Daiwa Capital Markets

Euro wrap-up

Overview

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- While euro area inflation plunged and almost 500k German firms applied for wage subsidies, Bunds made losses.
- Gilts also made losses ahead of April's record amount of new issuance.
- Wednesday will bring the March final PMIs and UK shop price survey, and February data for German retail sales and euro area unemployment.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.721	+0.030
OBL 0 04/25	-0.657	+0.029
DBR 0 02/30	-0.469	+0.032
UKT 0½ 07/22	0.143	+0.009
UKT 0⅝ 06/25	0.218	+0.019
UKT 4¾ 12/30	0.361	+0.028

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

Euro area

Headline CPI declines to joint-lowest since 2016

There were no major surprises from today's euro area flash inflation estimate for March, which saw the annual headline CPI rate decline ½ppt to 0.7%Y/Y, matching the three-year low reached in October. The deceleration was driven principally by the further plunge in oil prices this month – down on average a whopping 40% in euro terms compared with the average in February – to leave energy inflation recording the steepest decline (-4.3%Y/Y) since the summer of 2016. Services inflation showed some initial signs of downwards pressure from the Covid-19 outbreak too, down 0.3ppt to a seven-month low of 1.3%Y/Y. So, while the annual increase in non-energy industrial goods prices remained steady (0.5%Y/Y), core inflation fell 0.2ppt to 1.0%Y/Y, a six-month low. And this seems likely to be followed by further notable easing in price pressures at the start of Q2 too.

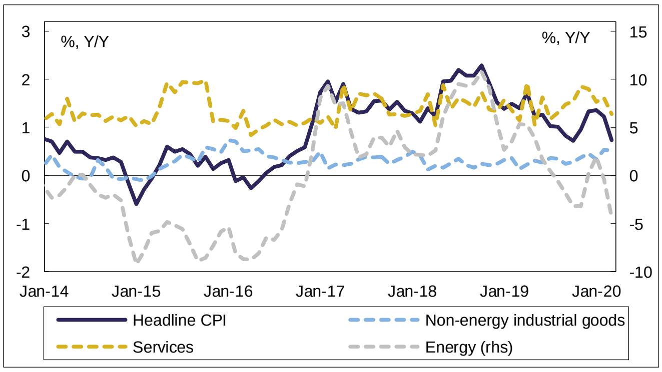
Inflation to fall below zero?

While prices of some items, including food, will have been boosted by supply constraints, the effective lockdown and restriction of movement across a significant share of the euro area will represent a more substantive and lasting hit to incomes and demand, and will thus weigh more significantly on underlying inflation. Lower fuel prices will also be passed on steadily to a wide range of goods and services prices. As such, we expect core inflation to fall below ½%Y/Y in Q2 and remain there through to the middle of next year. Moreover, energy inflation will increase its direct drag on the annual headline inflation rate over coming months. Indeed, due to the slower pass-through, in Germany energy prices were still down just 2%M/M in March and so headline inflation on the national measure dropped just 0.3ppt to 1.4%Y/Y. In contrast, the pace of decline in energy prices was twice as large in France, where headline inflation on the national measure thus dropped a steep 0.8ppt to 0.6%Y/Y, the lowest since 2016. Overall, we anticipate headline inflation to fall back close to zero in April, with a non-negligible risk that it will slide into negative territory over coming months too.

Almost 500k German firms apply for wage subsidies

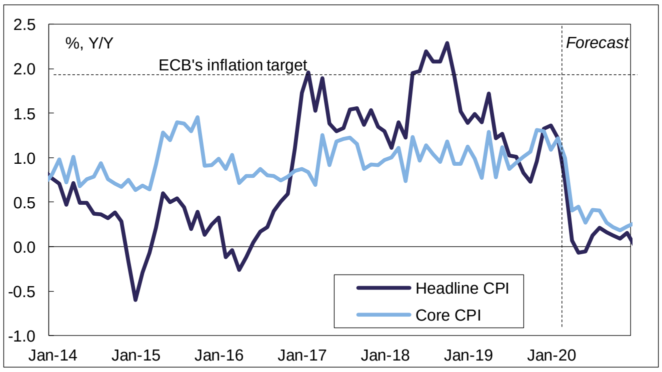
The hit to Germany's economy from Covid-19 and the measures taken to control its spread have yet to show up in its unemployment data. Today's report showed a modest rise of just 1k in the seasonally adjusted number of jobless workers in March to 2.267mn. As such, the unemployment claims rate remained unchanged at 5.0% for an eleventh successive month. The number of vacancies dropped just 9k to 697k, a three-year low and 106k lower than a year earlier, but still relatively elevated by historical standards. However, these data reflected the situation in the month only up to 12 March, since when non-essential businesses have closed and a huge number of workers have been furloughed or placed on short-time working

Euro area: Consumer price inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation forecast



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

in response to government restrictions on activity. Germany's Labour Agency today announced that a record 470k firms had applied for state wage subsidies (kuzarbeit), whereby the government will pay 60% of worker salaries received before the crisis (67% for workers with children). That followed the legislative change, on 13 March, to increase the range of firms that might participate in the scheme. But while the government estimated that 2.35mn workers – almost 1 million more than during the global financial crisis – will benefit from the scheme this time around, that figure looks likely to prove too conservative.

The day ahead in the euro area and US

Wednesday will bring the final March manufacturing PMIs, which seem likely to show downwards revisions from the flash estimates. Among other things, the preliminary figures reported a record drop of 9pts in the euro area manufacturing output PMI to 39.5, suggesting the steepest fall in production since April 2009. The headline manufacturing PMI, however, fell a more a more moderate 4.4pts to 44.8, inappropriately boosted by the increase in supplier delivery times reflecting severe supply-chain disruption. At the national level, the March manufacturing PMIs for Italy and Spain will be published for the first time tomorrow, with the drop in the former likely to be particularly sharp. March Italian new car registrations numbers are also out, and will be similarly weak. February figures due include euro area unemployment and German retail sales. In the markets, Germany will sell 5Y Bunds.

In the US, the ISM manufacturing survey for March is due along with the equivalent final PMIs. In addition, the ADP employment report and vehicle sales figures, both for March, are due along with February construction spending data.

UK

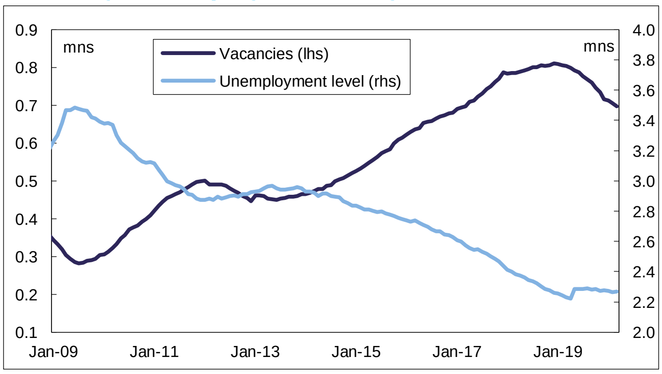
Consumer confidence survey unrepresentative of current conditions

The latest GfK consumer confidence survey offered few insights into current spending behaviour as it was conducted in the first two weeks of March, before the coronavirus had a significant impact on activity in the UK. For example, the headline consumer confidence index fell just 2pts to -9, matching January's level. Within the detail, the survey flagged a worsening in perceptions of the economic outlook for the coming year (down 6pts), as well as a more limited deterioration in assessments of the outlook for personal finances (down 3pts). But the 8pt fall in the Major Purchase Index was merely the biggest since mid-2017. We should expect next month's survey to give a more accurate gauge of consumers' willingness to make significant new purchases, with a good chance that the relevant index will hit a record low.

Weak Q4 GDP confirmed

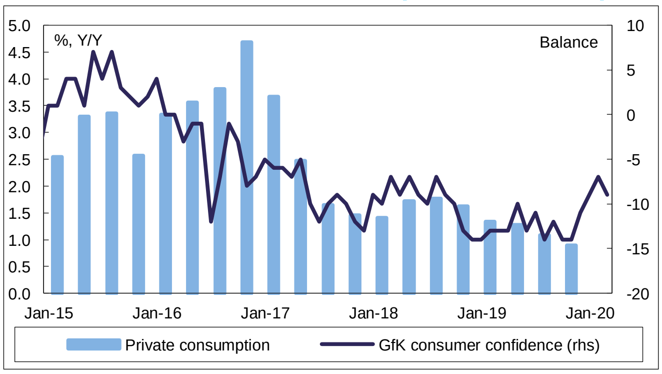
The final release of Q4 GDP confirmed the prior estimate of zero growth on the quarter, as Brexit uncertainty weighed significantly on demand. That left the annual rate of GDP growth in Q4 at 1.1%Y/Y, matching the softest since Q110. Within the detail, private consumption (0.0%Q/Q) was even weaker than previously thought, failing to grow for the first time in four years. Fixed investment fell 1.2%Q/Q, with business investment down 0.5%Q/Q to remain below end-2017 levels. In contrast, net trade made a third consecutive large positive contribution to growth (+1.5ppts), as vigorous growth in exports (5.0%Q/Q), partly related in part to transfers of gold within the banking sector, far outpaced that of imports (0.4%Q/Q). Happily, perhaps, the stronger headline net trade performance saw the external current account deficit shrink almost £15bn to £5.6bn (0.6% of GDP), the smallest in more than eight years. Excluding gold and other precious metals, however, the underlying UK current account deficit narrowed only slightly to £17.1bn (3.1% of GDP). So, the deficit is likely to have rebounded in Q1 to represent a source of economic vulnerability, one reason why sterling depreciated markedly earlier this month. Of course, following the Covid-19 outbreak and lockdown of activity, GDP is bound to have gone into reverse in the first quarter. And the chances of a historically steep drop in GDP of 10%Q/Q or more in Q2 currently look high.

Germany: Unemployment and job vacancies



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Consumer confidence and private consumption

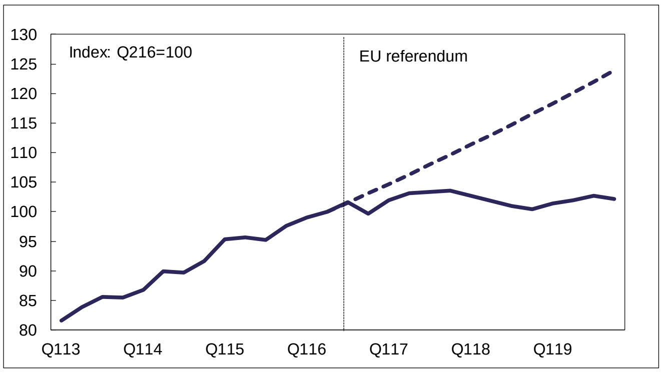


Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

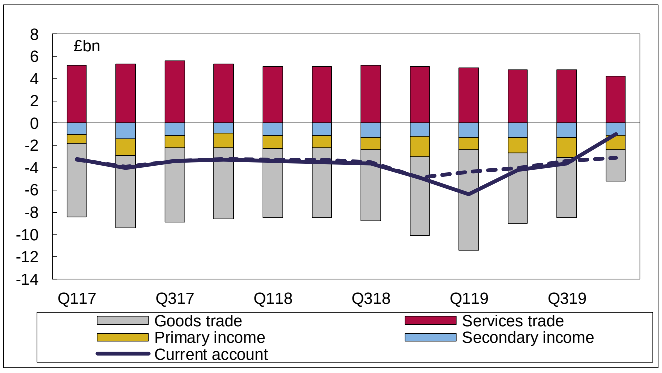
Like in the euro area, the UK's final manufacturing PMIs are due for release tomorrow. According to the flash estimate, the output PMI fell 8pts to 44.3, the lowest since 2012, with a similarly marked deterioration in the component for new orders. But, as in the euro area, due to the impact of lengthening delivery times the fall in the headline PMI was less striking, dropping 3.7pts to 48.0, merely a three-month low. The BRC's shop price index for March is also due tomorrow. In the markets, the DMO will sell £3bn of 8Y Gilts, the first auction of a month when it intends to raise £45bn, roughly one third the size of last year's total gross issuance and 60% more than the highest previous monthly issuance in mid-2009.

UK: Business investment*



*Dashed line represents pre-referendum trend. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Current account balance*



*Dashed line represents total current account balance excluding precious metals. Source: ONS 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 CPI (core CPI) Y/Y%	Mar	**0.7 (1.0)**	0.7 (1.1)	1.2 (1.2)	-
Germany	Unemployment rate % (change '000s)	Mar	**5.0 (1.0)**	5.1 (25.0)	5.0 (-10.0)	- (-8.0)
France	Preliminary CPI (EU-harmonised CPI) Y/Y%	Mar	**0.6 (0.7)**	1.0 (1.1)	1.4 (1.6)	-
	Consumer spending M/M% (Y/Y%)	Feb	**-0.1 (-0.6)**	0.7 (0.0)	-1.1 (-0.9)	-1.2 (-)
Italy	Preliminary CPI (EU-harmonised CPI) Y/Y%	Mar	**0.1 (0.1)**	-0.1 (-0.1)	0.3 (0.2)	-
Spain	Final GDP Q/Q% (Y/Y%)	Q4	**0.4 (1.8)**	0.5 (1.8)	0.4 (1.9)	-
UK	GfK consumer confidence	Mar	**-9**	-15	-7	-
	Lloyds business barometer	Mar	**6**	-	23	-
	Final GDP Q/Q% (Y/Y%)	Q4	**0.0 (1.1)**	0.0 (1.1)	0.4 (1.1)	-
	Current account balance £bn	Q4	**-5.6**	-7.0	-15.9	-19.9

Auctions

Country	Auction
Italy	sold €2.75bn of 0.35% 2025 bonds at an average yield of 0.80%
	sold €3.5bn of 0.95% 2030 bonds at an average yield of 1.48%
	sold €1.5bn of 1.5% 2030 bonds at an average yield of 1.44%
	sold €750mn of 2023 floating-rate bonds at an average yield of 0.66%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		09.00	Final manufacturing PMI	Mar	44.8	49.2
		10.00	Unemployment rate %	Feb	7.4	7.4
Germany		07.00	Retail sales M/M% (Y/Y%)	Feb	0.2 (1.5)	1.0 (2.1)
		08.55	Final manufacturing PMI	Mar	45.7	48.0
France		08.50	Final manufacturing PMI	Mar	42.9	49.8
Italy		08.45	Manufacturing PMI	Mar	41.0	48.7
		08.45	Unemployment rate %	Feb	10.0	9.8
		08.45	New car registrations Y/Y%	Mar	-	-8.8
Spain		08.15	Manufacturing PMI	Mar	44.0	50.4
UK		00.01	BRC shop price index Y/Y%	Mar	-0.6	-0.6
		09.30	Final manufacturing PMI	Mar	48.0	51.7
Country		**BST**	**Auction/Event**			
Germany		10.30	Auction: €4bn of 0% 2025 bonds			
UK		10.30	Auction: £3bn of 1.625% 2028 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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