

Euro wrap-up

Overview

- Bunds followed USTs lower even as German goods export and imports fell sharply and euro area PPI inflation remained firmly in negative territory in December.
- Gilts also made losses, while revised ONS labour force survey results saw a lower than previously estimated UK unemployment rate but also a weaker employment rate.
- Tuesday will bring the latest figures for euro area retail sales and German factory orders, as well as various euro area and UK sentiment surveys.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2½ 03/26 | 2.603 | +0.052 |
| OBL 2.1 04/29 | 2.232 | +0.071 |
| DBR 2.2 02/34 | 2.315 | +0.076 |
| UKT 3½ 10/25 | 4.489 | +0.096 |
| UKT 4½ 06/28 | 3.998 | +0.101 |
| UKT 3¼ 01/33 | 4.013 | +0.101 |

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

Source: Bloomberg

Euro area

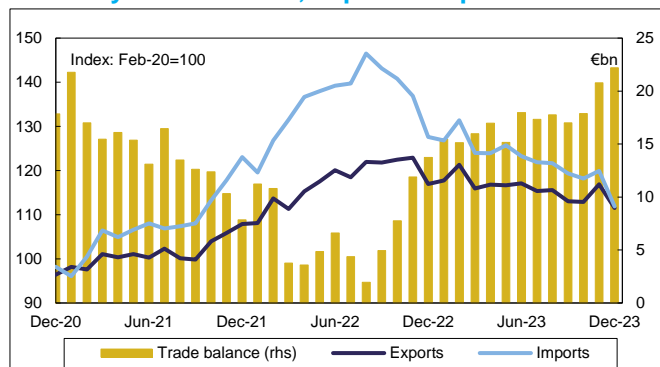
German trade surplus reaches a seven-year high, but exports and imports slumped at year-end

Consistent with the sharp decline in [German retail sales](#) reported in December, today's goods trade figures were equally disappointing, with the drop in the value of exports and imports exceeded only a handful of times in the past two decades. While the slump in exports in December (-4.6%M/M) in part reflected payback for a surge in November (3.5%M/M), the weakness was nevertheless broad-based, with sharp declines in shipments to other euro area countries (-6.0%M/M), the US (-5½%M/M), the UK (-4.3%M/M) and China (-7.9%M/M). And so, despite diminishing supply-side constraints, this left exports down 0.8%3M/3M over Q4 as a whole, the fourth consecutive quarterly contraction, emphasising the impact of waning global demand. Admittedly, the plunge in import values was even more striking in December, with a fall of 6.7%M/M leaving them down more than 3½%3M/3M, perhaps related in part to freight disruption in the Red Sea. As such, the goods trade surplus unexpectedly widened by €1.4bn to €22.2bn, the highest for more than seven years. Part of the decline in imports that month reflected the drop in imported prices (-1.1%M/M). But this still left import volumes down 5.6%M/M – the most since the start of 2022 – and a substantial 4.8%3M/3M in Q4 – the most since the global financial crisis when excluding the initial lockdown at the start of the pandemic. And so, while export volumes (-1.0%3M/3M) subtracted from GDP growth in Q4, today's report suggests that net trade provided a notable positive impulse last quarter, partially offsetting the drag from final domestic demand.

Euro area PPI data suggests that disinflationary trend in core goods inflation should be maintained

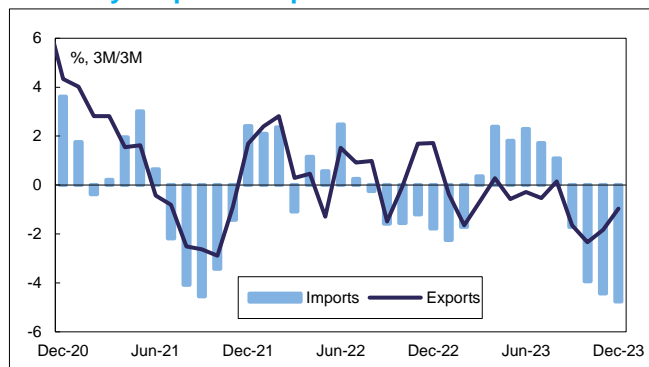
While the [flash estimates for euro area inflation](#) edged only slightly lower in January, momentum in core goods inflation continued to slow sharply. And today's producer price figures further illustrated that this disinflationary trend should be maintained over coming months too. Admittedly, the drop in factory producer prices in December (-0.8%M/M) was largely related to energy prices, which fell (-2.3%M/M) for a second successive month and by the most since May. And so, due partly to base effects from the rise in prices in December 2022, the annual headline PPI rate fell a further 1.7ppts to a three-month low of -10.6%Y/Y. But non-energy producer output goods prices also fell for the ninth consecutive month (-0.1%M/M), to leave the annual rate at -0.4%Y/Y, the joint-lowest since the first wave of Covid-19 in June 2020. While the drag from intermediate goods inflation eased slightly (up 0.2ppt to -4.9%Y/Y), capital and consumer goods inflation (2.8%Y/Y and 3.2%Y/Y respectively) slowed to its softest since summer 2021, with the latter down more than 12ppts from its peak in November 2022. With the manufacturing PMIs suggesting that input costs continue to fall and firms' pricing power remains limited by subdued demand, core HICP goods inflation will stay very subdued over coming quarters. Of course, services inflation will remain most important for the ECB over coming months. And today's final services PMIs signalled still above-

Germany: Goods trade, export & import values



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Germany: Export & import volumes



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

average cost pressures in the sector at the start of the year, while the prices charged component ticked higher for a third consecutive month to a seven-month high in January (56.3) to remain some 6pts above the long-run average.

The day ahead in the euro area

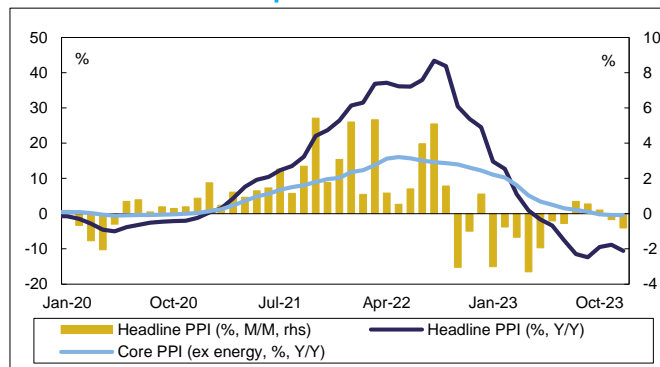
Tomorrow's releases will provide an update on economic activity at the turn of the year, including German factory orders figures for December. Despite the slump in exports that month, orders might well have received a boost from a notable aircraft order that month. Meanwhile, the latest euro area retail sales data will likely reveal a disappointing end to last year, with sales expected to have fallen around 1.0%M/M in December, in line national releases that indicated weakness in Germany, France, Spain and the Netherlands. And the January construction PMIs will also likely signal ongoing contraction, as higher interest rates continue to weigh on demand. In terms of the inflation outlook, tomorrow will bring the release of the ECB's consumer price expectations survey for December. With CPI having jumped in December and the Commission's measure of household price expectations having edged higher at the end of last year, the ECB's survey gauge for inflation expectations one year ahead might also increase in December from the nineteen-month low (3.2%Y/Y) in November. More important for the ECB will be developments in inflation expectations three-years ahead, which in November eased to 2.2%Y/Y, the lowest since February 2022.

UK

UK unemployment rate revised lower, but employment rate also weaker than previously estimated

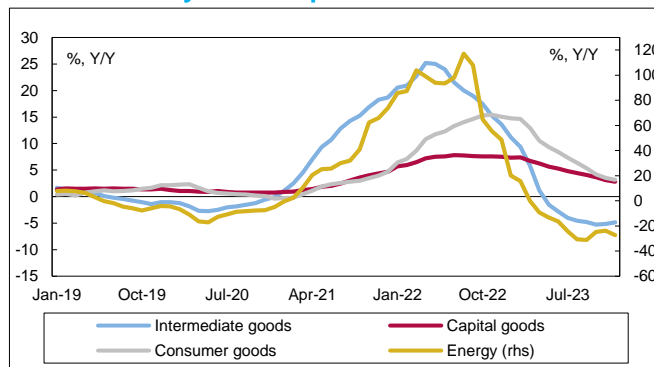
While the [BoE](#) last week acknowledged that the labour market had been a touch tighter than it had previously expected, the ONS' publication today of updated and reweighted Labour Force Survey (LFS) results – that had been suspended since the summer due to accuracy concerns amid a declining response rate – indicated that it was tighter still over the past year, further suggesting that policymakers won't be rushing into the first rate cut. Indeed, while the experimental unemployment rate (based on HMRC and claimant count figures) had moved sideways at 4.2% in the six months to November, today's reweighted LFS data recorded a fourth consecutive decline to 3.9% in the three months to November. This left it only fractionally higher than a year earlier (3.8%) and importantly some 0.4ppt below the BoE's updated forecast for Q4. The improvement in part reflects a more rapid rise in population estimates than previously assumed. This also included a larger proportion of women, which lowered the employment rate, and more young people that as a consequence skewed inactivity higher. Indeed, the employment rate was downwardly revised by 0.8ppt to 75.0% from the experimental estimates, suggesting that the labour market was not as firm as previously thought. And the number of those economically inactive was higher, due in part to long-term sickness presumably reflecting the effect of long-Covid and longer NHS waiting times. It is

Euro area: Producer price inflation



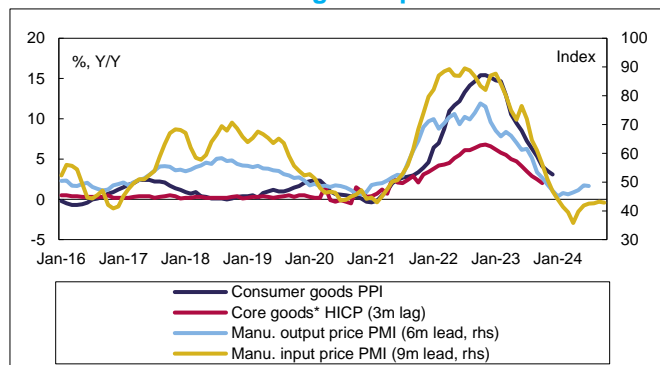
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Key PPI components



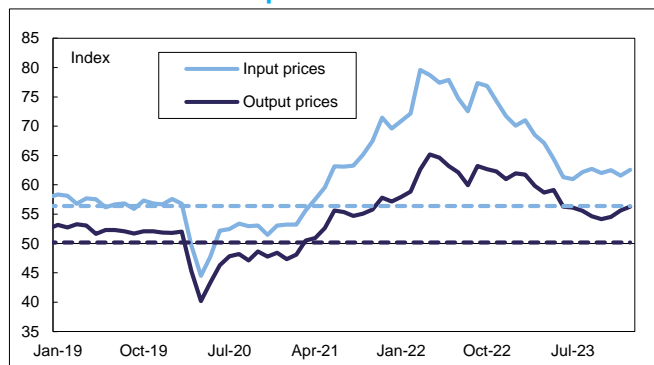
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Measures of goods prices



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

Euro area: Services price PMIs*



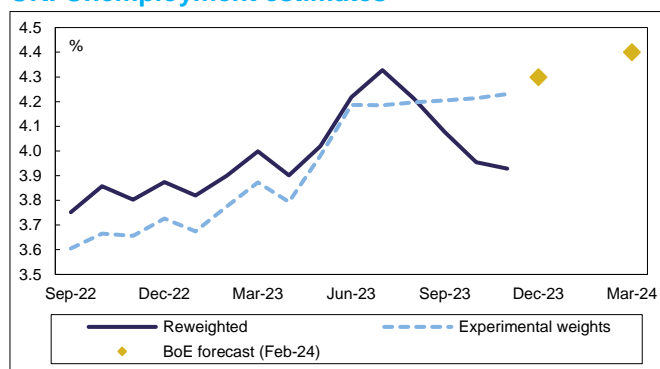
*Dashed lines represent pre-pandemic long-run average. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

worth noting that the ONS again cautioned that the LFS numbers should be interpreted alongside other measures of the labour market, with the re-instatement of the boost to the sample size in January likely to take time to emerge. The forthcoming labour market report (13 February) will also provide updated LFS estimates from 2011 for greater comparison. Moreover, this release is also likely to see a continuation of the slowing momentum in wage growth – another important variable in the BoE's reaction function – seen over recent months.

The day ahead in the UK

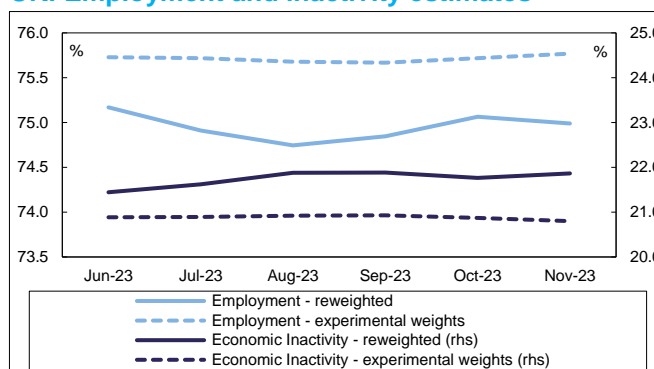
Tomorrow will bring updates on the construction and retail sectors at the start of the year, with the respective PMI and BRC surveys expected to flag ongoing challenges as a mix of high borrowing costs, weak consumer confidence and persisting economic uncertainties continue to hit demand.

UK: Unemployment estimates



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

UK: Employment and inactivity estimates



Source: ONS 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 | Final services (composite) PMI | Jan | 48.4 (47.9) | <u>48.4 (47.9)</u> | 48.8 (47.6) | - |
| | Sentix investor confidence | Feb | -12.9 | -15.0 | -15.8 | - |
| | PPI Y/Y% | Dec | -10.6 | -10.5 | -8.8 | - |
| Germany | Trade balance €bn | Dec | 22.2 | 18.7 | 20.4 | 20.8 |
| | Final services (composite) PMI | Jan | 47.7 (47.0) | <u>47.6 (47.1)</u> | 49.3 (47.4) | - |
| France | Final services (composite) PMI | Jan | 45.4 (44.6) | <u>45.0 (44.2)</u> | 45.7 (44.8) | - |
| Italy | Services (composite) PMI | Jan | 51.2 (50.7) | 50.8 (50.0) | 49.8 (48.6) | - |
| Spain | Services (composite) PMI | Jan | 52.1 (51.5) | 52.1 (52.0) | 51.5 (50.4) | - |
| UK | Final services (composite) PMI | Jan | 54.3 (52.9) | <u>53.8 (52.5)</u> | 53.4 (52.1) | - |
| | New car registrations Y/Y% | Jan | 8.2 | - | 9.8 | - |

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/ <i>Daiwa forecast</i> | Previous |
|-----------|-------|---|--------|--|--------------|
| Euro area | 08.30 | Construction PMI | Jan | - | 43.6 |
| | 09.00 | ECB 1Y (3Y) inflation expectations Y/Y% | Dec | - | 3.2 (2.2) |
| | 10.00 | Retail sales M/M% (Y/Y%) | Dec | -1.0 (-0.8) | -0.3 (-1.1) |
| Germany | 07.00 | Factory orders M/M% (Y/Y%) | Dec | -0.2 (-5.3) | 0.3 (-4.4) |
| | 08.30 | Construction PMI | Jan | - | 37.0 |
| France | 08.30 | Construction PMI | Jan | - | 42.6 |
| Italy | 08.30 | Construction PMI | Jan | - | 55.2 |
| | 09.00 | Business (manufacturing) confidence Indicator | Jan | - (96.5) | 107.2 (95.4) |
| | 09.00 | Consumer confidence indicator | Jan | 107.0 | 106.7 |
| UK | 00.01 | BRC retail monitor, like-for-like sales Y/Y% | Jan | 1.0 | 1.9 |
| | 09.30 | Construction PMI | Jan | 47.2 | 46.8 |

Auctions and events

| | | |
|----|-------|--|
| UK | 10.00 | Auction: £2.5bn of 1.5% 2053 green bonds |
|----|-------|--|

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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