

Euro wrap-up

Overview

- While 2Y Bund yields fell to a record low, longer-dated yields rose marginally as the flash euro area PMIs surprised on the upside.
- Gilt yields were also slightly higher even as the latest UK public finance figures reported the largest monthly surplus for more than a decade and a half.
- Tomorrow brings revised euro area CPI figures for January, the German Ifo index for February and the second estimate of Q4 UK GDP.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/18	-0.862	-0.012
OBL 0 04/22	-0.488	-0.001
DBR 0% 02/27	0.305	+0.008
UKT 1½ 07/18	0.105	+0.008
UKT 3% 09/21	0.434	+0.005
UKT 1½ 07/26	1.240	+0.012

*Change from close as at 4.30pm GMT.
Source: Bloomberg

Euro area

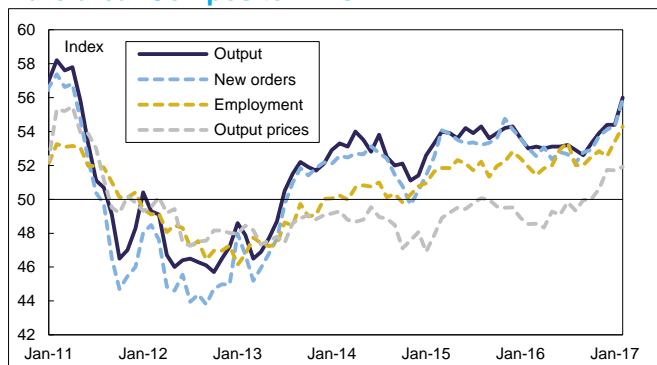
Euro area PMI at a near-6-year high

In contrast to yesterday's Commission survey that suggested that consumers in the euro area were a little less upbeat in February, today's flash PMIs signalled that businesses were at their most optimistic for years. In particular, the headline euro area composite PMI surprised significantly on the upside, rising 1.6pts on the month to 56.0, its highest level since May 2011, as the services and manufacturing output PMIs both improved markedly, also to their highest levels for almost six years. And so, on average in the first two months of Q1, the composite PMI was more than 1pt higher compared with the average in Q4, suggesting that GDP growth accelerated slightly at the start of the year. Meanwhile, the euro area manufacturing PMI was supported by robust growth in new orders, including from overseas, as well as improved expectations for output over the coming twelve months. And with manufacturers and services firms stepping up their recruiting in February, the composite employment PMI signalled the strongest job creation for almost 9½ years. The survey also reported a further pickup in pipeline price pressures in both the manufacturing and services sectors at the start of the year, with the input price PMIs rising to their highest since mid-2011. And while the output price indices also edged higher in February, they remained very subdued compared with input costs, suggesting that firms' profit margins continue to be squeezed.

German and French PMIs signal robust growth

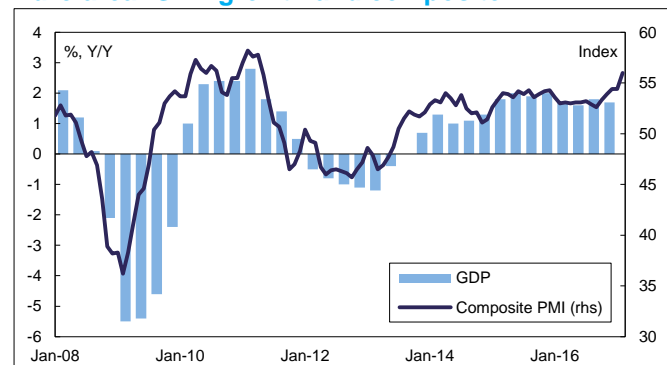
There was also a notable improvement in business sentiment in the largest two member states, with the German and French composite PMIs rising to 56.1 and 56.2 respectively, the former the highest for almost three years and the latter the strongest for almost six years. German manufacturers and services firms alike were more upbeat about conditions in February, with the headline manufacturing index rising to a near-six-year high as the survey signalled robust growth in output and new orders. And with price pressures emanating in both sectors, the composite output price PMI was up more than 1pt in February to 56.1, its highest since mid-2011. The sectoral breakdown in France was, however, more mixed. For example, the headline manufacturing index fell back from the near-six-year high hit in January, albeit at 52.3 it remained at the top of the recent range. And this was more than offset by the more dominant services sector, with the relevant PMI rising more than 2½pts to 56.7, its strongest since May 2011. Therefore, despite heightened uncertainty over the forthcoming national elections later this year, the firmer GDP growth seen in both Germany and France in Q4 looks to have been maintained at the start 2017. And while we will have to wait until the final PMIs are published at the start of March, growth elsewhere in the euro area likely remained solid too.

Euro area: Composite PMIs



Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth and composite PMI



Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.



The day ahead in the euro area and US

The flow of business sentiment surveys continues tomorrow with the German Ifo indicator for February, which seems likely to point to ongoing expansion in the first quarter of 2017. Wednesday will also see revised euro area CPI figures for January. While there was a slight downwards revision to the Spanish data last week, given that the German EU-harmonised CPI rate was unrevised at a 3½-year high of 1.9%Y/Y and the equivalent figure from France today was similarly unchanged at 1.6%Y/Y, tomorrow's release is likely to show that euro area headline CPI aligned with the flash estimate rising by 0.7ppt to 1.8%Y/Y, a near-four-year high. However, while the French core CPI rate (on the national measure) edged higher in January, at 0.7%Y/Y it remained well within the recent subdued trend, and we continue to expect the euro area's measure of core CPI to have remained unchanged for the second successive month at 0.9%Y/Y.

Focus in the US, meanwhile, will be firmly on the minutes from the most recent FOMC meeting, which should be scrutinised for clues as to the likely outcome of the next FOMC meeting on 14-15 March. Data-wise, tomorrow will bring existing home sales figures for January, while on the supply-side, the Treasury will sell 2Y floating-rate notes and 5Y notes.

UK

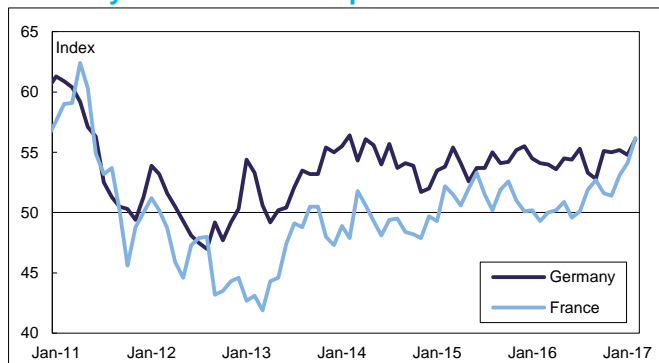
January tax receipts weaker than expected

Today's release of the latest public borrowing figures suggested that the government's fiscal position is slightly stronger than previously thought. In January, the most important month for central government receipts given that a large share of corporation tax and the majority of self-assessment income taxes are collected that month, public sector net borrowing (PSNB) recorded a surplus of £9.4bn, the largest monthly surplus since 2000 but only £0.3bn higher than a year ago. While many expected to see a more significant improvement, tax receipts still rose by £3.4bn but expenditure was higher, in particular in the goods and services category. This left PSNB over the first ten months this financial year at £49.3bn, £13.6bn lower than in the same period in FY15/16, more than £5bn of which came in the form of downward revisions to the previous outturns this month. So the full public borrowing number this year seems to be on track to beat the OBR's forecast, which was revised upward in November to £68.2bn.

The day ahead in the UK

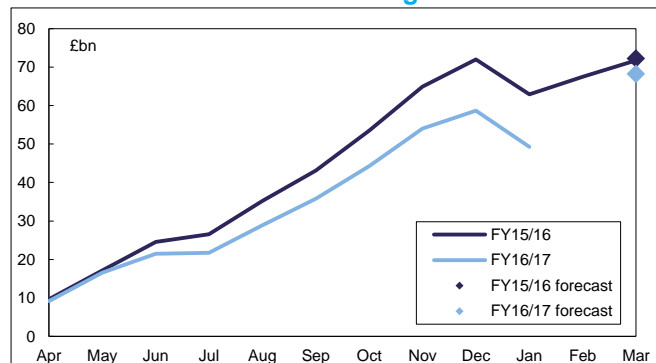
Tomorrow all eyes will be on the second estimate of Q4 GDP. Given that the industrial production and construction output figures for Q4 were stronger than the ONS had estimated in the preliminary GDP estimate, there is a significant probability of an upward revision to the 0.6%Q/Q growth reported initially. Meanwhile, the expenditure breakdown will show that consumer spending remained the main source of growth, with net trade and government consumption also set to have contributed positively, while the level of investment is likely to have declined. On the policy front, MPC members Cunliffe and Shafik are scheduled to speak.

Germany and France: Composite PMIs



Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Public sector net borrowing*












*Excluding public sector banks. Source: ONS and OBR

European calendar

Today's results







Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	 Preliminary manufacturing PMI	Feb	55.5	55.0	55.2	-
	 Preliminary services PMI (preliminary composite PMI)	Feb	55.6 (56.0)	53.7 (54.3)	53.7 (54.4)	-
Germany	 Preliminary manufacturing PMI	Feb	57.0	56.0	56.4	-
	 Preliminary services PMI (preliminary composite PMI)	Feb	54.4 (56.1)	53.6 (54.8)	53.4 (54.8)	-
France	 EU-harmonised CPI Y/Y%	Jan	1.6	1.6	0.8	-
	 Preliminary manufacturing PMI	Feb	52.3	53.5	53.6	-
	 Preliminary services PMI (preliminary composite PMI)	Feb	56.7 (56.2)	53.9 (53.8)	54.1 (54.1)	-
UK	 Public sector net borrowing excluding interventions £bn	Jan	-9.4	-14.0	6.9	4.7
Country Auction						
UK	 BoE APF operation purchased £775mn of 15Y+ Gilts (4.92 cover ratio)					





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	GMT	Release	Period	Market consensus/ Daiwa forecast	Previous
EMU	 10:00	CPI (core CPI) Y/Y%	Jan	<u>1.8 (0.9)</u>	1.1 (0.9)
Germany	 09:00	Ifo business climate index	Feb	109.6	109.8
	 09:00	Ifo current assessment balance (expectations)	Feb	116.6 (103.0)	116.9 (103.2)
Italy	 09:00	Final EU-harmonised CPI Y/Y%	Jan	0.7	0.5
UK	 09:30	GDP – second release Q/Q% (Y/Y%)	Q4	<u>0.7 (2.2)</u>	0.6 (2.2)
	 09:30	Index of services M/M% (3M/3M%)	Dec	0.1 (0.8)	0.3 (1.0)

Auctions and events

Country	GMT	Auction / Event
Germany	 10:30	Auction: To sell €1bn of 2.5% 2044 bonds (04-Jul-2044)
UK	 14:50	BoE APF operation: To purchase 7-15Y Gilts
	 11:00	BoE's Cunliffe scheduled to speak in London
	 20:00	BoE's Shafik scheduled to speak in Oxford

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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