Euro wrap-up

Overview

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- Bunds followed USTs higher on increased geopolitical risks from the Middle East while detailed German inflation data for March suggested that the persistence in services was in large part related to the timing of Easter.
- Despite a second successive month of positive UK GDP growth, Gilts also rallied while former Fed Chair Bernanke flagged deficiencies in the BoE's production and use of its macroeconomic projections.
- The coming week will bring final March estimates of euro area inflation as well as the equivalent data from the UK, and updates on euro area industrial production and the UK labour market.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.850	-0.103
OBL 2.1 04/29	2.362	-0.112
DBR 2.2 02/34	2.356	-0.104
UKT 0⅛ 01/26	4.329	-0.052
UKT 0½ 01/29	4.035	-0.062
UKT 4⅝ 01/34	4.132	-0.066

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

UK

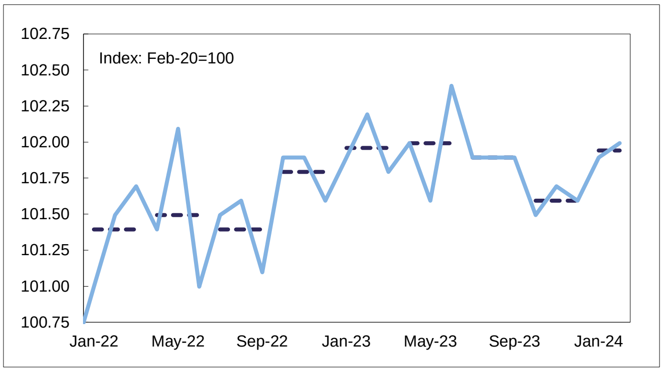
GDP rises for second successive month in February, suggesting firm rebound in Q1

Consistent with the improvement in the PMIs from the end of last year, today's monthly GDP data suggested that the UK economy returned to modest growth in Q1 following a mild technical recession in the second half of last year. Admittedly, GDP growth in February was modest at just 0.1%M/M to leave output still down 0.2%Y/Y. But it still marked a second successive monthly increase. And given an upward revision of 0.1ppt to the estimate of growth in January to 0.3%M/M – the second-strongest growth in a year – output reached its highest level since June, some 2% above the pre-pandemic level in February 2020, to be trending so far in Q1 0.3% above the Q4 average. While the timing of the early Easter holiday this year might well have a negative influence on manufacturing and construction activity in March, we suspect that services will receive a boost from hospitality as well as the retail sector. As such, we have now revised up our expectations for GDP growth in Q1 to 0.4%Q/Q, which would mark the strongest quarterly growth for two years. This would be a non-negligible 0.3ppt above the BoE's most recent GDP projection in the February Monetary Policy Report. However, it would also merely offset the Bank's misplaced optimism about output in Q423, for which it forecast zero growth in the February MPR compared with the 0.3%Q/Q contraction that eventually materialised. But with the BoE's near-term growth profile likely to be revised higher over the near term, today's release suggests that the MPC will feel in no rush to ease policy even if its updated projections next month suggested a stronger likelihood that it will meet its inflation target over the medium term.

Acceleration in car production and steady services recovery offset drop in construction

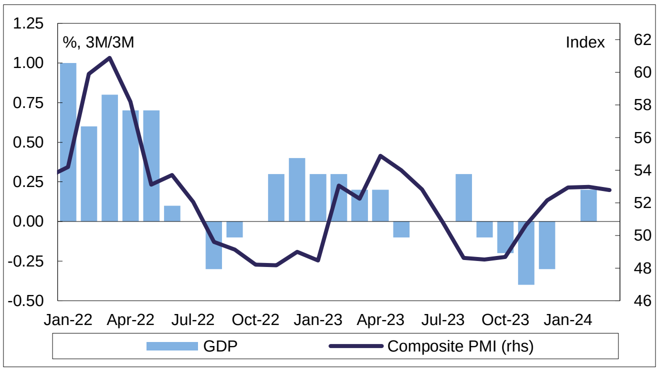
Within the detail, GDP growth in February was again supported by the services sector, where activity rose (0.1%M/M) for a third month out of the past four to the highest level since August and left it some 4½% above the pre-pandemic level. The services expansion was led by the transportation and storage subsector (2.6%M/M) and information and communication (1.0%M/M). That offset a drop in certain consumer-facing subsectors, including accommodation and food – down for a second successive month and by 1.2%M/M, the most since May – and healthcare (-0.6%M/M). Meanwhile, manufacturing production also surprised on the upside in February, rising for a third month out of four and by 1.2%M/M – the most since June – albeit leaving the level more than 4% below the February 2020 benchmark. The improvement was widespread, with 11 out of 13 subsectors reporting growth in February, driven by a fifth consecutive increase in car production (5.3%M/M) and the fastest since last April, to leave it up some 36%Y/Y and trending almost 9% above the Q4 average. The exception in February was machinery, with output falling (-3.2%M/M) to its lowest level since May 2020 and the global financial crisis when excluding the initial pandemic slump. And while production rose in February, it was also trending below the Q4 average in electrical equipment and pharmaceuticals. Meanwhile, having started the year on the front foot and despite an

UK: Monthly GDP level*



*Dashed dark blue line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & composite output PMI



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

improvement in the respective PMI and signs of a turnaround in the housing market, construction activity resumed a downtrend in February, declining 1.9%M/M – the most since January 2023 – to leave it down 2%Y/Y and trending almost ½% below the Q4 average. And the weakness in this sector was broad based, with new building work down 2.3%M/M to its lowest level for more than three years and more than 11% below the pre-pandemic level, while repair and maintenance fell 1.4%M/M to a four-month low, albeit remaining well above the February 2020 benchmark.

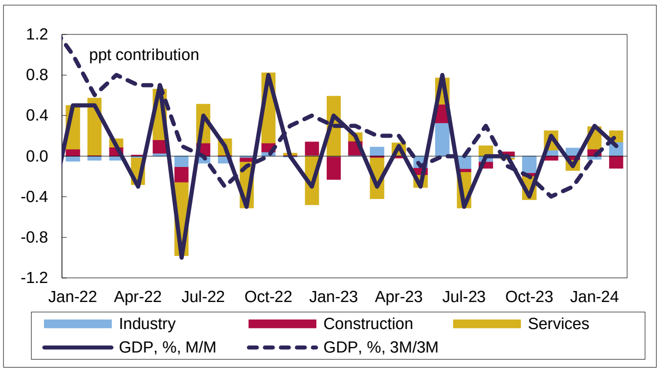
Net trade remains on track to be a modest drag on GDP in Q1

Having been a notable drag on GDP growth in Q4, net trade appears to have remained soft in the first quarter too. Admittedly, today's data suggested only a very modest widening in the trade deficit in February, by £0.1bn to £2.3bn, nevertheless a four-month high. But while the value of imports was unchanged on the month, export values slipped back slightly (-0.1%M/M) for a third consecutive month to the lowest level since September. Nevertheless, when excluding precious metals, which distort the underlying picture, export values rose for the first month in four (0.6%M/M). And when also excluding price effects, export volumes (excluding precious metals) increased a firmer 1.0%M/M, driven by a jump in goods exports (1.7%M/M) and a third consecutive modest increase in services exports (0.4%M/M). The drop in total export volumes (including precious metals) was more marginal in February (0.2%M/M), but left it trending some 1.3% below the Q4 average, while total import volumes were trending some 0.7% lower on the same basis.

BoE forecast errors similar to peers but Bernanke identifies shortcomings & recommends change

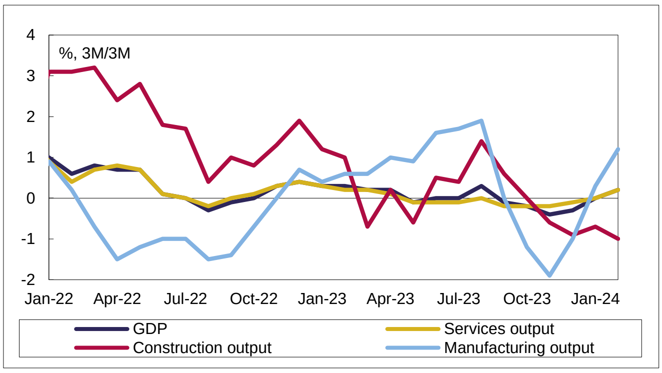
The review by Ben Bernanke of the BoE's approach to forecasting and analysis, which was commissioned last May and published today, did not pull its punches. The former Fed chair had been tasked with recommending changes due to the failure of the BoE to predict the extreme rise in inflation throughout 2021 and 2022 and subsequent persistence last year, and the resulting marked increase in political criticism and steep deterioration in its public satisfaction ratings. Of course, the UK was not alone in experiencing a sharp rise in inflation, and the BoE was not the only one of the central banks of the major industrialised economies to fail to forecast the phenomenon accurately. Indeed, compared against the track records of certain peer central banks that had similar forecast timing conventions or provided data, Bernanke judged that the BoE's inflation forecasts "were better than those of the ECB and the Riksbank but worse than those of the Bank of Canada, Norges Bank and RBNZ". Nevertheless, he identified several problems with respect to the way that the BoE produces forecasts and uses those forecasts in its policy-making and communication. And he therefore made a dozen interconnected recommendations for change, most of which are likely to be implemented over coming months by BoE Governor Andrew Bailey and Clare Lombardelli, who is currently OECD Chief Economist but will succeed Ben Broadbent as Deputy Governor for Monetary Policy from 1 July and will testify to Parliament's Treasury Select Committee on Tuesday.

UK: Contributions to monthly GDP growth



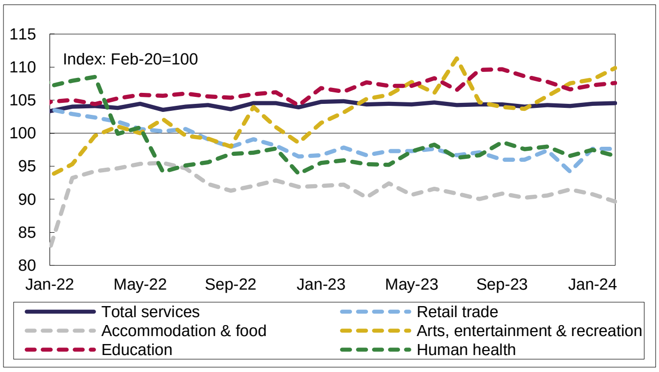
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP & sectoral output growth



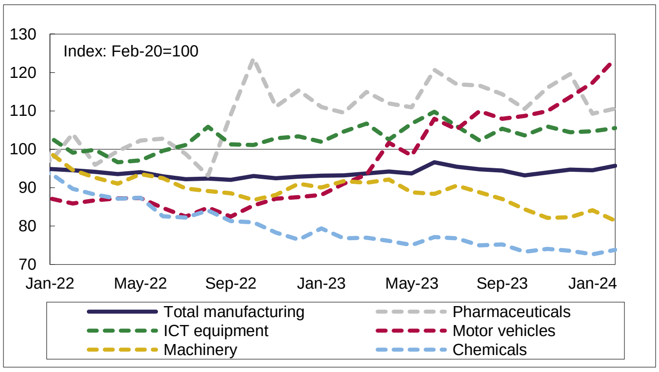
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services output in selected subsectors



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output in selected subsectors



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

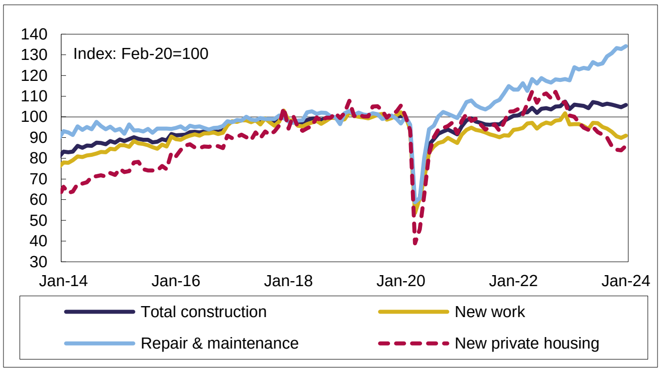
Forecasting "deficiencies" identified & MPC told to be clear about its opinion of the curve

Among other things, Bernanke identified "serious problems" with "deficiencies" in the Bank's forecasting infrastructure, including "significant shortcomings" related to the Bank's baseline economic model and use of "seriously out of date" technology. Bernanke also criticised the way by which the BoE used its forecasts in policymaking and communication. As expected, he judged its fan charts, which currently present probabilities for various paths of GDP and inflation under market-based and no-change rate assumptions, as suffering from "significant analytical weaknesses" and argued that they should be "eliminated". Instead, also as predicted, he recommended giving more attention to alternative scenarios in discussions of the outlook and policy, to provide the public with new information about the MPC's reaction function and its views of the monetary transmission mechanism. Bernanke also recommended that the MPC should de-emphasise the central forecast based on the market-implied path of interest rates in its communications. Indeed, investors should welcome his recommendation that the MPC should be "exceptionally clear" in warning about situations in which it considered the market-implied path for rates to be inconsistent with its own view of the outlook. But, likely mindful of existing opposition at the Bank to such a proposal, he did not explicitly recommend that the MPC produce a forecast based on its best collective judgement of the rate outlook, nor did he recommend publication of Fed-style dot plots of MPC members' forecasts of the path ahead for Bank Rate.

Will Bernanke's public criticism of the BoE result in a more risk averse MPC over the near term?

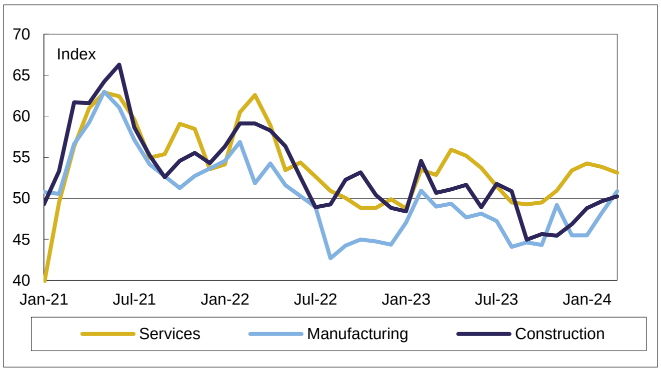
In implementing his recommendations, Bernanke suggested that the Bank first focus on improving its forecasting infrastructure before "moving cautiously in adopting changes to policymaking and communications". So, there will be no overnight revolution to the way that the BoE conducts its forecasts or uses them in its decision-making or communication. Indeed, the BoE will provide an update on implementation only by the end of the year. But next month's Monetary Policy Report will at least provide an opportunity to showcase an initial set of changes to the way it presents its projections, which should hopefully be more enlightening for investors than the current approach. Whether there will be any material impact on the BoE's near-term policy decision-making, however, is unclear. However, we wonder whether the negative media coverage and enhanced political criticism of the BoE, as well as a reduced faith in its projections, that will likely follow Bernanke's identification of its deficiencies might make the MPC become more risk-averse over coming months. And that could cause it to delay any initial easing of monetary policy that a more confident and assertive Committee might otherwise have delivered.

UK: Construction output



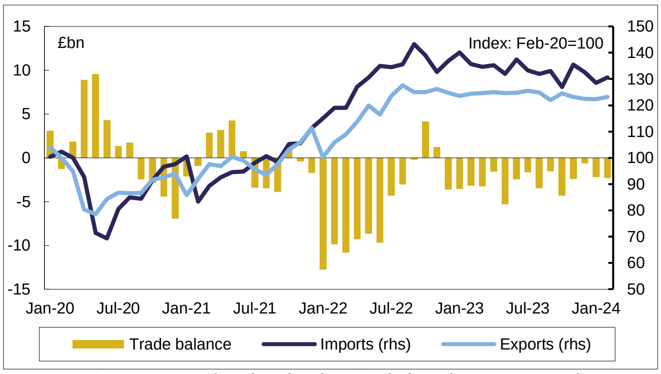
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output PMIs



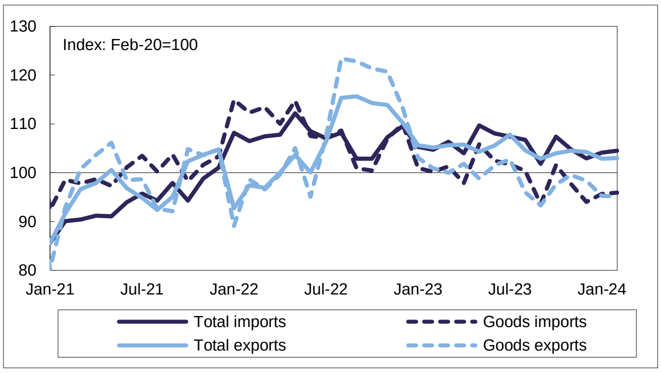
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Trade balance, export & import values



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Export & import volumes



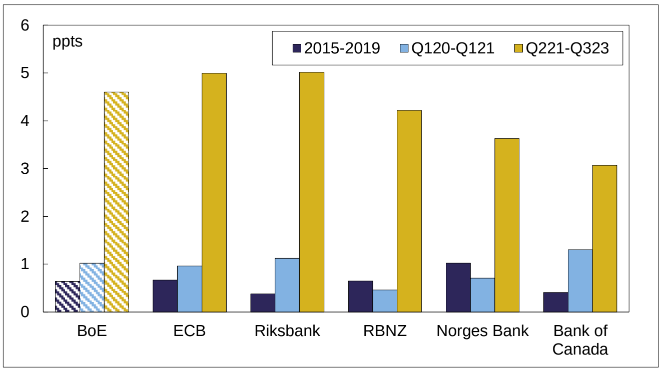
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The coming week in the UK

While the BoE's next monetary policy meeting is still almost four weeks away, the coming week's dataflow will provide an important update on the key variables in the MPC's reaction function, i.e. the underlying tightness of labour market conditions, wage growth and services price inflation. The previous Labour Force Survey (LFS) saw the unemployment rate tick slightly higher in the three months to January for the first month in six, to 3.9%, nevertheless just 0.3ppt above the series low recorded in August 2022 and therefore suggestive of a still tight labour market. While payrolled employees rose in February (20k) and today's GDP data signalled moderate recovery momentum, given the steady downtrend in job vacancies, we would expect Tuesday's labour market report to show that the unemployment rate has moved sideways in the three months to February. Meanwhile, having moderated in January to its softest rate in 18 months (5.6%3M/Y), total wage growth is likely to have eased slightly further in the three months to February, with regular pay growth similarly set to have edged lower from 6.1%3M/Y previously. This would be consistent with a further slowdown implied by the Indeed wage tracker, which in February fell to a fourteen-month low, while the REC/KPMG's measure of starting salaries moderated to a near-three-year low that month.

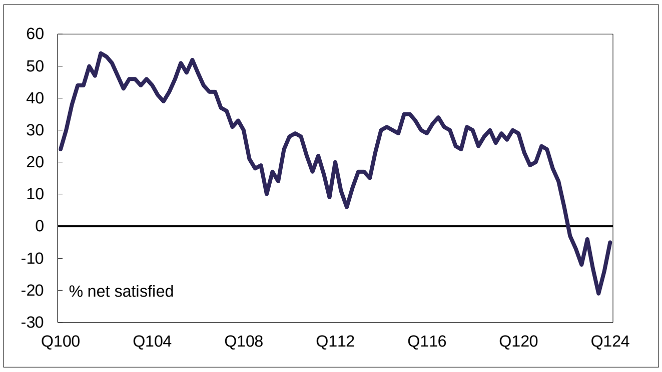
The CPI inflation report for March will be published on Wednesday. After a pause in the downtrend around the turn of the year, we expect headline inflation to fall for a second successive month in March, by 0.2ppt to 3.2%Y/Y, which would be the lowest rate since September 2021 and almost 8ppts below the peak in October 2022. While the energy component will again likely add slightly to inflation due in part to higher petrol prices, we expect the other major components to more than offset that impact, with food inflation likely falling more than 1ppt to its lowest level since March 2022 and core goods inflation likely falling about ½ppt to the lowest since April 2021. Not least due to the early Easter holiday period this year, the downtrend in services inflation is likely to be more modest, easing only slightly from 6.1%Y/Y in February, which would be the softest rate since January 2023 but above the MPC's forecast. Overall, we expect core inflation to fall a further 0.3ppt to 4.2%Y/Y, which would be the lowest since December 2021. Friday will also bring retail sales figures for March. While the BRC's retail monitor suggested that wet weather had dampened demand for garden furniture, BBQs and clothing, the survey also signalled a pickup in food sales ahead of the Easter holiday. And so, having moved sideways in February, sales are expected to have risen in March, by as much as ½%M/M, which would leave them on average in Q1 some 2% above the Q4 average.

Central bank inflation forecast errors*



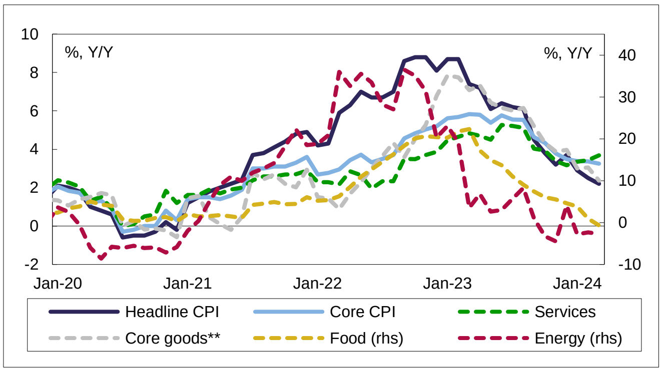
*Root mean squared forecast errors for inflation one-year ahead. CPI except for ECB (HICP) and Riksbank (CPIF). Source: BoE Bernanke Review and Daiwa Capital Markets Europe Ltd.

UK: Household satisfaction with the BoE*



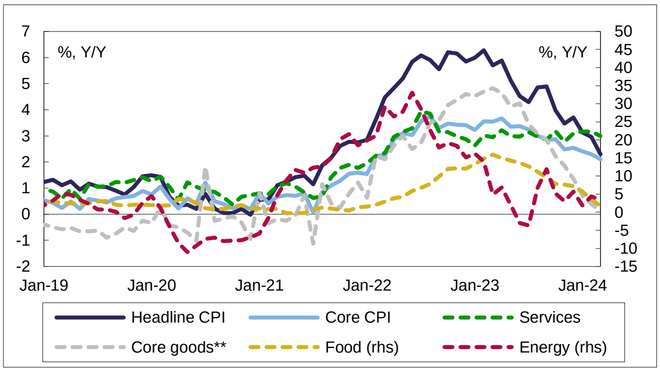
*Net balance of households satisfied with the way BoE is doing its job to set interest rates in order to control inflation. Source: BoE inflation attitudes survey,and Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation*



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

France: Consumer price inflation*



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

Euro area

German and French services inflation boosted in part by Easter in March

There were no surprises in the final March inflation estimates from Germany and France, which confirmed the ongoing downtrend recorded in the flash releases and suggested that the persistence of services pressures related at least in part to the early timing of Easter this year. In particular, the headline German EU-harmonised HICP measure fell 0.4ppt to 2.3%Y/Y, matching November's 29-month low, while the equivalent French figure fell 0.8ppt to 2.4%Y/Y, the lowest since August 2021. The detail confirmed that base effects related to food prices provided a sizeable drag in both countries, with Germany recording modest deflation for the first time in nine years. But consistent with the weakness in global goods price pressures, non-energy goods inflation also fell sharply in both countries in March, with downwards pressures from a wide range of manufactured products, including clothing, household appliances, motor vehicles, audio visual devices and toys and games. Despite a pickup in package holiday inflation – presumably related to the earlier timing of the Easter holiday – and a likely one-off jump in sporting event prices, French services inflation maintained a downwards trend in March (-0.2ppt to 3.2%Y/Y). In contrast, German services inflation ticked up to a five-month high (4.0%Y/Y). The detail suggested that this was also related in part to the Easter effect, with catering inflation up to a six-month high. But having jumped significantly at the start of the year, insurance prices continued to rise at an above-average pace in March leaving inflation of that component up to a series high 10.9%Y/Y. Overall, core HICP inflation eased in March, by 0.3ppt apiece to 3.2%Y/Y in Germany and 2.2%Y/Y in France.

The coming week in the euro area

The main focus in the euro area in the coming week will be the release of final euro area inflation figures for March on Wednesday. The flash release brought a modest downside surprise, with the headline and core HICP rates down 0.2ppt a piece to 2.4%Y/Y, matching November's 28-month low, and 2.9%Y/Y, a two-year low, respectively. Given their flash estimates to two decimal places, both the headline (2.44%Y/Y) and core rates (2.95%Y/Y) appear at risk of a potential upwards revision, although much will depend on the final estimates of Italian inflation on Tuesday. The euro area release will bring the granular detail, which will be used to calculate other measures of underlying inflationary pressures. In terms of activity data, the coming week will bring February figures for euro area industrial production (Monday), goods trade (Tuesday) and construction activity (Thursday). Based on the equivalent figures from the member states – which reported growth in Germany (1.8%M/M), Netherlands (1.4%M/M) and Ireland (3.7%Y/Y) but declines in Belgium (-2.7%M/M) and Greece (-2.1%M/M) – aggregate euro area IP is expected to have increased almost 1.0%M/M in February. However, the official Eurostat euro area figures have differed substantially from the country breakdown over recent months, with a decline of 3.2%M/M in January much larger than the drop of 1.7%M/M implied by the member state data. Meanwhile, in line with a notable narrowing of the goods trade surplus in Germany that month, the euro area balance is highly likely to have fallen back from the series high (€28.1bn) recorded at the start of the year. And while French construction activity fell in February, given the extreme weather-assisted surge in Germany (7.9%M/M), we expect euro area output to have risen for a third consecutive month. Finally, the German ZEW investor survey for April (Tuesday) and goods PPI data for March (Friday) are also due.

Daiwa economic forecasts

	2023 Q4	2024 Q1	2024 Q2	2024 Q3	2024 Q4	2025 Q1	2023	2024	2025
GDP								%, Y/Y	
Euro area	0.0	0.1	0.2	0.2	0.3	0.3	0.5	0.4	1.3
UK	-0.3	0.4	0.2	0.2	0.2	0.2	0.1	0.4	1.0
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.7	2.6	2.3	1.9	2.4	2.1	5.4	2.3	1.8
Core HICP	3.7	3.1	2.2	1.8	2.3	1.8	4.9	2.3	1.7
UK									
Headline CPI	4.1	3.5	1.8	2.1	2.3	1.9	7.3	2.4	1.8
Core CPI	5.3	4.6	3.1	2.7	2.7	2.2	6.2	3.2	1.8
Monetary policy, %									
ECB									
Deposit Rate	4.00	4.00	3.75	3.50	3.25	3.00	4.00	3.25	2.25
Refi Rate	4.50	4.50	4.25	3.65	3.40	3.15	4.50	3.40	2.40
BoE									
Bank Rate	5.25	5.25	5.00	4.75	4.50	4.25	5.25	4.50	3.50

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Final HICP (CPI) Y/Y%	Mar	**2.3 (2.2)**	*2.3 (2.2)*	2.7 (2.5)	-
France	Final HICP (CPI) Y/Y%	Mar	**2.4 (2.3)**	*2.4 (2.3)*	3.2 (3.0)	-
Spain	Final HICP (CPI) Y/Y%	Mar	**3.3 (3.2)**	3.2 (3.2)	2.9 (2.8)	-
UK	GDP M/M% (3M/3M%)	Feb	**0.1 (0.2)**	0.0 (0.1)	0.2 (-0.1)	0.3 (0.0)
	Industrial production M/M% (Y/Y%)	Feb	**1.1 (1.4)**	0.0 (0.6)	-0.2 (0.5)	-0.3 (0.3)
	Services output M/M% (3M/3M%)	Feb	**0.1 (0.2)**	0.1 (0.1)	0.2 (0.0)	0.3 (-)
	Construction output M/M% (Y/Y%)	Feb	**-1.9 (-2.0)**	-0.2 (-1.1)	1.1 (0.7)	- (2.0)
	Trade (goods trade) balance £bn	Feb	**-2.3 (-14.2)**	-	-3.1 (-14.5)	-2.2 (-14.1)

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming few week's key data releases

Country	BST	Release	Period	Market consensus/ *Daiwa forecast/actual*	Previous
		Monday 15 April 2024			
Euro area	10.00	Industrial production M/M% (Y/Y%)	Feb	*0.9 (-5.5)*	-3.2 (-6.7)
		Tuesday 16 April 2024			
Euro area	10.00	Trade balance €bn	Feb	-	28.1
Germany	10.00	ZEW current situation (expectations) balance	Apr	-	-80.5 (31.7)
Italy	10.00	Final headline HICP (CPI) Y/Y%	Mar	*1.3 (1.3)*	0.8 (0.8)
	10.00	Trade balance €bn	Feb	-	2.7
UK	07.00	Average earnings including bonuses (excluding bonuses) 3M/Y%	Feb	5.5 (5.8)	5.6 (6.1)
	07.00	Unemployment rate 3M%	Feb	3.9	3.9
	07.00	Employment change 3M 000s	Feb	72	-21
	07.00	Payrolled employees, change 000s	Mar	-	20
	07.00	Claimant count 000s (rate %)	Mar	-	16.8 (4.0)
		Wednesday 17 April 2024			
Euro area	10.00	Final headline HICP (core HICP) Y/Y%	Mar	*2.4 (2.9)*	2.6 (3.1)
UK	07.00	Headline (core) CPI Y/Y%	Mar	*3.2 (4.2)*	3.4 (4.5)
	07.00	PPI output prices (input prices) Y/Y%	Mar	0.6 (-2.9)	0.4 (-2.7)
	09.30	House price index Y/Y%	Feb	-	-0.6
		Thursday 18 April 2024			
Euro area	07.00	EU27 new car registrations Y/Y%	Mar	-	10.1
	10.00	Construction output M/M% (Y/Y%)	Feb	-	0.5 (0.8)
		Friday 19 April 2024			
Germany	07.00	PPI Y/Y%	Mar	-3.2	-4.1
Spain	08.00	Trade balance €bn	Feb	-	-3.7
UK	07.00	Retail sales, including auto fuel M/M% (Y/Y%)	Mar	0.3 (1.0)	0.0 (-0.4)
	07.00	Retail sales, excluding auto fuel M/M% (Y/Y%)	Mar	0.4 (1.0)	0.2 (-0.5)

**Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

The coming week's key events & auctions

Country		BST	Event / Auction
			Monday 15 April 2024
Euro area		13.00	ECB Chief Economist Lane scheduled to speak
UK		18.00	BoE Deputy Governor Breeden scheduled to speak
			Tuesday 16 April 2024
UK		10.00	Incoming BoE Deputy Governor Lombardelli scheduled to testify before Treasury Select Committee
		10.00	Auction: £1.5bn of 0.75% 2033 index-linked bonds
		18.00	BoE Governor Bailey scheduled to speak
			Wednesday 17 April 2024
Euro area		13.00	ECB's Schnabel scheduled to speak
		14.00	ECB's Cipollone scheduled to speak
Germany		10.30	Auction: 0% 2050 bonds
		10.30	Auction: 2.5% 2054 bonds
UK		10.00	Auction: £3.75bn of 4% 2031 bonds
		17.00	BoE Governor Bailey scheduled to speak
		19.00	BoE's Haskel scheduled to speak
			Thursday 18 April 2024
France		10.50	Auction: To sell fixed-rate and index-linked bonds with various maturities
Spain		09.00	Auction: To sell fixed-rate bonds with various maturities
			Friday 19 April 2024
UK		15.15	BoE Deputy Governor Ramsden scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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