

Euro wrap-up

Overview

- On a day of diminished risk appetite, Bunds made gains, particularly at the long end, as Lagarde suggested that near-term euro area economic growth would remain in the recent range and the Commission's flash estimate of consumer confidence suggested no improvement at the start of 2020.
- Gilts also made gains and the yield curve flattened on a day without any top-tier UK economic data.
- Friday will bring the flash January PMIs for the euro area and UK, the latter of which could be key for the BoE's forthcoming rate decision.

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Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.614	-0.015
OBL 0 10/24	-0.575	-0.033
DBR 0 02/30	-0.315	-0.052
UKT 3¾ 09/21	0.416	-0.029
UKT 1 04/24	0.396	-0.039
UKT 0% 10/29	0.584	-0.050

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

Euro area

ECB expects near-term growth to be little changed

The ECB's latest policy meeting was uneventful, inevitably concluding with no changes to its interest rates, QE and forward guidance. As such, the Governing Council continued to leave the door open to further rate cuts even as it formally launched its strategic policy review, which Christine Lagarde thought was unlikely to conclude until the fourth quarter of the year. In addition, Lagarde judged that incoming data since the December meeting had been in line with the ECB's baseline forecast of ongoing moderate economic growth, with the manufacturing sector remaining a notable drag. So, while the risks to the growth outlook were again considered to have become less pronounced, albeit still tilted to the downside, she stated that near-term growth was still expected merely to be similar to rates observed in previous quarters. While Lagarde also asserted that there were some signs of a 'moderate' increase in underlying inflation, as opposed to the 'mild' increase previously identified, these were also judged merely to be in line with expectations.

Lagarde formally launches strategic review

The launch of the ECB's strategic review confirmed that there will be two main work-streams. The first – and seemingly most important – will consider the 'quantitative formulation of price stability, monetary policy toolkit, economic and monetary analyses, and communication practices'. The second will consider auxiliary issues such as financial stability, employment and environmental sustainability. Of course, today Lagarde was keen not to preempt the findings of the review. Nevertheless, her responses to questions hinted as to the possible conclusions on certain issues.

HICP to remain ECB's target inflation measure?

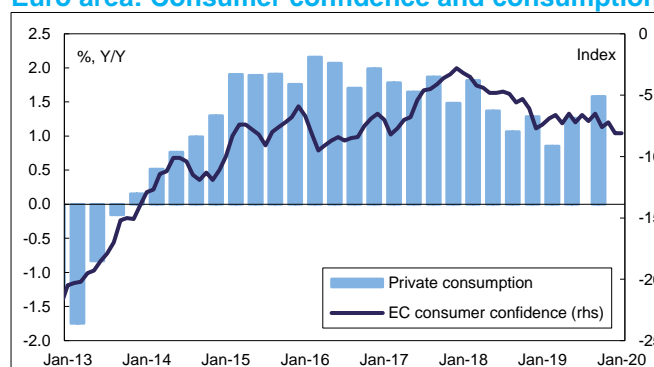
For example, with respect to the ECB's definition of price stability, Lagarde noted the difficulty of accurately gauging owner-occupied housing costs. Indeed, she considered it to be a challenge that only Eurostat – and not the ECB – could surmount over the longer term. As such, the currently targeted HICP inflation measure, rather than an alternative broader measure incorporating imputed rents, would seem likely to remain the focus of the ECB's target. And that would mean that the Governing Council would continue to treat strong increases in house prices as a secondary issue, perhaps to be addressed by macro-prudential policy, rather than a new source of upwards pressure on inflation that might merit a change in monetary policy.

Euro area: GDP growth and inflation forecasts

	GDP growth		Headline CPI		Core CPI	
	ECB	Daiwa	ECB	Daiwa	ECB	Daiwa
2019	1.2	1.2	1.2	1.2	1.0	1.0
2020	1.1	0.9	1.1	1.3	1.3	1.2
2021	1.4	0.6	1.4	1.4	1.4	1.3
2022	1.4	0.9	1.6	1.4	1.6	1.3

Source: ECB (December 2019) and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence and consumption



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Lagarde sees no need blindly to follow Swedish footsteps

Lagarde also insisted that the recent decision of Sweden's Riksbank to bring to an end to its negative rate policy was of no relevance to the ECB. Indeed, while the side-effects of the various monetary policy tools would be considered in detail in the strategic review, she suggested that the Governing Council continued to believe that its negative rate policy was supporting GDP growth, employment and inflation. She also noted that the new tiered system of reserve remuneration had been a success, and that there was currently no reason for the ECB to consider amending it. Overall, therefore, while the strategic review has the potential to significantly redesign ECB policy, the main message of Lagarde's press conference today was 'steady as she goes'.

Consumer confidence fails to improve

Consistent with Lagarde's view that near-term economic growth will likely remain close to recent rates, today's flash Commission euro area consumer confidence indicator for January made for disappointing reading. Indeed, having fallen in December to its lowest level since early 2017, the headline sentiment indicator implied no improvement whatsoever at the start of the year, moving sideways at -8.1, 0.7pt lower than its level a year ago and more than 5pts below its peak at the end of 2017. Like in December, subdued sentiment likely again reflected renewed weakness in France due to the ongoing disruption caused by the labour dispute over President Macron's pension reform proposals. But there is unlikely to have been a notable improvement in household confidence in other member states too. And overall, today's survey points to a relatively soft start to the year for household spending in the euro area.

The day ahead in the euro area and US

Friday will bring more sentiment indicators, with the flash January PMI surveys from the euro area and two largest member states. In December, the euro area's 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.

In the US, Friday will also bring the flash Markit PMIs for January, which are expected to show the composite PMI moving broadly sideways at the 52.7 level – an eight-month high – reached in December.

UK





The day ahead in the UK

After a quiet day for economic news, tomorrow will bring arguably the most relevant release for near-term BoE policy in the shape of the flash January PMIs. Reflecting the much-improved optimism reported in yesterday's [CBI manufacturing survey](#), the headline manufacturing PMI is expected to have risen at the start of the year, albeit to a level still consistent with contraction. The expectation is also for an improvement in the (more important) services index, which would push the composite PMI back above 50 for the first time since August. The consensus forecast for the composite PMI of 50.5, however, would still leave it at one of the weakest readings since the Global Financial Crisis and might fail to prevent a rate cut at the next MPC meeting.











European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 ECB main refinancing rate %	Jan	0.00	0.00	0.00	-
	 ECB marginal lending facility %	Jan	0.25	0.25	0.25	-
	 ECB deposit facility rate %	Jan	-0.50	-0.50	-0.50	-
	 Preliminary consumer confidence	Jan	-8.1	-7.6	-8.1	-









Auctions

Country	Auction
France	 sold €3.6bn of 0.0% 2023 bonds at an average yield of -0.53%
	 sold €3.0bn of 0% 2025 bonds at an average yield of -0.38%
	 sold €1.9bn of 1% 2027 bonds at an average yield of -0.23%
	 sold €648mn of 0.1% 2028 index-linked bonds at an average yield of -1.09%
	 sold €929mn of 0.1% 2029 index-linked bonds at an average yield of -1.13%
	 sold €172mn of 0.1% 2047 index-linked bonds at an average yield of -0.68%
Spain	 sold €2.7bn of 0.0% 2023 bonds at an average yield of -0.236%
	 sold €1.3bn of 2.15% 2025 bonds at an average yield of -0.013%
	 sold €900mn of 2.7% 2048 bonds at an average yield of 1.27%
UK	 sold £250mn of 0.0125% 2048 inflation-linked bonds at an average yield of -1.957%



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	 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	50.6 (52.2)	50.4 (52.4)
	 08.15	Preliminary composite PMI	Jan	52.0	52.0
UK	 09.30	Preliminary manufacturing PMI (services PMI)	Jan	48.8 (51.1)	47.5 (50.0)
	 09.30	Preliminary composite PMI	Jan	50.7	49.3

Auctions and events

Country	GMT	Auction / Event
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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