Euro wrap-up

Overview

- Despite some soft data from the region, euro area govvies sold off again as markets priced increased risks of an ECB rate hike this year due to the energy shock.
- Gilts also made significant losses as signs of easing business price expectations ahead of the war in the Middle East have now been overtaken by events.
- Friday will bring German factory orders figures for January and updated euro area Q4 GDP data.

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Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.249	+0.124
OBL 2½ 04/31	2.498	+0.131
DBR 2.9 02/36	2.850	+0.101
UKT 4⅜ 03/28	3.811	+0.113
UKT 4⅛ 03/31	4.040	+0.115
UKT 4¾ 10/35	4.552	+0.114

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

Euro area

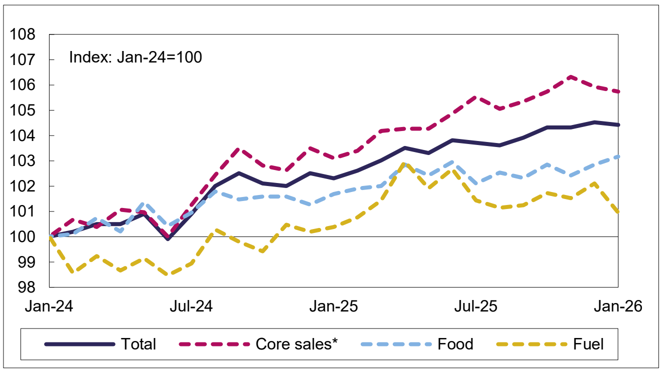
Retail sales edge down in January & at risk of drop in Q1 following events in Iran

Euro area retail sales volumes have risen in each quarter since Q423. But after an underwhelming start to 2026 and the risk of a pullback this month in response to the war in the Middle East, today's data flagged the possibility of a drop in retail sales in Q1. In line with our expectation, euro area retail sales volumes fell a minimal 0.1%M/M in January following upwardly revised growth of 0.2%M/M in December to be little changed from the Q4 average. Sales of food, drinks and tobacco rose for a second successive month and by 0.3%M/M. But sales of core items (i.e. excluding food and fuel) fell for the second month and by 0.2%M/M. The negative headline growth figure principally reflected a sharp drop of 1.1%M/M in sales of auto fuel, in part likely reflecting inclement weather. And among the member states it reflected a pullback in Germany (-0.9%M/M) from strength in December, while sales volumes rose in each of the other five largest member states. While consumer confidence edged up in February to a 14-month high, it seems bound to weaken over the near term as higher energy prices erode growth in real incomes, and economic uncertainty and associated precautionary savings rise. Higher prices of auto fuel will also deter driving. Admittedly, with the euro area unemployment rate down at the start of the year to a series low and increases in wholesale energy prices still less marked than after the Russian invasion of Ukraine, we do not expect retail sales and broader consumer spending to fall precipitously over the near term. A pullback in sales this month could well push their growth over Q1 as a whole into negative territory. And sales in Q2 will certainly hinge on how events pan out in the Gulf.

Despite bounce back in January, French IP no stronger than in Q4 as Spanish output disappoints

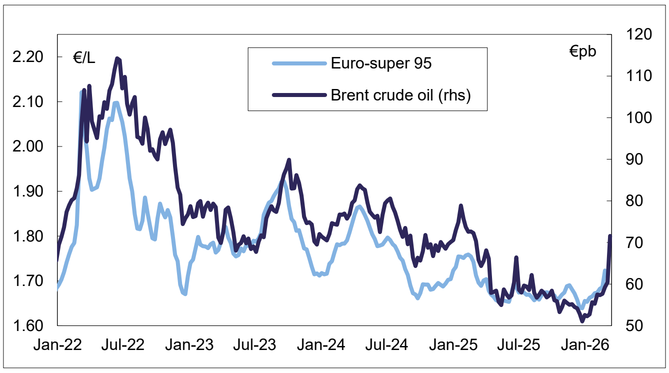
Today's French output data for January also broadly aligned with expectations, with industrial production (0.5%M/M) fully reversing the decline in December but construction activity (-1.4%M/M) seemingly impacted by bad weather. The bounce back in manufacturing was led by the aerospace subsector, which pushed transport equipment output (excluding autos) up a whopping 19.1%M/M, back in line with the average level in the second half of 2025. Machinery production also rose to a seven-month high, tracking more than 4% above the Q4 average. But car manufacturing again weakened, declining a striking 5.8%M/M to a 13-month low. And, overall, given the negative carry-over from the end of last year, the overall level of industrial output was no stronger than in Q4. To make matters worse, the INSEE survey suggested that business conditions had already deteriorated in February. Meanwhile, despite positive momentum from Q4, construction output in January was also tracking a touch below the Q4 average. So, even before the outbreak of war and the associated energy shock, French manufacturing and construction looked set to provide little support to GDP growth this quarter. Elsewhere, Spanish industrial production also disappointed in January, falling for a second month to the lowest level in a year. And the downturn would have been steeper still in the absence of further growth in energy production. Indeed, Spanish manufacturing output fell 1.4%M/M on broad-based weakness in intermediate, capital and consumer goods, to the lowest level since August 2024,

Euro area: Retail sales volumes



*Excl. food and fuel. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Weekly Brent crude oil* & petrol prices



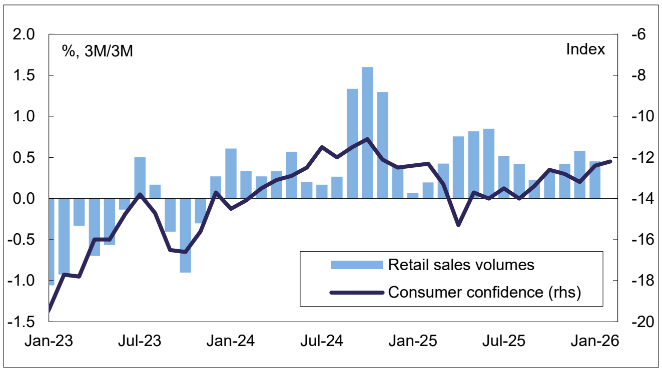
*Latest figure for Brent crude oil is based on current price.
Source: Macrobond, Bloomberg and Daiwa Capital Markets Europe Ltd.

some 3% below the Q4 average. And overall, all recent data point to a slowdown in Spanish GDP growth in Q1 to no more than half the 0.8%Q/Q rate last quarter, suggesting the weakest quarter in almost three years.

Construction PMIs point to strong German civil engineering & recovery in French & Italian housing

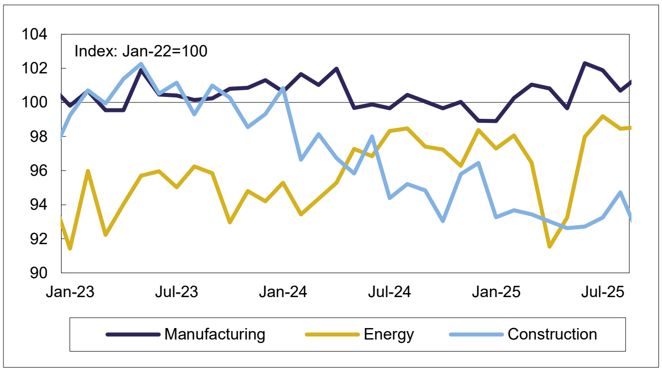
Today's construction PMIs for February signalled a mixed performance in the sector across the member states. At face value, the headline German activity PMI (43.7) disappointed, falling to a four-month low and signalling ongoing contraction. But this reflected very weak house-building and commercial work, which survey respondents partially attributed to severe wintery conditions. Admittedly, new orders also remained soft. But the index for German civil engineering (52.7) pointed to solid expansion for the sixth month out of the past seven. And while civil engineering indices were much softer in France and Italy – a more than three-year and eight-month low respectively – house building picked up in both member states. Overall, while contrasting the findings of the INSEE survey, the French construction activity index rose to a six-month high (43.9) in February, tracking some 1.5pts above the Q4 average albeit still well below the long-run trend. And the Italian PMI (50.4) was the highest in four months, some 3pts above the historical average.

Euro area: Retail sales & consumer confidence



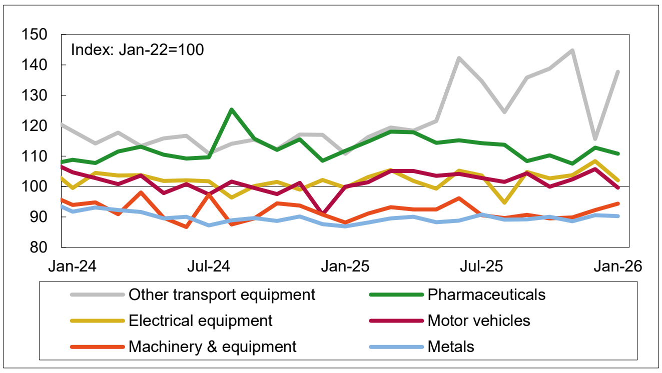
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

France: Industrial & construction output



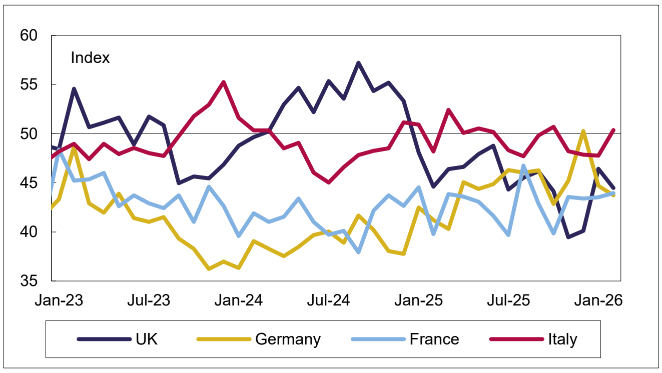
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Manufacturing output, by subsectors



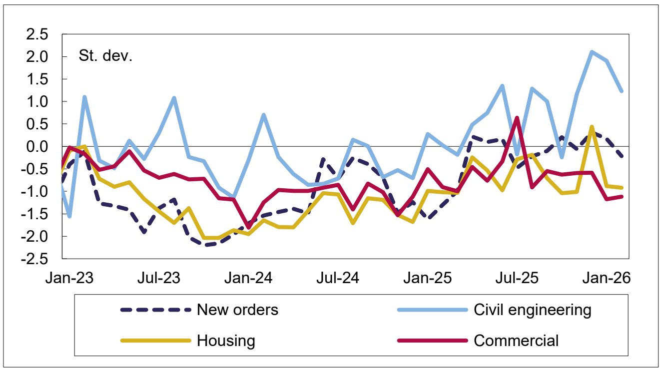
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Europe: Headline construction activity PMIs



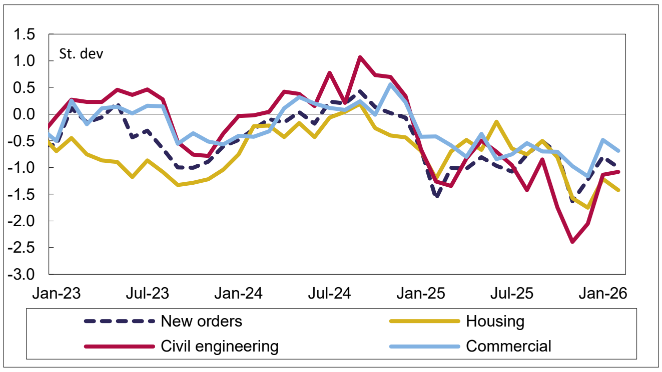
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Construction activity PMIs, by subsector



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

UK: Construction activity PMIs, by subsector



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

The day ahead in the euro area

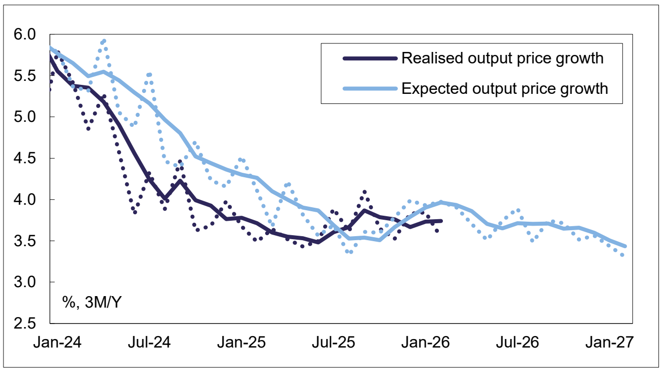
Friday's European dataflow brings an update on German factory orders. While the ifo and PMI surveys have so far flagged a further improvement in demand for German manufactured goods this year, January's orders appear primed to receive temporary but sizeable payback for their recent significant strength. Indeed, new factory orders rose in each of the last four months of 2025, and by a cumulative 18%, following another sizable boost in December (7.8%M/M) from defence-related orders. The other highlight of Friday's dataflow will be the third and final estimates of euro area Q4 GDP growth. Their release will confirm that euro area growth momentum held up at the end of last year, with earlier estimates pointing towards another quarter of growth of 0.3%Q/Q (0.347%Q/Q to three decimal places). The final Irish estimate today was revised down significantly to -3.8%Q/Q, and so an upwards revision to 0.4%Q/Q now looks unlikely. Still, of most interest will be the first official expenditure breakdown, which should confirm that the expansion was domestically driven. Household spending, government consumption and capital spending – the latter boosted by a surge in public investment in Germany, as well as the other three largest member states – each offering support. Net trade, at very best, was likely negligible.

UK

Signs of easing business price expectations won't sway the BoE to cut amid new inflation risks

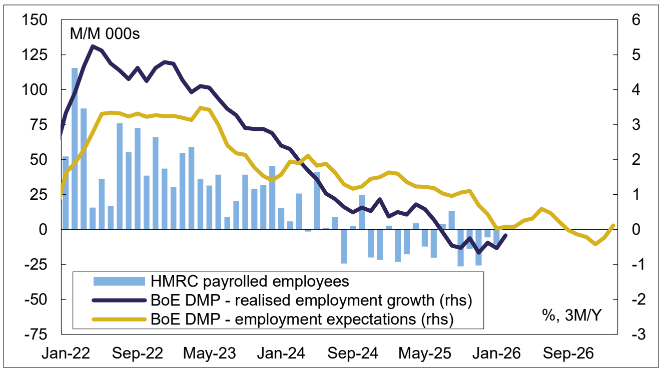
Had February's DMP survey arrived without the interjection of this week's events in the Middle East, it probably would have reinforced expectations of a BoE rate cut in two weeks' time. Indeed, output inflation expectations for the year ahead continued their steady downtrend in February, falling on a three-monthly basis to the weakest level since September 2021 (3.4%3M/Y). And within the detail, there were signs of convergence in firms' recent and future price growth intentions too. Year-ahead wage growth expectations also gave little cause for concern while indicators for employment growth remained consistent with weak labour demand. Medium-term CPI expectations were also unmoved (2.7%Y/Y) and, although year-ahead CPI expectations were nudged slightly higher, they failed to reverse the marked fall in January. Of course, all of this is now history. The MPC will surely be concerned that events in the Middle East will shift both inflation outcomes and inflation expectations significantly higher. Indeed, if current wholesale energy prices are sustained over coming weeks, inflation would likely decline only to around 2½%Y/Y in Q2, roughly ½ppt more than the BoE previously thought. And given the likelihood of a sharp rise in the Ofgem household energy price cap in July, and risks of pass-through to core and food prices too, it would likely move back up to around 3%Y/Y or more by September. The next DMP survey results will give an indication of how businesses expect CPI and their own prices and wages to evolve.

UK: DMP output price growth and expectations



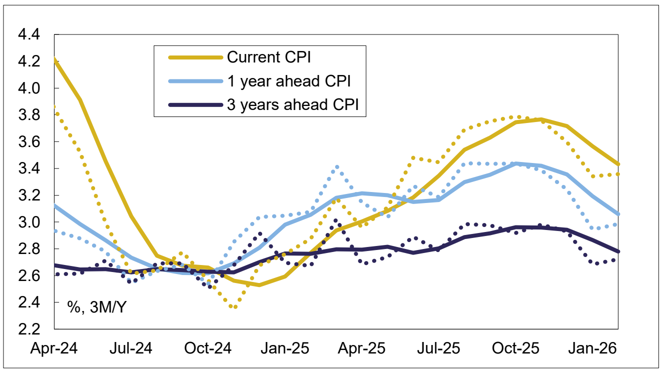
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employees & DMP employment



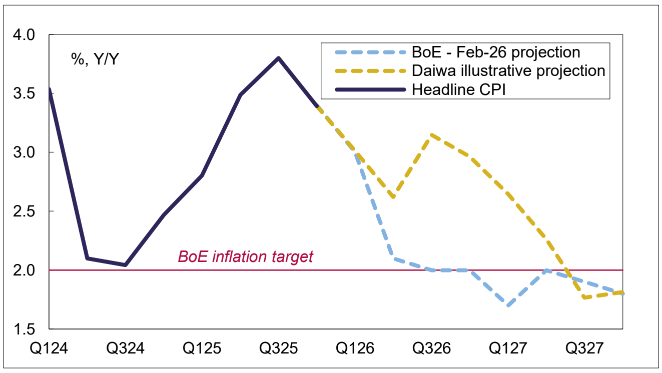
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: DMP – Firms' CPI inflation expectations*



**Dotted lines show single month Y/Y figures.*
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: CPI inflation projections



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

House building disrupted by wet weather, but civil engineering boosted by public projects

After some signs of recovery at the start of the year, today's UK construction PMIs signalled renewed weakness in February, contrasting the expansion implied by the equivalent services and manufacturing surveys. In particular, the headline construction activity index fell 1.9pts to 44.5, the fourteenth successive 'contractionary' reading. Admittedly, this still left it tracking more than 4pts above the Q4 average. And, while orders remained subdued, constructors noted that the weakness last month was exacerbated by exceptionally wet weather. Residential building (37.0) remained the weakest performing subsector, with the respective index little improved from the slump in Q4. This added to evidence of a stalling in the housing market at the end of last year, which seems likely to persist in the face of heightened global economic uncertainties and price pressures. But while commercial work also moderated last month, it was still trending notably higher than in Q4. Encouragingly too, a further recovery in civil engineering to a five-month high left the index on track to reverse the near-8pt drop in Q4. And, linked to forthcoming new infrastructure and energy projects, construction firms – ahead of the escalation in the Middle East and energy shock – were the most optimistic about the outlook for the year ahead since the start of 2025.

The day ahead in the UK

No top-tier data releases or events are slated on Friday, so it should be a quieter end to the week for UK economic news.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Retail sales M/M% (Y/Y%)	Jan	**-0.1 (2.0)**	*-0.1 (2.0)*	-0.5 (1.3)	0.2 (1.8)
	Construction PMI	Feb	**46.0**	-	45.3	-
Germany	Construction PMI	Feb	**43.7**	-	44.7	-
France	Industrial production M/M% (Y/Y%)	Jan	**0.5 (2.4)**	0.4 (2.3)	-0.7 (1.7)	-0.5 (1.6)
	Construction PMI	Feb	**43.9**	-	43.5	-
Italy	Retail sales M/M% (Y/Y%)	Jan	**0.6 (2.3)**	-	-0.8 (0.9)	-0.7 (1.1)
	Construction PMI	Feb	**50.4**	-	47.7	-
Spain	Industrial production M/M% (Y/Y%)	Jan	**-0.4 (0.3)**	0.5 (1.1)	-2.5 (-0.3)	-2.4 (-)
UK	DMP 3M output price (1Y CPI) expectations Y/Y%	Feb	**3.4 (3.0)**	3.4 (2.8)	3.5 (2.9)	-
	Construction PMI	Feb	**44.5**	47.0	46.4	-
	New car registrations Y/Y%	Feb	**7.2**	-	3.4	-

Auctions

Country	Auction
France	sold €6.455bn of 3.5% 2035 bonds at an average yield of 3.39%
	sold €2.696bn of 1.25% 2036 bonds at an average yield of 3.46%
	sold €2.015bn of 2.5% 2043 bonds at an average yield of 3.94%
	sold €2.283bn of 4.1% 2046 bonds at an average yield of 4.04%
Spain	sold €1.80bn of 2.35% 2029 bonds at an average yield of 2.398%
	sold €2.33bn of 3% 2033 bonds at an average yield of 2.859%
	sold €1.21bn of 3.5% 2041 bonds at an average yield of 3.605%
	sold €592mn of 1.15% 2036 inflation-linked bonds at an average yield of 1.292%
UK	sold £3.5bn of 4% 2029 bonds at an average yield of 3.81%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Economic data					
Euro area	10.00	GDP – final estimate Q/Q% (Y/Y%)	Q4	*0.3 (1.3)*	0.3 (1.4)
	10.00	GDP – household consumption Q/Q%	Q4	0.4	0.2
	10.00	GDP – government spending Q/Q%	Q4	0.5	0.7
	10.00	GDP – fixed investment Q/Q%	Q4	0.8	0.9
	10.00	Employment – second estimate Q/Q% (Y/Y%)	Q4	*0.2 (0.6)*	0.2 (0.6)
Germany	07.00	Factory orders M/M% (Y/Y%)	Jan	-4.1 (13.2)	7.8 (13.0)
Spain	08.00	INE house price index Q/Q% (Y/Y%)	Q4	-	2.9 (12.8)
Auctions and events					
Euro area	17.00	ECB Executive Board member Schnabel gives keynote speech at Booth Business School event, New York			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.