Daiwa Capital Markets

# Euro wrap-up

## Overview

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- Bunds followed USTs higher while German exports maintained their uptrend, a business survey suggested modest growth in French economic activity in Q1, and data showed that investment rose in the euro area in Q4.
- Gilts also made gains while a survey suggested positive growth in UK retail sales in February.
- Ahead of Thursday's ECB policy meeting, tomorrow will bring French industrial production data.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 0 03/23 | -0.692 | +0.000 |
| OBL 0 04/26 | -0.613 | -0.015 |
| DBR 0 02/31 | -0.305 | -0.025 |
| UKT 0⅛ 01/23 | 0.070 | -0.016 |
| UKT 0⅛ 01/26 | 0.325 | -0.026 |
| UKT 4¾ 12/30 | 0.722 | -0.030 |

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

# Euro area

### German exports maintain uptrend at the start of the year

While yesterday's German IP data for January were disappointing, with production in autos seemingly weighed by supply-chain issues and construction activity hit by the end of the VAT cut and weather, today's goods trade data showed that the uptrend in German exports remained intact at the start of the year. In particular, the value of exports rose 1.4%M/M in January to be 2.4% above the Q4 average. While they were still down some 8.0%Y/Y, exports were nevertheless still at the highest since the pre-pandemic level in February last year, albeit down 3.3% from that benchmark. Exports to other EU member states were down 6.0%Y/Y with those to the US down a similar 6.2%Y/Y. In contrast, exports to China were up 3.1%Y/Y. The end to the Brexit transition saw German exports to the UK fall 29.0%Y/Y.

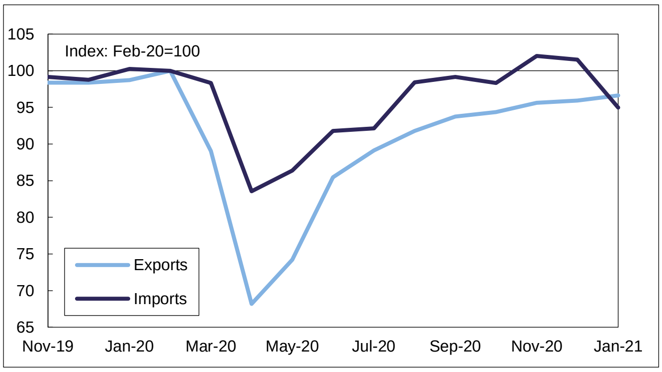
### Imports plunge on Brexit effect, German trade surplus highest since 2017

In contrast to the continued growth in exports, German goods imports fell 4.7%M/M to be down 9.8%Y/Y, 3.4% below the Q4 average and 5.2% below the pre-pandemic level. Brexit was the main culprit, with imports from the UK down an extraordinary 56.2%Y/Y and one quarter below the post-pandemic trough last April. However, imports from the US were down a steep 22.8%Y/Y while those from other EU countries were down 5.9%Y/Y. In contrast, imports from China rose 1.1%Y/Y. Adjusted for prices, while export volumes rose for the ninth successive month and by 0.7%M/M, imports dropped 6.4%M/M to the lowest level since July. Germany's trade surplus on a seasonally-adjusted basis rose €5.8bn to €22.2bn, the highest since November 2017 reinforcing the message that net trade made a positive contribution to German GDP growth at the start of the year. And looking forward, with the reopening of the US and UK economies proceeding ahead of Germany, and Asian demand also likely to remain firm, we expect external demand to continue to support economic growth over coming quarters.

### Bank of France survey points to stable output in February and March

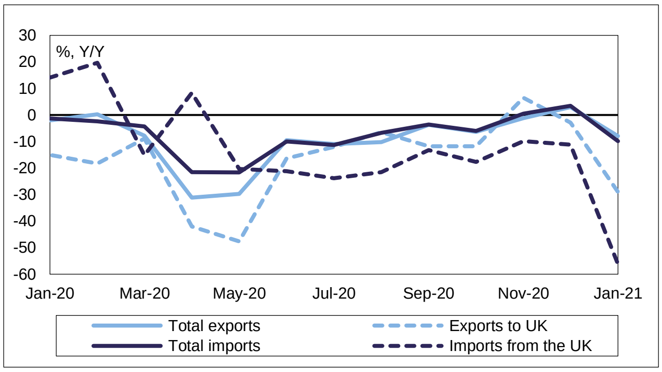
Based on its latest business survey, the Bank of France estimates that the level of French economic activity was broadly unchanged in February from the prior month, still running some 5% below "normal" levels of capacity, as the 6pm curfew continued and additional restrictions were imposed on certain regions. Nevertheless, some sub-sectors reported positive growth last month. In manufacturing, output of machinery and equipment, as well as electrical items, was firmer. In contrast, production in aerospace, autos and other transport goods remained subdued. While hospitality remained very weak, certain other services, in particular business services, saw growth. And construction output was also firmer, seemingly back close to

**Germany: Goods trade volumes**




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

**Germany: Goods trade values**




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

its pre-pandemic level. Judging from its survey responses, the Bank of France expects March to see further modest growth in industry (including among manufacturers of chemicals and electrical equipment) and construction but little change in services. And, overall, it expects total economic output to be little changed this month from February, still about 5% below "normal" levels and down about 4%Y/Y. That, however, would leave GDP up slightly in Q1 compared to Q4.

## Drop in euro GDP in Q4 led by household consumption but investment continued to grow

The updated euro area GDP data for Q4 saw minimal revisions from the prior estimates. GDP is now estimated to have contracted 0.7%Q/Q last quarter, just 0.1ppt more than previously thought and still significantly less than the drop of 2.2%Q/Q forecast by the ECB in December. The contraction in Q4 followed the record rebound in Q3 of 12.5%Q/Q, but left GDP still down 4.9%Y/Y in the fourth quarter and down 6.6%Y/Y over 2020 as a whole. Of greatest interest in these data was the expenditure breakdown, which was published for the first time. This confirmed that the dip in GDP in Q4 was more than fully explained by household consumption, which fell 3.0%Q/Q to subtract 1.6ppts from growth as non-essential retail and many services closed. In marked contrast, fixed capex rose 1.6%Q/Q, adding 0.3ppt to GDP growth, with investment in dwellings, machinery and equipment, and intellectual property all rising. Inventories added 0.6ppt to growth while government consumption added 0.1ppt. But net trade subtracted 0.1ppt as growth in imports (4.1%Q/Q) outpaced that of exports (3.5%Q/Q). We currently expect to see a contraction of a similar magnitude in Q1 before growth resumes from Q2 on as the pandemic wanes and economies reopen more substantially.

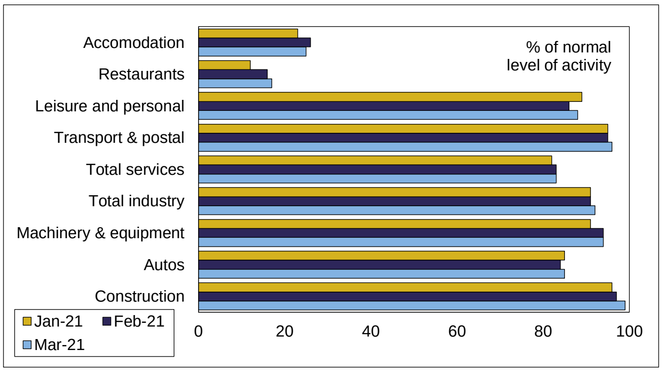
## The coming two days in the euro area

The flow of manufacturing output data continues tomorrow with the latest figures from France due to be published. French industrial output is expected to have risen a modest 0.5%M/M in January leaving it 2.8% lower compared to a year earlier. Today's Italian IP data were firm, reporting growth of 1.0%M/M thanks not least to a pickup in autos (3.2%M/M), machinery and equipment (2.2%M/M) and electrical items (4.6%M/M). Nevertheless, given the softness in the German and Spanish figures reported yesterday, the euro area measure – out on Friday – is also likely to have posted a modest drop. More promisingly, however, survey and new orders indicators suggest that a renewed pick-up in manufacturing activity is highly likely over coming months.

Thursday brings the main event of the week in the shape of the latest ECB Governing Council policy meeting. This will provide an opportunity for the policymakers to send a clearer message to investors about the recent bond market sell-off. Despite some differences of opinion, there has already been a good deal of commonality of opinion expressed by the various Governing Council members over recent weeks. For example, the policymakers recognize the importance of maintaining highly accommodative financial conditions to increase the chances of pushing inflation higher on a sustainable basis. And they also acknowledge that maintaining relatively low nominal and real sovereign yields will be necessary (if not sufficient) to maintain such accommodative financial conditions. At the same time, recent PEPP purchase data suggest no overwhelming desire to bear down on yields just yet. Net purchases settled in the week to 5 March, at €11.9bn, were the lowest since 8 January. However, that partly reflected increased redemptions, of €6.3bn, while gross purchases picked up by €1.3bn from the prior week to €18.9bn.

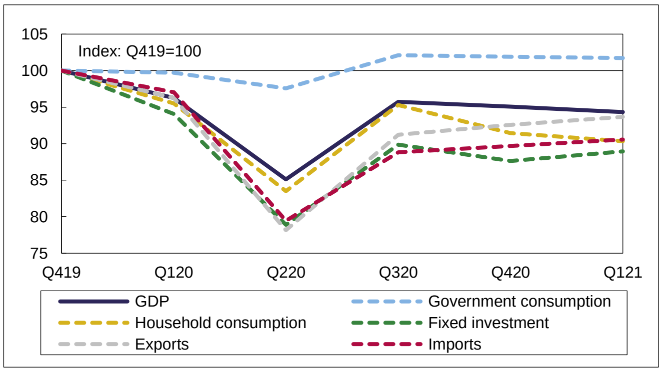
Indeed, the ECB will not be panicking. Despite recent evidence of a tightening of credit standards on bank loans, overall financial conditions remain highly accommodative by historical standards, while the GDP-weighted yield curve remains well below its level before the pandemic struck. The Governing Council will welcome the recent upwards shift in financial market inflation expectations as well as the modest weakening of the euro against the US dollar. And the ECB's updated economic projections will also suggest that it doesn't need suddenly to change course with policy. Today's data confirmed that euro area GDP fell less than the Bank expected in Q4. And while a contraction is now highly likely in Q1 (unlike the growth of 0.6%Q/Q forecast by the ECB), the GDP outlook ahead might be revised up thanks to the more favourable outlook for external demand. Indeed, we expect only a modest downwards revision to the forecast for GDP growth this year (currently 3.9%Y/Y) but a modest upwards revision to the forecast for 2022 (4.2%Y/Y). Moreover, the ECB's current forecast for

### France: Economic activity




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: GDP and expenditure components




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

inflation this year (1.1%Y/Y) is now clearly far too low while the forecasts for the following two years (1.1%Y/Y and 1.4%Y/Y) appear to merit little revision.

So, policy-wise, we probably should not expect a great deal this week. In her press conference, Lagarde will certainly signal that the ECB is mindful of the risks that excessive increases in yields might cause an undesirable and unwarranted tightening of financial conditions, which could ultimately undermine its ability to achieve its inflation target. So, she will likely state that the ECB will monitor financial market developments closely and emphasise a readiness to adjust all policy tools in future if necessary. She will also likely signal the ECB's willingness to accelerate purchases under the PEPP programme, albeit within the current envelope, if required to maintain accommodative financial conditions.

# UK

## BRC and Barclaycard data point to improved retail sales in February

While non-essential stores remained closed in the UK – and indeed will continue to do so in England until 12 April – some second-tier data point to a pickup in retail sales in February following the steep drop (8.2%M/M on the official ONS figures) at the start of the year. According to the BRC, total sales were up 1.0%Y/Y last month having dropped 1.3%Y/Y in January. And many of the spending trends of the lockdown periods featured again. Unsurprisingly, online sales remained historically high. And spending on non-food items for the home, including technology and furniture, accelerated again too. Spending on school uniforms jumped ahead of the reopening of classrooms this week, raising hopes for clothing sales ahead. Meanwhile, expenditure on food – a repeated source of strength during the pandemic – was also up again according to the BRC. Barclaycard data similarly reported strong growth in food and drink sales last month, as well as increased spending on items for the home and DIY. But expenditure on services remained impacted by restrictions on leisure and hospitality. So, the Barclaycard measures of overall consumer spending was down a steep 13.8%Y/Y in February, still an improvement on the 16.3%Y/Y drop in January.

## The coming two days in the UK

The middle of the week is quiet in terms of UK economic data, with no key releases scheduled for tomorrow. On Thursday, the RICS will publish its residential property survey for February.

***The next edition of the Euro wrap-up will be published on 11th March 2021***

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# European calendar

## Today's results

**Economic data**

| Country | Release | Period | **Actual** | Market consensus/ *Daiwa forecast* | Previous | Revised |
|---|---|---|---|---|---|---|
| EMU | Final GDP Q/Q% (Y/Y%) | Q4 | **-0.7 (-4.9)** | -0.6 (-5.0) | 12.4 (-4.3) | **12.5 (-4.2)** |
| | Final employment Q/Q% (Y/Y%) | Q4 | **0.3 (-1.9)** | 0.3 (-2.0) | 1.0 (-2.3) | **1.0 (-2.1)** |
| Germany | Trade balance €bn | Jan | **14.3** | 14.5 | 15.2 | - |
| France | Final private sector payrolls Q/Q% | Q4 | **-0.1** | -0.2 | 1.6 | **1.7** |
| | Bank of France industrial sentiment index | Feb | **99** | 99 | 98 | - |
| Italy | Industrial production M/M% (Y/Y%) | Jan | **1.0 (-2.4)** | 0.8 (-4.1) | -0.2 (-2.0) | **0.2 (-1.6)** |
| UK | BRC retail sales monitor Y/Y% | Feb | **9.5** | - | 7.1 | - |

**Auctions**

| Country | Auction |
|---|---|
| UK | sold £2.25bn of 1.25% 2041 bonds at an average yield of 1.223% |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Tomorrow's releases

**Economic data**

| Country | GMT | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|
| France | 07.45 | Industrial production M/M% (Y/Y%) | Jan | 0.5 (-2.8) | -0.8 (-3.0) |
| | 07.45 | Manufacturing production M/M% (Y/Y%) | Jan | 1.8 (-) | -1.7 (-3.6) |
| Italy | 10.00 | PPI Y/Y% | Jan | - | -2.3 |

**Auctions and events**

| Country | GMT | Event |
|---|---|---|
| Germany | 10.30 | Auction: €4bn of 0% 2026 bonds |
| UK | 10.00 | Auction: £800mn of 0.125% 2031 index-linked bonds |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Thursday's releases

**Economic data**

| Country | GMT | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|
| EMU | 12.45 | ECB main refinancing rate % | Mar | *0.00* | 0.00 |
| | 12.45 | ECB marginal lending facility % | Mar | *0.25* | 0.25 |
| | 12.45 | ECB deposit facility rate % | Mar | *-0.50* | -0.50 |
| Germany | 07.00 | Labour costs Q/Q% (Y/Y%) | Q4 | - | -1.7 (1.7) |
| UK | 00.01 | RICS house price balance % | Feb | 45 | 50 |

**Auctions and events**

| Country | GMT | Event |
|---|---|---|
| EMU | 12.45 | ECB monetary policy announcement |
| | 13:30 | ECB President Lagarde holds press conference |
| Italy | 10.00 | Auction: index-linked bonds |
| | 10.00 | Auction: 3Y and 7Y fixed-rate bonds |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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