

Euro wrap-up

Overview

- Bunds made modest gains despite new euro area data showing firm GDP growth and a steeper-than-expected jump in inflation.
- Gilts also made gains despite an improved UK consumer confidence survey while consumer credit growth slowed.
- Wednesday brings final January manufacturing PMIs from the euro area and UK.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.699	-0.019
OBL 0 10/21	-0.398	-0.017
DBR 0¼ 12/27	0.435	-0.014
UKT 1¼ 07/18	0.133	-0.013
UKT 3¼ 09/21	0.617	-0.011
UKT 1½ 07/26	1.416	-0.028

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

Euro area

Euro area GDP ended 2016 on a high

As had been signalled in advance by numerous economic surveys, euro area GDP growth picked up in the final quarter of 2016. In line with our forecast, the flash estimate of GDP rose 0.5%Q/Q, the strongest rate since Q116, leaving the annual rate for the fourth quarter unchanged at 1.8%Y/Y. No expenditure breakdown was provided with the headline growth figure, although domestic demand seems bound to have been the driver once again. That was the case in France, where the preliminary figures also published today similarly broadly met expectations. In particular, French GDP growth doubled in Q416 to 0.4%Q/Q, also the best reading since the first quarter of last year, with welcome acceleration in private consumption (0.6%Q/Q) and fixed investment (0.8%Q/Q). And with net trade also making a very modest positive contribution to the expansion, French GDP growth was restrained only by adjustments to inventories, which subtracted 0.2ppt. Following the release of preliminary growth data from Spain (0.7%Q/Q), Austria (0.6%Q/Q) and Belgium (0.4%Q/Q), we expect the equivalent figures for Germany and Italy (both due 14 February) to show growth of 0.6%Q/Q and 0.2%Q/Q respectively.

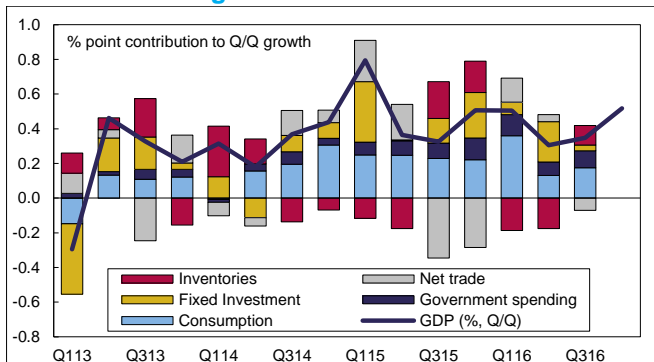
Inflation jumps above expectations again

While the flash GDP figures aligned with expectations, euro area inflation surprised significantly on the upside for the second successive month, jumping 0.7ppt in January – the most in more than six years – to 1.8%Y/Y, the highest rate in almost four years. The increase was driven most notably by energy prices, which posted their biggest monthly increase in four years to rise more than 8%Y/Y, as a predictable rise associated with recent shifts in the oil price was exacerbated by a spike in electricity prices attributable to adverse weather, particularly in Spain, where headline inflation more than doubled to 3.0%Y/Y, the highest since 2012. Food inflation also rose further, to 1.7%Y/Y, the highest in three years, while prices of non-energy industrial goods rose 0.5%Y/Y, the most in seven months. However, since services inflation eased slightly, to 1.2%Y/Y, core inflation remained unchanged at a tepid 0.9%Y/Y. Looking ahead, while we expect the inflation data to remain volatile not least as distortions related to the timing of Easter play out, we expect headline CPI to remain at or above 1.5%Y/Y over coming months and core CPI to rise gradually above 1%Y/Y too.

Fall in joblessness gives further cause for optimism

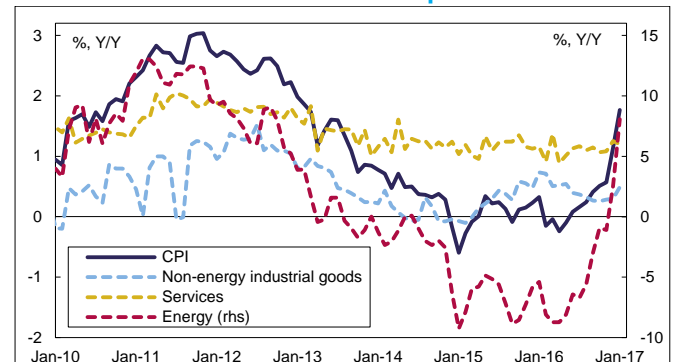
The latest labour market figures should also have given the ECB cause for optimism as it seeks to sustain a clear upwards trend in underlying inflation. Most notably, the euro area unemployment rate fell further than expected in December to 9.6%, the lowest since May 2009 and 2.5ppt below the peak, from a downwardly revised 9.7% in each of the previous two months. The number of jobless workers in the euro area was 1.25mn lower than a year earlier, taking the decline from the peak to more than 3.75mn. Declines in the latest month were led by Spain (down 0.3ppt to 18.4%) and the Netherlands (down 0.3ppt

Euro area: GDP growth and contributions



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: CPI inflation and components*



*Flash estimates for January 2017

Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



to 5.4%) while the German rate on the EU measure was unchanged at a series low of 3.9%. Unemployment rates in almost all member states are now on a clear downwards trend, with the notable exception of Italy where the unemployment rate of 12.0% in December was unchanged from its level eighteen months earlier. However, the increased number of registered workers unemployed in Italy in part reflects increased labour force participation related to structural reforms, with employment in December still more than 240k (1.1%) higher than one year earlier. And, as unemployment falls more widely in the euro area, labour market slack is gradually being used up. OECD estimates suggest that unemployment is now at or below the structural rates in Germany, the Netherlands, Belgium and Portugal, and the euro area unemployment rate is now less than 1ppt above the aggregate structural rate. While all such estimates are subject to significant uncertainty – and due to recent reforms we suspect that there is more labour market slack than the OECD figures imply – we do expect the gradual tightening of the euro area labour market to generate upwards pressure on wages and prices over coming quarters.

The day ahead in the euro area and US

Wednesday is set to be a less eventful day for economic news from the euro area with the final manufacturing PMIs for January the most notable. According to the flash estimate, the euro area manufacturing PMI rose to 55.1, its highest level since April 2011 on the back of sustained growth of new orders, including from abroad, as well as improved expectations for output over the coming twelve months. In the markets, Germany will sell 5Y Bunds.

Tomorrow will be a busy day in the US, not least with the conclusion of the Fed's latest FOMC meeting. With Fed Chair Yellen among others having recently reiterated that the pace of future tightening will remain gradual, and just six weeks having passed since the Committee last raised interest rates, the range for the Fed Funds Rate is widely anticipated to be left unchanged at 0.5-0.75%. But the post-meeting statement will no doubt be closely watched for insights into the near-term policy outlook. Data-wise, meanwhile, Wednesday will bring the ISM manufacturing indices and ADP employment report for January, as well as December construction spending figures.

UK

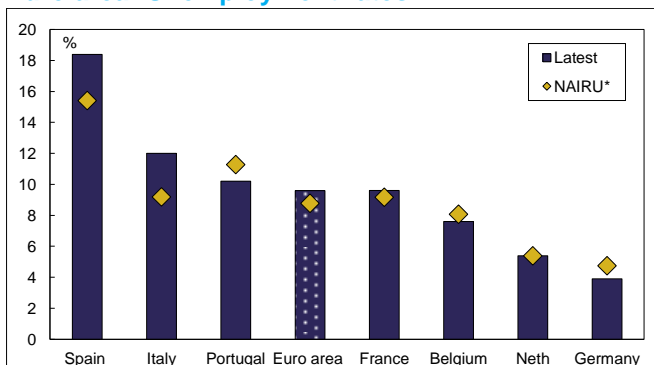
Consumers were more upbeat in January...

Despite a sharp pick-up in inflation at the end of 2016, consumers in the UK appear to have started the New Year on a positive note, with today's release of the GfK consumer confidence survey showing that the headline measure of consumer sentiment increased in January from -8 to -5, a three-month high albeit still well below the readings seen in the two years leading up to the Brexit referendum. The details of the survey were mixed, however, with consumers assessing that the economic outlook for the coming twelve months remained downbeat and that the climate for major purchases deteriorated slightly. So, the improvement only reflected more positive sentiment about their personal financial situation. Looking ahead, however, while inflation will rise, wage growth looks set to remain relatively subdued, and therefore real income growth will be squeezed.

...but consumer credit growth is slowing

Of course, if consumers continue to rely on borrowing to finance a significant a share of their spending, consumption might remain firm. However, today's BoE lending data hinted that the pace of consumer credit growth might be slowing, having consistently posted readings in excess 10%Y/Y in the second half of 2016. December saw growth moderating by 0.2ppt, to 10.6%Y/Y, and other details hinted that the near-term outlook might be less encouraging. For example, the net increase in lending was the smallest in nineteen months, with both credit card lending and personal loans posting weaker readings.

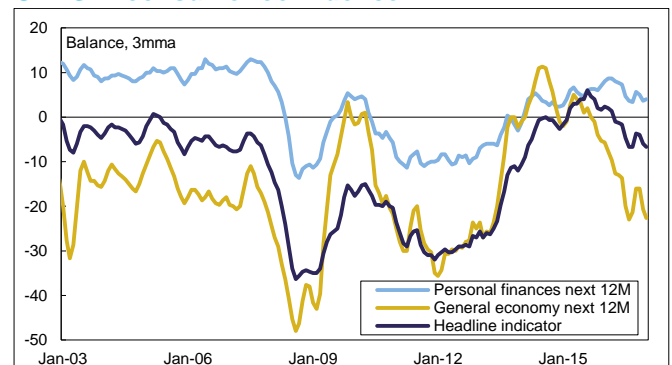
Euro area: Unemployment rates



*Non-accelerating inflation rate of unemployment.

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

UK: GfK consumer confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Those figures are consistent with recent data from the retail sector, which showed that sales fell sharply in December. And while it remains to be seen if today's numbers are the harbinger of a coming slowdown, or just a blip, we continue to think that consumption will slow over the coming months and quarters, inevitably putting a lid on GDP growth. Meanwhile, secured lending indicators were a bit more positive, with the total stock of mortgages up by an unchanged 3.1%Y/Y and mortgage approvals inching higher to a nine-month high of 67.9k, suggesting that housing market momentum was maintained around the turn of the year.



















The day ahead in the UK

The flow of UK January PMIs starts tomorrow with a release of the manufacturing survey. Having surged to a two-and-a-half year high of 56.1 in the previous month, the headline indicator is expected to have moderated at the start of 2017.

European calendar

Today's results







Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	 GDP – 1st release Q/Q% (Y/Y%)	Q4	0.5 (1.8)	<u>0.5 (1.7)</u>	0.3 (1.7)	0.4 (1.8)
	 Unemployment rate %	Dec	9.6	<u>9.8</u>	9.8	9.7
	 Flash CPI estimate Y/Y%	Jan	1.8	1.5	1.1	-
	 Flash core CPI estimate Y/Y%	Jan	0.9	0.9	0.9	-
Germany	 Retail sales M/M% (Y/Y%)	Dec	-0.9 (-1.1)	0.6 (0.5)	-1.8 (3.2)	-1.7 (3.5)
	 Unemployment change `000s (rate %)	Jan	-26 (5.9)	-5 (6.0)	-17 (6.0)	-20 (-)
France	 GDP – 1st release Q/Q% (Y/Y%)	Q4	0.4 (1.1)	<u>0.5 (1.2)</u>	0.2 (1.0)	- (0.9)
	 Preliminary EU-harmonised CPI Y/Y%	Jan	1.6	1.2	0.8	-
	 Consumer spending M/M% (Y/Y%)	Dec	-0.8 (1.5)	0.2 (2.1)	0.4 (3.3)	0.6 (3.7)
Italy	 Unemployment rate %	Dec	12.0	11.8	11.9	12.0
Spain	 Preliminary EU-harmonised CPI Y/Y%	Jan	3.0	2.2	1.4	-
	 Current account balance €bn	Nov	3.3	-	2.0	-
UK	 Lloyds business barometer	Jan	29	-	39	-
	 GfK consumer confidence survey	Jan	-5	-8	-7	-
	 Mortgage approvals `000s	Dec	67.9	69.2	67.5	-
	 Net consumer credit (net lending secured on dwellings) £bn	Dec	1.0 (3.8)	1.7 (3.2)	1.9 (3.2)	- (3.1)
Country	Auction					
UK sold	 £2.25bn of 1.5% 2026 bonds (22-Jul-2026) at an average yield of 1.451%					
	 BoE APF operation purchased £1bn of 15Y+ Gilts (2.71 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 	09:00	Final manufacturing PMI	Jan	55.1	54.9
Germany 	08:55	Final manufacturing PMI	Jan	56.5	55.5
France 	08:50	Final manufacturing PMI	Jan	53.4	53.5
Italy 	08:45	Manufacturing PMI	Jan	53.3	53.2
Spain 	08:15	Manufacturing PMI	Jan	55.0	55.3
UK 	00:01	BRC shop price index Y/Y%	Jan	-1.0	-1.4
	07:00	Nationwide house price index M/M% (Y/Y%)	Jan	0.0 (4.3)	0.8 (4.5)
	09:30	Manufacturing PMI	Jan	55.9	56.1

Auctions and events

Country	GMT	Auction / Event
Germany 	10:30	Auction: To sell €4bn of 2022 bonds (08-Apr-2022)
UK 	14:50	BoE APF operation: To purchase 7-15Y Gilts

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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