

Euro wrap-up

Overview

- While euro area inflation came in a touch firmer than expected in January, Bunds made significant gains as markets reacted to US President Trump's tariff plans.
- Gilts also made gains on a quiet day for top-tier UK economic news.
- After an absence of top-tier European releases tomorrow, focus on Wednesday will turn to the ECB's wage trackers and Chief Economist Lane's fireside chat about the euro area's economic outlook, as well as euro area PPI data and the final January services PMIs.

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Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.015	-0.086
OBL 2.4 04/30	2.150	-0.082
DBR 2½ 02/35	2.380	-0.076
UKT 4½ 01/27	4.151	-0.055
UKT 4½ 07/29	4.156	-0.063
UKT 4½ 07/34	4.485	-0.051

*Change from close as at 5.00pm GMT.

Source: Bloomberg

Euro area

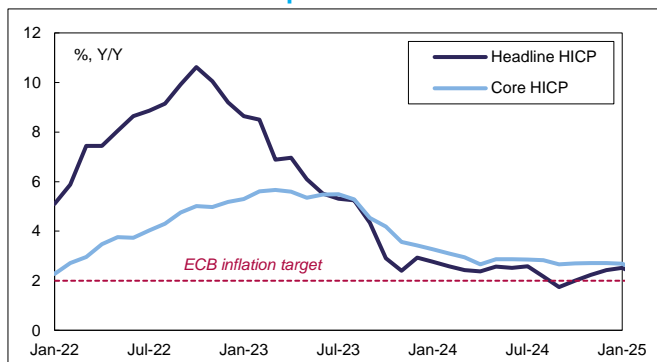
Euro area inflation a touch firmer than expected due to jump in energy prices

The flash euro area inflation estimates for January came in a touch firmer than expected, with the headline rate up 0.1ppt to 2.5%Y/Y, a six-month high. The upside surprise in part reflected increases in Italy (up 0.3ppt to 1.7%Y/Y, a 15-month high) and Austria (up 1.4ppts to 3.5%Y/Y, a 10-month high). A larger country weight allocated to Germany in 2025 also added slightly to the euro area rate despite inflation being steady there (2.8%Y/Y). Overall, euro area inflation was still a touch softer than the average in the first half of 2024, less the half the average in 2023 and more than 8ppts below the peak in October 2022. Moreover, the detail of today's report showed that the upwards impulse wholly reflected higher energy prices. Indeed, with prices up for a fourth consecutive month and by the most in seventeen months, the annual rate of that component jumped a chunky 1.7ppts to the highest level since February 2023. This in part reflected a jump in Italian regulated electricity prices at the start of the year, as well as the phasing out of earlier Spanish and Austrian government support measures, including an increase in Spain's electricity VAT rate from 10% to 21%. In contrast, inflation of food, alcohol and tobacco moderated 0.3ppt to a five-month low thanks in part to a smaller increase in French tobacco duty this year than in 2024. But while services inflation moderated slightly to 3.9%Y/Y and non-energy industrial goods inflation was unchanged at just 0.5%Y/Y, core inflation held steady at 2.7%Y/Y for a fifth consecutive month. That, nevertheless, was the joint lowest rate for three years.

Services inflation momentum continues to moderate, with factory pipeline pressures also absent

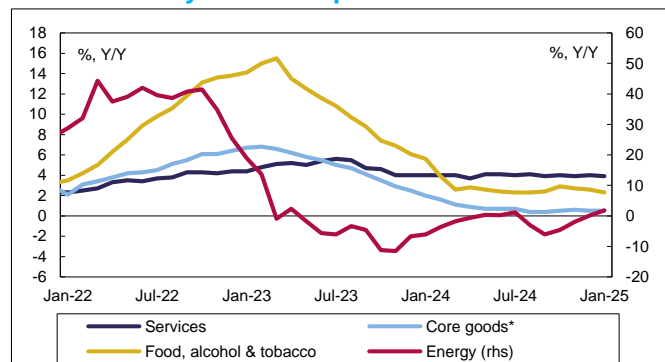
The hawks on the Governing Council might well express concern that services inflation remains almost double the 2% target. And although prices fell in January, the monthly drop (-0.2%M/M) was notably smaller than the average for the month in the years between the euro crisis and pandemic. But this followed an undershooting of the long-run norms in November and December, suggesting that services inflation momentum maintained a downtrend for the sixth successive month. While the decline in core goods prices was also smaller than the longer-term average for January, the recent profile similarly points to a persisting absence of meaningful momentum in the sector with the differential this year likely in part related to the timing of seasonal clothing discounts. Certainly, factory pipeline pressures remain subdued, with recent upside prints in producer price inflation largely relating to higher wholesale energy prices. Admittedly, higher food prices have contributed to a recent uptick in non-durable consumer goods PPI inflation to the highest since early 2024. But with intermediate goods inflation still in negative territory, durable consumer goods PPI inflation remains extremely subdued at around ½%Y/Y. And while today's final manufacturing PMIs suggested that input costs rose the most in five months in January, the output price index was merely consistent with stagnation, despite rising to a five-month high, as a persisting lack of demand constrained manufacturers' pricing powers.

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Key HICP components



*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

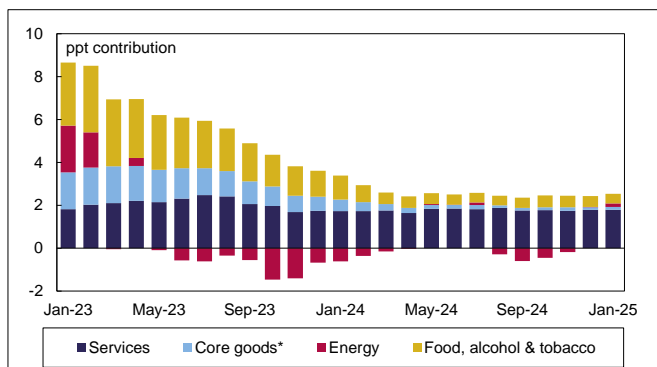
Outlook subject to significant uncertainties, but ECB's 2% inflation target still in sight

Like elsewhere, the euro area inflation outlook remains subject to significant uncertainties, not least given the impact on US and global inflation of President Trump's aggressive tariff proposals and possible countermeasures. But a near-10% cut in French regulated electricity tariffs this month should support a moderation in energy inflation in February. Soft domestic and overseas demand – as well as the possible reorientation of Chinese exports from the US to Europe – will keep price pressures on core goods subdued too. With base effects to become more favourable, consumer spending to remain relatively lacklustre and wage growth continuing to moderate, we expect to see a more meaningful disinflationary path in services over coming months. As such, we maintain our view that core inflation will ease gradually back to the 2%Y/Y target around mid-year. And notwithstanding some monthly volatility and a likely temporary uptick at the end of this year, we expect euro area HICP inflation to average only marginally above the 2% target through to November, before falling back to target and slightly below in 2026.

The coming two days in the euro area

With no top-tier euro area data scheduled for release on Tuesday, focus will no doubt remain on US trade policy. ECB Chief Economist Lane's fireside chat at the Peterson Institute for International Economics will be watched for insights into the potential impact of US tariffs on the euro area economic outlook and how the ECB might respond. In terms of the inflation outlook, focus will also be on the ECB's forward-looking wage tracker data, which will likely point to slowing wage growth and therefore fading inflationary pressures, in line with the Governing Council's expectations. Wednesday will also bring an update on factory pipeline pressures, with higher energy prices expected to have driven an increase in euro area producer prices in December. But headline PPI inflation will remain slightly in negative territory. Meanwhile, the final composite and services PMIs for January (also Wednesday) are expected to broadly align with their flash estimates. While still consistent with stagnating growth, the flash release encouragingly recorded the highest composite PMI for the euro area in five months (up 0.6pt to 50.2). A modest upwards revision in today's final manufacturing output index – up 0.3pt to a still-contractionary 47.1 – raises scope for a further modest improvement. Finally, French industrial production figures for December are also due on Wednesday.

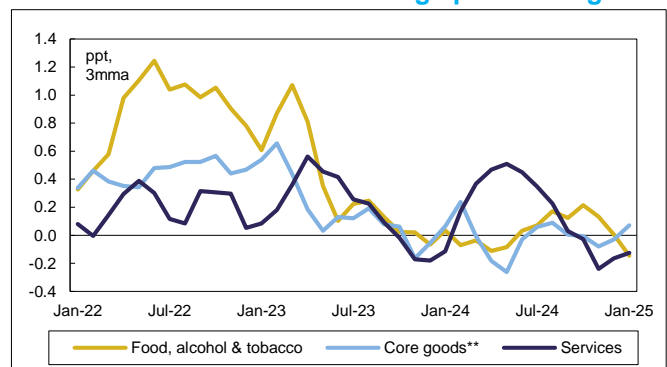
Euro area: Contributions to HICP inflation



*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

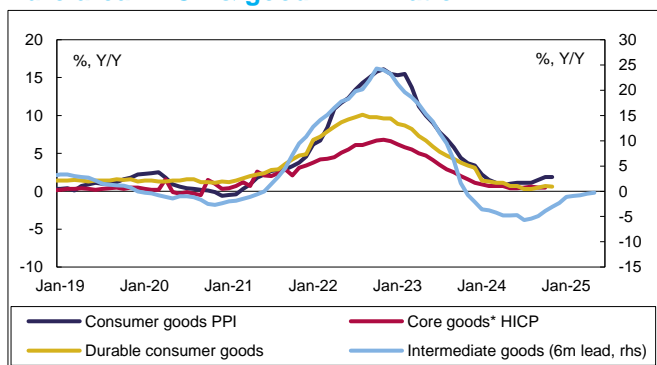
Euro area: Deviation from average price change*



*Monthly change in prices compared to average for the month in the decade before the pandemic. **Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

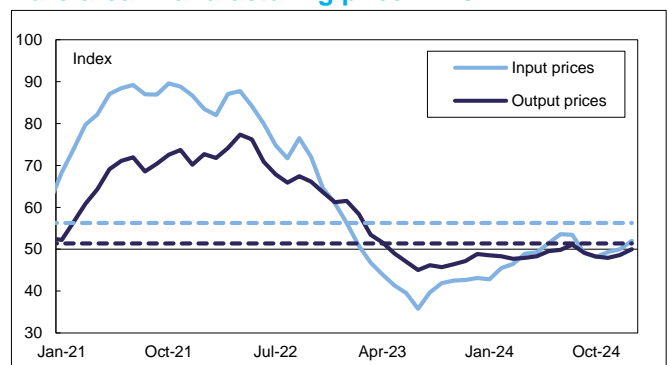
Euro area: HICP & good PPI inflation



*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing price PMIs*



*Dashed lines represent long-run average.

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

The coming two days in the UK









Ahead of Thursday's BoE monetary policy announcement, it should be a relatively quiet couple of days for the UK news-flow, with just Wednesday's release of the final composite and services PMIs for January of note. The final PMIs are expected to broadly align with the flash estimates which, despite not being as weak as initially feared, suggested that the composite output index (up 0.5pt to 50.9) remained largely consistent with ongoing stagnation at the start of the year. And with the survey likely to underscore that underlying demand remains weak and labour market conditions are deteriorating, Wednesday's release should lend support to a 25bps cut in Bank Rate on Thursday.

The next edition of the Euro wrap-up will be published on 05 February 2025

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Preliminary headline (core) HICP Y/Y%	Jan	2.5 (2.7)	<u>2.4 (2.6)</u>	2.4 (2.7)	-
	 Final manufacturing PMI	Jan	46.6	<u>46.1</u>	45.1	-
Germany	 Final manufacturing PMI	Jan	45.0	<u>44.1</u>	42.5	-
France	 Final manufacturing PMI	Jan	45.0	<u>45.3</u>	41.9	-
Italy	 Preliminary HICP (CPI) Y/Y%	Jan	1.7 (1.5)	1.4 (1.4)	1.4 (1.3)	-
	 Manufacturing PMI	Jan	46.3	46.9	46.2	-
Spain	 Manufacturing PMI	Jan	50.9	53.5	53.3	-
UK	 Final manufacturing PMI	Jan	48.3	<u>48.2</u>	47.0	-



Auctions

Country	Auction
- Nothing to report -	


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tuesday's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
France	 07.45	Budget balance YTD €bn	Dec	-	-172.5
Spain	 07.00	Unemployment (net employment) change 000s	Jan	-	-25.3 (42.7)











Auctions and events

UK	 10.00	Auction: to sell £4.25bn of 4.375% 2030 bonds
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	 09.00	Final composite (services) PMI	Jan	<u>50.2 (51.4)</u>	49.6 (51.6)
	 10.00	PPI Y/Y%	Dec	-0.1	-1.2
Germany	 08.55	Final composite (services) PMI	Jan	<u>50.1 (52.5)</u>	48.0 (51.2)
France	 07.45	Industrial production M/M% (Y/Y%)	Dec	-0.1 (-1.2)	0.2 (-1.1)
	 08.50	Final composite (services) PMI	Jan	<u>48.3 (48.9)</u>	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	56.0 (56.8)	56.8 (57.3)
UK	 09.30	Final composite (services) PMI	Jan	<u>50.9 (51.2)</u>	50.4 (51.1)
	 09.30	New car registrations Y/Y%	Jan	-	-0.2

Auctions and events

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			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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