

Euro wrap-up

Overview

- Bunds made further losses, with the 10Y yield moving closer to 3%, as wholesale energy prices remained highly elevated but data confirmed that euro area industrial production fell in January to a 13-month low.
- Gilts also made losses even as UK GDP failed to grow at the start of the year.
- The ECB and BoE will leave rates unchanged in the coming week, with the former also due to publish updated macroeconomic projections that should take stock of the possible impacts of the new energy price shock.

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Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.432	+0.024
OBL 2½ 04/31	2.632	+0.024
DBR 2.9 02/36	2.977	+0.023
UKT 4% 03/28	4.124	+0.037
UKT 4% 03/31	4.337	+0.043
UKT 4% 10/35	4.822	+0.050

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

Euro area

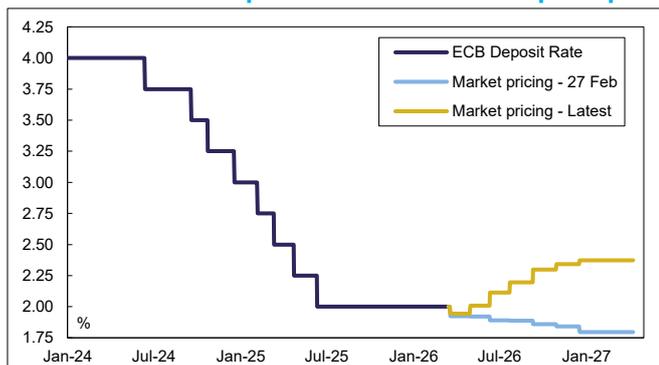
ECB to signal new hiking bias in response to energy price shock

The ECB is bound to leave policy unchanged at the coming week's Governing Council meeting. Ahead of the outbreak of the war in the Middle East, the policymakers repeatedly judged rates to be in a 'good place' with broadly balanced two-sided risks to the outlook. Despite an upside surprise related in part to Italy's Winter Olympics, headline consumer price inflation was still slightly below target according to February's [flash estimate](#). And [surveys](#) suggested that economic activity and the labour market remained resilient to heightened geopolitical uncertainty. However, while events remain in a state of flux, the war is transforming the near-term economic outlook. And having been scarred by the shocks triggered by Russia's war in Ukraine, on Thursday the Governing Council will flag its concerns about potential lasting effects on inflation from the new Iranian conflict. So, while they are likely to repeat their familiar mantra that policy will remain data dependent and decisions will be taken on a meeting-by-meeting basis, the policymakers will likely signal a new hiking bias with respect to rates. And although the new energy price shock and risks of large-scale second-round effects on inflation remain less extreme than in 2022, as events at the Straits of Hormuz and shifts in wholesale oil and gas prices remain hard to predict with any confidence, President Lagarde might well suggest that all future policy meetings from April onwards could be live for a possible rate hike.

Expect rate hike in June if conflict persists & energy prices remain high

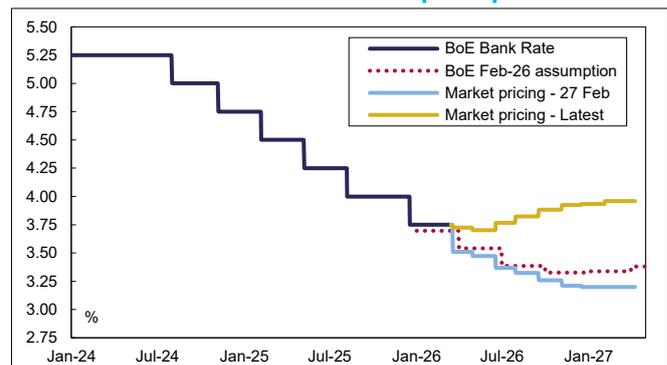
Certainly, comments since the outbreak of hostilities by several Governing Council members (see table) have underscored their understandable determination to prevent the current energy price shock from transmitting itself into another sustained bout of high inflation. Prices of petrol, heating oil and airfares, among other things, have already risen sufficiently to add ½ppt or more directly to inflation over coming months. And with core inflation still above target (2.4%YY) in February and the unemployment rate at a series low (6.1%) in January, some second-round effects are highly likely, not least given the non-linear response to larger-scale shocks. Indeed, policymakers will also be mindful that market-based measures of inflation expectations – both short- and medium-term – have increased markedly over the past 10 days. And business and consumer inflation expectations are likely to follow suit. The swap market is currently fully pricing a rate hike by the summer and a good chance of a further hike by year-end. And due to the ECB's likely reaction function to large-scale shocks, we think that's appropriate. Given the inevitable jump in consumer price inflation likely to show up in the data over coming months, unless events in the Middle East normalise and wholesale energy price futures fall significantly by early June, we would expect a first 25bps hike that month. And if disruption to shipping freight through the Strait of Hormuz persisted, a second hike to 2.50% – the top of the ECB's range of neutral policy estimates – couldn't be ruled out for the second half of the year.

Euro area: ECB Deposit Rate & market-implied path



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: BoE Bank Rate & market-implied path



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Selected quotes from ECB Governing Council members

Governing Council member	Selected quotes from Governing Council members since start of US/Israeli conflict with Iran
ECB President Christine Lagarde  (10 March)	"We are in a better situation and we have a greater capacity to absorb shocks. We will do all that is necessary to ensure inflation is under control...and Europeans don't suffer the same inflation increases like those we saw in 2022 and 2023... We won't rush into a decision because there is too much uncertainty, too much volatility."
Isabel Schnabel  (11 March)	"Euro-area inflation is projected to be at our 2% target over the medium term. Of course, this projection is the December projection — we are going to have a new one in March, which will at least partly already reflect recent developments." (11 March) "Monetary policy remains in a good place. But [the ECB] cannot be complacent." (6 March)
Chief Economist Philip Lane  (3 March)	"Directionally, a jump in energy prices puts upward pressure on inflation, especially in the near term."
Joachim Nagel  (11 March)	"If it becomes apparent that the current energy price increases will translate into broad consumer price inflation in the medium term, the Governing Council...will act decisively in a timely manner."
François Villeroy de Galhau  (11 March)	"As things stand today, I don't think we should raise rates now. But we will not let inflation take hold".
Peter Kažimír  (11 March)	"The balance of risks regarding inflation has clearly shifted to the upside...we can forget about all the discussions about an inflation undershoot...I'd say a reaction by the ECB is potentially closer than many people think. I don't want to speculate about April or June. But we will be ready to act if needed."
Madis Müller  (10 March)	"[The ECB shouldn't] rush into any decisions... the probability of the next change in the policy rates now being more towards an increase rather than the opposite. That probability has gone up in the last couple of weeks"
José Luis Escrivá  (6 March)	"With the information I currently have, I believe it is very unlikely that the Governing Council will change interest rates at the next meeting. Temporary movements should not lead us to make decisions - instead, we need to continue monitoring the situation."
Olaf Sleijpen  (6 March)	"While I would not use the word nirvana or Goldilocks anymore, I haven't dramatically changed my view on where we are, which is still a good place."
Olli Rehn  (5 March)	"My advice...for the Governing Council...keep a cool head, maintain a steady hand and do not make hasty conclusions about the current situation. We are facing a supply-side and demand-side shock. It makes sense that we take this with data dependency and with plenty of judgment."
Mārtiņš Kazāks  (3 March)	"The longer the period of elevated prices, the stronger the second-round effects will be. And then this may feed through into inflation and then potentially, we may need to take a policy decision. But not now."

Source: Bloomberg and ECB speeches

ECB to revise up inflation outlook, but new projections might not fully capture ongoing events

Normally, the ECB's updated macroeconomic projections would give strong clues to the near-term path of monetary policy. And a new set will be published on Thursday. While the initially planned cut-off date for determining the market-based conditioning assumptions came last month ahead of the outbreak of hostilities, Executive Board member Schnabel suggested that the updated projections "will at least partly already reflect recent developments". But it is not clear whether these forecasts, or any associated sensitivity analyses, will fully reflect the new reality or provide sufficient clarity regarding the ECB's inflation outlook to help firm up rate expectations. Certainly, against the backdrop of ongoing sharp swings in energy prices, whatever projections are published could be out-of-date in next to no time due to the decisions of the US, Israeli and/or Iranian leaderships. If current energy price futures curves prove a reliable guide, however, we would expect euro area headline and core inflation to rise back between 2½-3%Y/Y in Q2 and remain above 2½%Y/Y through to Q127. Certainly, higher prices of energy will also add pressure to food, core goods and many services prices. And while energy base effects could help push headline inflation back close to 2%Y/Y from Q227, second-round effects on wages could lead to above-target persistence via the broader services category through much, if not all, of next year. And if they reflect current market pricing, the ECB's baseline projections for full-year inflation would be revised up from 1.9%Y/Y previously to around 2½%Y/Y in 2026 and 1.8%Y/Y to about 2%Y/Y in 2027. However, inflation in 2028 might still be expected to come in at about 2.0%Y/Y as long as second-round effects are not long-lasting and expectations do not become de-anchored.

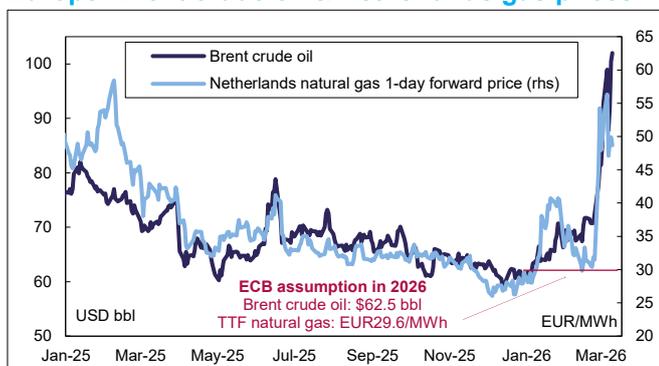
Hit to real incomes & confidence imply a weaker GDP outlook, but with no implications for rates

Just as the inflation outlook has been upended by events in the Middle East, the ECB will need to revise down its baseline GDP projection. Inflation is set to erode real incomes and add to business costs. Downbeat sentiment and elevated uncertainty will prompt more precautionary household savings and discourage businesses from committing to investments. And, as today's industrial production data for January illustrated, the ECB's forecast of GDP growth of 0.3%Q/Q this quarter looks hard to achieve. Contrary to initial expectations of an increase but consistent with the [German data](#) published at the start of the week, euro area IP dropped for a second successive month and by the most in nine months (-1.5%M/M) to the lowest level since December 2024. All major manufacturing categories started the year in reverse. And energy-intensive production, which seems bound to fall significantly over the near term due to the new cost pressures, fell to a level that has been lower in only two months since the introduction of the euro (i.e. in the post-GFC recession and first Covid lockdown). Given support from fiscal policy, not least military and infrastructure spending, we still don't expect any quarters of negative growth. But the ECB's previous baseline projection of quarterly growth rates of 0.4%Q/Q from Q2 on looks unrealistic in the absence of an imminent end to the conflict. And, overall, notwithstanding the elevated level of uncertainty, it might seem reasonable for the ECB to knock ½ppt off its full-year GDP growth forecast of 1.2%Y/Y in 2026. Nevertheless, with the policymakers fully focussed on limiting the persistence of inflation as opposed to balancing the trade-off between prices and growth, the downward revision to the GDP outlook will not have a material impact on the ECB rate outlook.

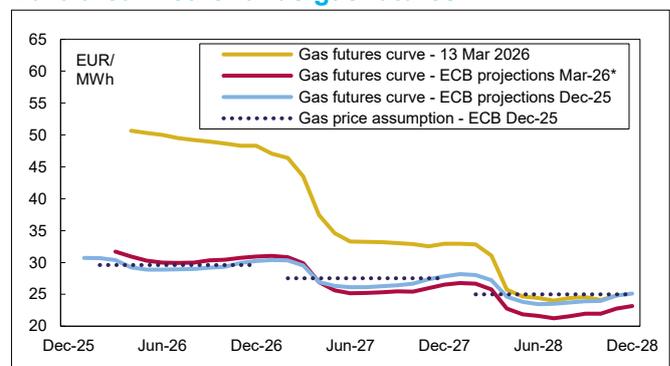
The week ahead for euro area data

In terms of euro area economic data in the coming week, the German ZEW investor survey (Tuesday) will arguably draw most attention. Like the Sentix survey, this will likely report an energy-related deterioration in perceptions of the near-term economic outlook. Given the further step up in wholesale gas and oil price futures over the past week, the hit to sentiment reported by the ZEW survey might be more accentuated than implied by the Sentix survey, whose headline German investor sentiment index fell merely to the lowest level since December. Meanwhile, construction activity data for January (Thursday) will be supported by a surprisingly solid outturn in Germany at the start of the year (2.9%M/M), which will offset some weather-related weakness in France. The latest euro area goods trade data (Friday) are also due. While Germany reported a decline in shipments to China, exports to the US jumped to the highest level since last March. In addition, final euro area inflation figures for February (Wednesday) will bring the detailed breakdown, which will likely confirm a 0.2ppt pickup in the headline rate to 1.9%Y/Y. That was driven by an increase in services inflation, which was likely due to a Winter Olympics-related boost to hospitality prices in Italy.

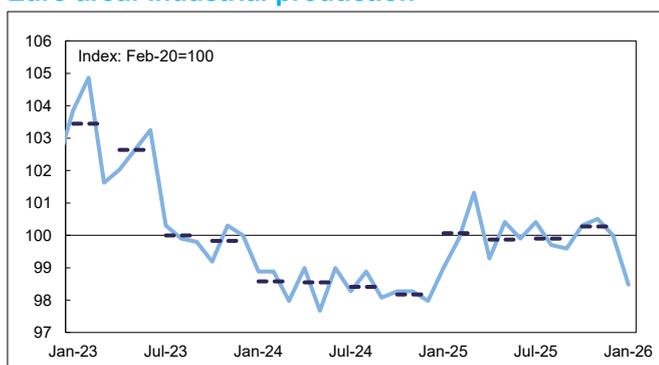
Europe: Brent crude oil & Netherlands gas prices



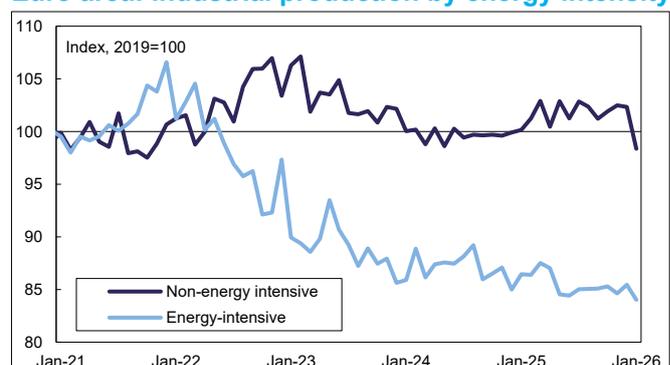
Euro area: Netherlands gas futures



Euro area: Industrial production*



Euro area: Industrial production by energy intensity



UK

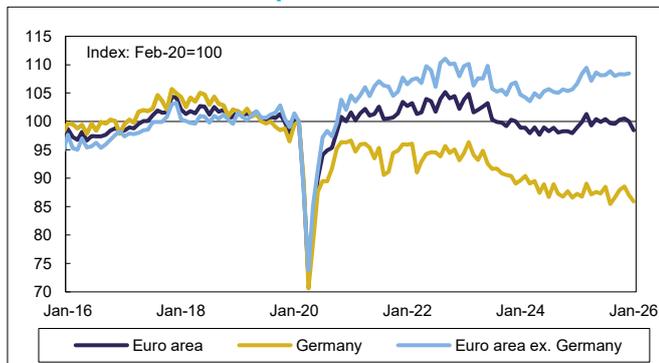
BoE to keep policy on hold as energy shock supersedes softening domestic growth momentum

Ahead of the outbreak of war in the Middle East, the BoE appeared poised to cut Bank Rate for a seventh time since the easing cycle began in August 2024. Indeed, in addition to the four MPC members that voted for a 25bps cut in early February, Governor Bailey suggested that he was getting very close to voting for a cut too given that the risks of inflation persistence were steadily dissipating. [Headline inflation](#) subsequently fell to a ten-month low. The latest [labour market](#) report saw unemployment rise to a five-year high and private regular pay growth fall back in line with the long-run average. And [GDP](#) suggested an absence of economic growth momentum at the turn of the year. As such, at the end of February, we – like the consensus – had expected at least five MPC members to vote for a rate cut on 19 March. But events in the Middle East and the associated energy shock have taken a near-term BoE rate cut taken off the table. Moreover, market-implied probabilities have swung from pricing in two rate cuts this year to a two-thirds chance of a rate hike.

BoE statement to flag wide-ranging views on risks, but a possible easing bias once shock passes

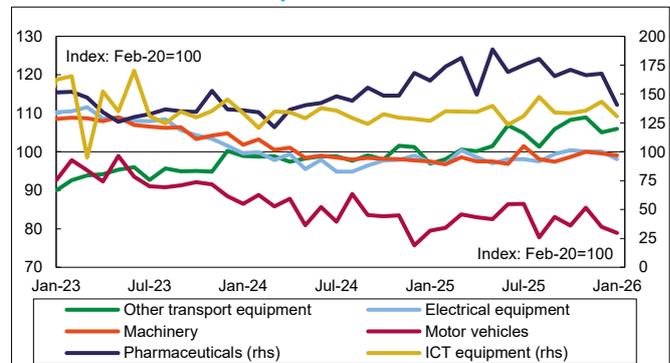
Given that Bank Rate (3.75%) is still in restrictive territory (compared with the broadly neutral policy stance of the ECB), we continue to expect the next move from the BoE to be down rather than up. And the more dovish members – i.e. Dhingra and Taylor – might continue to vote for a rate cut this month, mindful of the risk of excessive weakness in economic output from restrictive policy and the renewed demand hit from the energy shock. But with some on the Committee already concerned about inflation persistence – i.e. Pill and Greene – we expect the majority to be more wary of the renewed upside skew from wholesale gas and oil prices to the near-term inflation outlook, and increased risks of potential second-round effects. And so, while the outlook will depend on the persistence of the energy shock and policymakers will flag two-sided risks to the medium-term inflation outlook, the MPC’s previous guidance that “Bank Rate is likely to be reduced further” seems highly likely to be dropped from this month’s policy statement. Certainly, policymakers will be wary of cutting rates while inflation is on the way up again. Indeed, based on current energy future curves, we expect headline inflation to peak firmly above 3%Y/Y in September and November this year and only fall back below 3%Y/Y from March 2027. And with indexation of certain services and pay demands likely to be higher next year than previously assumed to compensate for the energy shock, we now expect headline inflation to remain above the 2.0% target through to end-2027 at least. But with inflation likely to moderate below target in 2028, we continue to expect the BoE to maintain an easing bias over coming years, albeit the next rate cut might not come before the end of this year.

Euro area: Industrial production



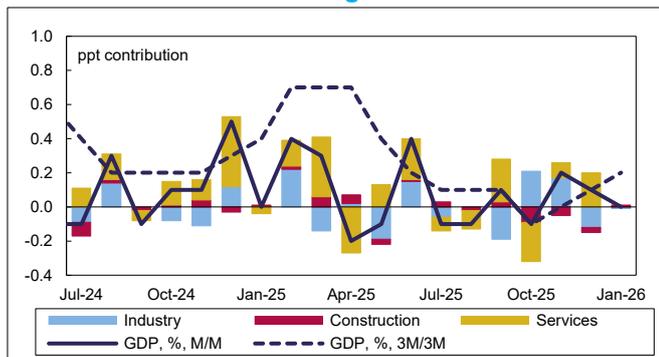
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production



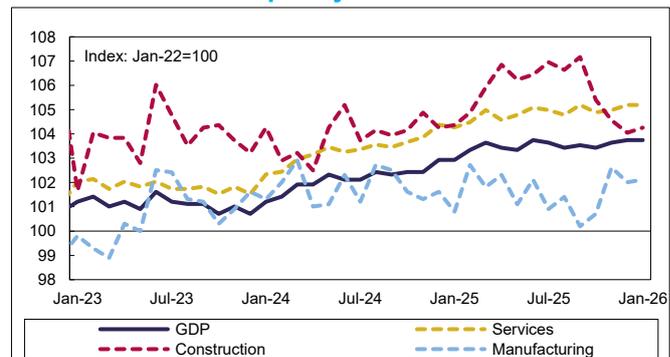
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Contributions to GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP level & output by sector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

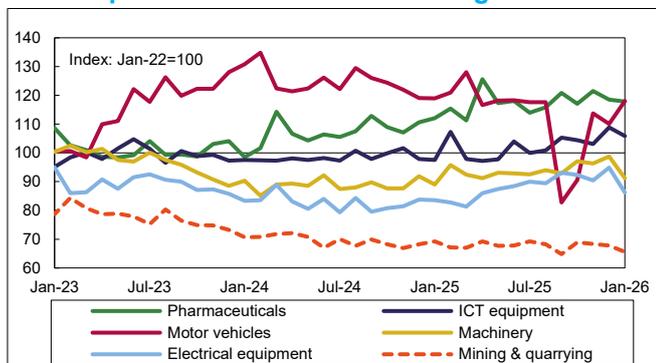
GDP failed to grow in January as services flatlined

Despite positive survey signals since the start of the year, today's monthly GDP data for January illustrated that the economy lacked growth momentum heading into this new energy shock and reinforced why some MPC members might continue to vote to cut rates now. Contrasting expectations of a return to growth, economic activity merely flatlined in January. While this took three-month growth up 0.1ppt to 0.2%3M/3M, a seven-month high, this was supported by a strong showing in November and flattered by weakness in the run up to the government's Budget. Indeed, the jump in manufacturing output in the three months to January – by 1.5%3M/3M, the most since August 2023 – was principally due to the ongoing recovery in car production following the cyber outage at Jaguar Land Rover last September. In contrast, there were sharp declines in production of machinery, electrical and ICT equipment. And with mining down for a fifth month in six, total industrial production fell for a second successive month in January (-0.1%M/M), tracking 0.3% below the Q4 average. And while construction activity rose slightly in January (0.2%M/M), the negative carry-over from 2025 left it almost ½% lower than in Q4. Despite a bounce in retail sales in January, services output merely flatlined. Hospitality was notably softer, perhaps reflecting inclement weather. And reinforcing weakening labour demand, employment agencies provided the largest drag from a single sector (-0.1ppt) to both services and GDP growth in January. Given significant economic uncertainties from the energy shock, today's figures raise non-negligible risks that the UK economy failed to grow in Q1.

Surge in exports in January might prove temporary

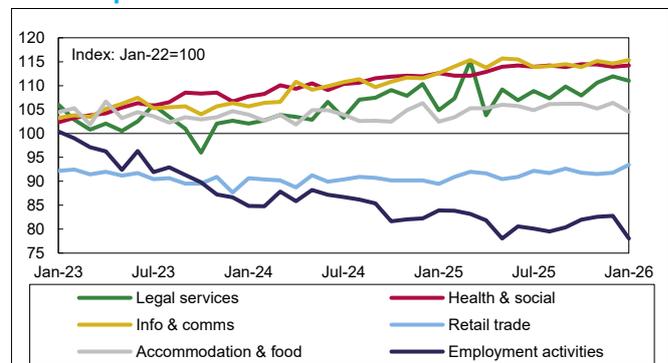
Today's economic data were not all doom and gloom, with export volumes (5.2%M/M) rising the most in 17 months. This in large part reflected a surge in shipments of precious metals, which pushed total goods export volumes up a striking 12.5%M/M. Excluding such items, goods exports still increased a solid 6.8%M/M, with notable increases in shipments of office machinery to the Netherlands, mechanical power generators to China and the UAE and pharmaceuticals to China, Turkey and Brazil. But services exports – which account for roughly 60% of the UK's shipments – rose a more modest 0.5%M/M. Nevertheless, taken together with a notable decline in imports, the trade deficit narrowed sharply in January by £5.6bn to £0.8bn – in real terms – the smallest since April 2023. Of course, the UK's trade figures are notoriously volatile and so we would expect some payback in February, with risks to the near-term outlook similarly skewed to the downside.

UK: Output in selected manufacturing subsectors



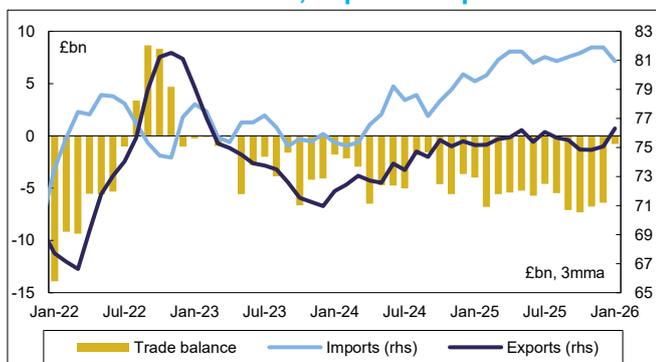
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output in selected services subsectors



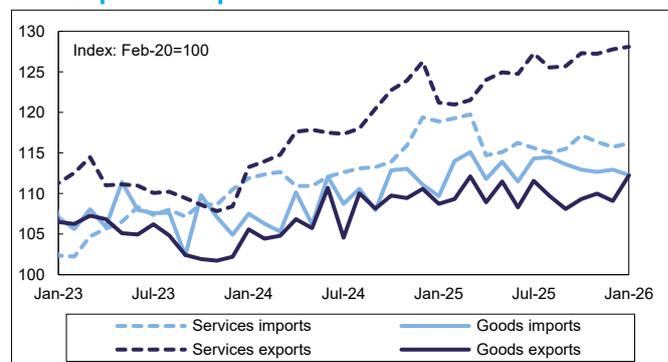
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Real trade balance, export & import volumes



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Export & import volumes*



*Excluding precious metals.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead for UK data

While backward looking economic data will remain of secondary importance in the coming week, January's labour market report (Thursday) will likely continue to illustrate the recent weakening trend. That said, we expect little change to the headline figures this time around, with the unemployment rate to merely move sideways at December's near-five-year high of 5.2%3M, overshooting the BoE's projection. We also expect the BoE's preferred wages series – private sector regular pay – to be broadly unchanged at around 3½%3M/Y, although a blend of subdued labour demand and the fading base effects of higher public sector settlements last year might continue to weigh on total wage growth. Meanwhile, February public finance statistics (Friday) will provide a penultimate update on government borrowing in FY25/6, and a first since last week's [OBR forecast update](#). While bound to slip back into deficit in February, January's outturn – record monthly surplus of £30.4bn – will also be closely watched for revisions. But of greater interest on Friday will be the CBI's industrial trends survey for March, which will offer a first insight into any immediate effects of recent energy market disruption on the manufacturing sector ahead of the flash PMIs (24 March).

The next Euro wrap-up will be published on Tuesday 17 March 2026

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Industrial production M/M% (Y/Y%)	Jan	-1.5 (-1.2)	<u>-1.5 (-1.1)</u>	-1.4 (1.2)	-0.5 (2.2)
France	 Final HICP (CPI) Y/Y%	Feb	1.1 (0.9)	<u>1.1 (1.0)</u>	0.4 (0.3)	-
Italy	 Industrial production M/M% (Y/Y%)	Jan	-0.6 (-0.6)	0.4 (0.8)	-0.4 (3.2)	-0.5 (2.7)
Spain	 Final HICP (CPI) Y/Y%	Feb	2.5 (2.3)	<u>2.5 (2.3)</u>	2.4 (2.3)	-
UK	 Monthly GDP M/M% (3M/3M%)	Jan	0.0 (0.2)	0.1 (0.3)	0.1 (0.1)	-
	 Services output M/M% (3M/3M%)	Jan	0.0 (0.2)	0.2 (0.3)	0.3 (0.0)	0.2 (-)
	 Industrial output M/M% (Y/Y%)	Jan	-0.1 (0.4)	0.2 (0.6)	-0.9 (0.5)	-
	 Construction output M/M% (Y/Y%)	Jan	0.2 (-0.2)	0.1 (-0.2)	-0.5 (-0.3)	-
	 Trade (goods trade) balance £bn	Jan	3.9 (-17.8)	-	-4.3 (-22.7)	-
	 BoE/Ipsos inflation attitudes survey – 1Y ahead CPI Y/Y%	Q1	3.2	-	3.5	-
Thursday's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
UK	 RICS house price balance %	Feb	-12	-9	-10	-
Auctions						
Country	Auction					
Italy	 sold €2.0bn of 2.4% 2029 bonds at an average yield of 2.75%					
	 sold €2.5bn of 3.15% 2033 bonds at an average yield of 3.34%					
	 sold €1.5 of 3.25% 2038 bonds at an average yield of 3.85%					
UK	 sold £500mn of 1.875% 2049 inflation-linked bonds at an average yield of 2.019%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases						
Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Monday 16 March 2026						
UK		00.01	Rightmove house prices M/M% (Y/Y%)	Mar	-	0.0 (0.0)
Tuesday 17 March 2026						
Germany		10.00	ZEW current situation (expectations) balance	Mar	-67.5 (39.2)	-65.9 (58.3)
Italy		09.00	Final HICP (CPI) Y/Y%	Feb	<u>1.6 (1.6)</u>	1.0 (1.0)
Wednesday 18 March 2026						
Euro area		10.00	Final headline (core) HICP Y/Y%	Feb	<u>1.9 (2.4)</u>	1.7 (2.2)
		10.00	Final job vacancy rate %	Q4	<u>2.2</u>	2.2
Thursday 19 March 2026						
Euro area		10.00	Final labour costs Y/Y%	Q4	<u>3.3</u>	3.4
		10.00	Construction output M/M% (Y/Y%)	Jan	0.5 (0.2)	0.9 (-0.9)
		13.15	ECB Deposit (Refinancing) Rate %	Mar	<u>2.00 (2.15)</u>	2.00 (2.15)
UK		07.00	Average wages (excluding bonuses) 3M/Y%	Jan	3.9 (4.0)	4.2 (4.2)
		07.00	Private sector regular wages 3M/Y%	Jan	3.5	3.4
		07.00	Unemployment rate 3M%	Jan	5.2	5.2
		07.00	Employment 3M/3M change 000s	Jan	-4	52
		07.00	Payrolled employees M/M change 000s	Feb	-10	-11
		07.00	Claimant count rate % (change 000s)	Feb	-	4.4 (28.6)
		12.00	BoE Bank Rate %	Mar	<u>3.75</u>	3.75
Friday 20 March 2026						
Euro area		09.00	ECB current account €bn	Jan	-	14.6
		10.00	Trade balance €bn	Jan	-	11.6
Germany		07.00	PPI Y/Y%	Feb	-2.7	-3.0
France		07.45	Final wages Q/Q%	Q4	<u>0.2</u>	0.3
UK		07.00	Public sector net borrowing £bn	Feb	8.8	-30.4
		11.00	CBI industrial trends survey – total orders (selling prices) net balance %	Mar	-30 (28)	-28 (26)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions			
Country	GMT	Event / Auction	
Monday 16 March 2026			
- Nothing scheduled -			
Tuesday 17 March 2026			
UK		10.30	Auction: to sell £4bn of 4.125% 2031 bonds
Wednesday 18 March 2026			
Germany		10.30	Auction: to sell up to €1bn of 2.5% 2046 bonds
		10.30	Auction: to sell up to €1.5bn of 2.9% 2056 bonds
Thursday 19 March 2026			
Euro area		13.15	ECB monetary policy announcement
		13.45	ECB President Lagarde holds post-Governing Council meeting press conference
		14.45	ECB to publish macroeconomic projections
France		09.50	Auction: to sell up to €15.5bn of 2.4% 2029, 2.5% 2030, 2.7% 2031 & 3.5% 2033 bonds
		10.50	Auction: to sell up to €1.5bn of 3.4% 2029, 0.1% 2031, 0.1% 2036 & 0.1% 2053 inflation-linked bonds
Spain		09.30	Auction: to sell 2.6% 2031, 2.55% 2032 & 3.3% 2036 bonds
UK		12.00	BoE monetary policy announcement, statement and minutes to be published
		12.00	BoE to publish quarterly Agents' summary of business conditions (Q126)
Friday 20 March 2026			
Germany		17.30	Bundesbank President Nagel to give speech about German economic outlook

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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