Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds made notable losses as Spanish inflation surprised on the upside and a marked acceleration in Irish GDP more than offset a modest contraction in Germany.
- Gilts were little changed on a quiet start to the week for UK economic releases.
- Tuesday will bring the first estimate of euro area GDP for Q4, as well as flash January inflation data from France, Portugal and Ireland. UK bank lending numbers are also due.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.656	+0.094
OBL 2.2 04/28	2.336	+0.091
DBR 2.3 02/33	2.300	+0.065
UKT 1 04/24	3.456	-0.010
UKT 1¼ 07/27	3.206	+0.002
UKT 4¼ 06/32	3.320	-0.003

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

Euro area

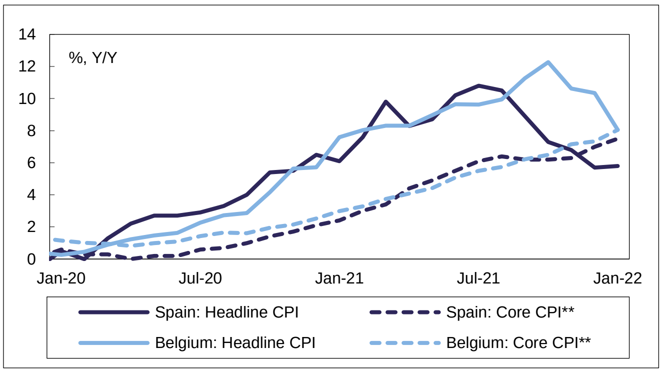
Spanish inflation surprises significantly to the upside with new weights likely playing a role

Ahead of the flash euro area inflation estimate on Wednesday, today's Spanish data surprised significantly on the upside. Contrary to expectations of a big drop, the headline HICP measure saw inflation rise by 0.3ppt to 5.8%Y/Y, a full 1ppt above the consensus, while the national measure rose 0.1ppt to 5.8%Y/Y. While we will have to await revised figures on 15 February for a detailed breakdown, Spain's statistical office (INE) suggested that the upwards shift was in part due to petrol and clothing prices, with the latter reflected in a notable rise of ½ppt in the national measure of core inflation (which excludes energy and fresh food) to a new high of 7.5%Y/Y. The upside surprise also likely in part reflected updated inflation basket weights from the start of the year. For example, the weight for transport (including fuel) rose significantly, while increased weights for recreation, restaurants and hotels and reduced weights for housing and utilities would similarly have added to inflation. Methodological changes to the calculation of gas and electricity prices this month, to better reflect developments in unregulated prices, might also have made a positive contribution. But offsetting the impact of some of these adjustments was a notable decline in the weight of food in the basket, while the temporary removal of VAT on basic foods (from 4% to 0%) from the beginning of the year for six months might also have reduced the contribution from this component in January below what it otherwise would have been.

Belgian inflation drops sharply to an eleven-month low

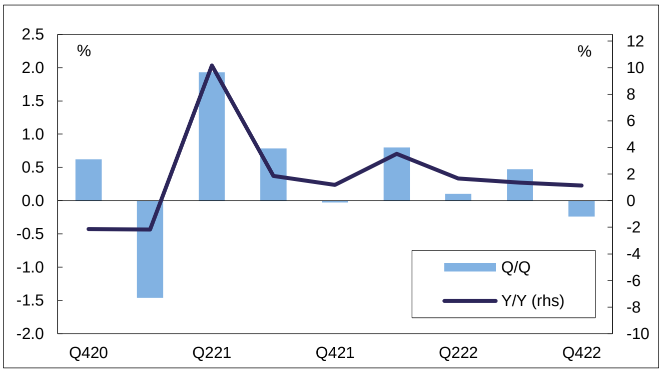
In contrast to the Spanish data, the flash inflation figures from Belgium today reported a marked decline in the national headline CPI rate in January, by 2.3ppts to 8.1%Y/Y, an eleven-month low. This principally reflected a substantial drop in prices of natural gas and electricity at the start of the year, to leave energy inflation down a whopping 28ppts at 5.2%Y/Y. Indeed, when excluding energy, the national measure of core inflation jumped 0.8ppt to a new high of 8.6%Y/Y. This in part reflected a continued uptrend in food inflation, which rose a further 0.4ppt to 15.6%Y/Y to contribute roughly 3ppts to headline inflation, with significant increases in prices of bread, cereals and dairy products. Health insurance premiums were also higher in January. Overall, the sharp drop in Belgium will offset the rise in Spain. But today's figures pose a significant risk of an upside surprise to the aggregate euro area figures on Wednesday; the Bloomberg survey consensus had previously been for a drop of 0.2ppt to 9.0%Y/Y. There is also a non-negligible risk that the euro area core rate (excluding energy and all food) rose to a new record high from 5.2%Y/Y in December. We note, however, that the release of the flash German data was postponed from tomorrow, due to technical problems associated with the basket reweighting. And so, the accuracy of the flash euro area figure on Wednesday might be called into question.

Spain & Belgium: Consumer price inflation*



*National measure. **Core inflation excludes energy and fresh foods.
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: GDP growth



Source: Destatis and Daiwa Capital Markets Europe Ltd.

German GDP weaker than consensus forecast with contraction in Q4

German GDP dropped 0.2%Q/Q in Q4, a notably weaker performance than the consensus expectation of no change. The decline took it back to the pre-pandemic level. Consistent with the forecast miss, the estimate of full-year GDP growth in 2022 (which had originally fuelled hopes that a drop in output in Q4 might have been avoided) was revised down slightly to 1.8%Y/Y. The Q4 figure suggests that German retail sales, production and net trade ended last year on a very soft note. While no detail was provided of the expenditure breakdown, Germany's statistics agency Destatis stated that the drop in GDP last quarter was led – perhaps unsurprisingly – by private consumption. While the consensus view is that Germany will now avoid a contraction in Q1, we see scope for disappointment in that respect, as household spending will remain under pressure from falling real disposable incomes while fiscal incentives to purchase electric vehicles – which seem to have boosted car sales in Q4 – have been reduced. Inventory adjustments are also likely to weigh on manufacturing output after the supply-chain improvements of the past quarter supported a replenishment of stocks. And while surveys point to improved expectations for coming months, we note also that the ifo current conditions index deteriorated this month, suggesting ongoing contraction at the start of 2023.

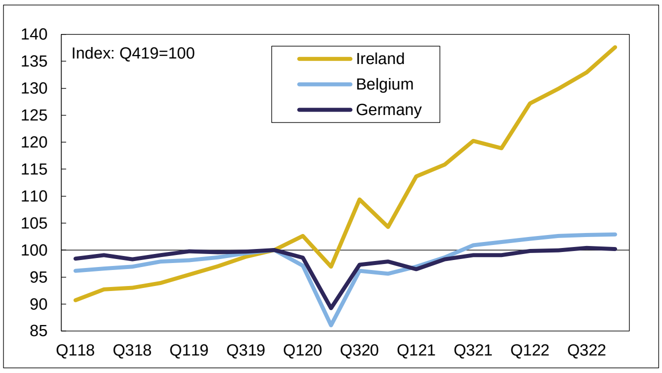
Irish GDP accelerates to more than offset negative contribution from Germany

Beyond Germany, the other Q4 GDP figures reported today were all consistent with positive growth in the euro area as a whole. Admittedly, Belgian GDP slowed slightly last quarter to just 0.1%Q/Q. And following sharp contraction in Q3, Latvian GDP rose a modest 0.3%Q/Q. However, strikingly, and as has become the norm over the past couple of years, Ireland reported extremely strong growth in Q4. Indeed, Irish GDP accelerated 1.2ppts to 3.5%Q/Q, to take the level of economic output up a whopping 13.5%Y/Y and more than 37% above the pre-pandemic level three years' earlier. With growth reportedly concentrated in the manufacturing sector, the vigour undoubtedly continues to reflect the activities of multi-national corporations based in Ireland. However, its positive impact on regional economic output substantively outweighs the negative impact from Germany, and so increases the likelihood that a contraction in euro area GDP was avoided in Q4.

Broad-based pickup in sentiment, but consumers extremely reticent to make major purchases

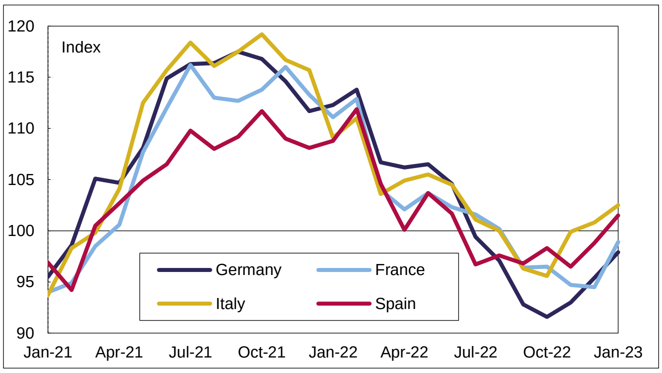
Expectations of firmer activity in Q1 are likely to have been reinforced by today's Commission business and consumer survey results for January. In particular, the headline Economic Sentiment Index (ESI) for the euro area rose for the third successive month, and by a firm 2.8pts to a seven-month high of 99.9, just shy of the long-run average. Improvement was widespread, with the national ESIs rising in each of the large member states. And the pickup in optimism was led by France, where the ESI rose 4.4pts to a five-month high (98.9), while Germany's rose 2.5pts to a six-month high (97.9). Confidence was stronger in both industry (up to a five-month high) and services (to a seven-month high), where firms reported stronger expectations for production and demand respectively. And while construction firms were less upbeat due to falling new orders, the fourth successive monthly improvement in consumer confidence to an eleven-month high, reported by the flash

Euro area: GDP level in selected member states



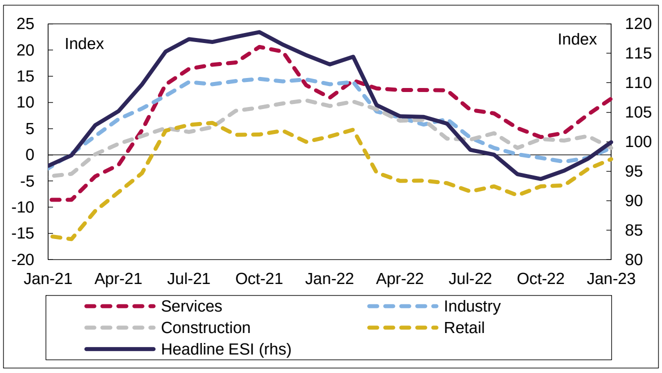
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Economic sentiment indices



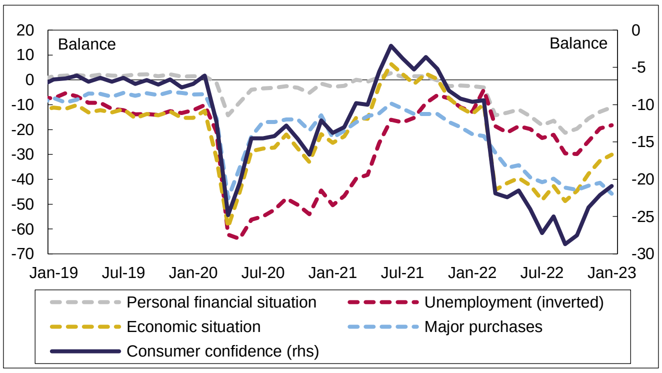
Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Economic sentiment indices



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

Euro area: Consumer confidence indices



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

index, was confirmed. Households were more upbeat about the outlook for their personal finances and the economy as a whole. However, the climate for making major purchases was judged to have deteriorated further to the second-worst on the series, a level that was only inferior at the onset of the pandemic in April 2020. And consumers' assessment of the outlook for spending over the coming twelve months was also essentially unchanged at a historically low level.

Consumer inflation expectations subside but services flag expectations of higher selling prices

Once again, the improvement in economic sentiment was matched by a further pickup in employment intentions, and coincided with further declines in inflation expectations. Indeed, the survey index of consumer price expectations for the coming twelve months dropped for the fourth successive month and by more than 5pts to 17.7, below the long-run average and a two-year low. Price-setting expectations for the coming three months also fell again in retail, industry and construction, with the latter two indices at the lowest in more than a year. However, having declined in six of the previous eight months, the survey measure of services price-setting expectations rose in January to a level just below October's series high. That probably reflects expectations of continued pass-through of increased costs of food, energy and other goods – and possibly labour too – to services prices. And it might therefore reinforce concerns among Governing Council members about possible second-round effects on inflation in this sector, even as the adverse shock to the euro area's terms of trade subsides.

The day ahead in the euro area

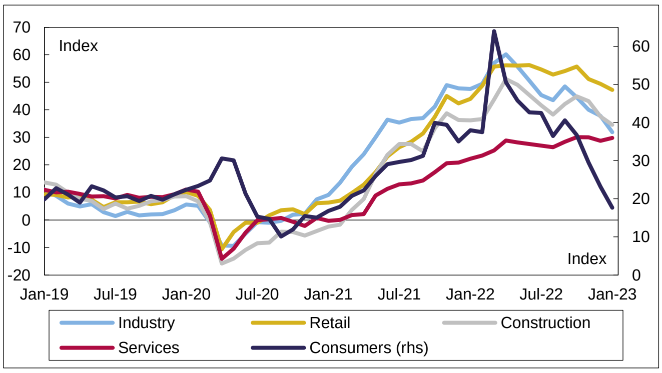
Tomorrow will bring the aforementioned estimate of euro area GDP for Q4. Even assuming that France's economy moved broadly sideways in the final quarter of last year, and Italy contracted (-0.2%Q/Q), we now assume aggregate euro area GDP to have been modestly positive in Q4. Focus tomorrow will also be on flash inflation figures from France, Portugal and Ireland, with the former expected to see the headline HICP rate rise in January in part due to higher energy prices reflecting the reduction of government support. Like today's numbers, however, there will be increased difficulties interpreting the figures due to the re-weighting of the respective CPI baskets. Indeed, the publication of the German CPI data has been postponed until next week due to technical issues related to those new weights. While Eurostat will still put out its flash aggregate estimate on Wednesday using an unpublished assumption for Germany, questions will be raised about the quality of the euro area figures. Beyond the GDP and inflation figures, tomorrow will bring German labour market data for January, as well as German retail sales figures for December.

UK

The day ahead in the UK

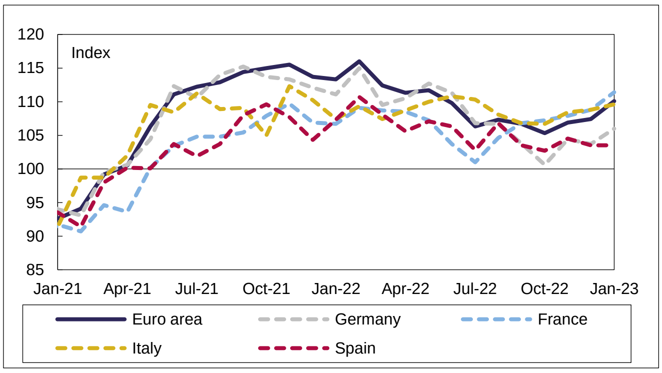
After a quiet start to the week for top-tier UK economic releases, Tuesday will bring bank lending numbers for December. Given higher borrowing costs, mortgage approvals are expected to have fallen further from November's more than two-year low (46.1k). Mortgage lending, however, is likely to have remained relatively robust in December, given that it will still reflect loan offers made before the Truss crisis. And there might well have been a pickup in credit card lending in the run up to the festive period.

Euro area: Price expectations indices



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

Euro area: Employment expectations indices



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

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		EC's economic sentiment indicator	Jan	**99.9**	97.0	95.8	**97.1**
		EC's industrial (services) confidence	Jan	**1.3 (10.7)**	-0.9 (9.0)	-1.5 (6.3)	**-0.6 (7.7)**
		EC's final consumer confidence	Jan	**-20.9**	-20.9	-22.2	-
Germany		First estimate - GDP Q/Q% (Y/Y%)	Q4	**-0.2 (0.5)**	*-0.1 (1.2)*	0.4 (1.3)	**0.5 (1.3)**
Italy		PPI Y/Y%	Dec	**39.2**	-	35.7	-
Spain		Preliminary HICP (CPI) Y/Y%	Jan	**5.8 (5.8)**	4.8 (5.0)	5.5 (5.7)	-
		Retail sales Y/Y%	Dec	**4.0**	-	-0.6	**-0.5**
UK		Lloyds business barometer	Jan	**22**	22	17	-

Auctions

Country		Auction
UK		BoE sold £649.9mn of 2050-71 gilts

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	First estimate – GDP Q/Q% (Y/Y%)	Q4	*0.1 (1.9)*	0.3 (2.3)
Germany		07.00	Retail sales M/M% (Y/Y%)	Dec	-0.5 (-2.6)	1.7 (-5.1)
		08.55	Unemployment rate % (change '000s)	Jan	5.5 (5.0)	5.5 (-13.0)
France		06.30	First estimate - GDP Q/Q% (Y/Y%)	Q4	*0.1 (0.6)*	0.2 (1.0)
		06.30	Consumer spending M/M% (Y/Y%)	Dec	0.2 (-3.8)	0.5 (-5.2)
		07.45	Preliminary HICP (CPI) Y/Y%	Jan	7.0 (6.1)	6.7 (5.9)
Italy		10.00	First estimate – GDP Q/Q% (Y/Y%)	Q4	*-0.3 (1.5)*	0.5 (2.6)
UK		09.30	Net consumer credit £bn (Y/Y%)	Dec	1.1 (-)	1.5 (7.0)
		09.30	Net mortgage lending £bn (approvals '000s)	Dec	3.9 (45.0)	4.4 (46.1)

Auctions and events

Country		GMT	Event
Germany		10.30	Auction: €6bn of 2.5% 2025 bonds
Italy		10.00	Auction: €4.0bn 3.4% 2028 bonds
		10.00	Auction: €3.5bn 4.4% 2033 bonds
		10.00	Auction: €1.5bn 2026 floating rate bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.