

Euro wrap-up

Overview

- While euro area equities fell as concerns about Ukraine persisted, Bunds made losses as the flash euro area PMIs signalled a rebound in services activity but also record price pressures in the sector.
- Gilts also made losses as the flash UK PMIs pointed to a marked acceleration in UK economic activity in February.
- Tuesday will bring the German ifo business climate indices and UK CBI industrial trends survey results for February, and final Italian inflation data for January.

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Daily bond market movements

| Bond | Yield | Change |
|---|--------|--------|
| BKO 0 03/24 | -0.468 | +0.019 |
| OBL 0 04/27 | -0.059 | +0.020 |
| DBR 0 02/32 | 0.198 | +0.010 |
| UKT 0 ⁷ / ₈ 01/24 | 1.274 | +0.013 |
| UKT 0 ⁹ / ₈ 10/26 | 1.292 | +0.013 |
| UKT 0 ¹ / ₄ 07/31 | 1.398 | +0.020 |

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

Euro area

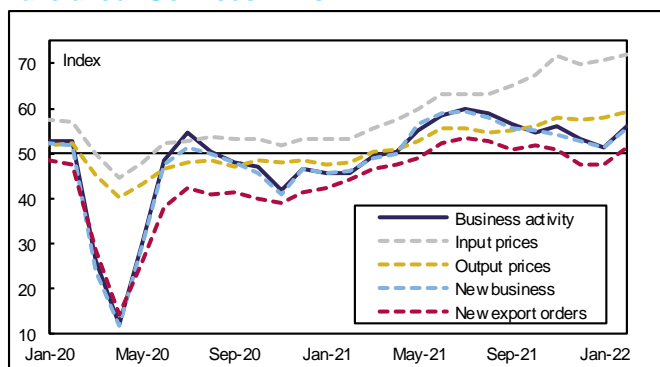
Flash euro area PMIs point to a rebound in services, but record price pressures

As the number of coronavirus cases appears to have peaked and containment measures are gradually reduced, today's flash euro area PMIs were inevitably more upbeat, with the composite PMI rising 3.5pts in February to 55.8, signaling the fastest pace of expansion since September. Consistent with mobility data implying increased recreation and retail activity, there was an unsurprisingly marked turnaround in the services sector, with the headline PMI up 4.7pts to 55.8, a three-month high, with looser restrictions enabling a particularly strong rise in consumer-facing services and tourism. And a more buoyant near-term outlook was supported by the strongest demand – domestic and overseas alike – for new business since August. There was, however, only a modest increase in the manufacturing output PMI, up 0.2pt to 55.6, although this still marked the third increase out of the past four months and the highest reading since September. And, encouragingly, the survey detail suggested a further easing of supply bottlenecks, with delivery times lengthening by the least since January 2021. Nevertheless, along with an increase in new manufacturing orders, there was a steep rise in backlogs of uncompleted work. And while manufacturers' input costs moderated slightly last month, growth in service sector costs accelerated to a record high reflecting increased wages and energy costs, leaving the composite input price PMI (74.5) at the second-highest in the survey's 24-year history. Moreover, factory output prices accelerated the most on the series, suggesting a greater willingness to pass on price pressures.

German services activity bounce back, manufacturing supply constraints ease further

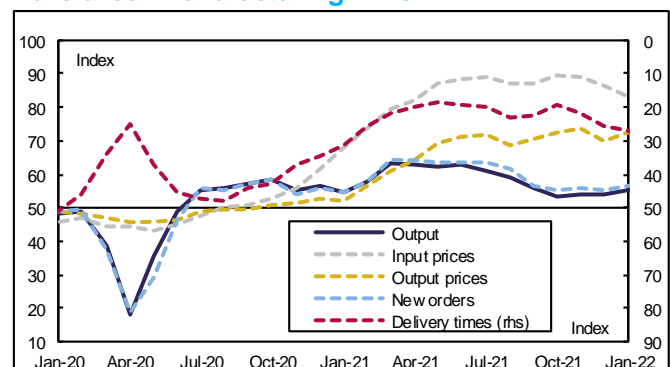
With respect to the country detail, Germany's composite PMI rose a further 2.4pts in February to a six-month high of 56.2, with the increase entirely due to a near-4½pt rebound in the services activity index to its best level since August. Moreover, the PMI for new business in services rose to its strongest since September, with expectations the most positive since June. But higher energy, wage and material costs led to a further intensification of input cost pressures in the sector, which resulted in firms increasing their output prices by the most on the series bar November. In contrast, the manufacturing output PMI fell back in February (-1.6pts). But this was the first decline in four months, to leave the index (55.4) still consistent with ongoing steady expansion, with the survey citing staff shortages due to Covid-related absences as a restraint on production. The survey detail was more encouraging, with the new orders index up to a six-month high (58.2) and supplier delivery times the shortest since November 2020. And the easing of supply constraints saw input cost burdens in the sector slow to the lowest in a year, which was just as well given the extremely strong producer price inflation in January. Indeed, today's data showed that the goods PPI index rose 2.2%MM last month to leave it up a record 25.0%Y/Y. While producer energy prices (+66.7%Y/Y) remained a significant source of inflationary pressure, there were also signs of mounting pressures further

Euro area: Services PMIs



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

Euro area: Manufacturing PMIs



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

along the supply chain, with record monthly increases in prices of intermediate (3.1%/MM), capital (1.8%/MM) and consumer durable goods (3.0%/MM) last month. And so, when excluding energy, producer prices were up more than 2%/MM to be up 11.7%YY, also a record high, suggesting the likelihood of greater pressures on consumer prices over coming months.

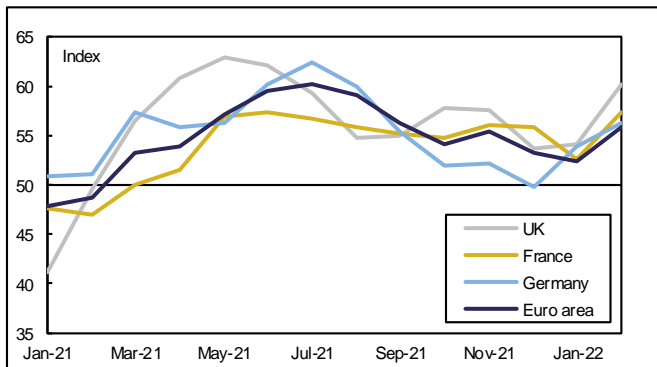
French services PMI up to a four-year high

Like in Germany, the flash French composite PMI signalled an accelerating pace of recovery in February, rising 4.7pts to 57.4, an eight-month high. And the improvements were widespread, with the services index rising 4.8pts to 57.9, a four-year high, and the manufacturing output index up 4.1pts to 55.0, a seven-month high. The survey implied a strong month of new orders growth in both sectors, although supply constraints continued to limit production capacity. As such the increase in work backlogs was reportedly the strongest since April 2011, while supply-side pressures saw the input price PMI remain close to the near-17-year high recorded in January. Beyond Germany and France, while Markit provided no detail, it stated that its survey suggested a strong recovery after a near-stalling in January, although economic growth there continued to lag the larger member states.

Informal ECB meeting to allow for discussion on policy outlook and Ukraine contingencies

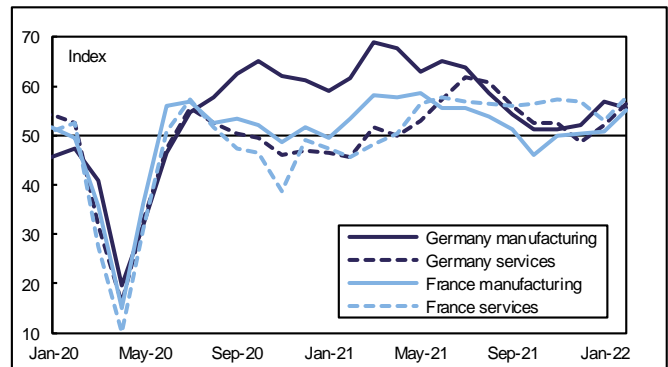
The past fortnight brought commentary from several members of the Governing Council flagging concerns about the upside risks to the outlook for euro area inflation and the need for the ECB to set a new path for monetary policy. Most notably, the typically dovish Chief Economist Philip Lane – who will soon start to prepare the updated economic forecasts upon which the ECB will determine its policy stance next month – appeared to join those advocating gradual policy normalisation, citing expectations that inflation will now settle back around the 2% target over the medium term. With Lane on board, there is now likely to be something close to a consensus on the Governing Council in favour of an accelerated phasing out of net asset purchases over the next two quarters to leave scope for a rate hike by year-end. Today it was confirmed that the Governing Council will hold an informal meeting on Thursday, ahead of the informal meeting of finance ministers and central bank governors the following day. While it will not pre-empt the precise outcome of next month’s policy discussion, it should allow for loose coordination of communication about the likely next steps. Additionally, it will allow the Governing Council members to discuss how ECB policy should respond if the adverse risks related to Ukraine crystallise. In that respect, Executive Board member Schnabel last week suggested that a Russian invasion would likely cause the ECB to delay policy normalisation in light of the negative impact on GDP and confidence.

Europe: Composite PMIs by country



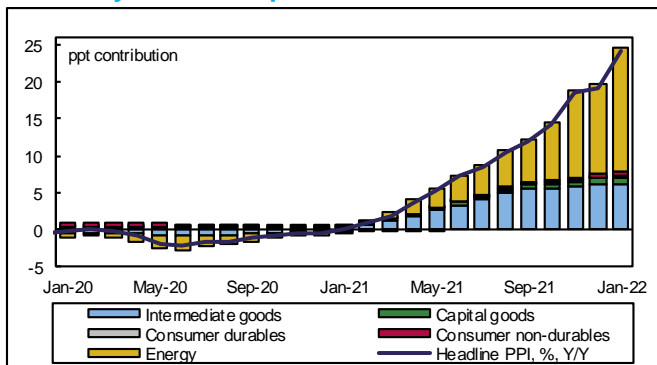
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Germany & France: Output PMIs



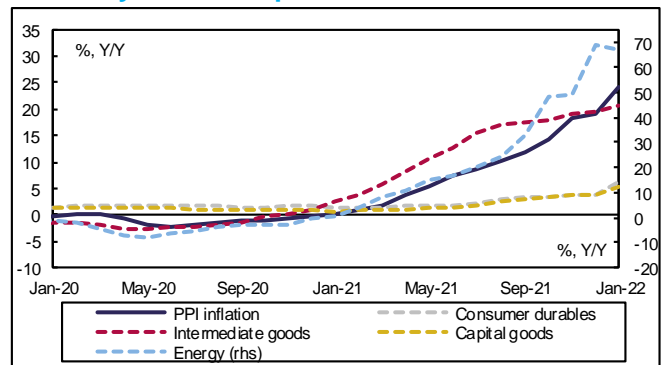
Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Germany: Producer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Producer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

The flow of economic sentiment survey results continues tomorrow, with the German ifo business climate indices for February due to be published. Consistent with today's flash PMIs, the ifo survey is expected to suggest that businesses in the largest member state are cautiously optimistic about the economic outlook. The current assessment balance is expected to have moved broadly sideways, coming in at 96.5 in February, but the expectations index is likely to rise to a five-month high. Also due to be published tomorrow are Italian final CPI numbers for January, which are expected to confirm the flash data and reveal that the EU-harmonised measure of inflation accelerated 1.1 ppts to a series high of 5.3% Y/Y in January, due to an extremely steep jump in household energy bills – where regulated energy prices rose 93.5% Y/Y.

UK

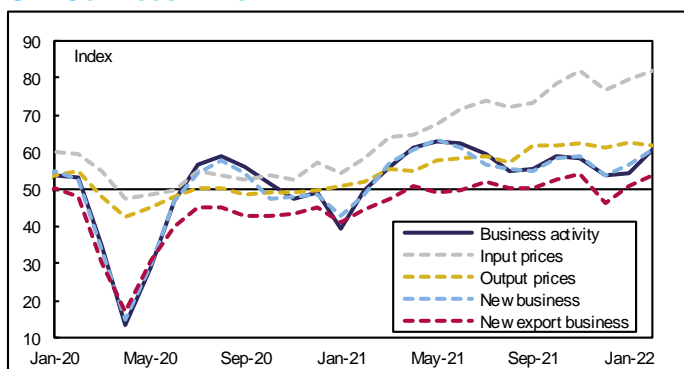
Flash PMIs suggest a sharp rebound in activity in February

After suggesting some stabilisation in economic activity in the UK in January, today's flash PMIs pointed to a marked improvement in conditions in February, supported by the relaxation in pandemic-related restrictions, that underscore the likelihood of further BoE tightening ahead. Perhaps inevitably, the rebound was most striking in the services sector, with the activity PMI jumping 6.7pts to 60.8, the highest since June 2021. There was a further sharp acceleration in new business in the sector too, with the relevant index up 3.7pts to 60.6, similarly an eight-month high. Meanwhile, the manufacturing output PMI rose for the fourth consecutive month, and by 2.2pts to 56.7, a seven-month high, boosted by an easing in supply-side constraints. While still lengthy, today's survey suggested that supplier delivery times were the least severe since November 2020, allowing manufacturers to restock key inputs. And with new orders stalling somewhat on the back of weaker external demand, backlogs of work fell sharply in February to their lowest since June 2020. Overall, the composite PMI rose 6pts to 60.2 in February, the highest since June with the index trending so far in Q1 almost 1pts above the Q4 average. The composite employment PMI also implied the strongest jobs growth since October. But despite the easing in supply constraints, price pressures remained elevated, with the input price PMI increasing 1.6pts to 81.8, just shy of November's survey high.

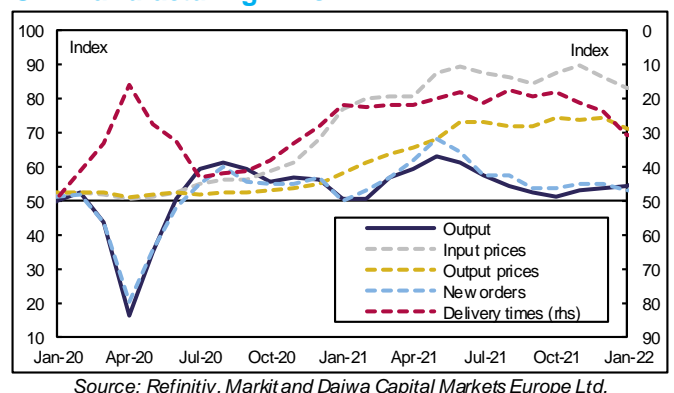
The day ahead in the UK

Tomorrow brings the release of the CBI's industrial trends survey for February and public finance figures for January. In December, the government borrowed £16.8bn, the fourth-highest level of borrowing in any December since monthly records began in 1993 but below the OBR's expectation. While public spending might well have risen further at the start of the year, not least on the back of higher debt interest payments, borrowing in the financial year to date is still expected to be well below the OBR's forecast and so suggest some limited room for fiscal giveaways in the Spring Statement on 23 March. In terms of BoE-speak, Deputy Governor Ramsden (who voted for a 50bps hike this month) is due to speak at a Union conference.

UK: Services PMIs













UK: Manufacturing PMIs



European calendar

Today's results

Economic data

| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|-----------|--|--------|--------------------|--|-------------|---------|
| Euro area |  Preliminary manufacturing (services) PMI | Feb | 58.4 (55.8) | 58.6 (52.3) | 58.7 (51.1) | - |
| |  Preliminary composite PMI | Feb | 55.8 | 52.6 | 52.3 | - |
| Germany |  PPI M/M% (Y/Y%) | Jan | 2.2 (25.0) | 1.4 (24.0) | 5.0 (24.2) | - |
| |  Preliminary manufacturing (services) PMI | Feb | 58.5 (56.6) | 59.4 (54.0) | 59.8 (52.2) | - |
| |  Preliminary composite PMI | Feb | 56.2 | 54.8 | 53.8 | - |
| France |  Preliminary manufacturing (services) PMI | Feb | 57.6 (57.9) | 55.2 (53.5) | 55.5 (53.1) | - |
| |  Preliminary composite PMI | Feb | 57.4 | 53.0 | 52.7 | - |
| UK |  Rightmove house price index M/M% (Y/Y%) | Feb | 2.3 (9.5) | 2.3 (9.5) | 0.3 (7.6) | - |
| |  Preliminary manufacturing (services) PMI | Feb | 57.3 (60.8) | 57.0 (55.5) | 57.3 (54.1) | - |
| |  Preliminary composite PMI | Feb | 60.2 | -55.3 | 54.2 | - |






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 | |
|---------|---|---------|---|--|-------------|-------------|
| Germany |  | 09.00 | ifo business climate index | Feb | 96.5 | 95.7 |
| |  | 09.00 | ifo current assessment (expectations) balance | Feb | 96.5 (96.5) | 96.1 (95.2) |
| Italy |  | 09.00 | Final CPI (EU-harmonised CPI) Y/Y% | Jan | 4.8 (5.3) | 3.9 (4.2) |
| UK |  | 07.00 | Public sector net borrowing, excluding banks £bn | Jan | -3.1 | 16.8 |
| |  | 11.00 | CBI industrial trends survey, total orders (selling prices) | Feb | 25 (68) | 24 (66) |

Auctions and events

| | | | |
|----|---|-------|--|
| UK |  | 10.45 | BoE's Deputy Governor Ramsden scheduled to speak |
|----|---|-------|--|

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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