

Euro wrap-up

Overview

- Bunds maintained a downwards trend as the headline euro area inflation rate edged lower but core inflation leapt to a new record high.
- Despite an easing in UK firms' price expectations, Gilts also made losses as the BoE's Chief Economist flagged that the economy had been slightly stronger and wage growth stickier than expected.
- Friday will bring euro area PPI inflation figures, as well as the final February services PMIs.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	3.184	+0.001
OBL 2.2 04/28	2.831	+0.024
DBR 2.3 02/33	2.745	+0.041
UKT 0% 06/25	3.689	+0.024
UKT 1% 10/28	3.684	+0.021
UKT 3¼ 01/33	3.880	+0.043

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

Source: Bloomberg

Euro area

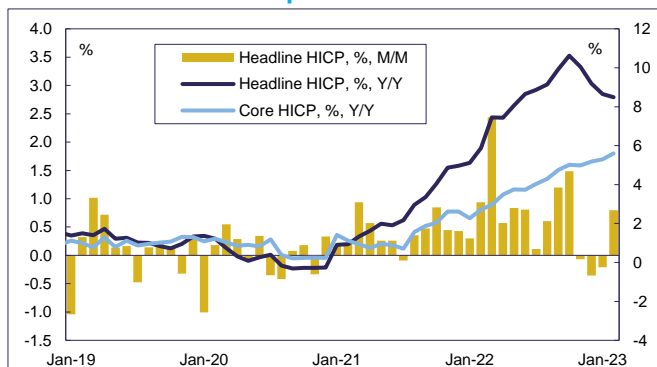
Headline inflation rate edges down but record core components will alarm ECB

According to the flash estimates, euro area headline consumer price inflation edged down 0.1ppt to 8.5%Y/Y in February. That marked the fourth successive monthly decline and left inflation 2.2ppts below last October's peak. However, the drop in February was smaller than expected and relied upon sizeable declines in Italy and Belgium, while inflation rose in the other four largest member states. More notably, however, the drop in euro area inflation also relied entirely upon a further fall in energy prices (-1.1%M/M) to knock more than 5ppts off the respective annual rate to a 20-month low of 13.7%Y/Y. Indeed, each of the other major components strikingly posted record monthly price increases for February to take their respective annual inflation rates to new series highs. In particular, despite recent falls of wholesale prices in the sector, inflation of food, alcohol and tobacco rose a further 0.9ppt to 15.0%Y/Y. While surveys continue to report an easing of supply-chain pressures, inflation of non-energy industrial goods edged up 0.1ppt to 6.8%Y/Y, likely at least in part due to a rebound in prices of clothing and footwear. And most importantly perhaps, services inflation rose a chunky 0.4ppt to a new high of 4.8%Y/Y, seemingly driven by further pressures in consumer-facing sectors such as hospitality and leisure. As a result, core inflation rose a bigger-than-expected 0.3ppt to another series high of 5.6%Y/Y, a development that will ensure that the ECB's hawks will maintain a large majority on the Governing Council over coming months.

Jump in services inflation and tight labour market will add to concerns about second-round effects

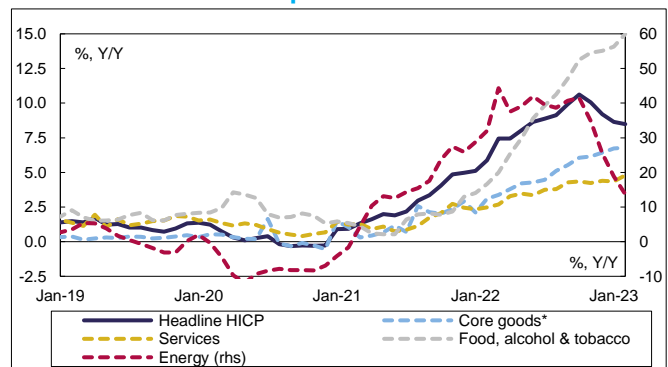
The record rise in core prices in February will dash previous hopes at the ECB – expressed in the account of the most recent monetary policy meeting – that inflation dynamics had started to decelerate. Indeed, the record monthly increase in services prices will likely further fuel concerns about second-round effects, particularly in labour-intensive sectors. The account noted “a clear acceleration” in wage growth, with very strong increases in pay under newly concluded contracts. And “while there was wide agreement that there were no signs of a wage-price spiral, it was argued that current wage growth was clearly not consistent with a 2% inflation target”. While pay is a lagging indicator, today's unemployment figures remained consistent with a tight labour market. Admittedly, the number of people unemployed in the euro area rose in January for the third consecutive month and by 40k to 11.29mn. But this still meant that the jobless rate moved sideways at 6.7% (upwardly revised by 0.1ppt in December) to be only a fractionally above the series low (6.6%) recorded in October. The rise in joblessness largely reflected increases in Italy, where the rate rose 0.1ppt to 7.9%, and Portugal, where it rose 0.3ppt to 7.1%, the highest for two years. In contrast, unemployment fell in the other larger member states, with the respective rates unchanged in Germany (3.0%) and Spain (13.0%) and down in France by 0.1ppt to 7.1%. Spanish numbers for February also released today were consistent with a stable labour market, with registered unemployment on a seasonally adjusted

Euro area: Consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



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

basis down by 6.35k and the unadjusted data reporting only a modest rise of 2.62k compared to the average increase for that month over the past 15 years of 35k.

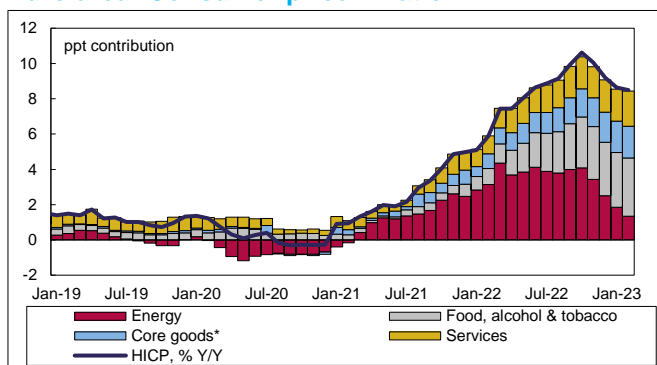
ECB worried about both wage- and price-setting, so further substantive tightening to come

Looking ahead, with surveys suggesting that labour shortages remain a limiting factor on production for many firms, they also report that hiring intentions remain stronger than normal in each of the larger member states. So, while economic activity appears somewhat weaker than implied by data and surveys ahead of the last ECB monetary policy meeting, the labour market seems likely to remain relatively tight and a source of potential price pressure in the absence of a sudden sharp contraction in economic activity. Indeed, with workers likely to continue to seek compensation for recent high inflation, the ECB account noted that “In some sectors and some countries, wages were expected to rise by more than 10%”. And it was judged that “upward pressure on wage growth, in line with the December staff projections”, which envisaged compensation per employee rising roughly between 4-5%Y/Y over the coming three years, remained likely. At the same time, the account implied that firms’ price-setting behavior might be a greater concern for the ECB than wages, as “so far, the association of fast-rising prices with lagging wages had implied a large shift in income from labour to capital. Developments in unit profit growth remained very strong, which suggested that the pass-through of higher costs to higher selling prices remained robust.” So, while the ECB’s updated economic projections, due to be presented to the forthcoming Governing Council meeting later this month, will revise down the profile of headline inflation to reflect the recent sharp drop in energy prices, the core inflation profile will likely remain above the 2.0%Y/Y target through to the end of the horizon. And with the account also noting that it was “emphasised that policy rates were, at present, barely consistent with the range of estimates for the neutral rate” and there was “still substantial distance to the prospective terminal rate”, after a further 50bps hike in rates later this month, further “substantive” hikes are likely in Q2.

The day ahead in the euro area

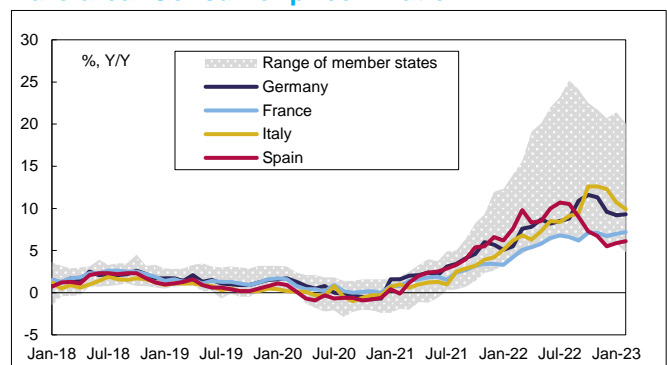
Tomorrow will bring more insight into price pressures in the euro area, with the release of PPI figures for January. These are expected to reveal a fifth consecutive drop in the annual growth rate, likely to its lowest reading in sixteen months. The final services and composite PMIs are also due and expected to align with the flash release, which showed that the services activity PMI rose 2.2pts to 53.0, thanks to a resurgence in consumer-facing activities such as tourism and recreation. Friday will also bring German goods trade numbers for January, French IP figures for the same month, and revised Italian Q4 GDP data, which will include the first official expenditure breakdown. Separately, ECB Vice President de Guindos and Governing Council members Vasle and Muller are due to speak.

Euro area: Consumer price inflation



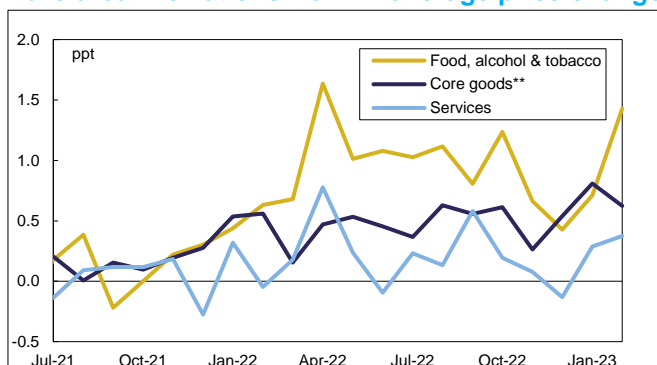
*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



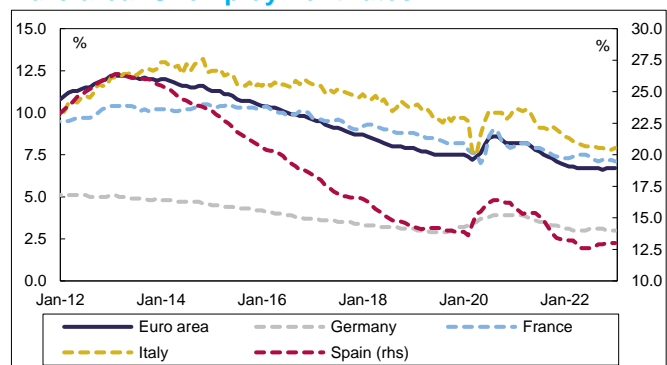
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Deviations from I-r average price change*



*Difference in monthly consumer price change from pre-pandemic long-run average. **Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment rates



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK

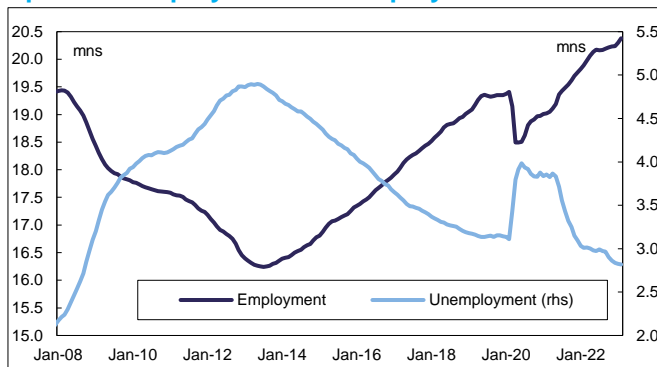
BoE's DMP results reported moderating price expectations, but still elevated wage projections

Given concerns about potential second-round effects on inflation from expectations and wages, today's results from the BoE's latest Decision Maker Panel (DMP) survey arguably offered something to support the arguments of both the doves and hawks on the MPC. While still elevated, there was a further modest easing in the survey estimate of annual private sector output price inflation in February, down 0.1ppt to 7.8%Y/Y, some 0.8ppt off the peak seen at the end of last year. And encouragingly, there was a more convincing drop in firms' expected year-ahead own-price inflation to 5.4%Y/Y, the lowest in twelve months, perhaps reflecting the moderation in manufacturers' cost burdens reported in yesterday's PMIs. Furthermore, DMP members revised down their expectations for CPI inflation one-year ahead, by 0.5ppt to 5.9%Y/Y, some 3½ppts below September's peak, and their expectation for CPI inflation in three years' time by 0.3ppt to 3.7%Y/Y, albeit a level still well above the Bank's target. But with wage growth having ticked higher at the end of last year (6.6%Y/Y), firms expected it to remain elevated at 5.7%Y/Y over the coming twelve months, well above levels judged consistent with achieving the inflation target on a sustained basis.

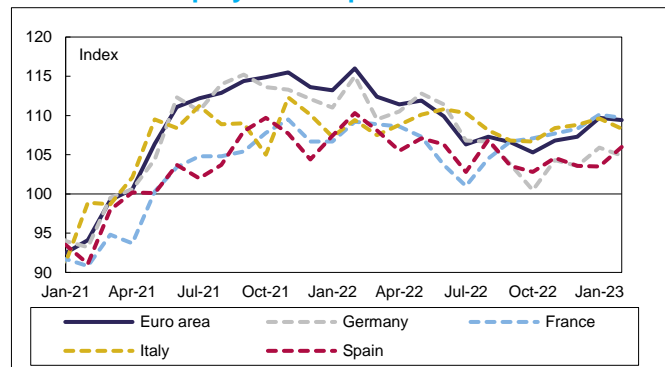
The day ahead in the UK

As in the euro area, tomorrow will bring the final February services and composite PMIs from the UK, which are expected to confirm a notable rebound in services activity, with the flash index having leapt 4.6pts to an eight-month high of 53.3. With the final manufacturing output index having been revised slightly lower, we might well see the headline composite PMI downwardly revised slightly from 53.0, albeit still implying surprisingly solid expansion last month.

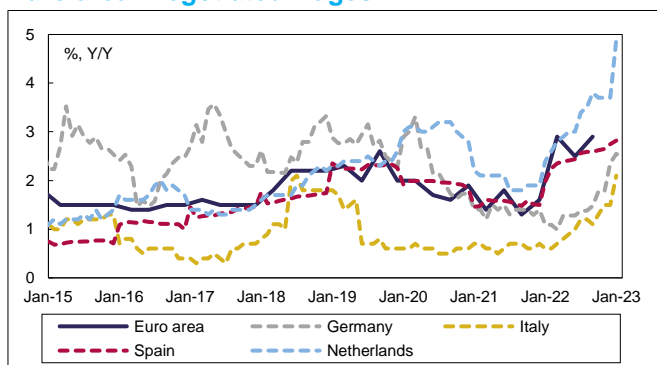
Spain: Unemployment and employment



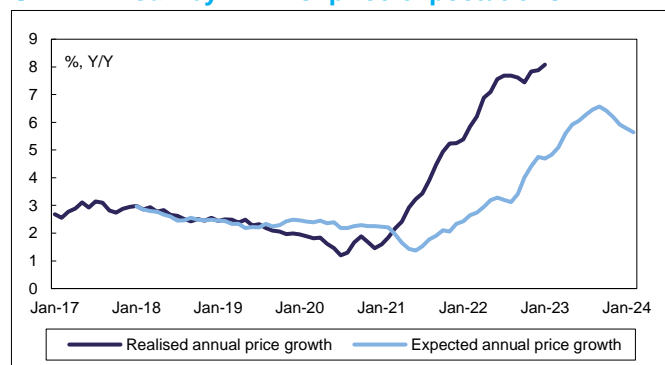
Euro area: Employment expectations indices



Euro area: Negotiated wages*







UK: DMP survey – firms' price expectations












European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Preliminary HICP (core HICP) Y/Y%	Feb	8.5 (5.6)	<u>7.9 (5.1)</u>	8.6 (5.3)	-
	 Unemployment rate %	Jan	6.7	6.6	6.6	6.7
Italy	 Preliminary HICP (CPI) Y/Y%	Feb	9.9 (9.2)	9.5 (9.2)	10.7 (10.0)	-
Spain	 Unemployment change 000s	Feb	2.6	-	70.7	-

Auctions

Country	Auction
France	 sold €5.055bn of 2.00% 2032 bonds at an average yield of 3.200%
	 sold €3.162bn of 1.25% 2034 bonds at an average yield of 3.310%
	 sold €2.543bn of 1.25% 2038 bonds at an average yield of 3.470%
	 sold €1.239bn of 4.00% 2060 bonds at an average yield of 3.490%
Spain	 sold €2.139bn of 2.80% 2026 bonds at an average yield of 3.433%
	 sold €1.475bn of 0.80% 2029 bonds at an average yield of 3.520%
	 sold €2.360bn of 3.15% 2033 bonds at an average yield of 3.765%
	 sold €502mn of 0.700% 2033 index-linked bonds at an average yield of 1.164%
UK	 sold £650mn of 0.125% 2051 index-linked bonds at an average yield of 0.835%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	09.00	Final services (composite) PMI	Feb	<u>53.0 (52.3)</u>	50.8 (50.3)
	10.00	PPI Y/Y%	Jan	-0.3 (17.8)	1.1 (24.6)
Germany	07.00	Trade balance	Jan	11.0	10.0
	08.55	Final services (composite) PMI	Feb	<u>51.3 (51.1)</u>	50.7 (49.9)
France	07.45	Industrial production M/M% (Y/Y%)	Jan	-0.2 (0.2)	1.1 (1.4)
	08.50	Final services (composite) PMI	Feb	<u>52.8 (-)</u>	49.4 (49.1)
Italy	08.45	Services (composite) PMI	Feb	52.3 (52.0)	51.2 (51.2)
	09.00	Final GDP Q/Q% (Y/Y%)	Q4	-0.1 (1.7)	0.5 (2.7)
Spain	0815	Services (composite) PMI	Feb	53.7 (53.5)	52.7 (51.6)
UK	09.30	Final services (composite) PMI	Feb	<u>53.3 (53.0)</u>	48.7 (48.5)

Auctions and events

Euro area	08.30	ECB Vice President de Guindos scheduled to speak the euro area economic outlook and future monetary policy
	09.00	ECB's Vasle and Muller scheduled to speak on inflation

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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