Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds made losses even as euro area industrial production surprised to the downside in January amid weakness in the capital goods sector.
- Gilts also made losses as UK GDP returned to modest positive growth at the start of 2024, albeit maintaining a broadly sideways trend.
- The remainder of the week will bring final February inflation estimates from France, Italy and Spain, as well as a UK housing market and household inflation expectations survey.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.873	+0.034
OBL 2.1 04/29	2.382	+0.027
DBR 2.2 02/34	2.354	+0.026
UKT 0⅛ 01/26	4.239	+0.048
UKT 0½ 01/29	3.923	+0.059
UKT 4⅝ 01/34	4.008	+0.064

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

Euro area

IP falls much further than expected in January due to weakness in capital goods sector

Industrial production in the euro area at the start of the year was much weaker than expected and also significantly softer than had been suggested by the figures published by the member states. Indeed, the drop of 3.2%M/M was the steepest in ten months. And with the estimate of IP growth in December revised down by 1.0ppt to 1.6%M/M, the level of production in January was 2.0% below the Q4 average and the lowest since September 2020. The weakness in January was centred on manufacturing output (-6.8%M/M), and in particular production of capital goods (-14.5%M/M), which had been the source of strength in December. Within that category, output of motor vehicles fell 9.3%M/M with production of computers and optical instruments down 10.1%M/M. In contrast, output of intermediate items (2.6%M/M) and consumer goods (0.2%M/M) rose, but energy-intensive production also declined (-1.4%M/M) due not least to drop in chemicals (-2.6%M/M).

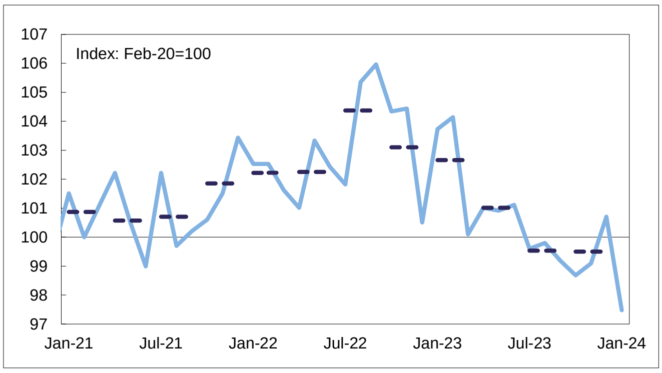
Production to drop again in Q1 after flat Q4

By member state, the weakness was centred in Ireland (an extreme drop of 29.0%M/M), and to a lesser extent in the Netherlands (-4.0%M/M), suggesting that the activities of certain multinational corporations based in those countries for tax reasons was one explanation. Among the largest member states, output dropped 1.0%M/M in France principally due to a sharp fall in motor vehicles. But it rose 0.6%M/M in Germany and 0.9%M/M in Spain, while the Italian data were not published. It is tempting to attribute the marked decline in overall euro area production in January to one-offs, including factory maintenance, tax planning and/or supply disruption related to events in the Red Sea. However, while the manufacturing output PMI rose last month to an eleven-month high consistent with stabilisation, the Commission's index of industrial sentiment fell to a six-month low suggestive of persistent weakness as firms continue to adjust output and inventories to thin order books. And notwithstanding the possibility of a significant revision in due course, the low level in January means almost certainly that IP will contract over Q1 as a whole having been flat on the quarter in Q4.

The coming two days in the euro area

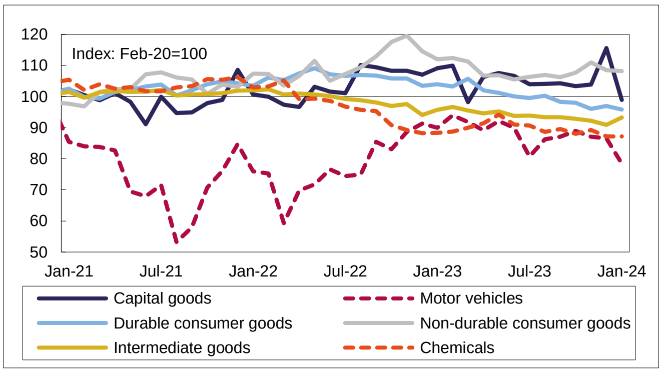
It should be a relatively quiet end to the week for euro area releases, with just final February inflation from Spain (tomorrow), France, and Italy (both Friday). The flash estimates saw headline HICP rates fall in France (-0.3ppt to a 29-month low of 3.1%Y/Y) and Spain (-0.6ppt to a six-month low of 2.9%Y/Y), while inflation moved sideways in Italy at 0.9%Y/Y, nevertheless one of the lowest rates among member states. Contrasting with a modest increase in Germany, the flash releases also saw core HICP inflation in France and Italy ease to multi-month lows of 2.4%Y/Y and 2.6%Y/Y respectively.

Euro area: Industrial production*



Dashed dark blue lines represent quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The core Spanish figure will be published for the first time tomorrow. Aside from the data, Executive Board members Schnabel and Lane will speak at events tomorrow and Friday respectively.

UK

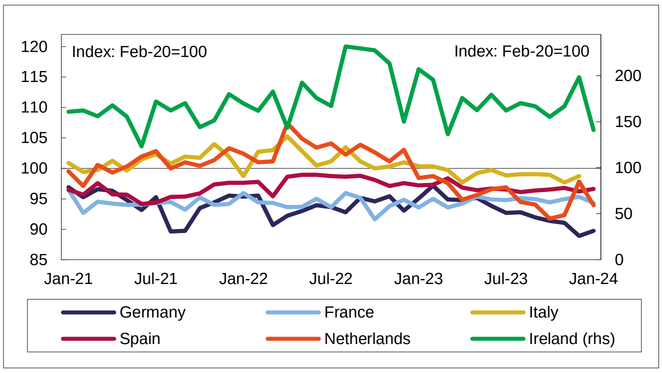
UK GDP returns to modest growth led by a rebound in retail sales

Consistent with the improvement in the PMIs, today's monthly GDP release suggested that the UK economy returned to modest growth at the start of the year, having entered a mild technical recession in the second half of last year. But while GDP rose 0.2%M/M in January, more than reversing the 0.1%M/M contraction in December, this still left output down 0.3%Y/Y and some 0.7% below last summer's peak. And while GDP was 0.2% above the Q4 level – in line with our growth forecast for Q1 as a whole – it was still down 0.1%3M/3M, implying a persisting lacklustre economic performance. The expansion in January was principally led by the retail sector, for which sales jumped 3.4%M/M amid heavy New Year discounting, reversing the slump in December. But while they added 0.2ppt to monthly GDP growth, sales were broadly unchanged on a three-month basis. Despite a near-doubling in the number of working days lost to strike action, there was also an increase in output from the healthcare and transport subsectors in January, while there was a second-successive rise in activity at travel agencies. This helped to offset renewed weakness in accommodation services and architectural work as well as a sharp decline in the often-volatile motion picture, video, TV, and music subsector, which was reportedly impacted by previous strike action in the US. Overall, services activity rose 0.2%M/M, to leave it on a broadly sideways trend over the past three months, therefore seemingly still lacking any meaningful recovery momentum.

Construction appears to have reached a turning point, but manufacturing production pauses

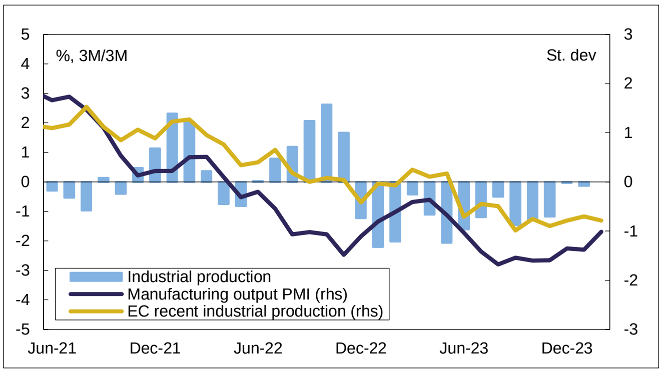
Tallying with signs of a turning point in the housing market and likely supported by unseasonably mild weather, the construction sector also had a better start to the year, with output rising for the first month in four, by 1.1%M/M, to add a further 0.1ppt to monthly GDP growth. This was underpinned by a second-successive rise in private sector house building (2.6%M/M), which was the strongest since October 2022, as well as a sixth consecutive increase in repair and maintenance work (1.2%M/M). So, while private residential work was still down more than 15%Y/Y, this was more than offset by a steady rise in public sector building and repair and maintenance work, to leave total construction up 0.7%Y/Y. In contrast, industrial production fell in January for the first month in three, by 0.2%M/M. Admittedly, this principally reflected sharp declines in sewerage and waste collection (-2.2%M/M), while the steady downtrend in mining and quarrying continued, with output down a further 1.3%M/M to be more than 19% below its level two years ago. But manufacturing production also paused in January,

Euro area: Industrial production by member state



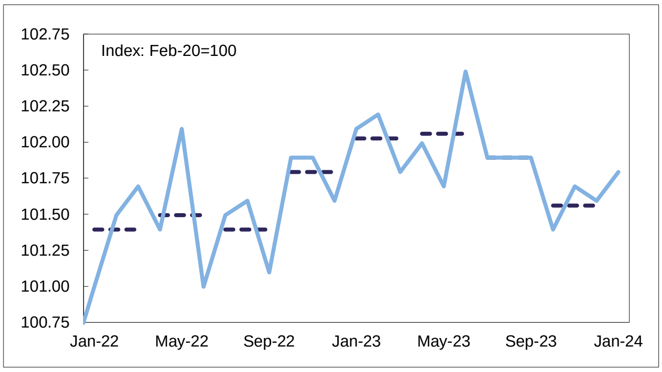
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: IP & manufacturing sentiment indices



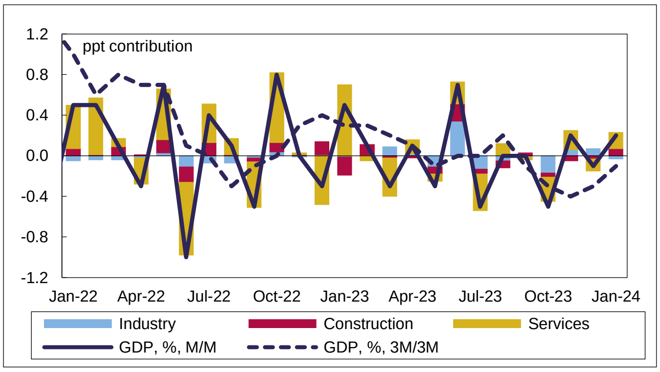
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Monthly GDP*



**Dashed line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Contributions to monthly GDP



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

having risen 0.8%M/M in both November and December, with a mixed performance among subsectors. Indeed, while car production rose for a fourth month to its highest level since October 2017 and machinery and equipment production increased for a second month, there was a marked contraction in output of pharmaceuticals. Overall, almost half of the subsectors saw production drop in January, with anecdotal evidence of supply disruption from events in the Red Sea impacting a range of industries including textiles, rubber and plastics, food and electrical equipment. While the manufacturing output PMI jumped to a three-month high in February, it remained firmly in contractionary territory. And although the equivalent services activity index remained at the top of the recent range, retail surveys – not captured by the PMIs – point to weak sales last month.

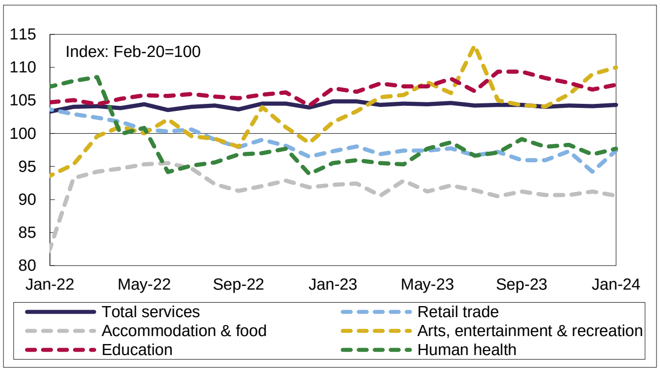
Net trade remained a drag on growth at the start of the year

Having been a notable drag on GDP growth in Q4, net trade appears to have remained soft at the start of the first quarter. Certainly, today's data suggested that imports were stronger than exports in January – suggesting little impact from shipping delays – so that the trade deficit widened £0.9bn to a three-month high of £4.2bn, to be some £1.2bn above the average in 2023. This principally reflected a first monthly increase in three in the value of imports, by 1.4%M/M in January, with a rise in imports of fuel and food and live animals offsetting lower imports of machinery and transport equipment, including fewer aircraft from Germany and France. The value of exports rose a more modest 0.7%M/M, with higher shipments of crude oil offsetting a decline in exports of machinery and transport equipment. When excluding precious metals, which distort the underlying picture, export values merely moved sideways in January. And when also excluding price effects, export volumes declined for a sixth successive month (-0.8%M/M), despite a modest increase in services exports (0.3%M/M). But while the drop in total export volumes (incl. precious metals) was more marginal in January (-0.3%M/M), they were still more than 1½% below the Q4 average, while total import volumes were trending some 1% lower on the same basis.

The coming two days in the UK

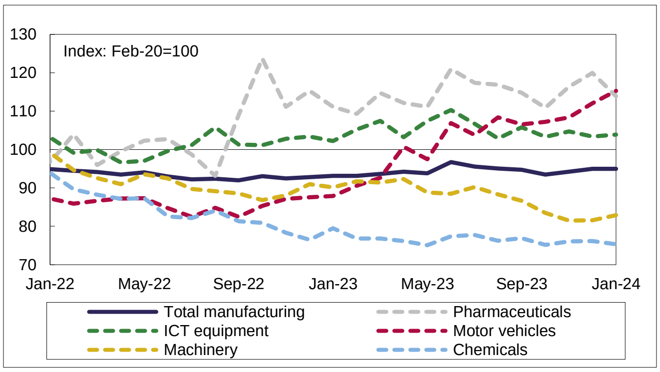
The remainder of the week will bring the RICS residential survey tomorrow, followed by the BoE's inflation attitudes survey on Friday. Consistent with the recent pickup in mortgage approvals and return to positive annual growth in the Nationwide house price gauge, and amid a further pickup in buyer enquiries, the RICS survey is expected to report the highest house price balance (albeit still likely in negative territory) since the Truss-related blowout in interest rates in October 2022. Meanwhile, the BoE's inflation attitudes survey will likely see a further decline in household inflation expectations in the coming twelve months to its lowest since Q321. But of more interest for BoE policymakers will be developments in medium-term expectations – in Q423, inflation expectations in two years' time moved sideways at 2.8%Y/Y, while expectations for five years' time rose to a four-quarter high of 3.2%Y/Y.

UK: Services output



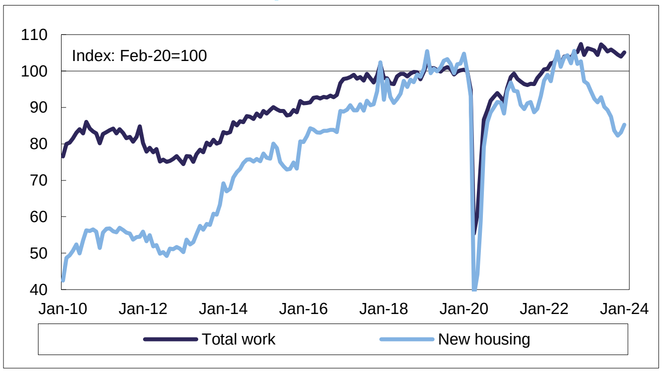
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output



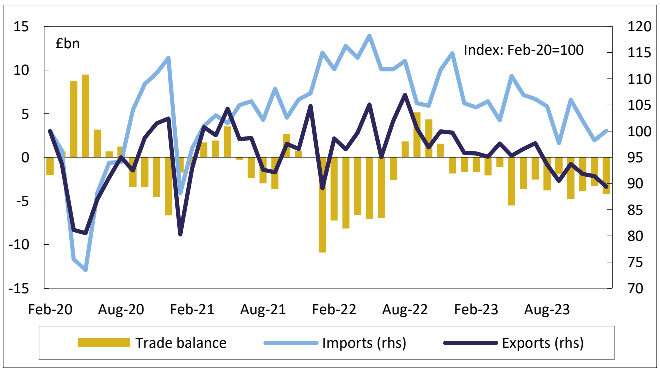
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Construction output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Trade balance, export & import volumes



Source: Macrobond 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		Industrial production M/M% (Y/Y%)	Jan	**-3.2 (-6.7)**	*-1.7 (-2.8)*	2.6 (1.2)	-
UK		GDP M/M% (3M/3M%)	Jan	**0.2 (-0.1)**	0.1 (-0.1)	-0.1 (-0.3)	-
		Industrial production M/M% (Y/Y%)	Jan	**-0.2 (0.5)**	0.0 (0.7)	0.6 (0.6)	-
		Manufacturing production M/M% (Y/Y%)	Jan	**0.0 (2.0)**	0.1 (2.0)	0.8 (2.3)	-
		Index of services M/M% (3M/3M%)	Jan	**0.2 (0.0)**	0.2 (0.0)	-0.1 (-0.2)	-
		Construction output M/M% (Y/Y%)	Jan	**1.1 (0.7)**	-0.1 (-0.5))	-0.5 (-3.2)	-
		Trade (goods) balance £bn	Jan	**-3.1 (-14.5)**	-3.1 (-15.1)	-2.6 (-14.0)	-

Auctions

Country		Auction
Germany		sold €3.74bn of 2.2% 2034 bonds at an average yield of 2.31%
Italy		sold €3bn of 2.95% 2027 bonds at an average yield of 3.06%
		sold €3bn of 3.5% 2031 bonds at an average yield of 3.31%
		sold €1.25bn of 4.0% 2031 bonds at an average yield of 3.3%
		sold €1.25bn of 3.25% 2038 bonds at an average yield of 3.85%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Spain		08.00	Final HICP (CPI) Y/Y%	Feb	*2.9 (2.8)*	3.5 (3.4)
UK		00.01	RICS house price balance %	Feb	-10	-18

Auctions and events

Country		GMT	Event
Euro area		11.00	ECB's Schnabel scheduled to speak
		17.00	ECB's Hernandez de Cos scheduled to speak
		18.00	ECB's Guindos scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
France		07.45	Final HICP (CPI) Y/Y%	Feb	*3.1 (2.9)*	3.4 (3.1)
Italy		09.00	Final HICP (CPI) Y/Y%	Feb	*0.9 (0.8)*	0.9 (0.8)
		10.00	Retail sales M/M% (Y/Y%)	Jan	-	-0.1 (0.3)
		11.00	Trade balance €bn	Jan	-	5.6
UK		09.30	BoE inflation expectations, next 12M %	Feb	-	3.3

Auctions and events

Country		GMT	Event
Euro area		09.00	ECB's Lane scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 15 March 2023

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs