# Euro wrap-up

## Overview

**Chris Scicluna**
+44 20 7597 8326

**Emily Nicol**
+44 20 7597 8331

- Bunds made gains as the flash March estimate of euro area inflation fell further than expected and the latest German retail sales and jobless claims data were softer than anticipated.
- Gilts were little changed as UK GDP in Q4 was revised up slightly but house prices marked their sharpest annual decline since 2009.
- The coming week brings data for German and French IP, and euro area PPI and consumer inflation expectations, all for February.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 2½ 03/25 | 2.677 | -0.047 |
| OBL 2.2 04/28 | 2.315 | -0.078 |
| DBR 2.3 02/33 | 2.296 | -0.069 |
| UKT 0⅝ 06/25 | 3.429 | - |
| UKT 1⅝ 10/28 | 3.349 | -0.001 |
| UKT 3¼ 01/33 | 3.499 | -0.013 |

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

# Euro area

### Headline inflation falls to 13-month low as energy component falls on huge base effect

Despite yesterday's upside surprise from Germany, today's flash estimate of euro area consumer price inflation surprised on the downside thanks not least to steeper-than-expected falls in Italy and the Netherlands. However, the detail of the report will have remained a cause for concern for the ECB, reinforcing the case for a further rate hike at its next monetary policy meeting in May. The headline HICP rate fell 1.6ppts to 6.9%Y/Y, 0.2ppt below the median forecast on the Bloomberg survey and a thirteen-month low. However, given the upside surprise in February, the average inflation rate in Q1 of 8.0%Y/Y was 0.2ppt above the ECB's forecast published earlier this month. And the drop in March was almost entirely due to energy, and in particular the huge base effect associated with the record jump in such prices of more than 12%M/M a year earlier following Russia's invasion of Ukraine. With energy prices falling by 2.2%M/M this March, the respective annual rate fell 14.6ppts to -0.9%Y/Y. As such, the contribution to headline inflation from energy – which had been more than 4ppts as recently as October – dropped to negative territory for the first time in more than two years.

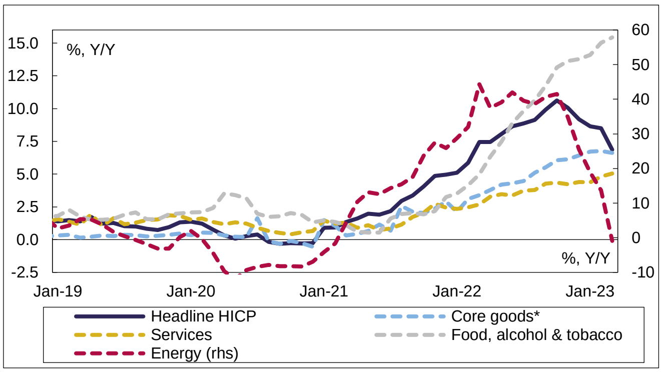
### Core goods inflation also moderates but services component hits new high

The good news in today's inflation data was not confined to energy. Possibly responding at last to eased pressures on supply chains, lower prices of freight, and/or softer demand, but also perhaps related in part to the reweighting of the index, prices of non-energy industrial goods were also better behaved in March. Indeed, their rise of 2.4%M/M was no more than the average for the month in the decade ahead of the pandemic. So, the respective annual rate declined 0.2ppt from last month's series high. However, despite some more favourable recent trends in wholesale markets, for the eleventh month out of the past twelve, food prices rose at a record monthly pace for the respective month, pushing the annual rate of food inflation up 0.4ppt to a new high of 15.4%Y/Y to contribute more than 3ppts to overall inflation. Probably of greatest worry for members of the Governing Council will be prices of services, for which the rise on the month matched the series high. That took the annual rate of services inflation up a further 0.2ppt to a new record of 5.0%Y/Y. As a result, core inflation (excluding all food and energy) edged up to a new series high of 5.7%Y/Y (admittedly, to two decimal places, the rise was just 0.04ppt to 5.65%Y/Y).

### Core inflation should start to moderate in Q2 but services persistence remains a risk

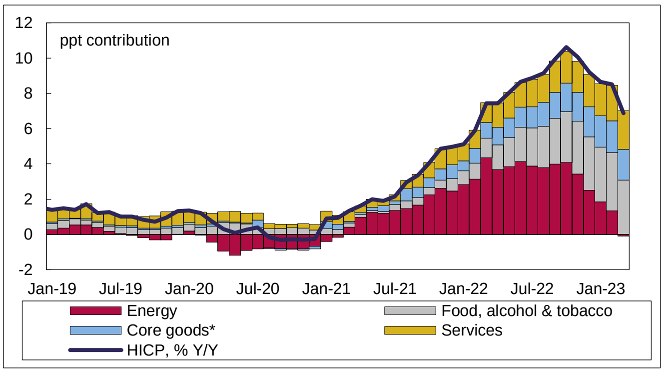
With ECB policymakers looking for a clear decline in underlying inflation before they stop the tightening cycle, and financial sector turbulence having eased for now, the new high for the core rate likely makes a further rate hike in May – albeit probably of 25bps – all-but inevitable. And while we think core inflation will fall back from next month to around 5.0%Y/Y by

**Euro area: Consumer price inflation**




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

**Euro area: Consumer price inflation**




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

the end of Q2, we expect a further 25bp rate hike in June too. Thereafter, base effects and diminished global pressures should allow for a more significant decline in core goods inflation. But whether or not the ECB will choose then to stop tightening will hinge principally on services prices. We suspect that diminished pass-through of costs of energy, food and other goods, and scope for margins to absorb increased wage costs, will result in a slight slowing of services inflation in time to justify an end to the rate-hike cycle by Q3. However, not least given the ability of firms in the sector over recent quarters to boost profits via aggressive price-setting, the risks of inflation persistence in this component are non-negligible, and with that so too are the risks of further ECB rate hikes in the second half of the year.

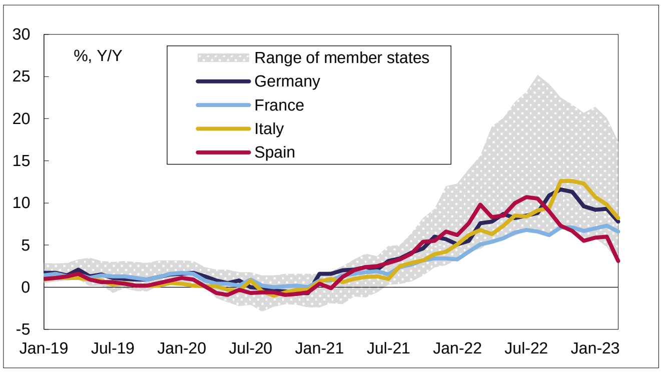
## Wage growth likely to pick up somewhat as labour market remains stable and tight

ECB Chief Economist Philip Lane asserted earlier this week "So far, rising wages have not been an important source of inflation". Indeed, he judged that, while pay increases have been "higher than normal, …in the grand scheme of things they look reasonably fair". He added, however, that the ECB would keep an eye on the labour market and still expects pay growth to pick up as unions seek compensation for the high inflation and erosion of living standards of the past year. Somewhat faster wage growth certainly seems likely. While economic growth in the euro area remains broadly absent, survey indicators, such as the Commission's employment intentions index, suggest that demand for workers remains relatively firm amid a historically tight labour market. Indeed, having been unchanged between April and December last year, the euro area unemployment rate edged down at the start of 2023 to a new series low of 6.6%, and remained at that level in February. In the large member states, on the EU-harmonised measure, unemployment rates have all broadly moved sideways over the past six months. Most notably perhaps, in January and February, Germany's jobless rate returned to the pre-pandemic low of just 2.9% while France's edged down last month to the series low of 7.0%. Today's German labour market data for March, however, reported a slightly larger-than-expected increase in jobless claims of 16k, which pushed the respective rate up 0.1ppt to 5.6%, the highest since July 2021. In addition, the number of job vacancies maintained its recent downtrend, falling below 800k for the first time since October 2021. However, total vacancies still remain high by historical standards, just 12k below the pre-pandemic peak, suggesting that businesses remain keen to hoard labour and hire new workers if good candidates are available.

## German retail sales maintain firm downtrend in middle of Q1

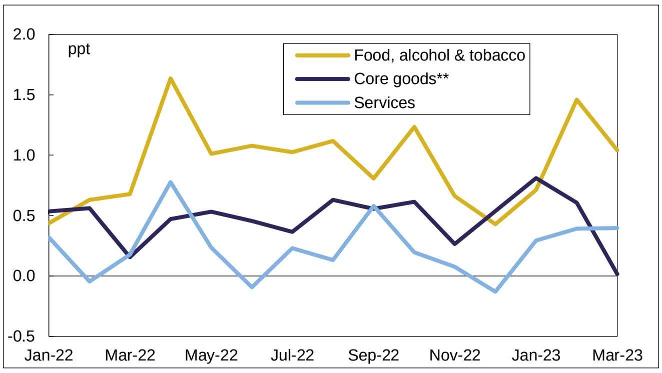
Today's German retail sales data were even more disappointing than the jobless claims figures, maintaining the firm downtrend that has been in place for about a year and providing a reminder that any economic growth in Germany in Q1 was

### Euro area: Consumer price inflation



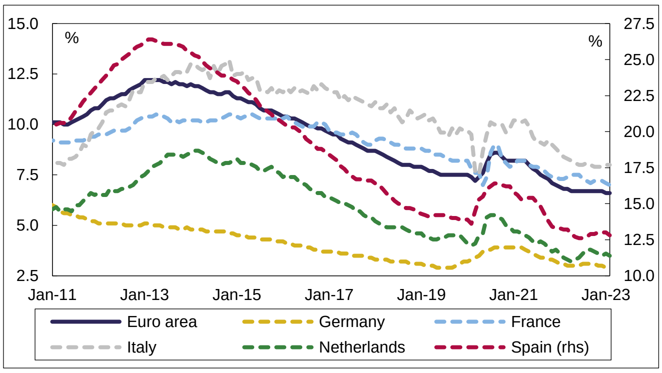

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

### Euro area: Deviations from l-r average price change*



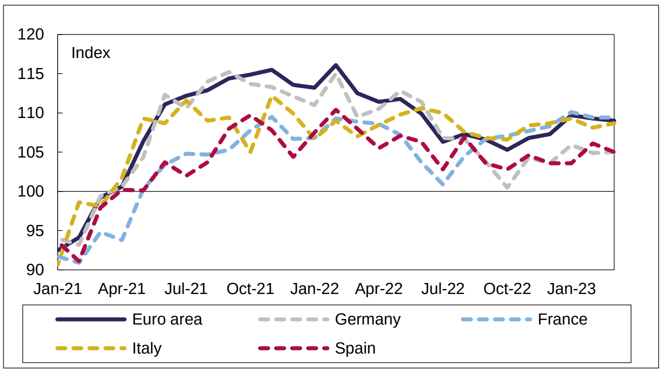

**Difference in monthly consumer price change from pre-pandemic long-run average. **Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: Unemployment rates




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: Employment intentions indices




*Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.*

very weak at best. In particular, the volume of German sales dropped 1.3%M/M in February following revised growth of just 0.1%M/M in January. That left sales in real terms down 7.0%Y/Y and 2.3%3M/3M, and firmly on track for a fourth successive quarterly contraction in Q1. Despite a further rise in prices, German retail sales in nominal terms fell for a third successive month in February, by 0.5%M/M to be down 1.5%3M/3M, albeit still up 2.6%Y/Y. While the GfK survey results this week pointed to a further modest improvement in consumer confidence in March, sentiment remains very subdued and willingness to spend also remains historically low. Indeed, as households continue to lick their wounds following the recent big hit to real disposable incomes, we expect household consumption to drop over Q1 for the second successive quarter and to remain weak into the second half of the year too. With retail spending, excluding car sales, to remain well down on levels achieved during the pandemic, core goods inflation should at least continue to subside.

### The week ahead in the euro area

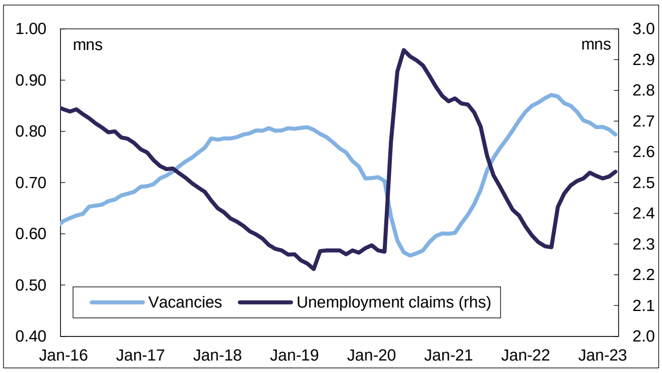
The coming week is set to be somewhat quieter on the euro area economic data front. Following today's consumer inflation release, February producer inflation figures and ECB consumer survey (Tuesday) will not be without interest, offering further insight into the disinflationary trend at the factory gate and inflation expectations respectively. Ahead of this, the start of the week brings the release of new car registrations data for March from France, Italy and Spain (Monday), which will be followed on Wednesday by German car registration and production figures. German goods trade (Tuesday), factory orders (Wednesday) and industrial production data for February (Thursday) will provide an update on manufacturing activity in the middle of Q1. February IP numbers from France and Spain (Wednesday) are also due midweek. In terms of business survey results, the final manufacturing and services PMIs will be published on Monday and Wednesday respectively, followed by the construction PMIs on Thursday. The euro area flash PMIs unexpectedly suggested that economic conditions improved significantly at the end of the first quarter despite financial sector turbulence. In particular, the euro area's composite output PMI jumped 2.1pts in March to 54.1, a ten-month high to be almost 7pts above October's trough. This left the quarterly index in Q1 (52.1) 4pts above the Q4 average and therefore suggestive of a return to modestly positive GDP growth this quarter.

# UK

### Despite an upwards revision in H222, UK GDP remains below pre-pandemic level

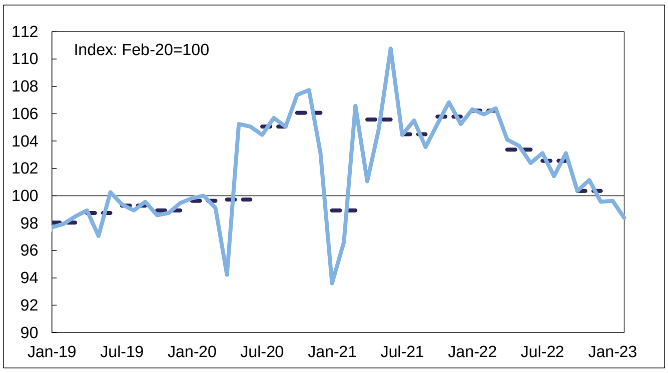
According to today's updated national accounts, the UK economy managed to avoid a technical recession in the second half of last year. In particular, GDP growth was upwardly revised in Q422 to eke out marginally positive growth of 0.1%Q/Q

**Germany: Unemployment claims & job vacancies**



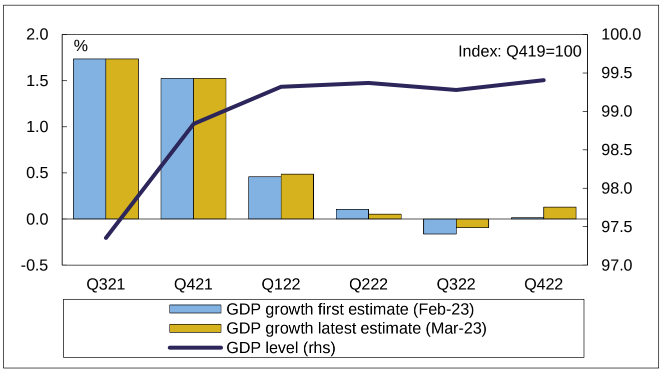

*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

**Germany: Retail sales***



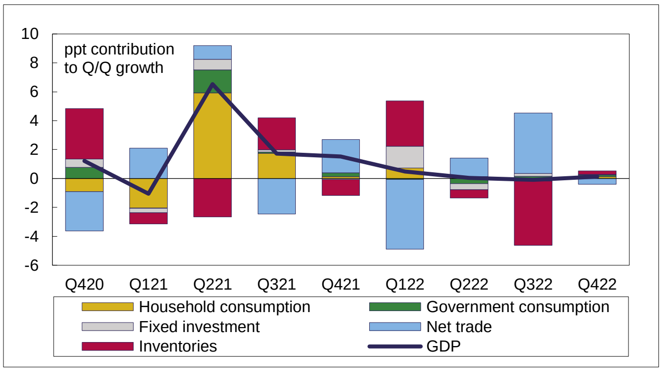

**Seasonally adjusted volumes. Dashed lines represent quarterly averages.*
*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

**UK: GDP growth and level**




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

**UK: GDP growth & expenditure contributions**




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

compared with the previous estimate of no growth. The magnitude of contraction in Q3 was also marginally smaller than previously thought, revised by 0.1ppt to -0.1%Q/Q. this still marked a significant slowdown compared with 2021 and the start of 2022. And so, year-on-year growth in Q4 was revised up 0.2ppt to a still-meagre 0.6%, while the level of output was still some 0.6% below the pre-pandemic level in Q419, maintaining the UK's ignominious distinction as the sole member of the G7 to fail to reach that benchmark. Despite strike-related disruption, growth in services was a touch firmer than initially assessed in Q4 (+0.1ppt to 0.2%Q/Q), as was industrial production (+0.2ppt to 0.0%Q/Q), manufacturing (+0.5ppt to 0.5%Q/Q) and construction (+1.0ppt to 1.3%Q/Q). Indeed, reflecting additional past revisions, manufacturing output in Q4 now stood some 3.6% above the pre-pandemic level, revised from 1.4% previously. Construction was 6% above, while services was still more than 1% below the Q419 level.

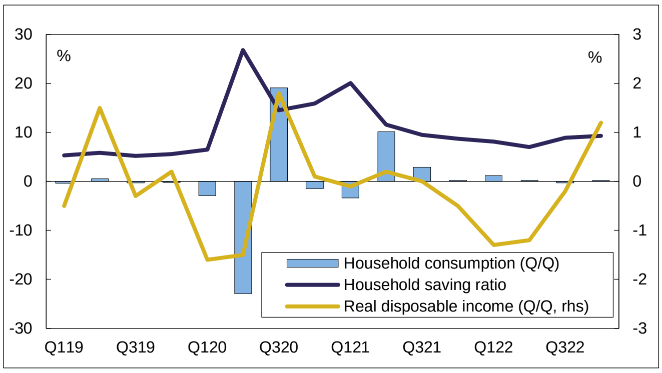
## Consumption benefits from net tourism, as real disposable income rises for first quarter in five

Despite record high inflation and the surge in the cost of borrowing, household consumption was a touch firmer than initially estimated in Q4 (0.2%Q/Q), driven by spending on net tourism, transport and household energy. The impact of higher prices was evident, however, with nominal household consumption up a much stronger 2.5%Q/Q. But thanks to solid employment gains and faster wage growth, as well as payments to households to help with their winter energy bills, real households' disposable income rose for the first quarter in five (1.3%Q/Q), allowing households to increase slightly their savings, taking the ratio up to 9.3% the highest since Q321. But real disposable income was still down 0.8%Y/Y. The BoE noted in its recent MPC minutes that it does not expect this to weaken further, as an anticipated drop in inflation will offset the impact of the end of the government energy bill support payments in April. But given tighter lending conditions, the ongoing adjustment in the housing market (see below) and still weak consumer confidence, household consumption growth will continue to lack vigour. Meanwhile, within the other expenditure components, there was a striking downwards revision to business investment growth of 5ppts to a decline of 0.2%Q/Q, driven by weaker spending on machinery. While this followed a notable upwards revision in Q3, the level of business investment was still more than 2% below the pre-pandemic level and also below the level at the time of the Brexit referendum in Q216, let alone the level that would have been achieved had investment maintained the pre-Brexit trend. Finally, a softer contraction in imports saw the drag from net trade halved to 0.4ppt.

## Current account deficit narrowed amid recovery in direct investment earnings from overseas

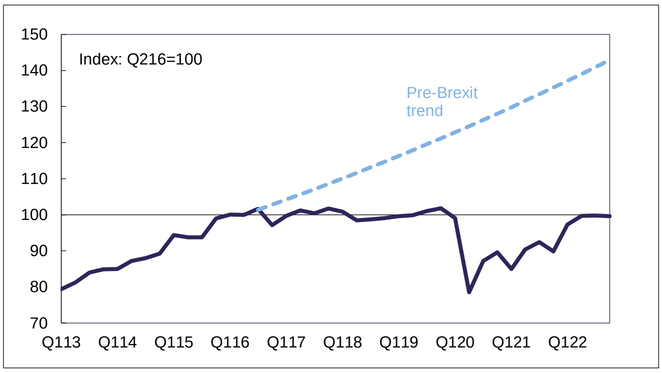
Despite the slight deterioration in the trade deficit in nominal terms last quarter, today's balance of payments figures suggested an improved current account position in the final quarter of 2022, at least at face value. In nominal terms, the

### UK: Household consumption and savings ratio



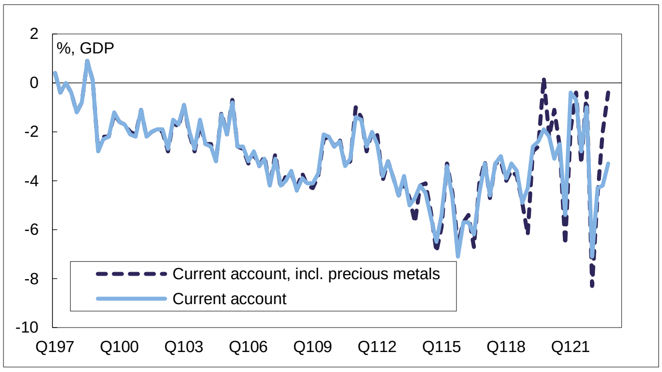

*Source: ONS, Refinitiv and Daiwa Capital Markets Europe Ltd.*

### UK: Business investment



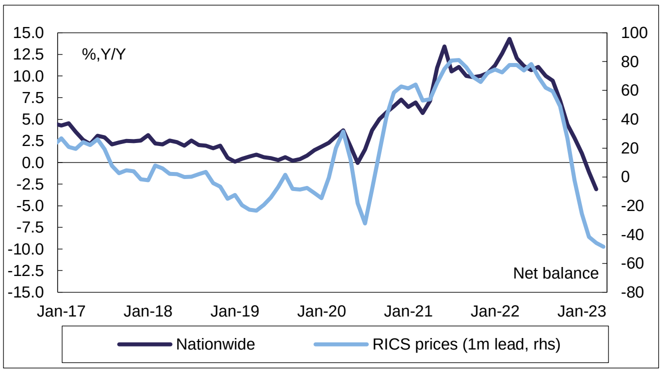

*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### UK: Current account balance




*Source: ONS and Daiwa Capital Markets Europe Ltd.*

### UK: House price indicators




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

deficit narrowed more than £10bn to just £2.5bn (0.4% of GDP) in Q4, down from the record £50.5bn (8.3% of GDP) at the start of the year. When excluding net trade in precious metals, which is typically highly volatile and distorts the picture, the underlying deficit narrowed a little less, by £5.2bn to £21.1bn, to be down 0.4ppt to 3.8% of GDP. That, nevertheless, was the smallest in a year and compared with the record deficit of more than 7% of GDP at the start of last year. The improvement in Q4 was caused principally by a widening of the primary income surplus (£9.8bn, 1.5% of GDP) as direct investment earnings from abroad continued to recover, especially in the energy sector.

## UK house prices down for the seventh consecutive month in March

Unsurprisingly, the reversal in UK residential property prices has continued this month. According to the Nationwide index, the average house price fell for the seventh successive month in March and by 0.8%M/M on a seasonally adjusted basis to be down 3.1%Y/Y, the largest annual decline since July 2009. The decline this month took the cumulative decline from August's peak to a chunky 4.6%. However, prices remain some 18½% above the level at the start of 2020 ahead of the pandemic. Surveys, as well as basic calculations of affordability for first-time buyers following the recent marked increase in interest rates, historically low mortgage approvals, and still very weak consumer confidence all point to further declines – at least matching the drop from the peak so far – to come over coming months.

## The week ahead in the UK

Like in the euro area, the holiday-shortened week is set to be very quiet on the UK economic data front, kicking off on Monday with the final March manufacturing PMIs, followed by the final service sector PMIs on Wednesday and construction PMIs on Thursday. The flash PMIs suggested that activity slowed on the month, although they were still consistent with expansion in the private sector. In particular, having surprisingly leapt 4.6pts in February to an eight-month high, the composite output PMI slipped back by 0.9pt to 52.2. That left the Q1 average at 51.3, the first quarterly reading above 50 since Q222. Wednesday will also bring new car registrations figures for March. In terms of BoE speak, Chief Economist Pill and external MPC member (and uber-dove) Tenreyro will talk publicly at separate events on Tuesday.

***The next edition of the Euro wrap-up will be published on 5th April 2023***

# Daiwa economic forecasts

| | 2022 | | 2023 | | | | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | | | |
| **GDP** | | | %, Q/Q | | | | | %, Y/Y | |
| Euro area | 0.4 | 0.0 | 0.0 | 0.1 | 0.1 | 0.2 | 3.5 | 0.6 | 1.0 |
| UK | -0.1 | 0.1 | -0.1 | -0.1 | 0.0 | 0.1 | 4.1 | -0.1 | 0.5 |
| **Inflation, %, Y/Y** | | | | | | | | | |
| Euro area | | | | | | | | | |
| Headline HICP | 9.3 | 10.0 | 8.0 | 6.0 | 4.4 | 2.7 | 8.4 | 5.2 | 2.3 |
| Core HICP | 4.4 | 5.1 | 5.5 | 5.1 | 4.5 | 3.7 | 3.9 | 4.7 | 2.4 |
| UK | | | | | | | | | |
| Headline CPI | 10.0 | 10.7 | 10.0 | 6.8 | 5.4 | 2.9 | 9.1 | 6.2 | 2.1 |
| Core CPI | 6.3 | 6.4 | 5.9 | 5.1 | 4.2 | 3.4 | 5.9 | 4.6 | 2.7 |
| **Monetary policy, %** | | | | | | | | | |
| ECB | | | | | | | | | |
| Refi Rate | 1.25 | 2.50 | 3.50 | 4.00 | 4.00 | 4.00 | 2.50 | 4.00 | 3.25 |
| Deposit Rate | 0.75 | 2.00 | 3.00 | 3.50 | 3.50 | 3.50 | 2.00 | 3.50 | 2.75 |
| BoE | | | | | | | | | |
| Bank Rate | 2.25 | 3.50 | 4.25 | 4.25 | 4.25 | 4.25 | 3.50 | 4.25 | 3.25 |

*Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.*

# The coming week's data calendar

## The coming week's key data releases

| Country | | BST | Release | Period | Market consensus/ *Daiwa forecast/actual* | Previous |
|---|---|---|---|---|---|---|
| | | | **Monday 03 April 2023** | | | |
| Euro area | | 09.00 | Final manufacturing PMI | Mar | 47.1 | 48.5 |
| Germany | | 08.55 | Final manufacturing PMI | Mar | 44.4 | 46.3 |
| France | | 08.50 | Final manufacturing PMI | Mar | 47.7 | 47.4 |
| | | - | New car registrations* Y/Y% | Mar | - | 9.4 |
| Italy | | 08.45 | Manufacturing PMI | Mar | 51.4 | 52.0 |
| | | 17.00 | New car registrations Y/Y% | Mar | - | 17.5 |
| Spain | | 08.15 | Manufacturing PMI | Mar | 50.5 | 50.7 |
| | | - | New car registrations* Y/Y% | Mar | - | 19.2 |
| UK | | 09.30 | Final manufacturing PMI | Mar | 48.0 | 49.3 |
| | | | **Tuesday 04 April 2023** | | | |
| Euro area | | 10.00 | PPI Y/Y% | Feb | 12.9 | 15.0 |
| Germany | | 07.00 | Trade balance €bn | Feb | 16.6 | 16.0 |
| Spain | | 08.00 | Unemployment change '000s | Mar | - | 2.6 |
| | | | **Wednesday 05 April 2023** | | | |
| Euro area | | 09.00 | Final services (composite) PMI | Mar | 55.6 (54.1) | 52.7 (52.0) |
| Germany | | 07.00 | Factory orders M/M% (Y/Y%) | Feb | -0.5 (-9.2) | 1.0 (-10.9) |
| | | - | New car production (registrations)* Y/Y% | Mar | - | 23.6 (2.8) |
| | | 08.55 | Final services (composite) PMI | Mar | 53.9 (52.6) | 50.9 (50.7) |
| France | | 08.50 | Final services (composite) PMI | Mar | 55.5 (54.0) | 53.1 (51.7) |
| | | 07.45 | Industrial production M/M% (Y/Y%) | Feb | 0.5 (-0.2) | -1.9 (-2.2) |
| Italy | | 08.45 | Services (composite) PMI | Mar | 53.0 (53.0) | 51.6 (52.2) |
| | | 10.00 | Retail sales M/M% (Y/Y%) | Feb | - | 1.7 (6.2) |
| Spain | | 08.00 | Industrial production M/M% (Y/Y%) | Feb | - | -0.9 (-0.4) |
| | | 08.15 | Services (composite) PMI | Mar | 57.5 (56.0) | 56.7 (55.7) |
| UK | | 09.00 | New car registrations Y/Y% | Mar | - | 26.2 |
| | | 09.30 | Final services (composite) PMI | Mar | 52.8 (52.2) | 53.5 (53.1) |
| | | | **Thursday 06 April 2023** | | | |
| Euro area | | 09.00 | Construction PMI | Mar | - | 47.6 |
| Germany | | 07.00 | Industrial production M/M% (Y/Y%) | Feb | -0.4 (-1.6) | 3.5 (-1.6) |
| | | 08.55 | Construction PMI | Mar | - | 48.6 |
| France | | 08.50 | Construction PMI | Mar | - | 45.2 |
| Italy | | 08.45 | Construction PMI | Mar | - | 48.9 |
| UK | | 09.30 | Construction PMI | Mar | - | 54.6 |
| | | | **Friday 07 April 2023** | | | |
| France | | 07.45 | Trade balance €bn | Feb | - | -12.9 |

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

## The coming week's key events & auctions

| Country | BST | Event / Auction |
|---|---|---|
| | | **Monday 03 April 2023** |
| | | - Nothing scheduled - |
| | | **Tuesday 04 April 2023** |
| Euro area | 09.00 | ECB publishes survey of consumers' inflation expectations |
| Germany | 10.30 | Auction: €400mn of 0.1% 2033 index-linked bonds |
| | 10.30 | Auction: €200mn of 0.1% 2046 index-linked bonds |
| UK | 10.00 | Auction: £2.25bn of 1.125% 2039 bonds |
| | 10.15 | BoE's Tenreyro scheduled to speak |
| | 17.30 | BoE Chief Economist Pill scheduled to speak |
| | | **Wednesday 05 April 2023** |
| Euro area | 15.00 | ECB Chief Economist Lane scheduled to speak |
| Germany | 11.30 | Auction: €4.0bn of 2.1% 2029 bonds |
| UK | 10.00 | Auction: £3.5bn of 0.5% 2029 bonds |
| | 10.15 | BoE's Tenreyro scheduled to speak |
| | | **Thursday 06 April 2023** |
| France | 09.50 | Auction: 3.0% 2033 bonds |
| | 09.50 | Auction: 2.5% 2043 bonds |
| | 09.50 | Auction: 3.0% 2054 bonds |
| | | **Friday 07 April 2023** |
| Euro area/UK | - | Easter – Good Friday holiday |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Today's results

**Economic data**

| Country | Release | Period | **Actual** | Market consensus/ *Daiwa forecast* | Previous | Revised |
|---|---|---|---|---|---|---|
| Euro area | HICP (core HICP) Y/Y% | Mar | **6.9 (5.7)** | *7.2 (5.8)* | 8.5 (5.6) | - |
| | Unemployment rate % | Feb | **6.6** | 6.6 | 6.7 | 6.6 |
| Germany | Retail sales M/M% (Y/Y%) | Feb | **-1.3 (-7.0)** | 0.5 (-5.2) | 0.0 (-4.2) | 0.1 (-4.0) |
| | Unemployment rate % (change '000s) | Mar | **5.6 (16.0)** | 5.5 (1.0) | 5.5 (2.0) | - (6.0) |
| France | Preliminary HICP (CPI) Y/Y% | Mar | **6.6 (5.6)** | 6.5 (5.5) | 7.3 (6.3) | - |
| | Consumer spending M/M% (Y/Y%) | Feb | **-0.8 (-4.1)** | -0.1 (-3.6) | 1.5 (-3.7) | 1.7 (-3.6) |
| | PPI Y/Y% | Feb | **15.7** | - | 17.9 | 17.6 |
| Italy | Preliminary HICP (CPI) Y/Y% | Mar | **8.2 (7.7)** | 8.8 (8.2) | 9.8 (9.1) | - (9.1) |
| UK | Lloyds business barometer | Mar | **32** | - | 21 | - |
| | Final GDP Q/Q% (Y/Y%) | Q4 | **0.1 (0.6)** | *0.0 (0.4)* | -0.2 (1.9) | -0.1 (2.0) |
| | Current account balance £bn | Q4 | **-2.5** | -17.4 | -19.4 | -12.7 |
| | Nationwide house price index M/M% (Y/Y%) | Mar | **-0.8 (-3.1)** | -0.3 (-2.2) | -0.5 (-1.1) | - |

**Auctions**

| Country | Auction |
|---|---|
| | - Nothing to report - |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs