

# Euro wrap-up

## Overview

- Longer-dated Bunds made modest gains even as ECB President Lagarde insisted that the Governing Council would not pre-commit to any particular future path in rates and euro area consumer confidence rose to its highest level in more than two years.
- Gilts made larger gains as UK inflation fell a touch further than the BoE and market consensus expected.
- Thursday will bring the BoE's latest monetary policy announcement as well as the March PMIs.

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### Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.919	+0.009
OBL 2.1 04/29	2.445	-0.005
DBR 2.2 02/34	2.432	-0.016
UKT 0½ 01/26	4.202	-0.044
UKT 0½ 01/29	3.908	-0.041
UKT 4½ 01/34	4.011	-0.045

\*Change from close as at 4:45pm GMT.  
Source: Bloomberg

## Euro area

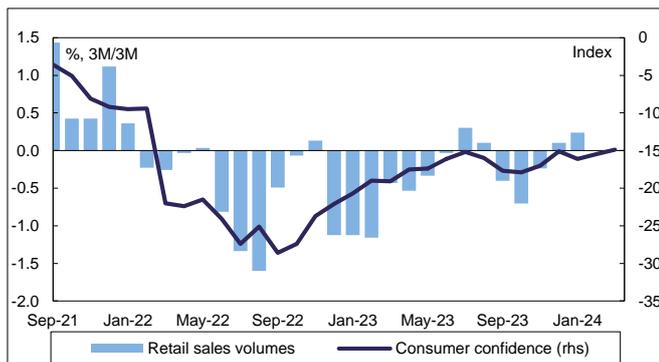
### Consumer confidence rises to the highest level in more than two years

Today's flash Commission consumer confidence index for March broadly aligned with expectations, signalling a further modest improvement at the end of the first quarter and therefore raising cautious optimism of a modest pickup in consumer spending as households benefit from rising real disposable incomes. In particular, the headline index rose 0.6pts to -14.9, the highest since February 2022 ahead of the Russian invasion of Ukraine. This left the index in Q1 some 1.2pts above the Q4 average. We will have to await the final release next week for a detailed survey breakdown. But the equivalent Dutch survey – which saw the headline index rise for a seventh consecutive month in March and by 5pts to -22, the highest since November 2021 – reported broad-based improvement. Admittedly, the improvement in the Netherlands was greatest in backwards-looking perceptions of economic conditions over the past twelve months, with the respective index up 14pts, similarly to the highest level since November 2021. But likely not least reflecting the marked easing in price pressures, households were also more upbeat about the twelve-month outlook for their own financial situation, with the respective index the highest since September 2021 and broadly in line with the pre-pandemic five-year average. As such, the share of households considering it a good time to make major purchases rose to the highest level in more than two years, with the survey component trending more than 6pts above the Q4 average.

### Construction output held up relatively well at start of 2024, but building work fell sharply

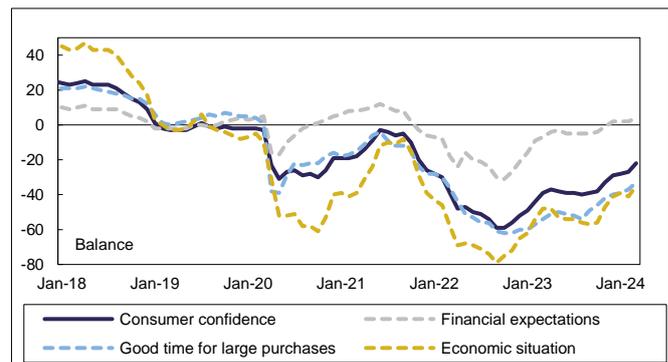
Contrasting with downbeat survey indicators, and despite being highly interest rate sensitive, activity in the euro area's construction sector continued to hold up relatively well at the start of the year. In particular, output rose for a second successive month in January, by 0.5%M/M, to leave it up 0.8%Y/Y and more than 3½% above the pre-pandemic level. The improvement was underpinned by a recovery in civil engineering, which increased for the first month in four and by 1.0%M/M to be up 2.8%Y/Y. In contrast, building work fell 2.1%M/M – the most for almost three years – to be down 2.4%Y/Y and still more than 6½% below the pre-pandemic benchmark. Growth in January appears to have benefitted from unseasonably mild weather that month, with activity up in Germany (2.7%M/M), France (0.3%M/M), Spain (1.6%M/M) and Portugal (1.4%M/M). But there was an unusually large decline in the Netherlands, with the 9.9%M/M drop a series record as building work slumped 15.8%M/M, to leave Dutch construction output down 15.7%Y/Y. While we won't see a repeat of January's slump in the Netherlands over the near term, the weakness in sentiment, falling house prices, lacklustre mortgage lending and downtrend in new building permits over the past year or so all suggests that the downturn in building work across the euro area as a whole still has further to play out.

### Euro area: Consumer confidence & retail sales



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Netherlands: Consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

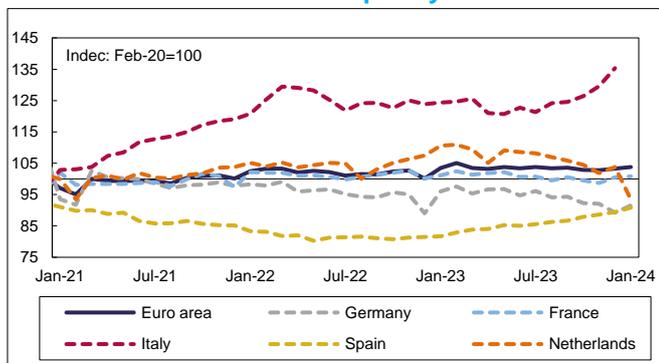
## German investors more upbeat about economic outlook, but current conditions still poor

At face value, yesterday's ZEW survey was encouraging, with investor confidence in Germany's economic outlook rising to the highest in two years. Certainly, the share of respondents expecting an improvement in conditions over the coming six months rose to the highest in more than a year, while the share anticipating further deterioration was the lowest since mid-2021. As such, the overall expectations balance jumped 11.8pts – the most in fourteen months – to 31.7, to be trending in Q1 some 15pts higher than in Q4, 10pts above the long-run average and suggestive of expectations of a return to positive GDP growth over the summer. The improvement also reflects waning price pressures, with roughly two-thirds of respondents expecting a decline in inflation over the next six months. There was also a substantial rise – to more than 80%, the biggest share since 2009 – in those anticipating the ECB to cut rates over the same period. Of course, the relatively low share of those expecting further weakening might simply be due to the dire state of current conditions, with activity being hit by a range of factors including subdued consumer spending, waning global demand, historically weak consumer and business confidence, and strike action across the transport sector. Admittedly, yesterday's survey saw the index of perceptions of economic conditions in March improve very marginally, up 1.2pt to -80.5. But the share of investors considering conditions to be 'bad' remained above 80%, the joint-highest since the first wave of the pandemic and the global financial crisis before that, consistent with another contraction in German GDP in Q1. This notwithstanding, yesterday's survey might tentatively suggest that Germany's downturn has finally reached its bottom.

## The day ahead in the euro area

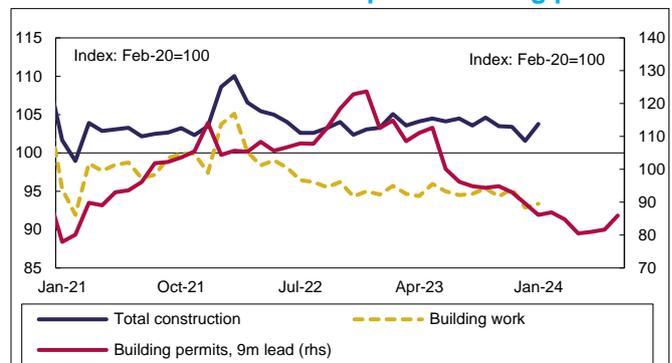
The highlight tomorrow will be the flash March euro area PMIs, which should continue to imply improving recovery momentum and therefore support our view that GDP returned to very modest positive growth in Q1. Admittedly, despite rising to an eight-month high in February, the composite PMI remained at a 'contractionary' 49.2, albeit trending 1.3pts above the Q4 average. The headline services activity PMI jumped 1.5pts to 50.2 in February, its highest since July. And although the manufacturing output PMI edged lower and remained consistent with ongoing contraction (46.5), this was still trending more than 2½pts above the Q4 average. But the PMIs continued to flag ongoing divergences between member states, suggesting that Germany's economy is on track for a second quarterly contraction, while Spanish GDP continues to drive the recovery. The French INSEE business surveys – often a more reliable guide to GDP growth than the PMIs – will offer further insight into recent developments in the construction and retail subsectors too.

### Euro area: Construction output by member state



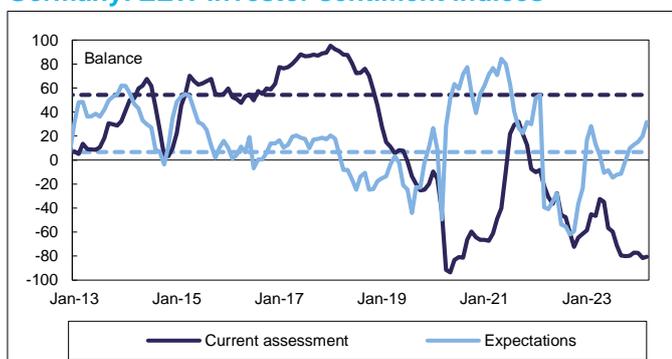
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: Construction output & building permits



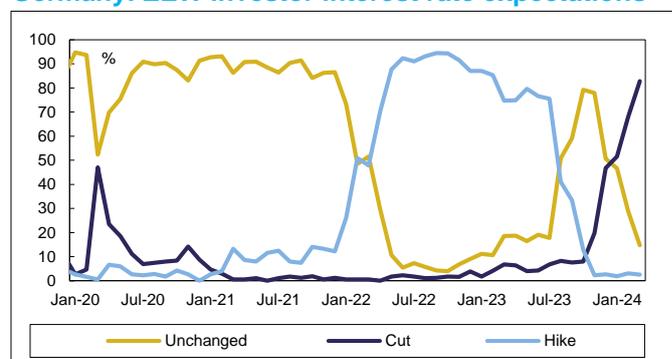
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Germany: ZEW investor sentiment indices\*



\*Dashed lines represent pre-pandemic five-year average. Expectations for coming six months. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Germany: ZEW investor interest rate expectations\*



\*Coming six months. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**UK**

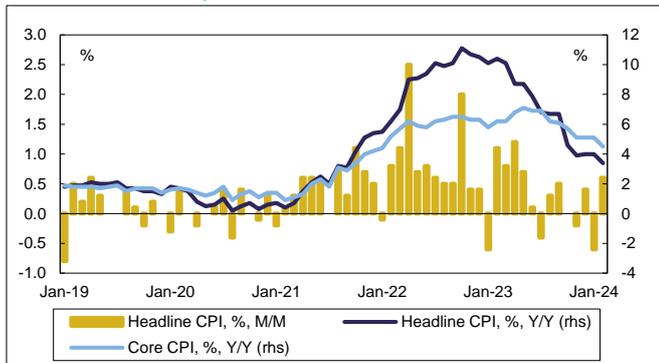
**Inflation takes further significant step down in February with core rate lowest in more than 2 years**

As the BoE's MPC met to discuss its latest policy decision, Committee members should have taken comfort in the further step down in inflation reported in today's CPI release, with encouraging signs of a further slowing in underlying price pressures too. In line with our forecast, headline inflation fell 0.6ppt in February to 3.4%Y/Y, the lowest since September 2021 and a whopping 7ppts below the peak a year ago. Moreover, like in January, the headline CPI rate came in 0.1ppt below the Bank's projection published in its Monetary Policy Report last month. The largest downwards contribution came from food inflation, which moderated for an eleventh consecutive month and by 2ppts to 5.0%Y/Y, in part reflecting base effects from a spike in prices a year ago (1.7%M/M) compared with another below-average monthly rise this February (0.2%M/M). And although the pace of decline eased slightly on the back of higher petrol prices, energy inflation (-13.8%Y/Y) remained a drag on headline inflation for an eighth consecutive month. Prices of non-energy industrial goods were also better behaved this month, with the 0.8%M/M increase bang in line with the long-run average for February. As such, core goods inflation fell for a ninth month, by 0.8ppt to 1.9%Y/Y, the softest since April 2021, reflecting weaker inflation of second-hand cars, household appliances, games, toys and hobbies and mobile phone handsets. Services inflation also took a welcome step down in February, moderating 0.4ppt to 6.1%Y/Y, a thirteen-month low and bang in line with the BoE's forecast. Admittedly, this principally reflected base effects within catering (-1.5ppts to a near-two-year low of 6.2%Y/Y), with alcohol prices having spiked a year ago following discounting at the start of last year. In contrast, there was a modest upwards impulse from rents and persisting stickiness in the accommodation and airfares categories. Overall, however, core inflation fell 0.6ppt to 4.5%Y/Y, the lowest since January 2022. And encouragingly, the share of the CPI basket with inflation above 2% fell to just 61% in February, the lowest since October 2021, while the share with rising inflation fell to just a little more than a quarter of the basket, further illustrating the steady easing in underlying price pressures.

**Inflation to maintain broad-based downtrend over coming months**

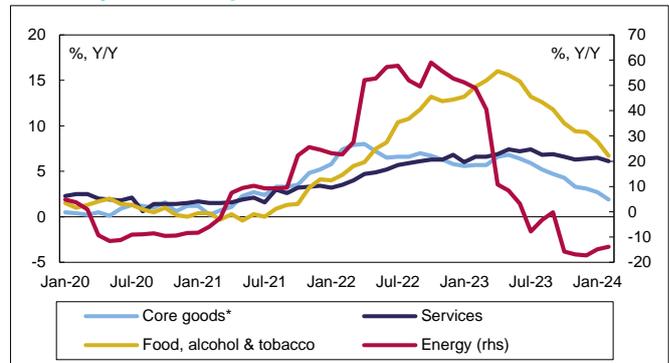
The near-term inflation profile remains uncertain, not least due to the timing of Easter this year, and potential upwards impulses on certain services in March. Nevertheless, given base effects from a strong rise in prices a year ago, private sector pay momentum back in line with the long-run average and domestic demand still soft, we expect services inflation to maintain a gradual downtrend this month and over coming quarters. Today's PPI figures also suggested limited impact so far from shipping delays associated with events in the Red Sea, with producer input prices declining for a fourth consecutive month in February (-0.4%M/M) to be down 2.7%Y/Y. And while core output PPI inflation edged marginally higher, it was still incredibly soft at just 0.2%Y/Y, suggestive of ongoing disinflation of non-energy industrial goods CPI. In addition, with food

**UK: Consumer price inflation**



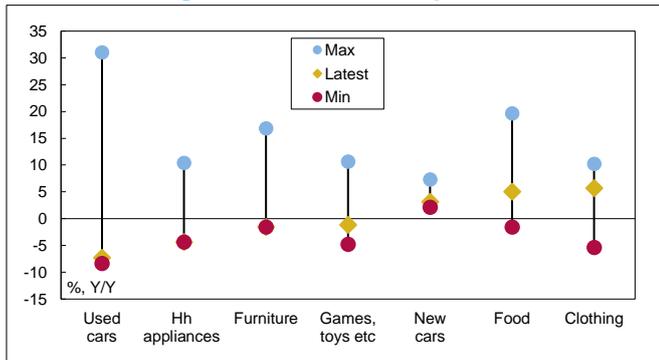
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**UK: Key CPI components**



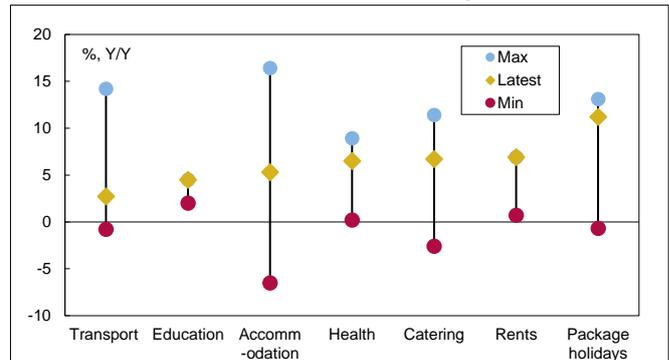
\*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**UK: Selected goods inflation components\***



\*Range since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**UK: Selected services inflation components\***



\*Range since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

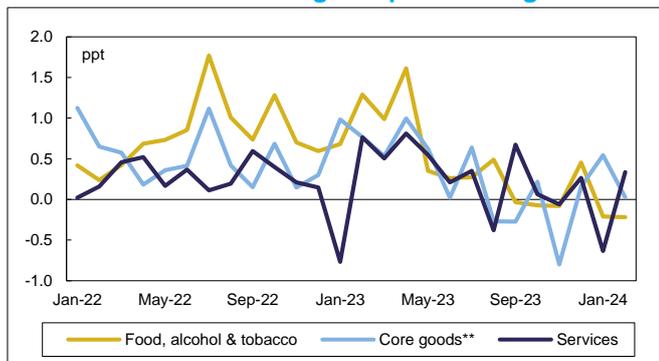
product inflation (-1.5%Y/Y) the lowest since October 2019, we expect consumer food inflation to fall steadily further over coming months. Moreover, energy inflation will take a renewed step down in April reflecting the 12% drop in the household energy price cap that month. As such, we currently expect headline inflation to drop sharply in Q2, to below the 2% target. Admittedly, like the BoE, we expect headline inflation to tick slightly higher again in the second half of the year. And the disinflationary pace in core inflation will be more moderate. However, we expect it to fall back below 2% by Q225. So, on balance, and in the absence of a significant downside surprise to inflation and wage growth over coming months, we maintain our view that the first rate cut will come alongside updated BoE macroeconomic projections in August.

## The day ahead in the UK

The main focus in the UK tomorrow will be the BoE's policy announcement, although the MPC is widely expected to keep Bank Rate unchanged at 5.25%. And, with the tightening bias already dropped last month, we also expect minimal changes to be made to its forward guidance. But the Committee will need to take stock of recent data and news, including the weaker-than-expected end to last year for GDP, firm signs of a pickup in growth in Q1, the downside surprise to inflation in January and February (see above), as well as the government's modest easing of fiscal policy earlier this month. While Governor Bailey is now less concerned about second-round effects on inflation emanating from the labour market, and the near-term inflation outlook might be judged by the Bank to have improved again somewhat compared to its February projections, the majority on the MPC will still consider it too soon to cut rates. Indeed, while inflation next quarter is likely to fall below 2.0%Y/Y, at least until new projections are published in May it will consider that a lasting return of inflation to target will not materialise before 2025. As such, the MPC's statement will repeat that monetary policy will need to be restrictive for an extended period. And the Committee's guidance will reiterate that the underlying tightness of labour market conditions, wage growth and services price inflation remain the most important variables in its reaction function for determining when rates might be cut. Indeed, we expect that, once again, only one member (the uber-dove Dhingra) will vote for a cut. But we also expect one of the hawks (Haskel) to shift from backing a rate hike to supporting the status quo. And so, there is likely to be only one member (Mann) still voting for extra tightening this month.

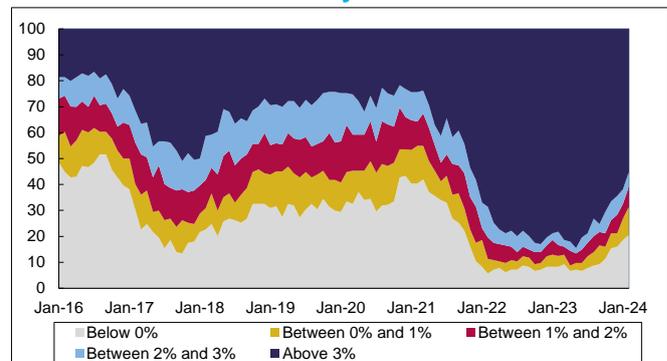
In terms of economic data, the flash PMIs will provide an update on recovery momentum at the end of Q1. The composite PMI is expected to be little changed for a second month from January's eight-month high of 53.0 and hence remain consistent with a return to positive GDP growth in Q1, probably around 0.2%Q/Q. While the headline services activity PMI moderated in February from January's eight-month high to 53.8, it remained consistent with moderate expansion in the sector. And the manufacturing output PMI rose almost 3pts to a three-month high of 48.3 suggestive of only mild contraction. Notably perhaps, tomorrow's survey detail will be also watched for a further uptick in costs and selling prices that were evident in manufacturing and services last month.

### UK: Deviations from long-run price change\*



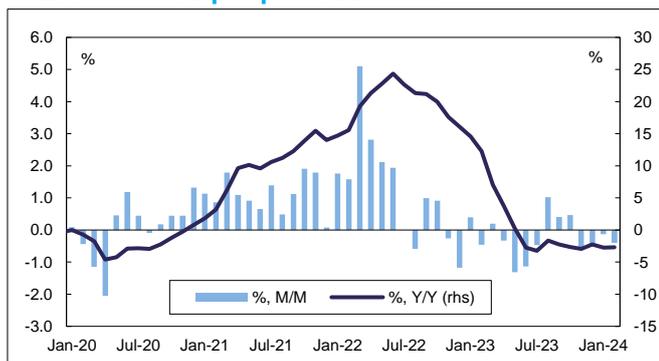
\*Monthly change in prices compared to average for the month in the decade before the pandemic. \*\*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Share of CPI basket by inflation rate



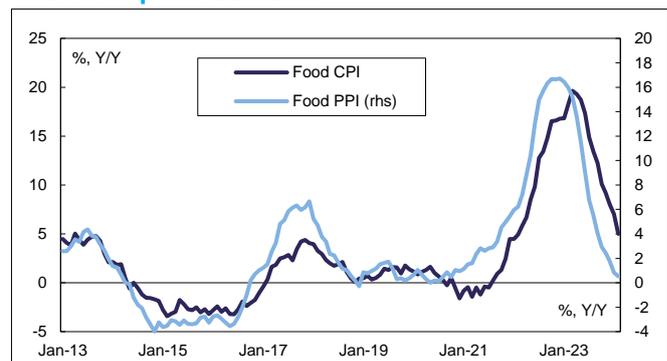
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Producer input price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Food price inflation



Source: Macrobond 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
Euro area	 Construction output M/M% (Y/Y%)	Jan	<b>0.5 (0.8)</b>	-	0.8 (1.9)	0.5 (2.8)
	 European Commission's preliminary consumer confidence	Mar	<b>-14.9</b>	-15.0	-15.5	-
Germany	 PPI Y/Y%	Feb	<b>-4.1</b>	-3.8	-4.4	-
Italy	 Industrial production M/M% (Y/Y%)	Jan	<b>-1.2 (-3.4)</b>	-0.5 (-)	1.1 (-2.1)	1.2 (-1.5)
UK	 CPI (core CPI) Y/Y%	Feb	<b>3.4 (4.5)</b>	<u>3.4 (4.5)</u>	4.0 (5.1)	-
	 PPI output (input) Y/Y%	Feb	<b>0.4 (-2.7)</b>	-0.1 (-2.7)	-0.6 (-3.3)	-0.3 (-2.8)
	 House price index Y/Y%	Jan	<b>-0.6</b>	-	-1.4	-2.2

#### Auctions

Country	Auction
Germany	 sold €812mn of 2.5% 2044 bonds at an average yield of 2.61%
	 sold €814mn of 0.0% 2052 bonds at an average yield of 2.52%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Yesterday's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Labour costs Y/Y%	Q4	<b>3.4</b>	-	5.3	5.2
Germany	 ZEW current assessment (expectations) balance	Mar	<b>-80.5 (31.7)</b>	-82.0 (20.5)	-81.7 (19.9)	-

#### Auctions

Country	Auction
UK	 Auction: £2bn of 4.75% 2043 bonds at an average yield of 4.467%

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	 07.00	EU27 new car registrations Y/Y%	Feb	-	12.1
	 09.00	Preliminary manufacturing (services) PMI	Mar	47.0 (50.5)	46.5 (50.2)
	 09.00	Preliminary composite PMI	Mar	49.7	49.2
Germany	 08.30	Preliminary manufacturing (services) PMI	Mar	43.0 (48.8)	42.5 (48.3)
	 08.30	Preliminary composite PMI	Mar	47.0	46.3
France	 07.45	INSEE business (manufacturing) confidence	Mar	99 (100)	98 (100)
	 08.15	Preliminary manufacturing (services) PMI	Mar	47.5 (48.8)	47.1 (48.4)
	 08.15	Preliminary composite PMI	Mar	48.7	48.1
	 -	Bank of France retail sales* Y/Y%	Feb	-	-3.1
UK	 07.00	Public sector net borrowing (excl. banks) £bn	Feb	6.4 (6.0)	-17.6 (-16.7)
	 09.30	Preliminary manufacturing (services) PMI	Mar	47.8 (53.8)	47.5 (53.8)
	 09.30	Preliminary composite PMI	Mar	53.1	53.0
	 12.00	BoE Bank Rate %	Mar	<u>5.25</u>	5.25

### Auctions and events

Euro area	 09.00	ECB publishes Economic Bulletin			
France	 09.50	Auction: 2.50% 2027 bonds			
	 09.50	Auction: 2.75% 2029 bonds			
	 09.50	Auction: 1.50% 2031 bonds			
	 10.50	Auction: 0.1% 2029 index-linked bonds			
	 10.50	Auction: 0.1% 2036 index-linked bonds			
Spain	 10.50	Auction: 0.1% 2040 index-linked bonds			
	 09.30	Auction: 2.50% 2027 bonds			
	 09.30	Auction: 5.75% 2032 bonds			
UK	 09.30	Auction: 3.45% 2043 bonds			
	 12.00	Bank of England monetary policy announcement and minutes published			
	 12.00	Bank of England publishes Agents' summary of business conditions – Q124			

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

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