

# Euro wrap-up

## Overview

- Euro area government bonds made losses as data confirmed a further rise in industrial production in the region at the start of the year.
- Gilts followed USTs sharply lower as UK GDP dropped by less than feared in January but exports to the EU fell at a record pace.
- The coming weeks brings the latest announcement from the BoE as well as updates on euro area goods trade, construction output and inflation.

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### Daily bond market movements

| Bond                                    | Yield  | Change |
|---|--------|--------|
| BKO 0 03/23                             | -0.696 | +0.004 |
| OBL 0 04/26                             | -0.617 | +0.018 |
| DBR 0 02/31                             | -0.298 | +0.038 |
| UKT 0 <sup>1</sup> / <sub>8</sub> 01/23 | 0.090  | +0.028 |
| UKT 0 <sup>1</sup> / <sub>8</sub> 01/26 | 0.379  | +0.061 |
| UKT 4 <sup>3</sup> / <sub>4</sub> 12/30 | 0.823  | +0.091 |

\*Change from close as at 4:00pm GMT.

Source: Bloomberg

## Euro area

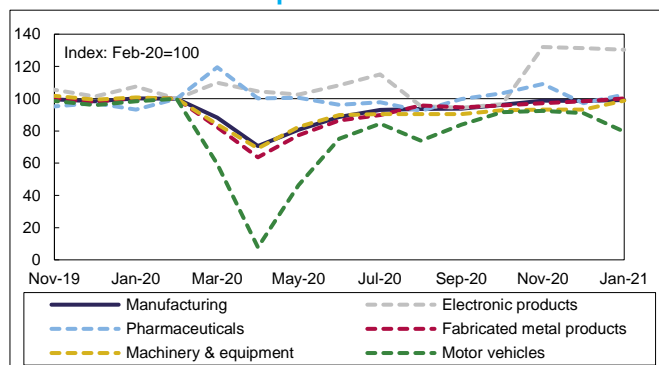
### Euro area IP posts first year-on-year rise since October 2018

On a relatively quiet end to the week, data confirmed that euro area industrial production (excluding construction) rose 0.8%M/M in January, with manufacturing output up 0.6%M/M. This left industrial production up 0.1% compared to a year earlier, marking the first Y/Y increase since October 2018, albeit still leaving it 5.1% below the peak level recorded in December 2017 and 0.4% lower than the pre-pandemic level in February 2020. Within the detail, growth in output was broad-based. Production of durable consumer goods rose 0.8%M/M, after having risen 1.2%Q/Q in Q4, while production of non-durable consumer goods was up 0.6%M/M, following a fall of 0.3%Q/Q in Q4. Output of capital goods rose 0.4%M/M, after rising 7.8%Q/Q in Q4, leaving it 1.4% higher compared with February 2020's pre-Covid level. Intermediate goods production was up 0.3%M/M, compared with 5.8%Q/Q in Q4. In particular, a 6.0%M/M jump in production of machinery equipment together with a 4%M/M increase in the production of electrical equipment contributed with gains elsewhere to offset a steep drop of 12.5%M/M in the manufacture of autos. Among the member states, increases in production were confirmed in France (+3.4%M/M) and Italy (1.0%M/M), as were modest falls in Germany (-0.4%M/M) and Spain (-0.7%M/M). Survey indicators and new orders data paint an optimistic picture for the coming months supported by both rising external demand expectations and firmer domestic demand as economies gradually reopen from lockdown. The euro area output PMI was revised up slightly to 57.6 in February, a four-month high. And the manufacturing new orders PMI was confirmed at 57.8, similarly up 3pts on the month and the highest since October.

### The week ahead in the euro area

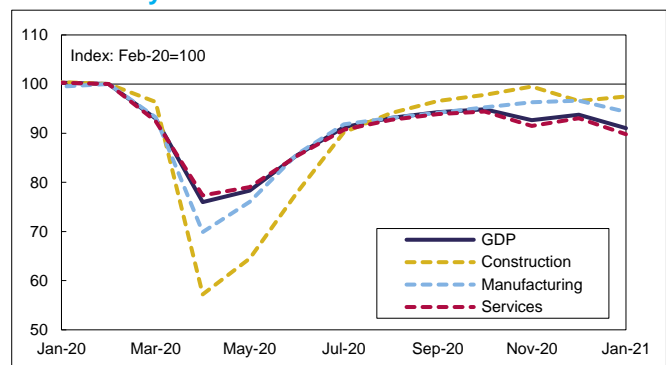
The coming week will be relatively quiet on the euro area economic data front, with little in the way of market-moving releases scheduled. After a very quiet start to the week, French and Italian final CPI data are due for release on Tuesday, followed by the aggregate euro area numbers on Wednesday. The flash estimate of euro area headline inflation was unchanged at January's eleven-month high of 0.9%Y/Y, as upwards pressure from higher energy prices offset the reversal of certain other temporary factors. So, core inflation fell back 0.3ppt from January's five-year high to 1.1%Y/Y. Meanwhile, the ZEW investor sentiment survey for March (out on Tuesday) is expected to report further improvement in the current assessment and expectations balances as the German government edges towards a gradual easing of lockdown measures. The Bank of France will also publish its retail sales survey results for February on Tuesday, while Wednesday brings the release of EU-27 new car registrations data for February and euro area construction output figures for January. On Thursday, euro area trade data for January will reveal the extent to which weakness in imports from and exports to the UK has been offset by flows to and from elsewhere.

### Euro area: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: GDP by sector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

## UK

### Drop in GDP in January less marked than feared

The decline in UK economic output at the start of the year as pandemic containment restrictions were tightened was not quite as sharp as had been feared. Nevertheless, following growth of 1.2%M/M in December, GDP fell a non-negligible 2.9%M/M in January to be 9.0% below the pre-pandemic level in February 2020 and 4.0% below the initial recovery peak last October. Services activity fell 3.5%M/M weighed by renewed declines in consumer-facing services (not least retail and hospitality) and education, with healthcare (including coronavirus vaccinations and test-and-trace) providing some offset. That left services activity down 10.2% from the pre-pandemic level and 4.9% below October's peak. Production sector activity fell 1.5%M/M as manufacturing output dropped 2.3%M/M, marking the first decline since April, with motor vehicles down a steep 16.9%M/M. So, manufacturing output was still 5.0% below the February 2020 level with production of autos down more than 13% from that date. But construction activity provided modest offset, rising 0.9%M/M in January, albeit still 2.6% below the pre-pandemic benchmark.

### Record drop in trade flows following end to Brexit transition

January's trade data highlighted the impact of the end of the Brexit transition, which prompted the steepest monthly declines in exports and imports on the series dating back to 1997. Goods exports (excluding non-monetary gold etc.) fell by a hefty £5.3bn (19.3%M/M) due to a plunge of £5.6bn (40.7%M/M) in exports to the EU. Goods imports on the same basis fell by £8.9bn (21.6%M/M) due to a drop of £6.6bn (28.8%M/M) in imports from the EU. Shipments in both directions of cars, chemicals, and pharmaceuticals were particularly affected. Goods imports from non-EU countries also declined markedly in January, down £2.4bn (12.7%M/M) while exports beyond the EU edged up £0.2bn (1.7%M/M). Meanwhile, imports of services fell just £0.3bn (2.4%M/M) while exports of services fell £0.2bn (0.9%M/M), with travel, other business services and transport most affected. So, despite the whack to shipments to the EU, the total trade deficit (excluding non-monetary gold etc.) narrowed by £3.7bn to £1.9bn, with the decline in total imports of £9.2bn (17.6%) exceeding the drop in total exports of £5.5bn (11.8%M/M). Given the marked volatility in prior months, however, the total trade deficit on a three-month basis widened by £6.7bn to £12.8bn with imports up £2.4bn (1.7%3M/3M) but exports down £4.3bn (3.1%3M/3M).

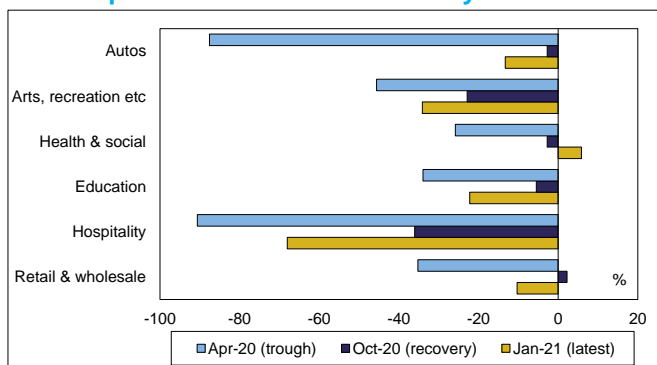
### Several factors weighed on shipments in January

The new barriers to trade with the EU imposed as a consequence of the end-year agreement hit exports in a number of sectors in January – e.g. exports of food and live animals to the EU (including the politically sensitive seafood sector) fell 63.6%M/M as stricter checks and certifications were imposed. But the sharp drop in trade flows in both directions also reflects payback for stockpiling ahead of the end of the transition, and the impact on demand from lockdowns both sides of the English Channel, as well as global supply-chain disruptions. High-frequency data points to some degree of rebound in flows in February. However, there are reasons to believe that the rebound in UK imports will outpace that of exports, as many of the UK's customs checks on imports from the EU have yet to be implemented while most of the EU's checks on imports from the UK were implemented from the start of the year.

### UK GDP to pick up in February and accelerate thereafter

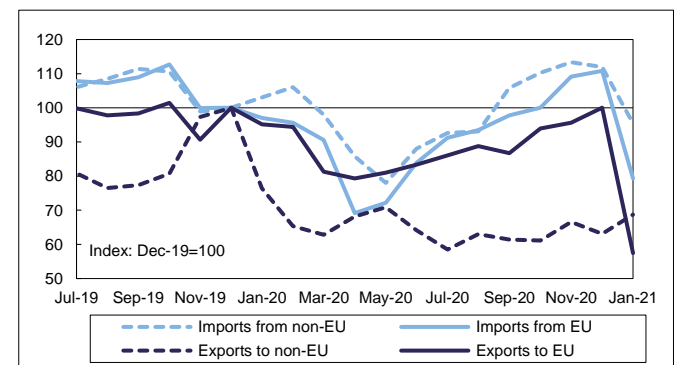
Even if, as we assume, the UK's trade deficit blows out again, UK GDP should pick up slightly in February and accelerate in March with the gradual easing of restrictions, not least the reopening of schools from the start of the month. So, the BoE's latest forecast of a contraction in GDP of a little more than 4%Q/Q in Q1 looks too downbeat – we now expect a drop of a little less than half that amount. And with more than one third of adults already vaccinated, non-essential stores scheduled to reopen from early April and a full reopening penciled in for late June, while government support is tapered gradually, GDP should rebound firmly in Q2 and Q3. With business investment incentives set to give an extra boost too, GDP growth close to 5%Y/Y in 2021 and more than 6½%Y/Y appears achievable.

#### UK: Output deviations from February 2020 level



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Goods trade values



Source: ONS, Refinitiv and Daiwa Capital Markets Europe Ltd.
















## The week ahead in the UK

The main event in the UK in the coming week will be the BoE's latest monetary policy announcement on Thursday. Since the BoE published forecasts following its previous MPC meeting on 4 February, economic activity appears to have been somewhat firmer than it expected. But inflation at the start of the year was broadly in line with the Bank's expectation. And while Gilt yields are up significantly since then – with the 10Y yield today about 40bps higher from just before the MPC's February announcement – the near-term path for fiscal policy will be materially more supportive than the BoE had assumed in its forecast. So, the unemployment profile will also likely undershoot the path set out in the BoE's projection. And while [Governor Bailey](#) recently emphasised the significant uncertainty surrounding the economic outlook, the overall shape of the BoE's forecasts for the coming couple of years – with GDP rising above the pre-Covid level early in 2022 and inflation returning close to the 2.0%Y/Y target this year and remaining thereabouts – still appears valid.

So, there will certainly be no change to policy at the coming MPC meeting. And while markets will no doubt watch closely any commentary about bond market developments, the MPC's forward guidance will be left unchanged too, i.e. stating that "If the outlook for inflation weakens the Committee stands ready to take whatever additional action is necessary to achieve its remit" and 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." Data-wise, the coming week will be very quiet in the UK with no show-stopping releases scheduled. Indeed, the calendar is empty until Friday when the GfK consumer confidence survey for March will be published, along with public finances data for February. A modest improvement in the headline consumer confidence indicator is expected, to -20 in March, albeit leaving it some way off the level recorded in the same month last year as the pandemic built up steam (-9). Meanwhile, public sector net borrowing (excluding banks) is expected to come in at £23.0bn in February, up from just £1.4bn a year earlier but down from the high of £47.2bn in April last year.

*The next edition of the Euro wrap-up will be published on 17<sup>th</sup> March 2021*

## Daiwa economic forecasts

|                           |   | 2020  | 2021  |       |       |       | 2022  | 2020  | 2021  | 2022  |
|---------------------------|---|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                           |   | Q4    | Q1    | Q2    | Q3    | Q4    | Q1    |       |       |       |
| <b>GDP growth, %, Q/Q</b> |   |       |       |       |       |       |       |       |       |       |
| Euro area                 |  | -0.7  | -0.8  | 1.4   | 1.4   | 1.3   | 1.1   | -6.8  | 3.5   | 4.4   |
| Germany                   |  | 0.3   | -1.0  | 1.2   | 1.2   | 1.2   | 1.0   | -5.3  | 2.5   | 4.0   |
| France                    |  | -1.4  | -0.5  | 1.2   | 1.4   | 1.2   | 1.2   | -8.2  | 5.0   | 4.5   |
| Italy                     |  | -1.9  | -0.5  | 1.5   | 1.5   | 1.4   | 1.2   | -8.9  | 4.0   | 4.7   |
| Spain                     |  | 0.4   | -1.0  | 1.5   | 1.4   | 1.2   | 1.2   | -11.0 | 3.9   | 5.0   |
| UK                        |  | 1.0   | -2.0  | 3.1   | 2.7   | 2.2   | 1.5   | -9.9  | 4.9   | 6.6   |
|                           |   |       |       |       |       |       |       |       |       |       |
| Euro area                 |   |       |       |       |       |       |       |       |       |       |
| Headline CPI              |  | -0.3  | 1.1   | 1.7   | 1.9   | 2.1   | 0.9   | 0.3   | 1.6   | 1.1   |
| Core CPI                  |  | 0.2   | 1.3   | 1.1   | 1.1   | 1.5   | 0.6   | 0.7   | 1.3   | 0.9   |
| UK                        |   |       |       |       |       |       |       |       |       |       |
| Headline CPI              |  | 0.5   | 0.9   | 1.9   | 2.0   | 2.4   | 2.3   | 0.9   | 1.8   | 2.0   |
| Core CPI                  |  | 1.3   | 1.5   | 2.0   | 2.0   | 2.1   | 2.0   | 1.4   | 1.9   | 1.9   |
|                           |   |       |       |       |       |       |       |       |       |       |
| ECB                       |   |       |       |       |       |       |       |       |       |       |
| Refi Rate %               |  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  |
| Deposit Rate %            |  | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 |
| PEPP envelope* (€bn)      |  | 1850  | 1850  | 1850  | 1850  | 1850  | 1850  | 1850  | 1850  | 1850  |
| BoE                       |   |       |       |       |       |       |       |       |       |       |
| Bank Rate %               |  | 0.10  | 0.10  | 0.10  | 0.10  | 0.10  | 0.10  | 0.10  | 0.10  | 0.10  |
| Bond purchases** (£bn)    |  | 895   | 895   | 895   | 895   | 895   | 895   | 895   | 895   | 895   |

\*Monthly target €bn, end of period. \*\*Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

## European calendar

### Today's results

#### Economic data

| Country | Release  | Period | Actual             | Market consensus/<br><i>Daiwa forecast</i> | Previous    | Revised            |
|---------|--|--------|--------------------|--|-------------|--------------------|
| EMU     | Industrial production M/M% (Y/Y%)                | Jan    | <b>0.8 (0.1)</b>   | 0.3 (-2.2)                                 | -1.6 (-0.8) | <b>-0.1 (-0.2)</b> |
| Germany | Final CPI (EU-harmonised CPI) Y/Y%               | Feb    | <b>1.3 (1.6)</b>   | 1.3 (1.6)                                  | 1.0 (1.6)   | -                  |
| Italy   | Unemployment rate %                              | Q4     | <b>9.2</b>         | -  | 9.8         | <b>9.6</b>         |
| Spain   | Final CPI (EU-harmonised CPI) Y/Y%               | Feb    | <b>0.0 (-0.1)</b>  | 0.0 (-0.1)                                 | 0.5 (0.4)   | -                  |
|         | Retail sales Y/Y%                                | Jan    | <b>-9.5</b>        | -2.8                                       | -1.5        | -                  |
| UK      | Monthly GDP M/M% (3M/3M%)                        | Jan    | <b>-2.9 (-1.7)</b> | -4.9 (-2.6)                                | 1.2 (4.1)   | -                  |
|         | Index of services M/M% (3M/3M%)                  | Jan    | <b>-3.5 (-2.4)</b> | -5.5 (-3.2)                                | 1.7 (0.6)   | -                  |
|         | Industrial production M/M% (Y/Y%)                | Jan    | <b>-1.5 (-4.9)</b> | -1.0 (-4.4)                                | 0.2 (-3.3)  | -                  |
|         | Manufacturing production M/M% (Y/Y%)             | Jan    | <b>-2.3 (-5.2)</b> | -1.0 (-3.7)                                | 0.3 (-2.5)  | -                  |
|         | Construction output M/M% (Y/Y%)                  | Jan    | <b>0.9 (-3.0)</b>  | -1.0 (-4.8)                                | -2.9 (-3.9) | -                  |
|         | Goods trade balance £bn                          | Jan    | <b>-9.8</b>        | -12.5                                      | -14.3       | -                  |
|         | BoE inflation expectations, next twelve months % | Feb    | <b>2.7</b>         | -  | 2.7         | -                  |

#### Auctions

| Country | Auction |
|---------|---------|
|---------|---------|

- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.




## Coming week's data calendar

### The coming week's key data releases

| Country                        | GMT   | Release                                       | Period | Market consensus/<br><i>Daiwa forecast</i> | Previous     |
|--------------------------------|-------|---|--------|--|--------------|
| <b>Monday 15 March 2021</b>    |       |   |        |  |              |
| UK                             | 00.01 | Rightmove house price index M/M% (Y/Y%)       | Mar    | -  | 0.5 (3.0)    |
| <b>Tuesday 16 March 2021</b>   |       |   |        |  |              |
| Germany                        | 10.00 | ZEW current assessment balance (expectations) | Mar    | -63.4 (75.0)                               | -67.2 (71.2) |
| France                         | 07.45 | Final CPI (EU-harmonised CPI) Y/Y%            | Feb    | 0.4 (0.7)                                  | 0.6 (0.8)    |
|                                | -     | Bank of France retail sales Y/Y%              | Feb    | -  | -0.8         |
| Italy                          | 07.45 | Final CPI (EU-harmonised CPI) Y/Y%            | Feb    | 0.6 (1.0)                                  | 0.4 (0.7)    |
| <b>Wednesday 17 March 2021</b> |       |   |        |  |              |
| EMU                            | 07.00 | EU27 new car registrations Y/Y%               | Feb    | -  | -24.0        |
|                                | 10.00 | Final CPI (core CPI) Y/Y%                     | Feb    | 0.9 (1.1)                                  | 0.9 (1.4)    |
|                                | 10.00 | Construction output M/M% (Y/Y%)               | Jan    | -  | -3.7 (-2.3)  |
| Spain                          | 08.00 | Labour costs Y/Y%                             | Q4     | -  | -1.1         |
|                                | 09.00 | Trade balance €bn                             | Jan    | -  | -1.07        |
| <b>Thursday 18 March 2021</b>  |       |   |        |  |              |
| EMU                            | 10.00 | Trade balance €bn                             | Jan    | -  | 27.5         |
|                                | 10.00 | Labour costs Y/Y%                             | Q4     | -  | 1.6          |
| Italy                          | 09.00 | Total trade balance €bn                       | Jan    | -  | 6.8          |
| UK                             | 12.00 | BoE Bank Rate %                               | Mar    | <u>0.10</u>                                | 0.10         |
|                                | 12.00 | BoE Gilt purchase target £bn                  | Mar    | <u>875</u>                                 | 875          |
| <b>Friday 19 March 2021</b>    |       |   |        |  |              |
| Germany                        | 07.00 | PPI Y/Y%                                      | Feb    | 2.0  | 0.9          |
| UK                             | 00.01 | GfK consumer confidence                       | Mar    | -19  | -23          |
|                                | 07.00 | Public Sector Net Borrowing £bn               | Feb    | 20.2                                       | 8.0          |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### The coming week's key events & auctions

| Country   | GMT   | Event / Auction  |
|---|-------|--|
| <b>Monday 15 March 2021</b>   |       |  |
| EMU      | -     | Video conference of euro area finance ministers – The impact of the pandemic on various sectors of the economy |
| <b>Tuesday 16 March 2021</b>  |       |  |
| Germany  | 10.30 | Auction: €5bn of 0% 2023 bonds   |
| UK       | 11.30 | Auction: £1.5bn of 1.625% 2054 bonds   |
| <b>Wednesday 17 March 2021</b>  |       |  |
| Germany  | 10.30 | Auction: €1.5bn of 0% 2050 bonds   |
| UK       | 10.00 | Auction: £2.5bn of 0.625% 2035 bonds   |
| <b>Thursday 18 March 2021</b>   |       |  |
| EMU      | 18.00 | ECB's Schnabel scheduled to speak  |
| France   | 09.50 | Auction: fixed rate bonds  |
|   | 10.50 | Auction: index-linked bonds  |
| Spain    | 09.30 | Auction: fixed-rate bonds  |
| UK       | 11.00 | BoE Deputy Governor Cunliffe scheduled to speak  |
|   | 12.00 | BoE monetary policy announcement   |
|   | 12.30 | BoE Governor Bailey to speak at MPC press conference   |
|   | 12.30 | BoE's Chief Economist Haldane scheduled to speak   |
| <b>Friday 19 March 2021</b>   |       |  |
| - Nothing scheduled -   |       |  |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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