

Euro wrap-up

Overview

- Bunds were little changed as surveys suggested that euro area consumer confidence and French business sentiment remained very subdued at the start of the year.
- Gilts outperformed, particularly at the shorter end of the curve following a downbeat UK manufacturing survey and after Chancellor Rachel Reeves signalled her readiness to tighten fiscal policy in March if necessary to ensure that she remains on track to meet her budgetary rules.
- Friday will bring the flash January PMIs and UK surveys of consumer confidence and retail activity.

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 2 12/26	2.236	+0.006
OBL 2½ 10/29	2.339	+0.007
DBR 2½ 02/35	2.536	+0.008
UKT 4½ 01/27	4.296	-0.046
UKT 4½ 07/29	4.316	-0.031
UKT 4½ 07/34	4.618	-0.011

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

Euro area

Consumer confidence remains subdued despite modest pickup in January

With inflation having temporarily ticked higher, growth momentum having slowed and fears of unemployment rising in the face of economic uncertainties, consumer confidence fell to an eight-month low in December. And the Commission's flash consumer indicator for January, published today, signalled little improvement at the start of the New Year. Indeed, the headline index rose just 0.3pt to -14.2 in January, the second-lowest reading of the past nine months and some 3½pts below the long-run average. While we have yet to see national consumer sentiment indicators from all of the member states, we suspect that the modest improvement might well have been led by France, with a modest rebound having last month fallen to a twelve-month low 11% below the long-run average as the Barnier government succumbed to a no-confidence vote. The most recent German GfK confidence survey also signalled a rise in the headline balance in January of almost 2pts from December's seven-month low. But other surveys published today suggested that sentiment remained fragile in the Netherlands and Belgium, with expectations for the economic outlook weakening. Overall, despite the slight pickup in January, today's survey underscored that household consumption will likely remain subdued in early 2025 despite rising real incomes.

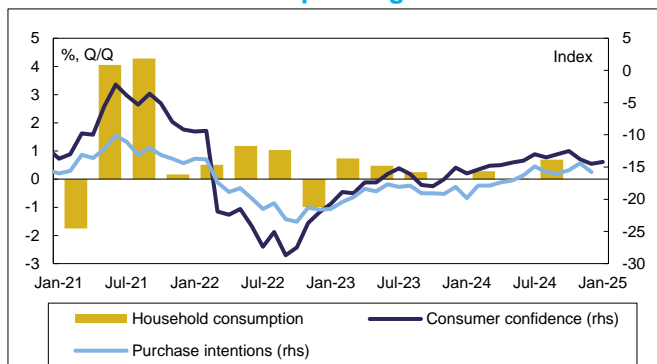
French business sentiment steady at start of 2025 but still firmly below long-run average

Today's French INSEE business survey gave a flavour as to what to expect in tomorrow's closely-watched flash PMIs. But while it suggested that conditions in France remained broadly stable at the start of the year, the headline indicator still suggested a pretty gloomy business climate, with the ½pt increase to 95 leaving it at the third-weakest level since 2014 when excluding the first year of the pandemic and 5% below the long-run average. While conditions in the services sector were steady in January, the respective synthetic indicator (96) remained below the long-run average (100) for a sixth month out of the past seven, with the business climate below the long-term trend in all subsectors except real estate. But recent activity in services reportedly weakened the most since September, while expected demand was the softest since July. And while sentiment among retailers (97) and builders (98) was unchanged on the month, those firms also reported a recent deterioration in activity.

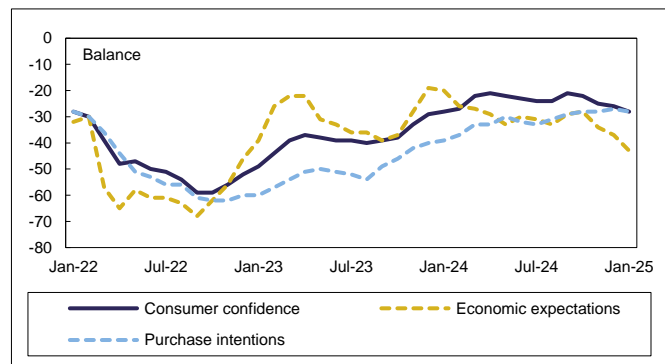
Outlook remains gloomy as new orders slump and concerns of political paralysis persist

In contrast, manufacturers reported a welcome pickup in production this month to an eight-month high. While this principally reflected a surge in the 'other transport' equipment category, manufactures of electronics, electrical and general machinery and pharmaceuticals were also less downbeat about the recent output. This notwithstanding, overall manufacturing

Euro area: Consumer spending & confidence



Netherlands: Consumer confidence indices



sentiment (-2pts to 95) was hit by a further notable decline in new orders – the respective index was the most negative since the euro crisis – with sentiment in the capital goods subsector also the lowest since 2014 outside of the first year of the pandemic. Perhaps reflecting domestic uncertainty related to the fragility of the current government as well as concerns about possible new trade barriers in the US, manufacturers investment plans were the weakest in more than three years. Services firms' capex plans similarly remained softer than normal. More encouragingly, with the new government having survived a no-confidence motion last week and the EU giving the green light to a slower pace of fiscal consolidation this year – with the deficit targeted to narrow from around 6% in 2024 to 5.4% of GDP under the latest proposals, compared with 5% of GDP under the Barriere-led administration – there appears a greater possibility that a budget might be able to pass the National Assembly before too long. However, with a summer election still likely, broader policy inertia is likely to persist, continuing to weigh on economic sentiment.

The day ahead in the euro area

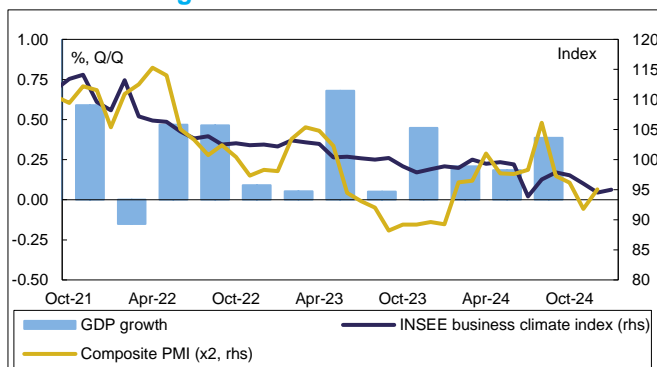
The focus in the euro area on Friday will be firmly fixed on January's flash PMIs. Over recent months, the PMIs have flagged the increasing likelihood that economic activity was largely stagnant in Q4 (we expect growth of 0.1%Q/Q), having been flattered by temporary factors in Q3. And while the removal of monetary policy restrictiveness and ongoing recovery in real incomes should lend support to the PMIs over coming months, we expect tomorrow's estimates to be relatively consistent with their recent trend. So, we expect the headline euro area composite PMI (49.6 in December) to remain slightly below 50 for a third successive month with services activity (previously 51.6), while sluggish, continuing to compensate for a protracted contraction in manufacturing (45.1 previously). January's flash estimates for Germany and France should underscore that this weakness remains concentrated in the euro area's largest member states, where economic challenges are most apparent and political uncertainty currently weighs heaviest. Beyond the data, ahead of next week's monetary policy announcement, ECB President Lagarde is scheduled to participate in a panel on the economic outlook in Davos.

UK

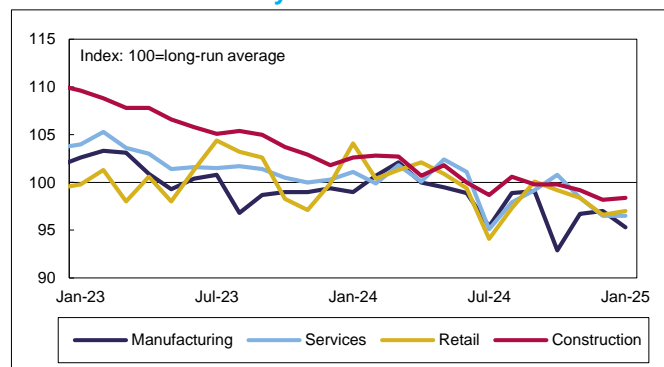
Manufacturers signal cut to investment and hiring plans amid declining output and new orders

Ahead of tomorrow's flash PMIs, today's CBI industrial trends survey painted a fairly gloomy picture of the start to the year for the manufacturing sector, suggesting a continuation of the downtrend in production seen during the second half of last year. Despite an improvement in the survey's net balance for output in the three months to January (-13) from December's more than four-year low (-25), this still marked the seventh consecutive monthly negative reading, tallying with ongoing steep

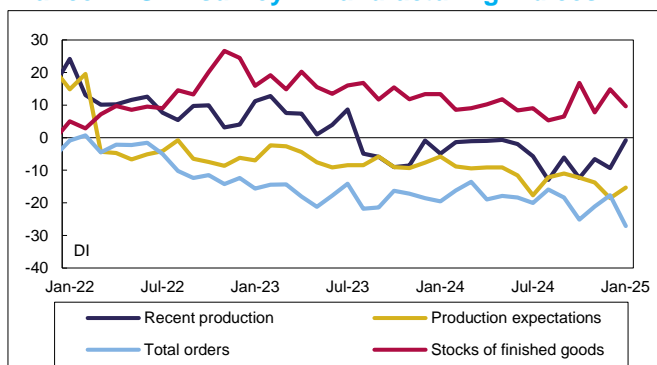
France: GDP growth & business sentiment



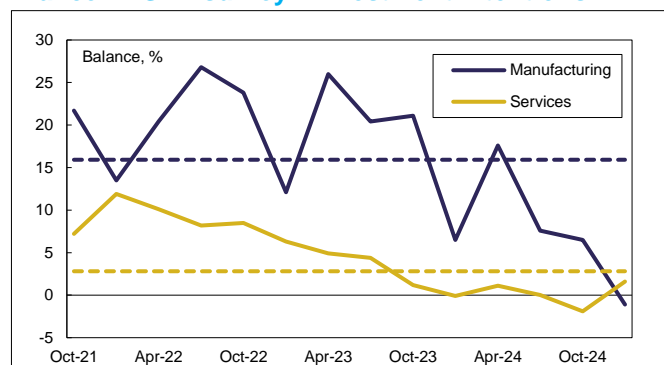
France: INSEE survey – business sentiment



France: INSEE survey – manufacturing indices

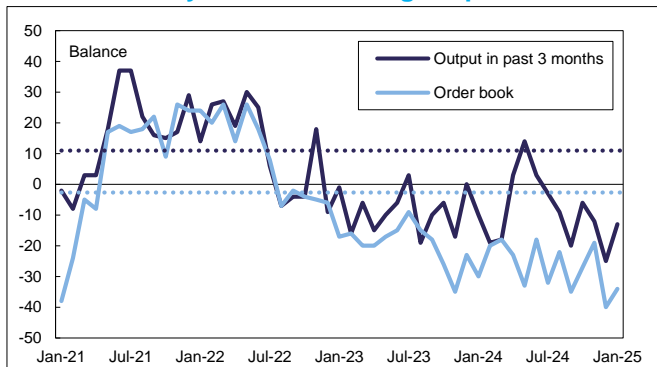


France: INSEE survey - investment intentions



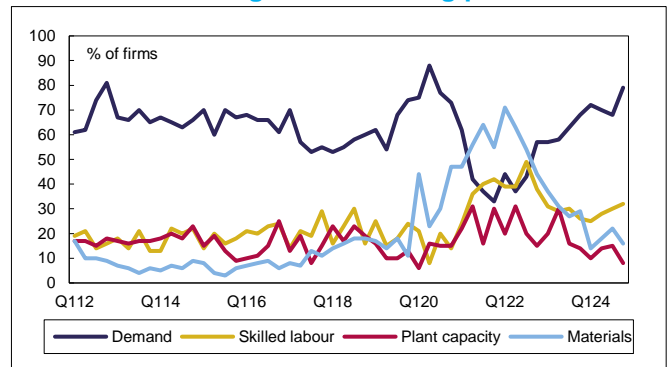
declines in domestic and overseas orders. The quarterly survey suggested that firms were the most pessimistic about the near-term outlook for orders since the global financial crisis (outside of Covid lockdown periods). And with almost 80% of respondents signalling that weak demand was holding back production, they were similarly the most downbeat about the near-term outlook for output for 16 years. With margins also increasingly squeezed by rising cost pressures – which were reportedly the highest in two years – business sentiment fell at the fastest pace in over two years. With the global manufacturing outlook tainted by uncertainties regards US tariff policies, and ahead of the rise in employers NICS and the National Living Wage in April, firms revised down significantly their investment intentions for the year ahead, with a broad-based expected reduction in expenditure on buildings, machinery, training and innovation, for which the latter was the lowest since the global financial crisis. And having cut headcount slightly further in the three months to January, manufacturers expected to make further job cuts over the coming three months and at the fastest pace since mid-2020.

UK: CBI survey – manufacturing output & orders



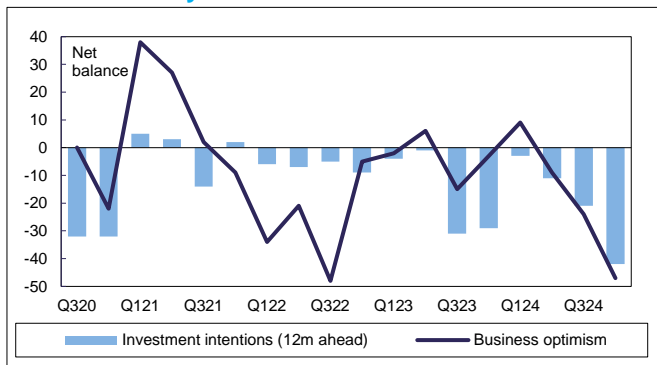
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Factors limiting manufacturing production



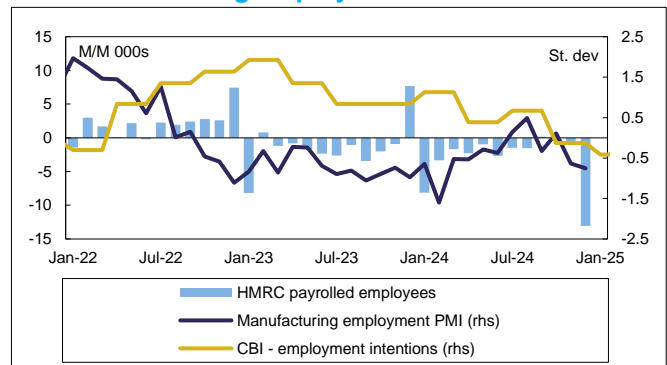
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: CBI survey – sentiment & investment intentions



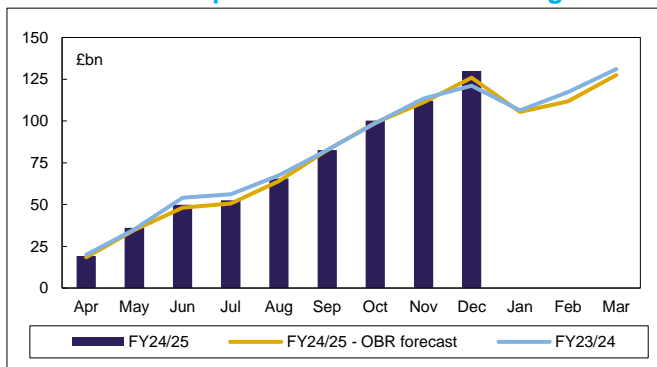
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing employment



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

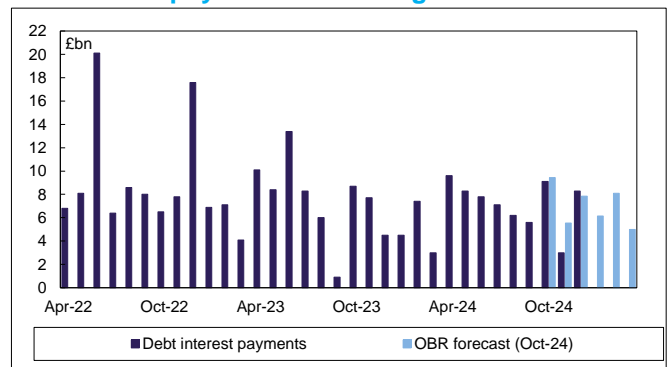
UK: Cumulative public sector net borrowing*



*Excluding public sector banks.

Source: OBR, ONS, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Interest payable on central government debt



Source: OBR, ONS, Macrobond and Daiwa Capital Markets Europe Ltd.












Public borrowing overshoot expectations in December despite central government undershoot

At face value, yesterday's public finance figures might have added to concerns that further fiscal tightening will be required to meet the Chancellors' fiscal targets. Certainly, public sector net borrowing of £17.8bn in December was £10.1bn more than a year ago and £3.2bn more than forecast by the OBR at the end of October. This left net borrowing in the year-to-date at £129.9bn, the second-highest respective reading since the monthly series began in 1993, £8.9bn more than in the financial year to December 2023 and £4.1bn above the OBR's October projection. But this reflected higher than expected borrowing by local government and public corporations (which accounted for £11.0bn of public sector borrowing in December). In contrast, central government borrowing – which matters most for the Gilt market – undershot expectations at £142.4bn in the year-to-date, some £2.4bn below the OBR's forecast. While central government spending was a touch firmer than expected, this in part reflected higher debt interest payments (£8.3bn), grants and net investment. But debt interest so far this financial year has risen less than expected. And overall central government spending in the year-to-date was some £4.2bn less than projected by the OBR. While central government tax revenues were broadly as expected last month, January's tax receipts – which include self-assessment returns – will be more important for determining whether or not the government will meet the OBR's projections over the fiscal year as a whole.

The day ahead in the UK

As in the euro area, January's flash PMIs are expected to attract the most attention in tomorrow's UK dataflow. Certainly, as some members of the MPC have recently noted, with GDP having flatlined on a three-month basis between August and November, and leading indicators increasingly suggestive that growth might have turned negative in the final quarter of the year, the possibility of protracted stagnation presents increasing downside risks to the BoE's inflation outlook. And having registered a fourth consecutive monthly decline in the headline composite index in December, albeit by a modest 0.1pt to 50.4, January's flash PMIs are not expected to provide evidence of a meaningful upturn. Policymakers will also keep a watchful eye over the services price PMIs, which ticked higher over the past three months to around 3½pts above the pre-pandemic average. Meanwhile, political events and downbeat markets reporting pose a risk to January's GfK consumer confidence indicator, while tomorrow's CBI's distributive trends survey will provide a bellwether for January's retail trade after a disappointing festive season.


European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
Euro area	 Preliminary consumer confidence indicator	Jan	-14.2	-14.1	-14.5	-	
France	 INSEE business (manufacturing) confidence indicator	Jan	95 (95)	94 (96)	94 (97)	-	
UK	 CBI industrial trends survey – total orders (selling prices) balance %	Jan	-34 (27)	-35 (20)	-40 (23)	-	
Auctions							
Country	Auction						
France	 sold €3.522bn of 2.5% 2027 bonds at an average yield of 2.51%  sold €1.796bn of 5.5% 2029 bonds at an average yield of 2.74%  sold €7.674bn of 2.75% 2030 bonds at an average yield of 2.84%  sold €814mn of 0.6% 2034 inflation-linked bonds at an average yield of 1.14%  sold €719mn of 0.55% 2039 inflation-linked bonds at an average yield of 1.41%  sold €473mn of 1.8% 2040 inflation-linked bonds at an average yield of 1.38%  sold €243mn of 0.1% 2053 inflation-linked bonds at an average yield of 1.35%						
UK	 sold £4.25bn of 4.375% 2028 bonds at an average yield of 4.384%						



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
UK	 Public sector net borrowing £bn	Dec	17.8	-	11.2	11.8












Auctions

Country	Auction
Germany	 sold €1.129bn of 2.6% 2041 bonds at an average yield of 2.74%
	 sold €392mn of 2.5% 2044 bonds at an average yield of 2.74%


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	Preliminary manufacturing (services) PMI	Jan	45.4 (51.5)	45.1 (51.6)
	 09.00	Preliminary composite PMI	Jan	49.7	49.6
Germany	 08.30	Preliminary manufacturing (services) PMI	Jan	42.7 (51.0)	42.5 (51.2)
	 08.30	Preliminary composite PMI	Jan	48.3	48.0
France	 08.15	Preliminary manufacturing (services) PMI	Jan	42.5 (49.4)	41.9 (49.3)
	 08.15	Preliminary composite PMI	Jan	47.7	47.5
Spain	 08.00	PPI Y/Y%	Dec	-	0.9
UK	 00.01	GfK consumer confidence indicator	Jan	-18	-17
	 09.30	Preliminary manufacturing (services) PMI	Jan	47.0 (50.8)	47.0 (51.1)
	 09.30	Preliminary composite PMI	Jan	50.1	50.4
	 11.00	CBI distributive trades survey – reported sales volumes %	Jan	-10	-15

Auctions and events

Euro area	 10.00	ECB President Lagarde to participate in panel on the Global Economic Outlook at the World Economic Forum, Davos.
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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