Euro wrap-up

Overview

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- Longer-dated Bunds made gains, as the final estimates of euro area inflation in April was revised down slightly but still confirmed a broadening of price pressures with headline and core measures at series highs.
- Longer-dated Gilts also made modest gains as UK inflation avoided an upside surprise, albeit rising to a four-decade high amid increased prices of energy, food and core items.
- Tomorrow brings the ECB account from the Governing Council's 14 April policy meeting.

Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.355	0.000
OBL 0 04/27	0.717	-0.010
DBR 0 02/32	1.010	-0.031
UKT 1 04/24	1.450	+0.001
UKT 1¼ 07/27	1.569	+0.007
UKT 4¼ 06/32	1.851	-0.029

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

Euro area

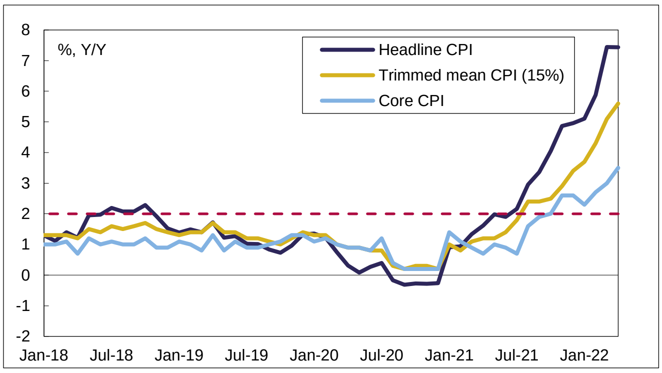
Headline inflation revised down slightly, but underlying inflation confirmed at series highs

Euro area consumer price inflation in April was revised down 0.1ppt from the flash estimate but still therefore remained at a series high of 7.4%Y/Y. Given yesterday's downside surprise to the final Italian figures, today's data were not unexpected and failed to alter the impression of increasingly broad-based price pressures. The downward revision reflected developments in energy prices, which are now estimated to have dropped 4.0%M/M not least due to increased government interventions such as cuts in fuel duty. Indeed, electricity prices fell 4.4%M/M while auto fuel prices fell 6.5%M/M. And given the significant base effect, energy inflation fell 6.8ppts from March's record high, nevertheless remaining exceptionally high at 38.0%Y/Y to account for 4.1ppts of overall inflation. Other major components, however, were barely revised from the flash. So, for example, prices of food, alcohol and tobacco rose were up by a record monthly amount (1.9%M/M), although rounding also nudged down the annual rate slightly from the flash to 6.3%Y/Y, still however a series high. The rise of 1.1%M/M in non-energy industrial goods prices was also by far the strongest in any April since the creation of the euro, to push the annual rate up 0.4ppt to a new high of 3.8%Y/Y. And with the 1.0%M/M increase in prices of services the joint highest for any April – in part boosted by the timing of Easter this year and revival in tourism – the annual rate jumped 0.6ppt to 3.3%Y/Y, similarly a series high. So, the rise of 0.5ppt in core inflation to a series high of 3.5%Y/Y was also confirmed. And the ECB's estimate of the 15% trimmed mean also rose 0.5ppt to 5.6%Y/Y, also a record.

Inflation likely to fall over coming quarters

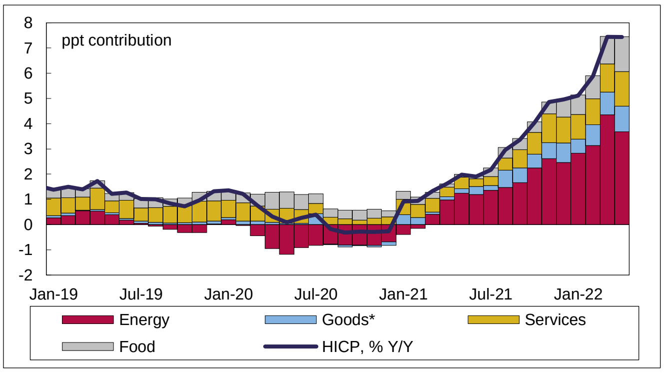
The near-term inflation outlook remains extremely uncertain, particularly given continued volatility in wholesale energy markets and big question marks about energy supply from Russia. Indeed, while the European Commission today agreed a draft plan for reducing purchases of Russian natural gas by two-thirds by year-end, the willingness and ability of member states to make the plan work must be questionable and the implications for prices highly unclear. But as illustrated by the sizeable drop of 1.5ppts to 8.3%Y/Y in inflation in Spain where the pass-through of wholesale market developments is typically much faster than in other member states, current oil and natural gas forward curves suggest that energy inflation in the euro area should take a further notable step down over coming months on base effects. Planned fuel duty cuts (of 29.55 cents per litre for petrol and 14.04 cents per litre for diesel) and reductions in public transport fees should additionally lower German inflation from June to August. And a new electricity price cap should weigh further on inflation in Spain and Portugal. So, the contribution to overall inflation from energy could well be halved by year-end and shift to negative territory within a year.

Euro area: Consumer price inflation



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

Euro area: Contributions to HICP inflation



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

But price pressures will remain far too high for ECB's comfort

Even if energy inflation moves steadily lower, however, the Ukraine war and Chinese pandemic restrictions pose meaningful risks of intensified pressures on prices of food, other commodities and intermediate inputs. Costs of imported items are also already being magnified by the euro's depreciation against the dollar of more than 7% over the past three months. And faced with rising costs, surveys suggest that firms in all sectors hope that – and indeed expect – their selling prices to rise further over coming months. On balance, on a quarterly basis, we still expect headline inflation to peak in Q2 between 7¼-7½%Y/Y. But that is almost 2ppts above the ECB's baseline projection. And our forecast of inflation in Q422 (around 5½%Y/Y) is still more than 1ppt higher than the ECB's baseline and way too high for the Governing Council's comfort, given its fear of persisting high inflation expectations. So, while the continued lack of significant wage growth and a subdued demand outlook, as well as forward energy pricing, means that inflation could well be back close to 2.0%Y/Y next spring, consecutive rate hikes of 25bps in July and September, and another in December, seem highly likely.

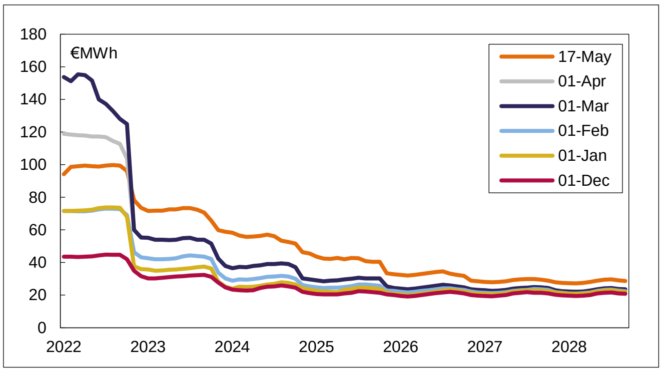
Euro area car registrations remain constrained by supply bottlenecks

The impact of persisting supply-side disruption was also evident in today's euro area new car registrations figures. On a seasonally adjusted basis, the ECB estimated that car sales rose in April by 1.1%M/M, driven by a rebound in Spanish car registrations (40.5%M/M). But this modest pickup at the euro area level followed a near-13½%M/M drop in March, to leave the number of units registered last month (581k) the second-lowest for any April on the series, almost 20% lower than a year earlier and 40% below the equivalent period in 2019. The unadjusted ACEA numbers reported that sales so far this year were down 15%YTD/Y and some 36% below the level in the first four months of 2019. Among the three largest member states, the numbers were overwhelmingly weak. In Germany, car sales fell a further 4.1%M/M in April, to 181k, the lowest since May 2020 to be almost 16% lower than the Q1 average. Registrations in France (down 2.3%M/M to 112k) and Italy (down 4.3%M/M to 93k) were likewise the lowest since the onset of the pandemic and roughly 11½% and 7½% lower than the respective Q1 averages. So, with surveys suggesting that auto production continues to be significantly restricted by supply constraints, consumer confidence having fallen sharply and household budgets being squeezed by higher prices, new car registrations look set to remain extremely subdued for several months to come.

The day ahead in the euro area

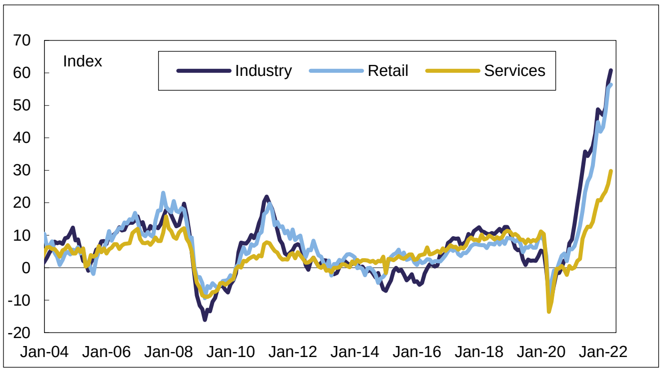
The main focus in the euro area tomorrow will be the ECB account from the Governing Council's 14 April policy meeting. That meeting saw the Governing Council indicate that, while future monetary policy decisions remained data dependent, the ECB's net asset purchases were still likely to come to an end in Q3. While subsequent commentary has suggested this will

Euro area: Natural gas forward curves*



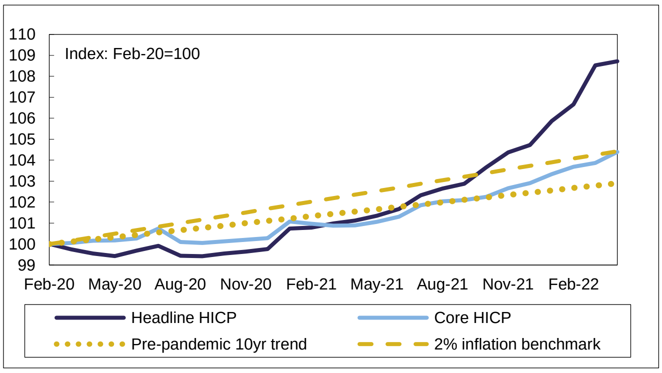
*Netherlands natural gas futures contract.
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Selling price expectations



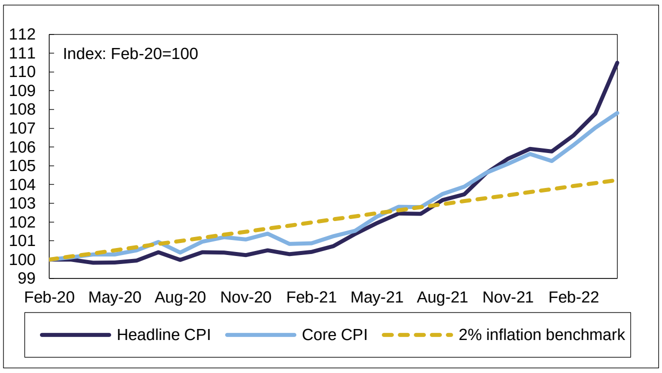
Source: European Commission, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: HICP price level vs target



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: CPI price level vs target



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

occur right at the start of the quarter, the account might well provide further guidance on the share of support for a first rate hike to follow swiftly thereafter. Certainly, subsequent commentary from Governing Council members – including today's comments from Finnish Governor Olli Rehn that negative interest rates should end relatively quickly and Spanish Governor Hernandez de Cos (among the most dovish on the Governing Council) that the first hike should occur shortly after net bond-buying terminates – suggests that rate lift-off at the 21 July meeting is odds-on. In terms of economic data, tomorrow brings just euro area construction output and current account data for March. After two strong gains at the start of the quarter, we expect tomorrow's construction figures to report some modest payback at the end of the first quarter – indeed, while German construction activity rose 1.1%M/M, French output fell 1.7%M/M.

UK

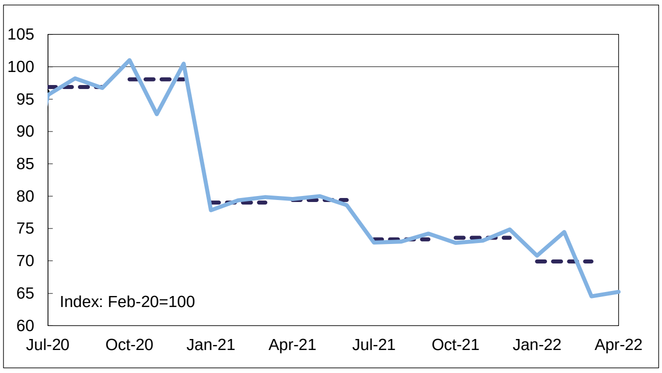
Inflation up to four-decade high, led by energy but with broad-based pressure

Broadly in line with expectations, the BoE's target CPI inflation measure rose 2.0ppts in April to 9.0%Y/Y, the highest on the series dating back more than three decades. Moreover, RPI inflation – used to determine payments on index-linked Gilts – rose 2.1ppts to 11.1%Y/Y, a four-decade high. A big jump in inflation was always inevitable in light of the increase of 54% in the regulated household energy price cap last month. And indeed, with auto fuel prices up too despite lower crude oil prices and the government's (admittedly modest) fuel duty cut, overall energy prices on the CPI measure rose more than 25%M/M to be up a series high 52.2%Y/Y, contributing a little more than one third (3.5ppts) to overall CPI inflation. However, the pressures in the UK are undeniably broad-based, and a lot more so than in the euro area, where energy accounted for significantly more than half of all inflation last month. UK food inflation rose a further 0.9ppt in April to 6.7%Y/Y, the highest since 2009. With inflation at restaurants and hotels continuing to rise (up 1ppt to 7.9%Y/Y) as the reduced rate of VAT expired at the end of March, services inflation rose 0.7ppt to 4.7%Y/Y, also the highest since 2009. Inflation of certain goods fell back from recent highs – for example, the clothing component dropped 1.8ppts to 8.4%Y/Y after a big jump the prior month related to the pricing of new-season items, while second-hand car inflation fell for the first time in a year, dropping 4ppts to an admittedly still high 27.0%Y/Y. But there were additional pressures in prices of certain other goods – garden furniture prices were up almost one third from a year earlier – as firms continued to pass cost pressures on to consumers. So, overall, inflation of non-energy industrial goods was steady at 7.9%Y/Y. And core CPI inflation rose 0.5ppt to 6.2%Y/Y, the highest in thirty years.

Domestic factors magnifying impact of global price shocks on UK inflation

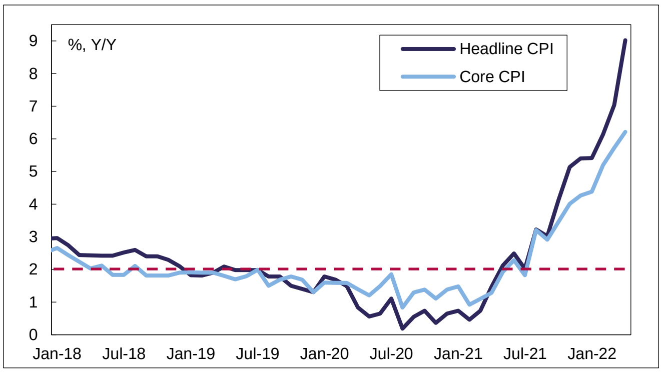
Cost pressures are undeniably intense and are likely to remain so for several months to come. Global factors are clearly important. Indeed, while input producer price inflation was steady at 18.6%Y/Y in April, the output PPI rate rose a much

Euro area: New car registrations*



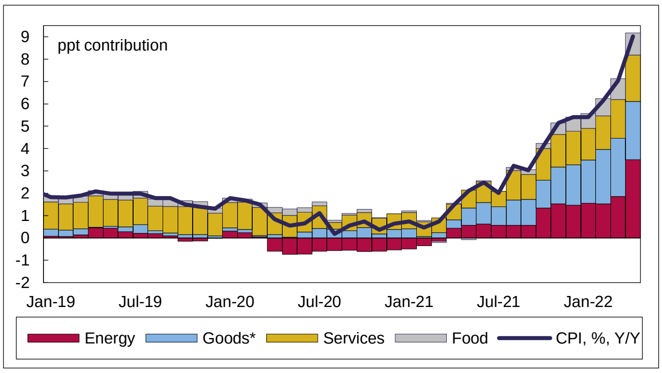
*Dashed dark blue line is quarterly average. Source: ECB and Daiwa Capital Markets Europe Ltd.

UK: Consumer price inflation



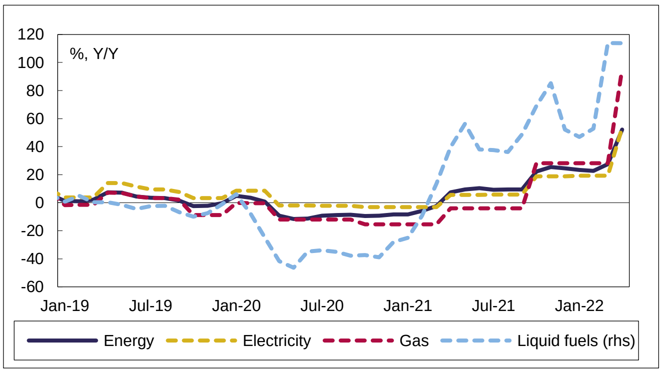
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Contributions to CPI inflation



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

UK: Consumer energy price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

larger-than-expected 2.1ppts to 14.0%Y/Y, and events in Ukraine and China risk additional price increases for intermediate items and commodities, including food for which BoE Governor Bailey this week flagged fears of “apocalyptic” inflation to come. However, domestic factors appear to be magnifying the impact of the external shocks on UK inflation. For example, due to significant labour market tightness related not least to rising inactivity, wages are rising above levels consistent with the inflation target, a particularly important driver of services CPI. And UK firms’ pricing behaviour suggests a much greater willingness to pass on costs to customers than in the past, probably in part reflecting the diminished level of competition in the UK economy post-Brexit. So, inflation looks set to remain some way above levels in the euro area. The CPI rate is likely to average a little more than 9%Y/Y this quarter. And while base effects should allow it drop back in Q3, a further substantive (30%-plus perhaps) rise in the household energy price cap in October will likely push CPI inflation above 10%Y/Y in Q4.

The day ahead in the UK

Ahead of next week’s preliminary May PMIs, tomorrow brings the release of the CBI industrial trends survey for May, which is expected to paint a fairly bleak picture of conditions in the manufacturing sector amid ongoing concerns surrounding supply constraints and higher input costs. In April, the survey’s output index dropped to the lowest for more than a year, with a moderation in new orders and renewed weakness in overseas demand also reported. And the survey’s total orders index is expected to moderate further in May, reflecting greater pessimism regarding exports as well as concerns related to weakening domestic demand as real incomes decline.

European calendar

Today’s results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	EU27 new car registrations Y/Y%	Apr	**-20.6**	-	-20.5	**-**
	Final CPI M/M% (Y/Y%)	Apr	**0.6 (7.4)**	0.6 (7.5)	2.4 (7.4)	**-**
	Final core CPI M/M% (Y/Y%)	Apr	**1.0 (3.5)**	1.1 (3.5)	1.2 (2.9)	**-**
UK	CPI M/M% (Y/Y%)	Apr	**2.5 (9.0)**	*3.1 (9.6)*	1.1 (7.0)	**-**
	Core CPI M/M% (Y/Y%)	Apr	**0.7 (6.2)**	*0.9 (6.4)*	0.9 (5.7)	**-**
	PPI output prices M/M% (Y/Y%)	Apr	**2.3 (14.0)**	1.5 (13.0)	2.0 (11.9)	**1.9 (-)**
	PPI input prices M/M% (Y/Y%)	Apr	**1.1 (18.6)**	1.6 (19.7)	5.2 (19.2)	**4.6 (18.6)**
	House price index Y/Y%	Mar	**9.8**	9.9	10.9	**11.3**

Auctions

Country	Auction
Germany	sold €1.34bn of 0% 2052 bonds at an average yield of 1.16%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases						
Economic data						
Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
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	12 (70)	14 (71)
Auctions and events						
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% 2031 index-linked bonds			
		09.50	Auction: 0.1% 2032 index-linked bonds			
		09.50	Auction: 0.1% 2036 index-linked bonds			
Spain		09.30	Auction: 0% 2025 bonds			
		09.30	Auction: 0.8% 2027 bonds			
		09.30	Auction: 0.7% 2032 bonds			
		09.30	Auction: 1% 2042 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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