Euro wrap-up

Overview

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- While the final euro area manufacturing PMIs signalled ongoing growth in the sector at the end of 2020, Bunds made gains in anticipation of a tightening and extension of Germany's pandemic containment measures.
- Sterling weakened and Gilts made modest gains at the longer end of the curve ahead of the expected announcement this evening of tighter pandemic restrictions across England.
- Tuesday will bring data for German retail sales, unemployment and car sales, French inflation, Spanish jobless claims and euro area bank lending.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/22	-0.733	-0.003
OBL 0 10/25	-0.766	-0.021
DBR 0 08/30	-0.605	-0.030
UKT 1¾ 09/22	-0.166	+0.021
UKT 0⅝ 06/25	-0.105	-0.008
UKT 4¾ 12/30	0.177	-0.011

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

Euro area

Final manufacturing PMIs suggested ongoing growth at end-2020

The start of the New Year for economic data was relatively uneventful for the euro area. Certainly, the final manufacturing PMIs for December provided no major surprises, with the headline euro area index revised down just 0.3pt from the flash to 55.2, still representing the highest since May 2018 to suggest relatively firm growth momentum in the sector at the end of 2020. Indeed, the survey indices for output and new orders both increased, with Markit citing the strongest improvement in the capital goods sub-sector but 'marginal' strengthening among consumer goods producers. All member states posted an improvement from November, with Germany (58.3) and the Netherlands (58.2) leading the way. Perhaps most notably, France (51.1) and Spain (51.0) rejoined Italy (52.8) back in expansion territory after weakness in November. And only Greece's headline manufacturing PMI (46.9) remained below 50 to suggest a drop in output at the end of the year. So, benefiting not least from ongoing growth in external demand, and – despite some evidence of supply-chain constraints, which were perhaps related to the closure of the Franco-English border – being relatively unaffected by pandemic containment measures during the second wave of Covid-19, the manufacturing sector appears to have continued to contribute positively to GDP growth in Q4 even as services activity went into reverse.

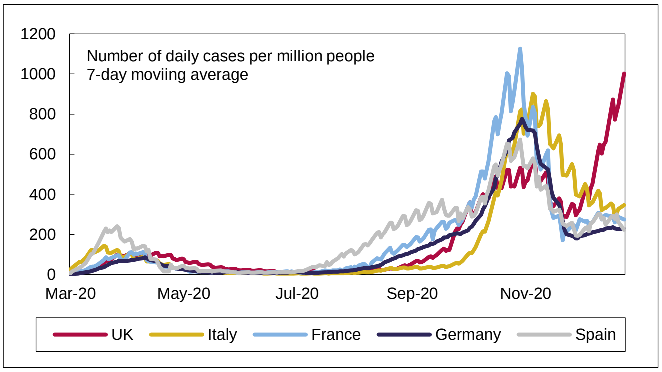
New car registrations end 2020 on a suitably downbeat note

The first member states to release December data for new car registrations all brought downbeat news to cap off an especially weak year. In France, new car registrations fell 10.1%Y/Y to be down almost 24%Y/Y in 2020. While Spanish new car registrations were unchanged from a year earlier in December that left them down last year by almost one third from 2019. And Italian new car registrations fell almost 15%Y/Y in December to be down over 2020 as a whole almost 28%Y/Y. The equivalent data from Germany are due tomorrow. However, despite an initial rebound following the first wave of Covid-19, new car registrations in the euro area are likely to have dropped by more than one fifth in 2020 with prospects for a rebound in 2021 weighed by subdued consumer confidence and the likelihood of a renewed pickup in unemployment.

The day ahead in the euro area

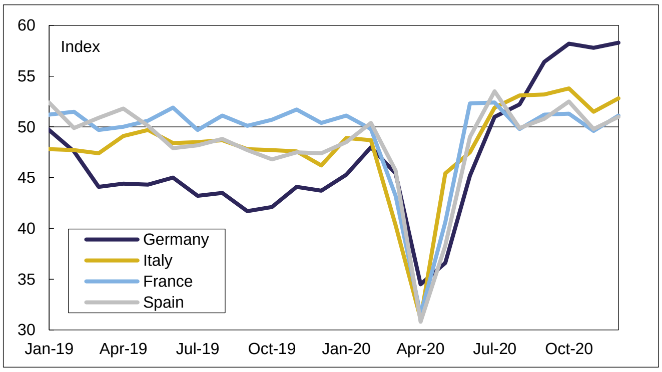
Looking ahead to tomorrow, euro area bank lending figures for November are scheduled for release, along with German retail sales data for the same month. In addition, German and Spanish labour market data for December are due together with German new car registrations and production data and the flash estimates of French inflation last month. In particular, following a strong start to Q4, German retail sales are expected to have been hit by the second wave of Covid-19 in

Selected countries: New covid-19 cases



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing PMIs



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

November, being forecast to fall about 2.0%M/M, which would be the steepest monthly drop since April and would leave the annual growth rate at about 4.0%Y/Y, down from 8.6%Y/Y in October. Meanwhile, German unemployment is expected to rise for the first time in five months, by about 10K, pushing the unemployment rate back up to 6.2% in December after falling in each of the two previous months. And with the trend in new Covid-19 cases still unfavourable – if nowhere near as grim as in the UK – German Chancellor Merkel is set to meet with state leaders tomorrow to discuss an extension of the national containment measures beyond the current deadline of 10 January.

UK

Post-transition trading arrangements come into force as pandemic worsens

Despite the closure of non-essential retail in much of England and the closure of schools nationwide, the second wave of Covid-19 continued to strengthen in the UK over the festive period. Indeed, today brought announcement of much tighter restrictions in Scotland from tonight, and further acknowledgement within the government that a further imminent tightening and extension of English containment measures was likely – indeed PM Johnson was set to address the nation this evening – all of which has increased risks of a contraction in UK GDP in Q1 and an easing of monetary policy in due course. Against the gloomy backdrop of the continued steady increase in new Covid-19 cases, the entry into force from 1 January of the historic UK-EU Trade and Cooperation Agreement (UK-EU TCA), which erected significant new obstacles to post-Brexit trade between the UK and EU, was greeted with relative equanimity by the markets. Of course, that was not least as the major disorder of no deal was avoided and the detail was broadly in line with expectations. But put to the test today on the first business-as-usual day of 2021, there was also no visible evidence of new major disruption to trade at UK ports, certainly in comparison to last month when the Franco-English border was closed due to the pandemic.

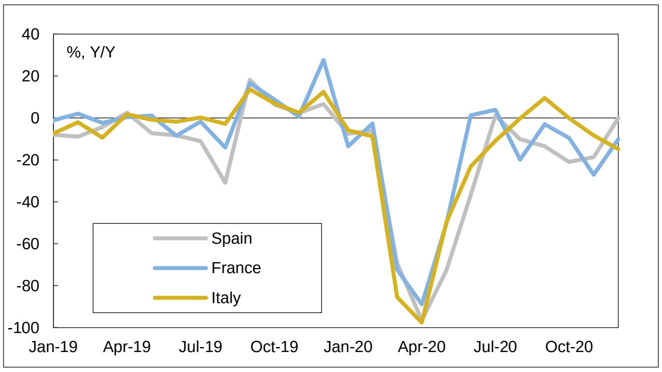
Major new obstacles to UK-EU trade erected

Via the UK-EU TCA, tariff-free and quota-free access for goods traded between the UK and EU was maintained for most products. But that trade is now subject to new customs documentation, procedures and other non-tariff barriers, including new ‘rules of origin’ requirements. And for many services firms, the agreement constrains or indeed prevents altogether continued trade between the UK and EU. So, the TCA represents the imposition of major new obstacles to trade and substantive new costs for exporting businesses. Trade volumes between the two partners will be lower than they otherwise would have been. The attractiveness of the UK as a destination for investment has been significantly tarnished. And the levels of productivity, overall economic activity and living standards in the UK will also be persistently lower than would otherwise have been the case.

Several sub-sectors to suffer from a lack of co-operation

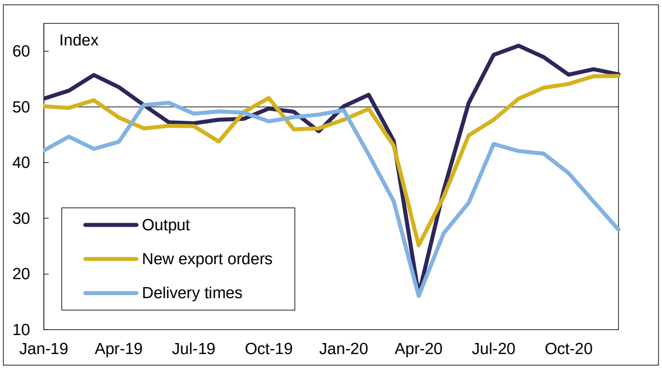
Indeed, the TCA was notable for its lack of cooperation in numerous areas, rendering the UK-EU agreement inferior to those previously reached between the EU and other developed countries (e.g. Canada and Switzerland). For example, no deal was reached on the mutual recognition of regulatory conformity assessments for goods, or on sanitary and phytosanitary (SPS) checks for agri-food products. And, in terms of services, the EU and UK also ended the mutual recognition of professional qualifications in several subsectors while the EU introduced new constraints on the extent to which UK service providers can access its customers. In addition, in many areas agreements were simply not brought to a final conclusion, with negotiations and assessments set to continue. Financial services were left particularly short-changed, with the EU and UK merely pledging to set out a “framework” for regulatory cooperation by March. Perhaps unsurprisingly too in light of the Johnson government’s negotiation stance, the EU failed to mirror the various financial services equivalence decisions granted by the UK, instead leaving in place just its temporary equivalence decisions for clearing and central securities depositories made in light of financial stability risks. Temporary arrangements were also put in place to allow data to continue being transferred from the EU to the UK for four months (extendable to six months) while the European Commission undertakes an assessment of the UK’s ‘adequacy’ in this area.

Euro area: New car registrations



Source: Refintiv, Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing PMIs



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

Relationship to be plagued by ongoing tension and uncertainty

Among other things, the UK-EU TCA also established a new governance structure in which the UK and EU will seek to resolve their differences going forward, including with respect to the maintaining the so-called 'level playing-field', agreed to try to prevent one side gaining competitive advantage over the other by easing regulation with respect to the environment, labour markets and state aid – something that UK PM Johnson had previously argued he could never sign up to. The new structure allows scope for the UK and EU to take punitive 'remedial' action against imports from the other market while that process is implemented – a possible source of ongoing tension and uncertainty.

Manufacturing PMIs flag impact of post-transition uncertainty

Meanwhile, there were no major surprises from the first UK economic data releases of the year. Certainly, the final manufacturing PMIs for December showed minimal revisions from the flash estimates. At 57.5, the headline index was up 0.2pt from the flash estimate and thus almost 2pts from November and the highest in more than three years. However, the detail of the survey suggested that uncertainty about the trading relationship from the start of the 2021 played a role in the increase, as foreign customers brought orders forward to end-2020, while delays at the ports and Channel Tunnel lengthened delivery times to extreme levels. Indeed, while the new export orders PMI rose to the highest level since January 2018 (55.6) and the delivery times PMI (27.9) was close to the worst on the series, the output PMI fell 0.9pt from November to 55.9, still – of course – consistent with positive growth in the sector in Q4.

Mortgage approvals up again to highest since 2007

The latest BoE bank lending data, meanwhile, remained consistent with the trends of recent months. UK mortgage approvals rose a further 6.7k in November to 105.0k, the highest level since August 2007. The RICS residential market survey suggested that new buyer enquiries remained elevated that month, with a net balance of +27% of respondents citing an increase in demand. So, together with continued strong growth in traffic at the main property websites, mortgage approvals will likely remain high over the near term and certainly up to the end of March when the current stamp duty holiday is set to come to an end. Nevertheless, some of the recent surge continues to reflect catchup after the sharp drop in activity in the first half of the year, with the twelve-month moving average of approvals still below the equivalent levels in Q1. Moreover, with joblessness set to continue to rise – the OBR forecasts the unemployment rate to peak at 7.5% in Q2 – we expect the housing market to lose steam in due course.

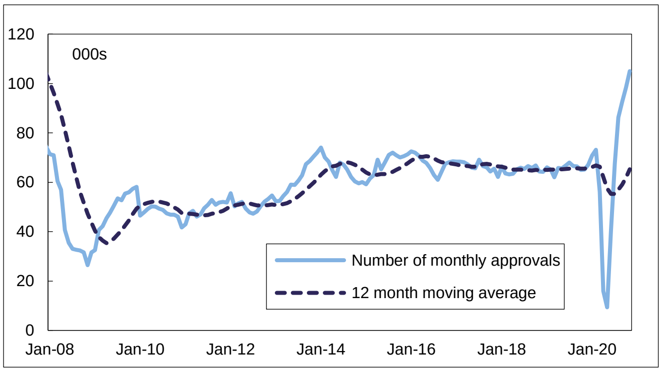
Households continue to pay back unsecured debt

With continued mortgage market strengthening, on net households borrowed an extra £5.7bn secured against their homes in November, above the average in the six months before the pandemic hit in February. But mirroring developments in the euro area, the solid recovery in UK mortgage borrowing contrasts the continued desire of households to reduce unsecured debt. Indeed, households made net repayments of unsecured debt of a further £1.5bn last month, with declines in both credit card borrowing and other loans, taking the total repayment since the start of March to £17.3bn. As a result, the stock of total consumer credit was down 6.7%Y/Y, a series low. While that partly reflects reduced demand for credit as households sit on an increased stock of savings (household deposits rose by a further £17.6bn, the most since May), it also likely reflects less generous supply, with banks having tightened their credit standards and increased the effective interest rate on new personal loans, which rose a further 31bps to 5.46% in October, while the average rate on credit card borrowing fell but remained elevated at close to 17.5%.

The day ahead in the UK

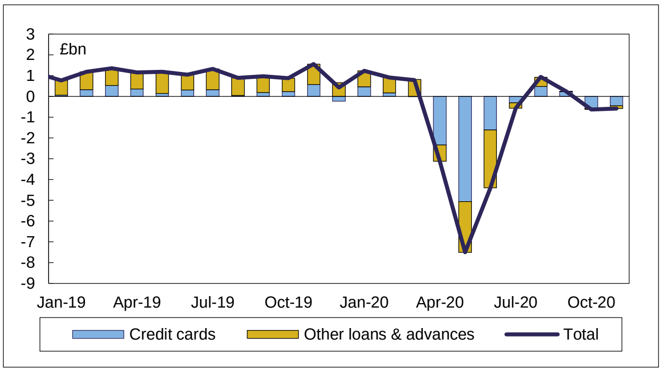
Tuesday is set to be a quiet day for UK economic data, with no key releases scheduled.

UK: Mortgage approvals



Source: Bank of England and Daiwa Capital Markets Europe Ltd.

UK: Consumer credit



Source: Bank of England 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 manufacturing PMI	Dec	**55.2**	55.5	53.8	-
Germany		Final manufacturing PMI	Dec	**58.3**	58.6	57.8	-
France		Final manufacturing PMI	Dec	**51.1**	51.1	49.6	-
		New car registrations Y/Y%	Dec	**-10.1**	-	-27.0	-
Italy		Manufacturing PMI	Dec	**52.8**	53.5	51.5	-
		New car registrations Y/Y%	Dec	**-15.0**	-	-8.3	**-8.2**
Spain		Manufacturing PMI	Dec	**51.0**	52.5	49.8	-
		New car registrations Y/Y%	Dec	**0.0**	-	-18.7	-
UK		Final manufacturing PMI	Dec	**57.5**	57.3	55.6	-
		Net consumer credit £bn (Y/Y%)	Nov	**-1.5 (-6.7)**	-1.3 (-)	-0.6 (-5.6)	**-0.7 (-5.5)**
		Net mortgage lending £bn (approvals '000s)	Nov	**5.7 (105.0)**	4.4 (83.5)	4.3 (97.5)	**-5.5 (98.3)**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		09.00	M3 money supply Y/Y%	Nov	10.6	10.5
Germany		07.00	Retail sales M/M% (Y/Y%)	Nov	-2.0 (4.0)	2.6 (8.6)
		08.55	Unemployment rate % (change '000s)	Dec	6.2 (10.0)	6.1 (-39.0)
		-	New car registrations* Y/Y%	Dec	-	-3.0
France		07.45	Preliminary CPI (EU-harmonised CPI) Y/Y%	Dec	0.2 (0.2)	0.2 (0.2)
Spain		08.00	Unemployment change '000s	Dec	-	25.3

Auctions and events

Country		GMT	Event
Germany		10.30	Auction: €6bn of 0% 2022 bonds

**Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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