Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds followed USTs lower while take-up at the ECB's latest TLTRO-III operation was higher than expected but euro area export data were weaker than expected.
- Gilts also made losses as the BoE left its forward guidance unchanged but were unconcerned by recent curve-steepening and were upbeat about the near-term outlook.
- Friday will bring new data for UK consumer confidence and public borrowing.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.694	-0.001
OBL 0 04/26	-0.622	+0.005
DBR 0 02/31	-0.267	+0.026
UKT 0$^1/_8$ 01/23	0.093	-0.004
UKT 0$^1/_8$ 01/26	0.407	+0.018
UKT 4¾ 12/30	0.869	+0.042

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

Euro area

High TLTRO-III take-up will help maintain easy financial conditions over coming months

The ECB's allotment of funds under the seventh operation of its TLTRO-III liquidity scheme significantly beat expectations. 425 banks borrowed €330.5bn under the programme. That compared with just €50.4bn to 156 banks at the prior operation in December and was the highest since June. With €15.7bn of TLTRO-II funds set to mature next week, the operation will result in a net €315bn increase in banks' total TLTRO borrowing to just over €2.0trn. This was the first TLTRO-III operation following the enhancement of the programme announced in December when, e.g., the maximum amount that banks were allowed to borrow was raised from 50% to 55% of their stock of eligible loans at end-February 2019. Under the scheme the funds will come with an interest rate as low as -1% for banks whose lending does not fall between October 2020 and December 2021. With lending to NFCs having stagnated over recent months after the surge in March and April last year, the high take-up today suggests that banks are preparing to increase lending again once lockdown restrictions end. That should help to maintain the highly accommodative financial conditions sought by the ECB despite recent steepening of yield curves. Indeed, the increased number of banks partaking in the operation suggests that a large number of banks in the core as well as the periphery chose to participate this time around, pointing to widespread benefits from the policy.

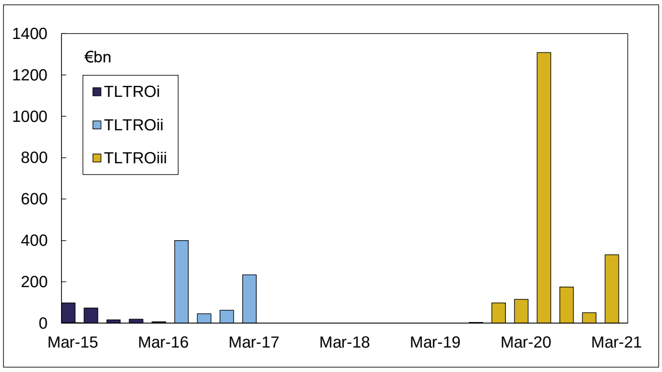
Exports fall for first time since April as Brexit kicks in

2021 got off to a weak start for goods trade to and from the euro area. On an adjusted basis, the value of exports fell for the first time since the first lockdown in April 2020 and by 2.8%M/M to a level 1.5% below the Q4 average. Imports fell for a second successive month but by a smaller 1.3%M/M to be 0.8% below the Q4 average. As a result, contrary to expectations of a further rise, the trade surplus on an adjusted basis narrowed by €3.3bn from December's series high to a still-elevated €24.2bn. On an unadjusted basis, the value of euro area exports fell 11.4%Y/Y, the sharpest drop since May, while imports fell 14.1%Y/Y, the most since July 2020. While tighter pandemic containment measures hardly helped, the end of the Brexit transition period was the main source of weakness, with exports to the UK down 29.7%M/M and 28.8%Y/Y. In contrast, exports to the US fell just 2.0%M/M and less than 10%Y/Y, while exports to China fell 1.7%M/M and up 9.5%Y/Y. Imports from the UK plunged 56.0%M/M and 58.6%Y/Y, while those from the US fell 9.3%M/M and 27.5%Y/Y, and those from China were down 5.9%M/M and 2.2%Y/Y to China.

Labour cost growth rebounded in Q4, but unlikely to add price pressure during recovery phase

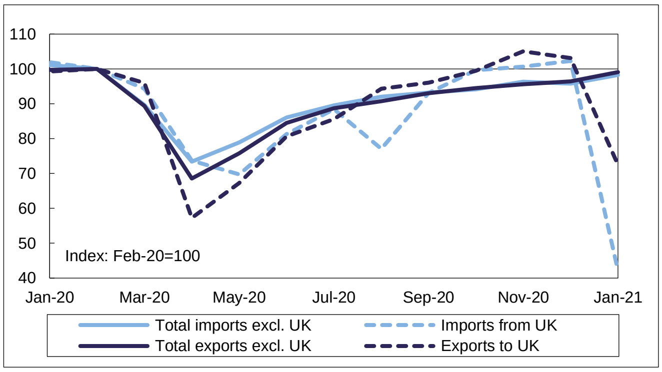
Having slowed in Q3 as the economy reopened from lockdown, hourly labour costs in the euro area accelerated 1.4ppts to 3.0%Y/Y in Q4, still nevertheless 1.0ppt down from the twelve-year high of 4.0%Y/Y reached in Q2. Pressure came largely from pay per hour worked, which rose 3.5%Y/Y while non-wage costs rose 1.5%Y/Y, subdued by fiscal policy support via tax

ECB: TLTRO allotment



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

Euro area: Export and import values



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

reliefs and government subsidies. Cost growth in the business economy was somewhat softer than the headline figure, up 2.6%Y/Y, with the same rate registered in services, costs in construction stronger (3.2%Y/Y), but those in manufacturing a touch softer (2.6%Y/Y). The acceleration in growth in labour costs per hour in Q4 principally reflected the reduction in hours worked due to renewed pandemic containment restrictions. So, going forward, as economies start to reopen again from next quarter, cost growth per hour worked should slow again, even if employee compensation accelerates as workers return from government-subsidised furlough schemes. With productivity also likely to pick up over the recovery phase, overall unit labour cost growth should be very tame. Indeed, the ECB currently forecasts negative growth (-0.6%Y/Y) in unit labour costs in 2022 followed by modest growth (1.2%Y/Y) in 2023, providing little impetus to overall inflation.

The day ahead in the euro area

The euro area's economic data calendar ends the week quietly, with no key releases scheduled for tomorrow. However, Fabio Panetta, the most dovish member of the ECB's Executive Board, will speak publicly.

UK

BoE leaves powder dry with policy guidance unchanged

As expected, the latest BoE monetary policy announcements were highly uneventful. Most importantly, the MPC's forward guidance was completely unchanged. So, "If the outlook for inflation weakens, the Committee stands ready to take whatever additional action is necessary to achieve its remit" and "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." In its statement, the MPC acknowledged the recent significant increases in yields. But it suggested that they were justified by positive news on global growth and vaccinations, and countered that aggregate financial conditions in the UK had been broadly unchanged since the 4 February meeting. Nevertheless, the minutes repeated that, should market functioning worsen materially, the BoE stands ready to increase the pace of asset purchases.

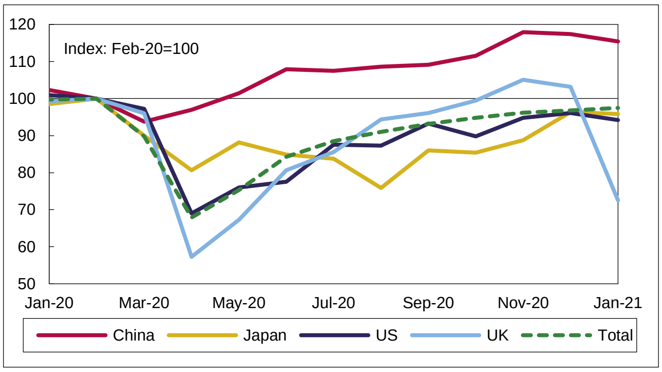
Uncertainty emphasised for the time being, but expect step change in policy from August

In terms of the economic outlook, the statement recited several factors that should give cause for optimism, including the aforementioned stronger-than-expected external demand and US fiscal stimulus; the marked drop in the rates of Covid-19 cases and rapid progress of vaccinations in the UK; plans for a gradual easing of restrictions which might support stronger consumption in the coming quarter; and the extra near-term fiscal support announced by the Government in the March Budget. However, just as BoE Governor Bailey had done over recent weeks, the MPC statement underscored that the outlook for economic activity and inflation is highly uncertain. That is particularly the case with respect to how the level of spare capacity – which the MPC judges still be "material" – will evolve over coming quarters. And until the picture is clearer, the BoE is unlikely to change its guidance on future policy. The most onerous pandemic containment restrictions are currently scheduled to be relaxed by late June. And despite some near-term concerns about supply, all adults are expected to have been offered a coronavirus vaccine by end-July. By then, the BoE should also have concluded its review of its exit strategy, including the appropriate sequencing between adjusting its balance sheet and raising rates. So, the August MPC meeting might see an important step change in the Committee's guidance. And we fully expect it to confirm by then that the BoE's net Gilt purchases will subsequently be tapered to zero before year-end.

The day ahead in the UK

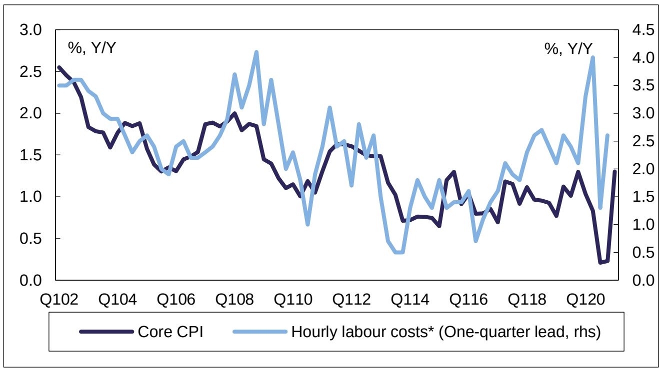
Looking ahead to tomorrow, the GfK consumer confidence survey for March will be published, along with public finances data for February. A modest improvement in the headline consumer confidence indicator is expected, to -20 in March, albeit leaving it some way off the level recorded in the same month last year as the pandemic built up steam (-9). Meanwhile, public sector net borrowing (excluding banks) is expected to come in at £21.4bn in February, up from just £1.7bn a year earlier but down from the high of £54.3bn in April last year.

Euro area: Exports by selected destination



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Labour costs and core inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		Trade balance €bn	Jan	**24.2**	29.0	27.5	**-**
		Labour costs Y/Y%	Q4	**3.0**	-	1.6	**-**
Italy		Total trade balance €bn	Jan	**1.6**	-	6.8	**6.9**
UK		BoE Bank Rate %	Mar	**0.10**	*0.10*	0.10	**-**
		BoE Gilt purchase target £bn	Mar	**875**	*875*	875	**-**

Auctions

Country		Auction
France		sold €4.99bn of 0% 2024 bonds at an average yield of -0.61%
		sold €3.098bn of 0% 2026 bonds at an average yield of -0.48%
		sold €1.405bn of 0.75% 2028 bonds at an average yield of -0.28%
		sold €360mn of 0.1% 2028 index-linked bonds at an average yield of -1.3%
		sold €609mn of 0.7% 2030 index-linked bonds at an average yield of -1.41%
		sold €1.028bn of 0.1% 2026 index-linked bonds at an average yield of -1.7%
Spain		sold €2.13bn of 0% 2024 bonds at an average yield of -0.396%
		sold €986.6mn of 1% 2050 bonds at an average yield of 1.297%
		sold €3.05bn of 0% 2028 bonds at an average yield of 0.000%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		07.00	PPI Y/Y%	Feb	2.0	0.9
UK		00.01	GfK consumer confidence	Mar	-20	-23
		07.00	Public sector net borrowing, excluding banks £bn	Feb	21.4	8.8

Auctions and events

Country		GMT	Event
EMU		10.45	ECB's Panetta scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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