

# Euro wrap-up

## Overview

- Bunds made substantial gains as investors responded to Trump's additional 20% 'reciprocal' tariff on EU exports to the US and the increased likelihood that it might trigger a further ECB rate cut this month.
- While a UK survey signalled an uptick in business inflation expectations, Gilts outperformed.
- Friday's release of February German factory orders and French industrial production figures might show signs of front-loading ahead of US tariff hikes.

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### Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	1.943	-0.090
OBL 2.4 04/30	2.229	-0.096
DBR 2½ 02/35	2.649	-0.070
UKT 3¾ 03/27	4.001	-0.158
UKT 4¾ 03/30	4.090	-0.161
UKT 4½ 03/35	4.518	-0.125

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

## Euro area

### If sustained, market response to 'reciprocal' tariff announcement will weigh on inflation

After President Trump yesterday evening announced an additional 20% 'reciprocal' tariff on EU exports to the US, euro area markets responded predictably today with equity markets sharply lower and Bunds bull-steepening. Notably too, the euro strengthened to above \$1.10, sitting almost 7% above the assumption used in the ECB's projections published just four weeks ago. With oil and gas prices also on average now more than 7% and 20% below the respective figures assumed for 2025 in the ECB's forecasts, if sustained and extended recent market moves will be judged by policymakers to have a non-negligible negative impact on the inflation outlook. Other things equal, that would increase the likelihood of a further rate cut at the ECB's Governing Council meeting on 17 April, which the account of the March meeting today suggested was possible but far from a done deal.

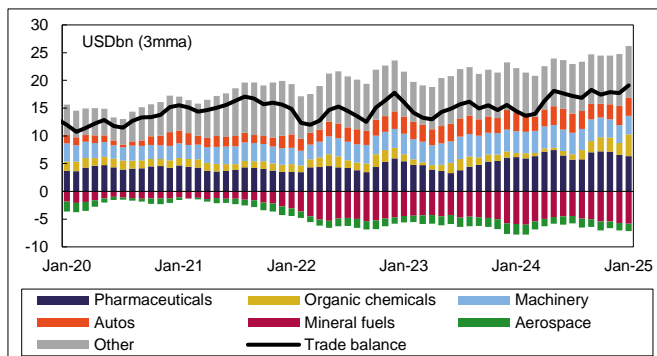
### While EU will retaliate, GDP growth in 2025 could yet be wiped out, also calling for further rate cuts

There was perhaps a little relief that pharmaceuticals – which account for the largest shares of euro area exports to the US (more than one fifth) and the bilateral trade surplus with the US (almost two-fifths) – were for the time being exempt from the new reciprocal tariffs. But goods accounting for some 14% of total euro area exports and worth more than 2% of GDP – and which were last year subject to an average tariff of less than 2% on a trade-weighted basis – are still on course to be subject to a double-digit ppt increase in tariffs by early next month. And with demand at home, in the US and in third countries all likely to be hit directly and indirectly over coming quarters, the full implementation of the new US tariff regime would be bound to have a marked dampening effect on euro area GDP over coming quarters. In our view, that could wipe out in full the moderate growth (0.9%Y/Y) that we and the ECB currently both have in our baseline projections. EU Trade Ministers will meet on Monday to discuss retaliatory tariffs against symbolic imports from the US as well as a possible digital services tax, barriers to US access to public procurement and other non-tariff barriers to the activities of US companies. And some of the Governing Council's hawks might be concerned that such measures will add to price pressures. But the likelihood that cheap goods shipments from Asia will be diverted away from the US towards Europe might negate that effect. So, like the impact of market developments on the inflation outlook, the economic consequences of the new tariff regime are also likely to be net-negative, similarly strengthening the case for ongoing monetary easing.

### Composite PMIs were consistent with expansion in Q1, with a return to growth in Germany and Italy

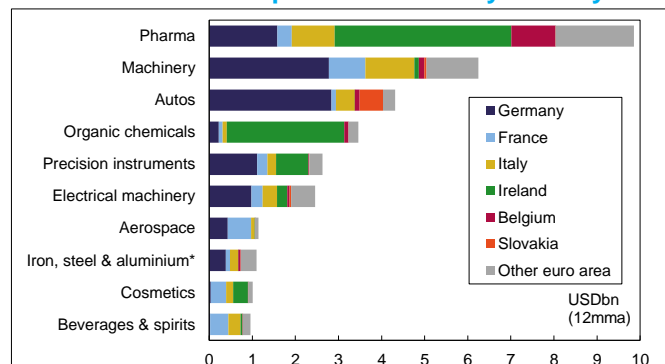
While the newsflow on US tariffs has significantly darkened the economic outlook, today's final March PMIs signalled ongoing expansion in euro area economic activity in Q1, which might suggest some resilience to the incoming trade shock.

#### Euro area: Goods trade balance with the US



Source: US Census Bureau, Macrobond and Daiwa Capital Markets Europe Ltd.

#### Euro area: Goods exports to the US by country



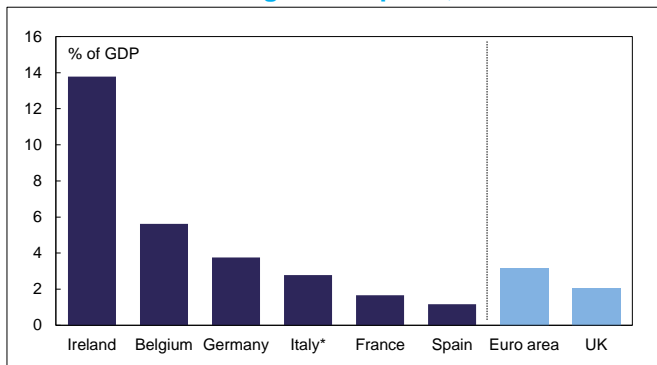
Source: US Census Bureau, Macrobond and Daiwa Capital Markets Europe Ltd.

Contrasting the modest decline reported in the flash release, the final services activity PMI rose in March for the first month in three, by 0.4pt to 51.0. This left the quarterly index (51.0) a touch firmer than the Q4 average, when output in the sector rose a spritely 0.9%Q/Q. Taken together with the upwards revision to the [manufacturing](#) indices, the headline composite output PMI rose 0.7pt in March to a seven-month high of 50.9. And this pushed up the average composite index more than 1pt in Q1 to 50.4, the highest in three quarters. So, while the PMIs underestimated the pace of expansion in the second half of 2024, we expect euro area GDP growth in Q1 to be at least as strong as the 0.2%Q/Q rate of Q4. The final German PMIs for March signalled the strongest economic growth in ten months (51.3), with the quarterly composite index (50.7) up 2.8pts to point to a return to positive GDP growth in Q1. The Italian composite PMI in Q1 (50.7) also suggested a return to growth, while the respective Spanish index (54.4) implied ongoing Iberian outperformance. The exception to the positive PMI story for Q1 was France. Despite jumping to a five-month high in March (48.0), the French quarterly composite index edged lower from Q4 (46.9) to imply contraction in GDP once again. But we caution that the French PMIs are often a less reliable guide to economic output than other survey indicators. Indeed, as suggested by the Bank of France survey, we expect a return to modest French GDP growth in Q1 after the dip at the end of 2024.

**The day ahead in the euro area**

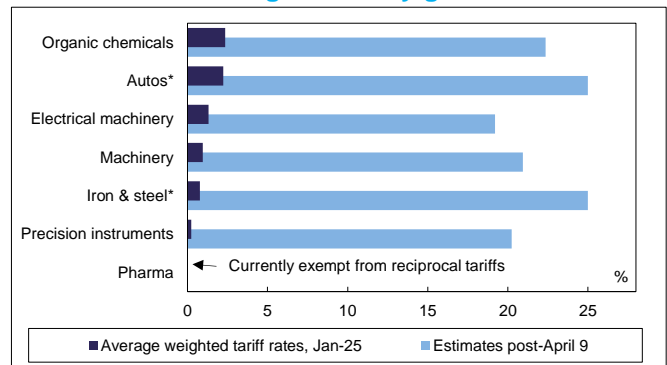
Whilst the aforementioned tariffs present a clear downside risk for euro area manufacturing demand going forward, February’s industrial output data may still see tailwinds from firms’ efforts to frontload orders ahead of their imposition. As such, and following a weak start to the year, an increase across both French and Spanish industry would seem highly probable. Notwithstanding the impacts of any trade-related windfalls, tomorrow’s German factory orders data should certainly see some payback in February, owing to the much steeper decrease (-7.0%M/M) in the month prior. Tomorrow’s manufacturing turnover estimate will also provide insights into German IP that month, due for release at the start of next week. The end of the week will also bring March’s euro area construction PMIs, for which we would also expect to see some improvement in line with this month’s manufacturing PMIs.

**Euro area & UK: US goods exports, % of GDP**



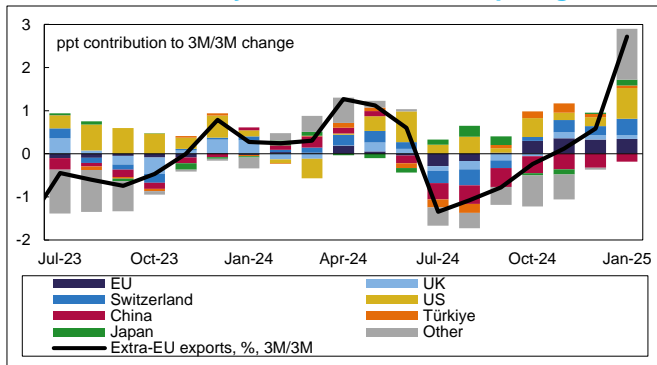
\*Daiwa approximation based on Istat elaboration. Source: National sources, Macrobond and Daiwa Capital Markets Europe Ltd.

**Euro area: US average tariffs by good**



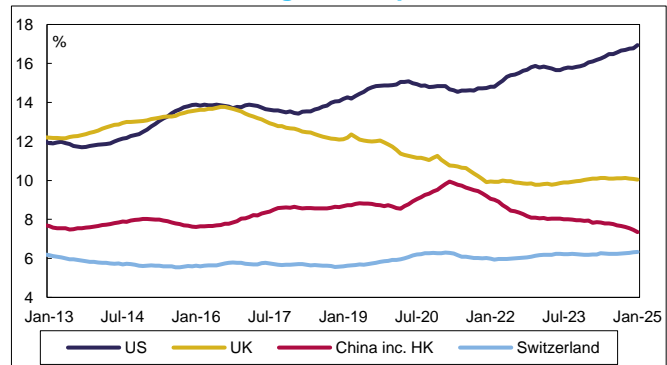
\*Subject to Section 232 tariffs and exempt from reciprocal tariffs. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**Euro area: Country contributions to export growth**



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**Euro area: Shares of goods exports**



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

# UK

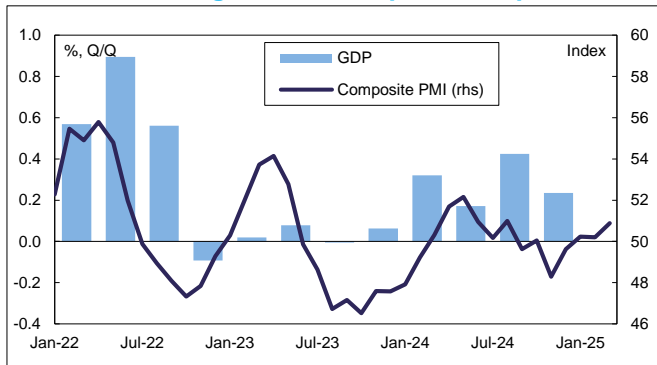
## Baseline ‘reciprocal’ tariffs will be growth- and inflation-negative

Given its broadly balanced goods trade position with the US, UK exports were assigned the 10% baseline ‘reciprocal’ tariff rate. However, as for the euro area, the US – which accounts for about 15% of UK goods exports – has been the most reliable UK export market over recent years, particularly as demand from the EU has been hit by Brexit-related trade barriers. So, if implemented, the new tariffs will be significantly growth-negative, perhaps wiping out in full the ¾%Y/Y increase in GDP that features in our baseline. And with the UK government less inclined to take retaliatory tariff action than the EU, and sterling firmer, the MPC might be more confident than the ECB that US trade policy will have a net negative impact on the inflation outlook. Certainly, recent developments increase our confidence that the BoE will cut rates three more times this year.

## Firms see inflation rising over the near term, but medium-term expectations remain anchored

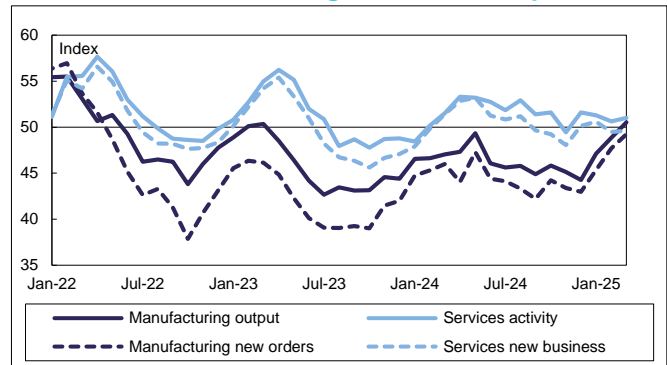
As in the euro area, at least the PMIs suggested that UK economic activity was looking a little more resilient to shocks ahead of the ‘reciprocal’ tariff announcement. While today’s final services activity PMI was downwardly revised from the flash, at 52.5, it still marked a seven-month high to suggest that economic growth continues to be services-led. Indeed, despite a disappointing manufacturing survey, the composite PMI rose 1pt in March to a five-month high of 51.5. Admittedly, this left the quarterly average in Q1 (50.9) little changed from that in Q4. However, given the positive carry-over from the strength of economic activity in December, we continue to expect growth to accelerate to 0.3%Q/Q in Q1. Meanwhile, the inflation-related PMIs suggested a further moderation in pressures in prices charged in March. And today’s BoE Decision Maker Panel survey suggested that, for now at least, firms’ medium-term inflation expectations remain well contained. Admittedly, CPI expectations one year ahead rose a further 0.3ppt in March to 3.4%Y/Y, a 14-month high and roughly ½ ppt above the average over the past 12 months. And expected CPI three years ahead rose to the highest in 16 months. But smoothing for monthly volatility, it was steady at 2.8%3M/Y for a third consecutive month, still consistent with anchored expectations. Moreover, amid a further slowdown in employment growth, businesses reported the softest pay growth (5.0%3M/Y) since mid-2022, with expectations for a further moderation over the coming twelve months to 3.9%3M/Y.

**Euro area: GDP growth & composite output PMI**



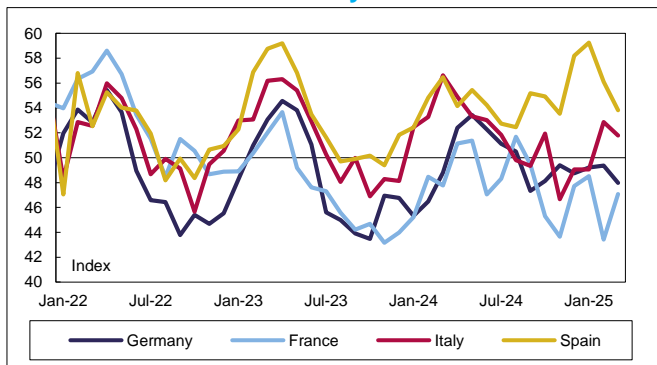
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

**Euro area: Manufacturing & services output PMIs**



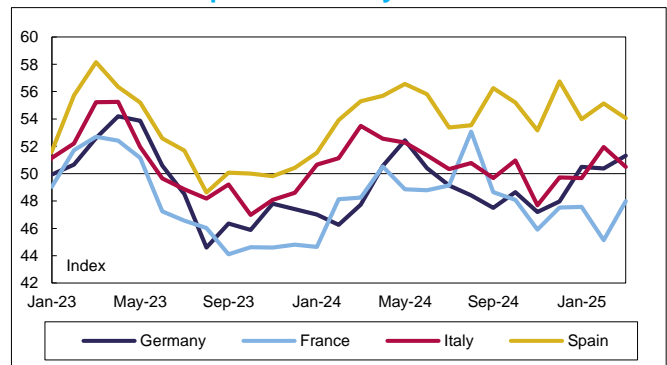
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

**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**

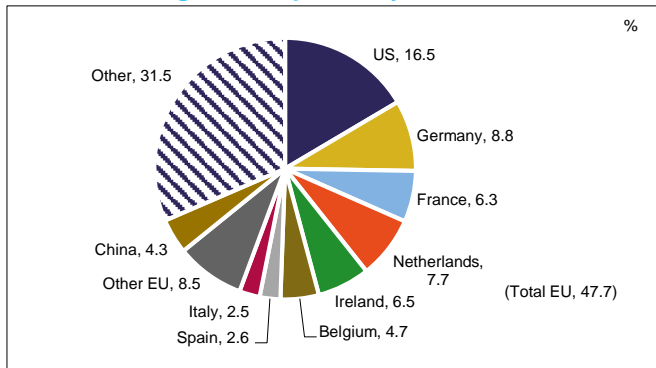


Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

### The day ahead in the UK

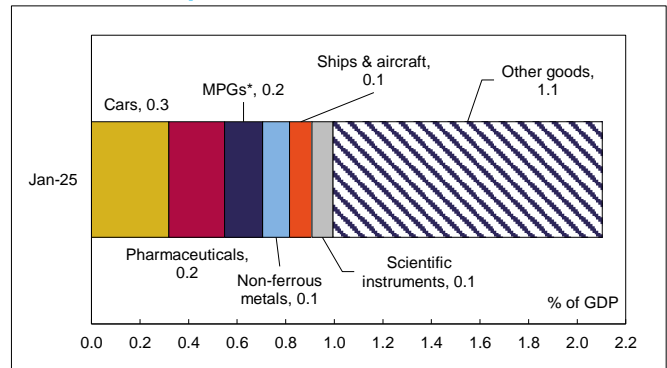
It will be a mostly quiet end to the week for UK dataflow, with March’s construction PMIs and new car registrations the sole releases. Following 10 months of expansion last year, the UK construction sector reportedly shrunk for a second consecutive month in February, with the total activity index contracting the most since the pandemic in May 2020 (44.6). March’s survey is expected to be less downbeat, with housebuilding activity – having itself slowed the most in more than four years (39.3) in February – particularly exposed to any potential upside after additional investment pledges were laid out in last month’s Spring Statement.

#### UK: Share of goods exports, by destination



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

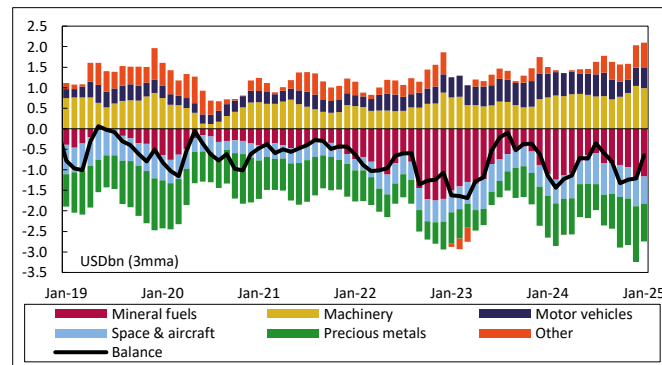
#### UK: Goods exports to US, % of GDP



\*Mechanical Power Generators.

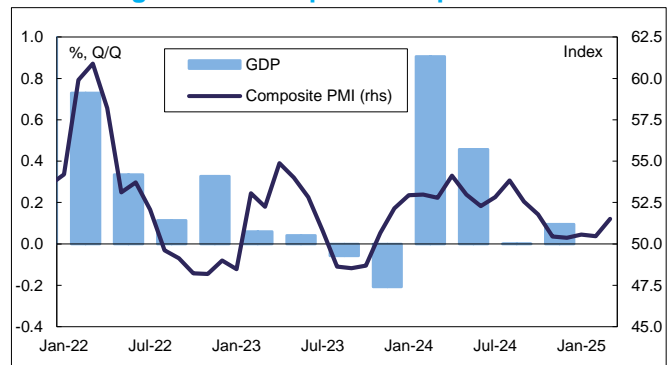
Source: ONS, Macrobond and Daiwa Capital Markets Europe Ltd.

#### UK: Goods trade balance with the US



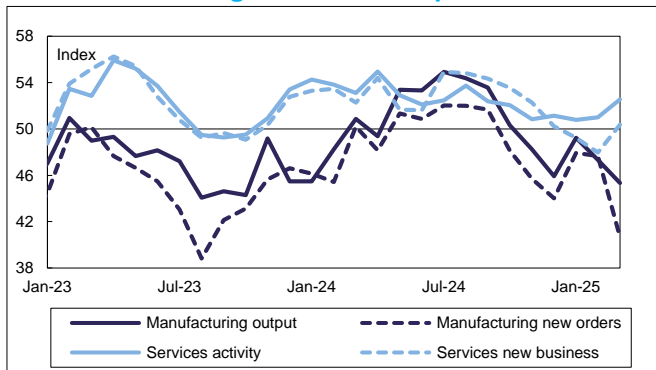
Source: US Census Bureau, Macrobond and Daiwa Capital Markets Europe Ltd.

#### UK: GDP growth & composite output PMI



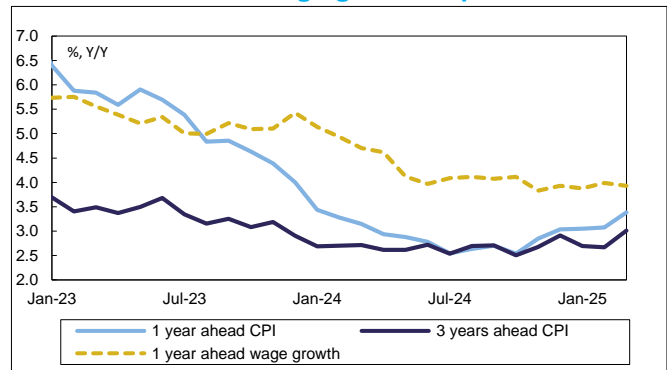
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

#### UK: Manufacturing & services output PMIs



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

#### UK: Firms' CPI and wage growth expectations



Source: Macrobond, BoE DMP survey 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 composite (services) PMI	Mar	<b>50.9 (51.0)</b>	<u>50.4 (50.4)</u>	50.2 (50.6)	-
	PPI Y/Y%	Feb	<b>3.0</b>	3.0	1.7	-
Germany	Final composite (services) PMI	Mar	<b>51.3 (50.9)</b>	<u>50.9 (50.2)</u>	50.4 (51.1)	-
France	Final composite (services) PMI	Mar	<b>48.0 (47.9)</b>	<u>47.0 (46.6)</u>	45.1 (45.3)	-
Italy	Composite (services) PMI	Mar	<b>50.5 (52.0)</b>	51.5 (52.5)	51.9 (53.0)	-
Spain	Composite (services) PMI	Mar	<b>54.0 (54.7)</b>	54.3 (55.5)	55.1 (56.2)	-
UK	DMP 3M output price (1Y CPI) expectations %	Mar	<b>3.9 (3.4)</b>	-	4.0 (3.1)	-
	Final composite (services) PMI	Mar	<b>51.5 (52.5)</b>	<u>52.0 (53.2)</u>	50.5 (51.0)	-

#### Auctions

Country	Auction
France	sold €3.446bn of 3.5% 2033 bonds at an average yield of 3.19%
	sold €2.62bn of 3.2% 2035 bonds at an average yield of 3.37%
	sold €5.93bn of 3.75% 2056 bonds at an average yield of 4.04%
Spain	sold €3.1bn of 2.4% 2028 bonds at an average yield of 2.292%
	sold €600m of 3.1% 2031 bonds at an average yield of 0.7%
	sold €1.67bn of 3.9% 2039 bonds at an average yield of 2.809%
	sold €1.48bn of 1% 2030 inflation-linked bonds at an average yield of 3.655%
UK	sold £3.25bn of 4.375% 2040 bonds at an average yield of 4.917%

### Wednesday's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Spain	Unemployment (net employment) change 000s	Mar	<b>-13.3 (23.1)</b>	-	-6.0 (58.7)	-

#### Auctions

Country	Auction
Germany	sold €3.42bn of 2.5% 2035 bonds at an average yield of 2.68%
UK	sold £1.6bn of 1.125% 2035 inflation-linked bonds at an average yield of 1.268%

### Tomorrow's releases

#### Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	08.30	Construction PMI	Mar	-	42.7
Germany	07.00	Factory orders M/M% (Y/Y%)	Feb	3.4 (1.5)	-7.0 (-2.6)
	08.30	Construction PMI	Mar	-	41.2
France	07.45	Industrial production M/M% (Y/Y%)	Feb	0.5 (-1.3)	-0.6 (-1.6)
	08.30	Construction PMI	Mar	-	39.8
Italy	08.30	Construction PMI	Mar	-	48.2
	09.00	Retail sales M/M% (Y/Y%)	Feb	-	-0.4 (0.9)
Spain	08.00	Industrial production M/M% (Y/Y%)	Feb	-	-1.0 (-1.0)
UK	09.00	New car registrations Y/Y%	Mar	-	-1.0
	09.30	Construction PMI	Mar	46.3	44.6

#### Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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