Euro wrap-up

Overview

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- Bunds followed USTs lower despite confirmation from the ECB's account from the April policy meeting that the Governing Council remains on track to cut rates in June.
- Gilts also made losses as UK GDP significantly beat expectations, recording the strongest quarterly growth since Q421.
- The coming week will bring updated estimates of euro area inflation in April and GDP in Q1, and the UK's labour market report.

Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.961	+0.034
OBL 2.1 04/29	2.552	+0.033
DBR 2.2 02/34	2.517	+0.024
UKT 0⅛ 01/26	4.277	+0.044
UKT 0½ 01/29	4.033	+0.038
UKT 4⅝ 01/34	4.165	+0.026

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

Euro area

ECB more confident in its forecasting abilities as economy continues to normalise

While only a few members of the Governing Council would have been ready to support a rate cut last month, the ECB's account of its April policy meeting, released today, confirmed that it is well on course to cut rates in June. Of course, that policy decision remains data dependent. But importantly, the account reported increased confidence on the Governing Council in its own projections as the shocks of recent years fade and the euro area economy continues to normalise. And that increased confidence in its own forecasting capability will allow the Governing Council to be similarly more confident in its judgement on the appropriate path for monetary policy. So, with its March economic projections having already predicted the return of inflation back to target by the middle of next year, all of its members – hawks and doves alike – should soon be ready to unite around an easier path for monetary policy.

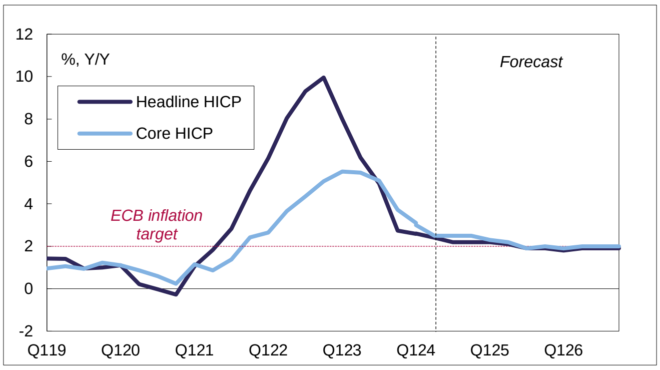
Recent data judged to validate projection that inflation will return to target next year

Given that recent projection that inflation will return to target by mid-2025, it was also notable that the account reported that the Governing Council judged subsequent inflation data, as well as indications from wages and profit margins, to have broadly validated that forecast. Certainly, where recent economic data had deviated somewhat from the ECB's expectation, the account reported a plausible explanation that implied there was no major cause for concern. For example, while the Governing Council acknowledged that momentum in services inflation – which remains a key variable in its reaction function – had appeared to pick up, it also recognised that the price pressures had largely stemmed from items typically affected by repricing at the start the year. And the early timing of Easter had also evidently contributed to persistent stickiness in services inflation. So, there remain good reasons to believe this persistence will be temporary, allowing services inflation to steadily subside over coming months.

Only major surprises likely to prevent a June rate cut, but path thereafter far more uncertain

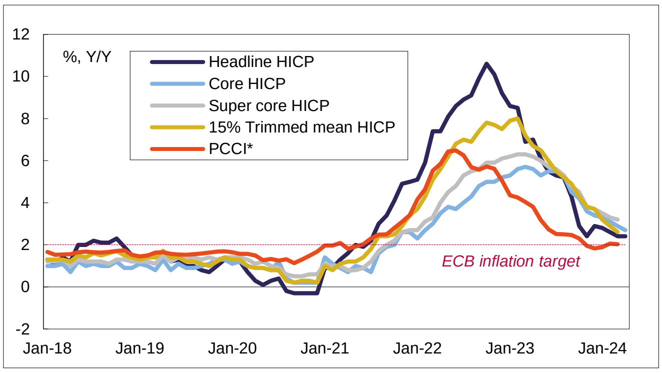
While a large majority of members had not quite been ready to pull the trigger on a rate cut last month, the account also made clear that the data to be released before the next meeting on 6 June, along with the ECB's updated macroeconomic projections, will allow the Governing Council to make a call on whether to ease policy on that occasion. Members also reportedly cautioned placing too much emphasis on any one data point, and recognised the likely bumpy path ahead for many indicators. That implies to us that it will now likely require a major unpleasant surprise in the incoming data – perhaps affecting a range of indicators – to prevent a rate cut next month. Where rates go after the first cut, however, remains far more uncertain and will, of course, also be data and event dependent. Indeed, in determining that profile for rates, a broader

Euro area: ECB inflation projections



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

Euro area: Selected measures of inflation



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

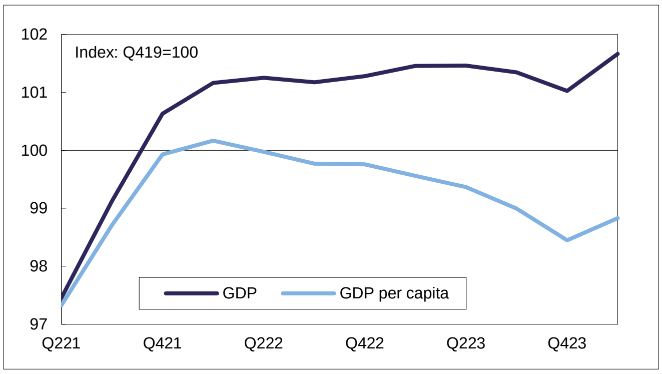
range of indicators will likely come into play. And while the Governing Council will be guided primarily by economic and financial conditions in the euro area, it will not be able to ignore events abroad. In that respect, members remain wary of geopolitical developments. Moreover, the account suggested that the ECB will be wary of significant divergence from the Fed, noting that the "spill-overs from the US through a sustained exchange rate effect would likely slow the disinflationary process in the euro area" and so the impact of forex market developments on the inflation outlook required "close monitoring". Nevertheless, a series of gradual rate cuts – perhaps by 25bps each quarter, coinciding with each forecast update – should still follow in the second half of the year as long as the ECB's current projection of a sustained return to inflation back to target from mid-2025 remains broadly valid.

The coming week in the euro area

The coming week's euro area calendar will bring the release of updated estimates of April inflation on Friday and Q1 GDP on Wednesday. The flash inflation release saw the headline HICP rate move sideways at the start of Q2, at 2.4%Y/Y – nevertheless matching November's 28-month low – as the drag from energy (-0.6%Y/Y) was the softest in twelve months reflecting the further rise in petrol prices and withdrawal of government support for household bills in countries such as Germany and Spain. Having reached a 2½-year low in March, inflation of food, alcohol and tobacco also rose (2.8%Y/Y). But the core components continued to decline in April, with non-energy industrial goods inflation at a near-three-year low of 0.9%Y/Y, while services inflation dropped 0.3ppt to 3.7%Y/Y, the lowest since August 2022. So, while the flash core HICP rate was a touch firmer than expectations, it declined for a ninth consecutive month to 2.7%Y/Y, the lowest since January 2022. The granular detail to be published with this release will likely suggest that the moderation in services in part reflected base effects associated with the early timing of Easter this year. Equivalent final figures from Germany and Spain (Tuesday), France (Wednesday) and Italy (Thursday) are also due.

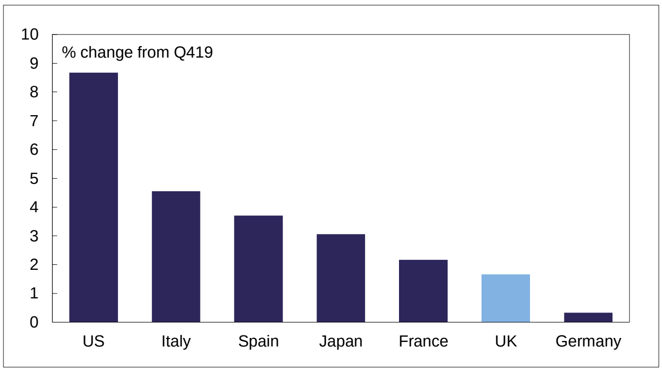
Meanwhile, the first estimate of Q1 GDP surprised to the upside, recording a return to positive growth for the first quarter in three and by 0.3%Q/Q, the firmest pace since Q322 and 0.2ppt above the ECB's projection. This release will also include a first estimate of employment in Q1. Figures already published from Germany (+38k) and Spain (+205k) suggest another quarter of steady jobs growth. Meanwhile, the latest industrial production figures for March, also due Wednesday, will provide further insight into the manufacturing performance at the end of the first quarter. Data published so far from the member states have been mixed, with declines in Germany (-0.4%M/M), France (-0.3%M/M), Italy (-0.5%M/M) and Spain (-0.7%M/M) contrasting with a jump in output from Ireland (12.8%M/M) and Portugal (2.6%M/M). Overall, we expect aggregate euro area production to have increased in March, by a little more than ½%M/M, to leave it down around 1%Q/Q in Q1. In addition, Germany's ZEW investor survey for May is due to be published on Tuesday and should reaffirm expectations of firmer economic activity ahead.

UK: GDP & GDP per capita



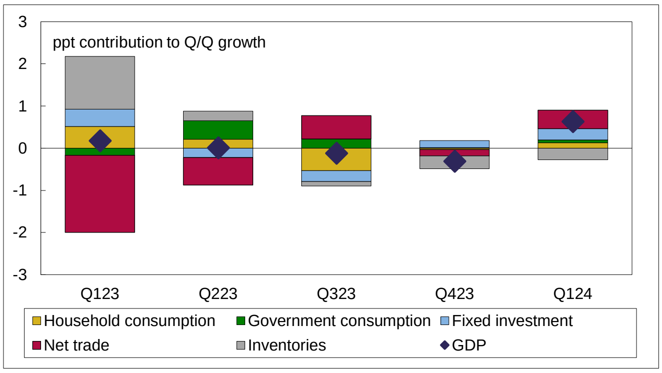
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP vs pre-pandemic level*



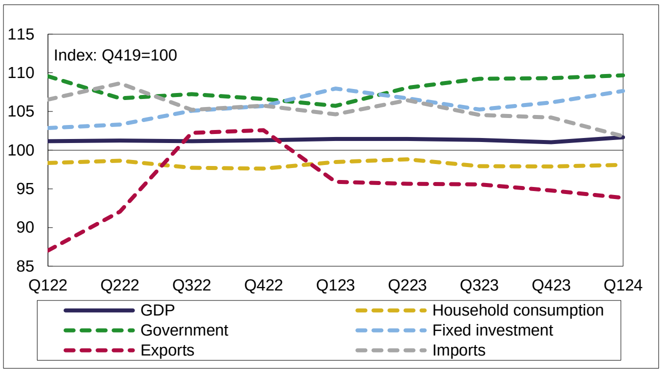
**Latest figures for Q124 except Japan which are Q423. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Expenditure contributions to GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP expenditure components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

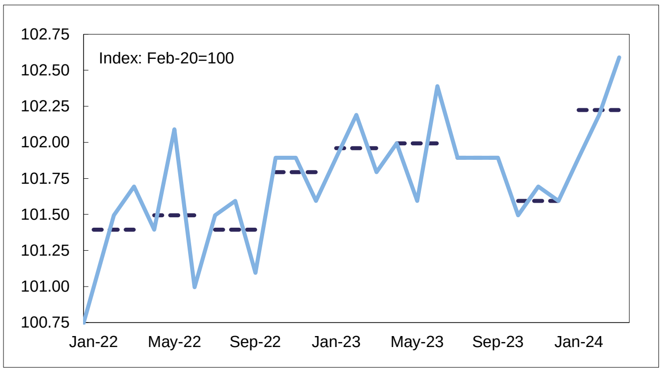
GDP beats expectations in Q1 with strongest growth in nine quarters

According to today's first estimate, GDP growth in Q1 significantly beat expectations, rising 0.6%Q/Q, the most since the post-pandemic rebound in Q421 and 0.2ppt above the BoE's projection published yesterday and the Bloomberg consensus. So, the figures confirmed that the technical recession was limited to the second half of 2023, when GDP fell by 0.1%Q/Q and 0.3%Q/Q in Q3 and Q4 respectively. But given that prior weakness, GDP in Q1 was still up merely 0.2%Y/Y to be just 1.7% above the pre-pandemic level in Q419. Moreover, reflecting firm population growth, growth in GDP per head was more moderate in Q1 at 0.4%Q/Q. And, as that marked the first such increase in eight quarters, it was still down 0.7%Y/Y and 1.2% below the pre-pandemic level. Nevertheless, the vigour of the rebound in economic activity in Q1 was encouraging, not least as it tallies with the firmness of survey indicators which has extended into Q2. Additionally, growth on the expenditure side was broad-based, with positive contributions from all major components of final domestic demand. But while net trade made the largest single contribution to growth, that reflected significant weakness in import volumes while export volumes fell for a fifth consecutive quarter to extend the dire post-Brexit trend.

Fixed investment led broad-based pickup in final domestic demand

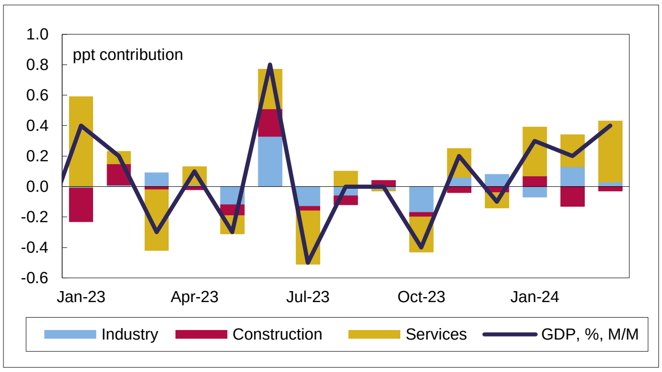
Like GDP, household consumption rose in Q1 following two successive declines, although the modest increase of 0.2%Q/Q left it down 0.4%Y/Y and contributing just 0.1ppt to GDP growth. Personal spending was driven by consumption of services including hospitality. And with net spending on tourism down, domestic household consumption was somewhat firmer (0.6%Q/Q and -0.3%Y/Y) than total household consumption. Encouragingly perhaps, with employee compensation up 0.2%Q/Q but nominal spending up a firmer 0.6%Q/Q, the household savings ratio appears to have fallen back to support expenditure in Q1, probably reflecting the further gradual improvement in consumer confidence. Meanwhile, government consumption rose for a fourth successive quarter (0.3%Q/Q, similarly adding 0.1ppt to overall growth). And more substantively, gross fixed investment rose for the second quarter in a row and by the most in a year (1.4%Q/Q), thus contributing a chunky 0.3ppt to growth. Perhaps surprisingly given the weakness of construction output (see below), capex was led by outlays on dwellings – which rose for the first quarter in six – and transport goods, with growth in spending on machinery and equipment – and overall business investment – more moderate.

UK: Monthly GDP level*



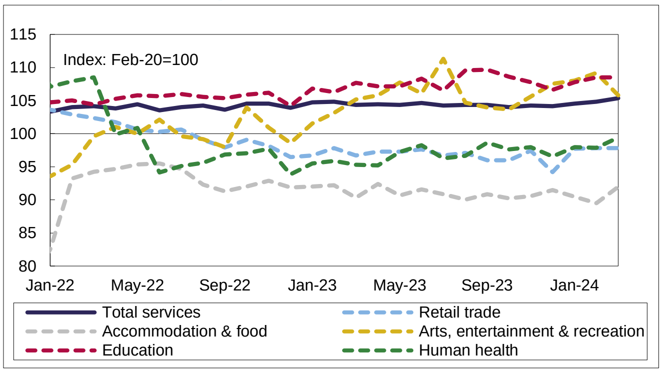
*Dashed dark blue lines represent quarterly averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Production contributions to GDP growth



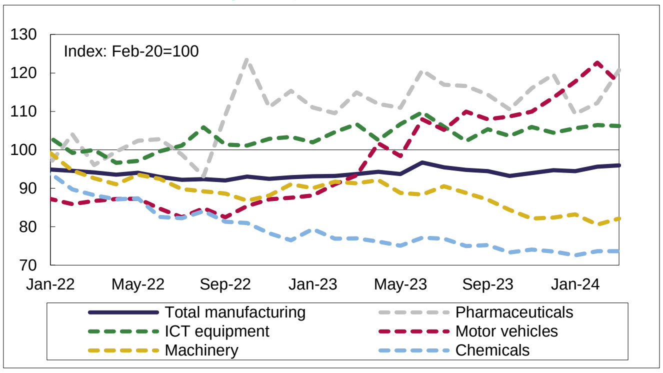
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

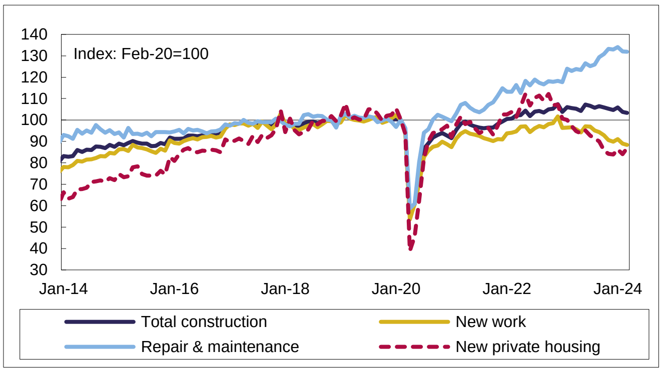
Net trade made largest contribution to GDP growth due only to a particularly sharp fall in imports

In terms of the external sector, net trade added 0.4ppt to GDP growth, the most in six quarters. The cause was discouraging, however, with the significant weakness in both exports and imports suggesting that the UK continues to become a less open economy due not least to the imposition of Brexit-related trade barriers. Indeed, a broad-based drop in import volumes (-2.3%Q/Q, the most in six quarters) left them at the lowest level since Q421 and more than 2% below the 2019 average. That import weakness, however, contributed a whopping 0.8ppt to GDP growth. The decline in export volumes was more moderate (-1.0%Q/Q) but still subtracted 0.4ppt from GDP growth and left them 1.1% below the average level in 2019. An increase in services exports was more than offset by a drop in goods exports due to lower shipments of machinery, transport equipment and fuels, as well as the highly erratic component of non-monetary gold. With relative shifts in import and export prices also favourable, the overall trade deficit declined by 0.5ppt in Q1 to a five-quarter low of 0.6% of GDP, with the deficit excluding non-monetary gold narrowing 0.7ppt to 1.1% of GDP, the smallest in more than two years. Finally, while both final domestic demand and net trade made sizeable positive contributions, inventories (including a sizeable alignment adjustment by the ONS statisticians) subtracted significantly from GDP growth.

Services sector drove growth in Q1 while manufacturing output rebounded

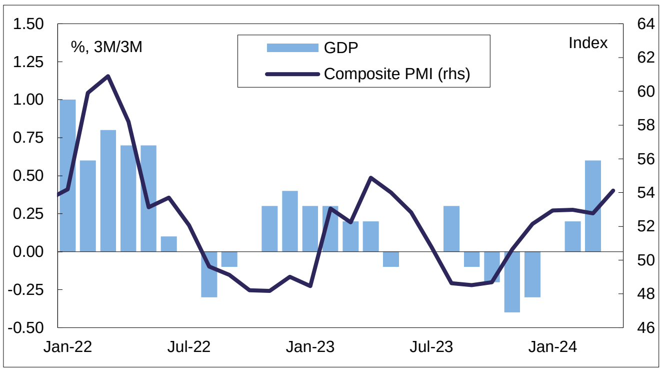
The upside surprise to Q1 GDP reflected the stronger-than-expected outcome for March. Indeed, economic output rose for the third successive month in March and by 0.4%M/M, the most in nine months and 0.3ppt above the median forecast on the Bloomberg survey. Services made the biggest contribution, similarly rising for a third successive month and by 0.5%M/M in March to be up 0.7%Q/Q in Q1 and 5.3% above the pre-pandemic level. The expansion in the sector was relatively broad-based, with two thirds of subsectors reporting growth. While the strongest increase was registered in the rather idiosyncratic category of pipeline services, consumer-facing services rose a solid 0.6%Q/Q led by retail trade and – benefiting from reduced strike action – healthcare. In the industrial sector, manufacturing output rose 0.3%M/M in March and 1.4%Q/Q in Q1, thus more than reversing the 1.0%Q/Q drop in Q4 albeit ending the first quarter still more than 4.0% below the pre-pandemic level. A sixth successive quarterly increase in output of transport equipment as well as growth in metals- and food-related items offset a sixth consecutive drop in textiles. Finally, likely in part due to particularly wet weather, construction output fell 0.9%Q/Q for a second successive quarter to be just 2.0% above the pre-pandemic level in March. The recent trends within the construction sector broadly remained in place. In particular, with high interest rates still weighing on activity, new building work dropped for a fifth successive quarter and by 1.8%Q/Q. But repair and maintenance rose for a ninth successive quarter, albeit by just 0.3%Q/Q, the softest rate of that winning run.

UK: Construction output



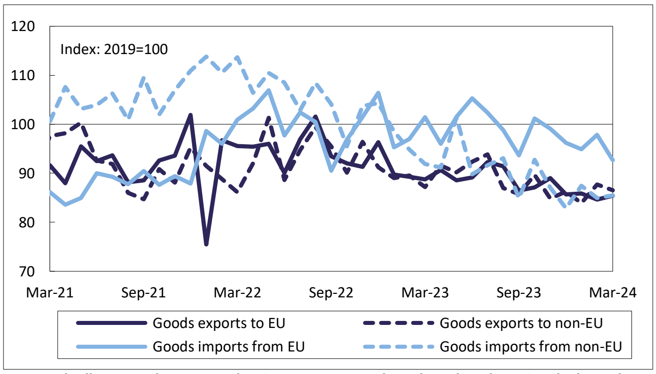
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth and composite output PMI



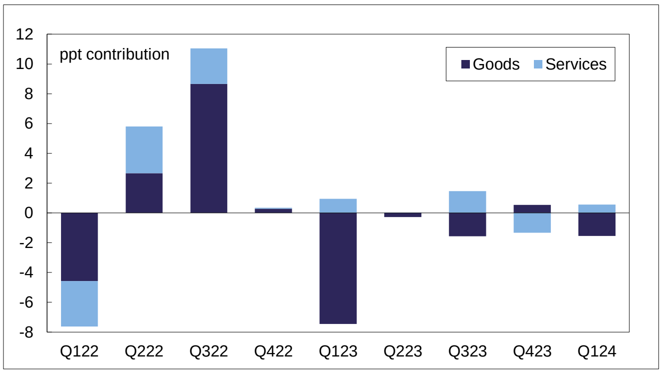
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Goods trade volumes with EU & non-EU*



**Excluding precious metals. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Export volume growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Most MPC members to place more weight on incoming labour market & inflation data than Q1 GDP

Based on today's data, the monthly profile of activity throughout Q1, including the firm expansion in March, represents a significant carry-over of growth into Q2. Indeed, if the level of economic output remains unchanged from March in each month of Q2, GDP over the quarter as a whole would again rise 0.4%Q/Q, 0.2ppt above the BoE's projection. However, we suspect that seasonal adjustment might not have fully captured the boost provided by the early timing of Easter in March, which would point to significant payback in consumption in April. In addition, the components for investment and trade look vulnerable to either downwards revision in Q1 or significant negative payback in Q2. Nevertheless, we acknowledge that survey indicators such as the composite PMI – which rose in April to 54.1, its long-run average – point to ongoing firm economic growth this quarter. So, while the monthly GDP profile will be choppy, we have revised up our GDP forecast to 0.4%Q/Q in Q2 and 0.7%Y/Y over 2024 as a whole. Of course, it remains to be seen how the MPC will interpret today's data. For the hawks, the strength of growth in Q1 and evidence of positive momentum in early Q2 will likely reinforce their desire to leave policy unchanged next month. However, given the significant uncertainty about the economy's supply potential, the majority of members will place much greater weight on the forthcoming data on the labour market and inflation. It is possible, of course, that stronger demand could allow firms to bolster margins and embolden workers to seek stronger pay rises. But if, as we expect, the incoming figures on jobs, wages and prices remain consistent with the MPC's projections, we would continue to expect Bank Rate to be cut next month and further in the second half of the year.

The coming week in the UK

All eyes in the UK in the coming week, therefore, will be on the results of the latest labour market figures, to be published on Tuesday. The previous Labour Force Survey (LFS) saw the unemployment rate tick up to a six-month high of 4.2% in the three months to February, nevertheless just 0.6ppt above the series low recorded in August 2022 and therefore suggestive of a still tight labour market. Despite the solid rise in economic output and slight uptick in job vacancies in March, the unemployment rate is forecast to have increased slightly further that month (4.3%) due in part to the steepest quarterly decline in employment since Q320. Meanwhile, having moved sideways in February at its joint-softest rate in 18 months (5.6%3M/Y), total wage growth is expected to have eased only marginally in the three months to March, perhaps reflecting the phasing in of the near-10% rise in the National Living Wage that came into effect at the start of April. Certainly, other measures of wage growth have been mixed, with the Indeed wage tracker rising to a three-month high in March (up 0.5ppt to 6.5%Y/Y), while median pay growth based on PAYE figures fell to a four-month low (6.1%3M/Y) with the single-month figure (5.6%Y/Y) the softest since November 2021.

The next edition of the Euro wrap-up will be published on 14 May 2024

Daiwa economic forecasts

	2024				2025				
	Q1	Q2	Q3	Q4	Q1	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	0.6	0.4	0.3	0.2	0.2	0.3	0.1	0.7	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	2.75	4.00	3.25	2.25
Refi Rate	4.50	4.25	3.65	3.40	3.15	2.90	4.50	3.40	2.40
BoE									
Bank Rate	5.25	5.00	4.75	4.50	4.25	4.00	5.25	4.50	3.50

Source: Bloomberg, ECB, BoE 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 13 May 2024			
		- Nothing scheduled -			
		Tuesday 14 May 2024			
Germany	07.00	Final HICP (CPI) Y/Y%	Apr	2.4 (2.2)	2.3 (2.2)
	10.00	ZEW current situation (expectations) balance	May	-	-79.2 (42.9)
Spain	08.00	Final HICP (CPI) Y/Y%	Apr	*3.4 (3.3)*	3.3 (3.2)
UK	07.00	Unemployment rate 3M%	Mar	4.3	4.2
	07.00	Employment 3M/3M change 000s	Mar	-210	-156
	07.00	Payrolled employees M/M change 000s	Apr	-	-67
	07.00	Average wages (excluding bonuses) 3M/Y%	Mar	5.5 (5.9)	5.6 (6.0)
	07.00	Claimant count rate % (change 000s)	Apr	-	4.0 (10.9)
		Wednesday 15 May 2024			
Euro area	10.00	GDP – second estimate Q/Q% (Y/Y%)	Q1	*0.3 (0.4)*	-0.1 (0.1)
	10.00	Employment – first estimate Q/Q% (Y/Y%)	Q1	-	0.3 (1.2)
	10.00	Industrial production M/M% (Y/Y%)	Mar	*0.6 (-1.1)*	0.8 (-6.4)
France	07.45	Final HICP (CPI) Y/Y%	Apr	*2.4 (2.2)*	2.4 (2.3)
		Thursday 16 May 2024			
Italy	10.00	Final HICP (CPI) Y/Y%	Apr	*1.0 (0.9)*	1.2 (1.2)
	10.00	Trade balance €bn	Mar	-	6.0
		Friday 17 May 2024			
Euro area	10.00	Final headline (core) HICP Y/Y%	Apr	*2.4 (2.7)*	2.4 (2.9)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's calendar

Today's results						
Economic data						
Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Italy	Industrial production M/M% (Y/Y%)	Mar	**-0.5 (0.0)**	-	0.1 (-3.1)	0.0 (-3.3)
UK	GDP – first estimate Q/Q% (Y/Y%)	Q1	**0.6 (0.2)**	*0.4 (0.0)*	-0.3 (-0.2)	-
	Monthly GDP M/M%	Mar	**0.4**	0.0	0.1	0.2
	Services activity M/M% (3M/3M%)	Mar	**0.5 (0.7)**	0.1 (0.4)	0.1 (0.2)	0.3 (0.3)
	Industrial production M/M% (Y/Y%)	Mar	**0.2 (0.5)**	-0.5 (0.2)	1.1 (1.4)	1.0 (1.0)
	Construction output M/M% (Y/Y%)	Mar	**-0.4 (-2.2)**	0.9 (-1.0)	-1.9 (-2.0)	-2.0 (-)
	Total (goods) trade balance £bn	Mar	**-1.1 (-14.0)**	-	-2.3 (-14.2)	-1.5 (-14.1)
Auctions						
Country	Auction					
Italy	sold €2.0bn of 2.95% 2027 bonds at an average yield of 3.32%					
	sold €1.0bn of 1.1% 2027 bonds at an average yield of 3.28%					
	sold €4.5bn of 3.45% 2031 bonds at an average yield of 3.52%					
	sold €1.0bn of 5.0% 2040 bonds at an average yield of 4.14%					
	sold €750mn of 2.15% 2072 bonds at an average yield of 3.96%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions			
Country		BST	Event / Auction
			Monday 13 May 2024
			- Nothing scheduled -
			Tuesday 14 May 2024
Germany		10.30	Auction: €5.0bn of 2.9% 2026 bonds
UK		08.30	BoE Chief Economist Pill to deliver keynote speech at ICAEW annual economic summit
		10.00	Auction: £600mn of 0.125% 2073 index-linked bonds
			Wednesday 15 May 2024
Germany		10.30	Auction: €1.0bn of 1.8% 2053 bonds
		10.30	Auction: €1.0bn of 2.5% 2054 bonds
UK		10.00	Auction: £3.0bn of 0.875% 2033 green bonds
			Thursday 16 May 2024
Euro area		-	ECB to publish Financial Stability Review
France		09.50	Auction: 2.5% 2027 bonds
		09.50	Auction: 2.75% 2029 bonds
		09.50	Auction: 2.75% 2030 bonds
		09.50	Auction: 2.5% 2030 bonds
		10.50	Auction: 0.1% 2028 index-linked bonds
		10.50	Auction: 0.1% 2029 index-linked bonds
		10.50	Auction: 0.1% 2032 index-linked bonds
		10.50	Auction: 0.1% 2053 index-linked bonds
UK		12.00	BoE's Greene scheduled to give speech on 'the current state of Britain's labour market'
			Friday 17 May 2024
UK		09.00	BoE's Mann scheduled to deliver keynote speech on 'cost of capital: measurement and implications for business investment'

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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https://www.uk.daiwacm.com/ficc-research/recent-blogs