

Euro wrap-up

Overview

- Bunds made modest gains despite a further improvement in euro area economic sentiment and an increase in German inflation to a 3-year high.
- Gilts followed Bunds higher on a quiet day for UK economic news.
- Tomorrow brings the first estimates of Q416 GDP and January CPI from the euro area, as well as a UK consumer confidence survey and lending data.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.675	-0.014
OBL 0 10/21	-0.382	-0.016
DBR 0¼ 12/27	0.447	-0.016
UKT 1¼ 07/18	0.143	-0.020
UKT 3¼ 09/21	0.622	-0.007
UKT 1½ 07/26	1.440	-0.030

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

Euro area

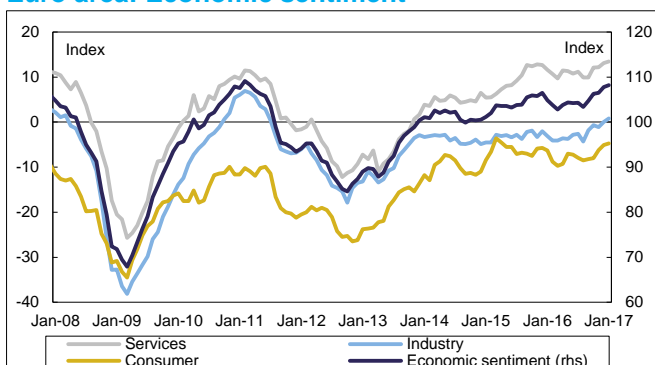
Economic sentiment improves further

If the latest economic surveys are to be believed, having picked up in the final quarter of 2016, economic growth momentum in the euro area at the start of the year remained the strongest since before the sovereign debt crisis. Indeed, while the flash euro area composite PMI for January released last week slipped back very slightly from December's multi-year high, the European Commission's economic sentiment index, which arguably provides the most reliable guide to euro area GDP growth, rose this month to its highest since March 2011. Among businesses, the improvement in confidence in the latest month was driven by the manufacturing and services sectors, taking the respective indices further above their long-run averages. With orders still the most plentiful in more than five years, supported by both domestic and a further improved assessment of external demand, manufacturers' production expectations jumped to the highest since May 2011. Confidence among services, meanwhile, rose to the strongest level since 2007. While sentiment in the construction sector slipped back a touch, it nevertheless represented the second-highest reading since 2008. And although retailers were also somewhat less upbeat, optimism among consumers rose further than implied by last week's preliminary estimate, rising to a new twenty-month high. Meanwhile, just as it had done at the end of 2016, the Commission survey also suggested again that the improvement in conditions is geographically widespread. There were renewed improvements in economic sentiment in Italy and Spain taking the respective indices closer to the top of the ranges of the post-Lehman period and well above long-run norms. And while the equivalent indicators slipped back in Germany and France, in both countries they were still the second-highest such readings since 2011.

German inflation jumps close to 2%

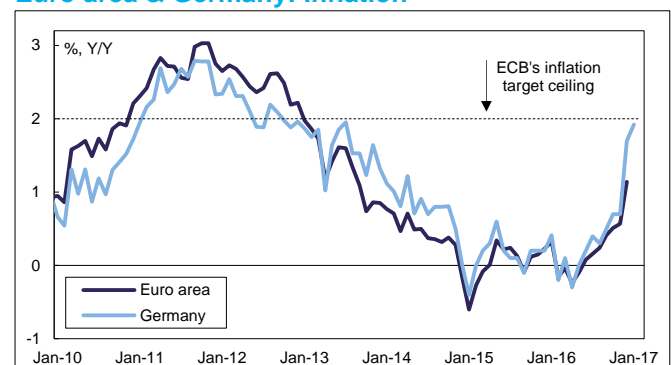
While today's Commission survey results signalled steady economic growth momentum, it also flagged rising price pressures. Unsurprisingly given recent energy price shifts, these appear most marked in the industrial sector, where the euro area index of price expectations for the coming twelve months rose well above the long-run average to the strongest since mid-2011. But the equivalent index for services also rose to the highest for nearly six years, while those for the retail sector and consumers were significantly higher too. Perhaps inevitably given that country's more advanced cyclical position, the German survey flagged some of the strongest increases in price expectations of the member states. And today's flash estimates of German inflation in January suggested that businesses and consumers are probably right to be wary of inflation. While it was a touch softer than expected, the EU-harmonised measure of German inflation rose 0.2ppt to 1.9%Y/Y, the highest since January 2013 and fully consistent with the ECB's objective of below but close to 2%Y/Y. Although the limited detail available on the national measure suggested that the drivers of the increase in inflation in the latest month were prices of fuel and food and so underlying inflation in Germany was probably no firmer than the previous month, we expect German inflation to remain close to 2%Y/Y over coming quarters.

Euro area: Economic sentiment



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

Euro area & Germany: Inflation*



*German flash estimate for January 2017.
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



Macron the new favourite for the Élysée?

As expected, the anti-establishment left-wing candidate, former Education Minister Benoît Hamon, defeated the more centrist former Prime Minister Manuel Valls in the second-round primary to earn the right to be the Socialist Party's candidate in the forthcoming French Presidential election. Hamon's ratings have received a boost from the primary process to the extent that he might now be expected to come ahead of the far left candidate Jean-Luc Mélenchon in the first round of the Presidential election on 23 April. However, that is little comfort for the Socialist Party, since it still looks highly unlikely that Hamon will come any higher than fourth. Indeed, an opinion poll published this morning in Le Figaro suggests that it is the centrist Emmanuel Macron, leader of his own new independent "En Marche!" ("Forward!") movement, who has the momentum, significantly closing the gap on the Republicans' right-wing candidate François Fillon and the far-right National Front's Marine Le Pen. Indeed, should Macron – who would seem far more likely to govern in a pragmatic way than the other two ideologically-driven candidates – make it through to the second round run-off on 7 May, today's poll suggests that he would be highly likely to become France's next President, with ratings comfortably superior to Fillon and Le Pen in any head-to-head contest. So, while he is yet to set out any detailed policy proposals, Macron is starting to look a good bet to win the Élysée Palace, not least since Fillon risks being further undermined by allegations surrounding payments of public funds to his wife.

The day ahead in the euro area and US

Tuesday will bring the first estimates of euro area GDP growth in Q416 and euro area inflation in January. With Spanish GDP growth confirmed today at 0.7%Q/Q, the same rate as in Q3, we expect euro area GDP growth to have risen 0.2ppt to 0.5%Q/Q, which would be the firmest pace since Q116. In addition, the preliminary estimate of French GDP growth is expected to have doubled to 0.4%Q/Q in Q4 from 0.2%Q/Q the previous quarter. Meanwhile, following today's German figure, we expect the flash estimate of euro area CPI in January to rise by 0.4ppt to 1.5%Y/Y, which would be the highest since July 2013, although the risks to this estimate are likely skewed slightly to the downside. And with the upwards pressure coming principally from energy and food prices, and services inflation probably slightly softer this month, we expect euro area core CPI to remain unchanged at 0.9%Y/Y. Preliminary inflation figures for January from France and Spain are also due for release tomorrow along with euro area and German unemployment figures and German retail sales data.

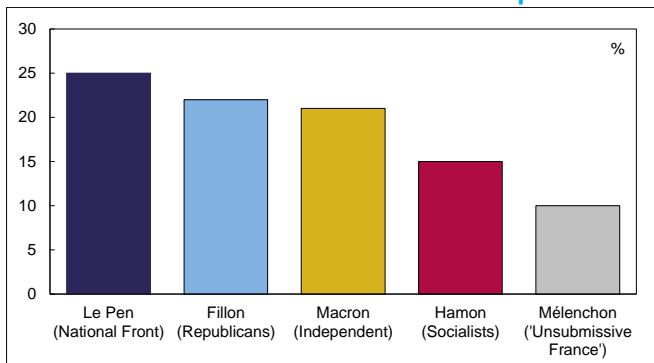
In the US, Tuesday will bring the Conference Board consumer confidence survey and Chicago PMI, both for January, along with Q416 employment cost data and the Case-Shiller home price data for November.

UK

The day ahead in the UK

After a quiet day today, the flow of new economic data in the UK picks up tomorrow, with the release of the GfK Consumer Confidence survey for January. An equivalent indicator released by the European Commission today showed that UK consumer sentiment improved at the start of 2017 (on a non-seasonally adjusted basis), so tomorrow's release is likely to contrast with market expectations of a 1pt fall from the -7 registered in December. Among other new data, the BoE lending figures, and in particular the pace of consumer credit growth, which in the second half of 2016 consistently exceeded 10%Y/Y, will also attract attention.

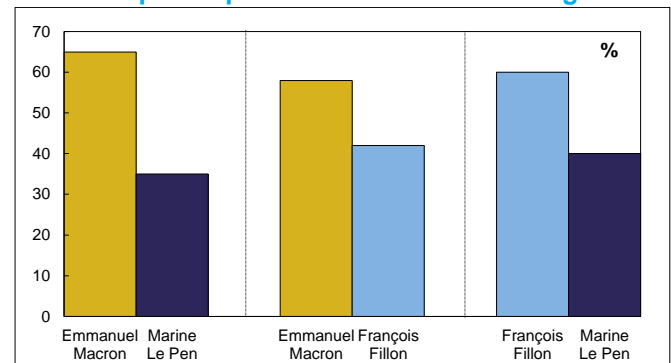
France: Presidential election first round poll*



*Survey published 29 January 2017.

Source: Étude Kantar Sofres-OnePoint (26 and 27 January 2017) for Le Figaro and Daiwa Capital Markets Europe Ltd.

France: Opinion polls – second round voting share*









*Survey published 29 January 2017.

Source: Étude Kantar Sofres-OnePoint (26 and 27 January 2017) for Le Figaro and Daiwa Capital Markets Europe Ltd.





European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	 Economic sentiment indicator	Jan	108.2	107.8	107.8	-
	 Services (industrial) sentiment	Jan	13.5 (0.8)	12.7 (0.2)	12.9 (0.1)	13.1 (0.0)
	 Final consumer confidence	Jan	-4.7	-4.9	-5.1	-
	 ECB public sector asset purchases €bn	Weekly	16.9	<u>17.5</u>	18.5	-
Germany	 Preliminary EU-harmonised CPI Y/Y%	Jan	1.9	2.0	1.7	-
Spain	 GDP – 1st release Q/Q% (Y/Y%)	Q4	0.7 (3.0)	<u>0.7 (3.1)</u>	0.7 (3.2)	-

















Country Auction

Italy sold		€2.75bn of 0.35% 2021 bonds (01-Nov-2021) at an average yield of 0.92%
		€2.25bn of 2024 floating-rate bonds (15-Feb-2024) at an average yield of 0.73%
		€4bn of 2.2% 2027 bonds (01-Jun-2027) at an average yield of 2.37%
UK		BoE APF operation purchased £1bn of 3-7Y Gilts (4.74 cove ratio)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	GMT	Release	Period	Market consensus/ Daiwa forecast	Previous
EMU	10:00	 GDP – 1st release Q/Q% (Y/Y%)	Q4	<u>0.5 (1.7)</u>	0.3 (1.7)
	10:00	 Unemployment rate %	Dec	<u>9.8</u>	9.8
	10:00	 Flash CPI estimate Y/Y%	Jan	1.5	1.1
	10:00	 Flash core CPI estimate Y/Y%	Jan	0.9	0.9
Germany	07:00	 Retail sales M/M% (Y/Y%)	Dec	0.6 (0.5)	-1.7 (3.2)
	08:55	 Unemployment change `000s (rate %)	Jan	-5 (6.0)	-17 (6.0)
France	06:30	 GDP – 1st release Q/Q% (Y/Y%)	Q4	<u>0.5 (1.2)</u>	0.2 (1.0)
	07:45	 Preliminary EU-harmonised CPI Y/Y%	Jan	1.2	0.8
	07:45	 Consumer spending M/M% (Y/Y%)	Dec	0.2 (2.1)	0.4 (3.3)
Italy	09:00	 Unemployment rate %	Dec	11.8	11.9
Spain	08:00	 Preliminary EU-harmonised CPI Y/Y%	Jan	2.2	1.4
	09:00	 Current account balance €bn	Nov	-	2.0
UK	00:01	 Lloyds business barometer	Jan	-	39
	00:01	 GfK consumer confidence survey	Jan	-8	-7
	09:30	 Mortgage approvals `000s	Dec	69.2	67.5
	09:30	 Net consumer credit (net lending secured on dwellings) £bn	Dec	1.7 (3.2)	1.9 (3.2)

Auctions and events

Country	GMT	Auction / Event
EMU	08:00	 ECB's Draghi scheduled to speak in Frankfurt
UK	10:30	 Auction: To sell 1.5% 2026 bonds
	14:50	 BoE APF operation: To purchase 15Y+ Gilts

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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