

Euro wrap-up

Overview

- While the German ifo business survey was better than feared, Bunds rallied and BTPs sold off as the COVID-19 coronavirus epidemic intensified in Italy.
- Gilts also rallied on a quiet day for UK economic news.
- Tomorrow will bring results of further business surveys from France and the UK, while ministers from Italy and its neighbours will meet to discuss a response to the spread of the coronavirus.

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Daily bond market movements

Bond	Yield	Change
BKO 0 12/21	-0.682	-0.026
OBL 0 04/25	-0.663	-0.042
DBR 0 02/30	-0.486	-0.051
UKT 3% 09/21	0.410	-0.050
UKT 1 04/24	0.431	-0.044
UKT 0% 10/29	0.543	-0.048

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

Euro area

Coronavirus risks Italian recession

Euro area equities plunged and most euro area sovereign bonds rallied today as the outbreak of the COVID-19 coronavirus intensified. BTPs sold off, however, as the number of cases in Italy rose sharply above 220 with six fatalities. That firmly established Italy as the country third most affected by the coronavirus worldwide (after China and South Korea). And over recent days, the authorities responded with extraordinary measures, particularly in the affected Northern regions, which have economic and social ties to China. Limits on freedom of movement have been imposed in certain towns in Lombardy and Veneto, which have also seen the cancellation of large-scale public events, including Serie A football matches and the Venice carnival. Some schools and universities have also been closed, while some businesses (including banks) have told staff to stay at home. Other Northern regions – Friuli Venezia Giulia, Piemonte and Emilia Romagna – have also cancelled large-scale gatherings.

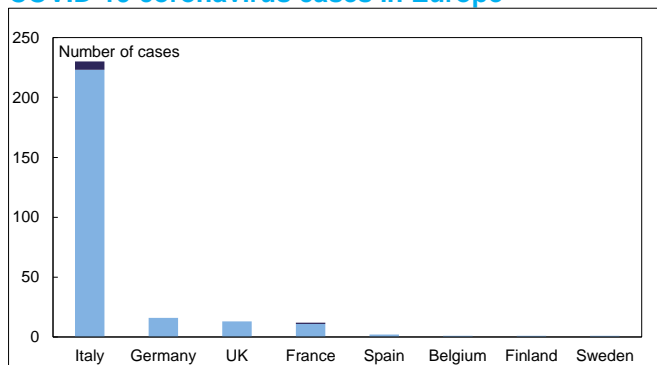
ECB to call for fiscal response in lieu of monetary easing

Taken together, the five regions most affected by the coronavirus account for about half of all Italian gross value added and two thirds of Italian manufacturing output. So, there is highly likely to be a hit to economic supply and demand, as well as confidence, of a magnitude sufficient to push Italy back into recession. While the evolution of the outbreak is impossible to predict with confidence, for the time being we have revised down our Italian GDP forecast for Q1 by 0.2ppt to -0.1%Q/Q. And if and when the outbreak spreads across European borders, it will pose a significant downside risk to economic growth elsewhere in the euro area too. In light of the concerns about possible negative side-effects from its policies, the ECB is likely to be reluctant to cut rates further or accelerate its purchases of sovereign bonds. Instead, over coming days, Governing Council members – including Christine Lagarde – are likely to echo comments made over the weekend by the French and Italian national bank governors, who called for governments to be ready to provide coordinated support via fiscal policy if the downside risks to growth from the outbreak crystallise. While we do expect the Italian government to provide support to the regions affected, we would not, however, expect the German government to revise its current budgetary plans unless GDP looked set to fall sharply.

Ifo suggests stabilisation in Germany, at least for now

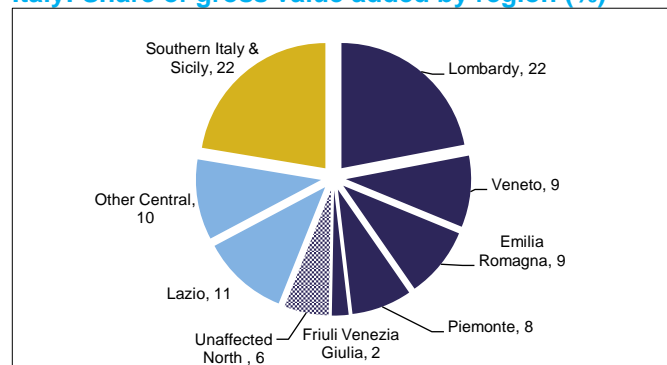
Despite concerns that they might have deteriorated due to the coronavirus, today's German ifo indices suggested that conditions remain little changed from recent months. The headline business climate index rose a minimal 0.1pt in February

COVID-19 coronavirus cases in Europe*



*Dark blue represent confirmed fatalities. Source: Centre for Systems Science and Engineering at John Hopkins University and Daiwa Capital Markets Europe Ltd.

Italy: Share of gross value added by region (%)



Source: ISTAT and Daiwa Capital Markets Europe Ltd.



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to 96.1, still below December's reading but above the average of the past six months. The index of current conditions reversed the 0.3pt improvement registered in January. But expectations about conditions six months ahead improved slightly, with the respective index up 0.5pt to 93.4, still merely a two-month high. The picture presented for the two main sectors mimicked that of Friday's [flash PMIs](#), suggesting gradual improvement in manufacturing but a weakening in services.

Manufacturers less downbeat as services become more pessimistic

In particular, the business climate index for manufacturers rose for a third consecutive month to an eight-month high. But while firms in that sector were more upbeat about the future and reported an improvement in new orders, they were more downbeat about current conditions. Services firms were more pessimistic about both current conditions and the future, to leave that sector's business climate index at a four-month low. Trading companies were also more downbeat, with retailers reporting the least favourable conditions in a year. And sentiment among construction firms deteriorated for a fifth consecutive month to the lowest since April 2017. Overall, the ifo survey points to only a slight pickup in German GDP in Q1 following no growth in Q4. And with the spread of the coronavirus in Europe having intensified significantly over recent days, we would currently expect to see a worsening in the March survey to suggest that the risks have skewed more significantly to the downside.

The day ahead in the euro area and US

Tomorrow will bring revised German GDP figures for Q4, which will include the first official expenditure breakdown. These are likely to confirm that the euro area's largest economy stagnated in the final quarter of last year as household and government spending slowed, and investment in machinery and equipment fell sharply. Tuesday will also see the release of the INSEE business confidence survey for February. In contrast with last week's flash PMIs, these are expected to show that conditions worsened slightly in February as downside risks to the global outlook re-intensified. Separately, ministers from Italy and its neighbours will meet tomorrow to discuss the management of the COVID-19 coronavirus outbreak, including how to coordinate a policy response, and no doubt also the merits of the reimposition of border controls. Spanish national bank Governor Hernandez de Cos will speak publicly. And in the markets, Italy will sell inflation-linked and zero-coupon bonds.

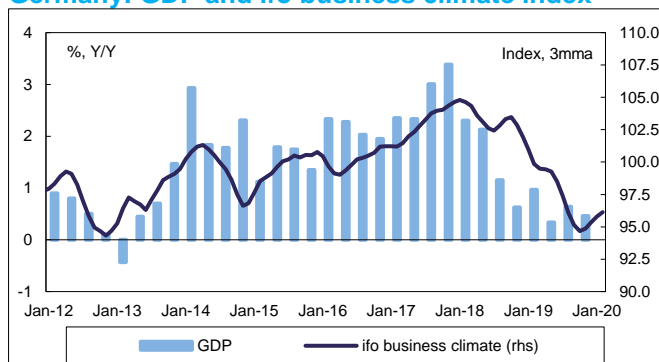
In the US, tomorrow will bring the Conference Board's consumer confidence survey for February, along with the FHFA and S&P CoreLogic home prices indices for December. The Fed's Vice Chair Clarida will speak at the NABE's annual conference on the US economic outlook and monetary policy, while in the markets the Treasury will sell 2Y notes.

UK

The day ahead in the UK

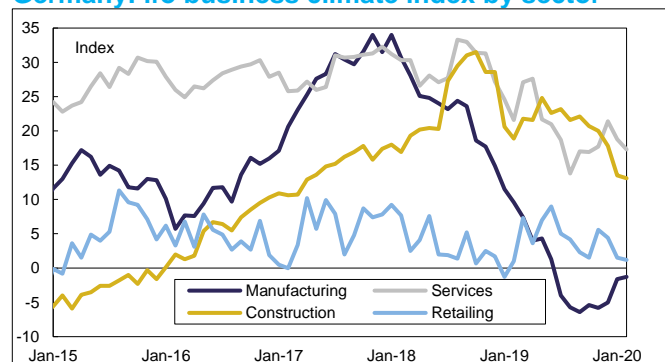
After a quiet start to the week for top-tier UK economic news, tomorrow will bring the latest CBI distributive trades survey for February, which is expected to suggest that retail sales growth remains relatively subdued having signalled no meaningful growth at the start of the year. The associated quarterly survey will also provide an update on retailers' employment and investment intentions over the coming year. In the UK, the DMO will sell 10Y Gilts.

Germany: GDP and ifo business climate index





Source: ifo Institute, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: ifo business climate index by sector












Source: ifo Institute, Thomson Reuters 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
Germany		ifo business climate index	Feb	96.1	95.3	95.9	96.0
		ifo current assessment balance (expectations)	Feb	98.9 (93.4)	98.6 (92.1)	99.1 (92.9)	99.2 (-)
Auctions							
Country	Auction						
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases						
Economic data						
Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Germany		07.00	Final GDP Q/Q% (Y/Y%)	Q4	0.0 (0.4)	0.2 (0.6)
France		07.45	Business confidence indicator	Feb	103	104
		07.45	Manufacturing confidence indicator (production outlook)	Feb	99 (-6)	100 (-5)
UK		11.00	CBI distributive trades survey, reported retail sales	Feb	3	0
Auctions and events						
Country	GMT	Auction / Event				
EMU		08.00	ECB's Hernández de Cos scheduled to speak			
Italy		10.00	Auction: 0.4% 2030 index-linked bonds			
		10.00	Auction: 1.25% 2032 index-linked bonds			
		10.00	Auction: €2.25bn of 0% 2021 bonds			
UK		10.30	Auction: £3.25bn of 0.875% 2029 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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