Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds made significant gains as the ECB cut rates by 25bps and signalled at least a couple of further cuts to come, while euro area GDP failed to grow and German GDP contracted more than initially thought in Q4.
- Gilts also rallied despite the strongest month of UK mortgage lending in more than two years and a further pickup in mortgage approvals.
- Friday will bring the flash estimates of German and French consumer price inflation in January and German retail sales in December.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.185	-0.072
OBL 2.4 04/30	2.308	-0.072
DBR 2½ 02/35	2.515	-0.067
UKT 4⅛ 01/27	4.244	-0.075
UKT 4⅛ 07/29	4.247	-0.071
UKT 4¼ 07/34	4.559	-0.061

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

Euro area

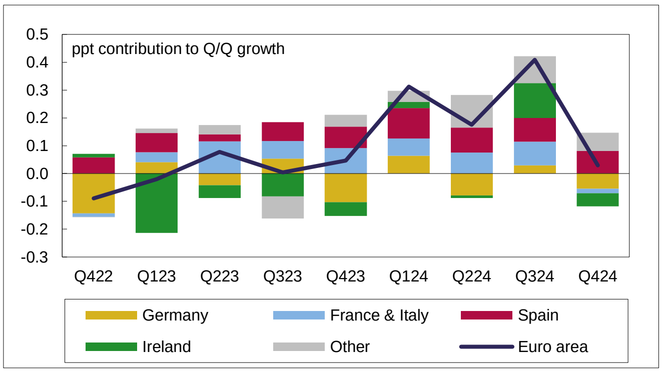
ECB cuts rates by 25bps again with further cuts to come before neutral is reached

As expected, the ECB eased policy for the fourth successive meeting and fifth time this cycle. The cut of 25bps was unanimously agreed by the Governing Council and took the key deposit rate to 2.75%, the lowest level since March 2023 and 125bps below last year's peak. In her press conference, President Lagarde insisted that a larger 50bps rate cut had not been discussed. Predictably too, the Governing Council left unchanged its forward guidance, restating that it will continue to follow a data-dependent and meeting-by-meeting approach to setting policy and insisting that it will not pre-commit to a particular rate path. But the policy statement remained consistent with expectations of further easing to come. It restated that the disinflation process remains well on track, with inflation developing broadly in line with the ECB's projections and judged to return to the 2% target this year. While it still expects demand steadily to pick up, the Governing Council recognised that the economy faces headwinds. And despite the interest rate cuts implemented so far, it was explicit that monetary policy remains restrictive. So, Lagarde signalled again the intention of the Governing Council to ease policy further to a neutral setting. While ECB studies previously suggested that would imply a deposit rate somewhere between 1.75-2.50%, Lagarde suggested in Davos that the upper end of that range was now likely to be 2.25%, and a staff report elaborating on that view will be published on 7 February. Today she also did not rule out an eventual shift to accommodative territory if the economic data eventually merited it. So, we should expect at least a couple of further rate cuts this cycle. And while we maintain our baseline expectation of a terminal rate of 2.0%, there are non-negligible risks to the downside of that estimate too.

Euro area GDP stagnates in Q4 as Germany & France contract while Italy moves sideways

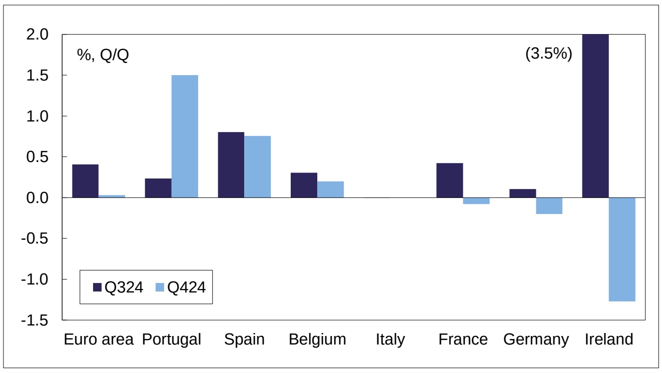
The case for ongoing ECB rate cuts was underscored by today's economic data. Most notably, following the increase of 0.4%Q/Q in Q3, euro area GDP was unchanged in Q4 to mark the first quarter without growth since Q423. GDP was still up 0.9%Y/Y, allowing Lagarde to insist that the economy continues to recover, albeit below its potential rate. But the flat quarter-on-quarter reading was consistent with survey indicators which signalled a marked loss of momentum towards year-end. It was also a touch softer than the consensus forecast of growth of 0.1%Q/Q, and 0.2ppt weaker than the ECB's projection published last month. And economic activity was particularly weak in the three largest member states. The contraction in German GDP was steeper than initially signalled by Destatis at 0.2%Q/Q to be down 0.2%Y/Y and still slightly below its level in Q419. Elsewhere, French economic output declined 0.1%Q/Q, marking the first drop in seven quarters and leaving the annual rate (0.7%Y/Y) at is weakest since 2020. Italian GDP was unchanged for a second successive quarter to be up just 0.5%Y/Y. Among the medium-sized member states, Austria continued to stagnate (0.0%Q/Q), while we learned yesterday of the drop in Irish GDP (-1.3%Q/Q) and tepid Belgian growth (0.2%Q/Q). So, euro area GDP would have contracted in Q4 had

Euro area: Contributions to GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth in selected member state



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

it not been for continued strong growth in Iberia. Indeed, while Spanish GDP grew 0.8%Q/Q for a fourth successive quarter, Portuguese GDP accelerated 1.5%Q/Q, the fastest since Q122.

French weakness partly due to post-Olympics fatigue

No expenditure breakdown was published with today's flash euro area GDP figure. But the information from the member states strongly suggests that positive growth in household and government consumption was offset by a negative contribution from net trade. That was true of the Spanish data published yesterday. While it provided no figures, Destatis also reported that German consumption grew but exports significantly weakened. And today's data from France – the only member state to publish a detailed expenditure breakdown today – showed that household and government consumption rose 0.4%Q/Q. In addition, net trade subtracted from French GDP growth as services exports fell the most in seven quarters, in part due to a reversal of the boost to exports of ICT services in Q3 from the sale of Olympic broadcasting rights. French fixed investment was also soft (-0.1%Q/Q), falling for a fifth successive quarter in Q4.

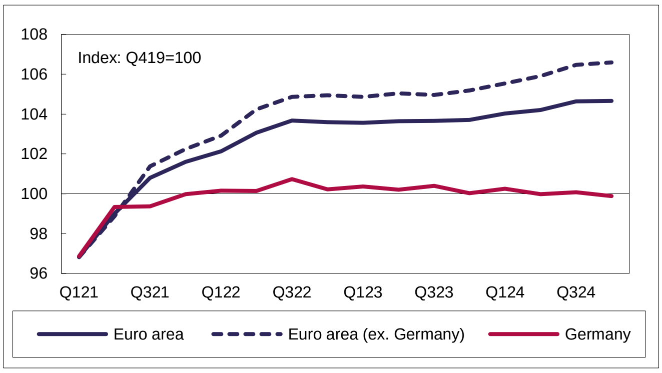
Consumption growth reflects rising real incomes as labour market remains resilient

The rise in euro area private consumption in Q4 appears to have been broadly in line with the ECB's projection of 0.4%Q/Q for that component, and so explains why it continues to expect GDP growth to regain traction over coming quarters. Its strength in part reflects the ongoing recovery in per capita real disposable income, which grew in Q3 for the seventh successive quarter to be up 2.2%Y/Y, the most since Q321. The labour market has also been surprisingly resilient, with the unemployment rate edging up just 0.1ppt at year-end from a downwardly revised series low of 6.2% in November. However, while the jobless rates in fast-growing Spain (10.6%), Portugal (6.4%) and Greece (9.4%) continued to decline, and the German ILO rate was steady (3.4%), French unemployment continued to rise to a three-year high (7.8%). According to the January Commission survey, firms in manufacturing and retail, particularly in Germany and France, are still looking to cut headcount. In addition, consumer confidence continues to be weighed by fears of unemployment, which remained close to December's two-year high. With no shortage of political and geopolitical uncertainty, household savings intentions have risen to a new series high. And major purchase intentions for the coming twelve months dropped in January to an eight-month low.

ESIs signal modest improvement in January, but ongoing weakness in Germany and France

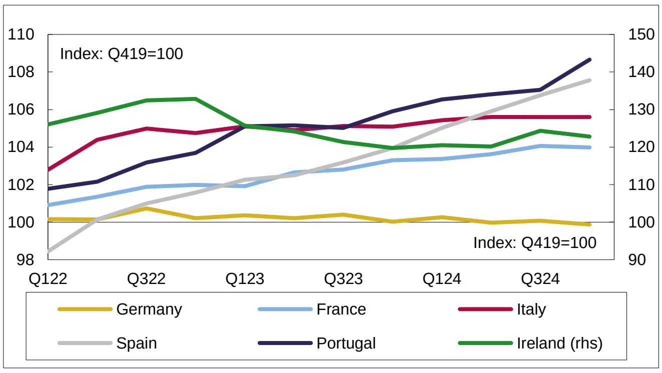
Like last week's flash PMIs, the Commission's Economic Sentiment Indicators (ESIs) pointed to modest improvement at the start of 2025. In particular, the headline ESI for the euro area rose 1.5pts in January to 95.3. Admittedly, this failed to fully reverse the drop in December when it reached a 15-month low, and left it still almost 5% below the long-run average and still

Euro area & Germany: GDP level



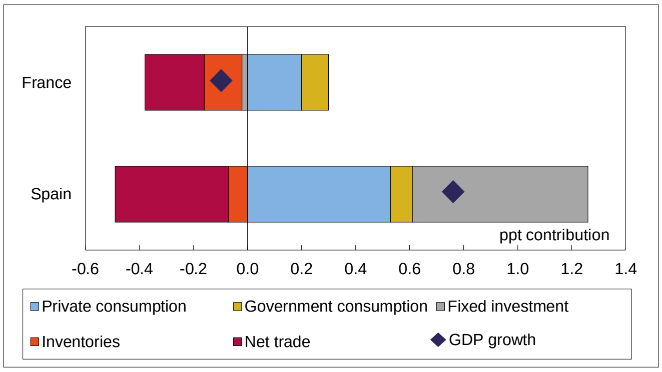
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: GDP level



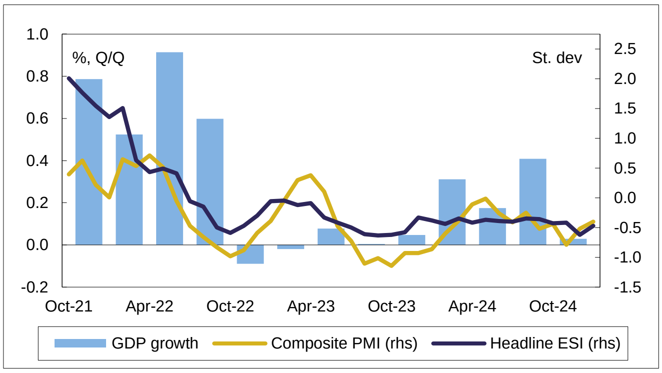
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France & Spain: Q4 GDP growth contributions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & survey indices



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

consistent with an absence of meaningful economic momentum. While the improvement was broad-based across the member states, the survey suggested ongoing significant weakness in Germany, with the respective ESI still some 12% below the long-run average. The French ESI was also consistent with sub-trend growth. And while Italy's ESI remained broadly in line with the long-run average, today's results suggest that economic growth in Q1 will remain firmest in Spain, Portugal and Greece. Sentiment in services rose to an eight-month high as demand was judged to be the strongest in a year. And construction firms were the least downbeat in more than a year, seemingly benefitting from the recent pickup in housing market. But despite an increase, the headline industry index remained close to the bottom of the range since the pandemic, suggesting that production will likely remain a non-negligible drag on euro area output over the near term. Certainly, in the face of ongoing uncertainties surrounding US trade policies, new orders – both domestic and overseas – were judged to be among the weakest since the global financial crisis, with the recent decline perhaps unsurprisingly most striking in Germany.

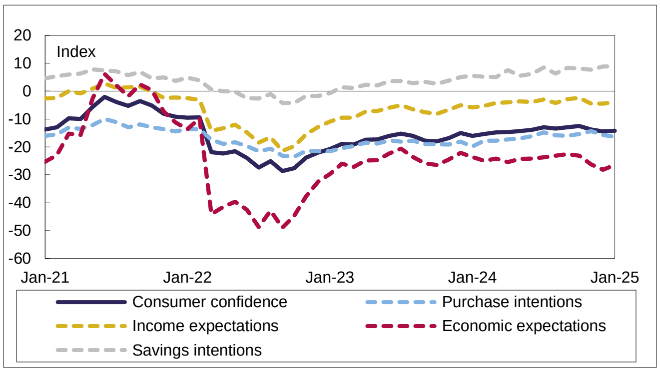
Selling-price intentions rise on higher oil prices, but consumer price expectations well anchored

Despite subdued economic activity and downbeat confidence, the price-related indices in today's Commission survey provided a reminder that some risks of inflation persistence remain, feeding the resistance of the Governing Council hawks to any near-term policy shift into accommodative territory. Indeed, firms' selling-price intentions for the coming three months rose across the sectors in January to multi-month highs. In part, that likely reflects recent increases in prices of oil, gas and electricity. Most notably, services selling-price expectations rose to an eleven-month high, a touch above the average in 2024 and well above the long-run trend, albeit still well down from the peak in 2022. And manufacturers' selling-price intentions rose back above the long-run average for the first time since April 2023. But declining orders, intense competition, and economic uncertainty will continue to restrain firms' pricing power, particularly in the industrial sector. And after consumer inflation expectations for the coming twelve months rose to a two-year high in December, the respective index edged slightly lower in January to be broadly in line with the long-run average and therefore seemingly consistent with the return of inflation to the ECB's 2% target January. Certainly, we expect the further rise in euro area HICP inflation at the start of the year (see below) to prove temporary, with a return to target likely by mid-year.

The day ahead in the euro area

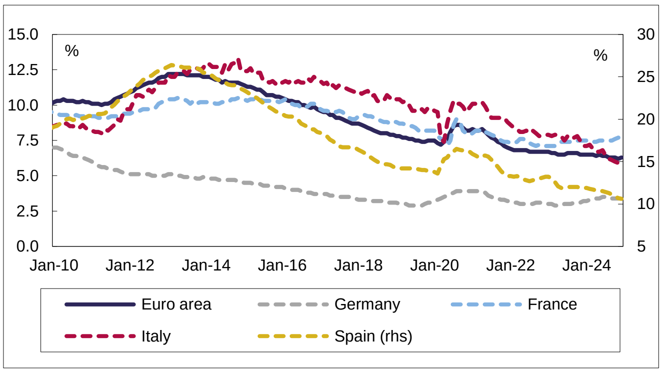
January's flash inflation estimates from Germany and France will provide Friday's main focus in the euro area. We expect to see a broadly similar story to today's Spanish release, which saw headline inflation tick higher on both the EU-harmonised HICP rate (by 0.1ppt to 2.9%Y/Y) and national CPI measure (by 0.2ppt to 3.0%Y/Y). The limited detail provided by the Spanish statistics office (INE) suggested the uptick reflected higher petrol and electricity prices. When excluding energy and fresh foods, the national estimate of core inflation eased back 0.2ppt to 2.4%Y/Y, the joint-lowest for three years.

Euro area: EC survey – consumer confidence



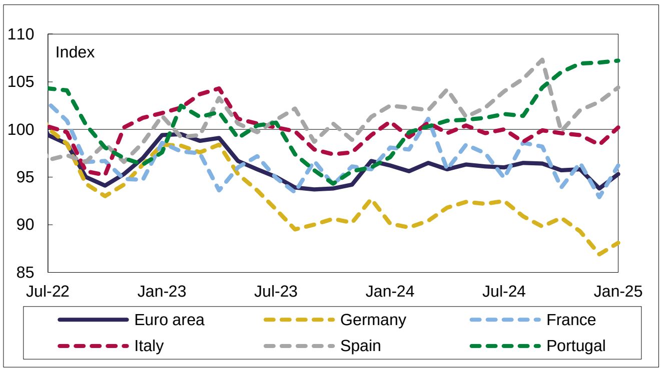
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment rates



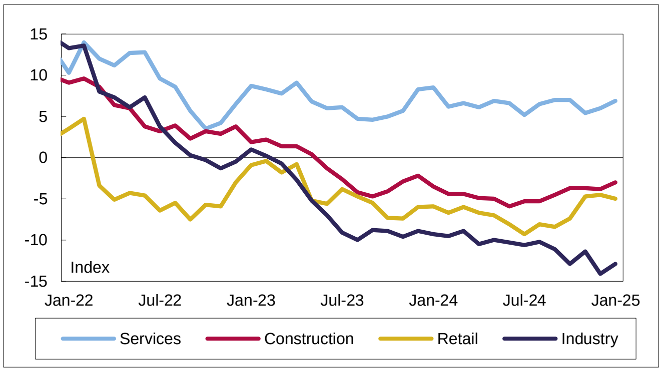
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: EC survey – member state ESIs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: EC survey – sectoral ESIs

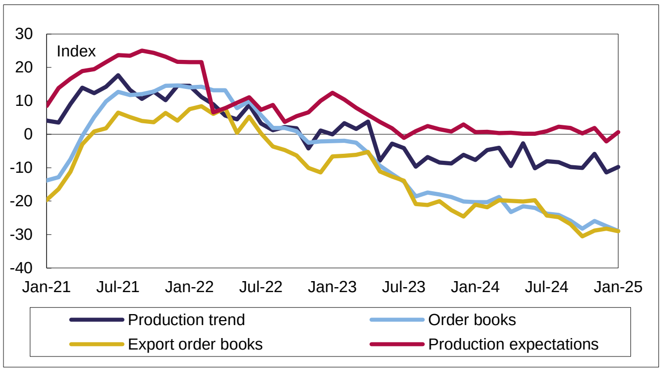


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Encouragingly, however, INE hinted at a smaller contribution from recreational prices to services inflation. In terms of tomorrow's releases, we expect headline HICP inflation to rise by 0.1ppt to 2.9%Y/Y in Germany and 1.9%Y/Y in France. The increase will be due principally to the recent uptrend in fuel prices, which has been particularly acute in Germany, where prices of petrol are up 3.8%M/M and heating oil up 5.6%M/M. More importantly, for policymakers' assessments of underlying persistence, core inflation should be better behaved. And medium-term inflation expectations, measured by the ECB's consumer survey (also due tomorrow), are also likely to be little changed and broadly well anchored, supporting the Governing Councils dovish bias.

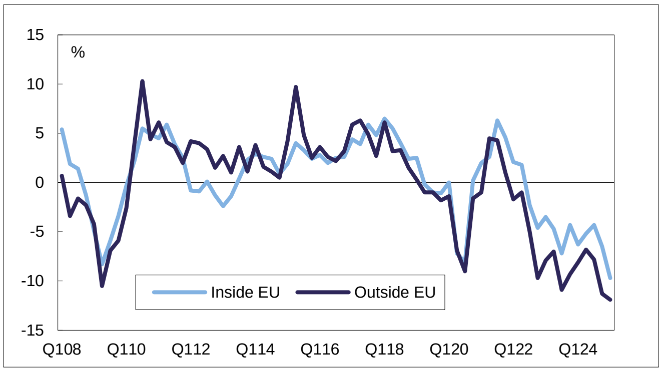
Meanwhile, tomorrow's German retail sales data for December seem bound to confirm a third consecutive quarter of positive retail sales growth in Q4, consistent with the reported increase in household consumption in today's GDP release. Given the improvement in consumer confidence in December, and after two consecutive monthly declines, a pickup in retail sales volumes in December seems more likely than not. Certainly, it would require a significant drop in retail activity to drag growth into negative territory on a 3M/3M basis. Spanish retail sales data for December and German unemployment claims figures for January are also due tomorrow.

Euro area: EC survey – industry



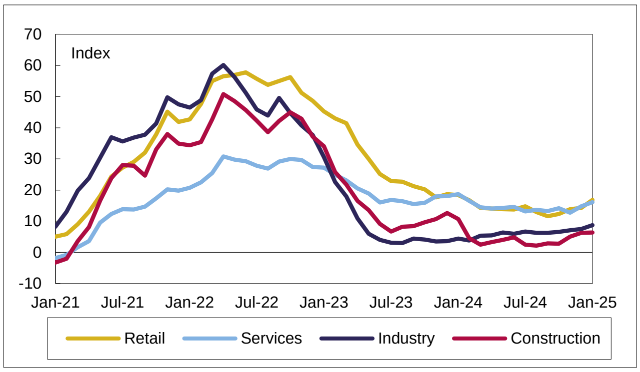
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: EC survey – competitiveness position



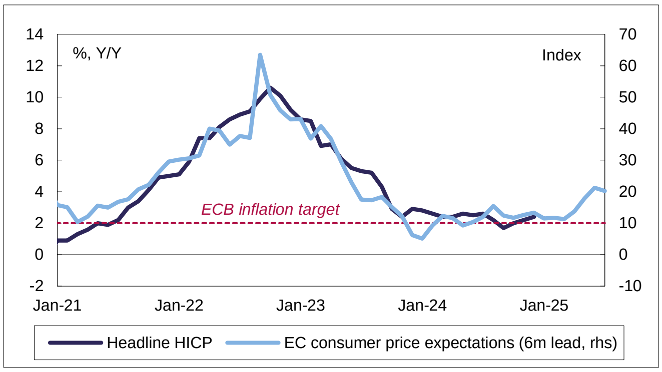
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Firms selling-price expectations*



*Three months ahead.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Consumer price inflation & expectations*



*Twelve months ahead.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

With no top-tier data releases due, it should be a relatively quiet end to the week for UK economic news. However, after today's more positive mortgage lending numbers – reporting the strongest net increase in more than two years in December and a pickup in new mortgage approvals too – the Nationwide house price index will bring an update on price growth at the start of the year. The Nationwide headline rate of home price inflation similarly posted the fastest annual rate of growth in more than two years in December (4.7%Y/Y).

European calendar

Today's results

Economic data						
Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	ECB Deposit Rate (Refi Rate) %	Jan	**2.75 (2.90)**	*2.75 (2.90)*	3.00 (3.15)	-
	GDP – first estimate Q/Q% (Y/Y%)	Q4	**0.0 (0.9)**	*0.1 (1.0)*	0.4 (0.9)	-
	Commission economic sentiment indicator	Jan	**95.2**	94.1	93.7	-
	Commission industrial (services) confidence indicator	Jan	**-12.9 (6.6)**	-13.7 (6.0)	-14.1 (5.9)	- (5.7)
	Final Commission consumer confidence indicator	Jan	**-14.2**	*-14.2*	-14.5	-
	Unemployment rate %	Dec	**6.3**	6.3	6.3	6.2
Germany	GDP – first estimate Q/Q% (Y/Y%)	Q4	**-0.2 (-0.2)**	*-0.1 (-0.1)*	0.1 (-0.3)	-
France	GDP – first estimate Q/Q% (Y/Y%)	Q4	**-0.1 (0.7)**	*-0.1 (0.7)*	0.4 (1.2)	-
	Consumer spending M/M% (Y/Y%)	Dec	**0.7 (0.9)**	0.1 (0.2)	0.3 (0.3)	0.2 (0.2)
Italy	GDP – first estimate Q/Q% (Y/Y%)	Q4	**0.0 (0.5)**	*0.1 (0.6)*	0.0 (0.4)	- (0.5)
Spain	Preliminary HICP (CPI) Y/Y%	Jan	**2.9 (3.0)**	2.8 (2.9)	2.8 (2.8)	-
UK	Net consumer credit £bn (Y/Y%)	Dec	**1.0 (6.5)**	1.0 (-)	0.9 (6.6)	-
	Net mortgage lending £bn (mortgage approvals 000s)	Dec	**3.6 (66.5)**	2.6 (65.1)	2.5 (65.7)	- (66.1)

Auctions	
Country	Auction
Italy	sold €2.75bn of 3% 2029 bonds at an average yield of 2.95%
	sold €1.5bn of 3.35% 2035 bonds at an average yield of 3.57%
	sold €2bn of 3.85% 2035 bonds at an average yield of 3.6%
	sold €2.75bn of 2033 floating bonds at an average yield of 4.11%
UK	sold £1.5bn of 0.125% 2026 bonds at an average yield of 3.888%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data					
Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	09.00	ECB consumer expectations survey – 1Y CPI (3Y CPI) Y/Y%	Dec	2.7 (2.4)	2.6 (2.4)
Germany	07.00	Retail sales M/M% (Y/Y%)	Dec	0.0 (2.6)	-0.1 (2.9)
	08.55	Unemployment rate % (change 000s)	Jan	6.1 (15)	6.1 (10)
	13.00	Preliminary HICP (CPI) Y/Y%	Jan	2.8 (2.6)	2.8 (2.6)
France	07.45	Preliminary HICP (CPI) Y/Y%	Jan	1.9 (1.5)	1.8 (1.3)
	07.45	PPI Y/Y%	Dec	-	-5.2
Italy	09.00	Hourly wages M/M% (Y/Y%)	Dec	-	0.2 (3.7)
	10.00	PPI Y/Y%	Dec	-	-0.7
Spain	08.00	Retail sales Y/Y%	Dec	-	1.0
UK	00.01	Lloyd's business barometer (own price expectations)	Jan	-	39 (62)
	07.00	Nationwide house price index M/M% (Y/Y%)	Jan	0.3 (4.3)	0.7 (4.7)

Auctions and events		
Euro area	09.00	ECB to publish Survey of Professional Forecasters for Q125

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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