

# Euro wrap-up

## Overview

- Bunds ended the day little changed despite further falls in European equities and some disappointing German IP and trade data.
- Gilts made modest losses as the latest UK trade report showed the deficit narrowing more than expected at the end of 2015.
- Tomorrow brings IP data from France, Italy and the UK. But all are likely to be overshadowed by Janet Yellen's testimony to Congress.

## Economic Research Team

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 12/17	-0.523	-0.009
OBL 0 04/21	-0.289	-0.002
DBR 0½ 02/26	0.238	+0.020
UKT 1 09/17	0.333	+0.015
UKT 2 07/20	0.766	+0.013
UKT 2 09/25	1.419	+0.008

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

## Euro area

### Risk aversion remains at the forefront

Rather than responding to economic data, the mood in Europe's financial markets was once again driven by concerns about the health of European banks. European banking stocks remained the worst performers today, down on average by more than 4½%. And while the cost of default protection on European financials' senior debt was little changed overall on Tuesday, it remained elevated, up more than 60bps since the start of the year, and at its highest since October 2013. No single factor lies behind the increased fears about banks. However, concerns about the increased likelihood of bond- (and equity-) holder losses through 'bail-in' following the implementation from the start of the year of new rules limiting the use of state support in assisting bank recapitalisations (i.e. the EU Bank Recovery and Resolution Directive, BRRD) appear to be one factor. Italian government proposals to deal with non-performing loans in its banking sector have also raised question marks. And a raft of weak earnings reports has also seen concerns rise about future profitability and possible solvency issues at certain other banks too. Indeed, the statement from Deutsche Bank yesterday that it had more-than-sufficient reserves to meet coupon payments on its debt this year and next appeared to provide little assurance to investors, with the cost of default protection on its senior debt having hit its highest level since 2011.

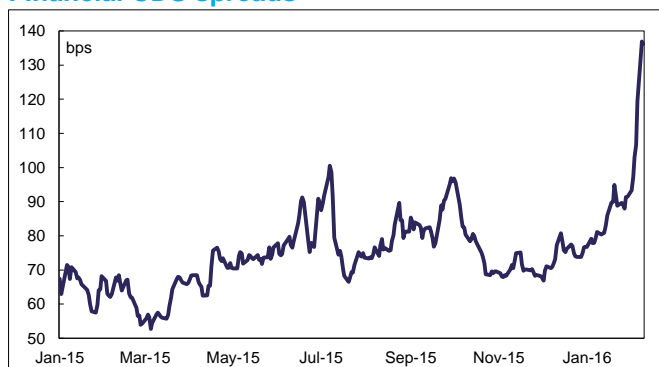
### German IP contracts sharply in Q4

In the current febrile market environment, the latest data from the euro area economies were never likely to have any significant bearing on risk appetite. However, today's releases from Germany were hardly supportive of sentiment. For example, industrial output fell for the fourth month out of the past five in December and by a steeper-than-expected 1.2% on the month, to leave it at its lowest level since October 2013. And the weakness was broad based, with manufacturing output down 1.1%M/M on the back of declines in the production of capital and non-durable consumer goods, by 2.6%M/M and 2.4%M/M respectively. Meanwhile, energy production was down 3%M/M and construction output fell 0.2%M/M, albeit this was the first decline in construction activity in three months. So, over the fourth quarter as a whole, industrial output was down 0.8%Q/Q, the steepest quarterly decline since Q214. And when excluding construction output (to align with the Eurostat measure), German industrial production was down more than 1%Q/Q in Q4, the largest drop in three years.

### German trade figures disappoint in December

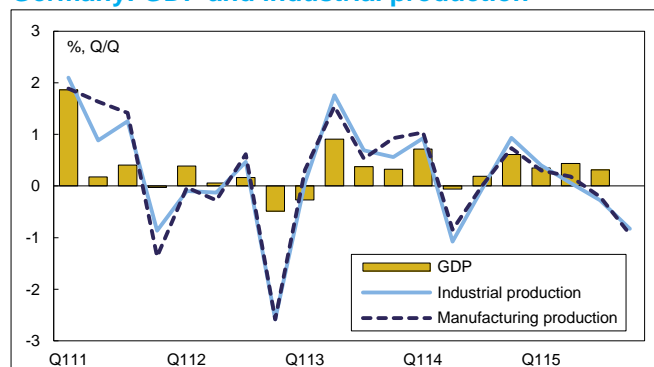
The latest German trade report was also on the soft side. Despite rising almost 6½% in 2015 as a whole to a new record full-year high, the value of German exports fell more than 1½%M/M in December. With the value of imports also down 1.6%M/M in December, this left the adjusted trade surplus little changed at a still-huge €19.4bn, to leave the trade surplus for

### Financial CDS spreads\*



\*iTraxx senior financials index, 5Y.  
 Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Germany: GDP and industrial production\*



\*IP including construction.  
 Source: Datastream and Daiwa Capital Markets Europe Ltd.



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2015 as a whole at an all-time high of €248bn. Nevertheless, the fourth-quarter trade surplus was still down compared with Q3, suggesting that net trade might have provided little support if any to GDP growth in the final quarter of 2015. Indeed, today's releases suggest that when the first estimate of Q4 German GDP growth is published on Friday it might well be a touch softer than the 0.3%Q/Q rate seen in Q3. So, with French GDP growth having moderated slightly in Q4, by 0.1ppt to 0.2%Q/Q, the euro area GDP figure, also due Friday, might struggle to beat the previous quarter's growth of 0.3%Q/Q.

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

The flow of national industrial production figures continues on Wednesday with the French and Italy releases due. Expectations are for a modest increase in output from both countries in December, although the downward surprise to the latest German and Spanish data suggests that risks to these figures are also to the downside. Supply-wise, Germany will sell 2Y Bunds.

Of course, the main focus tomorrow will be Janet Yellen's semi-annual monetary policy testimony before Congress, which will be watched closely for any insights into the Fed's assessment of recent global events, including market turbulence, and the slowdown in US economic activity around the turn of the year. Data-wise, tomorrow just brings the Federal monthly budget statement, while on the supply side, a 10Y UST auction will be conducted.

## UK

### Lower goods imports drive trade deficit down in December

The most notable economic data release in the UK today was the trade report, which showed that the headline deficit narrowed to £2.7bn in December, down from an upwardly revised November estimate of £4bn. While the improvement was larger than anticipated, the details of the report were not as encouraging as the headline number suggested. The drop was driven entirely by lower goods imports, while the value of goods exports was broadly unchanged at one of the lowest levels in recent years, to leave the total goods deficit at £9.9bn, about £0.5bn lower compared to the average for 2015. Looking at trade volumes, having fallen in Q3, exports seem to have risen slightly in the final quarter of the year, with the monthly goods data implying a 0.3%3M/3M increase. Meanwhile, import growth looks set to have been lower than the 3.5%3M/3M recorded in Q3, at about 1.2%3M/3M, but still stronger than exports. While these data represents goods trade only, they still suggest that net trade remained a drag on GDP at the end of 2015.

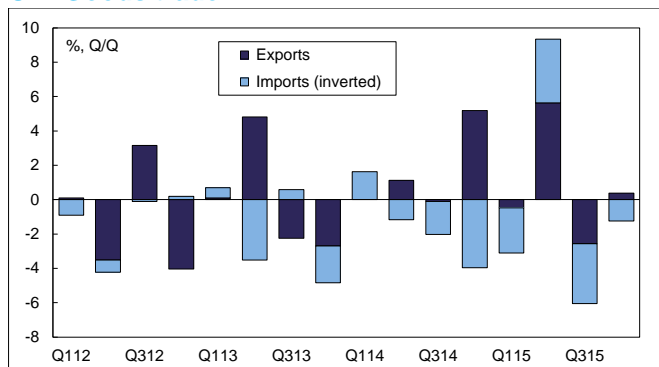
### Retail sector growth to recover in January

The BRC retail sales survey, meanwhile, suggested that retail sector growth picked up at the start of the year. Headline growth rose to 3.3%Y/Y in January, the highest since September and more than 2ppts higher than the previous month. Looking at the detail, the improvement was driven by non-food sales growth, which rose to 2.8%3M/Y from 1.5%3M/Y previously, while food sales growth remained unchanged, at 0.2%3M/Y. Given that similar results were reported by other surveys, the weak sales growth seen in December may prove to be temporary.

## The day ahead in the UK

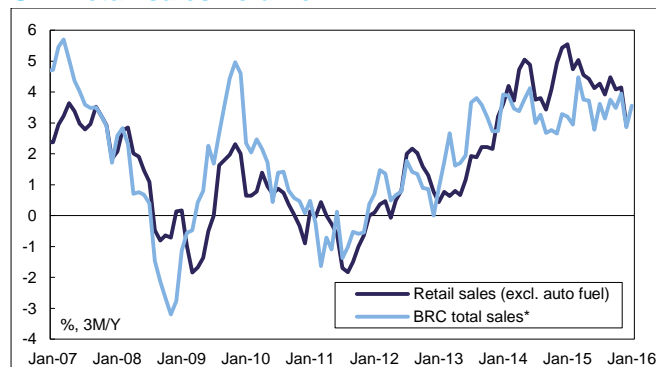
Tomorrow brings industrial production figures. Having dropped to 0.9%Y/Y in November, total output growth is expected to have remained little changed in December. Meanwhile, manufacturing growth is expected to have fallen further into negative territory, from -1.2%Y/Y to a twenty-seven-month low of -1.4%Y/Y.

### UK: Goods trade












Source: Datastream and Daiwa Capital Markets Europe Ltd.

### UK: Retail sales volume











\*Adjusted using BRC-Nielsen shop price index  
 Source: Datastream 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
Germany		Industrial production M/M% (Y/Y%)	Dec	-1.2 (-2.2)	0.5 (-0.6)	-0.3 (-0.1)	-0.1 (-)
		Trade balance €bn	Dec	18.8	20.0	20.6	20.5
		Imports (exports) M/M%	Dec	-1.6 (-1.6)	-0.5 (0.5)	1.6 (0.4)	1.3 (0.5)
		Current account balance €bn	Dec	25.6	26.7	24.7	24.3
UK		BRC like-for-like sales Y/Y%	Jan	2.6	0.3	0.1	-
		Visible trade balance £bn	Dec	-9.9	-10.4	-10.6	-11.5
		Total trade balance £bn	Dec	-2.7	-3.0	-3.2	-4.0
Auctions							
Country	Auction						
Germany sold		€365mn of 0.1% 2046 index-linked bonds (15-Apr-2046) at an average yield of -0.35%					
UK sold		£1.3bn of 0.125% 2026 index-linked bonds (22-Mar-2026) at an average yield of -0.903%					

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	
France		07.45	Industrial production M/M% (Y/Y%)	Dec	0.3 (1.7)	-0.9 (2.8)
		07.45	Manufacturing production M/M% (Y/Y%)	Dec	0.3 (1.7)	0.4 (2.8)
Italy		09.00	Industrial production M/M% (Y/Y%)	Dec	0.3 (1.4)	-0.5 (0.9)
UK		09.30	Industrial production M/M% (Y/Y%)	Dec	<u>-0.2 (0.9)</u>	-0.7 (0.9)
		09.30	Manufacturing production M/M% (Y/Y%)	Dec	0.1 (1.4)	-0.4 (-1.2)
		15.00	NIESR GDP 3M/3M%	Jan	-	0.6
Auctions and events						
Country	GMT	Auction / Event				
EMU		14.00	ECB's Praet scheduled to speak in Washington DC			
Germany		10.30	Auction: To sell €5bn of 2018 bonds (16-Mar-2018)			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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