Euro wrap-up

Overview

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- Bunds made losses and periphery bond spreads widened as France and Spain announced new fiscal support packages.
- Gilts made significant losses ahead of the announcement of a new UK loan guarantee package.
- Government responses to the coronavirus will remain in focus on Wednesday while euro area car registration and final inflation data for February are due for release.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.878	+0.045
OBL 0 04/25	-0.663	+0.046
DBR 0 02/30	-0.436	+0.033
UKT 0½ 07/22	0.322	+0.051
UKT 0⅝ 06/25	0.463	+0.116
UKT 4¾ 12/30	0.560	+0.126

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

Euro area

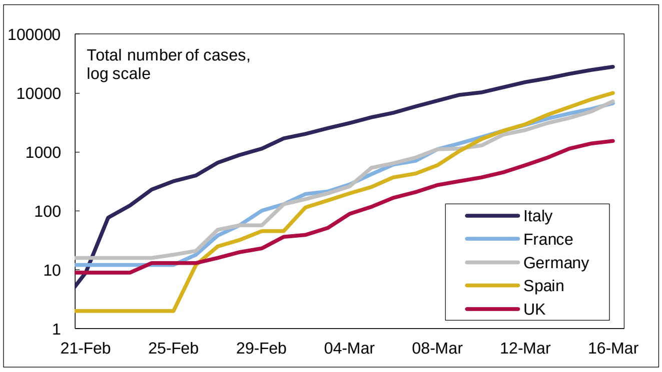
Baby steps towards fiscal coordination

At yesterday evening's Eurogroup meeting, euro area Finance Ministers and the European Commission finally decided on a loosely coordinated approach to fiscal policy to reflect the inevitability of a full-year contraction in GDP in 2020. In particular, they agreed to interpret the EU's budgetary rules in a way that will allow member states' automatic stabilisers to work in full. They also agreed that member states' temporary budgetary measures for dealing with the pandemic and its economic impact should also be accommodated. So, falls in tax revenues and increases in unemployment benefits resulting from the drop in economic activity will not have to be offset by adjustments to other measures. And policies to contain and treat the pandemic (e.g. via spending on healthcare and other public services), ensure liquidity support to firms and sectors in severely affected sectors (e.g. via tax holidays and loan guarantees), and protect jobs and incomes of affected workers (e.g. via short-term working subsidies, augmented sick pay and deferral of income tax payments) will also be permitted when interpreting compliance of member states' fiscal policies with the Stability and Growth Pact.

Fiscal response still looks inadequate

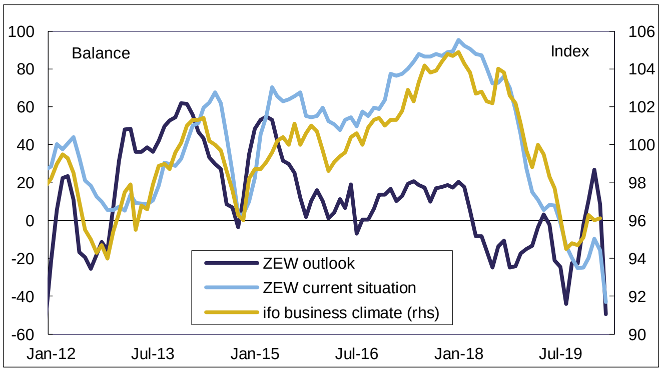
With a few exceptions, however, the response of euro area policymakers still looks inadequate. The European Commission estimated yesterday that extra fiscal measures worth only about 1% of GDP had been agreed by euro area governments so far to supplement the impact of the automatic stabilisers, with Italy's €25bn package (about 1½% of GDP) then leading the way. Governments had also committed to provide liquidity facilities, including public loan guarantees and tax deferrals, worth at least 10% of GDP. The French government, however, today unveiled its package of €45bn (about 1¾% of GDP) of extra spending and tax deferrals plus €300bn (more than 10% of GDP) of loan guarantees, and raised the prospect of extra funds being used for recapitalizing and/or nationalizing firms. And this afternoon, Spain's government offered €100bn (8% of GDP) of loan guarantees as well as €17bn (more than 1½% of GDP) of extra direct spending and tax deferrals. But so far, the total amount of government support to the euro area economy appears smaller than implemented in 2009 in the wake of the global financial crisis, and smaller than the equivalent package (likely to be close 4% of GDP) being prepared in the US. Yet the sudden stop to economic activity in Italy, Spain, France and other member states now appears at least as bad, if not more severe, than that occasion. So, discretionary fiscal measures worth twice as much as those currently announced might well eventually be required.

Europe: Coronavirus cases*



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

Germany: ZEW and ifo indicators



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Better coordination with monetary policy also required

A more aggressive monetary policy response, better coordinated with fiscal policy, also now seems necessary. The increase in ECB asset purchases of €120bn agreed last week pales into insignificance with the $700bn of extra QE announced by the Fed on Sunday. And following Christine Lagarde's poor communication on Thursday, which triggered a significant widening of sovereign spreads, the asset purchase programme is now simply insufficient to keep yields contained in a way that would allow all governments – not just those in the euro area's core – to implement the required fiscal boost without adverse market consequences. So, the ECB will need to increase its public sector bond purchases to a level that requires the lifting of its self-imposed issue and issuer limits. And ultimately, a form of yield curve control, perhaps incorporating activation of the OMT programme and an ESM package too, might well also be required.

German sentiment plummets

Today's ZEW survey of investor sentiment gave an indication of what to expect from next week's flash March and ifo indices, suggesting a marked deterioration of economic conditions as large swathes of Europe entered some form of lockdown. In particular, the headline current conditions balance fell a whopping 27.4pts in March to -43.1, its lowest level for a decade. And perhaps unsurprisingly, concerns about the near-term outlook were even greater, with the expectations balance down a massive 58.1, the most since the series began in 1991, to its lowest level (-49.5) since 2011. Of course, given the sudden shock not just to economic activity but to the whole way of life too, an even worse assessment would have been understandable. Within the detail, there was a marked deterioration in the balance for services profits, down 67pts to -31.9, while the outlook for profits in the autos sector remained weakest of all (-80.7). Overall, the ZEW noted that the combination of strongly negative readings for both current situation and expectations had been seen only once before, during the height of the Global Financial Crisis.

The day ahead in the euro area and US

The fallout from the coronavirus will continue to dominate the news flow tomorrow, while the release of euro area car registrations figures for February is set reveal a notable drop in demand amid greater concerns about the coronavirus. Certainly, national figures already released have been weak – e.g. new registrations in Germany fell 11%Y/Y, while those in France fell 3%Y/Y, Italy fell 9%Y/Y, and Spain fell 6%Y/Y. Wednesday will also bring final euro area inflation figures for February, which are likely to align with the flash estimates, at 1.2%Y/Y for both headline and core rates. But these seem bound to fall sharply from March onwards due to the plunge in oil prices and broader shock to demand from the coronavirus. January's euro area trade figures are also due, but likewise won't be representative of current challenges. In the markets, Germany will sell 30Y bonds.

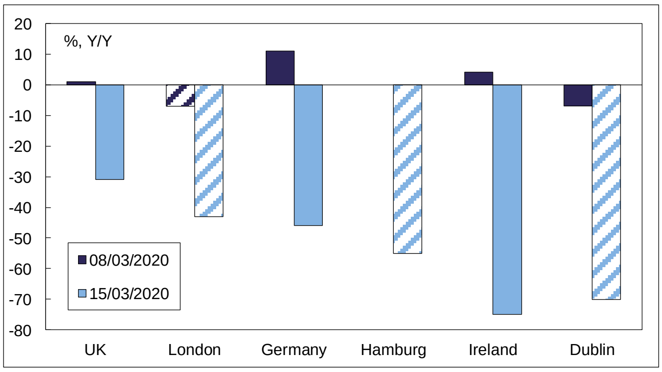
In the US, meanwhile, tomorrow will bring housing starts figures for February.

UK

UK employment at record high before COVID-19

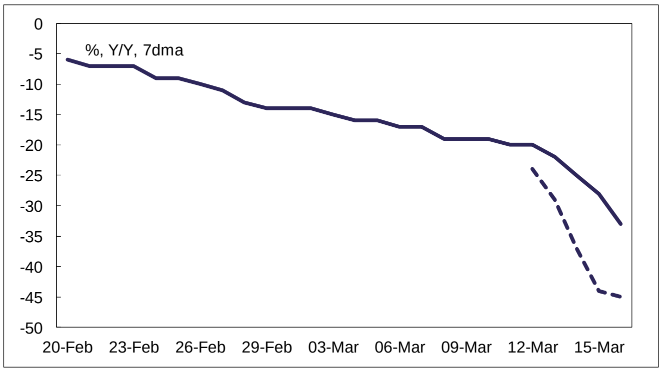
Before the outbreak of the coronavirus, the UK's labour market continued to defy expectations, with the number of people in employment rising a further 184k in the three months to January, to a record-high 32.99mn. But with the number of people in the labour force having risen, the unemployment rate ticked slightly higher to 3.9%. Admittedly, this remained only just off the near-4½-decade low seen in the previous four months, and 4½ppts below the post-financial crisis peak in 2011. But the claimant count rate also rose in February, by 0.1ppt to 3.5%. And measures being introduced to curb the spread of the

UK: Restaurant bookings*



Seated dinners including online and phone reservations, as well as walk-ins. Source: Open Table

UK: Hospitality footfall*



Dashed line represents unsmoothed growth. Source: Wireless Social coronavirus, including global travel restrictions, as well as the UK government's latest advice for citizens to avoid all non-essential contact, are inevitably now having a significant impact on economic activity and the labour market, particularly in the tourism and hospitality sectors.

Labour market now taking a sharp turn for the worse

Indeed, while hard data are thin on the ground, high-frequency figures related to the hospitality sector suggest a big hit to activity already. For example, figures published by OpenTable showed a significant drop in the number of UK restaurant bookings over the past weekend, down more than 30%Y/Y on Sunday having been slightly higher than a year earlier just a week earlier, with an even steeper drop in London (-43%Y/Y). These tally with the notable step-down in overall hospitality footfall across the UK over the past weekend, with yesterday's figures from Wireless Social reporting a drop of 45%Y/Y. And with the UK government's recommendations having also triggered the temporary closure of theatres and cinemas, among other activities, employment in the recreation and leisure sectors, as well as hospitality, are likely to have taken a significant hit already. Meanwhile, travel restrictions have seen the aviation sector take drastic action too, with Virgin Atlantic this week asking staff to take eight weeks of unpaid leave over the coming three months, while FlyBe entered administration earlier in the month.

More support measures on the way

So, while the government and BoE hade already announced measures to support SMEs impacted by the coronavirus, the sharp drop in economic activity underway is in the process of translating itself to a marked pickup in unemployment. Therefore, after Chancellor Sunak unveiled a £12bn support package in last week's Budget, this evening he laid out further measures to support businesses, including £330bn (about 13% of GDP) of loan guarantees. But like in the euro area, with the economic downturn likely to be as severe as or worse than during the global financial crisis, we would expect the BoE to have to add to its emergency 50bps interest rate cut at the MPC's next scheduled policy-setting on 26 March. Markets are currently pricing a further cut in Bank Rate to 10bps. And we think there is a significant probability that the MPC will also restart its QE programme, with an increase in its Gilt and corporate bond purchases.

The day ahead in the UK

There are no UK economic data of note due for release tomorrow.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		Labour costs Y/Y%	Q4	**2.3**	-	2.6	-
Germany		ZEW current situation balance (expectations)	Mar	**-43.1 (-49.5)**	-27.0 (-25.5)	-15.7 (8.7)	-
Spain		Labour costs Y/Y%	Q4	**2.3**	-	2.2	-
UK		Claimant count rate % (change '000s)	Feb	**3.5 (17.3)**	-	3.4 (5.5)	**- (-0.2)**
		Average earnings including bonuses (excluding bonuses) 3M/Y%	Jan	**3.1 (3.1)**	3.0 (3.2)	2.9 (3.2)	-
		ILO unemployment rate 3M%	Jan	**3.9**	3.8	3.8	-
		Employment change 3M/3M, '000s	Jan	**184**	148	180	-

Auctions

Country		Auction
UK		sold £2bn of 1.75% 2049 bonds at an average yield of 1.029%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK		Rightmove house price index M/M% (Y/Y%)	Mar	**1.0 (3.5)**	-	0.8 (2.9)	-
Italy		CPI (EU-harmonised CPI) Y/Y%	Feb	**0.3 (0.2)**	0.3 (0.3)	0.5 (0.4)	-

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		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	19.2	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

Auctions and events

Country		GMT	Event
Germany		10.30	Auction: €1.5bn of 0% 2050 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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