

Euro wrap-up

Overview

- Bunds made losses and the euro appreciated to a new three-year high as Germany's largest political parties reached a preliminary agreement on a plan for coalition government.
- Gilts also made losses on a quiet end to the week for UK economic news.
- The coming week's dataflow includes euro area and UK inflation, euro area trade and UK retail sales reports.

Chris Scicluna
+44 20 7597 8326

Mantas Vanagas
+44 20 7597 8318

Daily bond market movements

Bond	Yield	Change*
BKO 0 09/19	-0.592	+0.009
OBL 0 10/22	-0.104	+0.026
DBR 0½ 08/27	0.525	+0.012
UKT 1¼ 07/19	0.595	+0.037
UKT 0½ 07/22	0.866	+0.044
UKT 4¼ 12/27	1.249	+0.033

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

Euro area

A step towards a new German government

In Germany, the preliminary coalition talks between Merkel's centre-right CDU, her CSU sister party, and the centre-left SPD had a happy ending: after an intense 24-hour negotiation, a breakthrough was achieved, making a significant, albeit certainly not yet conclusive, step towards the establishment of a new coalition government. On most issues, the parties appear to have compromised, splitting the difference between their respective positions. To appeal to the SPD, which had previously rejected the notion of another period of collaboration with Merkel, the agreement had a focus on "social cohesion", with policy proposals including extended childcare rights and reforms to health insurance contributions. A welcome increase in infrastructure investment and spending on education, while eschewing tax hikes on higher earners and without risking a budget deficit, would also be in the pipeline. To please the CDU and CSU, the deal also included tighter limits on refugee migration, including an annual cap on the number of migrants of between 180-220k. The agreement also paid lip-service to French President Macron's initiatives to strengthen the euro area, notably including support for a proposal to develop the ESM into a full-blown European Monetary Fund and work towards some form of common 'investment budget'. However, overall, the European and foreign policy agenda looked underwhelming – indeed, there is no agreed position on key issues such as completing Europe's banking union or Brexit.

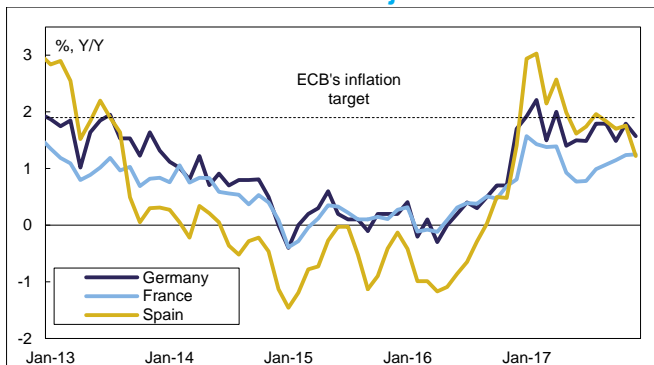
Forthcoming SPD votes crucial

Despite today's agreement, progression to formal negotiations is still far from guaranteed, with approval by SPD delegates required at a special convention on 21 January. Even if that hurdle is cleared, any final deal will have to be signed off in a vote by all party members. And, despite the inevitable warm tone from party leader Schultz as he presented the agreement, opposition within the SPD to any future cooperation with Merkel should not be underestimated. So, even under the assumption that SPD delegates vote next weekend to give a green light to formal negotiations, we might yet see more drama unfolding in German politics over coming weeks. And it appears unlikely that a new government will be in place before Easter.

The week ahead in the euro area and US

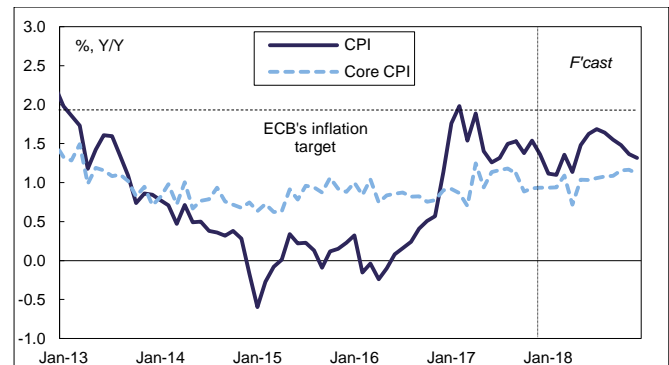
In the coming week, the most notable new data will be the final euro area inflation figures for December, due Wednesday. These appear a touch more interesting than might have been the case after today's French and Spanish figures showed downward revisions to the flash estimates, from 1.3%Y/Y to 1.2%Y/Y in both countries. This strongly suggests that a similar downward revision to the euro area headline rate from the preliminary estimate of 1.4%Y/Y, which represented a 0.1ppt

Euro area: CPI inflation* in major member states



*EU-harmonised measure. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: CPI inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



decline from November, is perfectly feasible. A downwards revision to the initial core CPI estimate of 0.9%Y/Y, however, seems less likely. The final Italian and German inflation estimates, due on Tuesday, will also be closely watched. Other euro area economic data releases in the coming week include November trade figures, which are expected to show a rebound in the surplus after a significant decline in October (Monday) and the balance of payments for the same month (Friday). Meanwhile, on Wednesday, alongside the inflation data, we will also receive December new car registration and November construction output data.
















In the US, following Monday's holiday for Martin Luther King Jr Day, the coming week's economic diary kicks off on Tuesday with the New York Fed manufacturing survey for January. The following day brings the December IP report – which is expected to report a fourth consecutive monthly increase in output – as well as the January NAHB housing index and the first Fed Beige Book for this year. On Thursday, the Philadelphia Fed's manufacturing survey for January will be released alongside December housing starts and building permits. The week will conclude with the University of Michigan's preliminary consumer survey results for January. Aside from economic data, the Q4 corporate reporting season will continue to heat up and there are a couple of speeches by Fed officials scheduled before the blackout period begins ahead of the 31 January FOMC meeting. In the bond market, the Treasury will auction 10-year TIPS on Thursday.

UK

The week ahead in the UK




The most notable UK economic data release in the coming week will be December's inflation report, due on Tuesday. While energy price inflation is set to increase further from 5.0%Y/Y in November, we expect that both headline and core rates will tick lower by 0.1ppt to 3.0%Y/Y and 2.6%Y/Y respectively. Away from inflation, the focus will be on the retail sales data due at the back end of the week. Major retailers reported mixed festive season results, and with the BRC survey suggesting that retail spending in nominal terms that month rose broadly in line with the average of the past year, December's sales appear to have been unimpressive: a decline on the month is expected after strong results in November, when Black Friday discounting helped to boost sales. Nevertheless, given that sales fell particularly sharply in December 2016, we will probably see the annual rate rising from 1.6%Y/Y in November. Among other major releases, alongside the inflation numbers on Tuesday, the ONS will release the UK House Price index for November, while Thursday brings the latest RICS Residential Market survey. Policy-wise, on Monday, BoE's Silvana Tenreiro will deliver her first speech since her appointment as an external member of the MPC last summer.

Daiwa economic forecasts

	2017		2018				2019		2017	2018	2019
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP forecasts %, Q/Q											
Euro area 	0.6	0.7	0.6	0.5	0.4	0.4	0.4	0.4	2.4	2.2	1.7
Germany 	0.8	0.8	0.7	0.6	0.5	0.5	0.5	0.5	2.6	2.6	2.0
France 	0.6	0.6	0.5	0.4	0.3	0.3	0.4	0.4	1.9	2.0	1.5
Italy 	0.4	0.4	0.3	0.2	0.3	0.3	0.3	0.3	1.6	1.3	1.1
Spain 	0.8	0.6	0.6	0.5	0.6	0.6	0.5	0.5	3.1	2.6	2.2
UK 	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	1.8	1.3	1.2
Inflation forecasts %, Y/Y											
Euro area											
Headline CPI 	1.4	1.4	1.2	1.4	1.6	1.4	1.3	1.3	1.5	1.4	1.4
Core CPI 	1.2	0.9	1.0	0.9	1.1	1.1	1.1	1.2	1.0	1.0	1.3
UK											
Headline CPI 	2.8	3.0	2.8	2.6	2.4	2.1	2.0	2.0	2.7	2.5	2.0
Core CPI 	2.6	2.6	2.6	2.2	2.1	2.0	1.9	2.0	2.4	2.2	1.9
Monetary policy											
ECB											
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25
Deposit Rate % 	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.25	-0.40	-0.40	0
Net asset purchases* 	60	60	30	30	30	5	0	0	60	5	0
BoE											
Bank Rate % 	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Net asset purchases** 	0	0	0	0	0	0	0	0	0	0	0


















*Monthly target €bn, end of period. **Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
France	 Final EU-harmonised CPI Y/Y%	Dec	1.2	<u>1.3</u>	1.2	-
Italy	 Industrial production M/M% (Y/Y%)	Nov	0.0 (2.2)	0.6 (3.3)	0.5 (3.1)	0.6 (3.0)
Spain	 Final EU-harmonised CPI Y/Y%	Dec	1.2	<u>1.3</u>	1.8	-
Auctions						
Country	Auction					
- Nothing scheduled -						







Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

Key data releases						
Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Monday 15 January 2018						
EMU		10:00 Trade balance €bn	Nov	22.3	19.0	
		14:45 ECB public sector asset purchases €bn	Weekly	<u>11.5</u>	2.5	
Tuesday 16 January 2018						
Germany		07:00 Final EU-harmonised CPI Y/Y%	Dec	1.7	1.8	
Italy		09:00 Final EU-harmonised CPI Y/Y%	Dec	1.0	1.1	
		10:00 Trade balance €bn	Nov	-	5.0	
UK		09:30 CPI (core CPI) Y/Y%	Dec	<u>3.0 (2.6)</u>	3.1 (2.7)	
		09:30 Input PPI (output PPI) Y/Y%	Dec	5.5 (2.9)	7.3 (3.0)	
		09:30 House price index Y/Y%	Nov	-	4.5	
Wednesday 17 January 2018						
EMU		07:00 EU27 new car registrations Y/Y%	Dec	-	5.9	
		10:00 Construction output M/M% (Y/Y%)	Nov	-	-0.4 (2.0)	
		10:00 Final CPI (final core CPI) Y/Y%	Dec	1.4 (0.9)	1.5 (0.9)	
Thursday 18 January 2018						
UK		00:01 RICS house price balance %	Dec	-	0	
Friday 19 January 2018						
EMU		09:00 Current account balance €bn	Nov	-	30.8	
Italy		09:30 Current account balance €bn	Nov	-	6.6	
Spain		09:00 Current account balance €bn	Nov	-	-2.5	
UK		09:30 Retail sales excluding petrol M/M% (Y/Y%)	Dec	-0.8 (2.9)	1.2 (1.5)	
		09:30 Retail sales including petrol M/M% (Y/Y%)	Dec	-0.8 (2.6)	1.1 (1.6)	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

Key events & auctions			
Country	GMT	Event / Auction	
Monday 15 January 2018			
UK		18:15	BoE's Tenreyro scheduled to speak in London
Tuesday 16 January 2018			
- Nothing scheduled -			
Wednesday 17 January 2018			
Germany		10:30	Auction: To sell €1.5bn of 1.25% 2048 bonds (15-Aug-2048)
Thursday 18 January 2018			
EMU		14:30	ECB's Couré scheduled to speak in Frankfurt
France		09:50	Auction: To sell 0% 2023 bonds (25-Mar-2023)
		09:50	Auction: To sell 0% 2021 bonds (25-Feb-2021)
		09:50	Auction: To sell 2.25% 2024 bonds (25-May-2024)
		10:50	Auction: To sell 0.25% 2024 index-linked bonds (25-Jul-2024)
		10:50	Auction: To sell 0.1% 2028 index-linked bonds (01-Mar-2028)
Spain		10:50	Auction: To sell 0.7% 2030 index-linked bonds (25-Jul-2030)
		09:30	Auction: To sell bonds
UK		10:30	Auction: To sell £2.5bn of 0.75% 2023 bonds (22-Jul-2023)
Friday 19 January 2018			
- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<http://www.uk.daiwacm.com/research-zone/research-blog>



Follow us
[@DaiwaEurope](https://twitter.com/DaiwaEurope)

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FCA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.