Euro wrap-up

Overview

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- Bunds made large losses as the ifo survey signalled accelerated recovery momentum in the German economy at the start of Q2, but Italian economic sentiment softened amid a deteriorating fiscal backdrop.
- Gilts also made losses as a UK survey signalled an improvement in manufacturing production expectations.
- Tomorrow will bring surveys of German consumers, French businesses and UK retailers.

Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.952	+0.054
OBL 2.1 04/29	2.585	+0.078
DBR 2.2 02/34	2.586	+0.086
UKT 0⅛ 01/26	4.429	+0.095
UKT 0½ 01/29	4.216	+0.096
UKT 4⅝ 01/34	4.332	+0.093

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

Euro area

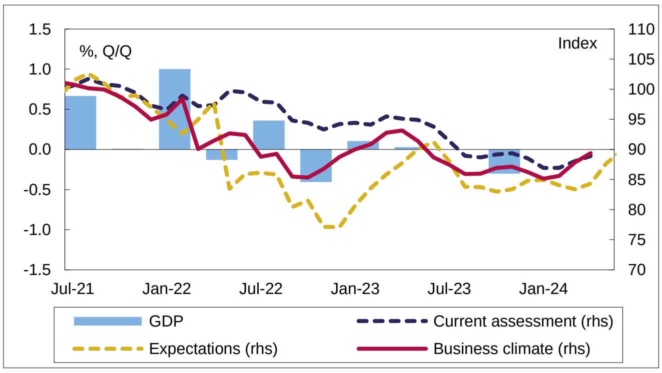
Ifo survey signals accelerated recovery momentum in German business climate at the start of Q2

Broadly validating the marked pickup in the German composite PMI reported yesterday, today's ifo business survey results similarly suggested a welcome improvement in economic conditions in the euro area's largest member state at the start of Q2. Indeed, the headline business climate index rose for the third consecutive month, by 1.5pts to 89.4, the highest in eleven months, to be more than 3pts above the Q1 average. Tallying also with the ZEW investor survey, there was a further notable increase in optimism regarding the coming six months, with the ifo expectations index up 2.2pts to 89.9, the highest in a year and the second-highest for more than two years. And while the pickup in the current conditions index was more modest (0.9pt) it still rose to a five-month high of 88.9 to be some 1½pts above the Q1 average. Admittedly, the improvement in the current conditions index in April might have been flattered by the timing of Easter this year. Moreover, the survey indices remain well below the pre-pandemic five-year averages. And, on balance, pessimists continue to outweigh optimists with respect to the near-term outlook. Nevertheless, like yesterday's flash PMIs and in line with our forecast, the ifo survey strongly suggests that German GDP will register positive growth this quarter. But while the government today revised up its full-year GDP forecast for 2024 amid signs that the economy has reached a turning point, its anticipated growth of 0.3%Y/Y would be weak and certainly below potential.

Services & retail firms benefit from firmer spending, but factory & construction outlook improving

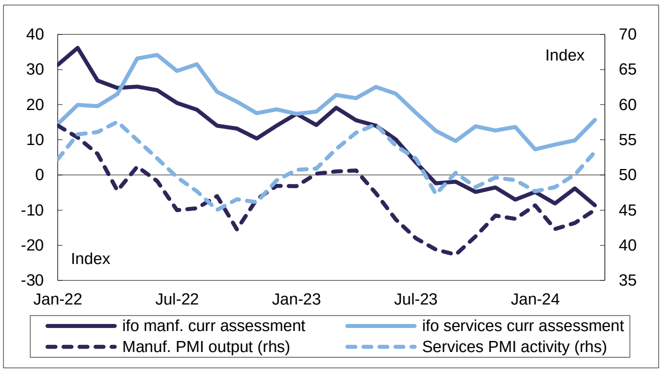
Similar to the PMIs, the ifo suggested that the pickup in activity at the start of Q2 was driven by services, for which the current business situations balance jumped the most since May 2022 to a nine-month high. Pointing to firmer consumer spending amid improved real disposable incomes, the equivalent retailers' balance also rose sharply to a twelve-month high. And while there was little improvement in retail expectations for the coming six months, the respective balances were nevertheless the highest for more than a year. In contrast, like yesterday's PMIs, today's survey flagged ongoing challenges in the manufacturing sector, where shrinking order books continue to limit production. Indeed, according to the ifo survey, manufacturers were the most downbeat about current conditions since the first Covid wave in 2020 and the Global Financial Crisis before that. And despite the recent surge in construction activity earlier in the year related to mild winter weather – output in the sector in first two months of Q1 was some 4½% above the Q4 average – a reported lack of orders also weighed on sentiment in the construction sector. Nevertheless, likely given the prospect of a first rate cut in June, expectations in the sector rose to a nine-month high, with the balance in April more than 10pts above the Q1 average. And while pessimists continued to outweigh optimists in the manufacturing sector, the respective expectations balance similarly jumped to its highest in a year.

Germany: GDP growth & ifo sentiment indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Business sentiment indices



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

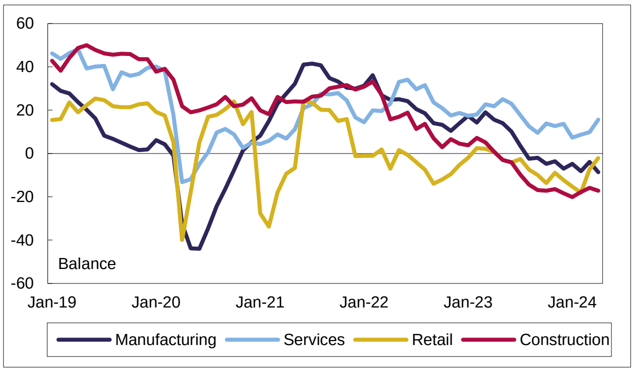
Italian economic sentiment softens at start of Q2 but growth likely to continue

While the flash PMIs reported improved conditions at the start of Q2 in both Germany and France, they also implied a slight moderation in momentum in the rest of the euro area. Today's ISTAT survey results for April suggest that a softening in sentiment in Italy might be a key reason for that. The consumer confidence index dropped 1.3%M/M to a five-month low, 1.5% below the Q1 average. And the business confidence index fully reversed its gain in March to drop 1.2%M/M and a similar amount below the Q1 average. The deterioration in sentiment was broad-based, as firms in all sectors nudged down their expectations for demand. Services sentiment weakened to a five-month low. Manufacturers and retailers were also a touch more pessimistic. And, in part reflecting the phase-out of the government's 'superbonus' fiscal inventive scheme to encourage energy-saving home renovations, construction firms were the most downbeat in 17 months. We are not overly alarmed by the latest ISTAT survey results. Consumer confidence was in line with the average of the past twelve months and still above the average in the fifteen years ahead of the pandemic. So, we still think that, having contracted in Q4, household consumption rose in Q1 and will grow again in Q2. Similarly, although it fell below the average of the past year, business sentiment also remained well above the long-run average and consistent merely with a modest slowing of growth at the start of Q2. And we maintain our forecast that Italian GDP growth will pick up gradually, from about 0.1%Q/Q in Q1 to 0.2%Q/Q in Q2.

Deterioration in public finances & fiscal policy uncertainty likely weighing on confidence

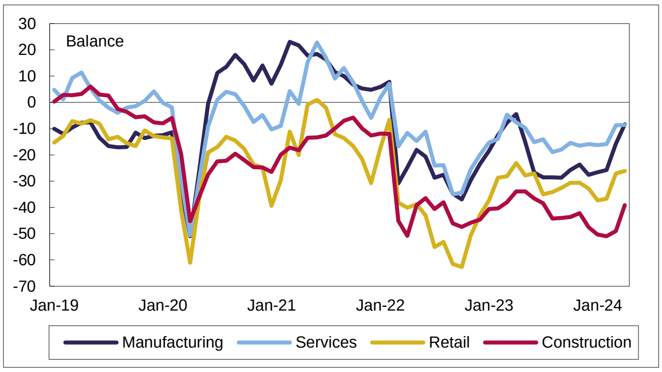
Uncertainty and concern about the future path of fiscal policy has likely played a role in the recent deterioration in sentiment among Italian consumers and businesses alike. Data released earlier this week confirmed that the general government budget deficit reached 7.4% of GDP last year, up 0.2ppt from the previous estimate to be roughly 3ppts above the initial plan. The overshoot, which reflects the much larger uptake of the 'superbonus' scheme than initially expected, means that the government debt-to-GDP ratio is likely to rise over the coming three years, among other things meriting the launch of a formal Excessive Deficit Procedure (EDP) by the European Commission seeking corrective action. The deterioration in the public finances raises questions about how the deficit might possibility be brought back below the 3% benchmark over coming years, particularly given the government's intention to extend temporary tax cuts for lower- and middle-income earners. And should bond market conditions suddenly deteriorate to the extent that market access was jeopardised – admittedly, a scenario to which we currently attach only a small probability – the EDP would also raise questions about Italian eligibility for purchases under the ECB's Transmission Protection Instrument (TPI).

Germany: ifo current conditions indices



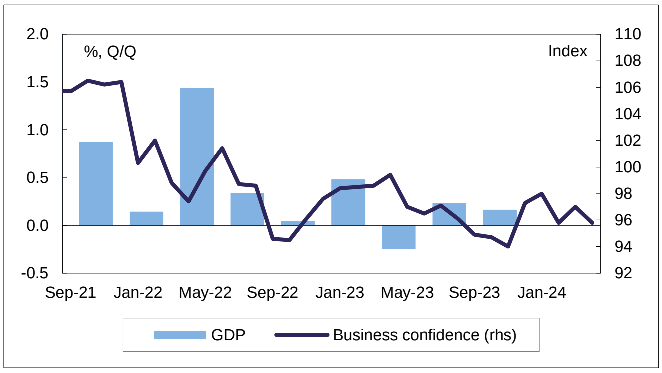
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ifo expectations indices



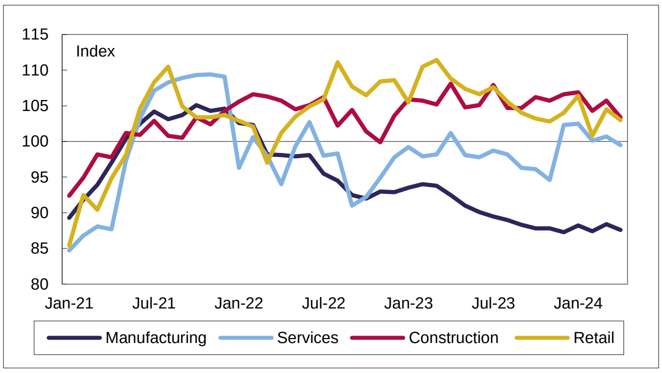
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: GDP growth & ISTAT sentiment index



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: ISTAT business sentiment indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

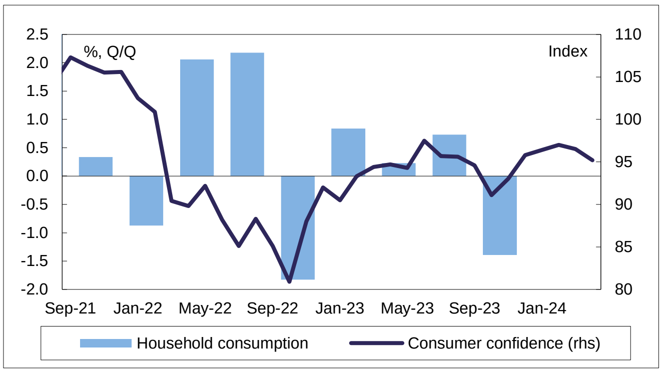
The flow of national sentiment survey indicators continues tomorrow with the German GfK consumer and French INSEE business confidence indices. After the Commission's flash consumer confidence indicator published earlier in the week rose to a more than two-year high, the GfK survey should similarly report a further rise in sentiment in Germany after the previous GfK survey saw the headline index – presented as a forecast for April – improved to a four-month high. But while last month the detail suggested improved income and economic expectations, household purchase intentions remained historically weak. Meanwhile, following the improvement in the French flash PMIs, tomorrow's INSEE business survey is likely to point to firmer recovery momentum at the start of Q2, with the headline index forecast to edge above the long-run average (100) for the first time in a year. Like the PMIs, the INSEE indices are likely to signal that the recovery remains services-led, but will also provide an update on retail and construction sector conditions at the start of Q2.

UK

CBI survey signals improved manufacturing production expectations

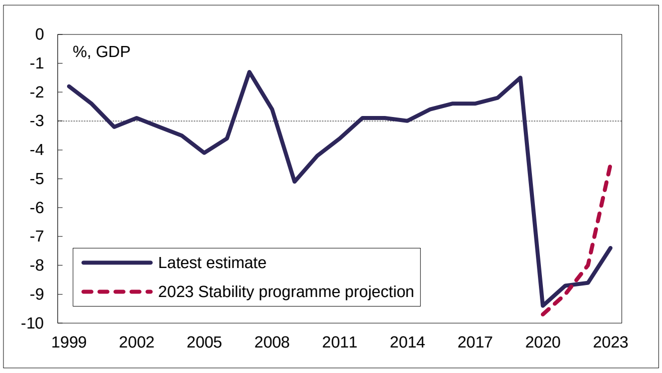
Like yesterday's manufacturing PMIs, today's CBI industrial trends survey suggested that factory production over recent months remained constrained by weak demand. Admittedly, according to the CBI, manufacturing output volumes were broadly stable in the three months to April having declined sharply in seven out of the previous eight months. And the headline figure masked a notable increase in output of consumer goods, with the net balance up 22pts to a four-month high. Meanwhile, the share of firms reporting a fall in production fell to one quarter, the lowest since November 2022. And although roughly 40% of manufacturers reported below-normal orders books, production expectations for the coming three months were the highest since October, with the net balance edging above the long-run average as the share of firms expecting to cut output fell to the lowest in almost two years. As such, business optimism improved at the start of the second quarter, to the highest since Q421. With concerns about the cost of finance falling from a 33-year high, firms revised up their investment intentions from three months ago. Indeed, while the survey implied that spending on buildings and plant and machinery would be merely stable in the year ahead, this compared favourably with the three-year low reported at the start of the year. And manufacturers expect to increase investment in production and process innovation by the most since the start of 2022. Employment intentions in manufacturing also improved from three months ago, although remained well below the average of the past two years. Meanwhile, similar to yesterday's PMIs, the CBI's measure of selling price expectations edged higher in April, although remained well below levels seen over recent years suggesting that goods inflation should remain well-behaved.

Italy: ISTAT consumer confidence & consumption



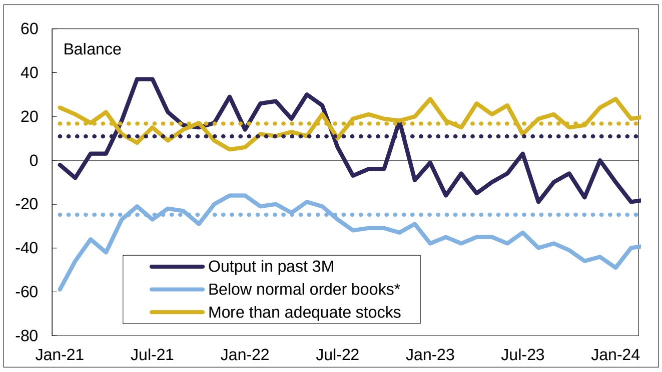
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: General government balance*



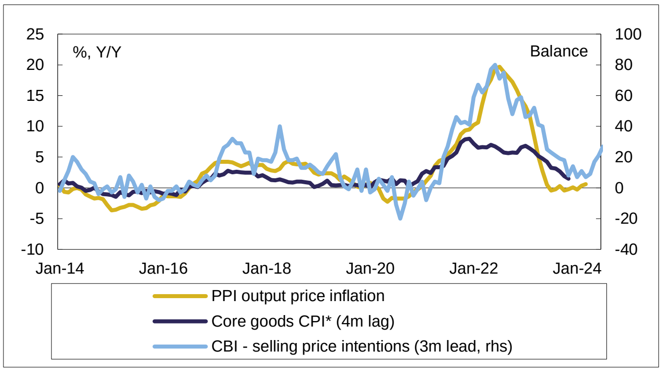
**Dashed line represents the EU Treaty deficit limit. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: CBI manufacturing sentiment indices



**Inverted index. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: Goods price indicators



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

The day ahead in the UK

Tomorrow will bring the CBI's distributive trades survey, which will provide an update on retail conditions at the start of Q2. Given the early timing of Easter this year, this might well suggest a slowdown in annual sales growth in April.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	ifo business climate index	Apr	**89.4**	88.8	87.8	87.9
	ifo business current conditions (expectations) index	Apr	**88.9 (89.9)**	88.7 (88.9)	88.1 (87.5)	- (87.7)
Italy	ISTAT business (manufacturing) confidence index	Apr	**95.8 (87.6)**	-	97.0 (88.6)	- (88.4)
	ISTAT consumer confidence index	Apr	**95.2**	96.7	96.5	-
UK	CBI industrial trends survey – total orders (selling prices) balance %	Apr	**-23 (27)**	-16 (-)	-18 (21)	-

Auctions

Country	Auction
Germany	sold €3.24bn of 2.2% 2034 bonds at an average yield of 2.54%

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	GfK consumer confidence index	May	-26.0	-27.4
France	07.45	INSEE business (manufacturing) confidence index	Apr	101 (103)	100 (102)
UK	11.00	CBI distributive trades survey – reported retail sales balance %	Apr	5	2

Auctions and events

Country	BST	Event
Euro area	08.00	ECB's Schnabel scheduled to give opening speech at research conference on challenges for monetary transmission

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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