Euro wrap-up

Overview

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- Euro area equities fell sharply but most government bonds rallied as the ECB cut rates on its special loan facilities while GDP in the euro area and several member states posted record declines in Q1.
- Gilts made gains as UK data provided further evidence of business stress under the lockdown and confirmed a sharp drop in car production.
- Friday will bring UK bank lending data and final manufacturing PMIs, while the ECB will publish new scenarios for the economic outlook.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.786	-0.052
OBL 0 04/25	-0.772	-0.091
DBR 0 02/30	-0.592	-0.093
UKT 0½ 07/22	0.017	-0.031
UKT 0⅝ 06/25	0.092	-0.057
UKT 4¾ 12/30	0.232	-0.052

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

Euro area

ECB takes further steps to support flow of credit

Following the conclusion of its latest scheduled policy meeting, the ECB left its main interest rates unchanged, confirming the deposit rate at -0.50% and the refi rate at zero percent. It also left unchanged the envelopes on its main asset purchase programme (APP) and €750bn PEPP programme, as well as its APP reinvestment policy. And it failed to add any new class of security to its range of assets purchased. But it still eased policy in a significant way to try to support the flow of credit to the real economy.

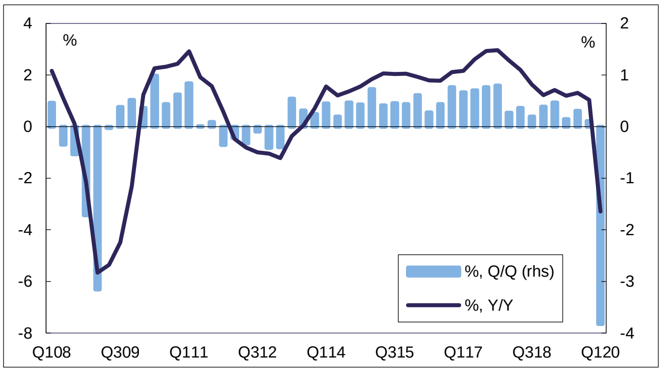
Rates cut on special liquidity operations

In particular, for the second successive month, it cut by 25bps the interest rate applied to its quarterly TLTRO III targeted long-term loan operations. So, for banks whose net lending reaches the necessary benchmark – which we assume will be most if not all banks participating under the scheme – the TLTRO III rate will be 50bps below the average deposit rate prevailing over the life of the operation, i.e. -1.00% in the absence of a future adjustment to the deposit rate. In addition, to support shorter-term funding needs, the ECB will also hold a series of seven monthly PELTROs (non-targeted pandemic emergency longer-term refinancing operations) commencing from 20 May and maturing between July and September 2021, to match the duration of the recent collateral easing measures. The interest rate to apply to the PELTRO funds will be 25bps below the average refi rate over the life of the loans, i.e. it will be -0.25% unless the refi rate is adjusted in coming months.

APP and PEPP purchases highly likely to be extended into 2021

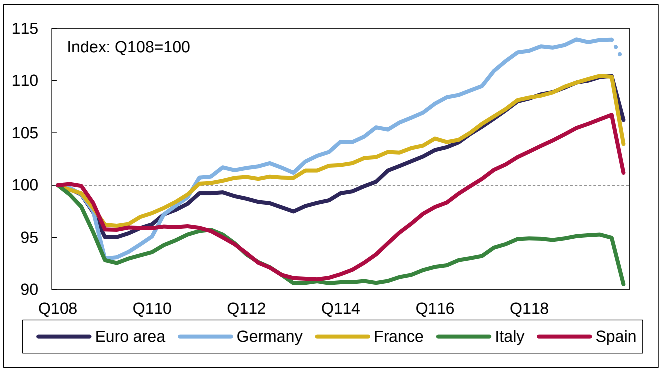
The ECB also maintained a clear easing bias on its full range of policy tools. So, for example, the door was left open to further reductions in interest rates. Asset purchases under the PEPP will be conducted for as long as the “coronavirus crisis” continues, at least until the end of the year but possibly beyond too. They will also continue to be conducted in a flexible manner over time, across asset classes and among jurisdictions, and the Governing Council remains willing to lift any self-imposed constraints (e.g. the issue and issuer limits) on them if necessary. And the regular APP purchases will be conducted for as long as necessary to meet the inflation target on a sustained basis. With the ECB now expecting GDP to drop between 5-12%Y/Y this year – and perhaps by as much as 15%Q/Q in Q2 – depending on the length of lockdowns and the evolution of Covid-19, it also expects underlying inflation to weaken significantly over the near term. So, we strongly expect APP and PEPP purchases to be extended into 2021, even though Lagarde cautioned that the consequences of the pandemic for inflation over the medium term were less clear.

Euro area: GDP growth*



*Q120 figure is flash estimate. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: GDP levels by member state*



*Q120 figures are flash estimates. Figure for Germany is forecast. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

A record drop in GDP in the euro area led by France

According to today's preliminary estimate, euro area economic output contracted at a record rate in Q1 as lockdowns took their toll. GDP declined 3.8%Q/Q to be down 3.3%Y/Y. But we should expect far steeper, double-digit percentage declines in Q2. There was no detail published on the expenditure or production breakdowns. But the figures published by the member states provide insight. French GDP appears to have contracted most abruptly, dropping 5.8%Q/Q, the biggest quarterly fall on the respective series which dates back to 1949, to be down 5.4%Y/Y. Household consumption plunged 6.1%Q/Q in Q1, with monthly data reporting a record decline in spending on goods of almost 18%M/M in March. And fixed investment fell a steeper 11.8%Q/Q. Exports fell by a similar amount (–6.5%Q/Q) with imports down 5.9%Q/Q, but net trade still contributed slightly negatively to GDP growth. In contrast, inventories added almost 1.0ppt. On the production side, construction output fell most sharply, down 12.6%Q/Q. Meanwhile, marketed services activity (-5.7%Q/Q) and industrial production (-5.8%Q/Q) fell at similar rates.

GDP in Italy, Spain and Austria breaks records too

Among the other member states, Italian GDP contracted a record 4.7%Q/Q to be down 4.8%Y/Y. Spanish GDP fell 5.2%Q/Q, similarly the worst on the series, to be down 4.1%Y/Y, with household consumption falling at a faster pace than investment. Elsewhere, Austrian GDP dropped a somewhat more moderate 2.5%Q/Q, although that was also the steepest decline on the series. But Lithuania, which has so far escaped the worst of the coronavirus, saw its economy get off lightly, with GDP dropping just 0.2%Q/Q to be still up more than 2½%Y/Y. While the German GDP data won't be published until 15 May, retail sales dropped 5.6%M/M, matching the previous sharpest decline on the data, which was recorded in March 1951.

Unemployment data not representative of labour market shock

At face value, today's euro area unemployment data appeared better than anyone might have dared to hope. Indeed, the headline unemployment rate rose just 0.1ppt in March to 7.4%, remaining still 0.3ppt below its level a year earlier. The number of unemployed workers rose 197k, the most since early 2013 but a relatively modest increase considering the huge shock to economic activity. However, these data were too good to be true. For a start, they only reflected the number of jobless workers actively looking for employment and available to start work within the next two weeks – extremely difficult criteria to fulfill where strict lockdowns apply. Moreover, the figures exclude the millions of workers placed on government-backed furlough schemes. Illustrating the severe limitations of the data, Italy's unemployment rate perversely fell 0.9ppt to 8.4%, as the number of people in employment dropped a modest 27k but the number of inactive workers fell by 301k, significantly more than the drop in the number of jobless workers actively seeking work. While they rose in the other large member states, the equivalent March unemployment rates in Germany, France and Spain similarly failed to represent the full picture.

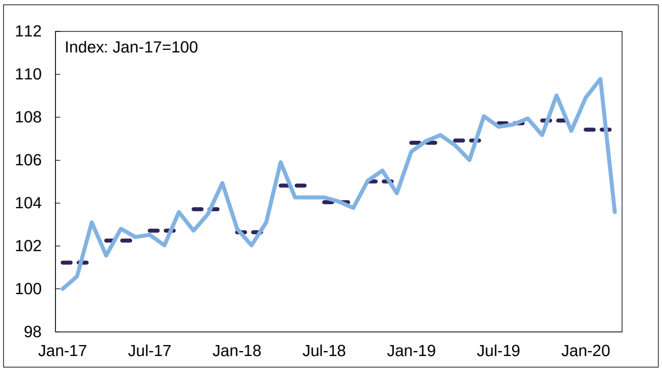
German joblessness above expectations

More informative were today's data from Germany, where the number of jobless claims rose a record 373k in April to push the claimant count rate up a larger-than-expected 0.8ppt to a three-year high of 5.8%. In addition, Germany's labour minister revealed that companies accounting for more than 10mn workers – about three times the peak in the global financial crisis – had applied to participate in the government's kurzabeit short-term working scheme. While many of these workers will still be working, as many as 20% of German workers might currently be out of work, one way or the other.

Inflation heading towards negative territory

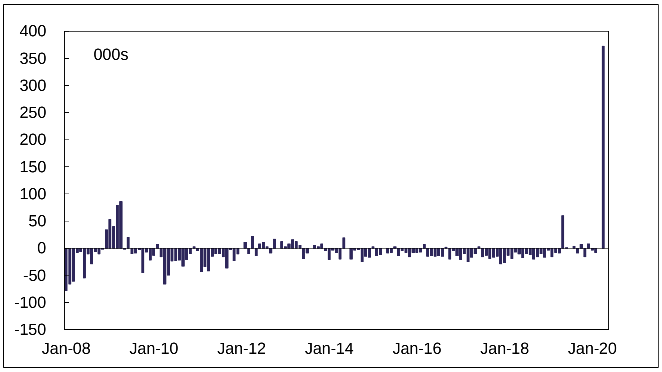
According to the flash estimate, euro area inflation fell 0.3ppt in April to 0.4%Y/Y. A positive impulse came from inflation of food, alcohol and tobacco, which rose 1.2ppts to 3.6%Y/Y, the most since 2008. But other major components fell. Indeed, energy inflation dropped 5.1ppts to -9.6%Y/Y, the steepest decline since 2009. Inflation of non-energy goods fell 0.2ppt to 0.3%Y/Y. But services inflation moderated by just 0.1ppt, with the fall likely restrained by data collection difficulties and the

Germany: Retail sales*



*Dashed dark blue line represents quarterly average. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: Unemployment claims



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

need to impute prices of many activities based on the levels in prior months. So, core inflation eased just 0.1ppt to 0.9%Y/Y. As lockdowns ease gradually, we expect services and core inflation to weaken significantly. And with energy inflation set to weaken further, we continue to forecast headline inflation to slip into negative territory over coming months.

The day ahead in the euro area and US

While many European markets will be closed tomorrow for May Day holidays, the ECB today confirmed that it will publish economic scenarios related to the coronavirus crisis. In the US, tomorrow will bring the manufacturing ISM and final Markit manufacturing PMI for April. Both are expected to point to a sharp contraction in output in the sector, declining orders and weak employment prospects. The latest vehicle sales figures for April seem bound to report a marked fall as demand fell off a cliff and car showrooms shut up shop.

UK

Businesses suffering under the lockdown

As the UK government was preparing draft guidance to allow for a ‘safe' return to work for when lockdown measures are eventually relaxed, today's UK economic releases made grim reading for businesses. Perhaps inevitably given the ongoing restrictions on activity, the ONS's latest business survey reported that, of the firms that were continuing to trade, one in four indicated that turnover had decreased by more than 50% between 6 and 19 April, with a further third noting a more modest Covid-19-related decline. And while roughly 30% of firms suggested that turnover was unaffected, this share was down 10ppts from the previous two weeks. Moreover, 13% of firms expected a further substantial decrease in turnover over the subsequent two-week period, with another third anticipating a ‘little' decline. And so, it was not surprising to see a large share of firms (roughly 80%) indicated that they would make use of at least one of the government's support schemes. The most popular of these is the Job Retention Scheme, with two thirds of respondent firms (whether still trading or temporarily closed) reporting that they had already furloughed staff (albeit less than 20% had already received financial support). More than half had requested to defer VAT payments while one-quarter had applied for local business property tax relief.

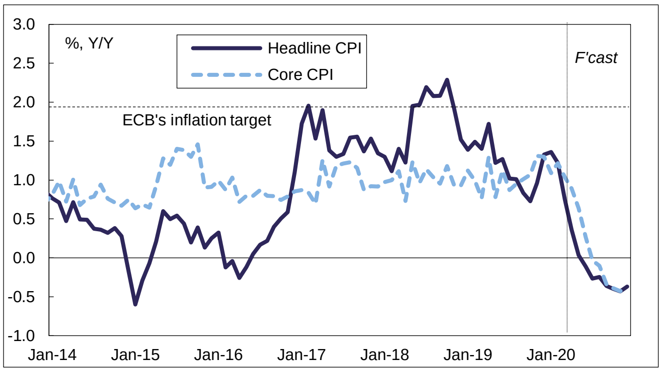
Car production slumps

Today's car production figures for March from SMMT clearly illustrated the significant strain being placed on the auto industry. Total production fell a whopping 36.7%Y/Y, with just 79k vehicles leaving the factory, by far the lowest March level since the global financial crisis. Production for both domestic and export markets were down by a similar rate, despite some signs of improved demand from China as the lockdown measures in that country began to ease. Additional analysis published in today's release painted a particularly gloomy near-term outlook. Given widespread shutdown of production facilities under the lockdown rules, almost two-thirds of full-time employees in the sector have been furloughed. Roughly one quarter of firms suggest that they had cash reserves of less than three months, with almost 60% of respondents indicating that they are either ineligible or unsuitable for funding support. And, even if all factories are able to re-open in mid-May, this would still result in a drop of around 257k units of production and more than 20% of annual turnover in 2020.

The day ahead in the UK

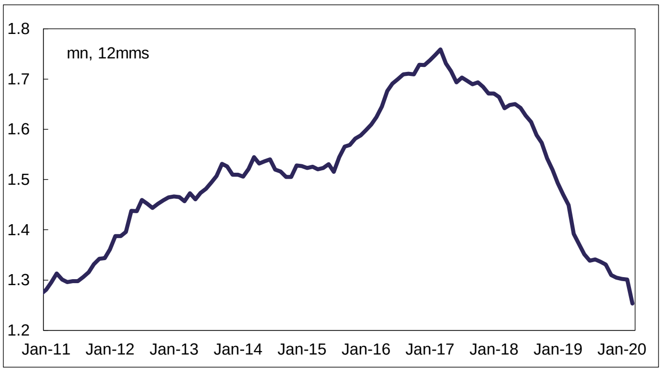
The end of the week will bring the final UK manufacturing PMI for April which is expected to reinforce the message of the preliminary figures that output fell sharply over the past month – indeed, the flash estimates showed the output PMI declining a record 27.2pts to a series low 16.6, with the new orders and business expectations indices similarly pointing to a bleak near-term outlook. The headline PMI will fall to a lesser degree as it is counter-intuitively boosted by a lengthening of supplier delivery times. Friday will also bring the BoE lending figures for March. While consumer credit growth will have remained positive, the number of mortgage approvals and associated loans are likely to have fallen significantly as the housing market has effectively come to a standstill. But, as in the euro area, lending to businesses is likely to have jumped as firms faced near-term liquidity constraints.

Euro area: Headline and core inflation*



*April-20 figure is flash estimate. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Car production



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		Preliminary GDP Q/Q% (Y/Y%)	Q1	**-3.8 (-3.3)**	-3.7 (-3.4)	0.1 (1.0)	-
		Preliminary CPI (core CPI) Y/Y%	Apr	**0.4 (0.9)**	0.1 (0.7)	0.7 (1.0)	-
		Unemployment rate %	Mar	**7.4**	7.8	7.3	-
		ECB main refinancing rate %	Apr	**0.00**	0.00	0.00	-
		ECB marginal lending rate %	Apr	**0.25**	0.25	0.25	-
		ECB deposit facility rate %	Apr	**-0.50**	-0.50	-0.50	-
Germany		Retail sales M/M% (Y/Y%)	Mar	**-5.6 (-2.8)**	-8.0 (-4.8)	0.8 (6.5)	**0.8 (6.5)**
		Unemployment rate % (change'000s)	Apr	**5.8 (373.0)**	5.2 (74.5)	5.0 (1.0)	-
France		Preliminary GDP Q/Q% (Y/Y%)	Q1	**-5.8 (-5.4)**	-4.0 (-3.6)	-0.1 (0.9)	-
		Preliminary CPI (EU-harmonised CPI) Y/Y%	Apr	**0.4 (0.5)**	0.2 (0.1)	0.7 (0.8)	-
		Consumer spending M/M% (Y/Y%)	Mar	**-17.9 (-18.1)**	-5.8 (-6.0)	-0.1 (-0.6)	**-0.5 (-1.1)**
Italy		Unemployment rate %	Mar	**8.4**	10.5	9.7	**9.3**
		Preliminary CPI (EU-harmonised CPI) Y/Y%	Apr	**0.0 (0.1)**	-0.3 (-0.3)	0.1 (0.1)	-
		Preliminary GDP Q/Q% (Y/Y%)	Q1	**-4.7 (-4.8)**	-5.4 (-5.4)	-0.3 (0.1)	-
Spain		Preliminary GDP Q/Q% (Y/Y%)	Q1	**-5.2 (-4.1)**	-4.3 (-3.2)	0.4 (1.8)	-
		Preliminary CPI (EU-harmonised CPI) Y/Y%	Apr	**-0.7 (-0.6)**	-0.6 (-0.8)	0.0 (0.1)	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		BST	Release	Period	Market consensus/ Daiwa forecast	Previous
UK		09.30	Final manufacturing PMI	Apr	32.9	47.8
		09.30	Net consumer credit £bn (Y/Y%)	Mar	0.6 (-)	0.9 (5.7)
		09.30	Net mortgage lending £bn (approvals '000s)	Mar	3.5 (60.0)	4.0 (73.5)

Auctions and events

Country	BST	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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