Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made losses while new car registrations data confirmed a weak fourth quarter for sales.
- Ahead of this evening's vote of confidence in Theresa May's Government, Gilts also made losses as UK core inflation data surprised slightly on the upside.
- Thursday will bring updated figures on inflation and construction output in the euro area and the BoE's UK credit conditions survey.

Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-0.602	+0.016
OBL 0 10/23	-0.373	+0.022
DBR 0¼ 02/29	0.223	+0.018
UKT 2 07/20	0.828	+0.028
UKT 0¾ 07/23	0.967	+0.045
UKT 1⅝ 10/28	1.310	+0.052

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

Euro area

New car registrations fall in Q4

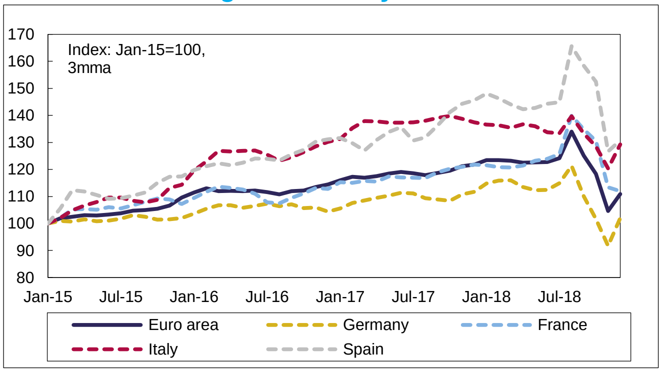
The weakness in demand for new cars weighed significantly on spending and production in the euro area in the second half of 2018. And today's new car registrations figures for December remained subdued, showing a drop compared with a year earlier for the fourth consecutive month and by a hefty 7.6%Y/Y. The weakness was seen across many member states, with German registrations down more than 6½%Y/Y on the ACEA measure, and French registrations down a whopping 14½%Y/Y. Euro area registrations were still up over 2018 as a whole, but only by a little more than 1%Y/Y, a marked slowdown from the 5%Y/Y increase in 2017 and the weakest full-year growth since 2013. Looking at monthly changes, there were at least signs of improvement towards year end – on an adjusted basis, new car registrations rose for the third consecutive month in December, up 2.5%M/M. Given the sharp decline at the end of Q3, however, that left registrations in Q4 as a whole still down a huge 11.4%Q/Q. By the same token, registrations in Germany were down 7.4%Q/Q, while those in Italy fell 3.0%Q/Q and those in France and Spain down 17.0%Q/Q or more. So, while we expect a return to growth in the current quarter, it is clear that new car sales subtracted significantly from growth in spending in the final quarter of last year.

The day ahead in the euro area and US

Thursday will bring final euro area inflation data for December. After Monday's figures from France (1.9%Y/Y) and Spain (1.2%Y/Y) aligned with the respective flash estimates, so too did today's numbers from Germany (1.7%Y/Y) and Italy (1.2%Y/Y). As such, we expect tomorrow's euro area data to confirm the flash estimates, with the headline CPI rate down 0.3ppt from November to an eight-month low of 1.6%Y/Y and the core rate unchanged at 1.0%Y/Y. Euro area construction output figures for November are also due. With production in the sector down in Germany and Spain but up in France, we expect a modest decline. In the markets, Spain will sell a range of bonds.

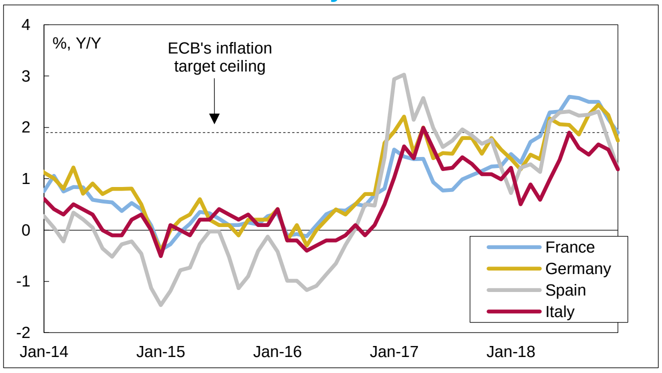
In the US, weekly jobless claims numbers and the Philly Fed index for January are due. The scheduled release of December housing starts and building permits figures will be postponed due to the government shutdown. In the markets, the Treasury will sell 10Y TIPS.

Euro area: Car registrations by member state



Source: ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Headline CPI by member state



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK

May to win confidence vote, but then what?

The outlook for Brexit remains as opaque as ever. After yesterday evening's record defeat in the House of Commons vote on her negotiated deal (202 in favour vs 432 against), Theresa May still seemed bound to win this evening's parliamentary no-confidence vote as the Northern Irish DUP and Brexiter Conservative MPs pledged their support. So, she was set tomorrow to start consulting with the DUP and 'other senior politicians' to try to identify a Brexit policy capable of winning the backing of a majority of MPs as well as the EU. In order to satisfy the EU, however, any Brexit deal will still need to incorporate the Withdrawal Agreement and controversial backstop arrangements as currently drafted. So, only the Political Declaration (PD) on future arrangements could be renegotiated. And given the magnitude of yesterday's defeat in the House of Commons, only if Theresa May was to relax one or more of her key red lines – e.g. her desire for independent trade policy that currently rules out a permanent customs union arrangement – could an alternative PD possibly find the support of a majority in Parliament.

Will May's cross-party consultations find a new solution?

Whether or not May's red lines are relaxed, however, it is still not clear whether a majority exists in Parliament for any particular future arrangement. And the prospects of discovering a majority in favour of one form of Brexit or another did not look particularly high today as doubts persisted that May would conduct her cross-party consultations in a sincere manner – a refusal to talk to Labour leader Corbyn (whose own policy, as currently specified, is admittedly unworkable) did not augur well in this respect. Moreover, comments from May during the confidence vote, coupled with indications from May's advisers, implied that she is not yet even prepared to relax her red lines in a meaningful way and so also suggested that an agreed deliverable form of Brexit is still a long way off.

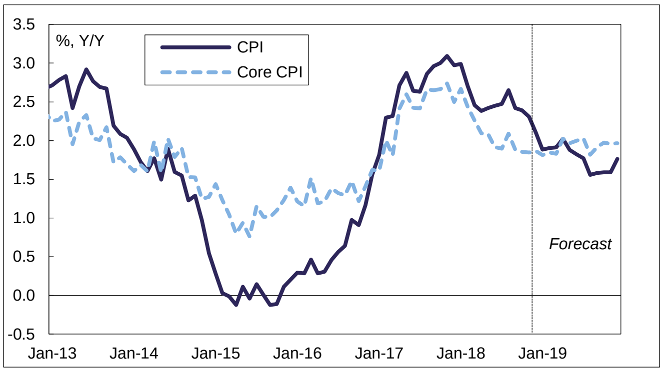
Article 50 bound to be extended

All the while, of course, the clock is still ticking towards the 29 March Article 50 deadline. There is now insufficient time for Parliament to discover and endorse an alternative Brexit deal, and adopt all of the necessary legislation to deliver it, in time for the UK to leave the EU by end-March. By the same token, there would also seem to be insufficient time for Parliament to adopt the legislation necessary to prepare adequately for a no-deal Brexit. Nevertheless, with a majority of MPs determined to avoid a no-deal Brexit, and May (and the EU) also likely to be keen to avoid further harm to her legacy by facilitating a destructive no-deal Brexit, we expect Brexit eventually to be postponed via an extension of the Article 50 notice. Indeed, there were reports today that, in a call with selected business leaders last night, Chancellor of the Exchequer Hammond said the Government would not erect 'obstacles' to an initiative by Conservative MP Nick Boles – who proposes a nine-month extension to the Article 50 notice – to avoid a no-deal Brexit. And, while we expect several weeks of uncertainty to persist over the near term, we anticipate such an extension of the Article 50 process eventually to be agreed by Parliament and the EU, thus avoiding a 'no deal' Brexit. Thereafter, however, we attach roughly equal probabilities to (i) a softened variant of May's 'blind' Brexit deal; and (ii) no Brexit at all. But, with the Labour party committed to call parliamentary votes of no confidence in the Government repeatedly over coming months, a new General Election at some point – if and when May loses the backing of Conservative hard Brexiters and the DUP – can certainly not be ruled out.

Inflation eased at the end of 2018

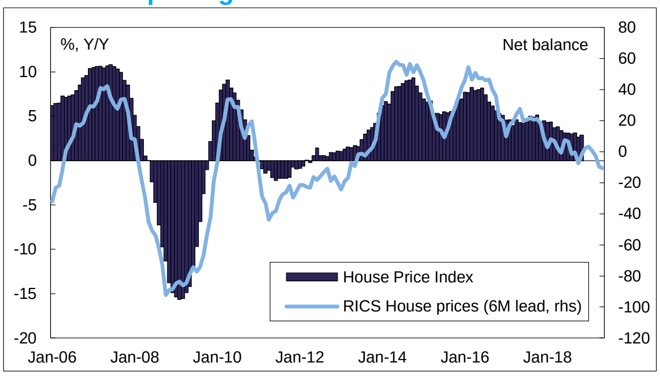
Having hovered around 2½%Y/Y for much of 2018 UK inflation started to ease towards the end of the year. And today's figures for December reported a 0.2ppt drop in the headline CPI rate to 2.1%Y/Y, the lowest since January 2017. Core inflation rose 0.1ppt to 1.9%Y/Y, but beyond one decimal the rise was minimal (merely from 1.844%Y/Y to 1.868%Y/Y). Indeed, changes in the main core components to a large extent offset each other – services inflation eased 0.1ppt to 2.4%Y/Y

UK: CPI inflation



Source: Thompson Reuters and Daiwa Capital Markets Europe Ltd.

UK: House price growth



Source: Thompson Reuters and Daiwa Capital Markets Europe Ltd.

and goods inflation (excluding food and energy) rose by the same amount to 1.0%Y/Y with both rates remaining within their recent ranges. Meanwhile, the largest downward contribution came from energy inflation: auto fuel prices declined by nearly 4½%M/M to leave energy inflation down 2.8ppt to 5.9%Y/Y. With a cap on retail energy tariffs set to exert significant downward pressure, we expect a further decrease in energy inflation to drive the headline CPI rate below the BoE's target of 2.0%Y/Y this month. Of course, Brexit uncertainty is set to remain high and concerns about global growth are becoming more prominent. So, UK GDP growth is set to remain very subdued. And despite the pickup in wage growth seen in recent months, we do not expect domestic price pressures to increase significantly this year. Against this backdrop, we continue to forecast core inflation to move broadly sideways this year at around 2%Y/Y or lower.

Low and stable house price growth

Today's UK House Price index, reported by the ONS alongside the aforementioned inflation data, did not bring any surprises. Predictably, house price growth was low and stable in November, with the headline rate inching up from 2.7%Y/Y, the slowest pace since 2013, to 2.8%Y/Y. Prices in London, where housing is least affordable, remained on a downward trend and declined by 0.6%Y/Y, a pace matching its average over the past nine months. But all other regions saw prices rise. Looking ahead, conditions in the housing market might well soften further over the near term and we would not expect to see a significant recovery in price growth unless real wages accelerate and/or Brexit uncertainty lifts.

The day ahead in the UK

The BoE Credit Conditions and Bank Liabilities surveys are due tomorrow alongside the RICS Residential Market survey for December. The latter is expected to signal a further moderation in price pressure, with the headline price balance likely to fall further having reached -11%, the lowest level in more than six years, reached in November.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
EMU	EU27 new car registrations Y/Y%	Dec	**-8.4**	-	-8.0	**-**
Germany	Final EU-harmonised CPI Y/Y%	Dec	**1.7**	*1.7*	2.2	**-**
Italy	Final EU-harmonised CPI Y/Y%	Dec	**1.2**	*1.2*	1.6	**-**
UK	CPI (core CPI) Y/Y%	Dec	**2.1 (1.9)**	*2.1 (1.8)*	2.3 (1.8)	**-**
	Input (output) PPI Y/Y%	Dec	**3.7 (2.5)**	3.7 (2.9)	5.6 (3.1)	**5.3 (3.0)**
	UK House Price Index Y/Y%	Dec	**2.8**	3.0	2.7	**-**

Auctions

Country	Auction
Germany sold	€1.2bn of 1.25% 2048 bonds (15-Aug-2048) at an average yield of 0.85%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

Tomorrow's data releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	10:00	Construction output M/M% (Y/Y%)	Nov	-	-1.6 (1.8)
	10:00	Final CPI (core CPI) Y/Y%	Dec	*1.6 (1.0)*	1.9 (1.0)
Italy	09:00	Trade balance €bn	Nov	-	3.8
UK	00:01	RICS house price balance %	Dec	-13	-11

ions and events

Country	GMT	Auction / Event
Spain	09:30	Auction: to sell bonds
UK	09:30	BoE releases Credit Conditions and Bank Liabilities surveys
	10:30	Auction: to sell £2.5bn of 1% 2024 bonds (22-Apr-2024)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

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