Daiwa Capital Markets

Euro wrap-up

Overview

- Bunds followed USTs lower as German core HICP inflation edged slightly higher in February, while headline inflation fell further on lower food inflation.
- Gilts made gains amid signs of a less tight UK labour market, with unemployment and redundancies up, employment and job vacancies down, and wage growth softer too.
- Wednesday will bring January figures for UK GDP and euro area industrial production.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.838	+0.042
OBL 2.1 04/29	2.505	+0.032
DBR 2.2 02/34	2.322	+0.022
UKT 0⅛ 01/26	4.182	-0.036
UKT 0½ 01/29	3.854	-0.034
UKT 4⅝ 01/34	3.935	-0.034

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

Euro area

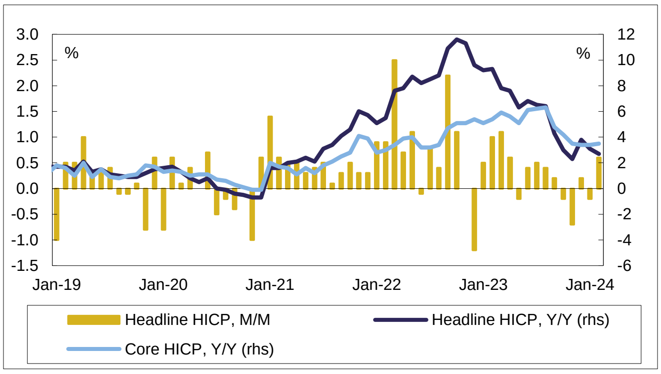
German inflation eases on lower food inflation, but core HICP inflation edged slightly higher

There were no surprises from today's final German inflation figures for February, which confirmed the flash estimates that saw the national CPI rate decline 0.4ppt to 2.5%Y/Y, its lowest since June 2021. The EU-harmonised HICP rate similarly fell 0.4ppt to 2.7%Y/Y, although due to the different treatment of package tour prices, this remained 0.4ppt above November's rate. Within the detail on the HICP measure, the drop in February principally reflected food prices, which fell for the first month in six and left the respective annual inflation rate down a sizeable 3.0ppts to 1.4%Y/Y, the softest since June 2021 and some 21ppts below last year's peak. In contrast, the drag from energy deflation eased slightly in February (by 0.4ppt to -2.6%Y/Y), as prices rose for a second successive month reflecting higher petrol costs, which rose the most in five months (1.7%M/M). Within the core components, reflecting persisting weakness in demand and declining producer prices, inflation of furniture eased to its lowest level since mid-2021. But there was also a rebound in clothing inflation following heavy discounting at the start of the year. So, this saw core goods inflation tick slightly higher, by 0.2ppt to 3.0%Y/Y. Meanwhile, services HICP inflation reversed only part of the jump in January, easing 0.1ppt to 3.7%Y/Y, as higher insurance premiums and catering costs offset a drop in accommodation inflation to a more than two-year low and the persisting drag from transport services related to the discounted travel pass. Overall, core HICP inflation rose 0.1ppt to 3.5%Y/Y. And while this still remains some 2.8ppts below last summer's peak, the above-average rise in core prices last month (0.8%M/M) might sustain the concerns of the more hawkish members on the Governing Council of stickiness in services inflation. Nevertheless, given the weakness of demand as well as the recent slowdown in wage growth, we continue to expect core German inflation to resume a downwards trend this month.

The day ahead in the euro area

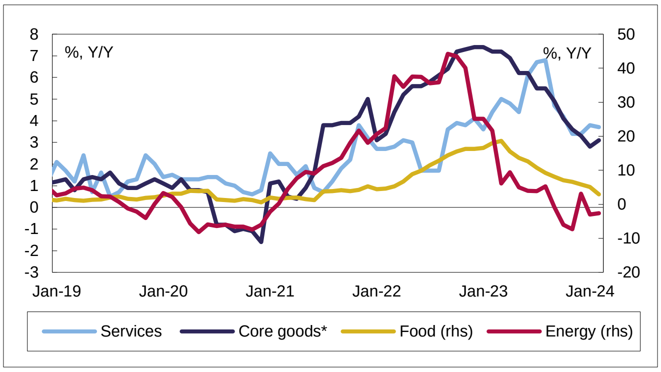
Tomorrow will bring euro area industrial production figures for January. The data published by the member states have been mixed. While there was upside surprise to German production (1.0%M/M), there were also declines in France (-1.1%M/M), the Netherlands (-4.7%M/M) and Ireland (-28.9%M/M). So, based on the member state figures published so far, this would imply a drop in aggregate euro area IP of almost 2%M/M in January. But it is worth noting that December saw a marked discrepancy between the Eurostat euro area figure (+2.6%M/M) and that implied by national figures (+1.7%M/M), so the forecast is more uncertain than normal.

Germany: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Key HICP inflation components



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

UK

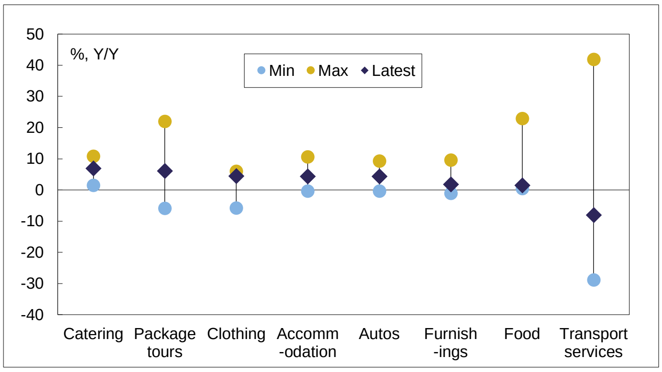
Signs that UK labour market is becoming gradually less tight

With economic activity weak, the UK's labour market appears to be becoming gradually less tight. Admittedly, the resumption of the Labour Force Survey (LFS) last month saw the unemployment rate decline for a fifth consecutive month in the three months to December, to 3.8%, just 0.2ppt above the series low recorded in August 2022 and some 0.5ppt below the BoE's previous forecast for Q4. But that BoE projection was based on the ONS' experimental data rather than the updated LFS series. Moreover, today's numbers saw the unemployment rate tick slightly higher in the three months to January, by 0.1ppt to 3.9%. And the pickup would have been greater in the absence of the further increase in economic inactivity as the number of people in education rose. While inactivity due to long-term sickness fell for the first time in seven months and by the most since the start of 2021, this was still up roughly 85k over the past year and a whopping 630k more than before the pandemic in part likely reflecting the near-doubling in NHS waiting lists during this period.

Employment and job vacancies declining with redundancies on the rise

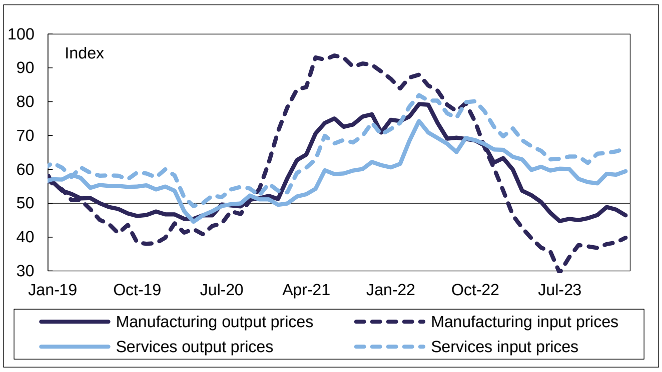
Today's figures also confirmed the first quarterly drop in the LFS measure of employment (-21k) in four months. And while this left the employment rate broadly unchanged for a fourth month at 75.0%, this was still some 1.2ppts below the pre-pandemic level. Admittedly, the fall in the number of people in employment in the three months to January reflected a seventh successive decline in part-timers (-220k). That more than offset a further rise in full-time employment (+199k), which was still some 435k above the February 2020 benchmark. And there remains some uncertainty regarding the true picture due to the low survey responses up to December last year. But while other measures of employment growth – including workforce jobs and the HMRC payrolled employees – remain considerably higher than before the pandemic, there are signs that growth is slowing. Certainly, the initial estimates for payrolled employees in February reported the softest annual growth (1.2%Y/Y) since June 2021. Meanwhile, the number of jobless claims rose last month for a fourth successive month (16.8k). Moreover, tallying with the ongoing decline in demand for permanent placements flagged by the REC report on jobs, the number of vacancies fell a further 43k in the three months to February for the 20th successive month to 908k, the lowest since June 2021 and within 100k of the average level in the year before the pandemic. And with the number of redundancies having also jumped at the start of the year – by 133k in the three months to January, the most since March 2021 – we expect unemployment to rise further over coming months, consistent with the ongoing rise in candidate availability flagged in the REC survey.

Germany: Selected HICP inflation components*



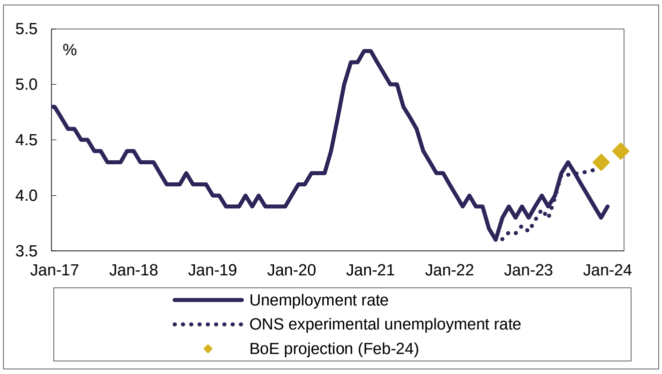
*Data range since the start of the pandemic. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Price PMIs



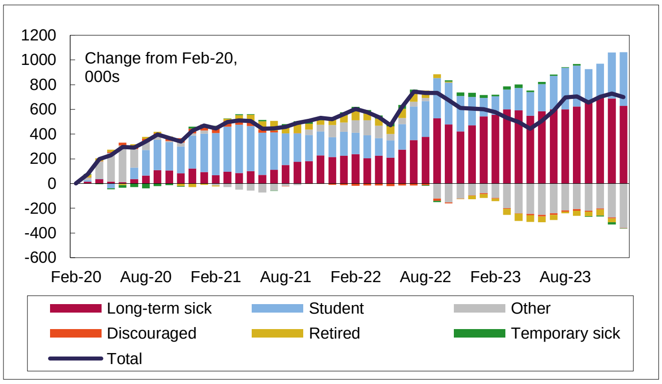
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Unemployment rate*



*BoE forecast based on ONS experimental unemployment rate. Source: BoE, ONS, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Reasons for inactivity

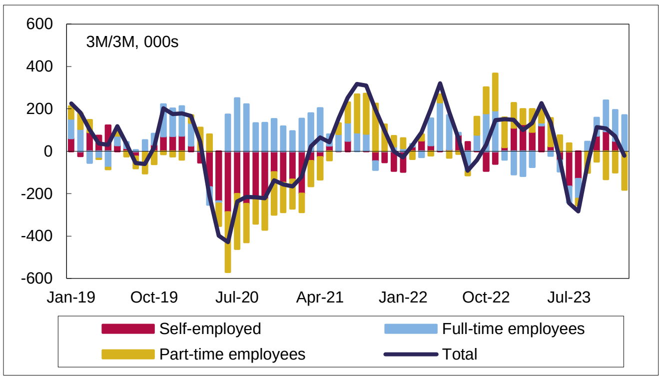


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

But wage growth remains too high for BoE comfort despite easing momentum

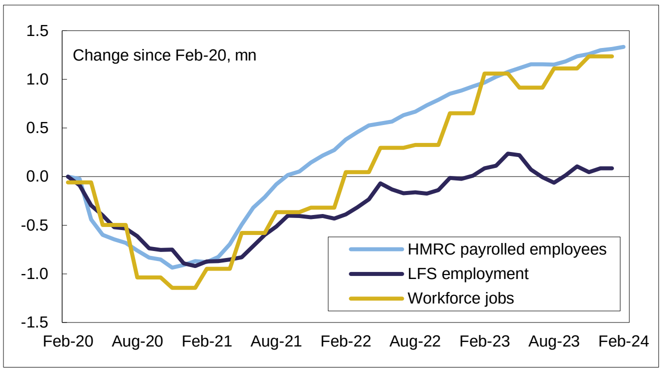
Given the ongoing rebalancing of labour demand and supply, today's figures also illustrated an ongoing, albeit gradual, easing in pay pressures. Indeed, having taken a step down at the end of last year, total wage growth fell a further 0.2ppt in January to 5.6%3M/Y, the softest for eighteen months and almost 3ppts below the peak six months ago, with regular pay growth also edging slightly lower to a fifteen-month low of 6.1%3M/Y. Regular private sector pay growth – of particular interest to BoE policymakers in their assessments of domestically-driven inflationary pressures – also moderated 0.1ppt to 6.1%3M/Y, the softest for eighteen months. The drop in single-month growth at the start of the year was more convincing too, with private sector regular pay down 0.4ppt to 5.8%Y/Y, with equivalent growth in the services sector down 0.3ppt to 6.0%Y/Y, the lowest since August 2022. While that is broadly consistent with the BoE's forecasts in its February MPR, it will nevertheless still be too high for comfort for the majority on the MPC. This notwithstanding, recent wage momentum points to the likelihood of ongoing moderation in pay growth over coming months. In particular, despite ticking higher in January (up 1.3ppt to 3.5%3M/3M annualised), regular wage growth on a three-month annualised basis has averaged just 3.2% over the past four months, with private sector pay averaging 3%, roughly 6ppts and 7ppts below the respective summer peaks and broadly consistent with achievement of the inflation target over the medium term.

UK: Employment



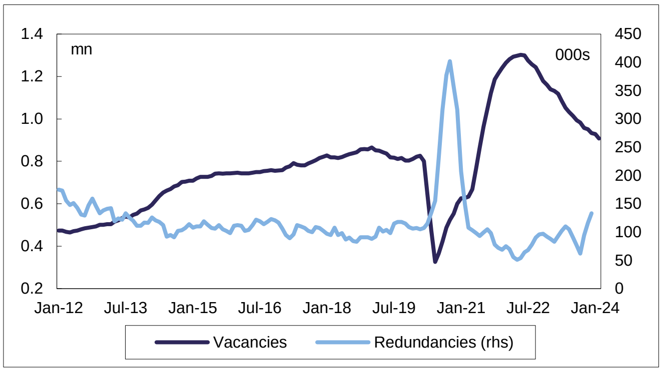
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measures of employment



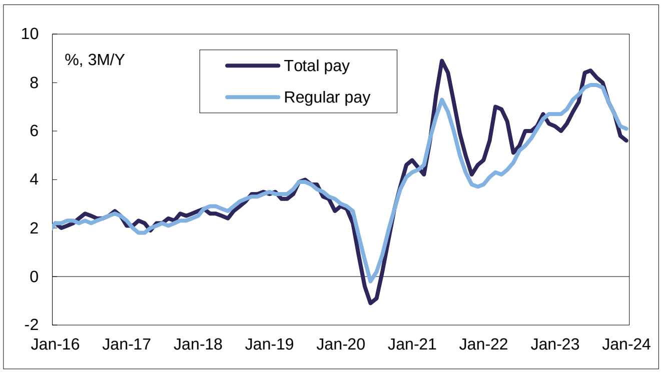
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Vacancies & redundancies



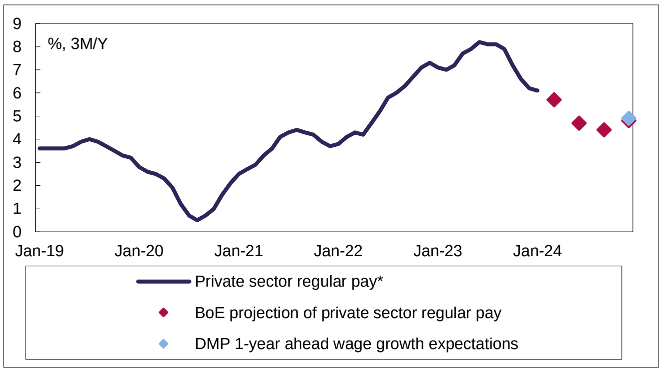
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Wage growth



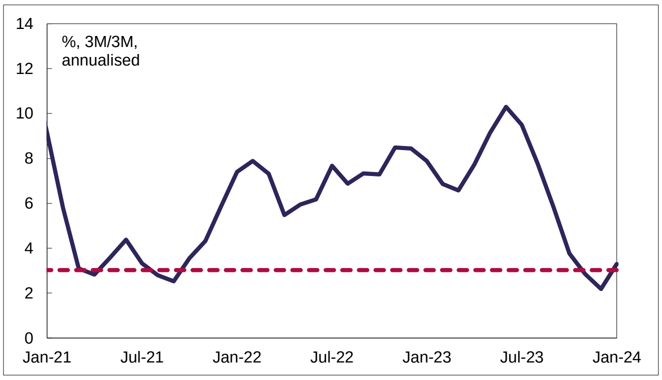
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Wage growth & forecasts



**Data between January 2020 and November 2022 are BoE staff estimates of underlying private sector regular pay growth. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Private sector regular growth*



**Dashed red line is 20-year average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

The day ahead in the UK

Tomorrow will bring monthly GDP figures for January, along with the usual activity breakdown for the services, manufacturing and construction sectors, as well as trade. Surveys such as the PMIs signalled a pickup in recovery momentum at the start of the year, with the composite index up to an eight-month high (53.0). Admittedly, the PMIs had implied stagnation in Q4 compared with the actual contraction in GDP of 0.3%Q/Q. And an increase in strike action that month – with more than 200k working days lost, almost double those in December and the most since September – likely provided a drag on the healthcare and transport services subsectors. Nevertheless, retail sales rebounded vigorously at the start of the year (3.4%M/M). And overall, we expect GDP to have posted a modest rise in January, reversing the 0.1%M/M decline in December, but nevertheless suggesting still lacklustre momentum.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Final HICP (CPI) Y/Y%	Feb	**2.7 (2.5)**	*2.7 (2.5)*	3.1 (2.9)	-
UK	Unemployment claimant count rate % (change '000s)	Feb	**4.0 (16.8)**	-	4.0 (14.1)	- (3.1)
	Average weekly earnings (excluding bonuses) 3M/Y%	Jan	**5.6 (6.1)**	5.7 (6.1)	5.8 (6.2)	-
	ILO unemployment rate 3M%	Jan	**3.9**	3.8	3.8	-
	Employment change 3M/3M 000s	Jan	**-21**	10	72	-
	Payrolled employees M/M 000s	Feb	**20**	25	48	15

Auctions

Country	Auction
Germany	sold €3.65bn of 2.5% 2026 bonds at an average yield of 2.8%
UK	sold £3.75bn of 4.625% 2034 bonds at an average yield of 3.927%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Spain	Retail sales Y/Y%	Jan	**0.3**	3.0	3.1	2.7

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		10.00	Industrial production M/M% (Y/Y%)	Jan	*-1.7 (-2.8)*	2.6 (1.2)
UK		07.00	GDP M/M% (3M/3M%)	Jan	*0.1 (-0.1)*	-0.1 (-0.2)
		07.00	Industrial production M/M% (Y/Y%)	Jan	0.0 (0.7)	0.6 (0.6)
		07.00	Manufacturing production M/M% (Y/Y%)	Jan	0.1 (2.0)	0.8 (2.3)
		07.00	Index of services M/M% (3M/3M%)	Jan	0.2 (0.0)	-0.1 (-0.2)
		07.00	Construction output M/M% (Y/Y%)	Jan	-0.1 (-0.5)	-0.5 (-3.2)
		07.00	Trade (goods) balance £bn	Jan	-3.1 (-15.1)	-2.6 (-14.0)

Auctions and events

Germany		10.30	Auction: €4.5bn of 2.2% 2034 bonds
Italy		10.00	Auction: €3.0bn of 2.95% 2027 bonds
		10.00	Auction: €3.0bn of 3.5% 2031 bonds
		10.00	Auction: €1.25bn of 4.0% 2031 bonds
		10.00	Auction: €1.25bn of 3.25% 2038 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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