Euro wrap-up

Overview

Chris Scicluna +44 20 7597 8326

Emily Nicol +44 20 7597 8331

- Bunds made losses while the flash euro area PMIs beat expectations but nevertheless signalled stagnation in April and rising pessimism about the economic outlook.
- Despite a deterioration in the UK PMIs, shorter-dated Gilts made losses as higher-than-expected public sector borrowing saw the DMO revise its financing remit for FY25 with extra issuance skewed to the short end of the curve.
- Thursday will bring the April results from the German ifo business, French consumer and UK CBI industrial trends surveys.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	1.740	+0.085
OBL 2.4 04/30	2.046	+0.067
DBR 2½ 02/35	2.494	+0.055
UKT 3¾ 03/27	3.899	+0.084
UKT 4⅜ 03/30	4.029	+0.060
UKT 4½ 03/35	4.549	+0.003

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

Euro area

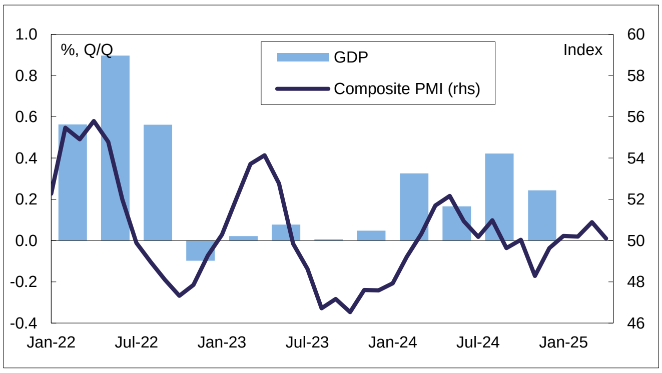
Flash PMIs point to stagnation at start of Q2 amid new US tariffs and ongoing uncertainties

Despite new US tariffs, persisting uncertainty surrounding future trade relations and heightened geopolitical risks, today's flash PMIs suggested that euro area economic activity held up relatively well at the start of Q2. As expected, the headline composite PMI fell in April, with the 0.8pt decline more than reversing the increase in March to take the index to a four-month low of 50.1. But this was a touch above the average in the past 12 months and merely consistent with private sector activity tracking sideways rather than contracting. Indeed, it was only a fraction below the average in Q1 (50.4), when production was given a boost by an apparent front-loading of shipments to the US (see below) and we think euro area GDP grew a respectable 0.3%Q/Q. And despite the increased US trade barriers, the April manufacturing output PMI (51.2) signalled the strongest growth in the sector since May 2022, with the new export order index similarly the highest in three years. This helped to offset renewed weakness in the services sector. Consistent with the deterioration in consumer confidence reported yesterday, the services activity PMI (49.7) fell to a five-month low in April, more than 1pt below the Q1 average. The weakness was reportedly led by the steepest decline in German activity in the sector in 14 months. And overall, the German composite PMI fell 1.6pts – the most in ten months – to 49.7, a four-month low, but nevertheless broadly in line with the average of the past 12 months and consistent with broadly stagnant output. Despite slipping back in April, the French composite PMI (47.4) was some 0.5pt higher than the Q1 average, albeit suggestive of falling GDP. But the respective index for the rest of the euro area (52.3) pointed to ongoing expansion, broadly in line with the average pace of the past year.

Rising pessimism about the outlook and easing price pressures support case for further rate cuts

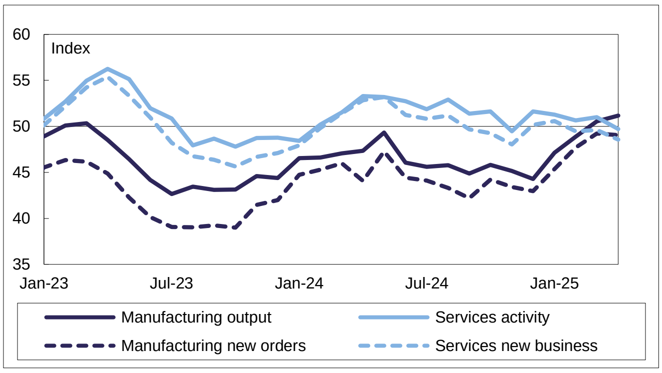
While today's survey suggests that overseas demand for euro area exports was boosted by the 90-day postponement of the higher 20% US 'reciprocal' tariff, the overall factory orders index remained in contractionary territory to suggest no material boost to underlying demand. With new services business also having weakened further, firms in both major sectors were unsurprisingly more downbeat about the year ahead, with the respective expectations index down some 4pts to a 2½-year low firmly below the long-run average. So, having reportedly risen in March for the first time in eight months, the flash PMIs pointed to a sideways move in employment, consistent with ongoing moderation in pay growth. Certainly, the updated ECB wage tracker published today continued to indicate that negotiated wage growth will slow sharply over coming quarters, to end the year close to 1½%Y/Y and below 3%Y/Y excluding one-off payments. The ECB will also note better news with respect to price pressures in today's PMIs. Due to lower energy prices, manufacturing input costs fell sharply in April to a six-month low. And while still above the long-run average, easing input costs and softer demand saw selling prices in the services sector fall to the lowest in seven months, which will give the Governing Council further scope to cut interest rates further to support the economy if and when it weakens over coming months.

Euro area: GDP growth & composite PMI



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

Euro area: Services & manufacturing output PMIs

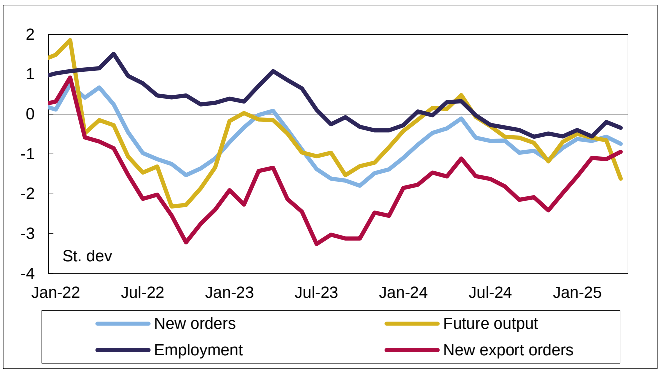


Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area goods exports to the US jump as manufacturers try to front-run tariff hikes

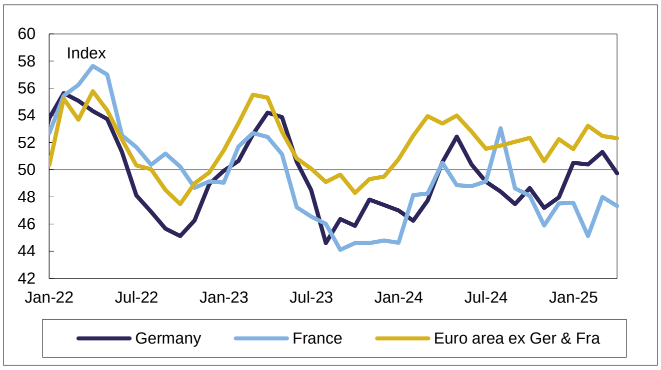
The boost to GDP in Q1 from the front-loading of production and shipments was illustrated by today's goods trade data, which saw the euro area's surplus widen notably in February by €6.5bn to €21.0bn, a 13-month high. This was led by a second successive increase in the value of exports (4.5%M/M) to be some 10% higher than in October. The increase was driven by a further rise in shipments of chemicals & pharmaceuticals (15%M/M). And while the pickup in exports was widespread across trading partners, shipments to the US rose a further 9½%M/M in February to be up a hefty 30%Y/Y and trending in the first two months of Q1 some 15½% above the Q4 average. Exports also jumped to Switzerland (30%Y/Y) and Japan (19%Y/Y), but were up a more modest 2½%Y/Y to the UK and still down on a year earlier to China (-1%Y/Y). Overall, total goods export values were trending some 5½% above the Q4 average. With imports up just 2.7% on the same basis, net goods trade likely provided a significant contribution to Q1 GDP growth. Meanwhile, euro area construction activity fell in February (-0.5%M/M). But it was still trending almost 1% higher than in Q4, suggesting that the sector also probably boosted economic growth for a second successive quarter in Q1.

Euro area: Selected composite PMI components



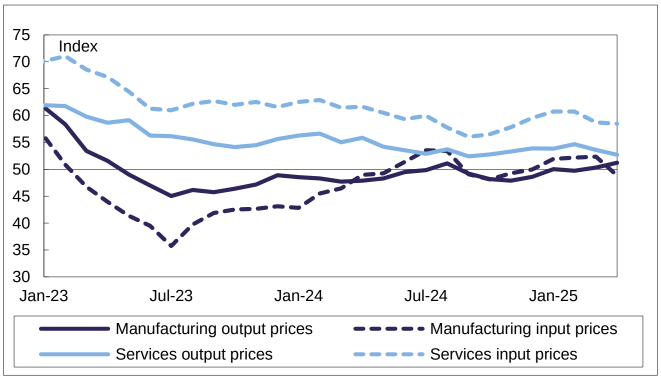
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Composite output PMIs by member state



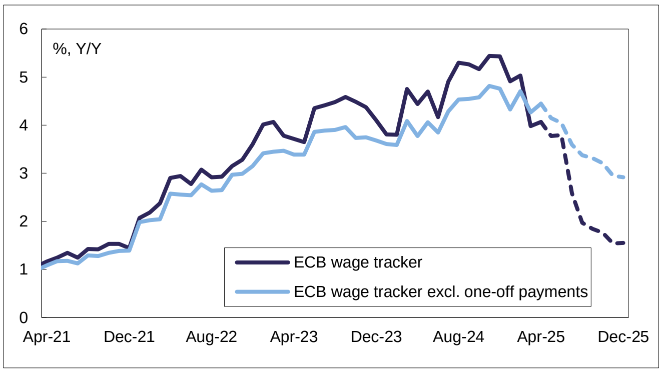
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing & services price PMIs



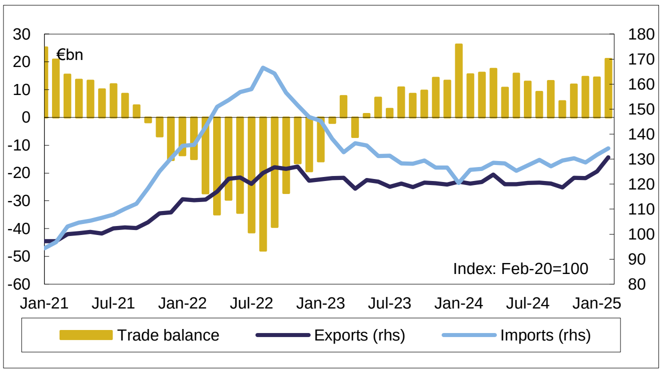
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: ECB wage tracker*



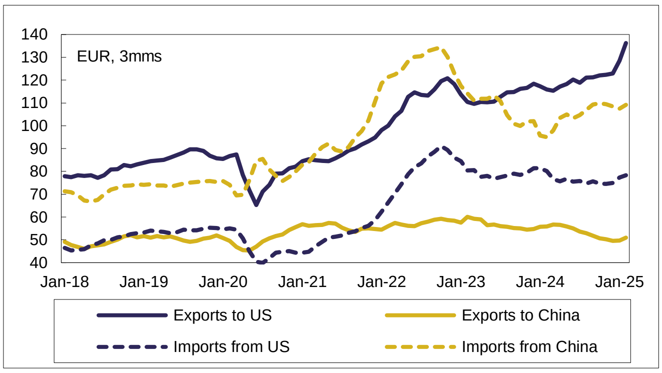
**Dashed lines are forward-looking paths based on active collective bargaining agreements. Source: Macrobond, ECB and Daiwa Capital Markets Europe Ltd.*

Euro area: Goods trade balance



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods exports & imports to US & China



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

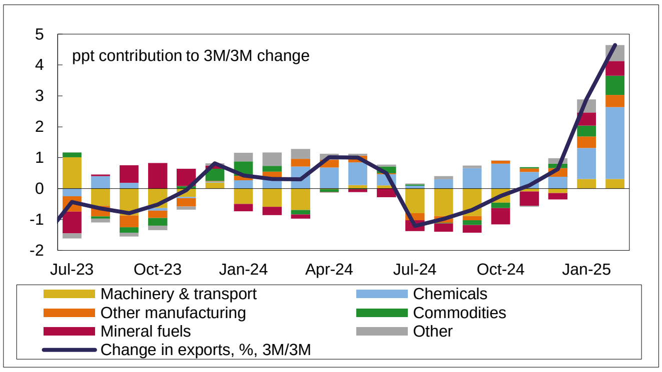
Tomorrow's new data releases will provide a cross-check on today's PMIs, with the German ifo business survey likely to flag a broad-based deterioration in conditions in April. Indeed, having risen to an eight-month high in March as the government agreed to boost public spending on military and infrastructure, we expect the manufacturing business climate index to fall this month, with greater pessimism with respect to the coming six months as higher US tariffs hit sentiment. And, like today's PMIs, we expect the ifo survey to suggest that conditions in services as well as retailing weakened amid the deterioration in consumer confidence. Tomorrow will also bring the results of the latest French INSEE consumer confidence survey, which will likely signal a greater preference to save than spend due to increased job insecurity.

UK

Flash UK PMIs fell sharply in April to signal contraction for the first time in 18 months

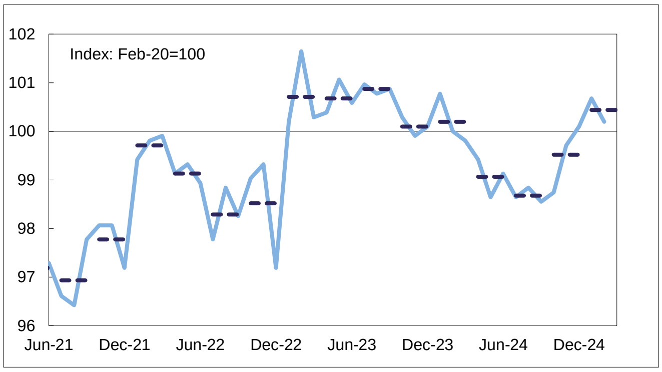
In contrast to the euro area, the flash UK PMIs were much weaker than expected in April, raising expectations that the economy will contract this quarter. In particular, the headline composite PMI fell a chunky 3.3pts – the most since May 2022 – to 48.2 in April, the first sub-50 contractionary reading in 18 months and the lowest since November 2022. This left the index almost 4pts below the average in the previous twelve months and at a level that in the five years before the pandemic would have implied a contraction in GDP of around ½%Q/Q. Of course, the PMIs have not always been a reliable guide to UK economic growth over recent years and failed to fully capture the likely strength in Q1. Indeed, not least supported by some front-loading of production ahead of US tariff hikes, we forecast GDP growth to have accelerated 0.6%Q/Q last quarter. If so, it would not be a surprise to see some modest pullback in Q2. Certainly, today's PMIs suggested that the impact of weaker global growth prospects had hit demand in both the manufacturing and services sectors at the start of Q2. Perhaps inevitably, the weakness was more striking in manufacturing, with the output index falling for the eighth month out of the past nine to signal the steepest contraction since August 2022. And while the new factory orders index edged up slightly, it remained some 10pts below the long-run average and firmly in contractionary territory, with the export orders index the weakest since the global financial crisis outside of the initial Covid-lockdown period. Services firms also attributed rising global growth risks and subdued domestic demand to the slump in the activity index (down 3.6pts to 48.9), which ended a 17-month period of expansion. And given significant economic uncertainties ahead, firms in both services and manufacturing reported a marked deterioration in business expectations, with the monthly drop in the respective index the largest since March 2020 and the Brexit referendum in July 2016 before that.

Euro area: Goods exports growth by selected sector



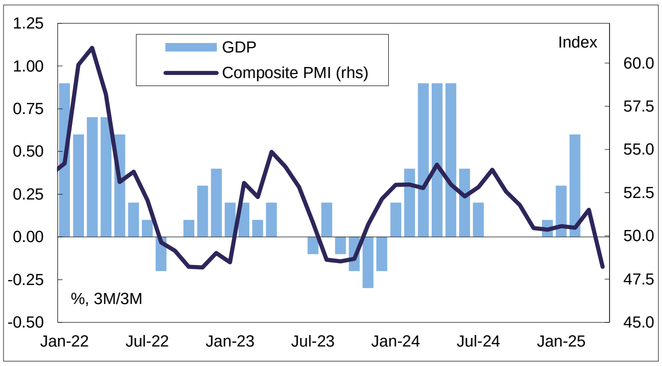
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction activity*



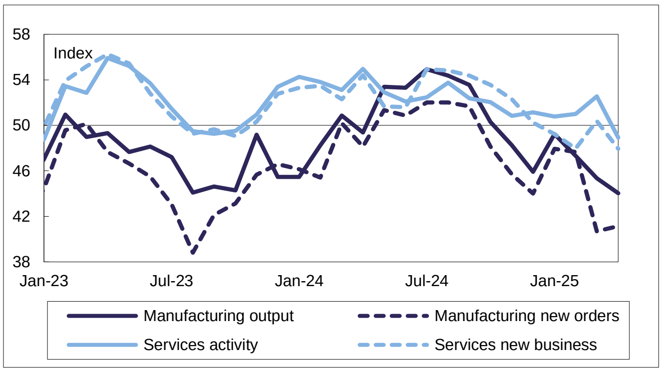
**Dashed dark blue lines represent quarterly average.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

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.

Price PMIs boosted by April's increase in NICs and minimum wages

While the deterioration in the flash PMIs this month might bolster the case for a 50bps rate cut at the BoE's next policy meeting on 8 May, we think that the majority on the MPC will still favour a 25bps cut, not least due to the strength in economic activity at the start of the year. And while today's employment PMI implied ongoing cuts to headcount, signals on the labour market have been mixed. Policymakers will also be wary about the potential inflationary impact of the increase in employer National Insurance Contributions and the minimum wage at the start of this month. Indeed, today's survey reported a further notable increase in input costs in both the major sectors in April, to leave the composite price index at the highest for almost two years. So, despite softening demand, firms also reportedly increased their selling prices this month by the most since May 2023.

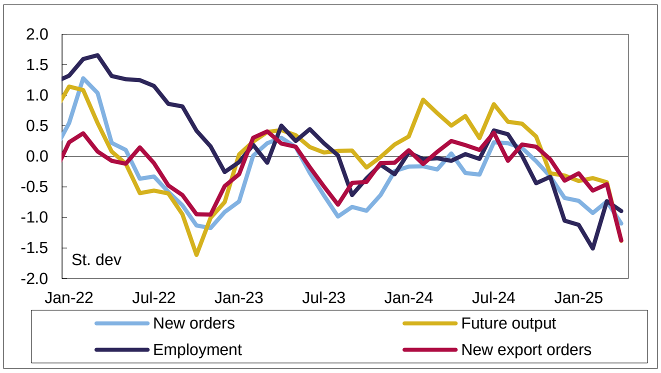
DMO revises financing remit for FY25 with extra issuance skewed to the short end of the curve

The Debt Management Office's (DMO's) net financing remit (NFR) for the current fiscal year (FY25/6) was revised up today after the ONS's first estimate of public borrowing in FY24/5 significantly overshot the OBR's forecast published just last month. In particular, public sector net borrowing excluding banks (PSNB ex) in FY24/5 was provisionally estimated at £151.9bn (5.3% of GDP), up £20.7bn (0.5ppt of GDP) from FY23/4 and £14.6bn (more than 10%) above the OBR's forecast. The current budget deficit and public sector net financial liabilities excluding banks – which are the focus of the government's two fiscal rules – respectively rose 0.3ppt to 2.6% of the GDP and 2.6ppt to 83.5% of GDP. And the central government net cash requirement (excluding UK Asset Resolution Ltd and Network Rail), which aligns more closely to the DMO's remit, came in at £180.5bn, £7.9bn above the OBR's forecast. As a result, the DMO's NFR forecast for FY25/6 was revised up by £4.9bn to £309.1bn, with the extra funds to come from an additional £5.0bn of net Treasury bill issuance (to £10.0bn). Planned Gilt sales were reduced by just £0.1bn to £299.1bn. But mindful of recent curve-steepening and uncertainty about possible limits to the market's absorption capacity at the long end of the curve, the amount of short conventional gilts to be issued was increased by £5.6bn, while planned sales of longer-dated conventional Gilts were cut by £10.4bn. The unallocated share of Gilt issuance was increased by £4.7bn.

Tax shortfall the main source of borrowing overshoot but autumn fiscal tightening still no done deal

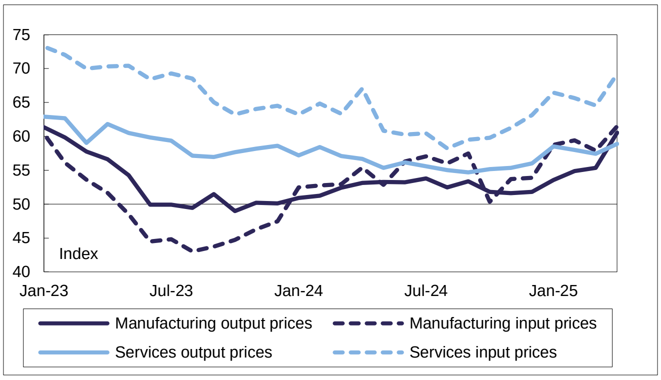
The sources of the latest overshoot in public borrowing in FY24/5 were broad-based. But central government accrued receipts, which came in £7.8bn (0.8%) below the OBR's forecast, accounted for the largest share. All major tax categories, but particularly income tax receipts and National Insurance Contributions, tracked below expectations. Meanwhile, central government spending ran £2.4bn (just 0.2%) above the OBR's forecast. Local government borrowing is also estimated to

UK: Selected composite PMI components



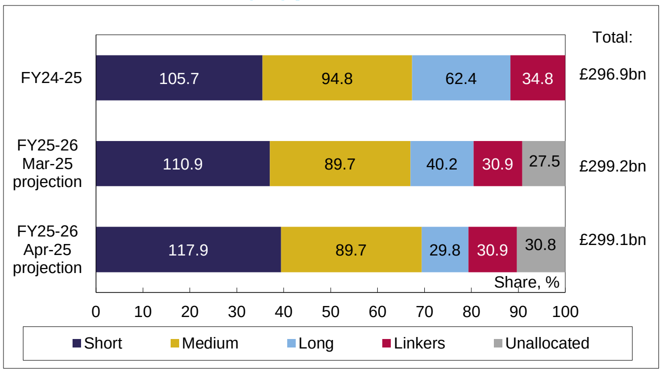
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing & services price PMIs



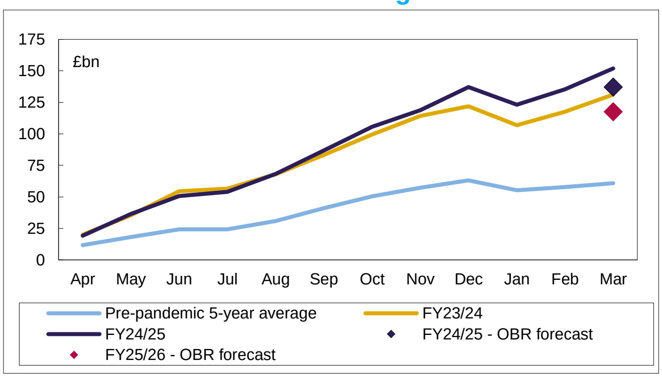
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Gilt issuance by type of bond



Source: DMO and Daiwa Capital Markets Europe Ltd.

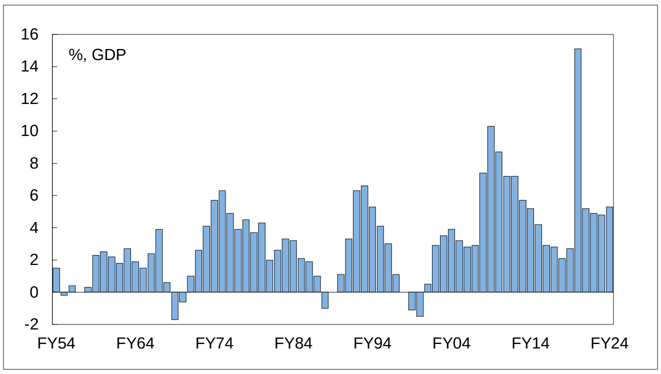
UK: Public sector net borrowing*



**OBR forecasts from March 2025.*
Source: Macrobond, OBR and Daiwa Capital Markets Europe Ltd.

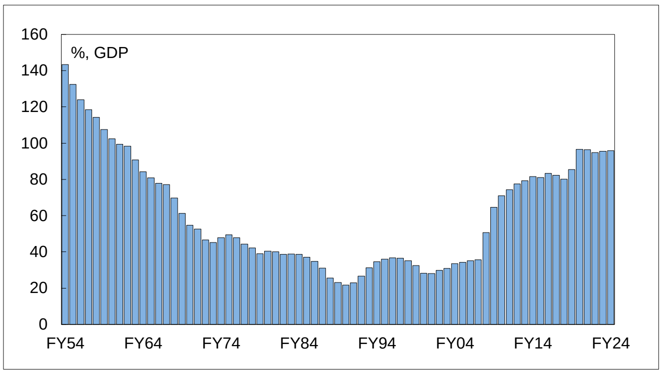
have been some £2.8bn (28%) higher than the OBR projected. And the surplus of public corporations was £1.8bn (8.6%) smaller than it forecast. Looking ahead, the sizeable overshoot of public borrowing in FY24/5 relative to expectations raises somewhat the probability that a tightening of fiscal policy will be required in the autumn to restore the government's £10bn 'headroom' relative to achieve its budgetary rules over the medium term. However, we note that fiscal policy has already tightened significantly this month, principally via the hike to employer National Insurance Contributions. Moreover, consistent a better performance of receipts in cash than accrual terms, we expect the tax shortfall in FY24/5 to be revised down in due course. And the skewing of Gilt issuance towards the short end of the curve over coming months against the backdrop of likely cuts to Bank Rate will at the margin also help to contain debt interest costs.

UK: Public sector net borrowing



Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Public sector net debt



Source: ONS and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

Thursday will bring a further update on manufacturing conditions at the start of Q2 with the latest CBI industrial trends survey. We expect this to show a further decline in factory output the three months to April amid ongoing declines in new orders. The quarterly survey will also likely report a marked deterioration in business optimism, with firms likely to revise down capex and hiring intentions for the year ahead as a result.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Preliminary manufacturing (services) PMI	Apr	**48.7 (49.7)**	47.5 (50.5)	48.6 (51.0)	-
	Preliminary composite PMI	Apr	**50.1**	50.3	50.9	-
	Trade balance €bn	Feb	**21.0**	15.0	14.0	14.4
	Construction output M/M% (Y/Y%)	Feb	**-0.5 (0.2)**	-	0.2 (0.0)	0.6 (0.1)
Germany	Preliminary manufacturing (services) PMI	Apr	**48.0 (48.8)**	47.6 (50.3)	48.3 (50.9)	-
	Preliminary composite PMI	Apr	**49.7**	50.6	51.3	-
France	Preliminary manufacturing (services) PMI	Apr	**48.2 (46.8)**	47.6 (47.5)	48.5 (47.9)	-
	Preliminary composite PMI	Apr	**47.3**	47.5	48.0	-
UK	Public sector net borrowing £bn	Mar	**16.4**	16.0	10.7	12.3
	Preliminary manufacturing (services) PMI	Apr	**44.0 (48.9)**	44.4 (51.6)	44.9 (52.5)	-
	Preliminary composite PMI	Apr	**48.2**	50.6	51.5	-

Auctions

Country	Auction
Germany	sold €3.05bn of 2.5% 2035 bonds at an average yield of 2.47%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	05.00	New car registrations Y/Y%	Mar	-	-3.9
Germany	09.00	ifo business climate indicator	Apr	85.2	86.7
	09.00	ifo current assessment (expectations) indicator	Apr	85.4 (85.0)	85.7 (87.7)
France	07.45	INSEE consumer confidence indicator	Apr	91	92
Spain	08.00	PPI Y/Y%	Mar	-	6.6
UK	11.00	CBI industrial trends survey – total orders (selling prices) balance %	Apr	-35 (20)	-29 (22)
	11.00	CBI industrial trends survey – business optimism balance %	Apr	-	-47

Auctions and events

Country	BST	Event
Euro area	14.00	ECB's Lane & BoE's Lombardelli participate in a panel discussion on the review of monetary policy strategy by central banks
Italy	10.00	Auction: to sell €3.0bn of 2.55% 2027 bonds
UK	10.00	Auction: to sell £1.75bn of 4.75% 2043 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs