Euro wrap-up

Overview

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- Bunds followed the global trend higher as concerns of China's coronavirus hit risk appetite, while the ECB's lending survey implied a drop in demand for business loans.
- Gilts also made gains despite a significant upside surprise to today's UK employment data.
- Wednesday will bring the French INSEE business and UK CBI manufacturing surveys.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.593	+0.005
OBL 0 10/24	-0.535	-0.017
DBR 0 02/30	-0.254	-0.033
UKT 3¾ 09/21	0.425	-
UKT 1 04/24	0.425	-0.009
UKT 0⅞ 10/29	0.627	-0.023

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

Euro area

A drop in demand for business loans…

The ECB's Q4 quarterly bank lending survey brought some disappointing news, reporting a drop in business demand for bank loans for the first time in six years. A net percentage of 8% of banks reported lower demand for loans from enterprises last quarter, even though banks had anticipated such demand to be stable. The decline in net demand was broad-based, although a softening in demand from firms in France and Spain, where macroeconomic growth has been steady, was notable. The ECB noted that in most countries where banks indicated a net decline in demand for such loans, the weakening was at least in part related to lower financing needs for fixed investment. A slightly larger net share of banks expects loan demand from enterprises to decline in Q1. In contrast, due not least to favourable housing market prospects, elevated consumer confidence and record low interest rates, banks reported a further increase in net demand for housing loans in Q4 (a net percentage of 25%, up 10ppts from Q3), above both expectations and the historical average. Net demand for consumer credit and other lending to households was also stronger (a net percentage of 10%, up 2ppts from Q3), albeit not quite as firm as had been previously anticipated.

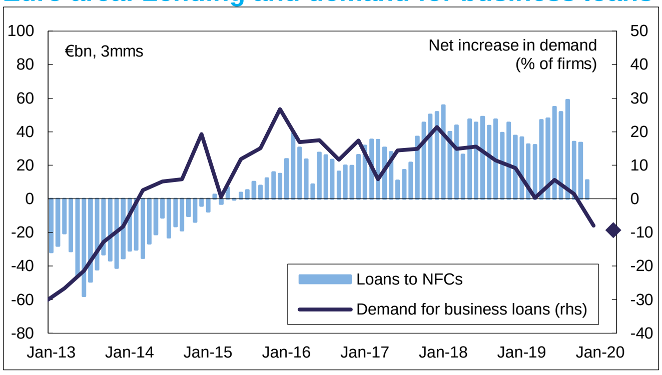
…and a modest tightening in credit standards

According to the ECB's survey, the deterioration in the economic environment in the second half of last year was also reflected in loan supply conditions. In particular, banks reported that increased perceptions of risks related to both borrower firms and the general economic situation had again had a net tightening impact on credit standards for loans to enterprises. Nevertheless, when taking other factors into account, banks reported minimal overall tightening of credit standards on business loans in Q4 (a net percent of just 1% of banks reported a tightening). And, on balance, they expect credit standards on loans to enterprises to remain broadly stable in the current quarter. Due to increased risk perceptions, banks also reported that credit standards for housing loans had tightened marginally in Q4, and those for consumer credit and other loans to households had tightened somewhat further too. However, while credit standards for housing loans are expected to become tighter still in the current quarter but those for consumer credit are expected to ease.

But no evidence that ECB has reached the 'reversal rate'

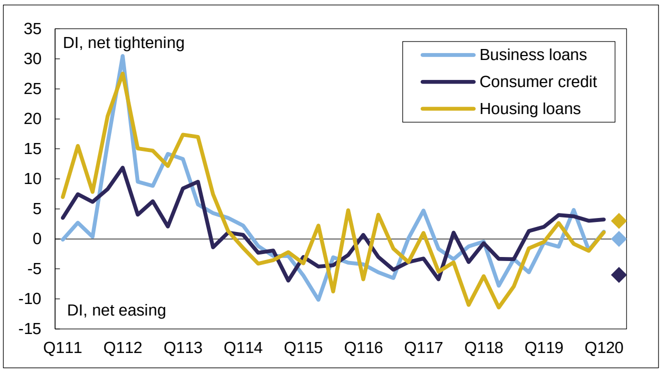
The published account of its most recent Governing Council meeting reported concerns about possible adverse side-effects from the ECB's policy settings. However, with the aforementioned adjustment of credit standards related to risk perceptions, the lending survey offered no compelling evidence that monetary policy had contributed to a net tightening of credit conditions in Q4. So, fears that the ECB has reached the so-called 'reversal rate', below which interest rate cuts lead to a

Euro area: Lending and demand for business loans*



Diamond represents survey forecast for Q120. Source: ECB bank lending survey, Thomson Reuters, Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Credit standards on loans*



Diamonds represent survey forecast for Q120. Source: ECB bank lending survey, Bloomberg and Daiwa Capital Markets Europe Ltd.

tightening of financial conditions, would currently seem unfounded. Moreover, the survey reported at least one positive consequence of its recent policy initiatives, as banks that had participated in the TLTRO-III operations reported that the extra liquidity had been principally used for lending to non-financial firms. And while take up at the first two rounds of TLTROs, cumulatively of little more than €100bn, had been disappointingly low, an increased share of banks – albeit still less than 50% of the total – signalled the likelihood that they will participate in future TLTROs.

ZEW survey surprisingly optimistic

In contrast to the ECB lending survey, Germany's ZEW survey of financial market professionals – the first to offer insight into sentiment at the start of the year – suggested much greater optimism about the economic outlook. Most notably, the German expectations balance rose for the fourth month out of the past five and by a sizeable 16pts to 26.7, the highest level since mid-2015. However, this index often tracks moves in equity markets, and is not a particularly reliable guide to future economic activity. At the same time, assessments of the current situation also improved, with the relevant index reaching a five-month high in January, up 10.4pts to -9.5. But this suggested, on balance, that survey respondents still judge conditions to be unfavourable. Indeed, it remained 37pts below its level this time last year and more than 100pts below its peak at the start of 2018, therefore suggesting progress towards stabilisation in economic conditions at the turn of the year rather than a sudden and vigorous recovery. Judging from the ZEW current situations balance, the more comprehensive ifo survey, due to be published on Monday, will point to only modest recovery in GDP growth at the start of the year.

The day ahead in the euro area and US

Wednesday will bring more national sentiment indicators, this time from the French INSEE business confidence survey for January. The headline index is expected to have slipped back slightly at the start of the year by 1pt to 105, albeit remaining comfortably above the long-run average. Italian industrial sales and orders data for November are also due.

In the US, tomorrow will bring existing home sales figures for December, along with the FHFA house price index for November and the Chicago Fed national activity index for December.

UK

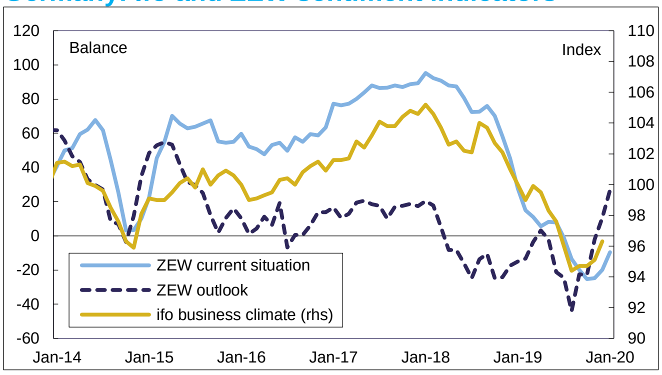
UK jobs growth surges

Most of last week's UK economic dataflow, from GDP to inflation to retail sales, seemed to justify a near-term rate cut from the BoE. But, at face value, today's labour market report appeared to support the case for leaving monetary policy unchanged at next week's MPC meeting. Certainly, the surge in jobs growth in the three months to November was significantly stronger than had been expected, with the increase of 208k the largest since January and taking the number of people in employment to a record 32.9mn. This principally reflected a notable pickup in full-time employment, with the 197k increase the strongest since 2015 thanks to the largest quarterly rise in female employment (126k) for more than 6½ years. As such, the unemployment rate remained steady at 3.8% in the three months to November, the joint-lowest level since the mid-1970s. But looking at the (admittedly volatile) one-month series, today's employment figures were somewhat less encouraging, with the strength reflecting an upwardly revised surge in September (305k) compared with a monthly decline of 128k in November. Moreover, although the level of vacancies edged up in November for the first time in 2019, it was still down more than 5½%Y/Y. So, while the recent profile might still suggest ongoing positive momentum in the labour market heading towards the end of the year, it might well already be past its peak.

Wage growth continues to moderate

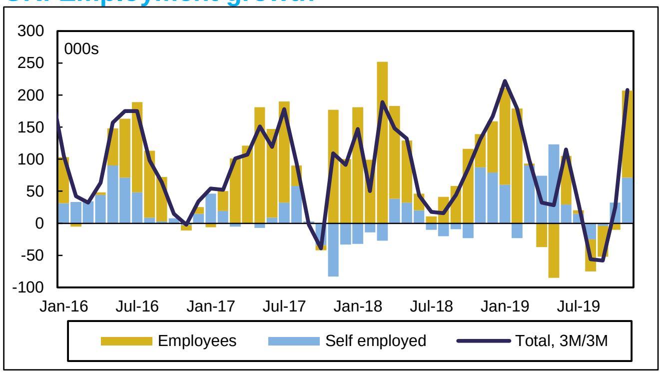
Despite the firm job growth, however, today's figures showed that wage growth remains relatively well contained. In

Germany: Ifo and ZEW sentiment indicators



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Employment growth



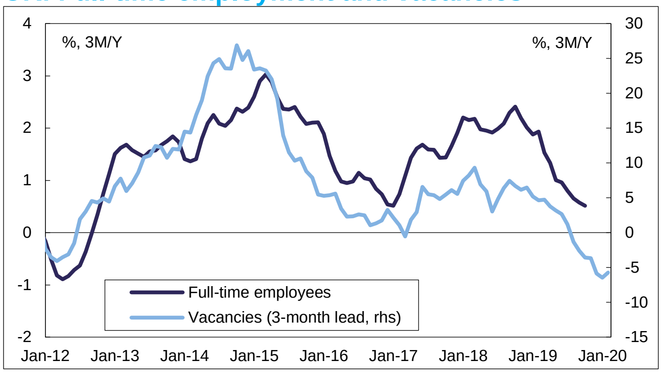
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

particular, total earnings growth moved sideways in November at 3.2%3M/Y, the joint-lowest since September 2018, with pay growth in the public sector (3.3%3M/Y) marginally firmer than in the private sector (3.2%3M/Y). When excluding bonuses, regular pay growth slowed for a fifth consecutive month, to 3.4%3M/Y, the softest since April. Underlying wage growth in the private sector also fell to its lowest for a year (down 0.1ppt to 3.4%3M/Y), with weakness in retailing, hotel and restaurants, as well as the manufacturing sector offsetting continued steady growth in construction. While the latest REC/KPMG recruitment survey suggested that demand for employees had picked up after December's General Election, it also indicated that firms on the whole were still not inclined to up salaries – indeed, that survey would suggest a further steady decline in private sector wage growth through the first half of this year. And certainly, for the time being, wages would seem to represent a relatively limited upside risk to the inflation outlook while persistent subdued demand appears to represent a more significant downside risk. So, as the two members who voted for easing in November and December have suggested, a risk management approach to monetary policy would still seem to justify a rate cut at next week's MPC meeting.

The day ahead in the UK

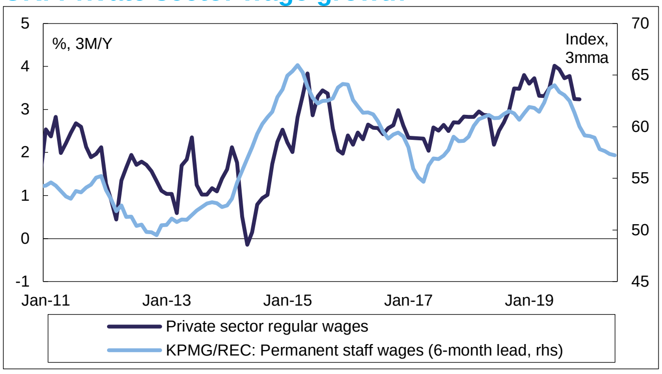
Wednesday will bring the CBI's latest industrial trends survey, which will provide an update on manufacturing conditions at the start of the year. While businesses are expected to be somewhat less downbeat about the outlook, the survey is also expected to show a further notable decline in new orders in January. Tomorrow will also see the release of December's public finance figures.

UK: Full-time employment and vacancies



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Private sector wage growth



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

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		ZEW current situation balance (expectations)	Jan	**-9.5 (26.7)**	-13.5 (15.0)	-19.9 (10.7)	-
Spain		Trade balance €bn	Nov	**-1.9**	-	-2.6	-
UK		Claimant count rate % (change '000s)	Dec	**3.5 (14.9)**	-	3.5 (28.8)	**3.4 (14.9)**
		Average weekly earnings (excluding bonuses) 3M/Y%	Nov	**3.2 (3.4)**	3.1 (3.4)	3.2 (3.5)	-
		ILO unemployment rate 3M%	Nov	**3.8**	3.8	3.8	-
		Employment change 3M/3M '000s	Nov	**208**	110	24	-

Auctions

Country		Auction
Germany		sold €3.2bn of 0% 2021 bonds at an average yield of -0.58%
UK		sold £2.25bn of 1.25% 2041 bonds at an average yield of 1.163%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		PPI M/M% (Y/Y%)	Dec	**0.1 (-0.2)**	0.1 (-0.3)	0.0 (-0.7)	-
UK		Rightmove house prices M/M% (Y/Y%)	Jan	**2.3 (2.7)**	`	-0.9 (0.8)	-

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
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 public sector banks £bn	Dec	5.3	5.6
		11.00	CBI industrial trends survey, total orders (business optimism)	Jan	-25 (-20)	-28 (-44)

Auctions and events

Country	GMT	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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