

# Euro wrap-up

## Overview

- Bunds reversed some of yesterday's gains as flash euro area inflation figures exceeded initial expectations, wholesale oil and gas prices jumped sharply, and the German labour market continued to improve.
- Gilts also made losses after MPC members signalled their preference for further rate hikes, and UK data pointed to stronger shop and home prices.
- Thursday will bring the account of the ECB's February policy meeting as well as data for euro area unemployment, German car production and sales, and the final services PMIs.

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### Daily bond market movements

| Bond          | Yield  | Change |
|---------------|--------|--------|
| BKO 0 03/24   | -0.644 | +0.109 |
| OBL 0 04/27   | -0.279 | +0.133 |
| DBR 0 02/32   | 0.010  | +0.090 |
| UKT 1 04/24   | 1.045  | +0.251 |
| UKT 1 ¼ 07/27 | 1.000  | +0.221 |
| UKT 4 ¼ 06/32 | 1.256  | +0.131 |

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

## Euro area

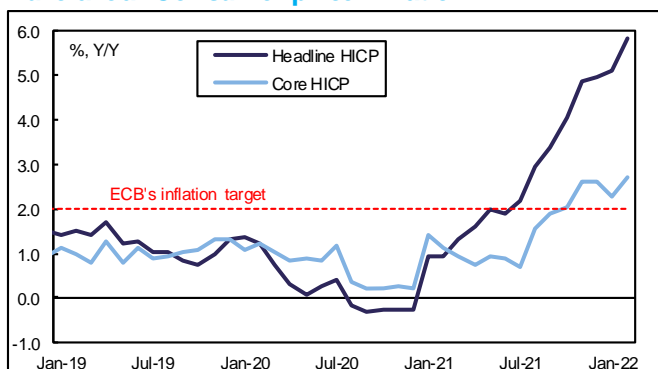
### Headline and core inflation up to new series highs on energy and goods prices

As had become increasingly likely as the national data were released over recent days, the flash estimate of euro area consumer price (HICP) inflation in February rose to a series high well above earlier expectations. The increase of 0.7ppt to 5.8%YY left the average for the first two months of Q1 more than 1¼ppts above the ECB's forecast of 4.1%YY for the first quarter. And given recent developments in wholesale energy and commodity markets, inflation now seems bound to rise significantly further in March and April. Once again, the principal impetus came from energy prices, which rose 3.3%MM on higher prices of gasoline and household energy to take the cumulative increase since the end of 2021 to almost 9½%. As a result, the annual rate of energy inflation also rose to a new record high, 31.7%YY, accounting for a whopping 3.5ppts of the headline inflation rate. Reflecting poor harvests and global market pressures, prices of food, alcohol and tobacco rose the most in any February since the creation of the euro, to be up 4.1%YY, the fastest since 2008. Similarly, prices of non-energy industrial goods also posted a record monthly increase for February, to be up a series high 3.0%YY as firms passed on some of their cost pressures to consumers. And while the monthly increase in prices of services was broadly normal for the time of year, it still pushed the respective annual rate up 0.2ppt to 2.5%YY, so core inflation rose a larger-than-expected 0.4ppt to a series high of 2.7%YY.

### Energy and food prices set inflation on track towards 7% or even above

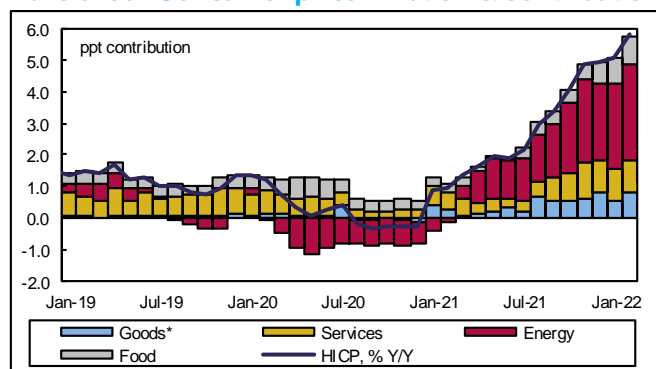
Looking ahead, not least given the intensified pressures in wholesale energy and commodity prices unleashed by Russia's invasion of Ukraine, inflation is bound to rise significantly further over the near term. With European demand for Russian crude reportedly having fallen significantly in response to sanctions, the extra demand for oil of alternative origins today initially pushed the euro-denominated spot price of Brent crude to a euro-era high above €100, more than 20% above last month's average, despite an agreement of OPEC+ to raise output next month. After hitting a record high early on, European natural gas futures for next month levelled off more than 40% higher on the day above €160, more than double the level priced by the market a month ago. And euro-denominated agricultural prices have risen to a new high, up more than 10% from the February average. So, with surveys also suggesting only modest easing of supply bottlenecks and no let-up in manufacturing cost pressures, some of which are likely to continue to be passed on to consumers, headline inflation could rise by 1ppt or more in March, and again in April to above 7.0%YY. And core inflation could well surpass 3.0%YY this month and rise further in April. Of course, prices of energy and commodities are bound to remain volatile, continuing to respond to developments in Ukraine and associated sanctions. And with the path of the conflict impossible to predict with any confidence, the range of plausible inflation outcomes over the near term, let alone further ahead, is extremely wide indeed. Chief Economist Philip Lane today stated that the ECB's upcoming projections would reflect February's inflation data as well

### Euro area: Consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Consumer price inflation & contributions



\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

as recent shifts in energy prices. And he repeated Christine Lagarde's statement from Friday that the ECB would respond flexibly to developments, while adding that it would consider new policy instruments – presumably related to the provision of liquidity – if needed.

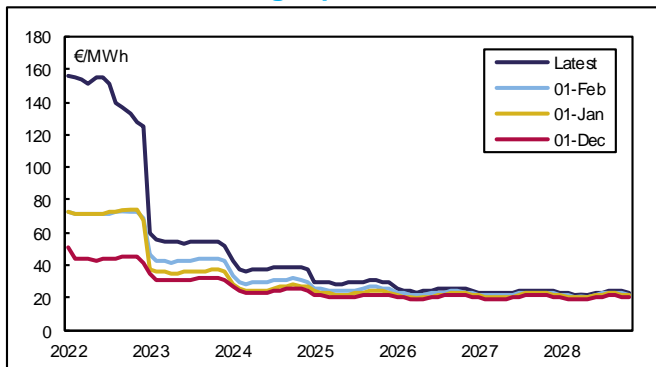
## German and Spanish unemployment continues to fall, for now

While events in Ukraine and their impact on costs and prices heighten economic uncertainty and are likely to weigh on confidence and demand from now on, today's data from Germany and Spain suggest that conditions in the labour market continued to improve last month. In Germany, following average monthly increases of 57k from March to December, the number of people employed rose a further 81k in January to 45.19mn. This left it just 96k (0.2%) lower than the pre-pandemic level, although the most recent data available suggest that around 641k employees were still benefiting from the government's Kurzarbeit short-time working scheme in December (up from 574k previously). In seasonally adjusted terms, there was also a further decline in claimant count unemployment in February, down a larger-than-expected 33k to 2.31mn. That took the claimant count rate down 0.1ppt to 5.1%, back to the pre-pandemic level for the first time and 1.4ppts lower than the peak in mid-2020. And vacancies rose to a new record high too. Of course, that positive momentum in the labour market is encouraging. But with negotiated wage growth having slowed further in the first two months of the year to just 1.1%YY, German real labour incomes look set to fall sharply this year. Meanwhile, today's Spanish labour market figures similarly pointed to ongoing recovery in February, with employment rising for the tenth consecutive month, by 37k, to 19.93mn, some 450k (2.3%) above the level two years ago. Reportedly only around 100k workers were supported by the government's temporary ERTE support scheme, with the majority of them working in hospitality and travel-related services. The number of Spanish jobless claims fell a further 36k to 2.98mn, the lowest since the euro crisis.

## The day ahead in the euro area

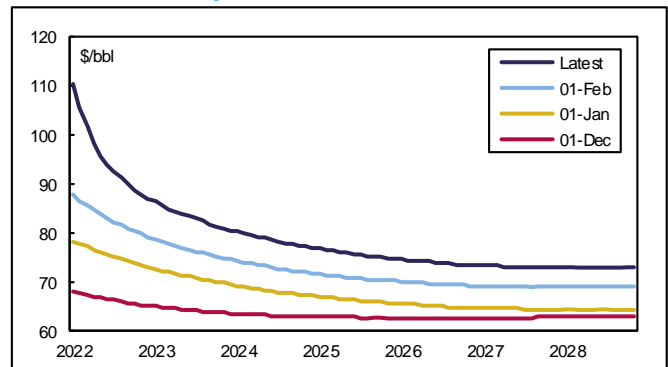
Tomorrow will bring a number of releases of note including euro area producer prices data for January, which will likely reveal additional inflationary pressures at the factory gate related not least to energy. Euro area unemployment figures for the same month are also due. Having declined for the eighth 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. Meanwhile, among the national releases, German car sales and production numbers for February are perhaps most notable. Survey-wise, the final euro area services PMIs will likely confirm the upbeat flash release suggesting a marked turnaround in the sector – the headline PMI rose 4.7pts to 55.8, a three-month high – with looser restrictions enabling a particularly strong rise in consumer-facing services and tourism. As such, the composite PMI rose 3.5pts in February to 55.8, signaling the fastest pace of expansion since September. In addition, the account of the ECB's February policy-setting meeting will also be

### Netherlands natural gas price futures curves



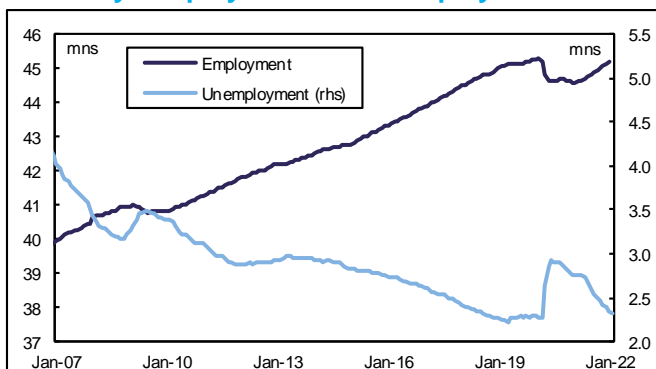
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Brent crude oil price futures curves



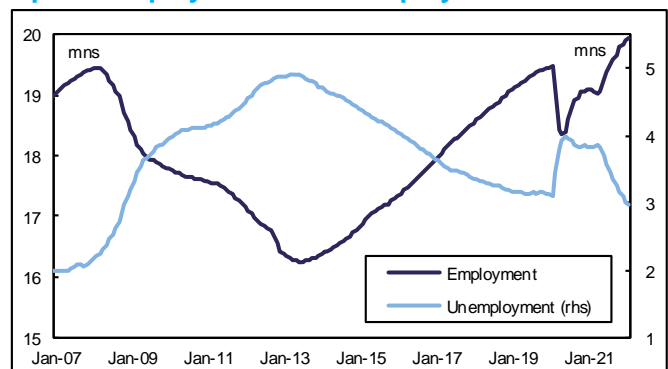
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Germany: Employment and unemployment levels



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

### Spain: Employment and unemployment levels



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

published tomorrow, although any detailed debate on the near-term policy profile will have been superseded by Russia's invasion of Ukraine.

## UK

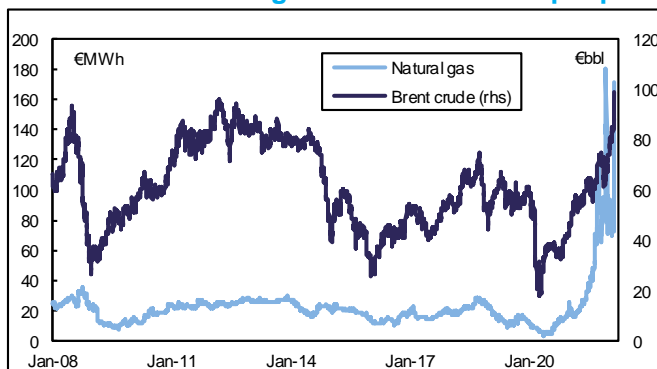
### External MPC members Mann and Saunders reaffirm intention to press ahead with rate hikes

Contrasting with the dovish commentary from ECB Governing Council members over the past couple of days, public remarks yesterday evening from external BoE MPC members Saunders and Mann – both of whom voted for a 50bps rate hike in February – signalled their intentions to vote for a further rate rise this month. Saunders judged that additional tightening now could help to limit the total scale of tightening required to return inflation to target, while Mann repeated that her strategy was very much to front-load rate hikes to counter rising price and wage expectations. Both were concerned that high inflation is now becoming embedded. While recognising that the unfolding events in Ukraine posed upside risks to near-term inflation, Saunders acknowledged that it was not yet clear what these developments would mean for the inflation outlook 2-3 years ahead. And so, he would not be drawn into what the conflict would mean precisely for monetary policy. Nevertheless, Saunders also stressed that his preference for a 50bps hike in February did not necessarily imply that he would vote again for a 50bps hike in coming meetings. And given the uncertainties posed by Ukraine, we expect both him and Mann to vote for a hike of just 25bps when the MPC meets to set policy on 17 March. Speeches scheduled for this evening by BoE Deputy Governor Cunliffe and external member Tenreiro might give a clearer indication of whether there will be a majority in favour of tightening again this month or whether economic and financial stability risks from the conflict might lead to a more cautious approach.

### Survey shop price inflation measure rises to an 11-year high

Of course, over the near term, UK consumer price inflation is set to rise sharply higher, probably to above 7% Y/Y by April. The February BRC shop price survey reported increased price pressures on the UK high street, despite the ongoing erosion of household real incomes and intense competition among retailers. The survey's headline inflation measure – which is inevitably tracking well below CPI inflation, not least due to the exclusion of prices of energy, cars and services – rose 0.3ppt in February to an eleven-year high of 1.8% Y/Y. Pressures came in part from higher prices of fresh food, which accelerated 0.4ppt to 3.3% Y/Y, the most since 2013, on poor domestic harvests and global developments. But non-food inflation was also up 0.4ppt to 1.3% Y/Y, the most since 2011, as supply bottlenecks and rising costs were passed on a little more to consumers.

### Netherlands natural gas and Brent crude spot prices



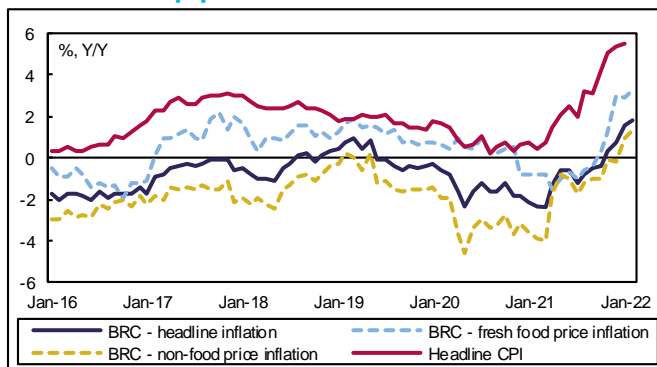
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Bloomberg agriculture spot price index



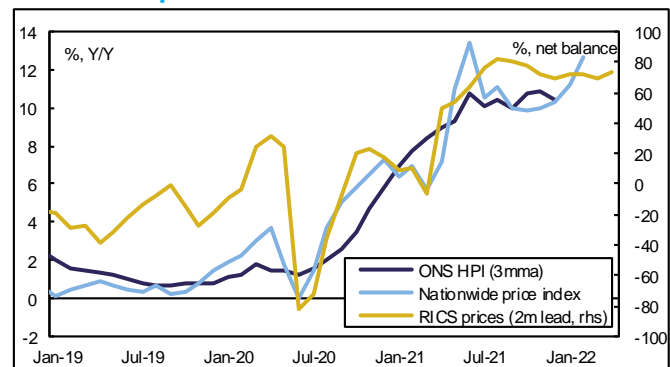
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### UK: BRC shop price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: House price indicators



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

## House prices continue to increase at a rapid rate

Consistent with strong [mortgage lending and approvals numbers](#) at the start of the year, today's Nationwide house price index reported a further sizeable increase in inflation in the sector in February, with prices up for the seventh consecutive month and by a 1.7%MM (the strongest since 2009 when excluding the spikes relating to the initial pandemic bounce-back and government's Stamp Duty holiday last year). So, the annual rate of house price growth accelerated 1.4ppts to 12.6%YY, the strongest since last June (when growth was flattered by weak base effects and government initiatives) – and excluding that month, growth was last stronger in 2004. While the ongoing supply-demand imbalance will continue to exert upwards pressure on house prices, the near-term outlook remains clouded by increasingly squeezed household budgets, declining consumer confidence, and prospects of further rises in Bank Rate over coming months.






## The day ahead in the UK

Like in the euro area, tomorrow brings the final UK services and composite PMI indices. The preliminary report revealed a striking improvement in the services sector, with the activity index jumping 6.7pts to 60.8, the highest since June 2021. So, the composite PMI also 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. But despite some easing in supply constraints, price pressures remained elevated, with the composite input price PMI increasing 1.6pts to 81.8, just shy of November's survey high. Also due to be published tomorrow are the BoE's Decision Maker Panel survey data for January.



## European calendar

### Today's results

#### Economic data

| Country   | Release  | Period | Actual             | Market consensus/<br><u>Daiwa forecast</u> | Previous    | Revised |
|-----------|--|--------|--------------------|--|-------------|---------|
| Euro area |  Preliminary CPI (core CPI) Y/Y%          | Feb    | <b>5.8 (2.7)</b>   | <u>5.8 (2.6)</u>                           | 5.1 (2.3)   | -       |
| Germany   |  Unemployment change '000s (rate %)       | Feb    | <b>-33.0 (5.0)</b> | -20.0 (5.1)                                | -48.0 (5.1) | -       |
| Spain     |  Unemployment change '000s                | Feb    | <b>-11.4</b>       | -  | 17.2        | -       |
| UK        |  BRC shop price index Y/Y%                | Feb    | <b>1.8</b>         | -  | 1.5         | -       |
|           |  Nationwide house price index M/M% (Y/Y%) | Feb    | <b>1.7 (12.6)</b>  | 0.6 (10.8)                                 | 0.8 (11.2)  | -       |










#### Auctions

| Country | Auction  |
|---------|--|
| Germany |  sold €1.44bn of 0% 2030 bonds at an average yield of -0.2%     |
| UK      |  sold £3.25bn of 0.25% 2025 bonds at an average yield of 0.952% |










Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's releases

#### Economic data

| Country   | GMT   | Release                                 | Period | Market consensus/<br><u>Daiwa forecast</u> | Previous    |
|-----------|---|---|--------|--|-------------|
| 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 (production) Y/Y% | Feb    | -  | 8.5 (8.1)   |
| 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) |

#### Auctions and events

|           |   |  |
|-----------|---|--|
| 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% 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                      |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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