Euro wrap-up

Overview

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- Bunds rallied and BTPs continued to sell as the coronavirus continued to spread in Europe and expectations of a near-term policy response from the ECB continued to rise.
- Gilts also rallied as market expectations of a rate cut as soon as this month also increased further.
- While the spread of the coronavirus and associated outcome from tomorrow's reported teleconference of G7 finance ministers and central bank governors will dominate attention, Tuesday will also bring the flash estimate of euro area inflation in February.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.841	-0.058
OBL 0 04/25	-0.807	-0.038
DBR 0 02/30	-0.626	-0.015
UKT 0½ 07/22	0.267	-0.042
UKT 0⅝ 06/25	0.257	-0.030
UKT 4¾ 12/30	0.413	-0.029

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

Euro area

ECB officials again suggest no rush to act

While the Fed, BoJ and the BoE (see below) all issued special statements either side of the weekend making clear their readiness to act to mitigate risks posed by the coronavirus, the ECB refrained from doing likewise. A couple of Governing Council members, however, did speak publicly today. And while they suggested no hurry to amend policy, they very much left on the table the possibility that new action would be taken before too long.

But ready to do more

In particular, in an early TV interview, Bank of France President Villeroy de Galhau stated that "We are vigilant, we are mobilized, but we remain calm and proportional in the responses we need to have". And while he noted that ECB monetary policy is already accommodative, and liquidity for banks is abundant, he added that "If more was needed and we were convinced that it would be effective, then we can do more. But we are not there yet." Later in the day, ECB Vice President de Guindos echoed Villeroy's vocabulary about vigilance, noted the Governing Council will closely monitor incoming data, and reiterated the current forward guidance, i.e. that the ECB stands ready to adjust all instruments as needed. So, rate cuts and/or further asset purchases are likely to be discussed at next week's Governing Council meeting.

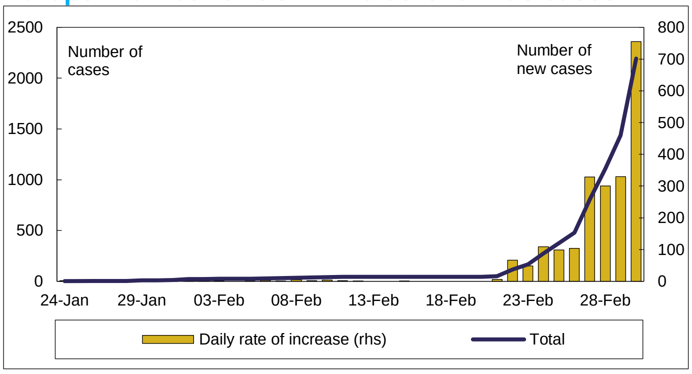
Market developments weaken economic outlook

While the Governing Council will try to weigh up the relative magnitudes of the evolving shocks to supply and demand, market developments suggest that the economic outlook has already weakened significantly. Financial conditions have tightened. Equity market losses have hit wealth and economic sentiment, which will reduce spending. And market-determined prices, such as those for oil, will lower the inflation outlook too. Indeed, market measures of inflation expectations have fallen, e.g. the 5Y5Y inflation forward swap rate today dropped near series lows below 1.10%, about 25bps lower than January's peak.

Governing Council to wait first for more data and fiscal policy?

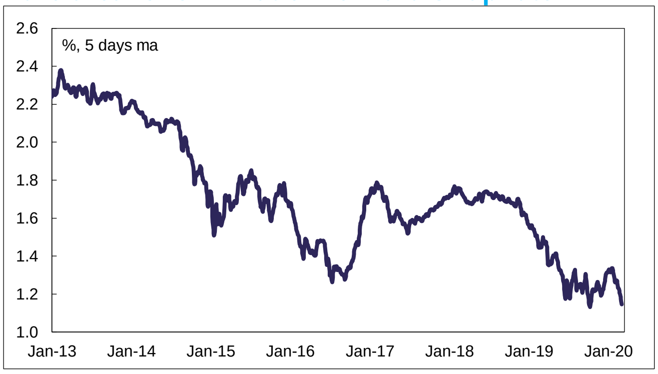
The number of coronavirus cases in Italy roughly doubled over the past weekend to above 1700, about fourteen times the level a week ago. A similar pace of increase might soon be registered in France, Spain and Germany. However, recent comments from ECB policymakers suggest that they still want to wait for the impact of the epidemic to show up more clearly

Europe: Number of COVID-19 coronavirus cases



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: 5Y5Y inflation forward swap rate



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

in the economic data before recalibrating policy. That probably will not be the case until the flash March PMIs are released in just over three weeks' time. The ECB might also want to wait for greater clarity on the response of fiscal policy. The first substantive announcement on this front came on the weekend from Italy. Today's better-than-expected Italian deficit outturn for 2019 (1.6% of GDP, 0.6ppt below target) suggested room for manoeuvre for the government. But the planned support package, which will include tax and spending measures, still looks likely to amount to little more than 0.2% of GDP, insufficient to fully offset the adverse impact on GDP.

ECB to be persuaded by others to move soon?

Admittedly, a teleconference among euro area finance ministers will be held on Wednesday, and the possibility of a more coordinated fiscal stimulus across the member states might be discussed. The outcome of a G7 teleconference of finance ministers and central bank governors, reportedly scheduled for tomorrow, might well also persuade the ECB of the case for earlier action. And next week's Governing Council meeting will at a minimum bring strengthened forward guidance to make clear that the likelihood of near-term monetary easing has increased. However, a 10bp cut in the deposit rate to -0.60%, perhaps accompanied by an increased pace of corporate bond purchases, might well not come until April.

Euro area manufacturing PMI nudged slightly higher

Overall, the final manufacturing PMI surveys for February, published today, will have offered little reassurance for officials. Admittedly, the euro area's headline index was nudged slightly higher (by 0.1pt) from the preliminary reading, which itself was up 1.2pts from January, to a twelve-month high of 49.2. The final output index was a touch firmer too, to leave it up 0.7pt on the month at a nine-month high 48.7. But this still pointed to mild contraction in the sector last month. The 'improvement' also in part reflected increased supplier delivery times as the initial impact of the coronavirus on availability of components started to take its toll, which counter-intuitively boosted the headline index. And while the final survey captured only 4% of total responses, there was further evidence of supply-side disruption than in the flash PMIs, with the relevant index revised even lower (by 0.2pt) to 46.2, representing the largest monthly drop (-4.8pts) since 2010 and suggesting the most widespread delays since end-2018. Moreover, with the outbreak of coronavirus cases across Europe having escalated since the survey was conducted (13-21 February), and the Chinese PMIs having subsequently implied a significant hit to economic activity over the past month, we would certainly expect to see a more severe hit to conditions reported in the March PMIs.

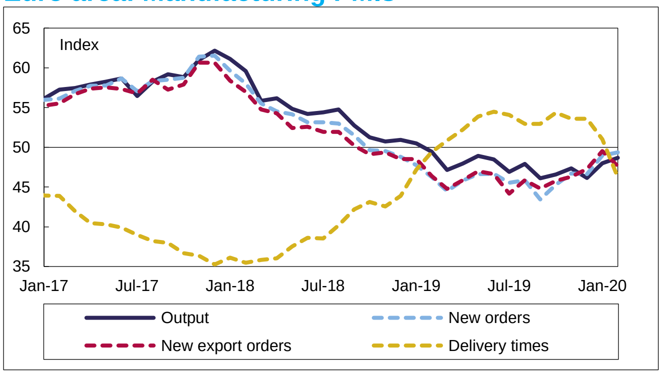
Mixed country performance before the surge in coronavirus cases

At the country level, the final February German survey followed a similar pattern to the euro area, i.e. the headline index was revised up by 0.2pt to 48.0, an increase of 2.7pts on the month and the highest reading since the start of 2019. The output component was also revised higher (by 0.3pt to 47.3), while the new orders index was a touch firmer than initially estimated (by 0.5pt to 49.4). Surprisingly, this reflected a slightly improved new exports orders PMI from the flash, although it was still 3.5pts lower than in January. And there was further evidence of supply constraints, with the index representing suppliers' delivery times down a whopping 8.3pts, the largest monthly drop since the series began in the mid-1990s. Despite a modest upwards revision, the headline French manufacturing PMI still fell 1.3pts over the month to 49.8, the first reading in contractionary territory since July. This was in spite of a 'boost' from longer supplier delivery times (down 2.5pts), as the output and new orders indices fell a steep 2.0pts and 3.1pts respectively. Finally, having been conducted before the lockdown in key manufacturing regions in Northern Italy, the drop in the Italian PMI was also modest, down just 0.2pt to 48.7, with the output PMI down 0.9pt to 46.7. But this still marked the nineteenth consecutive month in contractionary territory and seems bound to be pushed significantly lower this month.

The day ahead in the euro area and US

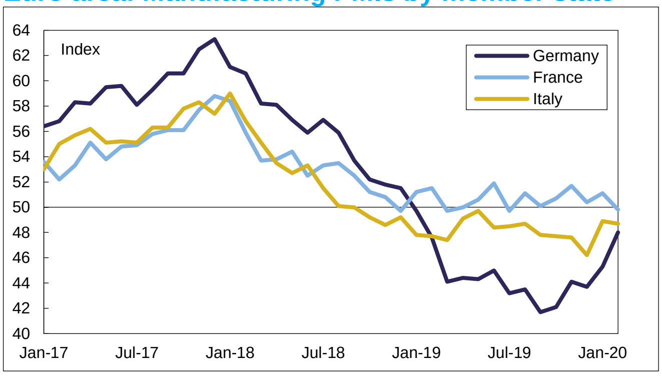
Reportedly tomorrow could bring a teleconference meeting of G7 finance ministers and central bank governors. While we would not expect imminent policy easing, we might well see a joint statement from policymakers emphasising that they stand

Euro area: Manufacturing PMIs



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

Euro area: Manufacturing PMIs by member state



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

ready to take necessary action to ensure financial stability and support growth as the impact of the coronavirus outbreak continues to weigh. Turning to the data, tomorrow will bring the flash euro area 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 Friday's national data also suggest that core inflation might well have edged back up, probably 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. Elsewhere, ECB Vice-President De Guindos and Executive Board member Schnabel are due to speak at a joint ECB and European Commission conference on "The roles of equity markets and financial technology". In the markets, Germany will sell 4Y and 10Y linkers.

In the US, Tuesday will bring vehicle sales figures for February, while FOMC voting member Mester is due to speak in London. 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

BoE preparing to take further action

Like the ECB, the BoE would probably prefer not to have to ease policy further if it could get away with it. So, unlike Fed Chair Powell's statement on Friday (which focused on the impact of the economic outlook), but like today's statement from BoJ Governor Kuroda, today's statement from the BoE focused on its desire to mitigate market risks rather than offset any economic slowdown. In particular, the BoE announced that it will "ensure all necessary steps are taken to protect financial and monetary stability", suggesting a preference, if any policy response is required, for special market operations over rate cuts. Like the ECB, the BoE will also await clarity on fiscal policy, which will come in the Chancellor's Budget announcement on 11 March. That might well see the government relax its fiscal rules and propose a significant near-term loosening of fiscal policy. However, with the impact of the fiscal stimulus likely to be lagged, and the deterioration in macroeconomic conditions likely to be laid bare in the flash UK PMIs on 24 March, sufficient evidence to justify a 25bp cut to Bank Rate should be available by the time of the MPC's next policy meeting on 26 March, the first to be chaired by Andrew Bailey as Governor.

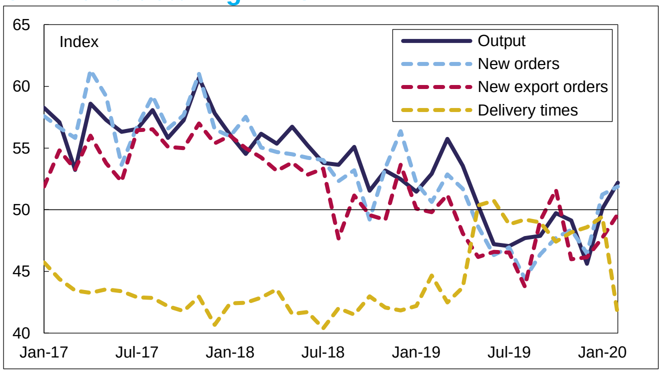
Manufacturing PMI flags early impact of the epidemic

Like in the euro area, the final UK manufacturing PMI at face value implied only a modest downwards revision from the flash survey, with the headline index 0.2pt lower at 51.7, suggesting an improvement in conditions in February with the 1.7pt increase on the month leaving it more than 4pts higher than the December low. But with the UK survey's response period four days longer than the euro area's survey (until 25 February), and roughly 20% of respondent firms having submitted their assessments subsequent to the flash release, there was greater evidence of an impact from the escalation of the coronavirus crisis. For example, there was a significant lengthening of suppliers' delivery times, with the revised PMI having declined by an additional 1pt to leave the monthly decline of 8pts the steepest in the survey's 28-year history. In addition, the downwards revision to the new exports orders PMI was striking, down 1.3pts from the flash estimate (6½pts in weighted terms) as manufacturers reported reduced demand from Asia as well as some signs of re-routing of supply chains following Brexit. So, while total new orders and production were reportedly higher than in January, the respective indices were also revised lower from the flash in February (by 0.4pt to 51.9 and 0.6pt to 52.2). Overall, like with the euro area survey, we would expect to see the PMIs take a marked downturn in March.

The day ahead in the UK

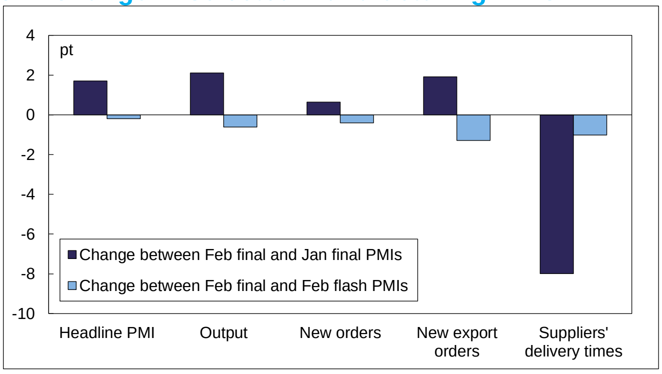
Tomorrow will bring the equivalent construction sector PMI, which is expected to suggest further improvement in conditions in the sector in February, albeit still leaving the headline index in contractionary territory.

UK: Manufacturing PMIs



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

UK: Change in selected manufacturing PMIs*



**Figures for January and February 2020. Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Final manufacturing PMI	Feb	**49.2**	49.1	47.9	-
Germany	Final manufacturing PMI	Feb	**48.0**	47.8	45.3	-
France	Final manufacturing PMI	Feb	**49.8**	49.7	51.1	-
Italy	Manufacturing PMI	Feb	**48.7**	49.0	48.9	-
	GDP Y/Y%	2019	**0.3**	0.2	0.8	-
Spain	Manufacturing PMI	Feb	**50.4**	48.9	48.5	-
UK	Final manufacturing PMI	Feb	**51.7**	51.9	50.0	-
	Net consumer credit, £bn (Y/Y%)	Jan	**1.2 (6.1)**	1.1 (-)	1.2 (6.1)	**1.3 (-)**
	Net mortgage lending, £bn (approvals, 000s)	Jan	**4.0 (70.9)**	4.6 (67.8)	4.6 (67.2)	**4.4 (67.9)**

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/ *Daiwa forecast*	Previous
EMU	10.00	Preliminary CPI (core CPI) Y/Y%	Feb	1.3 (1.2)	1.4 (1.1)
	10.00	Unemployment rate %	Jan	7.4	7.4
	10.00	PPI Y/Y%	Jan	-0.4	-0.7
Italy	09.00	Unemployment rate %	Jan	9.8	9.8
Spain	08.15	Unemployment change, 000s	Feb	5.8	90.2
UK	09.30	Construction PMI	Feb	49.0	48.4

Auctions and events

Country	GMT	Auction / Event
Germany	10.30	Auction: €250mn of 0.1% 2026 index-linked bonds
	10.30	Auction: €250mn of 0.5% 2030 index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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