Daiwa Capital Markets

# Euro wrap-up

## Overview

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

- Bunds made gains as the flash euro area PMIs signalled further economic stabilisation in March but ongoing contraction in the German economy.
- While the BoE kept rates unchanged and the flash UK PMIs signalled ongoing recovery momentum, Gilts made gains as no MPC member voted for a rate hike for the first time since September 2021.
- Friday will bring UK retail sales figures for February, as well as March results from the German ifo and UK GfK consumer confidence surveys.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 2½ 03/26 | 2.868 | -0.049 |
| OBL 2.1 04/29 | 2.401 | -0.042 |
| DBR 2.2 02/34 | 2.401 | -0.028 |
| UKT 0⅛ 01/26 | 4.159 | -0.038 |
| UKT 0½ 01/29 | 3.870 | -0.037 |
| UKT 4⅝ 01/34 | 3.993 | -0.018 |

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

# Euro area

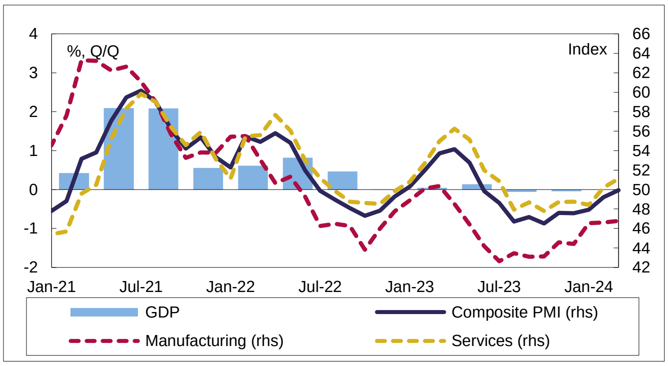
### Euro area PMIs point to further stabilisation led by stronger recovery in the periphery

Following yesterday's improvement in consumer confidence to its highest level in more than two years, today's flash PMIs also indicated improved recovery momentum in the euro area at the end of the first quarter. In particular, the headline composite PMI rose for a fourth month out of the past five in March, by 0.7ppt to a nine-month high of 49.9, albeit still signalling economic stabilisation rather than a return to vigorous growth. The quarterly index in Q1 was nevertheless some 1.8pts above the Q4 average, therefore supportive of our view – as well as the ECB's – that euro area GDP returned to modest positive growth of 0.1%Q/Q in Q1. The survey suggested that the recovery remains services-led, with the activity index rising 0.9pt to a nine-month high of 51.1. In contrast, manufacturing remained a sizeable drag, with the output PMI up just 0.2pt to 46.8, nevertheless the softest pace of contraction reported on the survey in almost a year. There also remain significant divergences in conditions across the region. Despite some stabilisation in German services activity in March (+1.5pts to 49.8), ongoing challenges in the manufacturing sector left the country's composite PMI trending merely sideways in Q1 (46.9), suggesting another quarterly contraction in GDP close to the 0.3%Q/Q decline in Q4. But while the French composite PMI slipped back in March to remain firmly in 'contractionary' territory (47.7), the index in Q1 was more than 2pts above the Q4 average. So, taken together with the improvement reported in today's INSEE business survey (up to a six-month high to 100, bang in line with the long-run average), we maintain our view that French GDP will record modest growth this quarter. Nevertheless, the euro area's economic recovery continues to be led by the rest of the region, for which the respective composite PMI rose 1.2pts to an eleven-month high of 53.6, averaging some 3.3pts above the Q4 level and consistent with a non-negligible acceleration in economic output in the periphery in Q1.

### Services most upbeat about outlook for two years, but manufacturers remain relatively gloomy

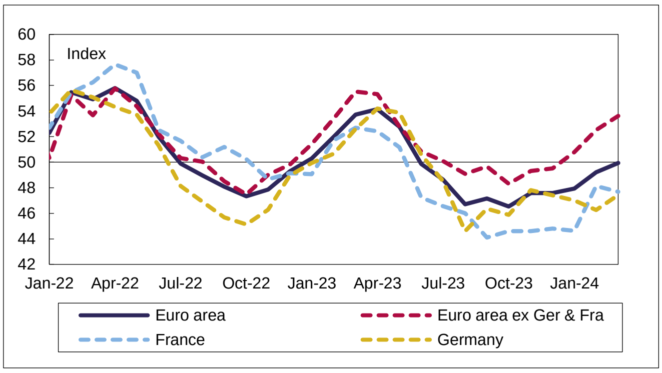
The survey detail offered encouragement with respect to the near-term services outlook too, with the new business component rising for the fifth consecutive month to a nine-month high (50.5). Furthermore, with consumers set to benefit from higher wages and easing price pressures, and borrowers to benefit from a first cut in interest rates over coming months, firms in the sector were the most upbeat about the twelve-month outlook for almost two years. And so, while the share of firms citing a rise in employment slipped back slightly from February's eight-month high, the respective survey component was still consistent with ongoing modest jobs growth in the sector. This contrasted markedly with the manufacturing sector, where firms continued to cut headcount at the fastest pace this cycle as new orders from overseas continued to deteriorate and the respective index for domestic orders was also little improved (45.5). Nevertheless, with stocks of finished goods reportedly cut notably further, the survey's ratio of orders to inventories was the joint-highest since mid-2022, pointing to the prospect of progress towards expansion in the sector when demand eventually picks up. Furthermore, having lengthened by

**Euro area: GDP growth & output PMIs**




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

**Euro area: Composite PMIs by member state**




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

the most in fourteen months in January amid concerns of shipping delays related to events in the Red Sea, the flash PMIs reported another notable reduction in suppliers' delivery times.

### Signs of easing cost pressures in services sector

Amid reduced supply-side challenges, an ongoing downtrend in global goods price pressures, and persisting lack of demand, today's survey again flagged an absence of any meaningful pricing pressures in the manufacturing sector, with selling prices reportedly declining for an eleventh consecutive month. And while the input cost PMI rose to its highest in a year, at 46.2 it remained consistent with disinflation in the sector. But arguably most encouraging in today's PMIs were signs of easing cost pressures in the services sector. Indeed, while still elevated by historical standards, the input price PMI fell 1.7pts – the most since last June – to 61.2, the lowest in eight months and some 18pts below the peak two years ago. Moreover, having risen in February to its highest in nine months, the services prices charged PMI fell for the first month in five and by 1.4pts – similarly the most in nine months – to 55.2, albeit a pace still consistent with persistent above-target inflation.

### The day ahead in the euro area

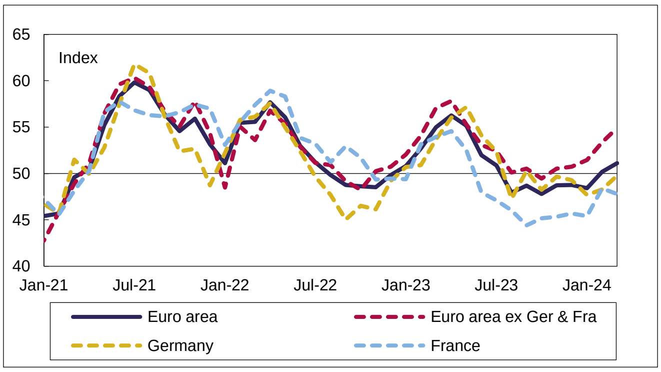
The flow of economic sentiment data continues tomorrow with the publication of the German ifo business survey to offer further insight into economic conditions, including in the construction and retail subsectors not included in today's PMIs. Similar to today's PMIs, the ifo survey is likely to suggest that current conditions remain challenging and consistent with another contraction in GDP in Q1. This notwithstanding, like this week's ZEW investor survey, the ifo expectations index should point to gradual recovery over the coming six months.

# UK

### Bank Rate inevitably unchanged again but MPC hawks stop voting for a hike

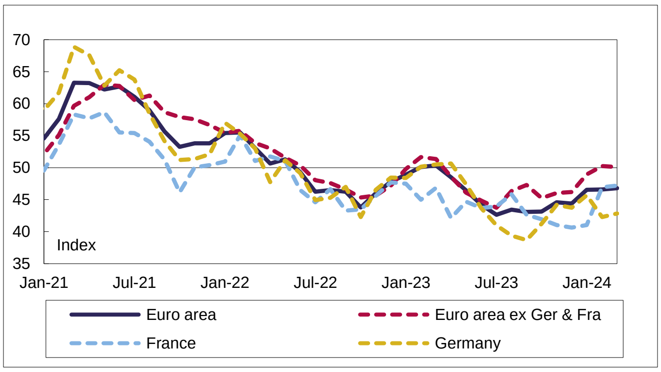
The BoE today inevitably kept Bank Rate unchanged at 5.25% for the fifth successive MPC meeting. With the Committee's tightening bias already having been dropped last month, there was also predictably no material change to its forward guidance. In particular, given its concerns that inflation might become embedded above the 2% target, the MPC's statement repeated that monetary policy will need to remain restrictive for an extended period. And it reiterated that the underlying tightness of labour market conditions, wage growth and services price inflation remain the most important variables in its reaction function for determining when rates might be cut. Once again, only one member (the uber-dove Dhingra) voted for a

**Euro area: Services PMIs by member state**



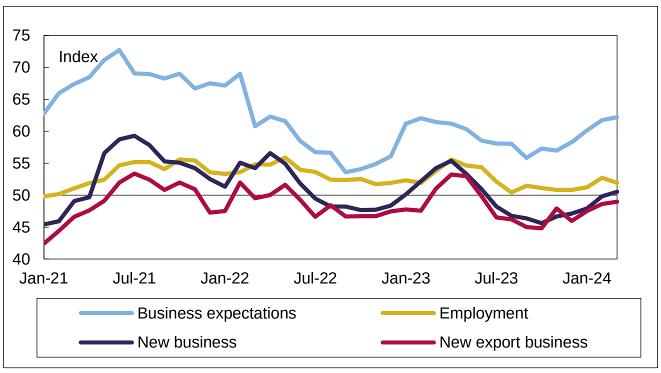

*Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

**Euro area: Manufacturing PMIs by member state**



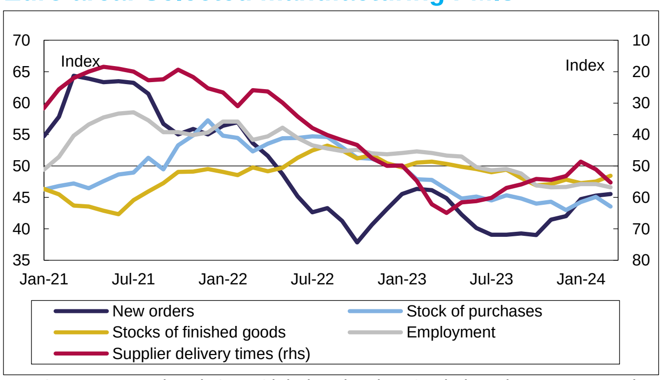

*Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

**Euro area: Selected services PMIs**




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

**Euro area: Selected manufacturing PMIs**




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

cut. But the range of views on the Committee was less hawkish as the two members who voted for a further hike at each of the past four meetings (Haskel and Mann) at last decided instead to back the status quo. So, for the first time since September 2021, no MPC member voted a rate hike, suggesting that the BoE has probably moved a little closer to easing policy.

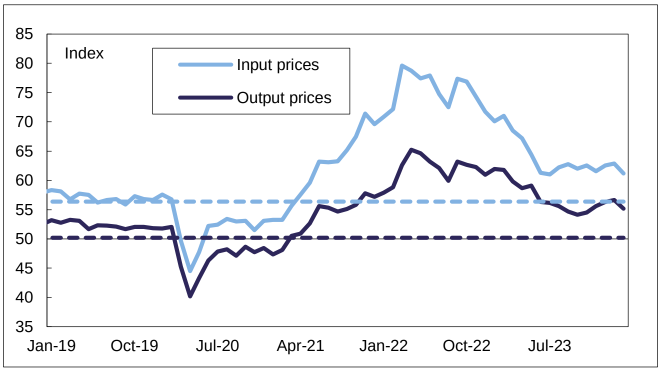
## Committee acknowledges more favourable recent wage and inflation developments

While GDP contracted in Q4 by more than the BoE had expected, the MPC noted clear signs – such as from the PMIs (see below) – that the outlook for economic activity has improved. But while it also judged that the government's recent Budget announcement would boost the level of GDP by around ¼% over coming years, it considered the impact on the output gap and inflation to be smaller. And, more importantly, the MPC's take on recent wage and price developments was favourable. While it was still thought to be tight by historical standards, the MPC thought that the labour market was loosening, with wage growth moderating. Indeed, the BoE's Agents today reported that firms continue to expect weaker pay settlements this year and cited greater difficulty in passing on cost increases to prices. In addition, the MPC had to acknowledge that inflation in February had fallen a touch further than it had expected, with the services component moderating and short-term inflation expectations easing too. The Committee also now expects the headline CPI rate to drop slightly further below target in Q2 than its projections last month had suggested. While the Bank's forecast had suggested that inflation would likely rebound above 2.0% in Q3 and Q4, the Committee decided to take stock of the outlook for inflation from H2 onwards only at the next MPC meeting when new projections will be available. A non-negligible downwards revision to the inflation outlook on that occasion could yet prompt an easing of policy as soon as May.

## BoE to cut in June if ECB and Fed ease policy that month

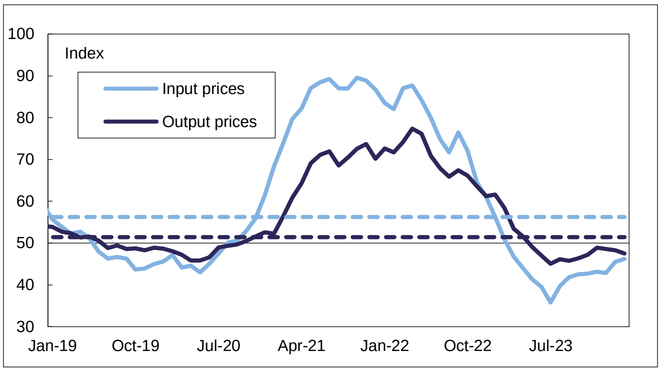
Despite the improved data on wages and prices, however, it is certainly not clear that the inflation outlook has improved sufficiently from the BoE's February projection to prompt a rate cut as soon as the next policy meeting. Indeed, the MPC judged again today that key indicators of inflation persistence remain elevated. And the meeting minutes reported a significant difference of opinion among the eight MPC members who voted for rates to remain unchanged about the risks of second-round effects. The more hawkish members remain concerned that wage growth is too high and services inflation will not fall sufficiently rapidly to a level consistent with the inflation target. But certain others – who we assume include Governor Bailey who today commented that the Bank is "well on the way" to defeating inflation and judged that current market pricing of rate cuts this year appears "reasonable" – appear to see the risks of second-round effects to have diminished. And all

### Euro area: Services price PMIs*



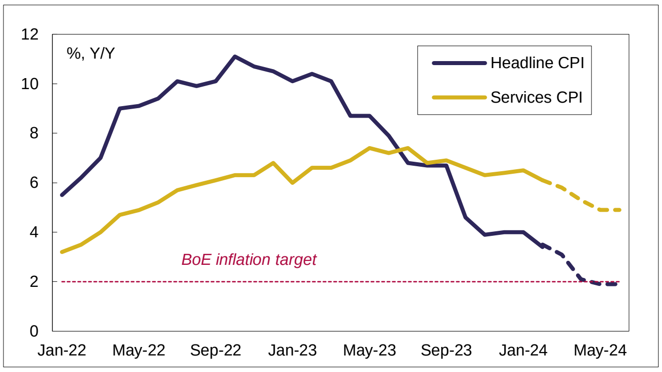

*Dashed lines represent long-run averages. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

### Euro area: Manufacturing price PMIs*



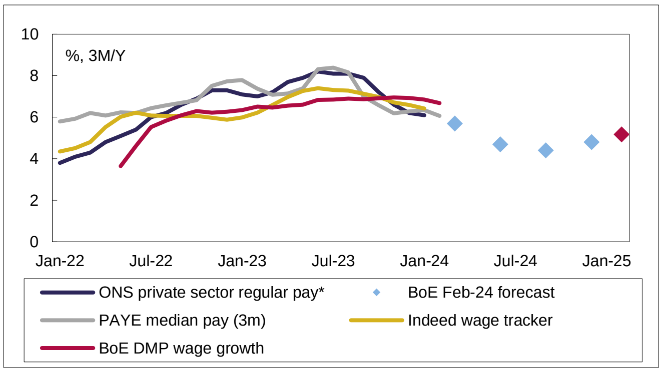

*Dashed lines represent long-run averages. Source: Macrobond, S&P Global Daiwa Capital Markets Europe Ltd.*

### UK: Headline & services CPI inflation*




*Dashed lines represent BoE forecast from Feb-24 MPR. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

### UK: Selected pay indicators




*Data between January 2022 and November 2022 are BoE staff estimates of underlying private sector regular pay growth. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.*

members acknowledge that the stance of monetary policy could well remain restrictive even if and when Bank Rate is cut. The extent of any further loosening of the labour market, and moderation in wage and price growth likely to be required to justify the first cut has not been spelled out. Indeed, the burden of proof required seemingly differs among the various MPC members, leaving it difficult to predict with confidence the future path of rates. But if the other four BoE staff members of the MPC share Bailey's view that the risks of second-round effects have diminished, and particularly if the ECB and Fed have already cut rates that month to ease any concerns on the MPC about a possible impact on sterling, June would now seem most likely to bring a first easing of monetary policy.

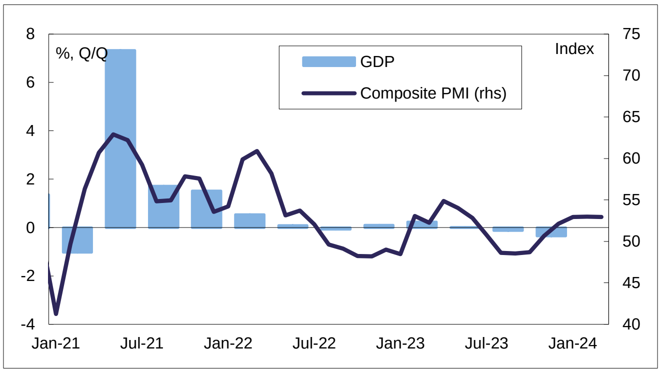
## Flash PMIs consistent with return to positive services-led GDP growth in Q1

Today's UK flash PMIs were consistent with the BoE's assessment that GDP returned to modestly positive growth in the first quarter. Indeed, while the headline composite index moved sideways for a second successive month, at 53.0, it still marked the fifth successive 'expansionary' reading. Moreover, the quarterly index in Q1 was some 2½pts above the Q4 average and a level that before the pandemic would have implied GDP growth between 0.1-0.2%Q/Q. While recovery momentum seemingly moderated very slightly at the end of the first quarter, the PMIs suggested that it remains services-led. Indeed, despite falling for a second successive month in March, the activity index (53.4) was similarly trending some 2½pts above the Q4 average. Admittedly, the detail was not overly encouraging, as the new business component also edged lower from February's nine-month high, while firms were a touch less optimistic about the coming year too, with a number of respondents citing concerns about lacklustre growth prospects and political uncertainty.

## Stabilisation reported in manufacturing for first time in more than a year

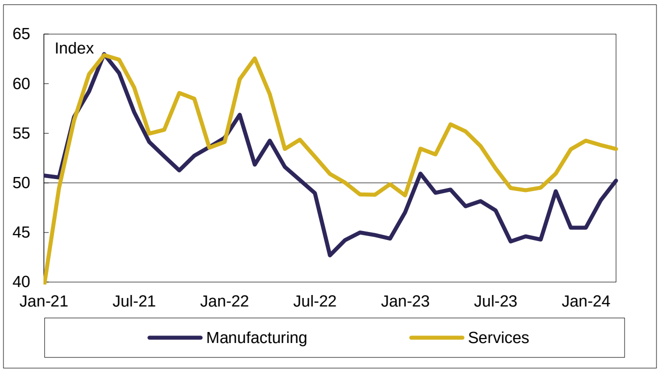
Nevertheless, today's survey also reported some stabilisation in manufacturing conditions at the end of the first quarter, with the output PMI up a further 2pts to 50.2, the first above-50 reading in thirteen months. Moreover, the flash PMIs suggested that the near-term production outlook has also improved, with the new orders component jumping 5pts to 50.5, its highest for almost two years and the order-inventory ratio the highest since June 2021. But while manufacturers flagged a less marked lengthening of suppliers' delivery times than in February, cost pressures in the sector crept slightly higher – the input cost index rose to a twelve-month high and the output price index was the highest since May, albeit with both indicators remaining below the respective long-run averages. But while BoE policymakers might take some comfort from the moderation in the services input price PMI this month, the prices charged index for the sector merely moved sideways, and both remain uncomfortably above the long-run averages.

### UK: GDP growth & output PMIs



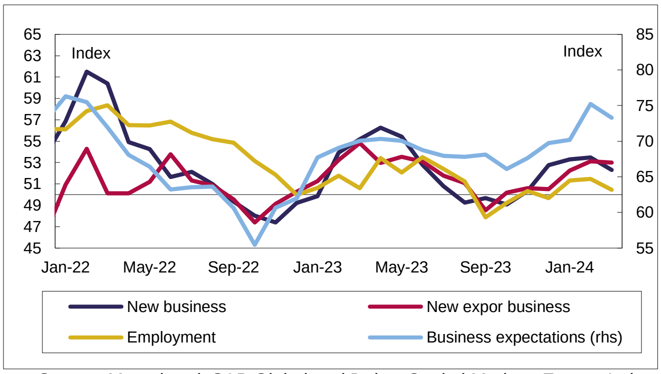

*Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

### UK: Manufacturing & services output PMIs



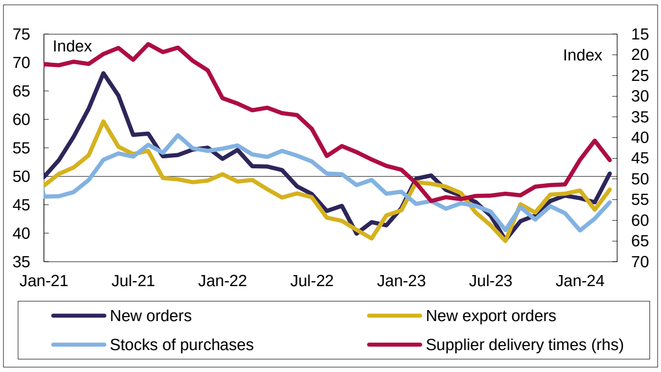

*Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

### UK: Selected services PMIs




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

### UK: Selected manufacturing price PMIs

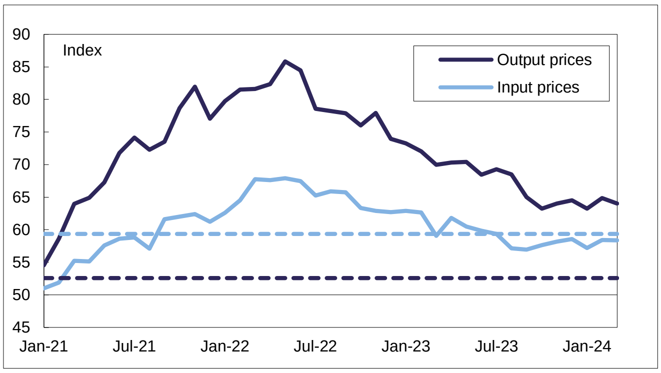



*Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

## The day ahead in the UK

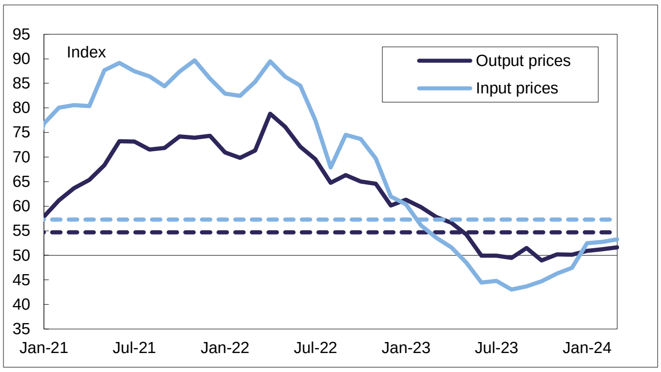
The UK data highlight tomorrow will be February retail sales, which may well have slipped back slightly following the discount-driven rebound of 3.4%M/M in January. Nevertheless, we expect the GfK consumer confidence index for March, also published tomorrow, to reverse the modest 2pt drop seen in February to remain below the long-run average albeit well above the lows of the past two years. Meanwhile, following today's PMIs, the CBI's industrial trends survey for March will give additional insights into recent developments in manufacturing conditions.

### UK: Services price PMIs*




*Dashed lines represent long-run averages. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

### UK: Manufacturing price PMIs*




*Dashed lines represent long-run averages. 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 | | EU27 new car registrations Y/Y% | Feb | **10.1** | - | 12.1 | - |
| | | Preliminary manufacturing (services) PMI | Mar | **45.7 (51.1)** | 47.0 (50.5) | 46.5 (50.2) | - |
| | | Preliminary composite PMI | Mar | **49.9** | 49.7 | 49.2 | - |
| Germany | | Preliminary manufacturing (services) PMI | Mar | **41.6 (49.8)** | 43.5 (48.8) | 42.5 (48.3) | - |
| | | Preliminary composite PMI | Mar | **47.4** | 46.8 | 46.3 | - |
| France | | INSEE business (manufacturing) confidence | Mar | **100 (102)** | 99 (100) | 98 (100) | - (101) |
| | | Preliminary manufacturing (services) PMI | Mar | **45.8 (47.8)** | 47.5 (48.6) | 47.1 (48.4) | - |
| | | Preliminary composite PMI | Mar | **47.7** | 48.7 | 48.1 | - |
| | | Bank of France retail sales Y/Y% | Feb | **-1.4** | - | -3.1 | -2.0 |
| UK | | Public sector net borrowing (excl. banks) £bn | Feb | **7.5 (8.4)** | 6.4 (6.0) | -17.6 (-16.7) | -17.0 (-16.1) |
| | | Preliminary manufacturing (services) PMI | Mar | **49.9 (53.4)** | 47.7 (53.8) | 47.5 (53.8) | - |
| | | Preliminary composite PMI | Mar | **52.9** | 53.2 | 53.0 | - |
| | | BoE Bank Rate % | Mar | **5.25** | *5.25* | 5.25 | - |

**Auctions**

| Country | | Auction |
|---|---|---|
| France | | sold €5.24bn of 2.50% 2027 bonds at an average yield of 2.71% |
| | | sold €4.64bn of 2.75% 2029 bonds at an average yield of 2.64% |
| | | sold €2.62bn of 1.50% 2031 bonds at an average yield of 2.65% |
| | | sold €1.10bn of 0.1% 2029 index-linked bonds at an average yield of 0.46% |
| | | sold €598mn of 0.1% 2036 index-linked bonds at an average yield of 0.69% |
| | | sold €301mn of 0.1% 2040 index-linked bonds at an average yield of 0.73% |
| Spain | | sold €2.90bn of 2.50% 2027 bonds at an average yield of 2.896% |
| | | sold €1.46bn of 5.75% 2032 bonds at an average yield of 2.976% |
| | | sold €1.71bn of 3.45% 2043 bonds at an average yield of 3.65% |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Tomorrow's releases

**Economic data**

| Country | | GMT | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|---|
| Germany | | 09.00 | ifo business climate index | Mar | 85.9 | 85.5 |
| | | 09.00 | ifo current assessment (expectations) index | Mar | 86.8 (84.7) | 86.9 (84.1) |
| UK | | 00.01 | GfK consumer confidence | Mar | -19 | -21 |
| | | 07.00 | Retail sales incl. auto fuels M/M% (Y/Y%) | Feb | -0.4 (-0.8) | 3.4 (0.7) |
| | | 07.00 | Retail sales excl. auto fuels M/M% (Y/Y%) | Feb | -0.4 (-0.8) | 3.2 (0.7) |
| | | 11.00 | CBI industrial trends, total orders (selling prices) | Mar | -20 (19) | -20 (17) |

**Auctions and events**

| Country | | GMT | Event |
|---|---|---|---|
| Euro area | | 17.00 | ECB's Lane gives a lecture on inflation |
| Italy | | 10.00 | Auction: €2.75bn of 3.2% 2026 bonds |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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