Daiwa Capital Markets

Euro wrap-up

Overview

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- While the flash euro area composite PMI fell to a 10-month low as services stagnated, shorter-dated Bunds made notable losses as the surge in wholesale energy prices was evident in the manufacturing input price index.
- Gilts also closed lower as the flash UK PMIs similarly pointed to substantially higher input prices and BoE Chief Economist Pill noted his readiness to respond to such pressures.
- Wednesday will bring the German ifo business survey for March, as well as February inflation figures from the UK.

Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.666	+0.099
OBL 2½ 04/31	2.754	+0.048
DBR 2.9 02/36	3.024	+0.024
UKT 4⅜ 03/28	4.461	+0.054
UKT 4⅛ 03/31	4.503	+0.032
UKT 4¾ 10/35	4.956	+0.045

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

Euro area

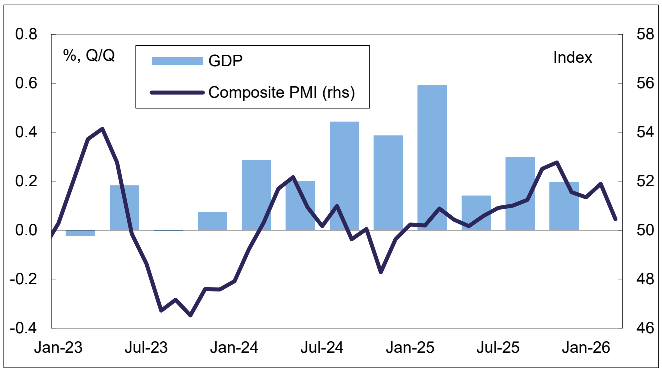
Flash composite PMI falls to 10-month low as services stagnate

Like in 2022 after the Russian invasion of Ukraine, today's flash PMIs suggested that the outbreak of war in the Middle East has so far slowed economic growth momentum rather than triggered a contraction in output. The euro area composite PMI fell in March by 1.4pts, the most in 16 months, to a ten-month low of 50.5. This left the average in Q1 (51.2) a little more than 1pt lower than in Q4, but still suggestive of GDP growth of 0.1%Q/Q. Admittedly, the slowdown would have been more marked in the absence of ongoing relatively solid expansion in manufacturing (51.7). This was supported not least by a further acceleration in Germany, for which the factory output PMI implied the strongest growth in more than four years (53.7) amid an ongoing pickup in orders related not least to higher public spending on defence and infrastructure. In contrast, the survey suggested that services activity (down 1.8pts to 50.1) stagnated in March for the first time since May as new business weakened the most in more than two years. And while the survey suggested the softest growth in German services in six months (51.2) and the steepest contraction in the sector in France in five months (48.3), the slowdown in the sector was also marked elsewhere in the region for which the respective index (50.4) was the lowest since mid-2023. This tallies with other recent indicators pointing to a significant slowdown in Spanish GDP in Q1 – possibly to just 0.2%Q/Q from 0.8%Q/Q in Q4 – having been the main driver of growth in the euro area over recent quarters.

Iranian war damages supply chains and pushes input prices up the most in 3 years

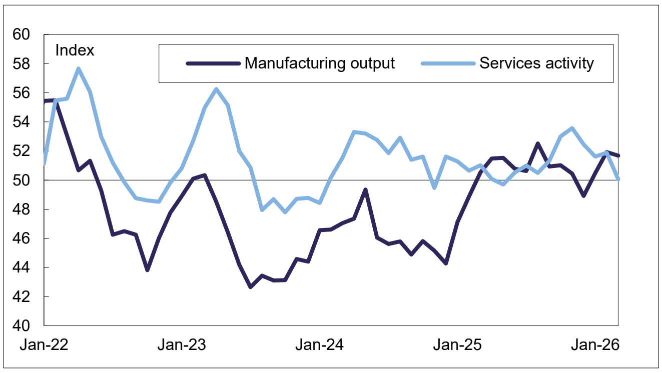
Despite the positive headline manufacturing message, today's survey flagged greater cause for concern about the near-term outlook for the sector as the new energy price shock and supply-chain disruptions caused by the war are inevitably already starting to bite. Indeed, the March flash PMIs reported the steepest rise in input cost inflation and factory output prices in more than three years. And while the pass-through to services prices was more limited this month, the composite output price gauge (53.9) rose to the highest level since February 2024. If sustained, that would be consistent with headline inflation accelerating above 4%Y/Y. Firms also reported a lengthening in supplier delivery times by the most in 3½ years. And overall business optimism regarding the outlook deteriorated to the lowest level since last April when Trump unveiled his Liberation Day tariffs. So, while the impact of the Iranian war will depend on the duration and severity of hits to energy infrastructure and disruption to freight shipped via the Strait of Hormuz, economic growth is already slowing and the risks to the outlook are further skewed to the downside.

Euro area: GDP & composite output PMI



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

Euro area: Manufacturing & services output PMIs

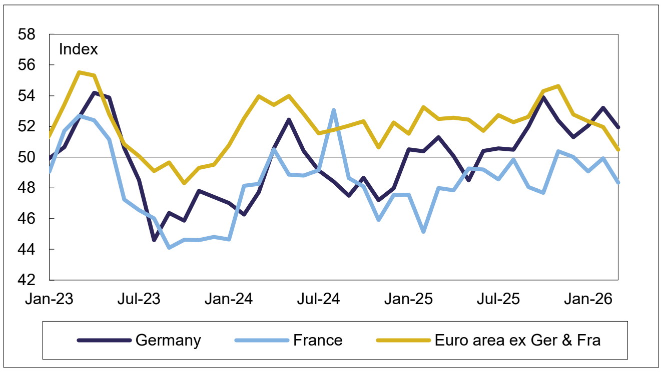


Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Consumer confidence drops sharply in March amid erosion of household purchasing power

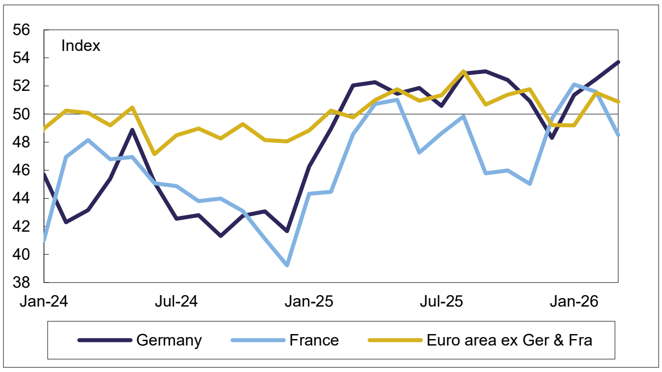
Tallying with the more marked deterioration in the services PMIs, yesterday's flash Commission consumer survey indicator signalled an immediate hit to household sentiment in the face of the spike in energy prices. In particular, the headline euro area index fell a chunky 4.1pts in March, a pace exceeded only in March 2022 following Russia's invasion of Ukraine (-12.5pts) and in Spring 2020 at the onset of the Covid outbreak. As a result, the consumer confidence index fell to -16.3, the lowest level since October 2023 and well below the long-run average, albeit still some way above the 2022 trough of -27.5. The national surveys published from the Netherlands and Belgium similarly saw sentiment slump, as households signalled increased pessimism about the economic outlook, concerns of unemployment and fears of a further erosion of purchasing power. Several European governments have announced fiscal measures to soften the blow of higher fuel prices and domestic energy bills. In Italy, for example, the consumer petrol price fell more than 2% in the past week despite a further 20% rise in the industrial petrol price. Nevertheless, the ongoing conflict and concerns about energy prices seem highly likely to weigh further on confidence and spending over coming months.

Euro area member states: Composite output PMIs



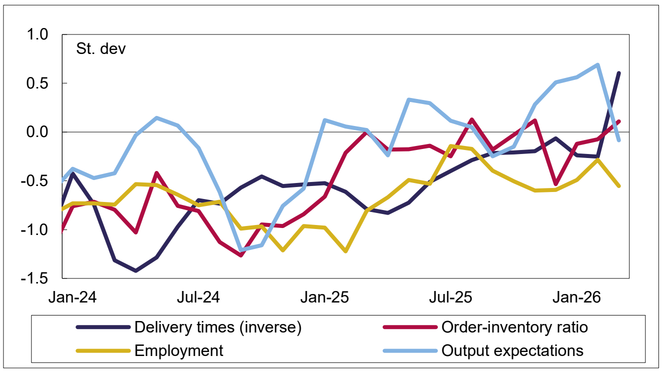
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Manufacturing PMIs



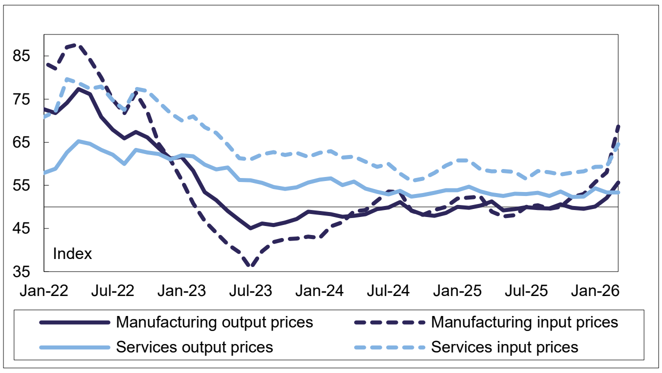
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected manufacturing PMIs



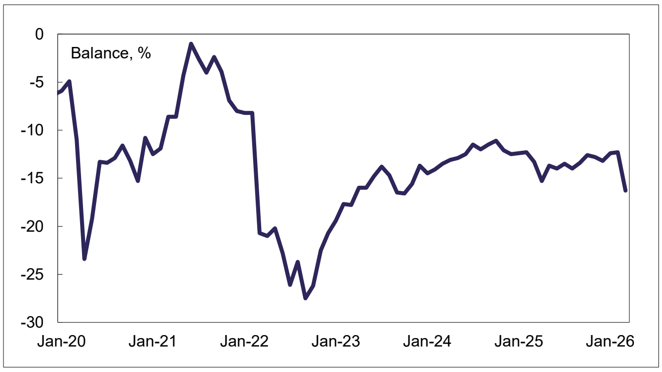
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing & services price PMIs



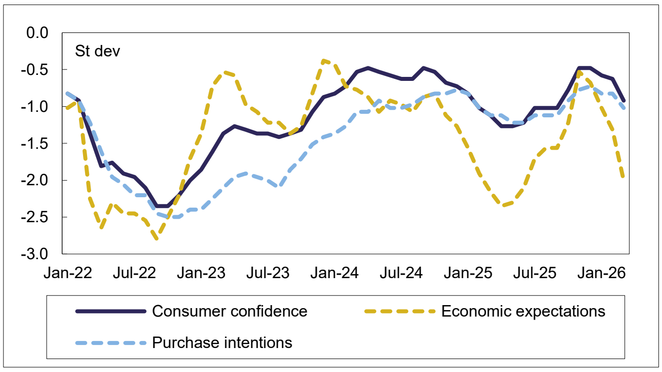
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer confidence index



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

Netherlands: Consumer confidence indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

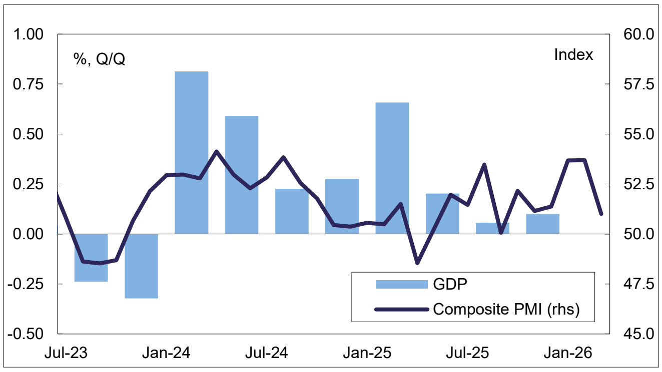
March business surveys will remain the focus of the euro area data calendar over the coming few days. On Wednesday, Germany's more comprehensive ifo business survey seems likely to complement the picture of today's flash PMIs. While that might suggest ongoing recovery in current manufacturing business conditions, we would expect a deterioration in expectations for the sector in the coming six months. It will also likely affirm a slowdown in services, while retailing conditions might be hit by softer consumer confidence and construction sentiment dented by the prospects of higher interest rates. Aside from the ifo, the annual ECB and Its Watchers conference in Frankfurt might clarify policymakers' thoughts regarding the ever-evolving economic outlook and the potential implications for near-term monetary policy decisions. President Lagarde and Chief Economist Lane are among those due to speak.

UK

Events in the Gulf burden UK firms with fresh cost pressures dampening activity at end-Q1

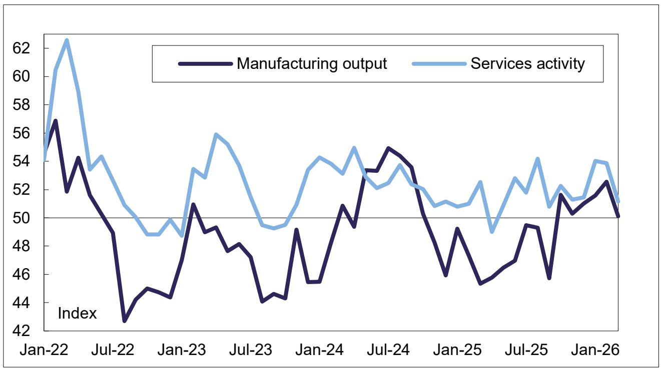
Like in the euro area, against the backdrop of war in the Middle East and the associated energy price shock, March's flash UK PMIs signalled a loss of momentum. The flash composite output PMI fell slightly more than expected to a six-month low of 51.0, but still consistent with modest expansion. And given firmer momentum over the first two months of the year, the index still held up over Q1 as a whole (52.8), some 1.2pts above its average in Q4 and consistent with our forecast for still-positive GDP growth of 0.1%Q/Q. As in the euro area, services activity (down 2.7pts to a six-month low of 51.2) bore the brunt of the slowdown, with marked weakening in both domestic and overseas demand. And while manufacturers reported a relatively smaller hit to demand, they also signalled that output growth was merely stagnant (50.1). Today's survey was predictably more bearish for the broader growth outlook. As disruption to shipping routes pushed suppliers' delivery times to their lengthiest since mid-2022, manufacturers also modestly reduced orders for input materials and ran down stocks too. And manufacturers were also more susceptible to the direct effects of the surge in wholesale energy prices. Indeed, the monthly rise in the manufacturing input price PMI of 14.2pts was the sharpest since the sterling depreciation following Black Wednesday in 1992, taking the index to the highest since October 2022. Admittedly, input price pressures for services were less pronounced, but still the highest since last April's NICs increase. Those higher cost burdens each translated into a moderate pass-through to output prices in both sectors, by the most in almost 12 months. Overall, faced with the prospects of another adverse price shock, firms were the least optimistic about output expectations for nine months and therefore signalled further cuts to headcount for an 18th consecutive month.

UK: GDP & composite output PMI



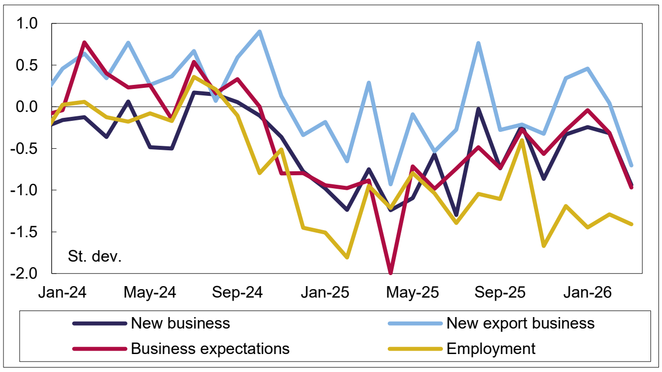
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing & services output PMIs



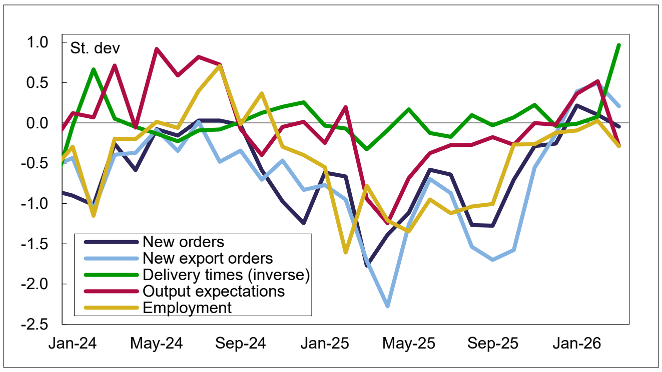
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected services PMIs



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

UK: Selected manufacturing PMIs

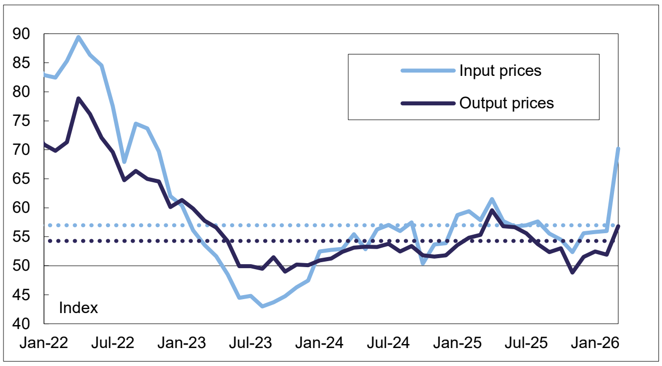


Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

CBI survey reports steepest drop in retail sales volumes since April 2020

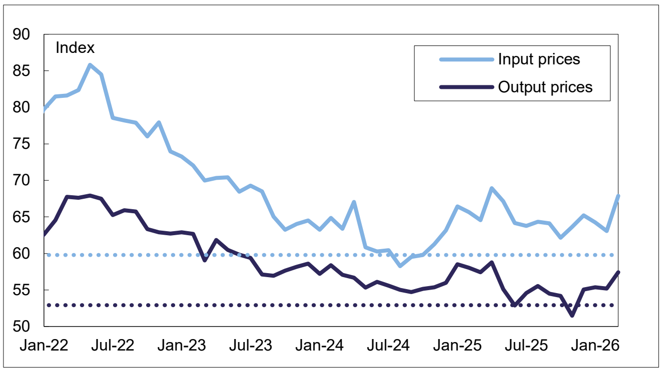
One sector which is not adequately reflected in the PMIs is retail. Unfortunately, after a firm start to the year with sales volumes up a vigorous 1.8%M/M in January amid New Year discounting, surveys point to a subsequent significant weakening in activity on the high street. Against the backdrop of a renewed deterioration in consumer confidence, the BRC survey suggested that annual growth in like-for-like sales volumes ground to a halt in February, marking the weakest rate in 15 months. And with consumers alarmed by events in the Middle East, and prices of petrol and diesel up last week by about 10% and 18% respectively from before the conflict, today's CBI distributive trades survey reported that March brought the weakest sales compared to a year earlier (a net balance of -52) since the first Covid lockdown of April 2020. For the time of year, sales were thus unsurprisingly considered to be 'poor' and to a greater extent than in February, if not quite as disappointing as December's festive period. And sales in April were expected to decline at a pace close to this month's rate. Admittedly, this survey often provides a less reliable guide to the official ONS sales data than the BRC survey. However, with wholesale and motor trade sales also reportedly well down on last year, the CBI survey raises alarm bells that the renewed squeeze in household budgets caused by the war in Iran will extinguish the moderate growth in consumer spending than was previously anticipated this year.

UK: Manufacturing price PMIs*



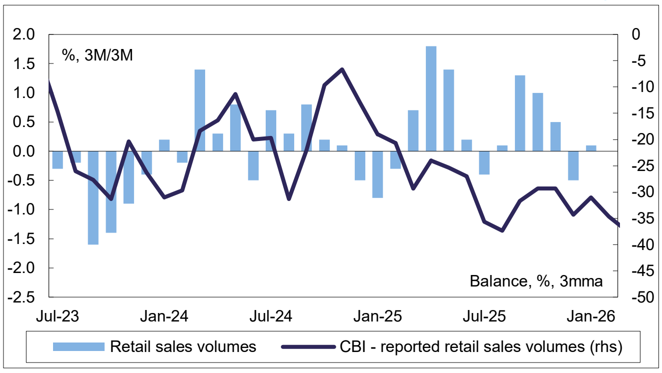
**Dotted lines show long-run averages.*
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services price PMIs*



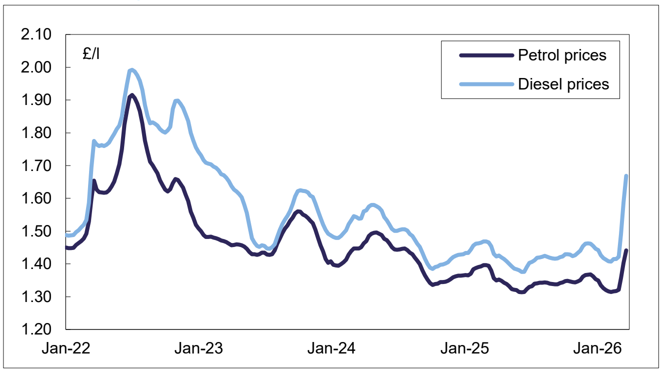
**Dotted lines show long-run averages.*
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales & CBI distributive trades survey



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Weekly petrol & diesel prices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

Though clearly superseded by recent events in the Gulf, February's UK inflation report will provide an update on the disinflation process through the end of last month. Having moderated at the start of the year, fuel prices fell slightly further in February, which should leave energy briefly subtracting from headline inflation in February. Meanwhile, food inflation also remains open to a modest downside skew as the steeper rises in chocolate and beef last year fall away. Core goods inflation may see some modest payback post-January's sales period. But more favourable base effects in services categories should keep core inflation steady for now, just above 3%Y/Y. Overall, we see the headline CPI rate edging down below 3% for the first month in 11, to 2.9%Y/Y, a touch softer than the BoE's latest projections.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Preliminary services (manufacturing) PMI	Mar	**50.1 (51.4)**	51.1 (49.6)	51.9 (50.8)	-
		Preliminary composite PMI	Mar	**50.5**	51.0	51.9	-
		New car registrations Y/Y%	Feb	**2.0**	-	-2.3	-
Germany		Preliminary services (manufacturing) PMI	Mar	**51.2 (51.7)**	52.5 (49.5)	53.5 (50.9)	-
		Preliminary composite PMI	Mar	**51.9**	52.2	53.2	-
France		Preliminary services (manufacturing) PMI	Mar	**48.3 (50.2)**	49.0 (49.5)	49.6 (50.1)	-
		Preliminary composite PMI	Mar	**48.3**	49.3	49.9	-
UK		Preliminary services (manufacturing) PMI	Mar	**51.2 (51.4)**	53.0 (50.3)	53.9 (51.7)	-
		Preliminary composite PMI	Mar	**51.0**	52.9	53.7	-
		CBI distributive trades survey –reported retail sales net balance %	Mar	**-52**	-	-43	-

Auctions

Country		Auction
Germany		sold €3.548bn of 2.5% 2031 bonds at an average yield of 2.72%
UK		sold £2.25bn of 4.75% 2035 bonds at an average yield of 4.911%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Preliminary Commission consumer confidence indicator	Mar	**-16.3**	-14.2	-12.2	-12.3

Auctions

Country	Auction
	- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		09.00	ifo business climate indicator	Mar	86.3	88.6
		09.00	ifo current assessment (expectations) indicator	Mar	86.2 (86.0)	86.7 (90.5)
Spain		08.00	PPI Y/Y%	Feb	-	-2.9
UK		07.00	Headline (core) CPI Y/Y%	Feb	*2.9 (3.1)*	3.0 (3.1)
		07.00	PPI – output (input) prices Y/Y%	Feb	2.6 (0.4)	2.5 (-0.2)
		09.30	House price index Y/Y%	Jan	-	2.4

Auctions and events

Country		GMT	Event
Euro area		08.45	ECB President Lagarde to give keynote address at the opening of the ECB Watchers conference, Frankfurt
		09.15	ECB Chief Economist Lane to speak on monetary policy panel at the ECB Watchers conference, Frankfurt
Germany		10.30	Auction: to sell up to €1bn of 2.6% 2041 bonds
		10.30	Auction: to sell up to €1bn of 0% 2052 bonds
Italy		10.00	Auction: to sell up to €2bn of 2.2% 2028 inflation-linked bonds
		10.00	Auction: to sell up to €1bn of 1.1% 2031 inflation-linked bonds
		10.00	Auction: to sell up to €1bn of 1.8% 2036 inflation-linked bonds
UK		12.00	External MPC member Greene to speak on panel at Jefferies Pan-European mid-cap conference, London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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