Euro wrap-up

Overview

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- Bunds followed USTs higher while euro area core inflation edged lower and the ECB's bank lending survey reported a significant tightening of credit conditions.
- Gilts also made gains as a survey suggested a slight softening of UK shop-price inflation while UK home prices unexpectedly rose for the first time in eight months.
- Ahead of the ECB's monetary policy announcement on Thursday, tomorrow will bring new data on euro area unemployment.

Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	2.602	-0.057
OBL 2.2 04/28	2.238	-0.058
DBR 2.3 02/33	2.254	-0.053
UKT 0⅝ 06/25	3.714	-0.036
UKT 1⅝ 10/28	3.542	-0.049
UKT 3¼ 01/33	3.667	-0.045

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

Euro area

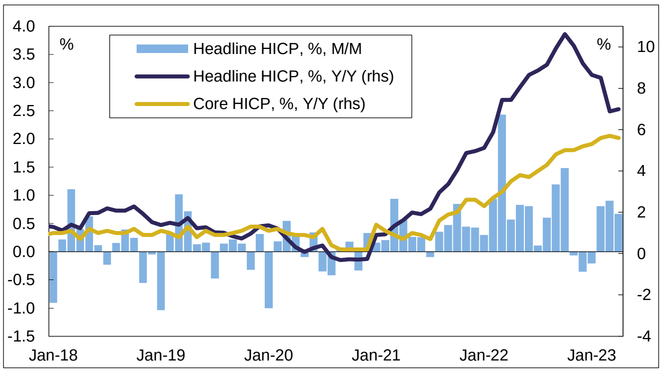
Headline inflation ticks up in April but core rate edges down

After declining in each of the prior five months, euro area consumer price inflation ticked up by 0.1ppt in April to 7.0%Y/Y. That, however, was still 3.6ppts below October's peak. And most importantly perhaps, the core rate (excluding energy and food, alcohol and tobacco) declined for the first time since June, albeit edging down just 0.1ppt from March's series high to 5.6%Y/Y. The detail was decidedly mixed, but the news was relatively favourable with respect to prices of items that had been driven higher over past quarters by supply shocks. Most notably perhaps, prices of unprocessed food fell for the first time since November and by 1.5%M/M, the most since July 2020, to push the respective inflation rate down almost 5ppts to an eleven-month low of 10.0%Y/Y. In addition, while petrol prices rose steadily through the first few weeks of April, overall energy prices fell for the fifth time in the past six months. But the drop of 0.8%M/M was less than in the same month a year earlier, so the annual energy inflation rate returned to moderate positive territory, up 3.4ppts to 2.5%Y/Y. Meanwhile, core goods prices rose on the month only 0.1ppt more than the average for April in the decade ahead of the pandemic. So, the respective inflation rate fell 0.4ppt to a five-month low of 6.2%Y/Y. However, sticky services inflation will remain a concern for the ECB, with the month-on-month increase a record for the third successive month to push the annual rate up a further 0.1ppt to a new series high of 5.2%Y/Y.

Stickiness in services inflation will prompt further ECB rate hike this week

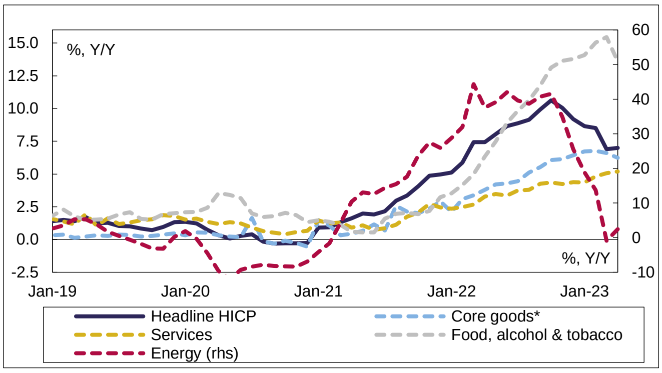
Looking ahead, developments in wholesale markets and base effects strongly suggest that energy and food inflation components will fall steadily over coming months. Survey data – including today's declines in the final April manufacturing input and output price PMIs to the lowest since 2020, as well as evidence of further normalisation in supply chains and an elevated level of inventories to new orders – point to a significant moderation in core goods inflation too. But the momentum in services prices – back up more 1ppt than to 5.8%3M/3M annualised in April – appears robust. Demand seems to be sufficiently strong to allow firms to continue to pass on increased input costs, including higher wages, and maintain or even boost profit margins. And base effects from last year's German transport subsidies will contribute to a likely further increase in services inflation over the summer. So, while we still expect core inflation to fall back over coming months, the hawks on the Governing Council will not yet judge that the peak has been safely passed. They will continue to doubt the ECB's projection that inflation will decline back to the 2% target in 2025. And they will be clear that the sustained decline in core inflation that they need to see to support a halt to the tightening cycle has not yet been achieved. So, the ECB will hike rates again this week and probably again in June.

Euro area: Consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



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

Demand for business loans weakest since GFC, while credit standards tighten further in Q1

While the inflation figures justify a further rate increase at this week's monetary policy meeting, the case for a slowing in the pace of tightening to 25bps was bolstered by today's bank lending releases. These highlighted some of the effects of the ECB's aggressive policy tightening since last summer and, importantly, suggested that the full impact had yet to be felt. Indeed, given increased perceptions of risks with respect to both the economic outlook and firm-specific conditions, as well as banks' lower risk tolerance, the ECB's Q1 Bank Lending Survey (BLS) today reported the steepest tightening of credit standards on loans to non-financial corporations (NFCs) since the euro debt crisis in 2011. And given higher interest rates and weaker investment intentions, banks suggested that net demand for business loans was notably weaker than had been expected three months ago, with the decline the strongest since the global financial crisis in Q408. Admittedly, despite interest rates on new business loans having risen in February to the highest rate (3.85%) for fourteen years, today's monthly lending figures reported a pickup in lending in March, with the net flow of loans to NFCs up for the first month in five and by €5.9bn. But when smoothing for monthly volatility, while lending on a three-month basis returned to positive territory at the end of Q1, at €2.7bn it still represented a significant slowing since last summer, when the flow of business loans peaked at €151bn. Moreover, today's BLS suggested that banks anticipated a further (albeit smaller) weakening in demand over the coming three months too, as well as a further tightening of credit standards on loans to firms.

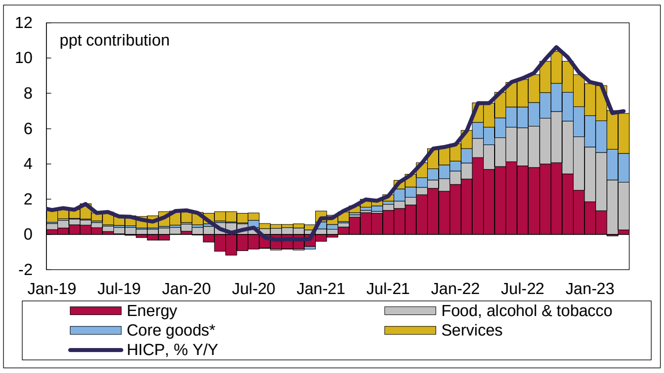
Loans to households continue to trend lower, despite a slight pickup in March

At face value, today's monetary figures also suggested a modest improvement in the flow of consumer credit in March, with the monthly increase (€2.6bn) the strongest for six months. The net flow of loans for house purchase also increased by the most in four months (€8.2bn). But overall, the flow of total lending to households slowed in March, to the softest since January 2016 when excluding the declines in the first two months of the pandemic. And so, on a three-month basis the flow (€21.9bn) was just one quarter of the peak last April and some €15bn weaker than at the end of 2022. This broadly tallied with the message from today's BLS, which due to higher interest rates, a weaker housing market outlook and low consumer confidence, suggested that the net decrease in mortgage lending in Q1 remained close to the sharpest on the survey, which had been recorded in Q4. And with credit standards on housing loans expected to tighten further over the coming three months, banks anticipated a further strong decrease in demand for such lending this quarter.

M1 money supply contracts sharply amid significant outflow from overnight deposits

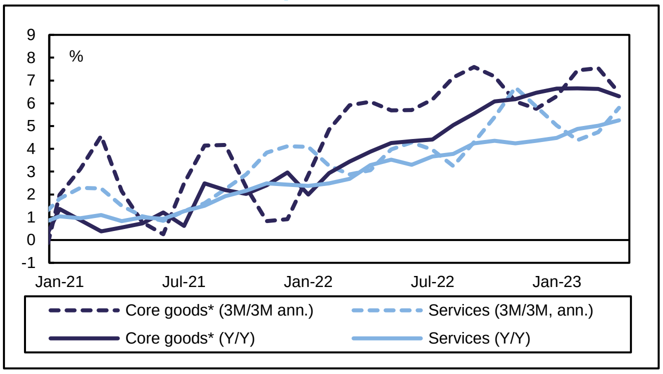
The BLS reported that banks considered that their access to retail and wholesale funding had deteriorated last quarter and would continue to deteriorate in Q2. Access to money and bond markets was arguably impaired by last month's financial

Euro area: Consumer price inflation



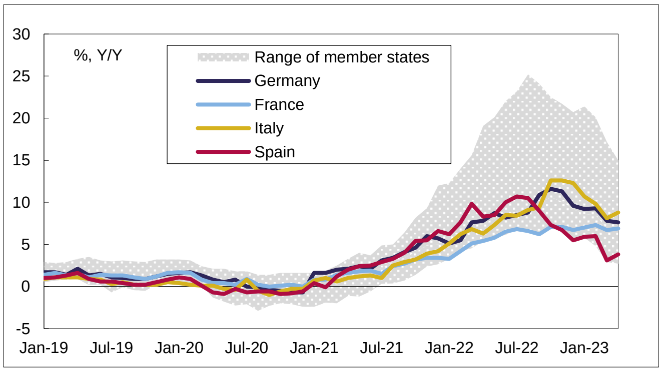
*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



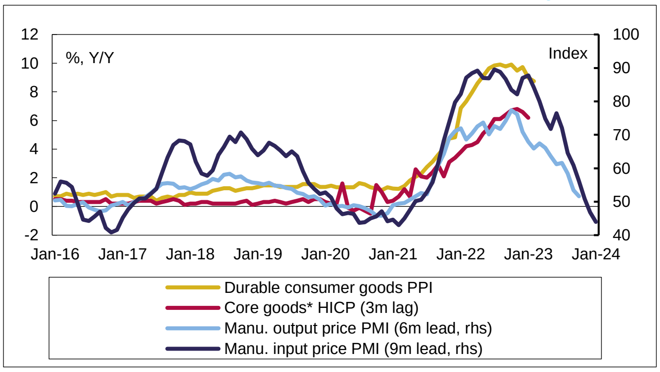
*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area member states: Consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Goods inflation & manufacturing PMIs



*Non-energy industrial goods. Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

market turbulence. And the deterioration in access to retail funding reflected the continued rise in interest rates on bank deposits and alternative savings products. With interest rates on deposits up to the highest since mid-2013, the flow into new household time deposits increased again in March, by a net €46bn to be up 56.6%Y/Y. But there was a significantly larger outflow from overnight deposits, to leave total household deposits down for the second successive month and by a notable €25.2bn, the most since the series began in 2003. Like households, firms also continue to take advantage of higher rates, with another sharp jump in business time deposits, up a whopping 106%Y/Y. However, there was a larger outflow from overnight deposits to leave total deposits placed by NFCs down for a fourth successive month to be up just 1.2%Y/Y, the softest rate in more than a decade. As such, M1 money supply (comprising of currency in circulation and overnight deposits) fell a steeper 4.1%Y/Y in March, the most since the series began in 1981. And M3 money supply growth slowed by a further 0.4ppt to 2.5%Y/Y, the softest pace since 2014.

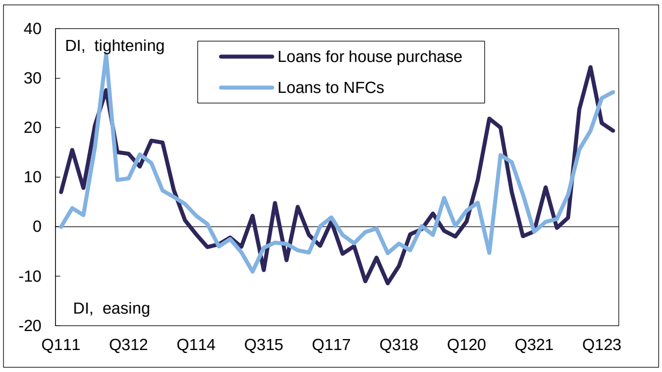
German retail sales disappoint at the end of Q1, with widespread weakness on spending

Separately, Friday's Q1 GDP figures from Germany came in on the soft side, with growth merely flat at the start of the year, and Destatis suggesting that household and government consumption declined. Today's retail sales numbers for March provided a little further colour, confirming very weak spending on goods at the end of the quarter. In particular, sales fell for the second successive month and by a much steeper-than-expected 2.4%M/M. While the drop in February was softer than previously estimated, this still left sales down 1.4%3M/3M and 6.5%Y/Y. Spending on food fell a further 1.1%M/M in March, to be down a whopping 10.3%Y/Y, the most since the start of the series in 1994, illustrating the significant erosion of household purchasing power amid record high food prices. But spending on non-food items also fell sharply (-2.3%M/M), with online and mail order sales down by almost 5%M/M.

The coming two days in the euro area

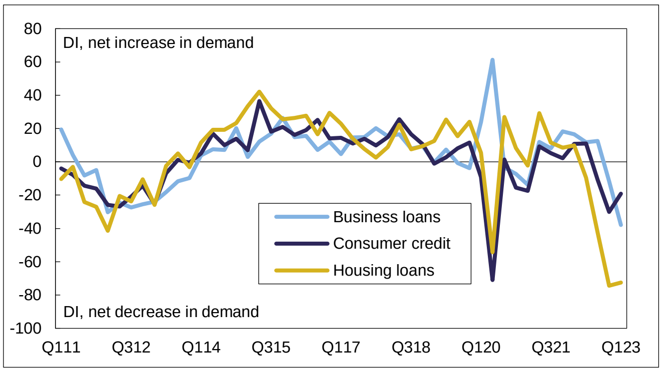
The main event in the euro area over the coming two days will, of course, be the conclusion on Thursday of the ECB's latest monetary policy meeting, the outcome of which is still not clear cut and unlikely to be unanimous. The most hawkish members of the Governing Council might well continue to favour a 50bps hike. However, on balance, today's slight drop in core inflation and evidence of a significant tightening of credit conditions support a slowing in the pace of tightening to 25bps, which would take the deposit rate to 3.25%. If the Governing Council does indeed slow the pace of tightening to 25bps, however, as a compromise, we would expect a signal – either in the policy statement or President Lagarde's press conference – that another rate hike is more likely than not to come in June. And while no decision on QT is likely at the forthcoming meeting, we would also expect a signal that the pace of balance sheet shrinkage might well accelerate from July on. In terms of the dataflow, tomorrow will bring euro area unemployment figures for March, followed on Thursday by PPI

Euro area: Credit standards



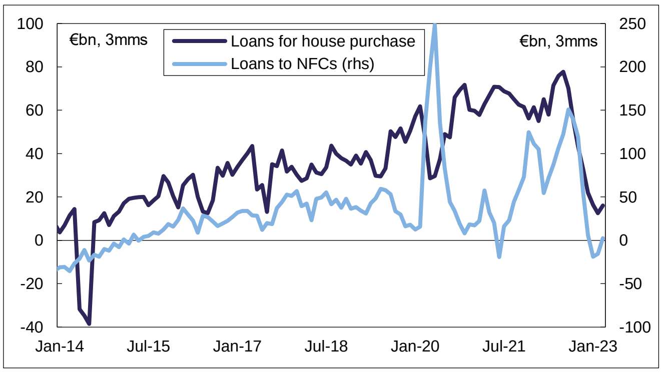
Source: ECB Bank Lending Survey, Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Demand for loans



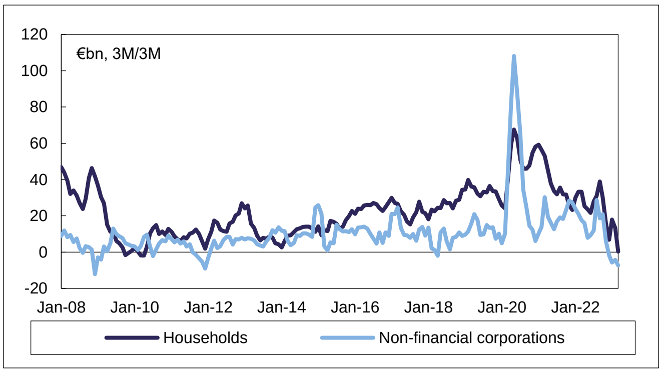
Source: ECB Bank Lending Survey, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Business & house purchase loans



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

Euro area: Household & NFC deposits



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

data for the same month and final services PMIs for April. The euro area unemployment rate is expected to remain unchanged at 6.6% in March for a third successive month, albeit with the risks probably skewed slightly to the upside.

UK

UK shop price inflation stabilises despite record high food inflation

According to the BRC survey, shop price inflation in the UK is likely to have peaked. Indeed, the survey's headline measure of inflation on the UK high street edged slightly lower in April from March's series high on the survey, by 0.1ppt to 8.8%Y/Y. Amid an easing in supply-side pressures and lacklustre domestic demand, the easing principally reflected heavy Spring discounting on clothing and furniture – indeed, non-food inflation moderated 0.4ppt to 5.5%Y/Y. In contrast, and despite a decline in wholesale food costs, fresh food inflation rose to a new record high of 17.8%Y/Y, to leave the survey's measure of overall food inflation up 0.7ppt to 15.7%Y/Y. While food prices should start to moderate over coming months, shop price inflation remains stubbornly high.

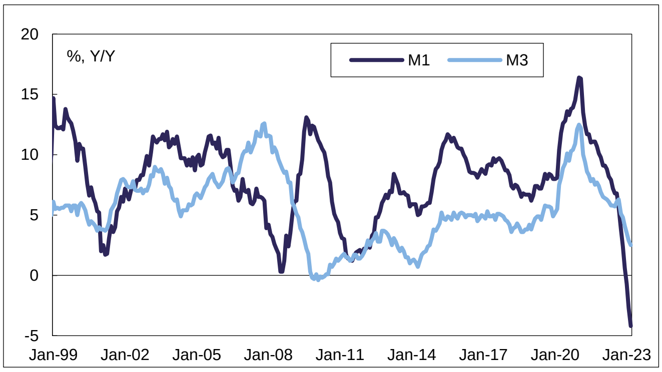
UK house prices rose for the first month in eight in April

Today's Nationwide house price report was somewhat more encouraging than expected, reporting the first increase in house prices in eight months. In particular, prices rose 0.5%M/M in April, which followed a softer than previously estimated drop in March. Admittedly, this still left prices down 2.7%Y/Y and about 4% below the August peak. Prices appear to have been supported by the recent tightness of the labour market, reflected in low unemployment and firm wage growth, as well as a recourse to longer mortgage terms. But with the BoE set to raise interest rates this month (and possibly again in June), more borrowers set to face higher mortgage rates as their previous ultra-low fixes expire, and greater awareness of the vulnerabilities in the commercially-owned residential market, historically weak consumer confidence will continue to act as a headwind on the housing market.

The coming two days in the UK

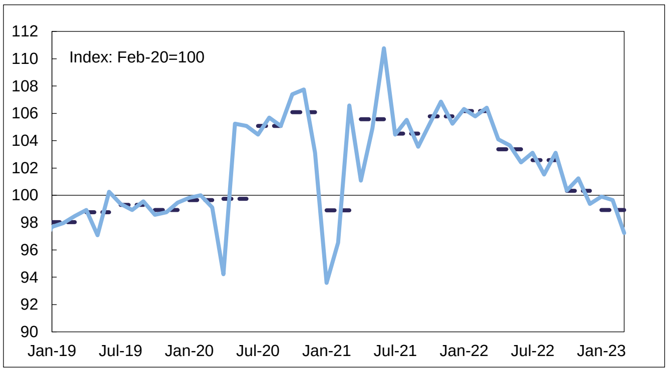
After a day bereft of UK economic data on Wednesday, Thursday will bring the latest bank lending numbers for March, which are likely to flag the negative impact from the ongoing tightening in financial conditions, with consumer credit and mortgage lending expected to be relatively subdued compared with the past year or so. This notwithstanding, mortgage approvals are expected to have ticked slightly up to the highest for five months. The latest new car registrations figures and final services

Euro area: M1 & M3 money supply



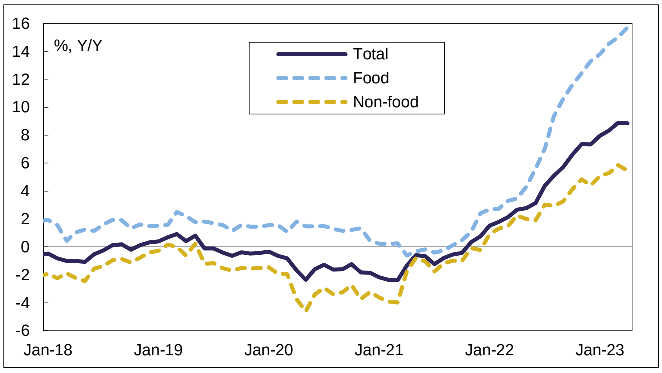
Source: ECB and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales*



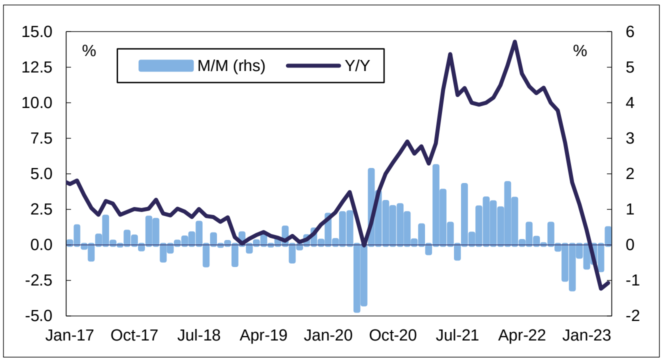
**Dark blue dashed line represents quarterly averages. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

UK: Shop price inflation



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

UK: Nationwide house prices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

PMIs for April are also due that day, while the BoE's results from the latest Decision Maker Panel will be of interest ahead of next week's MPC policy decision.

The next edition of the Euro wrap-up will be published on 4 May 2023

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	M3 money supply Y/Y%	Mar	**2.5**	2.4	2.9	-
	Final manufacturing PMI	Apr	**45.8**	45.5	47.3	-
	Preliminary HICP (core HICP) Y/Y%	Apr	**7.0 (5.6)**	7.0 (5.7)	6.9 (5.7)	-
Germany	Final manufacturing PMI	Apr	**44.5**	44.0	44.7	-
	Retail sales M/M% (Y/Y%)	Mar	**-2.4 (-6.5)**	0.4 (-6.5)	-1.3 (-7.0)	**-0.3 (-5.8)**
France	Final manufacturing PMI	Apr	**45.6**	45.5	47.3	-
Italy	Manufacturing PMI	Apr	**46.8**	49.6	51.1	-
	Preliminary HICP (CPI) Y/Y%	Apr	**8.8 (8.3)**	8.0 (-)	8.1 (7.6)	-
	PPI Y/Y%	Mar	**3.0**	-	10.0	
Spain	Manufacturing PMI	Apr	**49.0**	49.9	51.3	-
UK	BRC shop price index Y/Y%	Apr	**8.8**	-	8.9	-
	Nationwide house price index M/M% (Y/Y%)	Apr	**0.5 (-2.7)**	-0.4 (-3.6)	-0.8 (-3.1)	**-0.7 (-)**
	Final manufacturing PMI	Apr	**47.8**	46.6	47.9	-

Auctions

Country	Auction
Germany	sold €410mn of 0.1% 2033 index-linked bonds at an average yield of -0.04%

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	Unemployment rate %	Mar	6.6	6.6

Auctions and events

Country	BST	Event
Germany	10.30	Auction: €3bn of 2.1% 2029 bonds
UK	10.00	Auction: £4.0bn of 3.5% 2025 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data					
Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	09.00	Final services (composite) PMI	Apr	*56.6 (54.4)*	55.0 (53.7)
	10.00	PPI Y/Y%	Mar	5.7	13.2
	13.15	ECB Deposit (Refi) Rate %	May	*3.25 (3.75)*	3.00 (3.50)
Germany	07.00	Trade balance €bn	Mar	16.0	16.1
	08.55	Final services (composite) PMI	Apr	*55.7 (53.9)*	53.7 (52.6)
France	08.50	Final services (composite) PMI	Apr	*56.3 (53.8)*	53.9 (52.7)
Italy	08.45	Services (composite) PMI	Apr	57.0 (53.8)	55.7 (55.2)
Spain	08.00	Unemployment change 000s	Apr	-	-48.8
	08.15	Services (composite) PMI	Apr	59.3 (58.1)	59.4 (58.2)
UK	09.00	New car registrations Y/Y%	Apr	-	18.2
	09.30	Final services (composite) PMI	Apr	*54.9 (53.9)*	52.9 (52.2)
	09.30	Net consumer credit £bn (Y/Y%)	Mar	1.3 (-)	1.4 (7.7)
	09.30	Net mortgage lending £bn (approvals '000s)	Mar	1.6 (46.0)	0.7 (43.5)
	09.30	M4 money supply M/M% (Y/Y%)	Mar	-	-0.4 (1.0)
Auctions and events					
Euro area	13:15	ECB monetary policy announcement			
	13.45	ECB President Lagarde holds press conference following the Governing Council meeting			
France	09.50	Auction: 3.00% 2033 bonds			
	09.50	Auction: 1.75% 2039 bonds			
	09.50	Auction: 3.00% 2054 bonds			
	09.50	Auction: 0.50% 2072 bonds			
Spain	09.30	Auction: 2.80% 2026 bonds			
	09.30	Auction: 1.20% 2040 bonds			
	09.30	Auction: 0.00% 2028 bonds			
	09.30	Auction: 0.65% 2027 index-linked bonds			
UK	09.30	BoE publishes April Decision Maker Panel data			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs