Daiwa Capital Markets

Euro wrap-up

Overview

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- Core euro area government bonds largely made modest gains and BTPs made limited losses after the Eurogroup failed to reach agreement on new pandemic crisis support mechanisms and the Bank of France estimated a record drop in French GDP in Q1.
- Gilts made gains as Boris Johnson remained hospitalised in intensive care.
- Thursday will see euro area finance ministers try again to reach an agreement, while UK GDP data for February are due.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.656	+0.008
OBL 0 04/25	-0.549	-0.011
DBR 0 02/30	-0.321	-0.005
UKT 0½ 07/22	0.117	-0.041
UKT 0⅝ 06/25	0.204	-0.032
UKT 4¾ 12/30	0.386	-0.025

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

Euro area

Another Eurogroup failure

While finance ministers worked through the night, the Eurogroup's latest videoconference failed to make a breakthrough on new pandemic crisis financial support. The original three-pronged proposal to make €500bn more readily available via a combination of the ESM and new funds established by the Commission and EIB was judged inadequate for Italy. While France and Germany reportedly reconciled their differences by agreeing to a compromise suggestion referring to further 'innovative financial instruments', Italy appears to have insisted that finance ministers make an explicit reference to "coronabonds" as a means for financing recovery. It also rejected the notion that any conditionality might be attached to Covid-related ESM loans. Perhaps unsurprisingly, the Dutch failed to consent to any of that, let alone the Franco-German compromise. So, the finance ministers will resume discussions tomorrow, hopefully after gaining their leaders' consent for constructive concessions that would support fiscal sustainability once the health crisis has passed. However, judging from comments after the meeting from Dutch finance minister Hoekstra, another failure is very possible.

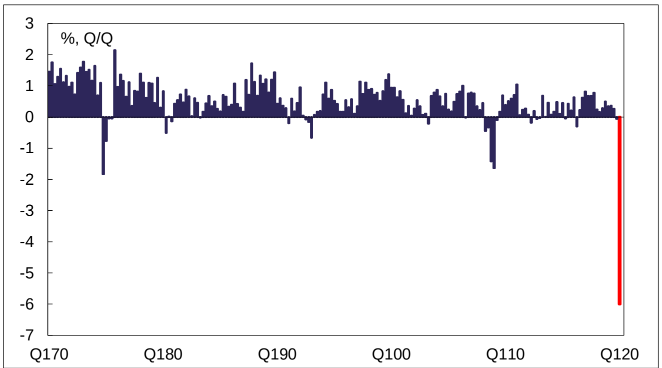
ECB collateral rules should promote bank lending

Thankfully, the ECB continues to support euro area bond markets via its PEPP and APP purchases. So, the sell-off in BTPs was not too marked today. And yesterday's detail from the ECB on its plans to relax its collateral rules provided additional support for markets this morning. Certainly, the measures should promote an increase in bank lending to firms and households. Among other things, the ECB decided to accept government- and public sector-guaranteed loans to firms, self-employed individuals and households in its frameworks, along with loans of lower credit quality and foreign-currency loans. It also reduced haircuts applied to assets provided as collateral, and reduced the importance of external credit ratings in the process. And its decision to accept Greek government bonds as collateral in its liquidity operations for the first time since that country's crisis also helped to avoid losses on such securities after the Eurogroup videoconference ended without agreement.

A record drop in French GDP in Q1

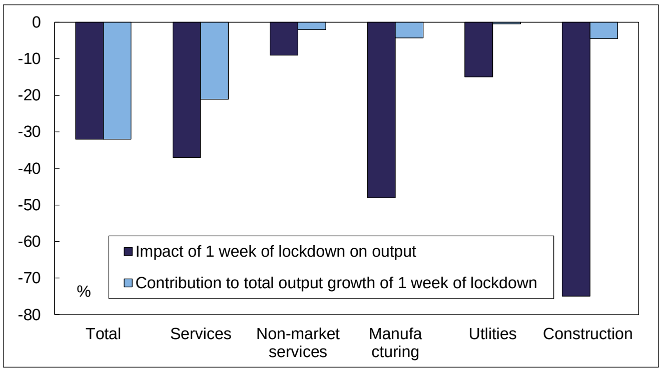
In terms of economic conditions, meanwhile, the Bank of France signalled that France suffered its biggest post-war contraction in Q1. In particular, informed by its latest business survey, it estimated that GDP dropped about 6%Q/Q, roughly four times the biggest quarterly decline during the global financial crisis and beating the previous record fall of 5.3%Q/Q during the social unrest in Q268. The contraction reflected an estimated decline in economic activity of 32% in the final two weeks of March, and 17% over March as a whole. The Bank also noted that the amount of payments made by bank cards

France: GDP growth*



*Q120 forecast is Bank of France estimate. Source: Bank of France, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

France: BoF survey – impact of Covid-19 lockdown*



*Conducted between 26 March and 3 April. Source: Bank of France and Daiwa Capital Markets Europe Ltd.

was roughly half its previous level during the week of 23-29 March. And as it judged that for every two weeks the country is locked down annual GDP will shrink by a further 1.5%, and the current restrictions are likely to be extended beyond the current end-date of 15 April, Q2 seems bound for a double-digit percentage fall in economic output in France, and indeed in the euro area as a whole.

Bank of France survey adds further colour

The detail of the Bank of France's latest business sentiment survey, conducted between 27 March and 3 April, gave further colour on the recent dramatic deterioration in activity. Among other things, it reported a marked decline in industrial production across all sectors in March. Indeed, the relevant index fell to the weakest reading on record, suggesting a decline in activity of almost 50% over the survey period. Worst affected were car manufacturers, metal producers and machinery and equipment manufacturers, with pharmaceuticals firms least harmed. With order books at their thinnest since 2009, the overall headline manufacturing sentiment indicator plunged 43pts in March to a series-low 51. Services activity was unsurprisingly also severely impacted, with the survey suggestive of a drop in activity in the sector of more than one third, with hotels and restaurants worst off and IT services among those least affected. Overall, the headline services sentiment indicator fell 21pts to 73, also a series low. The construction activity index was even weaker than those for services and manufacturing, suggesting a drop of about 75% in activity over the survey period, with the sector's sentiment index dropping 24pts to a record low of 80. Firms in each sector signal a further substantive deterioration in activity in April.

The day ahead in the euro area and US

The main event in the euro area on Thursday will be the further attempt by finance ministers to agree new pandemic crisis support. While a last-minute compromise is possible, there is a risk of a further stalemate that might only be overcome by leaders. Data-wise, Thursday will bring German goods trade and Italian IP reports for February. In the bond markets, Italy will sell a range of bonds.

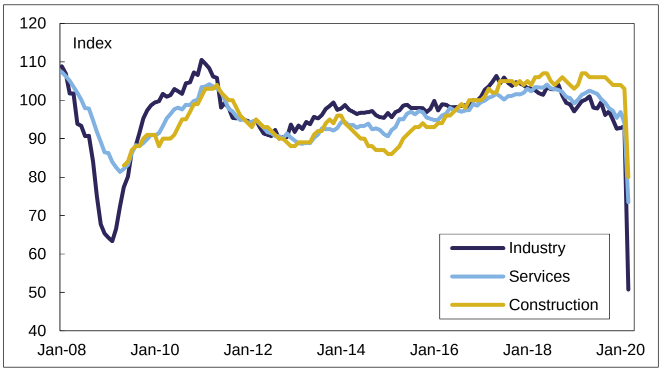
In the US, the latest weekly initial claims data are due, with another multi-million reading widely expected. In addition, the preliminary University of Michigan consumer confidence survey for April is due along with March producer price figures. In addition, Fed Chair Powell will give an update on the economic situation via a special webcast.

UK

Survey illustrates drop in labour demand and wage growth

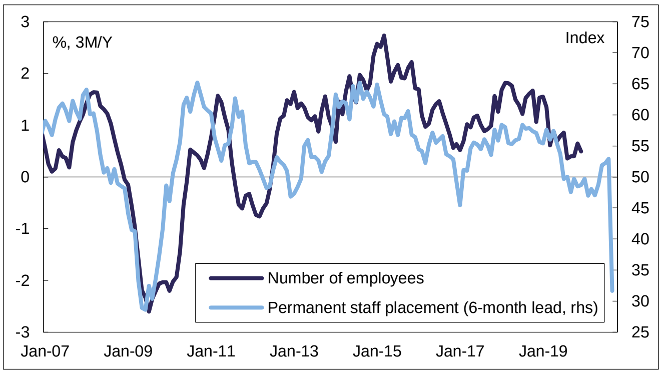
Unsurprisingly, Covid-19 has given a massive hit to the labour market. And while the full extent of job losses should be limited by the government's furlough scheme, recruitment has unsurprisingly collapsed. Indeed, having registered some signs of improvement at the start of the year, today's REC/KPMG survey on UK jobs for March reported the sharpest decline in permanent and temporary placements since February 2009 as firms cancelled plans to take on new staff. In terms of the specific survey indices, which might be interpreted like PMIs with 50 representing no change, the relevant index for permanent jobs fell a whopping 21.2pts to 31.7, while the temporary billings indicator was down 14pts to 35.6. Perhaps inevitably given the sudden-stop to activity in restaurants and hotels, as well as widespread working from home, catering was the hardest hit sector – the relevant DI fell 28.8pts to just 22.1 – while new IT, secretarial, blue-collar and executive positions also declined sharply. Indeed, the only reported subsector to see jobs growth was healthcare, a trend that seems bound to be maintained over coming months too. And against this backdrop, starting salaries reportedly rose at the weakest rate since the Brexit referendum in mid-2016 while wage inflation for temporary positions fell to its slowest in more than seven years.

France: BoF survey - headline sentiment indicators



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

UK: Employment and REC/KPMG survey indicator



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

The day ahead in the UK

While most attention will remain on the health of the Prime Minister, Thursday will bring plenty of new economic data from the UK. The ONS should publish an update of new coronavirus-related survey indicators, which should provide a clearer indication of the impact on activity of the lockdown. The RICS housing survey for March will provide an indication of the initial shock to the residential property market from Covid-19. And the monthly GDP, activity and trade figures for February are also due and expected to report GDP growth of just 0.1%M/M following no growth in January.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
France	Bank of France industrial sentiment survey	Mar	**51**	90	93	-

Auctions

Country	Auction
Germany	sold €3.26bn of 0% 2030 bonds at an average yield of -0.34%
UK	sold £2.75bn of 2% 2025 bonds at an average yield of 0.119%
	sold £2bn of 4.75% 2030 bonds at an average yield of 0.376%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany	07.00	Trade balance €bn	Feb	15.5	13.8
Italy	09.00	Industrial production M/M% (Y/Y%)	Feb	-1.6 (-2.3)	3.7 (-0.1)
UK	00.01	RICS house price balance %	Mar	10	29
	07.00	Monthly GDP M/M% (3M/3M%)	Feb	0.1 (0.1)	0.0 (0.0)
	07.00	Index of services M/M% (3M/3M%)	Feb	0.2 (0.3)	0.1 (0.0)
	07.00	Industrial production M/M% (Y/Y%)	Feb	0.2 (-3.0)	-0.1 (-2.9)
	07.00	Manufacturing production M/M% (Y/Y%)	Feb	0.1 (-4.0)	0.2 (-3.6)
	07.00	Construction output M/M% (Y/Y%)	Feb	0.3 (0.2)	-0.8 (1.6)
	07.00	Trade balance £bn	Feb	1.0	4.2

Key events and auctions

Country	BST	Auction/Event
Italy	10.00	Auction: up to €4.5bn of 0.6% 2023 bonds
	10.00	Auction: up to €3bn of 0.85% 2027 bonds
	10.00	Auction: up to €1.25bn of 1.45% 2036 bonds
	10.00	Auction: up to €750mn of 4.75% 2044 bonds
UK	-	ONS bi-weekly release of coronavirus indicators

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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