Euro wrap-up

Overview

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- Bunds ended the day a touch higher as the surge in German factory orders in December reflected one-off bulk purchases, while the downtrend in core orders was maintained.
- Following some dovish comments from certain BoE policymakers, Gilts made gains as a UK retail survey suggested a soft start to the year for consumer spending.
- Tomorrow will bring German and Spanish industrial production figures for December, while BoE Deputy Governor Breeden is due to speak.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.595	-0.008
OBL 2.1 04/29	2.222	-0.010
DBR 2.2 02/34	2.300	-0.013
UKT 3½ 10/25	4.446	-0.032
UKT 4½ 06/28	3.946	-0.042
UKT 3¼ 01/33	3.950	-0.052

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

Euro area

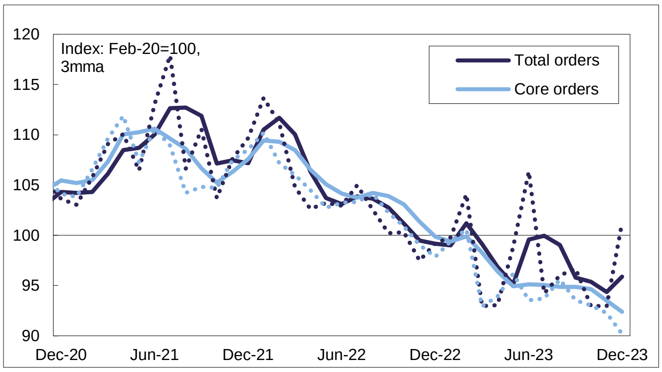
German orders surge in December on one-off bulk orders

With Germany's economy having contracted in Q4 and December's disappointing retail sales and exports figures suggesting a negative carry over into the start of 2024, today's factory orders release, at face value at least, hinted at the prospect of some stabilisation in the manufacturing sector. In particular, total orders jumped a stronger-than-expected 8.9%M/M in December – the most since re-unification when excluding the initial pandemic rebound in May and June 2020 – to leave them up 2.7%Y/Y, the first year-on-year increase since February 2022. Domestic orders rose for a third successive month and by a strong 9.4%M/M to a six-month high. And foreign orders (8.5%M/M) were boosted by a whopping 35%M/M surge in orders from other euro area countries to a series high, while orders to elsewhere fell to their lowest level since summer 2020. Of course, orders data are notoriously volatile. Given the recent steady downwards trend, when smoothing on a three-month basis, orders were merely up 0.1%3M/3M. Moreover, the rebound in December was propelled by a high volume of bulk orders in a number of industries, including aerospace (240%M/M), electrical equipment (39%M/M), and fabricated metals (18%M/M), which offset sizeable declines in autos (-15%M/M) and shipbuilding (-57%M/M). Indeed, when excluding large-scale purchases, core orders fell for a fourth consecutive month, by -2.2%M/M, to the lowest level since the first Covid-19 wave and 2010 before that, to be down 2.6%3M/3M in Q4 and some 18% below the pre-pandemic benchmark.

Manufacturing turnover stabilises in December, but contracted sharply over the fourth quarter

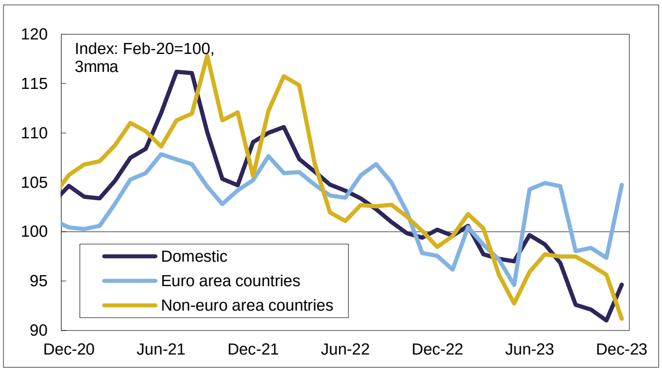
While order backlogs remain elevated in certain subsectors – in particular, electrical and ICT equipment – they continue to fall steadily in autos and have returned close to pre-pandemic levels in other industries. Indeed, various surveys suggest that order books are the thinnest since the first Covid lockdown and inventories remain elevated. Admittedly, today's data also showed that manufacturing turnover broadly stabilised in December, down just 0.1%M/M. But having declined more sharply in the previous six months, this left it down 1.8%3M/3M and 5% below the February 2020 level. While this suggests that German industrial production figures for the same month (due tomorrow) might well beat the downbeat consensus forecast on the Bloomberg survey (-0.5%M/M), the sharp decline in truck toll mileage (-3.5%M/M) still suggests that risks to output are skewed to the downside. Either way, tomorrow's data will confirm that the sector remained a significant drag on GDP growth in Q4. And with core orders still declining and an ifo survey suggesting that the share of manufacturers citing a lack of orders as a limiting factor on production rose in January to 36.9%, up from 20.9% a year ago, the near-term outlook for German manufacturing output remains subdued.

Germany: Factory orders*



*Core orders exclude major orders. Dotted lines represent unsmoothed data.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

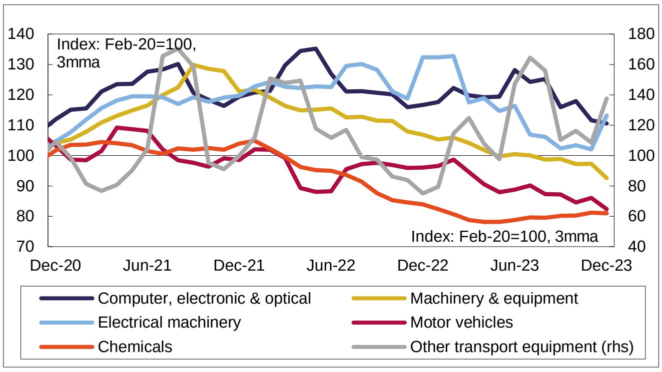
Construction PMIs flags ongoing challenges amid high borrowing costs and falling property prices

Today's PMIs similarly suggested ongoing significant challenges in Germany's construction sector at the start of the New Year as demand remained severely impacted by higher borrowing costs and falling real estate prices. Indeed, the headline activity index fell 0.6pt in January to 36.3, almost fully reversing the increase in December to mark the 22nd consecutive month with a sub-50 'contractionary' reading and one of the lowest in the series. There was also a notable deterioration in the respective French PMI at the start of the year, down 3pts to a three-year low of 39.6. In both member states, house building continued to report the steepest contractions, with the respective index in Germany (27.9) at one of the lowest levels since 2010 and in France the second-weakest for 3½ years (34.4). But growth in commercial building was also still in reverse reflecting the reluctance among firms to invest due to a range of structural and cyclical factors, including the downward adjustment in commercial real estate prices. In contrast, however, today's survey implied a sustained, albeit slightly softer, expansion in Italian construction in January, with ongoing modest growth in housing, commercial building and civil engineering alike.

Broad-based decline in euro area retail sales in December

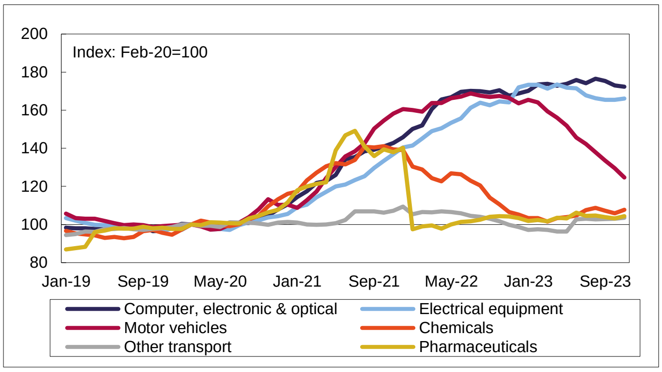
Rising interest rates, elevated prices and low consumer confidence also continued to take their toll on households' willingness to spend on goods at the end of 2023. In line with the weakness already reported in various member states including Germany, France and Spain, today's aggregate euro area figures reported the steepest monthly drop in sales (-1.1%M/M) for two years in December, to leave them down 0.8%Y/Y and at the lowest level since April 2021 when the relaxation of pandemic-related restrictions saw households pivot their consumption towards services. Admittedly, the decline in December came on the back of two consecutive increases to leave retail sales broadly unchanged over the fourth quarter as a whole, therefore having no material impact on GDP growth last quarter. But spending in Q4 was principally propped up by auto fuel sales, which posted the first quarterly increase in a year. In contrast, food sales were down a steep 1.6%M/M in December – the most since November 2020 – to fall around 1%3M/3M in Q4. And with core sales – i.e. excluding food and fuel – declining for the first month in three in December, they moved sideways over the quarter as a whole. Despite an improvement in purchasing power as pay growth outpaces inflation, surveys suggest that spending intentions remain extremely subdued at the start of the year too.

Germany: Factory orders by selected subsectors



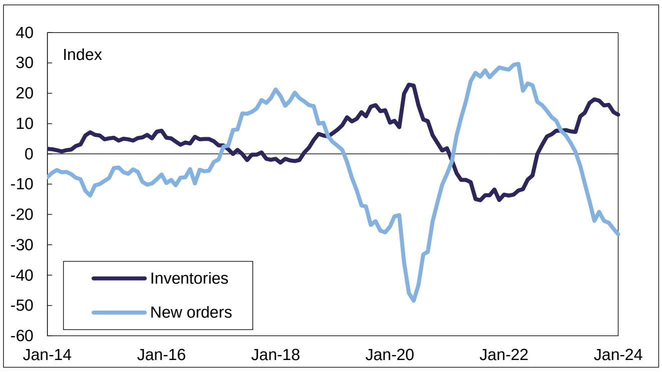
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory order backlogs



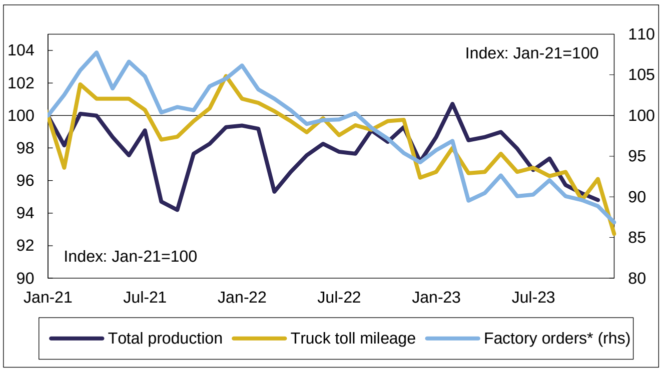
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing orders & inventories



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

Germany: Selected manufacturing indices



**Excluding major orders. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

ECB consumer survey provides mixed messages about inflation expectations

In terms of the inflation outlook, the results from today's ECB consumer survey were mixed. Despite the jump in headline inflation in December reflecting the temporary policy-driven surge in Germany, today's survey suggested that households were again more optimistic about the outlook for inflation in the coming twelve months, with the median forecast dropping 0.3ppt to 3.2%Y/Y in December, the lowest since February 2022. Indeed, while consumer inflation expectations in Germany and France moved sideways at 3.0%Y/Y, there were notable declines in Italy (down 0.7ppt to 4.0%Y/Y) and Spain (down 0.4ppt to 4.9%Y/Y). But what matters more for the ECB's monetary policy decision is inflation expectations over the medium term. And in this respect the survey was somewhat less encouraging, with the median forecast for three years ahead edging slightly higher by 0.1ppt to 2.5%Y/Y. This nevertheless was still some 0.6ppt below the peak in September 2022. Moreover, today's survey was the first to include results from an additional six member states, including Greece where the median expectation of around 9½%Y/Y was significantly higher and rather absurd. In marked contrast, while the equivalent forecast for Germany edged slightly higher in December it was only just above the ECB's inflation target at 2.1%Y/Y, which aligned with the forecast in France too.

The day ahead in the euro area

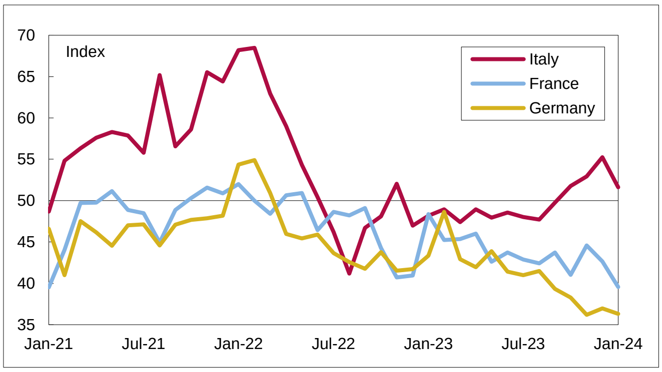
The data focus in the euro area tomorrow will be the aforementioned German industrial production release for December. While today's factory turnover results suggest only a modest decline in output that month, the sharp fall in truck toll mileage and moderation in business gas usage implies that risks to the production outturn are skewed to the downside. Spanish industrial production, French trade and Italian retail sales figures all for December are also due.

UK

KPMG/BRC survey adds to evidence of soft start to 2024 for retail sales

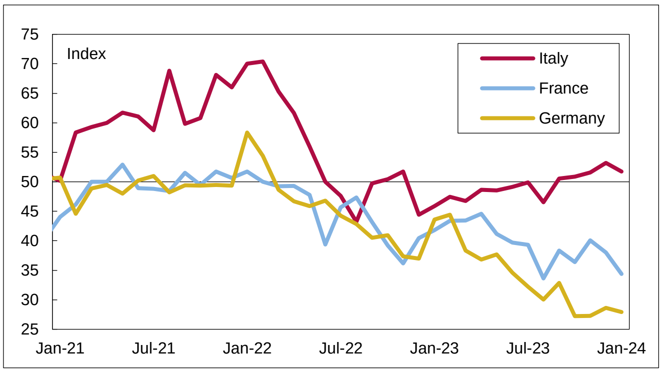
Like the CBI distributional trades survey, the KPMG/BRC retail survey suggests that spending on the UK high street had a weak start to the year. In particular, the survey's measure of total retail sales values slowed 0.5ppt in January to 1.2%Y/Y, the softest since August 2022. Like-for-like sales values growth also slowed 0.5ppt to 1.4%Y/Y, similarly the weakest since the second half of 2022. On a three-month basis, sales values of food (6.3%3M/Y) and non-food items (-1.8%3M/Y) were the softest in 14 and 17 months respectively. The survey authors reported that sales of big-ticket items such as furniture, household appliances and electricals remained particularly subdued with health-related and cosmetics faring better. Of

Euro area: Construction PMIs – total activity



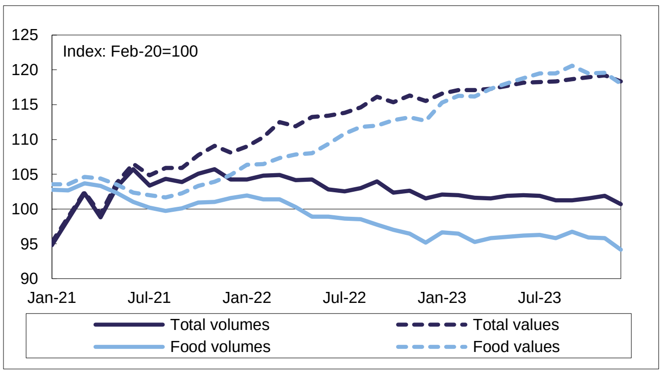
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Construction PMIs – house building



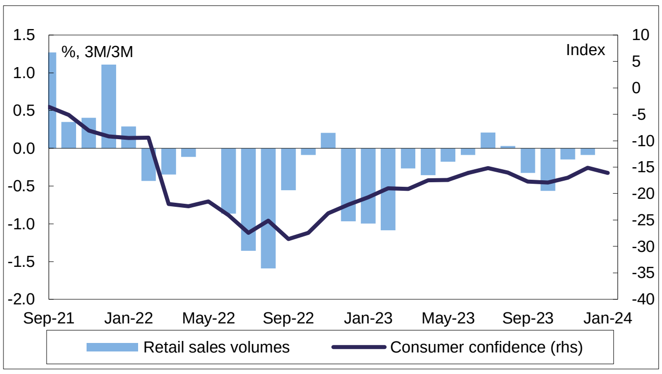
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales & consumer confidence



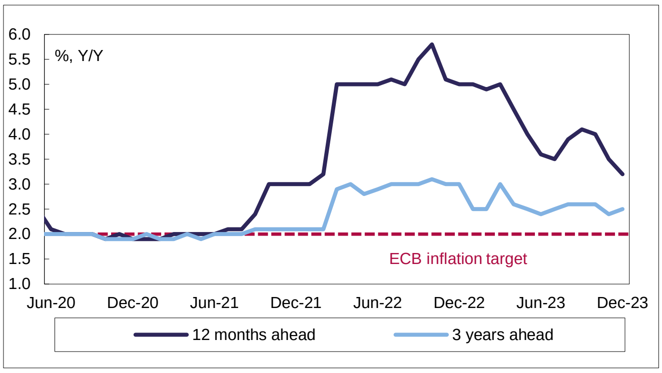
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

course, to a significant extent, the slowdown the growth of the value of sales reflects slower inflation, with the survey's own measure of shop-price inflation having dropped 1.4ppts in January to a 20-month low of 2.9%Y/Y. However, the implied measure of retail sales volumes was down a still-substantive 2.0%3M/Y in January, an improvement of just 0.3ppt from December albeit the softest fall since May 2022. That suggests that, as inflation moderates and real disposable incomes pick up, households are still more likely to be looking to save rather than spend the windfall as sentiment remains subdued by historical standards. Overall, after the official ONS measure of retail sales volumes fell in December by a surprisingly steep 3.2%M/M, the most since the pandemic lockdowns at the start of 2021, we expect only a moderate rebound in January – perhaps reversing little more than half the prior month's drop.

The day ahead in the UK

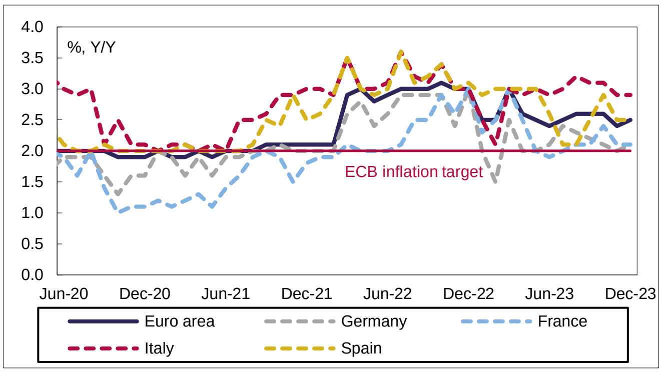
On a day bereft of top-tier UK data, focus tomorrow will turn to a speech by BoE Deputy Governor Breeden.

Euro area: Consumer inflation expectations



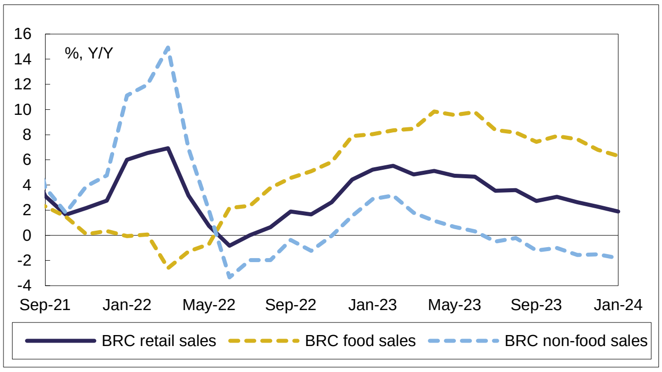
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer inflation expectations*



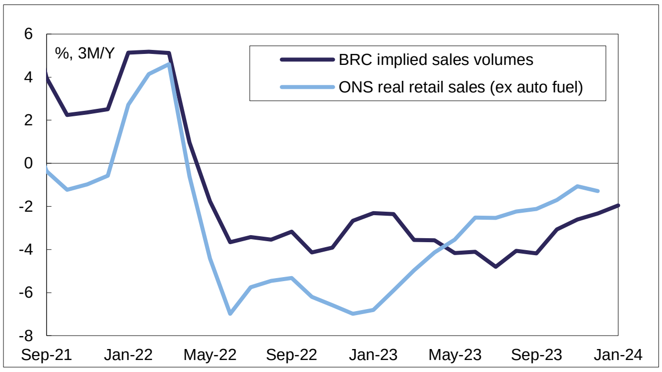
**Three years ahead. Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: BRC retail sales indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measures of retail sales volumes*



**BRC implied sales volumes deflated by BRC shop price inflation. Source: Macrobond 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		Construction PMI	Jan	**41.3**	-	43.6	-
		ECB 1Y (3Y) inflation expectations Y/Y%	Dec	**3.2 (2.5)**	-	3.2 (2.2)	3.5 (2.4)
		Retail sales M/M% (Y/Y%)	Dec	**-1.1 (-0.8)**	-	-0.3 (-1.1)	0.3 (-0.4)
Germany		Factory orders M/M% (Y/Y%)	Dec	**8.9 (2.7)**	-	0.3 (-4.4)	0.0 (-4.7)
		Construction PMI	Jan	**36.3**	-	37.0	-
France		Construction PMI	Jan	**39.6**	-	42.6	-
Italy		Construction PMI	Jan	**51.6**	-	55.2	-
		Business (manufacturing) confidence Indicator	Jan	**98.1 (88.3)**	-	107.2 (95.4)	97.3 (87.3)
		Consumer confidence indicator	Jan	**96.4**	-	106.7	95.8
UK		BRC retail monitor, like-for-like sales Y/Y%	Jan	**1.4**	-	1.9	-
		Construction PMI	Jan	**48.8**	-	46.8	-

Auctions

Country		Auction
UK		sold £2.5bn of 1.55% 2053 bonds at an average yield of 4.565%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		07.00	Industrial production M/M% (Y/Y%)	Dec	-0.5 (-2.4)	-0.7 (-4.8)
France		07.45	Trade balance €bn	Dec	-	-5.9
Italy		09.00	Retail sales M/M% (Y/Y%)	Dec	-	0.4 (1.5)
Spain		08.00	Industrial production M/M% (Y/Y%)	Dec	-	1.0 (0.8)

Auctions and events

Country		GMT	Event
Germany		10.30	Auction: €3bn of 2.4% 2030 bonds
UK		08.40	BoE Deputy Governor Breeden scheduled to speak
		10.00	Auction: £4bn of 3.75% 2027 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.