

# Euro wrap-up

## Overview

- While ECB Executive Board member Panetta called for action to resist a steepening of the yield curve, the latest German economic data were soft, and Chancellor Merkel was reportedly seeking a further extension of most current German lockdown restrictions, Bunds made only modest gains.
- Gilts made significant gains ahead of tomorrow's UK Budget statement.
- Wednesday will bring data on German new car registrations and production as well as the final services PMIs, while Merkel will discuss extending Germany's lockdown with state leaders.

**Chris Scicluna**

+44 20 7597 8326

### Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.703	-0.002
OBL 0 04/26	-0.646	-0.012
DBR 0 02/31	-0.351	-0.014
UKT 0 <sup>1</sup> / <sub>8</sub> 01/23	0.039	-0.045
UKT 0 <sup>1</sup> / <sub>8</sub> 01/26	0.293	-0.053
UKT 4 <sup>3</sup> / <sub>4</sub> 12/30	0.686	-0.070

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

Source: Bloomberg

## Euro area

### Headline inflation steady in February, but core falls while energy provides upwards pressure

As expected, the flash estimate of euro area headline inflation in February was unchanged at January's eleven-month high of 0.9%Y/Y. Within the detail, inflation of non-energy industrial goods fell 0.5ppt to 1.0%Y/Y, reflecting delays to the winter sales in France and elsewhere. In addition, services inflation fell 0.2ppt to 1.2%Y/Y as lockdown restrictions again weighed on prices in the hospitality and leisure sector, not least in Spain where the winter tourism season has been inevitably hard-hit. So, core inflation fell 0.3ppt from January's five-year high to 1.1%Y/Y, still slightly above the average of the past five years. Among the more volatile items, food inflation fell 0.1ppt to 1.4%Y/Y. So, energy inflation provided the upwards pressure in the latest data, rising 2.5ppts to a twelve-month high of -1.7%Y/Y.

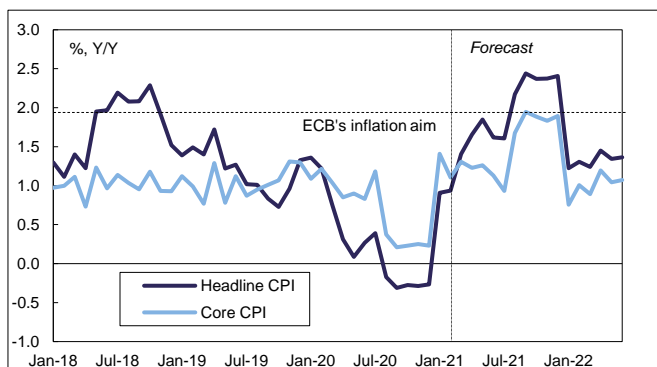
### Inflation to step up again in March, and peak through second half of 2021

Due not least to base effects associated with the sharp drop in global oil prices last Spring, energy inflation will jump sharply further over coming months and likely peak in May, when it could contribute as much as 1ppt to headline CPI inflation. Food inflation might ease further over the near term. But recent price pressures in manufacturing from commodity markets, freight costs and supply-chain disruption might be expected to push inflation of non-energy industrial goods higher. And while services inflation is likely to remain relatively steady for as long as demand remains impeded by pandemic containment restrictions, all components of inflation will take a further step up between July and December due to base effects from Germany's temporary VAT cut during those months last year. Therefore, we currently forecast headline inflation to peak close to 2½%Y/Y from September through to year-end, before roughly halving at the start of 2022. Likewise, core inflation will likely rise to about 2.0%Y/Y before falling to 1.0%Y/Y or below in the first quarter of next year.

### German retail sales fall again at start of 2021

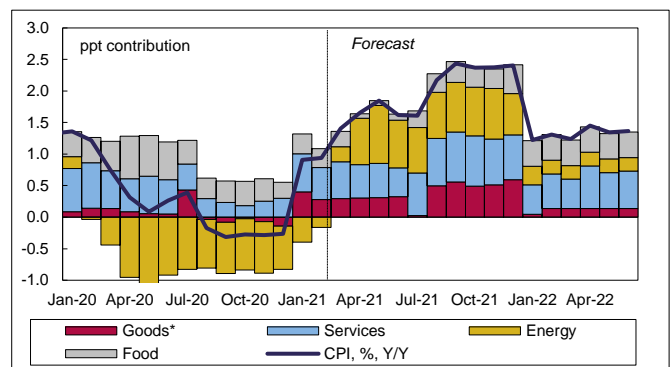
Having dropped sharply in December due to the closure of non-essential retail from the middle of that month, German retail sales were expected to be broadly stable in January. However, the reversal of last year's VAT cut from the start of the year, coupled with ongoing restrictions on activity throughout the month, took a much greater toll than expected. While the decline in December was revised to be 0.5ppt smaller than previously thought at 9.1%M/M, retail sales volumes fell a further 4.5%M/M in January to be down a hefty 8.7%Y/Y and 10.0% below the Q4 average. Even assuming some moderate recovery in February and March despite ongoing restrictions, German retail sales look set for a substantive decline well in excess of 5%Q/Q in Q1. With data last week having revealed that French spending on goods also fell close to 4½%M/M at the start of the year, the euro area retail sales figures due to be released on Thursday are also likely to report a significant decline in January, underscoring the likelihood of a notable contraction in private consumption (and GDP) this quarter.

### Euro area: Inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Inflation forecast



\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

## German unemployment rises for first time since June, Spanish unemployment up again too

The latest German labour market data were also a touch softer than expected, suggesting that the economic weakness at the start of the year has not been without consequence. While the claimant count unemployment rate was unchanged at 6.0%, the number of unemployed workers rose in February for the first time since June. The increase of 9k, however, reversed only a small part of the decrease of 37k the prior month and left the number out of work at 2.752mn, down still more than 180k from last year's peak. Of course, the ongoing support provided by the government's short-term working *kurzarbeit* scheme remains key, likely still providing support to more than 2mn jobs last month. Meanwhile, the number of job vacancies also dropped for the second month in a row in February, but remained above the average of the prior six months.

Elsewhere, unemployment in Spain also rose in February, surpassing 4.0mn on an unadjusted basis for the first time since 2016. With joblessness in Spain typically higher over the winter months, that figure exaggerated the recent deterioration in the labour market. However, on a seasonally adjusted basis, the level of unemployment still rose in February for the third month in the past four and by 20k to 3.87mn, the highest since August. On the same basis, Spanish employment dropped for the first time since April to be down 2.1%Y/Y.

### The day ahead in the euro area

Tomorrow brings the release of the final services and composite PMIs for February. With the sector still significantly affected by containment measures, the flash services sector indices suggested ongoing contraction – the euro area activity PMI dropped 0.7pt to 44.7, still above November's recent trough but slightly below the Q4 average. And the euro area composite PMI was little improved from January, up just 0.3pt to 48.1 to suggest ongoing contraction in euro area GDP at the start of the year. German car production and registration data for February are also due tomorrow. And Chancellor Merkel will discuss with German regional leaders plans to extend most of the current pandemic restrictions until 28 March.

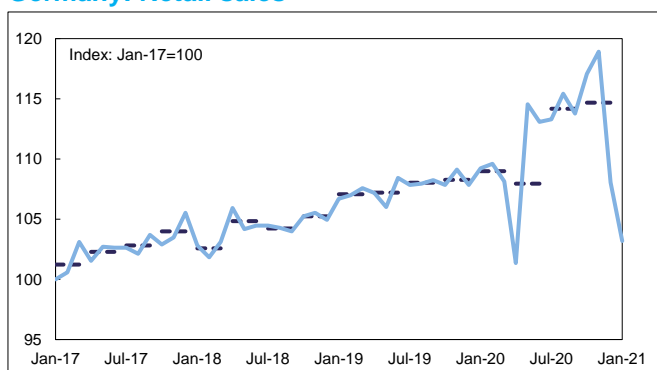
## UK

### The day ahead in the UK

All eyes in the UK tomorrow will be on Chancellor Sunak's Budget statement given the likely significant bearing on the near-term economic outlook of the new fiscal policy measures to be announced. In particular, the Government looks set to extend certain key business support programmes, including the Job Retention Scheme and loan guarantees, to better match the plans for gradual easing of lockdown restrictions through to late June. Given recent increases in oil prices, the Chancellor will probably also decide to postpone an increase in fuel duty. And decisions to extend the current hospitality VAT cut beyond end-March, and possibly reinstate the Eat Out to Help Out hospitality subsidies in the summer, would also impact the near-term inflation outlook. A decision to extend the stamp duty holiday from end-March would maintain near-term support for the housing market, while the Government is also expected to announce a mortgage guarantee scheme to assist first-time buyers. At the macro level, the Chancellor might well signal a continued desire to tighten fiscal policy, including via higher taxes on the corporate sector, once economic recovery is well underway. Given stronger revenues, the OBR will be able to revise down its forecast of borrowing in FY20/21 of £339.9bn. But while it will also likely revise up its GDP forecast for the coming fiscal year, it will likely also revise up its forecast of borrowing in FY21/22 too (from £164bn).

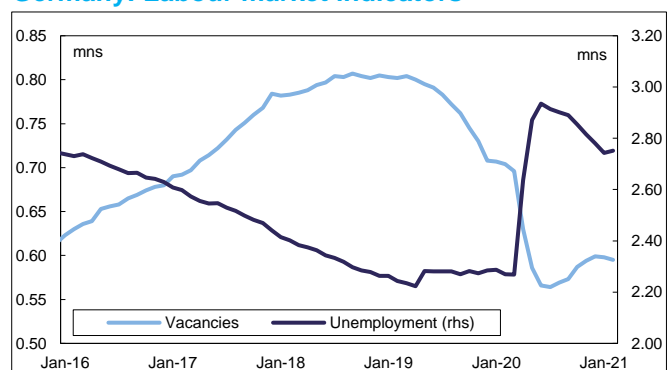
Data-wise, like in the euro area, the final UK services sector and composite PMIs for February will be published tomorrow. The flash PMIs revealed an improvement in services, suggesting a better ability of firms in the sector to cope with pandemic containment measures. Having dropped almost 10pts in January to an eight-month low of 39.5, the services activity PMI rebounded to 49.7 suggesting broad stability. And, as a result, the composite PMI rose 8.6pts to 49.8, similarly suggesting little change to overall economic output last month.

### Germany: Retail sales\*



\*Dark lines represent quarterly average. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany: Labour market indicators








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
EMU	 Preliminary CPI (core CPI) Y/Y%	Feb	<b>0.9 (1.1)</b>	1.0 (1.2)	0.9 (1.4)	-
Germany	 Retail sales M/M% (Y/Y%)	Jan	<b>-4.5 (-8.7)</b>	0.3 (1.7)	-9.1 (2.8)	-
	 Unemployment rate % (change '000s)	Feb	<b>6.0 (9.0)</b>	6.0 (-10.0)	6.0 (-41.0)	<b>6.0 (-37.0)</b>
Spain	 Unemployment change '000s	Feb	<b>44.4</b>	-10.0	76.2	-
UK	 Nationwide house price index M/M% (Y/Y%)	Feb	<b>0.7 (6.9)</b>	-0.3 (5.6)	-0.3 (6.4)	<b>-0.2 (-)</b>









#### Auctions

Country	Auction
Germany	 sold €370.25mn of 0.5% 2030 index-linked bonds at an average yield of -1.48%
	 sold €137mn of 0.1% 2046 index-linked bonds at an average yield of -1.29%
UK	 sold £3.0bn of 0.375% 2026 bonds at an average yield of 0.454%
	 sold £1.25bn of 0.5% 2061 bonds at an average yield of 1.261%







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	 09.00	Final services (composite) PMI	Feb	44.7 (48.1)	45.4 (47.8)
	 10.00	PPI Y/Y%	Jan	-0.4	-1.1
Germany	 08.55	Final services (composite) PMI	Feb	45.9 (51.3)	46.7 (50.8)
	-	New car registrations* Y/Y%	Feb	-	-31.1
France	 08.50	Final services (composite) PMI	Feb	43.6 (45.2)	47.3 (47.7)
Italy	 08.45	Services (composite) PMI	Feb	45.0 (59.9)	44.7 (47.2)
Spain	 08.15	Services (composite) PMI	Feb	42.6 (44.7)	41.7 (43.2)
UK	 00.01	BRC shop price index Y/Y%	Feb	-	-2.2
	 09.30	Final services (composite) PMI	Feb	49.7 (49.8)	39.5 (41.2)

#### Auctions and events

EMU	 13.00	ECB's Panetta scheduled to speak
	 15.00	ECB's de Guindos scheduled to speak
	 19.30	ECB's Schnabel scheduled to speak
Germany	 10.30	Auction: €3bn of 0% 2036 bonds
UK	 12.30	Chancellor Sunak to deliver the Budget
	 16.00	BoE's Tenreyro scheduled to speak on negative rate policies

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

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