# Euro wrap-up

## Overview

- Bunds made further sizeable losses as Germany's February inflation data surprised on the upside due to a further acceleration in food and services prices.
- Shorter-dated Gilts made gains as BoE Governor Bailey reiterated that further rate increases were not a done deal, while UK house prices posted the steepest annual drop since 2012.
- All eyes tomorrow will be on the euro area flash February inflation estimates, as well as the account of the most recent ECB policy meeting and the BoE's DMP survey results.

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**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 2½ 03/25 | 3.182 | +0.063 |
| OBL 2.2 04/28 | 2.807 | +0.077 |
| DBR 2.3 02/33 | 2.708 | +0.063 |
| UKT 0⅝ 06/25 | 3.672 | -0.018 |
| UKT 1⅝ 10/28 | 3.677 | -0.030 |
| UKT 3¼ 01/33 | 3.845 | +0.019 |

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

# Euro area

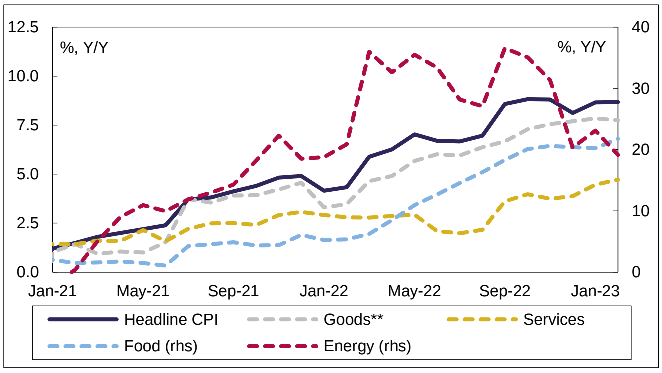
## German inflation surprises on the upside in February

After yesterday's upside inflation surprises from France and Spain, today's flash estimates from Germany similarly exceeded expectations. In particular, prices rose a stronger-than-normal 1.0%M/M in February, to leave the headline inflation rate (on the EU harmonised measure) up 0.1ppt at 9.3%Y/Y, contrasting with the Bloomberg survey consensus forecast of a drop of 0.3ppt. Admittedly, on the national measure, the headline CPI rate moved sideways at 8.7%Y/Y, with a further moderation in energy inflation (down 4ppts to 19.1%Y/Y) offset by a further acceleration in food prices. But like with yesterday's French release, ECB Governing Council members will be disheartened to see an increase in underlying price pressures in Germany too. Services inflation rose 0.2ppt to 4.7%Y/Y, with the Länder signalling a pickup in various consumer-facing services (including hospitality, entertainments and tourism). So while our estimate of core goods inflation edged slightly lower, core CPI looks to have increased 0.1ppt to a new high of 5.9%Y/Y. Taken together with the upticks in France, Spain and Ireland – for which data today saw the HICP rate rise ½ppt to 9.0%Y/Y – risks surrounding tomorrow's flash euro area estimate are skewed firmly to the upside. Indeed, in the absence of a drop in Italian inflation, there is a non-negligible possibility that the aggregate headline HICP rate will rise from the 8.6%Y/Y rate recorded in January. On balance, we think euro area inflation moved sideways. But we also now think that core inflation likely rose to a fresh series high of 5.4%Y/Y. And although today's manufacturing PMIs reported another significant easing in the input price index (50.9) to its lowest since September 2020 and well below the long-run average (56.3), the output price PMI (58.4) still remained uncomfortably high and some 7pts above the long-run average.

## Manufacturing PMIs signal stronger growth in Italy and Spain, but weakness in core countries

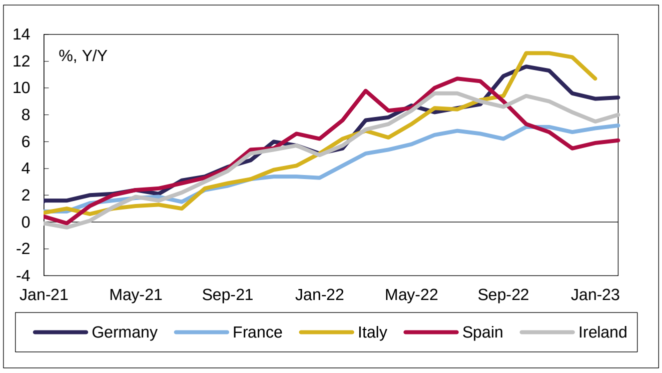
While the February manufacturing PMIs offered a notably more upbeat assessment than in the second half of last year amid a further easing of supply-chain strains, the survey was still consistent with persistent challenges in the sector relating not least due to lacklustre demand. For example, while notably higher than in the final quarter of last year (45.9) and the first non-contractionary reading for nine months, the output component (50.1) was still well below the pre-pandemic long-run average (52.9) and merely consistent with stagnation in February. Admittedly, the weakness was largely driven by a slump in demand in France (45.0). And although the German index (50.2) was the firmest for nine months and some 8pts above October's trough, it too implied little growth. But the survey signalled a more convincing recovery in other member states, and particularly so in Italy, where the output component jumped 3pts in February to 54.0, to be trending almost 6pts above the Q4 average. The improvement in Spain was striking too, up 4.6pts to 52.1, similarly implying the strongest growth for

**Germany: Consumer price inflation***




*National measures. **Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

**Euro area: Consumer price inflation***




*EU harmonised measures. Flash estimates for February 2023. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

eleven months. With the exception of Italy, however, today's PMIs still suggested that new orders continue to decline sharply, with more acute weakness in external demand, suggesting that the near-term production outlook remains highly uncertain.

### The day ahead in the euro area

All eyes tomorrow will be on the aforementioned euro area flash February inflation estimate. Ahead of the release of the national data this week, expectations had been for a further notable drop in the euro area headline rate for the fourth consecutive month. But risks to this outlook are now firmly to the upside. Indeed, in the absence of a notable decline in the Italian numbers (due tomorrow), we might well see the euro area headline HICP rate edge slightly higher. On balance, we see a sideways move as more likely (at 8.6%Y/Y). At the same time, we now expect core inflation to rise from January's record-high of 5.3%Y/Y. Meanwhile, the latest unemployment figures are expected to remain consistent with ongoing tightness in the labour market, with the aggregate euro area rate expected to be unchanged in January at a record-low 6.6%. Spanish numbers for February are also due.

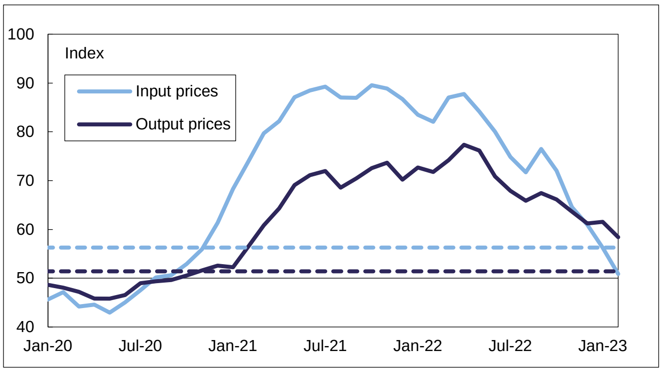
Tomorrow will also bring the publication of the ECB's account of its February monetary policy-setting meeting, which saw the Governing Council raise rates by 50bps taking the cumulative tightening so far this cycle to 300bps, and also signal its intention to raise interest rates by a further 50bps in March. Given that the Governing Council also judged the inflation outlook to be more balanced, and that policy decisions remained data dependent, the account will be closely watched for further insight into how much additional tightening might be anticipated beyond the current quarter. Separately tomorrow, ECB Executive Board member Schnabel will give a presentation, which is likely to maintain her typically hawkish tone.

## UK

### UK shop price inflation rises to a series high in February

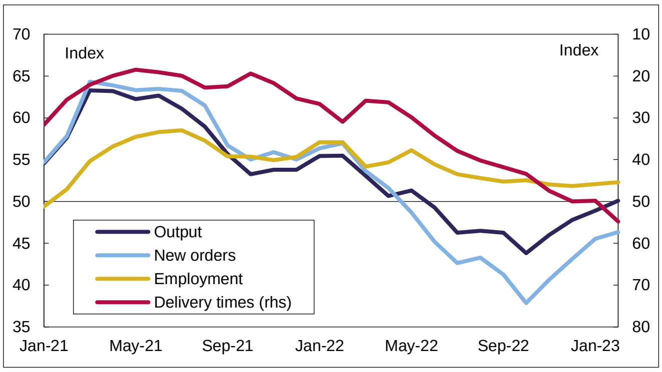
Despite weak demand and historically low consumer confidence, as well as some signs of easing input costs, the latest BRC shop price survey suggested that many UK retailers continue to increase their prices, flagging potential upside risks to the underlying price outlook. According to the BRC, shop prices rose an above-average 0.4%M/M in February, taking the annual inflation rate to a new series high of 8.4%Y/Y in February. There was a further acceleration in the survey's measure of food price inflation, by 0.8ppt to 14.5%Y/Y, with fresh food inflation rising close to 16½%Y/Y. But the increase appeared widespread, with prices at non-food stores similarly rising a record-high 5.3%Y/Y, with the BRC flagging notable rises in items as diverse as gardening tools and pet food. Despite the upside surprise to the BRC survey, we would not take this as

**Euro area: Manufacturing price PMIs**



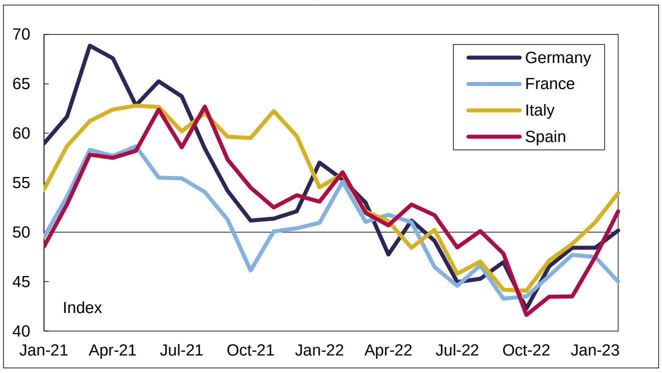

*Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.*

**Euro area: Manufacturing PMIs**



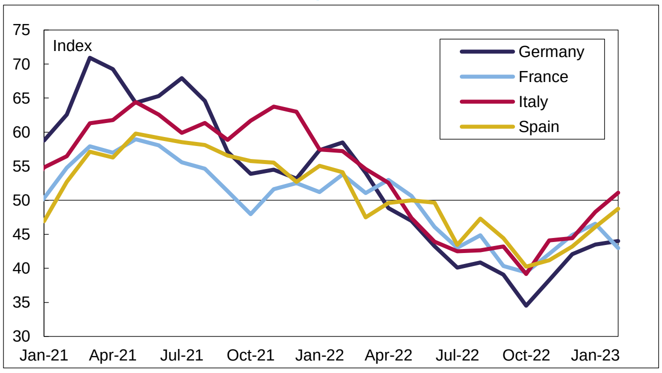

*Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.*

**Euro area: Manufacturing output PMIs**




*Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.*

**Euro area: Manufacturing new orders PMIs**




*Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.*

concrete evidence of more persistent inflationary pressures. With households' purchasing power continuing to be eroded and spending likely to remain weak, like the BRC, we expect to see retail prices fall back over the coming year as cost burdens fade.

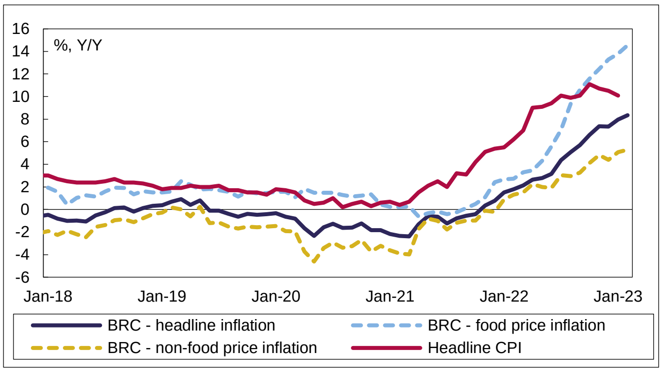
## House prices report steepest annual decline since 2012, with mortgage approvals weakening further

The deterioration in the housing market will do nothing to ease consumers' concerns about the economic outlook and should therefore continue to dampen demand. Certainly, today's Nationwide house price report offered a gloomy assessment, with prices having declined in February for a sixth consecutive month, by 0.5%M/M. This left prices some 3.7% below the August peak and down compared with a year earlier (-1.1%Y/Y) for the first time since mid-2020 and at the sharpest rate since November 2012. Consistent with the slowdown in the number of residential property completions since October (a cumulative drop of more than 7½%), BoE data today confirmed a further moderation in mortgage lending in January, with the net increase of £2.5bn well below the previous six-month average (£4.4bn) and the lowest since October 2021, the month after the conclusion of the pandemic stamp duty holiday. But this volume of lending still largely reflects completions based on mortgage offers made ahead of the Truss-related blow-out in interest rates. For example, the average effective interest rate on these loans stood at 3.88%, with the effective rate fixed for up to 2 years at 4.09%, whereas the average interest rate offered on a 2Y fixed-rate mortgage with an LTV ratio of 75% was more than 100bps higher than that in January. As such, the number of approvals on new mortgages again fell, down to 39.6k, from (an upwardly revised) 40.5k in December and the lowest outside of the initial pandemic slump since January 2009, suggesting that we will see a marked slowdown in secured lending over coming months.

## Manufacturing PMI points to positive growth as supply constraints ease and demand improves

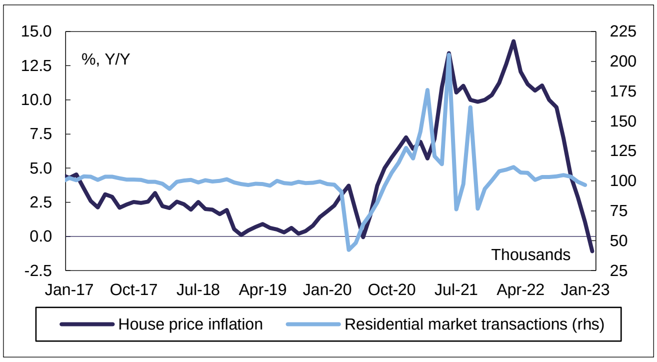
More encouragingly, the final manufacturing PMI was consistent with a more buoyant performance since the start of the year. While the output component was revised down from the flash release in February, at 51.0 it was still more than 6½pts above the level at the end of last year and implied the first month of positive growth since last June. The improvement was underpinned by solid production growth of investment goods (56.4) and consumer goods (51.1), which offset ongoing contraction in output of intermediate goods (46.2). While the recovery in part reflected a further improvement in supply chains – delivery lead times shortened for the first time since June 2019 – there was also a recovery in demand, with the new orders component implying a negligible drop in new orders for the first time in nine months. As such, firms expressed greater optimism about their output expectations for the coming year.

### UK: Consumer and shop price inflation



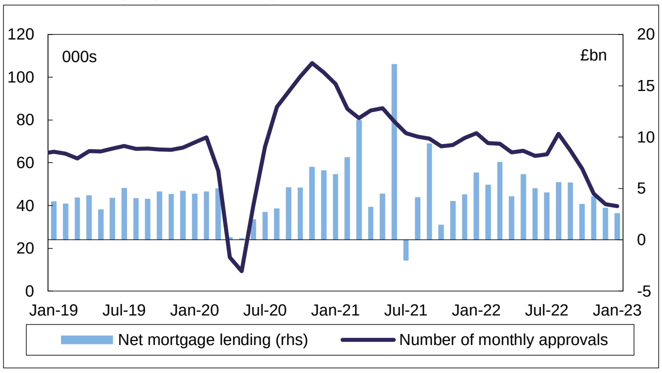

*Source: Refinitiv, BRC and Daiwa Capital Markets Europe Ltd.*

### UK: House price and residential transactions



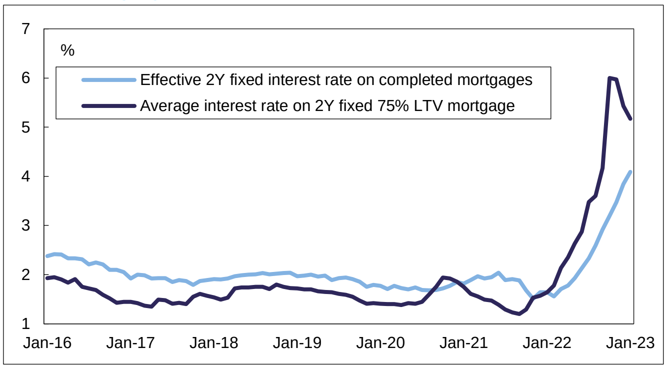

*Source: Refinitiv, Nationwide and Daiwa Capital Markets Europe Ltd.*

### UK: Mortgage lending and approvals




*Source: Refinitiv, BoE and Daiwa Capital Markets Europe Ltd.*

### UK: Mortgage interest rates




*Source: Refinitiv, BoE and Daiwa Capital Markets Europe Ltd.*

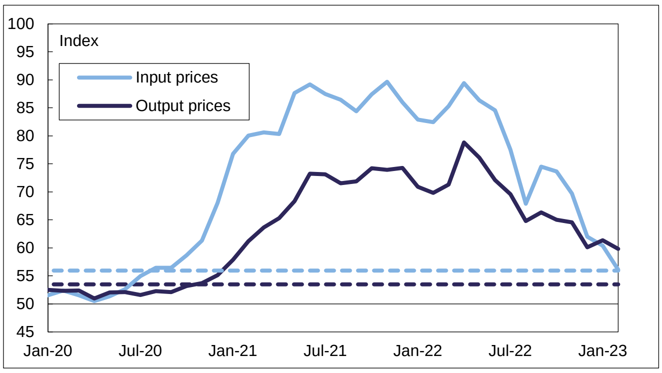
## BoE Governor Bailey offers a broadly balanced view of the outlook for rates

Encouragingly, today's final manufacturing PMIs implied a further easing in factory input prices in February, with the respective index down for the ninth month out of the past ten to 56.1, the softest reading since July 2020 and back broadly in line with the pre-pandemic long-run average. Admittedly, the output price PMI remained more elevated (59.8), nevertheless at its lowest for more than two years. And not least given the anticipated profile for energy inflation and lacklustre demand, we continue to expect headline CPI inflation to maintain a downwards trend. Certainly, in a speech today, BoE Governor Bailey reiterated that he expected inflation to fall sharply over the course of this year and below the Bank's 2% target in 2024. And while he noted that activity and wages had been slightly stronger but inflation slightly weaker than expected, overall recent data suggest that the economy is evolving broadly in line with the Bank's February projections. So, similar to the message from the February MPC meeting, Bailey noted that further tightening is not yet a done deal while also acknowledging that some further increase in Bank Rate may eventually turn out to be appropriate.

## The day ahead in the UK

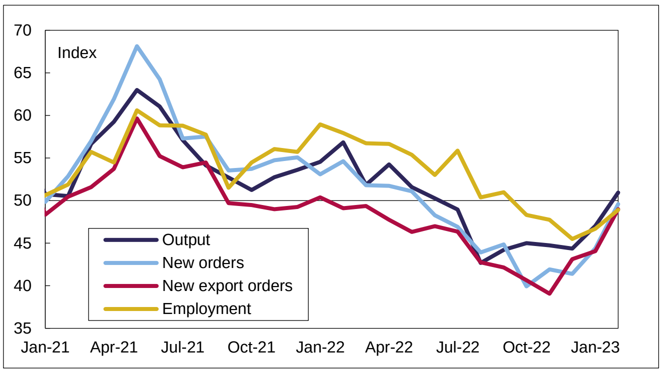
In the UK, tomorrow will see the BoE publishes the results from its latest Decision Marker Panel survey, with participants' expectations for prices and wage of particular interest. Separately, BoE Chief Economist Huw Pill is scheduled to speak publicly in London.

### UK: Manufacturing price PMIs




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### UK: Manufacturing PMIs




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

# European calendar

## Today's results

**Economic data**

| Country | Release | Period | **Actual** | Market consensus/ *Daiwa forecast* | Previous | Revised |
|---|---|---|---|---|---|---|
| Euro area | Final manufacturing PMI | Feb | **48.5** | *48.5* | 48.8 | - |
| Germany | Final manufacturing PMI | Feb | **46.3** | *46.5* | 47.3 | - |
| | Unemployment rate % (change 000s) | Feb | **5.5 (2.0)** | 5.5 (-10.0) | 5.5 (-22.0) | - (-11.0) |
| | Preliminary HICP (CPI) Y/Y% | Feb | **9.3 (8.7)** | 9.0 (8.6) | 9.2 (8.7) | - |
| France | Final manufacturing PMI | Feb | **47.4** | *47.9* | 50.5 | - |
| Italy | Manufacturing PMI | Feb | **52.0** | 51.0 | 50.4 | - |
| Spain | Manufacturing PMI | Feb | **50.7** | 49.0 | 48.4 | - |
| UK | BRC shop price index Y/Y% | Feb | **8.4** | - | 8.0 | - |
| | Nationwide house price index M/M% (Y/Y%) | Feb | **-0.5 (-1.1)** | -0.5 (-0.9) | -0.6 (1.1) | - |
| | Final manufacturing PMI | Feb | **49.3** | *49.2* | 47.0 | **-** |
| | Consumer credit £bn (Y/Y%) | Jan | **1.6 (7.5)** | 0.8 (-) | 0.5 (7.2) | **0.8 (-)** |
| | Mortgage lending £bn (approvals 000s) | Jan | **2.5 (39.6)** | 2.9 (38.5) | 3.2 (35.6) | **3.1 (40.5)** |

**Auctions**

| Country | Auction |
|---|---|
| Germany | sold €1.55bn of 1.00% 2038 bonds at an average yield of 2.79% |
| | sold €540mn of 4.25% 2039 bonds at an average yield of 2.76% |
| UK | sold £2.50bn of 3.75% 2038 bonds at an average yield of 4.142% |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Tomorrow's releases

**Economic data**

| Country | GMT | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|
| Euro area | 10.00 | Preliminary HICP (core HICP) Y/Y% | Feb | *7.9 (5.1)* | 8.5 (5.2) |
| | 10.00 | Unemployment rate % | Jan | 6.6 | 6.6 |
| Italy | 10.00 | Preliminary HICP (CPI) Y/Y% | Feb | 9.5 (8.9) | 10.7 (10.0) |
| Spain | 08.00 | Unemployment change 000s | Feb | - | 70.7 |

**Auctions and events**

| Country | GMT | Event |
|---|---|---|
| Euro area | 12.30 | ECB publishes account of February policy-setting meeting |
| | 12.30 | ECB's Schnabel scheduled to speak at Money Market Contact Group |
| France | 09.50 | Auction: 2.00% 2032 bonds |
| | 09.50 | Auction: 1.25% 2034 bonds |
| | 09.50 | Auction: 1.25% 2038 bonds |
| | 09.50 | Auction: 4.00% 2060 bonds |
| Spain | 09.30 | Auction: 2.80% 2026 bonds |
| | 09.30 | Auction: 0.80% 2029 bonds |
| | 09.30 | Auction: 2.00% 2032 bonds |
| | 09.30 | Auction: 3.15% 2033 bonds |
| | 09.30 | Auction: 0.70% 2033 bonds |
| UK | 09.30 | BoE publishes its Decision Maker Panel survey |
| | 10.00 | Auction: £650mn of 0.125% 2051 index-linked bonds |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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