Daiwa Capital Markets

Euro wrap-up

Overview

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- Bund yields jumped after reports suggested that an effective drug to treat the coronavirus might have been found. A disappointing euro area retail sales report was offset by somewhat more encouraging PMIs.
- Gilt yields at the longer end of the curve similarly followed the global trend higher, while there were sizeable upwards revisions to the final UK services and composite PMIs.
- Focus on Thursday will turn back to manufacturing, with German factory orders figures for December due.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.653	+0.007
OBL 0 04/25	-0.599	+0.023
DBR 0 02/30	-0.371	+0.031
UKT 3¾ 09/21	0.496	-0.005
UKT 1 04/24	0.447	+0.012
UKT 0⅞ 10/29	0.598	+0.032

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

Euro area

Retail sales fell sharply in December

Euro area retail sales fell in December by a larger-than-expected 1.6%M/M, the most since May 2011, to leave the annual rate at a seven-month low of 1.3%Y/Y. The drop at year-end erased the progress made earlier in the quarter, and left sales effectively unchanged in Q4 from Q3, to mark the weakest performance for five quarters. All major categories of sales, with the exception of online and mail order activity, dropped in December to cap a subdued quarter for sales of most items. Indeed, while sales of fuel fell 1.1%Q/Q in Q4, those of food were also down slightly (-0.1%Q/Q), and sales of core (ex-food and -fuel) items were up just 0.2%Q/Q, also the softest since Q318. At the country level, with the exception of Ireland and Malta, all member states to report data saw sizeable falls in sales in December. For example, sales in France, Spain and Portugal were all down by between 1.3-1.5%M/M. However, most striking was the fall in Germany of 3.3%M/M, which had already been reported but seems bound to be revised up significantly in due course. So, euro area retail sales certainly slowed notably from the rate of growth of 0.5%Q/Q in Q3, adding to evidence of a softer pace of expansion of private consumption in Q4. However, we expect future revisions eventually to show modest expansion in euro area retail sales last quarter, rather than the current estimate of zero growth.

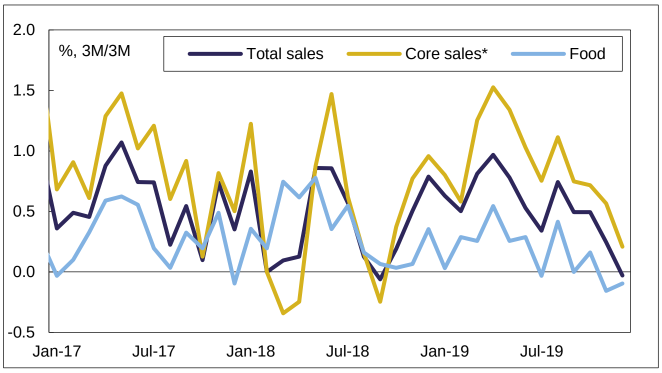
Final composite PMI nudged higher, but still subdued

Today's final services and composite PMIs were somewhat more encouraging in what they suggested about conditions at the start of the year. Like Monday's manufacturing survey, the headline euro area services index was nudged slightly higher from the flash estimate in January to 52.5. Admittedly, this was a touch weaker than in December, but nevertheless marginally stronger than the Q4 average and still consistent with ongoing moderate expansion. And an upwards revision to the new business component left it unchanged from December, which itself was the highest since August. Overall, today's outturn helped lift the final euro area composite PMI to 51.3 in January, 0.4pt higher than the January flash and December readings. While this was the strongest since August, it was nevertheless consistent with still subdued GDP growth of less than 0.2%Q/Q. And while the new orders PMI was also revised to a seven-month high (51.2), it too suggested continued moderate, rather than vigorous, growth over the months ahead.

Mixed performance among member states

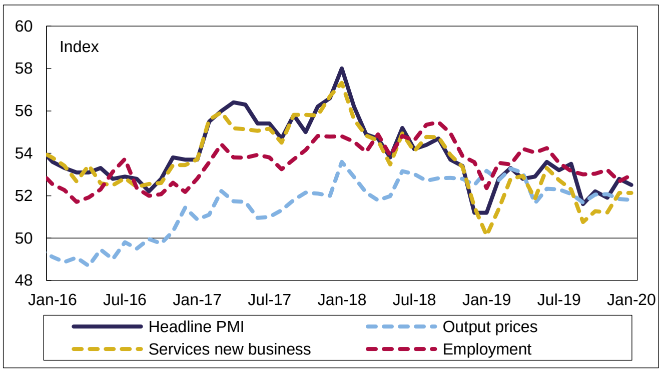
To some extent the upwards revision to the aggregate euro area figure appears to have reflected a particularly strong showing from Ireland, with the composite PMI up 1.7pts in January to its highest (54.7) for eleven months, while the services PMI rose to a seven-month high (56.9). Among the larger member states, the final German services PMI came bang in line

Euro area: Retail sales



*Excluding food and fuel. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Services PMI



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

with the flash, rising 1.3pts to a five-month high of 54.2 and suggesting that the sector remains resistant to the manufacturing weakness. So, overall, the German composite PMI increased 1pt to 51.2, its highest since August and almost 2pts above the Q4 average. And with firms their most upbeat about future output for sixteen months, today's survey suggests Germany's economy might have started to stabilise. In contrast, the final French services PMI was disappointing, being revised down a further 0.7pt from the flash to be down 1.4pt on the month to a nine-month low of 51.0. And that left the French composite PMI at 51.1, the lowest since September. Meanwhile, although the Italian composite PMI improved in January (up 1.1pts to 50.4), it was merely consistent with stabilisation at the start of the year. But most striking was the Spanish services PMI, which indicated a notable deterioration in conditions at the start of the year, falling 2.6pts to 52.3, to the weakest for more than six years, as political uncertainties reportedly weighed on sentiment, investment decisions and hiring. So, despite a notable improvement in the manufacturing output PMI (up 3.1pts to 48.5), Spain's composite PMI declined 1.2pts in January to 51.5, consistent with moderate expansion but nevertheless one of the softest paces of increase since the euro crisis.

The day ahead in the euro area and US

Focus tomorrow will turn to the manufacturing sector, with the release of German factory orders data for December. But while these are expected to have increased about ½%M/M, that would leave them around 6½% lower than a year earlier and little changed on the quarter in Q4 overall, pointing merely to stabilisation in the sector at the end of last year as opposed to significant expansion. The latest German construction PMI for January will also be published. Thursday will also see ECB President Lagarde appear before the European Parliament's economic and monetary affairs committee. In the markets, France and Spain will sell bonds with various maturities.

In the US, ahead of Friday's payrolls report, Thursday will bring Challenger job cuts figures for January, the usual weekly jobless claims figures and preliminary unit labour costs figures for Q4.

UK

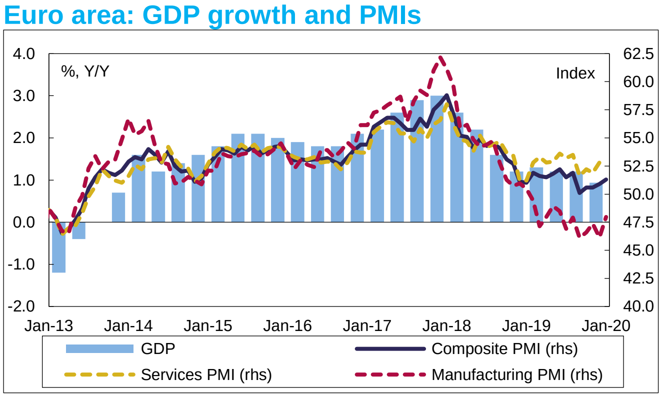
Services PMI surges to a sixteen-month high

Like in the equivalent manufacturing survey, the upwards revision in the UK's final services PMI in January was more striking than the euro area. In particular, the headline business index was further revised higher by 1pt from the flash to be up a whopping 3.9pts on the month – the most since the initial post-referendum bounce back – to a sixteen-month high of 53.9. And with new orders – the relevant PMI increased 3½pts to a nineteen-month high – reportedly having been boosted by higher consumer and business spending in light of reduced political uncertainty, services firms were the most optimistic about expectations of the year ahead since mid-2015. So, taken with the manufacturing output index (up 2½pts to 50.1), today's outturn saw the headline composite PMI upwardly revised from the flash by 0.9pt to 53.3, leaving it 4pts higher than December and at its strongest level since September 2018. And with growth in new orders reportedly the fastest since mid-2018, manufacturing and services firms together stepped up their hiring at the start of the year, with the composite employment PMI the highest since July.

Construction PMI points to some stabilisation

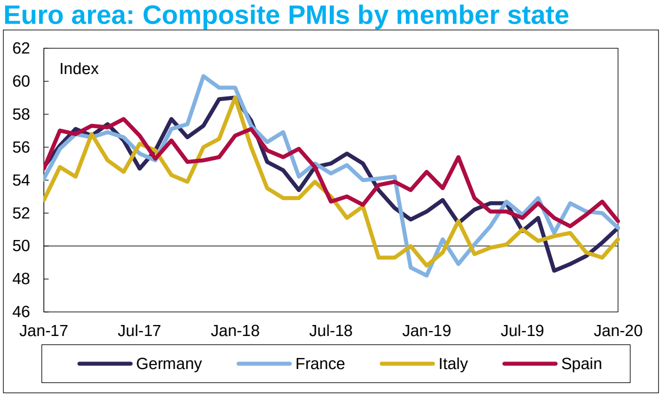
The headline composite survey excludes the construction sector. But yesterday's equivalent survey suggested that construction firms were more upbeat at the start of the year too. Indeed, coming on the back of signs of a pickup in housing market activity at the turn of the year, this suggested that expectations about future growth prospects in the sector were the highest since April 2018. The survey also showed some stabilisation in new orders in January, with the relevant index rising 5pts – the most since April 2010 – to 49.5, signalling the smallest pace of decline for ten months. And while output continued to decline in the three main subsectors, there was significant variation in this respect. For example, the housing and

Euro area: GDP growth and PMIs



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

Euro area: Composite PMIs by member state



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

commercial activity PMIs rose to an eight-month high of 48.8 and twelve-month high of 48.5 respectively, both consistent with only moderate contraction. But while there was a significant increase in the civil engineering PMI (up 6.1pts), at 43.5 it continued to imply very weak activity.

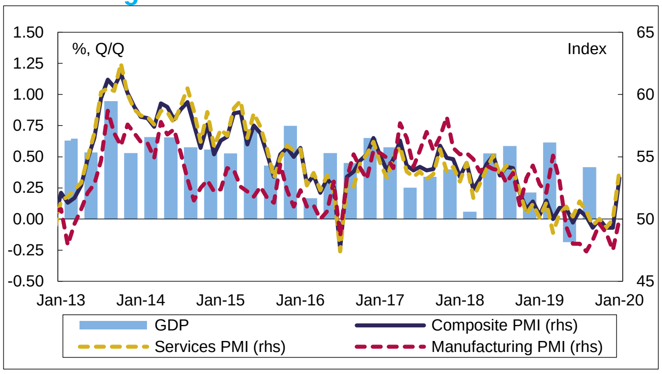
Composite PMI consistent modest GDP growth

Nevertheless, given the relatively small share of construction output in the economy, the all-sector PMI still returned to expansionary territory in January. But while the 3.9pt increase to 52.8 was impressive and represented the highest since September 2018, it still implies GDP growth no firmer than the 0.2%Q/Q assumed by the BoE and our own forecast. Certainly, today's new car registrations figures for January – reporting the steepest annual rate of decline (-7.3%Y/Y) since September 2018 – served as a reminder that economic conditions might not be as strong as the headline surveys imply. And we expect demand for new cars to remain subdued over coming quarters too, with full-year sales likely to post a fourth consecutive drop in 2020.

The day ahead in the UK

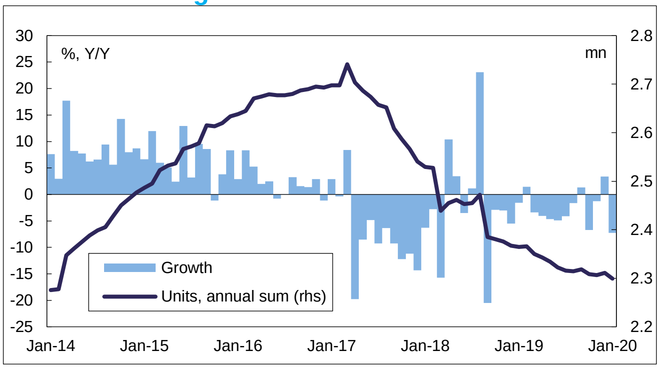
Thursday should be a quiet day for economic news, with no top-tier data due for release.

UK: GDP growth and PMIs



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

UK: New car registrations



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	Final services (composite) PMI	Jan	**52.5 (51.3)**	52.2 (50.9)	52.8 (50.9)	-
	Retail sales M/M% (Y/Y%)	Dec	**-1.6 (1.3)**	-1.1 (2.2)	1.0 (2.2)	**0.8 (2.3)**
Germany	Final services (composite) PMI	Jan	**54.2 (51.2)**	54.2 (51.1)	52.9 (50.2)	-
France	Final services (composite) PMI	Jan	**51.0 (51.1)**	51.7 (51.5)	52.4 (52.0)	-
Italy	Services (composite) PMI	Jan	**51.4 (50.4)**	50.5 (49.4)	51.1 (49.3)	-
Spain	Services (composite) PMI	Jan	**52.3 (51.5)**	54.0 (52.6)	54.9 (52.7)	-
UK	New car registrations Y/Y%	Jan	**-7.3**	-	3.4	-
	Final services (composite) PMI	Jan	**53.9 (53.3)**	52.9 (52.4)	50.0 (49.3)	-

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	PPI Y/Y%	Dec	**-0.7**	-0.7	-1.4	-
Italy	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	**0.6 (0.5)**	0.5 (0.5)	0.5 (0.5)	-
UK	Construction PMI	Jan	**48.4**	47.1	44.4	

Auctions

Country	Auction
Germany	sold €187mn of 0.5% 2030 index-linked bonds at an average yield of -1.41%
	sold €179mn of 0.1% 2046 index-linked bonds at an average yield of -1.24%
UK	sold £800mn of 0.125% 2036 index-linked bonds at an average yield of -2.263%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
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

Auctions and events

Country	GMT	Auction / Event
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

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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