Euro wrap-up

Overview

- Bunds followed Treasuries lower as German CPI rose above 2% for the first time since 2012.
- Gilts also made losses despite a weaker than expected UK manufacturing PMI.
- Tomorrow will bring the euro area flash CPI estimate for February, as well as euro area unemployment figures and the UK construction PMI.

Emily Nicol
+44 20 7597 8331

Mantas Vanagas
+44 20 7597 8318

Daily bond market movements

Bond	Yield	Change*
BKO 0 03/19	-0.826	+0.069
OBL 0 04/22	-0.498	+0.073
DBR 0¼ 02/27	0.284	+0.077
UKT 1¾ 07/19	0.115	+0.015
UKT 0½ 07/22	0.592	+0.039
UKT 4¼ 12/27	1.197	+0.046

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

Euro area

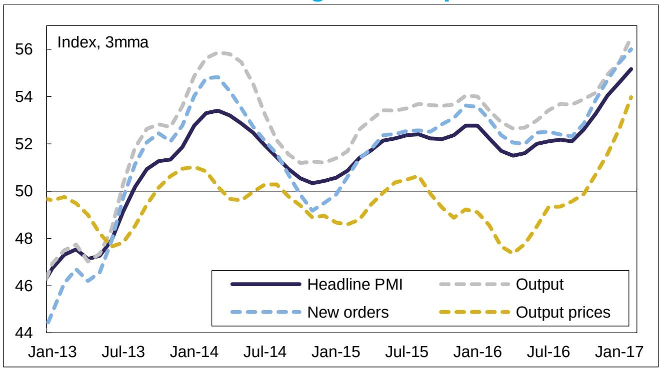
Manufacturing PMI at a near-six-year high

Today's final manufacturing PMIs continued to provide an upbeat assessment of conditions in the euro area in early 2017, notwithstanding a modest downward revision to the flash estimate which still left February's headline PMI 0.2pt higher on the month at 55.4, the highest level in almost six years. This left the average index so far in Q1 more than 1pt above the average in Q4. And there was a modest upward revision to the output component, signalling the fastest pace of growth in the sector since April 2011, while new orders were similarly the most plentiful for almost six years. While the relevant price indices were nudged slightly lower from the preliminary release, they too continued to report a surge in both input and output price pressures, with the latter at its highest level since mid-2011 and comfortably in inflationary territory. At the country level, Germany's manufacturing sector inevitably continues to lead the way. Despite a very slight downwards revision from the preliminary estimate, at 56.8 the headline German PMI was still at its highest level since mid-2011, with growth in output and new orders gathering momentum last month. There was good news from Italy too, with the headline indicator jumping to 55.0, its highest since July 2015, with marked improvements in the output, new orders and employment components – in particular, Italian manufacturers reportedly increased their workforces at the fastest pace since 2000. In contrast, however, the French PMI fell a touch more than initially thought, while the Spanish PMI eased to a three-month low, albeit at 52.2 and 54.8 respectively they still pointed to solid expansion so far in Q1. Indeed, Greece was the only country to signal contraction, with the index remaining below 50 for the sixth consecutive month.

German CPI above 2%

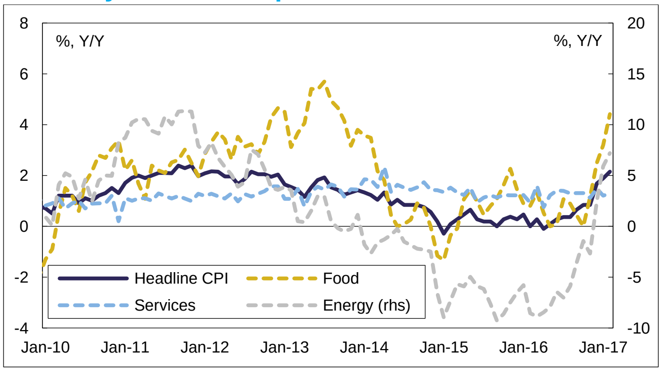
Today's survey also signalled a marked pickup in price pressures in Germany last month, with the 2½pt increase in the output price PMI the largest since the start of 2011 taking the index to 56.5. And today's flash CPI estimate came in above expectations, with the EU-harmonised rate rising 0.3ppt to 2.2%Y/Y, the highest for 4½ years. Taken together with the stronger readings from Italy and Spain, today's release suggests that when the euro area figures are published tomorrow, headline CPI might well rise to 2%Y/Y for the first time since the start of 2013. Meanwhile, the German national measure similarly increased to 2.2%Y/Y, underpinned by higher food and energy inflation, which rose at the fastest pace for 3½ and 4½ years respectively. But while services inflation edged slightly higher, at 1.3%Y/Y it has yet to break out of the recent trend. So, core CPI likely remained relatively subdued last month. Nevertheless, given the tightness in the labour market – data also published today showed unemployment falling for the nineteenth consecutive month in February to leave the unemployment rate unchanged at a post-reunification low of 5.9% – we continue to expect to see underlying price pressures in that country start to emerge over coming months.

Euro area: Manufacturing PMI components



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

Germany: Consumer price inflation*



**National measure. Source: Destatis, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

The day ahead in the euro area and US

The main data focus in the euro area tomorrow will be the aforementioned flash CPI estimate for February. While headline inflation is expected to have risen close to 2%Y/Y, core CPI seems likely to have remained unchanged at just 0.9%Y/Y for the third consecutive month. Thursday will also bring euro area unemployment figures for January, as well as the latest Spanish labour market data for February. Revised Spanish Q4 GDP figures will also be released. Supply-wise, France and Spain will sell bonds.

In the US, tomorrow brings the usual weekly jobless claims figures along with Challenge job cuts figures for February. Meanwhile, the Fed's Mester is due to speak in New York.

UK

Manufacturing outlook remained upbeat

Today's PMI survey signalled that business sentiment in the UK manufacturing sector continued to lose ground in February, with the headline index falling by 1.1pts on the month to 54.6. The output index declined from 60.1 to 56.7, while total new orders were also weaker despite a rebound in the export orders indicator from an eight-month low of 51.0 to 54.6. However, with most indices having remained above their long-term averages, the survey was consistent with output growth of close to 1½%Q/Q this quarter, which would beat the 1.2%Q/Q pace in Q4. And despite the uncertainty related to Brexit, firms maintained their optimism about the longer term outlook: nearly half of the respondents expected output to be higher in one year's time, while only 6% saw their production levels falling. Meanwhile, having risen particularly sharply in recent months, the survey indicators for output and input prices pressures eased slightly in February, by 2.2pts and 7.0pts to the still-high levels of 61.6 and 81.0 respectively.

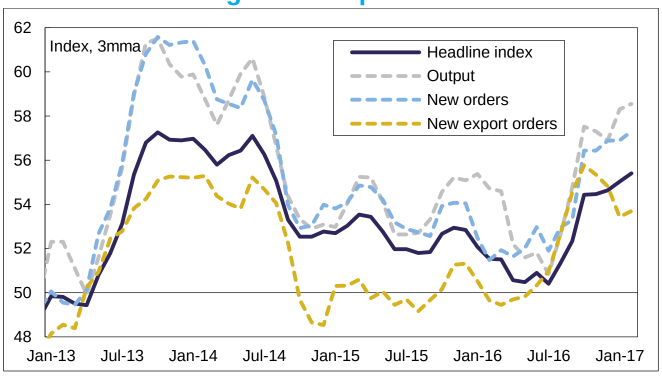
Lending to individuals: mixed picture

Double-digit consumer credit growth in the second half of last year raised concerns about consumer indebtedness against a backdrop of weak wage growth. But the BoE lending figures, released today, suggested that the pace might be slowing, with the rate having fallen for the second consecutive month in January to 10.3%Y/Y, a five month low. Meanwhile, the three-month annualised rate was 9.6%, the lowest level in more than a year, reflecting a moderation in credit card lending growth, which in line with weaker-than-expected retail sales in recent months fell from 10.0% in November to 6.9% in January. Meanwhile, growth in the other loans and advances category remained at a double-digit level, albeit also easing somewhat since November. But while consumer credit growth seems to be settling on a downward trajectory, mortgage lending seems to be gaining traction. Indeed gross new mortgage lending reached the highest level since March, a month before a rise in Stamp Duty Land Tax. So it was only thanks to higher repayments that the total stock of mortgages outstanding continued growing at an unchanged pace of 3.1%Y/Y. But with mortgage approvals having taken another step up to just below the 70k mark, which is the highest level since Q1, and housing market momentum remaining stable – for example, today's Nationwide index showed that house price growth inched up by 0.2ppt to 4.5%Y/Y– mortgage lending seems likely to remain firm over the coming months as house buyers continue taking advantage of record low mortgage rates.

The day ahead in the UK

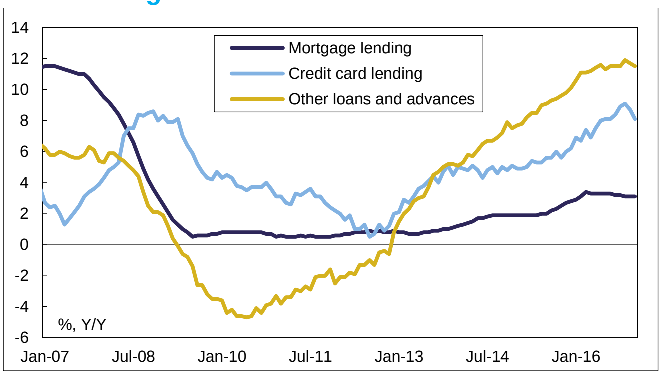
A relatively quiet day tomorrow brings only the construction PMI. Having moderated by 2pts to 52.2 at the start of the year, the construction index is expected to have been little changed in February.

UK: Manufacturing PMI components



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

UK: Lending to Individuals



Source: BoE

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ Daiwa forecast	Previous	**Revised**
EMU	Final manufacturing PMI	Feb	**55.4**	55.5	55.2	**-**
Germany	Final manufacturing PMI	Feb	**56.8**	57.0	56.4	**-**
	Unemployment change `000s (rate %)	Feb	**-14 (5.9)**	-10 (5.9)	-26 (5.9)	**-25 (-)**
	Preliminary EU-harmonised CPI Y/Y%	Feb	**2.2**	2.1	1.9	**-**
France	Final manufacturing PMI	Feb	**52.2**	52.3	53.6	**-**
Italy	Manufacturing PMI	Feb	**55.0**	53.5	53.0	**-**
	GDP Y/Y%	2016	**0.9**	1.0	0.8	**0.7**
Spain	Manufacturing PMI	Feb	**54.8**	55.8	55.6	**-**
UK	BRC shop price index Y/Y%	Feb	**-1.0**	-1.4	-1.7	**-**
	Nationwide house price index M/M% (Y/Y%)	Feb	**0.6 (4.5)**	0.2 (4.1)	0.2 (4.3)	**-**
	Manufacturing PMI	Feb	**54.6**	55.8	55.9	**55.7**
	Mortgage approvals `000s	Jan	**69.9**	68.7	67.9	**68.3**
	Net consumer credit (net lending secured on dwellings) £bn	Jan	**1.4 (3.4)**	1.4 (3.7)	1.0 (3.8)	**- (3.7)**

Country	**Auction**
Germany sold	€2.5bn of 0.25% 2027 bonds (15-Feb-2027) at an average yield of 0.25%
UK	BoE APF operation purchased £775mn of 7-15Y Gilts (3.38 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	Unemployment rate %	Jan	9.6	9.6
	10:00	Flash CPI estimate Y/Y%	Feb	*2.0*	1.8
	10:00	Flash core CPI estimate Y/Y%	Feb	*0.9*	0.9
Italy	09:00	Unemployment rate %	Jan	12.0	12.0
Spain	08:00	GDP – 2nd release Q/Q% (Y/Y%)	Q4	*0.7 (3.0)*	0.7 (3.2)
	08:00	Unemployment M/M ('000)	Feb	*4.6*	57.3
UK	09:30	Construction PMI	Feb	52.0	52.2
	15:00	BoE corporate bond purchases £bn	Weekly	-	7.1

Auctions and events

Country	GMT	Auction / Event
France	09:50	Auction: To sell 0.25% 2026 bonds (25-Nov-2026)
	09:50	Auction: To sell 1.75% 2066 bonds (25-May-2066)
	09:50	Auction: To sell 1.25% 2036 bonds (25-May-2036)
Spain	09:30	Auction: To sell 0.3% 2021 index-linked bonds (30-Nov-2021)
	09:30	Auction: To sell 1.5% 2027 bonds (30-Apr-2027)
UK	10:30	Auction: To sell £2.5bn of 0.5% 2022 bonds (22-Jul-2022)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
http://www.uk.daiwacm.com/research-zone/research-blog

Follow us
@DaiwaEurope