

Euro wrap-up

Overview

- Bunds made modest gains while the latest Commission survey reported an unexpected deterioration in sentiment in the middle of Q1 led by France, while bank lending remained subdued in January.
- Ahead of the results of today's by-election in Gorton and Denton, Gilts followed USTs higher on heightened global risk aversion.
- Friday will bring flash February inflation estimates from Germany, France and Spain, French consumer spending numbers and UK consumer confidence.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2.1 03/28 | 2.038 | -0.002 |
| OBL 2½ 04/31 | 2.299 | -0.005 |
| DBR 2.9 02/36 | 2.695 | -0.010 |
| UKT 3¾ 03/27 | 3.544 | -0.021 |
| UKT 4% 03/30 | 3.723 | -0.034 |
| UKT 4½ 03/35 | 4.281 | -0.035 |

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

Euro area

Euro area ESI deterioration in February led by France, but still trending up on Q4

Contrasting the slight recovery in momentum flagged by the [flash PMIs](#), today's Commission economic survey results for February came in on the soft side. Indeed, the headline euro area economic sentiment index (ESI) fell a full point to 98.3, almost 2% below the long-run average. But having jumped to a three-year high in January, this still left the index trending some 1.6pts above the Q4 average and at a level that remains consistent with euro area GDP growth close to the 0.3%Q/Q pace achieved in both of the past two quarters. And consistent with the PMIs, the deterioration reported in the Commission survey was led by France, where the ESI fell a chunky 2.8pts on the month to 97.8. But this still left it trending more than 4pts above the Q4 average, suggestive of another quarter of positive French growth. While the German ESI (93.0) again implied subdued economic performance, it too was at the top of the range of the past three years and almost 2pts above the level in Q4. And despite a drop in February (102.0), the Italian ESI was the second highest since spring 2023 and again suggestive of above-potential GDP growth, perhaps benefitting from the hosting of the Winter Olympics. Today's survey also pointed to continued outperformance in Spain, with the respective ESI (106.2) steady at the joint-highest level since September 2024, tracking 1pt above the Q4 average despite some inclement Iberian winter weather.

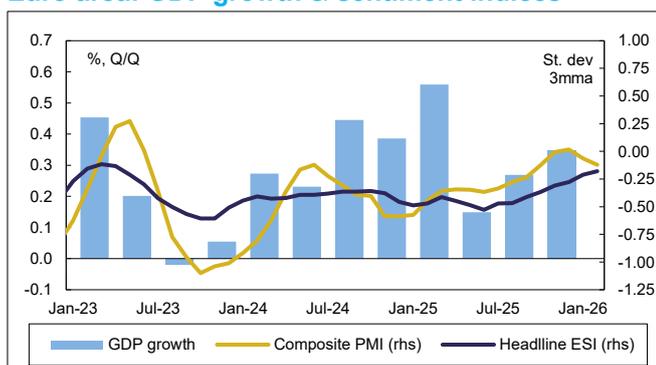
Services optimism softened with downwardly revised demand expectations weighing on prices

Despite the weaker headline euro area ESI, the survey detail was a mixed bag, offering cause for cautious optimism about the economic outlook. Sentiment in services slipped back in February to a four-month low, with firms less upbeat in hospitality, telecommunications and real estate. But this followed a marked pickup at the turn of the year, and recent growth in demand in the sector was judged to have been broadly in line with the long-run average. Nevertheless, French services firms certainly do appear to have become much more downbeat about the outlook. And concerns of a softening of demand appears to be weighing on firms' selling prices in the sector. That, however, should ensure that underlying inflation in the euro area remains consistent with (or below) the ECB's target over coming quarters.

Retailers & manufacturers more upbeat about outlook

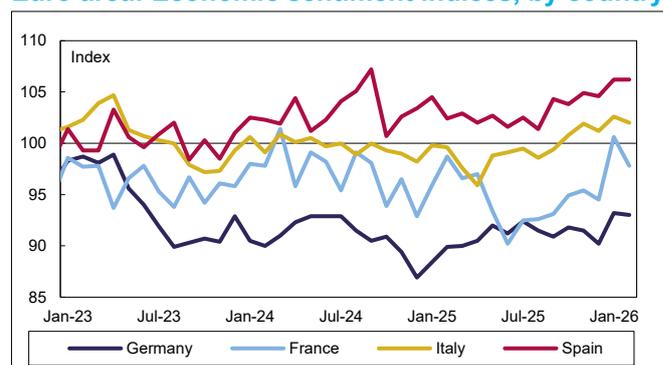
Harsh weather appears also to have dampened construction sentiment this month, particularly in France and Spain. But, supported by strength in Italy, growth in recent building work was judged to have been the strongest since October 2022. And while business sentiment among manufacturers also edged slightly lower in February, the recent production trend was considered the best in four months due to a recovery in autos and continued strong growth in output of other transport goods. Moreover, given a further pickup in orders, production expectations matched the highest in three years. In addition,

Euro area: GDP growth & sentiment indices



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

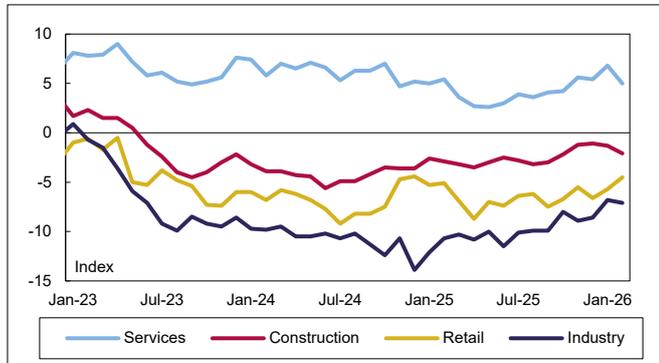
Euro area: Economic sentiment indices, by country



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

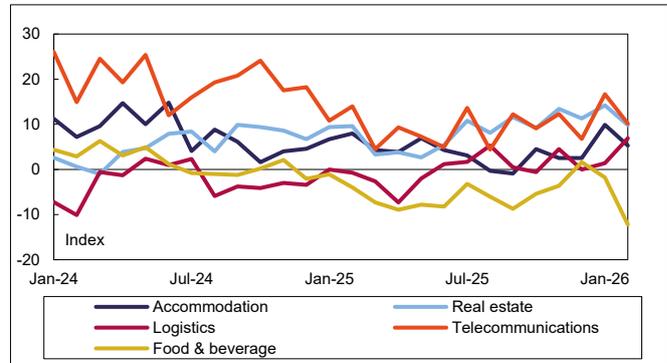
greater optimism among retailers tallied with improved consumer confidence, which rose to a 15-month high, benefitting from rising income expectations. And notably perhaps, employment intentions in the retail sector have accordingly picked up too. Admittedly, households signalled an intention to add to savings over the near term as inflation expectations for the 12 months ahead edged marginally higher. But purchase intentions remained above the long-run average, suggesting that household consumption should continue to support GDP growth over coming quarters.

Euro area: Economic sentiment indices by sector



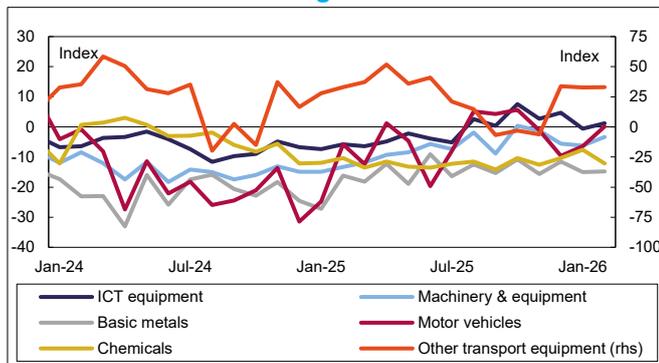
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Services sentiment indices



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

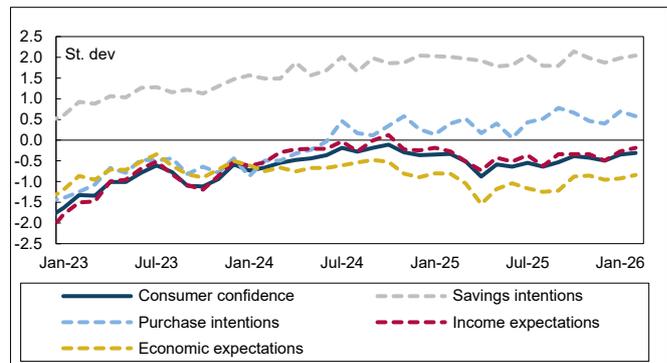
Euro area: Manufacturing sentiment indices*



*Recent production trends indices.

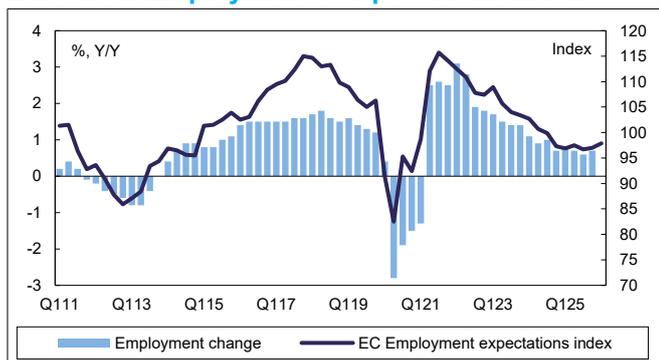
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence indices



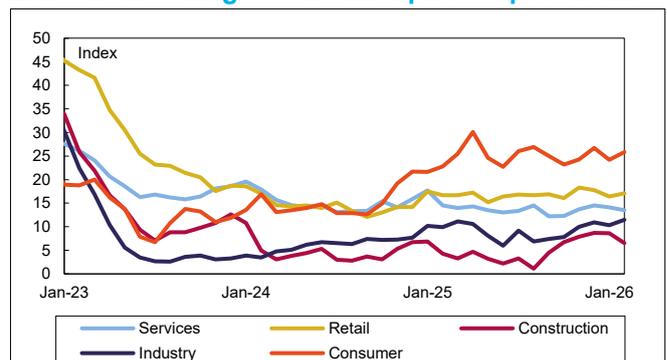
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Employment & expectations index*



*Employment expectations index for Q126 is average of January and February outturns. Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selling & consumer price expectations*



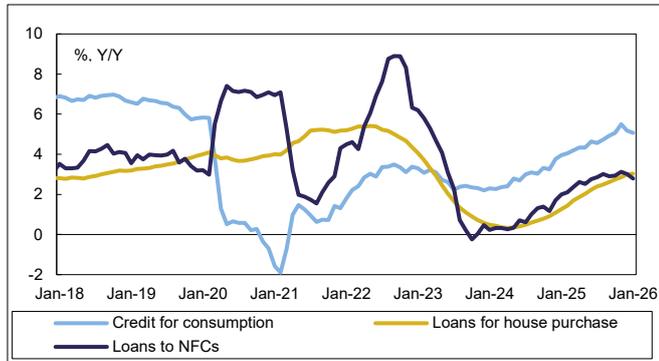
*Selling prices indices for 3 months ahead, consumer price index for 12 months ahead. Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Subdued bank lending strengthens case for rate cut if inflation undershoots expectations

Given the 200bps of cumulative monetary easing in the 12 months to last June, growth in bank lending in the euro area remains relatively underwhelming and softer than the ECB had hoped given past trends. Indeed, tallying with the ECB's Bank Lending Survey (BLS) finding that [credit conditions tightened](#) last quarter and were expected to tighten again in Q1, today's monetary data reported a negative monthly flow of loans to non-financial corporations (NFCs) in January. On an adjusted basis, lending fell €3bn to mark the weakest month in two years. Declines in loans of maturities up to five years offset an increase in longer-term loans, which tend to correspond to fixed investment. To some extent, the decline in part likely reflected payback for strength at the end of last year, as the flow of loans to NFCs in the three months to December had been the firmest since February. However, the annual rate still slowed 0.2ppt to a seven-month low of 2.8%Y/Y, 1ppt

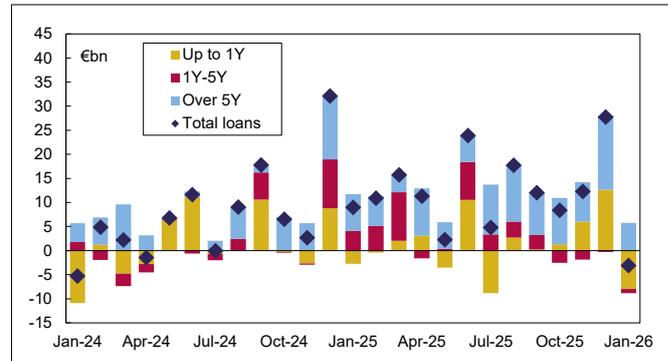
below the average in the year before the pandemic. The flow of loans to households also eased in January but only very modestly to a four-month low of €17bn. A slowdown in the flow of consumer credit to a 14-month low left the stock of such loans up 5.1%Y/Y, almost 1ppt below the average ahead of the outbreak of Covid-19. And the flow of loans for house purchase moderated to a five-month low to leave the respective annual rate unchanged at 3.0%Y/Y, some 0.5ppt below the average in the year before the pandemic. Overall, the subdued pace of lending growth suggests that the ECB's monetary stance remains neutral at best such that an undershoot of inflation relative to expectations and more significantly below target over coming months might well justify a further rate.

Euro area: Bank lending growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Monthly flow of loans to NFCs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

Hot on the heels of yesterday's [final euro area print](#) for January, the focus tomorrow will be flash February inflation releases from some of the largest member states, most notably Germany, France and Spain. Notwithstanding potential pressures from slightly higher fuel inflation, ongoing signs of moderation in the core and food categories add a slight downside skew to expectations in Germany and Spain. The opposite is true for France, where payback for last month's soft core goods component and a much smaller drop in regulated electricity prices compared to a year earlier should push the headline HICP inflation up from January's five-year low (0.4%Y/Y) closer to 1%Y/Y. Among other new data, German import price and French PPI data will give additional insight into the apparent absence of underlying price pressures at the start of the year, with the former potentially bringing further evidence of the disinflationary effects of euro strength and intense competition from China. The ECB's consumer expectations survey for January will show whether the broader softening in inflation last month contributed to a moderation in households' inflation expectations after ECB President Lagarde today suggested that the Governing Council has been mindful of their modest rise over recent months. German labour market statistics should be consistent with ongoing stabilisation in Q1. And French consumer spending figures for January are due alongside the final Q4 GDP reading. Consistent with the initial estimates, the data should confirm a deceleration in French GDP growth at the end of last year, to 0.2%Q/Q, despite another hefty positive contribution from net trade and an acceleration in private consumption.

The day ahead in the UK

The results of today's by-election (see yesterday's [UK preview](#)) in the Mancunian seat of Gorton-and-Denton are likely to be announced sometime in the early hours of the morning, so Friday's headlines should once again be dominated by politics and whether Keir Starmer's future as Prime Minister is more or less at risk. Interim reports suggest that the vote will be tightly contested between the ruling Labour party and populist forces Reform UK and the Greens, with the latter remaining the bookies' favourite. So, while the Government is expected to lose a seat that was won comfortably just 19 months ago, it won't meaningfully affect the Parliamentary arithmetic. And Labour should avoid a potentially catastrophic blow out, thus reducing the likelihood of any imminent challenge to PM Starmer before May's local council elections.

Separately, Friday will also bring a resumption to the flow of UK economic data, and most notably February's GfK consumer survey. Indeed, with consumer confidence having ticked higher at the start of the year – up 1pt to a 17-month high (-16), with the climate for major purchases also at a four-year high (-10) – the survey will give an indication as to whether the improvement in sentiment was sustained beyond the January's sales period. Hawkish BoE Chief Economist Huw Pill is also scheduled to feature in a webinar with Professor Ken Rogoff discussing US and UK economics.

European calendar

Today's results

Economic data

| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|-----------|---|--------|--------------------|--|-------------|----------|
| Euro area |  M3 money supply Y/Y% | Jan | 3.3 | 2.9 | 2.8 | - |
| |  Commission economic sentiment indicator | Feb | 98.3 | 99.8 | 99.4 | 99.3 |
| |  Commission services (industrial) confidence indicator | Feb | 5.0 (-7.1) | 7.4 (-6.2) | 7.2 (-6.8) | 6.8 (-) |
| |  Final Commission consumer confidence indicator | Feb | -12.2 | <u>-12.2</u> | -12.4 | - |
| Italy |  Istat business (manufacturing) confidence indicator | Feb | 97.4 (88.5) | -(89.6) | 97.6 (89.2) | 97.7 (-) |
| |  Istat consumer confidence indicator | Feb | 97.4 | 97.0 | 96.8 | - |

Auctions

| Country | Auction |
|---------|---|
| Italy |  sold €2.75bn of 2.85% 2031 bonds at an average yield of 2.62% |
| |  sold €2.5bn of 2035 floating bonds at an average yield of 2.71% |
| |  sold €3.75bn of 3.45% 2036 bonds at an average yield of 3.31% |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

| Country | GMT | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|-----------|---|--|--------|--|-------------|
| Euro area |  09.00 | ECB consumer expectations survey – 1Y (3Y) ahead CPI Y/Y% | Jan | 2.7 (2.5) | 2.8 (2.6) |
| Germany |  07.00 | Import prices M/M% (Y/Y%) | Jan | 0.6 (-2.8) | -0.1 (-2.3) |
| |  08.55 | Unemployment claims rate % (change 000s) | Feb | 6.3 (2) | 6.3 (0) |
| |  13.00 | Preliminary HICP (CPI) Y/Y% | Feb | 2.1 (2.0) | 2.1 (2.1) |
| France |  07.45 | Preliminary HICP (CPI) Y/Y% | Feb | 0.8 (0.8) | 0.4 (0.3) |
| |  07.45 | PPI Y/Y% | Jan | - | -2.0 |
| |  07.45 | Consumer spending M/M% (Y/Y%) | Jan | 0.4 (-0.1) | -0.6 (-1.0) |
| |  07.45 | GDP – final estimate Q/Q% (Y/Y%) | Q4 | <u>0.2 (1.1)</u> | 0.5 (0.9) |
| |  07.45 | Total (private sector) payrolls Q/Q% | Q4 | 0.0 <u>(-0.1)</u> | 0.0 (-0.1) |
| Spain |  08.00 | Preliminary HICP (CPI) Y/Y% | Feb | 2.3 (2.2) | 2.4 (2.3) |
| UK |  00.01 | GfK consumer confidence indicator | Feb | -15 | -16 |
| |  00.01 | Lloyds business barometer (own price expectations) balance % | Feb | - | 44 (62) |

Auctions and events

| | | |
|----|---|---|
| UK |  13.00 | BoE Chief Economist Pill to speak on SPE webinar on 'UK & US economics' |
|----|---|---|

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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