Euro wrap-up

Overview

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- Ahead of the outcome of the EU leaders' videoconference and after the ECB confirmed legally that its issue limits will not apply to its PEPP scheme, Bunds made notable gains while periphery spreads narrowed.
- Longer-dated Gilts also made gains as the BoE kept monetary policy unchanged but signalled that it was prepared to increase its asset purchases if required.
- Friday will bring more European sentiment surveys, with Italian household and business confidence likely to plunge to record lows.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.680	-0.048
OBL 0 04/25	-0.573	-0.103
DBR 0 02/30	-0.379	-0.110
UKT 0½ 07/22	0.117	+0.012
UKT 0⅝ 06/25	0.222	-0.024
UKT 4¾ 12/30	0.382	-0.060

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

Euro area

ECB Decision drops issue limits on PEPP purchases

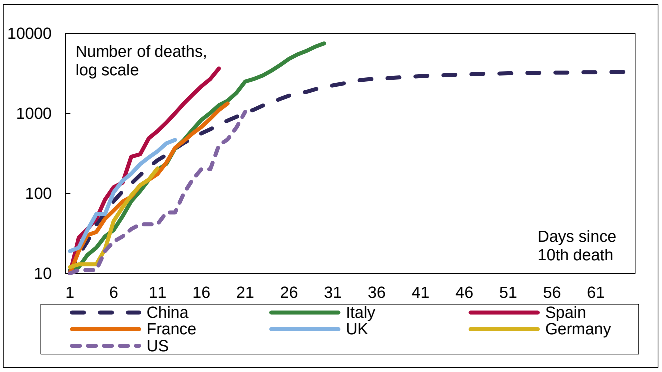
Ahead of this afternoon's videoconference where EU leaders were set to discuss issues related to the ESM and the call for issuance of a common euro area 'coronabond', last night the ECB published its legal Decision setting out the operational detail of its temporary €750bn Pandemic Emergency Purchase Programme (PEPP). And this text confirmed the massive increase in its commitment to addressing fragmentation risks. Most notably, the ECB Decision was explicit that the 33% issue and issuer limits will not apply to the assets purchased under the scheme. It also confirmed that the ECB will be able to buy securities with maturities shorter than those bought under the regular public sector purchase programme (PSPP). In particular, it will allow purchases of securities with a minimum remaining maturity of just 70 days, and a maximum remaining maturity of 30 years. And following the Decision, the Executive Board now has the power to set the appropriate pace and composition of PEPP monthly purchases, crucially allowing for fluctuations in the distribution of purchases across jurisdictions, thus facilitating extra purchases of BTPs across the curve and first purchases of GGBs, without the hawks on the Governing Council being able to interfere.

Surveys illustrate slump in sentiment

Data-wise, the latest survey results from Germany and France continued to illustrate the marked deterioration in economic confidence over the past month. For example, the German GfK consumer confidence survey unsurprisingly showed that households are significantly more concerned about the economic outlook (the relevant index fell 20pts to its lowest since the global financial crisis) and their income prospects, and therefore their willingness to buy durable goods dropped sharply (both indices were back at levels last seen during the euro crisis). And so, the headline confidence indicator was revised markedly lower in March, by 1.5pts from the forecast published a month ago to 8.3, albeit still well above levels seen during recent crises. Moreover, the forward-looking index for April plummeted to just 2.7, the lowest since May 2009. And with the survey having been conducted between 4-16 March, therefore well before the closure of businesses, production shutdowns and the increased restrictions on the freedom of movement, as well as the marked increases in recorded cases of Covid-19, this seems bound to worsen over the coming month.

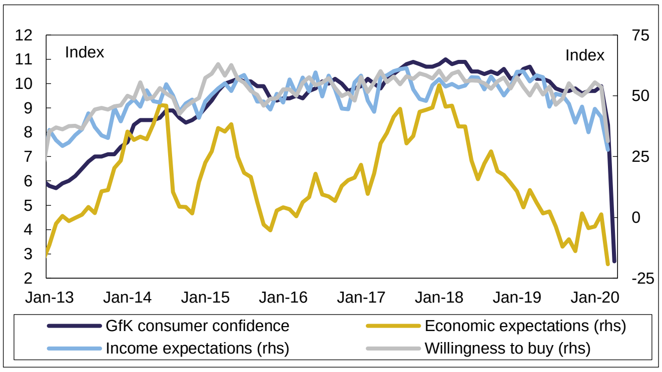
Like with the flash PMIs published earlier this week, today's French INSEE survey reported a significant worsening in business sentiment. In particular, the survey indicator of services sentiment fell the most on the series while retailers reported the worst deterioration in business conditions since October 2008. But while manufacturers were also more pessimistic, the drop in the headline composite index was relatively small. This notwithstanding, firms were clearly worried about the production prospects ahead, with the relevant index down a huge 30pts to its lowest level since mid-2013. Overall,

Europe: Covid-19 deaths by country



Source: WHO and Daiwa Capital Markets Europe Ltd.

Germany: GfK consumer confidence indicators



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

the headline business climate index fell 10pts in March, the most since the series began in 1980, with record monthly drops reported in the indices for the general outlook, expected activity and demand. Admittedly, at 95 it was merely the lowest since March 2015. But with most responses to the survey collected before restrictions on activity started to tighten with the closure of the schools on 16 March, and well before the fatality count (now above 1000) started to rise exponentially, French business sentiment seems bound to have deteriorated significantly further since the survey was conducted, with the INSEE indices probably likely to fall next month to below the levels seen during the Global Financial Crisis.

The day ahead in the euro area and US

The end of the week will bring more sentiment surveys at the national level, with the French INSEE consumer and Italian ISTAT consumer and business indicators set to show a marked deterioration in March. Indeed, with the coronavirus outbreak having significantly impacted activity in Italy since late February, the Italian surveys will almost definitely report the steepest declines on record and possibly to levels below that seen during the Global Financial Crisis.

In the US, tomorrow will bring the revised University of Michigan's consumer sentiment survey for March. The preliminary release showed the headline confidence index dropping 5pts to 95.9, a five-month low. But with COVID-19 crisis having escalated in the US over recent weeks, we would expect a notable downwards revision to both the headline and expectations components. Friday will also bring personal income and spending figures for February, including the closely-watched deflators. The House of Representatives will also vote on the US fiscal support package.

UK

BoE signals readiness to increase asset purchases

Over the past fortnight, the BoE had already announced exceptionally massive monetary easing, including two emergency Bank Rate cuts to a record low of 0.1%, arguably the effective lower bound; £200bn of extra Gilt and corporate bonds purchases as quickly as is materially possible; a new Term Funding Scheme and Covid Corporate Financing Facility to support the flow of funds to businesses; and, earlier this week, the relaunch of its Contingent Term Repo Facility (CTRF) to ease money market strains. So, it should not have come as a surprise that today's scheduled MPC announcement, which was the first since Andrew Bailey succeeded Mark Carney as Governor, brought no further amendments to policy. Nevertheless, the BoE is clearly willing to ease policy again, today stating that "if needed, the MPC can expand asset purchases further… [and]…stands ready to respond further as necessary to guard against an unwarranted tightening in financial conditions, and support the economy".

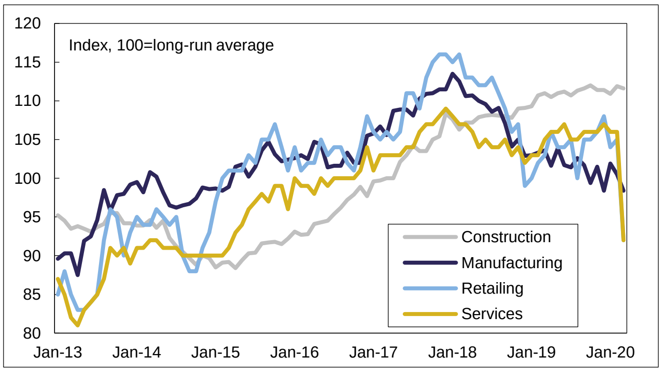
Financial strains could prompt further action

So, the BoE policy outlook depends on how financial and economic conditions evolve from here. In terms of the former, the MPC noted the drop in Gilt yields, the flattening of the curve, and modest appreciation of sterling since the commencement of its additional asset purchases on 20 March. It also welcomed the better tone to equity markets and stabilisation of corporate bond spreads. But it acknowledged the ongoing disruption to repo and money markets, which had prompted the recommencement of the CTRF earlier this week. And if financial market strains re-intensify, the BoE should be expected to act once more.

BoE would also ease further to mitigate longer-term economic damage

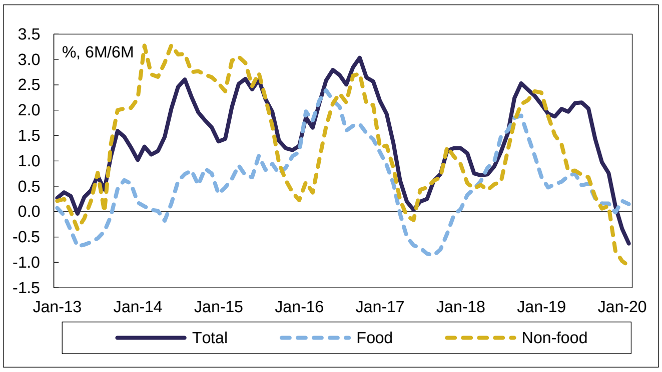
In terms of the economic outlook, the BoE is already braced for an extremely marked deterioration in activity due to the spread of Covid-19 and the social-distancing measures required to contain it. Indeed, the MPC acknowledged the risk of significant longer-term damage to the economy in the event of large-scale business failures and/or big increases in

France: INSEE business sentiment indicators



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

UK: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

unemployment. And so, increased asset purchases might well be forthcoming if the risks of such longer-term damage seem likely to crystallise. For the time being, however, it is difficult to gauge how the MPC might react precisely to the incoming flow of economic data, not least as today it refrained from offering a baseline forecast for the magnitude of the unfolding economic shock. Of course, given the flash March PMIs, insights from the BoE agents, the drop in footfall in the retail, leisure and hospitality sectors, and recent controls of activity, the MPC appeared to acknowledge that Q2 will see a drop in GDP of historical magnitude. And not least due to lower oil prices, the BoE now accepts that inflation will fall below 1.0%Y/Y over the near term too. It is also likely to look through any positive impulse to inflation further ahead resulting from sterling's depreciation. So, if the chances of a V-shaped recovery from Q3 on recede, we would expect the MPC to extend its asset purchases through to year end and probably into 2021 too.

Household spending to remain weak after controls are relaxed

For the record, after yesterday's CBI distributive trades survey for March suggested a marked weakening in retail activity, with the exception of grocery stores which were benefiting from household stockpiling, today's official sales figures for February suggested that the underlying trend had remained very subdued before the Covid-19 outbreak. Following a rare stronger performance in January (+1.1%M/M), total sales were down 0.3%M/M in February to mark the sixth month out of the past seven that sales have failed to grow. This left them down 0.6%3M/3M and unchanged compared with a year earlier, the lowest year-on-year rate since March 2013. With restrictions to freedom of movement and retailing now in place across the UK, non-food sales will fall extremely sharply in the second quarter. Social-distancing measures also spell doom for commercial social activities, which account for 20% of all household spending. And despite the government's Coronavirus Job Retention Scheme of wage subsidies, the sharp deterioration in the labour market already underway will likely significantly weaken the trend of spending even once controls on activity are lifted. Indeed, the Department of Work and Pensions stated yesterday that there had been 477k applications for the government's Universal Credit welfare benefits over the prior nine days, representing a total about three times the size of the biggest previous monthly increase in jobless claims, and roughly six times the biggest monthly increase during the global financial crisis.

The day ahead in the UK

It should be a relatively quiet end to the week with respect to economic news, with no top-tier monthly data due for release.

European calendar

Today's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		M3 money supply Y/Y%	Feb	**5.5**	5.2	5.2	-
Germany		GfK consumer confidence survey	Apr	**2.7**	7.5	9.8	8.3
France		Business confidence indicator	Mar	**95**	97	105	-
		Manufacturing confidence indicator (production outlook)	Mar	**98 (-33)**	93 (-)	102 (0)	101 (-)
UK		Retail sales including fuel M/M% (Y/Y%)	Feb	**-0.3 (0.0)**	0.2 (0.7)	0.9 (0.8)	1.1 (0.9)
		Retail sales excluding fuel M/M% (Y/Y%)	Feb	**-0.5 (0.5)**	-0.2 (1.1)	1.6 (1.2)	1.8 (1.3)
		BoE Bank Rate %	Mar	**0.10**	0.10	0.10	-
		BoE gilt and corporate purchase bond target £bn	Mar	**645**	645	645	-

Auctions

Country		Auction
Italy		sold €2.75bn of 0% 2021 bonds at an average yield of 0.307%
		sold €691mn of 2.55% 2041 bonds at an average yield of 1.77%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
France		07.45	Consumer confidence indicator	Mar	91	104
Italy		09.00	Economic sentiment indicator	Mar	-	99.8
		09.00	Consumer confidence indicator (manufacturing)	Mar	100.5 (88.0)	111.4 (100.6)

Key events and auctions

Country		GMT	Auction/Event
UK		-	UK sovereign debt rating review to be published by Fitch

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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