Euro wrap-up

Overview

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- Bunds made losses as euro area GDP fell less than expected in Q4 and French inflation jumped more than expected in January.
- Gilts also made losses despite some softer UK house price data.
- Wednesday will bring the flash estimate of euro area inflation for January as well as the final services PMIs and German car registration figures for the same month.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/22	-0.731	+0.026
OBL 0 10/26	-0.712	+0.020
DBR 0 02/31	-0.490	+0.028
UKT 1¾ 09/22	-0.105	+0.013
UKT 0⅝ 06/25	-0.020	+0.019
UKT 4¾ 12/30	0.346	+0.027

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

Euro area

Drop in Q4 GDP significantly less than forecast by the ECB

According to today's first estimate, euro area GDP fell 0.7%Q/Q in Q4 to be down 5.1%Y/Y. That was a slightly better outturn than was expected following Friday's first round of figures from the member states. And it was significantly stronger than the ECB's forecast decline of 2.2%Q/Q in its most recent projections published in December. Nevertheless, growth in Q3 was revised down slightly to 12.4%Q/Q. And the shortfall in euro area GDP from the pre-Covid peak in Q419 was roughly twice as large as the equivalent loss in the US (2.5%). While no detail of the expenditure breakdown of euro area Q4 GDP was published, household consumption likely declined significantly due to the intensified pandemic and associated containment restrictions. But net trade and inventories, and perhaps also certain components of fixed investment, likely provided some offset. Among the member states, after data published on Friday suggested that Spain (0.4%Q/Q), France (-1.3%Q/Q) and Belgium (0.2%Q/Q) had performed better than expected, today's data similarly revealed that Portugal also beat expectations with positive growth of 0.4%Q/Q to be down 5.9%Y/Y in Q4. But just as Germany had fared broadly as expected (0.1%Q/Q), today's data from Italy came in line with the consensus expectation, with a drop of 2.0%Q/Q to be down 6.6%Y/Y, representing the second-worst performance of all member states after Austria (-4.3%Q/Q) last quarter.

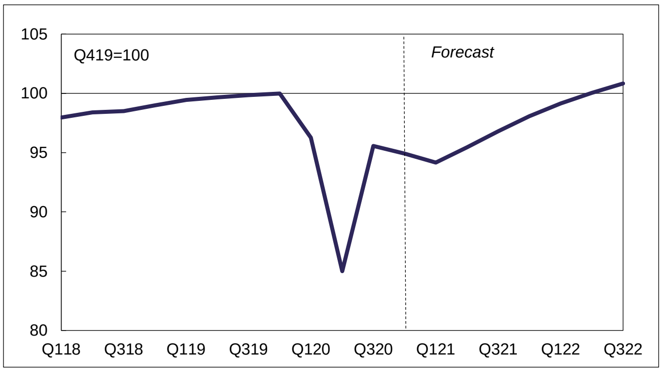
Economy more resilient to pandemic, but GDP to fall again in Q1

The smaller-than-feared drop in euro area GDP is relatively encouraging, reinforcing the impression of improved resilience to the pandemic as businesses and consumers found new ways to by-pass restrictions. However, the contribution to growth provided by the manufacturing sector in Q4 is unlikely to be as strong in Q1. The steady weakening of activity over the course of the quarter likely implies a significantly negative carry-over to the current quarter too. And while containment measures have eased in some countries – e.g. restrictions in fifteen of Italy's twenty regions were relaxed modestly this week to allow the partial reopening of bars, restaurants and tourist attractions – they remain tighter than the Q4 average in Germany and certain others. So, we still expect euro area GDP to drop again in Q1, implying a double-dip recession. Moreover, while Q2 should see a return to growth as restrictions are relaxed more significantly, the slow implementation of vaccination programmes is likely to weigh somewhat on the pace of recovery. So, we currently expect the full-year contraction in GDP of 6.8%Y/Y in 2020 to be followed by growth of 3.4%Y/Y in 2021.

French inflation surprises on the upside

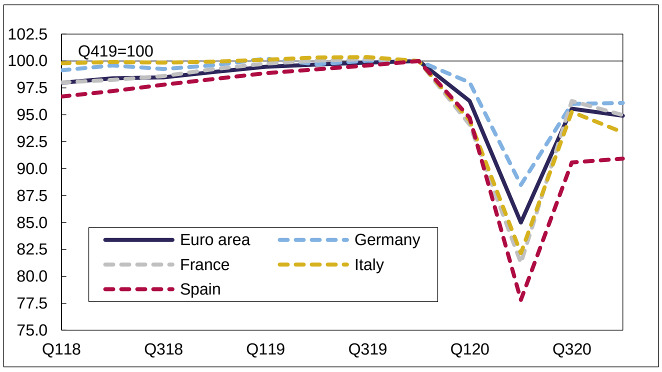
Like last week's equivalent data from Germany and Spain, the flash estimates of French inflation in January surprised significantly on the upside. Most notably, the headline EU-harmonised rate (HICP) jumped 0.8ppt, the most in nineteen

Euro area: GDP forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: GDP by member state



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

years, to a six-month high of 0.8%Y/Y. The detail of the national measure of CPI, which rose 0.6ppt to 0.6%Y/Y, suggested that most main categories made a positive contribution to rise in inflation. In particular, inflation of manufactured goods jumped 1.9ppts to 1.0%Y/Y, due not least to the delayed start to the winter sales, which kicked off twelve days later this year (on 20 January) than in 2020. In addition, services inflation rose 0.2ppt to 0.9%Y/Y, while the pace of decline in energy prices moderated by 1.1ppts to -5.9%Y/Y due to higher prices of petrol. Inflation of food, however, was unchanged at 1.0%Y/Y. As in Germany and Spain, updates to the basket weights used in the calculation, in particular lower weights on certain services adversely affected by the pandemic, likely contributed to the accelerated rise in inflation on the EU-harmonised measure. And French core inflation is likely to have jumped almost as much as the headline rate. Moreover, the leap in French inflation now means that the euro area headline rate, due tomorrow, is firmly on track to rise by a record monthly margin in January, perhaps to an eleven-month high of 0.8%Y/Y, having been stuck at -0.3%Y/Y in each of the prior four months. We also forecast the core euro area rate to rise by 0.9ppt to a six-month high of 1.1%Y/Y. Those increases might well halt talk of the possibility of further rate cuts from the ECB. But given the dominant role of one-off factors explaining the rise in inflation this month, underlying price pressures will still be muted. And so, the ECB certainly won't get carried away.

The day ahead in the euro area

The data highlight tomorrow will be the release of the aforementioned euro area flash inflation estimates for January, which will likely show a record monthly jump of 1.1ppt in the headline rate to 0.8%Y/Y as well as a steep rise in the core rate, perhaps to above 1.0%Y/Y. In addition, German new car registration and production figures for the same month are due. And survey-wise, tomorrow brings the release of the final services and composite PMI indices for January. In line with the flash estimate, the euro area services PMI is expected to drop 1.4pts to 45.0 in January, highlighting how the pandemic containment measures continue disproportionately to weigh on the sector. Meanwhile, some attention will also be on Italian politics, with President Mattarella having set a deadline of this evening to the parties that backed PM Conte's second government to see whether they could reach a deal on a new administration.

UK

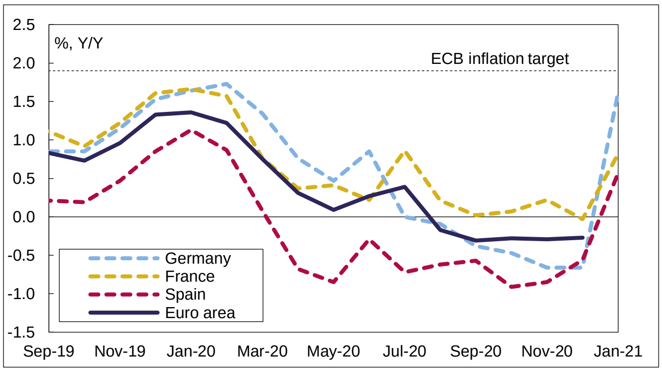
House prices start 2021 on a softer note

While yesterday's BoE bank lending data reported continued strength in mortgage approvals at the end of last year, according to Nationwide UK house prices unexpectedly fell on a seasonally adjusted basis in January for the first time since June, dropping 0.3%M/M. While that followed rapid house price growth throughout the second half of last year, the year-on-year growth rate moderated by a steeper-than-expected 0.9ppt to a three-month low of 6.4%Y/Y. The drop in prices at the start of the year tallies with other recent indicators of a softening of momentum in the housing market. For example, the December RICS residential market survey flagged a fifth successive moderation in new buyer demand, a negative reading for near-term sales expectations (the weakest since April) and a drop into negative territory (a net balance of -13%, the softest since May) in three-month price expectations. And growth in Rightmove's asking-price index halved last month to 3.3%Y/Y, the lowest since April. The revival in the pandemic and the planned expiration of the temporary stamp-duty holiday at the end of March are likely to be the main factors behind the easing of momentum in the housing market in the New Year. And with hundreds of thousands of foreign workers seemingly having left the UK over the past year, and unemployment likely to rise once the Job Retention Scheme ends on 30 April, momentum will likely peter out unless the rebound in wider economic activity from Q2 on is vigorous or the government provides extended support to buyers.

The day ahead in the UK

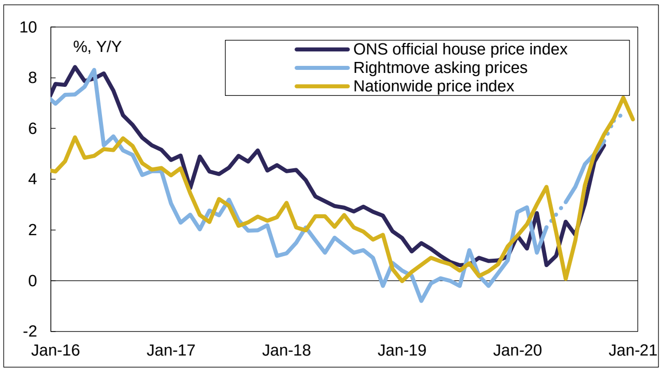
Like in the euro area, the UK's final services and composite PMIs are due on Wednesday. The flash estimates suggested a marked weakening of economic activity at the start of the year, with the services PMI dropping more than 10pts to 38.8, the lowest since May and weakest of all countries to report such indices. As a result, the composite PMI dropped almost 10pts to 40.6, similarly an eight-month low consistent with a notable drop in GDP due to the tightening of containment measures.

Euro area: Inflation*



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: House price indices*



**The Rightmove index was suspended in May and June 2020. Source: Refinitiv 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 GDP Q/Q% (Y/Y%)	Q4	**-0.7 (-5.1)**	*-1.0 (-5.4)*	12.5 (-4.3)	**12.4 (-)**
France		Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	**0.6 (0.8)**	0.3 (0.5)	0.0 (0.0)	**-**
Italy		Preliminary GDP Q/Q% (Y/Y%)	Q4	**-2.0 (-6.6)**	-2.0 (-6.6)	15.9 (-5.0)	**- (-5.1)**
Spain		Unemployment change '000s	Jan	**76.2**	-	36.8	**-**
UK		Nationwide house price index M/M% (Y/Y%)	Jan	**-0.3 (6.4)**	0.3 (6.9)	0.8 (7.3)	**0.9 (-)**

Auctions

Country		Auction
Germany		sold €4.73bn of 0% 2023 bonds at an average yield of -0.73%
UK		sold £3bn of 0.125% 2026 bonds at an average yield of 0.039%
		sold £1bn of 1.625% 2071 bonds at an average yield of 0.741%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
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	*0.8 (1.1)*	-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 (0.2)	-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)

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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