Europe | Economic Research | 19 March 2026

Daiwa Capital Markets

Euro wrap-up

Overview

- Bunds made losses as the ECB left monetary policy on hold but signalled a readiness to raise rates as its updated projection scenarios suggested that inflation could jump above 6% under a severe energy shock.
- Gilts again significantly underperformed as the BoE's MPC unanimously voted to leave rates on hold and several members appeared close to supporting a hike as soon as Q2.
- Friday will bring updates on euro area goods trade and the UK's manufacturing sector and public finances.

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Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.582	+0.145
OBL 2½ 04/31	2.681	+0.072
DBR 2.9 02/36	2.953	+0.017
UKT 4⅜ 03/28	4.398	+0.303
UKT 4⅛ 03/31	4.446	+0.180
UKT 4¾ 10/35	4.840	+0.106

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

Euro area

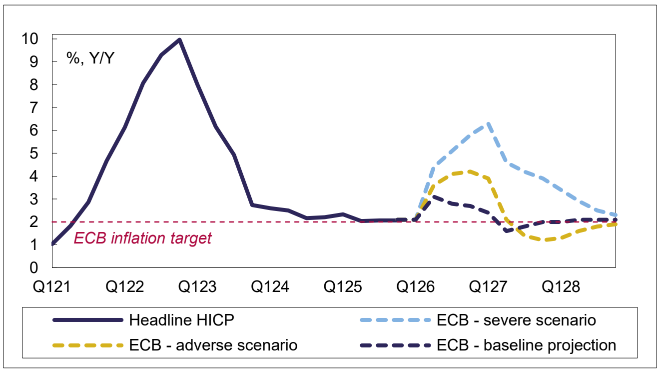
ECB takes measured approach to new shocks but looks on track to raise rates as soon as April

The ECB inevitably left policy unchanged today, keeping its main deposit rate on hold at 2.00% in a unanimous decision. As was also widely expected, it emphasised the massive new uncertainty generated by events in the Middle East, including upside risks to inflation and downside risks to growth. The statement was measured, with the Governing Council judging that policy is well positioned to respond to the unfolding shocks. Indeed, President Lagarde noted that macroeconomic conditions – including target-consistent inflation and neutral policy rates – remained more conducive for confronting the new reality than they had been at the time of the Russian invasion of Ukraine in Spring 2022. She also considered the ECB better able to understand how the new shocks might impact the economy than it had been back then. Over the near term, the ECB is braced for inflation to accelerate due to the direct impact of higher energy prices. But policy will be set to manage the medium-term outlook, which will depend crucially on the intensity and duration of the Iranian conflict, associated energy price shifts and supply-side disruption. It will also reflect indirect and second-round effects, not least on inflation expectations and wage growth. Lagarde made clear that policymakers will now be particularly attentive to a range of variables related to energy and commodity markets, broader supply-chain bottlenecks, selling-price expectations, wage trackers and indicators of the strength of demand. But her comments as well as the ECB's updated macroeconomic projections and scenario analyses implied that, unless the crisis in the Middle East de-escalates soon, the Governing Council will likely be raising rates in the coming quarter and perhaps at least twice this year.

ECB projects inflation to peak above 6%Y/Y on a 'severe' energy shock scenario

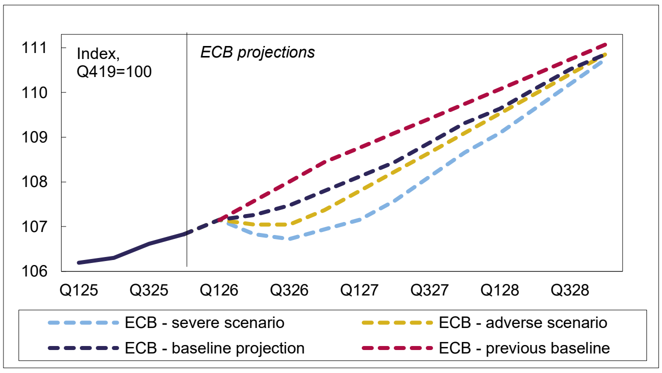
To reflect current uncertainty, the ECB published three main sets of projections reflecting differences in the severity of shocks and subsequent pass-through to inflation and activity. Its new baseline scenario is based on assumptions conditioned by market variables prevailing in the three days to 11 March, when swaps pricing implied about one hike this year and one more in 2027, and wholesale oil and gas prices were still some 20-25% below current levels. Alternative adverse and severe scenarios assumed, to different degrees, more intense and prolonged supply disruption via the Strait of Hormuz and associated price shifts in energy and other items. According to the baseline scenario, euro area GDP is projected to continue to grow, by 0.1%Q/Q in Q2 and gradually firmer through Q3 and Q4 and into next year. That would leave full-year growth at 0.9%Y/Y in 2026 and 1.3%Y/Y in 2027. At the other extreme, the severe scenario projects contractions of 0.3%Q/Q and 0.1%Q/Q in the next two quarters before a return to growth from Q4 on resulting in full-year growth of 0.4%Y/Y and 0.9%Y/Y this year and next. More importantly for monetary policy, the baseline projection foresees energy inflation jumping above 11%Y/Y and headline inflation peaking at 3.1%Y/Y in Q2 before moderating back close to target from Q327 on. But under

Euro area: ECB inflation projections



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

Euro area: ECB GDP level projections



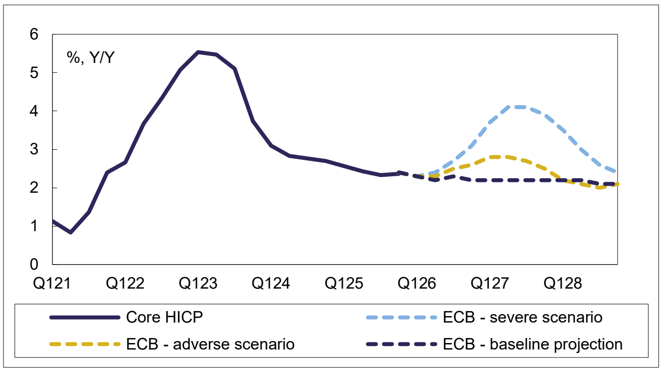
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

the severe scenario, energy inflation jumps above 26%Y/Y in Q3 and Q4. And given greater supply disruption and second-round effects under this variant, core inflation is projected to rise above 4%Y/Y by mid-2027 and headline inflation is expected to peak at 6.3%Y/Y in Q127 before moderating back to (a still above-target) 2.3%Y/Y by end-2028. Given this week's events in the Middle East including destruction to energy infrastructure, the severe scenario might currently appear more likely than the baseline. And certainly, without a significant de-escalation in the conflict by then, when it meets at the end of April, the Governing Council might well share that view. So, we are pencilling in a first rate hike this year at that meeting, and perhaps a second at the June meeting too.

The day ahead in the euro area

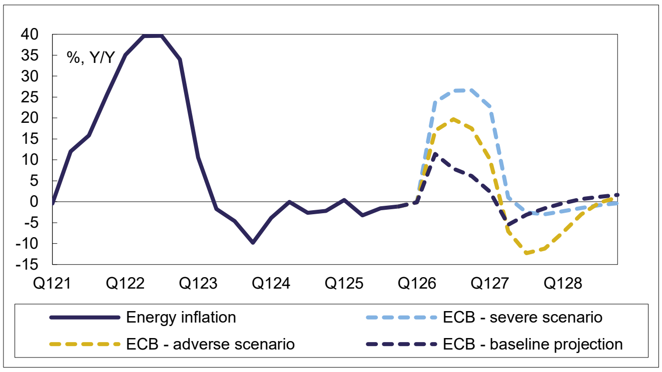
January's goods trade figures will be the most notable of Friday's euro area dataflow. Relative to the recent lukewarm signals on domestic activity, the export numbers published by the member states suggest that external demand had a slightly firmer start to the year. Indeed, while shipments to China cooled around the Lunar New Year, higher exports to the US, particularly from Germany, likely bolstered the trade surplus. Otherwise, German PPI data will provide an update on input cost pressures in the euro area's largest member state before this month's spike in energy prices. Influential Governing Council member and Bundesbank President Nagel is due to speak publicly.

Euro area: ECB core inflation projections



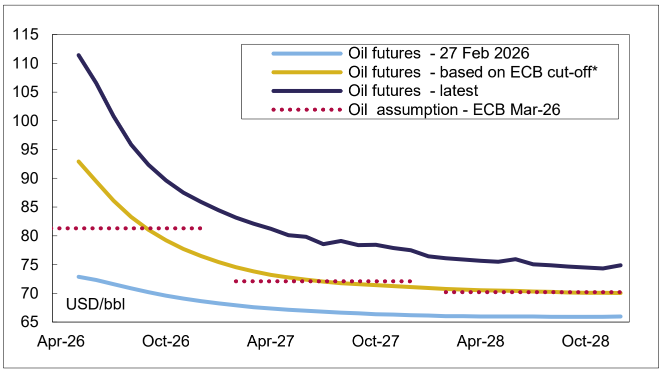
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB energy inflation projections



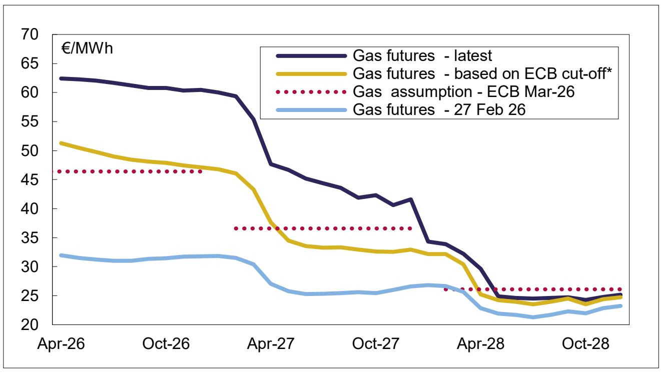
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Oil futures curves & ECB assumption



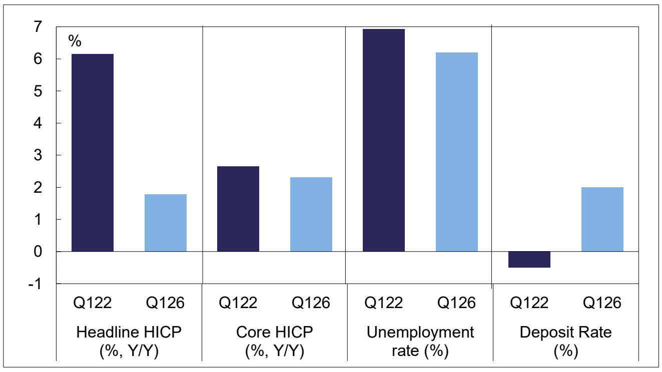
**3 days to 11 March*
Source: Bloomberg, ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Gas futures curves & ECB assumption



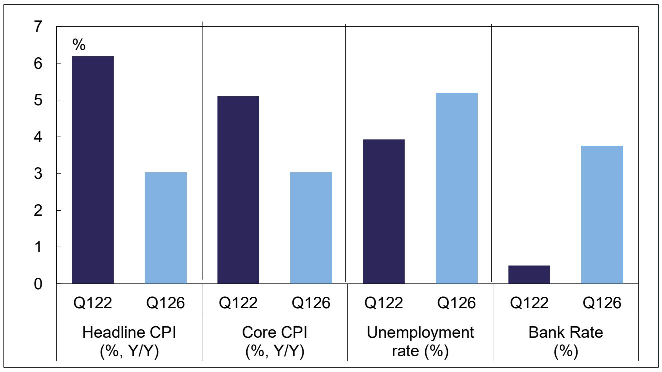
**3 days to 11 March*
Source: Bloomberg, ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Selected macro conditions, Q122 & latest



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected macro conditions, Q122 & latest



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

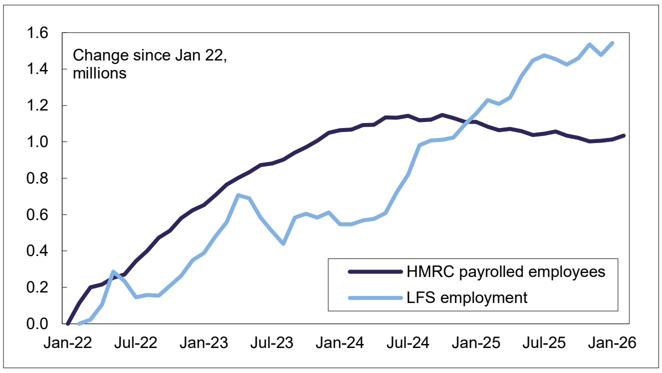
Bank Rate left at 3.75% but hawkish signal raises spectre of end-April hike

It was no surprise that the BoE also left policy unchanged today, keeping Bank Rate at 3.75%. But as the two most dovish Committee members had been expected to vote for a rate cut, the fact that the MPC's decision was unanimous for the first time since September 2021 was eye-catching. The MPC's policy statement and minutes were also more hawkish than expected. The Committee dropped its previous signal that it expects the next move in rates to be down. It also made clear its significant concern about the potential-second round effects on inflation from the new energy price shock. Indeed, with inflation expectations still potentially scarred by the experience of the past few years, those concerns about upside risks to prices appear to be outweighing their concerns about the downside risks to economic activity. Certainly, the updated views of the MPC members (see table) suggested that at least three were already close to voting for a hike today. And while Governor Bailey cautioned jumping to conclusions about the future path of interest rates, a hike as soon as the next meeting on 30 April – when the BoE will have updated macroeconomic projections – would seem a decent bet if events at the Strait of Hormuz and pressures in energy markets have not been defused.

Energy shock will shift near-term inflation notably higher, but economic backdrop different to 2022

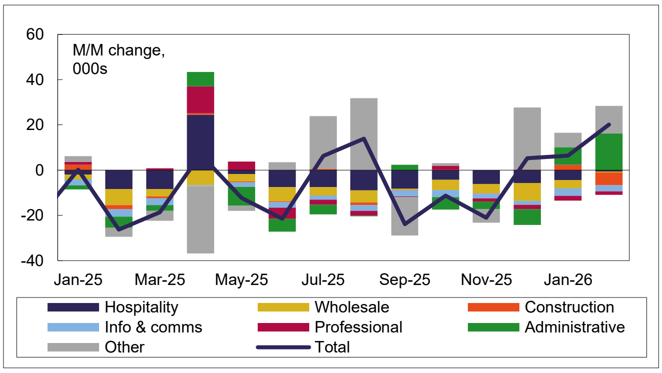
Like elsewhere, the medium-term outlook for UK inflation and growth will depend on the scale and duration of the conflict in the Middle East. But the MPC acknowledged that inflation is now bound to be significantly higher than it thought when it published its Monetary Policy Report projections last month. Broadly consistent with our own view, preliminary BoE staff estimates based on energy prices in the run-up to this week's policy meeting suggest that headline inflation could well rise to between 3-3½%Y/Y over coming quarters, having been projected just last month to fall back close to the 2.0% target from April. And as suggested by the ECB's severe projection scenario for the euro area, if today's spike in wholesale energy prices is sustained, the rise in UK inflation will be significantly more pronounced than that too. Given the quarterly pricing system for UK household electricity and gas, the peak in energy inflation will come a little later than in the euro area, with a more notable rise in H226 and possibly into 2027. And as at the ECB, the BoE sees significant risks of second-round effects on wages and prices, particularly if longer higher energy prices persist. As such, the MPC made clear that a larger and more protracted inflation shock would require a more restrictive policy stance going forward. But the MPC is also mindful that less tightening would be required if activity weakened such that economic slack increased. Indeed, Governor Bailey underscored that the current economic backdrop is very different to the one at the time of the energy shock in 2022, when the economy was operating above full capacity but policy was highly accommodative.

UK: Measures of employment



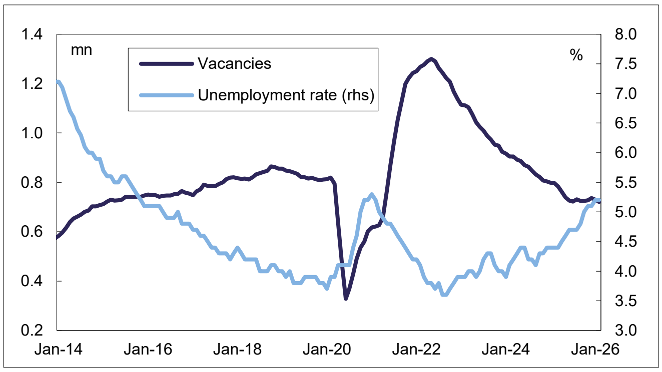
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employee growth, by sector



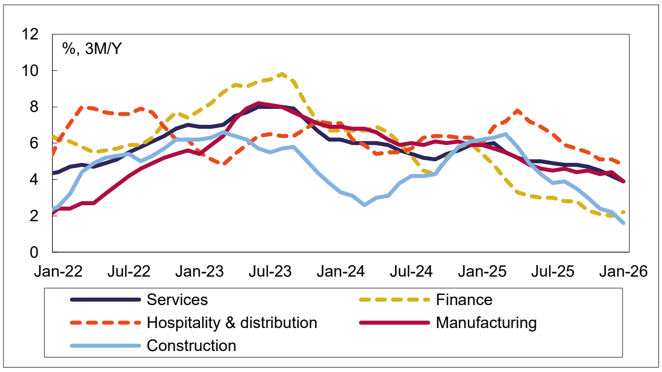
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Unemployment rate & job vacancies



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private regular pay growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Pay growth slows to softest rate in more than 5 years, but moderation might now prove temporary

Certainly, today's labour market report provided a reminder that there is already significant slack, with the unemployment rate at 5.2%, some 1½ppts higher than in early 2022. Nevertheless, there were signs of stabilisation in the UK jobs market at the start of the year, with the number of payrolled employees rising a surprisingly strong 20k in February – the most in 16 months – while the decline initially reported in January was revised to a modest increase (6k). The improvement principally related to growth in administrative and support roles (up a cumulative 24k so far this year), contrasting large declines in headcount in manufacturing and construction, the latter the most in almost six years. Meanwhile, the LFS measure of employment rose 84k in the three months to January on the back of part-time hires. But with inactivity having fallen at the start of the year, the unemployment rate held steady at 5.2%, matching the highest level in five years. Moreover, although the number of job vacancies appears to have stabilised over recent months, the ratio of vacancies to unemployed was unchanged at a level well below the long-run average to suggest the largest amount of labour slack in more than a decade outside of the pandemic period. Total pay growth slowed to 3.9%3M/Y in January, the softest rate since November 2020, while private sector regular pay growth – the BoE's preferred measure – eased to 3.3%3M/Y, a touch below the long-run average and some 2ppts below the level in Spring 2022. While labour slack might restrain wage demands somewhat, if the energy shock is prolonged and extreme, workers seem bound to demand greater compensation. So, while uber-dove Taylor today suggested that the bar for a rate hike is high, most other members are unlikely to share that view.

BoE March 2026: MPC members' views

MPC member	Vote	Selected quotes from the MPC minutes
Governor Bailey	3.75%	"Monetary policy cannot reverse [the energy] shock… [but it must] respond to the risk of a more persistent effect on UK CPI inflation". "A prolonged disruption…increases the upside risk to inflation. The recent experience of high inflation may also make households and businesses more sensitive to a new inflationary shock" "At the same time, the starting point for this shock is a real economy with limited pricing power. Holding Bank Rate at this meeting is appropriate."
Deputy Governor Lombardelli	3.75%	"The conflict in the Middle East will be damaging for the UK economy, increasing inflation and reducing output… The shock will have direct effects such as higher fuel and utility prices; indirect effects on business energy and transport costs; and broader second-round effects..." "We will learn more in coming weeks… I am prepared to act… to address any persistent inflationary effects…"
Deputy Governor Breeden	3.75%	"…The underlying disinflation process had continued broadly as I expected…But the conflict will have a significant, though at this point highly uncertain, impact on inflation. I associate myself strongly with the MPC's collective assessment…[the MPC] will learn more by its April meeting about the scale and duration of the shock, as well as its possible second-round effects."
Deputy Governor Ramsden	3.75%	"Data releases since the February MPR have… suggested continuing disinflation, so I would have otherwise voted for a 25bps cut… [but] the conflict has now led me to vote for a hold… There is a high degree of uncertainty around the scale and duration of the conflict, as well as its economic impact and any subsequent second-round effects."
Chief Economist Pill	3.75%	"…monetary policy can do little to dampen… short-term volatility in inflation. But [it] must contain potential second-round effects…" "I continue to believe structural change in price and wage-setting behaviour… has made the propagation of inflationary impulses more persistent than in the past…" "While financial conditions have tightened in recent weeks, whether this proves sufficient to contain potential upside risks… is an open question. I remain alert to those risks and stand ready to act if they intensify."
Catherine Mann	3.75%	"Due to the conflict, the tension between rising inflation and softening activity…has re-emerged and could easily worsen…" "[new forecasts & data] will help inform my next decision… I see the balance between inflation and activity to have shifted away from considering a cut towards considering a longer hold, or even a hike…"
Megan Greene	3.75%	"…Preliminary Bank staff estimates suggest CPI inflation will rise above 3% for much of this year, above the threshold at which households are more sensitive to inflation…energy and food prices are particularly salient… "Inflation has been above target for the best part of five years, and households and businesses are likely to be more sensitive to upside surprises…"
Swati Dhingra	3.75%	"In one scenario, we could see a more modest increase in energy prices which probably slows rather than derails disinflation... In another scenario, severe and longer-lasting constraints on oil and gas supply… could overwhelm orderly market adjustment. This could warrant a hold or increase in Bank Rate…" "[in the lower inflation scenario] I would expect to reduce Bank Rate, possibly quickly, over the rest of the year."
Alan Taylor	3.75%	"I think it…inappropriate to infer a directional shift from this meeting. Before events in the Middle East, the disinflation process was nearly complete" In a benign scenario, we might look through a milder shock… [but if] supply disruptions persist, the MPC faces a tougher policy trade-off between elevated inflation and even weaker activity. Given massive uncertainty around future energy prices, I currently see a high bar to hiking."

Source: BoE (March 2026 Monetary Policy Summary & Minutes) and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

The end of the week will bring a smattering of UK economic data. Perhaps of greatest interest, ahead of next Tuesday's flash UK PMIs release, the CBI's industrial trends survey for March will offer the first insights as to how this month's surge in wholesale energy prices has harmed the manufacturing sector. February's public finance statistics will provide a penultimate report on government borrowing in FY25/6, and a first since the Chancellor's Spring Statement. Public sector net borrowing is expected to slip back into its customary deficit in February, while January's record monthly surplus (£30.4bn) will also be watched for unfavourable revisions.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	ECB Deposit (Refinancing) Rate %	Mar	**2.00 (2.15)**	*2.00 (2.15)*	2.00 (2.15)	-
	Construction output M/M% (Y/Y%)	Jan	**-0.1 (-1.9)**	-	0.9 (-0.9)	0.7 (0.8)
	Final labour costs Y/Y%	Q4	**3.3**	*3.3*	3.3	3.4
UK	BoE Bank Rate %	Mar	**3.75**	*3.75*	3.75	-
	Average wages (excluding bonuses) 3M/Y%	Jan	**3.9 (3.8)**	3.9 (4.0)	4.2 (4.2)	- (4.1)
	Private sector regular wages 3M/Y%	Jan	**3.3**	3.5	3.4	-
	Unemployment rate 3M%	Jan	**5.2**	5.3	5.2	-
	Employment 3M/3M change 000s	Jan	**84**	-12	52	-
	Payrolled employees M/M change 000s	Feb	**20**	-10	-11	6
	Claimant count rate % (change 000s)	Feb	**4.4 (24.7)**	-	4.4 (28.6)	4.3 (4.7)

Auctions

Country	Auction
France	sold €3.901bn of 2.4% 2029 bonds at an average yield of 2.86%
	sold €2.499bn of 2.5% 2030 bonds at an average yield of 2.92%
	sold €4.201bn of 2.7% 2031 bonds at an average yield of 3.04%
	sold €1.798bn of 3.5% 2033 bonds at an average yield of 3.42%
	sold €395mn of 3.4% 2029 inflation-linked bonds at an average yield of 0.57%
	sold €393mn of 0.1% 2031 inflation-linked bonds at an average yield of 0.73%
	sold €383mn of 0.1% 2036 inflation-linked bonds at an average yield of 1.40%
	sold €230mn of 0.1% 2053 inflation-linked bonds at an average yield of 1.99%
Spain	sold €2.63bn of 2.6% 2031 bonds at an average yield of 2.934%
	sold €946mn of 2.55% 2032 bonds at an average yield of 3.079%
	sold €1.97bn of 3.3% 2036 bonds at an average yield of 3.476%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
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	*0.2*	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 (29)	-28 (26)

Auctions and events

Country	GMT	Event
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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