

# Euro wrap-up

## Overview

- Bunds made gains as the flash euro area PMIs pointed to a weakening of activity in January while BTPs continued to sell off following yesterday's comments by Lagarde that the ECB is not targeting yields and might not use the PEPP envelope in full.
- Gilts made gains as the UK flash PMIs signalled a significant deterioration at the start of the year while December retail sales data also disappointed.
- The coming week brings first estimates of German, French and Spanish GDP in Q4 and German inflation in January, and the latest UK and German labour market data.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 12/22	-0.718	-0.012
OBL 0 10/26	-0.720	-0.018
DBR 0 02/31	-0.514	-0.016
UKT 1½ 09/22	-0.134	-0.015
UKT 0% 06/25	-0.036	-0.014
UKT 4¾ 12/30	0.309	-0.020

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

Source: Bloomberg

## Euro area

### Flash PMIs point to weakening in activity at the start of 2021

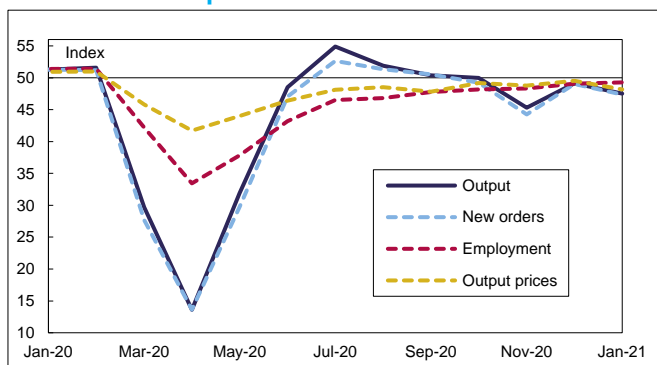
Broadly in line with expectations, the January flash PMIs suggested a weakening of economic activity in the euro area at the start of 2021 as the intensified pandemic and associated tighter restrictions took their toll. Being most directly affected by those containment measures, the deterioration was unsurprisingly registered principally in services, for which the euro area activity PMI dropped 1.4pts to 45.0, above November's recent trough but in line with the Q4 average. The PMI for new business in the sector (44.8) followed a similar path. The loss of momentum in manufacturing was relatively modest, however, with the 1.8pt drop in the output index to 54.5 leaving it consistent with steady growth albeit at a seven-month low. And the new orders PMI (54.4) suggested further growth ahead in the sector. Overall, however, the composite PMI fell 1.6pts to 47.5, the second-lowest reading since May and 0.6pt below the Q4 average, with the new orders index suggestive of ongoing contraction. And with pandemic containment measures being extended and tightened in many countries, the survey is consistent with a likely second successive contraction in euro area GDP in Q1.

### German manufacturers remain more resilient than their neighbours but services struggle

At the country level, the picture in Germany and France was similar to that presented by the headline euro area indices. While it dropped more than 1pt to a four-month low, at 57.0, Germany's manufacturing PMI remained consistent with solid expansion at the start of 2021. A pickup in growth in new export orders (for which the respective PMI rose 1.1pts to 58.4) was notable, with Markit noting that respondents cited increased demand from China and the US. In contrast, German services reportedly continued to shrink reflecting the persistence of restrictions, although the activity PMI for the sector dropped just 0.2pt to 46.8. That, however, left the German composite PMI at a seven-month low albeit in modest expansion territory at 50.8. We think, however, that the euro area's largest economy is contracting.

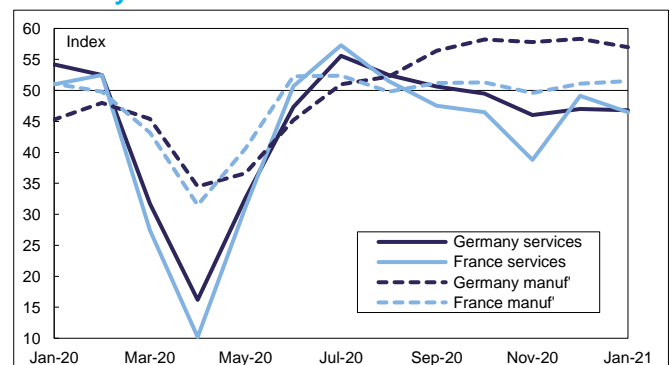
In France, the flash PMIs suggested a slightly sharper contraction in economic activity at the start of the year, likely in part related to the recent re-imposition of curfews. The headline services PMI dropped 2.5pts to 46.5, matching the second-lowest reading since May, albeit almost 2pts above the Q4 average. And contrasting with the findings of yesterday's INSEE survey, manufacturers reported a deterioration in output, with the respective PMI declining more than 2pts to 49.5. So, the French composite PMI dropped 2.5pts to 47.0, firmly in contraction territory albeit up more than 1pt from the average in Q4, when GDP likely fell by about 4.0%Q/Q. Finally, Markit reported that the pace of decline in activity in the rest of the euro area accelerated in January, with the respective composite PMI dropping 1.4pts to 44.7. Like in France, however, that was above November's trough.

### Euro area: Composite PMIs\*



\*Flash PMIs for January 2021. Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany & France: Selected PMIs\*



\*Flash PMIs for January 2021. Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

## The week ahead in the euro area

The coming week will be a busy one for top-tier economic data from the euro area, with the most noteworthy releases being the first estimates of Q4 GDP and January inflation from some of the largest member states. In particular, Friday will bring German, French and Spanish Q4 GDP figures. Following stronger-than-expected growth in Q3, the second wave of the pandemic and consequent re-imposition of lockdown measures will have resulted in a weak fourth quarter. Given the solid contribution from industrial production, however, German GDP looks to have just about avoided negative growth in Q4. In contrast, French GDP likely fell by about 4.0%Q/Q in Q4, while in Spain we forecast a contraction of 2.5%Q/Q. German inflation data for January will be published on Thursday, followed by Spanish numbers on Friday. Most significantly, German inflation is set for a big step up, following the reversal of the temporary VAT tax cut and introduction of a new carbon tax from the start of the year. The median forecast on the Bloomberg survey is for a jump of 1.2ppts in the EU-harmonised measure to 0.5%Y/Y in January. Thursday will also bring the release of the European Commission's sentiment survey for January, which will provide further clues on how the euro area economy is faring in the face of stricter containment measures. In a similar vein, Germany's ifo business climate survey for January will be published on Monday. And among other noteworthy releases, German labour market figures for the current month will be released on Friday. Following yesterday's ECB announcements, several Governing Council members will be speaking publicly over the course of the week. Among those, Christine Lagarde will give a keynote speech on Monday morning on 'Green Banking and Green Central Banking' and will also speak later in the day on 'Restoring Growth' to the 2021 Davos World Economic Forum.

## UK

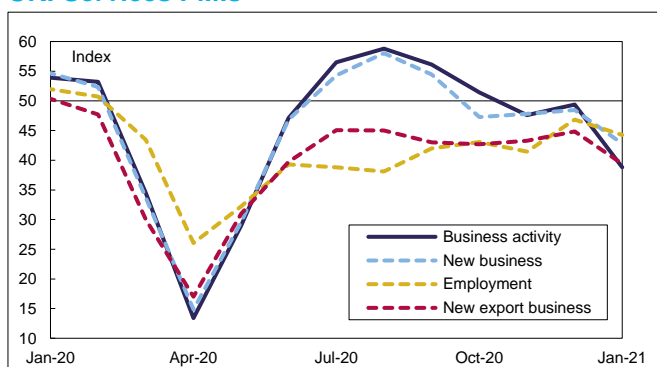
### Flash PMIs fall sharply on pandemic and Brexit impact

The UK's flash January PMIs were significantly weaker than expected, representing the worst of all countries to report so far. The composite PMI plunged almost 10pts – the most since the initial lockdown in April – to 40.6, by some margin the lowest level since May. The intensifying pandemic and associated tightening of restrictions was inevitably the main driver of the weakness for services, for which the activity PMI dropped more than 10pts to just 38.8 with notable additional deterioration in the indices for new work and employment. The survey also reported a significant loss of momentum in manufacturing, for which the headline PMI fell almost 5pts to 52.9. That figure was flattered by a sharp increase in the survey measure of supplier delivery times – representing the second-worst month of supply-side disruption in almost 30 years – related as much to Brexit as Covid-19. Indeed, based on the survey detail, manufacturing output was effectively unchanged on the month and supported only by attempts to clear past backlogs. And new orders fell sharply, particularly from abroad, as the temporary impact of stock-building ahead of the end of the Brexit transition wore off. Indeed, the detail of the UK's manufacturing PMIs was significantly weaker than that of the euro area. And looking ahead, the imposition of significant non-tariff barriers to trade with the EU from the start of the year – which has already caused significant disruptions for the agri-food sector – will persistently weigh on exports and overall economic activity. And, over the near term, the PMIs underscore the strong likelihood of a non-negligible drop in UK GDP in the first quarter of the year.

### Weak rebound in retail sales in December maintains possibility of negative GDP growth in Q4

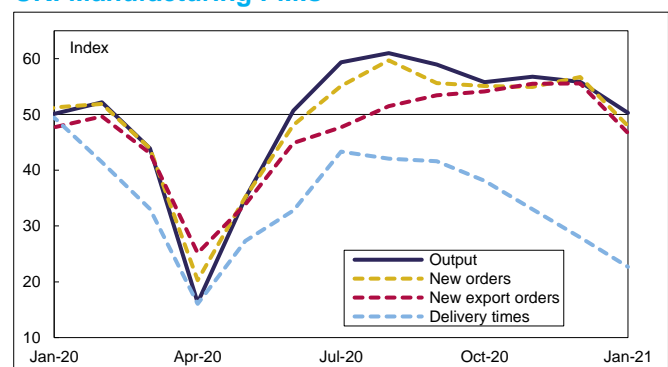
Following a sharp drop in November as non-essential stores closed, the rebound in UK retail sales in December upon their reopening for most of the month was disappointingly subdued. In particular, following a drop of 4.1%M/M in November, which was 0.3ppt steeper than previously estimated, total sales rose just 0.3%M/M in December. Reflecting the vigorous growth in prior months, sales were still up 2.9%Y/Y and were also 2.7% above February's pre-Covid level. However, that left sales down over Q4 as a whole, falling 0.4%3M/3M, and thus highlighting the continued possibility of a negative print for GDP growth too. Given the hit from the first wave, full-year sales in 2020 were down 1.9%Y/Y, the steepest such drop on the series.

#### UK: Services PMIs\*



\*Flash PMIs for January 2021. Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Manufacturing PMIs\*



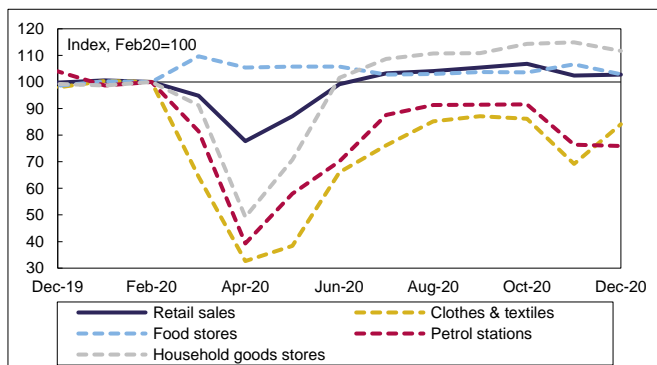
\*Flash PMIs for January 2021. Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

Within the detail, clothing retailers enjoyed rare success in December, with sales growth of 21.5%M/M following the drop of 19.6%M/M the prior month. That, however, left them down almost 16% from February's level. In contrast, food store sales fell 3.4%M/M following growth of 2.8%M/M in November but were still up 3.0% from the pre-Covid level. And sales at household goods stores fell 2.8%M/M but were still up 11.7% from February. With restrictions on movement persisting for most of the month, fuel sales remained subdued, edging down 0.1%MM to be almost one quarter below the pre-Covid level. Looking ahead, retail sales seem highly likely to have weakened again in January in response to the re-tightening of restrictions on a national basis. And despite decent progress implementing the vaccine programme in the UK, a renewed deterioration in consumer confidence will not help matters. The headline GfK indicator released overnight dropped 2pts in January to -28, still above levels in October and November but firmly below those registered from July to September. Most of the main survey sub-components, including with respect to the climate for making major purchases, weakened slightly.

## The week ahead in the UK

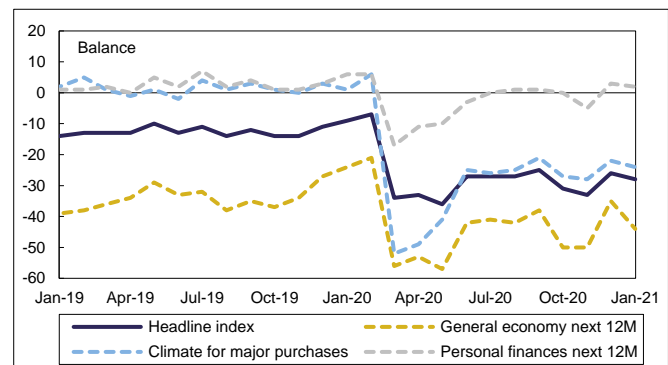
The main data release out of the UK in the coming week will be Tuesday's labour market report, which is likely to show that redundancies remained elevated after rising to a record high in the three months to October in response to ongoing pandemic containment restrictions. The ILO unemployment rate is expected to rise 0.2ppt in the three months to November to 5.1%, which would be the highest level since March 2016. And ongoing job cuts will likely be reflected in a further monthly drop in payrolls and a rise in the claimant count rate from 7.4% in November. Tuesday's CBI distributive trades survey for January will also be of some interest. With Covid containment restrictions in place and consumer confidence deteriorating, retail sales are expected to have fallen at the start of the year. Other January data to be published in the coming week include the BRC shop price index on Wednesday and Nationwide house price indices, possibly on Thursday.

### UK: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: Consumer confidence



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

## Daiwa economic forecasts

		2020	2021				2022	2020	2021	2022
		Q4	Q1	Q2	Q3	Q4	Q1			
<b>GDP growth, %, Q/Q</b>										
Euro area		-2.2	-0.7	2.2	1.7	1.2	1.0	-7.2	3.1	4.6
Germany		0.0	-1.0	2.3	1.5	1.0	1.0	-5.3	3.2	4.2
France		-4.0	-0.5	2.4	1.8	1.4	1.0	-9.0	4.2	4.9
Italy		-3.5	-0.5	1.6	1.5	1.5	1.2	-9.2	2.9	4.8
Spain		-2.5	-0.5	2.2	2.0	1.8	1.5	-11.4	3.3	6.5
UK		0.0	-1.6	1.8	2.5	2.2	1.5	-10.1	3.5	7.0
<b>Inflation forecasts, %, Y/Y</b>										
Euro area										
Headline CPI		-0.3	0.3	0.9	1.2	1.5	1.2	0.3	1.0	1.2
Core CPI		0.2	0.7	0.7	1.0	1.2	0.8	0.7	0.9	0.9
UK										
Headline CPI		0.5	0.9	1.8	1.7	1.9	1.8	0.9	1.6	1.6
Core CPI		1.3	1.6	2.1	1.9	1.7	1.5	1.4	1.8	1.3
<b>Monetary policy</b>										
<b>ECB</b>										
Refi Rate %		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
PEPP envelope* (€bn)		1850	1850	1850	1850	1850	1850	1850	1850	1850
<b>BoE</b>										
Bank Rate %		0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Bond purchases** (£bn)		895	895	895	895	895	895	895	895	895

\*Monthly target €bn, end of period. \*\*Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

































## European calendar

Today's results										
Economic data										
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised				
EMU	Preliminary manufacturing (services) PMI	Jan	<b>54.7 (45.0)</b>	54.4 (44.5)	55.2 (46.4)	-				
	Preliminary composite PMI	Jan	<b>47.5</b>	47.6	49.1	-				
Germany	Preliminary manufacturing (services) PMI	Jan	<b>57.0 (46.8)</b>	57.2 (45.0)	58.3 (47.0)	-				
	Preliminary composite PMI	Jan	<b>50.8</b>	50.0	52.0	-				
France	Preliminary manufacturing (services) PMI	Jan	<b>51.5 (46.5)</b>	50.5 (48.4)	51.1 (49.1)	-				
	Preliminary composite PMI	Jan	<b>47.0</b>	49.0	49.5	-				
UK	GfK consumer confidence	Jan	<b>-28</b>	-30	-26	-				
	Retail sales including fuel M/M% (Y/Y%)	Dec	<b>0.3 (2.9)</b>	1.3 (4.0)	-3.8 (2.4)	<b>-4.1 (2.1)</b>				
	Retail sales excluding fuel M/M% (Y/Y%)	Dec	<b>0.4 (6.4)</b>	1.0 (7.4)	-2.6 (5.6)	<b>-3.0 (5.3)</b>				
	Public sector net borrowing £bn	Dec	<b>33.4</b>	31.4	30.8	<b>25.4</b>				
	Preliminary manufacturing (services) PMI	Jan	<b>52.9 (38.8)</b>	53.6 (45.0)	57.5 (49.4)	-				
	Preliminary composite PMI	Jan	<b>40.6</b>	45.5	50.4	-				
<b>Auctions</b>										
Country	Auction									
- Nothing to report -										

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.











## Coming week's data calendar

### The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
<b>Monday 25 January 2021</b>						
Germany		09.00	IFO business climate index	Jan	91.3	92.1
		09.00	IFO current assessment (expectations)	Jan	90.5 (93.5)	91.3 (92.8)
<b>Tuesday 26 January 2021</b>						
Spain		08.00	PPI Y/Y%	Dec	-	-2.8
UK		07.00	Unemployment claimant count rate % (change '000s)	Dec	-	7.4 (64.3)
		07.00	Average earnings including bonuses (excluding bonuses) 3M/Y%	Nov	3.0 (3.2)	2.7 (2.8)
		07.00	ILO unemployment rate %	Nov	5.1	4.9
		07.00	Employment change '000s, 3M/3M	Nov	-108	-144
		11.00	CBI distributive trades survey, reported sales	Jan	-	-2
<b>Wednesday 27 January 2021</b>						
Germany		-	Retail sales* M/M% (Y/Y%)	Dec	-2.3 (4.7)	1.1 (5.0)
		07.00	GfK consumer confidence	Feb	-7.8	-7.3
France		07.45	INSEE consumer confidence	Jan	94	95
		11.00	Total jobseekers '000s	Q4	-	3673
UK		00.01	BRC shop price index Y/Y%	Jan	-	-1.8
<b>Thursday 28 January 2021</b>						
EMU		10.00	European Commission final consumer confidence	Jan	-15.5	-13.9
		10.00	European Commission economic confidence	Jan	89.4	90.4
		10.00	European Commission industrial confidence (services)	Jan	-7.1 (-18.0)	-7.2 (-17.4)
Germany		13.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	0.7 (0.5)	-0.3 (-0.7)
Italy		09.00	ISTAT economic confidence	Jan	-	87.7
		09.00	ISTAT consumer confidence (manufacturing)	Jan	100.1 (95.6)	102.4 (95.9)
Spain		08.00	Unemployment rate %	Q4	16.8	16.3
UK		-	Nationwide house price index* M/M% (Y/Y%)	Jan	0.3 (6.9)	0.8 (7.3)
<b>Friday 29 January 2021</b>						
EMU		09.00	M3 money supply Y/Y%	Dec	11.0	11.0
Germany		07.00	Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>0.0 (-4.0)</u>	8.5 (-4.0)
		08.55	Unemployment rate % (change '000s)	Jan	6.1 (8.5)	6.1 (-37.0)
France		06.30	Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>-4.0 (-7.6)</u>	18.7 (-3.9)
		06.30	Consumer spending M/M% (Y/Y%)	Dec	20.0 (2.9)	-18.9 (-17.1)
		07.45	PPI Y/Y%	Dec	-	-1.8
Italy		09.00	PPI Y/Y%	Dec	-	-2.8
Spain		08.00	Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>-2.5 (-11.4)</u>	16.4 (-9.0)
		08.00	Retail sales Y/Y%	Dec	-	-4.3
		08.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	-0.6 (-0.6)	-0.5 (-0.6)
UK		00.01	Lloyds business barometer	Jan	-	-4

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

### The coming week's key events & auctions

Country	GMT	Event / Auction
<b>Monday 25 January 2021</b>		
EMU		08.45 ECB President Lagarde scheduled to speak
		10.45 ECB's Panetta scheduled to speak
		13.45 ECB's Lane scheduled to speak
		16.15 ECB President Lagarde scheduled to speak
<b>Tuesday 26 January 2021</b>		
EMU		11.00 ECB's Panetta scheduled to speak
Germany		10.30 Auction: €4bn of 0% 2031 bonds
Italy		10.00 Auction: €1bn of 0.65% 2026 index-linked bonds
		10.00 Auction: €3bn of 0% 2022 bonds
UK		10.00 Auction: £2.5bn of 0.625% 2035 bonds
		11.30 Auction: £1bn of 0.125% 2031 index-linked bonds
		17.00 BoE Governor Bailey scheduled to speak
<b>Wednesday 27 January 2021</b>		
EMU		10.00 ECB's Villeroy scheduled to speak
		15.00 ECB's Lane scheduled to speak
<b>Thursday 28 January 2021</b>		
EMU		17.15 ECB's Schnabel scheduled to speak
<b>Friday 29 January 2021</b>		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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