Euro wrap-up

Overview

- Bunds made gains at the short end of the curve while French consumer confidence dipped on the more uncertain economic outlook.
- Gilts made gains across the curve as UK inflation came in below the market consensus while the DMO's gilt financing remit for the coming fiscal year also undershot market expectations and the UK government confirmed plans for public spending cuts over the coming parliament.
- Thursday will bring euro area bank lending data.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	2.111	-0.020
OBL 2.4 04/30	2.406	-0.018
DBR 2½ 02/35	2.789	-0.006
UKT 3¾ 03/27	4.268	-0.024
UKT 4⅜ 03/30	4.363	-0.019
UKT 4½ 03/35	4.727	-0.029

*Change from close as at 4:45pm GMT.
Source: Bloomberg

UK

Inflation undershoots consensus but matches BoE projection thanks to soft core goods component

In line with the BoE's projection but softer than the consensus forecast of no change, CPI inflation moderated in February by 0.2ppt to 2.8%Y/Y. Core inflation also fell 0.2ppt, to 3.5%Y/Y, to give the impression of a favourable report. The main driver of the improvement was the core goods component, which dropped 0.5ppt to a three-month low of 1.1%Y/Y due principally to weakness in clothing and footwear, furniture and household equipment, as well as new cars. More importantly, services inflation, a key focus for the MPC, was unchanged at 5.0%Y/Y, 0.1ppt below the BoE's forecast. That reflected softness in several items including auto insurance and hotels, which both fell to multi-year lows. However, inflation of many other services rose. And the BoE will note that various measures of underlying services inflation, which exclude highly volatile items such as those related to holidays and indexed prices such as rents, picked up on the month. Meanwhile, among the non-core items, the energy component fell a touch on petrol prices (-6.8%Y/Y) broadly offsetting an uptick in inflation of food, alcohol and tobacco ticked up (3.9%Y/Y).

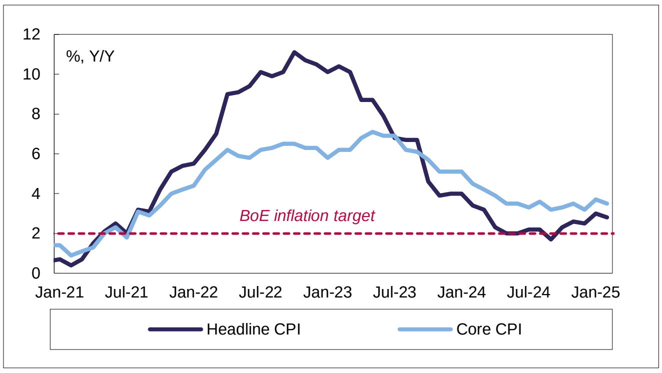
Inflation set to rise back above 3% in April on administered & indexed prices

As it in part reflected changes in the pattern of seasonal discounting, some of the drop in core goods inflation in February will reverse in March. We similarly expect to see a rebound in the hotel component. And the uptick in measures of underlying services inflation in February provides a reminder that various policy changes, including hikes in the national living wage and employer NICs from April, continue to add to price pressures. Further positive impulses to inflation will come in April from the increases in the regulated energy price cap and water tariffs, as well as other indexed prices. So, while we expect headline CPI inflation to moderate slightly further in March, we expect it to rise more than ½ppt in April back to about 3¼%Y/Y. Base effects will then likely push it up further into the summer with the risks of second-round effects on inflation from the policy changes non-negligible.

But lower inflation in February, sterling appreciation & gas prices support case for May rate cut

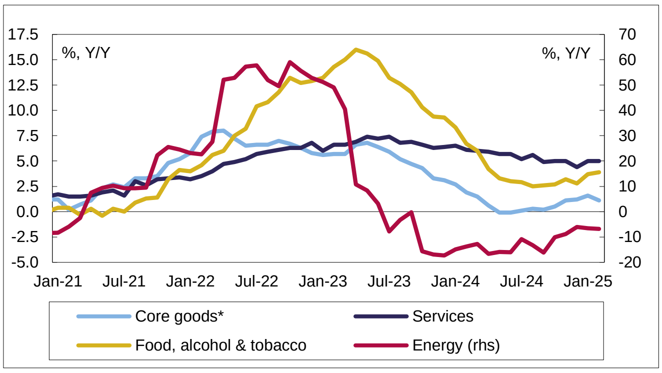
Not least also given global events, the inflation outlook remains highly uncertain. But we would expect the UK government to take less retaliatory action than the EU on response to US 'reciprocal tariffs'. And so, prices of imported items might yet be impacted negatively by global trade war developments. The recent strength of sterling in trade-weighted terms should certainly helpfully weigh somewhat on prices of imported core goods and food. And more favourable developments in European wholesale gas markets suggest that the Ofgem household energy price cap will be cut, perhaps significantly, in July. Most importantly, assuming that pay pressures continue to ease over coming quarters in response to softer labour

UK: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Key inflation components



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

market conditions, we expect the downtrend in underlying services inflation to resume soon as demand is likely to remain subdued. So, while we think that headline inflation will peak around 3½%Y/Y in Q3, it should gradually subside thereafter. And for the time being, the drop in February, as well as recent sterling strength and lower wholesale gas prices, should support the BoE's stance of for continued 'gradual and careful' monetary easing. And so, while we acknowledge that uncertainty remains highly elevated, we maintain our expectation that Bank Rate will next be cut by 25bps in May with further cuts of that magnitude each quarter in H225 and H126.

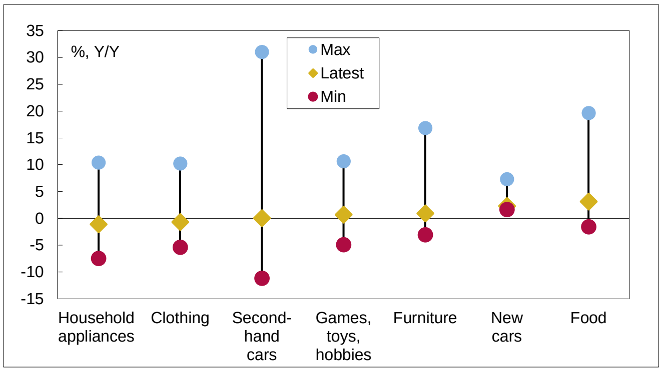
Spring Statement avoids bad surprises as government restores fiscal headroom via spending cuts

In terms of fiscal policy, the Chancellor's Spring Statement avoided nasty surprises, confirming how the government plans to rebuild the headroom above its target to balance the current budget by the end of the parliament. According to the OBR's updated forecast, public sector net borrowing (PSNB) in the current fiscal year, which ends this month, will come in £10bn above the prior projection at £137.3bn (4.8% of GDP), with most of that excess explained by lower receipts. Not least thanks to the increase in employer NICs next month, PSNB is still projected to decline by 1ppt in the coming fiscal year and steadily further thereafter. But with Gilt yields higher across the horizon, in the absence of new adjustments to policy, the OBR projected that PSNB would have remained more than £10bn per year above the path previously projected, eroding in full the headroom in FY29/30 estimated at the time of the October Budget. However, today's statement confirmed the government's intention to cut public spending on welfare and government departments by more than £6bn by the end of the parliament compared to the previous plan. In addition, the OBR (rather generously) judged that the government's policy agenda, particularly with respect to deregulation, will boost economic growth over the course of the parliament to further improve the budgetary arithmetic. As a result, the surplus on the current budget is again expected to come in at £9.9bn at the end of the parliament, thus maintaining in full from the previous estimate the government's headroom regarding the respective fiscal rule. Nevertheless, PSNB is projected to be some £3.5bn higher in FY29/30 than was previously the case, at £74.0bn (2.1% of GDP).

Planned Gilt issuance in the coming fiscal year below expectations

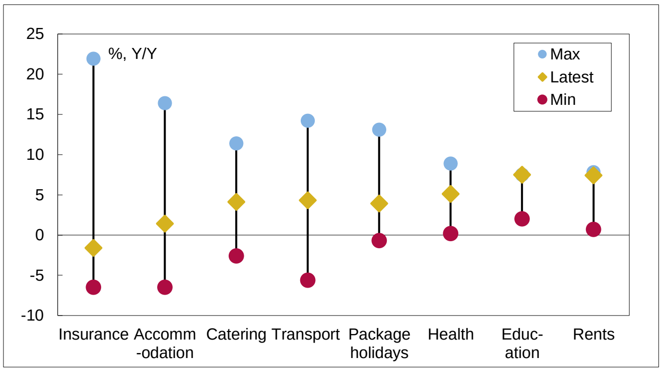
In terms of Gilt issuance, the DMO's gross financing requirement over coming years was necessarily revised up above the previous projection. Indeed, the central government net cash requirement over the coming five years will be cumulatively more than £55bn higher than the OBR projected in October. Nevertheless, DMO planned Gilt sales for the coming fiscal year were confirmed at a lower than expected £299.2bn, up just £2.3bn from FY24/5, with the announcement of that figure helping to push yields lower. A £2bn increase in the net contribution of Treasury bills helped to keep that figure symbolically

UK: Selected goods inflation components*



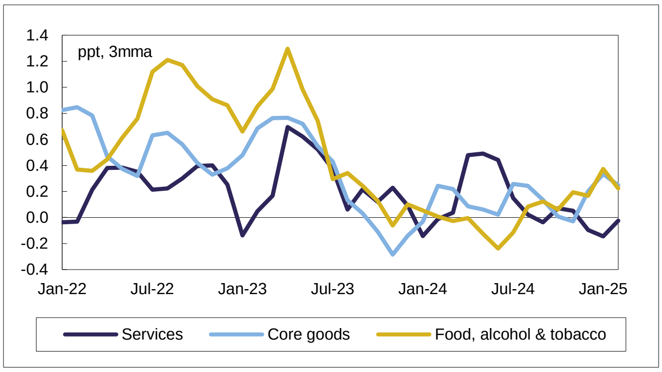
*Data since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected services inflation components*



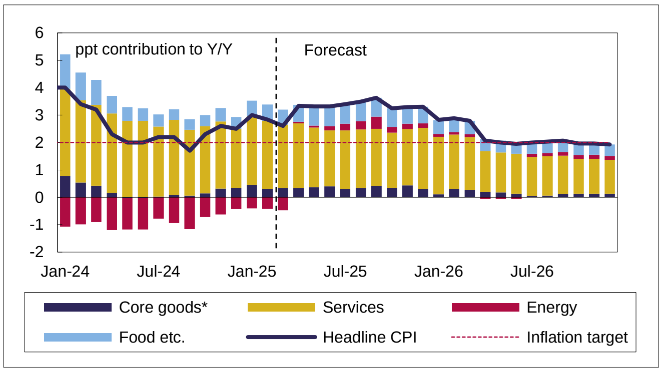
*Data since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Deviations from long-run monthly price change*



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

UK: Contributions to inflation & forecast



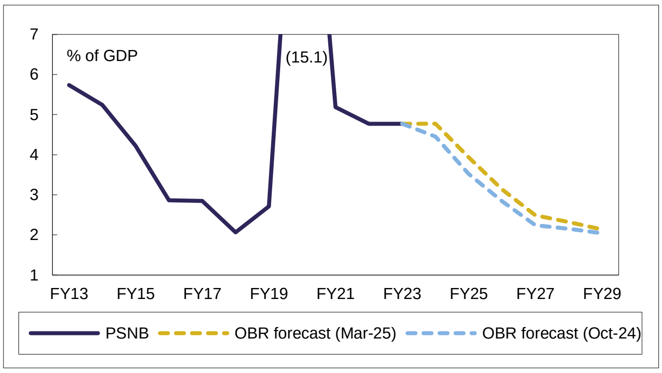
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

below £300bn. Of course, the average weighted maturity of Gilts outstanding is much longer than that of other major sovereign bonds, a feature of the market that strongly supports UK fiscal sustainability. Nevertheless, as expected, and reflecting the sense among many market participants and policymakers that Gilt demand at the longer end of the curve might be approaching a limit, the DMO increased the share of shorter-dated Gilts and reduced the share of longer-dated Gilts that it plans to issue over the coming year. Given the uncertain outlook, however, it also significantly increased the share of Gilts unallocated to any particular maturity bucket to more than 9%. While that will provide the DMO with flexibility to respond to changing market conditions over coming months, and could well lead to additional longer-dated issuance in due course, that will also have a cost in terms of diminished predictability for market participants.

The day ahead in the UK

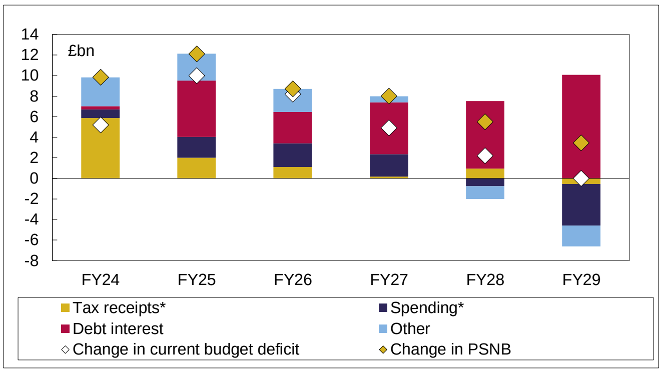
With the data flow on pause tomorrow, the day ahead should be quiet for UK economic news. External MPC member Dhingra – who cast the sole dissenting vote in favour of continued easing at the March monetary policy meeting – is due to participate in a panel discussion on inflation targeting at a conference hosted by the South African Reserve Bank. Her comments are unlikely to shed any light on near-term BoE policy decisions, for which her vote will remain predictably dovish.

UK: Public sector net borrowing



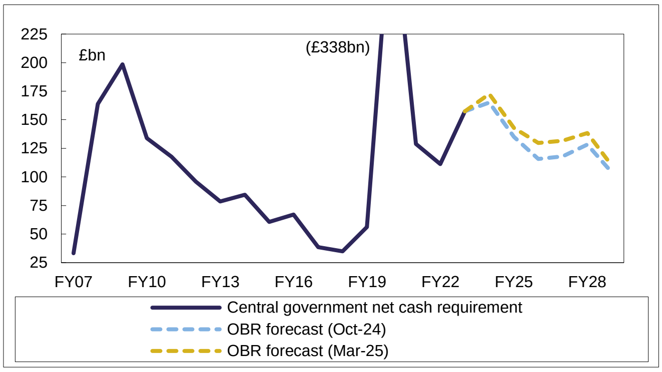
Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: Change in public borrowing forecast**



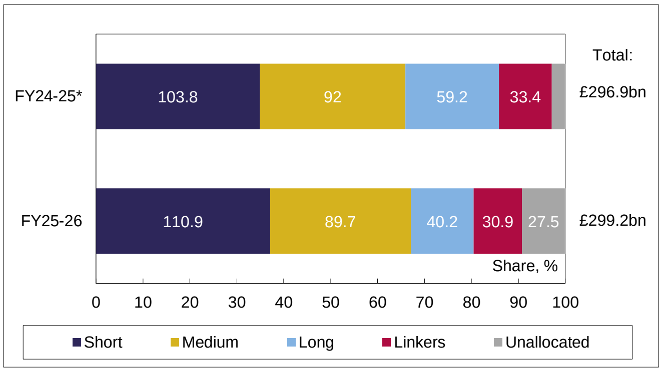
**Net of new policy measures. **Difference between October-24 and March-25 forecast. Source: OBR and Daiwa Capital Markets Europe Ltd.*

UK: Central government net cash requirement



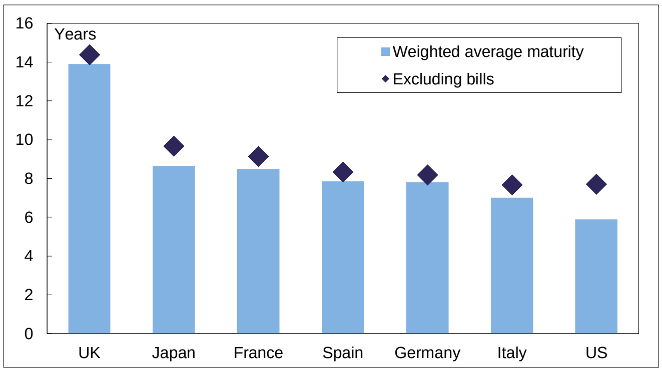
Source: DMO, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Breakdown of current planned Gilt issuance



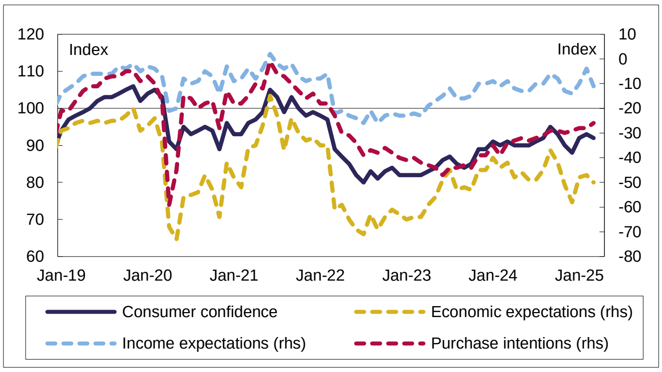
**Based on October-24 update.*
Source: DMO and Daiwa Capital Markets Europe Ltd.

UK: Average debt maturity by country



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

France: Consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area

French consumer confidence dips on uncertain outlook, but purchase intentions rise to 3-year high

According to today's INSEE survey, the deterioration in the flash estimate of euro area consumer confidence in part reflected increased pessimism among French households. Indeed, the headline INSEE sentiment indicator fell for the first month in three in March, by 1pt to 92, to be some 8% below the long-run average, as an increasingly uncertain economic outlook weighed. But the index was still some 12pts above the trough in mid-2022, above the average in 2024 and only 3pts below the recent Olympics-driven peak in September. While income expectations for the coming twelve months moderated as price expectations increased somewhat, households assessed their current income situation to be broadly stable, bang in line with the long-run average. And so, with fears of unemployment lessening, the share of households assessing it a good time to make major purchases rose to the highest in three years, suggesting that private consumption might well provide a boost to GDP growth in Q1 for a third consecutive quarter. Nevertheless, with purchase intentions still below the long-run average and savings intentions still close to February's record high, growth in household expenditure might struggle to exceed the average pace of 0.4%Q/Q in the second half of last year.

The day ahead in the euro area

On an otherwise quiet day ahead, February's bank lending figures will provide the main event in the euro area. The pass through from the ECB's cumulative policy easing into cheaper borrowing conditions and recent signs of recovery in housing market activity helped to boost mortgage lending data in January, which increased the most in 2½ years. The ECB will be hopeful that its more accommodative stance will sustain that recovery, and support a broader pickup in business lending in February too. Tomorrow will also bring figures for Spanish retail sales figures in February.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
France		INSEE consumer confidence indicator	Mar	**92**	94	93	-
Spain		GDP – final estimate Q/Q% (Y/Y%)	Q4	**0.8 (3.4)**	*0.8 (3.5)*	0.8 (3.5)	-
UK		Headline (core) CPI Y/Y%	Feb	**2.8 (3.5)**	*3.0 (3.7)*	3.0 (3.7)	-
		House price index Y/Y%	Jan	**4.9**	-	4.6	-

Auctions

Country		Auction
Germany		sold €1.135bn of 2.6% 2041 bonds at an average yield of 3.08%
		sold €497mn of 2.5% 2046 bonds at an average yield of 3.11%
Italy		sold €3bn of 2.55% 2027 bonds at an average yield of 2.38%
		sold €1.5bn of 1.5% 2029 inflation-linked bonds at an average yield of 1.02%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		09.00	M3 money supply Y/Y%	Feb	3.8	3.6
Spain		08.00	Retail sales Y/Y%	Feb	-	2.2

Auctions and events

Country		GMT	Event
Euro area		18.00	ECB Executive Board Member Schnabel to deliver lecture on financial literacy and monetary policy transmission in London
UK		08.30	BoE MPC member Dhingra to speak on a panel about inflation targeting in South Africa
		10.00	Auction: to sell £3bn of 4% 2031 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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