

# Euro wrap-up

## Overview

- Despite an improved sentiment survey, a further drop in euro area unemployment and a rise in German inflation, Bunds made significant gains as coronavirus fears continued to hit risk appetite.
- Gilts bucked the global trend, making losses as the BoE decided not to cut Bank Rate.
- Friday will bring the first estimates of euro area GDP in Q4 and inflation in January, and German retail sales in December.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.667	-0.019
OBL 0 04/25	-0.621	-0.024
DBR 0 02/30	-0.410	-0.031
UKT 3¼ 09/21	0.508	+0.074
UKT 1 04/24	0.431	+0.054
UKT 0% 10/29	0.545	+0.028

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

Source: Bloomberg

## Euro area

### Commission survey highlights manufacturing improvement

While last week's [flash PMIs](#) saw the headline euro area composite index move sideways, today's European Commission survey results suggested notable improvement at the start of the year. Indeed, the headline euro area Economic Sentiment Index (ESI) rose for the third successive month in January and by a larger-than-expected 1.5pts – the most in 2½ years – to 102.8, the highest since June. At the country level, confidence improved markedly in Germany and France, but deteriorated in Italy and, most significantly, in Spain. As for the PMIs and [German ifo](#) indices earlier this week, the improvement in January was led by the industrial sector, for which the headline confidence index rose 2pts to -7.3, the highest level since August, with firms more upbeat about the production outlook thanks to rising new orders. In addition, construction firms were the most optimistic since June. But, also tallying with the PMIs and ifo survey, services firms and retailers in the euro area were more downbeat, hinting at a lagged impact on activity from last year's manufacturing sector weakness. And as suggested by the flash estimate, consumer confidence was unchanged in January at December's near three-year low. Of course, much of the responses to the Commission survey will have been provided before China's coronavirus outbreak gained prominence. And so we would expect to see a deterioration, more marked in the services sector, in the February results.

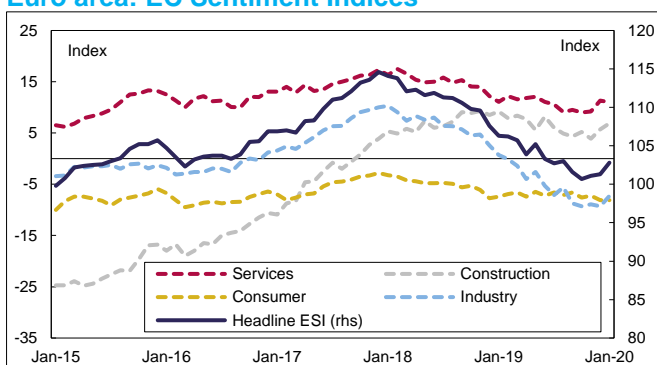
### Unemployment rate falls again

Today's labour market data also beat expectations with a drop of 0.1ppt in the euro area unemployment rate to 7.4%, the lowest since May 2008 and 4.7ppt below the peak. The improvement principally reflected a further decline in Spain, down 0.1ppt to 13.7% while rates in Germany, France and Italy (3.2%, 8.4% and 9.8%) were unchanged. The number of people out of work fell a further 34k to take the decline over the fourth quarter to 110k, a significant improvement from the drop of just 33k in Q3, which was the least since joblessness started to decline in mid-2013. While full data for the euro area have yet to be released, employment growth also looks to have picked up in Q4. And with the Commission survey pointing to an improved outlook in manufacturing, and little change in other sectors, in the absence of a significant adverse shock (such as from the coronavirus) we might expect to see the euro area unemployment rate edge down a little further over the near term. However, while German unemployment fell a further 2k in January, the rate on the national measure was unchanged (5.0%).

### German inflation misses consensus expectation

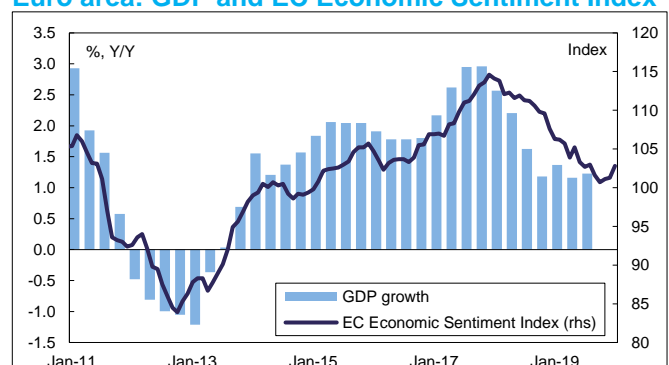
Germany's flash figures – the first guide to euro area inflation in January – came in a little short of the Bloomberg consensus. In particular, German inflation on the EU-harmonised measure rose just 0.1ppt to 1.6%Y/Y, still a nine-month

### Euro area: EC Sentiment Indices



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

### Euro area: GDP and EC Economic Sentiment Index



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



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high. The detail published on the national measure suggested that the rise was principally due to household energy and auto fuel (up 3.5ppts to 3.4%Y/Y), while food inflation was also a touch stronger (up 0.2ppt to 2.3%Y/Y). In contrast, core goods inflation was unchanged at 0.8%Y/Y. And services prices on the same basis rose 1.5%Y/Y, 0.3ppt less than in December. As such, core inflation in Germany appears to have weakened at the start of 2020.

## The day ahead in the euro area and US

Friday brings the first estimate of euro area GDP in Q4. Following today's initial estimates from Belgium (0.4%Q/Q), Austria (0.3%Q/Q) and Lithuania (a vigorous 1.3%Q/Q), we now anticipate euro area growth of 0.2%Q/Q, down from upwardly revised growth of 0.3%Q/Q in Q3. While Spain's economy is likely to have continued to outperform other major member states, with growth steady at the 0.4%Q/Q pace seen in the previous two quarters, we expect growth in France to have slowed slightly by 0.1ppt to 0.2%Q/Q. And we think that Italy's economy moved broadly sideways.

Friday will also bring the flash estimates of January inflation from the euro area, France and Spain. Following the aforementioned preliminary figures from Germany, we maintain our forecast that headline euro area inflation edged slightly higher at the start of the year, by 0.1ppt to 1.4%Y/Y due principally to higher energy prices. Indeed, with underlying price pressures still subdued, core inflation likely slipped back in January by 0.1ppt to 1.2%Y/Y. German retail sales figures for December are also due tomorrow with sales expected to have dropped about 0.5%M/M following downwardly revised growth of 1.5%M/M in November. That would leave sales up just 0.1%3M/3M, representing a marked slowdown in sales in Q4 following growth of 0.7%Q/Q in Q3.

In the US, Friday will bring personal income and spending data for December, which are expected to report moderate growth in both components. The associated core PCE deflator, the Fed's preferred measure of inflation, is expected to be unchanged at 1.6%Y/Y. In addition, the employment cost index for Q4 is due along with the final University of Michigan consumer confidence survey for January.

## UK

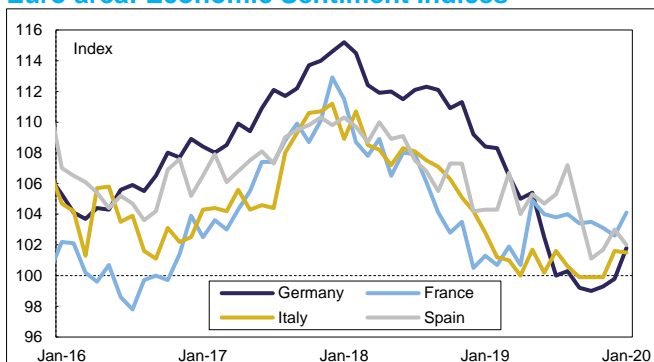
### BoE leaves its powder dry

As we expected, when Mark Carney's final monetary policy meeting as Governor concluded today, the BoE left Bank Rate unchanged at 0.75%. And, as at the previous two meetings, only two out of nine MPC members voted for a 25bp cut. As the markets had been priced for a cut, therefore, sterling jumped and Gilts sold off on the news. However, the BoE acknowledged that recent data had been weaker than anticipated, and spare capacity in the economy had been larger than previously thought. And it also revised down its forecasts for GDP and inflation over the projection horizon. Indeed, even assuming a near-term rate cut, the BoE expects inflation to remain materially below target this year, rise only gradually thereafter to reach the 2.0%Y/Y target two years from now, and inch only marginally higher by Q123 – an outlook that Carney today conceded would not be consistent with the BoE's mandate. So, there appears to have been a strong case for a rate cut today, particularly from a risk management perspective.

### But Bank Rate still likely to be cut by the summer

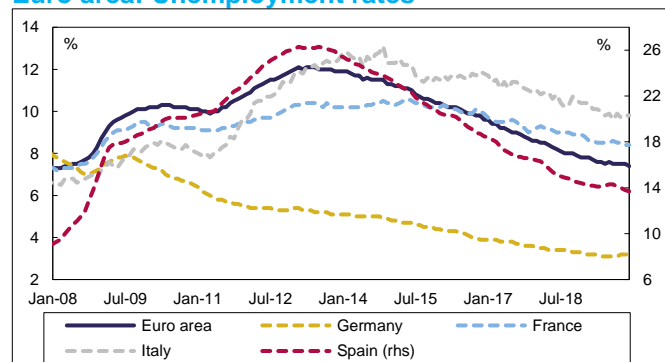
By leaving policy unchanged, therefore, the majority on the MPC appears to have been sufficiently comforted by recent surveys and other evidence that downside risks to the outlook from home and abroad have diminished. Indeed, Carney judged that recent data had been "good enough". But he also recognised that an eventual sustained pickup in growth and inflation was by no means assured. Indeed, the MPC statement repeated that "policy may need to reinforce the expected recovery". Given the positive sentiment indices, signs of improved investment intentions and a stronger housing market, and

### Euro area: Economic Sentiment Indices



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

### Euro area: Unemployment rates



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

noting the possibility that the “upcoming Budget [on 11 March] may be expansionary”, it nevertheless also stated that “if the economy recovers broadly in line with the MPC’s latest projections, some modest tightening of policy may be needed”. In his press conference, Carney subsequently clarified that, unlike the MPC’s previous language signalling “limited and gradual tightening”, this did not imply the likelihood of multiple hikes. And if events pan out in line with the BoE’s baseline forecast, any rate hike would be a long way off. We, however, expect growth to fall short of the BoE’s forecasts. And with the coronavirus posing a new non-negligible downside risk to the outlook, we maintain our forecast that the MPC – under Andrew Bailey’s leadership – will soon vote to cut Bank Rate by 25bps, most likely at the May meeting.

## Car production down again

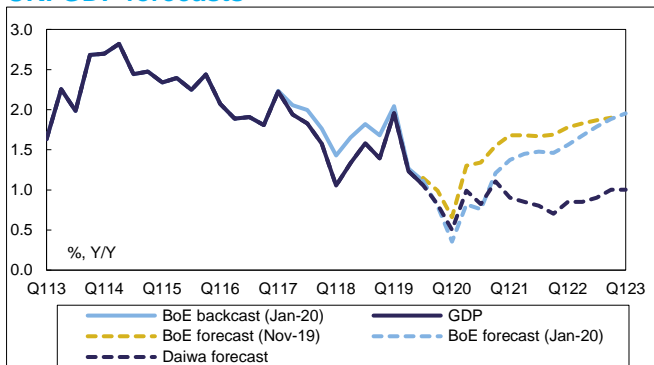
Today’s UK data-flow maintained the recent trend, with a more upbeat business survey but weak production figures. The Lloyds business barometer’s headline optimism index jumped in January to a fourteen-month high to leave it 22pts above the recent trough reached in August. In contrast, car production figures continued to disappoint, falling a further 6.4%Y/Y in December. Production for domestic car buyers was down a whopping 17%Y/Y. But production for overseas markets – which accounts for roughly 80% of total auto output – was also down more than 4%Y/Y, with the weakness in part reflecting model production changes as well as the ongoing shift in demand away from diesel cars in Europe. The December figures concluded a dismal 2019 for UK-based car manufacturers, with output down for the third consecutive year and by more than 14%Y/Y to 1.3mn units, the lowest full-year reading since 2010. And not least reflecting ongoing uncertainty about the future trading arrangement with the EU, SMMT anticipates another subdued year for UK car manufacturing, with output predicted to fall a further 2%Y/Y in 2020.

## The day ahead in the UK

Friday will bring the UK’s GfK consumer confidence survey for January as well as BoE bank lending data for December. Broadly as suggested by today’s European Commission indicator of UK consumer confidence (up 2.1pt to the best reading since August 2018), the headline GfK index is expected to rise to a sixteen-month high. [UK Finance](#) data published earlier this week suggest that the BoE figures will report a sizeable increase in mortgage approvals and stronger consumer credit too.

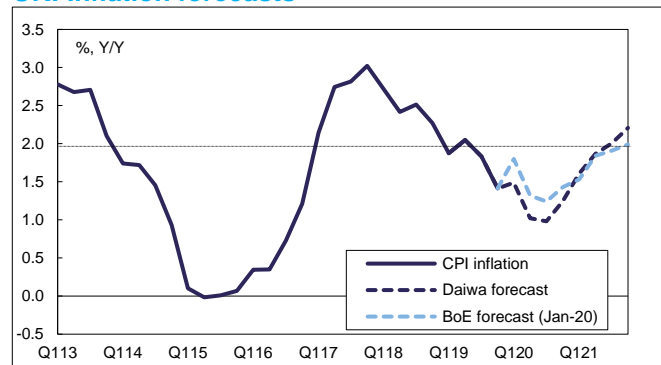
Of course, at 23.00 GMT on Friday the UK will leave the EU. Apart from losing its representation in EU decision-making, however, nothing of substance will change. The UK will continue to benefit from all the rights and fulfil all the obligations of EU membership throughout the transition period, set to last at least until the end of the year.

### UK: GDP forecasts



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

### UK: Inflation forecasts













Source: BoE, 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	 Economic confidence indicator	Jan	<b>102.8</b>	101.8	101.5	<b>101.3</b>
	 Industrial confidence indicator (services)	Jan	<b>-7.3 (11.0)</b>	-8.8 (11.3)	-9.3 (11.4)	<b>- (11.3)</b>
	 Final consumer confidence indicator	Jan	<b>-8.1</b>	-8.1	-8.1	-
	 Unemployment rate %	Dec	<b>7.4</b>	7.5	7.5	-
Germany	 Unemployment change '000s (rate %)	Jan	<b>-2.0 (5.0)</b>	5.0 (5.0)	8.0 (5.0)	-
	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	<b>1.7 (1.6)</b>	1.7 (1.7)	1.5 (1.5)	-
Italy	 Unemployment rate %	Dec	<b>9.8</b>	9.7	9.7	<b>9.8</b>
UK	 Lloyds business barometer	Jan	<b>23</b>	-	10	-
	 BoE Bank Rate %	Jan	<b>0.75</b>	<u>0.75</u>	0.75	-
	 SMMT car production Y/Y%	Dec	<b>-6.4</b>	-	-16.4	-













### Auctions

Country	Auction
Italy	 sold €2.75bn of 0.35% 2025 bonds at an average yield of 0.31%
	 sold €3.25bn of 1.35% 2030 bonds at an average yield of 0.94%
	 sold €2.75bn of 0.1% 2023 index-linked bonds at an average yield of 0.18%

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	Preliminary GDP estimate Q/Q (Y/Y%)	Q4	<u>0.2 (1.1)</u>	0.3 (1.2)
	 10.00	Preliminary CPI (core CPI) Y/Y%	Jan	<u>1.4 (1.2)</u>	1.3 (1.3)
Germany	 07.00	Retail sales M/M% (Y/Y%)	Dec	-0.5 (4.9)	1.5 (2.7)
France	 06.30	Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>0.2 (1.2)</u>	0.3 (1.4)
	 07.45	Consumer spending M/M% (Y/Y%)	Dec	0.0 (1.5)	0.1 (0.2)
	 07.45	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	1.5 (1.7)	1.5 (1.6)
Italy	 09.00	Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>0.1 (0.3)</u>	0.1 (0.3)
Spain	 08.00	Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>0.4 (1.7)</u>	0.4 (1.9)
	 08.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	1.0 (1.1)	0.8 (0.8)
UK	 00.01	GfK consumer confidence indicator	Jan	-9	-11
	 09.30	Net consumer credit (net mortgage lending) £bn	Dec	0.9 (4.1)	0.6 (4.1)
	 09.30	Mortgage approvals '000s	Dec	65.7	65.0

### Auctions and events

Country	GMT	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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