Euro wrap-up

Overview

- Bunds made losses as the euro area flash PMIs signalled solid economic expansion at the start of 2017.
- Gilts also made losses as the UK Supreme Court confirmed that national parliament approval is required to launch the process for leaving the EU, but also that the devolved legislatures do not need to be consulted.
- Wednesday brings further national business survey results from Germany, France and the UK.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.668	+0.018
OBL 0 10/21	-0.419	+0.032
DBR 0¼ 12/27	0.409	+0.047
UKT 1¼ 07/18	0.169	+0.015
UKT 3¾ 09/21	0.591	+0.014
UKT 1½ 07/26	1.395	+0.028

*Change from close as at 4.30pm GMT.
Source: Bloomberg

Euro area

Euro area PMIs consistent with robust expansion

After yesterday's flash Commission indicator suggested that consumers in the euro area are more confident than at any time since April 2015, today's flash PMIs signalled that businesses remain upbeat too. Admittedly, the headline euro area composite PMI edged marginally lower in January, as the services and manufacturing output PMIs both fell slightly. But at a still-healthy 54.3, the composite PMI was still the second highest since the end of 2015 and above the Q416 average. Meanwhile, the euro area manufacturing PMI rose to its best level since April 2011 on the back of sustained growth of new orders, including from abroad, as well as improved expectations for output over the coming twelve months. And, with manufacturers and services firms reportedly upping recruitment at the start of the year, the composite PMIs suggested the firmest employment growth in almost nine years. But while the survey also reported a further step-up in pipeline price pressures at the start of the year, with the input price PMI rising 1.7pts to its highest since May 2011, the output price index slipped back slightly, suggesting that margins are being squeezed and underlying inflationary pressures remained relatively subdued in January.

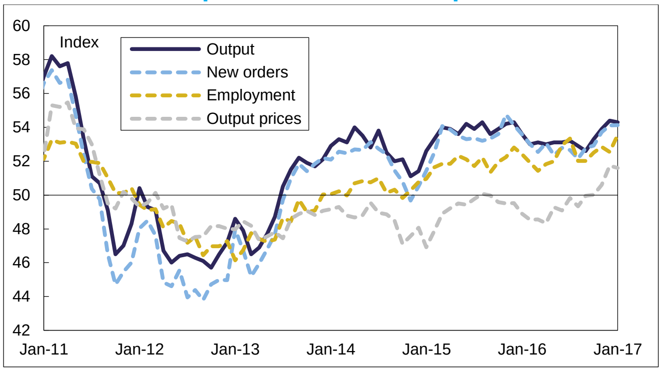
German and French PMIs close to multi-year highs

The slight moderation in the euro area composite PMI was caused principally by a slight moderation in Germany, where the flash PMIs suggested that services activity slowed in January. In contrast, however, the German manufacturing PMI rose 0.9pt to a three-year high of 56.5 as the output and new orders components pointed to solid growth momentum. And overall, Germany's composite PMI (54.7) was still well above the euro area average and only slightly lower than the ten-quarter high reached on average in Q416. There was better news from the French flash services PMIs, with the headline index rising 1pt on the month to 53.9, its strongest in nineteen months. So, despite a modest drop in the manufacturing output PMI from the more than 5½-year high reached in December, France's headline composite PMI rose to 53.8, its best since July 2011. Therefore, the firmer GDP growth likely seen in both Germany and France in Q416 looks to have been maintained at the start 2017. And while we will have to wait until the final PMIs are published at the start of February, growth elsewhere in the euro area likely remained solid too.

The day ahead in the euro area and US

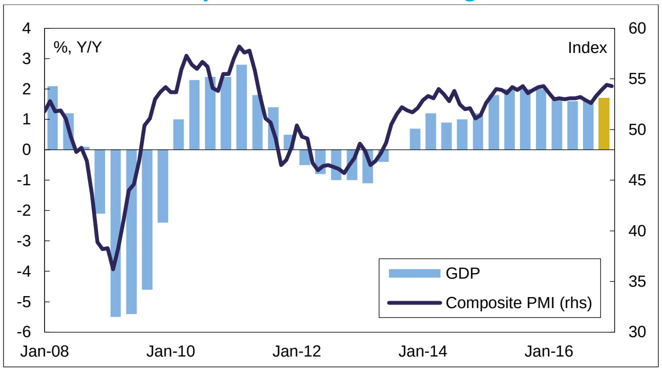
The flow of business sentiment surveys from the largest two member states continues tomorrow, with the German Ifo index to be accompanied by the equivalent French INSEE indicator. Wednesday will also bring Italian industrial sales and orders figures for November. And, on the supply side, Germany will sell 30Y bonds.

Euro area: Composite PMI and components



Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Composite PMI and GDP growth*



**Q416 GDP figure is Daiwa forecast.*
Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

In the US, with just the FHFA house price index due for release, attention will once again be on the early executive actions of President Trump. Supply-wise, the Treasury will sell 5Y notes and 2Y floating-rate notes.

UK

Supreme Court judgement unlikely to delay Article 50

As expected, the UK's Supreme Court today ruled that an Act of Parliament will be required to enable the Government to launch the process for exiting the EU by invoking Article 50. With the ruling Conservative Party currently having a working majority of just sixteen MPs in the House of Commons, and no majority whatsoever in the House of Lords, at face value the judgement might appear a significant headache for Theresa May. But, in practice, with the main opposition Labour Party currently a shambles and fearful for its future, and the supposedly independent-minded members of the House of Lords similarly unwilling to do anything that appears to go against the "will of the people", the Government looks set to get its forthcoming Article 50 Bill easily through Parliament. And while the opposition parties will propose amendments to the wording of the Bill, the conditions attached to the final text are unlikely to be of great substance. Most notable might be a clause requiring a meaningful vote in Parliament at the conclusion of the Article 50 negotiations that could in theory give MPs an opportunity to send Theresa May back to Brussels to seek a better deal should she fail to come up with a satisfactory settlement. In practice, however, for a range of reasons, such a scenario is highly improbable, not least given that any deal that Theresa May achieves will be on a 'take it or leave it' basis, with the rest of the EU not willing to re-open negotiations.

Another referendum on Scottish independence increasingly likely

Perhaps more significant in the longer term than the judgement on the role of the UK Parliament was what the Supreme Court had to say about the roles of the devolved national legislatures. In particular, the Court clarified that the Scottish, Welsh or Northern Irish legislatures do not have a veto on Brexit and that there is no obligation on the UK Government even to consult with them before invoking Article 50. As such, politicians in Westminster are now in full control of the domestic legislative process and timetable for launching Brexit. So, in line with Theresa May's plans, we should fully expect Article 50 to be triggered by end-March, which, according to the EU Treaty, also implies that the UK will almost certainly leave the EU by March 2019. However, with the Supreme Court today casting new light on the limitations of the powers delegated to the Scottish Parliament, and the Scottish National Party bound to be dissatisfied by the final Brexit deal once it has been negotiated by Theresa May, the probability of another referendum on Scottish independence in due course has no doubt risen further.

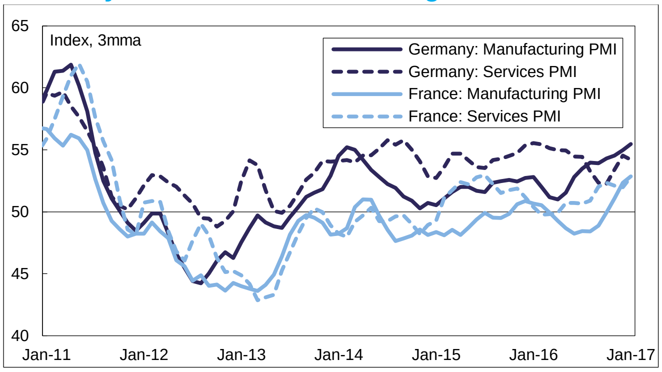
Net borrowing on track to meet OBR's revised forecast

With the government having scaled back its deficit reduction plans to reflect the deterioration in the medium-term economic outlook following the vote to leave the EU, UK public sector net borrowing seems to be growing broadly in line with the OBR's new full-year forecast of £68.2bn. While today's public finance figures for December suggested that net borrowing of £6.9bn was only slightly below that in December 2015, on a year-to-date basis, borrowing was about £11bn lower, at £63.8bn. While this is a larger improvement than the £7bn full-year reduction expected by the OBR in November, to some extent the better showing reflected revisions to the data for earlier months. And there are reasons to believe that net borrowing might be higher over the three remaining months of FY16/17. For example, among other things, Stamp Duty Land tax receipts are likely to have fallen due to the lower level of transactions in the housing market. Those effects, however, might be partly offset by higher self-assessment income tax receipts this month.

The day ahead in the UK

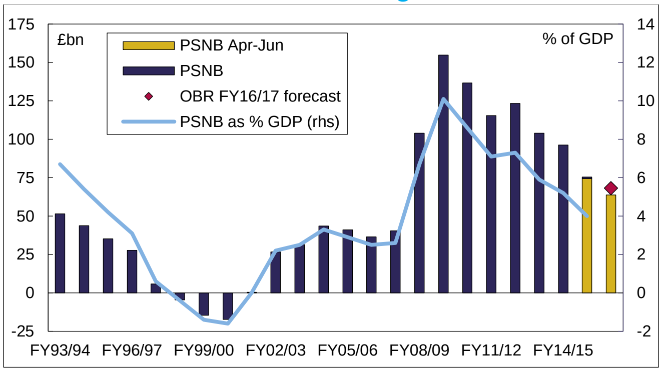
Tomorrow brings only the CBI Industrial Trends survey. The monthly figures will most likely signal that momentum in the manufacturing sector improved in January, while its quarterly results should be consistent with firm output growth in the latest three months.

Germany & France: Manufacturing & services PMIs



Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Public sector net borrowing*



**Excluding public sector banks.*
Source: ONS 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 PMI	Jan	**55.1**	54.8	54.9	-
	Preliminary services PMI (preliminary composite PMI)	Jan	**53.6 (54.3)**	53.8 (54.5)	53.7 (54.4)	-
Germany	Preliminary manufacturing PMI	Jan	**56.5**	55.4	55.6	-
	Preliminary services PMI (preliminary composite PMI)	Jan	**53.2 (54.7)**	54.5 (55.3)	54.3 (55.2)	-
France	Preliminary manufacturing PMI	Jan	**53.4**	53.4	53.5	-
	Preliminary services PMI (preliminary composite PMI)	Jan	**53.9 (53.8)**	53.2 (53.2)	52.9 (53.1)	-
UK	Public sector net borrowing excluding interventions £bn	Dec	**6.9**	6.7	12.6	**11.3**
Country	**Auction**					
UK	BoE APF operation purchased £1bn of 15Y+ Gilts (1.43 cover ratio)					

Source: Bloomberg and *Daiwa Capital Markets Europe Ltd.*

Tomorrow's data releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany	09:00	Ifo business climate index	Jan	111.3	111.0
	09:00	Ifo current assessment balance (expectations)	Jan	117.0 (105.8)	116.6 (105.6)
France	07:45	Business confidence indicator (production outlook)	Jan	105 (6)	105 (6)
Italy	09:00	Industrial sales M/M% (Y/Y%)	Nov	-	0.8 (-0.9)
	09:00	Industrial orders M/M% (Y/Y%)	Nov	1.0 (-)	0.9 (-3.2)
UK	11:00	CBI Industrial Trends survey, total orders	Jan	2	0
Auctions and events					
Country	GMT	Auction / Event			
Germany	10:30	Auction: To sell €1bn of 2.5% 2046 bonds (15-Aug-2046)			
UK	14:50	BoE APF operation: To purchase 7-15Y Gilts			
	16:00	BoE's Carney scheduled to speak in Wiesbaden, Germany			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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