

Euro wrap-up

Overview

- Bunds were little changed, while euro area industrial production data confirmed that manufacturing was tracking well below its Q4 level even before the outbreak of war in the Middle East.
- Longer-dated Gilts followed USTs slightly lower on a quiet day for UK economic data.
- Thursday will bring final euro area inflation data for March, UK GDP figures for February and the ECB account from the March Governing Council meeting.

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Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.530	-0.001
OBL 2½ 04/31	2.708	+0.008
DBR 2.9 02/36	3.035	+0.015
UKT 4% 03/28	4.201	+0.004
UKT 4% 03/31	4.314	+0.009
UKT 4% 10/35	4.795	+0.017

*Change from close as at 4:00pm BST.
Source: Bloomberg

Euro area

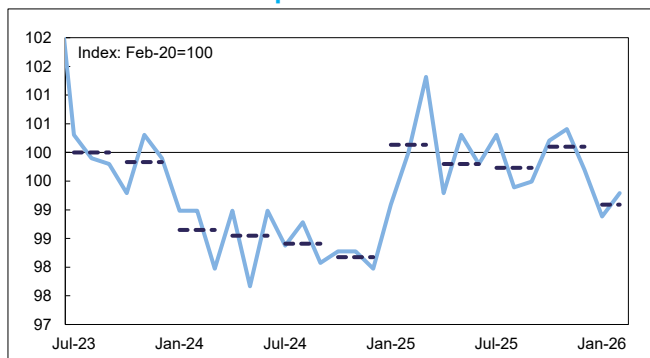
Euro area industrial output was trending down in Q1 even before the Middle East war

Despite some positive survey signals at the start of the year, today's euro area industrial output data for February suggested that the sector was on track for a soft quarter in Q1 even before the outbreak of war in the Middle East and the associated global energy price shock. Admittedly, production rose slightly that month, by 0.4%M/M, and the drop in January (-0.8%M/M) was smaller than initially estimated. But growth in February was more than fully accounted for by Ireland (5.7%/M), principally related to a partial rebound in output from the pharmaceuticals and ICT subsectors. There were also modest increases in aggregate production of electrical machinery, metal products and non-auto transport equipment, which contrasted a third successive decline in autos manufacturing. But given the broad-based weakness in January, output in the first two months of Q1 was tracking below the Q4 average in a wide range of subsectors, with food, coke and petroleum the main exceptions. A surge in energy production at the start of the year provided some offset. But, overall, industrial production was down 0.7%3M/3M in February, the steepest quarterly drop since May 2024, suggesting that the sector will provide a non-negligible drag on Q1 GDP.

German gas consumption falls sharply in March as Sentix survey signals recession concerns

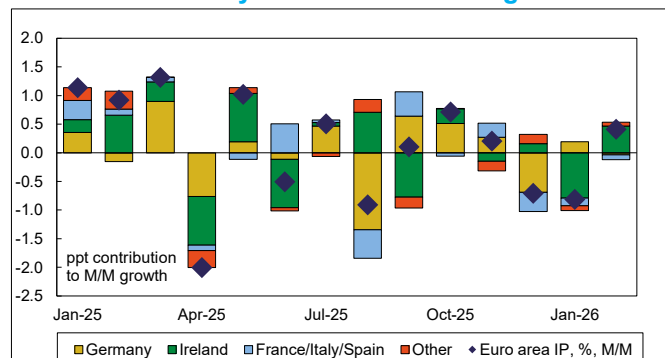
Like in 2022, the new global energy price and supply shock will likely hit production in energy-intensive industries such as chemicals, metals, glassware, ceramics, paper and petroleum in March and beyond. Higher energy input costs and localized supply-chain related disruption will likely bring about a broader hit to manufacturing output too. Certainly, industrial gas consumption in Germany was already down 7%Y/Y in March and more than 16% below the average in the five years ahead of the Russian invasion. While German new factory orders over recent quarters have benefited from a surge in defence-related contracts, underlying demand has remained relatively subdued. Indeed, when excluding large one-off items, core orders were down ½%3M/3M in February. And while business sentiment indices initially signalled relative resilience to the escalation of the Middle East conflict, an ifo institute survey published today suggested that uncertainties about future business conditions had risen across a wide range of sectors. Around 90% of German manufacturing companies expect the Iran war to affect their business, with uncertainties highest among energy-intensive manufacturers. Challenges are judged to have increased significantly in the services sector too, with the transport and logistics industries particularly hard hit. This broadly tallies with the latest Sentix investor survey – the first to be published for April – which provided a substantially more downbeat assessment of economic conditions in Germany and the euro area as a whole, with the respective expectations indices falling in April to levels that Sentix considers to be indicative of recession. And the longer the conflict and supply constraints continue, the greater the inflationary pressures and overall hit to growth.

Euro area: Industrial production*



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Country contributions to IP growth



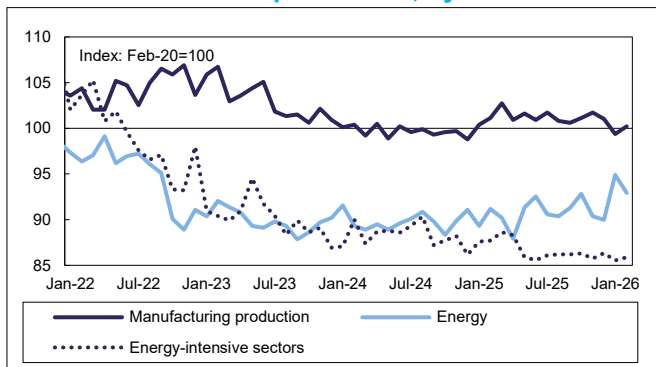
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

The final estimates of inflation in March mark the data highlight in the euro area on Thursday. We note that the upwards revisions to the French (2.0%Y/Y) and Spanish (3.4%Y/Y) HICP estimates, by 0.1ppt each, increase the likelihood of an equivalent revision to the euro area figure. Still, in the absence of further revisions from the remaining member states – including Thursday’s Italian release – we think the headline euro area reading should just about be unchanged too. If so, we will see confirmation that the headline HICP rate jumped to 2.5%Y/Y in March, up 0.6ppt and to a 14-month high. Inevitably, the granular detail will attribute that to higher energy inflation – up 8ppts to almost 5%Y/Y – and specifically to higher prices of petrol and heating oil. More reassuringly, the flash release also suggested that core inflation eased slightly to 2.3%Y/Y. The detail will also provide more information as to the sources of weakness in core goods, but we suspect a post-Winter Olympics normalisation in Italian hospitality was key to the moderation in services.

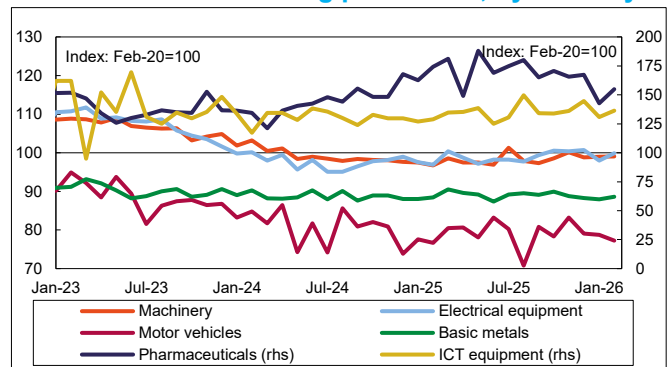
While policy measures may limit the pass through of higher wholesale energy costs to consumer energy price inflation in the coming months, we expect headline inflation to rise above 3%Y/Y in Q2, close to a rate consistent with the ECB’s baseline scenario published in March. Certainly, the monetary policy account of that meeting – also due on Thursday – will show that policymakers now see the risks to the inflation outlook skewed to the upside. With the fluid situation in the Middle East

Euro area: Industrial production, by sector



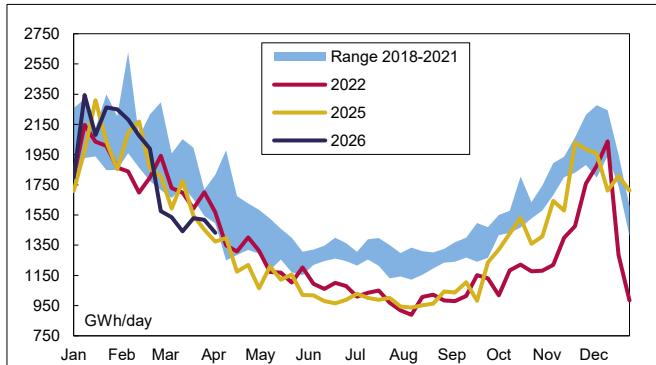
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing production, by industry



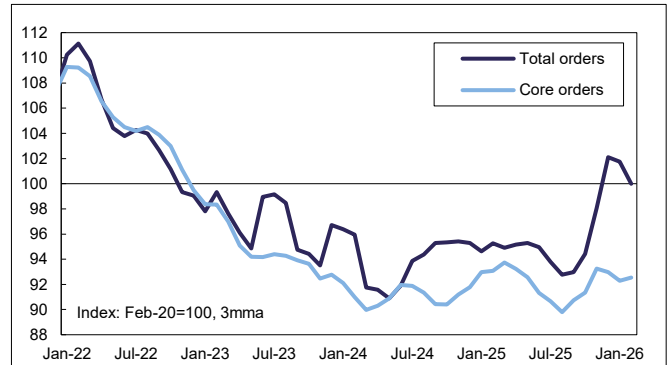
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industrial gas consumption



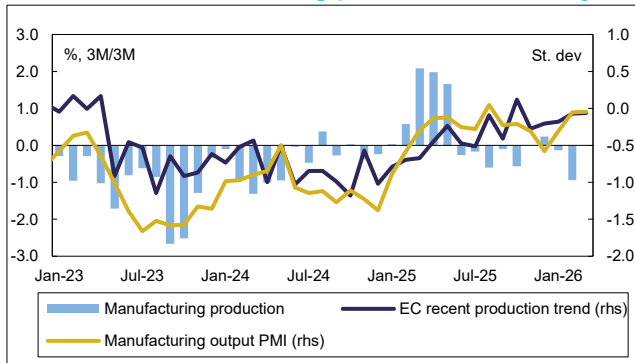
Source: Bundesnetzagentur and Daiwa Capital Markets Europe Ltd.

Germany: New factory orders



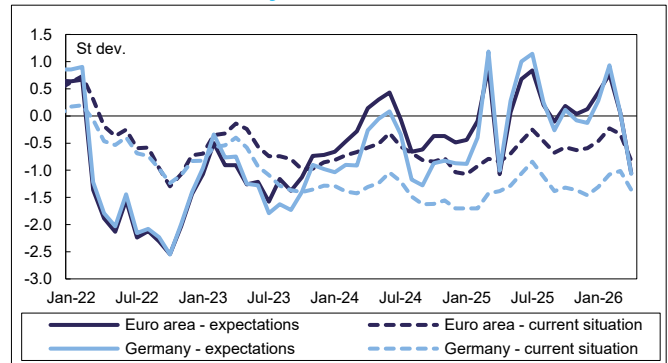
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing production & surveys



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

Euro area & Germany: Sentix investor indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

making it difficult to precisely diagnose the complete impact of the oil-supply shock, President Lagarde stated at that meeting that the Governing Council's decision to stand pat was unanimous. But we would not be surprised if some policymakers expressed their readiness to respond by raising interest rates soon should the spillovers to commodity markets re-intensify, or if the data flag increased concerns about deanchoring of inflation expectations. Comments from the ECB policymakers in Washington D.C. – including Chief Economist Lane and (now relatively dovish) Board member Schnabel – might also be of interest in that regard.



The day ahead in the UK

In terms of Thursday's UK data, we expect the monthly GDP release for February to show a modest uptick in economic activity before the oil price shock. Though retail sales volumes fell back after a strong performance in January, and wet weather might have posed an ongoing headwind to consumer-facing services and construction, the PMIs – particularly in industry – were relatively firm. So, after a flat January, we would not be surprised to see GDP growth of 0.2%M/M, which would leave growth on a three-monthly basis at around ¼%3M/3M. Of course, the stagnation in March's final PMIs demonstrated that the risks to growth last month are skewed firmly to the downside. So, that momentum should be difficult to sustain, even if we still expect GDP growth to have been slightly positive last quarter. Data-aside, external MPC-dove Alan Taylor will appear alongside ECB Chief Economist Lane on a monetary policy panel hosted by the Reinventing Bretton Woods Committee. While the new energy shock led Taylor to postpone his calls for a less tempered withdrawal of policy restriction, he has reiterated that he sees a 'high bar to hiking' against the backdrop of weak growth and looser labour market.




European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Industrial production M/M% (Y/Y%)	Feb	0.4 (-0.6)	<u>0.3 (-0.8)</u>	-1.5 (-1.1)	-0.8 (-0.6)
France	 Final HICP (CPI) Y/Y%	Mar	2.0 (1.7)	<u>1.9 (1.7)</u>	1.1 (0.9)	-








Auctions

Country	Auction
Germany	 sold €1.261bn of 1.25% 2048 bonds at an average yield of 3.55%
	 sold €463mn of 0% 2052 bonds at an average yield of 3.57%
	 sold €779mn of 2.9% 2056 bonds at an average yield of 3.58%









Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	 10.00	Final headline (core) HICP Y/Y%	Mar	<u>2.5 (2.3)</u>	1.9 (2.4)
Italy	 09.00	Final HICP (CPI) Y/Y%	Mar	<u>1.5 (1.7)</u>	1.5 (1.5)
UK	 07.00	Monthly GDP M/M% (3M/3M%)	Feb	<u>0.2 (0.3)</u>	0.0 (0.2)
	 07.00	Services output M/M% (3M/3M%)	Feb	-	0.0 (0.2)
	 07.00	Industrial output M/M% (Y/Y%)	Feb	-	-0.1 (0.4)
	 07.00	Construction output M/M% (Y/Y%)	Feb	-	0.2 (-0.2)
	 07.00	Trade (goods trade) balance £bn	Feb	-	3.9 (-14.4)

Auctions and events

Euro area	 12.30	ECB to publish monetary policy account of 18-19 March Governing Council meeting
	 14.00	ECB Executive Board member Schnabel to participate in PIIE panel discussion on the euro area, Washington D.C.
	 19.30	ECB Chief Economist Lane participates in panel discussion at IMF event, Washington D.C.
France	 09.50	Auction: to sell up to €13bn of 2.4% 2029, 2.7% 2031, 0% 2032 & 3% 2033 bonds
	 10.50	Auction: to sell up to €2bn of 0.1% 2038, 0.55% 2039, 0.95% 2043 & 0.1% 2053 inflation-linked bonds
Spain	 09.30	Auction: to sell 3.1% 2031, 3% 2033 & 3.5% 2041 bonds
UK	 10.00	Auction: to sell £900mn of 1.875% 2049 inflation-linked bonds
Euro area/UK	 16.40	ECB's Lane & BoE MPC's Taylor participate in monetary policy panel at Reinventing Bretton Woods event, Washington D.C.

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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