

Euro wrap-up

Overview

- Bunds were little changed as data confirmed that euro area industrial production fell sharply in December but still rose for a second successive quarter in Q4.
- Gilts made gains on a quiet day for UK economic news.
- Tuesday will bring updates on German inflation and the UK labour market as well as the results of the February ZEW investor survey.

Chris Scicluna
+44 20 7597 8326

Daily bond market movements		
Bond	Yield	Change
BKO 2.1 03/28	2.032	-0.001
OBL 2½ 04/31	2.330	-0.004
DBR 2.9 02/36	2.744	-0.009
UKT 3¾ 03/27	3.564	-0.013
UKT 4¾ 03/30	3.797	-0.025
UKT 4½ 03/35	4.387	-0.028

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

Euro area

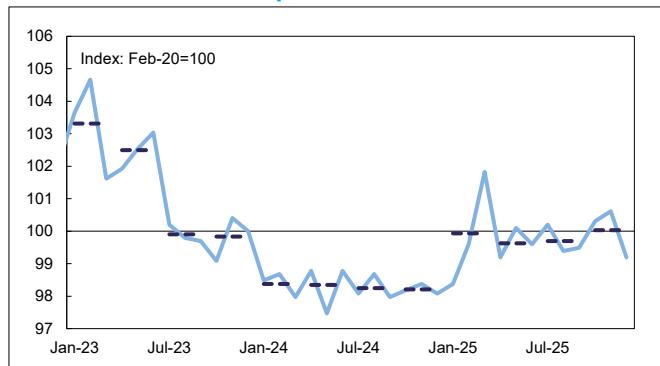
Industrial production up for second successive quarter in Q4 despite sharp drop in December

As expected, euro area industrial production (excluding construction) declined sharply in December. Indeed, the drop of 1.4%M/M was the steepest since April when firms pulled back after front-running US tariffs in Q1. Nevertheless, given the solid growth in October and November, it still rose for a second successive quarter in Q4 and by 0.3%Q/Q, the same pace as GDP. And as a result, last quarter marked the highest IP level since Q223. Due to the persistent weakness over recent years, however, the average level of production in Q4 was still more than 2% below that at the time of the Russian invasion of Ukraine in early 2022 and no higher than the pre-pandemic level in February 2020. Most categories of output were soft in December. The drop was particularly steep for production of capital goods (-1.9%M/M, the worst in 15 months), with cars, other transport goods and machinery and equipment all taking a big step down towards year-end. But given strength the prior month, output of motor vehicles was unchanged in Q4 from Q3, while capital goods production rose for a fourth successive quarter and by a vigorous 0.9%Q/Q. Output of intermediate items (0.4%Q/Q) rose for the first quarter since Q1 supported by growth in chemicals and other energy-intensive goods. And consumer durables (0.5%Q/Q) rose for the first quarter in four. In contrast, output of consumer non-durables (-1.7%Q/Q) fell sharply, weighed by pharmaceuticals, beverages and tobacco. As for the region, IP in each of the four largest member states fell in December and especially so in Germany (-2.9%M/M) and Spain (-2.5%M/M). But by the same token, over the quarter, growth in Q4 was geographically broad-based and relatively firm in Germany (0.8%Q/Q), Italy (0.9%Q/Q) and Spain (0.7%Q/Q).

Surveys & orders data point to return to modest IP growth from January & acceleration from Q2 on

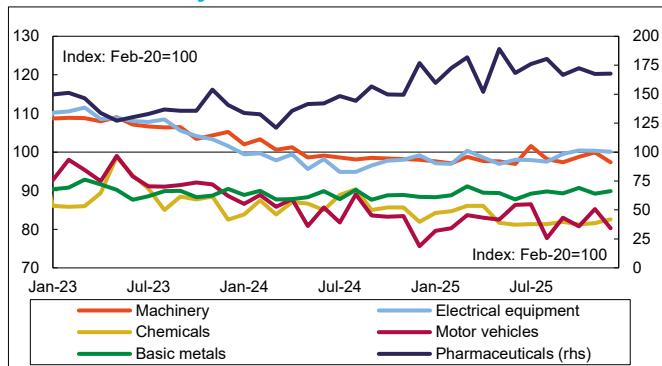
Given the vigour of the prior couple of months, the drop in production in December was not a surprise. Indeed, it had been foreshadowed by survey indices, such as the 1½pt decline in the euro area manufacturing output PMI that month to a 10-month low (48.9) firmly in contractionary territory. Fortunately, survey indicators point to a rebound in production in January as, for example, the aforementioned PMI reversed December's fall and the equivalent German indicator rose to a three-month high. Data and survey signals of strong new demand for German military equipment and French transport goods also point to stronger growth ahead. Indeed, the Commission survey's index of production expectations for the coming three months rose in January to the highest level in almost three years. Nevertheless, the sharp drop in production in December arithmetically represents significantly negative carry-over into Q1. So, the bar for achieving a third successive quarter of positive IP growth appears relatively high. Disruption to production in January due to adverse winter weather also represents a downside risk. For the time being, however, we retain our expectation that IP will grow again this quarter, albeit perhaps at a slightly slower pace than in Q4. And as the impact of German fiscal stimulus is increasingly felt, we look for an acceleration in production from Q2 on.

Euro area: Industrial production*



*Excludes construction. Dashed lines represent quarterly averages.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: IP by selected sub-sector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

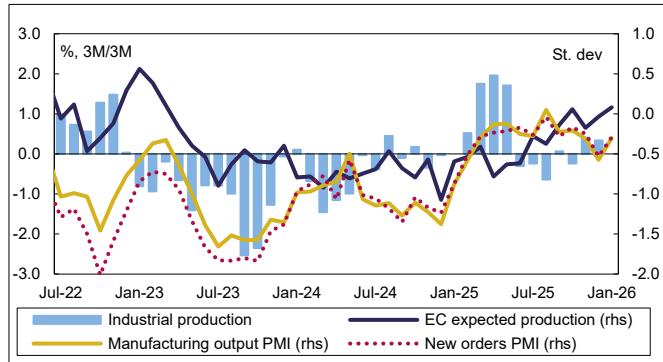
January's final German inflation estimates will be the most significant economic data out of the euro area on Tuesday. Indeed, given the downwards revision to last week's Spanish estimate, any notable change to the German number might also be consequential for next week's (February 25) euro area release. Having moderated sharply back to target at the end of last year, the flash estimates showed that the HICP rate ticked up just 0.1ppt in January, to 2.1%Y/Y. Payback in core goods after a soft December and an uptick in food categories provided most of the upward impulse. But services and energy categories look to have provided some offset. The accompanying detail may reveal the extent to which pass-through of the cut to VAT in hospitality venues contributed to moderation in the former, despite the broader upside risks posed by this year's minimum wage increase. We also expect electricity prices to have dropped at the start of the year, with lower grid fees countering the effects of a higher carbon tax. Meanwhile, the day ahead will also bring an update on German economic sentiment from the ZEW. Like this month's Sentix survey, perceptions of current and future economic conditions are expected to show further modest improvement in February.

UK

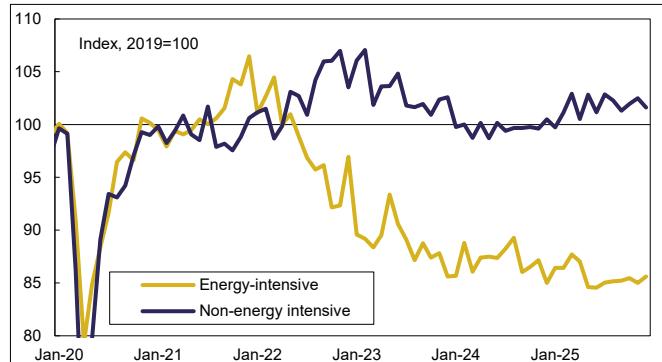
The day ahead in the UK

After a quiet start to the week for UK data, all eyes on Tuesday will be on the labour market data. At the BoE's last monetary policy meeting earlier this month, the MPC stated that 'some further [labour market] loosening is expected in the near term'. Bloomberg's survey suggests that the market generally thinks so too. And given the weaker-than-expected GDP growth in Q4 and signals of still subdued labour demand from various surveys, we would be unsurprised to see another round of weak employment indicators. The ILO unemployment rate is likely to have ended the year in the three months to December at 5.1%, up only 0.1ppt from Q3 but 0.7ppt higher than the same period a year earlier. Naturally, the wage data will be a key source of interest too, given not least the reservations of some rate-setters about elevated forward-looking pay indicators. However, those concerns appear to have diminished somewhat given the more favourable news regarding the inflation outlook. In any case, we expect to see further deceleration in underlying pay growth at the end of last year, with the BoE's preferred measure of private regular wages slowing to a five-year low of 3.4%3M/Y.

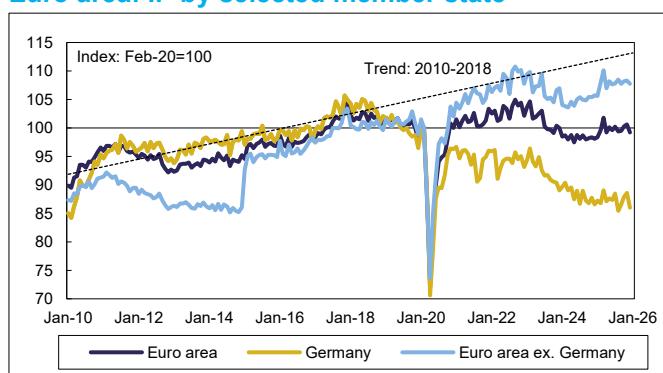
Euro area: IP & selected survey indicators



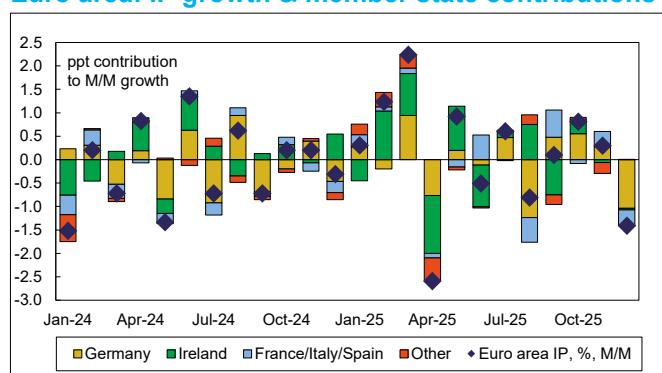
Euro area: IP by energy intensity of output



Euro area: IP by selected member state



Euro area: IP growth & member state contributions



European calendar

Today's results

Economic data							
Country	Release	Period	Actual	Market consensus/ <u>Daiwa forecast</u>	Previous	Revised	
Euro area 	Industrial production M/M% (Y/Y%)	Dec	-1.4 (1.2)	<u>-1.4 (1.1)</u>	0.7 (2.5)	0.3 (2.2)	
UK 	Rightmove house prices M/M% (Y/Y%)	Feb	0.0 (0.0)	-	2.8 (0.5)	-	
Auctions							
Country	Auction	- Nothing to report -					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data					
Country	GMT	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous
Germany 	07.00	Final HICP (CPI) Y/Y%	Jan	<u>2.1 (2.1)</u>	2.0 (1.8)
UK 	10.00	ZEW current situation (expectations) balance	Feb	-65.9 (65.1)	-72.7 (59.6)
UK 	07.00	Average wages (excluding bonuses) 3M/Y%	Dec	4.6 (4.2)	4.7 (4.5)
UK 	07.00	Private sector regular wages 3M/Y%	Dec	<u>3.4</u>	3.6
UK 	07.00	Unemployment rate 3M%	Dec	5.1	5.1
UK 	07.00	Employment 3M/3M change 000s	Dec	108	82
UK 	07.00	Payrolled employees M/M change 000s	Jan	-20	-43
UK 	07.00	Claimant count rate % (change 000s)	Jan	-	4.4 (17.9)
UK 	09.30	Output per hour Y/Y%	Q4	-	1.1
Auctions and events					
Germany 	10.30	Auction: to sell up to €6bn of 2.1% 2028 bonds			
UK 	10.00	Auction: to sell £500mn of 0.125% 2028 bonds			
UK 	11.30	Auction: to sell £750mn of 4.25% 2032 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research reports at:

<https://www.uk.daiwacm.com/ficc-research/research-reports>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited ("DCME"). DCME is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange. DCME and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or derivatives or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of DCME and its affiliates may have positions and effect transactions in such the Securities or derivatives or options thereof and may serve as Directors of such issuers. DCME may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended only for investors who are professional clients as defined in MiFID II and should not be distributed to retail clients as defined in MiFID II. Should you enter into investment business with DCME's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

DCME has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.