Euro wrap-up

Overview

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- Despite confirmation of minimal euro area GDP growth in Q4, a tick up in French inflation and continued German labour market resilience, euro govvies made modest gains as German retail sales slumped and an ECB survey signalled a further tightening in credit conditions.
- Gilts also made modest gains as UK mortgage approvals fell sharply to the lowest since January 2009 aside from the initial pandemic trough.
- Wednesday will bring flash euro area and Italian inflation estimates, along with euro area unemployment and UK house price numbers.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 12/24	2.627	-0.037
OBL 2.2 04/28	2.290	-0.053
DBR 2.3 02/33	2.274	-0.038
UKT 1 04/24	3.389	-0.021
UKT 1¼ 07/27	3.196	-0.013
UKT 4¼ 06/32	3.320	-0.012

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

Euro area

Euro area GDP edges up in Q4 thanks largely to activities of Ireland-based multinationals

Contrary to the consensus expectation of a slight decline, and also in contrast to the signals provided by economic surveys, euro area GDP continued to grow in Q4, albeit edging up just 0.1%Q/Q. That marked a slowdown of 0.2ppt from Q3, with the annual growth rate moderating 0.4ppt to 1.9%Y/Y. And it took euro area GDP 2.4% above the pre-pandemic level. At the country level, today's data showed that, along with Germany (-0.2%Q/Q), overall economic output in Italy (-0.1%Q/Q) and Austria (-0.7%Q/Q) contracted. In contrast, France and Belgium (both also 0.1%Q/Q) and Portugal (0.2%Q/Q) managed to grow alongside Spain (0.2%Q/Q). However, as suggested yesterday, it was the extraordinary growth again recorded in Ireland (3.5%Q/Q) that ensured that euro area GDP grew in Q4. Irish GDP growth undoubtedly principally reflects the relocation of sales proceeds and capital assets of multi-national corporations to that country for accounting purposes, raising concerns about the reliability of the aggregate euro growth figure as a guide to economic activity in the region.

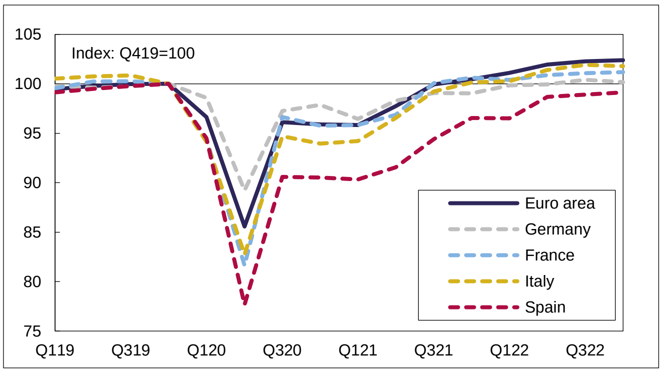
French household spending fell sharply in Q4 but falling imports supported GDP growth

Eurostat did not provide details of the expenditure breakdown of GDP with this flash estimate. However, it is clear that private consumption subtracted significantly from economic growth in Q4 as households tried to adjust to falling real incomes. In contrast, net trade provided support thanks principally to the weakness of imports. That was already the story in Germany and Spain. And today's figures confirmed it was also true in France, where household consumption dropped in Q4 by 0.9%Q/Q, the most since the lockdowns of Q1 last year. While fixed investment growth remained positive, it slowed 1.5ppts to 0.8%Q/Q. So, French final domestic demand subtracted from overall GDP growth. And with inventories also making a negative contribution to growth (-0.2ppt), it was only because imports (-1.9%Q/Q) dropped at a faster pace than exports (-0.3%Q/Q) that French GDP managed to pick up slightly. While no breakdown was provided in Italy, the statistical agency similarly reported that domestic demand fell while net exports offered some support.

French inflation rose in January as expected, but core pressures appear a touch softer

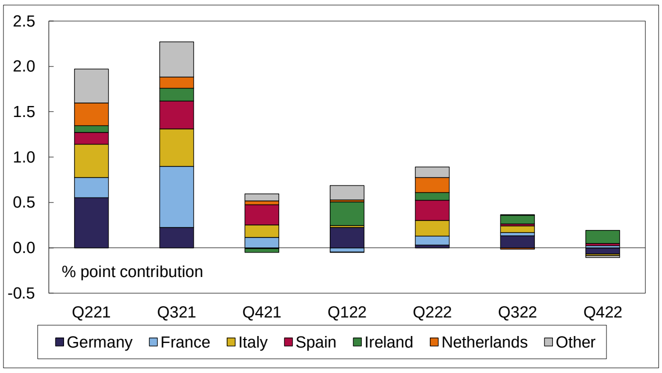
Unlike yesterday's big upside surprise from Spain, the flash estimates of French inflation in January broadly met expectations. However, like in Spain, French inflation rose at the start of the year. And the moderate increase of 0.3ppt in the French EU-harmonised measure, to 7.0%Y/Y, left it (admittedly only marginally) still below last year's peak. The limited detail on the French national CPI measure – which rose just 0.1ppt to 6.0%Y/Y – revealed that the pickup in inflation was again driven by non-core pressures. Food inflation was up 1.1ppts to a new high of 13.2%Y/Y. And reflecting the reduction in government support, energy inflation rose a similar 1.2ppts to 16.3%Y/Y. In contrast, with inflation of services down 0.3ppt to 2.6%Y/Y, and the equivalent rate for manufactured products unchanged at 4.6%Y/Y, French core inflation looks to have

Euro area: GDP levels



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to GDP growth*



**Based on 87% of published member state data.*
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

softened somewhat at the start of the year. With the official release of the flash German data postponed to next week, and a report by one news agency that the German CPI rate had risen 0.6ppt to 9.2%Y/Y subsequently denied by the statistics office, there remains insufficient national data to predict tomorrow's flash euro area figures with any confidence. Indeed, given the uncertainties over the new basket weights, and question marks related to the German numbers, upon their release the accuracy of the euro area estimates is likely to be called into question. However, a similar pattern to the French data – with a modest increase in headline inflation from 9.2%Y/Y in December but a decline in the core measure from 5.2%Y/Y – would now not be a surprise.

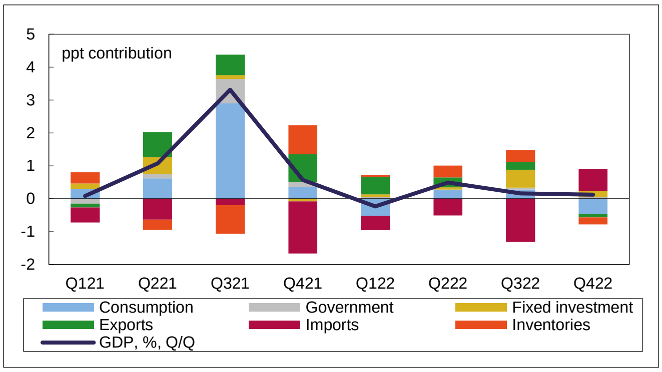
German retail sales slump in December

After Germany's statistical institute Destatis yesterday stated that household consumption was the principal cause of the drop in that country's GDP in Q4, today's retail sales figures reported a marked slump in spending on goods at the end of the year. Indeed, the volume of sales fell a much steeper-than-expected 5.3%M/M in December, the most since July 2021 and, excluding the pandemic, the worst since January 2007 when Germany's VAT rate was raised by 3ppts. This left sales down 2.7%3M/3M and 6.4%Y/Y as households cut back the volume of their purchases in the face of rising prices. Indeed, in nominal terms, sales were still up more than 4%Y/Y despite a drop of 4.8%M/M in December. We caution, however, that December readings for German retail sales are typically subject to more significant revisions than those for other months due to the impact of the festive period on data collection.

German labour market remains resilient as business pessimism subsides

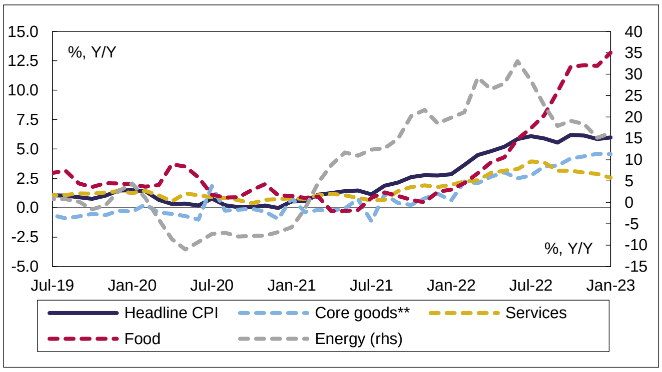
Despite the weakness of household spending at the end of last year, Germany's labour market appears to have remained relatively resilient at the start of 2023. Indeed, contrary to expectations of what would have been a sixth increase in seven months, German unemployment claims fell back for a second successive month in January. That took the level to a five-month low marginally below 2.5mn, albeit still more than 200k above the level in May just before Ukrainian refugees became eligible for jobless benefits. It also left the claimant count rate unchanged at 5.5% for a sixth successive month, up 0.5ppt from the trough reached in the first half of the year but still 0.9ppt below the pandemic peak in mid-2020. With improving business expectations for the coming year, hiring intentions appear to have turned for the better at the start of the year, e.g. the German Employment Intentions Index from the Commission survey rose in January to a five-month high firmly consistent with increased recruitment. Moreover, the number of vacancies on a seasonally-adjusted basis ticked up slightly, remaining at a relatively elevated level by historical standards, albeit still down on the figures throughout the first eleven months of 2022. Overall, the data suggest that Germany's jobless rate might continue to move broadly sideways over coming months. While that might point to persistent labour market tightness, and there remains some high-profile strike action (currently

France: GDP growth and contributions



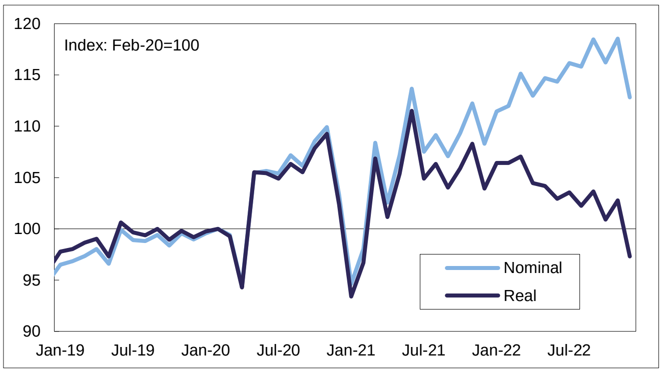
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Consumer price inflation*



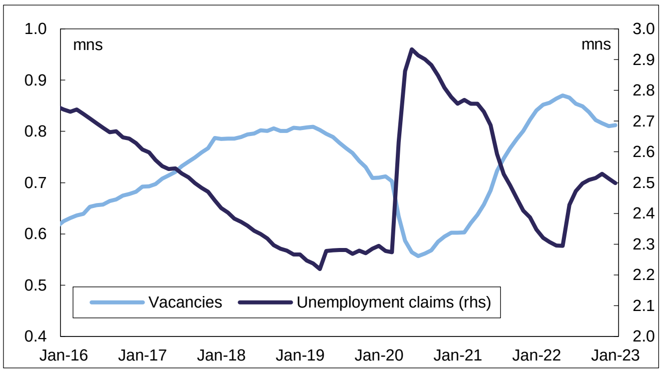
**National CPI measure. **Goods excluding food and energy.*
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Labour market indicators



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

notably in the postal sector), we continue to see no evidence in recent settlements of markedly higher pay growth that would be consistent with substantive second-round effects on inflation.

The day ahead in the euro area

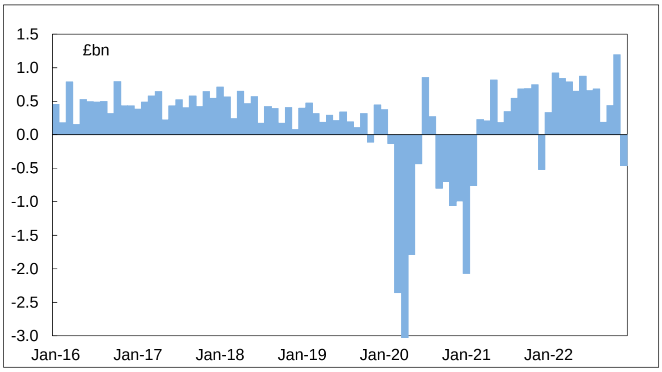
The flow of inflation figures continues tomorrow with the aforementioned publication of the flash euro area HICP numbers for January, as well as figures from Italy and the Netherlands. Given the mixed results from those member states that have already published figures, the reweighting of the CPI basket and the absence so far of the German and Italian numbers – which together account for 45% of the basket – the outcome for the headline euro area HICP rate is extremely difficult to forecast with any accuracy. Moreover, given the postponement of the German figures due to technical issues associated with the basket reweighting, the precision of tomorrow's euro area figure might well be called into question. However, it would not be a surprise to see the euro estimates present a similar pattern to the French data, with a modest increase in headline inflation from 9.2%Y/Y in December but a decline in the core measure from 5.2%Y/Y. Meanwhile, euro area unemployment figures are expected to be consistent with ongoing tightness in the labour market, while the final manufacturing PMIs are expected are expected to confirm a softer pace of decline in manufacturing output and new car registrations numbers from France, Italy and Spain are also due.

UK

Consumer credit slows and mortgage approvals slump at end of 2022

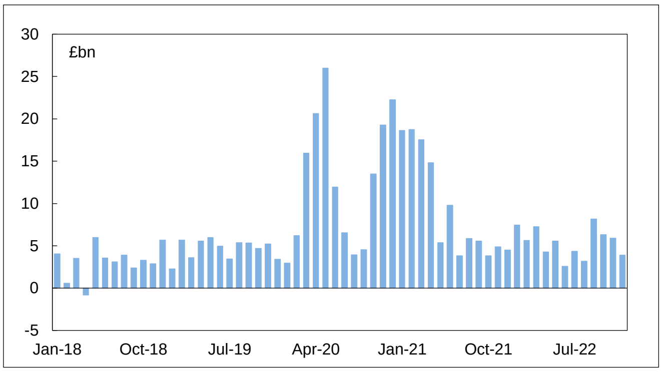
Amid declining economic activity, very weak consumer confidence, higher borrowing costs and tighter lending standards, today's BoE lending figures unsurprisingly suggested that household borrowing remained subdued at the end of last year. Individuals borrowed an additional net £0.5bn of unsecured credit in December, down from £1.5bn in November and the lowest since December 2021. This in part reflected the first net repayment (£0.5bn) on credit cards for a year. In contrast, borrowing such as car dealership finance and personal loans increased a net £1.0bn, the most since October 2019, possibly reflecting the ongoing squeeze in households' budgets in the run up to the festive period. Meanwhile, households deposited an additional £3.9bn with banks in December, down from £5.9bn in November, but nevertheless suggestive that they might have preferred to save than spend. With respect to secured lending, today's figures remained consistent with still solid growth in December, although the net increase of £3.2bn was below the previous six-month average (£4.8bn) and the lowest since October 2021, the month after the conclusion of the pandemic stamp duty holiday. But this figure still largely reflects completions based on mortgage offers made ahead of the Truss-related blow-out in interest rates. The average effective interest rate on this lending was still relatively low at 3.67% in December. Nevertheless, that was up 32bps on the month and

UK: Monthly credit card flows



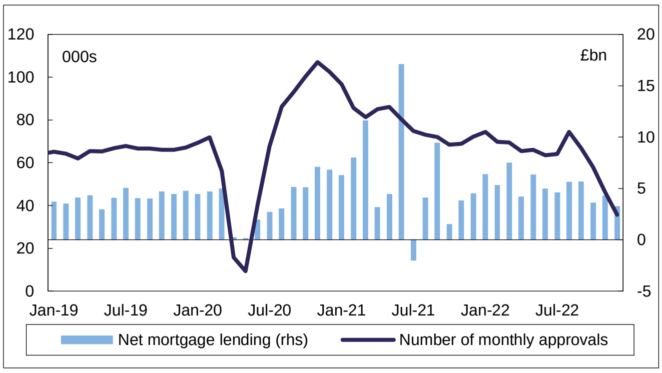
Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Monthly increase in household deposits



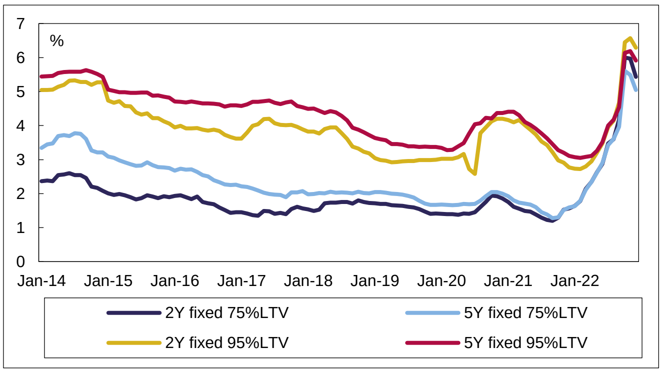
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Mortgage approvals and lending



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

UK: Mortgage lending interest rates



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

more than 200bps higher than a year ago. Indeed, with the average interest rate offered on a 2Y fixed-rate mortgage with a LTV ratio of 75% at 5.43% in December (admittedly more than 50bps lower than in November), the number of approvals on new mortgages again fell sharply, down to 35.6k, from 46.2k in November and the lowest outside of the initial pandemic slump since January 2009, suggesting that we will see a marked slowdown in secured lending in early 2023.

The day ahead in the UK

In the UK, tomorrow brings the release of the BRC shop price and Nationwide house price indices for January. Consistent with an easing in input costs and softer demand, inflation on the high street is likely to have moderated further at the start of the year. Meanwhile, in line with the downbeat RICS residential survey, the Nationwide index is forecast to report the fifth consecutive monthly decline in home prices. The final manufacturing PMIs for the same month will also be published.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	First estimate – GDP Q/Q% (Y/Y%)	Q4	**0.1 (1.9)**	*0.1 (1.9)*	0.3 (2.3)	-
Germany	Retail sales M/M% (Y/Y%)	Dec	**-5.3 (-6.6)**	-0.5 (-2.6)	1.1 (-5.7)	**1.9 (-4.9)**
	Unemployment rate % (change '000s)	Jan	**5.5 (-22.0)**	5.5 (5.0)	5.5 (-13.0)	-
France	First estimate - GDP Q/Q% (Y/Y%)	Q4	**0.1 (0.5)**	*0.1 (0.6)*	0.2 (1.0)	-
	Consumer spending M/M% (Y/Y%)	Dec	**-1.3 (-5.6)**	0.3 (-4.2)	0.5 (-5.2)	**0.6 (-5.1)**
	Preliminary HICP (CPI) Y/Y%	Jan	**7.0 (6.0)**	7.0 (6.1)	6.7 (5.9)	-
Italy	First estimate – GDP Q/Q% (Y/Y%)	Q4	**-0.1 (1.7)**	*-0.3 (1.5)*	0.5 (2.6)	**- (2.7)**
UK	Net consumer credit £bn (Y/Y%)	Dec	**0.5 (7.2)**	1.1 (-)	1.5 (7.0)	-
	Net mortgage lending £bn (approvals '000s)	Dec	**3.2 (35.6)**	3.9 (45.0)	4.4 (46.1)	**4.3 (46.2)**

Auctions

Country	Auction
Germany	sold €4.9bn of 2.5% 2025 bonds at an average yield of 2.64%
Italy	sold €4.0bn of 3.4% 2028 bonds at an average yield of 3.70%
	sold €3.5bn of 4.4% 2033 bonds at an average yield of 4.28%
	sold €1.5bn of floating rate 2026 bonds at an average yield of 2.58%

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	*48.8*	47.8
	10.00	Preliminary HICP (core HICP) Y/Y%	Jan	8.9 (5.1)	9.2 (5.2)
	10.00	Unemployment rate %	Dec	6.5	6.5
Germany	08.55	Final manufacturing PMI	Jan	*47.0*	47.1
France	08.50	Final manufacturing PMI	Jan	*50.8*	49.2
Italy	08.45	Manufacturing PMI	Jan	49.6	48.5
	10.00	Preliminary HICP (CPI) Y/Y%	Jan	10.7 (10.1)	12.3 (11.6)
Spain	08.15	Manufacturing PMI	Jan	48.0	46.4
UK	00.01	BRC shop price index Y/Y%	Jan	-	7.3
	07.00	Nationwide house price index M/M% (Y/Y%)	Jan	-0.5 (1.8)	-0.1 (2.8)
	09.30	Final manufacturing PMI	Jan	46.7	45.3

Auctions and events

Country	GMT	Event
Germany	10.30	Auction: €5bn of 2.3% 2033 bonds
UK	10.00	Auction: £3bn of 0.875% 2033 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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