

Euro wrap-up

Overview

- While German inflation was slightly softer than expected and the Commission sentiment indices slumped in April, Bunds made losses as consumer and business price expectations rose to multi-year highs.
- Gilts followed the global trend lower on a quiet day for UK economic news.
- The ECB and BoE will both leave monetary policy unchanged tomorrow, while the flash estimates of euro area inflation in April and GDP in Q1 are also due.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.720	+0.076
OBL 2½ 04/31	2.822	+0.056
DBR 2.9 02/36	3.100	+0.036
UKT 4¾ 03/28	4.530	+0.092
UKT 4¾ 03/31	4.596	+0.071
UKT 4¾ 10/35	5.056	+0.053

*Change from close as at 4:45pm BST.

Source: Bloomberg

Euro area

Flash German & Spanish data consistent with further drop in core inflation in April

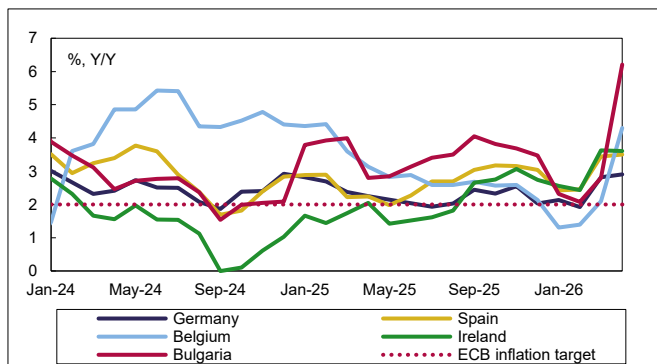
Today's flash April inflation estimates from several member states gave a guide as to what to expect from the euro area figures to be published tomorrow ahead of the ECB's policy announcement. As in March, the price shock from the Middle East appears to have been largely confined to energy while core components remained well-behaved. In Germany, the EU-harmonised HICP rate rose a smaller-than-expected 0.1ppt to 2.9%Y/Y, with the national CPI measure up 0.2ppt to the same rate. The detail published with the latter suggested that services inflation fell 0.4ppt to 2.8%Y/Y, the lowest since August 2022. That helped offset most of the near-3ppt increase in energy inflation to a 3-year high, although food inflation also rose to a three-month high. Looking ahead, a tax cut will suppress German auto-fuel prices in May and June to subtract about ¼ppt from inflation. Reflecting the earlier implementation, larger size and broader scope of that country's fiscal measures – including VAT cuts to electricity and gas prices as well as auto fuel – HICP inflation in Spain also rose just 0.1ppt in April to 3.5%Y/Y. And the Spanish CPI rate fell to 3.2%Y/Y. There was no detail published, but Spain's statistical agency noted lower electricity inflation as well as a smaller increase in prices of package holidays compared to a year earlier.

In Ireland, the energy component rose again, but HICP inflation was unchanged in April (3.6%Y/Y) as the core rate fell (2.5%Y/Y). So, along with Bulgaria, only the flash estimate from Belgium – where energy accounts for a particularly large share of the basket and methodological differences had suppressed the increase in March – suggested any upside risks to expectations for tomorrow's euro area figures. Indeed, Belgian HICP inflation more than doubled to 4.3%Y/Y, adding almost 0.1ppt to the euro area's headline rate from March, while the Bulgarian rate rose more than 3ppts to 6.8%Y/Y. Overall, while we also anticipate a near-1ppt increase in Italy, we see the risks to our euro area headline inflation forecast of 3.0%Y/Y as skewed to the downside. And we maintain our expectation of a drop in the core rate to 2.2%Y/Y, which would match January's more than 4-year low.

Commission survey adds to evidence of expectations of significant pass-through to come

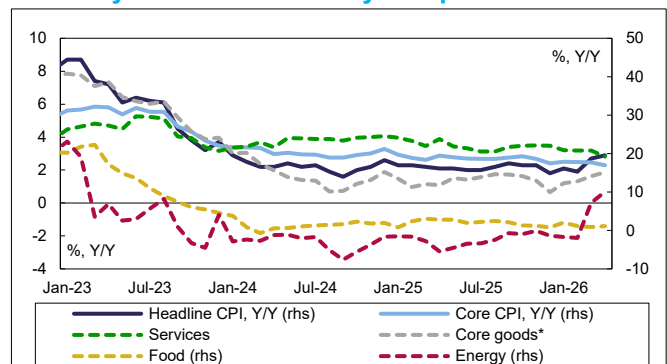
While, so far, the price shock from events in the Middle East appears largely confined to energy, a non-negligible pass-through to a range of goods and services seems likely over coming months. Tallying with the findings of yesterday's ECB SAFE survey, today's Commission survey results reported a further sizeable increase in business selling-price expectations in April. Indeed, the increases in the survey measures of three-month industrial and retail price expectations were the biggest on the series and pushed the respective indices to the highest level since end-2022 and spring 2023 respectively. And services and construction selling-price expectations jumped to the highest levels in more than two and three years respectively. Meanwhile, broadly consistent with the ECB consumer survey measures of near-term household inflation

Euro area member states: HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: CPI inflation & key components



*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

expectations, the Commission survey index of consumer price expectations 12 months ahead rose to the highest level since April 2022, just after the Russian invasion of Ukraine. With the Governing Council having flagged the importance of signals on inflation expectations in determining its next moves to policy, the Commission survey reinforced our baseline view that the ECB will eventually hike rates in June. However, with the ECB survey measures of medium-term price expectations still relatively well anchored, measures of near-term wage expectations having moderated, and market-based inflation expectations measures below their 2023-4 highs, there will be no panicked response from the Governing Council tomorrow.

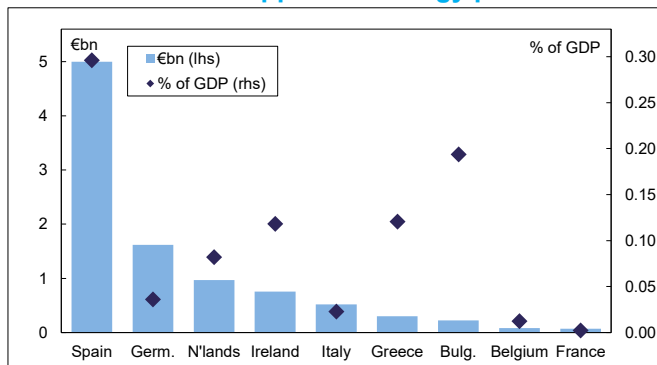
Economic sentiment slumps to the lowest since the second Covid wave

Certainly, in terms of economic activity, today's Commission survey suggested that sharply slowing growth momentum could help to neutralise potential second-round effects on inflation. In particular, the headline Economic Sentiment Index (ESI) fell for a third straight month in April, by the most in 3½ years, to 93.0, the lowest since November 2020 at the height of the second Covid wave and some 7% below the long-run average. While the pullback in March and April was smaller than immediately after the Russian invasion in 2022, the deterioration in sentiment was nevertheless broad-based. Having fared surprisingly well in March, the German ESI declined sharply this month, down 3.9pts to 88.5, a 15-month low. French sentiment also weakened for a third month to a 10-month low, some 9% below the long-run average, while the Belgian and Austrian indices implied a non-negligible risk of economic contraction. The Italian ESI also slipped below its long-run average, almost 4% below the Q1 level. But, despite also weakening in April, the indices from Spain, Portugal and Greece pointed to continued outperformance and economic growth in line with or above trend.

Services and retail sentiment hit as consumer spending hit by higher prices & unemployment fears

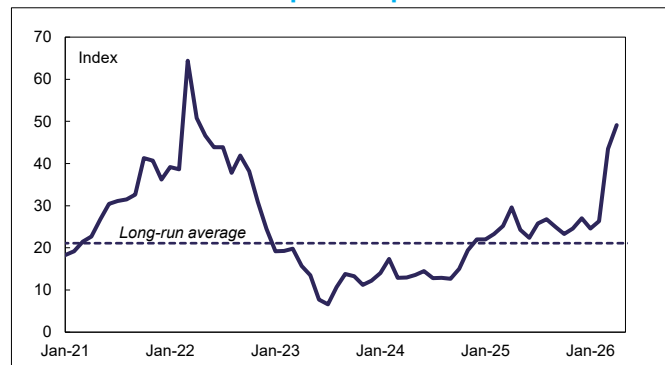
The deterioration was again driven by consumer-facing subsectors as households appeared to rein back spending. Indeed, services and retail sentiment weakened markedly in April, falling to the weakest levels since the end of the second Covid-lockdown in spring 2021, with travel, employment agencies, restaurants and logistics among the worst hit as firms revised down their expectations for future sales. Consumers reported rising job insecurity and increasing fears of another big hit to living standards. And although today's survey suggested some firms plan to hoard labour, on average businesses signalled an intention to cut headcount by the most in five years. This was particularly true among manufacturers, even though they reported the strongest increase in output in more than three years in an attempt to dodge future supply shortages and additional price pressures.

Euro area: Fiscal support for energy prices



Source: Bruegel and Daiwa Capital Markets Europe Ltd.

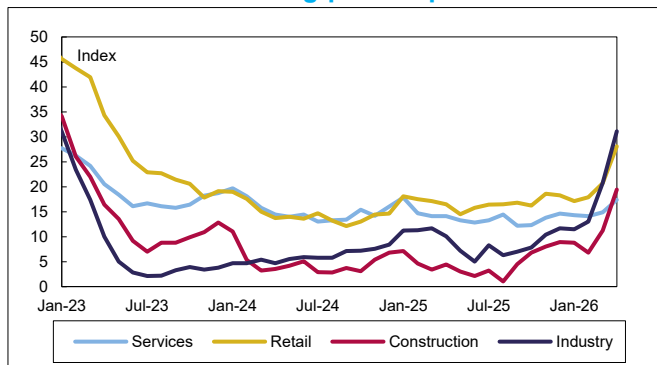
Euro area: Consumer price expectations*



*12 months ahead.

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

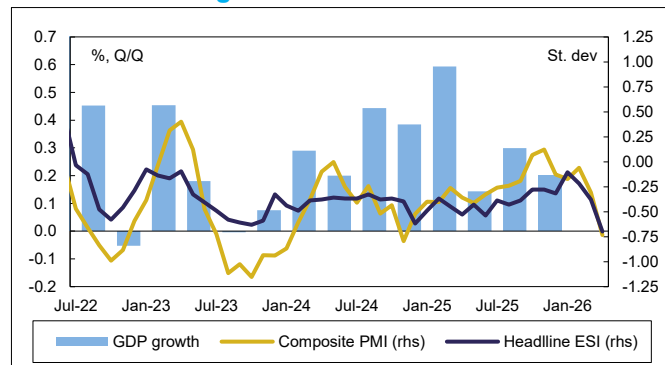
Euro area: Firms' selling-price expectations*



*3 months ahead.

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

Euro area: GDP growth & sentiment indices

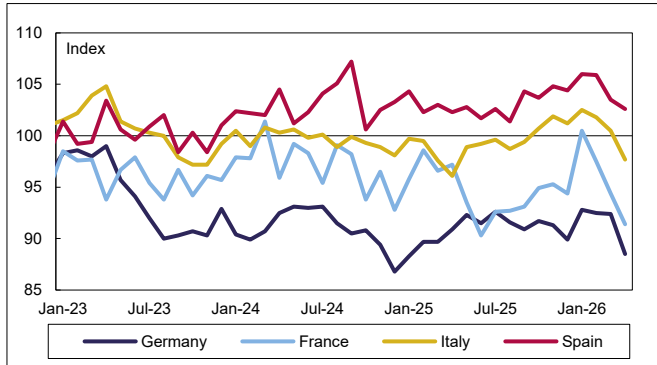


Source: EC, S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Demand for short-dated business loans & consumer credit jumps to meet liquidity needs

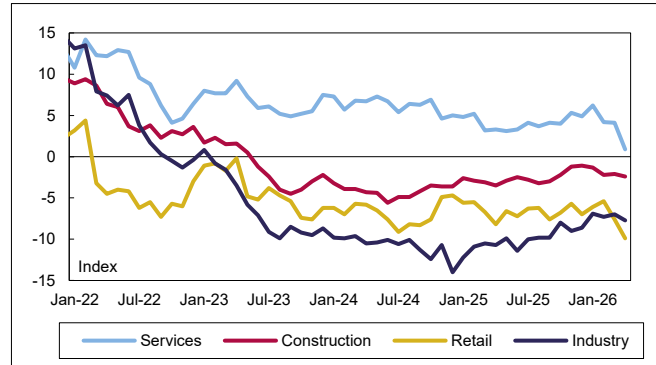
Despite the tightening of financial conditions flagged in yesterday’s Bank Lending Survey (BLS), today’s ECB monetary data showed a clear pickup in demand for business loans at the end of Q1 in the face of new liquidity needs. While it was less than half the peak after Russia’s invasion of Ukraine and well down on the initial Covid surge (€120bn), net new lending to NFCs totalled €27bn in March, the third highest monthly flow since 2022. The increase was concentrated in shorter-dated loans – i.e. maturities of less than five years. In contrast, the net flow of longer-dated loans was negligible and well down on the past year’s average, hinting at a scaling back of investment plans. While the flow of loans to households remained firm, this in part reflected the joint-strongest net issuance of consumer credit in 15 months, possibly linked to strained household budgets. And while mortgage lending moderated only slightly in March, it is expected to slow more sharply over coming months as credit conditions are expected to tighten and the housing market dynamics weaken.

Euro area: Economic sentiment indices, by country



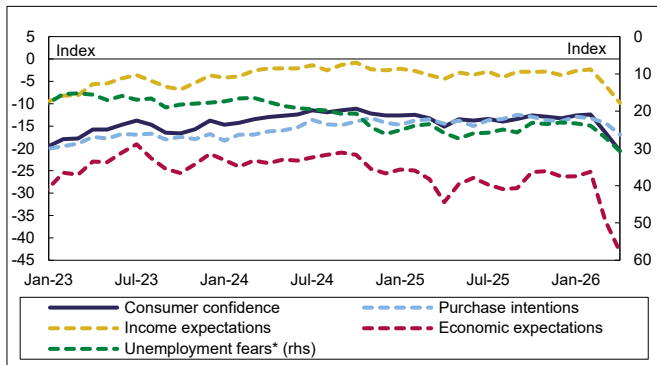
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Economic sentiment indices, by sector



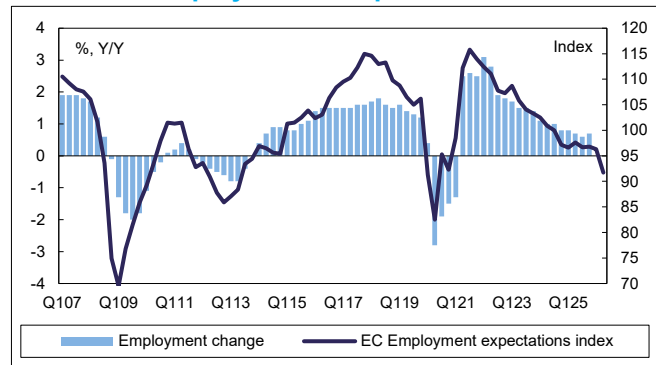
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence indices



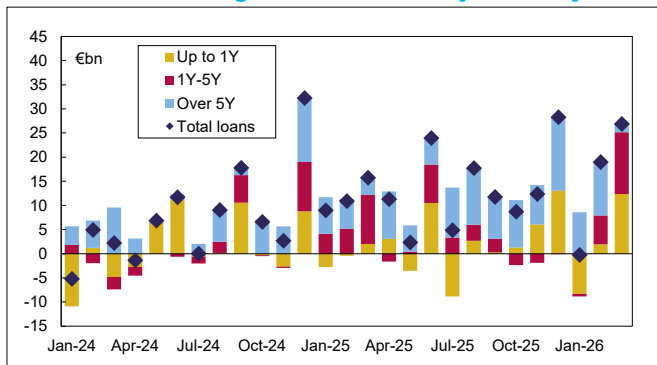
*Inverted axis. Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Employment & expectations index*



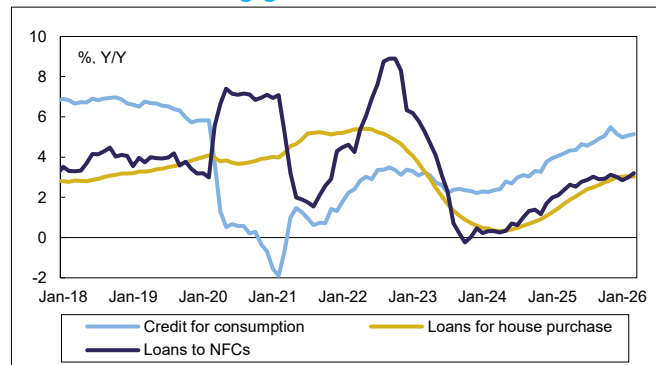
*April data represent Q226 EEI datapoint. Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Lending flows to NFCs by maturity



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Lending growth to households & NFCs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

ECB to leave policy unchanged, but Lagarde will signal coming meetings are live if shock persists

So, while the initial impact of the energy market shock on consumer prices is already evident, big question marks about its implications for the medium-term inflation outlook remain. Amid such high uncertainties regarding events in the Middle East, as well as that growing evidence of a significant near-term hit to economic activity and well-anchored medium-term price expectations, the ECB seems unlikely to rush into raising rates when its policy meeting concludes tomorrow. Still, most ECB policymakers agree that the energy price shock looks to be somewhat stronger and longer lasting than that assumed by its baseline scenario, which was conditioned on two rate hikes. This notwithstanding, President Lagarde will repeat that policy is not on a pre-determined path. But she will keep the ECB's options open and should signal that the ECB could (as we currently expect) tighten as soon as the policy meeting in June. (See Friday's [Euro wrap-up](#) for recent comments from Governing Council members and our full ECB preview).

The day ahead for euro area data

Thursday will also be a busy day for the euro area dataflow, with several top-tier releases including April's flash inflation figures and first GDP estimates for Q1 scheduled ahead of the ECB's announcement. As noted above, the softer-than-expected pickup in today's flash German estimates presents a downside risk to our euro area projection, which sees the headline HICP rate picking up to 3.0%Y/Y on further increases to energy prices. But we anticipate increases in France and Italy (whose data are also due tomorrow), so we still expect inflation to rise to that mark. And we maintain our call for a decline in the core rate to 2.2%Y/Y, a three-month low. In terms of GDP, we expect euro area growth to have moved sideways at 0.2%Q/Q at the start of the year, slightly undershooting the ECB's baseline projection. But as today's flash Irish estimate demonstrated (-2.0%Q/Q), a drag from manufacturing and construction output poses a threat to that view. Like Ireland, the pullback in IP was also evident in Germany. Thursday's retail sales figures are also likely to confirm a disappointing quarter for retail spending in the largest member state. So, we expect German GDP to have lagged its peers (0.1%Q/Q), while firmer consumption in France likely helped to sustain its momentum (0.2%Q/Q). Italy likely slowed only slightly (0.1%Q/Q), albeit with the potential for some temporary upside to activity from the Winter Olympic games. And Spain likely continued to outperform (0.5%Q/Q). Meanwhile, events in the Middle East are unlikely to have dislodged the euro area unemployment rate from its historical low (6.2%), but April's German jobless claims figures will provide a timelier view as to any adverse impact on hiring or firing.

UK










New forecasts to revise up inflation, but most of the MPC to hold Bank Rate at 3.75% for now

Like the ECB, a majority of MPC members should also adjudge that it is too soon for a change in policy. Indeed, as in March, the economic outlook remains highly uncertain. And we expect the MPC to reflect that fact via additional scenarios, to which MPC members can attach different weight. But its baseline projections – which will be published alongside the latest Monetary Policy Report – will reflect a wholly different world to the one presented to the MPC in February. Indeed, CPI inflation rose to 3.3%Y/Y in March, and as the BoE's assumptions for global oil and natural gas prices will be revised significantly higher, it will be expected to surpass that rate in Q3 as higher wholesale energy prices feed into regulated electricity and gas bills. But Governor Bailey has said that it is 'too early' to draw conclusions about how the oil shock might affect the broader price- and wage-setting environment. And most MPC members seem sympathetic to the case that weak demand will dampen firms' ability to pass on higher costs to selling prices. Certainly, despite an expectant upwards revision to the BoE's assumption for Q1 GDP, its full-year growth forecast will be revised lower. And monetary policy restrictiveness is expected to help too. Of course, further evidence of spillovers into expectations and selling prices – perhaps by the time of July's MPC meeting and forecast update – might eventually lead the MPC to conclude that more policy restriction is required. But until then, perhaps only Chief Economist Pill – who remains concerned about structural changes in the labour market – may vote in favour of a rate hike this week. (Our BoE preview and a collection of MPC members' comments can also be found in Friday's [Euro wrap-up](#).)





European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Commission economic sentiment indicator	Apr	93.0	95.1	96.6	96.2
	 Commission services (industrial) confidence indicator	Apr	0.9 (-7.7)	3.0 (-7.0)	4.9 (-7.0)	4.1 (-)
	 Final Commission consumer confidence indicator	Apr	-20.6	<u>-20.6</u>	-16.3	-
	 M3 money supply Y/Y%	Mar	3.2	3.1	3.0	-
Germany	 Preliminary HICP (CPI) Y/Y%	Apr	2.9 (2.9)	3.1 (2.9)	2.8 (2.7)	-
Italy	 Istat business (manufacturing) confidence indicator	Apr	95.2 (87.9)	-	97.3 (88.8)	- (88.7)
	 Istat consumer confidence indicator	Apr	90.8	91.3	92.6	-
	 Hourly wages M/M% (Y/Y%)	Q1	0.1 (2.4)	-	0.2 (2.9)	-
Spain	 Preliminary HICP (CPI) Y/Y%	Apr	3.5 (3.2)	3.4 (3.5)	3.4 (3.4)	-


















Auctions

Country	Auction
Germany	 sold €3.834bn of 2.9% 2036 bonds at an average yield of 3.08%
Italy	 sold €4bn of 3.15% 2031 bonds at an average yield of 3.32%
	 sold €1.5bn of 3.35% 2035 bonds at an average yield of 3.77%
	 sold €3.5bn of 2036 floating bonds at an average yield of 3.36%





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	 10.00	GDP – first estimate Q/Q% (Y/Y%)	Q1	<u>0.2 (0.8)</u>	0.2 (1.2)
	 10.00	Preliminary headline (core) HICP Y/Y%	Apr	<u>3.0 (2.2)</u>	2.6 (2.3)
	 10.00	Unemployment rate %	Mar	6.2	6.2
	 13.15	ECB Deposit (Refinancing) Rate %	Apr	<u>2.00 (2.15)</u>	2.00 (2.15)
Germany	 07.00	Retail sales M/M% (Y/Y%)	Mar	-0.5 (0.5)	-0.6 (0.6)
	 07.00	Import prices M/M% (Y/Y%)	Mar	3.2 (1.0)	0.3 (-2.3)
	 08.55	Unemployment claims rate % (change 000s)	Apr	6.3 (5)	6.3 (0)
France	 09.00	GDP – first estimate Q/Q% (Y/Y%)	Q1	<u>0.1 (0.2)</u>	0.3 (0.6)
	 06.30	GDP – first estimate Q/Q% (Y/Y%)	Q1	<u>0.2 (1.3)</u>	0.2 (1.2)
	 06.30	Consumer spending M/M% (Y/Y%)	Mar	-	-1.4 (-1.5)
	 07.45	Preliminary HICP (CPI) Y/Y%	Apr	2.3 (2.0)	2.0 (1.7)
	 07.45	PPI Y/Y%	Mar	-	-2.4
Italy	 07.45	Preliminary private sector payrolls Q/Q%	Q1	-	-0.1
	 09.00	GDP – first estimate Q/Q% (Y/Y%)	Q1	<u>0.1 (0.6)</u>	0.3 (0.8)
	 10.00	Preliminary HICP (CPI) Y/Y%	Apr	2.5 (2.5)	1.6 (1.7)
Spain	 08.00	GDP – first estimate Q/Q% (Y/Y%)	Q1	<u>0.5 (2.6)</u>	0.8 (2.7)
UK	 12.00	BoE Bank Rate %	Apr	<u>3.75</u>	3.75

Auctions and events

Euro area	 13.15	ECB monetary policy announcement
	 13.45	ECB President Lagarde to hold post-Governing Council meeting press conference
UK	 12.00	BoE monetary policy announcement, summary and minutes, and Monetary Policy Report to be published
	 12.30	BoE Governor Bailey to conduct post-MPC press conference

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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