Euro wrap-up

Overview

Emily Nicol
+44 20 7597 8331

- Despite political discussion between incoming German Chancellor Merz and the SDP to increase defence spending, Bunds followed USTs marginally higher as euro area negotiated wage growth moderated in Q4.
- While the UK energy regulator announced a chunky hike in household energy tariffs in April, Gilts also followed USTs higher as a retail survey signalled ongoing weakness in spending.
- Wednesday will bring the latest survey results for German and French consumer confidence.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.049	-0.030
OBL 2.4 04/30	2.203	-0.028
DBR 2½ 02/35	2.448	-0.026
UKT 4⅛ 01/27	4.156	-0.061
UKT 4⅛ 07/29	4.168	-0.074
UKT 4¼ 07/34	4.499	-0.063

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

Euro area

Moderating negotiated wage growth supports case for further easing

With the ECB having cut its deposit rate by a cumulative 125bps since last summer to 2.75%, the hawks on the Governing Council are increasingly questioning the current degree of monetary policy restrictiveness. And with core inflation having remained steady for the past five months due to persisting stickiness in the all-important services component at almost double the 2% target, some policymakers have cautioned about the extent of further rate cuts this cycle. Nevertheless, the case for ongoing rate cuts is still largely supported by recent economic data. For example, momentum in services prices has slowed sharply over recent months (2.4%3M/3M annualised), while core inflation momentum is consistent with a return to the 2% target (or below) around the summer. And today's euro area negotiated wage indicator will have further reinforced the view that the disinflation process remains on track. In particular, the ECB's composite measure of pay settlement growth in Q4 moderated 1.3ppts to 4.1%Y/Y. This in part reflected a moderation in wage settlement growth to a three-year low in France (2.4%Y/Y) and Italy (2.3%Y/Y). There was also a marked slowdown in German negotiated pay (down 3.1ppts to 5.8%Y/Y). However, that reflected a softer rate of increase of one-off payments, excluding which German negotiated wage growth accelerated to 6.4%Y/Y, the most since Q193.

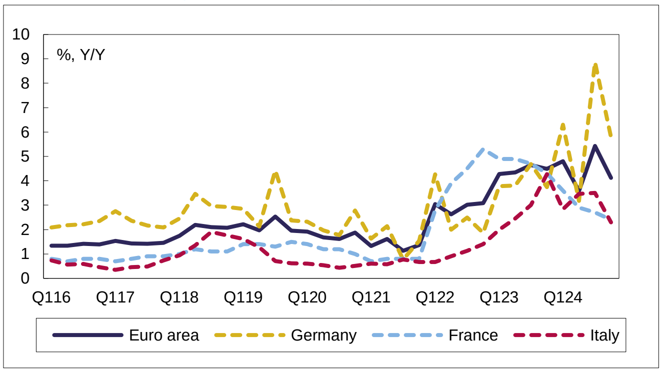
Wage growth falls further in January and softer jobs growth will limit wage bargaining

The pickup in German negotiated wages excluding one-off payments will have been expected by ECB policymakers. Indeed, the ECB's own wage tracker published earlier this month suggested that the measure excluding one-off payments would peak in Q4 (4.7%Y/Y). More importantly, this tracker suggested that negotiated pay growth would moderate to 2.8%Y/Y at end-2025 or just 1.3%Y/Y when including special payments. The latest Indeed monthly wage tracker also reported a notable step down at the start of the year to a three-year low (2.6%Y/Y), with moderation evident across the larger member states, albeit most striking in France (1.2%Y/Y). While the unemployment rate remains near a series low, job vacancies continue to decline to multi-year lows. And with surveys signalling an increasing desire of firms to cut headcount amid an ongoing absence of economic growth momentum, employee wage bargaining power will likely be limited and inflationary pressures related to labour costs should continue to fade.

Weakness in German GDP in Q4 led by a slump in exports

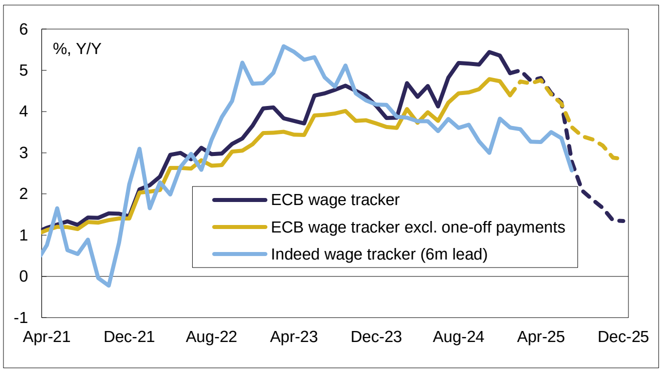
While Germany's incoming Chancellor Merz opened talks with the SPD to discuss options to by-pass the constitutional debt brake to give a big boost to defence spending, today's economic data confirmed that the German economy remained firmly in the slow lane at the end of 2024. Admittedly, government consumption rose for a sixth successive quarter in Q4

Euro area: Negotiated wage growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Wage trackers



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

(0.4%Q/Q) to leave it up almost 4%Y/Y and some 13% above the pre-pandemic level in Q419. Fixed investment (0.4%Q/Q) was boosted by a weather-assisted rise in construction and rebound in expenditure on transport equipment. But spending on machinery fell to the lowest level since 2013. And with household consumption growth slowing to just 0.1%Q/Q as the savings ratio remained elevated close to 11½%, final domestic demand added just 0.2ppt to GDP growth. But the most notable setback was a further sizeable decline in goods exports in Q4, which fell for the third successive quarter and by 3.4%Q/Q, the most since the global financial crisis when excluding the first Covid lockdown. While services exports offered some offset, imports were up 0.6%Q/Q to leave net trade subtracting more then 1ppt from growth. Although private inventories added a (questionably) large 0.7ppt, this still left GDP down 0.2%Q/Q and still just below the level ahead of the pandemic.

The day ahead in the euro area

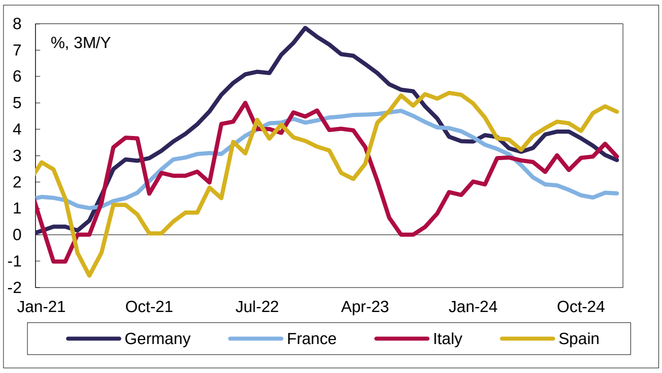
With the Commission's flash euro area consumer confidence indicator recovered to a five-month high in February (-13.6), tomorrow's German and French indicators are both expected to show a similar trend. In particular, the German GfK consumer survey – presented as a forecast for March – might have received a pre-election boost, although US rhetoric on European trade and security might minimise the potential improvement. Meanwhile, the French INSEE survey for February should also see another small uptick after the Budget adoption marked a welcome break from its recent political disorder.

UK

Diminished households' purchasing power to continue to limit discretionary spending

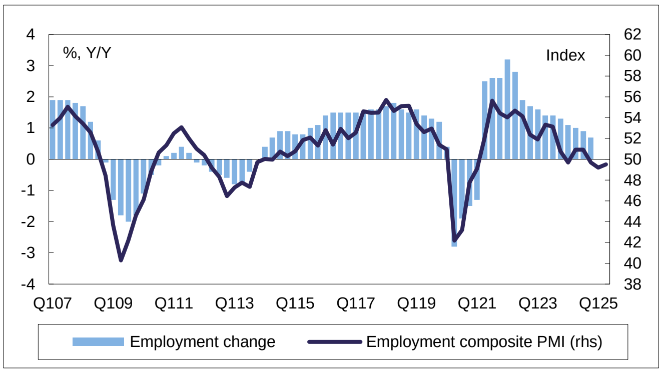
While UK retail sales were surprisingly strong in January, today's CBI distributive trades survey suggested that this bounce will prove temporary. In particular, the CBI's headline sales balance remained firmly in negative territory for a fifth successive month (-23), with retailers suggesting that sales were particularly weak for the time of year. And with consumers still downbeat about the economic outlook, retailers expect sales to remain extremely weak in March. While household incomes have benefited from strong wage growth and moderating inflation over the past year or so, we see limited prospects of a further loosening of purse strings over the near term. And although the National Living Wage is set to rise in April, households' purchasing power will be eroded at the start of Q2 by a third consecutive quarterly hike in energy tariffs. Indeed, the energy regulator Ofgem today announced that the price cap will increase by 6.4% (£1849) from 1 April. And taken together with other changes to administered and regulated prices – including the near-25% jump in the average water bill from April – as well as a further likely increase to the Ofgem cap in July, we expect headline inflation to rise steadily over the summer to peak at close to 4%Y/Y in September. This would leave inflation at 3.8%Y/Y in Q325, a touch firmer than the BoE

Euro area: Indeed wage tracker



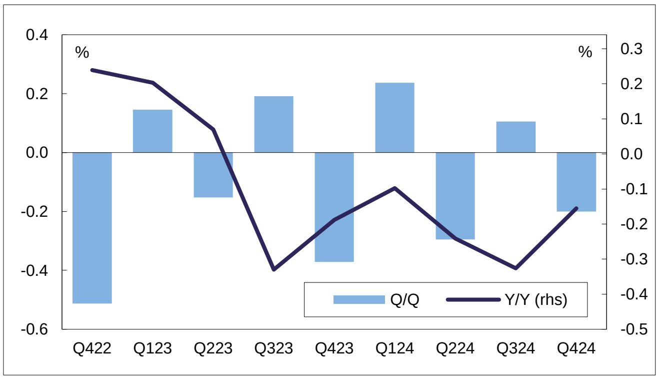
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Employment growth & PMI



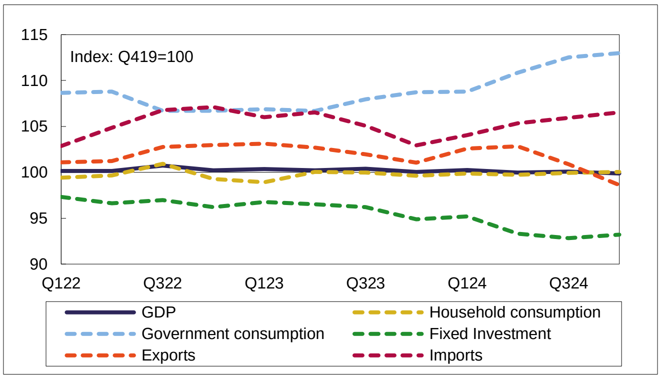
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Germany: GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: GDP and expenditure levels



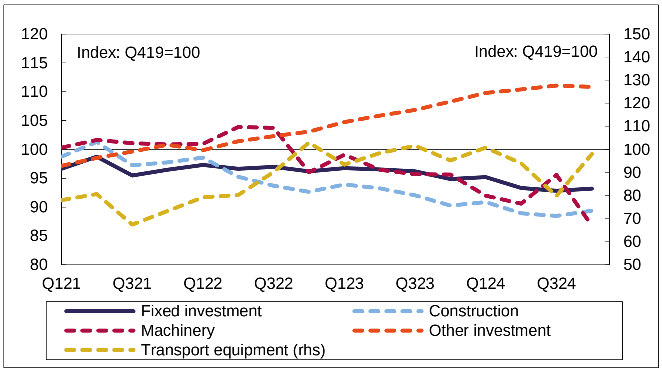
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

projected earlier this month. And while we expect an ongoing absence of meaningful demand and still-restrictive monetary policy to help bring inflation back to the 2% target in Q326, some five quarters ahead of the BoE, we continue to expect the MPC to cut Bank Rate only gradually this cycle, with one cut of 25bps each quarter through to Q226 to coincide with each set of the Bank's updated macroeconomic projections.

The day ahead in the UK

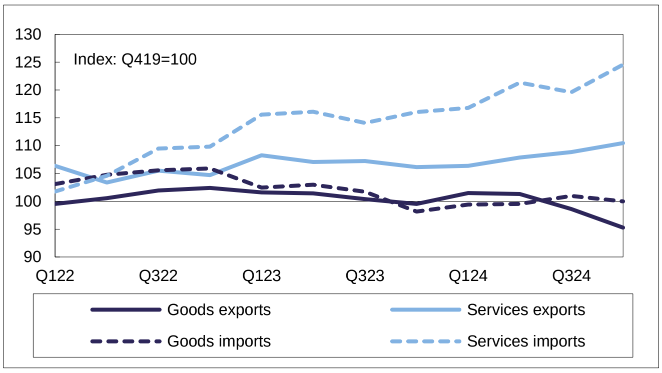
It is set to be a quiet day ahead on the data front in the UK. The MPC's uber-dove Swati Dhingra is due to deliver a speech on 'Trade fragmentation and monetary policy' to National Institute of Economic and Social Research (NIESR). While the February Monetary Policy Report noted that the BoE's updated macroeconomic projections were not conditioned on the potential impacts of new tariffs implemented by the US, with the threat of reciprocal tariffs now being levied, her comments may provide some insight into how trade risks are factored into the MPC's inflation outlook.

Germany: Fixed investment



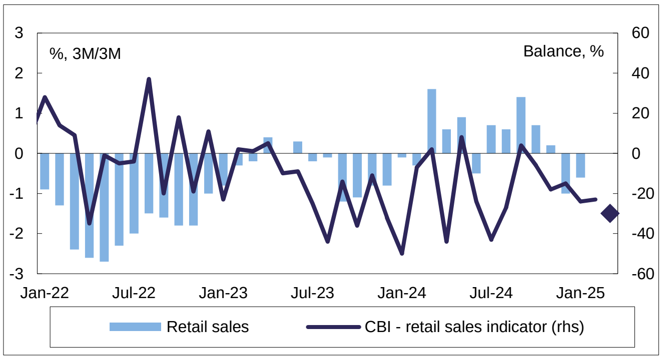
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Export and import volumes



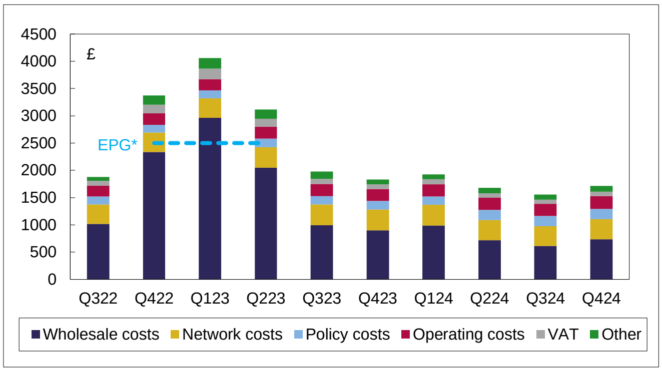
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales*



**Diamond represents survey forecast for March.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Household energy tariff



**Energy price guarantee. Direct debit payments. Source: Ofgem and Daiwa Capital Markets Europe Ltd.*

European calendar

Today's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Negotiated wages Y/Y%	Q4	**4.1**	-	5.4	-
		New car registrations Y/Y%	Jan	**-3.5**	-	3.6	-
Germany		GDP – final estimate Q/Q% (Y/Y%)	Q4	**-0.2 (-0.2)**	*-0.2 (-0.2)*	0.1 (-0.3)	-
UK		CBI distributive trades survey – reported sales volumes %	Feb	**-23**	-20	-24	-

Auctions

Country		Auction
Germany		sold €1.495bn of 1.8% 2053 bonds at an average yield of 2.73%
Italy		sold €2.75bn of 2.55% 2027 bonds at an average yield of 2.38%
		sold €1.5bn of 1.8% 2036 inflation-linked bonds at an average yield of 1.9%
UK		sold £1.6bn of 1.125% 2035 inflation-linked bonds at an average yield of 1.115%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		07.00	GfK consumer confidence indicator	Mar	-21.6	-22.4
France		07.45	INSEE consumer confidence indicator	Feb	92	92
Spain		08.00	PPI Y/Y%	Jan	-	2.3

Auctions and events

Country		GMT	Event
Germany		10.30	Auction: to sell up to €500m of 0% 2036 bonds
		10.30	Auction: to sell up to €1.5bn of 1% 2038 bonds
UK		16.30	MPC External Member Dhingra to deliver lecture on trade fragmentation and monetary policy at NIESR, London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.