

Euro wrap-up

Overview

- While euro area headline inflation was revised higher in March on the strongest energy inflation for more than three years, Bunds made modest gains as core inflation edged lower.
- Gilts made losses after UK GDP surprised significantly to the upside in February.
- Friday will bring euro area goods trade data for February.

Economic Research Team

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Daily bond market movements

Bond	Yield	Change
BKO 2.1 03/28	2.520	-0.018
OBL 2½ 04/31	2.699	-0.014
DBR 2.9 02/36	3.030	-0.011
UKT 4¾ 03/28	4.228	+0.008
UKT 4¾ 03/31	4.355	+0.022
UKT 4¾ 10/35	4.851	+0.038

*Change from close as at 4:00pm BST.

Source: Bloomberg

Euro area

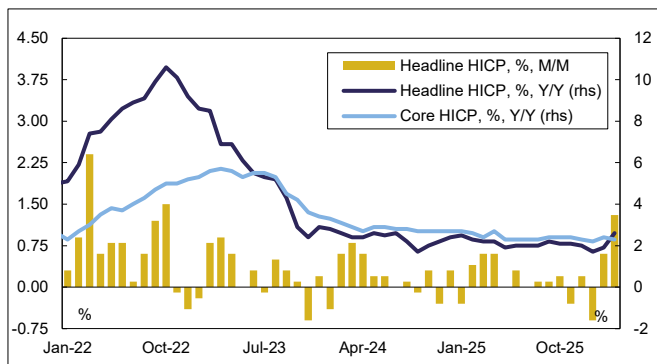
March inflation revised up but price pressures limited to fuels so core rate falls back

Euro area inflation in March was revised a touch higher from the flash estimate, by 0.1ppt to 2.6%Y/Y (2.554%Y/Y to 3dps), the highest since July 2024. That was not a major surprise given upwards revisions in France, Italy and Spain. The rise of 0.7ppt from February was the steepest since October 2022. But it will not cause alarm at the ECB. After all, the pressures among the major components were concentrated in energy, inflation of which jumped more than 8ppts to 5.1%Y/Y, the highest in more than three years. Within that component, auto fuel prices jumped 13.5%M/M, the most since March 2022. And heating oil prices leapt 32M/M%, similarly the steepest rise since Russia's invasion of Ukraine. Prices of gas (up 1.9%M/M) and electricity (down 0.4%M/M), however, were better behaved. Meanwhile, inflation of food, alcohol and tobacco moderated 0.1ppt to a five-month low (2.4%Y/Y) as pressures in items such as meat and chocolate continued to ease. Most importantly, core components showed no cause for concern. The impact of prices of higher aviation fuel was reflected in airfares, inflation of which more than doubled (4.9%Y/Y). But, as the impact of the Winter Olympics on Italian hotel prices reversed, services inflation returned to 3.2%Y/Y, just 10bps above the bottom of the range of the past four years. And despite pressures in external electronic storage devices reflecting different global factors, core goods inflation dropped to just 0.5%Y/Y, a touch below the average of the prior 12 months. As a result, core inflation (excluding energy, food and tobacco) edged down to 2.3%Y/Y, just 10bps above January's four-year low.

Inflation on track to rise back above 3% but risks of persistence call for measured approach to rates

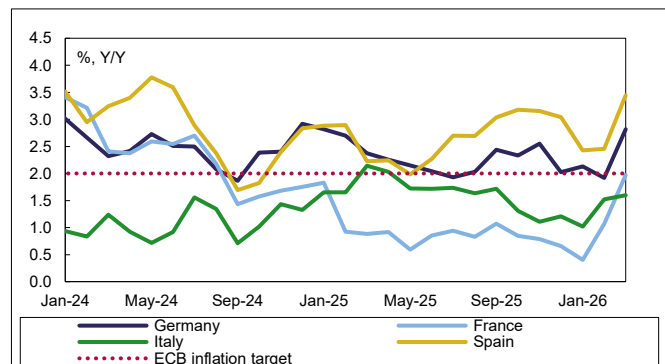
Some alternative measures of underlying inflation also fell in March. For example, a rate watched by the ECB that excludes clothing and travel-related services, as well as food and energy, fell to just 1.9%Y/Y, the lowest since 2021. But higher energy prices pushed up trimmed means and the weighted median to around 2½%Y/Y. And a measure capturing inflation of items purchased frequently by consumers – which is likely to provide the best guide as to how the current price shock is being felt by households – rose almost 1½ppts to 3.5%Y/Y, the highest since January 2024. While petrol prices fell slightly last week, so far this month they have averaged about 4% above the March level. But with the German government following its counterparts in Italy and Spain by cutting tax on auto fuel, that inflation component will moderate from next month. Of course, in due course, we do expect to see increased pressures on a range of prices from household energy to airfares, restaurants, food and various other goods. And so, we think headline inflation will still peak above 3%Y/Y. But with consumers feeling higher inflation acutely, and firms revising down plans for production and service provision in the face of cost pressures, risks of supply disruption and soft demand, economic growth is likely to slow. And that moderation could neutralise risks of substantial second-round effects from the current inflation shock. Of course, as ECB President Lagarde repeats, what matters for the inflation is the full magnitude and duration of the shock to wholesale energy prices and freight

Euro area: Headline & core inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: HICP inflation in selected member states



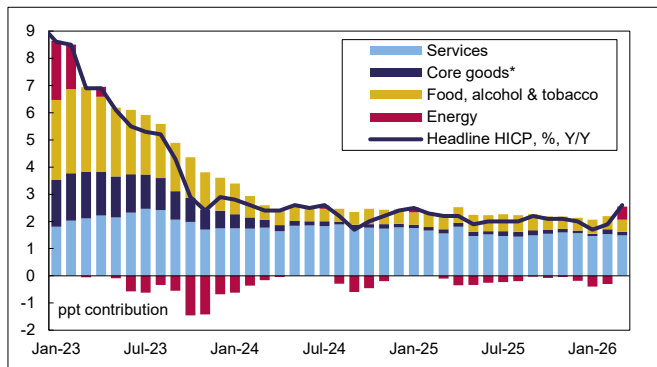
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

transit through the Strait of Hormuz. And that will depend on the path of the conflict, which remains extremely uncertain. The account of the Governing Council's March meeting reminded that the ECB is ready to respond to signals of rising risks of inflation persistence that might emerge in price expectations. But the policymakers appear willing to wait at least until it updates its projections in June before deciding whether to raise rates. At present, if the conflict gradually dissipates and freight transit via the Strait gradually resumes, we think that inflation will follow a path somewhere between the ECB's baseline and adverse scenarios, albeit perhaps with a touch more persistence. And we think that will eventually prompt some modest tightening of monetary policy, albeit perhaps with just a first hike in June and certainly no more than two by year-end.

The day ahead in the euro area

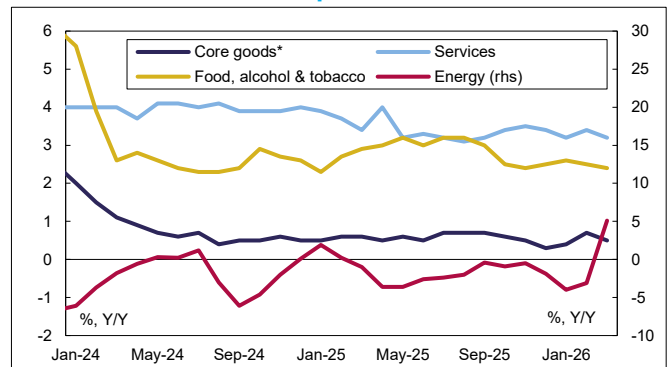
February's goods trade data will provide the sole economic data for the euro area at the end of the week. Timelier data from the member states – while also suggestive of some rebound in export values after [January's](#) drop – point towards a modestly narrower trade surplus this month. Indeed, Germany's good surplus narrowed marginally amid a firmer rebound in extra-regional imports, including from China after a lull over the Lunar New Year. Exports to the US also softened. And France's trade deficit widened on similar drivers, albeit exaggerated by intra-European trade flows.

Euro area: Contributions to inflation



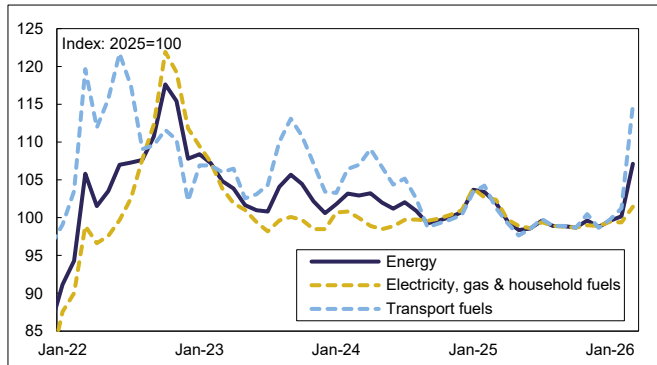
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation components



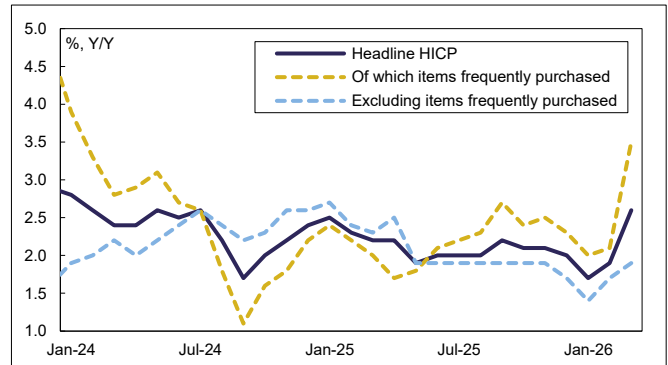
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Energy price levels



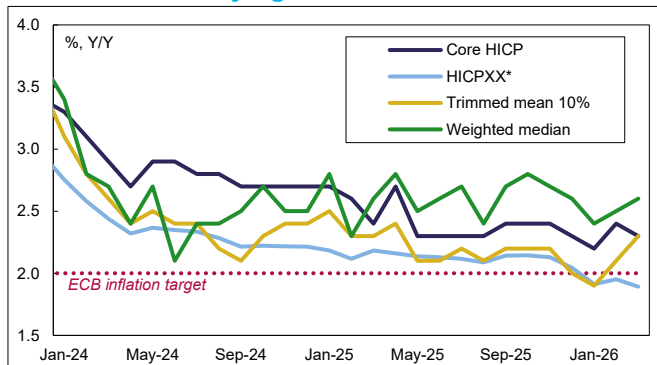
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation of frequent purchases



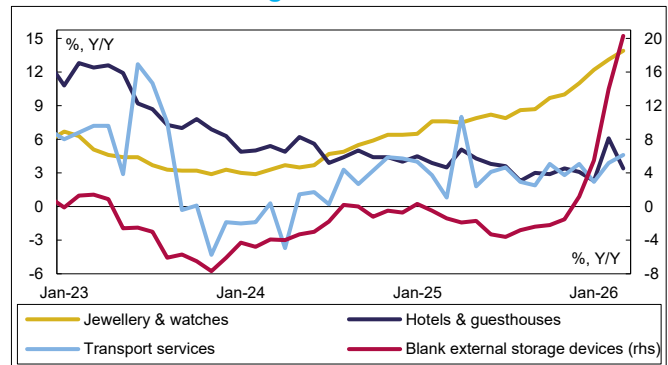
Source: Macrobond and Daiwa Capital Markets Europe Ltd..

Euro area: Underlying inflation measures



*Excludes energy, food, clothing & travel-related components. Source: Macrobond and Daiwa Capital Markets Europe Ltd..

Euro area: Selected goods & services inflation rates



Source: Macrobond and Daiwa Capital Markets Europe Ltd..

UK

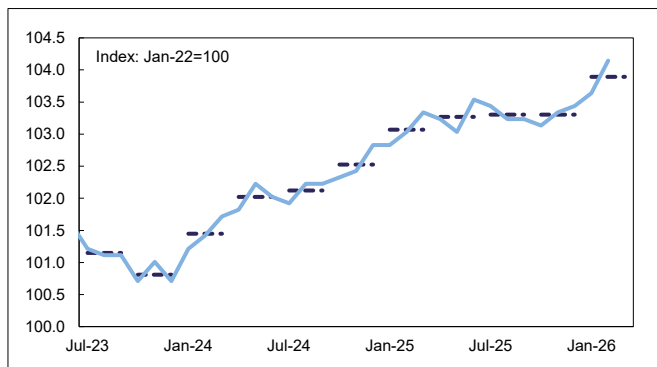
GDP surprises to the upside in February, but follows downwardly revised growth in H225

Today's UK GDP data for February surprised significantly to the upside, suggesting an acceleration in growth momentum ahead of the new global energy shock. In particular, economic output rose for a fourth successive month and by 0.5%M/M, the fastest pace in more than two years. This pushed growth on a three-month basis up 0.2ppt to 0.5%3M/3M, a ten-month high. And the annual rate rose back to 1.0%Y/Y, the firmest since September. So, while we anticipate a pullback in activity in March, today's release unexpectedly suggests that the UK economy was among the fastest growing of the G7 countries before the outbreak of war in the Middle East. Indeed, in the absence of back revisions, we would need to see a contraction of at least 2%M/M in March – a pace last recorded in 2002 outside of the Covid lockdown periods – for GDP to have merely stagnated in Q1. And that seems highly implausible. Of course, the composite PMI fell in March by the most since September when JLR was hit by a cyber- attack. So, we do see the risks to growth last month as skewed firmly to the downside. But given today's numbers, the drop in GDP that we expect to see in March would be consistent with growth of 0.5%Q/Q in Q1. Like in recent years, we suspect that part of the vigour in the first quarter relates to new seasonality. Indeed, today's release revised away the previously estimated paltry growth of 0.1%Q/Q in Q3 and Q4 to be consistent with repeated patterns of weakness in the second half of the year. So, while February's above-potential pace of expansion might reinforce the urge among the more hawkish MPC members to raise rates, we think that the majority (including Governor Bailey) will still want to wait at least until June before making a judgement on the likely economic impact of the Iran war and the associated case for adjusting monetary policy.

Broad-based growth in February masks soft underlying demand

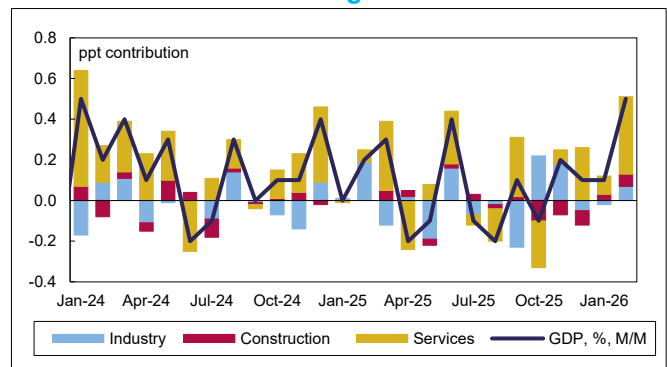
The pickup in activity in February was broad-based across the key sectors. Services output (0.5%M/M) made the largest contribution, rising for a fourth month and by the most since December 2024. Activity increased in 12 out of 14 subsectors, led by wholesale trade which made the largest positive contribution to GDP growth. But output in consumer-facing services was merely flat in February. And while employment services rose in February, their activity was still tracking some 5½% below the Q4 average suggesting ongoing labour market weakness. Real estate activities also maintained a downwards trend on a three-month basis amid a still-lacklustre housing market. Meanwhile, the return to production growth in the industrial sector (0.5%M/M) was driven by mining and quarrying (3.6%M/M) and energy supply (1.5%M/M). In contrast, manufacturing output fell slightly, with declines in transport equipment, metals and food offsetting growth in machinery, electrical and ICT equipment and pharmaceuticals. While industrial growth on a three-month basis remained solid (1.2%3M/3M) this rate was flattered by the bounce back in the autos manufacturing in the autumn. And although there was

UK: GDP level*



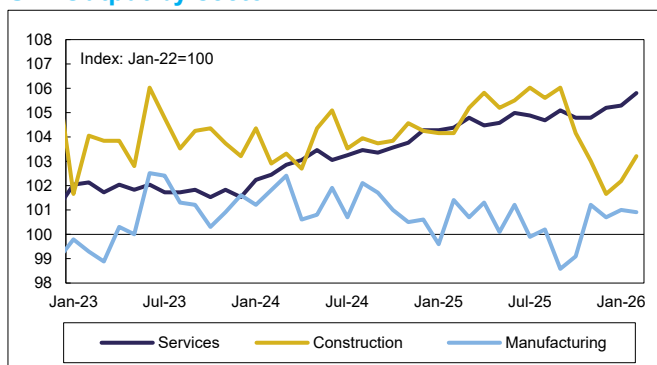
*Dashed dark blue line represents quarterly average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Contributions to GDP growth



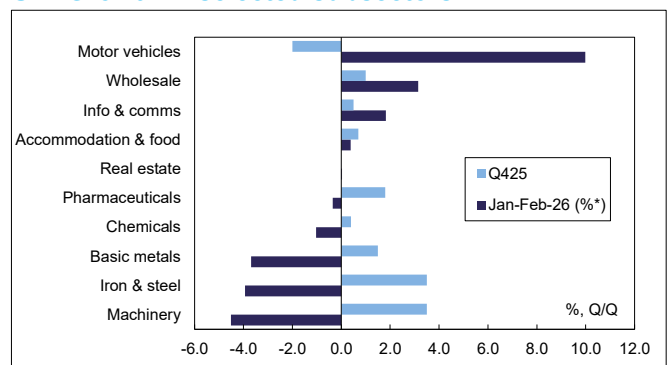
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output by sector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Growth in selected subsectors



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

an encouraging acceleration in construction activity in February (1.0%M/M), it was still down 2%3M/3M, with substantial quarterly contractions in new private (-6.5%3M/3M) and public housing work (-11.3%3M/3M).

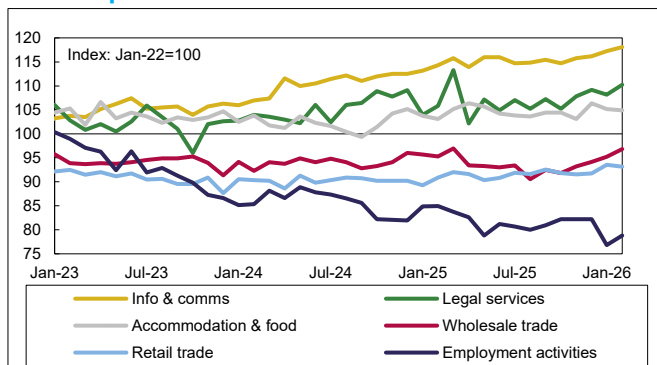
Net trade on track to boost GDP growth in Q1 despite softer exports & firmer imports in February

In contrast to the GDP report, at face value, today's trade numbers disappointed. After surging at the start of the year, the value of exports fell 1.5%MM. But, as in January, this principally reflected developments in shipments of precious metals, which pushed total goods export values down 3.9%M/M after growth of 12%M/M previously. Excluding such items, goods exports still fell 1.5%M/M, with declines in chemicals, particularly to the US, and machinery and transport equipment, including mechanical power generators to China and Singapore. But more encouragingly, services exports – which account for roughly 60% of the UK's total – rose modestly for a third successive month (0.3%M/M). And while an increase in imports saw the headline trade balance return to deficit in February (down some £3.7bn to £720mn), this was still significantly smaller than the average deficit in 2025 (£3.2bn). Indeed, given the strength at the start of the year, total exports were trending more than 3½% above the Q4 average, with imports tracking almost 3% down on the same basis. And while global trade seems bound to have been disrupted in March (and beyond), today's data strongly suggests that net trade volumes provided an unusual non-negligible boost to GDP growth in Q1.

The day ahead in the UK

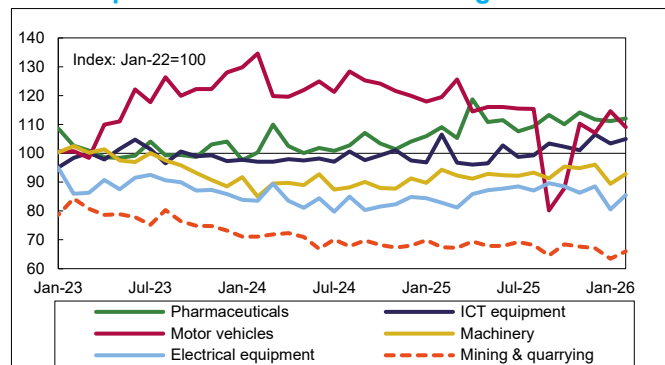
Comments from BoE Chief Economist Pill will conclude the circuit of central bank speak from this week's Spring meetings in Washington D.C. But with no data scheduled on Friday before a congested calendar next week, it should be a relatively quiet end to the week for UK economic news.

UK: Output in selected services subsectors



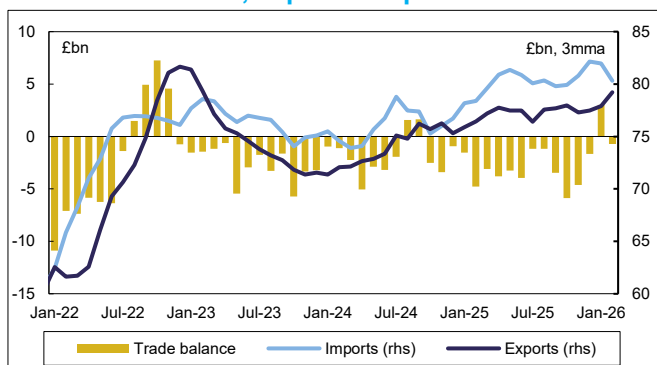
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output in selected manufacturing subsectors



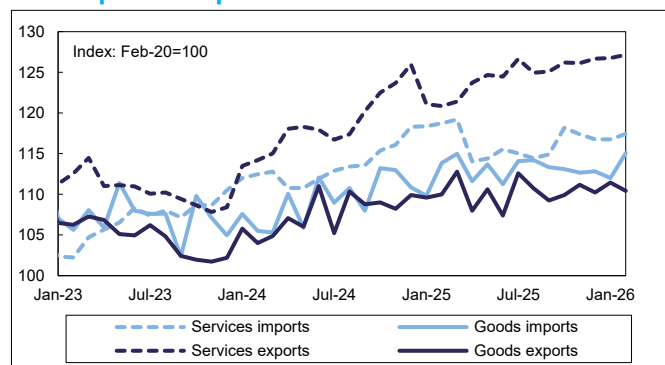
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Trade balance, export & import vales



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Export & import volumes*










*Excluding precious metals.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.













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	2.6 (2.3)	<u>2.5 (2.3)</u>	1.9 (2.4)	-
Italy	 Final HICP (CPI) Y/Y%	Mar	1.6 (1.7)	<u>1.5 (1.7)</u>	1.5 (1.5)	-
UK	 Monthly GDP M/M% (3M/3M%)	Feb	0.5 (0.5)	<u>0.2 (0.3)</u>	0.0 (0.2)	0.1 (0.3)
	 Services output M/M% (3M/3M%)	Feb	0.5 (0.5)	0.2 (0.3)	0.0 (0.2)	0.1 (0.3)
	 Industrial output M/M% (Y/Y%)	Feb	0.5 (-0.4)	0.2 (-1.0)	-0.1 (0.4)	-(0.5)
	 Construction output M/M% (Y/Y%)	Feb	1.0 (-1.0)	-0.5 (-1.0)	0.2 (-0.2)	0.5 (-1.9)
	 Trade (goods trade) balance £bn	Feb	-0.7 (-18.8)	-1.3 (-20.1)	3.9 (-14.4)	3.0 (-15.0)



Auctions

Country	Auction
France	 sold €4.355bn of 2.4% 2029 bonds at an average yield of 2.84%
	 sold €4.494bn of 2.7% 2031 bonds at an average yield of 3.03%
	 sold €2.023bn of 0% 2032 bonds at an average yield of 3.21%
	 sold €2.122bn of 3% 2033 bonds at an average yield of 3.34%
	 sold €664mn of 0.1% 2038 inflation-linked bonds at an average yield of 1.61%
	 sold €430mn of 0.55% 2039 inflation-linked bonds at an average yield of 1.85%
	 sold €310mn of 0.95% 2043 inflation-linked bonds at an average yield of 1.87%
Spain	 sold €294mn of 0.1% 2053 inflation-linked bonds at an average yield of 2.04%
	 sold €2.021bn of 3.1% 2031 bonds at an average yield of 2.911%
	 sold €2.222bn of 3% 2033 bonds at an average yield of 3.107%
UK	 sold €1.41bn of 3.5% 2041 bonds at an average yield of 3.845%
	 sold £900mn of 1.875% 2049 inflation-linked bonds at an average yield of 2.165%


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	 09.00	ECB current account €bn	Feb	-	37.9
	 10.00	Trade balance €bn	Feb	-	12.1

Auctions and events

UK	 13.00	BoE Chief Economist Pill to speak at breakfast roundtable, Washington D.C.
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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