Euro wrap-up

Overview

Chris Scicluna +44 20 7597 8326

Emily Nicol +44 20 7597 8331

- While euro area equities made solid gains, Bunds were also firmer and BTPs made losses as Germany's Constitutional Court demanded that the ECB justify its public sector bond purchases and flagged the importance of the issuer limits and capital key in constraining the programme.
- Gilts made gains as UK car registrations posted a record decline.
- Wednesday will bring March data for euro area retail sales and German factory orders as well as further April PMI survey results.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.812	-0.036
OBL 0 04/25	-0.778	-0.019
DBR 0 02/30	-0.581	-0.015
UKT 0½ 07/22	0.014	-0.018
UKT 0⅝ 06/25	0.072	-0.018
UKT 4¾ 12/30	0.210	-0.021

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

Euro area

German Court demands ECB justification of PSPP

Today's most notable event for euro area financial markets was the ruling by the German Constitutional Court (Bundesverfassungsgericht) on the ECB's public sector bond purchase programme (PSPP), under which it has so far amassed almost €2.2trn of securities and continues to increase its holdings at a rate of about €33bn per month. The judgement was not without controversy. Provocatively, the German Court asserted that an earlier review by the European Court of Justice (CJEU) on the PSPP was "not comprehensible". As such, it ruled that the associated judgement in favour of the PSPP issued by the CJEU in December 2018 should be considered "ultra vires". Therefore, it also stated that the ECB should conduct a new assessment of the PSPP to prove that the programme is "proportional". Indeed, the German Court ruled that, unless the ECB adopts a new decision within three months "that demonstrates in a comprehensible and substantiated manner that the monetary policy objectives pursued by the PSPP are not disproportionate to the economic and fiscal policy effects resulting from the programme", the Bundesbank would be unable subsequently to participate in the asset purchases. In such circumstances, the Bundesbank would also have to sell the bonds that it has already purchased under the PSPP.

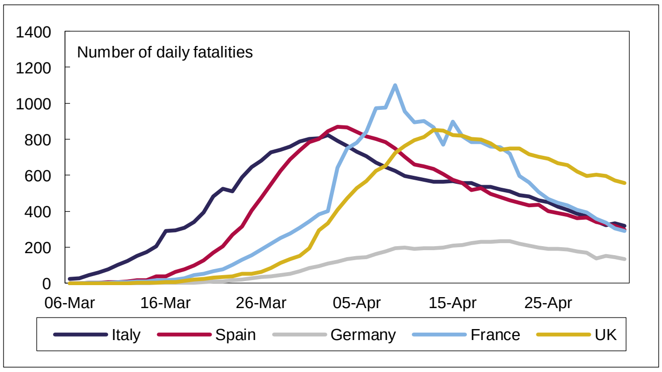
Bundesbank participation likely to be eventually confirmed

EU law has primacy over national law. And so, whether or not it likes them, the rulings of the CJEU are binding on the German Court and not vice versa, and we expect the EU institutions to make clear that the CJEU has legal supremacy on this issue. Nevertheless, Bundesbank President Weidmann stated that he would help the Governing Council to meet the requirements of today's judgement. Indeed, it is inconceivable that the ECB will not be able to publish some form of "proportionality assessment" within three months to provide a full justification of the PSPP on monetary policy grounds. So, we fully expect the Bundesbank's ongoing participation in the PSPP ultimately to be confirmed.

PEPP likely to be challenged next

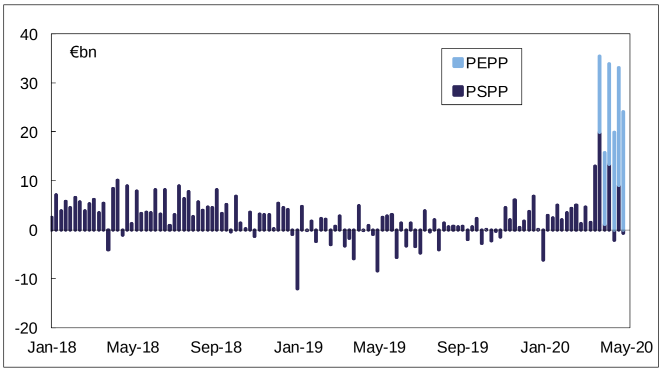
However, the German Court's attempt to constrain the independence of the ECB is harmful for the credibility of euro area monetary policy as well as the EU legal order. Moreover, while the German Court insisted that today's decision applied only to the PSPP, the ruling also flags concerns regarding the €750bn PEPP programme. In particular, the German Court judged that (the current 33%) issuer limits and use of the capital key to guide the allocation of PSPP purchases are "crucial safeguards" to ensure that the EU Treaty's ban on monetary financing is not breached. We expect the Governing Council next month to announce an increase in the amount of bonds to be purchased under the PEPP. And to implement such a

Europe: Confirmed Covid-19 fatalities*



*7dma. Source: WHO and Daiwa Capital Markets Europe Ltd.

Euro area: ECB weekly net asset purchases



Source: ECB, Bloomberg and Daiwa Capital Markets Europe Ltd.

decision, the issuer limit might eventually need to be lifted, e.g. to 49%. So, we expect the PEPP eventually to face a challenge at the German Constitutional Court. We note, however, the lengthy time lags between submission of a legal challenge at the Court and the subsequent ruling. Indeed, we would not expect to see any judgement from the Court before the second half of 2021, at which time the Governing Council would hope (if not necessarily expect) that the PEPP purchases have been concluded.

Sharp rise in Spanish jobless claims

Yesterday it was announced that more than 900k firms had applied to the French government's furlough scheme, with a massive 11.7mn workers in the private sector now registered as "partially unemployed". In addition, the number of German firms to have registered for its equivalent kurzarbeit facility was confirmed to be around 750k. And today's labour market figures from Spain were similarly shocking. Indeed, the number of people registered in employment fell a whopping 691k in April, almost double the drop recorded in March, which itself was previously by far the largest on the series. And so the total number of people in employment in Spain fell to 18.4mn, a drop of 770k from a year earlier and the lowest reading since October 2017. As such, the number of jobless claims jumped again, by 370k following a rise of 311k in March, to 3.8mn, marking a rise of 21%Y/Y and the highest level since mid-2016. And this might well rise further in the months ahead – indeed, the government yesterday suggested that it expects the unemployment rate eventually to reach 19% of the working-age population, from 14.5% currently.

Producer prices drop on weak energy costs

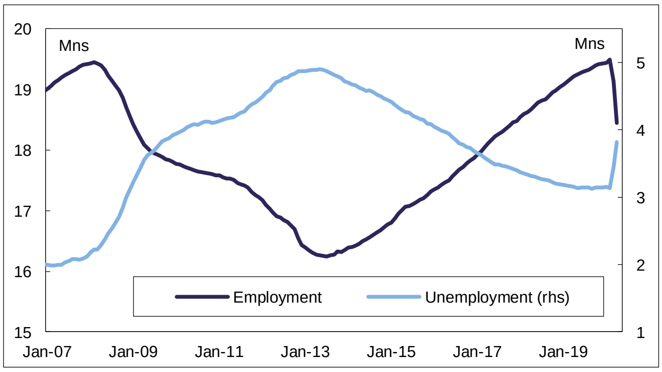
While the flash estimate of euro area CPI in April came in above expectations (nevertheless still falling 0.3ppt to 0.4%Y/Y), today's producer price inflation figures for March further flagged disinflationary price pressures further down the pipeline emanating not least from lower oil prices and other commodities. Indeed, producer prices fell by 1½%M/M in March, the steepest monthly drop since October 2008, as energy prices fell 5½%M/M. Prices of intermediate goods also fell for the sixth month out of the past seven, while there was only very limited upwards pressure from durable consumer goods. Compared with a year earlier, the headline PPI rate fell 1.4ppts to -2.8%Y/Y in March, with a double-digit annual drop in producer energy prices. Excluding energy, core PPI inflation eased to just 0.2%Y/Y, the lowest since October 2016. Supply-side disruption will, however, add a positive impulse to prices of some higher quality items along the value chain over coming months. Indeed, the FT today reported that Volkswagen, for one, has already seen a sharp increase in the costs of key car components. But overall, given the massive demand-side shock, disinflationary pressures will likely remain dominant for the foreseeable future.

The day ahead in the euro area and US

In the euro area tomorrow, we will see the final release of the service sector PMIs and composite indices for April. The flash services PMI fell to just 11.7 in April. And after yesterday's release of the final manufacturing PMIs saw the output index downwardly revised, the composite measure might well also come even weaker than the record low of 13.5 initially estimated. Also out tomorrow are euro area retail sales figures for March, which will shed more light on consumption at the end of the first quarter. With most countries entering into lockdown over the course of that month, sales are expected to have fallen at a record double-digit monthly pace, to leave sales 5% lower compared to a year earlier. German factory orders data, also to be published tomorrow, are expected to show a large fall in March (-10%M/M), as the impact of Covid-19 on both domestic and overseas demand became more acute. Supply-wise, Germany will sell €4bn of 5Y bonds.

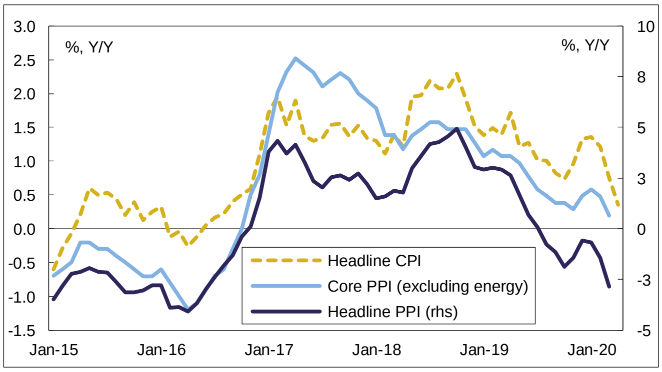
Meanwhile, in the US, the focus tomorrow will turn to the first of the week's labour market data. The ADP measure of private sector non-farm employment is expected to drop sharply in April, by more than 20mn, an outturn likely to be mirrored in Friday's more comprehensive labour market report.

Spain: Unemployment and employment



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer and producer price inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK

Car registrations plunge in April

After data released yesterday revealed that new car registrations in Italy and Spain plunged to record lows of just over 4k cars apiece in April, marking declines of 97.5%Y/Y and 96.5%Y/Y respectively, today's equivalent UK figures from the SMMT were similarly weak. Indeed, with showrooms having remained shut for the entire month, UK registrations were down 97.3%Y/Y from more than 161k a year earlier also to a little over 4k, by the far the lowest level of modern times. More than 70% of the total reflected purchases by companies buying for their fleets, with just 871 cars for private buyers. This left total registrations down more than 40% so far in the year to date. And SMMT expects full-year registrations to drop more than one quarter over the year as a whole to 1.68mn, which would be the lowest since 1992.

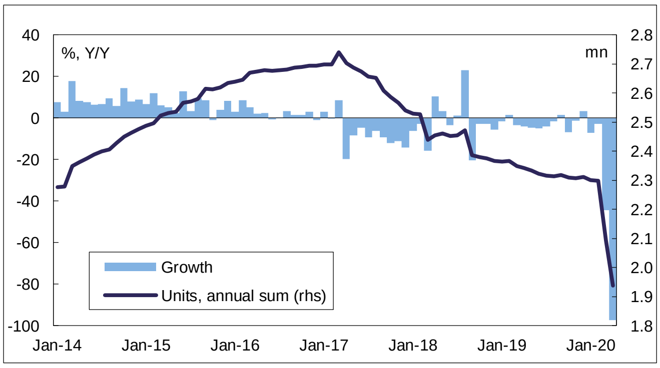
PMIs extremely weak despite upwards revision

While there was an upside surprise to today's final services PMI survey, the downbeat message remained firmly intact. Indeed, despite the more than 1pt upwards revision from the flash estimate, the headline business activity index was still down an unprecedented 21.1pts in April to 13.4, the lowest reading on the survey's 22-year history and by a considerable margin. Indeed, the survey suggested that just 21% of firms managed to avoid a drop in activity last month, of which two-thirds signalled unchanged output compared with March. And the survey also reported record declines in new orders, work backlogs and employment, with around half of respondents indicating a drop in payrolls in April. While many respondent companies had made use of the government's Job Retention Scheme (as of 3 May, 800k firms across all sectors had applied and 6.3mn jobs been furloughed), others indicated that employees in the services sector had been made redundant or might well be at risk of that further down the line due to cash-flow constraints. And while business expectations about the coming year unexpectedly rose in April, firms on the whole recognised that operations were likely to remain below normal levels over the near term. Overall, taken with an extremely downbeat assessment from manufacturers, the composite PMI – down more than 22pts at 13.8 – is consistent with a massive contraction in Q2 GDP. And when the retail and construction sectors are also included, the quarterly decline could be in excess of 15%Q/Q.

The day ahead in the UK

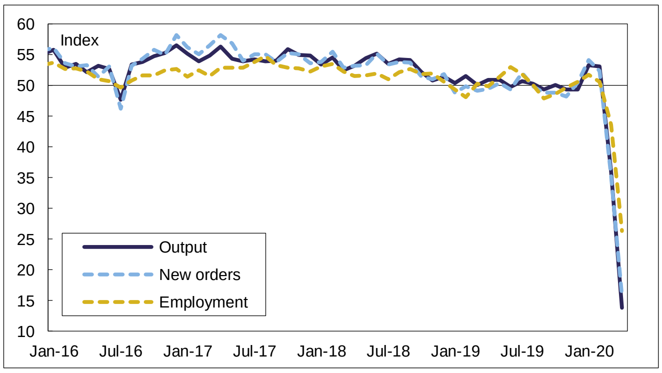
Ahead of Thursday's BoE MPC decision and Monetary Policy Report, tomorrow will bring just the construction PMI for April. This is expected to align with the downbeat messages from the latest manufacturing and services sector surveys and point to ongoing sharp contraction in activity. In the markets, the DMO will sell 2023 and 2054 Gilts.

UK: Car registrations



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Composite PMI



Source: Markit, 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		PPI Y/Y%	Mar	**-2.8**	-2.7	-1.3	**-1.4**
Spain		Unemployment change '000s	Apr	**289**	-	302	**-**
UK		New car registrations Y/Y%	Apr	**-97.3**	-	-44.4	**-**
		Final Services PMI (composite PMI)	Apr	**13.4 (13.8)**	12.3 (12.9)	34.5 (36.0)	**-**

Auctions		
Country		Auction
Germany		sold €379mn of 0.5% 2030 index-linked bonds at an average yield of -1.04%
		sold €69mn of 0.1% 2046 index-linked bonds at an average yield of -1.06%
UK		sold: £3.25bn of 2% 2025 bonds at an average yield of 0.017%
		sold: £3bn of 1.625% 2028 bonds at an average yield of 0.112%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data						
Country		BST	Release	Period	Market consensus/ Daiwa forecast	Previous
EMU		09.00	Final services PMI (composite PMI)	Apr	11.7 (13.5)	26.4 (29.7)
		10.00	Retail sales M/M% (Y/Y%)	Mar	-12.0 (-5.0)	0.9 (3.0)
Germany		07.00	Factory orders M/M% (Y/Y%)	Mar	-10.0 (-10.5)	-1.4 (1.5)
		08.55	Final services PMI (composite PMI)	Apr	15.9 (17.1)	31.7 (35.0)
France		08.50	Final services PMI (composite PMI)	Apr	10.4 (11.2)	27.4 (28.9)
Italy		08.45	Services PMI (composite PMI)	Apr	10.0 (10.1)	17.4 (20.2)
Spain		08.15	Services PMI (composite PMI)	Apr	10.0 (10.0)	23.0 (26.7)
UK		09.30	Construction PMI	Apr	20.0	39.3

Auctions and events			
Country		BST	Auction / Event
Germany		10.30	Auction: €4bn of 0% 2025 bonds
UK		10.00	Auction: £3.75bn of 0.125% 2023 bonds
		11.30	Auction: £1.75bn of 1.625% 2054 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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