

Euro wrap-up

Overview

- Despite a broad-based softening in German inflation in December, Bunds followed the global trend slightly lower and OATs underperformed as French PM Lecornu was set to revise his budget plan in an attempt to gain parliamentary support.
- Gilts also made modest losses on a quiet day for UK economic news.
- The coming week will bring flash January PMIs and December inflation estimates from the euro area and UK, as well as the UK's labour market report and ECB's account of its December policy meeting.

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Daily bond market movements		
Bond	Yield	Change
BKO 2 12/27	2.112	+0.017
OBL 2½ 04/31	2.454	+0.022
DBR 2.9 02/36	2.839	+0.022
UKT 3½ 03/27	3.665	+0.008
UKT 4% 03/30	3.873	+0.016
UKT 4½ 03/35	4.400	+0.014

*Change from close as at 4:00pm GMT.
Source: Bloomberg

Euro area

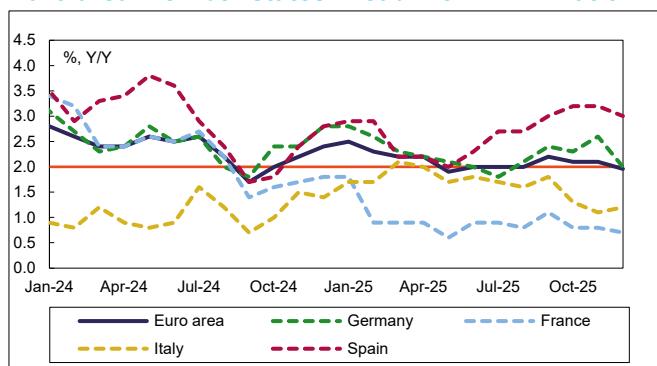
Broad-based softening in German inflation led by December discounting amid soft demand

Today's final German inflation estimates for December offered no surprises, suggesting that the updated aggregate euro area headline HICP rate (due Monday) will likewise align with the flash reading, which reported a drop of 0.1ppt to 2.0%Y/Y. Risks to that figure, however, remain skewed to the downside due to rounding as the initial estimate came in at 1.96%Y/Y to two decimal places. In Germany, the final release confirmed that the sharp drop in inflation at the end of last year on the EU-harmonised measure – by 0.6ppt to 2.0%Y/Y – resulted from a broad-based softening in price pressures. The easing was nevertheless led by core goods, for which the inflation rate fell the most in over two years, by 0.8ppt to 0.2%Y/Y. The detail suggested unseasonal discounting in a range of categories, including clothing, household furnishings and appliances and consumer electronics, both to entice demand and perhaps also in part reflecting ample supply of cheap imported items amid tariff-related trade diversion. As suspected, the drop in services inflation, by 0.3ppt to 3.9%Y/Y, related to a partial reversal of pressures in the typically volatile package holiday component after the jump in October to an eight-month high. Several other services components, including hospitality, also eased back. As such, German core HICP inflation fell a sizeable 0.5ppt – the most in 11 months – to 2.5%Y/Y, just 0.1ppt above the four-year low recorded in June and July. Among the non-core components, energy inflation fell a chunky 1.7ppts to -1.1%Y/Y, the lowest since March, thanks in part to lower petrol and electricity prices. In addition, food inflation maintained its downtrend, easing to a 21-month low of 1.8%Y/Y.

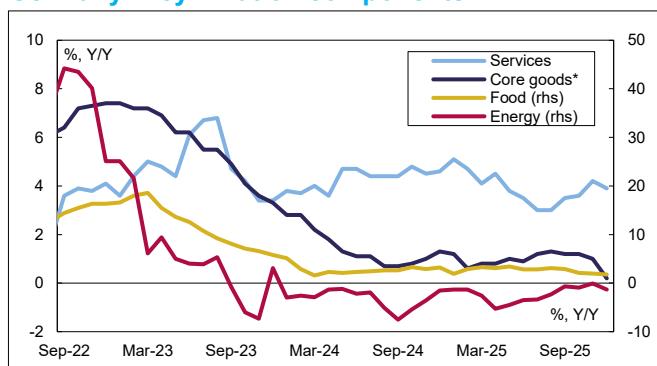
German inflation to take a further step down in January on softer energy and services prices

Looking ahead, German food inflation might take a step up in January due to unfavourable base effects after a near-5%M/M drop a year ago. And the recent significant pickup in wholesale gas prices and uptick in oil prices might provide a positive impulse in due course. Nevertheless, energy inflation in Germany should still take a further step down in January thanks to lower transmission grid fees and the abolition of the natural gas storage levy. And a 12ppt cut to VAT on restaurant meals will soften somewhat the impact of the near 8½% increase in the price of the 'Deutschlandticket' national public transport pass. Various services components, not least airfares and package holidays, will contribute to month-to-month volatility as usual. But, despite the increase in the statutory minimum wage of more than 8% and signs of further stabilisation in the jobs market, overall pay growth should continue to moderate, supporting a little further ongoing disinflation in services. And given the impact of past euro appreciation, as well as declining import prices and still subdued demand, non-energy industrial goods price pressures will remain largely absent. As such, and as for the euro area as a whole, we expect German HICP inflation to average a little less than 2.0%Y/Y in 2026, down from 2.3%Y/Y in 2025.

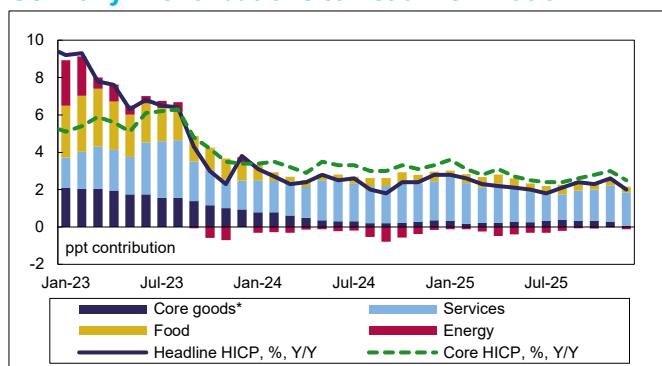
Euro area member states: Headline HICP inflation



Germany: Key inflation components

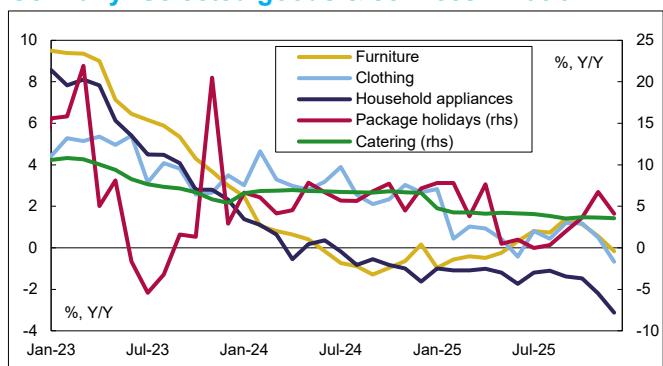


Germany: Contributions to headline inflation



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

Germany: Selected goods & services inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

Besides December's final estimates of inflation and accompanying detail (due Monday, outlined above), the highlight of the coming week's dataflow will be January's flash euro area PMIs (Friday), whose release will provide the first major signal as to whether the slightly firmer growth momentum suggested last quarter was sustained into the new year. Admittedly, while Q4's results were consistent with expansion – the composite output PMI rose in each member state on average versus Q3, and by some 1¼pts for the aggregate euro area – December's survey still underwhelmed. The composite euro area PMI fell to a three-month low, down 1.3pts to 51.5, led by a pullback in German and Italian manufacturing. Activity in France was also reportedly stagnant. But given the recent poor form of the PMIs in predicting GDP growth in that member state, INSEE's more comprehensive survey (also due Friday) should warrant attention too.

Amongst the other incoming surveys, January's flash Commission consumer confidence reading (Thursday) will give an update on household sentiment. This index most recently slipped to a three-month low firmly below the long-run average (-13.1), and renewed geopolitical concerns could again serve as a headwind. But mirroring this week's [Sentix survey](#), the ZEW sentiment indices (Tuesday) will likely report an improvement in investor expectations for the German economy at the start of the year. Meanwhile, euro area construction output (Tuesday) is likely to have edged down around ½% M/M in November, following contractions in Germany (-0.8% M/M) and France (-1% M/M). But that should not completely offset October's German-led boost, leaving output over the quarter thus far still a touch higher than its Q3 level. German PPI data (also Tuesday) should show that industrial output prices declined modestly in 2025, consistent with few underlying price pressures from the factory sector.

Beyond the economic data, the ECB's monetary policy account of December's monetary policy meeting (Thursday) will be of interest too. Content with the current policy stance policy, the Governing Council was predictably unmoved at that meeting. That was also justified by its updated macroeconomic projections, which nudged up its near-term inflation outlook for 2026 to reflect a slightly more bullish growth outlook, but continued to forecast a temporary undershoot of the 2% inflation target. So, with no cuts priced in for 2026, and Governing Council members downplaying the near-term likelihood of a rate hike, we expect that the account will keep to a similarly neutral message. The week ahead will also see policymakers converge on Davos for the World Economic Forum, so comments from senior ECB figures – President Lagarde, and Governing Council members Nagel & Villeroy all slated to speak on panels – are to be expected. Finally, after Prime Minister Lecornu was set to make today fresh proposals for a French 2026 Budget in an attempt to break the deadlock in the National Assembly, attention will also focus on how the various political parties respond and whether the PM will eventually decide to force the plans through Parliament using Constitutional powers or an alternative decree – procedures that might risk another vote of no-confidence in his government.

UK

The week ahead in the UK

A handful of top-tier economic data releases are scheduled for the UK over the coming week, including most notably the labour market report (Tuesday) and December's inflation figures (Wednesday). The softness of recent price and activity data (as well as a disinflationary Budget) were central to tipping the Bank's decision in favour of cutting rates in [December](#). But the MPC also struck a more cautious tone, highlighting upside risks posed by structural labour market changes and elevated forward-looking wage indicators. The labour market report should bring the MPC some reassurance about the pace of wage moderation. We expect regular pay growth to ease slightly, to around 4½% M/Y. But the BoE's preferred measure for the private sector should decelerate a touch more to 3.7% M/Y, a new five-year low and on track to converge to, or slightly below, the BoE's year-end expectation of 3.5% M/Y. The unemployment rate, which rose to 5.1% M in October, has already overshot the BoE's forecast. And given the continued weakness of hiring indicators post-Budget and the decline in November's payroll data, we expect employment growth to have stayed weak on approach to the end of the year.

Turning to inflation, the downside surprise to November's print – to 3.2%Y/Y, undershooting the BoE's forecast by 0.2ppt – provided welcome evidence of continued disinflation. But we expect to see some modest payback for its weakness in December. Indeed, we expect headline CPI to edge back up to 3.3%Y/Y, maintaining its gap to the BoE's projections.

While the later Budget timing provided some circumstantial relief to inflation in tobacco products, new duties are likely to restore its higher contribution. The BRC also signalled broader upside risks to food prices, which moderated a full 0.8ppt in November to 4%Y/Y. But despite an uptick in petrol prices, energy inflation should soften a touch on base effects. With regards to core inflation, our baseline assumes a sidestep (3.2%Y/Y) in December. But, with the services component likely ticking back up to 4.5%Y/Y and several goods prices likely to have been suppressed in November by Black Friday discounting, we see the risks to our estimate of core inflation as finely balanced to the upside.

Friday will provide the other flashpoint for the coming week's UK data, bringing January's flash PMIs and retail sales figures for December. Notwithstanding the results of the CBI's industrial survey (Wednesday) – which will provide a quarterly update on business trends and investment intentions too – the flash PMIs will provide a first indication about whether business activity picked up at the start of Q1 following a relatively subdued end to last year. In addition to the activity indices, insights about price and employment developments will also be of particular interest. Meanwhile, retail sales might be expected to see some payback in December for recent weakness, but more timely surveys failed to detect a much-hoped-for festive boost. So, any payback is likely to be modest, and we expect confirmation of a moderate contraction in retail sales over Q4 as a whole. Looking further ahead, the CBI's distributive trades survey (Thursday) will provide a first view of activity in the retail sector activity in January, while the GfK consumer survey (Friday) will show whether household sentiment sustained a post-Budget improvement into the new year. UK public finances data for December (Thursday) are also due, while MPC external member Megan Greene is due to speak publicly on the implications of monetary policy divergences between the US, UK and euro area (Friday).

Daiwa economic forecast

	2025		2026				2025	2026	2027
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	%, Q/Q						%, Y/Y		
Euro area		0.3	0.3	0.3	0.3	0.3	1.4	1.1	1.3
UK		0.1	0.1	0.2	0.3	0.3	1.4	0.9	1.3
Inflation, %, Y/Y									
Euro area									
Headline HICP		2.1	2.1	1.7	1.8	1.6	1.8	1.7	1.7
Core HICP		2.3	2.4	2.3	1.8	1.6	1.7	2.4	1.8
UK									
Headline CPI		3.8	3.4	3.0	2.1	2.1	2.1	3.4	2.3
Core CPI		3.6	3.3	3.0	2.4	2.4	2.3	3.5	2.5
Monetary policy, %									
ECB									
Deposit Rate		2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Refi Rate		2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.15
BoE									
Bank Rate		4.00	3.75	3.75	3.50	3.25	3.25	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/ <u>Daiwa forecast</u>	Previous
Monday 19 January 2026					
Euro area	10.00	Final headline (core) HICP Y/Y%	Dec	<u>2.0 (2.3)</u>	2.1 (2.4)
UK	00.01	Rightmove house prices M/M% (Y/Y%)	Jan	-	-1.8 (-0.6)
Tuesday 20 January 2026					
Euro area	09.00	ECB current account balance €bn	Nov	-	25.7
Germany	10.00	Construction output M/M% (Y/Y%)	Nov	<u>-0.6 (-0.8)</u>	0.9 (0.5)
UK	07.00	PPI Y/Y%	Dec	-2.3	-2.3
	10.00	ZEW current situation (expectations) balance	Jan	-75.0 (50.0)	-81.0 (45.8)
	07.00	Average wages (excluding bonuses) 3M/Y%	Nov	4.6 (4.5)	4.7 (4.6)
	07.00	Private sector regular wages 3M/Y%	Nov	3.7	3.9
	07.00	Unemployment rate 3M%	Nov	5.1	5.1
	07.00	Employment 3M/3M change 000s	Nov	23	-16
	07.00	Payrolled employees M/M change 000s	Dec	-19	-38
	07.00	Claimant count rate % (change 000s)	Dec	-	4.4 (20.1)
Wednesday 21 January 2026					
France	-	Retail sales Y/Y%	Dec	-	0.7
UK	07.00	Headline (core) CPI Y/Y%	Dec	<u>3.3 (3.2)</u>	3.2 (3.2)
	07.00	PPI – output (input) prices Y/Y%	Dec	3.5 (1.0)	3.4 (1.1)
	09.30	House price index Y/Y%	Nov	-	1.7
	11.00	CBI industrial trends survey – total orders (selling prices) net balance %	Jan	-33 (16)	-32 (19)
	11.00	CBI industrial trends survey – business optimism net balance %	Jan	-	-31
Thursday 22 January 2026					
Euro area	15.00	Preliminary Commission consumer confidence indicator	Jan	-13.0	-13.1
UK	07.00	Public sector net borrowing £bn	Dec	13.0	11.7
	11.00	CBI distributive trades survey – retailing reported sales net balance %	Jan	-35	-44
Friday 23 January 2026					
Euro area	09.00	Preliminary services (manufacturing) PMI	Jan	52.6 (49.2)	52.4 (48.8)
Germany	09.00	Preliminary composite PMI	Jan	51.8	51.5
France	08.30	Preliminary services (manufacturing) PMI	Jan	52.5 (47.6)	52.7 (47.0)
UK	08.30	Preliminary composite PMI	Jan	51.5	51.3
	07.45	INSEE business (manufacturing) confidence indicator	Jan	99 (101)	99 (102)
	07.45	INSEE production outlook (own company) indicator	Jan	-7 (9)	-7 (11)
	08.15	Preliminary services (manufacturing) PMI	Jan	50.4 (50.4)	50.1 (50.7)
	08.15	Preliminary composite PMI	Jan	50.0	50.0
	00.01	GfK consumer confidence indicator	Jan	-16	-17
	07.00	Retail sales – incl. auto fuels M/M% (Y/Y%)	Dec	0.0 (1.1)	-0.1 (0.6)
	07.00	Retail sales – excl. auto fuels M/M% (Y/Y%)	Dec	-0.1 (-1.7)	-0.2 (1.2)
	09.30	Preliminary services (manufacturing) PMI	Jan	51.7 (50.5)	51.4 (50.6)
	09.30	Preliminary composite PMI	Jan	51.5	51.4

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 19 January 2026		
- Nothing scheduled -		
Tuesday 20 January 2026		
Euro area		10.00 Eurostat to publish update on Q325 GDP aggregates and employment
UK		09.45 BoE Governor Bailey & Deputy Governor Ramsden to discuss the Financial Stability Report at Treasury Select Committee
Wednesday 21 January 2026		
Germany		10.30 Auction: to sell up to €1bn of 2.6% 2041 bonds
		10.30 Auction: to sell up to €1bn of 2.9% 2056 bonds
		18.30 Bundesbank President Nagel speaks on European growth on a panel at the WEF in Davos
UK		10.00 Auction: to sell £4.75bn of 4% 2029 bonds
Thursday 22 January 2026		
Euro area		10.00 Eurostat to publish Government financial accounts for Q325
		12.30 ECB to publish monetary policy account of December 17-18 Governing Council meeting
France		09.50 Auction: to sell up to €13.5bn of 2.4% 2028, 2.75% 2029, 2.7% 2031 & 3% 2033 bonds
		10.50 Auction: to sell up to €1.75bn 0.1% 2029, 0.1% 2036, 0.55% 2039 & 0.1% 2053 inflation-linked bonds
Friday 23 January 2026		
Euro area		10.00 ECB President Lagarde to speak on 'Global economic outlook' panel at the World Economic Forum in Davos
UK		09.30 External MPC member Greene to give speech on monetary policy titled 'Worlds apart?' at the Resolution Foundation, London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
Germany		Final HICP (CPI) Y/Y%	Dec	2.0 (1.8)	<u>2.0 (1.8)</u>	2.6 (2.3)	-
Italy		Final HICP (CPI) Y/Y%	Dec	1.2 (1.2)	<u>1.2 (1.2)</u>	1.1 (1.1)	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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