Daiwa Capital Markets

Euro wrap-up

Overview

Emily Nicol
+44 20 7597 8331

- While Germany unveiled a sizable support package implying an increase in new government debt this year, Bunds followed Treasuries higher as the Fed took extraordinary monetary policy action.
- Gilts also rallied in line with the global trend.
- Tomorrow will bring the flash March PMIs from the euro area, Germany, France and UK, which are likely to point to significant contraction at the end of Q1.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.743	-0.033
OBL 0 04/25	-0.569	-0.037
DBR 0 02/30	-0.385	-0.054
UKT 0½ 07/22	0.071	-0.066
UKT 0⅝ 06/25	0.205	-0.136
UKT 4¾ 12/30	0.421	-0.140

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

Euro area

German Cabinet approves support package

The weekend brought more downbeat news with respect to the coronavirus, with a surge in new cases across Europe, including in Germany. Indeed, the number of confirmed coronavirus cases jumped to more than 26,000, forcing the government to announce a ban of social gatherings of more than two, and the finance ministry to estimate that the economy could contract by at least 5% this year. So, coming on the back of significant fiscal support announced in France, Italy and Spain last week, the German Cabinet today signed off a sizeable support package totaling €750bn (circa 22% of GDP). Like in other member states, the majority will consist of a bailout financial rescue fund, to be known as the Economic Stabilisation Fund (WSF) including €400bn worth of loan guarantees, €100bn to take equity stakes in impacted firms, together with an additional €100bn for state-backed loans via KfW. The Cabinet also agreed to a supplementary budget for 2020 implying €156bn (4.6% of GDP) in new government debt, including €122.5bn of additional public spending and €33.5bn to cover foregone tax revenues. As a result, the German government will now seek the approval of the Bundestag to suspend the debt brake, which currently limits new government borrowing to just 0.35% of GDP. And total issuance in 2020 is now set to reach an estimated €360bn. The federal debt agency today announced an increase in its bond and bill issuance in the second quarter of the year of €32.5bn, with an additional €87bn planned for the second half of the year. The extra issuance of Bunds will be good news for the ECB, implying that it will be able to continue to buy them over the remainder of the year without breaching its self-imposed (albeit now flexible) 33% issue and issuer limits on its public sector bond purchases.

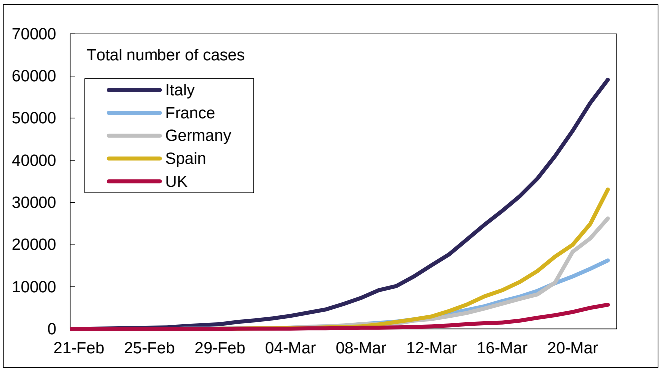
Consumer confidence weak, but further to fall

Today's economic data served as a reminder that the euro area will need all the support it can get, with the Commission's flash consumer sentiment index dropping 5pts in March, the largest monthly decline since the series began in the early 1990s. Admittedly, this left the index at -11.6, the lowest since late 2014 but still 10pts higher than the troughs seen during the Global Financial and euro crises. Certainly, given the severity of the virus outbreak across the euro area with rapidly rising death rates in several member states, including most notably Italy and Spain, as well as the associated widespread disruption to activity and uncertainty this presents for the economic outlook, we think household sentiment has significantly further to fall over the months ahead.

The day ahead in the euro area and US

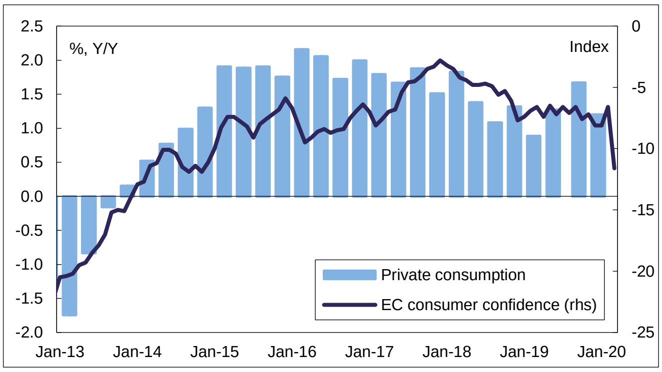
Looking ahead, of more interest tomorrow will be the flash PMIs from the euro area and largest two member states, which will provide a more comprehensive assessment of conditions in March. Indeed, they are likely to signal a substantial

Europe: Number coronavirus cases*



EEA countries and UK. Source: WHO

Euro area: Commission's consumer confidence



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

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. Overall, these are expected to point to marked contraction at the end of the first quarter and beyond. In the markets, Germany will sell 2Y Schatz.

In the US, focus will no doubt remain on what progress has been made with the government’s fiscal response to the escalating coronavirus crisis. But tomorrow will also bring the flash Markit PMIs for March, along with 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. In the markets, the Treasury will sell 2Y notes.

UK

UK continues to bolster support package

Late on Friday, UK Chancellor Sunak further bolstered the UK government’s response to the coronavirus. In particular, having previously announced a £12bn package of extra spending in the Budget and a new £330bn programme of business loan guarantees and three-month mortgage holiday, the government unveiled several new measures, the centerpiece of which was the Coronavirus Job Retention Scheme, whereby government grants will cover 80% of the salary of retained workers up to a total of £2500 per person per month. While difficult to assess to what extent this facility will be used, the Resolution Foundation estimates that for every one million employees taking up the scheme, the government would be paying out an average £4.2bn over the initial three-month period. While unprecedented in the UK’s economic history, it nevertheless brings it more in line with policies previously announced elsewhere in Europe, particularly the Nordic countries and Germany. The government also extended its unlimited business interest-free loan scheme by an additional six months to one year, while deferring business VAT payments in Q2 (worth around £30bn of cash to employers, 1.5% of GDP).

The day ahead in the UK

The main economic focus in the UK tomorrow will be the March flash PMIs, which like the euro area surveys, are expected to report 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. Tomorrow will also bring the CBI’s latest industrial trends survey, which will equally point to a significant drop in new orders.

European calendar

Today's results							
Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		Preliminary consumer confidence	Mar	**-11.6**	-	-6.6	-
Auctions							
Country		Auction					
		- Nothing to report -					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases						
Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		09.00	Preliminary manufacturing PMI (services)	Mar	39.0 (39.5)	49.2 (52.6)
		09.00	Preliminary composite PMI	Mar	38.8	51.6
Germany		08.30	Preliminary manufacturing PMI (services)	Mar	39.9 (43.0)	48.0 (52.5)
		08.30	Preliminary composite PMI	Mar	41.0	50.7
France		08.15	Preliminary manufacturing PMI (services)	Mar	40.6 (40.0)	49.8 (52.5)
		08.15	Preliminary composite PMI	Mar	38.1	52.0
UK		09.30	Preliminary manufacturing PMI (services)	Mar	45.0 (45.0)	51.7 (53.2)
		09.30	Preliminary composite PMI	Mar	45.0	53.0
		11.00	CBI industrial trends survey, total orders	Mar	-35	-18
Auctions						
Country		BST	Auction/Event			
Germany		10.30	Auction: €4bn of 0% 2022 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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