Daiwa Capital Markets

Euro wrap-up

Overview

- Bunds followed USTs lower, even as the Commission's flash consumer confidence survey saw only a modest improvement in February.
- Gilts also made losses as the latest UK public finances data flagged additional fiscal headroom and reinforced expectations that tax cuts will be announced in the Budget next month.
- Thursday will bring the flash PMIs for February, updated estimates of euro area inflation for January and the ECB's account from the January Governing Council meeting.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.843	+0.078
OBL 2.1 04/29	2.416	+0.075
DBR 2.2 02/34	2.441	+0.071
UKT 3½ 10/25	4.588	+0.075
UKT 4½ 06/28	4.126	+0.072
UKT 3¼ 01/33	4.094	+0.057

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

Euro area

Consumer confidence picks up in February, but remains consistent with subdued spending

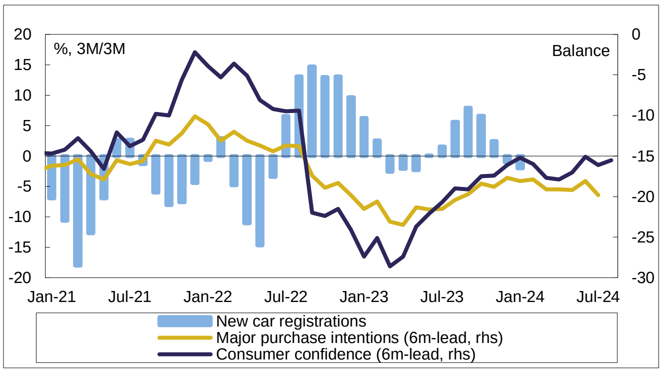
Despite moderating inflation, solid employment and strong pay growth, today's flash Commission consumer confidence indicator for February suggested that sentiment among euro area households remains muted. Admittedly, the headline confidence index partly reversed the decline recorded in January, rising 0.6pt to -15.5, the second-highest reading since before Russia's invasion of Ukraine. But while this left the index trending so far in Q1 some 0.9pt above the Q4 average, it remained well below the average in the five years before the pandemic (-6.5), suggesting that discretionary spending will stay subdued. The detailed breakdown of consumer confidence will be published in a week. But the findings from the Dutch survey indicated a deterioration in economic expectations for the coming twelve months, with the respective index down to a three-month low. So, despite a modest improvement in households' willingness to make large purchases, the respective index remained historically low. The reluctance to spend on big-ticket items was illustrated in yesterday's ECB figures for new car registrations, which reported a second successive decline in January, by 0.9%M/M, to leave them some 1.4% below the Q4 level. Overall, we continue to expect only a limited rebound in consumption in the first quarter of the year.

The day ahead in the euro area

Sentiment surveys will continue to dominate the data flow tomorrow, with the flash PMIs for February most noteworthy. The headline euro area composite output PMI edged up 0.3pt in January to a six-month high of 47.9, still nevertheless suggestive of a contraction. However, we note that, contrary to the more downbeat signals from the PMIs, GDP was steady in Q4 from the prior quarter. Within the detail, the January PMIs suggested that manufacturing output fell at the softest pace in nine months but also that services activity weakened the most in three months. But while they also implied that the German and French economies contracted significantly, they suggested that activity in the rest of the euro area actually grew the most in six months. Expectations are for a further modest improvement in conditions in February, albeit the composite output indices are forecast to remain below the key 50 'no change' mark. The French INSEE business indicators – which have been somewhat more upbeat than the French PMIs – are also due.

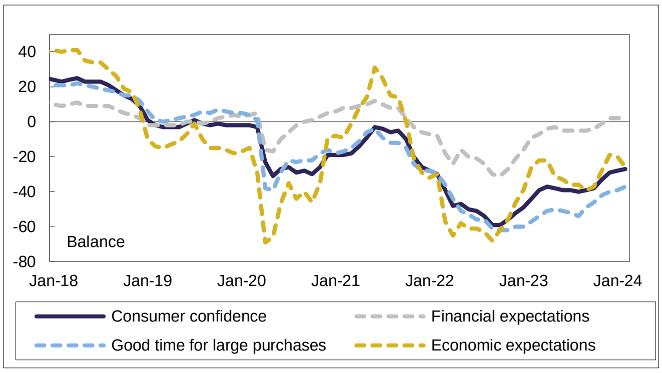
Also of note tomorrow will be the final euro area inflation data for January. These are likely to align with the flash estimates in which the headline HICP rate fell 0.1ppt to 2.8%Y/Y despite the inflationary consequences of the further withdrawal of fiscal policy support at the start of the year. With inflation of non-energy industrial goods down again and the services component steady, core inflation fell for a sixth successive month, by 0.1ppt to 3.3%Y/Y, the lowest since March 2022. The granular detail will allow calculation of other measures of underlying inflation, which eased significantly over the second half of last year. Meanwhile, with respect to monetary policy, the ECB will publish its account of the January monetary policy meeting, at

Euro area: Consumer confidence & car registrations



Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Netherlands: Consumer confidence indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

which the ECB's policy statement had a more dovish tone and, in her press conference, President Lagarde refused to rule out a rate cut in April.

UK

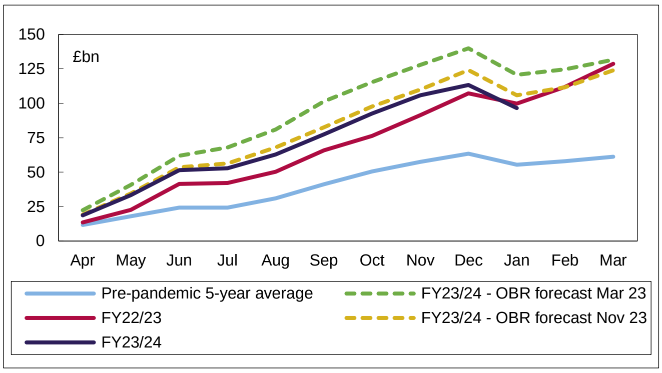
Largest monthly public sector surplus for any January since series began in 1993

Ahead of the spring Budget announcement on 6 March, today's public finances data appeared to give Chancellor Hunt a little extra wiggle room for a pre-election fiscal giveaway. In particular, the public sector recorded its largest monthly surplus for any January on record since the series began in 1993, of £16.7bn, more than double the surplus of January 2023 and the average in the five years before the pandemic. And with net borrowing having been revised lower over previous months, cumulative public borrowing in the first ten months of FY23/4 of £96.6bn was for the first time this fiscal year a touch lower than in the same period of FY22/3 and, more importantly, £9.2bn less than the OBR had forecast at the time of the autumn statement arguably suggesting some additional headroom for tax cuts next month. Despite lower costs associated with the government's energy support schemes, central government expenditure in January was a touch firmer than a year ago. But overall borrowing was lower reflecting higher tax receipts, with higher income tax revenue from strong jobs growth offsetting a notable drop in revenue from stamp duty. In addition, central government debt interest was lower, which at £4.4bn was £3.5bn less than a year earlier and £2.7bn less than the OBR had forecast, principally thanks to the impact of the decline in RPI inflation on payments related to index-linked gilts. Indeed, in the financial year-to-date, central government debt interest payable was down £28.9bn compared with a year ago.

Lower public borrowing provides extra room for fiscal giveaways in the Spring Budget

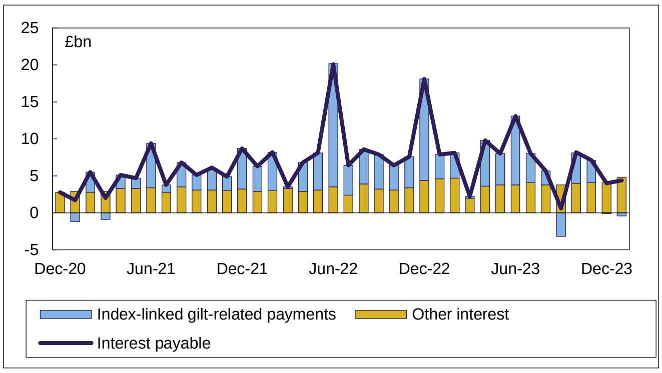
The OBR's projections in November suggested that the Government still had some £13.0bn of headroom available for tax cuts without jeopardising meeting its objective that the ratio of government debt to GDP should be falling in five years' time. In light of the latest public borrowing figures, the decline in market forward interest rates that will see debt interest payments undershoot significantly the OBR's previous projection and a softer inflation outlook, the OBR's updated borrowing projection next month will undoubtedly be revised lower. So, depending on the other assumptions made by the OBR, including with respect to potential GDP growth, the headroom for fiscal loosening in next month's Budget in March could be £20bn or more, which should allow for more personal tax cuts this year in a bid to boost electorate moral. Nevertheless, assuming the government leaves unchanged its plans for significant tax hikes following the election, the tax burden as a share of GDP will continue to rise to historically high levels. Moreover, with the government's plans for real-term current public expenditure

UK: Public sector net borrowing



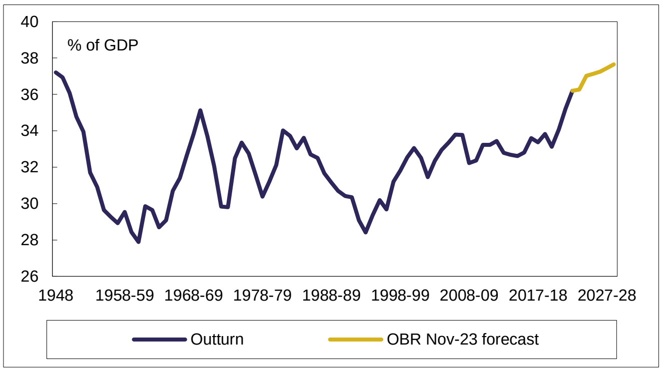
Source: OBR, ONS, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Central government debt interest payable



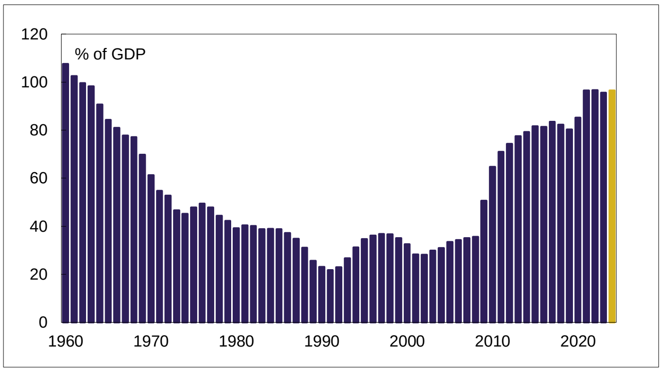
Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Tax revenues



Source: ONS, OBR and Daiwa Capital Markets Europe Ltd.

UK: Public sector net debt*



**Gold bar is latest figure as of January 2024. Source: ONS and Daiwa Capital Markets Europe Ltd.*

unrealistic and the OBR's profile for GDP likely to be revised lower, we wouldn't expect to see a material improvement in the outlook for public sector net debt, which in January was estimated at 96.5% of GDP (excluding public sector banks), up 1.8ppts from a year earlier and the second-highest since the early 1960s.

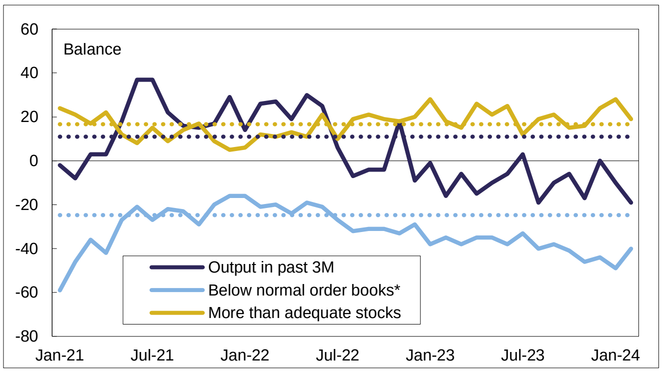
Manufacturing survey flags ongoing challenges in Q1

Ahead of tomorrow's flash PMIs, today's CBI industrial trends survey suggested that conditions in the manufacturing sector remained extremely challenging in February and unlikely to offer any material support to the UK's economic recovery over the near term. In particular, the survey's output component fell sharply in the three months to February, by 9pts to -19, matching the near-three-year low recorded last August. Output fell in fifteen out of seventeen subsectors, with firms in the consumer goods subsector most downbeat and a slowdown in production of investment goods offsetting a rebound in intermediate goods. And disappointingly, the share of total respondents suggesting a decline (42%) was the largest since September 2020, and the global financial crisis when excluding the first pandemic wave. The net balance of manufacturers expecting output to rise in the coming three months also eased back to a three-month low (4%). But other survey components were arguably less downbeat about recovery prospects ahead. For example, today's survey suggested positive developments in the manufacturing destocking process, with the share of firms citing that stocks were more than adequate back close to the long-run average. The share of manufacturers reporting that order books were below normal also eased to a five-month low in February (albeit a still-elevated 40%), with a similar share suggesting that they were in line with the norm. But while that left the net order book balance (-20%) at the least negative since September, it still remained some way below the pre-pandemic five-year average (-3%), suggesting lacklustre growth prospects over coming months. Today's survey also flagged an acceleration in expectations for selling prices in February, perhaps reflecting increased supply-side disruption with respect to events in the Red Sea. In particular, the respective index rose 8pts to +17%, the strongest since July, albeit still well down on the multi-decade high seen in spring 2022 (80%).

The day ahead in the UK

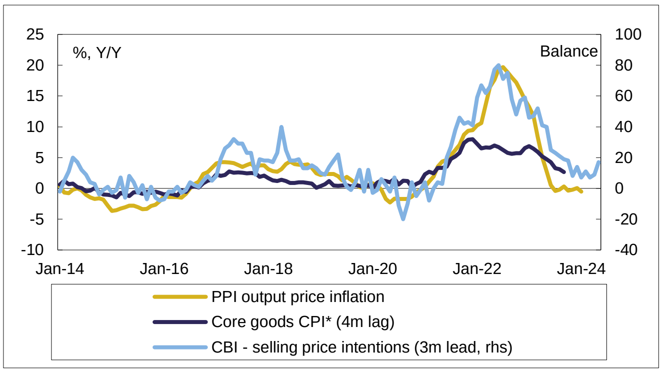
Like in the euro area, tomorrow's UK data highlight will be the February flash PMIs. Last month, the headline composite output PMI rose to a seven-month high of 52.5, suggestive of positive economic growth momentum at the start of the year. The expansion was supposedly led by services, for which the activity PMI jumped to an eight-month high of 54.3. However, we caution that the PMIs failed to provide a reliable guide to economic activity in Q4, when the headline composite index averaged 50.5 to suggest stable output in contrast to the decline of 0.3%Q/Q in GDP. Given the seemingly inexplicable strength of the PMIs in January, nevertheless, we expect the February survey to be somewhat weaker, albeit still consistent with a return to positive GDP growth in Q1.

UK: CBI manufacturing survey indices



Index inverted. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Goods inflation & CBI selling price expectations



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

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		European Commission's preliminary consumer confidence index	Feb	**-15.5**	-15.5	-16.1	-
UK		Public sector net borrowing (excl. banks) £bn	Jan	**-17.6 (-16.7)**	-18.5 (-18.4)	6.8 (7.8)	6.5 (7.4)
		CBI industrial trends, total orders (selling prices) balance	Feb	**-20 (17)**	-27 (11)	-30 (9)	-

Auctions

Country		Auction
Germany		sold €3.71bn of 2.2% 2034 bonds at an average yield of 2.38%
UK		sold £4.0bn of 4.5% 2028 bonds at an average yield of 4.095%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		09.00	Preliminary manufacturing (services) PMI	Feb	47.0 (48.8)	46.6 (48.4)
		09.00	Preliminary composite PMI	Feb	48.4	47.9
		10.00	Final headline (core) HICP Y/Y%	Jan	*2.8 (3.3)*	2.9 (3.4)
Germany		08.30	Preliminary manufacturing (services) PMI	Feb	46.0 (48.0)	45.5 (47.7)
		08.30	Preliminary composite PMI	Feb	47.5	47.0
France		07.45	INSEE business (manufacturing) confidence index	Feb	99 (99)	98 (99)
		08.15	Preliminary manufacturing (services) PMI	Feb	43.5 (45.6)	43.1 (45.4)
		08.15	Preliminary composite PMI	Feb	45.0	44.6
Italy		09.00	Final HICP (CPI) Y/Y%	Jan	*0.9 (0.8)*	0.5 (0.6)
UK		09.30	Preliminary manufacturing (services) PMI	Feb	47.5 (54.1)	47.0 (54.3)
		08.15	Preliminary composite PMI	Feb	52.9	52.9

Auctions and events

Country		GMT	Event
Euro area		12.30	ECB publishes account of January monetary policy meeting
UK		06.00	BoE's Greene scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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