

# Euro wrap-up

## Overview

- Bunds made gains and the euro weakened as ECB officials flagged the possibility of a further rate cut and a survey reported a marked deterioration in German consumer confidence.
- Gilts were little changed while a survey indicated additional downwards pressure on UK high street prices at the start of the year.
- Thursday will bring the flash estimate of German inflation and European Commission economic sentiment survey, both for January.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 12/22	-0.751	-0.019
OBL 0 10/26	-0.757	-0.020
DBR 0 02/31	-0.552	-0.015
UKT 1¼ 09/22	-0.146	+0.005
UKT 0% 06/25	-0.063	+0.005
UKT 4¾ 12/30	0.263	-

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

Source: Bloomberg

## Euro area

### ECB rate-cut risk comments weaken the euro

While today's consumer confidence reports from Germany and France (see below) were also conducive to today's market moves, the euro weakened and Bunds made gains across the curve primarily in response to a Bloomberg report of unattributed comments from ECB policymakers that the probability of a further rate cut from the central bank was underpriced by the markets. In particular, the report suggested that at last week's policy meeting Governing Council members were "uncomfortable that investors appear to be largely ruling out more interest-rate cuts, and [thus] agreed to stress that such stimulus remains a viable option". Indeed, in a subsequent interview with Bloomberg TV today, the typically hawkish Dutch Central Bank President Knot reminded that there was still scope to cut the deposit rate below its current level of -0.50% if needed. That, of course, tallies with the current in-house judgment of ECB staff that the so-called reversal rate, below which the adverse side effects would likely outweigh the benefits, is somewhere around -1.00%. We viewed the reports as an attempt at low-key verbal intervention to try to weaken the euro following President Lagarde's reiteration last week that the ECB is "monitoring very carefully exchange rates" and in that context that "all instruments can be adjusted and nothing is off the table". Nevertheless, we also maintain our forecast that the deposit rate will remain at -0.5% and the refi rate at 0.0% for the foreseeable future.

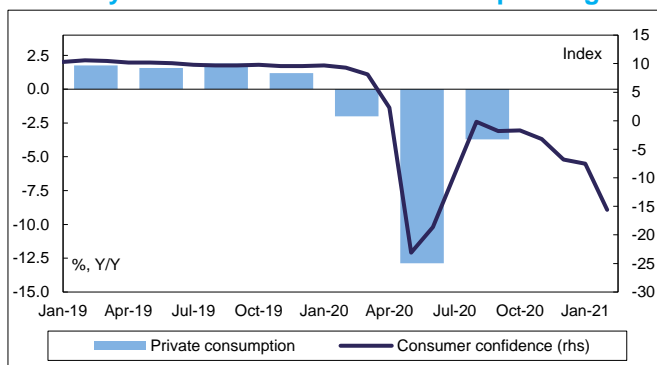
### German consumer confidence plunges amid extended lockdown

With Germany's lockdown last week extended to mid-February and rising recriminations about the sluggish rollout of the national Covid-19 vaccination programme, consumer confidence in the euro area's largest member state has tanked. It was no surprise that the latest GfK survey suggested that German consumer sentiment weakened for a fourth successive month heading into February. However, the size of the drop in the headline index, of more than 8pts, was the most since last May and much greater than expected. And it left the index at -15.6, the lowest since June. The deterioration was evident throughout the detail of the survey, with the measure of willingness to make major purchases plunging in January by a similar magnitude to during the peak of the first wave of Covid-19 last April. Income expectations were the worst since May. However, perhaps encouraged by the recent resilience in manufacturing and stability in the labour market, overall expectations about economic conditions weakened only marginally.

### French households only moderately more pessimistic

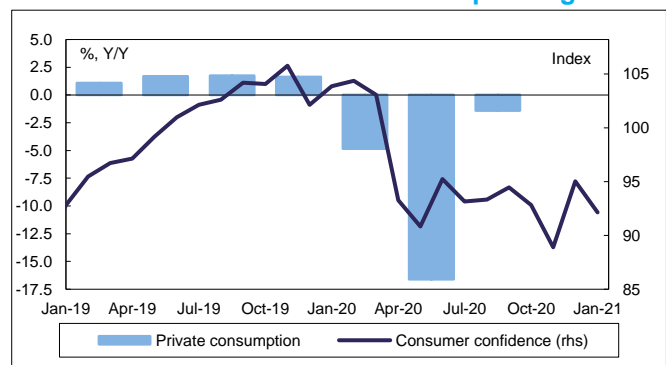
According to today's INSEE survey results, French consumer confidence also deteriorated by more than expected at the start of the year, albeit by no means as markedly as in Germany. In particular, following a rebound last month, the headline

#### Germany: Consumer confidence and spending



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### France: Consumer confidence and spending



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

French consumer confidence index fell 3pts in January to 92, back in line with the average in the three months to November. Within the detail, however, the survey reported a larger drop, of 6pts, in the share of households considering it a suitable time to make major purchases. In addition, the survey measure of savings intentions leaped 11pts back close to the series high registered at the time of the euro crisis. And household fears of unemployment rebounded too. With a tightening of French Covid-19 containment measures expected imminently, we expect a further deterioration in household sentiment next month. And today's German and French surveys certainly add to evidence of a significant drop in consumer spending at the start of 2021.

## The day ahead in the euro area

Tomorrow brings the flash estimate of German inflation in January, which is set to report a big step up due to the reversal of the temporary VAT tax cut and higher energy prices. The median forecast on the Bloomberg survey is for a jump of 1.2ppts in the EU-harmonised measure to 0.5%Y/Y. Also due tomorrow is the European Commission's sentiment survey for January, which will provide more clues on how the euro area economy is faring in the face of continued containment measures. In particular, a further fall in confidence is expected in the services sector, which remains hardest hit by the pandemic. The respective index is predicted to fall about 1pt from -17.4 in December, which was the lowest level since July and consistent with a significant pace of contraction in the sector. In contrast, the manufacturing sentiment index is expected to remain unchanged in January at -7.2, close to the levels seen before the pandemic.

## UK

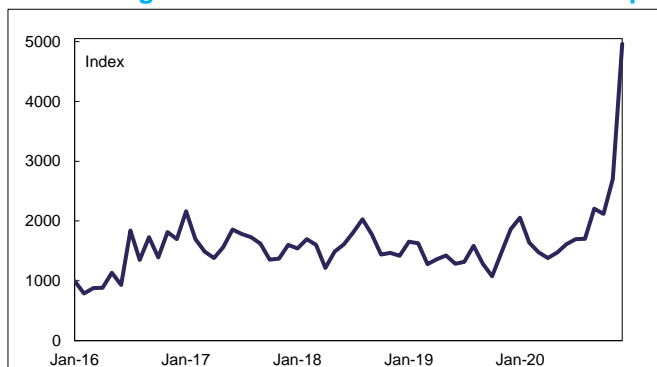
### Survey suggests weaker demand outweighs impact on prices from Brexit and shipping costs

UK retailers have faced a significant increase in costs at the start of 2021 from new barriers to trade with the EU and elevated prices for shipping goods from East Asia. However, today's BRC-Nielsen UK shop price index for January suggested that the adverse shock to demand from tighter lockdown restrictions trumped the impact of those higher costs to result in an acceleration in the pace of decline in prices on the high street. In particular, intense competition for customers prompted extra discounting in the winter sales to push the BRC's survey measure of inflation down 0.4ppt to -2.2%Y/Y, the lowest since the initial lockdown in May. With the current restrictions on non-essential stores likely to last throughout the coming month and probably for much of March, deflationary pressures seem likely to persist on the UK high street through to the spring. But while UK headline inflation will also likely remain subdued over the near term, it will take a significant step up in the second quarter, not least due to higher prices of fuel and energy as well as the reversal of last year's temporary VAT cut in the hospitality and tourism sector from 1 April. Any rebound in demand on the high street associated with a relaxation of restrictions in the spring could well accentuate that shift too.

## The day ahead in the UK

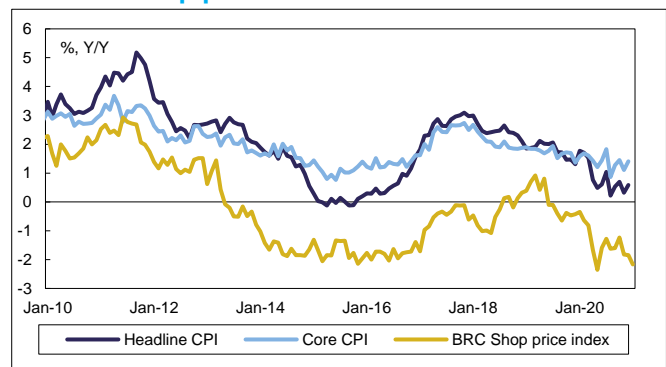
Tomorrow will be a quiet day on the UK economic data front, with no top-tier releases due.

### Ocean freight cost index: China to Northern Europe\*









\*Freightos Baltic Index (FBX). Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### UK: BRC shop price index and inflation














Source: 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
Germany	 GfK consumer confidence	Feb	-15.6	-7.9	-7.3	-7.5
France	 INSEE consumer confidence	Jan	92	94	95	-
	 Total jobseekers '000s	Q4	3574	-	3673	-
UK	 BRC shop price index Y/Y%	Jan	-2.2	-	-1.8	-
Auctions						
Country	Auction					
Germany	 sold €3.3bn of 0% 2031 bonds at an average yield of -0.54%					
UK	 sold £1bn of 0.125% 2031 index-linked bonds at an average yield of -2.82%					

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 European Commission's final consumer confidence	Jan	-15.5	-13.9	
		10.00 European Commission's economic confidence	Jan	89.5	90.4	
		10.00 European Commission's industrial confidence (services)	Jan	-7.2 (-18.3)	-7.2 (-17.4)	
Germany		13.00 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jan	0.7 (0.5)	-0.3 (-0.7)	
Italy		09.00 ISTAT economic confidence	Jan	-	87.7	
		09.00 ISTAT consumer confidence (manufacturing)	Jan	100.1 (95.8)	102.4 (95.9)	
Spain		08.00 Unemployment rate %	Q4	16.7	16.3	
Auctions and events						
EMU		17.15 ECB's Schnabel scheduled to speak				
Italy		10.00 Auction: €3.5bn of 0.5% 2026 bonds				
		10.00 Auction: €3.75bn of 0.9% 2031 bonds				
		10.00 Auction: €1.5bn of 0% 2026 floating-rate bonds				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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