Euro wrap-up

Overview

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- Despite a pickup in German industrial production, Bunds made gains as euro area national accounts figures confirmed that wages and unit labour costs growth slowed in Q4.
- Gilts also made modest gains on a quiet day for UK economic news.
- The coming week will bring updates on euro area industrial production and UK GDP and unemployment.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.750	-0.076
OBL 2.1 04/29	2.272	-0.066
DBR 2.2 02/34	2.264	-0.040
UKT 0⅛ 01/26	4.239	-0.031
UKT 0½ 01/29	3.909	-0.043
UKT 4⅝ 01/34	3.982	-0.013

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

Euro area

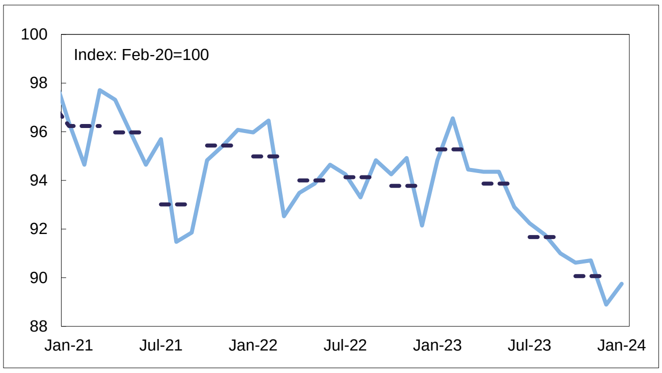
Rise in German IP in January broad-based, but likely to prove temporary

At face value, today's German industrial production figures offered a welcome break from the doom and gloom surrounding the manufacturing sector. Indeed, contrasting with the marked decline in yesterday's manufacturing turnover data, industrial production rose 1.0%M/M in January, just the second increase in the past eleven months (with November having merely eked out a modest rise of 0.1%M/M). The improvement was led by construction, where activity rose for the first month in four and by 2.7%M/M – the most since last January – benefitting from unseasonably mild weather. In addition, manufacturing output increased for the first month in five, by 1.0%M/M. Within the manufacturing detail, growth was boosted by the chemicals (4.7%M/M), food (5.9%M/M) and machinery maintenance and assembly (11.1%M/M) subsectors. Given also positive developments in the paper, basic metals and precious materials, production from the most energy-intensive sectors rose 2.8%M/M – the most in a year – albeit leaving output there still roughly 17% below the level ahead of the energy crisis following Russia's invasion of Ukraine. Disappointingly, however, car production fell for a third successive month and by 7.6%M/M, the steepest drop since March 2022, to be down more than 13½%Y/Y, some 20% below the pre-pandemic level and 10% below the Q423 level. And overall, given the downwards revision to total industrial production in December (down 0.4ppt to -2.0%M/M), IP was still almost ½% below the Q4 average, with manufacturing output some 0.8% lower.

Surveys and orders suggest manufacturing will remain a drag on GDP in Q1

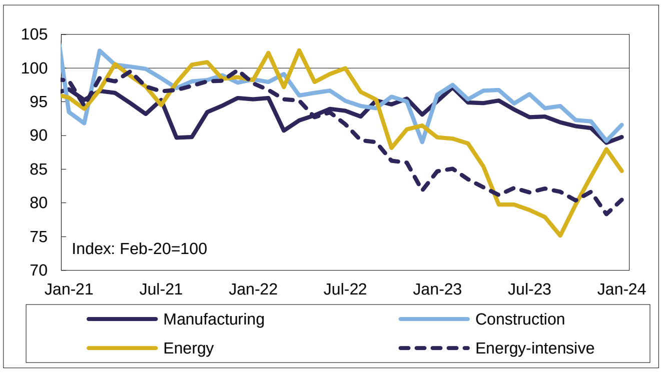
While truck toll mileage – often a useful guide for manufacturing activity – rose for a second successive month in February (1.5%M/M), other indicators provide a less encouraging assessment of recent conditions in the factory sector. For example, the manufacturing output PMI fell 3.4pts in February to 42.3 – signalling significant contraction – while the ifo institute industry sentiment index slipped to its lowest level since the global financial crisis excluding the first Covid-19 lockdown, with production expectations having deteriorated further amid an ongoing downtrend in orders. While order backlogs in certain subsectors – electrical equipment and computer, electronic and optical products – remain elevated, they continue to fall back steadily in the autos sector and are only marginally higher than pre-pandemic levels in other subsectors. Car production last month was also be dented by the temporary suspension of most production at Telsa's Berlin factory for two weeks due to a shortage of certain components due to shipping delays from Asia. And while building permits appear to have troughed last summer, they still suggest a relatively bleak outlook for the construction sector, with demand constrained by high borrowing costs and declining real estate prices. Overall, therefore, German industry has likely remained a drag on GDP in Q1, with lacklustre recovery expected thereafter amid subdued global demand and ongoing structural adjustments.

Germany: Industrial production*



*Dashed lines represent quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

German producer prices suggest disinflation of consumer goods to continue

Given the weakness in demand for German manufacturing and general downtrend in global goods price pressures, today's producer price figures suggested that the disinflationary trend in core consumer goods inflation should continue over coming months. Admittedly, despite a modest decline in energy prices (-0.1%M/M) as lower natural gas and electricity charges offset higher heating oil costs, producer prices rose in January for the first month in four (0.2%M/M). This left the annual PPI rate still highly negative at -4.4%Y/Y, albeit a softer pace of decline than in December (-5.1%Y/Y) and almost 4ppts above the trough (-9.2%Y/Y) in September. Notably, when excluding energy, core PPI inflation fell into negative territory (-0.5%Y/Y), to be down some 16½ppts from the peak in May 2022. Indeed, despite rising on the month, intermediate goods prices were down a steep 3.7%Y/Y, while non-durable consumer goods inflation slowed to 1.1%Y/Y, the lowest since May 2021, benefitting from the decline in food prices. The increase in capital goods prices (3.0%Y/Y) and durable consumer goods inflation (1.6%Y/Y) was also the softest since 2021.

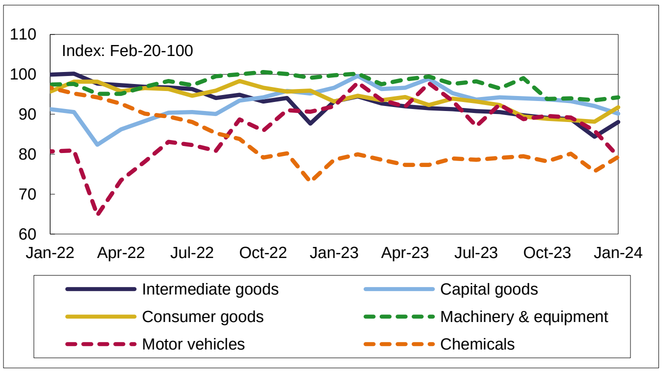
Domestic demand made a welcome positive contribution to GDP growth in Q4

As expected, today's final GDP data for Q4 confirmed that euro area economic output was unchanged from Q3, with growth of 0.0%Q/Q and just 0.1%Y/Y. However, despite that stagnation, the expenditure breakdown of GDP provided relatively good news, with all major components of final domestic demand increasing. Admittedly, the increase in private consumption last quarter was modest at just 0.1%Q/Q, 0.2ppt softer than in Q3. However, that represented a fourth successive quarter of growth in such spending to be up 0.6%Y/Y. Meanwhile, government consumption rose for the third consecutive quarter and at the same rate as in Q3 (0.6%Q/Q). At face value, most encouraging appeared to be the rise in fixed investment, which grew the most in five quarters (1.0%Q/Q). But growth in that component came from a likely one-off 9.5%Q/Q surge in the intellectual property component, probably reflecting the transfer of rights to within the euro area (probably Ireland) by certain multinational corporations for tax purposes. In contrast, due to ongoing weakness in real estate, construction spending fell for a third successive quarter (-0.4%Q/Q). And investment in machinery and equipment fell for the first time in four quarters (-2.3%Q/Q).

Net trade subtracted from growth due to services imports while inventories also weighed

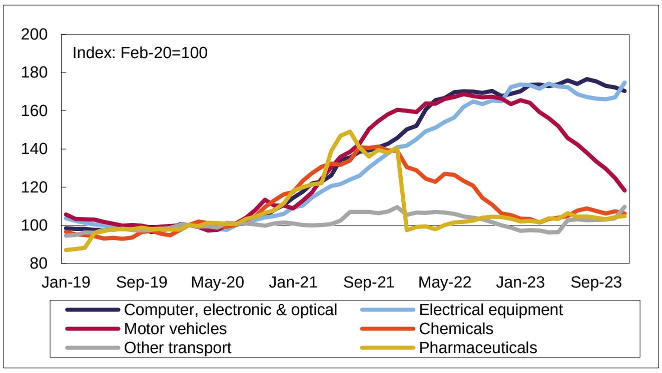
In total, final domestic demand contributed 0.4ppt to GDP growth in Q4. However, the counterpart to the surge in investment in intellectual property was a jump in imports of services of 3.8%Q/Q, the most in six quarters. In contrast, goods imports failed to grow for the fifth successive quarter (-0.6%Q/Q) while exports of both goods (0.1%Q/Q) and services (-0.1%Q/Q) were broadly flat. As a result, net trade subtracted 0.3ppt from GDP growth. And as firms attempted to align inventories with

Germany: Manufacturing output by selected sector



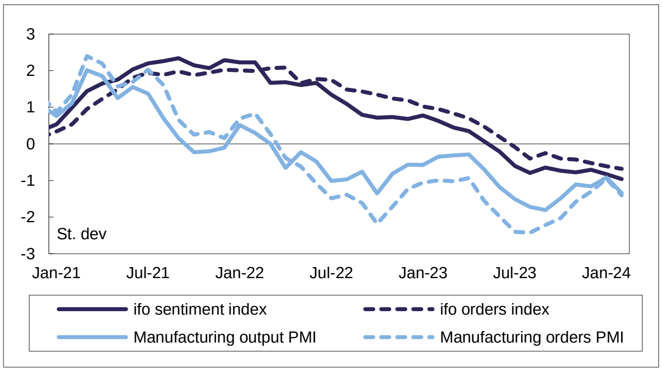
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing order backlogs



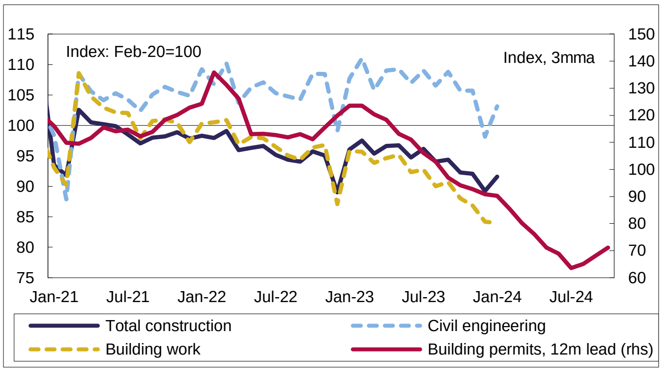
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing sentiment indices



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

Germany: Construction activity & building permits



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

weak new orders, stock adjustments subtracted 0.1ppt, representing their fourth negative contribution to growth in the past five quarters.

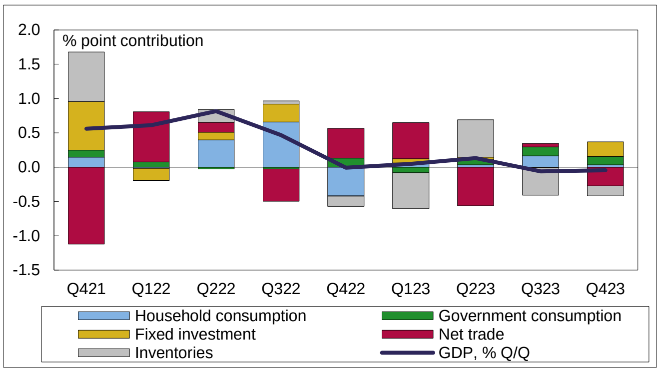
Labour cost growth moderated at end-Q4 to move the ECB another step closer to easing

With GDP flat but employment up 0.3%Q/Q to a new series high, Q4 extended the euro area's poor recent run with respect to labour productivity. Indeed, real labour productivity was down 1.1%Y/Y on a per worker basis and a similar 1.2%Y/Y per hour worked. Both indicators were just 0.1ppt better than in Q3, but should improve further if and when economic growth regains traction over coming quarters. And as far as the ECB is concerned, most notable in today's national accounts were the figures related to labour costs, which should have moved the Governing Council another step closer to a rate cut. Growth in wages and salaries moderated 0.9ppt to 6.0%Y/Y, the softest since Q121. And overall employee compensation also slowed 0.9ppt to 5.8%Y/Y, similarly an eleven-quarter low. So, on a per hour worked basis, employee compensation eased 0.7ppt to 3.2%Y/Y, the softest since Q122. And unit labour cost growth slowed 1.0ppt to 5.7%Y/Y. The ECB expects growth in wages and unit labour costs to slow on average to 4.4%Y/Y this year and 2.3%Y/Y next, with the latter rate judged to be consistent with a return of inflation back to the 2.0%Y/Y target.

The week ahead in the euro area

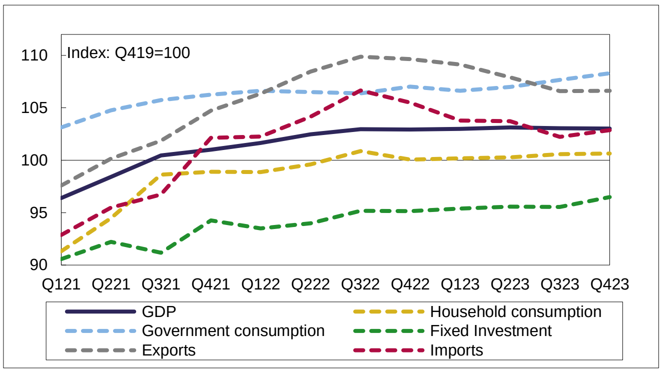
In a relatively light week ahead for top-tier economic releases, aggregate euro area industrial production figures for January will be published on Wednesday. Figures already published by member states have been mixed, with the increase in Germany (1.0%M/M) offsetting a drop in France (-1.1%M/M). But most striking was the near-29%M/M slump in (admittedly typically volatile) Irish IP, following downwardly revised growth in December (down 4½ppts to 19.1%M/M). So, based on the member state figures published so far, this would imply a drop in aggregate euro area IP of a little more than 1½%M/M in January, following growth of 2.6%M/M in December. But it is worth noting that December saw a marked discrepancy between the Eurostat euro area figure and that implied by national figures, so the forecast is more uncertain than normal. Meanwhile, final estimates of February inflation from Germany (Tuesday), Spain (Thursday), France and Italy (Friday) will provide the granular breakdown, offering greater insight into the underlying trends in goods and, more importantly, services inflation. In terms of the headline HICP rates, the flash estimates fell in Germany by 0.4ppt to a three-month low of 2.7%Y/Y, France by 0.3ppt to a near-2½-year low of 3.1%Y/Y, and Spain by 0.6ppt to a six-month low of 2.9%Y/Y, while inflation moved sideways in Italy at just 0.9%Y/Y.

Euro area: Contributions to GDP growth



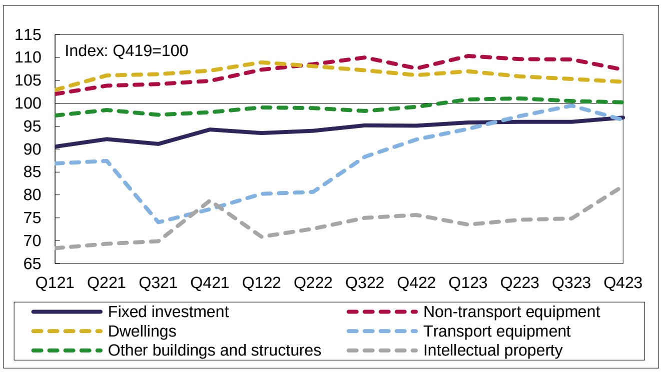
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP level & expenditure components



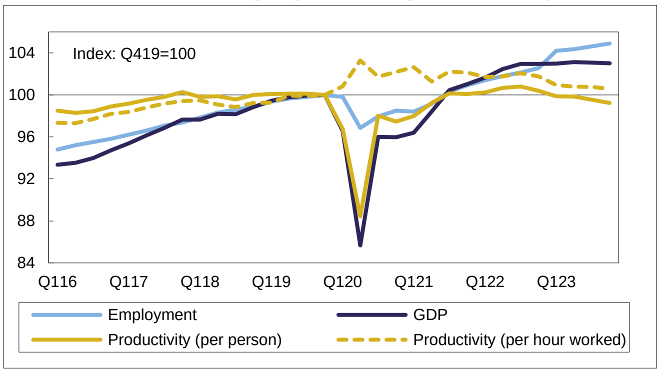
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Private investment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP, employment & productivity



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

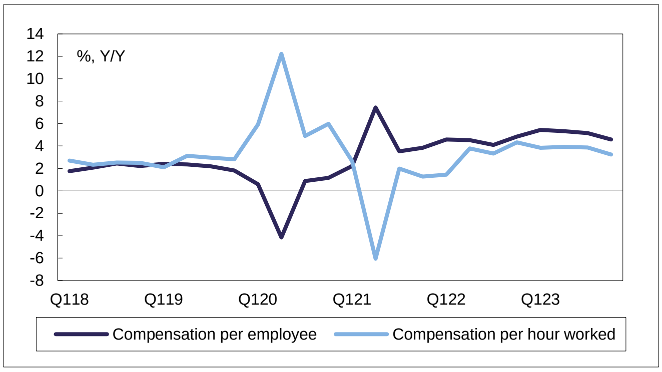
UK

The week ahead in the UK

It will be busier in the coming week for top-tier UK economic releases, which will include the latest labour market report (Tuesday), monthly GDP figures (Wednesday) and BoE quarterly inflation attitudes survey (Friday). The resumption of the Labour Force Survey (LFS) last month saw the unemployment rate decline for a fifth consecutive month in the three months to December, to 3.8%, just 0.3ppt above the series low recorded in August 2022. Given the contraction in economic activity in the final quarter of 2023 and the steady downtrend in job vacancies, we would expect the unemployment rate to have moved sideways in the three months to January, nevertheless suggesting a still very tight labour market. Meanwhile, having taken a step down at the end of last year to its softest rate in 17 months (5.8%3M/Y), total wage growth is likely to have slowed only slightly in the three months to January, with regular pay similarly expected to be little changed from December's 14-month low (6.2%3M/Y). The REC/KPMG report on jobs (Monday) will offer further insights into labour market conditions in February.

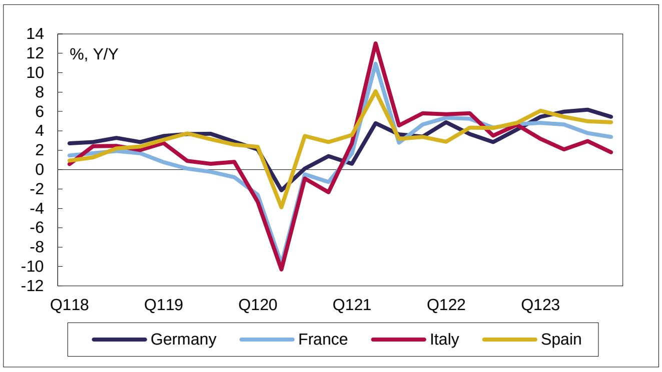
In terms of GDP growth, surveys such as the PMIs signalled an acceleration in recovery momentum at the start of the year, with the composite index up to an eight-month high (53.0). Admittedly, the PMIs had implied stagnation in Q4 compared with the actual contraction in GDP of 0.3%Q/Q. And strike action likely provided a drag on the healthcare and transport services subsectors in January. Nevertheless, retail sales rebounded at the start of the year (3.4%M/M). And overall, we expect GDP to have posted a modest rise in January, reversing the 0.1%M/M decline in December, but nevertheless suggesting still lacklustre momentum. The BoE's inflation attitudes survey will likely see a further decline in households' inflation expectations in the coming twelve months to its lowest since Q321. But of more interest for BoE policymakers will be developments in medium-term expectations – indeed, in Q423, inflation expectations in two years' time moved sideways at 2.8%Y/Y, while expectations for five years' time rose to a four-quarter high of 3.2%Y/Y. Finally, the latest RICS residential survey (Thursday) is likely to highlight the recent turnaround in the housing market.

Euro area: Employee compensation



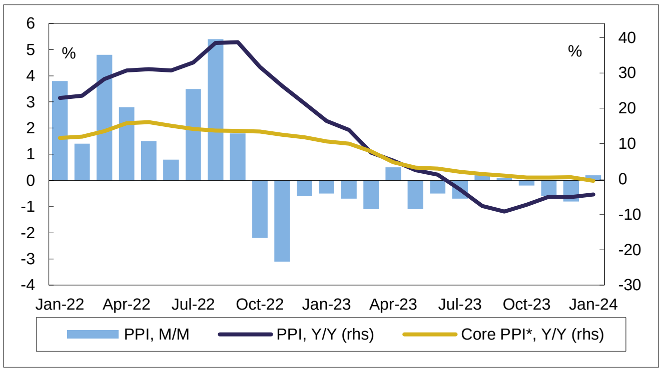
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Compensation per hour worked



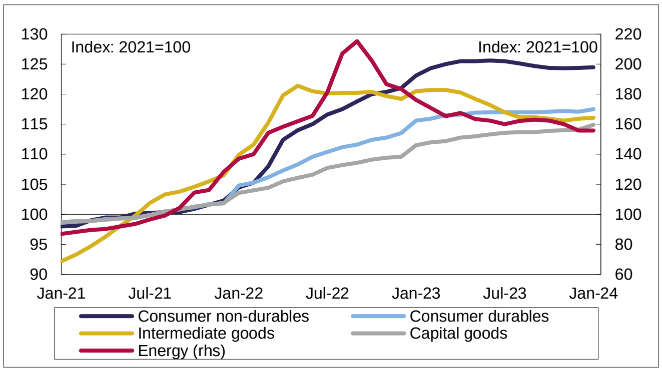
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Producer price inflation



**Excluding energy. Source: Destatis and Daiwa Capital Markets Europe Ltd.*

Germany: Producer price inflation



Source: Destatis and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 12 March 2024

Daiwa economic forecasts

	2023 Q4	2024 Q1	2024 Q2	2024 Q3	2024 Q4	2025 Q1	2023	2024	2025
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	2.6	2.3	2.0	2.5	2.1	5.4	2.3	1.8
Core HICP	3.7	3.1	2.2	1.9	2.3	1.8	4.9	2.4	1.6
UK									
Headline CPI	4.1	3.5	1.7	1.9	2.3	2.2	7.3	2.3	2.1
Core CPI	5.3	4.5	2.7	2.3	2.5	2.4	6.2	3.0	2.1
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	5.25	4.75	4.25	3.75	5.25	4.25	3.00

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Final GDP Q/Q% (Y/Y%)	Q4	**0.0 (0.1)**	*0.0 (0.1)*	-0.1 (0.0)	-
	Final employment Q/Q% (Y/Y%)	Q4	**0.3 (1.2)**	*0.3 (1.3)*	0.2 (1.3)	-
Germany	Industrial production M/M% (Y/Y%)	Jan	**1.0 (-5.5)**	0.6 (-4.8)	-1.6 (-3.0)	-2.0 (-3.5)
	PPI Y/Y%	Jan	**-4.4**	-6.6	-8.6	-5.1
France	Trade balance €bn	Jan	**-7.4**	-	-6.8	-6.4
Italy	PPI Y/Y%	Jan	**-14.0**	-	-20.5	-
Spain	Industrial production M/M% (Y/Y%)	Jan	**0.4 (-0.6)**	0.3 (-)	-0.3 (-0.2)	-0.6 (-1.4)

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg 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/ *Daiwa forecast/actual*	Previous
			Monday 11 March 2024			
Spain		08.00	Retail sales Y/Y%	Jan	3.0	3.1
			Tuesday 12 March 2024			
Germany		07.00	Final HICP (CPI) Y/Y%	Feb	*2.7 (2.5)*	3.1 (2.9)
UK		07.00	Unemployment claimant count rate % (change '000s)	Feb	-	4.0 (14.1)
		07.00	Average weekly earnings (excluding bonuses) 3M/Y%	Jan	5.7 (6.1)	5.8 (6.2)
		07.00	ILO unemployment rate 3M%	Jan	3.8	3.8
		07.00	Employment change 3M/3M 000s	Jan	10	72
		07.00	Payrolled employees M/M 000s	Feb	25	48
			Wednesday 13 March 2024			
Euro area		10.00	Industrial production M/M% (Y/Y%)	Jan	*-1.7 (-2.8)*	2.6 (1.2)
UK		07.00	GDP M/M% (3M/3M%)	Jan	0.1 (-0.1)	-0.1 (-0.2)
		07.00	Industrial production M/M% (Y/Y%)	Jan	0.0 (0.7)	0.6 (0.6)
		07.00	Manufacturing production M/M% (Y/Y%)	Jan	0.1 (2.0)	0.8 (2.3)
		07.00	Index of services M/M% (3M/3M%)	Jan	0.2 (0.0)	-0.1 (-0.2)
		07.00	Construction output M/M% (Y/Y%)	Jan	-0.1 (-)	-0.5 (-3.2)
		07.00	Trade (goods) balance £bn	Jan	-3.1 (-15.1)	-2.6 (-14.0)
			Thursday 14 March 2024			
Spain		08.00	Final HICP (CPI) Y/Y%	Feb	*2.9 (2.8)*	3.5 (3.4)
UK		00.01	RICS house price %	Feb	-10	-18
			Friday 15 March 2024			
France		07.45	Final HICP (CPI) Y/Y%	Feb	*3.1 (2.9)*	3.4 (3.1)
Italy		09.00	Final HICP (CPI) Y/Y%	Feb	*0.9 (0.8)*	0.9 (0.8)
		10.00	Retail sales M/M% (Y/Y%)	Jan	-	-0.1 (0.3)
		11.00	Trade balance €bn	Jan	-	5.6
UK		09.30	BoE inflation expectations, next 12M %	Feb	-	3.3

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		GMT	Event / Auction
			Monday 11 March 2024
UK		00.01	REC/KPMG report on jobs (February)
			Tuesday 12 March 2024
Germany		10.30	Auction: €4.5bn of 2.5% 2026 bonds
UK		10.00	Auction: €3.75bn of 4.625% 2034 bonds
			Wednesday 13 March 2024
Euro area		09.00	ECB's Lane scheduled to speak
Germany		10.30	Auction: €4.5bn of 2.2% 2034 bonds
Italy		10.00	Auction: 3Y and 7Y bonds
			Thursday 14 March 2024
Euro area		11.00	ECB's Schnabel scheduled to speak
		17.00	ECB's Hernandez de Cos scheduled to speak
		18.00	ECB's Guindos scheduled to speak
			Friday 15 March 2024
Euro area		09.00	ECB's Lane scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs