Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds ended the day little changed amid mixed ECB commentary about a potential June rate hike, confirmation of soft euro area GDP and employment growth and a sharp contraction in IP in Q1.
- Gilts partially reversed recent losses, despite rumours of an imminent challenge to Starmer's leadership.
- Thursday will bring data for UK GDP in Q1 and production in March, along with a UK housing market survey.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.714	+0.008
OBL 2½ 04/31	2.825	+0.013
DBR 2.9 02/36	3.109	+0.010
UKT 4⅜ 03/28	4.479	-0.052
UKT 4⅛ 03/31	4.606	-0.034
UKT 4¾ 10/35	5.069	-0.032

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

Euro area

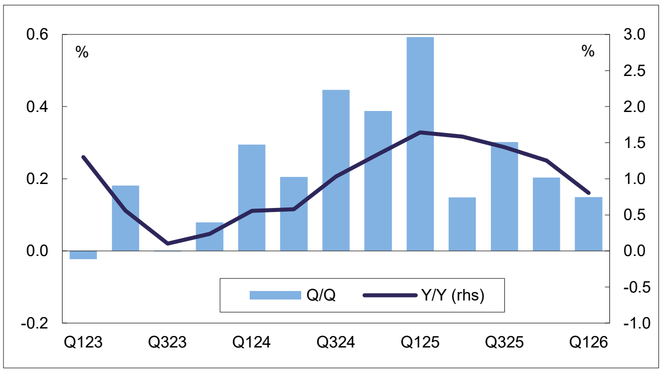
Euro area Q1 GDP growth unrevised at 0.1%Q/Q, nevertheless the joint-softest in nine quarters

Despite a non-negligible decline in industrial production (see below) and weakness in retail sales and construction activity in the first quarter, today's updated Q1 GDP figure left growth in the euro area unrevised from the preliminary estimate of 0.1%Q/Q, down 0.1ppt from Q4 and 0.2ppt below the ECB's forecast in March. To two decimal places, growth was nudged very slightly higher to 0.15%Q/Q. But this still marked the joint-weakest pace in nine quarters and pushed the annual rate down to a sub-potential 0.8%Y/Y, the softest since Q224. No amendments were made to the member-state GDP data published first time around. So, as in the preliminary release, the figures were boosted by surprisingly strong growth in Germany (0.3%Q/Q), which alone contributed 0.09ppt to the euro area figure. While the Spanish expansion (0.6%Q/Q) slowed from Q4, it was still the strongest of the larger member states, and the Italian economy increased for a third consecutive quarter (0.2%Q/Q). France was the exception of the big four member states, failing to grow for a first quarter in five. And Ireland contracted for a second successive quarter, with the 2%Q/Q drop knocking almost 0.1ppt off euro area growth.

Subdued growth in euro area IP in March points to sharpest quarterly drop in two years

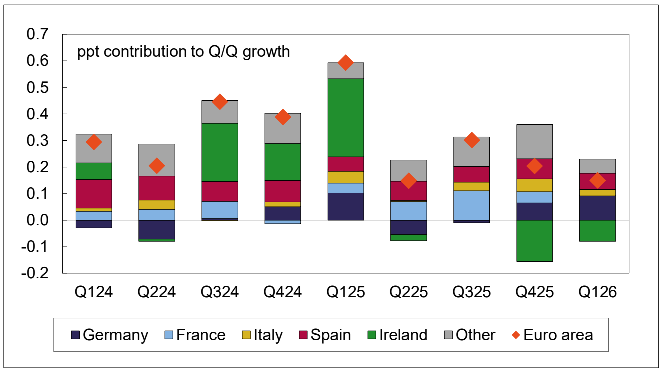
Despite some signs of production being brought forward in parts of the euro area to get ahead of supply bottlenecks and rising costs, today's data showed that aggregate industrial production was subdued in March, with growth steady at just 0.2%M/M. This dragged the annual rate down 1.3ppts to -2.1%Y/Y, an 18-month low. And given negative carry over from Q4 and a further decline at the start of the year, IP fell 0.9%Q/Q in Q1, marking the steepest quarterly contraction in two years. Part of the weakness in March reflected energy production (-1.5%M/M) and a sharp fall in non-durable consumer goods output (-4.5%M/M) due to a double-digit decline in pharmaceuticals. In contrast, production of capital goods (1.1%M/M) rose for a second month, boosted by strong growth in ICT and transport equipment and electrical machinery. Meanwhile, output of intermediate goods rose the most in 12 months (0.9%M/M), partly reflecting growth in energy-intensive industries such as chemicals as well as non-metallic minerals. But overall, manufacturing output still fell 1.2%Q/Q in Q1, matching the steepest decline since Q323 and marking the third contraction in four quarters. While manufacturing weakness appears to have been offset by solid gains in services – output in the first two months of the year was trending some 0.4% above the Q4 average – sizeable declines in retail sales and construction activity suggest that a downwards revision to Q1 GDP remains a risk to the final estimate due in early June.

Euro area: GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Country contributions to GDP growth

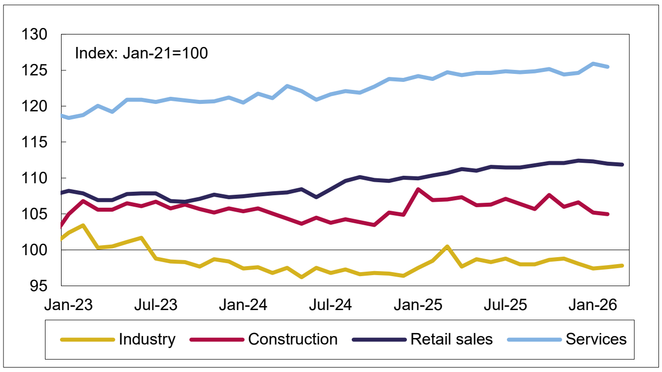


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Employment growth slowed in Q1 as German payrolls fell & French jobless rate rose to 5-year high

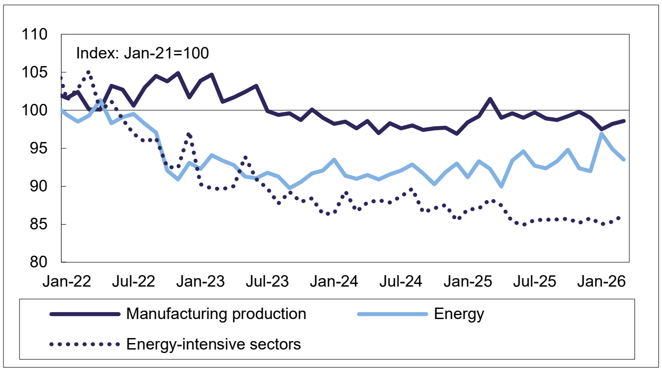
The slowing in economic activity in Q1 was accompanied by softer growth in employment which, alongside weakening consumer confidence and diminishing purchasing power, likely weighed on household consumption at the start of the year. Employment rose in line with GDP, by 0.1%Q/Q, down from 0.2%Q/Q in the previous two quarters, with the number of people in work rising just 148k in Q1. Growth was once again driven largely by Spain (up 73k) and Italy (28k). In contrast, employment fell in Germany for a fourth successive quarter. And there was a further turn for the worse in France where the unemployment rate rose 0.2ppt to 8.1% in Q1, the highest in five years. Although some firms have signalled a willingness to hoard labour, surveys suggest that, on average, businesses intend to cut headcount this quarter by the most in five years. With increased job insecurity as well as eroding real incomes, once again, consumers are increasingly favouring precautionary saving instead of spending. So, we expect household consumption to weaken further this quarter and possibly subtract from GDP growth for the first quarter since Q423.

Euro area: Industrial, services & construction output



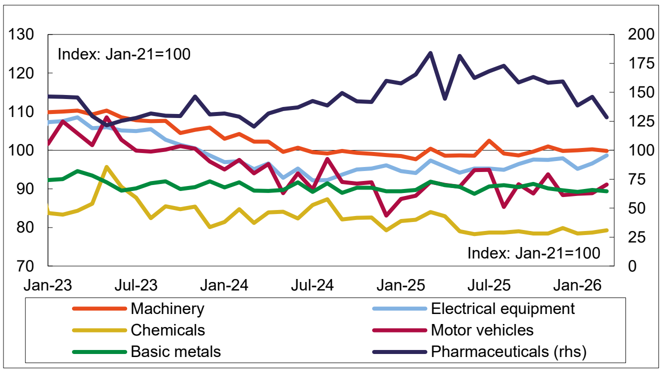
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output



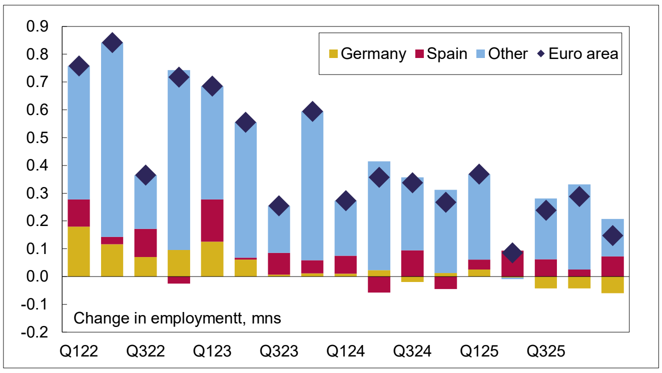
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output by subsector



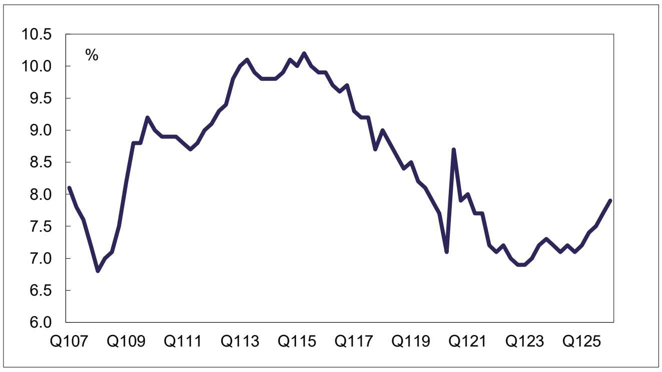
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Employment



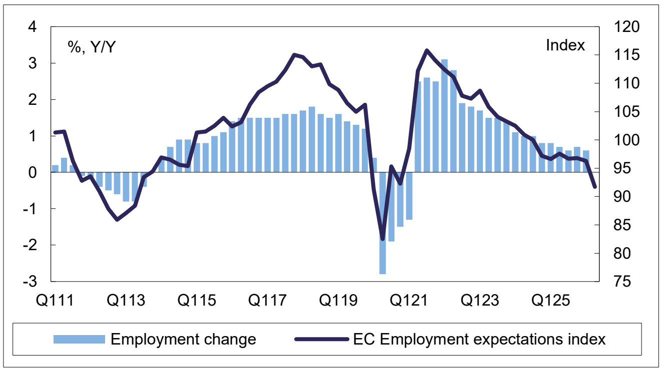
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Unemployment rate



Source: Macrobond and Daiwa Capital Markets Europe ltd.

Euro area: Employment growth & EEI



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

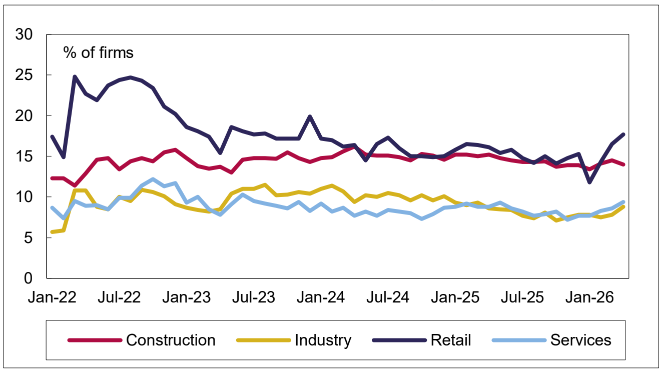
The day ahead in the euro area

Thursday looks set to be relatively quiet day for euro area economic news. In terms of the data calendar, April's inflation detail from the member states – most notably Spain – will continue to aggregate evidence about the drivers of euro area inflation ahead of next week's final release. For what it's worth, the flash estimates from Spain suggested that headline inflation moderated slightly on its national series, including with respect to the core components. But it edged up to a 22-month high (3.5%Y/Y) on the EU harmonised HICP measure. Liquid fuels are likely to have provided the primary source of upwards pressure on the headline rate yet again. Although given the relative scale of support from the Spanish Government to combat higher fuel prices, its impulse will be weaker than that which supported a further rise in today's French release. And similar tax cuts on electricity suggest that household energy (ex. liquid fuels) might have provided some offset. Meanwhile, core components should have moderated too, albeit likely flattered by favourable base effects relating to package holidays and the earlier timing of Easter festivities this year.

The day ahead in the UK

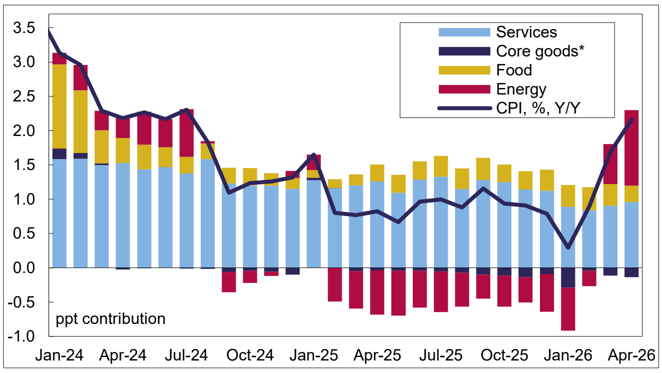
Notwithstanding ongoing focus on political developments relating to potential challenges to Starmer's leadership, the preliminary estimates for Q1 GDP – accompanied by March's monthly output – will be the highlight of the UK's dataflow on Thursday. Given the onset of the oil shock, business surveys broadly suggest that the risks to growth at the end of Q1 tilted quickly to the downside. And notwithstanding a temporary boost to retail spending on fuel and Easter-related spending, a first negative print on the monthly GDP series since October appears a firm possibility. Indeed, GDP in February surprised significantly on the upside, with broad-based growth contributing to the strongest monthly advance in more than two years (0.5%M/M). Owing principally to that strength, we expect GDP growth of 0.5%Q/Q in Q1, the firmest in four quarters. Amongst the sectors, services likely made the largest contribution. But manufacturing should have also contributed as auto production recovered further from the effects of the cyberattack at JLR. Construction, meanwhile, likely contracted for a second successive quarter. In terms of expenditure, with retail sales having marked their best quarter in almost five years, private consumption likely led the way. We caution, however, that the strength of economic output looks set to emulate a recent pattern whereby better-than-expected growth in the first half of the year is followed by weakness in the second half, suggesting that the data might not be sufficiently adjusting for seasonal spending patterns. In response to such speculation, the ONS will for the first time publish its unadjusted GDP data alongside the seasonally adjusted series. Meanwhile, the RICS residential survey will provide a more timely view as to whether the recent tightening of financial conditions has provided a headwind to housing market activity. In terms of BoE speak, Chief Economist Huw Pill – who was the lone dissenter in favour of a hike at the MPC's meeting a fortnight ago – is due to participate in a panel discussion.

Euro area: Share of firms planning to hoard labour



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

France: Contributions to CPI inflation



**Non-energy industrial goods.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

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European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		GDP – second estimate Q/Q% (Y/Y%)	Q1	**0.1 (0.8)**	*0.1 (0.8)*	0.2 (1.2)	-
		Employment – first estimate Q/Q% (Y/Y)	Q1	**0.1 (0.5)**	-	0.2 (0.7)	-
		Industrial production M/M% (Y/Y%)	Mar	**0.2 (-2.1)**	*0.5 (-2.4)*	0.4 (-0.6)	0.2 (-0.8)
France		Final HICP (CPI) Y/Y%	Apr	**2.5 (2.2)**	*2.5 (2.2)*	2.0 (1.7)	-
		Unemployment (mainland unemployment) rate %	Q1	**8.1 (7.9)**	7.8 (7.8)	7.9 (7.7)	-

Auctions

Country		Auction
Germany		sold €986mn of 3.4% 2047 bonds at an average yield of 3.54%
		sold €1.14bn of 2.5% 2054 bonds at an average yield of 3.62%
Italy		sold €3bn of 2.4% 2029 bonds at an average yield of 2.98%
		sold €3.25bn of 2.5% 2033 bonds at an average yield of 3.55%
		sold €1.25bn of 2.95% 2038 bonds at an average yield of 4.04%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Spain		08.00	Final HICP (CPI) Y/Y%	Apr	*3.5 (3.2)*	3.4 (3.4)
UK		00.01	RICS house price balance %	Apr	-25	-23
		07.00	GDP – first estimate Q/Q% (Y/Y%)	Q1	*0.5 (0.8)*	0.1 (0.5)
		07.00	Monthly GDP M/M%	Mar	-0.1	0.5
		07.00	Services output M/M% (3M/3M%)	Mar	-0.1 (0.6)	0.5 (0.5)
		07.00	Industrial output M/M% (Y/Y%)	Mar	-0.2 (0.3)	0.5 (-0.4)
		07.00	Construction output M/M% (Y/Y%)	Mar	-0.5 (-2.5)	1.0 (-1.0)
		07.00	Trade (goods trade) balance £bn	Mar	-	-0.7 (-18.8)

Auctions and events

Country		BST	Event
UK		16.15	BoE Chief Economist Pill to give speech at a roundtable event in London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.