Euro wrap-up

Overview

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- Bunds made losses as the ZEW investor survey flagged expectations of a broad-based pickup in German GDP growth over coming quarters.
- Gilts made modest gains as data suggested that the labour market was less tight while private regular wage growth moderated, and BoE Chief Economist Pill stated that expectations for a summer rate cut were not unreasonable.
- Tomorrow will bring an updated estimate of euro area GDP in Q1, along with employment growth in Q1 and industrial production figures for March.

Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.979	+0.033
OBL 2.1 04/29	2.576	+0.038
DBR 2.2 02/34	2.546	+0.038
UKT 0⅛ 01/26	4.296	-0.004
UKT 0½ 01/29	4.045	-0.001
UKT 4⅝ 01/34	4.171	-0.001

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

Euro area

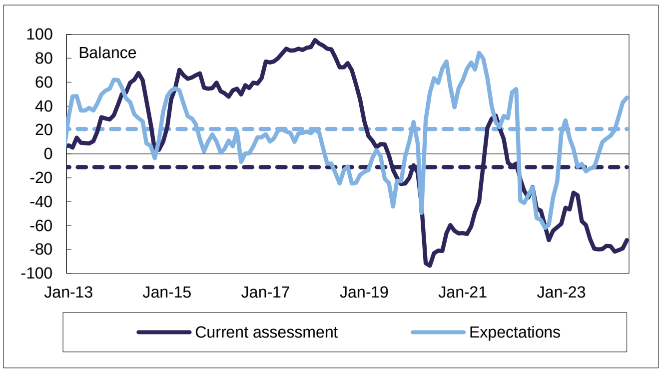
ZEW survey flags expectations of broad-based pickup in German GDP over coming months

Today's May ZEW survey results highlighted the increasingly widespread perceptions among investors that Germany's economic downturn is now well past its bottom. Admittedly, almost three quarters of survey recipients judged current conditions still to be bad. But while that share remained historically high, it was the smallest in nine months. Moreover, having last month risen above 50% for the first time since the Russian invasion of Ukraine, the share of respondents expecting conditions to improve over the coming six months rose further, and the share expecting a renewed deterioration fell to the lowest since July 2021. As such, the survey's expectations balance rose for the tenth successive month and by more than expected to a 28-month high of 47.1, more than 25pts above the long-run average, strongly suggestive of ongoing positive GDP growth in Germany into the autumn. Encouragingly, while the outlook appears most upbeat for firms in IT and services, investor expectations are also now firmly positive now for a wide range of sectors, suggesting that the recovery might be relatively broad-based. For example, with consumer spending widely expected to pick up on the back of strong real wage growth, the ZEW survey reported that investor perceptions of the German retail outlook are the most positive since early 2022. Notably too, thanks to the recent drop in wholesale energy prices, expectations for chemicals firms were the most positive since the Russian invasion of Ukraine, which had originally raised existential concerns for the sector. And with the ECB widely expected to cut rates over coming months, even expectations for the construction sector turned positive for the first time in more than two years.

Recovery momentum improving but GDP growth in Q2 to soften due to construction payback

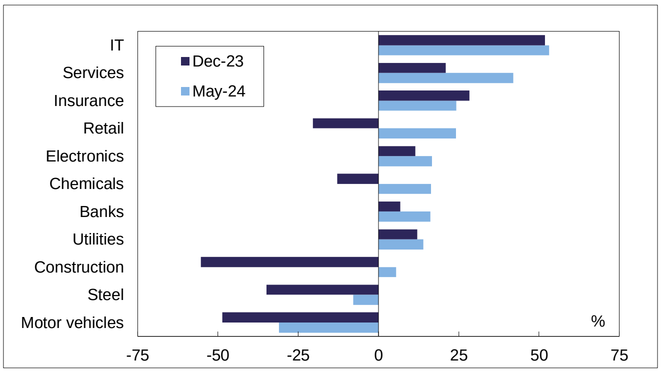
The improvement in investor mood reported by the ZEW survey in part reflects waning price pressures. However, perhaps given the recent pickup in auto fuel prices, the share of respondents expecting a decline in inflation over the next six months fell for a second successive month in May to 45.5%, its lowest in two years. Nevertheless, while the respective share also declined, a net balance of more than four fifths of recipients expects the ECB to cut rates over the same period. And a net balance of one third of investors expect long-term interest rates to decline. Of course, the ZEW survey reflects only the views of investors. And in gauging the economic outlook, we place greater weight on business survey indicators such as the PMIs and ifo indices. We also note that certain high-frequency indicators, reflected in the Bundesbank's weekly activity index, have pointed to a soft start to economic output in Q2 after GDP rose 0.2%Q/Q in Q1 thanks not least to a weather-assisted boost from construction. However, we expect the flash PMIs and ifo survey results, due later this month, to point to a firming of momentum in the middle of Q2. And we expect German GDP to rise again this quarter, albeit by just 0.1%Q/Q with the moderation from the first quarter only reflecting negative payback for the temporary surge in construction.

Germany: ZEW investor sentiment indices*



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

Germany: ZEW investor profit expectations



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

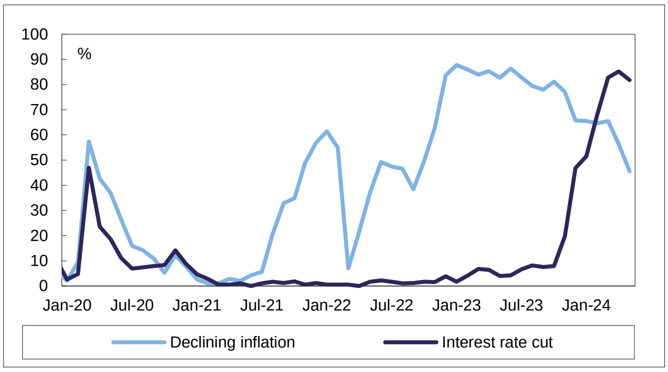
German core inflation down to a 26-month low as timing of Easter impacts airfares

There were no major surprises from today's final April consumer price inflation estimates from Germany, which confirmed that withdrawal of government energy support, higher oil prices and the timing of Easter played meaningful roles in recent price shifts. The slight uptick in the headline HICP rate in April, by 0.1ppt to 2.4%Y/Y, in part reflected a smaller drag from energy inflation, which rose 1.6ppt to -1.3%Y/Y due in part to the 12ppt increase in VAT on bills of gas and heating. However, natural gas prices actually rose just a modest 1.9%M/M while district heating prices rose 9.1%M/M, implying that charges before tax actually fell. Prices of auto fuel, however, rose 3.4%M/M, the most in nine months. Food prices also rose, and for the first month in three. That pushed the annual food inflation rate back to positive territory, albeit still historically subdued at just 1.0%Y/Y. In contrast, a range of core goods items maintained their disinflationary trends, with the components for furniture and motor vehicles falling to three-year lows, and clothing to a five-month low. As such, non-energy industrial goods inflation fell 0.4ppt to 1.8%Y/Y, the softest since June 2021. Meanwhile, the drop in services inflation – down 0.4ppt to 3.6%Y/Y – was partly due to a notable swing in airfares, which declined 9%Y/Y in April having rising almost 11%Y/Y in March. But the impact of the timing of Easter on inflation of certain other services was less evident, however, with catering inflation up to a seven-month high, and the package-holiday component also slightly higher. Nevertheless, overall, core HICP inflation fell 0.3ppt to 2.9%Y/Y, the lowest since January 2022.

The day ahead in the euro area

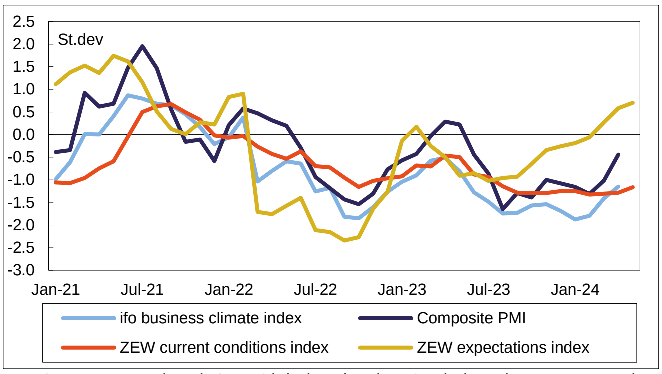
Tomorrow will bring updated estimates of euro area GDP for Q1, which are expected to confirm a return to positive growth for the first quarter in three and by 0.3%Q/Q, the firmest pace since Q322 and 0.2ppt above the ECB's projection. This release will also include a first estimate of employment in Q1. Figures already published from Germany (+38k) and Spain (+205k) suggest another quarter of steady jobs growth for a twelfth successive quarter. 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 industrial production to have increased in March, by a little more than ½%M/M, to leave it down around 1%Q/Q in Q1 despite a positive result from Germany.

Germany: ZEW investor inflation & rate expectations



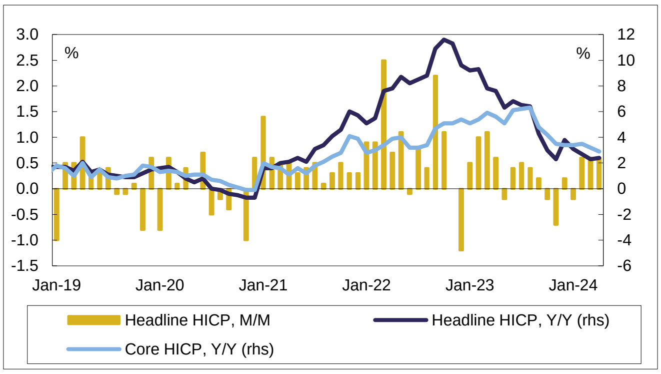
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Sentiment survey indices



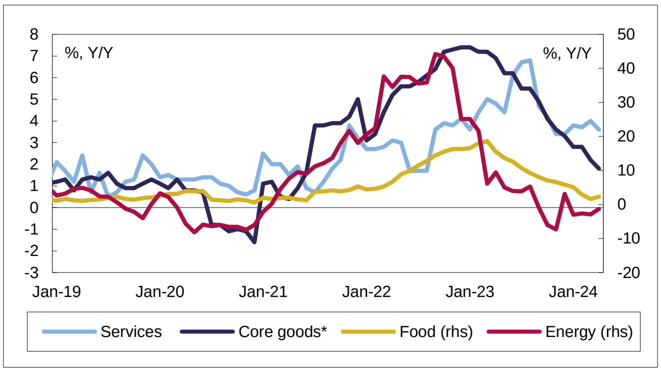
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation*



**EU-harmonised measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Germany: Key HICP components



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

UK

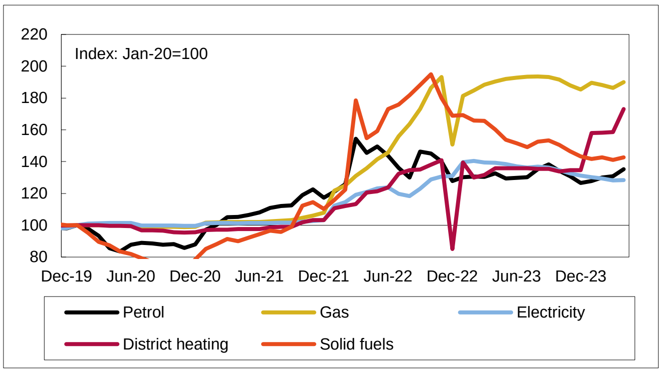
Unemployment rate rises to an eight-month high while inactivity rose again in Q1

Today's UK labour market data were somewhat mixed, with some further signs of loosening countered by still strong pay growth. In line with expectations, the unemployment rate rose in the three months to March for a third consecutive month, by 0.1ppt to 4.3%, to be 0.5ppt higher over the first quarter compared to Q4 and the highest for eight months. Admittedly, the unemployment rate remains slightly below the BoE's estimate of the equilibrium rate (4½%), suggesting that the labour market remains relatively tight. While economic inactivity edged slightly lower in March, the number of people out of the labour market in Q1 rose a further 105k to the highest level for twelve years due to a rise in short-term and long-term sickness, as well as an increase in the number of people retiring. So, supply-side problems – in part likely related to challenges in the National Health Service – are contributing to the tightness of the labour market.

Employment and vacancies fall but redundancies remain subdued

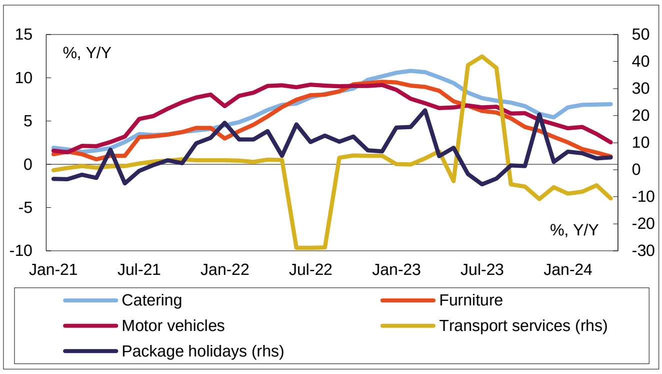
While supply-side issues are clearly an important restraint on the number of people in work, today's figures also suggested that labour demand continues to moderate. The Labour Force Survey (LFS) measure of employment fell a further 178k in the three months to March – the most since last August – to leave it down more than 200k compared with a year ago. The drop again principally reflected a fall in the number of part-time workers (-215k) to a nineteen-month low. But the rise in full-time employment (+37k) over the past quarter was also significantly softer than three months ago (+206k). Admittedly, there remains some uncertainty regarding the true picture of the labour market due to the low survey response rate. And the number of redundancies reported in March – which fell to a five-month low and remained at an historically low level – suggest that the LFS might well be over overemphasizing the recent decline in employment. Nevertheless, the number of job vacancies in April maintained a steady downwards trend to be more than 400k below the peak almost two years ago, further suggesting that labour demand has softened and that the labour market is less tight. The HMRC's estimate of payrolled employees reportedly fell sharply in April too, by 85.6k – by the most since May 2020 – to leave annual growth (0.4%Y/Y) the softest since May 2021. It is worth noting, however, that these data are often significantly revised, with the decline in March notably smaller at -8k compared with the initially estimated drop of 66k. And while the number of people claiming job seekers allowance and Universal Credit rose for a seventh month out of eight, the claimant count rate merely moved sideways at 4.1%.

Germany: Energy price level



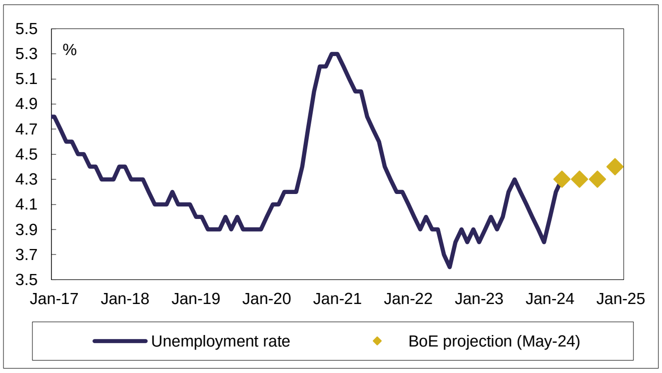
EU-harmonised measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Selected services & goods inflation*



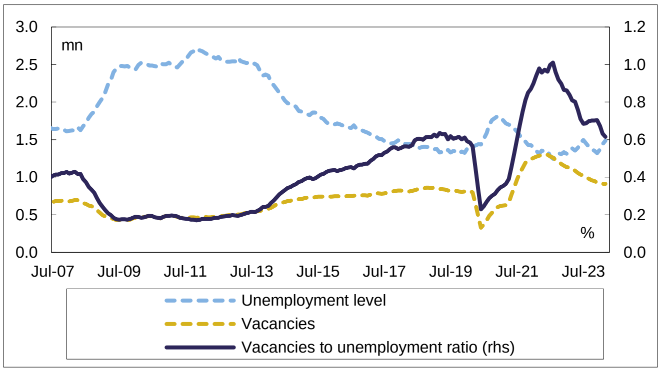
EU-harmonised measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Unemployment rate



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

UK: Vacancies to unemployment ratio



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

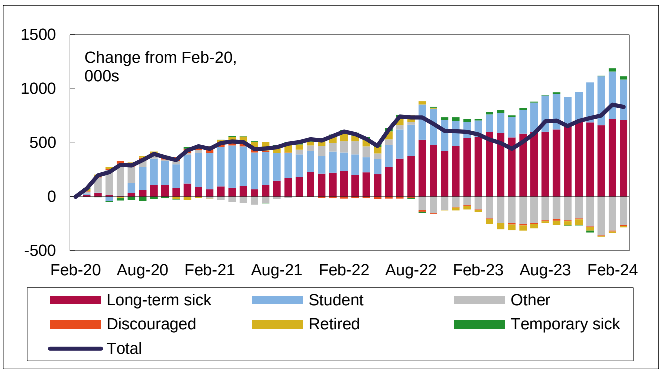
Wage growth moves sideways but private regular pay moderated slightly below BoE forecast

Contrasting with expectations of a moderation in March, today's wage figures suggested that pay pressures remained relatively strong at the end of Q1, with total and regular pay growth moving sideways at 5.7%3M/Y and 6.0%3M/Y respectively. Moreover, total private sector wage growth ticked up to a four-month high of 5.9%3M/Y, with the three-month annualised figure – up 2.3ppts to a six-month high of 6.5% – suggesting accelerated pay momentum at the end of Q1. The pickup in regular pay momentum was more moderate – up 1.5ppts to 6.1%3M/3M ann. – implying that bonuses and other one-off payments played a notable role. And on a six-month basis, regular pay momentum slowed to 4.2%, with the respective rate for private regular pay – of particular interest to BoE policymakers in their assessments of domestically-driven inflationary pressures – down to a more than two-year low of 3.9%6M/6M ann.. Moreover, the annual rate of private regular pay, which fell 0.1ppt to a 21-month low of 5.9%3M/Y, came in a touch below the BoE's recent projection. Some of the upwards pressure on momentum likely reflects the phasing in of the near-10% increase in the National Living Wage that came into effect at the start of April. And this was evident in more timely wage indicators, with median pay growth calculated from PAYE up 0.5ppt to an eight-month high 6.9%Y/Y in April, while the Indeed wage tracker was similarly up 0.4ppt to a seven-month high of 6.9%Y/Y. But these rates remain below levels seen a year ago, while last week's DMP survey findings suggest that firms' wage growth expectations for the twelve months ahead have eased to the lowest in two years.

Services inflation likely to be more important than wage growth for timing of first rate cut

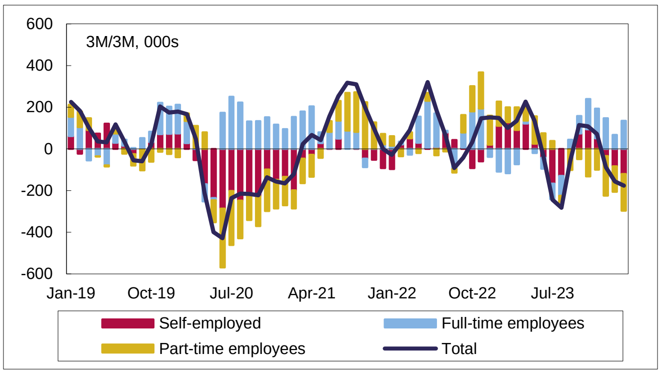
On balance, today's labour market findings continue to support our view that the MPC will soon be in a position to cut Bank Rate, possibly as soon as next month. Indeed, while BoE Chief Economist Pill – who has appeared the most hawkish of the internal MPC members of late – today cautioned that there is some way to go in getting and keeping inflation at target in light of the persisting tightness in the labour market, he also suggested that it was "not unreasonable" to think that the Bank will have enough evidence on the decline in inflation persistence to consider cutting rates over the summer. Of course, there will be a further labour market report before the next MPC meeting on 20 June. But for BoE Deputy Governor Breeden, her focus will be more on services inflation – for which there will be two sets of numbers before the June MPC meeting – rather than wages given signals from businesses on the increasing difficulties to pass through price increases this year than last. And given our expectation that services inflation will take a notable step down over coming months – from 6%Y/Y in March to below 5%Y/Y in May – we think that it is perfectly feasible that at least four Bank staff MPC members, and perhaps all five, will be in a position to support a rate cut next month.

UK: Reasons for inactivity



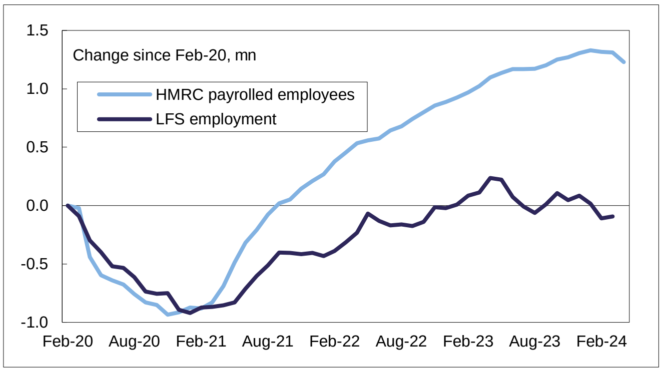
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Employment



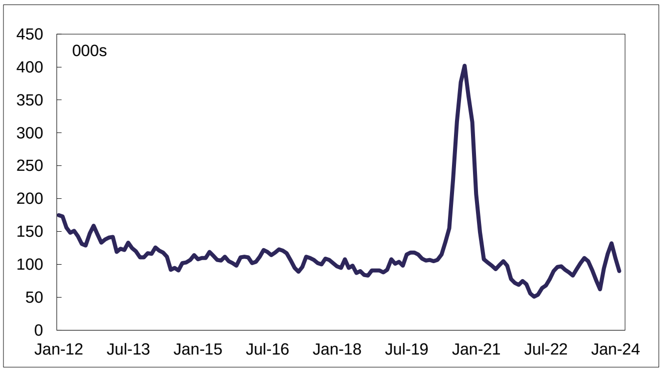
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measures of employment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Redundancies

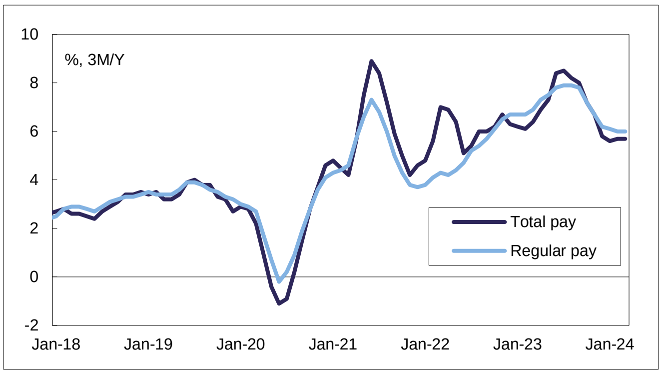


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

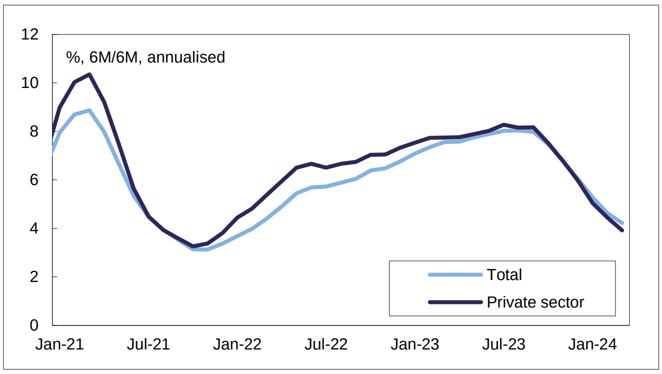
It will be quiet day of UK top-tier releases tomorrow, while former Fed Chair Bernanke will testify before the Treasury Select Committee on his recent review of economic forecasting at the BoE.

UK: Total & regular wage growth



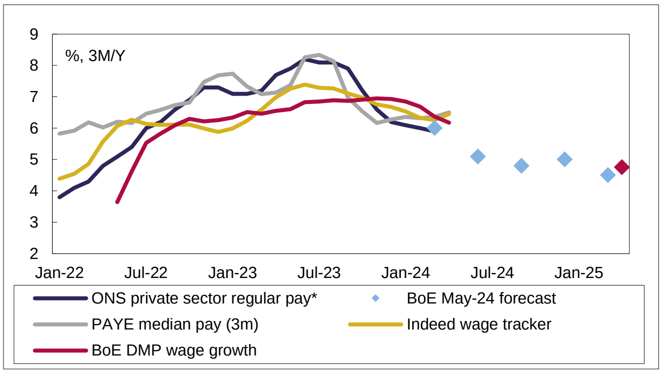
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Regular wage growth momentum



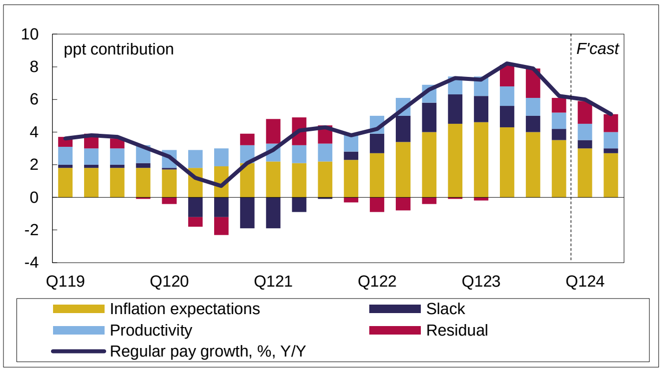
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measures of wage growth



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

UK: Contributions to private regular pay growth*



**BoE estimates from May-24 Monetary policy Report. Source: BoE and Daiwa Capital Markets Europe Ltd.*

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Final HICP (CPI) Y/Y%	Apr	**2.4 (2.2)**	*2.4 (2.2)*	2.3 (2.2)	-
		ZEW current situation (expectations) balance	May	**-72.3 (47.1)**	-	-79.2 (42.9)	-
Spain		Final HICP (CPI) Y/Y%	Apr	**3.4 (3.3)**	*3.4 (3.3)*	3.3 (3.2)	-
UK		Unemployment rate 3M%	Mar	**4.3**	4.3	4.2	-
		Employment 3M/3M change 000s	Mar	**-178**	-210	-156	-
		Payrolled employees M/M change 000s	Apr	**-85**	-	-67	-8
		Average wages (excluding bonuses) 3M/Y%	Mar	**5.7 (6.0)**	5.5 (5.9)	5.6 (6.0)	5.7 (-)
		Claimant count rate % (change 000s)	Apr	**4.1 (5.9)**	-	4.0 (10.9)	4.1 (-2.4)

Auctions

Country		Auction
Germany		sold €4.1bn of 2.9% 2026 bonds at an average yield of 2.93%
UK		sold £600mn of 0.125% 2073 index-linked bonds at an average yield of 0.994%

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	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)

Auctions and events

Country		BST	Event
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
		15.05	Ben Bernanke to testify before Treasury Select Committee on his review of the BoE's economic forecasting

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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