

# Euro wrap-up

## Overview

- Bunds made losses as further surveys suggested that firms in Germany and France remain upbeat about business conditions.
- Gilts also made losses as another survey signalled a pickup in the UK manufacturing sector.
- Thursday will bring results of a German consumer confidence survey and the first estimate of UK GDP in Q416.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.651	+0.023
OBL 0 10/21	-0.373	+0.048
DBR 0¼ 12/27	0.470	+0.063
UKT 1¼ 07/18	0.176	-
UKT 3¼ 09/21	0.633	+0.035
UKT 1½ 07/26	1.477	+0.074

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

## Euro area

### German Ifo still at elevated levels

While recent German surveys have suggested that firms remain optimistic about economic conditions at the start of the New Year, today's Ifo indicator came in a touch on the soft side. In particular, contrasting with an expected increase, the headline business climate index fell 1.2pts in January to 109.8 due to less sanguine expectations about the outlook for the coming six months. Admittedly, the drop was from a near-three-year high in December and so the headline index remains at the top end of the range of recent years. Moreover, firms were more upbeat about current conditions, assessing them to be more favourable than at any time since late-2011. Indeed, manufacturers were the most confident since mid-2014, while construction firms once again judged conditions to be the most favourable since the series began. Admittedly, both sectors were notably more cautious about the outlook, as were wholesalers and retailers. But, on the whole, expectations remain consistent with ongoing expansion at a relatively steady pace, and overall the Ifo survey signalled that Germany's economy will maintain its upward trend over the first quarter of the year.

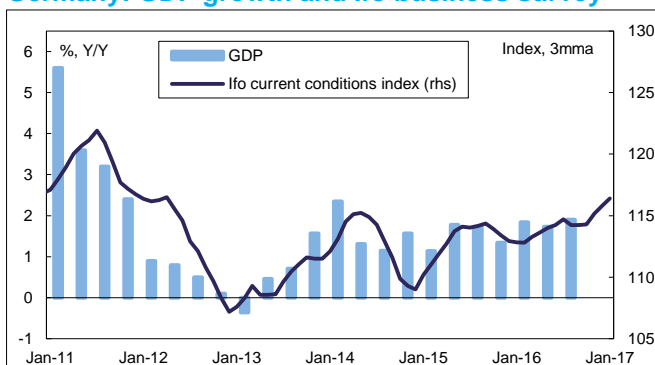
### French sentiment remains broadly upbeat

The French equivalent of the Ifo indices – the INSEE business climate indicators – were also broadly upbeat, albeit with the headline index slipping back by 1pt in January. But, like the Ifo, that followed a notable rise in December and, at 104, it remains well above the long-run average. And so, it also suggests that the strengthening of growth momentum which likely occurred in Q4 has broadly extended into the New Year. At the sectoral level, the survey suggested that manufacturing confidence remains stable and elevated by historical standards. But, in contrast to the findings of yesterday's flash PMIs, the INSEE survey suggested that, having improved markedly in December, sentiment in the services sector fully reversed that gain in January, albeit remaining the second best reading since mid-2011. Meanwhile, with the construction survey suggesting further modest improvement at the start of the year with the respective indicator rising to the highest level since 2012, overall the INSEE survey points to expansion in pretty much every sector in the French economy.

### Schulz unlikely to thwart Merkel

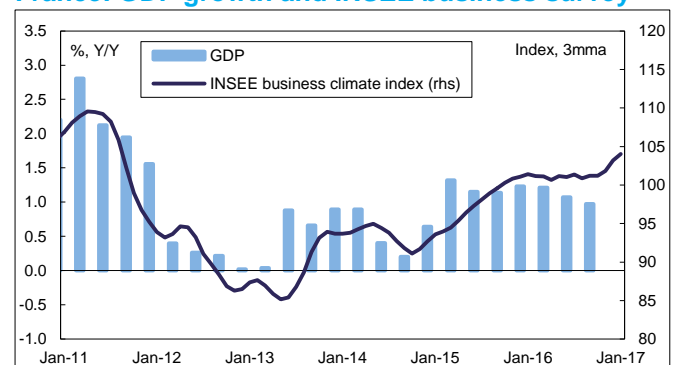
Of course, probably the main risks to the euro area economic outlook this year are political, with the French Presidential election in the spring and the German Federal election in the autumn among the key events. And the past couple of days provided further twists to heighten the unpredictability of their eventual outcomes. In Germany, yesterday's decision of centre-left Social Democrat Party (SPD) leader Sigmar Gabriel to step aside to allow former European Parliament President Martin Schulz to challenge Chancellor Merkel in the German election on 24 September seems highly likely to boost the showing for his party. Certainly, while Gabriel's recent personal ratings have been dire, Schulz's popularity among voters is

### Germany: GDP growth and Ifo business survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### France: GDP growth and INSEE business survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



much closer to that of Merkel, who nevertheless remains the public's current preferred choice as Chancellor. So, a near-term bounce in support for the SPD might be expected too. However, recent polls of Federal election voting intentions conducted before the Schulz announcement suggested that Merkel's CDU/CSU alliance was about 14ppts ahead of the SPD, a gap that might appear insurmountable. So, while there are several months to go before polling day, we continue to expect the next German government to be based on a CDU/CSU-led coalition including either the Greens and/or SPD, with perhaps a small role for the centre-right Free Democrats. And Merkel looks odds-on to be Chancellor for a fourth term. Only a very small probability should be attached to a so-called Red-Red-Green coalition government led by the SPD with the Greens and far-left 'Die Linke', which collectively currently look set to poll little more than 40% of the total vote.

### Fillon allegations highlight French Presidential unpredictability

In France, meanwhile, the identity of the two candidates most likely to participate in the second-round run-off for the Presidency on 7 May remains unclear. Recent opinion polls had suggested that the National Front's Marine Le Pen and the Republicans' François Fillon were comfortably ahead of the pack, each on track to receive about one quarter or more of the first-round vote on 23 April, with Fillon the most likely victor in the second round. However, recent opinion polls suggested improved momentum for the independent centrist Emmanuel Macron. Additionally, the likely success for the left-wing Benoît Hamon in this coming weekend's second-round Socialist primary is expected to see a further shift in support towards Macron among centre-left voters, and might also somewhat erode support for Le Pen. Against that backdrop, while the Republican nominee was quick to dispute the allegations, a report in the French satirical newspaper *Le Canard Enchaîné* that Fillon used public funds to pay his wife over several years – and subsequent confirmation that the matter is being formally investigated by France's financial prosecutor – served to highlight how unforeseen events might yet further shift the balance of support among the three front-runners as the Presidential election approaches. Certainly, the chance of an eventual victory in May for Macron – who, like Fillon, should be considered broadly investor-friendly – cannot be ignored.

### The day ahead in the euro area and US

The data focus in the euro area tomorrow turns to the household sector, with the German GfK consumer confidence survey likely to confirm that households assessed conditions to have remained favourable at the start of 2017. Meanwhile, Italian retail sales figures for November are expected to show that sales were broadly flat on the month following a surge at the start of Q4. Thursday will also bring a Eurogroup meeting which will include discussions on the progress in the ongoing review of Greece's bailout programme, as well as Spain's and Lithuania's updated budgetary plans. Supply-wise, Italy will sell 2018 zero-coupon bonds and 2032 inflation-linked bonds.

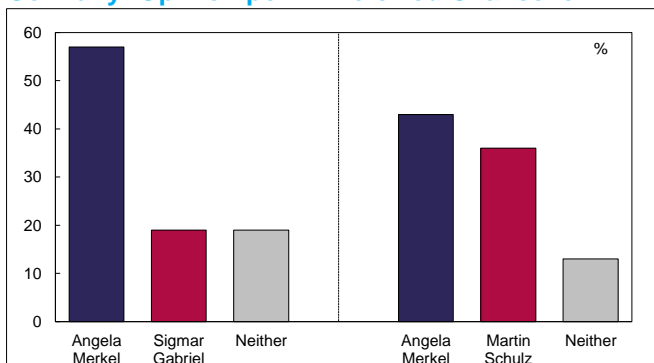
In the US, ahead of Friday's Q4 GDP release, attention tomorrow will be on the advance goods trade figures for December, as well as the advance inventories report for the same month. Thursday will also bring the Chicago and Kansas Fed's activity indices, the Conference Board's latest leading indicators, the flash Markit services and composite PMIs and new home sales figures. In the UST market, a 7Y note auction will be conducted.

## UK

### Surveys continue to signal a pick-up in manufacturing

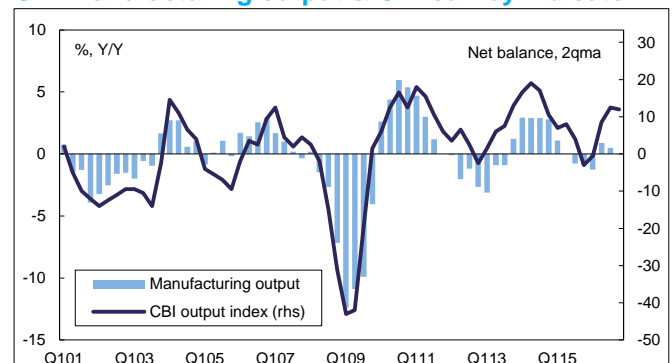
While the fall in the value of sterling in the wake of the Brexit vote raised hopes that improved external competitiveness would lead to a revival in UK manufacturing, production indicators in the second half of 2016 came in on the soft side, with manufacturing output falling by 0.8%Q/Q in Q3 and the October-November average reading pointing to growth in the sector of barely 0.1%Q/Q in Q4. Nevertheless, surveys continue to suggest that momentum in the sector is on the rise, with today's CBI Industrial Trends survey reporting that new orders in the three months to January increased at the fastest pace in two and a half years. Interestingly, according to this survey, domestic demand continued to outpace foreign orders, despite the fact that manufacturers took satisfaction from their much-improved competitiveness abroad. Indeed, the survey respondents expect

#### Germany: Opinion poll – Preferred Chancellor



Source: ARD and Infratest Dimap (December 2016) and Daiwa Capital Markets Europe Ltd.

#### UK: Manufacturing output & CBI survey indicator











Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

foreign orders to rise at a firmer pace over the coming three months. And so, output growth is also expected to pick up significantly. This, by no means, seems implausible not least given the stronger momentum in the manufacturing sector reported in other major economies in recent months. Meanwhile, the effect of weaker currency was also evident in the data for unit costs, which, according to the survey, rose at the fastest pace in more than five years, reinforcing the impression of building inflationary pressures in the UK economy.












## The day ahead in the UK

All attention in the UK tomorrow will be on the release of the preliminary Q4 GDP figures, which are expected to report that growth remained firm at the end of the year, moderating by only 0.1ppt to match the average pace of the previous eight quarters of 0.5%Q/Q. Meanwhile, the breakdown by output components will most likely confirm that services remained the only meaningful source of growth in the UK economy. Among other data due for release tomorrow, the BBA will publish its bank lending figures for December, while the CBI Distributive Trades survey is also due.

## European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
Germany	 Ifo business climate index	Jan	<b>109.8</b>	111.3	111.0	-
	 Ifo current assessment balance (expectations)	Jan	<b>116.9 (103.2)</b>	117.0 (105.8)	116.6 (105.6)	<b>116.7 (105.5)</b>
France	 Business confidence indicator (production outlook)	Jan	<b>104 (8)</b>	105 (6)	105 (6)	-
Italy	 Industrial sales M/M% (Y/Y%)	Nov	<b>2.4 (3.9)</b>	-	0.8 (-0.9)	-
	 Industrial orders M/M% (Y/Y%)	Nov	<b>1.5 (0.1)</b>	1.0 (-)	0.9 (-3.2)	<b>1.0 (-)</b>
UK	 CBI Industrial Trends survey, total orders	Jan	<b>5</b>	2	0	-
Country	Auction					
Germany sold	 €811mn of 2.5% 2046 bonds (15-Aug-2046) at an average yield of 1.2%					
UK	 BoE APF operation purchased £1bn of 7-15Y Gilts (4.67 cover ratio)					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases						
Economic data						
Country	GMT	Release	Period	Market consensus/ Daiwa forecast	Previous	
Germany	 07:00	GfK consumer confidence survey	Feb	10.0	9.9	
Italy	 09:00	Retail sales M/M% (Y/Y%)	Nov	0.0 (0.3)	1.2 (-0.2)	
Spain	 08:00	Unemployment rate %	Q4	18.7	18.9	
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	
Auctions and events						
Country	GMT	Auction / Event				
EMU	 14:00	Euro area finance ministers meet in Brussels				
Italy	 10:00	Auction: To sell up to €2.5bn of 0% 2018 bonds (28-Dec-2018)				
	 10:00	Auction: To sell up to €1bn of 1.25% 2032 index-linked bonds (15-Sept-2032)				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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