

Euro wrap-up

Overview

- While ECB policymakers were keen not to pre-judge the likely impact of events in the Middle East on the future path of rates, Bunds followed the global trend lower as wholesale energy prices jumped sharply.
- Gilts also made losses, while BoE dove Taylor suggested the MPC will need to be mindful of the downside risks to economic output posed by the Iran War.
- Tuesday will bring flash euro area inflation estimates for February, while the Spring Statement will provide a stocktake on UK fiscal policy.

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Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.081	+0.089
OBL 2½ 04/31	2.322	+0.087
DBR 2.9 02/36	2.709	+0.068
UKT 4% 03/28	3.633	+0.116
UKT 4½ 03/31	3.872	+0.086
UKT 4¾ 10/35	4.373	+0.075

*Change from close as at 5.00pm GMT.

Source: Bloomberg

Euro area

Rate cuts likely off the agenda as energy price shocks will push inflation above 2% if sustained

Markets responded to the escalation of events in the Middle East in a predictable fashion. Disruption to freight shipped through the Strait of Hormuz pushed the price of Brent crude up almost 10% on the day, and the most since Russia's invasion of Ukraine to near \$80 a barrel. And as Qatar shut its LNG production at its Ras Laffan facility – the world's largest – European benchmark gas futures rose more than 50%. ECB policymakers speaking publicly today were keen not to prejudge either the likely macroeconomic impact of events or how the Governing Council might respond. But if sustained, the price shocks will push inflation back up from 1.7%Y/Y in January to above 2%Y/Y by the spring and also above 2% for 2026 as a whole. And while Europe is more energy efficient than other major industrialised economies, and less dependent on energy transported via the Strait of Hormuz than the largest Asian economies, the price shock and heightened uncertainty will inevitably weigh on economic confidence and spending. Given concerns about the significant impact of energy prices on inflation expectations, the ECB will likely place greater weight in its policy reaction function on the new upside risks to inflation than the downside risks to economic output. And so, even if inflation undershoots expectations over the near term, the chances of any further monetary easing might be diminished for as long as the war in the Middle East persist.

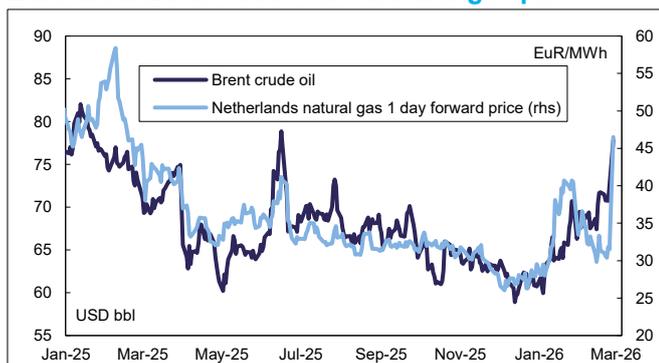
Manufacturing sector looked set for stronger activity before events in Iran escalated

Given the new downside risks to economic activity posed by the energy price shock, it is something of a relief that the euro area economy has been resilient to the multiple shocks of the past year. Indeed, surveys pointed to another quarter of positive GDP growth in Q1 and a likely acceleration heading towards the summer. Today's final manufacturing PMIs – for which the survey responses were collected from 9-20 February – maintained the broadly positive tone, signalling ongoing recovery momentum in the sector in the middle of Q1. Indeed, while there was a modest downwards revision from the flash estimate, the euro area output PMI still rose to a six-month high of 51.9. The data from the member states also pointed to firmer momentum across the region. A jump in the new orders index to the highest level in almost four years suggested the likelihood of a further pickup in growth over coming months too. Moreover, optimism about the near-term outlook was reportedly the best since the Russian invasion of Ukraine, despite a report of an increase in costs by the most in three years.

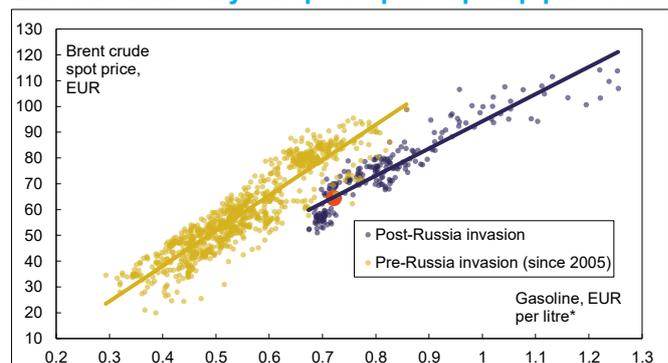
German retail sales started 2026 on the back foot, risks to spending outlook skewed to downside

While household spending had also been expected to contribute to firmer economic growth over coming quarters, today's German retail sales data suggested that consumption in the euro area's largest member state started the year on the soft

Euro area: Brent crude oil & natural gas prices



Euro area: Weekly oil spot & petrol pump prices

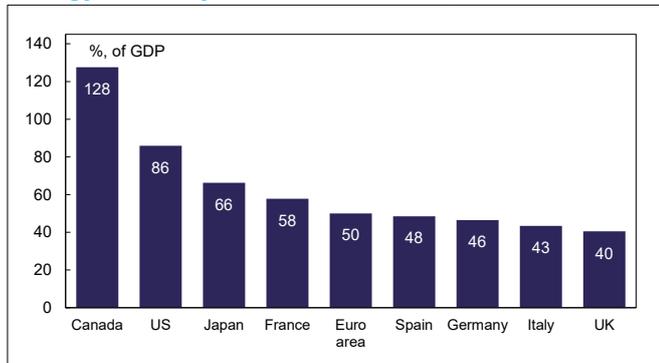


side. Sales volumes fell 0.9%M/M in January, the most since June 2024. Higher prices seemingly weighed as the value of sales was unchanged on the month. And the drop in volumes was likely principally payback for the strength of sales in December (1.2%M/M). Given the positive carryover from the end of 2025, the level of sales in January was still just 0.3% below the Q4 average. Within the detail, non-food sales fell 1.7%M/M in January, the most in 19 months. While this followed four months of consecutive growth, this still represented the lowest level since last February. Food sales were also subdued in January (0.1%M/M). But strong growth in December left the respective level almost 1% above the Q4 average. Nevertheless, according to the latest GfK consumer survey, purchase intentions had already weakened last month. And given today's spike in energy prices and uncertainties associated with events in Iran, we suspect that German households might tighten their purse strings over the near term. So, while German retail sales are notoriously volatile and subject to revisions, we doubt that the strong rate of growth in private consumption in Q4 (0.5%Q/Q) will be repeated this quarter.

The day ahead in the euro area

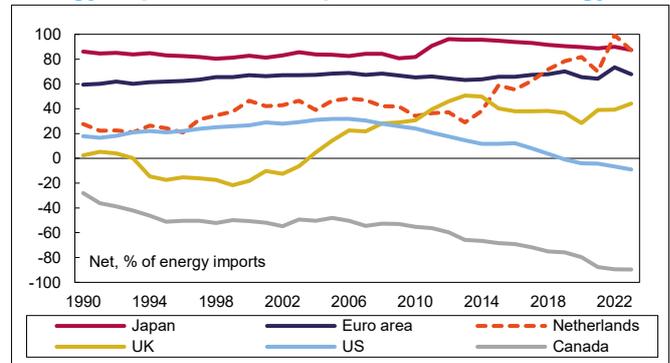
Notwithstanding the aforementioned risks presented by today's marked shifts in energy markets, tomorrow's flash euro area inflation estimates for February will at least be unaffected. However, subject to the flash releases from Italy and the Netherlands on Tuesday morning, we – like the consensus – expect headline inflation to move sideways at 1.7%Y/Y. A weaker drag from energy, owing to a less pronounced decline in electricity prices compared to last February, is expected to provide an upwards impulse. But food inflation should provide some offset. And the flash readings from the member states thus far suggest pressures in the core categories remain muted. As such, we also expect core inflation to be unchanged at 2.2%Y/Y too. February labour market statistics will also provide an update on jobs growth in Spain midway through Q1.

Energy intensity as a share of GDP, 2023



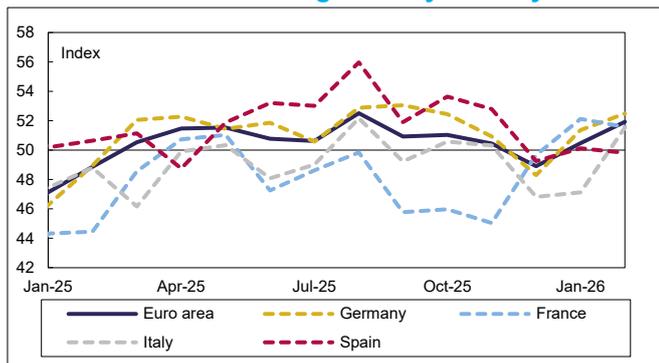
Source: IEA, World Bank and Daiwa Capital Markets Europe Ltd.

Energy imports as a net percent of total energy use



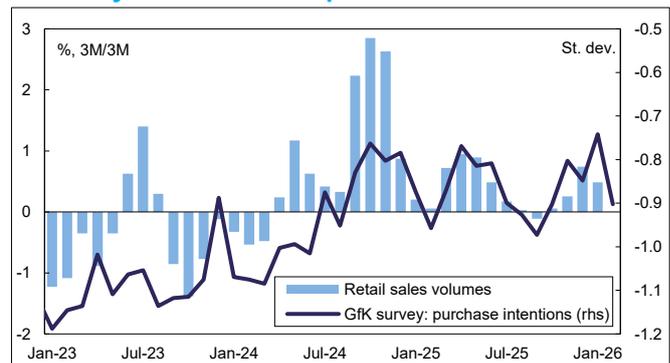
Source: IEA, World Bank and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing PMIs by country



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

Germany: Retail sales & purchase intentions



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

UK

Energy price shock might exacerbate divide on the MPC, but near-term rate cut still in play

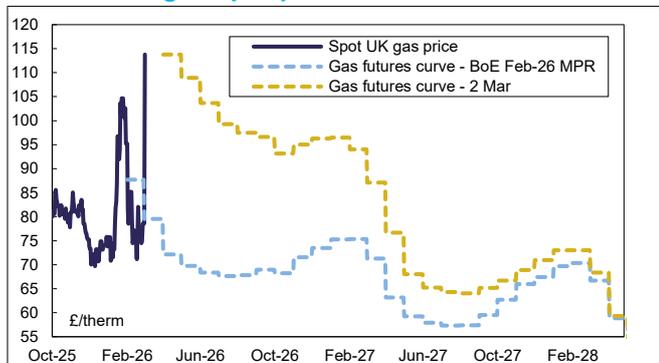
Given that the UK is also a net importer of energy these days, a lasting oil and gas price shock will likely have a similar economic impact to that of the euro area over the near term. But with interest rates in the UK still judged by most MPC members to be somewhat restrictive, the outlook for BoE monetary policy is less clear. Indeed, last week's Ofgem decision to cut the household energy price cap by almost 7% from 1 April will provide some offset in Q2 to renewed upwards pressures on petrol prices. But a likely sustained increase in wholesale gas and oil prices would then bring a notable increase in that price cap in Q3 and perhaps beyond. Given today's market moves, we expect CPI inflation to remain above

2.0%Y/Y this year. And the hawks on the MPC are likely to place greater weight on the risks of a renewed de-anchoring of inflation expectations and second-round effects on wages and prices than the hit to real disposable incomes. But as flagged by dovish external MPC member Taylor today, even in the event of a much larger shock to energy prices, the Committee ought to be mindful of the trade-off between returning inflation back to target quickly and the risk of excessive weakness in economic output. Certainly, events in Iran risk neutralising recent positive economic momentum. And today's final manufacturing PMIs for February suggested that – even before the weekend's developments – the pickup in output last month was softer than initially thought, as the output index was revised down a non-negligible 1.1pts from the flash estimate to 52.5. Taylor intimated today that he will still likely favour a rate cut on 19 March. But whether any of the 'swing' MPC voters, and most importantly Governor Bailey, agree, is far from clear. While it remains our expectation, the market-implied probability of a rate cut this month today fell below 50% from more than 85% on Friday.

UK business lending holding up, but mortgage approvals fall to a two-year low

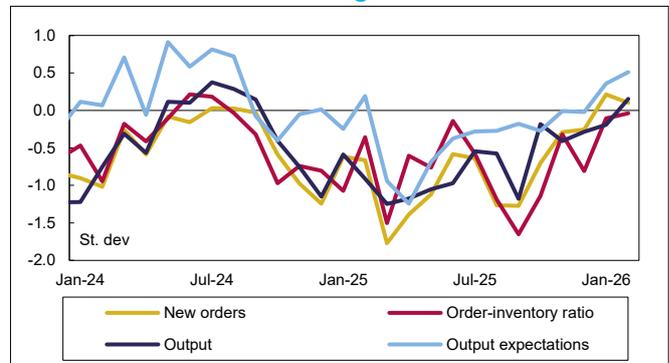
Today's bank lending figures for January were mixed. Consistent with the support from December's Bank Rate cut and receding post-Budget uncertainty, much of January's bank lending figures aligned with positive expectations. Unsurprisingly, lending to private sector businesses continued to pick up steadily, rising to a fresh near-five year high of 7.9%Y/Y. Consumer credit growth also held up at 8.3%Y/Y, despite evidence of tightening loan conditions. However, contrary to hopes that December's lull in housing market activity might have reflected buyer hesitancy before the BoE's monetary policy announcement and contrasting with the less downbeat signals from the RICS' surveyors survey, today's mortgage lending statistics disappointed. Indeed, mortgage lending decelerated at the start of the year. The monthly net change in new mortgage lending (£4.1bn) was the weakest since the subdued flows following the spike last March on the eve of the changes to Stamp Duty thresholds. Net mortgage lending growth, therefore, eased slightly further on a three-month annualised basis to 3.1%, down 0.3ppt from November. Most notably, new mortgage approvals – which can serve as a rough guide to future borrowing – fell for a fourth consecutive month to a two-year low of just 60k. So, we might expect mortgage lending to be subdued over the near term too. According to Nationwide, house prices rose only marginally in February to be up just 1.0%Y/Y. We note that the incoming High-Value Council Tax Surcharge (HVCTS) – which will impose an additional charge to properties valued at £2mn and greater from FY28/9 – is already likely having a depressing impact on prices at the upper margins and, more broadly, weakening demand. Halifax's alternative data reported an equivalent pace last month. And industry surveys suggest that rate is likely to persist over the near term as slowing wage growth bears down on affordability. Reduced expectations for further monetary policy easing, as outlined above, also pose an additional downside risk to the near-term outlook.

UK: Natural gas spot price & futures curve



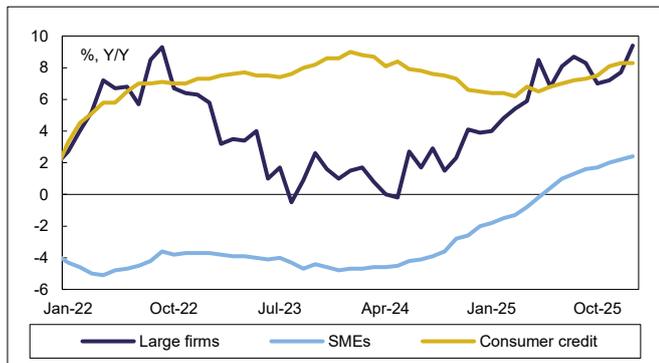
Source: Bloomberg, BoE and Daiwa Capital Markets Europe Ltd.

UK: Selected manufacturing PMIs



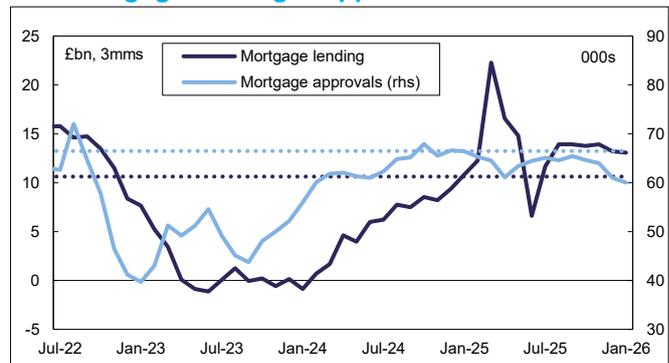
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Loans to businesses & consumer credit



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending & approvals*

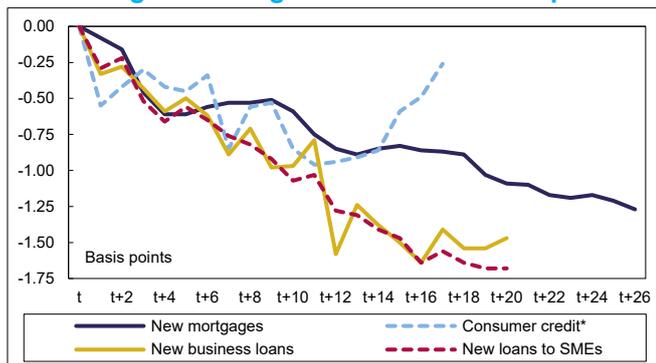


*Dotted lines represent pre-pandemic five-year average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

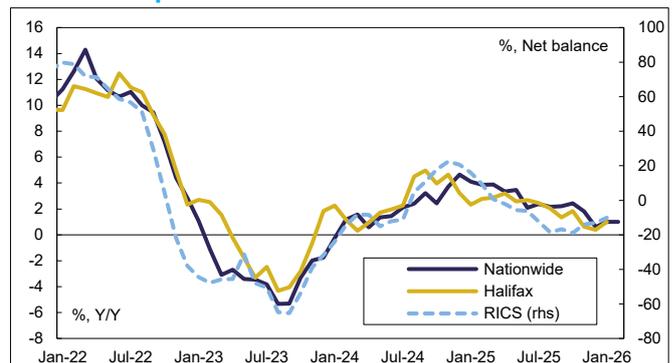
The Chancellor's Spring Statement will place UK fiscal policy back under the spotlight on Tuesday. However, in the spirit of the Government's pledge to move towards holding just the one key fiscal event each year (in the Autumn), it is unlikely to be momentous for broader fiscal policy. Not least benefitting from the good news of [January's monthly public sector finance](#) statistics, substantive policy announcements are expected to be few and far between, at least on the revenue side. Still, updated economic and fiscal projections from the OBR – the fiscal watchdog – and the DMO's mandate for gross gilt issuance will be available to scrutinise. With respect to the latter, the DMO is likely to announce a reduction in planned gilt sales for the first time in four years, by more than £50bn from the £304bn in sales scheduled in the current financial year. Issuance at the long end of the curve remains likely to be reduced again. In terms of more familiar economic data, the BRC's shop price survey will look to give an early indication of February's CPI inflation. We note, however, that the direction for goods and food inflation highlighted by that survey last month diverged somewhat with the ONS' inflation data.

UK: Change in average interest rates from peak*



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

UK: House price indices



Source: Macrobond 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 manufacturing PMI	Feb	50.8	<u>50.8</u>	49.5	-
Germany	Retail sales M/M% (Y/Y%)	Jan	-0.9 (0.7)	0.0 (1.2)	0.1 (3.2)	1.2 (4.3)
	Final manufacturing PMI	Feb	50.9	<u>50.7</u>	49.1	-
France	Final manufacturing PMI	Feb	50.1	<u>49.9</u>	51.2	-
Italy	Manufacturing PMI	Feb	50.6	49.2	48.1	-
	General Government deficit to GDP %	2025	3.1	-	3.4	-
Spain	Manufacturing PMI	Feb	50.0	50.0	49.2	-
UK	Net consumer credit £bn (Y/Y%)	Jan	1.8 (8.3)	1.7 (-)	1.5 (8.2)	1.7 (8.3)
	Net mortgage lending £bn (approvals 000s)	Jan	4.1 (60.0)	4.6 (62.0)	4.6 (61.0)	4.5 (-)
	Final manufacturing PMI	Feb	51.7	<u>52.0</u>	51.8	-
	Nationwide house prices M/M% (Y/Y%)	Feb	0.3 (1.0)	0.2 (0.7)	0.3 (1.0)	-

Auctions

Country	Auction
- Nothing to report -	

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 	10.00	Preliminary headline (core) HICP Y/Y%	Feb	<u>1.7 (2.2)</u>	1.7 (2.2)
Italy 	10.00	Preliminary HICP (CPI) Y/Y%	Feb	1.1 (1.1)	1.0 (1.0)
Spain 	08.00	Unemployment (net employment) change 000s	Feb	-	30.4 (17.3)
UK 	00.01	BRC shop price index Y/Y%	Feb	1.4	1.5

Auctions and events

Germany 	10.30	Auction: to sell up to €5bn of 2.5% 2031 bonds			
UK 	12.30	UK Chancellor of the Exchequer Reeves to deliver Spring Statement to Parliament			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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