

Euro wrap-up

Overview

- Bunds made modest gains despite significant upside surprises in the flash PMIs and euro area consumer confidence index for March.
- With the flash UK PMIs beating expectations, Gilts made modest losses at the shorter end of the curve despite a downside surprise from the latest UK inflation data.
- Thursday will bring results of March surveys of German consumers, French businesses and UK retailers.

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Daily bond market movements		
Bond	Yield	Change
BKO 0 03/23	-0.725	-0.003
OBL 0 04/26	-0.688	-0.011
DBR 0 02/31	-0.359	-0.015
UKT 0 1/8 01/23	0.048	+0.014
UKT 0 1/8 01/26	0.327	+0.005
UKT 4 3/4 12/30	0.754	-0.005

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

Euro area

Flash PMIs and consumer confidence beat expectations to point to recovery ahead

Today's flash March PMIs provided a timely reminder that businesses have learnt to cope better with ongoing pandemic restrictions and are preparing for a rebound in demand as economies reopen. Indeed, the surveys for manufacturing and services alike beat expectations. And contrasting with the consensus forecast of little change, the euro area composite output PMI rose almost 4pts to an eight-month high of 52.5, suggestive of a return to expansion at the end of Q1. Moreover, the future output index rose to 66.8, the highest in more than two years, to point to clear expectations of a firm rebound in activity over the coming twelve months. Beyond the PMIs, an improvement in the Commission's flash index of euro area consumer confidence – up 4pts to a twelve-month high of -10.8 – suggests that households are also feeling more upbeat about the outlook. We acknowledge that many of the responses to today's surveys will have been submitted before the recent extension of containment measures in Germany and France. However, those measures should not have come as a surprise, and we do not anticipate marked downwards revisions when the final estimates will be published.

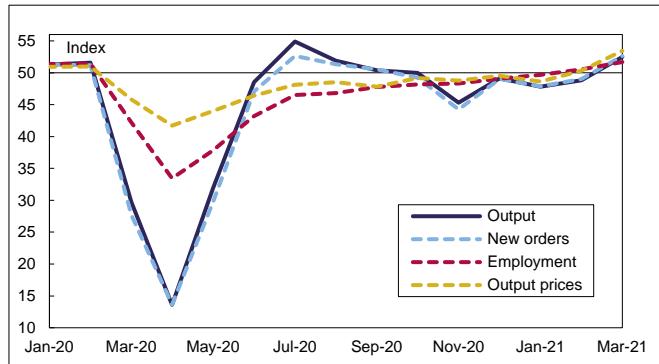
Strong growth in manufacturing, contraction easing in services

Within the PMIs, unsurprisingly, the manufacturing sector led the way, with the output index rising more than 5pts in March to a series high of 63.0 and similarly strong growth reported in new orders from home and abroad. In addition, the services PMIs pointed to a significant slowing in the pace of contraction in the sector, with the respective euro area activity index up more than 3pts to a seven-month high of 48.8 and the new orders index at its highest in more than a year. Encouragingly, firms also appear to have stepped up their recruitment activities, with the PMIs suggesting that employment is rising the most since November 2019. However, the survey also flagged further increases in pipeline price pressures. Against the backdrop of continued supply-chain challenges, those were again acute in manufacturing, for which the euro area PMIs for input costs and output prices rose to the highest in almost a decade. In services, the pressures were significantly less marked, although the equivalent indices rose to their highest levels in more than a year.

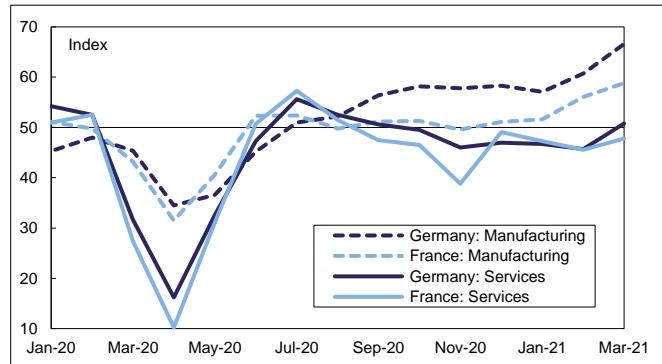
German PMIs suggest expansion in March with composite PMI at three-year high

At the country level, the story for Germany and France was similar to that for the euro area as a whole, with manufacturing strong and services weakness moderating. However, the German PMIs beat those of France, with an especially vigorous expansion reported in manufacturing and modest growth eking out in services in response to the (ultimately temporary) relaxation of pandemic containment measures earlier this month. Indeed, while France's manufacturing output PMI rose a welcome 4pts to its highest level in more than three years (57.6), the equivalent German index rose more than 6pts to a

Euro area: Composite PMIs*



Germany & France: Selected PMIs*



*Flash PMIs for March 2021. Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

*Flash PMIs for March 2021. Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

series high (68.5). And with Germany's services PMI surprisingly jumping more than 5pts to 50.8, the country's composite PMI also rose more than 5pts to an impressive 56.8, the best in more than three years. In contrast, France services (47.8) and composite activity (49.5) PMIs remained below the key 50 threshold for a seventh successive month, albeit suggesting minimal change in overall output at end-Q1.

Merkel cancels tighter Easter lockdown with additional fiscal support approved too

Despite the stronger March PMIs, the decision of the German authorities earlier this week to reverse the easing of restrictions in certain regions for four weeks, and implement an even tighter lockdown over the Easter holiday from 1-5 April, might have been expected to weaken recovery momentum slightly next month. However, faced by widespread criticism, from business to the church, and watching her CDU/CSU parties' lead in the opinion polls over the Green Party steadily narrow ahead of September's general election, Chancellor Merkel today scrapped the plans for Easter, which would have allowed no more than five adults from two households to meet and have compelled essential stores to shut for much of that five-day period. More generally, we also expect a large share of businesses to continue to cope adequately with the other restrictions to be in place at least through to 18 April. Those that are most directly affected will again benefit from ongoing government support. And with the cabinet today having approved a supplementary budget worth an additional €60bn this year, conditions remain for a rebound in German growth from Q2 on, just as the flash PMIs suggest.

The day ahead in the euro area

The flow of economic sentiment indices continues tomorrow, with the German GfK consumer confidence survey for April due as well as the French business confidence survey from INSEE. The headline German consumer confidence indicator is expected to rise from -12.9 in March, but remain some way below the pre-pandemic level of 9.1, suggesting that German households remain relatively cautious about the outlook. Judging from today's flash PMIs, however, the French business confidence survey should signal clear improvement. Euro area bank lending data for February are also due for release tomorrow. In addition, the ECB will publish its latest Monthly Bulletin while President Lagarde, Vice President du Guindos and board member Schnabel are due to speak publicly at separate events.

UK

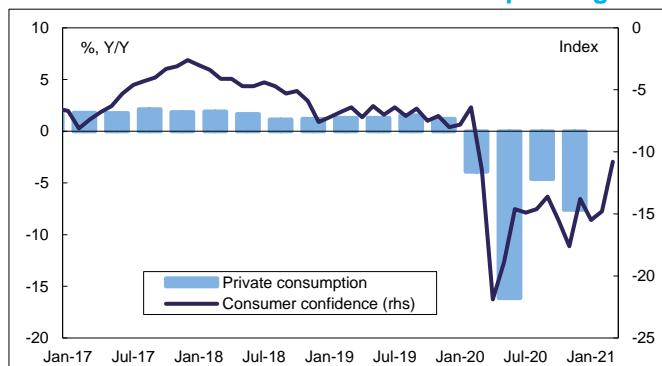
Flash PMIs point to return to growth at end-Q1 as optimism continues to rise

Like in the euro area, the UK's flash PMIs for March significantly beat expectations, with the composite output index rising 7pts to a 7-month high of 56.6, a level consistent with firm expansion. Improvement was broad-based. While it was not as elevated as in the euro area, the manufacturing output PMI rose more than 5pts to a three-month high of 55.6. And the new orders index for the sector was similarly the strongest since December's surge in activity ahead of the end of the Brexit transition. Moreover, the services activity PMI jumped more than 7pts, the highest since August, to 56.8, a level surpassing the equivalent index for manufacturing for the first time since the pandemic hit. Plans for a gradual easing of restrictions over coming months evidently helped the PMI for new business in services also rise to a seven-month high. And among other signs of significant business optimism, expectations for the coming twelve months were the best on the series dating back to 2012 while the survey measure of employment was reportedly the strongest since June 2019. Significant supply-chain problems – related to global factors and the additional burdens of Brexit – added to input cost pressures, which rose to the highest since February 2017. And the PMIs also suggested the strongest output price rises in more than three years.

Inflation surprises significantly on the downside on lockdown effects

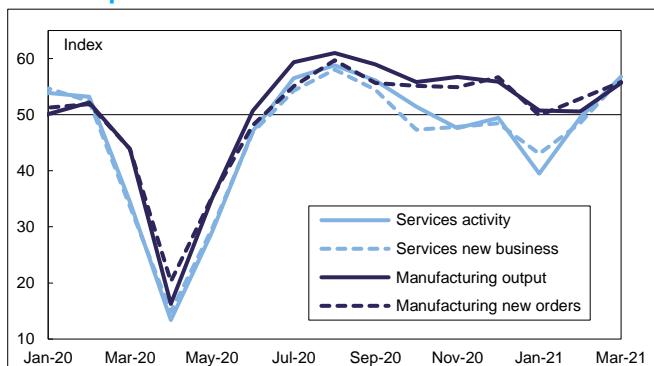
Nevertheless, having inched up at the start of the year, UK CPI inflation took a big step back down in February, dropping 0.3ppt to a three-month low of 0.4%Y/Y. Moreover, core inflation fell even further, down 0.5ppt to 0.9%Y/Y, similarly the lowest since November and below the average of the prior six months. As has frequently been the case throughout the pandemic, the key driver of the volatility was prices of clothing and footwear, for which the respective inflation rate fell more

Euro area: Consumer confidence and spending



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Output and new orders PMIs*



*Flash PMIs for March 2021. Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

than 2pppts to a sharply negative -5.7%Y/Y, as retailers faced up to the ongoing impact of lockdown on demand. Second-hand cars as well as the often erratic category of games and toys were also a significant drag. So, non-energy industrial goods prices fell in February for the first time on the series, pushing the respective annual rate down 1.0ppt to a nine-month low of 0.2%Y/Y. Moreover, prices of recreational and transport services, and hospitality, also provided downwards pressure due to the impact of restrictions on activity. So, services inflation reversed the previous month's increase, falling 0.2ppt to 1.5%Y/Y. In terms of non-core items, food inflation was unchanged at 0.4%Y/Y. But higher oil prices saw the pace of decline in petrol prices ease 4.6pppts to -3.5%Y/Y to provide a rare positive impulse to headline inflation.

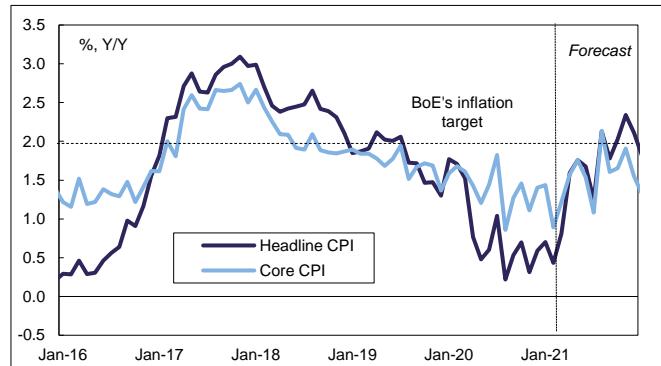
Headline and core inflation to rebound in March and move higher thereafter

Looking ahead, clothing prices are highly likely to rebound in March, while prices for various services affected by lockdown might also be expected to edge up as a gradual reopening of the economy proceeds from next month on. Moreover, not least due to base effects, fuel prices will provide a significant further boost to inflation over coming months. And the energy regulator Ofgem last month confirmed an increase of more than 9% in the household energy price cap for 11 million default tariff customers for sixth months from April, with a rise of more than 8% faced by a further 4 million customers on meters. So, with the flash March PMIs reporting a greater willingness of businesses to pass on increased input cost pressures, there seems every reason to expect both headline and core inflation to jump from the current month on. We expect headline inflation to rebound to 0.8%Y/Y in March, rise above 1.5%Y/Y from April, and move above 2.0%Y/Y in the second half of the year, peaking in the autumn when the hospitality VAT cut will come to an end. And we also expect core inflation to briefly surpass 2.0%Y/Y in H221 and remain close to the BoE's target throughout 2022 too.

The day ahead in the UK

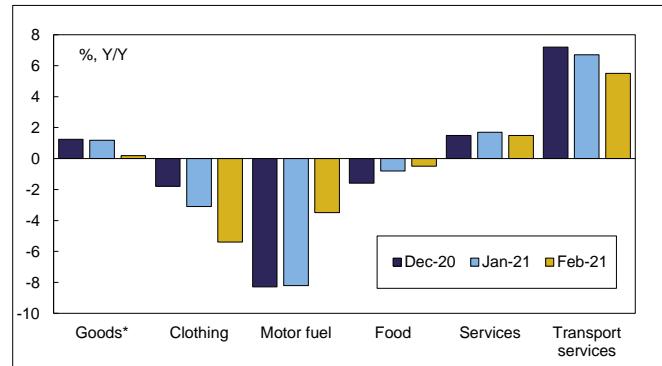
Tomorrow will see the release of the CBI distributive trades survey for March, which will provide an insight into retail activity in the final month of Q121. And with consumer confidence rising, not least thanks to the ongoing successful coronavirus vaccine rollout in the UK, a pickup in spending might be expected. Last month, the CBI distributive trades retail sales balance rose five points from the previous month to -45, and a slightly larger improvement seems likely tomorrow.

UK: Inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Selected inflation components



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

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	Preliminary manufacturing (services) PMI	Mar	62.4 (48.8)	57.8 (46.0)	57.9 (45.7)	-
	Preliminary composite PMI	Mar	52.5	49.1	48.8	-
Germany	European Commission's preliminary consumer confidence	Mar	-10.8	-14.5	-14.8	-
	Preliminary manufacturing (services) PMI	Mar	66.6 (50.8)	60.5 (46.5)	60.7 (45.7)	-
France	Preliminary composite PMI	Mar	56.8	51.6	51.1	-
	Preliminary manufacturing (services) PMI	Mar	58.8 (47.8)	56.3 (45.5)	56.1 (45.6)	-
UK	Preliminary composite PMI	Mar	49.6	47.2	47.0	-
	CPI (core) Y/Y%	Feb	0.4 (0.9)	<u>0.8 (1.4)</u>	0.7 (1.4)	-
	PPI input prices (output prices) Y/Y%	Feb	2.6 (0.9)	2.5 (0.3)	1.3 (-0.2)	1.6 (0.1)
	Preliminary manufacturing (services) PMI	Mar	57.9 (56.8)	55.0 (50.8)	55.1 (49.5)	-
	Preliminary composite PMI	Mar	56.6	51.1	49.6	-
	House price index Y/Y%	Jan	7.5	8.3	8.5	8.0

Auctions

Country	Auction
Germany	sold €3.28bn of 0% 2031 bonds at an average yield of -0.36%
UK	sold £350mn of 0.125% 2056 index-linked bonds at an average yield of -1.972%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU	09.00	M3 money supply Y/Y%	Feb	12.5	12.5
Germany	07.00	GfK consumer confidence	Apr	-12.1	-12.9
France	07.45	INSEE business confidence	Mar	91	90
	07.45	INSEE manufacturing confidence (production outlook)	Mar	98 (-3)	97 (-8)
Spain	08.00	PPI Y/Y%	Feb	-	0.9
UK	11.00	CBI distributive trades, reported sales	Mar	-	-35

Auctions and events

EMU	09.00	ECB publishes Economic Bulletin
	09.00	ECB President Lagarde speaks at BIS conference
	17.00	ECB's Vice President de Guindos scheduled to speak
	17.00	ECB's Schnabel scheduled to speak
Italy	10.00	Auction: fixed rate and index-linked bonds
UK	09.30	BoE publishes capital issuance – February 2021

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

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