

Euro wrap-up

Overview

- Bunds made modest gains while final German inflation data confirmed a modest uptick on higher goods components and an investor survey pointed to economic recovery in early 2026.
- Gilts made gains as a soft UK labour market report bolstered expectations of a BoE rate cut in March.
- Wednesday will bring French and UK inflation estimates for January.

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Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.031	-0.004
OBL 2½ 04/31	2.326	-0.010
DBR 2.9 02/36	2.737	-0.015
UKT 3¾ 03/27	3.569	-0.001
UKT 4¾ 03/30	3.793	-0.012
UKT 4½ 03/35	4.373	-0.026

*Change from close as at 4:45pm GMT.

Source: Bloomberg

Euro area

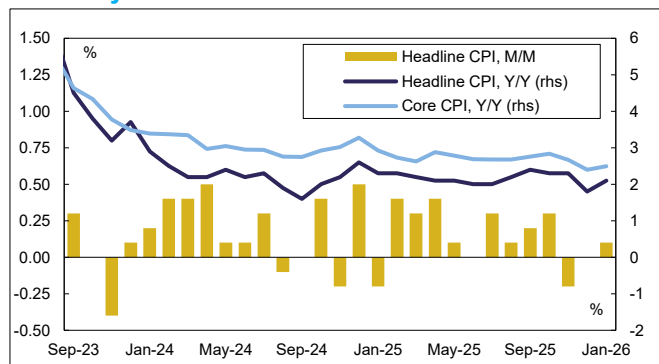
German inflation ticked up in January on higher core goods & food components

While the initial estimates of [euro area inflation](#) in January reported a softening in both the headline and core HICP rates, the opposite was true in Germany. And today's final German figures confirmed that inflation in the largest member state edged up at the start of the year. In line with the flash data, German inflation on the harmonised measure rose 0.1ppt to 2.1%Y/Y while the national CPI rate rose 0.3ppt, also to 2.1%Y/Y. In addition, core CPI edged up 0.1ppt to 2.5%Y/Y. The increase in the core rate occurred despite moderation in the services component, by 0.3ppt to 3.2%Y/Y, just 0.1ppt above the three-year low registered last summer. Despite an increase in the price of the "Deutschlandticket" and a higher contribution from airfares, transport services inflation slowed significantly. And an increase in the typically erratic package holiday component was offset by declines in other services components such as insurance, healthcare and hotels. While VAT in the sector was cut by 12ppts to 7%, however, inflation in restaurants and other catering establishments was unchanged. And with services pressures largely softer, the pressure on the core rate came from goods. Inflation of items such as clothing and footwear, textiles, appliances and jewellery were all higher. But, reflecting recent pressures on wholesale metals prices, only the latter was particularly firm. And inflation of cars fell to a 10-month low. Meanwhile, beyond the core items, food inflation jumped 1.3ppts to a four-month high of 2.1%Y/Y with continued pressures in sugar, chocolate, fruit and meat. In contrast, energy inflation fell 0.4ppt to a five-month low of -1.7%Y/Y. Lower household energy bills thanks to a cut to electricity transmission and gas storage charges more than offset higher prices of auto fuels, which in part reflected increased carbon pricing.

ZEW survey reported signs of German economic recovery, with outlook remaining positive too

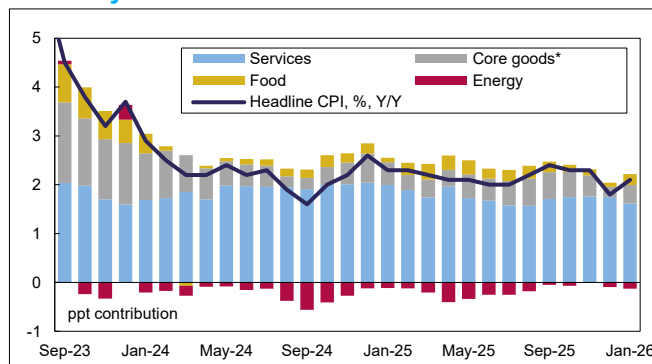
Consistent with the improving business sentiment presented by the PMIs and ifo indices, the ZEW's February investor survey suggested that the German economy has "entered a phase of recovery". Indeed, the survey's current conditions index rose for a second month in February to -65.9, a seven-month high and some 12pts above the average of the past two years. Admittedly, this remained well below the long-run average (-14.6), with roughly two-thirds of survey respondents still judging the business situation to be "bad", emphasising that Germany's revival remains "fragile". Nevertheless, investors judged the outlook for the coming six months to be broadly rosy. Certainly, the modest decline in the respective index in February (down 1.3pts to 58.3) was from a 4½-year high in January and remained comfortably above the long-run average. And while significant structural challenges in the manufacturing sector remain, near-term prospects for export-oriented subsectors are perceived to have improved markedly since the start of the year, as suggested by the recent surge in new [factory orders](#). Signs of stabilisation in the labour market and positive growth in real incomes are judged to have boosted the profit outlook for retailers and services too. And investor confidence in German constructors remained buoyed by a gradual upturn in the housing market and the government's fiscal pledges to boost spending on infrastructure.

Germany: CPI inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: CPI inflation & contributions



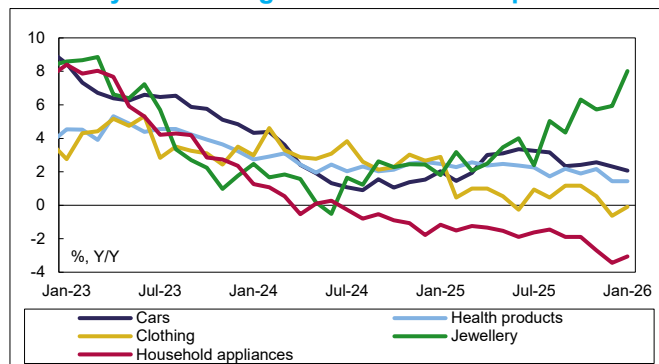
*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

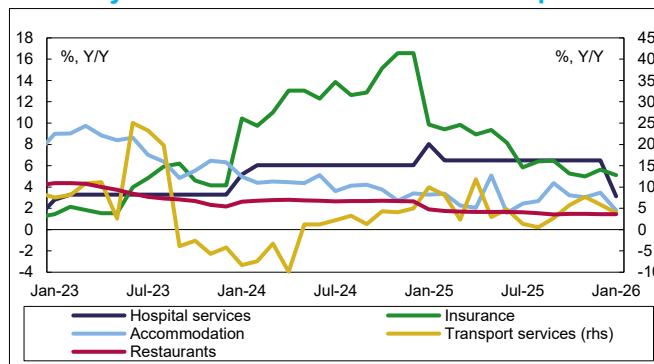
The day ahead in the euro area

Final January inflation estimates from France will be the main draw of Wednesday's euro area data. Though already tracking significantly below most of its peers, the flash release surprised to the downside, with headline French HICP inflation easing a further 0.3ppt to 0.4%Y/Y, a more than five-year low. As energy base effects are set to take hold from February, some of that softness should be temporary. But we expect much of the detail to prescribe January's softness to core components, with goods in particular weaker given significant effects from seasonal discounts in clothing. Indeed, INSEE noted in its press release that weakness was likely exaggerated by the inclusion of 18 sales days during the collection period, versus 13 last year. Services inflation, however, was also reportedly its weakest for four years, down 0.3ppt to 1.8%Y/Y.

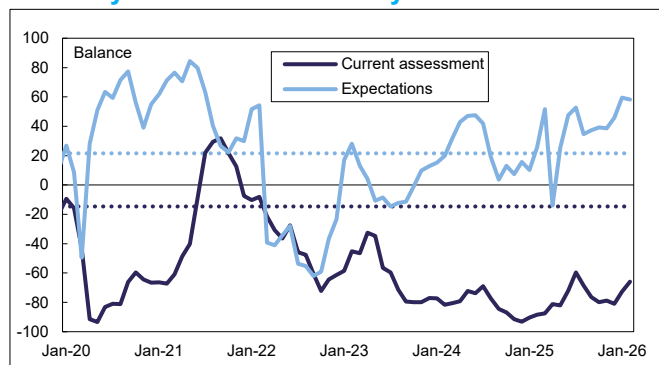
Germany: Selected goods inflation components



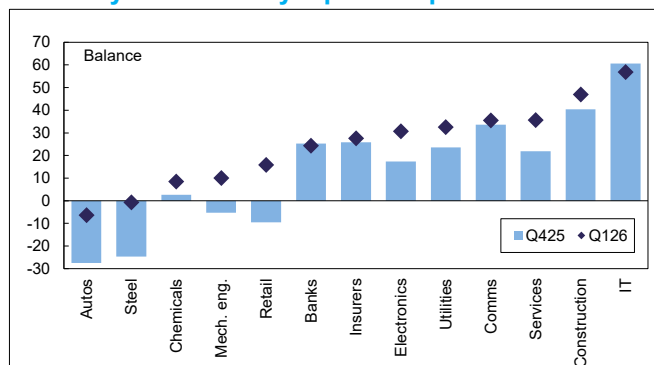
Germany: Selected services inflation components



Germany: ZEW investor survey indices*



Germany: ZEW survey – profit expectations*



UK

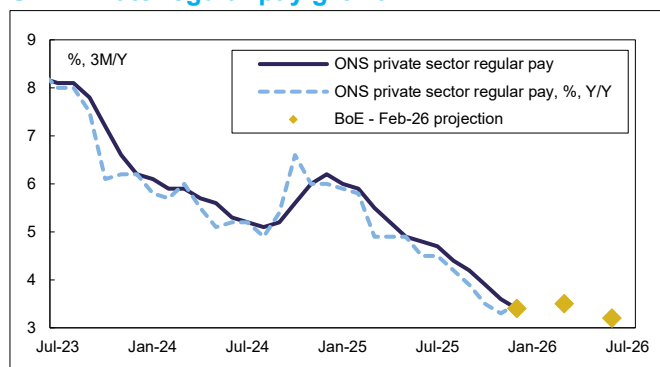
Private regular pay back in line with the long-run average, supporting a March rate cut

While the [BoE](#) kept interest rates unchanged at its policy meeting earlier this month, the MPC's 5-4 vote split was closer than expected. Moreover, against the backdrop of a downwards revision to the BoE's inflation outlook and plenty of evidence of dissipating inflation persistence, the policy statement suggested that two of the five MPC members backing the status quo – including Governor Bailey – were close to supporting a rate cut. So, coming on the back of last week's soft [Q4 GDP](#) report, today's soft labour market data bolstered our view that the Bank will cut rates next month by 25bps to 3.50%. Indeed, if and when it comes, that further monetary easing is likely to be long overdue. Certainly, the headline wage figure for the three months to December came in weaker than expected, slowing 0.7ppt over the quarter to 4.2%3M/Y, a 16-month low. Encouragingly too, in the private sector, total pay growth moderated a further 0.9ppt from three months earlier to 3.5%3M/Y, the softest rate in more than five years. Moreover, excluding bonuses, private sector regular pay – the BoE's preferred measure – slowed to 3.4%3M/Y, bang in line with the long-run average, therefore far more consistent with achievement of the 2% inflation target over the medium term. The single-month numbers suggest that the trend in regular pay in services (down 2.2ppts over the past year to 3.9%Y/Y) will ease further over coming months, while base effects on public wage growth will also become more favourable. And while certain MPC members, including Chief Economist Pill, remain concerned about the still-elevated nature of forward-looking wage indicators, the annual update from the Bank's Agents suggested that settlements point to a further slowdown in wage growth over the coming year, as rising labour slack has been keeping a lid on wage demands.

Unemployment rate hits a five-year high, while job growth maintains downtrend

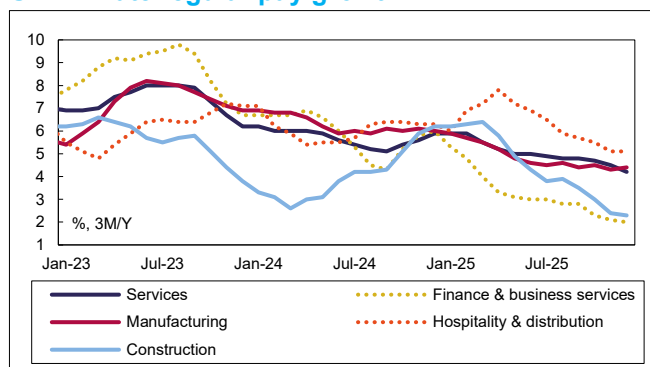
At face value, signals on labour demand remain somewhat mixed. The ONS's LFS measure of total employment rose for the second month in the three in December, by 52k3M/3M. But this was more than fully accounted for by part-timers, while full-time employment fell for a fourth month. And with inactivity down to a four-year low, the unemployment rate rose 0.2ppt over the quarter to 5.2%3M, a five-year high 0.8ppt above the level a year earlier and a touch above the BoE's projection for end-2025. Indeed, the single-month unemployment rate (5.4%) matched the highest in more than a decade. Furthermore, the provisional HMRC PAYE estimate of jobs growth fell in January for a fourth successive month (-11k). While this series has subsequently been revised higher from the flash release in the prior 10 months, it still left the number of payrolled employees down 134k over the past year. This weakness broadly tallies with signals from the employment PMI of ongoing cuts to headcount at the turn of the year. And the redundancy rate has ticked up to the highest level since 2013 outside of the pandemic lockdown period. While the number of job vacancies appears to have stabilised over recent months, the ratio of vacancies to unemployed was unchanged at 0.39, well below the long-run average and suggesting the largest amount of labour slack in over a decade outside of the pandemic period.

UK: Private regular pay growth



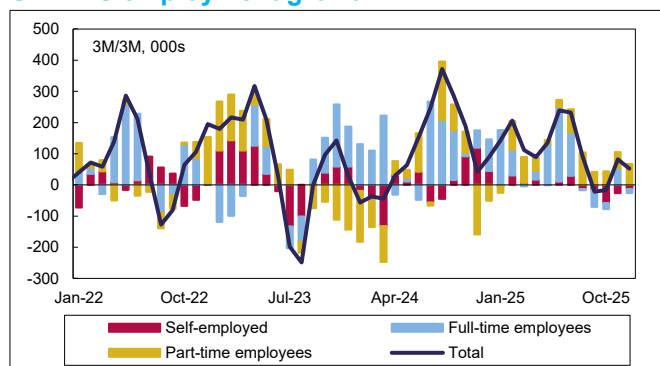
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private regular pay growth



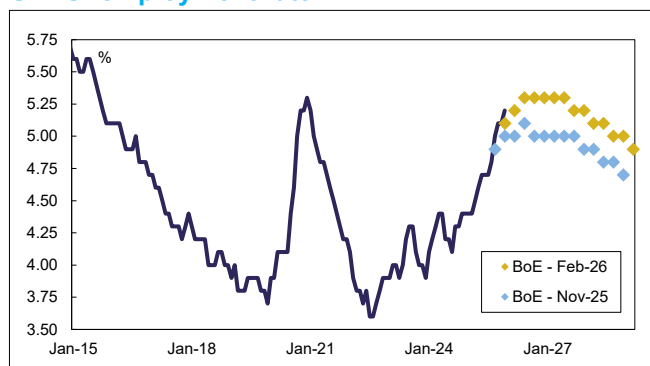
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: LFS employment growth



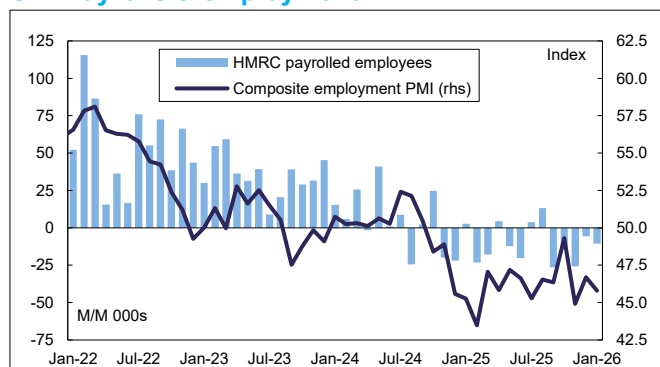
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Unemployment rate



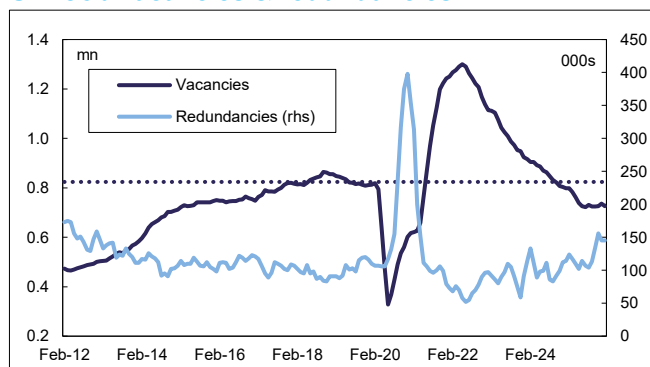
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolls & employment PMI



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

UK: Job vacancies & redundancies



Source: Macrobond and Daiwa Capital Markets Europe Ltd.










The day ahead in the UK

While, all other things being equal, today's labour market data appeared supportive of the case for a March rate cut by the MPC, tomorrow's UK inflation report will also be of particular significance as the only official data point for prices before the next policy meeting. Headline CPI inflation is widely expected to take a step down at the start of Q1. And the BoE's latest macroeconomic projections suggest that it expects that softness to be broad-based too. Indeed, we expect a more pronounced moderation in services inflation to reflect the earliest effects of policy changes announced in Budget 2024 – such as last January's VAT increase on private school fees – falling out of the year-over-year comparison. Despite potential warnings from some surveys, the BoE also expects a weaker impulse from food inflation compared to last January. Favourable base effects and lower petrol prices should also translate into a decline in energy inflation, despite a 0.2%Q/Q uptick in the Ofgem energy price level cap that month. Overall, the BoE anticipates a ½ppt moderation in the annual headline CPI rate, to a ten-month low of 2.9%Y/Y. That estimate is on the softer side of Bloomberg's consensus survey. Like the median estimate, we expect a slightly smaller moderation to 3.0%Y/Y. We see core inflation, meanwhile, easing just 0.1ppt to 3.1%Y/Y, but note that the risks to that figure are firmly to the downside.




European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Final HICP (CPI) Y/Y%	Jan	2.1 (2.1)	<u>2.1 (2.1)</u>	2.0 (1.8)	-
	 ZEW current situation (expectations) balance	Feb	-65.9 (58.3)	-65.9 (65.2)	-72.7 (59.6)	-
UK	 Average wages (excluding bonuses) 3M/Y%	Dec	4.2 (4.2)	4.6 (4.2)	4.7 (4.5)	4.6 (4.4)
	 Private sector regular wages 3M/Y%	Dec	3.4	<u>3.4</u>	3.6	-
	 Unemployment rate 3M%	Dec	5.2	5.1	5.1	-
	 Employment 3M/3M change 000s	Dec	52	108	82	-
	 Payrolled employees M/M change 000s	Jan	-11	-20	-43	-6
	 Claimant count rate % (change 000s)	Jan	4.4 (28.6)	-	4.4 (17.9)	4.3 (2.7)
	 Output per hour Y/Y%	Q4	-0.5	-	1.1	1.0





Auctions

Country	Auction
Germany	 sold €4.59bn of 2.1% 2028 bonds at an average yield of 2.02%
UK	 sold £500mn of 0.125% 2028 bonds at an average yield of 3.336%
	 sold £750mn of 4.25% 2032 bonds at an average yield of 3.952%


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
France	 07.45	Final HICP (CPI) Y/Y%	Jan	<u>0.4 (0.3)</u>	0.7 (0.8)
UK	 07.00	Headline (core) CPI Y/Y%	Jan	<u>3.0 (3.1)</u>	3.4 (3.2)
	 07.00	PPI – output (input) prices Y/Y%	Jan	2.9 (0.3)	3.4 (0.8)
	 07.00	House price index Y/Y%	Dec	-	2.5

Auctions and events

Germany	 10.30	Auction: to sell up to €5.5bn of 2.9% 2036 bonds
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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