Euro wrap-up

Overview

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- With equity markets making further gains, Bunds and other euro area government bonds made losses as the Eurogroup discussed new pandemic crisis support. Late in the day, the ECB announced a relaxation of its collateral rules, including acceptance of Greek bonds in its operations.
- Gilts also made losses as Boris Johnson remained hospitalised in intensive care and the number of UK Covid-19 deaths rose to a new daily high.
- The outcome of the Eurogroup meeting will have a bearing on how euro area markets open on Wednesday, when further surveys will illustrate the unfolding economic impact of Covid-19.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.661	+0.036
OBL 0 04/25	-0.545	+0.074
DBR 0 02/30	-0.322	+0.108
UKT 0½ 07/22	0.169	+0.061
UKT 0⅝ 06/25	0.240	+0.071
UKT 4¾ 12/30	0.412	+0.078

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

Euro area

Austria, Denmark and Norway point to way forward

The daily data on the European spread of Covid-19 still makes uncomfortable reading, e.g. with increases in deaths reported in Spain (today) and Italy (yesterday). However, in most member states, the trends in new deaths and confirmed cases continue to flatten (indeed Italy announced its fewest new cases since 13 March), allowing governments to start to consider lockdown exit strategies. Today's Norway's government followed those yesterday in Austria and Denmark, where death rates have been lower than the regional average, in confirming phased plans to ease their own restrictions, thus providing an indication of the paths likely to be followed by the large member states. In Austria, where the country went into lockdown on 16 March, small stores should be allowed to reopen on 14 April, but larger retailers and hairdressers are likely to be given the green light from 1 May. And hotels, restaurants and schools might only be allowed to reopen from the middle of next month. In Denmark, where lockdown was imposed on 11 March, nursery and primary schools will reopen from 15 April, but older children will not return for more than a month. And while some businesses will be permitted to go back to work on a gradual basis, services such as restaurants and hairdressers will remain closed. In both countries, large public gatherings will remain banned into Q3 and significant travel restrictions will remain in place.

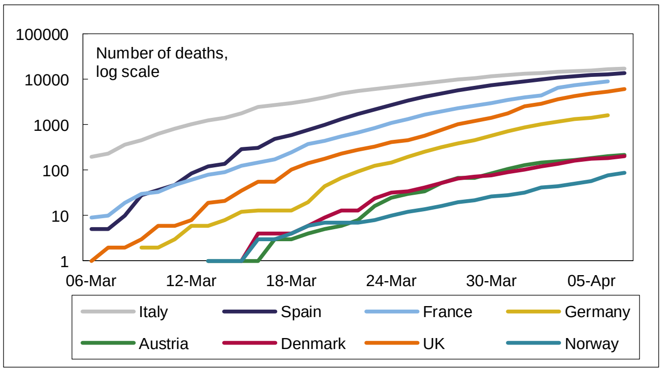
Larger member states to be on more gradual exit path

In the larger member states, the paths to the exit will be similarly partial but also more gradual than in Austria and Denmark. So, the contraction in euro area economic output in Q2 seems bound to be firmly in double-digit percentage terms even if other governments announce relaxation of certain controls relatively soon. And even though conditions should be in place for a moderate rebound in economic output in Q3, lingering restrictions, as well as risks of a second wave of Covid-19 and public fears of contagion, will likely keep economic activity suppressed well below the recent peak in Q4.

German IP boosted by pharmaceutical production…

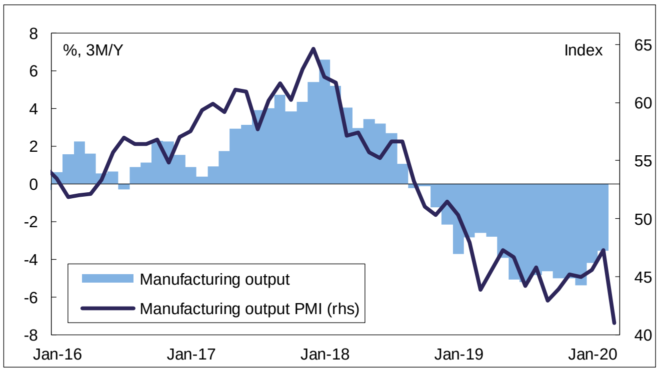
Like yesterday's German factory orders data, today's industrial production figures suggested limited adverse impact on the country's manufacturing activity from Covid-19 in February. Indeed, contrasting with an anticipated decline, total output rose 0.3%M/M in February following upwardly revised growth of more than 3%M/M in January, to its highest level for nine months. With construction activity having fallen back by 1%M/M in February (unsurprisingly so, given the near-6½%M/M increase at the start of the year), the pickup in overall manufacturing output was slightly stronger at 0.4%M/M. Notably perhaps, production of chemical and pharmaceutical products was up 5½%M/M and 12½%M/M respectively to the highest levels since September 2018, perhaps in response to the burgeoning pandemic. In contrast, output of general and electrical

Europe: Covid-19 fatalities in selected countries*



*German and French figures as of 6 April. Source: WHO, Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing output and PMI



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

machinery fell. And while production of autos rose in February, output on a three-month basis continued to fall, a trend that will be exacerbated in March by the temporary closure of various factories in light of increased coronavirus restrictions.

…but manufacturing outlook significant weaker

Indeed, we already know that car production fell a whopping 37%Y/Y last month, while survey indices, including the ifo and PMIs, also suggest that output more widely fell off a cliff in March. Indeed, while the ifo's sectoral breakdown suggested that demand for autos was the weakest since reunification (the component plunged 79pts to -97), the equivalent indicator for total manufactured goods fell more than 12pts on the month, the most since November 2008. Admittedly, this indicator was last weaker in September suggesting it could have much further to fall. Firms across most sectors expect a further marked deterioration in business conditions over the coming six months. For example, the relevant indices for the autos, machinery and equipment, chemicals and food subsectors declined to the lowest since the height of the global financial crisis. So, while manufacturing output in the first two months of Q1 was trending 2% higher than the Q4 average, this increase seems likely to be more than wiped out in March, with further marked weakening certainly coming in April too. And while the German construction PMI remained above levels seen in other member states last month, firms were anticipating a sharper deterioration in activity going forward, suggesting a marked contraction in output in the sector in Q2 even if it is able to eke out a positive outturn in Q1.

The day ahead in the euro area and US

The main focus in the euro area tomorrow will be the outcome of this evening's Eurogroup videoconference, with all eyes on whether finance ministers can agree to substantive new common pandemic crisis support to facilitate funding the policy response to the Covid-19 outbreak. In terms of economic data, the Bank of France's business sentiment survey seems bound to point to a significant deterioration in conditions over the past month, particularly in the services sector. As such, we would expect to see a marked downward revision to its GDP growth forecast for Q1. Also of interest will be the French weekly labour market figures, including the number of applications for temporary support by firms under the national 'partial unemployment' scheme.

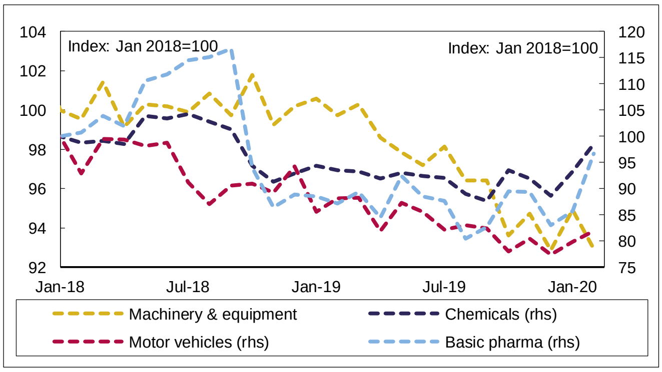
In the US, the focus will no doubt remain primarily on the coronavirus crisis and so economic releases will remain of secondary importance. Nevertheless, weekly mortgage applications figures will see a notable drop, while tomorrow will bring Fed minutes from the 15 March policy meeting where the FOMC announced a comprehensive support package, including the cutting of the Fed Funds Rate target by 100bps to 0.00-0.25% and pledge to boost its bond holdings by at least $700bn. That move, of course, was superseded by its subsequent announcement on 23 March of potentially unlimited purchases of Treasury securities and agency MBS and a new facility to buy corporate bonds.

UK

Raab an unconvincing substitute for Johnson

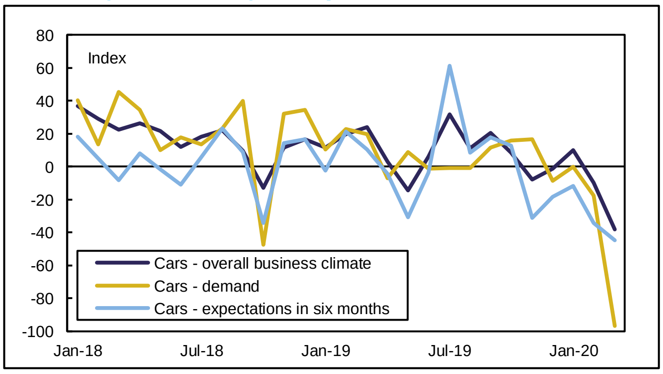
Following news today of the largest daily rise in the number of Covid-19 deaths (786), at the time of writing UK PM Boris Johnson remained hospitalised. While in an intensive care unit since early yesterday evening, a Number 10 spokesperson insisted that he was neither on a ventilator nor suffering with pneumonia. However, the very fact that he is in intensive care implies significant seriousness in his health condition. Certainly, at a minimum, Johnson's input to policymaking seems likely to be absent for some time. While Foreign Secretary (and hard Brexiter) Dominic Raab is now nominally in charge, and Chancellor Sunak would take the reins if Raab became incapacitated, it is difficult to believe that either has significant authority among other Cabinet members. Indeed, Raab conspicuously failed to impress when he responded to questions about Johnson's absence yesterday, and has always had limited public appeal. Meanwhile, Sunak is very much a novice in the Cabinet.

Germany: Manufacturing output by subsectors



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: Ifo survey components for auto sector



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

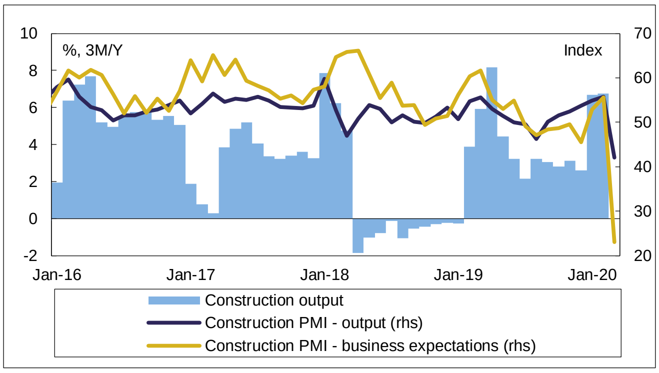
Leadership vacuum could delay development of exit strategy

Perhaps reassuringly, a vacuum at the top of government need not currently be problematic in terms of the economic policy response to the crisis, for which the main legislation has been adopted and Sunak (and Business Secretary Sharma) can now focus on resolving implementation challenges such as the slow disbursement of credit to SMEs. However, having belatedly rushed to implement restrictions on activity last month as the spread of Covid-19 appeared to be accelerating ahead of its expectation, the UK government lacks anything remotely resembling an exit strategy from the current lockdown arrangements. In that context, if and when decisions need to be taken to balance trade-offs between economic harm and risks to public health, the leadership vacuum will need to have been credibly filled.

The day ahead in the UK

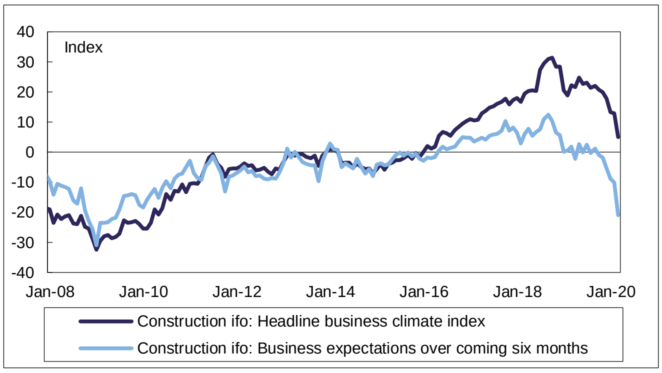
In the UK, the main focus will remain on the Covid-19 crisis and the health of PM Johnson. But Wednesday’s release of the REC/KPMG Jobs Report for March will no doubt signal a very weak outlook for recruitment prospects over the near term.

Germany: Construction output and PMI



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

Germany: Construction ifo survey components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Industrial production M/M% (Y/Y%)	Feb	**0.3 (-1.2)**	-0.8 (-3.0)	3.0 (-1.3)	3.2 (-0.9)
France		Trade balance €bn	Feb	**-5.2**	-5.1	-5.9	-6.0
Italy		Retail sales M/M% (Y/Y%)	Feb	**0.8 (5.7)**	-0.5 (1.6)	0.0 (1.4)	0.1 (1.5)
UK		Unit labour costs (output per hour) Y/Y%	Q4	**2.4 (0.3)**	- (0.3)	3.6 (0.3)	3.2 (-)

Auctions

Country		Auction
Germany sold		€323mn of 0.5% 2030 index-linked bonds at an average yield of -0.91%
		€77mn of 0.1% 2046 index-linked bonds at an average yield of -0.92%
UK sold		£3.25bn of 0.125% 2023 bonds at an average yield of 0.204%
		£1.25bn of 1.75% 2057 bonds at an average yield of 0.719%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
France		07.30	Bank of France business sentiment index	Mar	90	96

Key events and auctions

Country		BST	Auction/Event
Germany		10.30	Auction: €4bn of 0% 2030 bonds
UK		00.01	REC/KPMG Report on UK Jobs
		10.30	Auction: £2.75bn of 2% 2025 bonds
		10.30	Auction: £2bn of 4.75% 2030 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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