

Euro wrap-up

Overview

- Bunds made modest gains as the latest French and Italian IP data confirmed notable weakness in the manufacturing sector in Q4.
- Gilts also made gains as a UK jobs survey signalled a deterioration in the labour market at the start of the year.
- The coming week brings estimates of euro area, German and UK Q4 GDP, as well as UK CPI figures. Talks on Brexit will also remain ongoing.

Emily Nicol

+44 20 7597 8331

Mantas Vanagas

+44 20 7597 8318

Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-0.582	-0.005
OBL 0 04/24	-0.372	-0.025
DBR 0¼ 02/29	0.081	-0.034
UKT 2 07/20	0.701	-0.012
UKT 0¼ 07/23	0.791	-0.025
UKT 1½ 10/28	1.147	-0.030

*Change from close as at 4.00pm GMT.

Source: Bloomberg

Euro area

French IP up in December but down in Q4

Against the backdrop of weaker growth in external demand and no shortage of domestic supply-side disruptions, conditions in the euro area's manufacturing sector deteriorated steadily over the past year, with this week's national production data suggesting little improvement in December too. Admittedly, while yesterday's German IP data were particularly disappointing (with production falling for a fourth successive month to be down 1.5%Q/Q), the equivalent French figures today came in a touch stronger than expected, with overall industrial output up 0.8%M/M and manufacturing production up 1%M/M. The improvement in part reflected a bounce back in production of intermediate and consumer goods (up 1.6%M/M and 2.7%M/M respectively), with the latter boosted by another pickup in production of transport equipment. But total output of capital goods continued to fall as production of electrical machinery and equipment declined sharply. Overall, however, the increase in December followed a steeper than previously estimated decline in November and left IP down 1.4%Y/Y. And over the fourth quarter as a whole, French manufacturing output was down by 0.4%Q/Q. Nevertheless, the 1.5pt rise in the manufacturing PMI in January to 51.2, and increases in the indices for output and new orders, offers a touch of comfort about the near-term outlook for the sector.

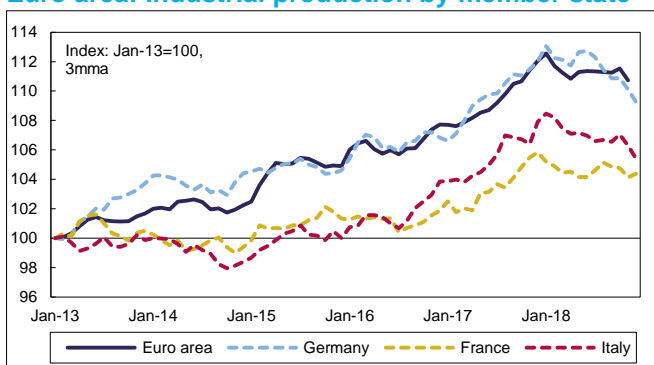
Italian IP weakens further in Q4

With Italy's economy having entered a technical recession in the second half of last year, and business surveys having suggested that the weakening towards the end of 2018 was more pronounced in the manufacturing sector, today's December IP data were predictably weak. Contrasting with the expected increase (following a sharp decline in November), total output fell for the fourth consecutive month and by 0.8%M/M, with manufacturing production down for the fifth month out of the past six (0.9%M/M). The weakness that month principally reflected a 3%M/M drop in consumer goods, with production of textiles and clothing down sharply. But smoothing out monthly volatility, the weakness in Q4 was more widespread. For example, production of machinery and transport equipment was down 1½%Q/Q, electrical equipment down 2½%Q/Q and furniture down more than 3%Q/Q. In contrast, however, total production of consumer durable goods posted the first quarterly rise in four. Overall, manufacturing output fell 0.9%Q/Q, the fourth consecutive quarterly drop and the steepest since Q314. And the 1.4pt drop in the Italian manufacturing PMI in January to a five-year low of 47.8 leaves us uneasy about prospects for the current quarter too.

Euro area IP likely declined sharply too

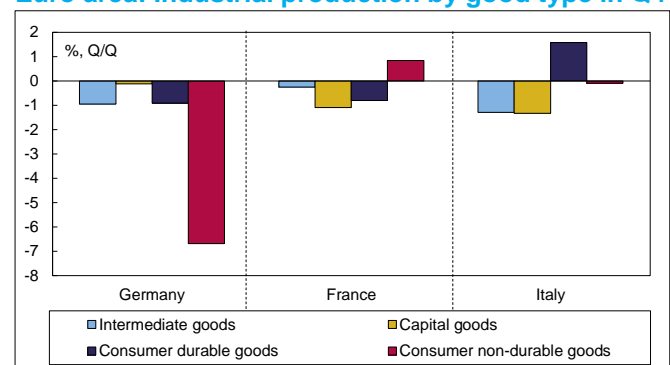
Meanwhile, the Dutch production figures, also published today, can only be described as dire. In particular, manufacturing production fell a much-steeper-than-expected 3.9%M/M in December, the sharpest monthly drop for a decade. This left it down 0.6%Q/Q, the largest quarterly drop since Q315, with notable declines in production of textiles (4½%Q/Q), electrical equipment (3.6%Q/Q) and

Euro area: Industrial production by member state



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production by good type in Q4



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



transport equipment (2.2%Q/Q). So, when the aggregate euro area figures are published on Wednesday, we expect industrial output to have dropped a little less than ½%M/M in December. This would leave production down around 1% over the quarter as a whole, the third quarterly contraction out of the past four and the steepest since 2012. And with the PMIs and Commission business survey indicators having signalled a further loss of momentum in January, we will not hold our breath for a marked turnaround in fortunes for the sector in the current quarter.

German exports pick up at year-end

Despite the weak manufacturing performance in Germany at the end of last year, however, December's trade report suggested that external demand held up well that month. Indeed, the value of exports rose 1.5%M/M, the strongest since May. Admittedly, on an unadjusted basis, this left exports merely flat compared with a year earlier. But with the value of imports up a smaller 1.2%M/M, the adjusted trade surplus widened slightly to €19.4bn in December, a six-month high and a level broadly in line with the average for the year as a whole. While the pickup in exports at the end of the year followed a drop in November, this still left them 1% higher over the fourth quarter as a whole, after a 0.2%Q/Q decline in Q3. And with the value of imports flat in Q4, today's data suggest that – like in France and Italy – net trade provided a modest boost to German GDP growth last quarter, for the first time in a year.

The week ahead in the euro area and US

Aside from the aforementioned IP data, the coming week will bring a handful of other notable releases, including euro area and German GDP, and euro area employment (all for Q4 and due Thursday). While the updated estimate of euro area GDP growth is expected to align with the flash estimate of 0.2%Q/Q, Germany will publish its Q4 data for the first time – with most activity indicators having remained weak last quarter, there's a significant probability that the economy moved no better than sideways in Q4 following the 0.2%Q/Q contraction in Q3. Against a backdrop of slowing economic growth, euro area labour market figures might also show only a limited rise in employment over the fourth quarter. Friday, meanwhile, will bring euro area trade figures for December, as well as new car registrations data for January. With respect to national releases, the latest business survey from the Bank of France is due on Monday, while final inflation numbers are due from Spain on Friday. In the markets, Germany and Italy will sell bonds on Wednesday.

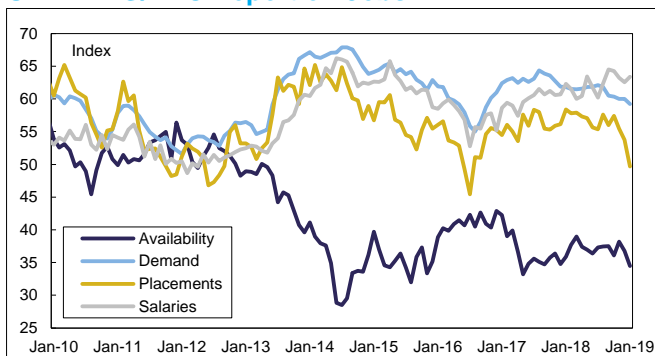
In the US, the coming week's diary begins with the release on Monday of revisions to the CPI, which will include new quality adjustments for telecommunication services and new seasonal factors. The NFIB small business survey for January and JOLTS survey for December are due on Tuesday. Attention the following day will turn to the January CPI report, with the PPI report for last month due on Thursday. Also on Thursday we will finally receive the December retail sales report and November business inventory data, which will provide additional information ahead of the Q4 GDP report now scheduled for release at the end of this month. On Friday January IP data and February's New York Fed manufacturing survey will cast more light on the factory sector. That day will also see the release of the preliminary findings of the University of Michigan's consumer survey for February and import price data for January. The coming week's US Treasury auction schedule contains only bills.

UK

Labour market outlook deteriorates

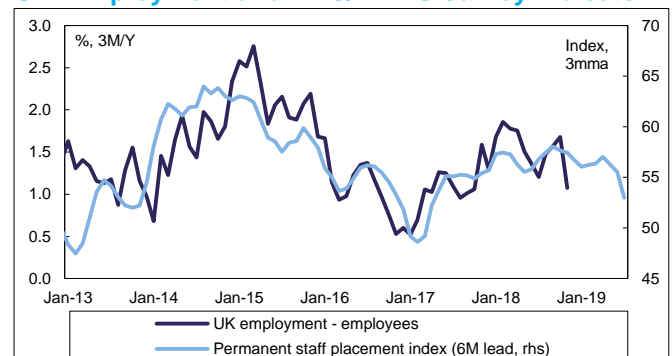
With most economic sentiment surveys pointing to a further loss of growth momentum in the UK at the start of the year, the labour market – whose fortunes will have a key bearing on BoE policy over coming quarters – now looks to be losing steam too. The latest PMIs, published earlier this week, implied that employment declined in January for the first time in six years. And today's KPMG and REC Report on Jobs – a survey of recruitment and employment consultancies – brought a similar message. Companies have reportedly become more cautious when making recruitment decisions, with vacancies as measured by this survey rising at the slowest rate for 27 months and respondents reporting the first drop in permanent staff placements since the Brexit referendum. Nevertheless, the labour market appears to remain tight – unsurprisingly with the most recent data for late last year showing that the UK employment rate was at a record high and the unemployment rate at the lowest level for decades – with the REC survey reporting that worker availability continued to decline in January and some workers are now unwilling to switch positions against a backdrop of Brexit uncertainty. Nevertheless, pay growth remained firm, with the relevant survey indicator rising slightly on the month

UK: KPMG/REC Report on Jobs



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Employment and REC/KPMG survey indicator



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.
















to a level in line with its average in Q418. As the economy continues to weaken, however, wage growth should be expected to soften – indeed, in its latest Inflation Report published yesterday, the BoE revised its forecast for wage growth this year and next slightly lower, to 3%Y/Y and 3¼%Y/Y respectively.

The week ahead in the UK

Following yesterday's meeting with Theresa May, Commission President Jean-Claude Juncker reiterated the unwillingness of the EU to reopen discussions on the Irish border backstop and other matters already agreed in the draft Withdrawal Agreement. However, there appears to be some room for renegotiation of the Political Declaration on the future relationship between the EU and UK, and officials will continue their talks in the coming week to pave a way for a new compromise. May is expected to make a statement to Parliament on the achieved progress on Wednesday, while the following day MPs should have a chance to debate it and vote on proposed amendments, just as they did on 29 January. As on that occasion, those votes could strengthen the hands of MPs trying to influence the course of Brexit policy, although their failure to do so last month suggests that they might struggle to succeed. Indeed, Parliament appears unlikely to hold a second meaningful vote before the start of next month at the earliest.

On the data front, the coming week brings UK Q4 GDP and January inflation and retail sales releases, due on Monday, Wednesday and Friday respectively. The BoE forecasts published yesterday suggested that growth last quarter is set to have eased from 0.6%Q/Q to 0.3%Q/Q, although we think that a lower reading of 0.2%Q/Q is possible. The monthly figures are expected to show that manufacturing output rose slightly at the end of the year, with Brexit-related precautionary stock-building likely to have provided support. But, as far as GDP is concerned, most will depend on the services sector. Consumer-focused services might be weaker, in line with the drop in retail sales in December. But the pace of increase in professional services is less certain – activity in this category has been growing at a decent pace in recent months, and it remains to be seen if this was maintained against the backdrop of higher uncertainty. Meanwhile, trade data, also due on Monday, are set to show that the deficit remained little changed at the end of 2018 at around £3bn. With regards to inflation, a fall in the headline CPI rate is on the cards on Wednesday, likely by 0.2ppt to 1.9%Y/Y, and the core rate might edge lower too from 1.9%Y/Y in December. Finally, the figures from the retail sector are set to be a bit more positive – following the disappointing festive period, some reports suggest that January discounting lured more buyers into shops. Among other releases, the RICS Residential Market survey, due on Thursday, will be worth watching too. Housing market sentiment turned for the worse at the end of last year, and price developments are likely to have remained skewed to the downside in January. Meanwhile, following the publication of the Inflation Report, in the coming week we should get some further insights into the MPC's assessment of recent changes in UK economic prospects with BoE Governor Carney and external member Vlieghe scheduled to speak about the outlook.

Daiwa economic forecasts








	2018		2019				2020		2018	2019	2020
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP forecasts %, Q/Q											
Euro area 	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	1.8	1.1	1.0
Germany 	-0.2	0.1	0.3	0.3	0.3	0.3	0.3	0.3	1.5	0.9	1.2
France 	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	1.5	1.1	0.9
Italy 	-0.1	-0.2	0.1	0.2	0.1	0.2	0.1	0.2	0.8	0.1	0.5
Spain 	0.6	0.7	0.5	0.4	0.4	0.4	0.4	0.4	2.5	2.0	1.7
UK 	0.6	0.2	0.1	0.1	0.4	0.3	0.3	0.3	1.4	1.0	1.1
Inflation forecasts %, Y/Y											
Euro area											
Headline CPI 	2.1	1.9	1.4	1.2	1.0	1.0	1.4	1.4	1.7	1.2	1.4
Core CPI 	1.0	1.0	1.1	1.1	1.1	1.2	1.2	1.2	1.0	1.1	1.3
UK											
Headline CPI 	2.5	2.3	1.9	1.9	1.7	1.7	1.9	1.9	2.5	1.8	1.9
Core CPI 	2.0	1.9	1.8	1.9	1.9	2.0	2.0	1.9	2.1	1.9	1.9
Monetary policy											
ECB											
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate % 	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40
Net asset purchases* 	30	15	0	0	0	0	0	0	15	0	0
BoE											
Bank Rate % 	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
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
Germany 	Trade (current account) balance €bn	Dec	13.9 (21.0)	16.5 (23.3)	20.5 (21.4)	20.4 (21.6)
	Exports (imports) M/M%	Dec	1.5 (1.2)	0.4 (0.5)	-0.4 (-1.6)	-0.3 (-1.3)
France 	Private sector payrolls Q/Q%	Q4	0.1	0.1	0.1	-
	Wages Q/Q%	Q4	0.2	0.3	0.3	-
	Industrial production M/M% (Y/Y%)	Dec	0.8 (-1.4)	0.6 (-1.4)	-1.3 (-2.1)	-1.5 (-2.2)
	Manufacturing production M/M% (Y/Y%)	Dec	1.0 (-1.0)	1.1 (-1.2)	-1.4 (-2.2)	-1.5 (-2.3)
Italy 	Industrial production M/M% (Y/Y%)	Dec	-0.8 (-5.5)	0.4 (-2.7)	-1.6 (-2.6)	-1.7 (-)
Auctions and events						
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	
Monday 11 February 2019						
France		07:30	Bank of France industrial sentiment	Jan	103	103
UK		09:30	GDP – first estimate Q/Q% (Y/Y%)	Q4	<u>0.2 (1.3)</u>	0.6 (1.5)
		09:30	Monthly GDP estimate M/M%	Dec	<u>-0.1</u>	0.2
		09:30	Industrial production M/M% (Y/Y%)	Dec	0.1 (-0.5)	-0.4 (-1.5)
		09:30	Manufacturing production M/M% (Y/Y%)	Dec	0.2 (-1.1)	-0.3 (-1.1)
		09:30	Construction output M/M% (Y/Y%)	Dec	0.1 (1.5)	0.6 (3.0)
		09:30	Services activity M/M% (3M/3M%)	Dec	<u>-0.1 (0.4)</u>	0.3 (0.3)
		09:30	Trade balance (goods trade balance) £bn	Dec	-3.1 (-12.0)	-2.9 (12.0)
Tuesday 12 February 2019						
- Nothing scheduled -						
Wednesday 13 February 2019						
EMU		10:00	Industrial production M/M% (Y/Y%)	Dec	-0.4 (-3.2)	-1.7 (-3.3)
UK		09:30	CPI (core CPI) Y/Y%	Jan	<u>1.9 (1.8)</u>	2.1 (1.9)
		09:30	Input (output) PPI Y/Y%	Jan	3.8 (2.2)	3.7 (2.5)
		09:30	UK House Price Index Y/Y%	Jan	2.5	2.8
Thursday 14 February 2019						
EMU		10:00	GDP - second estimate Q/Q% (Y/Y%)	Q4	<u>0.2 (1.2)</u>	0.2 (1.6)
		10:00	Employment Q/Q% (Y/Y%)	Q4	-	0.2 (1.3)
Germany		07:00	GDP - first estimate Q/Q% (Y/Y)	Q4	<u>0.1 (0.8)</u>	-0.2 (1.1)
France		06:30	ILO Unemployment rate 3M%	Q4	9.1	9.1
UK		00:01	RICS house price balance %	Jan	-20	-19
Friday 15 February 2019						
EMU		10:00	Trade balance €bn	Dec	16.3	15.1
		10:00	EU27 new car registrations Y/Y%	Jan	-	-8.4
Spain		08:00	Final EU-harmonised CPI Y/Y%	Jan	1.0	1.2
UK		09:30	Retail sales excluding auto fuel M/M% (Y/Y%)	Jan	0.2 (3.1)	-1.3 (2.6)
		09:30	Retail sales including auto fuel M/M% (Y/Y%)	Jan	0.2 (3.4)	-0.9 (3.0)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

Key events & auctions		
Country	GMT	Event / Auction
Monday 11 February 2019		
- Nothing scheduled -		
Tuesday 12 February 2019		
UK		13:00 BoE's Carney scheduled to speak in London
Wednesday 13 February 2019		
Germany		10:30 Auction: to sell €1.5bn of 2.5% 2046 index-linked bonds (15-Aug-2046)
Italy		16:00 Auction: to sell bonds
Thursday 14 February 2019		
UK		09:30 BoE's Vlieghe scheduled to speak in London
		10:30 Auction: to sell £2.25bn of 1.625% 2028 bonds (22-Oct-2028)
Friday 15 February 2019		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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