Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

- While the German CDU and CSU settled on a candidate to be the next Chancellor, Bunds made gains despite a rise in German producer price inflation to the highest in almost a decade.
- Gilts also made gains despite a further drop in the UK unemployment rate.
- Wednesday will bring the latest UK inflation data.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.702	-0.011
OBL 0 04/26	-0.607	-0.022
DBR 0 02/31	-0.264	-0.028
UKT 0$^1/_8$ 01/23	0.028	-0.001
UKT 0$^1/_8$ 01/26	0.309	-0.013
UKT 4¾ 12/30	0.729	-0.024

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

Euro area

CDU/CSU gambles on unpopular Laschet

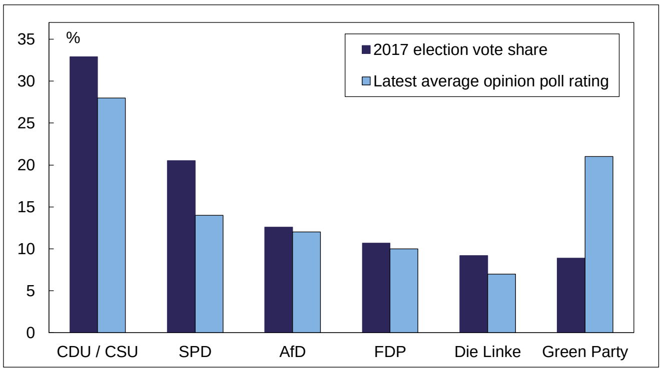
After months of speculation, the main contenders to be Angela Merkel's successor as Chancellor following September's general election have been confirmed. After a vote among CDU parliamentarians earlier today, the highly popular (and populist) CSU leader Markus Soeder withdrew from the race to be the candidate for the centre-right bloc. So, that allowed Armin Laschet, the unpopular more centrist CDU leader and Minister-President of North-Rhine Westphalia, to be confirmed in that role. With opinion polls still giving the CDU/CSU the largest share of support among voters and thus, on balance, being most likely to win the largest share of seats in the next Bundestag, Laschet now appears in pole position to be the next Chancellor. However, support for the CDU/CSU has dropped by almost 10ppts since the start of the year, to below 30%. And Laschet's lack of popularity risks further erosion of its ratings. Meanwhile, the Greens – who yesterday confirmed joint-leader Annalena Baerbock as its own candidate for Chancellor – have consolidated their position as the second-placed party, with average ratings up to about 22%, roughly 6ppts ahead of the centre-left SPD in third.

Of course, public opinion could shift markedly in either direction between now and September. At a similar point ahead of the last election, the then-SPD leader Martin Schulz was rising high in the polls before crashing precipitously as the election approached. But a recent RTL/ntv survey suggested that, if Germans could vote for their Chancellor directly, Laschet would get just 17%, the same share of the SPD's Scholz, while Baerbock would win 22%. So, while we attach a probability of more than 50% that Laschet will be Merkel's successor, we attach a probability of more than one third that Baerbock and the Greens will lead the next government, whether in coalition with the CDU/CSU or in an alternative formation. Among other things, that might bring growth-positive reform of Germany's constitutional debt brake and an associated looser fiscal policy with increased public investment over the medium term, and greater progress towards fiscal integration in the euro area.

German producer price inflation at highest in almost ten years

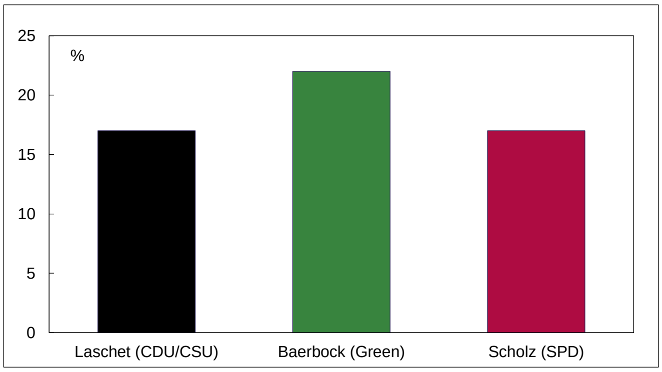
Data-wise, so far the week has brought only second-tier releases from the euro area. Today's German PPI figures, however, were not without interest, with industrial producer price inflation up a steep 1.8ppts in March to a near-ten-year high of 3.7%Y/Y. Given the past year's marked shifts in oil prices, unsurprisingly energy prices continued to add to pipeline price pressures, rising 8.0%Y/Y, up 4.3ppts on the month and the highest since November 2018. Germany's carbon pricing scheme compounded the impact of higher global energy prices, e.g. adding more than 11ppts to inflation of natural gas sold to large-scale industrial consumers (18.2%Y/Y). However, excluding energy, core producer price inflation still rose 1.0ppt to a three-year high of 2.4%Y/Y. For a third successive month, intermediate goods inflation accelerated markedly, rising 1.9ppts to be up 5.7%Y/Y, the most since mid-2011. That principally reflected higher prices of metallic secondary raw materials, up

Germany: National parliament voting intention



Source: Politico and Daiwa Capital Markets Europe Ltd.

Germany: Preference for next Chancellor



Source: RTL/ntv and Daiwa Capital Markets Europe Ltd.

almost 50%Y/Y, with prices of metals including steel and alloys up 17.5%Y/Y on firmer demand, increased global prices of iron ore, and supply-chain challenges. Among other intermediate items, however, prices of electronic components were down 9.5%Y/Y. And of the other major categories, inflation of durable consumer goods was steady (1.4%Y/Y), with inflation of capital goods (0.9%Y/Y) and non-durable consumer goods (-1.4%Y/Y) including food (-2.5%Y/Y) still subdued. With last year's trough in energy prices reached in May, energy price base effects will push producer price inflation higher still over the next few months in Germany and the euro area as a whole. But the pipeline pressures are likely to be temporary and unlikely to trigger lasting upwards pressure in underlying consumer price inflation.

Construction output set to pick up after February dip

Yesterday's euro area construction sector data were predictably soft, reporting a drop of 2.1%M/M in output in the sector in February which more than reversed the rise of 0.8%M/M at the start of the year. Weakness was broad-based, with building work down 1.9%M/M and civil engineering activity down 3.4%M/M. Weakness was also widespread across the euro area, with the steepest declines in France (-6.0%M/M), Belgium (-5.3%M/M), Spain (-3.8%M/M) and the Netherlands (-3.4%M/M). And while the fall in France followed a sharp rebound of 13.1%M/M in January, the decline of 1.2%M/M in Germany in February followed the plunge of 10.5%M/M the prior month in response to the rise in VAT at the start of the year. On average in the first two months of the year, the level of euro area construction output was down just 0.4% from the Q4 average. And, given that we expect a rebound in March, production in the sector was likely little changed over Q1 as a whole from Q4, when production rose 0.7%Q/Q. Looking ahead, surveys point to renewed construction growth in the current quarter, with new orders and employment in the sector rising and demand for residential work still firm.

The day ahead in the euro area

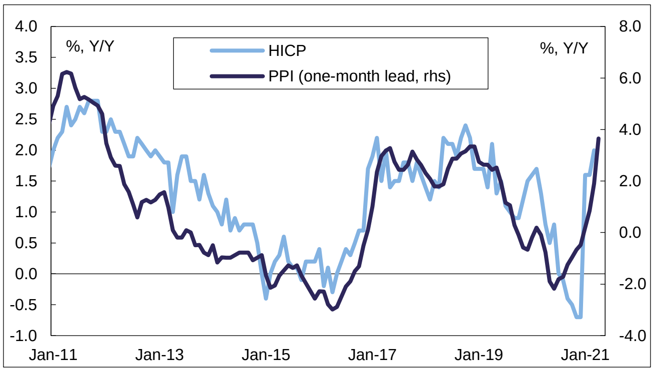
The quiet tone on the euro area economic data front continues tomorrow with no key releases scheduled.

UK

Employment and unemployment down in three months to February

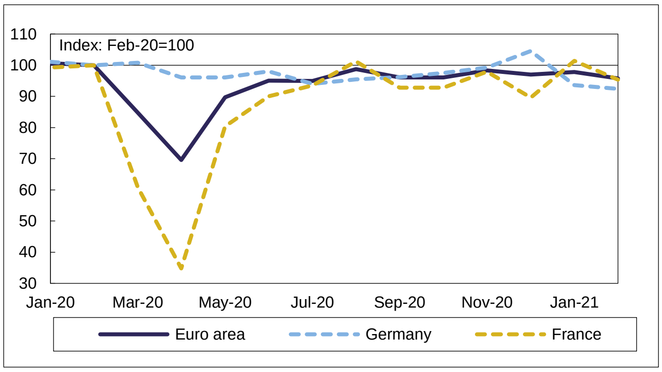
The latest UK labour market data remained consistent with broad stability as the government's Job Retention Scheme continued to provide support. Indeed, HMRC estimates that some 4.7mn jobs were furloughed at end-February, while the drop of 56k (-0.2%M/M) in payrolls in March was modest. That decline followed three consecutive months of gains in

Germany: Inflation



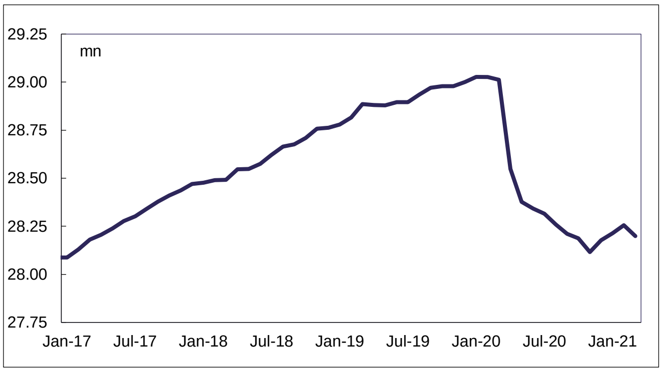
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output



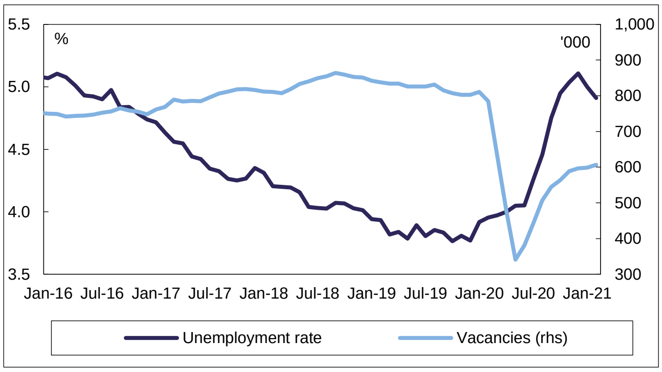
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employees



Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Unemployment rate and vacancies



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

payrolls, so the level was still some 83k above November's trough albeit down 813k from a year earlier (-2.8%Y/Y). On the ILO measure, with the fall in labour force participation steeper than the 73k drop in employment, and the male inactivity rate rising to its highest in a decade, the unemployment rate unexpectedly dropped in the three months to February for the second successive month, down a further 0.1ppt to just 4.9%. And while vacancies rose just 17k in the three months to March, that left the total at 607k, 266k above the trough in the three months to June albeit down 178k (-22.7%) from a year earlier. With the Job Retention Scheme extended to end-September, albeit with the share of salary paid by the government to be tapered gradually from July on, the unemployment rate seems likely to remain little changed into the summer. And while the level of redundancies might well pick up heading into the autumn, the unemployment rate seems likely to peak below the 6.5% rate forecast by the OBR.

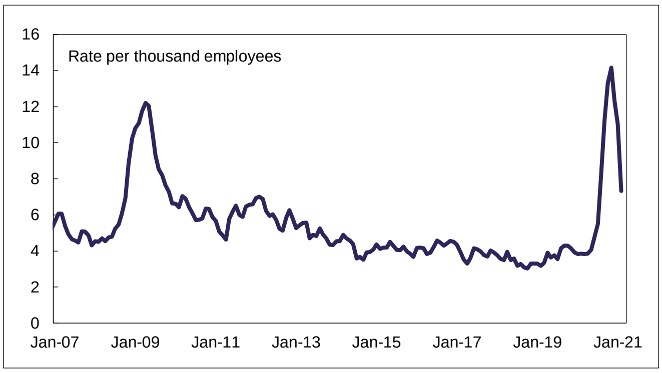
Underlying wage growth stable and consistent with limited price pressures

In terms of wages, growth in average total employee pay (including bonuses) in the three months to February slowed 0.3ppt from the prior month's 12-year high to 4.5%Y/Y. But, excluding bonuses, average pay ticked up 0.1ppt to 4.4%Y/Y. Most importantly, given the dominance of compositional effects in driving recent swings in pay growth – with lower paid workers having disproportionally lost their jobs throughout the pandemic – the ONS estimates that underlying wage growth was still relatively tame, at around 2.5%Y/Y for both total and regular pay. If sustained, that rate is unlikely to generate significant inflation pressures on a lasting basis.

The day ahead in the UK

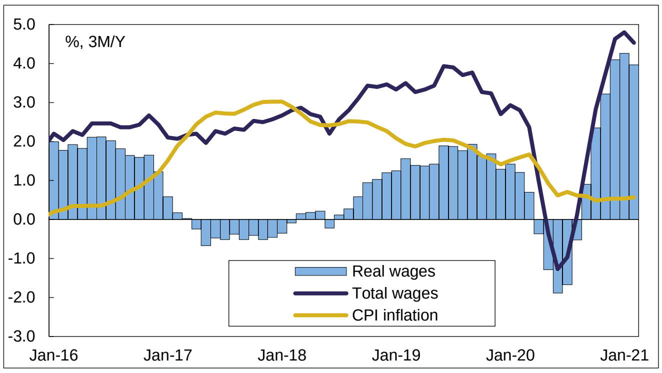
The focus tomorrow turns to the latest inflation data, which we expect to report a rise of 0.4ppt in the headline CPI rate to an eight-month high of 0.8%Y/Y in March, thanks not least to further upward pressure from energy prices. However, we also expect a pickup in clothes inflation to be reflected in an increase in the core measure to 1.2%Y/Y, from 0.9%Y/Y in February.

UK: Redundancy rate*



*Ratio of the redundancy level for the given quarter to the number of employees in the previous quarter, multiplied by 1000. Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Wage and price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		PPI Y/Y%	Mar	**3.7**	3.2	1.9	-
UK		Unemployment claimant count rate % (change '000s)	Mar	**7.3 (10.1)**	-	7.5 (86.6)	**7.3 (67.3)**
		Average earnings including bonuses (excluding bonuses) 3M/Y%	Feb	**4.4 (4.5)**	4.6 (4.2)	4.8 (4.2)	**- (4.3)**
		ILO unemployment rate 3M%	Feb	**4.9**	5.1	5.0	-
		Employment change '000s 3M/3M	Feb	**-73**	-150	-147	-

Auctions

Country		Auction
Germany		sold €4.095bn of 0% 2023 bonds at an average yield of -0.69%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		ECB current account balance €bn	Feb	**25.9**	-	30.5	**34.7**
		Construction output M/M% (Y/Y%)	Feb	**-2.1 (-5.8)**	-	0.8 (-1.9)	**- (-2.6)**
France		Bank of France retail sales M/M%	Mar	**0.5**	-	0.2	-
UK		Rightmove house price index M/M% (Y/Y%)	Apr	**2.1 (5.1)**	-	0.8 (2.7)	-

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
UK		07.00	CPI (core CPI) Y/Y%	Mar	*0.8 (1.2)*	0.4 (0.9)
		07.00	PPI input prices (output prices) Y/Y%	Mar	4.3 (1.7)	2.6 (0.9)
		09.30	House price index Y/Y%	Feb	8.0	7.5

Auctions and events

Country		BST	Event
Germany		10.30	Auction: €4bn of 0% 2031 bonds
UK		10.00	Auction: £2.5bn of 0.625% 2035 bonds
		11.30	BoE Governor Bailey gives a keynote speech at a virtual event on 'Diversity in Market Intelligence'

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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