

Euro wrap-up

Overview

- Bunds made significant losses as the flash euro area PMIs beat expectations suggesting a rebound in economic activity.
- Despite a weak CBI industrial survey, Gilts made even more substantive losses as the flash UK also surprised significantly on the upside.
- Wednesday will bring the ifo and INSEE business survey results for February and final German and Italian inflation data for the same month, while Thursday will bring the equivalent final estimates of euro area inflation.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	2.932	+0.051
OBL 2.2 04/28	2.592	+0.062
DBR 2.3 02/33	2.528	+0.074
UKT 1 04/24	3.862	+0.168
UKT 1¼ 07/27	3.551	+0.177
UKT 4¼ 06/32	3.612	+0.146

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

Euro area

Euro area flash PMIs surprise on the upside, with improvement widespread across region

Today's flash euro area PMIs surprised significantly on the upside, suggesting that economic activity remained resilient in the middle of the first quarter. Indeed, the headline euro area composite PMI jumped 2.0pts in February, the most in twelve months, to a nine-month high of 52.3. And it left the average in Q1 so far more than 3pts above that in Q4, pointing to another quarter of positive GDP growth this quarter. The improvement was widespread across the region. For example, the German composite output PMI rose 1.2pts to 51.1, implying the first month of positive growth since June. The French composite PMI jumped 2.5pts to 51.6. But S&P Global noted that the strongest performance was seen elsewhere in the euro area, for which the respective index rose 2.5pts to a nine-month high of 53.9 thanks to growth in both manufacturing and services.

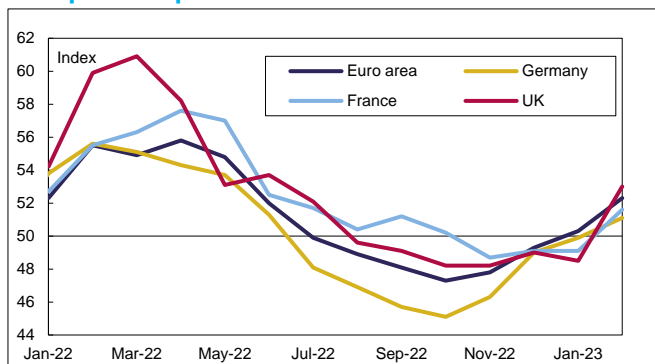
Services lead the recovery, manufacturing output benefits from easing supply bottlenecks

The euro area's rebound was led by an acceleration in services, for which the activity PMI rose 2.2pts to 53.0. S&P Global attributed that improvement to a resurgence in consumer-facing activities such as tourism and recreation, which offset persisting real estate weakness. In addition, amid a further improvement in supply chains – with the average supplier delivery time shortening for the first time since January 2020 and by the most since the post-global financial crisis rebound in May 2009 – the manufacturing output PMI recorded the first non-contractionary reading for nine months, rising by 1.5pts to 50.4. That was driven not least by a recovery in the autos sector, while production from energy-intensive subsectors including chemicals and plastics remained weak. Indeed, contrasting the picture in services, new orders in manufacturing continued to decline sharply with more acute weakness in external demand. That tallied with today's preliminary German export figures for January – despite moving broadly sideways last month, German shipments to non-EU countries this month were still down a whopping 5½% from the Q4 average. Overall, however, thanks to the strength in services, the euro area's composite new business PMI (50.6) pointed to modest economic growth ahead, with firms seemingly the most upbeat about the outlook for the coming twelve months since last February.

Despite cooling cost pressures in manufacturing, services prices remain sticky

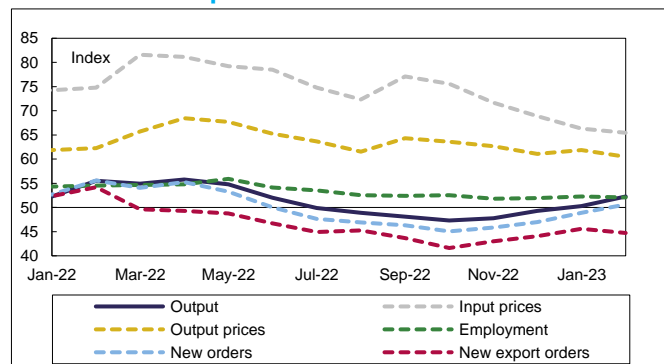
According to the flash PMIs, the easing in supply-chain disruption and decline in wholesale gas prices again led to a cooling of cost pressures, particularly in manufacturing. Indeed, that sector's input price PMI fell a further 5.1pts to a below-average 51.2 to be down almost 37pts from the peak, with the equivalent German index (46.3) almost 50pts off the high. But cost burdens in the services sector remain stickier (70.8), which firms attributed in part to higher wage costs. And so, while down

Europe: Composite PMIs



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Composite PMIs



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

from the record rates recorded last year, prices charged in both manufacturing and services sectors continued to rise at an above-average pace. Indeed, the composite output price PMI (60.5) was still some 10pts above the pre-pandemic average. Taken together with signs of ongoing resilience in the labour market, today's survey will no doubt be cited by the ECB hawks in arguing for further tightening in both of the Governing Council meetings scheduled for Q2. So, after the 50bps hike already penciled-in for March, in the absence of a significant sudden downside shift in euro area core inflation, we now expect a higher terminal deposit rate of 3.75%.

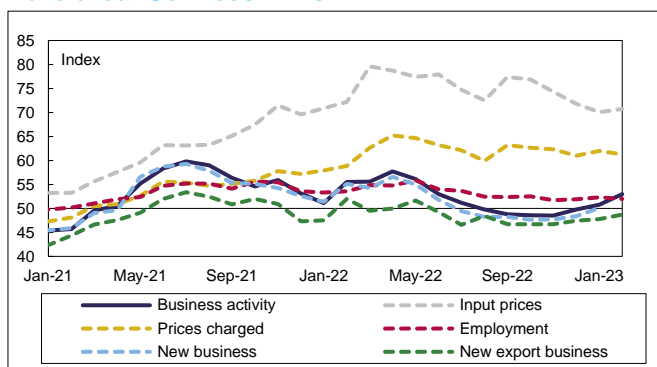
Investor and consumer confidence improves too

The improvement in euro area business sentiment suggested by the flash PMIs was matched by the strengthened investor optimism registered in today's ZEW survey results. These reported a sizeable pickup in the index of perceptions of German current conditions (up 13.5pts to -45.1), as well as a return to the long-run average reading in the balance of expectations for the economic outlook over the coming six months. Moreover, yesterday's data reaffirmed an uptrend in household sentiment. Most notably, the European Commission's flash euro area consumer confidence index rose 1.9pts to -19.0 in February, the highest reading for a year. While this remained well below the long-run average, it marked the fifth consecutive improvement to be almost 10pts above last year's trough. National surveys suggest a marked improvement in expectations for the economic outlook, with the respective index from the Netherlands rising to its highest since November 2021. Similarly, Dutch households' purchase intentions rose to the highest since August.

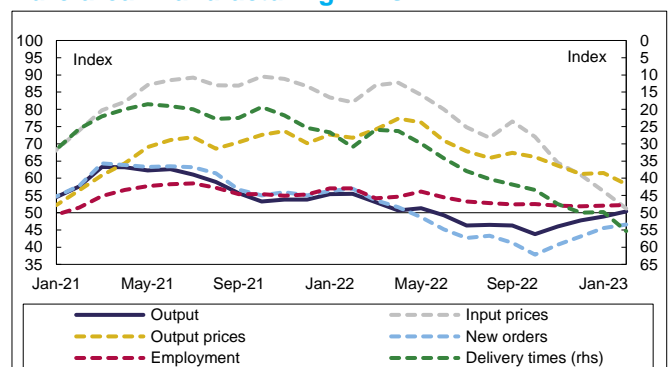
The coming two days in the euro area

The flow of sentiment indicators continues tomorrow with the German ifo and French INSEE business surveys due for release. Perhaps notably, the latter survey provides a more rounded guide to business conditions in France than the PMIs. Wednesday will also bring final January inflation numbers from Germany and Italy, ahead of updated euro area inflation estimates on Thursday. In the absence of significant revisions tomorrow, we expect the headline euro area HICP rate to align with the flash release, which fell 0.7ppt to an eight-month low of 8.5%Y/Y. Core inflation, however, is likely to be unrevised at a record-high 5.2%Y/Y.

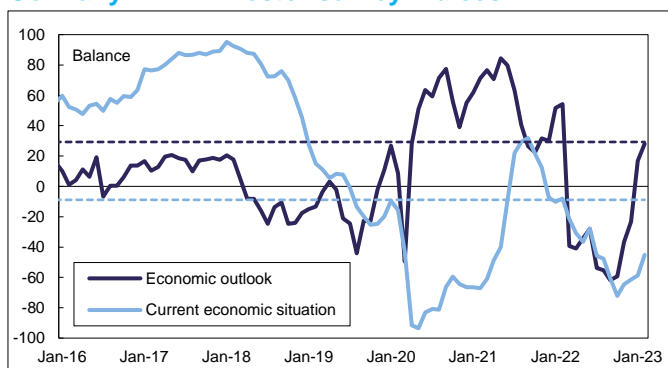
Euro area: Services PMIs



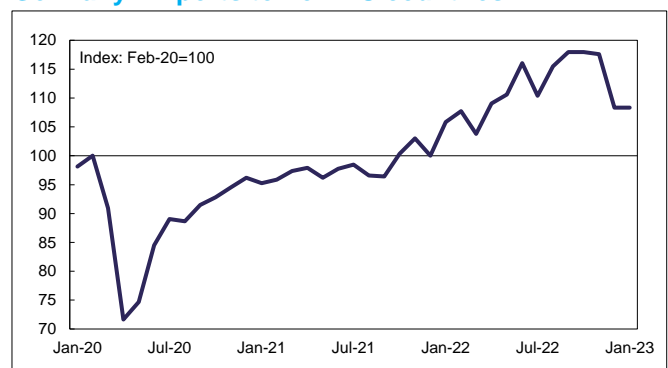
Euro area: Manufacturing PMIs



Germany: ZEW investor survey indices



Germany: Exports to non-EU countries



UK

Flash PMIs surprise on the upside suggesting firm rebound in activity in February

As in the euro area, the UK's flash PMIs for February surprised significantly on the upside, suggesting improvement in services and manufacturing alike. In particular, following six successive sub-50 readings, the headline composite output PMI leapt 4.5pts, the most in a year, to 53.0, the highest since June. That was 4pts above the median forecast on the Bloomberg survey, and took the average for the first two months of Q1 to 50.75, more than 2pts above the Q4 average. As in the euro area, the PMIs suggest that the rebound in activity this month was led by services, for which the activity index leapt 4.6pts to an eight-month high of 53.3, reportedly driven by business- rather than consumer-facing firms. Moreover, if this survey is to be believed, manufacturing output also made an unexpected return to growth, with the respective PMI up more than 4pts to a ten-month high of 51.6. An easing of supply-chain strains appears to have played a role, with delivery times of suppliers to the factory sector improving the most since mid-2009. Overall, growth in new orders was reportedly the strongest since May, buoyed by both domestic and (admittedly to a lesser extent) foreign demand.

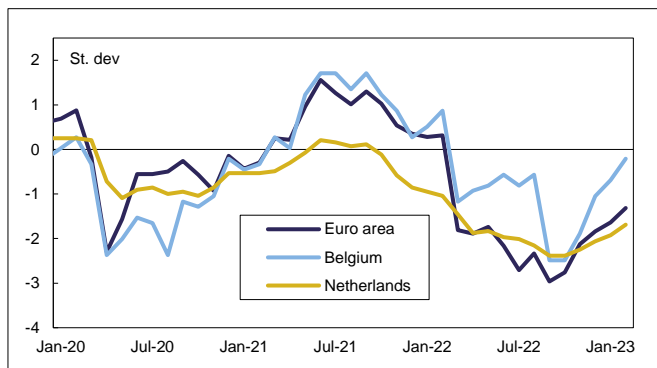
PMIs suggest improvement in labour market and only limited easing of price pressures

The BoE will therefore note that the flash PMIs raise the possibility that a renewed contraction in GDP this quarter might be avoided after the pause in Q4. Given the MPC's forward guidance, the Bank will also be mindful that the survey suggested a reversal of momentum in the labour market, with employment intentions reportedly the firmest since October. And while the PMIs implied the slowest overall increase in business costs since April 2021, the indices for output prices eased only modestly, with the respective composite PMI at an 18-month low but still historically elevated at 62.0. CIPS/S&P Global reported that many firms had felt it necessary to pass on higher wages, food costs and energy bills to customers. Overall, therefore, the flash PMIs supported the hawkish case for BoE policy.

CBI Industrial Trends survey flags case for caution

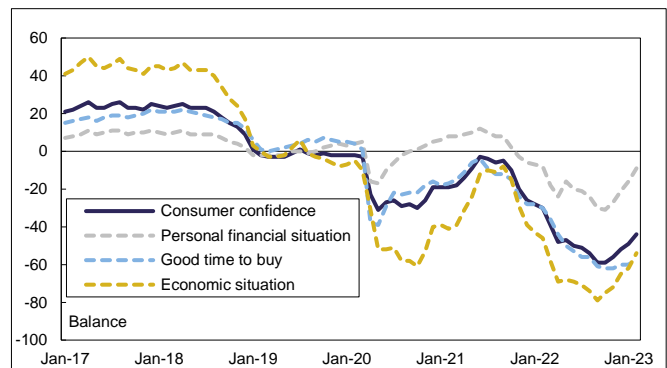
Nevertheless, there are good reasons to believe that GDP this quarter will be weaker than suggested by the PMIs. For example, today's indicators excluded retail and construction sectors, both of which are likely to contract in Q1 as consumers continue to cut spending volumes and builders respond to weakness in the housing market. Public sector output – also not captured by the PMIs – will also have been hit by intensified strike action, not least in education and healthcare. Moreover, in contrast to the flash PMIs, today's CBI's Industrial Trends survey results suggested that significant challenges persist in the

Euro area: Consumer confidence



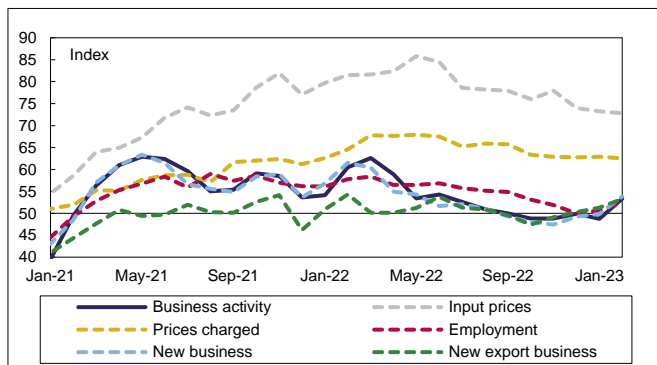
Source: Refinitiv, EC and Daiwa Capital Markets Europe Ltd.

Netherlands: Consumer confidence



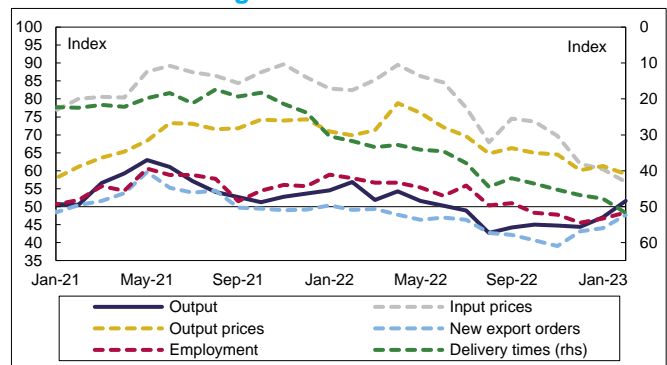
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Services PMIs



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing PMIs



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

manufacturing sector. Indeed, the CBI survey suggested that, in the three months to February, manufacturing output volumes fell at the sharpest pace since September 2020 (a net balance of -16%). Production was reportedly down in eleven out of seventeen sectors, with the overall drop over the three months in marked opposition to the rebound anticipated by firms in last month's survey (+19%). As such, the latest prediction of a moderate rise in output volumes in the coming three months (+7%) might be taken with a pinch of salt. Indeed, total order books were reported to be below "normal" in February to a similar extent as last month (-16%) with export order books weaker still (-27%). Like the flash PMIs, the CBI survey also reported a moderation in selling price expectations, with the respective index for the coming three months down to the lowest since May 2021. But while now half the peak last March, the net balance (+40%) was still well above the long-run average (+6%) suggesting continued pass-through of costs to customers.

UK fiscal figures beat expectations despite another monthly record for debt interest

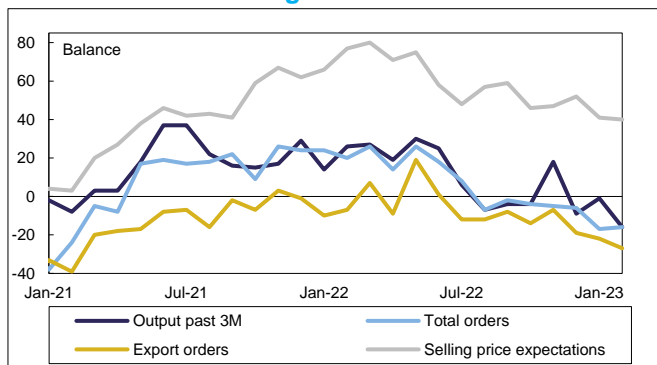
Today's UK public finances figures also beat expectations. Public sector net borrowing excluding banks (PSNB ex) registered a surplus of £5.4bn in January compared to the median forecast on the Bloomberg survey of a deficit of £7.9bn. Surpluses in January are the norm due to the timing of self-assessment tax payments. But receipts of such taxes rose to a record high and above expectations last month. And that helped to offset the impact of the exceptional spending on energy support as well as another record for the month of January for debt interest payments due to the impact of high inflation on linkers, which pushed central government spending a little more than £20bn higher than the level in the same month last year. The better-than-expected figures for January left the cumulative level of PSNB (ex) in the financial year to-date at £116.9bn, up £7.0bn from the same period in FY21/22 but a hefty £30.6bn less than the forecast by the OBR (after adjusting for differences of assumptions on student loans). That, along with the recent marked drop in wholesale gas prices which should reduce the cost of energy price support over coming months, as well as the drop in inflation and Gilt yields from their respective peaks last autumn, might suggest that the Chancellor will have room for manoeuvre on fiscal policy when he announces his Budget on 15 March. Among other things, we should certainly expect new budgetary measures to try to boost labour force participation and the Chancellor might also boost his energy price support payments. However, like the BoE in its recent Monetary Policy Report, the OBR is likely to decide that its assumption on potential growth needs to be revised down significantly with adverse consequences for both the medium-term fiscal outlook and the scope for budgetary giveaways.

The coming two days in the UK

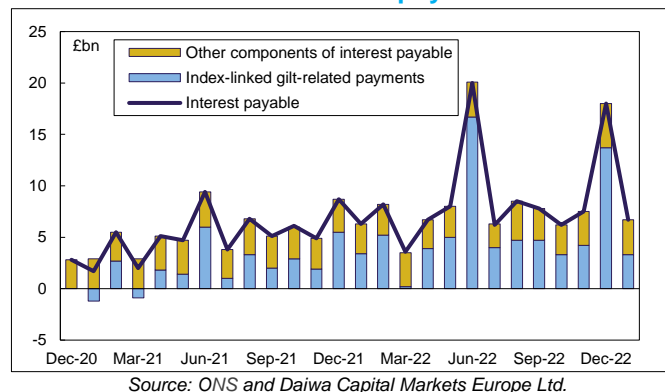
A quiet couple of days for UK economic data will bring just the CBI distributive trades survey on Thursday. Expectations are for another weak showing in February, suggesting that sales remained down on a year earlier as households' purchasing power continues to be eroded by high inflation. Separately, BoE hawk Catherine Mann will speak at a conference on "The results of rising interest rates".

The next edition of the Euro wrap-up will be published on 23 February 2023

UK: CBI manufacturing indices

















UK: Government debt interest payments






European calendar

Today's results

Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 EU27 new car registrations Y/Y%	Jan	11.3	-	12.8	-
	 Preliminary manufacturing (services) PMI	Feb	48.5 (53.0)	49.3 (51.2)	48.8 (50.8)	-
	 Preliminary composite PMI	Feb	52.3	50.7	50.3	-
Germany	 Preliminary manufacturing (services) PMI	Feb	48.5 (51.3)	48.0 (51.0)	47.3 (50.7)	-
	 Preliminary composite PMI	Feb	51.1	50.5	49.9	-
	 ZEW current situation (expectations) balance	Feb	-45.2 (29.7)	-52.5 (19.0)	-58.6 (16.9)	-
France	 Preliminary manufacturing (services) PMI	Feb	47.9 (52.8)	51.0 (49.9)	50.5 (49.4)	-
	 Preliminary composite PMI	Feb	51.6	49.6	49.1	-
UK	 Public sector net borrowing excl. banks £bn	Jan	-5.4	7.9	27.4	25.6
	 Preliminary manufacturing (services) PMI	Feb	49.2 (53.3)	47.5 (49.3)	47.0 (48.7)	-
	 Preliminary composite PMI	Feb	53.0	49.1	48.5	-
	 CBI industrial trends survey, total orders (selling prices)	Feb	-16 (40)	-14 (35)	-17 (41)	-
Auctions						
Country	Auction					
Germany	 sold €4.35bn of 2.2% 2029 bonds at an average yield of 2.59%					
UK	 Sold £3.5bn of 0.5% 2029 bonds at an average yield of 3.597%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.






Yesterday's results

Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 European Commission preliminary consumer confidence	Feb	-19.0	-19.0	-20.9	-20.7
	 Construction output M/M% (Y/Y%)	Dec	-2.5 (-1.3)	-	-0.8 (1.3)	-0.1 (1.6)
UK	 Rightmove house price index M/M% (Y/Y%)	Feb	0.0 (3.9)	-	0.9 (6.3)	-
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		07.00 Final HICP (CPI) Y/Y%	Jan	<u>9.2 (8.7)</u>	9.6 (8.6)
		09.00 Ifo business climate	Feb	91.0	90.2
		09.00 Ifo current assessment (expectations)	Feb	95.0 (88.5)	94.1 (86.4)
France		07.45 INSEE business (manufacturing) confidence	Feb	102 (103)	102 (103)
Italy		09.00 Final HICP (CPI) Y/Y%	Jan	<u>10.9 (10.1)</u>	12.3 (11.6)



Auctions and events

Germany		10.30 Auction: €5bn of 2.30% 2033 bonds			
Italy		10.00 Auction: €3.75bn of 2.3% 2025 bonds			
		10.00 Auction: €1.5bn of 0.1% 2033 index-linked bonds			
UK		10.00 Auction: £2.0bn of 1.5% 2053 bonds			


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area		10.00 Final HICP (core HICP) Y/Y%	Jan	<u>8.5 (5.2)</u>	9.2 (5.2)
UK		11.00 CBI distributive trades survey, reported retail sales	Feb	-	-23

Auctions and events

UK		09.30 BoE external MPC member Mann scheduled to speak – 'The results of rising rates'			
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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