

# Euro wrap-up

## Overview

- Bunds were little changed ahead of the weekend's key vote by Germany's SPD on whether to move to formal negotiations on a coalition government.
- Gilts were little changed despite a downside surprise to the latest UK retail sales figures.
- The coming week's ECB meeting is likely to see no material change to policy, while notable new data include the first euro area economic surveys for January and UK GDP and labour market reports.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 09/19	-0.628	-0.014
OBL 0 10/22	-0.143	-0.014
DBR 0½ 08/27	0.503	-0.005
UKT 1¼ 07/19	0.567	-0.011
UKT 0½ 07/22	0.857	-0.001
UKT 4¼ 12/27	1.339	+0.010

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

## Euro area

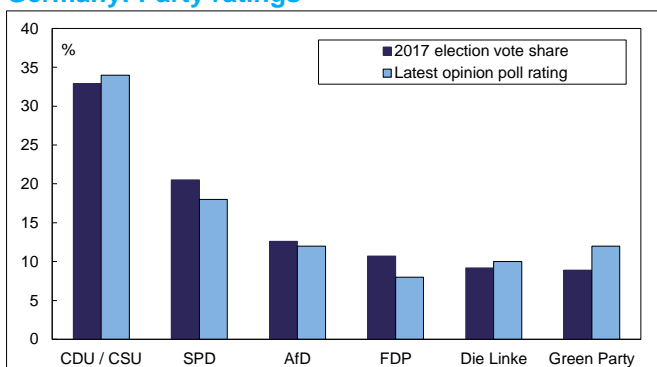
### GroKo to pass SPD hurdle?

All eyes on the weekend should be on Sunday's special party congress of delegates from Germany's Social Democrat Party (SPD), who will vote on whether to approve the start of formal negotiations with Chancellor Merkel's Christian Democrat Union (CDU) and its Bavarian sister party, the Christian Social Union (CSU) to establish a new Grand Coalition (GroKo). A week ago, preliminary coalition talks between the party leaders achieved a breakthrough with a deal that struck a broad compromise across a range of policies. Key elements included increased infrastructure investment and spending on education, some tax cuts, but also predictably a commitment to maintain a balanced government budget. In an attempt to please the SPD rank and file, there were commitments to extend childcare support and reforms to health insurance and pensions, while CDU and CSU members were supposed to take comfort in an agreement to set an annual cap on immigration. And encouragingly from a market perspective, the parties agreed to work with France on measures to strengthen the resilience of the euro area economy to shocks, notably including a willingness to develop the ESM into a full-blown European Monetary Fund and also develop some form of common budget. While perhaps still not sufficiently ambitious to minimise the euro area's economic and financial vulnerabilities, such policies would represent a significant step forward after a period whereby Germany represented an obstacle to further constructive integration within the euro area.

### Outcome difficult to predict with confidence

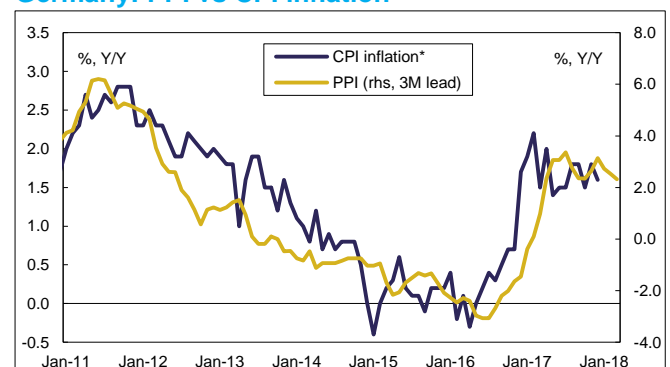
This weekend's vote is no done deal, however. While all three parties suffered their worst results since 1949 in September's general election, the SPD was most reluctant to rekindle the GroKo, with its leader Martin Schulz initially committing to a period out of government to try to rebuild the party, most likely around a more left-wing agenda. And while the collapse of Merkel's initial coalition talks with the Greens and Free Democrats led to a (seemingly reluctant) change of heart for Schulz, many party members – led by the Young Socialists – remain deeply opposed. In the past week, party executives from some smaller regions (Berlin, Saxony-Anholt and Thuringia) have voted to reject launching formal coalition talks, although several others (e.g. Lower Saxony) who will send larger delegations to Sunday's special congress have voted in favour. North Rhine-Westphalia – which will send almost one quarter of delegates – will not hold a vote at local level before Sunday, while others are set to decide their positions this evening. Those will probably determine the outcome one way or the other.

### Germany: Party ratings



Source: Forsa Institute poll for RTL (18 January 2018), Bundestag, and Daiwa Capital Markets Europe Ltd.

### Germany: PPI vs CPI inflation



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



But with the wider electorate appearing increasingly unimpressed – a poll published yesterday showed support for the SPD down to a new low of 18%, more than 2ppts lower than the party's miserable election tally – many of the delegates whose positions are currently undecided will likely eventually vote against. So, at the time of writing, the outcome of Sunday's vote appeared highly uncertain. If the GroKo deal is rejected, expect the euro to depreciate and euro area risk appetite to diminish on Monday morning. And even if it is approved, any final coalition deal would have to be confirmed in a further vote of all party members, the outcome of which – not least given the party's precarious poll ratings – would likewise be very difficult to predict.

### **ECB policy statement to be little changed**

Beyond the SPD party congress vote, the main event in the euro area over the coming week will be the outcome of the ECB's latest policy meeting on Thursday. The previous meeting in December was a relatively low-key one with little initial news emerging beyond the publication of the ECB's relatively upbeat updated economic forecasts. However, the subsequent publication of the account of the meeting shone some further light on the debate surrounding the ECB's guidance on future policy, which currently leaves open the possibility of additional asset purchases after September and foresees rates remaining at current levels well past the horizon of the net asset purchases. In particular, it raised the possibility of a change to the policy guidance early this year, as long as the economic data are favourable. That new language, presumably, would include a signal on what is likely to happen to the asset purchase programme once the current phase has been completed at the end of Q3, and it could also allude to expectations of how interest rates will be adjusted from next year on. We do not, however, expect the guidance to be changed at the coming meeting. Certainly, the Governing Council will remain upbeat about the outlook for economic growth. However, December's inflation data were again disappointingly weak, with core CPI unchanged at 0.9%Y/Y. And while higher oil prices will support inflation over the near term, the strengthening of the euro well above levels assumed in the ECB's forecasts has become a cause for concern among certain Governing Council members. So, while we expect most of the statement to be issued following the coming week's meeting to be little changed from that in December, we would not be surprised to see it repeat the wording used in September, i.e. that 'recent volatility in the exchange rate represents a source of uncertainty which requires monitoring with regard to its possible implications for the medium-term outlook for price stability'.

### **German inflation set to ease further**

Data-wise, consistent with the weaker German CPI figures released earlier this week, today's producer price numbers suggested that pipeline inflationary pressures diminished in the largest euro area member state last month. The headline index showed a third consecutive fall in producer price inflation, from 2.5%Y/Y to 2.3%Y/Y, matching the lowest level in 2017. Prices of consumer non-durables increased by 1.8%Y/Y, down from 2.4%Y/Y previously, while intermediate goods also showed a drop in inflation to 3.1%Y/Y. And while energy inflation ticked higher, to 3.1%Y/Y, its major subcategories showed diverging patterns: reflecting recent oil market developments, prices of petroleum products and electricity rose by 3.3%Y/Y and 5.3%Y/Y respectively, but natural gas prices showed a 4.1%Y/Y decline. Overall, with PPI inflation suggesting that cost-push pressures – at least for goods – are receding, these data support our expectation of a further moderation in the headline rate of German consumer price inflation at the start of this year.

### **The week ahead in the euro area and US**

In addition to the ECB policy announcement, in the coming week there will be no shortage of notable data releases, most of which will take the form of January economic sentiment surveys. Among them, Tuesday brings the flash European Commission consumer confidence indicator. Having risen to a sixteen-year high of 0.5 in December, this is expected to inch a touch higher again this month. Also due that day is the latest ZEW survey of investors. That, however, will be upstaged by the preliminary euro area PMIs, which are coming out on Wednesday. The euro area composite PMI index increased sharply at the end of 2017, to reach the highest level since early 2011, and we would not be surprised to see it moderate slightly. Nevertheless, the PMIs are set to remain very elevated by historical standards and consistent with rapid economic growth at the start of 2018. Thursday's dataflow will focus on Germany, with the GfK consumer confidence and Ifo business sentiment surveys due. We will be watching those to see if developments with respect to the formation of a new coalition government have had any impact on the German economy, one way or the other. The end of the working week on Friday will bring the latest French surveys, while the euro area bank lending figures for December from the ECB are also due. In the markets, Germany will sell 2Y bonds on Tuesday while Italy will sell zero-coupon and index-linked bonds on Friday.

In the US, on the assumption that a government shutdown is averted, the key day of the coming week data-wise will be Friday, which will bring the release of the advance estimate of Q4 GDP – likely to see growth come in close to the solid 3.2%Q/Q annualised pace in Q3 – and durable goods orders for December. Earlier in the week, December existing home sales and January's flash Markit PMI will be released on Wednesday. Advance goods trade and inventory reports are due on Thursday, together with December new home sales and the Conference Board's leading index for the same month. Aside from economic data, the Q4 corporate reporting season will gather pace. There are no Fed speeches scheduled with the Fed now in the blackout period ahead of the 31 January FOMC meeting. In the bond market, the Treasury will auction 2Y notes on Tuesday, 2Y FRNs and 5Y notes on Wednesday and 7Y notes on Thursday.

## UK

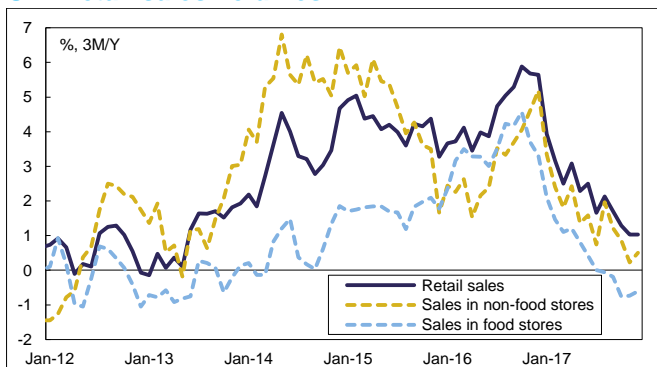
### No festive cheer on the high street

Official retail sales figures painted an even weaker picture of spending on the high street in the run-up to Christmas than reports from individual retailers and the BRC had suggested, with sales volumes slumping 1.5% M/M. After a (marginally revised) 1.0% M/M rise in November, a correction to some degree was inevitable in December. But in the event, the monthly decline was steeper than expected, and was the biggest December fall for seven years. The Office for National Statistics acknowledges that the rising popularity of “Black Friday” discounting in November (increasingly a multi-day event, despite the name) has shifted a significant part of festive spending earlier, and the seasonal adjustment process has almost certainly yet to fully catch up. Accordingly, this makes the monthly changes harder to interpret, and underscores that the 3M/3M rate remains the best guide to underlying trends. This rate slipped to 0.4% in December, down from 0.7% in November and 0.8% in Q3. Looking at the detail, food sales contracted slightly less (-1.1% M/M) than non-food sales (-1.3%), in line with anecdotal reports. Household goods sales were particularly hard-hit, falling by 5.3% M/M in December, signifying a reluctance by households to make big purchases. In 2017 as a whole, total retail sales registered growth of 1.9%Y/Y, the smallest expansion since 2013, suggesting that, burdened by Brexit uncertainty and squeezed real incomes, consumers have become increasingly cautious in their spending. The retail sales deflator remained unchanged at 3.1%Y/Y in December. While households are likely to remain the driving force of the UK economy, the indications are spending growth will remain subdued in 2018, supporting our forecast of full-year GDP growth slowing to 1.3%Y/Y, and our expectation of no change in Bank Rate.

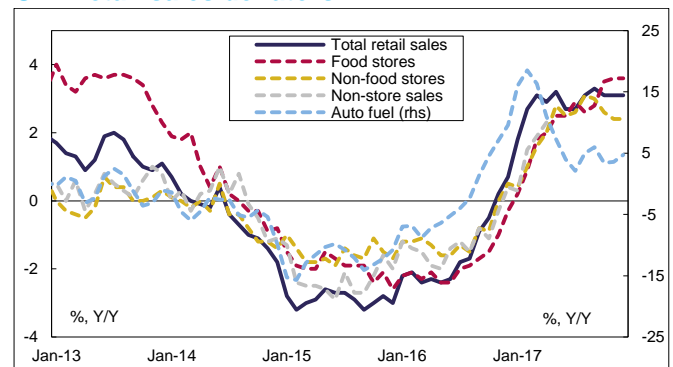
### The week ahead in the UK

In a busy week for UK data releases, the main event will be the first estimate of Q4 GDP on Friday. On the basis of the evidence to date, including the weak retail sales figures, we expect an expansion 0.4%Q/Q (1.4%Y/Y), a similar quarterly pace as Q3, which would leave full-year growth in 2017 in line with our estimate of 1.8%Y/Y. This preliminary release will be short on detail, although it is likely to confirm that the service sector expanded by 0.4%Q/Q in Q4, as it did in Q3. Surveys such as the PMI suggest that manufacturing may have outperformed again in Q4 (albeit not by as much as in the rest of the EU). Meanwhile, the latest labour market data on Wednesday may show that employment continued falling towards the end of the year, by 25k in the three months to November, less than the 56k reduction in October. And as additional evidence that activity in the labour market is losing momentum, the headline unemployment rate is set to have remained unchanged at 4.3% for a fourth consecutive month, having fallen by 0.4ppt over the first half of 2017. Average earnings growth is expected to have remained at 2.5% 3M/Y, below the rate of CPI inflation, and thus implying that real incomes continued to contract. Government borrowing figures on Tuesday are likely to show public net borrowing of around £5bn in December, an improvement on November’s reading due to the monthly pattern of tax receipts, which would leave borrowing on track to undershoot the latest OBR’s forecasts. The same day will see the release of the CBI Industrial Trends Survey, which may register manufacturing orders softening slightly after recent strength. Initial clues on the state of the housing market in 2018 will come with the release of figures on mortgage approvals by banks in December from UK Finance, out on Thursday.
















#### UK: Retail sales volumes



#### UK: Retail sales deflators








## Daiwa economic forecasts

	2017		2018				2019		2017	2018	2019
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
<b>GDP forecasts %, Q/Q</b>											
Euro area 	0.7	0.7	0.6	0.5	0.4	0.4	0.4	0.4	2.5	2.3	1.7
Germany 	0.8	0.8	0.7	0.6	0.5	0.5	0.5	0.5	2.6	2.7	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
<b>Inflation forecasts %, Y/Y</b>											
Euro area											
Headline CPI 	1.4	1.4	1.3	1.5	1.7	1.5	1.3	1.3	1.5	1.5	1.4
Core CPI 	1.2	0.9	1.0	0.9	1.1	1.2	1.2	1.3	1.0	1.0	1.3
UK											
Headline CPI 	2.8	3.0	2.8	2.5	2.4	2.1	2.0	2.0	2.7	2.5	2.0
Core CPI 	2.6	2.6	2.5	2.2	2.0	1.9	1.9	2.0	2.4	2.2	1.9
<b>Monetary policy</b>											
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/ Daiwa forecast	Previous	Revised
EMU 	Current account balance €bn	Nov	<b>32.5</b>	-	30.8	<b>30.3</b>
Italy 	Current account balance €bn	Nov	<b>4.8</b>	-	6.6	<b>6.4</b>
Spain 	Current account balance €bn	Nov	<b>-1.6</b>	-	-2.5	-
UK 	Retail sales excluding petrol M/M% (Y/Y%)	Dec	<b>-1.6 (1.3)</b>	-1.0 (2.6)	1.2 (1.5)	<b>1.1 (-)</b>
UK 	Retail sales including petrol M/M% (Y/Y%)	Dec	<b>-1.5 (1.4)</b>	-0.9 (2.6)	1.1 (1.6)	<b>1.0 (1.5)</b>
Auctions						
Country	Auction					
- Nothing to report -						











Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Yesterday's results

### Economic data




























Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
UK	 RICS house price balance %	Dec	8	-1	0	-

### Auctions

Country	Auction
France sold	 €2.7bn of 0% 2023 bonds (25-Mar-2023) at an average yield of 0.1%
	 €3.5bn of 0% 2021 bonds (25-Feb-2021) at an average yield of -0.24%
	 €1.3bn of 2.25% 2024 bonds (25-May-2024) at an average yield of 0.23%
	 €783mn of 0.25% 2024 index-linked bonds (25-Jul-2024) at an average yield of -1.12%
	 €377mn of 0.1% 2028 index-linked bonds (01-Mar-2028) at an average yield of -0.58%
Spain sold	 €585mn of 0.7% 2030 index-linked bonds (25-Jul-2030) at an average yield of -0.52%
	 €1.1bn of 0.45% 2022 bonds (31-Oct-2022) at an average yield of 0.324%
	 €1.4bn of 2.35% 2033 bonds (30-Jul-2033) at an average yield of 2.098%
UK sold	 €1.65bn of 2.9% 2046 bonds (31-Oct-2046) at an average yield of 2.691%
UK sold	 £2.5bn of 0.75% 2023 bonds (22-Jul-2023) at an average yield of 0.993%








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	
<b>Monday 22 January 2018</b>						
EMU		14:45 ECB public sector asset purchases €bn	Weekly	<u>10.0</u>	7.1	
<b>Tuesday 23 January 2018</b>						
EMU		10:00 ZEW expectations balance	Jan	-	29.0	
		15:00 Consumer confidence indicator	Jan	0.6	0.5	
Germany		10:00 ZEW current assessment balance (expectations)	Jan	89.5 (17.9)	89.3 (17.4)	
UK		09:30 Public sector net borrowing excluding interventions £bn	Dec	5.0	8.7	
		11:00 CBI Industrial Trends survey, total orders	Jan	12	17	
<b>Wednesday 24 January 2018</b>						
EMU		09:00 Preliminary manufacturing PMI	Jan	60.3	60.6	
		09:00 Preliminary services PMI (preliminary composite PMI)	Jan	56.4 (57.9)	56.6 (58.1)	
Germany		08:30 Preliminary manufacturing PMI	Jan	53.0	63.3	
		08:30 Preliminary services PMI (preliminary composite PMI)	Jan	55.5 (58.5)	55.8 (58.9)	
France		08:00 Preliminary manufacturing PMI	Jan	58.6	58.8	
		08:00 Preliminary services PMI (preliminary composite PMI)	Jan	58.9 (59.2)	59.1 (59.6)	
UK		09:30 Average earnings (excl. bonuses) 3M/Y%	Nov	<u>2.5 (2.4)</u>	2.5 (2.3)	
		09:30 ILO unemployment rate 3M%	Nov	<u>4.3</u>	4.3	
		09:30 Employment change 3M/3M '000s	Nov	<u>-25</u>	-56	
		09:30 Claimant count rate % (change 000s)	Dec	-	2.3 (5.9)	
<b>Thursday 25 January 2018</b>						
EMU		12:45 ECB refinancing rate %	Jan	<u>0.0</u>	0.0	
		12:45 ECB deposit rate %	Jan	<u>-0.4</u>	-0.4	
Germany		07:00 GfK consumer confidence survey	Feb	10.8	10.8	
		09:00 Ifo business climate index	Jan	117.0	117.2	
		09:00 Ifo current assessment balance (expectations)	Jan	125.3 (109.2)	125.4 (109.5)	
UK		09:30 UK Finance mortgage approvals '000	Dec	39.8	39.5	
		11:00 CBI Distributive Trades survey, retail sales	Jan	13	20	
<b>Friday 26 January 2018</b>						
EMU		09:00 M3 money supply Y/Y%	Dec	4.9	4.9	
France		07:45 Manufacturing confidence (production outlook)	Jan	106 (-)	105 (30)	
		09:30 GDP – first release Q/Q% (Y/Y%)	Q4	<u>0.4 (1.4)</u>	0.4 (1.7)	
		09:30 Index of services M/M% (3M/3M%)	Nov	0.2 (0.4)	0.2 (0.3)	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's events/auctions calendar

Key events & auctions			
Country	GMT	Event / Auction	
<b>Monday 22 January 2018</b>			
- Nothing scheduled -			
<b>Tuesday 23 January 2018</b>			
Germany		10:30	Auction: To sell €5bn of 0% 2019 bonds (13-Dec-2019)
UK		10:30	Auction: To sell £1.0bn of 0.125% 2026 index-linked bonds (22-Mar-2026)
<b>Wednesday 24 January 2018</b>			
- Nothing scheduled -			
<b>Thursday 25 January 2018</b>			
EMU		13:30	Draghi holds a press conference after a rate announcement
<b>Friday 26 January 2018</b>			
EMU		09:00	ECB publishes Survey of Professional Forecasters
		10:00	ECB's Cœuré scheduled to speak in Davos
Italy		10:00	Auction: To sell bonds
UK		14:00	BoE's Carney scheduled to speak in Davos

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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