

Euro wrap-up

Overview

- As several ECB policymakers again made the case for tighter monetary policy, Bunds reversed a sizeable share of yesterday's gains despite confirmation of a big drop in euro area industrial output in March.
- Gilts also made sizeable losses as UK unit labour cost growth at the end of last year appeared to be above the BoE's comfort zone.
- The coming week will bring the account of the ECB's April policy meeting as well as data on euro area consumer confidence and UK inflation, jobs and retail sales.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	0.089	+0.054
OBL 0 04/27	0.586	+0.079
DBR 0 02/32	0.934	+0.099
UKT 1 04/24	1.206	+0.063
UKT 1½ 07/27	1.358	+0.069
UKT 4¼ 06/32	1.732	+0.074

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

Euro area

IP takes step down in March but rises over Q1 as a whole

Euro area industrial production fell sharply in March, by 1.8%M/M. With growth in February revised down 0.2ppt from the prior estimate to 0.5%M/M, production fell 0.6% below the pre-pandemic level in February 2020 to the lowest since October. Given the profile of activity over prior months, production still rose 0.9%Q/Q in Q1 after declining slightly in Q4. But the weakness at the end of the quarter was broad-based. In the factory sector, output of capital goods fell 2.7%M/M, weighed not least by motor vehicles (-14.6%M/M) as well as machinery (-2.6%M/M). In addition, production of intermediate goods fell 2.0%M/M, with weakness in metals (-2.0%M/M) and chemicals (-1.4%M/M). And the nondurable consumer goods component fell 2.3%M/M despite growth in food products (0.6%M/M). Over Q1 as a whole, however, growth was recorded in most manufacturing sub-sectors, with the most striking exceptions being autos (-6.2%Q/Q) and chemicals (-1.1%Q/Q), where supply bottlenecks were most acute. Meanwhile, in no small part due to insufficient wind-generated power in Germany, energy production dropped 1.7%M/M to be down 3.0%Q/Q. Among the member states, on the EU-harmonised basis, German IP was weakest in March, down 5.0%M/M, with declines also recorded in France (-0.5%M/M) and Spain (-1.8%M/M) but a flat reading registered in Italy.

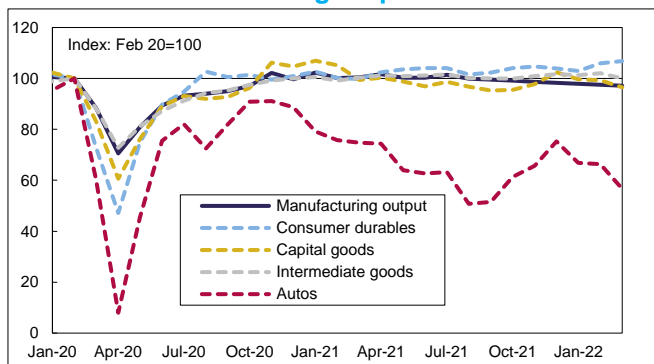
Contraction in industrial production likely in Q2

The substantive drop in IP in March raises the likelihood of a renewed decline in production in the second quarter. Of course, surveys suggest that the Ukraine conflict has intensified supply bottlenecks and added to costs, weighing on confidence in the sector at the start of Q2. The Commission's business survey suggested that euro area industrial sentiment deteriorated to a twelve-month low in April even though order books reportedly improved slightly and production expectations were broadly unchanged following a steep fall in March. Meanwhile, the euro area's manufacturing output PMI fell more than 2pts last month to 50.7, the lowest since the first wave of Covid-19 in June 2020, raising risks of a further drop in factory output over the near term.

Broad-based rise in French core CPI to a three-decade high

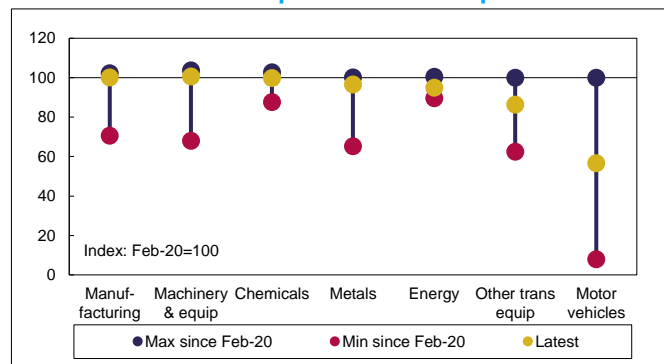
There were no surprises from today's final French CPI figures for April. Inflation on the EU-harmonised HICP rate aligned with the flash estimate, increasing 0.3ppt to 5.4%Y/Y. On the national measure, headline inflation also rose 0.3ppt to 4.8%Y/Y, the highest since the mid-1980s. Reflecting a rebound in prices of transport services (9.4%M/M) amid higher airfares and package holidays on the reopening of international travel, as well as stronger catering costs, services inflation rose 0.7ppt to 3.0%Y/Y. Food prices also recorded the strongest monthly increase (1.4%) for two years to leave the annual

Euro area: Manufacturing output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

rate (3.8%Y/Y) last higher in 2008. And manufactured goods inflation (up 0.5ppt to 2.6%Y/Y) was boosted by clothing, as well as upwards price pressures on major household appliances likely related to supply-side disruption. Despite the government's "price shield" caps on household bills and fuel discounts (e.g. of 15 cents per litre off auto fuel between April and July), energy inflation remained extremely elevated, albeit moderating slightly (down 2.7ppts to 26.5%Y/Y). So, reflecting the increasingly broad-based nature of inflation, the core CPI measure jumped 0.7ppt to 3.2%Y/Y, the highest since 1992.

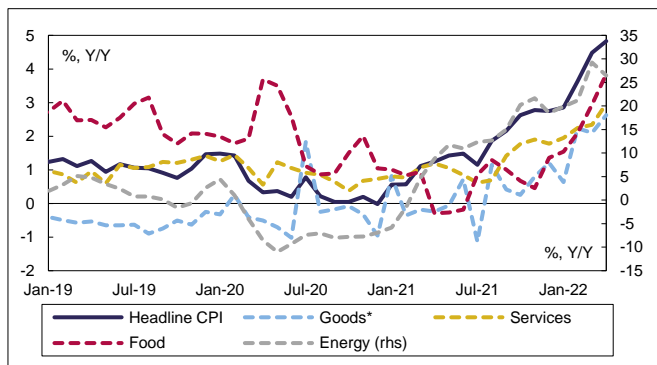
Despite easing in Spanish headline inflation, core CPI up to highest since 1995

Spanish HICP inflation in April was also unrevised from the preliminary estimate, which bucked the trend in the region with a drop of 1.5ppts to 8.3%Y/Y. Headline inflation on the national CPI measure was revised a touch lower, however, also to 8.3%Y/Y, on the back of a steeper drop in electricity prices (-26.9%M/M) reflecting the rapid pass-through of declines in wholesale markets and government interventions. And with the European Commission having consented to a lower cap on gas prices for Spanish electricity producers for twelve months from May, which should lower household energy bills, as well as the government's energy support package (including the 20 cents per litre reduction in petrol duty) energy inflation should fall further over coming months. But like in France, the detail of the release suggested a broadening of underlying price pressures. Not least reflecting the resumption of tourism, accommodation services prices jumped (11.7%M/M) as did package holiday costs (10.7%M/M), while eating services prices rose (1.7%M/M). So overall, services inflation rose 0.9ppt to 3.3%Y/Y, the highest since 2009. Clothing prices were also notably higher (9.4%M/M). And non-energy industrial goods inflation also increased 0.1ppt to 3.3%Y/Y, a new series high. So, Spanish core CPI inflation was confirmed to have risen 1ppt to 4.4%Y/Y, the highest since December 1995.

The week ahead in the euro area

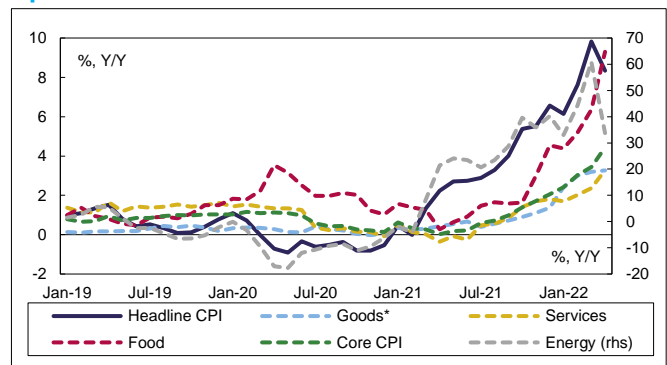
Looking to the coming week, likely of most interest will be Thursday's ECB account from the Governing Council's policy-setting meeting on 14 April. That meeting saw the Governing Council suggest that, while future monetary policy decisions remained data dependent, current information was judged to be consistent with the ECB's asset purchases coming to an end in Q3. While subsequent commentary has suggested this will occur right at the start of the quarter, the account might well provide further guidance on the timing of the first rate hike, with greater clarification on what constitutes "some time" after the end of it asset purchases. Certainly, subsequent commentary from Governing Council members suggests that rate lift-off at the 21 July meeting is odds-on. In terms of economic data, arguably the most noteworthy release will be European Commission's flash consumer confidence indicator for May on Friday. With inflation at a euro-era high, wage growth still subdued and uncertainty about the global economic outlook elevated, we would expect household sentiment to have remained extremely subdued this month, with the indicator forecast to be little improved from April's two-year low (-22.0).

France: CPI inflation



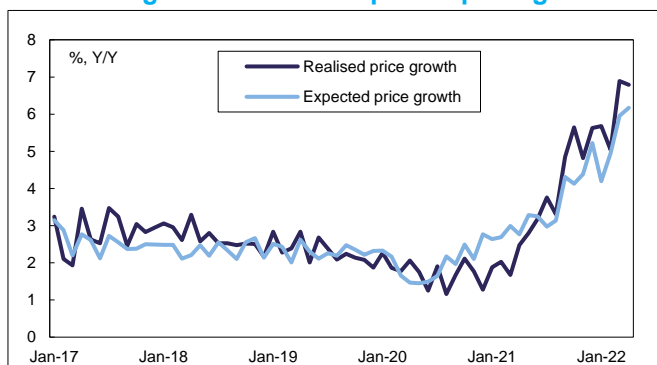
*Non-energy industrial goods. National measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Spain: CPI inflation



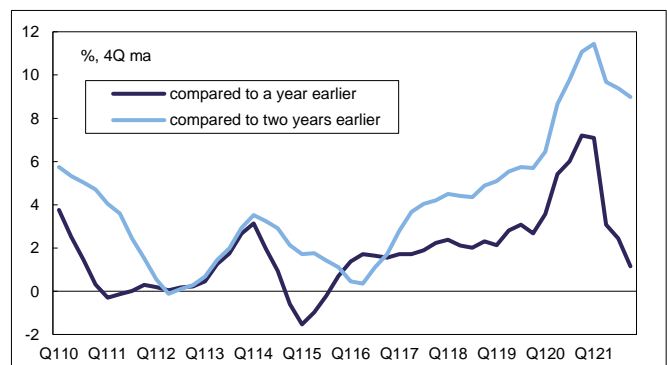
*Non-energy industrial goods. National measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: BoE Agents' contacts reported price growth*



*Survey conducted between mid-Jan-late-Feb, before the invasion of Ukraine. Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Unit labour costs



Source: ONS and Daiwa Capital Markets Europe Ltd.

Ahead of this, the week will bring an updated reading for Q1 GDP in the euro area (Tuesday) – expected to confirm that growth slowed slightly to 0.2%Q/Q, from 0.3%Q/Q in Q4 – alongside euro area employment figures for the first quarter. While we will have to wait until 8 June for the official expenditure breakdown, euro area goods trade figures for March (Monday) will provide some further guidance on net trade in Q1. Most notably perhaps, the trade deficit is likely to have blown out markedly to a new record high in March of €17bn or more due to higher prices of energy and commodity imports and a plunge in exports to Russia. The aforementioned euro area final inflation release (Wednesday) is expected to confirm that headline HICP inflation increased 0.1ppt to 7.5%Y/Y, with core inflation up a steeper 0.6ppt to 3.5%Y/Y, both record highs. This release will also provide the more granular detail, along with other estimates of underlying price pressures including the trimmed mean CPI. Euro area new car registrations numbers for April (Wednesday) and construction output for March (Thursday) are also due.

UK

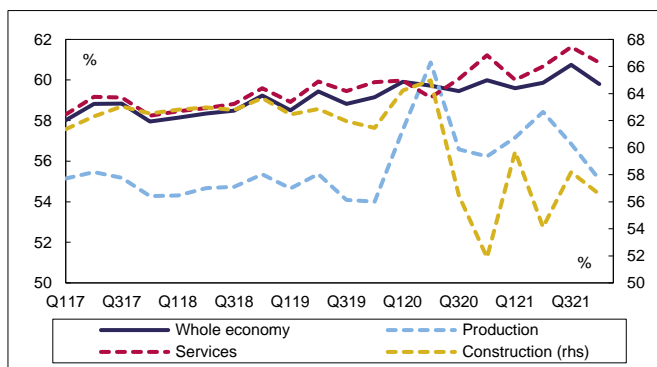
Labour cost growth too strong for comfort

On an otherwise quiet end to the week for UK economic data, the sole official release – unit labour costs for Q421 – will nevertheless have been studied by the BoE. At face value, the figures might suggest little cause for concern about domestically generated price pressures emanating from the labour market. After all, average labour compensation per hour worked grew 2.1%Y/Y, just 0.1ppt above the average in the decade ahead of the pandemic. And growth in overall nominal unit labour costs of 1.5%Y/Y was only 30bps stronger than the pre-Covid trend. If sustained at that pace, concerns might ease about the ability of the BoE to return inflation back to target on a sustained basis once the current global shock to prices of energy, food and other goods fades. However, these data have been highly volatile, distorted by the extreme swings in output experienced throughout the pandemic, the introduction and subsequent withdrawal of the government's Job Retention Scheme, and changes in composition of employment. Looking through the pandemic noise, employee compensation was up 11.1% in Q421 from the 2019 average with unit labour costs up 9.8%. And the average annual rates of growth over the past two years (4.2%Y/Y and 5.5%Y/Y respectively) were more than double the inflation target and well above the BoE's comfort zone, suggestive of second-round effects of high inflation from the tight labour market. Higher wages meant that the labour share of income rose for the fifth successive year in 2021, reaching 60% for the first time since 2016 (although on a quarterly basis, the share declined by 0.9ppt to 59.8% in Q421 to be down 0.2ppt from Q420. Today's data were broadly consistent with the more timely average weekly earnings series, which reported growth of 5.4%Y/Y in the three months to February, with growth of 4.5%Y/Y in the private sector excluding bonuses.

Services inflation in particular likely to be pushed high by labour costs

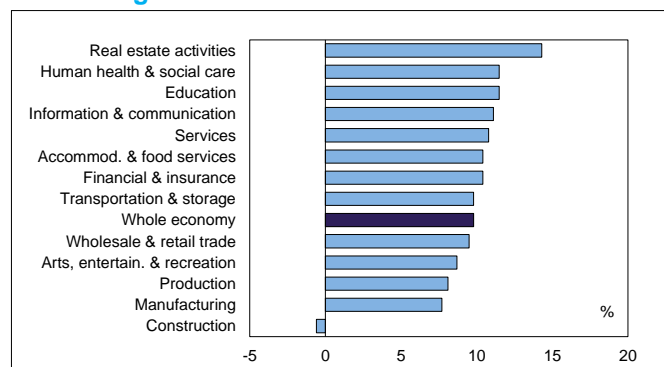
At the sectoral level, cumulative unit labour cost growth since the onset of the pandemic has been particularly strong in services, rising 10.8% in Q421 from the 2019 average. Real estate services, health and social work, education, ICT, hospitality and finance were among the subsectors registering double-digit percentage growth. While unit labour costs in retail and wholesale were also relatively strong (9.5% over the same timescale), manufacturing cost growth was a little less vigorous (7.7%). In marked contrast, unit labour costs in construction fell below 2019 levels. As labour costs typically account for a large share of costs faced by services firms, the BoE will judge that pay growth has been an important driver of services inflation, which leapt 0.5ppt in March to 4.0%Y/Y, the highest level in almost a decade. And services inflation is expected to rise further over the near term – a recent survey by the BoE's Agents found that consumer services firms expected to increase prices by 6% on average over the coming 12 months, with much of that rise expected to take place in the next three months. Strikingly, as highlighted by hawkish MPC member Michael Saunders, firms surveyed suggested that rising labour costs were the most important explanation for rising prices, more pertinent than rising materials and goods prices, utility prices, transport costs and general inflation.

UK: Labour share of income



Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Change in unit labour costs*












*Selected industries, compared with 2019 levels. Source: ONS and Daiwa Capital Markets Europe Ltd.

The week ahead in the UK

The coming brings plenty of top-tier UK data, including labour market (Tuesday), CPI inflation (Wednesday) and retail sales (Friday). Given the 54% hike in household energy bills last month, most focus seems bound to be on inflation, with the headline CPI rate expected to jump more than 2ppts to above 9%Y/Y for the first time since the series began in 1988. Of course, this will be driven by energy inflation, which we expect to have leapt 30ppts to above 55%Y/Y to account for roughly 40% of total inflation. Food inflation is likely to have risen to the highest in more than a decade. But with services and non-energy industrial goods inflation also set to rise further, not least due to persisting supply bottlenecks, we expect core inflation to rise an above-consensus 0.7ppt to 6.4%Y/Y. While the latest data are likely to point to ongoing tightness in the labour market – with the unemployment rate unchanged at 3.8%, a rate that was last lower in the mid-1970s – real wage growth is likely to remain firmly in negative territory. And with consumer confidence likely to have remained close to record lows (latest survey due Friday), and retail surveys signalling a poor performance at the start of Q2, we would expect Friday's retail sales figures to post a further decline in April, with consensus expectations for a drop of around ½%M/M.






The next edition of the Euro wrap-up will be published on 17th May 2022

Daiwa economic forecasts

		2021	2022				2023	2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1			
GDP			%, Q/Q					%, Y/Y		
Euro area		0.3	0.2	0.7	0.8	0.7	0.6	3.2	2.4	1.8
UK		1.3	0.8	-0.1	0.3	-0.6	0.0	3.7	-0.3	0.9
Inflation, %, Y/Y										
Euro area										
Headline HICP		4.6	6.1	7.4	7.0	5.7	3.4	6.6	2.2	1.8
Core HICP		2.4	2.6	3.5	3.3	2.7	2.0	3.1	1.8	1.8
UK										
Headline CPI		4.9	6.2	9.5	9.4	10.2	9.1	8.9	5.1	1.7
Core CPI		3.9	5.1	6.3	6.3	6.0	5.0	5.9	3.3	1.7
Monetary policy, %										
ECB										
Refi Rate		0.00	0.00	0.00	0.25	0.50	0.50	0.50	0.50	0.50
Deposit Rate		-0.50	-0.50	-0.50	0.00	0.25	0.25	0.20	0.25	0.25
BoE										
Bank Rate		0.25	0.75	1.00	1.25	1.25	1.25	1.25	1.00	1.00

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





European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Industrial production M/M% (Y/Y%)	Mar	-1.8 (-0.8)	-2.0 (-0.9)	0.7 (2.0)	0.5 (1.7)
France	 Final CPI M/M% (Y/Y%)	Apr	0.4 (4.8)	0.4 (4.8)	1.4 (4.5)	-
	 Final EU-harmonised CPI M/M% (Y/Y%)	Apr	0.5 (5.4)	0.5 (5.4)	1.6 (5.1)	-
Spain	 Final CPI M/M% (Y/Y%)	Apr	-0.2 (8.3)	-0.1 (8.4)	3.0 (9.8)	-
	 Final EU-harmonised CPI M/M% (Y/Y%)	Apr	-0.3 (8.3)	-0.2 (8.3)	3.9 (9.8)	-
UK	Unit labour costs Y/Y%	Q4	1.5	-	3.1	2.7
Auctions						
Country	Auction	- Nothing to report -				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.





















The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous
Monday 16 May 2022					
Euro area		10.00 Trade balance €bn	Mar	-16.5	-9.4
Tuesday 17 May 2022					
Euro area		10.00 GDP – 2 nd estimate Q/Q% (Y/Y%)	Q1	0.2 (5.0)	0.3 (4.7)
		10.00 Employment Q/Q% (Y/Y%)	Q1	-	0.5 (2.2)
France		06.30 Unemployment rate %	Q1	7.2	7.2
UK		07.00 ILO unemployment rate %	Mar	-	3.8
		07.00 Average earnings including (excluding) bonuses 3M/Y%	Mar	5.4 (4.1)	5.4 (4.0)
		07.00 Employment change '000s 3M/3M	Mar	-	10
		07.00 Payrolled employees '000s	Apr	-	35
		07.00 Unemployment claimant count rate % (change '000s)	Apr	- (-)	4.3 (-46.9)
Italy		09.00 Trade balance €bn	Mar	-	-1.6
		10.00 Final CPI M/M% (Y/Y%)	Apr	0.2 (6.2)	1.0 (6.5)
		10.00 Final EU-harmonised CPI M/M% (Y/Y%)	Apr	0.6 (6.6)	2.4 (6.8)
Spain		09.00 Trade balance €bn	Mar	-	-4.3
Wednesday 18 May 2022					
Euro area		07.00 EU27 new car registrations Y/Y%	Apr	-	-20.5
		10.00 Final CPI M/M% (Y/Y%)	Apr	0.6 (7.5)	2.4 (7.4)
		10.00 Final core CPI M/M% (Y/Y%)	Apr	1.1 (3.5)	1.2 (2.9)
UK		07.00 CPI M/M% (Y/Y%)	Apr	<u>3.1 (9.6)</u>	1.1 (7.0)
		07.00 Core CPI M/M% (Y/Y%)	Apr	<u>0.9 (6.4)</u>	0.9 (5.7)
		07.00 PPI output prices M/M% (Y/Y%)	Apr	1.5 (13.0)	2.0 (11.9)
		07.00 PPI input prices M/M% (Y/Y%)	Apr	1.6 (19.7)	5.2 (19.2)
		09.30 House price index Y/Y%	Mar	-	10.9
Thursday 19 May 2022					
Euro area		09.00 Current account balance €bn	Mar	-	20.8
		10.00 Construction output M/M% (Y/Y%)	Mar	-	1.9 (9.4)
UK		11.00 CBI industrial trends survey, total orders (selling prices)	May	-	14 (71)
Friday 20 May 2022					
Euro area		15.00 Flash European Commission consumer confidence	May	-22.0	-22.0
Germany		07.00 PPI M/M% (Y/Y%)	Apr	1.4 (30.4)	4.9 (30.9)
UK		00.01 GfK consumer confidence	May	-38	-38
		07.00 Retail sales including fuel M/M% (Y/Y%)	Apr	-0.3 (-7.2)	-1.4 (0.9)
		07.00 Retail sales excluding fuel M/M% (Y/Y%)	Apr	-0.3 (-8.5)	-1.1 (-0.6)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 16 May 2022		
Euro area	 09.20	ECB's Panetta scheduled to speak
	 09.40	ECB Chief Economist Lane and Panetta scheduled to speak
	 10.00	European Commission publishes economic forecasts
UK	 15.15	BoE Governor Bailey, Ramsden, Haskel and Saunders testify at Treasury Select Committee
Tuesday 17 May 2022		
Euro area	 18.00	ECB President Lagarde scheduled to speak
Germany	 10.30	Auction: €6.0bn of 2024 0% bonds
UK	 10.00	Auction: £1.75bn of 1.25% 2051 bonds
	 11.05	BoE's Cunliffe scheduled to speak
Wednesday 18 May 2022		
Euro area	 -	ECB President Lagarde and Panetta attend 3-day meeting of G7 finance ministers and central bank governors
Germany	 10.30	Auction: €1.5bn of 0% 2052 bonds
Thursday 19 May 2022		
Euro area	 12.30	ECB account from 14 April 2022 meeting to be published
	 13.30	ECB's de Guindos scheduled to speak
France	 09.50	Auction: 0% 2025 bonds
	 09.50	Auction: 0% 2026 bonds
	 09.50	Auction: 0.75% 2028 bonds
	 09.50	Auction: 0.1% 2032 index-linked bonds
	 09.50	Auction: 0.1% 2031 index-linked bonds
Spain	 09.50	Auction: 0.1% 2036 index-linked bonds
	 09.30	Auction: Fixed-rate bonds
Friday 20 May 2022		
UK	 08.30	BoE Chief Economist Pill scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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