

# Euro wrap-up

## Overview

- Bunds followed USTs slightly lower, while French inflation dropped to the lowest rate since 2020.
- Gilts were little changed as UK inflation eased to a ten-month low in January, but underlying services inflation remained sticky.
- Thursday will bring the Commission's flash February consumer confidence index, preliminary Q4 job vacancy and labour costs and December construction output data from the euro area.

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### Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.041	+0.009
OBL 2½ 04/31	2.332	+0.006
DBR 2.9 02/36	2.737	+0.001
UKT 3¾ 03/27	3.567	-0.004
UKT 4¾ 03/30	3.797	+0.002
UKT 4½ 03/35	4.372	-0.002

\*Change from close as at 5:00pm GMT.

Source: Bloomberg

## Euro area

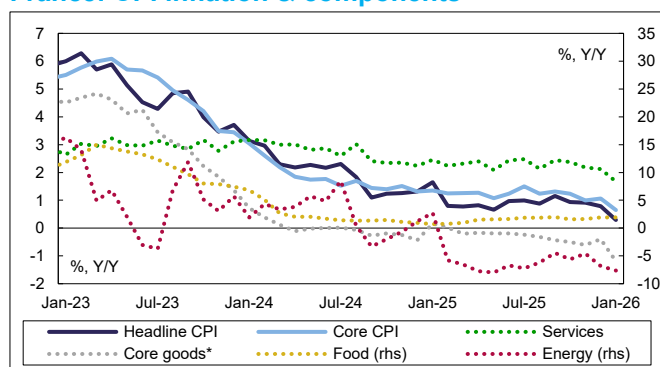
### French inflation drops to lowest level since 2020 & will remain well below target this year

While yesterday's data confirmed that German inflation rose back above the ECB's 2%Y/Y target at the start of the year, today's figures confirmed that French inflation fell below ½%Y/Y in January to the lowest level since 2020. As suggested by the flash estimates, French inflation on the EU-harmonised HICP measure dropped 0.3ppt to 0.4%Y/Y, a rate that is likely to have been the lowest of all euro area member states. Moreover, the national CPI rate fell a chunkier 0.5ppt to just 0.3%Y/Y. The detail on that CPI measure showed a 0.4ppt moderation in the services component to 1.7%Y/Y, the lowest in more than four years. In part, that reflected the government's decision not to repeat last year's hike in medical consultation fees, and so healthcare services inflation fell a steep 2.3ppts to -0.3%Y/Y. But other services such as social care, recreation and mobile phone charges were also significantly softer as were air and bus fares. But those for hospitality and insurance picked up. Core goods inflation also fell sharply, by 0.8ppt to -1.2%Y/Y, the weakest in almost nine years. Admittedly, that was likely exaggerated by the extended discounting period compared with last year, which weighed significantly on the clothing, textiles and home furnishings. But, as a result, core CPI inflation fell 0.4ppt to just 0.7%Y/Y, the softest since mid-2021. In terms of the non-core items, energy price deflation intensified to -7.6%Y/Y thanks to lower electricity prices and a smaller increase in petrol prices than a year earlier. A duty-related base effect also contributed to a drop in tobacco inflation. But food inflation ticked up 0.2ppt to 1.9%Y/Y. Looking ahead, French inflation will take a step back up in February due to a highly unfavourable base effect related to the cut of more than 12% in regulated electricity prices a year earlier. However, with the labour market having weakened steadily and wage growth now soft, underlying price pressures should remain absent. And so, while inflation in Germany is likely to remain close to target, inflation in France is set to average less than 1½%Y/Y once again this year.

### The day ahead in the euro area

A handful of top-tier data releases are scheduled for the euro area on Thursday. Of greatest interest will perhaps be the Commission's flash consumer confidence reading, which will give an early indication as to whether last month's improvement in household sentiment (up 0.8pt to an 11-month high of -12.4) was sustained. With respect to activity, we expect December's construction activity data to show that the sector enjoyed a better end to last year than manufacturing. Indeed, the available member state data point towards a pickup of around ¾%M/M, led by rebounds in Germany (3.0%M/M) and France (2.2%M/M). Such a gain would leave construction output some ½% higher than its level from Q3 too, consistent with a positive contribution to GDP growth last quarter. Finally, preliminary euro area job vacancies and labour cost data for Q4 will provide an update on labour market conditions which should be of interest to the ECB.

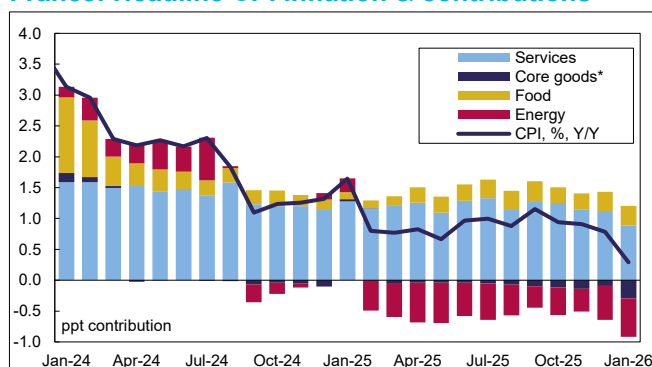
### France: CPI inflation & components



\*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### France: Headline CPI inflation & contributions



\*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

## UK

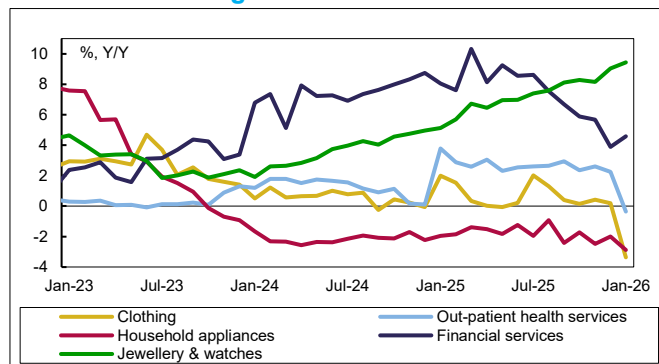
### UK inflation eases to a 10-month low, led by decline in food, energy and other goods prices

As was widely expected, today's UK data confirmed a chunky drop in inflation at the start of the year, with the headline CPI rate declining 0.4ppt to 3.0%Y/Y in January. While a touch firmer than the BoE's projection presented earlier this month, this still marked the softest reading in ten months and was down 0.8ppt from last summer's peak. So, after yesterday's soft [labour market](#) report, today's inflation figures reaffirmed our expectation that a majority on the MPC will support a 25bps rate cut at the Bank's next policy-setting meeting on 19 March. Admittedly, the decline in January was led by non-core components, with inflation of food, alcohol and tobacco down 0.9ppt to 3.8%YY, a ten-month low and weaker than the Bank had expected. In particular, inflation of such items that added significantly last year – e.g. meat, chocolate and coffee – continued to slow. In addition, despite the Ofgem electricity tariff increase, the energy component fell 1½ppts to 0.2%Y/Y, with declining gas and auto fuels prices accounting for roughly 0.14ppt of the monthly drop in headline CPI inflation. But non-energy industrial goods inflation (0.8%Y/Y) was also the softest in 15 months, with downwards pressure from discounted sporting equipment and toys and games, while cheaper EV models weighed on inflation of new cars. And despite a smaller-than-expected moderation in services inflation (down 0.1ppt to 4.4%Y/Y), core inflation eased to 3.1%Y/Y, the softest since September 2021.

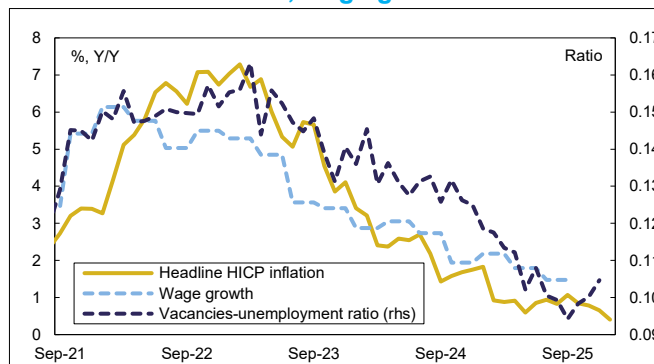
### Base effects push services inflation lower, but underlying price pressures tick higher

Given the increase in the weight of services in the CPI basket in January (by 2ppts to 52%), its contribution to headline inflation was unchanged on the month at 2.3ppts. And the hawks on the Committee might also point to the non-negligible impact of one-off factors in driving the slight moderation in that component last month. Certainly, there was a significant negative base effect on education as the introduction of VAT on private school fees fell out of the annual calculation, while indexation of certain items, such as rents, was smaller than a year ago. Air fares also declined to a greater extent than a year ago. So, when excluding indexed and volatile components, rents and foreign holidays, a measure of underlying services inflation often cited by the BoE jumped 0.5ppt to 4.5%Y/Y, the highest since December 2024. Admittedly, part of this uptick related to a likely temporary boost to inflation of cinema and theatre tickets last month, while medical and motor insurance premiums also edged higher. And, for the majority on the MPC, we suspect that the ongoing moderation in pay and weakness in jobs growth will outweigh concerns of stickiness in underlying services inflation. Certainly, smoothing for annual base effects, services momentum on a six-month annualised basis fell close to 3½%, while headline inflation momentum eased close to 2%, the lowest since 2024.

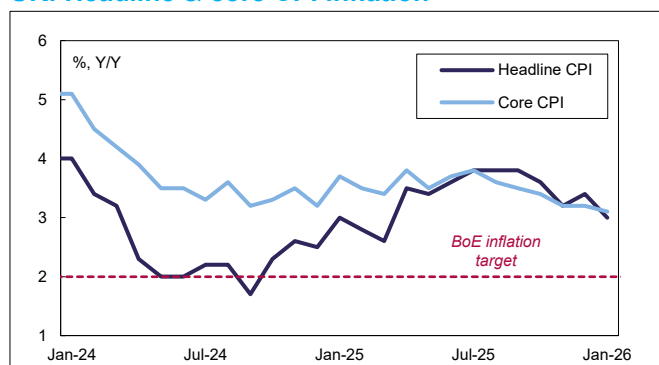
#### France: Selected goods & services CPI inflation



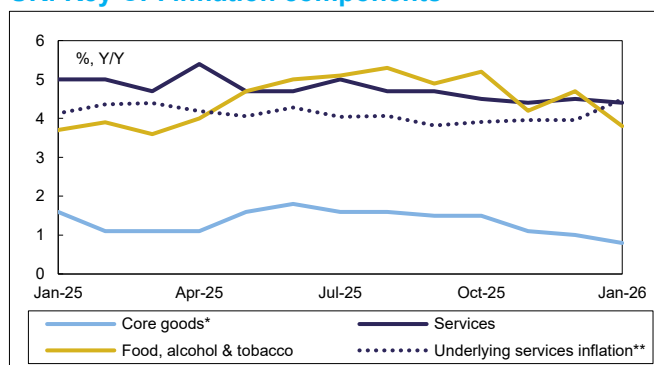
#### France: HICP inflation, wage growth & V-U ratio



#### UK: Headline & core CPI inflation



#### UK: Key CPI inflation components



\*Non-energy industrial goods. \*\*Excluding indexed & volatile components, rents & foreign holidays. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

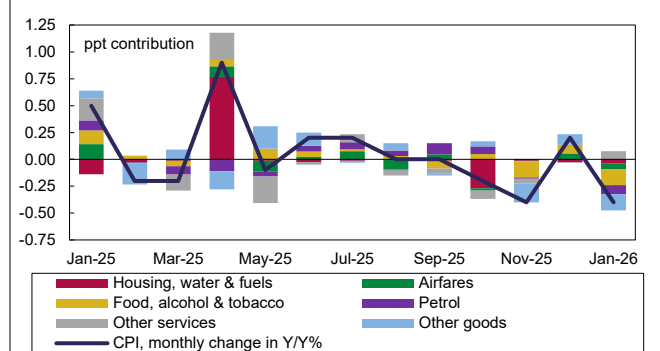
## Inflation to fall close to 2.0%Y/Y target in April, supporting at least two more rate cuts this year

Looking ahead, inflation will take a further substantial step down in April due to Budget-related measures and base effects on certain administered prices. Indeed, we expect services inflation to drop close to 3½%Y/Y in April, after which we expect it to move broadly sideways for the remainder of the year. The government's energy bills package and the expected cut in the Ofgem household energy cap in Q2 (due to be announced on 25 February) might see energy inflation fall by more than 5ppts in April. We expect food inflation to maintain a steady downtrend over coming months too as the impact of last year's spike in prices continues to fade. And continued subdued domestic demand should ensure that core goods inflation remains largely absent too. As such, like the BoE, we forecast headline inflation to fall sharply in April to 2.2%Y/Y, before returning to 2.0%Y/Y in 2027 and falling further to slightly below target in 2028. As such, after easing next month, we continue to expect the MPC to cut Bank Rate again in Q226 to 3.25%. And one further cut by the end of the year cannot to be ruled out if economic growth continues to undershoot expectations and the labour market weakens significantly further.

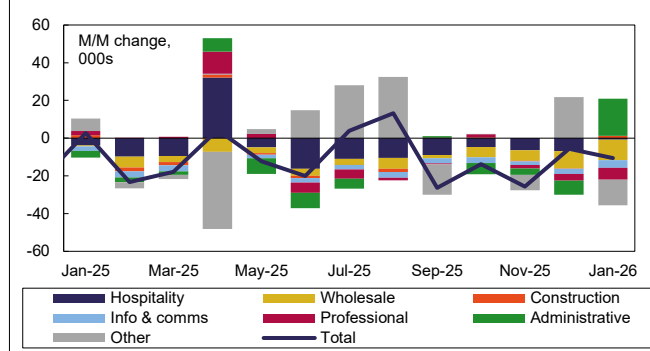
## The day ahead in the UK

As the focus in the UK shifts towards February's flash PMIs and January's retail sales data due on Friday, tomorrow will bring a brief pause to the flow of top-tier UK economic data. Thursday's sole release – the CBI's industrial trends survey – should nevertheless provide insights into conditions in the manufacturing sector ahead of the flash PMIs.

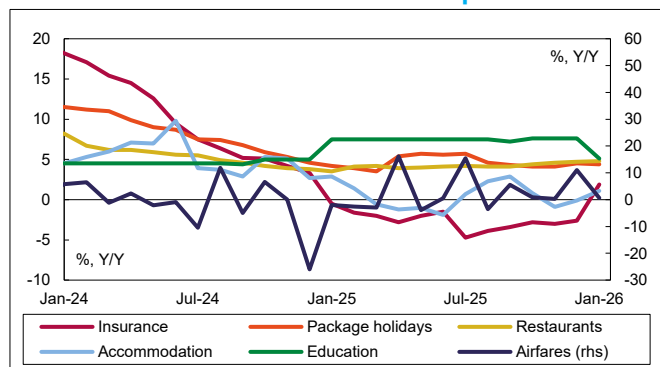
### UK: Contributions to change in headline inflation



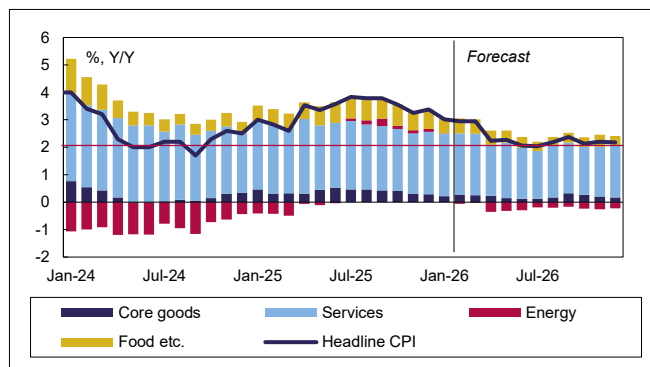
### UK: Change in payrolled employees by sector



### UK: Selected services inflation components



### UK: CPI inflation forecast







\*Non-energy industrial goods.


# European calendar

## Today's results

### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
France	 Final HICP (CPI) Y/Y%	Jan	<b>0.4 (0.3)</b>	<u>0.4 (0.3)</u>	0.7 (0.8)	-
UK	 Headline (core) CPI Y/Y%	Jan	<b>3.0 (3.1)</b>	<u>3.0 (3.1)</u>	3.4 (3.2)	-
	 PPI – output (input) prices Y/Y%	Jan	<b>2.5 (-0.2)</b>	2.9 (0.3)	3.4 (0.8)	3.1 (0.5)
	 House price index Y/Y%	Dec	<b>2.4</b>	-	2.5	2.8








### Auctions

Country	Auction
Germany	 sold €4.238bn of 2.9% 2036 bonds at an average yield of 2.73%





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Tomorrow's releases

### Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	 09.00	ECB current account balance €bn	Dec	-	8.6
	 10.00	Preliminary Commission consumer confidence indicator	Feb	-11.7	-12.4
	 10.00	Construction output M/M% (Y/Y)	Dec	-	-1.1 (-0.8)
	 10.00	Preliminary labour costs Y/Y%	Q4	-	3.3
	 10.00	Preliminary job vacancy rate %	Q4	-	2.2
France	 -	Retail sales Y/Y%	Jan	-	-1.0
UK	 11.00	CBI industrial trends survey – total orders (selling prices) net balance %	Feb	-28 (23)	-30 (29)

### Auctions and events

Euro area	 09.00	ECB to publish Economic Bulletin 1/2026
France	 09.50	Auction: to sell up to €13.5bn of 2.4% 2029, 2.7% 2031 & 2% 2032 bonds
	 10.50	Auction: to sell up to €1.5bn of 3.15% 2032, 0.6% 2034 & 1.8% 2040 inflation-linked bonds
Spain	 09.30	Auction: to sell 3.5% 2029, 2.6% 2031 & 3.3% 2036 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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