

Euro wrap-up

Overview

- Bunds made losses as the first estimates of Q4 GDP from the member states suggested relative resilience to the pandemic while the flash estimate of Spanish inflation in January surprised on the upside.
- Gilts followed USTs lower on a quiet end to the week for UK economic news.
- The coming week brings the BoE's monetary policy announcement as well as the first estimates of euro area GDP in Q4 and inflation in January.

Chris Scicluna

+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 0 12/22	-0.740	+0.013
OBL 0 10/26	-0.737	+0.018
DBR 0 02/31	-0.520	+0.022
UKT 1½ 09/22	-0.123	+0.002
UKT 0% 06/25	-0.037	+0.010
UKT 4¾ 12/30	0.320	+0.035

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

Source: Bloomberg

Euro area

Q4 GDP more resilient to pandemic than feared

On the whole, today's first member state estimates of Q4 GDP came in at the upper end of expectations, suggesting that the euro area economy has been more resilient than feared to the second wave of pandemic and associated containment measures. Broadly in line with the consensus view, Germany avoided contraction in Q4 with growth of 0.1%Q/Q following a rebound of 8.5%Q/Q in Q3, to be down just 2.9%Y/Y. But following a vigorous jump of 18.5%Q/Q in Q3, French GDP fell 1.3%Q/Q (and 5.0%Y/Y), a far more modest decline than the expected drop of about 4%Q/Q. And contrasting with the consensus expectation of a fall of around 1½%Q/Q, Spanish GDP actually managed to grow in Q4, rising 0.4%Q/Q following growth of 16.4%Q/Q in Q3. That, however, still left Spanish GDP down a steep 9.1%Y/Y, again likely representing the biggest drop from the pre-Covid level of output in the euro area. Among the other member states, Belgium (0.2%Q/Q) and Lithuania (1.2%Q/Q) also printed positive growth. But Austria's lockdown resulted in a steep drop of 4.3%Q/Q in Q4. Overall, however, today's results lead us to revise up our forecast for euro area GDP (due next Tuesday) to a drop of about 1.0%Q/Q to be down about 5½%Y/Y.

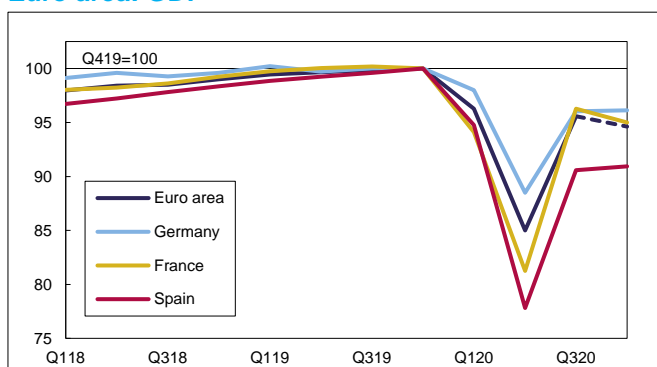
Household consumption fell while investment and net trade provided support

So far, France is the only one of the large member states to publish a detailed breakdown of Q4 GDP. And that made clear that the decline in GDP in Q4 was due to the fall in household consumption, which plunged 5.4%Q/Q following growth of 18.2%Q/Q the prior quarter. In contrast, fixed investment rose 2.4%Q/Q following growth of 24.0%Q/Q in Q3. And for a second successive quarter, exports (up 4.8%Q/Q) outpaced imports (up just 1.3%Q/Q) so net trade added 0.9ppt to GDP growth. With inventories adding 0.4ppt, final domestic demand subtracted 2.7ppts to GDP growth in Q4. Elsewhere, Germany's statistical institute stated that weakness in household consumption was offset by investment in construction and net exports. And Spanish expenditure is likely to have shown a similar pattern. Overall, today's figures give us cause to be cautiously optimistic about the economic outlook. Nevertheless, on balance, we maintain an expectation of further modest contraction in the euro area in Q1 due to the persisting lockdown restrictions, particularly in Germany, ahead of a rebound in Q2.

Spanish inflation provides big upside surprise on energy prices

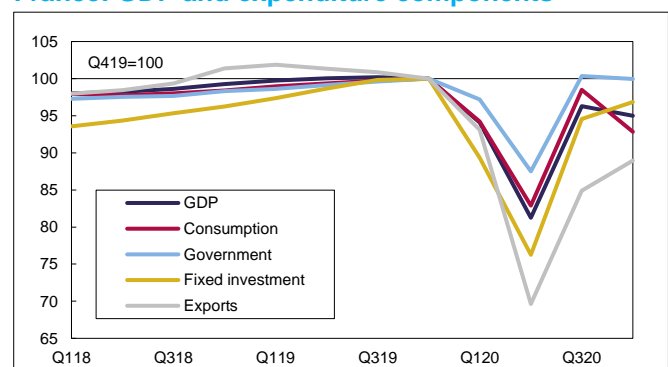
After yesterday's data revealed a much bigger-than-expected jump in German inflation in January, today's equivalent Spanish figures did likewise. In particular, Spanish inflation on the EU-harmonised (HICP) measure surprised significantly on the upside, rising 1.2ppts to 0.6%Y/Y in contrast to the expectation of no change. While no detailed data were published, the

Euro area: GDP*



*Dashed line represents our forecast. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: GDP and expenditure components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Spanish statistical institute reported that the rise looks to be largely due to higher prices of household energy, which would partly have reflected the extreme winter weather experienced earlier this month. Prices of food and beverages also made a contribution while the drop in prices of package holidays was lower than in the same month a year ago, contributing to a rise in core inflation. In light of today's figures, we have revised up our forecast of the flash estimates of euro area inflation (due on Wednesday) to 0.6%Y/Y headline and 1.1%Y/Y core.

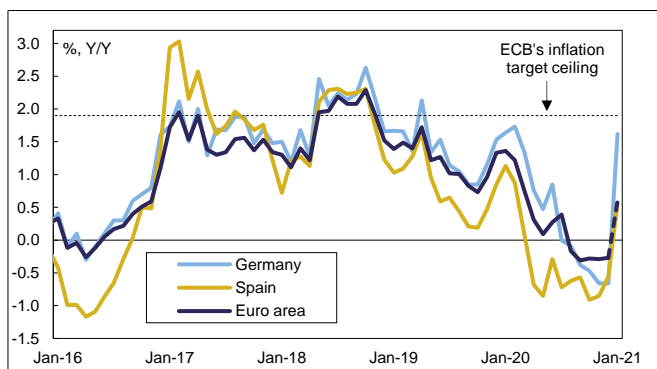
German unemployment steady in January as Kurzarbeit provides support

On a busy day for new economic data from the euro area, today's other top-tier releases were a mixed bag. Most encouragingly perhaps, the news-flow from Germany's labour market remained positive. In particular, the unemployment rate on the German national measure was unchanged at 6.0% in January, following a downward revision of 0.1ppt to the figure for the prior month. That left it up 1.0ppt from a year earlier but still 0.4ppt below the peak in June and July. Contrary to expectations of a small rise, unemployment claims fell by 41K following a revised 40K decline last month. Vacancies edged slightly higher on a seasonally adjusted basis too. We caution, however, that the number of workers, particularly in services, supported on the government's Kurzarbeit scheme also likely picked up.

Lending for house purchases remains solid, while firms repay short-term debt

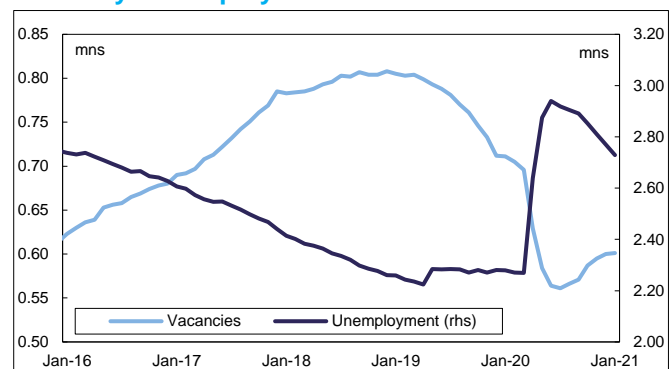
Meanwhile, the latest ECB monetary data revealed another solid month in lending to households at the end of last year, with an increase in the net flow on an adjusted basis to €23bn, thanks not least to another €19bn of net new loans for house purchase. That left growth in the stock of loans to households unchanged at 3.1%Y/Y. In contrast, December saw a net repayment to banks of €8bn from non-financial corporations, as firms paid back €10bn of precautionary short-term loans (maturities less than one year) and €5bn of loans of maturities greater than five years. After adjusting for sales and securitisations, however, there was still a positive net flow of new loans to NFCs of €11bn, leaving the total stock of such loans up 7.0%Y/Y.

Euro area: Inflation*



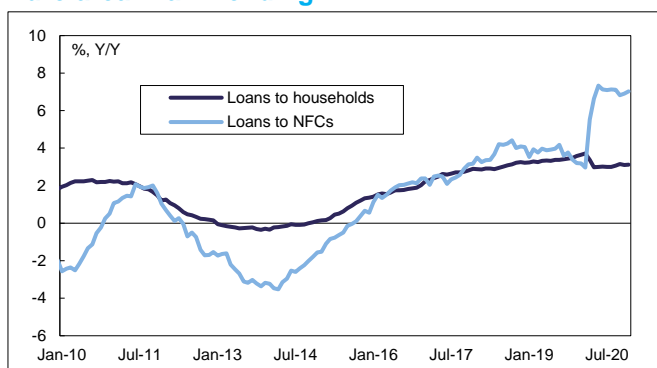
*Dashed line represents forecast euro area flash estimate in January 2021.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Unemployment and vacancies



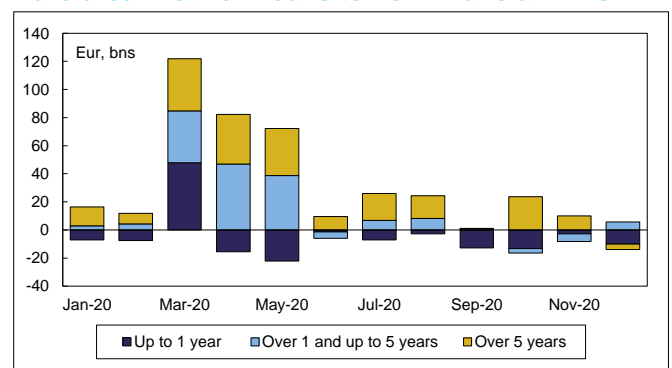
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Bank lending



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

Euro area: Net new loans to non-financial firms



Source: ECB and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

The focus in the coming week will be on the remaining Q4 GDP and flash January inflation data. In particular, the euro area and Italian GDP figures will be released on Tuesday, while the French inflation numbers will be published on Tuesday ahead of the euro area and Italian reports on Wednesday. Following today's better than expected Q4 GDP results, we expect GDP for the euro area as a whole to have contracted by around 1.0%Q/Q in the final quarter of last year to be down 5.4%Y/Y. Much will depend on the Italian data, however, for which the consensus expectation is for a drop of about 2.5%Q/Q. Meanwhile, euro area inflation is certain to move firmly out of negative territory in January after the German and Spanish HICP rates jumped by more than 2ppts and 1ppt respectively. We now forecast that euro area headline inflation will rise 0.9ppt to 0.6%Y/Y, with the core measure also increasing 0.9ppt to 1.1%Y/Y.

Ahead of these data, Monday sees the release of the euro area unemployment rate for December, which is expected to remain unchanged at 8.3%. January new car registrations data for France, Italy and Spain are also due that day. Survey-wise, we will get the final manufacturing PMIs on Monday with the services and composite indices due Wednesday. The flash PMIs suggested a weakening of economic activity in the euro area at the start of 2021. Being most directly affected by the pandemic containment measures, the deterioration was unsurprisingly registered principally in services, for which the euro area activity PMI dropped 1.4pts to 45.0. The loss of momentum in manufacturing was relatively modest and at 54.5, the respective PMI remained consistent with steady growth in the sector. Among other figures due, Thursday sees the release of euro area retail sales data for December, while on Friday German factory orders and French trade data for the same month will be published.

UK
















The week ahead in the UK

The main event in the UK in the coming week will be the conclusion of the BoE's first monetary policy meeting of the year, on Thursday, which will be accompanied by a new Monetary Policy Report featuring updated economic projections. Since the December meeting, there has been plenty of relevant news for the MPC to digest. Most notably, the agreement and implementation of the UK-EU Trade and Cooperation Agreement (TCA) avoided the disruption that a no-deal end to the Brexit transition would have caused, but nevertheless imposed significant new barriers to trade between the two blocs and also between Great Britain and Northern Ireland. Meanwhile, the economic data point to greater resilience in UK GDP than was expected by the MPC in its November projections, which foresaw a drop of about 3%Q/Q in Q4 – in contrast, overall output now looks to have been broadly flat last quarter. And despite the persisting restrictions on activity, the relatively swift start to the UK vaccination programme should have further bolstered the MPC confidence in the growth outlook for coming quarters. Moreover, inflation has seemingly behaved much like the MPC expected. And with the November projections having suggested that inflation would rise close to or above 2%Y/Y by the end of this year, and remain thereabouts over the following couple of years, a reaffirmation of that profile at the coming meeting would point to little need to adjust monetary policy over the horizon.

So, the MPC seems bound to leave policy unchanged at the coming meeting. And it will also likely retain its forward guidance, leaving open the possibility of further action if the inflation outlook weakens and repeating that it “does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made eliminating spare capacity and achieving the 2% inflation target sustainably”. We expect to see no mention of negative rates in the policy statement and meeting minutes.







Data-wise, BoE bank lending data for December will be published on Monday, with the final manufacturing, services and construction PMIs for January due on Monday, Wednesday and Thursday respectively. The UK's flash January PMIs were weaker than expected, with the intensification of the pandemic and associated tightening of restrictions inevitably the main cause of the weakness in services, for which the activity PMI dropped more than 10pts to just 38.8. The survey also reported a significant loss of momentum in manufacturing, for which the headline PMI fell almost 5pts to 52.9, with supply-chain disruption a notable feature of the report. Separately, Nationwide house price data for January are also due on Tuesday, while new car registration numbers for the same month are out on Thursday.

Daiwa economic forecasts

	2020	2021				2022	2020	2021	2022
	Q4	Q1	Q2	Q3	Q4	Q1			
GDP growth, %, Q/Q									
Euro area 	-1.0	-0.5	1.8	1.5	1.2	1.0	-6.9	3.8	4.4
Germany 	0.1	-1.0	2.3	1.5	1.0	1.0	-5.3	3.3	4.2
France 	-1.3	-0.5	1.5	1.5	1.4	1.2	-8.3	5.4	4.7
Italy 	-2.5	-0.5	1.5	1.5	1.4	1.2	-8.9	3.6	4.7
Spain 	0.4	-0.5	1.5	1.5	1.5	1.5	-11.0	4.5	5.9
UK 	0.0	-1.6	1.8	2.5	2.2	1.5	-10.1	3.5	7.0
Inflation forecasts, %, Y/Y									
Euro area									
Headline CPI 	-0.3	0.8	1.4	1.7	2.0	1.5	0.3	1.5	1.5
Core CPI 	0.2	1.1	1.1	1.4	1.6	0.9	0.7	1.3	1.0
UK									
Headline CPI 	0.5	0.9	1.8	1.7	1.9	1.8	0.9	1.6	1.6
Core CPI 	1.3	1.6	2.1	1.9	1.6	1.5	1.4	1.8	1.3
Monetary policy									
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) 	1850	1850	1850	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) 	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/ Daiwa forecast	Previous	Revised	
EMU 	M3 money supply Y/Y%	Dec	12.3	11.0	11.0	-	
Germany 	Preliminary GDP Q/Q% (Y/Y%)	Q4	0.1 (-3.9)	<u>0.0 (-4.0)</u>	8.5 (-4.0)	-	
	Unemployment rate % (change '000s)	Jan	6.0 (-41.0)	6.1 (7.5)	6.1 (-37.0)	6.0 (-40.0)	
France 	Preliminary GDP Q/Q% (Y/Y%)	Q4	-1.3 (-5.0)	<u>-4.0 (-7.6)</u>	18.7 (-3.9)	18.5 (-)	
	Consumer spending M/M% (Y/Y%)	Dec	23.0 (3.7)	23.7 (3.4)	-18.9 (-17.1)	-18.0 (-16.0)	
	PPI Y/Y%	Dec	-1.2	-	-1.8	-	
Italy 	PPI Y/Y%	Dec	-2.3	-	-2.8	-	
Spain 	Preliminary GDP Q/Q% (Y/Y%)	Q4	0.4 (-9.1)	<u>-2.5 (-11.4)</u>	16.4 (-9.0)	-	
	Retail sales Y/Y%	Dec	-1.5	-	-4.3	-3.9	
	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	0.6 (0.6)	-0.5 (-0.6)	-0.5 (-0.6)	-	
UK 	Lloyds business barometer	Jan	-7	-	-4	-	
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 01 February 2021					
EMU		09.00 Final manufacturing PMI	Jan	54.7	55.2
		10.00 Unemployment rate %	Dec	8.3	8.3
Germany		07.00 Retail sales M/M% (Y/Y%)	Jan	-2.3 (4.7)	1.1 (5.0)
		08.55 Final manufacturing PMI	Jan	57.0	58.3
France		08.50 Final manufacturing PMI	Jan	51.5	51.1
		- New car registrations* Y/Y%	Jan	-	-10.1
Italy		08.45 Manufacturing PMI	Jan	52.5	52.8
		09.00 Preliminary unemployment rate %	Dec	9.0	8.9
		17.00 New car registrations Y/Y%	Jan	-	-15.0
Spain		08.15 Manufacturing PMI	Jan	50.1	51.0
		- New car registrations* Y/Y%	Jan	-	0.0
UK		09.30 Final manufacturing PMI	Jan	52.9	57.5
		09.30 Net consumer credit £bn (Y/Y%)	Dec	-1.1 (-)	-1.5 (-6.7)
		09.30 Net mortgage lending £bn (approvals '000s)	Dec	5.5 (100.0)	5.7 (105.0)
		09.30 M4 money supply Y/Y%	Dec	-	12.8
Tuesday 02 February 2021					
EMU		10.00 Preliminary GDP Q/Q% (Y/Y%)	Q4	<u>-1.0 (-5.4)</u>	12.5 (-4.3)
France		07.45 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	0.3 (0.3)	0.0 (0.0)
Italy		09.00 Preliminary GDP Q/Q% (Y/Y%)	Q4	-2.2 (-6.8)	15.9 (-5.0)
Spain		08.00 Unemployment change '000s	Jan	-	36.8
UK		07.00 Nationwide house price index M/M% (Y/Y%)	Jan	0.3 (6.9)	0.8 (7.3)
Wednesday 03 February 2021					
EMU		09.00 Final services (composite) PMI	Jan	45.0 (47.5)	46.4 (49.1)
		10.00 Preliminary CPI (core CPI) Y/Y%	Jan	<u>0.6 (1.1)</u>	-0.3 (0.2)
		10.00 PPI Y/Y%	Dec	-1.2	-1.9
Germany		08.55 Final services (composite) PMI	Jan	46.8 (50.8)	47.0 (52.0)
		- New car registrations* Y/Y%	Jan	-	9.9
France		08.50 Final services (composite) PMI	Jan	46.5 (47.0)	49.1 (49.5)
Italy		08.45 Services (composite) PMI	Jan	39.5 (42.0)	39.7 (43.0)
		10.00 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	0.0 (0.1)	-0.2 (-0.3)
Spain		08.15 Services (composite) PMI	Jan	45.9 (46.5)	48.0 (48.7)
UK		09.30 Final services (composite) PMI	Jan	38.8 (40.6)	49.4 (50.4)
Thursday 04 February 2021					
EMU		10.00 Retail sales M/M% (Y/Y%)	Dec	1.8 (0.4)	-6.1 (-2.9)
Germany		08.30 Construction PMI	Jan	-	47.1
France		08.30 Construction PMI	Jan	-	40.5
Italy		08.30 Construction PMI	Jan	-	50.5
UK		09.00 New car registrations Y/Y%	Jan	-	-10.9
		09.30 Construction PMI	Jan	52.8	54.6
		12.00 BoE Bank Rate %	Feb	<u>0.10</u>	0.10
		12.00 BoE Gilt purchase target £bn	Feb	<u>875</u>	875
Friday 05 February 2021					
Germany		07.00 Factory orders M/M% (Y/Y%)	Dec	-1.0 (6.2)	2.3 (6.3)
France		07.45 Total trade balance €bn	Dec	-	-3.6
		07.45 Preliminary private sector payrolls Q/Q%	Q4	-0.7	1.6
Italy		09.00 Retail sales M/M% (Y/Y%)	Dec	1.6 (-4.8)	-6.9 (-8.1)

*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 01 February 2021		
- Nothing scheduled -		
Tuesday 02 February 2021		
Germany	 10.30	Auction: €6bn of 0% 2023 bonds
UK	 10.00	Auction: £3bn of 0.125% 2026 bonds
	 11.30	Auction: €2.75bn of 0.25% 2031 bonds
Wednesday 03 February 2021		
- Nothing scheduled -		
Thursday 04 February 2021		
EMU	 09.00	ECB publishes Economic Bulletin
France	 09.50	Auction: 0% 2030 bonds
	 09.50	Auction: 1.25% 2036 bonds
	 09.50	Auction: 1.75% 2039 bonds
	 09.50	Auction: 0.75% 2052 bonds
Spain	 09.30	Auction: 0% 2024 bonds
	 09.30	Auction: 0% 2026 bonds
	 09.30	Auction: 0.1% 2031 bonds
	 09.30	Auction: 0.7% 2033 index-linked bonds
UK	 12.00	BoE monetary policy announcement and publication of Monetary Policy Report
	 12.30	BoE Governor Bailey to speak at MPC press conference
Friday 05 February 2021		
EMU/UK	- 13.30	BoE's Bailey and ECB's Guindos scheduled to speak on Post-covid recovery

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FCA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.