Euro wrap-up

Overview

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- While the flash March estimate of euro area inflation surprised slightly to the downside, shorter-dated Bunds made modest losses as services inflation remained sticky at double the ECB's 2% target.
- Gilts made gains on a quiet day for UK economic releases.
- Tomorrow will bring the ECB's account from the March Governing Council meeting, BoE inflation expectations survey and the final March services PMIs.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.847	+0.014
OBL 2.1 04/29	2.377	-
DBR 2.2 02/34	2.393	-0.003
UKT 0⅛ 01/26	4.199	-0.022
UKT 0½ 01/29	3.901	-0.032
UKT 4⅝ 01/34	4.051	-0.030

*Change from close as at 5.00pm BST.
Source: Bloomberg

Euro area

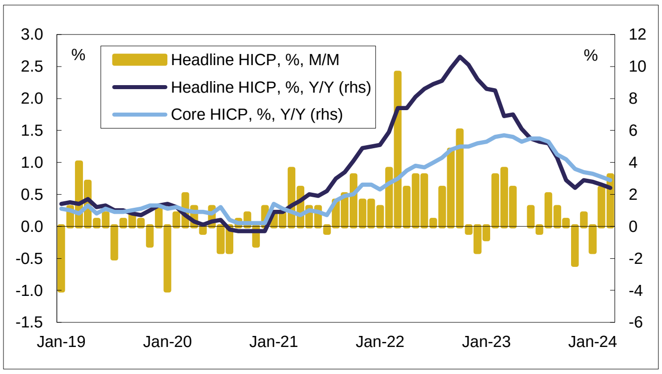
Core inflation falls to lowest in more than 2 years but services component remains high and sticky

Ahead of next week's ECB policy meeting, today's flash consumer price inflation estimate for March delivered a modest downside surprise. In particular, headline HICP inflation fell for a third month in March, by a slightly larger-than-expected 0.2ppt to 2.4%Y/Y, matching November's 28-month low and leaving the rate some 8.2ppts below the peak in October 2022. As a result, the average inflation rate in Q1 (2.6%) was bang in line with the ECB's forecast published last month. The drop in headline inflation would have been steeper in the absence of another rise in the energy component – due to the further withdrawal of government subsidies and higher petrol prices – which rose 1.9ppts to a ten-month high of -1.8%Y/Y. In contrast, the disinflationary trend in food, alcohol and tobacco was maintained, with that component down 1.1ppts in March to 2.7%Y/Y, the softest since November 2021 and almost 13ppts below the peak a year ago. ECB officials might also be encouraged to see that core HICP inflation also moderated for an eighth successive month, by 0.2ppt to 2.9%Y/Y, its lowest level in more than two years. But this merely reflected a further easing of pressures in core goods, with the monthly increase in non-energy industrial goods prices (1.9%M/M) the softest in any March since the global financial crisis. As such, core goods inflation fell 0.5ppt to just 1.1%Y/Y, its lowest level since July 2021. In marked contrast and of greatest importance for the ECB, services prices rose at an above-average pace for a third successive month in March. As a result, services inflation remained uncomfortably high and sticky, unchanged at 4.0%Y/Y, double the inflation target, for a fifth successive month.

Inflation in March exaggerated by Easter effects, so expect step down in April & May

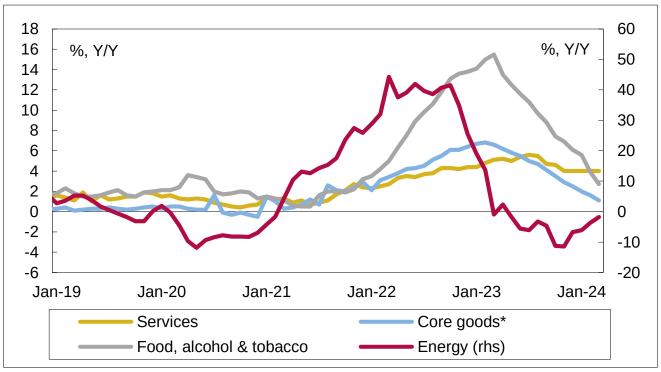
The ECB's seasonally adjusted data and associated momentum estimates might have reinforced the concerns at the ECB about the stickiness of inflation. On this basis, core prices were up 3.2%3M/3M annualised, a six-month high and a rate that if sustained would be incompatible with a return of inflation to target. While non-energy industrial goods prices were up a relatively modest 1.3%3M/3M annualised, this was the firmest for five months. And services momentum picked up more strikingly. Indeed, on a seasonally adjusted basis, services prices rose 0.4%M/M to be up 4.3%3M/3M annualised, almost 2ppts above the recent low at the start of the year and the highest such rate since June 2023. However, the limited detail published by the member states suggests that much of the stickiness in services last month related to the early timing of Easter this year, with evidence of a seasonal boost to hospitality and transport services. So, also given the sizeable Easter effect in April last year, services inflation should fall significantly this month, perhaps by as much as 1.0ppt, and further still in May. According to our own forecast, headline and core inflation should be close to 2.0%Y/Y by June and below target on average in Q3. However, the hawks on the Governing Council will certainly not take such a steep decline for granted. And so, with surveys suggesting that a very gradual cyclical upswing is now underway in most member states bar Germany, we think a rate cut is extremely unlikely to be agreed at next week's ECB monetary policy meeting. Instead, if inflation declines

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Key HICP components



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

as we expect in April and May and the Q1 wage data also avoid an unpleasant upside surprise, the first rate hike will come in June with further cuts to follow in Q3 and Q4.

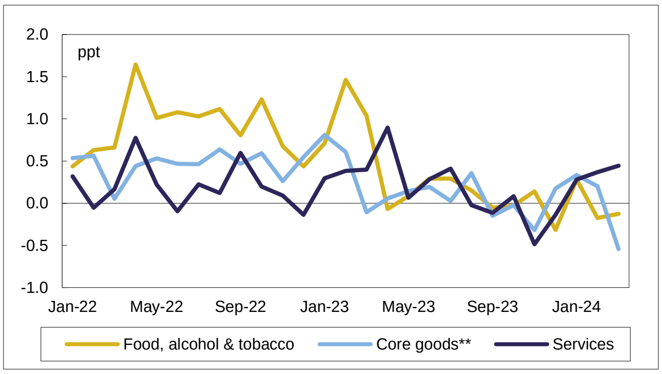
Record low unemployment provides hawks with further cause for caution

Just as services inflation has remained high and sticky over recent months, however, so too unemployment has remained historically low, providing additional cause for the hawks to remain concerned about persistence of domestically-generated inflation. The euro area unemployment rate was unchanged in February at the (revised) series low of 6.5% for the fourth successive month and the eleventh month out of the past twelve. The number of unemployed persons rose 17k on the month to 11.102mn, less than 100k above last June's series low and a mere 1k below the average since January 2023. Despite the likelihood of a further contraction in GDP in Q1 in the euro area's largest member state, Germany's unemployment rate was unchanged on the month at 3.2% on the EU-harmonised measure, just 0.3ppt above the level a year earlier which had matched the post-reunification low. Among the other large member states, the French jobless rate edged down 0.1ppt for a second month to a five-month low of 7.4%, similarly just 0.3ppt above the 40-year low a year earlier. Italian unemployment ticked up 0.2ppt from the 15-year low reached in the prior two months to 7.5%. And the equivalent Spanish rate edged down for a fourth successive month to 11.5%, the lowest since mid-2008.

Wage growth appears to moderate from last year's peak but remains elevated

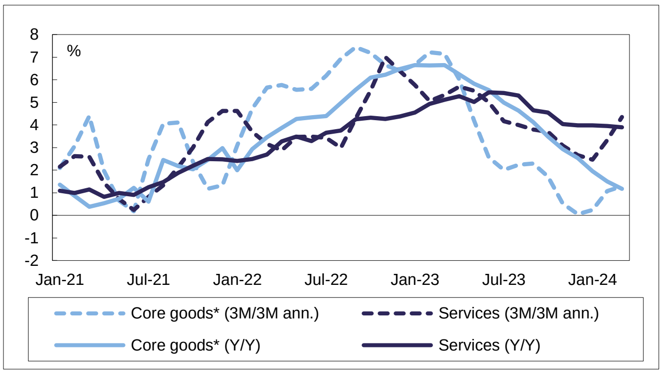
While the headline euro area unemployment rate is at a historical low, the ECB cannot know for sure whether the region's structural unemployment rate has fallen commensurately over recent years. So, while firms report that labour shortages are less of a constraint on output than they were over the past few years, it is unclear whether a pickup in joblessness will be required in due course to achieve a sustained moderation in wage growth and domestically-generated inflation consistent with its target. For the time being, the policymakers can only track the incoming data on wage settlements, which will in large part reflect attempts by workers to seek compensation for recent high inflation and so cannot be relied upon as a reliable guide to the extent of labour market slack. According to the latest Indeed tracker, average wage growth in its advertised job postings was steady in February at 3.9%3M/Y, up 0.2ppt from the three months to November and above rates that might be normally considered consistent with the achievement of the inflation target, but 0.9ppt below its level a year earlier and 1.3ppt below the peak. Among the member states, the Indeed wage tracker for Germany rose to 4.4%3M/Y, up 0.4ppt from three months earlier but down 1.6ppt from a year earlier. The equivalent rate for France dropped to a 22-month low of 3.2%3M/Y, and the Spanish rate was the lowest in a year (4.5%3M/Y), with both countries down about 1½ppts from their 2023 highs. These figures provide a rough guide to the Q1 negotiated wages figures, due late next month, which ECB President Lagarde recently flagged, alongside the updated Eurosystem macroeconomic projections, as important for

Euro area: Deviations from long-run price change*



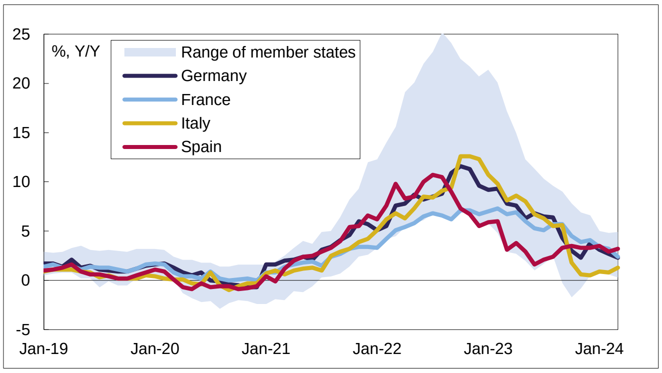
*Monthly change in prices compared to average for the month in decade before the pandemic. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core inflation momentum



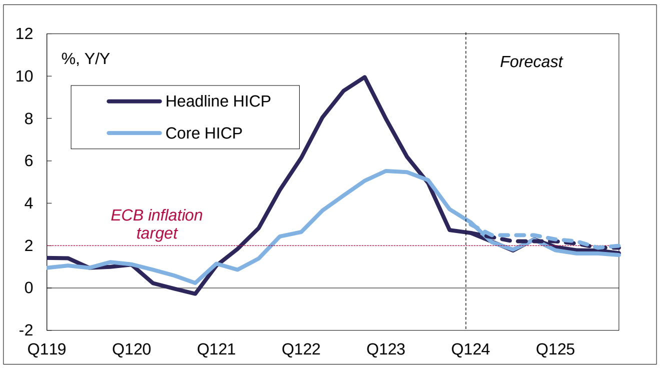
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation forecasts*



*Dashed lines represent ECB forecast. Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

informing the Governing Council's June monetary policy decision. Admittedly, a sharp jump in one-off payments in German negotiated wages in March poses an upside risk. But the Q1 figure for the euro area should still be broadly stable from Q4. And in the absence of a significant upside surprise to services inflation in April and May, these wage data should not represent an obstacle to a first rate cut in June.

The day ahead in the euro area

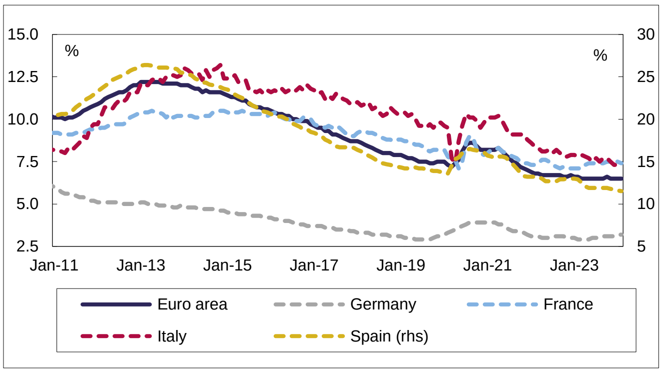
Ahead of next week's ECB policy-setting meeting, a key focus tomorrow will be the publication of the account from the Governing Council meeting on 7 March. While ECB President Lagarde noted in her press conference that there was no discussion of a possible rate cut at that meeting, particular attention in the minutes will be focused on any hint of a debate among policymakers on the pre-conditions required for a first rate cut. Meanwhile, February goods producer price data will offer further insight into the euro area's pipeline price pressures, with the headline PPI rate expected to remain firmly in negative territory close to January's rate (-8.6%Y/Y), as energy inflation remains a drag and underlying cost burdens continue to wane. The final services PMIs for March will also provide an update on price pressures in the sector. The preliminary release brought a welcome easing in the input price index to an eight-month low (61.2), while the prices charged component moderated to a four-month low (55.2), albeit both remained well above the respective long-run averages. The survey also suggested an acceleration in recovery momentum in the sector at the end of the Q1, with the activity index up to an eight-month high (51.1), with the new business index recording the first above-50 reading since last June.

UK

The day ahead in the UK

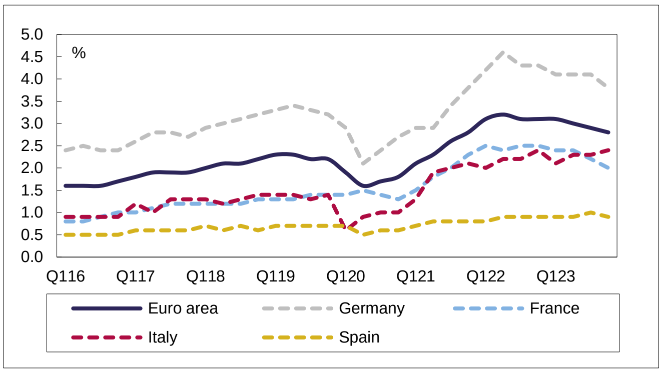
After a day bereft of top-tier UK economic data, the most noteworthy release tomorrow will be the BoE's latest Decision Maker Panel survey results, with firms' expectations for inflation and wage growth relevant for the MPC's judgement on the inflation outlook. In February, the survey suggested that firms' expectations for inflation three years ahead fell to the lowest (2.8%3M/Y) since the series began, but also indicated that expectations for wage growth over the coming year remained sticky – at 5.2%3M/Y for a third consecutive month – above rates that would be consistent with achieving the 2% inflation target over the medium term. Meanwhile, the final March services PMI surveys are likely to reaffirm the messages from the flash release, suggesting among other things that price pressures remain sticky amid increasing business activity in the sector. Indeed, although the input price index eased slightly last month (64.0), the price charged index merely moved sideways at an above-average 58.4. The activity index fell for the second successive month, albeit by just 0.4pt to a respectable 53.4.

Euro area: Unemployment rates



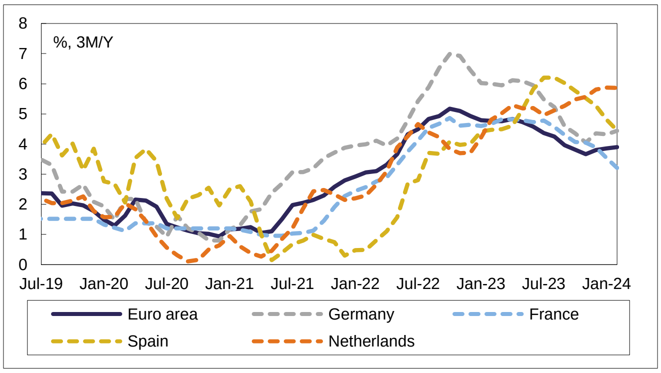
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Vacancy rates



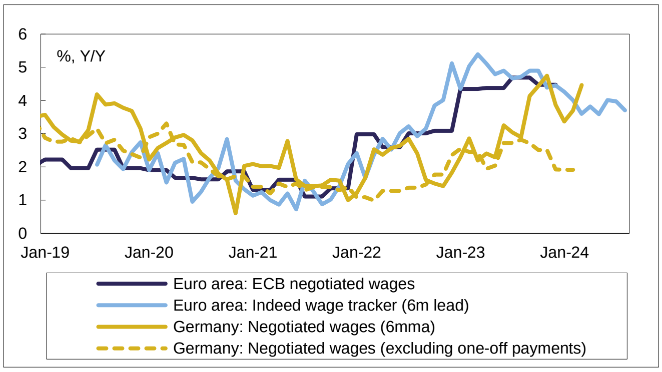
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Indeed wage tracker



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Negotiated wages



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ _Daiwa forecast_	Previous	Revised
Euro area		Preliminary HICP (core HICP) Y/Y%	Mar	**2.4 (2.9)**	2.5 (2.9)	2.6 (3.1)	-
		Unemployment rate %	Feb	**6.5**	6.4	6.4	6.5

Auctions

Country		Auction
Germany		sold €3.68bn of 2.2% 2034 bonds at an average yield of 2.38%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ _Daiwa forecast_	Previous
Euro area		09.00	Final services (composite) PMI	Mar	_51.1 (49.9)_	50.2 (49.2)
		10.00	PPI Y/Y%	Feb	-8.5	-8.6
Germany		08.55	Final services (composite) PMI	Mar	_49.8 (47.4)_	48.3 (46.3)
France		08.50	Final services (composite) PMI	Mar	_47.8 (47.7)_	48.4 (48.1)
Italy		08.45	Services (composite) PMI	Mar	52.5 (51.8)	52.2 (51.1)
Spain		08.15	Services (composite) PMI	Mar	55.0 (54.2)	54.7 (53.9)
UK		09.00	New car registrations Y/Y%	Mar	-	14.0
		09.30	BoE's DMP 3M output price (1Y-ahead CPI) expectations Y/Y%	Mar	4.2 (3.2)	4.3 (3.3)
		09.30	Final services (composite) PMI	Mar	_53.4 (52.9)_	53.8 (53.0)

Auctions and events

Country		BST	Event
Euro area		12.30	ECB publishes account of March policy decision
France		09.50	Auction: 3.50% 2033 bonds
		09.50	Auction: 1.75% 2039 bonds
		09.50	Auction: 3.25% 2055 bonds
		09.50	Auction: 4.00% 2060 bonds
Spain		09.30	Auction: 3.50% 2029 bonds
		09.30	Auction: 3.25% 2034 bonds
		09.30	Auction: 3.90% 2039 bonds
		09.30	Auction: 2.05% 2039 index-linked bonds
UK		10.00	Auction: £3.75bn of 4.625% 2034 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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