Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made gains as euro area data confirmed a drop in retail sales at the start of the year, ongoing weakness in construction but continued stability in the labour market.
- Gilts also made gains while UK car registrations fell to their weakest February level since 1959 but construction activity picked up.
- Friday will bring new data for German factory orders and French goods trade at the start of 2021.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.697	-0.005
OBL 0 04/26	-0.625	-0.018
DBR 0 02/31	-0.313	-0.023
UKT $0^1/_8$ 01/23	0.066	-0.009
UKT $0^1/_8$ 01/26	0.336	-0.023
UKT 4¾ 12/30	0.729	-0.047

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

Euro area

Retail sales start the year on a very weak note

Euro area retail sales fell further than expected at the start of the year, dropping 5.9%M/M in January to be down 6.4%Y/Y and 6.7% below the pre-pandemic level in February 2020. With non-essential stores shut in several countries, the hit was sharpest for non-food items, which fell 12.0%M/M to be down almost 14% from the pre-pandemic level. In contrast, sales of auto fuels declined just 1.1%M/M but were about 16% below the February 2020 level. And sales of food, alcohol and tobacco items continued to benefit from lockdown arrangements, rising 1.1%M/M to be 3.3% above the pre-pandemic level. And online and mail order sales rose to a new series high, 37.7% above the pre-pandemic level. Among the member states, it was already known that retail sales in Germany fell 4.5%M/M, as the reversal of the VAT cut at the start of the year compounded the extended lockdown measures. Having rebounded more than 20%M/M in December benefitting from the late Black Friday sales and reopening of non-essential stores, French retail volumes fell almost 10%M/M in January as the start to the winter sales was delayed. But the sharpest declines came in Austria and Ireland, where sales dropped more than 15%M/M.

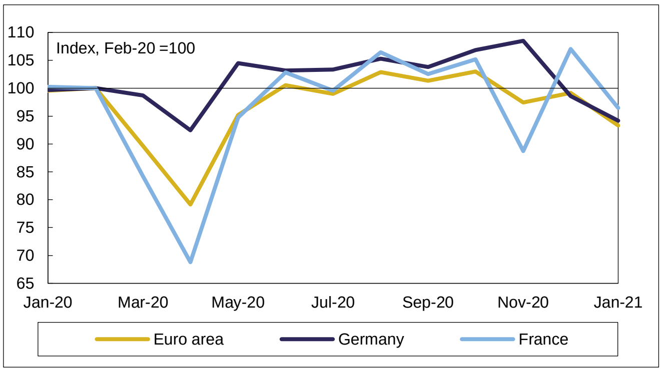
Sales to pick up again from February on?

Thankfully, January should represent the lowest point for retail sales during this phase of the pandemic. In France, for example, sales in February will have been boosted by the later start to the winter discounting period, while in Austria non-essential stores were allowed to reopen last month. And Spanish sales in January will have been hit by the extreme winter weather. Looking ahead, gradual easing of lockdown measures should support further growth in March and the second quarter. Indeed, yesterday evening saw Chancellor Merkel announce her plan for a gradual reopening of the German economy, which will see bookshops, florists and garden centres open from Monday, and rules subsequently reviewed and possibly eased further on a local level every two weeks. A gradual improvement in consumer confidence last month, above the Q4 average, should also support spending. However, there remain downside risks as illustrated by recent tightening of restrictions in five Italian regions, including Milan and Turin.

Labour market remained broadly stable in January

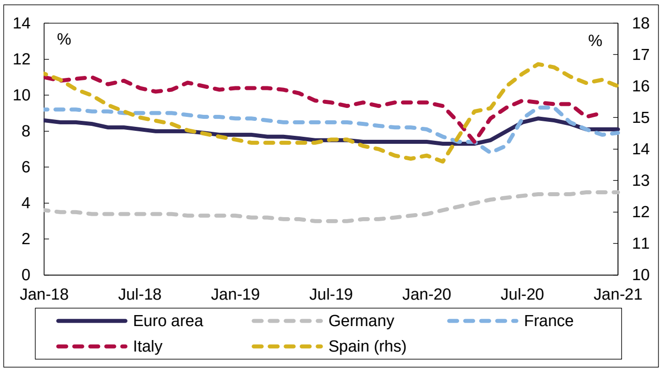
Consumer spending over coming months should remain supported by broad stability in the labour market. Indeed, today's data in this respect were better than expected, with the euro area unemployment rate unchanged in January from December's downwardly revised rate of 8.1%, 0.3ppt below October's recent peak and up just 0.7ppt from a year earlier. Having dropped in each of the prior four months and by a total of 945k, the number of unemployed persons edged up just 8k. But that still left it up more than 1.0mn from a year earlier. Among the larger member states, the unemployment rate on

Euro area: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment rates



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

the ILO measure was unchanged at just 4.6% in Germany and rose 0.1ppt in France to 7.9%. And it dropped in Spain and the Netherlands by 0.2ppt and 0.3ppt apiece to 16.0% and just 3.6% respectively, in both cases the lowest since the second quarter of 2020.

ECB too pessimistic about unemployment outlook

Of course, the low level of unemployment in part reflects the ongoing support provided by the various government short-term work and furlough schemes, which continue to provide job security for several millions of workers. And the re-intensification of the pandemic (and in some countries harsh winter weather) will have impacted the ability of many workers to search actively for work. So, many of the jobless will again not have been counted as unemployed for the purpose of these data. Indeed, in the fourth quarter of last year, the level of employment measured by the Labour Force Survey was down more than 3.0mn (and 2.0%) from a year earlier, implying a bigger hit to jobs than the unemployment data suggest. More happily, however, the Commission's February business and consumer survey reported an increase in the Employment Expectations Index to the best level since September, and the second-highest since March, suggesting that an improved economic outlook should help to contain some of the rise in unemployment over coming months as job retention schemes are phased out. And we think that the ECB's latest projection for the unemployment rate to peak at 9.3% this year is too pessimistic.

Construction PMIs point to weakness in February but optimism about the coming year

While the euro area construction PMI rose 0.9pt in February, at 45.0 it continued to signal a non-negligible pace of contraction in the sector. Among the three largest member states, only in Italy (up more than 6pts to a two-year high of 54.8) did the respective construction PMI point to growth last month, with Germany's (down more than 5pts to a nine-month low of 40.1) particularly weak. Notwithstanding the resilience in Italy, the weakness in the sector in the euro area as a whole was broad-based, with the sharpest declines recorded in civil engineering (with the respective index below 40 for the first time since May) and commercial construction, but house-building soft too. Discouragingly, the survey measure of new construction orders fell to a three-month low (43.9). However, construction companies signalled stronger optimism regarding the outlook for activity over the coming twelve months, to the best level in a year, when the pandemic is expected to be under far greater control. Indeed, confidence in the future among Italian construction firms was the highest in almost two decades. And in the euro area as a whole, the survey suggested that jobs in the sector were being cut at the slowest pace since the pandemic hit.

The day ahead in the euro area

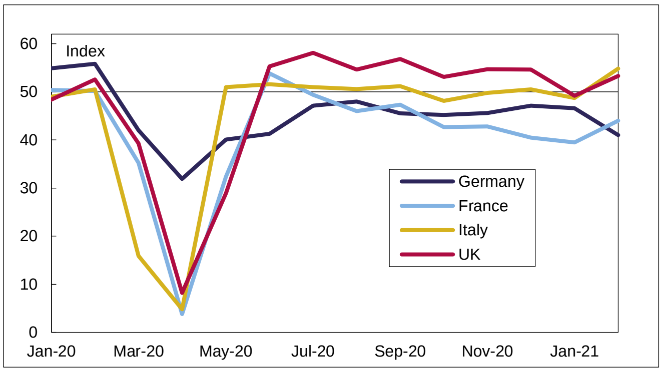
Looking ahead, Friday will bring the German factory orders data for January. After slightly disappointing expectations in December (down 1.9%M/M albeit still up 7.0%3M/3M), factory orders are expected to edge up 0.5%M/M in the latest month. The weakness in demand in December came from the rest of the euro area, for which new orders dropped a steep 7.5%M/M, likely in part accentuated by the intensification of the pandemic heading towards the New Year. But the latest German manufacturing PMI suggested that firms in the sector have benefitted from resurgent demand for goods in both domestic and export markets, linked to post-Covid recovery hopes and renewed stock-building. French goods trade data for January will also be published, and are likely to report a big hit to shipments to the UK – Destatis has estimated a drop of about 30%Y/Y in German exports to the UK since the start of the year due to the end of the Brexit transition. Finally, Italian retail sales numbers for the same month are also due tomorrow.

UK

New car registrations have weakest February since 1959

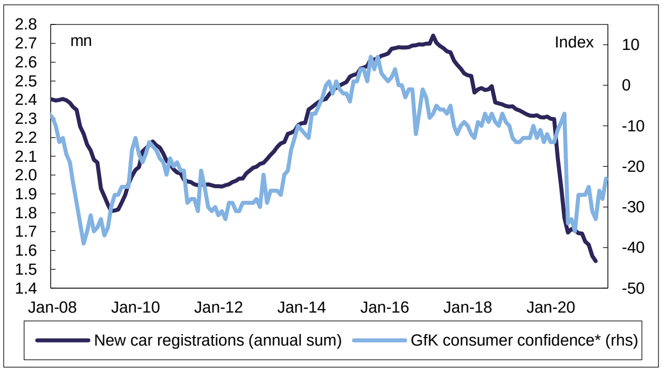
New car registrations remained weak last month as the ongoing closure of showrooms due to the pandemic continued to hit sales. It also seems likely that there was payback for strength in late 2020, as the end of the Brexit transition on 31 December encouraged some buyers to bring forward their purchases for fear that tariffs might be imposed from January in

Euro area & UK: Construction PMIs



Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: New car registrations & consumer confidence



**3month lead. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

the event that no trade deal was agreed between the UK and EU. In particular, new car registrations came in at 51.3k, the lowest level for any February since 1959, representing a drop of 35.5%Y/Y to be down 38.1%YTD/Y. As a result, the Society of Motor Manufacturers and Traders (SMMT) revised down its forecast for full-year sales in 2021 by 60k to 1.83mn, which would be more than 480k lower than in 2019 albeit up about 200k from 2020. We expect household demand for cars to rebound from Q2 on as the economy is gradually reopened from lockdown and some consumers spend a portion of their extra savings accumulated since the pandemic hit. And business demand for vehicles should benefit from yesterday's budget announcement of a 130% "super deduction" of the costs of fixed investment from taxable corporation tax profits for two years from April.

Construction PMIs point to rebound in activity in February

In contrast to the weak euro area survey, the UK construction PMIs signalled a return to solid expansion last month following a soft start to the year. In particular, the headline construction activity PMI rose more than 4pts in February to 53.3, albeit still modestly below the Q4 average. And with significant optimism about the post-pandemic outlook, new orders also reportedly rebounded, with the respective PMI also up more than 4pts to 55.3. House-building remained the strongest sub-sector, although growth seemingly slowed, probably in part due to the harsher winter weather last month. However, commercial work grew at the firmest rate since September and the pace of decline in civil engineering activity moderated. Like the manufacturing PMI, however, the survey reported significant supply-chain strains and cost pressures from rising commodity prices and freight charges. Indeed, the survey reported the highest rates of increase in input prices since 2008. Looking ahead, the sector should benefit from the extended policy support for the housing market, with the stamp duty holiday extended to June before tapering through to September, and some support for first-time buyers. And commercial work should get a boost from the aforementioned corporation tax "super deduction" for companies investing in new plants.

The day ahead in the UK

It should be an uneventful end to the week for UK economic news with no top-tier data scheduled for release.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Construction PMI	Feb	**45.0**	-	44.1	**-**
	Retail sales M/M% (Y/Y%)	Jan	**-5.9 (-6.4)**	-1.4 (-1.2)	2.0 (0.6)	**1.8 (0.9)**
	Unemployment rate %	Jan	**8.1**	8.3	8.3	**8.1**
Germany	Construction PMI	Feb	**41.0**	-	46.6	**-**
France	Construction PMI	Feb	**44.0**	-	39.5	**-**
Italy	Construction PMI	Feb	**54.8**	-	48.7	**-**
UK	New car registrations Y/Y%	Feb	**-35.5**	-	-39.5	**-**
	Construction PMI	Feb	**53.3**	51.0	49.2	**-**

Auctions

Country	Auction
France	sold €6.27bn of 0% 2030 bonds at an average yield of -0.07%
	sold €2.34bn of 0.5% 2040 bonds at an average yield of 0.43%
	sold €2.38bn of 0.75% 2052 bonds at an average yield of 0.72%
Spain	sold €1.12bn of 0% 2026 bonds at an average yield of -0.25%
	sold €1.17bn of 1.4% 2028 bonds at an average yield of 0.024%
	sold €731mn of 1% index-linked 2030 bonds at an average yield of -0.889%
	sold €1.88bn of 0.1% 2031 bonds at an average yield of 0.351%
	sold €1.29bn of 1.85% 2035 bonds at an average yield of 0.663%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Economic data						
Germany		07.00	Factory orders M/M% (Y/Y%)	Jan	0.5 (1.9)	-1.9 (6.4)
France		07.45	Trade balance €bn	Jan	-3.4	-3.4
Italy		09.00	Retail sales M/M% (Y/Y%)	Jan	-	2.5 (-3.1)
Auctions and events						
UK		14.00	BoE Haskel scheduled to speak			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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