

# Euro wrap-up

## Overview

- Bunds followed the global trend lower as Germany's ifo survey exceeded expectations. But Greek bonds rallied as reports suggested that the ECB will lift restrictions on Greek banks' holdings of domestic government debt.
- Gilts also made losses even as UK inflation figures suggested still subdued price pressures.
- Tomorrow will bring the BoE's policy announcement. Bank Rate is likely to be left on hold, with just two MPC members likely to vote for a 25bps cut. UK retail sales data are likely to be distorted by the Black Friday sales.

**Emily Nicol**  
+44 20 7597 8331

### Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.645	+0.007
OBL 0 10/24	-0.528	+0.028
DBR 0 08/29	-0.251	+0.047
UKT 3% 09/21	0.532	-0.002
UKT 1 04/24	0.576	+0.006
UKT 0% 10/29	0.782	+0.020

\*Change from close as at 4:20pm GMT.

Source: Bloomberg

## Euro area

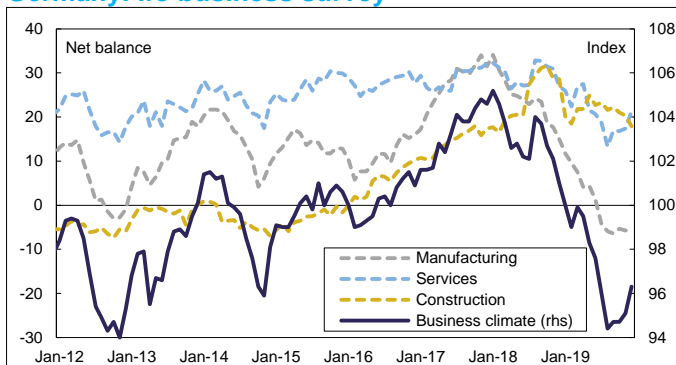
### Ifo improves but still signals subdued growth

Contrasting with Monday's [flash PMIs](#), today's ifo survey pointed to a further modest improvement in German business conditions heading into year-end, offering cause for cautious optimism that GDP growth might just avoid another return to negative territory in Q4. In particular, the ifo headline business climate index rose a stronger-than-expected 1.2pts in December to 96.3, a six-month high. Within the detail, the index of current conditions increased 0.8pt to 98.8, a five-month high but nevertheless still close to the bottom of the recent range. And while the expectations component rose a larger 1.5pts – the most since August 2018 – at 93.8 it still remained well below the long run average. Assessments of conditions by sector were more mixed. The most significant improvement came in services, with the business climate index jumping to a seven-month high. Manufacturers' signalled modest recovery in December too, although this merely implied that conditions over the fourth quarter as a whole were little changed from Q3. And the equivalent construction sector index fell for the third consecutive month to its lowest since early 2018. Overall, despite the gradual improvement as the quarter progressed, the headline business climate index was on average in Q4 only marginally higher than the Q3 average suggesting still sluggish economic growth in the final quarter of the year.

### No surprises to final euro area inflation

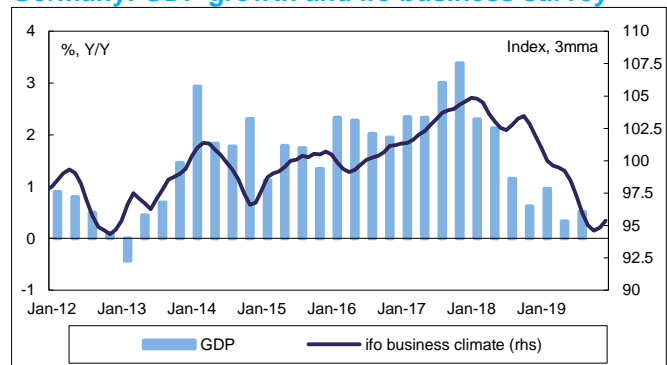
Final euro area inflation figures for November brought no major surprises. In particular, today's released merely aligned with the flash estimate that showed headline inflation increasing 0.3ppt from October's three-year low to 1.0%Y/Y. Admittedly, to two decimal places, headline inflation was 0.4ppt lower at 0.96%Y/Y. But this largely reflected a modest downwards revision to food price inflation (down 0.1ppt to 1.9%Y/Y). Non-energy industrial goods inflation was also a touch softer than initially estimated to two decimal places, nevertheless leaving the annual rate at 0.4%Y/Y and 0.1ppt higher than October. And with services inflation unrevised at 1.9%Y/Y, leaving it 0.3ppt above October's reading, the annual core CPI rate was also confirmed at the flash estimate of 1.3%Y/Y, a seven-month high. While we expect core inflation to move broadly sideways in December, with the drag from energy inflation set to temporarily subside we forecast headline CPI to have risen a further 0.3ppt this month to 1.3%Y/Y. But this still remains well below the ECB's price stability target and might well mark the peak for some time. Against this backdrop, and as the ECB is about to commence a review of its monetary policy strategy next month, outgoing ECB Executive Board member Cœuré in a speech today proposed that the ECB might shift to targeting a 'tolerance band' around the inflation target rather than the current commitment of 'below but close to 2%'.

### Germany: Ifo business survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Germany: GDP growth and ifo business survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



## The day ahead in the euro area and US

Tomorrow will bring just the French INSEE business sentiment survey for December, which is expected to show that conditions remained broadly stable heading into year-end. Elsewhere, ECB Chief Economist Philip Lane will chair a panel at an ECB conference on fiscal policy and EMU governance. In the US, Thursday will bring the Philly Fed index for December, Conference Board's Leading index for November, existing home sales figures for the same month and the latest balance of payments data for Q3. In the markets, the US Treasury will sell 5Y TIPS.

## UK

### Inflation remains well below 2% target

As the MPC met today ahead of tomorrow's policy announcement, the latest UK inflation figures illustrated that price pressures unsurprisingly remain subdued against the backdrop of weak economic growth. In particular, headline inflation was unchanged at 1.5%Y/Y in November, at the joint-weakest for three years. There were only modest tweaks to the main sub-components too. For example, energy inflation (-2.3%Y/Y) was little changed to remain a key source of downward pressure in November. While the monthly increase in food prices was more than we had forecast, the annual inflation rate was nudged only slightly higher, by 0.1ppt to 2.0%Y/Y. And while services inflation reversed the 0.1ppt increase in October to 2.5%Y/Y, inflation of non-energy industrial goods was unchanged at the very subdued 0.5%Y/Y. So, core inflation was also unchanged at 1.7%Y/Y, to match the average rate of the prior eight months and close to the bottom of the range of the past three years. And today's producer price inflation release suggested that pipeline price pressures remain very weak too, with output price inflation down 0.3ppt to 0.5%Y/Y, the lowest since July 2016.

### House prices continue to trend lower

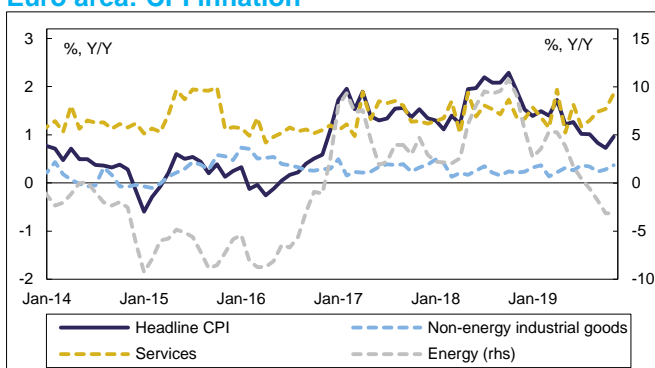
Elsewhere, the ONS's official house price figures for October fell short of expectations today, reporting the first monthly fall in UK house prices in six (-0.4%M/M) and the steepest since March 2018. This left the annual increase down 0.6ppt to 0.7%Y/Y, the lowest such rate for more than seven years. The weakness remained dominated by England, where prices were up just 0.4%Y/Y and house prices in London and the South East continued to decline (-1.6%Y/Y and -0.3%Y/Y respectively). But house price inflation also moderated in Scotland and Northern Ireland. While surveys point to some stabilisation in the housing market heading into the New Year, the outlook seems bound to depend largely on Brexit.

### The day ahead in the UK

The main event in the UK tomorrow will be the BoE policy announcement. The MPC adopted a more downbeat assessment of the economic outlook at November's meeting and two Committee members (Haskel and Saunders) voted for a 25bps rate cut – the first split decision since June 2018. This meeting seems likely to be largely uneventful, with Bank Rate again left unchanged at 0.75% and the same two members voting for monetary easing. The policy statement will, however, be closely watched for the Bank's judgement on recent developments. Near-term political uncertainties – both domestic and external – have diminished somewhat. But GDP has failed to rise in any month since August, and sentiment indicators remain consistent with contraction in Q4, compared to the BoE's previous expectation of growth of 0.2%Q/Q.

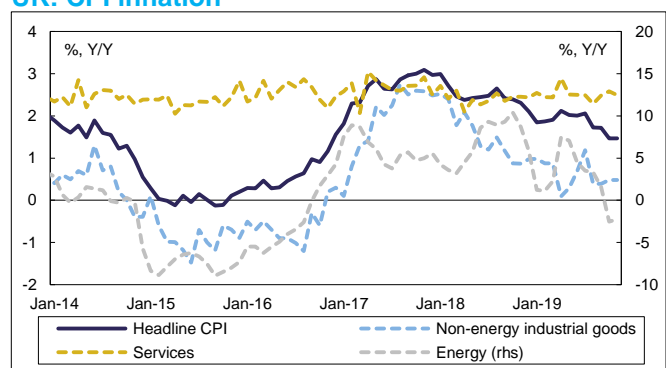
In terms of data, tomorrow will bring the ONS official retail sales release for November. But the figures are likely to be somewhat misleading, with the annual rate likely to be negatively impacted by the timing of the Black Friday sales – the ONS will incorporate this discounting period this year in the data for December rather than November. This release will also be accompanied by the CBI's distributive trades survey for December, which might shed more light on conditions in the retail sector over the fourth quarter as a whole.

### Euro area: CPI inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### UK: CPI inflation










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	 Construction output M/M% (Y/Y%)	Oct	<b>-1.0 (0.3)</b>	-	0.7 (-0.7)	<b>1.1 (-0.3)</b>
	 Final CPI (core CPI) Y/Y%	Nov	<b>1.0 (1.3)</b>	1.0 (1.3)	0.7 (1.1)	-
Germany	 Ifo business climate index	Dec	<b>96.3</b>	95.5	95.0	<b>95.1</b>
	 Ifo current assessment balance (expectations)	Dec	<b>98.8 (93.8)</b>	98.1 (92.9)	97.9 (92.1)	<b>98.0 (92.3)</b>
UK	 CPI (core CPI) Y/Y%	Nov	<b>1.5 (1.7)</b>	1.4 (1.7)	1.5 (1.7)	-
	 PPI input prices (output prices) Y/Y%	Nov	<b>-2.7 (0.5)</b>	-1.9 (0.8)	-5.1 (0.8)	<b>-5.0 (-)</b>
	 House price index Y/Y%	Oct	<b>0.7</b>	-	1.3	-







### Auctions

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/ <i>Daiwa forecast</i>	Previous
France	 07.45	Business confidence indicator	Dec	104	105
	 07.45	Manufacturing confidence (production outlook) indicator	Dec	99 (-2)	100 (-3)
UK	 09.30	Retail sales including fuel M/M% (Y/Y%)	Nov	0.2 (2.1)	-0.1 (3.1)
	 09.30	Retail sales excluding fuel M/M% (Y/Y%)	Nov	0.4 (2.0)	-0.3 (2.7)
	 11.00	CBI distributiives trades survey, reported sales	Dec	-5	-3
	 12.00	BoE Bank Rate %	Dec	0.75	0.75

### Auctions and events

Country	GMT	Auction / Event
EMU	 15.30	ECB Chief Economist Lane scheduled to speak
UK	 12.00	BoE MPC policy decision, statement and minutes published

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FCA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.