

Euro wrap-up

Overview

- Shorter-dated Bunds made modest losses as euro area consumer confidence surprisingly rose to an eleven-month high.
- While UK public borrowing was lower than expected, political speculation surrounding a potential future leadership challenge to PM Starmer saw longer-dated gilts reverse earlier gains.
- Friday will bring flash January PMIs from the euro area and UK, as well as the latest UK retail sales data and consumer confidence survey.

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Daily bond market movements		
Bond	Yield	Change
BKO 2 12/27	2.105	+0.022
OBL 2 1/04/31	2.471	+0.013
DBR 2.9 02/36	2.880	-0.001
UKT 3 1/03/27	3.661	-0.010
UKT 4 1/03/30	3.917	+0.007
UKT 4 1/03/35	4.467	+0.011

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

Euro area

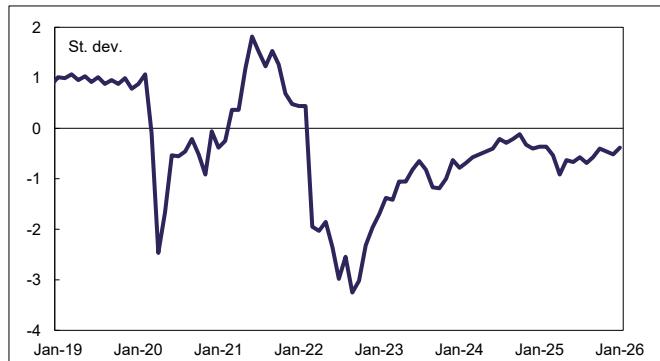
Consumer confidence surprisingly rises to an 11-month high in January despite Greenland angst

After slipping back at the end of 2025, and despite uncertainty related to President Trump's intentions for Greenland, today's flash Commission indicator suggested that household sentiment rebounded in January. In particular, the headline euro area consumer confidence index rose 0.8pt to -12.4, the highest in eleven months. But this was little better than the average in 2024 and remained some way below the long-run trend (-10.4). Moreover, the lengthy collection period for the survey responses (1-21 January) might suggest that the geopolitical events of the past few weeks weren't fully reflected in today's index. The equivalent national surveys published so far have flagged a slight worsening in perceptions of the economic outlook at the start of the year, with consumer sentiment in the Netherlands – one of the eight European countries initially threatened by the US with an extra 10% tariff – moderating to a three-month low. And while consumer confidence in Belgium rose to the highest level since April 2021, this principally reflected greater optimism about the jobs market. Historically low unemployment in the euro area, combined with strong balance sheets and improving real incomes, is a key reason why household consumption is expected to support a gradual pickup in economic growth momentum this year. But, as events over the past week or so illustrate, persisting uncertainty relating to geopolitics continues to pose a non-negligible downside risk to economic activity and inflation. And while today's account of the ECB Governing Council's December policy meeting noted that 'some' members thought that the risks to the inflation outlook at the end of the last year were tilted to the downside, only 'a few' thought that the opposite was the case.

The day ahead in the euro area

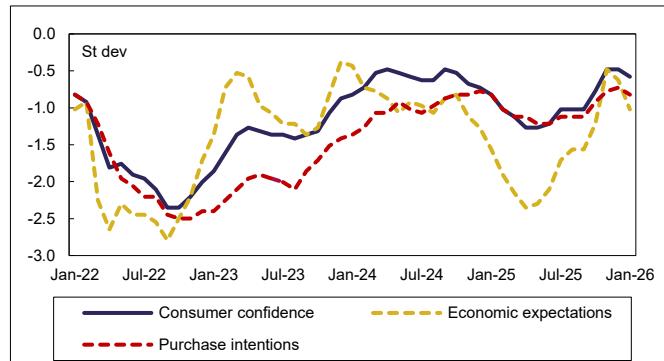
January's flash euro area PMIs will provide the main draw of Friday's economic data. The survey signalled a healthy and broad-based pickup in business activity at the end of last year, despite paring some of that momentum in December against a pullback in German and Italian manufacturing and slower expansion in the services sector. Nonetheless, while the euro area composite PMI eased to a three-month low, at 51.5, it remained consistent with positive growth. And we might expect to see some modest payback for last month's drop, particularly from Germany (51.3), where the composite PMI fell more than 1pt. The drop in the French PMIs last month was less stark, but still consistent with stagnation (50.0). Still, we caveat that the signal from the survey has been relatively poor for predicting GDP growth in that member state. As such, INSEE's more comprehensive business survey, which is due alongside the PMIs, should provide a more valuable signal.

Euro area: Consumer confidence index



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

Netherlands: Consumer confidence indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

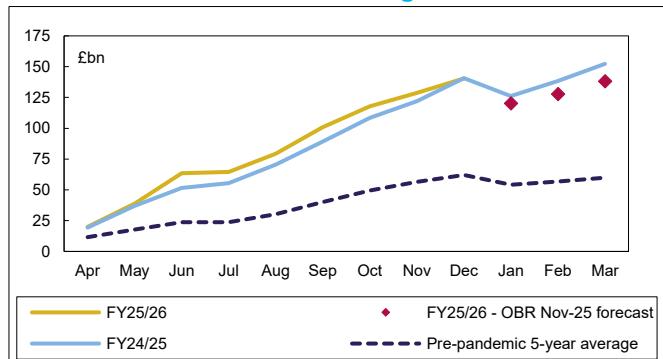
Public sector net borrowing softer than expected so far in FY25, supported by higher receipts

Today's UK public finance data provided a rare positive surprise, suggesting that government net borrowing was smaller than expected at the end of 2025. While tax receipts beat expectations, central government spending came in on the low side. As a result, public sector net borrowing in December came in at £11.6bn, down a chunky £7.1bn from a year ago. Given some favourable revisions to prior months, that took cumulative borrowing in the first nine months of the fiscal year to £140.4bn (4.6% of GDP), only £0.4bn lower than the equivalent period in FY24/25, but £4.1bn below the monthly profile of the OBR's forecast. Central government receipts were some £56.1bn higher in the first nine months of the fiscal year compared to the same period in 2024, benefiting from the hike in National Insurance Contributions from April and higher PAYE income taxes thanks to firm wage growth. Meanwhile, central government expenditure in the financial year to date was some £48.4bn higher than a year earlier, similarly reflecting elevated public sector pay growth as well as high inflation and debt interest costs. But with inflation data softer than it had expected, implied interest payments on inflation-linked gilts have started to undershoot the OBR's forecast. And today's release suggests that public sector net borrowing will slightly undershoot expectations this financial year as long as the large rise in capital gains tax receipts anticipated in January is forthcoming.

Gilts wobble on perceptions of increased risk of challenge to Starmer from Mancunian mayor

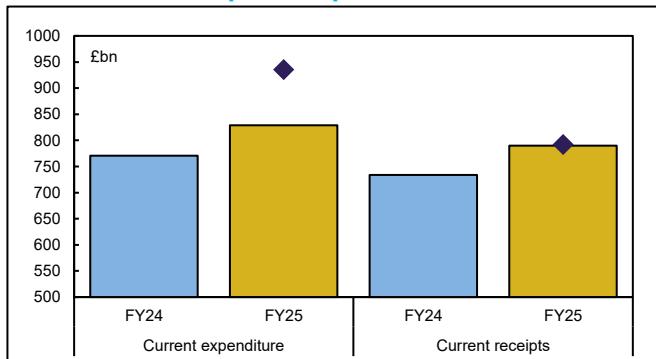
Gilts initially made gains in response to the improved fiscal numbers, which provided a reminder that – unlike many of its G7 peers – the UK government's borrowing should decline this year and next in the absence of shocks. But yields subsequently rose on political news which suggested a somewhat greater risk that Keir Starmer will soon be challenged as Labour leader and Prime Minister from the less fiscally responsible wing of his party. The specific report – that disgraced Mancunian MP Andrew Gwynne will soon retire from the House of Commons – might at first glance have seemed unlikely to have a market impact. However, any forthcoming by-election to confirm the successor to Gwynne's parliamentary seat would appear to give current Manchester Mayor and former government Minister Andy Burnham – a leading critic of Starmer within the Labour Party with a large support base – an opportunity to return to Westminster as an MP. And if he successfully seized that opportunity, Burnham might be expected to challenge the Prime Minister's leadership with a non-negligible chance of success. Moreover, as he argued last autumn that the government should not be "in hock" to the bond market – naïve comments which suggested little understanding of either the government's fiscal challenges or the mistakes of the Liz Truss era – perceptions of a greater risk that Burnham might find a route to Downing Street hit Gilts. However, we are far from convinced that Burnham will be able to position himself for a successful challenge to Starmer's premiership this year.

UK: Public sector net borrowing



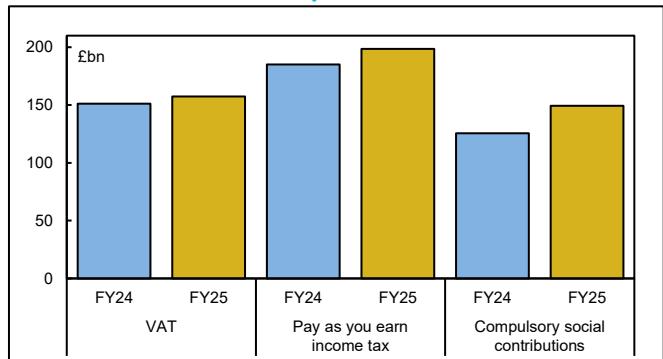
Source: OBR, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Current receipts & expenditure in FY-to-date*



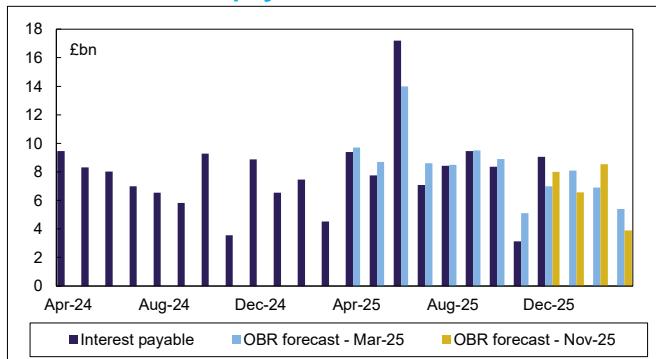
*Cumulative increase in financial year-to-November. Diamonds represent OBR forecast. Source: OBR, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Select current receipts in FY-to-date*



*Cumulative increase in financial year-to-November. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Debt interest payments



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Non-negligible risk of left-wing challenge to Starmer's leadership after May's local elections

Indeed, while today's decision by Gwynne to vacate his seat provides Burnham with a possible pathway to become an MP, his nomination as the Labour candidate in the resulting by-election looks unlikely. Labour Party rules state that directly elected mayors such as Burnham require the permission of the party's National Executive Committee (NEC) to stand. NEC membership is currently biased in favour of Starmer supporters, who would seem justified in opposing Burnham's candidature on the basis of the significant costs and risks surrounding the resulting election of a new Mancunian Mayor. The NEC might alternatively insist upon a female candidate. And while Burnham would be favourite with bookmakers to win the seat if he was allowed to stand as the Labour candidate, an eventual defeat in the by-election to the far-right Reform Party (or even the left-wing Greens) would also be possible. On balance, we don't expect Burnham to take Gwynne's place in Westminster. Nevertheless, there remains a significant probability that Starmer's leadership will be challenged after the English local elections and Scottish and Welsh assembly elections in May. And if Starmer is indeed challenged and defeated, his successor – whoever that might be – would seem likely to be less committed to the government's current fiscal consolidation plans.

The day ahead in the UK

It will be a relatively busy end to the week for UK data, with January's flash PMIs and retail sales figures for December providing the top-tier releases. Regarding the latter, the recent weakness of retail sales growth – having contracted for two consecutive months, to be 0.4% below the Q3 average – and post-Budget improvement in consumer confidence would appear to support the case for some festive-themed payback in December. But we note that more timely surveys, including from the BRC, have failed to detect as much, implying that payback, if at all, is likely to be modest at best. And we expect December's data to confirm a fall in volumes in Q4. The update to the GfK consumer survey will show whether confidence sustained a post-Budget uptrend and signal a possible improvement in the near-term retail outlook. Today's CBI distributive trades survey results for January, while characteristically choppy, might be seen as a tentative hope of such. Meanwhile, January's flash PMIs will provide a first signal about economic growth momentum in Q1. Following a lackluster Q4, we expect GDP growth to pick up in Q1 as headwinds from the JLR shutdown and Budget uncertainty recede. As a result, we might expect the UK composite PMI to continue on a modest uptrend. Though led by the services sector, the CBI's quarterly industrial survey also signalled a brighter outlook for manufacturers. From a monetary policy perspective, the employment and price PMIs will also be of particular interest. Finally, external MPC member Megan Greene is due to give a speech on the implications of monetary policy divergences between the US, UK and euro area.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <u>Daiwa forecast</u>	Previous	Revised
Euro area	 Preliminary Commission consumer confidence indicator	Jan	-12.4	-13.0	-13.1	-13.2
UK	 Public sector net borrowing £bn	Dec	11.6	13.0	11.7	10.9
	 CBI distributive trades survey – retailing reported sales net balance %	Jan	-17	-35	-44	-

Auctions

Country	Auction
France	<ul style="list-style-type: none">   sold €3.713bn of 2.4% 2028 bonds at an average yield of 2.34%   sold €5.313bn of 2.75% 2029 bonds at an average yield of 2.41%   sold €2.470bn of 2.7% 2031 bonds at an average yield of 2.76%   sold €2.003bn of 3% 2033 bonds at an average yield of 3.14%   sold €944mn of 0.1% 2029 inflation-linked bonds at an average yield of 0.60%   sold €435mn of 0.1% 2036 inflation-linked bonds at an average yield of 1.56%   sold €202mn of 0.55% 2039 inflation-linked bonds at an average yield of 1.94%   sold €169mn of 0.1% 2053 inflation-linked bonds at an average yield of 2.08%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous
Euro area	09.00	Preliminary services (manufacturing) PMI	Jan	52.6 (49.2)	52.4 (48.8)
	09.00	Preliminary composite PMI	Jan	51.8	51.5
Germany	08.30	Preliminary services (manufacturing) PMI	Jan	52.5 (47.6)	52.7 (47.0)
	08.30	Preliminary composite PMI	Jan	51.5	51.3
France	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
UK	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

Auctions and events

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.

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