Euro wrap-up

Overview

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- Despite a further decline in euro area unemployment, Bunds made gains as euro area core inflation moderated in March to the lowest since January 2022.
- While a UK retail price survey signalled a pickup in food inflation, Gilts also followed USTs higher, as the final manufacturing PMIs pointed to greater pessimism amid a slump in orders.
  All eyes on Wednesday will be on the announcements of US reciprocal tariffs, while the ECB's monetary policy account, final services PMIs and the UK's DMP survey results are due Thursday.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.015	-0.027
OBL 2.4 04/30	2.300	-0.036
DBR 2½ 02/35	2.683	-0.052
UKT 3¾ 03/27	4.166	-0.023
UKT 4⅜ 03/30	4.248	-0.029
UKT 4½ 03/35	4.632	-0.045

*Change from close as at 5.00pm BST.
Source: Bloomberg

Euro area

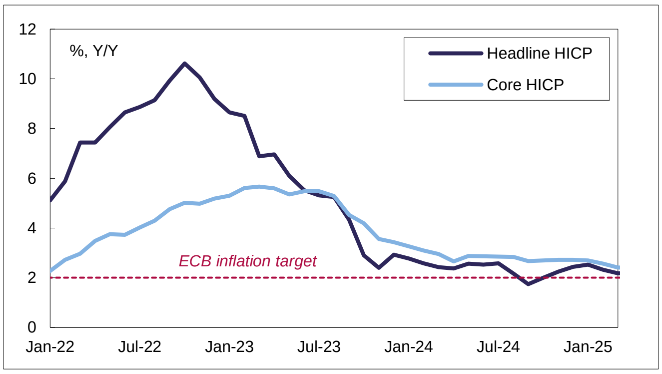
Disinflation continues with core HICP rate lowest since January 2022

According to today's flash estimates, euro area HICP inflation edged down 0.1ppt in March to a five-month low of 2.2%Y/Y. That aligned with the consensus forecast and left the Q1 average (2.3%Y/Y) in line with the ECB's projection. Lower energy inflation played a role in the decline in the headline rate, dropping almost 1ppt to a four-month low (-0.7%Y/Y) thanks not least to lower prices of petrol and heating oil. But renewed pressures in unprocessed food, inflation of which rose more than 1ppt to a 13-month high (4.1%Y/Y), provided some offset. Meanwhile, core goods inflation was steady and still subdued at 0.6%Y/Y. And perhaps most encouragingly for the ECB, the all-important services component fell a chunky 0.3ppt to 3.4%Y/Y, the lowest since June 2022. As a result, core inflation dropped 0.2ppt to 2.4%Y/Y, the softest rate in more than three years and consistent with continued disinflation. However, while that was 0.1ppt below the median on the Bloomberg survey, it left the Q1 average (2.6%Y/Y) a touch above the ECB's projection. On a seasonally-adjusted basis, core prices rose the least in four months (0.17%M/M). But that moderation reflected softness in the goods component, while the monthly rise in services prices on an adjusted basis edged marginally higher. Indeed, on a three-month annualised basis, momentum in both services (3.2%3M/3M annualised) and core prices (2.3%3M/3M annualised) ticked up slightly in March. We also caution that the services component might have been flattered this March by the timing of Easter, weighing on certain tourism-related prices which will then be boosted temporarily in April. Nevertheless, in part given base effects but also given survey evidence of moderation in price-setting, we strongly expect services inflation to fall in the current quarter. And as a result, we expect both the headline and core HICP rates to edge down further in Q2, justifying another ECB rate cut by the time of the June meeting.

Unemployment rate edges to new series low thanks to continued declines in Southern Europe

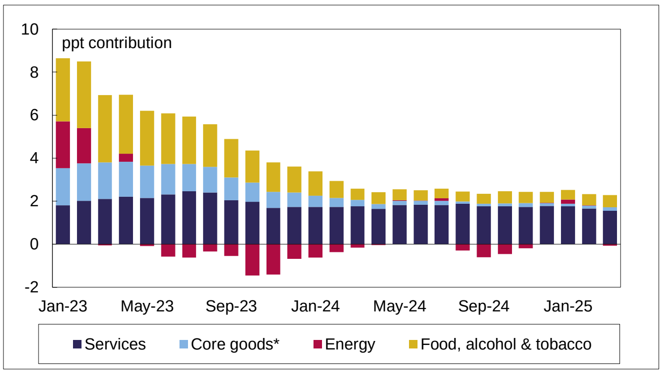
Of course, the inflation outlook remains extremely uncertain due to lack of clarity about the global tariff landscape, with Trump's announcement of reciprocal tariffs imminent and the detail of EU retaliation unclear. In part due to such uncertainty, as well as expectations that looser German fiscal policy will eventually provide impetus to GDP growth and inflation, our baseline forecast continues to assume no change to ECB rates in April before a cut in June. One reason why the Governing Council should feel able to be patient is the resilience of the labour market. While surveys have signalled greater willingness among firms, particularly in manufacturing, to cut headcount, the euro area unemployment rate fell in February to a new series low of 6.1%, down 0.4ppt from a year earlier and about 1½ppts below the pre-pandemic level. In line with the recent trend, the improvement was led by Southern Europe. Strikingly, Italian unemployment fell 0.3ppt to 5.9%, a rate that has been lower only once (in April 2007) on the series dating back more than four decades. And the Spanish (10.4%) and Greek (8.6%) rates also fell to their lowest since 2008. Elsewhere, German joblessness on the ILO measure was low and flat at

Euro area: HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to HICP inflation



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

3.5%. And the French rate edged up to a five-month high (7.4%), still about 1ppt below the 2019 average. As the drop in unemployment over recent years has been driven by Southern European countries where slack was previously ample, it need not be unsustainable. Indeed, with vacancies declining gradually and surveys suggesting that labour shortages are less of a constraint on economic activity, we do not consider the labour market to be overly tight. And even in the absence of a significant adverse shock to economic activity from trade wars, wage growth should remain on a moderating path consistent with underlying disinflation.

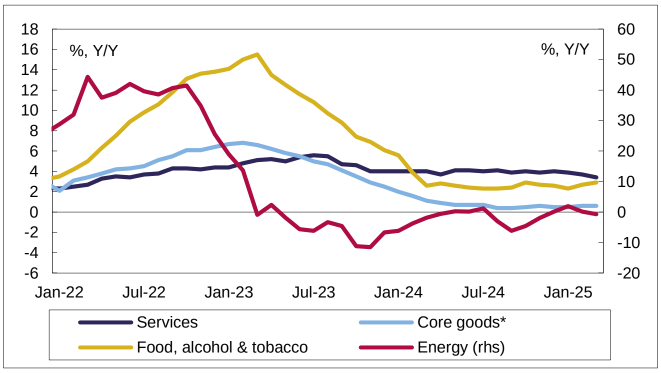
PMIs signal strongest factory production growth in two years

In terms of economic activity, today's final manufacturing PMIs reaffirmed the flash release's signal of a notable improvement in conditions. In particular, the euro area factory output component (50.5) suggested modest growth in the sector for the first time in two years and by the most since May 2022. And with the quarterly index some 3.8pts higher than in Q4, manufacturing production looks on track to contribute positively to GDP growth in Q1 for the first time in over two years. The improvement was particularly striking in Germany, where the final PMIs implied the strongest factory production in three years (52.1) and the largest quarterly increase (6.6pts) since the global financial crisis when excluding the initial Covid-19 rebound. Today's survey results also reported a rise in the output PMI in Spain to a three-month high (51.1), a return to growth in the Netherlands (51.1) and the strongest manufacturing expansion in Greece in 11 months (56.8). While still in contractionary territory, the French output index rose more than 4pts to a near-three-year high (48.6). And although the Italian PMI bucked the trend in March by falling some 2.6pts to a four-month low (46.2), this was still on average almost 2pts higher in Q1 than in Q4.

Manufacturers broadly optimistic about year ahead as new orders rise most in more than 3 years

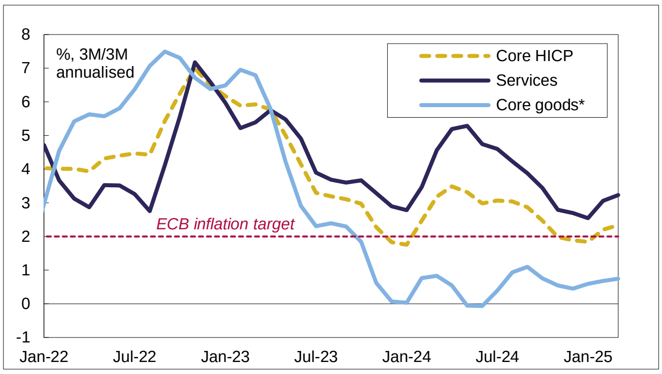
We suspect that the pickup in factory output at the end of Q1 was related in part to temporary front-loading of production to fulfil orders ahead of the announcement and imposition of US tariffs on imported European goods. Indeed, while it rose to a 35-month high, the euro area new factory orders index remained sub-50 to suggest no material boost to aggregate demand, while overseas orders reportedly fell at a faster pace than in February. But with manufacturers' stockpiles of finished goods having declined steadily over the past two years, the order-inventory ratio was the highest for three years and broadly in line with the long-run average, tentatively pointing to a further rise in production over the near term. Certainly, there was no meaningful deterioration in firms' output expectations for the coming year, which broadly aligned with the survey trend. The mood was most improved in Germany – with expected output growth the most in more than three years – as confidence was seemingly buoyed by the prospect of higher public spending on defence and infrastructure. So, while firms in the factory

Euro area: Key HICP inflation components



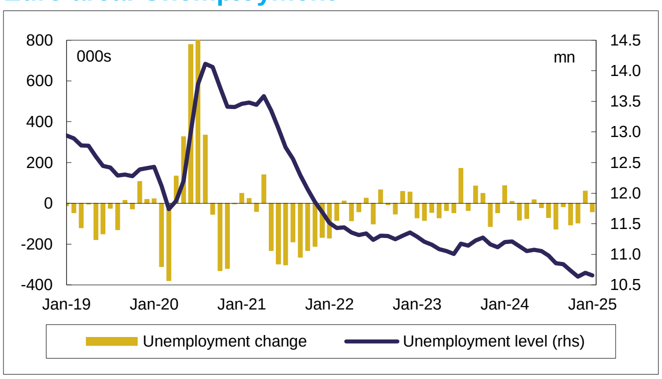
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core inflation momentum



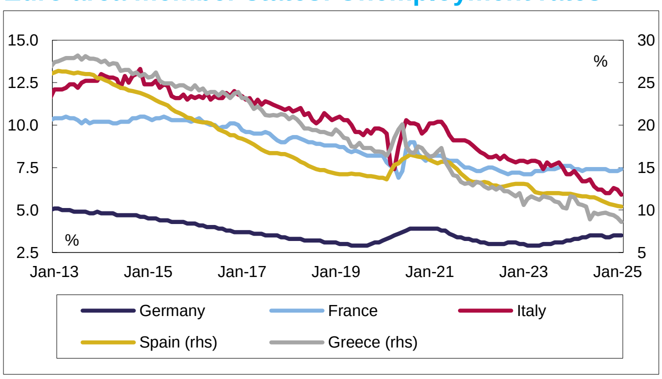
*Non-energy industrial goods.
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Unemployment rates



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

sector reportedly continued to see profit margins squeezed by rising input costs, the survey's employment component signalled the smallest cut in headcount in seven months

The coming two days in the euro area

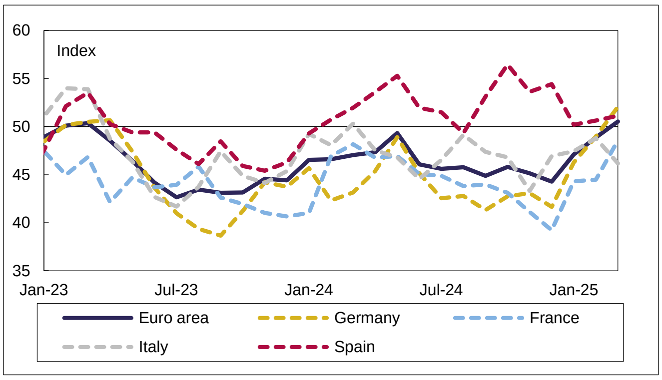
While Wednesday will bring a lull to the economic dataflow in the euro area, attention will be firmly on President Trump's 'Liberation Day' announcement of 'reciprocal' tariffs ahead of Thursday's implementation of 25% tariffs on US imports of autos. In theory, the announcements might mark a peak to the latest round of tariff-related uncertainty. But with retaliatory measures from the EU and, inevitably, further noise highly likely thereafter, that uncertainty won't be quickly dispersed. Certainly, the ECB's account of its March Governing Council meeting (due Thursday) will emphasise the challenges to its monetary policy calibration being posed by that heightened uncertainty. The Governing Council voted to lower its benchmark interest rates for a sixth consecutive meeting in March, taking the Deposit Rate to 2.50%, but flagged in its statement the impact of uncertainty relating to both international trade and promises of fiscal loosening in Germany. That uncertainty, along with the statement's emphasis of the ECB's 'meaningfully less restrictive' stance, would also imply the likelihood of a wide range of opinions about the future pathway for rates in the account. Thursday will also bring March's final euro area composite and services PMIs. Courtesy of March's manufacturing improvement, we expect the euro area composite output PMI to hold its (marginal) gain, of 0.2ppt to 50.4, in line with the flash.

UK

BRC retail price inflation gauge rises to 7-month high boosted by higher food inflation

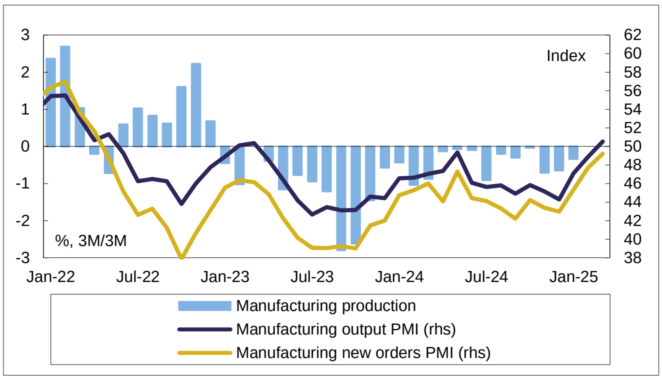
With households hit by higher energy and water bills from the start of April, and retailers similarly hit by increased National Insurance Contributions, minimum wages and rising farm and factory gate prices, today's BRC shop price monitor suggested that prices on the high street are also showing signs of stirring. While the BRC's measure of retail prices fell in March for the third month out of the past four, the pace of decline (-0.2%M/M) was less than half that seen in the same month a year ago. As such, the annual rate rose to a seven-month high (-0.4%Y/Y). Upwards pressures largely emanated from food, for which the BRC measure rose to a nine-month high amid a jump in ambient food prices, related in part to rising wholesale prices as well as an increase in the plastic packaging tax from 1 April. But while there was evidence of further discounting of furniture, DIY and gardening equipment, non-food inflation was also less negative due to a near-2ppt jump in the electrical goods component. The near-term price outlook remains uncertain, with retailers having to balance a persisting household preference to save rather than spend against a squeeze on profit margins as producer prices pick up. Indeed, according to

Euro area: Manufacturing output PMIs



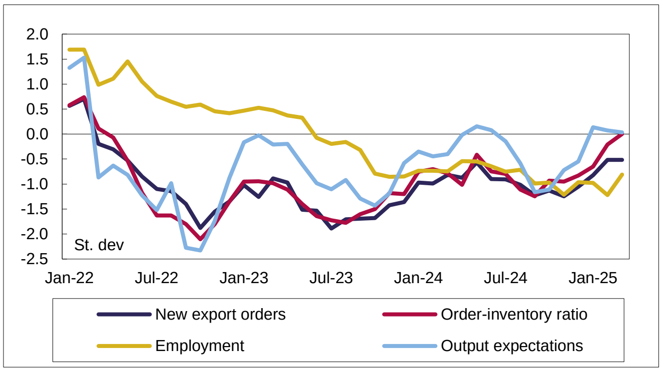
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output & PMIs



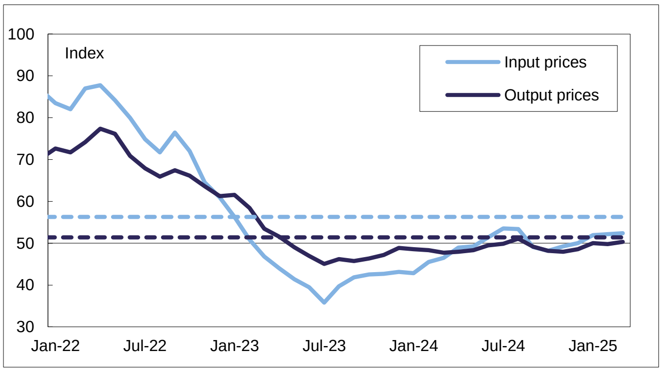
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Selected manufacturing PMIs



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

Euro area: Manufacturing price PMIs*



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

today's final manufacturing PMIs for March, output price inflation at the factory gate rose for a fourth consecutive month and by the most in almost two years (55.3). And while the respective input price index moderated by 1.5pts in March, at 57.9 it remained above the long-run average to point to non-negligible cost pressures in the goods price pipeline.

Manufacturers most downbeat about outlook in more than 2 years as orders slump

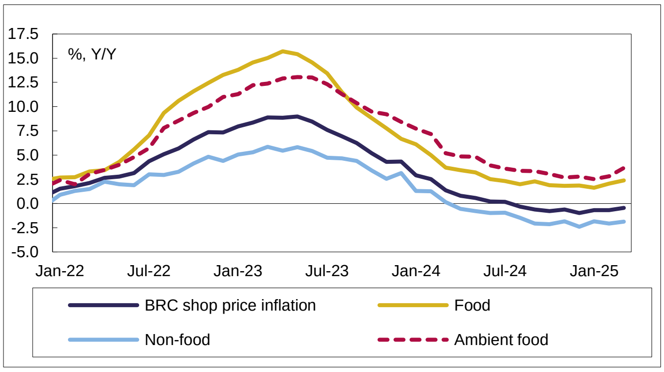
In terms of economic activity, today's final manufacturing PMIs were also disappointing, albeit not surprisingly so given heightened geopolitical uncertainties. Indeed, while it was revised up 0.8pt from the flash, the final output component fell in March for the seventh month out of the past eight and by a sizeable 2.0pts to 45.3, the lowest level since October 2023 and almost 9pts below the long-run average. The downturn was widespread, with contractions signalled across the consumer, intermediate and investment goods subsectors. While the decrease was reportedly steepest among small manufacturers, output was also down at large and medium-sized firms. The weakness related predominantly to a slump in new orders, with the respective component down a whopping 6.9pts – the joint-largest monthly drop since the first Covid-19 lockdown and the Brexit referendum before that – to 40.7, a 19-month low. Nevertheless, given the steady run down of stocks of finished goods over the past couple of years, the orders-to-inventories ratio stood at an above-average 1.03, which might normally point to growth ahead. Nevertheless, not least given significant uncertainties regarding US trade policies, manufacturers' production expectations for the coming 12 months were the weakest since October 2022.

The coming two days in the UK

There are no top-tier data releases scheduled for the UK on Wednesday. So, at least on the data front, focus will be on March's BoE Decision Maker Panel survey, due Thursday. Certainly, as BoE rate-setter Greene cautioned in a speech earlier today about the recent uptrend in consumer inflation expectations, one-year ahead CPI expectations have grown slightly firmer over the past six months, edging up a further 0.1ppt to an 11-month high of 3.1%3M/Y in February. And while expectations for three-years ahead remained steady that month (2.8%3M/Y), and still consistent with anchored expectations, the risks to both measures remain skewed to the upside with inflation set to tick higher into the latter half of this year. Meanwhile, and despite the deterioration confirmed by today's manufacturing PMI, Thursday's final composite reading is expected to confirm a sharp improvement. The flash release showed the composite index rise 1.5pts to a six-month high of 52.0, with services business activity, rising 2.2pts to 53.2, compensating for the lull in manufacturing.

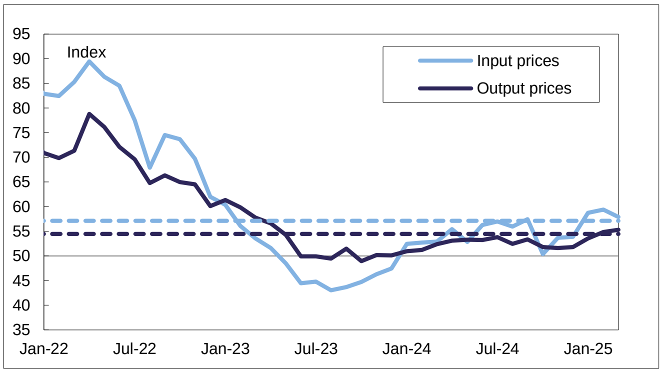
The next edition of the Euro wrap-up will be published on Thursday 03 April 2025

UK: BRC shop price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing price PMIs*



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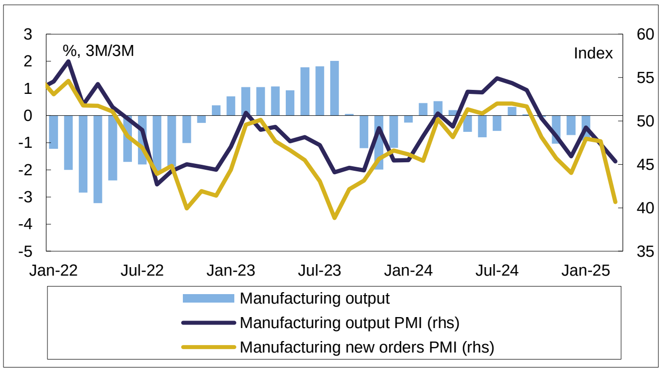
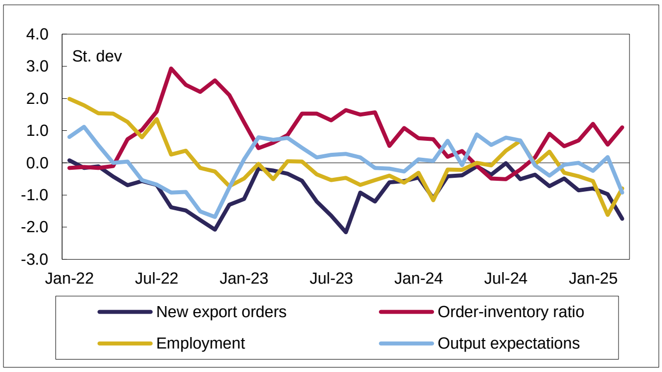
UK: Manufacturing output & PMIs



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

UK: Selected manufacturing PMIs



Source: Macrobond, S&P Global 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	Preliminary headline (core) HICP Y/Y%	Mar	**2.2 (2.4)**	*2.2 (2.5)*	2.3 (2.6)	-
	Final manufacturing PMI	Mar	**48.6**	*48.7*	47.6	-
	Unemployment rate %	Feb	**6.1**	6.2	6.2	-
Germany	Final manufacturing PMI	Mar	**48.3**	*48.3*	46.5	-
France	Final manufacturing PMI	Mar	**48.5**	*48.9*	45.8	-
Italy	Manufacturing PMI	Mar	**46.6**	48.0	47.4	-
Spain	Manufacturing PMI	Mar	**49.5**	49.7	49.7	-
UK	Final manufacturing PMI	Mar	**44.9**	*44.6*	46.9	-
	Nationwide house price index M/M% (Y/Y%)	Mar	**0.0 (3.9)**	0.2 (4.2)	0.4 (3.9)	-
	BRC shop price index Y/Y%	Mar	**-0.4**	-0.4	-0.7	-

Auctions

Country	Auction
Germany	sold €3.418bn of 2.2% 2027 bonds at an average yield of 2.01%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Spain	08.00	Unemployment (net employment) change 000s	Mar	-	-6.0 (58.7)

Auctions and events

Country	BST	Event
Euro area	11.30	ECB Executive Board Member Schnabel to give speech on 'reviving growth in the euro area' at SciencesPo, Paris
Germany	10.30	Auction: to sell up to €4.5bn of 2.5% 2035 bonds
UK	10.00	Auction: to sell £1.6bn of 1.125% 2035 inflation-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	09.00	Final composite (services) PMI	Mar	*50.4 (50.4)*	50.2 (50.6)
	10.00	PPI Y/Y%	Feb	2.8	1.8
Germany	08.55	Final composite (services) PMI	Mar	*50.9 (50.2)*	50.4 (51.1)
France	08.50	Final composite (services) PMI	Mar	*47.0 (46.6)*	45.1 (45.3)
Italy	08.45	Composite (services) PMI	Mar	51.5 (52.5)	51.9 (53.0)
Spain	08.15	Composite (services) PMI	Mar	54.3 (55.5)	55.1 (56.2)
UK	09.30	DMP 3M output price (1Y CPI) expectations %	Mar	4.0 (3.2)	4.0 (3.1)
	09.30	Final composite (services) PMI	Mar	*52.0 (53.2)*	50.5 (51.0)

Auctions and events

Country	BST	Event
Euro area	12.30	ECB to publish monetary policy account of 5-6 Mar Governing Council meeting
France	09.50	Auction: to sell up to €12bn of 3.5% 2033, 3.2% 2035 & 3.75% 2056 bonds
Spain	09.30	Auction: to sell 2.4% 2028, 3.1% 2031, 3.9% 2039 bonds & 1% 2030 inflation-linked bonds
UK	10.00	Auction: to sell £3.25bn of 4.375% 2040 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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