

Euro wrap-up

Overview

- Bunds made gains even as the ECB account signalled somewhat greater optimism about the outlook and wariness of potential harmful side effects of negative rates.
- Gilts also made modest gains despite a relatively upbeat UK housing survey.
- Friday will bring data on euro area final inflation and construction output, and UK retail sales.

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Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.603	-0.006
OBL 0 10/24	-0.523	-0.013
DBR 0 02/30	-0.217	-0.015
UKT 3% 09/21	0.458	-0.001
UKT 1 04/24	0.438	-
UKT 0% 10/29	0.648	-0.006

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

Source: Bloomberg

Euro area

ECB account suggests greater optimism about the outlook

The ECB's account of its December Governing Council meeting, when policy was left unchanged but the door left open to additional rate cuts, strongly suggested that the hurdle to further easing is high. It certainly had a somewhat more positive tone than of late, noting some signs of stabilisation in the growth slowdown and suggesting that there had been a mild upward movement in underlying price pressures, even if actual inflation was still projected to remain some way below target. As noted by Lagarde following the meeting, the account also underscored the message that risks to the outlook now appeared to be less skewed to the downside. And it also reported that various economic models had suggested that the impact of the September easing package on growth and inflation might prove to be much larger than currently envisaged in the ECB's forecasts.

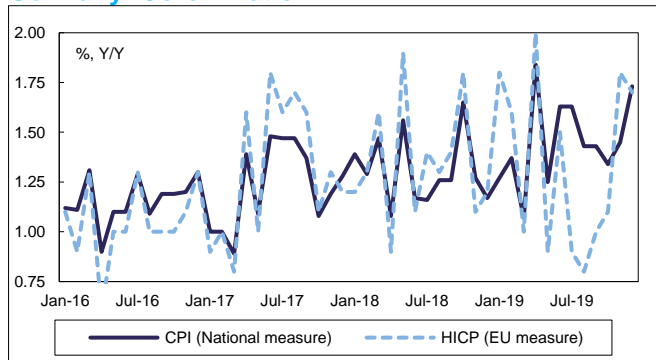
Possible adverse consequences of negative rates flagged

Some Governing Council members, however, highlighted possible side effects of the current ECB policy settings, which they suggested merited close monitoring. Concerns were noted regarding potential impacts of ample liquidity on prices of equities, housing and real estate. And the possible harmful consequences of negative rates, in particular on euro area household savings and consumption, were also flagged. These issues, of course, will be studied in the context of the ECB's strategic policy review, which is just getting underway. But until and unless those concerns are allayed, there are unlikely to be further rate cuts. Indeed, while Chief Economist Lane has repeatedly argued that negative rates and QE have worked together to significantly boost growth and inflation, the review might even conclude that a volte face on interest rates, such as that enacted by the Swedish Riksbank at the end of last year, is merited. Our working assumption, however, is that it will endorse the status quo on policy settings, but revise up the inflation target to 2.0%Y/Y with a symmetrical range.

Gradual uptrend in German core inflation intact

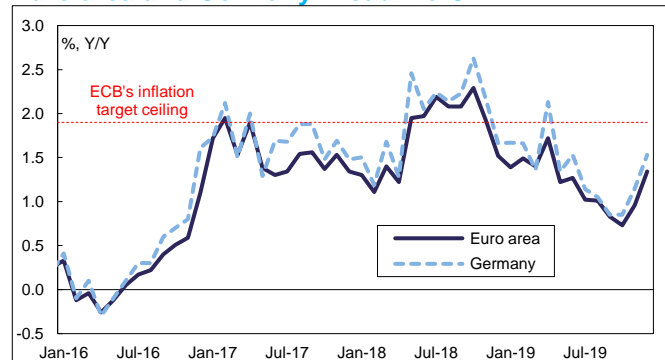
There was no surprise whatsoever from the final estimates of German CPI inflation in December, which aligned with the flash figures to leave the headline EU-harmonised measure at a six-month high of 1.5Y/Y, up 0.3ppt from the previous month. The increase in inflation was principally due to energy prices, which were down just 0.1%Y/Y having fallen 3.7%Y/Y in November. And core inflation on the EU measure edged down 0.1ppt to 1.7%Y/Y. On the national measure, the headline rate rose 0.4ppt to 1.5%Y/Y, while the core rate rose 0.2ppt to an eight-month high of 1.7%Y/Y, seemingly extending the gradual uptrend in underlying price pressures flagged by today's ECB meeting account. With the equivalent final estimates for France (1.6%Y/Y) and Spain (0.8%Y/Y) similarly having matched their preliminary estimates, tomorrow's euro area numbers

Germany: Core inflation*



*Excluding food and energy. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area and Germany: Headline CPI*



*EU-harmonised HICP measure. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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(1.3%Y/Y on both the headline and core flash rates) are also highly likely to do the same.

End-year surge in car registrations confirmed

Turning to economic data, today's car registration figures from the ACEA confirmed a surge in sales at the end of last year. These reported a whopping rise of 21.9%Y/Y in the euro area and 21.7%Y/Y in the EU as a whole. The headline growth rate was flattered to some extent by base effects (registrations had fallen more than 8%Y/Y at the end of 2018), but the level of sales nevertheless reached a series high for the month of December. Perhaps unsurprisingly, however, special factors which provided incentives to bring forward purchases ahead of the New Year also helped explain the spurt in growth. In particular, tax changes encouraged vigorous sales in France (27.7%Y/Y), the Netherlands (113.9%) and (beyond the euro area) Sweden (+109.3%Y/Y). But among other countries, registrations were also up 19.5%Y/Y in Germany and 12.5%Y/Y in Italy.

Further rise in car sales in 2020 seems unlikely

Given the leap in December, overall in 2019 new car registrations in the euro area rose for the sixth successive year, up 1.4%Y/Y (and 1.2%Y/Y in the EU as a whole). Germany chalked up the biggest full-year increase (up 5%Y/Y to the highest level since 2009), perhaps surprisingly in light of the sharp drop in car production in that country. But the drop in German production of 9%Y/Y in 2019 to the lowest level in 23 years, which prompted Merkel's government to prepare wage subsidies for auto firms and their suppliers to prevent a jump in redundancies, was due to softer external demand. Elsewhere, new car registrations in 2019 were up 1.9%Y/Y in France and a minimal 0.3%Y/Y in Italy. In contrast, Spain (-4.8%Y/Y) and (beyond the euro area) the UK (-2.4%Y/Y) saw new car registrations fall last year. Unfortunately, car registrations in the euro area are expected to fall back in 2020 leaving the industry reliant on a (perhaps unlikely) recovery in external demand to generate a recovery in output growth.

The day ahead in the euro area and US

Aside from the aforementioned final euro area CPI release for December, tomorrow will bring euro area construction output figures for November. Given strong growth of around 2½%M/M in Germany and France, this is bound to show a firm rebound following a drop of 1.0%M/M in October. The ECB's balance of payments report for November is also due. In the US, Friday will bring industrial production, housing starts and building permits data for December, as well as the preliminary University of Michigan consumer survey results for January.

UK

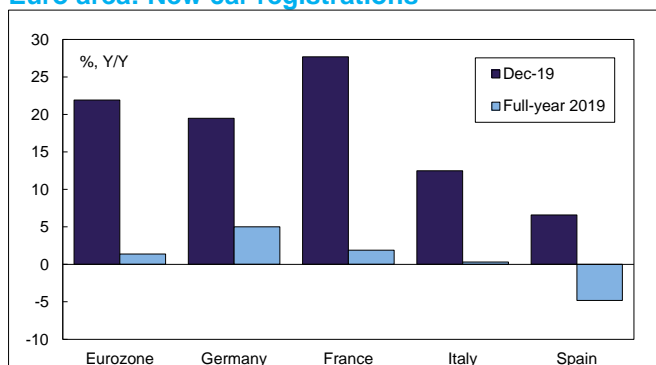
Housing market boosted by post-election optimism

After ONS data yesterday showed average house price inflation rising at the firmest annual rate for a year, today's RICS residential survey signalled somewhat greater optimism about the likelihood of a pickup in activity in the housing market over the coming year too. In particular, the headline house price balance rose 9pts in December to -2, a six-month high, as the outcome of the General Election seemingly offered greater certainty about the near-term outlook. The detail of the report was more encouraging too, with a sharp increase in new buyer enquiries at the end of last year – the relevant index rose 22pts to +17, the highest since August 2015 – while agreed sales also ticked higher, with a notable improvement in London. And surveyors were more upbeat about the outlook too, with near-term sales expectations the strongest since 2015 and expectations for the coming twelve months the highest since early 2014.

The day ahead in the UK

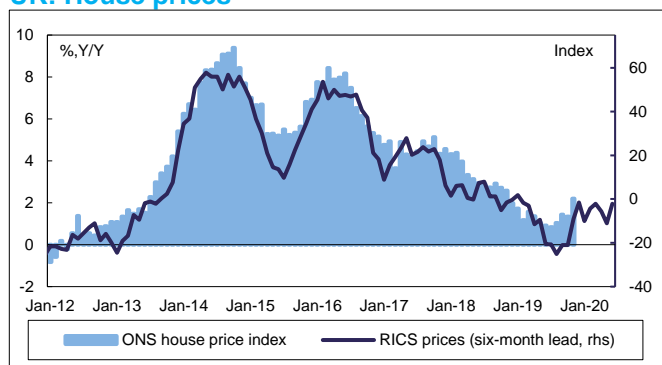
Friday will bring the December retail sales report, which will be closely watched by the BoE as it weighs the case for easing at the next MPC meeting. Expectations are for sales to do little more than reverse the drop of 0.6%M/M in November, which could leave sales down on the quarter in Q4 for the first time since Q118.

Euro area: New car registrations






Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: House prices









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	 EU27 new car registrations	Dec	21.7	-	4.9	-
Germany	 Final CPI (EU-harmonised CPI) Y/Y%	Dec	1.5 (1.5)	1.5 (1.5)	1.1 (1.2)	-
UK	 RICS house price balance	Dec	-2	-8	-12	-11
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	
EMU		10.00	Construction output M/M% (Y/Y%)	Nov	-	-1.0 (0.3)
		10.00	Final CPI (core CPI) Y/Y%	Dec	1.0 (1.3)	1.0 (1.3)
Italy		09.00	Trade balance €bn	Nov	-	8.0
		10.00	Final CPI (EU-harmonised CPI) Y/Y%	Dec	0.5 (0.5)	0.2 (0.2)
UK		09.30	Retail sales including fuel M/M% (Y/Y%)	Dec	0.6 (2.7)	-0.6 (1.0)
		09.30	Retail sales excluding fuel M/M% (Y/Y%)	Dec	0.8 (3.0)	-0.6 (0.8)
Auctions and events						
Country	GMT	Auction / Event				
- Nothing scheduled -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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