Euro wrap-up

Overview

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- While BTPs made losses after Fitch downgraded Italy's credit rating, most euro area government bonds made gains as the Commission's euro area sentiment index, Belgian GDP and Spanish retail sales posted record falls, and German inflation fell sharply.
- Gilts were little changed despite a very weak UK retail price survey.
- Thursday will bring the latest ECB policy announcement along with the first estimates of Q1 GDP from the euro area, France, Italy and Spain.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.729	-0.018
OBL 0 04/25	-0.674	-0.014
DBR 0 02/30	-0.490	-0.017
UKT 0½ 07/22	0.055	+0.002
UKT 0⅝ 06/25	0.155	-0.002
UKT 4¾ 12/30	0.289	+0.003

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

Euro area

Another record drop in the Commission's sentiment index

The European Commission's April business and consumer survey, which provides the most comprehensive guide to economic activity in the euro area, was predictably downbeat. Indeed, having dropped in March by the most on the survey dating back 35 years, the headline euro area economic sentiment index registered an even sharper fall in April, of more than 27pts. Nevertheless, at 67.0, it still remained slightly above the trough reached in March 2009. Likewise, despite record declines in April, the indices for confidence among consumers, manufacturers and, by some margin, construction firms remained above the worst readings during the global financial crisis. That, however, was not true of services and retailers, for which pessimism plummeted to record depths. Among the large member states, the economic sentiment indices for Germany and Spain fell to the lowest since the global financial crisis, while the equivalent French index fell to the lowest since the euro crisis. Given the disruption to data collection caused by the lockdown, there were no figures from Italy.

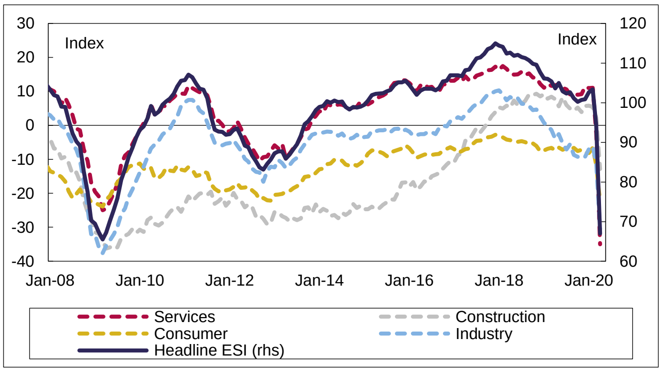
Survey points to subdued recovery and negative inflation ahead

The survey detail strongly suggested that the recovery will be very subdued despite member states' strategies to exit lockdown over coming weeks. In particular, measures of expected future demand and production, and new orders, crashed by record margins. Likewise, the euro area's employment expectations indicator plunged to a record low. And while consumer price expectations rose, selling price expectations in all business sectors fell sharply. So, today's survey added to evidence that headline inflation will fall into negative territory over coming months.

Spike in business lending confirmed

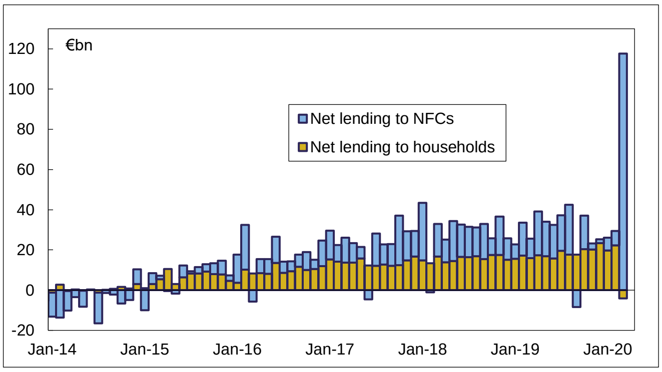
Yesterday's ECB Bank Lending Survey flagged the significant increase in demand for new business loans in Q1. And this was confirmed in today's ECB monetary data, which showed a record flow of new loans to non-financial corporations (€118bn) in March, as companies responded to increased liquidity strains caused by lockdowns. Also tallying with the findings of the BLS, about 40% of the new loans were of maturities of up to 1Y, with France accounting for the largest share (€38bn), but Germany, Italy and Spain also contributing significantly. Overall, the surge in new lending to businesses left the stock of such loans up 5.4%Y/Y, the strongest annual rate since early 2009. In contrast, the monthly net flow of new loans to households went into reverse in March (down €4bn on an adjusted basis) to leave the stock of such loans up 3.4%Y/Y. Weakness was most acute in terms of consumer credit while lending for house purchase edged higher. Looking ahead, the BLS suggested that we should expect a further significant increase in new loans to business in April, while lending for house purchase is likely to fall significantly along with new consumer credit.

Euro area: EC economic sentiment indices



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

Euro area: Net lending to households and NFCs



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Belgium GDP contracts at a record pace in Q1

Ahead of tomorrow's flash estimate of euro area Q1 GDP, today brought the first such data from a member state, which came from Belgium. This unsurprisingly reported a marked contraction in economic activity in the first quarter, with GDP down 3.9%Q/Q, by far the steepest quarterly decline since the series began in 1960. That left output down 2.8%Y/Y, the largest drop since Q209. Within the detail, the weakness in output was inevitably broad based, with industrial production down 3.5%Q/Q, construction down 6.6%Q/Q and services activity down 3.6%Q/Q. Admittedly, the National Bank of Belgium noted that there was greater uncertainty than normal surrounding the initial GDP estimate given difficulties in data collection in March. Indeed, much of the sectoral detail had been imputed based on news releases and surveys. And the outturn for the quarter as a whole masks the extreme hit to activity that occurred after the country went into lockdown on 18 March.

Spanish retail sales collapse in March

Certainly, Spanish retail sales figures for March published today – again the first of such data to be published among member states – illustrated the collapse in demand in the final month of the first quarter, with total sales down a whopping 15.3%M/M, by far the steepest pace on record. That occurred despite a near-8½%M/M jump in spending on food. Indeed, non-food store sales plunged by almost one third compared with February, with particular weakness in spending on household goods (similarly down by around 33%M/M) and sales of clothing and footwear (down by more than 50%M/M). Spending at petrol stations was also notably weaker (down 26½%M/M) as the movement of people slowed sharply when the nationwide lockdown came into place on 16 March. With the country having been in strict lockdown over the past month – with the exception of certain workers in manufacturing and construction having been allowed to return to work last week – April's spending and activity data will be significantly weaker than those for March. But Spain's government yesterday unveiled its exit strategy, proposing a four-phase return to a 'new normality' by the end of June. Appointment-based businesses such as hairdressers and food take-away services will be allowed to resume from next week, with other small businesses and hotels allowed to reopen from 11 May under strict social distancing conditions. Cinemas and theatres will be allowed to sell tickets for up to a third of their capacity from the end of the month. But larger shops and malls are only expected to open (at half capacity) from around the end of June. And so, private consumption will remain well below pre-pandemic levels for a considerable time to come.

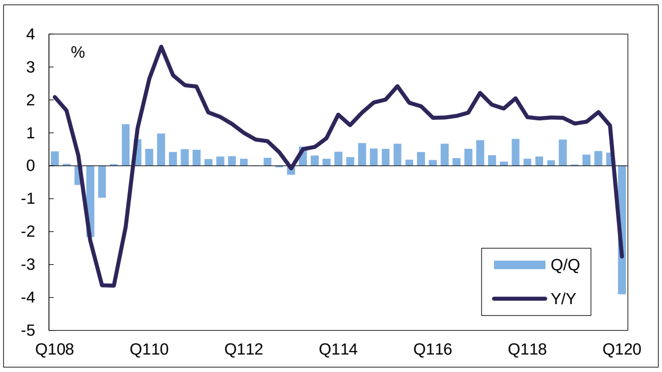
German inflation fell on lower energy costs

Ahead of tomorrow's flash euro area inflation release for April, today's figures from Germany came in a touch above expectations, albeit nevertheless still highlighting a further weakening of price pressures at the start of Q2. In particular, the headline inflation on the EU-harmonised basis fell 0.5ppt to 0.8%Y/Y, a 3½-year low, while the national measure of CPI similarly declined to 0.8%Y/Y from 1.4%Y/Y previously. Within the national detail, the weakening was principally driven by a sharp drop in energy costs, down 5.8%Y/Y following a decline of 0.9%Y/Y previously. This was offset to some extent by a jump in food inflation, up 1.1ppt to 4.8%Y/Y, the most for more than three years. Other goods inflation was also marginally softer, as was services inflation. And so, when the final figures are published next month, we would expect a more modest decline in core inflation than seen in the headline rate, by around 0.1ppt to 1.2%Y/Y. But as the impact of much weaker demand weighs more heavily in Germany, we would expect underlying price pressures to fall considerably further over coming months.

The day ahead in the euro area and US

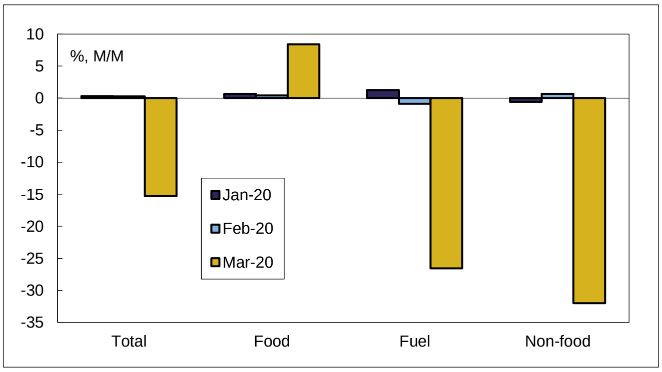
Thursday will be busy for euro area economic events, with the conclusion of the Governing Council's latest meeting to coincide with the flash estimates of Q1 GDP, April inflation and March unemployment. With the ECB having recently unveiled a wide range of large-scale actions, including its €750bn PEPP asset purchase programme to last through to year-end and a relaxation of collateral rules through to September next year, we think it unlikely that further policy initiatives will be announced. We do, however, expect the ECB to increase the range of assets purchased to include so-called "fallen-angels",

Belgium: GDP growth*



**Q120 is flash estimate. Source: National Bank of Belgium, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

Spain: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

thus matching its recent relaxation of collateral rules. And we would expect the Governing Council to reiterate that, with risks skewed heavily to the downside, it is 'ready to adjust all of its instruments, as appropriate'.

Of course, with the economic outlook having deteriorated so markedly since last month when President Lagarde stressed that the floor to interest rates had not yet been reached, there is a possibility that the ECB will ease policy again. Indeed, given the sharp spike in expected business loan demand reported in the ECB's Bank Lending Survey, a 25bps reduction in the minimum interest rate on the TLTRO-III loans to -1.00% would be desirable. But as it has scope to keep buying assets at the current pace under the PEPP through to October, we think it will wait until the summer to increase the envelope of the PEPP programme.

The first estimate of Q1 GDP from the euro area and further estimates from member states will undoubtedly show that output contracted sharply as the lockdown measures implemented in March significantly disrupted activity. Our forecast for the euro area for a drop of 4.5%Q/Q is more marked than the Bloomberg consensus and would represent the steepest contraction on record. Among country releases also due on Thursday, we anticipate French GDP to have declined by more than 5½%Q/Q, while Italian and Spanish GDP will also have contracted at an unprecedented pace, close to 5%Q/Q. Tomorrow will bring GDP data from Austria, Lithuania and Latvia.

Meanwhile, the flash estimate of April euro area inflation is expected to reveal a sharp decline in the headline rate (from 0.7%Y/Y in March) possibly to as low as zero for the first time for almost four years as weaker demand and the plunge in the oil price weighed. Core inflation will also decline, possibly to around ½%Y/Y from 1%Y/Y previously. At the country level, Italian and Spanish inflation will fall into negative territory. However, data collection problems could reduce the reliability of the published figures. Meanwhile, despite the various government job protection programmes, March unemployment figures are expected to show a jump in the overall unemployment rate last month by 0.4ppt to 7.7%. German labour market figures for April will be published tomorrow too.

In the US, the latest weekly jobless claims figures will likely remain alarming. But the latest monthly personal income and spending figures for March will provide further insight into the initial hit to private consumption at the end of the first quarter, while the Chicago PMI will provide an update on business conditions at the start of Q2.

UK

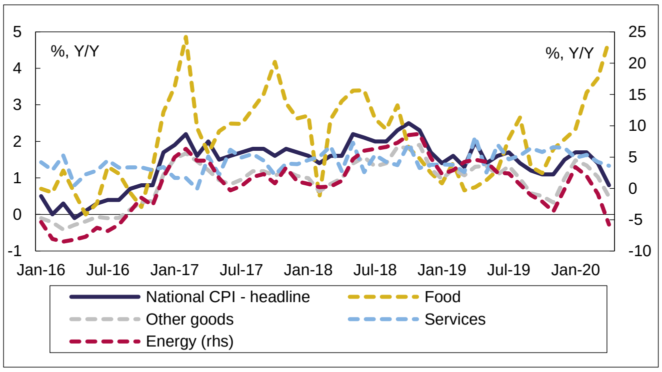
Shop price inflation falls sharply

In the UK, the effect on inflation of the slump in demand last month was clearly evident in today's release of the BRC shop price survey, as retailers offered heavy discounts to try to lure consumers. In particular, the survey measure of non-food prices fell by 2.7%M/M in April, to leave them down 3.7%Y/Y – the steepest annual drop since the series began in 2006. Clothing, footwear and furniture stores reported the steepest cuts in prices – the former down at a double-digit annual pace – as non-essential high street stores were forced to close during the lockdown and retailers attempted to reduce stock online. In contrast, however, food stores reduced the number of normal promotions in a bid to limit bulk buying, with food inflation rising 0.7ppt to 1.8%Y/Y, the firmest for almost a year. Nevertheless, given the weakness in underlying demand, the BRC measure of overall shop price inflation fell considerably in April, down 1.1ppts to -1.8%Y/Y, the steepest drop since August 2016. And while the BRC's estimate has repeatedly undershot official CPI figures by a significant margin, today's release still supports our view that the impact of much weaker demand (and lower energy costs) will offset any upside price pressures from supply-side disruption. Headline and core inflation will fall back significantly over the near term.

The day ahead in the UK

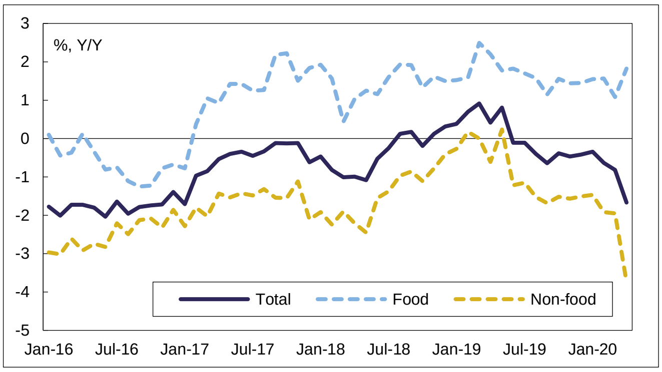
The main UK data focus tomorrow will be the ONS' bi-weekly business impact of Covid-19 survey, which will provide an update on the two-week period since 5 April.

Germany: Consumer price inflation*



*National measure. April-20 figures are flash estimates. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: BRC shop price inflation



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
EMU		M3 money supply Y/Y%	Mar	**7.5**	5.5	5.5	**-**
		Economic sentiment index	Apr	**67.0**	74.0	94.5	**94.2**
		Industrial confidence (services)	Apr	**-30.4 (-35.0)**	-25.0 (-26.0)	-10.8 (-2.2)	**-11.2 (-2.3)**
		Final consumer confidence	Apr	**-22.7**	-22.7	-11.6	**-**
Germany		Preliminary CPI (EU-harmonised CPI) Y/Y%	Apr	**0.8 (0.8)**	0.7 (0.5)	1.4 (1.3)	**-**
Spain		Retail sales Y/Y%	Mar	**-14.1**	-4.0	1.8	**-**
UK		BRC shop price index Y/Y%	Apr	**-1.7**	-	-0.8	**-**

Auctions

Country		Auction
Germany		sold €3.4bn of 0% 2030 bonds at an average yield of -0.48%
Italy		sold €745mn of 2024 floating-rate bonds at an average yield of 1.38%
		sold €3.75bn of 0.95% 2030 bonds at an average yield of 1.78%
		sold €1.5bn of 1.6% 2026 bonds at an average yield of 1.36%
UK		sold £3.0bn of 2.75% 2024 bonds at an average yield of 0.103%
		sold £2.0bn of 1.75% 2049 bonds at an average yield of 0.612%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		BST	Release	Period	Market consensus/ Daiwa forecast	Previous
EMU		10.00	Preliminary GDP Q/Q% (Y/Y%)	Q1	-3.7 (-3.4)	0.1 (1.0)
		10.00	Preliminary CPI (core CPI) Y/Y%	Apr	0.1 (0.7)	0.7 (1.0)
		10.00	Unemployment rate %	Mar	7.8	7.3
		12.45	ECB main refinancing rate %	Apr	0.00	0.00
		12.45	ECB marginal lending rate %	Apr	0.25	0.25
		12.45	ECB deposit facility rate %	Apr	-0.50	-0.50
Germany		07.00	Retail sales M/M% (Y/Y%)	Mar	-8.0 (-4.8)	0.8 (6.5)
		08.55	Unemployment rate % (change'000s)	Apr	5.2 (74.5)	5.0 (1.0)
France		06.30	Preliminary GDP Q/Q% (Y/Y%)	Q1	-4.0 (-3.6)	-0.1 (0.9)
		07.45	Preliminary CPI (EU-harmonised CPI) Y/Y%	Apr	0.2 (0.1)	0.7 (0.8)
		07.45	Consumer spending M/M% (Y/Y%)	Mar	-5.8 (-6.0)	-0.1 (-0.6)
Italy		09.00	Unemployment rate %	Mar	10.5	9.7
		10.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Apr	-0.3 (-0.3)	0.1 (0.1)
		11.00	Preliminary GDP Q/Q% (Y/Y%)	Q1	-5.2 (-5.4)	-0.3 (0.1)
Spain		08.00	Preliminary GDP Q/Q% (Y/Y%)	Q1	-4.3 (-3.2)	0.4 (1.8)
		08.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Apr	-0.6 (-0.8)	0.0 (0.1)

Auctions and events

Country		BST	Auction / Event
EMU		12.45	ECB monetary policy announcement
		13.30	ECB President Lagarde speaks at Governing Council's press conference
UK		09.30	ONS business impact of Covid-19 survey

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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