

Euro wrap-up

Overview

- Despite an upwards revision to the January estimates of euro area inflation, Bunds made gains as ECB dove Panetta judged that the risks to the inflation outlook are now more balanced and thus justify smaller rate hikes.
- Despite typically hawkish commentary from MPC external member Mann, Gilts saw a mix of modest gains and losses as a UK survey offered a gloomy assessment of the outlook for retailers.
- Friday will bring consumer confidence surveys from Germany, France and the UK, as well as revised Q4 German GDP figures.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	2.881	-0.023
OBL 2.2 04/28	2.531	-0.040
DBR 2.3 02/33	2.464	-0.053
UKT 1¼ 04/24	3.913	+0.002
UKT 1¼ 07/27	3.565	+0.004
UKT 4¼ 06/32	3.582	-0.017

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

Euro area

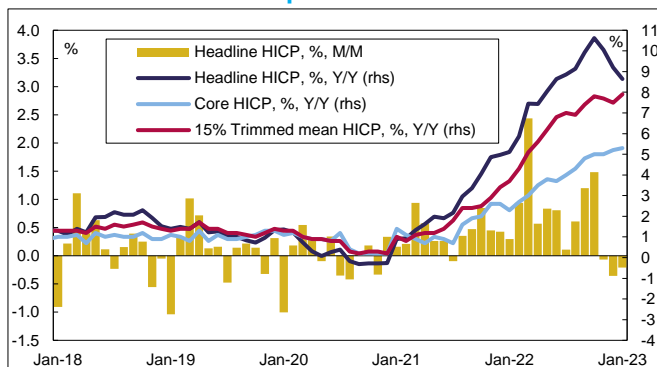
Headline euro area inflation revised a touch higher, but still 2ppts below last year's peak

The final estimate of euro area consumer price inflation in January was revised a touch higher from the flash figure, by 0.1ppt to 8.6%Y/Y, and was within a whisker of being revised higher still (8.645%Y/Y). The upwards revision was principally due to Germany, where the belated flash and final estimates (both down 0.4ppt from December to 9.2%Y/Y) were higher than the initial assumption used by Eurostat in its own preliminary figures for the euro area. Despite the upwards revision to euro area inflation, this still marked a drop of 0.6ppt from December and was 2ppts below the October peak. To some extent, that decline reflects the re-weighting of the inflation basket, which increased the relative importance of services in the calculation at the expense of energy, food and non-energy industrial goods, all of which have seen faster price rises over the past year. Nevertheless, among the member states, inflation fell in January in 14 of the 20 countries, with just Slovakia's headline HICP rate not below last year's peak. Indeed, despite rising slightly on the month on the EU-harmonised measure, inflation in France (7.0%Y/Y) and Spain (5.9%Y/Y) was still among the lowest in the region, with the latter some 4.8ppts below the peak. Meanwhile, among the other larger member states, admittedly thanks in part to the reweighting, inflation moderated in Germany (down 2.4ppts from the peak to 9.2%Y/Y), Italy (down an equivalent 1.9ppts to 10.7%Y/Y) and the Netherlands (down 8.7ppts to 8.4%Y/Y).

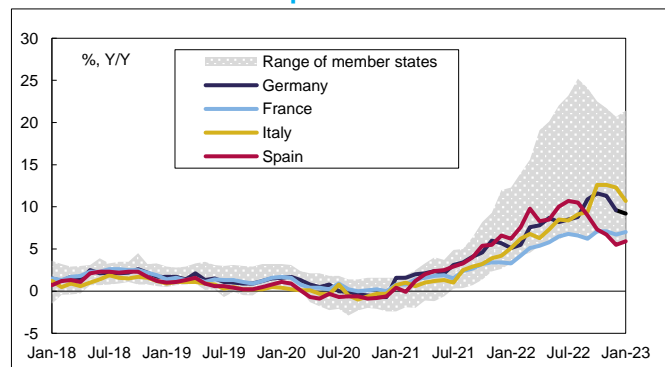
Core inflation rises to a new record high as some retailers eschewed usual January discounting

More important than the re-weighting of the basket, the drop in euro area inflation also reflects recent developments with respect to energy prices. However, the initially estimated decline in energy prices in January was revised to an increase of 0.6%M/M, reflecting a jump in petrol prices as well as a reduction in government support for household bills in Germany. That left the annual energy rate some 1.7ppts above the flash estimate at 18.9%Y/Y. But that was still down 5½ppts on the month with the contribution to the annual HICP inflation rate of 2.2ppts half that in October. In contrast, food inflation maintained a steady upwards trend at the start of the year, posting a higher-than-normal monthly increase (1.4%M/M) for the fifteenth consecutive month, and taking the annual rate to a new record high (14.1%Y/Y). While core goods prices fell at a slightly steeper pace than initially estimated (-1.9%M/M), this was notably smaller than the average drop for the time of year as some retailers eschewed their normal levels of January discounting. As such, core goods inflation rose a further 0.3ppt to a record-high 6.7%Y/Y, with higher clothing inflation (up 1.3ppts to 5.2%Y/Y) offsetting a moderation in the components for household furniture and new and second-hand cars. Finally, despite a sharp decline in airfares at the start of the year, services prices fell a smaller-than-normal 0.1%M/M in January, leaving the annual rate upwardly revised by 0.2ppt from the flash at 4.4%Y/Y, unchanged from December's series high. As such, the ECB Governing Council will have been discouraged

Euro area: Consumer price inflation



Euro area: Consumer price inflation



to see core inflation nudged even higher in January, by 0.1ppt to 5.3%Y/Y, a new record. Furthermore, having moderated at the end of last year, the ECB's alternative measures of underlying inflation jumped back in January, with the 15% trimmed mean HICP rate up 0.4ppt to 7.9%Y/Y, similarly a new high.

Downwards revisions to ECB forecasts in March unlikely to prevent further significant tightening

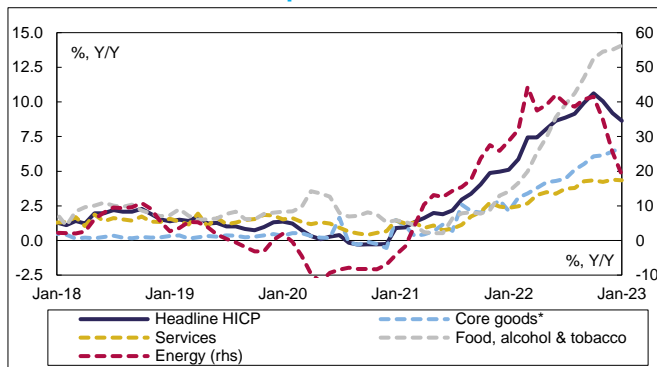
The drop in headline inflation in January clearly took it well below the ECB's December baseline forecast for Q1 (9.1%Y/Y). With energy inflation likely to continue to decline, and very sharply from March onwards due to base effects and recent developments in wholesale markets, the ECB's updated staff projections next month should revise down significantly the profile for coming quarters. Indeed, we expect headline inflation to average just 2.2%Y/Y in Q4, almost 1½ppts below the ECB's forecast. But despite improvements in global supply-side pressures, falling wholesale energy and food prices, little evidence of substantive lasting second-round effects on inflation via wages, and our associated expectation for core inflation to steadily ease back over the remainder of the year, the current stickiness will remain a persisting concern for the hawks on the Governing Council. Admittedly, BoF Governor Villeroy yesterday again pushed back against recent upwards moves in market expectations for ECB policy. And today the Executive Board's leading dove Panetta argued that the risks to the inflation outlook are now more balanced and thus justify smaller rate hikes from now on than up to now. However, today's revisions will undoubtedly strengthen the case of the hawks on the Council calling for additional significant tightening in Q2.

German and French business surveys should temper optimism generated by the PMIs

After Tuesday's [flash PMIs](#) suggested a significant pickup in economic activity this month, yesterday's national business survey results – which take stock of developments in a broader set of economic sectors than the PMIs – also reported an improvement, albeit modest, in Germany and France.

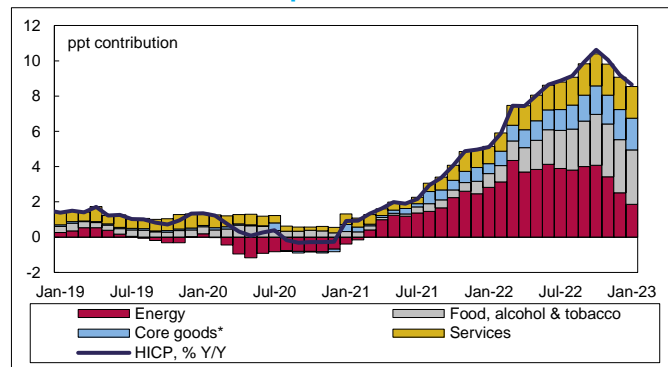
- In Germany, the headline ifo business climate index rose for a fifth successive month, by 1.6ppts to 90.2, the highest since June albeit still well below the long-run average. The improvement was again driven by expectations, with all major sectors more upbeat about the outlook and optimism in wholesale and retail trade at a twelve-month high. That in part reflected an assessment of diminished cost pressures, with a smaller share of firms (45.4%, down 3ppts from January) reporting challenges with supply bottlenecks and the proportion of companies planning to raise their prices in the next three months down again. Indeed, selling price expectations were down across all major sectors, with the respective manufacturing and construction indices at a near-two-year low. Meanwhile, due to a softening in

Euro area: Consumer price inflation



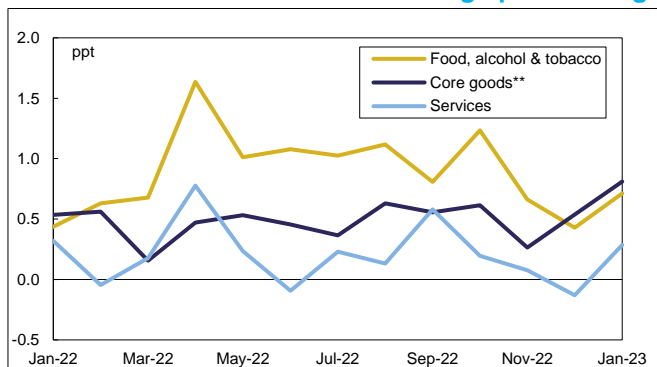
*Non-energy industrial goods.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



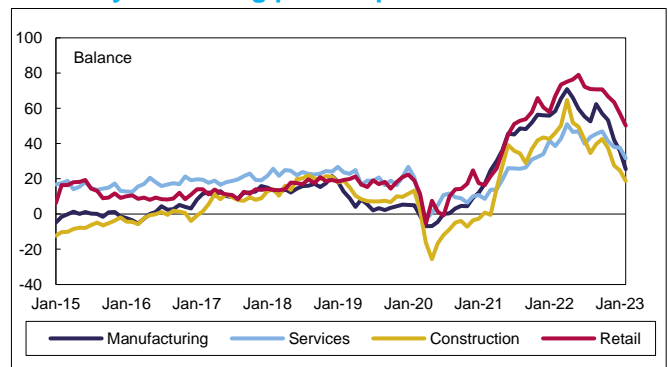
*Non-energy industrial goods.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Deviations from l-r average price change*



*Difference in monthly consumer price change from pre-pandemic long-run average. **Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ifo selling price expectations*



*Over coming three months. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

manufacturing related to a drop in new orders, the current conditions index edged down for a second successive month to remain close to the bottom of the range of the past two years, pointing to the likelihood of a contraction in German GDP in Q1 following the drop of 0.2%Q/Q in Q4.

- In France, the rise in the headline INSEE business climate index was also relatively underwhelming, merely reversing the 1pt drop last month to return to December's level (103). While that remained above the long-run average, it was also still some 10pts below the level a year earlier, and left the Q1 average little changed from the average in Q4 when French GDP rose just 0.1%Q/Q. Within the detail, the INSEE survey reported modest improvement in the manufacturing, services and retail sectors. But confidence in construction deteriorated to the lowest level since the second half of 2021. The survey also suggested a slight moderation in employment demand, as well as a further decline in the share of firms in both manufacturing and construction complaining of supply-side constraints to production. However, while expected selling prices in manufacturing, services and construction eased somewhat, expected selling prices in retail trade increased further.

The day ahead in the euro area

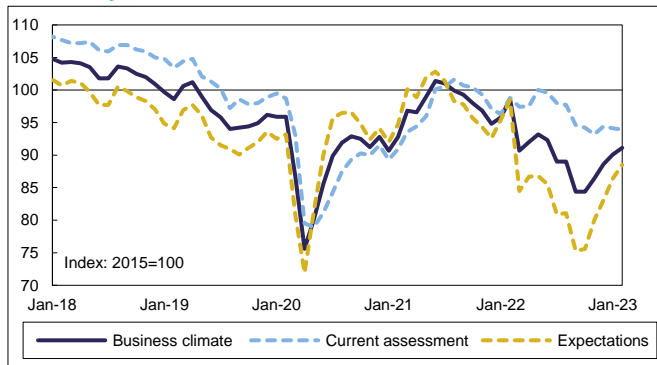
The end of the week will bring February consumer surveys from Germany and France. In line with the uptick reported in the Commission's flash confidence index earlier this week, the GfK's headline German confidence index is expected to rise to its highest since August, reflecting not least diminished concerns about inflation. But the Bloomberg survey forecast for the INSEE index is for French confidence to move sideways from January's four-month low, perhaps impacted by concerns about the government's plans for pension reforms and associated industrial action. In addition, Friday will bring revised German GDP figures for Q4, with steep declines in retail sales, hospitality, manufacturing and construction activity in December raising the possibility of a downwards revision to the previously estimated contraction of 0.2%Q/Q. This release will also bring the expenditure breakdown, which seems bound to confirm that household consumption was a significant drag on growth.

UK

CBI survey offered a gloomy assessment for UK retailers

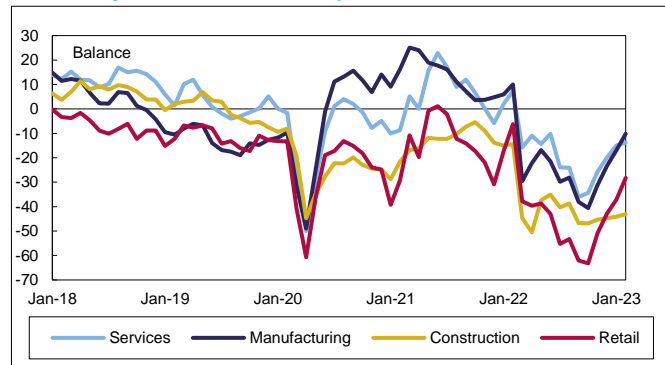
While today's CBI distributive trades survey beat expectations, it nevertheless offered a pretty gloomy assessment for UK retailers in February. Indeed, although retailers indicated that sales were considered to be relatively good for the time of the

Germany: ifo business climate indices



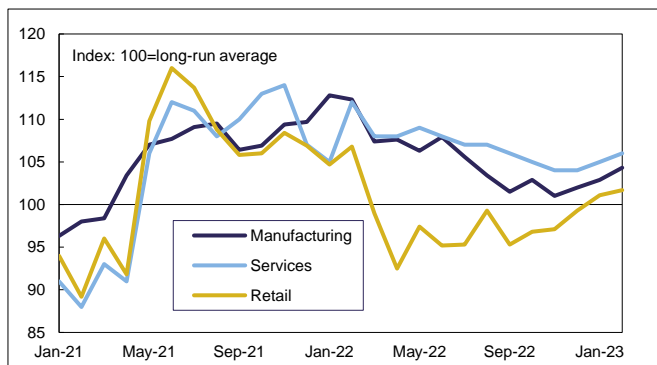
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ifo business expectations indices



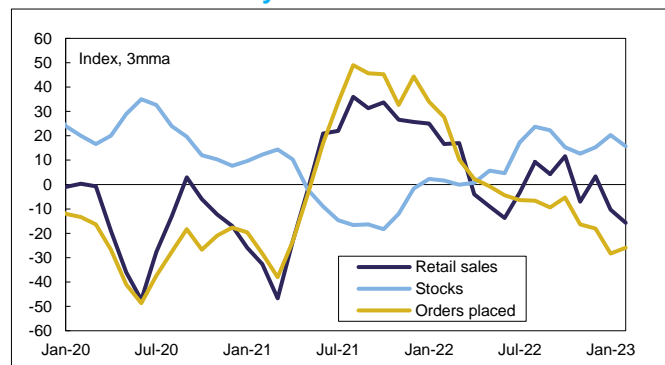
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: INSEE business sentiment indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: CBI retail survey indices






Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

year, they were merely flat compared with a year earlier, with the pace of decline in online sales accelerating this month. With sales anticipated to fall sharply again in March, with a net balance of 18% of respondent firms forecasting a decline next month, and stocks compared to sales still extremely elevated, retailers indicated that orders placed upon suppliers continued to be scaled back. And according to the survey, the weakness was even more acute in wholesale distribution and the autos sector. With consumer confidence still historically low, and household purchasing power continuing to be eroded by high inflation, retailers remained downbeat about the overall business situation for the coming three months, albeit to a lesser degree than in November. As such, they suggested that they scaled back headcount over the past quarter, with a further decline expected over the coming three months too. Despite weak demand, however, in a bid to reduce potential losses, retailers continued to raise prices at a historical pace and expected to do so again over the coming three months too.










The day ahead in the UK

In the UK, Friday will bring the latest GfK consumer confidence survey results for February. Amid the ongoing squeeze on household disposable incomes, we expect sentiment to remain very weak this month, with little signs of improvement in consumer purchase intentions.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final HICP M/M% (Y/Y%)	Jan	-0.2 (8.6)	<u>-0.2 (8.6)</u>	-0.4 (9.2)	-
	 Final core HICP Y/Y%	Jan	5.3	<u>5.2</u>	5.2	-
UK	 CBI distributive trades survey, reported retail sales	Feb	2	-	-23	-
Auctions						
Country	Auction					
- Nothing to report -						






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
Germany	 Final HICP (CPI) Y/Y%	Jan	9.2 (8.7)	<u>9.2 (8.7)</u>	9.6 (8.6)	-
	 Ifo business climate	Feb	91.1	91.2	90.2	90.1
	 Ifo current assessment (expectations)	Feb	93.9 (88.5)	95.0 (88.4)	94.1 (86.4)	-
France	 INSEE business (manufacturing) confidence	Feb	103 (104)	102 (103)	102 (103)	-
Italy	 Final HICP (CPI) Y/Y%	Jan	10.7 (10.0)	<u>10.9 (10.1)</u>	12.3 (11.6)	-
Auctions						
Country	Auction					
Germany	 sold €4.26bn of 2.30% 2033 bonds at an average yield of 2.56%					
Italy	 sold €3.75bn of 3.4% 2025 bonds at an average yield of 3.67%					
	 sold €1.5bn of 2033 index-linked bonds at an average yield of 2.19%					
UK	 sold £2.0bn of 1.5% 2053 bonds at an average yield of 4.018%					





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 GDP – second estimate Q/Q% (Y/Y%)	Q4	<u>-0.2 (1.1)</u>	0.4 (1.4)
		07.00 GfK consumer confidence	Mar	-30.5	-33.9
France		07.45 INSEE consumer confidence	Feb	81	80
Spain		08.00 PPI M/M% (Y/Y%)	Jan	-	-1.7 (14.7)
UK		00.01 GfK consumer confidence	Feb	-43	-45

Auctions and events

Italy		10.00 Auction: €2.5bn of 3.4% 2028 bonds			
		10.00 Auction: €3.5bn of 4.4% 2033 bonds			
		10.00 Auction: €3.5bn of 2028 floating-rate bonds			
UK		16.30 BoE MPC member Tenreyro scheduled to speak on a panel at a New York Fed conference			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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