Euro wrap-up

Overview

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- Bunds and other euro area government bonds made gains as Christine Lagarde signalled that the ECB would not respond to the German Constitutional Court's call to justify its bond purchases, while the euro area economic dataflow confirmed record weakness.
- Gilts were little changed as the BoE left policy unchanged but kept the possibility of additional QE very much on the table.
- Friday will bring data for German goods trade and Spanish industrial production.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.787	-0.015
OBL 0 04/25	-0.762	-0.033
DBR 0 02/30	-0.556	-0.045
UKT 0½ 07/22	-0.006	-0.013
UKT 0⅝ 06/25	0.070	-0.009
UKT 4¾ 12/30	0.234	+0.003

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

Euro area

German IP slumps in March…

The flow of economic data out of the euro area today was predictably dreadful, illustrating the massive hit to activity towards the end of Q1 and early in Q2 from member states' lockdown measures. While surveys suggest that services were more acutely impacted, today's monthly IP reports from Germany and France confirmed a marked contraction in that sector too. While the disruption to Germany's economy appears to have been less severe than in other member states, total industrial output still fell by more than 9%M/M in March, to leave it down almost 11½% compared with a year ago. And when excluding the positive outturn from the construction sector (see below), industrial production was down more than 11%M/M, likewise the steepest pace of decline since re-unification. Indeed, manufacturing output fell to its lowest level in almost a decade, with sharp drops in production of capital goods (-16½%M/M), consumer durables (-10.9%M/M) and intermediate goods (-7.4%M/M) alike. So, despite a positive start to the year for German IP, today's figures confirmed that total output from the sector fell more than 1%Q/Q in Q1, with manufacturing production down almost 2%Q/Q, both a similar pace of contraction to that seen in Q4.

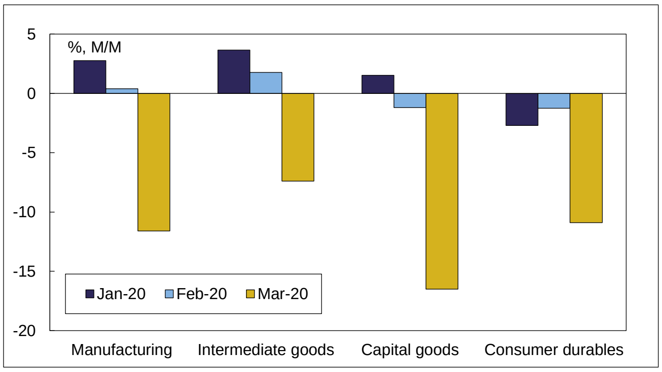
…construction set to fall back in Q2

In contrast, the construction sector held up well heading in the first quarter, with output rising 1.8%M/M in March, to leave it 5½% higher over the quarter as a whole, the firmest quarterly pace for four years. But while today's German construction PMI pointed to an inevitable substantial deterioration in conditions in April, it nevertheless suggested that the collapse in activity was again far less marked than in other large European countries. For example, the headline index fell 10.1pts to 31.9 in April, the lowest reading for more than a decade, with civil engineering recording the steepest contraction but house building remaining relatively more resilient. This compared with a near-complete cease to construction activity in France and Italy last month, with the headline PMIs down to just 3.8 and 4.8 respectively, both unsurprisingly by far the lowest on record, and weaker even than yesterday's UK construction PMI (8.2). But the near-term outlook for the sector in all countries remains extremely weak, with the survey's new orders components declining to record lows, even in Germany where the relevant PMI fell to 27.9. And given the uncertainty regarding the economic outlook and diminished appetite for investment, construction firms remained pretty pessimistic about expectations for future activity, albeit in Germany this was to a slightly lesser extent than in March.

French IP plummets in March…

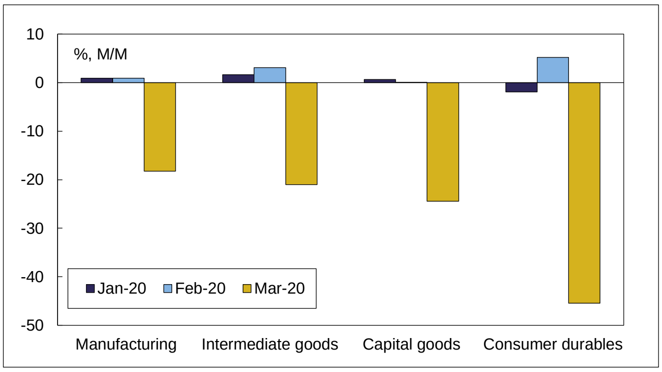
France's IP figures were similarly woeful. Total output plummeted a record 16.2%M/M in March, to the joint lowest level since the series began in 1990, to leave it down more than 17%Y/Y. And like in Germany, the drop in manufacturing production was steeper still, down more than 18%M/M, with steeper declines in production of intermediate goods (-21%M/M), capital goods (-24.4%M/M) and consumer durables (-45.4%M/M) as auto output halved from February. In contrast to Germany, construction activity collapsed

Germany: Manufacturing production



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

France: Manufacturing production



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

in France in March, down more than 40%M/M. And the aforementioned construction PMI would suggest an even sharper decline at the start of Q2 too. Overall, total output was down more than 5½%Q/Q in Q1, with manufacturing production down more than 6%Q/Q.

…private payrolls post record decline in Q1

The first estimate of French private sector payrolls in Q1 was also predictably weak. In particular, at the end of the first quarter, the number of jobs had dropped by a net 453.8k, 2.3%Q/Q, with those in the non-agricultural sector down 442.2k, 2.6%Q/Q, by a considerable margin the steepest quarterly drop since the series began in 1970. Indeed, during the global financial crisis, the sharpest decline recorded was -0.9%Q/Q. The overall weakness principally reflected an unprecedented decline in the number of temporary workers (-37%Q/Q). When excluding these, employment fell 1.3%Q/Q. Unsurprisingly, the respective statistical agencies Destatis and INSEE flagged greater uncertainty with respect to the accuracy of the latest figures due to data collection difficulties, which could in turn lead to greater revisions than normal.

Italian retail sales post steepest decline

After yesterday's aggregate euro area retail sales figures reported a record slump in March, today's Italian numbers predictably revealed the steepest decline of any country in the region, reflecting Italy's status as the first member state to implement Covid-19-related restrictions. In particular, the volume of sales fell 21.3%M/M to the lowest level since the series began two decades ago, with a 36.5%M/M drop in spending on non-food items. This left total sales down 6%Q/Q in Q1 and 19.5%Y/Y. Indeed, within the detail there was a marked decline in the value of sales of clothing (-57.1%Y/Y), furniture (-48.9%Y/Y) and household electrical items (-38.1%Y/Y). And unsurprisingly the weakness was more striking at smaller retailers. With strict lockdown measures having largely remained in place, like other monthly indicators, we would expect to see a further decline in demand in April too.

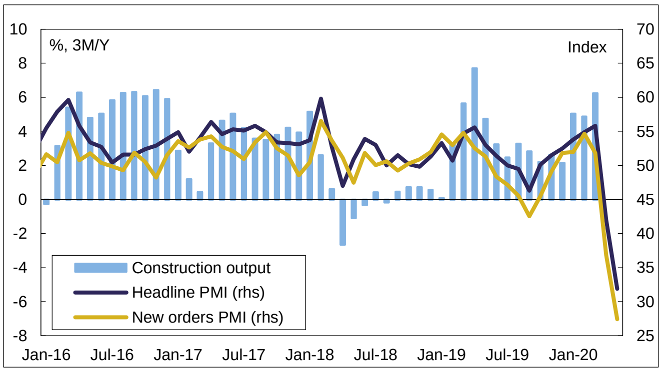
The coming week in the euro area and US

Tomorrow will bring data for German trade and Spanish industrial production. These will clearly be overshadowed by the US labour market report, which will show a record drop in monthly payrolls, perhaps around 25mn, while the unemployment rate could reach about 18%, the highest since the 1930s.

Looking further ahead, a key focus in the euro area next week will be the release on Friday 15 May of updated Q1 GDP figures, which will include the first estimate from Germany. We expect German GDP to have contracted by as much as 2%Q/Q, the steepest pace of decline since the global financial crisis, albeit the softest decline in Q1 of the major member states. Indeed, on aggregate, euro area figures are expected to confirm the record contraction of 3.8%Q/Q in Q1, leaving output down more than 3% compared with a year earlier. That day will also bring employment figures for Q1. It will be too early to see the full impact from the recent significant job losses seen since the escalation of the coronavirus crisis. In terms of monthly releases for March, euro area and Italian IP figures are due Wednesday and Monday respectively, while euro area trade numbers are due Friday. Final inflation data for April from Germany and Spain are due on Thursday, while the Bank of France survey for the same month will be published on Tuesday.

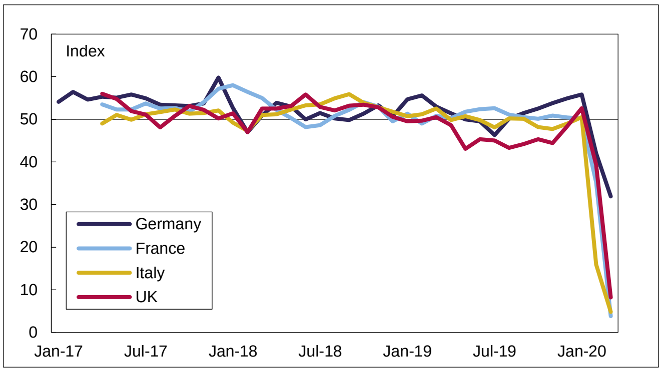
In the US, the main events next week will also come on Friday, with retail sales and industrial production data for April set to show an even sharper pace of decline in activity as the country remained in lockdown. Indeed, both are forecast to have declined at double-digit monthly rates. That day will also bring the University of Michigan's consumer sentiment and Empire Manufacturing surveys for May, which will no doubt suggest that conditions remain extremely weak, but no more so than in April. Ahead of this, the NFIB business optimism survey for April will come on Tuesday, along with CPI figures for the same month. Not least given the sharp fall in the oil price, headline inflation is expected to have fallen by 1ppt to just ½%Y/Y. With underlying price pressures also weakening, core inflation is forecast to have eased to leave the annual rate at 1.7%Y/Y, which would be the lowest since November 2017. And the weekly jobless claims figures (Thursday) will again be daunting.

Germany: Construction output and PMI*



**PMIs have one-month lead. Source: Markit, Destatis, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

Europe: Construction PMIs by selected countries



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

UK

BoE leaves policy unchanged

As expected, the BoE's MPC left Bank Rate at 0.1% and its current programme of net Gilt and corporate bond purchases unchanged at £200bn. While the rate decision was unanimous, two out of nine MPC members (the external members Haskel and Saunders) wanted to increase the programme of asset purchases by a further £100bn and extend the programme through to August. With the purchases currently on track to conclude by the beginning of July, we are confident that they will be augmented, and the programme extended (perhaps to last through to December), at the next MPC meeting in mid-June.

A sobering assessment of current economic conditions

The BoE's assessment of the impact of the pandemic on UK economic activity, expanded upon in a new Monetary Policy Report, was sobering. Among other things, the MPC noted that payments data currently point to a reduction in the level of household consumption of around 30%. And according to the Bank's Decision Maker Panel, companies' sales are expected to be around 45% lower than normal in the current quarter while business investment is likely to be roughly halved. Moreover, despite the protection provided by the government's Job Retention Scheme, which is subsidising incomes for more than one fifth of employees, it also expects to see a pronounced rise in the unemployment rate. The Bank also judged that, while markets had calmed following the severe trauma in March, financial conditions remain tighter than at any time since the global financial crisis.

Illustrative scenario sketches possible path for economic outlook

The MPC acknowledged the impossibility of forecasting the economic outlook with any precision at the current conjuncture, with the key determinant bound to be the evolution of the pandemic, as well as the respective responses of governments, households and firms. Clearly, there are many very different plausible paths for the economy from now on. So, the BoE did not publish updated economic projections along the usual lines, whereby specific probabilities are attached to different possible outcomes. Nevertheless, the Bank published what it judged to be a highly stylised illustrative scenario, conditioned on the market-implied expectation that Bank Rate remains at its current level into 2022, and whereby the current social distancing measures are gradually lifted but a degree of precautionary behaviour by households and businesses persists.

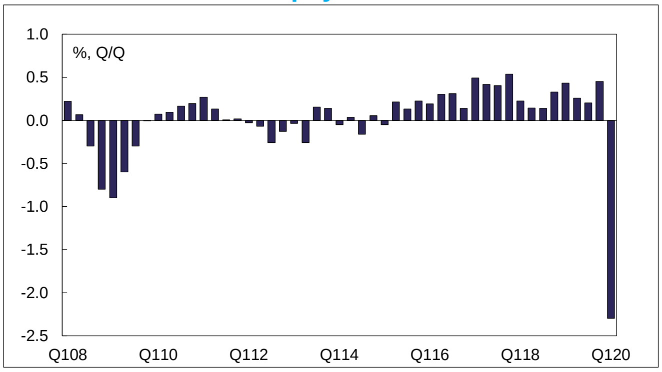
Sharpest contraction in more than three centuries?

On this basis, the BoE estimates that GDP would fall by a record 25%Q/Q in the current quarter, before recovering from the second half of the year on. Full-year GDP would fall 14% in 2020 – a minimal difference to the drop of 13.5% in our own baseline scenario and the weakest annual rate since 1706 (!) – with household consumption down at the same rate and business investment down by more than one quarter. However, GDP would subsequently rebound 15% in 2021 and a more moderate 3% in 2022. The unemployment rate would rise to 9% before falling gradually over the coming couple of years. In terms of prices, due to the weakness of demand and higher unemployment as well as the plunge in fuel prices, inflation would be expected to drop to around 0% at the end of the current year (and average 0.6% over 2020 as a whole). And while inflation would similarly be expected to average 0.5% next year, the recovery in output as well as higher oil prices might push inflation higher to average about 2.0% - in line with the BoE's target – in 2022.

Risks skewed to the downside

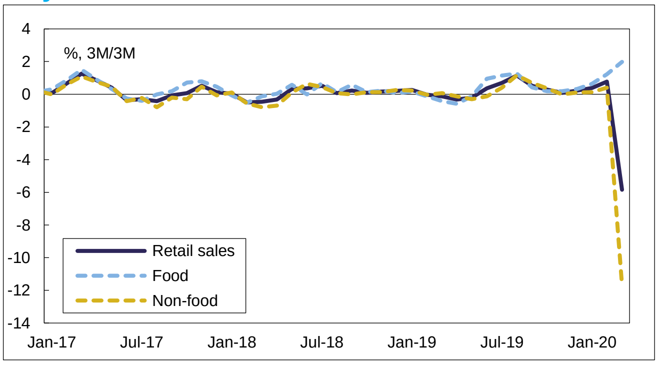
The MPC recognised that many very significant uncertainties relate to the medium term, including the risks that current events will lead to lasting scarring of the economy via an increase in the longer-term equilibrium unemployment rate and a diminished willingness of firms to invest. For the time being, however, policy is being calibrated principally to deal with the very troubling current conditions. Indeed, over the very near term, the MPC judged that the risks are probably skewed towards a longer period of precautionary behaviour than assumed in its baseline scenario, as voluntary social distancing might be more material, workers might be worried about their job security for a longer period of time, and companies could remain more risk averse too. On top of such mundane risks, of course, a second wave for the pandemic and a second lockdown phase would be economically devastating, and could trigger renewed financial turmoil too.

France: Private sector payrolls



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

Italy: Retail sales



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

Extra asset purchases likely to be announced in June

While the MPC didn't add to its asset purchase programme today, in his press conference Governor Bailey made clear that the decision had been finely balanced. Moreover, he noted that the MPC had made clear that it had already made a clear commitment to do whatever will be necessary to preserve financial stability, support economic recovery and help inflation return to target. Indeed, he suggested that the difference between the BoE's stance and the 'open-ended' asset purchase commitments of the Fed and ECB was minimal. (In contrast, he emphasised that the BoE certainly did not have an explicit objective to control the yield curve.) So, given the severity of the near-term baseline scenario, as well as the downside skew of the risks to the outlook, the likelihood of an extension of the BoE's asset purchases over the remainder of the year, and perhaps into 2021, would seem very high indeed.

The coming week in the UK

Tomorrow will be a Bank Holiday in the UK. Further ahead, after the government's official publication of its strategy for easing lockdown restrictions on Sunday – which is likely to allow only a limited initial relaxation of rules – the most noteworthy UK data to be released in the coming week will come on Wednesday with the first estimate of Q1 GDP, as well as the monthly output and trade figures for March. These will inevitably be extremely weak. We expect GDP to have contracted by around 3%Q/Q, which would be the biggest quarterly decline in the post-war era. And the monthly figures will further illustrate the significant hit to activity in March, across the services, manufacturing and construction sectors alike, as the country entered lockdown. Trade figures will also flag the significant negative impact travel restrictions elsewhere will have had on services exports.

Due to a public holiday, the next edition of the Euro wrap-up will be published on 11 May 2020.

Daiwa economic forecasts

	2019		2020				2019	2020	2021
	Q3	Q4	Q1	Q2	Q3	Q4			
GDP growth, %, Q/Q									
Euro area	0.3	0.1	-3.8	-16.0	6.0	2.0	1.2	-12.5	2.5
Germany	0.2	0.0	-2.0	-12.0	5.0	2.0	0.6	-8.0	2.5
France	0.3	-0.1	-5.8	-20.0	10.0	4.0	1.3	-15.0	5.5
Italy	0.1	-0.3	-4.7	-20.0	5.0	2.0	0.3	-17.0	1.0
Spain	0.4	0.5	-5.2	-20.0	8.0	4.0	2.0	-15.0	3.5
UK	0.5	0.0	-3.0	-22.0	12.0	3.0	1.4	-13.5	3.5
Inflation, %, Y/Y									
Euro area									
Headline CPI	1.0	1.0	1.1	-0.1	-0.3	-0.4	1.2	0.1	0.6
Core CPI	0.9	1.2	1.1	0.3	-0.4	-0.6	1.0	0.1	0.3
UK									
Headline CPI	1.8	1.4	1.7	0.6	0.2	0.1	1.8	0.6	0.7
Core CPI	1.7	1.6	1.6	1.2	0.7	0.5	1.7	1.0	0.5
Monetary policy									
ECB									
Refi Rate %	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
Net asset purchases*	0	20	107	107	107	107	20	107	20
BoE									
Bank Rate %	0.75	0.75	0.10	0.10	0.10	0.10	0.75	0.10	0.10
Net asset purchases**	0	0	36	36	36	36	0	36	0

**Monthly target €bn, end of period. **Monthly target £bn, end of period.*
Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Industrial production M/M% (Y/Y%)	Mar	**-9.2 (-11.6)**	-7.4 (-8.9)	0.3 (-1.2)	**- (-1.8)**
	Construction PMI	Apr	**31.9**	-	42.0	**-**
France	Industrial production M/M% (Y/Y%)	Mar	**-16.2 (-17.3)**	-13.4 (-11.1)	0.9 (-1.4)	**0.8 (-1.7)**
	Manufacturing production M/M% (Y/Y%)	Mar	**-18.2 (-19.3)**	-16.0 (-)	0.9 (-1.5)	**- (-1.7)**
	Private sector payrolls Q/Q%	Q1	**-2.3**	-	0.5	**0.4**
	Trade balance €bn	Mar	**-3.3**	-	-5.2	**-5.0**
Italy	Retail sales M/M% (Y/Y%)	Mar	**-21.3 (-19.5)**	-15.0 (-)	0.8 (5.7)	**1.0 (6.1)**
	BoE Bank Rate %	May	**0.10**	0.10	0.10	**-**
	BoE Gilt and corporate bond purchase target £bn	May	**645**	645	645	**-**

Auctions

Country	Auction
France	sold €3.75bn of 0.75% 2028 bonds at an average yield of -0.1%
	sold €4.96bn of 0% 2029 bonds at an average yield of 0.03%
	sold €1.39bn of 0.75% 2052 bonds at an average yield of 0.82%
	sold €988mn of 4% 2060 bonds at an average yield of 0.86%
Spain	sold €1.40bn of 0% 2023 bonds at an average yield of 0.036%
	sold €1.49bn of 0% 2025 bonds at an average yield of 0.254%
	sold €1.80bn of 0.8% 2027 bonds at an average yield of 0.62%
	sold €678mn of 0.7% 2033 index-linked bonds at an average yield of 0.38%
	sold €1.76bn of 1% 2050 bonds at an average yield of 1.673%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous
Germany	07.00	Trade balance €bn	Mar	18.8	20.6
Spain	08.00	Industrial production M/M% (Y/Y%)	Mar	-9.6 (-)	0.0 (-1.3)
UK	00.01	GfK consumer confidence	Apr	-37	-34

Country	BST	Auction / Event
Italy	-	Italian sovereign debt rating update by Moody's

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

The coming week's key data releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
			Monday 11 May 2020			
Italy		09.00	Industrial production M/M% (Y/Y%)	Mar	-	-1.2 (-2.4)
			Tuesday 12 May 2020			
France		07.30	Bank of France industrial sentiment survey	Apr	-	93
			Wednesday 13 May 2020			
EMU		10.00	Industrial production M/M% (Y/Y%)	Mar	-12.0 (-11.9)	-0.1 (-1.9)
UK		00.01	BRC retail sales monitor, like-for-like sales Y/Y%	Apr	-	-3.5
		07.00	Preliminary GDP Q/Q% (Y/Y%)	Q1	-2.6 (-1.9)	0.O (1.1)
		07.00	Monthly GDP M/M%	Mar	-7.0	-0.1
		07.00	Industrial production M/M% (Y/Y%)	Mar	-5.7 (-9.1)	0.1 (-2.8)
		07.00	Manufacturing production M/M% (Y/Y%)	Mar	-6.0 (-10.5)	0.5 (-3.9)
		07.00	Construction output M/M% (Y/Y%)	Mar	-5.0 (-5.3)	-1.7 (-2.7)
		07.00	Index of services M/M% (3M/3M)	Mar	-5.9 (-1.8)	0.0 (0.2)
		07.00	Total trade balance (goods trade balance) £bn	Mar	-2.0 (-10.0)	-2.8 (-11.5)
			Thursday 14 May 2020			
Germany		07.00	Final CPI (EU-harmonised CPI) Y/Y%	Apr	0.8 (0.8)	1.4 (1.3)
Italy		10.00	Total trade balance €bn	Mar	-	6.1
Spain		08.00	Final CPI (EU-harmonised CPI) Y/Y%	Apr	-0.7 (-0.6)	0.0 (0.1)
UK		00.01	RICS house price balance %	Apr	-50	11
			Friday 15 May 2020			
EMU		10.00	GDP – second estimate Q/Q% (Y/Y%)	Q1	-3.8 (-3.3)	0.1 (1.0)
		10.00	Preliminary employment Q/Q% (Y/Y%)	Q1	-	0.3 (1.1)
		10.00	Trade balance €bn	Mar	-	25.8
Germany		07.00	GDP – first estimate Q/Q% (Y/Y%)	Q1	-2.0 (-2.0)	0.0 (0.3)
France		07.45	Final CPI (EU-harmonised CPI) Y/Y%	Apr	0.4 (0.5)	0.7 (0.8)
Italy		09.00	Industrial orders M/M% (Y/Y%)	Mar	-	-4.4 (-2.6)
		09.00	Industrial sales M/M% (Y/Y%)	Mar	-	-2.1 (0.9)
		10.00	Final CPI (EU-harmonised CPI) Y/Y%	Apr	0.0 (0.1)	0.1 (0.1)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		BST	Event / Auction
			Monday 11 May 2020
			- Nothing scheduled -
			Tuesday 12 May 2020
Germany		10.30	Auction: €4bn of 2027 bonds
			Wednesday 13 May 2020
Germany		10.30	Auction: €1bn of 1.25% 2048 bonds
Italy		10.00	Auction: 3Y and 7Y bonds
UK		10.00	Auction: £600mn of 0.125% 2048 index-linked bonds
			Thursday 14 May 2020
EMU		09.00	ECB publishes its Econonic Bulletin
UK		10.00	Auction: £3.25bn of 0.625% 2025 bonds
		10.00	Auction: £2.25bn of 1.25% 2041 bonds
		11.30	BoE Governor Bailey speaks on Webinar event
			Friday 15 May 2020
France		-	French sovereign debt rating update from Fitch

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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