

Euro wrap-up

Overview

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- With ECB net PEPP purchases settled in the past week edging down again, to €11.9bn, Bunds made losses despite some weaker-than-expected German industrial production data.
- Gilts were little changed as BoE Governor Bailey emphasised the uncertainty of the UK economic outlook and insisted that all monetary policy tools – including more QE and negative rates – remain on the table.
- Tuesday will bring an updated estimate of euro area Q4 GDP along with its expenditure components, Italian IP data, and a UK retail sales survey.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.691	+0.010
OBL 0 04/26	-0.600	+0.021
DBR 0 02/31	-0.282	+0.023
UKT 0 ¹ / ₈ 01/23	0.083	+0.002
UKT 0 ¹ / ₈ 01/26	0.349	-0.008
UKT 4 ³ / ₄ 12/30	0.749	-0.004

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

Source: Bloomberg

Euro area

German IP held back by autos and construction at the start of the year

German industrial production in January fell a sharper-than-expected 2.5%M/M to be down 3.9%Y/Y, 4.2% below the pre-pandemic level in February 2020 and 0.7% below the Q4 average. Excluding energy and construction, production fell a relatively modest 0.5%M/M, with further growth in intermediate items (up 3.0%M/M) offset by declines in output of capital goods (-0.8%M/M) and consumer goods (-3.0%M/M). Within the detail, production of machinery jumped almost 10%M/M to above the pre-pandemic level. But supply-chain issues weighed on auto output, which fell 12.1%M/M to the lowest since August. And chemicals and pharmaceuticals (both down a little more than 2%M/M) were among other sub-sectors to shift output growth into reverse at the start of the year. Beyond manufacturing, energy output rose 0.6%M/M. But having leapt more than 5%M/M in December to a series high, construction dropped 12.2%M/M to a two-year low, likely weighed by the reversal of the temporary VAT cut.

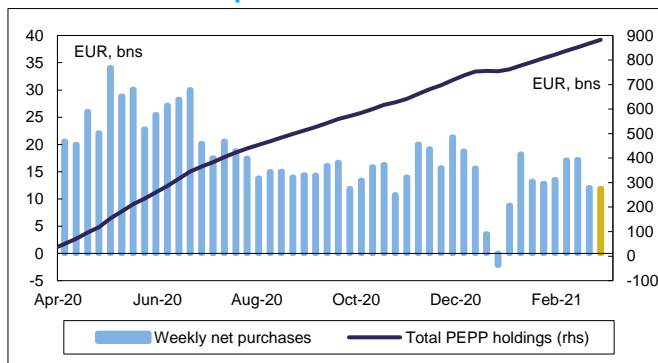
German manufacturing set to resume uptrend in February

Most recent data point to a rebound in German manufacturing in February and sustained growth beyond. For example, new [factory orders](#) rose more than expected in January, increasing 0.8% above the Q4 average and 3.7% above the pre-pandemic level. In addition, the manufacturing output PMI rose more than 3pts last month to a three-month high of 62.2, with the new orders PMI up similarly. And the ifo manufacturing expectations index rose in February to the highest since April 2018, with notable improvement in autos, electrical equipment, machinery and chemicals. Weakness in production expectations was principally concentrated in textiles. Meanwhile, in contrast to most manufacturing sub-sectors, the outlook for German construction appears to remain subdued.

Spanish industrial production also drops in January

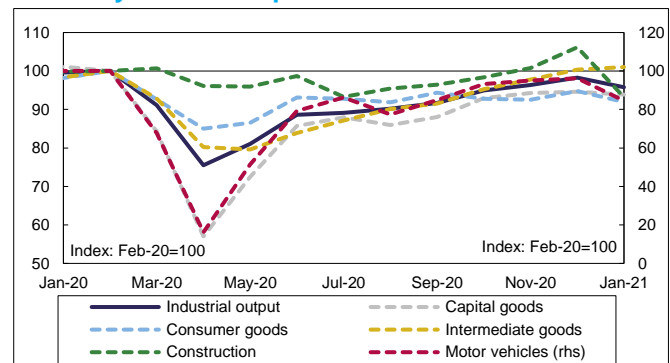
Elsewhere in the euro area, Spanish industrial production also started the year on a soft note dropping 0.7%M/M to be down 6.9%Y/Y, 2.0% below the pre-pandemic level in February 2020 and 0.5% below the Q4 average. Manufacturing output fell 1.0%M/M with declines in output of consumer, intermediate and capital goods alike as well as energy. Given the harsh winter weather, Spanish construction output is likely to have dropped sharply. Elsewhere, the January industrial production figures are due for release from Italy, France and the euro area tomorrow, Wednesday and Friday respectively.

ECB: PEPP asset purchases



*Net PEPP purchases settled in the week to 5 March 2021 highlighted in gold.
Source: ECB and Daiwa Capital Markets Europe Ltd.

Germany: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

Tuesday will bring the release of final euro area Q4 GDP figures. Despite some revisions in various member states, these are expected to confirm the preliminary estimates (-0.7%Q/Q and -5.1%Y/Y). The expenditure breakdown of euro area Q4 GDP, to be published for the first time, is likely to show that household consumption 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. Tomorrow also sees the release of Italian industrial production data for January, which are expected to reveal a modest 0.8%M/M increase in output, albeit leaving it down 4.1%Y/Y. While today's weaker-than-expected German and Spanish IP data suggest that aggregate euro area output may have fallen further in January, survey and new orders indicators suggest that a renewed pick-up in manufacturing activity is highly likely over coming months. Meanwhile, German goods trade figures, also to be published tomorrow, will highlight the impact of the end of the Brexit transition, with preliminary data having suggested a drop in the value of exports to the UK of about 30%Y/Y, similar to the steep hit registered in [France](#).

UK

Bailey emphasises uncertainty of the outlook for monetary policy

While it was a quiet start to the week for economic data from the UK, BoE Governor Bailey underscored the uncertainty of the outlook for the UK's economy and monetary policy in a speech to the Resolution Foundation. Among other things, he judged that the extension of government support measures announced in last week's Budget would probably lead the BoE to revise down its projection for the unemployment rate, which it had last month projected to peak at around 7¾% in the middle of 2021. But he still saw risks to be skewed, on balance, to the downside. He also emphasised the difficulty of predicting, over both the near term and further ahead, the paths for demand, supply and the output gap. While he was relatively sanguine that the degree of longer-term scarring from Covid-19 might be relatively modest, he was cautious about the extent to which pent-up consumer demand might be released over coming quarters, and recalled that business investment had been extremely weak in the years ahead of the pandemic. He also appeared skeptical that any near-term burst of inflation might be sustained into the medium term.

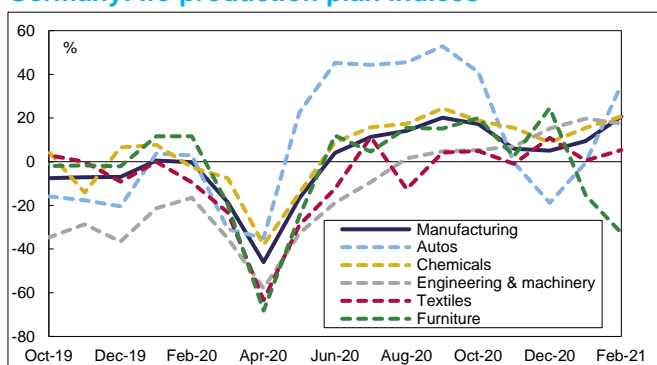
All policy tool options left open

From the perspective of monetary policy, Bailey unsurprisingly reiterated the MPC's (still-dovish) forward guidance, i.e. that the "Committee does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably" and "If the outlook for inflation weakens the Committee stands ready to take whatever additional action is necessary to achieve its remit." In the circumstances whereby additional monetary policy support might eventually be judged to be necessary, he emphasised that the precise tool to be used would depend on the circumstances. If the inflation outlook weakened due to an undesirable tightening of financial conditions, which might feasibly be related to spillovers from events in the UST market, then extra QE – on top of the current programme set to last until near year-end – might be preferred. But if the weakening of the inflation outlook was due to alternative causes, a reduction of Bank Rate into negative territory might yet be warranted. And in this case, Bailey repeated that ECB evidence suggested that such a policy might be most potent in boosting business investment in an upswing phase. Of course, for the time being, additional monetary easing would appear highly unlikely. And so, the outcome of the BoE's ongoing review of its strategy for an eventual tightening of monetary policy, if and when required in the future, is likely to be a key focus for the Gilt market over coming months.

The day ahead in the UK

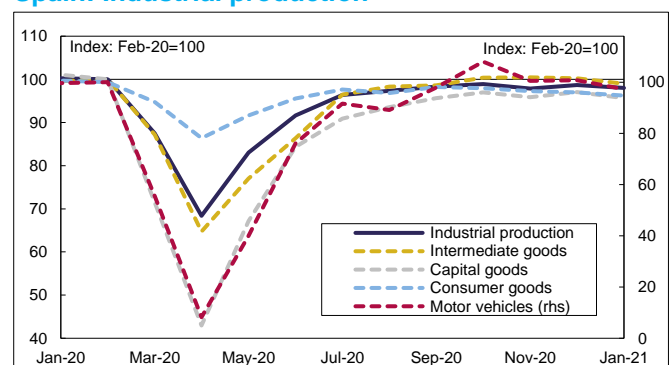
Looking ahead, tomorrow brings the release of the BRC retail sales survey for February, which will give an update on spending at major high-street retailers against the backdrop of the ongoing closure of non-essential stores last month.

Germany: ifo production plan indices*



*Production plans for the coming six months. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Spain: Industrial production






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	 Sentix investor confidence	Mar	5.0	1.4	-0.2	-
Germany	 Industrial production M/M% (Y/Y%)	Jan	-2.5 (-3.9)	-0.4 (-3.7)	0.0 (-1.0)	1.9 (1.0)
Spain	 Industrial production M/M% (Y/Y%)	Jan	-0.7 (5.0)	-0.5(-0.6)	1.1 (-0.2)	0.8 (-)








Auctions

Country	Auction
- Nothing to report -	



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 Final GDP Q/Q% (Y/Y%)	Q4	-0.6 (-5.0)	12.4 (-4.3)
		10.00 Final employment Q/Q% (Y/Y%)	Q4	0.3 (-2.0)	1.0 (-2.3)
Germany		07.00 Trade balance €bn	Jan	14.5	15.2
France		06.30 Final private sector payrolls Q/Q%	Q4	-0.2	1.6
		- Bank of France industrial sentiment*	Feb	99	98
Italy		09.00 Industrial production M/M% (Y/Y%)	Jan	0.8 (-4.1)	-0.2 (-2.0)
UK		00.01 BRC retail sales monitor Y/Y%	Feb	-	7.1

Auctions and events

EMU		10.00 OECD publishes interim Economic Outlook
UK		10.00 Auction: £2.25bn of 1.25% 2041 bonds

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

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