

Euro wrap-up

Overview

- Bunds followed US10s higher while the ECB's Bank Lending Survey reported a further drop in demand for business loans amid a further tightening of credit standards.
- Gilts also made gains despite a firm survey of UK retail sales.
- Ahead of the ECB's latest policy announcement on Thursday, tomorrow will bring just the latest Italian retail sales data.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 03/26	2.881	-0.038
OBL 2.1 04/29	2.382	-0.056
DBR 2.2 02/34	2.366	-0.066
UKT 0% 01/26	4.188	-0.032
UKT 0½ 01/29	3.904	-0.038
UKT 4% 01/34	4.027	-0.057

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

Source: Bloomberg

Euro area

ECB Bank Lending Survey suggests transmission of rate hikes to firms remains solid

According to the ECB's current guidance, the Governing Council's interest rate decisions are being made on the basis of its assessment of the inflation outlook, the dynamics of underlying inflation, and the strength of monetary policy transmission. At her press conference following the last monetary policy meeting, President Lagarde expressed satisfaction with respect to the latter criterion, considering the transmission of the ECB's rate hikes to be "good and solid to the financing sector and then further down the road to the economy". Indeed, given the past increases in the cost of borrowing, the ECB expects investment to continue to contract for a while yet. From the perspective of the majority on the Governing Council, that would be a desirable outcome, helping to suppress overall demand and thus weigh on domestically-generated inflation. And while there is some evidence that the transmission might be becoming marginally less potent, the assessment that the transmission of past rate hikes remains "good and solid" is likely to have been broadly maintained by today's ECB Bank Lending Survey (BLS) results.

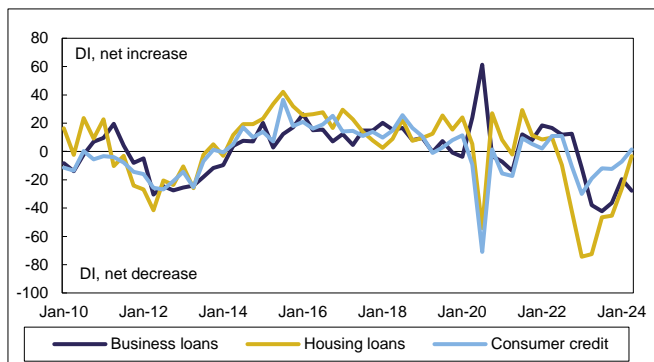
Business loan demand continues to weaken significantly amid further tightening of credit standards

In particular, contrasting previous expectations of a stabilisation in loan demand, euro area banks reported that firms' net demand for loans continued to decline markedly in Q1, with the net percentage of banks reporting lower demand (28%) up from Q4 but in line with the average in the second half of last year. According to the BLS detail, lower loan demand was evident in all of the large member states and reflected high interest rates and – consistent with recent subdued growth in long-term business loans – lower private fixed investment. Banks also expect firms' demand for loans to weaken further in the current quarter. And they reported a further tightening of their credit standards on loans to firms in Q1. But this represented the smallest such tightening in nine quarters, was less than banks had previously expected, and principally reflected developments in Germany and certain smaller member states. Admittedly, however, banks expect a further modest net tightening in the current quarter.

Monetary transmission becoming less potent with respect to lending to households

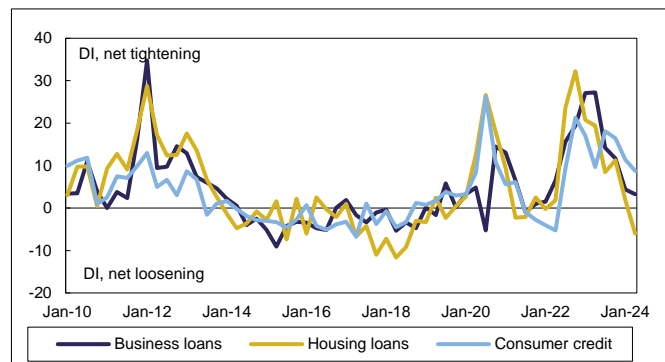
Unlike lending to businesses, the transmission of the ECB's monetary tightening appears to have become less potent for loans to households as consumer confidence turns for the better and real household incomes pick up. The BLS reported only a very modest net reduction in mortgage demand – the least in two years – in Q1. More strikingly, it also suggested that banks expect a significant increase in net demand for loans for house purchase – the most since Q316 – in Q2, which would represent the first such increase in two years. Perhaps surprisingly, that in part reflected developments in Germany, where

ECB BLS: Demand for loans



Source: Macrobond & Daiwa Capital Markets Europe Ltd.

ECB BLS: Credit standards



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

banks report improved housing market prospects amid improved affordability thanks in part to the past year's falls in home prices. Largely reflecting the activities of French banks, the survey also implied a net easing of credit standards for loans for house purchase in Q1. And it reported stability in demand for (and credit standards on) consumer credit in Q1, as well as expectations of a pickup in such demand in Q2.

Interest rates on new loans start to fall but doves wary that stance will tighten as inflation falls

According to the BLS, the recent drop in mortgage rates has also supported increased housing market affordability in Germany. Indeed, with financial markets anticipating that the ECB will cut rates over coming quarters, interest rates on loans to firms and households have started to decline from their recent peaks across the euro area as a whole – a further sign that the transmission of monetary policy tightening might have passed its peak. However, as noted today by Executive Board member Cipollone and likely to be echoed by other Governing Council doves at this week's monetary policy meeting, as inflation declines, the overall stance of monetary policy could yet tighten if rates do not fall commensurately with the improved outlook for prices. And the longer that policy remains restrictive and the recovery in investment remains suppressed, the greater the risk that the long-awaited cyclical rebound in productivity – that will likely be necessary for the sustained return of inflation back to target – will fail to materialise.

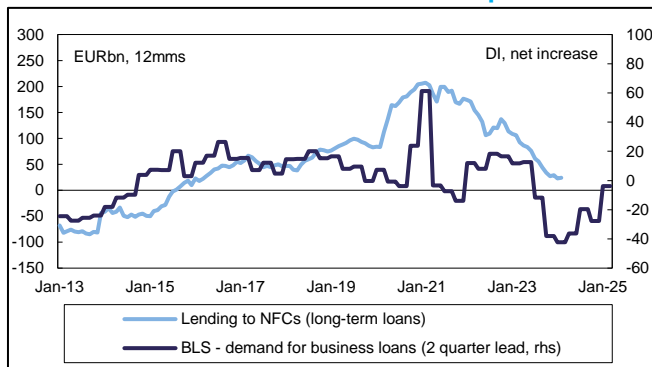
Improvement in bank net interest margins from monetary policy set to fade

Finally, with respect to the banking sector itself, reflecting lower yields, the BLS reported improved access in Q1 to funding for debt securities and to a lesser extent for money markets and securitisation, and this positive trend was expected to continue in Q2. That helps to offset the deterioration in retail funding conditions related to the ongoing downtrend in overnight deposits. And while a large net share of banks continued to report a negative impact from lower lending volumes (21%), and banks also reported higher provisioning needs and impairments, roughly double that net share (40%) reported a further positive impact on net interest margins from ECB rates over the past six months. With rate cuts expected, however, the cumulative net impact of monetary policy decisions on bank profitability is expected to diminish over the coming six months.

Irish IP rose in February, but remains on track for a notable decline in Q1

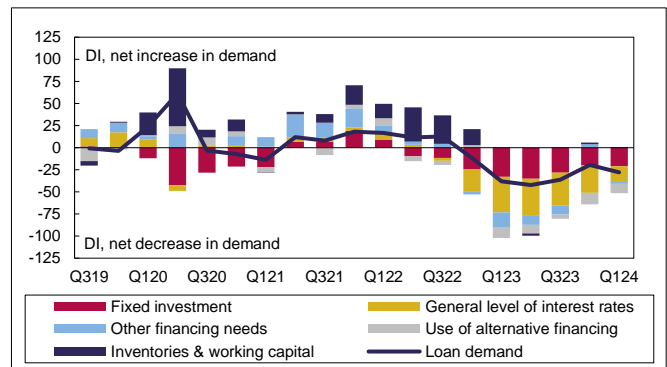
Following yesterday's surprisingly firm [German industrial production](#) figures for February, today's Irish data also reported a return to positive growth that month, with industrial output rising 3.7%M/M and manufacturing up 2.2%M/M. The increases reflected growth in the so-called modern sector (3.4%M/M) – which includes the chemical, pharmaceutical and computer and electronic subsectors, while the traditional sector reported a second successive drop (-2.2%M/M) as growth in transport

Euro area: Loans to non-financial corporations*



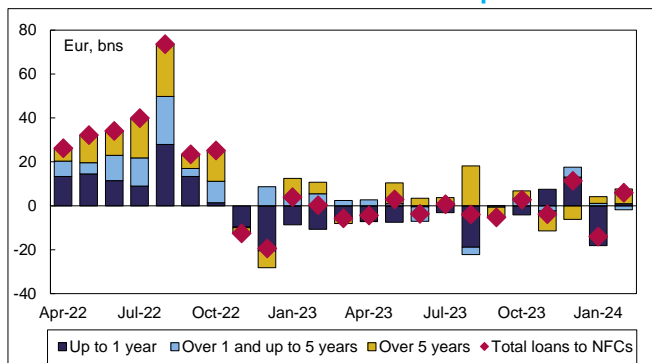
*BLS expected loan demand for Q224. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

ECB: BLS demand – loans for business



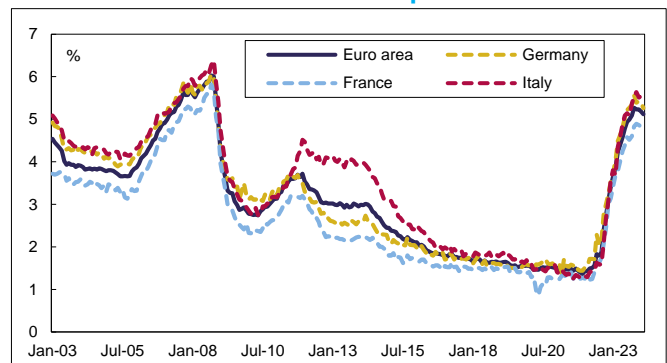
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Loans to non-financial corporations



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Loans to NFCs: composite cost



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

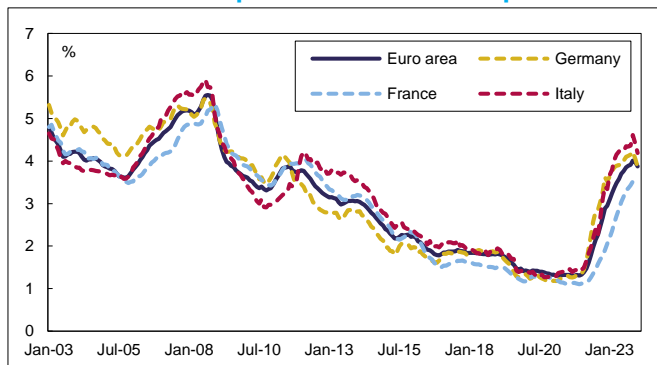
equipment and basic metals was offset by declines in other major subsectors. But contrasting Germany, the increase in Ireland followed a very steep decline in January of 26.9%M/M, with manufacturing out down an extreme 45.7%M/M. Admittedly, the Irish numbers are notoriously volatile due to the reporting by multinationals registered in that country. Indeed, given a jump in December, production on a three-month basis was still positive at 1.8%3M/3M, and notably stronger in manufacturing at 24.3%3M/3M. But, in the first two months of Q1, total production was trending some 14½% below the Q4 average (with manufacturing output down 22½% on the same basis), suggesting that the sector provided a non-negligible drag on both euro area IP and Irish GDP last quarter.

The coming two days in the euro area

After a relatively quiet day for economic data tomorrow, with just Italian retail sales figures for February due, Thursday will bring the main event of the week with the conclusion of the ECB’s monetary policy meeting. 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, mean 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.

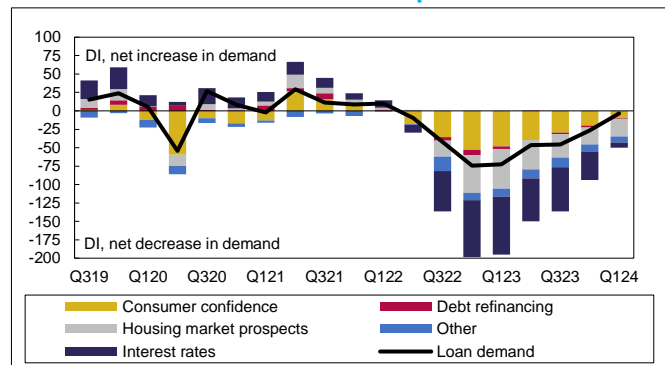
The Governing Council should at least take comfort that recent data have been broadly consistent with its March macroeconomic projections. Surveys point to the return of very modestly positive GDP growth in the euro area in Q1. Headline HICP inflation averaged 2.6%Y/Y in Q1, bang in line with the ECB’s 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.

Euro area: House purchase loans: composite cost



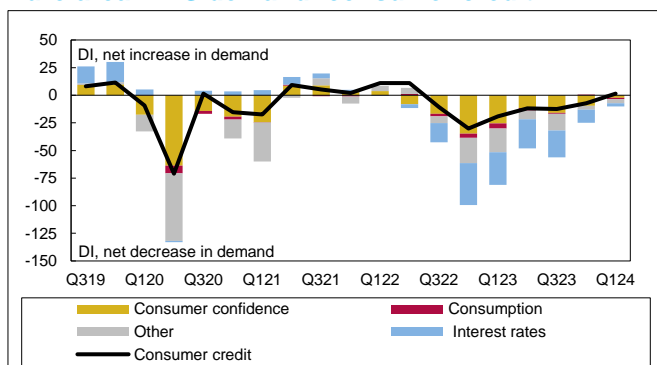
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: BLS demand: house purchase loans



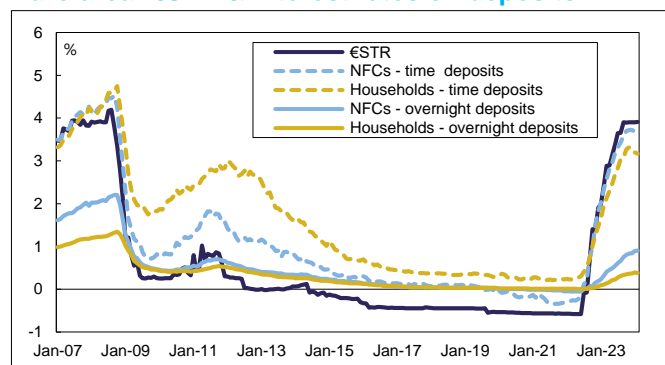
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: BLS demand: consumer credit



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: €STR & interest rates on deposits



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

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

UK

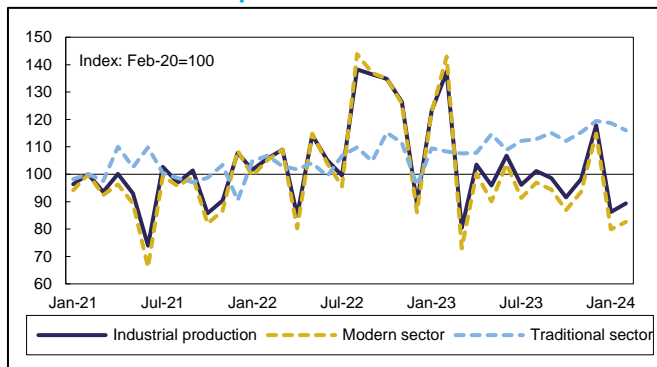
Survey suggests retail sales given a boost by early Easter, but spending outlook remains subdued

Consistent with the more upbeat CBI distributive trades survey published late last month, today’s BRC retail monitor suggested that sales were given a boost in March by the early Easter this year. According to the BRC, growth in the total value of retail sales accelerated to 3.2%Y/Y in March, the most since last August, more than double the pace in the previous three months, and above the average of the past twelve months (2.9%Y/Y). Like-for-like sales growth was similarly up more than 2ppts on the month to 3.2%Y/Y. Moreover, given the marked moderation in the BRC’s measure of shop price inflation that month, growth in retail sales volumes turned positive (+2.2%Y/Y) for the first time in two years. Amid the steady easing in price pressures and increased demand ahead of the long Easter weekend, food sales were up 6.8%3M/Y – a four-month high – with volumes (adjusted for the BRC’s shop price inflation) up 1.8%3M/Y, the most since September 2021. Sales of certain non-food items, such as cookware and home textiles, were also reportedly firmer in March. But overall, non-food sales remained subdued – down 1.9%3M/Y – as heavy rainfall last month dampened demand for garden furniture, BBQs, DIY products and clothing. And although the decline in volumes was the softest in more than a year, they were still down 2.8%3M/Y. While household real disposable incomes will benefit from the cut in the energy price cap this month, a further reduction in National Insurance Contributions and big increase in the National Living Wage, consumers continue to judge the climate for major purchases to be relatively unfavourable, suggesting that spending on big-ticket items will remain relatively subdued.

The coming two days in the UK

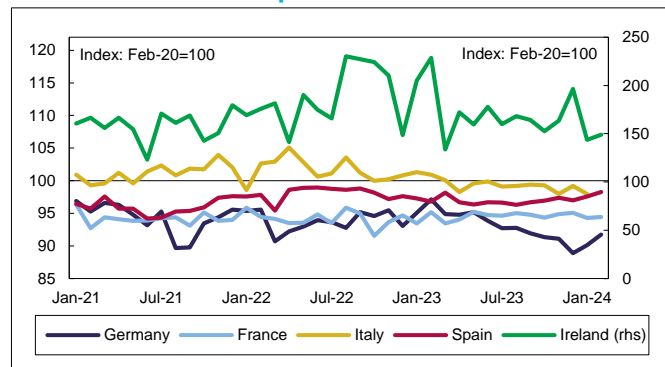
After a day bereft of UK data tomorrow, Thursday will bring the results of the latest BoE Credit Conditions and RICS Residential surveys. While the BoE’s previous survey signalled that banks expected credit supply, to both households and

Ireland: Industrial production



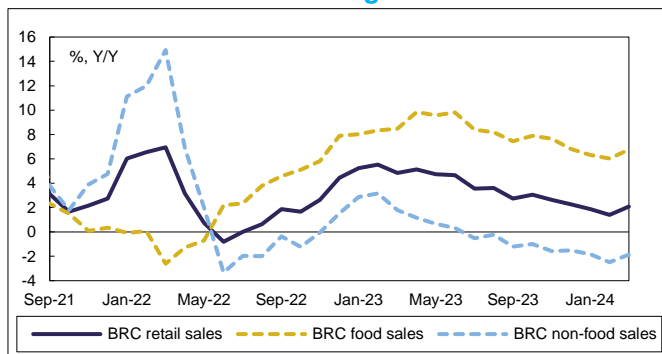
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production in member states



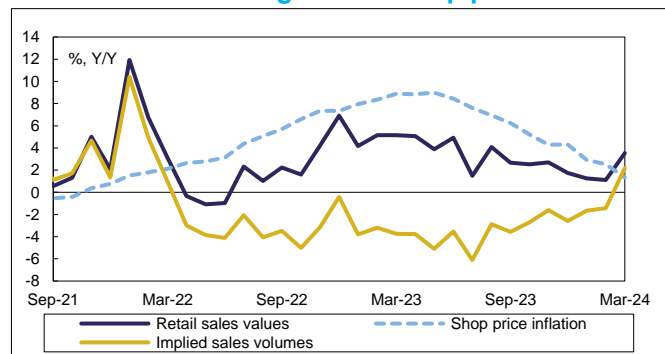
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BRC retail sales values growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BRC retail sales growth & shop price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.



businesses alike, to be little changed in three months to February, the recent pickup in mortgage approvals might imply a slight improvement. This notwithstanding, lenders are likely to suggest persisting weakness in loan demand amid still elevated borrowing costs. Meanwhile, in line with the recent increase in mortgage approvals and ongoing lack of supply, the RICS survey is expected to report a further improvement in the headline house price balance, up 4pts to -6%, which would imply the smallest share surveyors reporting price declines since October 2022.

The next edition of the Euro wrap-up will be published on 11 April 2024



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
France 	Trade balance €bn	Feb	-5.2	-	-7.4	-7.2
UK 	BRC retail monitor, like-for-like sales Y/Y%	Mar	3.2	-	1.0	-


Auctions

Country	Auction
Germany 	sold €3.28bn of 2.1% 2029 bonds at an average yield of 2.41%
UK 	sold £2.25bn of 4.75% 2043 bonds at an average yield of 4.495%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Italy 	10.00	Retail sales M/M% (Y/Y%)	Feb	-	-0.1 (1.0)




Auctions and events

Germany 	10.30	Auction: €2.5bn of 2039 bonds			
UK 	10.00	Auction: £4.0bn of 3.75% 2027 bonds			



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
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

Auctions and events

Euro area 	13.45	ECB President Lagarde speaks at post-meeting press conference			
UK 	09.30	BoE Credit Conditions Survey to be published			
	19.00	BoE's Greene scheduled to speak			

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<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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