Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made losses as flash estimates published by several member states suggested that euro area headline inflation did not fall quite as far as expected in March while core inflation might well have increased further.
- Gilts followed Bunds lower on a quiet day for UK economic news.
- Friday will bring the flash March estimates of inflation in the euro area as well as February data for unemployment in the region and retail sales in Germany.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	2.725	+0.095
OBL 2.2 04/28	2.390	+0.073
DBR 2.3 02/33	2.360	+0.040
UKT 0⅝ 06/25	3.460	+0.062
UKT 1⅝ 10/28	3.370	+0.061
UKT 3¼ 01/33	3.524	+0.053

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

Euro area

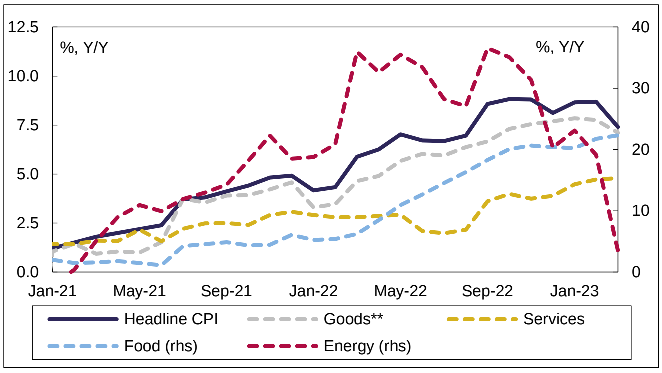
German inflation falls sharply but services inflation reaches new high

Based on today's flash estimates from several member states, it is clear that euro area inflation fell significantly in March. However, the extent of the decline was probably not quite as big as has been anticipated. And the limited detailed data published suggests that core inflation in the euro area probably rose further. That seems to have been the case in Germany, where the decline in inflation was somewhat smaller than expected, contributing to a moderate weakening in euro area government bonds in the afternoon session. In particular, Germany's EU-harmonised HICP inflation rate fell 1.5ppts to an eleven-month low of 7.8%Y/Y, 0.3ppt above the median forecast on the Bloomberg survey. The national CPI inflation rate fell 1.3ppts to a seven-month low of 7.4%Y/Y, only 0.1ppt above the Bloomberg survey median forecast. The detail published on the national measure showed that the decline was predominantly due to lower energy prices, thanks not least to the sizeable base effect associated with the record rise in fuel prices in March 2022 after Russia's invasion of Ukraine. Indeed, energy inflation slowed a whopping 15.6ppts to just 3.5%Y/Y, the lowest in more than two years, to subtract almost 1.2ppts from overall CPI inflation. In contrast, food inflation rose a further 0.5ppt to a new series high of 22.3%Y/Y. And services inflation – which remains the biggest concern of the ECB – edged up a further 0.1ppt to 4.8%Y/Y, also a series high. So, although non-energy industrial goods inflation appears to have fallen back in March, core inflation (excluding all food and fuel) probably failed to moderate from February's series high of 5.7%Y/Y.

Spanish inflation nearly halves to lowest rate since July 2021 but core measure remains elevated

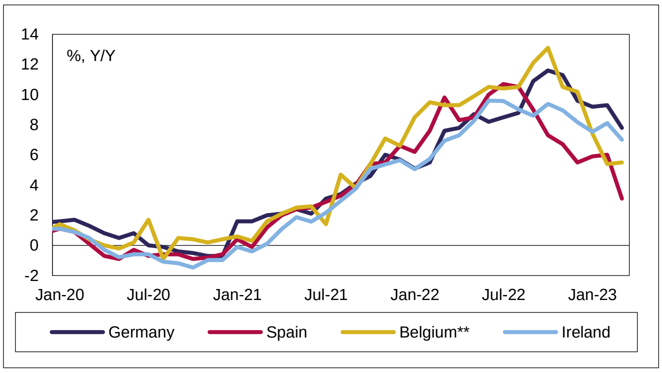
The drop in inflation in Spain was more striking than in Germany. Indeed, the flash Spanish headline EU-harmonised rate fell a much larger-than-expected 2.9ppts in March to 3.1%Y/Y, the lowest since July 2021 to be more than 7½ppts below last year's peak. The Spanish national CPI rate also dropped sharply, falling 2.7ppts to 3.3%Y/Y. While no detail was published, as in Germany the sharp drop was attributed principally to a decline in prices of fuel and electricity, the latter of which in Spain typically has a faster pass-through from wholesale gas prices than in other euro area member states. The much smaller weight on the CPI basket's clothing component this year – down more than 2ppts from last year to 3.9% – will also have played a role this month. Admittedly, when excluding energy and fresh foods, INE's core inflation measure remained extremely elevated at 7.5%Y/Y. However, this was down 0.1ppt from February raising some cautious optimism that underlying price pressures might well be close to the peak.

Germany: Consumer price inflation*



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

Euro area: Consumer price inflation*



*HICP measure. **Based on national measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Mixed messages on inflation from Ireland and Belgium

Like in Germany and Spain, the flash inflation figures from Ireland saw the harmonised rate fall sharply, dropping 1.1ppt to a twelve-month low of 7.0%Y/Y. Predictably, the downwards adjustment also principally reflected energy inflation, which dropped roughly 18ppts to 11.7%Y/Y. Indeed, when excluding energy, the Irish statistical office's estimate of core inflation jumped a further ½ppt to 6.3%Y/Y. Energy inflation also fell sharply in Belgium. Nevertheless, on the national measure, headline Belgian inflation bucked the trend to edge 0.1ppt higher to 6.7%Y/Y as inflation of food (up 0.9ppt to 17.0%Y/Y) and services (up 0.1ppt to 7.1%Y/Y) rose further. While member states accounting for more than half of all euro area GDP have yet to report their flash estimates for March, overall, today's figures point to a substantial easing in euro area headline inflation this month, between 1-1½ppts from 8.5%Y/Y in February. But it also looks likely that core inflation maintained its upwards trend to reach a new series high.

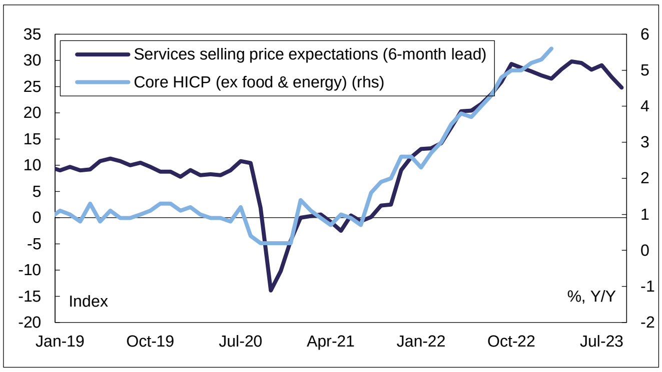
Firms' price-setting expectations maintain downward trend

Perhaps reflecting the upside surprise to euro area core inflation in February, today's European Commission economic survey results suggested that consumer price expectations for the year ahead edged slightly higher in March. Admittedly, this marked the first increase in six months, with the respective index (up 1.2pts to 18.9) still below the long-run average (23.1) and well down on last year's peak (64.0). Moreover, today's survey reported a further downwards adjustment in firms' price-setting expectations for the coming three months across all of the major sectors. Not least reflecting ongoing improvements in supply constraints, the easing in selling price expectations was again biggest in the manufacturing and construction sectors, for which the respective indices were down to their lowest since early 2021. Admittedly, the moderation in services' and retailers' price-setting expectations continues to be less marked, possibly reflecting the ongoing pass-through of increased input costs to consumers in these sectors as well as the larger share of costs accounted for by wages. Nevertheless, the respective services and retail indices were still the lowest for more than a year, suggesting that the upwards trend in underlying consumer price pressures should start to abate by the end of Q2.

Commission's economic sentiment index falls for a second successive month

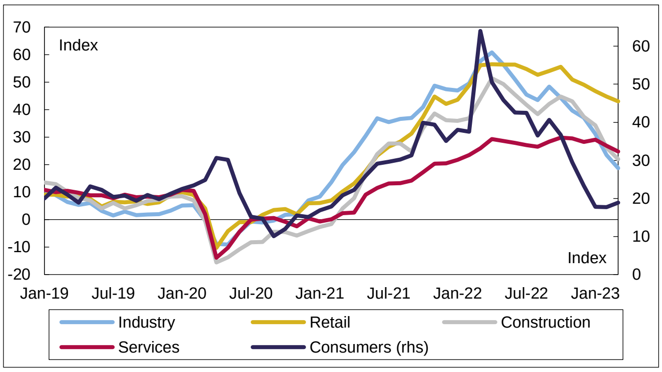
In terms of economic activity, contrasting with last week's upbeat flash PMIs, the Commission's survey offered a lacklustre assessment of current conditions at the end of the first quarter. Indeed, the headline euro area Economic Sentiment Index (ESI) – often a more reliable guide to euro area GDP growth – fell for the second successive month. Admittedly, the monthly decline was modest, down 0.3pt to 99.3, to leave the quarterly average in Q1 more than 4pts higher than in Q4 – a similar quarterly increase to the composite output PMI – and therefore suggestive of a return to modestly positive GDP growth in the

Euro area: Core inflation & services selling prices



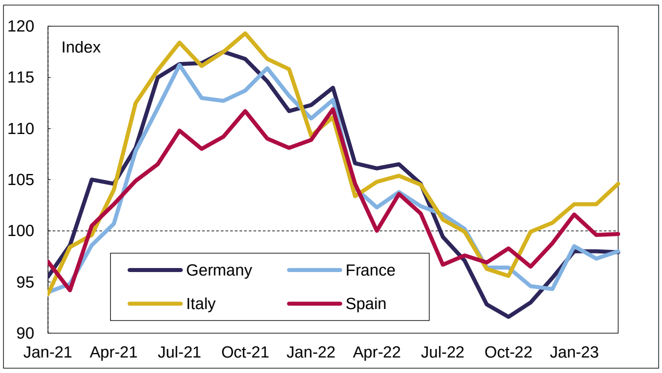
Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Price-setting expectations indices



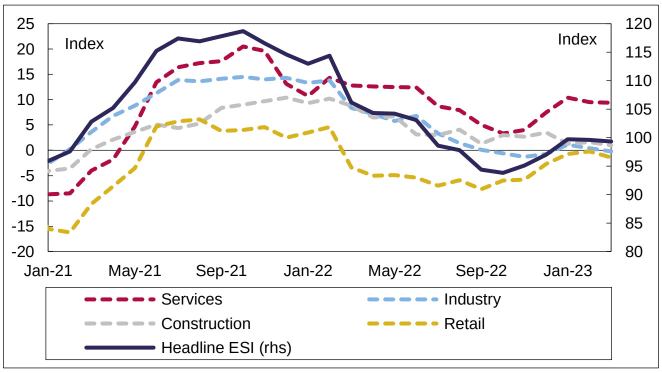
Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: ESIs by country



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

Euro area: ESIs by sector



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

euro area this quarter. The country breakdown suggested a mixed performance in March, with a modest weakening in sentiment in Germany (-0.1pt) and a more sizeable drop from Austria (-5.2pts), countering a strengthening in the ESIs from Italy (+2.0pts) to a ten-month high, Netherlands (+0.9pt), and France (+0.7pt) and broadly unchanged conditions in Spain (+0.1pt). Overall, however, the ESIs from all member states to publish results so far remain comfortably higher than in Q4.

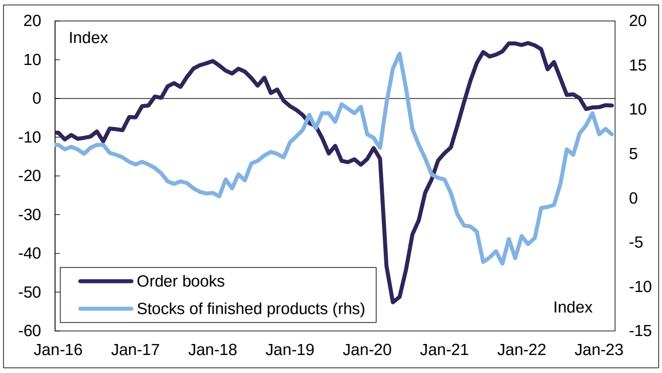
Modest deterioration in confidence across sectors

Also contrasting markedly with the upbeat detail in the PMIs, the Commission survey reported a further modest deterioration in services sentiment in March, albeit from an elevated level at the start of the year, as a perceived weakening in past activity offset a further expected improvement in demand over the coming three months. Manufacturers were similarly more downbeat amid a deterioration in expected output and still lacklustre order books. And confidence among construction firms fell to its weakest for two years, with firms again citing insufficient demand and financial constraints as limiting factors. But the largest decline in sentiment was seen among retailers as the volume of inventories continued to rise, perhaps unintentionally, amid the first (albeit modest) decline in consumer confidence in six months. Certainly, households were a touch less optimistic about the economic outlook and the survey signalled little improvement in major purchases conducted – indeed, the relevant survey index in Q1 stood 0.9pt below the Q4 average. Admittedly, the survey's measure for purchase intentions over the coming twelve months rose to the highest since last May, albeit still remaining below the long-run average.

The day ahead in the euro area

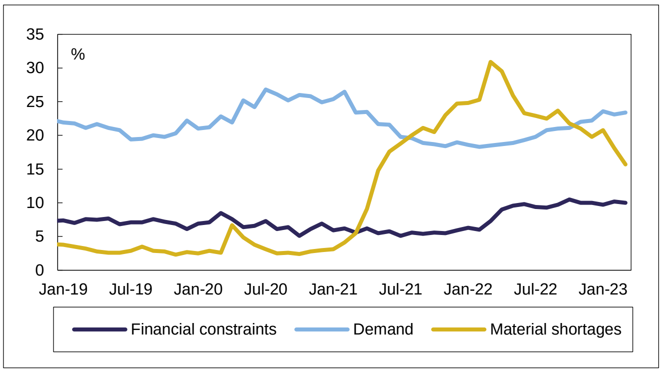
The data highlight tomorrow will be the aforementioned flash release of euro area inflation figures for March. We expect the annual HICP rate to ease for the fifth consecutive month. But the magnitude of decline remains uncertain with today's national releases suggesting it could range between1-1½ppts, which would leave inflation at an eleven-month low somewhere between 7.0-7.5%Y/Y. The easing in inflation will, however, certainly reflect a further substantial moderation in energy inflation thanks to base effects following the extreme spike in prices after the Russian invasion of Ukraine a year ago. Indeed, we expect core inflation to have ticked higher this month, to a new record high of 5.8%Y/Y, due to a further acceleration in core goods and services inflation. Also due out tomorrow are euro area labour market data for February, along with German labour market figures for March. We will also see the release of February data for German retail sales and French consumer spending on goods.

Euro area: Manufacturing orders & inventories



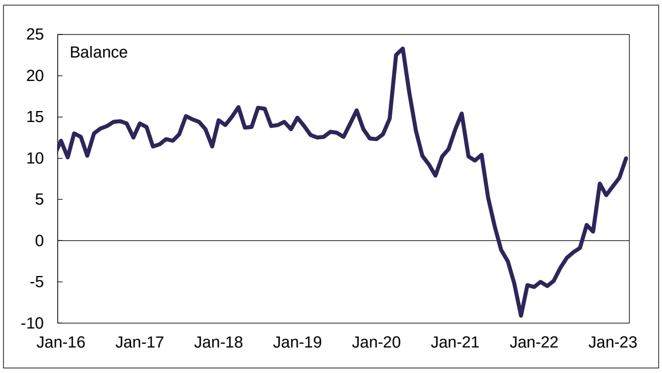
Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Limiting factors on construction output



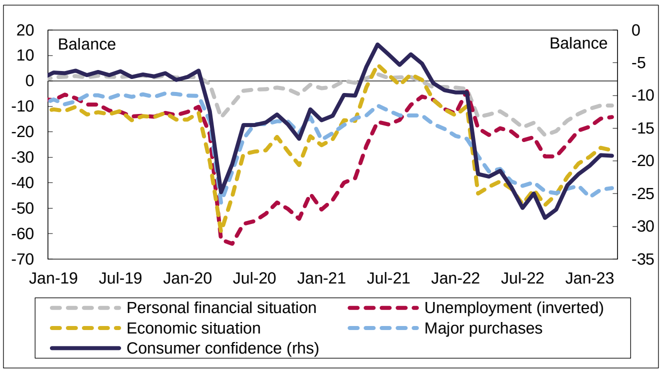
Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Retail inventories



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

Euro area: Consumer confidence



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

UK

The day ahead in the UK

Tomorrow brings updated Q4 UK GDP figures, which are likely to confirm that the economy stagnated in the final quarter of 2022 as a positive contribution from domestic demand was offset by a contraction in net trade. That left output still 0.8% below the pre-pandemic level in Q419, leaving the UK as the sole member of the G7 to have failed to surpass that benchmark. In nominal terms, however, the trade deficit narrowed slightly in Q4 by £2.5bn to £8.3bn. As such, tomorrow's balance of payments figures for Q4 will also likely confirm a slight narrowing in the current account deficit from £19.4bn in Q3. Meanwhile, the latest Nationwide house price index is expected to align with the downbeat RICS residential survey to report the seventh consecutive monthly decline in house prices in March.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	European Commission's economic sentiment indicator	Mar	**99.3**	100.0	99.7	**99.6**
	Final European Commission's consumer confidence	Mar	**-19.2**	*-19.2*	-19.1	**-**
	European Commission's industrial (services) confidence	Mar	**-0.2 (9.4)**	0.5 (10.0)	0.5 (9.5)	**0.4 (-)**
Germany	Preliminary HICP (CPI) Y/Y%	Mar	**7.8 (7.4)**	7.6 (7.3)	9.3 (8.7)	**-**
Italy	Unemployment rate %	Feb	**8.0**	7.9	7.9	**8.0**
	PPI Y/Y%	Feb	**10.0**	-	11.6	**-**
Spain	Preliminary HICP (CPI) Y/Y%	Mar	**3.1 (3.3)**	3.7 (3.9)	6.0 (6.0)	**-**

Auctions

Country	Auction
Italy	sold €3.00bn of 3.40% 2028 bonds at an average yield of 3.59%
	sold €3.50bn of 4.40% 2033 bonds at an average yield of 4.12%
	sold €1.25bn of 2029 floating rate bonds at an average yield of 2.80%
	sold €1.25bn of 2030 floating rate bonds at an average yield of 3.13%%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	10.00	HICP (core HICP) Y/Y%	Mar	*7.2 (5.8)*	8.5 (5.6)
	10.00	Unemployment rate %	Feb	6.6	6.6
Germany	07.00	Retail sales M/M% (Y/Y%)	Feb	0.5 (-5.2)	0.0 (-4.2)
	08.55	Unemployment rate % (change '000s)	Mar	5.5 (1.0)	5.5 (2.0)
France	07.45	Preliminary HICP (CPI) Y/Y%	Mar	6.5 (5.5)	7.3 (6.3)
	07.45	Consumer spending M/M% (Y/Y%)	Feb	-0.1 (-3.6)	1.5 (-3.7)
	07.45	PPI Y/Y%	Feb	-	17.9
Italy	10.00	Preliminary HICP (CPI) Y/Y%	Mar	8.8 (8.2)	9.8 (9.1)
UK	00.01	Lloyds business barometer	Mar	-	21
	07.00	Final GDP Q/Q% (Y/Y%)	Q4	*0.0 (0.4)*	-0.2 (1.9)
	07.00	Current account balance £bn	Q4	-17.4	-19.4
	07.00	Nationwide house price index M/M% (Y/Y%)	Mar	-0.3 (-2.2)	-0.5 (-1.1)

Auctions and events

Country	BST	Event
Euro area	16.00	ECB President Lagarde scheduled to speak to students in Florence

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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