Euro wrap-up

Overview

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- Bunds made losses as the ZEW investor survey reinforced expectations that the bottom in Germany's downturn has been reached, while the euro area trade surplus narrowed on stronger imports.
- Despite a rise in the UK's unemployment rate to a six-month high, Gilts made losses as wage momentum picked up and private sector regular pay growth remained above the BoE's forecast.
- Tomorrow will bring March inflation estimates from the euro area and UK.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.926	+0.023
OBL 2.1 04/29	2.479	+0.043
DBR 2.2 02/34	2.484	+0.046
UKT 0⅛ 01/26	4.446	+0.057
UKT 0½ 01/29	4.192	+0.063
UKT 4⅝ 01/34	4.293	+0.054

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

Euro area

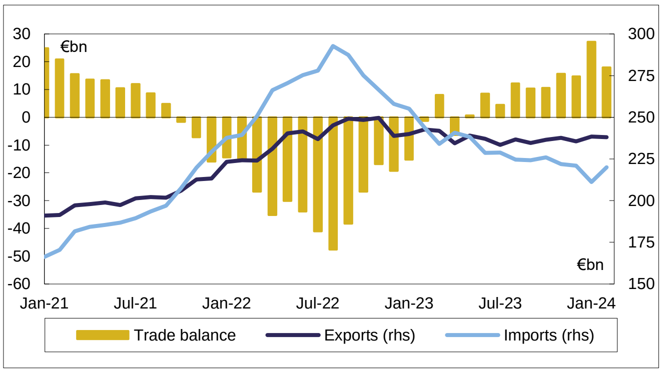
Trade surplus narrows in February as imports rebound from New Year weakness

Having registered a record deficit in August 2022 (€47.6bn in seasonally adjusted terms) due to the extreme energy price shock, the euro area's goods trade balance steadily improved. Export volumes were restrained by the sluggishness of global imports and, in aggregate, euro area firms failed to restore global market share. However, the region's terms of trade benefited from lower gas prices and increased export prices. So, having returned to positive territory in the first half of 2023, the trade balance continued to rise, reaching a record surplus in January this year (€27.1bn). Today's goods trade report for February, however, reported a drop of €9.2bn in the surplus – the most since April – to €17.9bn, still nevertheless above the average in 2019 ahead of the pandemic. The deterioration in February reflected a slight drop in the value of exports (-0.2%M/M) with a weakening in shipments to Asia, including China, more than offsetting an increase to the US. And imports, particularly from China, rebounded (4.2%M) from weakness at the start of the year that appears in part to have been related to disruption to the passage of freight via the Red Sea. However, export values in the first two months of the year were still trending some 0.7% above their Q4 level while imports were trending significantly below (-3.3%) their Q4 level. So, while we will need to wait for volumes data to be published next month for a better guide to the impact on GDP, today's data suggest that net goods trade made a positive contribution to growth in Q1, albeit principally due to the softness of imports. And looking ahead, while external demand should gradually pick up, survey indicators, particularly related to new orders, suggest that export growth will likely remain soft. With inventories ample, however, renewed supply disruptions related to events in the Red Sea should have limited impact on economic activity.

ZEW survey reinforces expectations that bottom in German downturn has been reached

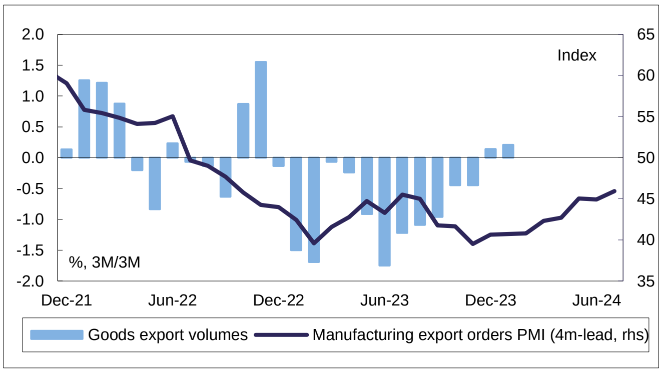
Like last week's [Sentix indices](), today's ZEW survey results suggested that Germany's economic downturn has probably reached its bottom. Indeed, the share of respondents expecting conditions over the coming six months to improve rose above 50% for the first time since the Russian invasion of Ukraine, while the share anticipating further deterioration was stable close to the lowest since mid-2021. As such, the overall expectations balance jumped more than 11pts for the second successive month, rising to a 26-month high of 42.9 in April, more than 20pts above the long-run average, strongly suggestive of expectations of a return to positive GDP growth over the summer. The improvement in mood only in part reflects waning price pressures. Indeed, perhaps given the recent pickup in oil prices, the share of respondents expecting a decline in inflation over the next six months fell some 9pts, albeit remaining above 50%. Nevertheless, the share of respondents anticipating the ECB to cut rates over the same period rose further to more than 85%, the largest since early 2009. Of course, the relatively low share (7.4%) of those expecting further deterioration in economic conditions in part relates to the challenging state of current conditions, with activity still being hit by historically weak consumer and business

Euro area: Goods trade balance*



Seasonally adjusted values. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods export volumes & orders



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

confidence, lacklustre global demand, and ongoing strike action across the transport sector. Admittedly, the index of perceptions of economic conditions improved marginally for a second successive month in April. But the share of investors considering conditions to be ‘bad’ remained above 80%, within a whisker of the highest since the first wave of the pandemic and the global financial crisis before that, and consistent with expectations of another contraction in German GDP in Q1.

The day ahead in the euro area

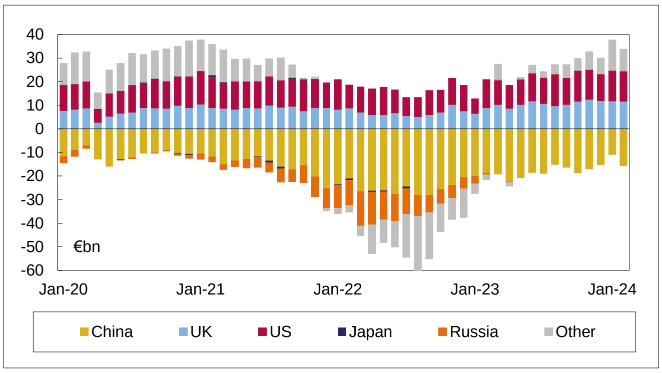
Focus in the euro area tomorrow will be on the release of final inflation figures for March on Wednesday. With an upwards revision in Spain offset by a downwards revision today in Italy – where the HICP rate was nudged down 0.1ppt to 1.2%Y/Y from the flash – we expect euro area inflation to align with the preliminary findings. In particular, these showed the headline and core rates falling 0.2ppt a piece to 2.4%Y/Y, matching November’s 28-month low, and 2.9%Y/Y, a two-year low, respectively. The euro area release will bring the granular detail, which will be used to calculate other measures of underlying inflationary pressures. Aside from the data, ECB President Lagarde will participate in a fireside chat at a Peterson Institute event.

UK

Unemployment rate rises to six-month high amid signs labour market is less tight

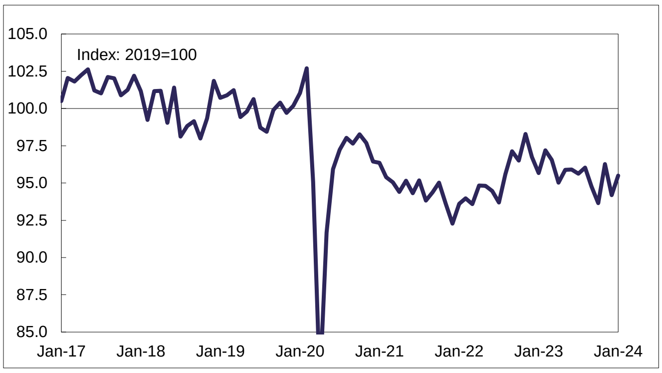
Today’s UK labour market data were a mixed bag, with some further signs of loosening countered by still sticky and elevated pay growth. When the ONS resumed the publication of its Labour Force Survey earlier this year it had reported a surprising decline in the unemployment rate during the second half of 2023 despite the economy having slipped into recession. But today’s figures saw the unemployment rate rise in the three months to February for a second successive month and by a larger-than-expected 0.2ppt to 4.2%. This marked a six-month high and was 0.6ppt above the trough in August 2022. Moreover, the pickup would have been greater in the absence of the further increase in economic inactivity to a twelve-year high, as the number of people in education and temporary sickness rose, while absence from the labour market due to long-term sickness was a new record high. While short-term unemployment remained firmly within the recent range, there was a further notable increase in those unemployed for twelve months or longer, suggesting that supply-side problems rather than soft demand might primarily be to blame. And, overall, the unemployment rate is still on track to be a touch below the BoE’s forecast for Q1 (4.4%) and below the BoE’s estimate of the equilibrium rate (4½%). Of course, the BoE’s projection and equilibrium rate estimate were based on the ONS’s experimental data rather than the updated LFS series. And today’s figures continued to be distorted by the smaller sample size up to the end of last year.

Euro area: Goods trade balance by country



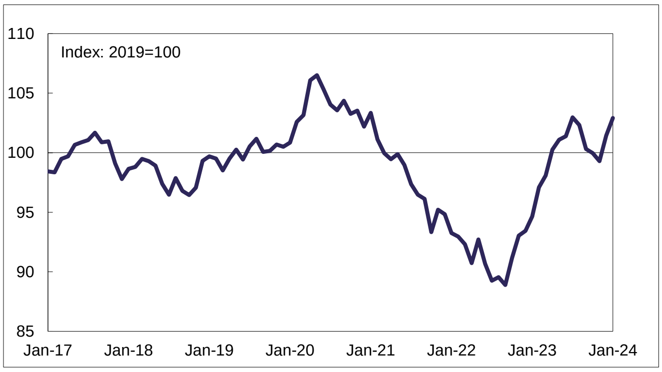
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Export share of global goods imports*



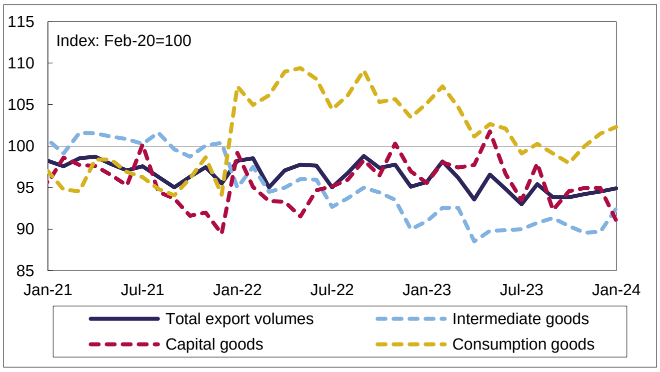
**Volume terms. Source: CPB, Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Terms of trade



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Export volumes by type of good



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

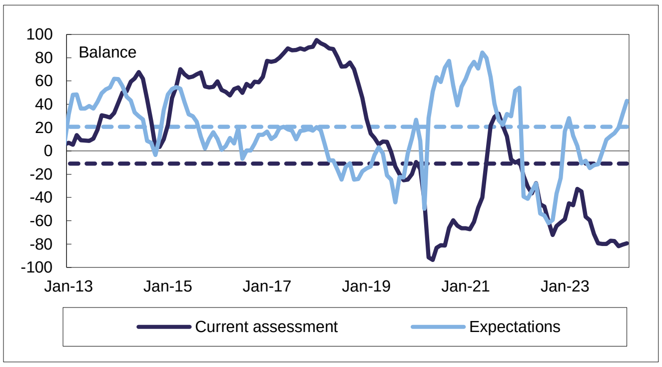
Employment declines sharply in February amid ongoing downtrend in job vacancies

While supply-side problems are certainly a key impediment to the functioning of the labour market, today's figures also suggested that labour demand continues to moderate, confirming a second successive quarterly drop in the LFS measure of employment, by a larger-than-expected 156k. And with the drop in three months to January also revised notably higher (by 68k to -89k), the number of people in employment was down 195k compared with a year ago and slipped back below the pre-pandemic benchmark. As such, the employment rate fell to 74.5%, the lowest since May 2021 and 1.7ppts below the pre-pandemic high. The drop in the three months to February again principally reflected a fall in the number of part-time workers. But there was also a marked slowdown in the rise in full-time employment over the past quarter, reflecting the first monthly decline in six. And while there remains some uncertainty regarding the true picture due to the low survey response rate up to December last year, other measures of employment, including HMRC's number of payrolled employees, similarly suggest that growth in job creation has slowed sharply. Certainly, the initial estimates for payrolled employees (which are admittedly often revised in the final release) reported a second monthly decline in March, by 66k – the most since November 2020 – to leave annual growth (0.7%Y/Y) the softest since April 2021. And while the number of job vacancies rose in March for the first month in 22 (up 6k to 916k), they maintained a downwards trend on a three-month basis for a 21st successive month and stood within 100k of the average level in the year before the pandemic. And so, there was a notable drop in the vacancy to unemployment ratio to its lowest since July 2021, further illustrating a less tight labour market.

Wages remains too high for BoE comfort with full impact of rise in National Living Wage to come

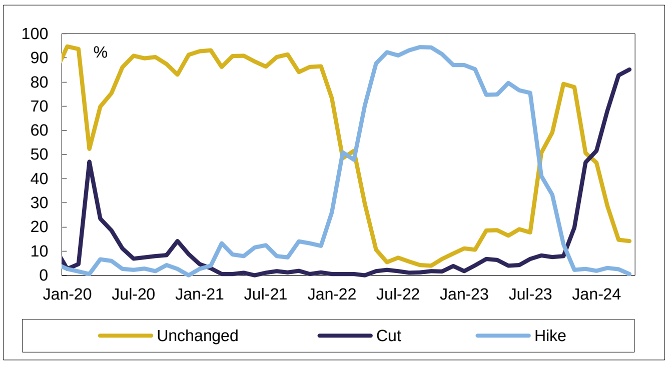
This notwithstanding, today's wage figures came in stronger than expected, suggesting ongoing persistence in pay pressures. Contrasting with expectations of a further easing in the three months to February, total wage growth moved sideways at 5.6%3M/Y, albeit the joint-softest reading since July 2022 and almost 3ppts below the peak last year. Admittedly, regular pay growth maintained a modest downtrend, falling 0.1ppt to 6.0%3M/Y, the lowest in seventeen months. Regular private sector pay growth – of particular interest to BoE policymakers in their assessments of domestically-driven inflationary pressures – also moderated 0.1ppt to 6.0%3M/Y, the softest for nineteen months, but nevertheless on track to exceed slightly the BoE's forecasts in its February Monetary Policy Report (5.7%3M/Y in Q1). And the pickup in wage momentum might unnerve some of the more hawkish members on the MPC: regular wage growth on a three-month annualised basis jumped 1.1ppts to 4.8% in February, the firmest for five months, with private sector regular pay up 0.9ppt to 4.4%, both some 4½ppts and 6ppts below the respective summer peaks but nevertheless above the long-run averages. Some of this increase might well reflect an early phasing in of the near-10% rise in the National Living Wage from the start of this month, although much of that impact has likely yet to be seen in the data. More encouragingly, however, HMRC's estimate of median pay

Germany: ZEW investor sentiment indices



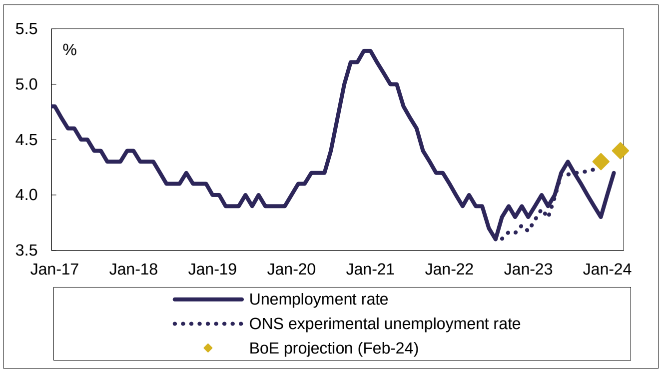
*Dashed lines represent long-run averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

ECB: ZEW survey interest rate expectations



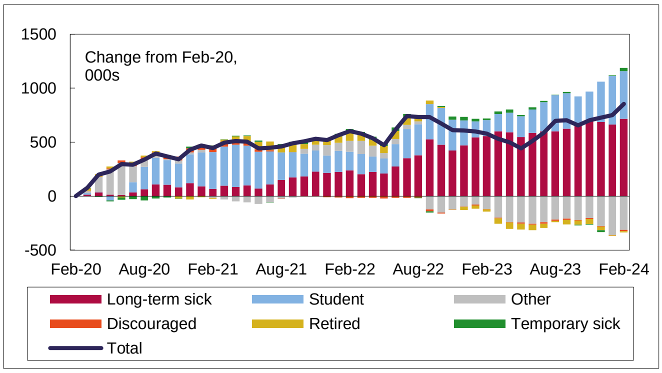
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Unemployment rate



Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Reasons for inactivity



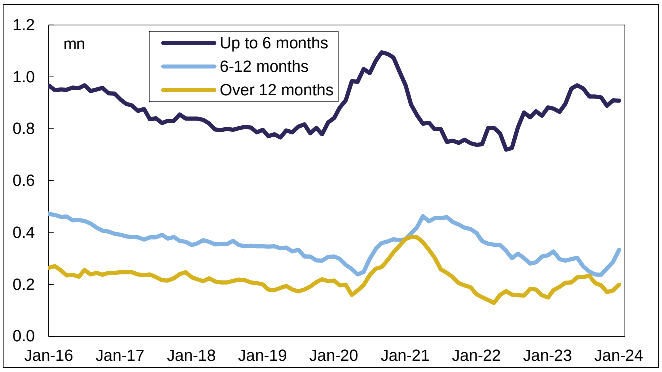
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

growth in March (5.6%Y/Y) dropped to its lowest since November 2021. And with wage growth typically lagging changes in the balance of labour demand and supply, the latest DMP survey results suggested that firms' expectations for wage growth over the coming year (4.7%Y/Y) have moderated to the lowest for almost two years.

The day ahead in the UK

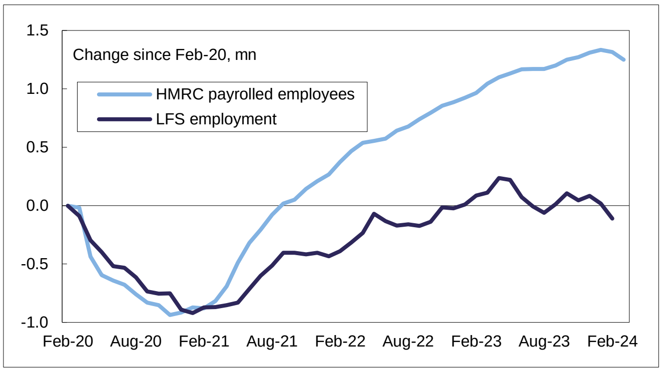
Like in the euro area, focus in the UK tomorrow will be on the March CPI report. After a pause in the downtrend around the turn of the year, we expect headline inflation to fall for a second successive month, by 0.2ppt to 3.2%Y/Y, which would be the lowest rate since September 2021 and almost 8ppts below the peak in October 2022. While the energy component will again likely add slightly to inflation due in part to higher petrol prices, we expect the other major components to more than offset that impact, with food inflation likely falling more than 1ppt to its lowest level since March 2022 and core goods inflation likely falling about ½ppt to the lowest since April 2021. Not least due to the early Easter holiday period this year, the downtrend in services inflation is likely to be more modest, easing only slightly from 6.1%Y/Y in February, which would be the softest rate since January 2023 but above the MPC's forecast. Overall, we expect core inflation to fall a further 0.3ppt to 4.2%Y/Y, which would be the lowest since December 2021.

UK: Unemployment by duration



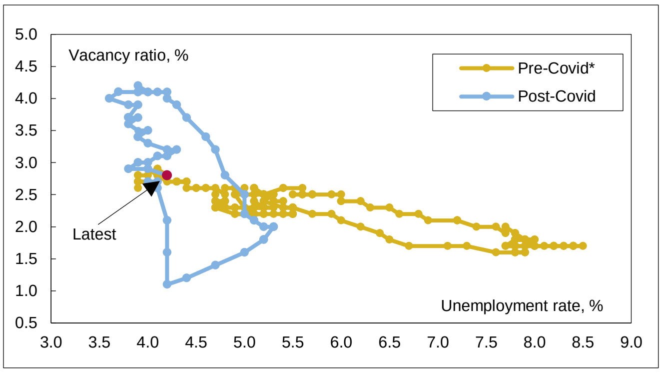
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Change in employment



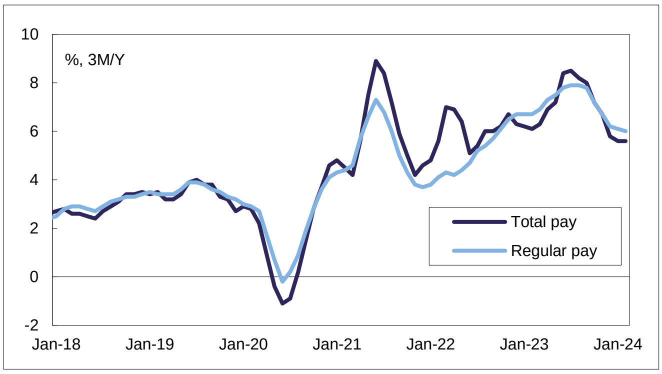
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Beveridge curve



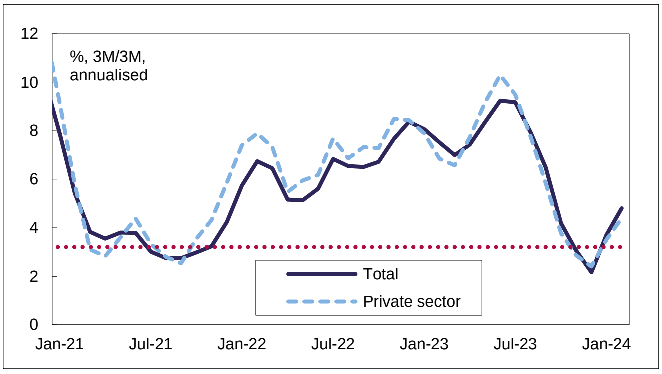
**2001-2020. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Wage growth



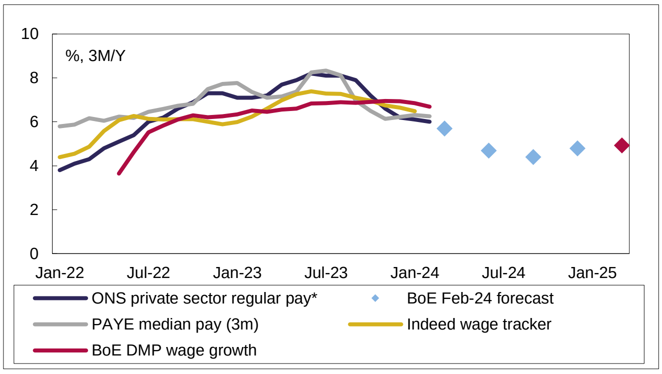
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Regular wage growth



**Dotted red line is 20-year average. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Wage growth & forecasts



**Data between January 2022 and November 2022 are BoE staff estimates of underlying private sector regular pay growth.. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

European calendar

Today's results

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Economic data							
Euro area		Trade balance €bn	Feb	**17.9**	-	28.1	27.1
Germany		ZEW current situation (expectations) balance	Apr	**-79.2 (42.9)**	-	-80.5 (31.7)	
Italy		Final headline HICP (CPI) Y/Y%	Mar	**1.2 (1.2)**	*1.3 (1.3)*	0.8 (0.8)	
UK		Average earnings including bonuses (excluding bonuses) 3M/Y%	Feb	**5.6 (6.0)**	5.5 (5.8)	5.6 (6.1)	-
		Unemployment rate 3M%	Feb	**4.2**	4.0	3.9	4.0
		Employment change 3M 000s	Feb	**-156**	72	-21	-89
		Payrolled employees, change 000s	Mar	**-67**	-	20	-18
		Claimant count 000s (rate %)	Mar	**10.9 (4.0)**	-	16.8 (4.0)	4.1 (-)

Auctions

Country		Auction
UK		sold £1.5bn of 0.75% 2033 index-linked bonds at an average yield of 0.44%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	Final headline HICP (core HICP) Y/Y%	Mar	*2.4 (2.9)*	2.6 (3.1)
UK		07.00	Headline (core) CPI Y/Y%	Mar	*3.2 (4.2)*	3.4 (4.5)
		07.00	PPI output prices (input prices) Y/Y%	Mar	0.6 (-2.9)	0.4 (-2.7)
		09.30	House price index Y/Y%	Feb	-	-0.6

Auctions and events

Euro area		14.00	ECB's Cipollone scheduled to speak at IIF Global Outlook Forum in Washington
		16.45	ECB's Schnabel scheduled to speak at a Fed International Research Forum on monetary policy
		19.00	ECB President Lagarde scheduled for a fireside chat at a Peterson Institute event
Germany		10.30	Auction: €1.0bn of 0% 2050 bonds
		10.30	Auction: €1.0bn of 2.5% 2054 bonds
UK		10.00	Auction: £3.75bn of 4% 2031 bonds
		17.00	BoE Governor Bailey scheduled to speak at IIF Global Outlook Forum in Washington

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

Access our research blog at:
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