Euro wrap-up

Overview

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- Despite a downwards revision to German inflation in February, Bunds followed USTs lower as the likelihood rose that Germany's Parliament would endorse plans to increase public spending on defence and infrastructure.
- As UK GDP contracted in January on manufacturing and construction weakness Gilts made modest gains despite a rise in household inflation expectations.
- The BoE will leave interest rates at 4.50% on Thursday, while UK and euro area wage data, final euro area inflation estimates and consumer confidence surveys are due.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.179	+0.006
OBL 2.4 04/30	2.501	+0.019
DBR 2½ 02/35	2.874	+0.023
UKT 3¾ 01/27	4.169	-0.010
UKT 4⅛ 07/29	4.281	-0.016
UKT 4¼ 07/34	4.663	-0.017

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

UK

GDP slips back in January, but growth momentum up to a six-month high

While today's UK monthly GDP release grabbed headlines as it suggested renewed weakness at the start of the year, the modest contraction (-0.1%M/M) in January was only a touch softer than expected. Moreover, the figures were still consistent with a moderate improvement in underlying growth momentum at the start of the year, further supporting our view that the majority on the MPC in the coming week will vote to keep Bank Rate steady (see below). Certainly, today's release was not overly surprising given the persisting weakness in recent business and consumer confidence surveys. And given the strength of GDP in December – with growth of 0.4%M/M the firmest in nine months – some payback was anticipated at the start of the year. Indeed, output was still up 0.2%3M/3M, the most on that basis since July, and 0.1ppt above the BoE's projection for Q1 GDP growth assumed in its February Monetary Policy Report.

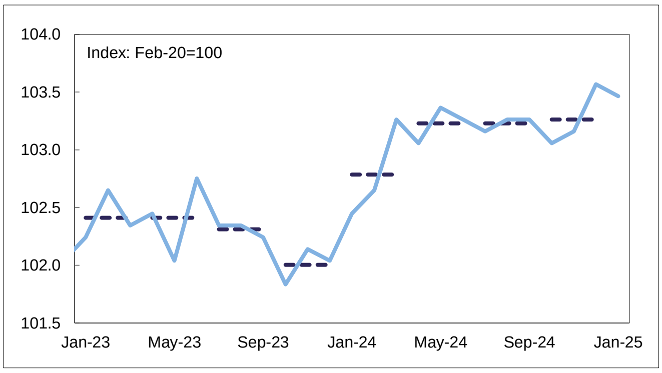
Global uncertainties weigh on manufacturing and construction activity

The weakness at the start of year was principally driven by a contraction in manufacturing, with production declining for the fourth month out of the past five and by 1.1%M/M, the most since July. This left output in the sector down 0.9%3M/3M and at the lowest level for more than two years, still a hefty 10% below the pre-Covid-19 benchmark in February 2020. More than two-thirds of subsectors reported drops in output in January, with the most significant declines in the manufacture of basic metals, pharmaceuticals and general machinery. And while production of wood and paper products and transport equipment rose in January, they were still down on a three-month basis, with new autos output down a notable 4½%3M/3M. Construction activity also edged down for a second successive month (-0.2%M/M), due to a drop in new private commercial work, perhaps in part related to heightened uncertainties surrounding the global economic outlook as well as unfavourable weather.

Services provides some offset, with activity likely to remain a positive support

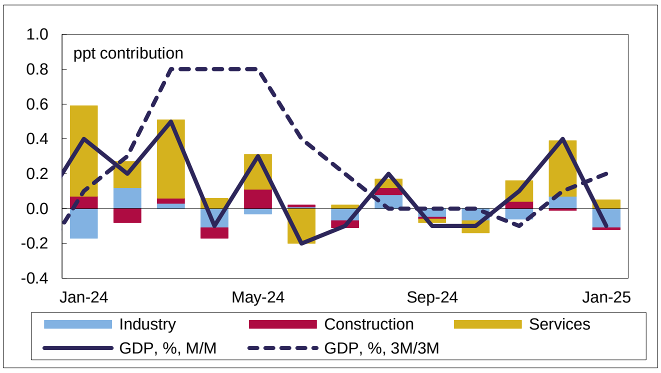
In contrast, services output rose for a third consecutive month in January (0.1%M/M), to push growth on a three-month basis in the sector up to 0.4%3M/3M, the most since June. Admittedly, this in part reflected surprising strength in retail sales at the start of the year, as households bought more food to consume at home rather than eating out. Support services related to rentals, landscaping and scientific research and development also reversed their weakness at the end of 2024. And there was a further modest increase in healthcare and defence, offsetting an ongoing downtrend in accommodation services to a

UK: GDP level*



*Dashed dark blue line represents quarterly average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Contributions to GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

15-month low. While surveys suggest some payback in retail spending in February, we might well see increased activity in real estate over coming months ahead of the Stamp Duty hike in April. And while surveys continue to point to an ongoing preference to save, the PMIs also remain consistent with further modest expansion in the services sector. Admittedly, risks to the near-term manufacturing and construction outlook are skewed to the downside. So, while we forecast GDP to grow 0.2%Q/Q in Q1 – a touch firmer than the BoE projection – we expect it to slow to 0.1%Q/Q in Q2 – softer than the BoE forecast – as household budgets are hit by a rise in energy and water tariffs and US tariff concerns continue to weigh on global business spending.

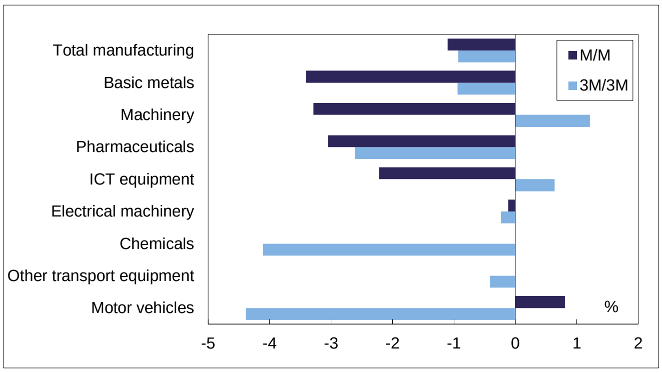
Household inflation expectations rise to multi-year high, but remain well-anchored

Notwithstanding downside risks to demand, today's BoE household inflation attitudes survey illustrated the challenges facing the MPC in the current environment of two-sided risks to the inflation outlook. In light of the uptick in inflation at the start of the year and upwards revision to the Bank's anticipated inflation profile for coming quarters, households revised up their expectations for headline CPI inflation in twelve months' time by 0.4ppt to 3.4%Y/Y. While this was the highest for six quarters and 0.7ppt above the recent trough in August, it was also 1½ppts below the peak in August 2022. Arguably more concerning for some policymakers on the MPC will be the pickup in medium- and longer-term expectations. In particular, households forecast inflation five years ahead to be 3.6%Y/Y, 0.2ppt higher than expected three months ago and the strongest for more than five years. Nevertheless, this was still within ½ppt of the long-run average and just 0.1ppt firmer than in the year before the pandemic when inflation expectations were considered to be well-anchored. So, while the MPC might pay lip-service to the recent rise in household and business price indices in its policy statement, we would not expect it to alter the Bank's forward guidance that a gradual removal of policy restrictiveness remains appropriate.

BoE to stand pat in March amid two-sided risks

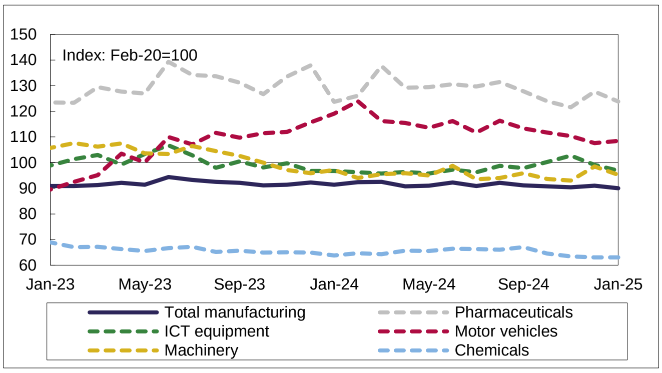
While February's monetary policy meeting saw the BoE resume its rate-cutting cycle – with a 25bps cut taking Bank Rate to a 20-month low of 4.50% – the Bank's updated macroeconomic projections increased markedly the near-term inflation profile – forecasting headline inflation to peak at 3.7%Y/Y in Q325 – while simultaneously pushing out the expected return to the 2% target until end-2027. As such, the MPC maintained that policy will remain restrictive for 'sufficiently long until the risks to inflation returning sustainably to the 2% target in the medium term have dissipated further'. And reflecting increasing two-sided risks, the statement added the need to be 'careful' alongside the existing call for a 'gradual' approach to the further withdrawal of monetary policy restraint. Against this backdrop, Thursday's policy announcement risks being a non-event. Certainly, we expect the MPC to leave Bank Rate unchanged at 4.50%, while heightened uncertainty with respect to the economic outlook should mean little material change to forward guidance.

UK: Selected manufacturing sub-sectors – Jan-25



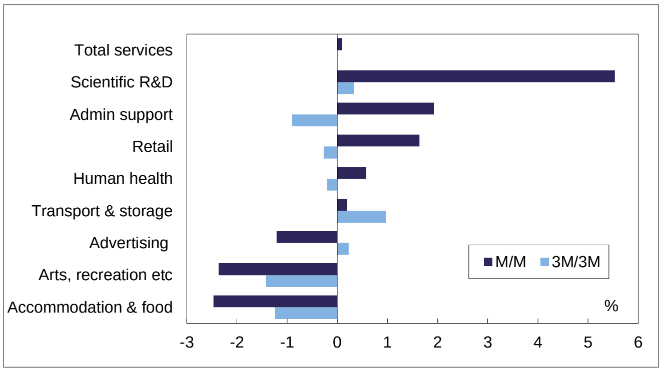
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output



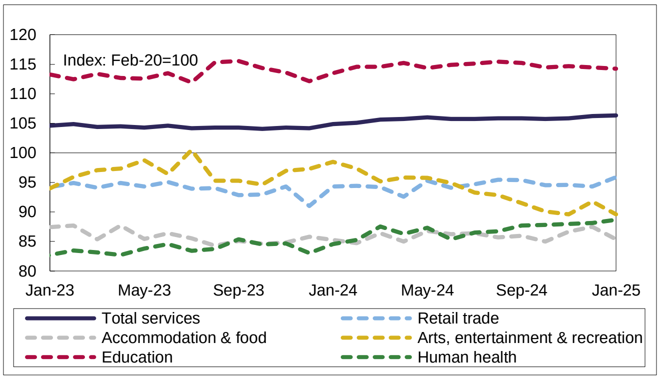
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected services sub-sectors – Jan-25



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services output



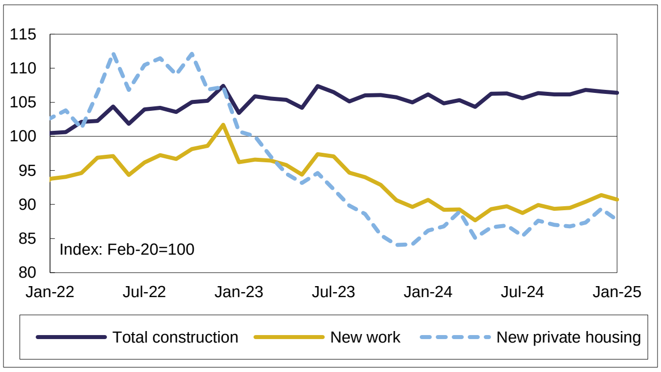
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

While the broader macro picture remains unsettling for policymakers, today's monthly GDP data might have offered some reassurance that current demand conditions remain slightly firmer than initially feared, with growth currently on track to beat the BoE's projection of 0.1%Q/Q in Q1, having also exceeded expectations in Q4. Furthermore, January's food-led inflation overshoot, still elevated wage growth – private sector regular pay grew in December at the fastest pace in a little over a year (6.2%3M/Y) – and above-target wage growth expectations for the coming year should all reinforce calls for a cautious approach. So, while uber-dove Dhingra will likely vote for a further cut this month, and possibly Mann too (following her vote for a 50bps cut in February), we expect a large majority on the MPC to favour keeping Bank Rate steady this month, preferring instead to wait for updated projections in May before considering whether to loosen monetary policy further. Indeed, by the time of the May decision, the MPC will also have had February's GDP report, a further set of labour market figures – in addition to next Thursday's report – and, most importantly perhaps, two more inflation reports.

The data week ahead in the UK

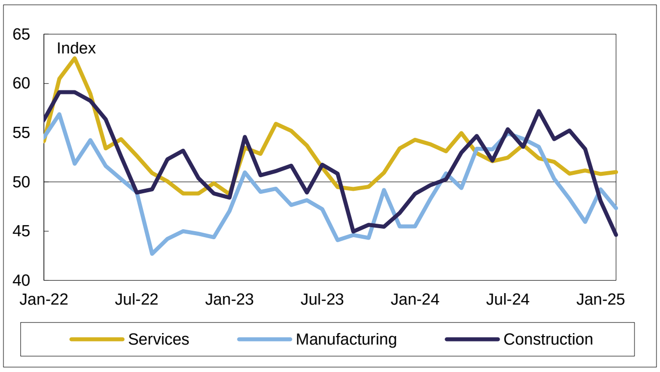
In terms of the economic data, the latest labour market report (Thursday) will provide the coming week's highlight. While the official labour force survey data suggested ongoing resilience in December, and the number of payrolled employees increased in January, recent surveys point to a more marked deterioration in employment intentions amid heighted uncertainties and elevated labour costs. So, the coming week's data will be watched for signs of renewed weakness in the labour market. Indeed, an uptick in the unemployment rate (by 0.1ppt to 4.5%) in the three months to January would be unsurprising, and a decline in payrolled employees would also be more consistent with the looser conditions suggested by survey employment components. Meanwhile, wage growth is expected to remain elevated in the three months to January, easing only slightly by 0.2ppt to 5.8%3M/Y, while regular pay growth is expected to be unchanged at 5.9%3M/Y. Elsewhere, the CBI's industrial trends survey (Thursday) will provide a first look at manufacturing conditions in March, ahead of the following week's flash PMIs. The GfK's consumer confidence survey for March is also due (Friday). Finally, public finance statistics for February are also scheduled for release at the end of the week. These will provide the last update ahead of the Chancellor's Spring Statement (March 26), which will take stock of the need for any further fiscal tightening over the coming years in order to meet the government's budgetary rules. January's budget surplus fell short of the OBR's forecast, but February's data might well see that shortfall narrow as more receipts from self-assessments filter through.

UK: Construction output



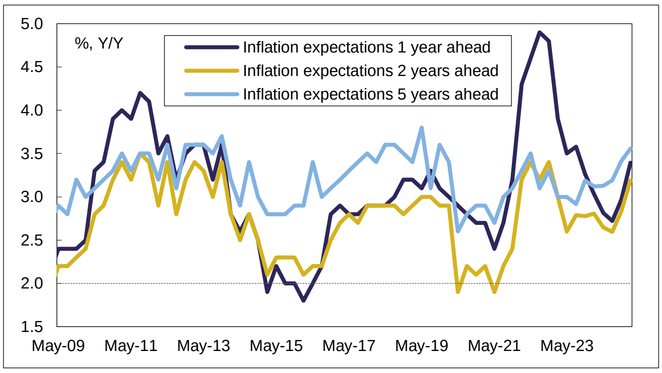
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output PMIs



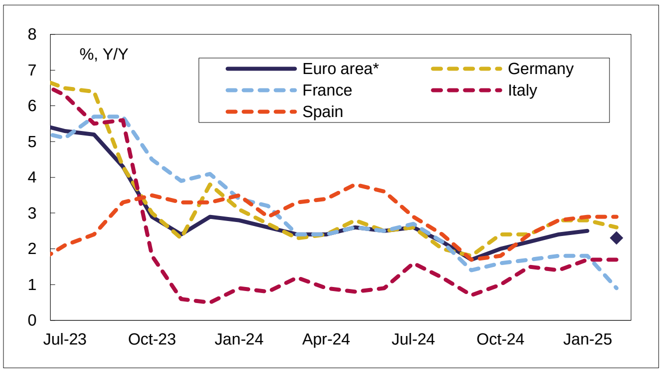
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Household inflation expectations



Source: BoE inflation attitudes survey, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Headline HICP inflation



**Diamond represents Daiwa forecast for final euro area inflation in February.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

In light of today's releases from various member states, the coming week's final euro area inflation print (Wednesday) seems likely to show that headline HICP inflation was a touch softer than initially estimated in February. Indeed, today's data reported a downward revision to German headline HICP inflation by 0.2ppt to 2.6%Y/Y, while affirming the flash estimates in France (down 0.9ppt to 0.9%Y/Y) and Spain (unchanged at 2.9%Y/Y). As such, we now expect the euro area headline inflation rate to be revised lower by 0.1ppt from flash to 2.3%Y/Y. The accompanying detail should confirm that moderating inflation came in spite of a non-negligible increase in food prices last month, with a decline in services inflation underscoring the fall in core HICP inflation to a three-year low (2.6%Y/Y), which should provide flexibility to ease policy further in response to more immediate growth risks. Meanwhile, final labour costs (also Wednesday) and job vacancy data for Q4 (Tuesday) will likely point to normalising labour market conditions, consistent with a return to the 2% inflation target. German PPI figures for February (Thursday) will also offer additional insight into factory cost pressures in the euro area.

The week ahead will also bring euro area releases for goods trade (Tuesday) and construction output (Thursday) in January. More timely data from US sources imply a significant, albeit likely temporary, spike in Irish chemical exports that month – perhaps relating to the front loading of exports in anticipation of increased tariffs. This should help to partly offset worsening trade balances in Germany and France that month, leaving the euro area trade surplus little changed (€14.6bn). Meanwhile, despite tentative signs of improvement in recent months, softer French activity (-3.9%M/M), particularly among housebuilders, likely drove a fall in euro area construction output at the start of the year. On the survey front, despite widespread dismay at US foreign policy, more constructive policymaking in Europe, and in particular Germany, might well provide support to the Commission's euro area consumer confidence indicator, for which the flash release for March is due Friday. Certainly, the German ZEW investor survey (Tuesday) is likely to echo the further notable improvement suggested in the Sentix expectations index in March as plans to allow for substantial fiscal stimulus in military and infrastructure investments remain on track to be adopted by the Bundestag and Bundesrat this month. The end of the week will also see the release of the French INSEE business surveys (Friday) ahead of the following week's flash PMIs.

The next edition of the Euro wrap-up will be published on 18 March 2025

Daiwa economic forecasts

	2024		2025				2024	2025	2026
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP			**%, Q/Q**					**%, Y/Y**	
Euro area	0.4	0.2	0.1	0.2	0.2	0.3	0.8	0.9	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	2.5	2.3	2.3	2.6	2.4	2.4	1.9
Core HICP	2.8	2.7	2.6	2.2	2.0	2.4	2.8	2.3	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
Germany	Final HICP (CPI) Y/Y%	Feb	**2.6 (2.3)**	*2.8 (2.3)*	2.8 (2.3)	-
France	Final HICP (CPI) Y/Y%	Feb	**0.9 (0.8)**	*0.9 (0.8)*	1.8 (1.7)	-
Italy	Industrial production M/M% (Y/Y%)	Jan	**3.2 (-0.6)**	1.4 (-2.9)	-3.1 (-7.1)	-2.7 (-6.9)
Spain	Final HICP (CPI) Y/Y%	Feb	**2.9 (3.0)**	*2.9 (3.0)*	2.9 (2.9)	-
UK	Monthly GDP M/M% (3M/3M%)	Jan	**-0.1 (0.2)**	0.1 (0.2)	0.4 (0.0)	-
	Services output M/M% (3M/3M%)	Jan	**0.1 (0.4)**	0.1 (0.3)	0.4 (0.2)	-
	Industrial output M/M% (Y/Y%)	Jan	**-0.9 (-1.5)**	-0.1 (-0.6)	0.5 (-1.9)	-
	Construction output M/M% (Y/Y%)	Jan	**-0.2 (0.2)**	0.0 (0.4)	-0.2 (1.5)	-

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 17 March 2025			
UK	00.01	Rightmove house prices M/M% (Y/Y%)	Mar	-	0.5 (1.4)
Italy	09.00	Final HICP (CPI) Y/Y%	Feb	*1.7 (1.7)*	1.7 (1.5)
Spain	08.00	Labour costs Y/Y%	Q4	-	4.4
		Tuesday 18 March 2025			
Euro area	10.00	Trade balance €bn	Jan	14.0	14.6
	10.00	Final job vacancy rate %	Q4	*2.5*	2.6
Germany	10.00	ZEW current situation (expectations) balance	Mar	-80.5 (50.3)	-88.5 (26.0)
		Wednesday 19 March 2025			
Euro area	10.00	Final headline (core) HICP Y/Y%	Feb	*2.3 (2.6)*	2.5 (2.7)
	10.00	Final labour costs Y/Y%	Q4	*3.7*	4.6
		Thursday 20 March 2025			
Euro area	10.00	Construction output M/M% (Y/Y%)	Jan	*-0.5 (-1.2)*	0.0 (-0.1)
Germany	07.00	PPI Y/Y%	Feb	1.0	0.5
UK	07.00	Average wages (excluding bonuses) 3M/Y%	Jan	5.8 (5.9)	6.0 (5.9)
	07.00	Private sector regular wages 3M/Y%	Jan	6.2	6.2
	07.00	Unemployment rate 3M%	Jan	4.4	4.4
	07.00	Employment 3M/3M change 000s	Jan	95	107
	07.00	Payrolled employees M/M change 000s	Feb	-17	21
	07.00	Claimant count rate % (change 000s)	Feb	-	4.6 (22.0)
	11.00	CBI industrial trends survey – total orders (selling prices) balance %	Mar	-28 (-)	-28 (19)
	12.00	BoE Bank Rate %	Mar	*4.50*	4.50
		Friday 21 March 2025			
Euro area	09.00	Current account balance €bn	Jan	-	38.4
	15.00	Preliminary Commission consumer confidence indicator	Mar	-13.0	-13.6
France	07.45	INSEE business (manufacturing) confidence indicator	Mar	96 (97)	96 (97)
	07.45	Final wages Q/Q%	Q4	*0.4*	0.4
	-	BoF retail sales Y/Y%	Feb	-	-0.7
UK	00.01	GfK consumer confidence indicator	Mar	-21	-20
	07.00	Public sector net borrowing £bn	Jan	-	-15.4

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		GMT	Event / Auction
			Monday 17 March 2025
			- Nothing scheduled -
			Tuesday 18 March 2025
UK		10.00	Auction: to sell £4.25bn of 4.375% 2028 bonds
			Wednesday 19 March 2025
Germany		10.30	Auction: to sell up to €1bn of 0% 2050 bonds
		10.30	Auction: to sell up to €1.5bn of 1.8% 2053 bonds
			Thursday 20 March 2025
Euro area		08.00	ECB President Lagarde to appear before the European Parliament's Committee on Economic & Monetary Affairs (ECON)
		09.00	ECB to publish Economic Bulletin
		12.00	ECB Chief Economist Lane to give lecture at University College Cork
France		09.50	Auction: to sell up to €13.5bn of 2.4% 2028, 2.75% 2030, 0% 2032 & 3% 2033 bonds
		10.50	Auction: to sell up to €2bn of 0.6% 2034, 0.1% 2036, 1.8% 2040 & 0.1% 2053 inflation-linked bonds
Spain		09.30	Auction: to sell 0.5% 2030, 3.15% 2035 and 3.45% 2043 bonds
UK		12.00	BoE monetary policy announcement and minutes to be published
		12.00	BoE to publish quarterly Agents' summary of business conditions (Q125)
			Friday 21 March 2025
			- Nothing scheduled -

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

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