Euro wrap-up

Overview

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- While German factory orders and turnover beat expectations in March, Bunds made gains as underlying demand remained subdued.
- Gilts also made gains while the UK construction PMIs signalled ongoing contraction in April despite a recovery in house building activity.
- On Thursday, we expect the BoE to cut Bank Rate by 25bps to 4.25%, revise down its inflation projection and emphasise the uncertainty of the economic outlook, while the data-flow will bring German industrial production and goods trade figures for March.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	1.707	-0.028
OBL 2.4 04/30	2.011	-0.051
DBR 2½ 02/35	2.472	-0.066
UKT 3¾ 03/27	3.791	-0.027
UKT 4⅜ 03/30	3.926	-0.040
UKT 4½ 03/35	4.456	-0.055

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

Euro area

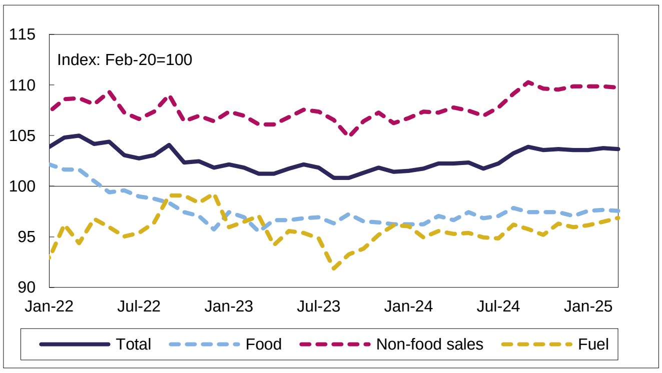
Euro area retail sales slipped back in March as confidence deteriorated

Euro area GDP growth accelerated in Q1 in part because some firms front-ran production and shipments ahead of US tariff hikes. But GDP releases from Germany, Italy and Spain also suggested that domestic demand supported growth in the first quarter. While we think household consumption provided a positive contribution, today's retail sales figures showed that spending on goods tailed off towards the end of the quarter amid a rise in economic uncertainties. In particular, euro area sales fell in March for the first month in three, albeit by a modest 0.1%M/M. And with growth in February also revised lower, sales were up just 0.1%3M/3M in Q1, the softest quarterly rise in five and down from an average increase of 0.6%3M/3M in 2024. While the weakness in March was broad-based across the larger member states, it was most striking in Italy, where sales fell to a 15-month low and by 0.5%3M/3M in Q1. In contrast, sales were up on a three-month basis in Germany (0.2%), France (0.3%) and Spain (0.3%). Tallying the decline in petrol prices, aggregate euro area sales of auto fuel rose for a third consecutive month in March (0.4%M/M) to a two-year high. But sales of food fell for the first month in three (-0.1%M/M), while spending on core goods (i.e. non-fuel & non-food) fell modestly after two months of zero growth. While the Commission's consumer survey indicator for recent major purchases was little changed in April, households were more downbeat about spending intentions for the year ahead as overall sentiment fell to a 17-month low.

German factory orders rebound in March, but underlying demand remains subdued

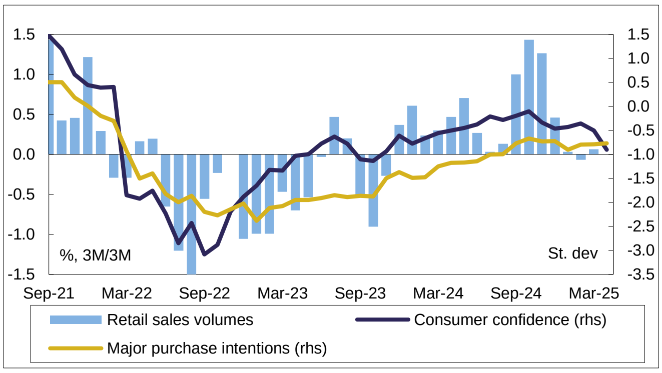
Last week's GDP figures showed that Germany's economy grew 0.2%Q/Q in Q1, as manufacturers front-loaded shipments to the US to avoid new Trump tariffs. But while tomorrow's production numbers look set to report the first quarterly rise in manufacturing output in four in Q1, and the firmest in two years, today's factory orders data illustrated that underlying demand for German goods remains subdued. Admittedly, new orders rose a larger-than-expected 3.6%M/M in March, the most since September. And, when excluding major items, growth in core orders (3.2%M/M) was the strongest since May 2023. Orders for pharmaceutical products rose a striking 17.3%M/M (11½%3M/3M) to the highest level since June 2021, while orders for electrical and general machinery jumped to the highest in eight and seven months respectively. But a rise in demand for transport-related goods in March failed to offset weakness at the turn of the year. Indeed, auto orders were broadly flat in Q1, but down more than 20%3M/3M for other transport equipment. As such, smoothing for monthly volatility, total orders were down 2.3%3M/3M in March – the most since last May – while core orders rose just 0.5%3M/3M. Admittedly, this reflected a significant negative carryover in foreign bulk orders in Q4. Indeed, when excluding major items, core orders from non-euro area countries in March rose to the highest level in more than two years. But we expect these to fall back over coming months as higher US tariffs kick in. And while domestic core orders encouragingly increased for a fourth month out of five to a nine-month high, it remains to be seen whether demand for German goods continues to rise if and when surplus cheap goods from China are redirected from the US to the region.

Euro area: Retail sales



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales & consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

German manufacturing turnover jumps the most in 22 months amid front-loading in certain sectors

Today’s figures showed that, in anticipation of Trump’s liberation day tariff announcements, manufacturers increased notably turnover in March, by 2.2%M/M – the most in 22 months – to the highest level in 12 months. This left turnover up 0.7%3M/3M, the most since December 2022, supporting our view that tomorrow’s manufacturing production release will confirm that the sector provided a non-negligible boost to GDP growth in Q1. But today’s figures showed that the rebound was largely driven by the subsectors that are more significantly exposed to potential higher US tariffs. For example, pharmaceuticals turnover jumped 16%M/M in March, amid a 38%M/M surge in activity in non-euro area countries. Turnover in the electrical equipment and autos industries also rose sharply in March, but fell over the first quarter as a whole. While turnover data have provided a poor guide to manufacturing production since December, today’s data nevertheless raise some potential upside to the expected increase, for which the Bloomberg survey consensus is for a rise of 1.0%M/M in March.

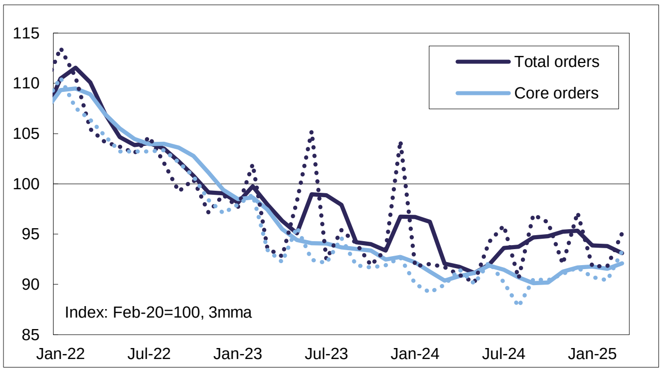
Euro area construction PMI jumps to 26-month high led by a rebound in Germany

There will also likely be some payback in German construction activity in March after the more than 3%M/M drop in February. Today’s April construction PMIs were also more upbeat about activity at the start of Q2 too, with the German headline index jumping 4.8pts to 45.1, a more-than two-year high. With demand seemingly benefiting from the further decline in borrowing costs, constructors were similarly the most upbeat about recent house building since February 2023 (albeit still a sub-50 reading). The implied contraction in commercial and civil engineering work was also smaller than over the past year or so. This contrasted with no improvement in the French activity PMI (43.6) and a drop in the respective Italian index (down 2.4pts to 50.1). Overall, the euro area construction PMI rose for a second successive month, by 1.2pts to 46.0, a 26-month high and some 4pts above the average in 2024. And with the new orders component rising to the highest in more than three years, we might see construction providing some modest offset to the likely manufacturing retrenchment over coming months.

The day ahead in the euro area

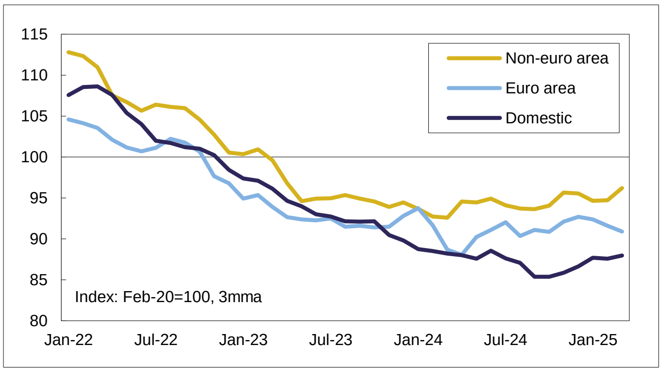
The data focus in the euro area on Thursday will be the release of the aforementioned German industrial production figures for March. Output looks set to more than reverse the 1.3%M/M drop in February to support the return to positive growth in Q1. Meanwhile, German goods trade figures might also report a non-negligible increase in exports for a second successive month at the end of the quarter.

Germany: Factory orders*



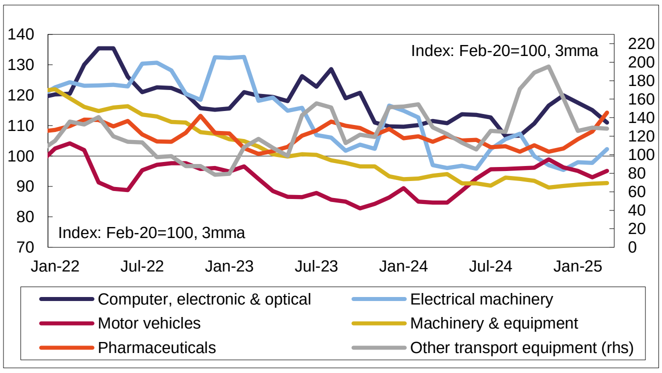
*Dotted lines represent unsmoothed data. Core orders exclude major items.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders*



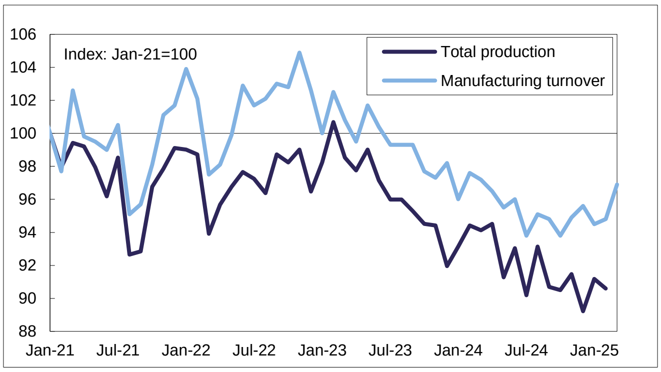
*Excluding major items.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing production & turnover



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

UK construction PMI points to ongoing contraction despite improvement in housing index

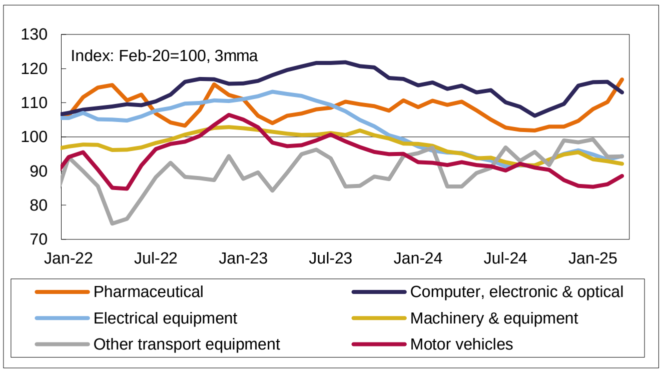
After a steady deterioration in the first quarter as adjustments to Stamp Duty thresholds weighed on the housing market, today's construction PMIs signalled ongoing contraction at the start of Q2 amid heightened economic uncertainties. In particular, the headline activity index rose just 0.2pt to 46.6, broadly in line with the Q1 average and well below the 2024 average (53.1). The housing activity component recovered in April, rising a further 2.3pts to a four-month high of 47.1, demonstrating that April's tax change will likely prove to be a temporary distortion. The survey also suggested a slower pace of decline in civil engineering (up 4.3pts to 43.1). But this was countered by a further deterioration in commercial construction, with the respective index signalling the steepest contraction in activity in almost five years as businesses reportedly postponed projects amid increased risk aversion. Indeed, today's survey indicated that the drop in new orders was the second-steepest since May 2020. Subdued demand and diminished workloads led to a faster decline in purchasing activity, while constructors reportedly continued to reduce headcount for a fourth consecutive month.

The day ahead in the UK

The main event in the UK tomorrow will be the BoE's latest policy announcement, which will be accompanied by its Monetary Policy Report (MPR) including updated macroeconomic projections. In line with consensus, we expect the MPC to cut Bank Rate by a further 25bps to 4.25%, which would mark the fourth cut of that magnitude at a three-month interval this cycle. We expect all nine policymakers to favour a cut in interest rates, with the deteriorating economic outlook arguably justifying a change in the forward guidance to signal its readiness to ease policy at a swifter pace if necessary. Certainly, we wouldn't be surprised to see uber-dove Swati Dhingra (and possibly Catherine Mann) vote for a 50bps cut this month. But GDP growth is in Q1 on track to be more than twice as strong as the Bank staff's most recent forecast in March (¼%Q/Q). Private sector pay growth is still close to 6.0%3M/Y (albeit a touch below the BoE's expectations). Meanwhile, inflation is expected to pick up in April due in part to administered prices, while the BoE's latest DMP survey results (also due tomorrow) will be watched closely for insights in business inflation and wage expectations. As such, we suspect the majority to favour a 25bps cut. And with the outlook subject to significant uncertainties relating to US tariff hikes, the MPC might, for now at least, stick with its forward guidance for a "careful and gradual" approach to future policy easing.

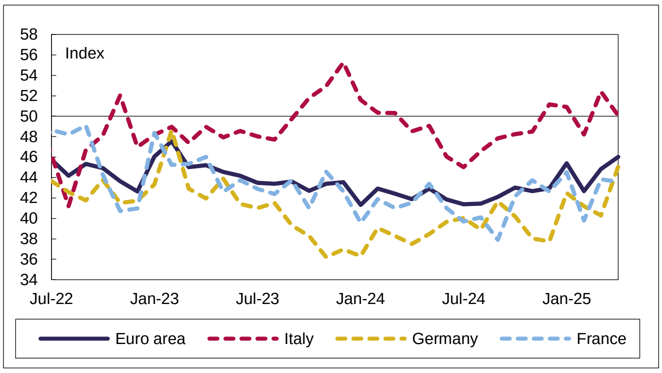
The MPC's forward guidance will reflect the Bank's updated macroeconomic projections. We expect the Bank to revise lower its near-term inflation projection to reflect significant adjustments in wholesale gas and oil prices over the past three months. The near-2½% appreciation in trade-weighted sterling will also have weighed somewhat on goods prices. But this impact on

Germany: Manufacturing turnover



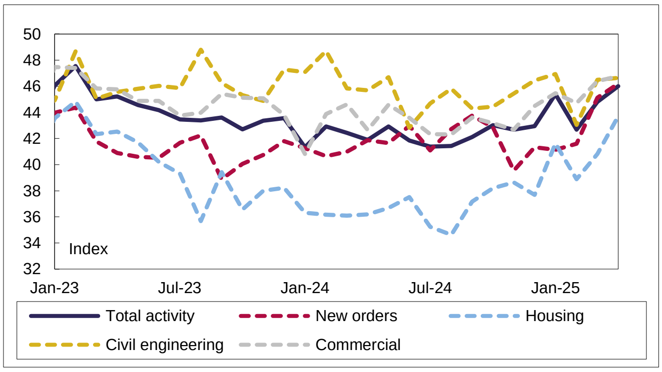
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Construction activity PMIs



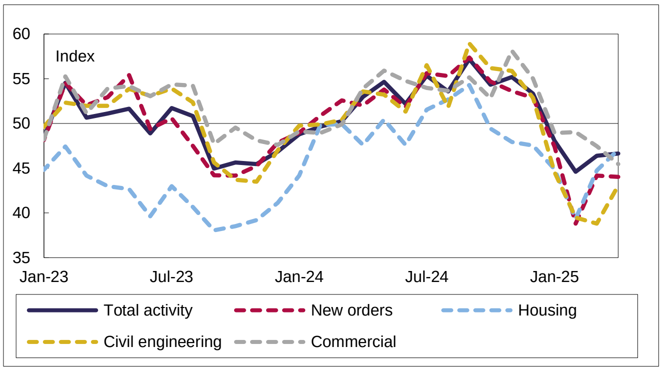
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Construction PMIs



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

UK: Construction PMIs



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

inflation will in part be offset by a loosening in financial conditions compared with three months ago. Overall, we currently forecast headline inflation to peak at 3.4%Y/Y in Q325, before moderating back to target in Q226, six quarters earlier than previously anticipated by the BoE in February. And not least due to the weaker growth prospects, we see the risks to this forecast as skewed to the downside. Admittedly, the Bank's GDP profile will need to be shifted notably higher in Q1, with economic activity seemingly on track for growth of up to 0.7%Q/Q, compared with the Bank's February projection of just 0.1%Q/Q. And while the quarterly growth rates for Q2 and Q3 will likely be revised lower, its full-year forecast for 2025 of 0.7% previously will likely be nudged higher. However, full-year growth in 2026 will almost certainly be revised down from 1½%Y/Y, perhaps closer to our own expectation of 1%Y/Y. And while the Bank will likely signal an expected recovery through 2027, we expect the MPC to judge the balance of risks to be skewed to downside and the baseline projection to be highly susceptible to revisions as trade negotiations unfold.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Construction PMI	Apr	**46.0**	-	44.8	-
	Retail sales M/M% (Y/Y%)	Mar	**-0.1 (1.5)**	0.0 (1.8)	0.3 (2.3)	0.2 (1.9)
Germany	Factory orders M/M% (Y/Y%)	Mar	**3.6 (3.8)**	2.0 (1.1)	0.0 (-0.2)	-
	Construction PMI	Apr	**45.1**	-	40.3	-
France	Trade balance €bn	Mar	**-6.2**	-	-7.9	-7.7
	Preliminary wages (private sector payrolls) Q/Q%	Q1	**0.7 (0.0)**	-	0.4 (-0.3)	-
	Construction PMI	Apr	**43.6**	-	43.8	-
Italy	Construction PMI	Apr	**50.1**	-	52.4	-
	Retail sales M/M% (Y/Y%)	Mar	**-0.5 (-2.8)**	-	0.1 (-1.5)	- (-1.4)
UK	Construction PMI	Apr	**46.6**	-	46.4	-

Auctions

Country	Auction
France	sold €2.20bn of 3.2% 2035 bonds at an average yield of 3.24%
	sold €7.77bn of 1.25% 2038 bonds at an average yield of 3.51%
	sold €2.03bn of 4.5% 2041 bonds at an average yield of 3.62%
UK	sold £4.5bn of 4.375% 2030 bonds at an average yield of 3.977%

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	Industrial production M/M% (Y/Y%)	Mar	1.5 (-2.1)	-1.3 (-4.0)
	07.00	Trade balance €bn	Mar	18.9	17.7
Spain	08.00	Industrial production M/M% (Y/Y%)	Mar	-	0.7 (-1.9)
UK	00.01	RICS house price balance %	Apr	-4	2
	12.02	BoE Bank Rate %	May	*4.25*	4.50
	14.00	DMP 3M output price (1Y CPI) expectations Y/Y%	Apr	4.0 (3.5)	3.9 (3.4)

Auctions and events

Country	BST	Event
Spain	09.30	Auction: to sell 2.4% 2028, 2.7% 2030 & 4% 2054 bonds & 1% 2030 index-linked bonds
UK	12.02	BoE monetary policy announcement, minutes and Monetary Policy Report to be published
	12.30	BoE Governor Bailey to present updated macroeconomic projections in press conference

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.