

Overview

- Bunds ended the day little changed as final euro area CPI figures confirmed that underlying inflation moved sideways at the end of 2019.
- Shorter-dated Gilts made more notable gains as very weak UK retail sales data added to the case for a near-term cut in Bank Rate.
- In the week ahead, Thursday's ECB policy announcement looks set to be uneventful. But Friday's flash January PMIs from the euro area and UK will be closely watched, as will UK labour market figures on Tuesday.

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Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.603	-
OBL 0 10/24	-0.521	+0.001
DBR 0 02/30	-0.219	+0.002
UKT 3¼ 09/21	0.421	-0.034
UKT 1 04/24	0.415	-0.018
UKT 0¾ 10/29	0.632	-0.011

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

Euro area

Underlying inflation little changed at end-2019

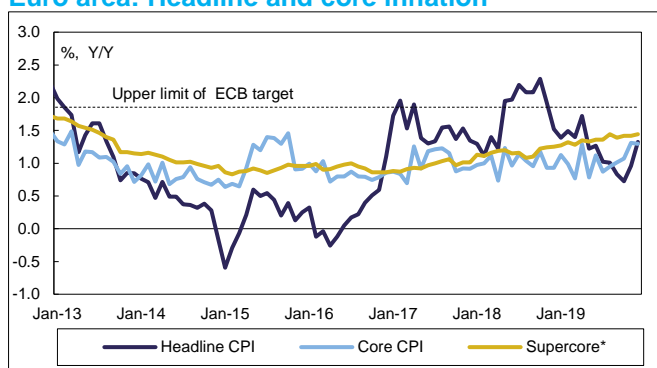
The final estimates of inflation in December brought minimal revisions from the preliminary figures. The headline annual HICP rate was left unchanged at 1.3%Y/Y, up 0.3ppt from November and a six-month high. As suggested by the flash estimates, the rise principally reflected higher energy inflation (confirmed to have risen 3ppts to 0.2%Y/Y). No material changes were made to the estimates of inflation of services (down 0.1ppt to 1.8%Y/Y) and non-energy industrial goods (up 0.1ppt to 0.5%Y/Y, the highest since January 2018). So, core inflation was confirmed at 1.3%Y/Y, unchanged from November's seven-month high. As such, while the 'mild' uptrend in underlying inflation noted by the ECB in its last Governing Council meeting account was reaffirmed, it remained underwhelming.

Calculations based on the detail published for the first time saw the 'supercore' measure of inflation, which excludes prices of package holidays as well as food and energy, unchanged at 1.4%Y/Y for a seventh successive month. Admittedly, to two decimal places, it edged back up to 1.44%Y/Y, matching the highest since July 2013, and thus seemingly supporting a further assessment in the ECB account that this measure has posted a 'solid upwards movement'. Nevertheless, looking ahead, while we expect headline inflation to edge a little higher over coming months on the back of increased energy inflation, we also expect underlying inflation – whether measured by core or supercore indicators – to level off, leaving the ECB's current target of close to 2.0%Y/Y still out of reach over the forecast horizon.

Construction output on track for growth in Q4

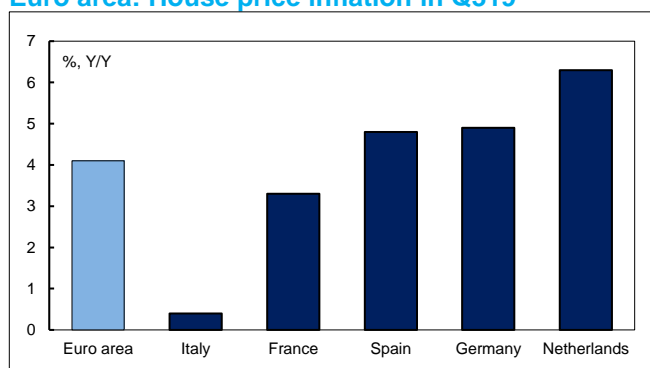
After a soft start to the quarter with a drop of 0.5%M/M in October, euro area construction output rose 0.7%M/M in November to be up 1.4%Y/Y, the strongest annual rate since July. Growth was centred on building work (up 1.1%M/M) while civil engineering activity was sluggish (up 0.3%M/M). The increase was not unexpected as we already knew that output in the sector had risen about 2½%M/M in Germany and France. The softer overall rate of growth principally reflected weaker activity in Iberia, with output in Spain and Portugal down 0.6%M/M and 1.4%M/M respectively. Today's data strongly suggest a return to expansion in the sector in Q4 after consecutive declines in output of about ½Q/Q in Q2 and Q3. And we would expect a mild uptrend to be sustained in 2020. While soft business investment will act as a restraint, building work should benefit from firm house price growth (up 4.1%Y/Y in the euro area in Q3), rising real household incomes, solid mortgage loan growth and historically low interest rates. And civil engineering activity should receive a boost from increased public investment against the backdrop of a moderate loosening of fiscal policy.

Euro area: Headline and core inflation



*Excluding package holidays, food and energy. Source: Thomson Reuters, Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: House price inflation in Q319



Source: Eurostat and Daiwa Capital Markets Europe Ltd.



The week ahead in the euro area and US

The coming week brings the latest policy meeting of the ECB's Governing Council, only the second to be chaired by Christine Lagarde. But this seems likely to be relatively uneventful. There seems no reason whatsoever for a change of monetary policy or forward guidance. And with no new economic forecasts to be published, the Governing Council's overall assessment of economic conditions will not change either. We would expect Lagarde again to take comfort from signs of stabilisation in the growth slowdown and note the mild increase in underlying inflation in line with previous expectations. And, as in December, she might judge the downside risks to the economic outlook to have become even less skewed to the downside. Most notable might be what Lagarde has to say about the ECB's strategic policy review, although with the work barely underway she will certainly not preempt its findings.

Data-wise, Friday's flash January PMIs will be most closely watched. In December, the services PMI rose to a four-month high (52.8) to suggest steady growth in the sector but the equivalent index for manufacturing (46.3) fell back below the average for the second half of the year, and thus close to the bottom of the range of the past seven years. That saw the composite PMI rise 0.3pt to 50.9, the highest since August but still consistent with a slowdown in economic growth over the fourth quarter as a whole. There are few additional top-tier releases due over the coming week, although other January survey indicators include the ZEW investor sentiment indices (Tuesday), the French INSEE business confidence indices (Wednesday) and the Commission's flash consumer confidence survey (Thursday). In the markets, Germany will sell 2Y Schatz on Tuesday while France will auction a range of bonds on Thursday.

It should be a relatively quiet week for top-tier US economic releases. With markets closed on Monday for Martin Luther King Day, the first of the coming week's releases will come on Wednesday with existing home sales figures for December and the FHFA home price index for November. That day will also bring the latest Chicago Fed national activity index, with the Kansas Fed manufacturing activity index due the following day. Thursday will also see the release of the Conference Board's Leading Index for December, while the flash Markit PMIs for January are due Friday. In the markets, the Treasury will sell 10Y TIPS on Thursday.

UK

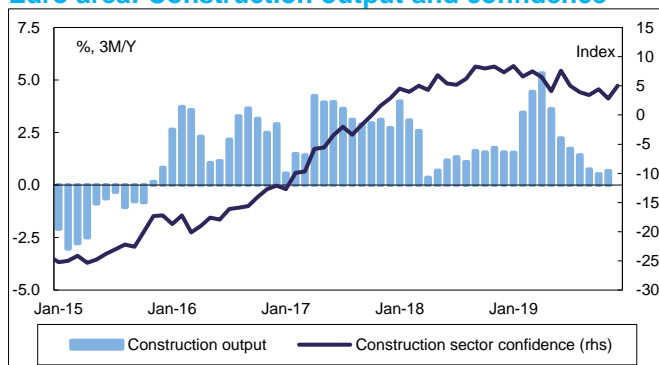
Worst Q4 retail sales in nine years

The UK's December retail sales figures were dire, concluding the worst fourth quarter for nine years and strengthening further the case for a cut in Bank Rate at the 30 January MPC meeting. While it had been expected to rise partly thanks to the timing of the Black Friday discounting period, the total volume of retail sales fell 0.6%M/M in December. That followed a drop of 0.8%M/M in November, which was a weaker performance than originally estimated, and made it five consecutive months without any positive sales growth. And as a result, total sales dropped 1.0%3M/3M to mark the biggest quarterly drop in sales since Q117. The drop in sales in December came despite a jump of 1.6%M/M at petrol stations, as sales at food stores fell 1.3%M/M, the most in three years, and sales in non-food stores fell for the third consecutive month and by 1.0%M/M, the most since July. Sales from clothes stores fell 2.1%M/M to be down 2.2%3M/3M to represent the worst quarter since Q116.

January rate cut now more likely than not

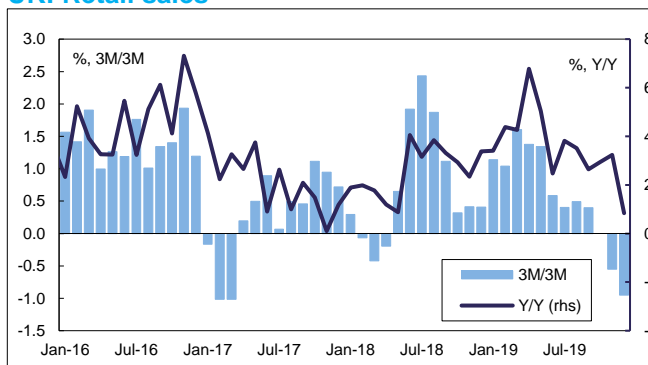
While the weakness in economic activity earlier in Q4 might be explained partly by risks of a disorderly no-deal Brexit at end-October, there appears no simple excuse for the drop in retail sales in November and December. Admittedly, inclement weather could have kept many consumers out of the shops, while some might quibble about the seasonal adjustment methodology used by the ONS around the Black Friday period. But with the deflator for total sales excluding fuel falling 0.3ppt to a seven-month low of 0.2%Y/Y, consumers appear simply to have eschewed bargain-hunting, deciding instead to cut spending on goods in the face of ongoing uncertainty about the economic impact of Brexit and the associated softening

Euro area: Construction output and confidence



Source: Thomson Reuters, Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.
















of conditions in the labour market. And with today's poor figures having come hot on the heels of monthly GDP and inflation figures that were somewhat softer than the BoE expected, and several MPC members having signalled their readiness to vote for monetary easing unless the economic data improve, we now expect a 25bp rate cut, to 0.5%, on 30 January unless next Friday's flash PMIs surprise very significantly on the upside.

The week ahead in the UK

The aforementioned January flash PMIs are certainly the most notable new economic data due in the coming week. The expectation is for improvements in the manufacturing and services indices to push the composite PMI back above 50 for the first time since August. Given the weakness of other recent economic data, the consensus forecast for the composite PMI of 50.5, however, would seem unlikely to prevent a rate cut at the next MPC meeting on 30 January. Other top-tier releases due in the coming week will also factor into the BoE's policy judgement, most notably Tuesday's labour market report. This is expected to report a stable unemployment rate at 3.8% in the three months to November, and a rebound in job growth to above 100k3M/3M for the first time since June. Pay growth is expected to slow for a fifth consecutive month, to 3.4%Y/Y when excluding bonuses, which would be the softest since April. Among the week's other new releases, the December public finance figures and the CBI's latest Industrial Trends survey are due on Wednesday. In the markets, the DMO will sell 2041 Gilts on Tuesday.

In the absence of significant news, the next edition of the Euro wrap-up will be published on 21 January 2020

Daiwa economic forecasts







	2019		2020				2021		2019	2020	2021
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP forecasts %, Q/Q											
Euro area 	0.2	0.1	0.2	0.3	0.2	0.2	0.2	0.1	1.2	0.9	0.6
Germany 	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.0	0.6	0.6	0.6
France 	0.3	0.2	0.3	0.3	0.2	0.2	0.2	0.2	1.3	1.1	0.8
Italy 	0.1	-0.1	0.1	0.1	0.0	-0.1	0.0	-0.1	0.1	0.1	-0.1
Spain 	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.2	1.9	1.6	1.2
UK 	0.4	-0.1	0.3	0.3	0.3	0.3	0.1	0.3	1.3	0.8	0.8
Inflation forecasts %, Y/Y											
Euro area											
Headline CPI 	1.0	1.0	1.3	1.2	1.4	1.3	1.3	1.2	1.2	1.3	1.4
Core CPI 	0.9	1.2	1.2	1.2	1.3	1.2	1.2	1.1	1.2	1.2	1.3
UK											
Headline CPI 	1.8	1.4	1.5	1.0	1.0	1.2	1.6	1.9	1.8	1.2	1.9
Core CPI 	1.7	1.6	1.4	1.4	1.4	1.5	1.8	2.0	1.8	1.4	2.0
Monetary policy											
ECB											
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate % 	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.60	-0.60	-0.50	-0.50	-0.60
Net asset purchases* 	0	20	20	20	20	20	30	30	20	20	30
BoE											
Bank Rate % 	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.50	0.50
Net asset purchases** 	0	0	0	0	0	0	0	0	0	0	0

*Monthly target €bn, end of period. **Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE 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%)	Nov	0.7 (1.4)	-	-1.0 (0.3)	-0.5 (0.9)
	 Final CPI (core CPI) Y/Y%	Dec	1.3 (1.3)	1.0 (1.3)	1.0 (1.3)	-
Italy	 Trade balance €bn	Nov	4.9	-	8.0	-
	 Final CPI (EU-harmonised CPI) Y/Y%	Dec	0.5 (0.5)	0.5 (0.5)	0.2 (0.2)	-
UK	 Retail sales including fuel M/M% (Y/Y%)	Dec	-0.6 (0.9)	0.6 (2.7)	-0.6 (1.0)	-0.8 (0.8)
	 Retail sales excluding fuel M/M% (Y/Y%)	Dec	-0.8 (0.7)	0.8 (3.0)	-0.6 (0.8)	-0.8 (0.6)



























Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 20 January 2020					
Germany	 07.00	PPI M/M% (Y/Y%)	Dec	0.0 (-0.3)	0.0 (-0.7)
UK	 00.01	Rightmove house prices M/M% (Y/Y%)	Jan	-	-0.9 (0.8)
Tuesday 21 January 2020					
Germany	 10.00	ZEW current situation balance (expectations)	Jan	-13.5 (15.0)	-19.9 (10.7)
Spain	 09.00	Trade balance €bn	Nov	-	-2.6
UK	 09.30	Claimant count rate % (change '000s)	Dec	-	3.5 (28.8)
	 09.30	Average weekly earnings (excluding bonuses) 3M/Y%	Nov	3.1 (3.4)	3.2 (3.5)
	 09.30	ILO unemployment rate 3M%	Nov	3.8	3.8
	 09.30	Employment change 3M/3M '000s	Nov	115	24
Wednesday 22 January 2020					
France	 07.45	Business confidence indicator	Jan	105	106
	 07.45	Manufacturing confidence indicator (production outlook)	Jan	101 (-5)	102 (-6)
Italy	 09.00	Industrial sales M/M% (Y/Y%)	Nov	-	0.6 (-0.2)
	 09.00	Industrial orders M/M% (Y/Y%)	Nov	-	0.6 (-1.5)
UK	 09.30	Public sector net borrowing, excluding banks £bn	Dec	5.3	5.6
	 11.00	CBI industrial trends survey, total orders (business optimism)	Jan	-25 (-28)	-28 (-44)
Thursday 23 January 2020					
EMU	 12:45	ECB main refinancing rate %	Jan	0.00	0.00
	 12:45	ECB marginal lending facility %	Jan	0.25	0.25
	 12:45	ECB deposit facility rate %	Jan	-0.50	-0.50
	 15.00	Preliminary consumer confidence	Jan	-7.6	-8.1
Friday 24 January 2020					
EMU	 09.00	Preliminary manufacturing PMI (services PMI)	Jan	46.8 (52.8)	46.3 (52.8)
	 09.00	Preliminary composite PMI	Jan	51.2	50.9
Germany	 08.30	Preliminary manufacturing PMI (services PMI)	Jan	44.5 (53.0)	43.7 (52.9)
	 08.30	Preliminary composite PMI	Jan	50.5	50.2
France	 08.15	Preliminary manufacturing PMI (services PMI)	Jan	50.5 (52.1)	50.4 (52.4)
	 08.15	Preliminary composite PMI	Jan	52.0	52.0
UK	 09.30	Preliminary manufacturing PMI (services PMI)	Jan	48.4 (51.0)	47.5 (50.0)
	 09.30	Preliminary composite PMI	Jan	50.5	49.3

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 20 January 2020		
- Nothing scheduled -		
Tuesday 21 January 2020		
Germany	 10.30	Auction: €4bn of 0% 2021 bonds
UK	 10.30	Auction: £2.25bn of 1.25% 2041 bonds
Wednesday 22 January 2020		
- Nothing scheduled -		
Thursday 23 January 2020		
EMU	 13.30	ECB Governing Council press conference
France	 09.50	Auction: 3Y, 5Y and 7Y fixed-rate bonds
	 09.50	Auction: Inflation-linked bonds
Friday 24 January 2020		
EMU	 09.00	ECB survey of professional forecasts
UK	 09.30	BoE's Haskel scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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