Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- While the flash March ifo survey illustrated the marked deterioration underway in the German economy, Bunds made losses and BTPs rallied hard following last night's emergency ECB policy announcement.
- Gilts rallied in the afternoon session after the BoE cut Bank Rate to 0.1%, re-launched QE and expanded its new Term Funding scheme.
- The coming week will bring the flash Commission consumer confidence index (Monday) and PMIs (Tuesday), while the BoE will make another monetary policy announcement on Thursday.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.706	+0.090
OBL 0 04/25	-0.432	+0.076
DBR 0 02/30	-0.203	+0.042
UKT 0½ 07/22	0.133	-0.213
UKT 0⅝ 06/25	0.475	-0.137
UKT 4¾ 12/30	0.724	-0.072

*Change from close as at 5:00pm GMT.
Source: Bloomberg

Euro area

ECB launches new PEPP to address COVID-19 impact

Over recent days, due not least to its own poor communication, the ECB had provoked profound doubts in the financial markets about its commitment to counter the economic and financial impact of COVID-19 and the associated threat to the future of the euro itself. But faced with highly damaging market developments, following an emergency teleconference, last night the ECB announced a new temporary asset purchase programme, the Pandemic Emergency Purchase Programme (PEPP). In particular, the PEPP will amount to €750bn with purchases to be conducted until the end of the year. Added to the extra €120bn of purchases committed a week ago to boost the existing Asset Purchase Programme, the PEPP means that the ECB will now purchase on average more than €100bn per month until the end of 2020. All asset classes eligible under the existing asset purchase programme (APP) will be included, i.e. public sector bonds, corporate and covered bonds, and asset-backed securities.

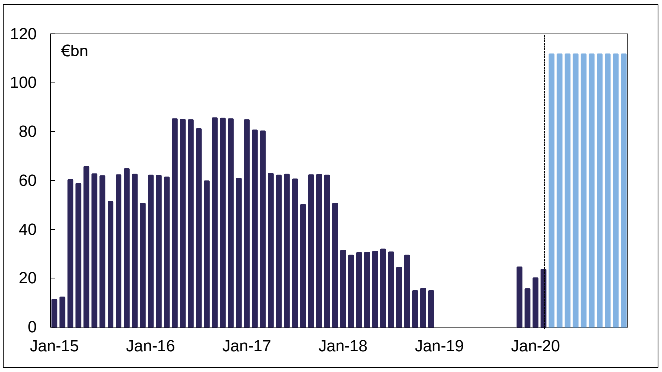
Flexibility of the PEPP as important as its size

In terms of the public sector asset purchases under the PEPP, the capital key will nominally still be the benchmark for allocation of purchases across jurisdictions. Crucially, however, those purchases will be conducted "in a flexible manner" to allow "fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions." As such, the capital key is no longer a binding constraint to prevent the ECB from increasing purchases of BTPs (or any other member state's bonds). Moreover, the ECB also committed to revising any of its self-imposed limits on the public sector bond purchases (i.e. the 33% issue and issuer limits) if they would prevent the ECB from buying assets to the extent necessary to achieve its mandate. And, for the first time, Greek government bonds will be incorporated in the ECB's asset purchases in the PEPP. Meanwhile, in terms of the corporate bond purchases under the PEPP, the ECB took a lead from the Fed and BoE and will now, for the first time, include non-financial commercial paper, an important source of funding for many companies. The collateral framework will also be adjusted to include claims related to the financing of the corporate sector.

ECB and governments might have to push policy to its limits

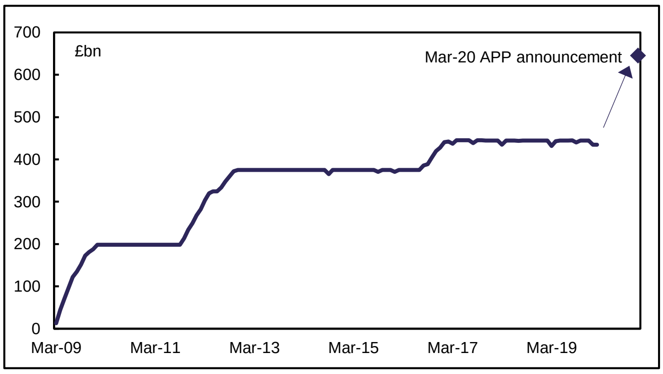
Overall, therefore, the announcement of the PEPP brought the response of the ECB closer in line with that of the Fed in terms of its magnitude and scope. And coupled with the recent increase in governments' fiscal commitments over the past couple of days, the euro area macroeconomic policy response appears a lot more substantive than it was at the end of last week. But as the full magnitude of the economic and financial shock underway will only be evident over time, doubts will remain as to whether policy is yet commensurate to the task in hand. While she still refuses to repeat Mario Draghi's

ECB: Monthly rate of asset purchases*



*Light blue bars represent estimated monthly purchases based on December 2019 and March 2020 announcements. Source: ECB and Daiwa Capital

BoE: Total asset holdings*



*Diamond represents March 2020 announcement. Time frame for latest purchases unspecified. Source: BoE and Daiwa Capital Markets Europe Ltd.

commitment to do "whatever it takes", following the announcement of the PEPP Christine Lagarde tweeted that "There are no limits to our commitment to the euro. We are determined to use the full potential of our tools, within our mandate." And while BTPs and GGBs rallied today, and corporate credit spreads narrowed too, in due course the ECB might well need to push its policy response much further out towards its limits. The same is true of governments. Next week, Chancellor Merkel's Government is expected to ask a special session of the Bundestag to lift the constitutional debt brake requirements and permit unlimited government borrowing. And collectively, euro area leaders might also eventually have to activate the ESM to support Southern European governments, and ultimately move to issue a single euro area 'coronabond' too.

Ifo indices plunge at a record rate

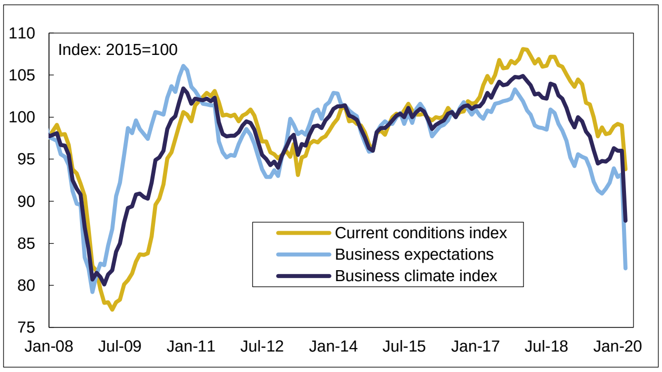
Today's special one-off preliminary release of Germany's ifo business climate survey for March gave an indication of the extreme initial hit to business confidence from Covid-19. In particular, the headline ifo index dropped more than 8pts, the most since reunification, to 87.7, the lowest level since August 2009. The current conditions index fell more than 5pts, also surpassing the largest drop during the global financial crisis to 93.8, the lowest level since April 2013. And signalling a deep recession to come, the survey's expectations index dropped by more than 11pts, the most on the series, to just 82, the lowest since January 2009 when global economic activity was last falling off a cliff. With the exception of construction, the declines in confidence in the other main sectors were of historical magnitude. Indeed, the business climate in manufacturing, services and trade was judged to be the worst since the summer of 2009, and expectations in manufacturing and trade were the lowest since reunification.

The week ahead in the euro area and US

News of the spread of the coronavirus crisis, its impact on financial conditions and the associated policy responses will continue to dominate the coming week in the euro area. But the data-flow will be of more interest than of late as further March surveys provide a clearer picture of the magnitude of the initial impact on economic activity and confidence. First up on Monday will be the European Commission's flash consumer confidence index, which is expected to reveal a significant decline in March, likely of a double-digit magnitude to levels seen during the euro crisis. Of greater interest on Tuesday will be the flash PMIs for the euro area and largest two member states. These too are expected to point to marked contraction at the end of the first quarter and beyond. Indeed, they are likely to signal a substantial worsening in services activity, with hospitality, recreation and aviation having been hit particularly hard, while the manufacturing PMIs will reflect the hit from supply constraints. National sentiment surveys will be dotted through the remainder of the week, including the final German ifo (Wednesday), German GfK consumer and French INSEE business indices (Thursday), and French INSEE consumer and Italian ISTAT consumer and business indicators (Friday). The only other release of note will be the ECB's bank lending figures for February (Wednesday). In the markets, Germany will sell 2Y notes on Tuesday, while Italy will sell fixed-rate and index-linked bonds on Thursday.

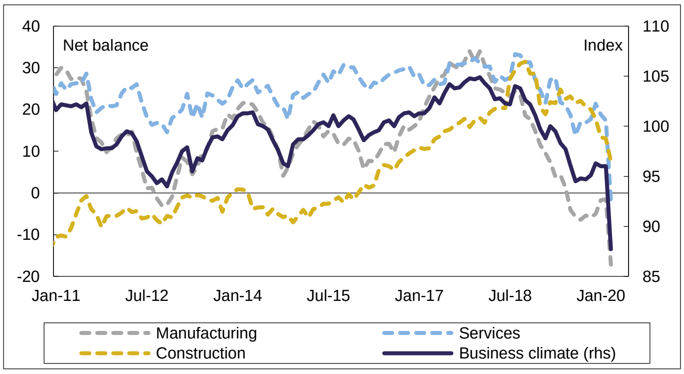
Sentiment indicators for March will also be closely watched in the US, kicking off on Tuesday with the flash Markit PMIs and the Richmond Fed manufacturing index. In February, the headline composite PMI fell to its lowest level since October 2013, while new orders were reportedly the weakest since the series began. And we expect these indices to have deteriorated notably further. Thursday will bring the Kansas Fed manufacturing index, followed by the revised University of Michigan consumer sentiment survey on Friday. The advance durable goods orders data (Wednesday) and goods trade report (Thursday) for February are likely to show some initial signs of an impact from the coronavirus on demand. Finally, Friday will also bring February personal income and spending figures, along with the final release of Q4 GDP. In the markets, the Treasury will sell 2Y notes (Tuesday), 2Y floating-rate and 5Y fixed-rate notes (Wednesday) and 7Y notes (Thursday).

Germany: Ifo business climate indices



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: Ifo business climate indices



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK

BoE cuts Bank Rate and increases asset holdings

Despite last week's emergency BoE rate cut and agreement of a new Term Funding scheme (TFSME), as well as this week's establishment of a new Covid Corporate Financing Facility (CCFF), UK financial conditions have continued to tighten over recent days. Mirroring developments in other major bond markets, but arguably exacerbated by rumours of an imminent lockdown of London (still denied by the Government), longer-dated yields on Gilts had risen sharply as investors actively sought more liquid shorter-dated securities. In response, the BoE's MPC held another emergency meeting today and agreed to cut Bank Rate by a further 15bps to 0.1%. The MPC also decided to enlarge the TFSME scheme, to provide even greater support to lending to SMEs. But most importantly given the recent tightening of financial conditions, the MPC also agreed to relaunch its QE programme, targeting an increase in the BoE's holdings of Gilts and sterling-denominated non-financial investment-grade corporate bonds by £200bn to £645bn.

Gilt purchases to be faster than ever before

The BoE made clear that Gilts will account for the majority of the extra asset purchases. And, in a sign of urgency (or even panic), it also stated that the asset purchases will be completed "as soon as is operationally possible". Indeed, the first Gilt purchase operation (of £5.1bn) will be conducted tomorrow, and, while the pace will vary over coming weeks, Governor Bailey subsequently confirmed that the rate of buying will be materially faster than in the past. (Previously, the fastest pace of purchase under the BoE's programme occurred in its initial phase in 2009, when the BoE took about seven months to acquire £150bn of assets.) The minutes of today's meeting will not be released until 26 March, when the next scheduled policy announcement is due. And given the extraordinarily fast pace of events, we do not rule out additional easing measures being unveiled on that occasion too. Given Bailey's recent comments, however, we do not expect an imminent move to negative rates or, indeed, helicopter money.

The week ahead in the UK

A key event in the UK in the coming week will therefore be the conclusion of the BoE's scheduled March MPC meeting on Thursday. After the emergency actions of recent days, and comments from new BoE Governor Andrew Bailey yesterday that the MPC is willing to take a range of unconventional measures, we would certainly not rule out further monetary policy easing in the coming week. Additional fiscal action is perfectly feasible too. And if and when new government measures imply a significant further increase in borrowing, we would not be surprised to see the BoE eventually seek to absorb the additional issuance via another increase in Gilt purchases.

Data-wise, insight into the likely hit to UK economic activity will be illustrated in the flash PMIs for March on Tuesday. Inevitably, we expect to see a marked deterioration in the headline services index to its weakest level since the Global Financial Crisis, with the manufacturing index similarly bound to point to marked contraction. That day will also bring the CBI's latest industrial trends survey, which will be followed on Wednesday by the equivalent distributive trades' survey. While food retailers are likely to have seen a marked increase in sales due to panic buying this month, other retailers are likely to indicate a sharp drop in spending at the end of the first quarter. Official retail sales figures for February are due on Thursday and are likely to be subdued. Meanwhile, February CPI figures (due Wednesday) are likely to have seen headline inflation fall back last month due to lower energy prices. And a steep drop in inflation seems inevitable over coming months too.

In the absence of significant economic news, the next edition of the Euro wrap-up will be published on 24 March 2020

European calendar

Today's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		Construction output M/M% (Y/Y%)	Jan	**3.6 (6.0)**	-	-3.1 (-3.7)	-1.8 (-2.3)
Germany		Preliminary ifo survey – business climate index	Mar	**87.7**	-	96.1	96.0
		Preliminary ifo survey – current assessment index (expectations index)	Mar	**93.8 (82.0)**	-	98.9 (93.4)	99.0 (93.2)
		BoE Bank Rate %	Mar	**0.10**	-	0.25	-
		BoE gilt and corporate bond purchase target £bn	Mar	**645**	-	445	-

Auctions		
Country		Auction
France		sold €3.2bn of 0% 2023 bonds at an average yield of -0.43%
		sold €2.4bn of 0% 2025 bonds at an average yield of -0.22%
		sold €1.9bn of 2.75% 2027 bonds at an average yield of -0.05%
		sold €220mn of 0.1% 2028 index-linked bonds at an average yield of -0.08%
		sold €339mn of 0.7% 2030 index-linked bonds at an average yield of -0.25%
Spain		sold €1.3bn of 0% 2023 bonds at an average yield of 0.024%
		sold €1.7bn of 1.5% 2027 bonds at an average yield of 0.473%
		sold €1.5bn of 0.5% 2030 bonds at an average yield of 0.661%
		sold €500mn of 2.35% 2033 bonds at an average yield of 0.827%
UK		sold £3.25bn of 0.625% 2025 bonds at an average yield of 0.64%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data						
Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		09.00	Current account balance €bn	Jan	-	32.6
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

Auctions and events			
Spain		-	Spanish sovereign debt to be rated by Moody's and S&P

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 23 March 2020			
EMU		15.00	Preliminary consumer confidence	Mar	-	-6.6
			Tuesday 24 March 2020			
EMU		09.00	Preliminary manufacturing PMI (services)	Mar	-	49.2 (52.6)
		09.00	Preliminary composite PMI	Mar	-	51.6
Germany		08.30	Preliminary manufacturing PMI (services)	Mar	40.0 (42.0)	48.0 (52.5)
		08.30	Preliminary composite PMI	Mar	-	50.7
France		08.15	Preliminary manufacturing PMI (services)	Mar	-	49.8 (52.5)
		08.15	Preliminary composite PMI	Mar	-	52.0
UK		09.30	Preliminary manufacturing PMI (services)	Mar	49.0 (48.0)	51.7 (53.2)
		09.30	Preliminary composite PMI	Mar	-	53.0
		11.00	CBI industrial trends survey, total orders	Mar	-	-18
			Wednesday 25 March 2020			
Germany		09.00	Final ifo business climate index	Mar	87.7	96.0
		09.00	Final ifo current assessment balance (expectations)	Mar	93.8 (82.0)	99.0 (93.2)
UK		09.30	CPI (core CPI) Y/Y%	Feb	1.7 (1.6)	1.8 (1.6)
		09.30	PPI input prices (output prices) Y/Y%	Feb	-	2.1 (1.1)
		09.30	House price index Y/Y%	Jan	-	2.2
		11.00	CBI distributive trade survey, total retail sales	Mar	-	1
			Thursday 26 March 2020			
EMU		09.00	M3 money supply Y/Y%	Feb	-	5.2
Germany		07.00	GfK consumer confidence survey	Apr	-	9.8
France		07.45	Business confidence indicator	Mar	-	105
		07.45	Manufacturing confidence indicator (production outlook)	Mar	-	102 (0)
UK		09.30	Retail sales including fuel M/M% (Y/Y%)	Feb	0.1 (0.6)	0.9 (0.8)
		09.30	Retail sales excluding fuel M/M% (Y/Y%)	Feb	-	1.6 (1.2)
		12.00	BoE Bank Rate %	Mar	0.10	0.10
		12.00	BoE gilt and corporate purchase bond target £bn	Mar	645	645
			Friday 27 March 2020			
Germany		-	Retail sales* M/M%	Feb	-	1.0 (2.1)
France		07.45	Consumer confidence indicator	Mar	-	104
Italy		09.00	Economic sentiment indicator	Mar	-	99.8
		09.00	Consumer confidence indicator (manufacturing)	Mar	-	111.4 (100.6)

**Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

The coming week's key events & auctions

Country		GMT	Event / Auction
			Monday 23 March 2020
			- Nothing scheduled -
			Tuesday 24 March 2020
Germany		10.30	Auction: €4bn of 0% 2022 bonds
			Wednesday 25 March 2020
			- Nothing scheduled -
			Thursday 26 March 2020
EMU		09.00	ECB publishes its Economic Bulletin
Italy		10.00	Auction: fixed rate and index-linked bonds
			Friday 27 March 2020
UK		-	UK sovereign debt to be rated by Fitch

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FCA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory. Regulatory disclosures of investment banking relationships are available at https://daiwa3.bluematrix.com/sellside/Disclosures.action.