Europe | Economic Research | 05 April 2024

Euro wrap-up

Overview

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- Bunds followed USTs lower despite some soft data for euro area retail sales and German factory orders and weak construction PMIs.
- Gilts also made losses while the UK construction PMIs suggested some stabilisation in activity at the end of Q1.
- The ECB's monetary policy announcement on Thursday will leave rates unchanged but the door will be left open to a cut in June; UK GDP figures for February and the Bernanke review of BoE forecasting will be published on Friday.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.867	+0.011
OBL 2.1 04/29	2.387	+0.025
DBR 2.2 02/34	2.395	+0.037
UKT 0⅛ 01/26	4.214	+0.045
UKT 0½ 01/29	3.919	+0.044
UKT 4⅝ 01/34	4.068	+0.048

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

Euro area

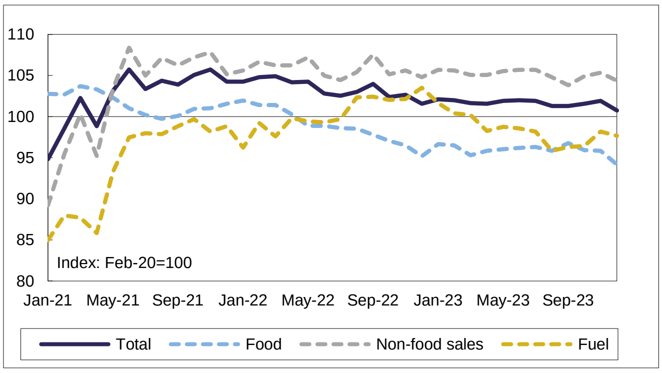
Retail sales fell in February and likely to be a drag on GDP in Q1

Despite the recent pickup in household real disposable income, demand for goods remains subdued. Euro area retail sales volumes fell in February for a second month out of the past three, by 0.5%M/M following no growth in January. That left sales down 0.7%Y/Y, 4.7% below the peak in November 2021 and trending ½% below the Q4 average. Among the larger member states to publish data, sales fell sharply in Germany (-1.9%M/M) and Belgium (-1.8%M/M) and declined modestly in France (-0.3%M/M). However, sales grew in Spain (0.5%M/M) and presumably also in Italy where the figures are not currently available. By category of good, with petrol prices having risen, sales of auto fuel volumes drove the weakness, declining for the first month in six and by 1.4%M/M. But sales at food stores also fell for a fourth month out of five (-0.4%M/M), while core (non-food and non-fuel) items were soft (-0.2%M/M). While persisting weakness in retail sales might well coincide with renewed momentum in demand for services – as illustrated by the new business PMI jumping to a ten-month high in March – today's figures serve as a reminder that household consumption growth likely remained relatively subdued in Q1, providing only a modest boost to GDP growth last quarter.

German factory orders held up by bulk purchases, but core orders maintain steady downtrend

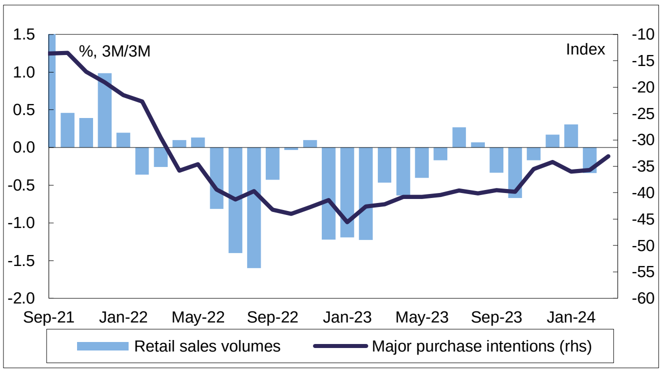
Consistent with soft demand for goods as well as the gloomy message from various manufacturing surveys, today's German factory orders data highlighted that the near-term production outlook remains weak in many subsectors. In particular, manufacturing orders rose just 0.2%M/M in February following the steep decline in January (-11.4%M/M) to leave them down 10.6%Y/Y – the most in eleven months – and some 21% below the pandemic peak. Admittedly, on a three-month basis, total orders were up 2.8%3M/3M, the firmest in six months, suggesting some stabilisation. But this reflected the 12%M/M surge in December due to large one-off orders in the aerospace and electrical machinery subsectors. Bulk orders in certain subsectors appear to have provided a boost to February's outturn too, with a jump in machinery and equipment (10.7%M/M) related to engines and turbines, as well as a significant pickup in pharmaceuticals (6.6%M/M) and chemicals (3.1%M/M). But those gains were offset by a sharp decline in new orders of cars, which fell 13.4%M/M, the most in eleven months. Indeed, when excluding major items, core orders were down for a fifth month out of the past six in February, by 0.8%M/M, to leave them down 1.9%3M/3M and at their lowest level since the first pandemic wave and 2010 before that. However, despite falling steadily over the past year or so as auto supply chains recovered, order backlogs remain well above pre-pandemic levels due to persistent bottlenecks in the electrical equipment and computer, electronics and optical subsectors.

Euro area: Retail sales



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales & purchase intentions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

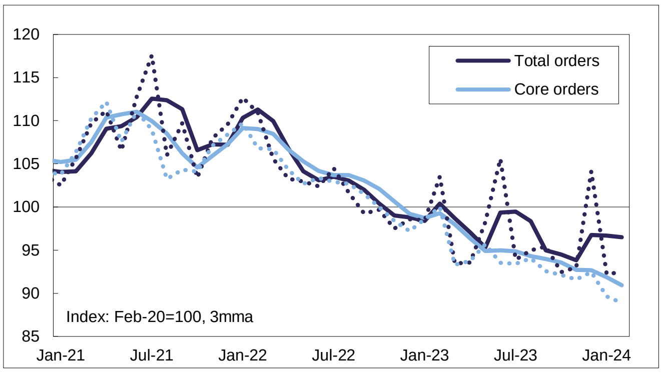
German turnover rises but maintains downwards trend, while French IP is little changed

Consistent with a further modest pickup in truck toll mileage that month, today's figures also reported an increase in manufacturing turnover in February of 2.1%M/M. Admittedly, this followed a drop of more than 5%M/M in January, to be still down 1.8%3M/3M. But, although turnover provided a poor guide to output at the start of the year, the figures suggest that we might well see a further modest increase in German manufacturing production when the February IP figures are published on Monday. Meanwhile, today's French numbers suggested a lacklustre manufacturing recovery in that country too. In particular, total industrial production rose just 0.2%M/M in February following a drop of 0.9%M/M in January to leave it flat on a three-month basis. This partly reflected renewed weakness in construction (-2.3%M/M) and energy output (-2.1%M/M). In contrast, manufacturing production rose 0.9%M/M supported by a rebound in coke and refined petroleum products (10.0%M/M), as well as modest growth in machinery and equipment, food, and certain intermediate goods. But French car production fell for a fourth consecutive month (-2.5%M/M) to its lowest level since April 2022 and some 14% below the pre-pandemic level.

Construction PMIs consistent with contraction as house prices decline

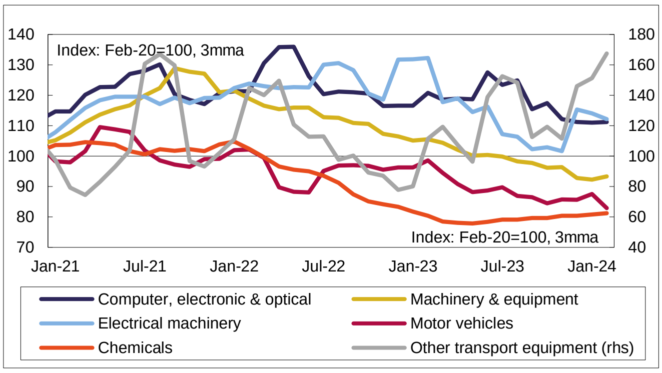
Today's construction PMIs similarly pointed to persisting contraction in the sector as higher borrowing costs and falling real estate prices restrained demand. In particular, the euro area's headline activity index fell in March, by 0.5pt to 42.2, the second-weakest reading since the initial pandemic slump as the civil engineering PMI fell almost 3pts to a five-month low (45.8). This was offset in part by a rise in the commercial activity index (+0.7pt to 44.6). But the survey signalled a persisting downtrend in house building, with the respective component (36.1) one of the weakest readings since the global financial crisis and consistent with significant contraction. This is arguably unsurprising given the adjustment in house prices, which in the euro area fell a striking 8.4%Y/Y in 2023, marking the first annual decline in sixteen years. The housing adjustment has been steepest in Germany, with prices declining for a six successive quarter in Q4 (-2.0%Q/Q) to be down 7.0%Y/Y and some 12% off the peak. But there was also a sharp drop in France in Q4, by 2.7%Q/Q – the most since Q109 – to be down 3.6%Y/Y and more than 4% below the peak. In contrast, despite having flatlined in the second half of 2023, Italian house prices were still up 1.8%Y/Y in Q4, with stronger growth in Spain (4.3%Y/Y) and Portugal (7.8%Y/Y). Against this backdrop, the German (29.3) and French (33.0) housebuilding PMIs continued to signal a steeper pace of contraction at the end of Q1, while the respective Italian index (49.9) consistent with stagnation in the sector. While construction activity was seemingly boosted by unseasonably mild weather at the start of the year, we continue to expect the construction sector to subtract from euro area economic growth over coming quarters.

Germany: Factory orders*



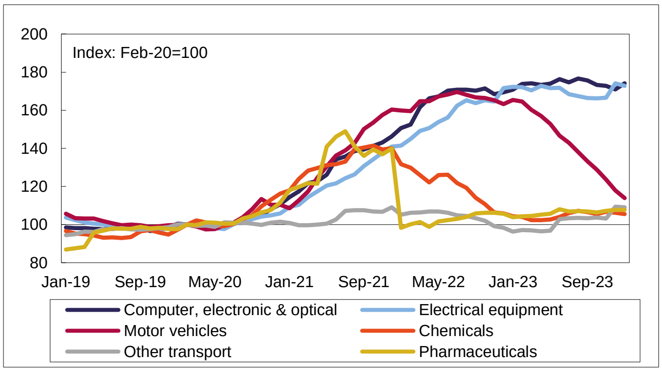
*Dotted lines represent unsmoothed data. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders



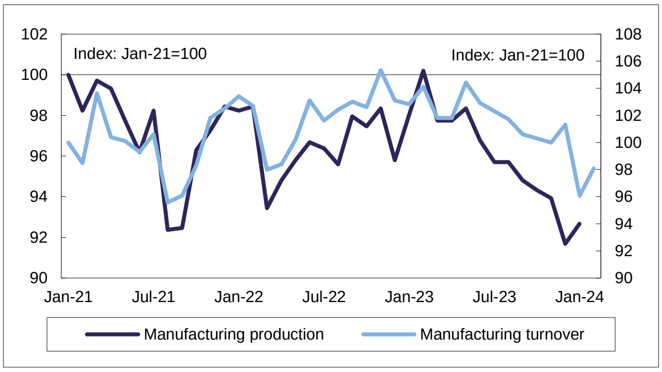
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing order backlogs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing production & turnover



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

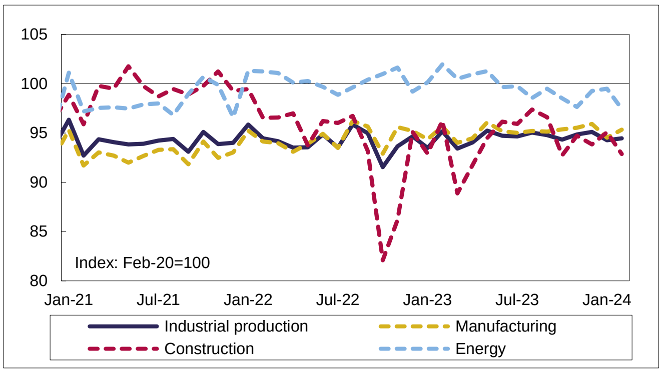
ECB to signal likelihood of June rate cut but insist path for rates remains data dependent

The main event of the coming week will be the conclusion of the ECB's monetary policy meeting on Thursday. We certainly do not expect a change to policy this month. However, we expect the Governing Council to signal more clearly that, should the incoming macroeconomic data over the next couple of months remain consistent with its macroeconomic projections, then rates will be cut for the first time this cycle in June. Admittedly, the ECB's inflation projection – which projects the headline HICP rate to fall below the 2% target in Q325 and remain sub-target thereafter – would in normal circumstances call for an immediate rate cut. But the ECB's recent history of significant forecast errors, as well as the currently elevated rates of services inflation and wage growth, means that the Governing Council will want to see further validation of its projections before it starts to cut rates. So, the policy statement is bound to repeat that future policy decisions will remain data dependent. And in her press conference, President Lagarde seems bound to underscore that the ECB will not pre-commit to any particular path for rates and that the outlook for policy beyond June remains highly uncertain. Certainly, while we think the current market pricing for the path of ECB rates over the remainder of the year appears credible, she seems unlikely to validate it firmly.

So far, the ECB can take comfort that recent data have been broadly consistent with its March macroeconomic projections. Surveys point to the return of very modestly positive GDP growth in the euro area in Q1. Headline HICP inflation averaged 2.6%Y/Y in Q1, bang in line with the ECB's forecast. However, with services inflation high and sticky at 4.0%Y/Y for a fifth successive month in March, core inflation over Q1 as a whole (3.1%Y/Y) was a touch stronger than the ECB projected. And the Governing Council cannot yet know for sure the extent to which the stickiness in services inflation in March reflected more the timing of Easter this year rather than persistence related to strong wage growth. So, it will certainly want to wait for the April and May inflation data, as well as Q1 negotiated wage figures due late next month, before confirming whether to ease policy.

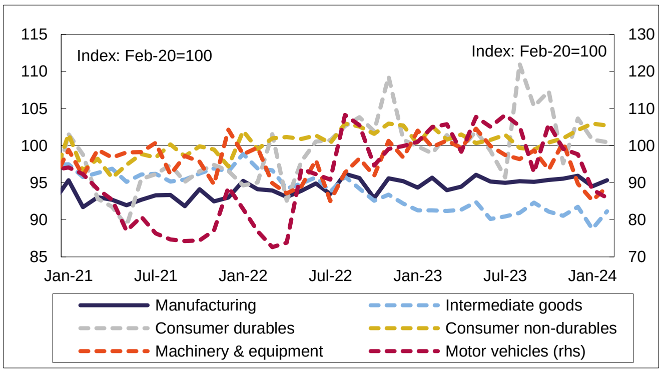
The decision to wait for the June Governing Council meeting before cutting rates would be fully consistent with the messaging from President Lagarde following last month's Governing Council meeting, as well as her subsequent public remarks. It would also be consistent with yesterday's account of the March monetary policy meeting, which reported that the "case for considering rate cuts was strengthening" but it would be "wise to await incoming data and evidence", and "it was highlighted that, in addition to new staff projections, the Governing Council would have significantly more data and information by the June meeting, especially on wage dynamics. By contrast, the new information available in time for the

France: Industrial production



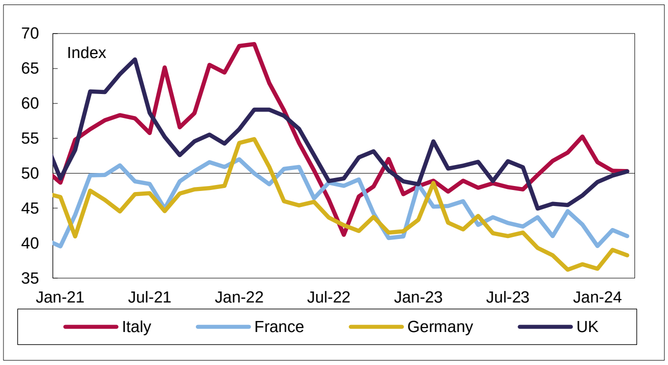
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Manufacturing production



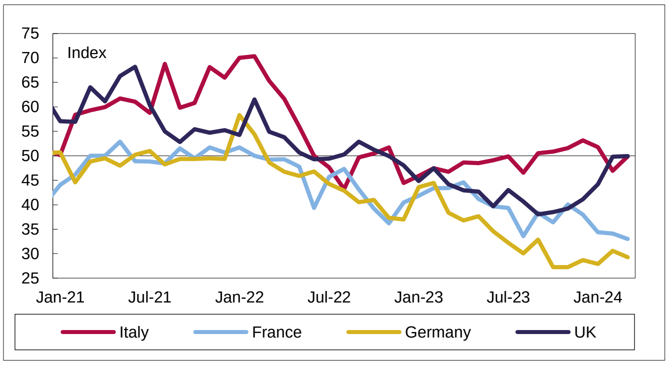
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Europe: Construction activity PMIs



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

Europe: House building PMIs



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

April meeting would be much more limited, making it harder to be sufficiently confident about the sustainability of the disinflation process by then".

The coming week's data: ECB bank lending survey & German IP in focus

In terms of the coming week's data, the results of the ECB's latest Bank Lending Survey (BLS) on Tuesday will feed into the Governing Council's discussions of the monetary policy transmission mechanism. In the previous survey, the BLS suggested that banks expected a further modest net tightening in credit standards in Q1 for households and businesses alike. But having declined for five consecutive quarters, lenders also expected a modest net increase in business loan demand in Q1, which would tally with the recent bank lending figures. While banks had also expected a modest increase in demand for mortgage lending, the latest monthly figures reported a further decline in the three months to February. Among the most noteworthy national releases, Monday kicks off with February industrial production figures from Germany and Ireland. Despite weakness in new factory orders, German manufacturing production is expected to have risen for a second successive month. But construction activity might well report some payback for the firm rise in January (2.7%M/M) limiting the rise in overall German industrial production to about ½%M/M. Irish production, meanwhile, might well partially reverse the near-29%M/M slump in January. At the end of the week, final March consumer price inflation figures are due from Germany, France and Spain on Friday, which will provide more detail than the preliminary releases, which saw headline HICP inflation ease in Germany (-0.4ppt to 2.3%Y/Y) and France (-0.8ppt to 2.4%Y/Y), but rise slightly in Spain (+0.3ppt to 3.2%Y/Y).

UK

Construction PMIs point to stabilisation in the sector after period of retrenchment

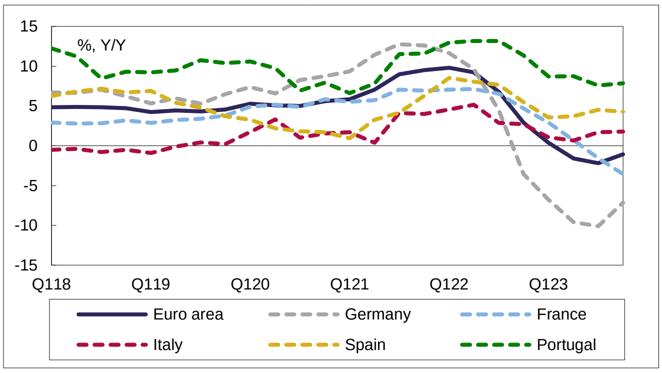
According to the construction PMIs, output in the sector stabilised at the end of Q1 after contracting over the prior six months. In particular, the headline activity PMI rose 0.5pt to 50.2, the highest since August albeit suggesting a flatlining sector rather than one that has turned convincingly towards growth. The survey detail suggests that there is now little difference in conditions between the various subsectors. With the housing activity PMI edging up just 0.1pt to 49.9, the survey suggested that construction of dwellings is now stabilising after five quarters of contraction, responding to a pickup in house prices (up 1.6%Y/Y in March according to the Nationwide index), survey evidence of a steady increase in new buyer enquiries, and an associated rise in mortgage approvals. The PMIs for commercial activity (up 1.0pt to a seven-month high of 49.9) and – reportedly supported by infrastructure and energy-related projects – civil engineering (up 0.5pt to 50.4, similarly the best since August) also pointed to stability of output. Among other detail, a pickup in new orders to a ten-month high increase the possibility of a modest pickup in activity over coming months. And the respective index suggested that an uptick in cost pressures over the prior two months largely dissipated in March. Not least given the interest-rate sensitivity of the sector, construction firms appear to remain cautious about the outlook, however. And reflecting that wariness, the PMIs suggesting that they cut headcount for a third successive month. Overall, we continue to expect the construction sector to be a drag on GDP growth this year.

The week ahead in the UK

Bernanke to call for BoE scenario analysis instead of fan charts, but dot-plots likely a step too far

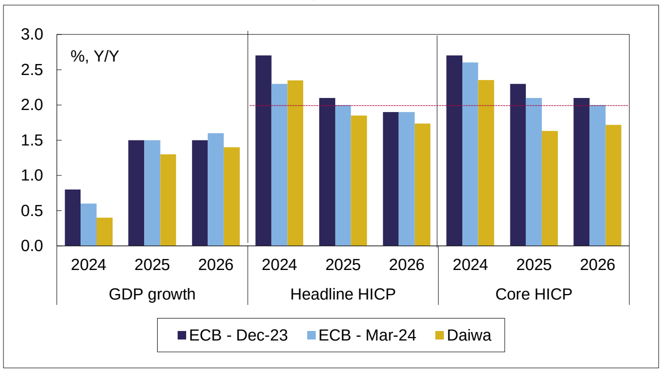
While the next BoE monetary policy announcement is not scheduled until 9 May, Friday will bring the publication of the review by former Fed Chair Bernanke of the Bank's approach to forecasting and analysis, which will inform the MPC's decision-making and policy communication from now on. The review was commissioned last May in response to the failure of the BoE to predict the extreme rise in inflation throughout 2021 and 2022, and the resulting marked increase in political criticism and steep deterioration in its public satisfaction ratings. Among other things, Bernanke was asked to focus on the

Euro area: House price growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: HICP & GDP growth forecast comparison



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

processes and analysis supporting the MPC's policy deliberations; the analytical framework for taking account of significant supply- and demand-side shocks and shifts; the role of the forecast in the MPC's policy decisions and communications; the appropriate assumptions to be used in its projections, including the interest rate path on which the forecast is based; and material provided to the MPC to assist the discussion and communication of the outlook and risks.

Comments from BoE Governor Bailey suggest that the most significant outcome of the review will probably be for the Bank to cease producing its projection fan charts, which present (arguably spurious) probabilities for various paths of GDP and inflation under both market-based and no-change rate assumptions. Indeed, Bernanke might recommend instead that the BoE follow the example of the Swedish Riksbank and, perhaps in each Monetary Policy Report, publish a limited number of alternative projections to its baseline forecast based on specific different economic scenarios. Bernanke is likely also to have considered the appropriateness that the MPC publish members' expected path for Bank Rate, akin to the Fed's dot-plots which were introduced while he was FOMC chair. However, Bailey has up to now appeared unconvinced of the merits of such an approach. Regardless of the precise conclusions that Bernanke has made, and how Bailey responds, we doubt that the content of the review will have a significant impact on the policy outlook. We maintain an expectation that the MPC will cut rates four times this year, with the first cut coming this quarter.

The coming week's data: February GDP likely broadly flat

In the coming week, the most notable data releases will come on Friday in the form of the February GDP data – including the detail for output in services, industry and construction as well as external trade. While GDP started the year on the front foot, rising 0.2%M/M in January, this followed two consecutive monthly declines at the end of last year to maintain a modest downtrend (-0.1%3M/3M). While the PMIs implied a similar pace of expansion in February, retail sales were merely flat that month amid subdued consumer confidence. And with the firmness of the rise in construction at the start of the year (1.1%M/M) unlikely to be repeated and the transport sector hit by industrial action, we expect GDP to have moved broadly sideways in February. Ahead of this release, the BRC retail sales monitor (Tuesday) will offer an update on retailing conditions in March, while the RICS residential survey (Thursday) will likely point to further modest recovery in housing market activity at the end of Q1. Thursday will also bring the BoE's quarterly Credit Conditions Survey for Q1, which is likely to suggest that loan demand remained relatively subdued despite the recent moderation in borrowing costs.

Daiwa economic forecasts

	2023 Q4	2024 Q1	2024 Q2	2024 Q3	2024 Q4	2025 Q1	2023	2024	2025
GDP								**%, Y/Y**	
Euro area	0.0	0.1	0.2	0.2	0.3	0.3	0.5	0.4	1.3
UK	-0.3	0.2	0.2	0.2	0.2	0.2	0.1	0.2	1.0
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.7	2.6	2.2	1.8	2.3	2.0	5.4	2.2	1.8
Core HICP	3.7	3.1	2.2	1.8	2.3	1.8	4.9	2.3	1.7
UK									
Headline CPI	4.2	3.5	1.7	2.0	2.2	1.9	7.3	2.4	1.8
Core CPI	5.3	4.6	3.1	2.7	2.7	2.2	6.2	3.2	1.8
Monetary policy, %									
ECB									
Deposit Rate	4.00	4.00	3.75	3.50	3.00	2.50	4.00	3.00	2.25
Refi Rate	4.50	4.50	4.25	3.65	3.15	2.65	4.50	3.15	2.40
BoE									
Bank Rate	5.25	5.25	5.00	4.75	4.25	3.75	5.25	4.25	2.50

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	Mar	**42.4**	-	42.9	-
		Retail sales M/M% (Y/Y%)	Feb	**-0.5 (-0.7)**	-0.2 (-0.3)	0.1 (-1.0)	0.0 (-0.9)
Germany		Factory orders M/M% (Y/Y%)	Feb	**0.2 (-10.6)**	0.5 (-10.3)	-11.3 (-6.0)	-11.4 (-6.2)
		Construction PMI	Mar	**38.3**	-	39.1	-
France		Industrial production M/M% (Y/Y%)	Feb	**0.2 (-0.8)**	0.4 (0.2)	-1.1 (0.8)	-0.9 (0.9)
		Manufacturing production M/M% (Y/Y%)	Feb	**0.9 (-0.3)**	-	-1.6 (0.1)	-1.5 (0.2)
		Construction PMI	Mar	**41.0**	-	41.9	-
Italy		Construction PMI	Mar	**50.3**	-	50.3	-
Spain		Industrial production M/M% (Y/Y%)	Feb	**0.7 (1.5)**	0.2 (-0.4)	0.4 (-0.6)	0.6 (0.3)
UK		Construction PMI	Mar	**50.2**	49.8	49.7	-
Auctions							
Country		Auction					
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming few week's key data releases						
Country		BST	Release	Period	Market consensus/ *Daiwa forecast/actual*	Previous
Monday 08 April 2024						
Euro area		10.00	Sentix investor confidence index	Apr	-8.5	-10.5
Germany		07.00	Industrial production M/M% (Y/Y%)	Feb	0.4 (-6.8)	1.0 (-5.5)
		07.00	Trade balance €bn	Feb	26.0	27.6
		07.00	Exports (imports) M/M%	Feb	0.0 (-1.0)	6.3 (3.7)
Tuesday 09 April 2024						
France		07.45	Trade balance €bn	Feb	-	-7.4
UK		00.01	BRC retail monitor, like-for-like sales Y/Y%	Mar	-	1.0
Wednesday 10 April 2024						
Italy		10.00	Retail sales M/M% (Y/Y%)	Feb	-	-0.1 (1.0)
Thursday 11 April 2024						
Euro area		13.15	ECB deposit rate (refi rate) %	Apr	*4.00 (4.50)*	4.00 (4.50)
Italy		09.00	Industrial production M/M% (Y/Y%)	Mar	-	-1.2 (-3.4)
UK		00.01	RICS house price balance %	Mar	-6	-10
Friday 12 April 2024						
Germany		07.00	Final HICP (CPI) Y/Y%	Mar	*2.3 (2.2)*	2.7 (2.5)
France		07.45	Final HICP (CPI) Y/Y%	Mar	*2.4 (2.3)*	3.2 (3.0)
Spain		08.00	Final HICP (CPI) Y/Y%	Mar	3.2 (3.3)	2.9 (2.8)
UK		07.00	GDP M/M% (3M/3M%)	Feb	0.1 (0.1)	0.2 (-0.1)
		07.00	Industrial production M/M% (Y/Y%)	Feb	0.0 (0.6)	-0.2 (0.5)
		07.00	Services output M/M% (3M/3M%)	Feb	0.1 (0.1)	0.2 (0.0)
		07.00	Construction output M/M% (Y/Y%)	Feb	-0.2 (-1.1)	1.1 (0.7)
		07.00	Trade (goods trade) balance £bn	Feb	-	-3.1 (-14.5)

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

The coming week's key events & auctions

Country	BST	Event / Auction
		Monday 08 April 2024
		- Nothing scheduled -
		Tuesday 09 April 2024
Euro area	09.00	ECB Bank Lending Survey to be published
Germany	10.30	Auction: €4.0bn of 2.1% 2029 bonds
UK	10.00	Auction: £2.25bn of 4.75% 2043 bonds
		Wednesday 10 April 2024
Germany	10.30	Auction: €2.5bn of 2039 bonds
UK	10.00	Auction: £4.0bn of 3.75% 2027 bonds
		Thursday 11 April 2024
Euro area	13.45	ECB President Lagarde speaks at post-meeting press conference
UK	09.30	BoE Credit Conditons Survey to be published
	19.00	BoE's Greene scheduled to speak
		Friday 12 April 2024
Euro area	09.00	ECB Survey of Professional Forecasters to be published
UK	09.30	Bernanke report on BoE forecasting to be published

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs