

Euro wrap-up

Overview

- Bunds and BTPs made gains at the short end of the curve but made losses at the long end as Christine Lagarde stated that any adjustment to rates would be gradual and the ECB would use all tools to ensure effective monetary policy transmission.
- Gilts were little changed on a quiet day for UK economic news.
- The coming couple of days will be relatively light for economic data bringing French trade figures and a UK retail survey tomorrow, and German trade and Italian production numbers on Wednesday.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	-0.319	-0.054
OBL 0 04/27	0.033	-0.006
DBR 0 02/32	0.216	+0.015
UKT 0 7/8 01/24	1.251	+0.002
UKT 0 7/8 10/26	1.306	+0.003
UKT 0 7/8 07/31	1.407	-0.001

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

Euro area

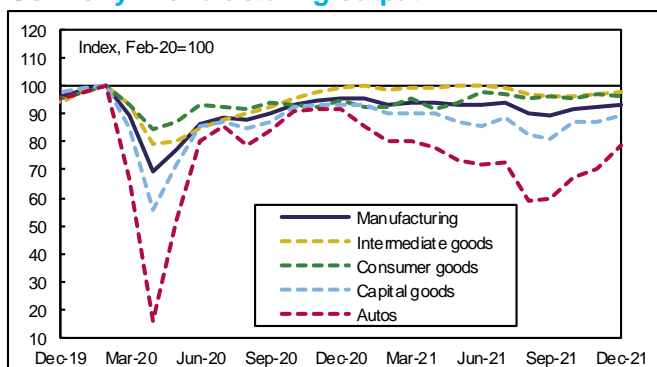
Lagarde seeks to calm market expectations of aggressive ECB tightening

Euro area bond markets have unsurprisingly been jittery following the ECB's hawkish pivot last Thursday, when President Lagarde signalled a recalibration of policy in March and opened the door to a rate hike this year. The increased likelihood of tightening in 2022 was underscored in weekend comments by (the admittedly usually hawkish) Dutch National Bank Governor Knot, who expected the first rate hike to come in Q4 with a subsequent hike likely in Q1 23. He also signalled the likelihood that rates would be hiked in increments of 25bps. Those comments aligned with our baseline view, which is a little more dovish than market pricing, which today implied rate take-off in Q3. However, perhaps mindful that investors might be getting ahead of themselves, and that the sell-off in periphery bonds risked an undesirable tightening in financial conditions, ECB President Lagarde seemingly sought to push against market pricing in her testimony to the European Parliament late this afternoon. In particular, she stated the Governing Council's forward guidance implied that there were "safeguards" in place "against a premature increase in interest rates". So, she added that any adjustment to the Bank's monetary policy would be gradual. And, evidently wary of the recent significant widening in periphery spreads, she insisted that the ECB would use all tools – presumably including flexible reinvestments of proceeds of maturing PEPP bonds – to ensure an effective transmission of its monetary stance.

German industrial production ended 2021 on a soft note, weighed by a sharp fall in construction

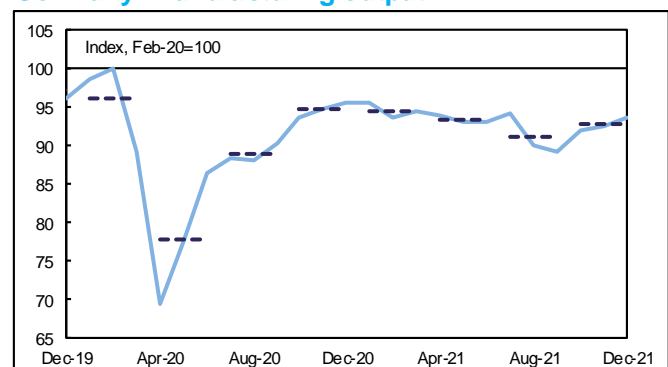
Data-wise, German industrial production ended last year on a soft note falling 0.3% M/M in December following an upwardly revised increase of 0.3% M/M in November to be down 4.1% Y/Y and 6.9% below the pre-pandemic level in February 2020. The weakness was due to construction, which contracted a marked 7.3% M/M, the most in eleven months to the lowest level since 2018, to be down 2.1% Q/Q in Q4. Construction was seemingly disproportionately impaired by supply bottlenecks and labour shortages, but perhaps also exaggerated by imperfect seasonal adjustment. Energy production also fell (-0.7% M/M) but rose 2.1% Q/Q in Q4. Most notably, manufacturing output fared better, rising for a third successive month and by a respectable 1.2% M/M – albeit still 6.6% below the pre-pandemic level – to be up 1.7% Q/Q in Q4 having declined in each of the prior three quarters. Within the detail, production of capital goods rose 2.5% M/M to be up 4.3% Q/Q in Q4. That reflected further strong growth in motor vehicle output, up 12.1% M/M and 13.2% Q/Q but still some 21.3% below the February 2020 level. But machinery and equipment was down 3.7% M/M and 2.5% Q/Q and almost 8% below the pre-pandemic level. Among other items, production of consumer durables rose 4.5% M/M in December to be up 0.9% Q/Q in Q4 and back above the February 2020 benchmark. But while output of intermediate items rose 0.6% M/M at the end of the year, it was still down 0.4% Q/Q in the fourth quarter and 2.2% below the pre-pandemic level.

Germany: Manufacturing output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing output*



*Dashed dark blue line represents quarterly average.
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Recovery in German car production appears to have paused at the start of the year

Following double-digit percentage growth in December, however, German car production in January looks to have been little changed on the month, at least according to last week's data from Germany's automotive association (VDA). Indeed, on an unadjusted basis, the number of vehicles produced rose just 100 to 256.3k. That left car production up some 8.1% Y/Y, but still down about one quarter from the level in January 2020 just ahead of the arrival of the pandemic and about one third below the average level in January from 2018-2020. German new car registrations were similarly up 8.5% Y/Y in January but down one quarter from the level in January 2020.

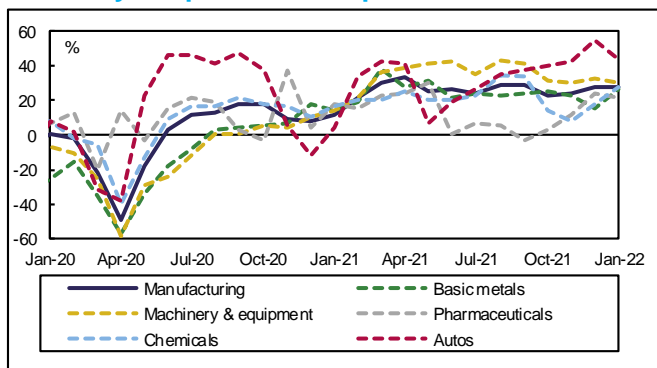
ifo surveys point to ongoing increase in production amid rising prices

Nevertheless, overall, surveys point to continued growth in manufacturing output – and a rebound in construction activity – at the start of the year as supply bottlenecks ease modestly and firms make gradual in-roads into order backlogs. Indeed, according to the latest ifo business survey, car manufacturers were slightly more upbeat in January, with the respective headline business climate index up almost 4pts to 4.6. While the net share of firms in the sector that expected to increase output in the coming three months dropped a little, it remained high at above 44%. Likewise, the overall net share of manufacturers looking to boost production over the coming three months was broadly steady close to 28%. With respect to prices, the net share of car manufacturers expecting to raise prices over the coming three months was little changed at 21%. But an increased share of car wholesalers and retailers was looking to raise prices. Overall, the share of German companies expecting to raise prices this quarter remained very high above 55%, just a whisker below November's series high, to point to ongoing pass-through of pipeline pressures further along the supply chain. The net balances for price expectations for computer equipment (91.2), domestic appliances (84.4), food (71.4) and wood products (71.0) were among the most striking.

Sentix reports firmer investor sentiment despite concerns about inflation, ECB and Ukraine

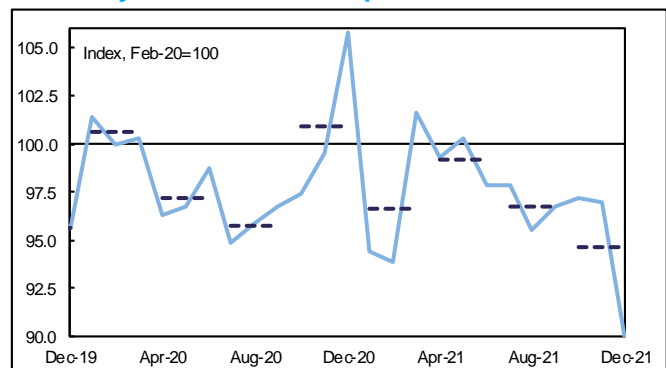
The expectation of further increases in inflation and tighter ECB monetary policy to come, not to mention heightened concerns about events on the Ukraine-Russia border, might normally conspire to undermine investor sentiment. For the time being, if the latest Sentix survey – conducted on 3-5 February (i.e. shortly before and after the ECB announcement) – is anything to go by, investors are not yet particularly perturbed. For the euro area as a whole, the current conditions index rose to a three-month high (up 3pts to 19.3) while the expectations index reached its highest in seven months (up 0.5pt to a seven-month high of 14.0), and the German sub-indices provided a similar picture.

Germany: ifo production expectations indices*



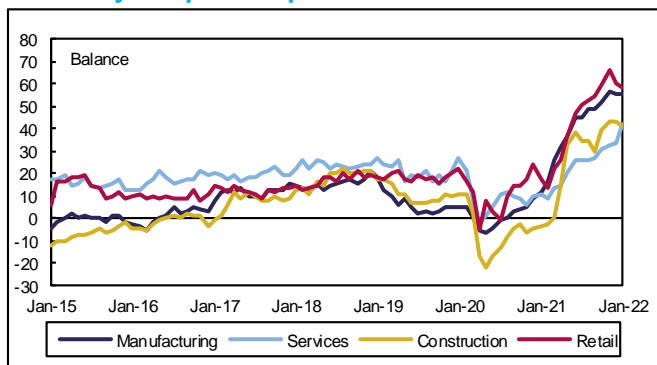
*Expectations balance for production three months ahead.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Construction output*



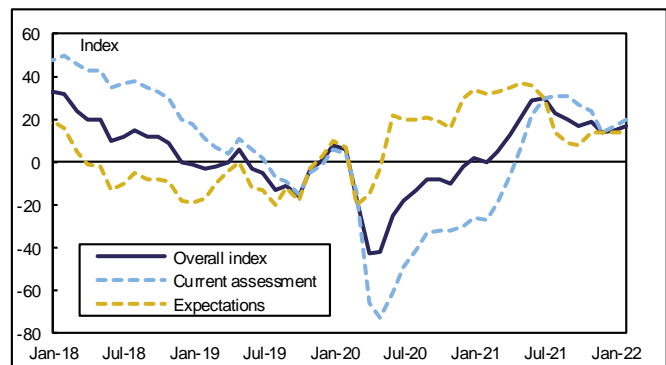
*Dashed dark blue line represents quarterly average.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ifo price expectations*



*Expectations balance for prices three months ahead.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Sentix investor sentiment indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The coming two days in the euro area

In the coming two days, while investors will continue to look out for comments from various ECB Governing Council members, the data focus will remain on the manufacturing sector with Spanish industrial production numbers for December due tomorrow, followed by the equivalent Italian numbers on Wednesday. Spanish output is expected to post a modest fall in December (-0.5% M/M). However, that would follow very strong growth of 4.5% M/M in November, and so Spanish production would still have grown a vigorous 2.4% Q/Q in Q4. Likewise, Italian production is forecast to have fallen back towards year-end (-0.7% M/M) following solid growth in November (1.9% M/M) to leave it up 1.0% Q/Q in Q4. Meanwhile, French and German trade figures for December are due tomorrow and Wednesday respectively, while the Bank of France should publish its business survey results for January on Wednesday. While manufacturing production likely held up at the start of the year, the survey is likely to point to a marked hit to activity in consumer-facing sectors due to the pandemic, suggestive of a modest decline in GDP overall.



UK

The coming two days in the UK








It was a quiet start to the week on the UK economic data front with no top-tier releases to report today. And the coming two days bring only the BRC retail sales monitor for January tomorrow. UK consumer confidence deteriorated at the start of the year with the headline GfK index dropping 4pts to an eleven-month low of -19. And with pandemic restrictions in place for much of last month, and prices on the high street rising at the fastest pace since 2012, we expect tomorrow's BRC monitor to indicate a subdued start to the year for retailers. However, the headline indicator – which represents year-on-year growth – might well suggest stronger growth at the start of the year simply due to the low base a year ago when pandemic restrictions were tighter. In terms of BoE-speak, Chief Economist Pill will speak publicly on the UK's monetary policy outlook on Wednesday. Of course, political noise will continue in the background, with it being well within the bounds of possibility that the threshold for Conservative MPs to trigger a vote of no-confidence in Prime Minister Boris Johnson will be reached.

The next edition of the Euro wrap-up will be published on 09 February 2022

European calendar






Today's results							
Economic data							
Country	Release		Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area		Sentix investor confidence	Feb	16.6	15.5	14.9	-
Germany		Industrial production M/M% (Y/Y%)	Dec	-0.3 (-4.1)	0.4 (-3.7)	-0.2 (-2.4)	0.3 (-2.2)
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
France		07.45	Trade balance €bn	Dec	-	-9.7
Italy		09.00	Retail sales M/M% (Y/Y%)	Dec	-0.2 (-)	-0.4 (12.5)
Spain		08.00	Industrial production M/M% (Y/Y%)	Dec	-0.5 (4.4)	4.5 (4.8)
UK		00.01	BRC retail sales, like-for-like Y/Y%	Jan	-	0.6
Auctions and events						
Euro area		17.00	ECB's Villeroy scheduled to speak			
Germany		10.30	Auction: €500mn of 0.1% of 2026 index-linked bonds			
		10.30	Auction: €200mn of 0.1% of 2046 Index-linked bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases
Economic data

Country		GMT	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous
Germany		07.00	Trade balance €bn	Dec	11.0	11.6
France		-	Bank of France industrial sentiment*	Jan	-	108
Italy		09.00	Industrial production M/M% (Y/Y%)	Dec	-0.7 (4.6)	1.9 (6.3)
Auctions and events						
Germany		10.30	Auction: €1.5bn of 2050 bonds			
UK		13.10	BoE Chief Economist Pill scheduled to speak on 'UK monetary policy outlook'			

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

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