

Euro wrap-up

Overview

- Bunds made sizeable losses amid the prospects of higher government military spending, even as core inflation fell to a three-year low.
- Gilts made more modest losses as UK mortgage lending picked up ahead of the Stamp Duty hike in April.
- The coming few days will bring euro area unemployment and PPI inflation figures for January, as well as final February services PMIs.

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Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.059	+0.042
OBL 2.4 04/30	2.208	+0.061
DBR 2½ 02/35	2.487	+0.082
UKT 3¾ 03/27	4.202	+0.026
UKT 4¼ 07/29	4.249	+0.028
UKT 4¼ 07/34	4.554	+0.026

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

Source: Bloomberg

Euro area

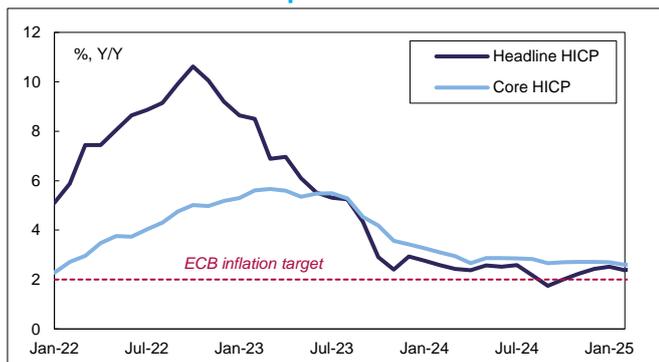
Flash inflation a touch firmer than expected, but the core rate down to a three-year low

While the flash euro area inflation estimates for February came in a touch firmer than expected, both the headline and core HICP rates fell for the first month in five, further underscoring that the [ECB](#) will cut rates again this week. Admittedly, the 0.1ppt decline in headline inflation to 2.4%Y/Y, left it merely in line with the 2024 average and tracking 0.2ppt above the ECB's December projection for Q1. But this was still more than 8ppts below the peak in October 2022. And to two decimal places the headline rate slowed 0.15ppt to 2.37%Y/Y. Meanwhile, disinflation was reported in more than half of the euro area's 20 member states, and the headline rate was at or below the 2% target in more than one third including France (0.9%Y/Y) and Italy (1.7%Y/Y). Furthermore, within the euro area detail, a significant upwards impulse came from fresh food inflation, which jumped to a 21-month high (3.1%Y/Y). As such, inflation of the wider food, alcohol and tobacco category increased 0.4ppt to a four-month high (2.7%Y/Y). While core goods inflation also edged slightly higher, perhaps reflecting base effects with the timing of seasonal discounting, it remained largely absent (0.6%Y/Y). The drop in energy inflation (down 1.7ppts to 0.2%Y/Y) was largely due to a near-15% cut in French regulated electricity prices, offsetting a modest rise in petrol prices that month. Most encouragingly, however, services inflation fell 0.2ppt to 3.7%Y/Y, matching April's near-two-year low. As such, core inflation moderated 0.1ppt to 2.6%Y/Y, the lowest since January 2022 to be trending 0.1ppt below the ECB's Q1 projection.

Weak demand and fading labour costs to support a return to target over coming quarters

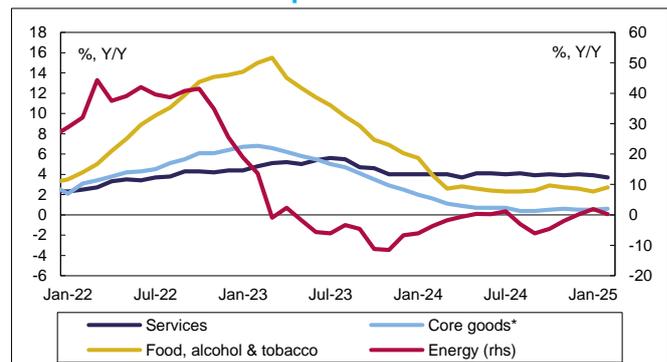
While the ECB's seasonally adjusted data suggest that services momentum on a three-month basis ticked up in February to a four-month high (3.2%3M/3M annualised), this was still almost 1ppt below the 2024 average and more than 4ppts off the peak. Certainly, the monthly increase remained relatively well behaved and below the average of recent years. With inflationary impulses from labour costs set to fade further, we maintain our view that services inflation will take a further step down over coming months to 2½%Y/Y by end-Q2. Today's data were also consistent with a continued absence of meaningful core goods momentum (0.7%3M/3M annualised). Admittedly, the depreciation in the euro exchange rate towards the end of last year might add some modest impulse over coming quarters. And the full nature and impact of US tariff hikes remains a significant unknown. But, for now at least, given weak domestic demand and competition from China which might intensify as production destined for the US redirects towards Europe, we expect non-energy industrial goods inflation to remain comfortably below 2% over coming years. Overall, therefore, we maintain our view that core inflation will be back near the 2% target this summer, before temporarily ticking higher in Q4. Not least due to base effects in energy and firmer food inflation, headline inflation will take a little longer to return to target. But while we expect the ECB's updated projections – to be published alongside the policy announcement on Thursday – to push higher the inflation outlook over the near term,

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

they will still point towards inflation settling around the 2% target from the second quarter of next year. As such, we expect the Governing Council to cut the deposit rate twice further beyond this week, albeit slowing the pace to one 25bps cut each quarter in Q2 and Q3.

The coming two days in the euro area

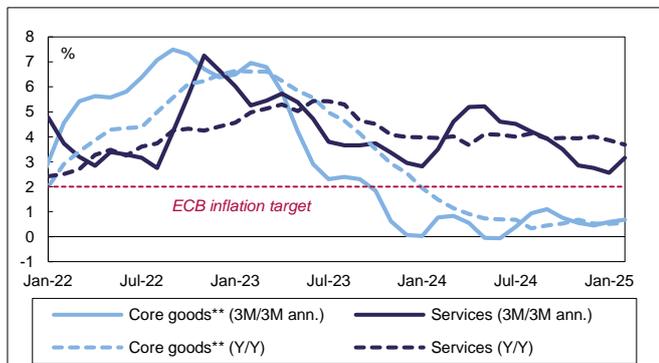
After February's final euro area manufacturing PMI was today revised slightly higher but remained contractionary (47.6), we also expect Wednesday's final services indices to lend greater support to the composite index than suggested by the flash release. Our assumption anticipates an upwards revision to French services index, whose surprising weakness (44.5) halted the recent uptrend in the euro area aggregates. Wednesday's final PMIs will likely show a third successive monthly rise in the euro area composite PMI, from the level of 50.2 in January which matched the flash February estimate, thanks also in part due to support from both Italy and Spain. Meanwhile, euro area producer prices (also due Wednesday) are expected to turn positive in January, on a year-on-year basis, for the first time since April 2023, primarily attributable to the effect of falling energy prices during the first half of last year. But while these base effects will continue to apply upwards pressure to the headline PPI over the coming months, core producer prices are expected to be relatively better behaved. Last week's soft uptick in German unemployment claims were consistent with only a sideways movement in the euro area unemployment rate in January (due tomorrow), which having briefly touched a new historic low of 6.2% ultimately edged up 0.1ppt at the end of last year. Elsewhere, French IP in January (Wednesday) might receive some payback after edging back in December (-0.4%M/M). And while today's annual GDP release flagged 0.7% real-terms growth for the Italian economy last year, final estimates for GDP growth in Q4 (also Wednesday) will likely affirm that this came despite a stagnant second half. The release will also include a breakdown of contributions to GDP growth by expenditure components.

UK

Mortgage lending picks up ahead of Stamp Duty hike in April

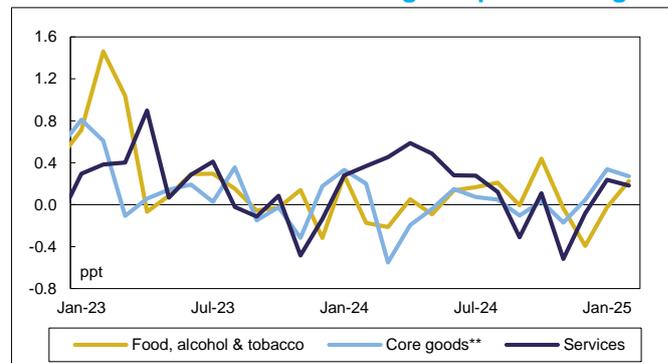
Despite the moderation in house price growth and further uptick in mortgage interest rates in January, today's BoE monetary figures suggested that mortgage lending accelerated at the start of the year. In particular, the net monthly increase in secured lending to households of £4.2bn was the firmest since September 2022, just ahead of the Truss-budget-related blowout in interest rates. This took the cumulative net increase in the three months to January to £9.8bn, close to the long-run average (£10.5bn) and the annual rate of growth in the stock of such loans to 1.8%Y/Y, a 20-month high. Another solid rise in mortgage approvals (66.2k) close to the pre-pandemic five-year average pointed to firmer lending growth over coming months too. Admittedly, this likely in part relates to front-loading of demand in the run up to the Stamp Duty hike in April. But

Euro area: Core inflation momentum*



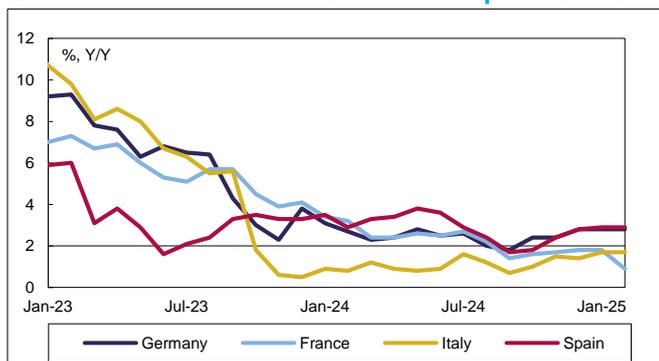
*Seasonally adjusted data. **Non-energy industrial goods.
 Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Deviations from long-run price change*



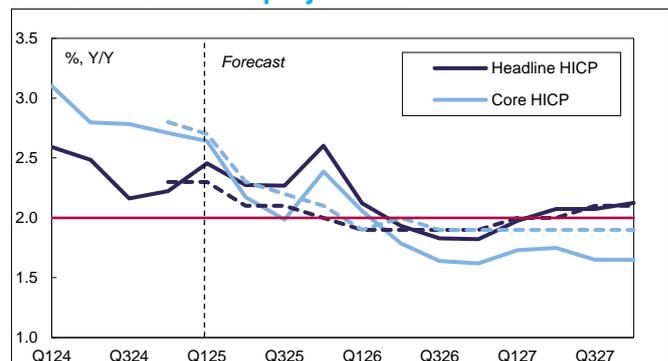
*Monthly change in prices compared with average for the month in the decade before the pandemic. **Non-energy industrial goods.
 Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation projections*



*Dashed lines represent ECB Dec-24 projections.
 Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

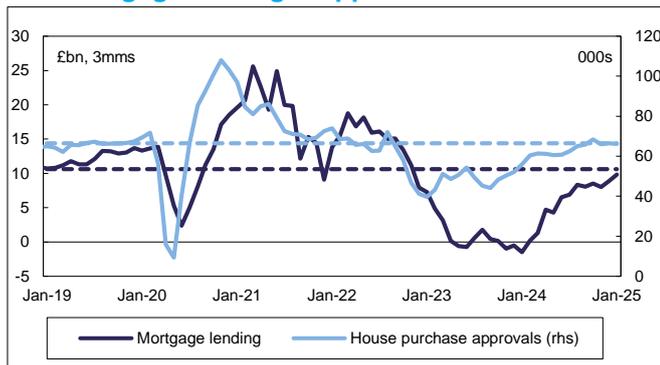
loan demand should also continue to benefit from a further gradual loosening in monetary policy restrictiveness over coming quarters. With interest rates still relatively high and consumers preferring to save than spend, households added to their deposits in January at more than double the average pace in the five years before the pandemic. But there was also an acceleration in consumer credit, with the net monthly increase (£1.7bn) the largest since November 2024. Meanwhile, in terms of business loans, encouragingly there was a fourth successive net monthly increase in lending to SMEs. That, however, still left the respective annual rate in negative territory at -1.7%Y/Y. And lending to large firms rose for an eighth month out of nine, taking the annual growth in the loan-stock to 4.0%Y/Y, the most in two years.

The coming two days in the UK

Like the euro area, Wednesday’s final UK services and composite PMIs should point towards only a limp pace of expansion in February, with a pickup in services offsetting that month’s fall back in manufacturing. But the focus will also be on the final price and employment indices, as the flash release signalled that input costs (65.5, up 0.2pt) climbed to a 21-month high, while job shedding was reportedly its most aggressive since November 2020. But amid these elevated cost pressures, food prices also emerged as a key driver of the upside surprise to January’s CPI print. So, tomorrow’s BRC shop price survey will be watched for insights into food inflation in February. Aside from the data, though perhaps most importantly given the recent data, BoE rate setters – including BoE Governor Bailey, alongside Chief Economist Pill and external members Green and Taylor – will respond to questions from the Treasury Select Committee on Wednesday afternoon.

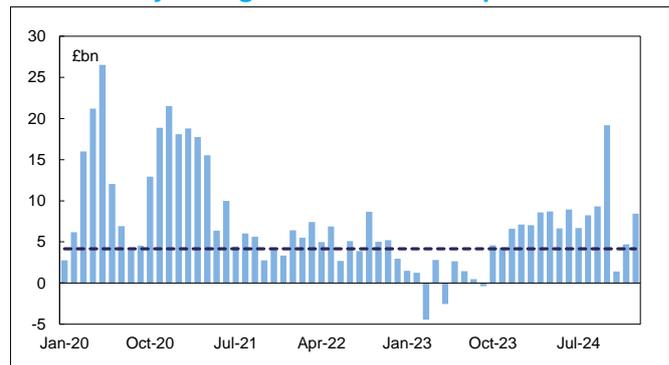
The next edition of the Euro wrap-up will be published on 05 March 2025

UK: Mortgage lending & approvals*



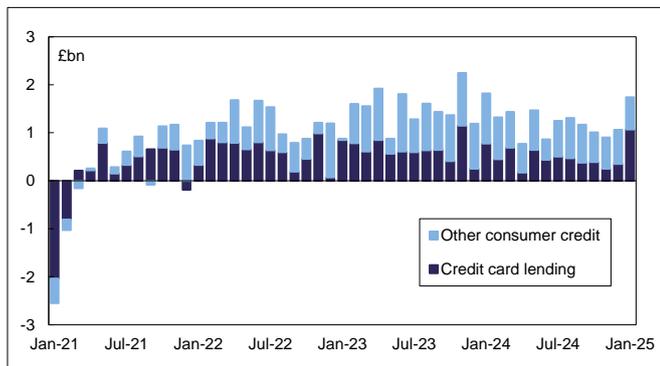
*Dashed lines represent pre-pandemic five-year average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Monthly change in household deposits*



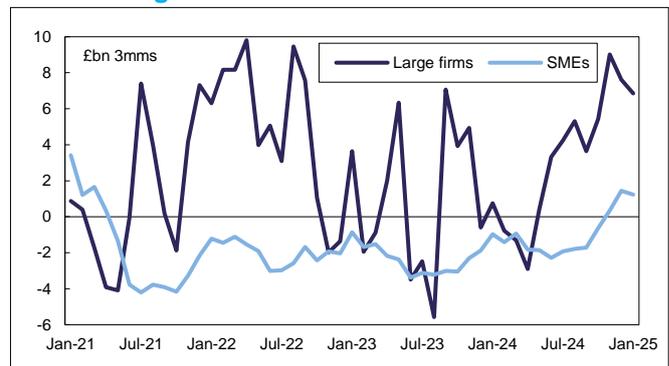
*Dashed line represents pre-pandemic five-year average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Consumer credit



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Lending to NFCs



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 headline (core) HICP Y/Y%	Feb	2.4 (2.6)	<u>2.3 (2.5)</u>	2.5 (2.7)	-
	 Final manufacturing PMI	Feb	47.6	<u>47.3</u>	46.6	-
Germany	 Final manufacturing PMI	Feb	46.5	<u>46.1</u>	45.0	-
France	 Final manufacturing PMI	Feb	45.8	<u>45.5</u>	45.0	-
Italy	 Manufacturing PMI	Feb	47.4	46.7	46.3	-
	 Annual GDP Y/Y%	2024	0.7	-	0.9	0.7
	 Fiscal deficit-to-GDP %	2024	3.4	-	7.2	-
Spain	 Manufacturing PMI	Feb	49.7	51.4	50.9	-
UK	 Net consumer credit £bn (Y/Y%)	Jan	1.7 (6.4)	1.2 (-)	1.0 (6.5)	1.1 (-)
	 Net mortgage lending £bn (mortgage approvals 000s)	Jan	4.2 (66.2)	3.5 (65.5)	3.6 (66.5)	3.3 (-)
	 Final manufacturing PMI	Feb	46.9	<u>46.4</u>	48.3	-
Auctions						
Country	Auction					
- Nothing to report -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tuesday's releases

Economic data						
Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
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	-0.6	-0.7	
Auctions and events						
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				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data						
Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Euro area	 09.00	Final composite (services) PMI	Feb	<u>50.2 (50.7)</u>	50.2 (51.3)	
	 10.00	PPI Y/Y%	Jan	1.3	0.0	
Germany	 08.55	Final composite (services) PMI	Feb	<u>51.0 (52.2)</u>	50.5 (52.5)	
France	 07.45	Industrial production M/M% (Y/Y%)	Jan	0.4 (-0.2)	-0.4 (-1.7)	
	 08.50	Final composite (services) PMI	Feb	<u>44.5 (44.5)</u>	47.6 (48.2)	
Italy	 08.45	Composite (services) PMI	Feb	50.0 (51.0)	49.7 (50.4)	
	 09.00	GDP – final estimates Q/Q% (Y/Y%)	Q4	<u>0.0 (0.5)</u>	0.0 (0.4)	
	 10.00	Retail sales M/M% (Y/Y%)	Jan	-	0.6 (0.6)	
Spain	 08.15	Composite (services) PMI	Feb	54.8 (55.5)	54.0 (54.9)	
UK	 09.00	New car registrations Y/Y%	Feb	-	-2.5	
	 09.30	Final composite (services) PMI	Feb	<u>50.5 (51.1)</u>	50.6 (50.8)	
Auctions and events						
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 appear before Treasury Select Committee				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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