

Euro wrap-up

Overview

- Bunds made modest gains despite some upbeat German data suggesting that the country's economic expansion accelerated in Q416.
- Gilts also made gains while sterling depreciated in response to PM May's remarks on Sunday suggesting that a 'hard' Brexit is increasingly likely.
- The European data focus over coming days will remain on the manufacturing sector, with IP figures due from France, Spain and the UK. November's trade report is also due from the UK.

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Daily bond market movements

| Bond | Yield | Change* |
|--------------|--------|---------|
| BKO 0 12/18 | -0.734 | -0.007 |
| OBL 0 10/21 | -0.484 | -0.015 |
| DBR 0 08/26 | 0.283 | -0.016 |
| UKT 1¼ 07/18 | 0.178 | -0.021 |
| UKT 3¾ 09/21 | 0.568 | -0.040 |
| UKT 1½ 07/26 | 1.335 | -0.047 |

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

Euro area

Manufacturing supports economic recovery in Q4

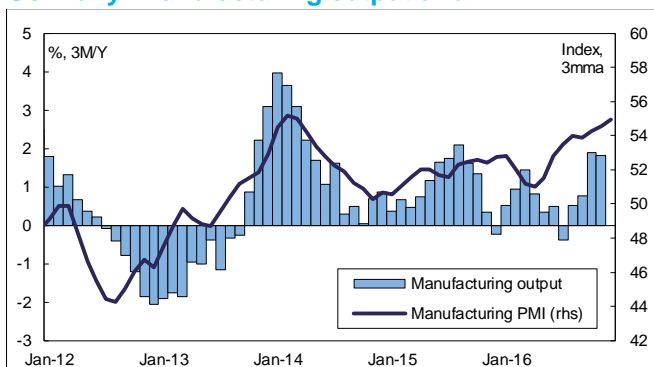
Judging from recent surveys, globally-speaking, the manufacturing sector is in its best shape for years. Certainly, in the euro area, fortunes for the sector have turned for the better with the manufacturing PMI in December up to its highest since 2011, supported not least by a resurgence in Germany. The latest industrial production data out of Germany showed total output rising for the second successive month and by 0.4%M/M in November. Within the detail, manufacturing production rose at the same 0.4%M/M rate, while a strong showing from construction (up 1.5%M/M) offset a (likely weather-related) drop in energy output. And with modest upward revisions made to the estimates of output in previous months, overall IP was up more than 2%Y/Y with manufacturing output up more than 2½%Y/Y. The recovery in Germany's manufacturing sector has been supported by a pickup in both domestic and external demand, with the latter reflected in the latest trade report. This showed a surge in the value of exports in November, by 3.9%M/M, the most since May 2012, to a record high, to leave it more than 5½% higher compared with a year earlier. But with the value of imports surging too, rising 3.5%M/M, today's release suggests that net trade might well have provided negligible support to GDP growth in Q416 having subtracted from growth in Q3. Nevertheless, strong domestic demand is likely to have underpinned an acceleration in German GDP in the final quarter of last year to 0.5%Q/Q from 0.2%Q/Q in Q3.

The manufacturing sector in the euro area's second largest member state looks to have strengthened at the end of last year too. Certainly, the December Bank of France business sentiment survey, also released today, tallied with other recent surveys pointing to a pickup in growth momentum in the economy in Q4. While the services index slipped back a touch, the manufacturing index rose further above the long-run average to its highest level since 2011 with firms reporting a notable step up in production towards year-end. And with sentiment among construction firms steady, overall the central bank assessed the survey to be consistent with French GDP growth in Q4 of 0.4%Q/Q, which is also our own forecast.

Euro area unemployment rate unchanged at 7-year low

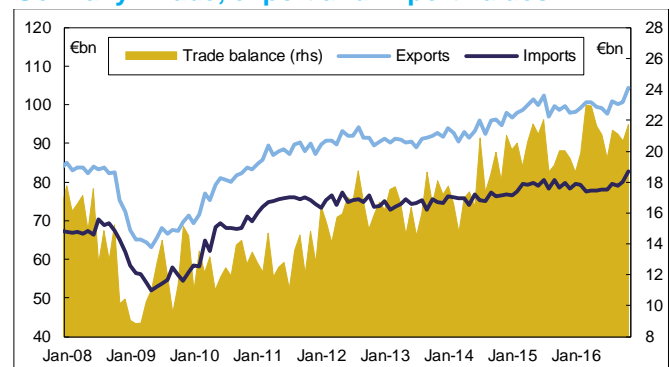
Elsewhere, the latest euro area labour market data broadly aligned with expectations, with only a modest drop of 15k in the number of workers unemployed in November – albeit representing the twenty-fifth consecutive monthly decline – to leave the headline unemployment rate unchanged at a seven-year low of 9.8%. This was also true of the largest member state, with Germany's unemployment rate moving sideways at a post-reunification low of 4.1%. However, there was a further

Germany: Manufacturing output and PMI



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

Germany: Trade, export and import values



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



improvement in France, where the rate fell for the third consecutive month and by 0.2ppt to a more than 4½-year low of 9.5%. Portugal's labour market recovery was also maintained with the unemployment rate falling to a 7½-year low of 10.5%, while Spain's unemployment rate was unchanged at a six-year low of 19.2%, with both countries' rates almost 2ppts lower than a year earlier. In contrast, however, despite an increase in the number of workers in employment, rising labour force participation meant that Italy's unemployment rate rose 0.1ppt to a seventeen-month high of 11.9%, the only member state with the exception of Cyprus with an unemployment rate higher than it was one year earlier.

The coming two days in the euro area and US

The data focus in the euro area over coming days will remain on the manufacturing sector, with French IP data for November due for release tomorrow and the equivalent Spanish release due on Wednesday. Given the improvement in sentiment surveys of late and following the modest decline in October, we expect French output to have risen by a little more than ½M/M. And in Spain, IP is expected to have risen a little less than ½M/M. Supply-wise, Germany will sell index-linked 2026 Bunds on Tuesday and 2027 Bunds on Wednesday.

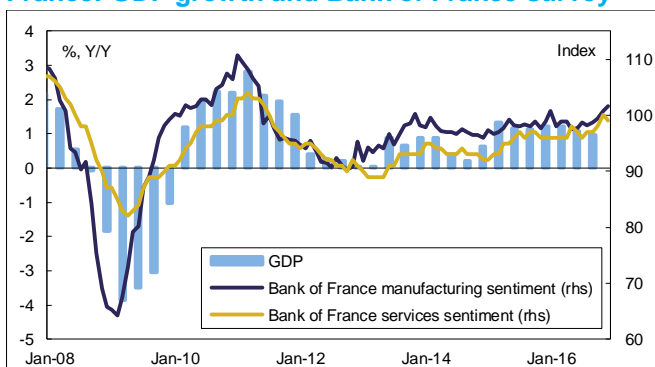
In the US, it should continue to be quiet for economic data over coming days with just the JOLTS survey for November due tomorrow to be accompanied by wholesale trade figures for the same month, while weekly mortgage application numbers are due Wednesday. More of note on Wednesday, ahead of next week's inauguration, incoming President Trump is scheduled to hold a press conference in New York. Meanwhile, in the UST market, a 3Y note auction will be conducted.

UK

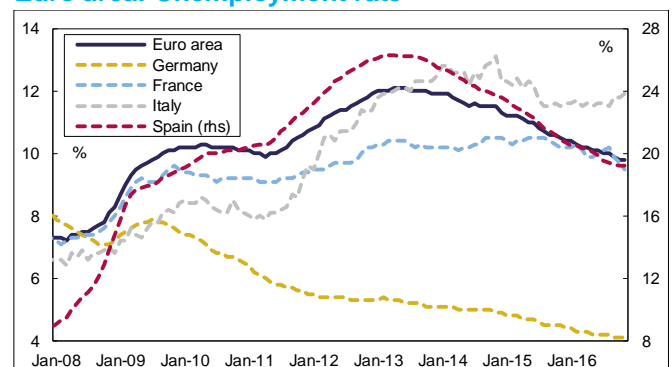
The coming two days in the UK

After a quiet start to the week for UK economic data, tomorrow brings the BRC's latest retail sales monitor for December, which will provide insight into consumer spending at the end of 2016. But likely of more interest with respect to the recent economic recovery will be Wednesday's release of November's IP, trade and construction output figures. Like in the euro area member states, industrial production is expected to be more upbeat, with output expected to have risen for the first month in four, any by almost 1%M/M. Construction output, meanwhile, is expected to have increased by 0.3%M/M, which would be sufficient to raise the annual growth rate to 2%Y/Y, the second-highest level in more than a year. And with respect to the trade report, the headline deficit is expected to have risen back above its average in 2016 of close to £3.5bn having fallen notably in October, to £2bn, one of the lowest levels of 2016. Elsewhere, Mark Carney will appear with certain other Financial Policy Committee (FPC) members before the Treasury Select Committee on Wednesday to answer questions regarding the most recent Financial Stability Report. Supply-wise, the DMO will auction index-linked 30Y Gilts.

France: GDP growth and Bank of France survey



Euro area: Unemployment rate













The next edition of Euro wrap-up will be published on 11 January 2017.

European calendar

Today's results




Economic data

| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|---------|---|--------|------------------|--|-----------|------------------|
| EMU |  Unemployment rate % | Nov | 9.8 | 9.8 | 9.8 | - |
| |  ECB public sector asset purchases €bn | Weekly | 11.0 | <u>16.5</u> | 16.3 | - |
| Germany |  Industrial production M/M% (Y/Y%) | Nov | 0.4 (2.2) | 0.6 (1.9) | 0.3 (1.2) | 0.5 (1.6) |
| |  Trade balance €bn | Nov | 22.6 | 20.3 | 19.3 | 19.4 |
| |  Current account balance €bn | Nov | 24.6 | 22.1 | 18.4 | 19.4 |
| |  Imports (exports) M/M% | Nov | 3.5 (3.9) | 1.1 (0.5) | 1.3 (0.5) | 1.2 (-) |
| France |  Bank of France manufacturing sentiment indicator | Dec | 102 | 101 | 101 | - |
| Italy |  Unemployment rate % | Nov | 11.9 | 11.6 | 11.6 | 11.8 |
| UK |  Halifax house price index M/M% (3M/Y%) | Dec | 1.7 (6.5) | 0.3 (5.8) | 0.2 (6.0) | 0.6 (-) |
| Country | Auction | | | | | |
| UK |  BoE APF operation purchased £1bn of 3-7Y Gilts (2.98 cover ratio) | | | | | |




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

| Country | GMT | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|---------|---|--|--------|--|-------------|
| France |  07:45 | Industrial production M/M% (Y/Y%) | Nov | 0.6 (-0.2) | -0.2 (-1.8) |
| |  07:45 | Manufacturing production M/M% (Y/Y%) | Nov | 0.7 (-0.2) | -0.6 (-1.5) |
| UK |  00:01 | BRC retail sales monitor, like-for-like Y/Y% | Dec | - | 0.6 |








Auctions and events

| Country | GMT | Auction / Event |
|---------|---|---|
| Germany |  10:30 | Auction: To sell €1bn of 0.1% 2026 index-linked bonds (15-Apr -2026) |
| UK |  10:30 | Auction: To sell £750mn of 0.125% 2046 index-linked bonds (22-Mar-2046) |
| |  14:50 | BoE APF operation: To purchase 15Y+ Gilts |




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's data releases

Economic data

| Country | GMT | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|---------|---|--------------------------------------|--------|--|-------------|
| Spain |  08:00 | Industrial production M/M% (Y/Y%) | Nov | 0.4 (1.0) | 0.1 (0.5) |
| UK |  09:30 | Visible trade balance £bn | Nov | -11.2 | -9.7 |
| |  09:30 | Total trade balance £bn | Nov | -3.5 | -2.0 |
| |  09:30 | Industrial production M/M% (Y/Y%) | Nov | 1.0 (0.7) | -1.3 (-1.1) |
| |  09:30 | Manufacturing production M/M% (Y/Y%) | Nov | 0.5 (0.4) | -0.9 (-0.4) |
| |  09:30 | Construction output M/M% (Y/Y%) | Nov | 0.3 (2.0) | -0.6 (0.7) |
| |  15:00 | NIESR GDP 3M/3M% | Dec | 0.5 | 0.4 |

Auctions and events

| Country | GMT | Auction / Event |
|---------|---|--|
| Germany |  10:30 | Auction: To sell €5bn of 2027 bonds (15-Feb-2027) |
| UK |  14:15 | BoE's Carney and other FPC members scheduled to testify at the Treasury Select Committee |
| |  14:50 | BoE APF operation: To purchase 7-15Y Gilts |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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