

# Euro wrap-up

## Overview

- Bunds rallied as euro area economic output edged up in Q1 but Germany's GDP failed to grow while its inflation declined again.
- Gilts also made gains on a quiet day for economic news from the UK.
- The ECB policy announcement on Thursday will likely depend on Tuesday's euro area data on inflation, bank lending and credit conditions.

**Chris Scicluna**

+44 20 7597 8326

### Daily bond market movements

Bond	Yield	Change
BKO 2.8 12/25	2.674	-0.125
OBL 2.2 04/28	2.308	-0.145
DBR 2.3 02/33	2.317	-0.137
UKT 0% 06/25	3.757	-0.035
UKT 1% 10/28	3.596	-0.054
UKT 3¼ 01/33	3.715	-0.071

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

Source: Bloomberg

## Euro area

### GDP edged slightly higher in Q1 but domestic demand probably contracted again

According to today's first estimate, euro area GDP returned to growth in Q1, albeit only by a very marginal 0.1%Q/Q following a flat Q422. So, GDP in Q1 was up just 1.3%Y/Y, the softest annual rate in two years, and only 2.5% above the pre-pandemic level in Q419. Growth was fully in line with the ECB's latest economic projections suggesting that the data might have little impact on its forthcoming monetary policy decision. And no detail for the expenditure breakdown was published with the estimate of GDP. However, despite significant variation among the member states, the information available so far suggests that domestic demand probably again subtracted from economic growth. Household consumption likely contracted as real disposable income continued to be eroded by high inflation. And private investment was likely restrained by elevated levels of uncertainty, ongoing (albeit diminishing) supply constraints and, importantly perhaps, higher interest rates. But given recent survey results, the ECB will probably judge that its forecast for a pickup in GDP growth in Q2 to 0.3%Q/Q, and full-year growth of 1.0%Y/Y in 2023, still appears reasonable.

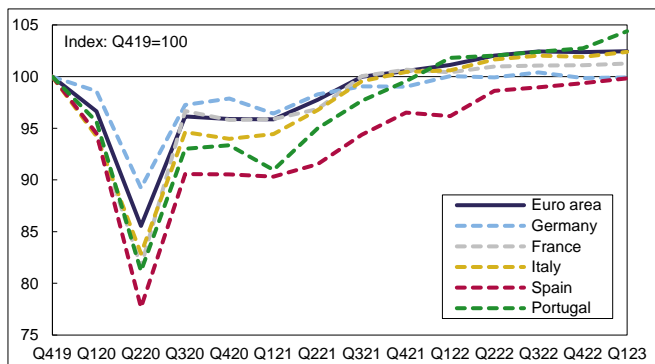
### Growth in Q1 led by Southern Europe

Strikingly, growth in Q1 was led by Southern Europe, with GDP in both Italy and Spain rising 0.5%Q/Q and Portuguese economic output accelerating a vigorous 1.6%Q/Q. In Italy, the expansion in Q1 marked a firm rebound from the slight contraction of 0.1%Q/Q in Q4, and left GDP up 1.8%Y/Y and – similar to the euro area as a whole – almost 2.5% above the respective pre-pandemic level. In Spain, however, it followed growth of 0.4%Q/Q in Q4 to be up a rapid 3.8%Y/Y. Nevertheless, that reflected belated catch-up, particularly as the all-important hospitality sector continued to normalise from the pandemic. And there remains some way to go to get back to normality in Spain, with GDP still 0.2% below the pre-pandemic level in Q1. Indeed, Spanish household consumption contracted for a second successive quarter, and by a steep 1.4%Q/Q. So, while fixed investment returned to growth after two consecutive contractions, Spanish domestic demand also contracted by 0.8%Q/Q for a second successive quarter, leaving growth again reliant on net trade. No detailed breakdown of Italian Q1 GDP was published, although ISTAT reported that net trade similarly contributed positively to growth. The marked spurt in Portuguese GDP in Q1, which left it up 2.5%Y/Y and more than 4% above the pre-pandemic level, was also reliant on net exports while domestic demand contracted.

### Economic activity much more subdued in the euro area's core

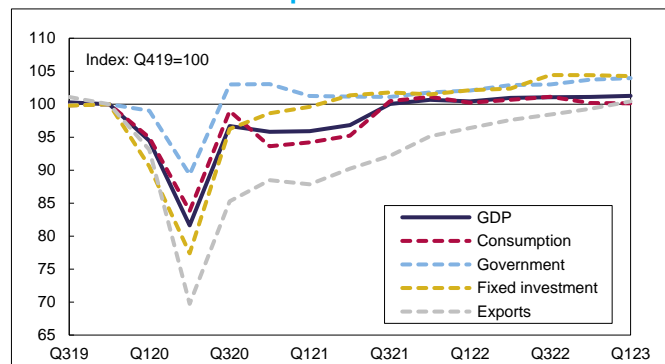
While growth in the Southern periphery was firm, economic activity in the euro area's two largest member states was lacklustre. Indeed, contrary to an expected return to expansion, German GDP was flat in Q1 after a contraction of 0.5%Q/Q

#### Euro area: GDP levels



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### France: GDP and components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

(0.1ppt sharper than previously thought) in Q4. That left it still marginally below the pre-pandemic level and down 0.1%Y/Y. There was no detailed breakdown of German GDP published today, but Destatis suggested that household and government consumption declined, while private investment and exports grew. A little more happily perhaps, French GDP aligned with expectations, with growth of 0.2%Q/Q after a flat (and downwardly revised) Q4 leaving it up 0.8%Y/Y and 1.3% above the pre-pandemic level. But the detail was disappointing, with final domestic demand a drag in Q1 (-0.1ppt) for a second successive quarter, albeit to a lesser extent than in Q4. Household consumption was stable after contracting 1.0%Q/Q the prior quarter, but private investment contracted. And with inventories providing a notable drag, it was merely thanks to another strong positive contribution from net trade (0.6ppt), related to both stronger exports and a drop in imports, that France's economy didn't contract. Finally, Austrian GDP contracted 0.3%Q/Q after a flat Q4 to further illustrate the softness within the core in Q1.

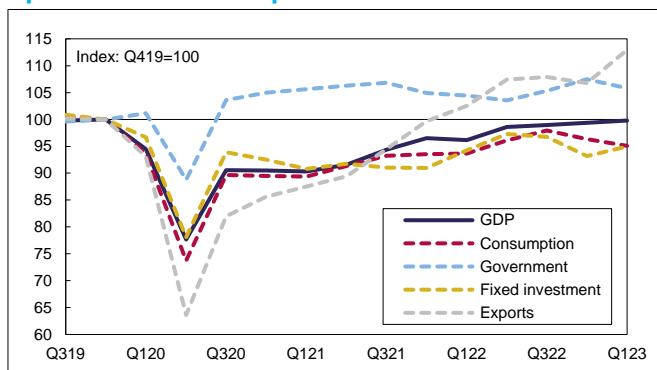
### Inflation moderates a little further in Germany as food prices finally fall

Just as the Q1 GDP data varied very significantly among the member states, so too did today's flash estimates of inflation in April. In part, that reflected differences in the pace of pass-through from wholesale to consumer prices and contrasts in government policies. Notably, German inflation maintained its gradual downtrend, with the national CPI rate falling 0.2ppt to 7.2%Y/Y and the EU-harmonised HICP rate down by the same margin to 7.6%Y/Y, some 4ppts below October's peak. And most encouragingly perhaps, food prices fell for the first time in 18 months, so that the respective inflation component dropped more than 5ppts, admittedly remaining extremely high at 17.2%Y/Y. In contrast, for the first time in six months, energy prices increased not least due to higher prices of auto fuel, pushing up the respective inflation component. But with non-energy goods and services inflation both little changed, German core inflation on the national measure appears likely to have edged only slightly lower from 5.8%Y/Y in March.

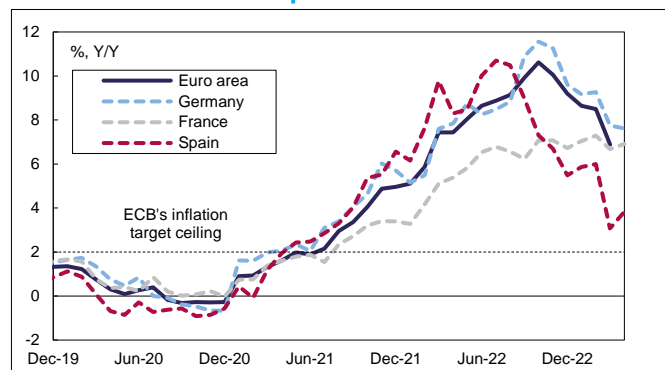
### But rise in inflation in France and Spain confuses the picture about the euro area figures

Elsewhere, as in [Belgium](#), and in good part reflecting base effects, inflation fell sharply in Portugal in April, down 1.1ppt on the headline HICP measure to 6.9%Y/Y with the national core rate (excluding fresh food and energy) down 0.4ppt to 6.6%Y/Y. In contrast, inflation in France and Spain rose in April. On the EU-harmonised measure, the French rate rose 0.2ppt to 5.9%Y/Y while Spanish inflation rose a steeper 0.7ppt to 3.8%Y/Y. But as in Germany, in both countries energy inflation picked up, while food inflation eased in France. And Spanish core inflation (excluding fresh food and energy) fell a chunky 0.9ppt to 6.6%Y/Y. Based on the national data released so far, both headline and core inflation in the euro area as a whole in April appear likely to have remained close to March's levels. Most importantly perhaps, we think the core rate fell slightly for the first time since June. But much will depend on the figures for Italy and the Netherlands, which together account for more than 20% of the region's economy.

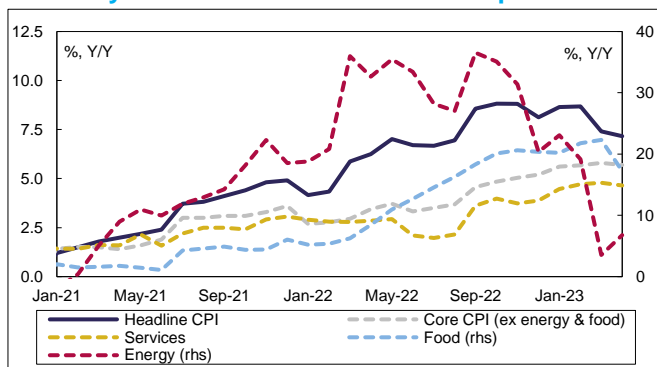
#### Spain: GDP and components



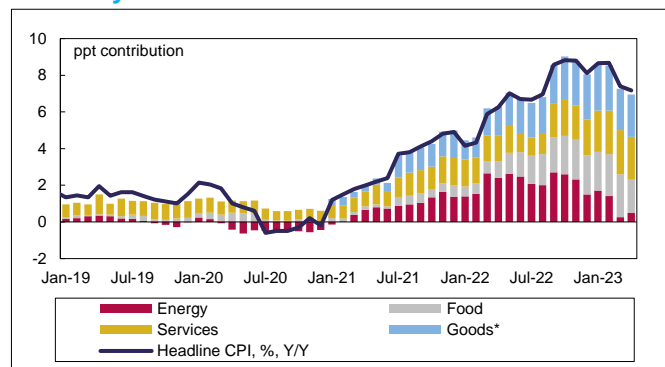
#### Euro area: Consumer price inflation



#### Germany: CPI inflation & selected components



#### Germany: CPI inflation contributions



## The week ahead in the euro area: 25 or 50bps from the ECB?

The main event of the coming week will, of course, be the ECB's announcements on Thursday. At the conclusion of the [last policy meeting](#) on 16 March, the Governing Council overlooked the recent market turmoil related to banking sector concerns and hiked by a further 50bps, taking the deposit rate to 3.0%. But it refrained from offering guidance with respect to the next steps for policy, instead merely emphasising that forthcoming decisions would be data dependent. While the policymakers made clear that evidence regarding underlying inflation would be key, they also stated that the ECB's reaction function would now explicitly take account of financial data and evidence on the strength of monetary policy transmission.

### Tuesday's inflation and banking data likely to be key to the rate decision

Since the March meeting, financial market turbulence has subsided, with confidence in banks this side of the Atlantic firmer, as illustrated by lower credit spreads, higher equity prices in the sector, and reports of a stabilisation of deposits at Deutsche Bank this month. Moreover, while headline euro area [HICP inflation](#) fell 1.6ppts to a 13-month low of 6.9%Y/Y in March, its Q1 average exceeded the ECB's forecast. Most importantly, the decline from the peak almost entirely reflected lower energy prices, while core inflation continued to rise in March, reaching a new series-high of 5.7%Y/Y. So, while the initial rise in inflation in the euro area was driven by an adverse supply shock, many Governing Council members now fear that excess demand is generating inflation persistence, reflected in firms' profit margins, even as survey evidence and wholesale market prices strongly suggests that the supply shocks are finally fading. With the economy having returned to modest growth in Q1 and surveys pointing to a further slight improvement in Q2, additional tightening at the forthcoming policy meeting is inevitable. The only question is whether the Governing Council will agree to another hike of 50bps or a moderation in the pace of rate hikes to 25bps, with both options likely to be discussed. The answer is likely at least in part to be determined by the key economic data to be published ahead of the meeting – in particular the flash estimates of euro area inflation in April, bank lending in March, and the latest ECB credit conditions survey – all of which will be released on Tuesday.

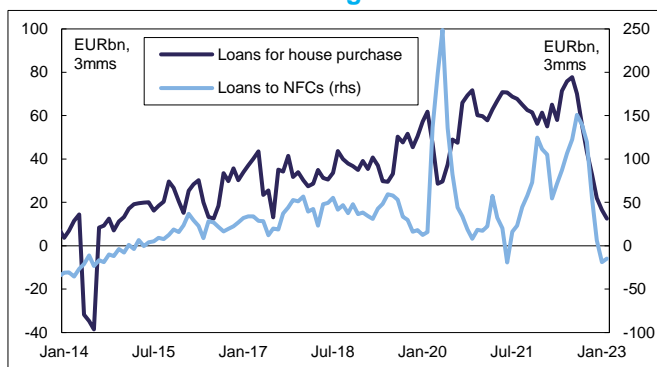
### Drop in core inflation should strengthen case for 25bps hike

The account of last month's Governing Council meeting reported that the policymakers were unsure whether the peak in core inflation had been reached. And the hawks identified several reasons why the risks to the outlook were still skewed to the upside, and cast significant doubt over the ECB's forecast that inflation will eventually fall back to target over the medium term. So, a further increase in core inflation in April would seem likely to trigger another 50bps rate hike. But today's flash estimates of inflation from Germany, France and Spain suggest that headline inflation was little changed in April and that core inflation (excluding food and energy) probably eased slightly – hopefully marking the start of a steady shift lower. And that would strengthen the case for a smaller rate hike this time around.

### Bank lending data to suggest that policy tightening continues to be felt

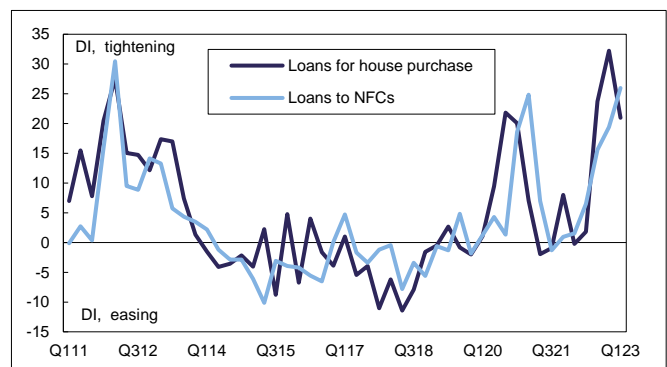
Meanwhile, bank lending has already been weakening since mid-Q4, with data reporting negative net loans to non-financial corporations for four successive months through to February, and loans for house purchase similarly trending at the softest pace since 2014. Moreover, the ECB's previous Bank Lending Survey reported the sharpest net tightening of credit standards since the euro crisis in 2011, and signalled a further similar tightening to come. So, a further loss of momentum in new lending in March, coupled with an additional net tightening of credit standards in the latest bank lending survey, would seem likely to persuade the majority that the rate hikes already implemented have yet to be fully felt on inflation. Together with recent survey evidence of a softening in price-selling expectations and a notable easing of supply-side constraints, assuming no further rise in core inflation in April, that should further persuade the majority of Governing Council members to choose to slow the pace of tightening this month to 25bps. If they did so, however, as a compromise, we would expect a signal – either in the policy statement or President Lagarde's press conference – that another rate hike is more likely than not to come in June. And while no decision on QT is likely at the forthcoming meeting, we would also expect a signal that the pace of balance sheet shrinkage is likely to accelerate from July on.

#### Euro area: Net bank lending



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Credit conditions



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.










## UK

### The week ahead in the UK

The coming week gets off to a quiet start in the UK, with financial markets closed on Monday for the early May public holiday. On Tuesday, the BRC shop price index for April will be watched closely for any evidence that inflation on the high street has peaked. Growth in the shop price index has been trending higher since July 2011, to an all-time high of 8.9% in March. In contrast, the Nationwide house price index (also Tuesday) is expected to suggest that house price inflation remains on a downward trend, with prices falling compared to a year earlier, for the third successive month, as affordability becomes increasingly stretched. The pace of decline in house prices will be the steepest since 2009. The BoE's lending data for March on Thursday will also likely flag the negative impact from the ongoing tightening in financial conditions. The coming week also brings the final manufacturing PMIs (Tuesday), the services and composite PMIs (Thursday) and construction PMIs on Friday.

The next edition of the Euro wrap-up will be published on 2<sup>nd</sup> May 2023








































## Daiwa economic forecasts

	2022	2023				2024	2023	2024	2025
		Q4	Q1	Q2	Q3				
<b>GDP</b>		<b>%, Q/Q</b>					<b>%, Y/Y</b>		
Euro area 	0.0	0.1	0.2	0.2	0.2	0.2	0.8	1.1	1.7
UK 	0.1	0.0	0.1	0.2	0.2	0.2	0.3	0.7	0.9
<b>Inflation, %, Y/Y</b>									
Euro area									
Headline HICP 	10.0	8.0	6.1	4.6	2.8	2.7	5.3	2.3	1.7
Core HICP 	5.1	5.5	5.1	4.5	3.7	3.0	4.7	2.4	1.8
UK									
Headline CPI 	10.7	10.2	7.6	6.1	3.7	3.3	6.8	2.2	1.5
Core CPI 	6.4	6.1	5.9	5.1	4.3	3.9	5.3	2.8	1.8
<b>Monetary policy, %</b>									
ECB									
Refi Rate 	2.50	3.50	4.00	4.00	4.00	4.00	4.00	3.25	3.00
Deposit Rate 	2.00	3.00	3.50	3.50	3.50	3.50	3.50	2.75	2.50
BoE									
Bank Rate 	3.50	4.25	4.50	4.50	4.50	4.25	4.50	3.50	2.75

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/ <i>Daiwa</i> <i>forecast/actual</i>	Previous
<b>Monday 01 May 2023</b>					
- Nothing scheduled -					
<b>Tuesday 02 May 2023</b>					
Euro area		09.00 M3 money supply Y/Y%	Mar	2.4	2.9
		09.00 Final manufacturing PMI	Apr	45.5	47.3
		10.00 Preliminary HICP (core HICP) Y/Y%	Apr	7.0 (5.7)	6.9 (5.7)
Germany		08.55 Final manufacturing PMI	Apr	44.0	44.7
		- Retail sales* M/M% (Y/Y%)	Mar	0.4 (-6.5)	-0.4 (-5.9)
France		08.50 Final manufacturing PMI	Apr	45.5	47.3
Italy		08.45 Manufacturing PMI	Apr	49.6	51.1
		10.00 Preliminary HICP (CPI) Y/Y%	Apr	8.0 (-)	8.1 (7.6)
		11.00 PPI Y/Y%	Mar	-	10.0
Spain		08.15 Manufacturing PMI	Apr	49.9	51.3
UK		00.01 BRC shop price index Y/Y%	Apr	-	8.9
		07.00 Nationwide house price index M/M% (Y/Y%)	Apr	-0.4 (-3.6)	-0.8 (-3.1)
		09.30 Final manufacturing PMI	Apr	46.6	47.9
<b>Wednesday 03 May 2023</b>					
Euro area		10.00 Unemployment rate %	Mar	6.6	6.6
<b>Thursday 04 May 2023</b>					
Euro area		09.00 Final services (composite) PMI	Apr	<u>56.6 (54.4)</u>	55.0 (53.7)
		10.00 PPI Y/Y%	Mar	5.7	13.2
		13.15 ECB Deposit (Refi) Rate %	May	<u>3.25 (3.75)</u>	3.00 (3.50)
Germany		07.00 Trade balance €bn	Mar	16.0	16.1
		08.55 Final services (composite) PMI	Apr	<u>55.7 (53.9)</u>	53.7 (52.6)
France		08.50 Final services (composite) PMI	Apr	<u>56.3 (53.8)</u>	53.9 (52.7)
Italy		08.45 Services (composite) PMI	Apr	57.0 (53.8)	55.7 (55.2)
Spain		08.00 Unemployment change '000s	Apr	-	-48.8
		08.15 Services (composite) PMI	Apr	59.3 (58.1)	59.4 (58.2)
UK		09.00 New car registrations Y/Y%	Apr	-	18.2
		09.30 Final services (composite) PMI	Apr	<u>54.9 (53.9)</u>	52.9 (52.2)
		09.30 Net consumer credit £bn (Y/Y%)	Mar	1.3 (-)	1.4 (7.7)
		09.30 Net mortgage lending £bn (approvals '000s)	Mar	1.6 (46.0)	0.7 (43.5)
		09.30 M4 money supply M/M% (Y/Y%)	Mar	-	-0.4 (1.0)
<b>Friday 05 May 2023</b>					
Euro area		08.30 Construction PMI	Apr	-	45.0
		10.00 Retail sales M/M% (Y/Y%)	Mar	-0.2 (-3.1)	-0.8 (-3.0)
Germany		07.00 Factory orders M/M% (Y/Y%)	Mar	-2.5 (-3.1)	4.8 (-5.7)
		08.30 Construction PMI	Apr	-	42.9
France		07.45 Industrial production M/M% (Y/Y%)	Mar	-0.4 (1.1)	1.2 (1.3)
		07.45 Manufacturing production M/M% (Y/Y%)	Mar	-	1.3 (2.2)
		08.30 Construction PMI	Apr	-	45.3
Italy		08.30 Construction PMI	Apr	-	47.4
		09.00 Retail sales M/M% (Y/Y%)	Mar	-	-0.1 (5.8)
Spain		08.00 Industrial production M/M% (Y/Y%)	Mar	-	0.6 (-0.4)
UK		08.30 Construction PMI	Apr	51.0	50.7

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







### The coming week's key events & auctions

Country	BST	Event / Auction
<b>Monday 01 May 2023</b>		
Euro area 	-	Public holiday – Labour Day
UK 	-	Public holiday – May Day
<b>Tuesday 02 May 2023</b>		
Euro area 	09.00	ECB publishes Bank Lending Survey
Germany 	10.30	Auction: €500mn of 0.1% 2033 index-linked bonds
<b>Wednesday 03 May 2023</b>		
Germany 	10.30	Auction: €3bn of 2.1% 2029 bonds
UK 	10.00	Auction: £4.0bn of 3.5% 2025 bonds
<b>Thursday 04 May 2023</b>		
Euro area 	13:15	ECB monetary policy announcement
	13.45	ECB President Lagarde holds press conference following the Governing Council meeting
France 	09.50	Auction: 3.00% 2033 bonds
	09.50	Auction: 1.75% 2039 bonds
	09.50	Auction: 3.00% 2054 bonds
	09.50	Auction: 0.50% 2072 bonds
Spain 	09.30	Auction: 2.80% 2026 bonds
	09.30	Auction: 1.20% 2040 bonds
	09.30	Auction: 0.00% 2028 bonds
	09.30	Auction: 0.65% 2027 index-linked bonds
	09.30	BoE publishes April Decision Maker Panel data
<b>Friday 05 May 2023</b>		
Euro area 	09.00	ECB publishes survey of professional forecasters

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area 	GDP – first estimate Q/Q% (Y/Y%)	Q1	<b>0.1 (1.3)</b>	<u>0.1 (1.3)</u>	0.0 (1.8)	-0.1 (-)
Germany 	Unemployment claims' 000s (rate %)	Apr	<b>24.0 (5.6)</b>	8 (5.6)	16 (5.6)	19.0 (-)
	GDP – first estimate Q/Q% (Y/Y%)	Q1	<b>0.0 (0.2)</b>	<u>0.1 (0.3)</u>	-0.4 (0.9)	-0.5 (0.2)
	Preliminary HICP (CPI) Y/Y%	Apr	<b>7.6 (7.2)</b>	7.8 (7.3)	7.8 (7.4)	-
France 	GDP – first estimate Q/Q% (Y/Y%)	Q1	<b>0.2 (0.8)</b>	<u>0.2 (0.8)</u>	0.1 (0.5)	0.0 (0.4)
	Preliminary HICP (CPI) Y/Y%	Apr	<b>6.9 (5.9)</b>	6.7 (5.8)	6.7 (5.7)	-
	Consumer spending M/M% (Y/Y%)	Mar	<b>-1.3 (-4.2)</b>	0.5 (-2.6)	-0.8 (-4.1)	-
	PPI Y/Y%	Mar	<b>2.0 (12.9)</b>	-	15.7	- (15.8)
Italy 	GDP – first estimate Q/Q% (Y/Y%)	Q1	<b>0.5 (1.8)</b>	<u>0.1 (1.5)</u>	-0.1 (1.4)	-
Spain 	GDP – first estimate Q/Q% (Y/Y%)	Q1	<b>0.5 (3.8)</b>	<u>0.3 (2.8)</u>	0.0 (2.7)	0.4 (2.9)
	Preliminary HICP (CPI) Y/Y%	Apr	<b>3.8 (4.1)</b>	4.0 (4.0)	3.1 (3.3)	-
UK 	Lloyds business barometer	Apr	<b>33</b>	-	32	-

#### Auctions

Country Auction

- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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