Daiwa Capital Markets

Euro wrap-up

Overview

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- Ahead of this evening's announcement of a further tightening of French pandemic containment measures, Bunds made gains while the flash estimate of euro area inflation in March surprised slightly on the downside.
- Gilts made losses as the estimate of GDP growth in the second half of 2020 was revised up.
- Thursday will bring German retail sales data for February, the first new car registrations figures for March and final manufacturing PMIs for the same month.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.704	-0.001
OBL 0 04/26	-0.636	-0.009
DBR 0 02/31	-0.299	-0.010
UKT $0^1/_8$ 01/23	0.091	+0.028
UKT $0^1/_8$ 01/26	0.387	+0.029
UKT 4¾ 12/30	0.841	+0.019

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

Euro area

Headline inflation up to 14-month high on energy prices, but core measure falls back

According to the flash estimate, euro area CPI inflation rose 0.4ppt in March to 1.3%Y/Y, a fourteen-month high albeit slightly less than expected. Within the detail, the increase was more than fully explained by energy inflation, which accelerated more than 5ppts to 4.3%Y/Y, the highest since April 2019. In contrast, food inflation slowed 0.2ppt to 1.1%Y/Y, the lowest in more than three years. Services inflation edged up 0.1ppt to 1.3%Y/Y, although we caution that data for about one fifth of those items will have been imputed by the statisticians. And strikingly, inflation of non-energy industrial goods fell a steep 0.7ppt to 0.3%Y/Y, likely due to discounting of clothing against the backdrop of ongoing pandemic containment measures. So, core inflation surprisingly fell 0.2ppt to a three-month low of 0.9%Y/Y. At the country level, today's figures from France (up 0.6ppt to 1.4%Y/Y on the EU-harmonised measure) and Italy (down 0.4ppt to 0.6%Y/Y) surprised on the downside. And the Netherlands (unchanged at 1.9%Y/Y), Portugal (down 0.2ppt to 0.1%Y/Y) and Greece (down 0.1ppt to -2.0%Y/Y) all avoided the significant energy-driven rises in inflation seen in Germany, Spain and several other member states.

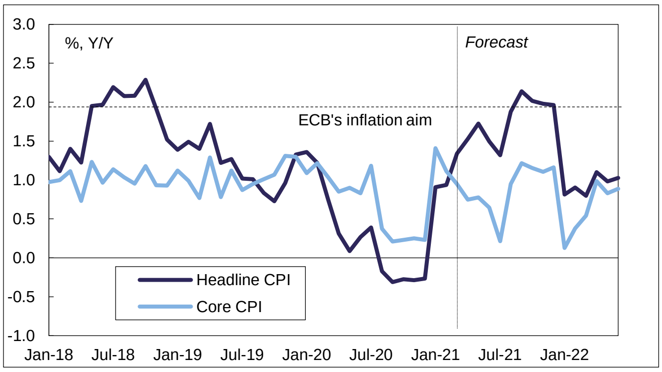
Inflation to move higher over coming quarters

Even without further significant increases in prices, energy inflation will accelerate over the coming quarter, probably exceeding 10%Y/Y next month to contribute roughly 1ppt to headline CPI inflation. In contrast, we expect food inflation to ease further over the near term. But as suggested by the March PMIs and Commission survey, pressures in manufacturing from commodities, freight costs and supply-chain disruption increase the likelihood of a renewed pickup in inflation of non-energy industrial goods. And while we expect services inflation to fall back over the near term not least as the travel and tourism sector faces another poor holiday season due to the pandemic, base effects from Germany's temporary VAT cut last year will add to inflation in the second half of the year when prices should also receive a boost from the relaxation of pandemic containment measures.

IG Metall settlement reinforces expectations of sub-par inflation from 2022 on

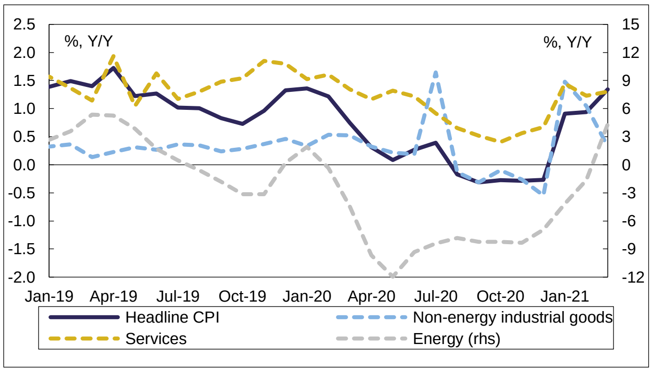
In particular, we forecast the headline CPI rate to rise to 1.5%Y/Y in April and remain thereabouts through Q2 and Q3. And we expect it to reach 2.0%Y/Y or more from September through to year-end. However, core inflation will likely remain below 1.5%Y/Y through to end-2021. And both headline and core CPI measures will fall sharply at the start of 2022 as the German VAT cut falls out of the calculation. Thereafter, we expect only a modest uptrend to develop, and only for as long as economic recovery is sustained. But we see no material impact on the inflation outlook from the ECB's decision to accelerate

Euro area: Inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

its asset purchases over the coming quarter, not least as there was no accompanying increase in the €1.85trn PEPP envelope. And yesterday's announcement of a damp-squib wage increase of 2.3%Y/Y over fifteen months from July for Germany's key manufacturing union IG Metall – which offers a guide to what to expect in other sectors and countries – suggests that the labour market will likely continue to provide little upwards cost pressure over the forecast horizon. So, underlying inflation still seems destined to remain below the ECB's aim over the medium term, meriting additional net asset purchases from the ECB beyond the current PEPP end-date of March 2022.

German unemployment falls in March, surveys point to rising labour demand

The tepid wage settlement for IG Metall came despite signs of a modest turn for the better in Germany's labour market. Today's figures reported a drop in unemployment claims in March of 8k, all but reversing the rise the prior month, to be just 1k above January's nine-month low. While that left the unemployment claims rate unchanged at 6.0% for a third consecutive month, the level of vacancies rose further to an eleven-month high to point to a further pickup in recruitment. And while the government's kurzarbeit likely continues to support the incomes of more than 2½ million workers, survey indicators point to increasing moves to hire new workers in sectors less affected by pandemic containment restrictions. For example, the ifo German Employment Barometer rose more than 3pts in March to a thirteen-month high of 97.6, with the Institute reporting increasing labour demand in electrical and electronics manufacturing, logistics companies and IT services.

New French pandemic restrictions to be announced while spending data disappoint

French household consumption expenditure on goods in February was disappointingly unchanged following January's drop of 4.9%M/M, which was a little steeper than previously thought, to be down 0.1%Y/Y. An increase of 3.4%M/M in purchases of manufactured goods in February was led by clothing and textiles (up 15.8%M/M albeit following a drop of 28.0%M/M in January) and items for the home (up 11.3%M/M following a drop of 24.7%M/M the prior month) thanks not least to the delayed start to the winter sales. But weakness in car sales weighed on purchases of transport items (-3.5%M/M). And spending on energy (-3.1%M/M) and food (-2.2%M/M) also fell back. Unfortunately, the tightening of pandemic containment measures affecting one third of the population is likely to have weighed on spending again this month. And with the number of patients with Covid-19 in intensive care now having surpassed the peak during the second wave in November, extra nationwide restrictions appear on the cards for April. At the time of writing an announcement from President Macron was scheduled for at 8pm local time this evening with a Parliamentary vote on the new measures also planned.

The day ahead in the euro area

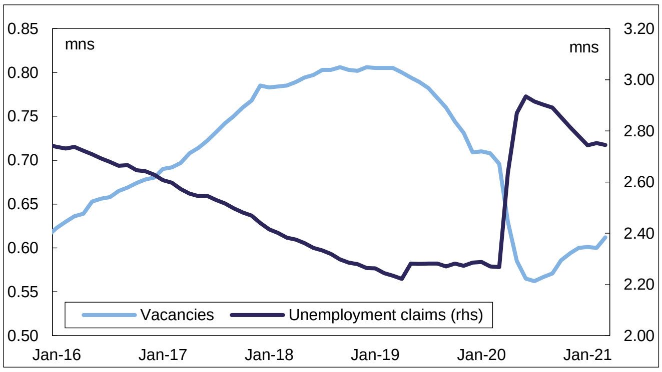
Tomorrow will bring the release of the final March manufacturing PMIs, which are expected to align with flash estimates and confirm that the euro area manufacturing output PMI rose 5pts to a series high of 63.0, with similarly strong growth reported in new orders from home and abroad. Also to be published tomorrow are German retail sales data for February as well as this month's new car registrations data for France, Italy and Spain. After a disappointing start to the year, with sales falling 6.5%M/M in January, German retail sales are expected to rise 2.0%M/M, leaving them 5.0% lower compared to a year earlier.

UK

GDP growth firmer than previously thought in H221

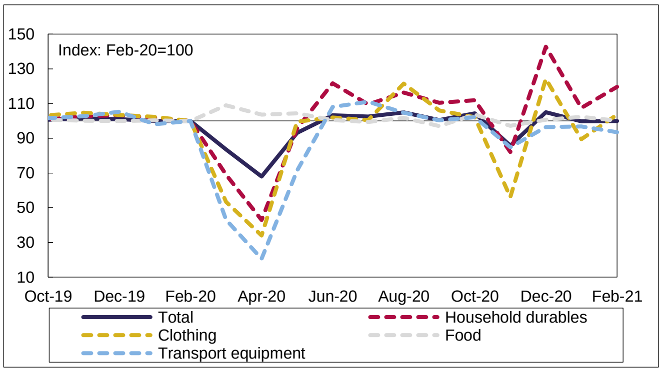
UK GDP rebounded somewhat faster than previously estimated through the second half of last year. However, with the contraction in Q2 now deeper than thought beforehand, GDP is estimated to have contracted by 9.8%Y/Y in 2020 as a whole, just 0.1ppt less than previously thought and still the steepest on the series dating back to 1949. In particular, total economic output in Q2 fell 19.5%Q/Q, 0.5ppt more than in the prior estimate. But growth in Q3 was 0.8ppt stronger than previously thought at 16.9%Q/Q, and growth in Q4 was revised up by 0.3ppt to 1.3%Q/Q leaving the year-on-year rate

Germany: Unemployment and vacancies



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Consumer spending on goods



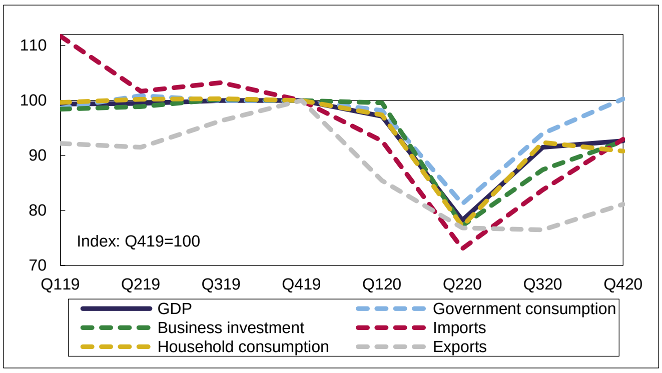
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

0.5ppt firmer at -7.3%Y/Y. Within the detail, business investment (now up 5.9%Q/Q, 4.6ppts more than previously estimated, albeit still down 7.4%Y/Y) largely explained the upwards revision last quarter, while government consumption also saw strong growth (6.7%Q/Q, a positive revision of 0.3ppt, to be up 0.3%Y/Y) due principally to increased spending on healthcare. But private consumption dropped more than thought earlier (down 1.7%Q/Q, a downwards revision of 1.5ppts, to be down 9.2%Y/Y). With lower spending, the household saving ratio increased 1.8ppts in Q4 to 16.1%, and the level of gross savings was up almost 110%Y/Y, representing a potential source of substantive extra demand to come. Meanwhile, stock-building ahead of the end of the Brexit transition saw inventories add 1.7ppts to growth last quarter while a wider trade deficit saw net exports subtract 1.5ppts. Indeed, the UK's current account deficit widened 2.2ppts in Q4 to 4.8% of GDP (4.2% of GDP excluding precious metals), the most since Q119. And the hit from Brexit will probably see a further significant negative contribution to growth over coming quarters, with the current account deficit likely to widen sharply further, probably reaching 7% of GDP or more in 2021.

The day ahead in the UK

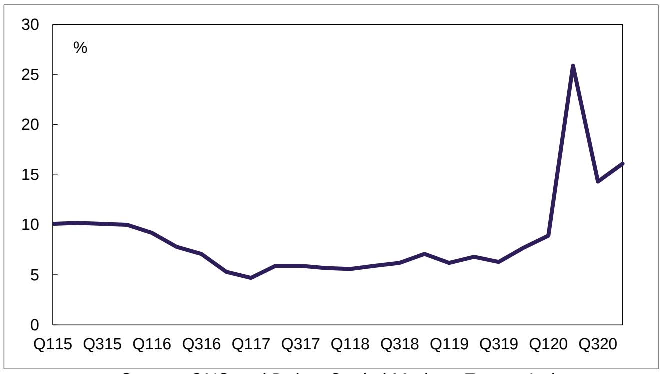
Ahead of the national holidays on Good Friday and Easter Monday, the week's UK data calendar will come to a close tomorrow with the final manufacturing PMIs, which are expected to reaffirm the impression that economic recovery is starting to stir. While not as elevated as in the euro area, the flash manufacturing output PMI rose more than 5pts to a three-month high of 55.6. And the new orders index for the sector was similarly the strongest since December's surge in activity ahead of the end of the Brexit transition.

UK: GDP and expenditure components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Household savings ratio



Source: ONS and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		Preliminary CPI (core) Y/Y%	Mar	**1.3 (0.9)**	1.4 (1.2)	0.9 (1.1)	-
Germany		Unemployment rate % (change '000s)	Mar	**6.0 (-8.0)**	6.0 (-3.0)	6.0 (9.0)	-
France		Consumer spending M/M% (Y/Y%)	Feb	**0.0 (-0.1)**	-	-4.6 (0.0)	**-4.9 (-0.1)**
		Preliminary CPI (EU-harmonised CPI) Y/Y%	Mar	**1.1 (1.4)**	0.9 (1.2)	0.6 (0.8)	-
		PPI Y/Y%	Feb	**1.8**	-	0.4	
Italy		Preliminary CPI (EU-harmonised CPI) Y/Y%	Mar	**0.8 (0.6)**	0.5 (1.1)	0.6 (1.0)	-
UK		BRC shop price index Y/Y%	Mar	**-2.4**	-	-2.4	-
		Final GDP Q/Q% (Y/Y%)	Q4	**1.3 (-7.3)**	1.0 (-7.8)	16.0 (-8.6)	-
		Current account balance £bn	Q4	**-26.3**	-34.8	-15.7	**-14.3**
		Nationwide house price index M/M% (Y/Y%)	Mar	**-0.2 (5.7)**	0.4 (6.4)	0.7 (6.9)	-

Auctions

Country		Auction
Germany		sold €2.07bn of 0% 2036 bonds at an average yield of 0.02%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		09.00	Final manufacturing PMI	Mar	62.4	57.9
Germany		08.55	Final manufacturing PMI	Mar	66.6	60.7
		07.00	Retail sales M/M% (Y/Y%)	Feb	2.0 (-5.0)	-6.5 (-9.3)
France		08.50	Final manufacturing PMI	Mar	58.8	56.1
		-	New car registrations* Y/Y%	Mar	-	-20.9
Italy		08.45	Manufacturing PMI	Mar	59.8	56.9
		17.00	New car registrations Y/Y%	Mar	-	-12.3
Spain		08.15	Manufacturing PMI	Mar	55.9	52.9
		-	New car registrations* Y/Y%	Mar	-	-38.4
UK		09.30	Final manufacturing PMI	Mar	57.9	55.1

Auctions and events

- Nothing scheduled -

**Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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