

Euro wrap-up

Overview

- As the EU looked to ban imports of Russian coal, Bunds followed USTs lower despite some downbeat data from the euro area's manufacturing sector.
- With the final UK services PMIs pointing to firm growth at the end of Q1, Gilts also made big losses despite some weak car registration data.
- Wednesday will bring new data for German factory orders and euro area producer prices as well as the construction PMIs.

Chris Scicluna

+44 20 7597 8326

Emily Nicol

+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	-0.045	+0.053
OBL 0 04/27	0.429	+0.093
DBR 0 02/32	0.607	+0.106
UKT 1 04/24	1.427	+0.080
UKT 1 ¼ 07/27	1.468	+0.090
UKT 4 ¼ 06/32	1.650	+0.105

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

Source: Bloomberg

Euro area

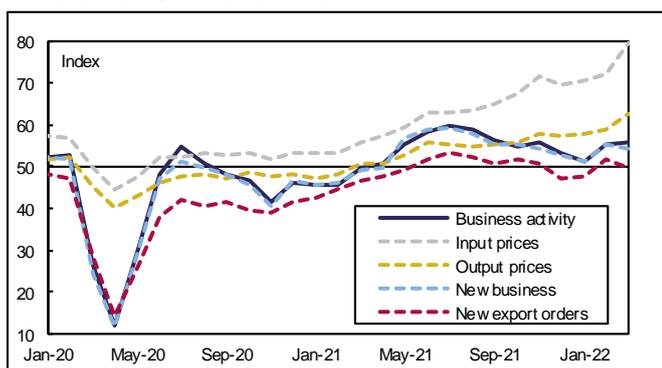
Final services PMIs add to evidence of rebound in the sector at end-Q1

The euro area economic outlook has undeniably deteriorated substantively as real incomes are eroded by high inflation, supply-chain disruption worsens once again, pressure grows for tighter restrictions on imports of Russian energy – albeit with only coal imports likely to be banned at first, rather than all-important supplies of natural gas and oil – and question-marks grow over external demand too. However, survey indicators, including last week's [Commission ESIs](#), suggest that economic activity was supported at the end of Q1 by a rebound in the services sector as pandemic restrictions were eased and households and firms sought greater normality. That was also the message of today's final euro area services activity PMI for March, which was revised up 0.8pt from the flash estimate to a four-month high of 55.6. And so, while the equivalent final manufacturing output PMI (down 2.4pts to 53.1) had signalled a notable softening of growth momentum in the sector, the euro area composite PMI edged down just 0.6pt to 54.9, suggesting that the pace of overall economic expansion was relatively well-maintained despite the shocks from Ukraine. Despite a reported drop in external demand for services, the sector's PMIs also reported continued firm growth in new business. And thanks to the ongoing reopening of the economy, all member states participating in the survey signalled expansion in the sector – and output as a whole – at end-Q1, with Germany's services activity PMI at a six-month high (56.1) and France's (57.4) and Ireland's (63.4) up to five-month highs.

But German auto output and registrations soften, and expectations crash, on supply disruption

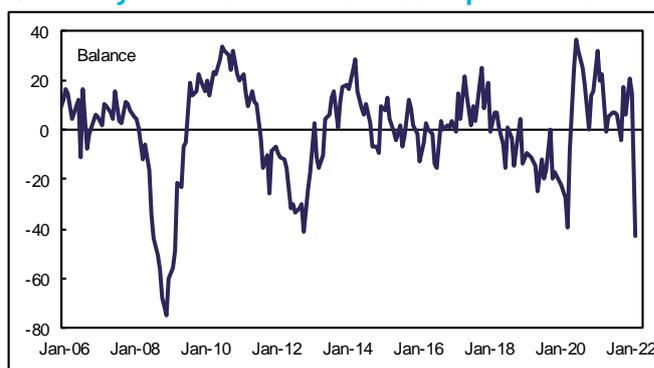
Despite ongoing support to economic activity from the easing of pandemic restrictions – particularly in hospitality, leisure and tourism where pent-up demand appears strong – the hit to sentiment from high inflation and events in Ukraine seems bound to weigh on both demand and supply over coming months. Indeed, in the industrial sector, German car production and sales already fell sharply in March from a year ago. According to the VDA, car production fell a little more than 29% Y/Y last month to be 41% below the level in March 2019 ahead of the pandemic and represent the weakest output for the month on the series. That left production down in the year-to-date by about 12% YTD/Y. While domestic new car orders were up 6% Y/Y to be up 2% YTD/Y, supply bottlenecks meant that new car registrations fell 17% Y/Y to be down 5% YTD/Y, representing the worst first quarter on the series. According to the ifo institute, German auto manufacturers and suppliers have also revised down sharply their expectations of conditions for the coming six months by a record amount - the respective survey index plunged almost 60pts in March to -43.1pts, the lowest since March 2009. More than 90% of firms in the sector cite a shortage of intermediate inputs, including a lack of key components produced in Ukraine, such as cable harnesses, and disruption to freight transport due to lack of availability of Ukrainian truck drivers. Elsewhere in the industrial sector, more than 80% of all German manufacturers continue to bemoan supply bottlenecks and difficulties sourcing intermediate goods and raw materials, with capital goods producers seemingly suffering as badly as auto firms.

Euro area: Services PMIs



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

Germany: Auto sector business expectations



Source: ifo institute, Refinitiv and Daiwa Capital Markets Europe Ltd.

Sentix investor expectations index lowest since 2011

Yesterday's euro area Sentix investor confidence survey results for April provided a further illustration of the ongoing marked deterioration in economic sentiment. Indeed, perhaps given recent equity market resilience, the declines in investor sentiment were larger than had been expected, with the headline indicator down a further 11pts on the month to -18.0, the lowest since July 2020. Investors' perceptions of current conditions deteriorated to a greater extent than in March, with the relevant index falling 13.3pts to -5.5, back below the long-run average (2.9) for the first time in a year and roughly 36pts below last summer's peak, albeit still some 67pts above the post-pandemic trough. And following a record decline last month, there was a further deterioration in investors' expectations of the outlook for the coming six months, with the relevant index down 9pts to -29.8, the lowest level since December 2011. Given its greater exposure to industrial sector woes and high reliance on Russian energy, the survey's index of current conditions in Germany fell a sharper 15pts to -4.8, the lowest in thirteen months, with the outlook component down a further 10pts to -28.8, its lowest since January 2009.

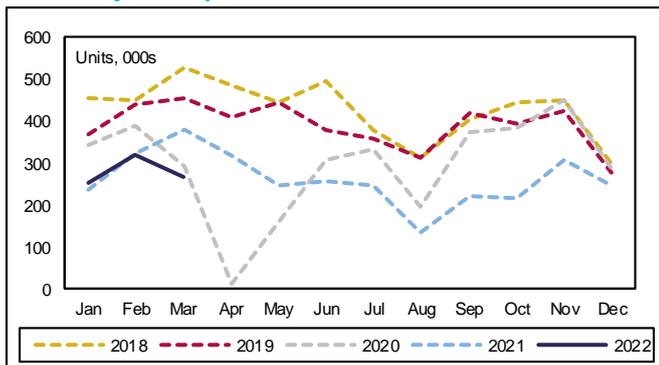
German exports bounce back in February, despite decline in shipments to Russia

The news from the industrial sector has not all been bad. For example, yesterday's German trade figures surprised on the upside, with the goods trade surplus widening in February by €2.5bn on the month to €11.4bn, nevertheless still well below the pre-pandemic five-year average (€18bn). The improvement reflected a solid rebound in the value of exports in February (6.4%/M/M), which outpaced the bounce back in the value of imports (4.5%/M/M). Among the detail, there were strong shipments to other euro area member states (9.2%/M/M), as well as an increase in the value of exports to China (6.4%/M/M) and the US (2.7%/M/M). But while sanctions on Russia were only strengthened towards the end of the month, export values to that country still fell by more than 6%/M/M – a trend that seems likely to be far more striking in March – with German imports from Russia down by more than 7%/M/M. Overall, in the first two months of the year, export values were up 1.6% compared with the Q4 average, with the value of imports up 2.0% on the same basis. However, these figures continue to be flattered by higher prices, with imports set to be boosted even further at the end of the first quarter by the spike in energy prices last month. Indeed, when adjusting for such price effects, the Bundesbank measure of export volumes was trending in the first two months of Q1 roughly 1½% lower than the Q4 average, with import volumes on the same basis down a steeper 3.6%, suggesting that net trade is currently on track to provide an arithmetical boost to GDP growth in Q1.

French manufacturing output down in February as autos firms still suffer supply shortages

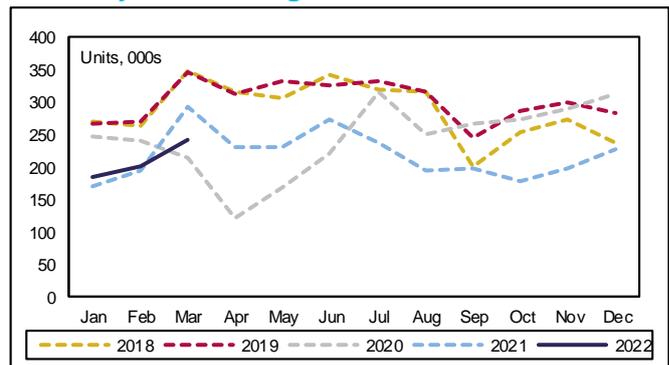
Having rebounded by 2.2%/M/M at the start of the year, French manufacturing output declined 0.5%/M/M in February to be still some 4.5% below the pre-pandemic level two years earlier. With positive growth in subsectors such as machinery,

Germany: Car production



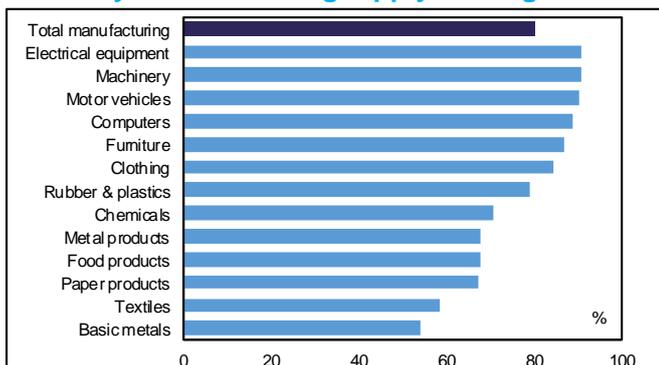
Source: VDA, Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: New car registrations



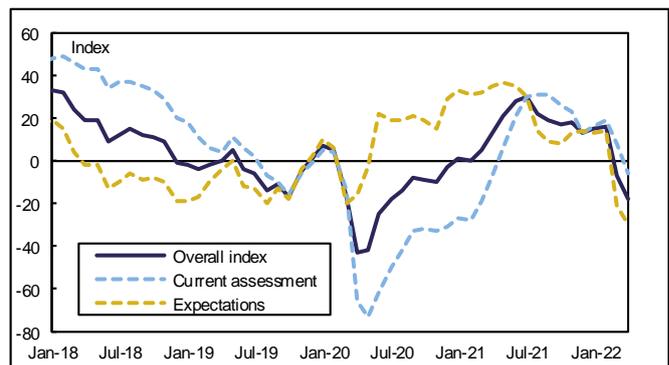
Source: VDA, Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing supply shortages*



*Share of firms in the sector reporting supply bottlenecks and problems procuring inputs. Source: ifo institute, and Daiwa Capital Markets Europe Ltd.

Euro area: Sentix investor sentiment indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

equipment, food and beverages, the weakness in the latest month principally reflected supply bottlenecks in autos, where production dropped by more than 5½%MM for a second successive month to be down 27½% below the pre-pandemic level. As in Germany, survey indicators point to a notable weakening in the outlook in the French manufacturing sector over the past month. While the INSEE confidence index for the sector was still above its long-run average last month, general production expectations for the coming three months turned negative and to their lowest since November 2020, with overall (and foreign) orders down too. However, French manufacturing output in the first two months of Q1 was trending more than 1.0% above the Q4 average. And following a surge in both January and February, construction output was trending more than 6.0% above the respective Q4 average. So, while cost pressures and supply constraints seem likely to weigh more heavily in Q2, the industrial sector looks to have provided a non-negligible contribution to French GDP growth in Q1.

The day ahead in the euro area

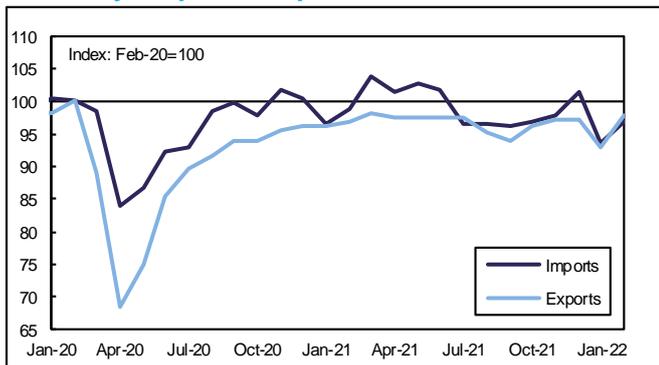
The data focus on Wednesday will return to Germany’s manufacturing sector, with the latest factory orders numbers expected to report only a very modest decline in February. While this would leave orders more than 11% above the pre-pandemic level, we expect a notable deterioration over coming months in response to the various shocks caused by Russia’s invasion of Ukraine. Tomorrow’s euro area producer price figures for February are expected to reveal a further increase in inflation above January’s series-high rate of 30.6%YY, but given the subsequent surge in wholesale gas and oil prices these are bound to exceed significantly in March. The March construction PMIs, however, are expected to imply ongoing solid expansion in the sector despite persisting supply-side challenges. In addition, dovish Chief Economist Lane is due to part in an economic forum panel discussion on inflation, while Executive Board members de Guindos and Schnabel will speak at a conference on financial integration and stability.

UK

Final services PMIs revised up to suggest very strong growth in sector at end-Q1

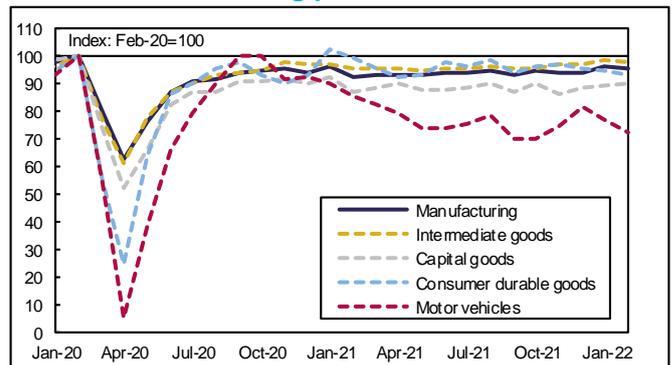
As in the euro area, the UK’s final services PMIs for March suggested that growth in the sector was stronger than previously thought at the end of Q1 benefiting from the ongoing easing of pandemic restrictions and a greater return of employees to the workplace. Indeed, the activity PMI was revised up a sizeable 1.6pts to 62.6, the second highest reading on the survey since spring 1997, and a level exceeded only in May 2021 when activity was similarly benefiting from an easing of pandemic restrictions. The survey also suggested that the flow of new business remained relatively strong even as growth in new export business ground to a near-halt. While on balance firms remained positive about prospects for growth over the coming year, optimism among services firms fell back to a seventeen-month low as they also reported the second-strongest input

Germany: Export & import volumes



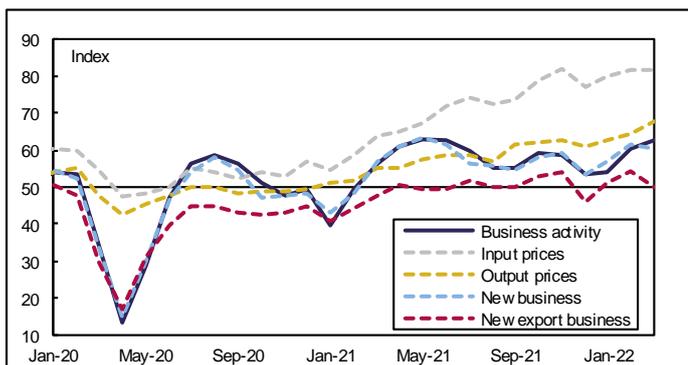
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

France: Manufacturing production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Services PMIs



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

UK: New car registrations & consumer confidence*



*2-month lead. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

cost pressures and fastest output price increases on the series, which dates back to 1996. With the March composite output PMI revised up more than 1pt to a nine-month high of 60.9, GDP growth in Q1 is highly likely to exceed the BoE's upwardly revised estimate of ¼% Q/Q, let alone its February projection of roughly zero. However, with real disposable incomes under significant downwards pressure, government pandemic-related spending falling, and an extra public holiday to come in June, we maintain our forecast of a contraction in UK economic output in Q2 and weakness throughout the second half of the year.

Car registrations suffer weakest March since 1998

Not least as it is one of two 'new number-plate' months, March is typically the strongest month of the year for auto sales in the UK, accounting for about one fifth of total annual sales. However, as in Germany, new car registrations in the UK were hit badly last month by renewed tightening of supply constraints. With production impeded not least by the shortage of semiconductors, new car registrations fell 14.3% Y/Y to represent the lowest level for the month since 1998, before March benefited from the new number-plate effect. Having fared better at the start of the year, registrations over Q1 as a whole were down 1.9% YTD/Y. But with supply restraints set to persist, and consumer confidence and willingness to make major purchases having taken a nose-dive, we do not expect a marked improvement over coming months.

The day ahead in the UK

A relatively quiet day for UK economic releases tomorrow will bring the March construction PMIs, which are expected to suggest that activity in the sector remained firm despite ongoing shortages of labour and materials and associated cost pressures. The headline activity index rose to an eight-month high in February of 59.1.

European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
Euro area	 Final services (composite) PMI	Mar	55.6 (54.9)	54.8 (54.5)	55.5 (55.5)	-	
Germany	 Final services (composite) PMI	Mar	56.1 (55.1)	55.0 (54.6)	55.8 (55.6)	-	
	 New car production (registrations) Y/Y%	Mar	-29.3 (-17.5)	-	-1.2 (3.2)	-	
France	 Industrial production M/M% (Y/Y%)	Feb	-0.9 (2.4)	-0.1 (2.5)	1.6 (-1.5)	1.8 (-1.1)	
	 Manufacturing production M/M% (Y/Y%)	Feb	-0.5 (3.4)	-	1.8 (-1.1)	2.2 (-0.6)	
	 Final services (composite) PMI	Mar	57.4 (56.3)	57.4 (56.2)	55.5 (55.5)	-	
Italy	 Services (composite) PMI	Mar	52.1 (52.1)	51.4 (-)	52.8 (53.6)	-	
Spain	 Services (composite) PMI	Mar	53.4 (53.1)	54.3 (-)	56.6 (56.5)	-	
UK	 New car registrations Y/Y%	Mar	-14.3	-	15.0	-	
	 Final services (composite) PMI	Mar	62.6 (60.9)	61.0 (59.7)	60.5 (59.9)	-	
Auctions							
Country	Auction						
Germany	 sold €432mn of 0.5% 2030 index-linked bonds at an average yield of -2.3%						
	 sold €47mn of 0.1% 2046 index-linked bonds at an average yield of -1.87%						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
Euro area	 Sentix investor confidence	Apr	-18.0	-9.4	-7.0	-	
Germany	 Trade balance €bn	Feb	11.4	10.1	3.5	3.2	
Spain	 Unemployment change '000s	Mar	-2.9	-	-11.4	-	
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/ <i>Daiwa forecast</i>	Previous	
Euro area		08.30	Construction PMI	Mar	-	56.3
		10.00	PPI M/M% (Y/Y%)	Feb	1.2 (31.7)	5.2 (30.6)
Germany		07.00	Factory orders M/M% (Y/Y%)	Feb	-0.2 (5.4)	1.8 (7.3)
		08.30	Construction PMI	Mar	-	54.9
France		08.30	Construction PMI	Mar	-	50.0
Italy		08.30	Construction PMI	Mar	-	68.5
UK		09.30	Construction PMI	Mar	58.0	59.1

Auctions and events

Euro area		08.00	ECB's de Guindos gives a speech at European Financial Integration and Stability conference		
		10.00	ECB's Schnabel moderates panel at European Financial Integration and Stability conference		
		11.45	ECB Chief Economist Lane participates in panel discussion on inflation dynamics		

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

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are MiFID 2 Professional (or equivalent) Clients and should not therefore be distributed to such Retail Clients. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply, in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Dislosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at:

<https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>