

Euro wrap-up

Overview

- While the drop in euro area inflation in February well below target was confirmed and German consumer confidence deteriorated more than expected in the latest survey, Bunds were little changed as data confirmed that German domestic demand growth was strong in Q4.
- Gilts made modest losses as the Ofgem cut its household energy price cap from April by a little less than expected.
- Thursday will bring the Commission economic sentiment survey results for February and euro area bank lending data for January.

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Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.039	+0.002
OBL 2½ 04/31	2.304	+0.001
DBR 2.9 02/36	2.706	+0.002
UKT 3¾ 03/27	3.566	+0.005
UKT 4% 03/30	3.755	+0.010
UKT 4½ 03/35	4.316	+0.012

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

Euro area

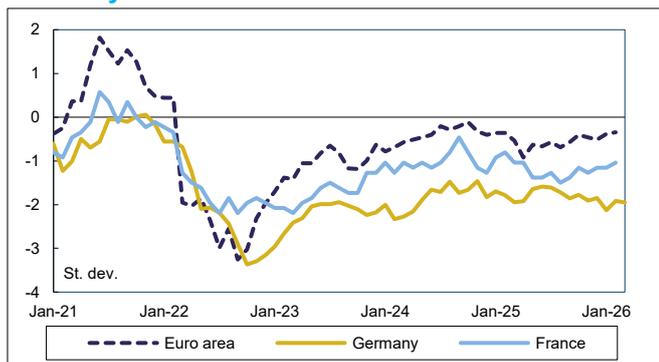
German consumer confidence falls to a near-2-year low, but spending intentions trending higher

While German business sentiment indicators – such as the [PMIs](#) and [ifo institute](#) indices – have signalled sustained growth momentum into 2026, today's consumer confidence survey results raised concerns about the extent to which households will be able to maintain recent firm spending growth. Certainly, the GfK's headline sentiment index – presented as a forecast for March – fell more than expected to -24.7, the second-lowest level in almost two years, a full two standard deviations below the long-run average. And that left the average index in Q1 almost 2pts below the Q4 level. However, the survey detail was more upbeat. Notwithstanding some monthly volatility, the respective indicator for income expectations was tracking more than 7pts above the Q4 average, benefiting in part from an improved inflation outlook. And while purchase intentions slipped to a four-month low in February from January's near-three-year high, this too was still trending above the Q4 average. With this indicator having been the more reliable guide to household consumption growth over the past 18 months, today's survey on balance remains consistent with another positive contribution to GDP growth from household consumption this quarter.

Q4 GDP growth boosted by the strongest domestic demand in almost four years

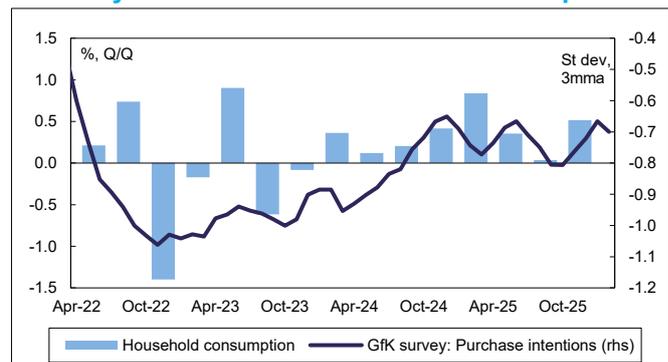
Today's updated German national accounts data for Q4 confirmed the return to growth at the end of 2025, with the 0.3%Q/Q expansion the strongest in more than three years excluding the tariff-front-loading related surge in Q125. The acceleration in part related to a bounce back in private consumption (0.5%Q/Q) from stagnation in Q3, supported by rising real incomes and a modest decline in the savings ratio. Meanwhile, government consumption (1.1%Q/Q) rose the most in six quarters, while fixed investment growth (1.0%Q/Q) was last stronger in Q221. Admittedly, private capex was weak, falling to the lowest level in more than a decade, with the continued downtrend in business spending on machinery and equipment suggestive of ongoing structural adjustment in German manufacturing. In contrast, government investment jumped 10%Q/Q in Q4, the most since Q199 aside from the post-lockdown bounce in Q220, as commitments to boost spending on infrastructure and defence started to bear fruit. Indeed, government investment in machinery – including military equipment – surged almost 40%Q/Q. And public non-residential construction rose around 2%Q/Q. So, final domestic demand added 0.7ppt to GDP growth in Q4, the most in almost four years. In contrast, private inventories subtracted a sizeable 0.3ppt from growth in Q4. And net trade (-0.1ppt) was a modest drag for a seventh quarter in eight as declines in both goods and services exports were only partially offset by the first drop in imports in seven quarters. Net trade looks set to remain a source of weakness over the near term. And inclement weather at the start of the year probably hit construction output. But we still expect German GDP to expand this quarter, albeit at a slightly softer pace than in Q4. And given ongoing fiscal policy support, full-year growth this year should be double the rate in 2025 (0.4%YY), and rise to around 1½%YY in 2027 and 2028.

Germany & France: Consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumer confidence & consumption



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

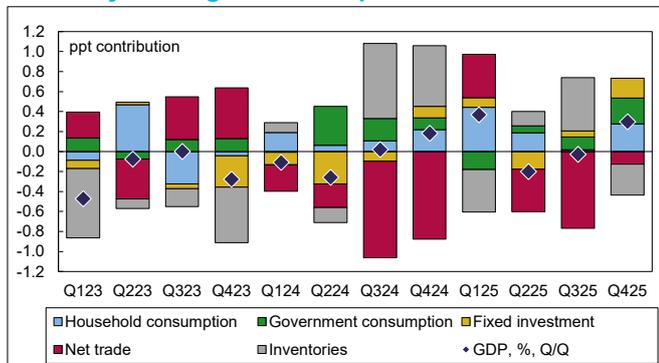
French consumer confidence ticks slightly higher, but unemployment fears remain a downside risk

Contrasting the decline in German consumer confidence and a deterioration in French [business sentiment](#), today's INSEE survey results suggested that French consumers were more upbeat in February. In particular, the headline sentiment index rose 1pt to 91, a ten-month high. And while this remained some 9% below the long-run average, it was tracking some 1pt above the Q4 average. Despite improvements in perceptions of the economic outlook and income expectations, households judged unemployment risks to have worsened in February to be well above the long-run average, tallying with signals from yesterday's business survey that firms planned to cut headcount further over the near term. As such, there was no increase in the share of households judging it to be a good time to make major purchases. Nevertheless, the Bank of France's latest retail survey showed that sales volumes bounced back in January (1.2%M/M) thanks to a rebound in spending on apparel, furniture and sports equipment. So, despite a negative carryover from the end of 2025, household consumption looks on track to remain modestly supportive to GDP growth in France this quarter.

Drop in euro area inflation in January to firmly below target confirmed

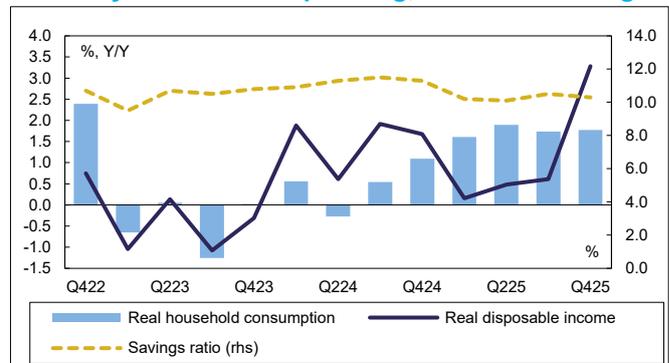
In line with the flash estimates and initial expectations, euro area inflation in January was confirmed at 1.7%Y/Y, down 0.3ppt on the month to match the lowest since April 2021. As the figures from Spain, Ireland and several small member states were revised down, euro area inflation was also exceptionally close to being nudged down to 1.6%Y/Y, coming in at 1.656%Y/Y to three decimal places. Within the detail, inflation of food, alcohol and tobacco was a touch lower than previously thought at 2.6%Y/Y, up just 0.1ppt but still a four-month high due to pressures in unprocessed items. But that impact on headline inflation was more than offset by a drop in energy inflation of 2.1ppts (which was slightly smaller than previously thought) to -4.0%Y/Y, the weakest in fifteen months. That, however, principally reflected a base effect associated with particularly sharp increases in prices of electricity and auto fuels a year earlier. Most notably perhaps, services inflation moderated by 0.2ppt to a four-month low of 3.2%Y/Y. Several items within that category, including transport, hospitality, healthcare, education and insurance were softer, more than offsetting higher inflation of package holidays and cultural services. With lower car inflation more than offset by modest increases in clothing and footwear, furnishings and recreational goods, as well as further step up in jewellery, the non-energy industrial goods component rose 0.1ppt in January. But reflecting the strong euro and ample supply from abroad, it remained very low at just 0.4%Y/Y. And so, core inflation (excluding food, energy, alcohol and tobacco) edged down 0.1ppt to 2.2%Y/Y, the lowest rate since October 2021.

Germany: GDP growth & expenditure contributions



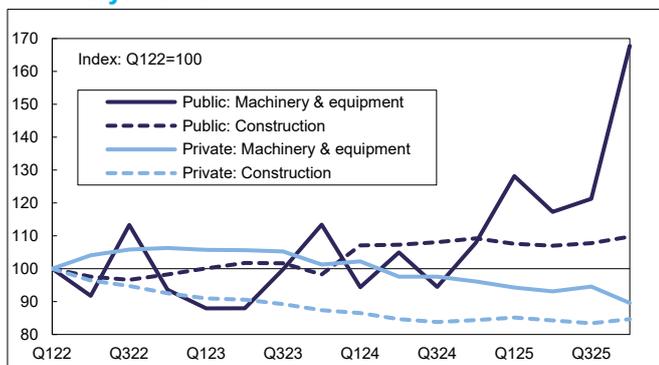
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Household spending, income & savings



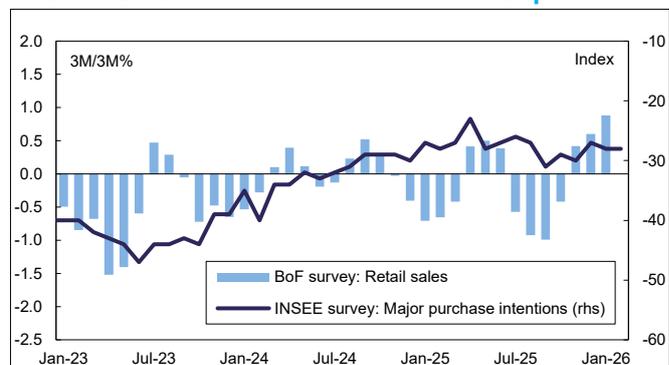
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Fixed investment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Consumer confidence & consumption



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

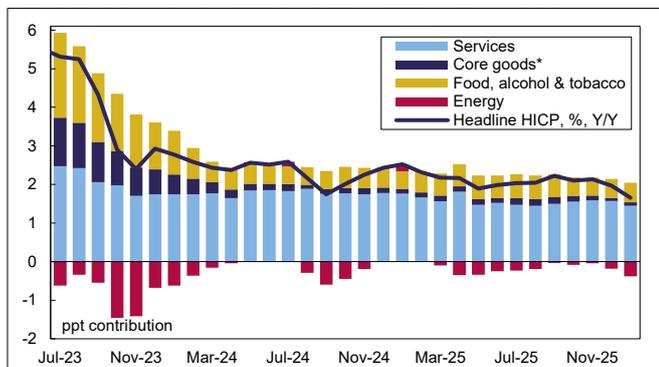
Fading momentum suggests that headline & core inflation will be below 2% from April

Consistent with the drop in the core rate to a multi-year low, other measures of underlying inflation also softened in January. 10% and 15% trimmed mean rates fell 0.1-0.2ppt, both to 4½-year lows below 2%Y/Y. And while still above-target, the weighted median fell to a five-month low. That mirrored a renewed moderation in three-month services inflation momentum, also to a five-month low. And with core goods price momentum now negative and the weakest since end-2020, core inflation momentum on a three-month basis fell back below an annualised 2% for the first time since mid-2021. That easing of inflation momentum reinforces our expectation that core inflation will move below 2%Y/Y from April. With pay growth still moderating and the euro exchange rate likely to remain elevated, and indexation of administered prices now much better behaved, we expect it to remain sub-2%Y/Y over the next two years. So, while an unfavourable base effect will push the energy component back into positive territory from April, and food inflation is likely to remain above 2%Y/Y, we also expect headline inflation to remain below 2%Y/Y through to January 2028 when the ETS-2 carbon trading scheme will temporarily inject new pressure. Overall, we see headline inflation averaging 1.7%Y/Y in 2026 and 2027, 0.2ppt and 0.1ppt respectively below the ECB projection. And we expect it to rise in 2028 to 2.1%Y/Y, 0.1ppt above the ECB's projection. Given that profile, in the absence of significant new shocks, we expect ECB rates to remain unchanged until the back end of that profile at the earliest.

The day ahead in the euro area

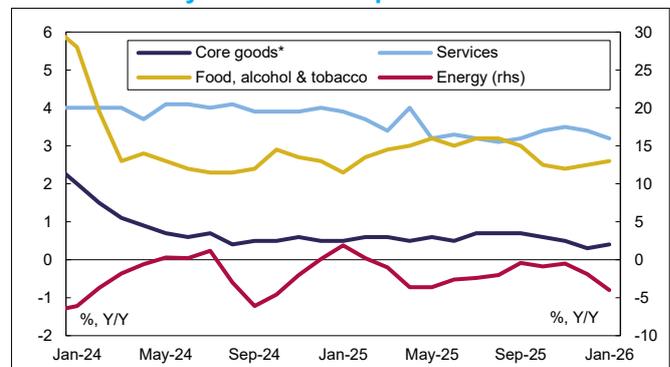
Surveys will remain the focus of Thursday's economic dataflow. Just as the German ifo and French INSEE surveys appeared to suggest a divergence in economic momentum between the region's two largest member states, the February Commission ESIs will provide a more comprehensive cross-check on the euro area [flash PMIs](#). The Commission survey suggested that business sentiment in the bloc jumped to a three-year high last month, and the more upbeat picture from the PMIs might suggest that a further modest improvement this month is more likely than not. Istat's monthly sentiment surveys will also provide a first view about business activity and consumer sentiment in the third largest member state. Given the conflicting movements in today's consumer confidence surveys, we suspect that a further rise in Italy or Spain was likely responsible for the uptick signalled by the Commission's flash euro indicator. In terms of hard data, euro area bank lending figures will provide an update on bank lending to firms and households at the start of the year. Meanwhile, ECB President Lagarde is due to discuss monetary policy in her quarterly dialogue with the EU Parliament's Committee on Economic and Monetary Affairs (ECON). ECON will also decide at that meeting whether to approve the appointment of Croatian Governor Vujcic as the next ECB Vice President.

Euro area: Contributions to headline inflation



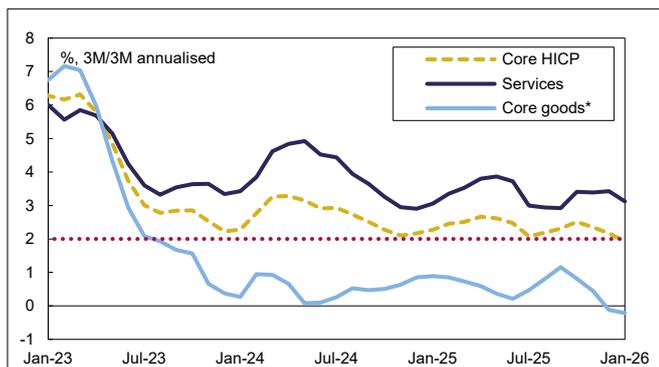
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Key inflation components



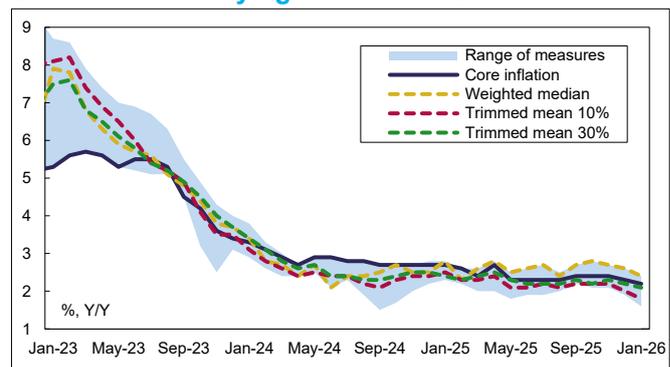
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core inflation momentum



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Underlying inflation measures



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

UK

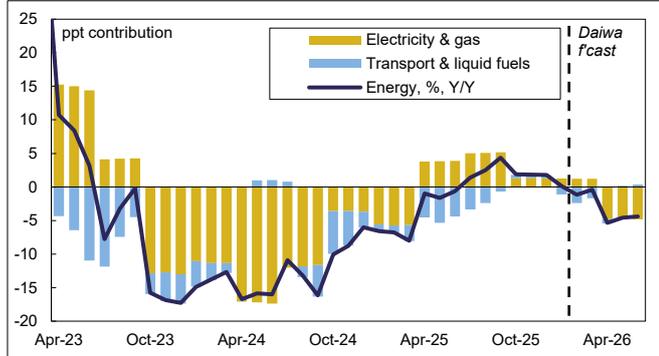
Ofgem energy price cap cut by 7% from April

The energy regulator Ofgem confirmed a drop of 7% in the household energy price cap for the three months from 1 April. If extended for the fiscal year, that would represent a cut of £117 in the annual energy bill for a typical household to £1,641. The reduction in the price cap principally reflects the government's decision in last November's Budget to remove approximately £150 of policy costs from bills. However, we note that the full reduction in policy-related was smaller than billed at only £130. Lower wholesale energy costs also subtracted from the price cap for a fourth successive quarter. But increased network costs added to bills. Indeed, given those higher network costs, the cut in the price cap was about 1ppt less than expected by us and the BoE. Nevertheless, the cut will alone reduce energy inflation by about 3½ppts from April. And given shifts in other components and base effects, we expect energy inflation to drop by about 5ppts in April to about -5½%Y/Y, subtracting 0.3ppt from headline CPI inflation, which is likely to fall close to (but still above) 2% from that month.

The day ahead in the UK

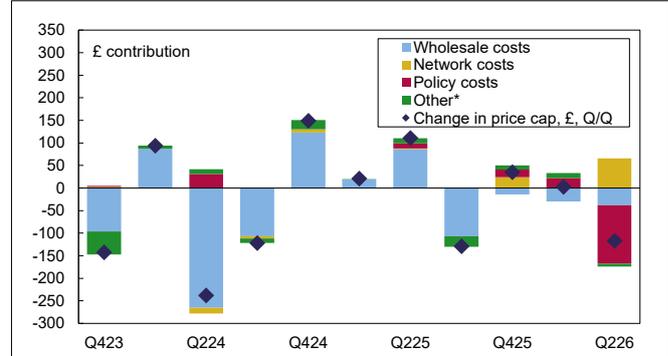
In the continued absence of new economic data, attention in the UK on Thursday will be on politics as the Manchester constituency of Gorton and Denton goes to the polls for a parliamentary by-election. Admittedly, voting will close only after UK markets, with the result likely to be announced sometime in the early hours of Friday morning. At the 2024 general election, the seat was a comfortable Labour hold. But the Government faces intense competition, in this instance from the populist-right Reform UK and left-wing Greens. At present, Labour just about trails both parties in betting markets, with the Greens expected to increase their Parliamentary seat count from four to five. But despite its insignificance to the broader Parliamentary arithmetic, the result could provoke a market impact if it was to surprise significantly in either direction. Ahead of May's local elections, a heavier than expected defeat for the Government would surely be damaging to PM Starmer's position. We, however, assign a low probability to the likelihood of a defeat being large enough to precipitate a leadership challenge in its immediate aftermath. On the other hand, a better performance, or even an unexpected Labour hold, could strengthen the PM's position, at least until May. Indeed, the available (if limited) opinion polling suggests that, while the Greens appear to have an edge, an unexpected win for Labour should be the more likely of the two extreme scenarios if turnout does not disappoint.

UK: Contributions to energy CPI inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Quarterly change in Ofgem energy price cap



*VAT, EBIT, payment method uplift allowance, headroom and adjustment allowances. Source: Ofgem and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final headline (core) HICP Y/Y%	Jan	1.7 (2.2)	<u>1.7 (2.2)</u>	2.0 (2.3)	-
Germany	 GDP – final estimate Q/Q% (Y/Y%)	Q4	0.3 (0.6)	<u>0.3 (0.6)</u>	0.0 (0.3)	-
	 GDP – private consumption Q/Q%	Q4	0.5	0.3	-0.3	0.0
	 GDP – government spending Q/Q%	Q4	1.1	0.7	0.8	0.6
	 GDP – capital investment Q/Q%	Q4	1.0	0.7	0.3	-
	 GfK consumer confidence indicator	Mar	-24.7	-23.0	-24.1	-24.2
France	 INSEE consumer confidence indicator	Feb	91	90	90	-
Spain	 PPI Y/Y%	Jan	-2.9	-	-3.0	-

Auctions

Country	Auction
Germany	 sold €821mn of 1% 2038 bonds at an average yield of 2.93%
	 sold €853mn of 2.6% 2041 bonds at an average yield of 3.09%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	 09.00	M3 money supply Y/Y%	Jan	2.9	2.8
	 10.00	Commission economic sentiment indicator	Feb	99.8	99.4
	 10.00	Commission services (industrial) confidence indicator	Feb	7.4 (-6.2)	7.2 (-6.8)
	 10.00	Final Commission consumer confidence indicator	Feb	<u>-12.2</u>	-12.4
Italy	 09.00	Istat business (manufacturing) confidence indicator	Feb	- (89.6)	97.6 (89.2)
	 09.00	Istat consumer confidence indicator	Feb	97.0	96.8

Auctions and events

Euro area	 08.30	ECB President Lagarde testifies on monetary policy before the EU Parliament's ECON Committee, Brussels
Italy	 10.00	Auction: to sell up to €2.75bn of 2.85% 2031 bonds
	 10.00	Auction: to sell up to €2.5bn of 2035 floating bonds
	 10.00	Auction: to sell up to €3.75bn of 3.45% 2036 bonds
UK	 09.00	BoE Deputy Governor Lombardelli speaks at annual networking event for the UK Women in Economics, London
	 22.00	Voting closes in the Gorton-and-Denton parliamentary by-election

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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