Euro wrap-up

Overview

- The global bond sell-off continued, with 10Y Bund yields rising above 3% for the first time since 2011, as investors fully priced three ECB rate hikes in 2026.
- Gilts again underperformed, with 10Y yields rising above 5% for the first time since 2008, as UK public finance data disappointed.
- The coming week will bring the flash PMIs and Spanish inflation data for March.

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Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.663	+0.081
OBL 2½ 04/31	2.762	+0.081
DBR 2.9 02/36	3.035	+0.082
UKT 4⅜ 03/28	4.563	+0.165
UKT 4⅛ 03/31	4.577	+0.131
UKT 4¾ 10/35	4.990	+0.150

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

Euro area

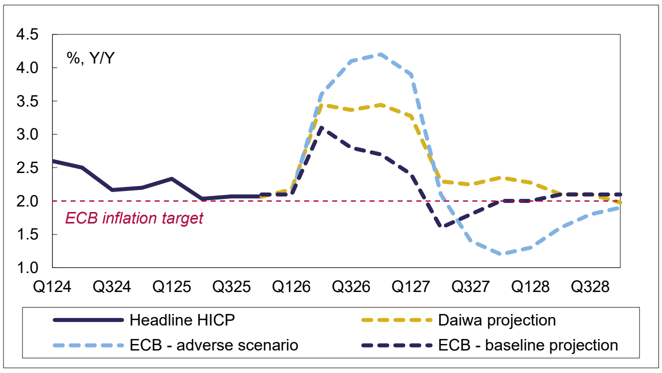
Market pricing of three ECB rate hikes by year-end looks appropriate as energy price shock hits

After the ECB yesterday set out key elements of its new policy reaction function for managing the impact of the shocks from the war with Iran, several Governing Council members today gave a further strong steer that a first rate hike is approaching. Among others, Bundesbank President Nagel noted that monetary tightening would be firmly on the table at the next policy meeting at end-April if the price outlook sours further. And Irish Governor Makhlouf reminded that up to two rate hikes are already assumed in the ECB's baseline projection, which factored in a lower path for energy prices than is embedded in current market pricing. Of course, the situation is dynamic. And many governments, including Spain's today, have announced fiscal measures to soften the blow of higher fuel prices and domestic energy bills. Like the ECB, however, we still expect energy inflation to rise into double digits in Q2. And given the additional uplift in wholesale energy prices since the ECB's cut-off date on 11 March, we think that energy inflation will remain higher for longer than the profile in the Governing Council's new baseline. As we also expect somewhat greater pass-through to food and services inflation, unless energy markets change course, we currently anticipate euro area inflation to be in a range of about 3-3½%Y/Y from March through to year-end, and peak a little above 3½%YY in early 2027. And we expect it to remain above the ECB's baseline projection through to mid-2028. As such, with the policy stance having been broadly neutral before the new shock, we are sympathetic with markets fully pricing in three rate hikes this year. Indeed, while we expect GDP to dip over the summer, we have pencilled-in a series of successive ECB rate hikes of 25bps apiece in April, June and July.

Euro area goods exports fell to a 15-month low at the start of the year

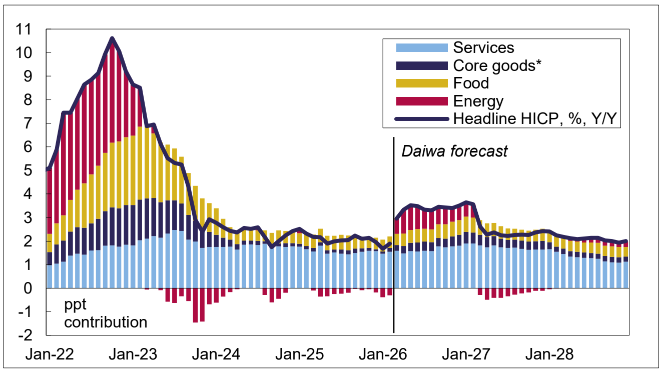
While the current macroeconomic data are of secondary importance to events in the Middle East, today's euro area trade report showed that, even before the war, goods shipments from the euro area started the year on the back foot. Indeed, the value of exports fell almost 2%M/M in January to a 15-month low, down more than 7½%Y/Y. While the annual rate was distorted by base effects as firms were seeking to front-run higher tariffs a year earlier, exports to the US fell to the lowest level in almost four years. Likely distorted by the timing of the Lunar New Year and payback for associated solid growth in December, exports to China dropped to a five-month low. Shipments to Japan, Switzerland and Turkey also fell sharply, while only the UK of the euro area's major trading partners outside of the EU bucked the trend. By good type, the weakness related to further declines in shipments of chemicals, machinery and transport. Notably, however, imports declined more sharply than exports in January (-2.8%M/M) to a 19-month low. So, the euro area goods trade surplus widened in January to €12.1bn, a three-month high. And overall, today's figures suggested that, ahead of the war, net trade likely provided modest support to euro area GDP growth at the start of the year. Of course, given the massive adverse terms of trade shock related to energy prices, the euro area's trade surplus will narrow markedly from March, with risks of a first deficit since 2023.

Euro area: HICP inflation & projections



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

Euro area: Contributions to HICP inflation



**Non-energy industrial goods*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

A key data focus in the coming week in the euro area will be several top-tier economic sentiment surveys for March and the first of the member state inflation estimates for the same month, which will provide a guide to the initial economic impact of the war in the Middle East. The European Commission’s preliminary consumer confidence index – due on Monday – might be expected to fall sharply, possibly to the lowest level in three years, as households fear another erosion of purchasing power. Most notably perhaps, the flash PMIs for March (due Tuesday) will take stock of business activity. While the PMIs in February signalled a slight pickup in growth momentum – the euro area manufacturing output index rose to a six-month high (51.9) and the services activity index (51.9) rose to a two-month high – this still left the composite PMI so far in Q1 tracking (51.9) a little more than ½pt below the Q4 average. Business conditions seem likely to have worsened this month. But the output indices might point to stagnation rather than contraction, with a more pronounced deterioration implied in the outlook for the coming 12 months. At the country level, the German ifo (Wednesday), French INSEE business and Italian ISTAT economic sentiment surveys (Thursday), which boast larger samples than the respective PMIs, will provide additional colour with respect to the early economic impact in the largest member states.

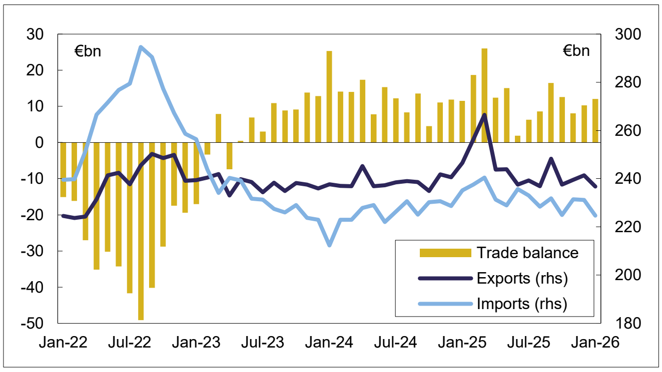
Having already risen to the highest level in almost three years, the price PMIs might be expected to signal renewed upward cost pressures on the back of the spike in wholesale energy prices. But the inflation highlight will be the flash March estimate from Spain (Friday). Given the marked increase in prices of auto fuel and heating oil so far this month – tracking some 10% and more than 30% above the February levels – and sharp declines a year ago, the headline HICP inflation rate might be expected to jump more than 1ppt from 2.5%Y/Y in February. Aside from the data, various Governing Council members are due to speak publicly in the coming week, including President Lagarde and Chief Economist Lane at the ECB Watchers’ Conference in Frankfurt on Wednesday.

UK

Middle East war pushing the public finances off track

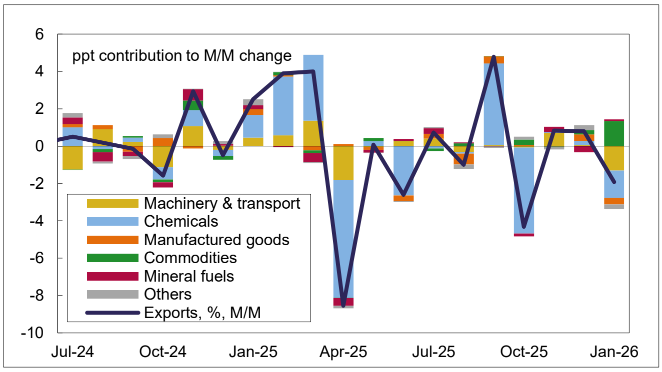
While monetary policy in the UK is already restrictive, with the inflation outlook transformed for the worse by the war in the Middle East, yesterday’s announcements from the BoE strongly suggested that its April MPC meeting will be live for a rate hike and that further tightening thereafter is also not a bad bet. But just as interest rates have now likely been shifted onto a new higher path, so too will public borrowing. Less than three weeks ago, the DMO announced its plan to cut Gilt issuance in FY26/7 by more than £50bn from the current fiscal year to a little more than £252bn. But the full extent of that reduction now looks very hard to achieve. The government has so far announced only modest extra spending (£50mn) to support

Euro area: Goods trade balance, exports & imports*



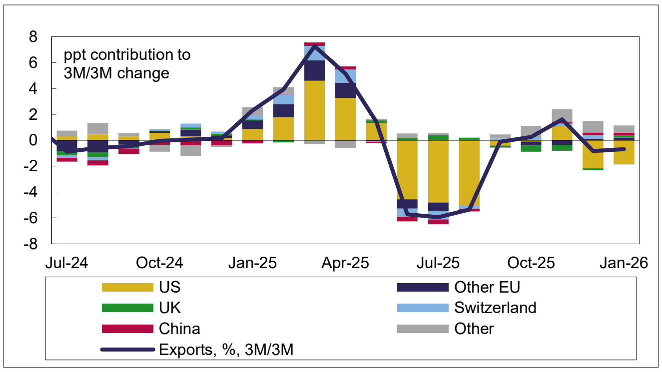
*Seasonally adjusted values.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Exports by good type



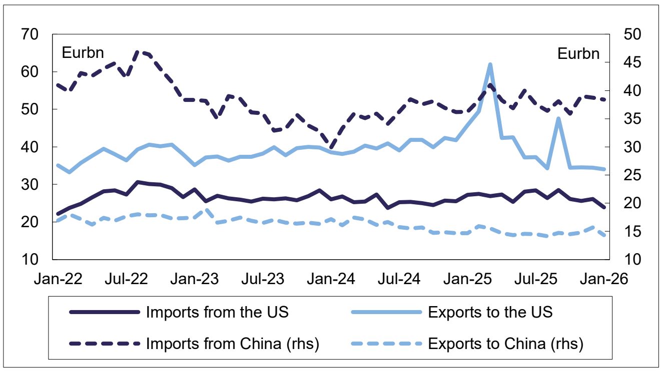
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Exports by destination



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Exports to/imports from US & China



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

households exposed to the spike in heating oil prices. But we expect larger-scale support to be forthcoming. The planned freeze in fuel duty might be expected to be extended beyond September when it is currently set to be gradually phased out, to reduce planned revenues by a little less than £1bn. There could be additional fiscal support to reduce petrol price pressures before then and/or restrain the steep increase in household energy bills (more than 15%) that is otherwise bound to come in July. Defence spending will be higher than otherwise planned. Weaker economic output will have consequences for welfare spending while also hitting the tax take. Higher inflation will add to public sector bills, via higher prices for goods, services and wages as well as higher interest payments on index-linked Gilts. And if sustained, the massive sell-off in all Gilts over recent days – which today pushed 10Y yields above 5% for the first time since 2008 – would add more than £2bn to debt interest costs.

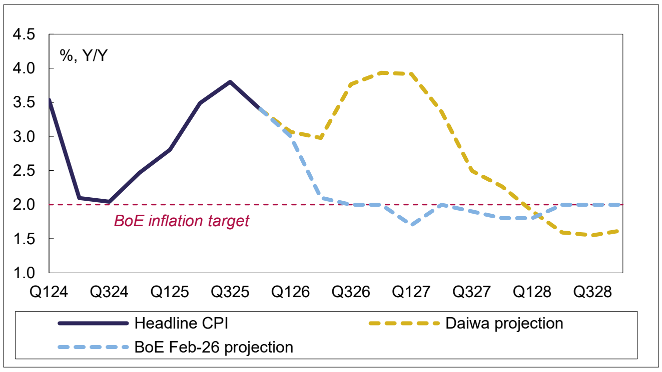
Record surplus in January was followed by higher-than-expected borrowing in February

After today's public finances data, the starting point for borrowing heading into this new shock also doesn't look quite as favourable as it did a month ago. While January's surprising monthly surplus was revised up by £1.5bn to £31.9bn, public sector net borrowing in February came in at £14.3bn, £5.5bn above the Bloomberg survey consensus and £2.2bn above the level a year earlier. That took borrowing in the first 11 months of FY25/6 to £125.9bn (about 4.1% of GDP), still nevertheless almost £12bn (or 8.7%) down on the same period of the prior fiscal year and broadly consistent with the OBR's latest projection. The current budget deficit in the fiscal year to-date reached £62.1bn, down £16.7bn (or 21.1%) from a year earlier. One reason for the lower borrowing compared to FY24/5 is policy. Indeed, central government receipts in February remained well up on a year earlier (9.3%Y/Y) thanks in part to the impact of fiscal drag on income tax revenues amid frozen thresholds as well as higher National Insurance contributions. But central government spending was also up sharply (9.6%Y/Y) with about two-thirds of that rise attributable to higher debt interest payments on linkers and other Gilts, and much of the remainder related to the impact of inflation on departmental spending and indexed benefit payments. Given the recent energy and bond market shifts, as well as UK political realities, public spending seems bound to be significantly higher than initially planned in the coming fiscal year too.

The week ahead in the UK

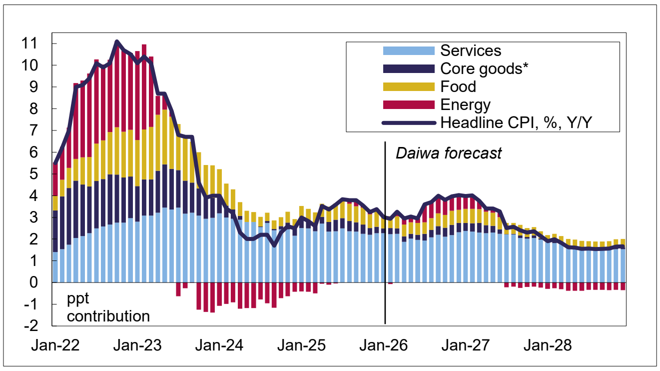
Like in the euro area, March sentiment surveys will take the spotlight in the UK's data calendar in the coming week, with the flash PMIs (Tuesday) the most notable. But like the initial response to the energy price shock in Spring 2022 in the wake of the Russian invasion of Ukraine, the March PMIs might still point to ongoing economic expansion at the end of Q1. In February, the manufacturing output index (52.5) jumped to a 17-month high in line with the long-run average, while the services index (53.9) implied solid growth. As such, the composite PMI (53.7) was tracking more than 2pts above the Q4

UK: CPI inflation & prjections



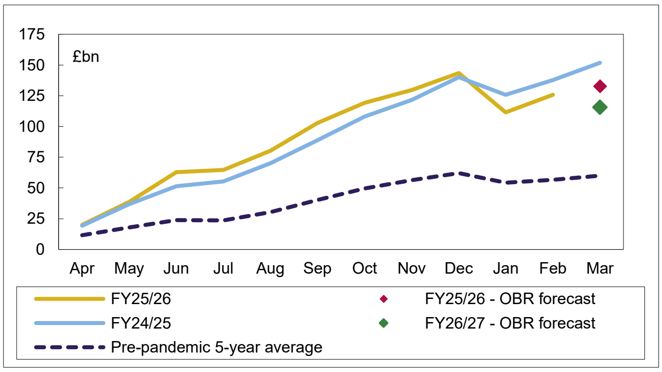
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Contributions to CPI inflation



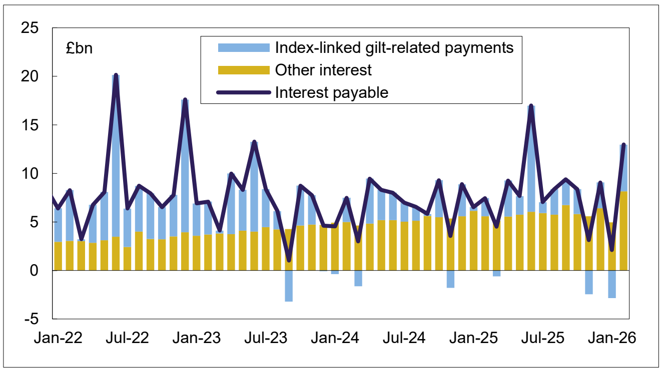
**Non-energy industrial goods.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Public sector net borrowing



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

UK: Central government debt interest payable



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

average, signalling a return to growth this quarter. Certainly, today's CBI industrial trends survey suggested no meaningful disruption from the impact of the war so far. While output was reportedly down in the three months to March, that was not significantly weaker than the average reading of the past six months. And production was expected to improve markedly in the coming three months as export orders rose to the highest level since July 2023. Nevertheless, the PMIs seem likely to show that firms are more downbeat about the near-term outlook amid higher cost burdens and therefore might also indicate an ongoing desire to reduce headcount. The GfK consumer survey (Friday) seems likely to show that, like in the euro area, the initial response of household confidence to the new shock was greater than that to business sentiment, with diminished expectations for near-term economic activity and pay growth likely to boost savings intentions and hit spending plans. More cautious consumption might also be reflected in the CBI's distributive trades indices (Tuesday), although this survey has provided a poor guide to retail sales growth over recent years.

While it has been superseded by recent events, the February CPI report (Wednesday) will give an update on inflationary pressures before the outbreak of the Iranian war. For what it is worth, we expect headline inflation to have slipped below 3%Y/Y in February for the first time in 11 months, due in part to favourable base effects in the energy and services components. But with non-energy industrial goods inflation expected to reverse the drop in January, core inflation likely moved sideways at 3.1%Y/Y. Other data due in the coming week include February retail sales figures (Friday), which are likely to show some payback for the surprisingly strong growth at the start of the year (1.8%M/M).

The next edition of the Euro wrap-up will be published on 24 March 2026

Daiwa economic forecast

	2025		2026						
	Q3	Q4	Q1	Q2	Q3	Q4	2025	2026	2027
GDP	%, Q/Q						%, Y/Y		
Euro area	0.3	0.3	0.2	0.0	0.1	0.2	0.6	1.0	1.5
UK	0.1	0.1	0.1	0.0	0.1	0.2	0.4	1.1	1.6
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.1	2.1	2.2	3.4	3.4	3.4	2.1	3.1	2.6
Core HICP	2.3	2.4	2.4	2.6	2.8	3.0	2.4	2.7	3.0
UK									
Headline CPI	3.8	3.4	3.1	3.0	3.8	3.9	3.4	3.4	3.0
Core CPI	3.6	3.3	3.1	2.7	3.1	3.3	3.5	3.1	3.0
Monetary policy, %									
ECB									
Deposit Rate	2.00	2.00	2.00	2.50	2.75	2.75	2.00	2.75	2.50
Refi Rate	2.15	2.15	2.15	2.65	2.90	2.90	2.15	2.90	2.65
BoE									
Bank Rate	4.00	3.75	3.75	4.25	4.25	4.25	3.75	4.25	3.75

Source: Bloomberg, ECB, BoE 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/ *Daiwa forecast*	Previous
			Monday 23 March 2026			
Euro area		15.00	Preliminary Commission consumer confidence indicator	Mar	-15.0	-12.2
			Tuesday 24 March 2026			
Euro area		05.00	New car registrations Y/Y%	Feb	-	-2.3
		09.00	Preliminary services (manufacturing) PMI	Mar	51.0 (49.4)	51.9 (50.8)
		09.00	Preliminary composite PMI	Mar	51.0	51.9
Germany		08.30	Preliminary services (manufacturing) PMI	Mar	52.5 (49.5)	53.5 (50.9)
		08.30	Preliminary composite PMI	Mar	52.2	53.2
France		08.15	Preliminary services (manufacturing) PMI	Mar	49.0 (49.3)	49.6 (50.1)
		08.15	Preliminary composite PMI	Mar	49.3	49.9
UK		09.30	Preliminary services (manufacturing) PMI	Mar	53.0 (50.3)	53.9 (51.7)
		09.30	Preliminary composite PMI	Mar	52.9	53.7
		11.00	CBI distributive trades survey –reported retail sales net balance %	Mar	-	-43
			Wednesday 25 March 2026			
Germany		09.00	ifo current assessment (expectations) indicator	Mar	86.1 (86.0)	86.7 (90.5)
		09.00	ifo business climate indicator	Mar	86.3	88.6
Spain		08.00	PPI Y/Y%	Feb	-	-2.9
UK		07.00	Headline (core) CPI Y/Y%	Feb	*2.9 (3.1)*	3.0 (3.1)
		07.00	PPI – output (input) prices Y/Y%	Feb	2.6 (0.3)	2.5 (-0.2)
		09.30	House price index Y/Y%	Jan	-	2.4
			Thursday 26 March 2026			
Euro area		09.00	M3 money supply Y/Y	Feb	3.2	3.3
Germany		07.00	GfK consumer confidence indicator	Apr	-28.0	-24.7
France		07.45	INSEE consumer confidence indicator	Mar	89	91
		07.45	INSEE business (manufacturing) confidence indicator	Mar	96 (101)	97 (102)
Italy		09.00	Istat consumer confidence indicator	Mar	95.5	97.4
		09.00	Istat business (manufacturing) confidence indicator	Mar	-	97.4 (88.5)
Spain		08.00	GDP – final estimate Q/Q% (Y/Y%)	Q4	*0.8 (2.6)*	0.6 (2.7)
			Friday 27 March 2026			
Euro area		09.00	ECB consumer expectations survey – 1Y (3Y) ahead CPI Y/Y%	Feb	2.8 (2.7)	2.6 (2.6)
Spain		08.00	Preliminary HICP (CPI) Y/Y%	Mar	3.8 (3.5)	2.5 (2.3)
UK		00.01	GfK consumer confidence indicator	Mar	-24	-19
		07.00	Retail sales – incl. auto fuels M/M% (Y/Y%)	Feb	-0.4 (2.3)	1.8 (4.5)
		07.00	Retail sales – excl. auto fuels M/M% (Y/Y%)	Feb	-0.7 (2.9)	2.0 (5.5)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions		
Country	GMT	Event / Auction
Monday 23 March 2026		
Euro area	16.00	ECB Chief Economist Lane gives speech on the European economy, Frankfurt
Tuesday 24 March 2026		
Germany	10.30	Auction: to sell up to €5bn of 2.5% 2031 bonds
UK	10.00	Auction: to sell £2.25bn of 4.75% 2035 bonds
	13.30	BoE Chief Economist Pill to give speech at conference on 'Central banking amid persistent global shifts'
Wednesday 25 March 2026		
Euro area	08.45	ECB President Lagarde to give keynote address at the opening of the ECB Watchers conference, Frankfurt
	09.15	ECB Chief Economist Lane to speak on monetary policy panel at the ECB Watchers conference, Frankfurt
	09.00	ECB to publish update to its wage tracker
Germany	10.30	Auction: to sell up to €1bn of 2.6% 2041 bonds
	10.30	Auction: to sell up to €1bn of 0% 2052 bonds
Italy	10.00	Auction: to sell up to €2bn of 2.2% 2028 inflation-linked bonds
	10.00	Auction: to sell up to €1bn of 1.1% 2031 inflation-linked bonds *
	10.00	Auction: to sell up to €1bn of 1.8% 2036 inflation-linked bonds
Thursday 16 March 2026		
UK	09.30	BoE Deputy Governor Breeden to participate in panel discussion on financial regulation & home ownership
	10.00	Auction: to sell £300mn of 5.375% 2056 bonds
	16.30	BoE's Greene to have a fireside chat at the PEI infrastructure global investor summit
	19.00	BoE's Taylor to give speech at a conference
Friday 27 March 2026		
Italy	10.00	Auction: to sell bonds*

**Details to be announced. Source: Bloomberg 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 current account €bn	Jan	**37.9**	-	14.6	-
	Trade balance €bn	Jan	**12.1**	-	11.6	-
Germany	PPI Y/Y%	Feb	**-3.3**	-2.7	-3.0	-
France	Final wages Q/Q%	Q4	**0.2**	*0.2*	0.3	-
UK	Public sector net borrowing £bn	Feb	**14.3**	8.8	-30.4	-31.9
	CBI industrial trends survey – total orders (selling prices) net balance %	Mar	**-27 (12)**	-30 (29)	-28 (26)	-
Auctions						
Country	Auction					
- Nothing to report -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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