

Euro wrap-up

Overview

- Bunds rallied as Chief Economist Lane emphasised that the ECB should be ready to adjust policy in either direction in response to events in Ukraine, French and Italian core inflation remained well-contained, and German and French spending data were relatively soft.
- Despite an upwards revision to UK GDP and further strong house price data, Gilts also made gains as real household disposable income fell for a third consecutive quarter in Q4.
- Friday will bring the flash estimate of euro area inflation in March as well as the final manufacturing PMIs for the same month.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	-0.081	-0.074
OBL 0 04/27	0.372	-0.102
DBR 0 02/32	0.544	-0.097
UKT 1 04/24	1.341	-0.017
UKT 1½ 07/27	1.404	-0.028
UKT 4¼ 06/32	1.615	-0.048

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

Euro area

French inflation up to highest since mid-1980s but core pressures still well-contained

Just like yesterday's figures from [Germany and Spain](#), the flash estimates of French inflation in March exceeded expectations. On both the national CPI measure, and the EU-harmonised HICP measure, inflation jumped a hefty 0.9ppt, to 4.5%Y/Y and 5.1%Y/Y respectively. Thanks to the government's electricity and gas "tariff shield", which INSEE estimates knocked about 1.5ppts off inflation last month, French inflation might well have remained the lowest of all euro area member states. However, the national annual measure still represented the highest since the mid-1980s, with the HICP annual and monthly (1.6%M/M) rates at series highs. Perhaps inevitably, French pressures in March were led by energy, up almost 8ppts to 28.9%Y/Y, principally due to higher prices of gasoline. In addition, food inflation rose 0.7ppt to 2.8%Y/Y. And services inflation was also a touch firmer, up 0.1ppt to 2.3%Y/Y, the highest since 2009. However, despite intense cost pressures, inflation of manufactured goods slowed 0.1ppt to 2.1%Y/Y. And so, core inflation appears to have been little changed in March, still close to the ECB's 2% target.

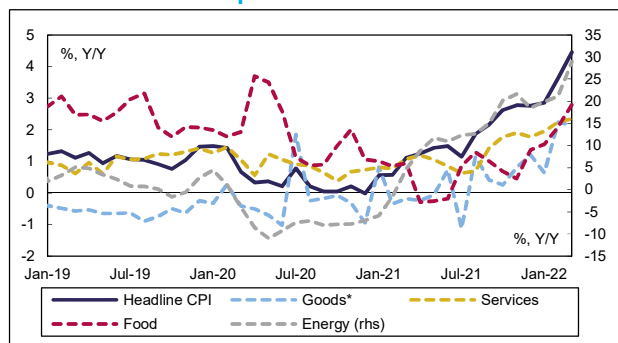
Italian inflation posts record rise, but misses expectation with core measure close to 2%

The flash March Italian inflation figures came in a touch softer than expected. Nevertheless, consumer prices on the HICP measure still rose by a record 2.6%M/M, to leave annual inflation 0.8ppt higher at 7.0%Y/Y. The pickup on the national measure was somewhat smaller, by 1.2%M/M and 6.7%Y/Y, given the adjustment for the winter sales. Within the HICP detail, energy prices jumped a further 6.9%M/M to be 53.5% higher than a year earlier. Prices of non-energy industrial goods also surged in March (5.8%M/M) as the price of clothing and footwear leapt 24.7%M/M, to leave the annual rate up 0.4ppt to 1.8%Y/Y, a seven-month high. But with services inflation unchanged at 1.9%Y/Y, weighed by an easing in transport services costs, core inflation edged just 0.2ppt higher to 2.1%Y/Y, nevertheless the highest since August 2012. Among today's other national data, Portuguese prices also rose by the most on the month (2.6%M/M) since the series began in 1996, pushing the headline inflation rate up 1.1ppts to 5.5%Y/Y. But with prices in Slovenia having fallen in March (-0.4%M/M), the annual HICP rate eased 1.0ppt to 6.0%Y/Y. As such, we maintain our view that the aggregate euro area inflation rate will rise by 1.2ppts to 7.0%Y/Y, with the risks skewed slightly to the upside.

Spending on goods on track for Q1 drop in Germany and France

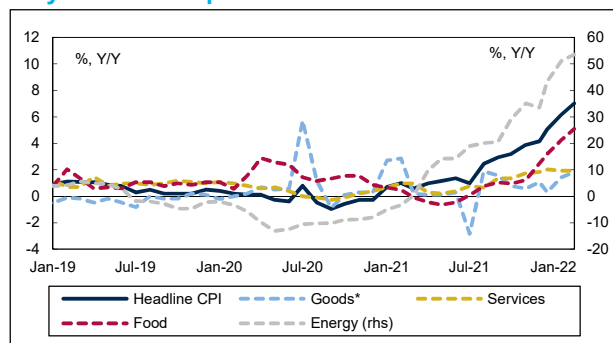
After taking a big step down in December as the latest pandemic wave intensified, and having been flat in January, German retail sales rose a modest 0.3%M/M in real terms in February. Food sales were little changed (up 0.1%M/M) but non-food sales were up 0.9%M/M. That left the volume of sales 4.4% above the pre-pandemic level two years earlier, and up 7.1%Y/Y

France: Consumer price inflation**



*Non-energy industrial goods. **National CPI measure.
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Italy: Consumer price inflation**



*Non-energy industrial goods. **EU-harmonised HICP measure
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

from the weak base a year ago. But the average level of sales in the first two months of Q1 was some 0.9% below the Q4 average. So, with consumer confidence having unsurprisingly taken a dive since Russia's invasion of Ukraine, German retail sales are on track for a non-negligible contraction in Q1. As in Germany, French household spending on goods rose in February, but growth of 0.8%M/M failed to fully reverse the drop of 2.0%M/M in January. And that left it trending so far in Q1 some 1.4% below the Q4 average, again suggesting the likelihood of a drop in spending on goods this quarter. Spending on services in both countries is likely to be up on Q4. But while overall household consumption in France is likely to have continued to grow in Q1, it is at clear risk of a second successive quarterly contraction in Germany.

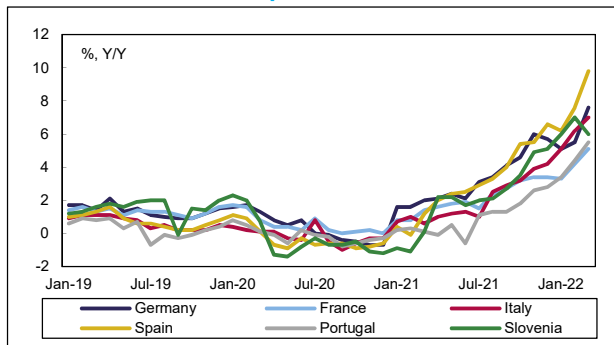
Unemployment continues to decline, but Lane mindful of two-sided risks from Ukraine war

Despite risks of a weakening of economic activity at the end of Q1, conditions in Germany's labour market appear to have remained favourable. March brought an eleventh successive monthly drop in jobless claims, of 18k, leaving the claimant count rate unchanged at 5.0%, the same level as ahead of the pandemic. Moreover, the number of job vacancies rose to a new high, above 850k for the first time. The euro area's labour market data for February reported a further drop in joblessness, with the unemployment rate declining for the tenth successive month, by 0.1ppt (from an admittedly upwardly revised January figure) to a series low of 6.8%. The number of jobless workers declined for the tenth successive month, by 181k, to 11.155mn, also a euro-era low. Of the five largest member states, only in Germany did the unemployment rate fail to fall in February. And despite the increase in economic uncertainty, hit to business confidence and intensification of cost pressures from events in Ukraine, survey measures – such as yesterday's Commission [employment expectations indicator](#) – point to a further drop in joblessness over the near term. Nevertheless, as ECB Vice President de Guindos reminded today, there remains no sign of significant wage pressures emerging from the euro area labour market. And while acknowledging the risks that inflation might remain above target over the medium term, Chief Economist Lane today insisted that the ECB should be fully prepared to adjust its policy settings if the Russia-Ukraine war were to result in a significant deterioration in macroeconomic prospects and thereby weaken the medium-term inflation outlook.

The day ahead in the euro area

Following the largely stronger-than-expected national inflation data of the past couple of days, all eyes tomorrow will be on the release of the flash March euro area estimates. We expect higher energy prices to continue to exert upward pressure on the euro area headline HICP rate, which we forecast to rise 1.1ppt to a new series high of 7.0%Y/Y, firmly above the ECB's revised baseline scenario of inflation, which suggested peaks of 5.4%Y/Y in Q1 and Q2. We also expect rising goods and services inflation to push the core CPI rate up above 3.0%Y/Y. In addition, tomorrow will also bring the final manufacturing PMIs for the euro area, Germany and France as well as initial results for Italy and Spain, which will also suggest a slowing of

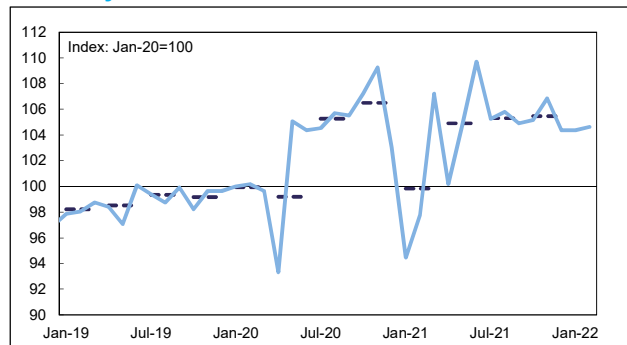
Euro area: Consumer price inflation*



*EU-harmonised measures.

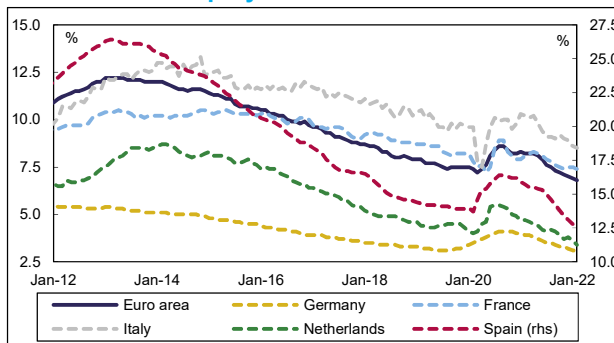
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales*



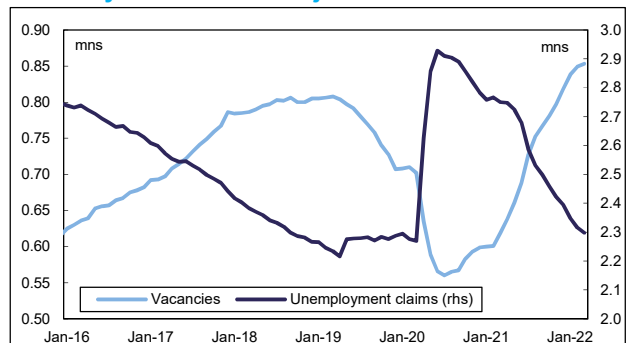
*Dashed lines represent quarterly average. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment rates



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Vacancies and jobless claims



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

economic activity at the end of Q1. The [flash euro area PMIs](#) saw the manufacturing output index decline 1.9pts to 53.6, a five-month low restrained by supply-chain disruption and cost pressure. Finally, March new car registrations data for France, Italy and Spain are likely to highlight the impact of ongoing supply-chain disruption.

UK

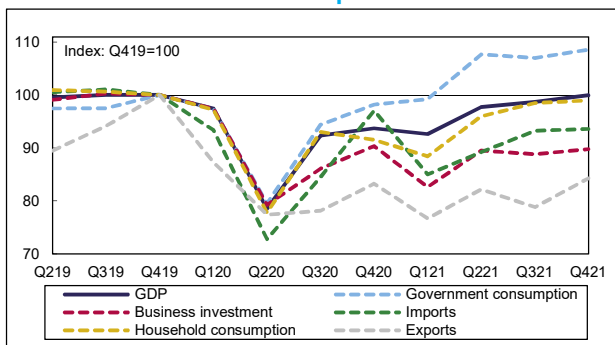
Q4 GDP revised up, but consumption revised down as savings and real disposable income fell

UK GDP in Q4 was revised up, with growth now estimated to have been 0.3ppt stronger than previously thought at 1.3%Q/Q. So, despite a modest downwards revision to growth in Q3, by 0.1ppt, the level of output was revised higher to be just 0.1% below the Q419 peak. The upwards revision (on the expenditure side) was overwhelmingly driven by a smaller drag in inventories – now estimated to have subtracted 1.3ppts from growth compared with 2.2ppts previously. In contrast, private consumption growth was revised notably lower in Q4, by 0.7ppt to just 0.5%Q/Q, reflecting a downwards revision to spending on transport, to leave it still 1% lower than the Q419 level (compared with the previously estimated shortfall of 0.4%). That slowdown coincided with a third successive quarterly decline in real household disposable income, reflecting the effects of higher inflation, while the household savings ratio fell 0.7ppt to 6.8%, more than 17ppts below the peak in Q220 and just 0.8ppt above the pre-pandemic level in Q419. Fixed investment growth (1.1%Q/Q) was also roughly half what had been previously estimated, while government spending growth was lowered by 0.4ppt to 1.5%Q/Q. And while growth in exports and imports was much stronger than previously projected, the contribution from net trade was unchanged (1.7ppt). On the production side, there were upwards revisions to a range of services activity in Q4 – led by healthcare – to leave total output in the sector 0.9% above the pre-pandemic level. But while manufacturing production was also revised a touch higher, it remains 1.5% below pre-Covid levels, similar to the pandemic-related shortfall in construction activity.

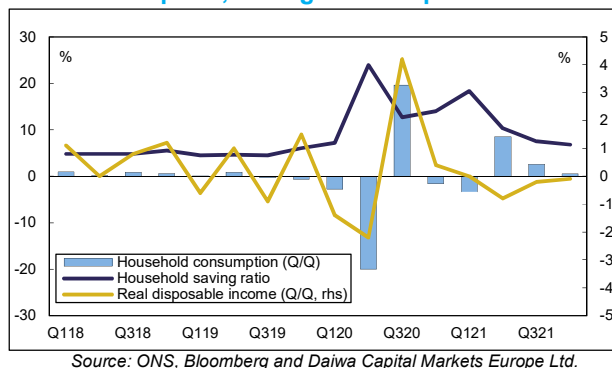
House prices up at fastest annual pace since 2004

According to the Nationwide house price index, residential property prices rose for the eighth consecutive month (1.1%M/M) in March. That pushed the annual rate up 1.7ppts to 14.3%Y/Y, the strongest rate since November 2004. The average home price rose to a new record high (£265.3k), more than a fifth higher than before the pandemic. BoE mortgage lending figures, released earlier this week, showed that net secured lending slowed only moderately to £4.7bn in February, still above the pre-pandemic average in the twelve months to February 2020 (£4.3bn). And while mortgage approvals slowed to 71k, they too remained broadly in line with the pre-pandemic level. Increases in Bank Rate are starting to feed through to mortgage rates. For example, for a 75% loan-to-value mortgage, the average interest rates on fixed 2Y and 5Y loans rose roughly 15bps in February to 1.76% and 1.79% respectively, up from the lows of 1.30% in October. With real disposable incomes set to fall markedly this year, the housing market should lose some momentum as borrowing costs also rise. However, the ongoing supply-demand imbalance in the housing market should continue to keep house prices elevated.

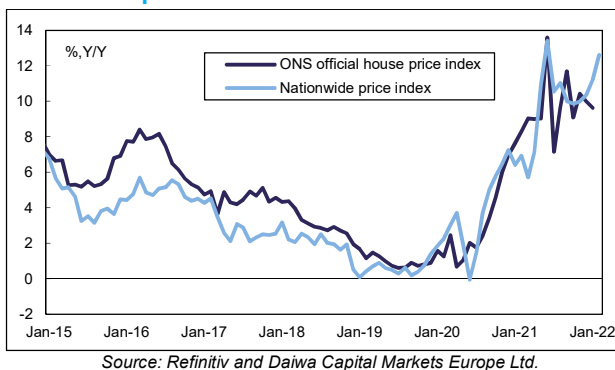
UK: GDP and selected components



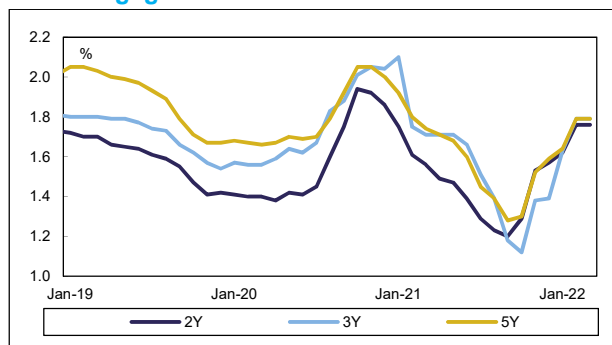
UK: Consumption, savings and disposable income



UK: House price indices



UK: Mortgage rates*













*Fixed-rate mortgages with 75% loan-to-value ratio.
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.












The day ahead in the UK

It will be a relatively quiet end to the week on the UK economic data front with only the final March manufacturing PMIs due. According to the flash figures, the headline manufacturing index fell 2.5pts to 55.5, a thirteen-month low, while the output PMI fell 4.3pts to 52.6, a five-month low. New orders growth was the softest in more than a year. And while supplier delays were the least widespread for seventeen months, manufacturers noted that shortages of raw materials, staff absences and shipping delays continued to limit production, with significant risks that these will be intensified by the Ukraine war over the months ahead.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Unemployment rate %	Feb	6.8	6.7	6.8	6.9
Germany	 Retail sales M/M% (Y/Y%)	Feb	0.3 (7.1)	0.5 (6.3)	1.4 (10.4)	0.0 (10.4)
	 Unemployment change '000s (rate %)	Mar	-18.0 (5.0)	-20.0 (5.0)	-33.0 (5.0)	-32.0 (-)
France	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Mar	4.5 (5.1)	4.3 (4.8)	3.6 (4.2)	-
	 PPI M/M% (Y/Y%)	Feb	1.1 (22.4)	-	4.6 (22.2)	4.7 (22.4)
	 Consumer spending M/M% (Y/Y%)	Feb	0.8 (-2.3)	1.1 (-0.9)	-1.5 (-2.1)	-2.0 (-2.8)
Italy	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Mar	6.7 (7.0)	6.4 (7.2)	5.7 (6.2)	-
UK	 Lloyds business barometer	Mar	33	-	44	-
	 Final GDP Q/Q% (Y/Y%)	Q4	1.3 (6.6)	1.0 (6.5)	1.1 (7.0)	-
	 Nationwide house price index M/M% (Y/Y%)	Mar	1.1 (14.3)	0.5 (13.4)	1.7 (12.6)	-
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/ <i>Daiwa forecast</i>	Previous	
Euro area		09.00	Final manufacturing PMI	Mar	57.0	58.2
		10.00	Preliminary CPI (core CPI) Y/Y%	Mar	<u>7.0 (3.2)</u>	5.8 (2.7)
Germany		08.55	Final manufacturing PMI	Mar	57.6	58.4
France		08.50	Final manufacturing PMI	Mar	54.8	57.2
		-	New car registrations* Y/Y%	Mar	-	-15.4
Italy		08.45	Manufacturing PMI	Mar	57.0	58.3
		17.00	New car registrations Y/Y%	Mar	-	-22.6
Spain		08.15	Manufacturing PMI	Mar	55.7	56.9
		-	New car registrations* Y/Y%	Mar	-	6.6
UK		09.30	Final manufacturing PMI	Mar	55.5	58.0
Auctions and events						
Euro area		-	ECB's Schnabel and Knot scheduled to speak			

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

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