

Euro wrap-up

Overview

- Longer-dated Bunds followed USTs lower as euro area producer price inflation rose to a new record high, but German factory orders fell short of expectations and the euro area construction PMIs fell sharply.
- Gilts also made losses while the UK construction PMI survey signalled ongoing solid expansion in the sector.
- Tomorrow will bring the ECB account from the March Governing Council meeting, while euro area retail sales and German IP data are also due.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	-0.058	-0.020
OBL 0 04/27	0.431	-0.003
DBR 0 02/32	0.642	+0.032
UKT 1 04/24	1.466	+0.012
UKT 1¼ 07/27	1.509	+0.031
UKT 4¼ 06/32	1.708	+0.055

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

Euro area

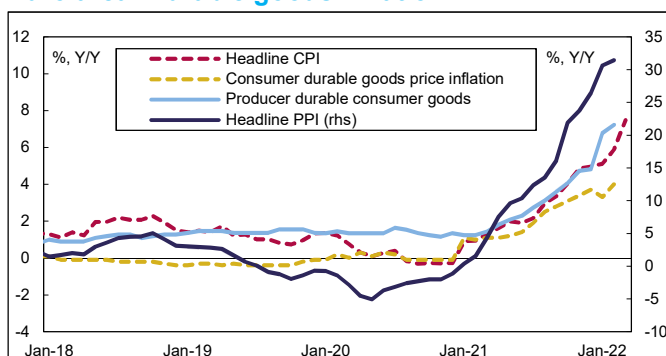
PPI inflation at new record high in February but has a lot further to rise

Broadly as expected, euro area industrial producer price inflation rose to a new series high in February. Prices rose 1.1%M/M to push the annual rate up 0.8ppt to 31.4%Y/Y. Producer energy prices rose 1.3%M/M, only slightly stronger than the overall index for a change. But that left them up a whopping 87.2%Y/Y. Among other components, prices of intermediate goods – which remain subject to significant supply impediments – rose 1.6%M/M, in line with the average of the prior twelve months, to be up at a new high annual rate of 20.8%Y/Y. And the equivalent rates for capital goods (5.9%Y/Y), and consumer durables (7.2%Y/Y) and non-durables (6.8%Y/Y) also reached new series highs. So, non-energy PPI rose to 12.2%Y/Y, suggestive of increased cost pressures that risk being passed on to consumers in due course. We note that the monthly pace of increase in the CPI component of non-energy industrial goods was not out of line with pre-Covid norms in February and March. However, not least given the extreme pressures on energy prices last month – with the respective CPI component having leapt a record 12.5%M/M to be up 44.7%Y/Y – producer price inflation seems bound to accelerate markedly further in March. And while real purchasing power is being rapidly eroded, consumer goods inflation risks accelerating over coming months too.

German factory orders down in February on weaker foreign demand

The outlook for Germany's manufacturing sector has darkened markedly on intensified cost pressures, a renewed tightening of supply restraints, uncertainty about the future of Russian energy imports and a questionable demand outlook. Indeed, today's factory orders data for February showed that, even before the full economic and financial impact of the Russian invasion in Ukraine had been felt, orders fell by a larger-than-expected 2.2%M/M. Admittedly, this followed three consecutive increases to be still almost 3% higher than a year earlier and still trending so far in Q1 almost 4% higher than the Q4 average. When excluding major items, the drop in February was somewhat more modest (-1.6%M/M), to leave orders so far in Q1 compared with Q4 on average up a softer 1.1%. The weakness in February was driven by overseas orders, which fell 3.3%M/M, while domestic orders were broadly flat (-0.2%M/M). Looking at product-type, orders for intermediate goods fell for the second successive month (-1.9%M/M), while capital goods orders (-2.8%M/M) reversed some of January's strength. Among other things, foreign orders for basic metals plunged 28%M/M (partly reversing the 38% increase in January), with overseas orders of chemicals (-3.8%M/M) failing to grow for the third consecutive month to leave the level more than 2% lower than in February 2020. But while domestic auto orders rose for the fifth consecutive month in February to the highest level since September 2019, overseas orders fell 6½%M/M to be some 2% lower than the pre-pandemic level. And yesterday the German association of the auto industry (VDA) cautioned that overseas car orders continued to decline in March, down by 11% since January and by one fifth from last March.

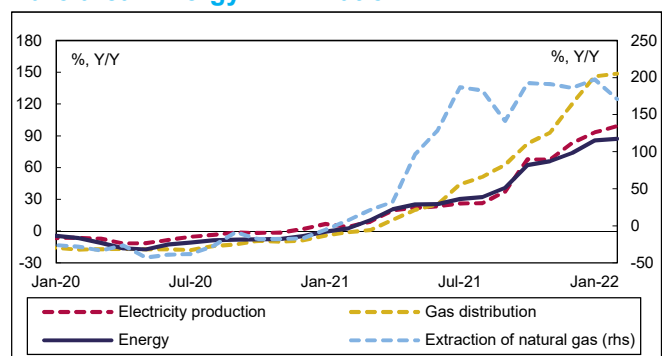
Euro area: Durable goods inflation*



*Flash estimate of CPI inflation in March 2022.

Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Energy PPI inflation



Source: Refinitiv, ECB and Daiwa Capital Markets Europe Ltd.

Turnover data signal a drop in German manufacturing output in February

Looking ahead to tomorrow's industrial output data, today's release also reported the first decline in manufacturing turnover in five months, likely at least in part due to supply bottlenecks affecting the availability of intermediate goods. Nevertheless, the 1.4%/M/M decline in turnover still left it trending in the first two months of the year more than 2½% higher than the Q4 average. But the figures suggest that there is a notable downside risk to tomorrow's industrial production release, with the Bloomberg consensus for an increase of 0.2%/M/M likely to be far too optimistic in the absence of vigorous growth in the construction sector. And given the surge in activity in the construction sector in January (10.1%/M/M) this seems unlikely.

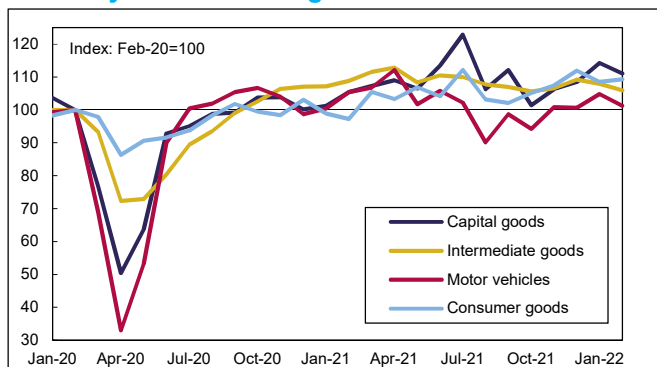
Construction PMIs fall sharply as prices rise and demand weakens

Admittedly, the German construction PMI rose in February to a two-year high (54.9) pointing to ongoing expansion. But today's survey for March flagged a marked deterioration at the end of the first quarter in the face of slower orders growth amid heightened uncertainty, increased supply disruptions and intensified price pressures. In particular, the headline activity index fell 4pts to 50.9, with marked weakness in house building and commercial activity, while the new orders component slumped 8.6pts to 45.7. Meanwhile, the French construction PMI fell for the second successive month, by 1.6pts to 48.4, a seven-month low. And while the Italian activity index remained consistent with ongoing solid expansion, at 62.9 it was 5.6pts lower than in February and the softest since October. And so, overall, the euro area activity PMI declined for the second successive month, by 3.5pts to 52.8, implying the softest pace of expansion since October. And there was a broad-based slowdown in new orders growth to the lowest in seven months as elevated prices and the Ukraine war weighed on confidence. Indeed, the input price PMI jumped 7pts to 88.0, a seven-month high, with supplier delivery times having lengthened by the most since last July. And overall, firms' confidence about the outlook over the coming twelve months deteriorated to its most downbeat since the end of 2020.

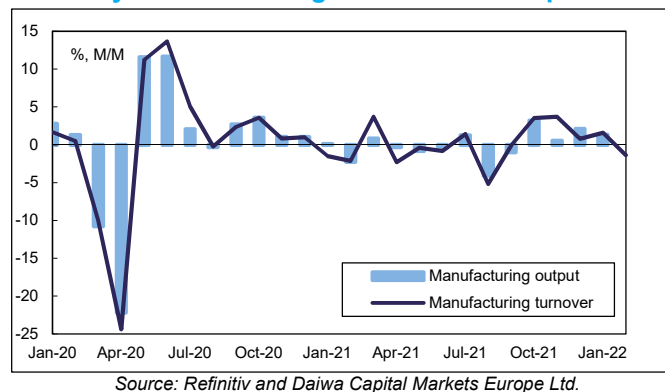
The day ahead in the euro area

After ECB Chief Economist Lane and Executive Board member Panetta today maintained the relatively dovish tone of their recent remarks – with Lane noting the ongoing hit to living standards from energy prices, while Panetta judged appropriately that there was so far no evidence of second-round inflationary effects – the most interesting release tomorrow will be the publication of the account of the ECB's March policy setting meeting, which will offer further insight into the initial debate on the expected economic impact of, and appropriate policy response to, Russia's invasion of Ukraine. Turning to the data, tomorrow sees the release of euro area retail sales figures for February. At the start of the year, retail sales could only muster a minimal rise of 0.2%/M/M, well below expectations. And any rebound in February following the relaxation of pandemic

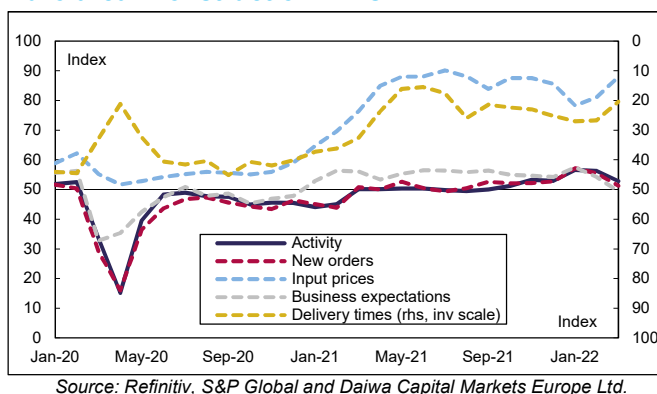
Germany: Manufacturing orders



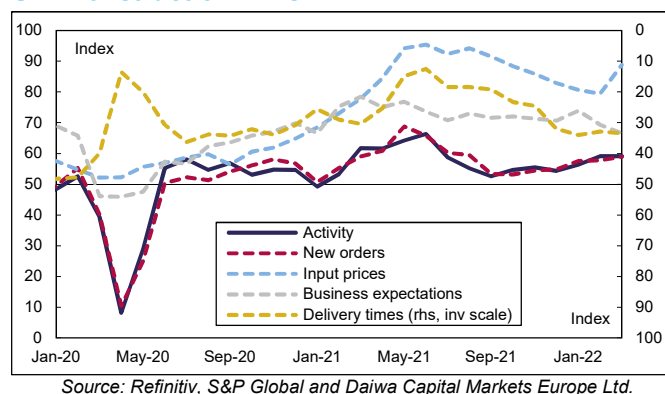
Germany: Manufacturing turnover and output



Euro area: Construction PMIs



UK: Construction PMIs



restrictions seems likely to be limited by the adverse impact of high inflation on real disposable incomes. An increase of about ½%M/M is a reasonable expectation. Meanwhile, as mentioned above, we now expect German industrial production to post a drop of more than 1.0%M/M in February.

UK











UK construction PMI points to ongoing solid expansion

Contrasting with the deterioration in the euro area, today's UK construction PMIs pointed to ongoing solid expansion in the sector at the end of the first quarter. In particular, the headline activity index was unchanged in March at 59.1, a level last exceeded in June, underpinned by the strongest demand for new orders since last August. But while commercial building activity accelerated – the index rose 2.3pts to 60.8, a nine-month high – the S&P Global report suggested a marked slowdown in growth in house building (the respective PMI fell 6.6pts to 54.9), with the equivalent civil engineering index also a touch softer (56.3). With capacity constraints and ongoing distribution disruptions, around one third of respondent firms cited longer lead times for products and materials, although delays were less widespread than last summer. Taken together with surging energy, fuel and commodity prices, the input price PMI jumped by 9.4pts to 88.7, a six-month high. So, with concerns about persisting higher cost burdens and a less favourable global outlook, confidence among construction firms about the year ahead weakened last month. Indeed, while almost half of respondent firms expected a rise in activity and only 15% forecast a decline, the associated sentiment index was the weakest since October 2020.

The day ahead in the UK

With no top-tier data of note due from the UK tomorrow, attention will be on the Bank of England, with Chief Economist Pill set to give opening remarks at a BoE-hosted conference on sovereign bond markets. The BoE's Decision Maker Panel survey data for March will also be published.



European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Construction PMI	Mar	52.8	-	56.3	-
	 PPI M/M% (Y/Y%)	Feb	1.1 (31.4)	1.2 (31.7)	5.2 (30.6)	5.1 (-)
Germany	 Factory orders M/M% (Y/Y%)	Feb	-2.2 (2.9)	-0.3 (5.4)	1.8 (7.3)	2.3 (8.2)
	 Construction PMI	Mar	50.9	-	54.9	-
France	 Construction PMI	Mar	48.4	-	50.0	-
Italy	 Construction PMI	Mar	62.9	-	68.5	-
UK	 Construction PMI	Mar	59.1	58.0	59.1	-
Auctions						
Country	Auction					
Italy	 sold €1.02bn of 2.8% 2028 bonds at an average yield of 1.779%					
	 sold €430mn of 2.7% 2047 bonds at an average yield of 2.626%					
	 sold €655mn of 1.7% 2051 bonds at an average yield of 2.656%					










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		10.00 Retail sales M/M% (Y/Y%)	Feb	0.5 (4.9)	0.2 (7.8)
Germany		07.00 Industrial production M/M% (Y/Y%)	Feb	<u>-1.0 (2.0)</u>	2.7 (1.8)

Auctions and events

Euro area		12.30 ECB publishes account of March monetary policy meeting
France		09.50 Auction: 0% 2032 bonds
		09.50 Auction: 1.25% 2038 bonds
Spain		09.50 Auction: 0.5% 2072 bonds
		09.30 Auction: 1.5% 2027 bonds
		09.30 Auction: 0.8% 2029 bonds
		09.30 Auction: 0.7% 2032 bonds
UK		- BoE Decision Maker Panel data for March to be published
		13.15 BoE's Pill to give opening remarks at BoE-hosted conference on sovereign bond markets

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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