

Euro wrap-up

Overview

- Bunds made losses today as comments by ECB Executive Board member Schnabel pushed back on expectations for an early rate cut, even as German IP contracted at an accelerated pace.
- Gilts made losses as BoE Deputy Governor Breeden reiterated the MPC's message that more evidence of receding inflation was needed before cutting interest rates.
- Tomorrow will bring results of UK housing and labour market surveys, following on Friday by final German inflation figures for January.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.613	+0.027
OBL 2.1 04/29	2.234	+0.024
DBR 2.2 02/34	2.310	+0.020
UKT 3½ 10/25	4.446	+0.006
UKT 4½ 06/28	3.961	+0.020
UKT 3¼ 01/33	3.980	+0.036

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

Euro area

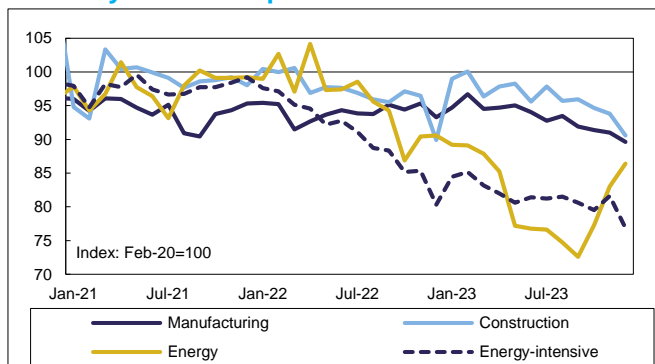
German manufacturing and construction contracts at an accelerated pace in December

Today's German industrial production figures for December disappointed, confirming the longest run of consecutive negative prints since the global financial crisis. And with output down at a steeper pace than during the prior months, the challenges in the sector appeared to intensify heading into year-end. In particular, total production fell for a fourth consecutive month in December and by 1.6%M/M, the most since March. And having failed to rise in any month since April last year, output was at its lowest level since July 2020 and 2010 when excluding the initial Covid-19 slump, down 1.8%Q/Q in Q4 and more than 10% below the pre-pandemic level. The drop would have been even steeper without a third consecutive jump in energy production (4.1%M/M). In contrast, consistent with various surveys and likely impacted by adverse weather conditions at the start of the month, construction activity fared much worse in December, falling for the fourth month out of the past five and by a steeper 3.4%M/M, to its lowest level for a year and down some 3.6%Q/Q over the fourth quarter as a whole. Building construction was down (-4.0%M/M) to its lowest since early 2021, while civil engineering work fell a near-8%M/M. And while the number of building permits appears to have stabilised, its steady adverse trend through the first half of last year suggests that the downturn in that sector still has further to play out. Meanwhile, manufacturing output contracted for the sixth month out of the past seven, by 1.5%M/M, to mark the third successive quarterly contraction (2.2%Q/Q) and leave it some 10½% below the pre-pandemic benchmark. So, with sales in the services sector trending in November some 1% below the Q3 average, today's IP data raises the risk that the contraction in GDP in Q4 was steeper than initially estimated (-0.3%Q/Q).

Broad-based weakness in manufacturing led by energy-intensive subsectors

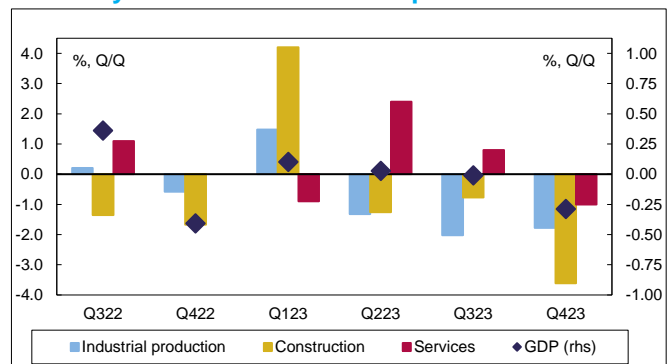
Within the manufacturing detail, the weakness was broad based. Consistent with the sharp decline in firms' gas usage at the end of last year, the contraction in output was most striking within the energy-intensive subsectors, which fell 5.8%M/M to be a whopping 23% below the pre-pandemic level. The weakness in December was led by chemicals, production of which fell 7.6%M/M to leave full-year output for 2023 at its lowest level since 1995. But there were also sizeable declines in glass and ceramics – to a new post-unification low – and basic metals. So, production of intermediate goods declined for a fourth consecutive month (-5.2%M/M) to be down 3.7%Q/Q in Q4 and at its lowest level since 2010 when excluding the initial Covid-19 lockdown. The drop in consumer goods production was more modest (-0.9%M/M) but nevertheless left it down a substantial 3.4%Q/Q in Q4. Despite a decline in machinery and equipment output in December, capital goods production rose for the first month in four (1.3%M/M), driven by an acceleration in car production (4.0%M/M) and other transport equipment (8.9%M/M), albeit still leaving the level of output in the latter two subsectors between 10-12% below the February 2020 benchmark.

Germany: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: GDP & subsector output*



*Q423 services figure based on October and November data.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Manufacturing outlook remains subdued at the start of 2024

While a jump in one-off bulk orders at the end of last year will in due course provide a boost to certain subsectors such as aerospace, the downtrend in core orders suggests that the near-term production outlook will remain lacklustre. Admittedly, daily truck toll mileage data – trending in the first few weeks of January some 5½% above the December average – suggests a temporary bounce in production at the start of 2024. But while the PMIs also suggest that the sharpest declines in the manufacturing downturn might have been passed, they remain consistent with contraction. Moreover, the ifo business climate indices reported renewed deterioration in January, with the respective index for expected production over the coming three months slumping to its lowest since May 2020 amid thinning order books. Prospects for energy-intensive subsectors remain extremely fragile, with the share of firms in these industries citing orders as a limiting factor on production notably higher than the average. While auto backlogs remain above pre-pandemic levels, they have declined steadily over the past year. And the latest VDA numbers suggested that car production went into reverse in January (-4.0%Y/Y). Moreover, with exports having slumped at the end of last year and global demand unlikely to accelerate significantly, we see little reason to expect a sudden rebound in German manufacturing over the near term.

The coming two days in the euro area

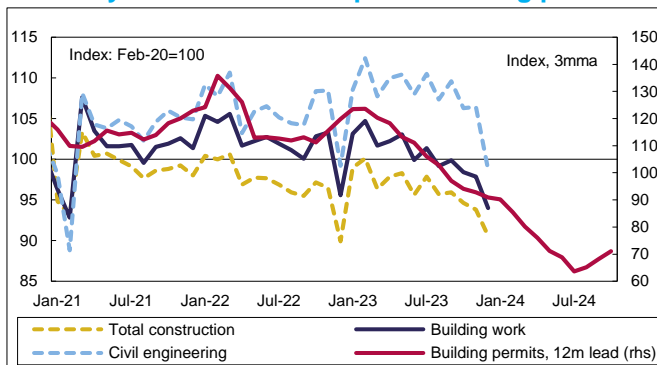
Looking ahead, with no key euro area data releases scheduled tomorrow, focus will turn to a fireside chat with ECB Chief Economist Lane, who will be speaking about disinflation in the euro area. On Friday, the final German consumer price data for January are expected to align with the preliminary estimates, whereby the EU-harmonised HICP rate fell a slightly larger-than-expected 0.7ppt to 3.1%Y/Y, 8.5ppts below the peak, albeit still 0.8ppt above November’s rate. 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. This release will provide more granular detail. Friday will also bring December industrial production figures from various member states including Italy, the Netherlands and Ireland.

UK

The coming two days in the UK

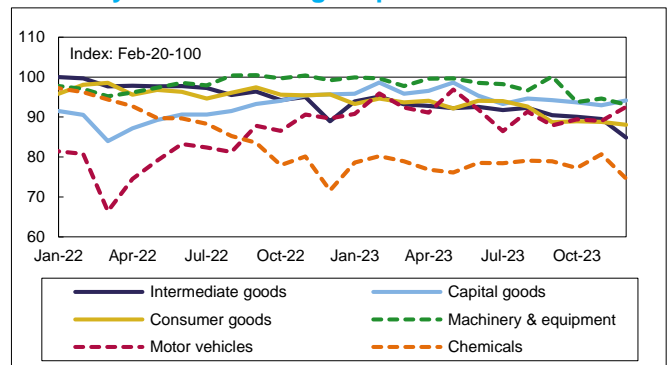
The remainder of the week will be light for top-tier UK releases. Tomorrow will bring the RICS residential survey for January, which is expected to see the headline house price balance rise to its highest since October 2022, albeit remain firmly in negative territory and well below the long-run average. Meanwhile, the REC/KPMG report on jobs will likely signal a further

Germany: Construction output & building permits



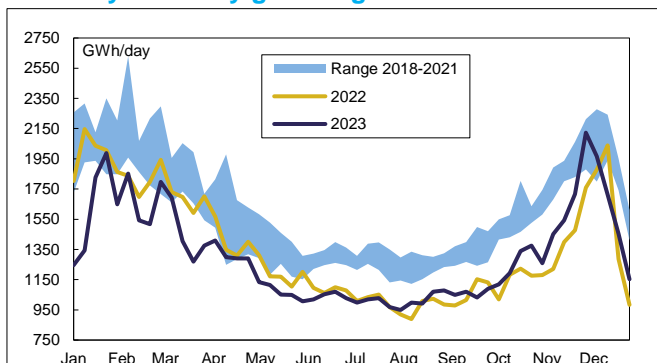
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing output



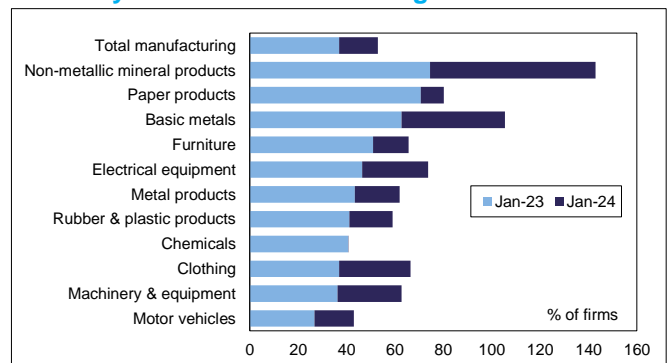
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industry gas usage



Source: Bundesnetzagentur and Daiwa Capital Markets Europe Ltd.

Germany: Lack of manufacturing orders*

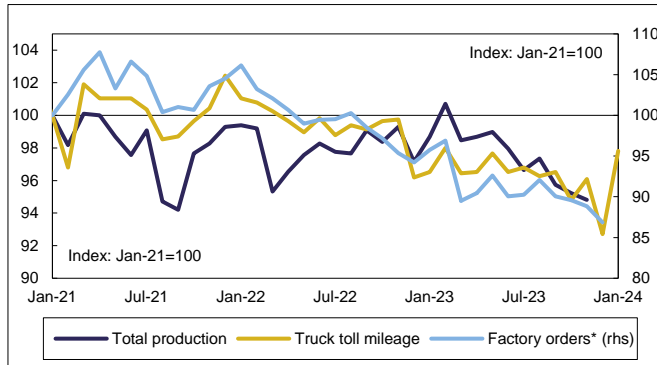


*Share of firms reporting orders as limiting factor on production.
Source: ifo and Daiwa Capital Markets Europe Ltd.

loosening in the labour market at the start of the year, with an ongoing moderation in starting pay growth. Aside from the data, BoE external member Mann is due to speak on inflation dynamics and drivers.

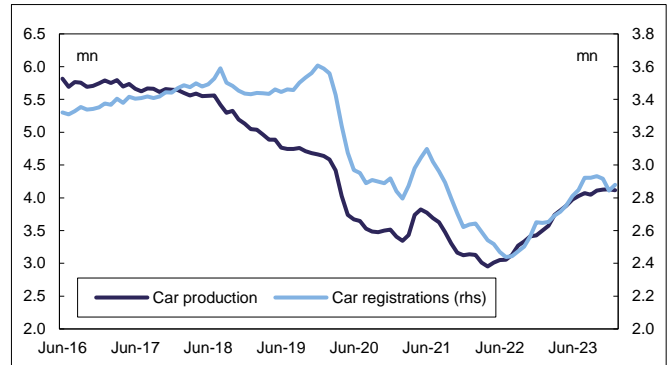
The next edition of the Euro wrap-up will be published 09 February 2023

Germany: Manufacturing sector indices



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

Germany: Car production & registrations*



*12mms. 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
Germany	Industrial production M/M% (Y/Y%)	Dec	-1.6 (-3.0)	-0.5 (-2.3)	-0.7 (-4.8)	-0.2 (-4.3)
France	Trade balance €bn	Dec	-6.8	-	-5.9	-
Italy	Retail sales M/M% (Y/Y%)	Dec	-0.1 (0.3)	-	0.4 (1.5)	0.3 (1.4)
Spain	Industrial production M/M% (Y/Y%)	Dec	-0.3 (-0.2)	-0.2 (-)	1.0 (0.8)	1.1 (0.9)

Auctions

Country	Auction
Germany	sold €2.48bn of 2.4% 2030 bonds at an average yield of 2.22%
UK	sold £4.0bn of 3.75% 2027 bonds at an average yield of 4.131%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ Daiwa forecast	Previous
UK	00.01	RICS house price balance %	Jan	-22	-30



Auctions and events

Euro area	11.30	ECB's Wunsch scheduled to speak
	15.30	ECB's Chief Economist Lane scheduled to speak
UK	00.01	REC report on jobs
	15.00	BoE's Mann scheduled to speak


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany 	07.00	Final HICP (CPI) Y/Y%	Jan	<u>3.1 (2.9)</u>	3.8 (3.7)
Italy 	09.00	Industrial production M/M% (Y/Y%)	Dec	0.9 (-2.5)	-1.5 (-3.1)

Auctions and events

Euro area 	14.15	ECB's Cipellone scheduled speak
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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