

Euro wrap-up

Overview

- Bunds made losses as a survey flagged increased inflation expectations in the euro area.
- Gilts made modest losses as UK retail sales figures surprised on the downside.
- The coming week brings several top-tier economic sentiment surveys from the euro area, the first estimate of UK GDP in Q4, and the UK Supreme Court judgement on the role of Parliament in launching the Brexit process.

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Daily bond market movements

| Bond | Yield | Change* |
|--------------|--------|---------|
| BKO 0 12/18 | -0.674 | +0.030 |
| OBL 0 10/21 | -0.416 | +0.032 |
| DBR 0 08/26 | 0.424 | +0.046 |
| UKT 1¼ 07/18 | 0.194 | -0.008 |
| UKT 3¼ 09/21 | 0.624 | +0.009 |
| UKT 1½ 07/26 | 1.430 | +0.022 |

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

Euro area

Inflation expectations moving higher

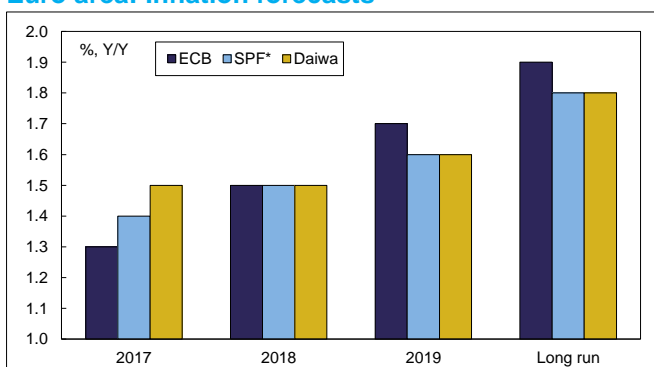
During his dovish press conference yesterday, Mario Draghi repeated that there were still no compelling signs yet of the self-sustaining upward trend in underlying inflation that is required for it to consider re-evaluating policy. With core CPI having inched only slightly higher in December to 0.9%Y/Y, still well within the range of the past three years, that is undeniable. But the ECB is hoping that, over coming months, higher headline CPI related to the upwards shift in the oil price eventually generates second-round effects on underlying inflation. Whether it does so will depend on a range of factors, not least those related to domestic costs and inflation expectations. On cost pressures, the evidence is currently mixed, not least as higher input prices might simply be absorbed by many firms via lower margins while labour cost pressures remain highly subdued. However, various indicators suggest that inflation expectations are better anchored of late. Financial market measures of inflation expectations have risen significantly since the autumn with, e.g., the 5Y5Y swap measure up almost 50bps from the September trough to above 1.70%, closing in on the ECB's target of close to but below 2%Y/Y. And the ECB's quarterly survey of professional forecasters published today saw the average inflation forecasts for 2017 and 2018 revised up from October by 0.2ppt and 0.1ppt to 1.4%Y/Y and 1.5%Y/Y respectively, both above the ECB's most recent forecast published last month. Our own forecast is slightly higher than average for 2017, but in line with the consensus for 2018. Meanwhile, having been revised higher last quarter, the average forecast for inflation in 2021 was unchanged at a relatively well-anchored 1.8%Y/Y, a figure that to us looks broadly credible but also, of course, subject to huge uncertainty.

The week ahead in the euro area and US

The main event in the euro area this weekend will be the first round of the primary of the French Socialist Party to determine its candidate for the Spring Presidential election. The outcome of the primary looks too close to predict, with any two of the three main candidates – the more centrist former Prime Minister Manuel Valls and the more left-leaning former Education Minister Benoît Hamon and former Minister of Industrial Renewal Arnaud Montebourg – in with a good chance of reaching the second round of the selection process. However, whoever wins the Socialist primary seems most likely to come fourth and hence be eliminated in the first round of the Presidential election on 23 April. Indeed, the latest opinion polls suggest that either the Republicans' François Fillon or the independent former Economy Minister Emmanuel Macron will qualify to compete against the National Front's Marine Le Pen in the Presidential election's head-to-head second-round vote on 7 May.

Data-wise, the coming week in the euro area will be dominated by economic sentiment surveys for January, kicking off on Monday with the flash estimate of the Commission's consumer confidence index, which is expected to edge up to a twenty-one month high. The flash PMIs are due the following day with the headline composite euro area index expected to

Euro area: Inflation forecasts



*ECB Survey of Professional Forecasters.

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

Euro Area: 5Y5Y inflation expectations



Source: Bloomberg



inch up to a new five and a half-year high. Wednesday brings the German Ifo survey and the equivalent INSEE business survey from France, with the German GfK consumer confidence indices due Thursday. And Friday brings the ISTAT Italian economic sentiment indices for January along with euro area bank lending numbers for December and, possibly, German retail sales data for the same month. In the bond markets, Germany will sell 30Y bonds on Wednesday while Italy will sell a range of bonds on Thursday.

In the US, it will be busy end to the coming week for top-tier data, with most notably the first estimate of Q4 GDP on Friday expected to show that growth slowed in the final quarter of 2016 as some temporary factors which flattered growth in Q3 reversed. Indeed, expectations are for annualised growth of around 2%Q/Q down from a rate of 3½%Q/Q in Q3 but broadly in line with the average of the previous two years. Friday will also bring December's preliminary durable goods figures, which will be preceded on Thursday by the advance goods trade report and wholesale inventories data. Various housing market indicators are also due throughout the week, including existing home sales (Tuesday), the FHFA home price index (Wednesday) and new home sales figures (Thursday). But, all eyes, of course, will be on the first policy actions of President Trump. Supply-wise, the US Treasury will sell 2Y notes on Tuesday, 2Y floating-rate notes and 5Y notes on Wednesday and 7Y notes on Thursday.

UK

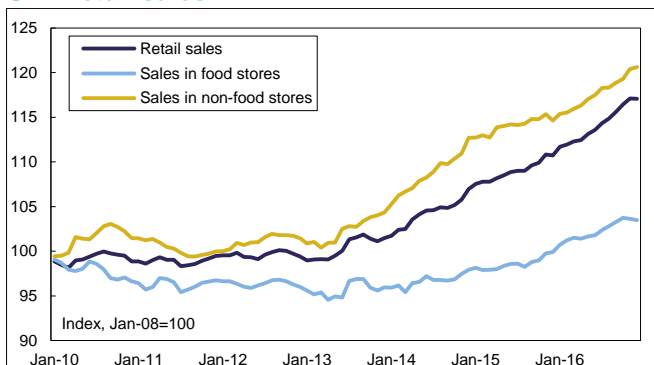
Retail sales dip – monthly volatility or a new trend?

In marked contrast with expectations of only a small decrease in December, today's retail sales figures showed a decline of 1.9%M/M, the steepest since April 2012, with sales in the non-food category accounting for 1.2ppt of the fall. While this left the annual pace of growth moderating from 5.7%Y/Y to 4.3%Y/Y, thanks to a particularly sharp increase of 2%M/M in October, the quarter-on-quarter pace remained healthy, at 1.2%Q/Q, albeit below the 2.0%Q/Q rate seen in Q3. Of course, the willingness of UK consumers to go on a post-referendum spending splurge has been the main reason that the UK economy defied expectations of a marked slowdown in the latter part of 2016. At least some of that strength might be due to the fact that inflation expectations have picked up notably, and some consumers are likely to have front-loaded purchases before prices begin to rise. Certainly, prices are now starting to pick up in response to the drop in sterling, with today's retail sales deflator suggesting that inflation on the High Street hit 0.9%Y/Y in December, having been below zero for twenty-eight consecutive months to October. And as we head through the year, inflation will pick up further while real earnings growth is set to turn negative. So, we expect to see consumer spending growth slow over coming months and quarters, inevitably pulling GDP growth down this year.

The week ahead in the UK

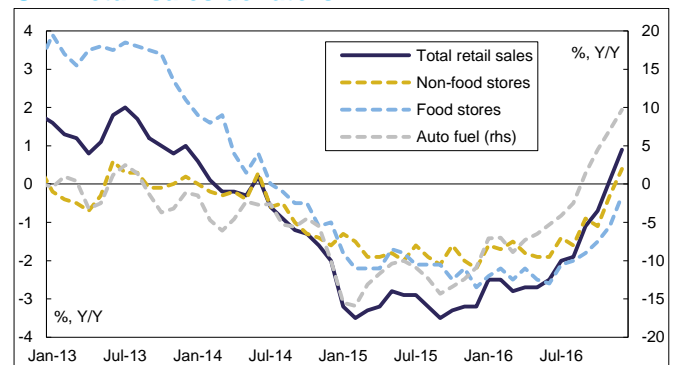
In the coming week, on Tuesday the Supreme Court will deliver its judgment in the Brexit case, where the Government is appealing the High Court's decision requiring that it seeks Parliamentary approval before triggering Article 50. It is widely expected that the Government will lose this appeal. But with the opposition Labour Party in disarray, there is no doubt that parliamentary approval will in due course be easily won in both houses of Parliament. However, that's not to say that the Supreme Court judgment is not worth watching, most notable of which might be what the Supreme Court decides about the requirements to consult the devolved administrations. At present there is no Government in Northern Ireland, with elections to be held in early March. If the Supreme Court was to require the approval of the devolved Governments that could potentially delay the triggering of Article 50. But that seems an unlikely outcome and, following Theresa May's speech in the past week, a triggering of Article 50 looks odds on by the end of March, which would then likely see the UK leaving the EU (and the Single Market) two years thereafter. On the data front, the highlight of the week will be the release of the preliminary Q4 GDP figures on Thursday. Having remained relatively high in Q3 despite an increase in uncertainty in the wake of the Brexit vote, GDP growth is expected to have fallen only slightly, from 0.6%Q/Q to 0.5%Q/Q. While the industrial and construction sectors are unlikely to have provided much support, growth will once again have been driven mainly by services. Among other data releases, the latest public finance figures for December are out on Tuesday, while the CBI releases its surveys – the Industrial Trends and Distributive Trades surveys – on Wednesday and Thursday. Mark Carney is scheduled to speak on Wednesday.

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 |
| UK |  Retail sales excluding petrol M/M% (Y/Y%) | Dec | -2.0 (4.9) | -0.4 (7.5) | 0.5 (6.6) | 0.2 (6.4) |
| |  Retail sales including petrol M/M% (Y/Y%) | Dec | -1.9 (4.3) | -0.1 (7.2) | 0.2 (5.9) | -0.1 (5.7) |
| Country | Auction | - Nothing to report - | | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

| Key data releases | | | | | | |
|----------------------------------|---|---|--------|--|---------------|--|
| Country | GMT | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous | |
| Monday 23 January 2017 | | | | | | |
| EMU |  14:45 | ECB public sector asset purchases €bn | Weekly | <u>18.0</u> | 18.9 | |
| |  15:00 | Preliminary consumer confidence | Jan | -4.8 | -5.1 | |
| Tuesday 24 January 2017 | | | | | | |
| EMU |  09:00 | Preliminary manufacturing PMI | Jan | 54.8 | 54.9 | |
| |  09:00 | Preliminary services PMI (preliminary composite PMI) | Jan | 53.9 (54.5) | 53.7 (54.4) | |
| Germany |  08:30 | Preliminary manufacturing PMI | Jan | 55.4 | 55.6 | |
| |  08:30 | Preliminary services PMI (preliminary composite PMI) | Jan | 54.5 (55.4) | 54.3 (55.2) | |
| France |  08:00 | Preliminary manufacturing PMI | Jan | 53.3 | 53.5 | |
| |  08:00 | Preliminary services PMI (preliminary composite PMI) | Jan | 53.1 (53.2) | 52.9 (53.1) | |
| UK |  09:30 | Public sector net borrowing excluding interventions £bn | Dec | 6.6 | 12.6 | |
| Wednesday 25 January 2017 | | | | | | |
| Germany |  09:00 | Ifo business climate index | Jan | 111.2 | 111.0 | |
| |  09:00 | Ifo current assessment balance (expectations) | Jan | 117.0 (105.9) | 116.6 (105.6) | |
| France |  07:45 | Business confidence indicator (production outlook) | Jan | 105 (-) | 105 (6) | |
| Italy |  09:00 | Industrial sales M/M% (Y/Y%) | Nov | - | 0.8 (-0.9) | |
| |  09:00 | Industrial orders M/M% (Y/Y%) | Nov | 1.0 (-) | 0.9 (-3.2) | |
| UK |  11:00 | CBI Industrial Trends survey, total orders | Jan | 2 | 0 | |
| Thursday 26 January 2017 | | | | | | |
| Germany |  07:00 | GfK consumer confidence survey | Feb | 10.0 | 9.9 | |
| Italy |  09:00 | Retail sales M/M% (Y/Y%) | Nov | 0.1 (0.7) | 1.2 (-0.2) | |
| Spain |  08:00 | Unemployment rate % | Q4 | 18.65 | 18.90 | |
| UK |  09:30 | GDP – 1st release Q/Q% (Y/Y%) | Q4 | <u>0.5 (2.1)</u> | 0.6 (2.2) | |
| |  09:30 | BBA loans for house purchase 000s | Dec | 41.0 | 40.7 | |
| |  09:30 | Index of services M/M% (3M/3M%) | Nov | 0.3 (0.9) | 0.3 (1.0) | |
| |  11:00 | CBI Distributive Trades survey, retail sales | Jan | 27 | 35 | |
| |  15:00 | BoE corporate bond purchases £bn | Weekly | - | 5.29 | |
| Friday 27 January 2017 | | | | | | |
| EMU |  09:00 | M3 money supply Y/Y% | Dec | 4.9 | 4.8 | |
| Germany |  - | Retail sales M/M% (Y/Y%)* | Dec | 0.6 (0.4) | -1.7 (3.2) | |
| France |  07:45 | Consumer confidence survey | Jan | 100 | 99 | |
| Italy |  09:00 | Consumer confidence indicator | Jan | 110.5 | 109.5 | |
| |  09:00 | Manufacturing (economic) confidence | Jan | 103.6 (-) | 103.5 (100.3) | |
| Spain |  08:00 | Retail sales Y/Y% | Dec | 3.0 | 3.3 | |

* Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

| Key events & auctions | | | |
|----------------------------------|---|-------|--|
| Country | | GMT | Event / Auction |
| Monday 23 January 2017 | | | |
| EMU |  | 11:30 | ECB's Draghi schedule to speak in Torino |
| |  | 15:15 | ECB's Praet scheduled to speak in Brussels |
| UK |  | 14:50 | BoE APF operation: To purchase 3-7Y Gilts |
| Tuesday 24 January 2017 | | | |
| EMU |  | 13:45 | ECB's Praet scheduled to speak in Rome |
| UK |  | - | Supreme Court judgement on Article 50 |
| |  | 14:50 | BoE APF operation: To purchase 15Y+ Gilts |
| Wednesday 25 January 2017 | | | |
| Germany |  | 10:30 | Auction: To sell €1bn of 2.5% 2046 bonds (15-Aug-2046) |
| UK |  | 14:50 | BoE APF operation: To purchase 7-15Y Gilts |
| |  | 16:00 | BoE's Carney scheduled to speak in Wiesbaden, Germany |
| Thursday 26 January 2017 | | | |
| Italy |  | 10:00 | Auction: To sell bonds |
| |  | 10:00 | Auction: To sell index-linked bonds |
| Friday 27 January 2017 | | | |
| - Nothing scheduled | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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<http://www.uk.daiwacm.com/research-zone/research-blog>



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