

Euro wrap-up

Overview

- Bunds closed little changed as the December flash euro area inflation estimate aligned with expectations, rising to a six-month high.
- On a day bereft of UK economic data, Gilts made losses as the DMO announced plans to increase Gilt issuance this quarter.
- Wednesday will bring the European Commission's economic sentiment survey, German factory orders data and UK productivity figures.

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Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.637	-0.002
OBL 0 10/24	-0.557	+0.001
DBR 0 08/29	-0.284	+0.006
UKT 3% 09/21	0.606	+0.012
UKT 1 04/24	0.616	+0.030
UKT 0% 10/29	0.796	+0.027

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

Euro area

Headline inflation boosted by energy

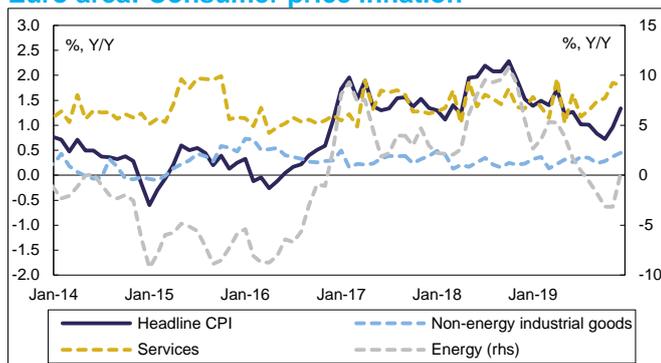
There were no major surprises from today's euro area flash inflation figures for December. In particular, the headline CPI rate rose 0.3ppt to 1.3%Y/Y, a six-month high. Admittedly, to two decimal places the increase was stronger (0.38ppt to 1.34%Y/Y), suggesting the possibility of an upwards revision in due course. The pickup almost fully reflected energy inflation, which posted the first year-on-year increase for five months. Food price inflation was also a touch firmer, up 0.1ppt to 2.1%Y/Y. In contrast, services inflation eased slightly in December (down 0.05ppt to 1.8%Y/Y) while non-energy industrial goods inflation moved broadly sideways at 0.4%Y/Y (again to two decimal places it was 0.08ppt stronger at 0.45%Y/Y). As such, core inflation was unchanged at 1.3%Y/Y, the joint-highest for more than four years.

But underlying price pressures seem unlikely to shift higher over the near-term. Indeed, following a temporary dip in January, we expect core inflation to trend broadly sideways this year, with our full-year forecast of 1.2%Y/Y in 2020 a touch softer than the ECB's. Of course, the recent rise in the oil price – yesterday saw Brent crude briefly leap above \$70bpb for the first time since September's spike – on the back of heightened geopolitical tensions in the Middle East poses a potential upside risk to headline inflation. Indeed, assuming the oil price remains around its current level, headline inflation will likely edge slightly higher in January. However, we would still expect to see a brief weakening around the middle of the year on the back of base effects. And we currently forecast inflation to end 2020 close to where it starts it. Overall, we have shifted our full-year forecast for the headline CPI rate only slightly higher to 1.4%Y/Y. That, however, is 0.3ppt above the ECB's most recent projection, and could well help the Governing Council to justify withholding additional stimulus over coming quarters.

Retail sales rebound but maintain softer trend

After yesterday's positive German retail sales release, today's euro area figures were inevitably more encouraging. Indeed, euro area retail sales jumped 1.0%M/M in November, the strongest monthly increase in five. And with the decline in October (-0.3%M/M) half the pace initially estimated, the level of sales was more than 2% higher than a year. While Germany led the recovery among the larger member states (2.1%M/M), sales were also stronger in France (+1.1%M/M) and Spain (+0.7%M/M). The strength in the euro area as a whole was concentrated in core items (i.e. goods excluding food and auto fuel), sales of which rose 1.4%M/M, the most since last January, as purchases of clothing, electrical goods, furniture and pharmaceuticals all increased. But while internet and mail order sales rose 2.7%%M/M, this only partly reversed weakness seen in previous months – indeed, the level of such sales in October and November was almost 2% below the Q3 average. And overall, while euro area sales were currently trending 0.3% higher than the average in Q3, this suggests a moderation in growth in Q4 compared with the first three quarters of the year.

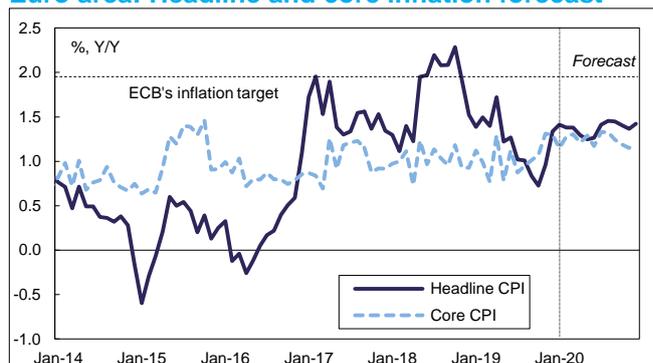
Euro area: Consumer price inflation*



*December's figures are flash estimates.

Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Headline and core inflation forecast



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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The day ahead in the euro area and US

Tomorrow will bring more top-tier releases, including the European Commission’s economic sentiment indices for December, which often provide the most reliable guide to economic activity. While the headline euro area ESI ticked up in November to 101.3, it was still merely the second lowest reading in almost five years, and little improvement is expected in the December figure. German factory orders figures for November are due tomorrow, along with the French INSEE consumer confidence survey for December. In the markets, Germany will sell 10Y Bunds.

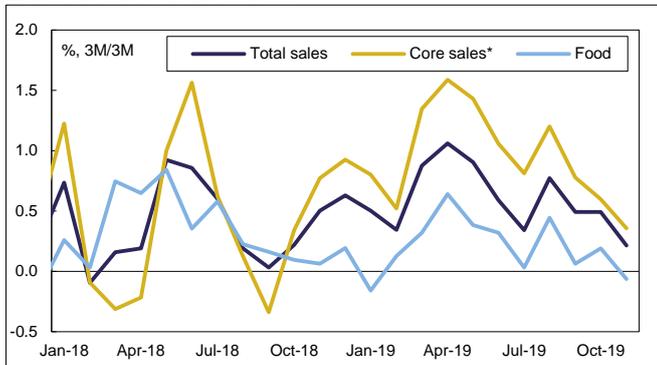
In the US, ahead of Friday’s labour market report, tomorrow will bring the ADP employment survey for January, which is likely to report a notable pickup in light of the return of GM strikers to the workplace. November consumer credit figures are also due, while in the markets the Treasury will sell 10Y notes.

UK

The day ahead in the UK

After a quiet day for UK economic data, tomorrow will bring final Q3 productivity and labour costs data.

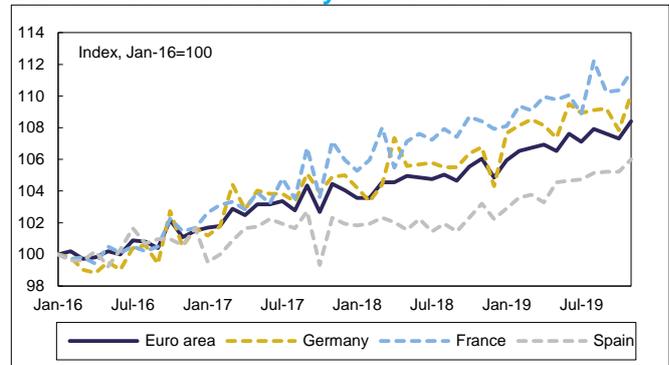
Euro area: Retail sales



*Excluding food and fuel.

Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales by member state



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	 Retail sales M/M% (Y/Y%)	Nov	1.0 (2.2)	0.6 (1.5)	-0.6 (1.4)	-0.3 (1.7)
	 Preliminary CPI (core CPI) Y/Y%	Dec	1.3 (1.3)	1.3 (1.3)	1.0 (1.3)	-
Germany	 Construction PMI	Dec	53.8	-	52.5	-
Italy	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Dec	0.5 (0.5)	0.5 (0.5)	0.2 (0.2)	-
Auctions						
Country	Auction					
Germany	 sold €418mn of 0.50% 2030 index-linked bonds at an average yield of -1.29%					
UK	 sold £2.75bn of 0.875% 2029 bonds at an average yield of 0.794%					

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	10.00	Economic confidence	Dec	101.4	101.3	
	10.00	Industrial confidence indicator (services)	Dec	-9.0 (9.5)	-9.2 (9.3)	
	10.00	Final consumer confidence	Dec	-8.1	-7.2	
Germany	07.00	Factory orders M/M% (Y/Y%)	Nov	0.2 (-4.7)	-0.4 (-5.5)	
France	07.45	Consumer confidence	Dec	104	106	
	07.45	Trade balance €bn	Nov	-5.1	-4.7	
UK	09.30	Unit labour costs Y/Y%	Q3	-	3.6	
Auctions and events						
Country	GMT	Auction / Event				
Germany	10.30	 Auction: to sell €5bn of 2030 bonds				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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