Euro wrap-up

Overview

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- Bunds made gains even as the European Commission's flash consumer confidence indicator rose by the most in five years.
- Gilts also made gains despite the first increase in UK retail sales in six months.
- The main European economic focus tomorrow will be the flash February PMIs. Friday will also bring final euro area CPI figures for January, as well as UK public finance figures.

Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.656	+0.002
OBL 0 04/25	-0.635	-0.007
DBR 0 02/30	-0.447	-0.025
UKT 3¾ 09/21	0.514	-0.006
UKT 1 04/24	0.457	-0.010
UKT 0⅞ 10/29	0.577	-0.022

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

Euro area

Consumer sentiment up to five-month high

Having moved sideways in January, the Commission's flash euro area consumer confidence indicator had been expected to edge lower in February to a new three-year low. But despite concerns about a possible harmful impact on external demand and supply chains from the coronavirus, it rose 1.5pts, the most in five years, to a five-month high of -6.6, close to the top of the range of the past year. It is not clear at all where the improvement in sentiment might have come from. Indeed, the flash Commission indicator contrasted with today's results from the GfK survey of German consumers, which suggested that sentiment has softened slightly. In particular, the latest headline GfK index, which was quoted as a forecast for March, dropped 0.1pt to 9.8, still near the top of the range of the past nine months but well down on the levels registered from the second half of 2017 through to the middle of last year. Admittedly, the GfK index of German consumers' expectations about the economic outlook rose to a three-month high in February. But the other survey indices slipped back. Nevertheless, the measure of propensity to buy remained relatively elevated by historical standards and above its level a year ago, suggesting that German consumer spending should continue to grow – albeit probably only modestly – in the first quarter.

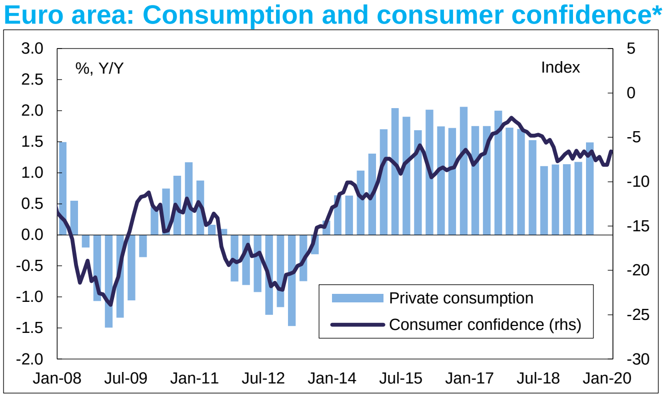
ECB account notes need for caution

The account of the ECB's January Governing Council meeting, held before the coronavirus had gained prominence and at which policy was inevitably left unchanged, was relatively light on new information. As had been suggested by Christine Lagarde following the meeting, the account confirmed that the ECB expects near-term economic growth in the euro area to remain close to rates observed in recent quarters, broadly in line with its December forecasts but also below potential. While some positive developments were cited, the account also noted the need for caution, not least due to concerns about the outlook for the auto sector as well as the persistence of the downside tilt to risks from abroad. Indeed, while financial markets had responded positively to first-phase trade agreement between the US and China, it was noted that this could adversely impact exports from the euro area. Likewise, despite the removal of risks of a no-deal Brexit at the end of last month, it was recognised that there could eventually be more divergence in the future relationship between the EU and UK than was previously expected.

ECB should ease if it sees fit, but hurdle is high

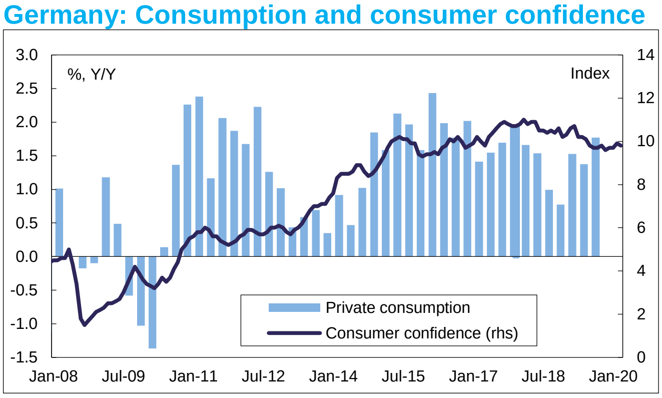
Meanwhile, despite the initial disagreements over that policy package, members of the Governing Council thought that the additional monetary easing measures announced in September had contributed to a substantial relaxation in financial conditions. They were also therefore judged to be supporting economic activity and helping to increase price pressures. There remained concern, however, that the pass-through to inflation of wage growth was slow. And with a robust

Euro area: Consumption and consumer confidence*



Flash estimate of consumer confidence for February. Source: Thomson Reuters, European Commission and Daiwa Capital Markets Europe Ltd.

Germany: Consumption and consumer confidence



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

convergence of inflation towards the ECB's target 'not yet assured', members unsurprisingly agreed that 'monetary policy had to remain highly accommodative for a prolonged period of time', even though it was also noted that potential side effects might become more pronounced over time. Moreover, it was emphasised that the strategic review discussions should be kept separate from ongoing monetary policy deliberations. And so, the account suggested that if economic conditions merit new action, there should be nothing to prevent the Governing Council from easing policy further, via any of its instruments, before the review concludes. Nevertheless, while the coronavirus clearly represents a significant new downside risk to the economic outlook – and could subtract 0.1-0.2ppt from euro area GDP growth in Q1 – the hurdle for further ECB easing is high.

The day ahead in the euro area and US

Friday will bring the week's most notable new euro area data, the flash PMIs for February. Last month, the manufacturing survey had suggested further progress towards stabilisation in the sector at the start of the year, with the respective euro area PMI up to a nine-month high of 47.9. And while the services PMI slipped back (52.3), the composite PMI rose to a five-month high (51.3). Uncertainty surrounding the impact of the coronavirus on both demand and supply seem likely to weigh on the flash manufacturing PMI for February, while the services survey is also expected to be a touch weaker again. So, the euro area composite PMI is also expected to fall in the latest month, and remain consistent with economic growth no firmer than the 0.1%Q/Q rate in Q4.

Friday's other top-tier euro area data will be the final estimate of euro area consumer price inflation in January. While the final German figure on the EU measure aligned with the flash estimate of 1.6%Y/Y, today saw the equivalent French figure revised up by 0.1ppt to a thirteen-month high of 1.7%Y/Y. Nevertheless, we expect the euro area headline rate to match its flash estimate of 1.4%Y/Y, marking a modest increase of 0.1ppt from December due principally to higher energy inflation. We do, however, see a non-negligible risk of an upwards revision of 0.1ppt to the core rate, for which the preliminary estimate declined 0.1ppt to 1.1%Y/Y. The final estimates of Italian inflation in January, as well as December industrial sales and orders data from the same country, are also due tomorrow.

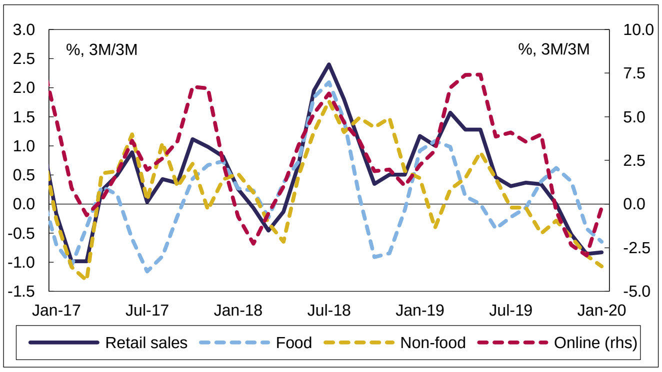
In addition, ECB Chief Economist Lane is due to give the keynote speech at the 2020 US Monetary Policy Forum, on "Monetary Policy for the Next Recession", in New York. That event will also receive contributions from FOMC members Clarida, Brainard, Bostic and Mester, while Dallas Fed President Kaplan will also speak publicly tomorrow. Finally, the US data-flow will similarly bring the respective flash Markit PMIs for February, as well as existing home sales figures for January.

UK

Retail sales jump in January, but trend remains weak

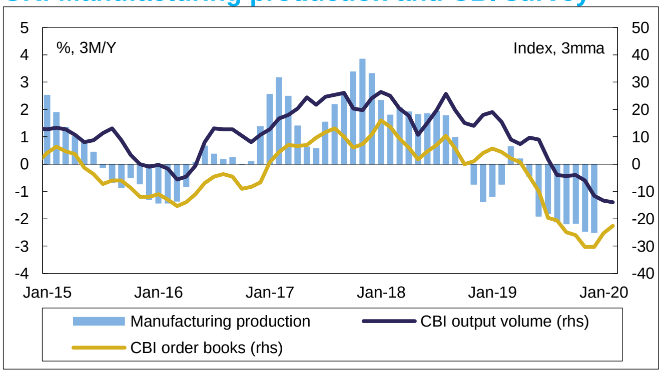
At face value, today's UK retail sales figures exceeded expectations. In particular, total retail sales increased 0.9%M/M in January, the strongest growth since March. And this was despite a sharp drop in sales at fuel stores (5.7%M/M) by the most since April 2012. Indeed, when excluding fuel, sales jumped an even stronger 1.6%M/M in January, twice the expected pace and the fastest since May 2018, with year-on-year growth accelerating 0.5ppt to 1.2%Y/Y. But a rebound at the start of the year had been expected, marking the first monthly increase in six, the longest period without positive growth since the series began in 1997. And the annual rate was still more than 3ppts lower than this time last year. Moreover, when stripping out monthly volatility, sales (whether including or excluding auto fuel) remained weak, suggesting no material improvement in underlying momentum in spending at the start of the year. Indeed, total sales declined 0.8%3M/3M in January, up just 0.1ppt from December. And despite a notable increase in spending at department and clothing stores in January (1½%M/M and 4%M/M respectively) as retailers enticed consumers with heavy discounting, growth on a three-month basis continued to trend lower. Sales at food stores were also down 0.7%3M/3M. In contrast, however, a further notable improvement in online sales in January resulted in broadly flat growth on a three-month basis, following a near-3%3M/3M drop in December.

UK: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing production and CBI survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

CBI survey points to stabilisation in manufacturing

The latest CBI latest industrial trends survey, meanwhile, provided some further tentative signs of stabilisation in the manufacturing sector, with the headline output and orders indices posting the second successive increase in February. Admittedly, a net balance of -11% of manufacturers still assessed that the volume of output over the past three months was lower than a year earlier, to mark the fifth successive negative reading. And just five of seventeen sub-sectors reported an increase in production. But manufacturers were reportedly more upbeat about the outlook for the coming three months, with the relevant index rising to its highest (+8%) for a year. And once again, the share of respondents reporting declining order books moderated, with a net balance of -17% the best reading for six months. Of course, this still points to ongoing weakness in the manufacturing sector over the months ahead, albeit also suggesting that the worst has now passed.

The day ahead in the UK

Of far more significance for the markets, and providing a much more reliable guide to the near-term production outlook, will be tomorrow's flash PMI surveys for February. Indeed, the PMIs capture information regarding almost twice as many manufacturers as the CBI's survey. And while the headline manufacturing PMI jumped in January to 50.0 (the first non-contractionary reading since April), it seems likely to have fallen back somewhat as concerns about external demand revived. The services PMI is also likely to have moderated from the sixteen-month high of 53.9 recorded in January, leaving the composite PMI consistent with only modest economic expansion in February. Finally, Friday will also bring January public finance figures, the last update before the 11 March Budget, at which a significant relaxation of the fiscal stance is now expected.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Preliminary consumer confidence	Feb	**-6.6**	-8.0	-8.1	-
Germany	GfK consumer confidence	Mar	**9.8**	9.8	9.9	-
France	Final CPI (EU-harmonised CPI) Y/Y%	Jan	**1.5 (1.7)**	1.5 (1.6)	1.5 (1.6)	-
UK	Retail sales including fuel M/M% (Y/Y%)	Jan	**0.9 (0.8)**	0.7 (0.6)	-0.6 (0.9)	**-0.5 (-)**
	Retail sales excluding fuel M/M% (Y/Y%)	Jan	**1.6 (1.2)**	0.8 (0.5)	-0.8 (0.7)	-
	CBI industrial trends survey, total orders	Feb	**-18**	-20	-22	-

Auctions

Country	Auction
France	sold €3.3bn of 0% 2023 bonds at an average yield of -0.59%
	sold €2.9bn of 0.25% 2026 bonds at an average yield of -0.40%
	sold €548mn of 0.1% 2025 index-linked bonds at an average yield of -1.16%
	sold €490mn of 0.1% 2029 index-linked bonds at an average yield of -1.21%
	sold €459mn of 0.1% 2036 index-linked bonds at an average yield of -0.97%
Spain	sold €3.2bn of 0% 2025 bonds at an average yield of -0.22%
	sold €1.4bn of 0.5% 2030 bonds at an average yield of 0.235%
UK	sold £3.25bn of 1.5% 2026 bonds at an average yield of 0.435%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data					
Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	09.00	Preliminary manufacturing PMI (services PMI)	Feb	47.5 (52.3)	47.9 (52.5)
	09.00	Preliminary composite PMI	Feb	51.0	51.3
	10.00	Final CPI (core CPI) Y/Y%	Jan	1.4 (1.1)	1.3 (1.3)
Germany	08.30	Preliminary manufacturing PMI (services PMI)	Feb	44.8 (53.8)	45.3 (54.2)
	08.30	Prelimianry composite PMI	Feb	50.7	51.2
France	08.15	Preliminary manufacturing PMI (services PMI)	Feb	50.7 (51.4)	51.1 (51.0)
	08.15	Preliminary composite PMI	Feb	50.8	51.1
Italy	09.00	Industrial sales M/M% (Y/Y%)	Dec	-	0.0 (0.1)
	09.00	Industrial orders M/M% (Y/Y%)	Dec	-	-0.3 (-4.3)
	10.00	Final CPI (EU-harmonised CPI) Y/Y%	Jan	0.6 (0.5)	0.5 (0.5)
UK	09.30	Preliminary manufacturing PMI (services PMI)	Feb	49.7 (53.4)	50.0 (53.9)
	09.30	Preliminary composite PMI	Feb	52.9	53.3
	09.30	Public sector net borrowing, excluding banks £bn	Jan	-11.5	4.8

Auctions and events		
Country	GMT	Auction / Event
EMU	17.00	ECB's Lane scheduled to speak
UK	18.30	BoE's Tenreyro scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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