

Euro wrap-up

Overview

- Bunds made modest losses even as a German survey reported a notable drop in household medium-term inflation expectations.
- Gilts also posted marginal losses while a BoE survey suggested that household inflation expectations remain relatively well anchored.
- The coming week's BoE monetary policy decision on Thursday will leave Bank Rate and the MPC's broader guidance unchanged, while February inflation figures and the flash March PMIs are due from the euro area and UK.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.940	+0.032
OBL 2.1 04/29	2.465	+0.019
DBR 2.2 02/34	2.440	+0.016
UKT 0½ 01/26	4.303	+0.012
UKT 0½ 01/29	4.009	+0.017
UKT 4½ 01/34	4.096	+0.010

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

Euro area

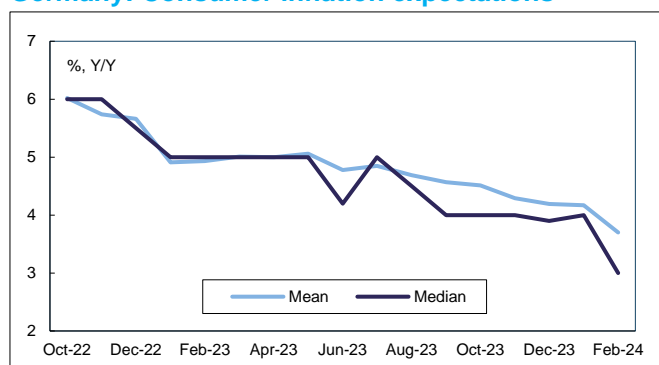
Inflation expectations and wage growth eases in February

While the ECB's [Governing Council](#) last week suggested that the current rates of inflation and wage growth remain too high to justify a rate cut, the latest findings from the Bundesbank's consumer inflation expectations survey, published today, might ease somewhat lingering concerns about price stickiness in the euro area's largest member state. Consistent with the resumption of the downtrend in German headline inflation at the start of the year, households' expectations for inflation twelve months ahead fell a further ½ppt to 3½%Y/Y in February, the softest since August 2021. Moreover, having moved broadly sideways at 4.0%Y/Y since September, the median forecast for three years ahead fell a full percentage point to 3.0%Y/Y, some 3ppts below the peak in October 2022. The closely-watched Indeed wage tracker release was also encouraging, following positive developments in [labour costs](#) in the final quarter of last year, when growth slowed to an eleven-quarter low. According to Indeed, euro area wage growth moderated 0.3ppt to 3.7%Y/Y in February, the softest for three months and 1.7ppts below the peak in September 2022. Admittedly, German wage growth on this measure was a touch firmer last month (+0.2ppt to 4.4%Y/Y), albeit maintaining the broadly sideways trend since October, while French wage growth was unchanged at January's 21-month low (3.0%Y/Y). But growth in Spain took a notable step down (-0.6ppt to 3.9%Y/Y), the softest for 15 months, while growth in Italy fell 1.1ppt to 2.2%Y/Y (although this series is updated infrequently). Overall, this release signals a gradual slowing in wage pressures over the coming six months. And while the record-low unemployment rate signals a historically tight labour market, a further decline in job vacancies in Q4 saw the vacancy to unemployment ratio drop to its lowest level for two years, suggesting a further easing of the risks of second-round effects on inflation.

French inflation eases to more than 2-year low as food and core goods prices ease

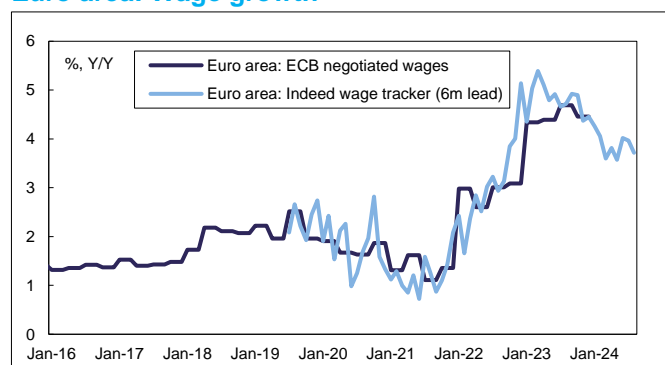
There were no major surprises from today's final February inflation releases from the member states, which confirmed a further easing in price pressures and suggested that the final aggregate euro area February HICP estimates – due to be published on Monday – should align with the initial release. The headline French HICP and national CPI rates, nevertheless, were nudged a touch higher from the preliminary report, by 0.1ppt a piece to 3.2%Y/Y and 3.0%Y/Y. These still marked the softest rates for more than two years. Moreover, the downtrend would have been greater in the absence of a notable policy-related jump in electricity charges and higher petrol prices – which on the national measure rose 9.3%M/M and 3.5%M/M respectively – leaving energy inflation up 2.5ppts to 4.4%Y/Y. In contrast, benefitting from base effects in fresh food prices following a spike in February 2023, food inflation took a further step down last month to a two-year low (3.5%Y/Y). Despite a modest upwards revision from the flash release, the disinflationary trend in manufactured goods was also maintained for an eighth successive month (-0.3ppt to 0.4%Y/Y), as upwards pressures from clothing were offset by declining prices of

Germany: Consumer inflation expectations*



*Three years ahead. Source: Macrobond, Bundesbank and Daiwa Capital Markets Europe Ltd.

Euro area: Wage growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

furniture, household appliances and games, toys and hobbies. Arguably, the most disappointing aspect was the modest upwards tweak to services inflation, which moved sideways at 3.2%Y/Y, some 0.2ppt above the average of the past year. Upwards impulses from insurance premiums, accommodation and healthcare services offset easing pressures in transport – notably airfares – catering and rents. Nevertheless, INSEE suggested that core CPI inflation fell to 2.7%Y/Y, the lowest since March 2022 and more than 3ppts below last year's peak, with the harmonised HICP measure also down 0.3ppt to 2.4%Y/Y.

Italian inflation revised down slightly to the lowest of the major member states

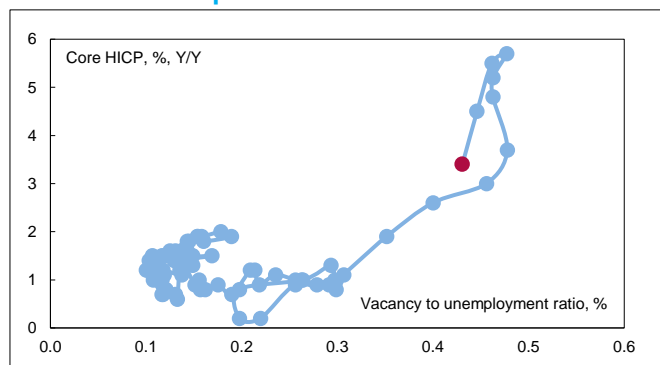
While the Italian national CPI measure saw the headline rate unrevised at 0.8%Y/Y, today's release brought a slight downwards revision to the harmonised HICP rate, by 0.1ppt to 0.8%Y/Y, by far the lowest rate of the major member states. The revision reflected a more significant drop in food inflation than initially estimated (-2ppt to 3.9%Y/Y). And while there was a slightly smaller pace of decline in energy inflation in February, at -17.4%Y/Y, it remained a non-negligible drag on headline inflation. Developments in non-energy goods inflation were also more positive than initially thought, as weaker demand diminished price pressures in furniture, household appliances and autos, offsetting an upwards impulse from clothing likely related to the timing of seasonal discounting. Overall, core goods HICP inflation fell ½ppt to 1.2%Y/Y, the lowest since January 2022. But while hospitality and other recreational costs remained sticky at the start of the year, services inflation (-0.1ppt to 3.1%Y/Y) benefitted from a drop in transport costs, related to lower airfares and rail travel. As such, Italian core HICP inflation fell 0.2ppt to 2.6%Y/Y, a 22-month low and almost 3ppts below the peak a year ago.

The week ahead in the euro area: Final February inflation data & March flash PMIs in focus

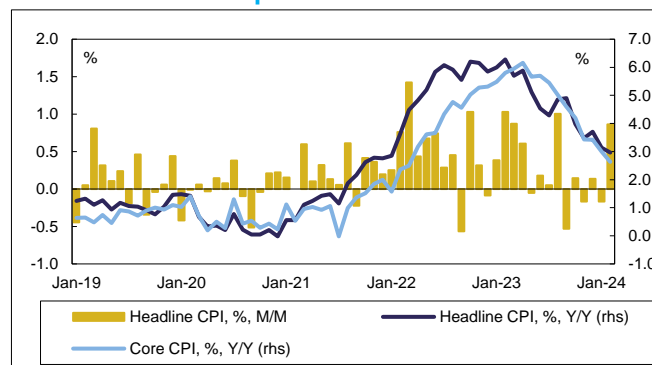
The coming week's data calendar will bring further updates on inflationary pressures in the euro area with updated HICP figures due on Monday, as well as insight into the strength of economic recovery momentum at the end of the first quarter with the March Commission consumer confidence index due Wednesday and the flash PMIs due Thursday. The flash inflation estimates saw the headline HICP rate fall 0.2ppt to 2.6%Y/Y – albeit remaining 0.2ppt above November's 28-month low – despite a smaller drag from energy amid a jump in petrol prices. There was a further notable drop in food inflation to its lowest level in more than two years, while core goods inflation fell to its softest rate since mid-2021 and the services component resumed a downtrend. As such, core HICP inflation fell 0.2ppt to a near-two-year low of 3.1%Y/Y. Monday's release will provide more granular detail, which will allow other measures of underlying inflation watched by ECB policymakers to be calculated.

The flash euro area PMIs should continue to imply improving recovery momentum in Q1 and therefore support our view that GDP likely returned to very modest positive growth in Q1. Admittedly, despite rising to an eight-month high in February, the

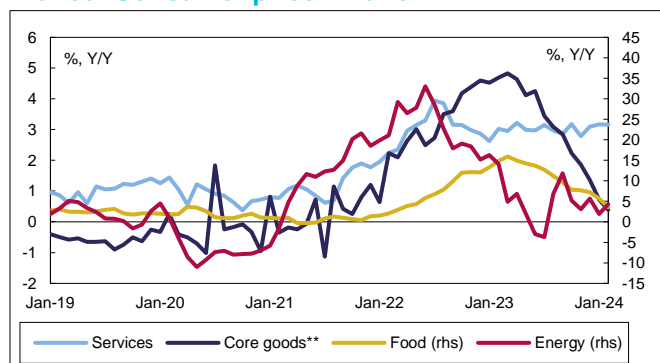
Euro area: Phillips curve*



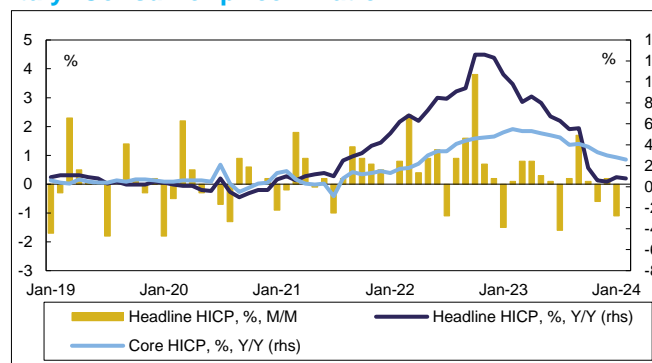
France: Consumer price inflation



France: Consumer price inflation



Italy: Consumer price inflation



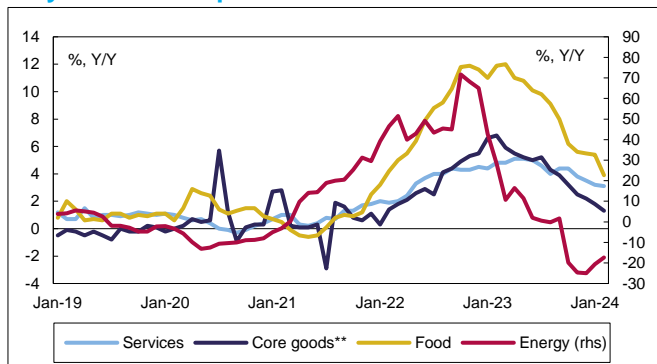
composite PMI remained at a 'contractionary' 48.9. But the headline services activity PMI jumped 1.5pts to 50.0, its highest since July. And although the manufacturing output PMI edged lower and remained consistent with ongoing contraction (46.2), this was still trending more than 2pts above the Q4 average. Overall, the composite PMI was trending 1.2pts above the Q4 average. But the PMIs continued to flag ongoing divergences between member states, suggesting that Germany's economy is on track for a second quarterly contraction, while Spanish GDP continues to drive the recovery. The German ifo (Friday) and French INSEE (Thursday) business surveys will offer further insight into recent developments in the construction and retail subsectors. The Commission's consumer confidence indicator is forecast to rise slightly in March, albeit the expected rise of ½pt would leave it merely back to its December level. Among other data due in the coming week, the January euro area construction activity figures (Wednesday) will likely see a further increase at the start of the year, not least reflecting a rebound in German output (2.7%M/M). Euro area figures for goods trade for January (Monday) and new car registrations for February (Wednesday) are also due. Aside from the data, ECB President Lagarde will give a keynote address at the start of the ECB Watchers conference on Wednesday, while Chief Economist Lane and influential Executive Board member Schnabel will participate on panel discussions.

UK

Consumer & business inflation expectations remain relatively well anchored

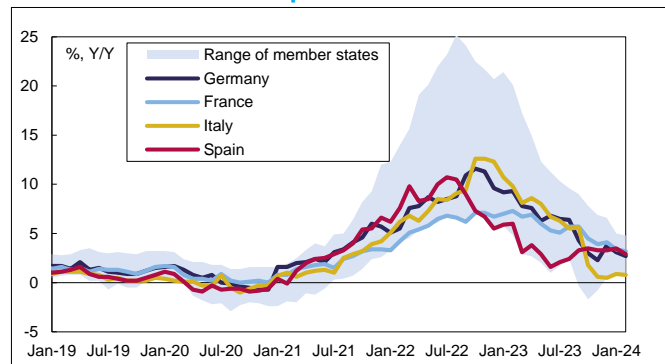
Ahead of the forthcoming monetary policy meeting, the BoE's quarterly consumer survey suggested that household inflation expectations remain relatively well anchored. Indeed, the MPC will have been pleased to see that consumer inflation expectations for the coming twelve months continue to subside, dropping 0.3ppt this quarter to 3.0%Y/Y, the lowest since Q321. In addition, inflation expectations for the following twelve months were unchanged at 2.8%Y/Y. And those for five years' time edged down 0.1ppt on the quarter to 3.1%Y/Y, admittedly above the BoE's inflation target and also slightly above the figures for the first three quarters of last year. However, consumer inflation expectations for 24 months ahead were in line with the pre-pandemic average and those for five years ahead were marginally below the equivalent benchmark. This tallies with the YouGov/Citigroup survey, for which the five-to-ten year ahead measure has also been broadly flat close to the pre-pandemic average. According to the BoE's DMP survey released earlier this month, firms' medium-term inflation expectations also appear relatively well anchored, dropping in the three months to February to 2.8%3M/Y, the lowest on the relatively short series. And according to the BoE's Financial Participants' survey, median five-year ahead expectations remained unchanged in February at the 2.0% target, albeit with an upside skew to the distribution.

Italy: Consumer price inflation



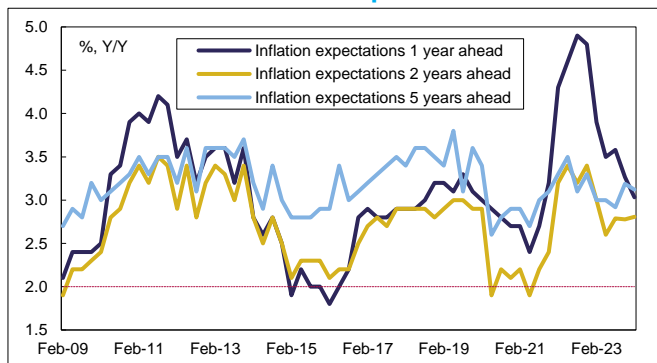
**Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



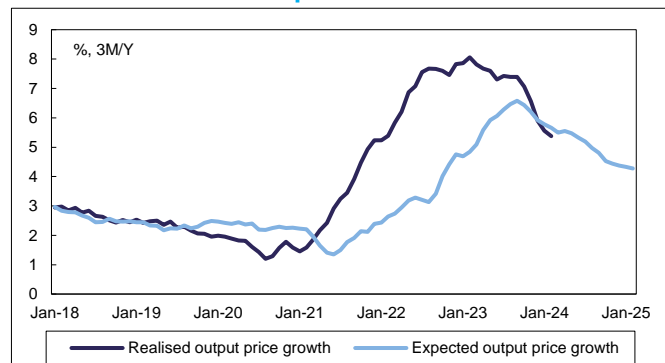
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Households' inflation expectations



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

UK: Firms' inflation expectations



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

Anchored expectations will ease concerns about second-round effects on inflation

While the DMP survey suggested that business inflation expectations appear relatively well anchored, regular pay growth (6.1%3M/Y in January) and firms' expectations for wage growth one year ahead (5.2%3M/Y) remain elevated and above rates that would be considered consistent with the inflation target over the medium term. However, with falling consumer inflation expectations, workers' wage demands should moderate. And as such, concerns of second-round effects on inflation emanating from the labour market should diminish. Of course, despite a steady decline in the level of vacancies over recent quarters, the labour market likely remains relatively tight. Indeed, the ONS's estimate of the unemployment rate in January (3.9%) was below the BoE's previous estimate of the sustainable medium-term rate. And this week, BoE Governor Bailey reportedly judged that the economy is now "near or at full employment". But, perhaps taking encouragement of the better anchoring of inflation expectations, he added that there was "very limited evidence so far" that a rise in unemployment will be needed to get inflation back to target. And so, he added that his concerns about potential second-round effects on inflation had abated.

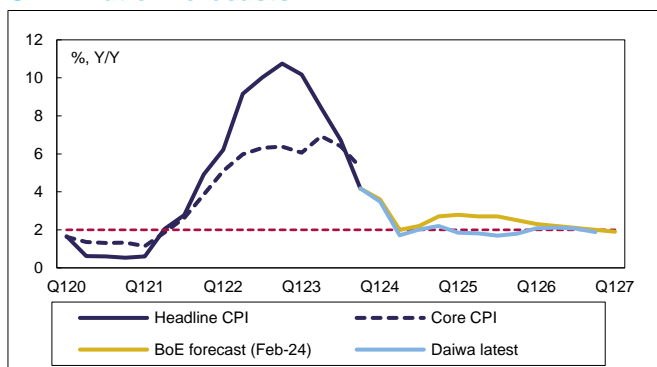
GDP likely picking up but inflation on track to undershoot BoE's projection

While wage growth at the start of the year was broadly in line with the MPC's expectation, other aspects of the BoE's projections, which were published at the start of last month, will need to be updated for recent economic data and events. For example, GDP in Q4 was significantly softer than the BoE anticipated, dropping 0.3%Q/Q compared to its projection of a contraction of 0.1%Q/Q. At the same time, however, surveys point to a return to moderate expansion in the current quarter, in contrast to the BoE's forecast of a drop of 0.1%Q/Q. And with real disposable incomes to be supported by firm wage growth, a further modest easing of fiscal policy via lower National Insurance Contributions from April, the 12.3% cut in the household energy price cap which will also kick in next month, and a broader easing in inflation, the BoE's projection of growth of about 0.1%Q/Q each subsequent quarter this year – assuming four rate cuts by year-end – also looks a little too soft to us. At the same time, CPI inflation (4.0%Y/Y) and the all-important services component (6.5%Y/Y) came in a touch below the Bank's expectation in January. We expect the February data, due on Wednesday, also to undershoot slightly the BoE's forecast, with headline CPI inflation likely down 0.6ppt to 3.4%Y/Y and the core rate down by a similar margin to 4.5%Y/Y. And benefiting in part from the freezing of fuel and alcohol duty as well as lower energy prices, inflation should continue to undershoot the BoE's outlook in Q2 – when we expect the headline rate to average less than 2.0%Y/Y – and over subsequent quarters too.

Rates and forward guidance likely to be unchanged and backed by a larger majority this month

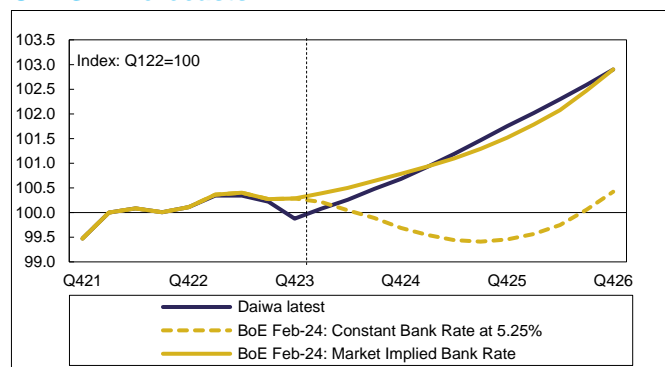
At its previous monetary policy meeting last month, the BoE's updated projections – which significantly revised down its inflation outlook – persuaded the majority to drop the MPC's tightening bias. However, the Committee repeated that monetary policy will need to be restrictive for an extended period. And in his press conference Governor Bailey made clear that the MPC needs to see a lot more evidence that inflation will fall all the way to 2% and stay there before it decides to lower rates. While he is now less concerned about second-round effects emanating from the labour market, and the near-term inflation outlook should be judged to have improved again somewhat, the majority on the MPC will still consider it too soon to cut rates. Indeed, at least until new projections are published in May, it will expect any drop in inflation next quarter below 2.0%Y/Y to be temporary, and consider that a lasting return to target will not materialise before 2025. As such, rates will again be left unchanged this month and the statement will repeat that monetary policy will need to be restrictive for an extended period. And the Committee's guidance will reiterate that the underlying tightness of labour market conditions, wage growth and services price inflation remain the most important variables in its reaction function for determining when rates might be cut. Indeed, we expect that, once again, only one member (the uber-dove Dhingra) will vote for a cut. But we also expect one of the hawks (Haskel) to shift from backing a rate hike to supporting the status quo. And so, there is likely to be only one member (Mann) still voting for extra tightening this month. Our baseline forecast assumes that rates will be cut for the first time this cycle in August but a cut in Q2 cannot be ruled out.

UK: Inflation forecasts



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

UK: GDP forecasts*












*Market implied path assumes Bank Rate at 4¼% at end-24, 3½% at end-25 and 3¼% at end-26. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the UK: February inflation & flash PMIs before the BoE

Data-wise, the most notable two new releases of the coming week will come ahead of the BoE announcements, with the February inflation figures due on Wednesday and the March flash PMIs due Thursday. As noted above, in January the headline CPI inflation rate was a touch softer than expected, remaining unchanged at 4.0%Y/Y despite a significant increase in the regulated household energy price cap. The BoE projection published last month envisaged a drop to 3.5%Y/Y in February. And we expect a slightly steeper drop to 3.4%Y/Y, which would be the lowest since September 2021. While the energy component will again add to inflation, we expect the other major components to more than offset that impact, with food inflation likely falling more than 1ppt to its lowest level since April 2022 and core goods inflation likely falling about ½ppt to the lowest since April 2021. Moreover, in part reflecting a significant base effect from a year earlier when prices in the category rose the most in any February on the series, services inflation is also likely to drop about ½ppt to 6.0%Y/Y or less for the first time since January 2023. As a result, we expect core inflation to fall a chunky 0.6ppt to 4.5%Y/Y, which would be the lowest since December 2021.

Meanwhile, the flash PMIs should be little changed in March from February and hence remain consistent with a return to positive GDP growth in Q1, probably around 0.2%Q/Q. The composite PMI was unchanged in February at 53.0, the highest since May 2023. While the headline services activity PMI moderated 0.5pt from January's eight-month high to 53.8, it remained consistent with moderate expansion in the sector. And the manufacturing output PMI rose almost 3pts to a three-month high of 48.3 suggestive of only mild contraction. Notably perhaps, the survey detail also suggested that costs and selling prices picked up in both manufacturing and services. Among other data due in the coming week, the February retail sales data (Friday) might well slip back slightly following the discounting-driven rebound of 3.4%M/M in January. And we expect the GfK consumer confidence index for March (the same day) to reverse the modest 2pt drop seen in February to remain well below the long-run average albeit well above the lows of the past two years.

Daiwa economic forecasts

		2023	2024				2025			
		Q4	Q1	Q2	Q3	Q4	Q1	2023	2024	2025
GDP										
								%, Y/Y		
Euro area		0.0	0.1	0.2	0.2	0.3	0.3	0.5	0.4	1.3
UK		-0.3	0.2	0.2	0.2	0.2	0.2	0.1	0.2	1.0
Inflation, %, Y/Y										
Euro area										
Headline HICP		2.7	2.6	2.3	1.9	2.4	2.0	5.4	2.3	1.8
Core HICP		3.7	3.1	2.2	1.8	2.3	1.8	4.9	2.3	1.7
UK										
Headline CPI		4.1	3.5	1.7	1.9	2.3	2.2	7.3	2.3	2.1
Core CPI		5.3	4.5	2.7	2.3	2.5	2.4	6.2	3.0	2.1
Monetary policy, %										
ECB										
Deposit Rate		4.00	4.00	3.75	3.25	2.75	2.25	4.00	2.75	2.25
Refi Rate		4.50	4.50	4.25	3.40	2.90	2.40	4.50	2.90	2.40
BoE										
Bank Rate		5.25	5.25	5.25	4.75	4.25	3.75	5.25	4.25	2.50

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

The coming week's data calendar

The coming few week's key data releases

Country	GMT	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous
Monday 18 March 2024					
Euro area	10.00	Final HICP (core HICP) Y/Y%	Feb	<u>2.8 (3.1)</u>	2.9 (3.3)
	10.00	Trade balance €bn	Jan	-	13.0
Spain	09.00	Trade balance €bn	Jan	-	-3.4
UK	00.01	Rightmove house prices M/M% (Y/Y%)	Mar	-	0.9 (0.1)
Tuesday 19 March 2024					
Euro area	10.00	Labour costs Y/Y%	Q4	-	5.3
Germany	10.00	ZEW current assessment (expectations) balance	Mar	-82.2 (20.5)	-81.7 (19.9)
Wednesday 20 March 2024					
Euro area	10.00	Construction output M/M% (Y/Y%)	Jan	-	0.8 (1.9)
	15.00	European Commission's preliminary consumer confidence	Mar	-15.0	-15.5
Germany	07.00	PPI Y/Y%	Feb	-3.8	-4.4
Italy	09.00	Industrial production M/M% (Y/Y%)	Jan	-	1.1 (-2.1)
UK	07.00	CPI (core CPI) Y/Y%	Feb	<u>3.4 (4.5)</u>	4.0 (5.1)
	07.00	PPI output (input) Y/Y%	Feb	-0.1 (-2.7)	-0.5 (-3.3)
	09.30	House price index Y/Y%	Jan	-	-1.4
Thursday 21 March 2024					
Euro area	07.00	EU27 new car registrations Y/Y%	Feb	-	12.1
	09.00	Preliminary manufacturing (services) PMI	Mar	47.0 (50.5)	46.5 (50.2)
	09.00	Preliminary composite PMI	Mar	49.7	49.2
Germany	08.30	Preliminary manufacturing (services) PMI	Mar	43.5 (48.8)	42.5 (48.3)
	08.30	Preliminary composite PMI	Mar	46.8	46.3
France	07.45	INSEE business (manufacturing) confidence	Mar	99 (100)	98 (100)
	08.15	Preliminary manufacturing (services) PMI	Mar	47.5 (48.6)	47.1 (48.4)
	08.15	Preliminary composite PMI	Mar	48.7	48.1
	-	Bank of France retail sales* Y/Y%	Feb	-	-3.1
UK	07.00	Public sector net borrowing (excl. banks) £bn	Feb	4.5 (5.9)	-17.6 (-16.7)
	09.30	Preliminary manufacturing (services) PMI	Mar	47.7 (53.8)	47.5 (53.8)
	09.30	Preliminary composite PMI	Mar	53.2	53.0
	12.00	BoE Bank Rate %	Mar	<u>5.25</u>	5.25
Friday 22 March 2024					
Germany	09.00	ifo business climate index	Mar	86.0	85.5
	09.00	ifo current assessment (expectations) index	Mar	86.8 (84.8)	86.9 (84.1)
UK	00.01	GfK consumer confidence	Mar	-20	-21
	07.00	Retail sales incl. auto fuels M/M% (Y/Y%)	Feb	-0.4 (-0.9)	3.4 (0.7)
	07.00	Retail sales excl. auto fuels M/M% (Y/Y%)	Feb	-0.3 (-0.8)	3.2 (0.7)
	11.00	CBI industrial trends, total orders (selling prices)	Mar	-20 (-)	-20 (17)

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







The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 18 March 2024		
- Nothing scheduled -		
Tuesday 19 March 2024		
Euro area	08.30	ECB's Guindos scheduled to speak
UK	10.00	Auction: £2bn of 4.75% 2043 bonds
Wednesday 20 March 2024		
Euro area	-	The ECB and its Watchers conference – ECB's Lagarde, Lane, De Cos and Schnabel all scheduled to speak
Germany	10.30	Auction: 2.5% 2044 bonds
	10.30	Auction: 0.0% 2052 bonds
Thursday 21 March 2024		
Euro area	09.00	ECB publishes Economic Bulletin
France	09.50	Auction: 2.50% 2027 bonds
	09.50	Auction: 2.75% 2029 bonds
	09.50	Auction: 1.50% 2031 bonds
	10.50	Auction: 0.1% 2029 index-linked bonds
	10.50	Auction: 0.1% 2036 index-linked bonds
	10.50	Auction: 0.1% 2040 index-linked bonds
Spain	09.30	Auction: 2.50% 2027 bonds
	09.30	Auction: 5.75% 2032 bonds
	09.30	Auction: 3.45% 2043 bonds
UK	12.00	Bank of England monetary policy announcement
	12.00	Bank of England publishes Agents' summary of business conditions – Q124
Friday 22 March 2024		
Euro area	17.00	ECB's Lane gives a lecture on inflation
Italy	10.00	Auction: Index-linked bonds

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
France	 Final HICP (CPI) Y/Y%	Feb	3.2 (3.0)	<u>3.1 (2.9)</u>	3.4 (3.1)	-
Italy	 Final HICP (CPI) Y/Y%	Feb	0.8 (0.8)	<u>0.9 (0.8)</u>	0.9 (0.8)	-
	 Retail sales M/M% (Y/Y%)	Jan	-0.1 (1.0)	-	-0.1 (0.3)	-0.2 (0.2)
	 Trade balance €bn	Jan	2.6	-	5.6	
Spain	 Labour costs Y/Y%	Q4	5.0	-	5.0	-
UK	 BoE inflation expectations, next 12M %	Feb	3.0	-	3.3	-



Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Spain	 Final HICP (CPI) Y/Y%	Feb	2.9 (2.8)	<u>2.9 (2.8)</u>	3.5 (3.4)	-
UK	 RICS house price balance %	Feb	-10	-10	-18	-19

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>

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