Euro wrap-up

Overview

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- Bunds largely made modest gains as the detailed euro area inflation data for March suggested that the timing of Easter contributed to the stickiness of services pressures that month.
- Longer-dated Gilts also made gains even as UK inflation in March slightly exceeded the BoE's projection.
- Thursday will bring data for euro area construction output while figures for UK retail sales and German producer prices will be published the following day.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.945	+0.014
OBL 2.1 04/29	2.476	-0.006
DBR 2.2 02/34	2.468	-0.016
UKT 0⅛ 01/26	4.454	+0.004
UKT 0½ 01/29	4.194	-
UKT 4⅝ 01/34	4.274	-0.023

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

Euro area

Final inflation data for March confirm third consecutive decline

Today's final consumer price inflation figures for March aligned with the flash estimates that saw the headline HICP rate decline for a third consecutive month, by 0.2ppt to 2.4%Y/Y, matching November's 28-month low and leaving the rate some 8.2ppts below the peak in October 2022. As a result, the average inflation rate in Q1 (2.6%) was bang in line with the ECB's forecast published last month. But the drop in headline inflation would have been steeper in the absence of another rise in the energy component – up 1.9ppts to a ten-month high of -1.8%Y/Y to add around 0.2ppt to the headline rate – due to higher petrol and diesel prices as well as a smaller drag from household energy as government subsidies continued to be withdrawn. More encouragingly, the disinflationary trend in food, alcohol and tobacco was maintained, with that component down a slightly steeper-than-previously-estimated 1.3ppts to 2.6%Y/Y, the softest since November 2021 and almost 13ppts below the peak a year ago. Non-energy industrial goods prices were also better behaved, with the monthly increase (1.9%M/M) the softest in any March since the global financial crisis. As such, core goods inflation fell 0.5ppt to just 1.1%Y/Y, its lowest level since July 2021, with downwards pressure from clothing, furniture, second-hand cars and PCs.

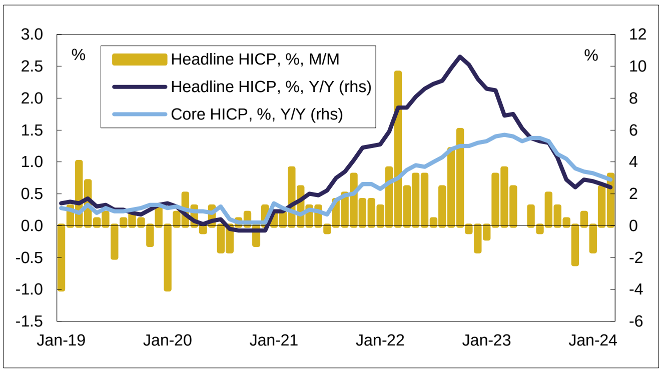
Stickiness in services component due principally to early Easter

In marked contrast to the data for goods prices, and of greatest importance for the ECB, services prices rose at an above-average pace for a third successive month in March. Indeed, the monthly rise in prices in that component (0.5%M/M) was the strongest in ten months. As a result, services inflation remained high and sticky, unchanged at 4.0%Y/Y, double the inflation target, for a fifth successive month, to account for roughly three-quarters of all euro area inflation. And on a seasonally adjusted basis, services price momentum picked up to 4.3%3M/3M annualised, the firmest in nine months. However, today's detail suggested that the early timing of Easter this year was key, with upwards pressures on airfares and accommodation offsetting modest disinflation in catering services.

Several measures of underlying inflation continue to trend lower

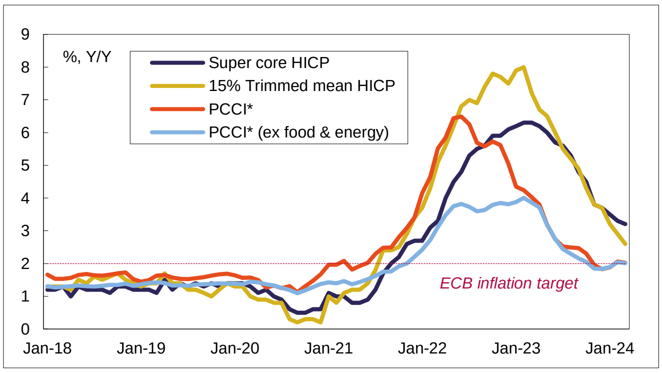
With services inflation steady but core goods inflation softer, overall core inflation moderated for an eighth successive month in March, by 0.2ppt to 2.9%Y/Y, its lowest level in more than two years. Other measures of underlying inflation consistent with a further downtrend in price pressures included the 15% trimmed mean HICP, which fell 0.3ppt to 2.6%Y/Y, the lowest since October 2021. And the persistent and common component of inflation (PCCI) – which the Governing Council believes can provide one of the more reliable guides to future inflation – eased back to just 2.0%3M/Y, consistent with the inflation

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected measures of underlying inflation



**Persistent and Common Component of inflation. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

target. Moreover, today's detail also showed that the share of the HICP basket with inflation at 2% or higher fell to 56% in March, some 35ppts below the peak at the start of 2023 and the lowest since November 2021.

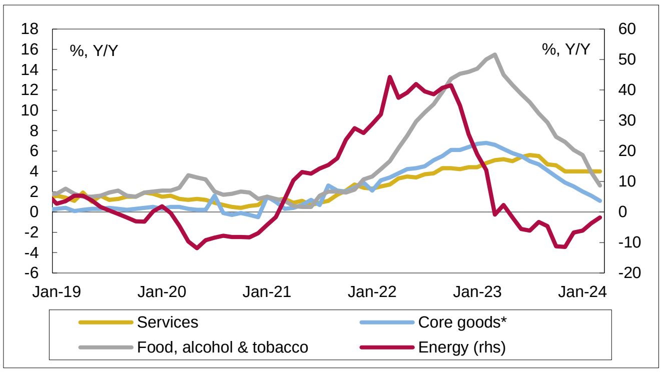
Inflation outlook still merits a first cut in June

Not least given firm wage growth, as well as the unpredictable path of energy prices given events in the Middle East, the near-term inflation outlook remains highly uncertain. However, we continue to expect both headline and core HICP inflation to maintain a downwards trend over coming months. Importantly, as the Easter effect reverses and also due to significant base effects, we expect services inflation to take a notable step down this month, to closer to 3.0%Y/Y, which would mark the lowest for more than two years. Restrained by lacklustre demand and soft global producer price pressures, core goods inflation should remain extremely subdued over coming quarters too. As such, we expect core inflation to move back close to 2.0%Y/Y by the summer, with our current expectation for Q2 below the ECB's most recent projection (2.5%Y/Y). So, while the path of inflation will remain choppy over coming quarter and energy is expected to maintain a positive impulse such that the ECB might well decide to revise slightly higher its near-term projection, we expect headline inflation to fall below the 2% target on a sustained basis from Q225. As such, we maintain our view that a first rate cut will come in June when the ECB next updates its macroeconomic projections.

The coming two days in the euro area

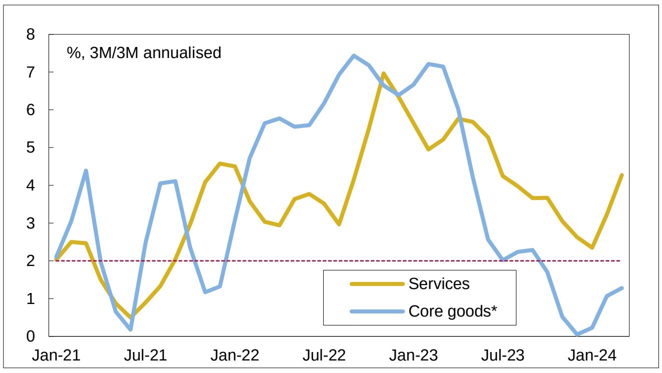
It should be relatively quiet for top-tier euro area data over the remainder of the week, with just figures for euro area construction output for February and new car registrations for March due tomorrow, followed by German producer price inflation for March on Friday. While French construction activity fell in February (-2.1%M/M) to its lowest level since December 2021, given the extreme weather-assisted surge in Germany (7.9%M/M), we expect euro area output to have risen for a third consecutive month. Based on figures published so far by member states – including Germany (-6.0%Y/Y), France (-1.5%Y/Y), Italy (-3.7%Y/Y) and Spain (-4.7%Y/Y) – euro area new car registrations are expected to have fallen compared to a year earlier in March. Meanwhile, German producer prices are expected to have risen in March for only the second month out of the past six due to a pickup in energy prices. Nevertheless, this would still leave the annual rate firmly in negative territory for a ninth consecutive month.

Euro area: Key HICP components



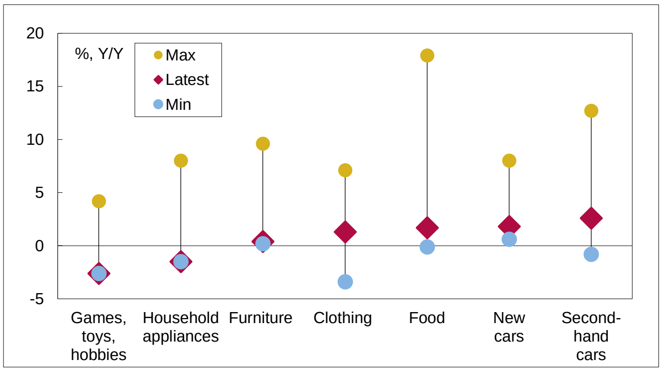
**Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Core inflation momentum



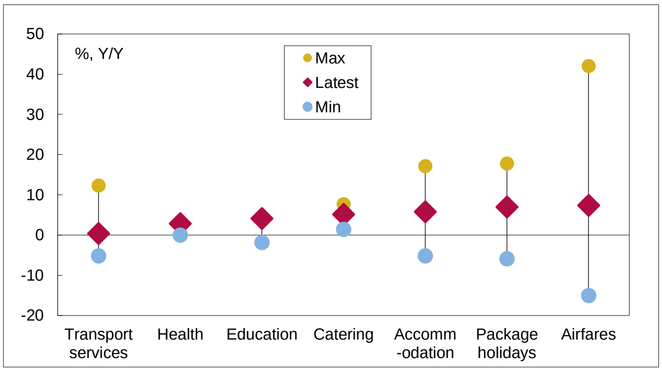
**Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Selected goods HICP components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected services HICP components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

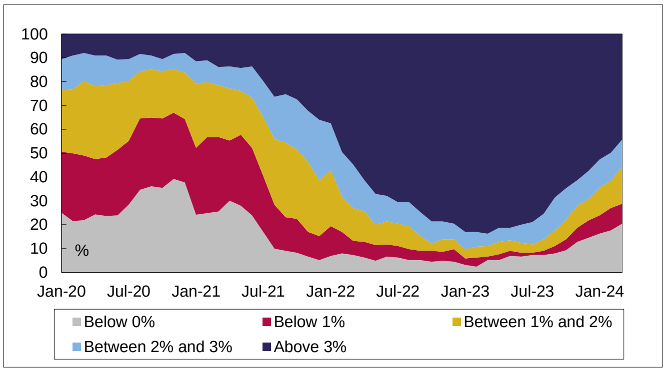
Inflation drops in March to lowest since September 2021 but exceeds BoE projection

CPI inflation fell 0.2ppt in March to 3.2%Y/Y, the lowest since September 2021 and a hefty 7.9ppts below the peak in October 2022. That was bang in line with our forecast, but 0.1ppt above the BoE projection and Bloomberg survey median, initially prompting a negative reaction for Gilts. However, the drop in inflation would have been greater had it not been for higher prices of petrol and diesel, which slowed the pace in decline in energy prices to the softest in six months (-12.7%Y/Y) and added almost 0.1ppt to the headline CPI rate. And, beyond that category, relatively broad-based disinflation continued. Reflecting the global trend, goods accounted for three quarters of the decline in inflation from February. The food component fell 1.1ppts to 3.9%Y/Y, the lowest since November 2021. And with lower prices of clothing, furniture and household goods more than offsetting increases in mobile phones and toys and games, inflation of core goods slowed 0.4ppt to 1.5%Y/Y, the lowest in almost three years. Services inflation also fell in March, albeit by just 0.1ppt to 6.0%Y/Y. So, in line with our forecast, that pushed core inflation down 0.3ppt to 4.2%Y/Y, the lowest since December 2021 albeit still seemingly 0.1ppt above the BoE's expectation.

Services boosted by special factors, other measures point to easing underlying pressures

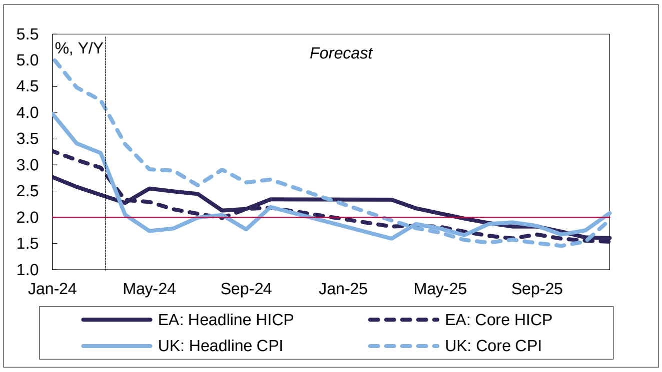
With the MPC having singled out services inflation as a key variable in its reaction function, the limited decline in that component in March will have been disappointing for those hoping for an early rate cut. Indeed, services inflation last month was 0.2ppt above the BoE's projection. However, on average in Q1 it matched the BoE's expectation (6.0%Y/Y). And the detail suggested that certain special factors played a role in keeping it so elevated. For example, a pickup in hotel inflation (up 0.9ppt to a four-month high of 5.4%Y/Y) likely reflected the early timing of Easter this year, while rail inflation remained relatively sticky due to a near-5%M/M increased in regulated fares. Admittedly, the air fare component was surprisingly soft, falling into negative territory (-1.1%Y/Y) raising the risk of payback in April and May. But not least given significant base effects and lower indexation of certain items this year than last, the BoE, like us, will still expect services inflation to fall over the second quarter to about 5%Y/Y by June. And despite a likely further impulse from petrol prices, headline inflation will drop significantly further too. In part, that will reflect the 12% cut in the OFGEM regulated energy price cap this month. Indeed, while petrol prices will likely inject new pressure, headline CPI inflation should still drop close to 2.0% in Q2. And while it will likely tick slightly higher during H224, we expect it to fall back below target from the start of 2025.

Euro area: Share of basket by inflation rate



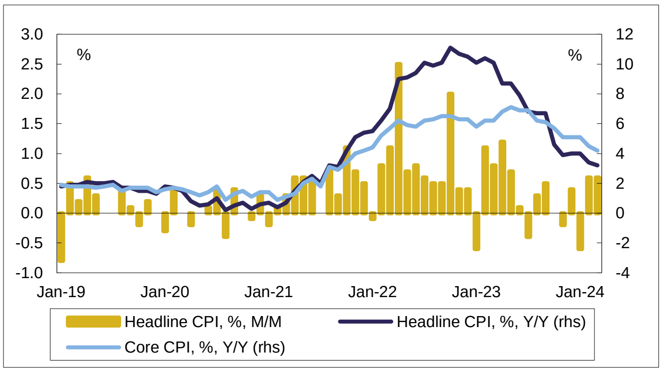
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area & UK: Inflation forecasts



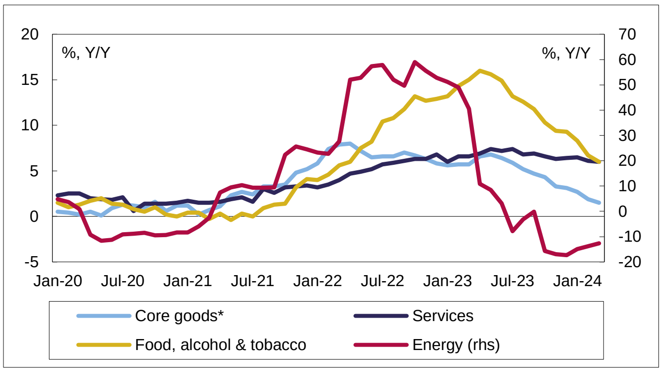
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Key CPI components



**Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

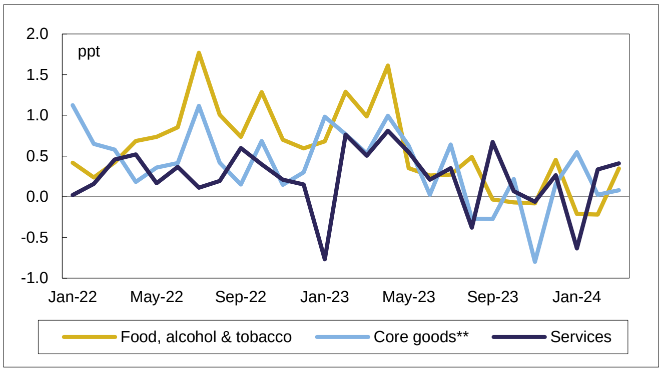
BoE could nudge down inflation forecast in May, but first rate cut unlikely to come before June

Despite higher oil prices, due to the upwards shift in the yield curve over recent weeks, in its May Monetary Policy Report the BoE might yet nudge down its inflation projection based on the market-implied path for rates. However, we doubt that these revisions will prompt a majority on the MPC to vote for a first rate cut that month. Certainly, signs of renewed momentum in private sector pay flagged in yesterday's labour market figures will have provided a reminder of the potential upside risks to services inflation. The Committee will also likely want to wait to see the impact on average labour earnings and prices of the near-10% increase in the National Living Wage from the start of this month. Signs that the economy emerged from recession in the first quarter will also add to the case that the Committee can wait a little longer before pulling the trigger. However, Governor Bailey's view that the risks of second-round inflation effects have now diminished should be shared by a majority of MPC members. And the additional inflation and labour market data due to be published before the policy meeting on 20 June should reassure the majority that the underlying disinflation continues despite the rise in the National Living Wage. So, while we acknowledge the possibility that the MPC might wait until August, in the absence of any nasty surprises in the data-flow we maintain our view that the first cut will come in June.

The coming two days in the UK

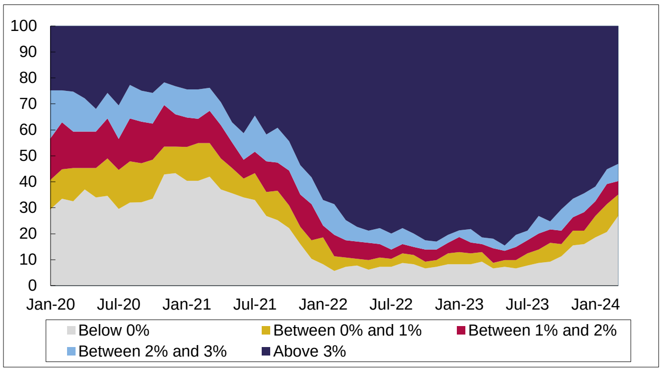
After a day bereft of UK releases tomorrow, Friday will bring retail sales figures for March. While the BRC's retail monitor suggested that wet weather had dampened demand for garden furniture, BBQs and clothing, the survey also signalled a pickup in food sales ahead of the Easter holiday. And so, having moved sideways in February, sales are expected to have risen in March, by as much as ½%M/M, which would leave them on average in Q1 some 2% above the Q4 average. Aside from the data, BoE Deputy Governor Ramsden is scheduled to participate in a panel discussion at a Peterson Institute event.

UK: Deviations from long-run price change*



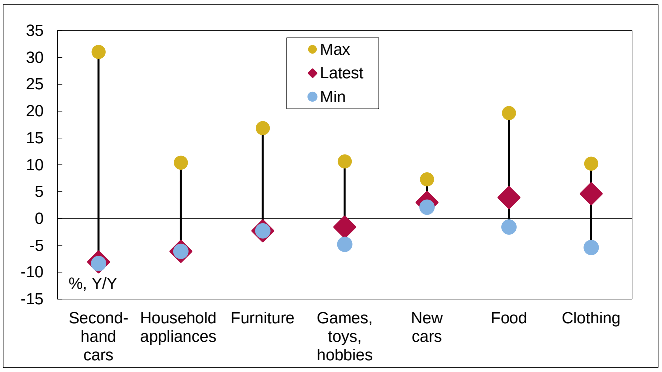
*Monthly change in prices compared to average for the month in the decade before the pandemic. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Share of CPI basket by inflation rate



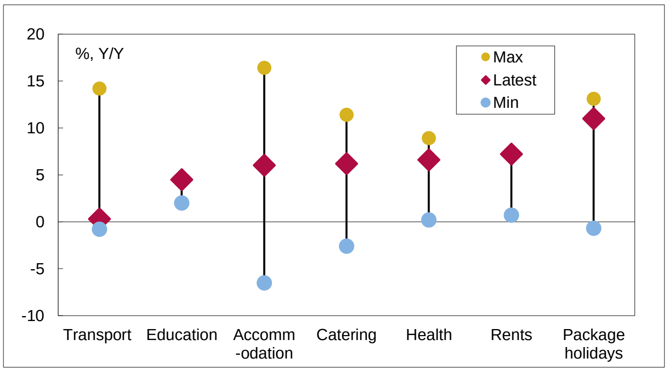
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected goods CPI components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected services CPI components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 19 April 2024

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Final headline HICP (core HICP) Y/Y%	Mar	**2.4 (2.9)**	*2.4 (2.9)*	2.6 (3.1)	-
UK		Headline (core) CPI Y/Y%	Mar	**3.2 (4.2)**	*3.2 (4.2)*	3.4 (4.5)	-
		PPI output prices (input prices) Y/Y%	Mar	**0.6 (-2.5)**	0.6 (-2.9)	0.4 (-2.7)	-
		House price index Y/Y%	Feb	**-0.2**	-	-0.6	-1.3

Auctions

Country		Auction
Germany		sold €805mn of 0% 2050 bonds at an average yield of 2.58%
		sold €803mn of 2.5% 2054 bonds at an average yield of 2.62%
UK		sold £3.75bn of 4% 2031 bonds at an average yield of 4.218%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		07.00	EU27 new car registrations Y/Y%	Mar	-	10.1
		10.00	Construction output M/M% (Y/Y%)	Feb	-	0.5 (0.8)

Auctions and events

Country		BST	Event
France		09.50	Auction: To sell 2.5% 2027 bonds
		09.50	Auction: To sell 0% 2027 bonds
		09.50	Auction: To sell 2.75% 2030 bonds
		09.50	Auction: To sell 0% 2027 bonds
		09.50	Auction: To sell 2.5% 2032 bonds
		10.50	Auction: To sell 0.1% 2029 index-linked bonds
		10.50	Auction: To sell 0.6% 2034 index-linked bonds
		10.50	Auction: To sell 0.55% 2039 index-linked bonds
		10.50	Auction: To sell 0.1% 2039 index-linked bonds
Spain		09.30	Auction: To sell 2.5% 2027 bonds
		09.30	Auction: To sell 1.95% 2030 bonds
		09.30	Auction: To sell 3.25% 2034 bonds
		09.30	Auction: To sell 3.45% 2066 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		07.00	PPI Y/Y%	Mar	-3.2	-4.1
UK		07.00	Retail sales, including auto fuel M/M% (Y/Y%)	Mar	0.3 (1.0)	0.0 (-0.4)
		07.00	Retail sales, excluding auto fuel M/M% (Y/Y%)	Mar	0.4 (1.0)	0.2 (-0.5)

Auctions and events

Country		BST	Event
UK		15.15	BoE Deputy Governor Ramsden scheduled to speak on a panel at a Peterson Institute event

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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