

Euro wrap-up

Overview

- Bunds made gains as euro area GDP growth slowed to the weakest rate since early 2013, while France and Italy's economies went into reverse.
- Ahead of the UK's departure from the EU later tonight, Gilts also followed the global trend higher.
- The coming week will bring euro area retail sales figures, as well as German and French IP and trade data. Final January PMIs are also due.

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Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.685	-0.020
OBL 0 04/25	-0.654	-0.034
DBR 0 02/30	-0.447	-0.038
UKT 3½ 09/21	0.506	-0.003
UKT 1 04/24	0.404	-0.024
UKT 0% 10/29	0.516	-0.027

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

Euro area

Q4 GDP growth weakest since 2013

The euro area economy slowed in Q4 to its weakest rate since the recovery begun in early 2013. In particular, consistent with recent survey evidence, GDP growth moderated by 0.2ppt from Q3 to just 0.1%Q/Q, leaving it up just 1.0%Y/Y, likewise the softest annual rate for six years. No expenditure breakdown for the euro area has been published yet. And some member states – most notably Germany – have yet to provide any figures too. However, while those countries who have already released data saw significant variation in performance, weaker domestic demand appears to have played an important role in the slowdown in Q4.

France shifts into reverse...

Most striking among the countries to publish GDP data today were France and Italy where economic output went into reverse in Q4. Indeed, in marked contrast to the consensus expectation of growth of 0.2%Q/Q, French GDP fell 0.1%Q/Q, marking the first decline since Q216. That left it up just 0.8%Y/Y, likewise the softest annual rate in more than three years. The expenditure breakdown was weaker across the board. Growth in private consumption halved from Q3 (0.2%Q/Q), and fixed investment slowed a full 1.0ppt to 0.3%Q/Q. Trade was down on both sides of the ledger, with imports and exports falling 0.2%Q/Q to have a neutral impact on GDP. But inventories subtracted 0.4ppt from growth.

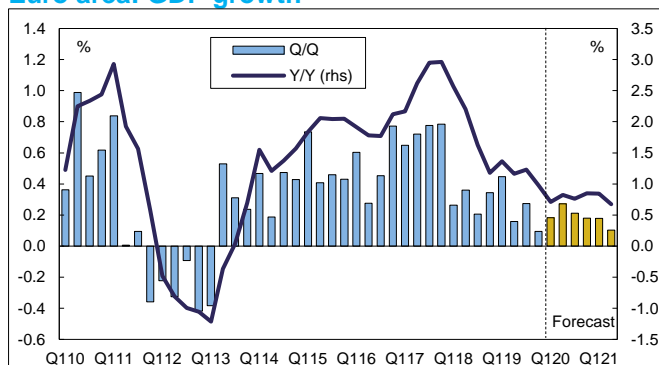
...as does Italy...

Meanwhile, Italian GDP fell for the first time in five quarters, dropping 0.3%Q/Q to be unchanged on a year-on-year basis. Unlike in France, no detailed breakdown was published. But Italy's statistical agency reported that a drop in domestic demand had more than outweighed a positive contribution from net trade that was likely related at least in part to a drop in imports.

...but Spain accelerates

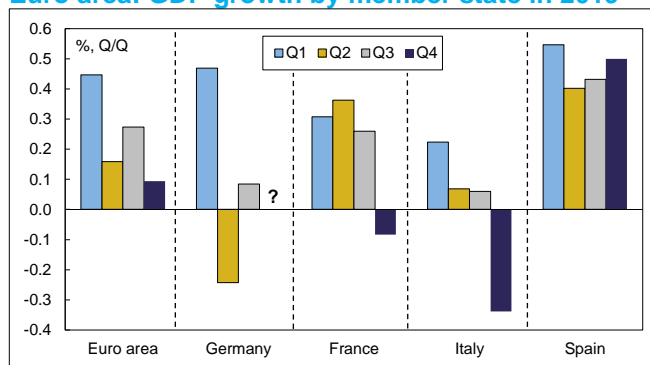
In contrast, and beating expectations, Spain's economy accelerated in Q4, with GDP up 0.5%Q/Q, 0.1ppt stronger than the rate of the previous two quarters. The detail of the Spanish release was not encouraging, however. Household consumption was unchanged from Q3, marking the first quarter without growth since Q313. And fixed investment fell 3.2%Q/Q, the most since Q111. So, domestic demand fell for the first time since the euro area crisis in Q412, dropping 0.4%Q/Q. But that weakness in domestic demand meant that imports fell 1.2%Q/Q. And with exports up a robust 1.5%Q/Q, net trade was able to deliver a slight pickup in GDP growth.

Euro area: GDP growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth by member state in 2019



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



German retail sales unfeasibly weak in December

The first estimate of German GDP in Q4 will be released on Valentine's Day. And if the December retail sales figures are anything to go by, it will be very weak indeed. According to the preliminary figures, German retail sales in December plunged a huge 3.3%M/M, the most in more than two decades. Extremely sharp declines were registered in every category (e.g. sales of clothing and footwear were down almost 9%M/M, while sales of IT items were down almost 5%M/M). But the sheer magnitude of the drop is hard to explain, and we fully expect the figures to be revised in due course. Indeed, December retail data are typically subject to major revisions – the German statistical agency noted that the initial growth estimate for that month has on average in the past four years been subsequently revised by 2ppts. Nevertheless, for the time being, today's data imply a drop of 0.7%Q/Q in German retail sales in Q4, which would represent the weakest quarter since the euro crisis in Q112.

Core inflation falls back in January

In line with expectations, the flash euro area estimate of inflation in January rose 0.1ppt to a nine-month high of 1.4%Y/Y. However, the increase was principally due to energy inflation, which rose 1.6ppts to 1.8%Y/Y, the highest since May. Food inflation also edged up slightly (2.2%Y/Y). However, non-energy industrial goods prices rose 0.5%Y/Y, the same as in December. And services inflation eased 0.3ppt to a three-month low of 1.5%Y/Y. As such, core inflation fell 0.2ppt to 1.1%Y/Y, also the lowest since October. So, while ECB President Lagarde noted at last week's press conference that 'there are some signs of a moderate increase in underlying inflation in line with expectations', there appears to have been no further improvement at the start of the year. Indeed, while it is likely to edge up next month, we expect core inflation to remain within the range of the past three months over the coming year. Likewise, we expect headline inflation to move broadly sideways, with recent oil price moves adding to the near-term downside risks.

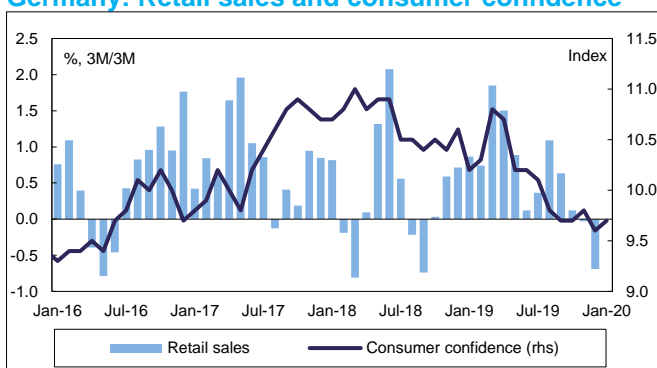
The week ahead in the euro area and US

The coming week's euro area calendar will bring a mixed bag of economic data, many of which are likely to be soft. Among the more notable releases will be those offering insights into industrial sector activity at the end of 2019. In particular, Germany's factory orders figures for December will come on Thursday, with German and French IP and goods trade data for the same month coming the following day. And, overall, these are likely to point merely to stabilisation in the sector as opposed to significant expansion. Indeed, while German factory orders are expected to have increased about ½%M/M, that would leave them little changed on the quarter in Q4. And not least given ongoing weakness in car production, the expected small drop in German IP would leave it down in Q4 for a sixth successive quarter. Meanwhile, euro area retail sales figures for December, due on Wednesday, seem bound to post a substantive decline due to the steep drop reported today in Germany. And that could leave sales down in Q4 for the first quarter since Q415. Other data due in the coming week include the final January PMIs (Monday and Wednesday). The flash estimates suggested improvement in the manufacturing sector but weakening in services and so the euro area composite PMI was unchanged at 50.9 to imply no overall improvement in overall growth at the start of the year.

The coming week will also bring appearances by several ECB policymakers including Christine Lagarde, who will speak publicly on Monday, Wednesday and Thursday. In the bond markets, Germany will sell inflation-linked bonds on Tuesday, while France and Spain will sell a range of bonds on Thursday.

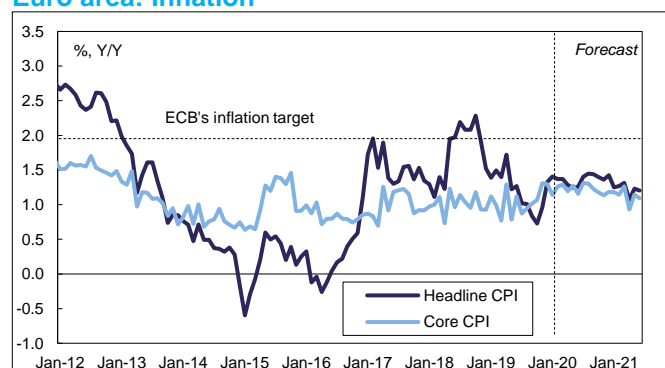
It will be a busy week for US top-tier economic releases. Monday kicks off with January's manufacturing ISM, which, despite some reversal of the sharp drop seen in December, is expected to remain in contractionary territory. In contrast, the final Markit manufacturing PMI is expected to confirm a further decline in January, albeit to a level still consistent with expansion. That day will also bring construction spending figures for December, followed by revised durable goods and trade data for the same month on Tuesday and Wednesday respectively. The non-manufacturing ISM and final services PMI for January are also due on Wednesday, both of which are expected to remain comfortably in expansionary territory. That day will also

Germany: Retail sales and consumer confidence



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

Euro area: Inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

see the release of the latest ADP employment report, while Challenger job cuts and weekly jobless claims figures are due Thursday. Of course, of greater significance will be Friday's non-farm payrolls report, which is expected to show a slightly stronger increase in January (160k) than December, albeit a touch below the average for the past year as whole. The unemployment rate will likely move sideways at 3.5%, while average weekly earnings growth is expected to be little changed at 2.9%Y/Y. Friday will also see the Fed publish its semi-annual Monetary Policy Report, which will be followed by Chair Powell's testimony to the Senate and House committees the following week. Meanwhile, the Fed's Quarles will speak on monetary policy and the economic outlook on Thursday. There are no UST bond auctions scheduled in the coming week.

UK

Beyond Brexit Day, focus shifts to future relationship

At 23.00 GMT today the UK will leave the EU. Apart from losing its representation in EU decision-making, 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, which is currently set to last at least until the end of the year. What comes thereafter will be determined by a series of negotiations that will commence on 3 March and will likely run through to the final quarter of the year. Most of the detailed negotiations will not occur until the second half of the year. Nevertheless, on Monday, Boris Johnson will set out the UK position in a speech that is likely to feature his usual mix of bluster and obfuscation. He will also likely restate his desire for a quick and simple Free Trade Agreement – as in the EU-Canada and EU-Japan relationships – principally governing goods, to provide for tariff-free trade while allowing the UK significant freedom to diverge from EU rules. Ad hoc deals on fishing rights and financial services will also be sought. The same day, the EU will publish its own mandate, which – in contrast to Johnson's gambit – is likely to be transparent, specific and technical. This will also likely call for a more substantive arrangement (perhaps based on a so-called Association Agreement, which could have implications for ratification requirements) involving shared institutions and detailed procedures governing a wider range of issues for the future relationship, including foreign policy, transport and security. This would also incorporate substantial Level Playing Field rules to constrain the ability of the UK to diverge from EU rules without significant consequences.

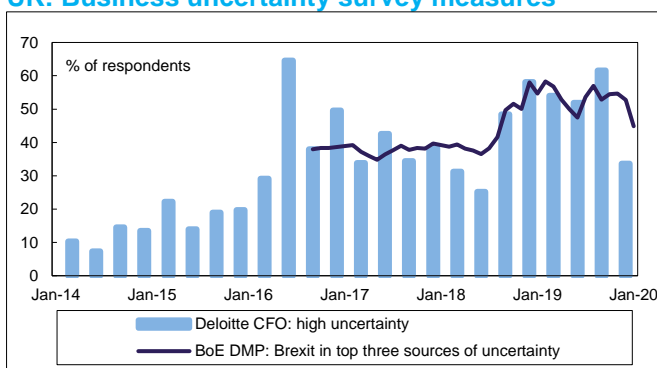
Small (non-negligible) risk of failure to agree new relationship by year-end

As throughout the negotiations on the Brexit Withdrawal Agreement, the EU is bound to have the upper hand in this more important next phase. And so, we would expect the eventual outcome to resemble the EU's proposals. It is still possible, however, that the UK and the EU will not be able to reach agreement on, or legally ratify, the future relationship by the end of the year. And since the UK is unlikely to agree by July to an extension of the transition beyond year-end, the economic impact of a failure to reach and implement a deal would be highly adverse, requiring the imposition of significant trade barriers between the EU and UK from January 2021. We attach a small, albeit non-negligible, probability to such a damaging outcome. The risks of that happening, as well as the likelihood that over time barriers to trade between the EU and UK will rise as and when the UK diverges from EU rules, will weigh on UK business investment and overall GDP growth over coming quarters.

The week ahead in the UK

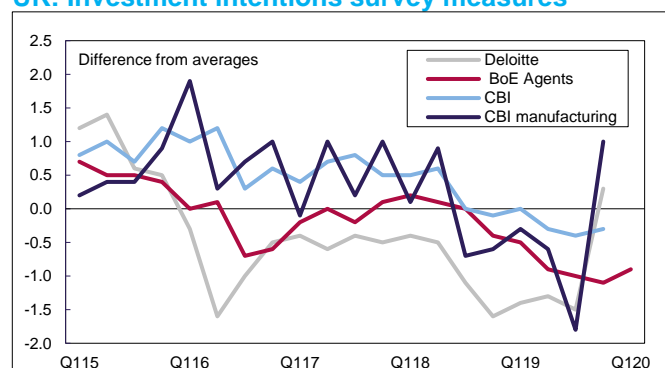
The coming week should be quieter for UK economic data. The final January PMIs in the first half of the week will nevertheless attract some attention. The flash manufacturing and services surveys certainly exceeded expectations, with the respective headline indices up 2.3pts to a nine-month high of 49.8, and 2.9pts to a sixteen-month high of 52.9. The construction PMI (due on Tuesday) will also tally with increasing signs of stabilisation in the housing market. And we would expect the final composite PMI (Wednesday) to confirm a return back to expansionary territory for the first month in five – indeed, the flash estimate was up 3.1pts in January to 52.4, its highest since September 2018. Wednesday will also bring new car registrations figures for January, which might also report another month of positive growth as near-term uncertainties have receded somewhat. In the markets, the DMO will sell 15Y index-linked Gilts on Tuesday.

UK: Business uncertainty survey measures


















Source: Bank of England and Daiwa Capital Markets Europe Ltd.

UK: Investment intentions survey measures









Source: Bank of England and Daiwa Capital Markets Europe Ltd.

Daiwa economic forecasts

	2019		2020				2021		2019	2020	2021
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP forecasts %, Q/Q											
Euro area 	0.3	0.1	0.2	0.3	0.2	0.2	0.2	0.1	1.2	0.8	0.6
Germany 	0.1	0.0	0.2	0.2	0.2	0.2	0.2	0.0	0.5	0.6	0.6
France 	0.3	-0.1	0.3	0.3	0.2	0.2	0.2	0.2	1.2	0.8	0.8
Italy 	0.1	-0.3	0.1	0.1	0.0	-0.1	0.0	-0.1	0.2	-0.1	-0.1
Spain 	0.4	0.5	0.3	0.4	0.4	0.4	0.4	0.2	1.9	1.6	1.2
UK 	0.4	-0.1	0.2	0.3	0.3	0.3	0.1	0.3	1.3	0.7	0.8
Inflation forecasts %, Y/Y											
Euro area											
Headline CPI 	1.0	1.0	1.3	1.2	1.4	1.4	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	1.0	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	1.6	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	0.75	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 	Preliminary GDP estimate Q/Q (Y/Y%)	Q4	0.1 (1.0)	<u>0.2 (1.1)</u>	0.2 (1.2)	0.3 (1.2)	
	Preliminary CPI (core CPI) Y/Y%	Jan	1.4 (1.1)	<u>1.4 (1.2)</u>	1.3 (1.3)	-	
Germany 	Retail sales M/M% (Y/Y%)	Dec	-3.3 (0.8)	-0.5 (4.5)	2.1 (2.8)	1.6 (2.7)	
France 	Preliminary GDP Q/Q% (Y/Y%)	Q4	-0.1 (0.8)	<u>0.2 (1.2)</u>	0.3 (1.4)	-	
	Consumer spending M/M% (Y/Y%)	Dec	-0.3 (2.0)	0.0 (1.5)	0.1 (0.2)	0.7 (1.0)	
	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	1.5 (1.6)	1.5 (1.7)	1.5 (1.6)	-	
Italy 	Preliminary GDP Q/Q% (Y/Y%)	Q4	-0.3 (0.0)	<u>-0.1 (0.3)</u>	0.1 (0.3)	- (0.5)	
Spain 	Preliminary GDP Q/Q% (Y/Y%)	Q4	0.5 (1.8)	<u>0.4 (1.7)</u>	0.4 (1.9)	-	
	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	1.1 (1.1)	1.0 (1.1)	0.8 (0.8)	-	
UK 	GfK consumer confidence indicator	Jan	-9	-9	-11	-	
	Net consumer credit (net mortgage lending) £bn	Dec	1.2 (4.6)	0.9 (4.1)	0.6 (4.1)	0.7 (4.2)	
	Mortgage approvals '000s	Dec	67.2	65.6	65.0	65.5	
Auctions							
Country	Auction						
- Nothing to report -							



















Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 3 February 2020					
EMU		09.00 Final manufacturing PMI	Jan	47.8	46.3
Germany		08.55 Final manufacturing PMI	Jan	45.2	43.7
France		08.50 Final manufacturing PMI	Jan	51.0	50.4
Italy		08.45 Manufacturing PMI	Jan	47.5	46.2
Spain		08.15 Manufacturing PMI	Jan	48.8	47.4
UK		09.30 Final manufacturing PMI	Jan	49.8	47.5
Tuesday 4 February 2020					
EMU		10.00 PPI Y/Y%	Dec	-0.8	-1.4
Italy		10.00 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	0.6 (0.6)	0.5 (0.5)
UK		09.30 Construction PMI	Jan	47.1	44.4
Wednesday 5 February 2020					
EMU		09.00 Final services (composite) PMI	Jan	52.2 (50.9)	52.8 (50.9)
		10.00 Retail sales M/M% (Y/Y%)	Dec	-1.1 (2.2)	1.0 (2.2)
Germany		08.55 Final services (composite) PMI	Jan	54.2 (51.1)	52.9 (50.2)
France		08.50 Final services (composite) PMI	Jan	51.7 (51.5)	52.4 (52.0)
Italy		08.45 Services (composite) PMI	Jan	50.7 (49.5)	51.1 (49.3)
Spain		08.15 Services (composite) PMI	Jan	53.9 (52.3)	54.9 (52.7)
UK		09.00 New car registrations Y/Y%	Jan	-	3.4
		09.30 Final services (composite) PMI	Jan	52.9 (52.4)	50.0 (49.3)
Thursday 6 February 2020					
Germany		07.00 Factory orders M/M% (Y/Y%)	Dec	0.6 (-6.7)	-1.3 (-6.5)
		08.30 Construction PMI	Jan	-	53.8
Friday 7 February 2020					
Germany		07.00 Trade balance €bn	Dec	14.0	18.6
		07.00 Industrial production M/M% (Y/Y%)	Dec	-0.2 (-3.6)	1.1 (-2.6)
France		07.45 Industrial production M/M% (Y/Y%)	Dec	-0.2 (0.9)	0.3 (1.3)
		07.45 Trade balance €bn	Dec	-	-5.6
Italy		09.00 Retail sales M/M% (Y/Y%)	Dec	-	-0.2 (0.9)
Spain		08.00 Industrial production M/M% (Y/Y%)	Dec	-1.0 (2.1)	1.0 (2.1)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 3 February 2020		
EMU	 09.15	ECB Vice President de Guindos scheduled to speak in Athens
Tuesday 4 February 2020		
Germany	 10.30	Auction: €250mn of 0.5% 2030 index-linked bonds
	 10.30	Auction: €250mn of 0.1% 2046 index-linked bonds
UK	 10.30	Auction: £800mn of 0.125% 2036 index-linked bonds
Wednesday 5 February 2020		
EMU	 11.30	ECB Chief Economist Lane scheduled to speak in Berlin
	 12.15	ECB President Lagarde scheduled to speak in Paris
Thursday 6 February 2020		
EMU	 08.00	ECB President Lagarde testifies at the European Parliament's Committee on Economic and Monetary Affairs
	 09.00	ECB publishes its Economic Bulletin
	 14.00	ECB's Villeroy scheduled to speak
France	 09.50	Auction: 1.75% 2039 bonds
	 09.50	Auction: 0% 2029 bonds
	 09.50	Auction: 1.25% 2034 bonds
	 09.50	Auction: 1.75% 2066 bonds
Spain	 09.45	Auction: 0% 2023 bonds
	 09.45	Auction: 1.95% 2026 bonds
	 09.45	Auction: 0.5% 2030 bonds
	 09.45	Auction: 0.65% 2027 index-linked bonds
Friday 7 February 2020		
Italy	 -	Italian sovereign debt to be rated by Fitch

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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