Euro wrap-up

Overview

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- Bunds followed USTs lower despite some very weak data for euro area retail sales and German factory orders.
- Gilts also made losses while a UK construction survey pointed to modestly positive growth in the sector.
- The main focus in the coming week will be the BoE's rate announcement on Thursday, which will be accompanied by its updated economic forecasts. UK Q1 GDP data are also due for release.

Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	2.552	+0.105
OBL 2.2 04/28	2.230	+0.119
DBR 2.3 02/33	2.291	+0.105
UKT 0⅝ 06/25	3.761	+0.116
UKT 1⅝ 10/28	3.583	+0.117
UKT 3¼ 01/33	3.776	+0.130

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

Euro area

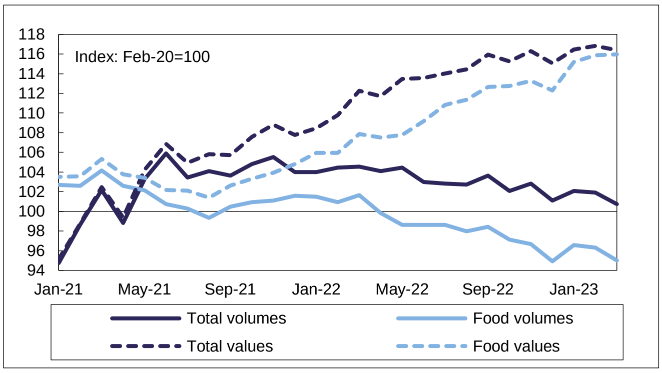
Euro area retail sales fell sharply in March as high prices continued to erode purchasing power

While euro area GDP returned to modest growth in Q1, today's retail sales data suggested that, with purchasing power eroded by higher prices and increased borrowing costs, and consumer confidence still weak, household consumption of goods was a drag on GDP for a fifth consecutive quarter. In particular, sales volumes fell a steeper-than-expected 1.2%M/M in March to the lowest level for almost two years. This left sales down almost ½%3M/3M and more than 3½%Y/Y, and less than 1.0% above the pre-pandemic level in February 2020. The decline would have been even steeper in the absence of a pickup in auto fuel sales, which seemingly benefitted from lower prices that month. Indeed, sales of core items and food fell by more than 1%M/M a piece in March, with the latter no doubt hit by record high inflation. Certainly, the impact of prices was illustrated in the near 7½%Y/Y rise in the value of food sales compared with a decline in volumes of more than 6½%Y/Y. Among the member states, the weakness was most striking in Germany, where sales fell 2.4%M/M to the lowest since February 2021. But sales also fell in France and Italy to be similarly down over the first quarter as a whole. In marked contrast, Spanish sales rose above the pre-pandemic level for the first time in March to the highest since mid-2011.

German factory orders plummet, while turnover suggests manufacturing output contracted in Q1

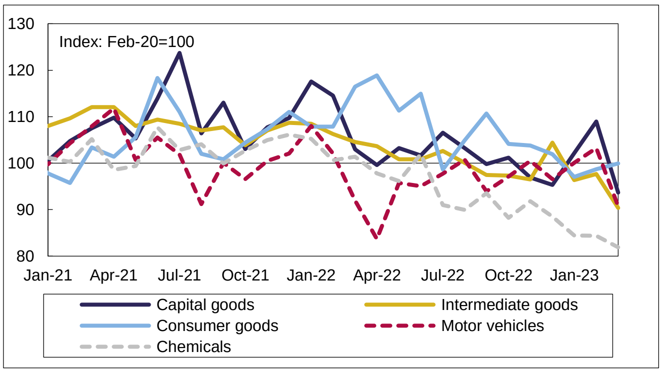
The weakness in Germany's economy at the end of Q1 was not confined to the retail sector, with today's data, at least at face value, suggesting an alarming adjustment in manufacturing too. In particular, German factory orders plummeted in March, by a whopping 10.7%M/M, the most since the initial pandemic slump and before that August 1976. This left orders down 11%Y/Y and more than 20% below the pandemic peak. The weakness was in part driven by a slump (-47.4%M/M) in new major orders in the "other vehicle construction" sub-sector (ships, railway, aircrafts, spacecrafts and army vehicles), which largely reversed a surge in February. But new auto sector orders also fell sharply (12%M/M) to an eleven-month low, albeit moving broadly sideways over the first quarter as a whole. Orders for intermediate goods continued to contract sharply in March to be down more than 4½%Q/Q, with a similar quarterly pace of contraction in consumer goods orders too. Admittedly, given the pickup in capital goods orders in the first two months of the year, total orders were broadly flat in Q1 (+0.1%Q/Q) as foreign orders (+1.6%Q/Q) offset a drop in domestic demand (-1.9%Q/Q). But when excluding major items, total orders fell 1.3%Q/Q to the lowest level since July 2020. While pandemic-related backlogs and easing of supply bottlenecks should continue to support production, today's figures, like the recent ifo and PMI surveys, point to a lacklustre manufacturing performance as demand for goods has faded. Certainly, ahead of Monday's industrial production release, today's manufacturing turnover numbers reported a notable weakening in activity in the sector at the end of Q1. Indeed, turnover fell 2.9%M/M in March – the most in twelve months – led by steep declines in autos and chemicals, to leave it down almost 1%Q/Q.

Euro area: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

French IP hit by strikes at refineries in March, but broadly flat over Q1

French industrial production was also weaker than expected in March, falling for the second month out of the past three, by 1.1%M/M. Admittedly, this left output merely unchanged over the first quarter as a whole and broadly in line with its level a year ago, albeit still almost 5% below the pre-pandemic level. The weakness in March was principally driven by a strike-related slump in output from the petroleum refinery sun-sector (-45.6%M/M). Construction activity also fell for the first month in three. In contrast, autos production rose to a six-month high, to be up more than 1½%Q/Q in Q1, albeit still some 8½% below the pre-pandemic level. While we will likely see a rebound in manufacturing output in April as production resumed at French refineries, surveys suggest still very challenging conditions in the sector as a whole amid subdued demand.

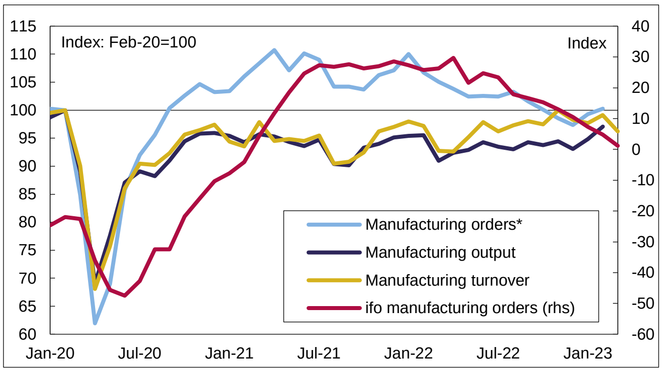
Construction PMIs point to ongoing contraction, as borrowing rates jump to multi-year highs

Today's PMI surveys provided a pretty gloomy assessment for the euro area construction sector at the start of the second quarter too. The headline euro area activity index rose just 0.2pt in April to 45.2, to remain firmly in contractionary territory for the twelfth consecutive month and roughly 1pt below the Q1 average, with housing again the largest drag. Amid a steeper decline in orders, construction firms reportedly again scaled back their workforces and purchases of inputs. But with supply constraints easing, input costs moderated to their lowest in almost 2½ years. According to the PMIs, Germany continued to lead the downturn, with the activity index (42.0) down to its lowest since December, while the respective indices from France (46.0) and Italy (49.0) were the firmest since January and November. Admittedly, official construction figures have defied survey indicators since the start of the year, with output trending in February some 3½% above the Q4 average, supported not least by unseasonably mild weather. But given ongoing economic uncertainties and higher borrowing costs, we would expect to see some payback over coming months in both the residential and commercial real estate sectors. Indeed, figures published by the ECB today showed the composite borrowing rate for businesses rising a further 37bps to 4.22% in March, the highest rate since January 2009 and some 275bps above the rate a year ago, while the respective rate for house purchases rose increased to 3.77%, the highest since July 2012.

The week ahead in the euro area

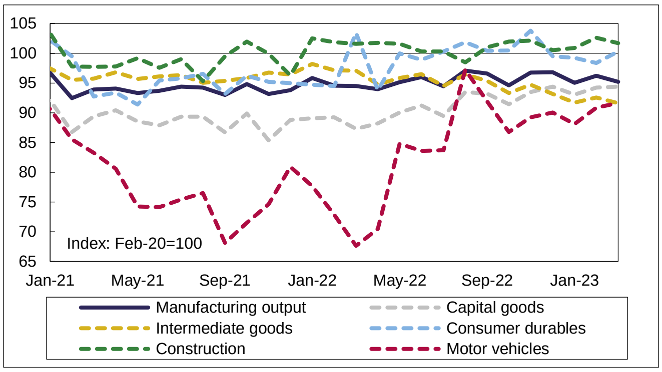
The coming week, which is set to be somewhat quieter on the economic data front, kicks off on Monday with German IP figures. German industrial output is expected to fall 1.1%M/M in March, although the risks to that view appear skewed to the downside following today's weak manufacturing turnover data. A drop of 1%M/M or so would still leave IP up roughly 3%Q/Q in Q1. While the improvement in the first quarter, related not least to an easing of supply-chain strains in manufacturing and favourable weather in construction, would be welcome, German industrial output would still be more than 3% below its pre-

Germany: Manufacturing indicators



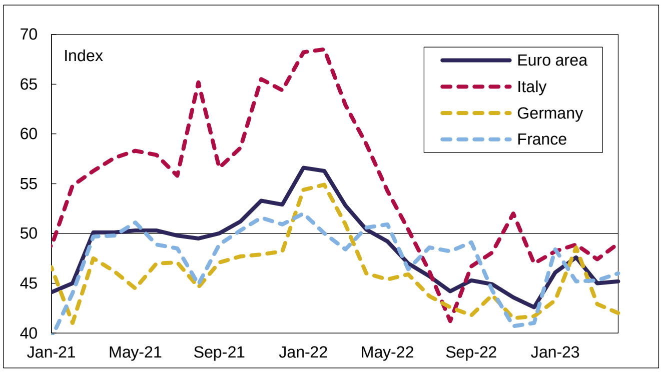
*Excluding major items. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Industrial production



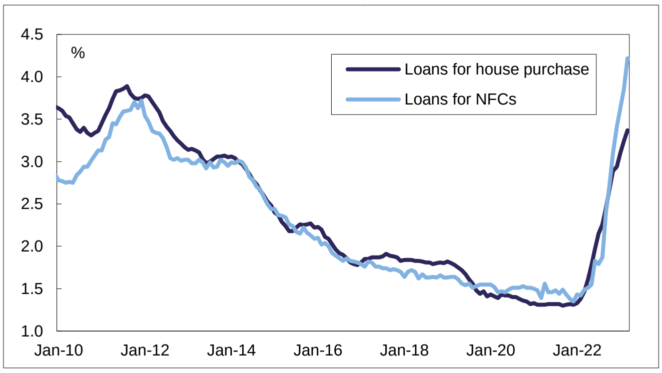
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area member states: Construction PMIs



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

Euro area: Cost of borrowing



Source: ECB and Daiwa Capital Markets Europe Ltd.

pandemic level. Elsewhere, Italian IP data for March will be published on Wednesday. Other releases due in the coming week include the euro area Sentix investor confidence survey results for May (Monday), French trade data for March (Tuesday), and final consumer price inflation for April from Germany (Wednesday) and France (Friday). The preliminary inflation data from the member states were mixed. German HICP inflation slowed 0.2ppt to 7.6%Y/Y, while the French rate rose 0.2ppt to 5.9%Y/Y.

UK

Construction PMI consistent with modest growth despite housing market adjustment

A relatively quiet end to the week for UK data brought just the construction PMIs for April. Overall, these suggested that activity in the sector continued to grow modestly at the start of the second quarter, with the headline activity index up 0.4pt to 51.1, to be broadly unchanged from the Q1 average. This was despite a further deterioration in housing activity, for which the respective index (43.0) slumped to its lowest since the initial collapse at the start of the pandemic and the global financial crisis before that. Respondents cited ongoing weak demand due to soft residential market conditions and higher borrowing costs, as well as delays to new house-building projects. But with supplier delivery times reportedly the shortest since the global financial crisis, and demand subdued, cost pressures eased in the sector, with the input price index falling to the lowest since November 2020 to be just 1pt above the pre-pandemic average.

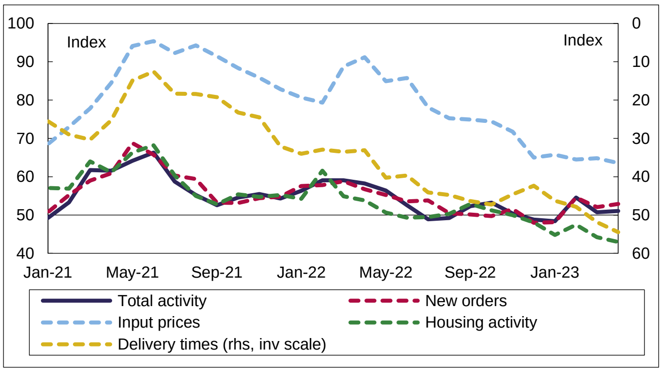
The week ahead in the UK: All eyes on the BoE

The main event of the coming week in the UK will be the BoE's latest monetary policy announcement on Thursday, which will be accompanied by updated macroeconomic projections in its latest Monetary Policy Report. At the previous policy meeting in March, the BoE slowed the pace of tightening to 25bps, taking Bank Rate to 4.25%. Seven MPC members voted for the rate hike while the two doves (external members Sylvia Tenreyro and Swati Dhingra) again voted for no change. In terms of forward guidance, the Committee repeated that "If there were to be evidence of more persistent [inflationary] pressures, then further tightening in monetary policy would be required." While the statement also acknowledged that uncertainties around the financial and economic outlook had risen due to banking sector turbulence in the US and Switzerland, the MPC once again highlighted the importance of developments regarding wages and services prices.

Another 25bps hike to come from the BoE as UK economic data have surprised on the upside

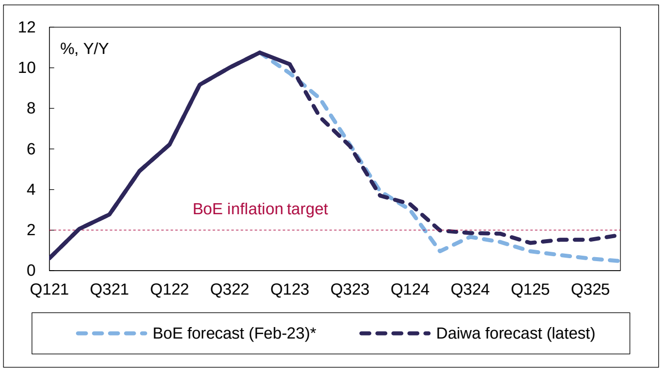
Since that meeting, the data regarding both wages and inflation have surprised on the upside. Indeed, basic pay growth was stronger than expected and unchanged in March at an upwardly revised 6.6%3M/Y. While additional pressure came from the

UK: Construction PMIs



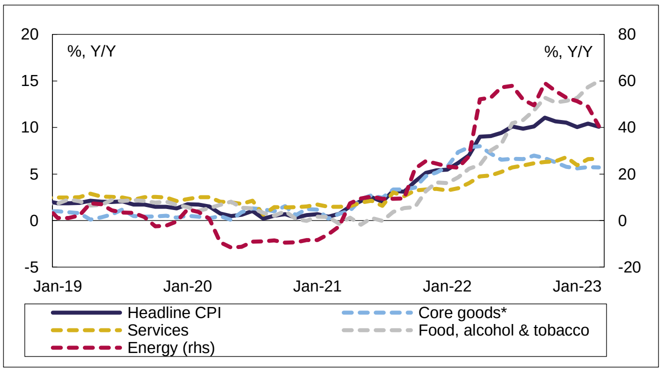
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: CPI forecasts compared



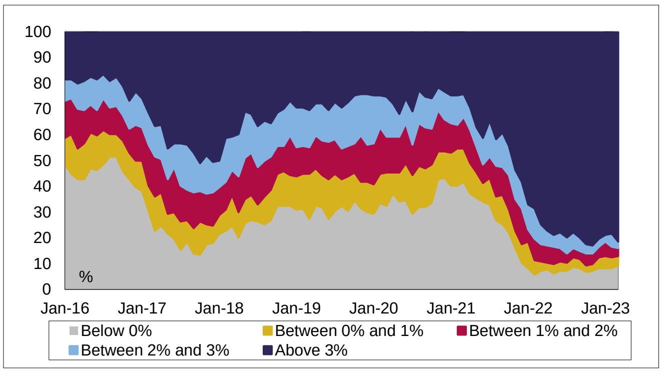
**BoE forecast based on market-implied path for Bank Rate.*
Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Major CPI components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Share of CPI components by inflation rate



Source: ONS and Daiwa Capital Markets Europe Ltd.

strike-afflicted public sector, private sector basic pay growth also remained too high for the BoE's comfort at 6.9%3M/Y. In addition, CPI inflation unexpectedly remained in double-digits in March, at 10.1%Y/Y, 0.9ppt above the BoE's forecast in its February Monetary Policy Report (MPR). That left the Q1 average at 10.2%Y/Y, 0.5ppt above the BoE's forecast. Moreover, contrary to expectations, core inflation failed to fall in March, remaining at an elevated 6.2%Y/Y. And services inflation was sticky at 6.6%Y/Y. In addition, in contrast to the BoE's MPR forecast, GDP is unlikely to have contracted in Q1. And surveys, such as this week's final April PMIs, point to a firm pickup in economic activity in Q2 contrary to the BoE's forecast of a decline of 0.4%Q/Q. And while the recent rate hikes are continuing to feed through to tighter financial conditions, and households withdrew almost £5bn from banks and building societies in March, the BoE will judge that the UK's banking sector remains resilient to recent events. So, most of the evidence since the last MPC meeting supports the case for further tightening at the forthcoming meeting. We expect the voting pattern from that month to be repeated, with seven members supporting a further 25bps hike in Bank Rate to 4.50% and just two doves voting for no change.

Inflation forecast to be revised down over the near term but revised up over the medium term

The BoE's previous guidance on the future path of policy might also be repeated. However, market expectations for further rate hikes will depend in part on the BoE's updated economic projections in the May MPR. Certainly, the near-term profile of economic growth will be revised up. As well as recent upbeat survey evidence, such an upwards revision will reflect recent changes to fiscal policy, which in March the MPC judged would add about 0.3% to GDP over coming years, as well as higher wage and employment growth. So, while the BoE in February expected GDP to contract ½%Y/Y in 2023, we expect it now to forecast modestly positive growth this year. And we also expect it to forecast growth of ½%Y/Y or more in 2024, contrary to its previous forecast of a modest decline. Meanwhile, despite the higher-than-anticipated starting point in March, the BoE will expect inflation to decline more sharply than previously predicted from April on, not least reflecting the government's energy price guarantee and lower wholesale prices. But while the near-term path for inflation from Q2 on should be pushed down, due in part to base effects the projection from Q224 on will likely be revised up, and perhaps very significantly. Indeed, with the amount of spare capacity in the economy over the coming couple of years expected to be much smaller than previously estimated, the BoE might judge that inflation will settle closer to 1½%Y/Y through 2025 than the current forecast of less than 1%Y/Y. And with the risks to the baseline projection still likely to be skewed to the upside, the MPR might suggest that at least one further rate hike after next week is more likely than not.

The week ahead in the UK: Q1 GDP the data highlight

Aside from the BoE's monetary policy announcement, the data highlight of the holiday-shortened week will come on Friday, in the form of the first estimate of Q1 GDP and associated monthly output and trade figures for March. Following a flat February, we think GDP fell moderately in March, albeit not as sharply as the drop of 0.9%M/M already reported for retail sales. Indeed, we forecast a drop of 0.4%M/M, with softness in services, manufacturing and construction alike due to a range of factors from wet weather to public sector strikes. That would leave GDP unchanged over Q1, with consumer spending subtracting from growth given persisting pressure on real disposable income from high inflation. The risks to that GDP forecast, however, appear skewed to the upside. Ahead of the GDP release, April survey results will include the BRC retail sales monitor (Tuesday), REC report on jobs (Wednesday) and RICS residential housing market indicators (Thursday).

The next edition of the Euro wrap-up will be published on 11th May 2023

Daiwa economic forecasts

	2022	2023				2024			
	Q4	Q1	Q2	Q3	Q4	Q1	2023	2024	2025
GDP		%, Q/Q						%, Y/Y	
Euro area	0.0	0.1	0.2	0.2	0.2	0.2	0.8	1.1	1.7
UK	0.1	0.0	0.1	0.2	0.2	0.2	0.3	0.7	0.9
Inflation, %, Y/Y									
Euro area									
Headline HICP	10.0	8.0	6.2	4.5	2.8	2.7	5.3	2.3	1.7
Core HICP	5.1	5.5	5.4	4.7	4.0	3.2	4.9	2.5	1.8
UK									
Headline CPI	10.7	10.2	7.6	6.1	3.7	3.3	6.8	2.2	1.5
Core CPI	6.4	6.1	5.9	5.1	4.3	3.9	5.3	2.8	1.8
Monetary policy, %									
ECB									
Refi Rate	2.50	3.50	4.00	4.25	4.25	4.25	4.25	3.25	3.00
Deposit Rate	2.00	3.00	3.50	3.75	3.75	3.75	3.75	2.75	2.50
BoE									
Bank Rate	3.50	4.25	4.50	4.50	4.50	4.25	4.50	3.50	2.75

Source: Bloomberg, ECB, BoE 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	Construction PMI	Apr	**45.2**	-	45.0	-
	Retail sales M/M% (Y/Y%)	Mar	**-1.2 (-3.8)**	-0.2 (-3.3)	-0.8 (-3.0)	-0.2 (-2.4)
Germany	Factory orders M/M% (Y/Y%)	Mar	**-10.7 (-11.0)**	-2.3 (-3.1)	4.8 (-5.7)	4.5 (-6.0)
	Construction PMI	Apr	**42.0**	-	42.9	-
France	Industrial production M/M% (Y/Y%)	Mar	**-1.1 (-0.1)**	-0.4 (1.1)	1.2 (1.3)	1.4 (0.9)
	Manufacturing production M/M% (Y/Y%)	Mar	**-1.1 (0.7)**	0.0 (-)	1.3 (2.2)	- (1.8)
	Construction PMI	Apr	**46.0**	-	45.3	-
Italy	Construction PMI	Apr	**49.0**	-	47.4	-
	Retail sales M/M% (Y/Y%)	Mar	**0.0 (5.8)**	-0.5 (-)	-0.1 (5.8)	-
Spain	Industrial production M/M% (Y/Y%)	Mar	**1.5 (4.5)**	0.3 (-)	0.6 (-0.4)	0.7 (0.1)
UK	Construction PMI	Apr	**51.1**	51.0	50.7	-

Auctions	
Country	Auction
- Nothing to report -	

Source: Bloomberg 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/ *Daiwa forecast/actual*	Previous
		Monday 08 May 2023			
Euro area	09.30	Sentix investor confidence	May	-7.8	-8.7
Germany	07.00	Industrial production M/M% (Y/Y%)	Mar	-1.1 (1.6)	2.0 (0.6)
		Tuesday 09 May 2023			
France	07.45	Trade balance €bn	Mar	-	-9.9
UK	00.01	BRC retail sales monitor, like-for-like sales Y/Y%	Apr	-	4.9
		Wednesday 10 May 2023			
Germany	07.00	Final HICP (CPI) Y/Y%	Apr	*7.6 (7.2)*	7.8 (7.4)
Italy	09.00	Industrial production M/M% (Y/Y%)	Mar	0.2 (-1.7)	-0.2 (-2.3)
		Thursday 11 May 2023			
UK	00.01	RICS house price balance %	Apr	-38	-43
	12.00	BoE Bank Rate %	May	*4.50*	4.25
		Friday 12 May 2023			
UK	07.00	Preliminary GDP Q/Q% (Y/Y%)	Q1	*0.0 (0.1)*	0.1 (0.6)
	07.00	GDP M/M%	Mar	*-0.4*	0.0
	07.00	Industrial production M/M% (Y/Y%)	Mar	0.0 (-3.0)	-0.2 (-3.1)
	07.00	Manufacturing production M/M% (Y/Y%)	Mar	-0.2 (-2.6)	0.0 (-2.4)
	07.00	Index of services M/M% (Q/Q%)	Q1	0.0 (0.2)	-0.1 (0.1)
	07.00	Construction output M/M% (Y/Y%)	Mar	-0.1 (3.6)	2.4 (5.7)
	07.00	Goods trade balance £bn	Mar	-17.5	-17.5
France	07.45	Final HICP (CPI) Y/Y%	Apr	*6.9 (5.9)*	6.7 (5.7)
Spain	08.00	Final HICP (CPI) Y/Y%	Apr	*3.8 (4.1)*	3.1 (3.3)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
		Monday 08 May 2023
Euro area	15.00	ECB's Chief Economist Lane scheduled to speak – 'Resetting the Economy after the Crises'
UK	-	Public holiday – Coronation of King Charles III
		Tuesday 09 May 2023
Euro area	09.00	ECB's Chief Economist Lane scheduled to speak – 'Taming inflation without a recession'
	09.00	ECB's Schnabel scheduled to speak
Germany	10.30	Auction: €5.0bn of 2.2% 2028 bonds
		Wednesday 10 May 2023
Germany	10.30	Auction: €1.0bn of 0% 2050 bonds
	10.30	Auction: €1.5bn of 1.8% 2053 bonds
UK	10.00	Auction: £3.5bn of 3.25% 2033 bonds
		Thursday 11 May 2023
Euro area	13.00	ECB's Schnabel scheduled to speak
	18.30	ECB's de Guindos scheduled to speak
Italy	10.00	Auction: 3Y and 7Y bonds
UK	12.00	BoE monetary policy announcement, statement, minutes and Monetary Policy Report to be published
	12.30	BoE Governor Bailey holds press conference on the BoE's latest Monetary Policy Report
		Friday 12 May 2023
Euro area	09.00	ECB's de Guindos scheduled to speak
UK	12.00	BoE Chief Economist scheduled to speak on the BoE's latest Monetary Policy Report

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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