

Euro wrap-up

Overview

- Bunds made further losses despite an unexpected drop in the Commission's euro area sentiment index, falls in business and consumer inflation expectations, and a record decline in M1 money supply.
- Gilts also made losses as the UK government struck a deal with the EU to reduce trade barriers between Great Britain and Northern Ireland.
- Tuesday will bring flash February inflation data from France and Spain.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2½ 03/25 | 3.049 | +0.037 |
| OBL 2.2 04/28 | 2.654 | +0.032 |
| DBR 2.3 02/33 | 2.576 | +0.044 |
| UKT 0% 06/25 | 3.647 | +0.056 |
| UKT 1¼ 07/27 | 3.686 | +0.054 |
| UKT 4¼ 06/32 | 3.804 | +0.047 |

*Change from close as at 4:45pm GMT.

Source: Bloomberg

Euro area

Euro area economic sentiment deteriorates slightly in February but remains well October's trough

Compared against last week's upbeat [flash PMIs](#), today's European Commission survey offered a more lacklustre assessment of economic conditions in February, with the headline Economic Sentiment Index (ESI) – often a more reliable guide to euro area GDP growth – falling for the first month in four. Admittedly, the monthly drop was negligible (-0.1pt) and followed three solid gains to leave the ESI at 99.7, close to the long-run average (100) and trending almost 4½pts above the Q4 average. But this was nevertheless still some 15pts below the level a year earlier and 19pts below the post-pandemic peak. And overall, given the carryover from the marked weakening in economic activity at the end of 2022, we still see a sizeable risk that euro area GDP contracted in Q1. The country breakdown suggested a mixed performance in February, with a notable weakening in the ESIs from France (-1.5pts) and Spain (-2.0pts) offset by strengthening in the Netherlands (+2.9pts) and Austria (+2.8pts) and broadly unchanged conditions in Germany and Italy. Overall, however, the ESIs from all member states to publish results so far remain comfortably higher than in Q4.

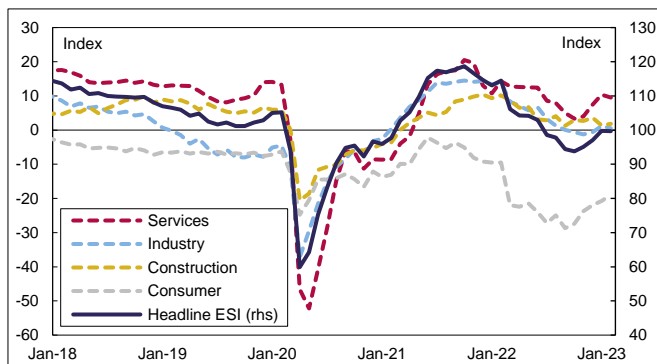
Consumers more upbeat, but optimism in manufacturing and services softens slightly

Within the detail, aligning with the flash reading, consumer confidence in the euro area rose for a fifth consecutive month, to its highest level in a year, with households similarly the most optimistic about the economic outlook and their expected financial situation since last February. But today's survey suggested that households remain relatively cautious with respect to their spending intentions, preferring instead to increase their savings. And so, while retailers were markedly more upbeat about past sales, the volume of unsold stocks continued to rise. More notably perhaps, contrasting with the renewed momentum suggested by the PMIs and a reported surge in past production, the Commission's manufacturing sentiment index slipped back in February amid a deterioration in expected output and still lacklustre order books. Services sentiment similarly edged lower, albeit from an elevated level in January, reflecting a significant decline in demand expectations. And although confidence among construction firms improved slightly in February, it was still close to the bottom of the range of the past two years, with firms again citing insufficient demand and financial constraints as limiting factors.

Price-setting expectations moderate sharply in manufacturing but remain sticky in services

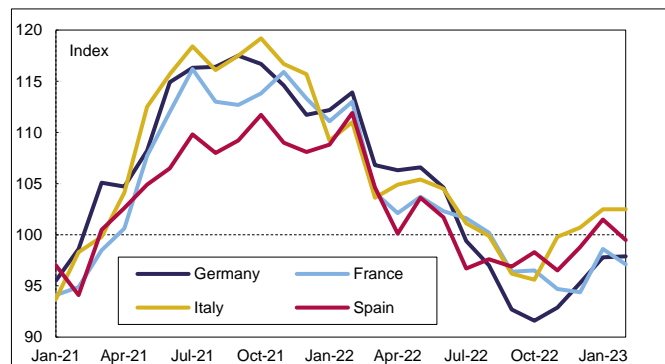
Given subdued demand and the ongoing decline in energy prices, today's survey reported a further downwards adjustment price-setting expectations for the coming three months across the major sectors. This was most marked in industry and construction, with the former the lowest in almost two years. But the moderation in services' and retailers' price-setting expectations was much less striking, possibly reflecting prospects of continued pass-through of increased costs of food,

Euro area: Economic sentiment indices



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

Euro area: Economic sentiment indices



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

energy and other goods to consumers and therefore potentially reinforcing concerns among Governing Council members about possible second-round effects on inflation. This notwithstanding, the survey index of consumer price expectations for the coming twelve months fell (very slightly) for the fifth successive month to the lowest for more than two years and below the long-run average.

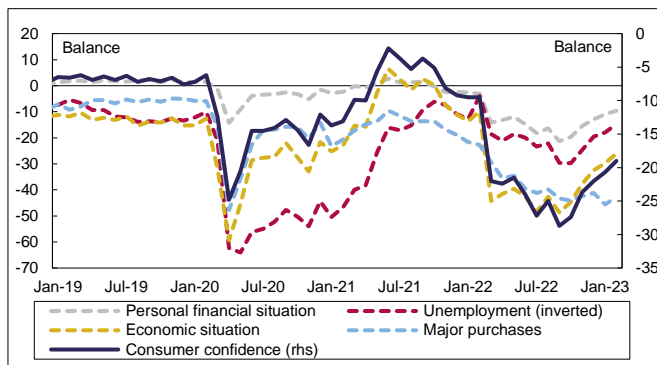
Mortgage lending slumps amid higher interest rates and tighter lending conditions

While record high rates of inflation and the erosion of household disposable income have dampened demand, the aggressive tightening in monetary policy since last summer has played a role too. Indeed, taken together with heightened economic uncertainty and lower risk tolerance, the ECB's Q4 Bank Lending Survey reported the steepest tightening of credit standards on loans to non-financial corporations since the euro debt crisis in 2011. It also reported another strong net tightening of lending conditions for house purchase too, while banks anticipated the steepest decline in demand for such loans on the survey. Indeed, with the composite interest rate on new loans for house purchase having risen in December by a cumulative 164bps from the pandemic trough to their highest since April 2014, today's monthly monetary data reported a widespread and marked weakening in mortgage lending at the start of the year. On a seasonally adjusted basis, the net flow of such loans eased for the sixth month out of the past seven, by €1.7bn to €2.8bn, the smallest amount since May 2019. And in unadjusted terms, the net flow was negative (-€8.3bn) for the first time in five years, by the most since mid-2014 and representing one of the largest falls on the series. Each of the four largest member states recorded declines too, with Germany registering its first negative net flow since 2014. With interest rates on new business loans having increased sharply over the past year too – the average composite rate is up more than 200bps to above 3.40% – business lending remained weak. Indeed, after falling sharply in the final two months of 2022, the flow of loans to NFCs merely moved sideways in January, to be down on a three-month basis by the most since June 2021.

M1 money supply contracts for first time on four-decade survey

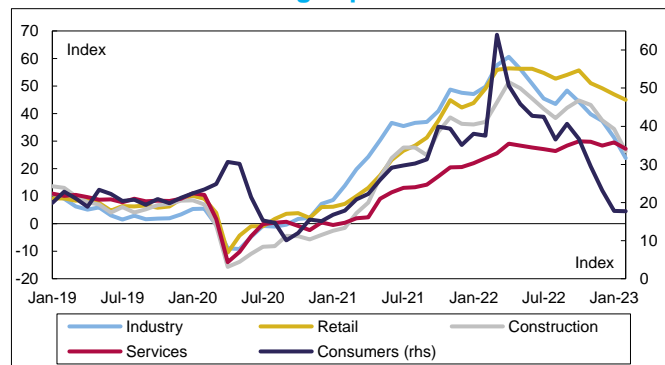
With interest rates having also risen on deposits, and amid consumer prudence in spending, the flow of new household deposits increased again in January, by a net €12.8bn. Admittedly, this was less than half the pace of increase over the past five years as households continue to suffer declining real disposable incomes amid high inflation. Meanwhile, deposits placed by NFCs fell for a third successive month to be up just 3.3%Y/Y, the softest rate in seven years. However, within NFC deposit holdings, there was a further sharp jump in time deposits to take advantage of higher rates. Indeed, the net flow with an agreed maturity up to two years reached €40.2bn to be up a whopping 82%Y/Y while overnight deposits were down 7.5%Y/Y. As such, M1 money supply (comprising currency in circulation and overnight deposits) fell 0.7%Y/Y, in January, taking the annual rate into negative territory for the first time since the series began in 1981. And with M3 money supply

Euro area: Consumer confidence



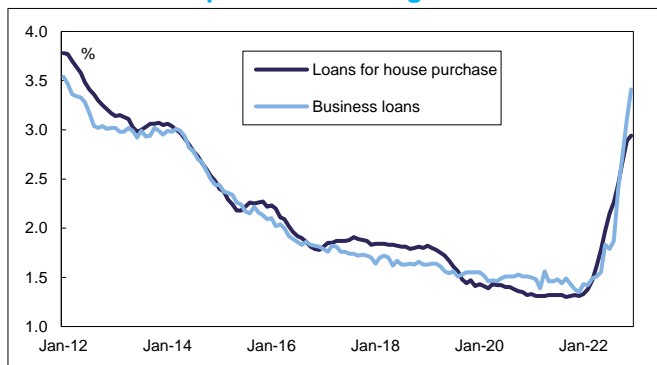
Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Price-setting expectations



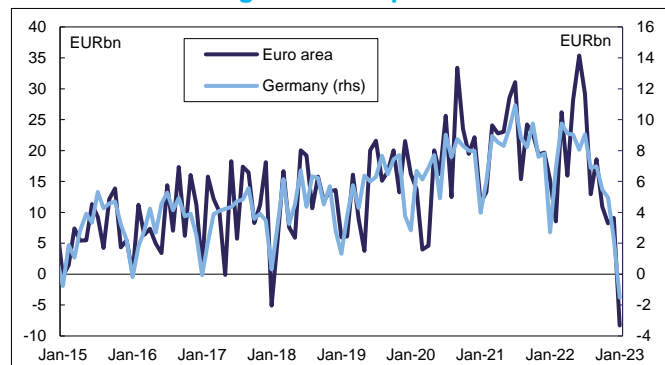
Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Composite borrowing cost



Source: ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Lending for house purchase*



*Unadjusted data. Source: ECB and Daiwa Capital Markets Europe Ltd.

having once again moved broadly sideways, its annual growth rate slowed by a further 0.6ppt in January to 3.5%Y/Y, the softest pace since 2014.

The day ahead in the euro area

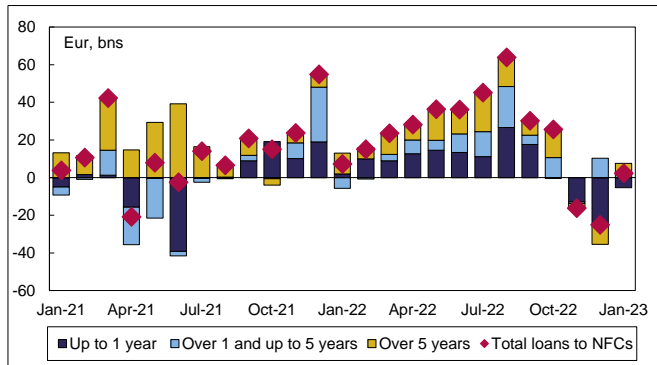
Ahead of Thursday's flash euro area inflation measure, tomorrow will bring insights into February inflation, with preliminary HICP data from France, Spain and Portugal. The French rate is forecast to rise for the second successive month, taking it back to the series high of 7.1%Y/Y recorded in November, while the Spanish HICP rate is forecast to remain unchanged at 5.9%Y/Y. But national CPI figures from Belgium today saw the headline inflation rate fall sharply again in February, by 2.3ppts to 8.1%Y/Y. Meanwhile, final French Q4 GDP figures are also due tomorrow and expected to confirm that output rose 0.1%Q/Q, despite a decline domestic private demand, while French consumer spending numbers are expected to point to only a modest recovery in January.

UK

The day ahead in the UK

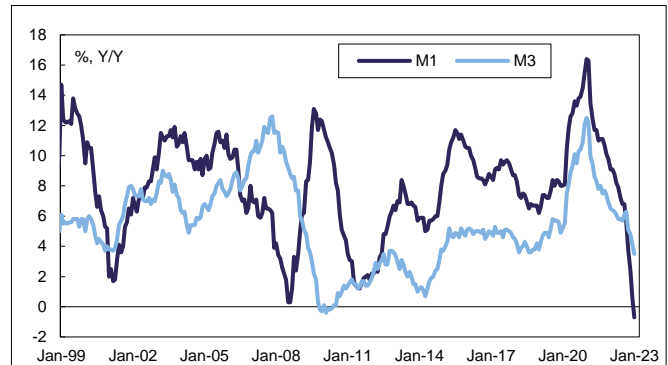
After a quiet start to the week for UK data today, tomorrow brings only the Lloyds business barometer for February. Arguably of more interest tomorrow will be BoE external board member Catherine Mann participation in a panel discussion on the interaction of monetary and fiscal policy and financing conditions. However, she seems bound to remain hawkish.

Euro area: Lending to NFCs



Source: ECB and Daiwa Capital Markets Europe Ltd.

Euro area: M1 and M3 money supply





Source: ECB and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|---|--|--------|----------------------|--|---------------|------------|
| Euro area  | M3 money supply Y/Y% | Jan | 3.5 | 3.9 | 4.1 | - |
| | EC Economic Sentiment Index | Feb | 99.7 | 101.0 | 99.9 | 99.8 |
| | EC industry (services) sentiment index | Feb | 0.5 (9.5) | 1.8 (12.1) | 1.3 (10.7) | 1.2 (10.4) |
| | EC consumer confidence Index | Feb | -19.0 | <u>-19.0</u> | -20.7 | - |
| Italy  | ISTAT business (manufacturing) sentiment index | Feb | 109.1 (102.8) | -(103.0) | 109.1 (102.7) | -(102.8) |
| | ISTAT consumer confidence index | Feb | 104.0 | - | 100.9 | - |





Auctions

| Country | Auction |
|-----------------------|---------|
| - Nothing to report - | |



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.7

Tomorrow's releases

Economic data

| Country | GMT | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|--|-------|-------------------------------------|--------|--|-------------|
| Germany  | 07.00 | Import price index M/M% (Y/Y%) | Jan | -1.5 (6.3) | -1.6 (12.6) |
| France  | 07.45 | Preliminary HICP (CPI) Y/Y% | Feb | 7.1 (6.1) | 7.0 (6.0) |
| | 07.45 | PPI Y/Y% | Jan | - | 20.7 |
| | 07.45 | Consumer goods spending M/M% (Y/Y%) | Jan | 0.4 (-4.6) | -1.3 (-5.6) |
| | 07.45 | Final GDP Q/Q% (Y/Y%) | Q4 | <u>0.1 (0.5)</u> | 0.2 (1.0) |
| Spain  | 08.00 | Preliminary HICP (CPI) Y/Y% | Feb | 6.0 (5.9) | 5.9 (5.9) |
| UK  | 00.01 | Lloyds business barometer | Feb | - | 22 |

Auctions and events

| | | | | | |
|---|-------|--|--|--|--|
| Germany  | 10.30 | Auction: €6.0bn of 2.5% 2025 bonds | | | |
| UK  | 12.30 | BoE's Mann scheduled to speak – "Interaction of monetary and fiscal policy and financing conditions" | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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