

Euro wrap-up

Overview

- Bunds followed USTs lower, while euro area industrial production returned to growth in February, but failed to reverse the decline at the start of the year, suggesting manufacturing will remain a drag on GDP growth in Q1 for a fourth successive quarter.
- Gilts also made losses on a quiet day for UK economic data.
- Tomorrow will bring updates on euro area goods trade and UK labour market in February, as well as Germany's ZEW investor survey for April.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2½ 03/26 | 2.903 | +0.056 |
| OBL 2.1 04/29 | 2.437 | +0.075 |
| DBR 2.2 02/34 | 2.438 | +0.081 |
| UKT 0½ 01/26 | 4.386 | +0.058 |
| UKT 0½ 01/29 | 4.131 | +0.094 |
| UKT 4½ 01/34 | 4.240 | +0.105 |

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

Euro area

Euro area industrial output returns to growth in February, but likely a drag on GDP in Q1

Unlike recent months when there were inconsistencies between the data published by the member states and Eurostat, today's euro area industrial production figure for February aligned with expectations, rising 0.8%M/M. Of the major economies, growth was led by Germany (1.1%M/M) and Spain (1.3%M/M), but was modest in France (0.2%M/M) and Italy (0.1%M/M). As is often the case, Ireland (3.8%M/M) also made a non-negligible contribution to the overall euro area figure. Nevertheless, having fallen a steep 3.0%M/M in January – the most in ten months – to its lowest level since September 2020, industrial output was still down 6.4%Y/Y. And it was also trending some 1½% below the Q4 average, suggesting that the sector remained a drag on GDP growth for a fourth successive quarter (and fifth quarter in the past six) in Q1. Similarly, despite rising 1.1%M/M in February, manufacturing output was trending a marked 2½% below the Q4 average. So, while services output in the euro area had a better start to the year, rising some 1.4% above the Q4 average in January, and construction received a temporary boost from mild weather in Germany, we maintain our view that GDP returned to only very modest growth in Q1.

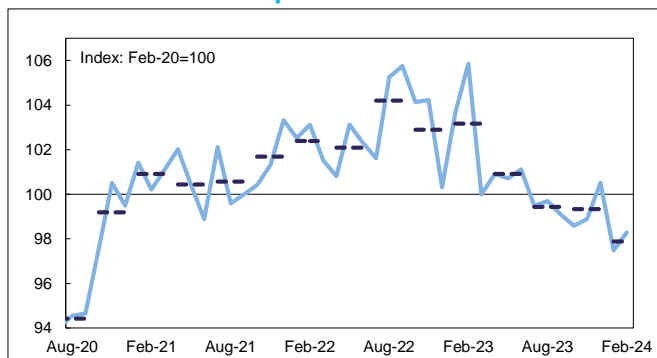
Broad-based pickup in manufacturing production driven by car production

Within the manufacturing sector, the improvement was driven by a pickup in production of capital goods (1.2%M/M) thanks to a first increase in production of motor vehicles in four months (4.9%M/M), as well as a modest rise in general machinery (0.9%M/M). But this reversed only a very small share of the slump in January (-15.5%M/M) to leave capital goods output trending some 8½% below the Q4 average. In contrast, despite falling for a second successive month (-0.5%M/M), production of consumer goods in January and February was broadly in line with the Q4 average. Moreover, likely benefitting from the ongoing decline in producer energy prices, today's figures saw firmer growth in the chemicals, basic metals, and paper products industries, to push up output of intermediate goods (1.1%M/M) to the highest level for seven months and leave it trending 1½% above the Q4 level. Indeed, while energy production fell sharply for the first month in five (-3.0%M/M) due to the warmer temperatures, production of energy-intensive items grew for the first month in four (2.2%M/M), the firmest monthly increase in that category for almost three years.

Surveys suggest that order books are starting to stabilise

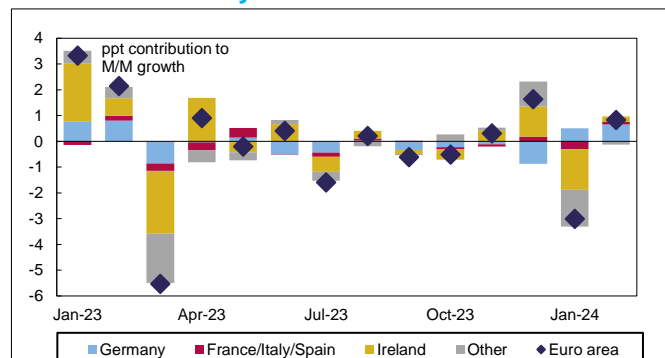
The near-term outlook for manufacturers remains challenging given the persisting subdued level of goods demand both within the region and abroad. Indeed, more than one third of firms in the sector surveyed at the start of the year suggested that demand remained a key limiting factor on production, the most since the euro crisis when excluding the early stages of

Euro area: Industrial production*



*Dashed dark blue line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Country contributions to IP



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

the pandemic. However, while new orders have declined sharply over the past couple of years, the Commission survey offered tentative signs that the trough has now been reached, with the respective index up to a four-month high in March. And while still above the long-run average, surveys suggest that the steady run down in stocks over recent quarters has brought the orders-inventory ratio into somewhat better balance over recent months. That should permit a steady recovery in production as and when demand returns more robustly. Also encouragingly, manufacturers have recently signalled a notable easing in material shortages, suggesting that supply-side disruption associated with shipping delays related to the re-routing of freight to avoid the Red Sea has remained relatively limited compared to that experienced due to the pandemic.

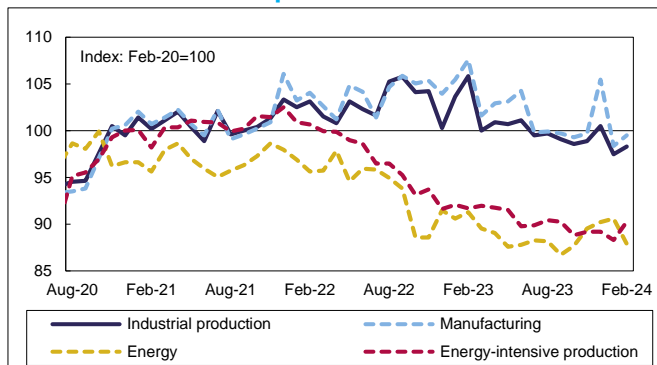
January likely represented the trough in the industrial sector cycle

Overall, we think that the drop in euro area industrial production in January now represents the trough for the cycle. Indeed, the latest monthly sentiment surveys suggest gradual progress towards stabilisation in the sector towards the end of the first quarter. For example, the manufacturing output PMI (47.1) and Commission production trend index (-3.4) both rose to their highest levels for eleven months. Admittedly, the Commission survey suggested that sentiment among subsectors remained mixed in March, with producers of cars and basic metals the most downbeat since the first Covid-19 lockdown. In contrast, optimism among manufacturers of other transport equipment was the highest on the series following a notable increase in orders over recent months. In addition, thanks to lower energy prices, chemicals producers were the least pessimistic since June 2022. And sentiment in the ICT, electrical equipment and general machinery subsectors was also off the recent lows.

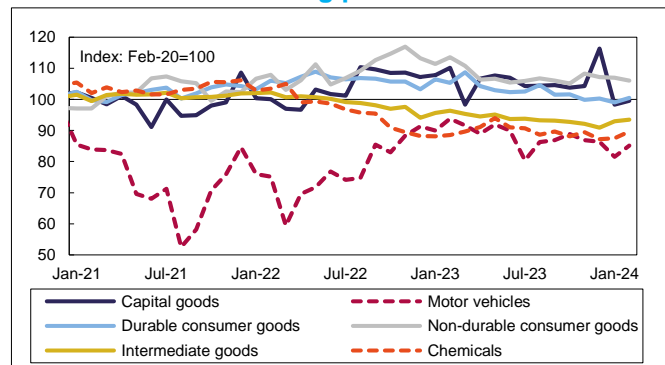
The day ahead in the euro area

Despite the improvement in manufacturing output in February, tomorrow's euro area goods trade report is likely to suggest that external demand remained relatively subdued. Indeed, in line with a notable narrowing of the goods trade surplus in Germany that month, the euro area balance is highly likely to have fallen back from the series high (€28.1bn) recorded at the start of the year. Meanwhile, the ZEW investor survey is likely to provide mixed messages about Germany's economic outlook, with the current conditions index likely to remain consistent with limited recovery at the start of Q2. Nevertheless, tallying with the findings of the Sentix survey, the outlook index is likely to point to further improvement over the coming six months as the prospect of rate cuts come into focus. In addition, ahead of the release of final estimates of euro area inflation in March on Wednesday, tomorrow will bring equivalent figures from Italy. The preliminary Italian release saw the EU-harmonised HICP rate rise 0.5ppt to 1.3%Y/Y, albeit remaining one of the lowest rates of the member states.

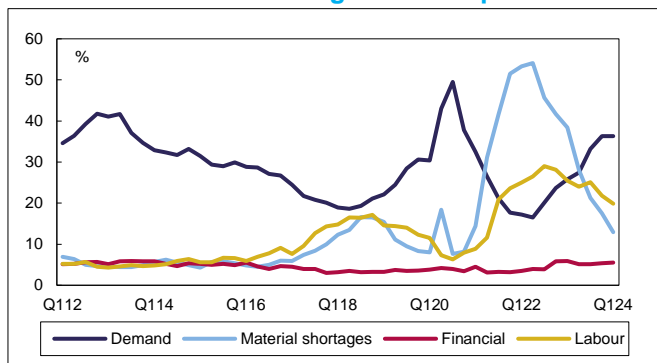
Euro area: Industrial production



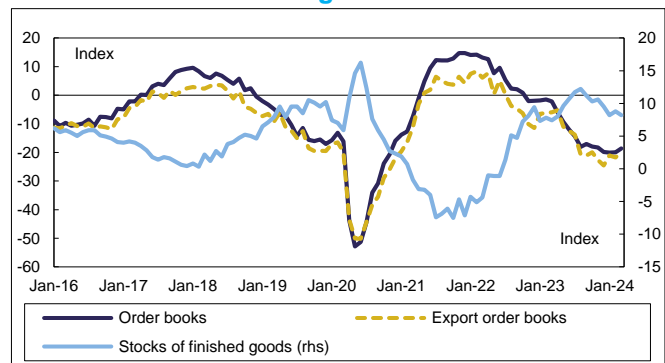
Euro area: Manufacturing production



Euro area: Factors limiting industrial production



Euro area: Manufacturing orders & stock indices

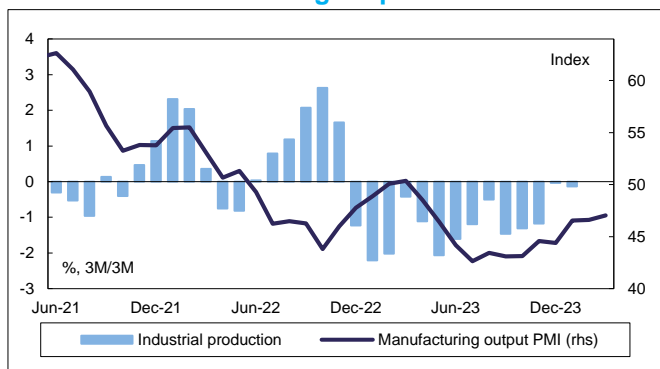


UK

The day ahead in the UK

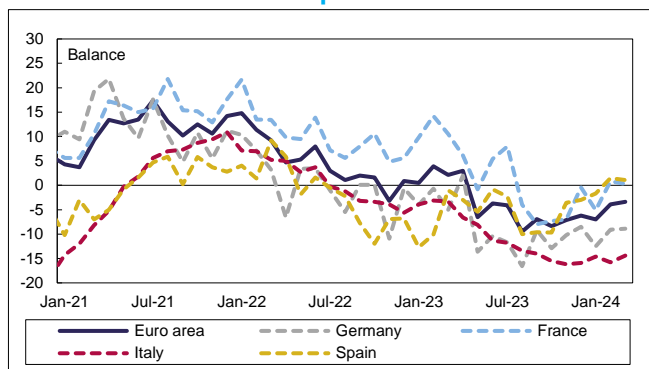
After a quiet start to the week for UK economic news, tomorrow will bring the latest labour market report, which will be watched closely for further signs of loosening and moderating pay pressures. The previous Labour Force Survey (LFS) saw the unemployment rate tick slightly higher in the three months to January for the first month in six, to 3.9%, nevertheless just 0.3ppt above the series low recorded in August 2022 and suggestive of a still tight labour market. While the number of payrolled employees rose in February (20k) and Friday's [GDP data](#) signalled moderate recovery momentum, given the steady downtrend in job vacancies, we would expect a further modest rise in the unemployment rate in the three months to February. Meanwhile, having moderated in January to its softest rate in 18 months (5.6%3M/Y), total wage growth is likely to have eased slightly further in the three months to February, with regular pay growth similarly set to have edged lower from 6.1%3M/Y previously. Aside from the data, BoE Governor Bailey is due to speak publicly tomorrow in the margins of the IMF Spring meetings. In addition, Clare Lombardelli, who is currently OECD Chief Economist and scheduled to succeed Ben Broadbent as Deputy Governor for Monetary Policy from 1 July, will testify to Parliament's Treasury Select Committee.

Euro area: Manufacturing output & PMI



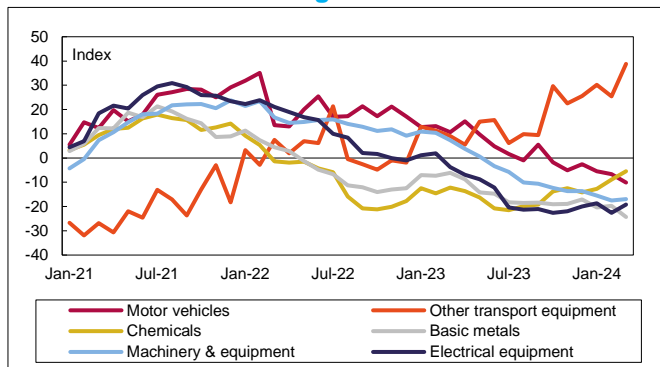
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: EC industrial production indices



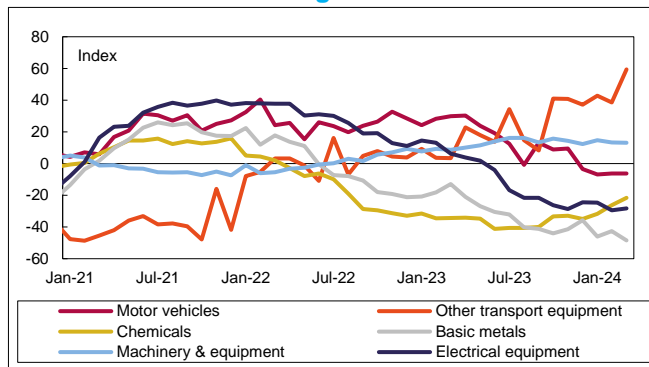
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing sentiment indices



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

Euro area: Manufacturing orders indices




Source: EC, 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  | Industrial production M/M% (Y/Y%) | Feb | 0.8 (-6.4) | <u>0.9 (-5.5)</u> | -3.2 (-6.7) | -3.0 (-6.6) |





Auctions

| Country | Auction |
|-----------------------|---------|
| - Nothing to report - | |




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  | 10.00 | Trade balance €bn | Feb | - | 28.1 |
| Germany  | 10.00 | ZEW current situation (expectations) balance | Apr | - | -80.5 (31.7) |
| Italy  | 10.00 | Final headline HICP (CPI) Y/Y% | Mar | <u>1.3 (1.3)</u> | 0.8 (0.8) |
| | 10.00 | Trade balance €bn | Feb | - | 2.7 |
| UK  | 07.00 | Average earnings including bonuses (excluding bonuses) 3M/Y% | Feb | 5.5 (5.8) | 5.6 (6.1) |
| | 07.00 | Unemployment rate 3M% | Feb | 3.9 | 3.9 |
| | 07.00 | Employment change 3M 000s | Feb | 72 | -21 |
| | 07.00 | Payrolled employees, change 000s | Mar | - | 20 |
| | 07.00 | Claimant count 000s (rate %) | Mar | - | 16.8 (4.0) |

Auctions and events

| | | | | | |
|--|-------|--|--|--|--|
| UK  | 10.00 | Auction: £1.5bn of 0.75% 2033 index-linked bonds | | | |
|  | 10.00 | Incoming BoE Deputy Governor Lombardelli scheduled to testify before Treasury Select Committee | | | |
|  | 18.00 | BoE Governor Bailey scheduled to speak | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

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