

# Euro wrap-up

## Overview

- Ahead of tomorrow's long-awaited ECB policy announcements, Bunds ended the day little changed despite further solid German export data.
- Gilts were also little changed ahead of this evening's Brussels Brexit dinner between the UK PM and Commission President.
- All eyes tomorrow will be on the ECB's policy announcement, while markets will digest the latest Brexit news, and data for French industrial production and UK GDP will be released.

**Chris Scicluna**

+44 20 7597 8326

### Daily bond market movements

Bond	Yield	Change
BKO 0 12/22	-0.784	-0.002
OBL 0 10/25	-0.798	+0.000
DBR 0 08/30	-0.608	+0.000
UKT 1½ 09/22	-0.094	-0.001
UKT 0% 06/25	-0.047	-0.002
UKT 4% 12/30	0.255	+0.001

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

Source: Bloomberg

## Euro area

### German exports continue to outpace imports during the pandemic's second wave

After net trade contributed a whopping 3.9ppts to GDP growth in Q3, German goods exports continued to outpace imports at the start of Q4. In particular, the value of German exports rose 0.8%M/M, 0.5ppt stronger than the pace of imports. That pushed the trade surplus on an adjusted basis up a further €0.3bn to €17.1bn, the highest since February (€17.7bn). Nevertheless, while they were up 38% from April's trough, given the steep drop during the first wave of the pandemic, exports were still down 6.5%Y/Y and 6.8% below February's level. Imports were up 'only' 19% from the trough but were down a smaller 5.9%Y/Y and 5.2% below February's level. Adjusting for changes in prices, export volumes also rose for a sixth successive month and by 0.8%M/M to be 3.2% above the Q3 average. In contrast, import volumes fell 0.1%M/M to reverse September's tiny rise and be just 1.8% above the Q3 average. So, in marked contrast to the pandemic's first wave when it subtracted significantly from GDP growth in both Q1 and Q2, net trade appears firmly on track to provide support to GDP growth during the second wave in Q4. By destination, exports to China stood out, although they rose just 0.3%Y/Y. In marked contrast, exports to the US were still down a steep 10.5%Y/Y and those to the UK were down 11.7%Y/Y. Exports to the rest of the euro area fell 5.1%Y/Y, with those to non-euro area EU member states down a more modest 1.9%Y/Y.

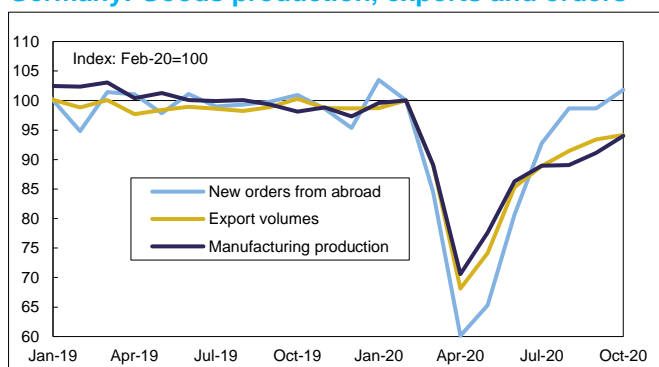
### French trade shows similar pattern

Today's German trade data tallied with yesterday's figures from France, which similarly showed exports outpacing imports in October but still with further to go to close the gap from February. In particular, French export values rose 3.3%M/M at the start of Q4 to be about 7.0% above the Q3 average but still down 7.6% from the pre-pandemic level and down 12.0%Y/Y. In contrast, French imports rose a more modest 1.2%M/M on the same basis and were up just 1.9% from the Q3 average. They were down a smaller 6.7% from February and 10.8%Y/Y. French goods exports to the US and UK were still down more than 20%Y/Y, while shipments to China and Hong Kong were down just 2.0%Y/Y and those to South Korea were up 2.0%Y/Y.

### Orders and surveys point to further German export growth supporting manufacturing recovery

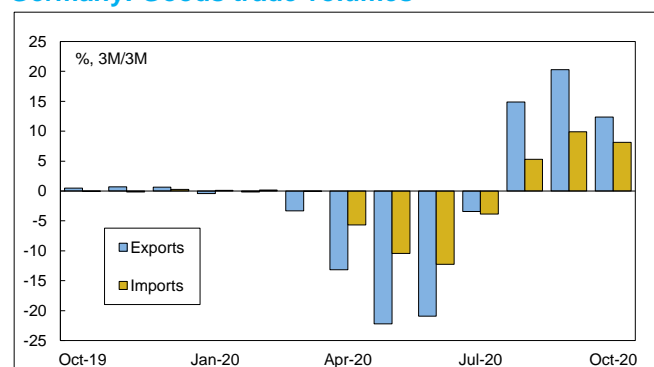
The sustained pick up in export growth, particularly from Asia, has provided a significant source of impetus for the recovery in the manufacturing sector. Indeed, in October German manufacturing output and goods export volumes had both recovered to about 6.0% below February's pre-pandemic level. And with new orders from abroad having risen above the February level, and survey indicators upbeat (e.g. Germany's manufacturing new exports PMI remained above 60 last month), the manufacturing recovery in the euro area's largest member state looks set to continue for the time being. We

#### Germany: Goods production, exports and orders



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Germany: Goods trade volumes



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

note, however, that surveys point to a notable weakening in momentum for exports from the other large member states, with the new export orders PMIs close to or below 50 last month in France, Italy and Spain. That might reflect the larger share of capital and intermediate goods in German exports. However, we also have doubts that net trade will continue to make a positive contribution to German economic growth in the first quarter, when shipments to the UK in particular will be impacted by additional non-tariff barriers. And, by implication, growth in manufacturing output in Q1 is likely to provide less of an offset for ongoing services weakness.

## The day ahead in the euro area

Tomorrow's principle focus in the euro area will be the long-awaited announcement from the ECB of its latest monetary policy initiatives, which President Lagarde signalled following the ECB's [previous policy meeting](#) on 29 October. Information from the [published account](#) of that meeting, as well as repeated public commentary from various Governing Council members (both hawks and doves), emphasised that the PEPP purchases and TLTRO funding operations will be the main tools to be adjusted. But the influential Executive Board members Lane and Schnabel have suggested that the Governing Council will look to extend the current level of monetary accommodation to better match the duration of the pandemic, rather than increase the amount of current accommodation.

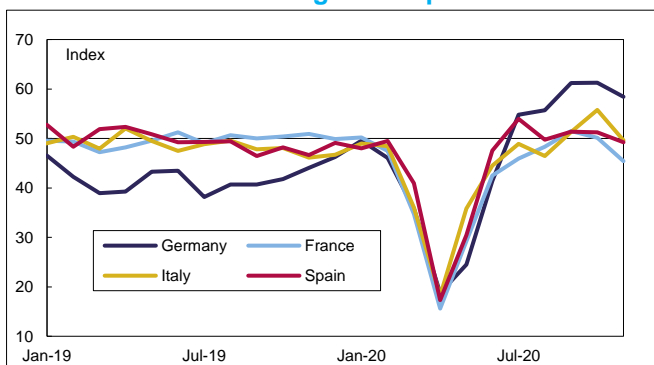
So, we should not expect an acceleration in the current pace of asset purchases. Instead, we should look for the PEPP purchases to be extended, at least to the end of 2021 but – not least given concerns about the recent appreciation of the euro – probably as far as mid-2022, initially at the current pace of roughly €15bn per week. The extension to mid-2022 would seem to merit an increase in the PEPP purchase envelope of up to €650bn, although the Governing Council would also then emphasise that the resulting €2.0trn envelope might not be used in full. In addition, the regular €20bn per month Asset Purchase Programme, which has been augmented by an additional envelope of €120bn to the end of this year, might be expected to continue into 2021. And the Governing Council could also announce further quarterly TLTRO-iii operations beyond next March, perhaps also into 2022, and extend the period beyond next June during which the minimum interest rate of -1.0% will be applied to all TLTRO-iii loans. Adjustments to other policy tools, including the tiering multiplier and collateral rules, cannot be ruled out. However, we certainly do not expect any changes to the ECB's main policy interest rates.

The extension of the monetary policy measures will be justified by the ECB's updated macroeconomic projections. Despite stronger-than-expected growth in Q3, the setback of a likely drop in GDP in Q4 and persistent weakness into Q1 means that full-year GDP forecasts for 2020 and 2021 will be little changed. So, the Q419 level of GDP will still likely not be reached before the second half of 2022. And while inflation will be expected to rise next year due to the end of the German VAT cut and higher energy inflation, the outlook will be weighed by persistent spare capacity and the stronger euro. Indeed, the ECB is likely to project that inflation will remain below its target of below but close to 2% over the horizon to end 2023. And the post-meeting statement will likely again flag concerns about the downside risks posed by exchange rate movements.

Data-wise, Thursday will be French industrial production data for October. We expect a sixth successive monthly increase in manufacturing output, albeit at a modest rate close to ½%M/M in contrast with the jump of 3.3%M/M in [Germany](#) announced at the start of this week. On the political front, the European Council meeting will get underway in the afternoon, with leaders looking to resolve the current impasse on the EU Budget and €672.5bn Recovery and Resilience Facility – in this context, Hungarian PM Orban, who has so far vetoed progress, yesterday suggested cause for optimism, stating that a deal to secure approval of the EU programmes is now just 'one centimetre away'.

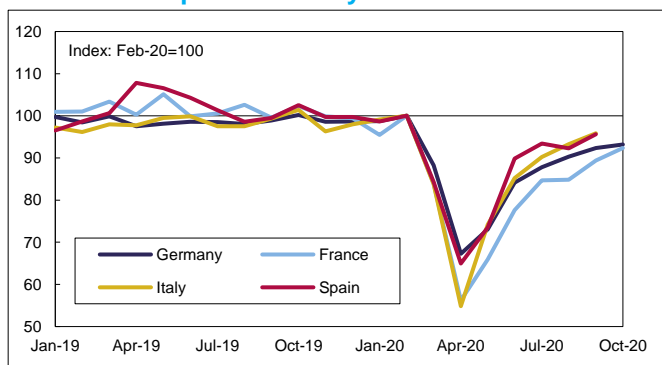
Please note that the release of the Bank of France business survey results for November, previously scheduled for today, has been postponed to Monday 14 December.

### Euro area: Manufacturing new export orders PMIs



Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Export values by member state



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

## UK

### **Brussels dinner expected to lead to further Brexit negotiations at the end of the week**

Ahead of this evening's Brussels dinner between UK PM Johnson and European Commission President von der Leyen, sterling initially appreciated today before subsequently giving up most of its gains. Certainly, the dinner looked highly unlikely to result in a deal. However, if the two leaders make progress, then the chief negotiators from the EU and UK would resume discussions on Friday once the European Council leaders' summit – which is due to start on Thursday afternoon – has passed. There were some further signs of progress today, however, when the detail of yesterday's agreement governing trade between Northern Ireland and the rest of the United Kingdom was announced, and which a senior UK cabinet minister described as providing a 'smoother glide-path' to a deal. But there remains significant distance between the two camps on the main issues, not least the level playing-field. Chancellor Merkel today acknowledged that the EU's demand for an "evolution clause" – which would allow one side to reduce market access to the other if it failed to keep pace with improvements in labour and environmental standards over time – was probably the key stumbling block to a deal. Indeed, the EU's current position on the matter currently appears tougher than its original position that merely sought non-regression from existing agreed standards.




### **The day ahead in the UK**

Beyond the Brexit negotiations, tomorrow will bring the UK data highlight of the week with the first estimate of GDP in October, which we expect to show a drop of 0.5%M/M to be down a hefty 9.1%Y/Y. The revival in the pandemic likely hit spending on services. In contrast, output of manufacturing and construction is likely to have posted positive growth. Goods trade data for the same month are also due tomorrow.




## European calendar

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa</i> <i>forecast</i>	Previous	Revised
Germany	 Trade balance €bn	Oct	<b>19.4</b>	18.5	20.8	<b>20.6</b>
	 Labour costs Q/Q% (Y/Y%)	Q3	<b>-1.7 (1.7)</b>	-	1.9 (5.1)	<b>1.0 (3.9)</b>
Spain	 Industrial production M/M% (Y/Y%)	Oct	<b>0.6 (-1.6)</b>	0.0 (-2.7)	0.8 (-3.4)	<b>-3.1 (0.9)</b>













#### Auctions

Country	Auction
Germany	 sold €2.4bn of 0% 2022 bonds at an average yield of -0.78%
UK	 sold £2.5bn of 0.625% 2035 bonds at an average yield of 0.61%
	 sold £250mn of 0.125% 2048 index-linked bonds at an average yield of -2.30%








Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's releases

#### Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast</i>	Previous
EMU	 12.45	ECB main refinancing rate %	Dec	<u>0.00</u>	0.00
	 12.45	ECB marginal lending facility %	Dec	<u>0.25</u>	0.25
	 12.45	ECB deposit facility rate %	Dec	<u>-0.50</u>	-0.50
France	 07.45	Industrial production M/M% (Y/Y%)	Oct	0.4 (-5.5)	1.4 (-6.0)
	 07.45	Manufacturing production M/M% (Y/Y%)	Oct	0.5 (-5.5)	2.2 (-6.3)
UK	 00.01	RICS house price balance	Nov	63	68
	 07.00	Monthly GDP M/M% (3M/3M%)	Oct	<u>-0.5 (9.9)</u>	1.1 (8.0)
	 07.00	Industrial production M/M% (Y/Y%)	Oct	0.3 (-6.4)	0.5 (-6.3)
	 07.00	Manufacturing production M/M% (Y/Y%)	Oct	0.3 (-8.4)	0.2 (-7.9)
	 07.00	Construction output M/M% (Y/Y%)	Oct	1.1 (-7.4)	2.9 (-10.0)
	 07.00	Index of services M/M% (Y/Y%)	Oct	0.3 (9.7)	1.0 (14.2)
	 07.00	Trade balance £bn	Oct	-0.2	0.6

#### Auctions and events

EMU	 12:45	ECB monetary policy announcement
	 13:30	ECB President Lagarde speaks at post-meeting press conference
	 15:30	European Council meeting
Italy	 10.00	Auction: €2.75bn of 0% 2024 bonds
	 10.00	Auction: €3bn of 0.95% 2027 bonds
Spain	 09.45	Auction: €1.5bn of 1.25% 2030 bonds
	 09.45	Auction: €750mn of 0.65% 2027 index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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