Daiwa Capital Markets

Euro wrap-up

Overview

- While surveys suggested that banks are tightening credit standards and investors are again downbeat about Germany's economic outlook, Bunds made losses as euro area IP rose the most in six months while firms attempted to front-load production and exports ahead of US tariff hikes.
- While UK pay growth remained elevated, Gilts made gains as the number of payrolled employees fell the most since the initial pandemic slump and job vacancies declined to a four-year low.
- Wednesday will bring March inflation figures from the euro area and UK.

Economic Research Team
+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	1.759	+0.008
OBL 2.4 04/30	2.087	+0.016
DBR 2½ 02/35	2.530	+0.023
UKT 3¾ 03/27	3.952	-0.053
UKT 4⅜ 03/30	4.106	-0.044
UKT 4½ 03/35	4.646	-0.016

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

Euro area

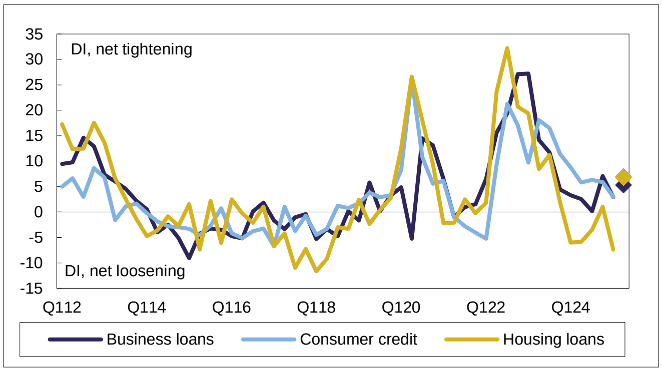
Banks tighten credit standards on business loans & expect to do so again this quarter

With the ECB having cut rates steadily since last June to levels that it no longer judges to be particularly restrictive, bank lending has picked up, albeit only very gradually. While growth in both components was the strongest since H123, loans to households and non-financial corporations were growing relatively modestly (and below the rate of inflation) at just 1.4%Y/Y and 2.2%Y/Y respectively in the middle of Q1. Moreover, today's ECB Bank Lending Survey (BLS) reported that, on average, banks in the euro area continued to tighten their credit standards on loans to businesses last quarter. Admittedly, the extent of the tightening of loan standards was modest and less than had been anticipated at the end of last year. But banks also signalled an expectation to tighten standards on loans to firms a touch further this quarter. They also reported a modest further tightening on consumer credit standards, and similarly expect to tighten those standards again this quarter. And while standards on loans for house purchase were loosened somewhat in Q1, most of that relaxation is expected to be reversed in Q2. Banks also reported a slight drop in demand for business loans last quarter. But with rates now at levels that almost 90% of banks believe is no obstacle to loan demand, they expected that decline to be reversed in Q2. Banks also expect demand for consumer credit and, particularly, loans for house purchase to grow in the current quarter, albeit at a slower pace than in Q1. So, the BLS neither stands as an obstacle to further easing, nor compels the ECB to cut rates again.

Investor perceptions of the German outlook fall off a cliff on tariff announcements

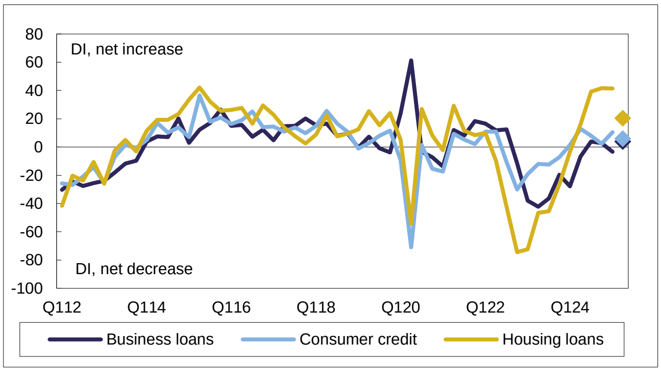
Unlike the BLS, however, today's ZEW investor survey strongly supported the case for further ECB monetary easing. The prospect of increased German public spending on infrastructure and defence had last month given a marked boost to investor perception of the German economic outlook. Indeed, the ZEW German expectations index rose in March by more than 25pts – a magnitude rarely seen on the series – to the highest level (51.6) since the Russian invasion of Ukraine. Just one month later, US tariffs have trashed sentiment. Just as the Sentix survey last week suggested that investor confidence in the German economic outlook deteriorated the most on the series in April to a 17-month low, the ZEW German expectations index dropped to a 21-month low (-14.0), with the month-on-month decline the sharpest in that series outside of the energy crisis in early 2022. The ZEW index of perceptions of current conditions admittedly improved slightly to an eight-month high (-81.2). But it remained heavily downcast relative to its pre-pandemic trend with less than 1% of respondents assessing current economic conditions as 'good'. The sectoral detail also made for grim viewing, with the deterioration in firms' profit assessments broad-based but predictably most severe within manufacturing sectors exposed to the tariff shocks. Autos and steel manufacturers – both subjected to targeted, and relatively higher, average US tariff rates – were most clearly affected, with the profit assessment in the former (-76.5) its worst since January 2009 with the exception of the initial pandemic slump in March 2020. The outlook for steel and chemicals producers was also the weakest since late-2022. The outlook for sectors only indirectly affected by the announcements to-date, including services, utilities, and construction, were also revised down.

Euro area: BLS survey – credit standards



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

Euro area: BLS survey – loan demand

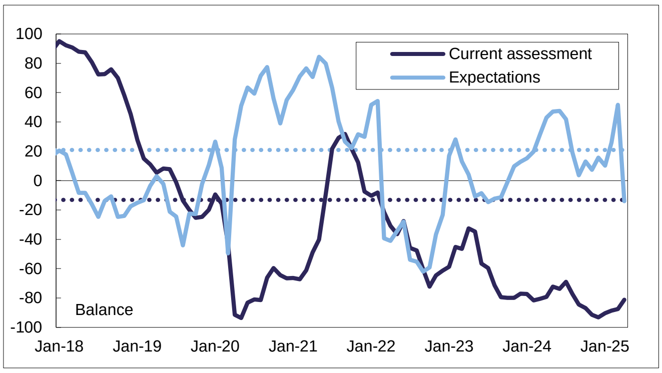


Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area industrial production rises to highest level since 2023 amid front-loading

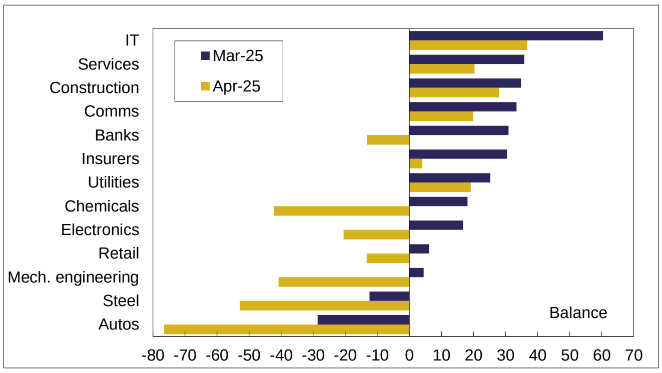
In terms of economic activity, today's data reinforced the view that industrial output supported GDP growth in Q1 for the first quarter in eleven as certain manufacturers attempted to front-load production and exports ahead of US tariff hikes. Indeed, euro area IP rose for the third month in four in February, by 1.1%M/M – the most in six months – to the highest level since end-2023. This left output up 1.2%Y/Y and trending in the first two months of the year some 0.7% above the Q4 average. The improvement in February reflected a surge in Ireland (10.8%M/M) and Belgium (7.4%M/M), driven by large increases in output from pharmaceutical firms. Indeed, today's Irish trade figures showed exports of pharmaceutical products surged 146%Y/Y in February, with total goods exports up 54%Y/Y and those to the US up a whopping 210%Y/Y. Across the euro area as a whole, production from the pharma industry rose 10.4%M/M to be trending so far in Q1 some 4% above the Q4 level. Meanwhile, chemicals production rose to a six-month high in February, while food manufacturing was trending almost 2% above the Q4 average. But despite rising in February, output of ICT equipment and autos was tracking below the Q4 average, while machinery fell to the lowest level for more than four years. And with machinery and autos jointly accounting for around a fifth of euro area goods exports to the US, we expect output to weaken further over the second quarter, while there will be substantial payback in production of pharmaceutical products, which account for the largest share (also about one fifth) of shipments to the US.

Germany: ZEW sentiment survey



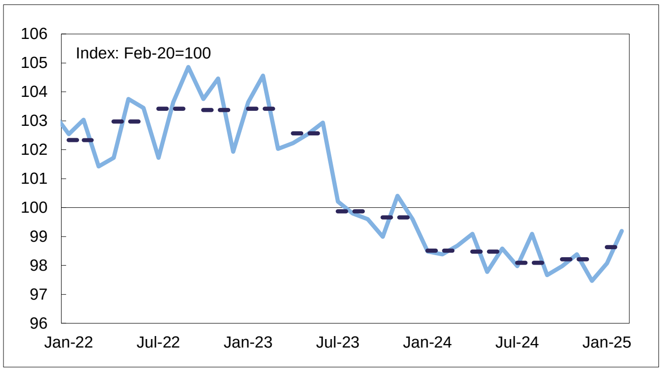
Dotted lines show series averages.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ZEW – profit expectations by sector



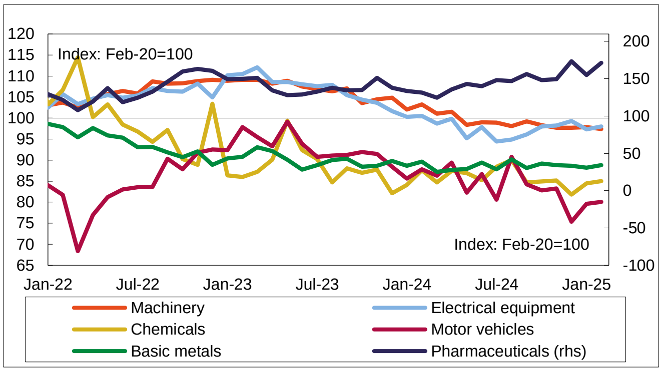
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production*



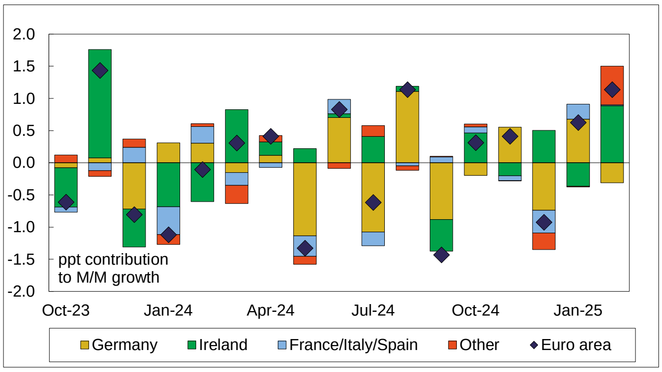
Dashed lines represent quarterly average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing production



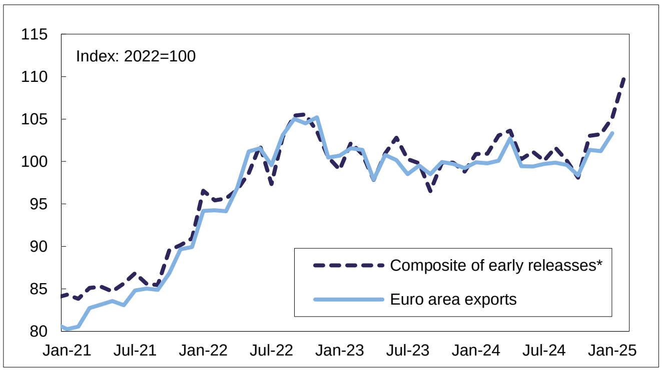
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods exports



**Based on German, French and Irish data. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

The day ahead in the euro area

With final estimates of inflation in March from some of the most important member states broadly aligning with their flash estimates, tomorrow's euro area HICP detail will surely too confirm that headline inflation edged down (by 0.1ppt) last month to a five-month low of 2.2%Y/Y. The full component detail with the release will likely show that, in spite of ongoing food price pressures, lower energy prices and more notable moderation in services categories drove that decline. Indeed, that preliminary services print – at 3.4%Y/Y, its softest since June 2022 – led core inflation to just 2.4%Y/Y, down 0.2ppt on February and its lowest since before Russia's invasion of Ukraine. Perhaps more importantly in the context of Thursday's Governing Council meeting, the detail will also offer clues about the extent to which disinflation might be attributed to the later timing of Easter as national releases highlighted the softness in more volatile categories such as package holidays and transport services. Regardless, with the inflation outlook dulled by cratering oil and gas prices, a strong euro, and mounting downside risks to euro area (and global) GDP growth, any nasty surprises in the data are unlikely to deter the Governing Council from another 25bps cut on Thursday.

UK

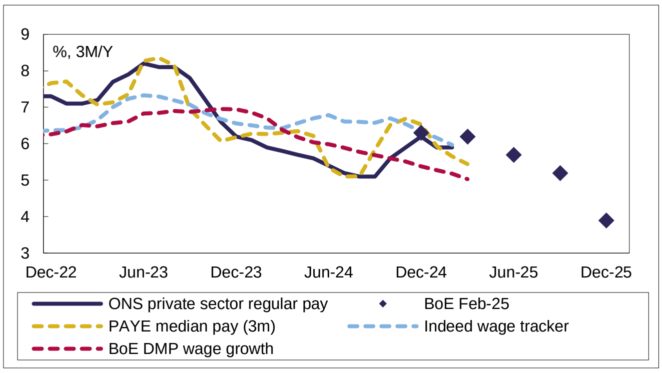
Wage growth remains unchanged at elevated rate in February

Coming on the back of Friday's strong GDP print, today's wage data reinforced our view that the majority on the MPC will likely vote at its next scheduled meeting on 8 May for a further cut of no greater than 25bps in Bank Rate and maintain that a 'gradual and careful' approach to the further withdrawal of monetary restrictiveness remains appropriate. In particular, total wage growth (including bonuses) moved sideways at 5.6%3M/Y in the three months to February. A moderation in total private sector pay (down 0.2ppt to 5.6%3M/Y) was offset by a rise in public sector pay growth to a nine-month high (5.7%3M/Y). Meanwhile, when excluding bonuses, total regular pay grew 5.9%3M/Y in February, up 0.1ppt from January and the joint-highest for 11 months. And, adjusting for inflation, real wage growth – both total and regular – remained close to 2%3M/Y, double the long-run average.

But private regular pay growth below BoE's expectation with momentum slowing

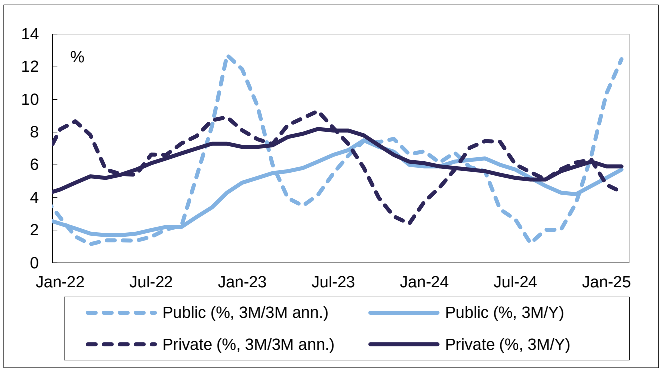
But despite an acceleration in rates in hospitality (up 0.9ppt to 6.8%3M/Y), private regular pay growth – the measure closely watched by the MPC for domestic inflationary pressures – was unchanged at January's downwardly revised rate of 5.9%3M/Y. And while this was still more than double the pre-pandemic average and inconsistent with achieving the 2% inflation target over the medium term, it was nevertheless 0.3ppt below the BoE's end-Q125 projection published in

UK: Measures of wage growth



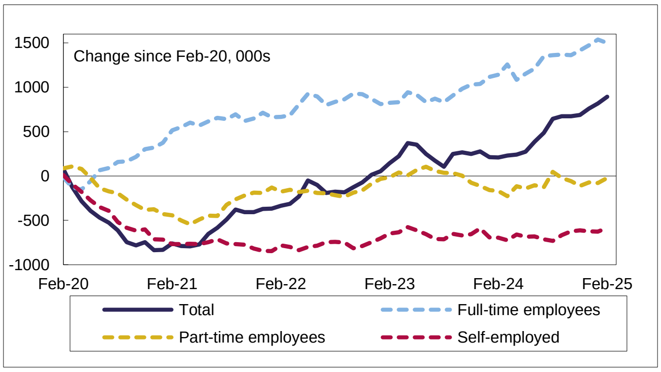
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Regular pay growth



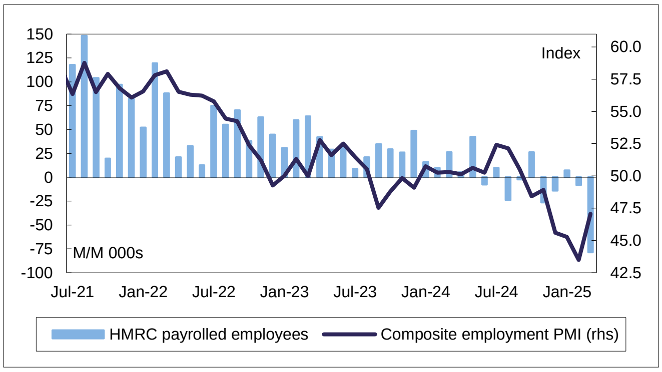
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: LFS measure of employment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: HMRC payrolled employees & employment PMI



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

February. Moreover, momentum on this measure has recently slowed, with the three-month annualised growth rate down a further ½ppt to 4.3%3M/3M, the softest since January 2024, while the six-month annualised growth rate (2.7%6M/6M) eased to an eight-month low. The HMRC's figure for median pay also suggested a further moderation in March, with growth slowing to a seven-month low of 5.4%3M/Y, while the BoE's DMP survey suggested that growth (5.0%3M/Y) was the softest for almost three years. And, notwithstanding the increase in the National Living Wage in April, the DMP survey and REC report on jobs still suggest that pay growth will moderate further over the coming year, with weakening labour demand in the current uncertain economic environment likely to constrain wage bargaining.

Mixed jobs data add to uncertainty about degree of tightness

Despite rising labour costs for businesses and signals of a desire to cut headcount since the start of the year, the job market appears to have remained remarkably resilient, at least according to the Labour Force Survey (LFS). Indeed, the LFS measure of employment rose a larger-than-expected 206k in the three months to February, the most in five months. This left total employment up 683k (2.1%) compared with a year earlier, the most in almost three years. Admittedly, the annual rate was flattered by base effects. And importantly, the reliability of these data remains questionable due to the low survey response rate. Certainly, the HMRC measure of payrolled employees painted a markedly different picture, reporting a fourth monthly drop out of the past five in March (-78k) and the steepest since the initial pandemic slump. This took the number of payrolled employees to a 16-month low and some 70k (0.2%) lower than a year earlier. The recent decline has been largest in the hospitality and wholesale and retail subsectors, which together accounted for two-thirds of the near-120k drop over the past five months and perhaps in part reflects the impact of the hike in the National Living Wage in April. But manufacturing headcount on this measure also fell to the lowest since mid-2021. While the HMRC numbers are subject to revisions, these broadly tally with the steady downtrend in the number of job vacancies, which fell in March to a near-four-year low. So, while the unemployment rate held steady at 4.4% for a fourth successive month, the ratio of the number of unemployed people per job vacancy remained comfortably below levels ahead of the pandemic, supporting the view that labour market tightness continues to gradually ease.

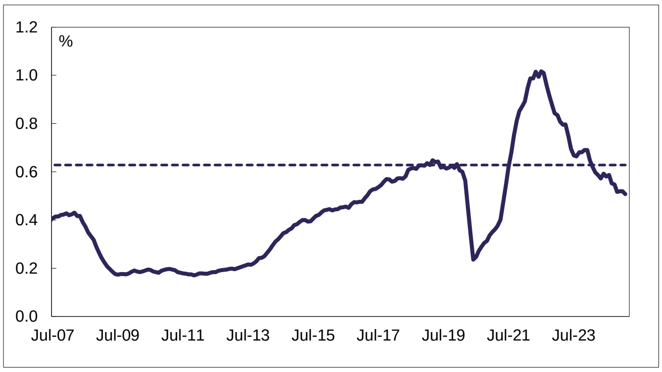
BRC retail sales growth measure moderates in March but underlying demand looks firm

Last Friday's GDP data for February strongly suggested that UK economic output grew ½ppt or more in Q1. A contributor to that solid growth was the retail sector, where sales volumes were trending roughly 1½% above the Q4 level in the first two months of Q1. And today's BRC survey results suggested that underlying demand on the high street remained firm in March. Admittedly, headline total sales growth in nominal terms was unchanged at 1.1%Y/Y, some 0.5ppt below the three-month average rate and almost 2½ppts below the rate a year earlier. However, the figure for March 2024 was flattered by the early timing of Easter, and so we expect a notable acceleration in the BRC sales indices in April. According to today's survey results, food sales last month were up 2.3%3M/Y with non-food sales up just 0.6%3M/Y. While sales of big-ticket items such as furniture reportedly remained subdued, sunny weather contributed to an acceleration at the end of the month in other items such as garden-related equipment. In terms of shop prices, the BRC measure of inflation picked up 0.3ppt to -0.4%Y/Y in March, with the food measure up 0.3ppt to a nine-month high of 2.4%Y/Y and the non-food measure up 0.2ppt to -1.9%Y/Y. As a result, the BRC measure of real retail sales volume growth moderated 1.0ppt to a still-respectable 2.2%3M/Y.

The day ahead in the UK

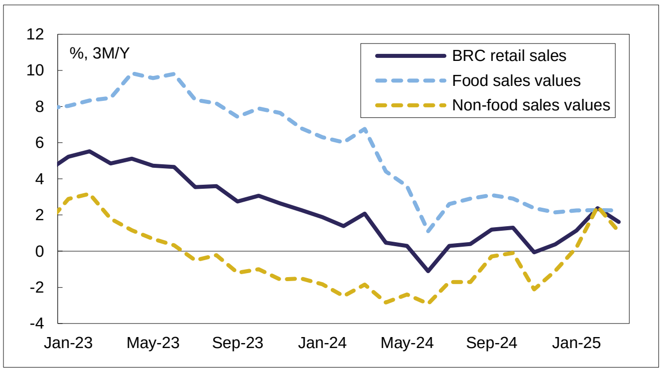
Like in the euro area, all eyes in the UK tomorrow will turn to March's CPI report. Despite some resistance in services components and higher food inflation in February, headline and core inflation measures were each 0.2ppt softer, at 2.8%Y/Y and 3.5%Y/Y respectively. And we expect March's print to extend that moderating trend, with a step-down in services to potentially spur a further 0.1ppt fall in core inflation (to 3.4%Y/Y). That, as well as lower petrol prices, should also retain scope for a further 0.2ppt decline in headline CPI that month, to 2.6%Y/Y, marking a slight undershoot of the BoE's projections (by 0.1ppt) before inflation takes a step-up in April as administered prices and tax changes came into effect.

UK: Vacancies to unemployment ratio*



**Dashed line represents 2019 average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

UK: BRC retail sales monitor



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		Industrial production M/M% (Y/Y%)	Feb	**1.1 (1.2)**	*0.7 (0.0)*	0.8 (0.0)	0.6 (-0.5)
Germany		ZEW current situations (expectations) balance	Apr	**-81.2 (-14.0)**	-86.9 (10.0)	-87.6 (51.6)	-
France		Final HICP (CPI) Y/Y%	Mar	**0.9 (0.8)**	*0.9 (0.8)*	0.9 (0.8)	-
UK		Average wages (excluding bonuses) 3M/Y%	Feb	**5.6 (5.9)**	5.7 (6.0)	5.8 (5.9)	5.6 (5.8)
		Private sector regular wages 3M/Y%	Feb	**5.9**	6.0	6.1	5.9
		Unemployment rate 3M%	Feb	**4.4**	4.4	4.4	-
		Employment 3M/3M change 000s	Feb	**206**	170	144	-
		Payrolled employees M/M change 000s	Mar	**-78**	-15	21	-8
		Claimant count rate % (change 000s)	Mar	**4.7 (18.7)**	-	4.7 (44.2)	4.6 (16.5)
		BRC retail monitor – like-for-like sales Y/Y%	Mar	**0.9**	0.6	0.9	-

Auctions

Country		Auction
Germany		sold €3.55bn of 2.4% 2030 bonds at an average yield of 2.06%
UK		sold £4bn of 4.5% 2035 bonds at an average yield of 4.638%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK		Rightmove house prices M/M% (Y/Y%)	Apr	**1.4 (1.3)**	-	1.1 (1.0)	-

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/ *Daiwa forecast*	Previous
Euro area		09.00	Current account balance €bn	Feb	-	35.4
		10.00	Final headline (core) HICP Y/Y%	Mar	*2.2 (2.4)*	2.3 (2.6)
Italy		09.00	Final HICP (CPI) Y/Y%	Mar	*2.1 (2.0)*	1.7 (1.6)
UK		07.00	Headline (core) CPI Y/Y%	Mar	*2.6 (3.4)*	2.8 (3.5)
		09.30	House price index Y/Y%	Feb	-	4.9

Auctions and events

Germany		10.30	Auction: to sell up to €1.5bn of 2.9% 2056 bonds
		10.30	Auction: to sell up to €1bn of 0% 2052 bonds
UK		10.00	Auction: to sell £1.5bn of 0.125% 2028 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
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