Euro wrap-up

Overview

- Bunds followed USTs higher, as German core inflation fell to the lowest since mid-2021, and French and Italian services inflation also declined to multi-year lows.
- Gilts also made gains even as BoE Deputy Governor reiterated that a gradual approach to future rate cuts is appropriate given uncertainty about the strength of wage settlements this year.
- Looking ahead, on Thursday the ECB will cut the deposit rate to 2.50% but revise slightly higher its near-term inflation outlook. On Monday, the flash euro area inflation estimates will resume a downtrend.

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Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.006	-0.021
OBL 2.4 04/30	2.134	-0.028
DBR 2½ 02/35	2.388	-0.024
UKT 4⅛ 01/27	4.148	-0.023
UKT 4⅛ 07/29	4.151	-0.034
UKT 4¼ 07/34	4.464	-0.047

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

Euro area

German inflation steady amid jump in food prices, but core inflation lowest since mid-2021

Ahead of the release of the flash euro area inflation estimates for February on Monday, the figures published so far by the larger member states point to a decline in both the headline and core measures, which should further support the case for another ECB rate cut in the coming week (see below). Admittedly, German HICP inflation was unchanged in February for a third consecutive month at 2.8%Y/Y, 1ppt above the trough in September and 0.3ppt above the average last year. The national CPI rate also held steady (2.3%Y/Y). But this was due to a jump in food prices – by the most since March 2023 – to take inflation up a hefty 1.6ppts to a 13-month high (2.4%Y/Y). Indeed, underlying price pressures continued to ease in February, with services inflation down 0.2ppt to 3.8%Y/Y and the core goods component down 0.5ppt to 1.0%Y/Y, both the lowest for five months. The detail published by the states points to softer inflation of several key services components, including hospitality, recreation and healthcare, and clothing within goods. As such, the national core CPI rate (excluding food and energy) fell for a second successive month by 0.3ppt to 2.6%Y/Y, the lowest since June 2021.

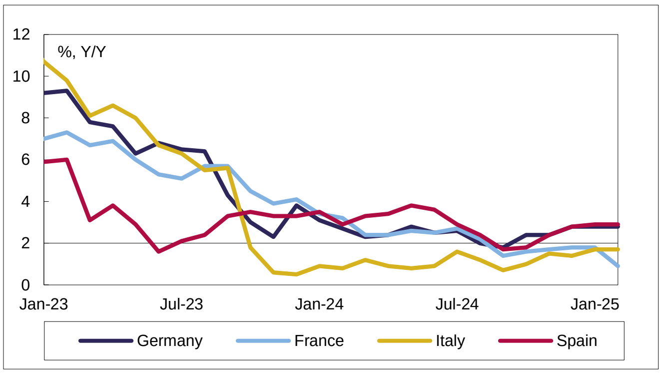
French inflation halves due to a cut in electricity tariffs, but services inflation also moderated

In contrast to the flat headline German figure, there was a marked downwards shift in French inflation in February, with the headline HICP rate halving to just 0.9%Y/Y (0.8%Y/Y on the national measure), the first sub-1% reading for four years. Within the national detail, the downwards impulse predictably in part reflected the energy component, for which prices fell 4.5%M/M – the most since December 2008 at the height of the global financial crisis – due to a near-15% cut in regulated electricity tariffs. This took energy inflation down a chunky 8.5ppts to -5.7%Y/Y. Meanwhile, there was an ongoing absence of price pressures in food (0.3%Y/Y) and manufactured goods (0.0%Y/Y). But today's figures also suggested that services price-setting was better behaved in February, just 0.1ppt above the pre-pandemic long-run trend for this month. As a result, the annual rate of services inflation fell 0.4ppt to 2.1%Y/Y, the lowest for more than three years.

Italian inflation steady as energy inflation impulses offsets services disinflation

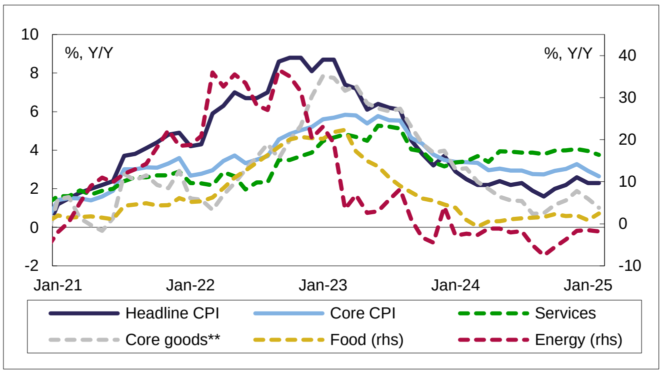
Like in Germany and Spain, Italian HICP inflation merely moved sideways in February (1.7%Y/Y). But this contrasted an expected modest increase and still marked the 17th successive sub-target reading. And, similar to France, the predominant impulses this month related to regulated prices (albeit in the opposite direction), with the energy component up 1.3ppts to 0.6%Y/Y. In contrast, core goods inflation slipped slightly into negative territory (-0.1%Y/Y) and, most importantly, services inflation fell 0.3ppt to 2.6%Y/Y, the softest since April 2022. While seasonal discounting may have played a role in clothing, transport services and package holidays, core inflation declined 0.3ppt to 1.5%Y/Y, the lowest since January 2022. Overall,

Euro area: HICP inflation in selected member states



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation*



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

taken together with the downside surprise to Spain's core inflation, we expect the aggregate euro area core HICP rate to moderate for the first month in six in February, by 0.2ppt to 2.5%Y/Y, the softest for more than three years. So, having edged gradually higher since September, we also forecast the headline HICP rate to fall 0.2ppt to 2.3%Y/Y. Looking ahead, after a further gradual decline through to the autumn, we expect a pickup in inflation towards the end of the year associated with base effects. But that should prove temporary, allowing a return to 2% or lower from Q126. Certainly, today's ECB consumer survey results suggested that household medium-term inflation expectations remain well anchored, with the median forecast for headline inflation three years ahead broadly in line with the target in Germany (2.1%Y/Y) and France (2.0%Y/Y).

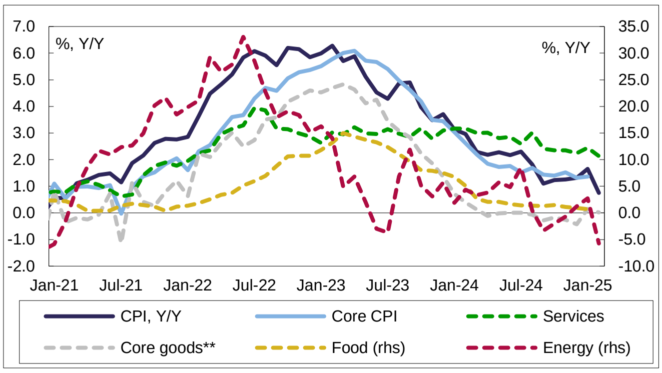
German and French household spending remains subdued amid heighted uncertainties

While we expect fading labour cost pressures to support disinflation in services, the pass-through of factory pipeline pressures will also be restrained by continued weakness in goods demand, which was again illustrated in today's spending figures. In particular, German retail sales rose a smaller-than-expected 0.2%M/M in January, with a modest rebound in food sales offsetting a fourth successive drop in non-food sales. And while the decline in December was predictably smaller than initially estimated (revised from -1.6%M/M to -0.9%M/M), this still left the level of sales in January some 0.3% below the Q4 average. French household expenditure on goods also undershot expectations at the start of the year (-0.5%M/M). While this in part reflects a marked drop in sales of new autos (-6.4%M/M), spending on clothing and household appliances also fell. And we suspect that discretionary spending on goods will remain subdued over the near term. Certainly, consumer confidence surveys continue to point to a preference to save amid heightened economic uncertainties. And today's German labour market figures will have further added to concerns about labour market conditions in the euro area's largest member state. Indeed, while the claimant count rate held steady in February (6.2%), the number of people claiming jobless benefits rose for a twenty-sixth consecutive month. And with job vacancies down more than 210k from the pandemic peak and some 120k below the pre-pandemic average in 2019, and firms signalling an ongoing desire to cut headcount, we expect a further rise in unemployment over coming quarters.

ECB to cut rates for 5th consecutive meeting, bringing the Deposit Rate to 2.50%

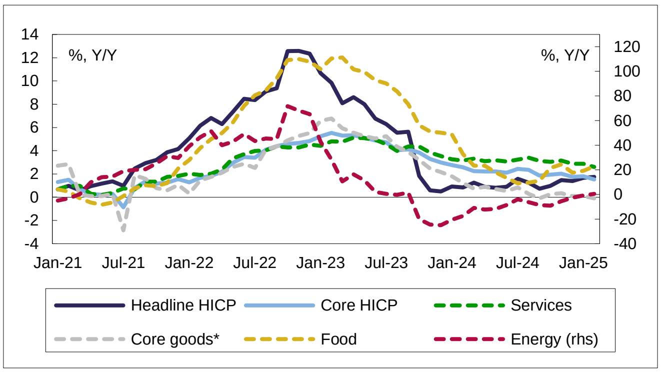
Notwithstanding the possibility that more detail will emerge on President Trump's plans for reciprocal tariffs on imports from the EU, Thursday's ECB monetary policy announcement, and accompanying staff economic projections, will be the main event in euro area in the coming week. The Governing Council looks firmly set to cut its policy rates by a further 25bps – marking a sixth such easing this cycle, and for a fifth consecutive meeting – bringing the key deposit rate to a two-year low of 2.50%. Indeed, with inflation in Q4 slightly softer than forecast and leading indicators still consistent with significant moderation in wage growth later this year, we expect the Governing Council's decision again to be unanimous. In terms of its

France: Consumer price inflation*



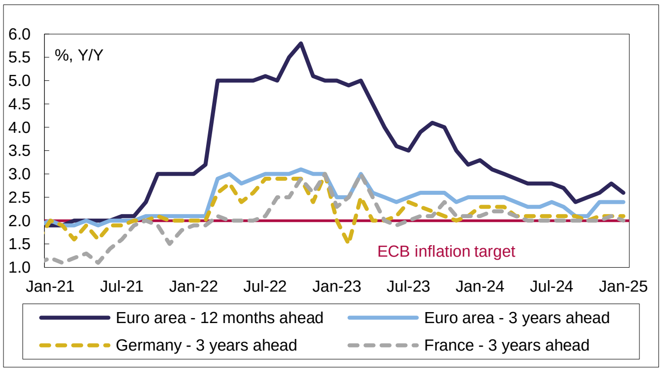
*National measure. **Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: Consumer price inflation*



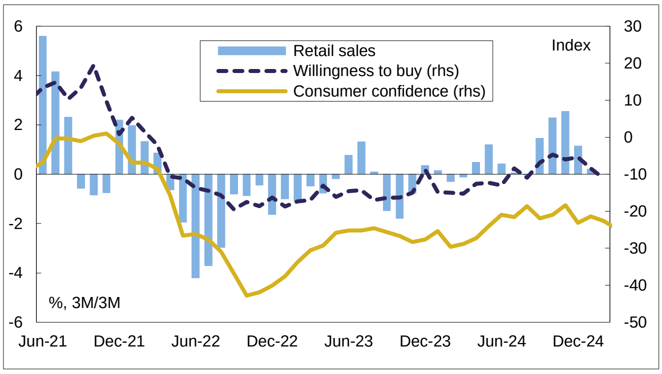
*EU-harmonised measure. **Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB consumer price expectations



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales & consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

forward guidance, the statement will maintain the emphasis on keeping a data-dependent, meeting-by-meeting approach to setting policy. But as the resulting policy stance will be closer to neutral, we also expect the pace of cuts after this meeting to slow to a quarterly frequency. So, clues as to the likely rate of future easing (if any) within the tone and language of the policy statement and President Lagarde's press conference will be of particular importance in dictating the market's response.

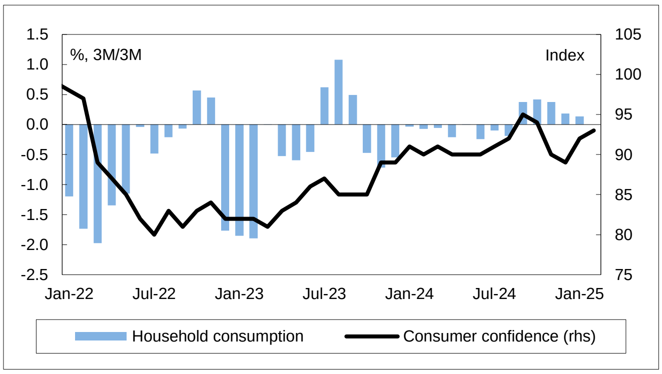
Pace of easing expected to slow as debate about restrictiveness approaches

Given the range of views on the Governing Council, however, Lagarde might try her best to be non-committal. While the account of January's monetary policy meeting noted that 'it was relatively safe to make the assessment that monetary policy was still restrictive', the extent of such restrictiveness has recently been called into question by certain ECB hawks, most notably Executive Board member Schnabel. Certainly, with the cumulative easing since June still feeding through into financial and macroeconomic conditions, the more cautious policymakers on the Governing Council may prefer to pause at the following meeting in April to allow more time to assess the incoming data and implications of any potential shocks stemming from US tariffs. On the other hand, certain doves, such as Portuguese Governor Centeno, will likely want to leave open the door to maintaining the existing pace of cuts over coming meetings and the possibility of eventually reaching an accommodative stance, not least given the downside risks to an already subdued economic growth outlook. There will certainly remain no consensus surrounding the eventual 'landing zone' for policy.

Inflation projections to be revised higher, but to remain consistent with further cuts to come

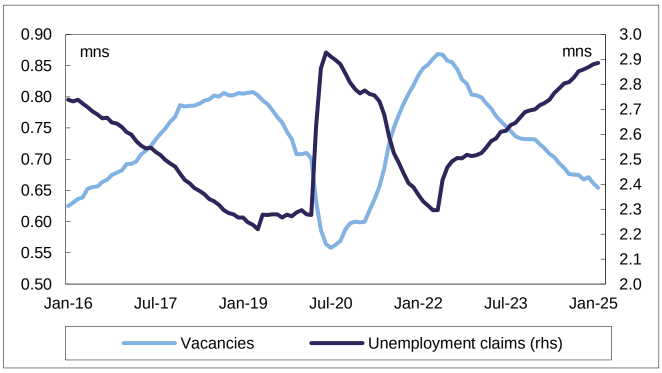
In keeping with the ECB's data-dependent and inflation-target based approach to setting policy, the updated macroeconomic projections will be considerably more useful than estimates of neutral in determining the pathway for policy. Both inflation (2.2%Y/Y versus the projected 2.3%Y/Y) and GDP growth (0.1%Q/Q versus the projected 0.2%Q/Q) were very slightly softer than the ECB had anticipated in Q424. But higher oil and, in particular, gas prices around the cut-off dates for the updated forecasts compared to their predecessors', as well as a pickup in electricity prices in some countries and ongoing currency weakness, should all lead the staff to revise up the near-term inflation outlook. But that revision should not materially affect the ECB's assessment of the likelihood of inflation persistence. Indeed, we would continue to expect the projections to point towards inflation settling around the 2% target from the first half of next year, potentially only a couple of quarters beyond the dates predicted in December (Q425). With its previous growth projection of 1.1%Y/Y having been conditioned on an unlikely 0.3%Q/Q in Q125, a downwards revision to its profile for GDP in 2025 should also weigh on the inflation profile. We also note that wholesale gas prices have eased considerably since the cut-off date, raising the risks that the updated forecasts will be out of date before they are published. But given the extremely uncertain geopolitical environment, and with the

France: Consumer spending & confidence



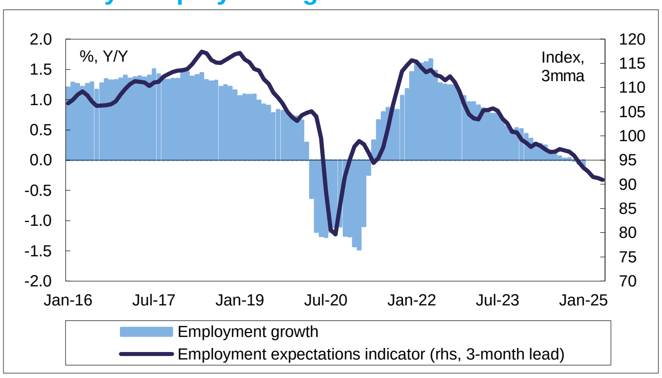
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Unemployment claims & job vacancies



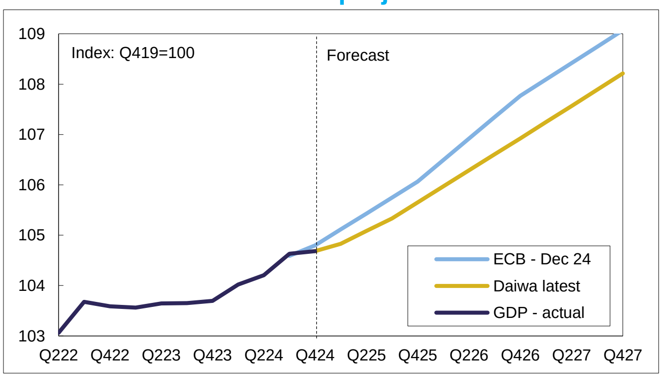
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Employment growth & intentions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB GDP level projection



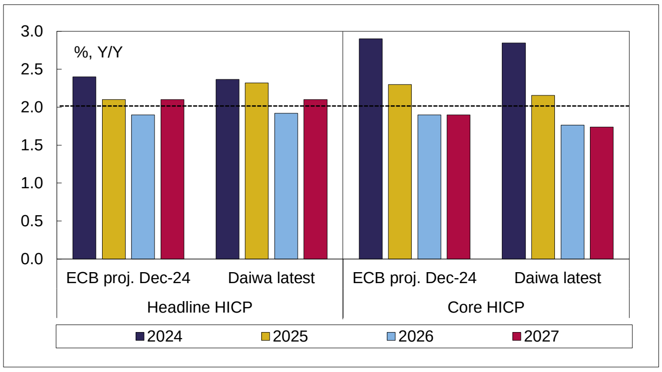
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

precise nature of any new tariff barriers between Europe and the US unknown, the risks to the GDP outlook will likely be skewed significantly to the downside, even if the risks to the inflation outlook will be two-sided.

The data week ahead in the euro area

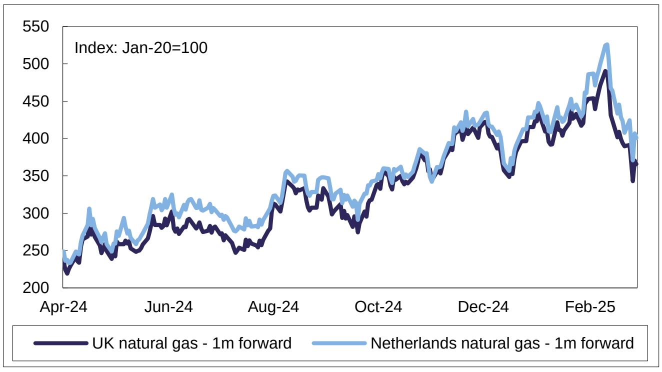
A busy week on the data front nevertheless seems highly unlikely to offer up any surprises which could influence the outcome of Thursday's decision. Notwithstanding today's sticky headline German figure, Monday's aforementioned flash euro area inflation estimates should firm up the confidence that underlying price pressures are fading, as core inflation looks set to fall to a more than three-year low (2.5%Y/Y). Likewise, a sideways step in the euro area unemployment rate in January (6.3%) should contain any immediate concerns about labour market developments one way or the other. But we expect February's final PMIs to give a slightly improved picture compared to the flash estimates, as the French services and composite indices (due Wednesday), which halted the uptrend for the euro area aggregates, should be revised up. Meanwhile, at the end of the week, the third and final estimates for euro area GDP in Q4 (Friday), which will include a breakdown by expenditure components, should confirm the latest estimate of growth of 0.1%Q/Q and 0.9%Y/Y. And they should also show that final private domestic demand continued to contribute positively but that net trade provided a non-negligible drag. Retail sales volumes had risen for a fifth consecutive quarter at the end of that year, despite having slipped back in December. And January's data (Thursday) should signal only a slight improvement at the start of this year. Payback will be more obvious in Germany's factory orders (Friday), which are due to fall back following an outsized rise of 6.9%M/M in December.

Euro area: ECB inflation projections



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

Europe: Natural gas futures



Source: Bloombergg and Daiwa Capital Markets Europe Ltd.

The week ahead in the UK

In another relatively thin week ahead for UK data, most notable will be January's bank lending data (Monday) and February's BoE Decision Maker Panel survey (Thursday). Certainly, with respect to the latter, businesses' selling-price and CPI expectations will be closely watched given multiple cost pressures in the pipeline and after the upside surprise to January's inflation data. That hotter CPI print owed particularly to food prices (3.3%Y/Y), for which the BRC's shop price index (Tuesday) could provide a gauge for developments in February. But as core goods (1.6%Y/Y) also more broadly helped to drive that increase, and following a surprisingly firm labour market report for the end of last year, attention will also be on firms' wage expectations and any changes to their expected response to April's rise in employer NICs and national minimum wage.

To date, the DMP has flagged firms' intentions to absorb the increased costs through a combination of lower wages, headcount and profit margins, as well as higher prices. Indeed, this blended approach would be consistent with the evidence from other business surveys, including the further rise in input costs and job-shedding highlighted by February's flash PMIs. The final composite PMIs (Wednesday) will be expected to confirm each of those, with the headline output index also expected to remain consistent with a lack of notable growth momentum amid the uncertain outlook. February's construction PMI (Thursday) will also be of interest after disruptive weather and general uncertainty reportedly contributed to a sudden reversal in momentum at the start of the year (down 5.2pts to 48.1).

Circling back to the start of the week, and Monday's aforementioned credit report, elevated borrowing costs and prevailing uncertainty will likely continue to dampen the recovery in business lending, particularly to SMEs. On the other hand, mortgage approvals could remain firm. With mortgage rates having failed to respond fully to cuts to Bank Rate in recent months, but prices supported by ample demand as flagged by continued solid price growth in today's Nationwide index (0.4%M/M, 3.9%Y/Y), impending changes to stamp duty levies from April – potentially worth up to £2.5k to homeowners, and £6.25k for first-time buyers – might help to bring forward some activity ahead of that date.

Daiwa economic forecasts

	2024		2025				2024	2025	2026
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	**%, Q/Q**						**%, Y/Y**		
Euro area	0.4	0.1	0.1	0.2	0.2	0.3	0.7	0.8	1.2
UK	0.0	0.1	0.2	0.1	0.2	0.3	0.9	0.7	1.1
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.2	2.2	2.4	2.2	2.2	2.5	2.4	2.3	1.9
Core HICP	2.8	2.7	2.5	2.0	1.8	2.2	2.8	2.1	1.8
UK									
Headline CPI	2.0	2.5	2.9	3.3	3.8	3.6	2.5	3.4	2.3
Core CPI	3.3	3.3	3.6	3.1	3.2	3.2	3.7	3.3	2.2
Monetary policy, %									
ECB									
Deposit Rate	3.50	3.00	2.50	2.25	2.00	2.00	3.00	2.00	2.00
Refi Rate	3.65	3.15	2.65	2.40	2.15	2.15	3.15	2.15	2.15
BoE									
Bank Rate	5.00	4.75	4.50	4.25	4.00	3.75	4.75	3.75	3.25

Source: Bloomberg, ECB, BoE 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	ECB consumer expectations survey – 1Y CPI (3Y CPI) Y/Y%	Jan	**2.6 (2.4)**	2.8 (2.5)	2.8 (2.4)	-
Germany	Preliminary HICP (CPI) Y/Y%	Feb	**2.8 (2.3)**	2.7 (2.3)	2.8 (2.3)	-
	Retail sales M/M% (Y/Y%)	Jan	**0.2 (3.5)**	0.5 (1.7)	-1.6 (1.1)	-0.9 (2.0)
	Unemployment rate % (change 000s)	Feb	**6.2 (5)**	6.2 (14)	6.2 (11)	-
France	Preliminary HICP (CPI) Y/Y%	Feb	**0.9 (0.8)**	1.1 (1.0)	1.8 (1.7)	-
	GDP – final estimate Q/Q% (Y/Y%)	Q4	**-0.1 (0.6)**	*-0.1 (0.7)*	0.4 (1.2)	-
	Total (final private sector) payroll employment Q/Q%	Q4	**-0.3 (-0.3)**	- *(-0.2)*	0.2 (0.1)	0.1 (-)
	Consumer spending M/M% (Y/Y%)	Jan	**-0.5 (0.4)**	-0.8 (0.5)	0.7 (0.9)	- (0.4)
Italy	Preliminary HICP (CPI) Y/Y%	Feb	**1.7 (1.7)**	1.8 (1.6)	1.7 (1.5)	-
UK	Lloyd's business barometer (own price expectations)	Feb	**49 (64)**	-	37 (59)	-
	Nationwide house price index M/M% (Y/Y%)	Feb	**0.4 (3.9)**	0.2 (3.4)	0.1 (4.1)	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
		Monday 3 March 2025			
Euro area	09.00	Final manufacturing PMI	Feb	*47.3*	46.6
	10.00	Preliminary headline (core) HICP Y/Y%	Feb	*2.2 (2.4)*	2.5 (2.7)
Germany	08.55	Final manufacturing PMI	Feb	*46.1*	45.0
France	08.50	Final manufacturing PMI	Feb	*45.5*	45.0
Italy	08.45	Manufacturing PMI	Feb	46.7	46.3
	09.00	Annual GDP Y/Y%	2024	-	0.9
	09.00	Fiscal deficit-to-GDP %	2024	-	7.2
Spain	08.15	Manufacturing PMI	Feb	51.4	50.9
UK	09.30	Net consumer credit £bn (Y/Y%)	Jan	1.2 (-)	1.0 (6.5)
	09.30	Net mortgage lending £bn (mortgage approvals 000s)	Jan	3.5 (65.6)	3.6 (66.5)
	09.30	Final manufacturing PMI	Feb	*46.4*	48.3
		Tuesday 4 March 2025			
Euro area	10.00	Unemployment rate %	Jan	6.3	6.3
Spain	08.00	Unemployment (net employment) change 000s	Feb	-	38.7 (35.8)
UK	00.01	BRC shop price index Y/Y%	Feb	-0.5	-0.7
		Wednesday 5 March 2025			
Euro area	09.00	Final composite (services) PMI	Feb	*50.2 (50.7)*	50.2 (51.3)
	10.00	PPI Y/Y%	Jan	1.3	0.0
Germany	08.55	Final composite (services) PMI	Feb	*51.0 (52.2)*	50.5 (52.5)
France	07.45	Industrial production M/M% (Y/Y%)	Jan	0.5 (-0.1)	-0.4 (-1.7)
	08.50	Final composite (services) PMI	Feb	*44.5 (44.5)*	47.6 (48.2)
Italy	08.45	Composite (services) PMI	Feb	50.0 (51.0)	49.7 (50.4)
	09.00	GDP – final estimate Q/Q% (Y/Y%)	Q4	*0.0 (0.5)*	0.0 (0.4)
	10.00	Retail sales M/M% (Y/Y%)	Jan	-	0.6 (0.6)
Spain	08.15	Composite (services) PMI	Feb	54.7 (55.5)	54.0 (54.9)
UK	09.00	New car registrations Y/Y%	Feb	-	-2.5
	09.30	Final composite (services) PMI	Feb	*50.5 (51.1)*	50.6 (50.8)
		Thursday 6 March 2025			
Euro area	08.30	Construction PMI	Feb	-	45.4
	10.00	Retail sales M/M% (Y/Y%)	Jan	0.1 (1.9)	-0.2 (1.9)
	13.15	ECB Deposit Rate (Refi Rate) %	Mar	*2.50 (2.65)*	2.75 (2.90)
Germany	08.30	Construction PMI	Feb	-	42.5
France	08.30	Construction PMI	Feb	-	44.5
Italy	08.30	Construction PMI	Feb	-	50.9
UK	09.30	DMP 3M output price (1Y CPI) expectations %	Feb	4.0 (3.1)	3.9 (3.0)
	09.30	Construction PMI	Feb	49.8	48.1
		Friday 7 March 2025			
Euro area	10.00	GDP – final estimate Q/Q% (Y/Y%)	Q4	*0.1 (0.9)*	0.4 (0.9)
	10.00	GDP – household consumption Q/Q%	Q4	*0.2*	0.7
	10.00	GDP – government expenditure Q/Q%	Q4	*0.1*	0.6
	10.00	GDP – fixed investment Q/Q%	Q4	*0.0*	2.0
	10.00	Final employment Q/Q% (Y/Y%)	Q4	*0.1 (0.6)*	0.2 (1.0)
Germany	07.00	Factory orders M/M% (Y/Y%)	Jan	-2.3 (2.6)	6.9 (-6.3)
France	07.45	Trade balance €bn	Jan	-	-3.9
Spain	08.00	Industrial production M/M% (Y/Y%)	Jan	-	0.9 (2.1)
	08.00	House price index Q/Q% (Y/Y%)	Q4	-	2.8 (8.1)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions			
Country		GMT	Event / Auction
Monday 3 March 2025			
Germany		11.00	Bundesbank to publish selected article on "sound public finances, stronger investment: a proposal to reform the debt brake"
Tuesday 4 March 2025			
Germany		10.30	Auction: to sell up to €4.5bn of 2.4% 2030 bonds
UK		10.00	Auction: to sell £2.25bn of 4.375% 2054 bonds
Wednesday 5 March 2025			
UK		10.00	Auction: to sell £4.25bn of 4.375% 2030 bonds
		14.30	BoE Governor Bailey, Chief Economist Pill & External Members Taylor & Greene to before the Treasury Select Committee
Thursday 6 March 2025			
Euro area		13.15	ECB monetary policy announcement
		13.45	ECB President Lagarde to hold post-Governing Council meeting press conference
		14.45	ECB to publish updated macroeconomic projections
France		09.50	Auction: to sell up to €13bn 3.2% 2035, 4.75% 2035, 1.75% 2039 and 2.5% 2043 bonds
Spain		09.30	Auction: to sell 3.1% 2031, 3.15% 2035 bonds, and 0.7% 2033 inflation-linked bonds
Friday 7 March 2025			
Euro area		18.00	ECB Governing Council members Centeno & Kazāks participate in panel on monetary policy and the labour market, Lisbon

**Details to be announced. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*