

# Euro wrap-up

## Overview

- On a quiet end to the week for euro area economic news, Bunds made losses but BTPs outperformed as Mario Draghi finalised plans for the new Italian government.
- Gilts made further significant losses at the longer end of the curve as the UK's Q4 GDP data beat expectations.
- The coming week brings the flash PMIs for February along with the account of the ECB's January policy meeting.

**Chris Scicluna**

+44 20 7597 8326

### Daily bond market movements

| Bond         | Yield  | Change |
|--------------|--------|--------|
| BKO 0 12/22  | -0.716 | +0.011 |
| OBL 0 40/26  | -0.687 | +0.022 |
| DBR 0 02/31  | -0.431 | +0.030 |
| UKT 1¼ 09/22 | -0.052 | -0.001 |
| UKT 0% 06/25 | 0.075  | +0.015 |
| UKT 4¾ 12/30 | 0.512  | +0.045 |

\*Change from close as at 4:40pm GMT.

Source: Bloomberg

## UK

### GDP firmer than expected in Q4, but down almost 10% in 2020

For the second successive quarter, UK GDP surprised on the upside, rising 1.0%Q/Q in Q4 despite the worsening of the pandemic, following slightly upwardly revised growth of 16.1%Q/Q in Q3. Given the severe contraction in the first half of the year, however, GDP was still down 7.8%Y/Y in the fourth quarter and a record 9.9%Y/Y in 2020 as a whole. Among the expenditure components, private consumption dropped very slightly (-0.2%Q/Q) in Q4 in response to the tightening of coronavirus containment measures and so was still down a steep 8.4%Y/Y. Business investment managed to rise 1.3%Q/Q but was still down 10.3%Y/Y. Government consumption leapt 6.4%Q/Q due not least to increased spending on healthcare and education. But growth in goods imports (14.1%Q/Q) ahead of the end of the Brexit transition period significantly outpaced that in goods exports (7.5%Q/Q), which nevertheless returned back to the pre-Covid level. And services exports fell more sharply (-9.2%Q/Q) than services imports (-7.0%Q/Q). As a result, while total exports rose just 0.1%Q/Q, total imports rose 8.9%Q/Q, so net trade subtracted 2.5ppts from growth having subtracted 4.2ppts the prior quarter.

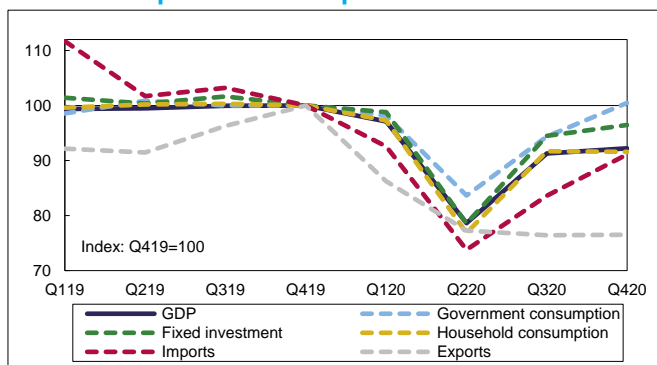
### Drivers include test-and-trace, school re-openings and end to the Brexit transition

Growth in Q4 was relatively broad-based across industry, construction and services, although there were significant differences within the main sectors. While a tightening of restrictions hit hospitality (down by almost one third), retail, arts and certain other face-to-face activities, services output rose 0.6%Q/Q thanks to strong growth in healthcare (up 12.4%Q/Q due not least to the rollout of the government's Covid-19 test-and-trace scheme) and education (up 5.6%Q/Q as schools largely reopened), with warehousing, transportation and postal services growing on the back of increased online shopping. Overall, however, the level of services output was still 7.3% below the pre-pandemic level. Buoyed by the recovery in transport equipment (up 11.5%Q/Q), increased growth in chemical production (again benefiting from test-and-trace), and Brexit-related stockpiling, manufacturing output rose 3.3%Q/Q to narrow the shortfall with respect to before the pandemic to 3.5%. And construction output rose 4.6%Q/Q to be just 2.8% below the pre-Covid level.

### After a dip in Q1, expect sustained recovery over coming quarters

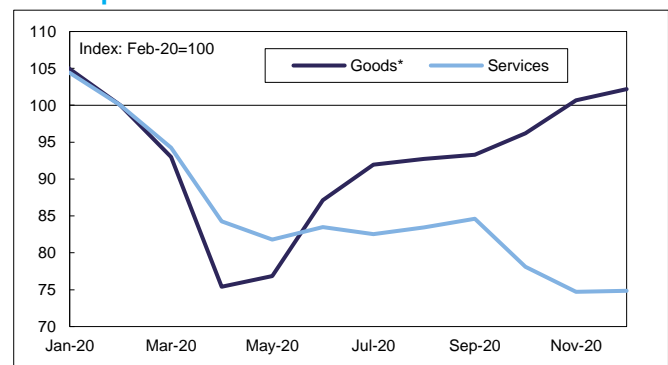
Over the course of the fourth quarter, economic activity fluctuated in response to the evolution of the pandemic and associated containment measures. So, while GDP contracted 2.3%M/M in November in response to the tightening of restrictions, it rose 1.2%M/M in December as some of the measures were relaxed. Unfortunately, GDP likely dropped in January at a faster pace than in November. But with new cases of Covid-19 now falling significantly, February should see a pick-up in activity and beyond. Indeed, in the week commencing 22 February, the government will announce its strategy for

### UK: GDP expenditure components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: Export volumes



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

reopening the economy, which will likely see the reopening of schools from 8 March and the reopening of non-essential stores by the second quarter too. The roll-out of the vaccination programme will ensure that healthcare services continue to make a substantive contribution to growth. And with the national statistical treatment of healthcare and education having contributed to the marked underperformance of UK GDP relative to other major economies during the lockdown in the first half of last year, growth in those sectors should contribute to an outperformance of the UK during the recovery phase. However, a relatively slow pace of normalization in certain face-to-face services, which account for a larger share of GDP than in many of the UK's peers, as well as the big new hit to exports of both goods and services in response to the end of the Brexit transition, will act as a restraint. We currently forecast a contraction of 2.8%Q/Q in Q1 to be followed by a relatively upswing in subsequent quarters, resulting in full-year growth of 4.5%Y/Y in 2021. Assuming that the vaccination programme proves successful in the face of the constant mutations of Covid-19, we would then expect even stronger growth – perhaps around 7%Y/Y – in 2022.

## The week ahead in the UK

The UK data highlights of the coming week will be the latest inflation figures on Wednesday and official retail sales figures on Friday. The intensification of the pandemic and tightening of containment measures at the start of the year might be expected to add some downwards pressure to inflation. However, a significant share of prices in the basket will need to be imputed. A reweighting of the components in the inflation basket might also have an impact, as could recent sterling strengthening. But the extra costs faced by businesses due to Brexit are likely to provide an upwards impulse, particularly to prices of imported items and goods containing a large share of imported components. On balance, we expect inflation to continue to move broadly sideways in Q1 and the consensus for January is for CPI to fall 0.1ppt to 0.5%Y/Y.

Friday's retail sales data will reveal how the sector is fairing in England's third lockdown. The past week's retail survey data has brought somewhat contrasting impressions of the extent of the hit to consumer spending at the start of the year, with spending on the high street and on fuel reportedly lower last month as people stayed home. In contrast, spending on food and durable goods for the home (including IT equipment to support home-schooling) via online retailing was reported to have risen last month. Excluding fuel, retail sales are forecast to fall 1% on the month in January, albeit leaving them 4.7% higher compared to their pre-pandemic level. Friday's consumer confidence survey from the GfK will offer some insight into spending intentions going forward. And the preliminary manufacturing and services sector PMIs for February, also to be published that day, will, as in the euro area, likely be little changed from January. In other news, BoE Deputy Governor Ramsden will be speaking on Wednesday about the BoE's QE policy. The comments might be of interest in light of the MPC's decision this month to review its current tightening strategy, whereby the BoE would not reduce its asset holdings until Bank Rate had risen to 1.5%.

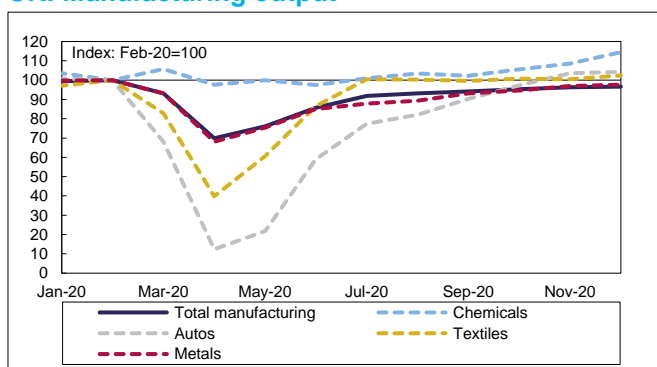
## Euro area

### The week ahead in the euro area

It was a quiet end to the week for economic data from the euro area with no top-tier figures released. The immediate focus is now Italian politics, for which the near-term outlook looks positive. After the populist Five Star Movement membership voted to join the right-wing League and Forza Italia, centre-left Democrats, and centrist Italia Viva in backing his government, Mario Draghi is set imminently to present to President Mattarella his nominations for members of his cabinet. Assuming the names are accepted, the new Prime Minister and cabinet should be sworn into office by Monday to allow for votes of confidence in both houses of parliament in the course of the coming week.

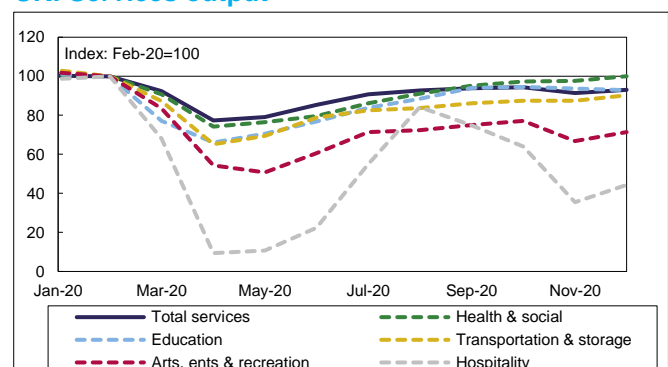
The most notable new data of the week will come on Friday in the shape of February's flash PMIs. These are likely to show very little change from January's indices, which pointed to expansion in manufacturing (with the respective euro area PMI at 54.8) but contraction in services (the respective euro area PMI at 45.4) and overall GDP (euro area composite PMI at 47.8).

### UK: Manufacturing output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: Services output

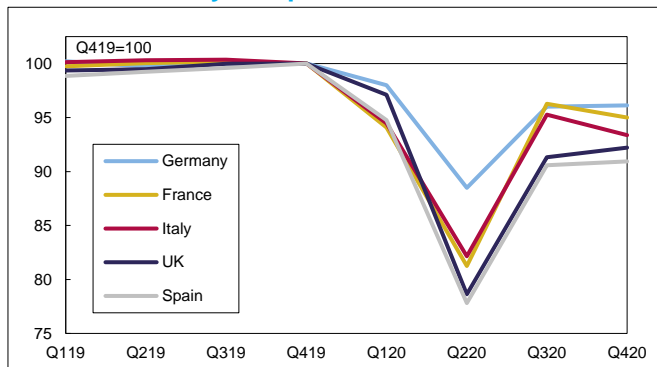


Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Other February survey indicators due include the German ZEW investor sentiment survey on Tuesday, and the European Commission's preliminary consumer confidence survey on Thursday. Also of note will be the publication of the account of the ECB's [January policy meeting](#), when Lagarde's insistence that the ECB might well not buy the full PEPP envelope and was also not targeting yields prompted a sell-off of bonds.

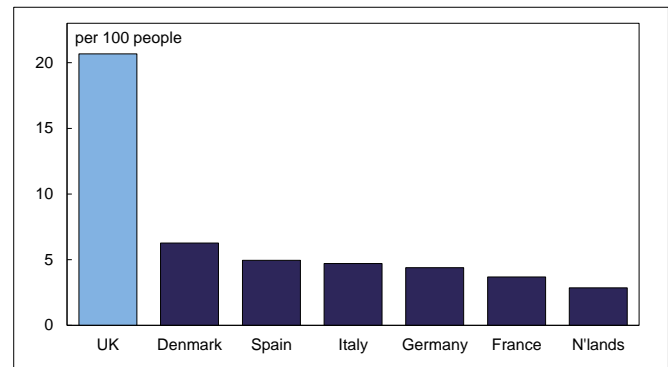
The week will kick off with the release on Monday of euro area industrial production data for December. Among the largest member states, production (excluding construction) rose in [Germany and Spain](#) and slid only slightly in Italy. Nevertheless, due to a drop of roughly one quarter in Ireland (where production had jumped more than 50% in November), and a larger-than-expected drop in [French](#) manufacturing output, we expect the euro area figure to report a drop of roughly ½%M/M in December to be down about 1.3% from February's pre-pandemic level. But that will still likely leave production up about 4%Q/Q in Q4, confirming that the manufacturing sector provided helpful support to offset some of the impact of renewed weakness in services. Meanwhile, the updated estimate of euro area GDP (due Tuesday) will likely reaffirm the smaller-than-expected drop of about 0.7%Q/Q to be down 5.1%Y/Y.

### UK: GDP country comparisons


















Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Coronavirus vaccinations











Source: Politico 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                 |    | -0.7  | -0.8  | 1.4   | 1.4   | 1.3   | 1.1   | -6.8  | 3.4   | 4.4   |
| Germany                   |    | 0.1   | -1.0  | 1.2   | 1.2   | 1.2   | 1.0   | -5.3  | 2.3   | 4.0   |
| France                    |    | -1.3  | -0.5  | 1.2   | 1.4   | 1.2   | 1.2   | -8.3  | 5.1   | 4.5   |
| Italy                     |    | -2.0  | -0.5  | 1.5   | 1.5   | 1.4   | 1.2   | -8.9  | 4.0   | 4.7   |
| Spain                     |    | 0.4   | -1.0  | 1.5   | 1.4   | 1.2   | 1.2   | -11.0 | 3.9   | 5.0   |
| UK                        |    | 1.0   | -2.8  | 3.5   | 3.0   | 2.2   | 1.5   | -9.9  | 4.5   | 6.9   |
| <b>Euro area</b>          |   |       |       |       |       |       |       |       |       |       |
| Headline CPI              |    | -0.3  | 1.0   | 1.6   | 1.9   | 2.2   | 1.1   | 0.3   | 1.7   | 1.2   |
| Core CPI                  |    | 0.2   | 1.3   | 1.3   | 1.5   | 1.7   | 0.8   | 0.7   | 1.5   | 0.9   |
| <b>UK</b>                 |   |       |       |       |       |       |       |       |       |       |
| Headline CPI              |    | 0.5   | 0.9   | 1.9   | 1.9   | 2.1   | 2.1   | 0.9   | 1.7   | 1.7   |
| Core CPI                  |    | 1.3   | 1.6   | 2.1   | 2.1   | 1.9   | 1.7   | 1.4   | 1.9   | 1.5   |
| <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/<br>Daiwa forecast | Previous    | Revised           |  |
| Spain                 |  Final CPI (EU-harmonised CPI) Y/Y%   | Jan    | <b>0.5 (0.4)</b>   | 0.6 (0.6)                           | -0.5 (-0.6) | -                 |  |
| UK                    |  Preliminary GDP Q/Q% (Y/Y%)          | Dec    | <b>1.0 (-7.8)</b>  | 0.5 (-8.1)                          | 16.0 (-8.6) | -                 |  |
|                       |  Monthly GDP M/M%                     | Dec    | <b>1.2</b>         | 1.0                                 | -2.6        | <b>-2.3</b>       |  |
|                       |  Industrial production M/M% (Y/Y%)    | Dec    | <b>0.2 (-3.3)</b>  | 0.5 (-3.7)                          | -0.1 (-4.7) | <b>0.3 (-3.9)</b> |  |
|                       |  Manufacturing production M/M% (Y/Y%) | Dec    | <b>0.3 (-2.5)</b>  | 0.7 (-3.2)                          | 0.7 (-3.8)  | <b>1.1 (-2.6)</b> |  |
|                       |  Construction output M/M% (Y/Y%)      | Dec    | <b>-2.9 (-3.9)</b> | 0.5 (-0.2)                          | 1.9 (-1.4)  | <b>1.7 (-2.0)</b> |  |
|                       |  Index of services M/M% (3M/3M%)      | Dec    | <b>1.7 (0.6)</b>   | 1.0 (0.0)                           | -3.4 (3.7)  | <b>-3.1 (4.1)</b> |  |
|                       |  Goods trade balance, £bn             | Dec    | <b>-14.3</b>       | -15.0                               | -16.0       | <b>-14.7</b>      |  |
| Auctions              |  |        |                    |                                     |             |                   |  |
| 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/<br><i>Daiwa forecast</i> | Previous     |
|-----------------------------------|---|---|--------|--|--------------|
| <b>Monday 15 February 2021</b>    |   |   |        |  |              |
| EMU                               |    | 10.00 Industrial production M/M% (Y/Y%)                     | Dec    | -0.5 (-0.2)                                | 2.5 (-0.6)   |
|                                   |    | 10.00 Trade balance €bn                                     | Dec    | -  | 25.1         |
| Spain                             |    | 08.00 House transactions Y/Y%                               | Dec    | -  | 1.9          |
| UK                                |    | 00.01 Rightmove house price index M/M% (Y/Y%)               | Feb    | -  | -0.9 (3.3)   |
| <b>Tuesday 16 February 2021</b>   |   |   |        |  |              |
| EMU                               |    | 10.00 Preliminary GDP Q/Q% (Y/Y%)                           | Q4     | -0.7 (-5.1)                                | 12.5 (-4.3)  |
|                                   |    | 10.00 Preliminary employment Q/Q% (Y/Y%)                    | Q4     | -  | 1.0 (-2.3)   |
| Germany                           |    | 10.00 ZEW current assessment balance (expectations)         | Feb    | -66.3 (60.0)                               | -66.4 (61.8) |
| France                            |    | 06.30 ILO unemployment rate (mainland unemployment rate) %  | Q4     | 9.3 (9.0)                                  | 9.0 (8.8)    |
|                                   |    | - Bank of France retail sales Y/Y%                          | Jan    | -  | 15.4         |
| Italy                             |    | 09.00 Total trade balance €bn                               | Dec    | -  | 6.7          |
| <b>Wednesday 17 February 2021</b> |   |   |        |  |              |
| EMU                               |    | 07.00 EU27 new car registrations Y/Y%                       | Jan    | -  | -3.3         |
|                                   |    | 10.00 Construction output M/M% (Y/Y%)                       | Dec    | -  | 1.4 (-1.3)   |
| UK                                |    | 07.00 CPI (core CPI) Y/Y%                                   | Jan    | 0.5 (1.3)                                  | 0.6 (1.4)    |
|                                   |   | 07.00 PPI input prices (output prices) Y/Y%                 | Jan    | -  | 0.2 (-0.4)   |
|                                   |  | 09.30 Land Registry house price index Y/Y%                  | Dec    | -  | 7.6          |
| <b>Thursday 18 February 2021</b>  |   |   |        |  |              |
| EMU                               |  | 15.00 European Commission's preliminary consumer confidence | Feb    | -15.0                                      | -15.5        |
| <b>Friday 19 February 2021</b>    |   |   |        |  |              |
| EMU                               |  | 09.00 Preliminary manufacturing (services) PMI              | Feb    | 54.4 (45.9)                                | 54.8 (45.4)  |
|                                   |  | 09.00 Preliminary composite PMI                             | Feb    | 48.0                                       | 47.8         |
| Germany                           |  | 07.00 PPI Y/Y%  | Jan    | -  | 0.2          |
|                                   |  | 08.30 Preliminary manufacturing (services) PMI              | Feb    | 57.0 (46.5)                                | 57.1 (46.7)  |
|                                   |  | 08.30 Preliminary composite PMI                             | Feb    | 50.5                                       | 50.8         |
| France                            |  | 07.45 Final CPI (EU-harmonised CPI) Y/Y%                    | Jan    | 0.6 (0.8)                                  | 0.0 (0.0)    |
|                                   |  | 08.15 Preliminary manufacturing (services) PMI              | Feb    | 51.3 (47.0)                                | 51.6 (47.3)  |
|                                   |  | 08.15 Preliminary composite PMI                             | Feb    | 48.4                                       | 47.7         |
| Italy                             |  | 09.00 Final CPI (EU-harmonised CPI) Y/Y%                    | Jan    | 0.2 (0.5)                                  | -0.2 (-0.3)  |
| Spain                             |  | 09.00 Trade balance €bn                                     | Dec    | -  | -0.6         |
| UK                                |  | 00.01 GfK consumer confidence                               | Feb    | -25  | -28          |
|                                   |  | 07.00 Retail sales including fuel M/M% (Y/Y%)               | Jan    | -1.0 (1.4)                                 | 0.3 (2.9)    |
|                                   |  | 07.00 Retail sales excluding fuel M/M% (Y/Y%)               | Jan    | -0.9 (4.0)                                 | 0.4 (6.4)    |
|                                   |  | 07.00 Public sector net borrowing £bn                       | Jan    | 19.8                                       | 33.4         |
|                                   |  | 09.30 Preliminary manufacturing (services) PMI              | Feb    | 53.0 (42.0)                                | 54.1 (39.5)  |
|                                   |  | 09.30 Preliminary composite PMI                             | Feb    | 43.0                                       | 41.2         |
|                                   |  | 11.00 CBI industrial trends survey, total orders            | Feb    | -32  | -38          |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## The coming week's key events & auctions

| Country                           | GMT   | Event / Auction  |
|-----------------------------------|---|--|
| <b>Monday 15 February 2021</b>    |   |  |
| EMU                               |  -       | EU finance ministers 2-day meeting   |
| <b>Tuesday 16 February 2021</b>   |   |  |
| UK                                |  10.00   | Auction: £3.25bn of 0.125% 2024 bonds  |
|                                   |  11.30   | Auction: £1.25bn of 1.75% 2057 bonds   |
| <b>Wednesday 17 February 2021</b> |   |  |
| Germany                           |  10.30   | Auction: €1.5bn of 1.25% 2048 bonds  |
| UK                                |  10.00   | Auction: £2.5bn of 0.625% 2035 bonds   |
|                                   |  16.00   | BoE Deputy Governor Ramsden scheduled to speak on quantitative easing                |
| <b>Thursday 18 February 2021</b>  |   |  |
| EMU                               |  12.30   | ECB publishes the minutes of the 20-21 <sup>st</sup> January monetary policy meeting |
|                                   |  16.15   | ECB's Schnabel scheduled to speak  |
| France                            |  09.50   | Auction: 0% 2024 bonds   |
|                                   |  09.50   | Auction: 0% 2026 bonds   |
|                                   |  09.50   | Auction: 0.5% 2029 bonds   |
|                                   |  09.50   | Auction: 0.1% 2026 index-linked bonds  |
|                                   |  09.50   | Auction: 0.1% 2036 index-linked bonds  |
|                                   |  09.50   | Auction: 0.1% 2047 index-linked bonds  |
| Spain                             |  09.30  | Auction: fixed rate bonds  |
| UK                                |  11.00 | BoE's Saunders scheduled to speak  |
| <b>Friday 19 February 2021</b>    |   |  |
| - Nothing scheduled -             |   |  |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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