

Euro wrap-up

Overview

- Gilts were little changed, while UK GDP failed to grow in February as strikes hit public services and factory output remained subdued.
- Bunds were also little changed as a Reuters report suggested that ECB policymakers are “converging” on a 25bps rate hike in May while euro area IP data for February beat expectations and the rise in German core inflation in March was confirmed.
- Friday will bring final French inflation data for March, while updates on inflation in the UK and euro area as well as the April flash PMIs are due next week.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	2.765	-0.006
OBL 2.2 04/28	2.381	-0.005
DBR 2.3 02/33	2.364	+0.002
UKT 0% 06/25	3.484	-0.005
UKT 1% 10/28	3.382	-0.006
UKT 3¼ 01/33	3.564	-

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

Source: Bloomberg

UK

GDP unchanged in February as construction offsets soft production and strike-hit services

UK GDP was unchanged on the month in February, a touch softer than the median forecast on the Bloomberg survey. However, growth in January was revised up by 0.1ppt to 0.4%M/M. And given revisions to the profile of output throughout last year, GDP is now estimated to be 0.3% above the pre-pandemic level three years earlier, albeit still slightly below the pre-pandemic peak at the start of 2020. Economic activity in February was weighed by contractions in both services and industrial production, which were offset by growth in construction. In particular, services output edged down 0.1%M/M to be 0.2% below the pre-pandemic level, as strikes by teachers and civil servants impacted output in education and administration. That weakness in public services more than offset growth in consumer-facing private sector services such as retail and hospitality, as well as further expansion in ICT, business and financial services. Strikingly, however, the level of activity in consumer-facing services remains a hefty 8.9% below the pre-pandemic level, suggesting a substantive lasting legacy of Covid-19 on household behavior.

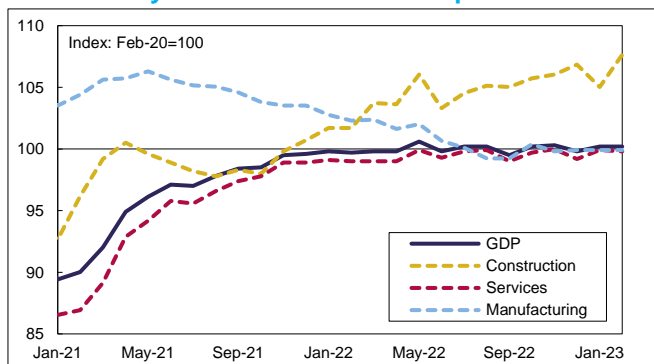
Manufacturing stagnates but construction booms on repair and maintenance

Industrial production fell 0.2%M/M in February following a revised drop of 0.5%M/M the prior month, also thus remaining below the pre-pandemic level. In part due to unseasonably mild weather, utilities were particularly soft in the latest month, more than outweighing the impact of a modest rebound in mining and quarrying. And manufacturing output was flat, with declines in more than half of the thirteen main subsectors, including chemicals, electrical equipment and textiles, offsetting growth in the transport goods and computers sectors. But while production of motor vehicles continued to recover from supply-chain disruption to rise to a ten-month high, it remained 26.5% below the pre-pandemic level. Finally, following a drop of 1.7%M/M in January, the warmer-than-usual winter weather helped construction output to rebound a strong 2.4%M/M in February to rise to a new series high more than 7½% above the pre-pandemic level. The strength of construction appears all the more eye-catching following the aggressive tightening of monetary policy that has hit housing affordability and raised concerns about commercial real estate valuations. However, the drop in transactions has seemingly increased demand for repair and maintenance work, as many households and businesses choose to upgrade existing property instead of moving to or building new property.

GDP likely to drop in March but avoid contraction in Q1

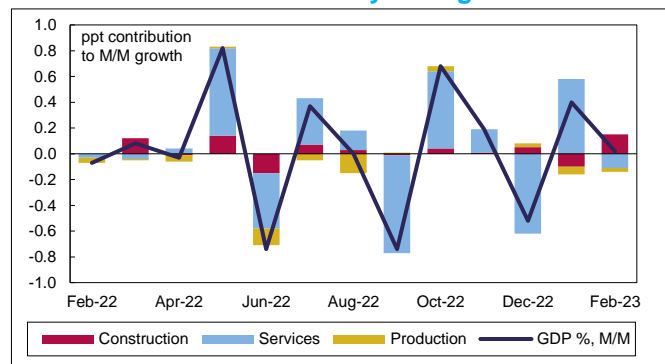
While softer than the consensus expectation, the flat reading for GDP in February left it up 0.1%3M/3M. As a result, while the BoE had forecast a drop of 0.1%Q/Q – and Chief Economist Pill today stated that Bank staff maintain that forecast after the

UK: Monthly GDP and its main components



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

UK: Contributions to monthly GDP growth



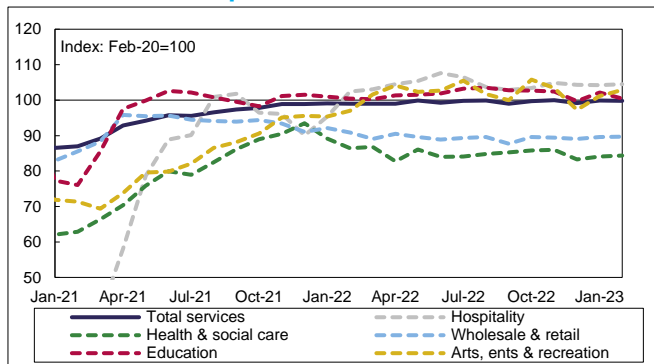
Source: ONS and Daiwa Capital Markets Europe Ltd.

February GDP data – a contraction now looks more likely than not to be avoided in Q1 as a whole. On balance, that might strengthen slightly the case for a further rate hike next month. Nevertheless, GDP has effectively trended sideways since the start of last year, suggesting a stagnant economy unable to shrug off the impacts of a series of shocks. Most recently, in March, services activity was again hit by strike action, particularly by teachers, railway workers and junior doctors. Retail sales, leisure and hospitality were likely hit by the wettest weather for the month in decades. And construction seems likely to have seen payback for the strength in February. Therefore, GDP is likely to have slipped back in March, and we think it was broadly unchanged overall in Q1 from Q4. Looking ahead, economic output in Q2 will be restrained by the extra national holiday in May for the King's coronation as well as the effects of monetary tightening, including reduced availability of secured credit for households. So, while real incomes should decline no further from current levels, we do not expect a clear return to expansion before Q3 when energy bills should be cut. Indeed, as suggested by the IMF's projections published earlier this week, GDP growth in the UK is still likely to be the weakest of all G7 economies in 2023. The outlook for 2024 also appears underwhelming not least in light of the evident deterioration in growth potential over recent years caused by the imposition of barriers to trade with the EU, and persistent underinvestment in infrastructure, skills and productive capital.

Moribund goods trade performance extends into Q1

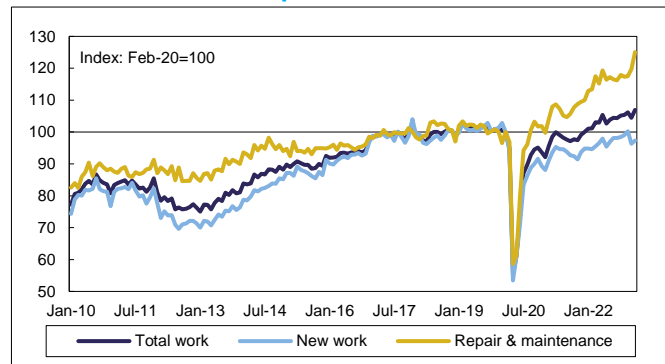
The hit to UK economic openness from Brexit continues to be reflected in a moribund goods trade performance, which has been the weakest of all G7 countries since the pandemic hit. In Q4, excluding precious metals which distort the underlying picture, goods exports were still more than 9% below the 2019 pre-pandemic average. And today's data pointed to ongoing sluggishness of shipments in Q1. Indeed, excluding non-monetary gold and other precious metals, after growth in January, goods export volumes dropped 3.1%M/M in February to leave the average for the first two months of Q1 down 0.7% from Q4. Having firmly strengthened towards the end of 2022, goods imports have weakened too, falling 1.5%M/M in February to leave the average for Q1 so far some 6.5% below the Q4 average. In contrast to goods, however, services exports are estimated by the ONS to have provided some support to economic activity in Q1. So, total export volumes in the first two months of the year were trending about 0.9% above their Q4 level while total import volumes were trending about 3½% below their Q4 level. But accounting for price shifts, excluding precious metals, and looking through the month-to-month volatility, in February the value of total exports was down 2.6%3M/3M while imports were down 1.4% on the same basis. So, the nominal trade deficit in the three months to February rose £2.3bn to £23.5bn to reverse roughly half of the improvement, related not least to lower wholesale gas prices, seen in the prior three-month period.

UK: Services output – selected subsectors



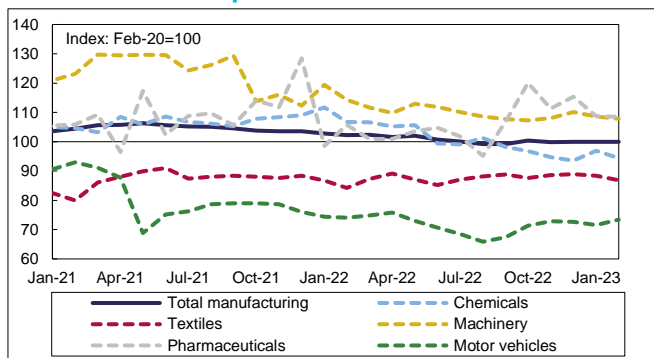
Source: ONS, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Construction output indices



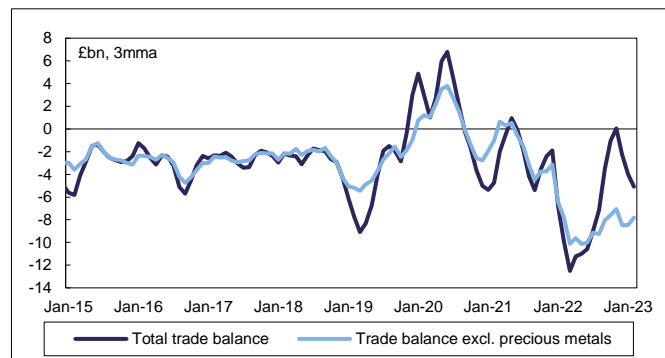
Source: ONS, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Industrial output – selected subsectors



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

UK: Total trade balance



Source: ONS and Daiwa Capital Markets Europe Ltd.

The week ahead in the UK

A busy week ahead for UK economic data will bring updates on inflation (Wednesday), the labour market (Tuesday) and retail sales (Friday), as well as the April flash PMIs (also Friday). [CPI inflation](#) in February surprised on the upside, rising 0.3ppt to 10.4%Y/Y. However, the upside surprise largely reflected a record increase in food prices, as well as a likely associated rise in prices in restaurants and cafes, and also higher clothing prices, which are often erratic. The food component is hard to forecast with accuracy. But clothing prices should be better behaved in March. Indeed, we expect a softening of inflation of both non-energy industrial goods and core services to allow the core CPI rate to reverse the 0.4ppt rise to 6.2%Y/Y seen in February. Headline inflation also seems bound to fall thanks in part thanks to an energy-price base effect associated with the Russian invasion of Ukraine. And, overall, we expect the headline CPI inflation rate to fall back 0.7ppt to 9.7%Y/Y, which would be the lowest since June.

Over recent months, the [labour market](#) has been more stable than feared, as firms have hoarded labour despite weak economic activity, and employment growth has coincided with a welcome fall in inactivity. We expect the unemployment rate to remain unchanged for a fifth successive month at 3.7% in the three months to February. Vacancies are likely to remain well above the pre-pandemic norm. But in January private sector regular pay growth slowed 0.3ppt to 7.0%3M/Y, and, most strikingly, by 0.6ppt to 0.8%3M/3M. A further cooling in pay growth the three months to February – which surveys suggest is possible – would strengthen the hand of those MPC looking for an excuse to stop raising rates. Consistent with recent signals of firmer economic activity, [retail sales](#) surprised on the upside in both January and February. With real incomes still squeezed, and the month having been the wettest March in decades, we certainly expect payback for that strength at the start of the year. However, while we think sales dropped by more than 1.0%M/M in March, it will take a decline of about 2.0%M/M to extend the number of consecutive quarterly declines in retail sales to seven in Q1.

Finally, the March PMIs suggested a slight loss of momentum at the end of Q1, with the services activity index down 0.6ppt to 52.9 and the manufacturing output index down about 2pts to 49.0. As such, the composite output PMI dropped 0.9ppt to 52.2, still nevertheless suggestive of expansion. As in the euro area, we expect the April flash PMIs to suggest a similar pace of output growth at the start of Q2. However, not least as they exclude activity in the public sector, the PMIs have not provided a particularly reliable guide to GDP over recent months. Meanwhile, we will look for a moderation of inflation pressures to be signalled in the input and output price PMIs, with the respective composite indices likely to drop to two-year lows.

Euro area

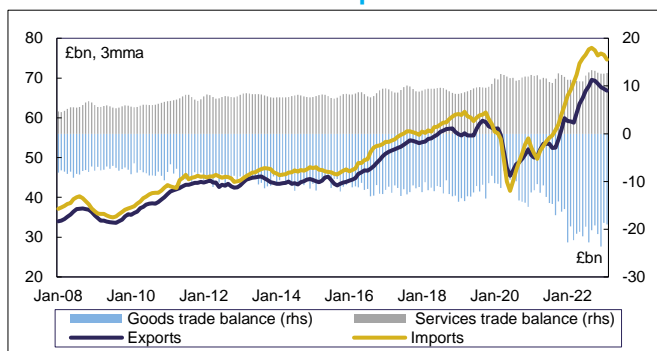
Industrial sector providing boost to GDP in Q1

The euro area industrial sector is firmly on track to make a positive contribution to euro area GDP growth in Q1. Thanks to rapid growth in several smaller member states – including Belgium (6.1%M/M) and Greece (4.8%M/M) – IP rose a larger-than-expected 1.5%M/M in February having risen 1.0%M/M the prior month. That took it 5.6% above the pre-pandemic level in February 2020, and the average in the first two months of Q1 1.3% above the Q4 average. Growth was given a boost from the continued easing of supply constraints in the autos sector, where output leapt 7.3%M/M to its highest level since the end of 2020 and just 6.5% below the pre-pandemic level. However, growth in February was encouragingly broad-based across the manufacturing sector, with chemicals, pharmaceuticals, computers and other electrical products also particularly strong.

Rise in German core inflation in March confirmed

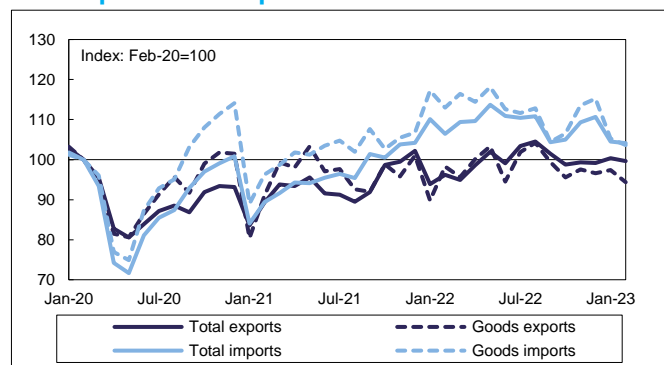
With respect to prices, the final estimates of German inflation in March predictably aligned with the flash figures. So, the 1.5ppt drop in the EU-harmonised HICP measure to an eleven-month low of 7.8%Y/Y was confirmed, as was the fall of 1.3ppt in the national CPI measure to 7.4%Y/Y. The detail published on the national measure also confirmed that the decline in inflation was caused by a sharp fall in energy inflation of more than 15ppt to a more than two-year low of 3.5%Y/Y, benefiting from a huge base effect as well as the government's price brake measures. In contrast, food inflation accelerated to a new record high of 22.3%Y/Y with pressure in all major sub-components. And with pressures in certain

UK: Trade balance and components*



*Excluding precious metals. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Exports and import volumes*



*Excluding precious metals. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

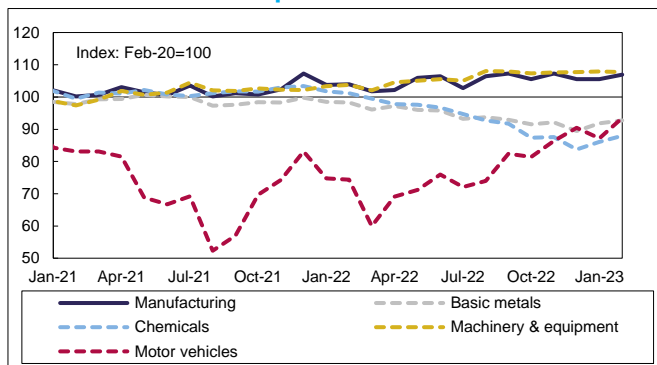
services such as eating out (10.8%Y/Y), the national measure of core inflation (excluding all food and energy) edged up 0.1ppt to a new high of 5.8%Y/Y. So, unsurprisingly, Bundesbank Governor Nagel today insisted on the need for further ECB tightening. But while certain other Governing Council hawks over the past couple of days have flagged the case for another 50bps increase, a credible report from Reuters today suggested that the policymakers were “converging on a 25bps rate hike in May, even if other options remain on the table and the debate is not yet settled”. And a 25bps hike next month and again in June remains our baseline expectation.

The week ahead in the euro area

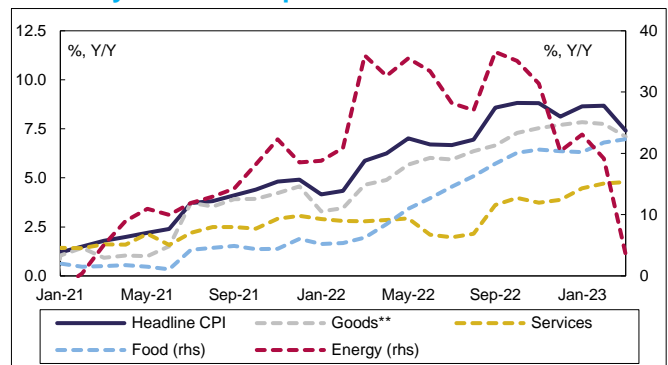
Like today’s German figures, the final estimates of inflation for the euro area as a whole, due on Wednesday, are likely to align with the [initial estimates](#). These reported a drop of 1.6ppts in the headline euro area HICP rate to a 13-month low of 6.9%Y/Y. But the decline was largely due to lower energy prices. And while core goods inflation moderated somewhat, increased pressures in services meant that core inflation (excluding all food and energy) edged up to a new series high of 5.7%Y/Y. As that was 5.65%Y/Y to two decimal places, however, we cannot exclude a downwards revision to the core rate in the final estimate. Ahead of the release of the euro area data, the final estimates of French and Spanish inflation in March will be released tomorrow, with the equivalent data from Italy due Monday.

Perhaps the main euro area data focus in the coming week will be the April economic survey results, most notably the flash PMIs due on Friday 21st. In March, the final euro area services activity PMI index rose 2.3pts to a 10-month high of 55.0, while the manufacturing output PMI rose 0.3pt to 50.4, suggestive of stagnation in the sector but also the best since May 2022. As such, the euro area composite output PMI rose 1.5pts to 53.7, a level consistent with moderate economic growth heading towards Q2. While we expect little change to the output PMIs in April, we expect the price indices to suggest a moderation of input and output inflation pressures in manufacturing and – more importantly perhaps – services. Other April survey results due in the coming week include the Commission’s flash estimate of consumer confidence on Thursday and the ZEW investor sentiment indices on Tuesday.

Euro area: Industrial production












Germany: Consumer price inflation*



The next edition of the Euro wrap-up will be published on 18th April 2023

Daiwa economic forecasts





	2022	2023				2024	2023	2024	2025
		Q4	Q1	Q2	Q3				
GDP		%, Q/Q					%, Y/Y		
Euro area 	0.0	0.1	0.1	0.1	0.2	0.2	0.7	1.0	1.7
UK 	0.1	0.0	0.0	0.1	0.2	0.2	0.2	0.7	0.9
Inflation, %, Y/Y									
Euro area									
Headline HICP 	10.0	8.0	6.1	4.6	2.8	2.7	5.3	2.3	1.7
Core HICP 	5.1	5.5	5.1	4.5	3.7	3.0	4.7	2.4	1.8
UK									
Headline CPI 	10.7	10.0	6.8	5.4	2.9	2.6	6.2	2.1	1.4
Core CPI 	6.4	5.9	5.1	4.2	3.4	3.2	4.6	2.7	1.6
Monetary policy, %									
ECB									
Refi Rate 	2.50	3.50	4.00	4.00	4.00	4.00	4.00	3.25	3.00
Deposit Rate 	2.00	3.00	3.50	3.50	3.50	3.50	3.50	2.75	2.50
BoE									
Bank Rate 	3.50	4.25	4.25	4.25	4.25	4.00	4.25	3.25	2.75

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.










European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area 	Industrial production M/M% (Y/Y%)	Feb	1.5 (2.0)	<u>1.1 (1.4)</u>	0.7 (0.9)	1.0 (-)
Germany 	Final HICP (CPI) Y/Y%	Mar	7.8 (7.4)	7.8 (7.4)	9.3 (8.7)	-
Italy 	Industrial production M/M% (Y/Y%)	Feb	-0.2 (-2.3)	0.5 (-1.6)	-0.7 (1.4)	-0.5 (1.6)
UK 	RICS house price balance %	Mar	-43	-48	-48	-47
	GDP M/M% (3M/3M%)	Feb	0.0 (0.1)	<u>0.1 (-0.1)</u>	0.3 (0.0)	0.4 (0.2)
	Industrial production M/M% (Y/Y%)	Feb	-0.2 (-3.1)	0.2 (-3.7)	-0.3 (-4.3)	-0.5 (-3.2)
	Manufacturing production M/M% (Y/Y%)	Feb	0.0 (-2.4)	0.2 (-4.5)	-0.4 (-5.2)	-0.1 (-2.8)
	Index of services M/M% (3M/3M%)	Feb	-0.1 (0.1)	-0.1 (-0.1)	0.5 (0.0)	0.7 (0.1)
	Construction output M/M% (Y/Y%)	Feb	2.4 (5.7)	1.0 (1.6)	-1.7 (0.6)	- (3.3)
	Total trade balance (goods trade balance) £bn	Feb	-17.5 (-19.0)	-17.0 (-)	-17.9 (-19.3)	-16.1 (-18.7)



Auctions

Country	Auction
Italy 	sold €3.25bn of 3.80% 2026 bonds at an average yield of 3.59%
	 sold €3.75bn of 3.70% 2030 bonds at an average yield of 4.02%
	 sold €1.25bn of 4.00% 2037 bonds at an average yield of 4.42%
	 sold €1.25bn of 4.75% 2044 bonds at an average yield of 4.60%
Spain 	sold €2.51bn of 2.80% 2026 bonds at an average yield of 3.004%
	 sold €2.54bn of 3.15% 2033 bonds at an average yield of 3.401%
	 sold €1.44bn of 1.00% 2042 bonds at an average yield of 3.802%
	 sold €479mn of 0.70% 2033 index-linked bonds at an average yield of 1.055%
UK 	sold £3.25bn of 3.25% 2033 bonds at an average yield of 3.592%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
France 	07.45	Final HICP (CPI) Y/Y%	Mar	<u>6.6 (5.6)</u>	7.3 (6.3)
Spain 	08.00	Final HICP (CPI) Y/Y%	Mar	<u>3.1 (3.3)</u>	6.0 (6.0)




Auctions and events

UK  17.00 BoE's Tenreyro scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast/actual</i>	Previous
Monday 17 April 2023					
Italy 	09.00	Final HICP (CPI) Y/Y%	Mar	<u>8.2 (7.7)</u>	9.8 (9.1)
Tuesday 18 April 2023					
Euro area 	10.00	Trade balance €bn	Feb	-	-11.3
Germany 	10.00	ZEW current assessment (expectations) balance	Apr	-	-46.5 (10.0)
Italy 	09.00	Total trade balance €bn	Feb	-	-4.2
UK 	07.00	Payrolled employees monthly change '000s	Mar	-	98
	07.00	Unemployment claimant count rate % (change '000s)	Mar	-	3.8 (-11.2)
	07.00	Average weekly earnings (excl. bonuses) 3M/Y%	Feb	-	5.7 (6.5)
	07.00	ILO unemployment rate 3M%	Feb	<u>3.7</u>	3.7
	07.00	Employment change 3M/3M '000s	Feb	-	65
Wednesday 19 April 2023					
Euro area 	07.00	EU27 new car registrations Y/Y%	Mar	-	11.5
	09.00	ECB current account balance €bn	Feb	-	17.1
	10.00	Final HICP (core CPI) Y/Y%	Mar	<u>6.9 (5.7)</u>	8.5 (5.6)
	10.00	Construction output M/M% (Y/Y%)	Feb	-	3.9 (0.9)
UK 	07.00	CPI (core CPI) Y/Y%	Mar	<u>9.7 (5.8)</u>	10.4 (6.2)
	07.00	PPI output (input) prices Y/Y%	Mar	-	12.1 (12.7)
	09.30	House price index Y/Y%	Feb	-	6.3
Thursday 20 April 2023					
Euro area 	15.00	European Commission's preliminary consumer confidence	Apr	-	-19.2
Germany 	07.00	PPI Y/Y%	Mar	-	15.8
France 	07.45	INSEE business (manufacturing) confidence	Apr	-	103 (104)
	-	Bank of France retail sales Y/Y%	Mar	-	-4.3
Spain 	09.00	Trade balance €bn	Feb	-	-39.6
Friday 21 April 2023					
Euro area 	09.00	Preliminary manufacturing (services) PMI	Apr	-	47.3 (55.0)
	09.00	Preliminary composite PMI	Apr	-	53.7
Germany 	08.30	Preliminary manufacturing (services) PMI	Apr	-	44.7 (53.7)
	08.30	Preliminary composite PMI	Apr	-	52.6
France 	08.15	Preliminary manufacturing (services) PMI	Apr	-	44.7 (53.7)
	08.15	Preliminary composite PMI	Apr	-	52.6
UK 	00.01	GfK consumer confidence	Apr	-	-36
	07.00	Retail sales incl. auto fuels M/M% (Y/Y%)	Mar	-	1.2 (-3.5)
	07.00	Retail sales excl. auto fuels M/M% (Y/Y%)	Mar	-	1.5 (-3.3)
	09.30	Preliminary manufacturing (services) PMI	Apr	-	47.9 (52.9)
	09.30	Preliminary composite PMI	Apr	-	52.2

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 17 April 2023		
Euro area	-	ECB publishes survey of professional forecasters
	-	EU Commission publishes latest economic forecasts
UK	14.00	BoE Deputy Governor Cunliffe scheduled to speak at the Innovate Finance Global Summit
Tuesday 18 April 2023		
UK	10.00	Auction: £2.25bn of 3.75% 2053 bonds
Wednesday 19 April 2023		
Euro area	17.00	ECB's Schnabel scheduled to speak – 'Monetary policy challenges in times of high inflation'
Germany	10.30	Auction: €4bn of 2.3% 2033 bonds
UK	11.30	Auction: 4.125% 2027 bonds
	17.30	BoE's Mann takes part in a panel discussion – 'Climate policy and monetary policy'
Thursday 20 April 2023		
Euro area	12.30	ECB publishes account of the 15-16 th March monetary policy meeting
France	09.50	Auction: Fixed rate and index-linked bonds
Friday 21 April 2023		
Italy	10.00	Auction: Fixed rate and index-linked bonds




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
- Nothing to report -						

Auctions

Country	Auction
Germany	 sold €818.5mn of 1.25% 2048 bonds at an average yield of 2.33%  sold €1.23bn of 0.00% 2052 bonds at an average yield of 2.31%
UK	 sold £900mn of 0.125% 2039 index-linked bonds at an average yield of 0.334%

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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