European Periphery Macro Weekly

30 March 2020
(09:00 CET)

Weekly macro update

Insights

The current state of play:

- The news flow this week has been relentless. **The COVID-19 outbreak means that uncertainty and caution remain the name of the game**. In places like Spain and Italy, data appear to indicate that the outbreak may still have a few weeks to run before it peaks, and we do not know what the curve will look like thereafter. However, in other countries (the US), the curve seems to be ramping up (and steeply) and some scenarios are now reportedly being discussed of the peak not being reached until late April . In terms of the economic impact, we have yet to see how harsh the downturn may be, and it may be some months before we see the bottom of the trough.

  As for this week's data, **the question is not whether data will be negative but how bad it will be**: the first **inflation figures for March** in the Eurozone will be released with a c.0.4/0.5pp deceleration to be expected (to levels around 0.8% YoY for the EMU); confidence indicators (**EC economic climate , PMIs**) will also depict a rather negative scenario as a drop to historical lows will very likely be registered across all economies (the sharp drop in services indicators will combine with the already weak manufacturing component and push the composite reference to levels close to 30). Regarding the **US, a sharp drop in monthly payroll** figures should also be expected following the spectacular rise seen in the last weekly jobless claims.

Fiscal issues: funding the extra bill will not be a problem in the short term, but medium-term challenges persist

As positive as our reading of the latest market developments is (particularly regarding the periphery), we have to consider what is at stake now.

i. The supportive effect thus far has come solely from the ECB's PEPP (nothing so far from common EU political/fiscal institutions). This sort of intervention by the ECB is particularly helpful for flows: **the PEPP implies a material change in the supply-demand balance of sovereign debt, but within a particular time frame**. By guaranteeing that it can cope with whatever may be needed in terms of asset purchases, the ECB is acting to significantly reduce the risk of "accidents" in 2020 overall.

   In this sense, the PEPP is a rather powerful instrument within the framework it has been assigned. As we stated in our special note, "PEPP: flexibility may be as important as size" (see here): i) **the foreseeable increase in government debt issuance will be covered/countered (and even in some cases outpaced) by the ECB's increase in purchases**. Thus, bond issuance net of redemptions and ECB purchases

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(including the APP+ envelope and the PEPP) would not increase significantly; in fact, they may drop in YoY terms; and ii) this would be especially relevant for those countries that are heavily exposed to increasing their issuance levels. In the particular case of peripheral countries, **the net issuance scenario after the latest announcement could be similar to the scenario seen in 2016-17**. As a result, we expect this announcement to be supportive for peripheral assets.

ii. Nonetheless, **we recall that this support is focused on the "flow" side of the market (2020 being apparently "nailed down") but it does not reverse the deterioration in the fiscal metrics.** All **the fiscal packages that have been put to work and the fiscal impact of the automatic stabiliser now unfolding in most EU countries will leave a mark on the deficit and debt figures across the board**: in a few cases an increase of at least c.5pp of GDP in the deficits and public debt figures from pre-crisis estimates could be the best-case scenario for this year.

As risky as this may be on a medium-term perspective, it does not seem to have sparked any feeling amongst EU members that some sort of EU joint fiscal approach (debt burden sharing, fiscal solidarity, etc) is now warranted. In fact, **the focus for some core members is apparently more on the moral hazard consequences of any such action, rather than the need for emergency joint action**.

Our view on this remains unchanged: **only ESM standard intervention (with precautionary credit lines as the main candidate) is within reach at this stage** and will finally be triggered by a number of members. Similarly, **the likelihood that any sharing of the debt burden will become politically palatable for core member states still appears rather remote**, in our view.

iii. So far **this lack of commitment has only created some underlying political noise, but it has not been particularly negative for the market (mainly as it is the ECB's PEPP that has taken centre stage for now**). However, it is the timeline rather than the size of the debt that is being softened, and consequently, as has happened before, we will continue to be exposed to episodes when investors will ask the questions about how and when the bill will be paid, who will foot it and/or how bad all this may be in terms of credit rating issues (Italy's rally last week was partially hampered by mounting rumours that a rating downgrade is imminent – see our view on this in the Periphery section below). We cannot yet definitely draw a line under the considerations about fiscal metrics, debt-sustainability analysis and how dependent the highly leveraged economies are on the ECB 's accommodative policy (will the PEPP end up turning into the APP3.0?).

Week ahead

Weekly Calendar

Country	Monday	Tuesday	Wednesday	Thursday	Friday
Spain	**Flash Inflation (Mar):** February headline inflation: 0.7% YoY	**Budget execution 2019** **Current Account (Jan):** Previous EUR2.21bn Forecast EUR-0.37bn **Final GDP (4Q19):** 3Q19 was 0.4% QoQ and 1.9% YoY	**Spain bank lending (Feb**	**Labour force survey (Mar):** Unemployment fell by 7.8k in February.	**Final services and Composite PMI (Mar):** Services (Bloomberg consensus: 25.5; Feb: 52.1) and Composite (Bloomberg consensus: 31.0; Feb: 51.8)
Italy		**Flash Inflation (Mar):** February inflation:-0.1% YoY			**Final services and Composite PMI (Mar):** Services (Bloomberg consensus: 22.5; Feb: 52.1) and Composite (Bloomberg consensus: 25.0; Feb: 50.7). **Budget execution 2019**
Portugal		**Flash inflation (Mar):** -0.6% YoY in February	**Bank new lending (Feb)** **General government debt (Mar)**		
EMU	**Asset Purchase Programme**	**Flash Inflation (Mar):** February headline inflation:1.2% YoY with core inflation at 1.3%			**DBRS Rating**
Germany					**S&P Rating (AAA)**
France					**S&P Rating (AA)**
Other		**UK Final GDP (4Q19)**			**US employment**

Source: BBVA GMR

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