

Euro wrap-up

Overview

- While euro area labour cost growth continued to moderate, Bunds made losses as ECB Executive Board member Schnabel suggested that the Governing Council might soon need to pause or cease its easing cycle.
- Gilts also made losses as UK inflation in January beat expectations.
- Thursday will bring the flash estimate of euro area consumer confidence in February as well as a UK manufacturing survey for the same month and euro area construction data for December.

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Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.168	+0.045
OBL 2.4 04/30	2.324	+0.060
DBR 2½ 02/35	2.555	+0.064
UKT 4½ 01/27	4.267	+0.036
UKT 4½ 07/29	4.300	+0.053
UKT 4½ 07/34	4.609	+0.053

*Change from close as at 5:00pm GMT.
Source: Bloomberg

Euro area

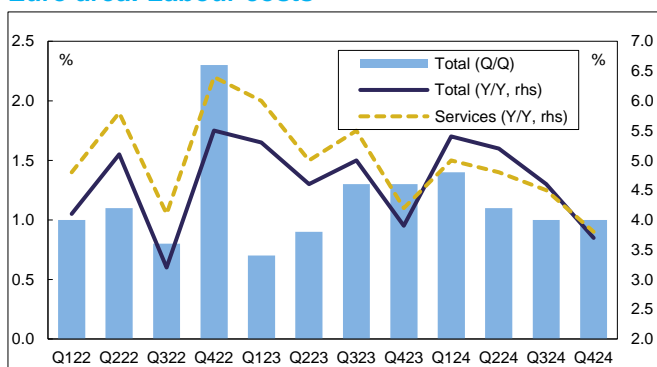
Labour costs and vacancies moderate to multi-year lows in Q4

ECB Executive Board member Isabel Schnabel has for some time provided the most articulate explanation of the hawkish position on the Governing Council. So, today euro area government bond yields rose in response to her suggestion that the Governing Council might soon need to pause or halt its rate-cutting cycle, as she questioned whether the current monetary stance was still restrictive. Nevertheless, today's economic data should have reinforced the view that the euro area disinflation process remains on track, in part as cost pressures emanating from the labour market continue to dissipate. Indeed, with the quarterly rate steady at the softest since Q223, the annual rate of labour cost growth slowed 0.9ppt in Q4 to 3.7%Y/Y, the softest in ten quarters, with business-economy labour costs slowing 0.5ppt to 4.1%Y/Y. At the sectoral level, the cooling of labour cost pressures was most marked in services (3.8%Y/Y), including consumer-facing services such as hospitality, recreation and retail, where concerns about inflation persistence are greatest. In contrast, while labour cost growth also moderated in construction (4.5%Y/Y), it was merely steady on the quarter in manufacturing (4.7%Y/Y) despite the weakness of final demand in the sector. Meanwhile, the business-economy job vacancy rate also continued to moderate in Q4 to 2.5%, the lowest since Q221 to be in line with the pre-pandemic level in Q419. Like for labour costs, the vacancy rate eased in services but was steady (albeit at a lower level) in industry. Wage trackers, such as the ECB's, signal the likelihood of a significant further decline in labour cost growth over the course of the year, facilitating the return of inflation to target or below, and giving scope for further rate cuts beyond next month, albeit probably by just 25bps in Q2 and Q3.

The day ahead in the euro area

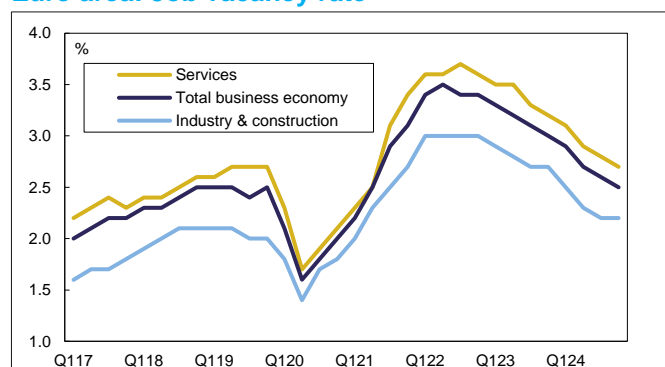
Despite the headwinds provided by Trump's increasingly aggressive trade and foreign policies, the improved sentiment flagged by investors in this week's ZEW survey may serve as a bellwether for the February Commission flash consumer confidence indicator. After consumer confidence declined to an 8-month low in December (-14.5), its rise in January was only marginal (-14.2). So, reduced political and fiscal uncertainty in France, and the prospect of similar in Germany after Sunday's federal elections, could well bring about another, albeit moderate, increase. Ongoing ECB rate cuts may also have provided a boost to consumers as mortgage rates start to decline. Separately, in part likely reflecting easier monetary policy, tomorrow's eurozone construction output data for December should confirm just a second positive quarter of growth in the sector since Q223, in part owing to the positive carryover from the previous quarter. But national releases have also flagged the likelihood of a strong month in December, particularly in Southern Europe. And while German and French construction continues to lag behind the bloc average, recent data should also offer hope that the lull for housebuilders in the euro area's largest member states has also started to bottom out. German PPI data for January are also due tomorrow.

Euro area: Labour costs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Job vacancy rate



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

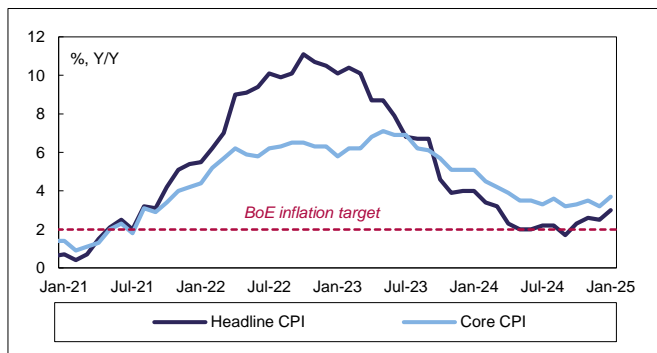
Jump in UK inflation to a 10-month high seemingly shuts the door to a March rate cut

When the BoE cut rates earlier this month it restated that a gradual approach to the further withdrawal of monetary policy restrictiveness remains appropriate. And while risks to the economic outlook appear skewed to the downside, a firmer-than-expected outturn in [Q4 GDP](#), an acceleration in [pay growth](#) in December and jump in inflation at the start of the year seem bound to have shut the door completely to a further rate cut in March. In particular, today's CPI report showed headline inflation rising a larger-than-expected 0.5ppt to 3.0%Y/Y, a ten-month high. This was 0.2ppt above the Bloomberg survey consensus and the BoE's projection published earlier this month. The core CPI rate was also higher than expected, up 0.5ppt to 3.7%Y/Y, similarly the firmest since April and above equivalent rates in the US, euro area and Japan.

Momentum in core goods and food prices rising, but softening in services

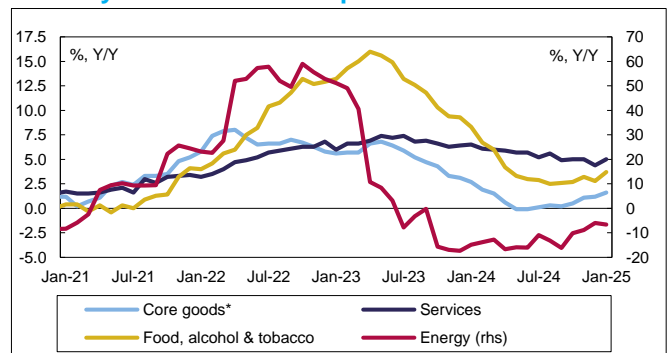
The upside surprise in part reflected non-energy industrial goods items, for which the decline in prices (-0.9%M/M) was just half the norm for the month in the two decades before the pandemic. This in part likely reflected reduced seasonal discounting of clothing and furniture as well as the weakening of sterling over the final quarter, and brought about a fourth consecutive increase in core goods inflation to an 11-month high (1.6%Y/Y). Policymakers will also be conscious of the recent pickup in momentum in food, with prices rising in January by the most since April 2023, to take inflation of food and non-alcoholic beverages up a sizeable 1.3ppts to a ten-month high (3.3%Y/Y) and almost 1ppt above the BoE's forecast. More encouragingly, the monthly rise in services prices was bang in line with the pre-pandemic norm for January suggesting that momentum maintained a moderate downtrend at the start of the year. Admittedly, services inflation jumped 0.6ppt in January – reversing the decline in December – to record 5.0%Y/Y for the third month out of the past four. But this was 0.2ppt lower than the BoE's projection. Moreover, it in part reflected the rise in private school fees as schools became subject to VAT at the start of the year, as well as a softer-than-usual decline in airfares after a smaller-than-normal rise in December. Indeed, when excluding indexed and volatile components, rents and foreign holiday-related components, a measure of underlying services inflation watched by the MPC fell 0.4ppt to 4.2%Y/Y, the lowest for 3½ years. And the NIESR estimate of the 10% trimmed mean CPI rate remained extremely subdued at 1.88%Y/Y.

UK: Headline & core CPI inflation



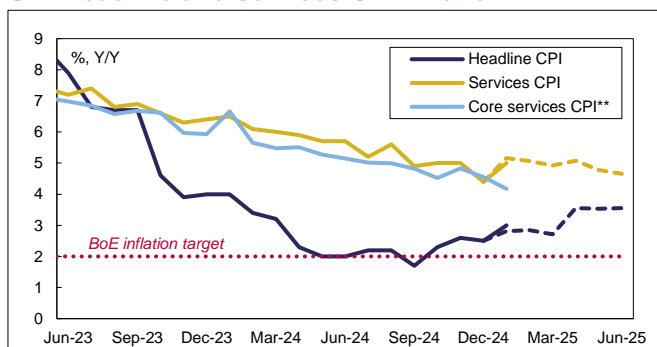
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Key CPI inflation components



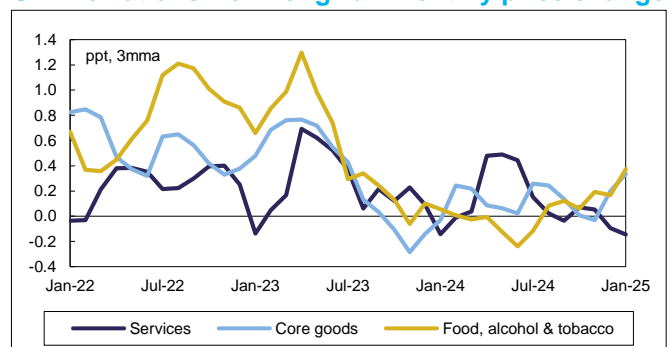
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Headline and services CPI inflation*



*Dashed lines represent BoE projections from MPR February 2025. **Excluding indexed and volatile components, rents and foreign holidays' measures. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Deviations from long-run monthly price change*



*Monthly change in prices compared to the average for the month in the decade before the pandemic. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

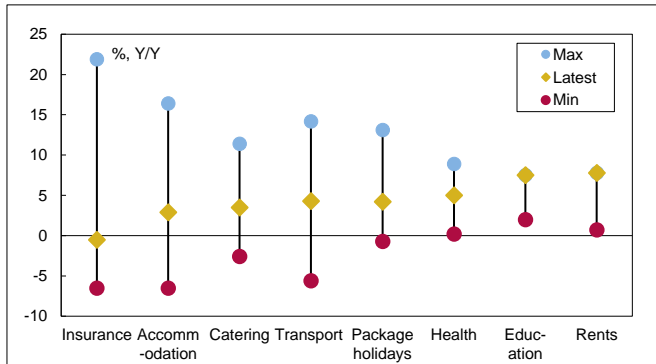
Inflation could rise as high as 4%Y/Y by September but should steadily decline thereafter

Notwithstanding some monthly volatility, and upside risks from the increase in employer NICs and National Minimum Wage in April, we expect services inflation to ease to around 4.0%Y/Y from the start of Q2 after which it will likely move broadly sideways though to the end of the year. But with the jobs market continuing to slow and wage pressures continue to fade, we expect it to resume a modest downtrend in 2026. In contrast, other components are likely to add to inflation over coming quarters. With a food packaging levy also adding to costs for retailers from April, we expect food inflation to edge up further over coming months, peaking at around 5.0%Y/Y over the summer. Although base effects in electricity and gas prices helped keep energy inflation firmly in negative territory in January (down 0.6ppt to -6.6%Y/Y), we expect it to take a step up over coming months, not least due to an anticipated hike of around 5% in the household energy tariff in April (Ofgem will publish the official increase in the price cap on 25 February). And despite subdued global demand, the impact of recent sterling weakness on import prices will also add upwards pressure to core goods inflation over coming quarters. So, overall, we expect headline CPI to rise from April onwards to a peak close to 4%Y/Y in September. Thereafter, however, once some of the temporary impulses start to fade, we think that inflation will gradually ease, returning to the Bank's 2% target by end-2026. Indeed, we think that the peak in core inflation should have been reached in January and that a gradual downtrend should allow it to return to 2%Y/Y or below by mid-2026. As such, we maintain our view that the BoE will cut rates by 25bps each quarter through to Q226, coinciding with updated macroeconomic projections in May, August, November and February.

The day ahead in the UK

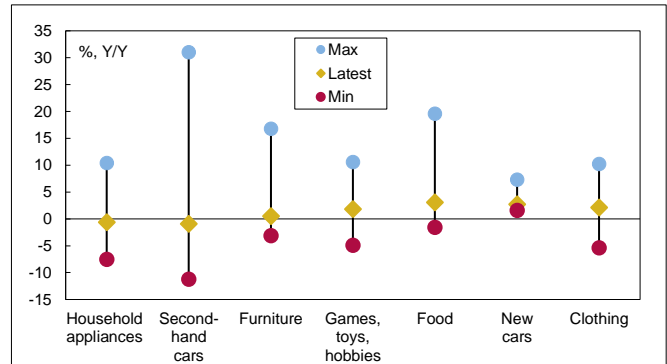
Following successive days of top-tier UK data, Thursday should bring some respite before Friday brings February's flash PMIs and retail sales data for January. Tomorrow's sole release – February's CBI industrial trends survey – will provide an account of manufacturing conditions ahead of the PMIs. Like the PMIs, the CBI survey has disappointed as of late, with manufacturers reporting shrinking order books and output expectations in the face of subdued demand, as well as a sharper increase in selling price expectations.

UK: Selected services inflation components



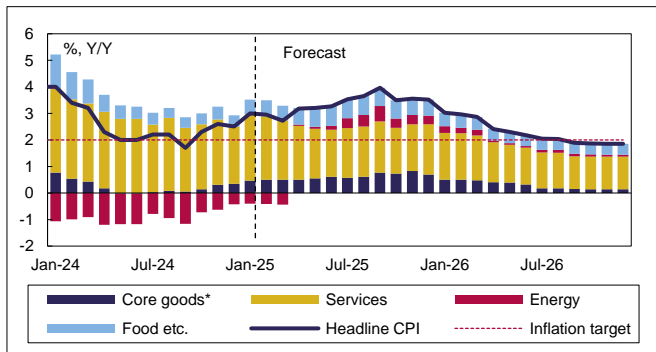
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected goods inflation components*



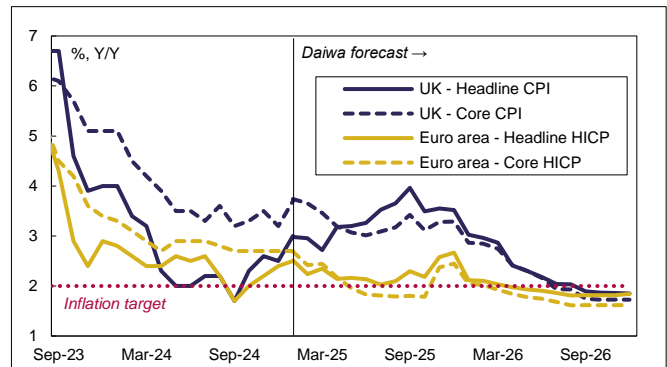
*Since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: CPI inflation forecast



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

Euro area & UK: Headline & core inflation forecast









Source: Macrobond and Daiwa Capital Markets Europe Ltd.



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Preliminary labour costs Y/Y%	Q4	3.7	-	4.6	-
	 Preliminary job vacancy rate %	Q4	2.5	-	2.6	-
	 Current account balance €bn	Dec	38.4	-	27.0	25.1
UK	 CPI (core CPI) Y/Y%	Jan	3.0 (3.7)	2.8 (3.6)	2.5 (3.2)	-
	 PPI – output (input) prices Y/Y%	Jan	0.3 (-0.1)	0.1 (-0.6)	0.1 (-1.5)	-0.1 (-1.3)
	 House price index Y/Y%	Dec	4.6	-	3.3	3.9

Auctions

Country	Auction
Germany	 sold €3.47bn of 2.5% 2035 bonds at an average yield of 2.52%
UK	 sold £4.25bn of 4.375% 2028 bonds at an average yield of 4.294%




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	10.00	Construction output M/M% (Y/Y%)	Dec	-	1.2 (1.4)
	15.00	Preliminary consumer confidence indicator	Feb	-14.4	-14.2
Germany	07.00	PPI Y/Y%	Jan	1.2	0.8
France	-	Retail sales Y/Y%	Jan	-	-0.8
UK	11.00	CBI industrial trends survey – total orders (selling prices) balance %	Feb	-30 (30)	-34 (27)

Auctions and events

France	 09.50	Auction: to sell up to €13.5bn of 2.4% 2028, 0% 2029 and 2.75% 2030 bonds
	 10.50	Auction: to sell up to €2.25bn of 0.1% 2031, 0.1% 2032, 0.1% 2036 and 0.95% 2043 inflation-linked bonds
Spain	 09.30	Auction: to sell 2.4% 2028, 2.7% 2030 and 3.55% 2033 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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