

# Euro wrap-up

## Overview

- Bunds were largely little changed as euro area inflation was unchanged in December, euro area retail sales in November fell sharply but German factory orders for the same month beat expectations.
- Gilts followed USTs lower while the UK's construction PMIs suggested ongoing growth in the sector towards year-end.
- Friday will bring November data for German and French industrial production and goods trade.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 12/22	-0.712	+0.002
OBL 0 10/25	-0.734	+0.001
DBR 0 02/31	-0.519	+0.006
UKT 1% 09/22	-0.141	+0.008
UKT 0% 06/25	-0.054	+0.030
UKT 4% 12/30	0.290	+0.049

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

## Euro area

### Inflation unchanged for a fourth month in December

As suggested by yesterday's national data from Germany and France, inflation in the euro area as a whole remained highly subdued at the end of 2020. The flash estimate of headline inflation remained unchanged in December at -0.3%Y/Y for a fourth month in a row, with the core CPI measure similarly unchanged at the series low of 0.2%Y/Y for a fourth month. Within the detail, however, there was significant variation. Weighed by both recent euro strength and excess global capacity, the prices of non-energy industrial goods fell 0.4%M/M, the most in any December since the introduction of the euro. And that sent the respective annual inflation rate down to a series low of -0.5%Y/Y. In contrast, inflation of services edged up 0.1ppt to a four-month high of 0.7%Y/Y. We caution, however, that a large share of the prices of those items will have been imputed by the statisticians. In terms of non-core items, prices of food, alcohol and tobacco fell 0.4%M/M, also a record decline for December. And that resulted in a moderation of 0.5ppt in the annual rate of increase to 1.4%Y/Y, the lowest since February 2018. In contrast, energy prices rose 1.6%M/M, the most in six months, to push the annual rate of increase up 1.4ppt to -6.9%Y/Y, the highest since March.

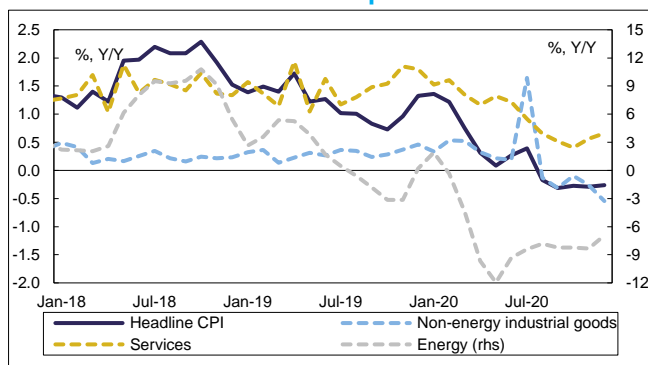
### Inflation to rise back above zero in January and move gradually higher throughout 2021

Looking ahead, we expect the headline euro area inflation rate to rise back above zero percent in January due to higher oil prices, the reversal of the German temporary VAT cut and also the impact of the German carbon tax on domestic energy bills. And base effects from past shifts in energy prices should continue to push inflation higher as the year goes on, as should a gradual normalization of economic activity from the second quarter on as vaccine programmes are rolled. So we expect headline inflation to end the year close to 1½%Y/Y, with core inflation also back above 1.0%Y/Y. Thereafter, however, in the absence of further pressure from energy prices, we expect both headline and core inflation to ease back before levelling off through 2022 at levels well below the ECB's inflation aim, ensuring that rates remain low and the ECB maintains an active presence in bond markets into the medium term.

### Retail sales fell sharply in November as restrictions bit

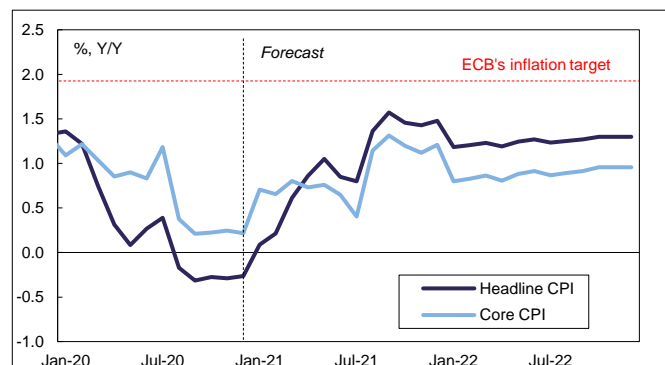
The strength in German retail sales (+1.9%M/M) in November, confirmed earlier this week, proved to be a red herring, as pandemic containment measures significantly hit sales in France (-18.0%M/M), Belgium (-15.9%M/M) and Austria (-9.9%M/M). With more moderate declines recorded in several other member states, including Spain (-1.2%M/M) and Portugal (-3.3%M/M), retail sales in the euro area fell a much steeper-than-expected 6.1%M/M, the biggest drop since the initial lockdown in April to be down 2.9%Y/Y. Within the detail, online and mail order sales (up 1.8%M/M) provided only

### Euro area: Inflation and components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

modest support while all other main components fell. Sales of electrical goods and furniture remained relatively resilient, however, dropping just 0.3%M/M to be still up more than 10%Y/Y. But growth in core (i.e. non-food, non-fuel) items overall fell 8.9%M/M to be down a little more than 5%Y/Y. Sales of clothing and textiles fell by 17%M/M to be down more than a quarter from a year earlier. Food sales fell 1.7%M/M to almost fully reverse the previous month's rise and be up 2.7%Y/Y. And with mobility falling due to restrictions on movement, sales of fuel fell for the third month in a row and by more than 10%M/M to be down 18%Y/Y. While restrictions in some member states, including France, eased last month, they tightened in Germany. And so, with the average level of sales in October and November already 1.3% below the Q3 average, euro area retail sales now look to have fallen over Q4 as a whole. And with spending on many services more significantly impacted by pandemic containment measures, household consumption now seems bound to have contracted significantly last quarter.

### German factory orders beat expectations with seventh successive monthly rise

More happily, contrary to expectations of a drop, German factory orders rose for a seventh successive month in November and by a robust 2.3%M/M to be up a striking 6.3%Y/Y, 4.0% above February's pre-pandemic level and at their highest level since November 2018. To some extent the headline figure was flattered by one-off large-scale items, but even excluding them orders rose a firm 1.6%M/M. The increase in demand was widespread, with domestic orders up 1.6%M/M and foreign orders up 2.9%M/M. Of the latter, orders from within the euro area leapt 6.1%M/M. By type of good, the increase in demand was also broad-based, with orders for intermediate goods up 4.9%M/M and capital goods up 1.1%M/M, while orders for consumer goods lagged somewhat, up a more modest 0.5%M/M. However, orders for autos fell 3.0%M/M, the first decline since April. Meanwhile, German manufacturing turnover rose 1.1%M/M in November, suggesting that tomorrow's IP data will similarly reveal a seventh successive month of growth in production. Nevertheless, turnover was still 3.6% below February's level and, while recent survey indicators pointed to continued positive momentum towards year-end, manufacturing output also likely remained below the pre-pandemic level in December too.

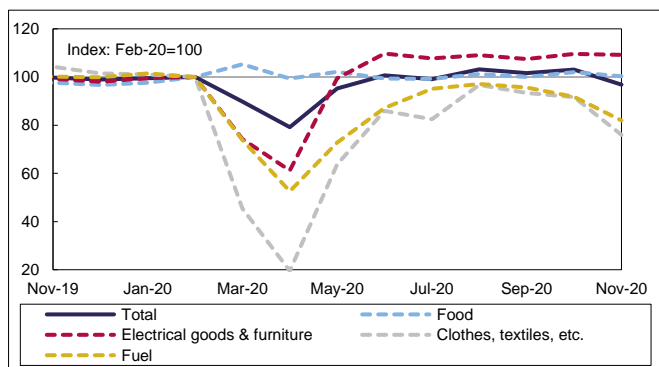
### Industrial sector drives improvement in Commission sentiment indicator

The European Commission's latest economic sentiment survey also provided cause for cautious optimism. Admittedly, it highlighted the ongoing weakness of confidence in the euro area retail and services sectors in December, with the respective indices dropping to their lowest levels since July. However, the overall tone of the survey was more positive. Confidence in industry registered a significant improvement, rising to the highest level since February on the back of stronger production expectations and bigger order books. And with consumer confidence up to a three-month high, the Commission's headline euro area Economic Sentiment Indicator (ESI) rose a larger-than-expected 2.7pts to 90.4, also the highest since September. Strikingly, the ESIs for each of the five largest member states also rose. While the indicators for Germany, France and Italy remained below their levels in October, however, those for Spain and the Netherlands rose to their highest since March. Among other detail on the Commission survey, employment expectations rose thanks to improved plans in industry and retail, which offset further retrenchment expected by services firms, with consumers less fearful of unemployment too. But while selling price expectations rose in all sectors, consumer price expectations declined.

### Construction PMIs suggest ongoing weakness in the sector

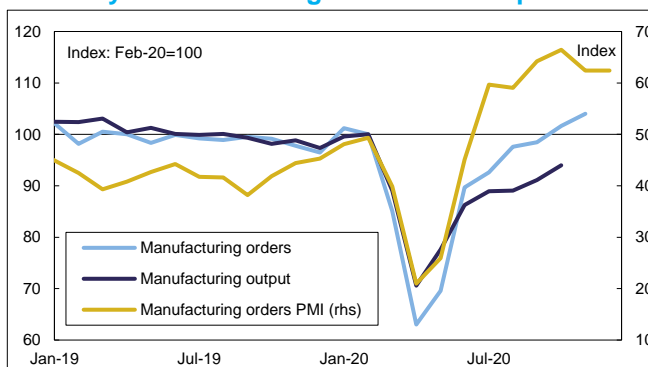
According to the Commission's survey, construction sentiment in the euro area rose in December to the highest since March on the back of stronger new orders. But that assessment contrasted with Markit's construction PMIs, for which the headline euro area activity index edged down 0.1pt last month to 45.5, remaining firmly in contraction territory for a tenth consecutive month, albeit still well above the trough during the first wave of pandemic. The PMIs suggested broad-based weakness in the sector, with the sharpest decline reported in commercial work, which continues to struggle in each of the three largest member states. But civil engineering and house-building were also still subdued, with the latter notably weak in France. At the country level, Italy's builders were the only ones to be upbeat about the coming twelve months, with the existential threat to city-centre office, retail and leisure activity posed by the pandemic weighing on wider sentiment.

#### Euro area: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Germany: Manufacturing orders and output



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

## The day ahead in the euro area

Tomorrow brings the release of the euro area unemployment rate for November, which is expected to edge up just 0.1ppt to 8.5%. While the reintroduction of lockdown measures in France and certain other member states that month will likely push the jobless rate higher, short-term working schemes, such as Germany's *kurzarbeit* programme, continue to have success in supporting employment. Meanwhile, Germany's November industrial production figures and trade data will likely highlight the support to GDP growth in Q4 provided by the manufacturing sector. German industrial production is expected to rise close to 1%M/M in November, after rising 3.2%M/M in October. That, however, would still leave it down about 2%Y/Y and around 4% below February's pre-pandemic level. In contrast, French industrial output is expected to fall 1%M/M, after rising 1.6%M/M previously, leaving it 5% lower compared to a year earlier and down around 4.5% from February. German new car registration data for December should also be published tomorrow.

## UK

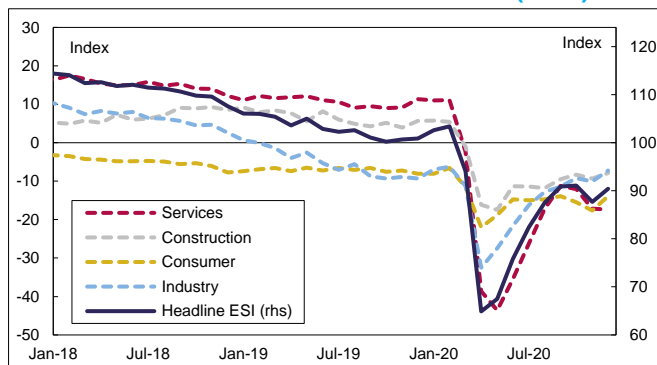
### Construction PMIs signal continued growth in the sector towards year-end

With the sector not bound by pandemic containment restrictions, UK construction output appears to have continued to grow towards year-end. In particular, the construction PMI fell just 0.1pt in December to a relatively robust 54.6. Against the backdrop of the solid rebound in market activity following the initial lockdown, the PMIs reported a further sharp rise in house building last month. Commercial activity also continued to grow, albeit at the softest pace since June. But civil engineering output reportedly dropped for the fourth month in the past five. Order books also improved. But like the UK's manufacturers, firms also complained of supply-chain problems which caused delays to receiving inputs of building materials, and input price pressures were the strongest in almost two years. Nevertheless, looking ahead to the coming twelve months, construction firms were the most upbeat since April 2017.

## The day ahead in the UK

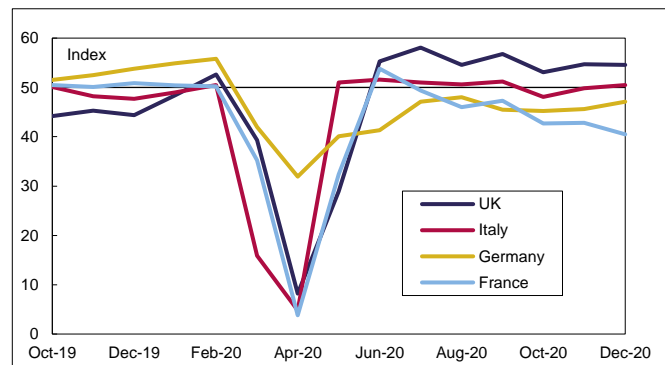
This week's UK economic data calendar ends quietly, with no key releases scheduled for tomorrow.

### Euro area: Economic sentiment indices (ESIs)



Source: European Commission, Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area & UK: Construction PMIs



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

# European calendar

## Today's results

### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	Construction PMI	Dec	45.5	-	45.6	-
	European Commission economic confidence	Dec	90.4	89.4	87.6	87.7
	European Commission final consumer confidence	Dec	13.9	-13.9	-17.6	-
	European Commission industrial (services) confidence	Dec	-7.2 (-17.4)	-8.6 (-15.0)	-10.1 (-17.3)	- (-17.1)
	Retail sales M/M% (Y/Y%)	Nov	-6.1 (-2.9)	-3.2 (1.0)	1.5 (4.3)	1.4 (4.2)
	CPI estimate (core CPI) Y/Y%	Dec	-0.3 (0.2)	-0.2 (0.3)	-0.3 (0.2)	-
Germany	Factory orders M/M% (Y/Y%)	Nov	2.3 (6.3)	-1.2 (2.5)	2.9 (1.8)	3.3 (2.3)
	Construction PMI	Dec	47.1	-	45.6	-
France	Construction PMI	Dec	40.5	-	42.8	-
Italy	Construction PMI	Dec	50.5	-	49.8	-
	Preliminary CPI (EU-harmonised CPI) Y/Y%	Dec	-0.1 (-0.3)	-0.2 (-0.3)	-0.3 (-0.3)	-
UK	Construction PMI	Dec	54.6	-	54.7	-

### Auctions

Country	Auction
France	sold €3.0bn of 0.5% 2040 bonds at an average yield of 0.1% sold €5.0bn of 0% 2030 bonds at an average yield of -0.33% sold €3.0bn of 0.75% 2052 bonds at an average yield of 0.37%
Spain	sold €1.03bn of 0% 2026 bonds at an average yield -0.407% sold €486mn of 0.7% 2033 index-linked bonds at an average yield of -0.856% sold €1.92bn of 1% 2050 bonds at an average yield of 0.877% sold €2.6bn of 0% 2024 bonds at an average yield of -0.501%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Tomorrow's releases

### Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU	10.00	Unemployment rate %	Nov	8.5	8.4
Germany	07.00	Industrial production M/M% (Y/Y%)	Nov	0.8 (-2.3)	3.2 (-3.0)
	07.00	Trade balance €bn	Nov	19.2	19.4
France	07.45	Industrial production M/M% (Y/Y%)	Nov	-1.0 (-5.0)	1.6 (-4.2)
	07.45	Manufacturing production M/M% (Y/Y%)	Nov	-2.0 (-5.9)	0.5 (-5.7)
	07.45	Consumer spending M/M% (Y/Y%)	Nov	-15.9 (-14.2)	3.7 (2.7)
	07.45	Trade balance €bn	Nov	-	-4.8
Italy	10.00	Preliminary unemployment rate %	Nov	10.0	9.8

### Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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