Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made gains as the euro area consumer confidence index posted the second-steepest monthly decline in the history of the survey.
- Despite an upside surprise to UK inflation and an easing of fiscal policy, Gilts outperformed as the DMO planned less debt issuance than expected.
- Tomorrow brings the flash PMIs for March, which are likely to suggest a loss of recovery momentum amid higher price pressures and increased concerns about supply bottlenecks since the start of the Ukraine conflict.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	-0.253	-0.003
OBL 0 04/27	0.199	-0.017
DBR 0 02/32	0.475	-0.025
UKT 1 04/24	1.342	-0.049
UKT 1¼ 07/27	1.416	-0.047
UKT 4¼ 06/32	1.641	-0.067

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

Euro area

Euro area consumer confidence slumps in March

Following a substantial deterioration in investor confidence since the Russian invasion of Ukraine, a decline in today's European Commission's consumer confidence indicator was inevitable. But the preliminary release still reported a much-larger-than-expected drop in March, of 9.9pts – the second-largest monthly fall in the history of the survey – to -18.7, the weakest since the onset of the pandemic and only 5pts above the record low logged at the height of the global financial crisis. While we will have to wait until the final release (a week today) for a detailed breakdown, this seems bound to see a marked deterioration in households' perceptions of economic conditions and their own financial situations, reflecting not least the significant eroding of disposable incomes in light of the recent surge in inflation and prospects of further price pressures. Indeed, even before the worsening in conditions this month, households' willingness to make major purchases had declined for eight consecutive months to its lowest level in a year.

The day ahead in the euro area

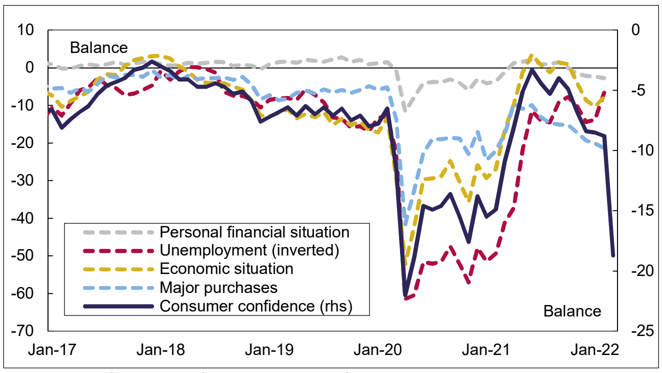
Tomorrow's releases will provide an update on business conditions since the start of the Ukraine conflict, with the flash manufacturing and services PMIs for March. Consistent with the weakening in consumer confidence, we might well see the euro area's services activity PMI signal a loss of momentum this month. And while the euro area manufacturing output index might have risen further from the five-month high recorded in February (55.5), we would expect to see a worsening in supply bottlenecks, and the price indices to signal marked pressures. Meanwhile, France's INSEE will also publish its business confidence survey results.

UK

UK inflation beats expectations again rising to a new 30-year high

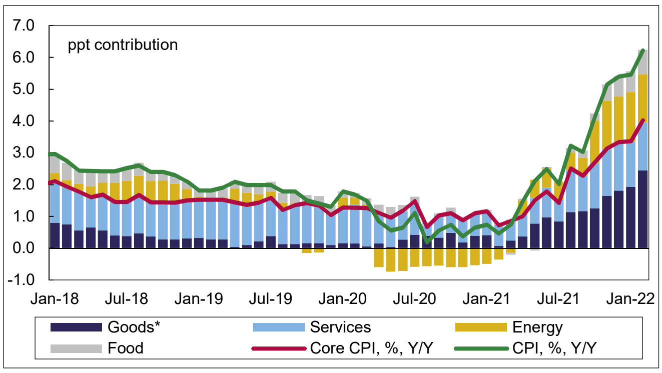
Once again, UK inflation beat expectations, with the headline CPI rate rising 0.7ppt in February to 6.2%Y/Y, the highest since March 1992. On the month, prices rose 0.8%M/M, the most in any February since 2009. For a fourth successive month, the principal driver to the rise in the annual CPI rate last month was non-energy industrial goods, inflation of which rose 1.6ppts to a new high of 7.4%Y/Y, as firms sought to pass on ongoing cost pressures to consumers. Within the detail of that component, inflation of clothing rose 2.7ppts to 8.8%Y/Y, furniture and other household items rose 0.7ppt to 9.1%Y/Y, and used cars rose almost 2ppts to 30.6%Y/Y. In addition, inflation of games, toys and hobbies – which is typically highly volatile – jumped almost 8ppts to 1.5%Y/Y, likely at least in part reflecting the composition of the best-sellers list. Meanwhile, with

Euro area: Consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Consumer price inflation



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

services inflation rising 0.1ppt to 3.4%Y/Y, core inflation rose 0.8ppt to 5.2%Y/Y. Inflation of food and non-alcoholic beverages was also higher, rising 0.7ppt to 6.2%Y/Y, the highest in more than a decade. But, while energy prices rose 1.0%M/M, for a third successive month their annual rate of inflation edged lower, falling 0.5ppt to an admittedly still astronomical 22.8%Y/Y, reflecting a slightly softer pace of increase of petrol prices at the pump.

Inflation to rise above 8%Y/Y in April and remain high through to Q423

Looking ahead, the path of UK inflation will be determined to a large extent by energy prices. Given recent increases in the price of petrol at the pump, the headline CPI rate is bound to rise further in March to around 6½%Y/Y. And despite the government's announcement today of a cut in fuel duty of 5p per litre (which will reduce the petrol price by 3½%), and notwithstanding a lack of clarity about the statistical treatment of government 'loans' to temporarily reduce the rise in energy bills this year, inflation will likely rise above 8%Y/Y in April due to the hike of more than 50% in the regulated household energy price cap. In addition, while wholesale gas and electricity prices have fallen back from recent peaks, if they remain near current levels household energy bills will probably be raised again in October by one third or more. Beyond the energy component, ongoing cost pressures – reflected in part by further increases in input and output PPI inflation to 10.1%Y/Y and 14.7%Y/Y in February – are likely to be passed on to consumers of a range of goods and many services. So, while base effects could mean that April will represent the peak, our baseline forecast still sees inflation rising again back towards 8%Y/Y in the autumn, averaging more than 7% this year, and remaining above 3%Y/Y through to next September, before falling back to 2%Y/Y or below thereafter.

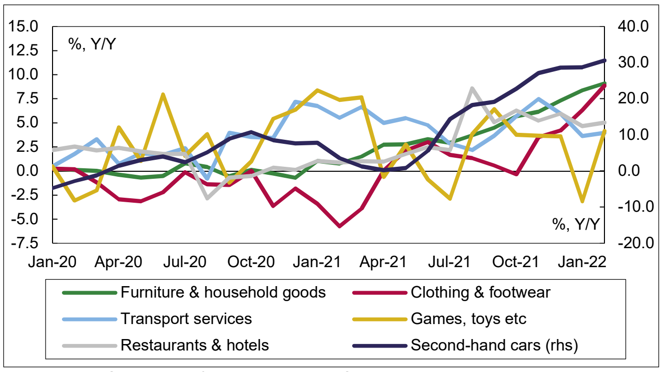
Fiscal stance eased, but real disposable incomes still to fall at a record rate

In light of the impact of high inflation on real incomes, the government today announced certain other measures on top of the cut in fuel duty to try to limit the economic and political damage. That included reductions to personal income tax and National Insurance Contributions (NICs), which will have the effect of returning to individuals a little more than a quarter of the amount to be raised via those policy tools from measures announced last year which take effect next month. As a result, compared its previous estimate made in October, the OBR estimated that the fiscal stance has been eased by a non-negligible £19.4bn (about 0.8% of GDP) in FY22-23, and by an average of £7.5bn (0.3% of GDP) a year from FY23-24 onwards (excluding amendments to the student loans scheme). Nevertheless, despite the additional government support for personal budgets, real household disposable incomes per person are still forecast by the OBR to fall by 2.2% in FY22-23, representing the biggest fall in a single financial year since ONS records began in 1956-57. And so, despite the easing of fiscal policy, the near-term outlook for economic growth remains subdued – the OBR now expects GDP to rise just 1.8% in 2023 and 2.1% in 2024, before falling back to the potential rate around 1¾% per year thereafter. It also expects the unemployment rate to tick higher over the near term. And that subdued outlook for economic growth and associated softening in the labour market is a key reason why we maintain our forecast that the BoE will raise rates by less than the market currently expects this year.

Gilts rally as public borrowing outlook is revised down

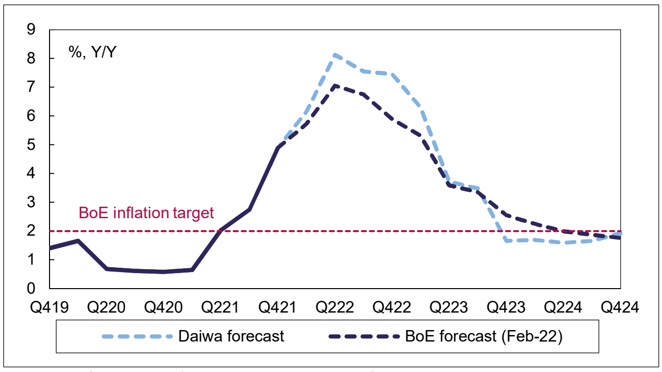
Given the stronger-than-expected recent tax-take and additional policy measures in the baseline, revenues as a share of GDP will still rise over the coming five years to above 40%, the highest since the late 1940s. Unsurprisingly, the OBR revised down by £55bn its forecast of net public sector borrowing in FY21-22 to £128bn (5.4% of GDP). But given today's easing of fiscal policy as well as an increase in debt interest payments related not least to higher inflation, it revised up its forecast of net borrowing in FY22-23 by £16.1bn to £99.1bn (3.9% of GDP). Borrowing in subsequent years, nevertheless, is forecast to be roughly £11bn or so (½% of GDP) per year lower than previously thought. And public sector net debt is now forecast to peak in FY21-22 at 95.6% of GDP, more than 2½ppts below the prior forecast, before steadily declining over coming years to be almost 5ppts below the level expected in five years' time. With the DMO's planned debt issuance for the coming fiscal year also more than £27bn lower than anticipated by the average primary dealer in the Bloomberg survey at £124.7bn, down from £195bn in the past year, Gilts rallied.

UK: Selected CPI components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: CPI forecast

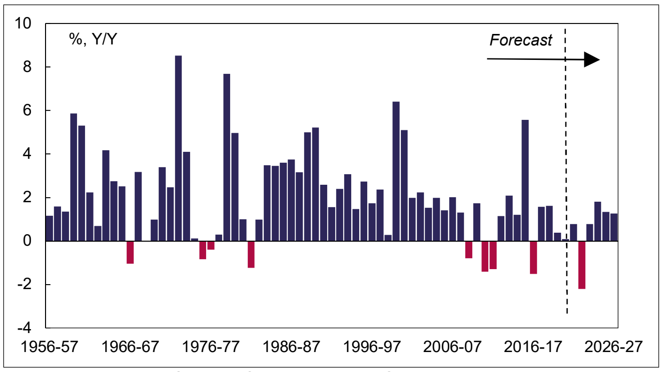


Source: Refinitiv, BoE and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

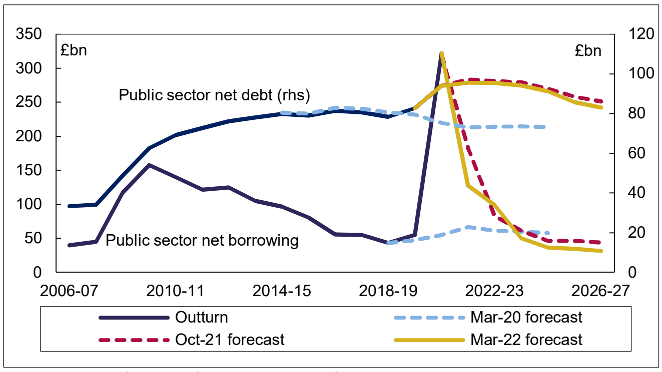
Like in the euro area, the main data focus in the UK tomorrow will also be on the flash PMIs for March. Yesterday's CBI industrial trends survey offered an initial update on manufacturing conditions since the Russian invasion of Ukraine a month ago. This suggested that output continued to grow at a robust pace in the three months to March, driven by the autos and chemicals subsectors. Order books remained ample too, with the relevant indicator matching November's series high. And so firms expected production growth to remain solid over the coming three months. However, manufacturers also continued to flag persisting supply-side challenges, assessing stock levels still to be inadequate, albeit to a lesser extent than over recent quarters. They also noted that cost burdens had been amplified by the Ukraine conflict, with the balance of manufacturers expecting to increase prices rising to a survey record high (80). Overall, we think the March PMIs might well signal a slight softening of growth momentum but increased price pressures. Thursday will also bring the CBI's distributive trades survey, which might well flag a deterioration in conditions reflecting softer non-essential household spending amid declining disposable incomes, while retailers' costs burdens continued to rise.

UK: Real household disposable income*



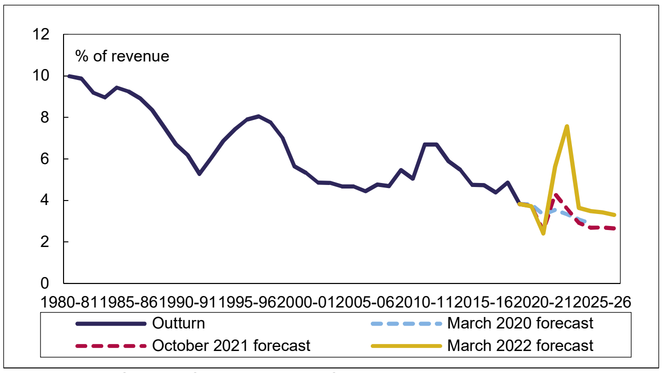
*Per person. Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Public sector net borrowing & debt



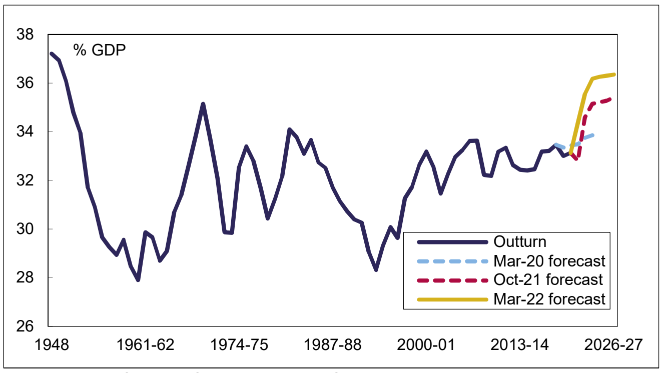
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Net interest payments



Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: National accounts taxes as a share of GDP



Source: OBR and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		European Commission's preliminary consumer confidence	Mar	**-18.7**	-12.5	-8.8	
UK		CPI (core CPI) Y/Y%	Feb	**6.2 (5.2)**	*6.2 (5.1)*	5.5 (4.4)	-
		PPI input (output) prices Y/Y%	Feb	**14.7 (10.1)**	13.9 (10.1)	13.6 (9.9)	**14.2 (-)**
		House price index Y/Y%	Jan	**9.6**	10.3	10.8	**10.0**
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/ *Daiwa forecast*	Previous	Revised
Euro area		Current account balance €bn	Jan	**22.6**	-	22.6	-
		Construction output M/M% (Y/Y%)	Jan	**3.9 (4.1)**	-	-4.0 (-3.9)	**-1.4 (0.2)**
UK		Public sector net borrowing, excluding banks £bn	Feb	**13.1**	6.3	-2.9	**-7.1**
		CBI industrial trends survey, total orders (selling prices)	Mar	**26 (80)**	17 (80)	20 (77)	-
Auctions							
Country		Auction					
Germany		sold €3.33bn of 0% 2027 bonds at an average yield of 0.21%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		PPI M/M% (Y/Y%)	Feb	**1.4 (25.9)**	1.6 (25.7)	2.2 (25.0)	-
UK		Rightmove house price index M/M% (Y/Y%)	Mar	**1.7 (10.4)**	-	2.3 (9.5)	-
Auctions							
Country		Auction					
		- Nothing to report -					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data						
Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
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
Auctions and events						
- Nothing scheduled -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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