Europe Economic Research 17 January 2025

Euro wrap-up

Overview

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- Bunds were little changed as final euro area inflation data confirmed a rise in the headline HICP rate in December to a five-month high, but unchanged core inflation and the softest services inflation momentum for more than three years.
- Gilts outperformed as UK retail sales disappointed expectations in December to record the steepest quarterly decline in a year.
- The coming week will bring the flash January PMIs and consumer confidence surveys from the euro area and UK, alongside the UK's latest labour market report.

Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.220	-0.002
OBL 2½ 10/29	2.331	-0.009
DBR 2½ 02/35	2.525	-0.017
UKT 4⅛ 01/27	4.353	-0.017
UKT 4⅛ 07/29	4.374	-0.029
UKT 4¼ 07/34	4.650	-0.027

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

Euro area

Rise in inflation in December due to petrol prices as core inflation remained steady for 4th month

There were no surprises from today's final euro area inflation figures for December, which aligned with the flash estimates showing that headline HICP inflation rose 0.2ppt to a five-month high of 2.4%Y/Y. As suggested by the flash release, the detail confirmed that the energy component was the principal driver of the monthly rise. Indeed, with prices of auto fuel and household utilities up last month in contrast to the marked declines a year earlier, energy inflation jumped a chunky 2.1ppts to a five-month high (0.1%Y/Y). In contrast, inflation of food, alcohol and tobacco moderated for a second successive month (2.6%Y/Y). And inflation of non-energy industrial goods reversed the 0.1ppt increase in November to ease back to an extremely low 0.5%Y/Y. That was largely due to a downwards impulse from clothing, with inflation of that component at its softest since July 2022. But, in similar vein, services inflation reversed the slight drop in November to rise back to 4.0%Y/Y – bang in line with the average for 2024 – with a pickup in inflation of package holidays more than offsetting a moderation in the airfares and insurance components. So, core inflation was steady at 2.7%Y/Y for a fourth successive month.

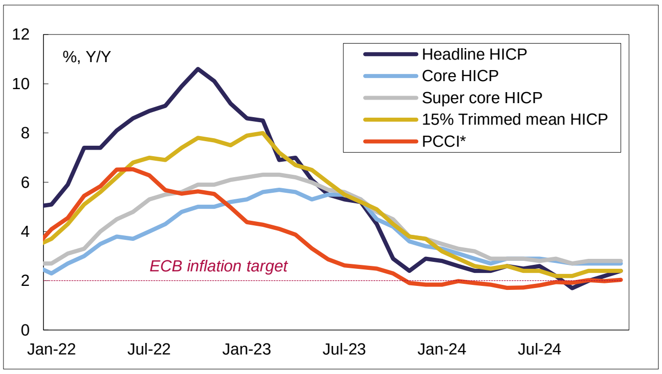
Core inflation momentum consistent with achieving ECB's 2% target

Other measures of underlying inflation published by the ECB today might support concerns of certain Governing Council hawks that the disinflationary trend might have paused towards the back end of last year. For example, the 15% trimmed mean rate moved sideways at 2.4%Y/Y, 0.2ppt above September's low, while the weighted median rate edged up 0.1ppt to 2.5%Y/Y. But the persistent and common component of inflation (PCCI), which is judged by ECB staff to have good leading qualities, remained at 2.0%Y/Y, consistent with an eventual return to target. Moreover, as flagged by Chief Economist Lane at the December Governing Council meeting, the sizeable gap between the PCCI for services (around 2½%) and headline services inflation pointed to the likelihood of a renewed downtrend in that key component over coming months. Certainly, recent monthly changes in services prices have been in line with their norms in the years between the euro crisis and pandemic and a touch below their respective long-run averages. And on a seasonally adjusted basis, services inflation momentum fell for the fifth successive month in December to a 3-year low of 2.6%3M/3M annualised. Furthermore, overall core momentum dropped below 2.0%3M/3M annualised for the first time since last January, suggesting consistency with the ECB's target if recent price-setting behaviour is maintained.

Inflation on track to return to target in Q2 despite recent jump in oil prices

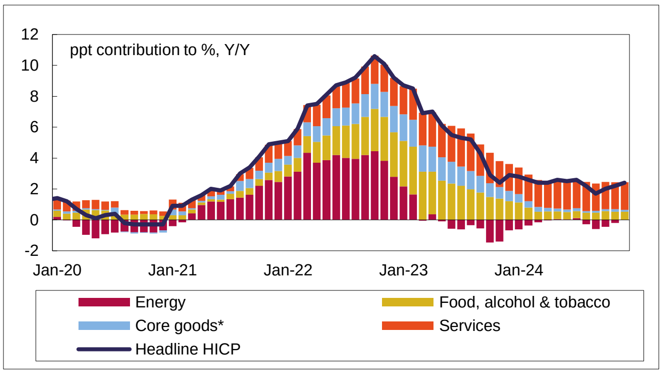
Given the loss of economic momentum during the second half of last year, we expect December to mark the peak in the recent inflation upturn. Admittedly, the jump in oil prices – with Brent crude up around 8% since the start of year – poses

Euro area: Selected measures of inflation



*Persistent and common component of inflation.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to HICP inflation



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

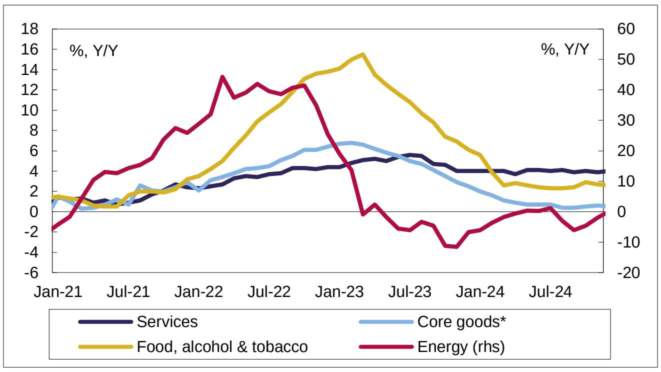
some further upside risks to the energy component over the near term. But strong increases in such prices early last year should limit any impact on headline inflation. Importantly, like the ECB, we expect a notable step down in services inflation over coming quarters as pricing powers remain constrained by lacklustre demand and wage growth continues to moderate. Indeed, we forecast services inflation to average only a little more than 2½%Y/Y this year and 2½%Y/Y next year too. So, with an ongoing absence of non-energy industrial goods price pressures, core inflation looks set to fall slightly below the 2% target in Q2 and average a little less than 2% in 2026 too, supporting our view that the ECB will cut the deposit rate to neutral territory in the first half of this year. And with the likelihood that inflation will undershoot the target persistently should the economy fail to pick up, we certainly do not rule out the deposit rate being cut below 2.00% into accommodative territory by the end of the year.

The week ahead in the euro area

In the coming week, the flash PMIs for January (Friday) will mark the highlight in the euro area. After euro area GDP growth in Q3 was flattered by temporary factors, the PMIs have recently flagged the increasing likelihood that economic activity was largely stagnant in Q4 (we expect growth of 0.1%Q/Q). While the removal of monetary policy restrictiveness and continued growth in real incomes should offer greater support to the PMIs in the coming months, for the time being, we expect the flash January estimates to remain very close to December's levels. So, we expect the headline euro area composite PMI (49.6 in December) to remain slightly below 50 for a third successive month, with the manufacturing index (45.1 previously) still consistent with significant contraction and services activity (51.6 previously) very sluggishness. The flash January PMIs will also underscore that weakness remains more acute in the largest two member states, where economic challenges are currently greatest and political uncertainty adds to the gloom. Political forces should also continue to weigh on other sentiment survey results due in the coming week, including the Commission's consumer confidence indicator (Thursday) – which hit an 8-month low in December – Germany's ZEW investor sentiment indices (Tuesday) and the INSEE business survey (also Thursday), despite the improved prospects of ending the French budget deadlock under new-Prime Minister Bayrou.

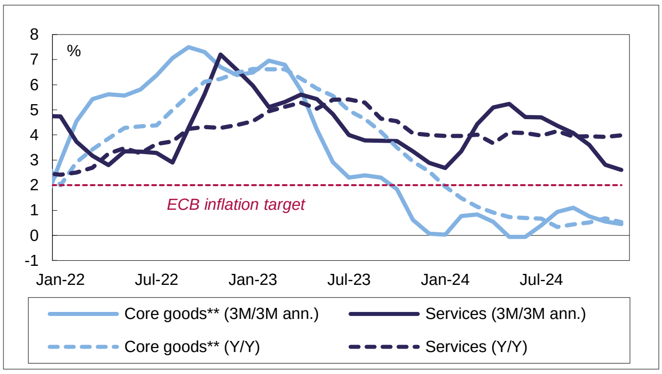
Meanwhile, among the coming week's hard data, euro area construction output (Monday) in November will be supported by firm growth in Germany (2.1%M/M) and an uptick in France (0.3%M/M). That raises the likelihood of a second successive month of growth after October registered its strongest monthly expansion in 20 months (1.0%M/M). With respect to inflation, German (also Monday) and Spanish (Friday) PPI figures for December are also due. Having the previous month recorded a first year-on-year increase in prices for 17 months, German PPI inflation will likely increase further in December, in part owing to energy-related base effects. Finally, beyond the data, ECB President Lagarde (and other Eurosystem Governors) are due to speak publicly in Davos at the World Economic Forum.

Euro area: Key inflation components



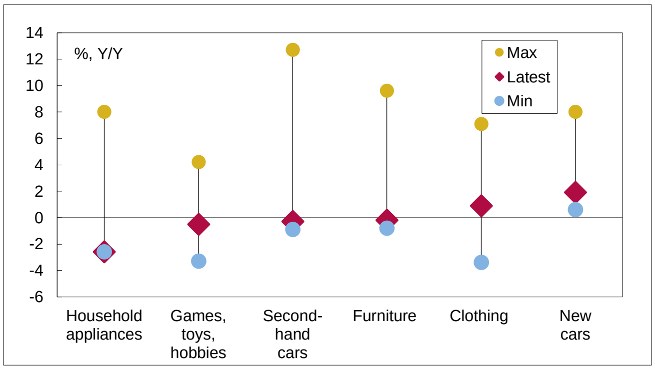
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core inflation momentum*



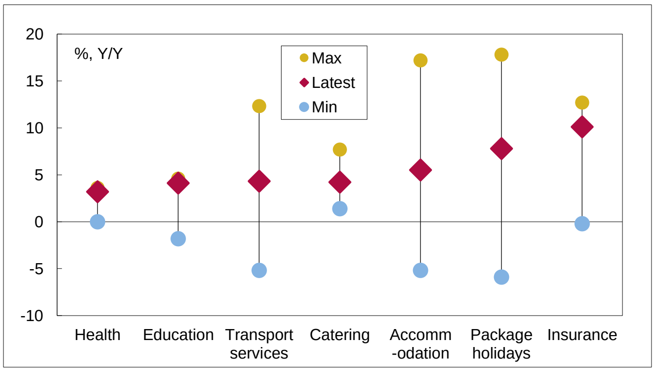
*Seasonally adjusted data. **Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected goods HICP components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected services HICP components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

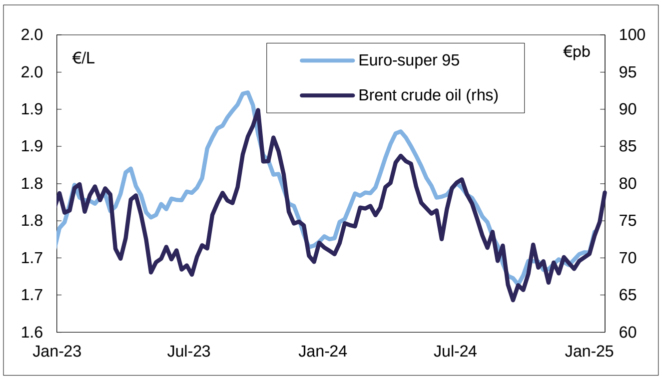
Retail sales disappoint in December amid bad weather and weak underlying demand

Following yesterday's soft November economic output figures, today's December retail sales numbers disappointed, raising the likelihood that UK GDP contracted in Q4 and underscoring that monetary policy remains excessively tight. In particular, contrasting expectations of an increase due to the inclusion of Black Friday in the December sample this year, retail sales fell for the third month out of the past four (-0.3%M/M). And with growth revised marginally lower in November (by 0.1ppt to 0.1%M/M), sales volumes fell to the lowest level in six months. The decline in the run up to the festive period was led by an unexpected drop in food store sales (-1.9%M/M) to the lowest since April 2013. And while this was partly offset by reports of stronger Christmas sales at department stores – and clothing in particular – this largely reflected payback for marked weakness over recent months.

Decline in Q4 retail sales the steepest since in four quarters

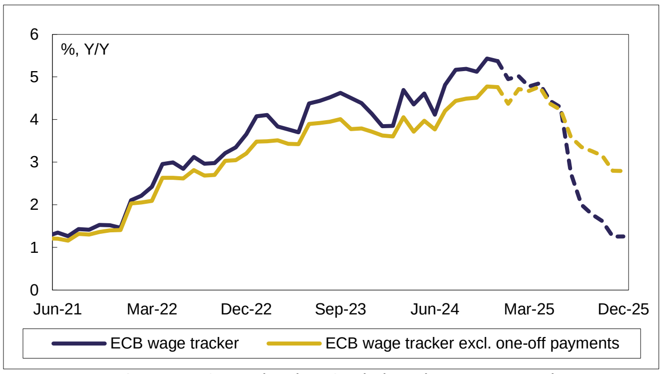
Overall, the Black Friday effect is judged to have been limited as many retailers started their discounting early, probably in recognition of weak demand. Certainly, sales of certain household goods – such as furniture and lighting – remained very

Euro area: Weekly petrol and oil prices



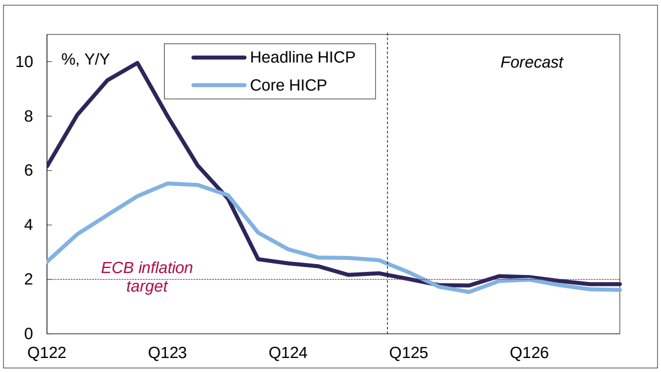
Source: Macrobond, Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: ECB wage tracker



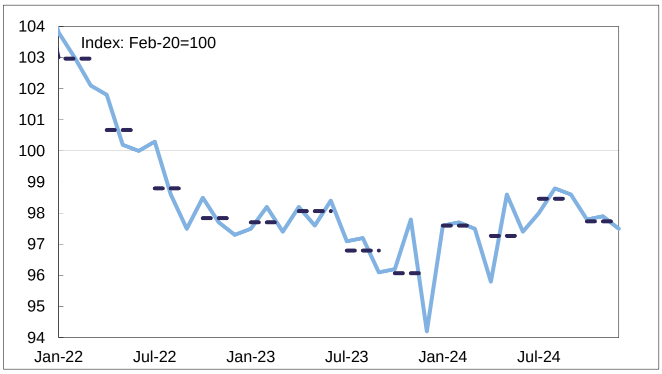
Source: ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Headline & core inflation projections



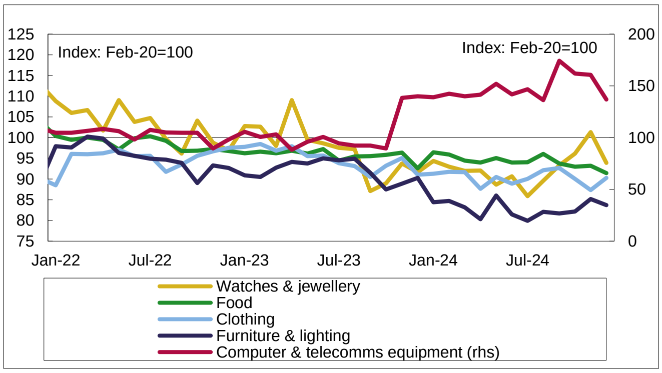
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales*



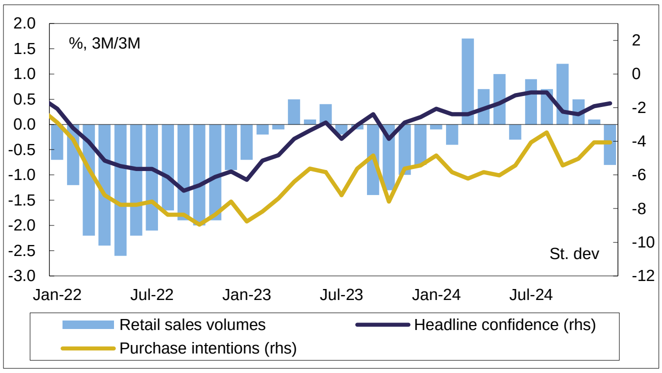
*Dashed dark blue lines represent quarterly average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales & consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

subdued as consumers remained downbeat about the economic outlook and income expectations. We suspect that bad weather played a role in hitting sales in early December too. Nevertheless, the weak December figure concludes a soft set of retail results for the past three months, as the impact of temporary factors that boosted sales in Q3 – such as the launch of a new iPhone and return-to-school spending – wore off. Indeed, retail sales were down a chunky 0.8%Q/Q in Q4, the biggest drop in four quarters. With other consumer-facing services and construction also likely disrupted to some extent by adverse weather conditions in December, we now think GDP contracted 0.1%Q/Q in Q4, well below the 0.3%Q/Q growth rate initially forecast by the BoE in the November Monetary Policy Report. These data therefore underscore the strong likelihood that the BoE will cut Bank Rate by 25bps in February. And with growth momentum likely to remain subdued at best well into 2025, we expect a further 25bps cut in each quarter from Q225 through to Q226.

The week ahead in the UK

The coming week will continue to bring top-tier UK data, with the latest labour market update (Tuesday) and January flash PMIs (Friday) the highlights. Since November, leading indicators, including the PMIs, DMP survey and REC report on jobs, have signalled that firms have revised their hiring expectations in advance of April's increases to employer NICs and the National Living Wage. As such, the risks to November's round of labour market data are skewed to the downside, with the Bloomberg consensus median forecasts currently suggesting an increase in the ILO unemployment rate of 0.1ppt to 4.4% and a further slowdown in employment growth to the softest rate in seven months or more. The BoE will watch most closely the data on pay, a key input into the MPC's assessment of the risks of persistence of services inflation. But, after private sector wages accelerated to 5.4%3M/Y in October (from 4.9%3M/Y), a further pickup is expected in November to point to the risks of an overshoot to the BoE's projection for year-end (5.1%3M/Y). Indeed, HMRC's leading indicator flagged a second consecutive monthly increase in PAYE median pay growth that month, of 0.1ppt to 6.7%3M/Y.

With November's monthly GDP series confirming that output on a three-month basis flatlined for a fourth consecutive month, and data increasingly suggestive that growth might have turned negative in the final quarter of the year, we do not expect the flash PMIs to provide evidence of a meaningful upturn at the start of the year. A modest fifth successive monthly decline in the headline composite PMI, from a stagnant 50.4 in December, might seem likely. While the absence of growth will present downside risks to the BoE's inflation outlook, policymakers will also pay attention to the services price PMIs, which have recently ticked higher for three consecutive months to around 3½pts above the pre-pandemic average. Elsewhere, political events and downbeat markets reporting may pose a downside risk to January's GfK consumer confidence indicator (Friday), while the CBI's industrial trends survey (Thursday) for January will provide a prelude to Friday's PMIs. The CBI's distributive trends survey (Friday) will also provide a first indicator for retail trade in January.

Daiwa economic forecasts

	2024		2025				2024	2025	2026
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.4	0.1	0.1	0.2	0.2	0.3	0.7	0.9	1.2
UK	0.0	-0.1	0.2	0.1	0.2	0.3	0.7	0.5	1.1
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.2	2.2	2.0	1.8	1.8	2.1	2.4	1.9	1.9
Core HICP	2.8	2.7	2.3	1.8	1.6	2.0	2.8	1.9	1.8
UK									
Headline CPI	2.0	2.5	2.5	2.6	2.7	2.5	2.5	2.6	2.0
Core CPI	3.3	3.3	3.3	2.6	2.3	2.2	3.7	2.6	1.8
Monetary policy, %									
ECB									
Deposit Rate	3.50	3.00	2.50	2.25	2.00	2.00	3.00	2.00	2.00
Refi Rate	3.65	3.15	2.65	2.40	2.15	2.15	3.15	2.15	2.15
BoE									
Bank Rate	5.00	4.75	4.50	4.25	4.00	3.75	4.75	3.75	3.25

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

The coming week's data calendar

The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
		Monday 20 January 2025			
Euro area	10.00	Construction output M/M% (Y/Y%)	Nov	-	1.0 (0.2)
Germany	07.00	PPI Y/Y%	Dec	1.0	0.1
UK	00.01	Rightmove house prices M/M% (Y/Y%)	Jan	-	-1.7 (1.4)
		Tuesday 21 January 2025			
Euro area	05.00	New car registrations Y/Y%	Dec	-	-3.4
Germany	10.00	ZEW investor survey – current situation (expectations) balance %	Jan	-93.0 (15.2)	-93.1 (15.7)
France	-	Retail sales Y/Y%	Dec	-	-0.1
UK	07.00	Average wages (excluding bonuses) 3M/Y%	Nov	5.6 (5.5)	5.2 (5.2)
	07.00	Unemployment rate 3M%	Nov	4.4	4.3
	07.00	Employment 3M/3M change 000s	Nov	33	173
	07.00	Payrolled employees M/M change 000s	Dec	-15	-35
	07.00	Claimant count rate % (change 000s)	Dec	-	4.6 (0.3)
		Wednesday 22 January 2025			
UK	07.00	Public sector net borrowing £bn	Dec	-	11.2
		Thursday 23 January 2025			
Euro area	15.00	Preliminary consumer confidence indicator	Jan	-14.0	-14.5
France	07.45	INSEE business (manufacturing) confidence indicator	Jan	94 (96)	94 (97)
UK	11.00	CBI industrial trends survey – total orders (selling prices) balance %	Jan	-35 (-)	-40 (23)
		Friday 24 January 2025			
Euro area	09.00	Preliminary manufacturing (services) PMI	Jan	45.5 (51.5)	45.1 (51.6)
	09.00	Preliminary composite PMI	Jan	49.7	49.6
Germany	08.30	Preliminary manufacturing (services) PMI	Jan	42.9 (51.0)	42.5 (51.2)
	08.30	Preliminary composite PMI	Jan	48.3	48.0
France	08.15	Preliminary manufacturing (services) PMI	Jan	42.6 (49.5)	41.9 (49.3)
	08.15	Preliminary composite PMI	Jan	47.9	47.5
Spain	08.00	PPI Y/Y%	Dec	-	0.9
UK	00.01	GfK consumer confidence indicator	Jan	-18	-17
	09.30	Preliminary manufacturing (services) PMI	Jan	47.0 (50.7)	47.0 (51.1)
	09.30	Preliminary composite PMI	Jan	50.0	50.4
	11.00	CBI distributive trades survey – reported sales volumes %	Jan	-	-15

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
		Monday 20 January 2025
		- Nothing scheduled -
		Tuesday 21 January 2025
Germany	10.30	Auction: to sell €1bn of 2.1% 2029 green bonds
Germany	10.30	Auction: to sell €1bn of 2.3% 2033 green bonds
		Wednesday 22 January 2025
Euro area	17.15	ECB President Lagarde to participate in panel on at the World Economic Forum, Davos.
Germany	10.30	Auction: to sell €1.5bn of 2.6% 2041 bonds
	10.30	Auction: to sell €500mn of 2.5% 2044 bonds
		Thursday 23 January 2025
France	09.50	Auction: to sell up to €13bn of 2.5% 2027, 5.5% 2029 and 2.75% 2030 bonds
	10.50	Auction: to sell up to €2.25bn of 0.6% 2034, 0.55% 2039, 1.8% 2040 and 0.1% 2053 inflation-linked bonds
UK	10.00	Auction: to sell £4.25bn of 4.375% 2028 bonds
		Friday 24 January 2025
Euro area	10.00	ECB President Lagarde to participate in panel on the Global Economic Outlook at the World Economic Forum, Davos.

Source: Bloomberg 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 headline (core) HICP Y/Y%	Dec	**2.4 (2.7)**	*2.4 (2.7)*	2.2 (2.7)	-
	Current account balance €bn	Nov	**27.0**	-	25.8	30.2
UK	Retail sales – including auto fuel M/M% (Y/Y%)	Dec	**-0.3 (3.6)**	0.4 (4.9)	0.2 (0.5)	0.1 (0.0)
	Retail sales – excluding auto fuel M/M% (Y/Y%)	Dec	**-0.6 (2.9)**	0.3 (4.0)	0.1 (0.3)	0.1 (-0.5)

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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