Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds were little changed as surveys showed a stabilisation in euro area consumer confidence but a deterioration in investor sentiment towards Germany.
- Gilts made losses despite a downside surprise from the latest UK inflation data.
- Ahead of the Fed's announcement, Wednesday will bring the latest UK labour market data.

Daily bond market movements

Bond	Yield	Change*
BKO 0 03/20	-0.589	+0.008
OBL 0 10/22	-0.133	+0.009
DBR 0½ 02/28	0.579	+0.010
UKT 2 07/20	0.877	+0.051
UKT 0¾ 07/23	1.204	+0.053
UKT 4¼ 12/27	1.484	+0.040

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

Euro area

Consumer optimism stabilises

The flash European Commission consumer confidence indicator, released today, suggested that euro area consumer sentiment stabilised in March. Having reached the highest level since 2000 in January, but fallen the most in a year in February, the confidence index remained unchanged this month at 0.1, more than 1pt lower than the peak at the start of the year. This is still high by historical standards – the index averaged only -7.8 in 2016 and -2.5 in 2017 – suggesting that consumers are unlikely to be too hesitant when making spending decisions. However, it might not be the best guide to private consumption growth. Indeed, despite the steady improvement in confidence throughout 2017, private consumption growth disappointed in the second half of the year, with the annual pace falling in Q4 to just 1.3%Y/Y, less than half the rate implied by the confidence index. And, while fundamentals, such as the strong labour market, point to a firm increase in spending, we would not be overly surprised if Q1 brought another set of unimpressive private consumption figures, with growth below the 0.5%Q/Q rate seen in Q1 and Q2 of 2017.

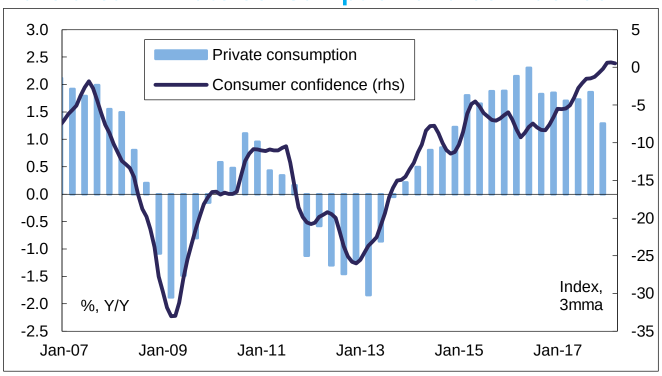
Investor optimism towards Germany wanes too

Today's German ZEW survey of financial sector experts came in on the soft side, suggesting a moderation in investor sentiment in the first quarter of the year. Having hit a series high in January, the current situation index eased for the second successive month, albeit remaining well above the range recorded last year. And the deterioration in the survey's expectations index was marked, declining the most since the Brexit referendum to the lowest level since September 2016 and well below the long-run average. The current conditions index often acts as a good guide to what to expect from the Ifo business climate indices, for which the March release is due on Thursday, and ultimately for GDP growth too. However – similar to the euro area consumer confidence index – those indicators signalled a stronger rate of economic expansion in Q4 than the actual outturn (0.6%Q/Q). And with the degree of caution implied by the ZEW expectations index perhaps shared by many households and businesses, GDP growth in Q1 might again fall short of rates implied by the more contemporaneous business climate indicators.

German producer price pressures ease

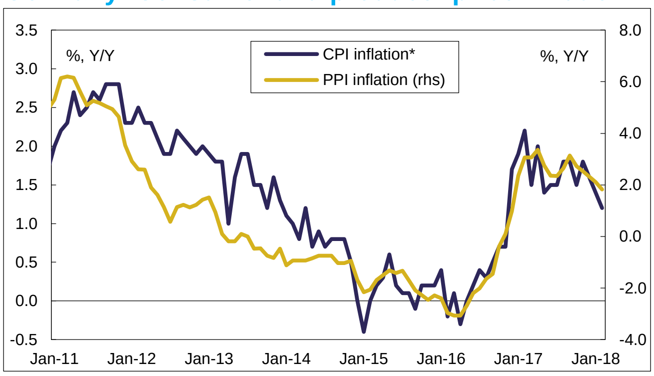
Meanwhile, on the inflation front, despite the very tight labour market and above-potential GDP growth, today's PPI data were consistent with a moderation in pipeline price pressures in Germany. Tallying with the significant decline in German consumer price inflation in recent months, with the EU-harmonised measure of CPI having fallen to a fourteen-month low of 1.2%Y/Y last month, the headline PPI rate surprised on the downside too dropping by 0.3ppt in February to 1.8%Y/Y, the lowest since December 2016. Within the details, energy price inflation, declined the most, down 0.4ppt to 1.8%Y/Y, but other major components also eased, perhaps as the stronger euro exchange rate exerted some downward pressure.

Euro area: Private consumption and confidence



Source: European Commission, Thomson Reuters & Daiwa Capital Markets Europe Ltd.

Germany: Consumer and producer price inflation



**EU-harmonised measure. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

The day ahead in the euro area and US

Tomorrow's dataflow brings no top-tier releases from the euro area. In the markets, Germany will sell 10Y Bunds. All eyes, of course, will be on the US, with the conclusion of the latest FOMC meeting due. A further 25bps lift in the fed funds rate seems assured, so most interest will centre on the Fed's revised projections and in particular the 'dot plot' to see to what extent support might be rising for four rate hikes this year. Chair Jerome Powell's first post-meeting press conference will also be scrutinized closely for clues. Looking at the US economic data calendar, current account figures for Q4 and existing home sales for February are due for release.

UK

Inflation surprises on downside

Headline CPI inflation came in a touch weaker than expected at 2.7%Y/Y in February, down from 3.0%Y/Y in January and the weakest rate since July, as the impact of sterling's post-referendum depreciation started to fade. Prices of food exerted downward pressure as did those of fuel, after petrol prices fell slightly between January and February having risen over the same period last year. Moreover, core inflation also weakened by 0.3ppt to 2.4%Y/Y. Notably, services inflation slipped 0.2ppt to 2.1%Y/Y, a rate not seen since October 2015. The ONS highlighted that the timing of Saint Valentine's Day may have played some role in this respect, as prices were collected on that day in 2017 – when it says that hotel and, perhaps surprisingly, ferry prices spiked – but were collected a day later this year. Romantic distortions apart, the headline rate was substantively weaker than the 2.9%Y/Y assumed by the BoE in February's Inflation Report. And it is consistent with our view that inflation has now embarked on a sustained downward path, and should be back at the 2%Y/Y target by year-end, sooner than the BoE estimates. Accordingly, the probability of a Bank Rate rise in May might have diminished somewhat, not least as Q1 GDP growth is also likely to have been softer than originally anticipated due to the recent exceptionally wintery weather. So, the BoE may be tempted to wait for more data from Q2 to better gauge the underlying strength of the economy before deciding to tighten policy again.

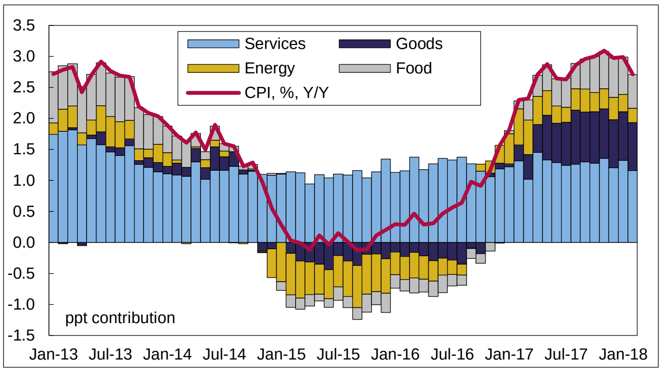
More subdued price pressures ahead

The accompanying producer price inflation data from the ONS reinforce the view of a weakening of inflationary pressures. Output price inflation undershot expectations at 2.6%Y/Y in February, the smallest rise since November 2016. And raw material costs fell 1.1% M/M, to register the smallest Y/Y increase since before the referendum in June 2016, of 3.4%. Meanwhile, the rate of increase in house prices on the official measure eased 0.1ppt to 4.9%Y/Y in January, but that remained in line with the average rate seen over the post-referendum period. Consistent with other measures, house price inflation in London weakened to 2.1%Y/Y, as the capital was outpaced by regions such as the South West and East Midlands, in a reversal of the trend seen over the last few years. We expect a modest rise in property values, in the region of 2-3%Y/Y on average, over the course of this year.

The day ahead in the UK

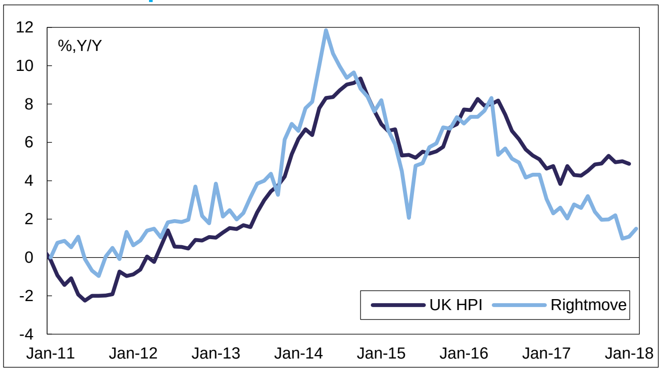
The latest labour market data, due Wednesday, will further shape the BoE's latest thinking on rates. Average earnings growth is expected to have nudged up 0.1ppt to 2.6%3M/Y in January, implying that the squeeze on real incomes may be easing (albeit not ending just yet). Additionally, after the unemployment rate rose for the first time in sixteen months in December, to 4.4%, we expect it to have remained unchanged in January, while employment may have increased by 100k between November and January. The public finance figures for February will also be released. Last week's Spring Statement contained an improved forecast deficit of £45.2bn for FY17/18, almost £5bn smaller than previously estimated, and the monthly borrowing numbers should be in line with that. And the CBI industrial trends survey should provide some clues on the extent to which the heaviest snow in over five years disrupted production.

UK: CPI inflation



Source: Thomson Reuters & Daiwa Capital Markets Europe Ltd.

UK: House prices



Source: Thomson Reuters & Daiwa Capital Markets Europe Ltd..

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
EMU		ZEW expectations balance	Mar	**13.4**	-	29.3	**-**
		European Commission flash consumer confidence indicator	Mar	**0.1**	0.0	0.1	**-**
Germany		ZEW current assessment balance (expectations)	Mar	**90.7 (5.1)**	90.0 (13.0)	92.3 (17.8)	**-**
UK		CPI (core CPI) Y/Y%	Feb	**2.7 (2.4)**	*2.8 (2.5)*	3.0 (2.7)	**-**
		Input PPI (output PPI) Y/Y%	Feb	**3.4 (2.6)**	3.8 (2.7)	4.7 (2.8)	**-**
		House price index Y/Y%	Jan	**4.9**	5.0	5.2	**5.0**

Auctions

Country		Auction
Germany sold		€4bn of 0%.2020 bonds (13-Mar-2020) at an average yield of -0.59%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
UK		09:30	Average earnings (excl. bonuses) 3M/Y%	Jan	*2.6 (2.6)*	2.5 (2.5)
		09:30	ILO unemployment rate 3M%	Jan	*4.4*	4.4
		09:30	Employment change 3M/3M '000s	Jan	*100*	88
		09:30	Claimant count rate % (change 000s)	Feb	-	2.3 (-7.2)
		09:30	Public sector net borrowing excluding interventions £bn	Feb	1.8	-10.0
		11:00	CBI Industrial Trends Survey, total orders	Feb	8	10

Auctions

Country		GMT	Auction / Event
Germany		10:30	Auction: To sell €3bn of 0.5% 2028 bonds (15-Feb-2028)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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