

# Euro wrap-up

## Overview

- Bunds made minimal gains as data confirmed a plunge in euro area industrial production in November.
- Gilts made modest losses as a letter of new reassurances from the EU to the UK on Brexit appeared unlikely to change materially the outcome of Tuesday's Parliamentary meaningful vote.
- Tuesday brings data on German GDP and euro area goods trade, as well as the UK Parliament's meaning vote on Brexit.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-0.593	-0.012
OBL 0 10/23	-0.362	-0.011
DBR 0¼ 02/29	0.231	-0.007
UKT 2 07/20	0.826	+0.012
UKT 0¼ 07/23	0.963	+0.011
UKT 1½ 10/28	1.303	+0.012

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

## Euro area

### Biggest drop in industrial output since early 2016

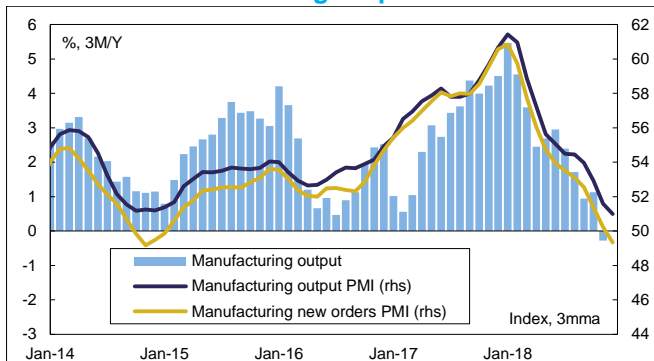
With each of the four largest member states having last week reported declines in industrial production well in excess of 1%M/M, there was no surprise when today's euro area figures revealed a drop of 1.7%M/M, which represented the sharpest fall since February 2016. Following an increase of just 0.1%M/M the previous month, today's figure left industrial production down 3.3%Y/Y at its lowest level since June 2017. Every component of production fell in November, for example with output of capital goods down 2.3%M/M, the most since February, and output of consumer durables down 1.7%M/M, the most since April. Production of energy fell for the third successive month, down 0.6%M/M. The extent of the decline in November relates partly to special factors, including the timing of the All Saints Day holiday, and so we expect production to rebound somewhat in December. Nevertheless, the average level of production in October and November was 0.7% below the Q3 average. And with survey indicators for December remaining weak – the manufacturing output PMI rose just 0.3ppt from the previous month's five-year low to a still-subdued 51.0 while the new orders PMI fell to a four-year low of 48.8 – the sector is highly likely to have subtracted from economic growth in the fourth quarter of 2018. And with no signs of acceleration in either domestic or external demand over the near term, industrial production looks set to be subdued in the current quarter too.

### The day ahead in the euro area and US

Tuesday will bring a preliminary full-year German GDP growth figure for 2018 along with an estimate of the government budget surplus – consistent with our forecast of a modest rebound of 0.2%Q/Q in Q4, we expect the figures to show full-year GDP growth of 1.5% down from 2.2% in 2017. November's euro area goods trade data are also due, as are final French and Spanish inflation numbers for December for which the flash estimates posted declines of 0.3ppt and 0.5ppt respectively to 1.9%Y/Y and 1.2%Y/Y.

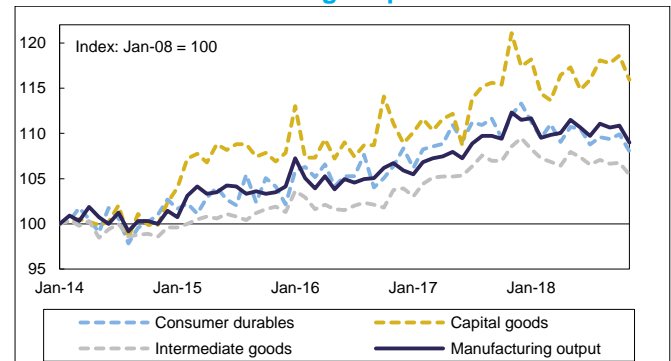
In the US, the week's economic dataflow gets underway with the Empire Manufacturing survey for January and December PPI figures.

### Euro area: Manufacturing output and PMI



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

### Euro area: Manufacturing output



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

## UK

### May on track for defeat despite new EU assurances

Ahead of Tuesday evening's crucial 'meaningful vote' in the House of Commons, all indications were that Theresa May remained firmly on track for defeat, perhaps of record proportions for any UK government. That was despite a letter from Commission President Juncker and Council President Tusk seeking to provide new reassurances to the UK on the Withdrawal Agreement and Political Declaration. In particular, the two leaders insisted that any recourse to the controversial Irish backstop arrangements after the transition period ended would be 'temporary' with alternative arrangements put in place 'as quickly as possible'. As such, they committed to reconsider technological solutions to achieving a frictionless border in Ireland. If the end-2020 target for a new trade agreement was not achieved, they committed to redouble efforts to try to conclude 'a subsequent agreement very rapidly' thereafter. And once a trade deal had been agreed, they would also be prepared to apply certain parts of the future relationship provisionally prior to full ratification. Meanwhile, acknowledging that the Withdrawal Agreement had stronger legal force than the Political Declaration, they noted that there was a legal connection between the two and also that the December European Council conclusions, which had also made assurances to the UK, had 'legal value' too.

Overall, the letter has changed little. Most importantly, the draft Withdrawal Agreement and Irish backstop remain intact, and so the minds of few MPs are likely to have been swayed by the new commitments. Indeed, May suffered yet another resignation from her Government today as party whip Gareth Johnson quit and insisted he would vote against her Brexit deal. In addition, the Westminster leader of the Northern Irish DUP stated that the letter reinforced the concerns of the party, upon whose MPs May relies for her majority and whose opinions on the backstop are followed by many Conservative MPs. Reports today also suggested that confirmation of the defeat for May's deal in tomorrow evening's vote could well be followed by further resignations from May's Government and new initiatives from the various Parliamentary factions on all sides of the debate.

### The day ahead in the UK

All eyes, of course, will be on the meaningful vote tomorrow evening. The Parliamentary debate will conclude with a speech from Theresa May before MPs vote. Votes on various amendments selected by the Speaker, some of which (such as one which rejects both May's deal and no deal, and others that would be consistent with a Norway-plus mode for the future relationship) should be closely watched, come from about 7pm UK time. If May's deal is still intact, the key vote will likely come sometime between 8 and 9pm.


It is still highly uncertain what May's strategy will be in the event of defeat tomorrow. She will be pressed to give an early indication of her planned next steps, perhaps as soon as tomorrow evening or at Prime Ministers' Questions in the House of Commons the following day. And the Government's loss in a vote last week specifies that, in the event of defeat, May will have to submit a statement to Parliament on her intended next steps by close of business next Monday. Much might depend on the size of defeat, which could indicate whether or not it is worth her seeking to resume talks with the EU to try to find a new way forward. In the event of a very heavy loss (200 votes or more), May is bound to face immediate calls to resign, and the responses of the various Parliamentary factions to try to wrest control of the Brexit process could come swiftly after the result is announced. Of course, Labour leader Jeremy Corbyn could also immediately demand to hold a Parliamentary vote of no confidence in the Prime Minister, which could be voted on as soon as Wednesday.

Whatever happens, however, there would seem to be very little chance of Parliament endorsing a Brexit deal and adopting all of the necessary legislation in time for the UK to leave the EU by end-March. As such, we continue to expect Brexit to be delayed beyond end-March, perhaps initially to July. So, we also expect a 'no deal' Brexit to be avoided. And we continue to attach roughly equal probabilities to the likelihoods of eventual (i) endorsement of a variant of May's deal (perhaps whereby the door is left open to the so-called Norway-plus arrangement) or (ii) revocation of the Article 50 notice, with a second referendum or general election possible before then too.

Data-wise, Tuesday will again be quiet, with no top-tier figures due, allowing all attention to remain on Brexit.








## European calendar

### Today's results

Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Industrial production M/M% (Y/Y%)	Nov	-1.7 (-3.3)	-1.6 (-2.4)	0.2 (1.2)	0.1 (-)
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	 10:00	Trade balance €bn	Nov	12.6	12.5	
Germany	 09:00	Full year GDP Y/Y%	2018	1.5	2.2	
	 09:00	Budget balance % of GDP	2018	-	1.0	
France	 07:45	Final EU-harmonised CPI Y/Y%	Dec	1.9	2.2	
Spain	 08:00	Final EU-harmonised CPI Y/Y%	Dec	1.2	1.7	
Country	GMT	Auction / Event				
EMU	 15:00	Draghi presents ECB 2017 Annual Report				
UK	 -	UK Parliament holds the 'meaningful vote' on the Brexit Withdrawal Agreement				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

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