Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds made gains as European gas futures plunged as Germany called for exemptions from storage targets, and euro area industrial production maintained its relentless downtrend at the end of 2024.
- Gilts also made gains even as UK GDP data beat expectations by registering a very modest pickup in Q4.
- Friday will bring the second estimate of euro area Q4 GDP and employment data for the same quarter, as well as the final estimate of Spanish inflation in January.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.079	-0.049
OBL 2.4 04/30	2.204	-0.058
DBR 2½ 02/35	2.416	-0.059
UKT 4⅛ 01/27	4.168	-0.020
UKT 4⅛ 07/29	4.190	-0.027
UKT 4¼ 07/34	4.488	-0.053

*Change from close as at 5:00pm GMT.
Source: Bloomberg

Euro area

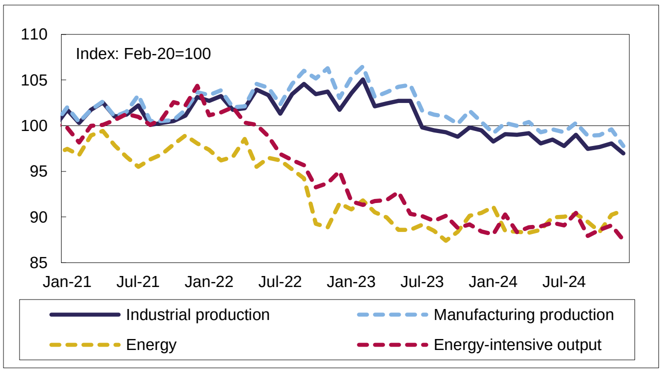
Industrial production down for 7th successive quarter as cars and machinery maintain downtrend

While the euro area economy failed to grow in the final quarter of last year, today's industrial figures for December confirmed that the sector remained a drag in Q4 and provided a negative carryover into the start of 2025 too. Indeed, industrial production fell 1.1%M/M in December to drop to the lowest level since September 2020. That left output down ½%Q/Q to mark the seventh consecutive quarterly contraction. The weakness in December was most striking in Germany, Italy, Austria and Belgium, contrasting markedly with a strong rebound in Ireland. And the drop in overall industrial production would have been stronger still in the absence of a further modest increase in energy production and non-durable goods output, the latter of which rose the most in 3½ years thanks to a jump in production of pharmaceuticals. In particular, manufacturing output dropped the most in 17 months (-1.8%M/M), leaving it down almost 2½%Y/Y and 0.7%3M/3M. Within the manufacturing detail, production of capital goods fell sharply in December to be down a hefty 8.1%Y/Y, reflecting an ongoing downtrend in cars and machinery to their weakest levels since September 2021 and December 2020 respectively. And likely reflecting the impact of a spike in gas prices, production in energy-intensive industries – including chemicals and basic metals – fell to the lowest level since the global financial crisis when excluding the first Covid-19 lockdown. While surveys point to a modest improvement in manufacturing conditions in January, we suspect that growth will remain lacklustre at best over the near term amid declining orders and heightened economic uncertainties not least with respect to global trade.

The day ahead in the euro area

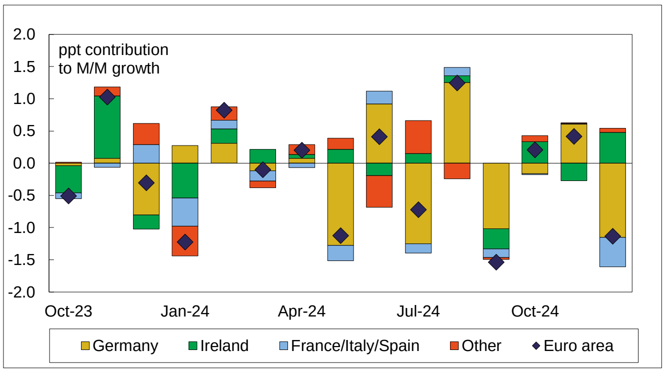
After the initial figures for Q4 GDP indicated that the euro area economy flatlined at the end of last year (0.0%Q/Q), the end of the week will bring updated estimates. But while recent data – including the surprises to December's Irish and Italian industrial production figures – may before too long lead to revisions at the national level, we expect tomorrow's update to align with the first estimates. Thankfully, this release will also be accompanied by preliminary estimates for employment growth in Q4. Early national estimates suggest that strong employment growth in Spain and a less troubling quarter for employment in Germany should offset a weakening in France and perhaps elsewhere to sustain job growth at the 0.2%Q/Q rate in Q3 or above. The annual rate might be expected to moderate slightly, however, from 1.0%Y/Y in Q3. Elsewhere, Spain's final inflation print for January is also due after the flash release reported a further marginal rise in both the headline HICP (up 0.1ppt to 2.9%Y/Y) and national CPI (up 0.2ppt to 3.0%Y/Y) rates. The Spanish statistics office principally attributed this increase to higher petrol prices, whilst encouragingly noting the softer contribution from the services-heavy leisure category. So, with core inflation on the national measure (which excludes prices of energy and fresh food) falling 0.2ppt to 2.4%Y/Y, tomorrow's HICP detail may also confirm a resumption in core HICP disinflation.

Euro area: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

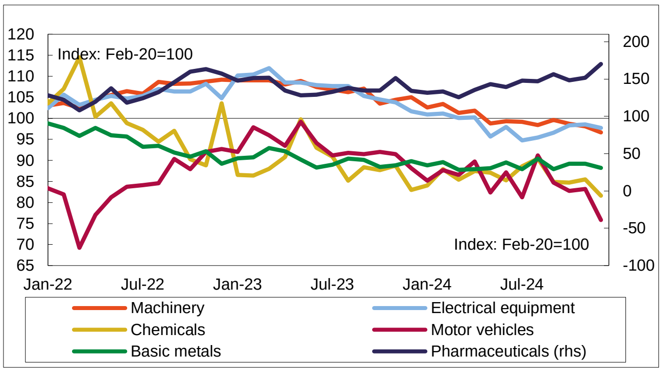
Modest GDP growth in Q4 beats consensus but living standards continue to deteriorate

Contrary to the BoE and consensus projections of a small drop, GDP grew 0.1%Q/Q in Q4. So, after zero growth in Q3, but stronger-than-previously-estimated growth earlier in 2024, total economic output was up 1.4%Y/Y, marking the strongest year-on-year rate in eight quarters. Over 2024 as a whole, GDP rose 0.9%Y/Y, an improvement of 0.5ppt from 2023. Adjusting for population growth, however, real per capita GDP – a proxy for living standards – fell 0.1%Q/Q, marking a second successive negative quarter. And that left it down for a second successive year in 2024, albeit by just 0.1%Y/Y. Strikingly, while the level of GDP in Q4 was 2.9% above the pre-pandemic level in Q419, GDP per capita was more than 1% below the equivalent level five years earlier.

Stronger-than-expected pickup in December raises likelihood of firmer growth in Q1

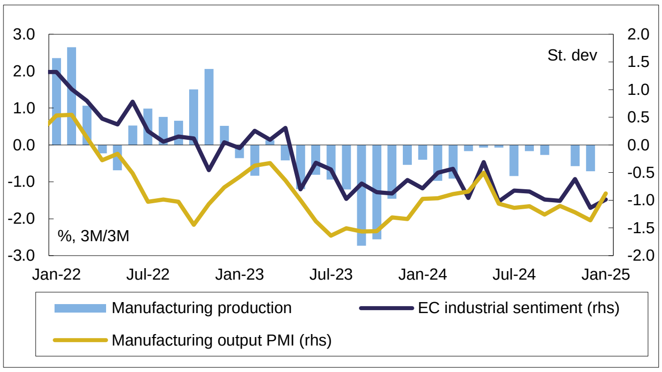
The upside surprise to GDP growth in Q4 reflected a stronger-than-expected end to the year, with growth in December of 0.4%M/M at the upper end of the range in 2024 despite bad weather. That in part reflected stronger services, particularly professional activities and restaurants, in December. Manufacturing and mining output also ended the year on a firmer note

Euro area: Manufacturing production



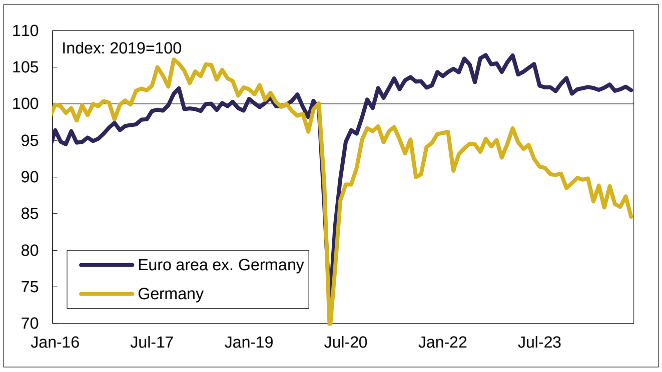
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing production & sentiment



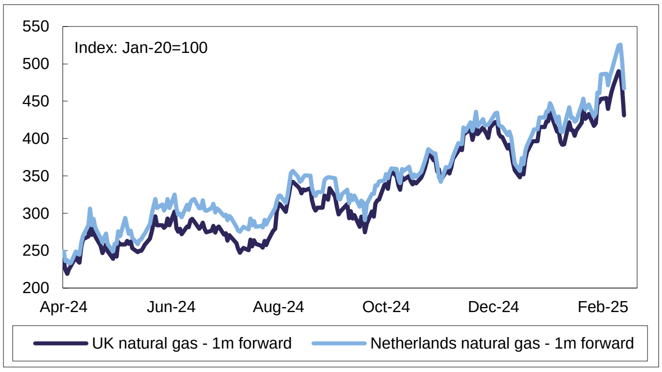
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production



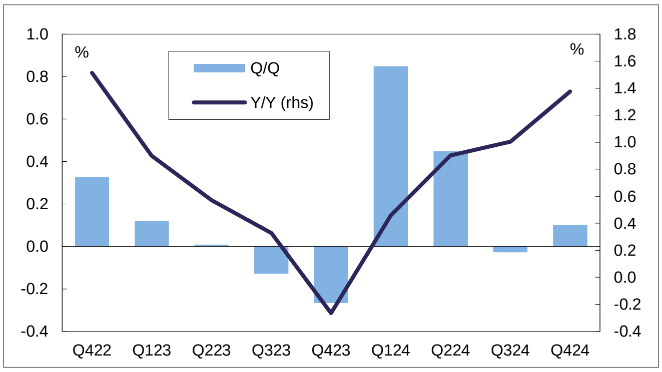
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Europe: Gas prices



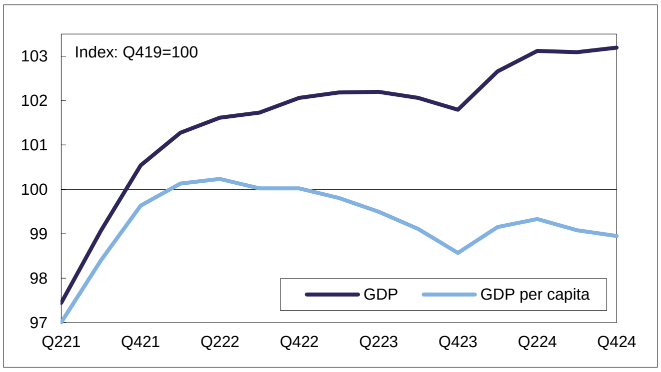
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP & GDP per capita levels



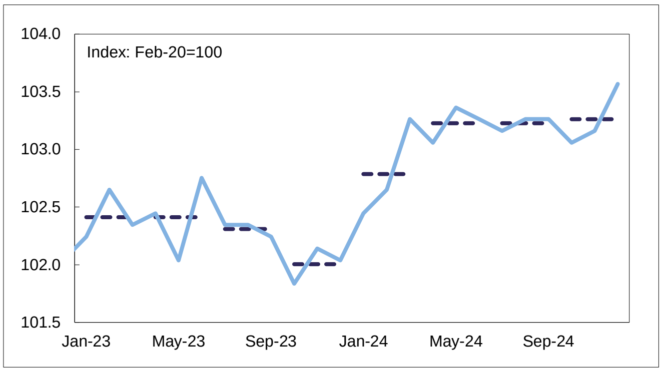
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

to more than offset a softer month for construction. Of course, the profile of activity through the second half of the year was still little better than flat. However, the positive carry-over for GDP from December increases the likelihood that Q1 will be stronger than the BoE's projection of 0.1%Q/Q. We forecast a rise of 0.2%Q/Q this quarter, but a flat monthly profile from January to March would deliver growth of 0.3%Q/Q. So, these data underscore the likelihood that the BoE will cut rates by no more than 25bps per quarter, at least until the peak in inflation that is likely to come in Q3, has passed.

Services & construction output rose in Q4 but IP dropped for fifth successive quarter

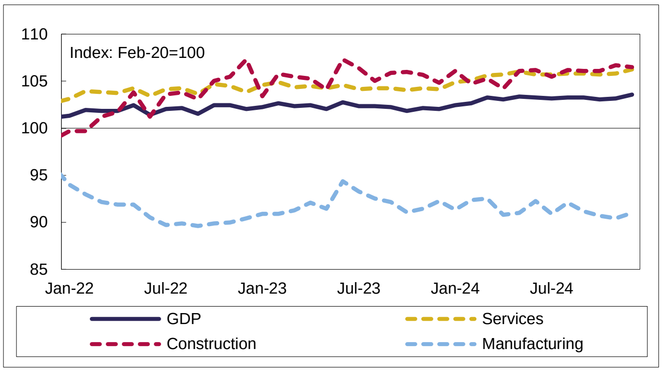
Despite the firmer end to the quarter, services activity rose just 0.2%Q/Q in Q4 after a flat Q3, with consumer-facing services up just 0.1%Q/Q. The main source of growth within the sector was health and social care rather than business-related activities. Nevertheless, given the decent start to the year, that left services output up a respectable 1.7%Y/Y. In contrast, manufacturing output fell 0.7%Q/Q to be down 0.9%Y/Y. And mining and quarrying fell a sharp 2.5%Q/Q to be down a whopping 7.6%Y/Y and more than 40% below the pre-pandemic level. So, industrial production fell for a fifth successive quarter and by 0.8%Q/Q. Meanwhile, despite a softer December amid inclement weather, construction output grew for the third successive quarter in Q4 and by 0.5%Q/Q to be up 0.9%Y/Y. That reflected a welcome pickup in new private housing, which rose for a second successive quarter and by 1.3%Q/Q, admittedly from a very low base.

UK: Monthly GDP level*



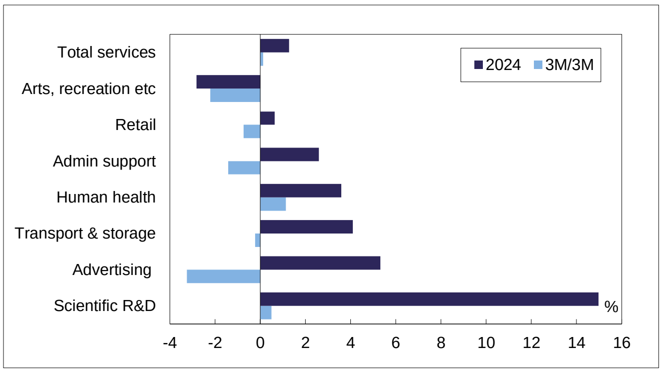
**Dashed dark blue line represents quarterly average.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output level by sector



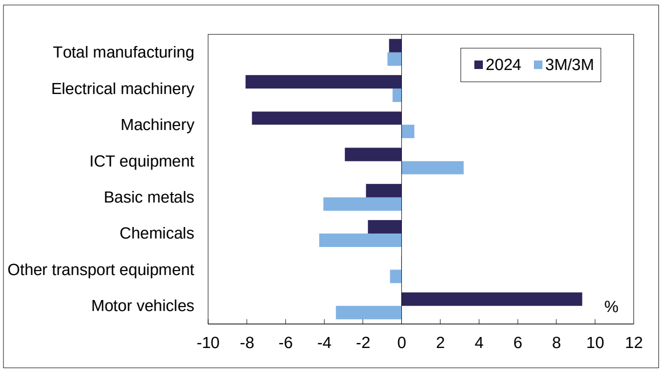
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services output in selected subsector



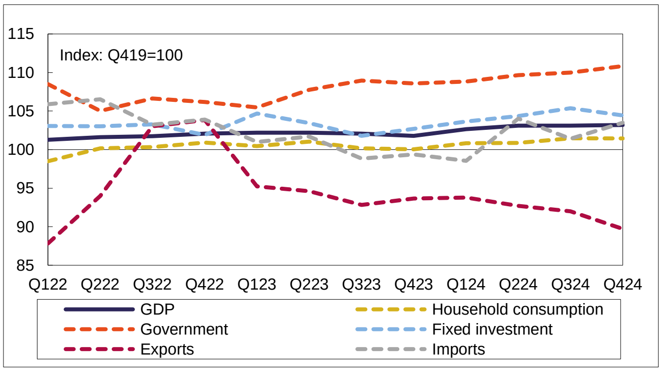
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output in selected subsector



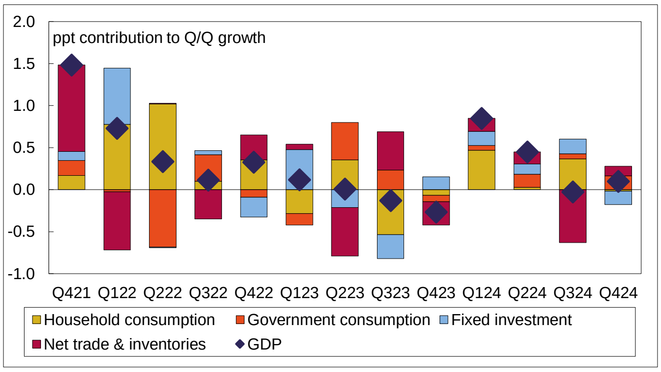
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP expenditure components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & expenditure contributions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

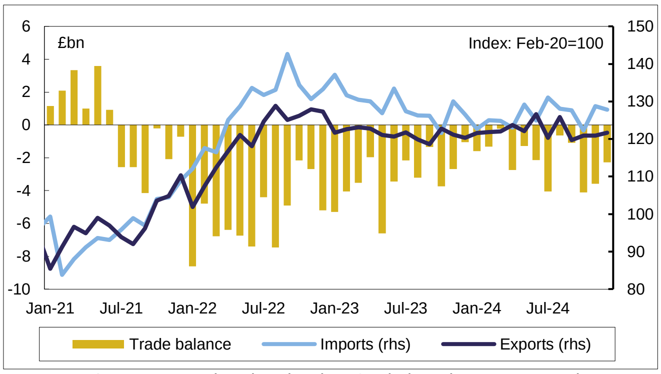
Government consumption & inventories offset weakness in private final demand in Q4

On the expenditure side, a drop in private sector final demand underscored the underlying weakness. Despite strong growth in real incomes, household consumption was flat on the quarter as increased spending on hospitality was offset by less expenditure on food and education. Nevertheless, that still left household consumption up 1.4%Y/Y. More of a concern, business investment fell 3.2%Q/Q, the most since Q121. That subtracted a chunky 0.4ppt from GDP growth on the quarter and left business capex down 0.7%Y/Y. Perhaps reassuringly, initial estimates of business investment are frequently significantly revised, and so we hope that will be the case again in Q4. But the post-Brexit trend in business capex has undeniably been weak and there seems little reason to expect a notable improvement anytime soon. Some of the negative impact on GDP growth from business investment was offset by a boost from government consumption, which rose 0.8%Q/Q to be up 2.1%Y/Y, reflecting higher spending on defence and healthcare. But the largest positive contribution to GDP growth (1.6ppts) came from inventories and a statistical adjustment. That broadly offset an extremely large negative contribution from net trade (-1.5ppts), as the deficit for goods and services rose more than 1ppt on the quarter to 1.6% of GDP. In part, the weak trade performance reflected a sharp drop in goods shipments, which more than offset growth in services exports. But imports surged too, in large part due to movements in non-monetary gold, which frequently distort the underlying picture.

Goods exports remain a significant drag as shipments to the EU maintain downtrend

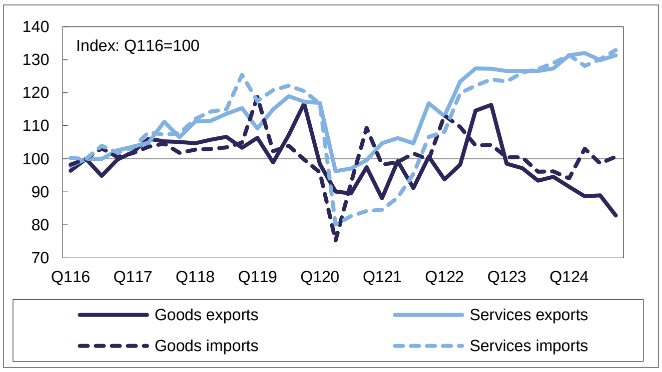
At face value, the December trade figures appeared to report an improvement heading into year-end. In particular, the overall trade deficit narrowed £1.5bn to £2.8bn in December, as the value of exports rose ½%M/M to a four-month high and import values fell around 1½%M/M to a three-month low. But when adjusting for relative price changes, the trade deficit reached the widest on a three-month basis (£24bn) since May 2022. The deterioration related to a further decline in goods export volumes, which at the end of 2024 fell more than 17% below the pre-Brexit referendum level in Q216. Shipments to the EU fell to the lowest level since January 2021 – when the Brexit withdrawal agreement came into effect – and 1997 before that, in particular due to lower shipments of machinery to Germany and France. In contrast, exports to non-EU countries rose (3.3%M/M) thanks to a jump in shipments to the US, perhaps relating to increased activity ahead of the possible imposition of tariffs. In that context, iron and steel and non-ferrous metals (including aluminium) – which have already been targeted by proposals for higher tariffs – account for around 5% of UK goods exports, of which 7% were destined for the US. Of course, a more widespread increase in tariffs to include motor vehicles, machinery and pharmaceuticals – which account for almost 50% of UK exports to the US – would have a far more negative impact.

UK: Trade balance, export & import values



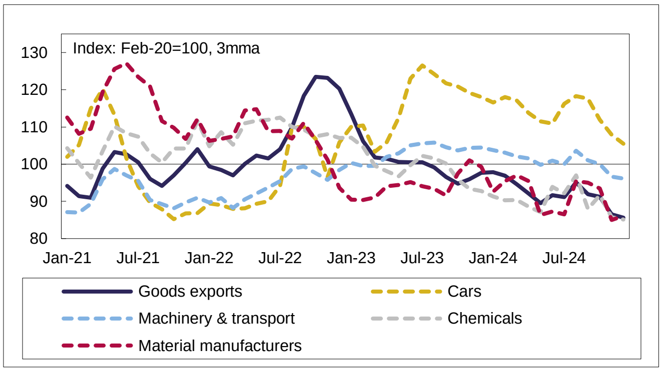
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Export & import volumes



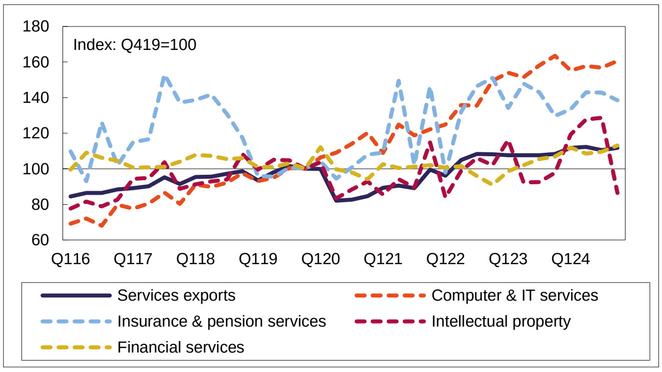
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Goods exports



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services exports



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Services exports close to a record high in Q4

The weakness in goods exports over recent years has been partly offset by a steady rise in exports of services, which remain a key strength of the UK economy. Indeed, in Q424 services exports were close to a record high, some 12% above the pre-Covid benchmark. Growth last quarter was again strong in exports of financial, computer and other business services. And while UK services imports also continue to rise steadily, there remained a healthy surplus on the sector's trade balance at the end of 2024 (£40.3bn). A significant share of that services trade surplus is associated with the US, which accounts for more than a quarter of all UK services exports and about one fifth of all UK services imports.

The day ahead in the UK

It should be a quiet end to the week in the UK, with no top-tier data releases scheduled.

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Industrial production M/M% (Y/Y%)	Dec	**-1.1 (-2.0)**	-0.6 (-3.1)	0.2 (-1.9)	0.4 (-1.8)
Germany	Final HICP (CPI) Y/Y%	Jan	**2.8 (2.3)**	*2.8 (2.3)*	2.8 (2.6)	-
UK	GDP – first estimate Q/Q% (Y/Y%)	Q4	**0.1 (1.4)**	*-0.1 (1.0)*	0.0 (0.9)	- (1.0)
	Monthly GDP M/M% (3M/3M%)	Dec	**0.4 (0.1)**	0.1 (-0.1)	0.1 (0.0)	-
	Services output M/M% (3M/3M%)	Dec	**0.4 (0.2)**	0.1 (0.1)	0.1 (0.0)	0.2 (-)
	Industrial output M/M% (Y/Y%)	Dec	**0.5 (-1.9)**	0.2 (-2.1)	-0.4 (-1.8)	-0.5 (-2.0)
	Construction output M/M% (Y/Y%)	Dec	**-0.2 (1.5)**	0.2 (1.2)	0.4 (0.2)	0.6 (1.0)
	Trade (goods trade) balance £bn	Dec	**-2.8 (-17.4)**	-4.0 (-18.4)	-4.8 (-19.3)	-4.4 (-18.9)
	RICS house price balance %	Jan	**22**	28	28	26

Auctions

Country	Auction
Italy	sold €3.25bn of 2.7% 2027 bonds at an average yield of 2.52%
	sold €1.25bn of 3.15% 2031 bonds at an average yield of 3.18%
	sold €1.25bn of 3.45% 2031 bonds at an average yield of 3.13%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Italy	Industrial production M/M% (Y/Y%)	Dec	**-3.1 (-7.1)**	-0.2 (-2.5)	0.3 (-1.5)	- (1.6)

Auctions

Country	Auction
Germany	sold €795m of 0% 2050 bonds at an average yield of 2.65%
	sold €1.19bn of 2.5% 2054 bonds at an average yield of 2.7%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tuesday's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
France	ILO unemployment rate (mainland) %	Q4	**7.3 (7.1)**	7.5 (7.3)	7.4 (7.2)	-
UK	BRC retail sales monitor – like-for-like sales Y/Y%	Jan	**2.5**	1.0	3.1	-

Auctions

Country	Auction
Germany	sold €3.78bn of 2.4% 2030 bonds at an average yield of 2.17%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Sentix investor confidence index	Feb	**-12.7**	-16.5	-17.7	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	GDP – second estimate Q/Q% (Y/Y%)	Q4	*0.0 (0.9)*	0.4 (0.9)
		10.00	Preliminary employment Q/Q% (Y/Y%)	Q4	-	0.2 (1.0)
Spain		08.00	Final HICP (CPI) Y/Y%	Jan	*2.9 (3.0)*	2.8 (2.8)

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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