Daiwa Capital Markets

Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds reversed much of yesterday's losses as concerns over China's coronavirus persisted and data showed business lending in the euro area slowed further.
- Gilts also made gains as a survey highlighted the continued lack of underlying price pressures on the UK's high street.
- The main event on Thursday will be the BoE policy announcement. A busy day for economic data includes the Commission's sentiment survey, euro area unemployment figures and Germany's flash inflation estimate.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.649	-0.016
OBL 0 04/25	-0.596	-
DBR 0 02/30	-0.377	-0.032
UKT 3¾ 09/21	0.437	-0.006
UKT 1 04/24	0.382	-0.015
UKT 0⅞ 10/29	0.522	-0.030

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

Euro area

Business lending continues to slow

Last week's ECB bank lending survey reported a drop in business demand for bank loans in Q4 for the first time in six years, in part due to weaker investment intentions. Consistent with that, today's ECB monetary data reported a second successive month of very weak new loan issuance to non-financial corporations (NFCs) in December. Adjusted for sales and securitisations, net new lending to NFCs fell to just €0.7bn, the third-weakest reading of the past two years. And, as a result, growth in the total stock of such loans slowed 0.2ppt to 3.2%Y/Y, the softest in more than two years. The ECB's survey suggested that the downtrend in business loan growth will continue in Q1. In contrast, today's data confirmed continued firm growth in lending to households. Thanks in particular to stronger mortgage activity, net new issuance of loans to households in December of €23.9bn was the highest in almost twelve years, and pushed growth in the stock of such loans to 3.65%Y/Y, similarly the highest since Q408.

Consumers more willing to spend

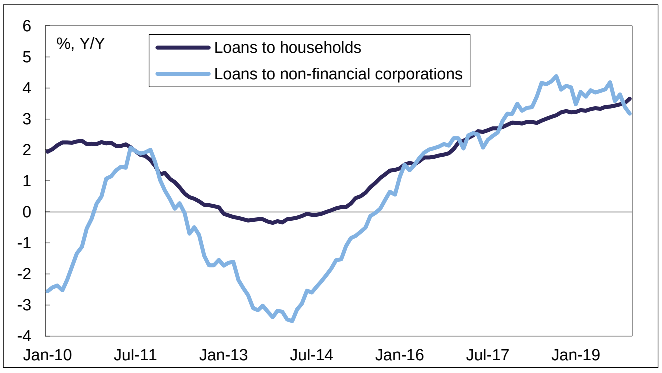
After last week's flash Commission indicator suggested that consumer confidence in the euro area was unchanged in January at the lowest level in almost three years, today brought national survey results, which provided detail on sentiment in each of the three largest member states. Perhaps encouragingly, each of them reported an increased willingness to spend.

- Like the Commission's euro area index, Germany's GfK consumer sentiment indicator was similarly unchanged in January, and at 9.7, only 0.1pt above November's 3½-year low. But the detail reported modest improvements in households' assessments of economic conditions as well as their income expectations. More significantly, the survey measure of consumers' willingness to buy rose to the highest level in a year. And GfK forecasts its headline sentiment indicator to rise 0.2pt to an eight-month high in February.

- Having fallen to a six-month low in December, the headline French INSEE consumer confidence index rose 1.7pts in January to 103.6. That, nevertheless, was still a touch below the Q4 average to suggest rather moderate consumer spending growth momentum. While households were the least optimistic about the economic outlook since April, they were a touch happier about prospects for their own finances. And so, they were also slightly more confident about making major purchases, albeit with the respective index also still below the Q4 average.

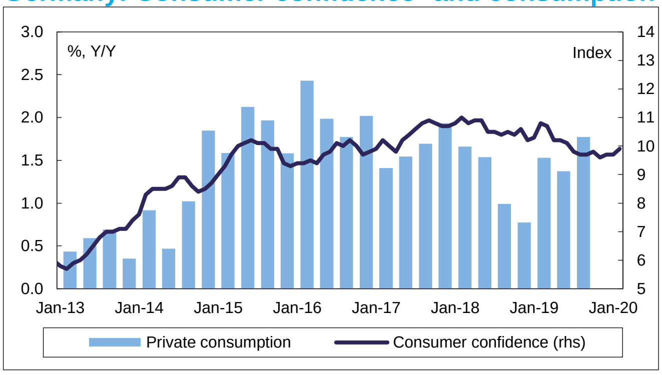
- Italy's ISTAT consumer confidence index rose for the second successive month in January, up 1pt to a four-month high of 111.8. With household expectations of the economic outlook and their own financial situation considered to

Euro area: Bank loans*



**Adjusted for sales and securitisations. Source: ECB, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

Germany: Consumer confidence* and consumption



**GfK forecast for February 2020. Source: GfK, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

be somewhat less negative, the survey measure of willingness to make major purchases at present rose to an eleven-month high. And most strikingly, the measure of willingness to make major purchases over the coming twelve months rose to the best in almost a decade.

Italian business sentiment broadly stable

If consumers are more willing to spend, however, the message does not appear to have reached Italian retailers and wholesalers, as the ISTAT business confidence survey suggested that sentiment among such firms declined in January to a seven-month low. Among other sectors, the survey was mixed. Tallying with recent surveys from elsewhere in the euro area, manufacturing confidence rose to a six-month high. And construction firms were the most upbeat since September. But services sector sentiment deteriorated to a four-month low. Overall, while the composite measure of Italian business confidence rose to a four-month high, it still suggested that economic growth is highly likely to remain close to recent rates. After Italian GDP rose 0.1%Q/Q in each of the previous four quarters, Q4 GDP, due Friday, could be flat. And we currently forecast GDP growth in Q1 to be just 0.1%Q/Q too.

The day ahead in the euro area and US

Thursday will be a busy day for economic data from the euro area. The first guide to inflation in January will come in the shape of Germany's flash figures, which are expected to report an increase of 0.2ppt on the EU-harmonised measure to a nine-month high of 1.7%Y/Y. In addition, the euro area's unemployment figures for December are expected to show the headline rate unchanged at 7.5% for a third successive month. And the European Commission's economic sentiment survey for January – which provides the most comprehensive guide to euro area economic activity – is also due. With increased signs of stabilisation in the industrial sector, a third successive monthly increase in the headline economic sentiment index to a five-month high is expected. Finally, ahead of Friday's preliminary Q4 data from the euro area, France, Italy and Spain, tomorrow will bring the Belgian growth estimate, which will be the first to be released by any member state. In the bond markets, Italy will sell 5Y and 10Y BTPs and 3Y floaters.

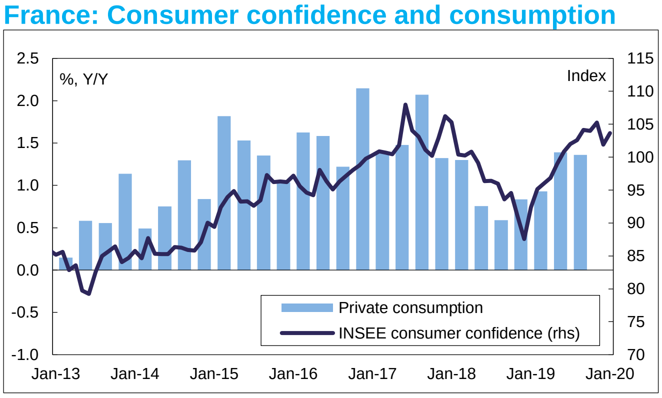
Thursday will bring the first estimate of US Q4 GDP, which is expected to report a third consecutive quarter of growth close to 2%Q/Q annualised. Consumer spending growth is expected to be moderate, but residential construction growth is likely to have been strong. Net trade will have made a significant positive contribution, due principally to weak imports. Business investment, however, will likely have been weak again, while inventories probably made a large negative contribution to growth. The usual weekly jobless claims data are also due.

UK

Retail survey signals no growth in early 2020

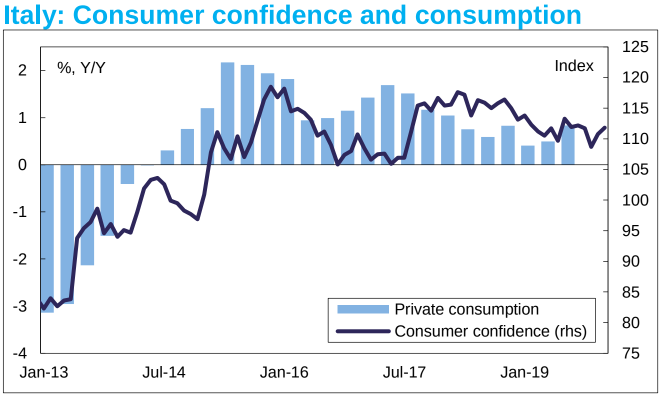
While the flash PMIs offered a more positive assessment of business conditions at the start of the year, these indicators fail to reflect conditions in the retail sector. And after disappointingly weak spending over the Christmas period, yesterday's CBI distributive trades survey suggested no improvement in momentum whatsoever in sales this month. In particular, the headline retail sales index was unchanged at 0, consistent with no growth compared with January 2019, with retailers noting that sales continued to be weak for the time of year. Indeed, while sales of clothing were higher, there were still notable declines in furniture and hardware stores. Overall, retailers were not overly encouraged about the near-term outlook either, anticipating sales to remain below the seasonal norms in February. Certainly, there was a steeper pace of decline in the amount of orders placed in January – the relevant index fell 7pts to -17, the lowest since August – with a further drop expected over the coming month too. Admittedly, the CBI survey has proved a fairly unreliable guide to the official retail sales figures over the past year. But it nevertheless supports our view that, against the backdrop of still subdued consumer

France: Consumer confidence and consumption



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

Italy: Consumer confidence and consumption



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

confidence and waning wage growth, household spending is likely to remain on a moderate, rather than vigorous, growth path over coming months.

High street price pressures remain subdued

The weakness in spending at the start of the year was even more disappointing in light of the heavy post-Christmas discounting seen at high street retailers. Indeed, the BRC's shop price index today showed that non-food prices fell sharply in January, with the 1%M/M decline leaving the annual rate of growth firmly in negative territory (-1.5%Y/Y) for the eighth consecutive month. Clothing prices continued to record the steepest annual drop, while the pace of decline in prices at DIY/garden furniture stores was the largest for 2½ years. So, while food price inflation moved higher in January, up 0.2ppt to 1.6%Y/Y, today's release illustrated the continued lack of underlying inflationary pressures on the high street, with the BRC survey measure of overall prices down 0.3%Y/Y in January. That marked the eighth consecutive monthly year-on-year decline, albeit the softest since July. Not least given intense competition on the high street and online, the BRC measure of retail price inflation has been significantly weaker than overall consumer price inflation over recent years. Nevertheless, against the backdrop of subdued demand, underlying inflation will remain soft and the annual CPI rate will remain sub-target over the coming year.

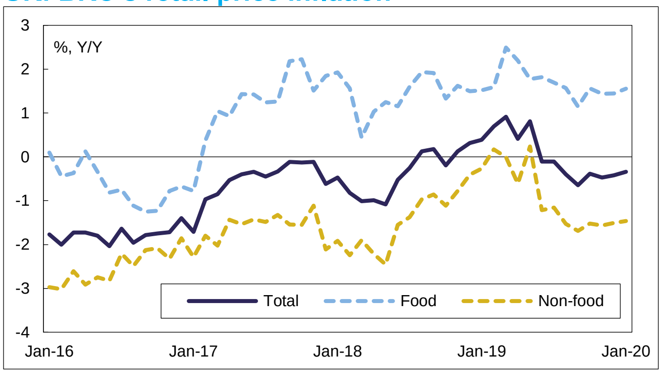
Housing market continues to stabilise

After UK Finance figures on Monday reported the highest number of mortgage approvals by the major high street banks for almost 4½ years, today's Nationwide house price indices for January also suggested improvement in the housing market at the start of the year. In particular, the lender suggested that house prices increased ½%M/M in January, increasing the annual rate by ½ppt to 1.9%Y/Y, the firmest since October 2018 and above the sub-1% average seen through 2019. The improvement at the start of the year tallies with other house price indices including those published by Rightmove and the RICS (see chart). Activity in the housing market might get a further boost over coming weeks as foreign buyers complete purchases ahead of the anticipated increase in the rate of stamp duty paid by non-UK residents in the forthcoming Budget (11 March). Nevertheless, the weak economic outlook might well weigh on activity once again after that boost has worn off. And, indeed, Nationwide indicated that it now expects house prices to remain broadly flat over the coming year.

The day ahead in the UK

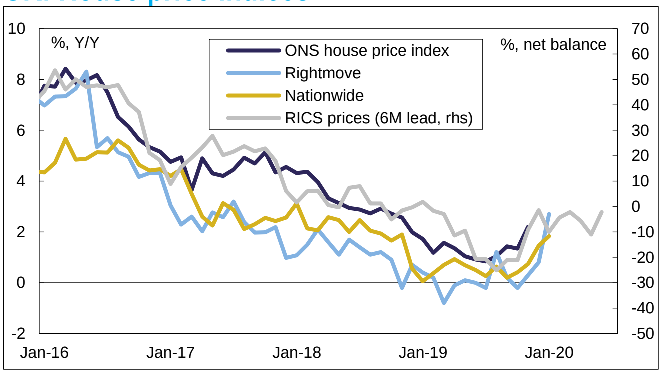
The main event tomorrow will be the BoE's policy announcement. The prior two MPC meetings saw two external members – Haskel and Saunders – vote for a 25bp rate cut. And since the start of the year, three further members – Vlieghe, Tenreyro and Governor Carney, for whom this will be the final MPC meeting – have suggested that they would be ready to vote for a rate cut if the economic recovery anticipated in the BoE's November base case forecast was unlikely to materialise. But while several recent lagging data releases were weaker than expected, the improvement in the flash January PMIs would suggest that the Bank's updated forecasts will maintain a baseline of economic recovery from Q1 on and also show inflation moving above target by the end of the projection horizon. Of course, concerns surrounding the impact of the outbreak of China's coronavirus might add to the case for near-term policy easing. But, on balance, we expect Haskel and Saunders to remain the only two members to vote for a rate cut this month, with the remaining opting to keep Bank Rate at 0.75% for a little longer yet. Moreover, the BoE's forward guidance might be little changed, to suggest again that 'some modest tightening of policy, at a gradual pace and to a limited extent, may be needed' in due course to maintain inflation sustainably at target.

UK: BRC's retail price inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: House price indices



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	M3 money supply Y/Y%	Dec	**5.0**	5.5	5.6	-
Germany	GfK consumer confidence indicator	Feb	**9.9**	9.6	9.6	**9.7**
France	Consumer confidence indicator	Jan	**104**	102	102	-
Italy	Economic sentiment indicator	Jan	**99.2**	-	100.7	-
	Consumer confidence indicator (manufacturing)	Jan	**111.8 (99.2)**	110.5 (99.4)	110.8 (99.1)	**- (99.3)**
Spain	Retail sales Y/Y%	Dec	**1.7**	-	2.9	**2.5**
UK	BRC shop price index Y/Y%	Jan	**-0.3**	-	-0.4	-
	Nationwide house price index M/M% (Y/Y%)	Jan	**0.5 (1.9)**	0.2 (1.5)	0.1 (1.4)	-

Auctions

Country	Auction
Germany	sold €3.2bn of 0% 2025 bonds at an average yield of -0.59%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK	CBI distributive trades survey, reported sales	Jan	**0**	5	0	-

Auctions

Country	Auction
Italy	sold €2.0bn of zero-coupon 2021 bonds at an average yield of -0.168%
	sold €1.25bn of index-linked 2023 bonds at an average yield of -0.50%
UK	sold £2.75bn of 0.875% 2029 bonds at an average yield of 0.50%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	10.00	Economic confidence indicator	Jan	101.8	101.5
	10.00	Industrial confidence indicator (services)	Jan	-8.8 (11.3)	-9.3 (11.4)
	10.00	Final consumer confidence indicator	Jan	-8.1	-8.1
	10.00	Unemployment rate %	Dec	7.5	7.5
Germany	08.55	Unemployment change '000s (rate %)	Jan	5.0 (5.0)	8.0 (5.0)
	13.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	1.7 (1.7)	1.5 (1.5)
Italy	09.00	Unemployment rate %	Dec	9.7	9.7
UK	00.01	Lloyds business barometer	Jan	-	10
	12.00	BoE Bank Rate %	Jan	*0.75*	0.75

Auctions and events

Country	GMT	Auction / Event
Euro area	16.00	ECB Economist Lane to participate in panel discussion on 'Fiscal rules in Europe'
Italy	10.00	Auction: up to €2.75bn of 0.35% 2025 bonds
	10.00	Auction: up to €3.25bn of 1.35% 2030 bonds
	10.00	Auction: up to €2.75bn of 0.1% 2023 index-linked bonds
UK	12.00	BoE MPC announcement, meeting minutes and Monetary Policy Report published
	12.30	BoE post-MPC meeting press conference

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs