

Euro wrap-up

Overview

- While the ECB's Bank Lending Survey reported an unwelcome tightening of credit conditions and stagnant demand for business loans, Bunds followed USTs lower.
- Gilts were also weaker as a survey suggested that deflation on the UK high street moderated somewhat at the start of the year.
- Wednesday will bring the first estimate of Spanish GDP growth in Q4 as well as updates on euro area bank lending growth and German consumer confidence.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.254	-
OBL 2.4 04/30	2.363	+0.026
DBR 2½ 02/35	2.562	+0.033
UKT 4½ 01/27	4.298	+0.023
UKT 4½ 07/29	4.304	+0.025
UKT 4½ 07/34	4.612	+0.028

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

Source: Bloomberg

Euro area

ECB lending survey reports tightening conditions on loans to firms by most in five quarters

While the ECB cut rates by a cumulative 100bps between June and December last year, policy remains restrictive, with tight financial conditions weighing on economic demand as well as underlying inflation. Indeed, today's ECB Bank Lending Survey (BLS) reported a net tightening of credit standards in Q4 by the most in five quarters as lenders worried about increased downside risks to the economic outlook. Loans to commercial real estate (CRE), wholesale and retail trade, construction and energy-intensive manufacturing were subject to the greatest tightening of credit standards over the second half of the year. And the tightening was judged to be most significant in Germany and France, where political uncertainties are greatest. In contrast, credit conditions on loans to firms reportedly eased in Italy. Unfortunately, firms anticipate a further tightening in business loan standards in the current quarter.

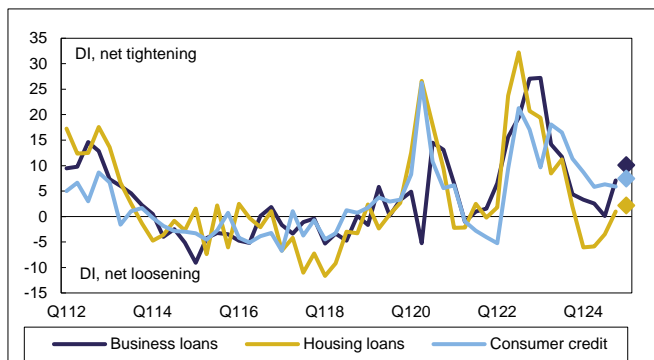
Minimal business loan demand growth as firms revise down investment plans

Meanwhile, weighed in particular by France, firms' demand for loans remained weak, increasing only minimally and by less than in Q3 as firms appeared to revise down their plans for fixed investment. Lower rates were judged to offer support to business loan demand, but only very modestly. Indeed, while the average composite cost of bank loans for businesses in the euro area dropped in November to 4.5%, almost 80bps lower than a year earlier, yesterday's ECB Survey on Access to Finance of Enterprises (SAFE) suggested that lower rates are benefitting only a minority of firms. Only a net balance 1% of SME survey recipients reported lower rates on loans in Q4. And while the net share of large firms benefiting from lower rates in Q4 was larger at 7%, that was down slightly from the equivalent share in Q3. Banks do not expect business loan demand to pick up in the current quarter. And with the stock of loans to businesses having grown by less than 1.0%Y/Y in November (the most recent month for which we have data), the BLS and SAFE point to the likelihood of minimal year-on-year growth in nominal terms and continued negative growth in real terms for a while to come. Certainly, both surveys strengthen the case for a further ECB rate cut this week, and additional cuts further ahead to give long-overdue support to capex.

Mortgage demand firmer as housing market prospects turn for the better

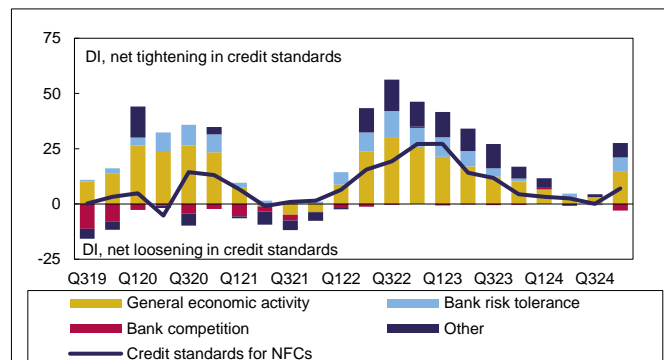
Like business loan demand, the BLS also reported only minimal growth in demand for consumer credit last quarter. Soft demand for durable goods and weak consumer confidence negated the modest positive impulse from lower rates. And banks tightened their conditions on consumer loans too. But banks do at least envisage a pickup in demand for consumer credit this quarter. Moreover, credit conditions on housing loans were left broadly unchanged in Q4 while net demand for home mortgages was judged to have picked up the most in almost a decade. Lower rates on loans for house purchase and recent

Euro area: ECB BLS – credit standards*



*Diamonds represent survey forecast for Q125. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB BLS – credit standards to NFCs



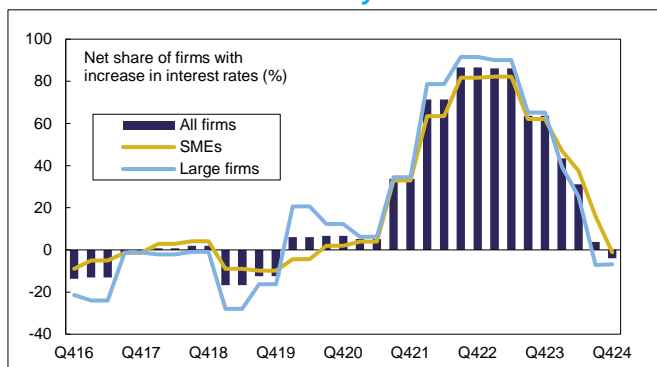
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

house price adjustments in certain member states have supported affordability while the outlook for residential real estate was also judged to have improved for the second successive quarter. And banks expect firm growth in demand for housing loans across the euro area again in the current quarter, pointing to an acceleration in the pace of expansion in this category of loan from just 0.4%Y/Y in November.

French consumer confidence recovers in January, but remains well below long-run average

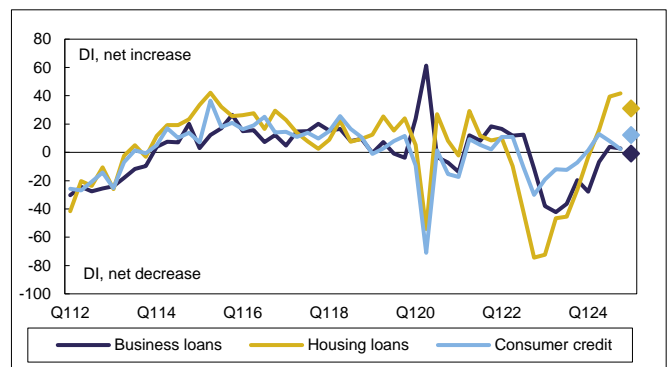
With the Bayrou government having survived a vote of no confidence earlier this month and proposals for a softer pace of fiscal consolidation seemingly having a greater chance of adoption by the National Assembly, today's INSEE French consumer confidence survey – like the equivalent [business](#) survey – signalled some stabilisation in conditions at the start of the year. In particular, the headline confidence index rose 3pts in January to 92, a three-month high and a touch above the average of the past year (91). But this was still some 8% below the long-run average. And while households were seemingly less downbeat about the economic outlook than they were at the end of last year when the Barnier government faced increasing political resistance, the respective survey index was still below the average in the first ten months of 2024. The improvement in part reflected a slight decrease in concerns about unemployment at the start of the year after spiking in December to a near-four-year high amid a jump in the number of jobless claimants. Indeed, the number of those seeking

Euro area: ECB SAFE survey – level of interest rates



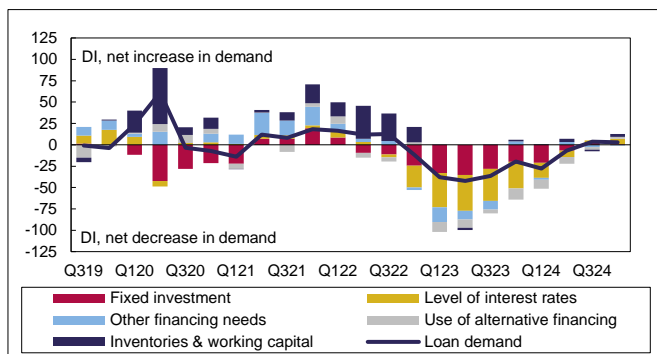
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB BLS – demand for loans*



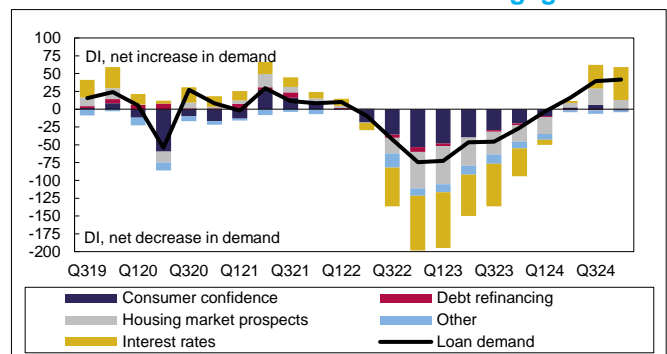
*Diamonds represent survey forecast for Q125.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB BLS – demand for business loans



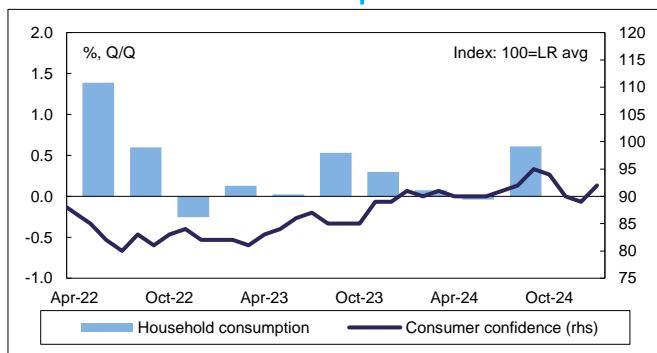
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB BLS – demand for mortgage loans



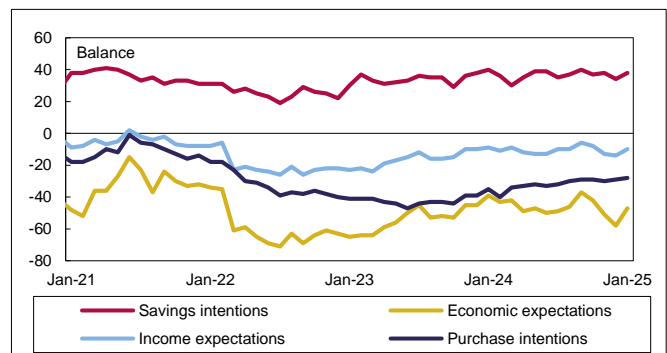
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Household consumption & confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: INSEE consumer confidence indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

permanent full-time employment rose 114k (4.0%) to 2.928mn in Q4. Admittedly, this in part reflected a re-categorisation of unemployment in the data, although the rise in overall jobseekers of 92k (1.8%) to 5.216mn, nevertheless still took it to the highest level since Q122. A larger share of consumers now expect prices to fall over the coming year, and they were also less pessimistic about the outlook for incomes. Nevertheless, households still expressed an ongoing preference to save at the start of the year. So, while the survey's index for purchase intentions edged up to its highest since March 2022, it remained well below the long-run average suggesting that discretionary spending will likely remain relatively subdued this quarter.

The day ahead in the euro area

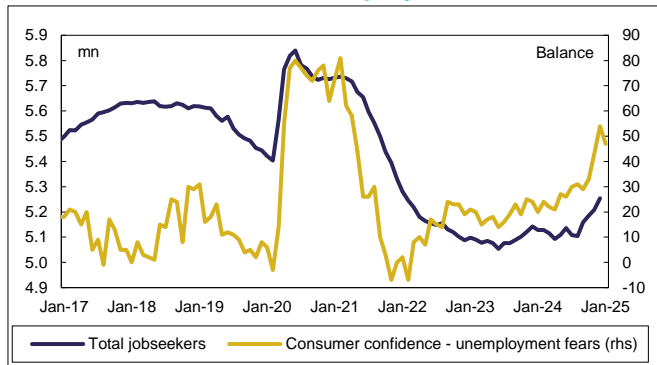
December's monetary aggregates will provide further insight into bank lending the momentum at the end of last year. Consistent with the strong demand noted by today's Bank Lending Survey in Q424, we expect to see a further pickup in net mortgage lending last month. But with lending conditions for firms having tightened in Q4, we suspect that business lending remained relatively subdued. Meanwhile, ahead of Thursday's release of euro area Q4 GDP, tomorrow will bring first estimates from Spain and Belgium – with the former to include a breakdown of contributions by expenditure component. As it has done in each of the past five quarters, Spanish GDP is expected to have continued to outperform the region's major economies in the final quarter – indeed, despite the impact of the flash floods in late October, we expect growth to moderate only slightly, by 0.2ppt to around 0.6%Q/Q. This would be enough to offset the drag from Ireland, where the economy contracted 1.3%Q/Q in Q4 following growth of 3.5%Q/Q in Q3. Finally, ahead of Thursday's Commission sentiment indices, tomorrow will bring Germany's GfK consumer confidence and Italy's ISTAT consumer and business surveys for January.

UK

BRC survey shows shop prices falling for first month in four despite rise in food prices

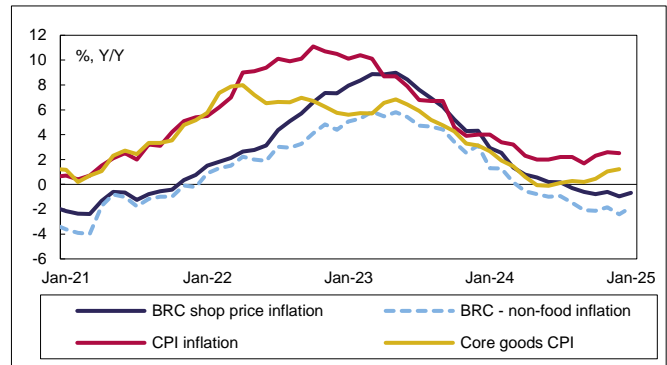
Today's British Retail Consortium (BRC) shop price survey suggested that, against the backdrop of higher energy and food prices, deflation on the high street moderated slightly at the start of the year. Indeed, while shop prices fell for the first month in four and by 0.4%M/M in January, the annual rate of decline eased from a near-3½-year high of -1.0%Y/Y to -0.7%Y/Y. According to the BRC, food prices rose for a seventh successive month, by 0.5%M/M, the most since April, with ambient food jumping 1.0%M/M, matching the strongest rise in a year, as prices spiked for confectionary and alcohol. But this still left the annual rate down to a more than three-year low of 1.6%Y/Y. Despite another month of heavy discounting in non-food items (-0.4%M/M), the annual rate rose 0.6ppt to -1.8%Y/Y. But this principally reflected base effects in clothing, with prices

France: Jobseekers & unemployment concerns



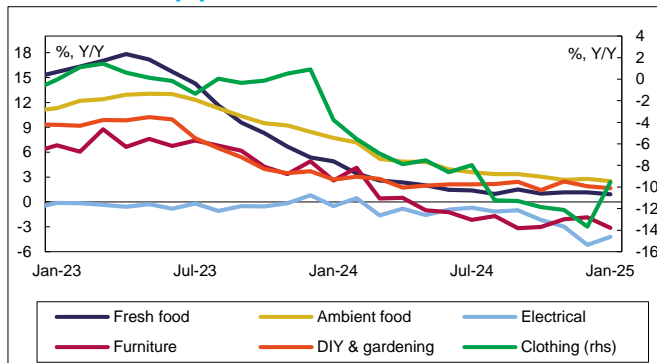
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measures of inflation



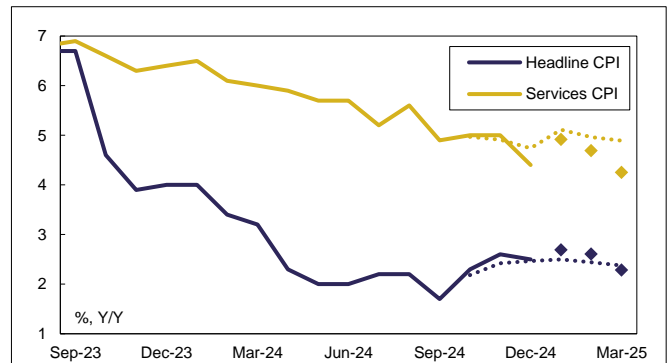
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BRC shop price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Headline & services CPI inflation*



*Dotted lines represent BoE November-24 projections. Diamonds represent Daiwa forecast. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

this month declining (-1.4%M/M) by significantly less than in January 2024 (-5.9%M/M). In contrast, furniture prices were cut (-2.5%M/M) by the most since April 2020 in a bid to boost demand. And we suspect that weakness in consumer confidence and ongoing preferences to save rather than to spend will continue to restrain retailers' pricing power, despite the impending increase in employers' NICs contributions and the National Living Wage in April. What matters most for BoE policy making is arguably services inflation, which undershot the BoE's end-2024 projection by 0.3ppt. While we expect it to tick higher at the start of the year in part due to the Budget-related increase in bus fares and VAT on private school fees, services inflation should moderate again from the spring onwards as subdued demand limits the pass-through of higher costs. And so, the MPC seems highly likely to cut Bank Rate by 25bps next week, and again in each quarter through to Q226 coinciding with updates of the Bank's macroeconomic projections.




The day ahead in the UK

With no top-tier data due, it should be a relatively quiet day ahead for UK economic news.






European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
France	 INSEE consumer confidence indicator	Jan	92	90	89	-
Spain	 Unemployment rate %	Q4	10.6	11.1	11.2	-
UK	 BRC shop price index Y/Y%	Jan	-0.7	-0.7	-1.0	-






Auctions

Country	Auction
Germany	 sold €3.82bn of 2.2% 2027 bonds at an average yield of 2.26%
Italy	 sold €3bn of 2.55% 2027 bonds at an average yield of 2.61%
	 sold €1.25bn of 1.5% 2029 inflation-linked bonds at an average yield of 1.17%
	 sold €1.25bn of 1.8% 2036 inflation-linked bonds at an average yield of 1.9%
UK	 sold £1.5bn of 1.125% 2035 inflation-linked bonds at an average yield of 1.128%



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	M3 money supply Y/Y%	Dec	3.9	3.8
Germany	 07.00	GfK consumer confidence indicator	Feb	-	-21.3
Italy	 09.00	ISTAT consumer confidence indicator	Jan	96.5	96.3
	 09.00	ISTAT business (manufacturing) confidence indicator	Jan	-(85.8)	95.3 (85.8)
Spain	 08.00	GDP – first estimate Q/Q% (Y/Y%)	Q4	<u>0.6 (3.1)</u>	0.8 (3.3)

Auctions and events

Germany	 10.30	Auction: to sell up to €4.5bn of 2.5% 2035 bonds
UK	 10.00	Auction: to sell £3bn of 0.875% 2033 green bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited ("DCME"). DCME is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange. DCME and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or derivatives or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of DCME and its affiliates may have positions and effect transactions in such the Securities or derivatives or options thereof and may serve as Directors of such issuers. DCME may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended only for investors who are professional clients as defined in MiFID II and should not be distributed to retail clients as defined in MiFID II. Should you enter into investment business with DCME's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

DCME has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.