

Euro wrap-up

Overview

- Despite intra-day volatility, Bunds closed little changed on the day as the flash euro area PMIs suggested a marked weakening of growth momentum and significant increase in cost pressures in April.
- While the DMO revised down its issuance plan for the new fiscal year and UK consumer confidence deteriorated, Gilts made modest losses as the flash PMIs suggested that UK economic activity in April was firmer than expected amid rising cost pressures.
- Friday will bring the latest German ifo indices, UK DMP wage- and price-expectations measures, and UK retail sales data.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.551	+0.004
OBL 2½ 04/31	2.697	+0.001
DBR 2.9 02/36	3.002	-0.003
UKT 4¾ 03/28	4.354	+0.023
UKT 4¾ 03/31	4.454	+0.019
UKT 4¾ 10/35	4.931	+0.024

*Change from close as at 4:30pm BST.
Source: Bloomberg

Euro area

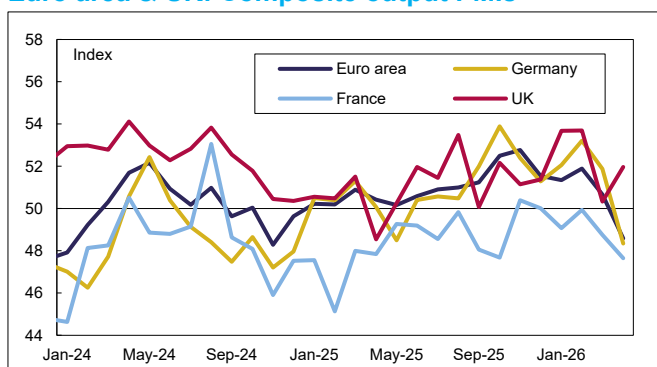
Flash PMIs signal contraction in services while manufacturers front-load output amid supply risks

ECB policymakers have made clear that they are in no rush to change policy, instead wanting time to gauge the impact of events in the Middle East on the euro area inflation outlook. In doing so, they have made clear that they will place significant weight on incoming surveys. And in that context, today's flash PMIs for April will have been closely scrutinized for evidence of the initial response of euro area businesses to recent developments. Unfortunately, the findings will have provided uncomfortable reading, with signals of a sharper-than-expected retrenchment in economic activity, emerging supply-chain strains and substantive new pressures on costs and prices. Notably perhaps, the headline euro area composite output PMI fell more than 2pts – the most in almost three years – to an 18-month low of 48.6, significantly weaker than expected and consistent with contraction for the first time since end-2024. The cause was a sudden retrenchment in services, for which the headline activity index fell almost 3pts to 47.4, the lowest level since late 2023. In contrast, the manufacturing output PMI edged up to 52.2, suggesting a pace of production growth exceeded only once in the past four years. That, however, appears to have reflected a concerted effort by firms to frontload production and stockpile inputs while they can, as a precaution for possible more severe supply disruption ahead. Indeed, today's survey already reported the most significant lengthening of delivery times since mid-2022 as firms also stockpiled inputs by the most since the Russian invasion of Ukraine. So, despite a pickup in new orders, manufacturing optimism in the outlook worsened to the most downbeat in 17 months, while services firms were the most pessimistic in more than three years. Among the member states, firms in Germany were most alarmed.

Firms signal rising output prices as input costs jump most since 2022

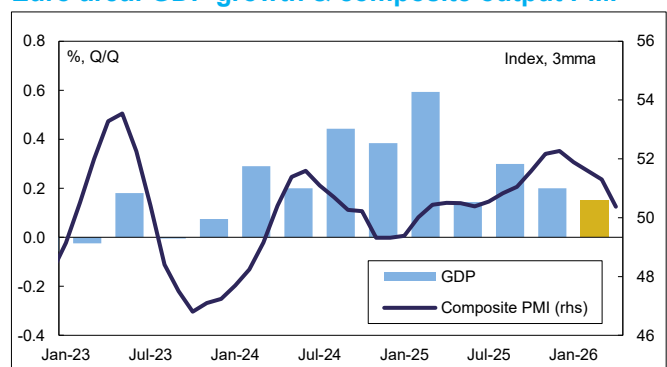
The ECB will be mindful of the downside risks to the growth outlook signalled by the flash PMIs. But they will not be able to ignore the evidence of a major shock to input costs triggered by the Iran War. Indeed, having jumped almost 11pts in March, the euro area manufacturing input cost PMI rose a further 8pts in April to the highest since June 2022 (76.9). The equivalent index for services costs also rose, to a three-year high (65.7) well above the long-run average. And while firms are still trying their best to absorb or offset those rising costs, the respective PMIs suggested that selling prices were being hiked by the most in more than two years in services and the most in more than three years in manufacturing. The ECB will continue to hope that the eventual magnitude, duration and pass-through of costs will be limited and that soft demand and labour slack will restrain eventual second-round effects. And the policymakers will wait for a further couple of months of evidence on price (and wage) expectations, including from other surveys and market measures (such as the 5Y5Y inflation forward swap rate, which remains relatively well-behaved) before deciding whether to tighten policy in June. But given today's snapshot from the flash PMIs, as well as the continued impasse at the Strait of Hormuz, we continue to expect a hike that month.

Euro area & UK: Composite output PMIs



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

Euro area: GDP growth & composite output PMI*

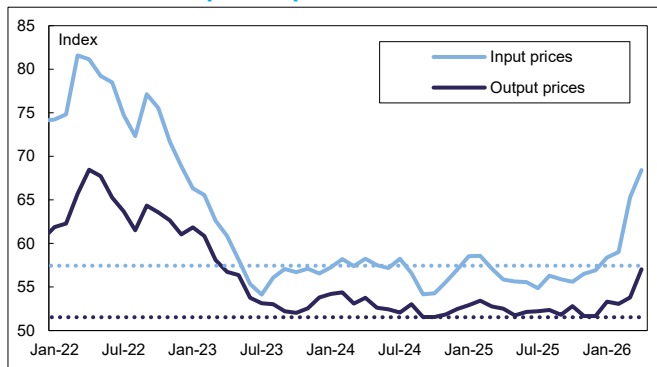


*Gold bar shows Daiwa forecast for Q126.
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

Data-wise, April survey results will remain the focus in the euro area, with the German ifo indices Friday's highlight. As expectations soured at the onset of the Iran War, this survey flagged a sharp deterioration in the business conditions last month, with the headline index down 2pts to a 13-month low of 86.4. The widening odds of a swift and clean resolution to the conflict suggests that expectations in April will be gloomier still, and today's flash PMIs also imply that the current conditions index won't be as resilient as it was in March either. Like the PMIs, however, the sectoral breakdown might also show temporary resilience in manufacturing output. Separately, the detail of INSEE's French consumer survey will help to identify the drivers of the 3¼-year low in euro area consumer confidence registered in Wednesday's [flash Commission index](#).

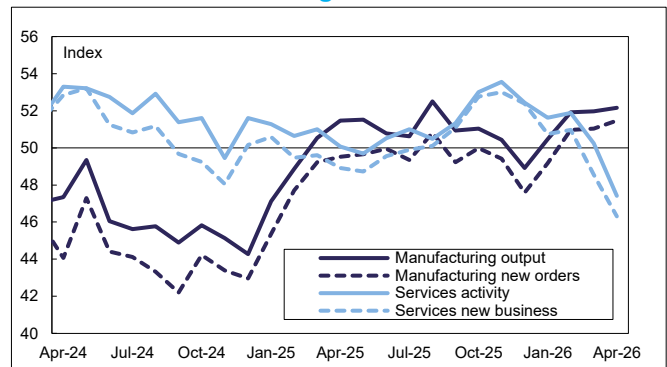
Euro area: Composite price PMIs*



*Dotted lines show long-run averages.

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

Euro area: Manufacturing & services PMIs



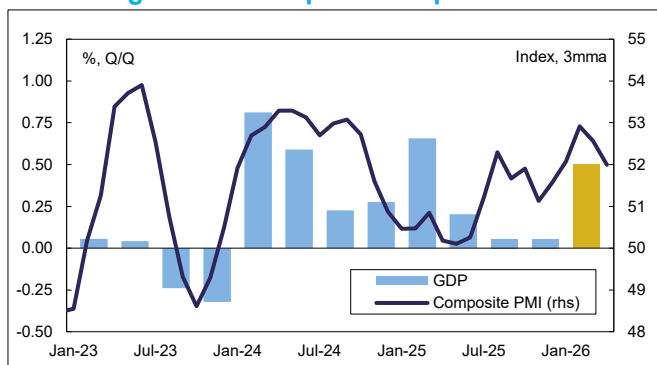
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK

Flash UK PMIs surprise to the upside but clear signs of underlying weakness remain

Contrasting the euro area, the flash UK PMIs suggested that economic activity in April was firmer than expected. After falling to a six-month low last month (50.3), the composite output PMI (52.0) recouped half of that loss this month to be consistent (at least, for the time being) with modestly positive GDP growth in Q2. The increase was reflective of partial rebounds in activity across both sectors. As in the euro area, the sizable jump in the headline manufacturing PMI (up to 53.6, a near four-year high) was flattered by firms' efforts to hedge against supply disruption, evidenced by a further steep increase in delivery times and higher input stocks. As such, we think that the reported expansion in factory output and employment (a first for 18 months) will prove temporary. Services activity (52.0) was supposedly boosted in April by 'tailwinds' from technology investments and other intangible initiatives. By extension, consumer-facing subsectors were likely softer, tallying with the further marked deterioration in household confidence reported by the GfK today. And the slight contraction in services order books reported by the flash PMIs suggested that underlying demand in the sector remains weaker than headline activity index implied, while firms also pared headcount at a faster rate. According to the composite PMIs, overall output expectations also slid to a 12-month low reflecting expectations that the supply shock will have a protracted effect. We also note that the near-term boost to manufacturing output was largely absent from the CBI's April industrial trends survey results. Indeed, they suggested that firms were the most pessimistic entering Q2 since the pandemic lockdowns, as the share of firms reporting falling orders (56%) rose to its highest in more than five years.

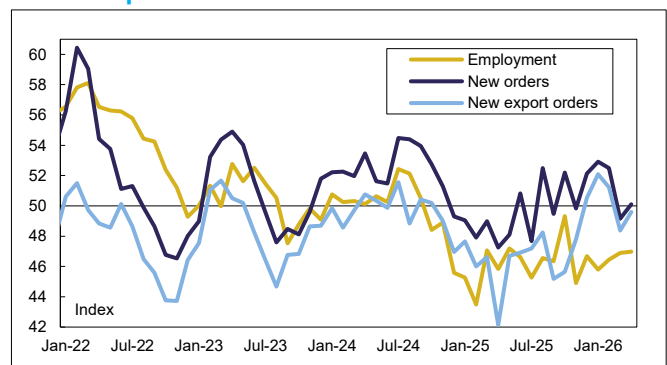
UK: GDP growth & composite output PMI*



*Gold bar shows Daiwa forecast for Q126.

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

UK: Composite PMIs



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

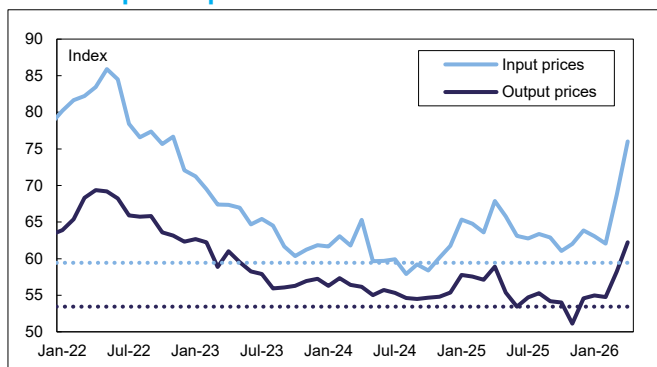
Price PMIs continue to rise sharply, posing a trade-off for the MPC

The weak underlying signals from UK business surveys are likely to discourage policymakers from placing too much weight on the stronger February monthly GDP outturn. And given the substantive evidence of growing economic slack, as well as the increasingly negative spillovers in the Gulf, they will surely still see the risks to the growth outlook to the downside. So, a number of MPC members have downplayed the extent to which the supply shock might transmit into broader price-setting dynamics. But the evidence of today's flash PMIs suggests that, faced with exceptional cost pressures, businesses will still try their best to pass along a share of those higher costs onto their customers. Indeed, while still not at their mid-2022 highs, both the composite input (76.0) and output (62.2) price PMIs were consistent with their fastest monthly deterioration on record, rising 7¼pts and 4pts respectively.

DMO revises down slightly Gilt issuance in FY26/7 as PSNB falls to 6-year low as % of GDP

Public sector net borrowing (PSNB) came in at £12.6bn in March, down £1.4bn on a year earlier and the lowest for the month in four years. As a result, full-year PSNB in FY25/6 came in at £132bn, down almost £20bn on the prior fiscal year and a touch below the OBR forecast last month. That improvement reflected the substantive boost to government revenues over the past year related not least to the controversial hike in employer National Insurance Contributions a year ago as well as stronger-than-expected nominal pay growth. As a share of GDP, PSNB in the past fiscal year fell almost 1ppt to 4.3%, the

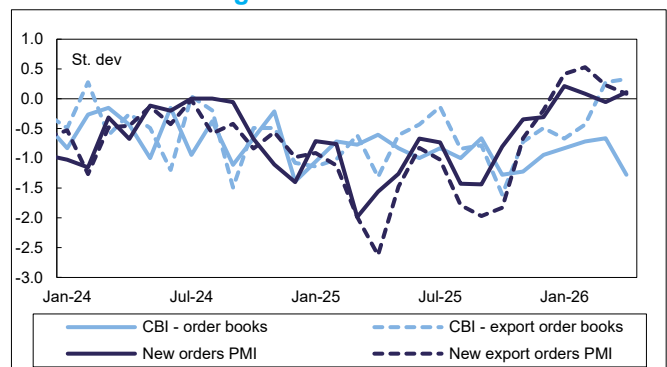
UK: Composite price PMIs*



*Dotted lines show long-run averages.

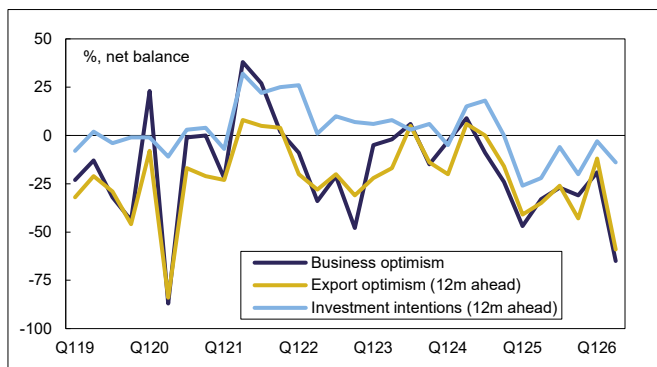
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing new orders indicators



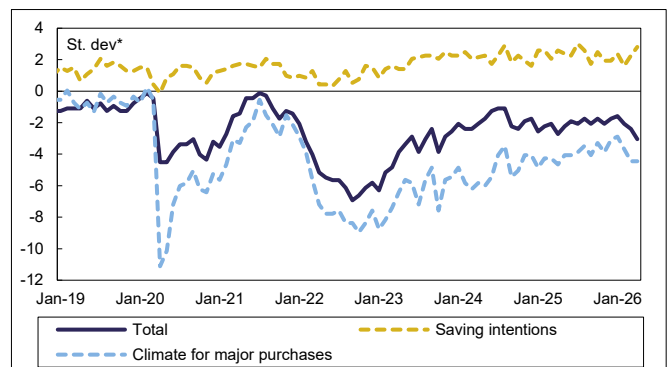
Source: S&P Global, CBI, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: CBI industrial trends – selected indices



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

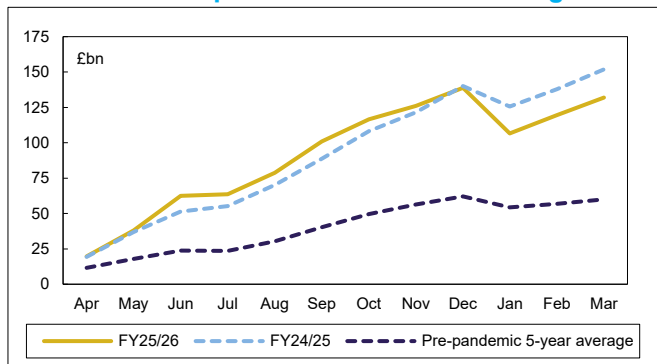
UK: Consumer confidence indicators



*Standard deviation based on pre-pandemic five-year average.

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

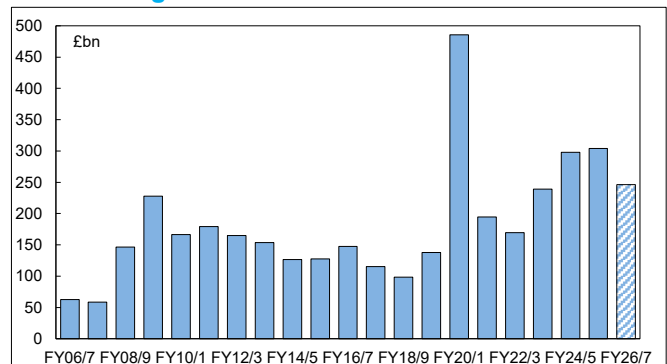
UK: Cumulative public sector net borrowing*



*Fiscal year to date.

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

UK: Gross gilt issuance*



*Updated plan for FY26/7.

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
















lowest since FY19/20. Given the better-than-expected performance, the DMO today reduced its planned net financing requirement for the current fiscal year by £5.9bn from last month's estimate to £251.2bn. Notably, it cut its planned issuance for each main maturity bucket of bonds – short-, medium- and long-dated alike – as well as its planned issuance of index-linked Gilt. Its unallocated portion was also revised down slightly while planned issuance of Treasury bills was unchanged. Looking ahead, given the likely economic and fiscal costs of developments in the Middle East, we see non-negligible risks that the DMO will have to revisit its arithmetic and revise back upwards its issuance plans for this fiscal year.

The day ahead in the UK

While the underlying softness in the latest UK [inflation](#) and [labour market](#) figures will help to justify the BoE's caution about raising Bank Rate before obtaining further clarity about the outlook, today's flash price PMIs provided another reminder of upside inflation risks should the stalemate at the Strait of Hormuz persist. In that regard, the BoE's latest DMP survey will provide an indication of firms' expectations of the pass-through of current cost pressures into their ultimate selling prices. Given the MPC's alertness to second-round effects, focus will be given to both price- and wage-setting intentions, as well as firms' broader inflation expectations. Having jumped at the start of the war, further increases in input prices seem likely to lend additional pressure to the latter. And increases in all of the forward-looking measures could reinforce the hawkishness of some (albeit still a minority of) members on the MPC over coming meetings.

Meanwhile, March's retail sales figures might be more ambiguous. Though the price shock presents some downside risks to fuel consumption, sales volumes could have been flattered by some consumers' efforts to fill their tanks before higher wholesale market prices passed through fully to the pumps. And the [BRC's retail survey](#) was suggestive of a firm pickup in food sales relating to the earlier timing of Easter. But other indicators – including those of the [CBI distributive trades](#) and [GfK consumer surveys](#) – were much more downbeat. Overall, Bloomberg's consensus forecast suggests that sales volumes were little changed. But irrespective of March's precise number, the release looks bound to confirm solid growth in retail sales over Q1 as a whole – in the range of 1¼-1¾%Q/Q – thanks largely to the 2%M/M jump in January. The further sizable drop in consumer confidence in April to a 2½-year low, reported early by GfK today, underscored that the risks to private consumption in Q2 are skewed clearly to the downside.





European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
Euro area	 Preliminary services (manufacturing) PMI	Apr	47.4 (52.2)	49.8 (50.9)	50.2 (51.6)	-	
	 Preliminary composite PMI	Apr	48.6	50.1	50.7	-	
	 New car registrations Y/Y%	Mar	12.4	-	2.0	-	
Germany	 Preliminary services (manufacturing) PMI	Apr	46.9 (51.2)	50.4 (51.4)	50.9 (52.2)	-	
	 Preliminary composite PMI	Apr	48.3	51.2	51.9	-	
France	 Preliminary services (manufacturing) PMI	Apr	46.5 (52.8)	48.5 (49.5)	48.8 (50.0)	-	
	 Preliminary composite PMI	Apr	47.6	48.6	48.8	-	
	 INSEE business (manufacturing) confidence indicator	Apr	94 (100)	96 (98)	97 (99)	-	
	 INSEE production (own-company) outlook indicator	Apr	-18 (7)	-12 (10)	-9 (8)	-10 (7)	
UK	 Preliminary services (manufacturing) PMI	Apr	52.0 (53.6)	50.0 (50.3)	50.5 (51.0)	-	
	 Preliminary composite PMI	Apr	52.0	49.8	50.3	-	
	 CBI industrial trends survey – total orders (selling prices) net balance %	Apr	-38 (32)	-34 (21)	-27 (12)	-	
	 CBI industrial trends survey – business optimism net balance %	Apr	-65	-25	-19	-	
	 GfK consumer confidence indicator	Apr	-25	-25	-21	-	
	 Public sector net borrowing £bn	Mar	12.6	10.4	14.3	12.8	
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/ <i>Daiwa forecast</i>	Previous
Germany 	09.00	ifo current assessment (expectations) indicator	Apr	86.2 (85.5)	86.7 (86.0)
	09.00	ifo business climate indicator	Apr	85.7	86.4
France 	07.45	INSEE consumer confidence indicator	Apr	88	89
Spain 	08.00	PPI Y/Y%	Mar	-	-7.0
UK 	07.00	Retail sales – incl. auto fuel M/M% (Y/Y%)	Mar	0.0 (1.1)	-0.4 (2.5)
	07.00	Retail sales – excl. auto fuel M/M% (Y/Y%)	Mar	0.0 (2.0)	-0.4 (3.4)
	09.30	DMP – 3M output price (1Y CPI) expectations Y/Y%	Apr	-	3.5 (3.5)

Auctions and events

Italy 	10.00	Auction: to sell up to €2.5bn of 2.2% 2028 bonds			
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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