Euro wrap-up

Overview

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- While an ECB survey reported a significant drop in consumer inflation expectations, Bunds made losses as a German survey suggested that investors are more upbeat about the economic outlook.
- Gilts ended the day little changed even as private sector pay growth continued to slow ahead of the BoE's expectations.
- Wednesday will bring December inflation estimates from the euro area and UK.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 12/25	2.588	+0.020
OBL 2.1 04/29	2.147	-
DBR 2.2 02/34	2.255	+0.025
UKT 3½ 10/25	4.132	-0.002
UKT 4½ 06/28	3.661	-
UKT 3¼ 01/33	3.792	-

*Change from close as at 5:00pm GMT.
Source: Bloomberg

Euro area

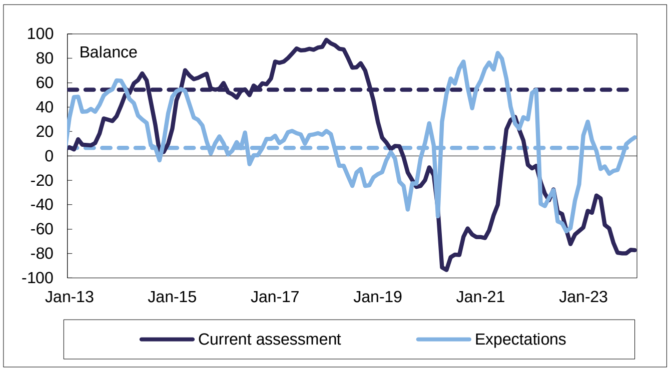
Investors more upbeat about the German outlook as expectations of rate cuts rise

After Germany's statistical office yesterday estimated that the economy contracted in Q423 (-0.3%Q/Q) at the fastest pace in a year, today's German ZEW investor survey signalled little immediate improvement in economic conditions at the start of the New Year. In particular, the survey's current assessment balance edged a touch lower in January, by 0.2pt to -77.1, to remain well below the average the five years before the pandemic (+54.2). Admittedly, having risen to a four-month high in December, the index started the year some 1½pts above the Q4 average. Moreover, the recovery in investors' expectations for the coming six months further raised hopes that the trough in Germany's downturn was reached at the end of last year. Indeed, the respective survey index rose for a sixth successive month to an eleven-month high of 15.2 in January, marking the third consecutive reading to exceed the pre-pandemic five-year average. Certainly, investor morale appears to have been boosted by expectations of moderating inflation and the prospect of looser monetary policy. Indeed, while the share of survey respondents expecting inflation to rise over the coming six months rose to a fourteen-month high (10%), roughly two-thirds continued to expect it to decline. And the share expecting short-term interest rates to fall in the next six months rose above 50% for just the third time since 2011.

Consumers revise down inflation expectations significantly

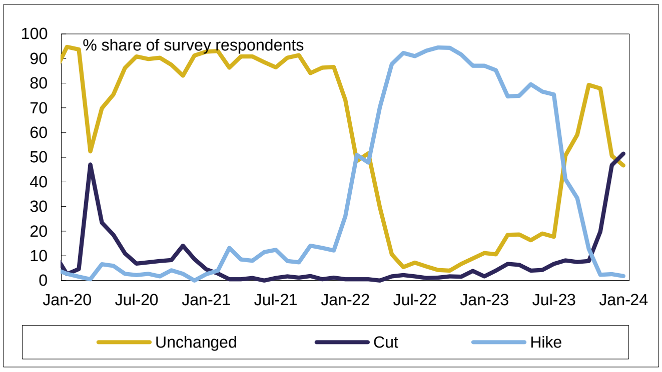
According to the ECB's consumer survey, households have also significantly revised down their inflation expectations. The survey's median forecast for inflation over the coming twelve months moderated 0.8ppt in November to 3.2%Y/Y, the lowest since February 2022. And the median expectation for inflation three years ahead was revised down by 0.3ppt to 2.2%Y/Y, also the lowest since Russia's invasion of Ukraine and within close reach of the ECB's inflation target. The median expectation for the coming twelve months was nudged lower in each of the three largest member states and to 3.0%Y/Y in Germany and France. The median medium-term inflation expectation was revised down in each of the four largest member states, and to just 2.0%Y/Y in Germany and 2.1%Y/Y in France. The downshift in inflation expectations likely in part reflects the steeper-than-expected drop of 0.5ppt in headline euro area consumer price inflation in November to 2.4%Y/Y, as survey responses were collected either side of the release of the flash estimate. The rest of the survey's findings regarding the outlook for the coming twelve months were rather mixed. With inflation falling, perhaps in anticipation of easier monetary policy, consumers revised down slightly their expectations for mortgage rates and also judged that access to credit is likely to become somewhat easier. But they also lowered their expectations for nominal spending (3.2%Y/Y) to a rate implying negligible real consumption growth. While they revised up slightly their expectations for nominal income growth (1.2%Y/Y), they still expect real incomes to decline significantly. And while they were slightly less downbeat about the outlook for GDP, consumers continue to expect a relatively deep contraction (-1.2%Y/Y).

Germany: ZEW investor sentiment indices*



Dashed lines present pre-pandemic 5-year average. Expectations index refers to coming 6 months. Source: Macrobond & Daiwa Capital Markets Europe Ltd.

Germany: ZEW interest rate expectations indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

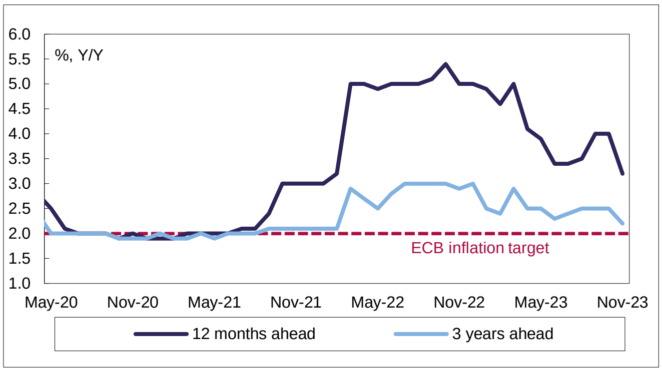
Wednesday will bring the final estimates of euro area consumer price inflation in December. According to the flash estimates, euro area headline inflation jumped 0.5ppt to 2.9%Y/Y due principally to energy base effects associated with the German government's one-off support payments a year earlier. In contrast, core inflation eased a further 0.2ppt to a 21-month low of 3.4%Y/Y, thanks to a drop in non-energy industrial goods inflation to a 23-month low of 2.5%Y/Y. With today's final German (3.8%Y/Y) and Italian (0.5%Y/Y) HICP data having aligned with their respective flash estimates, and last week's final French (4.1%Y/Y) and Spanish (3.3%Y/Y) figures having done likewise, we fully expect the final euro area inflation rates to confirm the initial estimates. Tomorrow's release will provide additional granular detail, however, allowing for calculation of additional measures of underlying inflation.

UK

Private sector pay growth slows well below path projected by the BoE

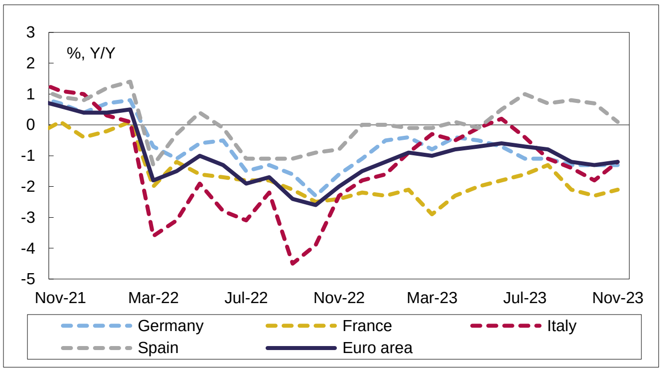
With economic activity weak, the UK's labour market appears to be becoming less tight. And so, with inflation gradually fading, pay growth is moderating significantly. Growth in average weekly total earnings slowed further than expected in the three months to November, down 1.7ppts from the prior quarter and 2.0ppts below the peak in July to a ten-month low of 6.5%3M/Y. Excluding bonuses, regular pay growth similarly slowed to the softest since the three months to January, declining 1.3ppts below the summer peak to 6.6%3M/Y. And private sector regular pay – one of the three key variables in the BoE's current reaction function – eased to 6.5%3M/Y, down 1.6ppts on the quarter and the lowest since the three months to August 2022, with the single-month figure (6.0%Y/Y) reaching a 17-month low. Notably, those annual rates are exaggerated by the big pay rises in the spring and early summer, when workers were seemingly better able to extract compensation for the high inflation of the past couple of years. And since then, momentum in private sector pay has faded significantly. Excluding bonuses, regular private pay growth moderated in November to 2.6%3M/3M annualised, down almost 8ppts from the peak in June, the softest since September 2021 and well below the long-run average. Momentum in services and manufacturing alike was the softest since autumn 2021. That strongly suggests that the BoE's projections for private sector regular pay growth of 7.2%3M/Y at year-end and 6.5%3M/Y next March are too high. And private pay growth currently looks on track to return to rates consistent with achievement of the inflation target over the medium term. While momentum in public sector regular pay picked up to a nine-month high of 7.4%3M/3M ann., momentum in total regular pay still slowed to just 2.8%3M/3M ann., also the softest in more than two years.

Euro area Consumer inflation expectations*



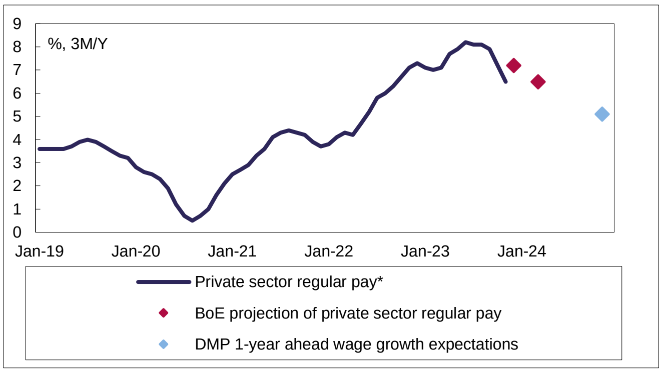
*Median inflation expectations. Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer GDP growth expectations*



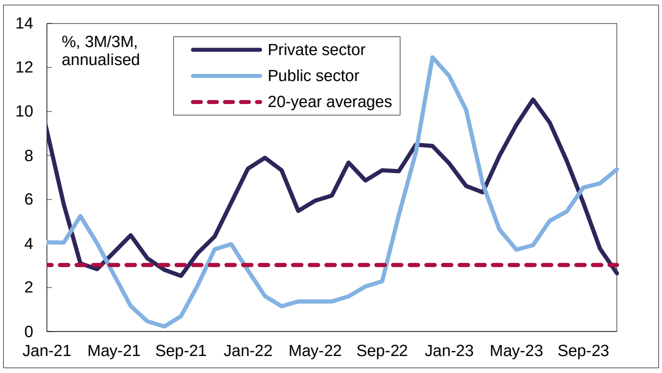
*Median GDP growth expectations for coming 12 months. Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private sector regular pay growth



*Data between January 2020 and November 2022 are BoE staff estimates of underlying private sector regular pay growth. Source: Macrobond, BoE, and Daiwa Capital Markets Europe Ltd.

UK: Regular pay growth momentum



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

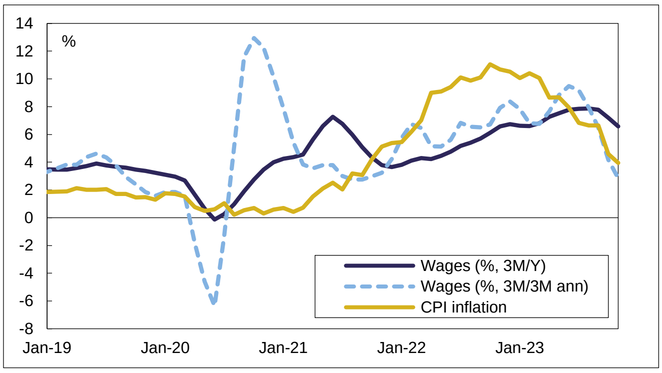
Labour market less tight with number of vacancies and payroll growth at lowest since mid-2021

The continued suspension of the official Labour Force Survey, due to the low response rate, complicates analysis of the precise extent of labour market tightness. However, a range of indicators tallies with the slowdown in private pay growth to suggest that labour market conditions continue to ease. Admittedly, according to the ONS's experimental series derived from the HMRC Pay As You Earn and Claimant Count figures, the employment rate (for those aged 16 to 64 years) edged up 0.1ppt in the three months to November to a six-month high (75.8%). But the unemployment rate (for those aged 16 years and over) was unchanged for a sixth successive month at 4.2%, 0.7ppt above last year's trough and matching the highest rate since the three months to October 2021, albeit still about ¼ppt below the BoE's latest estimate of the medium-term equilibrium rate. Moreover, the 16-64Y inactivity rate edged down 0.1ppt to a six-month low, matching the bottom of the range since the onset of the pandemic. In terms of the raw data, in December, the number of jobless claims rose for a fourth successive month while the initial estimate of payrolled employees fell, pushing the respective growth rate down to 1.0%Y/Y, the softest since May 2021. Most notably perhaps, in the three months to December, the number of vacancies fell 49k on the quarter for the 18th successive month to 934k, the lowest since June 2021. But with redundancy notices towards year-end remaining relatively low by historical standards, falling labour demand is continuing to translate into a lower number of job openings rather than higher unemployment. Overall, today's figures tally with survey evidence such as that from the REC report on jobs. Earlier this month that survey of recruitment consultancies suggested that permanent job placements fell for a sixteenth consecutive month in December while candidate availability rose strongly and growth in permanent starting salaries slowed to the second-weakest rate since early 2021, well below the average in the five years before the pandemic.

The day ahead in the UK

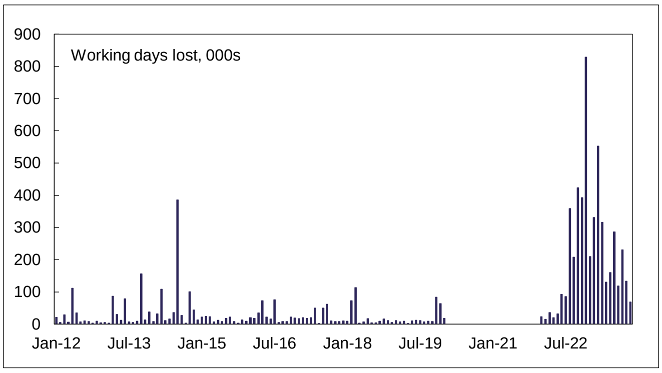
The focus on Wednesday will be December's inflation data. Having eased to a 26-month low in November, we expect the headline CPI rate to edge only slightly lower, by 0.1ppt to 3.8%Y/Y. This would leave the average inflation rate in Q4 at 4.1%Y/Y, some 0.5ppt below the BoE's forecast published in November. The slowdown last month will in part reflect a sharp drop in petrol prices. But with services inflation also expected to ease slightly to a fifteen-month low of 6.2%Y/Y, core inflation might well similarly fall 0.1ppt to 5.0%Y/Y, which would be the lowest since January 2022.

UK: CPI inflation & total pay growth



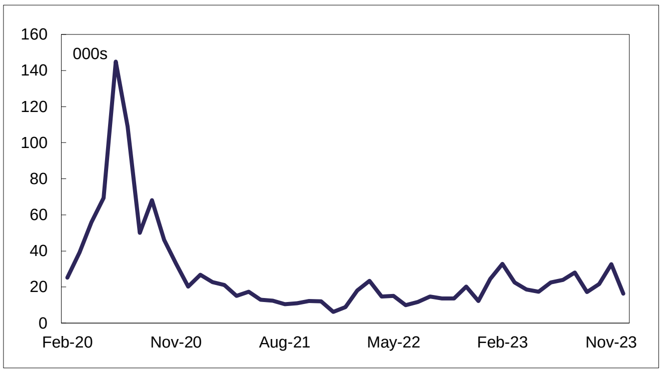
Source: Refinitiv Datastream, Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: Working days lost to strike action



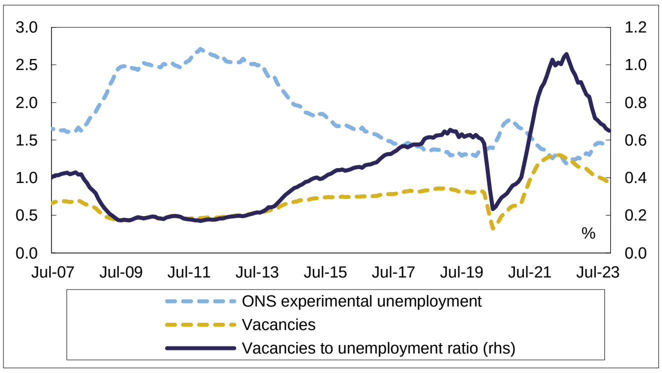
Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Potential redundancy HR1 forms filed



Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Employment & payrolled employees



Source: Bloomberg, ONS 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		ECB 1Y (3Y) ahead CPI expectations Y/Y%	Nov	**3.2 (2.2)**	-	4.0 (2.5)	-
Germany		Final HICP (CPI) Y/Y%	Dec	**3.8 (3.7)**	*3.8 (3.7)*	2.3 (3.2)	-
		ZEW current assessment (expectations) balance	Jan	**-77.3 (15.2)**	-77.0 (12.0)	-77.1 (12.8)	-
Italy		Final HICP (CPI) Y/Y%	Dec	**0.5 (0.6)**	*0.5 (0.6)*	0.6 (0.7)	-
UK		Payrolled employees monthly change '000s	Dec	**-24**	-15	-13	9
		Claimant count rate % (change '000s)	Dec	**4.0 (11.7)**	-	4.0 (16.0)	- (0.6)
		Average weekly earnings including (excluding) bonuses 3M/Y%	Nov	**6.5 (6.6)**	6.8 (6.6)	7.2 (7.3)	- (7.2)

Auctions

Country		Auction
Germany		sold €3.2bn of 2029 bonds at an average yield of 2.12%
UK		sold £1.5bn of 0.75% 2033 index-linked bonds at an average yield of 0.423%

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	Final HICP (core HICP) Y/Y%	Dec	*2.9 (3.4)*	2.5 (3.6)
UK		07.00	CPI (core CPI) Y/Y%	Dec	*3.8 (5.0)*	3.9 (5.1)
		07.00	PPI output (input) prices Y/Y%	Dec	0.4 (-1.9)	-0.2 (-2.6)
		07.00	House price index Y/Y%	Nov	-	-1.2

Auctions and events

Country		GMT	Event
Germany		10.30	Auction: €1bn of 0% 2052 bonds
		10.30	Auction: €1bn of 1.8% 2053 bonds
UK		11.30	Auction: £3.75bn of 4.625% 2034 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.