Daiwa Capital Markets

Euro wrap-up

Overview

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- Euro area government bonds made losses as French inflation data exceeded expectations and German GDP was revised up, while the ECB's initial estimates of the possible impact of the Ukraine conflict on euro area economic activity was reported.
- Gilts rallied at the short end of the curve as UK consumer confidence fell sharply.
- The coming week will bring the flash euro area estimates of inflation in February while ECB and BoE policymakers should give early indications of their assessment of the economic impact of the conflict in Ukraine.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	-0.395	+0.044
OBL 0 04/27	-0.009	+0.074
DBR 0 02/32	0.224	+0.058
UKT $0^{1}/_{8}$ 01/24	1.191	-0.052
UKT $0^{3}/_{8}$ 10/26	1.244	-0.044
UKT $0^{1}/_{4}$ 07/31	1.452	+0.008

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

Euro area

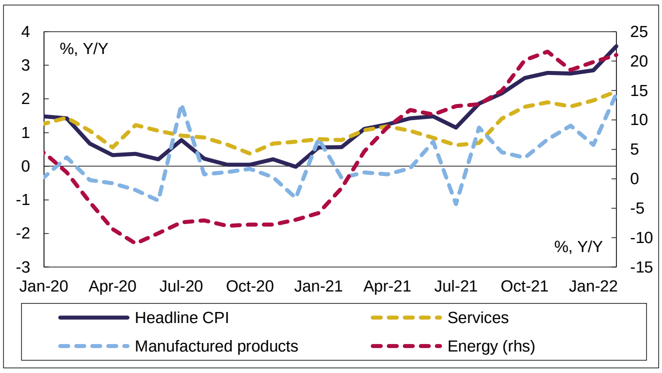
French inflation beats expectations with broad-based pressures

Having surprised on the downside last month, the flash measure of French inflation in February – the first to come from the euro area member states – exceeded expectations. The national CPI measure rose 0.7ppt to 3.6%Y/Y, the highest since 2008, and the EU-harmonised HICP measure rose 0.8ppt to a series high of 4.1%Y/Y, with the detail revealing increasingly broad-based pressures. Having been suppressed last month by shifts in the timing of New Year discounting, inflation of manufactured goods jumped 1.6ppts to 2.2%Y/Y, the highest since 1992, as the winter sales came to an end and firms passed on some of their increased costs to consumers. Services inflation rose 0.2ppt to 2.2%Y/Y, the highest since 2009, on increased transport prices, so core inflation rebounded. In addition, inflation of fresh food jumped 1.6ppts to 5.6%Y/Y. And with increased prices of petrol, energy prices rose 3.5%M/M to push the respective inflation rate up 1.1ppts to 21.0%Y/Y – a rate that would be markedly higher were it not for the government's measures to limit the rise in household electricity prices to 4%. We saw yesterday that the erosion of real incomes by inflation is increasingly weighing on French consumer confidence. And data released today showed that French consumer spending on goods fell a larger-than-expected 1.5%M/M in January back below the pre-pandemic level for the first time since October, weighed by notable declines in sales of clothing, food and engineered goods. After a flat December, that left consumer spending on goods 1.5% below the Q4 average. So, while spending on services is likely to pick-up as the current coronavirus wave fades further, on average this quarter spending on goods is likely to remain below the Q4 level. And having risen 0.4%Q/Q in Q4, French private consumption growth in Q1 will be very subdued indeed.

German GDP in Q4 not quite as weak as previously thought, but revision increases recession risk

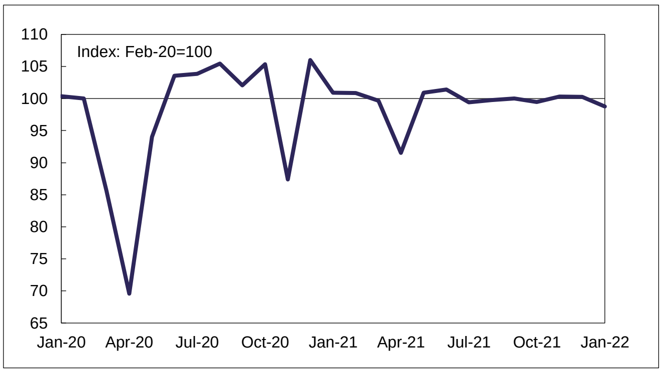
The extent of the decline in German GDP in Q4 was not quite as marked as previously estimated, raising the possibility of an eventual upwards revision to euro area growth. While that is good news, the higher base raises risks of a further decline in German GDP in Q1, which would mean that the euro area's largest member state is now in technical recession. On balance, we still think that German GDP should edge higher this quarter, but weakening consumer confidence amid high inflation and concerns about developments in Ukraine pose significant downside risks. Indeed, the 0.3%Q/Q drop in German economic output last quarter – which was 0.4ppt less than previously thought and left it still 2.0% below the pre-pandemic level – was explained by household consumption, which fell 1.8%Q/Q as the latest wave of pandemic weighed following two successive quarters of strong expansion. In addition, restrained by supply constraints, construction investment was unchanged having fallen 3.9%Q/Q in Q3. And the rebound in investment in machinery and equipment in Q4 was relatively soft at 0.9%Q/Q after dropping 3.6%Q/Q the prior quarter. Government consumption provided some support, rising 1.0%Q/Q. And while growth in exports fell slightly short of growth in imports, net trade added 0.2ppt to growth while inventories added 0.1ppt.

France: CPI inflation*



*National measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Consumer spending on goods



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Improvement in economic sentiment in February to be short-lived

Tallying with the flash PMIs, the European Commission's February economic sentiment indices (ESIs) suggested a firming of activity in Q1. The headline euro area ESI rose for the first time in four months and by a bigger-than-expected 1.3pts to 114, the highest since November, while the equivalent indices for each of the four largest member states also picked up. While consumer confidence dropped for a fifth successive month to the lowest since March, business sentiment registered a broad-based improvement, with a notable turn for the better in services and retail trade thanks to the more favourable coronavirus trend. In addition, confidence was steady at a historically high level in the industrial sector where production expectations and orders remained elevated but inventories low. And the survey suggested that firms had the most ambitious job hiring plans in more than two decades, led by services. However, selling price expectations for the coming three months rose once again reaching series highs in industry, services and retail trade, and a more than thirty-year high in construction. Somewhat more encouraging, and contrasting a surge in recent price perceptions, consumer price expectations eased very slightly but remained highly elevated, continuing to erode expectations of financial well-being.

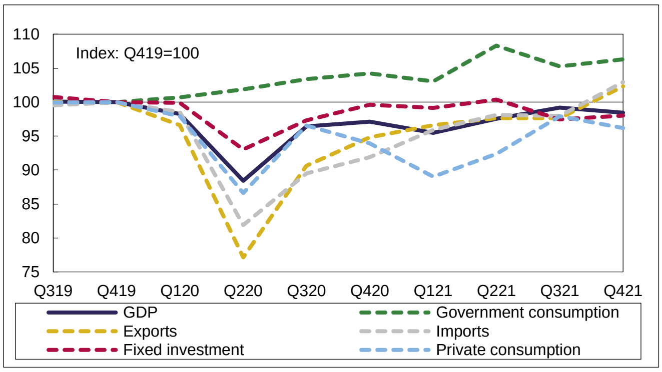
Reports suggest initial ECB assessment of GDP growth hit from Ukraine conflict

While the Commission indices were consistent with stronger economic growth, we caution that it was conducted between 1-18 February, before the recent marked deterioration in events in Ukraine. According to a Reuters report, "very preliminary" ECB estimates presented by Chief Economist Philip Lane to the Governing Council yesterday evening suggested that the impact on energy prices from Russia's invasion could reduce euro area GDP growth by up to 1ppt this year, with a central scenario of a hit of 0.3-0.4ppt. But while consumer price inflation this year is likely to be more than 1ppt higher than previously anticipated, the weakening of growth momentum this year might then be expected to cause inflation to fall back below 2% in 2023 and 2024. Subsequent comments from President Lagarde downplayed the reports of the ECB's assessment of the impact on growth, rightly noting that the situation continues to evolve. And, of course, much will depend on the length and severity of the conflict, and developments with respect to sanctions and countersanctions and their effects on prices of energy and other commodities. Moreover, next month's economic surveys, and other high-frequency data, will provide a much better guide to the initial impact on business and consumer confidence, which is highly likely to have taken a marked hit to the detriment of GDP growth.

Household deposits and longer-term lending to NFCs rise at start of year

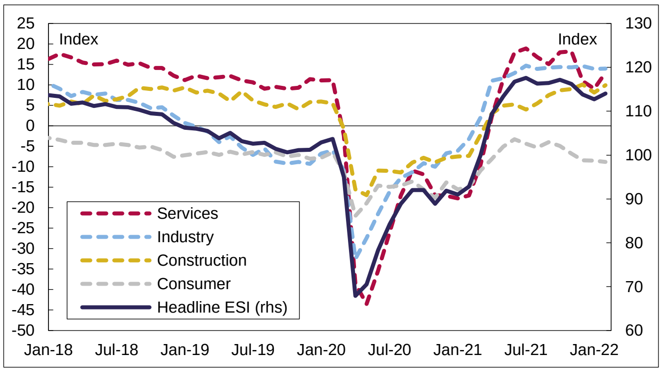
Today's ECB bank lending numbers offered mixed messages at the start of the year. While there was still solid growth in M3 money supply, it moderated further in January by 0.5ppt to 6.4%Y/Y, some 12ppts down from the peak rate a year ago and the softest pace for almost two years. This largely reflected the softest pace of annual growth in overnight deposits for two

Germany: GDP and major expenditure components



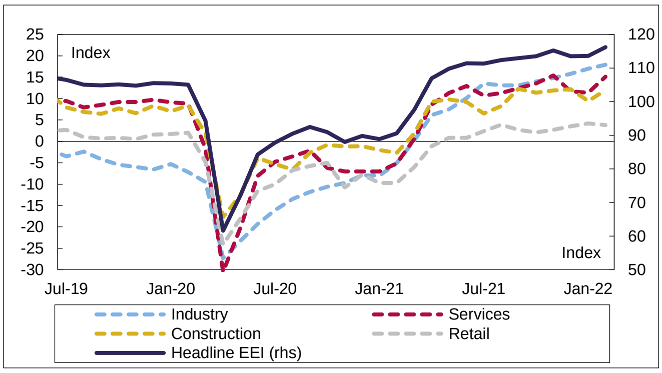
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Economic sentiment



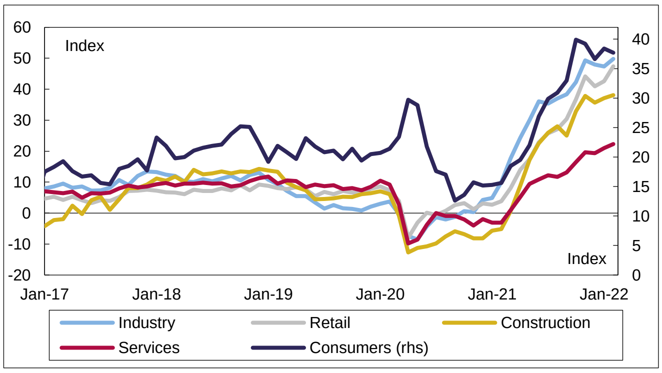
Source: Refinitiv, EC and Daiwa Capital Markets Europe Ltd.

Euro area: Employment expectations



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

Euro area: Price expectations



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

years, down 0.9ppt to 9.3%Y/Y, as non-financial corporations withdrew funds for first time in nine months and by the most for almost four years. But probably reflecting reduced opportunities to spend due to the latest pandemic wave and heightened fears about rising prices, household deposits rose by the most since August, with the net monthly flow (€44.6bn) some €10bn stronger than average over the past year. So, household 'excess savings' during the pandemic rose to about €470bn, equating to roughly 8% of annual household consumption. Meanwhile, demand for consumer credit remained very subdued, with the net flow of such lending down for the second successive month. So, the slight uptick in growth in total loans to households (by 0.1ppt to 4.4%Y/Y) was thanks to the strongest monthly net flow in mortgage lending (€24bn) for nine months. There was also stronger growth in the stock of loans to NFCs too, by 0.1ppt to 4.4%Y/Y, due to an acceleration in the net flow of loans of maturities longer than five years, tentatively suggestive of firmer business fixed investment.

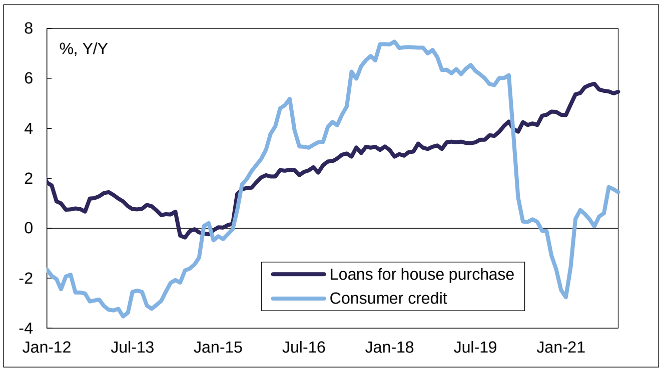
The week ahead in the euro area

Ahead of the forthcoming ECB policy meeting on 10 March, market participants will be watching closely for any commentary from policy makers ahead of the pre-meeting seven-day blackout period. The normally highly dovish Executive Board member Panetta is scheduled to speak on Monday while Chief Economist Lane might elaborate on his assessment of the impact of the Ukraine conflict on the euro area economic outlook. The account of the ECB's February policy-setting meeting will be published on Thursday, although any detailed debate on the near-term policy profile will have been subsequently superseded by the past week's Russian invasion of Ukraine.

Data-wise, the coming week brings preliminary February inflation figures from Spain (Monday), Germany and Italy (Tuesday), concluding with the aggregate euro area data on Wednesday. We expect higher energy prices to continue to exert upward pressure on the euro area headline HICP rate, which we forecast to rise at least 0.4ppt to a new record high of 5.5%Y/Y or more. But having dipped to 2.3%Y/Y in January, thanks principally to the timing of tax changes and New Year, we also expect a rebound in goods and services price inflation to push the core CPI rate back up to 2.6%Y/Y. Other euro area data due include unemployment figures on Thursday and retail sales on Friday. Having declined for the eighth successive month in December to a series low of 7.0%, the unemployment rate might have moved sideways at the start of the year as the latest pandemic wave tempered jobs growth. However, euro area retail sales data are expected to reverse some of the weakness seen in December, with forecast growth of 1½%M/M following the 3.0%M/M decline previously. Meanwhile, February new car registration numbers for France, Italy and Spain will be published on Tuesday, followed by German car sales and production numbers on Thursday.

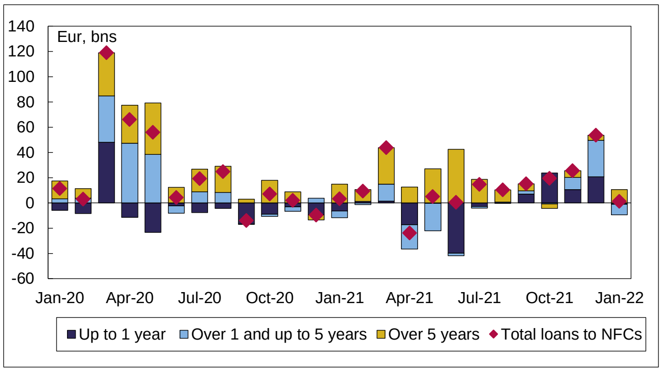
Survey-wise, final manufacturing PMIs for the euro area, Germany and France as well as survey results for Italy and Spain will be published on Tuesday, followed by the equivalent services and construction PMIs on Thursday and Friday

Euro area: Loans to households



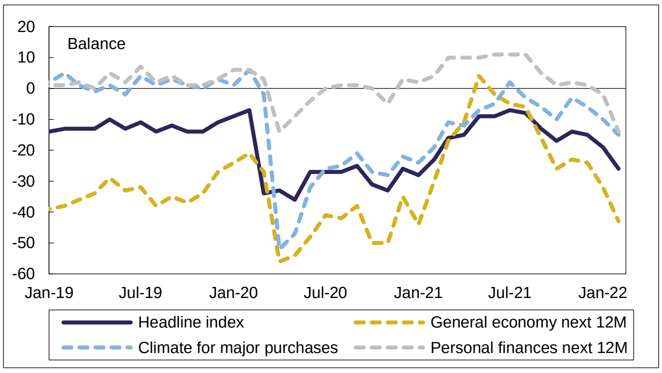
Source: ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Net lending to NFCs



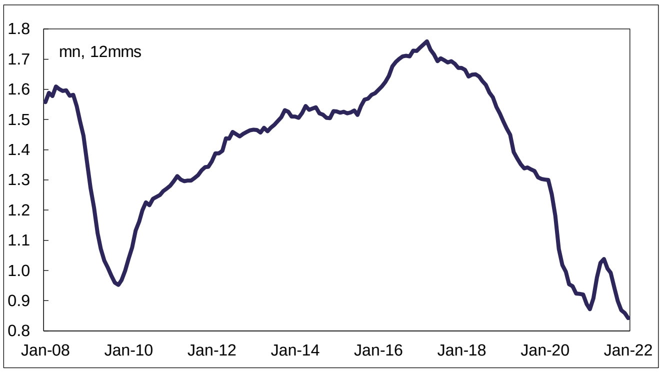
Source: ECB and Daiwa Capital Markets Europe Ltd.

UK: Consumer confidence



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

UK: Car production



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

respectively. The flash euro area PMIs were upbeat, with the composite PMI rising 3.5pts in February to 55.8, signaling the fastest pace of expansion since September, underpinned by a marked turnaround in the services sector, with the respective activity PMI up 4.7pts to 55.8, a three-month high.

UK

UK consumer confidence plunges on inflation fears pointing to a weak spending outlook

While yesterday's CBI survey suggested that UK consumer spending has held up over the past month, the latest GfK survey published overnight signalled a sharp drop in household confidence that likely foreshadows weakness ahead. The headline index dropped 7pts – the most since the onset of the pandemic – to a thirteen-month low of -26, well below the long-run average and a level normally consistent with falling spending. All major sub-indices fell significantly as households fretted about the rising cost of living, with inflation already at multi-decade highs, household energy prices set to rise more than 50% in April when national insurance contributions will also be increased, and mortgage rates increasing too. Strikingly, expectations regarding personal finances over the coming twelve months were judged to be the worst since the first wave of the pandemic in April 2020, and were inferior only once in the past 25 years back in the midst of the financial crisis in 2008. Additionally, the climate for making major purchases was considered the worst in twelve months, with the respective indicator well below the long-run average and consistent with falling spending.

Car production remains in reverse

Finally, today's UK car production numbers capped a disappointing week for UK data. According to the car manufacturers' association SMMT, in January only 68.8k new cars were produced, the weakest outturn for the month since 2009 and down 20% from a year earlier (which itself was particularly low), weighed by persisting supply bottlenecks, extended maintenance shutdowns and new post-Brexit trading frictions. Production was a little more than 40% lower than in January 2020 ahead of the pandemic and roughly 50% below the level ahead of the Brexit referendum in 2016. With BMW's Mini plant in Oxford having closed in the past week due to the ongoing semiconductor chip shortage, production is likely to have remained subdued in February, suggesting that pressures on second-hand car prices – up a record 28.7%Y/Y in January – will persist for a while yet.

The week ahead in the UK

In the coming week, eyes will remain on the BoE with MPC members Saunders and Mann in action on Tuesday, followed by Tenreyo and Cunliffe on Wednesday. Their comments will inevitably be watched for their assessment of the likely impact of the Ukraine conflict on UK GDP and inflation, and hence what that could mean for monetary policy. On the data front, it should be a relatively quiet week for top-tier UK releases, beginning with bank lending figures for January on Tuesday. Consistent with stronger retail sales last month, we would expect to see a further increase in consumer credit in January, while demand for secured lending likely remained robust in line with ongoing strength in the housing market. Meanwhile, the BRC shop price index for February on Wednesday will provide an early indication into inflation on the high street, with the survey's headline rate having risen in January to the highest since 2012. Like in the euro area, the final UK manufacturing PMIs for February will be published on Tuesday, followed by the final services and composite PMIs on Thursday and construction PMIs on Friday. The flash PMIs pointed to a marked improvement in conditions in February, supported by the relaxation in pandemic-related restrictions. 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. Friday will also bring new car registrations numbers for February.

The next edition of the Euro wrap-up will be published on 1 March 2022

The coming week's data calendar

The coming week's key data releases

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast/actual*	Previous
			Monday 28 February 2022			
Spain		08.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Feb	6.1 (7.0)	6.1 (6.2)
UK		00.01	Lloyds business barometer	Feb	-	39
			Tuesday 01 March 2022			
Euro area		09.00	Final manufacturing PMI	Feb	58.4	58.7
Germany		08.55	Final manufacturing PMI	Feb	58.5	59.8
		13.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Feb	5.0 (5.3)	4.9 (5.1)
France		08.50	Final manufacturing PMI	Feb	57.6	55.5
		-	New car registrations* Y/Y%	Feb	-	-18.6
Italy		08.45	Manufacturing PMI	Feb	58.0	58.3
		10.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Feb	5.3 (5.4)	4.8 (5.1)
		17.00	New car registrations Y/Y%	Feb	-	-19.7
Spain		08.15	Manufacturing PMI	Feb	56.0	56.2
		-	New car registrations* Y/Y%	Feb	-	1.0
UK		09.30	Net consumer credit £bn (Y/Y%)	Jan	1.0 (-)	0.8 (1.4)
		09.30	Net mortgage lending £bn (mortgage approvals '000s)	Jan	4.0 (72.0)	3.6 (71.0)
		09.30	Final manufacturing PMI	Feb	57.3	57.3
			Wednesday 02 March 2022			
Euro area		10.00	Preliminary CPI (core CPI) Y/Y%	Feb	*5.5 (2.6)*	5.1 (2.3)
Germany		08.55	Unemployment change '000s (rate %)	Feb	-20.0 (5.1)	-48.0 (5.1)
Spain		08.00	Unemployment change '000s	Feb	-	17.2
UK		00.01	BRC shop price index Y/Y%	Feb	-	1.5
		07.00	Nationwide house price index M/M% (Y/Y%)	Feb	0.6 (10.8)	0.8 (11.2)
			Thursday 03 March 2022			
Euro area		09.00	Final services (composite) PMI	Feb	55.8 (55.8)	51.1 (52.3)
		10.00	PPI M/M% (Y/Y%)	Jan	2.4 (26.9)	2.9 (26.2)
		10.00	Unemployment rate %	Jan	7.0	7.0
Germany		08.55	Final services (composite) PMI	Feb	56.6 (56.2)	52.2 (53.8)
		-	New car registrations Y/Y%	Feb	-	8.5
France		08.50	Final services (composite) PMI	Feb	57.9 (57.4)	53.1 (52.7)
Italy		08.45	Services (composite) PMI	Feb	52.7 (-)	48.5 (50.1)
Spain		08.15	Services (composite) PMI	Feb	51.7 (-)	46.6 (47.9)
UK		09.30	Final services (composite) PMI	Feb	60.8 (60.2)	54.1 (54.2)
			Friday 04 March 2022			
Euro area		08.30	Construction PMI	Feb	-	56.6
		10.00	Retail sales M/M% (Y/Y%)	Jan	1.3 (9.1)	-3.0 (2.0)
Germany		07.00	Trade balance €bn	Jan	6.5	6.6
		08.30	Construction PMI	Feb	-	54.4
France		07.45	Inudstrial production M/M% (Y/Y%)	Jan	0.5 (-3.2)	-0.2 (-0.5)
		07.45	Manufacturing production M/M% (Y/Y%)	Jan	-	0,.1 (-0.3)
		08.30	Construction PMI	Feb	-	52.0
Italy		09.00	Final GDP Q/Q% (Y/Y%)	Q4	0.6 (6.4)	2.6 (3.9)
		08.30	Construction PMI	Feb	-	68.2
UK		09.00	New car registrations Y/Y%	Feb	-	27.5
		09.30	Construction PMI	Feb	57.3	56.3

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

The coming week's key events & auctions

Country	GMT	Event / Auction
		Monday 28 February 2022
Euro area	11.30	ECB's Panetta scheduled to speak on "Monetary policy and the euro area economic outlook"
		Tuesday 01 March 2022
Euro area	-	ECB's Panetta takes part in virtual G7 meeting of finance ministers and central bank governors
UK	18.30	BoE's Saunders scheduled to speak
	19.00	BoE's Mann scheduled to speak on a panel on 'Inflation and monetary policy'
		Wednesday 02 March 2022
Euro area	10.00	ECB's Schnabel takes part in economic roundtable discussion
	11.00	ECB's de Guindos gives remarks before economic Q&A session
	13.00	ECB President Lagarde visits German Chancellor Olaf Scholz
	16.00	ECB Chief Economist Lane to speak on the outlook for the European economy
Germany	10.30	Auction: €1.5bn of 0% 2030 bonds
UK	10.00	Auction: £3.25bn of 0.25% 2025 bonds
	18.30	BoE's Tenreyo scheduled to speak
	20.00	BoE's Cunliffe scheduled to speak
		Thursday 03 March 2022
Euro area	12.30	ECB publishes account of February's Governing Council Policy meeting
France	09.50	Auction: 0% 2032 bonds
	09.50	Auction: 3.25% 2045 bonds
	09.50	Auction: 0.75% 2053 bonds
Spain	09.30	Auction: 0.266% 2025 bonds
	09.30	Auction: 0.8% 2029 bonds
	09.30	Auction: 1% 2042 bonds
	09.30	Auction: 0.7% 2033 inflation-linked bonds
UK	09.30	BoE publishes Monthly Decision Maker Panel data
		Friday 04 March 2022
		- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	M3 money supply Y/Y%	Jan	**6.4**	6.7	6.9	-
	Commission's Economic Sentiment Indicator	Feb	**114.0**	113.1	112.7	-
	Commission's industrial (services) index	Feb	**14.0 (13.0)**	14.1 (10.2)	13.9 (9.1)	-
	Commission's final consumer confidence	Feb	**-8.8**	-8.8	-8.5	-
Germany	GDP – second estimate Q/Q% (Y/Y%)	Q4	**-0.3 (1.8)**	-0.7 (1.4)	1.7 (2.9)	-
France	Preliminary CPI (EU-harmonised CPI) Y/Y%	Feb	**3.6 (4.1)**	3.3 (3.7)	2.9 (3.3)	-
	PPI M/M% (Y/Y%)	Jan	**4.6 (22.2)**	-	1.0 (17.7)	**1.3 (18.0)**
	GDP – second estimate Q/Q% (Y/Y%)	Q4	**0.7 (5.4)**	0.7 (5.4)	3.1 (5.4)	-
	Consumer spending M/M% (Y/Y%)	Jan	**-1.5 (-2.1)**	-0.8 (-1.8)	0.2 (-5.1)	**0.0 (-5.4)**
UK	GfK consumer confidence	Feb	**-26**	-18	-19	-

Auctions

Country	Auction
Italy	sold €4bn of 1.1% 2027 bonds at an average yield of 1.07%
	sold €3bn of 0.95% 2032 bonds at an average yield of 1.81%
	sold €1.25bn of 2026 floating rate bonds at an average yield of -0.1%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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