Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds followed USTs higher as euro area producer prices fell again and French industrial production data disappointed.
- Gilts also made gains as a UK retail survey pointed to weak sales in February.
- Wednesday will bring new data for euro area retail sales and German goods trade as well as the construction PMIs and the UK government's budget announcements.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.840	-0.054
OBL 2.1 04/29	2.357	-0.057
DBR 2.2 02/34	2.321	-0.068
UKT 0⅛ 01/26	4.263	-0.029
UKT 0½ 01/29	3.969	-0.079
UKT 4⅝ 01/34	4.006	-0.106

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

Euro area

Producer prices fall again thanks to lower prices of energy and intermediate goods

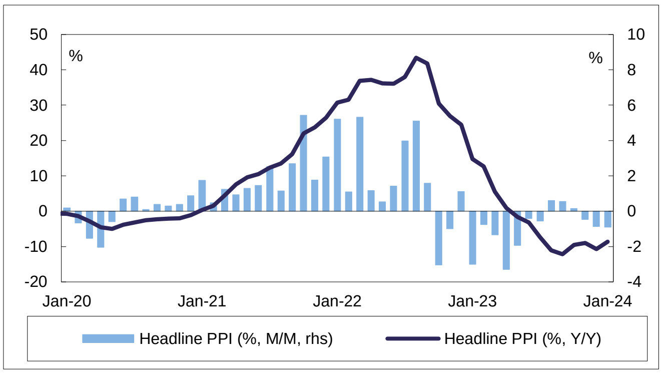
According to last week's flash estimates of euro area consumer price inflation, the pace of increase in core goods prices slowed in February to just 1.6%Y/Y, the lowest since July 2021. And today's producer price inflation figures similarly suggested that disinflation continued in the factory sector at the start of the year. In particular, overall industrial producer prices fell for a third successive month in January, and by 0.9%M/M for the second month in a row. That left them down 8.6%Y/Y, the smallest annual pace of decline since July, but also more than 15% below the level in September 2022. The largest disinflationary impulse in January came from energy prices, which fell 2.9%M/M, the most in nine months, to be down 21.3%Y/Y and more than 40% below the peak sixteen months earlier. In addition, prices of intermediate goods declined for the twelfth successive month, albeit by just 0.2%M/M, to be down 5.8%Y/Y, the most since 2009. And while producer output prices of consumer durables were still up 1.1%Y/Y, they fell 0.2%M/M and have not risen since April. However, output prices of consumer nondurables rose for the first time in April, up 0.2%M/M to be up 2.0%Y/Y. And capital goods prices rose 0.6%M/M, the most in a year. Nevertheless, that left them up just 2.1%Y/Y, a 2½-year low.

Looking ahead, surveys and wholesale market prices suggest that the disinflation trend in the goods sector might persist over the near term. For example, despite concerns about possible new pressures from disruption to freight via the Red Sea, the manufacturing input cost and output price PMIs remained below the key 50 mark in February. And the Commission survey's three-month industrial selling price expectations index remained below the long-run average and at a level consistent with goods prices rising at annual rate below the ECB's 2% target.

French manufacturing output disappoints in January with weakness widespread

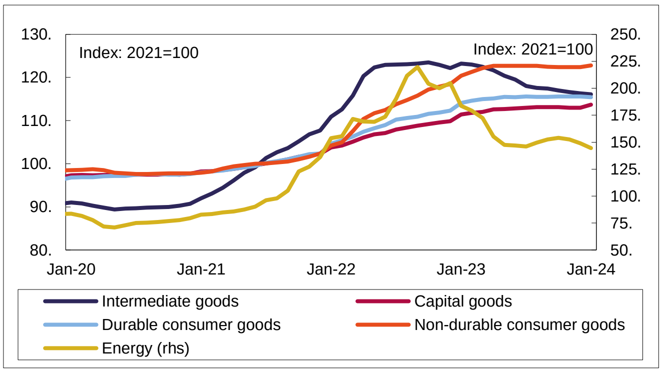
Consistent with an ongoing downtrend in demand for goods and contraction implied by the manufacturing PMIs, today's French industrial production figures suggested that the sector started the year on the back foot. In particular, output fell a steeper-than-expected 1.1%M/M in January – the most in ten months – while the rise in December was revised down (by 0.7ppt to 0.5%M/M), leaving the level at its lowest since April 2023. And the drop would have been larger still in the absence of a modest increase in construction (0.7%M/M) and energy (0.3%M/M). Indeed, manufacturing production fell 1.6%M/M – the most in 15 months – to leave it some 1.2% below the Q4 level. And the weakness in manufacturing was broad-based, led by a second-successive decline in autos production (-6.0%M/M), as well as a drop of almost 5%M/M in other transport equipment. But output of machinery and equipment was also down to its lowest level since July 2022, with electrical equipment at its lowest since December 2020. In aggregate, the levels of production of intermediate (-3.5%M/M) and capital goods (-1.8%M/M) were some 11½% and 7½% below the respective pre-pandemic levels. Production of non-durables

Euro area: Producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Producer price indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

bucked the trend at the start of the year, rising for the fourth consecutive month (1.6%M/M) to be more than 2% above the Q4 level and more than 3% above the pre-pandemic benchmark, boosted by a further pickup in food production. And the marked improvement in the manufacturing output PMI in February (up 5.9pts to a 13-month high of 47.0), while the INSEE industry confidence index rose back to a 7-month high to be a touch above the long-run average, raises some cautious optimism that production rebounded last month. Of course, what matters most for the French economy is services, and the respective activity PMI similarly jumped to its highest level in nine months in February. And with the INSEE business composite index also trending so far this year some 0.4pt above the Q4 average, we continue to expect to see another modest expansion of GDP in Q1.

The day ahead in the euro area

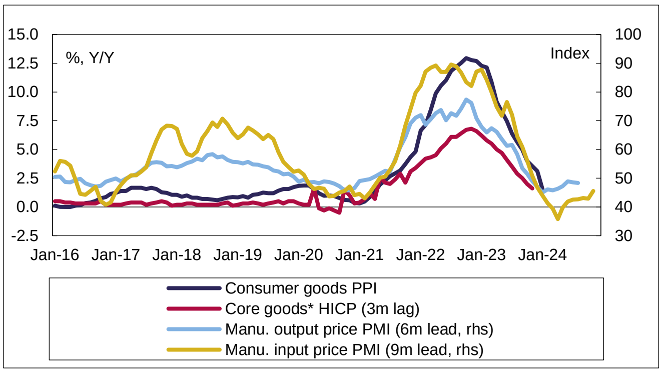
Wednesday will bring euro area retail sales figures for January. With spending in Germany and France having been soft that month, euro area retail sales are likely to have been broadly unchanged on the month. Given the more positive revisions to the German data, the extent of the drop in December (currently estimated at 1.1%M/M) is likely to be revised down and growth in euro area retail sales over Q4 as a whole might well be revised into modestly positive territory. Meanwhile, the euro area construction PMIs are likely to suggest that the sector continued to contract last month, particularly in Germany. German goods trade figures for January are also due.

UK

Survey suggests demand for goods remains weak, while private car registrations fall further

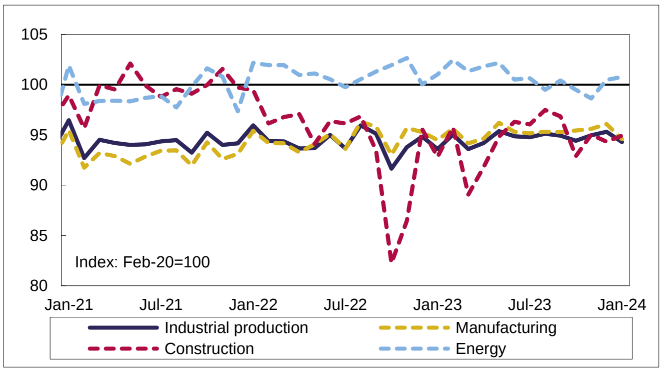
Like last week's CBI distributive trades survey, today's BRC monitor suggested that household demand for goods remained lacklustre in February, as subdued consumer confidence, high borrowing costs and one of the wettest Februarys on record kept UK consumers away from the high street. According to the BRC, growth in the value of total sales slowed 0.1ppt to 1.1%Y/Y in February, with like-for-like sales growth down 0.4ppt to 1.0Y/Y, both the softest rates since August 2022. The weakness largely reflected a steeper drop in non-food sales (-2.5%3M/Y) as subdued demand for larger items such as furniture, household appliances and electricals offset continued growth in beauty products. Growth in food sales (6.0%3M/Y) also fell back to the softest since November 2022. Admittedly, part of the downtrend in sales reflects easing inflation, with the BRC's shop price measure having fallen a further 0.4ppt to a near-two-year low of 2.5%Y/Y in February. Nevertheless, this suggests that volumes were down some 1½%Y/Y, the 23rd consecutive negative reading, albeit the softest since December 2022. So, despite the boost to household incomes following the cut in National Insurance Contributions at the start of the year, and the likely further near-term boost to personal incomes following tomorrow's Budget announcement, as well as the

Euro area: Goods price indices



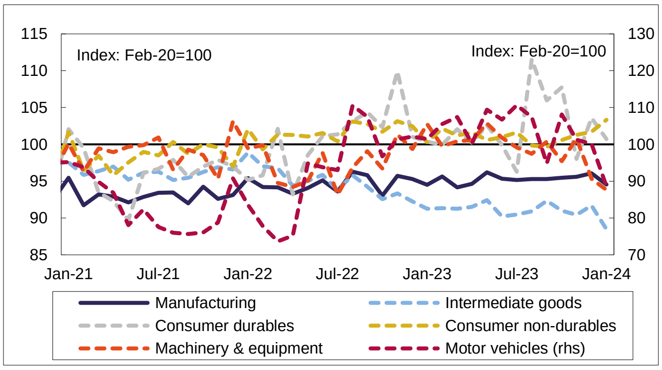
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

France: Industrial production



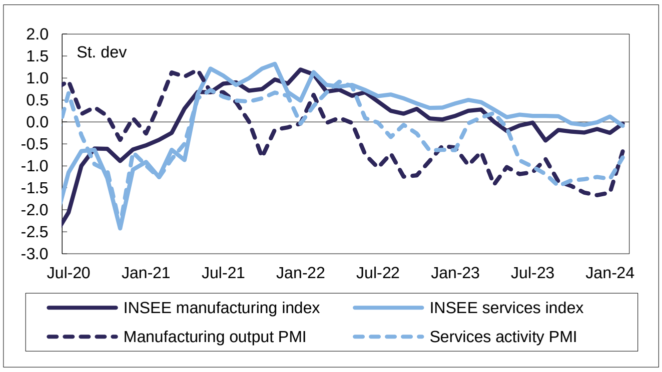
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Manufacturing production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Business sentiment indices



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

sharp reduction in the price cap on household energy bills next month, households remain extremely cautious with their purchases. Certainly, today's new car registration figures illustrated an ongoing lack of demand for big-ticket items, with private sales down a further 2.6%Y/Y in February. The was offset by a pickup in business and fleet sales, however, to leave total new car registrations up some 14%Y/Y.

The day ahead in the UK

Wednesday will bring the most notable event for UK financial markets this week in the shape of the government's Budget announcement, which will probably be the last to come before the next general election. Given the ruling Conservative party's dire poll ratings and comments from ministers and tory MPs, the announcement of certain further tax cuts, following the reduction in National Insurance Contributions at the start of the year and extension of business investment incentives, is fully expected. However, the full extent, nature and timing of any net easing of the fiscal stance to be announced is uncertain.

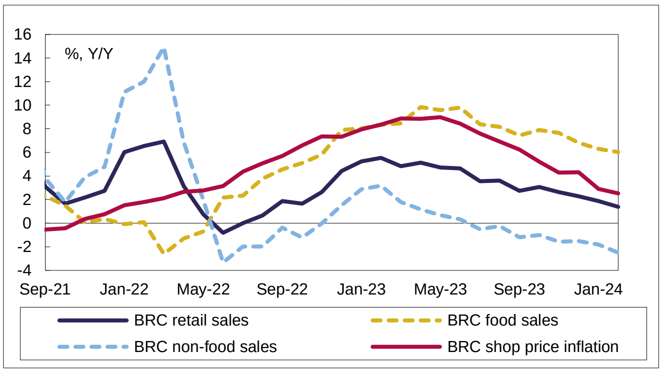
The OBR's updated forecasts for the public finances will determine the 'fiscal headroom' available to the Chancellor to ease policy while, at face value, remaining on track to meet the government's rather arbitrary objective for debt to fall as a share of GDP in five years' time. However, many of the OBR's assumptions – including for public expenditure and fuel duties – will be unrealistic. Indeed, the use of alternative, more plausible assumptions would suggest that tax cuts at the present juncture would be inappropriate and probably need to be reversed following the general election. And if he is serious about wanting to meet his debt objective, it would certainly be unwise for the Chancellor to give away all of the headroom that the OBR suggests is available to him.

Nevertheless, at the time of the government's Autumn statement, the OBR's projections suggested that the Chancellor might have headroom for a further £13bn (or roughly ½% of GDP) easing of fiscal policy this time around. Since then, public net borrowing has come in below the OBR's expectations. And – despite recent market moves – lower expectations for Bank Rate, lower Gilt Yields, and the likelihood of a sharp drop in inflation in April thanks not least to the cut in the regulated household energy price cap – should also increase the amount of headroom. At the same time, the 0.3%Q/Q drop in GDP in Q4, as well as the recent downwards revision to estimates of the unemployment rate and upwards revision to the level of labour inactivity, might lead the OBR to revise down its assessment of potential GDP growth (which is far higher than that of the BoE), acting to reduce the extent of fiscal headroom. And a recent media report even suggested that the Chancellor had been told that headroom had not increased at all since the autumn.

This notwithstanding, some cuts to personal taxation seem bound to come. In particular, a report today in the Times newspaper suggested that a 2p cut in National Insurance Contributions – which have a cost to the government of about £10bn – had been agreed. And an inevitable freezing of fuel duty will cost a further £5bn. However, there are likely to be some offsetting revenue-raising measures and perhaps also a downwards revision to plans for public expenditure. So, overall, we now expect the net overall amount of fiscal easing to be no more than ½% of GDP, which might be insufficient to influence significantly BoE monetary policy decisions over coming months.

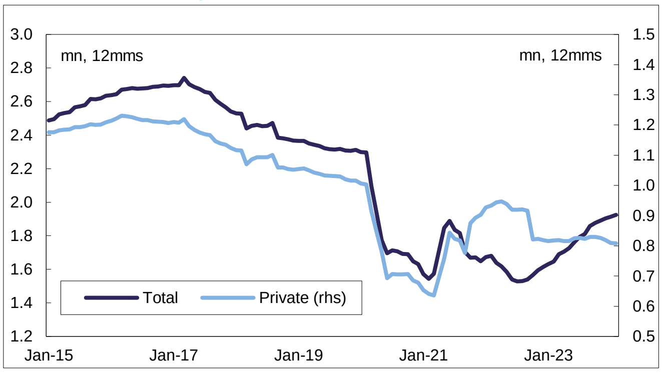
Data-wise, the construction PMIs for February are expected to remain in contractionary territory for a sixth successive month as the subdued pipeline of work in response to higher interest rates continues to hit house-building activity. However, given signs of a stabilisation of house prices and uptick in new mortgage approvals, business optimism in the sector regarding the coming twelve months is likely to rise to the highest in more than two years.

UK: BRC retail sales & shop price indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: New car registrations



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		Final services (composite) PMI	Feb	**50.2 (49.2)**	*50.0 (48.9)*	48.4 (47.9)	-
		PPI Y/Y%	Jan	**-8.6**	-8.0	-10.6	-10.7
Germany		Final services (composite) PMI	Feb	**48.3 (46.3)**	*48.2 (46.1)*	47.7 (47.0)	-
France		Industrial production M/M% (Y/Y%)	Jan	**-1.1 (0.8)**	0.0 (1.7)	1.1 (0.9)	0.4 (0.5)
		Final services (composite) PMI	Feb		*48.0 (47.7)*	45.4 (44.6)	-
Italy		Services (composite) PMI	Feb	**52.2 (51.1)**	52.3 (51.5)	51.2 (50.7)	-
		Final GDP Q/Q% (Y/Y%)	Q4	**0.2 (0.6)**	*0.2 (0.5)*	0.1 (0.1)	-
Spain		Services (composite) PMI	Feb	**54.7 (53.9)**	53.4 (52.0)	52.1 (51.5)	-
UK		BRC retail sales monitor, like-for-like sales Y/Y%	Feb	**1.0**	1.6	1.4	-
		New car registrations Y/Y%	Feb	**14.0**	-	8.2	-
		Final services (composite) PMI	Feb	**53.8 (53.0)**	*54.3 (53.3)*	54.3 (52.9)	-

Auctions

Country		Auction
Germany		sold €3.32bn of 2.1% 2029 bonds at an average yield of 4%
UK		sold £3.75bn of 3.75% 2027 bonds at an average yield of 4.314%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Sentix investor confidence index	Mar	**-10.5**	-10.8	-12.9	-
Spain		Unemployment change 000s	Feb	**-7.5**	*-7.5*	60.4	-

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		08.30	Construction PMI	Feb	-	41.3
		10.00	Retail sales M/M% (Y/Y%)	Jan	0.1 (-1.3)	-1.1 (-0.8)
Germany		07.00	Trade balance €bn	Jan	21.0	22.4
		08.30	Construction PMI	Feb	-	36.3
France		08.30	Construction PMI	Feb	-	39.6
UK		08.30	Construction PMI	Feb	49.0	48.8

Auctions and events

Country		GMT	Event
UK		12.30	UK Chancellor Hunt to present Spring Budget

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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