Euro wrap-up

Overview

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- Gilts rallied at the shorter end of the curve as the BoE's MPC signalled that it might cut Bank Rate in June while its inflation projection suggested that policy should be eased more aggressively than is currently priced by the markets.
- Bunds made losses on a quiet day for economic news from the euro area.
- Friday will bring the account of the ECB's April policy meeting and the first estimate of UK GDP in Q1.

Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.927	+0.004
OBL 2.1 04/29	2.519	+0.022
DBR 2.2 02/34	2.493	+0.033
UKT 0⅛ 01/26	4.233	-0.057
UKT 0½ 01/29	3.995	-0.020
UKT 4⅝ 01/34	4.139	+0.002

*Change from close as at 5.00pm BST.
Source: Bloomberg

UK

BoE opens the door to a June rate cut & more aggressive easing than priced by the markets

As expected, the BoE today left monetary policy unchanged, keeping Bank Rate at 5.25% for the sixth successive MPC meeting. Only one additional MPC member – Deputy Governor Ramsden – joined uber-dove Dhingra in voting for a cut, with the other seven members voting for the status quo. But while the majority didn't have quite enough confidence in the inflation outlook to ease policy just yet, and made no pre-commitment to doing so next month, as we expected it opened the door wider to a possible June rate cut. Indeed, the MPC's statement made clear that next month's decision is now dependent on the incoming data, which will prompt a rate cut if they suggest that the risks of inflation persistence have further receded. Moreover, while it repeated that policy will still need to be restrictive for an extended period of time, and there remains a range of views on the Committee about the risks of inflation persistence, Governor Bailey also underscored that, if the economy evolves in line with its updated projection, Bank Rate is likely to be cut more rapidly than has recently been priced into the markets.

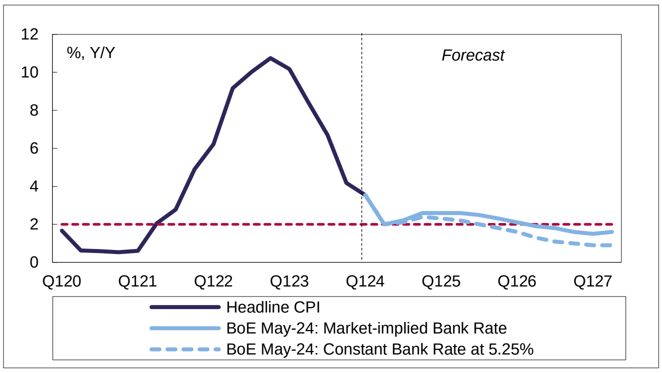
Economy progressing gradually back to normal after extreme inflation shocks of recent years

In his press conference, Bailey judged that – following the extreme shocks of recent years – economic conditions have reassuringly become much more 'normal'. Indeed, the MPC thinks that the bulk of the imported cost pressures of recent years has now been passed on to consumers. While recent price data have been close to its expectations, the MPC also considers that the risks of inflation persistence have diminished somewhat. And as those risks of second-round effects are considered by the BoE to be smaller in the UK than in the US, it is fully ready to cut rates before the Fed whenever the domestic data merit it. Admittedly, the MPC judges that underlying inflationary dynamics have not yet returned fully to pre-pandemic norms. And for the time being wage growth and services inflation still remain too high for the comfort of most members of the Committee, particularly also given some lingering uncertainty about the impact of geopolitics. So, today was still too soon for the majority on the MPC to contemplate a rate cut.

Inflation projected to fall below target over the horizon if Bank Rate follows market-implied path

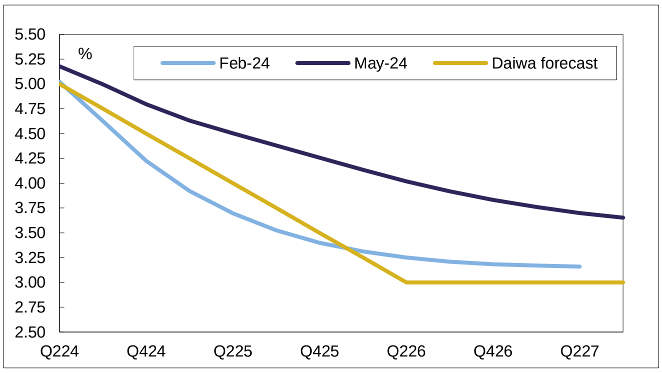
Nevertheless, the MPC continues to expect inflation to drop to the 2.0%Y/Y target in the current quarter (and specifically to 2.1%Y/Y in April and 1.9%Y/Y in May). And while it projects inflation to pick up somewhat in the second half of the year due principally to energy price base effects, it revised down its projection across the horizon thereafter. Assuming a market-implied path for monetary policy – whereby Bank Rate is cut to 4.8% by year-end, 4.3% by end-2025 and 3.7% by the end of the projection horizon – CPI inflation is projected to fall below target from Q226 onwards, at 1.9%Y/Y in two years' time and

UK: BoE inflation projections



Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Market-implied & Daiwa forecast for Bank Rate



Source: BoE and Daiwa Capital Markets Europe Ltd.

1.6%Y/Y in three years. In truly 'normal' circumstances, that projection would probably already have prompted a rate cut today. So, if the wage and price data to be published ahead of next month's MPC meeting are consistent with the MPC's projection, a majority on the Committee (albeit probably not all members) should support a cut in Bank Rate on 20 June. Moreover, assuming no unpleasant surprises thereafter, rates might also be cut ahead of market pricing – once a quarter, say – in the second half of the year.

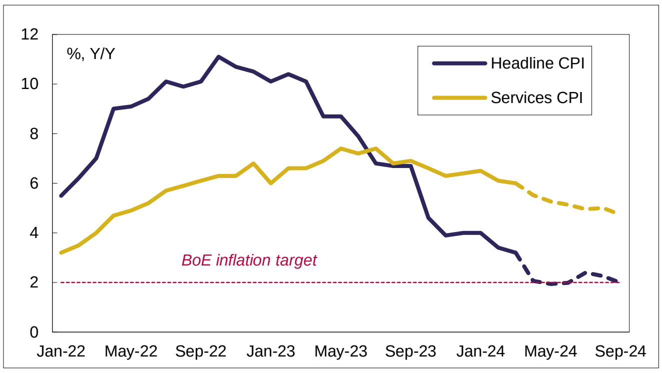
GDP growth outlook revised up as labour incomes rebound

While measures of the underlying tightness of the labour market, wage growth and services inflation remain the most important variables in its policy reaction function, broader economic activity will, of course, not be ignored. While the 0.3%Q/Q drop in GDP in Q4 had come as a surprise to the MPC, growth in Q1 in the UK – as in the US and euro area – appears to have been stronger than it had anticipated. Indeed, close to our own projection, the MPC now forecasts UK GDP growth of 0.35%Q/Q last quarter, before moderating slightly to just above 0.2%Q/Q in each quarter through to mid-2025. Despite the recent pickup in mortgage rates, the expansion is still expected to be led by household consumption. That should be buoyed by historically elevated growth in real post-tax labour income of more than 3.0%Y/Y this year, supported by strong pay settlements, lower inflation as well as recent fiscal policy decisions such as last month's cut in National Insurance Contributions.

Potential supply revised up more than GDP so plenty of slack to emerge unless Bank Rate is cut

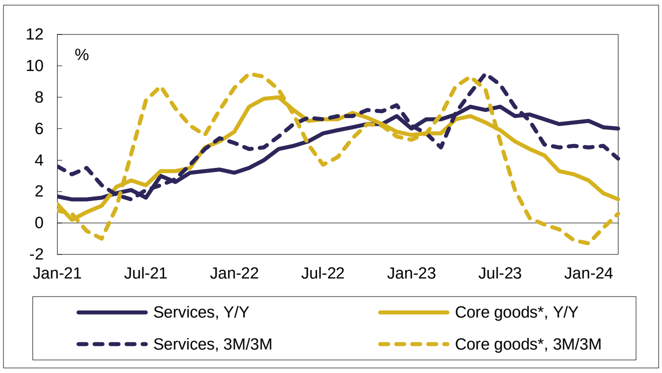
The MPC's economic growth outlook marks a significant upwards revision from its previous projection published in February. But its expected full-year rise in GDP of 0.4%Y/Y in 2024, 1.0%Y/Y in 2025 and 1.2%Y/Y in 2026 – which is close to our own outlook – is still less than its updated estimate of potential supply growth. Indeed, thanks to the ONS's recent upwards revision to its estimates of population growth as well as an upwards revision to the BoE's estimate of labour force participation, potential supply growth is now expected to rise to around 1¾%Y/Y in the middle of the forecast period. Therefore, while the MPC judges that supply and demand are currently broadly in balance – and thus consistent with Bailey's recent assertion that the economy is running at full employment – it projects that unemployment will pick up by about ½ppt over the next couple of years to peak around 4.8%, and a margin of economic slack will emerge this year, rise to about 1¼% of potential GDP (above its previous estimate) by the start of 2026, and persist at about 1% of potential GDP into the medium term. That persistent economic slack would reflect the continued restrictiveness of monetary policy if Bank Rate follows the path implied by the markets. And it should also therefore weigh on inflation, pushing it back to and – in the absence of more rate cuts than currently priced by the markets – eventually persistently below target over the medium term. So, to us, the case for a June rate cut is strong.

UK: Headline & services inflation – BoE projections*



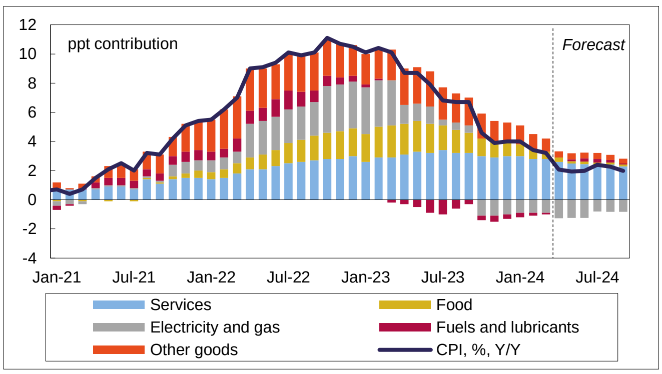
**Dashed lines represent BoE's forecast. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Core inflation momentum



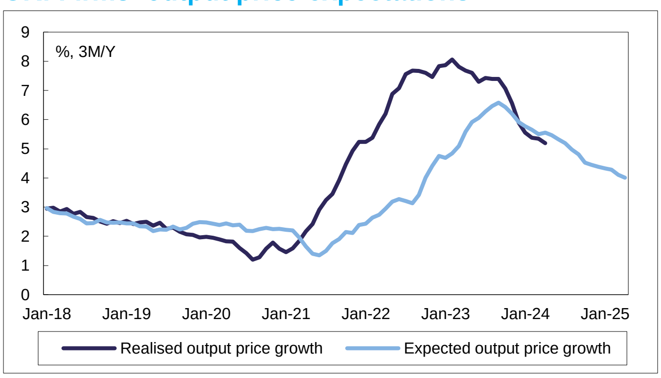
**Non-energy industrial goods. Source: BoE and Daiwa Capital Markets Europe Ltd.*

UK: Contributions to headline CPI inflation



Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Firms' output price expectations



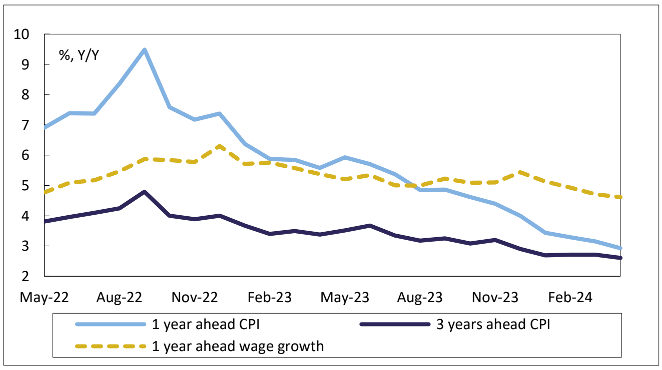
Source: BoE DMP survey, Macrobond and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

The day ahead in the UK

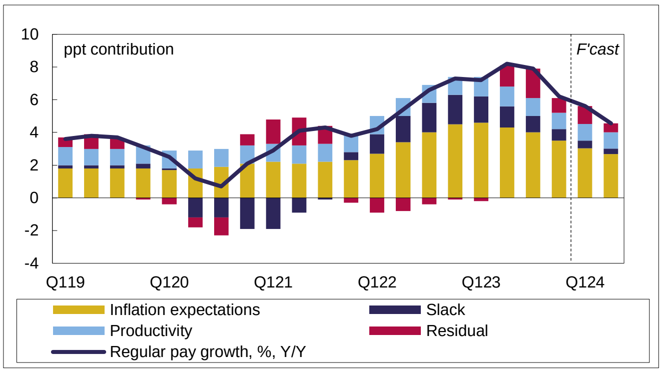
Focus in the UK tomorrow will turn to the preliminary estimate of Q1 GDP, which will be accompanied by the monthly GDP indices for March. While certain services sectors – including restaurants, accommodation, travel and tourism – might well have benefitted from stronger demand related to the earlier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

UK: Firms' CPI & wage growth expectations



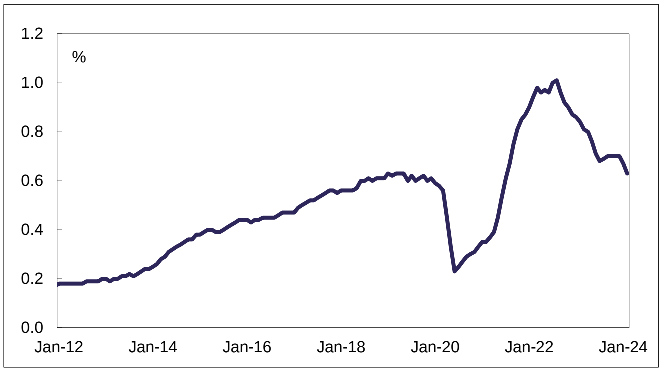
Source: BoE DMP survey, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Contributions to private regular pay growth



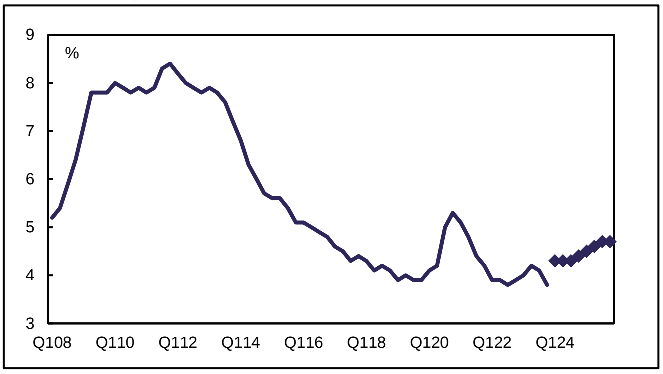
Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Vacancies to unemployment ratio



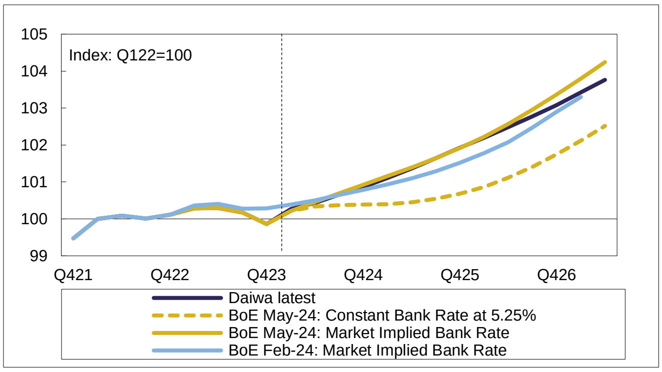
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Unemployment rate forecast



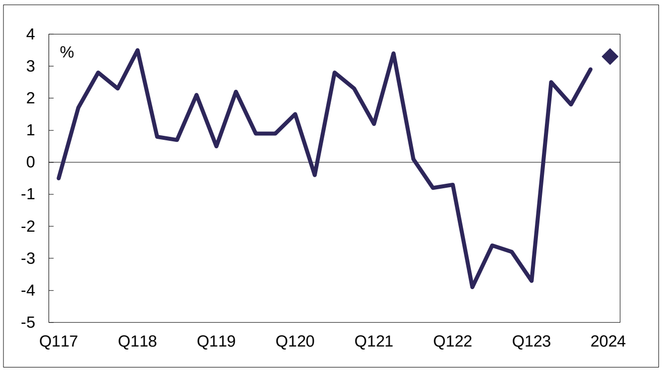
Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: BoE GDP projections



**Diamond represents BoE forecast for 2024. Source: BoE and Daiwa Capital Markets Europe Ltd.*

UK: Real household disposable income growth*



**Diamond represents BoE forecast for 2024. Source: BoE and Daiwa Capital Markets Europe Ltd.*

Euro area

The day ahead in the euro area

The main focus in the euro area tomorrow will be the publication of the ECB's account from the Governing Council's policy meeting on 11 April. At that meeting, while the deposit rate was maintained at a record high 4.00%, the ECB signalled that the June policy meeting was live for a first rate cut, while President Lagarde stated that 'a few' members of the Governing Council would already have supported a rate cut. And while the ECB insisted that it would not pre-commit to any particular path for rates, the minutes will be watched for discussions on how the inflation outlook has evolved since it last published projections in March as well as the possible path for policy beyond the next meeting. In terms of economic data, tomorrow will bring just Italian industrial production figures for March, which are expected to report a modest increase for a second successive month. However, given the decline at the start of the year, output will probably be down almost 1%Q/Q in Q1.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
UK	RICS house price balance %	Apr	**-5**	-1	-4	-5
	BoE Bank Rate	May	**5.25**	*5.25*	5.25	-
	DMP 1Y ahead CPI (3M output price) expectations Y/Y%	Apr	**2.9 (4.0)**	-	3.2 (4.1)	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
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)

Auctions and events

Country	BST	Event
Euro area	12.30	ECB monetary policy account from 11 April Governing Council meeting to be published
Italy	10.00	Auction: €2.0bn of 2.95% 2027 bonds
	10.00	Auction: €1.0bn of 1.1% 2027 bonds
	10.00	Auction: €4.5bn of 3.45% 2031 bonds
	10.00	Auction: €1.0bn of 5.0% 2040 bonds
	10.00	Auction: €700mn of 2.15% 2072 bonds
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.