Euro wrap-up

Overview

- Bunds made gains as Draghi acknowledged recent weak economic data, illustrated by today's German GDP and euro area trade reports.
- Gilts also made gains ahead of this evening's key UK Parliament vote on Brexit.
- Wednesday will be dominated by the fallout from this evening's Brexit vote, while euro area car registration and UK inflation data are also due.

Chris Scicluna
+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-0.621	-0.020
OBL 0 10/23	-0.397	-0.030
DBR 0¼ 02/29	0.203	-0.025
UKT 2 07/20	0.801	-0.010
UKT 0¾ 07/23	0.920	-0.032
UKT 1⅝ 10/28	1.254	-0.041

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

Euro area

Dovish Draghi acknowledges weaker dataflow

In his short speech late this afternoon at the European Parliament, Mario Draghi was dovish, with his words tallying with our view that the ECB will struggle to adjust the stance of monetary policy this year. In particular, he acknowledged that recent economic developments have been weaker than expected and that uncertainties, notably related to global factors, remain prominent. So, he repeated that a 'significant amount of monetary policy stimulus is still needed', and also stated that 'there is no room for complacency'. The weakening of economic activity to which Draghi alluded was evident in today's most notable new data, the first full-year estimate of German GDP growth in 2018 and euro area trade figures for November.

German GDP posted modest growth in Q418

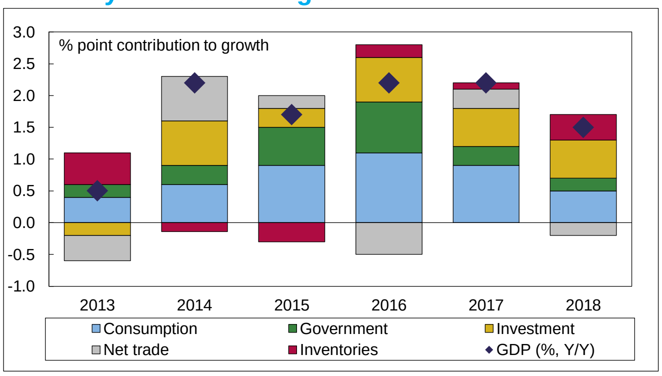
The first estimate of full-year German GDP for 2018 aligned with expectations, reporting growth of 1.5%Y/Y, the weakest for five years. Despite solid growth in real disposable incomes (down just 0.2ppt from 2017's sixteen-year high to 3.2%Y/Y) amid record-high employment and firm wage growth, private consumption slowed to 1.0%Y/Y, the softest rate since 2014, as households increased their savings by the most in four years. And while growth in fixed investment remained strong, up 0.1ppt to 3.0%Y/Y, and inventories added 0.4ppt to GDP growth, the most in five years, the slowdown in economic activity reflected a marked deterioration in the contribution from net trade – having added 0.3ppt to economic growth in 2017, net trade subtracted 0.2ppt in 2018, as exports slowed more abruptly than imports. Meanwhile, the contribution to growth from government consumption moderated to 0.2ppt, the least in five years, as firm growth in revenues saw the general government budget surplus rise 0.7ppt to 1.7% of GDP, the biggest since reunification, contrary to the small decline targeted.

Following the 0.2%Q/Q decline in GDP in Q3, today's full-year GDP figure implies a modest rebound in GDP in Q4 – we forecast an expansion of just 0.2%Q/Q. Looking ahead, as we expect private consumption growth to continue to be restrained by a desire to increase savings and export growth to remain subdued due to weak global demand, we forecast GDP growth of 0.3%Q/Q in each quarter of 2019, which would result in a further slowing from 2018 to full-year growth of just 1.0%Y/Y. But we also expect the budget surplus again to exceed the Government's 1.0% of GDP target.

Trade remained subdued in November

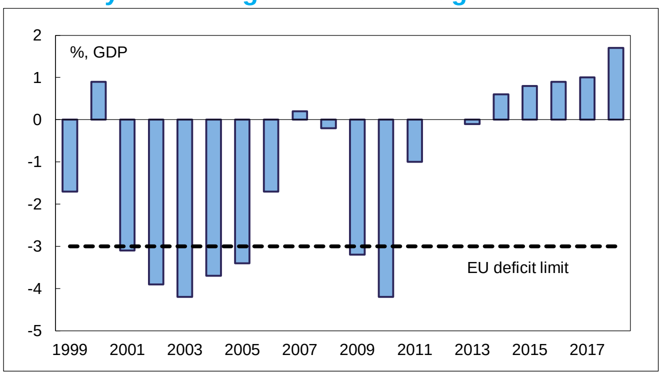
As in Germany, export weakness was a key cause of the economic slowdown in the euro area in 2018, with net trade having subtracted from euro area GDP growth in each of the first three quarters of the year. Today's goods trade figures for November were again underwhelming, with the value of exports declining for the second month in three and by 1.0%M/M. As a result, with notable weakness still in shipments to major emerging markets such as Turkey, Brazil and Russia (respectively down by about one third,

Germany: Annual GDP growth



Source: Destatis and Daiwa Capital Markets Europe Ltd.

Germany: General government budget balance



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

10% and more than 4% compared to a year earlier), export values were up just 1.6%Y/Y, the softest annual rate since March. But the value of imports fell too, and by a firmer 1.9%M/M, to be up 4.5%Y/Y, the weakest since May. As a result, on average over the first two months of Q4, the value of exports was up 1.7% on the Q3 average while imports were up 2.0% on the same basis. Given relative price shifts – not least the significant fall in the oil prices – growth in the volume of imports likely outpaced that of exports over this period. And with December's data likely in due course to reveal a notable deterioration in shipments to China, there is a significant risk of a fourth negative contribution to GDP growth in a row from net trade in Q4.

The day ahead in the euro area and US

Wednesday will bring euro area new car registration numbers for December, which seem bound to remain weak not least as German registrations fell a hefty 7%Y/Y. After the final French and Spanish inflation numbers for December released today aligned with the flash estimates to show declines of 0.3ppt and 0.5ppt respectively to 1.9%Y/Y and 1.2%Y/Y, the equivalent final German and Italian CPI figures, also due Wednesday, are similarly expected to align with the preliminary estimates of 1.7%Y/Y and 1.2%Y/Y, down 0.5ppt and 0.4ppt from November respectively. The Italian figures, however, are often subject to revisions. Finally, Italian industrial sales and orders data for November will round off a day with no likely show-stoppers. In the markets Germany will sell 30Y bonds.

In the US, Wednesday will bring import and export price data for December, the NAHB housing market survey for January and the Fed Beige Book. The other scheduled top-tier data (retail sales and business inventories) has been postponed due to the shutdown.

UK

Waiting for MPs to vote

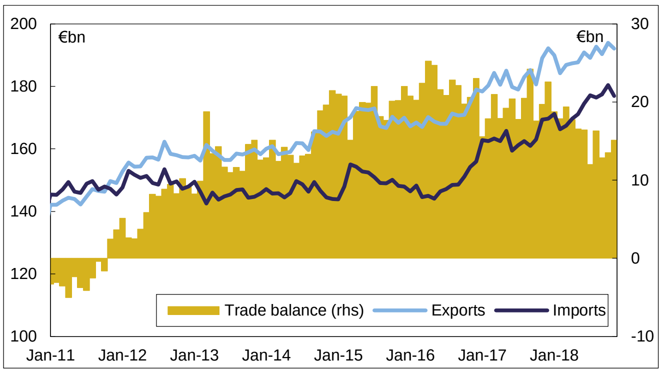
There were no UK economic data released ahead of this evening's Brexit 'meaningful vote' in the House of Commons, which Theresa May was widely expected to lose by a large margin. And it remained highly uncertain what May's strategy would be once the inevitable defeat has been confirmed. At the time of writing, May was expected to give an early indication of her planned next steps, perhaps as soon as this evening. But much depends on the size of her defeat, which could indicate whether or not it is worth her seeking to resume talks with the EU to try to gain further concessions in the hopes of achieving a majority in favour at a future date. Certainly, while the EU seems unlikely to rule out further negotiations, it will also stick by the current draft Withdrawal Agreement and contentious backstop arrangements, leaving the ball in the court of the UK Government to make any constructive new proposals compatible with the current negotiated deal that might eventually find support in the UK Parliament.

In the event of a very heavy loss (some way above 100 votes), however, further negotiations might be considered pointless. And May would face immediate calls to resign. So, the responses of the various Parliamentary factions (e.g. the Hard Brexiters, or those in favour of draft legislation seeking to rule out a no-deal Brexit issued earlier today by Conservative MP Nick Boles) could also come swiftly after the result as they seek to wrest control of the process. And, of course, Labour leader Jeremy Corbyn is expected to call immediately for a Parliamentary vote of no confidence in the Prime Minister, which could be conducted as soon as tomorrow. Whatever happens, however, there is no 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 will continue to expect Brexit to be postponed via an extension of the Article 50 notice, perhaps until a new European Commission is in place in the autumn. And given that expectation of an extension of the Article 50 process, we also still expect a 'no deal' Brexit to be avoided. Of course, if Theresa May was to resign as Prime Minister, the Conservative Party would struggle to unite around any successor. Indeed, the quality of the likely candidates for the role is low. And the person eventually elected would likely be a more ardent Brexiter. So, the biggest risk over the near term from a market perspective would be the resignation of Theresa May as Prime Minister, which would see sterling fall sharply and risk aversion rise.

The day ahead in the UK

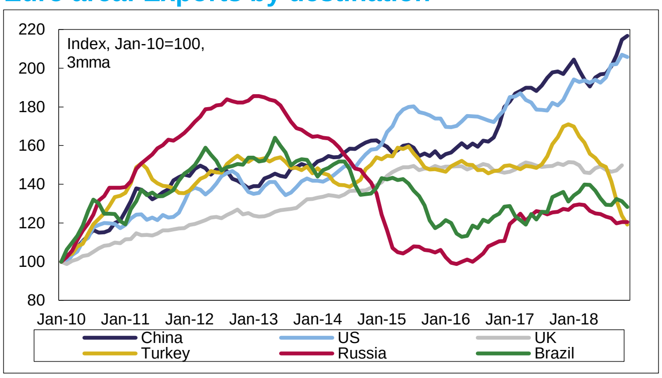
The political fallout from this evening's Brexit vote will clearly dominate attention on Wednesday. Meanwhile, after a day free of notable new economic data today, Wednesday will bring December's inflation figures. We expect the annual core CPI rate to remain unchanged at 1.8%Y/Y, the lowest rate since Q117. But with energy prices having fallen very significantly, the headline CPI rate should fall 0.2ppt from November to 2.1%Y/Y, the lowest since the start of 2017. ONS official house price data for November are also due. Meanwhile, BoE Governor Carney will testify on financial stability at the House of Commons Treasury Select Committee.

Euro area: Goods trade



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Exports by destination



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
EMU		Trade balance €bn	Nov	**15.1**	12.6	12.5	**13.5**
Germany		Full year GDP Y/Y%	2018	**1.5**	*1.5*	2.2	-
		Budget balance % of GDP	2018	**1.7**	-	1.0	-
France		Final EU-harmonised CPI Y/Y%	Dec	**1.9**	*1.9*	2.2	-
Spain		Final EU-harmonised CPI Y/Y%	Dec	**1.2**	*1.2*	1.7	-

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/ *Daiwa forecast*	Previous
EMU		07.00	EU27 new car registrations Y/Y%	Dec	-	-8.0
Germany		07:00	Final EU-harmonised CPI Y/Y%	Dec	*1.7*	2.2
Italy		10:00	Final EU-harmonised CPI Y/Y%	Dec	*1.2*	1.6
UK		09:30	CPI (core CPI) Y/Y%	Dec	*2.1 (1.8)*	2.3 (1.8)
		09:30	Input (output) PPI Y/Y%	Dec	3.7 (2.9)	5.6 (3.1))
		09:30	UK House Price Index Y/Y%	Dec	3.0	2.7

Country		GMT	Auction / Event
Germany		10:30	Auction: to sell €1.5bn of1.25% 2048 bonds (15-Aug-2048)
UK		09:15	BoE's Carney and other FPC members testify before the Treasury Select Committee

Source: Bloomberg and Daiwa Capital Markets Europe Ltd