Euro wrap-up

Overview

- Bunds made losses while periphery bonds made gains after euro area finance ministers agreed that the ESM should make available new Pandemic Crisis Support and nine EU leaders called for ‘coronabonds’.
- As the BoE’s purchases and new liquidity support provided support to markets, Gilts made gains as UK inflation remained well-behaved and a survey pointed to subdued retail sales in March.
- Thursday will bring a videoconference of EU leaders, a scheduled meeting of the BoE’s MPC and further economic sentiment survey results from Germany and France.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.647	+0.023
OBL 0 04/25	-0.486	+0.033
DBR 0 02/30	-0.297	+0.035
UKT 0½ 07/22	0.068	-0.033
UKT 0⅝ 06/25	0.216	-0.027
UKT 4¾ 12/30	0.426	-0.044

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

Euro area

New ESM support to offer new Pandemic Crisis Support

With the ECB having strengthened its response to the Covid-19 crisis last week with its new flexible €750bn PEPP asset purchase progamme, last night finance ministers discussed the euro area’s fiscal policy response ahead of a videoconference of EU leaders scheduled for tomorrow. The Commission judged that the size of member states’ discretionary fiscal measures roughly doubled over the past week to about 2% of euro area GDP, with liquidity support schemes boosted by a further 3ppts to more than 13% of GDP. And to facilitate funding the planned extra government spending, last night the finance ministers “broadly agreed” that the ESM should make available new Pandemic Crisis Support, based on its existing Enhanced Conditions Credit Line (ECCL) albeit with a maturity longer than one year (the maximum currently available under that instrument).

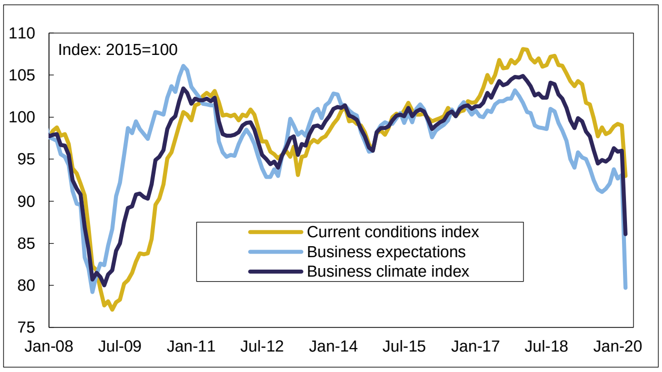
Conditions should be minimal, lending capacity large

Under the new facility, all member states would initially have access to funds equivalent to about 2% of national GDP on the basis of an up-front assessment by the EU institutions. The funds would have to be used to meet the health and economic costs caused by the Covid-19 outbreak. And member states would be expected to make new commitments to achieve longer-term fiscal sustainability. But the precise nature and extent of the conditionality remains to be decided. To be supportive of investor sentiment, EU leaders tomorrow should make clear that the conditions will be minimal and not onerous. And they should also make clear that, if necessary, the Pandemic Crisis Support might in due course be able to offer significantly more than 2% of national GDP to countries in need.

9 leaders call for a ‘coronabond’

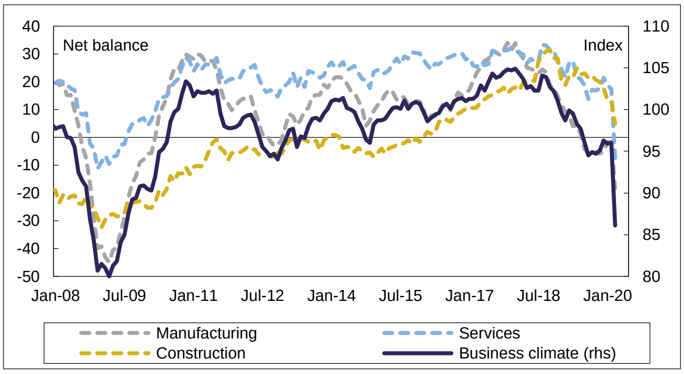
The ESM currently has an available lending capacity of €410bn, about 3.4% of GDP. So, a larger Pandemic Crisis Support mechanism might eventually require an augmentation of ESM resources, particularly if Germany, the Netherlands and Austria continue to block the issuance of a common ‘coronabond’ debt instrument. However, the leaders of nine member states, including France, Italy, Spain and Belgium, today wrote to EU President Michel stressing the need for such a common bond of sufficient size and long maturity to be issued by a European institution. And markets would certainly respond positively if the leaders tomorrow agreed to consider with urgency how such a bond might work in future.

Germany: ifo business climate indices



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: ifo business climate indices by sector



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

German ifo indices flag initial economic shock

Following yesterday's flash PMIs, today's final ifo business survey for March added to evidence that the German economy is in the midst of a contraction to rival, or indeed surpass, that suffered during the global financial crisis in 2008-9. Predictably, all indices were revised down from the exceptional preliminary release published last Thursday. Among others, the headline business climate index was revised down 1.6pts from the initial estimate to 86.1, the lowest since July 2009, with the decline of almost 10pts from February comfortably the biggest on the survey. And the expectations index was revised down 2.3pts to 79.7, the second lowest since reunification (beaten only in December 2008), with the drop of more 13pts from last month also a record margin. According to today's survey results, manufacturers and construction have not been more pessimistic since the first half of 2009. And services and trading firms have never been more downbeat about the outlook since the respective series began. Today's survey commenced on 2 March, and 90% of responses had been received by 19 March, since when the spread of Covid-19 in Germany has intensified as have the government's lockdown measures taken to tackle it. Therefore, we fully expect to see a significant further deterioration in the indices for current conditions and business expectations in next month's survey.

The day ahead in the euro area and US

While the aforementioned EU leaders' videoconference, which is scheduled to start at 16.00 CET, will be most notable, Thursday will also bring more sentiment survey results from euro area member states. The focus in Germany will turn to the household sector, with the GfK consumer confidence index expected to have fallen sharply to a multi-year low, albeit to a level still considerably higher than the troughs reached during the euro crisis. In France, meanwhile, the INSEE business confidence survey is likely to echo the downbeat message from yesterday's flash PMIs, which saw the composite index decline to a series low. The ECB's latest bank lending figures for February are also due for release.

In the US, of most interest tomorrow will be the weekly jobless claims figures. Following a notable rise in last week's figures (up 70k, or 33%, to 281k), initial claims are expected to post an extraordinary jump to a record high, with a number well in excess of 1.5mn feasible. Thursday will also bring advance goods trade figures for February which are likely to show some signs of disruption to external demand from the coronavirus outbreak, while the Kansas Fed manufacturing activity index for March is also due. Of less interest will be the final release of Q4 GDP, which is likely to confirm the current estimate of 2.1%Q/Q annualised.

UK

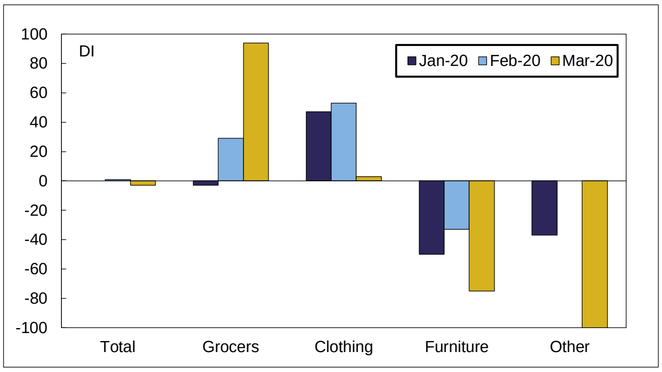
CBI survey points to significantly weaker sales ahead

At face value today's CBI distributive trades survey suggested that conditions in the retail sector were little changed in March from the subdued trend seen since the start of 2020, Indeed, the survey measure of overall retail sales was unchanged compared with a year earlier. But even before Covid-19-related restrictions on trading and the freedom of movement kicked in – the survey was conducted between 26 February and 13 March – the survey showed a significant divergence between sectors. Food stores reported exceptionally strong growth in sales as households stockpiled groceries (a net balance of +94% in March). In contrast, other retailers reported a marked decline in sales as households put off buying of non-essentials – indeed, the survey reported net balances of -75% for clothing and furniture and -100% for its category of 'other normal goods'. Overall, the survey suggested that sales remained poor for the time of year, with the outlook markedly worse. In particular, orders placed with suppliers fell for the eleventh consecutive month in March and were expected to fall further in April, with retailers anticipating sales next month to be the weakest since the height of the Global Financial Crisis.

Inflation edges lower in February

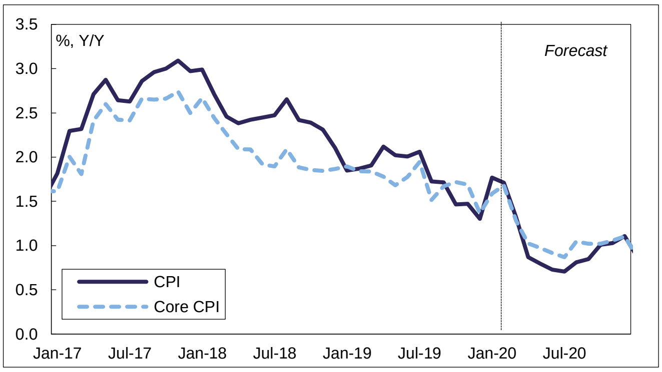
There were no major surprises in February's CPI release, which saw headline inflation edge slightly lower by 0.1ppt to

UK: CBI survey of sales volumes by store-type



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Headline and core inflation forecast



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

1.7%Y/Y, nevertheless still the second-highest rate of the past five months. This principally reflected lower energy inflation, which fell 1.1ppts to 3.7%Y/Y, while computer games also contributed to the downward trend. But higher hotel changes that month (a trend that won't continue) provided a boost to services inflation, which rose 0.2ppt to 2.5%Y/Y. And so, core inflation edged slightly higher in February, by 0.1ppt to 1.7%Y/Y. This seems highly likely to mark the high point for the year. Certainly, the slump in demand will weigh on prices for the foreseeable future, not least in the services sector. And while the recent sterling depreciation will provide some support to non-energy industrial goods inflation, the plunge in the oil price (down 55% since the start of the year in sterling terms) combined with a further cut in the regulator's domestic energy price cap and lower water bills from April will see energy inflation become a significant drag over the near term. As such, we now expect headline inflation to fall below 1%Y/Y at the start of Q2. And with previous concerns surrounding domestically generated price pressures associated with the labour market now removed, we see limited upward impulses from underlying inflationary pressures over coming quarters either. And the BoE will be able to continue to do whatever is required to navigate the UK's economy through the current crisis without worrying about potentially overshooting its inflation target over the forecast horizon.

The day ahead in the UK

Certainly, the MPC has been proactive over the past two weeks, announcing two emergency Bank Rate cuts to a record-low 0.1% (the effective lower bound), a new Term Funding Scheme to support SMEs, and the relaunch of its QE programme, pledging to purchase £200bn of extra Gilt and corporate bonds as quickly as is materially possible. The Bank has also offered several facilities to ensure that money markets are able to operate smoothly, including yesterday's temporary enhancement to its liquidity insurance resources following a surge in demand for cash under its regular weekly operation. In particular, over the next two weeks, the Contingent Term Repo Facility (CTRF) will lend reserves for a period of three months in exchange for less liquid assets at a fixed price of Bank Rate plus 15bps (i.e. currently 25bps).

Against this backdrop, the BoE's scheduled MPC announcement tomorrow seems unlikely to offer anything materially new. Admittedly, following the Fed's decision earlier this week, the Bank might signal its willingness to do unlimited asset purchases if required to stabilise market conditions. But under the current pace of purchases, the Bank's targeted £200bn increase in its Gilt and corporate bond holdings will not be achieved until August, allowing it more time to assess the economic outlook. In this respect, the minutes from today's and last week's emergency meeting, to be published alongside the latest policy statement, will be closely watched for the Bank's current economic assessment. Meanwhile, beyond monetary policy, the Government will announce new measures to support the incomes of self-employed workers, who were conspicuous by their absence in consideration when the Coronavirus Job Retention Scheme was announced at the end of last week.

In terms of economic data, tomorrow will also bring ONS official retail sales figures for February.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Final ifo business climate index	Mar	**86.1**	87.7	96.0	-
	Final ifo current assessment balance (expectations)	Mar	**93.0 (79.7)**	93.8 (82.0)	99.0 (93.2)	-
UK	CPI (core CPI) Y/Y%	Feb	**1.7 (1.7)**	1.7 (1.5)	1.8 (1.6)	-
	PPI input prices (output prices) Y/Y%	Feb	**-0.5 (0.4)**	-0.5 (0.4)	2.1 (1.1)	1.6 (1.0)
	House price index Y/Y%	Jan	**1.3**	2.7	2.2	1.7
	CBI distributive trade survey, total retail sales	Mar	**-3**	-15	1	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	09.00	M3 money supply Y/Y%	Feb	5.2	5.2
Germany	07.00	GfK consumer confidence survey	Apr	7.5	9.8
France	07.45	Business confidence indicator	Mar	97	105
	07.45	Manufacturing confidence indicator (production outlook)	Mar	93 (-)	102 (0)
UK	07.00	Retail sales including fuel M/M% (Y/Y%)	Feb	0.2 (0.7)	0.9 (0.8)
	07.00	Retail sales excluding fuel M/M% (Y/Y%)	Feb	-0.2 (1.1)	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

Key events and auctions

Country	GMT	Auction/Event
EMU	09.00	ECB publishes its Economic Bulletin
	15.00	EU leaders to hold a videoconference
Italy	10.00	Auction: fixed rate and index-linked bonds
UK	12.00	BoE monetary policy announcement

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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