

Euro wrap-up

Overview

- On a risk-off end to the week with few top-tier economic data, Bunds and other euro area government bonds rallied.
- Gilts also rallied further ahead of the weekend's last-ditch negotiations between the EU and UK.
- While Brexit will dominate attention, the coming week will also bring the December flash PMIs, data on euro area and UK inflation, euro area IP and trade, UK employment and retail sales, and a meeting of the BoE's MPC.

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Daily bond market movements

Bond	Yield	Change
BKO 0 12/22	-0.796	-0.017
OBL 0 10/25	-0.818	-0.025
DBR 0 08/30	-0.641	-0.035
UKT 1% 09/22	-0.136	-0.010
UKT 0% 06/25	-0.108	-0.021
UKT 4% 12/30	0.164	-0.034

*Change from close as at 4:00pm GMT.

Source: Bloomberg

Euro area

Italian manufacturing production resumes uptrend

On a quiet end to the week for euro area economic data, today's Italian industrial production figures confirmed solid growth in the sector in each of the large member states in October. In particular, having dropped a revised 4.9%M/M in September, Italian manufacturing output rose 1.4%M/M. That left it only a fraction above the Q3 average and 2.6ppts below February's level when Covid-19 was starting to spread across Italy's Northern regions. As elsewhere in the large member states, production of capital goods was firm, up 2.6%M/M in October, with output of transport items up 4.4%M/M back above February's level and machinery up 2.5%M/M, albeit still some 6.6% below that benchmark. Production of intermediate goods rose 1.3%M/M, with chemicals and metals up at similar rates, with the former close to February's level. Production of consumer goods was somewhat softer, at 0.7%M/M, with output of textiles and clothing up a modest 0.4% to remain more than 15% below February's level.

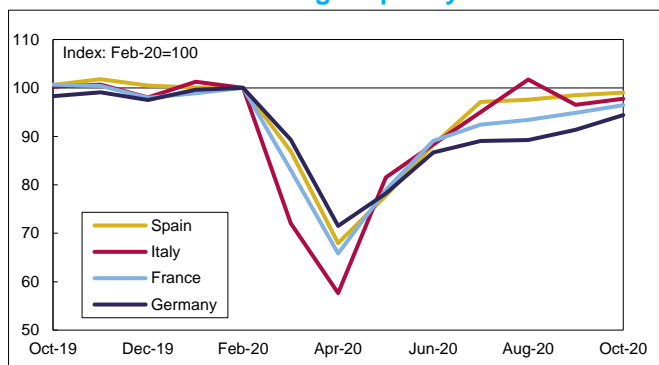
Evidence of a loss of momentum heading into the New Year

Despite the return to growth in October, the outlook for manufacturing – and in most member states, perhaps bar Germany – appears to have clouded over the past couple of months. The ISTAT manufacturing survey results for November reported deterioration in domestic and foreign orders. And most discouragingly, the outlook for both production and order books was downgraded to the worst since May. The November manufacturing PMIs also pointed to a softening of growth in Italy's industrial sector, albeit not as marked as that in France or Spain where the sector already appeared to shift clearly into reverse last month. The loss in momentum across these member states likely reflects a mix of domestic and external factors, from rising unemployment, contamination from weakness in the services sector, the clearance of past backlogs, and the completion of Brexit-related stock-building. So, the flash December PMIs due on Wednesday will be closely watched for further evidence of a loss of momentum at the end of the year, which would suggest risks of a contraction in production in Q121.

The week ahead in the euro area

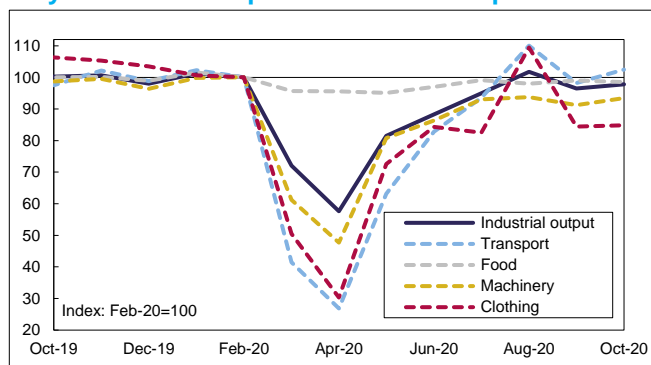
The coming week brings several new top-tier economic data from the euro area, including the flash December PMIs, to be released on Wednesday. These seem likely to underscore the likelihood of a contraction in euro area GDP in Q4 with another sub-50 reading expected in the headline composite index, which fell to 45.3 in November dragged lower in particular by weakness in services. The latest survey will be watched for continued resilience in the manufacturing sector, not least in Germany, where the composite PMI encouragingly remained above 50 last month. Other December survey results due in the coming week include the French INSEE and German ifo business climate indices on Thursday and Friday respectively.

Euro area: Manufacturing output by member state



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Italy: Industrial output & selected component



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The week will start, however, with the release of the aforementioned euro area industrial production report for October. Given the firm results from each of the four large member states, we expect IP to rise around 2.0%M/M, which would leave it about 4.0% down from February's pre-pandemic level. Among other data due, Tuesday will bring the final estimate of French and Italian inflation in November, ahead of the release of the euro area figures on Thursday. According to the flash estimates, the euro area headline and core inflation rates were both unchanged last month at -0.3%Y/Y and 0.2%Y/Y respectively. Today the equivalent headline final estimate from Germany was confirmed at the flash estimate of -0.7%Y/Y, but the Spanish figure was revised up by 0.1ppt to -0.8%Y/Y. Euro area goods trade data for October and labour cost figures for Q3 are also out on Wednesday, while November's EU new car registrations and October's euro area construction output figures are due on Thursday.

UK

BoE sanguine about stability risks of a no-deal Brexit, but notes market risks and likely disruption

With no new data to distract, attention today inevitably remained on Brexit and the continuing risks of no deal, which saw sterling weaken again and 10Y Gilt yields fall further to their lowest levels since October. On the positive side, the BoE's Financial Stability Report maintained a sanguine view of the ability of the banking sector to withstand a no-deal outcome, judging that most of the risks to UK financial stability that could arise have now been mitigated. However, the BoE acknowledged the risks of market volatility and disruption to certain financial services, including related to derivatives where some market participants might not be ready to trade with EU counterparties or EU-recognised trading venues. Of course, the BoE has previously noted that, even if a deal is reached, the disruption to exports and domestic supply chains will reduce UK GDP by about 1%Q/Q in Q121, while the OBR assessed that no deal would likely reduce GDP by a further 2% in Q1, and by about 1½% over the long term.

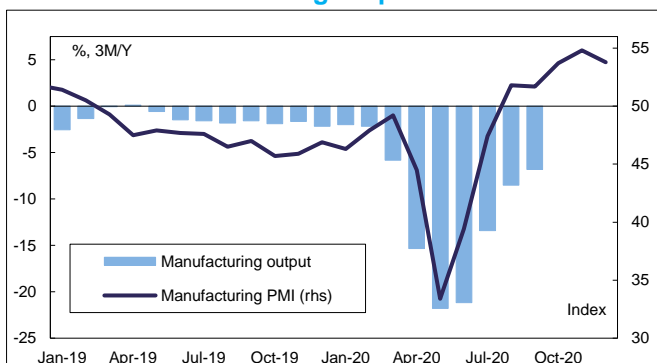
Is Johnson serious?

It remains the case that the landing zone for a deal is reasonably clear, with the main thing lacking being the political will to make the compromises required. While UK PM Johnson last night addressed the nation on the need to prepare for no deal, his body language and smirking raised, not for the first time, significant doubts about the sincerity of his message. One possibility is that he is currently simply running down the clock, not necessarily to force the EU into concessions but instead (once again) to minimize scope for UK parliamentary scrutiny on a deal. We also note the inconsistency of his current willingness to accept punishing tariffs across the board at the start of 2021 in the event of no deal, with his unwillingness to accept a process that could theoretically result one day in selective tariff hikes in the event that the UK and EU diverged significantly on environmental or labour standards. Today EU President von der Leyen insisted that the EU proposals would not "require the UK to follow [the EU] every time" it sought to tighten regulation. Instead, the UK "would remain free – sovereign if you wish – to decide what they want to do". We maintain doubts that an agreement will have been reached by the time Sunday's new deadline has passed. However, it also remains our expectation that a deal will eventually be reached.

The week ahead in the UK

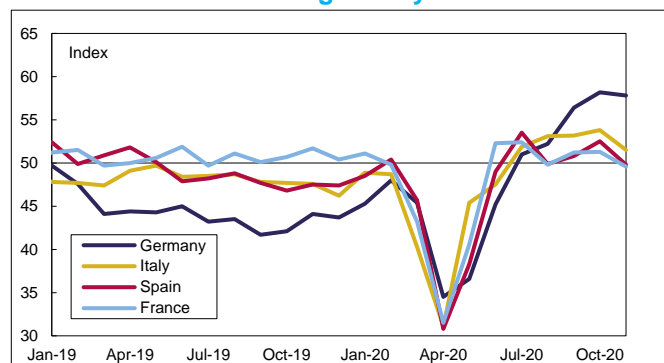
While markets will first and foremost take their cue from the news on Brexit and the state of play of discussions on Sunday night, like in the euro area the coming week will be a busy one for top-tier economic data from the UK, while it also brings the final BoE MPC meeting of the year. In the event that the UK government has reached agreement with the EU on a new FTA beforehand, the latter should be a non-event, not least as the MPC agreed last month an increase in its asset purchase programme to last well into the second half of next year. However, should a no-deal Brexit be on the agenda for the start of 2021, then the MPC might be expected to prepare its response, although pre-emptive action seems unlikely unless financial markets are already highly turbulent.

Euro area: Manufacturing output and PMI*



*Manufacturing PMI 1-month lead. Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.
















Euro area: Manufacturing PMI by member state



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





Data-wise, the coming week brings the final top-tier releases before the New Year, including the latest labour market report (Tuesday), the December flash PMIs and November inflation figures (Wednesday), and November retail sales and December GfK consumer confidence survey (Friday). Despite the belated extension of the Job Retention Scheme, Tuesday's labour market report will show ongoing redundancies, a further drop in payroll employment and a pickup in the ILO unemployment rate above 5.0% to its highest level since 2015. While inflation ticked up to a three-month high of 0.7%Y/Y in October, we see risks that it will slip back 0.1ppt in November, and that the core measure will fall back by as much as 0.2ppt to 1.3%Y/Y. The flash PMIs will probably continue to flag the likelihood that the economy is contracting in Q4, although the composite PMI might edge up from 49.0 in November reflecting the easing of some pandemic containment restrictions as well as Brexit-related stock-building. But with non-essential stores having been closed last month, retail sales seem bound to fall back sharply even though online and click-and-collect sales will have provided some support.

Daiwa economic forecasts

		2020				2021		2020	2021	2022
		Q1	Q2	Q3	Q4	Q1	Q2			
GDP growth, %, Q/Q										
Euro area		-3.7	-11.7	12.5	-2.5	1.0	1.6	-7.2	4.2	3.8
Germany		-1.9	-9.8	8.5	-1.0	0.7	1.2	-5.6	3.2	3.2
France		-5.9	-13.8	18.7	-3.5	1.5	2.0	-8.9	6.4	3.8
Italy		-5.5	-13.0	15.9	-3.0	1.2	1.2	-9.0	4.8	4.3
Spain		-5.2	-17.8	16.7	-4.0	1.5	2.0	-11.8	4.2	5.5
UK		-2.5	-19.8	15.5	-1.5	0.4	2.0	-11.0	4.0	6.6
CPI										
Euro area										
Headline CPI		1.1	0.2	0.0	-0.3	0.3	0.9	0.3	1.0	1.2
Core CPI		1.1	0.9	0.6	0.3	0.8	0.8	0.7	0.7	0.7
UK										
Headline CPI		1.7	0.6	0.6	0.6	0.9	1.9	0.9	1.6	1.6
Core CPI		1.6	1.4	1.3	1.3	1.6	2.1	1.4	1.8	1.4
Interest Rates										
ECB										
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)		750	1350	1350	1850	1850	1850	1850	1850	1850
BoE										
Bank Rate %		0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Bond purchases** (£bn)		645	745	746	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	
Germany	 Final CPI (EU-harmonised CPI) Y/Y%	Nov	-0.3 (-0.7)	-0.3 (-0.7)	-0.2 (-0.5)	-	
Italy	 Industrial production M/M% (Y/Y%)	Oct	1.3 (-2.1)	1.0 (-4.3)	-5.6 (-5.1)	-5.1 (-4.9)	
	 Unemployment rate %	Q3	9.8	9.8	8.3	8.4	
Spain	 Final CPI (EU-harmonised CPI) Y/Y%	Nov	-0.8 (-0.8)	-0.8 (-0.9)	-0.8 (-0.9)	-	
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/ <i>Daiwa forecast</i>	Previous
Monday 14 November 2020					
EMU		10.00 Industrial production M/M% (Y/Y%)	Oct	1.8 (-4.4)	-0.4 (-6.8)
France		- Bank of France business survey, industrial sentiment	Nov	95	97
UK		00.01 Rightmove house price index M/M% (Y/Y%)	Dec	-	-0.5 (6.3)
Tuesday 15 December 2020					
France		07.45 Final CPI (EU-harmonised CPI) Y/Y%	Nov	0.2 (0.2)	0.0 (0.1)
Italy		09.00 Final CPI (EU-harmonised CPI) Y/Y%	Nov	-0.2 (-0.3)	-0.3 (-0.6)
		10.00 Total trade balance €bn	Oct	-	5.8
UK		07.00 Unemployment claimant count rate % (change '000s)	Nov	-	7.3 (-29.8)
		07.00 Average earnings including bonuses (excluding bonuses) 3M/Y	Oct	2.3 (2.6)	1.3 (1.9)
		07.00 ILO unemployment rate %	Oct	5.1	4.8
		07.00 Employment change '000s, 3M/3M	Oct	-	-164
Wednesday 16 December 2020					
EMU		09.00 Preliminary manufacturing (services) PMI	Dec	53.0 (41.0)	53.8 (41.7)
		09.00 Preliminary composite PMI	Dec	45.5	45.3
		10.00 Labour costs Y/Y%	Q3	-	4.2
		10.00 Trade balance €bn	Oct	-	24.0
Germany		08.30 Preliminary manufacturing (services) PMI	Dec	56.0 (44.0)	57.8 (46.0)
		08.30 Preliminary composite PMI	Dec	50.8	51.7
France		- Bank of France retail sales Y/Y%	Nov	-	2.7*
		08.15 Preliminary manufacturing (services) PMI	Dec	49.6 (38.0)	49.6 (38.8)
		08.15 Preliminary composite PMI	Dec	41.3	40.6
Italy		09.00 Industrial orders (sales) Y/Y%	Oct	-	3.2 (-4.6)
UK		07.00 CPI (core CPI) Y/Y%	Nov	0.7 (1.4)	0.7 (1.5)
		07.00 PPI input (output) prices Y/Y%	Nov	-0.5 (-0.8)	-1.3 (-1.4)
		09.30 Preliminary manufacturing (services) PMI	Dec	54.8 (50.4)	55.6 (47.6)
		09.30 Preliminary composite PMI	Dec	51.3	49.0
		09.30 House price index Y/Y%	Oct	-	4.7
Thursday 17 December 2020					
EMU		07.00 EU-27 new car registrations Y/Y%	Nov	-	-7.8
		10.00 Final CPI (Core CPI) Y/Y%	Nov	-0.3 (0.2)	-0.3 (0.2)
		10.00 Construction output M/M% (Y/Y%)	Oct	-	-2.9 (-2.5)
France		07.45 INSEE business confidence	Dec	-	79
		07.45 INSEE manufacturing confidence (production outlook)	Dec	-	92 (-39)
Spain		08.00 Labour costs Y/Y%	Q3	-	-8.3
UK		12.00 BoE Bank Rate %	Dec	<u>0.10</u>	0.10
		12.00 BoE corporate bond target £bn	Dec	<u>20</u>	20
		12.00 BoE gilt purchase target £bn	Dec	<u>875</u>	875
Friday 18 December 2020					
Germany		07.00 PPI Y/Y%	Nov	-0.6	-0.7
		09.00 Ifo business climate	Dec	89.8	90.7
		09.00 Ifo current assessment (expectations)	Dec	89.0 (93.0)	90.0 (91.5)
Italy		09.30 PPI Y/Y%	Nov	-2.9	-2.9
Spain		09.00 Trade balance €bn	Oct	-	-1.5
UK		00.01 GfK consumer confidence	Dec	-31	-33
		07.00 Retail sales including fuel M/M% (Y/Y%)	Nov	-1.3 (5.2)	1.2 (5.8)
		07.00 Retail sales excluding fuel M/M% (Y/Y%)	Nov	-2.1 (-)	1.3 (7.8)
		11.00 CBI industrial trends survey, total orders	Dec	-	-40

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

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 14 December 2020		
EMU	 09.45	ECB's Panetta scheduled to speak
	 13.30	ECB's Schnabel scheduled to speak
Tuesday 15 December 2020		
EMU	 14.00	ECB's Lane scheduled to speak
Wednesday 16 December 2020		
EMU	-	ECB President Lagarde and Panetta participate in Eurogroup video conference
	 15.30	ECB's de Guindos scheduled to speak
	 16.15	ECB's Schnabel scheduled to speak
	 17.30	ECB's de Guindos scheduled to speak
Thursday 17 December 2020		
EMU	 16.00	ECB's Schnabel scheduled to speak
UK	 12.00	BoE monetary policy announcement and minutes published
	 12.00	BoE publishes Agents' summary of business conditions Q420
Friday 18 December 2020		
UK	 12.00	BoE publishes Q420 Quarterly Bulletin

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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