

Euro wrap-up

Overview

- Bunds made modest gains despite a more positive euro area trade report, while the market reaction to Friday night's Italian rating downgrade was relatively modest.
- On a quiet day for UK data, Gilts also made gains amid expectations that tomorrow's speech by PM May will signal a 'hard' Brexit.
- Tomorrow will also bring surveys from the ECB and ZEW, as well as UK CPI data for December.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.737	-0.019
OBL 0 10/21	-0.504	-0.028
DBR 0¼ 02/27	0.324	-0.014
UKT 1¼ 07/18	0.153	-0.025
UKT 3¼ 09/21	0.540	-0.040
UKT 1½ 07/26	1.319	-0.046

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

Euro area

Euro area trade surplus bounces back in November

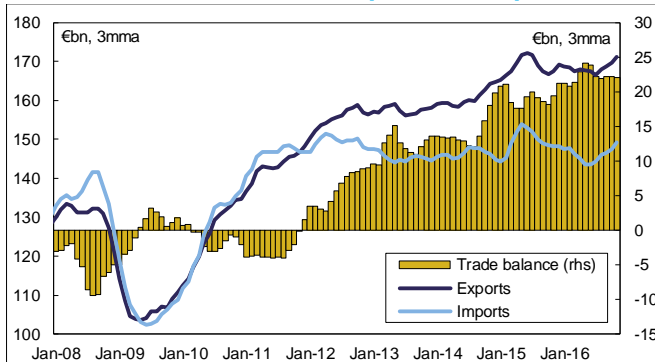
Recent economic surveys suggest that euro area GDP accelerated in the final quarter of the year thanks to improvements in both domestic and external demand, which also appeared to be reflected in November's goods trade report released today. Indeed, the monthly figures came in ahead of expectations, with the trade surplus rising by almost €3bn to €22.7bn, a touch above the average in the year to date. In particular, the value of exports rose for the first month in three and by more than 3%M/M, the strongest such increase since September 2014, to leave it up 4% compared with a year earlier, with a notable increase in exports to China (up 17%Y/Y), Japan (up 11%Y/Y) and the US (up 10%Y/Y). Meanwhile, the value of imports increased for the second successive month, by almost 2%M/M and 3½%Y/Y, to the highest level since mid-2015. As a result, on average in the first two months of Q4, the value of imports was almost 3% higher than the Q3 average, compared with a rise of 2% in the value of exports. To some extent, that pickup in imports over recent months reflects price adjustments, with prices of imported industrial goods rising for the second successive month in November and at the fastest monthly pace for twenty months. But, on balance, while external demand is likely providing a welcome stimulus for manufacturers, we still expect net trade overall to have provided little more than a broadly neutral contribution to GDP growth in Q4.

Italian and Spanish inflation unchanged from flash estimates

Today also brought the final release of Italy's inflation figures in December, which aligned with the flash estimates showing the EU-harmonised CPI rate rising 0.4ppt to 0.5%Y/Y, a more than 2½-year high. While the pickup in the national measure (similarly up 0.4ppt to 0.5%Y/Y) in part reflected higher unprocessed food and energy prices, with the price of non-energy industrial goods posting the first year-on-year increase since early 2014, core inflation also rose 0.2ppt to 0.6%Y/Y, its firmest since July. So, with revised Spanish inflation numbers, published on Friday, also confirming the flash estimates – most notably with the headline EU-harmonised CPI rate rising 0.9ppt in December to 1.4%Y/Y – in the absence of a significant revision to the equivalent German data on Wednesday the aggregate euro area figure, due the same day, seems likely to confirm that the headline rate rose 0.5ppt in December to 1.1%Y/Y, the highest since September 2013, and that the core measure rose 0.1ppt to 0.9%Y/Y.

Separately, Friday's sovereign credit rating downgrade for Italy means that its government bonds are now classified by the ECB as a lower grade of asset quality causing an increase in the size of haircuts on BTPs used as collateral in its financing operations. However, perhaps as the move did not come out of the blue, the subsequent market reaction appears to have been relatively limited. Indeed, while Italian equity markets underperformed their European counterparts today, the spread of Italian sovereign 10Y bonds over German Bunds closed less than 3bps wider from Friday's close.

Euro area: Trade balance, export and import values



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Haircut applied to BTPs in ECB funding operations

Residual Maturity (years)	Central government securities			
	Fixed coupon (%)		Zero coupon (%)	
	New	Former	New	Former
0-1	6.0	0.5	6.0	0.5
1-3	7.0	1.0	8.0	2.0
3-5	9.0	1.5	10.0	2.5
5-7	10.0	2.0	11.5	3.0
7-10	11.5	3.0	13.0	4.0
>10	13.0	5.0	16.0	7.0

Source: ECB and Daiwa Capital Markets Europe Ltd.



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The day ahead in the euro area and US

Tomorrow will bring one of the first insights into economic sentiment at the start of 2017 with the German ZEW investor survey for January. Tuesday also brings new car registrations figures for December, as well as the ECB's quarterly Bank Lending Survey. In the markets, Germany will sell 2Y bonds.






In the US, meanwhile, it should be another relatively quiet day for economic data, with just the Empire Manufacturing indicator for January. Policy-wise, the Fed's Dudley and Williams are due to speak publicly.

UK

The day ahead in the UK

The market focus tomorrow will be on Prime Minister Theresa May's speech on Brexit policy (at the time of writing the PM's office had yet to announce at what time the speech will start). Sterling already took a notable step down today – breaking through \$1.20 – in response to newspaper reports over the weekend that she will lay out her intention for a 'hard' Brexit, providing a clear steer that the UK will leave both the Single Market and the Customs Union. And some initial effects of the decision to leave the EU look set to be evident in the latest inflation data tomorrow, which are expected to show that prices rose sharply at the end of last year, thanks to higher energy prices and, crucially, the drop in sterling. Both effects have been well reflected in recent PPI figures, and tomorrow's data are likely to show that input price growth increased to more than 15%Y/Y at the end of last year. Meanwhile, we expect the headline CPI rate to have increased by 0.2ppt to 1.4%Y/Y, which would be the highest since August 2014, while the core rate might also inch higher to 1.5%Y/Y.








European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	 Trade balance €bn	Nov	22.7	20.8	19.7	19.9
	 ECB public sector asset purchases €bn	Weekly	18.9	<u>16.0</u>	11.0	-
Italy	 Final EU-harmonised CPI Y/Y%	Dec	0.5	-	0.1	-
UK	 Rightmove house price index M/M% (Y/Y%)	Jan	0.4 (3.2)	-	-2.1 (3.4)	-
Country	Auction					
UK	 BoE APF operation purchased £1bn of 3-7Y Gilts (2.21 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
EMU	 07:00	EU27 new car registrations	Dec	-	5.8
	 10:00	ZEW expectations balance	Jan	-	18.1
Germany	 10:00	ZEW current assessment balance (expectations)	Jan	65.0 (18.4)	63.5 (13.8)
Italy	 09:00	Trade balance €bn	Nov	-	4.3
UK	 09:30	CPI (core CPI) Y/Y%	Dec	<u>1.4 (1.5)</u>	1.2 (1.4)
	 09:30	PPI input (output) price inflation Y/Y%	Dec	15.5 (2.2)	12.9 (2.3)
	 09:30	House price index Y/Y%	Nov	6.1	6.9

Auctions and events

Country	GMT	Auction / Event
EMU	 09.00	ECB publishes the Euro area Bank Lending Survey
Germany	 10:30	Auction: To sell €5bn of 0% 2018 bonds (14-Dec-2018)
UK	 -	PM May to deliver speech on the Government's Brexit policy
	 14:50	BoE APF operation: To purchase 15Y+ Gilts

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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