Euro wrap-up

Overview

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- Ahead of tonight's Fed announcements, shorter-dated Bunds followed USTs slightly lower but made modest gains at the longer-end while euro area inflation was revised down from the flash estimate.
- Gilts made modest gains on a quiet day for UK economic news.
- The BoE on Thursday will leave Bank Rate unchanged and maintain its forward guidance that a gradual approach to future easing will likely remain appropriate. Data-wise, UK labour market and euro area construction activity figures are due.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.183	+0.014
OBL 2.4 04/30	2.466	-0.001
DBR 2½ 02/35	2.793	-0.015
UKT 3¾ 03/27	4.184	-0.005
UKT 4⅜ 03/30	4.279	-0.013
UKT 4½ 03/35	4.622	-0.024

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

Euro area

Euro area inflation revised down from the flash estimate in February to a three-month low

As we expected following Friday's adjustment to the German data, today's updated euro area HICP inflation estimate brought a modest downwards revision from the flash figure. In addition, the detail confirmed a further moderation in services price pressures which might in due course provide the Governing Council with scope to ease policy in response to any deterioration in the growth outlook. In particular, the headline HICP rate is now estimated to have declined 0.2ppt in February to a three-month low of 2.3%Y/Y. Admittedly, this merely left inflation trending so far in Q1 in line with the 2024 average (2.4%) and a touch firmer than the ECB's Q1 projection published earlier this month (2.3%). But this was still more than 3ppts below the 2023 average and more than 8ppts below the peak in October 2022. Moreover, disinflation was recorded in more than half of the euro area's 20 member states, and the headline HICP rate was at or below the 2% target in more than one third of the member states accounting for roughly 40% of the region.

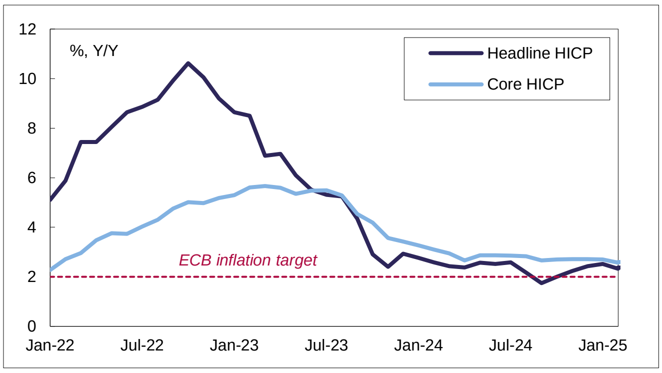
Widespread disinflation across services, with core inflation down to a three-year low

The drop in headline inflation in February largely reflected a decline in energy inflation (down 1.7ppts to 0.2%Y/Y) due to a near-15% cut in French regulated electricity prices as well as a favourable base effects in petrol prices. The revision in part reflected a slightly softer increase in fresh food inflation, which nevertheless still doubled (3.0%Y/Y) to leave the broader food, alcohol and tobacco component up to a four-month high (2.7%Y/Y). While core goods inflation also edged slightly higher in February (up 0.1ppt to 0.6%Y/Y), price pressures remained largely absent in a range of goods including second-hand cars, clothing, furniture and household appliances. Most encouragingly, however, services inflation fell 0.2ppt to 3.7%Y/Y, matching April's near-two-year low. And to two decimal places the drop was somewhat larger than in the preliminary release (0.25ppt). Moreover, disinflation was widespread across a range of services, with a three-year low in hospitality, an 11-month low in insurance, a five-month low in airfares and a second-successive easing in the package holiday component. As such, core inflation moderated 0.1ppt (0.13ppt to 2dp) to 2.6%Y/Y, the lowest since January 2022.

Measures of underlying inflation and moderating labour costs consistent with a return to 2% target

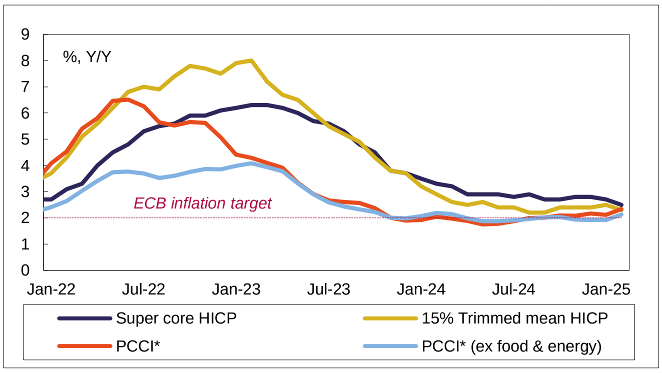
Other measures of underlying inflation published by the ECB today were also consistent with a renewed easing in price pressures and a return to the 2% target over coming quarters. For example, the 15% trimmed mean and weighted median HICP rates (2.3%Y/Y) were the softest in five and six months respectively. And while the persistent and common component of inflation (PCCI), which is judged by ECB staff to have good leading qualities, rose to a 16-month high, it too remained close to target at 2.3%Y/Y, and the core PCCI rate rose to just 2.1%. Admittedly, the ECB's seasonally adjusted data suggest

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected measures of underlying inflation



**Persistent and Common Component of inflation.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

that services momentum on a three-month basis ticked up in February to a four-month high (3.1%3M/3M annualised). But this was still almost 1ppt below the 2024 average. And inflationary impulses from labour cost growth – which fell 0.8ppt to a nine-quarter low of 3.7%Y/Y in Q4, with the services component similarly easing to 3.8%Y/Y – look set to fade further. Certainly, the ECB's updated wage tracker signalled a marked slowing in growth over the remainder of the year, from 4.9%Y/Y in February to just 1.4%Y/Y by year-end (2.9%Y/Y when excluding one-off payments). As such, we maintain our view that services inflation will take a further step down over coming months to 2½%Y/Y by end-Q2.

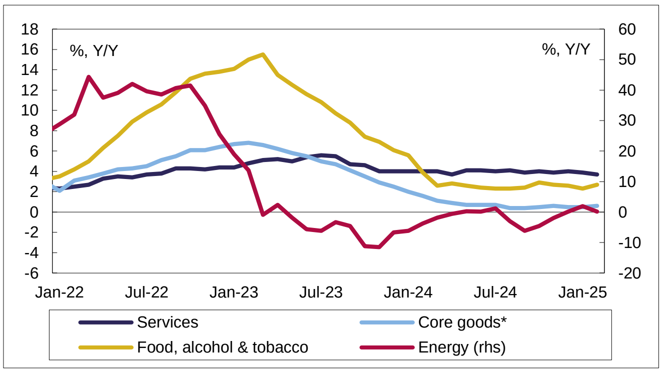
Inflation outlook subject to significant uncertainties

So, in the absence of shocks, we maintain our view that core inflation will likely be back near the 2% target this summer, before temporarily ticking higher in Q4 due to base effects. Like the ECB, we also expect headline inflation to return to target on a sustained basis from Q126. But, as President Lagarde flagged in her post-meeting press conference earlier this month, there are "exceptionally high" uncertainties surrounding near-term forecasts of both inflation and growth related to US trade policies. And while the 2 April announcement of US reciprocal tariffs will be closely watched, any direct upwards pressure on prices from retaliatory action and trade disruption might eventually be offset by the impact weak demand and increased competition as Chinese production destined for the US redirects towards Europe. The ECB will also eventually need to take into consideration the impact of additional fiscal spending in Germany. As such, the near-term policy outlook remains unclear. Certainly, with the ECB's monetary policy stance having become 'meaningfully' less restrictive – with the current deposit rate (2.50%) approaching the top end of the range of ECB staff estimates of the neutral rate – we strongly suspect that the Governing Council will leave rates unchanged at the next meeting in April. And whether the ECB cuts rates again will depend on its updated macroeconomic projections in June, which will need to take into account the impact of news on tariffs and any newly legislated German fiscal plans.

The day ahead in the euro area

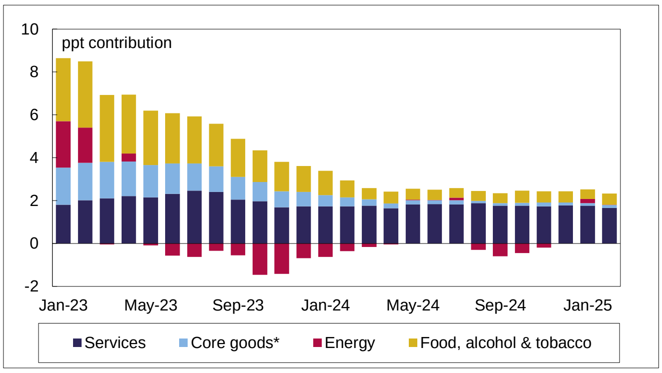
With today's euro area HICP release illustrating an ongoing absence of core goods price pressures, tomorrow's German PPI figures will provide further insights into factory pipeline price developments in February. In part due to unfavourable base effects, producer price inflation is expected to have risen at its fastest rate since late-2023, most likely in excess of 1%Y/Y. The accompanying detail, meanwhile, should signal that underlying goods price pressures remained relatively benign. Tomorrow will also bring euro area construction output figures in January. Despite the cumulative 150bps of rate cuts from the ECB over the past nine months , tentative signs of improvement in the sector in Q4 – construction output rose 0.6%3M/3M – and a jump in the construction PMIs, we expect construction activity to have declined in January. Indeed, despite modest growth in Germany, steep declines in France (-3.9%M/M) and Spain (-1.9%M/M) flag weakness at the start

Euro area: Key HICP components



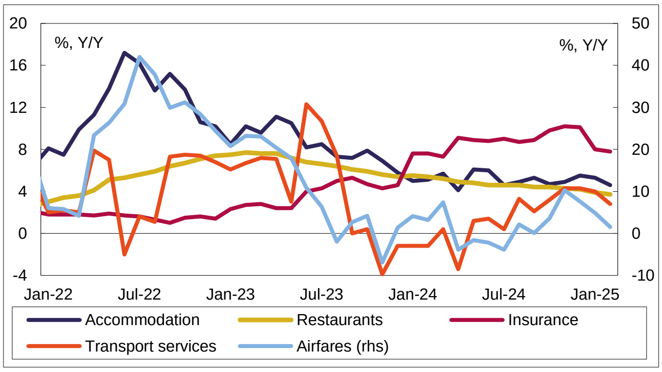
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to HICP inflation



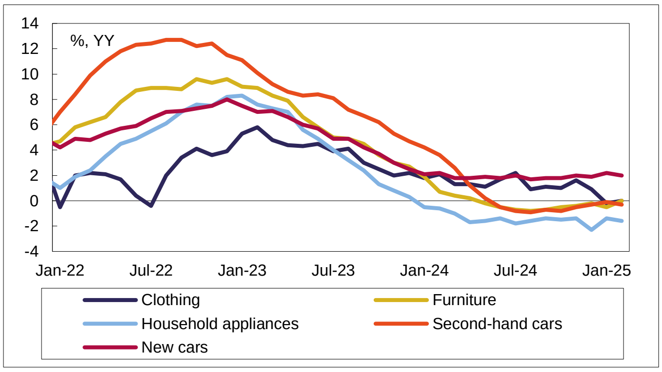
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected goods inflation components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

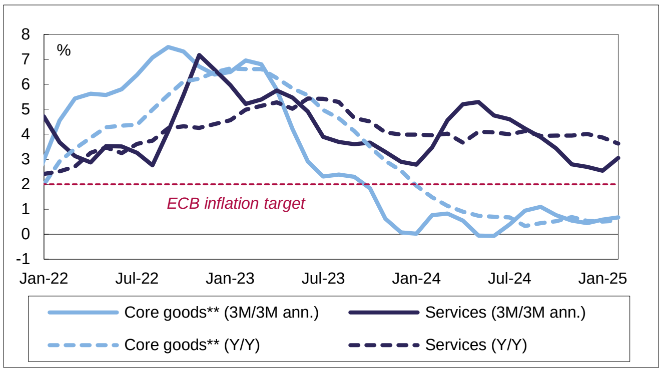
Euro area: Selected services inflation components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

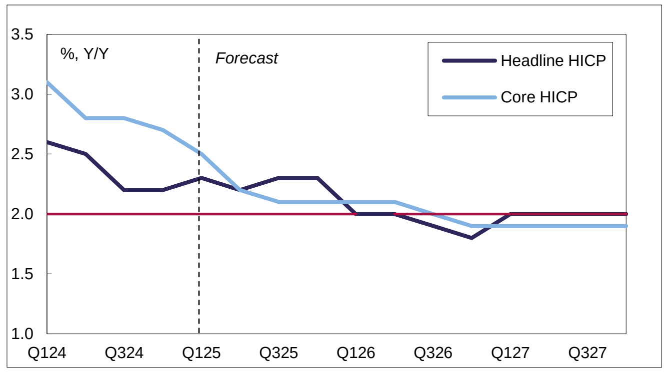
of the year – we expect aggregate activity to have slipped back at the start of the year, possibly by as much as 0.7%M/M. Aside from the data, ECB President Lagarde and Chief Economist Lane are scheduled to speak at separate events.

Euro area: Core inflation momentum



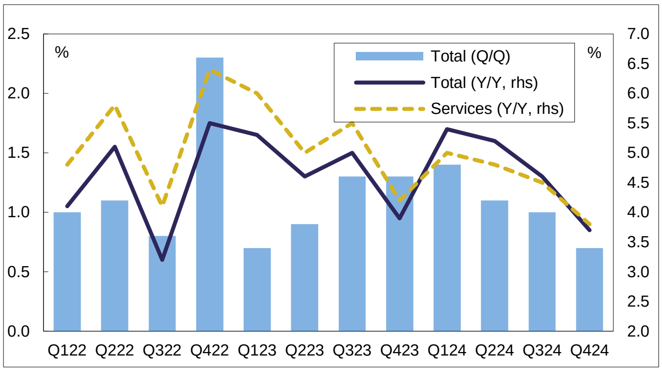
**Seasonally adjusted data. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: ECB inflation projections*



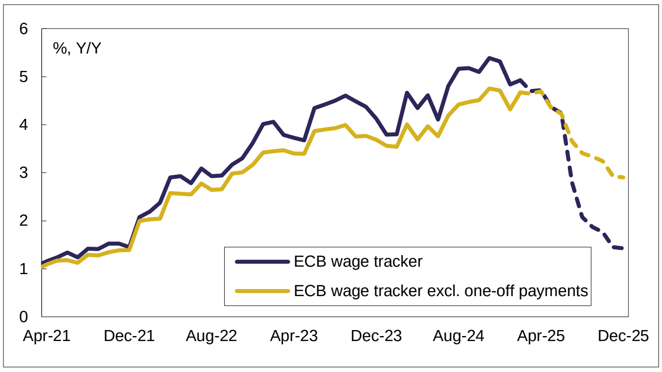
**Mar-25 projections. Source: ECB and Daiwa Capital Markets Europe Ltd.*

Euro area: Labour cost growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB wage tracker



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

The day ahead in the UK

After a quiet few days for UK economic releases, tomorrow’s news flow will be dominated by the BoE’s monetary policy announcement. Like the consensus, we expect the MPC to hold Bank Rate steady at 4.50%. Certainly, given heightened uncertainty and proliferation of two-sided risks to the inflation outlook, we suspect that the MPC will maintain its forward guidance 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 reiterate that a ‘careful and gradual’ approach to further monetary policy loosening remains appropriate. Like the BoJ today, the statement might acknowledge the increasingly uncertain global environment ahead of the reciprocal tariff announcement on 2 April, as well as insights from the Agents’ summary of business conditions in Q125 (to be published with the MPC decision). It may also note the recent uptick in inflation expectations and persistence of elevated private sector wage settlements. The latest labour market report will also be published tomorrow, with the BoE to pay close attention to January’s private sector regular wage growth, which it expects to remain around 6.2%3M/Y for at least the coming few months. But tomorrow’s release will also be watched for broader signs of labour market weakness. Certainly, recent surveys point to a further decline in job vacancies, while the PMIs signalled the largest cut to headcount in four years. The CBI’s industrial trends survey, also due, will provide a forward-looking signal of manufacturing activity in March.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Final headline (core) HICP Y/Y%	Feb	**2.3 (2.6)**	*2.3 (2.6)*	2.5 (2.7)	-
		Final labour costs Y/Y%	Q4	**3.7**	*3.7*	4.6	4.5

Auctions

Country		Auction
Germany		sold €822mn of 0% 2050 bonds at an average yield of 3.04%
		sold €1.162bn of 1.8% 2053 bonds at an average yield of 3.08%

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	Construction output M/M% (Y/Y%)	Jan	*-0.7 (-1.4)*	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

Auctions and events

Country		GMT	Event
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)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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