

Euro wrap-up

Overview

- Bunds made modest gains as the final December inflation figures from Germany and Italy confirmed their preliminary estimates.
- Gilts also made gains as core UK inflation eased by more than expected.
- Tomorrow's economic data focus will be on euro area inflation, construction output and car registration figures.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 09/19	-0.602	+0.011
OBL 0 10/22	-0.124	-0.002
DBR 0½ 08/27	0.500	-0.022
UKT 1¾ 07/19	0.582	-0.013
UKT 0½ 07/22	0.840	-0.016
UKT 4¾ 12/27	1.305	-0.018

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

Euro area

German and Italian figures point to no revision to euro area inflation

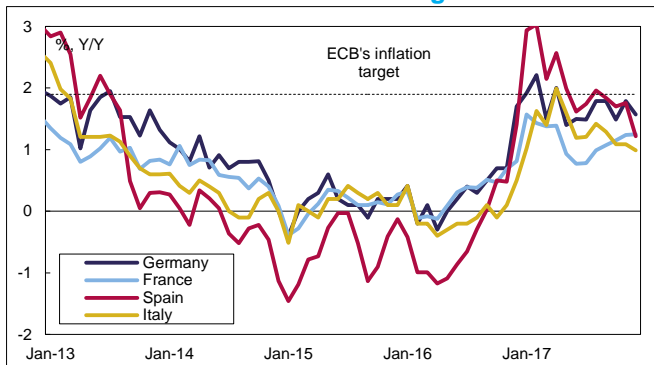
The only data releases of note in the euro area today were final December inflation figures from Germany and Italy. Last week we saw downward revisions to the equivalent French and Spanish numbers, but today's data did not bring any surprises. The preliminary estimate of 1.6%Y/Y, down from 1.8%Y/Y, was confirmed in Germany. And the figures showed that energy price inflation was one of the main factors driving inflation lower there that month, while core inflation on the national measure remained unchanged at 1.5%Y/Y. Similarly, today's Italian figures also reported an unchanged headline inflation rate, at 1.0%Y/Y, down from 1.1%Y/Y in November and the lowest since the start of the year. The Italian core rate, meanwhile, remained at 0.4%Y/Y. Nevertheless, while today's releases imply that we should get no revisions to the euro area inflation figures tomorrow, with the headline rate likely to be confirmed at 1.4%Y/Y, down from 1.5%Y/Y in November, the probability of a lower reading is certainly not fully eliminated. We are certainly more confident that the euro area core CPI rate will be left unrevised at 0.9%Y/Y.

The day ahead in the euro area and US

In addition to the euro area inflation figures tomorrow, we will also receive construction figures for the month of November. Growth in this sector was unimpressive for the large part of 2017 and in October output declined by -0.4%M/M. But we saw a particularly sharp increase in Germany in November, so despite slightly weaker French figures, we are likely to see euro area construction output rising tomorrow. Meanwhile, December car registration figures should also be worth watching tomorrow. In the second half of 2017, we saw increases in the range of 5-8.7%Y/Y and a pace of growth at the top end is expected for December.

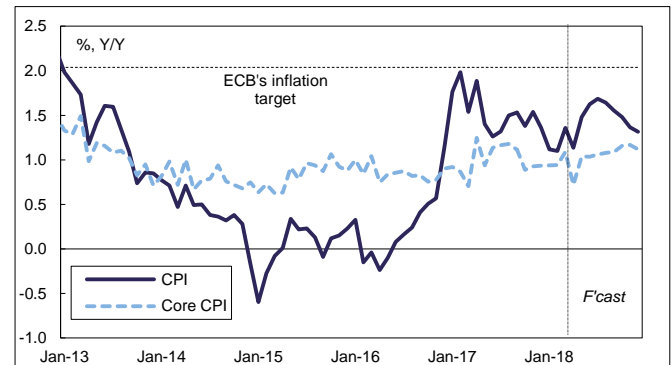
Wednesday brings perhaps the most notable US economic data release this week – December industrial production. With the latest business surveys from this sector having reported solid gains and factory employment also consistent with elevated activity, we are likely to see a fourth consecutive monthly increase in output, likely by a few tenths of a percent. Among other new data tomorrow, the latest NAHB housing index and the Beige book will also be worth watching, while speeches of regional Fed Presidents Evans, Kaplan and Mester could be interesting too.

Euro area: CPI inflation* in the large 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.



UK

Inflation passed its peak?

In line with our expectations, UK consumer prices rose by 3.0%Y/Y in December, down from the 3.1%Y/Y pace in November. Food and energy prices provided upward contributions. Rising motor fuel prices pushed energy inflation up to 5.5%Y/Y, a four-month high. And in line with the steep upward trends seen over 2017, food inflation rose by a 0.2ppt to 4.4%Y/Y, a level last seen more than four years ago, with alcohol and tobacco prices within this category being the main driver. So, the weakness was accounted for by other components, as reflected in a 0.2ppt drop in the core CPI rate to 2.5%Y/Y. While goods inflation remained stable, also at 2.5%Y/Y despite a negative effect from games and toys prices, services inflation fell 0.2ppt to the same rate. Within that category, air fares, the usual suspect for volatility around the festive season, provided the biggest downward contribution to the annual inflation rate – although they rose very sharply in December broadly in line with increases seen that month in previous years, their contribution was smaller due to their lower share in the CPI basket. Overall, today's data were consistent with our view that November represented the peak in the current inflation cycle, and going forward we will most likely see the headline rate easing steadily. The upward trend in oil prices should suggest that we are likely to see more support coming from energy CPI over the coming months than we previously expected. But looking beyond early spring, when the timing of Easter holidays this year will probably distort the smooth inflation profile, we forecast that both core and headline rates will fall gradually, with the latter set to reach a levels only marginally higher than the 2.0%Y/Y BoE target at the end of 2018.

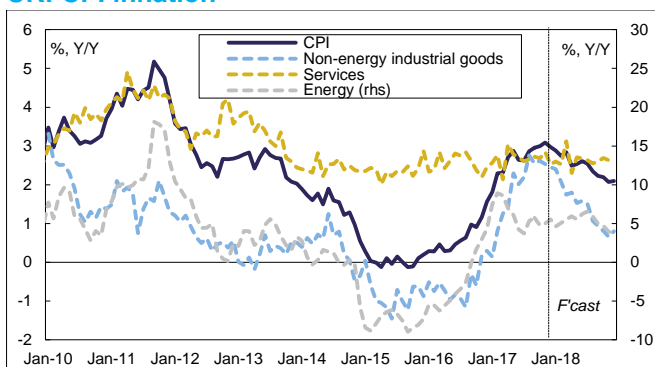
House prices continue to rise at a firm pace

The message from today's release of the UK House Price Index was a mixed one. While growth eased to 5.1%Y/Y in November, this occurred from the upwardly revised level of 5.4%Y/Y in the previous month, and so it remained broadly consistent with its average over the last six months and significantly higher than suggested by other similar housing market indicators in recent months. For example, the Rightmove asking prices index was up only 1.1%Y/Y in January, and the Nationwide indicator rose 2.5%Y/Y in December, both rates close to the bottom of their recent ranges. Meanwhile, the November surveyors' survey from the RICS indicated that sentiment on the market deteriorated further towards the end of last year, and we might see that the headline indicator for price pressures dipped below zero when the December survey is released later this week. So, given subdued consumer sentiment and falling real wages, the above-5% house price growth rate reported today looks surprisingly firm, and we expect it to ease gradually this year, despite the fact that falling consumer price inflation should give a bit more breathing space for households' budgets.

The day ahead in the UK

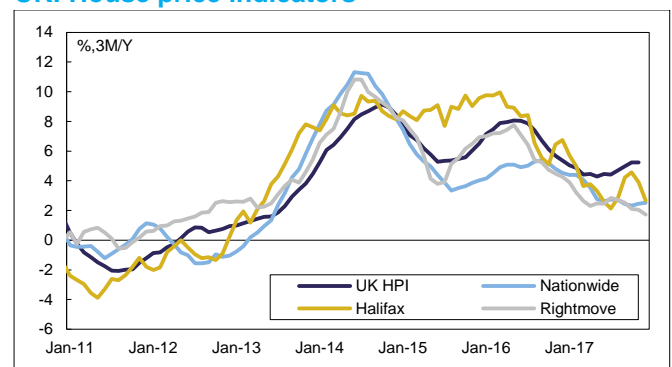
On a quiet day for new economic data releases, MPC member Michael Saunders is scheduled to speak tomorrow.

UK: CPI inflation









Source: Thompson Reuters and Daiwa Capital Markets Europe Ltd.

UK: House price indicators








Source: Thompson Reuters 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
Germany	 Final EU-harmonised CPI Y/Y%	Dec	1.6	1.6	1.8	
Italy	 Final EU-harmonised CPI Y/Y%	Dec	1.0	1.0	1.1	
	 Trade balance €bn	Nov	4.8	-	5.0	
UK	 CPI (core CPI) Y/Y%	Dec	3.0 (2.5)	<u>3.0 (2.6)</u>	3.1 (2.7)	
	 Input PPI (output PPI) Y/Y%	Dec	4.9 (3.3)	5.3 (2.9)	7.3 (3.0)	- (3.1)
	 House price index Y/Y%	Nov	5.1	4.2	4.5	5.4
Auctions						
Country	Auction					
- Nothing to report -						

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	 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	<u>1.4 (0.9)</u>	1.5 (0.9)	
Auctions						
Country	GMT	Auction / Event				
Germany	 10:30	Auction: To sell €1.5bn of 1.25% 2048 bonds (15-Aug-2048)				
UK	 11:45	BoE's Saunders scheduled to speak in London				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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