Euro wrap-up

Overview

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- Bunds made sizeable gains as oil prices fell again, and a survey of investors reported a marked deterioration in perceptions of the economic outlook and a sharp rise in inflation concerns.
- Gilts made more modest gains as the latest UK labour market data suggested increasing tightness supporting the case for another rate hike.
- The BoE looks set to raise Bank Rate for a third consecutive meeting on Thursday, by 25bps to 0.75%. Several ECB policymakers will speak publicly that day while final euro area CPI numbers are also due.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	-0.429	-0.064
OBL 0 04/27	0.011	-0.064
DBR 0 02/32	0.327	-0.035
UKT 1 04/24	1.354	-0.026
UKT 1¼ 07/27	1.341	-0.021
UKT 4¼ 06/32	1.566	-0.028

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

Euro area

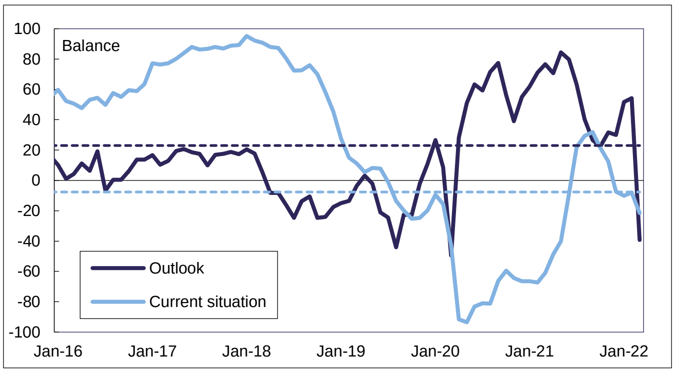
German investor expectations index slumps most on series

Like last week's Sentix indices, today's German ZEW confidence survey predictably signalled a substantial deterioration in investors' perceptions of the economic situation, with Russia's invasion of Ukraine and subsequent sanctions driving energy and commodity prices significantly higher and expected to dampen economic growth. The drop in the current economic conditions index was broadly as expected, down 13.3pts to -21.4, the lowest since last May and some 53ppts below September's recent peak. However, there was a more striking drop in expectations for the outlook for the coming six months, with the relevant index down a whopping 93.6pts to -39.3. While the index remains roughly 10pts higher than the April 2020 trough, the monthly move was by far the largest since the series began in 1991, about 50% larger than the initial post-Covid decline, and more than double the decline following the 1998 Russian debt default and steepest drop during the euro crisis. The plummet in economic expectations in part reflects a significant increase in inflation expectations, with the relevant ZEW index surging 107.7pts on the month – again by far the largest monthly move on record – to 70.2, its highest since June. In addition, long-term interest rates were expected to continue to rise, with the associated balance (76.5) rising to the highest since 2011. Unsurprisingly, this deteriorating outlook was judged to hit substantially the profit outlook for almost all sectors, with the energy-intensive, autos and financial sectors the most severely impacted.

BoF survey suggest French businesses are still relatively upbeat

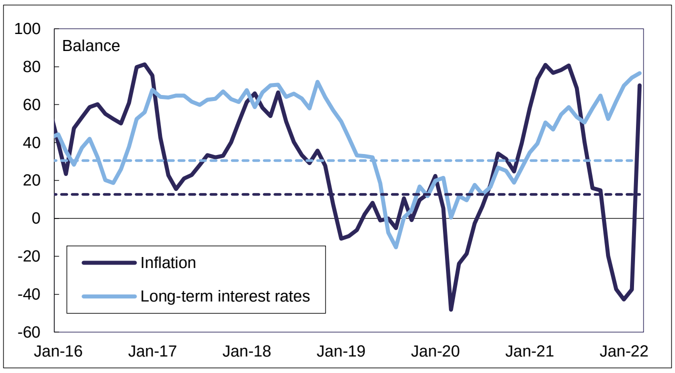
In marked contrast, yesterday's Bank of France (BoF) business survey was on the whole broadly upbeat. Industrial production and construction activity reportedly grew more than had been expected in February, with consumer-facing services also rebounding having been most severely hit during the pandemic wave at the start of the year. Services firms anticipated further recovery in March, with only modest growth in manufacturing and a slight decline in construction this month. Due to its lower reliance on Russian energy, the French economy should be less exposed to the impact of the ongoing Ukraine conflict than many other euro area member states, such as Germany and Italy. However, the BoF cautioned that expectations for the near-term outlook were subject to greater uncertainty, with manufacturers in particular reporting concerns about supply-chain disruption – already more than 50% of firms in the sector assessed that supply difficulties were a restraint on activity. The respective share of construction firms reporting such challenges, however, fell sharply in February to 46%, the lowest since last May. Overall, the BoF estimates that GDP will hold up relatively well in the first quarter of 2022, with its current forecast for growth of ½%Q/Q. But the outlook for Q2 on will depend in part on events in Ukraine and Russia.

Germany: ZEW investor confidence*



*Dashed lines represent long-run averages. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ZEW investor confidence*



*Dashed lines represent long-run averages. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area IP stable at the start of year

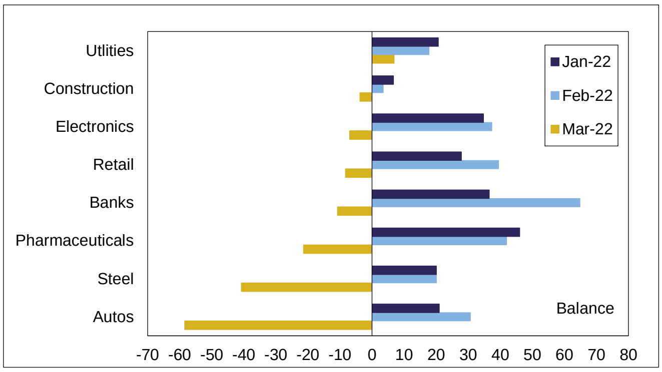
There were no major surprises from the euro area's January industrial production data, which suggested that output remained stable at the start of the year. Having risen to an eight-month high in December, a little more than 1% above the pre-pandemic level, production moved sideways in January, albeit leaving it a little more 1% lower than its level a year ago. Solid growth in Germany (1.3%M/M), France (1.6%M/M) and Austria (6.2%M/M) was offset by weakness in Italy (-3.2%M/M), Portugal (-5.0%M/M), Ireland (-3.1%M/M) and Greece (-4.1%M/M). The production performance by product-type was mixed too, with rebounds in machinery, pharmaceuticals and food offset by weakness in chemicals, electronics and autos. Indeed, car production recorded the first drop (-11.4%M/M) in five months in January to leave output in the sector almost one third lower than in February 2020. The ongoing Ukraine conflict appears already to be exacerbating supply-chain challenges in that sector, with concerns about supplies and/or prices of nickel, palladium, steel, wire-casing and energy, as well as semi-conductors, pointing to another year of production well below the pre-pandemic level. Indeed, VW's CEO Herbert Diess last week cautioned that the economic impact of the Ukraine conflict risked being "very much worse" than that of the pandemic.

The two days ahead in the euro area

In what should be a relatively quiet couple of days for euro area economic data, the most notable release will be the final euro area inflation figures for February on Thursday. The preliminary release reported a leap of 0.7ppt in the headline HICP rate to 5.8%Y/Y and an increase of 0.4ppt in the core rate to 2.7%Y/Y. But following last week's upwards revision to Spain's HICP inflation (by 0.1ppt to 7.6%Y/Y), today's French HICP also came in 0.1ppt above the flash estimate at 4.2%Y/Y. And so, in the absence of a sizeable downwards revision to tomorrow's equivalent Italian numbers, there seems a good chance that the euro area aggregate inflation rate will be nudged higher still in February. This release will also provide further signs of underlying price pressures, including the ECB's estimate of trimmed mean CPI, which in January rose to a record-high 3.7%Y/Y. Other data due on Thursday include the aggregate euro area new car registrations figures for February.

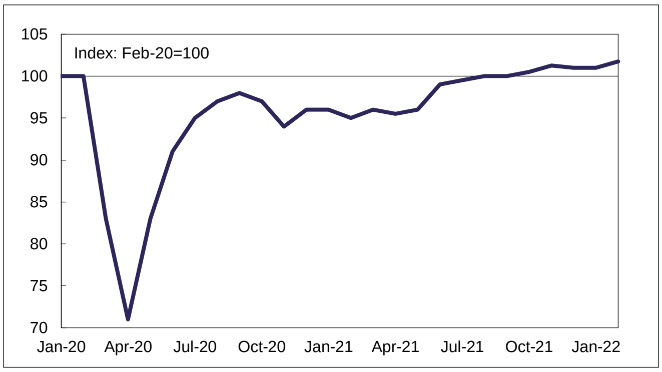
After the excitement of last week's hawkish ECB announcements, likely of most interest on Thursday will be the appearances from ECB President Lagarde, Chief Economist Lane and influential Executive Board Member Schnabel at the ECB Watchers' conference on Thursday, while hawkish Dutch National Bank Governor Knot is also due to speak at a separate event that same day.

Germany: ZEW investor profit expectations



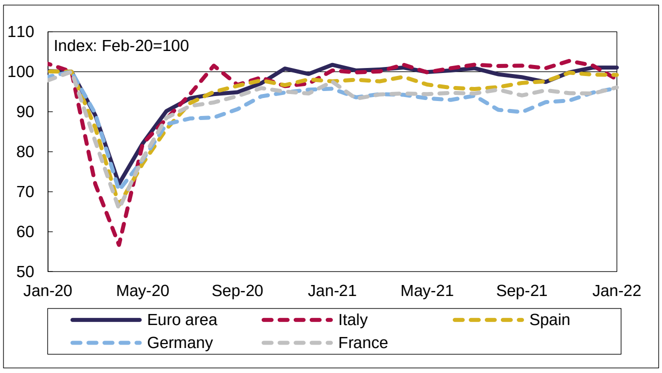
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Bank of France monthly GDP estimate



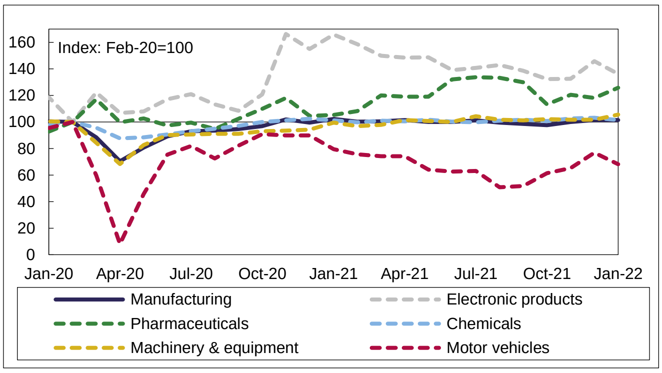
Source: BoF and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK

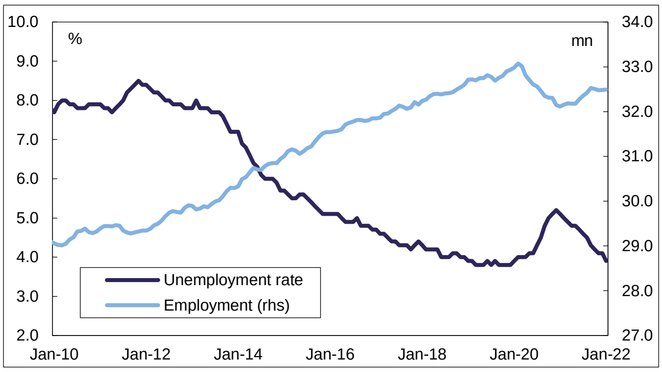
UK labour market tightens further as vacancies and inactivity both rise further

By and large, today's labour market report – the last top-tier UK economic data to be published ahead of the BoE's monetary policy announcement on Thursday – extended recent trends, suggesting increasing tightness consistent with the case for another rate hike, even as pay struggles to keep up with rising prices. Indeed, as economic growth was well maintained at 1.1%3M/3M at the start of the year despite the spread of Omicron, the unemployment rate fell 0.2ppt in the three months to January to 3.9%, the lowest in the two years since the outbreak of Covid-19. Thanks to an increase in the number of full-time employees, the employment rate edged up to 0.1ppt to 75.6%, the highest since June 2020, albeit still 1.0ppt lower than before the pandemic. However, the number of people in employment fell 12k in the three months to January, so the drop in the unemployment rate reflected a further rise in the inactivity rate to 1.1ppt above the level before the pandemic due not least to increased long-term sickness. Looking further ahead, the timeliest (albeit not necessarily most reliable) estimate of payroll employment leapt 275k in February, suggesting renewed strength last month. And while the pace of increase slowed again, the number of job vacancies rose to a new record high, up 105k to 1.318mn in the three months to February, with record levels in half the sectors. So, the ratio of unemployed workers to vacancies – a key measure of labour market tightness – looks set to hit a new record low.

Signs of additional pressures on pay, but real incomes still set to decline sharply

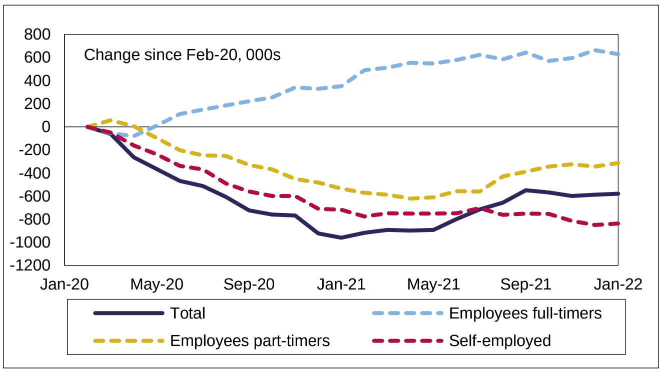
Meanwhile, average total pay (including bonuses) accelerated 0.5ppt to 4.8%3M/Y in January largely thanks to higher bonuses. However, it was only up a minimal 0.1%3M/Y in real terms. Growth in regular pay (i.e. excluding bonuses) edged up 0.1ppt to 3.8%3M/Y – back close to the top end of the range between the global financial crisis and the pandemic – with the 3M/3M annualised rate up to 5.0%, the highest in a year. Nevertheless, in real terms, regular pay fell a marked 1.0%3M/Y in real terms. Some MPC members were recently alarmed by the BoE agents' survey finding that firms expect pay to rise 4.8%Y/Y this year, judging such evidence of potential second-round effects from high inflation sufficient cause to tighten monetary policy further. But with inflation having accelerated markedly at the start of the year, and to rise significantly further over the near term – probably well above 8.0%Y/Y in April and to spike again above 8.0%Y/Y in the autumn in the absence of government intervention on household energy bills – real pay will fall sharply this year, with household real disposable incomes set to fall the most in more than four decades.

UK: Employment and unemployment



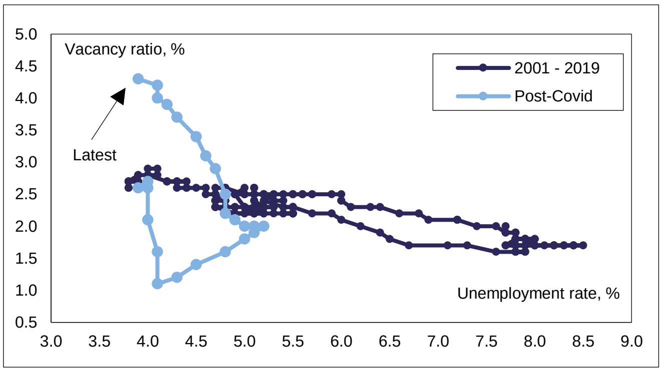
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Employment by type of job



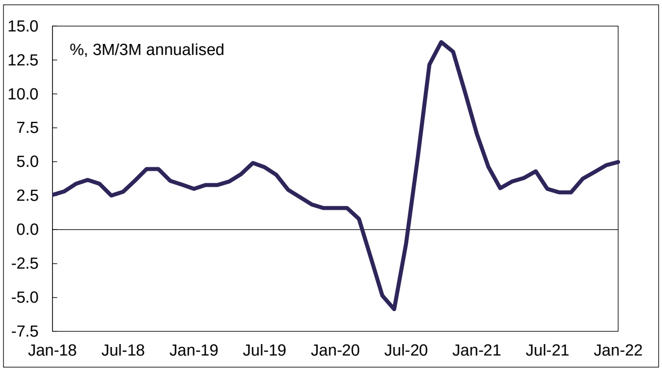
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Beveridge curve



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Regular pay (excluding bonuses)



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The two days ahead in the UK

All eyes in the UK now turn to Thursday's BoE monetary policy announcements, where the MPC is set to tighten policy for the third consecutive meeting. The rate decision in February was a close one, with four MPC members out of nine having preferred a hike of 50bps. But the MPC signalled only that "further modest tightening in monetary policy is likely to be appropriate in the coming months". Since then, GDP has come in well above the BoE's expectations and inflation has also surprised significantly on the upside, with the near-term price outlook having worsened markedly too due to developments in wholesale markets for energy, food and other commodities as well as the prospect of further supply bottlenecks. However, policy-makers will also be mindful that high inflation will significantly erode real disposable incomes, which this year look set to decline the most in more than 40 years. Consumer confidence deteriorated markedly even before Russia's invasion of Ukraine, further suggesting that the outlook for domestic demand has weakened. And the probability of a recession sometime this year is non-negligible – indeed a contraction in economic output in Q2 now looks a decent bet. Moreover, financial market turbulence should also make some MPC members wary about tightening policy aggressively. So, while MPC members have remained largely tight-lipped since the Russian invasion, we expect the majority to want to avoid a marked shift in its policy stance and – as is currently priced by the markets – vote for a hike in Bank Rate of 25bps to 0.75%.

The next edition of the Euro wrap-up will be published on 17 March 2022

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Industrial production M/M% (Y/Y%)	Jan	**0.0 (-1.3)**	0.0 (-0.7)	1.2 (1.6)	**1.2 (2.0)**
Germany	ZEW current situation balance (expectations)	Mar	**-21.4 (-39.3)**	-23.0 (8.0)	-8.1 (54.3)	-
France	Final CPI (EU-harmonised CPI) Y/Y%	Feb	**3.6 (4.2)**	3.6 (4.1)	2.9 (3.3)	-
UK	Payrolled employees change '000s	Feb	**275**	-	108	**61**
	Unemployment claimant count rate % (change '000s)	Feb	**4.4 (-48.1)**	-	4.6 (-31.9)	
	Average weekly earnings (excluding bonuses) 3M/Y%	Jan	**4.8 (3.8)**	4.6 (3.7)	4.3 (3.7)	4.6 (-)
	ILO unemployment rate 3M%	Jan	**3.9**	4.0	4.1	-
	Employment change 3M/3M '000s	Jan	**-12**	10	-38	-

Auctions

Country	Auction
Germany	sold €4.4bn of 2024 zero coupon bonds at an average yield of -0.36%
UK	sold £1.2bn of 0.125% 2031 inflation-linked bonds at an average yield of -2.829%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
France	Bank of France industrial sentiment	Feb	**107**	106	106	**107**
	Trade balance €bn	Jan	**-8.0**	-9.7	-11.3	**-11.4**
Spain	Retail sales Y/Y%	Jan	**4.7**	4.0	-2.3	**-2.4**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Italy	09.00	Final CPI (EU-harmonised CPI) Y/Y%	Feb	5.7 (6.2)	4.8 (5.1)

Auctions and events

Country	GMT	Release
Germany	10.30	Auction: €4bn of 2032 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data						
Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	Final CPI (core CPI) Y/Y%	Feb	*5.9 (2.7)*	5.1 (2.3)
		07.00	EU27 new car registrations Y/Y%	Feb	-	-6.0
Spain		08.00	Labour costs Y/Y%	Q4	-	4.9
UK		12.00	BoE Bank Rate %	Mar	*0.75*	0.50
Auctions and events						
Euro area		09.00	ECB's Knot scheduled to speak			
		-	ECB's Lagarde, Lane and Schnabel to speak at The ECB and Its Watchers conference			
France		09.50	Auction: 0.5% 2026 bonds			
		09.50	Auction: 0% 2027 bonds			
		09.50	Auction: 0.5% 2029 bonds			
		10.50	Auction: 0.1% 2031 inflation-linked bonds			
		10.50	Auction: 0.1% 2036 inflation-linked bonds			
		10.50	Auction: 0.1% 2053 inflation-linked bonds			
Spain		09.30	Auction: 0% 2025 bonds			
		09.30	Auction: 1.4% 2028 bonds			
		09.30	Auction: 0.7% 2032 bonds			
UK		12.00	BoE monetary policy announcement, summary and minutes to be published			
		12.00	BoE Agents' summary of business conditions for Q1 to be published			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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