

Euro wrap-up

Overview

- Bund made modest gains as euro area labour cost growth slows in Q4 and the goods trade balance recorded a third consecutive deficit in January.
- Gilts continued yesterday's rally on a quiet day for UK economic data.
- The coming week will bring March sentiment surveys, including the flash PMIs and consumer confidence indices. Inflation and retail sales numbers and a fiscal policy update are also due in the UK.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	-0.367	-0.013
OBL 0 04/27	0.073	-0.022
DBR 0 02/32	0.364	-0.016
UKT 1 04/24	1.189	-0.086
UKT 1½ 07/27	1.242	-0.078
UKT 4¼ 06/32	1.497	-0.065

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

Euro area

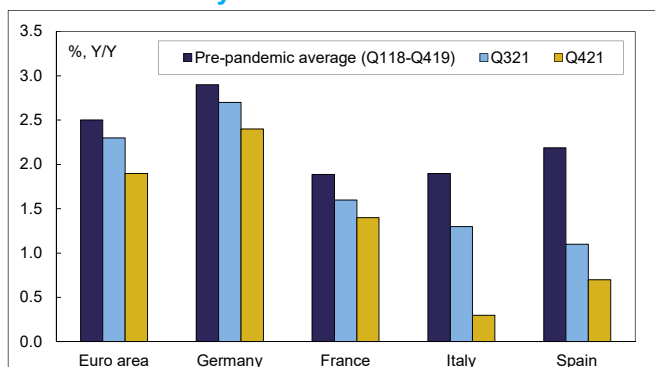
Euro area labour cost growth slows in Q4

While the [ECB's](#) Governing Council decided last week to slow its asset purchases more abruptly over coming months due to concerns about the worsening inflation outlook, today's labour cost numbers provided a reminder that meaningful second-round pressures on inflation remain largely absent. Indeed, whole economy hourly labour costs slowed 0.4ppt in Q4 to 1.9%Y/Y, well below the range in the two years ahead of the pandemic. Labour costs in the business economy moderated 0.3ppt to 2.3%Y/Y. While there was an acceleration in non-wage costs (up 0.9ppt to 3.5%Y/Y), wage growth moderated 0.6ppt to just 1.7%Y/Y, the second-weakest rate since Q117, with softer wage growth in industry (1.2%Y/Y), services (1.9%Y/Y) and construction (1.7%Y/Y) alike. The slowdown in labour costs was seen in all of the large member states, of which the steepest was in Italy (down 1.0ppt to just 0.3%Y/Y), while pressures also remained very weak in Spain (0.7%Y/Y) and France (1.4%Y/Y). German labour cost growth (2.4%Y/Y) was in part supported by higher non-wage costs and remained below pre-pandemic levels.

Wage settlements to remain moderate despite rapid energy price inflation

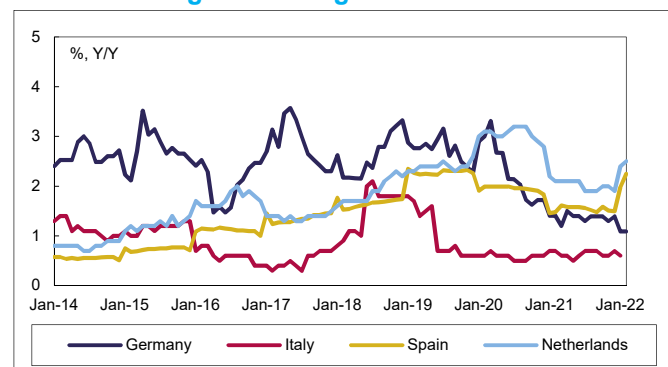
Wage growth has to some extent been constrained by the persisting pandemic, with renewed restrictions towards the end of last year reducing worker bargaining power while support from government job retention schemes has diminished. Wage data from the member states suggest a lack of significant upwards pressure on labour costs in early 2022. Certainly, negotiated wage growth in Germany remained very weak in February at 1.1%Y/Y, the joint-lowest rate for eleven years, with equivalent numbers in Italy reporting growth of just 0.6%Y/Y. And while they have ticked higher in Spain and the Netherlands (to around 2½%Y/Y) these remain below pre-pandemic rates. The lack of bargaining power in part reflects the swift recovery in labour force participation back to the pre-Covid level, contrasting the US and UK where a significant shortage of available workers persists. Moreover, while the unemployment rate has fallen to a euro-era low below 7%, a large amount of slack remains. Additionally, wage bargaining arrangements now typically lend themselves to moderation. Just 3% of private sector employees in the euro area have wage settlements automatically linked to inflation. And a formal role for inflation in wage negotiations applies to less than a fifth of employees, and these are largely based on forward-looking forecasts excluding energy prices. For more than half of private sector employees, inflation plays no formal role in wage setting, particularly during times of uncertainty when job security is paramount. So, we expect wage growth to significantly lag inflation this year and next. The ECB forecasts employee compensation growth of around 3½%Y/Y this year and next, before slowing below 3% in 2024. And with economic recovery expected to be maintained, it expects unit labour costs to grow just 1.3%Y/Y this year and next, and remain below 2%Y/Y in 2024 – rates inconsistent with above-target inflation over the medium term.

Euro area: Hourly labour costs



Source: Eurostat and Daiwa Capital Markets Europe Ltd.

Euro area: Negotiated wages



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Goods trade balance in deficit for 3rd month

The euro area goods trade balance remained in deficit for a third successive month at the start of the year as the adverse terms-of-trade shock associated with rising energy and commodity prices continued to take its toll. Nevertheless, on a seasonally adjusted basis, the value of exports (up 3.4%M/M) outpaced that of imports (2.3%M/M) for the first time in six months as shipments to China, Japan and the US rebounded following weakness in November and December while imports from Asia fell back. So, the trade balance also improved for the first time since July, with the seasonally-adjusted deficit narrowing by €2bn to €7.7bn. That, however, was still the euro area's second-widest goods trade deficit since 2008. And while the value of goods exports was up at a 13-month high quarterly rate of 5.6%3M/3M in January, the pace of import growth on the same basis was more than double that (11.4%3M/3M). On an unadjusted basis, goods exports were up 19%Y/Y, far outpaced by the leap of 44%Y/Y in imports.

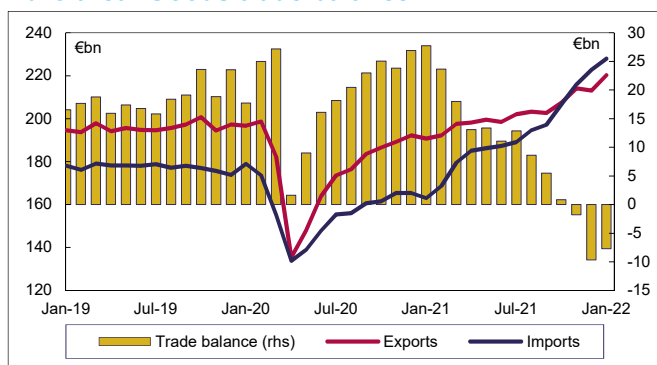
Trade deficit with Russia at series high ahead of invasion of Ukraine

The main cause of the deterioration in the goods trade balance, of course, has been the surge in the value of imported energy, up more than 88%Y/Y in January, and more than fully accounted for by higher prices. Indeed, producer import prices rose 24.7%Y/Y in January, with prices of imported energy electricity and gas about three times higher and other imported energy prices roughly doubling. So, by trading partner, growth in the value of euro area imports from energy producers inevitably remained extremely strong. Imports from Norway, the euro area's number one source of natural gas at the start of the year, were up almost 250%Y/Y. And imports from Russia were up almost 90%Y/Y, accounting for about 6.5% of total extra-euro area imports (and so more than double the share of extra-euro area exports) and pushing the bilateral deficit up to a series high of €8.1bn in the month prior to the invasion of Ukraine. Meanwhile, prices of imported manufactured goods were up a marked 13.5%Y/Y. So, while the bilateral deficit with China narrowed by €2.5bn, at €21.2bn it was still the second-highest on the series. Adjusting for price shifts, net trade likely provided modest support to growth at the start of the year. And while the trade deficit has probably widened further in Q1 on even-higher prices of energy, food and other commodities, export volumes should outpace import volumes this quarter and over the year as a whole.

The week ahead in the euro area

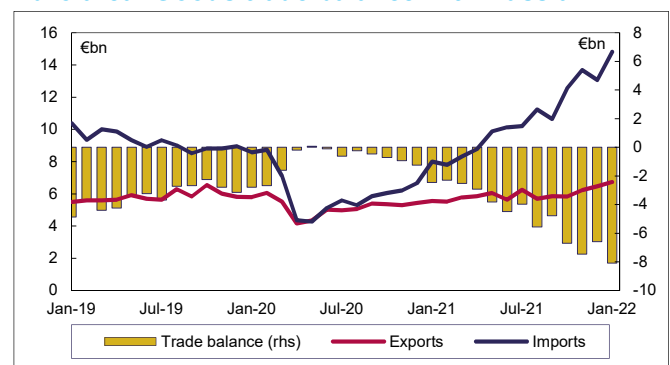
The coming week's data focus in the euro area will be the results of several top-tier economic sentiment surveys, which should provide a guide to the hit to economic growth, additional price pressures and renewed tightening of supply bottlenecks in the wake of Russia's invasion of Ukraine. The European Commission's preliminary consumer confidence index for March will be published on Tuesday, with the likelihood of a sixth successive monthly drop to the lowest level in at least one year. Most notably perhaps, the preliminary manufacturing, services and composite PMIs for March are due on Thursday. In February, the PMIs signalled a pickup in growth momentum, with the euro area manufacturing output index rising to a five-month high (55.5), and the services activity index up to a three-month high (also 55.5) above its average of the second half of 2021. But while there were hints of an easing of supply bottlenecks, the price indices continued to signal marked pressures. At the country level, France's INSEE will publish its business confidence survey results on Thursday, while the German ifo business conditions indices and Italian ISTAT economic sentiment figures will be published on Friday. Other data to be published in the coming week include the euro area's construction output numbers for January (Tuesday) and February bank lending numbers (Friday).

Euro area: Goods trade balance*



*Seasonally adjusted values.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade balance with Russia*



*Seasonally adjusted values.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK










The week ahead in the UK

Key UK data to be published in the coming week include Wednesday's inflation report for February. UK CPI inflation edged up in January, rising 0.1ppt to 5.5%Y/Y, while core inflation rose a further 0.2ppt to 4.4%Y/Y, with both rates the highest since March 1992. We expect a much bigger increase in February – perhaps as much as 0.7ppt to both headline and core rates to 6.2%Y/Y and 5.1%Y/Y respectively – with additional pressures in energy, food and non-energy goods components. Like in the euro area, the flash PMIs for March are due Thursday – following marked improvements in February (the manufacturing output index rose to a seven-month high of 56.9, while the services activity index rose to an eight-month high of 60.6), the March indices seem likely to report a softening of growth momentum but increased price pressures following the Russian invasion of Ukraine. The end of the week brings February retail sales data as well as the GfK consumer confidence survey for March. While retail sales are likely to grow further following a rebound of 1.9%M/M at the start of the year, consumer confidence is likely to have weakened to the lowest level in at least fourteen months.

Among other UK data due, the February public finances figures will come on Tuesday ahead of the OBR's updated fiscal forecasts on Wednesday. The associated spring fiscal statement from the Chancellor on Wednesday seems likely to bring certain new budgetary measures, most likely to ease somewhat the impact of higher energy prices on disposable incomes. In particular, a cut in fuel duty as well as an increase in welfare benefits might be in order. Following Russia's invasion of Ukraine, Conservative backbenchers have also called for additional spending on defence. Scope for additional public spending will be provided by recent trends in government net borrowing, which is set to come in some £30bn lower than the OBR previously expected in the current fiscal year. While public spending on debt interest has leapt due to high inflation, tax revenue has significantly exceeded expectations as a large number of workers switched from self-employed status to income tax-generating permanent employee status, and a shift in spending towards non-food goods has also boosted VAT receipts.

The next edition of the Euro wrap-up will be published on 23 March 2022
















Daiwa economic forecasts

	2021		2022				2022	2023	2024
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP forecasts %, Q/Q									
Euro area 	2.3	0.3	0.3	0.7	0.8	0.7	3.3	2.4	1.8
UK 	1.0	1.0	1.0	-0.1	0.4	0.1	3.8	1.0	1.3
Euro area									
Headline CPI 	2.8	4.6	5.9	6.9	6.3	4.8	6.0	2.2	1.8
Core CPI 	1.4	2.4	2.8	3.5	3.3	2.7	3.1	1.7	1.7
UK									
Headline CPI 	2.8	4.9	6.1	8.0	7.4	8.0	7.4	4.3	1.9
Core CPI 	2.6	3.9	4.9	5.0	4.4	3.4	4.4	2.1	1.8
Monetary policy									
ECB									
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.50	0.50
Deposit Rate % 	-0.50	-0.50	-0.50	-0.50	-0.50	-0.25	-0.25	0.25	0.25
BoE									
Bank Rate % 	0.10	0.25	0.75	1.00	1.25	1.25	1.25	1.00	1.00

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

The coming week's data calendar

The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ <i>Daiwa</i> forecast/actual	Previous
Monday 21 March 2022					
Germany 	07.00	PPI M/M% (Y/Y%)	Feb	1.6 (25.7)	2.2 (25.0)
UK 	00.01	Rightmove house price index M/M% (Y/Y%)	Mar	-	2.3 (9.5)
Tuesday 22 March 2022					
Euro area 	10.00	Current account balance €bn	Jan	-	22.6
	10.00	Construction output M/M% (Y/Y%)	Jan	-	-4.0 (-3.9)
UK 	07.00	Public sector net borrowing, excluding banks £bn	Feb	6.3	-2.9
	11.00	CBI industrial trends survey, total orders (selling prices)	Mar	17 (80)	20 (77)
Wednesday 23 March 2022					
Euro area 	15.00	European Commission's preliminary consumer confidence	Mar	-12.5	-8.8
UK 	07.00	CPI (core CPI) Y/Y%	Feb	5.8 (4.9)	5.5 (4.4)
	07.00	PPI input (output) prices Y/Y%	Feb	13.9 (10.1)	13.6 (9.9)
	09.30	House price index Y/Y%	Jan	10.3	10.8
Thursday 24 March 2022					
Euro area 	09.00	Preliminary manufacturing (services) PMI	Mar	56.8 (54.8)	58.2 (55.5)
	09.00	Preliminary composite PMI	Mar	54.5	55.5
Germany 	08.30	Preliminary manufacturing (services) PMI	Mar	56.3 (54.8)	58.4 (55.8)
	08.30	Preliminary composite PMI	Mar	54.5	55.6
France 	07.45	INSEE business confidence	Mar	111	112
	07.45	INSEE manufacturing confidence (production outlook)	Mar	109 (-)	112 (22)
	08.15	Preliminary manufacturing (services) PMI	Mar	56.5 (55.0)	57.2 (55.5)
	08.15	Preliminary composite PMI	Mar	54.5	55.5
UK 	09.30	Preliminary manufacturing (services) PMI	Mar	57.0 (58.0)	58.0 (60.5)
	09.30	Preliminary composite PMI	Mar	57.5	59.9
	11.00	CBI distributive trades survey, reported retail sales	Mar	10	14
Friday 25 March 2022					
Euro area 	09.00	M3 money supply Y/Y%	Feb	6.3	6.4
Germany 	09.00	Ifo business climate	Mar	94.1	98.9
	09.00	Ifo current assessment (expectations)	Mar	97.0 (93.2)	98.6 (99.2)
Italy 	09.00	ISTAT business (manufacturing) confidence	Mar	- (112.0)	108.2 (113.4)
	09.00	ISTAT consumer confidence	Mar	108.0	112.4
Spain 	08.00	PPI Y/Y%	Feb	-	35.7
	08.00	Final GDP Q/Q% (Y/Y%)	Q4	2.0 (5.2)	2.6 (3.4)
UK 	00.01	GfK consumer confidence	Mar	-30	-26
	07.00	Retail sales including autos fuel M/M% (Y/Y%)	Feb	0.5 (7.8)	1.9 (9.1)
	07.00	Retail sales excluding autos fuel M/M% (Y/Y%)	Feb	1.0 (6.0)	1.7 (7.2)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.





The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 21 March 2022		
Euro area	 07.30	ECB's Lagarde scheduled to speak
	 15.30	Bundesbank President Nagel scheduled to speak
Tuesday 22 March 2022		
Euro area	 07.30	ECB's de Guindos scheduled to speak
	 13.15	ECB's Lagarde scheduled to speak at BIS Innovation Summit
	 17.00	ECB's Lane scheduled to speak on a panel "50 years of flexible exchange rates"
Germany	 10.30	Auction: €4bn of 0% 2027 bonds
UK	 15.15	BoE's Cunliffe scheduled to speak
Wednesday 23 March 2022		
UK	 12.00	BoE's Bailey scheduled to speak at BIS Innovation Summit
	 12.30	Chancellor's Spring Statement
	 -	OBR publishes UK economic and fiscal forecasts
Thursday 24 March 2022		
Euro area	 09.00	ECB publishes Economic Bulletin
	 09.30	ECB's Elderson scheduled to speak
UK	 10.30	BoE publishes Financial Policy Summary and Record of Financial Policy Committee meeting
	 13.00	BoE's Mann scheduled to speak
Friday 25 March 2022		
Italy	 10.00	Auction: fixed rate and inflation-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
Euro area	 Trade balance €bn	Jan	-7.7	-9.0	-9.7	-
	 Labour costs Y/Y%	Q4	1.9	-	2.5	2.3
France	 Final wages Q/Q%	Q4	0.5	0.5	0.3	-
Italy	 Trade balance €bn	Jan	-5.1	-	1.1	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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