Euro wrap-up

Overview

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- Bunds followed USTs lower, while the euro area goods trade surplus rose in Q4 to its highest since Q121 despite a modest narrowing in December.
- Gilts made modest losses even as the UK's economy slipped into recession in H223 and GDP per capita extended the longest run without growth since at least 1955.
- The coming week will bring the flash February PMIs, along with updated estimates of euro area inflation in January and negotiated wage growth in Q4, and the ECB's account from the January Governing Council meeting.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/06	2.744	+0.023
OBL 2.1 04/29	2.322	+0.023
DBR 2.2 02/34	2.349	+0.015
UKT 3½ 10/25	4.538	+0.007
UKT 4½ 06/28	4.054	+0.006
UKT 3¼ 01/33	4.051	+0.011

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

Euro area

Goods trade surplus in Q4 up to highest since Q121

Having in November reached the highest level since March 2021, the euro area's goods trade surplus narrowed in December. However, while industrial production and GDP were flat last quarter, net goods trade still looks to have made a positive contribution to economic growth, albeit if only because imports fell so far amid weak domestic demand. In particular, on an adjusted basis, the euro area goods trade surplus fell €2.1bn in December to €13.0bn. And that left the average in Q4 at €13.1bn, the highest quarterly figure since Q121, when domestic demand remained subdued due to the pandemic and a year before Russia's invasion of Ukraine triggered an extreme adverse shock to the euro area's terms of trade. Admittedly, the value of euro area goods exports fell in December for the first month in three and by 0.8%M/M to be down a steep 8.8%Y/Y. However, they were still up 4.5%Q/Q in Q4. And while import values were flat on the month, due to the sharp drop in intermediate goods, they were still down a whopping 18.7%Y/Y in December and also down 1.7%Q/Q in Q4. Of course, relative price shifts explain a great deal of the swings in trade values, and December volumes data have yet to be published. Nevertheless, in the first two months of Q4, import goods volumes were trending 2.7% below their Q3 level while export volumes were down just 0.3% on the same basis, albeit still down 4.3%Y/Y.

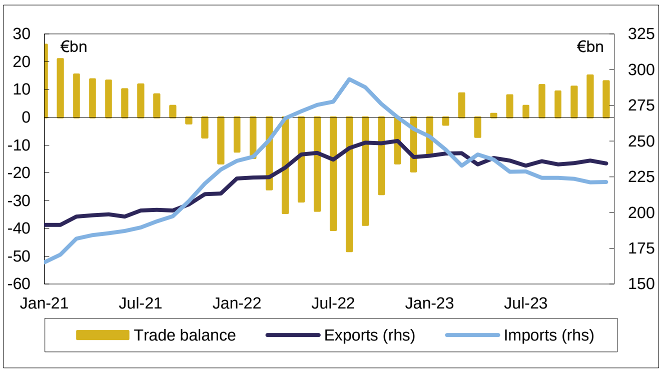
Trade deficit with China steady while surplus with UK rises to series high

Based on Eurostat's current available data, despite a drop in export values and volumes, the euro area's bilateral goods trade deficit with China (excluding Hong Kong) was broadly steady in Q4, having narrowed in Q3 to a two-year low. But thanks to increased export shipments to those markets, the bilateral surplus with the US rose to the highest since Q121 while that with the UK rose to a series high. Export volumes of all major categories of good were still trending lower over the first two months of Q4. But compared to a year earlier, shipments of intermediate items (down 6.0%Y/Y in volume terms in the first two months of Q4) have been underperforming those of capital (-3.6%Y/Y) and consumer goods (-4.1%Y/Y), in part reflecting the sharp retrenchment in energy-intensive production.

A tepid outlook for euro area trade

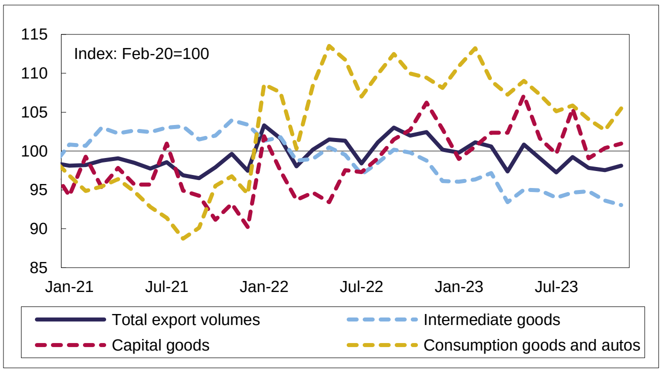
Looking ahead, survey indicators for export orders have recently become a little less downbeat, albeit consistent with an ongoing downtrend. For example, the euro area manufacturing export orders PMI rose 2.3pts in January to a nine-month high, but was still suggestive of contraction at 45.0. Demand for euro area exports should strengthen gradually this year amid a broader pickup in global trade. But the competitiveness of several sectors will remain impaired, not least by high energy prices. And there is no shortage of downside risks, as illustrated by the recent further intensification of disruption to

Euro area: Goods trade values*



*Seasonally-adjusted basis. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods export volumes



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Red Sea shipping transit volumes, which were down 57%Y/Y in the first eleven days of February compared to the decline of 45%Y/Y in January. So, while it should turn positive this year, growth in euro area exports is likely to remain well below historical norms. And we expect net trade to subtract slightly from euro area GDP growth in 2024.

The week ahead in the euro area

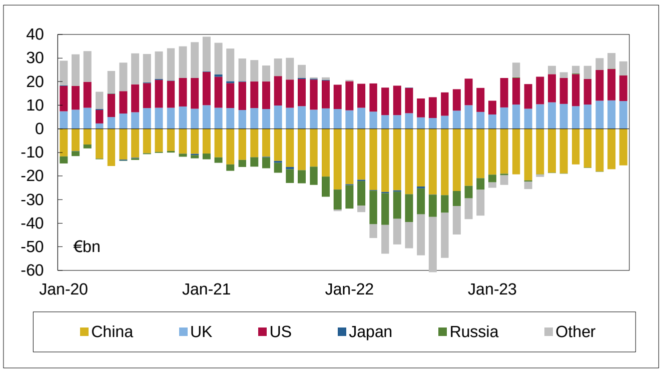
The week ends on a quiet note data-wise in the euro area, with only final French inflation data for January scheduled for release tomorrow. The preliminary data revealed that French inflation fell a little further than expected at the start of the year, with the headline HICP rate declining 0.7ppt to 3.4%Y/Y, the lowest for two years and 3.9ppts below the peak last February. While the components for core goods, food and energy all fell significantly, services inflation in France edged a touch higher. The final euro area inflation data for January are due on Thursday. These are likely to align with the flash estimates in which the headline HICP rate fell 0.1ppt to 2.8%Y/Y despite the inflationary consequences of the further withdrawal of fiscal policy support at the start of the year. With inflation of non-energy industrial goods down again and the services component steady, core inflation fell for a sixth successive month, by 0.1ppt to 3.3%Y/Y, the lowest since March 2022. The granular detail will allow calculation of other measures of underlying inflation, which eased significantly over the second half of last year.

Arguably the most notable new data of the coming week will be the February top-tier survey results, including the flash PMIs for February on Thursday. The headline euro area composite output PMI edged up 0.3pt in January to a six-month high of 47.9, still nevertheless suggestive of a contraction. However, we note that, contrary to the more downbeat signals from the PMIs, GDP was steady in Q4 from the prior quarter. Within the detail, the January PMIs suggested that manufacturing output fell at the softest pace in nine months but also that services activity weakened the most in three months. But while they also implied that the German and French economies contracted significantly, they suggested that activity in the rest of the euro area grew the most in six months.

Other top-tier economic survey results for February due in the coming week include the French INSEE business indicators – which have been somewhat more upbeat than the French PMIs – also on Thursday and the German ifo indices – which have been as downbeat as the German PMIs – on Friday. In addition, having fallen 1pt in the prior month to a relatively weak -16.1 due to a particular deterioration in Germany, the Commission's flash euro area consumer confidence index is due on Wednesday. And the ECB's consumer survey results are due on Friday. We expect all survey indicators to point to only modest improvements in business and household sentiment in February, but price expectations should moderate slightly too.

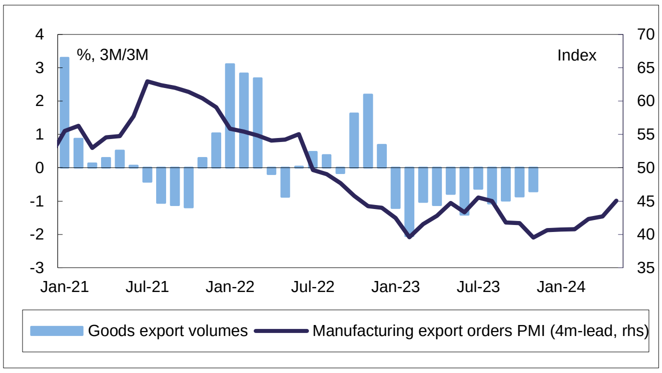
Beyond the survey indicators, euro area figures for negotiated wages in Q4 and construction output in December are due on Tuesday. With German construction down a hefty 3.4%M/M, output in the euro area as a whole likely dropped for a third

Euro area: Goods trade balance by country



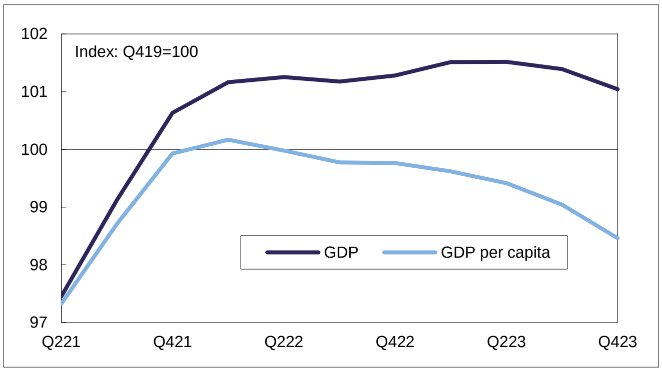
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods exports & export orders PMI



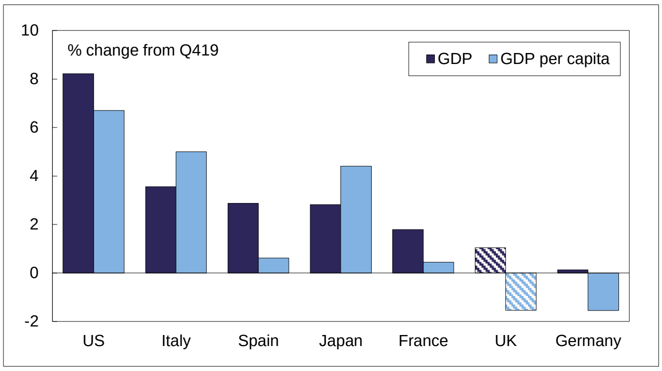
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: GDP & GDP per capita levels



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Major economies: GDP levels in Q423 vs Q419



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

successive month at the end of 2023. Given the ECB's concerns about the upside risks to inflation from labour costs, the negotiated wage data are likely to have a greater bearing on its forthcoming monetary policy decisions. With respect to monetary policy, on Thursday the ECB will publish its account of the January monetary policy meeting. Notably, the ECB's policy statement issued following the meeting had a more dovish tone and, in her press conference, President Lagarde refused to rule out a rate cut in April.

UK

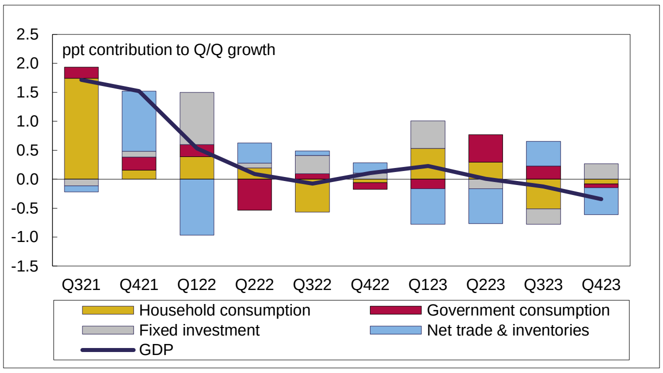
Economy slipped into recession in H223, with GDP per capita on the weakest run since at least 1955

Contrasting markedly with the improving recovery momentum implied by the PMI surveys, today's first estimate of Q4 GDP signalled a notable weakening in the economy at the end of last year, recording a technical recession for the first time since H120 and, before that, the global financial crisis in 2009. In particular, GDP contracted for the second successive quarter in Q4 and by a steeper 0.3%Q/Q – the most since Q121 when the UK was still in lockdown – some 0.2ppt below the Bloomberg survey consensus and 0.3ppt below the BoE's latest projection. With growth having flatlined in Q2 and been revised lower in Q1 (by 0.1ppt to 0.2%Q/Q), GDP was estimated to be some 0.4% lower than previously estimated in Q3 and up just 0.1% in 2023 as a whole. And GDP in Q4 was merely 1.0% above the pre-pandemic level in Q419. While this is superior to the woeful performance in Germany against the same benchmark (0.1%), it lags significantly the expansions of the US (8.2%), euro area as a whole (3.5%) and Japan (2.8%) on that basis. Moreover, in terms of GDP per head, the UK's performance was even worse, declining in each of the past five quarters and down 0.7% in 2023. Indeed, having failed to increase in any quarter since Q122, this marked the longest run without growth on a per capita basis since the series began in 1955.

Firmer capex growth offset by declines in exports and household and government consumption

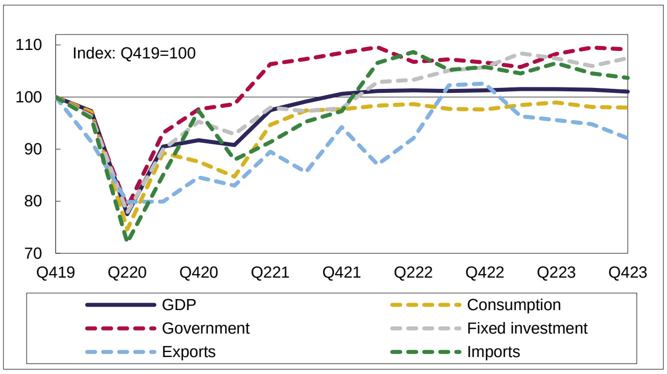
Despite an improvement in disposable incomes amid strong pay growth, low unemployment and moderating inflation, household consumption fell for a second successive quarter in Q4 (-0.1%Q/Q), to leave it still 2% below its level four years ago. The decline reflected reduced discretionary spending on recreation and culture, miscellaneous goods, services and transport, perhaps reflecting a desire to boost savings following the protracted period of falling real incomes and ahead of the rise in household energy tariffs at the start of this year. Government spending also fell at the end of the year (-0.3%Q/Q). Together, private and public consumption accounted for roughly half of the contraction in GDP. Admittedly, their impact was offset by an eighth quarterly rise out of nine in business investment (1.5%Q/Q). And total fixed investment boosted GDP growth by 0.3ppt, reversing the drag in Q3, as it rose some 7½% above the pre-pandemic benchmark. Perhaps surprisingly

UK: GDP growth & expenditure components



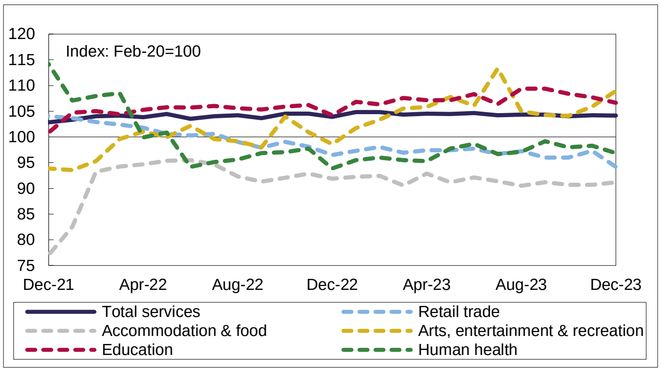
Source: Datastream Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: GDP levels & expenditure components



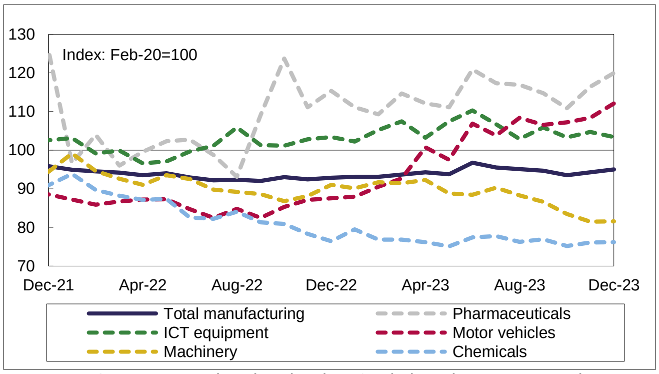
Source: Datastream Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Services output by selected subsector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output by selected subsector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

and unintentionally in light of weak final demand and insubstantial order books, private sector inventories also added to GDP growth (0.2ppt) for a fifth successive quarter. But this contribution was more than offset by a fourth consecutive drop in exports (-2.9%Q/Q), amid the steepest decline in services exports (-6.0%Q/Q) in seven quarters. And while the drag was reduced somewhat by a second drop in import volumes (-0.8%Q/Q), net trade nevertheless knocked 0.6ppt off GDP.

GDP growth to remain lacklustre in 2024

Looking ahead, we expect to see some positive payback via net trade in the first quarter, with services exports likely stronger and new post-Brexit trade barriers perhaps weighing a bit more heavily on goods imports. Government consumption is likely to be firmer too. Despite the cut to National Insurance Contributions at the start of the year, household spending seems likely to be restrained by the additional squeeze on budgets from higher household energy bills, while unseasonably warm temperatures are likely to act as a disincentive to spending on winter apparel. And firms are likely to try to run down stocks in the face of persistently lacklustre demand. Overall, we expect only a partial reversal of the Q4 drop in GDP in Q1, with growth in Q1, of 0.2%Q/Q. And notwithstanding the possibility that tax cuts will be announced in next month's Budget statement, we expect growth of just 0.2%Qover the remainder of the year. While this would exceed the pace of growth projected by the BoE earlier this month, due not least to the lower starting point our forecast would leave GDP up just 0.2% in 2024 and a touch below the level projected by the BoE for Q424.

Services and construction activity fell further in December but manufacturing picked up

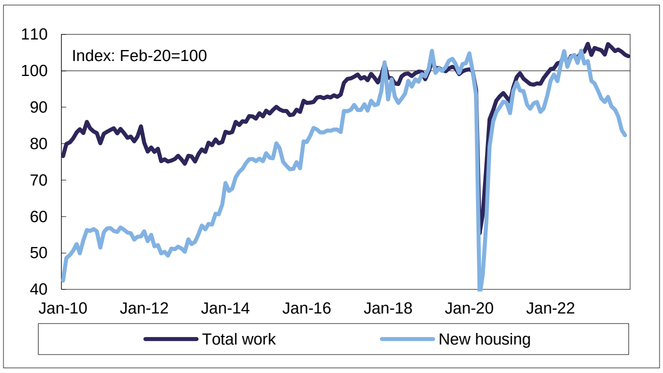
While the contraction in Q4 in part reflected a sharp drop in output at the start of the quarter (down 0.5%M/M in October), the monthly profile also showed that the economy ended the year on the back foot too, declining 0.1%M/M in December, suggesting a negative carry-over of growth into the start of 2024. The weakness was led by services (-0.1%M/M), with retail, healthcare, education, and personal services such as hairdressing and beauty faring worse in the festive period. The drop was partially offset by architectural and engineering activities, despite the ongoing downturn in the construction sector. Indeed, construction activity fell for a third consecutive month in December (-0.8%M/M) to a fifteen-month low to be down 1.3%Q/Q in Q4. This was underpinned by a further significant decline in new building work, of which private housing fell for a fifth consecutive quarter and by a whopping 8%Q/Q, to be down 22%Y/Y and at its lowest level since January 2016 excluding the initial Covid-19 slump. And the sharp drop in new construction orders last quarter (-13.1%Q/Q) suggests that the downturn still has further to play out. Somewhat more encouraging was the manufacturing performance at the end of last year, with production having risen for a second successive month in December (0.8%M/M), with positive contributions from the transport equipment, pharmaceuticals and basic metals subsectors. But this still left output down in Q4 for the first time in five quarters (-0.9%Q/Q), with quarterly output having contracted in 10 out of the 13 subsectors.

The week ahead in the UK

Tomorrow sees the release of January retail sales data. While we 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. We forecast growth of a little more than 1½%M/M, thus reversing roughly half of December's drop and leaving sales still down only a little less than 1.0%3M/3M.rther ahead

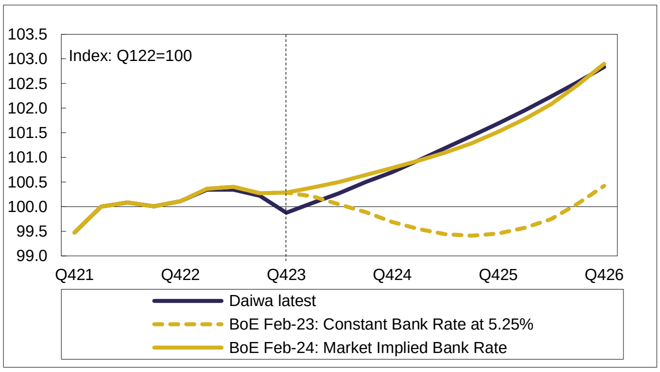
Looking further ahead, the most notable UK data release of the coming week will be the February flash PMIs, which are due for release on Thursday. Last month, the headline composite output PMI rose to a seven-month high of 52.5, suggestive of positive economic growth momentum at the start of the year. The expansion was supposedly led by services, for which the activity PMI jumped to an eight-month high of 54.3. However, we caution that the PMIs failed to provide a reliable guide to economic activity in Q4, when the headline composite index averaged 50.5 to suggest stable output in contrast to the decline of 0.3%Q/Q in GDP. Given the seemingly inexplicable strength of the PMIs in January, nevertheless, we expect the February survey to be somewhat weaker, albeit still consistent with a return to positive GDP growth in Q1.

UK: Construction output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP forecast



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

Other notable survey data due in the coming week include the February GfK consumer confidence indices on Friday. While the headline sentiment index rose to a two-year high of -19 in January, it remained some way below the long-run average. Likewise, the survey measure of spending intentions remained low by historical standards to suggest that private consumption will remain subdued over the near term after contracting in both Q3 and Q4. With real incomes rising, we expect to a fourth successive modest increase in the headline GfK index in February. The coming week will also bring the latest CBI industrial trends survey results on Wednesday, which will give a guide to the flash manufacturing PMIs the following day. Also Wednesday, the January public finances figures will give a guide to the fiscal headroom available to the Chancellor when he looks to announce tax cuts in the Government's Budget on 6 March..

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	-0.3	0.2	0.2	0.2	0.2	0.2	0.1	0.2	1.0
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	3.3	1.4	1.7	1.9	1.7	7.3	2.1	1.7
Core CPI	5.3	4.4	2.6	2.3	2.2	2.0	6.2	2.9	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 next edition of the Euro wrap-up will be published on 20 February 2024

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Trade balance €bn	Dec	**13.0**	-	14.8	15.1
Spain	Final HICP (CPI) Y/Y%	Jan	**3.5 (3.4)**	*3.5 (3.4)*	3.3 (3.1)	-
UK	GDP – first estimate Q/Q% (Y/Y%)	Q4	**-0.3 (-0.2)**	*-0.1 (0.1)*	-0.1 (0.3)	- (0.2)
	GDP M/M%	Dec	**-0.1**	-0.2	0.3	0.2
	Industrial production M/M% (Y/Y%)	Dec	**0.6 (0.6)**	-0.4 (-4.4)	-0.3 (-0.1)	0.5 (0.1)
	Manufacturing production M/M% (Y/Y%)	Dec	**0.8 (2.3)**	0.1 (1.3)	0.4 (1.3)	0.8 (1.9)
	Index of services M/M% (3M/3M%)	Dec	**-0.1 (-0.2)**	-0.2 (-)	0.4 (0.0)	0.2 (-0.2)
	Construction output M/M% (Y/Y%)	Dec	**-0.5 (-3.2)**	-0.4 (-)	-0.2 (0.9)	-0.7 (-0.7)
	Trade (goods) balance £bn	Dec	**-2.6 (-14.0)**	-	-1.4 (-14.1)	-3.7 (-15.1)

Auctions

Country	Auction
France	sold €4.70bn of 2.5% 2027 bonds at an average yield of 2.67%
	sold €5.00bn of 2.75% 2029 bonds at an average yield of 2.62%
	sold €2.29bn of 0% 2031 bonds at an average yield of 2.65%
	sold €732mn of 0.1% 2028 index-linked bonds at an average yield of 0.58%
	sold €836mn of 0.1% 2029 index-linked bonds at an average yield of 0.48%
	sold €571mn of 3.15% 2032 index-linked bonds at an average yield of 0.52%
	sold €349mn of 0.1% 2053 index-linked bonds at an average yield of 0.73%
Spain	sold €1.86bn of 2.5% 2027 bonds at an average yield of 2.875%
	sold €2.19bn of 3.5% 2029 bonds at an average yield of 2.873%
	sold €1.85bn of 2.35% 2033 bonds at an average yield of 3.139%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
France	07.45	Final HICP (CPI) Y/Y%	Jan	*3.4 (3.1)*	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)

Auctions and events

Country	GMT	Event
Euro area	08.45	ECB's Schnabel scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

The coming week's data calendar

The coming few week's key data releases

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast/actual*	Previous
			Monday 19 February 2024			
Spain		09.00	Trade balance €bn	Dec	-	-2.4
UK		00.01	Rightmove house price index M/M% (Y/Y%)	Feb	-	1.3 (-0.7)
			Tuesday 20 February 2024			
Euro area		07.00	EU27 new car registrations Y/Y%	Jan	-	-3.3
		10.00	ECB indicator of negotiated wages Y/Y%	Q4	-	4.7
		10.00	Construction output M/M% (Y/Y%)	Dec	-	-1.0 (-2.2)
			Wednesday 21 February 2024			
Euro area		15.00	European Commission's preliminary consumer confidence index	Feb	-15.8	-16.1
France		-	Bank of France retail sales Y/Y%	Jan	-	-2.4
UK		07.00	Public sector net borrowing (excl. banks) £bn	Jan	-	6.8 (7.8)
		11.00	CBI industrial trends, total orders (selling prices) balance	Feb	-	-30 (9)
			Thursday 22 February 2024			
Euro area		09.00	Preliminary manufacturing (services) PMI	Feb	47.0 (48.7)	46.6 (48.4)
		09.00	Preliminary composite PMI	Feb	48.5)	47.9
		10.00	Final headline (core) HICP Y/Y%	Jan	2.8 (3.3)	2.9 (3.4)
Germany		08.30	Preliminary manufacturing (services) PMI	Feb	46.5 (48.5)	45.5 (47.7)
		08.30	Preliminary composite PMI	Feb	48.0	47.0
France		07.45	INSEE business (manufacturing) confidence index	Feb	-	98 (99)
		08.15	Preliminary manufacturing (services) PMI	Feb	-	43.1 (45.4)
		08.15	Preliminary composite PMI	Feb	-	44.6
Italy		09.00	Final HICP (CPI) Y/Y%	Jan	0.9 (0.8)	0.5 (0.6)
UK		09.30	Preliminary manufacturing (services) PMI	Feb	-	47.0 (54.3)
		08.15	Preliminary composite PMI	Feb	-	52.9
			Friday 23 February 2024			
Euro area		09.00	ECB 1Y (3Y) price expectations	Jan	-	3.2 (2.5)
Germany		07.00	Final GDP Q/Q% (Y/Y%)	Q4	*-0.3 (-0.2)*	-0.1 (-0.3)
		09.00	Ifo business climate index	Feb	85.8	85.2
		09.00	Ifo current assessment (expectations) balance	Feb	-	87.0 (83.5)
UK		00.01	GfK consumer confidence index	Feb	-	-19

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions			
Country		GMT	Event / Auction
			Monday 19 February 2024
UK		19.40	BoE Chief Economist Pill scheduled to speak
			Tuesday 20 February 2024
Germany		10.30	Auction: €5bn of 2.5% 2026 bonds
UK		10.00	Auction: £1.75bn of 4.0% 2063 bonds
			Wednesday 21 February 2024
Germany		10.30	Auction: €4.5bn of 2.2% 2034 bonds
UK		10.00	Auction: £4bn of 4.5% 2028 bonds
		14.00	BoE's Dhingra scheduled to speak
			Thursday 22 February 2024
Euro area		12.30	ECB publishes account of January monetary policy meeting
UK		06.00	BoE's Greene scheduled to speak
			Friday 23 February 2024
Euro area		09.20	ECB's Schnabel scheduled to speak on 'Has the fight against inflation been won?'
Italy		10.00	Auction: To sell 2Y index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.