Daiwa Capital Markets

Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds followed the global trend lower as Lagarde stated that the side effects of the ECB's current policies were likely to become greater over time.
- Gilts also made losses as Q4 GDP figures showed that the UK economy stagnated in Q4 but growth was revised higher in the first three quarters of 2019.
- Wednesday will bring euro area IP figures for December, which will confirm a steep drop in manufacturing output at the end of last year.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.649	+0.001
OBL 0 04/25	-0.607	+0.009
DBR 0 02/30	-0.392	+0.021
UKT 3¾ 09/21	0.507	+0.021
UKT 1 04/24	0.438	+0.026
UKT 0⅞ 10/29	0.571	+0.014

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

UK

UK economy stagnated in Q4

The first estimate of Q4 GDP indicated that the UK's economy stagnated in the final quarter of 2019, bang in line with the Bank of England's assumption in its January Monetary Policy Report. There were, however, upwards revisions to growth in the previous two quarters, of 0.1ppt apiece to -0.1%Q/Q in Q2 and 0.5%Q/Q in Q3 respectively. (And to two decimal places, Q119 was also nudged higher to 0.64%Q/Q.) Of course, the profile of activity last year was significantly affected by repeated risks of a no-deal Brexit. And when looking through the volatility, quarterly growth in 2019 averaged about 0.25%Q/Q, extending the slowdown of the past five years. So, the year-on-year increase in GDP slowed to 1.1%Y/Y in Q4, the softest such pace for seven quarters. This, however, is bang in line with the BoE's estimate of growth in potential supply, suggesting that there was no material increase in the amount of slack in the economy despite the slowdown. Indeed, at 1.4%Y/Y, full-year growth in 2019 was firmer than potential and also a touch stronger than growth in 2018, albeit this was still one of the slowest rates of the past decade.

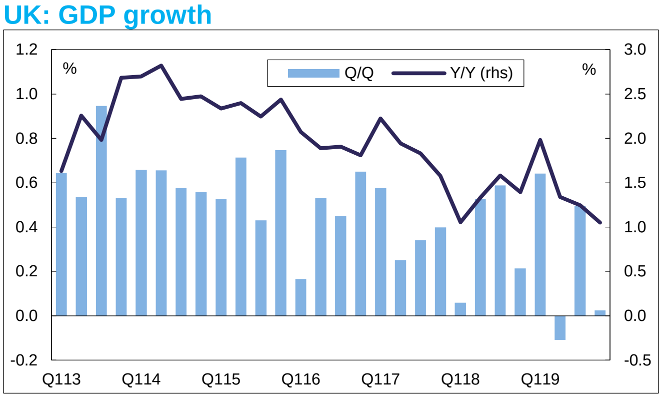
Government offset impact of weak private sector spending

The detail of the GDP report was relatively depressing, with a contraction in Q4 avoided only thanks to the public sector. Indeed, the 2.1%Q/Q increase in government spending was the largest since Q112 and contributed a sizeable 0.4ppt to GDP growth. In contrast, against the backdrop of ongoing political uncertainty for much of the fourth quarter, households tightened their purse strings, with private consumption growth of 0.1%Q/Q in Q4 the softest for four years to leave full-year growth in that expenditure component in 2019 at the weakest since 2011. In addition, with Brexit uncertainty having weighed on business confidence, fixed investment was predictably weak. Indeed, the 1.6%Q/Q drop in capex represented its largest drag on GDP growth since the start of 2013 and was driven by declines in spending on ICT equipment, dwellings, transport, and intellectual property. Indeed, the level of business investment in Q4 fell below where it was in the quarter following the 2016 referendum.

Stocks offset support from net trade

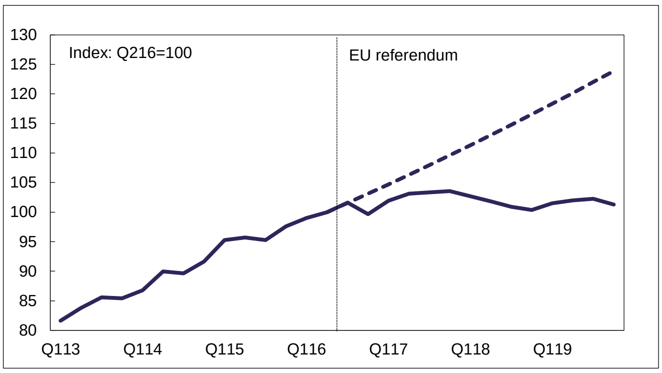
Of course, the shifting Brexit deadlines significantly distorted trade patterns over the past year too. And there was a welcome surge in goods exports in Q4 driven by a record-16.1%M/M increase in December on the back of stronger demand from countries outside the EU. This more than offset the impact of a concerning further decline in services exports, which were

UK: GDP growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Business investment*



**Dashed line is based on pre-referendum trend from Q111.*
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

down about 6½%Q/Q and at a similar pace on a Y/Y basis too. So, total export shipments were up more than 4%Q/Q. And with total imports down 0.8%Q/Q, net trade again provided a sizeable contribution to GDP growth of 1.5ppts. But as is also often the case, the contribution from net trade was largely offset by private inventories, which subtracted 1.6ppts in Q4.

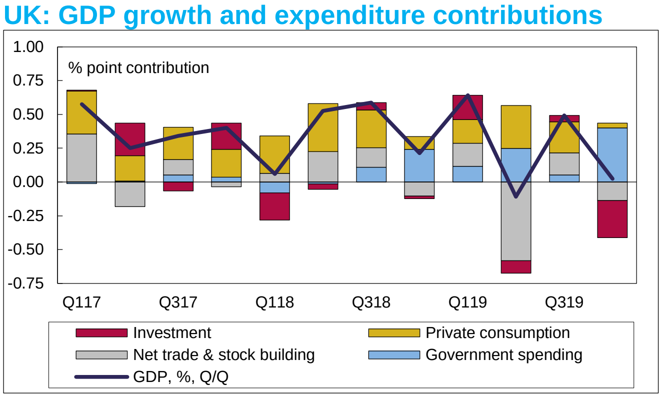
Monthly GDP points to growth in Q1

While the UK's quarterly economic performance was nothing to write home about, arguably it could have been worse (particularly compared with the three largest euro area member states). Indeed, the monthly output profile was somewhat more encouraging. GDP rose 0.3%M/M in December, the firmest growth for five months, to effectively reverse the drop the previous month. This was principally driven by a pickup in services (0.3%M/M) on the back of firmer activity in the information and communications, financial services and transportation/storage sub-sectors. Construction activity also posted positive growth for the second successive month (0.4%M/M), underpinned by new work. But a very subdued rebound in industrial output in December (0.1%M/M) concluded a particularly disappointing year for the sector – indeed, IP posted the first full-year decline since 2013, with manufacturing having contracted in each of the final three quarters of the year. Thankfully, the PMIs suggest that manufacturing conditions turned for the better at the start of the year. And overall, the jump in January's composite PMI was consistent with quarterly GDP growth of 0.2%Q/Q. Indeed, given the recent monthly GDP profile, even in the absence of growth in the first three months of the year, the carryover from Q4 would imply a quarterly increase of 0.1%Q/Q in Q1.

Bank Rate on hold until November?

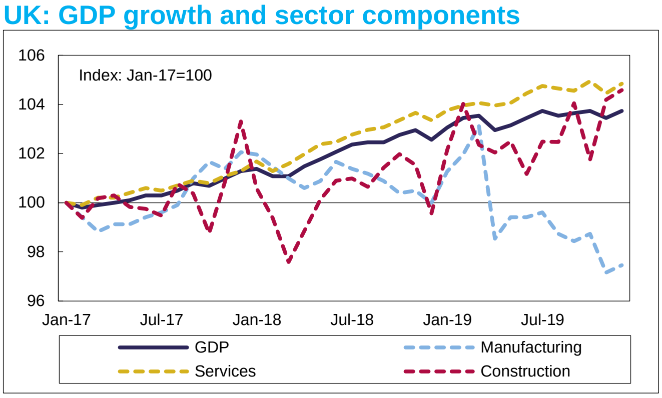
In line with the BoE's January projection, our baseline forecast for GDP growth in Q1 is 0.2%Q/Q. And, while we are more downbeat than the BoE about prospects for 2021, our GDP forecast through to the end of this year is also very similar to that of the BoE. Today's investment figures support the BoE's view that growth in productivity – and hence overall supply potential – will remain very weak. Indeed, full-year GDP growth this year is likely to be little weaker than potential. So, with the improvement in business confidence also suggesting that employment should remain firm over coming quarters, MPC members might remain concerned about upside risks to domestically generated price pressures. As such, we now think the majority on the MPC will want to see greater evidence of weakness in the economy before considering a rate cut. Accordingly, we have shifted back our expectation for a 25bps cut to Bank Rate to 0.50% from May to November.

UK: GDP growth and expenditure contributions



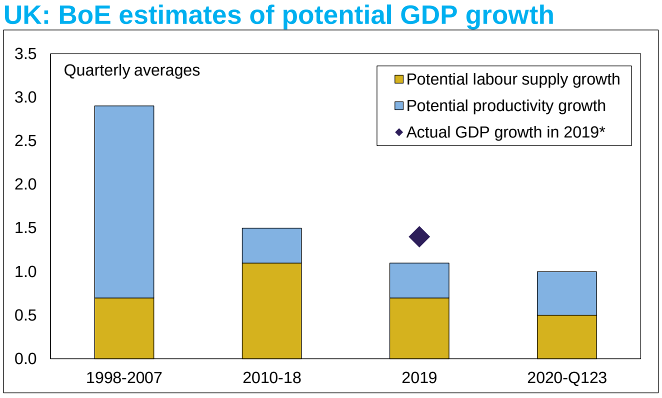
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: GDP growth and sector components



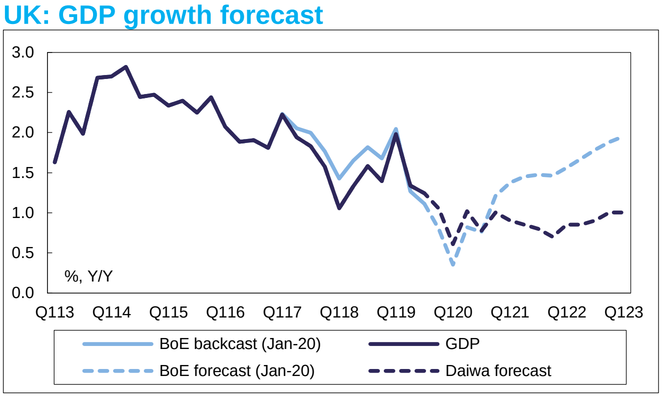
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: BoE estimates of potential GDP growth



**Based on first estimate of Q4 GDP. Source: BoE, ONS and Daiwa Capital Markets Europe Ltd.*

UK: GDP growth forecast



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

The day ahead in the UK

It should be a quieter day for UK economic news tomorrow with no top-tier releases due.

Euro area

The day ahead in the euro area and US

After a day bereft of euro area top-tier economic releases today, Wednesday will bring the euro area's industrial production figures for December. Given the sharp declines in output in each of the large member states, tomorrow will undoubtedly confirm a disappointingly weak end to the year for the euro area's manufacturing sector. Indeed, we expect industrial output to have contracted by 2½%M/M in December, which would leave it on average in Q4 almost 1½% lower than the Q3 average and almost 3% lower than a year earlier.

In the US, a quiet day for top-tier US data releases will see Fed Chair Powell repeat his monetary policy testimony to the Senate Banking Committee.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK	BRC retail sales monitor, like-for-like sales Y/Y%	Jan	**0.0**	-	1.7	**-**
	Preliminary GDP Q/Q% (Y/Y%)	Q4	**0.0 (1.1)**	*-0.1 (0.8)*	0.4 (1.1)	**0.5 (1.2)**
	GDP M/M%	Dec	**0.3**	*0.0*	-0.3	**-**
	Services output M/M% (3M/3M)	Dec	**0.3 (0.1)**	0.2 (0.0)	-0.3 (0.1)	**-0.4 (0.0)**
	Industrial production M/M% (Y/Y%)	Dec	**0.1 (-1.8)**	0.3 (-0.8)	-1.2 (-1.6)	**-1.1 (-2.5)**
	Manufacturing production M/M% (Y/Y%)	Dec	**0.3 (2.5)**	0.5 (-1.0)	-1.7 (-2.0)	**-1.6 (-3.3)**
	Construction output M/M% (Y/Y%)	Dec	**0.4 (5.0)**	-0.1 (3.9)	1.9 (2.0)	**2.4 (2.6)**
	Trade balance (goods trade balance) £bn	Dec	**7.7 (0.8)**	-0.7 (-10.1)	4.0 (5.3)	**1.8 (-4.9)**

Auctions

Country	Auction
- Nothing to report -	

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	Industrial production M/M% (Y/Y%)	Dec	*-2.5 (-3.0)*	0.2 (-1.5)

Auctions and events

Country	GMT	Auction / Event
EMU	09.59	ECB Chief Economist Lane scheduled to speak in Dublin
Germany	10.30	Auction: €4bn of 0% 2030 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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