Euro wrap-up

Overview

Economics Research Team
+44 20 7597 8326

- Despite extremely strong growth in German new factory orders, Bunds followed USTs to close the day slightly higher as the ECB left its policy and forward guidance unchanged.
- The BoE left Bank Rate unchanged but opened the door to a March cut pushing shorter-dated Gilts higher, but longer-dated Gilts weakened in response to heightened uncertainty about Starmer's future as UK PM.
- Friday will bring December figures for German industrial production and goods trade.

Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.087	-0.001
OBL 2½ 04/31	2.418	-0.010
DBR 2.9 02/36	2.841	-0.017
UKT 3¾ 03/27	3.644	-0.056
UKT 4⅜ 03/30	3.938	-0.025
UKT 4½ 03/35	4.558	+0.013

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

Euro area

ECB offers no new clues to the rate outlook amid two-sided inflation risks

There were no surprises whatsoever from today's ECB policy announcements. The Governing Council predictably left rates unchanged, a decision which President Lagarde later confirmed was unanimous. It also left its forward guidance intact, reiterating that it will continue to follow a "data-dependent and meeting-by-meeting approach" without pre-committing to a particular rate path. Certainly, with Lagarde repeating that the ECB is in a "good place", the current policy settings seem likely to remain in place for a while yet. And it remains difficult to be confident whether the direction of the next change in rates will be up or down. While inflation dropped to 1.7%Y/Y in January, the Governing Council judged that it remains sufficiently close to target for comfort. And it saw the inflation outlook as broadly unchanged amid two-sided risks which are considered by the ECB to be balanced.

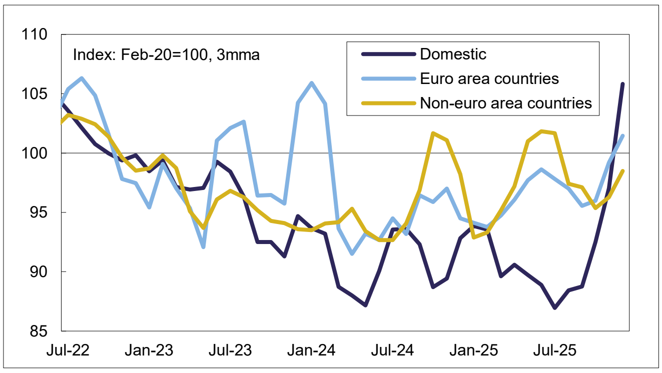
Risks to growth outlook also balanced as fruits of German stimulus become more apparent

The ECB's assessment of broadly balanced two-sided risks looks appropriate. On the downside, with the global trade environment already challenging, recent geopolitical events – not least Trump's short-lived Greenland-related threats of higher tariffs – are likely to have weighed on sentiment, particularly in export-oriented sectors. And while Lagarde sought to downplay recent shifts in the exchange rate – noting that the impact of last year's appreciation was already incorporated in the baseline expectation – additional marked gains would certainly weigh on the outlooks for both growth and inflation. On the upside, the statement again flagged encouraging labour market conditions and solid private sector balance sheets. And despite evidence of a recent tightening of credit conditions, the Governing Council believes that past easing is still supporting activity. Euro area GDP growth exceeded the ECB's projection for a second successive quarter in Q4 (0.3%Q/Q). And surveys signal a possible pickup in growth momentum at the start of the year, with Lagarde citing the leading role of services, including ICT, as well as increased investment in AI and related infrastructure. Crucially too, with much clearer signs that increased German public spending on defence and infrastructure is at last feeding through to activity, the ECB rightly also sees the risks to demand as broadly balanced.

German new factory orders rise to highest level in almost 4 years led by defence-related demand

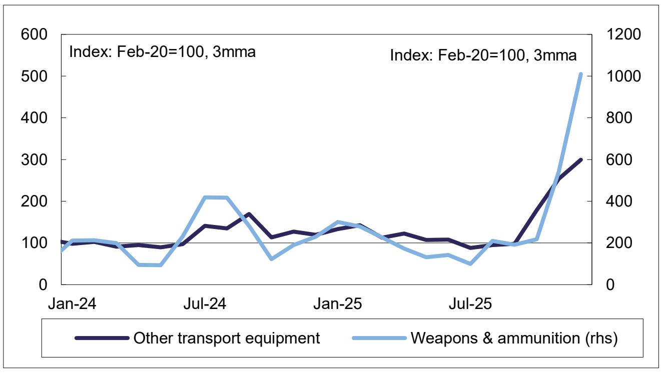
The impact of a more expansionary German fiscal stance was certainly evident in today's factory orders data and construction PMIs. New factory orders rose for a fourth successive month in December and by the most in two years (7.8%M/M). This took the level to the highest in almost four years, while quarterly growth in Q4 (9.6%Q/Q) was the strongest since 1976 outside the rebounds from the first Covid lockdown and Global Financial Crisis. Major orders again underpinned

Germany: New factory orders



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Selected new domestic factory orders



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

substantial growth in fabricated metals – including a further surge in domestic orders for weaponry and ammunition, up roughly five-fold in Q4 – and machinery. There was also solid growth in orders for electrical and ICT equipment. And although there was some payback in December for prior strength in other transport equipment (i.e. aircraft, ships, trains, military vehicles), those orders in Q4 more than doubled their level in Q3. The only slight disappointment related to autos, new orders of which fell to the lowest level since spring 2024. This notwithstanding, today's data undeniably imply a pickup in underlying demand for German goods over recent quarters. Indeed, when excluding bulk items, new orders rose for the sixth month out of seven, to be up 2.5%Q/Q, the most since Q221. Separately, today's construction PMIs also signalled solid growth in civil engineering at the start of the year, with the respective index (56.4) marking the fifth above-50 'expansionary' reading in six, well above the long-run average. So, while today's data for factory turnover – which fell 1½%M/M in December to be unchanged over the fourth quarter – suggested that overall production remained subdued at the end of last year, we continue to expect positive growth in both manufacturing and construction output over coming quarters.

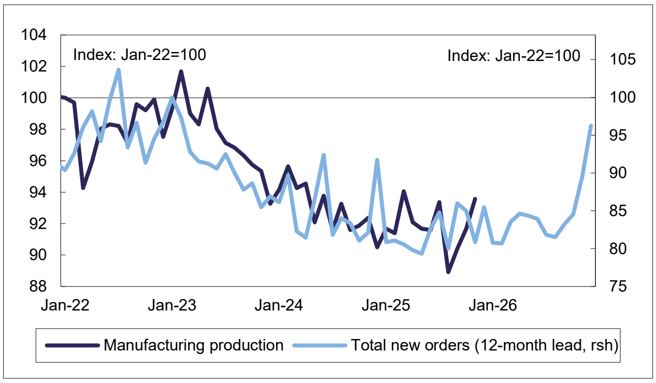
Euro area retail sales volumes fell in December, but confirmed ninth consecutive quarterly increase

While the preliminary estimate of Q4 euro area GDP demonstrated that growth momentum remained firm through to the end of last year, the expenditure components will only be available next month. Still, sector-level output data has implied that domestic demand continued to offer the bulk of the support. And despite a dip of 0.5%M/M due to weakness in core items (i.e. those excluding food and fuel), euro area retail sales volumes in December remained consistent with an ongoing expansion in consumption last quarter. Indeed, sales rose 0.4%3M/3M in Q4 to cement a ninth consecutive quarter of positive growth with core sales up 0.3%3M/3M. Reflecting the broad-based expansion across the member states, retail sales volumes rose across each of the five largest member states, including Germany (0.3%3M/3M), France (0.5%3M/3M), and Spain (0.9%3M/3M). Although the ECB expects private consumption to continue to support growth, the poor carry-over from December's decline somewhat weakens the prospects for a contribution to growth from the retail sector this quarter. But based on forward-looking business surveys, and the rise of household purchase intentions in the latest consumer confidence survey, we still see the prospects for a tenth consecutive quarterly rise in sales in Q1 as fairly strong.

The day ahead in the euro area

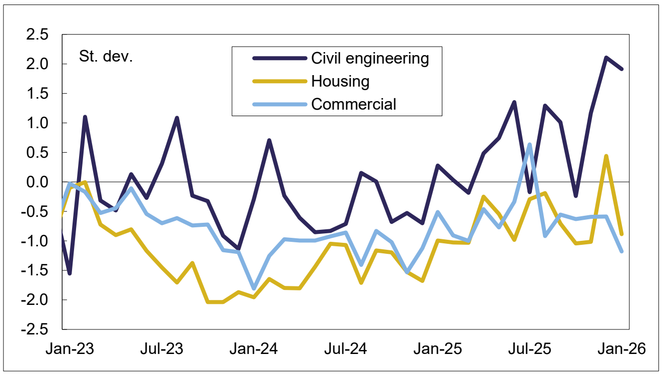
Friday will continue to bring a steady flow of December activity data from the member states. With respect to IP, figures from Germany and Spain will give a clearer indication as to December's euro figure. Despite the welcome surprise from today's factory orders data, German (and Spanish) IP will still be expected to mirror a similar pattern to that of today's French figure (-0.7%M/M). Indeed, having gained for three consecutive months through November, and bearing in mind the temporary weakness signalled by the manufacturing output PMI, German IP probably slipped back in December. But we expect any

Germany: Manufacturing production & new orders



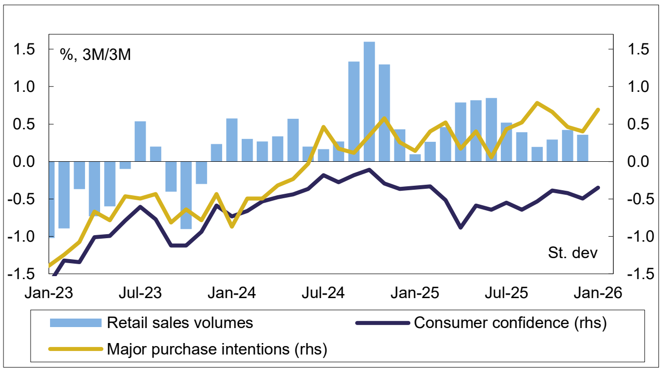
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Construction PMIs



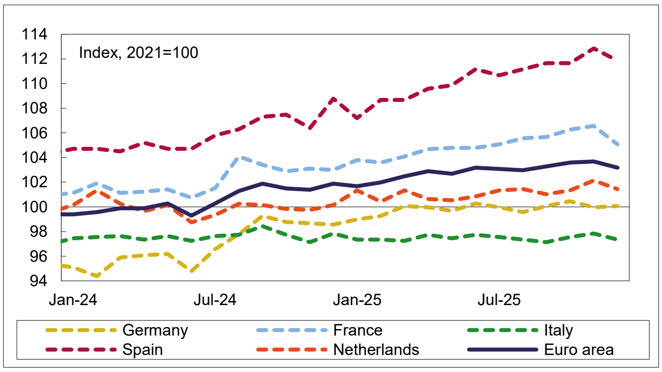
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales & consumer confidence



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

Euro area: Retail sales volumes by member states



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

decline to be only modest. And with output in the first two months of Q4 trending 1¾% above its Q3 level, Friday's release is bound to confirm that the manufacturing sector returned to growth last quarter. German and French goods trade figures are also due. Despite a likely negligible-at-best contribution to the pickup in GDP growth in Q4, some payback for the weakness of November's export performance is likely to support a wider German goods trade surplus in December. The ECB's quarterly Survey of Professional Forecasters survey is also due for release.

UK

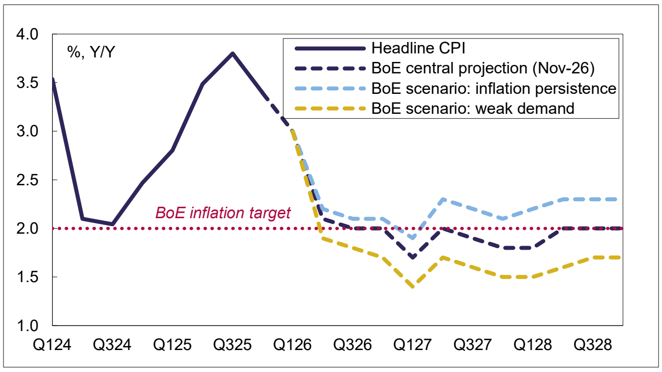
BoE leaves rates unchanged but majority of MPC members looks prepared to cut rates in March

Like the ECB, the BoE also predictably left policy unchanged today with Bank Rate held at 3.75%. But the vote on the MPC was much tighter than anticipated. Four out of nine members called for a cut with BoE Deputy Governors Ramsden and Breeden unexpectedly joining the external uber-doves Dhingra and Taylor in preferring to ease policy today. Moreover, the stated views of two further members – Governor Bailey and external MPC member Mann – suggested that they are now getting very close to voting for a cut too. That reflects a significant downwards revision to the BoE's baseline inflation projection as well as an assessment that the risks of inflation persistence are steadily dissipating. As a result, the market-implied expectation of the magnitude of easing by year-end increased closer to 50bps. And while it is certainly not a done deal, we have brought forward our expected timing of the next 25bps cut in Bank Rate by one month to March. We would then continue to expect one further rate cut to 3.50% before the autumn. And we still certainly do not rule out the possibility of a further cut to reach a terminal Bank Rate of 3.0% by year-end.

Inflation now expected to be close to target from Q2 on

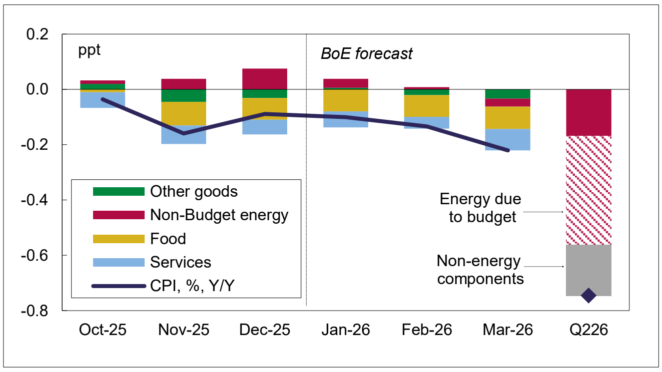
A significant downwards revision to the BoE's inflation projection was always on the cards today due to the mechanistic impact on prices of the Government's Budget measures announced at end-November. Indeed, at the last MPC meeting in December, Bank staff had already suggested that those new fiscal policies were likely in Q2 to subtract about ½ppt from headline inflation, an estimate that was broadly affirmed today. But given also recent moves in wholesale energy prices, the BoE cut significantly its estimate of Ofgem's household energy price cap from April. So, with inflation – not least of food – having recently undershot its expectations, services prices better behaved and import price pressures softer, the MPC reduced by a full 80bps its forecast of CPI inflation in Q2 to just 2.1%Y/Y. It also revised down its price outlook thereafter, so that inflation is now expected to remain at or below target over the baseline projection horizon. In part, that reflects a view that lower inflation outcomes will help price and wage expectations to moderate further. It also reflects upwards revisions to the BoE's estimate of the current extent of labour slack and the outlook for unemployment, as well as a downwards revision

UK: BoE inflation projections



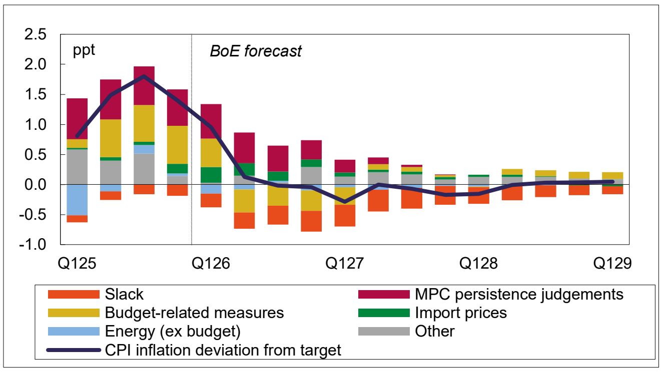
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Change in BoE inflation projection from Nov-25



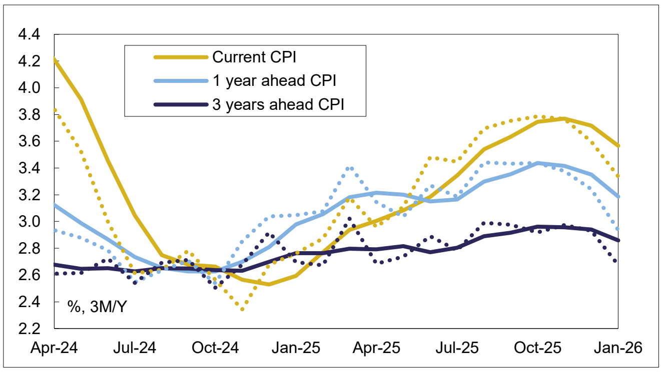
Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Drivers of deviation from BoE inflation target



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

UK: Business inflation & wage expectations*



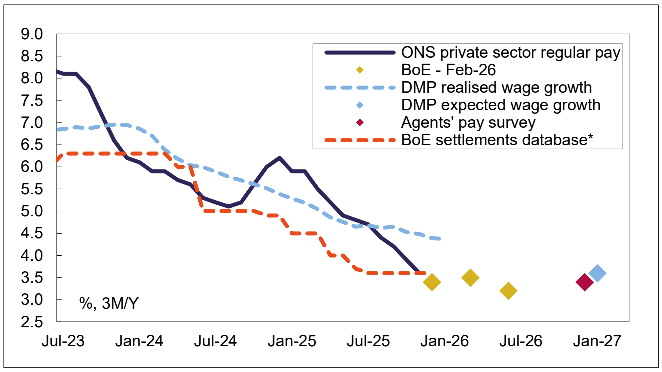
**Dotted lines show single month figures & solid lines show the 3-month average.*
Source: BoE DMP survey, Macrobond and Daiwa Capital Markets Europe Ltd.

to the near-term GDP growth outlook. And it incorporates more favourable judgements on labour productivity and labour market functioning, which should help to sustain a moderation in underlying inflation into the medium term.

Scenarios & MPC member statements suggest that 50bps of cuts this year would be reasonable

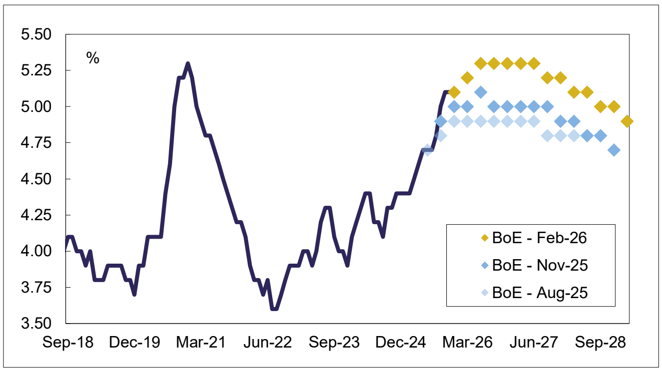
In our view, the BoE's baseline outlook of target-consistent inflation over the policy horizon is credible. And based on various policy rules, it points to the possibility of up to three rate cuts until the terminal rate is reached. Even under the scenario of heightened inflation persistence, most policy rules point to at least one further cut. And if demand remains persistently weak, the BoE's scenarios suggest that as many as four rate cuts could be called for before the end of the easing cycle. In their comments today, two MPC members (Ramsden and Taylor) already flagged the possibility of a 3.0% terminal rate. And on balance, the Committee's forward guidance was more dovish than in December. Certainly, the comments of several MPC members today were more dovish too with less concerns expressed about wage and price persistence (see table below for selected key quotes). And while the Committee repeated that, given the extent of policy easing to-date "judgements around further policy easing will become a closer call", a majority of members – including the Governor – look ready to back 50bps of rate cuts by mid-year. Indeed, in a Bloomberg interview today, Bailey suggested that 50-50 odds of a rate cut as soon as March was "not a bad place to be". And in his press conference, he stated that the current yield curve appeared "broadly reasonable". While the outlook is still highly uncertain – with heightened political uncertainty regarding Starmer's future as UK Prime Minister now added to geopolitics and market volatility as potential complicating factors beyond those associated with wage and price formation – we are inclined to agree.

UK: Measures of private regular wage growth



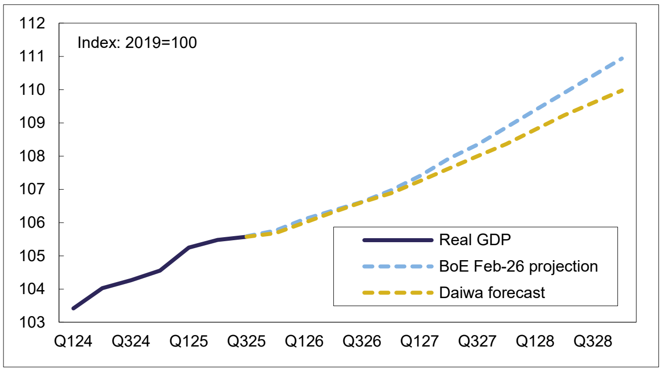
**12-month average to December 2025.*
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BoE unemployment rate projections



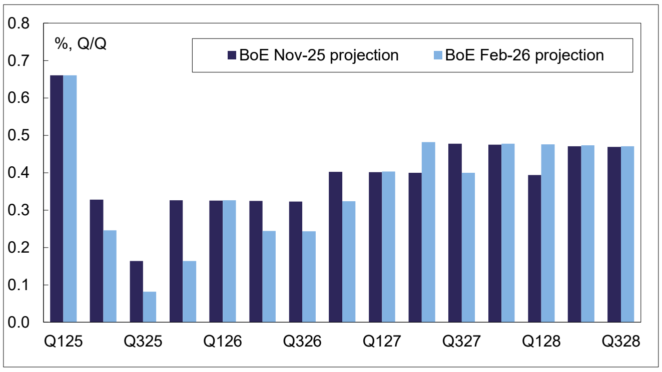
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BoE GDP projections



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

UK: BoE GDP growth projections



Source: BoE and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

While BoE Chief Economist Pill – who is firmly in the hawkish camp on the MPC – will brief the BoE's national agents on today's Monetary Policy Report, it should be a quiet end to the week for UK economic data.

BoE February 2026: MPC members' views

MPC member	Bank Rate (3.75%)	Selected quotes from the MPC minutes
Governor Bailey	3.75%	"Overall, the risks from inflation persistence appear to have continued to reduce. I therefore see scope for some further easing of policy. This does not mean that I expect to cut Bank Rate at any particular meeting."
Deputy Governor Lombardelli	3.75%	"While the near-term fall in CPI inflation should reduce second-round effects, it is not assured that wage growth will return to target-consistent rates... I remain concerned about both upside and downside risks to inflation. The current degree of restrictiveness is uncertain... I am more concerned about the costs of cutting rates too quickly than too slowly."
Chief Economist Pill	3.75%	"While I draw comfort about the medium-term inflation outlook... I remain concerned that inflationary pressures stemming from an overly rapid withdrawal of policy restriction over the past two years still need to be contained and eliminated… I continue to favour a cautious withdrawal of policy restriction, guided by longer-term trends rather than short-term news."
Catherine Mann	3.75%	"New analysis and current developments have moved the appropriate time for a cut in Bank Rate closer. This will partly depend on how various one-off policies... affect the underlying disinflation process. Wage and price moderation is in train... [but] wage growth is not target-consistent"
Megan Greene	3.75%	"I continue to place more weight on the risk of inflation persistence, preferring to wait for clearer evidence that inflation will settle sustainably at the target before easing policy further... I continue to think the monetary policy stance is not materially restrictive."
Deputy Governor Breeden	3.50%	"New analysis, rather than new data, has further supported my view that upside risks to inflation have diminished: wage growth is set to end this year at target-consistent levels ... and slack is judged to be a little wider... The improved near-term inflation outlook should support a swifter normalization of wage and price-setting dynamics… Upside risks to inflation cannot however be ruled out... But I place greater weight on downside risks, particularly in the near term"
Deputy Governor Ramsden	3.50%	"I see risks to the latest central projection for inflation as now tilted to the downside... Core disinflation is clearly progressing with cumulative weakening in the labour market and subdued activity... I am increasingly confident that wage growth will fall to target-consistent rates this year ... I do not discount upside risks to inflation nor various ongoing uncertainties. However, with my starting point for an estimate of the neutral rate of around 3%, I judge that policy should be less restrictive in order to meet the 2% target sustainably "
Swati Dhingra	3.50%	"Overall, I still expect monetary policy to contribute to disinflation over the next year. The market-implied path for Bank Rate looks too tight. The costs of making a policy mistake seem much higher on the downside, especially given weak labour demand. And the reverse strategy of holding Bank Rate then cutting aggressively would be no panacea were there to be a sharp downturn in activity and employment."
Alan Taylor	3.50%	"…inflation is now expected to return to the target this year... earlier than previously expected... inflation expectations are likely to moderate significantly... [and] softer price-wage dynamics and emerging slack also contribute across the forecast period. Together with normalising wages, all this reduces or even eliminates the risk of the inflation persistence scenario. ...if we expect to be at or below the target with significant slack emerging in about six months, a neutral rate of 3% should be in our sights now."

Source: BoE (February 2026 Monetary Policy Summary & Minutes) 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 (Refinancing) Rate %	Feb	**2.00 (2.15)**	_2.00 (2.15)_	2.00 (2.15)	-
	Retail sales M/M% (Y/Y%)	Dec	**-0.5 (1.4)**	_-0.4 (1.4)_	0.2 (2.3)	0.1 (2.4)
	Construction PMI	Jan	**45.3**	-	47.4	-
Germany	Factory orders M/M% (Y/Y%)	Dec	**7.8 (13.0)**	-2.2 (1.2)	5.6 (10.5)	5.7 (10.6)
	Construction PMI	Jan	**44.7**	-	50.3	-
France	Industrial production M/M% (Y/Y%)	Dec	**-0.7 (1.7)**	0.2 (2.3)	-0.1 (2.1)	0.1 (2.0)
	Construction PMI	Jan	**43.5**	-	43.4	-
Italy	Construction PMI	Jan	**47.7**	-	47.9	-
UK	BoE Bank Rate %	Feb	**3.75**	_3.75_	3.75	-
	DMP 3M output price (1Y CPI) expectations Y/Y%	Jan	**3.5 (2.9)**	3.5 (3.2)	3.6 (3.2)	-
	Construction PMI	Jan	**46.4**	42.0	40.1	-
	New car registrations Y/Y%	Jan	**3.4**	-	3.9	-

Auctions

Country	Auction
France	sold €6.29bn of 3.2% 2035 bonds at an average yield of 3.38%
	sold €4.322bn of 3.5% 2035 bonds at an average yield of 3.45%
	sold €1.719bn of 3.6% 2042 bonds at an average yield of 3.98%
	sold €1.169bn of 3% 2049 bonds at an average yield of 4.24%
Spain	sold €1.532bn of 2.35% 2029 bonds at an average yield of 2.341%
	sold €2.367bn of 3% 2033 bonds at an average yield of 2.905%
	sold €1.939bn of 3.2% 2035 bonds at an average yield of 3.223%
	sold €646mn of 0.7% 2033 inflation-linked bonds at an average yield of 1.078%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ _Daiwa forecast_	Previous
Germany	07.00	Industrial production M/M% (Y/Y%)	Dec	-0.3 (1.9)	0.8 (0.8)
	07.00	Trade balance €bn	Dec	14.1	13.1
France	07.45	Trade balance €bn	Dec	-	-4.2
	07.45	Preliminary wages Q/Q%	Q4	0.3	0.3
Spain	08.00	Industrial production M/M% (Y/Y%)	Dec	-0.5 (2.5)	1.0 (4.5)

Auctions and events

Euro area	09.00	ECB to publish quarterly Survey of Professional Forecasters for Q126
UK	12.15	BoE Chief Economist Pill to speak publicly on updated macroeconomic projections

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research reports at:
https://www.uk.daiwacm.com/ficc-research/research-reports