

# Euro wrap-up

## Overview

- Bunds followed USTs lower despite a marked drop in euro area inflation.
- Gilts also made significant losses despite the latest PMIs suggesting that UK GDP growth slowed in Q4.
- The coming week brings data on euro area retail sales, UK GDP, German and French IP as well as euro area economic sentiment, while the UK parliament will start debating Brexit again.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-0.599	+0.014
OBL 0 10/23	-0.349	+0.037
DBR 0¼ 08/28	0.204	+0.052
UKT 2 07/20	0.747	+0.041
UKT 0¼ 07/23	0.885	+0.060
UKT 1½ 10/28	1.266	+0.073

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

## Euro area

### Downside surprise to flash CPI sets tone for the New Year

Today's flash estimate of euro area inflation in December surprised on the downside, with the headline CPI rate declining 0.4ppt – the most in nineteen months – to 1.6%Y/Y, the lowest since April. The drop was almost entirely due to weaker energy inflation, which fell a hefty 3.6ppts to an eight-month low of 5.5%Y/Y. Food inflation was very slightly softer, edging down to a ten-month low of 1.8%Y/Y. In contrast, inflation of services (1.3%Y/Y) and non-energy industrial goods (0.4%Y/Y) was unchanged. So, the main core CPI rate was also unchanged at 1.0%Y/Y, matching the average of the past two years and hence stubbornly inconsistent with the ECB's aim of achieving a self-sustainable rise in underlying inflation. Given the striking loss of economic momentum of recent quarters – highlighted again in today's final December services and composite PMIs discussed below – we expect core inflation to continue to oscillate around 1.0%Y/Y over the coming couple of quarters. And, in light of the recent step down in the oil price, headline inflation looks set to take another big step down and remain lower throughout 2019. We forecast a further drop in the annual CPI rate to 1.2%Y/Y this month and an average rate of just 1.0%Y/Y this year. That's well below the ECB's 2019 projection of 1.6%Y/Y, and in our view too low to allow the Governing Council to start raising rates, particularly as GDP growth also looks set to disappoint its expectation.

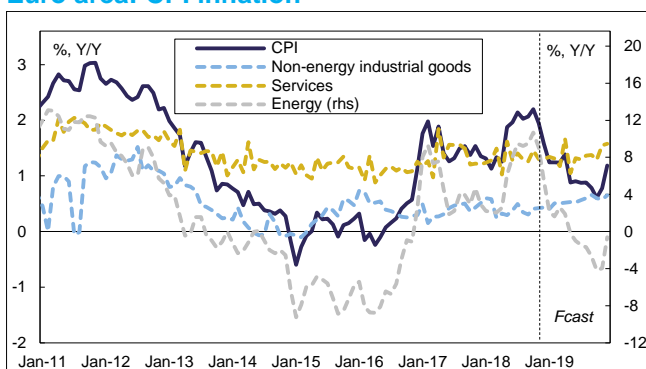
### Services end year on a particularly weak note

Indeed, the final services PMIs for December were even weaker than previously thought, suggesting a sharp slowdown in the sector at the end of 2018. The euro area services activity PMI was revised down 0.2pt from the flash to 51.2, the weakest reading in five years and 2.2pts lower than in November to represent the biggest monthly drop in more than six years. Among the member states, the German headline services PMI was revised down 0.7pt from the flash to a very subdued 51.8, 1.5pt lower than in November and the worst since July 2013. And with economic activity hindered by the Gilets Jaunes protests, the equivalent French index was revised 0.6pt lower to a very weak 49.0, the lowest in more than four years and down more than 6pts on the month, the most since 2011. At least the Italian services PMI rose 0.2pt, albeit to a still-sluggish 50.5, while Spain's remained unchanged at a more respectable 54.0.

### PMIs suggest GDP growth well below the ECB's projection

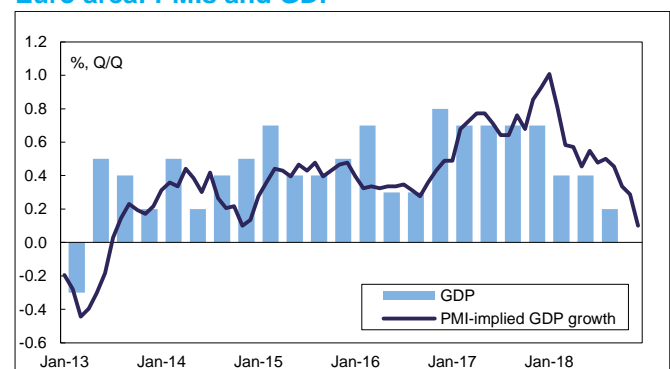
With the euro area manufacturing output PMI earlier this week having been left unchanged from the underwhelming preliminary estimate of 51.0, today's final services indices saw the composite PMI revised down to 51.1, 1.6pts lower than in November and the worst reading since November 2014. The equivalent German index was revised down to 51.6, the lowest

### Euro area: CPI inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: PMIs and GDP



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



in more than five years, with the French composite PMI revised down to a four-year low of 48.7, firmly in contractionary territory for the first time in more than two years. Spain's composite PMI fell to a three-month low of 53.4 while Italy's edged up to a three-month high of 50.0. Looking at the quarter as a whole, the PMIs suggest euro area GDP growth of less than 0.3%Q/Q in the final quarter of the year (compared to the ECB's central forecast of 0.4%Q/Q), similarly subdued expansion in Germany and France, and the risk of recession in Italy. With the euro area composite new orders PMI down in December to a four-year low of just 50.7, they also suggest continued sub-par GDP growth over the near term, well down on the rates of 0.5%Q/Q from Q1 to Q3 projected by the ECB. And with the input and output price PMIs down to their lowest levels in more than a year, the surveys point to dissipating pipeline inflation pressures heading into 2019 too.

## The week ahead in the euro area and US

The coming week is set to be a relatively busy one for euro area economic data, with several reports due on the strength of activity in November and sentiment in December. Monday kicks off with euro area retail sales figures for November, which look set to show a second successive monthly increase which would also point to positive growth in consumer spending over Q4 as a whole. Monday also brings German factory order figures for the same month, ahead of the related industrial production report the following day: we expect a rebound in production (excluding construction) following two successive monthly declines. The European Commission's economic sentiment survey results for December are also due Tuesday: not least given the significant drop in consumer confidence to a twenty-two-month low flagged in its flash estimate, we expect the headline Economic Sentiment Index to decline for a twelfth successive month to the lowest level since March 2017. Wednesday brings unemployment data for November, with the headline euro area rate having remained unchanged at 8.1% since July in a further sign of slowing economic momentum. German goods trade figures for the same month and the INSEE French consumer confidence survey for December are also due that day. French industrial production figures for the previous month are due Thursday while the week will end with the equivalent Italian and Spanish IP data and the Bank of France business survey for December. ECB speakers will include Vice President De Guindos on Monday and Bank of France Governor (and possible next ECB President) De Galhau on Friday. In the markets, finally, Germany will sell 2030 inflation-linked bonds on Tuesday, and 10Y Bunds the following day. France will sell a range of bonds on Thursday while Italy will sell 3Y and 7Y BTPs on Friday.

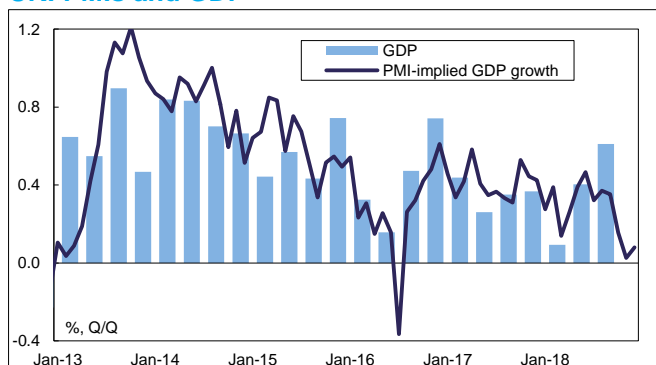
In the US, what should have been a busy week for economic releases looked set, at the time of writing, to be disrupted once again by the federal government shutdown. Scheduled releases that should be unaffected, however, include the December non-manufacturing ISM survey on Monday, the December NFIB small business sentiment survey and November JOLTS job openings figures the following day, and the minutes from the December's FOMC meeting on Wednesday. The usual weekly claims numbers are due on Thursday, while December's CPI report is due on Friday. The headline CPI is expected to drop slightly due not least to falling fuel prices, which would likely push its annual rate back below 2.0%Y/Y. Core CPI, however, is currently expected to post another increase of 0.2%M/M to leave the respective annual rate unchanged at 2.2%Y/Y. Final factory orders figures (Monday) and the latest federal budget statement (Friday) risk postponement from the shutdown. By the same token, trade, inventory, home sales and construction data – all postponed from the past couple of weeks – could be published in the event of a deal to resolve the shutdown. Meanwhile, there are plenty of Fed policymakers set to speak publicly, with Chair Powell set to address the Economic Club of Washington on Thursday. Finally, in the bond market, the Treasury will auction 3Y notes on Tuesday, 10Y notes on Wednesday and 30Y bonds on Thursday.

## UK

### PMIs imply minimal growth in Q4

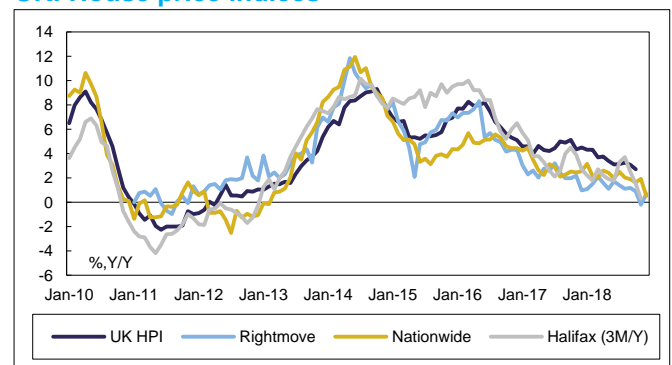
The manufacturing and construction PMIs, released the past couple of days, provided a mixed picture of business sentiment at the end of the year. On the whole, however, we took a downbeat message from them, not least as the boost to manufacturing

#### UK: PMIs and GDP



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

#### UK: House price indices



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

activity mainly reflected stock building ahead of a possible no-deal Brexit. And today's services PMIs also provided little to cheer. While the headline index rose 0.8pt from a twenty-eight month low to 51.2, that level was still well below readings in Q318 and last year's average. Within the detail, outstanding business activity continued to shrink, with the relevant index remaining below 50 for a third consecutive month, while new business and employment rose only marginally, with survey respondents citing Brexit-related challenges as well as weaker consumer demand as the main headwinds. And, overall, December's PMIs were consistent with little improvement in economic conditions at the end of the year. While the composite PMI rose 0.6pt, the reading of 51.4 was the second lowest since the Brexit referendum. And a mechanistic interpretation of all three PMI surveys together suggests an increase in GDP of only 0.1%Q/Q in Q4, which would represent a sharp slowdown from the 0.6%Q/Q pace in Q3.

### Retail price inflation edged up in December

The composite PMIs also suggested somewhat stronger inflationary pressures in the UK, with the output prices PMI index rising to 54.1, the highest level in six months. And today's release of the BRC Shop Price index of retail prices brought a similar message. Despite the drop in fuel prices, which would have reduced distribution costs, after returning to positive territory in November the BRC's measure of High Street inflation rose further at the end of the year to 0.3%Y/Y, the highest since April 2013. Food inflation inched down to 1.5%Y/Y, a level in line with the average for 2018 as a whole. But prices in the non-food category fell only 0.4%Y/Y – a significant improvement from the 2½%Y/Y decline seen around mid-year, perhaps in part due to the recent weakening of sterling. Although reports this week pointed to a broadly satisfactory showing over the festive period from key retailers John Lewis and Next, overall consumer demand appears to have softened. And with consumer confidence having deteriorated since the end of the summer, we still think that price pressures on the High Street will weaken in the near term.

### Housing market deteriorates
















Sentiment in the UK housing market seems to have taken a turn for the worse towards the end of the year. Today's release by Nationwide suggested that in December UK house prices declined by 0.7%M/M. As such, compared to a year ago the average home price was up only 0.5%Y/Y, the slowest pace of growth since February 2013. Meanwhile, BoE lending figures also signalled weaker housing market momentum in November. For example, households secured only £3.5bn of net new mortgage lending in November, a notable drop from readings around £4bn in the previous two months, and mortgage approvals for house purchase dropped by 3k to 66.7k, the lowest since April, signalling weaker activity ahead. With regard to unsecured lending, the figures were even weaker, with net new consumer credit remaining below £1bn for a third consecutive month, down from an average of £1.5bn in the first half of the year. And compared to a year ago, the stock of consumer credit was 7.1%Y/Y higher, the weakest pace since March 2015. Looking ahead, we do not expect conditions in the housing market or consumer willingness to borrow and spend to improve significantly until near-term Brexit uncertainty has been resolved.

### The week ahead in the UK

The focus in the coming week will shift back to politics and Brexit. Having aborted her plan to hold the parliamentary 'meaningful vote' in December in the face of mass opposition among MPs to her deal, Theresa May promised that parliament will have its say in the third week of January. Ahead of that vote, currently expected on 15 or 16 January, MPs should re-start debating the deal again in the second half of the coming week. But in the absence of a sudden concession from the EU (which appears highly unlikely to emerge), there currently seems little reason to believe that a majority in favour of May's plan will suddenly emerge. Before then, MPs could vote on a proposed amendment to the finance bill that seeks to grant parliament powers to stop a no-deal Brexit.







Data-wise, the first half of the week should be relatively quiet. New car registrations data, due on Monday, and the BRC retail sales monitor, due on Wednesday, will provide more information about consumer spending at the end of the year. But Friday's release of monthly output indicators for November will be most notable. We expect only a small increase in GDP, likely of 0.1%M/M, which would be an unchanged reading from October with manufacturing and construction output stronger but services activity slowing. The November trade figures will probably show a modest reduction in the large deficit.

## Daiwa economic forecasts

	2018				2019				2018	2019	2020
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
<b>GDP forecasts %, Q/Q</b>											
Euro area 	0.4	0.4	0.2	0.2	0.3	0.3	0.3	0.3	1.8	1.1	1.1
Germany 	0.4	0.5	-0.2	0.3	0.3	0.3	0.3	0.3	1.5	1.1	1.2
France 	0.2	0.2	0.4	0.2	0.3	0.3	0.3	0.3	1.5	1.1	0.9
Italy 	0.3	0.2	-0.1	0.0	0.1	0.2	0.1	0.2	0.9	0.3	0.5
Spain 	0.6	0.6	0.6	0.5	0.5	0.4	0.4	0.4	2.5	1.9	1.6
UK 	0.1	0.4	0.6	0.2	0.2	0.2	0.3	0.3	1.4	1.1	1.1
<b>Inflation forecasts %, Y/Y</b>											
Euro area											
Headline CPI 	1.3	1.7	2.1	1.9	1.2	1.1	0.8	0.9	1.7	1.0	1.4
Core CPI 	1.0	0.9	1.0	1.0	1.0	1.0	1.1	1.1	1.0	1.1	1.3
UK											
Headline CPI 	2.7	2.4	2.5	2.3	2.0	2.0	1.7	1.7	2.5	1.8	1.9
Core CPI 	2.5	2.0	2.0	1.9	1.9	2.0	2.0	2.0	2.1	2.0	2.0
<b>Monetary policy</b>											
<b>ECB</b>											
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	-0.40	-0.40	-0.40	0.00
Net asset purchases* 	30	30	30	15	0	0	0	0	15	0	0
<b>BoE</b>											
Bank Rate % 	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	0.75	1.00	1.25
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
EMU 	Final services PMI (final composite PMI)	Dec	<b>51.2 (51.1)</b>	51.4 (51.3)	53.4 (52.7)	-
	PPI Y/Y%	Nov	<b>4.0</b>	4.2	4.9	-
	Preliminary CPI (core CPI) Y/Y%	Dec	<b>1.6 (1.0)</b>	<u>1.7 (1.0)</u>	2.0 (1.0)	-
Germany 	Final services PMI (final composite PMI)	Dec	<b>51.8 (51.6)</b>	52.5 (52.2)	53.3 (52.3)	-
	Unemployment change 000s (rate%)	Dec	<b>-14 (5.0)</b>	-13 (5.0)	-16 (5.0)	-
France 	Preliminary EU-harmonised CPI Y/Y%	Dec	<b>1.9</b>	2.0	2.2	-
	Final services PMI (final composite PMI)	Dec	<b>49.0 (48.7)</b>	49.7 (49.4)	55.1 (54.2)	-
Italy 	Services PMI (composite PMI)	Dec	<b>50.5 (50.0)</b>	50.1 (49.3)	50.3 (49.3)	-
	Preliminary EU-harmonised CPI Y/Y%	Dec	<b>1.2</b>	1.4	1.6	-
Spain 	Services PMI (composite PMI)	Dec	<b>54.0 (53.4)</b>	53.7 (53.7)	54.0 (53.9)	-
UK 	BRC Shop price index Y/Y%	Dec	<b>0.3</b>	-	0.1	-
	Nationwide house price index M/M% (Y/Y%)	Dec	<b>-0.7 (0.5)</b>	0.1 (1.5)	0.3 (1.9)	<b>0.4 (-)</b>
	Net consumer credit (net mortgage lending) £bn	Nov	<b>0.9 (3.5)</b>	1.0 (4.0)	0.9 (4.1)	<b>0.8 (-)</b>
	Mortgage approvals 000's	Nov	<b>63.7</b>	66.0	67.1	<b>66.7</b>
	Services PMI (composite PMI)	Dec	<b>51.2 (51.4)</b>	50.7 (50.8)	50.4 (50.7)	<b>- (50.8)</b>
Country	Auction	- Nothing to report -				











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 07 January 2019</b>						
EMU		10:00	Retail sales M/M% (Y/Y%)	Nov	0.2 (0.4)	0.3 (1.7)
Germany		07:00	Factory orders M/M% (Y/Y%)	Nov	-0.1 (-2.7)	0.3 (-2.7)
		07:00	Retail sales M/M% (Y/Y%)	Nov	0.4 (-0.4)	0.1 (5.0)
UK		09:00	New car registration Y/Y%	Dec	-	-3.0
<b>Tuesday 08 January 2019</b>						
EMU		10:00	Economic sentiment indicator	Dec	108.2	109.5
		10:00	Services (industrial) confidence	Dec	12.3 (3.0)	13.3 (3.4)
		10:00	Final consumer confidence indicator	Dec	-6.2	-3.9
Germany		07:00	Industrial production M/M% (Y/Y%)	Nov	0.3 (-0.8)	-0.5 (1.6)
France		07:45	Trade (current account) balance €bn	Nov	-5.0 (-)	-4.1 (-0.7)
UK		08:30	Halifax house price index M/M% (3M/Y%)	Dec	0.5 (0.4)	-1.4 (0.3)
<b>Wednesday 09 January 2019</b>						
EMU		10:00	Unemployment rate%	Nov	8.1	8.1
Germany		07:00	Trade balance €bn	Nov	18.9	18.9
		07:00	Current account balance €bn	Nov	24.8	15.9
		07:00	Exports (imports) M/M%	Nov	-0.5 (0.0)	0.9 (0.8)
France		07:45	INSEE consumer confidence indicator	Dec	90	92
Italy		09:00	Unemployment rate%	Nov	10.5	10.6
<b>Thursday 10 January 2019</b>						
France		07:45	Industrial production M/M% (Y/Y%)	Nov	0.2 (-0.2)	1.2 (-0.7)
		07:45	Manufacturing production M/M% (Y/Y%)	Nov	0.4 (-)	1.4 (-1.3)
UK		00:01	BRC Like-for-like sales Y/Y%	Dec	-0.3	-0.5
<b>Friday 11 January 2019</b>						
France		07:30	Bank of France industrial sentiment indicator	Dec	100	101
Italy		09:00	Industrial production M/M% (Y/Y%)	Nov	-0.3 (0.4)	0.1 (1.0)
Spain		09:00	Industrial production M/M% (Y/Y%)	Nov	0.2 (0.0)	1.2 (0.8)
UK		09:30	Monthly GDP estimate M/M%	Nov	<u>0.1</u>	0.1
		09:30	Industrial production M/M% (Y/Y%)	Nov	0.3 (-0.6)	-0.6 (-0.8)
		09:30	Manufacturing production M/M% (Y/Y%)	Nov	0.4 (-0.7)	-0.9 (-1.0)
		09:30	Construction output M/M% (Y/Y%)	Nov	0.2 (2.5)	-0.2 (3.8)
		09:30	Services activity M/M% (3M/3M%)	Nov	0.1 (0.2)	0.2 (0.3)
		09:30	Trade balance (goods trade balance) £bn	Nov	-2.8 (-11.4)	-3.3 (-11.9)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's events/auctions calendar

Key events & auctions			
Country	GMT	Event / Auction	
<b>Monday 07 January 2019</b>			
EMU	 12:45	ECB's Guindos scheduled to speak in Riga, Latvia	
<b>Tuesday 08 January 2019</b>			
Germany	 10:30	Auction: to sell €500mn of 0.5% 2030 index-linked bonds (15-Apr-2030)	
UK	 10:30	Auction: to sell £2.25bn of 1.625% 2028 bonds (22-Oct-2028)	
<b>Wednesday 09 January 2019</b>			
Germany	 10:30	Auction: to sell €4bn of 2029 bonds (15-Feb-2029)	
<b>Thursday 10 January 2019</b>			
EMU	 12:30	ECB publishes an account of the Governing Council meeting in December	
France	 09:50	Auction: to sell 0.75% 2028 bonds (25-Nov-2028)	
	 09:50	Auction: to sell 1.25% 2034 bonds (25-May-2034)	
	 09:50	Auction: to sell 2% 2048 bond (15-May-2048)	
	 17:30	Bank of France governor Francois Villeroy de Galhau scheduled to speak in Luxembourg	
<b>Friday 11 January 2019</b>			
Italy	 10:00	Auction: to sell bonds	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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