

# Euro wrap-up

## Overview

- Bunds made losses while the rise in euro area core inflation in March was confirmed and data also suggested that construction activity provided a boost to euro area GDP in Q1.
- Gilts made much bigger losses as, contrary to expectations, UK CPI inflation remained in double-digits and core inflation failed to fall.
- Thursday will bring the publication of the account of the ECB's March policy meeting as well as updates on euro area consumer confidence and goods trade.

**Chris Scicluna**  
+44 20 7597 8326

**Emily Nicol**  
+44 20 7597 8331

### Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/25	2.960	+0.051
OBL 2.2 04/28	2.556	+0.035
DBR 2.3 02/33	2.504	+0.027
UKT 0% 06/25	3.830	+0.139
UKT 1% 10/28	3.716	+0.130
UKT 3¼ 01/33	3.856	+0.110

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

## Euro area

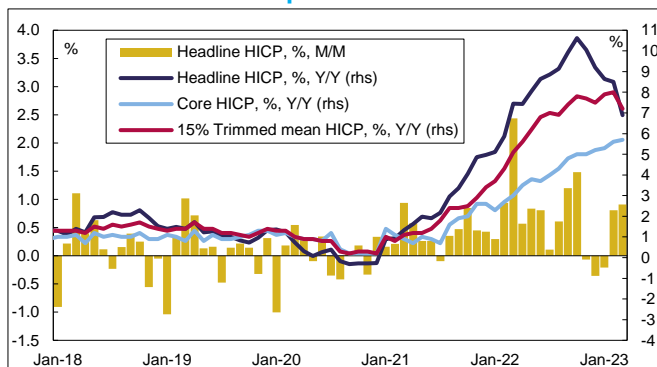
### Headline inflation unrevised at a 13-month low in March due to decline in energy inflation

There were no surprises in the final estimates of euro area consumer price inflation in March. In line with the flash readings, the headline rate moderated for the fifth consecutive month, by 1.6ppts to 6.9%Y/Y, a thirteen-month low. Nevertheless, this left the average inflation rate in Q1 at 8.0%Y/Y, 0.2ppt above the ECB's forecasts published last month. As reported in the preliminary release, the drop principally reflected energy prices and the huge base effect associated with the record jump in prices a year ago following Russia's invasion of Ukraine. Indeed, with prices down more than 2%M/M this March, the annual rate of this component fell more than 14½ppts to record the first negative reading (-0.9%Y/Y) for more than two years. Today's detail confirmed that gas prices fell a further 4%M/M in March to take the cumulative decline since October to more than 22%, while petrol prices fell for the first month in four to leave the year-on-year rate in negative territory (-10.4%) for the first time since early 2021. Meanwhile, the monthly increase in prices of non-energy industrial goods was bang in line with the norm for the month of March. As such, the annual rate of that component also fell for the first time in fourteen months, albeit by a more modest 0.2ppt to 6.6%Y/Y, reflecting not least a moderation in inflation of clothing, furniture and household appliances.

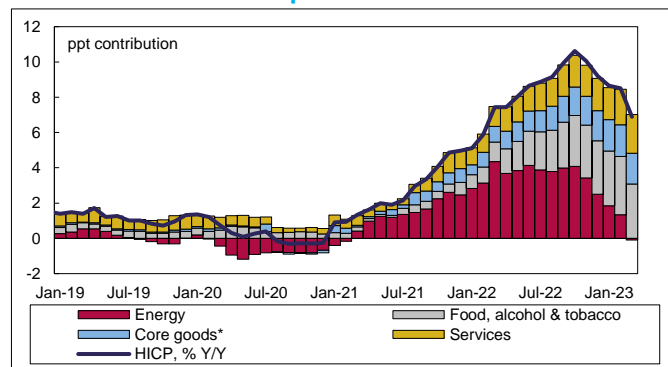
### Services inflation revised higher, but some signs that core inflation may have peaked

Today's release also confirmed that food prices rose at a record monthly pace for the respective month for the eleventh out of the past twelve months, pushing the annual rate of food inflation up 0.4ppt to a new high of 15.4%Y/Y to contribute more than 3ppts to overall inflation. But likely of greater concern for the ECB's Governing Council will be prices of services, with the monthly increase (0.6%M/M) matching the series high for March. This left the annual rate of services inflation up a touch firmer than initially estimated, by 0.3ppt to a new record of 5.1%Y/Y, with inflation of package holidays rising to a five-month high amid stronger demand for tourism. Due to rounding, core inflation (excluding food and energy) was unrevised from the flash estimate at 5.7%Y/Y, nevertheless still a series high. The ECB's super-core measure (which focuses on output-gap sensitive items) also edged slightly higher in March, by 0.1ppt to 6.3%Y/Y. But more encouragingly, the 15% trimmed mean CPI fell sharply, by 0.8ppt to a seven-month low of 7.2%Y/Y. So, we continue to expect March to mark the peak in the main core inflation measure. Admittedly, the downwards trend in underlying inflation will be more gradual than that for headline inflation, with our forecast for the core rate to end the year still above 3½%Y/Y and to only fall to 2% at the end of 2024, while the headline rate is likely to return to target around the middle of next year. As such, while the majority on the Governing Council will likely favour a slowing in the magnitude of rate increase to 25bps next month, we continue to expect a further 25bps rate hike in June too. And should core inflation continue to surprise on the upside, there must be risks of additional tightening thereafter.

### Euro area: Consumer price inflation



### Euro area: Consumer price inflation



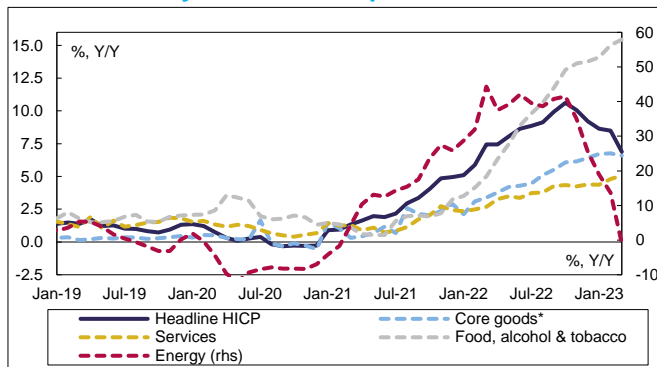
## Construction recovery continues to support GDP growth

In terms of economic activity, contrasting with downbeat surveys which have pointed to a loss of momentum in construction, today's activity data for the sector were broadly consistent with the improvement seen in manufacturing since the start of the year. In particular, benefiting in part from unseasonably mild winter weather, output rose in February for the fifth month out of the past six, by 2.4%M/M. This left it up 2%Y/Y and more than 5½% above the pre-pandemic level in February 2020. Moreover, construction output was trending in the first two months of Q1 almost 3½% above the Q4 average and therefore pointing to a solid contribution to GDP growth last quarter. There was strong growth in both building (2.1%M/M) and civil engineering (2.4%M/M). And most member states saw a pickup, with Germany leading the way, with activity trending so far in Q1 almost 8% above the Q4 average. Despite no growth in February, Italian construction was also trending more than 2½% higher than in Q4, with Spanish activity up almost 1½% on a consistent basis. In contrast, despite rising 1.6%M/M in February, French output was merely flat compared with Q4. Looking ahead, we expect negative payback in March for the strength in February in Germany and the euro area as a whole. And as rising interest rates and falling real estate prices take their toll, we expect construction output to subtract from GDP growth in Q2.

## The day ahead in the euro area

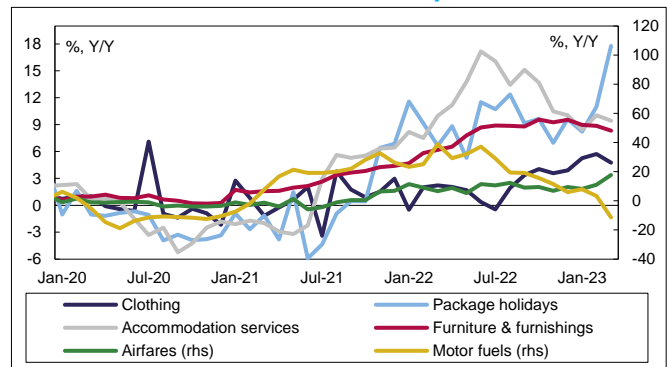
The main focus in the euro area tomorrow will be the publication of the ECB account from the Governing Council's [15-16 March policy-setting meeting](#). Despite renewed turbulence in global financial markets, this meeting saw the Governing Council press ahead with the 50bps rate hike to which it had pre-committed the previous month. President Lagarde noted in her press conference that a smaller rate hike had not been discussed and only three or four members had preferred to pause to await more insight into the impact of the recent tightening of financial conditions. But the Governing Council refrained from offering further guidance on rates. And so, the minutes will be analysed for any further insights into the near-term policy path, and for signs of a possible shift in the balance between the hawks and doves on the Governing Council. In terms of economic data, Thursday will bring the Commission's flash consumer confidence indicator for April, along with the French INSEE business survey for the same month. The postponed euro area goods trade figures for February will also be published, while German PPI and French BoF retail sales numbers for March are also due.

### Euro area: Key inflation components



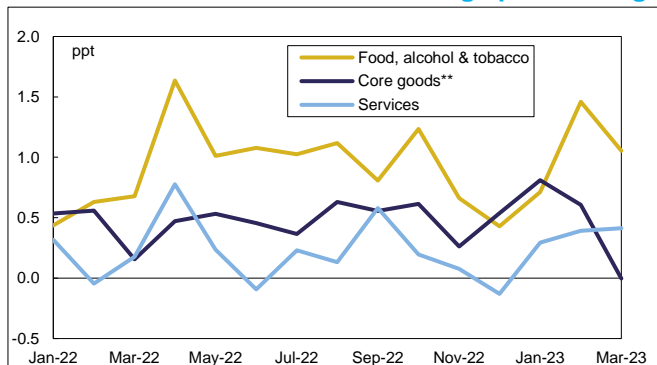
\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Selected inflation components



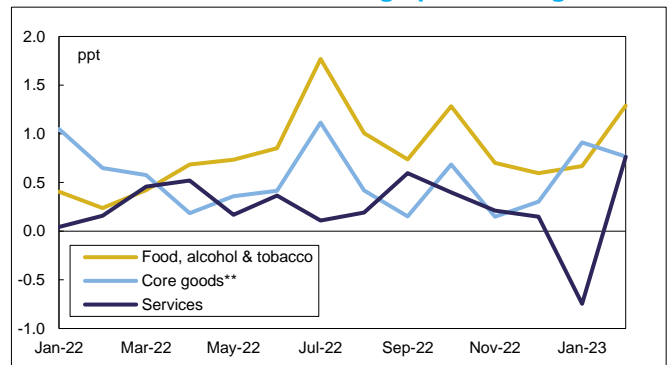
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### 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.

### UK: 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.

## UK

### UK inflation falls less than expected with core inflation sticky

While yesterday's UK [labour market](#) data suggested a slight improvement in the balance between supply and demand in the latest month, seemingly leaving uncertain the outcome of the May MPC meeting, today's consumer price inflation data for March came in well above expectations, making a further 25bps rate hike to 4.5% next month now appear a done deal. Strikingly, the headline CPI rate remained in double digits for the seventh successive month, dropping just 0.3ppt in March to 10.1%Y/Y, 0.3ppt above the median forecast on the Bloomberg survey. This left inflation in Q1 averaging 10.2%Y/Y, 0.5ppt above the BoE's forecast in February's Monetary Policy Report. And importantly, having risen in the prior month, core inflation failed to deliver the expected fall, remaining unchanged at a lofty 6.2%Y/Y. Moreover, the NIESR 10% trimmed mean CPI rose 0.2ppt to a new series high of 9.9%Y/Y.

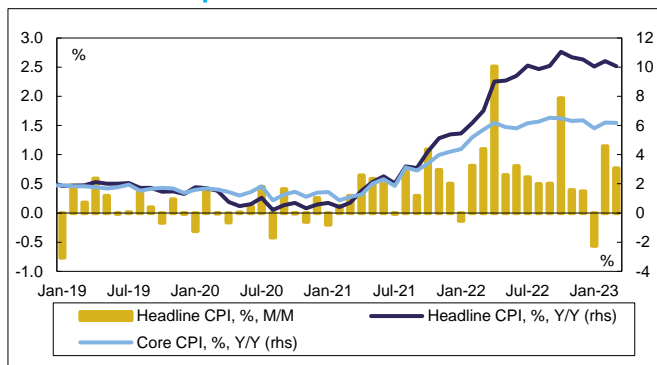
### Persisting pressures in all major components bar energy

Today's data revealed continued significant pressures in every major component of inflation except energy, which moderated 8.5ppts (albeit remaining high above 40%Y/Y) thanks to a further drop in petrol prices. In contrast, increases in a range of items, not least a record rise in bread and cereals, pushed food inflation up a further 0.7ppt to a new series high of 15.0%Y/Y. Clothing prices rose less than a year earlier after a stronger February. And furniture and other household goods inflation also cooled slightly. But, prices of certain other goods, including data processing equipment, added pressure. And the pace of decline of used car prices moderated. As such, overall, prices of non-energy industrial goods rose above the monthly norm for an eighteenth consecutive month, by 0.5%M/M, to leave the respective annual rate unchanged at 5.7%Y/Y. Meanwhile, despite a slight cooling in hospitality, services inflation was also steady at 6.6%Y/Y due to increases in air and rail fares as well as prices of recreation and culture. Excluding airfares, package holidays, education and VAT – a measure currently being closely watched by the BoE – core services inflation also appeared to move sideways at the end of the quarter. Admittedly, that was a somewhat better outcome than had been anticipated by the Bank staff in February. But given the pressures elsewhere, that might be cold comfort for the MPC.

### Inflation to fall back as easing supply-side pressures start to feed through

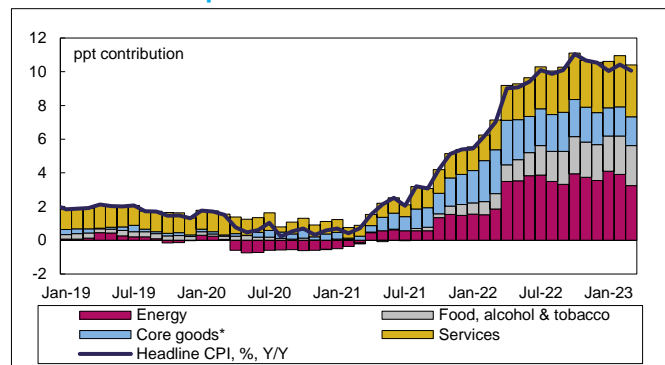
Thankfully, headline inflation will fall sharply in April, probably close to 8%Y/Y, due to a favourable base effect associated with last year's extreme hike in household energy bills. Today's PPI data also flagged the likelihood of a softening of non-energy industrial goods inflation over coming months. Indeed, given easing supply-chain pressures and more favourable

#### UK: Consumer price inflation



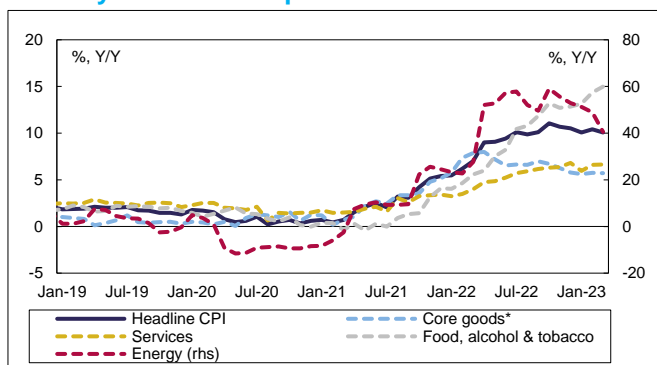
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Consumer price inflation



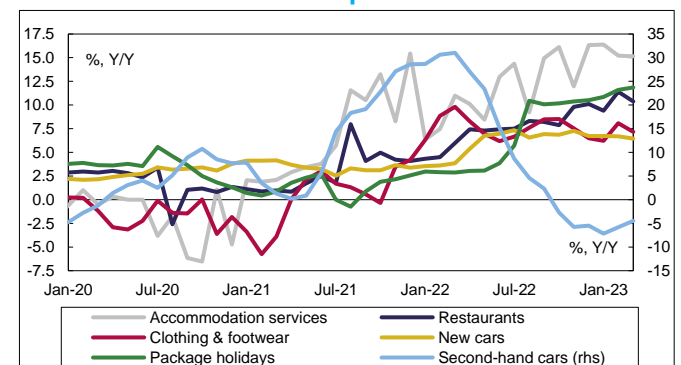
\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Key inflation components\*



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

#### UK: Selected inflation components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

developments in wholesale, producer goods input price inflation slowed more than 5ppts in March to a two-year low of 7.6%Y/Y, while producer output price inflation fell a further 3.3ppts to 8.7%Y/Y, the lowest in eighteen months. In addition, services PPI inflation moderated for a second successive quarter in Q1, by 0.4ppt to 4.9%Y/Y. But while relatively firm wage growth will keep consumer services inflation high for longer than core goods inflation, overall, we expect headline inflation to fall steadily to below 3½%Y/Y by the end of this year and to just below the Bank's 2% target by the middle of next year. We still expect core inflation to follow a downwards trend and to return to 2% by the start of 2025. But the recent persistence raises the risk that next month's interest rate hike won't be the last.








## The day ahead in the UK

Thursday will bring no top-tier UK data for note, while external MPC member Silvana Tenreyro (who leaves the BoE on 4 July) will speak on a panel about the return of inflation.



## European calendar

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 EU27 new car registrations Y/Y%	Mar	<b>28.8</b>	-	11.5	-
	 ECB current account balance €bn	Feb	<b>24.3</b>	-	17.1	18.6
	 Final HICP (core CPI) Y/Y%	Mar	<b>6.9 (5.7)</b>	<u>6.9 (5.7)</u>	8.5 (5.6)	-
	 Construction output M/M% (Y/Y%)	Feb	<b>2.3 (2.3)</b>	-	3.9 (0.9)	3.8 (0.5)
UK	 CPI (core CPI) Y/Y%	Mar	<b>10.1 (6.2)</b>	<u>9.7 (5.8)</u>	10.4 (6.2)	-
	 PPI output (input) prices Y/Y%	Mar	<b>8.7 (7.6)</b>	8.5 (7.0)	12.1 (12.7)	<b>11.9 (12.8)</b>
	 House price index Y/Y%	Feb	<b>5.5</b>	5.1	6.3	<b>6.5</b>

#### Auctions

Country	Auction
Germany	 sold €3.21bn of 2.300% 2033 bonds at an average yield of 2.51%
UK	 sold £3.75bn of 4.125% 2027 bonds at an average yield of 4.039%











Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's releases

#### Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	10.00	Trade balance €bn	Feb	-	-11.3
	15.00	European Commission's preliminary consumer confidence	Apr	-18.5	-19.2
Germany	07.00	PPI Y/Y%	Mar	9.8	15.8
France	07.45	INSEE business (manufacturing) confidence	Apr	103 (103)	103 (104)
	-	Bank of France retail sales Y/Y%	Mar	-	-4.3
Spain	09.00	Trade balance €bn	Feb	-	-39.6

#### Auctions and events

Euro area	 12.30	ECB publishes account of the 15-16 <sup>th</sup> March monetary policy meeting
France	 09.50	Auction: 2.50% 2026 bonds
	 09.50	Auction: 2.75% 2029 bonds
	 09.50	Auction: 2.50% 2026 bonds
	 10.50	Auction: 0.10% 2028 index-linked bonds
	 10.50	Auction: 0.10% 2038 index-linked bonds
Spain	 10.50	Auction: 0.10% 2053 index-linked bonds
	 09.30	Auction: 0.80% 2029 bonds
	 09.30	Auction: 2.70% 2048 bonds
	 09.30	Auction: 3.15% 2033 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are MiFID 2 Professional (or equivalent) Clients and should not therefore be distributed to such Retail Clients. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

#### **Explanatory Document of Unregistered Credit Ratings**

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: <https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>

#### **IMPORTANT**

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Opinions [and/or estimates] reflect a judgment as at the date of publication and are subject to change without notice. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.