Daiwa Capital Markets

Euro wrap-up

Overview

Chris Scicluna +44 20 7597 8326
Emily Nicol +44 20 7597 8331

- Bunds followed the global trend lower even as the ECB signalled that the June policy meeting is live for a first rate cut, albeit with the decision inevitably still data dependent.
- Gilts also made losses as surveys suggested further stabilisation in the UK's housing market, while household demand for loans increased in the first quarter of the year.
- Tomorrow will bring final March inflation numbers from Germany, France and Spain, as well as UK GDP figures for February and the Bernanke review of BoE forecasting.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.969	+0.003
OBL 2.1 04/29	2.488	+0.027
DBR 2.2 02/34	2.475	+0.040
UKT 0⅛ 01/26	4.428	+0.063
UKT 0½ 01/29	4.121	+0.072
UKT 4⅝ 01/34	4.218	+0.071

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

Euro area

ECB signals that June is live for a rate cut but insists that decision will be data dependent

As expected, the ECB left rates unchanged once again today when its latest monetary policy meeting concluded. So, the deposit rate was maintained at the record high of 4.00% where it has been since September. And in her press conference, President Lagarde stated that only "a few" members of the Governing Council would have supported a rate cut today. Meanwhile, in terms of its guidance on future policy, the ECB predictably insisted that it will still not pre-commit to any particular path for rates. And, also predictably, it reiterated that its policy decisions will continue to be taken on a meeting-by-meeting basis and remain data-dependent. But, as we expected, the statement additionally gave a clear signal that the next policy meeting in June is live for a first rate cut. In particular, it specified that if the "updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission were to further increase its confidence that inflation is converging to the target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction." Inevitably perhaps, however, the statement gave no guidance whatsoever with respect to what might happen to rates in the second half of the year and beyond.

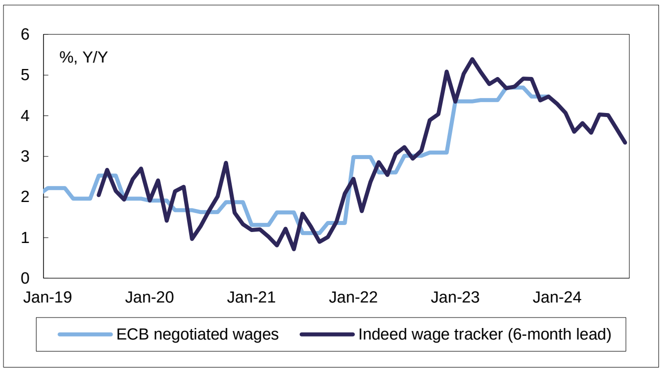
Lagarde downplays relevance of US data & Fed policy for ECB's rate decisions

Of course, with the decision dependent on the incoming flow of data over the next couple of months, as well as the Eurosystem's updated projections to be completed ahead of the next policy meeting, a June rate cut is still not yet a done deal. Indeed, the ECB's inflation outlook for the coming few quarters might well have to be lifted somewhat, not least due to the recent rally in oil prices, but also in response to evidence of firmer economic activity and inflation in the US. However, the impact of higher oil prices will in part be offset by lower gas prices. Moreover, Lagarde's comments today suggested that the Governing Council was not overly alarmed by yesterday's upside surprise to US CPI and the associated repricing of Fed rate expectations. And events in the US will not be a showstopper for ECB rate cuts.

Euro area price pressures are easing sufficiently to justify gradual rate cuts from June on

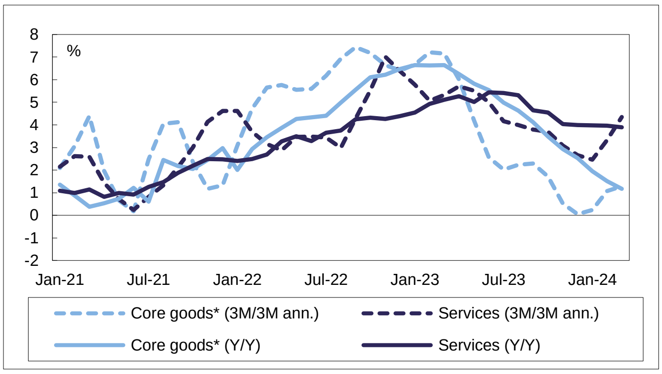
Importantly, the Governing Council judges that current macroeconomic conditions in the euro area are very different to those on the other side of the Atlantic. As the euro area is a large and relatively closed economy, and China and other emerging markets are also important for external demand and import prices, the relevance of the EURUSD exchange rate should not be exaggerated. And most importantly, today's monetary policy statement reaffirmed that the ECB still judges that price pressures in the euro area are gradually diminishing. Among other things, it suggested that the policymakers have been comforted that wages and unit profits grew less firmly than anticipated in Q4 and also that recent indicators point to further

Euro area: Wage growth



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.*

moderation in pay growth in Q1. And while services inflation remained high and sticky at 4.0%Y/Y in March, and services inflation momentum has appeared to pick up recently, the ECB – like us – will consider the early timing of Easter to have played a significant role in that persistence and will therefore predict those pressures to reverse in April and May. As such, we expect the Eurosystem's updated projections to continue to suggest that inflation will be back at or below target on a sustained basis from mid-2025 on. And so, we also maintain our expectation that rates will be cut for the first time, by 25bps, in June, with a second cut following when the projections are updated once again in September.

The day ahead in the euro area

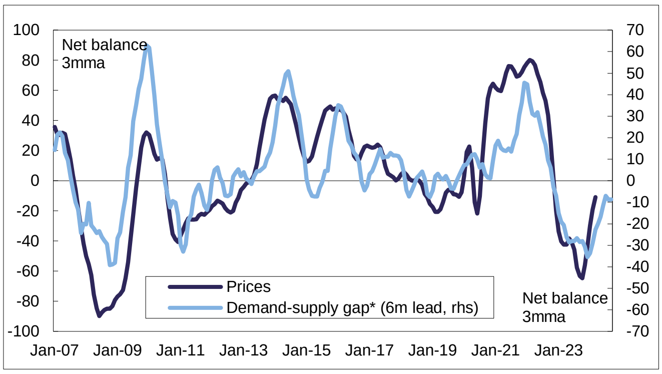
A relatively quiet end to the week for euro area releases will bring just final March consumer price inflation figures from Germany, France and Spain, which will provide more granular detail than the preliminary releases, which saw headline HICP inflation ease in Germany (-0.4ppt to 2.3%Y/Y) and France (-0.8ppt to 2.4%Y/Y), but rise slightly in Spain (+0.3ppt to 3.2%Y/Y).

UK

House price recovery likely to remain moderate despite signs of improving market conditions

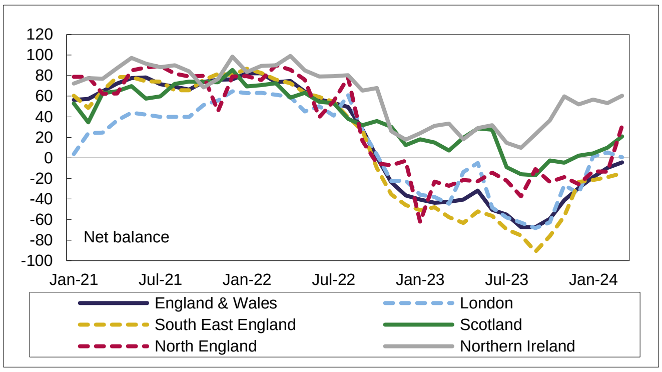
The RICS residential survey suggested that surveyors are becoming cautiously more optimistic about the UK's housing market, with signs of renewed demand raising sales expectations over the near term. In particular, with the average interest rate on a 2Y mortgage with an LTV ratio of 75% down some 110bps from the peak last September – albeit at a still lofty 4.77% – new buyer enquiries rose for a third consecutive month in March and by the most in two years. Admittedly, the net balance of newly agreed sales fell back last month, to imply a broadly stable trend at the end of Q1. But surveyors were more upbeat about sales expectations in the three months ahead, with the respective net balance the highest since the start of 2022. And expectations for sales over the coming years were the best since before the pandemic. Indeed, there was an additional modest increase in supply onto the market reported last month, with the respective new instructions balance recording a fourth successive positive reading. Against this backdrop, there was a further stabilisation in the survey's headline house price balance, which rose for the sixth successive month and by 6ppts to -4%, a seventeen-month high and some 63ppts above the low hit last August. Within the regional breakdown, there were positive net house price balances in the North of England (32%), Wales (12%), Scotland (21%) and Northern Ireland (60%). Nevertheless, with borrowing costs still significantly higher than two years ago, expected house price growth over the coming twelve months was expected to remain relatively subdued, at just 0.7%Y/Y, suggesting that the turnaround in the housing market will likely remain relatively modest for the time being.

UK: RICS house price and demand-supply indices



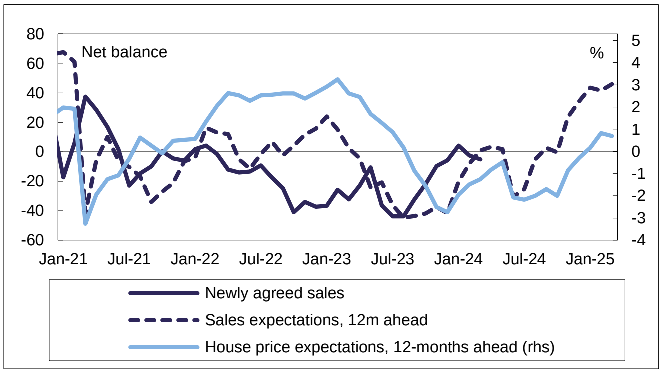
**New buyer enquiries minus new instructions. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: RICS house price indices



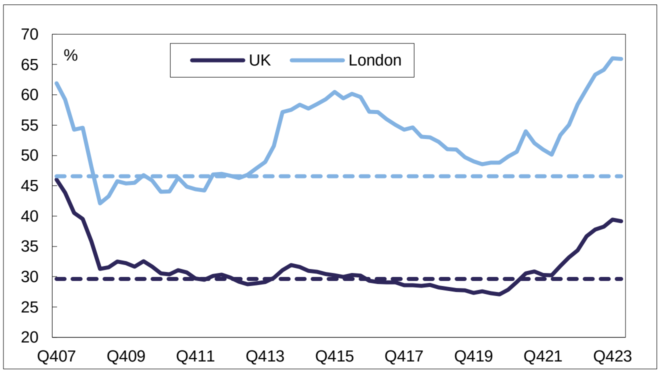
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: RICS house price & sales expectations



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage payments to earnings ratio*



**For first time buyers. Dashed lines represent long-run average. Source: Nationwide, Macrobond and Daiwa Capital Markets Europe Ltd.*

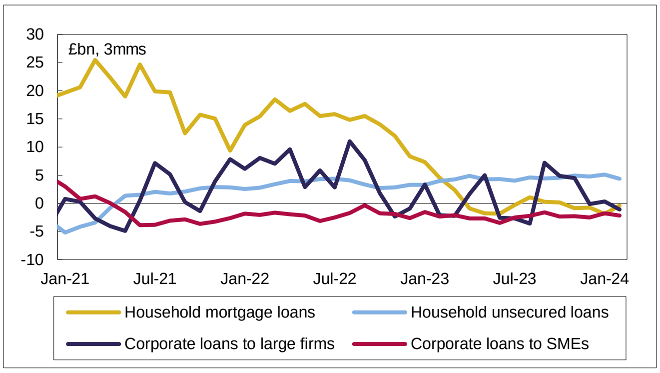
Demand for household lending jumps on improved economic outlook and housing market

Nevertheless, like the ECB's bank lending survey published earlier this week, today's BoE credit conditions survey suggested that the transmission of the rate hikes of the past couple of years has become somewhat less potent amid an improvement in the economic outlook, prospects for higher house prices, and market expectations of rate cuts to come. According to the Bank's survey, lenders reported a notable increase in mortgage demand in Q1, with a net balance of 35.9% the second firmest since Q221 and well above the long-run average (0.1%), with banks expecting another quarter of strong demand for loans for house purchase in Q2 too. While banks reported a fifth consecutive rise in mortgage defaults last quarter, this was smaller than had been expected at the end of last year. So, given also the modest easing in wholesale funding conditions, and tallying with the recent pickup in mortgage approvals in February, lenders reported a larger-than-expected net increase in credit availability for loans for house purchase in Q1 – for a second successive quarter and by the most since Q421. And credit supply for house loans is expected to rise further over the coming three months too. Despite a pickup in household disposable income and still subdued consumer confidence, demand for consumer credit also jumped in Q1, with the respective balance (up 56.5ppts to 32.8%) the highest for two years, with a further net increase expected in Q2.

Demand for business loans from large firms rises, but small firms remain reluctant to borrow

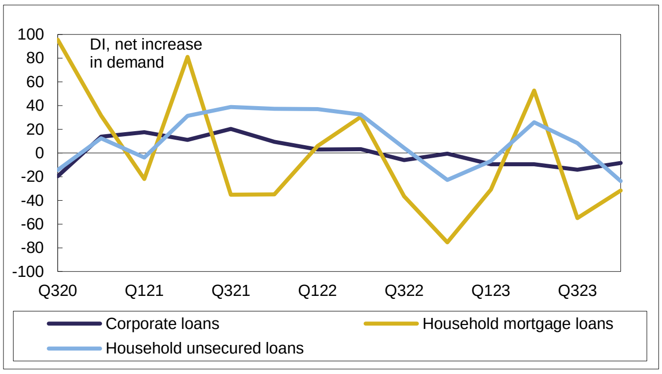
While bank lending to businesses has remained particularly weak over the past year or so, lenders suggested that demand from large firms rose modestly in Q1 for the first quarter in seven, with the respective balance (5.8%) the firmest since Q421. And demand from medium-sized enterprises rose for first time in three years, with the respective balance (6.3%) the strongest since Q216 when excluding the surge in funding needs at the start of the pandemic. In contrast, with lenders reporting that spreads on corporate lending to small firms widened slightly in Q1, there was a further net decline in demand from such firms for a thirteenth quarter out of fourteen. And lenders expected ongoing subdued in demand in overall corporate lending in Q2. But having remained broadly unchanged in Q1, banks expect a slight increase in overall credit supply in the coming three months and by the most in three years. And while property prices remained a notable constraint on available credit to the commercial real estate sector, lenders nevertheless reported a modest net increase in such supply for the first time in two years.

UK: Net change in household & corporate lending



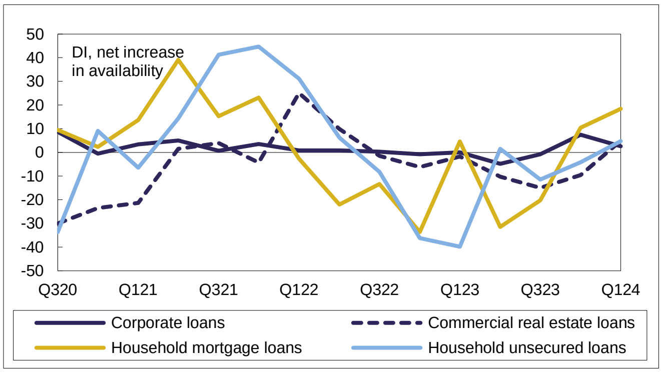
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Household & corporate loan demand



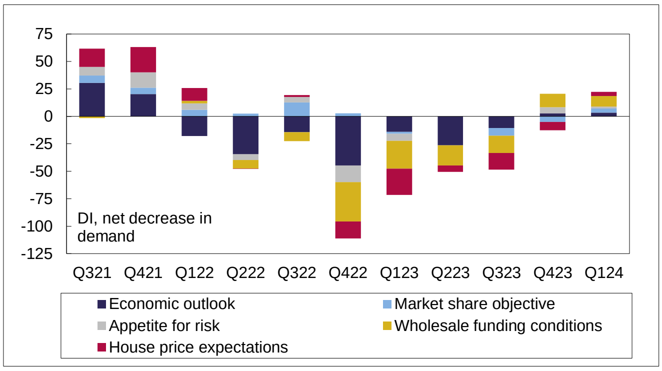
Source: BoE consumer credit survey, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Household & corporate loan availability



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

UK: Factors influencing supply of mortgage loans



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

The day ahead in the UK

In terms of economic data, tomorrow will bring the highlight of the week, with the February GDP data, including the detail for output in services, industry and construction as well as external trade. While GDP started the year on the front foot, rising 0.2%M/M in January, this followed two consecutive monthly declines at the end of last year to maintain a modest downtrend (-0.1%3M/3M). While the PMIs implied a similar pace of expansion in February, retail sales were merely flat that month amid subdued consumer confidence. And with the firmness of the rise in construction at the start of the year (1.1%M/M) unlikely to be repeated and the transport sector hit by industrial action, we expect GDP to have moved broadly sideways in February.

While the next BoE monetary policy announcement is not scheduled until 9 May, tomorrow will bring the publication of the review by former Fed Chair Bernanke of the Bank's approach to forecasting and analysis, which will inform the MPC's decision-making and policy communication from now on. The review was commissioned last May in response to the failure of the BoE to predict the extreme rise in inflation throughout 2021 and 2022, and the resulting marked increase in political criticism and steep deterioration in its public satisfaction ratings. Among other things, Bernanke was asked to focus on the processes and analysis supporting the MPC's policy deliberations; the analytical framework for taking account of significant supply- and demand-side shocks and shifts; the role of the forecast in the MPC's policy decisions and communications; the appropriate assumptions to be used in its projections, including the interest rate path on which the forecast is based; and material provided to the MPC to assist the discussion and communication of the outlook and risks.

Comments from BoE Governor Bailey suggest that the most significant outcome of the review will probably be for the Bank to cease producing its projection fan charts, which present (arguably spurious) probabilities for various paths of GDP and inflation under both market-based and no-change rate assumptions. Indeed, Bernanke might recommend instead that the BoE follow the example of the Swedish Riksbank and, perhaps in each Monetary Policy Report, publish a limited number of alternative projections to its baseline forecast based on specific different economic scenarios. Bernanke is likely also to have considered the appropriateness that the MPC publish members' expected path for Bank Rate, akin to the Fed's dot-plots which were introduced while he was FOMC chair. However, Bailey has up to now appeared unconvinced of the merits of such an approach. Regardless of the precise conclusions that Bernanke has made, and how Bailey responds, we doubt that the content of the review will have a significant impact on the policy outlook. We maintain an expectation that the MPC will cut rates four times this year, with the first cut coming this quarter.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		ECB deposit rate (refi rate) %	Apr	**4.00 (4.50)**	*4.00 (4.50)*	4.00 (4.50)	-
Italy		Industrial production M/M% (Y/Y%)	Mar	**0.1 (-3.1)**	-	-1.2 (-3.4)	-1.4 (-3.7)
UK		RICS house price balance %	Mar	**-4**	-6	-10	-

Auctions

Country		Auction
Italy		sold €3.00bn of 2.95% 2027 bonds at an average yield of 3.32%
		sold €3.50bn of 3.5% 2031 bonds at an average yield of 3.53%
		sold €1.75bn of 4.15% 2039 bonds at an average yield of 4.16%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Italy		Retail sales M/M% (Y/Y%)	Feb	**0.1 (2.4)**	-	-0.1 (1.0)	0.0 (-)

Auctions

Country		Auction
Germany		sold €2.01bn of 2.6% 2039 bonds at an average yield of 2.54%%
UK		sold £4.00bn of 3.75% 2027 bonds at an average yield of 4.204%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		07.00	Final HICP (CPI) Y/Y%	Mar	*2.3 (2.2)*	2.7 (2.5)
France		07.45	Final HICP (CPI) Y/Y%	Mar	*2.4 (2.3)*	3.2 (3.0)
Spain		08.00	Final HICP (CPI) Y/Y%	Mar	3.2 (3.3)	2.9 (2.8)
UK		07.00	GDP M/M% (3M/3M%)	Feb	0.0 (0.1)	0.2 (-0.1)
		07.00	Industrial production M/M% (Y/Y%)	Feb	0.0 (0.6)	-0.2 (0.5)
		07.00	Services output M/M% (3M/3M%)	Feb	0.1 (0.1)	0.2 (0.0)
		07.00	Construction output M/M% (Y/Y%)	Feb	-0.2 (-1.1)	1.1 (0.7)
		07.00	Trade (goods trade) balance £bn	Feb	-	-3.1 (-14.5)

Auctions and events

Euro area		09.00	ECB Survey of Professional Forecasters to be published
UK		09.30	Bernanke report on BoE forecasting to be published

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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