

Euro wrap-up

Overview

- Bunds made only modest gains despite a big downside surprise to the latest German IP figures.
- Gilts also rose as a UK retail survey signalled a slowdown in sales growth at the start of the year.
- Tomorrow brings the results of business surveys from the Bank of France and Bank of England.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.776	-0.010
OBL 0 04/22	-0.406	-0.007
DBR 0% 02/27	0.358	-0.012
UKT 1½ 07/18	0.087	-0.004
UKT 3% 09/21	0.498	-0.021
UKT 1½ 07/26	1.286	-0.029

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

Euro area

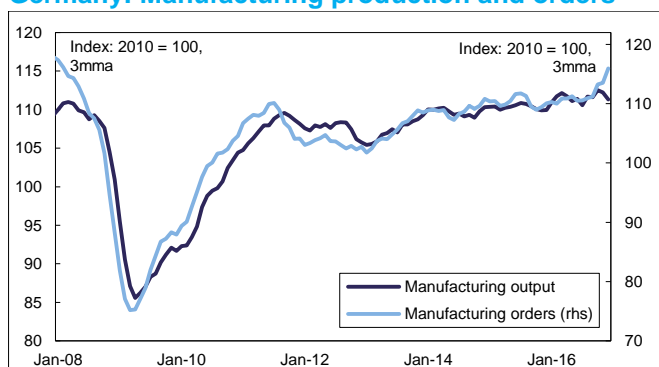
Big downside surprise to German IP

While yesterday's German factory orders data provided a massive upside surprise with growth of more than 5%M/M in December on the back of very strong domestic orders, today's industrial production figures from the euro area's largest member state did the opposite, surprising very significantly on the downside. Indeed, contrasting markedly with an expected third consecutive monthly increase of around ½%M/M, total production fell 3% on the month in December, the steepest monthly decline since the start of 2009. Within the detail, manufacturing output fell almost 3½%M/M, with production of capital goods down almost 5½%M/M and production of intermediate and consumer goods down more than 1%M/M and 3%M/M respectively. Moreover, energy and construction output fell too. So, over the fourth quarter as a whole, total industrial production disappointingly fell 0.1%Q/Q with manufacturing output down 0.3%Q/Q. The weakness in December certainly looks at odds with the full gamut of other recent data and surveys out of Germany, which have been wholly upbeat. And while we do not discount the possibility that German manufacturers and consumers might become more cautious over coming quarters as political uncertainty in the region and beyond weighs, given the sharp pickup in orders in December, as well the stronger industrial sector sentiment in January reported in surveys, we fully expect to see German IP bounce back at the start of the year. Indeed, more than anything else, the weakness in today's data smacked of statistical noise.

Political uncertainties will not be lifted soon

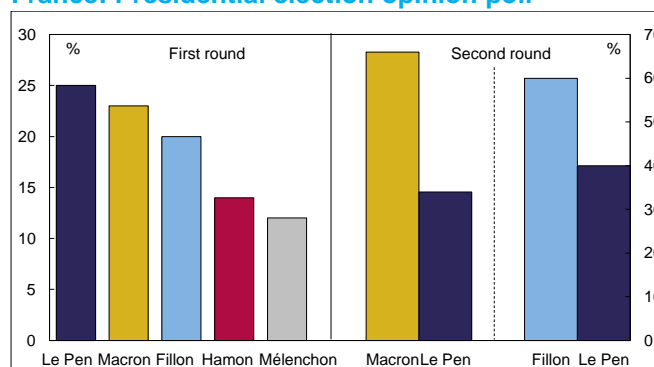
Having underperformed at the start of the week sending the respective sovereign spread over 10Y Bunds to a more than four-year high close to 80bps, French government bonds marginally outperformed their German counterparts today. But it will likely be several weeks before the political concerns that have driven the widening in French spreads can be alleviated. Certainly, the far-right National Front's Marine Le Pen – who on the weekend released her election manifesto confirming her readiness to take France out of the euro area and EU – represents an existential threat to the single currency. In addition, the refusal of Republican candidate François Fillon yesterday to withdraw his candidature means that his 'Penelopegate' scandal will continue to dominate attention and risks undermining the bid of any substitute (e.g. former Prime Minister Alain Juppé) who might in due course be forced to take his place as the candidate of the establishment right-wing parties. And with the centrist Emmanuel Macron – who, according to the latest Opinion Way poll published today, remains on course to face and defeat Le Pen in the second-round vote in May – also increasingly subject to scurrilous gossip as well as suggestions of threats of sabotage from Wikileaks, with still more than six weeks to go to the first round of the French Presidential election there is plenty of time for further twists and turns.

Germany: Manufacturing production and orders



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

France: Presidential election opinion poll



Source: OpinionWay for Les Echos (7 February 2017) and Daiwa Capital Markets Europe Ltd.



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Of course, the French Presidential election is not the only political event that is becoming less predictable to call, with an INSA and YouGov German opinion poll yesterday suggesting that, just two weeks after the appointment of new leader Martin Schulz, the SPD might have edged slightly ahead of Angela Merkel's CDU/CSU for the first time in more than a decade. However, this poll also suggested that a left-wing coalition of the SPD, Greens and Die Linke would still fall short of a majority. Moreover, other recent polls strongly suggest that the CDU/CSU remains on track to become the largest party in the next Bundestag. So, while there is still a long way to go before the election in September, on balance, we expect Merkel to win a fourth term as Chancellor and the next government to represent a continuation of the current Grand Coalition between the CDU/CSU and SPD.

The coming two days in the euro area and US

The flow of national industrial production figures for December continues tomorrow with the Spanish report, which is expected to show that output was broadly flat on the month. And despite a near-2%M/M increase in November, this would leave output in Q4 little changed from Q3. Wednesday will also bring the Bank of France's latest business sentiment survey for January. Meanwhile, Thursday will see the release of Germany's trade report for December, which is expected to see some temporary payback for the surge in the value of exports in November. Supply-wise, Germany will sell 10Y Bunds on Wednesday, while Portugal will sell 5Y and 7Y bonds.

It should be a relatively quiet couple of days for economic releases from the US, with just December's wholesale trade figures due on Thursday alongside the usual weekly jobless claims data. So, perhaps of more interest will be the speech by FOMC voting member Evans on Thursday. Meanwhile, in the UST market, a 10Y note auction will be conducted on Wednesday, followed by a 30Y bond auction on Thursday.

UK

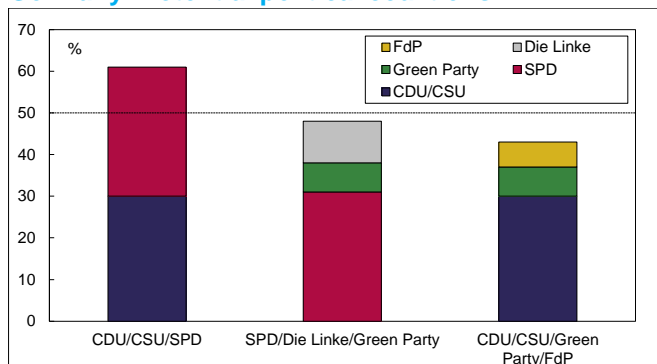
Consumer spending growth losing steam?

Today's release of the BRC's latest retail sector survey suggested that growth momentum on the High Street continued to moderate in January, with headline sales growth down from 1.7%Y/Y to just 0.1%Y/Y, and like-for-like sales faring even worse, falling 0.6%Y/Y, both representing the slowest pace in five months. The survey details pointed to a weaker performance of non-food stores, which saw growth of only 0.3%3M/Y, while food sales growth remained robust, at 2.0%3M/Y, albeit down by 0.4ppt from the previous month. Furthermore, smoothing out monthly volatility, headline growth of 1.1%3M/Y represented the slowest pace of increase of festive-season sales since 2009. Meanwhile, other recent indicators of the latest changes in consumer spending were mixed. For example, the consumer credit figures for December showed an unexpected slowdown. However, January car sales, the figures for which were reported yesterday, seem to have had a good start to the year, with growth back up to 2.9%Y/Y, having fallen to -1.1%Y/Y in the previous month. Overall, we continue to expect that accelerating inflation will squeeze household incomes over coming quarters, exerting downward pressure on private spending.

The coming two days in the UK

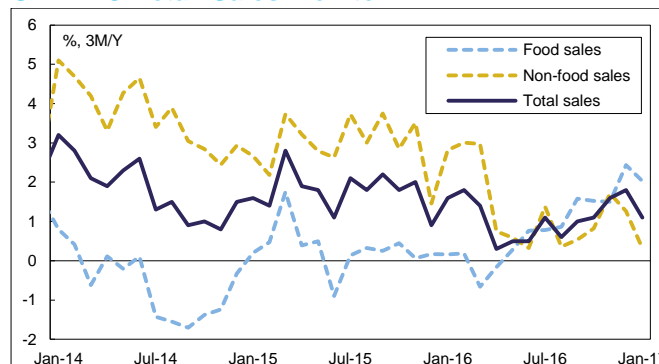
On a relatively quiet day tomorrow, the only data release worth watching will be the BoE survey of business conditions. Meanwhile, on Thursday, the RICS Residential Market survey will provide an update on the latest developments in the housing market.

Germany: Potential political coalitions*



*Based on INSA & YouGov opinion poll (6 February 2017).
 Source: INSA & YouGov and Daiwa Capital Markets Europe Ltd.

UK: BRC Retail Sales monitor










Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 9 February 2017.

European calendar

Today's results



Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
Germany	 Industrial production M/M% (Y/Y%)	Dec	-3.0 (-0.7)	0.3 (2.5)	0.4 (2.2)	0.5 (2.3)
France	 Trade balance €bn	Dec	-3.4	-3.5	-4.4	-
UK	 BRC Sales like-for-like Y/Y%	Jan	-0.6	0.9	1.0	-
	 Halifax house price index M/M% (3M/Y%)	Jan	-0.9 (5.7)	0.0 (6.0)	1.7 (6.5)	1.6 (-)
Country	Auction					
Germany sold		€396mn of 0.1% 2046 index-linked bonds (15-Apr-2046) at an average yield of -0.48%				
UK sold		£3bn of 1.75% 2019 bonds (22-Jul-2019) at an average yield of 0.17%				
		BoE APF operation purchased £775mn of 15Y+ Gilts (4.08 cover ratio)				





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	GMT	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous
France	 07:30	Bank of France manufacturing sentiment indicator	Jan	103	102
Spain	 08:00	Industrial production M/M% (Y/Y%)	Dec	0.2 (2.8)	1.8 (3.2)






Auctions and events

Country	GMT	Auction / Event
Germany	 10:30	Auction: To sell €3bn of 0.25% 2027 bonds (15-Feb-2027)
UK	 09:30	BoE publishes Agents' Summary of Business Conditions
	 13:00	BoE's Cunliffe is scheduled to speak in Birmingham
	 14:50	BoE APF operation: To purchase 7-15Y Gilts



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's data releases

Economic data

Country	GMT	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous
Germany	 07:00	Trade balance €bn	Dec	20.5	22.7
	 07:00	Current account balance €bn	Dec	24.8	24.6
	 07:00	Imports (exports) M/M%	Dec	-1.1 (-1.3)	3.5 (3.9)
UK	 00:01	RICS house price balance %	Jan	22	24
	 15:00	BoE corporate bond purchases £bn	Weekly	-	6.1





Auctions and events

Country	GMT	Auction / Event
UK	 10:30	Auction: To sell £2.5bn of 1.5% 2047 bonds (22-Jul-2047)
	 18:30	BoE's Carney is scheduled to speak in London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <u>Daiwa forecast</u>	Previous	Revised
EMU	 ECB public sector asset purchases €bn	Weekly	17.3	17.5	16.9	-
Germany	 Factory orders M/M% (Y/Y%)	Dec	5.2 (8.1)	0.7 (4.2)	-2.5 (3.0)	-3.6 (2.0)
UK	 New car registrations Y/Y%	Jan	2.9	-	-1.1	-
Country	Auction					
UK	 BoE APF operation purchased £775mn of 3-7Y Gilts (3.22 cover ratio)					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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