Daiwa Capital Markets

# Euro wrap-up

## Overview

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- Bunds followed Treasuries lower as the December flash PMIs signalled a pickup in euro area economic growth in the fourth quarter.
- Gilts made significant losses as the BoE left policy unchanged and UK retail sales figures again beat expectations.
- Friday brings final November inflation figures and October trade data from the euro area and an industrial sector survey from the UK.

**Daily bond market movements**

| Bond | Yield | Change* |
|---|---|---|
| BKO 0 12/18 | -0.780 | -0.010 |
| OBL 0 10/21 | -0.445 | +0.023 |
| DBR 0 08/26 | 0.359 | +0.057 |
| UKT 1¼ 07/18 | 0.150 | +0.032 |
| UKT 3¾ 09/21 | 0.623 | +0.066 |
| UKT 1½ 07/26 | 1.485 | +0.102 |

*Change from close as at 4.30pm GMT.
Source: Bloomberg

# Euro area

## Flash PMIs signal stronger growth in Q4

All indications are that the euro area economy has strengthened in the fourth quarter of the year, with the flash PMIs for December adding to the evidence. Most notably, the headline composite index was unchanged from November at 53.9, matching the highest since the end of 2015 to suggest a slight pickup in GDP growth in Q4 to 0.4%Q/Q. The improvement was driven by manufacturing, for which the euro area headline PMI rose to the highest in more than five years, the output index rose to the highest in almost three years and the survey's measure of new orders also reached its highest since the first half of 2011. Conditions in the services sector, however, weakened a touch, albeit still leaving the respective PMI on average in Q4 at the highest since the first quarter of the year and consistent with ongoing moderate expansion in the sector. Among the other detail there was plenty more for the ECB to be encouraged by, with the euro area composite indices suggesting the strongest job recruitment and backlogs of work for more than five years and – most notably perhaps – the highest gauge of euro area output price pressures on the survey since the first half of 2011.

## Italy lets the side down?

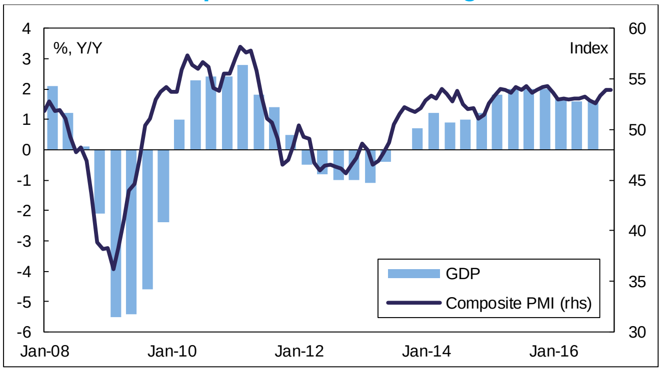
At the country level, the figures from Germany and France pointed to a stronger performance than was eventually suggested by the euro area PMIs. While the German composite PMI edged down slightly for the second month, at 54.8 it left the Q4 average at the highest in a year, while the survey also reported the most favourable conditions in the country's manufacturing sector since the start of 2014. And more eye-catching were the improvements in the French PMIs, with the composite index up almost 1½pts to an eighteen-month high thanks to a rebound in the services sector and a jump in the manufacturing index to its highest in more than five years. Therefore, with other data pointing to a continued vigorous recovery in Spain, the figures for the euro area as a whole were most likely weighed by Italy, for which no flash PMIs are released but where political uncertainty perhaps acted as a restraint on growth.

## The day ahead in the euro area and US

Friday will bring the final estimate of euro area inflation in November. According to the flash figures which we expect to be confirmed, headline CPI rose for the third consecutive month to a 2½-year high of 0.6%Y/Y, while the core rate remained at 0.8%Y/Y for the fourth consecutive month. In addition, the euro area trade report for October is scheduled for release along with the French INSEE business confidence survey for December.

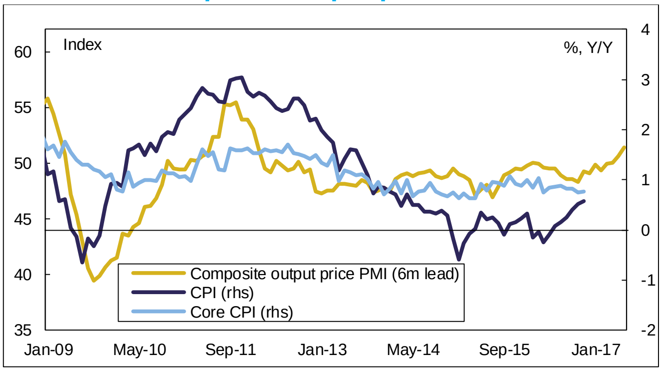
In the US, November housing starts figures are due for release.

**Euro area: Composite PMI and GDP growth**




*Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

**Euro area: Composite output price PMI & inflation**




*Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

# UK

## Retail sales surprise on upside again

UK retail sales data have consistently surprised on the upside in the wake of the Brexit referendum and today's November numbers were no exception. The value of retail sales excluding auto fuel rose 0.5%M/M in November, having been expected to be flat on the month in the wake of the 1.9%M/M increase in October. That left sales up 6.6%Y/Y, down from the 7.6%Y/Y pace seen in October but still in the upper range of recent observations. Growth on the month was driven by non-food stores, for which sales of household goods reportedly received a boost from 'Black Friday' initiatives, and non-store retailing, while food stores reported a drop in sales. But, in line with the recent CPI data, there were signs of prices beginning to move, with average store prices up 0.1%Y/Y, the first increase on this basis since June 2014. That is likely to be the precursor of stronger price rises to come from the New Year on as the impact of the referendum-induced fall in sterling is increasingly passed on to consumers. And those higher prices will ultimately crimp spending growth against a backdrop of relatively insipid wage growth.

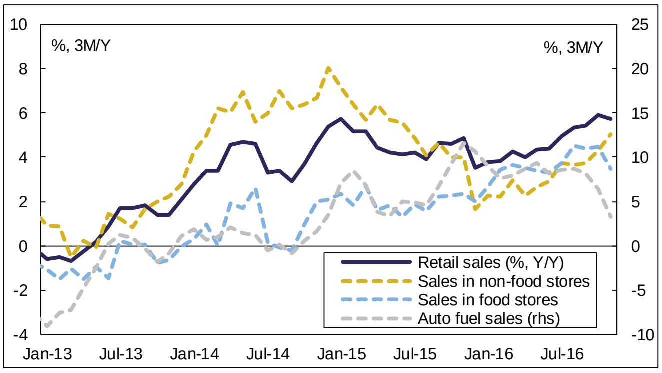
## BoE holds pat

Today's MPC announcement was inevitably uneventful, with policy left unchanged and the votes unanimous. The statement and minutes suggested that the Committee's thinking was little changed from November, at which time the MPC assessed that monetary policy could move in either direction in response to changes in the economic outlook. In terms of developments since the November meeting and forecasts the most significant has been the 6% appreciation in the sterling effective exchange rate, which points to a more gradual pick-up in inflation than the November forecast envisaged. At the same time, data since the meeting had pointed to growth of 0.4%Q/Q in the fourth quarter of 2016, although forward-looking indicators continued to point to a slowdown in 2017. The MPC remains explicit that it will not raise rates automatically in response to the coming rise in inflation. Instead, for the time being, it is prepared to look through what it expects to be a temporary increase. And unless inflation expectations and/or wage growth take off sharply, that will remain the case. Indeed, if rising inflation serves to squeeze real incomes and hence household spending, which continues to drive the economy, slows more than the MPC expects, then thoughts next year may start to turn once again to easing. But for the foreseeable future, the MPC will hold pat.

## The day ahead in the UK

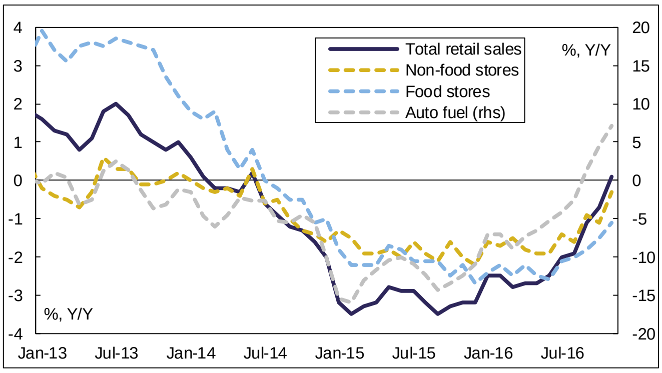
Friday will bring the CBI's latest Industrial Trends survey, offering insights, among other things, into the impact of weaker sterling on the fortunes of the manufacturing sector.

### UK: Retail sales




*Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

### UK: Retail sales deflators




*Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

# European calendar

## Today's results

**Economic data**

| Country | Release | Period | Actual | Market consensus/ *Daiwa forecast* | Previous | Revised |
|---|---|---|---|---|---|---|
| EMU | EU27 new car registrations | Nov | **5.8** | - | 0.0 | - |
| | Preliminary manufacturing PMI | Dec | **54.9** | 53.7 | 53.7 | - |
| | Preliminary services PMI (preliminary composite PMI) | Dec | **53.1 (53.9)** | 53.8 (53.9) | 53.8 (53.9) | - |
| Germany | Preliminary manufacturing PMI | Dec | **55.5** | 54.5 | 54.3 | - |
| | Preliminary services PMI (preliminary composite PMI) | Dec | **53.8 (54.8)** | 54.9 (54.9) | 55.1 (55.0) | - |
| France | Preliminary manufacturing PMI | Dec | **53.5** | 51.8 | 51.7 | - |
| | Preliminary services PMI (preliminary composite PMI) | Dec | **52.6 (52.8)** | 51.9 (51.6) | 51.6 (51.4) | - |
| UK | Retail sales excluding petrol M/M% (Y/Y%) | Nov | **0.5 (6.6)** | 0.0 (6.0) | 2.0 (7.6) | **1.9 (7.5)** |
| | Retail sales including petrol M/M% (Y/Y%) | Nov | **0.2 (5.9)** | 0.0 (5.9) | 1.9 (7.4) | **1.8 (7.2)** |
| | BoE bank rate % | Dec | **0.25** | *0.25* | 0.25 | - |
| | BoE asset purchase target £bn | Dec | **435** | *435* | 435 | - |
| | BoE corporate bond purchases £bn | Weekly | **4.61** | - | 4.45 | - |

| Country | Auction |
|---|---|
| Spain sold | €900mn of 0.75% 2021 bonds (30-Jul-2021) at an average yield of 0.207% |
| | €1.3bn of 1.3% 2026 bonds (31-Oct-2026) at an average yield of 1.423% |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Tomorrow's data releases

**Economic data**

| Country | GMT | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|
| EMU | 10:00 | Trade balance €bn | Oct | 24.5 | 24.9 |
| | 10:00 | Final CPI (core CPI) Y/Y% | Nov | *0.6 (0.8)* | 0.5 (0.8) |
| France | 07:45 | Business confidence indicator (production outlook) | Dec | 102 (4) | 102 (3) |
| | 07.45 | Wages Q/Q% | Q3 | -0.3 | -0.3 |
| Italy | 09:00 | Trade balance total €bn | Oct | - | 3.7 |
| Spain | 08.00 | Labour costs Y/Y% | Q3 | - | -0.1 |
| UK | 11:00 | CBI Industrial Trends survey, total orders | Dec | -5 | -3 |

**Auctions and events**

| Country | GMT | Auction / Event |
|---|---|---|
| EMU | 12:15 | ECB's Constâncio scheduled to speak in Madrid |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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