Euro wrap-up

Overview

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- Shorter-dated Bunds made losses as the flash euro area PMIs beat expectations, but the German composite PMI implied a steeper pace of contraction, while final euro area inflation figures suggested a further slowing in momentum.
- Gilts had a mixed performance, even as the flash February PMIs signalled an accelerated pace of recovery and persisting services price pressures.
- Tomorrow will bring the German ifo business survey and UK GfK consumer survey results, while ECB Executive Board member Schnabel is due to speak.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.897	+0.054
OBL 2.1 04/29	2.444	+0.024
DBR 2.2 02/34	2.438	-0.007
UKT 3½ 10/25	4.581	-0.012
UKT 4½ 06/28	4.149	+0.015
UKT 3¼ 01/33	4.104	+0.002

*Change from close as at 5.00pm GMT.
Source: Bloomberg

Euro area

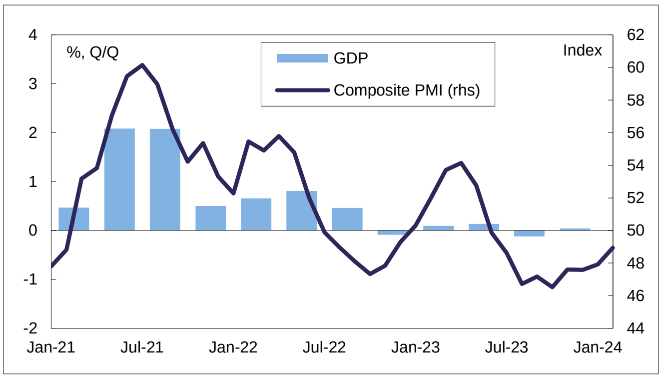
Flash February PMIs beat expectations despite further deterioration in German factory conditions

Overall today's flash PMIs for February were more upbeat about the euro area's recovery momentum so far in the first quarter of 2024. Certainly, the euro area composite output PMI came in ahead of expectations, rising for the third month out of the past four in February, by 1pt to an eight-month high 48.9, some 1.2pt above the Q4 average. And although that level – before the pandemic – would have been consistent with a modest contraction in GDP of 0.1-0.2%Q/Q, we note that contrary to the more downbeat signals from the PMIs, GDP was steady in Q4. But the headline euro area figures continue to mask significant divergences in conditions across both sectors and region. Indeed, while the euro area services activity index rose 1½pts to 50, the first non-contractionary reading since July, the manufacturing sector remained a significant drag, with the output index dropping 0.4pt to a two-month low of 46.2. The deterioration in factory conditions was led by Germany, where the manufacturing output PMI slumped 3.6pts to a four-month low (42.1). So, despite an implied easing in the downturn in services in February, the German composite PMI fell 0.9pt to 46.1, some 0.5pt below the Q4 average and therefore signalling a steeper pace of contraction in Q1. In contrast, the French composite PMI jumped more than 3pts to a nine-month high (47.7), supported by a softer pace of contraction in both services (+2.6pts to 48.0) and manufacturing (+5.3pts to 46.3). Nevertheless, the euro area's economic recovery continues to be led by the rest of the region, for which the respective composite PMI rose 1.4pts – the most since March – to a nine-month high of 52.2, and consistent with an acceleration in economic output in the periphery.

Gloomy prospects for manufacturing contrasts with improving confidence among services

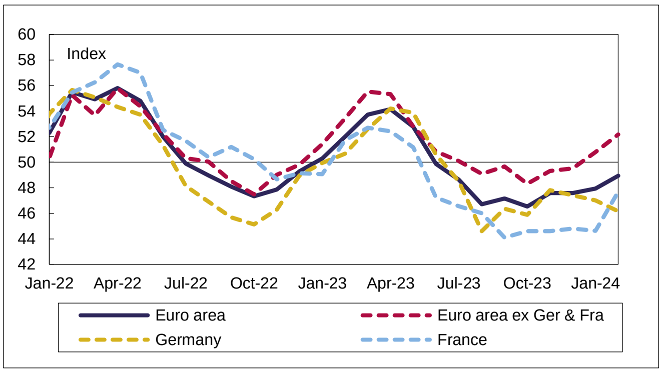
Disappointingly, the survey detail offered a relatively gloomy outlook for manufacturing output over the near-term too, with slowing global demand weighing further on new orders from overseas, while the respective index for domestic orders was little improved at a historically low level (44.8). And so, manufacturers continued to cut headcount. Nevertheless, with stocks of finished goods reportedly falling further, the survey's ratio of orders to inventories was the joint-highest since mid-2022, pointing to the prospect of progress towards expansion in the sector over coming quarters when demand picks up. And having lengthened by the most in fourteen months in January, an improvement in the manufacturing suppliers' delivery times PMI tentatively suggests fewer shipping delays related to events in the Red Sea. Meanwhile, the outlook for the services sector was brighter, with the new business component rising for the fourth consecutive month and by 1.7pts – the most since last March – to an eight-month high (49.7). And with confidence about activity over the coming twelve months having also improved to an eleven-month high, firms in the services sector reported the strongest job growth since last July.

Euro area: GDP growth & composite PMI



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

Euro area: Composite PMIs by member state



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

Signs of rising price pressures to remain a concern for ECB policymakers

While today's PMIs may have eased policymakers concerns about the downside risks to near-term GDP growth, many members of the ECB Governing Council will be more perturbed by signs of increased cost pressures since the start of the year, particularly in services. While the manufacturing input cost PMI remained consistent with disinflation in the sector, it still rose to an eleven-month high. And although it remains well below highs seen over recent years, the services input cost PMI rose to a nine-month high, in this instance well above the long-run norm, seemingly pressured by above-average wage settlement growth amid still-firm demand for workers in the sector. As a result, while manufacturers reported that their selling prices fell for a tenth successive month, services output prices rose the most since May and at a pace consistent with persistent above-target inflation.

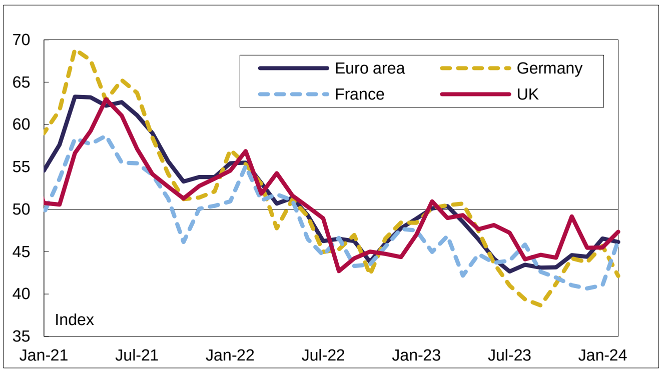
Headline inflation eases in January despite upward impulses from government policy

Today's final euro area HICP inflation figures for January, however, aligned with the flash estimates that saw the headline HICP rate resume a downwards trajectory at the start of the year, by 0.1ppt to 2.8%Y/Y. And while that remained 0.4ppt above November's 28-month low, it was still 7.8ppts below the peak in October 2022. Moreover, the detailed breakdown published today suggested that, despite the additional inflationary impulse from various government policy initiatives at the start of the year, the underlying disinflationary trend appears to remain intact. Certainly, the impact of reduced subsidies and tax changes to lower household utility bills was evident in the near-6ppt rise in electricity and gas inflation to a four-month high (-7.6%Y/Y) and six-month high (-9.7%Y/Y) respectively. But this was in part offset by the steepest annual drop in fuel inflation (-3.4%Y/Y) for six months. Moreover, the ongoing decline in food inflation (-0.7ppt to 5.3%Y/Y) to its lowest since March 2022, more than offset the uptick in tobacco prices – related to an increase in taxes in France – which rose at the fastest monthly pace since March 2019. And while services inflation was steady at 4.0%Y/Y for a third successive month, this in part reflected high hospitality prices associated with the German government's increase in VAT on restaurants, as well as a one-off jump in insurance premiums. So, with the core goods component having declined for an eleventh successive month (to 2.0%Y/Y, the lowest since October 2021), with a disinflationary trend for furniture, household appliances and motor vehicles maintained, overall core inflation fell for a sixth successive month in January, by 0.1ppt to 3.3%Y/Y, the lowest since March 2022.

Inflation momentum continues to slow steadily

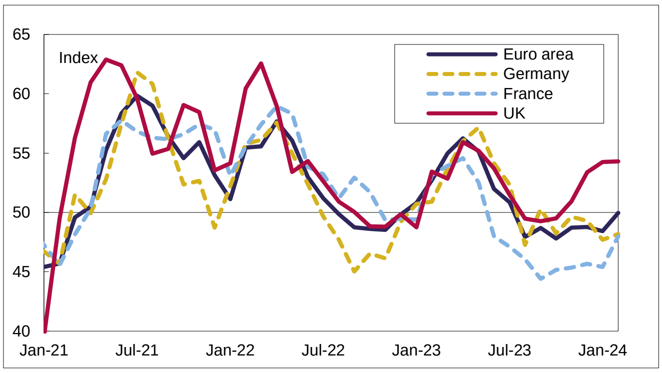
Notwithstanding persisting stickiness in services inflation, today's data implied a further improvement in momentum. According to the ECB's seasonally adjusted figures, services inflation on a 3M/3M annualised basis slowed 0.3ppt to 2.2%,

Europe: Manufacturing output PMIs



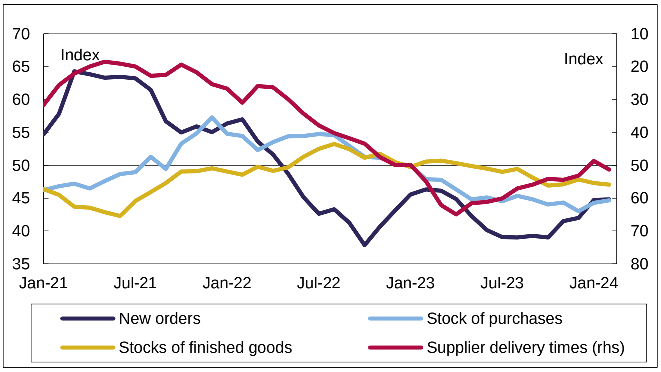
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Europe: Services activity PMIs



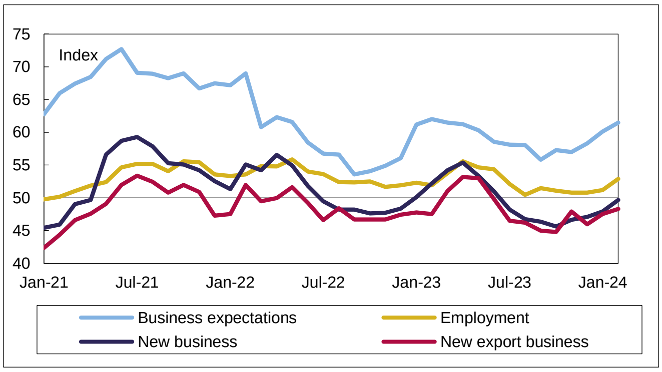
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Selected manufacturing PMIs*



**Supplier delivery times on an inverse scale. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

Euro area: Selected services PMIs



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

the lowest since September 2021 and a marked 4.8ppts below the peak. And while momentum in non-energy industrial goods inflation edged slightly higher in January, it remained extremely subdued at just 0.3%3M/3M annualised and well below the long-run average. As a result, core inflation momentum eased slightly further to just 1.5%3M/3M annualised, the softest since July 2021. Today's data revealed a significant easing in several other measures of underlying inflation too. The share of items with inflation of 2.0% or more fell to less than two-thirds for the first time for two years, while the 15% trimmed mean HICP rate fell 0.5ppt to 3.2%Y/Y, the lowest since November 2021. And while the ECB's model-based measure of persistent and common component of inflation (PCCI), which the Governing Council believes can provide one of the more reliable guides to future inflation, edged up slightly in January, at 1.9%3M/Y it remained below the ECB's 2% target for a second-successive month.

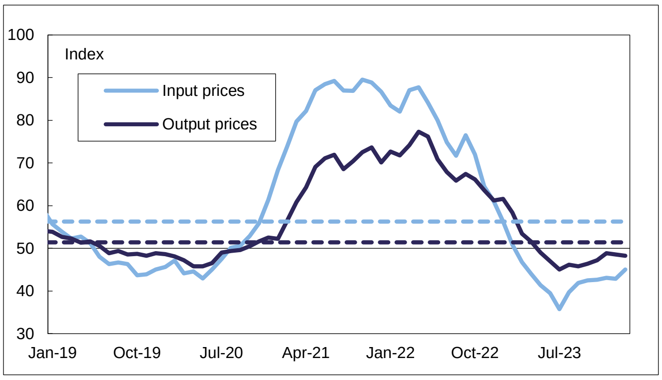
Policymakers remain cautious about cutting rates too soon

While the near-term inflation outlook remains uncertain, we maintain our view that headline and core inflation will take a notable step down in February before easing gradually further to the 2% target in Q224. Indeed, our current expectation for headline inflation in Q1 of 2.4%Y/Y is some ½ppt below that assumed by the ECB in its December macroeconomic projections. And we suspect that the ECB will need to revise down its profile for both headline and core inflation across the forecast horizon when updated macroeconomic projections are published next month. But while the account from the ECB's Governing Council meeting in January, published today, acknowledged that the risks to reaching its inflation target were seen as broadly balanced, many members were still concerned about the persistence of strong wage growth. Indeed, it was argued that more evidence of slowing pay pressures was required before the first rate cut. Furthermore, with the risk of cutting rates too soon seen to outweigh the risk of cutting too late, we continue to see June as the most likely month for the first rate cut to coincide with a fresh set of economic forecasts.

The day ahead in the euro area

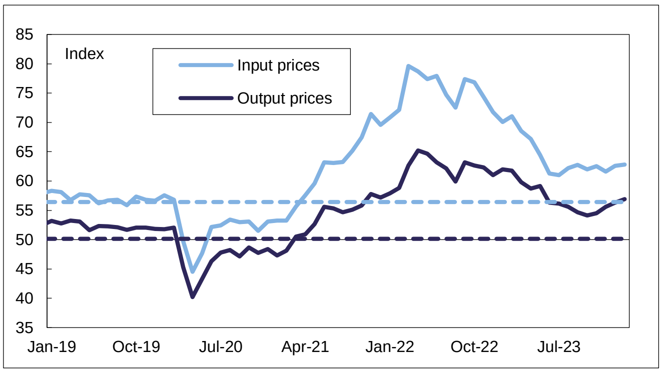
The flow of economic sentiment surveys continues tomorrow, with the German ifo indices due to be published. January's ifo business survey offered a pretty bleak assessment of economic conditions at the start of 2024. In particular, the headline business climate index fell for the second successive month, led by a worsening in the assessment of current conditions, for which the respective index fell for the ninth month out of the past twelve. And consistent with today's flash PMIs, the current assessment balance is expected to edge lower again in February to lowest level since July 2020. Tallying with the weak German survey data will be the final results of German Q4 GDP, which will likely confirm that the economy contracted by 0.3%Q/Q, after falling 0.1%Q/Q in Q3. This release will bring the first official expenditure breakdown. Also of interest tomorrow will be the publication of the ECB's measure of consumer inflation expectations, which, on a 3Y ahead basis, is

Euro area: Manufacturing price PMIs*



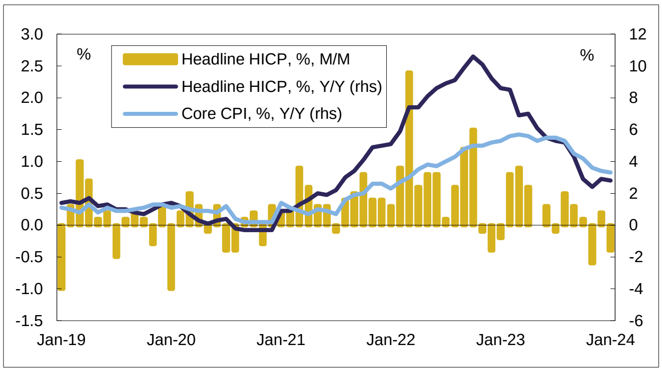
*Dashed lines represent pre-pandemic averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Services price PMIs*



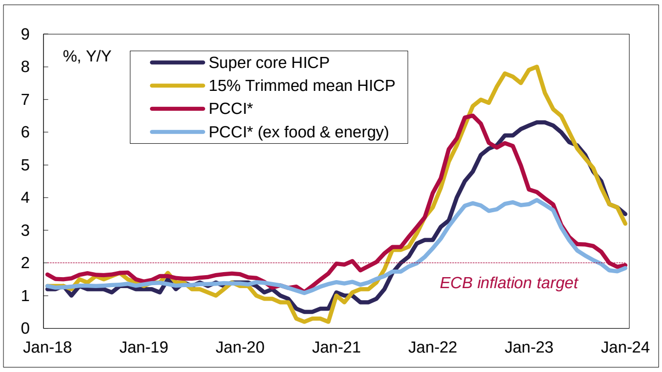
*Dashed lines represent pre-pandemic averages. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected measures of underlying inflation



*Persistent and Common Component of Inflation. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

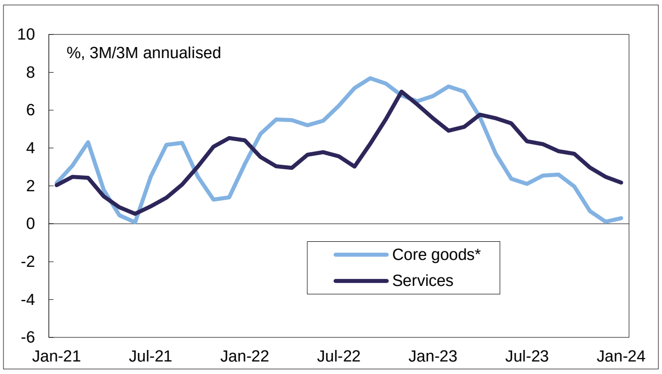
expected to fall to 2.4%, from 2.5%. Aside from the data, influential ECB Executive Board member Isabel Schnabel is due to speak on whether the fight against inflation has been won.

UK

Flash PMIs point to accelerated recovery momentum led by services sector

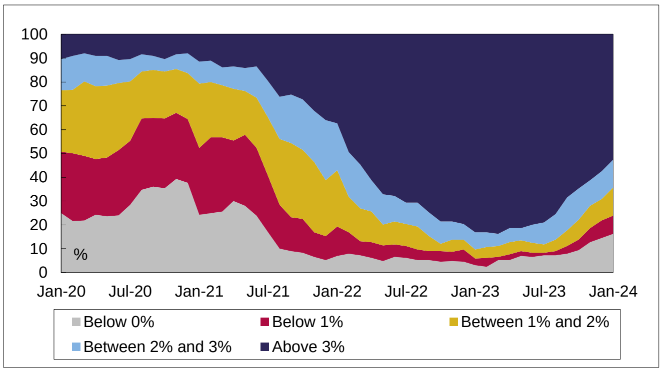
Like in the euro area, today's UK flash PMIs beat expectations in February, extending the run of above-50 "expansionary" readings to four months and implying an acceleration in the UK's economic recovery momentum in the first quarter of 2024. In particular, the headline composite index increased for a fifth consecutive month in February, by 0.3pt to a nine-month high of 53.3, to leave it trending some 2.6pts above the Q4 average, a level that before the pandemic would have implied GDP growth of around 0.2%Q/Q. But it is worth noting that while the PMIs were broadly consistent with a stagnation in Q4, output contracted 0.3%Q/Q. As in the euro area, the PMIs suggest that the UK's recovery remains services led, with the respective activity index moving sideways at 54.3, its joint highest since last May, as survey respondents cited a pickup in consumer spending amid lower borrowing costs. Indeed, with the new business component reporting the strongest growth for nine months and optimism about the outlook for the coming year the highest for almost two years, firms in the sector reported the strongest jobs growth since July. While there was a notable improvement in the manufacturing output index – up 1.8pts on the month – at 47.3 it marked the nineteenth sub-50 "contractionary" reading of the past twenty months. Moreover, the flash PMIs suggested that the near-term production outlook was clouded by a further decline in domestic orders as well as marked weakening export demand, perhaps relating to the imposition of new Brexit-related import checks in certain subsectors. And today's survey suggested additional supply-side challenges arising from longer freight times related to the rerouting of vessels away from the Suez Canal. Indeed, today's survey suggested that supplier delivery times lengthened by the most in nineteen months. This notwithstanding, price pressures in the manufacturing sector remained relatively muted, with the both the input and output price indices below the long-run averages. But less encouragingly for BoE policymakers, the services price PMIs ticked higher in February, thanks principally to pressures related to higher labour costs.

Euro area: Core inflation momentum



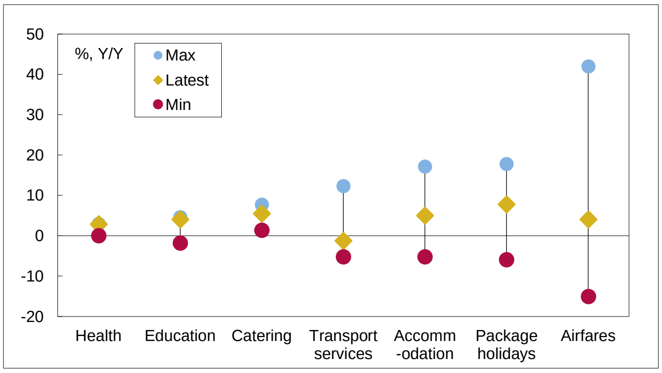
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Share of HICP basket by inflation rate



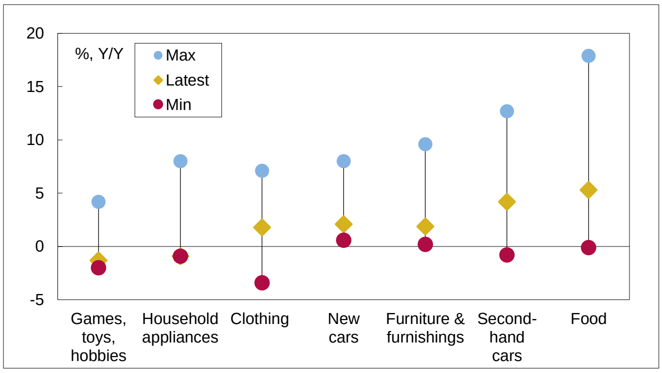
Source: Eurostat and Daiwa Capital Markets Europe Ltd.

Euro area: Selected services HICP components*



*Data range since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected goods HICP components*

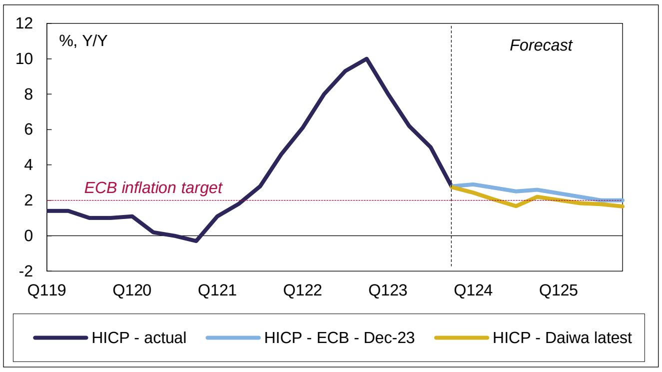


*Data range since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

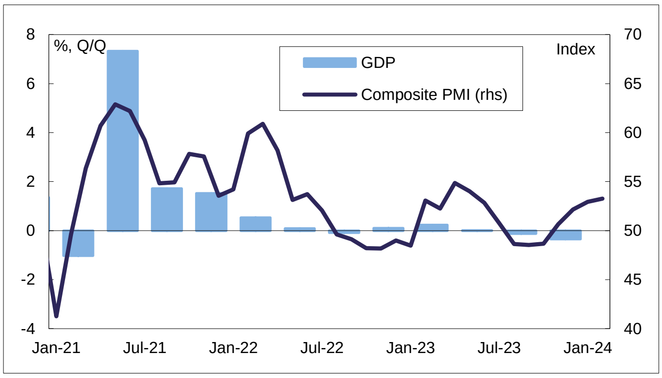
The UK data calendar ends the week with the release of the GfK consumer confidence index for February, which is forecast to rise a little to -18, from -19 in January. While this would mark the highest level since December 2021, it would remain firmly below the pre-Pandemic five-year average of -6.2.

Euro area: Inflation forecasts



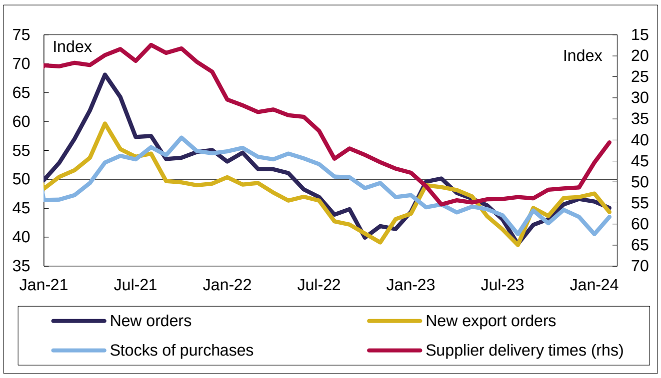
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & composite PMI



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

UK: Selected manufacturing PMIs*



**Supplier delivery times on an inverse scale. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

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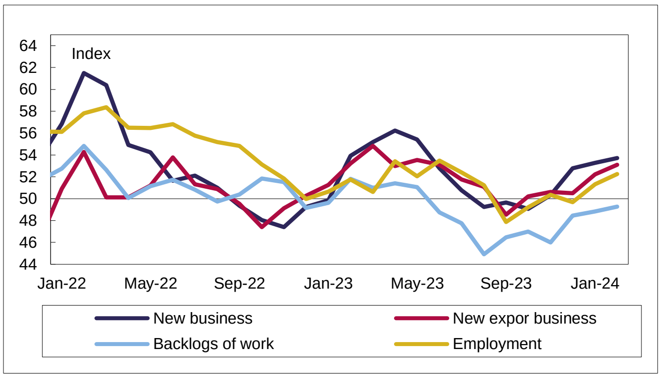
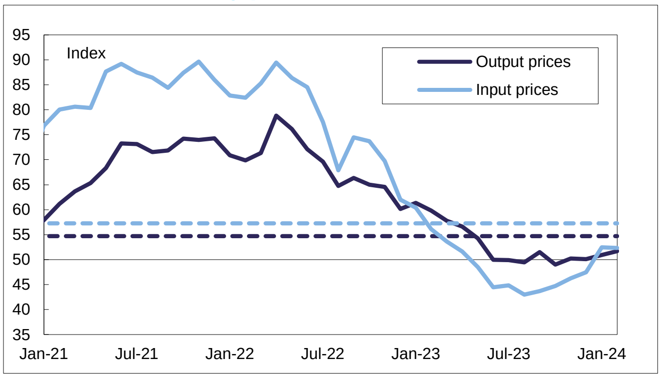


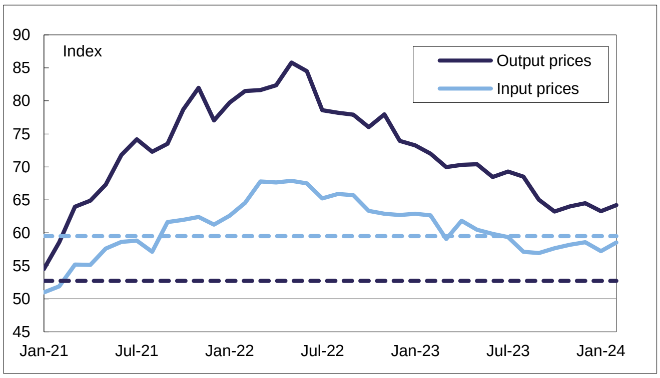
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing price PMIs*



**Dashed lines represent pre-pandemic averages. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

UK: Services price PMIs*



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European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Preliminary manufacturing (services) PMI	Feb	**46.1 (50.0)**	47.0 (48.8)	46.6 (48.4)	-
		Preliminary composite PMI	Feb	**48.9**	48.4	47.9	-
		Final headline (core) HICP Y/Y%	Jan	**2.8 (3.3)**	*2.8 (3.3)*	2.9 (3.4)	-
Germany		Preliminary manufacturing (services) PMI	Feb	**42.3 (48.2)**	46.0 (48.0)	45.5 (47.7)	-
		Preliminary composite PMI	Feb	**46.1**	47.5	47.0	-
France		INSEE business (manufacturing) confidence index	Feb	**98 (100)**	99 (99)	98 (99)	99 (-)
		Preliminary manufacturing (services) PMI	Feb	**46.8 (48.0)**	43.5 (45.6)	43.1 (45.4)	-
		Preliminary composite PMI	Feb	**47.7**	45.0	44.6	-
		Bank of France retail sales Y/Y%	Jan	**-3.1**	-	-2.4	-3.2
Italy		Final HICP (CPI) Y/Y%	Jan	**0.9 (0.8)**	*0.9 (0.8)*	0.5 (0.6)	-
UK		Preliminary manufacturing (services) PMI	Feb	**47.1 (54.3)**	47.5 (54.1)	47.0 (54.3)	-
		Preliminary composite PMI	Feb	**53.3**	52.9	52.9	-

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/ *Daiwa forecast*	Previous
Euro area		09.00	ECB 1Y (3Y) price expectations	Jan	- (2.4)	3.2 (2.5)
Germany		07.00	Final GDP Q/Q% (Y/Y%)	Q4	*-0.3 (-0.2)*	-0.1 (-0.3)
		09.00	Ifo business climate index	Feb	85.5	85.2
		09.00	Ifo current assessment (expectations) balance	Feb	86.8 (84.0)	87.0 (83.5)
UK		00.01	GfK consumer confidence index	Feb	-18	-19

Auctions and events

Euro area		09.20	ECB's Schnabel scheduled to speak on 'Has the fight against inflation been won?'
Italy		10.00	Auction: €4bn of 3.2% 2026 bonds
		10.00	Auction: €1bn of 1.5% 2029 index-linked bonds
		10.00	Auction: €500mn of 2.55% 2041 index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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