# Euro wrap-up

## Overview

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- As EU leaders met to discuss loosening the region's fiscal rules to fund more military spending and the Governing Council noted that its policy is 'becoming meaningfully less restrictive', euro area government bonds made further significant losses even as the ECB cut rates by a further 25bps.
- Gilts made gains at the shorter end of the curve despite a slight pickup in UK business wage and price expectations.
- Friday will bring German factory orders data for January and a probable upwards revision to euro area GDP in Q4.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 2.2 03/27 | 2.268 | +0.030 |
| OBL 2.4 04/30 | 2.567 | +0.087 |
| DBR 2½ 02/35 | 2.885 | +0.095 |
| UKT 4⅛ 01/27 | 4.222 | -0.042 |
| UKT 4⅛ 07/29 | 4.325 | -0.017 |
| UKT 4¼ 07/34 | 4.688 | +0.003 |

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

# Euro area

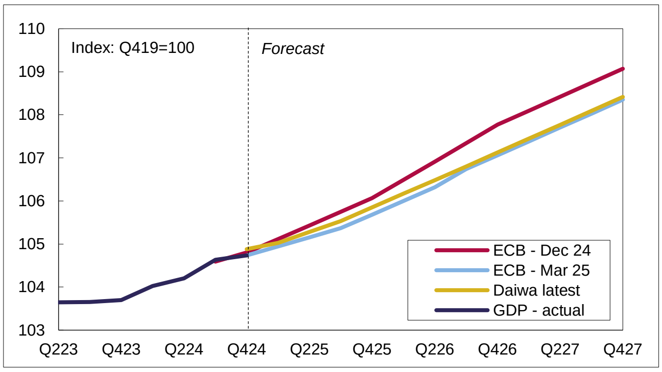
### ECB cuts rates by 25bps but flags uncertainty & notes 'meaningfully less restrictive' stance

Despite Germany's pivot to easier fiscal policy and ongoing discussions among EU leaders to relax the region's budgetary rules, it was no surprise whatsoever that the ECB cut rates again today by 25bps. That marked the sixth such step since last summer, and took the deposit rate to 2.50%, approaching the top end of the range of ECB staff estimates of neutral policy over the medium term. No member of the Governing Council opposed the decision but Austrian Governor Holzmann abstained. Given the cumulative easing so far, the Governing Council's statement stated explicitly that 'policy is becoming meaningfully less restrictive, as the interest rate cuts are making new borrowing less expensive', a form of words that should be considered less dovish than assessments made in recent statements. Indeed, in her press conference, President Lagarde emphasised the word 'meaningfully', and noted that the word was 'not innocuous'. The Governing Council noted 'high trade policy uncertainty as well as broader policy uncertainty', underscoring the need for a cautious approach to future decisions. It also emphasised the 'current conditions of rising uncertainty' as it repeated its forward guidance that it will continue to follow a data-dependent and meeting-by-meeting approach to setting policy. Given that uncertainty, we still strongly expect rates to be left unchanged at the next meeting in April. And whether the ECB cuts the deposit rate below 2.50% in June will depend on the staff's updated projections. Crucially, those forecasts will need to take account of any concrete decisions on fiscal policy – which Lagarde rightly judged was still a 'work in progress' but might in due course be significantly stimulating for GDP and inflation – as well as news on US tariffs and associated European retaliation.

### Inflation still expected to return to target & GDP projection nudged down

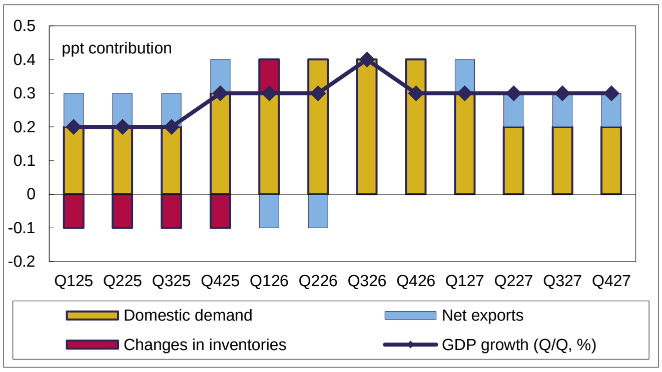
As usual, today's policy decision was guided by the ECB staff's updated macroeconomic projections. The inflation forecast for 2025 was nudged up by 0.2ppt to 2.3%Y/Y. But that reflected an assumption of elevated energy prices, which have fallen back significantly since the projections were finalised to render the upwards revision inappropriate. Moreover, the expected return of inflation to target was pushed back merely to early 2026, with the headline rate still projected to average 1.9%Y/Y next year and 2.0%Y/Y in 2027. In addition, with the disinflation process still considered to be 'on track', the updated staff projections foresee a decline in core inflation (excluding food and energy) to 2.0%Y/Y in 2026 and below-target the following year. In part due to the impact of heightened uncertainty, the full-year GDP projections for 2025 and 2026 were revised down by 0.2ppt apiece to 0.9%Y/Y and 1.2%Y/Y, bang in line with our own updated forecasts.

**Euro area: Real GDP levels projections**




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

**Euro area: ECB projected contributions to GDP**




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

## Risks now 'all over the place' with fiscal initiatives likely to be key to the rate outlook

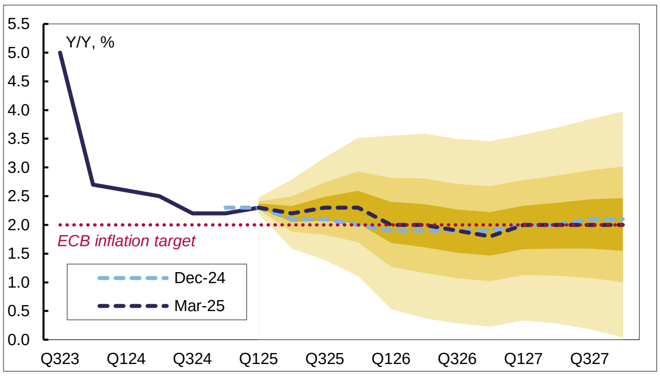
Of course, as Lagarde herself stated in the press conference, the 'risks are all over the place'. The ECB considered that rising real incomes and the fading effects of past tightening would remain the principal drivers of that recovery. But today's soft retail sales data – which reported a drop in January to be down on a three-month basis for the first time in more than a year – provided a reminder that households still prefer to save than spend, and perhaps all the more so given the extremely grim geopolitical backdrop. Likewise, the threat of tariffs might yet weigh so heavily as to negate any boost to capex from lower rates. So, the pickup in economic recovery momentum might well have to rely on German and other EU leaders putting their encouraging words on fiscal policy into action. Given our optimism of progress on that front, however, we now see the risks to our terminal rate forecast of 2.0% to be skewed to the upside.

## The day ahead in the euro area

Following yesterday's marginal upwards revision to Italian GDP in Q4 (up 0.1ppt 0.1%Q/Q), today's (often-unpredictable) Irish GDP data saw a more dramatic reversal from the initial estimate. Indeed, Irish growth in Q4 was revised up from a preliminary marked contraction of -1.3%Q/Q to extremely strong growth of 3.6%Q/Q, marginally higher than growth in Q3 (3.5%Q/Q) which contributed some 0.13ppt to euro area growth that quarter. Consequently, having been previously upwardly revised to growth of 0.1%Q/Q, tomorrow's third and final estimate for euro area GDP seems bound to record another upwards revision, most likely to 0.2%Q/Q, although with the potential for further upside. The final release will also feature a breakdown by expenditure components which, consistent with the detail from core member states, should show that household and government consumption continued to contribute positively to euro area GDP growth, while net trade was a drag. Final employment data for Q4 will also be expected to affirm the gradual slowdown in job creation (0.1%Q/Q) suggested by the first estimates.

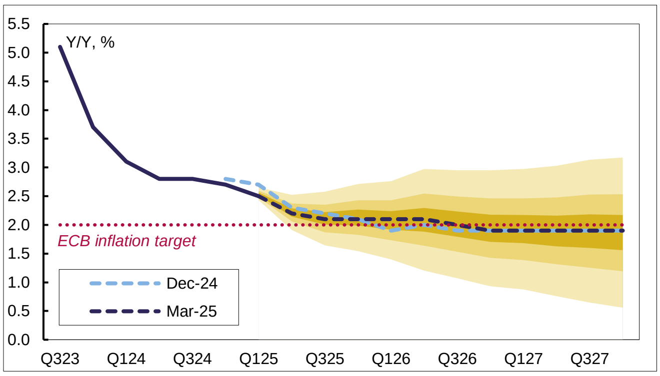
Perhaps more relevant to current economic momentum in the euro area, German factory orders figures for January are also due at the end of the week. While December's release had hinted towards a modest improvement in underlying demand, the overall pickup of 6.9%M/M was flattered principally by major one-off orders. So, a sizable fall back in total orders would seem likely, with momentum in underlying demand likely to remain lacklustre at the start of the year. Spanish IP might also be a touch softer following a 0.9%M/M rise in December, while French trade data for January are also due.

### Euro area: ECB headline HICP inflation projections



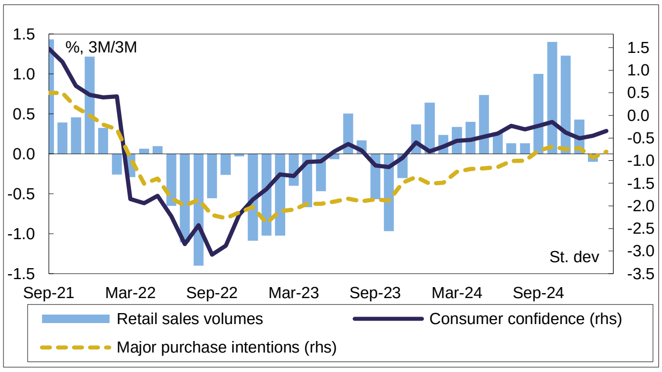

*Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.*

### Euro area: ECB core HICP inflation projections



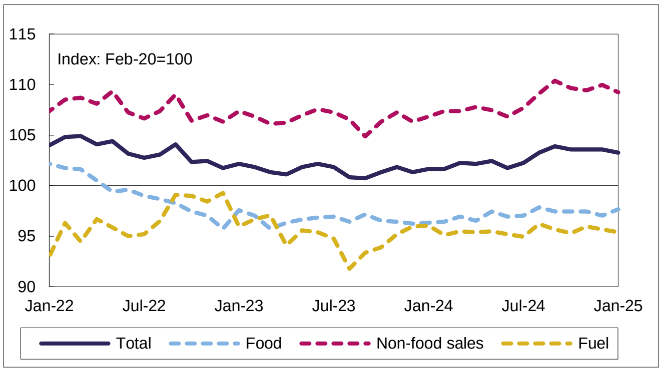

*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Euro area: Retail sales & consumer confidence




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

### Euro area: Retail sales by category




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

# UK

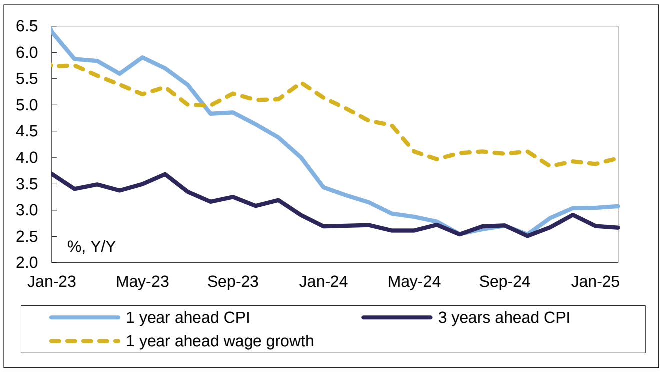
## BoE DMP survey results reinforce 'cautious' approach to policy loosening

With UK inflation a touch firmer than expected in January and wage growth proving more stubborn in recent months too, BoE policymakers continue to emphasise that a 'gradual and careful' approach to the withdrawal of monetary policy restraint is appropriate. Certainly, Deputy Governor Ramsden acknowledged in his speech last week that he now sees the risks to inflation as two-sided, with pay growth stronger and wage settlements more generous than he had previously expected. In some ways, today's Decision Maker Panel survey will have validated his assessment. Admittedly, the changes in February's survey were only subtle. Nevertheless, businesses' wage growth expectations one-year ahead ticked up to 4%Y/Y in February, a four-month high and re-establishing the broadly sideways trend in place for the past nine months. This notwithstanding, policymakers will note that firms' CPI expectations three-years ahead were still well behaved (2.7%Y/Y). But expectations for inflation one year ahead edged up a touch, by 0.1ppt to 3.1%Y/Y, an 11-month high, and ½ppt higher than pre-budget expectations in October. Perhaps reflecting upcoming policy measures coming into effect in April – including the hikes in the National Living Wage and employer NICS contributions – firms' output price expectations were also slightly higher (up 0.1ppt to 4.0%Y/Y). And while falling realised output price growth – for which 3.5%Y/Y marked a ½ppt drop from December and the softest rate since August 2021 – might reflect businesses' weakened pricing power in the face of soft demand, stubbornness in wage growth, as well as increased uncertainties surrounding global inflation pressures, will likely justify a cautious approach for the time being.

## The day ahead in the UK

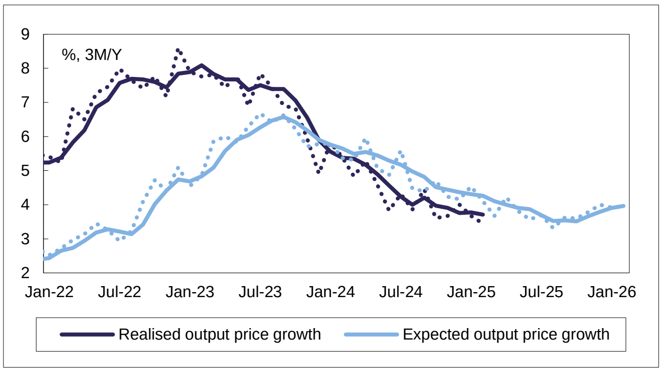
There are no top-tier data releases scheduled for the UK this Friday.

### UK: Firms' CPI & wage growth expectations




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

### UK: Firms' output price expectations*




**Dotted lines show the single month (Y/Y) series.*
*Source: Macrobond 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 Deposit Rate (Refi Rate) % | Mar | **2.50 (2.65)** | *2.50 (2.65)* | 2.75 (2.90) | - |
| | | Retail sales M/M% (Y/Y%) | Jan | **-0.3 (1.5)** | 0.1 (2.0) | -0.2 (1.9) | 0.0 (2.2) |
| | | Construction PMI | Feb | **42.7** | - | 45.4 | - |
| Germany | | Construction PMI | Feb | **41.2** | - | 42.5 | - |
| France | | Construction PMI | Feb | **39.8** | - | 44.5 | - |
| Italy | | Construction PMI | Feb | **48.2** | - | 50.9 | - |
| UK | | DMP 3M output price (1Y CPI) expectations % | Feb | **4.0 (3.1)** | 4.0 (3.1) | 3.9 (3.0) | - |
| | | Construction PMI | Feb | **44.6** | 49.5 | 48.1 | - |

**Auctions**

| Country | | Auction |
|---|---|---|
| France | | sold €6.38bn of 3.2% 2035 bonds at an average yield of 3.54% |
| | | sold €2.9bn of 4.75% 2035 bonds at an average yield of 3.51% |
| | | sold €1.19bn of 1.75% 2039 bonds at an average yield of 3.71% |
| | | sold €2.52bn of 2.5% 2043 bonds at an average yield of 3.88% |
| Spain | | sold €2.53bn of 3.1% 2031 bonds at an average yield of 3.067% |
| | | sold €2.77bn of 3.15% 2035 bonds at an average yield of 3.507% |
| | | sold €514mn of 0.7% 2033 inflation-linked bonds at an average yield of 1.271% |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Tomorrow's releases

**Economic data**

| Country | | GMT | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|---|
| 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 | -2.5 (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 | -0.2 (1.3) | 0.9 (2.1) |
| | | 08.00 | House price index Q/Q% (Y/Y%) | Q4 | - | 2.8 (8.1) |

**Auctions and events**

| Country | | GMT | Event |
|---|---|---|---|
| Euro area | | 18.00 | ECB Governing Council members Centeno & Kazāks participate in panel on monetary policy and the labour market, Lisbon |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs