Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- European equities had a somewhat better end to the week, Bund yields rose notably higher while Italian BTP spreads reversed some of yesterday's widening, as the ECB attempted to restore faith that it is mindful of fragmentation risks.
- Gilts also followed the global trend lower on a quiet day for UK economic news.
- The coming week will be dominated by news on the coronavirus and the efforts by governments to tackle its impact.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.956	+0.017
OBL 0 04/25	-0.800	+0.092
DBR 0 02/30	-0.594	+0.016
UKT 0½ 07/22	0.264	+0.074
UKT 0⅝ 06/25	0.309	+0.085
UKT 4¾ 12/30	0.385	+0.122

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

Euro area

ECB tries to clean up Lagarde's mess

With her loose tongue, Christine Lagarde yesterday reintroduced fragmentation risk to euro area markets, stating in her press conference that "It is not the function or the mission of the ECB" to close spreads. Those remarks overshadowed the announcement of the ECB's constructive, albeit perhaps rather timid, policy response. More importantly, they fueled a record daily drop in euro area stocks, a record daily rise in BTP yields, and a sharp rise in high-grade credit spreads to the highest level since the euro crisis. So, the ECB was in damage-limitation mode today. Indeed, in an unprecedented move, Lagarde's press conference transcript was annotated with her subsequent CNBC TV interview comments. That noted that she is "fully committed to avoid any fragmentation"; acknowledged that "High spreads due to the coronavirus impair the transmission of monetary policy"; and stated that the ECB "will use the flexibility embedded in the asset purchase programme, including within the public sector purchase programme …to avoid dislocations in bond markets".

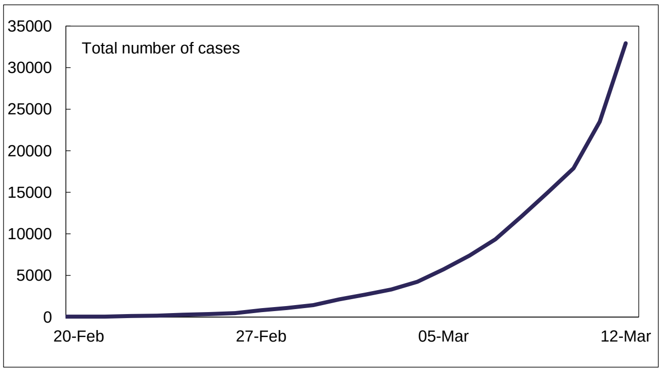
Lane suggests intolerance of elevated spreads

Remarks this morning from Bank of France President Villeroy and a blog article by ECB Chief Economist Lane also tried to mop up the mess caused by Lagarde, reinforcing the message of her CNBC interview. Indeed, Lane's article stated that "We will not tolerate any risks to the smooth transmission of our monetary policy in all jurisdictions of the euro area. We clearly stand ready to do more and adjust all of our instruments, if needed to ensure that the elevated spreads …do not undermine transmission". And the collective "mea culpa" was just about sufficient to change the dynamic for BTPs, whose spreads over Bunds fell back as euro area stocks also revived. Nevertheless, complacent comments from Dutch National Bank Governor Knot that the ECB is "saving the rate cut for when it is really needed" provided reminders that the hawks still have the upper hand in the Governing Council and that economic conditions are set to deteriorate rapidly. And now that the market has been reminded of the existential risks to the integrity of the euro area, it will now require far more than a blog – and perhaps ultimately the activation of the OMTs and an ESM loan programme – to put fragmentation risk back in its box.

New German measures to support affected firms

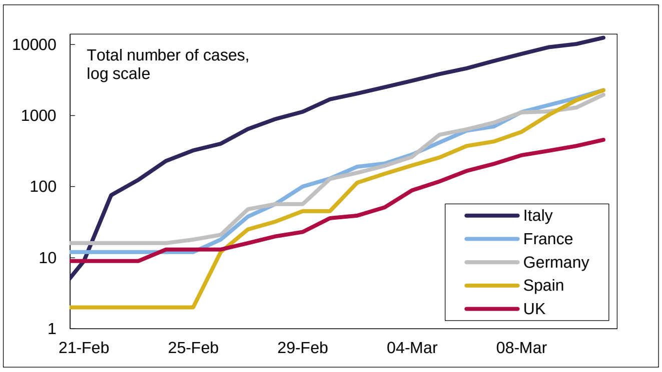
Rightly, nevertheless, the ECB insists that governments should do far more to support the euro area economy. In yesterday's press conference, Lagarde bemoaned the fact that the measures announced by governments had so far amounted merely to about €27bn, or ¼% of euro area GDP. The European Commission today confirmed its willingness to allow Italy and other member states to increase borrowing significantly to confront the crisis without sanction under the Stability and Growth Pact. And Germany's Finance Minister Scholz claimed that he would be willing to spend whatever was necessary, and would not

Coronavirus cases in Europe*



*EEA countries and UK. Source: WHO and Daiwa Capital Markets Europe Ltd.

Total number of cases by country



Source: WHO and Daiwa Capital Markets Europe Ltd.

be compelled to achieve a balanced budget. He also confirmed a plan for immediate tax relief for affected SMEs and unlimited loans from KfW for firms of all sizes.

But fiscal policy response remains uncoordinated and inadequate

Nevertheless, beyond the previously announced measures to subsidise short-time working, there was no extra tangible boost to German public spending announced today. And Scholz stated that a full economic stimulus would only be prepared if and when the economic cycle takes a more extreme turn for the worse. As member states continue to increase their controls against the spread of the virus – from a declaration of a state of emergency in Spain, to the suspension of major national soccer leagues, the halting of air transport between various member states, and the closure of shops, bars and restaurants in various regions – the current euro area fiscal stance appears far too tight. And there remains no signs of a coordinated fiscal policy, let alone more ambitious initiatives such as the launch of common euro area government bonds that the current crisis would ultimately seem to merit. So, the European Commission today assessed that euro area GDP will contract 1.0% in 2020. And that judgement looks hard to argue with.

The week ahead in the euro area and US

All eyes in the euro area in the coming week will be on the spread of the coronavirus and the efforts by member state governments to tackle its impact. In that respect, moves towards fiscal stimulus, whether coordinated or not, will be closely watched. Economic data releases will be of secondary importance, particularly given the lack of timeliness of the most of the figures due. One exception, however, will be the results of the ZEW's March survey of investor sentiment, due on Tuesday. Sharp drops in the assessments of current and future conditions are inevitable, and declines to the lowest levels since the euro crisis would seem appropriate even if that is not currently the consensus expectation.

Other data releases due in the coming week will be of mere passing interest. Monday's most notable release will be the final estimates of Italian inflation in February. Like today's equivalent figures from Germany (1.7%Y/Y), France (1.6%Y/Y) and Spain (0.9%Y/Y), the final Italian headline rate on the EU measure is expected to align with the flash estimate (0.3%Y/Y). Likewise, the headline and core euro area figures, due on Wednesday, will likely align with the flash estimates, both 1.2%Y/Y. But these seem bound to fall sharply from March onwards due to the fall in oil prices and broader shock to demand from the coronavirus. Meanwhile, February new car registration data (also Wednesday) are bound to be weak in light of the national figures already released (e.g. German new registrations fell 11%Y/Y and 9%YTD/Y according to the VDA). In the markets, Germany will sell 30Y bonds on Wednesday and France will sell a range of bonds on Thursday.

In the US, the main event will clearly be the monetary policy announcement of the FOMC on Wednesday. This follows yesterday's announcement of a significant expansion in the Fed's planned repurchase operations and its decision to alter the composition of its purchases of Treasury securities. At the time of writing, markets were pricing the likelihood of a cut of at least 75bps in the target range for the fed funds rate to 0.25-0.50% on Wednesday. Data-wise, the calendar includes February retail sales and industrial production (Tuesday), and housing starts for the same month (Wednesday). More timely indicators include the usual weekly jobless claims figures and March Philly Fed indices (Thursday). In the markets, the Treasury will sell 10Y TIPS on Thursday.

UK

The week ahead in the UK

To some extent, the response of the UK economic authorities to the coronavirus so far has been exemplary, with monetary, financial and fiscal policies coordinated to prove significant support to economic demand and maintain the flow of bank lending to affected firms and households. As the number of coronavirus cases continue to rise, albeit with a lag, on the path seen in the other large EU member states, the government's rather laissez-faire approach to managing the pandemic seems likely to face greater criticism. Indeed, with the private sector seemingly leading the way in reducing activity and cancelling events (e.g. all schools remain open, but the Premier League suspended all matches through to early April), somewhat more draconian controls, with more significant economic consequences, might well be announced in the coming week.

Meanwhile, from Monday Andrew Bailey will take over from Mark Carney as BoE Governor. Bailey was actively involved in the BoE's policy announcements on Wednesday, and we should expect continuity from the previous regime. On the data front, as in Europe, most UK releases due in the coming week will be of little relevance for assessing current economic conditions. Indeed, perhaps the most notable release – the latest labour market report due on Tuesday – will relate to the three months to January, although the claimant count rate will respond to February. The public sector borrowing numbers (due Friday) are now of mere historical interest after the government announced on Wednesday a significant increase in near-term borrowing to fund its initiatives to confront the impact of the coronavirus. In the markets, the DMO will sell 30Y Gilts on Tuesday and 5Y 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	-0.6	-0.6	0.1	0.2	0.2	0.2	1.2	-0.7	0.3
Germany	0.2	0.0	-0.3	-0.5	0.1	0.2	0.2	0.2	0.6	-0.5	0.4
France	0.3	-0.1	-0.5	-0.5	0.2	0.2	0.2	0.2	1.3	-0.6	0.6
Italy	0.1	-0.3	-0.8	-0.7	0.2	0.2	0.1	0.1	0.3	-1.4	0.1
Spain	0.4	0.5	-0.5	-0.7	0.1	0.2	0.4	0.2	2.0	-0.2	0.7
UK	0.5	0.0	-0.3	-0.6	0.2	0.2	0.1	0.3	1.4	-0.4	0.5
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	33	33	33	33	20	20	20	33	20
BoE											
Bank Rate %	0.75	0.75	0.25	0.25	0.25	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/ *Daiwa forecast*	Previous	Revised
Germany	Final CPI (EU-harmonised CPI) Y/Y%	Feb	1.7 (1.7)	1.7 (1.7)	1.7 (1.7)	-
France	Final CPI (EU-harmonised CPI) Y/Y%	Feb	1.4 (1.6)	1.4 (1.6)	1.5 (1.7)	-
Spain	Final CPI (EU-harmonised CPI) Y/Y%	Feb	0.7 (0.9)	0.8 (0.9)	1.1 (1.1)	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

In the absence of significant economic news, the next edition of the Euro wrap-up will be published on 17 March 2019

Coming week's data calendar

The coming week's key data releases

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
		Monday 16 March 2020			
UK	00.01	Rightmove house price index M/M% (Y/Y%)	Mar	-	0.8 (2.9)
Italy	09.00	CPI (EU-harmonised CPI) Y/Y%	Feb	0.0 (0.3)	0.1 (0.4)
		Tuesday 17 March 2020			
EMU	10.00	Labour costs Y/Y%	Q4	-	2.6
Germany	10.00	ZEW current situation balance (expectations)	Mar	-27.0 (-25.5)	-15.7 (8.7)
Spain	08.00	Labour costs Y/Y%	Q4	-	2.2
UK	09.30	Claimant count rate % (change '000s)	Feb	-	3.4 (5.5)
	09.30	Average earnings bonuses (excluding bonuses) 3M/Y%	Jan	3.0 (3.2)	2.9 (3.2)
	09.30	ILO unemployment rate 3M%	Jan	3.8	3.8
	09.30	Employment change 3M/3M, '000s	Jan	148	180
		Wednesday 18 March 2020			
EMU	07.00	EU27 new car registrations Y/Y%	Feb	-	-7.5
	10.00	Final CPI (core CPI) Y/Y%	Feb	1.2 (1.2)	1.4 (1.1)
	10.00	Trade balance €bn	Jan	-	22.2
Italy	09.00	Industrial sales M/M% (Y/Y%)	Jan	-	-3.0 (-1.4)
	09.00	Industrial orders M/M% (Y/Y%)	Jan	-	1.4 (6.0)
	10.00	Total trade balance €bn	Jan	-	5.0
		Thursday 19 March 2020			
EMU	10.00	Construction output M/M% (Y/Y%)	Jan	-	-3.1 (-3.7)
		Friday 20 March 2020			
Germany	07.00	PPI Y/Y%	Feb	0.1	0.2
Spain	08.00	Trade balance €bn	Jan	-	-2.1
UK	09.30	Public sector net borrowing £bn	Feb	1.0	-10.5

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	GMT	Event / Auction
		Monday 16 March 2020
		- Nothing scheduled -
		Tuesday 17 March 2020
UK	10.30	Auction: £2bn of 1.75% 2049 bonds
		Wednesday 18 March 2020
Germany	10.30	Auction: €1.5bn of 0% 2050 bonds
		Thursday 19 March 2020
France	09.50	Auction: 0% 2023 bonds
	09.50	Auction: 0% 2025 bonds
	09.50	Auction: 2.75% 2027 bonds
	10.50	Auction: 0.1% 2028 index-linked bonds
	10.50	Auction: 0.7% 2030 index-linked bonds
UK	10.30	Auction: £3.25bn of 0.625% 2025 bonds
		Friday 20 March 2020
Spain	-	Spanish sovereign debt to be rated by Moody's and S&P

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs