

Euro wrap-up

Overview

- Bunds made further losses as a survey signalled further improvement in German consumer confidence at the start of 2017.
- Gilts also made losses as the UK GDP data for Q4 surprised slightly on the upside.
- Friday will bring euro area bank lending figures as well as new economic sentiment survey results from Italy and France.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.649	+0.004
OBL 0 10/21	-0.360	+0.016
DBR 0¼ 12/27	0.486	+0.021
UKT 1¼ 07/18	0.182	+0.010
UKT 3¼ 09/21	0.657	+0.030
UKT 1½ 07/26	1.511	+0.040

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

Euro area

German consumer confidence up again

The European Commission's flash euro area consumer confidence indicator released at the start of the week hit the highest level since April 2015 to suggest that private consumption growth is likely to remain firm in the first quarter. And tallying with that, today's GfK consumer sentiment survey suggested that the improvement was likely led by German households, who are also evidently feeling more confident, with the headline survey indicator rising back to 10.2 to match the highest readings recorded since 2001. Within the survey detail, all key indicators improved to suggest rising optimism about the outlook for business and personal incomes, and a greater willingness to spend. That is hardly a surprise as unemployment continues to hit post-reunification lows, employment is still rising, the number of vacancies is at a series high, and, following a 4% rise in the minimum wage at the start of the year, the unions appear in a strong position to secure accelerated wage growth in the upcoming pay negotiations. And with households reporting increased price expectations, consumers might be tempted to bring forward purchases of big-ticket items to guard against future inflation too.

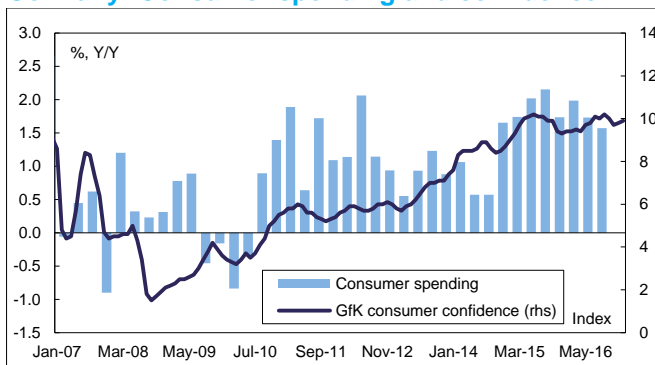
Court judgement raises Italian uncertainty

As if political uncertainty was not large enough given the forthcoming Dutch, French and German elections, yesterday's constitutional court judgement added to the sense of unease by increasing the probability of an early Italian election this year, with knock-on consequences for BTPs which today significantly underperformed other euro area government bonds. While the court's full report will not be released until late February, it announced that it had rejected some of former Prime Minister Matteo Renzi's electoral reforms adopted in 2015, most notably the second-round run-off vote that would have been conducted between the two largest parties in the lower house. It also concluded that the amended law might be applied with immediate effect, without necessarily waiting for parliament to pass new electoral reforms, and so the court appeared to give the green light for an election to be held before the end of the legislature's current term in February 2018, and perhaps as soon as June.

Renzi best-positioned for early election

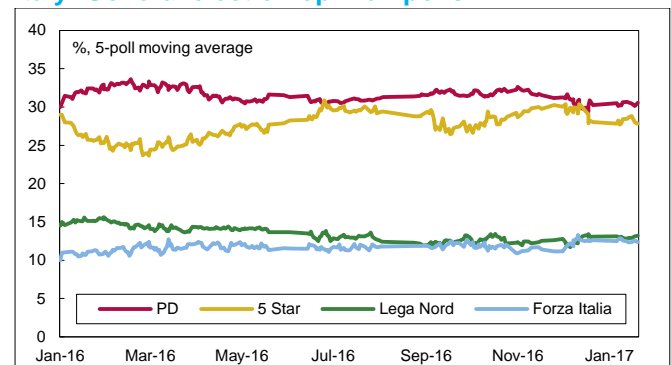
On the basis of the ruling, the seats in the next election would be allocated according to a proportional-representation system with a twist, whereby a party winning more than 40% of the vote would gain bonus seats to give it a majority in the lower house. However, recent opinion polls suggest that, if an election was held soon, no parties would qualify for the bonus, with the centre-left Democratic Party (PD), still led by Renzi, and the populist Five Star Movement (5MS) of Beppe Grillo, neck-and-neck, each perhaps on track to win about 30% of the vote, and other parties lagging well behind. So,

Germany: Consumer spending and confidence



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

Italy: General election opinion polls



Source: Various polling agencies and Daiwa Capital Markets Europe Ltd.



the most likely outcome might be a new coalition centred on the PD. Although that would be unlikely to deliver meaningful structural reform, it would at least avoid the risks to stability posed by a government led by 5MS, whose chances of ruling will be diminished by its refusal to form an alliance with other Italian parties.

Election timing still unclear

But while Renzi has again called for a snap election, given its poor showing in the opinion polls Silvio Berlusconi's centre-right Forza Italia, as well as some opponents of Renzi within the PD and certain other parties, are certainly in no hurry. Although he echoed Renzi's call for a new election soon, Grillo's desire to shake off the reputational damage associated with the 5MS Mayor of Rome Virginia Raggi might also mean that he is content to prefer to wait for things to blow over. And most importantly, before dissolving parliament, President Mattarella might continue to insist that additional legislative amendments are made to further increase the consistency of the electoral laws of the lower and upper houses. And with such amendments likely to be politically sensitive and potentially technically complex, if such a path is taken it remains to be seen whether early elections will be feasible.

The day ahead in the euro area and US

Friday will bring euro area bank lending data for December, which are expected to show a further pickup in credit growth at year-end in response to easy financial conditions. In addition, Italy's ISTAT economic sentiment survey for January is also scheduled for release along with France's INSEE consumer sentiment survey for the same month.

In the US, Friday brings the first estimate of Q416 GDP, which is expected to show that growth moderated to 2-2½%Q/Q annualised, down from 3½%Q/Q in the third quarter but broadly in line with the average of the previous few years. In terms of the detail, net exports likely made a sizeable negative contribution to GDP growth having provided a big boost the previous quarter. But consumption growth and residential construction are likely to have been solid, and inventories also likely added to growth. And business fixed investment was again likely underwhelming. Tomorrow will also bring preliminary durable goods figures for December as well as the final University of Michigan consumer confidence survey for January.

UK

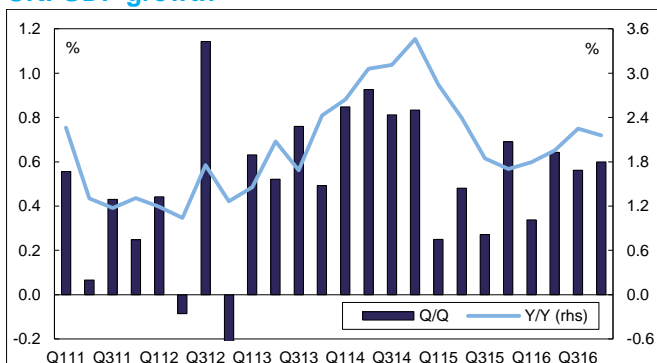
GDP growth unchanged in Q4

Today's preliminary Q4 GDP figures showed that the UK economy continued to expand by 0.6%Q/Q at the end of the last year. The firm pace of increase, which beat the consensus estimate of 0.5%, pointed to an economy more resilient than many anticipated, including the BoE, which in November expected Q4 growth of 0.4%Q/Q. However, growth continued to be unevenly balanced, with services, up by 0.8%Q/Q, remaining the only source of growth, while output in the other major sectors, production and construction, was broadly unchanged. Within services, consumer-focused industries, such as retail sales and travel agencies, reported the strongest growth. Meanwhile, looking at 2016 as a whole, despite the Brexit vote, growth of 2.0%Y/Y was robust, albeit 0.2pts lower compared to 2015 and down by 1.1ppt from 2014. But with the economy facing significant challenges this year, most notably a sharp rise in inflation and, of course, Brexit negotiations, we think that 2017 is likely to see growth slowing more notably, to around 1½%Y/Y.

Borrowing remained firm in December

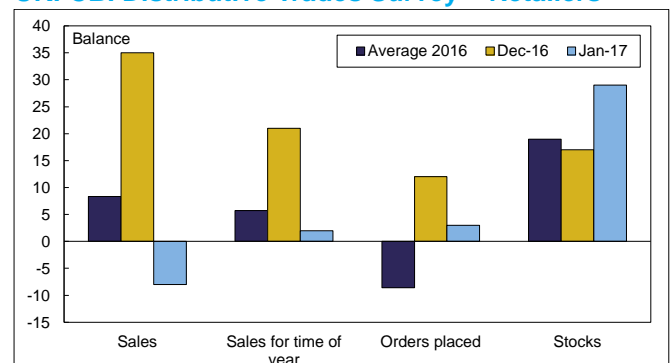
With concerns rising that household consumption might fall abruptly, given that it is being increasingly financed by new household debt, today's retail lending figures from the BBA suggested that growth in consumer credit remained strong at the end of 2016. Credit card borrowing rose by 5.6%Y/Y, a firm pace albeit nearly 1ppt lower compared to October. And the pace

UK: GDP growth



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

UK: CBI Distributive Trades Survey – Retailers



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

of increase in personal loans and overdrafts rose to 7½%Y/Y, a level close to its multi-year high. On the mortgage lending side, growth remained broadly stable at around 2½%Y/Y. However, gross new lending inched up, and the number of approvals for house purchase rose notably hitting the highest level since March.











Retail sales set to slow

The firm borrowing figures for December seem to have been at odds with the retail sales results that month, which showed a drop of almost 2%M/M. And today's CBI Distributive Trades survey suggested that retail sales in January should be weaker too. The diffusion index for the volume of sales fell particularly sharply to -8, a level last seen in Q3, while the indicator for the level of stocks reached a more-than-two-year high, implying that retailers were prepared for much stronger demand than they were experiencing. The data seem to be consistent with the idea that consumers brought forward some of their purchases to Q4, and now as prices start to rise more rapidly, retail sales might slow appreciably in Q1.







The day ahead in the UK

It should be a quiet end of the week in the UK with no notable economic data due for release.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
Germany	 GfK consumer confidence survey	Feb	10.2	10.0	9.9	-
Italy	 Retail sales M/M% (Y/Y%)	Nov	-0.7 (0.8)	0.0 (0.3)	1.2 (-0.2)	-
Spain	 Unemployment rate %	Q4	18.6	18.7	18.9	-
UK	 GDP – 1st release Q/Q% (Y/Y%)	Q4	0.6 (2.2)	<u>0.5 (2.1)</u>	0.6 (2.2)	-
	 BBA loans for house purchase 000s	Dec	43.2	41.0	40.7	41.0
	 Index of services M/M% (3M/3M%)	Nov	0.3 (1.0)	0.3 (0.9)	0.3 (1.0)	-(1.1)
	 CBI Distributive Trades survey, retail sales	Jan	-8	27	35	-
	 BoE corporate bond purchases £bn	Weekly	5.76	-	5.29	-
Country	Auction					
Italy sold	 €2.5bn of 0% 2018 bonds (28-Dec-2018) at an average yield of -0.071%					
	 €976mn of 1.25% 2032 index-linked bonds (15-Sept-2032) at an average yield of 1.22%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases						
Economic data						
Country	GMT	Release	Period	Market consensus/ Daiwa forecast	Previous	
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	110.0	109.5	
	 09:00	Manufacturing (economic) confidence	Jan	103.3 (-)	103.5 (100.3)	
Spain	 08:00	Retail sales Y/Y%	Dec	3.2	3.3	
Auctions and events						
Country	GMT	Auction / Event				
- Nothing scheduled -						

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

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