Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds followed USTs lower as the Swedish Riksbank ended its negative rate policy and a French survey suggested that business conditions remained stable towards year-end.
- Gilts also made losses as the BoE left monetary policy unchanged but UK retail sales data missed expectations.
- Friday will bring new survey results on consumer confidence in the euro area, Germany and the UK, and data on French consumer spending and UK public finances.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.650	-0.005
OBL 0 10/24	-0.522	+0.008
DBR 0 08/29	-0.241	+0.013
UKT 3¾ 09/21	0.559	+0.022
UKT 1 04/24	0.600	+0.030
UKT 0⅞ 10/29	0.809	+0.032

*Change from close as at 4:30pm GMT.
Source: Bloomberg

Euro area

INSEE survey signals stable French business conditions

Broadly in line with the findings of the flash PMIs released at the start of the week, today's INSEE survey results suggested that French business conditions have been broadly stable so far in December. Most striking perhaps, the survey pointed to a notable improvement in retail sector conditions to the best so far this year – jarring with anecdotes of a possible hit to spending from the pension-reform protests – with firms reporting improved sales and improved orders. Like the flash PMIs, the survey also suggested an improvement in services, while conditions in manufacturing and construction were also judged to be stable. Less positively, however, the survey suggested a deterioration in the employment climate, although it still pointed to ongoing jobs growth. Given today's survey, we maintain our forecast for French GDP growth in Q4 of 0.3%Q/Q, the same pace as in each of the three previous quarters but 0.1ppt firmer than the rate implied by the Bank of France's own business survey.

The day ahead in the euro area and US

The end of the week will bring more December sentiment indicators, including most notably the Commission's flash consumer confidence index. While this is expected to have ticked slightly higher on the month, this would remain firmly within the sideways trend seen since the start of the year and still well below the peak at the end of 2017. The latest German GfK consumer survey is also due and likely to signal little improvement in household sentiment at the turn of the year. ISTAT will also publish the latest Italian business and consumer surveys. French consumer spending figures for November are also due, as are euro area balance of payments data for October.

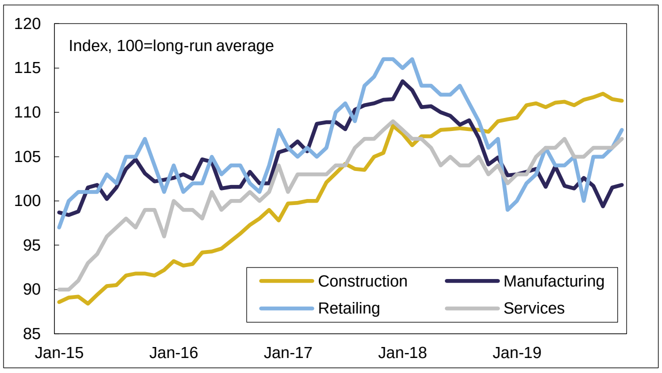
In the US, tomorrow will bring final Q3 GDP figures, which are expected to confirm that growth was little changed from Q2 at 2.1%Q/Q annualised. Likely of more interest will be personal income and spending figures for November, including the closely-watched deflators, while the revised University of Michigan consumer confidence survey for December is also due.

UK

No surprises from the BoE

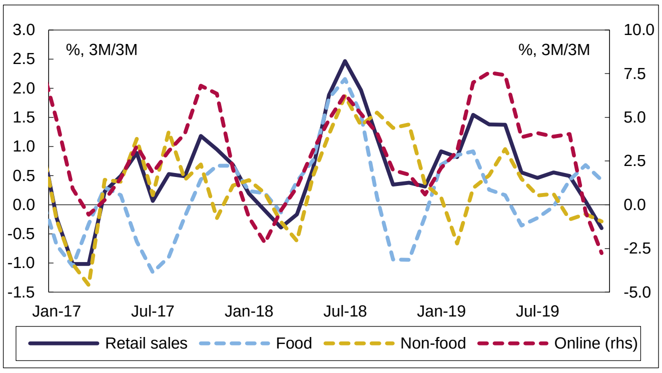
There were no major surprises from today's BoE policy announcements. Bank Rate was left unchanged at 0.75%. And the MPC's forward guidance was unamended from last month too. So, the Committee restated that "Monetary policy could respond in either direction to changes in the economic outlook" with the impact of Brexit and prospects for global demand key in determining the next move in Bank Rate. If the economy recovers broadly in line with the MPC's November forecasts, gradual and limited rate hikes "may be needed". But if global growth fails to stabilise or Brexit uncertainties continue to weigh on economic growth and inflation, then a rate cut is likely to be the consequence.

France: INSEE business sentiment indicators



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Doves make "risk management" case for a cut

Indeed, as last month, while seven members again thought it best to leave policy on hold, two external MPC members – Jonathan Haskel and Michael Saunders – today voted for immediate easing. They noted that the BoE staff now expects GDP to rise just 0.1%Q/Q in the current quarter, slightly weaker than in its November forecasts. They also noted that business surveys conducted prior to the election suggested flat or negative growth in Q4. And they recognised that core inflation was now subdued, there was a rising (albeit still modest) amount of spare capacity, and that the labour market was slowing too. So, with limited space to cut Bank Rate further, they argued that "risk management considerations" favoured easing sooner rather than later.

Identity of next Governor to have bearing on policy in 2020

Boris Johnson's large parliamentary majority will reduce near-term Brexit risks, with the UK bound to leave the EU at end-January. However, uncertainty surrounding the future trading relationship between the UK and EU will persist, and barriers to trade seem likely to rise from end-2020 when Johnson intends to end the Brexit transition period. As such, we expect business investment to remain weak, labour market conditions to continue to soften, and overall economic growth to remain sub-potential. So, the case for easing monetary policy should, if anything, strengthen, and we maintain our forecast for a 25bp cut in Bank Rate in May. However, we acknowledge uncertainty about the outlook for UK rates, not least since Mark Carney is set to depart the BoE at end-January and his replacement as Governor has yet to be identified. A formal nomination from the Treasury is likely to be imminent, but the field of potential candidates appears wide.

Retail sales disappoint

Certainly, the MPC doves' concerns about the weak near-term economic outlook might have been strengthened by today's disappointing retail sales figures. Indeed, these reported a larger-than-expected decline in November of -0.6%M/M, the steepest monthly drop since December 2018, to mark the fourth consecutive month that sales have failed to grow. And while the weakness was widespread, department store sales posted the sharpest fall (-1.4%M/M) for almost three years, while online sales declined for the fourth consecutive month (-1.8%M/M). Admittedly, moves in retail sales are notoriously volatile. But the marked moderation in the annual increase – down 2.1ppts to 1%Y/Y – and the drop on a three-month basis (-0.4%3M/3M) were the weakest showings since April 2018, when economic activity was impacted by unseasonably heavy snow.

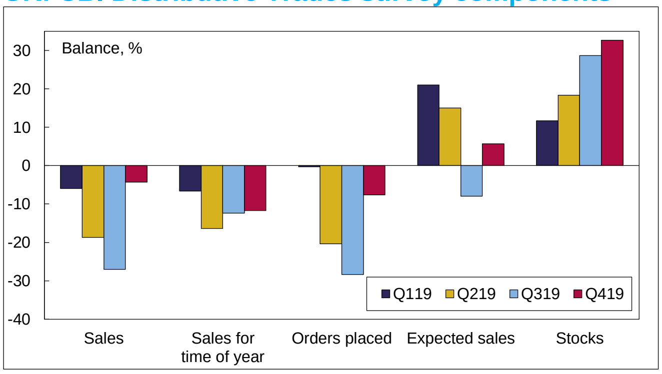
Black Friday sales confuse the picture

Of course, the increasing importance of Black Friday sales has made assessing underlying conditions in the retail sector over the festive season more challenging over recent years. And today's release was further distorted by the late date of this discounting period this year, which will be captured in the ONS's December retail sales release this year. As a result we would expect to see a notable bounce back in the official sales figures this month. This notwithstanding, the CBI's Distributive Trades survey today suggested that retailers remained under pressure heading into year-end. In particular, the survey's headline sales index implied no growth in December compared with a year earlier for the second successive month. And while this compared more favourably to the declines reported in the survey in recent months, retailers were nevertheless pessimistic about sales volumes for this time of the year, while new orders placed with suppliers fell for the eighth consecutive month.

The day ahead in the UK

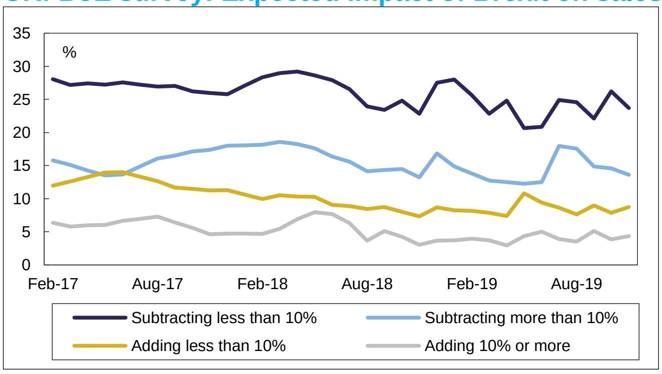
It will be a relatively busy end to the week for UK data, with new releases including final Q3 GDP figures and the current account balance. Likely of greater interest will be the latest GfK consumer confidence survey for December, while public finance figures for November are also due.

UK: CBI Distributive Trades survey components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: BoE survey: Expected impact of Brexit on sales



Share of respondents signalling the expected impact of Brexit on sales once the UK has left the EU compared with remaining within the EU.
Source: BoE DMP survey

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
France	Business confidence indicator	Dec	**106**	104	105	**106**
	Manufacturing confidence (production outlook) indicator	Dec	**102 (-6)**	99(-2)	100(-3)	**102 (-2)**
UK	Retail sales including fuel M/M% (Y/Y%)	Nov	**-0.6 (1.0)**	0.2 (2.1)	-0.1 (3.1)	**0.0 (-)**
	Retail sales excluding fuel M/M% (Y/Y%)	Nov	**-0.6 (0.8)**	0.4 (2.0)	-0.3 (2.7)	**-0.1 (-)**
	CBI Distributiive Trades survey, reported sales	Dec	**0**	-5	-3	**-**
	BoE Bank Rate %	Dec	**0.75**	0.75	0.75	**-**

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/ *Daiwa forecast*	Previous
EMU	15:00	Consumer confidence indicator	Dec	-7.0	-7.2
	9:00	Current account balance €bn	Oct	-	28.2
Germany	07:00	GfK consumer confidence indicator	Jan	9.8	9.7
France	07:45	Consumer spending M/M% (Y/Y%)	Nov	0.2 (0.4)	0.2 (-0.2)
Italy	9:00	Consumer confidence indicator (manufacturing confidence)	Dec	109.0 (99.1)	108.5 (98.9)
	9:00	Economic sentiment indicator	Dec	-	99.1
UK	0:01	GfK consumer confidence indicator	Dec	-14	-14
	0:01	Lloyds business barometer	Dec	-	9
	9:30	Final GDP Q/Q% (Y/Y%)	Q3	0.3 (1.0)	-0.2 (1.3)
	9:30	Current acount balance £bn	Q3	-15.5	-25.2
	9:30	Public sector net borrowing £bn	Nov	6.1	11.2

Auctions and events

Country	GMT	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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