

Euro wrap-up

Overview

- Bunds followed Treasuries lower even as euro area IP declined in Q4 at the steepest quarterly pace for seven years.
- Gilts also made notable losses on a day bereft of UK economic data.
- The remainder of the week will bring Q4 GDP data from Germany and the euro area, with risks that both will report negative growth. Euro area employment and trade figures are also due.

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Daily bond market movements

| Bond | Yield | Change |
|--------------|--------|--------|
| BKO 0 12/21 | -0.647 | +0.003 |
| OBL 0 04/25 | -0.599 | +0.010 |
| DBR 0 02/30 | -0.378 | +0.017 |
| UKT 3% 09/21 | 0.537 | +0.035 |
| UKT 1 04/24 | 0.485 | +0.048 |
| UKT 0% 10/29 | 0.614 | +0.046 |

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

Source: Bloomberg

Euro area

IP falls at steepest pace for almost four years

After some dire output figures last week from the largest member states, and sentiment surveys having previously implied deterioration in manufacturing conditions in December, today's euro area industrial production figures for that month were predictably weak. In particular, total production declined 2.1% M/M, the most in almost four years, while the modest growth initially reported in November was revised away. As such, industrial output fell to its lowest level since mid-2016, to leave it down more than 4% Y/Y and 1.4% Q/Q, the fifth quarterly contraction out of the past six and the steepest since Q412. With the exception of Portugal (+2.9% M/M) and Greece (+2.5% M/M), production fell sharply across the member states in December, including particularly steep declines in Germany (-2.5% M/M), France (-2.9% M/M), Italy (-2.7% M/M) and Ireland (-6.2% M/M).

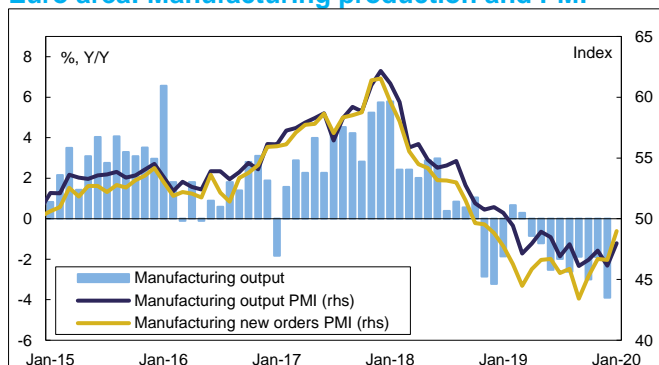
Autos a key source of weakness

By type of good, 20 out of the 22 main manufacturing sub-sectors declined in December. And the sizeable drop in capital goods production (-4.0% M/M) stood out in December, driven by further significant weakness in the autos and general and electrical machinery equipment sub-sectors. Indeed, autos output dropped almost 5% Q/Q in Q4 to the lowest level since mid-2014, and production of electrical equipment fell 1.5% Q/Q to the lowest in more than a decade. And so, over the fourth quarter as a whole total capital goods production was down 3% Q/Q, the steepest such decline for seven years. Production of intermediate and consumer goods was also much weaker at the end of the year as falls in chemicals and pharmaceuticals continued to weigh. Admittedly, strength in the pharmaceutical sector earlier in the quarter helped total production of consumer goods eke out a modest increase (0.3% Q/Q) in Q4. But overall, manufacturing production declined 1.5% Q/Q in Q4, the most in seven years.

Risks to production outlook still skewed to the downside

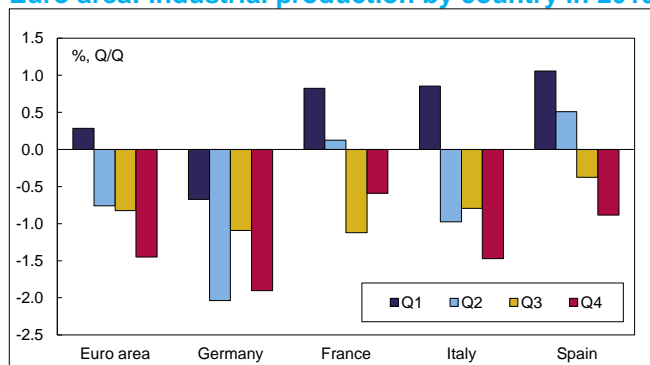
Part of the weakness in December is likely to reflect the timing of public holidays and associated bridge days, particularly in Germany. And so we expect to see a rebound in production in January. Indeed, various sentiment indicators also point to some welcome stabilisation in the manufacturing sector at the start of year. But recent surveys were largely conducted before the outbreak of China's coronavirus took greater prominence. China is the euro area's third most important trading partner, accounting for about 4% of total exports (5% including Hong Kong). Germany's manufacturers are more exposed, with exports to China accounting for more than 7% of the total and worth almost 3% of GDP. And the virus likely poses a downside risk from the perspective of supply as well as demand.

Euro area: Manufacturing production and PMI



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

Euro area: Industrial production by country in 2019



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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Car production set to remain particularly weak

Indeed, concerns about supply chain disruption related to the coronavirus already saw Fiat Chrysler last week warn that it might halt production at one plant in Europe. Meanwhile, the January car production figures published by the Association of the German Automotive Industry (VDA) disappointed, with production down 8%Y/Y, to leave the level of output trending (on a 12 month sum basis) to the lowest since the series began in 2005. And this coincided with a fall in new German car registrations last month for both home (-5%Y/Y) and foreign markets (-13%Y/Y). Demand for new cars appears to have continued to fall in other large member states too. In January, French registrations fell 12.7%Y/Y, Italian registrations were down 5.9%Y/Y and Spanish registrations were down 7.6%Y/Y. Overall, activity in the autos sector seems highly likely to remain subdued over the first quarter of 2020 as a whole, and probably beyond.

The coming two days in the euro area and US

A key euro area data focus over the coming two days will be Friday's publication of Germany's Q4 GDP data. Given the marked weakness in December's retail sales and production figures, Germany's economy now looks to have gone into reverse in the final quarter of 2019. We forecast growth of -0.1%Q/Q, to mark the second quarterly decline in the past three and leave each of the three largest euro area member states in contraction. As such, and after today's IP figures, we also see a risk that the updated euro area GDP figure (also due Friday) will revise down growth from the flash estimate of 0.1%Q/Q, 1.0%Y/Y. Indeed, we now think that the economy stagnated in Q4, with a non-negligible risk that it also contracted. Friday will also bring euro area employment figures for Q4, which, despite the softer economic backdrop, are likely to show that growth stepped up slightly from the 0.1%Q/Q increase of Q3.

In contrast, tomorrow should be relatively uneventful, with just final German inflation figures for January expected to confirm that the headline CPI rate edged slightly higher at the start of the year, while core inflation likely slipped back slightly. The Commission will also publish updated economic forecasts.

In the US, it will be busier for top-tier releases, with tomorrow's January inflation figures expected to show increases of 0.2%M/M in both the headline and core measures. As such, the annual headline CPI rate is forecast to have shifted slightly higher by 0.2ppt to a fifteen-month high of 2.5%Y/Y, on the back of energy price movements. Core inflation, however, is expected to move shifted slightly lower by 0.1ppt to 2.2%Y/Y. The following day will bring retail sales figures for the same month, expected to report another solid increase at the start of the year, while the latest IP report for the same month seems likely to disappoint, with manufacturing output forecast to have more than reversed the increase in December. Friday will also bring the preliminary University of Michigan consumer sentiment survey for February.

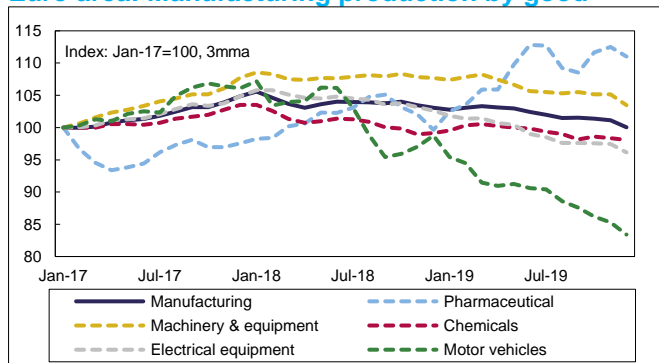
UK

The coming two days in the UK

After the excitement of yesterday's [Q4 GDP](#) figures, it should be a quiet second half of the week for UK releases with just the RICS residential market survey for January due on Thursday. In line with the more positive tone to various sentiment indicators since the start of the year, the RICS survey is expected to point to further stabilisation in the housing market, with the headline house price index set to post the first positive reading since July 2018.

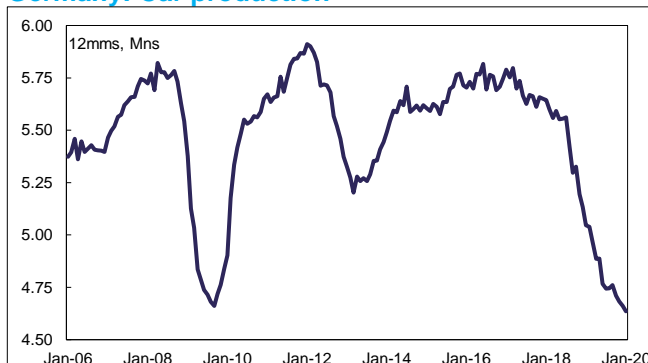
In the absence of significant news, the next edition of the Euro wrap-up will be published on 14 February 2020

Euro area: Manufacturing production by good



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: Car production



Source: Bloomberg, VDA 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 | Industrial production M/M% (Y/Y%) | Dec | -2.1 (-4.1) | -2.0 (-2.5) | 0.2 (-1.5) | 0.0 (-1.7) |

Auctions

| Country | Auction |
|---------|---|
| Germany | sold €3.18bn of 0% 2030 bonds at an average yield of -0.38% |

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 |
|---------|-------|------------------------------------|--------|--|-----------|
| Germany | 07.00 | Final CPI (EU-harmonised CPI) Y/Y% | Jan | 1.7 (1.6) | 1.5 (1.5) |
| UK | 00.01 | RICS house price balance | Jan | 3 | -2 |

Auctions and events

| Country | GMT | Auction / Event |
|---------|-------|--|
| EMU | 08.30 | ECB's Hernández de Cos scheduled to speak |
| | 08.30 | ECB's Panetta scheduled to speak in Rome |
| | - | European Commission publishes Winter Forecasts |
| Italy | 10.00 | Auction: to sell €2.25bn of 0.05% 3Y bonds |
| | 10.00 | Auction: to sell €2.75bn of 0.85% 7Y bonds |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's data releases

Economic data

| Country | GMT | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|---------|-------|------------------------------------|--------|--|-----------|
| EMU | 10.00 | GDP – second estimate Q/Q% (Y/Y%) | Q4 | <u>0.0 (0.9)</u> | 0.2 (1.1) |
| | 10.00 | Trade balance €bn | Dec | 19.3 | 19.2 |
| | 10.00 | Employment Q/Q% (Y/Y%) | Q4 | - | 0.1 (0.9) |
| Germany | 07.00 | Preliminary GDP Q/Q% (Y/Y%) | Q4 | <u>-0.1 (0.3)</u> | 0.1 (0.5) |
| Italy | 09.00 | Trade balance €bn | Dec | - | 4.8 |
| Spain | 08.00 | Final CPI (EU-harmonised CPI) Y/Y% | Jan | 1.1 (1.1) | 0.8 (0.8) |

Auctions and events

| Country | GMT | Auction / Event |
|-----------------------|-----|-----------------|
| - Nothing scheduled - | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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

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