Euro wrap-up

Overview

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- Bunds made further gains, with 10Y yields briefly at a record low, as the coronavirus continued to spook investors.
- Gilts plunged to record lows across the curve after Carney did not rule out the BoE easing policy ahead of the next scheduled MPC meeting.
- The coming week will see the ECB announce its response to the coronavirus epidemic while the BoE might respond after the UK government's budget announcement.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.882	-0.013
OBL 0 04/25	-0.876	-0.008
DBR 0 02/30	-0.729	-0.039
UKT 0½ 07/22	0.096	-0.074
UKT 0⅝ 06/25	0.119	-0.093
UKT 4¾ 12/30	0.224	-0.110

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

Euro area

Bund yields and inflation expectations test new lows

Ahead of another weekend that seems more likely than not to bring further bad news on the spread of the coronavirus, Europe's financial markets had another torrid day. Certainly, the European newsflow on the epidemic continues to worsen, with the death toll above 150 in Italy, and the number of cases in the other large member states up sharply too (e.g. about one third higher in Germany to more than 530, up more than 50% in the region of Madrid to 137, and the first death confirmed in the Netherlands). So, investors appropriately ignored today's extraordinarily strong report for German factory orders (the strongest rise in more than five years, detail below) as well as yesterday's announcement that it would relax fiscal policy by more than previously expected (about €7.5bn, or 0.4% of GDP). Stocks fell sharply again while core government bonds rallied, pushing the 10Y Bund yield briefly down to a record low of -0.75%). And with the price of Brent crude falling firmly below $47bbl for the first time since mid-2017, the euro up to its strongest level in trade-weighted terms in more than a year, and market measures of inflation expectations crashing to new lows (the 5Y5Y euro inflation forward swap rate briefly dropped to below 1.00%), financial market events alone already suggest a significant deterioration in the inflation outlook.

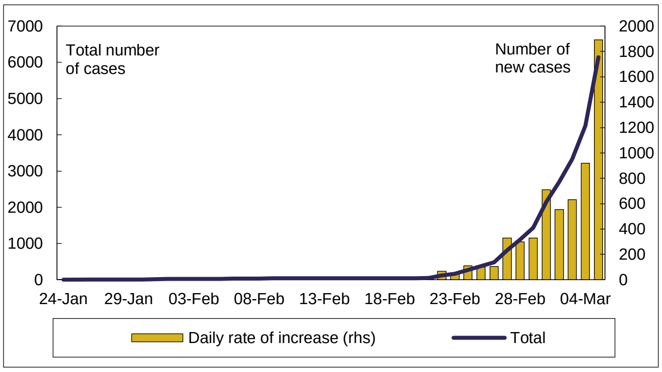
Economic impact still unclear, but case for ECB easing strong

The recent sharp moves in financial market variables and accelerated spread of the epidemic in Europe, came well after the end of the cut-off dates (in the third week of February) to be used in the ECB's updated economic forecasts due in the coming week. So, those projections will be out of date before they have been published. But given the lack of hard economic data for the period since the outbreak (the first meaningful macro figures will arguably be the flash March PMIs on 24 March), as well as the unpredictability of the spread of the virus, it is impossible to forecast with any precision the near-term economic outlook. Nevertheless, based on early indications of the hit to activity in various sectors, not least travel, tourism, recreation and hospitality, as well as recent market moves, we have revised down our own projections to provide an indicative guide to the likely profile of activity. We now anticipate two consecutive negative quarters of GDP growth in the euro area in Q1 and Q2, with a rebound in Q3. Inflation will weaken over the near term too – probably to well below 1%Y/Y in March, and close to ½%Y/Y in Q2 and perhaps also well into the second half of the year. And given that likelihood, as well as the likely adverse financial market consequences if it did not act, the ECB seems bound to announce changes to policy when the Governing Council makes its next scheduled policy announcement on Thursday.

ECB decision to prove highly divisive

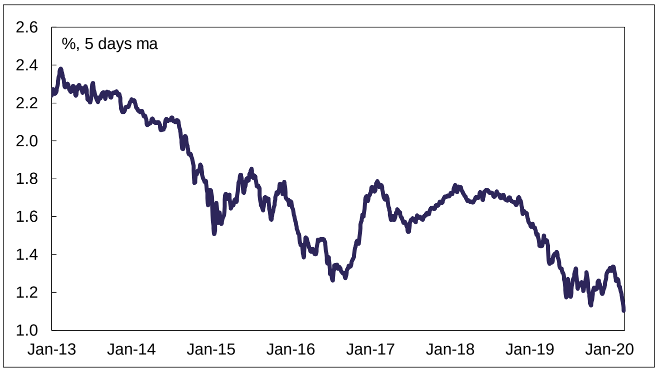
Quite what the ECB will agree to do, however, is unclear. Just as last September's easing package proved divisive, with several Governing Council members opposed particularly to the resumption of net asset purchases, there will also be opposition to aggressive monetary easing this time around. Many members remain sceptical about the wisdom of that decision to recommence

Europe: Number of coronavirus COVID-19 cases



Source: WHO and Daiwa Capital Markets Europe Ltd.

Euro area: 5Y5Y inflation expectations



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

QE. Several also have doubts about the appropriateness of cutting the deposit rate further given concerns about potential negative side-effects. And another TLTRO-III operation is already to be conducted this month, with bids due by 18 March. So, policy already looks close to the limits of what the Governing Council might judge to be acceptable.

Don't rule out a package of easing measures

Reports have suggested that, like the BoJ and BoE, the ECB is considering a special facility to support lending to SMEs affected by the coronavirus. Designing an effective system for a region of nineteen member states, where governments might be required to indemnify against losses, will be complex. And while Lagarde might announce plans to develop such arrangements, the detail would likely need to be finalised at a future meeting. In the meantime, however, the Governing Council would be justified in announcing more generous conditions, including a lower interest rate, for the current round of TLTRO-III loans. It might also announce an explicit increase in its corporate bond purchases, which have averaged just over €4.5bn per month over the past four months. And, if the euro keeps appreciating and financial market measures of inflation expectations keep falling, we certainly would not rule out a further 10bp cut in the deposit rate to -0.60%, offset somewhat with an increase in the increase the share of banks' deposits exempt from the negative deposit facility rate to soften the impact on the banking sector.

German factory orders surge…

Germany's factory orders data released today smashed expectations, rising an extraordinary 5.5%M/M in January to be down just 1.4%Y/Y to suggest that the manufacturing sector was turning for the better at the start of the year before the coronavirus hit. Admittedly, the rise came on the back of December's drop of 2.1%M/M to a four-year low. And these data are typically highly volatile. Moreover, the rise was significantly flattered by major orders, particularly in the aerospace sector and machinery. Nevertheless, even excluding such major orders, new German factory orders rose 2.3%M/M to be down just 0.2%3M/3M and 4.0%Y/Y, the smallest year-on-year decline on this basis in a year. Excluding those bulky items, domestic orders were still unchanged, but orders from elsewhere in the euro area were up 2.0%M/M while those from beyond the euro area were up 5.2%M/M.

…pointing to positive production in January

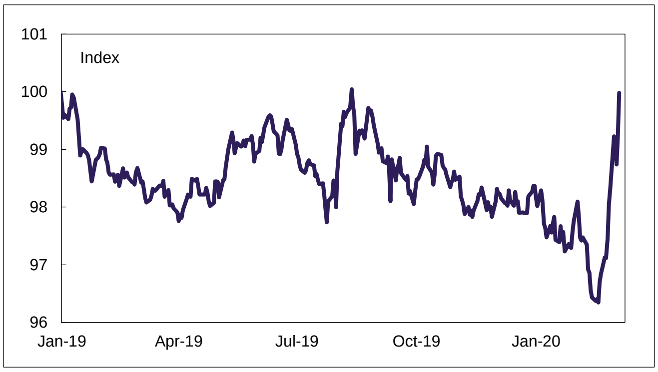
Within the detail, most major categories saw growth in orders in January (e.g. chemicals were up 7.0%M/M, and basic metals were up 2.5%M/M). But the dire performance in the autos sector continued, with total orders down another 0.5%M/M and domestic orders down almost 10%M/M. We already learned earlier this week that German new car registrations dropped 11.0%Y/Y in February, while car production was down 12.0%Y/Y last month. Nevertheless, overall manufacturing turnover rose 2.0%M/M in January to suggest that the IP figures due to be released on Monday will also show a firm rebound. The consensus forecast is for growth of 1.7%M/M. But given the extreme weakness in manufacturing and (in particular) construction in December, we see the risks to that as skewed to the upside.

The week ahead in the euro area and US

With economic conditions across the euro area having deteriorated markedly over the past couple of weeks as the coronavirus took hold across the member states, the coming week's data releases for January should be of relatively little relevance for the ECB's decision. Nevertheless, they will still provide an insight into the strength of the incipient recovery in the manufacturing sector at the start of the year, with euro area IP figures due for release on Thursday. These are expected to show that output rose almost 1½%M/M in January, albeit not fully offsetting the drop of more than 2%M/M in December. More insight from the member states will come from Germany (Monday), France, Italy (Tuesday), and the Netherlands (Wednesday). The Bank of France's latest business sentiment survey for February is also due for release on Monday.

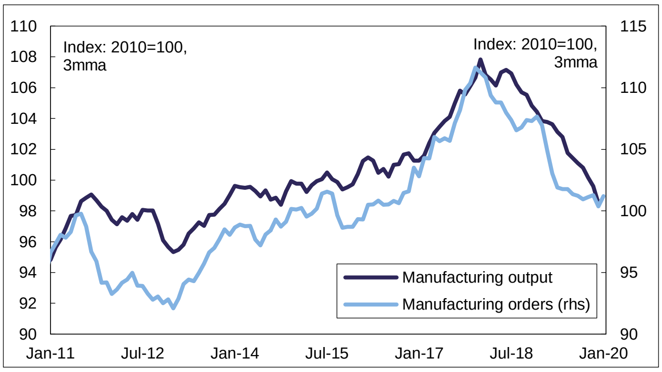
Also of note will be Tuesday's release of updated euro area national accounts figures for Q4, which will provide the first official expenditure breakdown. While GDP growth is expected to be unrevised at 0.1%Q/Q, we expect household consumption growth to have slowed to its weakest rate since Q114 to provide only modest support. And a boost from net trade will likely be more than offset by a drag from inventories. That day will also bring updated Q4 employment figures. Tuesday will also bring German labour

Euro: Trade-weighted exchange rate



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

Germany: Manufacturing output and orders



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

costs figures for Q4. The end of the week will see the release of final February inflation figures from Germany, France and Spain. In the markets, Germany will sell 10Y Bunds on Wednesday.

In the US, the coming week's data calendar kicks off on Tuesday with the latest NFIB small business optimism index and will conclude with the preliminary University of Michigan's consumer sentiment survey for March on Friday. Both seem bound to suggest a drop in confidence as the coronavirus spread in the US. Indeed, while February's headline consumer confidence index rose to its second-highest reading since the early 2000s, the survey flagged some growing concerns in the latter responses and global equity markets have subsequently plummeted. In between, Wednesday's release of February CPI figures will be most noteworthy. With prices expected to be unchanged on the month, the annual inflation rate is forecast to have fallen back last month, by 0.3ppt to 2.2%Y/Y on the back of lower energy inflation. Indeed, core inflation is anticipated to be little changed at 2.3%Y/Y. In terms of politics, Tuesday will also bring the results of the Democrat primaries in a further 6 states, to leave 48% of delegates determined. In the markets, the Treasury will sell 3Y notes on Tuesday, 10Y notes on Wednesday and 30Y bonds on Thursday.

UK

Carney left door open to an emergency rate cut

While Gilt yields continue to hit new record lows, the BoE is fully expected to ease policy this month. The questions are when and how far it will go. In the Q&A section of his UCL lecture yesterday evening, Governor Carney left open the possibility of action before the next scheduled MPC meeting on 26 March. And with confirmation that the BoE is closely coordinating policy with HM Treasury, we would not rule out an announcement from the BoE shortly after the Chancellor's Budget statement on Wednesday. Certainly, the Government will announce fiscal stimulus that day. And while UK Finance, which represents the main High Street banks, announced today that its members would support customers hit by the virus by possibly increasing overdrafts or offering repayment relief, the Chancellor looks set to unveil a new programme of loan guarantees for affected firms. To support that agenda, the BoE might be expected to bring back a variant of its Term Funding Scheme to support lending. An adjustment to banks' countercyclical buffer rate, which is currently scheduled to be increased at the end of the year, could also be made. And while it might be left to the scheduled meeting later in the month, we do not rule out an emergency rate cut – of either 25 or 50bps – in the coming week too.

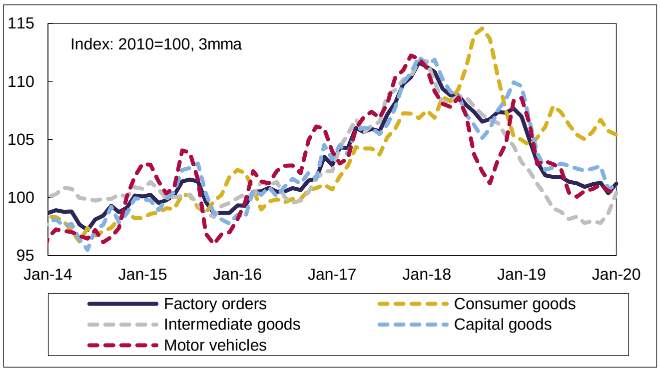
Labour market improves, but demand remains weak

Turning to today's releases, the REC/KPMG Report on UK Jobs predictably suggested a further improvement in labour market conditions last month as businesses continued to see stronger activity in the face of diminished political uncertainties. In particular, recruiters suggested that permanent placements rose at the fastest pace in fourteen months in February, while demand for staff also improved with vacancies rising by the most for more than a year. So, with recruiters citing a shortage of skilled candidates, today's survey also implied a pickup in starting salaries, by the most since June. However, the outlook for jobs growth over the near term will undoubtedly be impacted by increased concerns about the coronavirus, with a notable hit already underway in the tourism and recreation-related sectors in particular. But even as the jobs market was looking more promising, yesterday's new car registrations figures – down 2.9%Y/Y to leave the annual level of registrations at its lowest for six years – signalled little improvement in domestic demand in February.

The week ahead in the UK

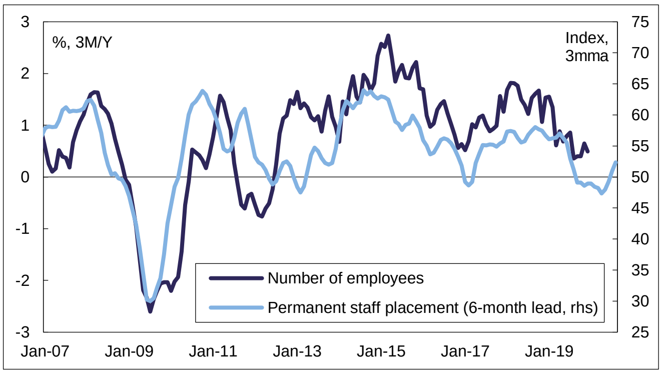
While all attention in the UK on Wednesday will be on the economic policy announcements, that day will also be the most notable for UK economic releases, with monthly GDP, output and trade figures for January due. GDP is expected to have increased by 0.2%M/M that month, reflecting modest growth in services and manufacturing output. But having recorded the first surplus since the mid-1980s in December, the goods trade balance is expected to have returned to deficit as the one-off effect boosting December's outturn reversed. The coming week will also bring the BRC retail sales monitor for February (Tuesday) and the RICS house price survey (Thursday). In the markets, the DMO will sell 10Y Gilts on Tuesday.

Germany: Manufacturing orders by type of good



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Employment and REC/KPMG survey indicator



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

Daiwa economic forecasts

	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2019	2020	2021
GDP forecasts %, Q/Q											
Euro area	0.3	0.1	-0.1	-0.3	0.4	0.2	0.2	0.1	1.2	0.2	0.6
Germany	0.2	0.0	0.0	-0.2	0.4	0.2	0.2	0.0	0.6	0.1	0.6
France	0.3	-0.1	0.0	-0.2	0.3	0.2	0.2	0.2	1.3	0.2	0.7
Italy	0.1	-0.3	-0.3	-0.5	0.4	0.1	0.1	0.1	0.3	-0.6	0.3
Spain	0.4	0.5	0.1	-0.1	0.5	0.4	0.4	0.2	2.0	1.0	1.2
UK	0.5	0.0	0.1	-0.1	0.3	0.3	0.1	0.3	1.4	0.4	0.7
Inflation forecasts %, Y/Y											
Euro area											
Headline CPI	1.0	1.0	1.1	0.4	0.5	0.5	0.6	1.1	1.2	0.6	1.1
Core CPI	0.9	1.2	1.1	0.6	0.5	0.4	0.5	0.9	1.0	0.6	1.0
UK											
Headline CPI	1.8	1.4	1.5	0.8	0.9	1.1	1.5	2.0	1.8	1.1	1.9
Core CPI	1.7	1.6	1.4	1.0	1.1	1.2	1.6	2.2	1.7	1.2	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	0.50	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/ <u>*Daiwa forecast*</u>	Previous	Revised
Germany	Factory orders M/M% (Y/Y%)	Jan	**5.5 (-1.4)**	1.3 (-5.2)	-2.1 (-8.7)	**- (-8.9)**
France	Trade balance, €bn	Jan	**-5.9**	-4.8	-4.1	**-3.7**
Italy	Retail sales M/M% (Y/Y%)	Jan	**0.0 (1.4)**	-	0.5 (0.9)	**- (0.8)**
Spain	Industrial production M/M% (Y/Y%)	Jan	**0.2 (-2.1)**	0.5 (-1.4)	-1.4 (0.8)	**-1.2 (1.1)**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Construction PMI	Feb	**55.8**	-	54.9	-
UK		New car registrations Y/Y%	Feb	**-2.9**	-	-7.3	-

Auctions		
Country		Auction
France		sold €5.1bn of 0% 2029 bonds at an average yield of -0.32%
		sold €3.0bn of 1.25% 2034 bonds at an average yield of -0.09%
		sold €1.3bn of 0.75% 2052 bonds at an average yield of 0.45%
Spain		sold €1.5bn of 0% 2023 bonds at an average yield of -0.416%
		sold €1.35bn of 0% 2025 bonds at an average yield of -0.26%
		sold €1.7bn of 0.5% 2030 bonds at an average yield of 0.201%%
		sold €0.5bn of 0.7% 2033 index-linked bonds at an average yield of -0.621%
UK		Auction: £1.1bn of 0.125% 2028 index-linked bonds at an average yield of -2.715%

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/ *Daiwa forecast*	Previous
Monday 9 March 2020						
Germany		07.00	Industrial production M/M% (Y/Y%)	Jan	1.7 (-3.9)	-3.5 (-6.8)
		07.00	Trade balance, €bn	Jan	15.0	15.2
France		07.30	Bank of France industrial sentiment indicator	Feb	95	96
Tuesday 10 March 2020						
EMU		10.00	Final GDP Q/Q% (Y/Y%)	Q4	0.1 (0.9)	0.3 (1.2)
		10.00	Final employment Q/Q% (Y/Y%)	Q4	0.3 (1.0)	0.1 (0.9)
Germany		07.00	Labour costs Q/Q% (Y/Y%)	Q4	-	0.9 (3.1)
France		07.45	Industrial production M/M% (Y/Y%)	Jan	1.8 (-2.0)	-2.8 (-3.0)
		07.45	Manufacturing production M/M% (Y/Y%)	Jan	1.7 (-1.7)	-2.6 (-3.2)
Italy		09.00	Industrial production M/M% (Y/Y%)	Jan	1.5 (-3.7)	-2.7 (-4.3)
UK		00.01	BRC retail sales monitor, like-for-like retail sales Y/Y%	Feb	-	0.0
Wednesday 11 March 2020						
Spain		08.00	Retail sales Y/Y%	Jan	1.5	1.7
UK		09.30	Monthly GDP estimate M/M% (3M/3M%)	Jan	0.2 (0.1)	0.3 (0.1)
		09.30	Services activity M/M% (3M/3M)	Jan	0.2 (0.1)	0.3 (0.1)
		09.30	Industrial production M/M% (Y/Y%)	Jan	0.3 (-2.6)	0.1 (-1.8)
		09.30	Manufacturing production M/M% (Y/Y%)	Jan	0.3 (-3.5)	0.3 (-2.5)
		09.30	Construction output M/M% (Y/Y%)	Jan	0.0 (2.4)	0.4 (5.0)
		09.30	Trade balance (goods trade balance), £bn	Jan	-1.0 (-7.0)	7.7 (0.8)
Thursday 12 March 2020						
EMU		10.00	Industrial production M/M% (Y/Y%)	Jan	1.4 (-3.1)	-2.1 (-4.1)
		12.45	ECB main refinancing rate %	Dec	0.00	0.00
		12.45	ECB marginal lending rate %	Dec	0.25	0.25
		12.45	ECB deposit facility rate %	Dec	-0.50	-0.50
UK		00.01	RICS house price balance, %	Feb	20	17
Friday 13 March 2020						
Germany		07.00	Final CPI (EU-harmonised CPI) Y/Y%	Feb	0.6 (1.7)	-0.8 (1.6)
France		07.45	Final CPI (EU-harmonised CPI) Y/Y%	Feb	1.4 (1.6)	1.5 (1.7)
Spain		08.00	Final CPI (EU-harmonised CPI) Y/Y%	Feb	0.8 (0.9)	1.1 (1.1)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

The coming week's key events & auctions			
Country		GMT	Event / Auction
Monday 9 March 2020			
- Nothing scheduled -			
Tuesday 10 March 2020			
UK		10.30	Auction: £2.25bn of 4.75% 2030 bonds
Wednesday 11 March 2020			
Germany		10.30	Auction: €4bn of 0% 2030 bonds
UK		11.30	Government announces 2020 Budget
Thursday 12 March 2020			
EMU		13.30	ECB post-meeting press conference
Italy		10.00	Auction: 3Y and 7Y bond auctions
Friday 13 March 2020			
- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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