Euro wrap-up

Overview

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- Bunds followed USTs higher, while the ECB reduced the pace of tightening to 25bps but also signalled that it would stop APP reinvestments from July.
- Despite an upside surprise to the final UK services PMIs, Gilts also made gains as mortgage lending slowed sharply.
- Friday will bring March results for euro area retail sales and German factory orders, and the April construction PMIs.

Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	2.447	-0.171
OBL 2.2 04/28	2.112	-0.127
DBR 2.3 02/33	2.186	-0.058
UKT 0⅝ 06/25	3.645	-0.097
UKT 1⅝ 10/28	3.466	-0.091
UKT 3¼ 01/33	3.646	-0.043

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

Euro area

ECB slows pace of rate hikes to 25bps, but speeds up pace of QT

As expected, the ECB today slowed its pace of rate hikes to 25bps, having previously tightened by 50bps at each of the prior three meetings, taking the deposit rate to 3.25%. But unexpectedly, and (although denied by President Lagarde) perhaps as a move to keep the hawks happy despite the smaller rate hike, the Governing Council also signalled that it intends to speed up the pace of quantitative tightening. In particular, the ECB now expects to discontinue the reinvestments under the regular APP (but not the PEPP) from July. As a result, the pace of balance sheet run-off will increase from the current average €15bn per month to an average of about €25bn per month from Q3 on. That decision to end APP reinvestments from July did not come out of the blue, but had been expected to come next month rather than today. Finally, the ECB repeated that future policy decisions will be data-dependent and based on its assessment of the inflation outlook, which of course will be updated again next month. However, the updated wording of its forward guidance – specifying that "future decisions will ensure that the policy rates will be brought to levels sufficiently restrictive to achieve a timely return of inflation to the 2% medium-term target and will be kept at those levels for as long as necessary" – suggested that further tightening after today is more likely than not, an assessment endorsed by President Lagarde in her press conference.

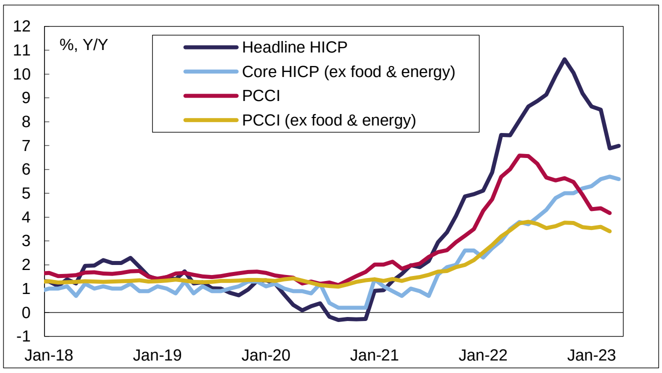
While policy stance is now restrictive, ECB still has "more ground to cover"

Indeed, Lagarde stated that all members of the Governing Council agreed on the need for a rate hike today, and some would have preferred 50bps. Importantly, she also emphasised that the ECB was "not pausing" in its tightening path. And based on recent data and the Bank's most recent economic projections, she insisted that there was still likely to be "more ground to cover" before policy was "sufficiently restrictive". Nevertheless, she also acknowledged that the current monetary stance was already restrictive, as had been illustrated by the significant tightening of credit standards and weakening in loan growth reported this week. Vice President de Guindos added that the ECB also couldn't be complacent about financial stability risks. But while the Bank's lending survey results in particular demonstrated that rate hikes had already contributed to a significant tightening of financial conditions, Lagarde also suggested that there was not yet clear evidence of a material impact on the real economy.

With ECB projections broadly on track, we now expect two more rate hikes this cycle

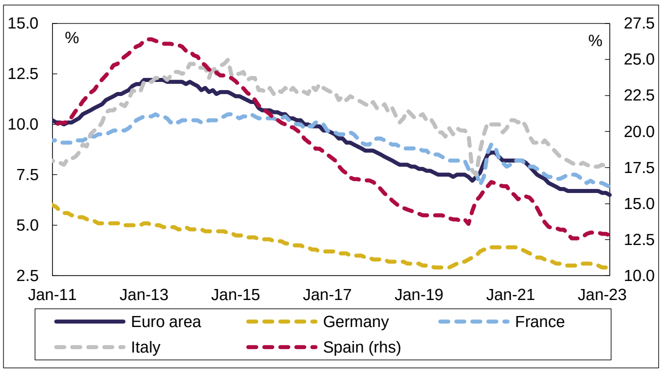
Given recent euro area macroeconomic data – including the only very slight drop in core inflation to 5.6%Y/Y in April, the further decline to a series low of 6.5% in the unemployment rate in March, and the signal of a pick-up in economic growth momentum led by Southern Europe in today's final PMIs for April – the ECB will judge that its macroeconomic projections

Euro area: Measures of inflation



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

Euro area: Unemployment rates



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

published in March, which anticipated a pickup in economic growth this quarter, remain broadly on track. But those forecasts saw inflation returning back close to target from early 2025. And while core inflation remains high and sticky, and the risks to the inflation outlook are still considered to remain skewed to the upside, Lagarde noted that a range of measures of underlying inflation should be watched closely. Notably perhaps, she flagged the PCCI (Persistent and Common Component of Inflation) measures, which peaked several months ago and in March were already 1½ppts or more below the current core rate. Some ECB staff will believe those measures provide a better guide to the path of inflation ahead, and many will be wary of the Governing Council tightening policy too far due to an excessive focus on past rather than future inflation. Nevertheless, overall, we interpreted Lagarde's comments to suggest that the hawks continue to remain in the majority on the Governing Council. And as a clear downtrend in the main core inflation measure might not be evident until the end of Q3, we now expect two further hikes of 25bps apiece to come in June and July to take the terminal deposit rate to 3.75%.

The day ahead in the euro area

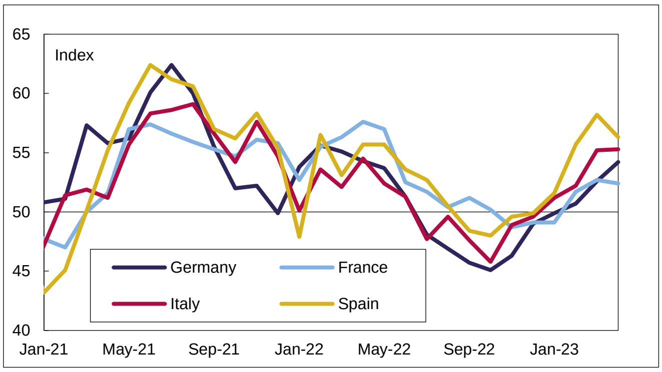
After last week's flash Q1 euro area GDP estimate, tomorrow's release of euro area retail sales data for March will offer some more colour on household consumption last quarter. The Bloomberg survey forecast is for sales to have fallen 0.2%M/M in March, although the German figures earlier this week raise the risk of a notable downside surprise. Overall, the figures should support our view that household consumption was a drag on growth. We will also get various March manufacturing sector data, including German factory orders, and French and Spanish IP. German factory orders are expected to have partly reversed February's strong increase of 4.8%M/M, while output growth in France and Spain is forecast to reveal little growth at the end of Q1. Meanwhile, the latest euro area construction PMIs will likely point to ongoing weakness in the sector.

UK

Services PMIs point to surprisingly robust recovery momentum and still elevated price pressures

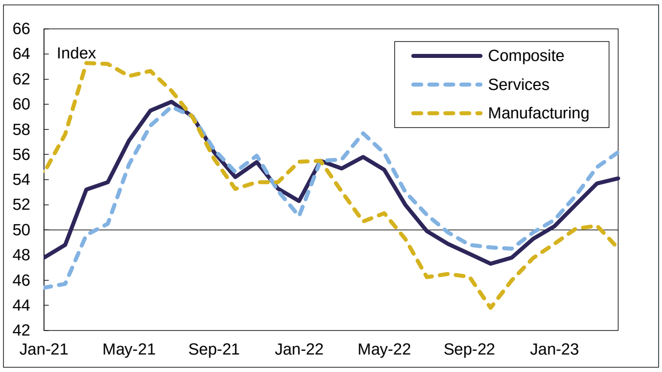
According to today's final April PMIs, the UK economy saw surprisingly robust recovery momentum at the start of Q2. The composite output PMI was revised notably higher from the flash estimate to 54.9, the highest for a year, some 3.6pts above the Q1 average, and a level that prior to the pandemic would have implied GDP growth of around 0.4%Q/Q if sustained over the quarter. The PMIs suggest that the recovery remains driven by services, with the activity index jumping 3.0pts in April to 55.9, which firms attributed to stronger consumer spending in the travel, tourism and leisure sub-sectors. Services firms also reported the strongest jobs growth for seven months. But while cost pressures in the sector have moderated from last year's peak, almost half of respondent firms suggested that they continued to rise, not least due to higher pay. As such, overall

Euro area member states: Composite PMIs



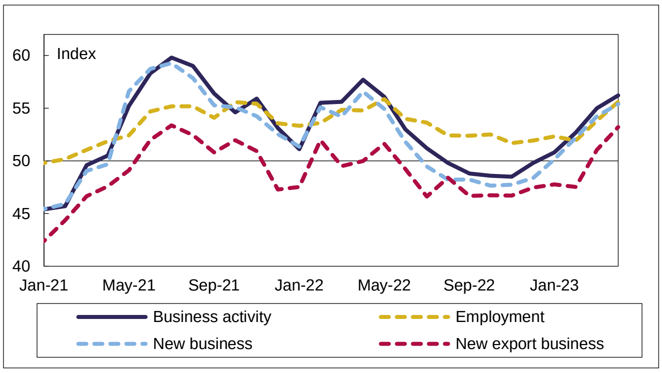
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Headline output PMIs



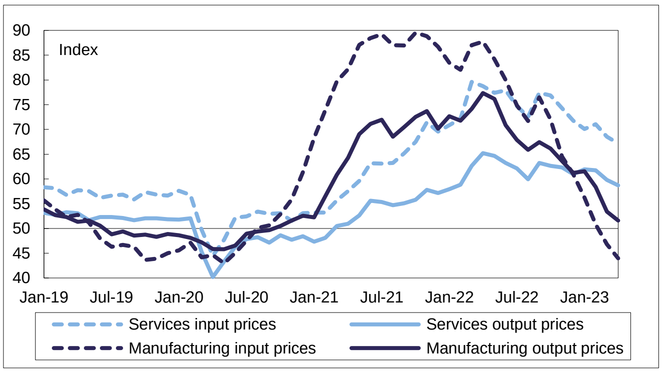
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Services PMIs



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

Euro area: PMI price indices



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

input price inflation reportedly rose for the first time since November. A little more than one third of respondent firms reported an increase in their own prices charged last month – indeed, the respective survey PMI rose 2.8pts in April to be still some 10pts above the pre-pandemic average. The latest results from the BoE's Decision Maker Panel survey today also showed that firms' expectations for output prices over the coming year rose in April, by 0.6ppt to a six-month high of 5.9%Y/Y. Admittedly, firms' one-year ahead expectations for consumer price inflation maintained a modest downwards trend, by 0.2ppt to 5.6%Y/Y. But while expected wage growth over the year ahead also moderated slightly, at 5.4%Y/Y it will still be too high for comfort for the MPC. And importantly, inflation expectations three years ahead (3.4%Y/Y) were still well above the Bank's 2% target.

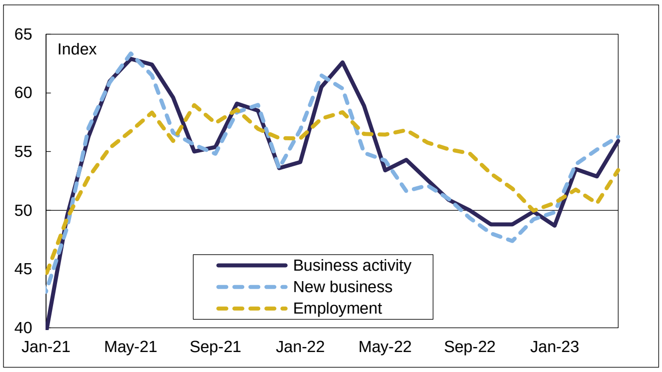
Mortgage lending slows sharply in March, but approvals start to pick up

Given signs of a stronger pace of recovery and still stubbornly high inflation, the BoE looks set to raise interest rates at least once more this cycle, with a further 25bps hike taking Bank Rate to 4.50% at its policy-setting meeting next week now seemingly inevitable. Of course, this decision will not be unanimous, with two external Committee members having voted for no change to Bank Rate at the previous three meetings. The MPC will also be mindful of the lagged impact of the cumulative monetary tightening to date. Certainly, today's UK bank lending figures showed another marked slowdown in net new mortgage lending to just £18mn in March, well below the average in 2022 (£5.1bn) and compared with the pre-pandemic ten-year average of £2.3bn. Indeed, when excluding pandemic-related volatility, net borrowing was the lowest since June 2011. The slowdown tallied with a further rise in the effective interest rate on these loans up to 4.41%, some 185bps higher than in August. Nevertheless, today's mortgage approvals were somewhat more encouraging, with net approvals for new house purchases up to a five-month high of 52.0k. Admittedly, they remain almost 15k below the pre-pandemic five-year average and consistent with still subdued mortgage lending over the near term.

Above-average consumer credit lending while households withdraw bank deposits

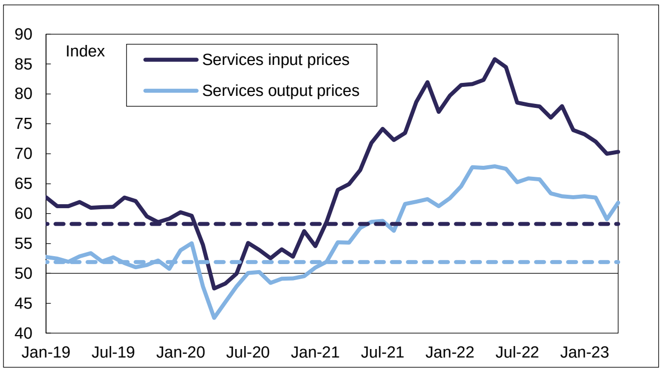
Perhaps reflecting the ongoing erosion of households' purchasing power, consumer credit growth remained broadly in line with the recent above-average trend. Indeed, at £1.6bn net lending was double the average seen in the decade before the pandemic, and £0.4bn higher than the average in 2022. This saw the outstanding amount of consumer credit increase 9.5%3M/3M annualised, the most since June 2018, with growth in credit card lending up 16.6% on the same basis. Meanwhile, there was a further sizeable inflow of household deposits paid into higher-yielding time accounts in March (£6.5bn). But these were more than offset by the largest outflow from sight accounts since the series began in 2008, with the total amount that households deposited in banks actually falling £4.8bn, the biggest withdrawal since the series began in

UK: Services PMIs



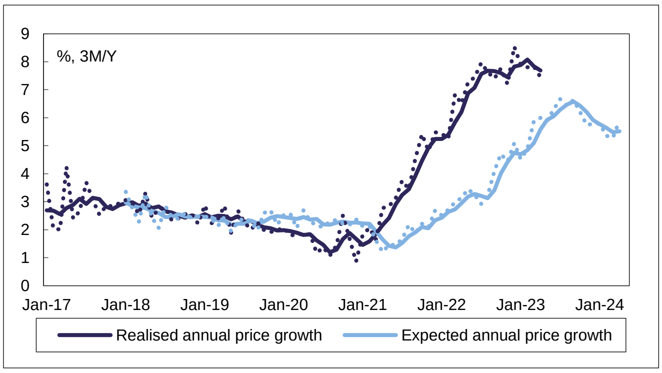
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Services PMI price indices*



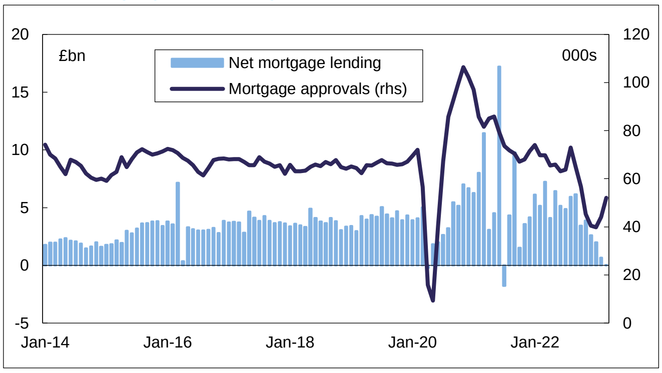
**Dashed lines are pre-pandemic long run average. Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.*

UK: Firms' output price expectations*



**Dotted lines represent single-month Y/Y rates. Source: BoE DMP survey and Daiwa Capital Markets Europe Ltd.*

UK: Mortgage lending & approvals



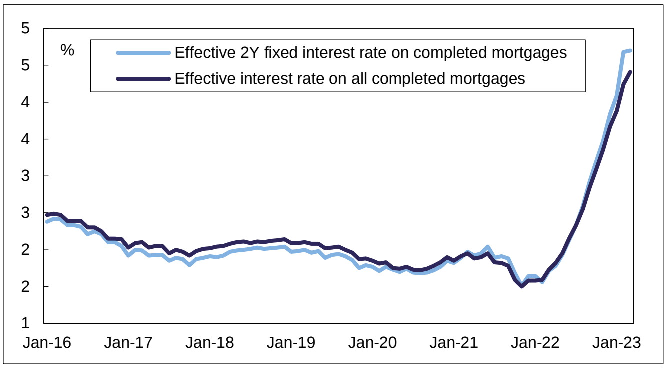
Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.

1997. This was partly offset by a significant inflow into the government's National Savings & Investment accounts, by a net £3.5bn, the most since September 2020.

The day ahead in the UK

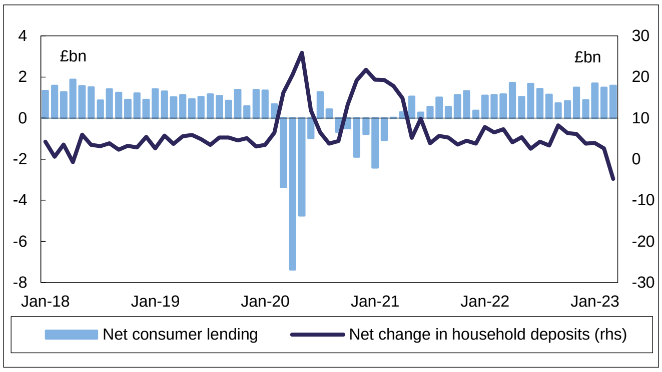
It is set to be a quiet end to the week in the UK, with only the April construction PMIs scheduled for release. In March, the survey pointed to a marked slowdown in activity with the headline activity index falling 3.9pts, to 50.7. It is expected to move broadly sideways in April (51.0), suggesting that elevated borrowing costs and expectations of weaker demand continue to weigh on new housing projects.

UK: Effective mortgage interest rates



Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Household credit & deposits



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

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Final services (composite) PMI	Apr	**56.2 (54.1)**	*56.6 (54.4)*	55.0 (53.7)	-
	PPI Y/Y%	Mar	**5.9**	5.7	13.2	13.3
	ECB Deposit (Refi) Rate %	May	**3.25 (3.75)**	*3.25 (3.75)*	3.00 (3.50)	-
Germany	Trade balance €bn	Mar	**16.7**	16.3	16.0	16.1
	Final services (composite) PMI	Apr	**56.0 (54.2)**	*55.7 (53.9)*	53.7 (52.6)	-
France	Final services (composite) PMI	Apr	**54.6 (52.4)**	*56.3 (53.8)*	53.9 (52.7)	-
Italy	Services (composite) PMI	Apr	**57.6 (55.3)**	57.0 (53.8)	55.7 (55.2)	-
Spain	Unemployment change 000s	Apr	**-73.9**	-	-48.8	-
	Services (composite) PMI	Apr	**57.9 (56.3)**	59.9 (58.5)	59.4 (58.2)	-
UK	New car registrations Y/Y%	Apr	**11.6**	-	18.2	-
	Final services (composite) PMI	Apr	**55.9 (54.9)**	*54.9 (53.9)*	52.9 (52.2)	-
	Net consumer credit £bn (Y/Y%)	Mar	**1.6 (7.9)**	1.2 (-)	1.4 (7.7)	1.5 (-)
	Net mortgage lending £bn (approvals '000s)	Mar	**0.0 (52.0)**	1.6 (46.0)	0.7 (43.5)	- (44.1)
	M4 money supply M/M% (Y/Y%)	Mar	**-0.6 (0.4)**	-	-0.4 (1.0)	-0.3 (1.1)

Auctions

Country	Auction
France	sold €5.08bn of 3.00% 2033 bonds at an average yield of 2.83%
	sold €1.91bn of 1.75% 2039 bonds at an average yield of 3.10%
	sold €2.25bn of 3.00% 2054 bonds at an average yield of 3.33%
	sold €1.51bn of 0.50% 2072 bonds at an average yield of 2.82%
Spain	sold €2.43bn of 2.80% 2026 bonds at an average yield of 2.941%
	sold €2.17bn of 0.00% 2028 bonds at an average yield of 2.922%
	sold €1.77bn of 1.20% 2040 bonds at an average yield of 3.751%
	sold €559mn of 0.65% 2027 index-linked bonds at an average yield of 0.652%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data					
Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	08.30	Construction PMI	Apr	-	45.0
	10.00	Retail sales M/M% (Y/Y%)	Mar	-0.2 (-3.3)	-0.8 (-3.0)
Germany	07.00	Factory orders M/M% (Y/Y%)	Mar	-2.3 (-3.1)	4.8 (-5.7)
	08.30	Construction PMI	Apr	-	42.9
France	07.45	Industrial production M/M% (Y/Y%)	Mar	-0.4 (1.1)	1.2 (1.3)
	07.45	Manufacturing production M/M% (Y/Y%)	Mar	-	1.3 (2.2)
	08.30	Construction PMI	Apr	-	45.3
Italy	08.30	Construction PMI	Apr	-	47.4
	09.00	Retail sales M/M% (Y/Y%)	Mar	-	-0.1 (5.8)
Spain	08.00	Industrial production M/M% (Y/Y%)	Mar	0.3 (-)	0.6 (-0.4)
UK	08.30	Construction PMI	Apr	51.0	50.7
Auctions and events					
Euro area	09.00	ECB publishes survey of professional forecasters			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
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