Euro wrap-up

Overview

- Bunds followed the global trend lower as the first estimates of German GDP reported a return to growth in Q4 and a narrowing of the budget deficit in 2025.
- Gilts also made losses as UK GDP beat expectations in November.
- A quiet end to the week for European economic data will bring final estimates of German and Italian inflation in December.

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Daily bond market movements

Bond	Yield	Change
BKO 2 12/27	2.095	+0.024
OBL 2.2 10/30	2.385	+0.020
DBR 2.6 08/35	2.817	+0.005
UKT 3¾ 03/27	3.657	+0.044
UKT 4⅜ 03/30	3.857	+0.057
UKT 4½ 03/35	4.387	+0.048

*Change from close as at 5.00pm GMT.
Source: Bloomberg

Euro area

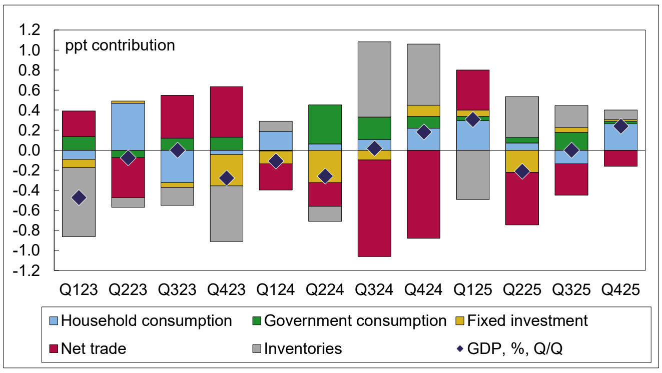
German GDP returns to growth in Q4, budget deficit unexpectedly narrows in 2025

According to Destatis' "first, very early" estimate, German GDP returned to growth in Q4, rising 0.2%Q/Q following a flat Q3 to mark the first positive quarter since Q1. That took full-year growth in 2025 to 0.2%Y/Y, marking the first positive annual reading since 2022. Growth in 2025 was driven by household (1.4%Y/Y) and government consumption (1.5%Y/Y), which both expanded for a second successive year. Fixed investment contracted for a fifth successive year (-0.5%Y/Y) despite increased spending on military equipment and a pickup in capex on non-residential structures. Net trade subtracted from GDP growth last year principally as goods exports fell while goods imports rebounded firmly. Based on the preliminary full-year data, GDP growth in Q4 was similarly driven by household and government consumption, but fixed investment also probably picked up. Net trade in Q4, however, likely remained a drag on growth. We expect German GDP growth to pick up gradually further from Q1, again driven by domestic demand as increased public investment crowds in private capex. But net trade is likely to remain a drag. We currently expect German GDP growth in 2026 to accelerate by 0.5ppt to 0.7%Y/Y, which would be the best since 2022. Finally, in terms of fiscal policy, the German general government budget deficit unexpectedly narrowed in 2025, by 0.3ppt to 2.4%Y/Y. The smaller deficit reflected strength in budget revenues (up 5.8%Y/Y), which outpaced government spending. With the policy stance loosened, the deficit is set to rise above 3½% of GDP in 2026, albeit likely remaining well below the projection of 4¾% in the government's initial draft budgetary plan for this year.

Broad-based IP growth in November suggests return to growth in the factory sector in Q4

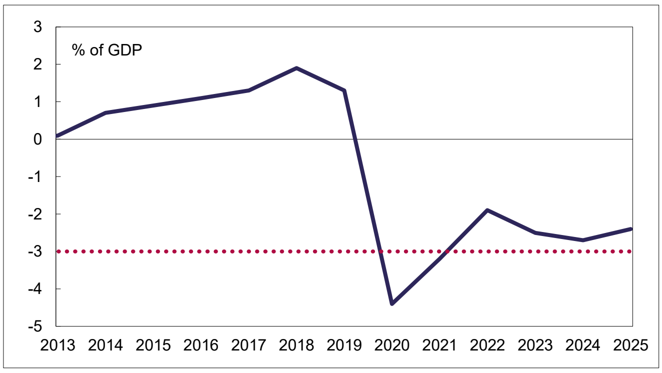
As was widely expected given the strength of the member state releases, euro area industrial production reported another firm monthly increase in November to reinforce expectations of a return to quarterly growth in the sector in Q4 for the first time since Q1. Indeed, IP rose by 0.7%M/M for a second consecutive month taking total output to its highest level since March's pre-tariff-induced boost and June 2023 before that. Like the previous month, growth was fronted by expansion in Germany (1.1%M/M), this time led by autos. Unsurprisingly, the aggregate euro area data reflected that pickup, with gains in autos production (7.6%M/M) outstripping modest increases in machinery, electronics, chemicals and pharmaceuticals. But growth was broad based across the other member states, including Ireland (1.4%M/M), Spain (1%M/M) and Italy (1.5%M/M). And despite a marginal decline in France (-0.1%M/M), production in that member state, like the member states listed, was on track for positive growth in Q4. Consequently, euro area IP through November was trending some 0.9% above its average level in Q3. We note that the manufacturing PMIs suggest that seasonal shutdowns could have bitten in December. And structural challenges persist, particularly for the still-subdued energy intensive subsectors and firms squeezed by US tariffs and increased competition from China. But more upbeat business surveys, likely reflecting extra support from fiscal policy, gives us cause for cautious optimism about the near-term manufacturing outlook.

Germany: GDP growth & expenditure contributions*



*2025 expenditure contributions are Daiwa forecasts. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: General government balance*



*Red dotted line represents Maastricht deficit limit. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

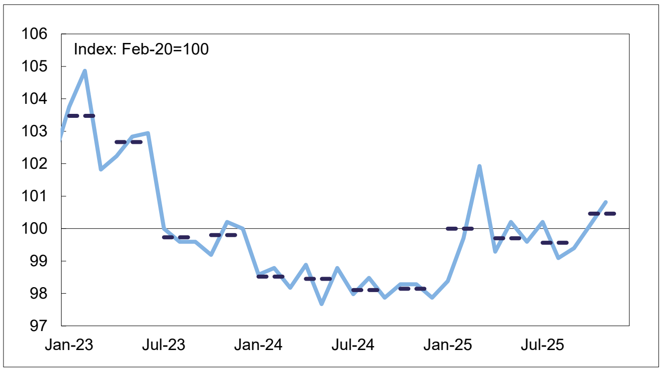
Import surge from China continues, while exports to China & US remain weak

November's goods trade data illustrated the structural changes facing key subsectors. The topline figures reported a predictably narrower goods surplus, down €3bn to a three-month low of €10.7bn. Total export values increased only moderately from October's 12-month low (1.1%M/M) – and by less than ½%M/M for machinery, transport goods and chemicals – but were outstripped by a rebound in imports (2½%M/M), not least of commodities and fuels. To the extent that the weakness in exports over the first two months of Q4 (-1.6% relative to the Q3 average) remains slightly less than that of imports (-1.9%), some support from net trade to GDP in Q4 is not out of the question. But the bilateral country data reported further strong growth in imports from China, rising 13%Y/Y in volume terms to their second highest monthly level on record. Characteristic of the loss of euro area competitiveness in sectors such as autos and machinery, export volumes to China were equally the lowest in 15 years and down more than 9%Y/Y. Moreover, with the hangover from periods of front-running earlier last year and new exports to the US confronted by higher tariffs, demand from the euro area's largest export market remained subdued, with shipments falling to their lowest level in volume terms for nine years.

The day ahead in the euro area

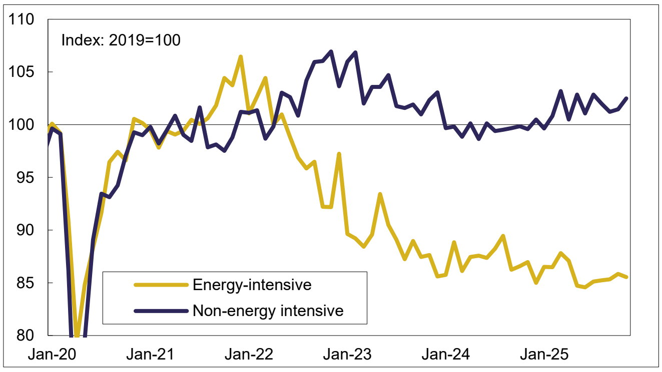
Leading on from today's French and Spanish inflation releases, Friday's focus in the euro area will be December's final estimates from Germany and Italy. Assuming that those follow today's example, we shouldn't expect much in the way of a surprise. Indeed, both the final French (0.7%Y/Y) and Spanish (3%Y/Y) aligned with their flash releases. The granular detail on offer was also consistent with expectations that weaker energy inflation, owing to a drop in auto fuel prices, was principally responsible for December's moderation. Slightly firmer food inflation provided some offset, but core components were also broadly well behaved. The minor revisions from the flash estimates for France and Spain broadly offset each other. So, the downside risks to December's euro area print – provisionally estimated at 2.0%Y/Y, but 1.96%Y/Y to two decimal places – remain. The flash German estimates surprised to the downside, with a broader softening in inflation taking the HICP rate down 0.6ppt to 2.0%Y/Y, a five-month low. By contrast, the Italian rate was nudged up 0.1ppt to 1.2%Y/Y, as pressure from food outweighed an only modestly larger drag from energy. Downward revisions to either member state could well push the euro area figure to a rounded 1.9%Y/Y.

Euro area: Industrial production*



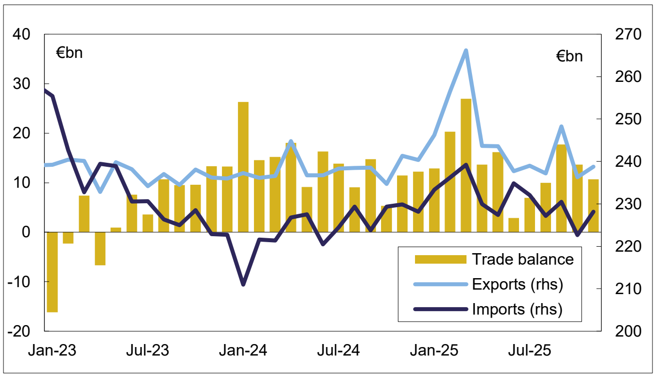
*Dashed blue lines show quarterly averages. Q425 average shows Oct-Nov.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production by energy intensity



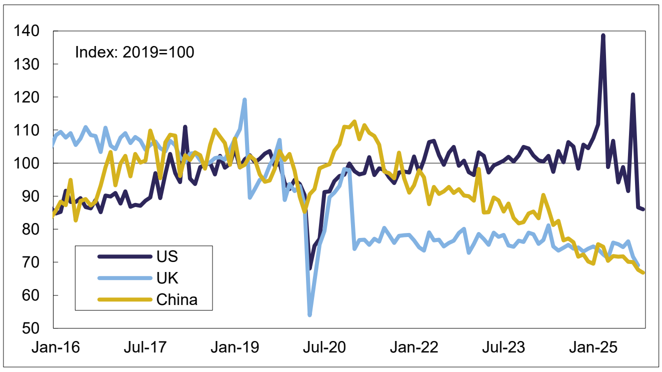
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade balance, exports & imports



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Export volumes by destination



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

GDP beat expectations in November, but underlying economic growth remains subdued

Today's UK GDP data for November beat expectations, suggesting that the economy eked out modest growth in the final quarter of 2025, firmer than the BoE's November projection for stagnation. Indeed, economic activity rose 0.3%M/M – the strongest pace in five months – leaving it trending in the middle of Q4 some 0.2% above the Q3 level and up 1.4%Y/Y, broadly in line with potential. Admittedly, the rebound in November was flattered by one-off factors such as the continued resumption of operations at Jaguar Land Rover (JLR) after the cyber-related outage in September (see below) and payback for prior weakness in certain business-related services. And today's slight upward revision to the September outturn suggests that GDP growth in Q4 will also benefit from a moderate carry-over from Q3. Overall, surveys suggest that underlying economic growth in the UK remained lacklustre heading into end-2025. So, while we have revised higher our Q4 GDP estimate to growth of 0.1%Q/Q this would leave full-year growth at 1.4%Y/Y, probably no stronger than potential.

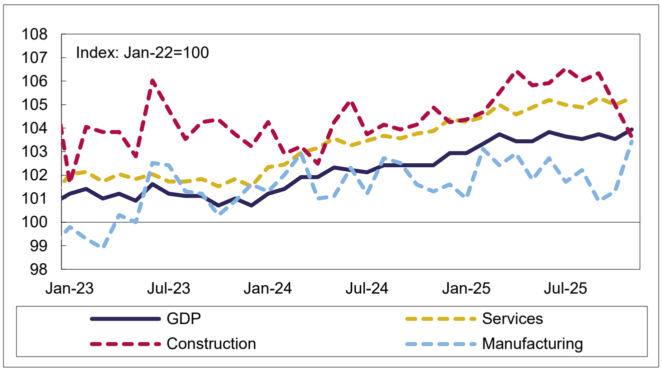
Manufacturing driven by autos rebound, but consumer-facing services takes step back

Within the detail, the pickup in November was driven by a further acceleration in autos output (25.5%M/M), taking production in the subsector back close to pre-cyber-attack levels. Growth in pharmaceuticals, basic metals and iron and steel helped to offset ongoing weakness in machinery and ICT equipment too. As such, total industrial output rose for a second month in November (1.1%M/M) to be tracking some 1% above the Q3 average, despite a near-4% drag from car production on the same basis. Meanwhile, services activity (0.3%M/M) also seemingly benefited from the resumption of operations at JLR. Wholesale trade rose to the highest level in four months. And professional, scientific and technical services in November rebounded from prior weakness. In aggregate, business-related services rose almost ½%M/M. In contrast, due to declines in retail, hospitality and real estate, consumer-facing services fell 0.2%M/M after a flat prior month to drop to the lowest level since August. As a result, overall, services activity was trending just 0.1% above the Q3 level.

Construction activity weakness stands out on policy uncertainty & bad weather

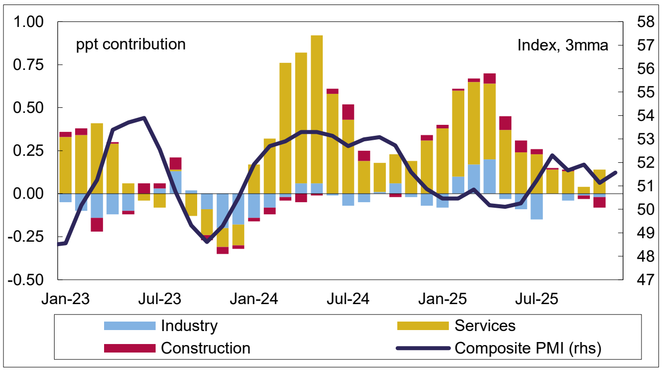
The main weakness in November related to construction, where persisting uncertainty about tax policy ahead of the end-month Budget announcement and above-average rainfall saw output fall sharply for a second month (-1.3%M/M) to a 19-month low. This left output in the sector trending almost 2% below the Q3 average, with particularly sharp declines in private and public housing work. The BoE's credit conditions survey today suggested that lenders expect to remain cautious in secured lending in the current quarter amid weaker expectations for house prices. But today's RICS survey suggested that

UK: GDP level



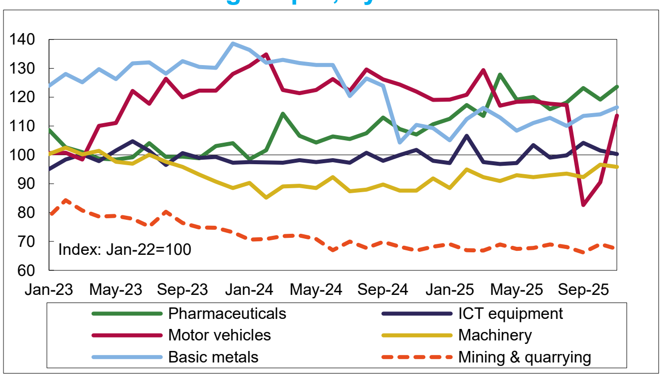
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & composite PMI



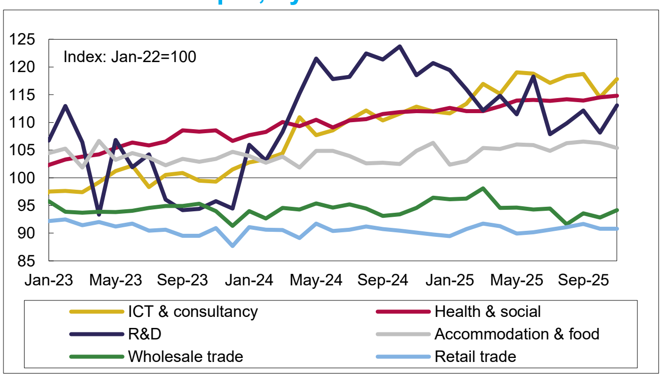
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output, by selected subsector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services output, by selected subsector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

surveyors have become a little more optimistic about the outlook for residential prices, with the lifting of uncertainty about tax policy prompting increased new buyer enquiries and sale instructions in December and further interest rate cuts expected to provide further support ahead.

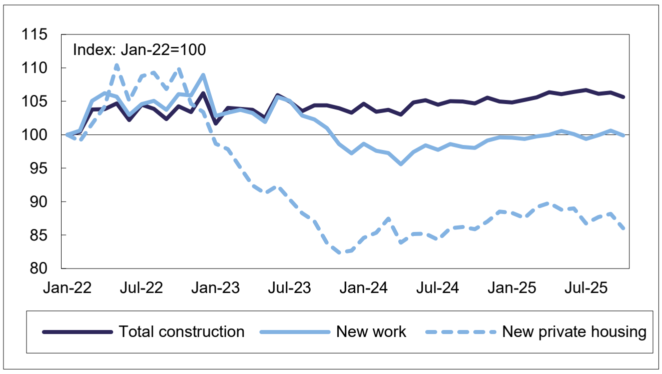
Trade performance continues to underwhelm despite slight pickup in goods shipments

While today's monthly trade data reported some stabilisation in shipments in November, they nevertheless suggested that net exports likely provided no support to GDP growth in Q4. After jumping in October (4.4%M/M) due to higher imports of precious metals, the total value of imports moved sideways in November. And despite a further sizeable decline in shipments to the US – down 10.4%M/M and more than one quarter below the March peak – the total value of exports edged up slightly in November. As such, the nominal trade deficit narrowed very slightly to £6.1bn, albeit remaining one of the largest since mid-2022. When excluding precious metals and price effects, the real underlying trade deficit fared a little better, narrowing to a four-month low (£4.6bn) as import volumes slipped to the lowest level in five months. But while goods export volumes rose for a second successive month, they were still tracking some 2½% below the Q3 average. Moreover, services export volumes – which account for roughly 60% of total exports – were merely trending sideways, tallying with the broader absence of meaningful growth in the sector in the middle of Q4.

The day ahead in the UK

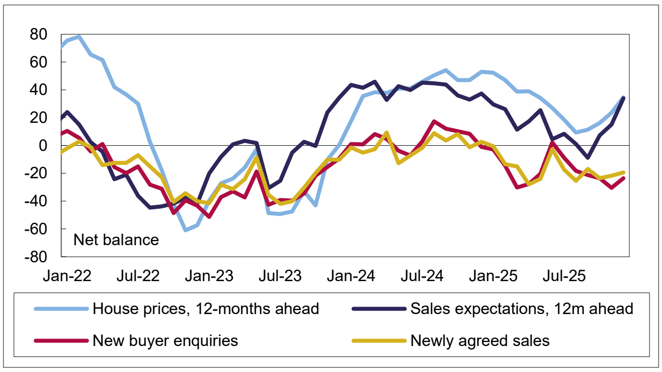
With no top-tier data releases scheduled for Friday, it looks set to be a quiet end to the week for UK economic news.

UK: Construction output



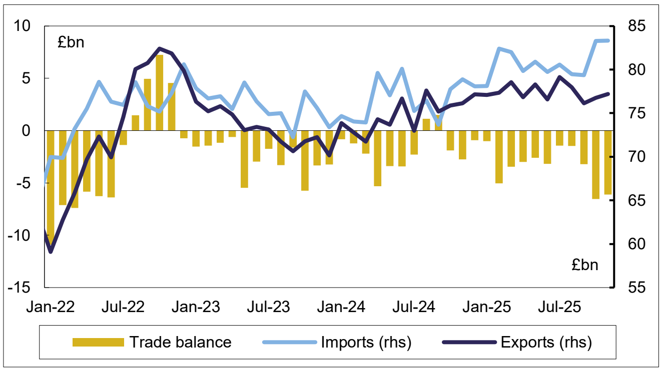
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected RICS residential survey indices



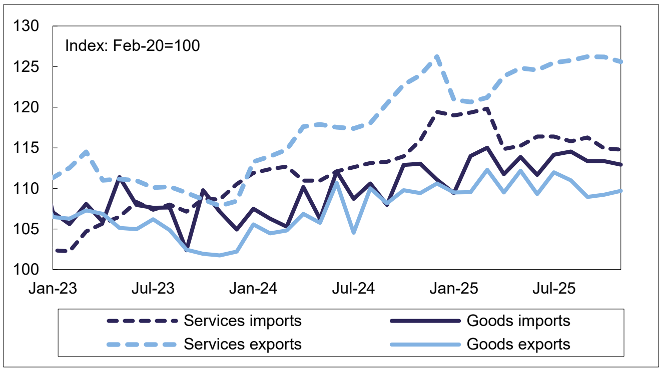
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Nominal trade balance, export & import values*



**Including precious metals.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Export & import volumes*



**Excluding precious metals.*
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		Industrial production M/M% (Y/Y%)	Nov	**0.7 (2.5)**	*0.5 (2.3)*	0.8 (2.0)	0.7 (1.7)
		Trade balance €bn	Nov	**10.7**	-	14.0	13.7
Germany		GDP Y/Y%	2025	**0.2**	0.2	-0.2	-0.5
		Government fiscal balance % of GDP	2025	**-2.4**	-	-2.6	-2.7
France		Final HICP (CPI) Y/Y%	Dec	**0.7 (0.8)**	*0.7 (0.8)*	0.8 (0.9)	-
Italy		Industrial production M/M% (Y/Y%)	Nov	**1.5 (1.4)**	0.5 (-0.2)	-1.0 (-0.3)	- (-0.2)
Spain		Final HICP (CPI) Y/Y%	Dec	**3.0 (2.9)**	*3.0 (2.9)*	3.2 (3.0)	-
UK		Monthly GDP M/M% (3M/3M%)	Nov	**0.3 (0.1)**	*0.1 (-0.2)*	-0.1 (-0.1)	- (0.0)
		Services output M/M% (3M/3M%)	Nov	**0.3 (0.2)**	0.1 (0.0)	-0.3 (0.0)	- (0.1)
		Industrial output M/M% (Y/Y%)	Nov	**1.1 (2.3)**	0.2 (-0.4)	1.1 (-0.8)	1.3 (0.4)
		Construction output M/M% (Y/Y%)	Nov	**-1.3 (-1.1)**	-0.3 (-0.1)	-0.6 (0.9)	-1.2 (0.9)
		Trade (goods trade) balance £bn	Nov	**-6.1 (-23.7)**	-2.5 (-20.4)	-4.8 (-22.5)	-6.5 (-24.2)
		RICS house price balance %	Dec	**-14**	-16	-16	-14

Auctions

Country		Auction
Spain		sold €3.25bn of 2.35% 2029 bonds at an average yield of 2.342%
		sold €1.51bn of 3.5% 2041 bonds at an average yield of 3.67%
		sold €1.1bn of 1.45% 2071 bonds at an average yield of 4.024%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
			- Nothing to report -				

Auctions

Country		Auction
Germany		sold €701mn of 3.25% 2042 bonds at an average yield of 3.23%
		sold €809mn of 0% 2052 bonds at an average yield of 3.45%
		sold €822mn of 2.9% 2056 bonds at an average yield of 3.45%
UK		sold £4.5bn of 4.75% 2035 bonds at an average yield of 4.456%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		07.00	Final HICP (CPI) Y/Y%	Dec	*2.0 (1.8)*	2.6 (2.3)
Italy		09.00	Final HICP (CPI) Y/Y%	Dec	*1.2 (1.2)*	1.1 (1.1)

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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