Daiwa Capital Markets

Euro wrap-up

Overview

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- While a survey suggested that German consumers are increasingly gloomy about the outlook, Bunds ended the day little changed lending to euro area businesses jumped in December and Spanish GDP beat expectations in Q4.
- Gilts were also little changed on a quiet day for UK economic news.
- On Thursday the ECB seems bound to cut the deposit rate by 25bps to 2.75%, while figures for Q4 GDP from the euro area, Germany, France and Italy are due alongside the flash estimate of Spanish inflation and the Commission's economic sentiment survey for January.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.256	+0.002
OBL 2.4 04/30	2.370	+0.009
DBR 2½ 02/35	2.570	+0.009
UKT 4⅛ 01/27	4.307	+0.007
UKT 4⅛ 07/29	4.305	0.000
UKT 4¼ 07/34	4.606	-0.007

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

Euro area

Spanish GDP beats expectations amid strong domestic demand

Ahead of tomorrow's euro area Q4 GDP data, today's Spanish figures again beat expectations. In particular, despite the extremely damaging Valencia flash floods in late October, economic output increased a robust 0.8%Q/Q for a third consecutive quarter. This left the level of Spanish GDP up 3.5%Y/Y and an impressive 7.6% above the pre-pandemic benchmark in Q419. Admittedly, to two decimal places growth slowed slightly, by 0.05ppt to 0.75%Q/Q, the softest for four quarters. This partly reflected a marked slowdown in government consumption last quarter (down 2.1ppts to 0.4%Q/Q), which nevertheless left it some 20% higher than in Q419. While household consumption growth also moderated slightly, it was still robust at 1.0%Q/Q, adding ½ppt to GDP growth. Moreover, there was a notable jump in fixed investment, by 3.4%Q/Q to contribute 0.6ppt to growth, with a surge in spending on machinery and equipment (7.6%Q/Q) perhaps in part relating to replacement and reconstruction after the floods. Overall, final domestic demand contributed an impressive 1.2ppts to GDP growth in Q4, the most since Q123. But given the ongoing strength in domestic demand, imports rose the most in five quarters. And with a decline in goods shipments offsetting another solid contribution from services exports, net trade provided a drag for a second successive quarter, subtracting 0.4ppt from GDP growth.

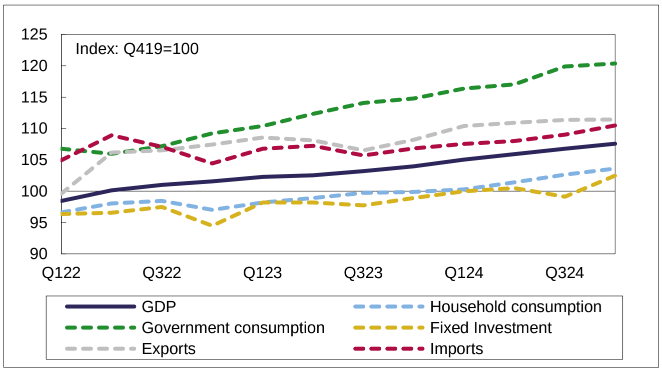
Euro area growth likely slowed sharply in Q4, with Ireland, Germany and France a drag

Once again in Q4, Spain will be the outperformer of the euro area's large member states. Certainly, the initial full-year GDP estimate suggested that the German economy contracted slightly (-0.1%Q/Q). And the French economy looks set to have flatlined at best after growth in Q3 was flattered by the summer Olympics. While data published today reported positive growth in Belgium (albeit down 0.1ppt to 0.2%Q/Q), yesterday's Irish figures suggested a notable contraction (-1.3%Q/Q following growth of 3.5%Q/Q in Q3). While Portugal and Greece will likely provide some support, overall, we maintain our forecast that euro area GDP growth slowed from 0.4%Q/Q to a four-quarter low of 0.1%Q/Q in Q4.

German consumers increasingly gloomy about outlook

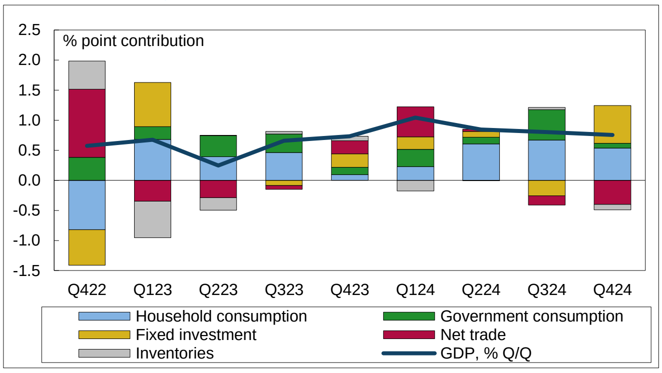
While the Commission's flash indicator of euro area consumer confidence posted a modest improvement in January, it was consistent with little more than stabilisation in conditions at the start of the year rather than a rebound in consumption. Certainly, today's GfK survey suggested that consumers were increasingly gloomy about the outlook, with the headline sentiment index – presented as a forecast for February – declining 1pt to -22.4, close to the bottom of the range of the past nine months and well below the long-run average. With German GDP having contracted for a second successive year in 2024, inflation having recently ticked up on higher energy prices, and concerns of unemployment rising, German households

Spain: GDP level & expenditure components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Spain: GDP growth & expenditure contributions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

were unsurprisingly more gloomy about the economic outlook at the start of the year. Indeed, the respective index was the second-weakest since March. And given greater pessimism about prospects for income over the coming twelve months, households again reported a preference to save rather than to spend, with the survey's index for purchase intentions dropping to a five-month low in January. So, while retail sales – up some 1% on average in October and November compared with the Q3 – appear to have provided some support to German GDP in Q4, today's survey suggests that discretionary spending weakened at the start of the year.

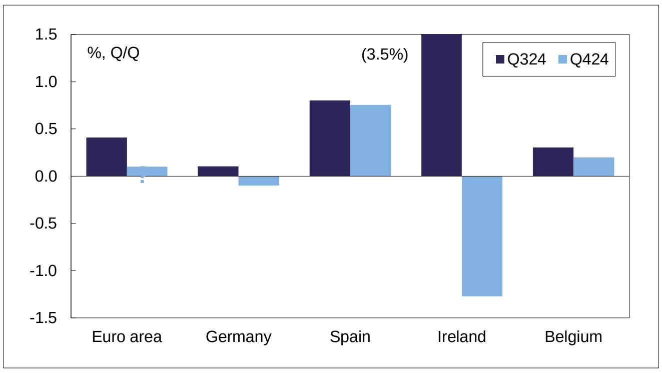
Italian consumer and business sentiment points to a modest pickup in GDP in early 2025

Contrasting the increased pessimism in Germany, but tallying with yesterday's French survey, today's ISTAT survey suggested that Italian consumers were more upbeat in January. In particular, the headline sentiment index jumped to a four-month high of 98.2 to remain comfortably above the long-run average. With households more optimistic about the economic outlook, income expectations and jobs, the survey's index for purchase intentions rose close to the top of the range of the past three years, broadly in line with the long-run average. So, household consumption might well provide modest support to Italian GDP growth this quarter. Today's Italian business survey was somewhat more encouraging too. Having slumped to a 3½-year low in November, the composite sentiment index rose to a nine-month high in January (95.7), similarly comfortably above the long-run average and arguably at a level consistent with modestly positive GDP growth. While the services and retail sentiment indices edged slightly lower in January, both remained close to the top of the range of the past 18 months. And constructors were notably more upbeat as order books were judged to be the best in ten months. Indeed, firms in the sector reported that labour shortages were the main constraint on activity. But while the manufacturing sentiment index rose to a five-month high in January, it remained close to the bottom of the post-pandemic range and some 4% below the long-run average, suggesting that industrial production will likely continue to offer little support to GDP growth.

Notable pick up in business lending at end-24 points to firmer capex ahead

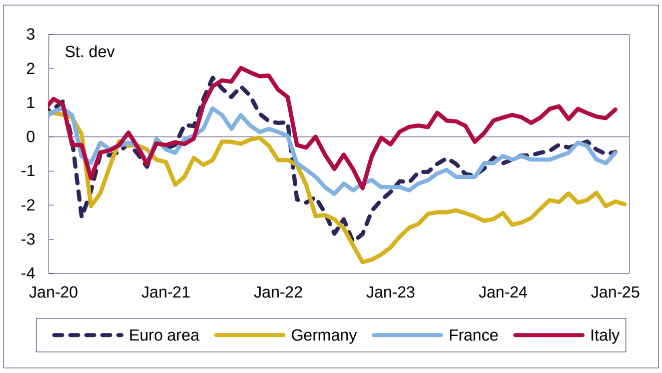
This week's ECB surveys suggested that credit conditions on business loans tightened in Q4, and that demand for such loans remained very subdued. Nevertheless, today's monetary data reported a welcome pick up in lending to firms at the end of last year to suggest that the credit cycle is gradually turning for the better to the benefit of economic growth. Indeed, the monthly net flow of loans to businesses, adjusted for sales and securitisations, of €39bn in December was the strongest since August 2022. And that took the cumulative net flow over Q4 as a whole to €46bn, similarly the best in nine quarters. Compared to a year earlier, growth in business loans picked up 0.5ppt to a 17-month high of 1.5%, still however negative in real terms. Encouragingly, the increase in lending was concentrated in medium-term (i.e. with a maturity of between 1-5 years) and long-term loans (i.e. those over 5 years), which are likely to be more closely correlated with business fixed

Euro area: GDP growth in selected member states*



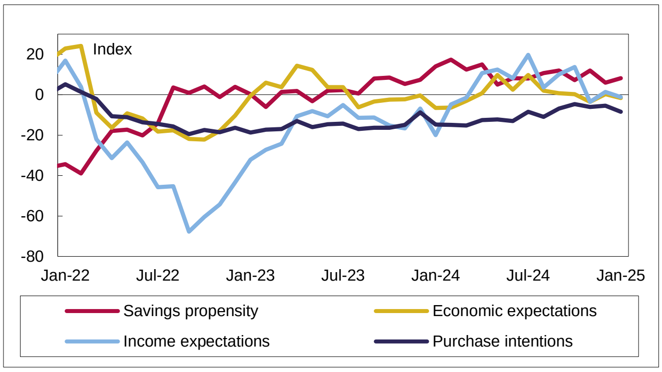
*Q424 figures from member states based on flash estimates.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence



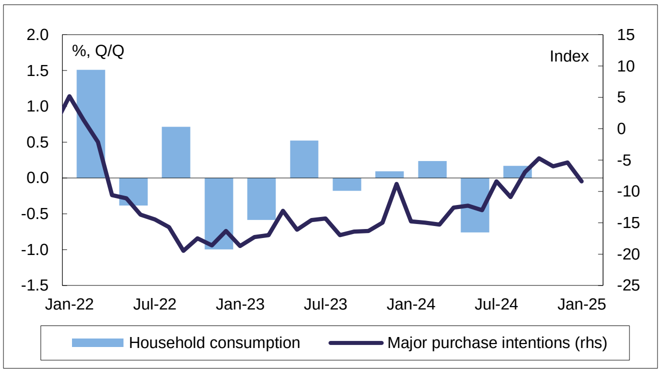
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumer confidence indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumption & purchase intentions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

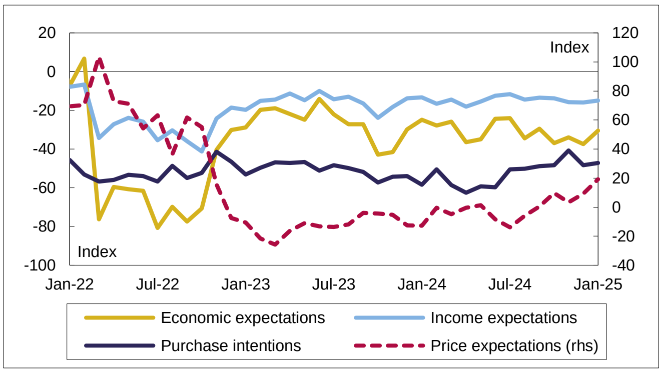
investments. The pickup in lending to households in December was less emphatic than that for firms. Nevertheless, the net flow in Q4 (€36bn) was the best in two years. Growth in consumer credit was also firm, rising in December to a 27-month high of 3.5%Y/Y. And while loans for house purchase were merely up at a three-month high of 0.6%Y/Y, the ECB's Bank Lending Survey suggested that category will see the strongest pace of expansion of coming months as the residential property market turns for the better.

The day ahead in the euro area

Attention tomorrow will be firmly on the ECB's policy announcement, although a further rate cut seems wholly inevitable. Certainly, the adjustment to the Governing Council's forward guidance in December, which dropped the commitment to keep policy "restrictive for as long as necessary", signalled a desire to shift policy to a neutral stance. And past ECB studies suggest that means the deposit rate should be cut in due course somewhere in the range of 1.75-2.50%. Since the December meeting, measures of underlying inflation have been consistent with a return to the 2% target. Euro area GDP growth in Q4 likely slowed more than the ECB projected last month and the flash January PMIs point to an ongoing absence of economic growth. So, while energy prices have picked up, there appear increasing risks of a potential inflation target undershoot over the medium term. As such, we expect the Governing Council to cut the deposit rate again by 25bps to 2.75%. And while the statement will continue to note that policy decisions will remain data dependent, we expect the updated forward guidance to signal its readiness to cut rates again to a neutral stance over the near term. But while President Lagarde will restate that disinflation remains on track and inflation should be back on target by mid-year, we don't expect her to flag the possibility of an eventual shift into accommodative territory.

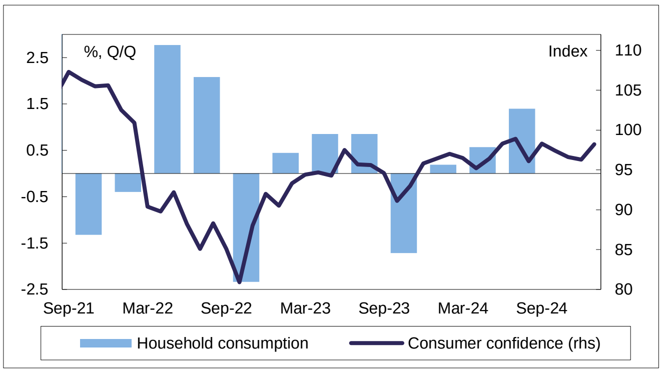
The first estimates of Q4 GDP from the euro area and member states will illustrate slowing economic momentum in the final quarter of last year. On balance, we still expect euro area GDP growth of just 0.1%Q/Q in Q4 down from 0.4%Q/Q in Q3, which was boosted by special factors. Having narrowly avoided a quarter of negative growth in Q3, we expect German GDP to have contracted 0.1%Q/Q in Q4 to maintain a sideways trend since the pandemic. A similar contraction is also possible in France, where the Olympic Games previously inflated quarterly GDP (0.4%Q/Q in Q3), while we see only marginal growth in Italy (0.1%Q/Q). Meanwhile, the Commission's comprehensive economic sentiment surveys will provide a cross-check to the slight improvement in the flash PMIs – national surveys would suggest a bounce back in the headline ESI from December's 15-month low (93.7) albeit still remain firmly below the long-run average. Thursday will also bring the first of the flash January inflation estimates from Spain, Belgium and Austria. While the Spanish headline HICP rate is expected to remain steady at 2.8%Y/Y, we see risks skewed to the upside due to the recent rise in petrol and heating gas oil prices. Finally, the euro area unemployment rate is expected to be unchanged at a series-low of 6.3% for a fourth consecutive month.

Italy: Consumer confidence indices



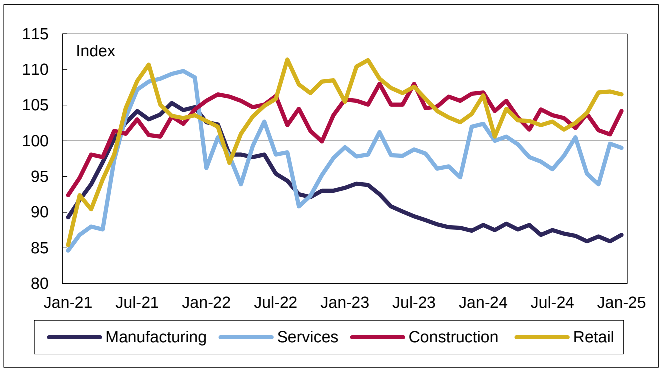
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: Consumption & consumer confidence



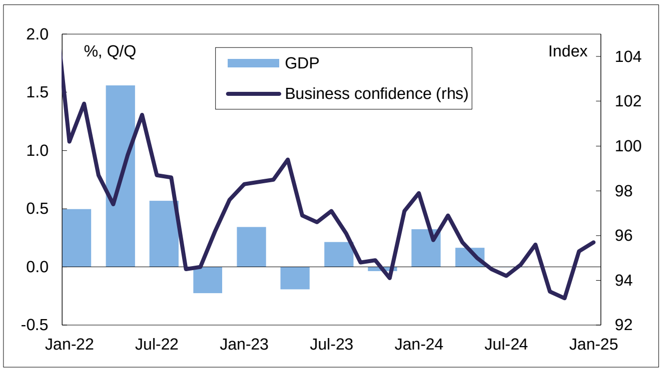
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: Business sentiment indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: GDP growth & business sentiment

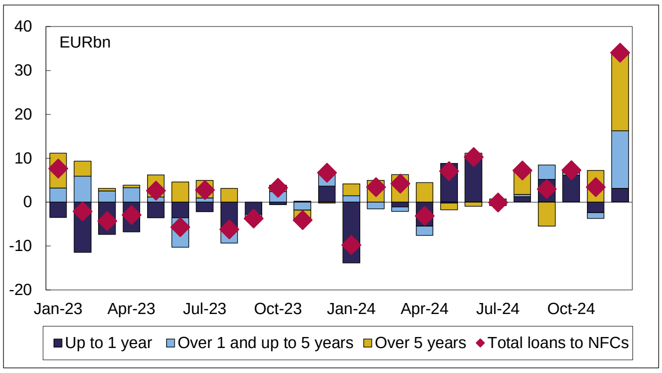


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

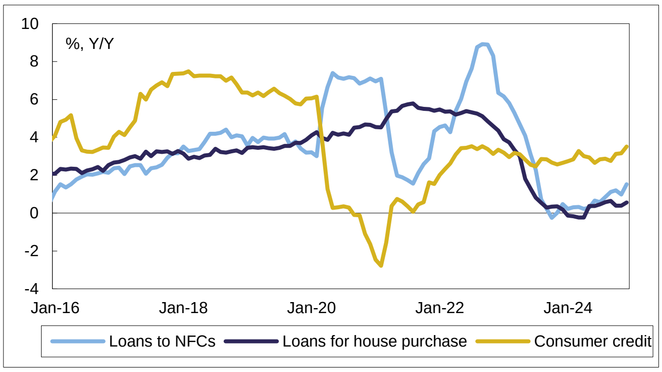
After a quiet day for UK economic data, tomorrow will bring the BoE's bank lending report for December. Since the MPC set off on a gradual loosening cycle in the summer, the report has pointed towards a steady recovery in mortgage lending, which reached a 25-month high in October (£3.4bn), while approvals (68.1k) similarly surpassed the long-run average that month. But November's report subsequently showed net mortgage lending slipping back to a 6-month low (£2.5bn). With the RICS survey signalling a further slowdown in new buyer enquiries in December and interest rates having risen over the month, we might expect to see minimal improvements in lending last month.

Euro area: Net flow of new loans to NFCs*



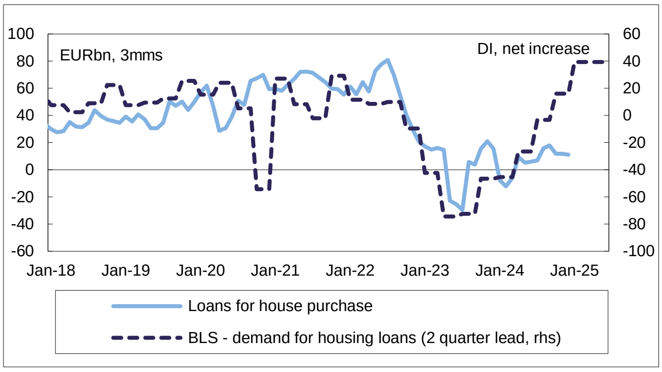
*Non-financial corporations.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Growth in the stock of loans by category



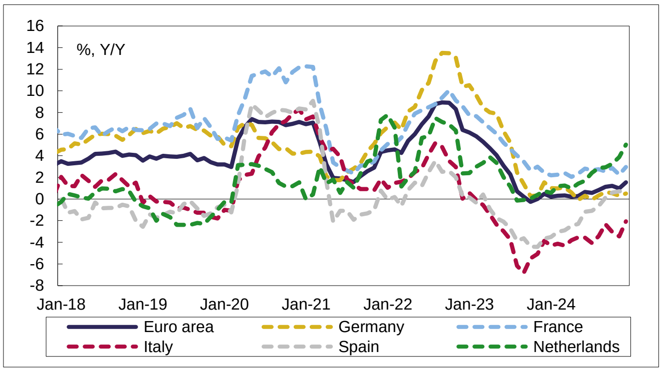
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Loans for house purchase



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Growth in the stock of loans to NFCs



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
Euro area		M3 money supply Y/Y%	Dec	**3.5**	3.9	3.8	-
Germany		GfK consumer confidence indicator	Feb	**-22.4**	-	-21.3	-21.4
Italy		ISTAT consumer confidence indicator	Jan	**98.2**	96.5	96.3	-
		ISTAT business (manufacturing) confidence indicator	Jan	**95.7 (86.8)**	- (85.8)	95.3 (85.8)	- (85.9)
Spain		GDP – first estimate Q/Q% (Y/Y%)	Q4	**0.8 (3.5)**	*0.6 (3.1)*	0.8 (3.3)	- (3.5)

Auctions

Country		Auction
Germany		sold €3.44bn of 2.5% 2035 bonds at an average yield of 2.54%
UK		sold £3bn of 0.875% 2033 green bonds at an average yield of 4.473%

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 – first estimate Q/Q% (Y/Y%)	Q4	*0.1 (1.0)*	0.4 (0.9)
		10.00	Unemployment rate %	Dec	6.3	6.3
		10.00	Commission economic sentiment indicator	Jan	94.1	93.7
		10.00	Commission industrial (services) confidence indicator	Jan	-13.8 (6.1)	-14.1 (5.9)
		10.00	Final Commission consumer confidence indicator	Jan	*-14.2*	-14.5
		13.15	ECB Deposit Rate (Refi Rate) %	Jan	*2.75 (2.90)*	3.00 (3.15)
Germany		07.00	GDP – first estimate Q/Q% (Y/Y%)	Q4	*-0.1 (-0.1)*	0.1 (-0.3)
France		06.30	GDP – first estimate Q/Q% (Y/Y%)	Q4	*-0.1 (0.7)*	0.4 (1.2)
		06.30	Consumer spending M/M% (Y/Y%)	Dec	0.1 (0.2)	0.3 (0.3)
Italy		09.00	GDP – first estimate Q/Q% (Y/Y%)	Q4	*0.1 (0.6)*	0.0 (0.4)
Spain		08.00	Preliminary HICP (CPI) Y/Y%	Jan	2.8 (2.9)	2.8 (2.8)
UK		09.30	Net consumer credit £bn (Y/Y%)	Dec	1.0 (-)	0.9 (6.6)
		09.30	Net mortgage lending £bn (mortgage approvals 000s)	Dec	2.6 (65.0)	2.5 (65.7)

Auctions and events

Country		GMT	Event
Euro area		13.15	ECB monetary policy announcement
		13.45	ECB President Lagarde holds post Governing Council meeting press conference

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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