

Euro wrap-up

Overview

- Bunds followed USTs higher while data suggested that Germany's economy stagnated in the final quarter of 2018.
- Gilts also made gains as a survey suggested further weakening in the UK housing market and MPs debated Brexit once again.
- Friday will bring data on UK retail sales and euro area goods trade and car registrations.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-0.553	+0.006
OBL 0 04/24	-0.347	-0.006
DBR 0¼ 02/29	0.102	-0.020
UKT 2 07/20	0.726	-0.007
UKT 0¼ 07/23	0.800	-0.031
UKT 1½ 10/28	1.142	-0.039

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

Euro area

Germany avoids technical recession

Germany avoided technical recession at the end last year, but only just. Following the decline of 0.2%Q/Q in Q3, economic output was unchanged in Q4, a performance that was a touch softer than the consensus forecast but not wholly unexpected. That left GDP just 0.6% higher than a year earlier, the weakest such rate since Q313. No expenditure breakdown was provided with this initial estimate. But the German statistical office stated that all components of final domestic demand grew on a quarterly basis in Q4, with business investment and government spending putting in another strong performance, and household spending rising modestly. With exports and imports rising at broadly the same pace, however, net trade reportedly made no contribution to growth. By intimation, changes in inventories appear to have subtracted from growth. Given the progress in adjustments in certain sectors over the course of the fourth quarter – most notably in autos – we expect German GDP to return to positive growth in Q1, at 0.3%Q/Q. However, survey indices for January provided mixed messages, with the Ifo business climate index dropping to a near-three-year low but the composite PMI rising due to a better performance from services. So, the equivalent figures for February due next week should be closely watched for a clearer indication of the trajectory of German GDP this quarter.

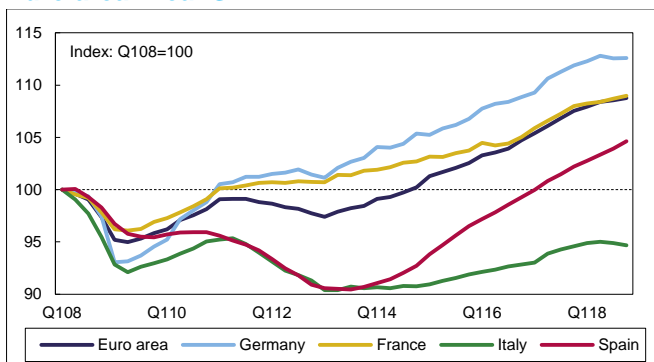
Euro area job creation a touch firmer

There was no surprise from the second estimate of euro area GDP growth in Q4, which aligned with the flash estimate of 0.2%Q/Q, the same rate as Q3. That left the annual rate at just 1.2%Y/Y, 1.5ppts lower than a year earlier and the weakest in five years. Nevertheless, despite the subdued rate of GDP growth, euro area employment rose in Q4 by just under 440k to a new series high of 158.75mn. That represented a 0.1ppt pickup in growth from Q3 to 0.3%Q/Q, although this was still the second weakest rate since Q115. While the country breakdown is not yet available, the lion's share of job growth appears to have been largely accounted for by Germany and Spain. Despite the pickup in the quarter-on-quarter figure, the annual rate of euro area employment growth moderated 0.1ppt to 1.2%Y/Y, the softest in more than three years. Looking ahead, we expect only a modest pickup in euro area economic growth in Q1 to 0.3%Q/Q and GDP growth to remain no stronger than potential over coming quarters. As such, we expect the trend in job creation to slow further, and the unemployment rate to fall only slightly this year from 7.9% in December 2018. And as a result, we do not expect wages to accelerate markedly, with the rate of growth in compensation per employee likely to remain a little less than 2½%Y/Y.

The day ahead in the euro area and US

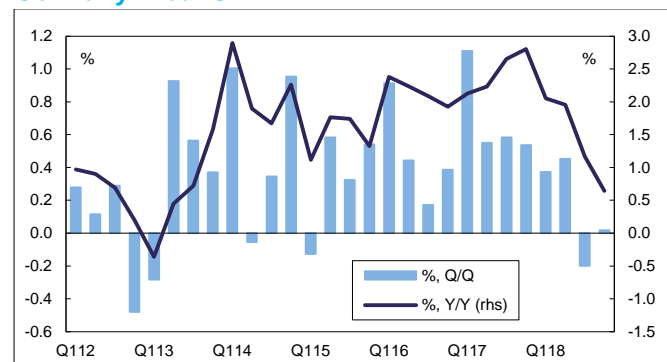
The working week in the euro area will come to an end with December's goods trade report – which should signal a pickup in exports and imports as well as a modest increase in the surplus to a four-month high – as well as January's new car

Euro area: Real GDP



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: Real GDP



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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registrations figures. The final estimate of Spanish inflation in January is also due – the flash estimate dropped 0.2ppt to 1.0%Y/Y the lowest level in a year thanks not least to lower energy prices. Beyond the data, after the Spanish Parliament yesterday failed to pass the Government's 2019 budget, the cabinet will meet tomorrow to discuss possible ways forward, with a growing expectation that Prime Minister Sanchez will subsequently call a snap election, most likely to be held in April. That would be the third election in less than four years. And with no single party commanding a clear lead in the polls, the likely outcome would be another weak Government. Nevertheless, the political complexion of the next Government would be highly uncertain, with a shift from the current minority centre-left Socialist administration to a coalition between the centrist Ciudadanos and establishment right-wing Partido Popular one possible outcome.

In the US, several economic reports are due, including the January industrial production report, which is expected to show an eighth consecutive month of growth, albeit with only a slight increase this time around. Other new releases include the preliminary University of Michigan consumer sentiment survey and Empire Manufacturing indices, both for February, the import and export price data for January, and TIC capital flow figures for December.

UK

Today's votes could be inconsequential, but key vote likely on 27 February

The main UK focus today was the House of Commons debate on Brexit, with Theresa May facing possible defeat this evening on a vote related to her strategy of seeking alternative arrangements to the Irish backstop. Apart from political embarrassment for the Prime Minister and the further sign of her lack of authority, such a defeat could have little consequence. Certain proposed amendments, aimed at giving MPs greater influence over the process, were also set to be voted on. But with May having promised to come back to Parliament on 26 February with a further update, and parliamentarians to be given yet another opportunity to influence Brexit policy the following day, today's debate risked largely being a rerun of what happened a fortnight ago when MPs failed to agree on anything of substance. Nevertheless, there was a good chance that the Government would be forced by one vote among MPs to publish the most recent Government assessments of the likely impact of a no-deal Brexit on business and trade. And that could influence the outcome of a further vote, likely to be held on 27 February, on an amendment to be proposed by Labour's Yvette Cooper and the Conservative Oliver Letwin, that would demand the Prime Minister to seek an extension of the Article 50 deadline if Parliament fails to approve a Brexit deal by 13 March.

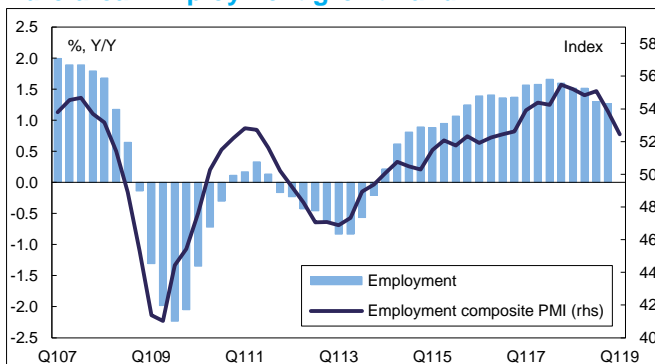
Housing market continues to weaken

The latest economic data, meanwhile, provided further evidence of the damaging impact of continued Brexit uncertainty. In particular, the RICS housing market survey for January suggested that downward pressure on house prices intensified at the start of the year with a net balance of 22% of respondents reporting falling prices in January, the most since 2012. Predictably, the weakness was most evident in London, with a net 72% of survey respondents signalling falling prices, the most since late 2008. And the weakness persisted on both sides of the market with the indicator for new buyer enquiries deteriorating notably in January, to -35%, the lowest since June 2008, while the new vendor instructions index fell to -25%. Against this backdrop, transaction levels also maintained a downward trend, while the near-term sales expectations indicator dropped to the lowest level since the survey began in 1999. And with the price expectations balance at its lowest level for almost a decade, we see little chance of a marked pickup in house prices over coming quarters even if a no-deal Brexit is avoided.

The day ahead in the UK

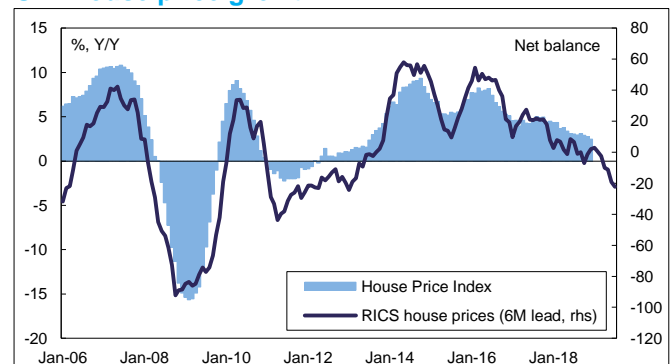
Friday will bring January's retail sales figures. After a disappointing festive period, which saw sales decline over the fourth quarter as a whole, reports from certain retailers and surveys suggest that discounting lured more buyers into shops at the start of the year. So, the consensus expectation is for modest positive growth in sales whether including or excluding auto fuel to push the annual rates above 3.0%Y/Y.

Euro area: Employment growth and PMI*



*Euro area composite employment PMI. January 2019 figure for Q119.
 Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: House price growth








Source: Thomson Reuters 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
EMU	 GDP - second estimate Q/Q% (Y/Y%)	Q4	0.2 (1.2)	<u>0.2 (1.2)</u>	0.2 (1.6)	-
	 Employment Q/Q% (Y/Y%)	Q4	0.3 (1.2)	-	0.2 (1.3)	-
Germany	 GDP - first estimate Q/Q% (Y/Y)	Q4	0.0 (0.6)	<u>0.1 (0.7)</u>	-0.2 (1.1)	-
France	 ILO Unemployment rate 3M%	Q4	8.5	8.8	8.8	-
UK	 RICS house price balance %	Jan	-22	-20	-19	-







Auctions and events

Country	Auction
UK sold	 £2.25bn of 1.625% 2028 bonds (22-Oct-2028) at an average yield of 1.159%

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	07:00	 EU27 new car registrations Y/Y%	Jan	-	-8.4
	10:00	 Trade balance €bn	Dec	15.7	15.1
Italy	09:00	 Trade balance €bn	Dec	-	3.8
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 (3.2)	-1.3 (2.6)
	09:30	 Retail sales including auto fuel M/M% (Y/Y%)	Jan	0.2 (3.4)	-0.9 (3.0)

Auctions and events

Country	GMT	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

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