Daiwa Capital Markets

# Euro wrap-up

## Overview

- Shorter-dated Bunds made losses as the EU suspended for 90 days its retaliatory tariff hikes on US imports.
- Gilts rallied at the long end while the BoE suspended a longer-dated Gilt sale and BoE Deputy Governor Breeden expressed concern about the risks of ongoing market volatility.
- Friday will bring UK GDP figures for February, while final German and Spanish inflation data for March are also due.

**Chris Scicluna**
+44 20 7597 8326

**Emily Nicol**
+44 20 7597 8331

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 2.2 03/27 | 1.776 | +0.059 |
| OBL 2.4 04/30 | 2.109 | +0.011 |
| DBR 2½ 02/35 | 2.575 | -0.013 |
| UKT 3¾ 03/27 | 3.893 | -0.090 |
| UKT 4⅜ 03/30 | 4.074 | -0.142 |
| UKT 4½ 03/35 | 4.642 | -0.139 |

*Change from close as at 5.00pm BST.
Source: Bloomberg

# Euro area

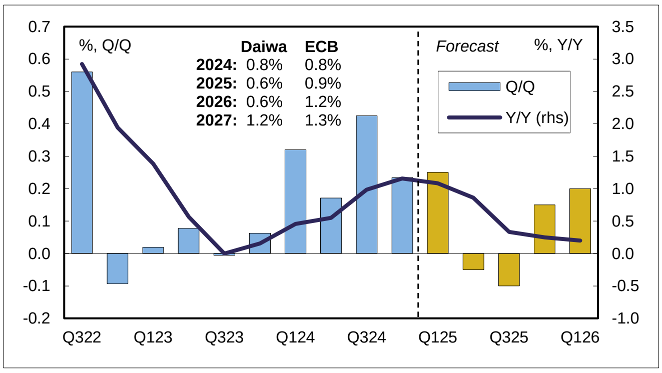
### Despite relief at suspension of ‘reciprocal’ rates, Trump tariffs will still take toll on euro area activity

Yesterday evening’s 90-day suspension of Trump’s reciprocal tariffs brought some welcome relief to European markets today. And the EU added to the positive mood by agreeing to suspend for a similar 90 days its own retaliatory tariffs on €21bn of US agricultural goods and motorcycles, as long as negotiations proceed in a satisfactory manner. But the new 10% baseline tariffs, coupled with additional 25% tariffs on autos, steel and aluminium products, still represent a marked hike in the US weighted average tariff on European imported goods from less than 2% at the start of the year. The increased trade barriers will ultimately hit demand for and deter supply of European goods exports. And lack of trust in the US administration and persistent uncertainty surrounding the global tariff landscape – including the future of tariffs on European imports at the end of the 90-day suspension period, developments in the US-China trade war and other bilateral negotiations – will weigh on business sentiment and capex for several quarters. Not least given wealth effects, the recent financial market turbulence will also have further dented consumer confidence and willingness to make big-ticket purchases despite the welcome drop in wholesale energy prices. So, while acknowledging that the outlook remains extremely uncertain, we have revised down our forecasts for euro area GDP and inflation this year and next, and have also increased the number of ECB rate cuts that we expect over coming meetings.

### Near-term stagnation to be followed by gradual recovery into 2026 and beyond

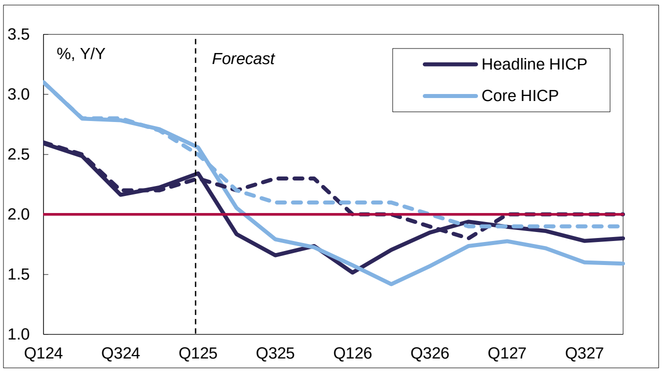
While we are more downbeat about the GDP growth outlook, Q1 appears to have been as firm as might have been expected. Certainly, production and shipments to the US of certain goods from the euro area – not least chemicals from Ireland – leapt in Q1 as firms sought to front-run new tariffs. So, industrial production likely grew last quarter for the first time in two years. With the principal exception of autos and metals, further front-running might occur in some subsectors in Q2. In addition, construction looks to have risen again in Q1. And, more importantly, consumer spending likely rose again for a third successive quarter. But while we think that euro area GDP grew as much as 0.3%Q/Q in Q1, the Trump tariff shock and persisting uncertainty will take its toll on growth in Q2 and Q3. In the absence of further insights from the flash PMIs and other April survey indicators, we now anticipate that activity in both quarters will be broadly flat before edging higher towards year-end. Given the detail of yesterday’s government coalition agreement, recovery should steadily gain traction on a quarterly sequential basis in 2026 and 2027 thanks to targeted tax cuts and increased public spending in Germany. Given the weak carry-over from this year, however, we forecast full-year euro area GDP to rise just 0.6%Y/Y in both 2025 and 2026 – some 0.3ppt and 0.6ppt below the ECB’s current projections – before accelerating 1.2%Y/Y in 2027.

**Euro area: GDP growth projections***




*ECB projections from March 2025.
Source: Macrobond, ECB and Daiwa Capital Markets Europe Ltd.

**Euro area: Inflation projections***




*Dashed lines represent ECB projections from March 2025.
Source: Macrobond, ECB and Daiwa Capital Markets Europe Ltd.

## Soft demand, stronger euro, lower energy prices and tax changes all point to lower inflation

With retaliatory countermeasures on ice, the weaker demand outlook coupled with the prospect of cheap Chinese supply diverted away from the US compels us to revise down our inflation outlook over coming quarters. The impact of the Trump tariff shock on market variables – including significantly lower oil and gas prices and the stronger euro – also call for downwards revisions to our projections of prices, particularly of energy, food and core goods. And with the incoming German government pledging to cut energy tariffs and, from January, reduce VAT on restaurant meals by 12ppts, the impact of its increased infrastructure and military expenditure is unlikely to be evident in national inflation until 2027. Overall, we now expect euro area headline inflation to fall below 2.0%Y/Y in the current quarter. And with core inflation likely to ease below 2.0%Y/Y by the summer, we expect headline inflation to remain modestly sub-target over the horizon, averaging 1.9%Y/Y in 2025 and 1.8%Y/Y in both 2026 and 2027.

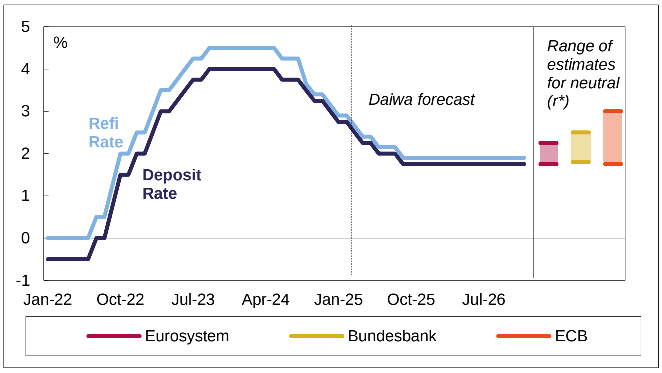
## ECB to respond to Trump tariffs with rate cuts in April, June and perhaps beyond

On Thursday, the ECB has a first scheduled opportunity to respond to the economic uncertainty and market turmoil generated by Trump's tariff announcements when it makes its latest monetary policy announcement. Of course, at its March policy meeting, the Governing Council noted that its policy was "becoming meaningfully less restrictive". And also given rising uncertainty and two-sided risks, the published account of the meeting made clear that the policymakers would this month consider with an open mind the cases for leaving policy unchanged and a further rate cut. But with the economic growth outlook having darkened somewhat, and the inflation outlook cooled, like the consensus we now firmly expect a further rate cut of 25bps this month to take the deposit rate to 2.25%. As at the last meeting, Austrian Governor Holzmann would seem to be the only member of the Governing Council – if there are any at all – not to vote in favour. The ECB's forward guidance will no doubt repeat that it will continue to follow a data-dependent and meeting-by-meeting approach to determining policy, and that the Governing Council is not pre-committing to a particular rate path. However, if the economic outlook unfolds as we expect, we would expect further rate cuts of 25bps in June and one of the two policy meetings in Q3 to take the deposit rate to 1.75%, which is our new estimate of the terminal rate for this cycle.

## Further front-loading of Irish production in February

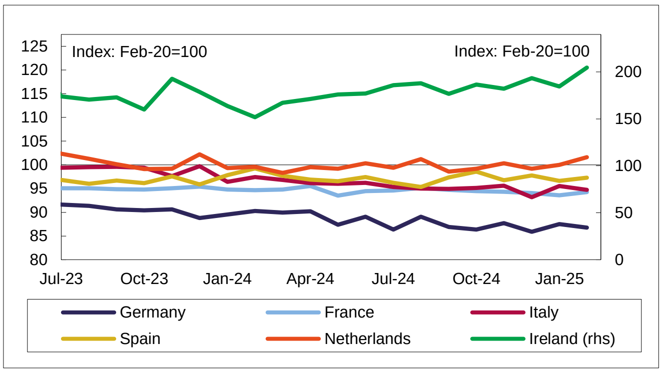
While industrial production data from euro area member states were inevitably volatile in the first two months of the year, overall there were signs of further front-loading to provide a boost to GDP growth in Q1. This was particularly evident in the Irish numbers, for which industrial production rose 10.8%M/M in February – the most since November 2023 – to the highest

### Euro area: ECB interest rate projections



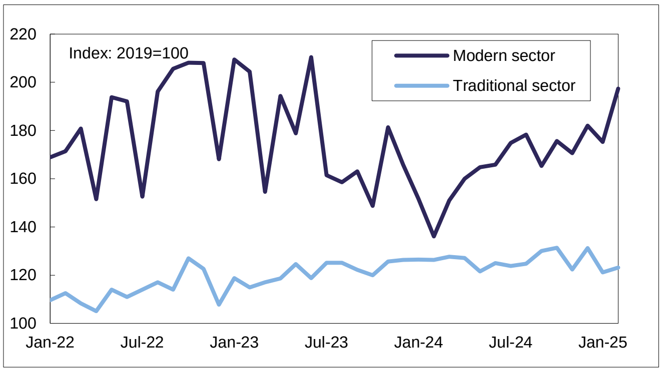

*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Euro area member states: Industrial production



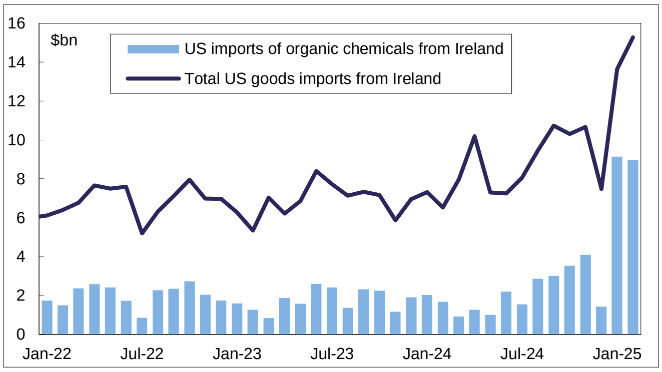

*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Ireland: Industrial production




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

### US goods imports from Ireland




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

level since June 2023. While these numbers are often subject to large monthly swings, on a smoothed three-month basis production accelerated 6.8%3M/3M, the most in six months. The pickup was driven by the “modern” sector, which includes the chemical, pharmaceutical, ICT and electrical equipment sectors, where output jumped 12.7%M/M in February, to be up some 8½%3M/3M and 22%3M/Y, the most since December 2022. These production numbers broadly tally with US goods trade data that reported a near-two-fold increase in imports of Irish organic chemicals on average in January and February compared with Q4, with total goods imports from Ireland up a little more than 50% on the same basis.

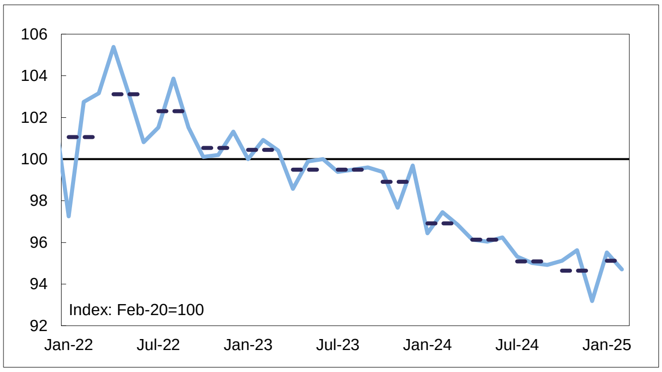
## But Italian IP declined after rebound in January

In contrast to Ireland, but like Germany, today’s Italian IP figures suggested some payback in February (-0.9%M/M) for the rebound at the start of the year (2.5%M/M). The weakness that month was broad-based, with declines in machinery, basic metals, ICT and electrical equipment and textiles, with output in the latter component at the lowest level since the first Covid lockdown in April 2020. Nevertheless, total Italian production was still trending so far in 2025 some ½% higher than the Q4 average. Admittedly, this partly reflected a significant jump in energy production in February (7.3%M/M) to a near-three-year high. Meanwhile, manufacturing production was averaging a more modest 0.2% higher than in Q4. But with roughly 15% of Italian goods exports shipped to the US, we might see a temporary boost in production in March in subsectors including machinery, chemicals, pharmaceuticals and transportation. Indeed, despite mixed messages from recent surveys, we see the likelihood that the manufacturing sector posted positive growth in Q1 for the first quarter in ten. Taken together with rising production in France (0.7%M/M), Spain (0.7%M/M) and the Netherlands (1.6%M/M), we expect aggregate euro area industrial output – data due for release on Tuesday – to rise around ¾%M/M in February. This would leave output trending almost 1% above the Q4 average and firmly on track to provide a positive contribution to euro area GDP growth in Q1 for the first time in two years.

## The day ahead in the euro area

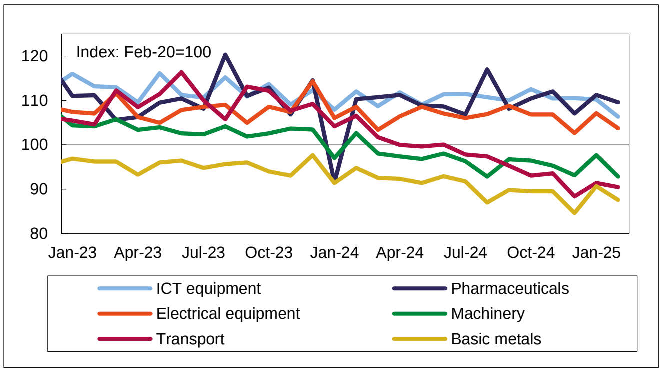
Ahead of next week’s final estimates of euro area inflation in March, Friday will bring those data for both Germany and Spain. Preliminary estimates for both member states were central to the softness in last month’s euro area print, with the headline HICP rates down respectively by 0.3ppt and 0.7ppt to 2.3%Y/Y and 2.2%Y/Y. Friday’s release should reaffirm those results, with the detail likely to point towards notable – albeit potentially fortuitous, given the earlier timing of Easter – slowing in services inflation

### Italy: Industrial production*



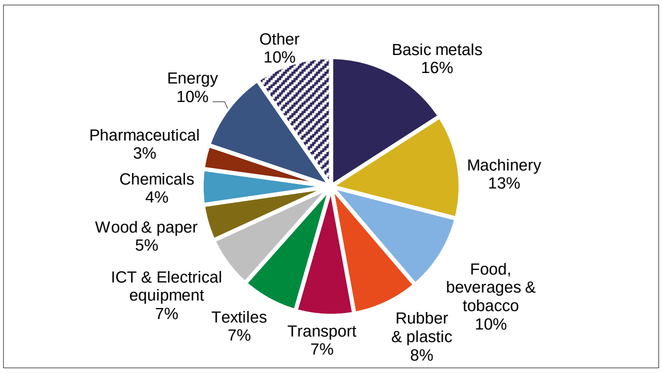

*Dashed dark blue lines represent quarterly average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Italy: Industrial production by selected subsector



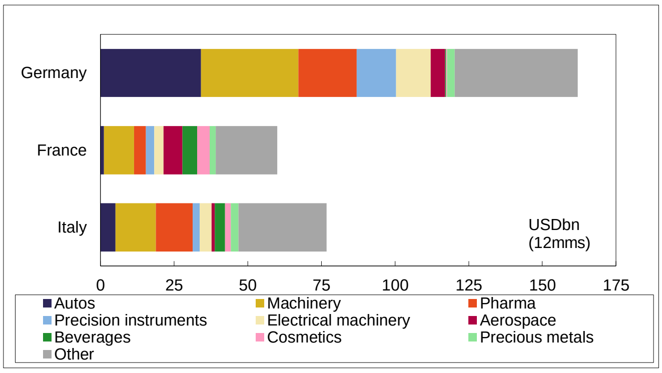

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Italy: Share of industrial production by sector




Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Germany, France & Italy: Goods exports to the US




Source: Macrobond, US Census Bureau and Daiwa Capital Markets Europe Ltd.

# UK

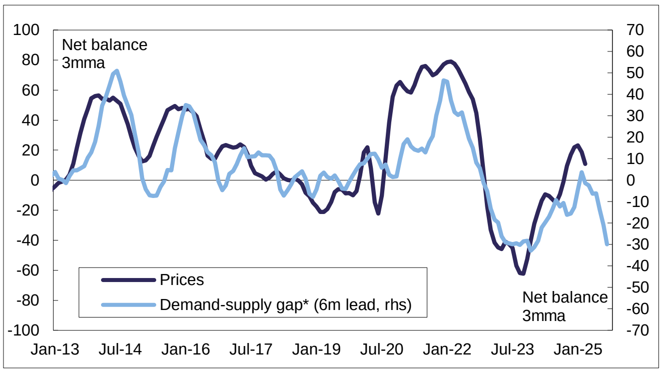
## Heightened economic uncertainties and Stamp Duty changes weigh on housing demand

In an otherwise quiet day for UK economic data, today's RICS residential survey signalled a further slowing in the housing market recovery as heightened global uncertainties weighed on demand that was already weakened by still-elevated borrowing costs and a scheduled reduction in the 0% Stamp Duty threshold from the start of April. In particular, buyer enquiries fell for a third successive month in March and by the most since September 2023, while new instructions fell to an eight-month low. Newly agreed sales dipped to the lowest since October 2023. And so, the headline price balance fell to a seven-month low consistent with no growth, while price expectations for the three months ahead also fell the most in 17 months. While the uncertain environment might cause some to delay or reconsider a house move over the near term, we suspect that the forthcoming Stamp Duty adjustments played a greater role in the deterioration in the market in March. But looking further ahead, surveyors were increasingly less upbeat than in recent months about expectations for house price growth and sales in the coming 12 months, with the survey index for the latter falling below the long-run average for the first time since 2023. So, while rates on new mortgage deals have fallen to a near-two-year low amid falling swap rates and the prospect of more aggressive Bank Rate cuts, weak household confidence might yet prompt a prolonged pause in housing market activity.

## The day ahead in the UK

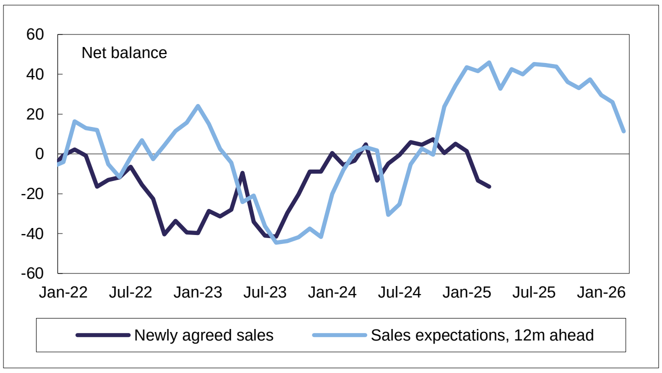
UK monthly GDP for February will mark the data focus in the UK tomorrow. January's release reported a slight drop of 0.1%M/M, but that was somewhat unsurprising given the strength of growth at the end of last year (0.4%M/M) and downcast framing of consumer and business sentiment surveys. And while those same surveys failed to meaningfully improve in February, we see monthly growth prospects as being more upbeat, albeit with overall output up just 0.1%M/M. Indeed, consistent with the resilience across most official statistics of late, retail sales data for February were again particularly strong (1.0%M/M), and we would expect to see some help from the construction sector after consecutive weather-affected monthly contractions. Marginal growth in February would also be more supportive of our prediction for a return to respectable quarterly growth (~¼%Q/Q) in Q1, with growth on a three-monthly basis set to accelerate to an eight-month high (0.4%3M/3M). Meanwhile, attention will also be on Friday's KPMG/REC report on jobs, which will provide insights into labour market conditions in March ahead of April's increase in minimum wage bands and employer National Insurance Contributions.

### UK: RICS survey – house prices, demand & supply




*Demand-supply gap calculated as the difference between new buyer enquiries and new instructions. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: RICS survey – newly agreed & expected sales




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 |
|---|---|---|---|---|---|---|---|
| Italy | | Industrial production M/M% (Y/Y%) | Feb | **-0.9 (-2.7)** | -1.0 (-1.5) | 3.2 (-0.6) | 2.5 (-0.8) |
| UK | | RICS house price balance % | Mar | **2** | 8 | 11 | - |

**Auctions**

| Country | | Auction |
|---|---|---|
| Spain | | sold €2.85bn of 3.5% 2029 bonds at an average yield of 2.462% |
| | | sold €1.64bn of 2.55% 2032 bonds at an average yield of 3.014% |
| | | sold €1.97bn of 3.15% 2035 bonds at an average yield of 3.349% |

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

## Wednesday's results

**Economic data**

| Country | Release | Period | Actual | Market consensus/ *Daiwa forecast* | Previous | Revised |
|---|---|---|---|---|---|---|
| | | | - Nothing to report - | | | |

**Auctions**

| Country | | Auction |
|---|---|---|
| UK | | sold £4.5bn of 4.375% 2030 bonds at an average yield of 4.142% |

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

## Tuesday's results

**Economic data**

| Country | | Release | Period | Actual | Market consensus/ *Daiwa forecast* | Previous | Revised |
|---|---|---|---|---|---|---|---|
| France | | Trade balance €bn | Feb | **-7.9** | - | -6.5 | - |

**Auctions**

| Country | | Auction |
|---|---|---|
| Germany | | sold €2.386bn of 2.5% 2035 bonds at an average yield of 2.62% |
| UK | | sold £2.25bn of 4.375% 2054 bonds at an average yield of 5.357% |

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

## Tomorrow's releases

**Economic data**

| Country | | BST | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|---|
| Germany | | 07.00 | Final HICP (CPI) Y/Y% | Mar | *2.3 (2.2)* | 2.6 (2.3) |
| Spain | | 08.00 | Final HICP (CPI) Y/Y% | Mar | *2.2 (2.3)* | 2.9 (3.0) |
| UK | | 07.00 | Monthly GDP M/M% (3M/3M%) | Feb | *0.1 (0.4)* | -0.1 (0.2) |
| | | 07.00 | Services output M/M% (3M/3M%) | Feb | 0.1 (0.5) | 0.1 (0.4) |
| | | 07.00 | Industrial output M/M% (Y/Y%) | Feb | 0.1 (-2.3) | -0.9 (-1.5) |
| | | 07.00 | Construction output M/M% (Y/Y%) | Feb | 0.2 (1.7) | -0.2 (0.2) |
| | | 07.00 | Trade (goods trade) balance £bn | Feb | -1.4 (-17.9) | -0.6 (-17.8) |

**Auctions and events**

| Country | | BST | Auction |
|---|---|---|---|
| Italy | | 10.00 | Auction: to sell up to €3.5bn of 2.65% 2028 bonds |
| | | 10.00 | Auction: to sell up to €2.5bn of 3.15% 2031 bonds |
| | | 10.00 | Auction: to sell up to €1.5bn of 0.95% 2032 bonds |
| | | 10.00 | Auction: to sell up to €1.5bn of 3.25% 2038 bonds |

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

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