Euro wrap-up

Overview

Chris Scicluna +44 20 7597 8326

Emily Nicol +44 20 7597 8331

- Bunds made notable losses again, but BTPs reversed a big further sell-off on reports that euro area officials are considering activation of the ESM to contain the economic and financial impact of Covid-19.
- The pound plunged to its weakest level since 1985 and Gilts also made further losses as BoE Governor Bailey signalled his willingness to take additional unconventional measures.
- Thursday will bring preliminary German ifo survey results for March, which are bound to be bad.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.796	+0.082
OBL 0 04/25	-0.518	+0.152
DBR 0 02/30	-0.239	+0.203
UKT 0½ 07/22	0.332	+0.020
UKT 0⅝ 06/25	0.594	+0.136
UKT 4¾ 12/30	0.786	+0.233

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

Euro area

Holzmann sabotages attempts to calm the markets

The sell-off in most euro area bonds and stocks continued today, with yields on BTPs at one point in the morning more than 50bps higher across the curve to take 2Y yields above 2.00%, more than 220bps above their level a fortnight ago and the highest since 2018. A key cause was some further disastrous communication from the ECB. While recent days had seen various Governing Council members seek to douse the flames caused by Christine Lagarde's careless talk last Thursday – when she triggered the euro area bond market sell-off by denying that the ECB had an interest in narrowing spreads – an irresponsible and inflammatory interview from Austrian central bank governor Robert Holzmann published this morning undid their work in a flash. Among other things, Holzmann claimed that there had been unanimous support for Lagarde's comments; that (contrary to the Governing Council's forward guidance) ECB monetary policy had now reached its limit; and, crassly and insensitively in the current circumstances, that "every crisis is a cleansing".

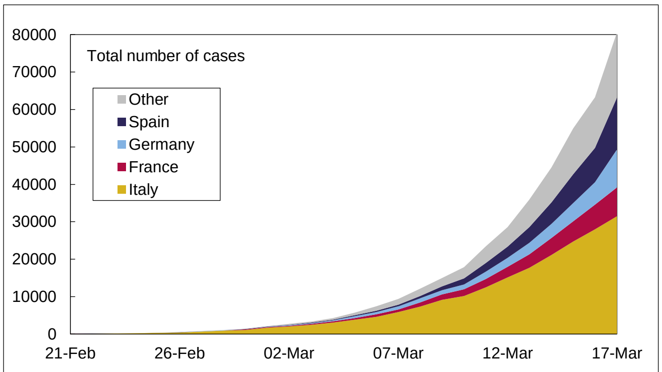
ECB now part of the problem?

Shortly after the publication of Holzmann's interview, the ECB rushed out a statement in an attempt to mitigate its market impact. In particular, it noted that the Governing Council "stands ready to adjust all of its measures, as appropriate, should this be needed to safeguard liquidity conditions in the banking system and to ensure the smooth transmission of its monetary policy in all jurisdictions". But, while other major central banks are actively trying to ease market strains – and euro area banks today benefited from the Fed's dollar swap line with the ECB by borrowing $112bn, the most since 2009, in two operations – the overriding impression was that the ECB is now part of the problem and not the solution.

ESM and OMT talk gives late relief to BTPs

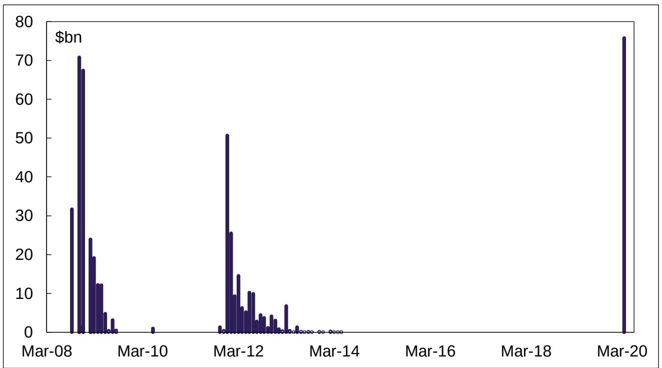
So, despite the additional support announced over recent days by member state governments, to counter market doubts about its commitment to ensuring "a smooth monetary transmission mechanism in all jurisdictions" the ECB might well soon need to increase its public sector bond purchases. And that would also likely require the lifting of its self-imposed issue and issuer limits too. Of course, the member states could also assuage all market doubts if they swiftly took more assertive action too. The most effective option would be to issue a common euro area 'corona' bond, a notion that Chancellor Merkel yesterday refused to rule out. But such issuance still seems unlikely. Nevertheless, agreement of a simple precautionary OMT loan, which could open the door to activation of the ECB's OMT programme and yield curve control, seems feasible. Indeed, reports this afternoon suggested that recourse to the ESM and OMTs is now actively under discussion at official level. And that caused BTPs eventually to reverse more than fully their initial big losses to end higher on the day.

Europe: Coronavirus cases*



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

Euro area: Take-up from 84-day ECB USD swap line



Source: ECB and Daiwa Capital Markets Europe Ltd.

Car registrations in reverse

The news-flow from the autos sector remains dire, with BMW now added to the list (including VW, Daimler, Nissan and Ford) of firms in the sector to cease European production over coming weeks. And today's release of EU car registrations figures for February inevitably confirmed that demand has remained subdued since the start of the year. Admittedly, new registrations in the euro area posted a modest increase on a seasonally adjusted basis last month, by 1.8%M/M. But this left them down 6%Y/Y at the lowest February level for four years. Moreover, this followed a sizeable decline in January (-14.6%M/M). And it was merely thanks to an acceleration in French car registrations (12.1%M/M) that February's overall figures weren't weaker. Indeed, registrations in Germany, Italy and Spain all declined for the second successive month. On average in the first two months of the year, registrations were notably lower in the four largest member states compared with Q4, to leave euro area registrations trending 8% lower than the fourth-quarter average. And with much of Europe now in lockdown, this seems bound to get much worse in the final month of Q1 and into Q2 too.

February to represent the high point for inflation

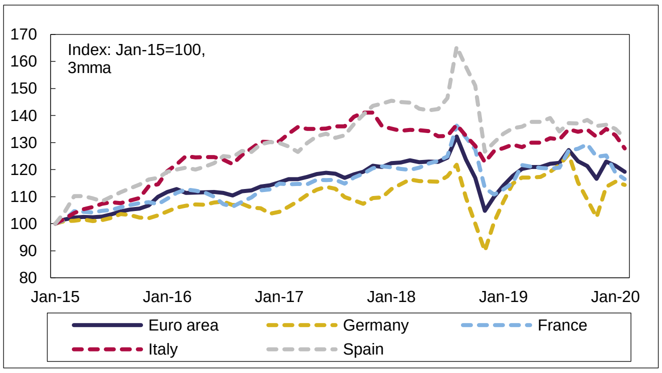
There were no surprises whatsoever from today's final inflation figures for February. In particular, headline inflation aligned with the flash estimate of 1.2%Y/Y, down 0.2ppt from January due to a renewed drag from energy inflation (-0.4%Y/Y). But with services and non-energy industrial goods inflation having ticked slightly higher from January (to 0.5%Y/Y and 1.6%Y/Y respectively), core inflation rose 0.2ppt to 1.2%Y/Y. But this seems highly likely to represent the high point. Indeed, while we might see some upwards price pressures from supply constraints, these will undoubtedly be offset by the significant and widespread hit to demand. Certainly, euro area GDP looks to be sliding into a deep recession, probably of a magnitude similar to that seen during the Global Financial Crisis. As such, we expect core inflation to take a notable step down over coming months, with record lows on the core measure well within the realms of possibility this year. And while food price inflation will likely come under some upwards pressure over the near term, the plummet in the oil price – down 45% since the end of February in euro terms, and more than 55% since the start of the year – will see energy inflation provide a greater drag on headline inflation going forward. Indeed, while we currently expect the headline CPI rate to remain in positive territory, we do not rule out a return to deflation this year.

The day ahead in the euro area and US

The main data focus in the euro area tomorrow will be a one-off preliminary release of Germany's ifo business climate survey for March. In line with yesterday's ZEW survey of investors, this seems bound to report a significant deterioration in both the current conditions and expectations indicators. Certainly, we wouldn't be surprised to see the headline business climate index plummet to its lowest level since the Global Financial Crisis. Thursday will also bring euro area construction output figures for January. Given the sizeable bounce in activity in Germany (4.7%M/M) and France (1.8%M/M) at the start of the year, euro area output is likely to largely reverse the drop of more than 3%M/M seen in December. But like with other January releases, these should be taken with a pinch of salt given the significant worsening of economic conditions since. In the markets, France and Spain will sell bonds with various maturities.

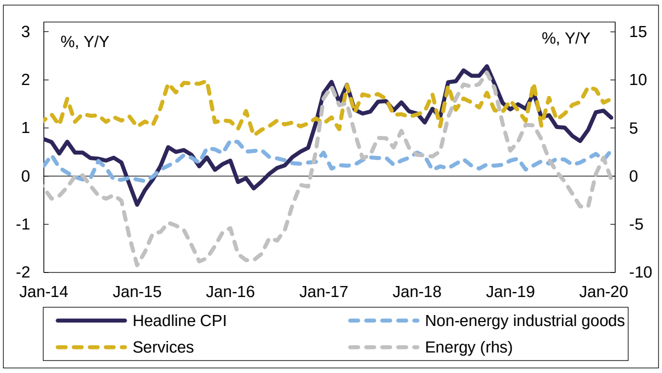
In the US, tomorrow will bring the Philly Fed business survey for March. Like the Empire Manufacturing release on Monday, this seems set to report a significant decline in the outlook component following the sharp jump in February. The weekly jobless claims figures will also be closely watched, while the Conference Board's leading index for February and current account figures for Q4 are also due. In the markets, the Treasury will sell 10Y TIPS.

Euro area: Car registrations in member states



Source: ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK

BoE to print new money to cover business cash-flows

Alongside yesterday's announcement by Chancellor Sunak of a new £330bn programme of loan guarantees and three-month mortgage holiday, the BoE announced its new Covid Corporate Financing Facility (CCFF). Under this new facility, the BoE will provide newly-created money to businesses suffering disruption to cash-flows by purchasing commercial paper of maturities up to 1Y. To be able to participate, firms will need to be judged to be "making a material contribution to the UK economy" and "in sound financial health prior to the shock" (i.e. based on firms' credit ratings before the spread of the virus). They do not need to have previously issued commercial paper. The facility will offer financing on terms comparable to those prevailing in the markets in the period before the coronavirus hit. And it will operate for at least twelve months and for as long as needed.

Pound plummets as BoE signals willingness to do whatever it takes

In interviews today, BoE Governor Bailey also refused to rule out following up the CCFF with more unconventional measures if economic and financial conditions deteriorated further. Indeed, giving the distinct impression that, unlike the ECB, the BoE would be willing to do whatever it takes, he suggested a readiness to consider direct funding of the government by the BoE and negative interest rates. Not least given concerns about negative side-effects, the latter still seems unlikely to ever be in favour at the BoE. And Bailey also suggested that "helicopter money" should be a decision for the government to take. Nevertheless, next week's MPC meeting seems likely to bring a further rate cut of at least 10bps to Bank Rate (to 0.15% or less), and the recommencement of QE would also now seem in order. And with the pound already weakened by Brexit concerns and the UK's sizeable current account deficit, the talk of possible direct monetary funding of the UK government appeared to put the skids under sterling, which depreciated sharply further in the afternoon session to below $1.15 at one stage.

The day ahead in the UK

It should be another quiet day for monthly UK economic releases tomorrow. But high-frequency business data will continue to be watched for clues on the size of the current shock to activity. For example, the daily Open Table restaurant booking and Wireless Social hospitality footfall numbers both slid further yesterday (to -52%Y/Y and -58%Y/Y respectively) after the government recommended that citizens avoid all non-essential contact.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	EU27 new car registrations Y/Y%	Feb	**-7.4**	-	-7.5	**-**
	Final CPI (core CPI) Y/Y%	Feb	**1.2 (1.2)**	1.2 (1.2)	1.4 (1.1)	**1.3 (-)**
	Trade balance €bn	Jan	**17.3**	19.2	22.2	**21.5**
Italy	Industrial sales M/M% (Y/Y%)	Jan	**5.3 (3.8)**	-	-3.0 (-1.4)	**-2.8 (-1.5)**
	Industrial orders M/M% (Y/Y%)	Jan	**1.2 (-1.8)**	-	1.4 (6.0)	**1.3 (5.7)**
	Trade balance €bn	Jan	**0.5**	-	5.0	**-**

Auctions

Country	Auction
Germany	sold €1.2bn of 0% 2050 bonds at an average yield of 0.01%

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	Construction output M/M% (Y/Y%)	Jan	-	-3.1 (-3.7)
Germany	10.00	Preliminary ifo survey – business climate index	Mar	-	96.1
	10.00	Preliminary ifo survey – current assessment index (expectations index)	Mar	-	98.9 (93.4)

Auctions and events

Country	GMT	Event
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
Spain	09.45	Auction: 0% 2023 bonds
	09.45	Auction: 1.5% 2027 bonds
	09.45	Auction: 0.5% 2030 bonds
	09.45	Auction: 2.35% 2033 bonds
UK	10.30	Auction: £3.25bn of 0.625% 2025 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

https://www.uk.daiwacm.com/ficc-research/recent-blogs