Euro wrap-up

Overview

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- Bunds followed USTs higher, while unemployment figures illustrated the ongoing resilience in the euro area's labour market.
- Gilts also made gains on a quiet day for top-tier UK releases.
- The coming week will see the BoE leave Bank Rate unchanged, but likely revise down its inflation projection, while the first estimate of Q1 GDP is expected to have exceeded the BoE's previous forecast. Euro area retail sales and German industrial production figures are also due, along with the ECB's account from the April Governing Council meeting.

Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.927	-0.053
OBL 2.1 04/29	2.525	-0.044
DBR 2.2 02/34	2.507	-0.032
UKT 0⅛ 01/26	4.348	-0.062
UKT 0½ 01/29	4.105	-0.065
UKT 4⅝ 01/34	4.230	-0.055

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

UK

BoE moving closer to a rate cut but not there yet

The main event in the coming week will be the BoE's monetary policy decision on Thursday, which will be accompanied by the publication of its updated macroeconomic projections in the May Monetary Policy Report. At the previous meeting in March, for the first time since September 2021, no one on the MPC voted for a rate hike, suggesting that the mood on the Committee is becoming more dovish. However, the MPC's updated projections are highly unlikely to provide sufficient comfort for a rate cut this month and the MPC seems bound to leave Bank Rate unchanged at 5.25% for a seventh successive meeting. Nevertheless, the policy statement and press conference should make it clear that, as far as the majority of its members are concerned, the Committee is gradually moving closer to easing policy. Indeed, the possibility of a rate cut as soon as June is unlikely to be explicitly ruled out.

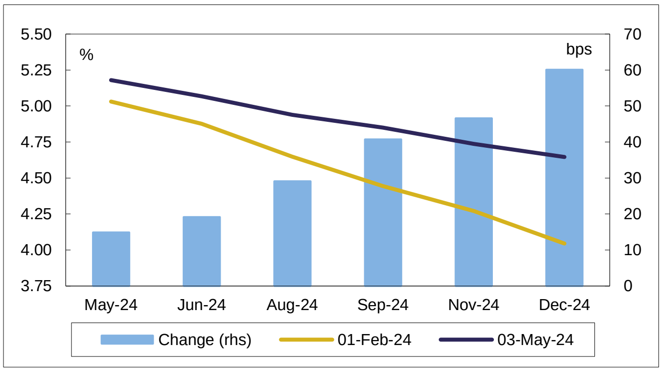
Market-implied path of interest rates has shifted significantly higher since February

The MPC's decision and MPR publication come at a difficult time for the BoE, being the first since the review by former Fed Chair Bernanke of the BoE's forecasting processes. Bernanke was highly critical and made several recommendations with respect to how the Bank produces its projections, as well as advising that it cease publication of its projection fan-charts and instead conduct analysis of alternative scenarios. However, Governor Bailey intends to consider and implement those recommendations only gradually over time, so we assume that there will not be significant changes yet to the nature and presentation of the MPC's updated projections in the forthcoming MPR. Importantly, however, since the last MPR, the market-implied path for Bank Rate has shifted significantly higher, a move that will have a significant impact on the MPC's baseline projection however it is presented. Indeed, while the baseline projection in February assumed that Bank Rate would be cut by 100bps in 2024 and about 75bps further in 2025, a similar convention this time around would imply only around 50bps of cuts by year-end and perhaps no more than 100bps two years' ahead. An assumption of such a higher path for interest rates should have a material impact on the BoE's baseline projection. Other things being equal, the higher path for rates would imply a significantly softer profile for both GDP and inflation.

MPC to revise up its near-term GDP growth projection

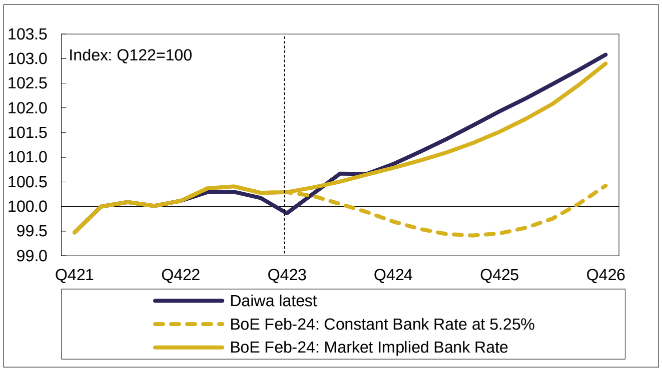
Despite the upward shift in the market-implied path for Bank Rate, however, the MPC is likely to revise up its projected near-term profile for GDP growth. Admittedly, the contraction of economic output in Q4 (-0.3%Q/Q) was a much weaker performance than the BoE's baseline projection of a flat quarter. However, while the early timing of Easter this year might have adversely affected activity in March, data due on Friday should reveal that GDP grew at least 0.3%Q/Q in Q1, which

UK: Market-implied path for Bank Rate



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: GDP forecast



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

would be the strongest rate in two years and 0.2ppt above the BoE's previous baseline projection. Moreover, with today's final services PMIs suggesting that economic recovery momentum gained further traction in April – with the composite output index confirmed at a twelve-month high of 54.1 – GDP growth in the current quarter might be as strong as in Q1, again surpassing the MPC's market-based projection of 0.1%Q/Q. So, the level of GDP at the end of Q2 could be 0.2% above that previously projected by the Committee. And with real household disposable incomes supported by cuts to National Insurance Contributions and the Ofgem energy price cap at the start of April, the housing market looking more resilient to past rate hikes, and external demand firmer than previously anticipated, the MPC's updated projection of economic growth this year seems bound to exceed the BoE's previous baseline forecast of just ¼%Y/Y, perhaps by up to ½ppt. The case for revising up the growth projection for 2025 (previously ¾%) looks weaker, however. And the MPC should still judge that full-year growth will remain below the economy's potential rate, and so a degree of spare capacity should still emerge, helping wage and price pressures to dissipate further.

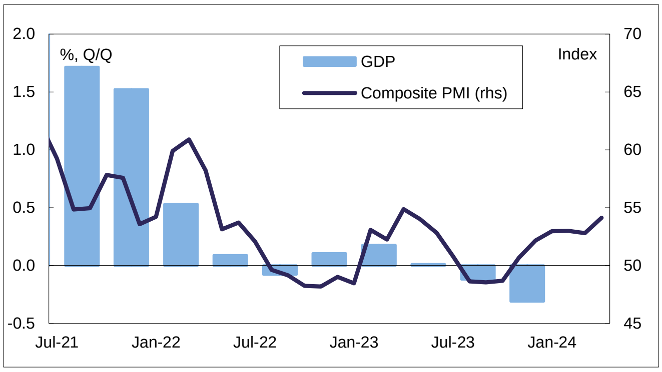
Labour market, wages and prices broadly in line with MPC's projection in Q1

While the profile of GDP is important to the MPC, the underlying tightness of the labour market, wage growth and services price inflation will remain the most important variables in its reaction function for determining the future path of Bank Rate. Due to data inadequacies and the use of new methodologies, the condition of the jobs market has been difficult to gauge with any confidence. But while it has appeared to loosen, Governor Bailey recently judged that it was still broadly consistent with 'full employment', and the MPC will likely still judge it to be relatively tight by historical standards. Nevertheless, while there is significant uncertainty about the impact of the approximately 10% rise in the National Living Wage in April, private sector wage growth appears to be moderating broadly in line with the MPC's projection. And while headline inflation (3.2%Y/Y) and the services component (6.0%Y/Y) in March slightly exceeded the MPC's projection, special factors including the timing of Easter likely played a role. Moreover, the respective Q1 average rates were consistent with the BoE's expectation.

Inflation should fall below target in Q2 but rebound somewhat in H224

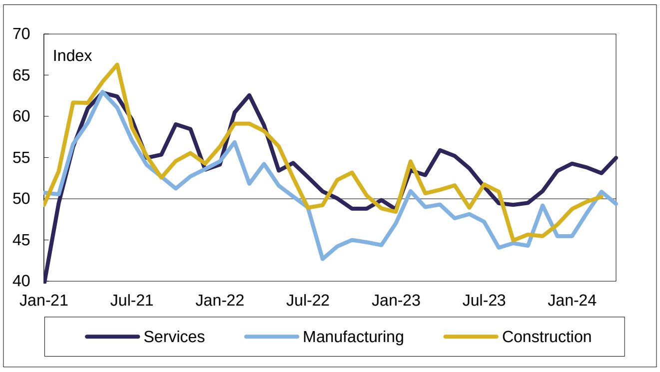
Looking ahead, the MPC's updated projections will need to accommodate the changes to duty announced in the Government's March Budget, notably the cancellation of the planned 5p increase in fuel duty and a delay to the planned uprating of alcohol duties, which together will subtract about 0.2ppt from the inflation forecast for twelve months from April but add about 0.1ppt to the projection from March 2025. And while the PMIs reported a pickup in input costs at the start of

UK: GDP growth & composite output PMI



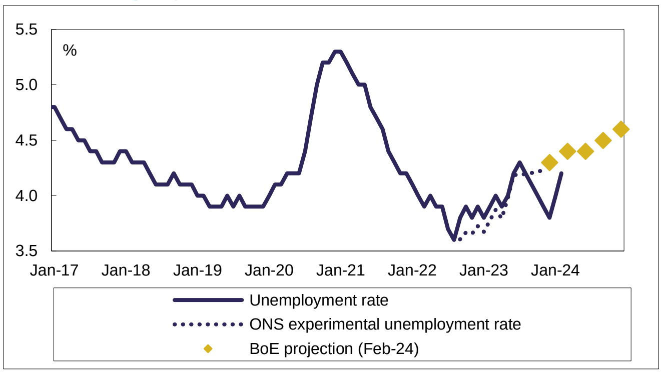
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Output PMI indices



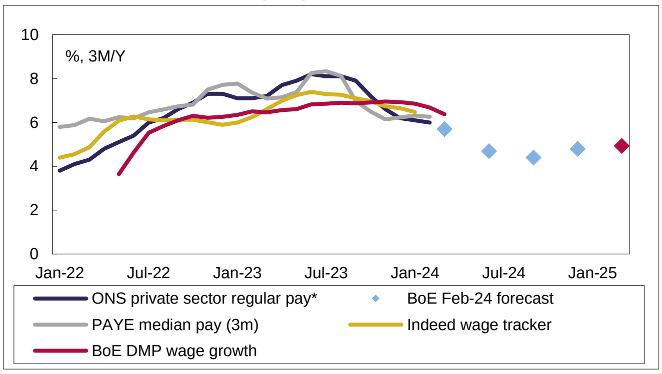
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Unemployment rate*



**BoE projection based on previous ONS experimental figures. Source: BoE, ONS, Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Measures of wage growth



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

Q2 in part likely reflecting the rise in the minimum wage – with most notably the services PMI component up more than 3½pts to an eight-month – the survey also signalled limited pass-through to consumers, with the respective prices charged index easing to its lowest in three years. Moreover, given the marked cut in the regulated energy price cap in April, inflation is still likely to fall below the 2.0% target this quarter and perhaps also below the BoE's most recent projection. The Ofgem price cap currently looks likely to be cut further in July – perhaps by more than 7% – which should help limit the rise in inflation back above target in Q3 that the MPC previously anticipated. Nevertheless, given recent market moves, the price cap would seem likely to be hiked again in October. And with crude oil prices currently implied by the markets to remain higher for longer than the MPC assumed in February, inflation might be expected to pickup in Q4.

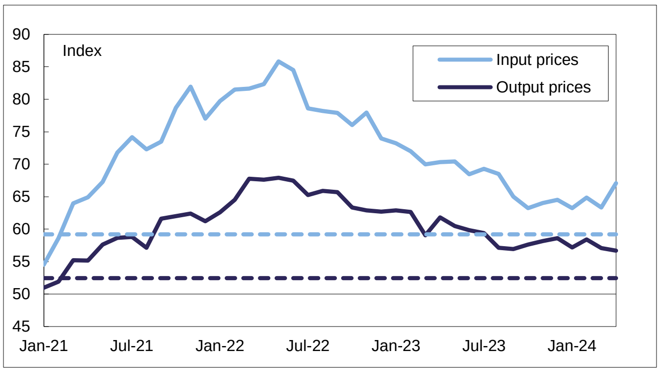
Opinion on MPC to remain split, but new projection should reduce extent of inflation persistence

Thereafter, however, the path of inflation will depend on the extent of wage and price persistence. At the time of the previous MPC meeting in March, there were significant differences of opinion among MPC members about the risks of persistent inflationary pressures. While some saw evidence to support diminishing risks of second-round effects, the more hawkish members were still concerned that wage growth remained too high and that services inflation would not fall sufficiently rapidly. And given some lingering upside risks, the majority of members had wanted to see further evidence of fading inflation persistence before being ready to advocate a shift in monetary policy. Recent comments by BoE Chief Economist Pill suggest that, in his opinion, the outlook for policy has not materially changed since March, stating that he is yet to be convinced that the persistent momentum in underlying inflation has stabilised and considering that 'the time for cutting Bank Rate remains some way off'. But Deputy Governor Ramsden recently signalled greater confidence that the upside risks to domestic inflationary pressures are receding. And Governor Bailey has certainly become less concerned about second-round effects on inflation from the labour market, judging that the UK price outlook is more aligned with the current disinflationary profile of the euro area rather than the inflation persistence of the US. As we suspect that Deputy Governor Broadbent will share that view, we see a strong probability that the MPC will this month remove the upside skew and reduce the extent of inflation persistence built into its projection. And on the assumption of the current market-implied path for Bank Rate, we see a significant probability that the MPC will project inflation to fall below target over the policy horizon, a profile that might normally call for an easing of policy.

Door to a June cut shouldn't be closed, but MPC majority might wish to wait for August projections

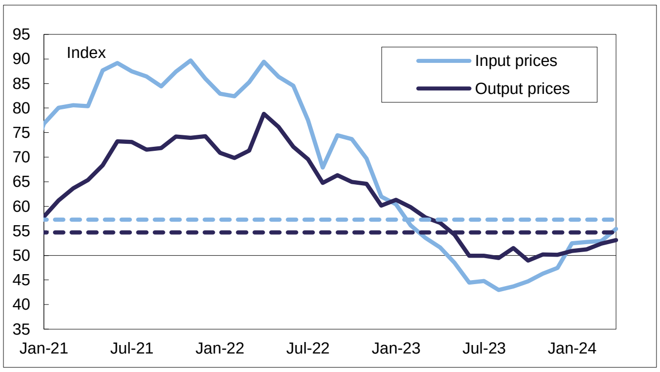
With the damning Bernanke review possibly making the Bank more risk averse, however, like the ECB's Governing Council last month, the majority on the BoE's MPC is highly likely to conclude that wage growths and services inflation remains too high to allow for a rate cut this month. Indeed, while there is a possibility that Ramsden might join Dhingra in supporting

UK: Services price PMIs*



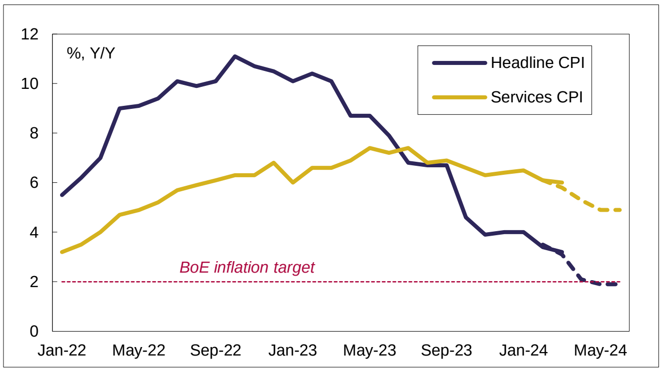
Dashed lines are pre-pandemic long-run averages. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing price PMIs*



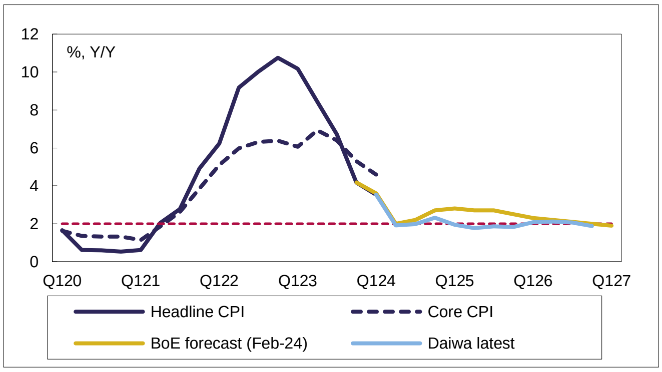
Dashed lines are pre-pandemic long-run averages. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Headline & services inflation*



Dashed lines represent BoE forecast from Feb-24 MPR. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Inflation forecast*



BoE projection based on marker-implied interest rates. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

some monetary easing, another 8-1 vote in favour of the status quo remains likely. Nevertheless, if forthcoming data suggest that the rise in the National Living Wage in April has not injected new inflationary momentum, then we still see scope for a first cut as soon as June. But we also recognise that a further round of projections in August might be required to seal the deal.

The data week ahead in the UK: Q1 GDP set to confirm a return to positive growth

The data highlight in the UK in the coming week will be the aforementioned preliminary estimate of Q1 GDP on Friday, which will be accompanied by the monthly GDP indices for March. While certain services sectors – including restaurants, accommodation, travel and tourism – might well have benefitted from stronger demand related to the earlier timing of Easter this year, retail sales were merely flat in March, while new car registrations were also weak. Meanwhile, industrial production is expected to have edged lower that month, reflecting not least a drop in car production. And while construction might well see some bounce back from the weather-dampened drop in February (-1.9%M/M), overall monthly GDP is expected to have moved broadly sideways in March. Nevertheless, given the jump in GDP in January, this would still leave economic output up as much as 0.4%Q/Q in Q1, which would mark the strongest growth for two years, and some 1.4% above the pre-pandemic level.

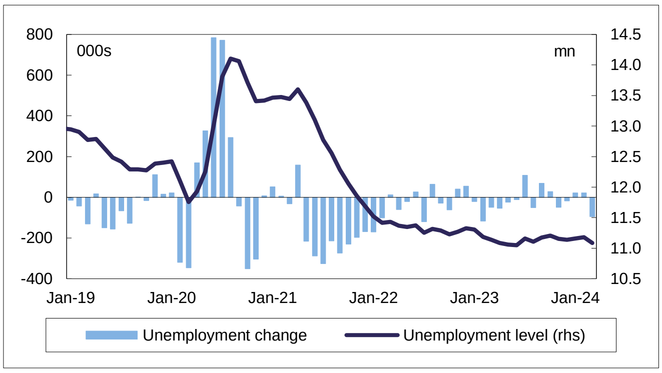
The results from the BoE's Decision Maker Panel survey (Thursday) will also feed into the MPC's policy discussions, with attention on firms' expectations for inflation and wage growth. In March, firms' expectations for output price inflation in twelve months' time eased to the lowest since August 2021. But while one-year ahead wage growth expectations also fell to a near-two-year low, firms' judgement for inflation three years ahead moved sideways for third month at 2.7%Y/Y, nevertheless still more than 2ppts below the peak in September 2022. The REC/KPMG report on jobs (Tuesday) will also provide insight into labour market conditions at the start of Q2 and likely to signal further weakening in labour demand and moderating pay pressures. Other April surveys due in the coming week include the BRC retail sales monitor and construction PMIs (Tuesday) and the RICS residential indices (Thursday).

Euro area

Euro area unemployment rate remains at series low

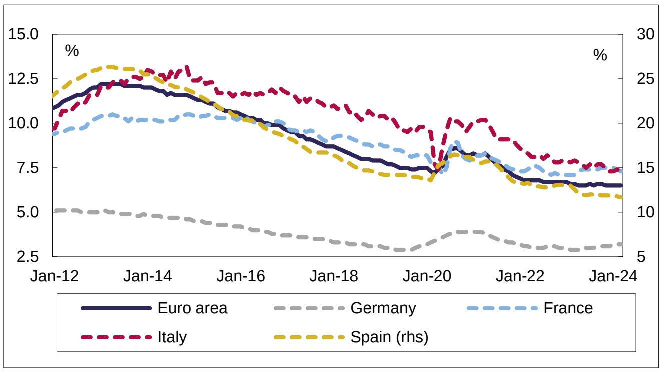
While economic output moved broadly sideways in the five quarters to Q423, the euro area's labour market remained remarkably resilient through the second half of last year as firms appeared to hoard labour in anticipation of a recovery in demand. And tallying with the more encouraging GDP release earlier this week, which saw a return to positive growth in Q1,

Euro area: Unemployment



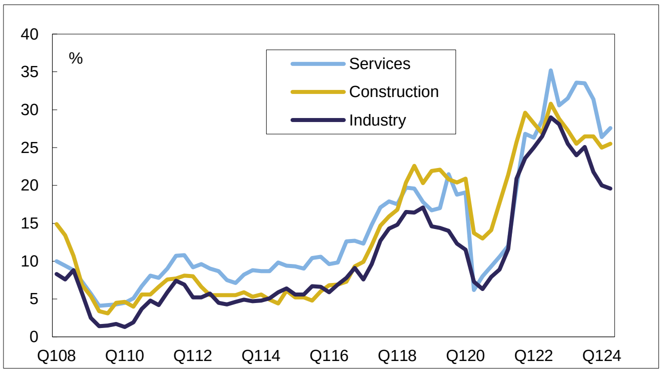
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Unemployment rates



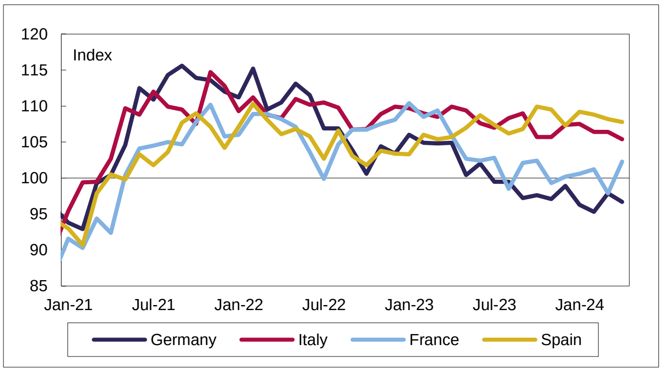
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Labour shortages as a limiting factor



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

Euro area: Employment expectations indices



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

today's figures saw the number of unemployed people fall for the first month in three in March, by 94k – the most in 13 months – to 11.087mn. This was only slightly above the record low reached last summer (11.049mn), and some 51k lower than a year ago to leave the jobless rate in March unchanged at a series-low 6.5% for a fifth consecutive month. The improvements were led by southern Europe, where economic growth momentum has been more positive. Indeed, the drop in unemployment was largest in Italy (-53k), taking the jobless rate down 0.2ppt to 7.2%, the lowest for fifteen years. There was also another decline in Spain (-13k), where the unemployment rate eased 0.1ppt to 11.7%, the lowest since mid-2008, while the Greek rate dropped 0.6ppt to 10.2%, similarly the lowest since the global financial crisis. The respective French unemployment rate also dropped 0.1ppt to an eleven-month low of 7.3%. In contrast, the number of people out of work in Germany rose for an eleventh successive month in March, albeit leaving the respective unemployment rate unchanged at 3.2%.

But employment expectations deteriorate at start of Q2

The near-term employment outlook remains somewhat uncertain. While Germany's national claimant count rate was also unchanged for a fifth successive month in April (at 5.9%), the number of job vacancies fell to 710k, the lowest since June 2021. Admittedly, vacancies remain broadly in line with the average in the five years ahead of the pandemic and the share of German firms willing to hoard labour remained well above the long-run average in April (14.8%), suggesting the labour market should remain broadly stable over coming months. Nevertheless, the share of euro area firms reporting labour shortages as a restraining factor on output continued to fall steadily in the manufacturing sector at the start of Q2, with the equivalent shares for services and construction also well below the peak in 2022. So, according to the latest European Commission survey, with the exception of France, firms across the larger member states were more downbeat about employment expectations in April. Indeed, the aggregate euro area index was the lowest for three years in April, more than 3% below the 2023 average and 7% below the 2022 average. So, while negotiated wage growth in Germany has risen over recent months – in part reflecting one-off payments to compensate for recent high inflation – we continue to expect pay pressures to moderate over coming quarters as workers prioritise job security over wage growth.

The week ahead in the euro area: ECB account, euro area retail sales & German IP data due

While the first estimate of euro area GDP in Q1 saw growth rise a stronger-than-expected 0.3%Q/Q, we will have to wait until June to see which expenditure components underpinned the recovery at the start of the year. The coming week's euro area retail sales figures for March (due Tuesday) will, however, provide some insights into consumer spending at the end of the first quarter. Tallying with the recent improvement in consumer confidence and a solid increase in sales in Germany (1.8%M/M), aggregate euro area retail sales are expected to have risen in March, by around 1.0%M/M. But having moved sideways in January and declined in February, this would leave spending on goods broadly unchanged over the first quarter as a whole. Admittedly, surveys suggest that demand for services picked up in Q1. And the final April services PMIs (Monday) are expected to confirm accelerated recovery momentum at the start of Q2 – indeed, the flash release saw the services activity index rise to an eleven-month high (52.9), with the composite output PMI similarly up to the highest since last May, at 51.4. Meanwhile, the construction PMIs for April will be published for the first time on Tuesday.

At the country level, the coming week's data flow will be focussed on the manufacturing sector, with the most notable releases to be German factory orders and industrial production figures for March (Tuesday and Wednesday respectively). With orders set to remain lacklustre at the end of Q1 and given the likely payback for the surge in construction activity in February, total IP is expected to have fallen around 1.0%M/M, but nevertheless leaving it up 1.0%3M/3M in Q1. Industrial production data from Italy (Friday), Spain (Wednesday) and Ireland (Thursday) – for which the latter often have a significant bearing on aggregate euro area output – are also due. Meanwhile, aside from the data, the publication on Friday of the account from the ECB's Governing Council meeting from 10 April will be watched closely.

Daiwa economic forecasts

	2024 Q1	2024 Q2	2024 Q3	2024 Q4	2025 Q1	2025 Q2	2023	2024	2025
GDP	%, Q/Q						%, Y/Y		
Euro area	0.3	0.2	0.2	0.3	0.3	0.4	0.5	0.6	1.3
UK	0.4	0.2	0.3	0.2	0.2	0.3	0.1	0.5	1.0
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.6	2.4	2.2	2.8	2.5	2.1	5.4	2.5	1.8
Core HICP	3.1	2.3	2.1	2.5	2.1	1.8	4.9	2.3	1.7
UK									
Headline CPI	3.5	1.9	2.0	2.3	2.0	1.8	7.3	2.4	1.9
Core CPI	4.6	3.1	2.8	2.8	2.3	1.7	6.2	3.3	1.8
Monetary policy, %									
ECB									
Deposit Rate	4.00	3.75	3.50	3.25	3.00	3.00	4.00	3.25	2.25
Refi Rate	4.50	4.25	3.65	3.40	3.15	3.15	4.50	3.40	2.40
BoE									
Bank Rate	5.25	5.00	4.75	4.50	4.25	4.25	5.25	4.50	3.50

Source: Bloomberg, ECB, BoE 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	Unemployment rate %	Mar	**6.5**	6.5	6.5	-
France	Industrial production M/M% (Y/Y%)	Mar	**0.7 (-0.3)**	0.3 (1.3)	0.2 (-0.8)	- (-0.6)
UK	Final services (composite) PMI	Apr	**55.0 (54.1)**	54.9 (54.0)	53.1 (52.8)	-

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK	Nationwide house price index M/M% (Y/Y%)	Apr	**-0.4 (0.6)**	0.1 (1.2)	-0.2 (1.6)	-
	Final manufacturing PMI	Apr	**49.1**	*48.7*	50.3	-

Auctions

Country	Auction
UK	sold £3.75bn of 4.625% 2034 bonds at an average yield of 4.371%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

The coming week's data calendar

The coming few week's key data releases

Country	BST	Release	Period	Market consensus/ _Daiwa forecast/actual_	Previous
		Monday 06 May 2024			
Euro area	09.00	Final services (composite) PMI	Apr	_52.9 (51.4)_	51.5 (50.3)
	10.00	PPI Y/Y%	Mar	-7.7	-8.3
	10.00	Sentix investor confidence index	May	-5.2	-5.9
Germany	08.55	Final services (composite) PMI	Apr	_53.3 (47.7)_	50.1 (50.5)
France	08.50	Final services (composite) PMI	Apr	_50.5 (49.9)_	48.3 (48.3)
Italy	08.45	Services (composite) PMI	Apr	54.6 (53.3)	54.6 (53.5)
Spain	08.00	Unemployment change 000s	Apr	-	-33.4
	08.15	Services (composite) PMI	Apr	56.0 (55.1)	56.1 (55.3)
		Tuesday 07 May 2024			
Euro area	08.30	Construction PMI	Apr	-	42.4
	10.00	Retail sales M/M% (Y/Y%)	Mar	0.7 (-0.2)	-0.5 (-0.7)
Germany	07.00	Factory orders M/M% (Y/Y%)	Mar	0.4 (-0.7)	0.2 (-10.6)
	07.00	Trade balance €bn	Mar	22.4	21.4
	08.30	Construction PMI	Apr	-	38.3
France	07.45	Trade balance €bn	Mar	-	-5.2
	07.45	Wages (payrolls) Q/Q%	Q1	-	0.4 (-0.1)
	08.30	Construction PMI	Apr	-	41.0
Italy	08.30	Construction PMI	Apr	-	50.3
UK	00.01	BRC retail monitor – like-for-like sales Y/Y%	Apr	-	3.2
	09.30	New car registrations Y/Y%	Apr	-	10.4
	09.30	Construction PMI	Apr	50.5	50.2
		Wednesday 08 May 2024			
Germany	07.00	Industrial production M/M% (Y/Y%)	Mar	-0.6 (-3.3)	2.1 (-4.9)
Spain	08.00	Industrial production M/M% (Y/Y%)	Mar	-	0.7 (1.5)
Italy	09.00	Retail sales M/M% (Y/Y%)	Mar	-	0.1 (2.4)
		Thursday 09 May 2024			
UK	00.01	RICS house price balance %	Apr	-1	-4
	12.00	BoE Bank Rate	May	_5.25_	5.25
	14.00	DMP 1Y ahead CPI (3M output price) expectations Y/Y%	Apr	-	3.2 (4.1)
		Friday 10 May 2024			
Italy	09.00	Industrial production M/M% (Y/Y%)	Mar	-	0.1 (-3.1)
UK	07.00	GDP – first estimate Q/Q% (Y/Y%)	Q1	_0.4 (0.0)_	-0.3 (-0.2)
	07.00	Monthly GDP M/M%	Mar	0.0	0.1
	07.00	Services activity M/M% (3M/3M%)	Mar	0.1 (0.4)	0.1 (0.2)
	07.00	Industrial production M/M% (Y/Y%)	Mar	-0.5 (0.2)	1.1 (1.4)
	07.00	Construction output M/M% (Y/Y%)	Mar	0.9 (-1.0)	-1.9 (-2.0)
	07.00	Total (goods) trade balance £bn	Mar	-	-2.3 (-14.2)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		BST	Event / Auction
			Monday 06 May 2024
UK		10.00	Public holiday
			Tuesday 07 May 2024
			- Nothing scheduled -
			Wednesday 08 May 2024
UK		10.00	Auction: £2.5bn of 1.5%% 2053 green bonds
			Thursday 09 May 2024
Euro area		13.15	ECB Vice President de Guindos scheduled to give remarks and participate in Q&A session at an event in Madrid
UK		12.00	BoE monetary policy statement, minutes and Monetary Policy Report published
		12.30	BoE Governor Bailey to present updated Monetary Policy Report at press conference
		17.15	BoE Chief Economist Pill to partipate in a virtual Q&A session
			Friday 10 May 2024
Euro area		12.30	ECB monetary policy account from 11 April Governing Council meeting to be published
UK		12.15	BoE Chief Economist Pill to present MPC's latest Monetary Policy Report findings to Bank Agents

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Final manufacturing PMI	Apr	**45.7**	*45.6*	46.1	-
Germany		Final manufacturing PMI	Apr	**42.5**	*42.2*	41.9	-
France		Final manufacturing PMI	Apr	**45.3**	*44.9*	46.2	-
Italy		Manufacturing PMI	Apr	**47.3**	51.4	50.4	-
Spain		Manufacturing PMI	Apr	**52.2**	50.4	51.4	-

Auctions

Country		Auction
France		sold €4.32bn of 3.5% 2033 bonds at an average yield of 3.01%
		sold €3.22bn of 1.25% 2034 bonds at an average yield of 3.03%
		sold €2.62bn of 2.5% 2043 bonds at an average yield of 3.36%
		sold €1.76bn of 3.25% 2055 bonds at an average yield of 3.47%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.