

Euro wrap-up

Overview

- As the markets priced a significant risk of an ECB rate hike by year-end, Bunds made losses despite a downwards revision to euro area GDP growth at end-2025.
- Gilts made big losses as the price of Brent crude rose above \$90 per barrel further fuelling concerns about inflation.
- Events in the Middle East will continue to dominate the economic dataflow in the coming week.

Economics Research Team

+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.304	+0.071
OBL 2½ 04/31	2.518	+0.035
DBR 2.9 02/36	2.856	+0.018
UKT 4¾ 03/28	3.870	+0.066
UKT 4¾ 03/31	4.118	+0.088
UKT 4¾ 10/35	4.626	+0.087

*Change from close as at 5.00pm GMT.

Source: Bloomberg

Euro area

ECB rate hike by the summer feasible if conflict appears open-ended by then

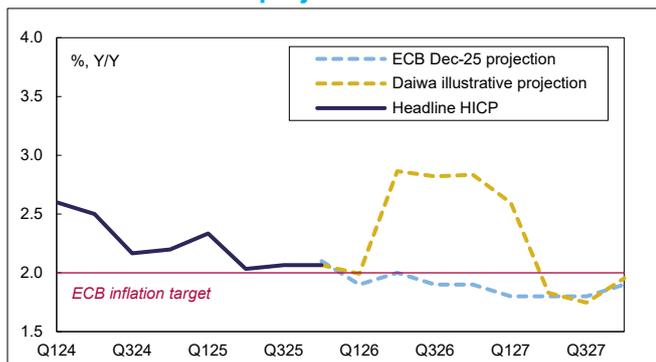
With euro area inflation below 2% and having been expected to remain below target into next year, market pricing ahead of the US and Israeli strikes on Iran suggested a greater probability of an ECB rate cut in 2026 than a hike. But with the conflict in the Middle East posing a significant lasting threat to energy supply and prices, and the euro having weakened too, market pricing today implied a strong likelihood of an ECB hike by year-end. We are not yet fully convinced the ECB will feel obliged to move. But it is clearly scarred by the inflationary experience after the Russian invasion of Ukraine. And if the conflict looks set to extend towards the back end of Q2, a rate hike before the summer – and perhaps further tightening thereafter in the event of lasting conflict – could well be on the cards. Certainly, the shock to oil prices is now feeding through to auto fuel and airfares. While the shock to wholesale gas prices due to events in Qatar has so far dwarfed that to broader power prices, and there will be significant differences between the member states, household energy bills will be moving significantly higher in the absence of new government interventions. The increased costs of inputs will add particularly to inflation of food as well as core goods. And there will be a steady flow of second-round effects on prices of services, not least restaurants, extending into next year. If the conflict and the past week's market shifts are sustained, we would expect inflation to rise above 2½%Y/Y by mid-year and remaining thereabouts into 2027.

Given that shock to energy prices and additional uncertainty, growth in household consumption – which started the year on a soft note – risks grinding to a halt. And business investment risks a go-slow amid massive uncertainty and risks of supply disruption. Exports will be hit too. So, euro area growth will likely be more reliant on fiscal support, not least from German spending on defence and infrastructure and projects related to the final tranches of NGEU funds. Overall, we have knocked off about ½ppt from our full-year euro area GDP growth projection for 2026, taking it down to about ½%Y/Y, before a rebound in 2027 close to 1%Y/Y – about ¼ppt less than previously expected. But the ECB will be more perturbed about the shock to inflation and risks of lasting second-round effects.

GDP growth revised down to 0.2%Q/Q in Q4, but domestic demand firm

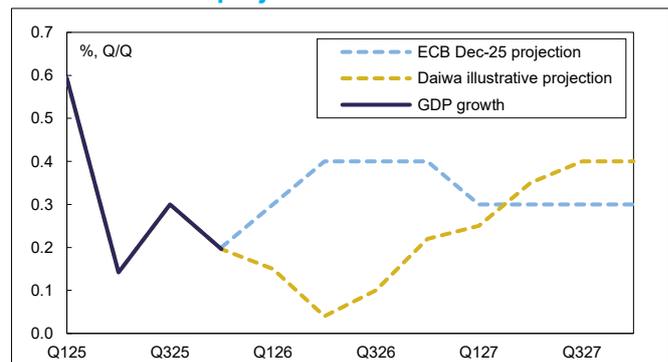
Today's updated euro area GDP data for Q4 brought a surprising downwards revision, suggesting that the region's economic growth platform at the end of last year was not quite as strong as had been previously assumed. GDP growth was nudged down by 0.1ppt to 0.2%Q/Q. Admittedly, this was in line with the ECB's projection published in December. And the weakness principally related to Ireland (-3.8%Q/Q), which knocked 0.16ppt off the euro area aggregate. Indeed, when excluding Ireland, euro area growth was the strongest since Q322. And the expenditure breakdown suggested that, with net trade subtracting for a third successive quarter and inventories also a drag (by 0.15ppt a piece), growth remained domestically led.

Euro area: Inflation projections



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

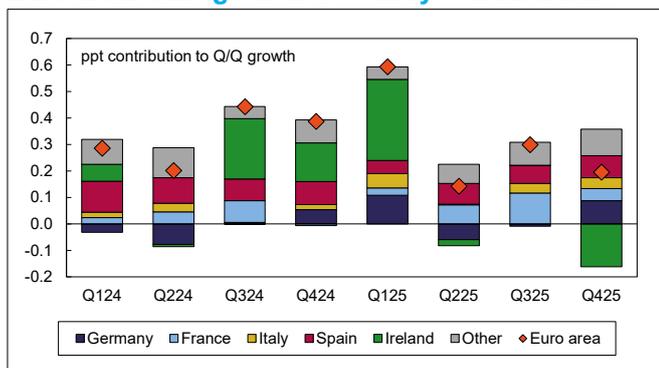
Euro area: GDP projections



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

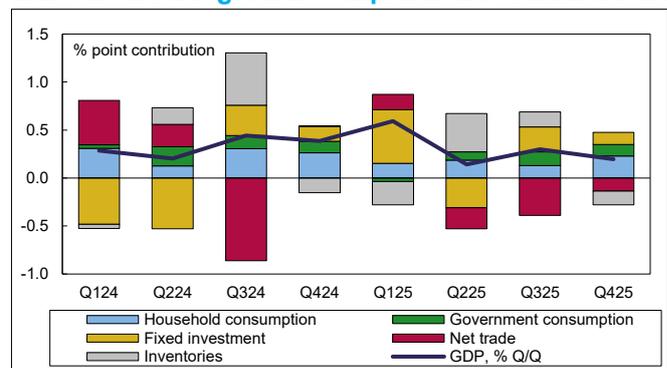
Household consumption (0.4%Q/Q) rose the most in a year while government consumption (0.5%Q/Q) maintained steady uptrend. While the rise in fixed investment (0.6%Q/Q) was roughly half that in Q3, this reflected payback in intellectual property (presumably in Ireland after strong growth in Q3) and a moderation in transport equipment. In contrast, investment in machinery and weaponry rose to a series high, while residential investment posted the strongest growth since Q123. Meanwhile, the updated national accounts reported a further pickup in firms' profit margins at the end of last year, suggesting some scope to absorb increased costs over the near term. And a further moderation in growth of employee compensation to a near-five-year low of 3.7%Y/Y, a touch below the ECB's expectations, suggests that, before the outbreak of the war in the Middle East, labour cost pressures continued to wane.

Euro area: GDP growth & country contributions



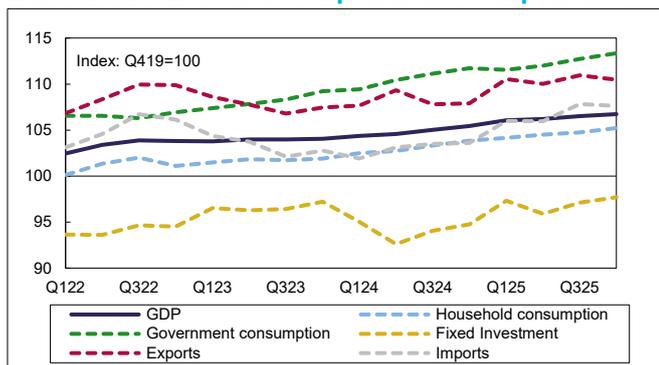
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & expenditure contributions



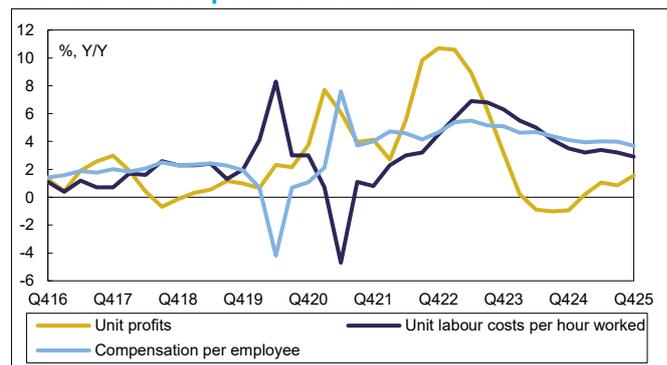
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP level & expenditure components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Unit profits & labour costs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

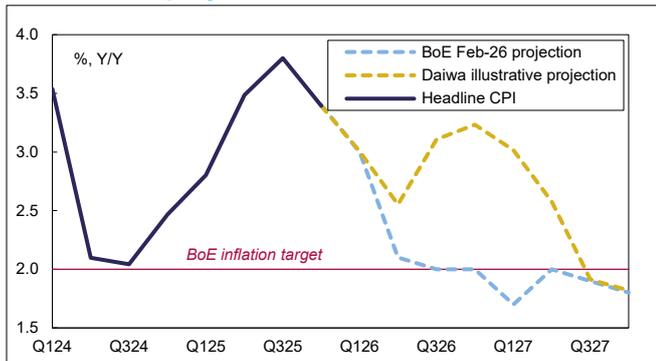
Given the major shocks coming from the war in the Middle East, the flow of hard economic data over the coming week will provide only limited information about economic growth momentum in Q1. But the euro area Sentix investor survey for March – the first to capture the period since the escalation of the conflict – might garner more attention than usual when it is released on Monday. Given the correlation with equity markets and broader risk appetite, the Sentix's current conditions index seems bound to have fallen sharply from February's near-three-year high (-6.75). And the survey index for investor perceptions of the coming six months will have similarly darkened. Admittedly, other business surveys – such as the PMIs and Commission indices – often provide a more accurate guide to coincident euro area GDP growth. And the respective March releases will have a few extra weeks to assess the initial economic impact before they are released. For what it's worth, in terms of hard data in the coming week, industrial production in Germany and Ireland (Monday) and the euro area (Friday) will likely register some bounce back from the sharp declines in December. And while the postponed German factory orders release (also Monday) will surely report some negative payback from recent significant strength – up in each of the last four months of 2025, and by a cumulative 18% – these data are also likely to point to an ongoing gradual uptrend in demand for German goods ahead of the war in the Middle East. German and French goods trade reports (Tuesday) will give an update on external demand at the start of the year. Final [German inflation](#) numbers for February, including the first detailed breakdown, are also due (Wednesday), followed by final inflation numbers from France and Spain (Friday).

UK

Inflation set to rise above 3% in H226, pushing next BoE rate cut back to Q4 at the earliest

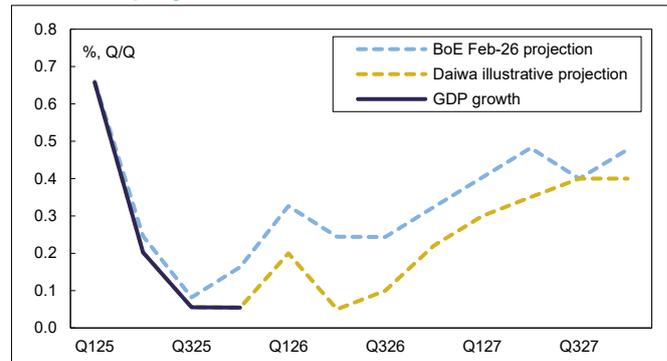
If the wholesale energy price shock and elevated geopolitical uncertainty is sustained into next quarter, the impacts on inflation and GDP growth in the UK will unsurprisingly be similar to those in the euro area. In the UK, higher prices of auto fuel will maintain the headline CPI rate close to 3.0%Y/Y this quarter. But inflation should still take a step down in April thanks to Ofgem's announced cut in the household energy price cap. But it would still likely average in Q2 a touch above 2½%Y/Y, which would be about 50bps above the BoE's current baseline expectation. And the drop in inflation would be short-lived, as the Ofgem price cap will likely need to be hiked in July by the most in more than three years. As in the euro area, pass-through of higher input costs to prices of food and core goods will also steadily boost those items in the inflation basket over coming months, with supply constraints adding additional upside risks. And second-round effects on services inflation could be a drawn-out affair, extending into 2027 due to indexation of certain. So, inflation will likely rise in Q3 back above 3.0%Y/Y, more than 1ppt above the BoE's baseline projection, and remain thereabouts until Q227. And while economic slack will now increase further than previously anticipated, we would not expect inflation to fall back to 2% or below until H227 when it should ease due to base effects. Against that backdrop, UK GDP will inevitably be on a softer path than previously hoped. For the time being, however, we expect minimal growth in Q2 and Q3 thanks principally to government consumption and public investment rather than recession. And if the conflict in the Middle East diffuses by mid-year, we would expect growth to regain traction into 2027. Overall, we have knocked about ½ppt off our GDP growth forecast this year to about ½%Y/Y rising to about 1% next year and just above 1½% in 2028. But given the elevated inflation profile, we now expect no rate cut from the BoE before November at the earliest.

UK: Inflation projections



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

UK: GDP projections



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

The week ahead in the UK

While superseded by events over the past week, the coming week's UK economic dataflow will give an update on growth momentum at the start of the year, with monthly GDP figures for January (Friday) most notable. Having slowed to 0.1%M/M (0.1%3M/3M) in December, the PMIs pointed to a marked improvement at the start of the year, with the composite output PMI (53.7) the highest in two years. But while we might see some payback for the decline in industrial output in December, unseasonably cold and wet weather seems bound to have weighed on construction activity. And although retail sales exceeded expectations and should provide a boost to GDP in January, other consumer-facing services might have been impacted by the bad weather. Overall, like the consensus, we expect GDP growth to hold steady at 0.1%M/M, which would push three-month growth up to 0.3%3M/3M supported in base by a strong showing in November and flattered by weakness in the run up to the government's Budget. Trade figures for January might also report some payback for the declines in export and import values the previous month. Meanwhile, the REC jobs report (Monday), BRC retail monitor (Tuesday) and RICS residential survey (Thursday) for February are also due.

Daiwa illustrative projection

	2025		2026				2025	2026	2027
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	%, Q/Q						%, Y/Y		
Euro area 	0.3	0.2	0.2	0.0	0.1	0.2	1.5	0.6	1.0
UK 	0.1	0.1	0.2	0.1	0.1	0.2	1.3	0.5	1.1
Inflation, %, Y/Y									
Euro area									
Headline HICP 	2.1	2.1	2.0	2.9	2.8	2.8	2.1	2.6	2.0
Core HICP 	2.3	2.4	2.4	2.6	2.7	2.7	2.4	2.6	2.1
UK									
Headline CPI 	3.8	3.4	3.0	2.6	3.1	3.2	3.4	3.0	2.3
Core CPI 	3.6	3.3	3.1	2.7	2.6	3.2	3.5	3.0	2.5
Monetary policy, %									
ECB									
Deposit Rate 	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Refi Rate 	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.15
BoE									
Bank Rate 	4.00	3.75	3.75	3.75	3.75	3.50	3.75	3.50	3.25

Source: Bloomberg, ECB, BoE 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 	GDP – final estimate Q/Q% (Y/Y%)	Q4	0.2 (1.2)	<u>0.3 (1.3)</u>	0.3 (1.4)	-		
	GDP – household consumption Q/Q%	Q4	0.4	0.4	0.2	-		
	GDP – government spending Q/Q%	Q4	0.5	0.5	0.7	-		
	GDP – fixed investment Q/Q%	Q4	0.6	0.8	0.9	1.3		
	Employment – second estimate Q/Q% (Y/Y%)	Q4	0.2 (0.7)	<u>0.2 (0.6)</u>	0.2 (0.6)	-		
Spain 	INE house price index Q/Q% (Y/Y%)	Q4	1.8 (12.9)	-	2.9 (12.8)	-		
Auctions								
Country	Auction							
- Nothing to report -								

Source: Bloomberg 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/ <i>Daiwa forecast</i>	Previous
Monday 9 March 2026					
Euro area	09.30	Sentix investor confidence indicator	Mar	-3.0	4.2
Germany	07.00	Factory orders M/M% (Y/Y%)	Jan	-4.5 (13.2)	7.8 (13.2)
	07.00	Industrial production M/M% (Y/Y%)	Jan	1.0 (-0.8)	-1.9 (-0.6)
Tuesday 10 March 2026					
Germany	07.00	Trade balance €bn	Jan	15.2	17.2
France	07.45	Trade balance €bn	Jan	-	-4.8
Italy	09.00	PPI Y/Y%	Jan	-	-2.0
UK	00.01	BRC retail monitor – like-for-like sales Y/Y%	Feb	2.0	2.3
Wednesday 11 March 2026					
Germany	07.00	Final HICP (CPI) Y/Y%	Feb	<u>2.0 (1.9)</u>	2.1 (2.1)
Spain	08.00	Retail sales Y/Y%	Jan	-	2.9
Thursday 12 March 2026					
UK	00.01	RICS house price balance %	Feb	-9	-10
Friday 13 March 2026					
Euro area	10.00	Industrial production M/M% (Y/Y%)	Jan	0.6 (1.3)	-1.4 (1.2)
France	07.45	Final HICP (CPI) Y/Y%	Feb	<u>1.1 (1.0)</u>	0.4 (0.3)
Italy	09.00	Industrial production M/M% (Y/Y%)	Jan	0.4 (0.8)	-0.4 (3.2)
Spain	08.00	Final HICP (CPI) Y/Y%	Feb	<u>2.5 (2.3)</u>	2.4 (2.3)
UK	07.00	Monthly GDP M/M% (3M/3M%)	Jan	0.1 (0.3)	0.1 (0.1)
	07.00	Services output M/M% (3M/3M%)	Jan	0.2 (0.3)	0.3 (0.0)
	07.00	Industrial output M/M% (Y/Y%)	Jan	0.2 (0.6)	-0.9 (0.5)
	07.00	Construction output M/M% (Y/Y%)	Jan	0.1 (-0.2)	-0.5 (-0.3)
	07.00	Trade (goods trade) balance £bn	Jan	-	-4.3 (-22.7)
	09.30	BoE/Ipsos inflation attitudes survey – 1Y ahead CPI Y/Y%	Q1	-	3.5

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
Monday 9 March 2026		
UK	00.01	REC, KPMG and S&P Global UK Report on Jobs for February
Tuesday 10 March 2026		
Germany	10.30	Auction: to sell up to €5bn of 2.1% 2028 bonds
Wednesday 11 March 2026		
Euro area	15.00	ECB's Schnabel scheduled to give keynote speech in Frankfurt
Germany	10.30	Auction: to sell up to €5bn of 2.9% 2036 bonds
Thursday 12 March 2026		
Italy	10.00	Auction: to sell bonds*
UK	10.00	Auction: to sell £500mn of 1.875% 2049 inflation-linked bonds
Friday 13 March 2026		
- Nothing scheduled -		

*Details to be announced. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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