Daiwa Capital Markets

Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds were little changed on a quiet day for economic news from the euro area.
- Gilts made gains as UK GDP growth remained sluggish in Q4, slightly undershooting the BoE's projection.
- Friday will bring updated euro area GDP and employment data for Q4, the region's goods trade figures for December, and the final detail of Spanish inflation in January.

Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.057	-0.003
OBL 2½ 04/31	2.370	-0.005
DBR 2.9 02/36	2.784	-0.006
UKT 3¾ 03/27	3.588	-0.018
UKT 4⅜ 03/30	3.857	-0.015
UKT 4½ 03/35	4.452	-0.023

*Change from close as at 4:00pm GMT.
Source: Bloomberg

UK

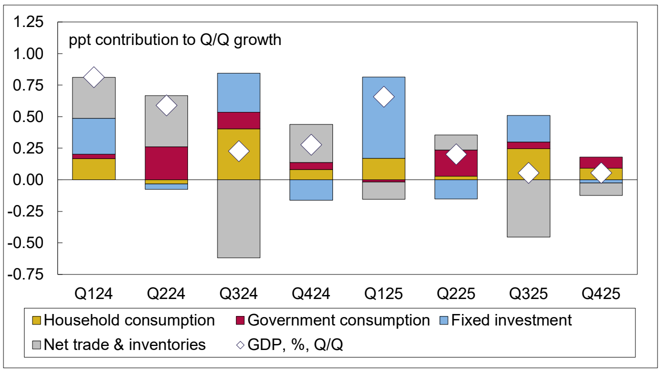
GDP growth remains sluggish in Q4 on private domestic demand weakness

According to the preliminary estimate, GDP growth was unchanged in Q4 at just 0.1%Q/Q, 0.1ppt below the BoE's forecast published last week. That left it up 1.0%Y/Y, the softest annual rate in six quarters and firmly below most estimates of potential growth, including that of the BoE (1.9%Y/Y in 2024-5). So, economic slack likely continued to rise towards year-end. And while forthcoming figures on the labour market and inflation will certainly influence the decision, the Q4 GDP report bolsters the case for a rate cut at the March MPC meeting. Indeed, final private domestic demand was weak, adding less than 0.1ppt to GDP growth in Q4 having contributed almost 0.5ppt in Q3. Household consumption slowed by 0.2ppt from an upwardly revised rate in Q3 to 0.2%Q/Q. Growth in this component was reliant on increased spending on hospitality, recreation and culture, and clothing and footwear. But it was likely restrained by uncertainty about tax changes in the Budget at end-November. Despite stronger public investment, gross fixed capital spending fell 0.1%Q/Q due to a marked drop of 2.7%Q/Q in the business sector. Once again, Budget-related uncertainty likely played a role in suppressing private capex. We caution, however, that estimates of business investment are usually significantly revised in subsequent releases and expect the Q4 level to be revised up in due course. Nevertheless, business capex probably still contracted last quarter. In contrast to the soft private spending, government consumption accelerated 0.4%Q/Q reflecting higher expenditure on health and defence, both clear policy priorities.

Gold weighs on net exports but contrast between services & goods trade continues

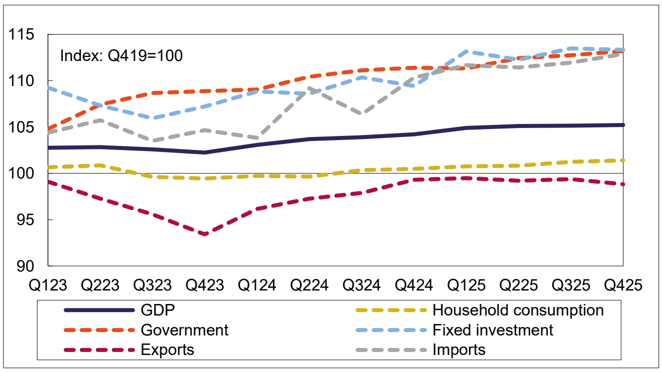
While private final domestic demand growth was subdued, net trade subtracted almost ½ppt from growth, an effect only partly offset by stock-building (+0.4ppt). Export volumes fell 0.6%Q/Q, the most in two years, while imports rose 0.8%Q/Q, the most in three quarters. But the weakness of net exports largely reflected shifts in flows of precious metals including non-monetary gold. Indeed, while the total trade deficit rose in Q4 to 2.0% of GDP, it narrowed to a four-quarter low of just 0.5% of GDP when excluding precious metals. Strong growth in import volumes reflected a surge in precious metals, principally non-monetary gold, excluding which imports fell 1.1%Q/Q, a steeper pace than the drop of 0.3%Q/Q in underlying exports. But even excluding precious metals, there was still a marked contrast between trade in goods and services. Indeed, adjusting for flows in precious metals, goods export volumes fell for a third successive quarter and by a steep 2.1%Q/Q, with broad-based weakness across the subsectors. And while underlying goods imports fell at a similar pace, the full-year underlying goods trade deficit widened in 2025 to the largest on record (close to £250bn in real terms). In contrast, thanks to strength in business services and travel, growth in services exports (1.0%Q/Q) slightly outpaced that of imports in Q4. As a result, the full-year services surplus rose to a series high above £190bn in real terms.

UK: GDP growth & expenditure contributions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP & expenditure levels



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

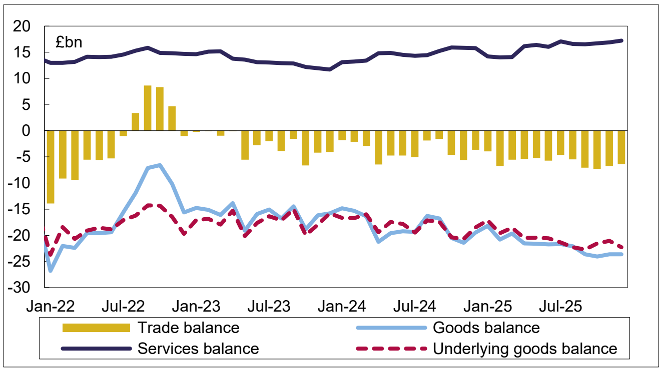
Services were flat while industrial production led growth in Q4

Soft GDP growth in Q4 in part reflected a subdued end to the year, with economic output in December rising just 0.1%M/M from downwardly revised growth in November and contraction in October. Within the various sectors, while services exports were firm in Q4, overall services activity was unchanged over the quarter from Q3 despite growth in December. Business-facing services also saw zero growth in Q4, while consumer-facing activity in the sector ticked up 0.2%Q/Q. In contrast, despite a pullback in December, industrial production was strong in Q4, rising 1.2%Q/Q. Manufacturing output rose 0.9%Q/Q buoyed by subsectors such as machinery and equipment, pharmaceuticals, and computers and electronics. But production of chemicals and transport goods fell. The latter was weighed by the slow restart to car production at JLR at the start of the quarter as well as weakness at the end of the quarter in cars, aerospace and other transport items. Reassuringly perhaps, survey indicators point to a pickup in momentum in manufacturing and particularly services in January. The manufacturing output PMI rose more than ½pt to a three-month high of 51.6 while the services activity PMI leapt more than 2½pts to a five-month high of 54.0.

Construction output fell sharply in Q4 but signs of recovery in housing market at start of 2026

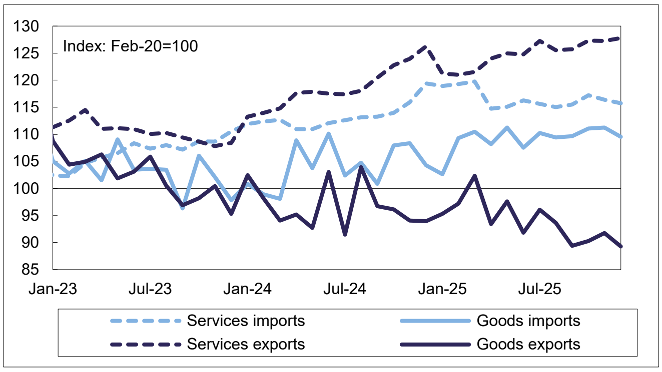
A key source of weakness towards the end of 2025 related to the construction sector, where activity fell in December for a fourth month in six to a 15-month low, as Budget-related uncertainty and inclement weather weighed. Overall, construction output fell 2.1%Q/Q in Q4, the steepest drop since Q321, to knock 0.13ppt off GDP growth. The weakness was led by a further slump in new private housing (-3.6%Q/Q) to a two-year low. Unfortunately, activity in the sector in January seems bound to have been impacted by below average temperatures, several major storms and above-average rainfall. But various surveys and indicators raise cautious optimism that Q4 will mark the quarterly trough. Certainly, the construction PMIs rebounded in January to suggest stabilisation in the sector. Despite a drop on the quarter in Q4, total construction new orders were up 29%Y/Y in Q4, with new housing orders rising to a six-quarter high and public housing new orders the highest in a decade. And the January RICS residential survey suggested further tentative recovery in the housing market at the turn of the year. While the headline price balance remained in negative territory (-10%) and well below the level a year ago (+16%), this was nevertheless the best since June. New buyer enquiries and agreed sales also reportedly picked up, while surveyors were the most optimistic about the 12-month ahead sales outlook since 2024. We suspect that the marked drop in new mortgage approvals in December – to an 18-month low – related to a temporary lull in the hope of better mortgage deals to follow the BoE's widely anticipated rate cut that month. Indeed, mortgage lending in December remained firmly above the long-run average for a seventh successive month. Improved housing affordability and the prospect of further interest rate cuts should support a further gradual recovery in the property market over coming quarters.

UK: Trade balance



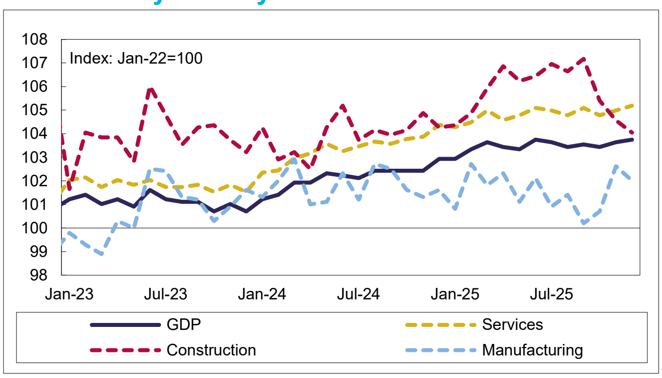
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Trade volumes (excluding precious metals)



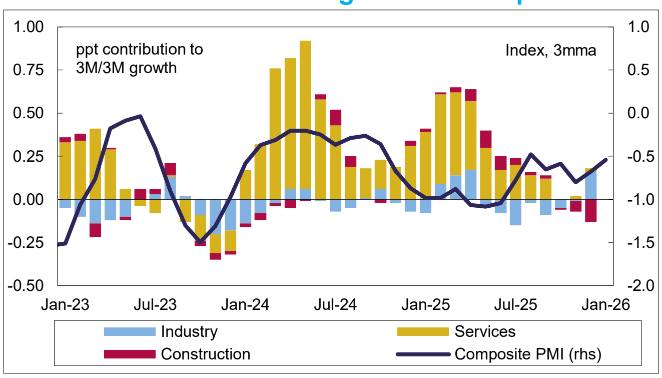
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Monthly GDP by sector



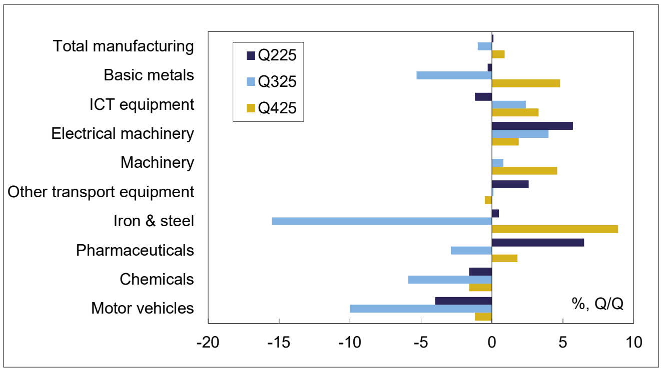
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Contributions to GDP growth & composite PMI



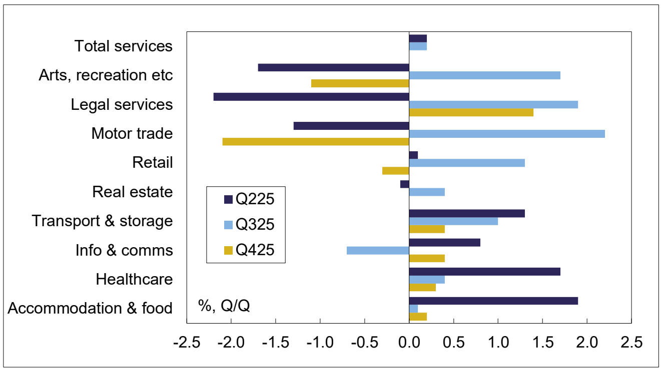
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output by sub sector



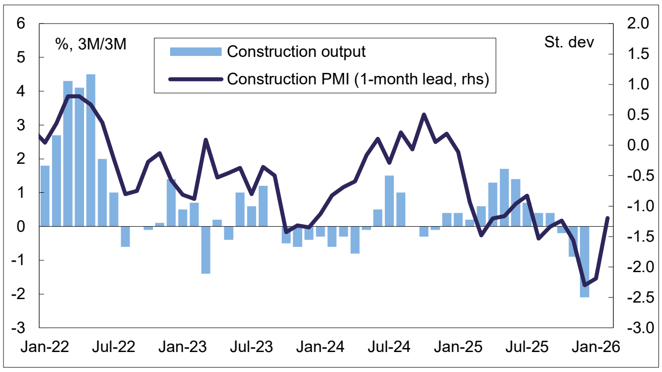
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services output by sub sector



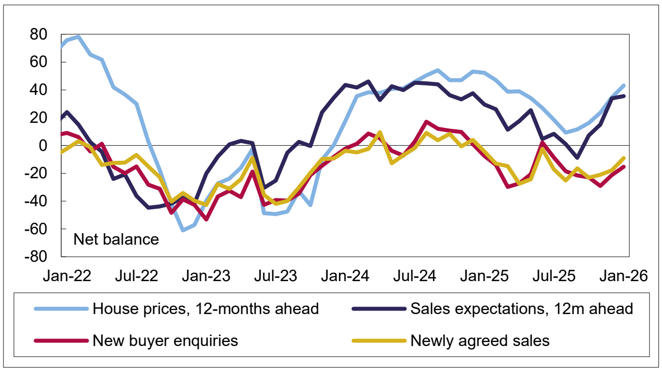
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Construction output & PMI



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

UK: RICS housing market indicators



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

In terms of the economic data, it should be a quiet end to the week for the UK. However, a speech by BoE Chief Economist Huw Pill – who was unsurprisingly among the five MPC members who voted to hold rates last week – may offer some additional insights into his monetary policy views and interpretation of the BoE's latest macroeconomic projections. Given his hawkish stance, we caveat that his perspective is unlikely to be representative of the median MPC voter, and so should not be decisive for near-term policy decisions.

The day ahead in the euro area

The highlight of Friday's European dataflow will be the updated estimates of euro area Q4 GDP. As usual, its release will be accompanied by the first estimates of employment growth last quarter. The preliminary figures suggested that GDP growth sustained a 0.3%Q/Q expansion in Q4, slightly better than the ECB's projection and Bloomberg survey consensus. The second estimate will factor in additional data from December's available retail sales, production and goods trade figures. But we don't expect any revision to the headline GDP figure. Indeed, while a decrease in euro area IP in December seems inevitable – compounded by further declines in Italy and Ireland (both -0.4%M/M) – the industrial sector should have contributed to GDP growth over the quarter as a whole. Any contribution from net trade, at best, was probably negligible in Q4. But we anticipate an encouraging rebound in exports at the end of the quarter to be flagged in Friday's euro area goods trade data. With regards to employment, jobs growth likely continued at a familiar pace. An increase of 0.1-0.2%Q/Q – as suggested by the sparsely available member state pre-releases – would leave the annual rate no firmer than 0.6%Y/Y. Job gains are expected to have remained concentrated in southern Europe, and particularly Spain, but was still subdued in the core member states. The data also suggest that German employment shrunk for a third consecutive quarter, albeit at a slower pace that in Q3 and with some indicators now pointing towards a stabilisation in the labour market. Otherwise, the end of the week will also bring the first detail of January's inflation. We expect the Spanish data to confirm that the ½ppt step down in the HICP rate was driven principally by energy base effects.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK	GDP – first estimate Q/Q% (Y/Y%)	Q4	**0.1 (1.0)**	*0.2 (1.2)*	0.1 (1.3)	- (1.2)
	Monthly GDP M/M% (3M/3M%)	Dec	**0.1 (0.1)**	*0.1 (0.2)*	0.3 (0.1)	0.2 (-0.1)
	Services output M/M% (3M/3M%)	Dec	**0.3 (0.0)**	0.1 (0.2)	0.3 (0.2)	0.1 (0.2)
	Industrial output M/M% (Y/Y%)	Dec	**-0.9 (0.5)**	0.0 (1.4)	1.1 (2.3)	1.3 (-)
	Construction output M/M% (Y/Y%)	Dec	**-0.5 (-0.3)**	0.5 (-0.1)	-1.3 (-1.1)	-0.8 (-0.3)
	Trade (goods trade) balance £bn	Dec	**-4.3 (-22.7)**	-4.8 (-22.3)	-6.1 (-23.7)	-5.6 (-23.6)
	RICS house price balance %	Jan	**-10**	-11	-14	-13

Auctions

Country	Auction
Italy	sold €3.5bn of 2.4% 2029 bonds at an average yield of 2.36%
	sold €1.25bn of 3.25% 2032 bonds at an average yield of 2.92%
	sold €1.5bn of 3.15% 2033 bonds at an average yield of 3.02%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Italy	Industrial production M/M% (Y/Y%)	Dec	**-0.4 (3.2)**	-0.5 (2.8)	1.5 (1.4)	-

Auctions

Country	Auction
Germany	sold €749mn of 2.5% 2054 bonds at an average yield of 3.47%
	sold €1.16bn of 2.9% 2056 bonds at an average yield of 3.47%
UK	sold £300mn of 4.25% 2049 bonds at an average yield of 5.256%

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	GDP – second estimate Q/Q% (Y/Y%)	Q4	*0.3 (1.3)*	0.3 (1.4)
	10.00	Employment – first estimate Q/Q% (Y/Y%)	Q4	*0.1 (0.6)*	0.2 (0.6)
	10.00	Trade balance €bn	Dec	12.0	10.7
Spain	08.00	Final HICP (CPI) Y/Y%	Jan	*2.5 (2.4)*	3.0 (2.9)

Auctions and events

Country	GMT	Event
UK	12.00	BoE Chief Economist Pill speaks in fireside chat, London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.