

# Euro wrap-up

## Overview

- Despite a marked acceleration in euro area labour costs, Bunds followed USTs sharply higher as concerns about banking sector stability persisted.
- Gilts also rallied while a BoE survey reported a notable decline in household inflation expectations.
- The coming week brings the BoE's latest monetary policy announcement as well as the March flash PMIs, and new data on UK inflation and retail sales.

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### Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	2.384	-0.190
OBL 2.2 04/28	2.097	-0.206
DBR 2.3 02/33	2.104	-0.176
UKT 0 <sup>5</sup> / <sub>8</sub> 06/25	3.217	-0.161
UKT 1¼ 07/27	3.159	-0.158
UKT 4¼ 06/32	3.238	-0.135

\*Change from close as at 4:35pm GMT.  
Source: Bloomberg

## Euro area

### Final euro area inflation data confirm fourth consecutive drop in headline rate

While the [ECB](#) yesterday refrained from offering guidance on the likely path of monetary policy ahead, certain Governing Council hawks – Kazimir, Muller and Simkus – today signalled their expectation that further hikes will be required, albeit with somewhat less conviction than in recent months. And while it will be some time before the economic impact of the intense financial market turbulence over the past week starts to show up in the dataflow, today's releases will have likely reinforced the view of the majority on the Governing Council that the fight against inflation is far from over. Admittedly, there were no surprises to the final estimates of euro area consumer price inflation in February, which, in line with the flash readings, confirmed that the headline rate moderated for the fourth consecutive month, albeit by a modest 0.1ppt to 8.5%Y/Y. As reported in the preliminary release, this reflected a drop of more than 5ppts in energy inflation to a 20-month low of 13.7%Y/Y to be roughly one third of the peak in October. Today's detail confirmed that gas prices fell a further 5½%M/M in February to take the cumulative decline since October to roughly 19%. And while petrol prices were unchanged on the month, the annual increase eased to just 3.3%Y/Y from the peak of 39%Y/Y a year ago.

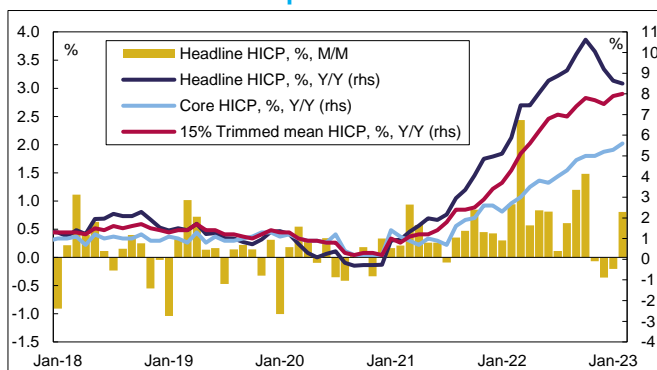
### Core prices continue to rise at a record pace, but services momentum has moderated

As in the flash release, each of the other major components of the inflation basket posted record monthly price increases for February to take their respective annual inflation rates to new series highs. In particular, food inflation rose a further 1.0ppt to 17.7%Y/Y. Inflation of non-energy industrial goods edged up 0.1ppt to 6.8%Y/Y, with an acceleration in clothing and footwear offsetting a further moderation in motor vehicles, furniture and household appliances. Services inflation also rose a chunky 0.4ppt to a new high of 4.8%Y/Y, driven by further pressures in consumer-facing sectors such as hospitality and leisure as well as the strongest increase in rents since 1997. As a result, core inflation rose a bigger-than-expected 0.3ppt to another series high of 5.6%Y/Y. And today's release confirmed a further upwards drift in other measures of underlying inflation too, including the 15% trimmed mean HICP rate, which similarly rose to a new series high of 8%Y/Y in February. Looking at the data on a three-month seasonally adjusted basis, momentum in core goods prices appears to remain on an upwards trend despite evidence of diminished supply-chain challenges and a cooling in producer price pressures. But on the same basis, momentum in services prices appears to have peaked (see chart below), suggesting that the annual rate of that component might also start to moderate in due course. If so, core inflation might now have reached its peak.

### Record labour cost growth will further fuel concerns of second-round effects

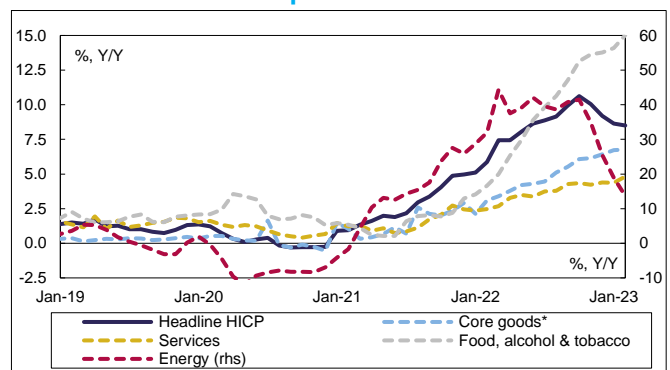
Today's labour cost data, however, will have further fuelled concerns about second-round effects on inflation, which might be felt most forcefully in services over coming quarters. Hourly labour cost growth in the euro area leapt in Q4 to 5.7%Y/Y, from

#### Euro area: Consumer price inflation



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

#### Euro area: Consumer price inflation



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

a significantly upwardly-revised estimate in Q3 of 3.7%Y/Y, to be more than double the average pace of the past two decades and well above levels considered consistent with the ECB's inflation target. This reflected a surge in both wages (up 2.1ppts to a series-high 5.1%Y/Y) and non-wage costs (up 1.8ppts to 7.7%Y/Y). At the sectoral level, labour costs in the euro area grew 4.4%Y/Y in industry, but 6.9%Y/Y in construction and 6.2%Y/Y in services, with hospitality registering growth of 9.0%Y/Y as staff shortages seemingly became acute. At the country level, labour costs accelerated in Germany (6.3%Y/Y), France (5.2%Y/Y), Italy (8.7%Y/Y) and Spain (3.6%Y/Y). But growth was highest in Lithuania (15.5%Y/Y), Slovenia (11.4%Y/Y) and Estonia (10.3%Y/Y) where inflationary pressures have been particularly severe. And labour cost growth across the euro area was still well below the rate of consumer price inflation in Q4, providing a reminder that average wages declined significantly in real terms while firms in many sectors were able to boost margins. Indeed, negotiated wage growth moved sideways at a more modest 2.9%Y/Y in Q4. However, the ECB will expect that pace to accelerate over the coming quarters as workers continue to seek compensation for recent high inflation. And labour cost growth is highly likely to remain too high for the ECB's comfort both this year and next.

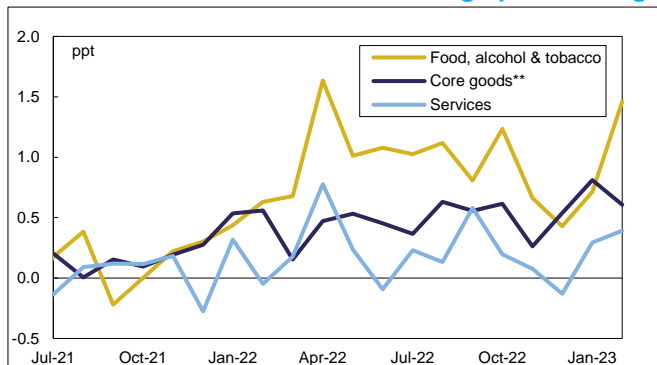
## The week ahead in the euro area

Following yesterday's ECB monetary policy announcement, President Lagarde, Chief Economist Lane and dovish Executive Board Member Panetta are all due to speak publicly in Frankfurt on Wednesday at the annual ECB Watchers' conference. Lagarde yesterday suggested that we might expect to hear a more thorough assessment from her of how recent financial market developments might affect the transmission of monetary policy. Data-wise, the focus will be on the first economic sentiment survey results for March, including the ZEW investor indices (Tuesday), the Commission's flash euro area consumer confidence index (Thursday) and, most notably, the preliminary PMIs (Friday). Last month, the euro area manufacturing PMI edged above the key 50 expansion/contraction level for the first time in nine months. And with the services PMI up to an eight-month high of 52.7, the composite PMI rose 2pts to 52.0, the best level since May. We expect a slight softening in the services index to result in a modest decline in the composite PMI but leave the average for quarter consistent with our view of 0.1%Q/Q growth in Q2, following zero growth in Q1. Given recent market turbulence, however, we expect the ZEW survey to point to a deterioration of both current conditions and expectations. Ahead of the surveys, euro area goods trade figures for January and German PPI inflation data for February will be published on Monday. EU27 new car registrations data for February and euro area construction output numbers for January come the following day.

## The week ahead in the UK

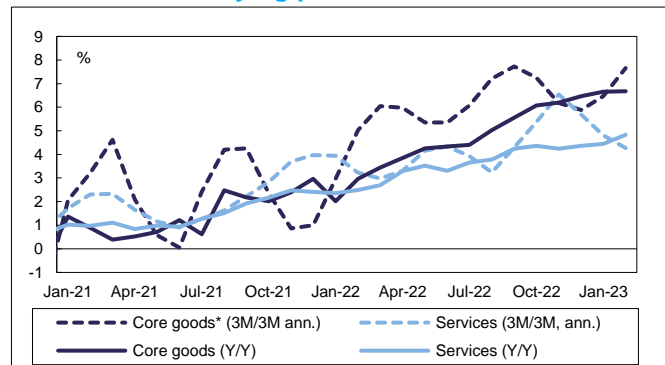
All eyes in the coming week will be on the BoE, where the monetary policy outcome seems more uncertain than yesterday's ECB decision. While the MPC again hiked Bank Rate by 50bps at the [previous meeting](#) in February, its updated forward

### Euro area: Deviations from l-r average price change\*



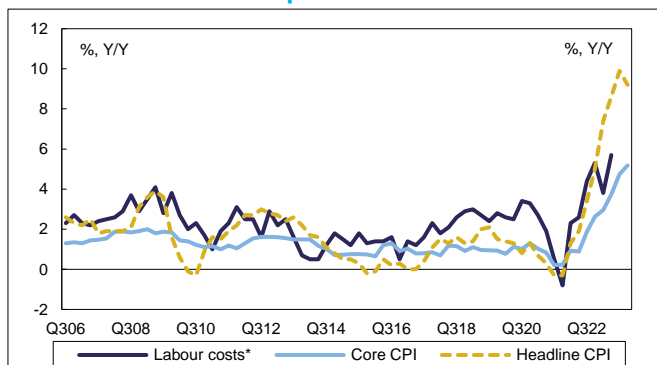
\*Difference in monthly consumer price change from pre-pandemic long-run average. \*\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Underlying price momentum



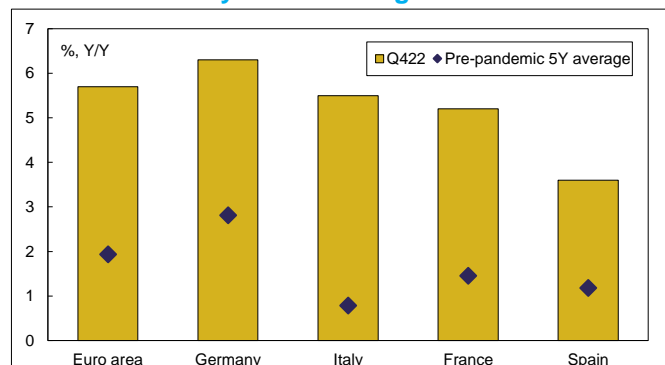
\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Consumer price inflation & labour costs



\*Two-quarter lag. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Hourly labour cost growth












Source: Eurostat and Daiwa Capital Markets Europe Ltd.

guidance and economic projections – which suggested that inflation will fall significantly below the 2% target from Q224 on – made clear that the end of the tightening cycle might be near. Notably, its guidance suggested that news with respect to services prices and wage settlements would be key to determining the future path of rates. And, on both counts, we think the data would justify a slowing in the pace of hikes, or even no hike at all this month. The BoE's latest public inflation attitudes survey, released today, additionally pointed to a moderation in price expectations – one-, two- and five-years ahead – to the lowest rates since 2021. Wariness at possible adverse spillovers from recent stress in certain US banks and Credit Suisse, and associated financial market turbulence, would also call for caution on interest rates. And at face value, the confirmation in this week's Budget statement that increased government support will avoid a further rise in household energy bills in April will mean that inflation will fall more sharply than previously projected next quarter. However, the significant relaxation of the overall fiscal stance in the Budget – with net public borrowing in the coming fiscal year set to be £18.6bn higher than would otherwise have been the case if policy had been left unchanged – would call for additional monetary tightening. So, we expect the MPC merely to slow the pace of rate increases on Thursday to 25bps, taking Bank Rate to 4.25%, where we still think the current tightening cycle will conclude.

Data-wise, a busy week ahead in the UK will bring updates on inflation (Wednesday), retail sales, consumer confidence and the flash PMIs (all Friday). Having peaked in October at a 40-year high, inflation looks to set to return to single digits in February. We forecast a fall of 0.4ppt in the headline CPI rate, to an eight-month low of 9.7%Y/Y, with the core rate easing 0.2ppt to 5.6%Y/Y, the lowest level in a year. In terms of economic activity, surveys suggest that retail sales rose modestly for a second successive month – by about 0.2%M/M following growth of 0.5%M/M in January – albeit leaving the average level in the first two months of Q1 still about ½% below the Q4 average. The GfK survey (Friday) is also expected to post another modest increase in consumer confidence in March, to -35, which would be the highest in a year albeit still low by historical standards. Finally, after the PMIs surprised significantly on the upside in February – with the headline composite output PMI jumping 4.5pts, the most in a year, to 53.0, the highest since June – we expect some adverse payback this month.

*The next edition of the Euro wrap-up will be published on 21 March 2023*

## Daiwa economic forecasts

	2022		2023				2022	2023	2024
	Q3	Q4	Q1	Q2	Q3	Q4			
<b>GDP</b>	%, Q/Q						%, Y/Y		
Euro area 	0.4	0.0	0.0	0.1	0.1	0.2	3.5	0.6	1.0
UK 	-0.2	0.0	-0.2	-0.1	-0.1	0.0	4.0	-0.4	0.3
<b>Inflation, %, Y/Y</b>									
Euro area									
Headline HICP 	9.3	10.0	7.9	5.9	4.2	2.5	8.4	5.1	2.2
Core HICP 	4.4	5.1	5.1	5.5	4.6	3.7	3.9	4.2	2.2
UK									
Headline CPI 	10.0	10.7	9.6	6.1	4.7	2.3	9.1	5.6	2.0
Core CPI 	6.3	6.4	5.5	4.5	3.6	2.8	5.9	4.1	2.6
<b>Monetary policy, %</b>									
ECB									
Refi Rate 	1.25	2.50	3.50	3.75	3.75	3.75	2.50	3.75	3.25
Deposit Rate 	0.75	2.00	3.00	3.25	3.25	3.25	2.00	3.25	2.75
BoE									
Bank Rate 	2.25	3.50	4.25	4.25	4.25	4.25	3.50	4.25	3.25

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> <i>forecast/actual</i>	Previous
<b>Monday 20 March 2023</b>					
Euro area	10.00	Trade balance €bn	Jan	-	-18.1
Germany	07.00	PPI M/M% (Y/Y%)	Feb	-1.4 (14.4)	-1.0 (17.8)
UK	00.01	Rightmove house prices M/M% (Y/Y%)	Mar	-	0.0 (3.9)
<b>Tuesday 21 March 2023</b>					
Euro area	07.00	EU27 new car registrations Y/Y%	Feb	-	11.3
	10.00	Construction output M/M% (Y/Y%)	Jan	-	-2.5 (-1.3)
Germany	10.00	ZEW current assessment (expectations)	Mar	-48.0 (20.0)	-45.1 (28.1)
France	-	Bank of France retail sales Y/Y%	Feb	-	-2.6
UK	07.00	Public sector net borrowing (excl. banks) £bn	Feb	10.2 (11.5)	-6.2 (-5.4)
<b>Wednesday 22 March 2023</b>					
Euro area	09.00	ECB current account balance €bn	Jan	-	15.9
UK	07.00	CPI M/M% (Y/Y%)	Feb	<u>0.5 (9.7)</u>	-0.6 (10.1)
	07.00	Core CPI Y/Y%	Feb	<u>5.6</u>	5.8
	07.00	PPI output prices M/M% (Y/Y%)	Feb	0.1 (12.4)	0.5 (13.5)
	07.00	PPI input prices M/M% (Y/Y%)	Feb	-0.2 (12.0)	-0.1 (14.1)
	11.00	CBI industrial trends, total orders (selling prices)	Mar	-15 (-)	-16 (40)
<b>Thursday 23 March 2023</b>					
Euro area	15.00	Preliminary consumer confidence	Mar	-18.5	-19.0
UK	12.00	BoE Bank Rate %	Mar	<u>4.25</u>	4.00
<b>Friday 24 March 2023</b>					
Euro area	09.00	Preliminary manufacturing (services) PMI	Mar	49.0 (52.5)	48.5 (52.7)
	09.00	Preliminary composite PMI	Mar	52.0	52.0
Germany	08.30	Preliminary manufacturing (services) PMI	Mar	47.0 (51.0)	46.3 (50.9)
	08.30	Preliminary composite PMI	Mar	51.0	50.7
France	08.15	Preliminary manufacturing (services) PMI	Mar	48.0 (51.8)	47.4 (53.1)
	08.15	Preliminary composite PMI	Mar	51.6	51.7
Spain	08.00	Final GDP Q/Q% (Y/Y%)	Q4	<u>0.2 (2.7)</u>	0.2 (4.8)
	08.00	PPI M/M% (Y/Y%)	Feb	-	-2.0 (8.2)
UK	00.01	GfK consumer confidence	Mar	-	-38
	07.00	Retail sales including auto fuel M/M% (Y/Y%)	Feb	0.2 (-4.7)	0.5 (-5.1)
	07.00	Retail sales excluding auto fuel M/M% (Y/Y%)	Feb	0.2 (-4.8)	0.4 (-5.3)
	09.30	Preliminary manufacturing (services) PMI	Mar	49.7 (53.0)	49.3 (53.5)
	09.30	Preliminary composite PMI	Mar	52.7	53.1





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## The coming week's key events & auctions

Country	GMT	Event / Auction
<b>Monday 20 March 2023</b>		
Euro area	 09.00	ECB publishes Survey of Monetary Analysts March 2023
	 14.00	ECB President Lagarde hearing before the Committee on Economic and Monetary Affairs
<b>Tuesday 21 March 2023</b>		
Germany	 10.30	Auction: €1.5bn of 1.3% 2027 bonds
UK	 10.00	Auction: £2bn of 3.75% 2053 bonds
<b>Wednesday 22 March 2023</b>		
Euro area	 08.45	The ECB and its Watchers conference – President Lagarde, Chief Economist Lane, and Panetta due to speak
	 11.30	ECB Board Member Rehn scheduled to speak – Lessons from Europe's Crises
Germany	 10.30	Auction: €5bn of 2.3% 2033 bonds
UK	 11.30	Auction: £3.5bn of 4.125% 2027 bonds
<b>Thursday 23 March 2023</b>		
Euro area	 16.00	ECB Chief Economist Lane participates in a panel – Post-1973 currency regime and inflation experiences
UK	 12.00	BoE monetary policy announcement, statement, minutes and Monetary Policy Report to be published
	 12.30	BoE Governor Bailey holds press conference on the BoE's latest Monetary Policy Report
<b>Friday 24 March 2023</b>		
UK	 16.00	BoE's Mann takes part in panel discussion – 'Ukraine – one year later'

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	 Final (core) CPI Y/Y%	Feb	<b>8.5 (5.6)</b>	<u>8.5 (5.6)</u>	8.6 (5.3)	-
	 Labour costs Y/Y%	Q4	<b>5.7</b>	-	2.9	3.7
Italy	 Trade balance €bn	Jan	<b>-4.2</b>	-	1.1	1.4
UK	 BoE inflation expectations, next 12M, Y/Y%	Feb	<b>3.9</b>	-	4.8	-
Auctions						
Country	Auction					
- Nothing to report -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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