

# Euro wrap-up

## Overview

- Bunds made gains even as euro area industrial production surprised significantly to the upside and employment growth picked up in Q4 despite flat GDP.
- Gilts made notable gains as UK inflation came in below expectations to move sideways in January, despite a modest uptick in services inflation.
- Tomorrow will bring estimates of UK GDP in Q4 and monthly activity in December, as well as goods trade numbers from the euro area.

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### Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/06	2.727	-0.028
OBL 2.1 04/29	2.305	-0.049
DBR 2.2 02/34	2.342	-0.049
UKT 3½ 10/25	4.538	-0.108
UKT 4½ 06/28	4.053	-0.120
UKT 3¼ 01/33	4.407	-0.098

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

## Euro area

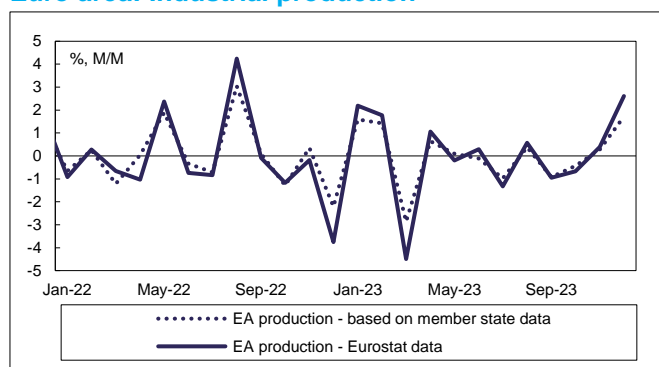
### Industrial production unexpectedly jumps to 10-month but detail raises questions over data quality

According to today's data from Eurostat, industrial production in the euro area grew more rapidly than expected at the end of last year. However, the detail suggests that exceptional factors, and perhaps dubious seasonal adjustment and statistical irregularities, flattered the figures. In particular, despite a significant decline in Germany (-1.3%M/M), euro area industrial production excluding construction jumped in December by 2.6%M/M, the most in 16 months to the highest level in ten months, and a whopping 2.8ppts above the median forecast on the Bloomberg survey. However, growth was also almost 1ppt above the rate that can be explained by Eurostat's national figures, raising questions about data quality. Indeed, more than half of all growth came from Ireland, where IP jumped a barely credible 23.5%M/M but the figures are frequently distorted by the activities of large multinational corporations. More reliably, production in France and Italy rose 1.1%M/M while Spain registered a modest decline (-0.3%M/M). Very strong growth in the Netherlands (6.6%M/M) made the second-largest contribution. On a sectoral basis, manufacturing output leapt 7.6%M/M, the most since the reopening of production in June 2020 during the first wave of Covid-19. And within that category, capital goods production reportedly jumped an extreme 20.5%M/M to a series high. However, the detailed data obfuscates the precise source of that growth. While no Irish component breakdown was provided to illuminate matters, euro area output of machinery and equipment supposedly rose a moderate 1.1%M/M while production of motor vehicles increased 6.0%M/M and other transport goods rose 4.2%M/M, admittedly the best in 13 and 26 months respectively. Meanwhile, growth in output of consumer durables (0.5%M/M) and non-durables (0.2%M/M) was modest in comparison. And despite a pickup in the chemicals subsector, output of intermediate goods fell (-1.2%M/M) to the lowest level since June 2020 as energy-intensive production also fell to a 3½-year low.

### Employment growth picked up in Q4 despite flat GDP to maintain weak productivity trend

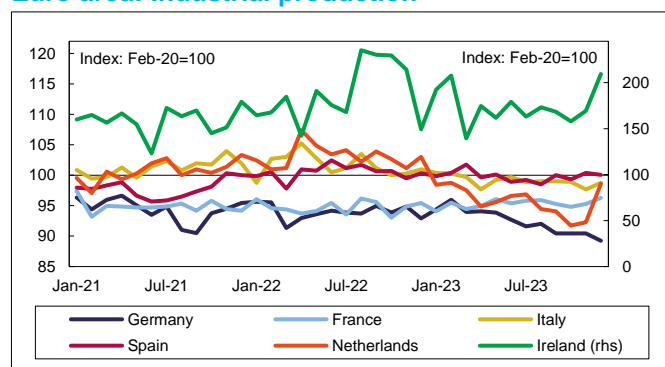
Given such strong production growth in December, and with industrial output now estimated to have risen in November by 0.4%M/M contrary to the initial estimate of a fall, overall IP was unchanged in Q4 from Q3, thus avoiding a fifth successive quarterly decline. Zero growth in the industrial sector thus matched the flat reading for GDP, which was also confirmed today. Following the drop of 0.1%Q/Q in Q3, that left euro area GDP up just 0.1%YY, illustrating the broad stagnation in economic output evident over the past five quarters. However, in a continued break from the pre-pandemic relationship between GDP and jobs, euro area employment growth unexpectedly accelerated in Q4, rising 0.3%Q/Q, the most in three quarters, to be up a firm 1.3%Y/Y. So, total employment rose 533k to a new series high of 169.3mn, almost 7.9mn or 4.9% above the pre-pandemic level, while GDP was up a more moderate 3.5% relative to that Q419 benchmark. As in Q3, jobs growth in Q4 was led by Spain, which accounted for one third of the total. With employment up again but economic output stagnant, labour productivity per person deteriorated further, down 1.1%Y/Y in Q4. Looking ahead, surveys point to ongoing broad stagnation

### Euro area: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

in economic activity in Q1, with the surge in IP in December raising risks of negative payback over the near term. At the same time, while jobs growth is likely slowing in Q1, and the downtrend in job vacancies has likely continued, the euro area unemployment rate appears likely to remain steady around the series low of 6.4% reached in the final two months of last year. And firms appear content to continue to hoard labour, awaiting a gradual pickup in economic output, which should eventually facilitate a pickup in productivity by the second half of the year.

## The day ahead in the euro area

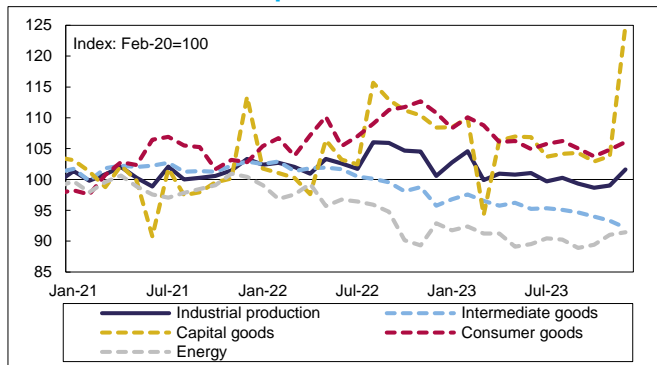
The euro area economic data highlight tomorrow will be the release of the latest goods trade data for January, which are likely to report a sizeable decline in export and import values that month, in line with the findings from the [German trade](#) release. Meanwhile, Spanish final inflation readings for January are expected to confirm the preliminary estimates, which saw the EU-harmonised HICP rate edge up to 3.5%Y/Y from 3.3%Y/Y in December, while the equivalent national rate rose 0.3ppt to 3.4%Y/Y. Aside from the data, ECB President Lagarde will testify before the European Parliament Economic and Monetary Affairs Committee, while Chief Economist Lane is due to give a keynote speech at a separate event.

## UK

### UK inflation below expectations and steady in January

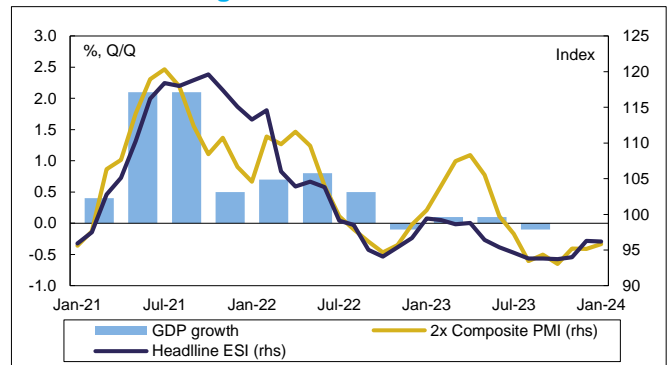
Following yesterday's stronger-than-expected [pay growth](#), BoE policymakers should have taken some relief from the modest downside surprise in today's inflation figures. Contrary to expectations of a slight pickup, CPI inflation moved sideways in January at 4.0%Y/Y, 0.1ppt above November's 26-month low, but 6.1ppts lower than a year earlier and 0.1ppt below the BoE's projection. While still providing a drag on headline inflation, the energy component (-14.9%Y/Y) added some 0.4ppt to the month-on-month change as the 5%M/M increase in household energy tariffs at the start of the year combined with a smaller decline in petrol prices (-2.0%M/M) than a year earlier. But that was in part offset by better behaved food prices in January, which fell (-0.4%M/M) for only the second month in more than two years. Indeed, that represented the largest monthly drop in any January since 2016 and compared with the average increase for that month of 0.3%M/M across the series. And so, inflation of food, alcohol and tobacco maintained a downtrend, falling a further 1.0ppt to a 19-month low of 8.3%Y/Y.

### Euro area: Industrial production



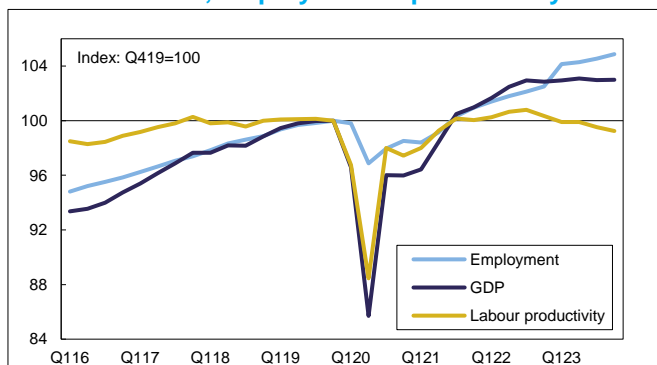
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: GDP growth & sentiment indices



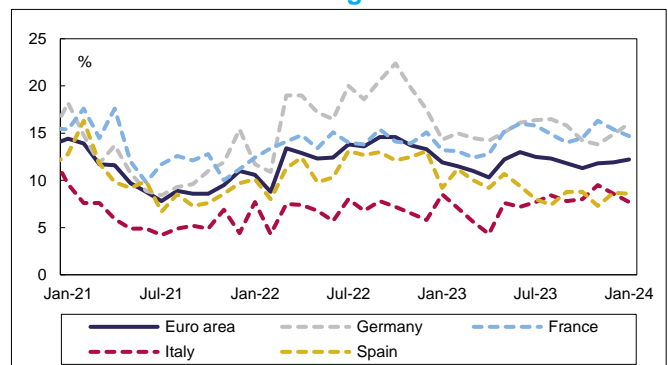
Source: EC, Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

### Euro area: GDP, employment & productivity



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: Labour hoarding indices\*



\*Share of firms expecting output to decline but employment to remain stable or increase. Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

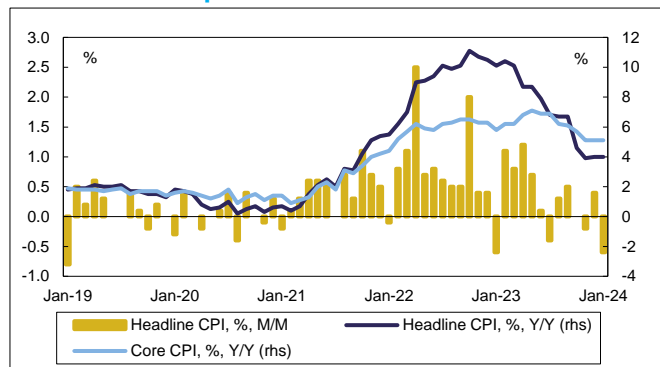
## Goods inflation maintained downtrend, but contribution from services a touch firmer than expected

Within the core goods category, inflation of furniture, clothing and footwear, toys and games, and certain household appliances fell back. And so, despite a softer pace of decline in prices of used cars and an above-average monthly increase in overall prices of core goods, non-energy industrial goods inflation maintained its downtrend, falling for an eighth consecutive month to 2.7%Y/Y, the lowest since July 2021. Of course, inflation of services remains most important as far as the BoE is concerned. And that component edged up a smaller-than-expected 0.1ppt to 6.5%Y/Y. But while this was a touch softer than expected by BoE staff (6.6%Y/Y), the contribution (3.2ppt) to headline inflation was a touch firmer due to the higher share of services in this year's reweighting of the CPI basket. The undershoot in services inflation was in part due to the exaggerated impact of the monthly decline in airfares due to a larger CPI weight this year. And while accommodation costs eased, hospitality inflation was boosted by a smaller drop in prices in January compared with last year. Overall, core inflation was unchanged at 5.1%Y/Y, 2.0ppts below May's peak. However, to two decimal places it eased 0.09ppt to 5.05%Y/Y, which was the lowest since January 2022.

## Inflation to resume broad-based downtrend in February

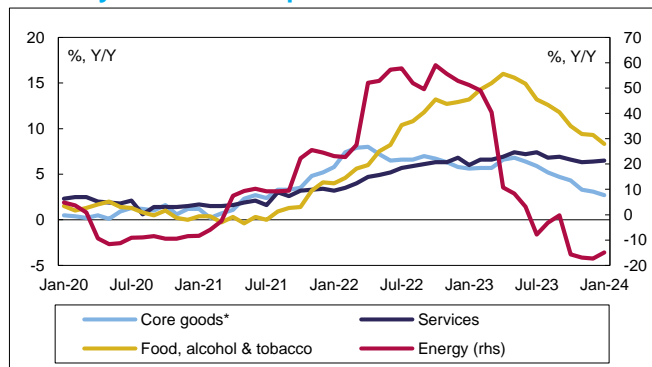
Despite the persisting stickiness in services inflation, policymakers might be encouraged to see that overall services prices fell on the month in January (-0.8%M/M) for a second month out of the past three and to a greater extent than is the norm for the time of year, suggesting that inflation momentum is moderating significantly. Indeed, with pay momentum back in line with the long-run average and domestic demand soft, we expect services inflation to resume a downtrend this month and continue to undershoot the BoE's projection. Today's PPI figures also suggested limited inflationary impact so far from disruption to supply caused by events in the Red Sea. Indeed, producer input prices fell for a third consecutive month in January (-0.8%M/M). And with food product inflation (0.5%Y/Y) the lowest since November 2020 and core output PPI inflation in negative territory (-0.4%Y/Y) for the first time since August 2020 and to the greatest extent since the global financial crisis, we expect non-energy consumer goods inflation to fall steadily further over coming months. Most importantly, when Ofgem confirms the household energy price cap for April on 23 February, the tariff could be reduced by as much as 15%. As such, we currently expect headline inflation to drop sharply below the 2% target in Q2. And while the disinflationary pace in core inflation will be more moderate, we expect it to fall back below 2% by the end of this year. So, on balance, and in the absence of an upside surprise to inflation and wage growth over coming months, we maintain our view that the first rate cut will likely come alongside updated BoE macroeconomic projections in May.

### UK: Consumer price inflation



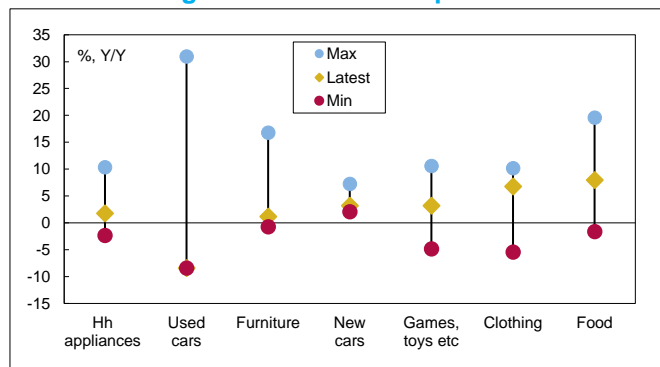
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Key inflation components



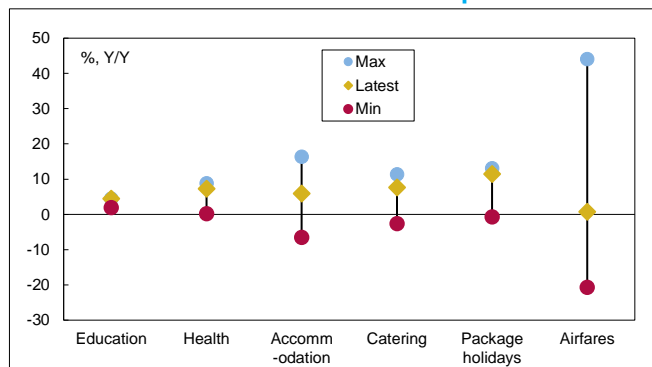
\*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Selected goods inflation components\*



\*Since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Selected services inflation components\*

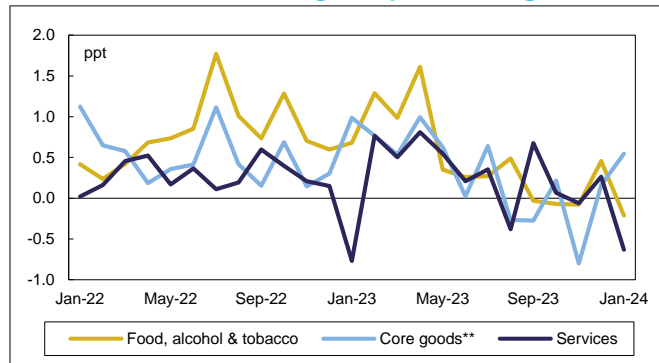


\*Since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd..

## The day ahead in the UK

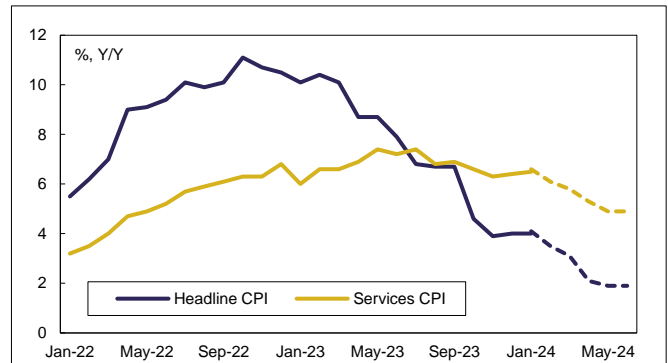
Looking ahead to tomorrow, the data highlight in the UK will be the publication of the first estimates of Q4 GDP and the accompanying December output figures, which are expected to report a continued lack of recovery momentum at year-end. Despite the improvement signalled by the PMIs, retail sales declined 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. Aside from the data, external MPC members Mann and Greene are due to speak at separate events.

### UK: Deviations from long-run price change\*



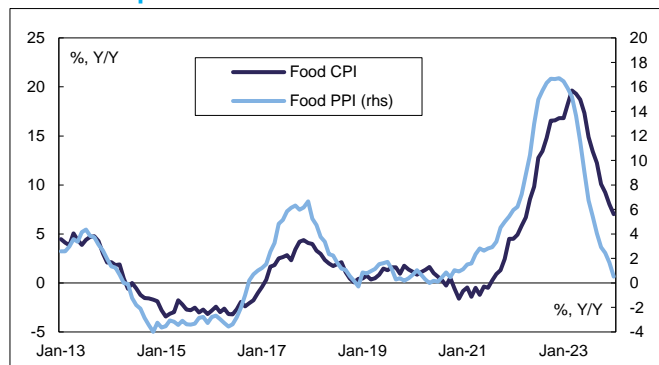
\*Monthly change in prices compared with average for the month in the decade before the pandemic. \*\*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Headline & services CPI\*



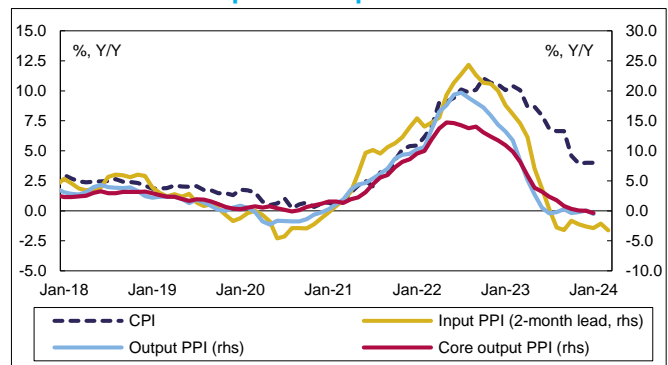
\*Dashed lines represent BoE forecast from the February 2024 MPR. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Food price inflation



Source: Datastream and Daiwa Capital Markets Europe Ltd.

### UK: Consumer & producer price inflation



Source: Datastream 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	GDP – second estimate Q/Q% (Y/Y%)	Q4	<b>0.0 (0.1)</b>	<u>0.0 (0.1)</u>	-0.1 (0.0)	-
	Preliminary employment Q/Q% (Y/Y%)	Q4	<b>0.3 (1.3)</b>	-	0.2 (1.3)	-
	Industrial production M/M% (Y/Y%)	Dec	<b>2.6 (1.2)</b>	<u>1.6 (-2.3)</u>	-0.3 (-6.8)	0.4 (-5.4)
UK	CPI (core CPI) Y/Y%	Jan	<b>4.0 (5.1)</b>	<u>4.2 (5.2)</u>	4.0 (5.1)	-
	Output (input) PPI Y/Y%	Jan	<b>-0.6 (-3.3)</b>	-0.6 (-3.3)	0.1 (-2.8)	- (-2.1)
	House price index Y/Y%	Dec	<b>-1.4</b>	-	-2.1	-2.3

### Auctions

Country	Auction
Germany	sold €805mn of 1.8% 2053 bonds at an average yield of 2.53%
	sold €852mn of 2.5% 2054 bonds at an average yield of 2.53%
UK	sold £3.75bn of 4.625% 2034 bonds at an average yield of 4.132%

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	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)

### Auctions and events

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			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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