

Euro wrap-up

Overview

- Despite a slump in German IP, Bunds made losses as Bundesbank Governor Nagel suggested that the ECB needed to tighten policy before the opportunity to do so passes, and BoF Governor Villeroy suggested that it would be reasonable to increase ECB rates to above zero by year-end.
- Longer-dated Gilts also made losses despite a slightly softer UK construction PMI survey.
- The coming week will bring speeches from several ECB policymakers, as well as euro area IP numbers for March and the UK Q1 GDP report.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 03/24	0.317	+0.046
OBL 0 04/27	0.859	+0.096
DBR 0 02/32	1.138	+0.098
UKT 1 04/24	1.487	-0.033
UKT 1½ 07/27	1.661	+0.003
UKT 4½ 06/32	2.009	+0.048

*Change from close as at 4:15pm BST.
Source: Bloomberg

Euro area

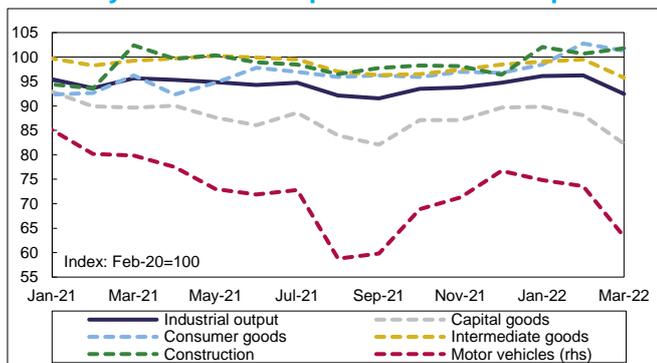
German IP slumps in March but supported GDP growth in Q1

German industrial production in March slumped 3.9%M/M, the sharpest decline since the first wave of Covid-19. While it was three times the consensus forecast decline on the Bloomberg survey, the weakness had been foreshadowed by the marked decline in [manufacturing turnover](#) reported yesterday. The drop left industrial production about 7½% below the pre-pandemic level. Constrained by [supply-chain challenges](#) and high energy prices aggravated by the war in Ukraine, the fall in overall IP was due principally to an even steeper decline in manufacturing output, which dropped 4.6%M/M to be some 10% below the pre-pandemic level. Indeed, weakness in the factory sector at the end of the first quarter was widespread. Most notably perhaps, output of capital goods fell 6.6%M/M, with the cars component down 14.0%M/M to be more than 35% below the pre-pandemic level. Production of intermediate goods fell 3.8%M/M with consumer goods down a more moderate 1.5%M/M. Beyond the manufacturing sector, energy output fell a series-high 11.4%M/M, attributed by Destatis to weaker wind-generated power. In contrast, construction output rose 1.1%M/M. Despite the weak performance in March, German manufacturing output rose 0.4%Q/Q and construction grew a substantive 4.0%Q/Q, the most since Q420. So, while energy output was down 2.0%Q/Q, overall industrial production rose 1.0%Q/Q, providing welcome support to GDP. The big drop in March, however, raises risks of an eventual downward revision to the initial estimate of GDP growth of just 0.2%Q/Q.

Industrial production set to contract in Q2, but services should offset the impact on German GDP

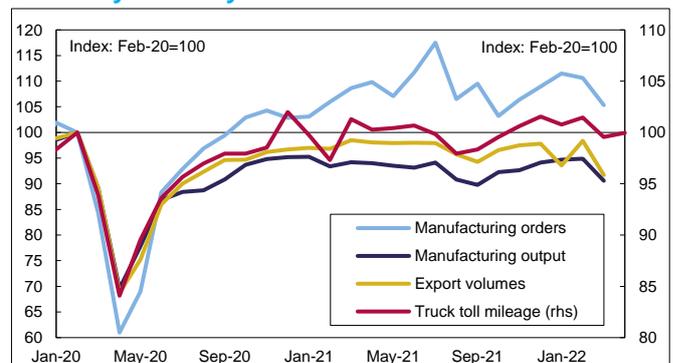
While industrial production grew in Q1, the weakness at the end of the quarter likely presages a decline over Q2 as a whole. For example, the VDA's car production data published earlier this week suggested that the steep drop in March was far from reversed in April. Likewise, the modest rise of 0.4%M/M in the truck toll mileage index in April left it below the Q1 average. While the backlog of unfilled orders is at a series high, new factory orders fell 3.4%M/M in March to be more than 4% below the average of the previous nine months. The manufacturing output PMI fell almost 2½pts in April to a 22-month low of 50.7, suggesting stagnation in production. And the ifo business survey suggested a deterioration in manufacturing conditions in April to the least favourable in more than a year, with expectations for the coming six months still firmly negative due to persisting supply-chain bottlenecks, high energy prices and concerns about EU plans for embargoes on imports of Russian energy. For similar reasons, construction surveys also point to contraction this quarter following the strong growth in Q1. Fortuitously perhaps, the relaxation of pandemic restrictions should ensure that growth in services in Q2 more than offsets contraction in the industrial sector.

Germany: Industrial output – selected components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Factory sector indicators



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

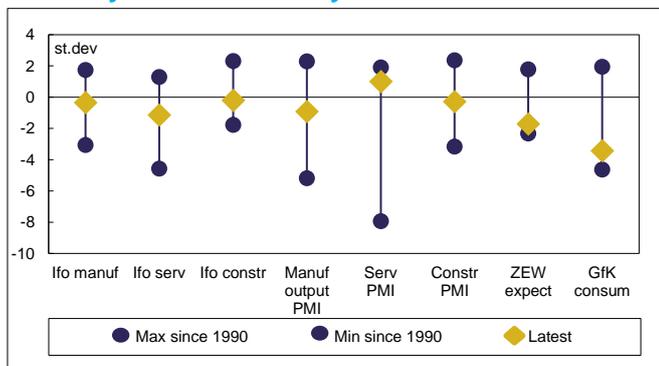
Spanish IP slips back in March, surveys suggest challenges remain ahead too

Like their German equivalents, today's Spanish IP figures also fell well short of expectations. Indeed, total production fell 1.8%M/M in March, the most since May 2021, to the lowest level for five months and still almost 1½% below the pre-Covid benchmark. The pandemic shortfall in manufacturing was a touch larger still at more than 2%. In March, the weakness was broad based, reflecting a hefty drop in production of intermediate goods (-7.3%M/M) to its lowest level since July 2020, as well as declines in output of capital goods (-2.6%M/M) and consumer durables (-2.7%M/M). At the more granular level, falls in the production of autos, basic metals and clothing offset a surge in pharmaceuticals. Surveys suggest that manufacturing conditions remained challenging at the start of Q2 too. Spain's manufacturing output PMI fell more than 4pts in April to 51.9, a fourteen-month low, while the new orders component fell firmly into contractionary territory. And the European Commission's industrial sentiment indicator slipped to a thirteen-month low. Of course, with the services sector all important for Spain's economy – accounting for roughly two-thirds of output – near-term economic activity should remain supported by a revival in international travel and a recovery in tourism. Indeed, the number of overseas visitors rose above 4mn in March, more than seven times higher than in March 2021, albeit still almost 30% lower than the equivalent period in 2019.

The week ahead in the euro area

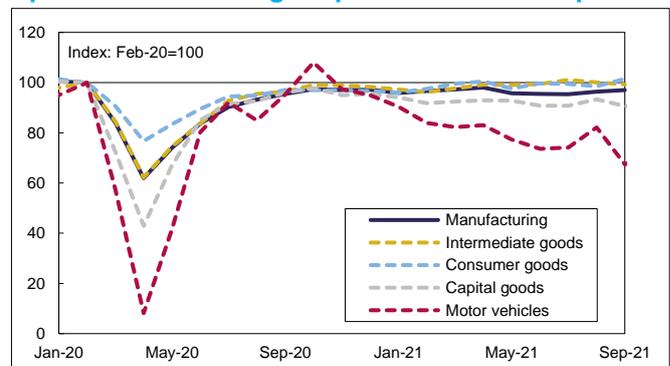
The flow of euro area data from the manufacturing sector continues in the coming week with (the often volatile) Irish industrial production numbers (Monday) to be followed by equivalent Italian figures (Tuesday) and euro area industrial production data (Friday). So far, national IP results have disappointed in Germany, France and Spain, suggesting that industrial output for the euro area as a whole fell sharply – the Bloomberg market consensus sees a fall of around 2.0%M/M, although that would still leave euro area production up roughly 1.0%Q/Q in Q1. Survey-wise, the euro area Sentix investor confidence survey for May will be published on Monday, followed by the latest German ZEW investor and Bank of France business surveys (Tuesday). Despite the ongoing normalisation of the economy following the lifting of pandemic-related restrictions, persisting supply bottlenecks and cost pressures from events in Ukraine and renewed lockdowns in China, as well as the prospect of embargoes on Russian energy imports, are likely to continue to weigh on confidence. Meanwhile, the second half of the week sees the release of final CPI data for April, from Germany (Wednesday), France and Spain (Friday). The preliminary data were mixed – German and French inflation was a touch stronger than expected, with the HICP rates rising 0.2ppt to 7.8%Y/Y and 0.3ppt to 5.4%Y/Y respectively. In contrast, the equivalent Spanish rate fell a much larger-than-expected 1.5ppts to 8.3%Y/Y. ECB-wise, there are plenty of Governing Council members in action in the coming week, including President Lagarde and Executive Board members Schnabel (Wednesday) and Hernández de Cos (Thursday).

Germany: Headline survey indicators



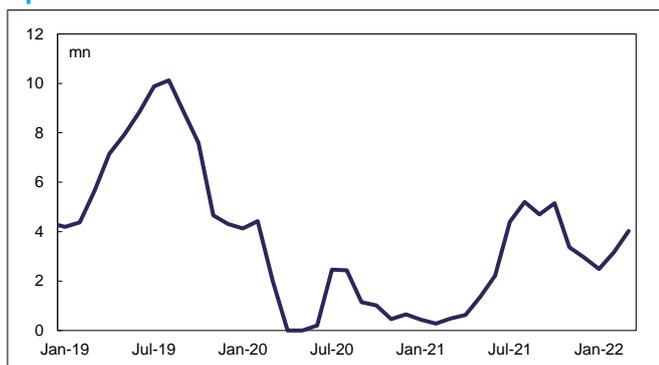
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Spain: Manufacturing output – selected components



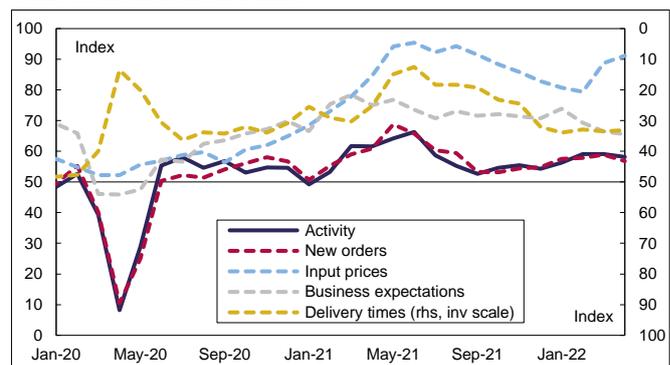
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Spain: Overseas visitors



Source: INE and Daiwa Capital Markets Europe Ltd.

UK: Construction PMIs



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

UK

UK construction PMI consistent with solid expansion, but challenges to the sector remain

Similar to yesterday's [services PMIs](#), today's UK construction survey suggested a slight moderation in recovery momentum at the start of the second quarter. In particular, the headline activity index fell for the first month in four in April (-0.9pt) to 58.2, admittedly still the second-strongest reading of the past nine months and consistent with ongoing solid expansion. While the slowdown was broad-based across the sub-sectors, it was more evident in housing, with the respective activity PMI down a further 1pt in April to 53.8, a seven-month low. According to the PMIs, commercial activity remained the fastest growing, although BoE agents' contacts recently reported some projects having been cancelled due to rising costs. And while the government's HS2 development continued to support civil engineering activity, publicly funded projects were likely to stabilise in due course. Due also to higher borrowing costs, heightened geopolitical uncertainty, persisting supply challenges and substantial cost burdens, the near-term outlook for construction was judged to have deteriorated. Indeed, the new orders PMI declined 2.1pts to 56.8, a four-month low, while firms' expectations for output over the year ahead fell for the third consecutive month to its lowest since September 2020.

The week ahead in the UK

The UK data highlight of the coming week will be Thursday's Q1 GDP report, which we forecast to reveal only a modest easing in the pace of growth, to 1.0%Q/Q, from 1.3%Q/Q in Q4. We expect the detail to reveal that household consumption was supported to some extent by increased opportunities to spend on services. However, we expect the monthly profile to report no growth whatsoever in March, following growth of just 0.1%M/M in February. Indeed, given exceptionally high inflation and the pre-announced additional hit to disposable income from the 54% hike in household energy bills last month, consumer spending will slow markedly this quarter. Indeed, the latest BRC retail sales monitor for April (due Tuesday) is expected to signal a substantial drop in spending on goods. Other data due in the coming week include the REC report on jobs on Thursday, which is expected to suggest that the labour shortage continues to drive up starting salaries. Meanwhile the RICS house price balance for April (Thursday) is expected to remain elevated due to the ongoing supply-demand imbalance. In terms of BoE-speak, MPC external member Saunders is due on Monday to discuss current monetary policy challenges at the Resolution Foundation.

The next edition of the Euro wrap-up will be published on 10th May 2022

Daiwa economic forecasts

	2021		2022				2022	2023	2024
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	%, Q/Q						%, Y/Y		
Euro area 	2.2	0.3	0.2	0.7	0.8	0.7	3.2	2.4	1.8
UK 	0.9	1.3	1.0	-0.1	0.3	-0.6	3.7	-0.3	0.9
Inflation, %, Y/Y									
Euro area									
Headline HICP 	2.8	4.6	6.1	7.4	7.0	5.7	6.6	2.2	1.8
Core HICP 	1.4	2.4	2.6	3.5	3.3	2.7	3.1	1.8	1.8
UK									
Headline CPI 	2.8	4.9	6.2	9.5	9.4	10.2	8.9	5.1	1.7
Core CPI 	2.6	3.9	5.1	6.3	6.3	6.0	5.9	3.3	1.7
Monetary policy, %									
ECB									
Refi Rate 	0.00	0.00	0.00	0.00	0.25	0.50	0.50	0.50	0.50
Deposit Rate 	-0.50	-0.50	-0.50	-0.50	0.00	0.25	0.25	0.25	0.25
BoE									
Bank Rate 	0.10	0.25	0.75	1.00	1.25	1.25	1.25	1.00	1.00

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous	
Monday 09 May 2022						
Euro area		09.30	Sentix investor confidence	May	-21.1	-18.0
France		07.45	Trade balance €bn	Mar	-10.9	-10.3
Tuesday 10 May 2022						
Germany		10.00	ZEW current situation (expectations) balance	May	-35.0 (-43.0)	-30.8 (-41.0)
France		-	Bank of France industrial sentiment*	Apr	103	103
Italy		09.00	Industrial production M/M% (Y/Y%)	Mar	-1.5 (1.4)	4.0 (3.3)
UK		00.01	BRC retail sales monitor, like-for-like Y/Y%	Apr	-	-0.4
Wednesday 11 May 2022						
Germany		07.00	Final CPI M/M% (Y/Y%)	Apr	0.8 (7.4)	2.5 (7.3)
		07.00	Final EU-harmonised CPI M/M% (Y/Y%)	Apr	0.7 (7.8)	2.5 (7.6)
UK		09.30	Unit labour costs Y/Y%	Q4	-	3.1
Thursday 12 May 2022						
UK		00.01	RICS house price balance %	Apr	71	74
		07.00	Preliminary GDP Q/Q% (Y/Y%)	Q1	<u>1.0 (9.0)</u>	1.3 (6.6)
		07.00	Monthly GDP M/M%	Mar	<u>0.0</u>	0.1
		07.00	Industrial production M/M% (Y/Y%)	Mar	0.0 (0.5)	-0.6 (1.6)
		07.00	Manufacturing production M/M% (Y/Y%)	Mar	0.0 (2.3)	-0.4 (3.6)
		07.00	Index of services M/M% (3M/3M%)	Mar	0.1 (0.9)	0.2 (0.8)
		07.00	Construction output M/M% (Y/Y%)	Mar	0.2 (2.2)	-0.1 (6.1)
		07.00	Trade in goods balance £bn	Mar	-18.5	-20.6
Friday 13 May 2022						
Euro area		10.00	Industrial production M/M% (Y/Y%)	Mar	-1.8 (-1.1)	0.7 (2.0)
France		07.45	Final CPI M/M% (Y/Y%)	Apr	0.4 (4.8)	1.4 (4.5)
		07.45	Final EU-harmonised CPI M/M% (Y/Y%)	Apr	0.5 (5.4)	1.6 (5.1)
Spain		08.00	Final CPI M/M% (Y/Y%)	Apr	-0.1 (8.4)	3.0 (9.8)
		08.00	Final EU-harmonised CPI M/M% (Y/Y%)	Apr	-0.2 (8.3)	3.9 (9.8)

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

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 09 May 2022		
UK	 14.00	BoE's Saunders speaks at the Resolution Foundation – 'Taking the right path'
Tuesday 10 May 2022		
Euro area	 15.00	ECB's Nagel scheduled to speak on "From global pandemic to geopolitical conflict: Pathways for the world economy"
	 18.20	ECB's de Guindos scheduled to speak
Germany	 10.30	Auction: €3bn of 0% 2027 bonds
UK	 10.00	Auction: £2.25bn of 0.875% 2033 bonds
Wednesday 11 May 2022		
Euro area	 09.00	ECB President Lagarde and Vasle scheduled to speak at a Bank of Slovenia event
	 09.55	ECB's Knot scheduled to speak
	 13.20	ECB's Schnabel scheduled to speak
Germany	 10.30	Auction: €4bn of 0% 2032 bonds
UK	 10.00	Auction: £2.5bn of 0.5% 2029 bonds
Thursday 12 May 2022		
Euro area	 09.05	ECB's Hernández de Cos scheduled to speak
Italy	 10.00	Auction: 3Y and 7Y bonds
UK	 00.01	REC/KPMG report on Jobs
Friday 13 May 2022		
Euro area	 08.00	ECB's de Guindos scheduled to speak
	 17.00	ECB's Schnabel chairs panel at International Research Forum on monetary policy

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
Germany	 Industrial production M/M% (Y/Y%)	Mar	-3.9 (-3.5)	-1.0 (-0.2)	0.2 (3.2)	0.1 (3.1)	
Italy	 Retail sales M/M% (Y/Y%)	Mar	-0.5 (5.6)	-	0.7 (4.3)	- (4.6)	
Spain	 Industrial production M/M% (Y/Y%)	Mar	-1.8 (0.1)	-0.5 (2.8)	0.9 (3.0)	- (2.8)	
UK	 Construction PMI	Apr	58.2	58.0	59.1	-	
Auctions							
Country	Auction						
- Nothing to report -							

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/Disclosures.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>

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Opinions [and/or estimates] reflect a judgment as at the date of publication and are subject to change without notice. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.