Euro wrap-up

Overview

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- Bunds followed USTs lower, while an investor survey suggested a further deterioration in German economic conditions in Q1, but greater optimism about the coming six months.
- Gilts made more sizeable losses as UK pay growth exceeded expectations, while the unemployment rate fell to an eleven-month low.
- Tomorrow will bring an updated estimate of euro area Q4 GDP and UK inflation figures for January.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/06	2.754	+0.072
OBL 2.1 04/29	2.351	+0.051
DBR 2.2 02/34	2.389	+0.031
UKT 3½ 10/25	4.634	+0.119
UKT 4½ 06/28	4.159	+0.114
UKT 3¼ 01/33	4.129	+0.077

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

Euro area

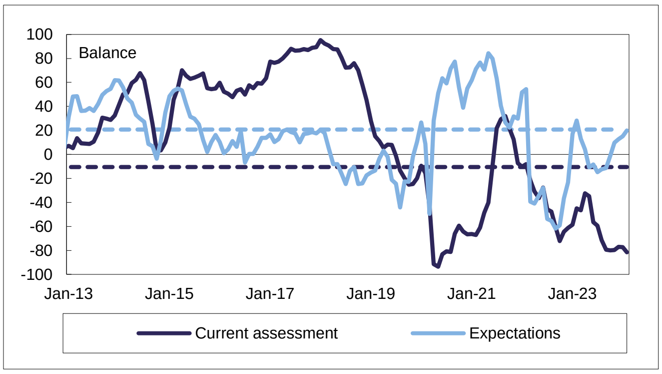
ZEW survey suggests further deterioration in Q1 but greater optimism about the coming six months

The findings of the latest ZEW survey of investors were mixed. Concerningly, they reported a significant worsening of perceptions of German current economic conditions in February. Indeed, the respective index dropped 4.4pts – the most in six months – to -81.7, the lowest since the first wave of Covid-19 and, before that, the global financial crisis. The very low February index for current conditions also left the average for the first two months of Q1 below the Q4 figure to flag increased worries of a possible further contraction in German GDP this quarter. While more than four fifths of survey respondents judge current conditions to be bad, however, an increasing net share of investors anticipate improvement over the coming six months. Indeed, the survey's German expectations index rose 4.7pts – the most in three months – to 19.9, the highest in a year and a level less than 1pt below the long-run average. But we note that little more than one third of survey respondents expect conditions to improve while almost one half expect no change. And the relatively low share expecting further deterioration might in part be due simply to the wretched state of conditions at present. But, undoubtedly, key drivers of the diminished pessimism in the economic outlook are fading price pressure and rising expectations that monetary policy will be loosened. In particular, after German inflation fell a touch further than expected last month, fewer than 5% of survey respondents now expect inflation to pick up over the coming six months. And more than two-thirds of survey respondents (68.1%) – up more than 16ppts from last month and the biggest share since early 2009 – expect the ECB to cut rates over the same period.

The day ahead in the euro area

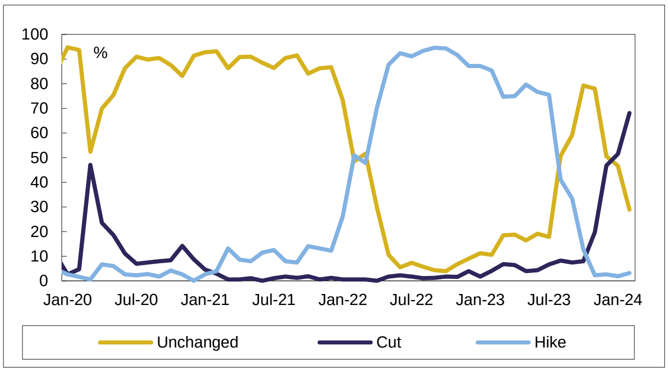
In the euro area tomorrow, we will get an updated estimate of Q4 GDP, which is likely to confirm that the economy merely stagnated in the final quarter of last year, while December industrial production data will provide more insight into momentum at year-end. In particular, the preliminary GDP report recorded zero growth in Q4 following a modest contraction in Q3 and therefore narrowly avoided a technical recession. But this left output moving broadly sideways for five consecutive quarters. The latest industrial production figures will likely offer a more encouraging picture of economic activity at the start of the year. Indeed, despite the contraction recorded in Germany, and thanks to strong growth in France (1.2%M/M), Italy (1.1%M/M), Ireland (23.5%M/M) and the Netherlands (6.8%M/M), euro area output is expected 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. This notwithstanding, the latest employment figures – also included in tomorrow's national accounts 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.

Germany: ZEW investor sentiment indices*



Dashed lines represent long-run averages. Expectations index refers to coming 6 months. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ZEW interest rate expectations indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

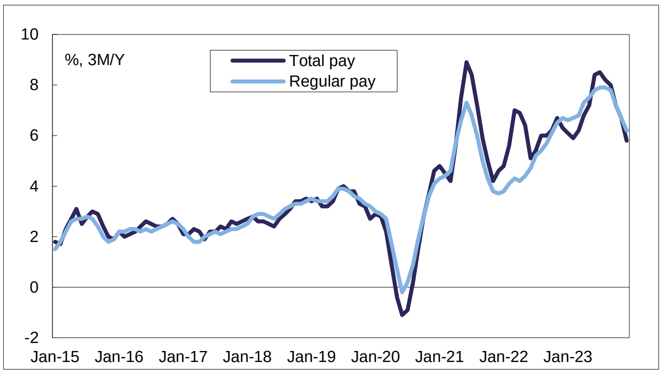
Pay growth slightly firmer than previously thought but downtrend maintained in December

Although the UK's economy moved broadly sideways for much of the past year, the labour market has remained remarkably resilient and arguably tighter than the BoE previously expected. And with wage growth a touch firmer in the latest data than it forecast, on balance, the majority on the MPC will still likely require additional evidence of easing inflationary pressures before voting for a first rate cut. Despite having been revised higher in November, growth in average weekly earnings nevertheless slowed further in the three months to December, by 2.2ppts from the prior quarter and 2.7ppts below the summer peak, to a seventeen-month low of 5.8%3M/Y. And growth on a three-month annualised basis fell (-0.4%) for the first time since April 2021 and 2014 when excluding the height of the pandemic. However, the downtrend was exaggerated somewhat by one-off payments in the public sector over the summer. When excluding bonuses, regular pay growth moderated 1.6ppts to 6.2%3M/Y, which was still the softest since the three months to October 2022, with growth on a three-month basis (2.2%3M/3M ann.) the lowest for 3½ years. And private sector regular pay – one of the three key variables in the BoE's current reaction function – also maintained a downwards trend in December, easing to 6.2%3M/Y, down 1.7ppts on the quarter and the lowest since the three months to August 2022, albeit a touch above the Bank's recent forecast of 6.0%3M/Y. Momentum on a three-month basis (2.4%3M/3M ann.) was also the softest since the first Covid-19 lockdown, and below the long-run average (3.2%) therefore arguably below rates that would be consistent with achieving the Bank's 2% inflation target over the medium term.

Unemployment drops to an eleven-month low, but inactivity significantly higher

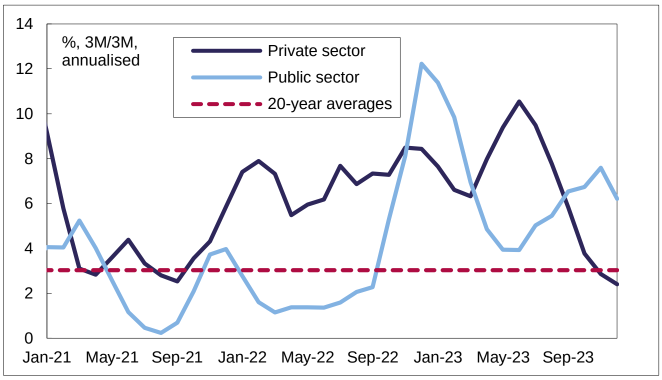
Today's news on the extent of labour market tightness was mixed, with various indicators providing contrasting messages and thus no doubt leaving the MPC rather confused about the true state of play. The reinstatement of the Labour Force Survey (LFS) suggested that the labour market has remained historically tight, with the ILO unemployment rate unexpectedly falling further in the three months to December, down 0.3ppt on the previous quarter to 3.8%, the lowest in eleven months and just 0.2ppt above the recent low reached in summer 2022. Furthermore, it was 0.5ppt below the BoE's recent projection published earlier this month and almost ¾ppt below the BoE's latest estimate of the medium-term equilibrium rate. We note, however, that the BoE's projection and NAIRU estimate were not based on the ONS's updated re-weighted LFS data. Moreover, the decline in unemployment in part reflects an increase in the estimate of inactivity. Indeed, the number of people economically inactive rose a further 24k in the three months to December to be up 120k compared with a year earlier and a striking 728k higher than before the pandemic, with the lion's share of the rise since February 2020 reflecting long-term sickness (688k), which tallies with the sharp rise in National Health Service waiting lists over that period. But while the

UK: Total & regular wage growth



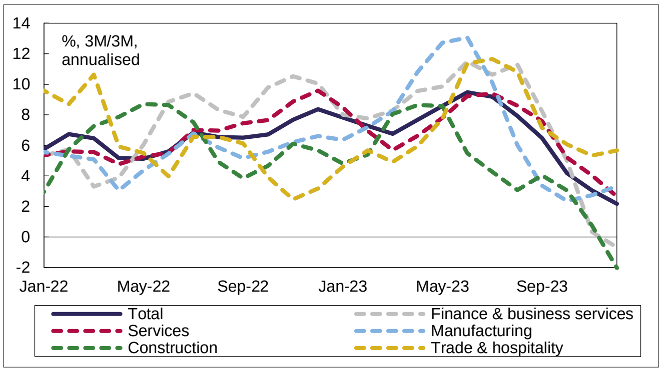
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Regular wage growth momentum



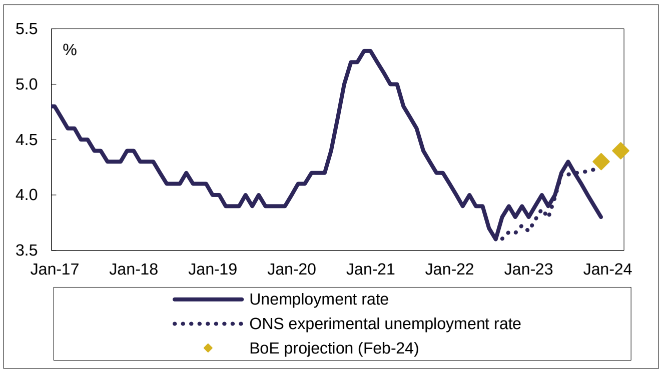
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private sector regular wage growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Unemployment rate



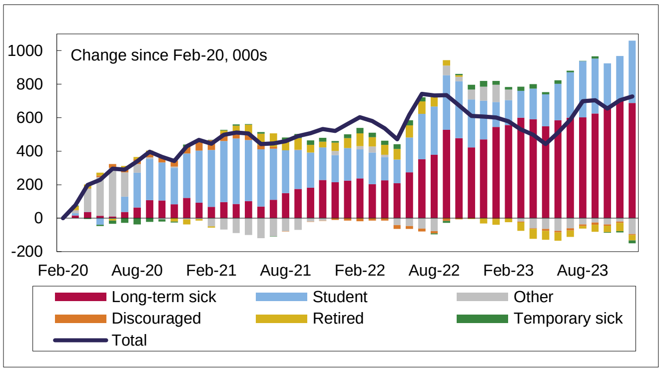
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

employment rate was down slightly compared with a year earlier, by 0.2ppt to 75.0%, there was a further rise in employment in the three months to December, up 72k on the quarter, to 33.17mn, with a notable rise in the number of full-time workers (206k) offsetting a drop in part-timers (-134k). And the initial estimate for payrolled employees (based on HRMC data) rose for a fifth consecutive month in January and by 48k, leaving it up 413k compared with a year earlier and 1.34mn above the pre-pandemic level in February 2020. However, the LFS measure of year-on-year employment growth was notably softer at 107k (0.3%Y/Y), while the number of people in employment was just 84k above the pre-pandemic level in February 2020. Moreover, the number of jobless claims rose for a fifth successive month in January, while the number of job vacancies fell in the three months to January for a nineteenth consecutive month, by 26k to 932k, admittedly still elevated by historical standards but nevertheless some 370k below the peak in April 2022. And overall, given the lacklustre growth outlook, we continue to expect momentum in jobs growth to slow further over coming months, which should help pay growth to moderate further.

The day ahead in the UK

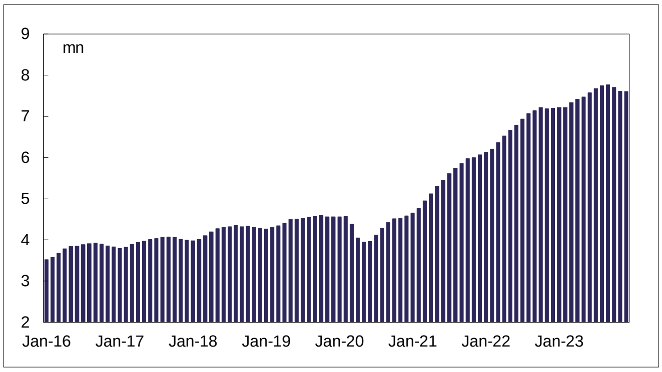
The focus in the UK tomorrow will be on January inflation figures, with the headline CPI rate expected to rise, not least due to the 5ppt increase in the household energy price cap. Services inflation will also probably take a significant, but temporary, step up, not least as the sharp declines in transport 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. Nonetheless, PPI data, which will be published alongside the headline CPI figures, are expected to reveal a further easing in price pressures at the factory gate. Aside from the data, BoE Governor Bailey is scheduled to testify before the House of Lords Economic Affairs Committee.

UK: Inactivity by reason



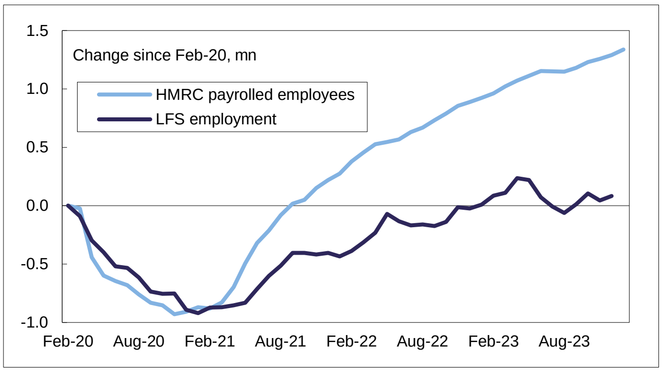
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Number of people on NHS waiting lists



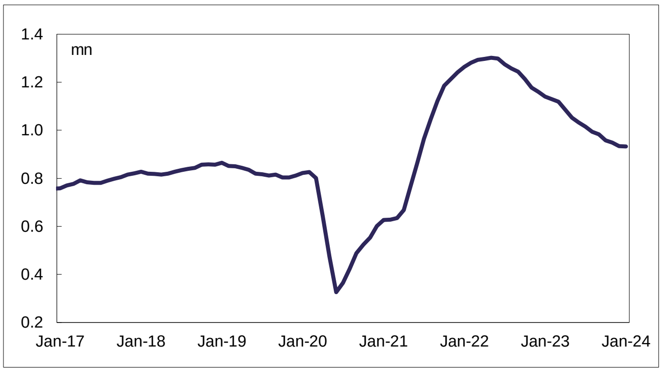
Source: NHS England and Daiwa Capital Markets Europe Ltd.

UK: Measures of employment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Job vacancies



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		ZEW current assessment (expectations) balance	Feb	**-87.1 (19.9)**	-79.5 (17.2)	-77.3 (15.2)	-
UK		Payrolled employees, monthly change '000s	Jan	**48**	-20	-24	31
		Unemployment claimant count rate % (change '000s)	Jan	**4.0 (14.1**	-	4.0 (11.7)	- (5.5)
		Unemployment rate 3M%	Dec	**3.8**	-	3.9	-
		Employment change 3M/3M 000s	Dec	**72**	-	108	-
		Average earnings (excluding bonuses) 3M/Y%	Dec	**5.8 (6.2)**	5.7 (6.0)	6.5 (6.6)	6.7 (6.7)

Auctions

Country		Auction
Germany		sold €3.29bn of 2.1% 2029 bonds at an average yield of 2.3%
Italy		sold €3.5bn of 2.95% 2027 bonds at an average yield of 3.15%
		sold €2.0bn of 4.0% 2030 bonds at an average yield of 3.53%
		sold €1.5bn of 3.7% 2030 bonds at an average yield of 3.48%
		sold €1.5bn of 4.45% 2043 bonds at an average yield of 4.38%
UK		sold £1.5bn of 0.75% 2033 index-linked bonds at an average yield of 0.634%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	GDP – second estimate Q/Q% (Y/Y%)	Q4	*0.0 (0.1)*	-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	*1.6 (-2.3)*	-0.3 (-6.8)
UK		07.00	Headline CPI (core CPI) Y/Y%	Jan	*4.2 (5.2)*	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

Auctions and events

Country		GMT	Event
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

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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