Euro wrap-up

Overview

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- Euro area govvies made losses as December industrial production surprised on the upside in Italy, Ireland and the Netherlands, while final German inflation estimates confirmed a moderation in goods inflation but a slight uptick in services in January.
- Gilts also made losses on a quiet end to the week for top-tier UK data.
- The coming week will bring figures for euro area IP and trade, as well as UK inflation, labour market, GDP and retail sales.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/06	2.707	+0.053
OBL 2.1 04/29	2.329	+0.048
DBR 2.2 02/34	2.377	+0.026
UKT 3½ 10/25	4.574	+0.055
UKT 4½ 06/28	4.090	+0.048
UKT 3¼ 01/33	4.078	+0.032

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

Euro area

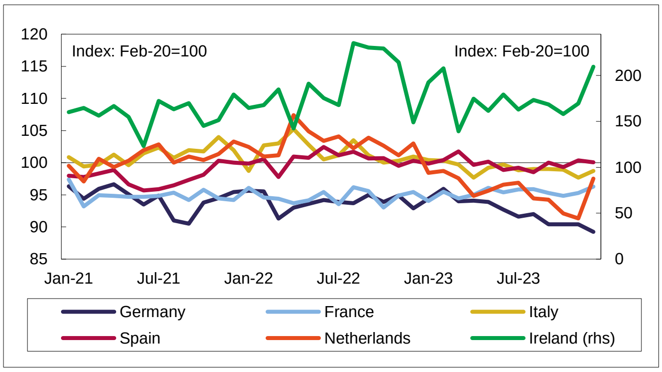
Italian manufacturing production sees broad-based growth in December

Contrasting with the downside surprise to German industrial production in December and persisting pessimism reported in a range of sentiment surveys, today's figures from various member states suggested a more encouraging end to the year for the euro area manufacturing sector. The largest member state to report figures today was Italy, where industrial production rose for the first month in three in December, by 1.1%M/M, with a firmer rise in manufacturing (1.4%M/M) offsetting a second successive drop in energy generation (-2.0%M/M). Admittedly, this still left total IP down a fraction in Q4, by 0.2%Q/Q, and more than 2% lower than a year ago. But manufacturing output narrowly avoided a contraction last quarter (+0.1%Q/Q), albeit remaining some ½% below the pre-pandemic level in February 2020. The improvement in December was led by a pickup in basic metals, electrical machinery, clothing and pharmaceuticals. And with an increase in transport equipment offsetting a modest decline in general machinery, capital goods production rose to the highest level since 2008 and more than 4½% above the pre-pandemic benchmark, offsetting the persisting underperformance in the intermediate goods sector where output remained some 5% below the February 2020 level. The Italian manufacturing PMIs point to further progress towards stabilisation at the start of 2024, with the output component jumping 4pts to a ten-month high of 49.2 in January. And the ISTAT manufacturing indices offered a more favourable assessment of orders books and production expectations.

Irish and Dutch IP surge at year-end, but euro area IP still on track to contract in Q4

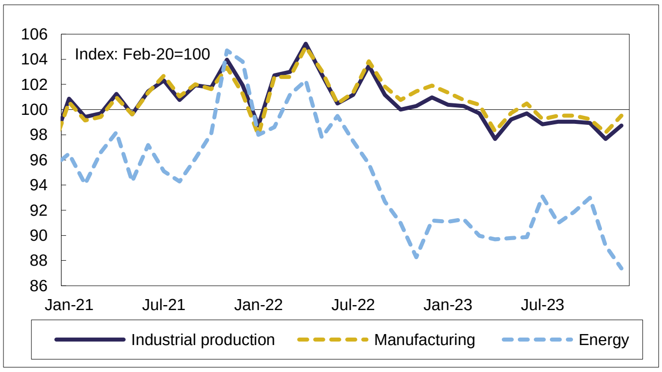
But the most striking economic news today came in Ireland's IP report, where data are admittedly notoriously volatile due to the activities of multinational corporations. Indeed, today's figures recorded a whopping 23.5%M/M increase in output in December, with production also revised significantly higher in November (up 6.6ppts to 7.3%M/M). This reflected a near-28%M/M rise in production from the modern subsectors – which includes the chemical, pharmaceutical, computer and electronic sectors – to its highest level since November 2022, perhaps reflecting the opening of Intel's new chip manufacturing facility last September. Indeed, this left Irish industrial production up 6.3%Q/Q in Q4, the strongest quarterly increase since Q322, with manufacturing output up a substantial 32%Q/Q, albeit down 4.4%Y/Y compared with Q422, illustrating the extreme volatility in this series. Overall, today's figures raise the probability that the initially estimated contraction in Irish GDP in Q4 (-0.7%Q/Q) will be revised down in due course. And taken together with notable increases in the Netherlands (6.8%M/M) and France (1.2%M/M), aggregate euro area IP appears to have risen around 1½%M/M in December, albeit still contracting around ½%Q/Q and therefore representing a modest drag on GDP growth in Q4.

Euro area: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

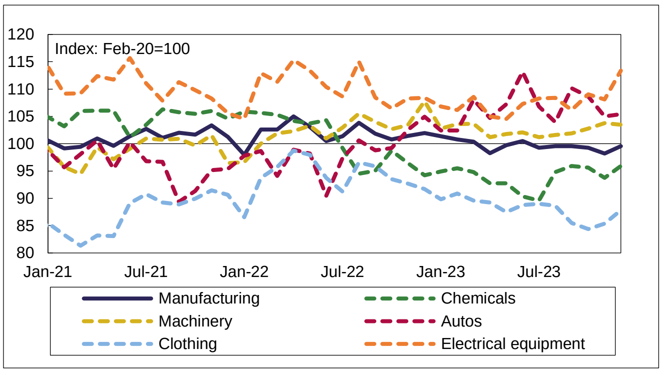
Resumption of German inflation downtrend confirmed on lower energy, food and core goods prices

There were no surprises from today's final German inflation figures for January, which confirmed the flash estimates that had come in slightly lower than initially anticipated when they were published at the end of last month. So, the EU-harmonised HICP rate fell 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. Within the harmonised detail, energy inflation provided the largest drag on inflation at the start of the year, despite the 50% increase in the carbon price and removal of the government's energy price brake at the end of last year that saw district heating prices jump more than 17%M/M in January. Indeed, the annual energy HICP rate fell more than 6ppts to -3.0%Y/Y in January, supported by a fifth successive monthly decline in electricity prices and much smaller increases in natural gas and petrol prices than a year ago. Food inflation moderated 0.7ppt to 5.1%Y/Y, the lowest since Russia's invasion of Ukraine in spring 2022, with price declines in dairy items, cooking fats and oils offsetting a pickup in fresh foods. Core goods inflation also eased a further 0.5ppt to 2.8%Y/Y, the lowest since June 2021 and some 4.6ppts below the peak, reflecting lower producer prices and subdued domestic demand. Indeed, inflation of furniture and cars declined to the lowest since mid-2021, while clothing inflation resumed a downwards trend having temporarily ticked higher at the end of last year. In contrast, and despite an ongoing drag from transport services costs, services HICP inflation ticked higher in January, by 0.4ppt to a three-month high of 3.8%Y/Y. In part, that reflected a smaller monthly decline in package holiday prices this January compared with last. In addition, restaurant and other catering prices jumped 2.2%M/M due to the end of the temporary VAT reduction for food services. Overall, core HICP inflation moved sideways at 3.4%Y/Y in January, matching the lowest since summer 2022. And with demand soft and German pay settlements surprisingly soft at the start of the year, we expect core inflation to resume a downwards trend this month.

The coming week in the euro area

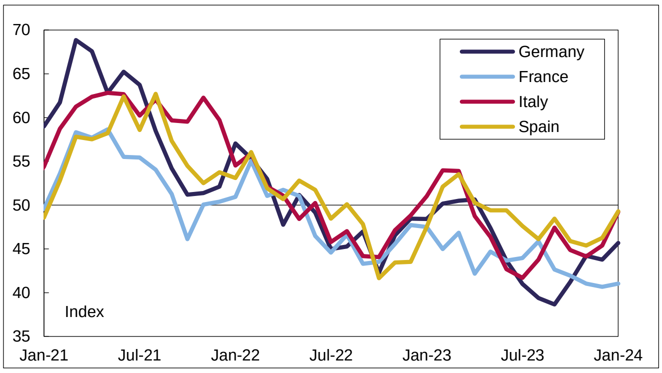
The euro area's data flow in the coming week will be relatively light, with an updated estimate of Q4 GDP (Wednesday) likely to confirm that the economy merely stagnated in the final quarter of last year, while December industrial production and goods trade figures (Wednesday and Thursday respectively) will provide more insight into momentum heading towards the New Year. In particular, the preliminary GDP report recorded zero growth in Q4 following a modest contraction in Q3 and therefore narrowly avoiding a technical recession. But this left output moving broadly sideways for five consecutive quarters. This notwithstanding, the latest employment figures – also included in this release – will likely point to ongoing resilience in the labour market. Indeed, figures already published from Germany and Spain showed a combined increase of 190k in Q4, albeit down from an equivalent rise of 271k in Q3. Monthly activity data will, however, provide mixed messages on economic momentum in December. Indeed, the aforementioned euro area industrial production is expected to report growth of around

Italy: Industrial production



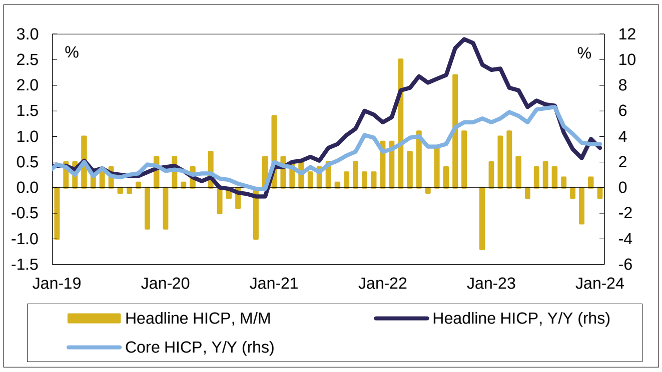
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output PMIs



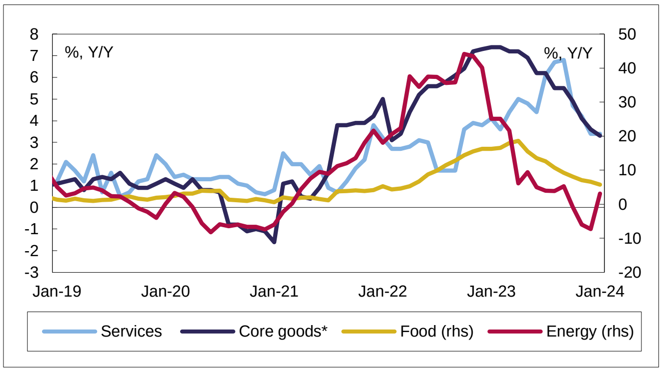
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Key inflation components



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

1½%M/M, but goods trade is likely to report a sizeable decline in exports and imports that month, in line with the findings from the German trade release. Among the national releases, Germany's ZEW investor sentiment survey for February (Tuesday), as well as final January inflation estimates from France (Friday) and Spain (Thursday) are also due. The flash inflation estimates saw the EU-harmonised HICP rates ease in France, by 0.7ppt to a two-year low of 3.4%Y/Y, but rise in Spain, by 0.2ppt to 3.5%Y/Y.

UK

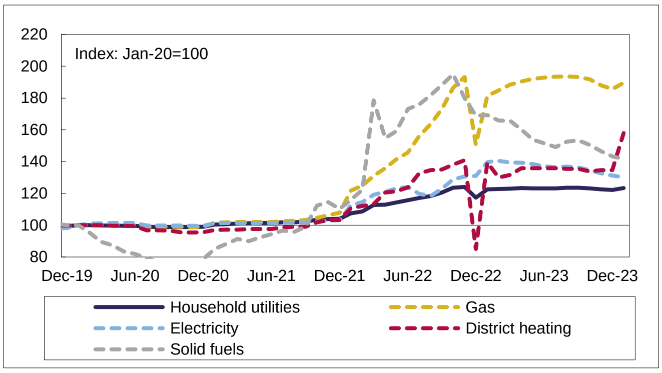
Further signs of stability in the residential property and indications of growth ahead

In its Monetary Policy Report published earlier this month, the BoE revised down somewhat its assessment of the impact of higher interest rates that will be felt in the real economy over coming months. Among other things, given recent declines in market and mortgage rates, it judged that house prices had held up to a greater extent than might have been expected. Indeed, according to Nationwide, the average house price rose a surprisingly strong 0.7%M/M in January to be down just 0.2%Y/Y, the smallest year-on-year decline in twelve months. Signs of increased activity in the housing market were reflected in the pickup in new mortgage approvals in December to a six-month high of 50.5k. Admittedly that was still roughly one third below the 2019 average level, while the annual rate of mortgage lending fell to zero that month. And although they were also much improved, yesterday's RICS survey results were consistent with a stabilisation of residential market conditions than a sudden return to significant price growth. Among the key variables, the net balance of surveyors' three-month price expectations rose in January by more than 10ppts for the third successive month to -2.2%, the best since June 2022 and broadly consistent with stable prices. In addition, the index of house price expectations twelve months ahead rose back into positive territory for the first time since August 2022, albeit at just 0.2% and so similarly still below the long-run average. Among other welcome signs of improved demand and supply, new buyer enquiries and sale instructions rose further, the former to a 23-month high. So, surveyors' sales expectations for the coming three months were the best in two years while those for twelve months ahead were the best since the pandemic. A pick up in residential property prices and transactions should provide an increasing positive impulse for household consumption as the year goes on.

The coming week in the UK

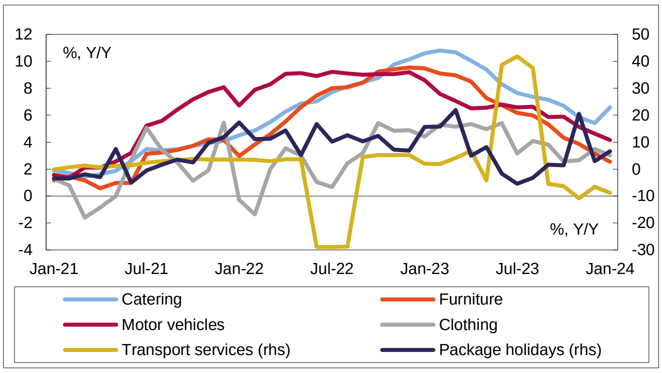
The coming week will be a busy one for top-tier UK releases, including the latest estimates for the labour market (Tuesday), inflation (Wednesday), GDP (Thursday) and retail sales (Friday). The key focus will be the January inflation figures, where the headline CPI rate is expected to rise, not least due to the 5ppt increase in the household energy price cap. But services

Germany: Energy prices



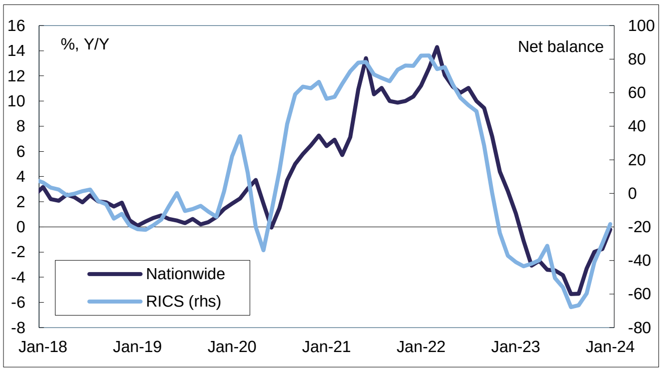
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Selected inflation components



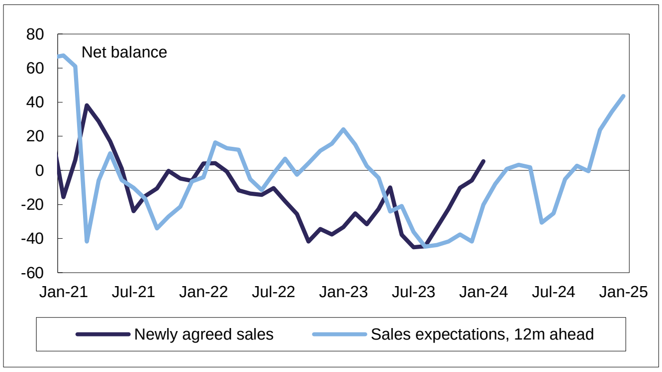
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: House price indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: RICS house sales indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

inflation will also probably take a significant, but temporary, step up, not least as the sharp declines in transport and hospitality prices a year earlier are unlikely to be repeated. The reweighting of the CPI basket to reflect consumption trends last year adds another element of uncertainty with this release. Overall, we forecast a modest increase in the headline rate by 0.2ppt to 4.2%Y/Y, 0.1ppt above the BoE's projection. And despite a further moderation in non-energy industrial goods inflation, we also expect core CPI to edge up by 0.1ppt to 5.2%Y/Y. The labour market figures will be watched closely for insight into near-term inflationary impulses. Reweighted Labour Force Survey (LFS) results published earlier this week saw the headline unemployment rate in the three months to November revised down 0.3ppt to 3.9%, some 0.4ppt below the recent peak in July. But the coming week's data will bring significant revisions all the way back to 2011, which will allow for greater assessment of current labour market tightness. Meanwhile, having declined to a ten-month low of 6.0%3M/Y in the three months to November, regular pay growth is highly likely to have slowed further in December.

In terms of activity, the first estimate of Q4 GDP and the accompanying December output figures are expected to report lacklustre recovery momentum at year-end. Despite the improvement signalled by the PMIs, retail sales declined sharply in December to be down almost 1%Q/Q. Rail and NHS strikes will have also had a dampening impact on activity in the transport and healthcare sectors that month. So, overall, we expect GDP to have edged slightly lower in December (-0.1%M/M), which would leave GDP down 0.1%Q/Q in Q4 for a second successive quarter and therefore in a very mild technical recession. While retail sales in January might well see some payback from the slump in December, surveys suggest that spending remained subdued at the start of the year amid persisting concerns about squeezed household budgets and the economic uncertainties ahead, which will limit any bounce back. We forecast growth of a little more than 1½%M/M, thus reversing roughly half of December's drop band and leaving sales still down only a little less than 1.0%3M/3M.

The next edition of the Euro wrap-up will be published on 13 February 2023

Daiwa economic forecasts

	2023	2024				2025	2023	2024	2025
	Q4	Q1	Q2	Q3	Q4	Q1			
GDP								**%, Y/Y**	
Euro area	0.0	0.1	0.2	0.2	0.3	0.3	0.5	0.4	1.3
UK	-0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.3	0.9
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.7	2.4	2.0	1.6	2.1	2.0	5.4	2.0	1.8
Core HICP	3.7	2.9	1.9	1.6	2.0	1.7	4.9	2.1	1.6
UK									
Headline CPI	4.2	3.6	1.6	1.9	2.1	1.7	7.3	2.3	1.7
Core CPI	5.3	4.6	2.8	2.4	2.4	2.0	6.2	3.0	1.7
Monetary policy, %									
ECB									
Refi Rate	4.50	4.50	4.25	3.75	3.25	2.75	4.50	3.25	2.75
Deposit Rate	4.00	4.00	3.75	3.25	2.75	2.25	4.00	2.75	2.25
BoE									
Bank Rate	5.25	5.25	5.00	4.50	4.00	3.50	5.25	4.00	2.50

Source: Bloomberg, ECB, BoE 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/ <u>Daiwa forecast/actual</u>	Previous
			Monday 12 February 2024			
			- Nothing scheduled -			
			Tuesday 13 February 2024			
Germany		10.00	ZEW current assessment (expectations) balance	Feb	-79.5 (17.2)	-77.3 (15.2)
UK		07.00	Payrolled employees, monthly change '000s	Jan	-20	-24
		07.00	Unemployment claimant count rate % (jobless claims '000s)	Jan	-	4.0 (11.7)
		07.00	Unemloyment rate %	Dec	-	3.9
		07.00	Average earnings (excluding bonuses) 3M/Y%	Dec	5.7 (6.0)	6.5 (6.6)
			Wednesday 14 February 2024			
Euro area		10.00	GDP – second estimate Q/Q% (Y/Y%)	Q4	<u>*0.0 (0.1)*</u>	-0.1 (0.0)
		10.00	Preliminary employment Q/Q% (Y/Y%)	Q4	-	0.2 (1.3)
		10.00	Industrial production M/M% (Y/Y%)	Dec	<u>*1.5 (-2.3)*</u>	-0.3 (-6.8)
UK		07.00	CPI (core CPI) Y/Y%	Jan	<u>*4.2 (5.2)*</u>	4.0 (5.1)
		07.00	Output (input) PPI Y/Y%	Jan	-0.6 (-3.3)	0.1 (-2.8)
		09.30	House price index Y/Y%	Dec	-	-2.1
			Thursday 15 February 2024			
Euro area		10.00	Trade balance €bn	Dec	-	14.8
Spain		08.00	Final HICP (CPI) Y/Y%	Jan	<u>*3.5 (3.4)*</u>	3.3 (3.1)
UK		07.00	GDP – first estimate Q/Q% (Y/Y%)	Q4	<u>*-0.1 (0.1)*</u>	-0.1 (0.3)
		07.00	GDP M/M%	Dec	-0.2	0.3
		07.00	Industrial production M/M% (Y/Y%)	Dec	-0.4 (-4.4)	-0.3 (-6.8)
		07.00	Manufacturing production M/M% (Y/Y%)	Dec	0.1 (1.3)	0.4 (1.3)
		07.00	Index of services M/M% (3M/3M%)	Dec	-0.2 (-)	0.4 (0.0)
		07.00	Construction output M/M% (Y/Y%)	Dec	-0.4 (-)	-0.2 (0.9)
		07.00	Trade (goods) balance £bn	Dec	-	-14.2 (-14.1)
			Friday 16 February 2024			
France		07.45	Final HICP (CPI) Y/Y%	Jan	<u>*3.4 (3.1)*</u>	4.1 (3.7)
UK		07.00	Retail sales incl. auto fuels M/M% (Y/Y%)	Jan	1.5 (-1.7)	-3.2 (-2.4)
		07.00	Retail sales excl. auto fuels M/M% (Y/Y%)	Jan	2.0 (-1.1)	-3.3 (-2.1)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		GMT	Event / Auction
			Monday 12 February 2024
Euro area		09.45	ECB Chief Economist Lane and De Cos scheduled to speak
UK		18.00	BoE Governor Bailey scheduled to speak
			Tuesday 13 February 2024
Germany		10.30	Auction: €4bn of 2.1% 2029 bonds
Italy		10.00	Auction: €3.5bn of 2.95% 2027 bonds
		10.00	Auction: €2.0bn of 4.0% 2030 bonds
		10.00	Auction: €1.5bn of 3.7% 2030 bonds
		10.00	Auction: €1.5bn of 4.45% 2043 bonds
UK		10.00	Auction: £1.5bn of 0.75% 2033 index-linked bonds
			Wednesday 14 February 2024
Germany		10.30	Auction: 1.8% 2053 bonds
		10.30	Auction: 2.5% 2054 bonds
UK		11.30	Auction: £3.75bn of 4.625% 2034 bonds
		15.00	BoE Bailey scheduled to testify before House of Lords Economic Affairs Committee
			Thursday 15 February 2024
Euro area		08.00	ECB President Lagarde scheduled to testify before European Parliament Committee on Economic and Monetary Affairs
		12.00	ECB Chief Economist Lane scheduled to speak
France		09.50	Auction: 2.5% 2027 bonds
		09.50	Auction: 2.75% 2029 bonds
		09.50	Auction: 0% 2031 bonds
		10.50	Auction: 0.1% 2028 index-linked bonds
		10.50	Auction: 0.1% 2029 index-linked bonds
		10.50	Auction: 3.15% 2032 index-linked bonds
		10.50	Auction: 0.1% 2053 index-linked bonds
Spain		09.30	Auction: 2.5% 2027 bonds
		09.30	Auction: 2.35% 2033 bonds
		09.30	Auction: 3.5% 2029 bonds
UK		-	BoE's Mann scheduled to speak
		-	BoE's Greene scheduled to speak
			Friday 16 February 2024
Euro area		08.45	ECB's Schnabel scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Final HICP (CPI) Y/Y%	Jan	**3.1 (2.9)**	*3.1 (2.9)*	3.8 (3.7)	-
Italy		Industrial production M/M% (Y/Y%)	Dec	**1.1 (-2.1)**	0.9 (-2.5)	-1.5 (-3.1)	**-1.3 (-2.9)**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK		RICS house price balance %	Jan	**-18**	-22	-30	**-29**
Auctions							
Country		Auction					
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.