Euro wrap-up

Overview

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- Bunds made gains as data confirmed that Germany's economy failed to grow in Q4.
- Gilts followed USTs higher on a quieter day for UK economic news.
- The coming week will bring the flash February PMIs, updates on UK inflation, jobs and retail sales, and the account of the ECB's latest policy meeting.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.664	-0.009
OBL 0 04/25	-0.620	-0.016
DBR 0 02/30	-0.407	-0.018
UKT 3¾ 09/21	0.532	-0.033
UKT 1 04/24	0.481	-0.035
UKT 0⅞ 10/29	0.611	-0.040

*Change from close as at 4:00pm GMT.
Source: Bloomberg

Euro area

Euro area growth weak, German GDP flat in Q4

Euro area GDP growth in Q4 was today confirmed at its flash estimate of 0.1%Q/Q (0.06%Q/Q), representing the weakest quarter since the economic recovery began almost seven years ago. Due to revisions, the annual growth rate in Q4 was nudged slightly lower to 0.9%Y/Y, the softest in six years. Meanwhile, the first estimate of German GDP in Q4 suggested that the euro area's largest member state avoided contraction in the fourth quarter of 2019, but only just. In particular, German economic output was effectively unchanged from Q3 (growth of 0.03%Q/Q in Q4) to be up just 0.4%Y/Y. And while the growth rate in Q3 was revised up by 0.1ppt to 0.2%Q/Q, the GDP level in Q4 was still marginally below that in Q1. However, full-year growth was revised up by 0.1ppt to 0.6%Y/Y.

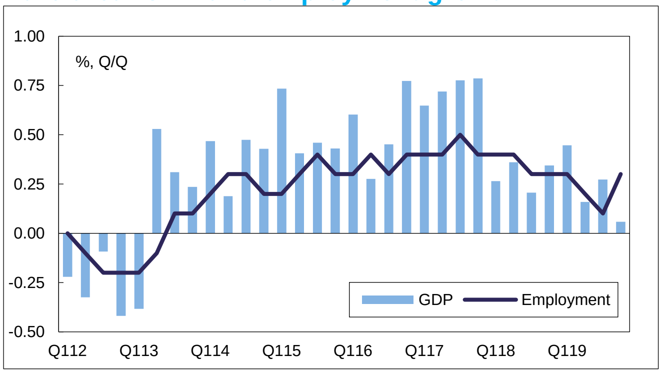
Consumption slowed, while equipment investment fell

No detailed arithmetic for the various expenditure components in the euro area or Germany was published today. However, the respective statistical agency (Destatis) stated that German household and government consumption slowed markedly in Q4. In addition, export volumes fell slightly while imports picked up to suggest that net trade subtracted from GDP growth. And investment in machinery and equipment fell sharply. In contrast, investment in construction and other fixed assets reportedly continued to increase. That jars somewhat with last week's German construction data, which reported a sharp drop of 1.9%Q/Q in output from the sector last quarter. We expect those figures, and other components of Germany's December industrial production report, to be revised up in due course. Indeed, today Destatis significantly revised up its data for retail sales, which are now estimated to have been flat in Q4 compared to the previous estimate of a drop of 0.7%Q/Q.

Employment outpaced GDP

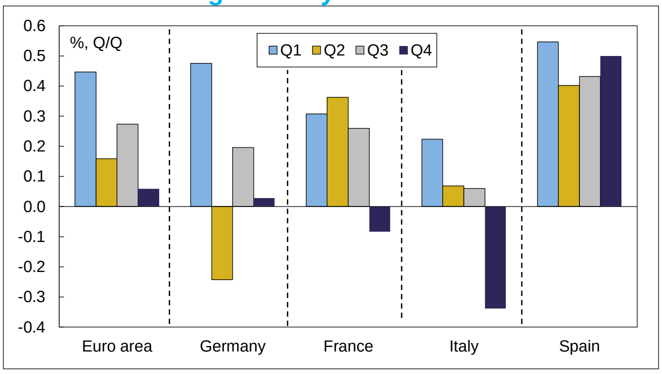
Despite the slowdown in GDP, job growth in the euro area picked up in the fourth quarter. Indeed, employment rose 0.3%Q/Q, up 0.2ppt from Q3 and the strongest rate since Q1. That, however, left the annual rate unchanged at 1.0%Y/Y, matching the softest since Q315 and only very slightly firmer than the increase in economic output. In terms of the number of people in work, employment in Q4 rose by 433k, up more 220k from the increase in Q3. Among the member states, Spain – where GDP growth stepped up to 0.5%Q/Q – appears to have been the principal driver, with employment rising 0.8%Q/Q (164k), the most since Q215. Fully consistent data from the other member states have yet to be published. But national figures suggest that employment also rose in France and Italy (where GDP declined) as well as in Germany. Nevertheless, we expect job growth to continue to trend lower over the coming year, and the euro area unemployment rate to edge down only slightly from 7.4% in December.

Euro area: GDP and employment growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth by member state



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

The coming week in the euro area and US

A key data focus in the euro area in the coming week will be Friday's flash PMIs for February. While the manufacturing survey implied some stabilisation in the sector at the start of the year, the subsequent increase of downside risks to the global outlook in light of the coronavirus outbreak looks set to have weighed on sentiment in the sector over the past month. Meanwhile, the services PMI is also expected to post a further modest deterioration in conditions this month. As such, the composite PMI will surely take a step down from the five-month high (51.3) reached in January. While the impact of the coronavirus on household sentiment will be more limited for now, the Commission's flash estimate of consumer confidence (due Thursday) is expected to show no improvement in February, with the index set to move sideways at a level that was last weaker in 2016.

The back end of the week will also bring final euro area inflation figures for January (Thursday), which, in line with this week's final German and Spanish figures, are expected to confirm the modest increase in the headline rate (up 0.1ppt to 1.4%Y/Y) on the back of firmer energy prices. The preliminary release saw core inflation decline 0.1ppt to 1.1%Y/Y and this also seems highly likely to be confirmed. That day will also bring the publication of the account from the ECB's January Governing Council meeting. Ahead of this, euro area construction output data for December are due on Monday, followed by new car registrations figures for January on Tuesday. Not least given significant weakness reported in Germany and France in the respective data sets, both releases are likely to report a notable decline in the euro area as a whole. At the country level, Germany's ZEW survey of financial professionals and GfK consumer confidence survey are also due on Tuesday and Thursday respectively.

In the US, when markets reopen after Monday's Presidents' Day holiday, Tuesday will bring the first of the week's housing market indicators with the NAHB housing index for February. This will be followed by January housing starts figures (Wednesday) and existing home sales data (Friday). Other scheduled releases include the Empire Manufacturing index (Tuesday) and the Philly Fed and Conference Board leading indicators (Thursday), while the latest PPI figures will be published alongside the minutes from the Fed's January policy-setting meeting (Wednesday). In terms of Fed-speak, Wednesday will see FOMC voting members Mester, Kashkari and Kaplan speak publicly, while Friday will see several members speak at a policy forum in New York.

UK

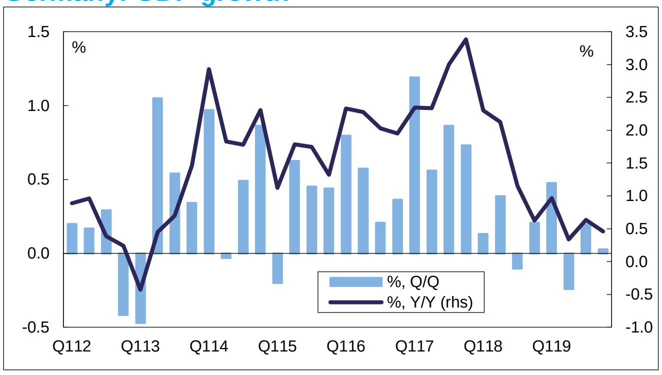
Johnson's increased control is bad news for Gilts

Yesterday's news that Sajid Javid had resigned as Chancellor of the Exchequer, due to an argument with Boris Johnson over the roles played by his advisers, had an immediate substantive impact on Gilts and Sterling, some of which was sustained today. In our view, those initial market shifts were appropriate. The new organisational arrangements imposed by Johnson, which triggered Javid's resignation, represent a significant loss of independence for the Treasury, which will effectively now come under the command of the Prime Minister and his unpredictable chief adviser Dominic Cummings. So, Javid's replacement Rishi Sunak appears now to be Chancellor in name only, forced to share advisers under the control of Number 10 Downing Street.

BoE to be wary of extent of fiscal loosening

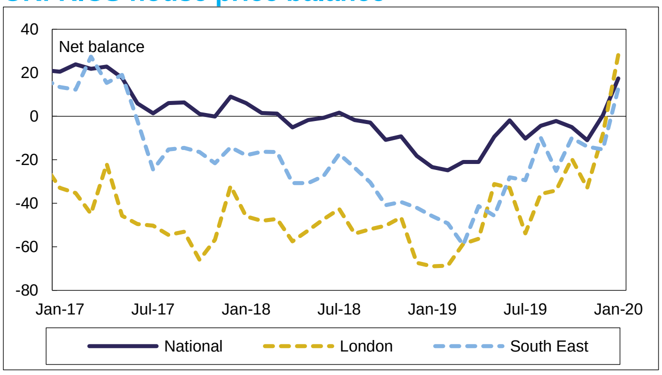
We therefore now expect the Government's commitment to its current fiscal rules, which include a pledge to erase the current budget deficit and reduce public debt as a share of GDP, to be weaker than would otherwise have been the case. And so, next month's Budget announcement is likely to imply looser fiscal policy than otherwise would have been the case. Indeed, we cannot rule out a Trump-style big-bang stimulus. We should also expect UK public spending decisions and tax policy changes to be driven more by politics than economic analysis. That's further bad news for the UK economy's medium-

Germany: GDP growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: RICS house price balance



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

to longer-term prospects, which have already been hit hard by Brexit and an associated flat-lining of business investment since the referendum. But the expectation that fiscal policy will be somewhat looser than expected also implies that the BoE is likely now to be less inclined than it otherwise would have been to cut rates further.

UK housing market on the up

In line with the more positive tone of various sentiment indicators since the start of the year, yesterday's release of the RICS residential market survey pointed to further improvement in the housing market at the start of the year. In particular, the headline house price index surged in January by 17pts to +17, the first positive balance since July 2018 and the highest since May 2017. While the improvement was widespread, the most significant increase was seen in London, where the house price balance jumped 37pts to +28, the highest since August 2015, while the house price balance in the South East (up 28pts) returned to positive territory for the first time since mid-2017. Other details of the report were more encouraging for the near-term housing market outlook too, with a notable increase in the survey measure of supply of properties on the market – reportedly the most since the summer of 2013 – accompanied by higher buyer enquiries and the most agreed sales since April 2014. And so, surveyors were more optimistic about near-term sales expectations too, with the relevant index the strongest since 2015, while the outlook for prices over the near term and the coming twelve months were the firmest since the start of 2016. This improved optimism is likely to be echoed in February's release of the Rightmove's index of asking prices, due on Monday.

The coming week in the UK

The coming week will be a busy one for top-tier UK economic releases, with the December labour market figures (due Tuesday), January CPI and retail sales data (Wednesday and Thursday respectively) and the February flash PMIs (Friday) all likely to play an important role in the considerations of the Bank of England. While employment growth is likely to have slowed in the three months to December from the ten-month high of 208k in November, it is expected to remain in positive territory to leave the unemployment rate unchanged at 3.8%. But regular earnings growth looks set to have edged slightly lower in the three months to December, to 3.2%3M/Y, which would be the softest for fifteen months. This notwithstanding, with the flash estimate of productivity in Q4 set to have remained weak, this would imply still solid unit labour cost growth in the final quarter of 2019. Meanwhile, January's CPI figures are expected to show that headline inflation increased 0.3ppt from December's near-three-year low of 1.3%Y/Y on the back of higher energy inflation. The upwards drift in core inflation will, however, be more modest.

Turning to the retail sector, while the January BRC and CBI surveys signalled a soft start to the year, Thursday's retail sales release seems likely to report the first monthly increase in four, albeit leaving year-on-year growth at a still very subdued rate. That day will also bring the latest CBI industrial trends survey, which will provide an update on the manufacturing sector in February. But likely of greater interest will be Friday's flash February PMIs, which will provide a more comprehensive assessment of economic conditions since the outbreak of the coronavirus gained greater media attention. And while the headline manufacturing PMI jumped in January to 50.0 (the first non-contractionary reading since April), this seems likely to have fallen back as concerns about the global outlook intensified. The services PMI is also likely to have moderated from the sixteen-month high of 53.9 recorded in January, leaving the composite PMI consistent with only modest expansion in February. Finally, Friday will also bring January public finance figures, the last update before the March Budget.

In the absence of significant news, the next edition of the Euro wrap-up will be published on 18 February 2020

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	GDP – second estimate Q/Q% (Y/Y%)	Q4	**0.1 (1.0)**	*0.0 (0.9)*	0.2 (1.1)	**-**
	Trade balance €bn	Dec	**22.2**	19.3	19.2	**19.1**
	Employment Q/Q% (Y/Y%)	Q4	**0.3 (1.0)**	-	0.1 (0.9)	**- (1.0)**
Germany	Preliminary GDP Q/Q% (Y/Y%)	Q4	**0.1 (0.3)**	*-0.1 (0.3)*	0.1 (0.5)	**0.2 (0.6)**
Italy	Trade balance €bn	Dec	**5.1**	-	4.8	**4.9**
Spain	Final CPI (EU-harmonised CPI) Y/Y%	Jan	**1.1 (1.1)**	1.1 (1.1)	0.8 (0.8)	**-**

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
Germany	Final CPI (EU-harmonised CPI) Y/Y%	Jan	**1.7 (1.6)**	1.7 (1.6)	1.5 (1.5)	-
UK	RICS house price balance	Jan	**17**	3	-2	**0**

Auctions	
Country	Auction
Italy	sold €2.25bn of 0.05% 2023 bonds at an average yield of -0.1%
	sold €2.75bn of 0.85% 2027 bonds at an average yield of 0.48%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa economic forecasts

	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2019	2020	2021
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	0.2	0.0	0.2	0.2	0.2	0.2	0.2	0.0	0.6	0.5	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	0.2	0.1	0.0	-0.1	0.0	-0.1	0.2	0.0	-0.1
Spain	0.4	0.5	0.3	0.4	0.4	0.4	0.4	0.2	2.0	1.5	1.2
UK	0.5	0.0	0.2	0.3	0.3	0.3	0.1	0.3	1.4	0.9	0.8
Inflation forecasts %, Y/Y											
Euro area											
Headline CPI	1.0	1.0	1.3	1.2	1.4	1.3	1.3	1.2	1.2	1.3	1.3
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	1.5	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	-0.50	-0.50	-0.50	-0.50	-0.50
Net asset purchases*	0	20	20	20	20	20	20	20	20	20	20
BoE											
Bank Rate %	0.75	0.75	0.75	0.75	0.75	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.*

Coming week's data calendar

The coming week's key data releases						
Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
			Monday 17 February 2020			
EMU		10.00	Construction output M/M% (Y/Y%)	Dec	-	0.7 (1.4)
UK		00.01	Rightmove house price index M/M% (Y/Y%)	Feb	-	2.3 (2.7)
			Tuesday 18 February 2020			
EMU		07.00	EU27 new car registrations	Jan	-	21.7
Germany		10.00	ZEW current situation balance (expectations)	Feb	-10.5 (20.0)	-9.5 (26.7)
UK		09.30	Claimant count rate % (change '000s)	Jan	-	3.5 (14.9)
		09.30	Average weekly earnings (excluding bonuses) 3M/Y%	Dec	3.1 (3.3)	3.2 (3.4)
		09.30	ILO unemployment rate 3M%	Dec	3.8	3.8
		09.30	Employment change 3M/3M '000s	Dec	159	208
		09.30	Preliminary output per hour Y/Y%	Q4	-	0.1
			Wednesday 19 February 2020			
UK		09.30	CPI (core CPI) Y/Y%	Jan	1.7 (1.5)	1.3 (1.4)
		09.30	PPI output prices Y/Y%	Jan	1.0	0.9
		09.30	ONS house price index Y/Y%	Dec	-	2.2
			Thursday 20 February 2020			
EMU		15.00	Preliminary consumer confidence	Feb	-8.0	-8.1
Germany		07.00	GfK consumer confidence	Mar	9.8	9.9
		07.00	PPI Y/Y%	Jan	-0.5	-0.2
France		07.45	Final CPI (EU-harmonised CPI) Y/Y%	Jan	1.5 (1.6)	1.5 (1.6)
UK		09.30	Retail sales including fuel M/M% (Y/Y%)	Jan	0.7 (0.6)	-0.6 (0.9)
		09.30	Retail sales excluding fuel M/M% (Y/Y%)	Jan	0.9 (0.6)	-0.8 (0.7)
		11.00	CBI industrial trends survey, total orders	Feb	-18	-22
			Friday 21 February 2020			
EMU		09.00	Preliminary manufacturing PMI (services PMI)	Feb	47.5 (52.3)	47.9 (52.5)
		09.00	Preliminary composite PMI	Feb	51.0	51.3
		10.00	Final CPI (core CPI) Y/Y%	Jan	1.4 (1.1)	1.3 (1.3)
Germany		08.30	Preliminary manufacturing PMI (services PMI)	Feb	44.8 (53.8)	45.3 (54.2)
		08.30	Prelimianry composite PMI	Feb	50.7	51.2
France		08.15	Preliminary manufacturing PMI (services PMI)	Feb	50.7 (51.4)	51.1 (51.0)
		08.15	Preliminary composite PMI	Feb	50.8	51.1
Italy		09.00	Industrial sales M/M% (Y/Y%)	Dec	-	0.0 (0.1)
		09.00	Industrial orders M/M% (Y/Y%)	Dec	-	-0.3 (-4.3)
		10.00	Final CPI (EU-harmonised CPI) Y/Y%	Jan	0.6 (0.5)	0.5 (0.5)
UK		09.30	Preliminary manufacturing PMI (services PMI)	Feb	49.7 (53.4)	50.0 (53.9)
		09.30	Preliminary composite PMI	Feb	52.9	53.3
		09.30	Public sector net borrowing, excluding banks £bn	Jan	-11.5	4.8

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		GMT	Event / Auction
			Monday 17 February 2020
EMU		14.00	ECB's Lane scheduled to speak
			Tuesday 18 February 2020
Germany		11.30	Auction: €5bn of 2022 bonds
			Wednesday 19 February 2020
Germany		10.30	Auction: €1.5bn of 2048 bonds
			Thursday 20 February 2020
EMU		10.30	ECB Vice President Guindos scheduled to speak
		12.30	ECB account of January's Governing Council meeting published
France		09.50	Auction: to sell fixed rate and inflation-linked bonds
Spain		09.45	Auction: to sell bonds
UK		10.30	Auction: to sell £3.25bn of 1.5% 2026 bonds
			Friday 21 February 2020
EMU		17.00	ECB's Lane scheduled to speak
UK		18.30	BoE's Tenreyro scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.