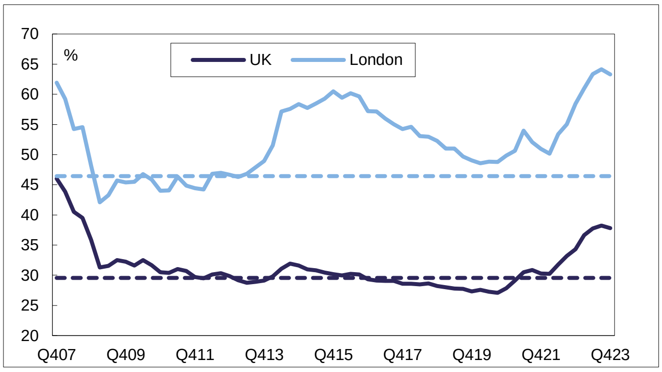

*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### UK: House price indicators




*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### UK: Mortgage payments to earnings ratio*




**First-time buyers. Dashed lines represent long-run averages.*
*Source: Nationwide, Macrobond and Daiwa Capital Markets Europe Ltd.*

## The day ahead in the UK

All eyes in the UK tomorrow will be on the BoE's monetary policy announcement and updated macroeconomic projections, which will steer the MPC's rate decision and forward guidance. The MPC is expected to keep Bank Rate unchanged at 5.25%. But having previously maintained a tightening bias in its forward guidance, the MPC's statement should drop its tightening bias and acknowledge that, if inflation follows the path assumed in its projection, the next move in rates is likely to be down. Indeed, 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), compared to three in December, to continue to vote for a hike.

Since the December MPC 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. Pay momentum over the past few months has arguably also slowed to levels consistent with the achievement of the inflation target over the medium term. And GDP has been softer than previously assumed, with recent hard data – including retail sales and output in manufacturing and construction – pointing to a possible second successive slight contraction in Q4, despite the positive signals from the PMIs. Despite the weakness of GDP since Q223, the economic outlook for 2024 appears to have brightened somewhat since the publication of the Bank's November Monetary Policy Report, thanks in part to a loosening of fiscal policy, declining energy prices from three months ago and a reduction in mortgage rates. So, the BoE will see a significant improvement in real household disposable income compared to its previous forecast, and will accordingly revise up its projection for private consumption and GDP. 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 in the BoE's inflation forecast. The Bank previously expected inflation to fall below 2.0%Y/Y in 2025, while 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.

In terms of economic data, the most noteworthy release tomorrow will be the January results of the BoE's Decision-Maker Panel business survey. 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). Tomorrow will also bring the final January manufacturing PMIs. 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. But arguably of most interest for the BoE will be the extent to which input cost burdens increased amid increased supply-side disruptions associated with events in the Red Sea.

# European calendar

## Today's results

**Economic data**

| Country | | Release | Period | **Actual** | Market consensus/ _Daiwa forecast_ | Previous | Revised |
|---|---|---|---|---|---|---|---|
| Germany | | Retail sales M/M% (Y/Y%) | Dec | **-1.6 (-4.4)** | 0.5 (-1.2) | -2.5 (-2.0) | -0.8 (-1.2) |
| | | Unemployment change '000s (rate %) | Jan | **-2.0 (5.8)** | 11.0 (5.9) | 5.0 (5.9) | 2.0 (5.8) |
| | | Preliminary HICP (CPI) Y/Y% | Jan | **3.1 (2.9)** | 3.2 (3.0) | 3.8 (3.7) | - |
| France | | Preliminary HICP (CPI) Y/Y% | Jan | **3.4 (3.1)** | 3.6 (3.2) | 4.1 (3.7) | - |
| Spain | | Retail sales Y/Y% | Dec | **3.1** | - | 5.2 | 5.0 |
| UK | | Lloyds business barometer | Jan | **44** | - | 35 | - |
| | | Nationwide house price index M/M% (Y/Y%) | Jan | **0.7 (-0.2)** | 0.1 (-0.9) | 0.0 (-1.8) | - |

**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/ _Daiwa forecast_ | Previous |
|---|---|---|---|---|---|---|
| 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 | 47.0 | 45.3 |
| | | 10.00 | Preliminary HICP (CPI) Y/Y% | Jan | 0.8 (0.9) | 0.5 (0.6) |
| Spain | | 08.15 | Manufacturing PMI | Jan | 48.0 | 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 | 3.8 | 4.0 |

**Auctions and events**

| Country | | GMT | Event |
|---|---|---|---|
| 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: 1.45% 2029 bonds |
| | | 09.30 | Auction: 0.1% 2031 bonds |
| | | 09.30 | Auction: 3.25% 2034 bonds |
| | | 09.30 | Auction: 2.05% 2039 index-linked bonds |
| 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 |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*