

Euro wrap-up

Overview

- Bunds made gains as euro area trade data disappointed and inflation figures met expectations, but a French survey pointed to firmer growth.
- Gilts made losses at the short end of the curve as a survey pointed to buoyant output and rising price pressures in the UK manufacturing sector.
- The coming week brings the latest German Ifo business sentiment survey, euro area and UK consumer confidence surveys, euro area labour cost figures and revised UK GDP data.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.786	-0.005
OBL 0 10/21	-0.457	-0.017
DBR 0 08/26	0.339	-0.026
UKT 1¼ 07/18	0.163	+0.018
UKT 3¾ 09/21	0.658	+0.030
UKT 1½ 07/26	1.484	-0.005

*Change from close as at 4.00pm GMT.
Source: Bloomberg

Euro area

Inflation on course to reach 1%Y/Y this month

The final estimates of euro area inflation in November brought minimal changes from the flash figures and confirmed the seventh consecutive monthly rise in headline CPI, up 0.1ppt to 0.6%Y/Y, the highest since April 2014. The detail also confirmed that the increase in the latest month was entirely due to higher food inflation. In contrast, energy prices fell at a slightly faster pace than in October while inflation of services (1.1%Y/Y) and non-energy industrial goods (0.3%Y/Y) was unchanged on the month. As such, core inflation was also unchanged for the fourth consecutive month, at a still-subdued 0.8%Y/Y. Over the near term, the rate of increase in headline inflation is set to pick up. Indeed, given the accelerated depreciation of the euro – which yesterday reached its weakest level against the dollar since 2003 and a nine-month low in broad trade-weighted terms – and higher oil prices in the wake of the OPEC agreement, we now expect CPI to rise to 1.0%Y/Y in December (for which the flash figure is due on 4 January), 1.3%Y/Y in January and to reach a near-term peak perhaps a touch above 1½%Y/Y in April. However, given the persistent lack of underlying price pressures amid significant wage restraint – as illustrated by French and Spanish data released today – in the absence of a further sharp move lower in the euro, core inflation might yet remain below 1%Y/Y until April and no higher than 1¼%Y/Y over the remainder of 2017.

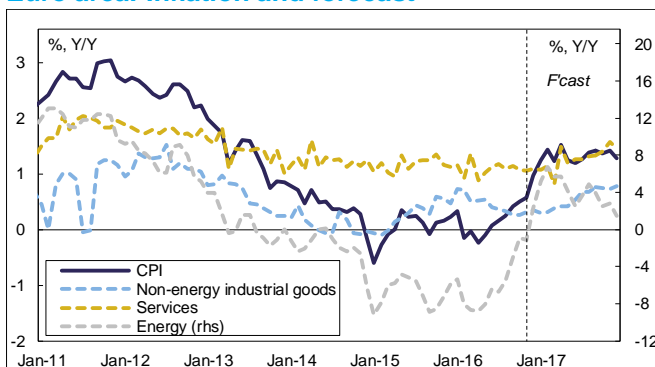
A disappointing start to Q4 for trade

Having subtracted from economic growth in the third quarter, net trade appears to have acted as a drag at the start of Q4 too. In particular, the euro area goods trade surplus dropped in October by almost €5bn, significantly more than expected and the most in nineteen months, to an eight-month low just short of €20bn – still, of course, highly elevated by historical standards. The value of exports fell for the second successive month in seasonally adjusted terms to a touch below the level a year earlier, albeit still above the average in 2016 to-date. In contrast, imports rose almost 3%M/M to the highest level since mid-2015. To some extent, however, the deterioration reflects shifts in relative prices, which are likely to exaggerate significantly the weakness in volume terms – e.g. prices of imported energy rose more than 5%M/M in October while export prices appear to have remained little changed. Moreover, as suggested by the increase of more than 6%M/M in German factory orders from outside the euro area in October, we strongly expect exports to have subsequently rebounded. Thus, despite today's disappointing trade report, we also do not expect net trade to subtract from GDP growth in Q4.

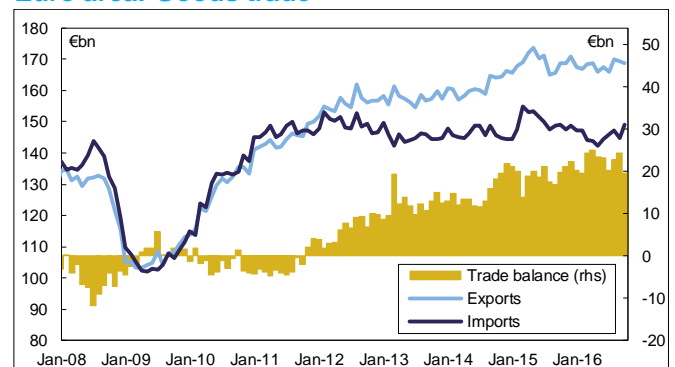
French economy ending the year on a high

Perhaps most pleasing about the December flash PMIs released yesterday were the marked improvements in France, where the composite index rose almost 1½pts to an eighteen-month high thanks to a rebound in the services sector and a jump in the manufacturing index to its highest in more than five years. And the INSEE business climate survey released today

Euro area: Inflation and forecast



Euro area: Goods trade



reinforced the impression that the French economy has taken a notable turn for the better at the end of the year. In particular, following more than a year moving broadly sideways, the headline business climate indicator jumped 3pts to 105, well above the long-run average and the highest in more than five years. Moreover, reported improvements were widespread, with the respective indices for services and manufacturing likewise both signalling firm expansion at their highest levels since mid-2011, and the retail sector indicator particularly strong at its highest since 2008, with conditions worsening only in the construction sector, where the relevant indicator remains below the long-run average. Overall, taken together with other survey evidence, we now forecast a pickup in French GDP growth in Q4 to 0.4%Q/Q, twice the rate of Q3.

The week ahead in the euro area and US

The coming week brings a handful of notable new economic data releases from the euro area. Monday brings the December Germany Ifo business sentiment survey, for which the headline business climate index was at its highest since Spring 2014 in October and November. Also due Monday are euro area construction output figures for October and euro area labour costs numbers for Q3, which are likely to illustrate why underlying inflationary pressures remain so subdued. In addition, euro area balance of payments numbers for October are due on Tuesday, while the Commission's flash consumer confidence indicator for December is due Wednesday. Meanwhile, Italian retail sales and industrial orders numbers for October are due on Thursday, followed on Friday by Germany's latest GfK consumer confidence survey results and final French GDP numbers for Q3.

In the US, the second half of the coming week will be data-heavy with a number of top-tier economic releases on Thursday, including revised Q3 GDP figures, which are expected to show growth little changed from the 3.2%Q/Q annualised rate in the second estimate. Thursday also brings the latest monthly personal income and spending figures, including the closely-watched deflators, as well as durable goods orders data and the Chicago Fed national activity index, all for November. Meanwhile, housing market indicators due in the coming week include existing home sales figures (Wednesday), the FHFA index (Thursday) and new home sales numbers (Friday). The revised University of Michigan's consumer sentiment survey is also due Friday. In the UST market, a 5Y TIPS auction will be conducted on Thursday.

UK

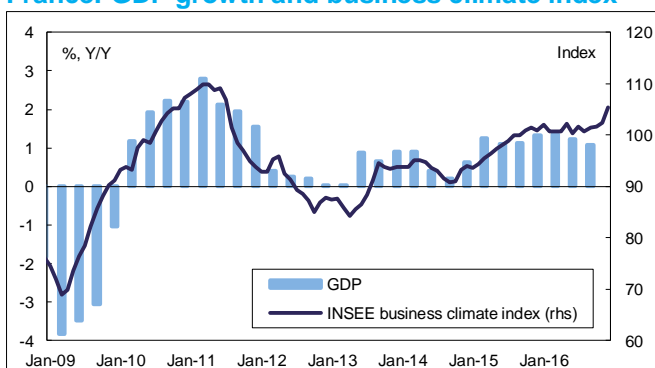
CBI survey signals firm industrial output but rising price pressures

In many ways, conditions in the UK's manufacturing sector appear the most favourable for several quarters, with weak sterling giving a boost to external competitiveness while domestic demand remains relatively firm. Certainly, the tone of the CBI's December Industrial Trends survey was largely upbeat, with the net balance of firms reporting a rise in the volume of output up to the highest since July 2014. And, with overall order books also reportedly in the best shape in twenty months, positive output growth is expected to be sustained over the coming quarter too. Despite sterling weakness, however, the net balance of firms reporting rising *export* orders fell for the second successive month to the lowest since July, suggesting that more than currency depreciation will be required to sustain a renaissance in the sector. Moreover, the impact of higher import costs resulting from the drop in the pound was clearly visible, with the net balance of firms in December expecting to increase prices over the coming quarter rising to the highest in more than five years. With producer price data for November published earlier this week having already reported a rise in factory gate inflation to 2.3%Y/Y, the highest since April 2012, and prices of imported materials rising 14.6%Y/Y, the most since September 2011, pipeline price pressures are clearly building. And so, as far as the New Year outlook for consumer prices is concerned, the only way is up.

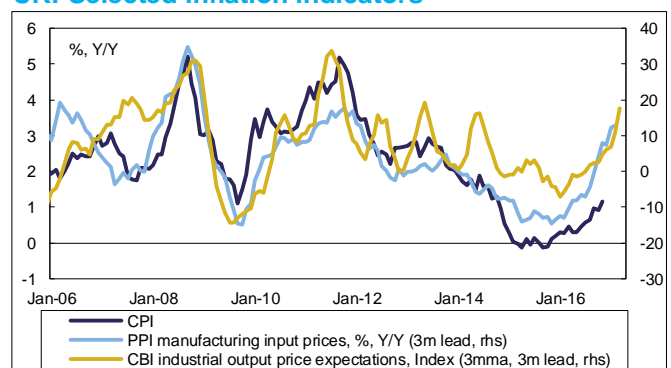
The week ahead in the UK

Before breaking for the Christmas holidays, the coming week brings a handful of new releases including the final estimate of Q3 GDP figures on Friday. After large revisions to Q3's trade data, the expenditure breakdown is set to show that net exports subtracted less from economic growth than previously thought. However, due to offsetting changes elsewhere in the detail of the data, we still expect GDP growth to be unrevised at 0.5%Q/Q in Q3, down from 0.7%Q/Q in the previous quarter. In addition, Q3 balance of payments figures will also be released for the first time on Friday. Ahead of those data, Tuesday will bring the December CBI Distributive Trades survey, with November's public finances figures following on Wednesday and the December GfK consumer confidence survey on Thursday.








France: GDP growth and business climate index



UK: Selected inflation indicators

























European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Trade balance €bn	Oct	19.7	24.5	24.9	24.4
	 Final CPI (core CPI) Y/Y%	Nov	0.6 (0.8)	0.6 (0.8)	0.5 (0.8)	-
France	 Business confidence indicator (production outlook)	Dec	105 (6)	102 (4)	102 (3)	-
	 Wages Q/Q%	Q3	0.2	0.2	0.3	-
Italy	 Trade balance €bn	Oct	4.3	-	3.7	-
Spain	 Labour costs Y/Y%	Q3	-0.5	-	-0.1	-
UK	 CBI Industrial Trends survey, total orders (selling prices)	Dec	0 (26)	-5 (-)	-3 (19)	-
Country	Auction	- Nothing to report -				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

Key data releases						
Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Monday 19 December 2016						
EMU	 10:00	Labour costs Y/Y%	Q3	-	1.0	
	 10:00	Construction output M/M% (Y/Y%)	Oct	-	-0.9 (1.8)	
	 14:45	ECB public sector asset purchases €bn	Weekly	10.0	16.3	
Germany	 09:00	Ifo business climate index	Dec	110.6	110.4	
	 09:00	Ifo current assessment balance (expectations)	Dec	115.9 (105.6)	115.6 (105.5)	
Tuesday 20 December 2016						
EMU	 09:00	Current account balance €bn	Oct	-	25.3	
Italy	 09:30	Current account balance €bn	Oct	-	2.8	
UK	 11:00	CBI Distributive Trades survey, retail sales	Dec	20	26	
Wednesday 21 December 2016						
EMU	 15:00	Preliminary consumer confidence	Dec	-6.0	-6.1	
UK	 09:30	Public sector net borrowing excluding interventions £bn	Nov	12.1	4.8	
Thursday 22 December 2016						
Italy	 09:00	Industrial sales M/M% (Y/Y%)	Oct	-	-4.6 (-0.3)	
	 09:00	Industrial orders M/M% (Y/Y%)	Oct	0.5 (2.9)	-6.8 (2.6)	
	 09:00	Retail sales M/M% (Y/Y%)	Oct	0.3 (-1.1)	-0.6 (-1.4)	
Spain	 09:00	Trade balance €bn	Oct	-	-2.2	
UK	 00:01	GfK consumer confidence survey	Dec	-8	-8	
Friday 23 December 2016						
Germany	 07:00	GfK consumer confidence survey	Jan	9.8	9.8	
France	 07:45	GDP – third release Q/Q% (Y/Y%)	Q3	0.2 (1.1)	-0.1 (1.2)	
	 07:45	Consumer spending M/M% (Y/Y%)	Nov	-0.1 (2.4)	0.9 (1.5)	
UK	 00:01	Lloyds business barometer	Dec	-	32	
	 09:30	GDP – third release Q/Q% (Y/Y%)	Q3	0.5 (2.3)	0.7 (2.1)	
	 09:30	Index of services M/M% (3M/3M%)	Oct	0.2 (0.8)	0.2 (0.8)	
	 09:30	Current account balance £bn	Q3	-28.0	-28.7	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

Key events & auctions			
Country	GMT	Event / Auction	
Monday 19-21 December 2016			
- Nothing scheduled -			
Thursday 22 December 2016			
EMU		09:00	ECB publishes Economic Bulletin
Friday 23 December 2016			
- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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