

Euro wrap-up

Overview

- Euro area government bonds made gains as the flash estimates of German inflation in December fell much further than expected and surveys indicated a further moderation in supply pressures.
- Longer-dated Gilts also made gains as the final UK manufacturing PMIs for December were revised up modestly from the very weak preliminary estimates.
- Wednesday will bring flash French inflation data for December as well as surveys of French consumer confidence and UK retail prices, and UK bank lending figures.

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Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.636	-0.005
OBL 1.3 10/27	2.400	-0.041
DBR 1.7 08/32	2.375	-0.053
UKT 1 04/24	3.586	+0.008
UKT 1½ 07/27	3.606	-0.006
UKT 4¼ 06/32	3.968	-0.025

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

Source: Bloomberg

Euro area

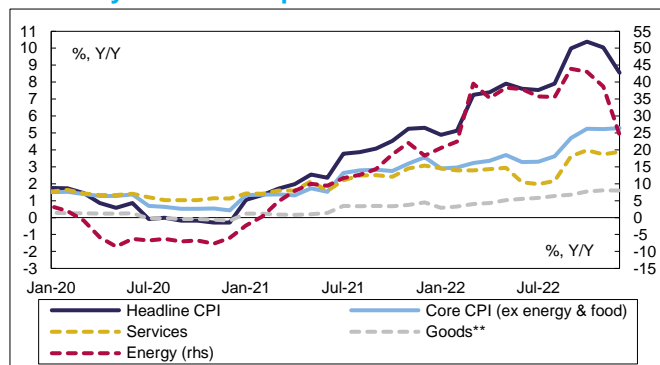
German inflation falls further than expected in December on lower energy prices

While the [ECB](#) ended 2022 on an extremely hawkish note in response to the upwards revision to its price outlook, today's flash estimates of German inflation in December surprised significantly on the downside. The EU-harmonised HICP measure fell 1.7ppts to 9.6%Y/Y, 2.0ppts below October's peak and 0.6ppt below the median forecast on the Bloomberg survey. And the national CPI measure dropped 1.4ppts, 1.8ppts below the peak and 0.4ppt below the Bloomberg consensus. Both the HICP and CPI rates represented four-month lows, and we expect further declines over coming months as base effects become far more favourable and cost pressures moderate in response to an improved balance between supply and demand as well as government policy interventions. Just as the rise in German inflation into the autumn had been driven by prices of energy, that category accounted for most of the decline in December. Indeed, on the national measure, energy inflation fell more than 14ppts – the most on the series – to 24.4%Y/Y. In part, that reflected the federal government's one-off payment to reduce domestic energy bills at the end of the year, ahead of the implementation of the more substantive price cap from the start of 2023. It also reflected lower prices of petrol, which fell about 7½%M/M thanks not least thanks to lower crude oil prices. Beyond energy, there was also a welcome fall in food inflation, albeit of just 0.4ppt from November's series high to 20.7%Y/Y. And inflation of non-energy industrial goods appears to have benefited from lower cost pressures, dropping 0.2ppt on our estimate to 7.9%Y/Y. However, the national measure of services inflation reversed much of the prior month's decline, rising 0.3ppt to 3.9%Y/Y. So, our estimate of core German inflation ticked up to a new high of 5.3%Y/Y.

Spanish inflation falls to 13-month low also thanks to weaker energy inflation

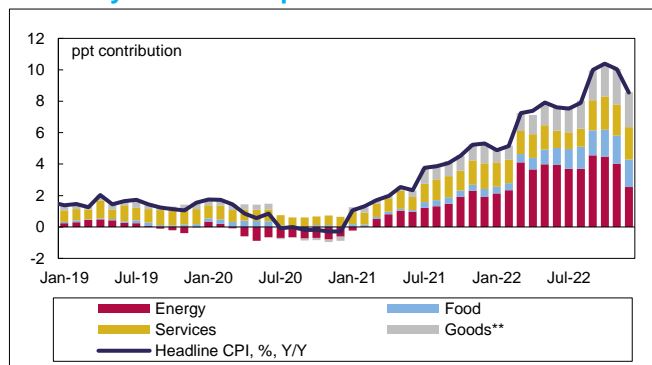
Like in Germany, Spanish inflation at the end of 2022 also surprised on the downside. In particular, the flash headline HICP rate eased for the fifth consecutive month in December, by 1.1ppt to 5.6%Y/Y, more than 5ppts below July's peak and the lowest since November 2021. The national measure was similarly down 1.0ppt in December to 5.8%Y/Y, a thirteen-month low. Spain's statistical office attributed the decline to a smaller increase in electricity prices last month compared with December 2021, as well as a steeper fall in petrol prices, for which weekly figures implied a drop of 8%M/M. But when excluding energy and fresh food, the national core CPI measure jumped 0.6ppt to 6.9%Y/Y. While this in part reflects higher clothing inflation as seasonal discounting was reportedly smaller than in December 2021, it will also be due to higher prices of processed food. Indeed, while we will have to wait for Eurostat's final estimates on 18 January, Spanish HICP core inflation is likely to have been only marginally higher than November's rate of 4.0%Y/Y and still below the summer peak (4.9%Y/Y). More importantly perhaps, given the much faster pass-through of shifts in wholesale energy prices to consumer

Germany: Consumer price inflation*



*National CPI measure. **Non-energy industrial goods.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation*



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prices in Spain than elsewhere in the euro area, the marked drop of Spanish inflation since the summer gives a taste of what to expect in other member states over coming quarters.

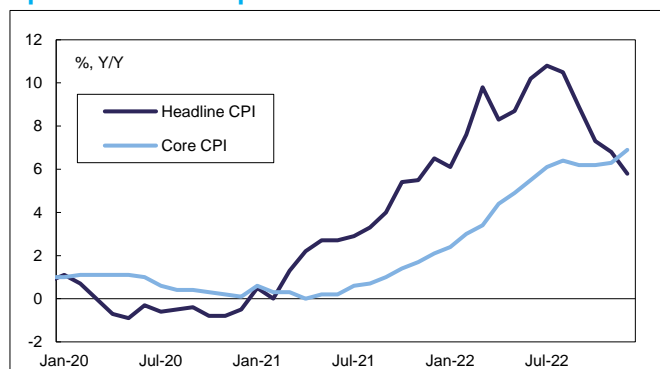
Unemployment claims continue to fall in Germany and Spain

Despite the declines in headline inflation reported in Germany and Spain, the increases in core inflation as well as evidence of resilient labour markets in both countries will be a source of worry among the ECB's hawks. Indeed, despite the slowdown in economic activity, Destatis reported that roughly 45.9mn people were in employment in Germany in November, up around 45k on the month and a new high. Furthermore, contrasting with an expected seventh consecutive increase, German unemployment claims fell in December, by 13k. Admittedly, given the inclusion of Ukrainian refugees in the labour market over the summer, the number of jobless claimants ended the year some 130k higher than at the end of 2021, to leave the claimant count rate at 5.5%. But while that was 0.3ppt higher than a year earlier, it was also still almost 1ppt below the pandemic high in June 2020. And while the number of job vacancies fell for the seventh consecutive month in December, it remained above the pre-pandemic level and well above the long-run average. The number of unemployed people in Spain also fell for the third consecutive month in December, by 24k to 2.83mn (seasonally adjusted terms), the lowest level since September 2008. And so, the number of people in employment in Spain stood above 20.3mn at the end of 2022, representing an increase of almost ½mn compared with end-2021, with almost 5mn more permanent contracts signed than in the year preceding the pandemic.

Cost pressures from beyond the labour market continue to moderate

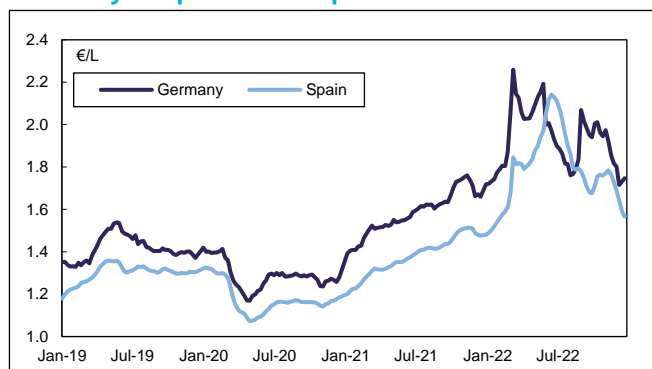
While continued labour market tightness will remain a concern for the ECB as it frets about potential second-round effects on inflation from wages, survey indicators and wholesale market prices continue to suggest that cost pressures from beyond the labour market are moderating. Supply bottlenecks in manufacturing are certainly easing, with the ifo institute reporting today that the share of German manufacturers citing shortages of intermediate goods fell more than 8ppts in December to 50.7%, about 30ppts below last spring's peak. That is still above the long-run average, and machinery, equipment and autos firms remain hardest hit. Nevertheless, the share of manufacturers affected by material shortages has fallen significantly in all sub-sectors, and particularly so for producers of furniture, and energy-intensive sub-sectors such as paper, chemicals and metals where output has been cut sharply. Yesterday's final euro area manufacturing PMIs for December broadly confirmed the findings of the flash survey that suggested that supplier delivery times failed to rise for the first time since before the pandemic. In part, that reflects the continued decline in production, albeit by the least since June (the respective PMI rose 1.2pts to 47.8). With easing supply pressures and softer demand, the estimates of input costs and output prices were revised down from the flash indices, the former to the lowest in more than two years (61.0) and the latter to a 21-month low (61.2).

Spain: Consumer price inflation*



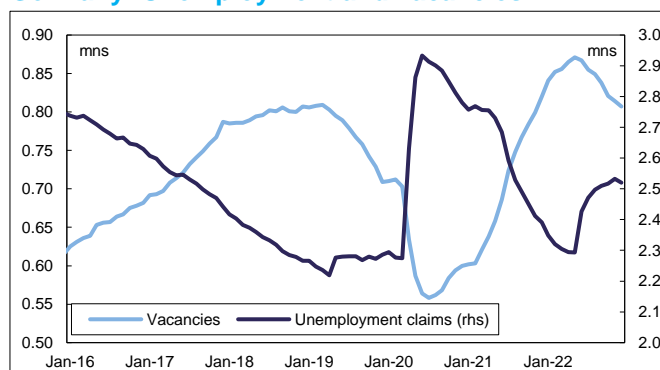
*National CPI measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany & Spain: Petrol prices



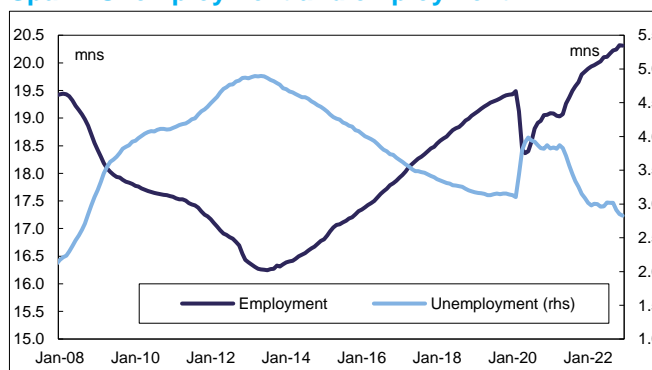
Source: European Commission and Daiwa Capital Markets Europe Ltd.

Germany: Unemployment and vacancies



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Spain: Unemployment and employment



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

And with the mild and windier winter weather helping to reduce benchmark wholesale prices of natural gas to below their levels a year ago ahead of Russia's invasion of Ukraine, and petrol prices little different from a year ago, we expect non-labour cost pressures to continue to moderate.

The day ahead in the euro area

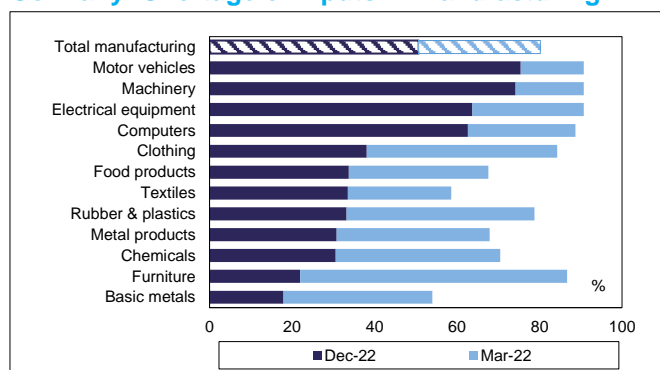
The main data focus in the euro area tomorrow will be the release of preliminary French consumer price inflation data for December. Contrasting with the significant declines in Germany and Spain, French inflation is expected to have risen slightly further at the end of last year, with the Bloomberg survey consensus forecasting an increase in the EU-harmonised measure of 0.2ppt to 7.3%Y/Y. While this would mark a fresh series high, it would remain well below the average inflation rate across the euro area. Meanwhile, the final euro area services and composite PMIs for December will also be published, along with new survey results for Italy and Spain. The flash survey saw the euro area composite output PMI rise 1pt to a four-month high of 48.8, suggesting that the current downturn in economic activity might not be as severe as initially feared. The INSEE consumer confidence survey is also expected to indicate that there was a modest improvement in French household sentiment at the end of the year too.

UK

UK manufacturing conditions remained tough at the end of 2022

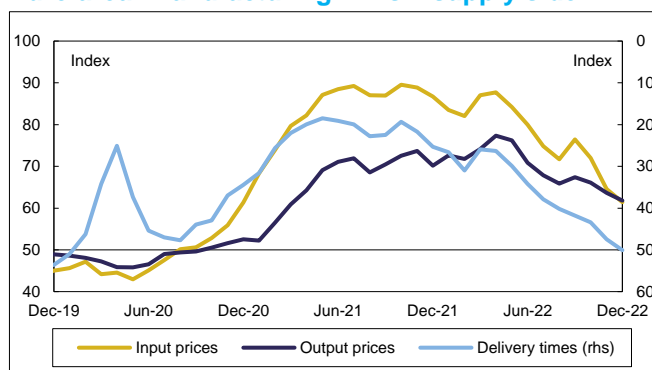
While the final UK manufacturing PMIs were upwardly revised from the preliminary results, they still pointed to a bleak end to the year for the sector, with output falling sharply and demand remaining lacklustre. Indeed, the output component fell for the second successive month in December, by 0.4pt to 44.4, the sixth-consecutive sub-50 reading, with production of intermediate goods reportedly the hardest hit, and a steeper pace of contraction in output of consumer goods too. Amid ongoing economic uncertainties, diminishing budgets and Brexit-related complications, demand was among the weakest since the start of the pandemic. So, firms in the sector continued to cut their purchases of inputs, and scaled back staff for a third consecutive month and by the most since October 2020. There was at least a further modest improvement in supplier delivery times, which likely contributed to a further marked easing in cost burdens reported this month, with the input price PMI down more than 7½ pts to 61.7, the lowest in more than two years. And so, taken together with the moderation in demand, the extent to which manufacturers were able to pass on higher prices to consumers also diminished, with the output PMI (60.1) also the weakest since the start of 2021.

Germany: Shortage of inputs in manufacturing*



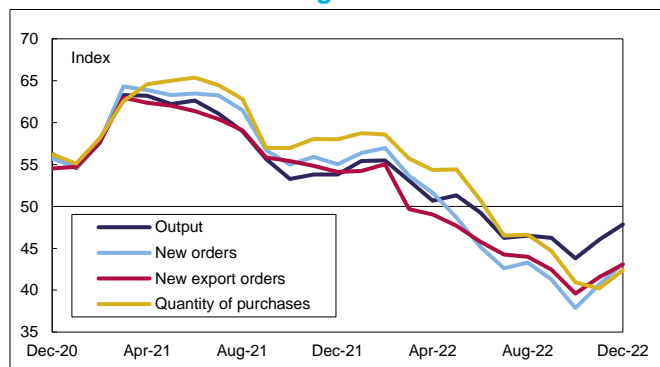
*Share of firms in the respective sub-sector experiencing shortages of intermediate goods. Source: ifo institute and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing PMIs – supply side



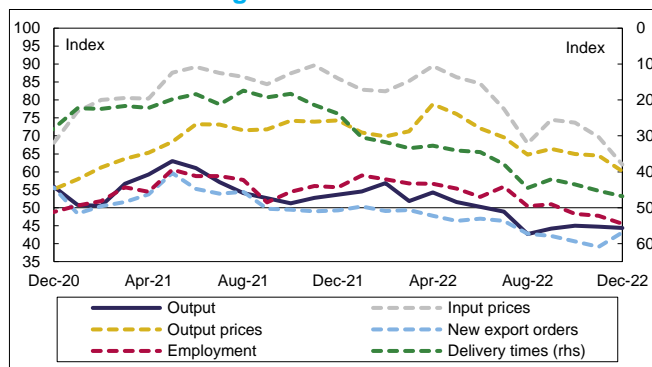
Source: S&P Global, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing PMIs – demand side



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

UK: Manufacturing PMIs



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






The day ahead in the UK

Looking ahead to tomorrow, the BRC shop price index for December is likely to confirm still significant price pressures on the High Street as retailers try to compensate for higher input costs. Separately, the Bank of England's monthly lending figures for November are likely to report still subdued demand for consumer credit, while mortgage approvals are expected to have slowed again amid higher borrowing costs.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Unemployment rate % (change '000s)	Dec	5.5 (-13.0)	5.6 (14.0)	5.6 (17.0)	5.5 (15.0)
	 Preliminary CPI M/M% (Y/Y%)	Dec	-0.8 (8.6)	-0.6 (9.2)	-0.5 (10.0)	-
	 Preliminary HICP M/M% (Y/Y%)	Dec	-1.2 (9.6)	-0.8 (10.2)	0.0 (11.3)	-
Spain	 Unemployment change 000s	Dec	-43.7	-	-33.5	-
UK	 Final manufacturing PMI	Dec	45.3	44.7	46.5	-

Auctions









Country	Auction
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- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final manufacturing PMI	Dec	47.8	47.8	47.1	-
Germany	 Final manufacturing PMI	Dec	47.1	47.4	46.2	-
France	 Final manufacturing PMI	Dec	49.2	48.9	48.3	-
	 New car registrations Y/Y%	Dec	-0.1	-	9.8	-
Italy	 Manufacturing PMI	Dec	48.5	48.6	48.4	-
	 New car registrations Y/Y%	Dec	21.0	-	14.7	-
Spain	 Manufacturing PMI	Dec	46.4	46.0	45.7	-
	 New car registrations Y/Y%	Dec	-14.1	-	10.3	-







Auctions

Country	Auction
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- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases
Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area 	09.00	Final services (composite) PMI	Dec	49.1 (48.8)	48.5 (47.8)
Germany 	08.55	Final services (composite) PMI	Dec	49.0 (48.9)	46.1 (46.3)
	-	New car registrations (production) Y/Y%	Dec	-	31.3 (25.3)
France 	07.45	Preliminary CPI M/M% (Y/Y%)	Dec	0.5 (6.4)	0.3 (6.2)
	07.45	Preliminary HICP M/M% (Y/Y%)	Dec	0.4 (7.3)	0.4 (7.1)
	08.50	Final services (composite) PMI	Dec	48.1 (48.0)	49.3 (48.7)
	07.45	INSEE consumer confidence	Dec	84	83
Italy 	08.45	Services (composite) PMI	Dec	-	51.2 (49.6)
Spain 	08.15	Services (composite) PMI	Dec	-	51.2 (49.6)
UK 	00.01	BRC shop price index Y/Y%	Dec	-	7.4
	09.30	Net consumer credit £bn (Y/Y%)	Nov	-	0.8 (7.0)
	09.30	Net mortgage lending £bn (approvals '000s)	Nov	- (53.0)	4.0 (59.0)

Auctions and events

Germany 	10.30	Auction: €5bn of 2024 bonds
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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