Euro wrap-up

Overview

Economic Research Team
+44 20 7597 8326

- Bunds made gains as German inflation was unchanged on the EU measure in January but core CPI components moderated, and retail sales fell sharply in December.
- Gilts also made gains as the Nationwide survey reported a moderation in UK house price growth at the start of the year.
- The coming week will see the BoE cut Bank Rate by 25bps and publish updated projections, while the flash January estimates of euro area inflation, the ECB wage trackers and German IP and trade figures are due.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.098	-0.092
OBL 2.4 04/30	2.233	-0.079
DBR 2½ 02/35	2.458	-0.057
UKT 4⅛ 01/27	4.202	-0.045
UKT 4⅛ 07/29	4.217	-0.032
UKT 4¼ 07/34	4.533	-0.026

*Change from close as at 4:45pm GMT.
Source: Bloomberg

Euro area

German inflation in January steady on the EU measure but core CPI components soften

Ahead of the release of the flash euro area inflation estimates for January on Monday, the figures published so far by the larger member states point to little change in the headline rate but a possible softening of the core measure. While the Italian figures could yet change that picture, the data from Germany and France suggest that there will be no reason for the ECB to reconsider its signal that policy should be heading for a neutral stance. German HICP inflation was unchanged to one decimal place in January at 2.8%Y/Y. However, to two decimal places, it dropped 7bps to 2.77%Y/Y suggesting a slight improvement. And having risen to an 11-month high in December, the national CPI rate fell 0.3ppt to 2.3%Y/Y, back in line with the average last year. Moreover, the core CPI rate (excluding food and energy) declined a larger 0.4ppt to a three-month low of 2.9%Y/Y, 0.2ppt below last year's average. That underlying improvement reflected a slight drop in services inflation (4.0%Y/Y) and an apparently steeper fall in the core goods component (1.5%Y/Y), which admittedly might in part be related to the timing of new year discounts. And while the discrepancy between the HICP and CPI rates likely in part reflects different methodology with respect to package holiday prices, the detail published by the states points to softer inflation of several key services components, from hospitality to insurance. Beyond the core components, German energy inflation was steady despite a pickup in auto fuel and heating oil prices. But food inflation fell to an eight-month low.

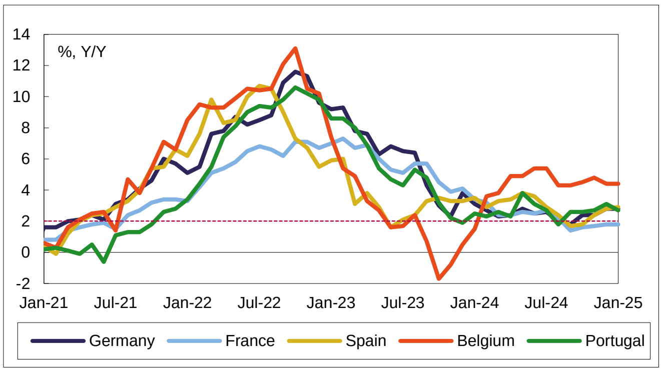
French inflation remains below target as services inflation drops to 3-year low

French inflation on the EU-harmonised measure was also steady in January, remaining at 1.8%Y/Y to mark the fifth successive sub-target reading. Admittedly, the national headline CPI rate edged slightly higher, by 0.1ppt to 1.4%Y/Y. But this was still historically subdued and down from more than 3%Y/Y a year ago and more than 6%Y/Y in early 2023. Like in Germany, the upwards impulse on the national measure principally reflected higher auto fuel prices, which took energy inflation up to a six-month high. But this should at least partially be reversed next month when regulated electricity tariffs will be cut by 15%. While inflation of manufactured goods also rose more than ½ppt to an eleven-month high, it remained extremely low at just 0.2%Y/Y. And the French statistical office (INSEE) attributed the uptick to the timing of winter clothing sales and therefore should prove temporary. Despite a renewed impulse from insurance costs, services inflation declined 0.3ppt to 1.9%Y/Y, the softest in more than three years.

Euro area inflation likely to be steady, but core inflation to maintain a downtrend in January

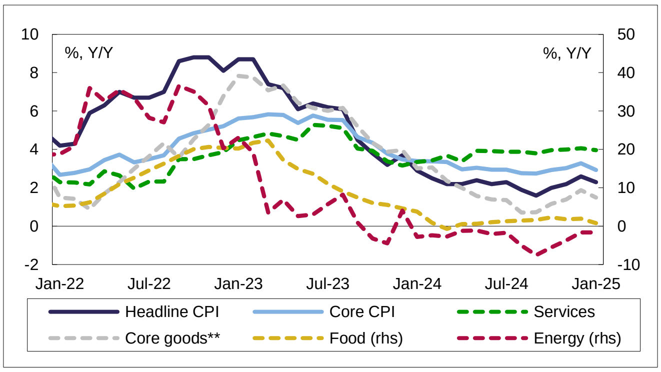
January inflation data often need to be treated with caution due to the effects of the reweighting of baskets and timing of new year discounts. But based on the figures published from roughly two-thirds of the region – including Spain (up 0.1ppt to

Euro area: HICP inflation in selected member states



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation*



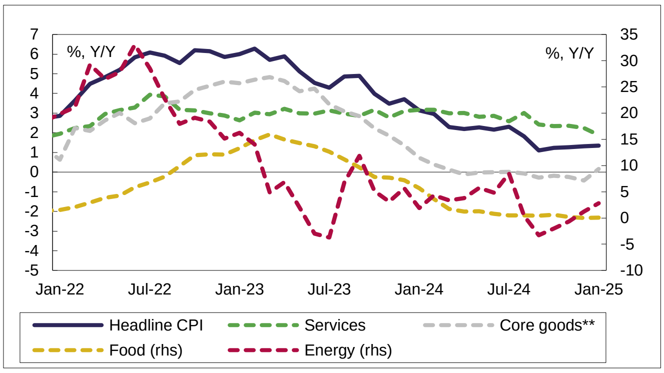
**National measure. **Non-energy industrial goods.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

2.9%Y/Y), Portugal (down 0.4ppt to 2.7%Y/Y), Belgium (steady at 4.4%Y/Y) and Ireland (up 0.5ppt to 1.5%Y/Y) – we expect euro area headline inflation to be unchanged at 2.4%Y/Y in January. With energy likely providing an upwards impulse, we suspect that core inflation will decline. Indeed, services inflation likely moderated, possibly to its softest in nine months. As such, we expect the core HICP rate to edge down 0.1ppt to 2.6%Y/Y, which would be the lowest for three years, with risks to this forecast arguably skewed to the downside. Against this backdrop, Governing Council members should not be overly concerned with the recent uptick in household inflation expectations. Indeed, having risen to a five-month high in November, today's ECB survey measure of consumer inflation expectations for 12 months' time remained steady at 2.8%Y/Y in December. And although the median medium-term expectation for inflation three years ahead (2.4%Y/Y) was 0.3ppt higher than in October, it was nevertheless well below the peak (3.1%Y/Y) in October 2022. Moreover, yesterday's Commission measure of consumer price expectations eased back in January to be bang in line with the long-run average.

German retail sales supported GDP growth in Q4 but Q1 looks weaker

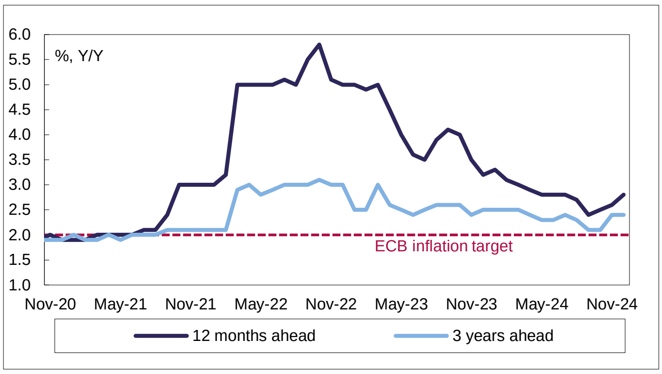
Despite the weakness in German GDP in Q4, Destatis yesterday suggested that household consumption provided a boost in the final quarter of last year. This was backed up by today's retail sales figures, which confirmed a third consecutive quarterly increase in Q4 of 0.6%Q/Q, with spending on non-food sales up 0.9%3M/3M. Admittedly, total sales volumes growth slowed sharply from Q3 (1.5%3M/3M). And the positive reading in Q4 merely

France: Consumer price inflation*



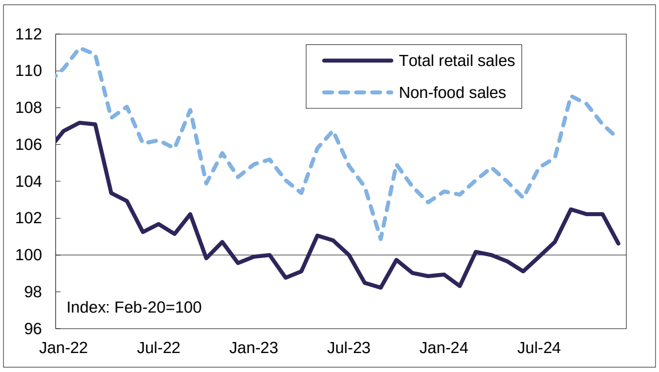
*National measure. **Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB consumer price expectations



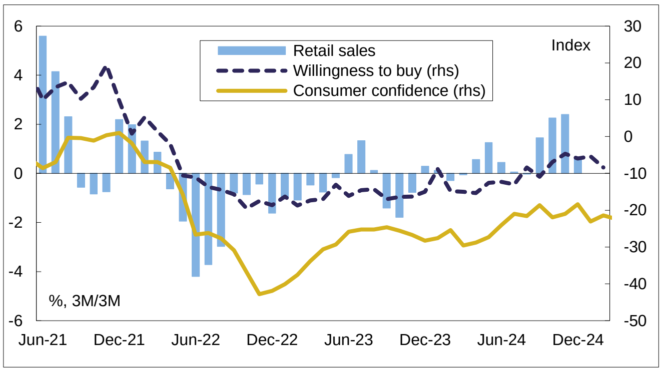
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales



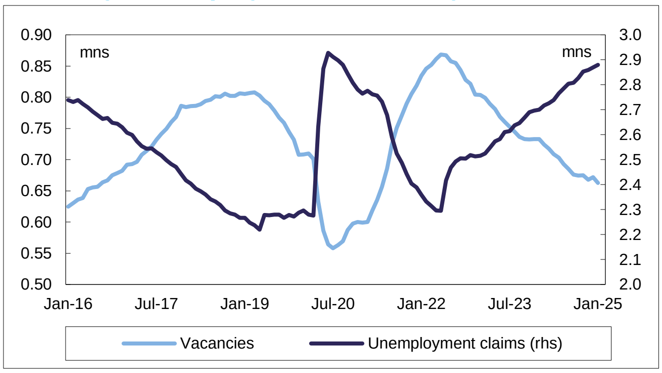
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales & consumer confidence



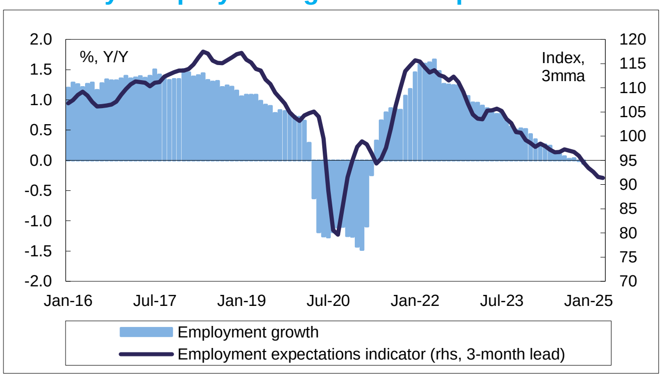
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Unemployment claims & job vacancies



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Employment growth & expectations



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

reflected the positive carry over from strong sales in September. Indeed, today's figures showed that retail sales volumes fell a hefty 1.6%M/M in December, the most in more than two years, which followed no growth in November and a modest decline in October. The weakness in December was broad-based with a sharp decline in food sales (-1.5%M/M) and spending on core items also down modestly for a second successive month (-0.2%M/M). Of course, German retail sales are notoriously volatile and December's figures are often subject to significant revisions. Nevertheless, the near-term outlook for consumer spending remains weak, with household confidence close to the bottom of the range of the past nine months and purchase intentions having worsened amid heightened economic uncertainties and unemployment fears. Certainly, today's labour market figures illustrated these concerns, with jobless claims rising in January to the highest since 2014 outside of the first Covid-19 wave, while job vacancies fell to the lowest since mid-2021 to be some 110k below the 2019 average.

The week ahead in the euro area

The coming week's dataflow kicks off with the aforementioned euro area flash HICP estimates for January on Monday. Despite some upwards pressure from higher fuel prices, we expect headline inflation to be unchanged at 2.4%Y/Y. But with services price inflation likely to have moderated, core inflation is set to ease for the first month in four, by 0.1ppt to a three-year low of 2.6%Y/Y. Euro area PPI figures for December will likely point to a continued absence of factory pipeline pressures despite the rise in energy prices. In terms of the inflation outlook, the latest release of the ECB wage tracker (Wednesday) should continue to point towards a moderation in wage growth over the coming quarters, consistent with the ECB's expectation. Also of interest will be an ECB report on its range of estimates of the neutral interest rate (Friday).

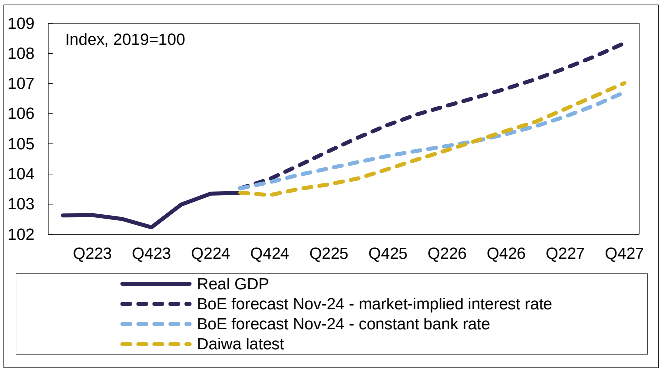
In terms of activity figures, euro area retail sales (Thursday) are expected to have declined slightly in December, in part due to German weakness and fragile consumer confidence. Nonetheless, due to a positive carry over from Q3, they should confirm a fifth consecutive quarter of positive growth in Q4. Meanwhile, December industrial output figures are due from Germany (Friday) and France (Wednesday). Following November's rebound in energy production, the manufacturing PMIs and ifo survey pointed to a marked decline in manufacturing output last month. The risks to the December factory orders data (Thursday) seem skewed to the downside too. While November's decline owed principally to a drop in major orders, industry surveys have continued to underscore that demand remained particularly subdued at the end of the year. German and French trade data (due Friday) are also expected to reflect waning export demand at the end of the year. Finally, the final January manufacturing (Monday), services (Wednesday) and construction PMIs (Thursday) are also expected to broadly align with the flash releases that pointed to only a modest improvement in conditions at the start of the year.

UK

BoE to maintain 'gradual' pace of easing with third 25bps cut on Thursday

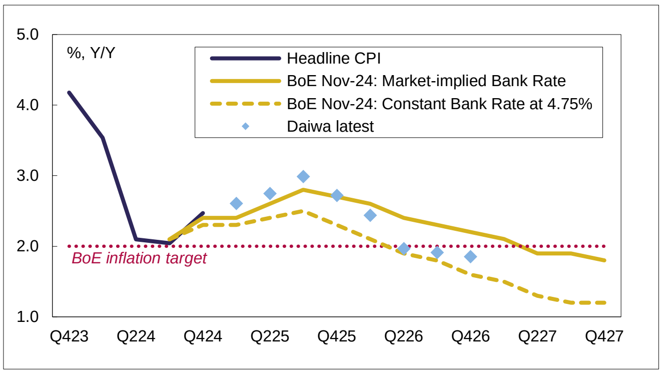
All eyes in the UK in the coming week will be on the BoE's monetary policy announcement on Thursday, which will be accompanied by its Monetary Policy Report (MPR) including updated medium-term macroeconomic projections. Consistent with the 'gradual' withdrawal of policy restrictiveness signalled by the MPC's forward guidance in December, we (like the consensus) expect it to cut Bank Rate next week by a further 25bps to 4.50%. This would mark the third such reduction this easing cycle, and take Bank Rate to a 20-month low. As in November when the MPC last relaxed its policy stance, we expect eight of the nine MPC members to vote for the cut, with only the external hawk Mann preferring no change. The rate cut will be justified by the updated projections, which will downgrade the GDP growth outlook and, most importantly, should suggest that inflation increasingly risks undershooting the 2% target over the medium term despite a possible upwards revision to its profile over the coming year. Indeed, in our view, the current policy stance is excessively tight, contributing to the weakness of demand. So, while the MPC's updated forward guidance will likely continue to point to ongoing 'gradual' monetary easing this year – which we interpret as representing one 25bps rate cut per quarter – the MPR should illustrate the non-negligible possibility that policy could be eased at a faster pace than is currently priced by the markets.

UK: BoE MPR projections – Real GDP



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

UK: BoE MPR projections – CPI



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

Data released since the MPC's last meeting justify a more dovish bias

While the majority of its members elected to leave interest rates unchanged at the last meeting in December, the MPC nonetheless demonstrated a more dovish bias. Three members (Deputy Governor Ramsden and external members Dhingra and Taylor) voted for a cut on that occasion, whilst the statement indicated that a fourth (still unidentified member) signalled their willingness to favour accelerated cuts if the data continued to disappoint to the downside. Indeed, gloomy data in the lead up to December's meeting already led the Bank staff to revise down its growth forecast for GDP in the final quarter, from 0.3%Q/Q to zero. And data released since then have remained weak. Among other releases, November's monthly GDP estimate reinforced expectations that GDP stagnated in the second half of last year, while December's retail sales figures subsequently raised the probability that economic output contracted slightly in Q4. January's flash PMIs flagged that the weakness of demand extended into this year. Moreover, December's CPI inflation report surprised on the downside. Most encouragingly, the all-important services component undershot the Bank's projection to suggest that the disinflation process continues and might even be accelerating. However, while the unemployment rate also rose above the BoE's forecast as soft economic activity was reflected in a looser labour market, private sector wage growth came in hotter than expected in November to suggest that some residual risks of inflation persistence remain.

Tighter financial conditions should be offset by the BoE despite higher oil prices & weaker sterling

As well as having to consider the recent economic dataflow, the MPC's updated projections will also need to reflect the impact of the recent sharp moves in various market variables. Notably, while they have subsided somewhat from their mid-January peak, sterling swap rates and Gilt yields remain well above levels previously assumed by the MPC, and represent an unwelcome material tightening in financial conditions that will weigh on economic activity and prices. Indeed, whereas the November MPR projections were conditioned on cumulative easing of a little more than 100bps this year, the market-implied path for Bank Rate in the updated forecasts will be approximately 50bps higher this year with no more than 75bps of easing by end-2027. On the other hand, sterling's depreciation in trade-weighted terms (roughly 2½% since the November MPR) might support net trade while adding to inflation of imported items over coming quarters. Significantly higher gas and oil prices also risk boosting the near-term profile of inflation, albeit to the detriment of domestic demand. But the steeper pace of decline in oil forward prices should reinforce an accelerated return to inflation thereafter.

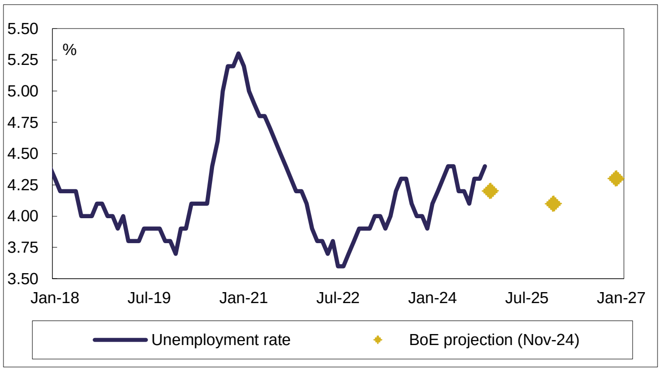
Inflation outlook to be nudged higher over the near term, but medium-term target undershoot likely

Overall, therefore, we expect the MPR to revise up the projection of inflation in the current year from 2¾% but revise down the projection for 2026 from 2¼% previously. While acknowledging the two-sided risks, it will also continue to signal the likelihood that, on balance, inflation will undershoot the target in 2027 at around 1¾%. That undershoot will in part reflect its judgement that a rising amount of economic slack will open up from now on. Indeed, the MPR projection of GDP growth will be revised down for both 2024 and 2025, from about 1% and 1½% respectively. And any positive payback for the GDP projection for 2027 (previously 1¼%) should be minimal. Overall, therefore, despite near-term upwards pressures on headline inflation, the updated projections should lead Governor Bailey to adopt a more dovish tone in Thursday's press conference, despite the continued stated preference for 'gradual' rather than 'accelerated' easing. Certainly, BoE monetary policy this year should evolve more closely in line with the ECB's than the Fed's.

QT to continue according to plan despite recent rise in Gilt yields

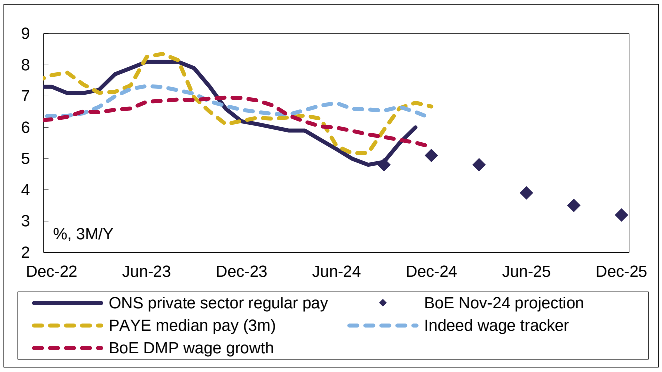
Finally, we expect Thursday's policy statement to sidestep any mention of quantitative tightening. Despite some questions about the merits of active Gilt sales on top of the automatic roll-off, most often in the context of freeing up additional fiscal headroom for public spending, the Bank will most likely recall the global drivers underpinning the recent uplift in gilt yields and – contrary to the sell-off during the Truss crisis – their orderly adjustment. And in the absence of further evidence that QT is more broadly affecting the transmission of monetary policy, we suspect that the Bank will be keen to avoid being drawn in to any debates concerning its independence that might arise if it ceased QT policy earlier than planned.

UK: BoE MPR projections – Unemployment rate



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

UK: BoE MPR projections – Private sector wages



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

The data week ahead in the UK

Aside from Thursday's monetary policy announcement, it should be a relatively quiet week ahead for economic data releases. January's BoE Decision Maker Panel survey (Thursday) should mark the highlight. Indeed, recent rounds of the survey had sought to inform on businesses' response to planned increases in employment costs, and thus could factor into the BoE's assumptions underpinning its updated inflation projections. But after December's softer-than-expected CPI print, policymakers will also be hopeful to see some relief in both consumers' and firms' own price expectations. Meanwhile, January's final manufacturing (Monday), services and composite PMIs (Wednesday) will be expected to align with last week's downbeat flash release. By contrast, the construction PMIs (Thursday) should continue to perform relatively better, driven in particular by commercial and civil engineering activity, with the latter to be supported by increased public investment over coming quarters.

Daiwa economic forecasts

	2024		2025				2024	2025	2026
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.4	0.0	0.1	0.2	0.2	0.3	0.7	0.8	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	2.1	1.9	1.9	2.2	2.4	2.0	1.9
Core HICP	2.8	2.7	2.4	1.9	1.7	2.1	2.8	2.0	1.8
UK									
Headline CPI	2.0	2.5	2.6	2.7	3.0	2.7	2.5	2.8	2.0
Core CPI	3.3	3.3	3.4	2.8	2.6	2.5	3.7	2.8	1.9
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*/**Actual**	Previous
Monday 3 February 2025						
Euro area		09.00	Final manufacturing PMI	Jan	*46.1*	45.1
		10.00	Preliminary headline (core) HICP Y/Y%	Jan	*2.4 (2.6)*	2.4 (2.7)
Germany		08.55	Final manufacturing PMI	Jan	*44.1*	42.5
France		08.50	Final manufacturing PMI	Jan	*45.3*	41.9
Italy		08.45	Manufacturing PMI	Jan	47.0	46.2
		10.00	Preliminary HICP (CPI) Y/Y%	Jan	1.4 (1.4)	1.4 (1.3)
Spain		08.15	Manufacturing PMI	Jan	53.5	53.3
UK		09.30	Final manufacturing PMI	Jan	*48.2*	47.0
Tuesday 4 February 2025						
France		07.45	Budget balance YTD €bn	Dec	-	-172.5
Spain		07.00	Unemployment (net employment) change 000s	Jan	-	-25.3 (42.7)
Wednesday 5 February 2025						
Euro area		09.00	Final composite (services) PMI	Jan	*50.2 (51.4)*	49.6 (51.6)
		10.00	PPI Y/Y%	Dec	-0.1	-1.2
Germany		08.55	Final composite (services) PMI	Jan	*50.1 (52.5)*	48.0 (51.2)
France		07.45	Industrial production M/M% (Y/Y%)	Dec	-0.1 (-1.1)	0.2 (-1.1)
		08.50	Final composite (services) PMI	Jan	*48.3 (48.9)*	47.5 (49.3)
Italy		08.45	Composite (services) PMI	Jan	49.7 (50.5)	49.7 (50.7)
		09.00	Retail sales M/M% (Y/Y%)	Dec	-	-0.4 (1.1)
Spain		08.15	Composite (services) PMI	Jan	55.8 (56.9)	56.8 (57.3)
UK		09.30	Final composite (services) PMI	Jan	*50.9 (51.2)*	50.4 (51.1)
		09.30	New car registrations Y/Y%	Jan	-	-0.2
Thursday 6 February 2025						
Euro area		08.30	Construction PMI	Jan	-	42.9
		10.00	Retail sales M/M% (Y/Y%)	Dec	-0.1 (1.9)	0.1 (1.2)
Germany		07.00	Factory orders M/M% (Y/Y%)	Dec	2.3 (-10.5)	-5.4 (-1.7)
		08.30	Construction PMI	Jan	-	37.8
France		08.30	Construction PMI	Jan	-	42.6
Italy		08.30	Construction PMI	Jan	-	51.2
UK		09.30	Construction PMI	Jan	53.8	53.3
		12.00	BoE Bank Rate %	Feb	*4.50*	4.75
		14.00	DMP 3M output price (1Y CPI) expectations %	Jan	3.9 (3.0)	3.8 (3.0)
Friday 7 February 2025						
Germany		07.00	Industrial production M/M% (Y/Y%)	Dec	-0.7 (-2.1)	1.5 (-2.8)
		07.00	Trade balance €bn	Dec	17.0	19.7
France		07.45	Trade balance €bn	Dec	-	-7.1
		07.45	Wages – first estimate Q/Q%	Q4	0.3	0.4
		07.45	Private sector payroll employment – first estimate Q/Q%	Q4	-0.1	0.1
Spain		08.00	Industrial production M/M% (Y/Y%)	Dec	0.3 (0.7)	-0.8 (-0.4)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions		
Country	GMT	Event / Auction
		Monday 3 February 2025
		- Nothing scheduled -
		Tuesday 4 February 2025
UK	10.00	Auction: to sell £4.25bn of 4.375% 2030 bonds
		Wednesday 5 February 2025
Euro area	09.00	ECB to update wage tracker indicators
	14.00	ECB Chief Economist Lane gives presentation at Peterson Institute for International Economics, Washington.
UK	10.00	Auction: to sell £2bn of 1.5% 2053 green bonds
		Thursday 6 February 2025
France	09.50	Auction: to sell up to €13bn of 3.2% 2035, 1.25% 2036, 1.25% 2038, and 3.25% 2055 bonds
Spain	09.30	Auction: to sell 2.4% 2028, 3.1% 2031, 1.15% 2036, 4% 2054 bonds
UK	12.00	BoE monetary policy announcement, minutes and Monetary Policy Report to be published
	12.30	Governor Bailey to present updated macroeconomic projections in press conference
		Friday 7 February 2025
Euro area	-	ECB to publish report on range of estimates of neutral interest rate
UK	12.15	BoE Chief Economist Pill to brief Bank's Agents on updated macroeconomic projections

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	ECB consumer expectations survey – 1Y CPI (3Y CPI) Y/Y%	Dec	**2.8 (2.4)**	2.7 (2.4)	2.6 (2.4)	-
Germany	Preliminary HICP (CPI) Y/Y%	Jan	**2.8 (2.3)**	2.8 (2.6)	2.8 (2.6)	-
	Retail sales M/M% (Y/Y%)	Dec	**-1.6 (1.1)**	0.0 (2.6)	-0.6 (2.3)	0.0 (3.1)
	Unemployment rate % (change 000s)	Jan	**6.2 (11)**	6.1 (15)	6.1 (10)	-
France	Preliminary HICP (CPI) Y/Y%	Jan	**1.8 (1.4)**	1.9 (1.5)	1.8 (1.3)	-
	PPI Y/Y%	Dec	**-3.8**	-	-5.2	-4.7
Italy	Hourly wages M/M% (Y/Y%)	Dec	**0.1 (-0.6)**	-	0.2 (3.7)	-
	PPI Y/Y%	Dec	**1.3**	-	-0.7	-
Spain	Retail sales Y/Y%	Dec	**4.0**	-	1.0	0.9
UK	Lloyd's business barometer (own price expectations)	Jan	**37 (59)**	-	39 (62)	-
	Nationwide house price index M/M% (Y/Y%)	Jan	**0.1 (4.1)**	0.3 (4.3)	0.7 (4.7)	-

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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