

Euro wrap-up

Overview

- As the rout in global stocks continued, Bunds rallied and BTPs continued to sell off as concerns about the coronavirus epidemic mounted further and financial markets priced in near-term monetary policy easing.
- Gilts also made gains and sterling depreciated again on heightened risk aversion.
- While the spread of the coronavirus will obviously dominate, the coming week will also bring data on euro area inflation, retail sales and unemployment, as well as the final PMIs.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.796	-0.049
OBL 0 04/25	-0.774	-0.045
DBR 0 02/30	-0.608	-0.061
UKT 0½ 07/22	0.312	-0.017
UKT 0% 06/25	0.332	-0.021
UKT 4% 12/30	0.443	-0.028

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

Source: Bloomberg

Euro area

Markets fully price an ECB rate cut by June

With fears about the spread of the coronavirus and its eventual economic impact dominating investor sentiment, the financial market rout continued in the euro area ahead of a weekend that might well bring further bad news. Equities opened lower and failed to rebound, with the Stoxx Europe 600 down close to 4% at the time of writing to be down more than 12% over the week. Core euro area government bonds made further gains, with 10Y Bund yields falling below -0.60% to the lowest since September. BTPs made further losses, leaving the 10Y spread to Bunds up more than 30bps over the week. And OIS markets fully priced the likelihood of a 10bp ECB rate cut by June.

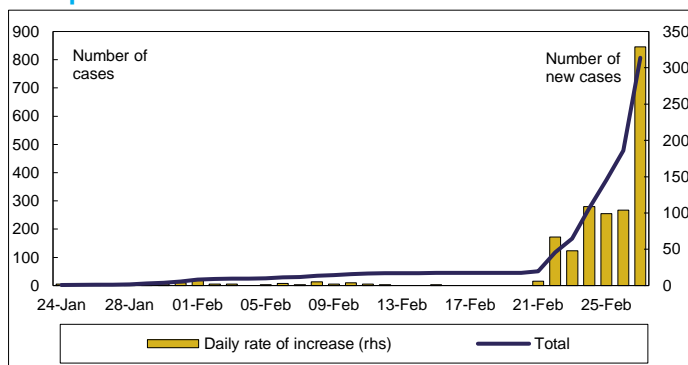
March meeting too soon for decision to ease policy?

With inflation already set to undershoot the ECB's target for the foreseeable future, if the epidemic spreads further, market trends continue unabated, and the hit to economic confidence and growth increases, the case for another rate cut, perhaps accompanied by increased purchases of corporate bonds, would seem strong. While it would not alleviate the supply-side strains, and fiscal policy should also provide support to demand, further monetary easing could reduce funding costs for cash-constrained businesses and households, offsetting the recent tightening of financial conditions. Tallying with remarks over the past couple of days from ECB Board members Lagarde, Lane and Schnabel, today Bundesbank President Weidmann and Lithuanian National Bank President Vasiliauskas suggested that the next Governing Council policy meeting on 12 March was likely to be too soon for a decision to ease policy. But they acknowledged the increased risks to the economic outlook posed by the coronavirus as well as the scope to cut the deposit rate further if necessary. And Vasiliauskas also noted that an extraordinary meeting of the Governing Council could be called at any point if the case for a rate cut and/or increased asset purchases strengthens significantly.

Flash February inflation data mixed

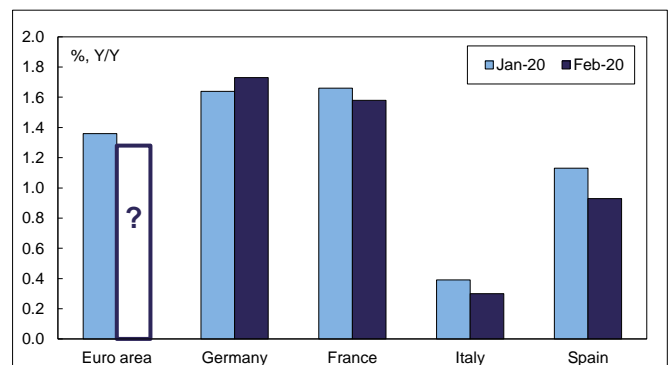
Ahead of the release on Tuesday of the flash estimates of euro area inflation in February, today brought the equivalent figures from the three largest member states. On the EU-harmonised measure, German inflation surprised on the upside, edging up 0.1ppt to a ten-month high of 1.7%Y/Y. The detail published on the national measure, for which headline inflation was unchanged at 1.7%Y/Y, suggested that weaker energy inflation was partly offset by increased inflation of food, with services inflation also a touch higher. In contrast, the French EU-harmonised rate fell 0.1ppt to 1.6%Y/Y, as inflation of both food and energy fell even though core components were a touch stronger. And the equivalent figure for Italy also fell 0.1ppt, to 0.3%Y/Y, also due to weaker inflation of non-core items. So, while we expect the flash headline rate of euro area inflation

Europe: Number of COVID-19 coronavirus cases



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation*



*National February figures are flash estimates. Euro area February figure is Daiwa forecast. Source: Thomson Reuters and Daiwa Capital Markets Europe



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in February to edge down 0.1ppt to 1.3%Y/Y, today's national data suggest that core inflation might well have edged back up to 1.2%Y/Y.

French consumption declines sharply in January

Separately, final French national accounts figures for Q4 today confirmed that the euro area's second largest member state contracted at the end of 2019, with growth of -0.1%Q/Q the first negative reading since Q2'16, to leave output up just 0.9%Y/Y (admittedly a touch firmer than the initial estimate). The detail of the report confirmed that the weakness principally reflected a sizeable drag from private sector inventories. While private sector capex growth was softer than initially estimated (0.2%Q/Q, the weakest for seven quarters), household consumption was a touch firmer (0.3%Q/Q). But today's household spending figures for January signalled a disappointing start to 2020. In particular, expenditure on goods fell for the second successive month and by 1.1%M/M, the most since 2018, to the lowest level since last March. The weakness was dominated by spending on manufactured goods (-2.7%M/M), particularly cars – spending on transport equipment was down more than 7%M/M – and clothing and household appliances sales continued to decline. Admittedly, these data are notoriously volatile. But they still suggested that expenditure was down 0.9% compared with a year ago and up just 0.2% on a three-month on three-month basis. Moreover, given the recent monthly profile, we would need to see growth in excess of 1%M/M in February and March to avoid a contraction over the first quarter as a whole.

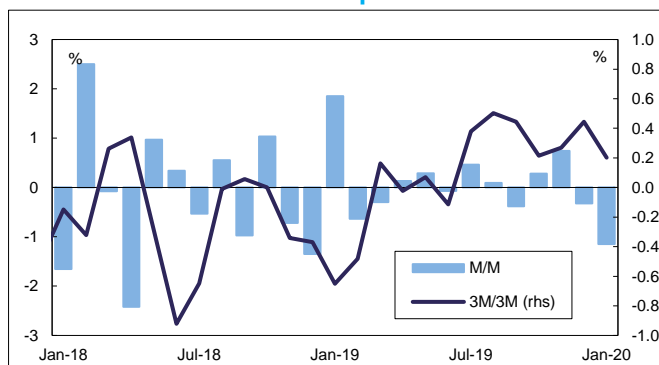
The coming week in the euro area and US

News on the spread of the COVID-19 coronavirus and the responses, if any, of policymakers will continue to dominate attention in the coming week. Nevertheless, several euro area economic releases of note are due, kicking off with the final manufacturing PMIs on Monday. The flash estimates showed the headline index rising 1.2pts to a twelve-month high of 49.1, implying further stabilisation in the sector. But this in part reflected increased supplier delivery times as the initial impact of the coronavirus on availability of components started to take its toll, a development which should be judged to be negative. The majority (if not all) of the survey responses were collected before the virus outbreak escalated in Italy. So, we would expect to see only minimal amendments made to the various PMIs in the final manufacturing survey for this month. The equivalent final services PMI survey (due Wednesday) typically has a slightly longer collection period and therefore might have seen a modest share of firms respond after the surge in Italian cases. But overall, we expect to see only modest downward revisions to the services and composite indices, from the four-month high of 52.8 and six-month high of 51.6 reported in the respective flash estimates.

Wednesday will also bring euro area retail sales figures for January, which seem bound to have picked up at the start of the year following weakness at the end of 2019. However, the 1.6%M/M decline in euro area sales reported in December is likely to be revised given that the drop in Germany is now estimated to have been 2.0%M/M rather than the steeper plunge of 3.3%M/M originally published. Separately, Tuesday will bring the euro area's flash CPI estimate for February. Not least given the downwards shift in the oil price over the past month we expect headline inflation to have fallen back slightly, by 0.1ppt to 1.3%Y/Y. But today's national data also suggest that core inflation might well have edged back up to 1.2%Y/Y. Tuesday will also bring the euro area's latest labour market figures, which are expected to show the unemployment rate unchanged at 7.4% in January, the joint-lowest reading since mid-2008 but still only 0.1ppt lower than in June. Meanwhile, at the country level, German factory orders data, Spanish IP figures and Italian retail sales numbers, all for January, are due to be published on Friday. In the markets, Germany will sell inflation-linked bonds on Tuesday, while France and Spain will sell bonds with various maturities on Thursday.

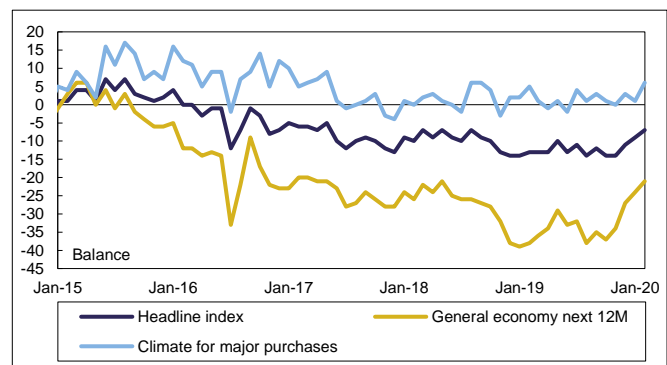
It will be a busy week for US top-tier releases, with the first half dominated by February sentiment surveys, including the manufacturing ISM and final Markit manufacturing PMI (Monday) and the non-manufacturing ISM and final Markit services PMI (Wednesday). The flash PMIs showed signs of a notable weakening in conditions in both the manufacturing and non-manufacturing sectors – indeed, the flash composite PMI fell a sizeable 3.7pts in February to 49.6, the first contractionary reading since October 2013, with the new orders PMI reporting the first sub-50 reading since the series began more than a

France: Household consumption*



*Expenditure on goods. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: GfK consumer confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

decade ago. The ISM indices, however, are expected to remain consistent with steady expansion. Wednesday will also bring the ADP employment report ahead of Friday's more closely watched BLS payrolls report. The latter is expected to show another strong increase in non-farm payrolls in February (below the 225k increase seen in January but above the 175k average of 2019), to leave the unemployment rate unchanged at 3.6%. Friday will also see the release of the full trade report for January, as well as consumer credit figures for the same month. Other releases include February vehicle sales numbers (Tuesday), January factory orders and revised productivity figures for Q4 (Thursday). Meanwhile, politics-wise, 'Super Tuesday' will determine the results of the Democrat primaries in 14 states and about one third of delegates to the National Convention in July.

UK

Carney keeps his powder dry

Like in the euro area, today's UK economic releases played second fiddle to market developments. Indeed, while the reported number of cases in the UK (19) remains relatively low compared with other major euro area member states, UK markets unsurprisingly followed the global trend. The FTSE 100 touched its lowest levels since July 2016 and, at the time of writing, was on track to end the day down more than 3% to more than 11% lower over the week as a whole. And 10Y Gilt yields briefly hit a record low below 0.40%, with markets pricing in a probability of greater than 50% of a 25bp cut in Bank Rate as soon as next month. In a Sky TV interview earlier today, BoE Governor Carney was non-committal, judging that it is still too soon to assess the likely overall macroeconomic impact of the virus and hence the case for monetary easing. But he acknowledged that global growth is likely to be weaker, and that there is already evidence of an impact on UK demand (e.g. via tourism) while supply chains are becoming tighter. The relative magnitudes of the supply- and demand-side effects will determine the case for further easing, as monetary policy is largely only able to address the latter. But we suspect that the demand impact will be greater, strengthening the case for a rate cut despite the tight UK labour market.

Consumers were a touch more upbeat
















The escalation of the coronavirus outbreak and associated market developments seem likely to weigh on business and household sentiment in due course. But today's release of the GfK consumer confidence survey for February showed a modest improvement in household sentiment this month against the backdrop of low unemployment, reduced political uncertainty and rising housing prices. In particular, the GfK survey's headline confidence index increased by 2pts to -7, its highest reading since August 2018. Households were reportedly more sanguine about general economic conditions both over recent months and looking ahead – indeed, the index for expectations over the coming twelve months rose 3pts in February to -21, 17pts above its level a year ago. And so, the survey also reported a notable pickup in households' willingness to make major purchases – the relevant index rose 5pts on the month to +6, albeit only marginally stronger than a year earlier. Today's survey was conducted during the first half of the month and we should fully expect next month's survey to paint a much gloomier picture.

The coming week in the UK

The start of the week will bring the launch of the first round of negotiations between the UK and EU on their future relationship. There appears to be a [significant gap](#) between the positions of the two sides. And the UK government has already soured the mood with its threat of walking away from the talks if there is insufficient progress in line with its wishes by June, and also by suggesting that it might backtrack on its earlier commitments (e.g. indicating an unwillingness to implement fully the Northern Ireland Protocol of the Withdrawal Agreement). Nevertheless, we still see scope for an eventual deal, albeit perhaps not until October. As such, the talks seem likely to generate far more heat than light for several months, a process that might thus be expected to fuel uncertainty and, given the risks that the EU and UK will be trading on WTO rules from the start of 2021 if there is no deal, undermine business confidence and harm investment expenditure too.

Turning to the data, the final UK PMI surveys for February will be the main focus at the start of the week, with the manufacturing, construction and services indices due Monday, Tuesday and Wednesday respectively. But similar to the euro area releases, responses to these surveys are likely to have been largely collected before the acceleration of coronavirus cases in Italy. And given the arithmetic calculation of the manufacturing PMI – that an undesirable lengthening of supplier delivery times adds positively to the headline index – we wouldn't expect to see a significant downwards revision to the preliminary estimate (which had risen 1.9pts to a ten-month high of 51.9). However, the longer survey collection period might trigger a modest downwards revision to the services PMI (which already fell 0.6pt in the flash estimate to 53.3) on heightened coronavirus concerns. Other releases due in the coming week include the BoE's latest lending figures (Monday), new car registrations numbers (Thursday) and the REC/KPMG Report on UK Jobs (Friday). In the markets, the DMO will sell 5Y Gilts on Wednesday and 8Y inflation-linked Gilts on Thursday.

Daiwa economic forecasts










		2019		2020				2021		2019	2020	2021
		Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP forecasts %, Q/Q												
Euro area		0.3	0.1	0.1	0.2	0.2	0.2	0.2	0.1	1.2	0.6	0.6
Germany		0.2	0.0	0.1	0.1	0.2	0.2	0.2	0.0	0.6	0.4	0.6
France		0.3	-0.1	0.2	0.2	0.2	0.2	0.2	0.2	1.2	0.7	0.8
Italy		0.1	-0.3	-0.1	0.0	0.0	-0.1	0.0	-0.1	0.2	-0.2	-0.1
Spain		0.4	0.5	0.2	0.3	0.4	0.4	0.4	0.2	2.0	1.4	1.2
UK		0.5	0.0	0.1	0.2	0.3	0.3	0.1	0.3	1.4	0.7	0.8
Inflation forecasts %, Y/Y												
Euro area												
Headline CPI		1.0	1.0	1.3	1.1	1.3	1.3	1.3	1.2	1.2	1.3	1.3
Core CPI		0.9	1.2	1.2	1.2	1.2	1.1	1.2	1.1	1.0	1.2	1.2
UK												
Headline CPI		1.8	1.4	1.5	1.0	1.0	1.2	1.6	1.9	1.8	1.2	1.9
Core CPI		1.7	1.6	1.4	1.4	1.4	1.6	1.8	2.0	1.8	1.4	2.0
Monetary policy												
ECB												
Refi Rate %		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %		-0.50	-0.50	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60	-0.50	-0.60	-0.60
Net asset purchases*		0	20	20	20	20	20	20	20	20	20	20
BoE												
Bank Rate %		0.75	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.75	0.50	0.50
Net asset purchases**		0	0	0	0	0	0	0	0	0	0	0

*Monthly target €bn, end of period. **Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE 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	 Unemployment rate % (change '000s)	Feb	5.0 (-10.0)	5.0 (4.5)	5.0 (-2.0)	- (-4.0)
	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Feb	1.7 (1.7)	1.7 (1.5)	1.7 (1.6)	-
France	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Feb	1.4 (1.6)	1.5 (1.6)	1.5 (1.7)	-
	 Consumer spending M/M% (Y/Y%)	Jan	-1.1 (-0.9)	0.0 (0.3)	-0.3 (2.0)	-
	 Final GDP Q/Q% (Y/Y%)	Q4	-0.1 (0.9)	-0.1 (0.8)	0.3 (1.4)	-
Italy	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Feb	0.4 (0.3)	0.6 (0.4)	0.5 (0.4)	-
UK	 GfK consumer confidence indicator	Feb	-7	-8	-9	-
	 Lloyds business barometer	Feb	23	-	23	-
	 Nationwide house price index M/M% (Y/Y%)	Feb	0.3 (2.3)	0.4 (2.3)	0.5 (1.9)	-










Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.












Coming week's data calendar

The coming week's key data releases

Country		GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 2 March 2020						
EMU		09.00	Final manufacturing PMI	Feb	49.1	47.9
Germany		08.55	Final manufacturing PMI	Feb	47.8	45.3
France		08.50	Final manufacturing PMI	Feb	49.7	51.1
Italy		08.45	Manufacturing PMI	Feb	49.0	48.9
		10.00	GDP Y/Y%	2019	0.2	0.9
Spain		08.15	Manufacturing PMI	Feb	48.9	48.5
UK		09.30	Final manufacturing PMI	Feb	51.9	50.0
		09.30	Net consumer credit, £bn (Y/Y%)	Jan	1.1 (-)	1.2 (6.1)
		09.30	Net mortgage lending, £bn (approvals, 000s)	Jan	4.6 (67.8)	4.6 (67.2)
Tuesday 3 March 2020						
EMU		10.00	Preliminary CPI (core CPI) Y/Y%	Feb	1.2 (1.2)	1.4 (1.1)
		10.00	Unemployment rate %	Jan	7.4	7.4
		10.00	PPI Y/Y%	Jan	-0.5	-0.7
Italy		09.00	Unemployment rate %	Jan	9.8	9.8
Spain		08.15	Unemployment change, 000s	Feb	-	90.2
UK		09.30	Construction PMI	Feb	49.0	48.4
Wednesday 4 March 2020						
EMU		09.00	Final services (composite) PMI	Feb	52.8 (51.6)	52.5 (51.3)
		10.00	Retail sales M/M% (Y/Y%)	Jan	0.6 (0.8)	-1.6 (1.3)
Germany		07.00	Retail sales M/M% (Y/Y%)	Jan	0.8 (1.5)	-2.0 (1.7)
		08.55	Final services (composite) PMI	Feb	53.3 (51.1)	54.2 (51.2)
France		08.50	Final services (composite) PMI	Feb	52.6 (51.9)	51.0 (51.1)
Italy		08.45	Services (composite) PMI	Feb	51.5 (50.2)	51.4 (50.4)
		09.00	Final GDP Q/Q% (Y/Y%)	Q4	-0.3 (0.0)	0.1 (0.3)
Spain		08.15	Services (composite) PMI	Feb	52.5 (51.7)	52.3 (51.5)
UK		09.30	Final services (composite) PMI	Feb	53.3 (53.3)	53.9 (53.3)
Thursday 5 March 2020						
Germany		08.30	Construction PMI	Feb	-	54.9
UK		09.00	New car registrations Y/Y%	Feb	-	-7.3
Friday 6 March 2020						
Germany		07.00	Factory orders M/M% (Y/Y%)	Jan	1.5 (-5.1)	-2.1 (-8.7)
France		07.45	Trade balance, €bn	Jan	-	-4.1
Italy		09.00	Retail sales M/M% (Y/Y%)	Jan	-	0.5 (0.9)
Spain		08.00	Industrial production M/M% (Y/Y%)	Jan	- (-)	-1.4 (0.8)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		GMT	Event / Auction
Monday 2 March 2020			
EMU		10.00	OECD publishes its Interim Economic Outlook
Tuesday 3 March 2020			
Germany		10.30	Auction: €250mn of 0.1% 2026 index-linked bonds
		10.30	Auction: €250mn of 0.5% 2030 index-linked bonds
Wednesday 4 March 2020			
UK		10.30	Auction: £3.5bn of 0.625% 2025 bonds
Thursday 5 March 2020			
France		09.50	Auction: 0% 2029 bonds
		09.50	Auction: 1.25% 2034 bonds
		09.50	Auction: 0.75% 2052 bonds
UK		10.30	Auction: £1.1bn of 0.125% 2028 index-linked bonds
		13.00	BoE Chief Economist Haldane scheduled to speak
		17.00	BoE Governor Carney scheduled to speak
Friday 6 March 2020			
UK		00.01	REC/KPMG Report on UK Jobs

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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