

Euro wrap-up

Overview

- Bunds made losses at the short end of the curve, but made gains at the long end, as euro area inflation was confirmed at a series high but German consumer confidence deteriorated to a nine-month low.
- Gilts made gains at the short end as dovish BoE MPC member Sylvia Tenreyro said that “only a small amount of policy tightening” is required.
- Thursday will bring surveys on French consumer confidence and UK retail sales while the ECB Governing Council will hold informal discussions, presumably in part to take stock of events in Ukraine.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	-0.377	+0.035
OBL 0 04/27	-0.003	+0.004
DBR 0 02/32	0.220	-0.019
UKT 0 7/8 01/24	1.272	-0.051
UKT 0 7/8 10/26	1.314	-0.040
UKT 0 7/8 07/31	1.464	-0.004

 *Change from close as at 4:40pm GMT.
 Source: Bloomberg

Euro area

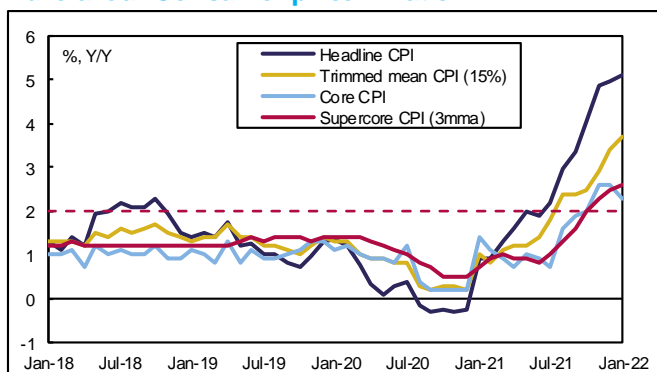
Euro area inflation confirmed at record high due to energy inflation

There were no major surprises from today's final euro area inflation figures, with the headline and core HICP rates confirmed at the flash estimates. The upwards shift in headline HICP inflation in January, by 0.1ppt to 5.1%Y/Y, largely reflected energy prices, which rose a stronger-than-previously estimated 6.2%MM – the most in any month since the start of the euro – to leave the annual rate up 2.7ppts to 28.8%Y/Y. This in part reflected a steep rise in household energy bills in Italy – where regulated energy prices rose 93.5%Y/Y – to leave aggregate euro area electricity prices up more than 27%Y/Y and gas prices by more than 40%Y/Y in January, and energy inflation accounting for more than half of euro area inflation (3.1ppts). Despite being nudged slightly lower from the preliminary estimate, food price inflation (4.0%Y/Y) still rose to its highest since October 2008. And although core inflation fell back at the start of the year, by 0.3ppt to 2.3%Y/Y, this was largely due to the timing of tax changes, New Year discounting and the latest wave of pandemic, the impact of which is likely to be reversed this month. Within the detail, the decline in non-energy industrial goods price inflation (down 0.8ppt to a three-month low of 2.1%Y/Y) was thanks in part to a temporary fall in clothing inflation into negative territory (down 3.5ppts to -0.5%Y/Y). And despite upwards price pressures from package holidays (up 4.7ppts to 11.9%Y/Y, the most since 2015), services inflation (down 0.1ppt to 2.3%Y/Y) was restrained by a steep drop in airfares (down 11.7ppts to 6.1%Y/Y).

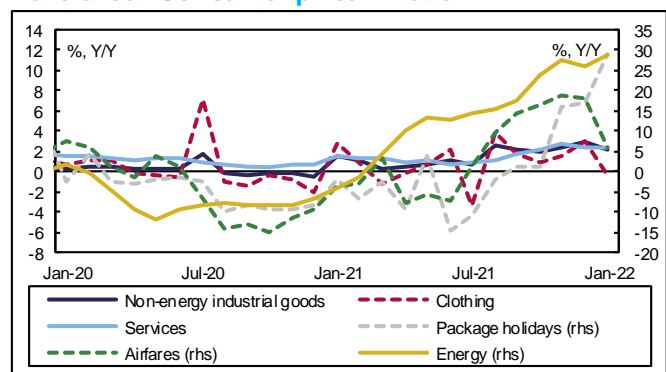
ECB to be mindful of broader underlying price pressures

Despite the decline in the main core inflation measure (which excludes food and energy prices), today's release implied a further broadening of price pressures at the start of the year. Indeed, the supercore measure, of output gap-sensitive items, rose further to 2.6%3M/Y. And the 15% trimmed mean CPI rate rose 0.3ppt to a new high of 3.7%Y/Y. We continue to expect the main core inflation measure to resume an upwards trend over the near term, and to rise by more than 1ppt to a peak similarly around 3½%Y/Y in April. With oil prices having maintained their uptrend and further pass-through of increases in wholesale gas prices to come, energy inflation seems bound to rise further over the near term too. And so, headline inflation is also expected to rise to 6.0%Y/Y or more by the start of Q2 before subsequently falling back only gradually. The ECB will therefore have to revise significantly higher its inflation forecasts, which will be updated next month. And it will be mindful of additional upside risks to energy prices posed by events in Ukraine. So, on 10 March the Governing Council will revise down its near-term plans for its net asset purchases. Today, Austrian National Bank Governor Holzmann argued that the ECB should go further, advocating a first rate hike in the summer before the net purchases have been fully phased out, and providing scope for two hikes before the end of the year. Such a decision to start raising rates while net purchases were still being conducted would run counter to the ECB's existing forward guidance. And given the adverse impact on the ECB's

Euro area: Consumer price inflation



Euro area: Consumer price inflation



balance sheet, it would be highly controversial too. We note also that Holzmann is invariably a hawkish outlier on the Governing Council. So, despite today's comments, we expect no change to the ECB's plan for sequencing the withdrawal of its current exceptional policy measures. And – providing no major further escalation of events in Ukraine – we expect the net asset purchases to be gradually reduced to zero by end-Q3, to be then followed by a 25bps hike in the deposit rate by the end of the year.

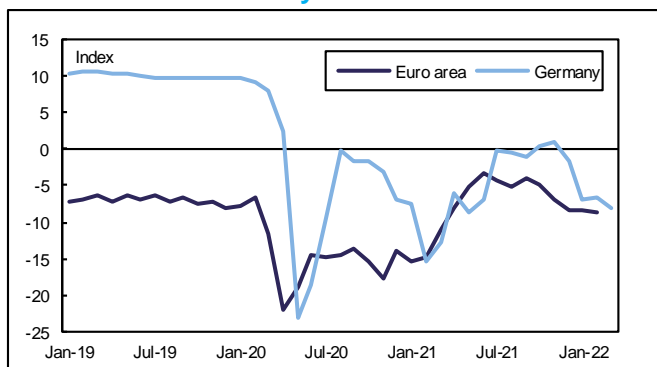
German consumer confidence hit by weaker income and higher price expectations

After last week's flash estimate of euro area consumer confidence unexpectedly suggested a further modest deterioration in February to an eleven-month low, today's GfK indices from Germany offered some further insight. Contrasting markedly with the upbeat ifo and PMI business survey results of the past week, the GfK survey suggested that persisting pandemic-related restrictions, high inflation and subdued wage growth continued to weigh on household sentiment and spending intentions. Indeed, the headline sentiment indicator fell 1.4pts on the month to -8.1, the lowest since May. Within the survey detail, the weakness in part reflected a marked decline in the income expectations index, by 13pts to its lowest level since January 2021, with respondents bemoaning a weakening in purchasing power on the back of higher energy and food prices. As such, there was renewed weakness in consumers' willingness to buy, with the respective survey index falling to its third-lowest reading of the pandemic, to be 6pts lower than the level a year earlier and more than 19pts below the long-run average. And households remained concerned about the near-term inflation outlook – the price expectations index was the third-highest since 2008 despite falling back in February. Nevertheless, consumers were a touch more upbeat about the economic outlook. And with the number of new coronavirus cases having seemingly peaked since the survey was conducted, travel to recreation and retail having risen over recent weeks, and containment measures set to be relaxed over coming weeks, we expect to see a rebound in consumer spending over coming months following the weakness around the turn of the year.

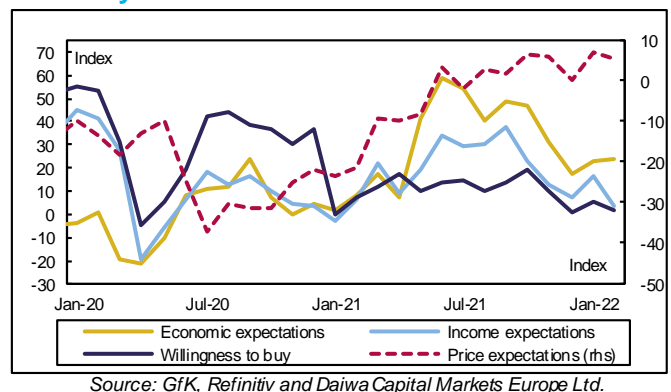
French services sentiment rebounds on improved outlook

Consistent with the more positive flash PMIs, today's French INSEE business survey implied a sizeable improvement in conditions in February. In particular, the headline business climate index rose a stronger-than-expected 5pts to 112, a three-month high and a level well above the long-run average (100). This was principally driven by a solid rebound in the services sector – the respective headline synthetic indicator rose 6pts to 112, similarly a three-month high – reflecting much greater optimism about the general outlook among hospitality and admin support firms in particular. Admittedly, firms across the services, retail, and manufacturing sectors were more downbeat about the level of recent activity. But all expected a more favourable recovery in output over coming months and so were more upbeat about their employment intentions – indeed, the survey's employment climate index rose to a level not seen since April 2008. But like the PMIs, today's survey also flagged

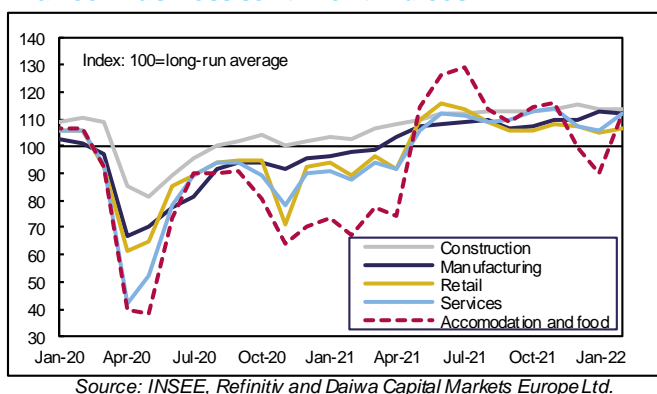
Euro area and Germany: Consumer confidence



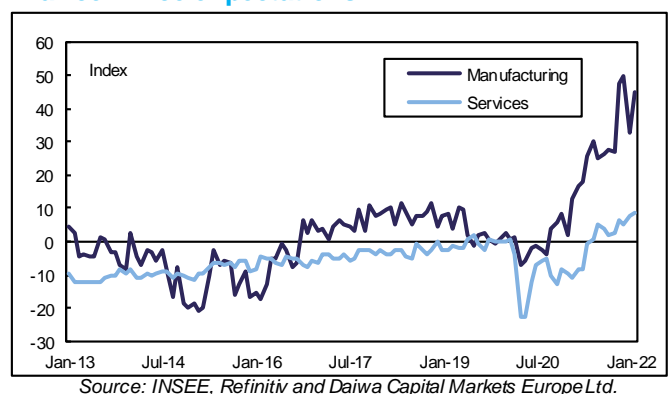
Germany: Consumer confidence indicators



France: Business sentiment indices



France: Price expectations



the persistence of price pressures, with the expected trend in selling prices in the services sector up to the highest since 1990, while the expected price trend in the manufacturing sector rose back close to December's survey high. As such, French consumers seem unlikely to be as upbeat about the outlook as French businesses.

The day ahead in the euro area

It should be a relatively quiet day for European economic data releases tomorrow, with only the French INSEE consumer confidence survey for February due. Perhaps of more interest will be ECB Executive Board member Schnabel's participation in a BoE panel discussion tomorrow about unwinding QE. And the Governing Council will hold an informal meeting ahead of Friday's meetings with European finance ministers, probably to discuss the latest developments with respect to Ukraine and their possible implications for monetary policy ahead of next month's policy decision. Friday will also bring the release of the European Commission's detailed economic sentiment indicators (ESIs), which like the flash PMIs are likely to suggest a pickup in activity thanks not least to the drop in new coronavirus cases across the region. The end of the week will also bring the first estimates of February inflation from France, which are expected to report that headline HICP inflation rose to its highest rate since mid-2008. An update on Germany's Q4 GDP will bring the first official expenditure breakdown, which will likely confirm that the decline of 0.7%Q/Q in overall economic output was caused by declines in private consumption and construction investment. In contrast, the second estimate of French Q4 GDP is expected to confirm that output grew by 0.7%Q/Q thanks to increased private consumption and fixed investment. Other data to be published on Friday include the euro area's latest bank lending numbers.






UK

The day ahead in the UK

After a day bereft of UK data, the highlight tomorrow will be the release of the CBI's retail sales survey for February. Retailers are expected to report higher sales compared to a year ago, not least due to the easing of coronavirus cases, albeit with the balance falling slightly to 25 in February, from 28 in January. But with household disposable incomes being squeezed by higher inflation and the prospect of a further increase in household energy bills in April alongside an increase in national income contributions and higher mortgage payments, Friday's consumer confidence survey from the GfK seems unlikely to signal a notable improvement in sentiment and spending intentions this month. Meanwhile, the Bank of England will hold its first two-day annual research conference, which will bring together academics and policymakers to discuss monetary policy issues. Governor Bailey will give the welcome address, while Deputy Governor Broadbent will moderate the panel on unwinding QE, the Bank's proposals on which have yet to be fully announced. Chief Economist Huw Pill will give closing remarks on Friday.



The next edition of the Euro wrap-up will be published on 25 February 2022

European calendar




Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final CPI (core CPI) Y/Y%	Jan	5.1 (2.3)	5.1 (2.3)	5.0 (2.6)	-
Germany	 GfK consumer confidence index	Feb	-8.1	-6.3	-6.7	-
France	 INSEE business (manufacturing) confidence index	Feb	112 (22)	108 (-)	107 (112)	- (113)
Auctions						
Country	Auction					
Germany	 sold €1.28bn of 0% 2036 bonds at an average yield of 0.37%					
Italy	 sold €3bn of 0% 2023 bonds at an average yield of 0.14%					

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 INSEE consumer confidence index	Feb	100	99
UK		11.00 CBI distributive sales survey, total retailing sales	Feb	25	28

Auctions and events






Euro area		16.00 ECB's Schnabel speaks on panel at BoE research conference, The Monetary Toolkit – Unwinding QE
UK		13.15 BoE Governor Bailey gives a pre-recorded welcome address at BoE research conference
		16.00 BoE Deputy Governor Broadbent moderates a BoE panel on The Monetary Toolkit – Unwinding QE

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases
Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area		10.00 M3 money supply Y/Y%	Jan	6.7	6.9
		10.00 Commission's Economic Sentiment Indicator	Feb	113.0	112.7
		10.00 Commission's industrial (services) index	Feb	14.1 (10.0)	13.9 (9.1)
		10.00 Commission's final consumer confidence	Feb	-8.8	-8.5
Germany		07.00 GDP – second estimate Q/Q% (Y/Y%)	Q4	-0.7 (1.4)	1.7 (2.9)
France		07.45 Preliminary CPI (EU-harmonised CPI) Y/Y%	Feb	-	2.9 (3.3)
		07.45 PPI M/M% (Y/Y%)	Jan	-	1.0 (17.7)
		07.45 GDP – second estimate Q/Q% (Y/Y%)	Q4	0.7 (5.4)	3.1 (5.4)
		07.45 Consumer spending M/M% (Y/Y%)	Jan	-0.8 (-1.8)	0.2 (-5.1)
Italy		09.00 ISTAT business (manufacturing) confidence index	Feb	- (113.5)	105.4 (113.9)
		09.00 ISTAT consumer confidence index	Feb	114.4	114.2
UK		00.01 GfK consumer confidence	Feb	-18	-19

Auctions and events

Euro area		- ECB President Lagarde and Board Member Panetta participate in Eurogroup meeting
Italy		10.00 Auction: €4bn of 1.1% 2027 bonds
		10.00 Auction: €3bn of 0.95% 2032 bonds
		10.00 Auction: €1.25bn of 2026 floating rate bonds
		18.00 BoE Chief Economist Pill gives closing remarks at the BoE's research conference

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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