Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Despite a sharp drop in the Commission's consumer confidence index, Bunds and most other euro area governments made losses. But BTPs stabilised, seemingly thanks to ECB purchases.
- Gilts made more moderate losses as UK inflation fell in line with expectations.
- Thursday will bring the flash April PMIs and the latest EU leaders' videoconference to discuss proposals for a future Recovery Fund.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.692	+0.026
OBL 0 04/25	-0.621	+0.046
DBR 0 02/30	-0.426	+0.056
UKT 0½ 07/22	0.074	+0.006
UKT 0⅝ 06/25	0.181	+0.011
UKT 4¾ 12/30	0.316	+0.020

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

Euro area

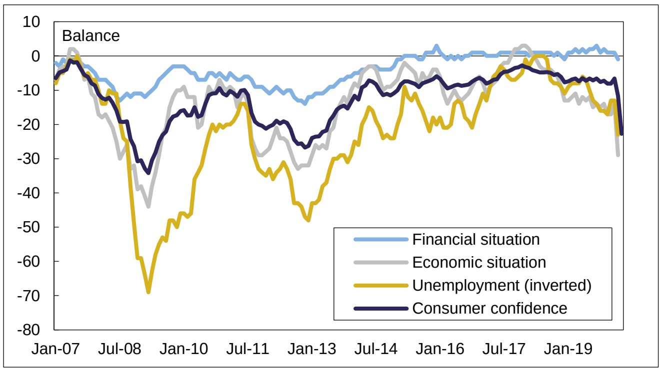
Consumer confidence collapses

With a significant share of the euro area having been in lockdown for much of the past month, economic activity having been significantly impaired, and a large share of workers now unemployed (whether it be on a permanent or temporary basis), the Commission's flash consumer confidence indicator for April was predictably weak. In particular, the index plunged more than 11pts on the month – the most on record – to -22.7, well below the long-run average and close to the lows reached during the height of the euro crisis. It remains, however, some way above the lows recorded during the global financial crisis. So, given the severity of the current crisis, the consumer confidence index might have been expected to fall further today. Instead, we suspect that the hit was lessened by the comfort provided by the various government-funded furlough schemes. Indeed, today's weekly update on French labour market conditions showed that more than 800k firms (roughly 60% of the total) had taken advantage of the partial unemployment scheme, with 10.2mn workers – an increase of more than 1mn over the past week – now temporarily laid off receiving up to 87% of their previous net salary. This notwithstanding, the current crisis has inevitably seen a marked decline in consumption since the second half of March when most lockdowns came into force – statistical agencies suggesting by more than one third in larger member states. And today's consumer sentiment survey signals the likelihood of ongoing significant contraction in consumption throughout Q2, even where and when lockdowns are gradually eased.

ECB ambiguity fuels upwards shift in periphery yields

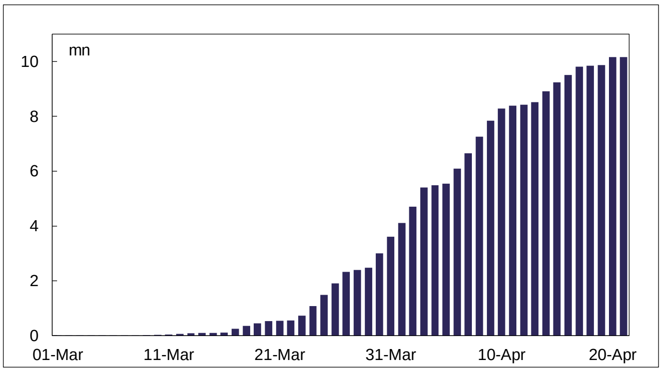
Investors remain unclear about the ECB's reaction function, including the maximum yields and spreads on periphery bonds that it is willing to tolerate. While the central bank might consider such ambiguity to be constructive, and leave it ample flexibility to respond to different circumstance, over recent days it has also allowed Italian sovereign yields to leap to their highest levels since the Governing Council announced its €750bn PEPP programme. Today's greater stability in BTP yields suggested, however, that the ECB decided to draw a line in the sand to prevent exceeding current yields and/or spreads. So instead, seemingly without that support, today it was the turn of Spanish and Portuguese government bonds to sell off most aggressively. Those moves also partly reflected the huge amount of issuance required to finance the countries' fiscal support packages – indeed, today saw Spain sell €15bn of 10Y bonds, a record amount for that member state. But they also seemed to reflect relatively low expectations for tomorrow's EU videoconference, when leaders will discuss the Eurogroup's proposal of 9 April for a Recovery Fund to support economic activity once the covid-19 pandemic has passed.

Euro area: EC consumer confidence*



*April reading for headline confidence indicator is flash estimate.
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

France: Workers enrolled in furlough scheme



Source: French Ministry of Labour and Daiwa Capital Markets Europe Ltd.

Recovery Fund now in focus

A fortnight ago, Finance Ministers agreed that the Recovery Fund would be "temporary, targeted and commensurate with the extraordinary costs of the current crisis and help spread them over time" to reduce refinancing risks over coming years. The leaders were asked to agree practical aspects, including the relationship of the Fund to the EU budget, its sources of financing and whether to use "innovative financial instruments". Southern member states have since called for a fund to provide more than €1tn, at least twice the size of funds available to euro area member states via the ESM, EIB and Commission to deal with the current crisis. They also want the support take the form of grants financed via common debt issuance. Most eye-catchingly, Spain called for the issuance of up to €1.5trn of perpetual EU debt, to be bought by the ECB, to finance transfers to the most needy member states over 2-3 years from January 2021.

Low expectations for leaders' videoconference

The issuance of common perpetual bonds looks a non-runner, not least as the ECB will not buy bonds of maturity longer than 30Y. And, perhaps inevitably, many northern member states would prefer to make support available via loans rather than grants. But that might do little to reduce refinancing risks in Italy and other southern member states. And so, nor would it allow those countries to increase near-term fiscal support closer to the levels provided by Germany – in terms of direct stimulus, tax deferments and credit guarantees – which some policymakers (including ECB Executive Board member Panetta) suggest provide German firms with an unfair advantage within the Single Market. Ultimately, a combination of grants and loans, financed by a mixture of existing budget lines and loan mechanisms as well as some new borrowing, would seem the most likely outcome. But little detail seems likely to be agreed tomorrow. And that lack of clarity could, in due course, put further upwards pressure on periphery yields.

The day ahead in the euro area and US

In addition to the EU leaders' videoconference, Thursday will also bring the flash PMIs for April, which seem bound to signal economic contraction of record magnitude for the post-War period. With lockdown measures remaining in place across much of the euro area, the indices seem bound to show further declines in both the headline services and manufacturing indices, with the former to drop to a new record low and the latter to reach its weakest since the global financial crisis. And so the composite PMI will similarly fall further from last month's record low of 29.7. The latest French INSEE business climate indices and German GfK consumer confidence survey results are also due.

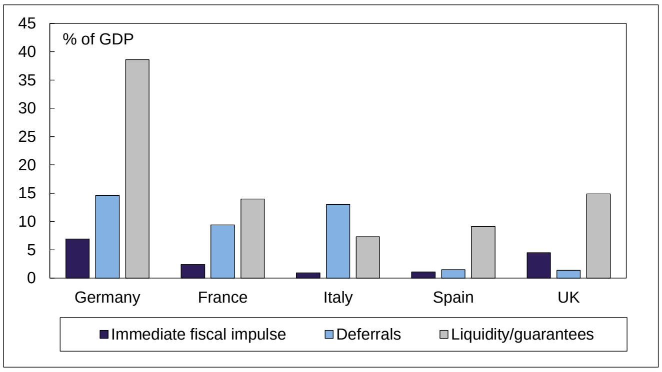
In the US, the latest weekly jobless claims numbers are likely again to be alarming. While perhaps down on the past few weeks, initial claims are likely again to reach several millions, while continuing claims are likely to rise above 16mn. The flash Markit PMIs and Kansas Fed manufacturing activity indices for April are highly likely to report further significant declines.

UK

Inflation drops as expected

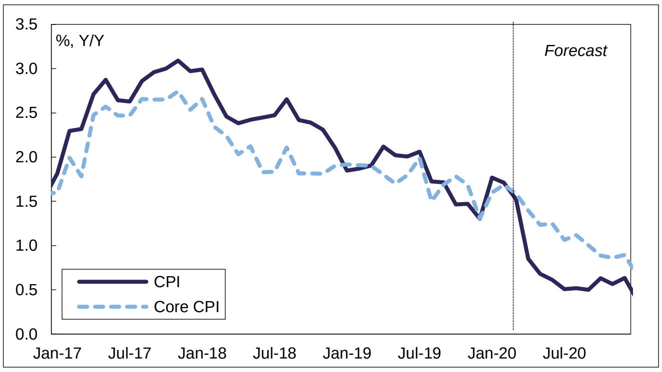
As expected, falling oil prices and the impact of Covid-19 on spending on the High Street and social activities weighed on UK inflation last month. In line with the consensus forecast, the annual CPI rate fell 0.2ppt to a three-month low of 1.5%Y/Y. Prices of petrol (to the lowest level in thirteen months), clothing, and hotels made significant negative contributions, while higher air fares and phone charges provided some modest offset. Overall, despite sterling weakness, inflation of non-energy industrial goods fell 0.3ppt to an eleven-month low of 0.2%Y/Y. But services inflation picked up, rising 0.1ppt to a five-month high of 2.6%Y/Y. So, core inflation fell just 0.1ppt to 1.6%Y/Y. In terms of the non-core items, the drop in energy inflation, down 2.8ppts to 0.8%Y/Y, was partly offset by higher inflation of food, beverages and tobacco (up 0.4ppt to 1.4%Y/Y) reflecting higher duty on cigarettes etc. following the March Budget and as consumers started stockpile for the lockdown.

Europe: Fiscal responses to Covid-19 crisis



Source: Bruegel and Daiwa Capital Markets Europe Ltd.

UK: Headline and core inflation forecast



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

CPI set to fall below 1% from April

Looking ahead, the further drop in oil prices, together with reduced cap on regulated household energy prices, will push headline inflation significantly lower over coming months. Indeed, assuming that data collection difficulties do not significantly impede the production of the figures, from April we expect headline inflation to fall below 1.0%Y/Y, requiring an explanatory letter from the BoE Governor to the Chancellor. And we expect it to fall further, to 0.5%Y/Y or lower, during the summer. Given the weakness of demand, we do not expect sterling weakness to provide a significant boost. Indeed, despite supply-side disruption from covid-19, the significant deterioration in labour market conditions is likely to weigh significantly on domestically-generated inflationary pressures, particularly in the services sector. And while the scheduled end of the current Brexit transition period represents an upside risk to the price outlook from January 2021 onwards, we currently expect inflation to remain firmly below target through to 2022 at the earliest, allowing the BoE to continue to provide whatever support is necessary to maintain easy financial conditions and support the eventual recovery in economic activity.

The day ahead in the UK

Like in the euro area, tomorrow brings the flash April PMIs, which will provide further insight into the marked deterioration in economic conditions since the official lockdown came into effect in the final week of March. The extent of the shock was illustrated today by new data revealing that 2.2 million workers from 309k firms were now registered for the Government's Job Retention Scheme. With many firms in the sector temporarily closed due to the lockdown, the headline services PMI is once again likely to see the most striking decline in April having fallen by a record 18.6pts to 34.5 last month. The manufacturing PMIs will also point to marked contraction, although the headline index will be held up to some extent by a further lengthening of supplier delivery times. The CBI's industrial trends survey – also due to be published tomorrow – will similarly point to a marked decline in output and the steepest drop in manufacturing orders for decades. Overall, the composite PMI will fall to a new record low and a level consistent with a deep contraction at the start of Q2. Elsewhere, external MPC member Vlieghe will give a webcast speech on monetary policy and the BoE's balance sheet.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Government debt to GDP ratio %	2019	**84.1**	-	85.9	85.8
	Preliminary consumer confidence	Apr	**-22.7**	-20.0	-11.6	-
Italy	Industrial orders (sales) Y/Y%	Feb	**-2.6 (0.9**	-	-1.8 (3.8)	-1.9 (-)
UK	CPI (core CPI) Y/Y%	Mar	**1.5 (1.6)**	1.5 (1.6)	1.7 (1.7)	-
	PPI input prices (output prices) Y/Y%	Mar	**-2.9 (0.3)**	-3.0 (0.1)	-0.5 (0.4)	-0.2 (0.5)
	House price index Y/Y%	Feb	**1.1**	1.6	1.3	1.5

Auctions

Country	Auction
UK	sold £3bn of 1.25% 2027 bonds at an average yield of 0.16%
	sold £3.25bn of 1% 2024 bonds at an average yield of 0.123%

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 PMI)	Apr	38.0 (22.8)	44.5 (26.4)
		09.00	Preliminary composite PMI	Apr	25.0	29.7
Germany		07.00	GfK consumer confidence	May	-1.8	2.7
		08.30	Preliminary manufacturing PMI (services PMI)	Apr	39.0 (28.0)	45.4
		08.30	Preliminary composite PMI	Apr	28.5	35.0
France		06.30	Business confidence indicator	Apr	80	95
		06.30	Manufacturing confidence (production outlook)	Apr	83 (-45)	98 (-33)
		08.15	Preliminary manufacturing PMI (services PMI)	Apr	37.0 (24.5)	43.2 (27.4)
		08.15	Preliminary composite PMI	Apr	24.5	28.9
UK		07.00	Public sector net borrowing £bn	Mar	1.8	-0.4
		09.30	Preliminary manufacturing PMI (services PMI)	Apr	42.0 (27.8)	47.8 (34.5)
		09.30	Preliminary composite PMI	Apr	29.5	36.0
		11.00	CBI industrial trends, total orders (business optimism)	Apr	-51 (-58)	-29 (23)

Key events and auctions

Country		BST	Auction/Event
EMU		-	EU leaders' videoconference
UK		10.30	BoE's Vlieghe scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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