Daiwa Capital Markets

Euro wrap-up

Overview

- Longer-dated Bunds followed USTs lower even as German inflation fell more than expected in March, with the core CPI rate down to a two-year low.
- Despite a marked slowdown in a survey measure of UK shop price inflation, Gilts also made sizable losses in line with the global trend as UK mortgage approvals rose the most since September 2022.
- Tomorrow will bring the flash March estimates of euro area inflation, along with the latest unemployment figures.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.839	-0.004
OBL 2.1 04/29	2.389	+0.070
DBR 2.2 02/34	2.408	+0.112
UKT 0⅛ 01/26	4.230	+0.076
UKT 0½ 01/29	3.944	+0.126
UKT 4⅝ 01/34	4.092	+0.161

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

Euro area

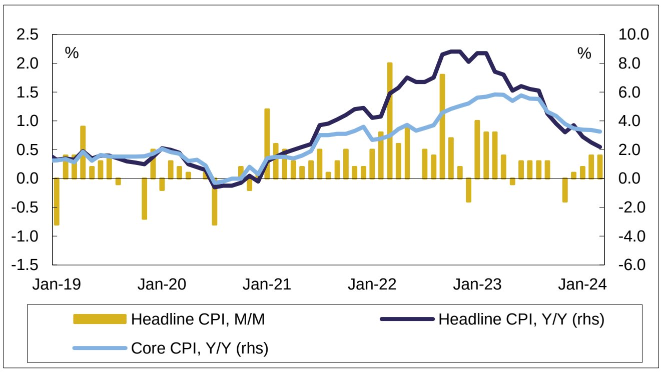
German inflation falls more than expected despite uptick in services

Ahead of tomorrow's flash estimate of euro area inflation in March, figures published so far by the member states, including today's numbers from Germany, strongly suggest a further moderation in headline inflation this month, and a further easing in underlying price pressures too. In particular, German consumer price inflation fell for a third consecutive month in March, with the EU-harmonised HICP rate down a larger-than-expected 0.4ppt to 2.3%Y/Y, to match November's 29-month low. Moreover, the decline in the national CPI rate, by 0.3ppt to 2.1%Y/Y, left it at its lowest since April 2021. Within the detail on the German national measure, the drop in March again reflected food prices, which fell for the second month out of the past seven, and left the annual inflation rate in negative territory (-0.7%Y/Y) for the first time since early 2015 and 23ppts below the peak a year ago. And with prices declining for the first month in three, the energy component was a drag on the headline rate for a fifth month out of the past six. Within the core components, inflation of core goods – according to our calculation – fell a marked 0.7ppt to 2.4%Y/Y the lowest since May 2022, as persisting weak demand and subdued global goods prices pressures continued to limit pricing power. More disappointingly, services prices rose by the most (0.8%M/M) in any March since re-unification, to leave inflation up 0.3ppt to a five-month high of 3.7%Y/Y. Admittedly, the regional releases suggest that the uptick reflected higher restaurant, hotel and transport services inflation, likely due to the earlier timing of Easter this year. Moreover, this still left core inflation down 0.1ppt to 3.3%Y/Y in March, the lowest for two years. And with the monthly increase in core prices bang in line with the long-run average, and services likely to resume a downwards trend this month, we expect the disinflationary trend in core inflation to continue next month.

French inflation eases to lowest since summer 2021, with broad-based easing in price pressures

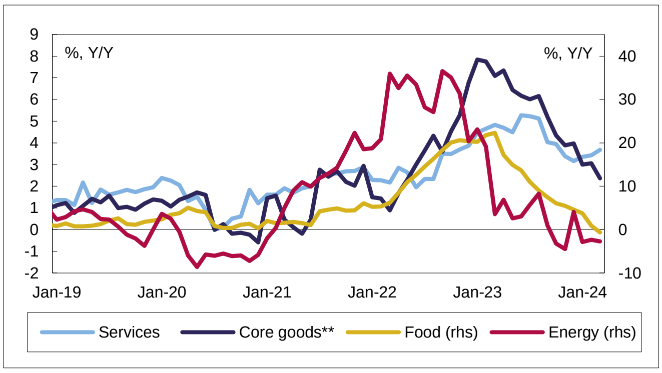
French inflation also surprised to the downside in March, with consumer prices – on an EU-harmonised basis – rising at just half the normal pace for the time of year (0.3%M/M). This left the headline HICP rate down for a fifth month out of the past six and by a sizeable 0.8ppt to 2.4%Y/Y, the lowest since August 2021 and more than 5ppts below the peak in February 2022. The national measure of headline inflation also fell 0.7ppt to 2.3%Y/Y, the lowest since September 2021, with the limited detail provided with the preliminary release suggesting a widespread easing in price pressures. Not least due to base effects, food inflation maintained a steady disinflationary trend, easing a further 1.9ppts to 1.7%Y/Y, the lowest since the start of 2022 and more than 14ppts below the peak a year ago. Energy inflation also edged to a three-month low (down 1ppt to 3.4%Y/Y). But the core components were also better behaved, with services prices unchanged in March compared with an average increase of 0.2%M/M for that month in the decade before the pandemic. As such, services inflation resumed a modest downwards trend for the first month in four, by 0.1ppt to 3.0%Y/Y, albeit remaining 0.2ppt above November's 20-

Germany: Consumer price inflation*



National measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Key CPI components*



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

month low. But with manufacturing goods inflation down to just 0.1%Y/Y – the softest since July 2021 – today's release suggests that core inflation eased to its lowest rate since January 2022.

Italian inflation ticks higher, but underlying inflation fell to a two-year low

In contrast to the downtrend in Germany and France, Italian inflation edged higher in March. But the ½ppt increase was smaller than expected and took the EU-harmonised HICP rate to just 1.3%Y/Y, still one of the softest of the member states. The upwards impulse principally reflected base effects in the energy component, with the annual rate of decline moderating 6½ppts to -10.9%Y/Y. In contrast, food inflation eased to a 27-month low of 3.1%Y/Y. And while services inflation ticked slightly higher, by 0.2ppt to a three-month high of 3.3%Y/Y – as transport services were likely impacted by the timing of the Easter period this year – non-energy industrial goods inflation fell to just 0.8%Y/Y, the lowest since January 2022. As such, the core HICP rate fell 0.4ppt to 2.2%Y/Y, the lowest for two years. While Spanish inflation also moved slightly higher in March, this was also by less than expected. And despite other smaller member states also ticking higher, overall, we now expect tomorrow's estimate of aggregate euro area inflation to have maintained a modest downtrend in March, by 0.1ppt to 2.5%Y/Y. This would still leave it 0.1ppt above November's low. But core inflation is likely to have slipped back below 3%Y/Y for the first time since March 2022.

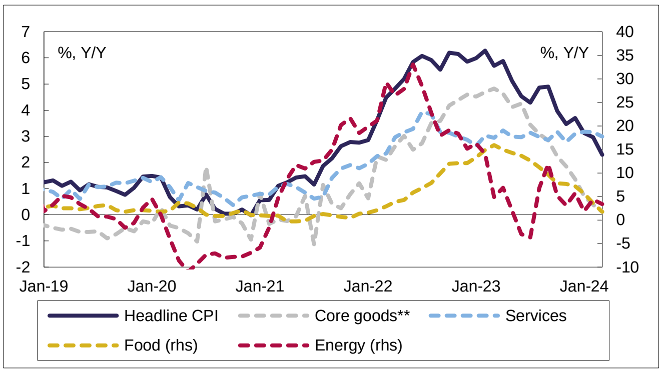
ECB survey suggests households more optimistic about near-term inflation outlook

In terms of the inflation outlook, the results from today's ECB consumer survey were somewhat mixed. Households were again more optimistic about the outlook for inflation in the coming twelve months, with the median forecast dropping 0.2ppt to 3.1%Y/Y in February, the lowest since February 2022. Indeed, while consumer inflation expectations in Italy rose and in France moved sideways, there were declines in Germany (down 0.3ppt to 3.0%Y/Y) and Spain (down 0.2ppt to 3.3%Y/Y). But what matters more for the ECB's monetary policy decision is inflation expectations over the medium term. And in this respect the survey was somewhat less encouraging, with the median forecast for three years ahead merely moving sideways for a third consecutive month at an above-target 2.5%Y/Y. This nevertheless was still some 0.6ppt below the peak in September 2022. Moreover, it partly reflected a pickup in Italy (up 0.4ppt to 2.9%Y/Y), while equivalent rates in Germany (2.3%Y/Y) and France (2.2%Y/Y) were closer to the ECB's inflation target.

The day ahead in the euro area

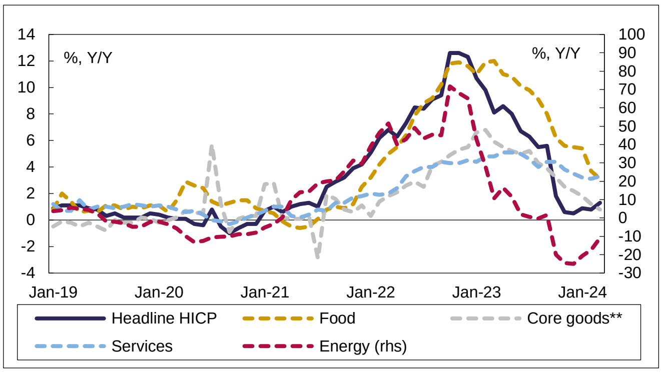
The main focus tomorrow will be the aforementioned aggregate euro area flash inflation estimates for March. Due to base effects associated with the withdrawal of various government support measures as well the relatively earlier timing of Easter

France: Consumer price inflation*



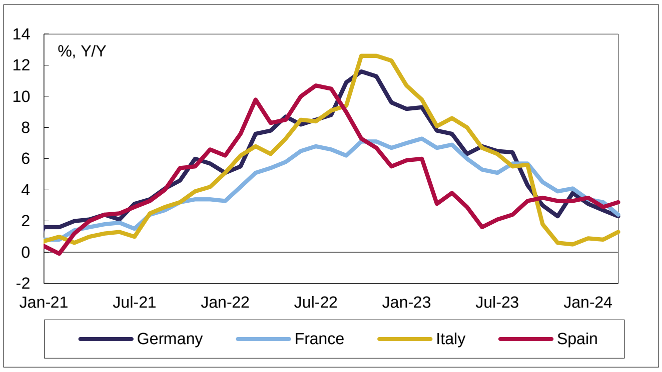
*National measure. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: Consumer price inflation*



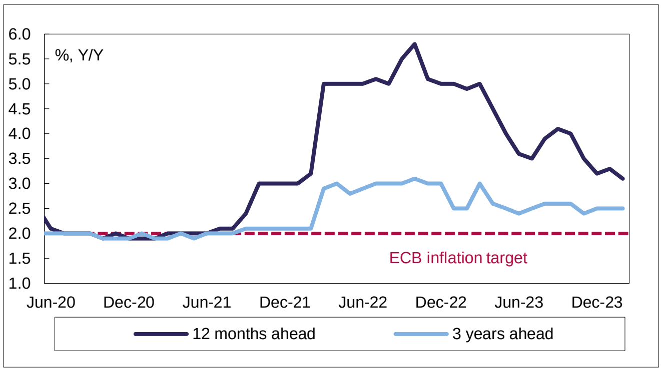
*EU-harmonised measure. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Headline HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price expectations



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

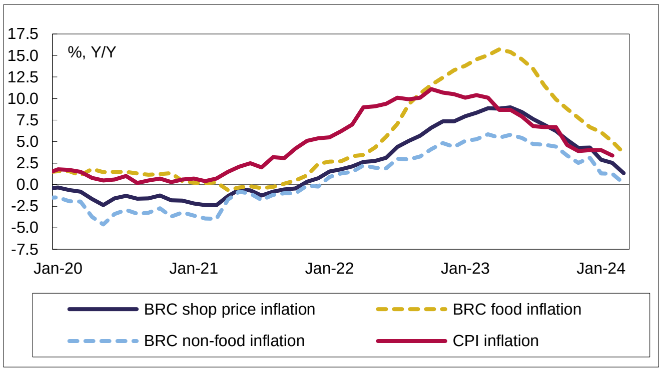
this year that could exaggerate price pressures, uncertainties surrounding this release are high. On balance, we think headline inflation moderated slightly further in March, by 0.1ppt to 2.5%Y/Y, albeit remaining some 0.2ppt above November's 2½-year low but nevertheless 8ppts below the peak in October 2022. While remaining a drag on headline inflation, energy will likely provide a further modest upwards impulse compared with February due to the ongoing withdrawal of government energy support and rise in petrol prices. But food and non-energy industrial goods inflation is expected to have edged lower. Of most interest will be developments in services inflation, which we now expect to have moved broadly sideways for a fourth consecutive month at around 4.0%Y/Y. As a result, we forecast core inflation to drop slightly, by 0.2ppt to 2.9%Y/Y, which would be the lowest since February 2022. Tomorrow will also bring euro area unemployment figures for February, which are likely to imply a still historically tight labour market, with the jobless rate expected to have moved sideways at a series-low 6.4%.

UK

Shop price inflation falls sharply in March amid lower food prices and subdued demand

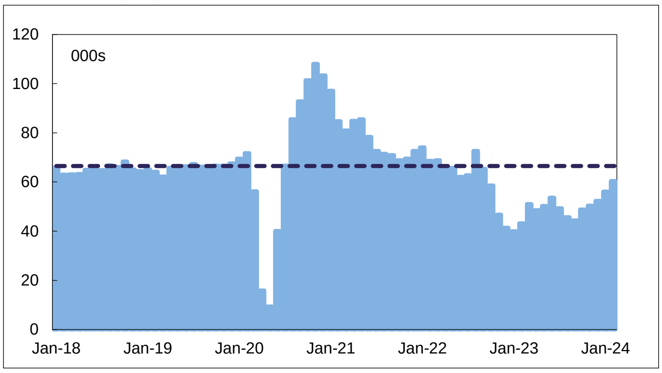
According to the BRC, inflation on the UK high street fell notably further in March, as retailers continued to pass on lower input costs to consumers amid fierce competition and subdued demand. Overall, the BRC's shop price measure of inflation dropped 1.2ppts in March to 1.3%Y/Y, the lowest since December 2021 and 7.7ppts below last year's peak. The decline in part reflected an ongoing disinflationary trend in food prices, with the BRC's measure reporting a second successive monthly decline (-0.3%M/M) and the largest since December 2020, with retailers seemingly opting to absorb higher global cocoa and sugar prices in the run up to Easter. This left the respective inflation component down 1.3ppts to 3.7%Y/Y, the softest since April 2022. But non-food inflation also fell sharply, by 1.1pts to just 0.2%Y/Y, the lowest since December 2021, with heavy discounting in clothing (down 1.4ppts to -6.9%Y/Y), furniture (down 3.7ppts to 0.4%Y/Y) and electricals (down 2.1ppts to -1.6%Y/Y). While retailers will face higher input costs from the rise in minimum wages from the start of this month, costs associated with shipping delays amid the rerouting of cargo due to events in the Red Sea so far appear limited. And so, given the weakness in demand and low consumer confidence, we would expect the disinflationary trend in core goods to be maintained over coming months. And thanks not least to the steep drop in household energy bills this month, as well as a gradual dissipation of pressures in services, we expect CPI inflation to temporarily drop below the BoE's 2.0% target this quarter.

UK: Consumer & shop price inflation



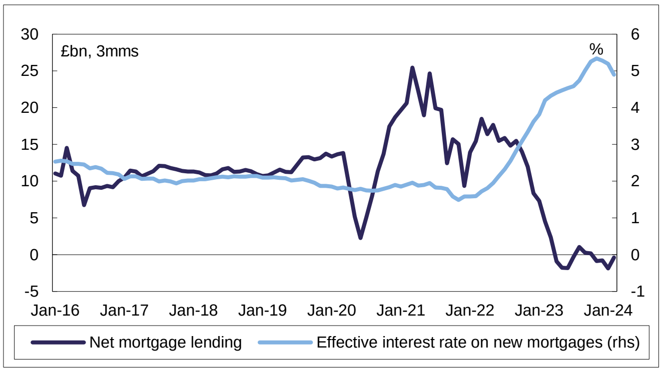
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage approvals*



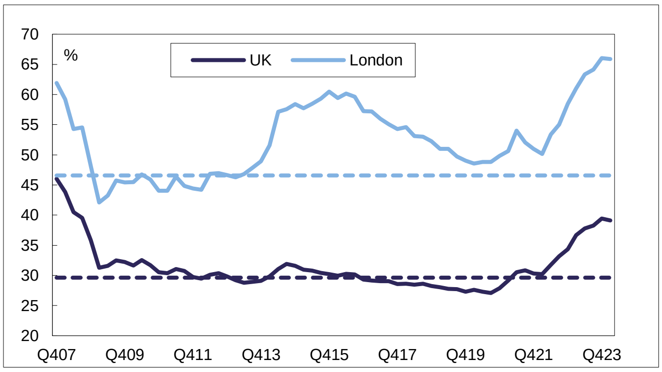
**Dashed dark blue line represents pre=pandemic five-year average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Mortgage lending & interest rate



Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage payments to earnings ratio*



**First-time buyers. Source: Nationwide, Macrobond and Daiwa Capital Markets Europe Ltd.*

Mortgage lending and approvals jump in February, but housing affordability remained stretched

With various indicators signalling that house prices has passed the trough last year, and with the effective interest rate on mortgages having fallen a further 29bps in February to 4.9%, the lowest rate since August, today's BoE bank lending figures flagged tentative signs of renewed momentum in mortgage lending. Indeed, having failed to rise in each of the previous five months and contrasting expectations of another net repayment, today's figures showed that individuals borrowed a net £1.5bn in February, the highest monthly borrowing since January 2023. Admittedly, this was still less than half the average monthly increase in the five years before the pandemic. And in the three months to February net borrowing was still down £0.4bn, while the annual growth in the stock of outstanding secured loans remained slightly negative at -0.1%Y/Y. But there was a notable pickup in net approvals for house purchases in February, which rose for the fifth successive month and from 56.1k to 60.4k, the most since September 2022. But this still remained some 6k below the pre-pandemic five-year average. And today's Nationwide house price report suggested that the recovery in the housing market will be restrained by still elevated borrowing rates and subdued consumer confidence. Indeed, this showed that although the ratio of first-time buyer mortgage payments to earnings edged slightly lower in Q1, at 39.1% it was still some 10ppts above the long-run average, with the respective ratios for London at an eye watering 66% and the South East and South West at 45%. Against expectations, today's report also showed a drop in house prices in March (-0.2%M/M) to leave annual growth at a relatively soft 1.6%Y/Y, albeit the firmest rate since December 2022.

The day ahead in the UK

It should be a quiet day for UK economic news, with no top-tier data due for release.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	ECB 1Y (3Y) CPI expectations Y/Y%	Feb	**3.1 (2.5)**	-	3.3 (2.5)	-
	Final manufacturing PMI	Mar	**46.1**	*45.7*	46.5	-
Germany	Final manufacturing PMI	Mar	**41.9**	*41.6*	42.5	-
	Preliminary HICP (CPI) Y/Y%	Mar	**2.3 (2.2)**	2.4 (2.2)	2.7 (2.5)	-
France	Final manufacturing PMI	Mar	**46.2**	*45.8*	47.1	-
Italy	Manufacturing PMI	Mar	**50.4**	49.0	48.7	-
Spain	Unemployment change '000s	Mar	**-33.4**	-	-7.5	-
	Manufacturing PMI	Mar	**51.4**	51.0	51.5	-
UK	BRC shop price index Y/Y%	Mar	**1.3**	-	2.5	-
	Nationwide house price index M/M% (Y/Y%)	Mar	**-0.2 (1.6)**	0.3 (2.4)	0.7 (1.2)	-
	Final manufacturing PMI	Mar	**50.3**	*49.9*	47.5	-
	Net consumer credit £bn (Y/Y%)	Feb	**1.4 (8.7)**	1.6 (-)	1.9 (8.9)	1.8 (9.0)
	Net mortgage lending £bn (approvals '000s)	Feb	**1.5 (60.4)**	-0.6 (56.5)	-1.1 (55.2)	- (56.1)

Auctions

Country	Auction
Germany	sold €3.71bn of 2.5% of 2026 bonds at an average yield of 2.84%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
France		Preliminary HICP (CPI) Y/Y%	Mar	**2.4 (2.3)**	2.9 (2.7)	3.2 (3.0)	-
		PPI Y/Y%	Feb	**-5.5**	-	-5.1	-4.9
		Consumer spending M/M% (Y/Y%	Feb	**0.0 (-0.8)**	0.3 (-0.6)	-0.3 (-0.7)	-0.6 (-1.2)
Italy		Preliminary HICP (CPI) Y/Y%	Mar	**1.2 (1.3)**	1.5 (1.3)	0.8 (0.8)	-

Auctions

Country	Auction
- Nothing to report -	

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	Preliminary HICP (core HICP) Y/Y%	Mar	*2.5 (2.9)*	2.6 (3.1)
		10.00	Unemployment rate %	Feb	6.4	6.4

Auctions and events

Country		BST	Event
Germany		10.30	Auction: €4.5bn of 2.2% 2034 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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