

Euro wrap-up

Overview

- Bunds followed US10s lower ahead of the Fed announcements, while final euro area inflation figures for February aligned with the flash estimates and data suggested contrasting fortunes for new car registrations and construction output in the euro area.
- Gilts also made significant losses ahead of tomorrow's BoE monetary policy announcement.
- Along with the BoE MPC news, Thursday will bring data on euro area goods trade and labour costs.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.694	+0.006
OBL 0 04/26	-0.631	+0.022
DBR 0 02/31	-0.296	+0.043
UKT 0 ¹ / ₈ 01/23	0.098	+0.019
UKT 0 ¹ / ₈ 01/26	0.390	+0.029
UKT 4 ³ / ₈ 12/30	0.826	+0.044

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

Source: Bloomberg

Euro area

Energy offsets lower core items to keep inflation steady in February

As expected, the final estimate of euro area headline inflation in February matched the flash figure, to be unchanged at January's eleven-month high of 0.9%Y/Y. There were also precious few revisions 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 which pushed clothes inflation down 2ppts to 0.8%Y/Y. In addition, services inflation fell 0.2ppt to 1.2%Y/Y as lockdown restrictions again weighed on prices in the hospitality, leisure and tourism sector, e.g. the pace of decline of package holidays accelerated 1.8ppts to -2.7%Y/Y. So, the final estimate of core inflation in February similarly matched the flash estimate, falling 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, inflation of food, alcohol and tobacco fell 0.2ppt – a little more than previously thought – to 1.3%Y/Y. But as in the preliminary figures, energy inflation rose 2.5ppts to a twelve-month high of -1.7%Y/Y to represent the main source of upwards pressure.

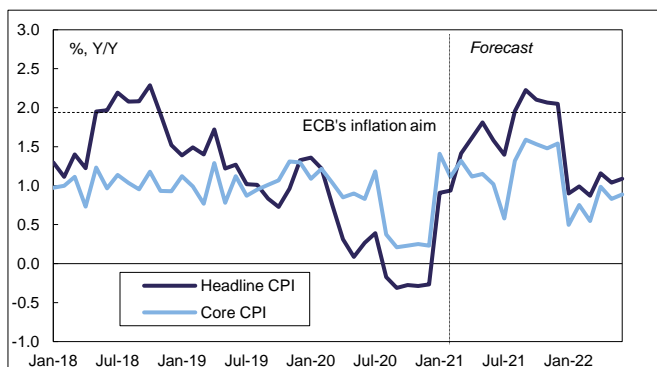
Inflation to peak in second half of 2021 before falling back next year

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 well push inflation of non-energy industrial goods higher. And while services inflation is likely to remain relatively subdued as long as demand remains impeded by pandemic containment restrictions, all components of inflation will take a further step up in the second half of the year due to base effects from Germany's temporary VAT cut last year. We currently forecast headline inflation to rise 0.5ppt to 1.4%Y/Y in March and above 2.0%Y/Y from September through to year-end. But it will then roughly halve at the start of 2022. Likewise, although core inflation will likely rise above 1.5%Y/Y in the autumn, it will probably fall back below 1.0%Y/Y in the first quarter of next year. And while the ECB last week committed to increase its asset purchases over the coming quarter, we see no material impact on the inflation outlook from the policy, not least as there was no accompanying increase in the €1.85bn PEPP envelope.

New car registrations stuck well below Q4 level with weakness widespread

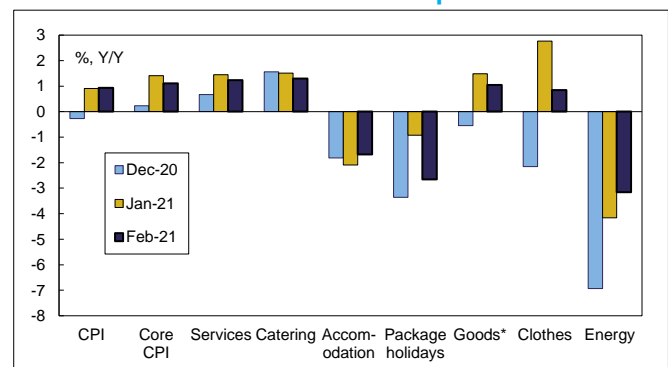
As had already become clear from the data from the large member states, new car registrations in the euro area remained extremely weak in February, down 20.9%Y/Y to be down a slightly larger 22.7%YTD/Y. On a working day and seasonally-adjusted basis, registrations dropped a further 1.1%M/M following a steep drop of 22.5%M/M in January to be more than 21% below the Q4 average. Declines were widespread across the euro area. We already knew that new car registrations in Germany (-19.0%Y/Y) continued to be affected by the reversal of last year's temporary VAT cut as well as pandemic

Euro area: Inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Selected inflation components



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

restrictions, while French registrations were similarly subdued (down 20.9%Y/Y). While registrations in Italy fell a more moderate 12.3%Y/Y, they plummeted 38.4%Y/Y in Spain and saw the steepest decline in Portugal (-59.0%Y/Y). And of all the member states, only in Ireland (+4.9%Y/Y) were new car registrations higher than a year earlier in February. But, given the poor start to the year, even there they were still down 11.1% over the first two months of 2021 compared to the same period last year.

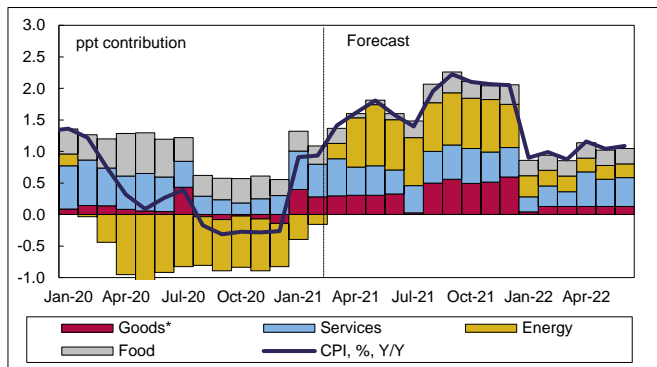
Construction output increased at start of year despite plunge in Germany

Euro area construction output rose a modest 0.8%M/M in January. While that was insufficient to reverse the drop of 1.5%M/M at the end of 2020 and left it 1.7% below the pre-pandemic level in February 2020, it was nevertheless 0.7% above the Q4 average suggesting scope for further growth over the first quarter as a whole. Growth in January came predominantly from new building work, which rose 1.3%M/M to an eleven-month high just 0.6% below the pre-pandemic level, supported by relatively firm housing market conditions. In contrast, civil engineering activity rose just 0.1%M/M to be still more than 5% below the level in February 2020. The small increase in January masked sharp differences across the member states. Most notably, following a surge of 7.0%Q/Q in Q4, including growth of 5.4%M/M in December, construction output plunged 12.2%M/M in Germany principally due to the reversal of last year's VAT cut. In marked contrast, after a drop of 2.5%Q/Q in Q4, including a fall of 9.2%M/M in December, French construction output rose a vigorous 16.3%M/M. While activity in the sector in Germany is likely to remain relatively subdued, surveys point to further near-term growth over coming months. For example, the Commission's construction confidence index rose for a third successive month in February to an eleven-month high, albeit still well down on pre-pandemic levels. And the same survey's index of new orders in the sector similarly rose last month to the highest since March 2020. While residential work should see further growth supported by economic recovery and ultra-low mortgage rates, commercial construction activity is likely to remain subdued as businesses remain hesitant to invest and city-centre office, retail and leisure developments continue to feel the impact of the pandemic.

The day ahead in the euro area

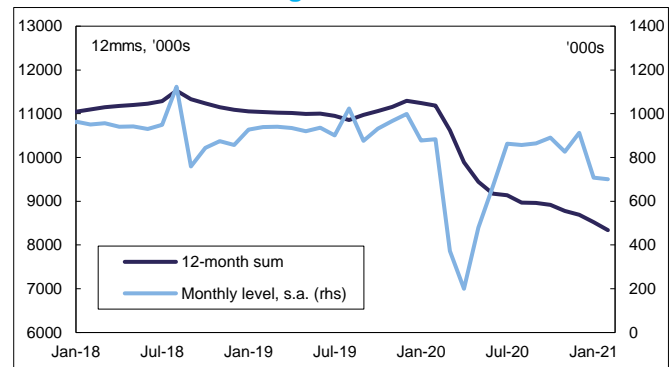
Tomorrow will bring euro area goods trade data for January. With exports likely again to have outpaced imports, the trade surplus on an adjusted basis is expected to rise to a new series high from €27.5bn in December. Weakness in imports is likely to be accentuated by the impact of the end of the Brexit transition period – data released on Friday showed that UK goods exports to the EU fell a marked 40.7%M/M while UK imports from the EU fell 28.8%M/M. Euro area labour cost figures for Q4 will also be released. As in Q1 and Q2, these are likely to be affected significantly by pandemic containment

Euro area: Inflation forecast



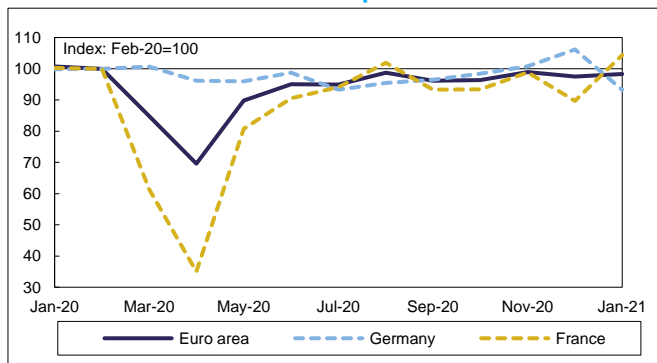
*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: New car registrations



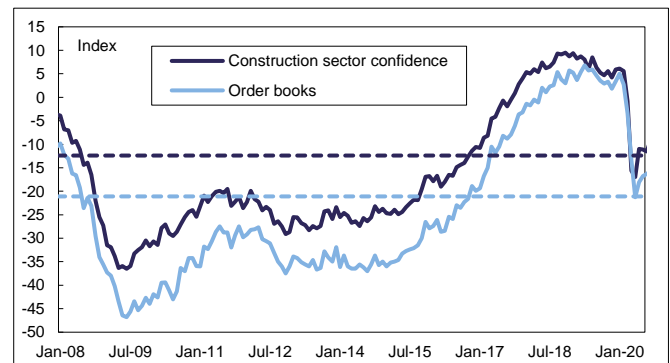
Source: ECB, Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Construction confidence and orders*



*Dashed lines represent euro-era averages. Source: European Commission, Refinitiv and Daiwa Capital Markets Europe Ltd.








measures, which restricted the number of hours worked in Q4. As such, we look for an acceleration in euro area labour cost growth back above 3.5%Y/Y in Q4 from just 1.7%Y/Y in Q3.

UK








The day ahead in the UK

The main event in the UK tomorrow will be the BoE's latest monetary policy announcement. Since the Bank published updated forecasts following its previous MPC meeting on 4 February, economic activity appears to have been somewhat firmer than it expected, while inflation has been broadly in line with the Bank's expectation. And while Gilt yields are up significantly since then – with the 10Y yield today roughly 45bps higher from just before the MPC's February announcement – Governor Bailey recently stated that the market moves appear broadly consistent with an improved economic outlook. Indeed, the near-term path for fiscal policy will be more supportive than the BoE had assumed in its forecast and the unemployment profile will likely undershoot the path set out in its projection. And while Governor Bailey recently emphasised the significant uncertainty still surrounding the economic outlook, the main thrust 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. As such, there will certainly be no change to policy at tomorrow's MPC meeting. And while there is the risk of a slightly more hawkish tone, and markets will no doubt watch closely any additional commentary about bond market developments, we expect the MPC's forward guidance to be left unchanged too. So, it will likely continue to state 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."


European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 EU27 new car registrations Y/Y%	Feb	-19.3	-	-24.0	-
	 Final CPI (core CPI) Y/Y%	Feb	0.9 (1.1)	0.9 (1.1)	0.9 (1.4)	-
	 Construction output M/M% (Y/Y%)	Jan	0.8 (-1.9)	-	-3.7 (-2.3)	-1.5 (0.0)
Spain	 Labour costs Y/Y%	Q4	-0.1	-	-1.1	-
	 Trade balance €bn	Jan	-1.8	-	-1.07	-
Auctions						
Country	Auction					
Germany	 sold €1.2bn of 0% 2050 bonds at an average yield of 0.21%					
UK	 sold £2.5bn of 0.625% 2035 bonds at an average yield of 1.179%					
















Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 ZEW current assessment balance (expectations)	Mar	-61.0 (76.6)	-62.0 (74.0)	-67.2 (71.2)	-
France	 Final CPI (EU-harmonised CPI) Y/Y%	Feb	0.6 (0.8)	0.4 (0.7)	0.6 (0.8)	-
	 Bank of France retail sales Y/Y%	Feb	-3.5	-	-0.8	-1.0
Italy	 Final CPI (EU-harmonised CPI) Y/Y%	Feb	0.6 (1.0)	0.6 (1.0)	0.4 (0.7)	-
Auctions						
Country	Auction					
Germany	 sold €3.9bn of 0% 2023 bonds at an average yield of -0.7%					
UK	 sold £3.5bn of 0.125% 2024 bonds at an average yield of 0.182%					
	 sold £1.5bn of 1.625% 2054 bonds at an average yield of 1.276%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
UK	 Rightmove house price index M/M% (Y/Y%)	Mar	0.8 (2.7)	-	0.5 (3.0)	-	
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 Trade balance €bn	Jan	29.0	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		
Auctions and events							
EMU		18.00 ECB's Schnabel scheduled to speak					
France		09.50 Auction: 0% 2024 bonds					
		09.50 Auction: 0% 2026 bonds					
		09.50 Auction: 0.75% 2028 bonds					
		10.50 Auction: 0.1% 2028 index-linked bonds					
		10.50 Auction: 0.7% 2030 index-linked bonds					
Spain		09.30 Auction: 0% 2024 bonds					
		09.30 Auction: 1% 2050 bonds					
		09.30 Auction: 0% 2028 bonds					
UK		12.00 BoE monetary policy announcement					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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