

Euro wrap-up

Overview

- Bunds followed the global trend higher, while the Commission's euro area consumer confidence index paused its recent recovery.
- Gilts also rallied following a relatively dovish 25bps hike from the BoE, as the MPC flagged an improvement in the outlooks for both growth and inflation.
- Friday will bring the flash European March PMIs, alongside reports on UK retail sales and consumer confidence.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2½ 03/25 | 2.488 | -0.194 |
| OBL 2.2 04/28 | 2.177 | -0.184 |
| DBR 2.3 02/33 | 2.185 | -0.137 |
| UKT 0% 06/25 | 3.291 | -0.205 |
| UKT 1% 10/28 | 3.213 | -0.159 |
| UKT 3¼ 01/33 | 3.359 | -0.089 |

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

Euro area

Recovery in euro area consumer confidence paused in March

After the [ZEW](#) survey earlier this week reported that investors' expectations for the near-term outlook has predictably deteriorated amid heightened financial market turbulence, the Commission's flash consumer confidence index for March, published today, also suggested that the recovery in household sentiment paused at the end of the first quarter. In particular, the headline index marginally slipped back in March for the first month in six, by just 0.1pt to -19.2. This level is still some 9½pts above last September's trough, and left the Q1 average more than 4½pts above the Q4 level. However, it remains some 8pts below the long-run average and overall was still broadly consistent with lacklustre household consumption. Among the member states, the first March surveys to be published – from the Low Countries – were mixed. The Dutch survey was more encouraging than of late, with the headline index up 5pts to -39, the highest reading for a year. Household expectations for economic conditions over the coming twelve months were the best since November 2021 and the index of willingness to buy the highest since last May. But, in Belgium, households were a touch more downbeat in March, with the headline index down 1pt to -9, just below the long-run average but nevertheless still some 18pts above last year's trough.

The day ahead in the euro area

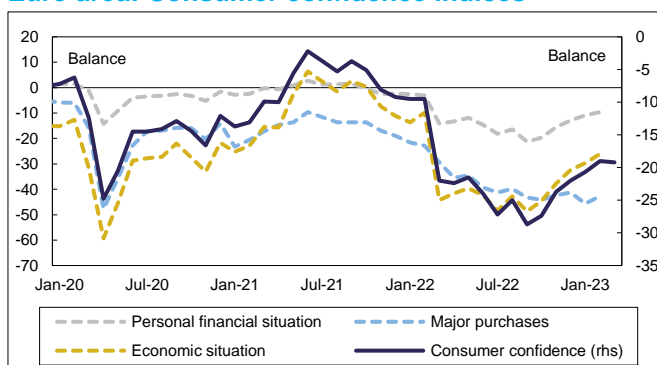
Tomorrow brings the release of the flash PMIs, which will provide the first guide to business activity in March. Last month, the euro area composite PMI rose 2pts to 52.0, the best level since May last year. That reflected a jump in the services PMI to an eight-month high of 52.7 and the return of the manufacturing output PMI back above the key 50 expansion/contraction level for the first time in nine months. Given the recent financial market turbulence, there seems a greater likelihood of a modest deterioration in the headline PMIs this month, which would also be consistent with the findings of the [ZEW survey](#) published earlier this week. Nevertheless, we still expect the composite PMI to remain in expansionary territory and therefore consistent with our view of a return to modestly positive GDP growth in Q1, following zero growth in Q4.

UK

MPC hikes rates by 25bps and leaves guidance unchanged

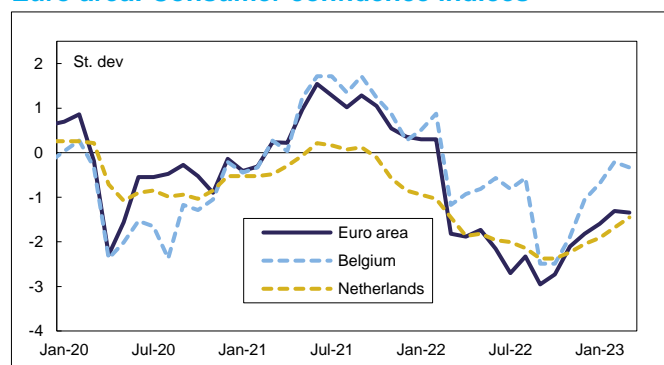
As expected, the BoE today slowed the pace of tightening to 25bps, taking Bank Rate to 4.25%. Seven MPC members voted for the rate hike while the two doves (external members Sylvia Tenreyro and Swati Dhingra) again voted for no change. The Committee also left the door open to further tightening ahead, maintaining its forward guidance that "If there were to be evidence of more persistent [inflationary] pressures, then further tightening in monetary policy would be required." Once

Euro area: Consumer confidence indices



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

Euro area: Consumer confidence indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

again, it also highlighted the importance of developments regarding wages and services prices. However, the statement also acknowledged that uncertainties around the financial and economic outlook have risen. Admittedly, it also noted that the Financial Policy Committee (FPC) judged the UK banking sector to be resilient to recent developments in the US and Switzerland. And the next policy decision in May will be informed in particular by updated economic projections in the next Monetary Policy Report, which will take stock fully of the impact of recent financial market and banking sector events. However, on balance, we think the MPC statement suggested that its next meeting is more likely than not to leave policy unchanged, and that 4.25% will be the terminal Bank Rate for this cycle.

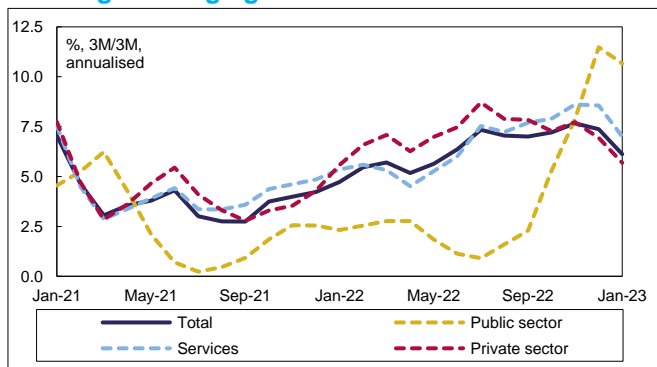
Growth outlook firmer thanks to fiscal support...

Notwithstanding the additional uncertainties generated by recent financial sector events, and a recognition that bank wholesale funding costs have risen, the MPC noted many improvements in economic conditions since its February policy meeting that will have contributed to today's decision to raise rates. While Bank staff still expect GDP to drop 0.1%Q/Q in Q1, they now project it to pick up slightly in Q2 in contrast to the previously anticipated further contraction of 0.4%Q/Q. Given the extension of the Government's Energy Price Guarantee (EPG) at the current level for three months from April, real household disposable income is expected to remain broadly flat in the near term rather than drop significantly. And the unemployment rate is no longer anticipated to rise in Q2. Moreover, the fiscal stimulus announced in last week's Budget statement is expected by Bank staff to boost the level of GDP by around 0.3% over coming years.

...but wage growth is moderating and inflation is set to "fall quite rapidly"

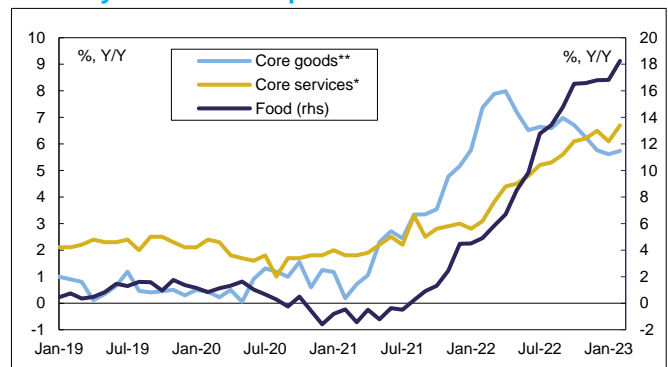
Despite the firmer growth outlook, the price outlook has also arguably improved since last month. While CPI inflation in [February](#) was stronger than the BoE expected, in a post-meeting interview Governor Bailey considered it to be a "one off". In particular, the main additional sources of pressure – food and clothing – were judged by the MPC unlikely to be persistent. Services inflation was weaker than the BoE forecast last month and is expected by Bank staff to remain broadly unchanged over the near term. Wage growth slowed further than anticipated in the three months to January (down to 5.7%3M/3M annualised for private sector regular pay, 3ppts below the peak last summer) and is also now considered likely to fall back more quickly than projected last month. That should in due course help services inflation to subside. And thanks to the EPG and lower wholesale energy prices, inflation is now expected to fall further in Q2 than the BoE projected last month. Indeed, in a post-meeting statement on Twitter, Governor Bailey stated that the Bank thinks "inflation will begin to fall quite rapidly before the summer", and it seems highly likely to continue to do so through the second half of the year. At the time of the

UK: Regular wage growth



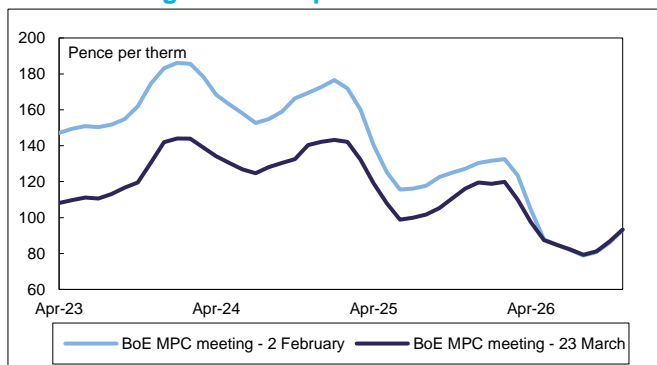
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Key inflation components



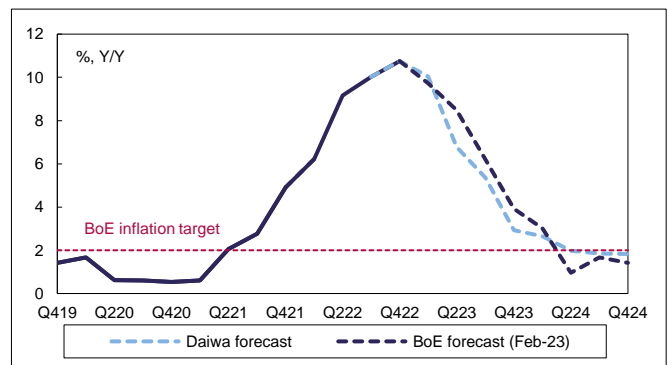
*Core services excluding airfares, package holidays & education. **Non-energy industrial goods inflation. Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Natural gas futures prices



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: Inflation forecasts



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

May policy meeting, the BoE's updated projections are likely to suggest that the case for additional tightening has significantly diminished.

The day ahead in the UK

A busy end to the week for UK data will include the release of reports on retail sales, consumer confidence and the flash PMIs. Recent 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 level in the first two months of Q1 still about ½% below the Q4 average. Meanwhile, the GfK survey is also expected to post another modest increase in consumer confidence in March, to -36, 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 4.8pts, to 53.5, the highest since June – we expect some adverse payback this month.

European calendar

| Today's results | | | | | | |
|-----------------|---------------------------------|-----------------------|--------------|-------------------------------------|----------|--------------|
| Economic data | | | | | | |
| Country | Release | Period | Actual | Market consensus/ Daiwa forecast | Previous | Revised |
| Euro area | Preliminary consumer confidence | Mar | -19.2 | -18.2 | -19.0 | -19.1 |
| UK | BoE Bank Rate % | Mar | 4.25 | <u>4.25</u> | 4.00 | - |
| 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 | 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 (52.5) | 47.4 (53.1) | |
| | | 08.15 Preliminary composite PMI | Mar | 51.5 | 51.7 | |
| Spain | | 08.00 Final GDP Q/Q% (Y/Y%) | Q4 | <u>0.2 (2.7)</u> | 0.2 (4.8) | |
| UK | | 00.01 GfK consumer confidence | Mar | -36 | -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 | |
| Auctions and events | | | | | | |
| Euro area | | 09.15 Bundesbank President Nagel to speak in Edinburgh | | | | |
| | | - ECB President Lagarde participates in European Council meeting in Brussels | | | | |
| UK | | 16.00 BoE external MPC member Mann to speak on a panel in Washington | | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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