Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made notable losses as German inflation significantly exceeded expectations. BTPs outperformed after Italian President Mattarella was re-appointed for a second term to enable Draghi to remain as Prime Minister.
- As the "Party-gate" political saga appeared set to drag on with little near-term consequence, Gilts also made losses, while a UK survey suggested that business sentiment was stable despite omicron and price concerns.
- Tomorrow brings the latest euro area labour market data, as well as the French flash inflation estimate and UK bank lending numbers. Final January manufacturing PMIs are also due.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/23	-0.543	+0.077
OBL 0 04/27	-0.121	+0.078
DBR 0 02/32	0.008	+0.056
UKT 0⅛ 01/24	1.035	+0.077
UKT 0⅜ 10/26	1.133	+0.067
UKT 0¼ 07/31	1.308	+0.064

*Change from close as at 4:30pm GMT.
Source: Bloomberg

Euro area

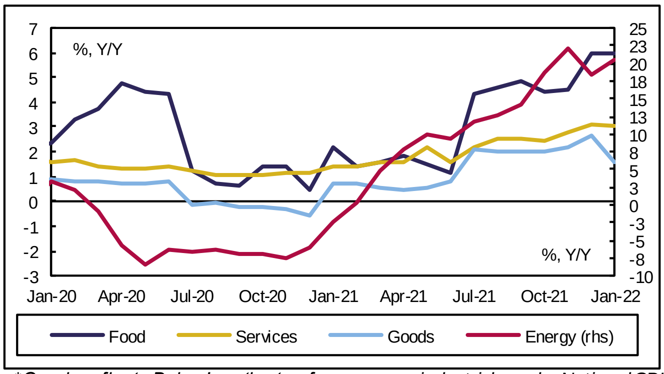
German inflation beat expectations to highlight uncertainty of ECB policy outlook

At this week's ECB policy meeting, President Christine Lagarde will probably repeat that the preconditions for a rate hike are unlikely to be reached this year. But she will need to underscore the uncertainty of the inflation outlook and insist that the Governing Council is ready to accelerate moves to tighten if required. And she might well have to concede that the ECB's inflation forecast published in mid-December already looks too low, at least as far as the near-term outlook is concerned. Certainly, today's first flash inflation estimates for January – from Germany, Spain and Portugal – all significantly surprised on the upside, causing forecasters (including ourselves) to revise up predictions for Wednesday's preliminary euro area data. Admittedly, as expected, German inflation fell back in January as the base effects from past tax changes fell out of the arithmetic. However, the declines in both the HICP EU-harmonised measure (down 0.6ppt to a three-month low of 5.1%Y/Y compared to the median forecast on the Bloomberg survey of just 4.3%Y/Y) and national CPI measure (down 0.4ppt to 4.9%Y/Y, versus to the Bloomberg consensus of 4.4%Y/Y) were much smaller than anticipated. Once again, energy was the main culprit, rising on the national measure by more than 2.0ppts to 20.5%Y/Y, due not least to higher prices of gasoline at the pump. However, services inflation declined a very modest 0.1ppt to 3.0%Y/Y, still just the second-highest reading since 1997, likely in no small part due to higher package tour prices. Meanwhile, better reflecting the base effect related to taxation, inflation of food fell 1.0ppt from December's 13-year high to 5.0%Y/Y while the non-energy industrial goods component (on our estimate) also fell about 1ppt from the prior month's series high to 1.7%Y/Y.

Iberian inflation also stronger-than-expected

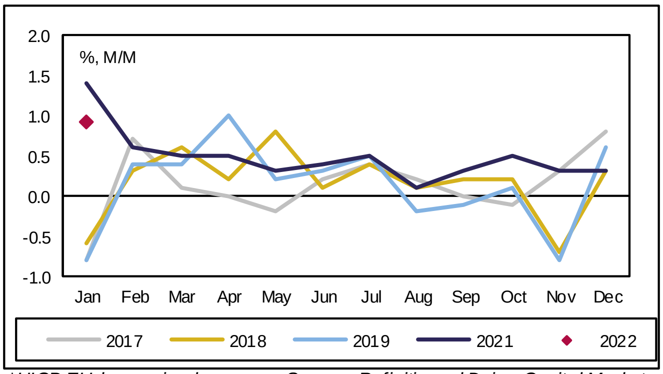
There was also an upside surprise to the preliminary Spanish and Portuguese inflation data. In Spain, headline HICP inflation came in well above expectations in January at 6.1%Y/Y, down just 0.5ppt having been forecast to decline by more than 1ppt. The national measure similarly saw headline inflation decline 0.5ppt to 6.0%Y/Y, still the second-highest reading since comparable statistics began in 1986. The Statistical Office suggested that, as is often the case in Spain, electricity prices were predominantly behind the latest move, having risen sharply this time last year. Indeed, the core measure rose 0.3ppt to 2.4%Y/Y, the highest for more than nine years. In Portugal, meanwhile, headline inflation jumped 0.6ppt to 3.4%Y/Y, the highest for almost a decade. On the national measure, headline inflation rose 0.6ppt to 3.3%Y/Y, with core inflation also up 0.7ppt to 2.5%Y/Y, the highest since September 2011, with the national Statistical Office noting an acceleration in prices in most categories. Overall, today's releases suggest that Wednesday's flash euro area headline figure will come in somewhere between 4½%Y/Y and December's euro-era high of 5.0%Y/Y. And with ongoing upside risks to

Germany: Consumer price inflation*



*Goods reflects Daiwa's estimate of non-energy industrial goods. National CPI measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation*



*HICP EU-harmonised measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

energy prices as well as the possibility of further pass-through of pipeline pressures to non-energy goods and services, euro area inflation might yet hit new highs.

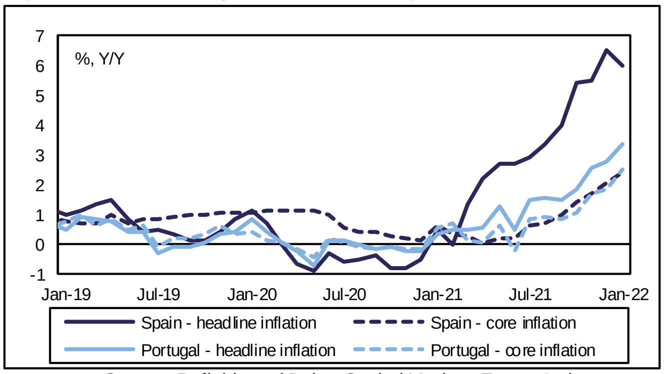
Euro area GDP growth slowed sharply, but output still back to pre-pandemic level

There were no major surprises from today's preliminary estimate of euro area GDP in Q4, with growth aligning with our projection at 0.3%Q/Q, a touch softer than the consensus but marginally stronger than the ECB's December forecast. And while it represented a marked slowdown from growth in Q3 (which was upwardly revised slightly to 2.3%Q/Q), as the latest pandemic wave and persisting supply challenges weighed on activity, growth was still strong enough to return output back to its pre-pandemic level for the first time. Today's release provided no additional detail on the national accounts. But the country reports have so far suggested a mixed performance. Perhaps unsurprisingly, those member states that saw an earlier surge in coronavirus cases or were most exposed to supply bottlenecks fared worst over the past quarter, with the German economy contracting 0.7%Q/Q amid a fall in household consumption, and Austrian GDP declining 2.2%Q/Q, the steepest drop since the onset of the pandemic. Meanwhile, the Italian numbers published today suggested that GDP growth slowed 2.0ppts to 0.6%Q/Q, to leave output just ½% lower than the pre-pandemic level. Like in France (where the economy grew 0.7%Q/Q), growth in Italy in Q4 appears to have been supported by domestic demand and inventories, with net trade a drag. And while Portugal's GDP growth exceeded expectations (1.6%Q/Q), the best performing economy in Q4 was Spain, with growth of 2.0%Q/Q, albeit leaving output still 4% lower than in Q419.

The day ahead in the euro area

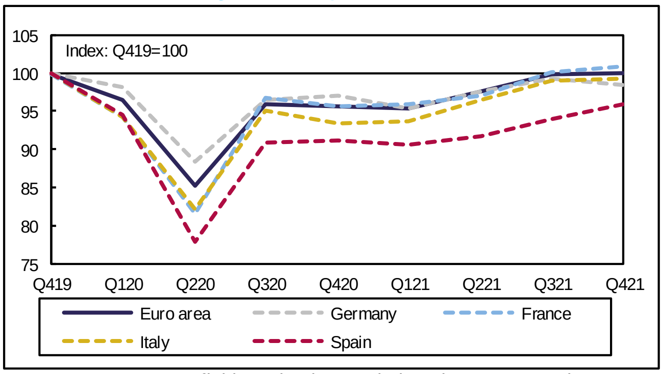
Despite the slowing economic recovery, tomorrow's labour market figures are expected to report a further decline in euro area unemployment at the end of last year, with the rate forecast to fall 0.1ppt in December to 7.1%. German labour market figures for January are also due. Meanwhile, ahead of Wednesday's flash euro area inflation estimate for January, tomorrow's French CPI numbers are expected to reveal that the EU-harmonised measure of inflation eased to 2.9%Y/Y from the 13½-year high of 3.4%Y/Y in December. Tomorrow will also see the release of German retail sales numbers for December, as well as January new car registrations numbers from France, Italy and Spain and the final January manufacturing PMIs. The preliminary euro area manufacturing output PMI rose by 2pts to a five-month high of 55.8 with the detail hinting at a modest easing of supply bottlenecks.

Spain and Portugal: Consumer price inflation



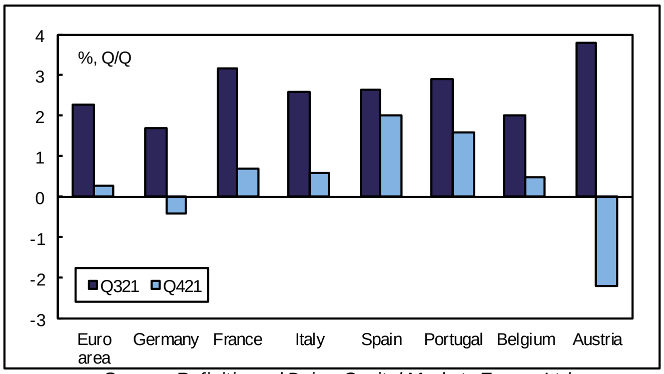
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth by selected member states



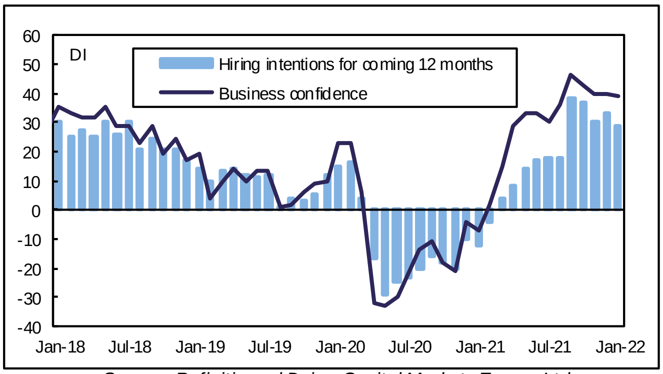
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth by selected member states



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Lloyds business barometer indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK

Survey suggests stable sentiment despite omicron and price concerns

A relatively quiet start to the week brought the latest Lloyds business barometer, which suggested that UK corporate sentiment remains broadly stable at a relatively elevated level. However, amid concerns about the ongoing coronavirus wave and rising prices, the headline index softened slightly for the third month out of the past four, dropping 1ppt to 39%, still comfortably above the long-run average (28%). Among the sector detail, there was a further modest increase in the manufacturing index, by 3ppts, to its highest for three months with signs of an easing in supply-chain pressures. Retailers were also slightly more upbeat than in December. And while the services index extended its recent run of losses, Lloyds noted an encouraging improvement in the hospitality sub-sector. The index for firms' economic optimism versus conditions three months ago slipped to a six-month low (37%), while the index of firms' trading expectations for the coming twelve months also slipped back very slightly. Perhaps of most interest to the BoE, almost half of firms expect to raise prices over the coming year with the respective index up to a series high. However, the share of firms expecting average pay growth of 2%Y/Y fell again in January leaving the respective index down 7ppts at a five-month low (41%) and the share expecting pay growth to top 3%Y/Y dropped 5ppts to 21%. And the survey index of hiring intentions similarly fell to a five-month low, although almost half of firms still expected to increase headcount over the coming year.

The day ahead in the UK

Tomorrow will provide an update on household lending in December. Demand for consumer credit is likely to have weakened as the rise in coronavirus cases and reintroduction of certain pandemic restrictions limited consumption of services while retail sales fell sharply at the end of the year. Net consumer credit is forecast at £0.4bn in December, compared with £1.2bn in November. Meanwhile, we would expect another solid month of growth in mortgage lending, while the Nationwide house price index will provide the first insight into house price growth in January. Like in the euro area, tomorrow also brings final manufacturing PMI data, which are expected to align with the flash survey data and suggest that output rose further at the start of the year amid a limited easing in supply constraints.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Preliminary GDP Q/Q (Y/Y%)	Q4	**0.3 (4.6)**	*0.3 (4.5)*	2.2 (3.9)	**2.3 (-)**
Germany	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	**4.9 (5.1)**	4.3 (4.3)	5.3 (5.7)	**-**
Italy	Preliminary GDP Q/Q% (Y/Y%)	Q4	**0.6 (6.4)**	*0.4 (6.1)*	2.6 (3.9)	**- (4.0)**
Spain	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	**6.0 (6.1)**	5.4 (5.5)	6.5 (6.6)	**-**
	Retail sales Y/Y%	Dec	**-2.3**	-	4.9	**5.1**
UK	Lloyds business barometer	Jan	**39**	-	40	**-**

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/ *Daiwa forecast*	Previous
Euro area	09.00	Final manufacturing PMI	Jan	59.0	58.0
	10.00	Unemployment rate %	Dec	7.1	7.2
Germany	07.00	Retail sales M/M% (Y/Y%)	Dec	-1.4 (3.4)	0.8 (0.5)
	08.55	Unemployment rate % (change '000s)	Jan	5.2 (-6.0)	5.2 (-23.0)
	08.55	Final manufacturing PMI	Jan	60.5	57.4
France	07.45	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	2.5 (2.9)	2.8 (3.4)
	08.50	Final manufacturing PMI	Jan	55.5	55.6
	-	New car registrations* Y/Y%	Jan	-	-15.1
Italy	08.45	Manufacturing PMI	Jan	61.2	62.0
	09.00	Unemployment rate %	Dec	9.1	9.2
	17.00	New car registrations Y/Y%	Jan	-	-27.5
Spain	08.15	Manufacturing PMI	Jan	56.0	56.2
	-	New car registrations* Y/Y%	Jan	-	-18.7
UK	07.00	Nationwide house price index M/M% (Y/Y%)	Jan	0.6 (10.9)	1.0 (10.4)
	09.30	Net consumer credit £bn (Y/Y%)	Dec	0.4 (-)	1.2 (0.4)
	09.30	Net mortgage lending £bn (approvals '000s)	Dec	3.5 (66.0)	3.7 (67.0)
	09.30	Final manufacturing PMI	Jan	56.9	57.9

Auctions and events

Germany	10.30	Auction: €6bn of 0% 2024 bonds

Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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