

Euro wrap-up

Overview

- Bunds made gains as the account of the ECB's March policy meeting suggested that it was "wise to await incoming data and evidence" but also that "the date of a first rate cut [was] coming more clearly into view".
- Gilts also made gains as a BoE survey reported a further moderation of business wage and price expectations.
- Tomorrow will bring February results for euro area retail sales, German factory orders and French IP, as well as the March construction PMIs.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.853	+0.007
OBL 2.1 04/29	2.359	-0.018
DBR 2.2 02/34	2.358	-0.035
UKT 0½ 01/26	4.168	-0.032
UKT 0½ 01/29	3.873	-0.028
UKT 4½ 01/34	4.018	-0.034

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

Euro area

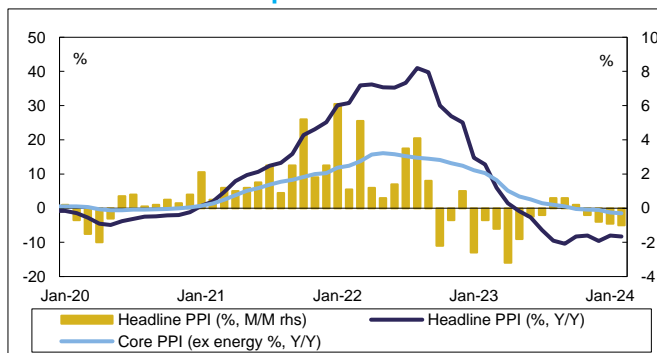
Euro area producer price inflation suggests ongoing easing in underlying pipeline pressures

According to yesterday's flash estimates of euro area [consumer price inflation](#), the monthly increase in the price of core goods was the softest in any March since the global financial crisis to leave the annual rate of that component at just 1.1%Y/Y, its lowest since mid-2021. And today's producer price inflation figures also suggested that pipeline pressures in the factory sector continue to diminish. In particular, overall industrial producer prices fell for a fourth consecutive month in February, by 1.0%M/M – the most for ten months – to leave them down 8.3%Y/Y and some 13% below the peak in September 2022. Admittedly, the decline reflected another notable drop in energy prices, by 3.5%M/M – the most since last May – as wholesale natural gas futures fell to the lowest level for almost three years. This left producer energy prices down 21.1%Y/Y and roughly one third below the peak 17 months earlier. In contrast, non-energy producer output prices rose for a second successive month in February, albeit by just 0.1%M/M. But having fallen in the previous nine months, this pushed core PPI inflation further into negative territory, by 0.2ppt to -1.5%Y/Y, some 17½ppts below the peak and the weakest since 2009. While the drag from intermediate goods inflation eased very slightly (+0.1ppt to -5.3%Y/Y) it was still the second most negative rate since the global financial crisis, with the largest declines in this category recorded in the chemicals, paper and basic metals subsectors. And while prices of capital and non-durable consumer goods were also up on the month, the respective annual rates continued to moderate to 2.0%Y/Y and 1.4%Y/Y, the lowest since spring 2021, with the latter reflecting in part the steepest producer food deflation (-0.9%Y/Y) since June 2016. Despite higher shipping costs associated with the rerouting of cargo around the Red Sea, indicators – including the PMI and European Commission surveys – signal persistent below-average selling-price expectations for goods as firms' pricing power remains limited by subdued demand. As such, core HICP goods inflation will stay very subdued over coming quarters.

Services price pressures start to ease while activity accelerated at end-Q1

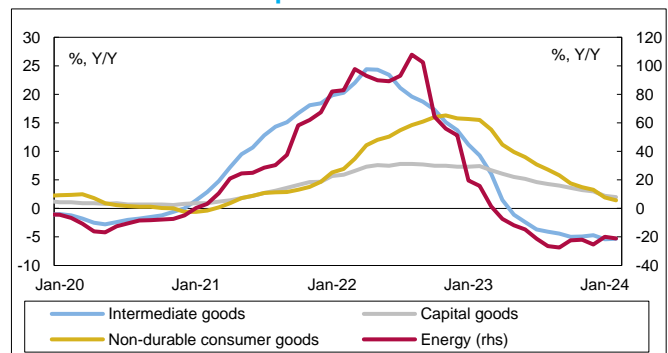
Of course, services inflation will remain the key determinant of the ECB's policy decisions over coming months. And consistent with the renewed moderation in the Commission's selling price expectations index, today's final services PMIs suggested a modest easing in inflationary pressures at the end of the first quarter. In particular, the input price PMI fell for the first month in three in March to a nine-month low of 61.5. And encouragingly, the rate of increase in prices charged also fell for the first month in five, to 55.1, a four-month low. Admittedly, these indices remain well above the long-run average. And given the persistent stickiness in services inflation and signs of a return to positive growth, ECB officials will likely want to see further evidence of easing price pressures in the sector before cutting interest rates for the first time. Certainly, the survey detail pointed to accelerated recovery momentum at the end of Q1. Indeed, the final euro area services activity index was upwardly revised from the flash release by 0.4pt to 51.5, a nine-month high taking the Q1 average some 1.6pts above

Euro area: Producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

the Q4 level. And the survey suggested a notable improvement in demand, with the new business component almost 1pt higher than the initial estimate at a ten-month high of 51.4.

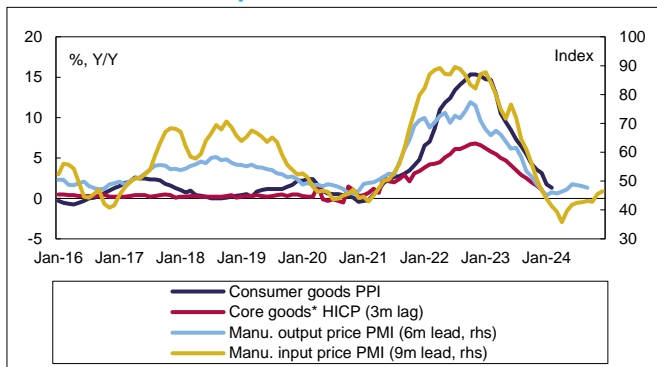
PMIs suggests recovery driven by the periphery, while Germany remains in recession

Taken together with the upwards revision to the manufacturing output index (to a still-contractionary 47.1), the composite output PMI was also stronger than initially estimated, up 1.1pt from February to 50.3, the first above-50 reading since May. While this remains broadly consistent with stagnation rather than a return to firm growth, the average composite PMI in Q1 (49.2) was nevertheless some 1.3pts above the Q4 average, supporting our forecast for GDP growth of 0.1%Q/Q last quarter. Like the Commission’s survey, today’s PMIs implied that recovery momentum in March remained strongest in Southern Europe, with the composite indices for Italy (+2.4pts to 53.5) and Spain (+1.4pts to 55.3) the highest for eleven months. The respective French PMI was revised up to a ten-month high (48.3) to be trending more than 2pts higher over the first quarter, therefore implying a return to positive GDP growth. But while the German composite PMI was similarly upwardly revised from the preliminary release to a four-month high (47.7), the Q1 average was unchanged from Q4 when the economy contracted 0.3%Q/Q.

The day ahead in the euro area

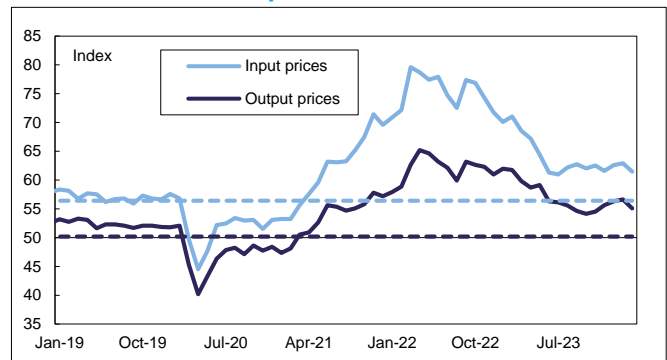
Tomorrow will bring euro area retail sales figures for February, providing an update on household spending in the middle of the first quarter. Despite the pickup in real household disposable incomes, households remain reluctant to loosen their purse strings amid persisting economic uncertainties. Certainly, German retail sales were particularly weak in February, declining 1.9%M/M – the most since October 2022 – while French consumer spending was unchanged. Focus will also turn to the manufacturing sector, with German factory orders and French industrial production data for February. German orders were particularly volatile around the turn of the year with a double-digit decline in January following a double-digit rise in December. But overall, surveys remain consistent with shrinking industrial order books. Finally, the construction PMIs are likely to suggest that the contraction remains steepest in Germany, while output continues to rise modestly in Italy.

Euro area: Goods price indices



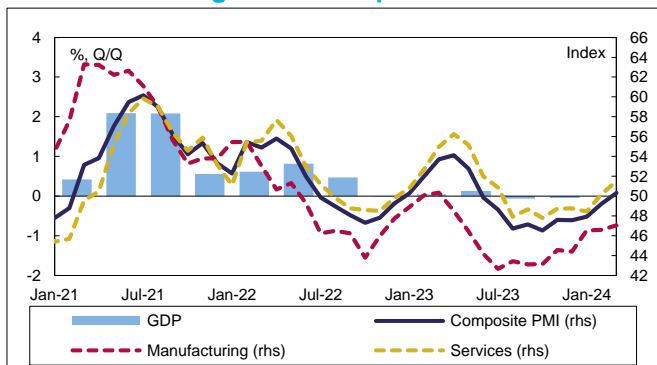
*Non-energy industrial goods. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Services price PMIs*



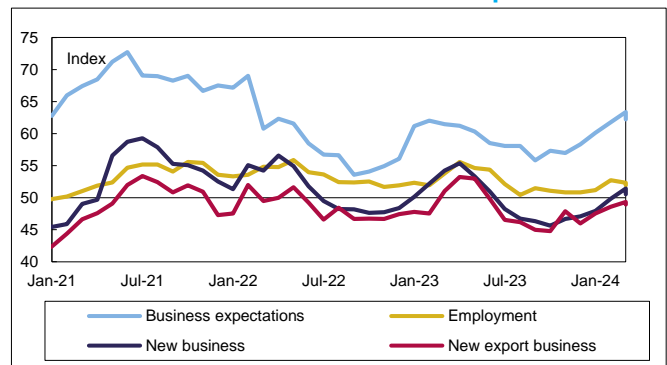
*Dashed lines represent pre-pandemic long-run average. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & output PMIs



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

Euro area: Selected services PMI components



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

UK

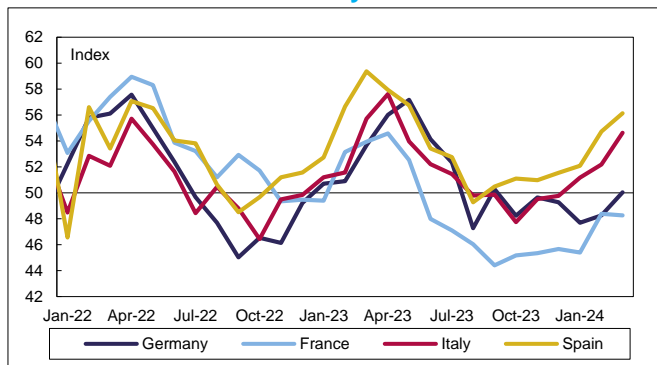
A further moderation of business wage and price expectations

Over the past month or so, BoE Governor Andrew Bailey has suggested that he is much less concerned about the risks that high inflation will become embedded. The latest Decision Maker Panel survey results from the BoE should have reinforced his more dovish assessment as it reported a further easing of business inflation and wage growth expectations. In particular, firms' expected selling-price growth over the coming twelve months fell 0.4ppt in March to 3.7%Y/Y, the least since August 2021, albeit still 1.3ppts above the average in the three years before the pandemic. On a three-month basis, firms' expectation for CPI inflation twelve months and three years ahead dropped respectively by 0.3ppt and 0.1ppt to 3.2%3M/Y and 2.7%3M/Y, both the lowest on the admittedly short series. And their expectation for wage growth over the coming twelve months dropped 0.3ppt to 4.9%3M/Y, the lowest since June 2022 and 1.5ppts below their realised wage growth over the past year. Among the other detailed findings of the survey, the share of firms assessing conditions for recruiting staff to be normal was the largest on the series dating back 2½ years while the share judging that those conditions were much harder than normal was the smallest on the series. And the average interest rate paid on bank and market-based borrowing by the surveyed firms rose a further 0.4ppt in March to a new survey high of 7.1%. And while they expected the average interest rate on their borrowing to fall to 6.2% over the coming year, this was up 0.4ppt on the month and still more than 2½ppts above the average rate paid when the BoE started to raise rates at the end of 2021.

Services price and activity PMIs revised down but consistent with inflation persistence in the sector

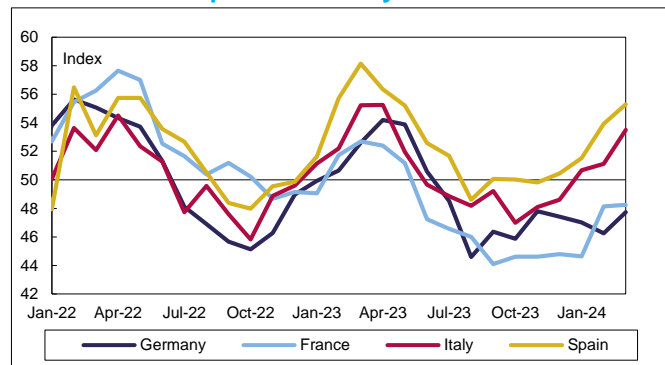
In terms of inflation outturns, like the ECB Governing Council, the BoE's MPC continues to single out developments in services – where the CPI rate was still highly elevated at 6.1%Y/Y in February – as most important for its policy reaction function. So, it might also be pleased to have seen the final services output price PMI for March revised down a sizeable 1.3pts from the flash estimate to a six-month low of 57.1. While that matched the second-softest level in almost three years, it was just 0.5pt below the Q4 average and still almost 5pts above the pre-pandemic long-run average. Likewise, despite a downward revision, the services input cost PMI (63.4) was just ½pt below the Q4 average and more than 3pts above the pre-pandemic average pointing to the likelihood of ongoing inflation persistence in the sector. Soft demand should force many firms to absorb some of those cost pressures within their margins. And the services activity PMI for March was below the also revised down today, by 0.3ppt from the flash estimate to a four-month low of 53.1. However, that was still just 0.4pt pre-pandemic average. And it left the Q1 average above that pre-pandemic benchmark at 53.7, up almost 2½pts from Q4 and the best quarterly reading since Q223, consistent with a return to expansion in the sector. With the final manufacturing output PMI for March having already been revised up to a 13-month high of 50.9, the composite output PMI for that month was

Euro area: Services PMIs by member state



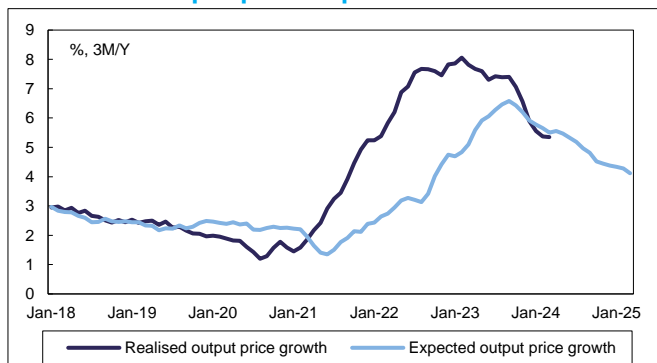
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Composite PMIs by member state



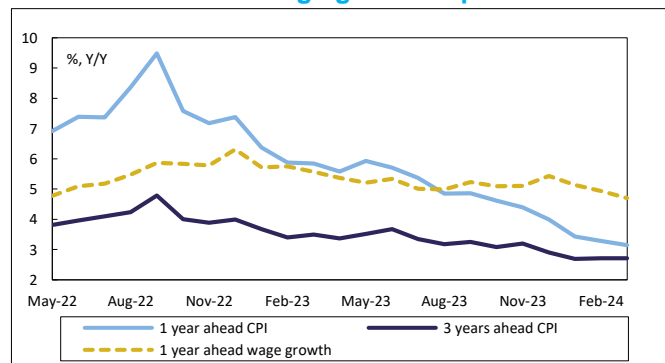
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Firms' output price expectations



Source: Macrobond, BoE DMP survey and Daiwa Capital Markets Europe Ltd.

UK: Firms' CPI and wage growth expectations



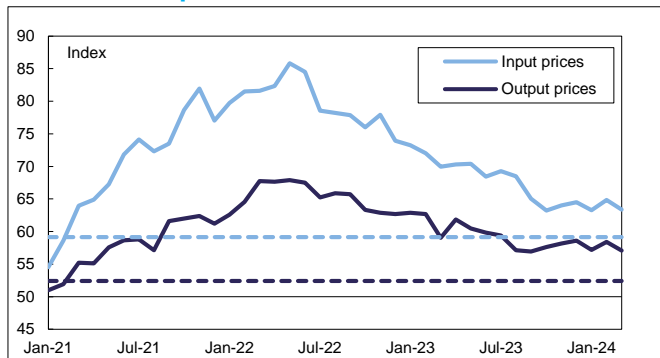
Source: Macrobond, BoE DMP survey and Daiwa Capital Markets Europe Ltd.

revised down only modestly to 52.8. And that left the Q1 average at 52.9, also the best in three quarters and consistent with a return to modestly positive GDP growth of 0.1-0.2%Q/Q following a contraction of 0.3%Q/Q in Q4.

The day ahead in the UK

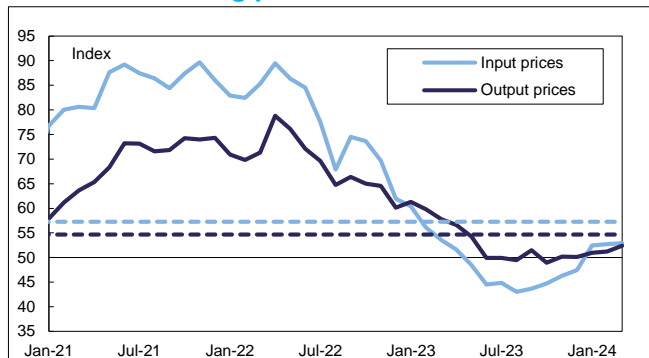
It should be a quiet end to the week for top-tier UK data with just the release of the March construction PMIs scheduled. In February, the survey reported a notable improvement, with the headline activity index rising to a seven-month high of 49.7. The pickup was led by a recovery in the housing component, which jumped the most since February 2022 to 49.8, albeit signalling stagnation rather than expansion.

UK: Services price PMIs*



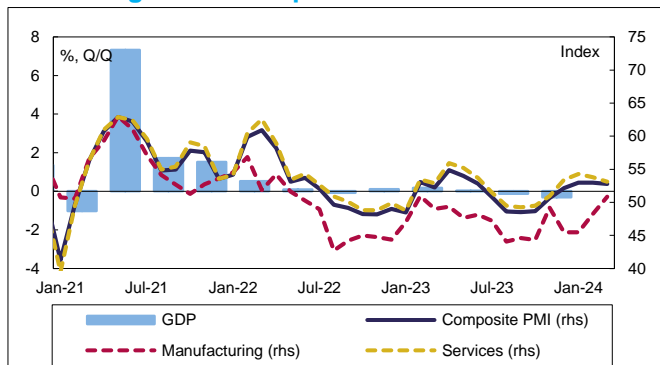
*Dashed lines represent pre-pandemic long-run average. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing price PMIs*



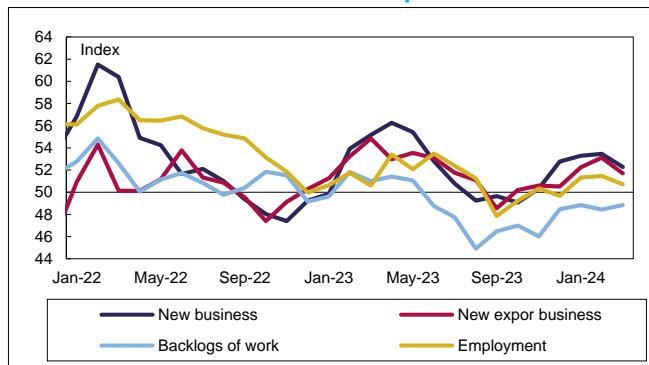
*Dashed lines represent pre-pandemic long-run average. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & output PMIs



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

UK: Selected services PMI components












Source: Macrobond, S&P Global 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	 Final services (composite) PMI	Mar	51.5 (50.3)	<u>51.1 (49.9)</u>	50.2 (49.2)	-
	 PPI Y/Y%	Feb	-8.3	-8.5	-8.6	-8.0
Germany	 Final services (composite) PMI	Mar	50.1 (47.7)	<u>49.8 (47.4)</u>	48.3 (46.3)	-
France	 Final services (composite) PMI	Mar	48.3 (48.3)	<u>47.8 (47.7)</u>	48.4 (48.1)	-
Italy	 Services (composite) PMI	Mar	54.6 (53.5)	52.5 (51.8)	52.2 (51.1)	-
Spain	 Services (composite) PMI	Mar	56.1 (55.3)	55.0 (54.2)	54.7 (53.9)	-
UK	 New car registrations Y/Y%	Mar	10.4	-	14.0	-
	 BoE's DMP 3M output price (1Y-ahead CPI) expectations Y/Y%	Mar	4.1 (3.2)	4.2 (3.2)	4.3 (3.3)	-
	 Final services (composite) PMI	Mar	53.1 (52.8)	<u>53.4 (52.9)</u>	53.8 (53.0)	-











Auctions

Country	Auction
France	 sold €5.67bn of 3.50% 2033 bonds at an average yield of 2.87%
	 sold €2.26bn of 1.75% 2039 bonds at an average yield of 3.09%
	 sold €1.67bn of 3.25% 2055 bonds at an average yield of 3.38%
	 sold €1.46bn of 4.00% 2060 bonds at an average yield of 3.33%
Spain	 sold €2.19bn of 3.50% 2029 bonds at an average yield of 2.848%
	 sold €2.13bn of 3.25% 2034 bonds at an average yield of 3.191%
	 sold €1.75bn of 3.90% 2039 bonds at an average yield of 3.531%
	 sold €506mn of 2.05% 2039 index-linked bonds at an average yield of 1.329%
UK	 sold £3.75bn of 4.625% 2034 bonds at an average yield of 4.015%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	 08.30	Construction PMI	Mar	-	42.9
	 10.00	Retail sales M/M% (Y/Y%)	Feb	-0.2 (-0.3)	0.1 (-1.0)
Germany	 07.00	Factory orders M/M% (Y/Y%)	Feb	0.5 (-10.3)	-11.3 (-6.0)
France	 08.30	Construction PMI	Mar	-	39.1
	 07.45	Industrial production M/M% (Y/Y%)	Feb	0.4 (0.2)	-1.1 (0.8)
	 07.45	Manufacturing production M/M% (Y/Y%)	Feb	-	-1.6 (0.1)
Italy	 08.30	Construction PMI	Mar	-	41.9
	 08.30	Construction PMI	Mar	-	50.3
Spain	 08.00	Industrial production M/M% (Y/Y%)	Feb	0.2 (-0.4)	0.4 (-0.6)
UK	 09.30	Construction PMI	Mar	49.8	49.7

Auctions and events

- Nothing scheduled -

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 ("DCME"). DCME is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange. DCME 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 derivatives 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 DCME and its affiliates may have positions and effect transactions in such the Securities or derivatives or options thereof and may serve as Directors of such issuers. DCME 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 only for investors who are professional clients as defined in MiFID II and should not be distributed to retail clients as defined in MiFID II. Should you enter into investment business with DCME'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.

DCME 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://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

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. 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.