Daiwa Capital Markets

Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Despite some strong figures for euro area labour costs and indications that net trade supported growth in Q1, Bunds made gains as the job vacancy rate in the region continued to fall and the annual rate of decline of German producer prices accelerated slightly.
- Gilts also made gains as a UK manufacturing survey suggested that expectations for selling price inflation softened in May despite a pickup in output.
- Wednesday's focus will be UK inflation data for April.

Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.968	-0.018
OBL 2.1 04/29	2.550	-0.020
DBR 2.2 02/34	2.506	-0.021
UKT 0⅛ 01/26	4.295	-0.027
UKT 0½ 01/29	4.017	-0.024
UKT 4⅝ 01/34	4.139	-0.027

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

Euro area

Labour cost growth rebounds in Q1

While the most comprehensive national accounts measure of euro area wage growth – compensation per employee – will not be published until after the next Governing Council meeting, today's preliminary estimates of labour costs in Q1 made clear that pressures remained firm by historical standards at the start of the year. In particular, average labour costs per hour worked rose 1.2%Q/Q on a seasonally adjusted basis in Q1, up 0.1ppt from Q4 and the same rate as in Q3. Given a softer first quarter in 2023, which reflected payback for a surge at end-22, that pushed the annual rate of labour cost growth up 1.5ppts to 4.9%Y/Y, back close to the average of the prior five quarters. Growth in labour costs was driven by wages and salaries, which leapt 1.8ppts to 5.0%Y/Y, with broad-based strength reflected in construction (5.9%Y/Y), manufacturing (5.4%Y/Y) and business economy services (5.2%Y/Y). The strongest growth in pay was recorded in finance (6.4%Y/Y) and professional and technical services (6.8%Y/Y), while wholesale, retail and hospitality (4.2%Y/Y) and real estate (1.3%Y/Y) saw more muted increases.

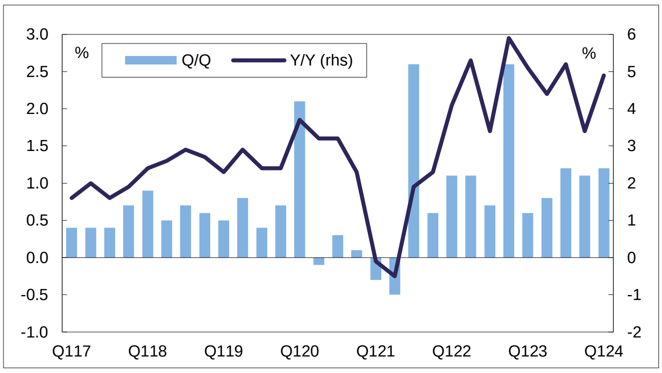
Vacancy rate moderates for seventh successive quarter

The ECB's Governing Council is obviously mindful of the risks of inflation persistence, particularly in labour-intensive services, should such strong pay growth be maintained. So, it will continue to watch closely various leading indicators of labour costs, including its estimates of negotiated wage growth due on Thursday. National data suggest that negotiated wage growth likely remained close to the Q423 rate of 4.5%Y/Y, although one-off payments might have skewed that figure upwards. But the Indeed wage tracker points to moderation ahead. And, while the unemployment rate has recently levelled off at the series low of 6.5%, a seventh successive quarterly decline in the seasonally adjusted job vacancy rate in Q1, to the lowest level since Q321 just 0.5ppt above the 2019 average, suggests that excess labour demand has dissipated significantly. So, the Governing Council should expect pay growth to moderate steadily over coming quarters, particularly as softer inflation outturns become factored into future settlements. Over the near term, firms' margins should continue to absorb some of the pressures from pay. And stronger economic output should in due course allow unit labour cost growth to moderate back in line with rates consistent with the achievement of the inflation target on a sustained basis.

German producer prices suggest consumer goods inflation should remain subdued for now

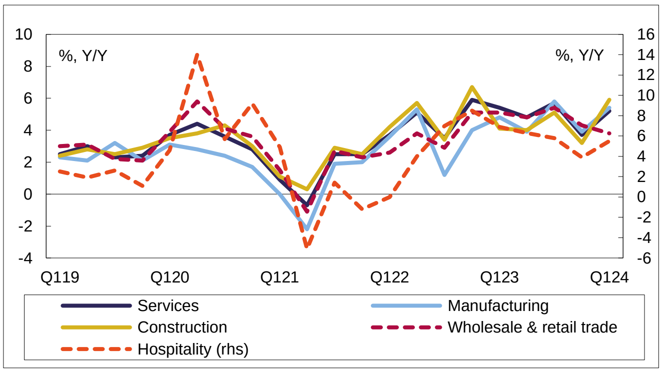
Today's German producer price figures showed that pipeline pressures in the factory sector remained largely absent at the start of Q2, suggesting that core consumer goods inflation should remain very subdued over coming months. Indeed, while German producer prices rose in April for a third month in four (0.2%M/M), that left the annual PPI rate still firmly in negative

Euro area: Labour costs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Wage growth by selected sector



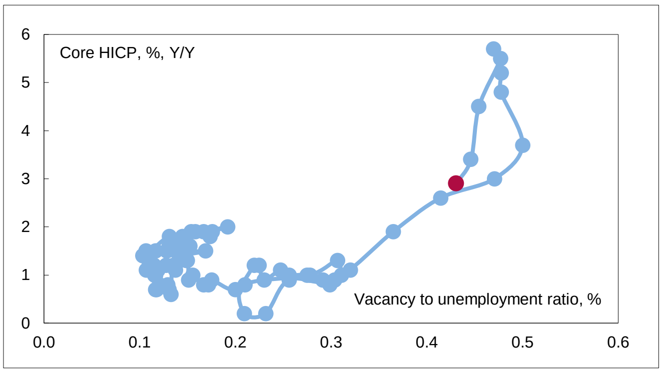
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

territory for a tenth consecutive month, down 0.4ppt to -3.3%Y/Y, albeit 5.9ppts above September's trough. Admittedly, energy prices remained the principal drag (-8.2%Y/Y), with favourable base effects sustaining significant negative prints in gas (-18%Y/Y) and electricity prices (-14%Y/Y) offsetting higher prices of petroleum products (2.1%Y/Y) and heating oil charges (9.7%Y/Y). When excluding energy, German core producer prices rose for a fifth successive month (0.3%M/M). But due to base effects, annual core PPI inflation remained in negative territory (-0.6%Y/Y) close to February's near-eight-year low of -0.8%Y/Y, therefore suggesting still very weak underlying pressure. Within the detail, intermediate prices rose the most since January 2023 (0.3%M/M). But this merely pushed the annual rate up 0.6ppt to a four-month high of -3.1%Y/Y. Meanwhile, capital goods inflation (2.4%Y/Y) eased to the lowest since August 2021, while consumer goods inflation moved sideways at an extremely subdued 0.4%Y/Y, despite a further upwards impulse from producer food prices. While surveys suggest that the disinflationary trend in the factory sector has faded somewhat due in part to the increase in oil prices in April related to heightened geopolitical risks, some of that pressure has eased in May while wholesale gas prices have moved broadly sideways. Moreover, surveys suggest that lacklustre goods demand continues to constrain firms' ability to pass on increased costs to consumers.

Euro area trade likely provided a boost to Q1 GDP

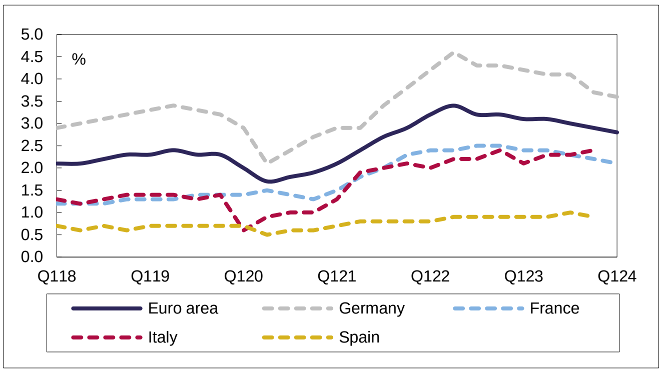
Today's euro area goods trade data illustrated the subdued trend in global goods demand. Indeed, the value of goods exports fell 9.2%Y/Y in March to be down 3.2%3M/Y over the first three months of the year. Nevertheless, the trend in the value of imports has been even weaker (-12.0%Y/Y and -12.3%3M/Y). And, indeed, in seasonally adjusted terms, the euro area's trade surplus widened slightly in March, by €600mn to €17.3bn, as a very modest increase in exports on the month (0.1%M/M) combined with a slight decline in imports (-0.1%M/M). So, having reached a monthly series high at the start of the year (€26.0bn), this left the quarterly surplus in Q1 (up €20.0bn to €60.0bn) at the highest for three years. This in part reflected a record surplus with the US in March as exports rose to a four-month high, while the euro area's goods deficit with China narrowed over the first quarter as a whole despite widening slightly in March. Moreover, having reached a series high in Q4, the trade surplus with the UK moved broadly sideways in Q1. Within the sectoral detail, despite ongoing concerns about the need for significant structural adjustments in Germany following the recent energy crisis, today's data confirmed a healthy surplus in the chemicals subsector (€21.8bn in March), with the euro area's trade balance in machinery and transport equipment in Q1 also the highest since before the pandemic. And reflecting the marked decline in wholesale gas prices from the recent peak, the energy deficit in Q1, while still substantial, was the smallest in 2½ years. Over the first quarter as a whole, the value of imports fell almost 2½%3M/3M, while exports rose 0.5%3M/3M. So, while the detail of export and import prices in March has yet to published, today's figures strongly suggest that net goods trade offered a non-negligible boost to euro area GDP growth in Q1.

Euro area: Phillips curve



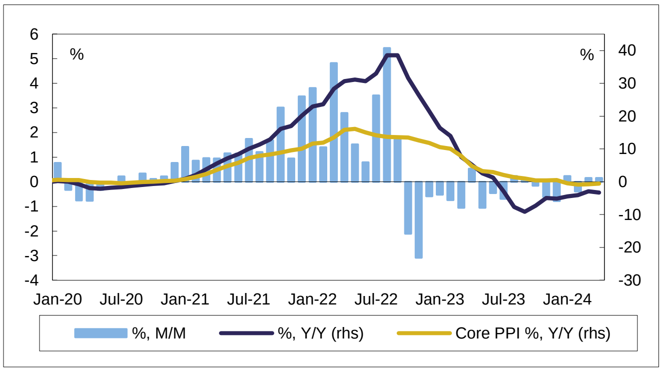
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Job vacancy rates



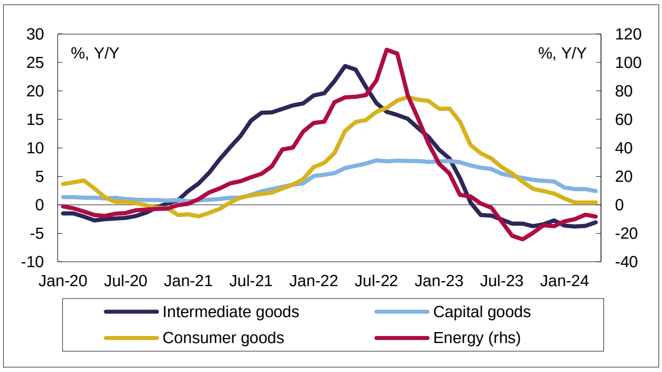
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Selected PPI components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

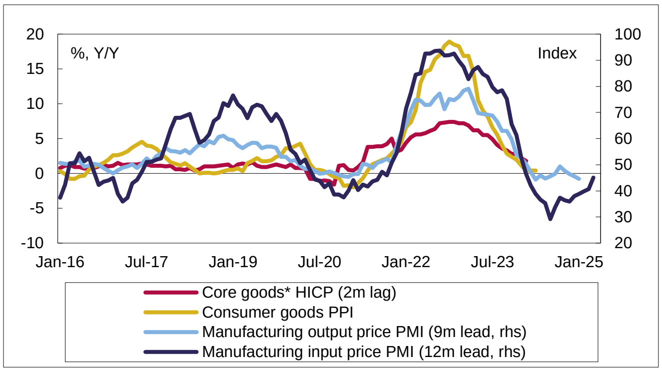
Euro area construction boosted by strong civil engineering activity in Q1

The construction sector also provided surprisingly strong support to the euro area's expansion in the first quarter. Indeed, while today's figures suggested that activity rose a more modest 0.1%M/M in March, this still marked a fourth successive increase to leave output up 1.3%3M/3M in Q1, the firmest such growth since Q123. And the expansion would have been stronger still in the absence of the contraction in Spain (-1.3%3M/3M) and zero growth in the sector in France. Indeed, growth was robust in Germany, where a weather-assisted boost brought growth of almost 4%3M/3M in Q1, the most since Q221. In addition, activity rose 1½%3M/3M in Italy despite declining for a second successive month in March. Euro area construction activity was underpinned by civil engineering work (3.3%3M/3M in Q1), while building work contracted (-0.2%3M/3M) for a fourth consecutive quarter as the impact of higher interest rates and declining house prices continued to weigh on demand. And while mortgage rates appear to have peaked, the still low level of building permits and survey evidence suggests that housebuilding will remain relatively weak over the near term. Certainly, the euro area's housebuilding PMI (36.2) implied ongoing contraction at the start of Q2, with acute weakness in Germany (29.2) and France (34.1). But the civil engineering PMI also fell to a five-month low in April and remained below the long-run average. Moreover, with almost a third of firms in the sector surveyed by the European Commission reporting that demand was limiting activity at the start of Q2, we maintain our view that construction will be a drag on GDP in Q2 and provide only limited support through the second half of the year.

The day ahead in the euro area

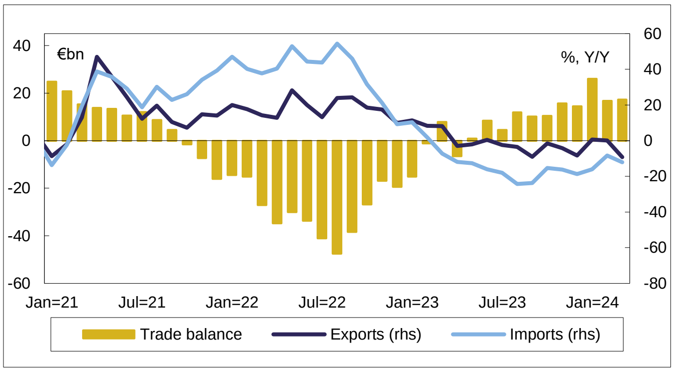
Wednesday should be a relatively quiet day for top-tier euro area economic releases, with just the release of aggregate new car registrations in April. National releases previously published suggest an acceleration in sales growth in April – including increases in Germany (19.8%Y/Y), France (10.9%Y/Y), Italy (7.9%Y/Y) and Spain (23.1%Y/Y) – supported by the recent improvement in consumer confidence and rise in household disposable income. But the magnitude of increase will also be flattered by additional working days this year compared with last due to the earlier timing of the Easter holiday period.

Germany: Goods price indicators



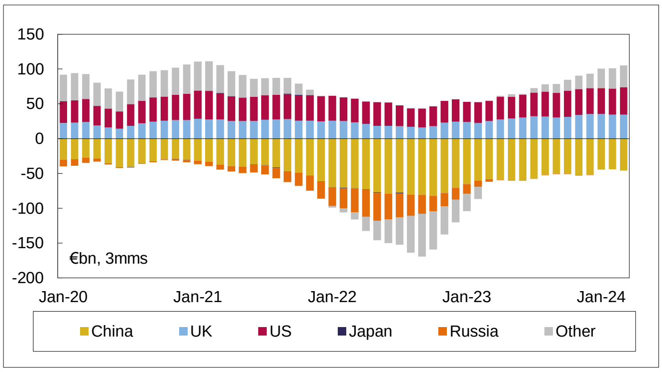
*Non-energy industrial goods. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade balance, imports & exports*



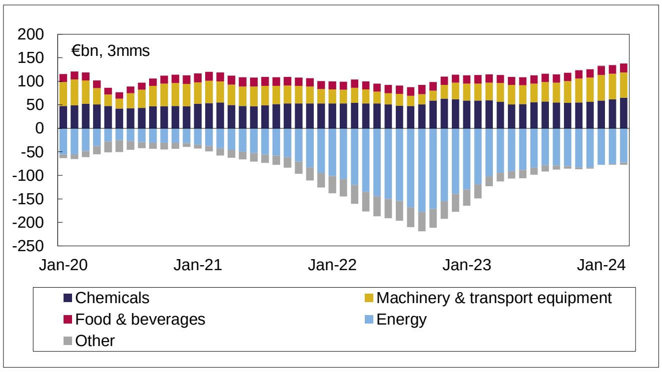
*Seasonally adjusted values. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade balance by country*



*Seasonally adjusted values. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade balance by commodity*



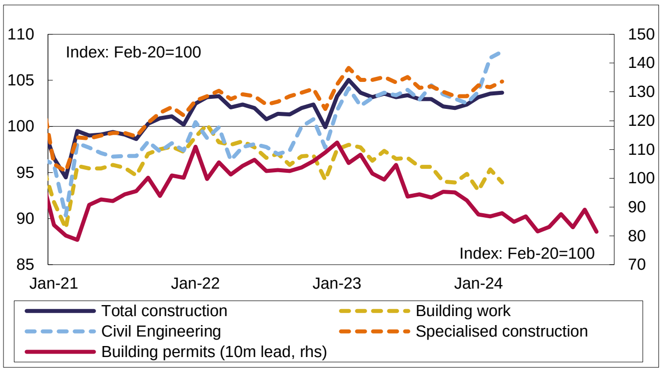
*Seasonally adjusted values. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

The day ahead in the UK

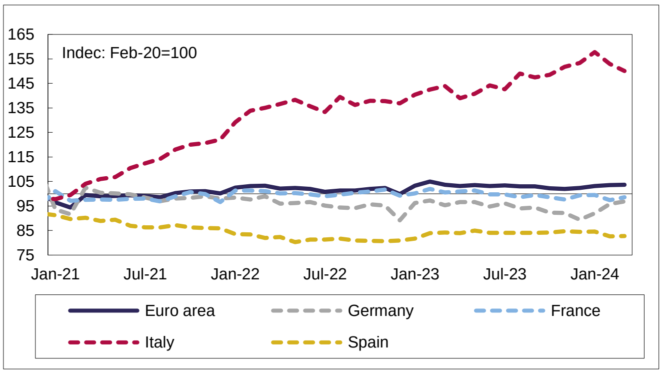
All eyes tomorrow will be on UK inflation data for April. Given the 12% cut in Ofgem's energy price cap from the start of April, we expect headline CPI to take a notable step down, by 1.1ppt to 2.1%Y/Y, which would be bang in line with the BoE's latest projection and mark the lowest rate since July 2021. It would also be below the equivalent rates in the US, euro area and Japan. Due to base effects, food inflation is also expected to slow significantly further to around 4.3%Y/Y to be almost 12ppts below the peak a year ago. But more encouraging for the MPC should be the moderation in core inflation – our expectation is for a drop of 0.7ppt to a 30-month low of 3.5%Y/Y – although this would principally reflect base effects around the early timing of Easter this year. In particular, we expect services inflation to drop a little more than ½ppt to a near-two-year low of 5.3%Y/Y, while non-energy industrial goods inflation is forecast to decline to a near-four-year low of 0.5%Y/Y. While a touch lower than in the US, that core rate would still, however, be some way above the equivalent rates in the euro area and Japan.

Euro area: Construction output & building permits



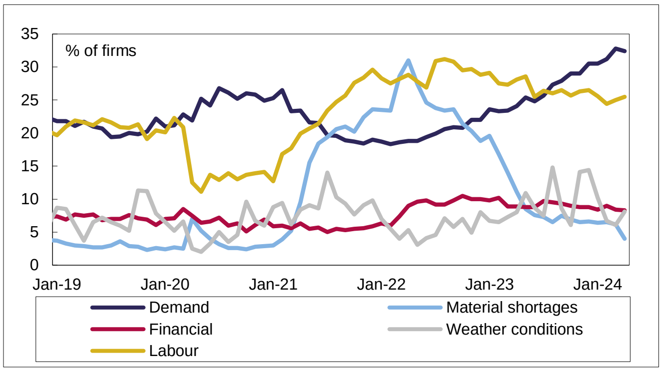
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output by country



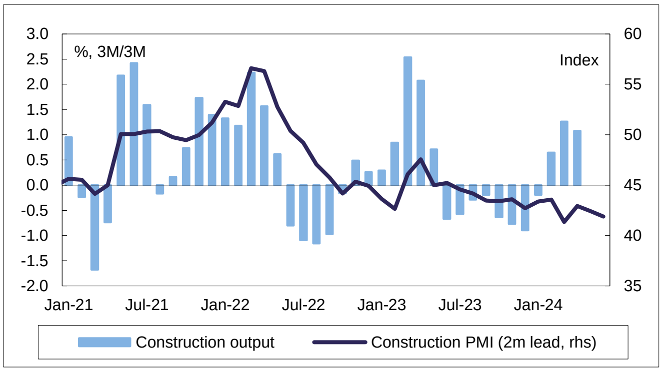
**Seasonally adjusted values. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Factors limiting construction output



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

Euro area: Construction output & PMI



Source: Macrobond, S&P Global 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	Labour costs – first estimate Y/Y%	Q1	**4.9**	-	3.4	-
	Job vacancy rate – first estimate %	Q1	**2.8**	-	2.9	-
	Construction output M/M% (Y/Y%)	Mar	**0.1 (0.1)**	-	1.8 (-0.4)	0.4 (-1.8)
	Trade balance €bn	Mar	**17.3**	20.0	17.9	16.7
Germany	PPI Y/Y%	Apr	**-3.3**	-3.2	-2.9	-
UK	CBI industrial trends survey – total orders (selling price) balance %	May	**-33 (15)**	-20 (25)	-23 (27)	-

Auctions	
Country	Auction
Germany	sold €3.330bn of 2.1% 2029 bonds at an average yield of 2.56%
UK	sold £2.25bn of 4.75% 2043 bonds at an average yield of 4.58%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK	Rightmove house price index M/M% (Y/Y%)	May	**0.8 (0.6)**	-	1.1 (1.7)	-

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	07.00	New car registrations Y/Y%	Apr	-	-4.9
UK	07.00	Headline (core) CPI Y/Y%	Apr	*2.1 (3.5)*	3.2 (4.2)
	07.00	Output (input) PPI Y/Y%	Apr	1.1 (-1.5)	0.6 (-2.5)
	07.00	Public sector net borrowing £bn	Apr	18.5	11.0
	07.00	House price index Y/Y%	Mar	-	-0.2

Auctions and events

Country	BST	Event
Germany	10.30	Auction: €4.0bn of 2.2% 2034 bonds
UK	10.00	Auction: £4.0bn of 4.125% 2029 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs