

Euro wrap-up

Overview

- As the German government agreed new measures to ease the pain from high energy prices, Bunds made losses while the flash PMIs suggested a moderation in euro area growth amid worsening supply-chain challenges.
- Gilts were little changed as the UK PMIs suggested firm economic growth in Q1 but a deterioration in business confidence, and a retail survey suggested that sales have been subdued this month.
- Friday will bring further economic sentiment surveys from Germany, Italy and the UK and data on euro area bank lending and UK retail sales.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	-0.213	+0.052
OBL 0 04/27	0.261	+0.076
DBR 0 02/32	0.522	+0.060
UKT 1 04/24	1.320	-0.007
UKT 1¼ 07/27	1.396	+0.007
UKT 4¼ 06/32	1.633	+0.009

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

Euro area

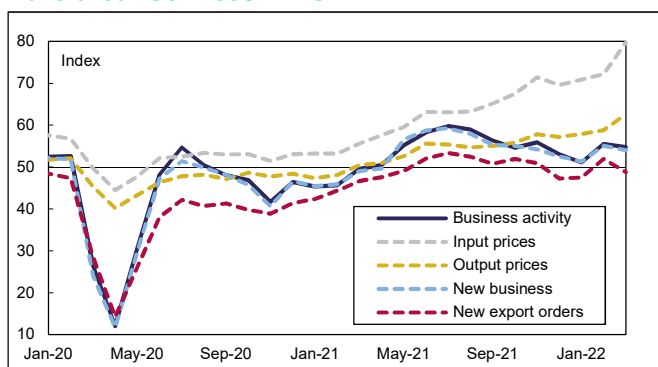
Flash PMIs flag moderation in growth, worsening supply pressures and deteriorating sentiment

After yesterday's flash [consumer confidence](#) index reported a marked deterioration in household sentiment to the lowest level since the initial Covid-19 wave, today's flash PMIs only suggested a moderate slowing of economic activity at the end of Q1. In particular, the euro area composite PMI fell 1pt in March to 54.5 to leave the average in Q1 (54.1) marginally below that in Q4 (54.3), broadly tallying with our forecast of a second successive quarter of GDP growth of 0.3%Q/Q. However, the detail of the survey flagged greater cause for concern than implied by the headline index, as the adverse impact of Russia's war in Ukraine was evident. Indeed, having over recent months suggested a slight improvement in supply-side challenges, the March flash PMIs reported record increases in firms' input costs and output prices as well as a four-month high in supplier delivery times. Moreover, export demand reportedly fell for the first time since late 2020, with a weakening in both services and manufacturing. And business optimism regarding the outlook deteriorated to a seventeen-month low suggesting that risks to economic growth over coming quarters are once again skewed to the downside.

Ukraine hit offsets boost from pandemic re-opening

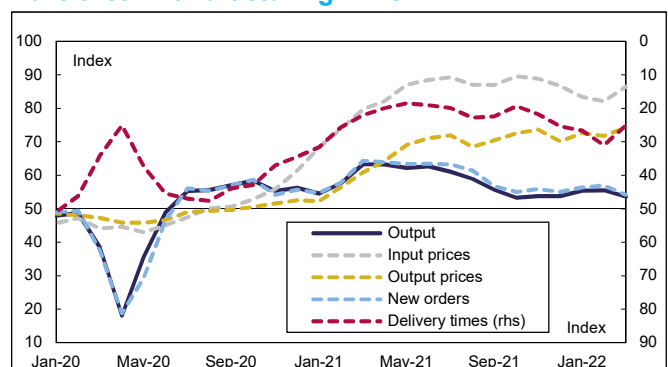
Among services firms, the benefit from ongoing economic reopening from pandemic restrictions – which had been hoped to result in a marked acceleration in output – appears to have been neutralized by the impacts from the Ukraine conflict. So, despite increased demand in tourism and recreation, the flash PMIs suggested that overall growth in activity in the sector softened (the respective euro area index fell 0.7pt to 54.8) with new business also slowing. In addition, growth in manufacturing output reportedly slowed to a five-month low (down 1.9pts to 53.6) restrained by supply-chain disruption – related to inputs from China as well as those impeded by the war – and cost pressures. And while expected output in the coming year was judged to be the softest since November 2020 in services, it was the weakest since the first wave of Covid-19 in manufacturing. It was not all bad news, however, as the flash PMIs suggested a pickup in employment growth in services. At the country level, the French indices suggested the fastest growth since July as a rebound in services more than offset a notable weakening in manufacturing production. That contrasted with the message from today's INSEE survey results, which reported a drop in business sentiment to an eleven-month low. And, while German growth reportedly slowed from the prior month in both services and manufacturing, it was still firmer than seen throughout Q4 and at the start of the year, suggesting that the economy has avoided a second successive contraction in GDP in Q1 – that tallies with our forecast of German growth of 0.2%Q/Q in Q1 following the drop of 0.3%Q/Q in Q4. S&P Global reported that output growth in the rest of the euro area slowed to the weakest pace in a year bar January, with services most significantly affected.

Euro area: Services PMIs



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

Euro area: Manufacturing PMIs



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

Germany adds to policy support to soften hit from energy prices on consumers

The deterioration in forward-looking measures of business and consumer sentiment seems warranted by the hit to real incomes from the rise in energy and commodity prices, flagged by the record-high input-cost and output-price PMIs, which will weigh heavily on demand over coming months. And the full extent of the impact on economic activity will depend in large part on the future path of those prices, which remain volatile, as well as government support measures aimed at softening the blow on households and firms. Building on the range of measures already implemented by the member states over recent months, France's government will enact a €15-cent rebate on auto fuel duty from 1 April for four months. On Tuesday, Italy implemented its 25-cent cut in petrol duty to last one month, with firms set to benefit from tax credits related to their energy consumption, in part funded by a levy on energy company profits. And Germany's ruling coalition today agreed a new package of measures, worth about €15bn, including a 30-cent cut to fuel duty to last for three months, as well as one-off payments of €300 for employed taxpayers and €100 for welfare claimants, and an increase of €100 in child support payments. While the member states' measures should help to avoid a contraction in euro area economic activity in Q2, and keep the peak in inflation below 7.0%Y/Y over coming months, shifts in wholesale markets and possible energy-supply disruption could yet more than offset fully the benefits. And we continue to expect euro area GDP to come in firmly below the ECB's baseline projection over coming quarters.

The day ahead in the euro area

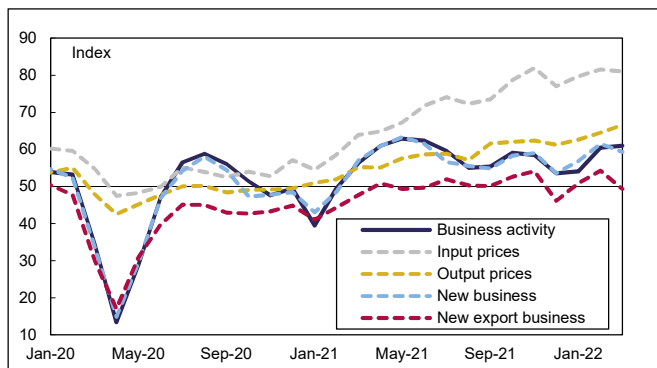
Looking ahead, tomorrow's sentiment surveys from Germany and Italy will offer more insight into economic conditions at the end of the first quarter. In particular, the German ifo index is expected to tally with today's PMI release and reveal a dip in the headline business climate index in March, driven by a pronounced deterioration in the expectations indicator. Similarly, Italy's ISTAT business and consumer sentiment surveys are also expected to report considerable declines. Friday also brings the release of euro area monetary data for February. In January, the ECB reported solid growth in mortgage lending and an acceleration in lending to non-financial corporations, but consumer credit remained subdued. While household deposits rose that month by the most since August, we would expect pace to have slowed again reflecting rising prices and increased opportunities to spend as pandemic restrictions eased.

UK

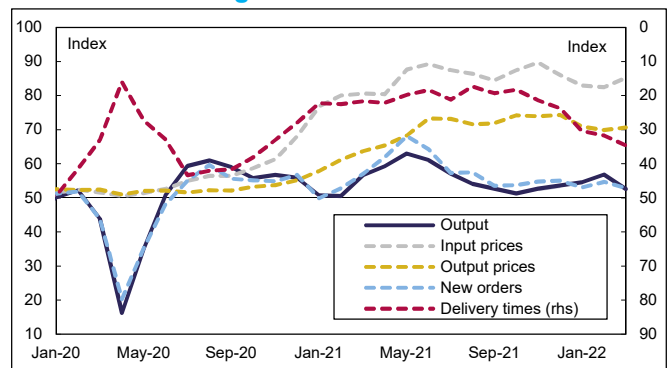
Flash PMIs remain consistent with solid expansion, but flag downside risks

Today's flash UK PMIs were consistent with ongoing economic expansion at the end of the first quarter. Despite increased uncertainties in the face of the Ukraine conflict, the composite PMI slipped only slightly in March, by 0.2pt to a still-elevated

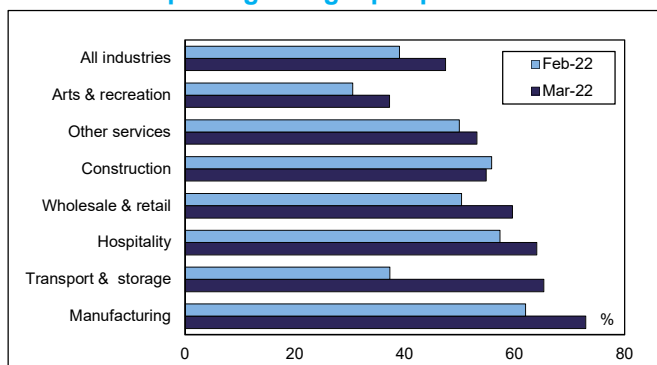
UK: Services PMIs



UK: Manufacturing PMIs

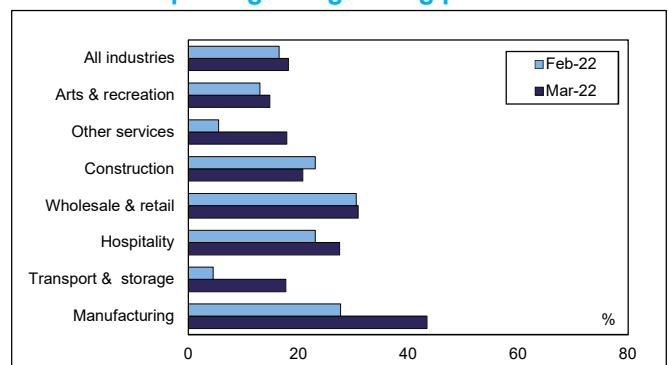


UK: Firms reporting rising input prices*



*Compared with normal fluctuations. Source: ONS BICS survey and Daiwa Capital Markets Europe Ltd.

UK: Firms reporting rising selling prices*



*Compared with normal fluctuations. Source: ONS BICS survey and Daiwa Capital Markets Europe Ltd.

59.7, the second-highest reading of the past nine months. This left the quarterly index (57.9) some 1½pts higher than the Q4 average, suggesting that Q1 GDP growth should be at least as strong as the 1.0%Q/Q increase seen in the previous two quarters. Consistent with an improvement in some high-frequency numbers – e.g. restaurant bookings and use of public transport – the services activity index rose a further 0.5pt to 61.0 in March, the highest since June, as relaxed Covid restrictions, a return to offices and pent-up demand for travel and hospitality provided a boost. But other survey indicators from the sector were less encouraging, with new business slowing as overseas tourism weakened, while input cost burdens remained extremely elevated. So, services firms were the least optimistic about the coming twelve months since November 2020.

Conditions in manufacturing more challenging than in services

Conditions in the manufacturing sector were reportedly much more challenging than in services, with the output PMI falling 4.3pts to 52.6, a five-month low. New orders growth was the softest in more than a year as concerns about the Ukraine conflict weighed. While supplier delays were the least widespread for seventeen months, manufacturers noted that shortages of raw materials, staff absences and shipping delays continued to limit production, with risks these will be intensified by the Ukraine war over the months ahead. Unsurprisingly, the flash PMIs suggested that inflationary pressures remained elevated in the sector too. And that tallied with the latest ONS business insights survey that showed almost three-quarters of manufacturers had seen input prices rise over the past month. Indeed, overall, almost half of firms reported that prices had increased compared with normal fluctuations, compared with 39% in February, the largest monthly increase since comparable estimates began in June 2020.

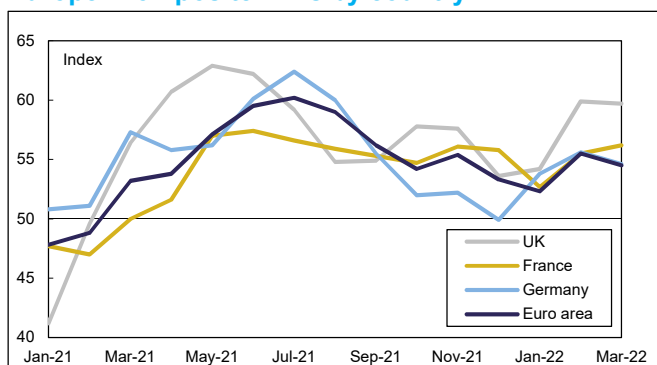
Retail survey suggest sales were poor in March

Today's CBI distributive trades survey presented a pretty downbeat assessment of activity on the high street over the past month. Despite the low base a year ago and improvement in weather from February, the survey suggested that retail sales grew at a softer pace in the year to March, with the relevant index down 5pts to 9, the second-lowest reading of the past twelve months. Moreover, the CBI noted that sales were particularly poor for the time of year – indeed, the respective index for March was last lower during the strict lockdown at the start of last year when non-essential stores were closed. And while retailers expected a bounce back in April, sales were anticipated to remain below seasonal norms. This is hardly surprising given the increasing squeeze on household budgets from high inflation. And while the government yesterday offered modest additional support for households, with the tax burden set to rise for the vast majority of households and real disposable incomes set to fall by the most since the 1950s if not before then, we expect spending on non-essential items to remain subdued.

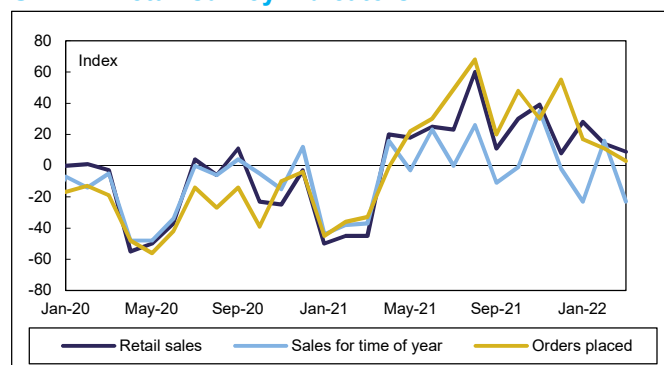
The day ahead in the UK

Tomorrow will bring the release of official UK retail sales data for February as well as the latest GfK consumer confidence survey for March. Retail sales are expected to have moved broadly sideways last month, after rising almost 2%/M/M in January. In addition, the headline consumer confidence index is forecast to have fallen for the fourth consecutive month in March, to -30, close to the lows recorded at the start of the Covid pandemic (-34). Friday will also bring the SMMT's measure of auto production in February. With car production having previously dropped 20.1%Y/Y to mark the weakest January since 2009, last month was likely similarly weak as supply constraints continued to bind.

Europe: Composite PMIs by country














UK: CBI retail survey indicators



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Preliminary manufacturing (services) PMI	Mar	57.0 (54.8)	56.0 (54.3)	58.2 (55.5)	-
	 Preliminary composite PMI	Mar	54.5	54.5	55.5	-
Germany	 Preliminary manufacturing (services) PMI	Mar	57.6 (55.0)	56.0 (53.7)	58.4 (55.8)	-
	 Preliminary composite PMI	Mar	54.6	54.5	55.6	-
France	 INSEE business confidence	Mar	107	110	112	113
	 INSEE manufacturing confidence (production outlook)	Mar	106 (-2)	109 (-)	112 (22)	-
	 Preliminary manufacturing (services) PMI	Mar	54.8 (57.4)	55.1 (55.0)	57.2 (55.5)	-
	 Preliminary composite PMI	Mar	56.2	54.5	55.5	-
UK	 Preliminary manufacturing (services) PMI	Mar	55.5 (61.0)	57.0 (58.0)	58.0 (60.5)	-
	 Preliminary composite PMI	Mar	59.7	57.5	59.9	-
	 CBI distributive trades survey, reported retail sales	Mar	9	10	14	-

Auctions

Country	Auction
- Nothing to report -	



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	09.00	M3 money supply Y/Y%	Feb	6.3	6.4
Germany	09.00	Ifo business climate	Mar	94.1	98.9
	09.00	Ifo current assessment (expectations)	Mar	97.0 (93.2)	98.6 (99.2)
Italy	09.00	ISTAT business (manufacturing) confidence	Mar	- (112.0)	108.2 (113.4)
	09.00	ISTAT consumer confidence	Mar	108.0	112.4
Spain	08.00	PPI Y/Y%	Feb	-	35.7
	08.00	Final GDP Q/Q% (Y/Y%)	Q4	2.0 (5.2)	2.6 (3.4)
UK	00.01	GfK consumer confidence	Mar	-30	-26
	00.01	SMMT auto production Y/Y%	Feb	-	-20.1
	07.00	Retail sales including autos fuel M/M% (Y/Y%)	Feb	0.5 (7.8)	1.9 (9.1)
	07.00	Retail sales excluding autos fuel M/M% (Y/Y%)	Feb	0.5 (5.6)	1.7 (7.2)

Auctions and events

Italy		10.00	Auction: €2bn of 0% 2023 bonds
		10.00	Auction: €1.5bn of 0.1% inflation-linked 2033 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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