

Euro wrap-up

Overview

- Bunds made gains as the final estimates of euro area inflation in March confirmed that the core rate fell to the lowest level in more than three years, albeit in part due to Easter effects.
- Despite gains at the longer end of the curve, gilts were little changed at the short end as a downside surprise to UK inflation in March similarly in part reflected the timing of Easter.
- On Thursday, the ECB will cut its Deposit Rate by 25bps to 2.25%, while President Lagarde will likely flag heightened economic uncertainties.

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Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	1.734	-0.025
OBL 2.4 04/30	2.049	-0.037
DBR 2½ 02/35	2.497	-0.033
UKT 3% 03/27	3.951	-0.001
UKT 4% 03/30	4.078	-0.028
UKT 4½ 03/35	4.593	-0.056

*Change from close as at 4:30pm BST.

Source: Bloomberg

Euro area

Euro area inflation in line with ECB expectations in Q1 to allow a further rate cut this week

Ahead of Thursday's ECB policy announcement, the final estimates of euro area inflation in March provided no major surprises. So, they will allow the Governing Council to respond to the rising downside risks to the growth outlook with a further 25bps cut in the Deposit Rate to 2.25%. Aligning with the flash estimate, the headline HICP inflation rate edged down 0.1ppt in March to a four-month low of 2.2%Y/Y, to leave the Q1 average (2.3%Y/Y) bang in line with the ECB's projection published in early March. While the core rate in Q1 (2.6%Y/Y) was marginally firmer than ECB staff had expected, it nevertheless fell 0.2ppt in March to 2.4%Y/Y, the lowest for more than three years. Despite a modest upwards revision from the flash release, the ongoing downtrend reflected the services component, which eased 0.2ppt to 3.5%Y/Y, the lowest since June 2022. Core goods prices remained well behaved (0.6%Y/Y), with an ongoing absence of inflationary pressures in a range of components including second-hand cars, furnishings and major appliances. And the pickup in inflation of food, alcohol and tobacco (2.9%Y/Y) was offset by a marked decline in energy inflation (down 1.2ppts to -1.0%Y/Y) as petrol prices and heating oil prices fell sharply.

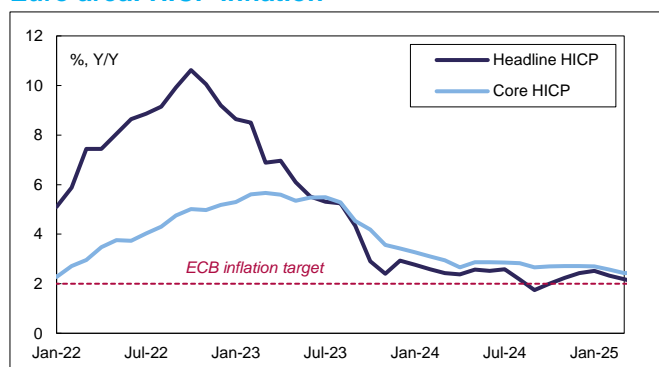
Services inflation flattered by timing of Easter

Admittedly, the detail on services inflation was somewhat less encouraging than the headline suggests, as it largely reflected base effects relating to the earlier timing of Easter last year. For example, inflation of package holidays fell 5ppts to the lowest since October 2021, and airfares fell the most in 16 months, while the annual rate for accommodation moderated to an 11-month low. Indeed, when excluding package holidays and accommodation, recreation services ticked slightly higher, while insurance costs also rose for the first month in four. Moreover, on a seasonally-adjusted basis, services momentum on a three-month basis ticked up in March to a five-month high (3.3%3M/3M annualised), while core momentum on a three-month basis was also the firmest since October (2.3%3M/3M annualised). Other measures of underlying inflation also picked up. The ECB's weighted median estimate rose 0.4ppt to 2.7%Y/Y, a touch above the average of the past 12 months, while the 15% trimmed mean rate also edged slightly higher (2.4%Y/Y). But the headline and core persistent and common component (PCCI) inflation estimates were steady (2.3%Y/Y and 2.1%Y/Y) respectively.

Inflation likely to fall to 2%Y/Y in April and remain sub-target over the forecast horizon

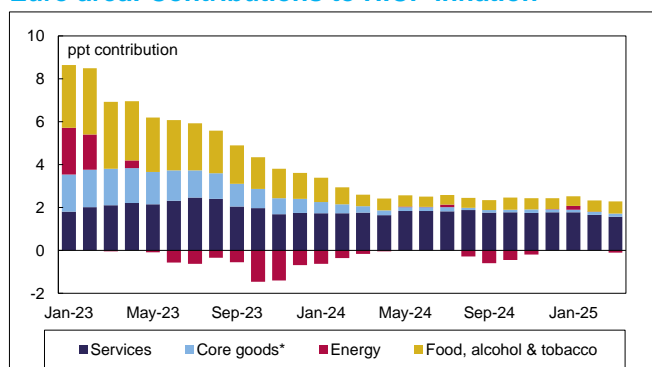
While we expect to see Easter-related upwards pressure on tourism-related prices in April, we forecast services inflation to merely move sideways this month, before taking another step down in May to around 2½%Y/Y. The weaker demand outlook in the face of heightened economic uncertainties, as well as the stronger euro exchange rate, will also weigh on goods prices

Euro area: HICP inflation



Source: 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.

over the near term, as will the prospect of an influx of cheap Chinese goods diverted from the US. As such, we expect core inflation to fall back below 2% by the end of this quarter and remain there through to at least end-2027. Indeed, our updated full-year forecasts of 1.6%Y/Y in 2026 and 2027 compare with the respective ECB March projections of 2.0%Y/Y and 1.9%Y/Y. The recent drop in the wholesale gas and oil prices will also see energy inflation provide a greater drag on headline inflation over the near term, with upwards pressure on food pressures also likely to dissipate gradually thanks in part to the stronger euro and lower energy prices. As such, we forecast headline inflation to fall back to the 2% target this month, before easing gradually further to around 1½%Y/Y in Q3. And we expect it to remain modestly sub-target over the horizon, averaging 1.9%Y/Y 2025 and 1.8%Y/Y in both 2026 and 2027. As such, in addition to tomorrow's easing of monetary policy, we continue to expect the Governing Council to cut rates by a further 25bps in June and once again in Q3, with additional easing on top of that possible in the event of US recession.

The day ahead in the euro area

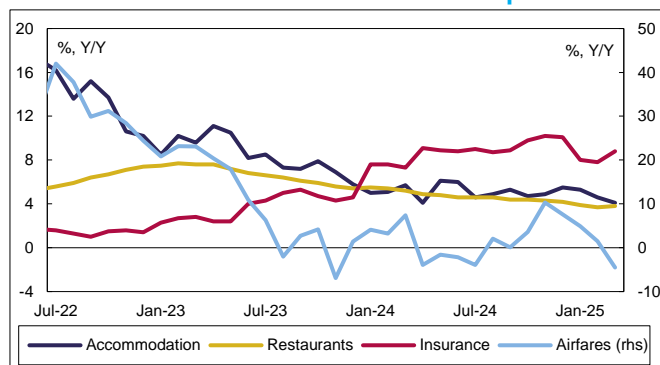
Thursday's Governing Council meeting will bring the first opportunity for the ECB to take stock of recent market volatility and the heightened economic uncertainty sparked by Trump's tariff policy. We, like the consensus, expect policy to be eased by a further 25bps, marking a sixth successive cut and taking the deposit rate to 2.25%, its lowest level in a little over two years. After March's cut brought policy in line with the upper bounds of recent estimates of neutral, the Governing Council was predictably non-committal about the prospects for further rate easing thereafter. And tomorrow's policy statement will no doubt repeat that future decisions will remain data dependent and taken on a meeting-by-meeting basis. But risks have certainly and decisively tilted to the downside. And while we will have to wait until June for the ECB's updated macroeconomic projections, in her press conference President Lagarde might acknowledge possible new disinflationary impulses from lower energy prices, the stronger euro and deteriorating confidence. For a further preview of tomorrow's ECB meeting, please refer to last week's [Euro wrap-up](#). German producer price indices for March are also due on Thursday.

UK

Inflation undershoots BoE forecast but softness largely due to Easter effects & non-core items

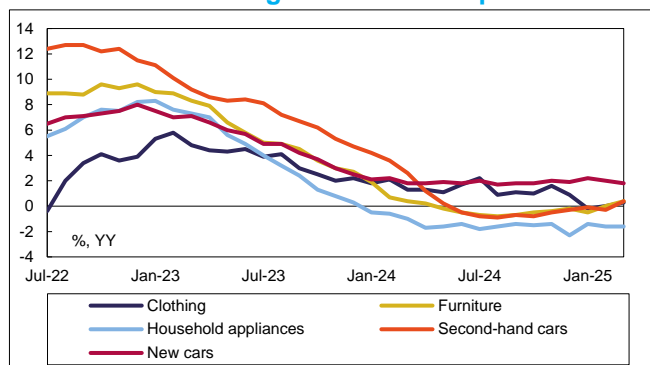
In line with our forecast but 0.1ppt below the consensus and 0.2ppt below the BoE's February Monetary Policy Report projection, headline CPI inflation fell 0.2ppt in March to a three-month low of 2.6%Y/Y. Also as we expected, the core CPI rate edged down 0.1ppt to 3.4%Y/Y, similarly the lowest since December. The improvement in the core measure reflected a drop of 0.3ppt in the services component to 4.7%Y/Y, 0.2ppt below the BoE's forecast. But that fall was largely due to lower inflation in vacation-related items including accommodation and package holidays. As those declines were likely primarily

Euro area: Selected services HICP components



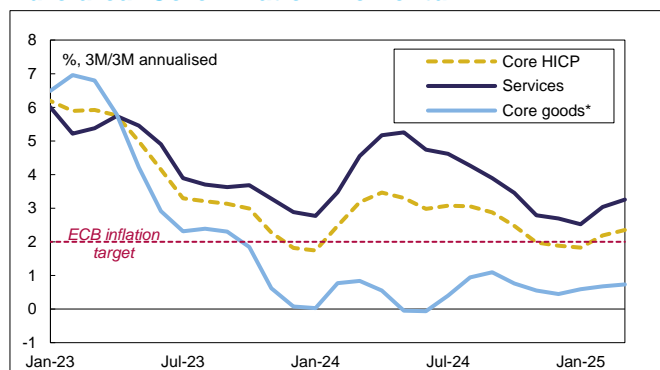
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected goods HICP components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

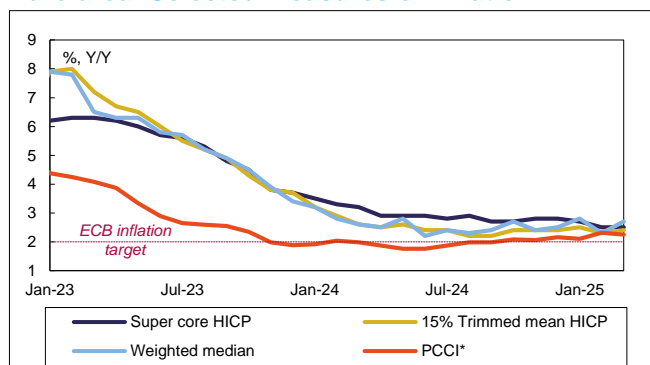
Euro area: Core inflation momentum



*Non-energy industrial goods.

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

Euro area: Selected measures of inflation



*Persistent and common component of inflation.

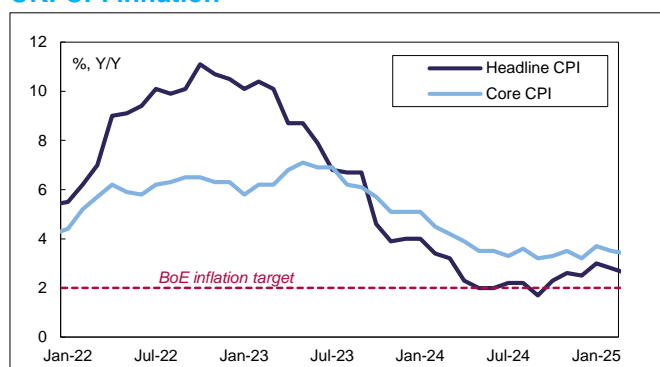
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

due to the early timing of Easter last year, we expect them to reverse more than fully in April. Among other services, the impact of lower insurance prices was offset by new pressures in entertainments. So, excluding indexed and volatile components such as rents and foreign holidays, a measure of underlying services inflation monitored by the BoE was merely unchanged at 4.4%Y/Y. Meanwhile, with higher inflation of clothes, footwear and furniture broadly offset by a softening in recreation goods, non-energy industrial goods inflation was also broadly steady at 1.1%Y/Y. However, goods items beyond the core contributed to the decline in headline inflation in March. A drop of 1.2%M/M in petrol prices almost fully reversed the prior month's hike. So, energy inflation fell more than 1ppt to a four-month low of -8.0%Y/Y. And with prices slightly lower on the month in contrast to the rise a year earlier, food inflation moderated 0.2ppt to a three-month low of 2.9%Y/Y.

BoE will need to revise down its inflation projection next month due to global developments

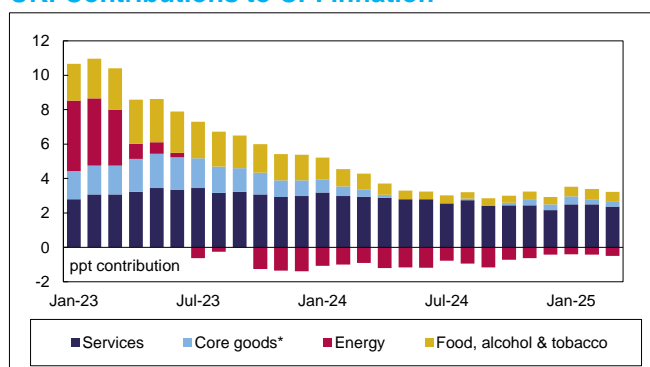
In addition to the temporary Easter effect on certain services components in April, several changes to regulated and indexed prices – not least sharp hikes to household energy and water tariffs – will push headline CPI inflation markedly higher to above 3¼%Y/Y this month. The unknown impact on prices – particularly in services – of increased employer NICs and minimum wages suggests additional non-negligible upside risks. But not least given lower petrol prices, which were already trending 1.8% below the March level in the first two weeks of the month, we expect the CPI rate to undershoot the BoE's

UK: CPI inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

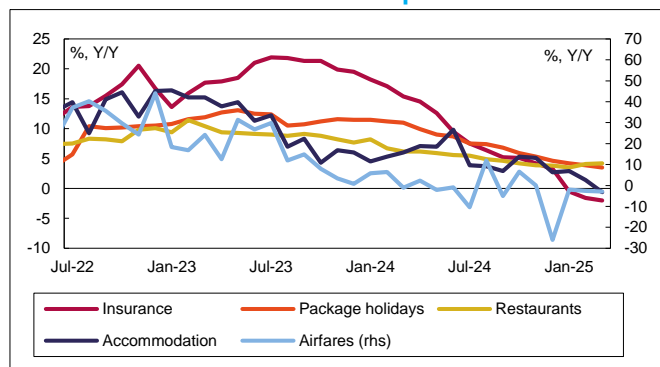
UK: Contributions to CPI inflation



*Non-energy industrial goods.

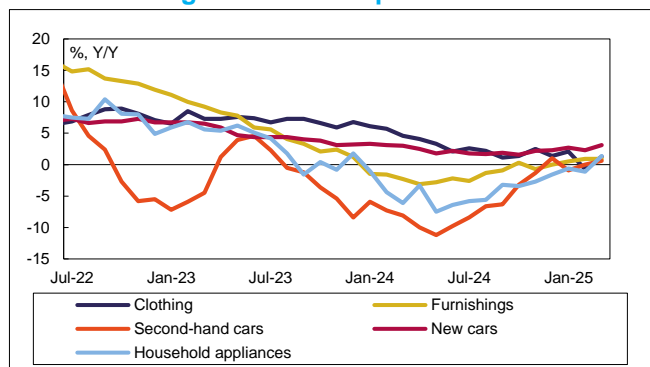
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected services CPI components



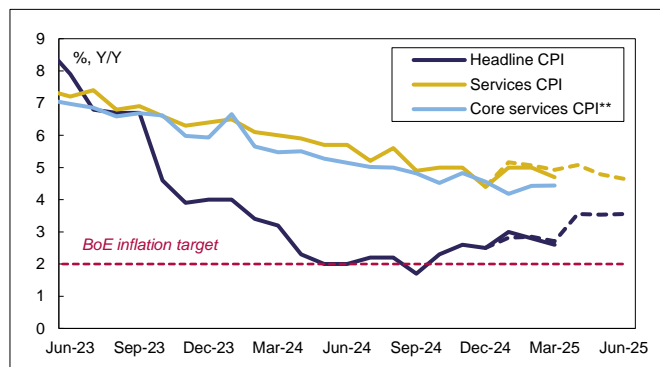
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected goods CPI components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

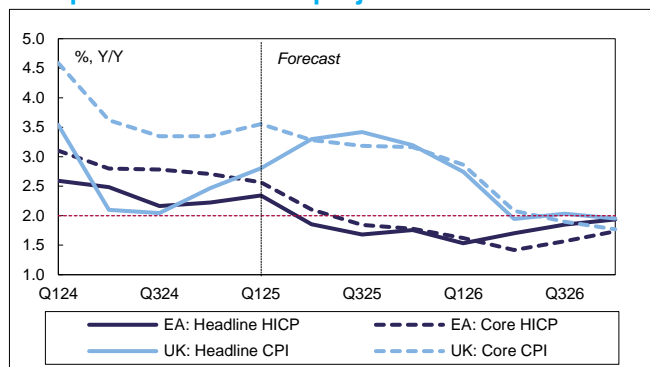
UK: Headline & services inflation*



*Dashed lines are BoE projections from May-25 MPR. **Services excluding indexed and volatile components, rents & foreign holiday measures.

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

Europe: Daiwa inflation projections



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

forecast of 3.6%Y/Y in April. Lower wholesale power prices also suggest that the Ofgem energy price cap will be cut significantly in July, probably more than reversing the April increase. With services momentum well down from the peak and likely to moderate further as the labour market continues to soften, commodity prices and weakening global demand likely to weigh on prices of a range of goods, and sterling firmer too, the BoE will revise down its inflation projection next month when it publishes its updated Monetary Policy Report. Indeed, we expect it to bring forward from mid-2027 to 2026 the date at which it projects inflation to return to the 2.0%Y/Y target. As such, we continue to expect the MPC to cut rates by 25bps next month and further by 25bps apiece in Q3, Q4 and Q126. And in the event of recession in the US and perhaps world-wide, the BoE would cut rates more aggressively than that.






The day ahead in the UK

While all eyes tomorrow will be on the ECB announcement, the day ahead in the UK will also bring the BoE's quarterly bank liabilities and credit conditions surveys for Q1. As well as providing insights into the strength of household and corporate credit demand in Q1, the update will report banks' expectations about the outlook for loan availability and demand for the coming three months. However, crucially, those assessments will have most likely been submitted by mid-March, prior to the subsequent rise in uncertainty and market volatility after Trump's Liberation Day announcement.




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%	Mar	2.2 (2.4)	<u>2.2 (2.4)</u>	2.3 (2.6)	-
	 Current account balance €bn	Feb	34.3	-	35.4	40.3
Italy	 Final HICP (CPI) Y/Y%	Mar	2.1 (1.9)	<u>2.1 (2.0)</u>	1.7 (1.6)	-
UK	 Headline (core) CPI Y/Y%	Mar	2.6 (3.4)	<u>2.6 (3.4)</u>	2.8 (3.5)	-
	 House price index Y/Y%	Feb	5.4	-	4.9	4.8



Auctions

Country	Auction
Germany	 sold €750m of 0% 2052 bonds at an average yield of 2.83%
	 sold €1.14bn of 2.9% 2056 bonds at an average yield of 2.9%
UK	 sold £1.5bn of 0.125% 2028 bonds at an average yield of 3.631%






Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	 13.15	ECB Deposit (Refinancing) Rate %	Apr	<u>2.25 (2.40)</u>	2.50 (2.65)
Germany	 07.00	PPI Y/Y%	Mar	0.4	0.7

Auctions and events

Euro area	 13.15	ECB monetary policy announcement
	 13.45	ECB President Lagarde holds post-Governing Council meeting press conference
France	 09.50	Auction: to sell up to €12bn of 2.4% 2028, 2.7% 2031 and 2% 2032 bonds
	 10.50	Auction: to sell up to €2bn of 0.6% 2034, 0.1% 2036, 0.55% 2039 and 0.1% 2053 inflation-linked bonds
UK	 09.30	BoE to publish quarterly Bank Liabilities and Credit Conditions surveys for Q125

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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