WEEKLY UPDATE

ECB – When doves cry

Recent growth data in the euro zone has underlined the slowdown in activity. Italy entered a "technical" recession in the fourth quarter, i.e. two consecutive quarters of declining Gross Domestic Product (GDP), while Germany came close – QoQ growth was 0.0% in Q4 after -0.2% in Q3. Against this sluggish backdrop, the European Central Bank's (ECB) policy meeting was held on March 7. What would Mario Draghi pull out of the hat?

Going into the meeting, expectations were for no change to policy settings but for some hints on future easing measures. In the event, Chairman Draghi delivered some dovish surprises:

- The ECB cut its forecasts by more than expected. GDP growth was slashed from 1.7% in 2019 to 1.1% with 2020 lowered from 1.7% to 1.6%. Headline inflation forecasts were also revised lower, by 0.4 points this year and 0.2 points next, suggesting the ECB's inflation target remains out of reach.
- The central bank also announced a third round of Targeted longer-term refinancing operations (TLTRO), i.e. longer-term cheap refinancing for banks which might have difficulty otherwise in attracting sufficient funding. With the second round due to expire in June next year, this move was expected to come a bit later to improve financing visibility.
- Mr Draghi also extended the ECB's forward guidance on rates. Whereas previously he had expected the first rate hike to come in late summer 2019, he now made clear it will not happen before year-end (and also mentioned that several members had suggested postponing till next March).

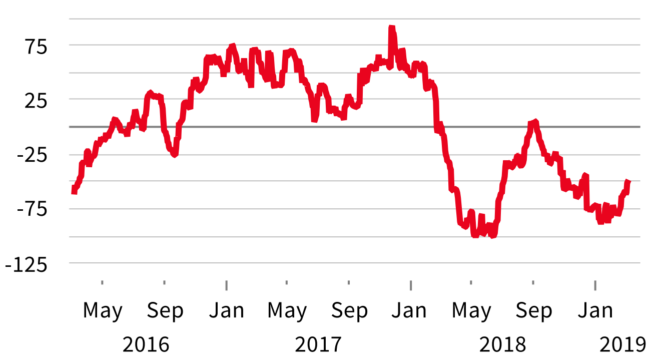
At first sight, the market reaction to the announcements seemed churlish. Bond yields tumbled, with the 10-year Bund yield hitting only 0.06%, the lowest since October 2016. The euro also fell, down 1.0% to 1.119 against the dollar, the lowest since June 2017. And euro zone bank shares slid 4.0%, their worst day in seven months. Why?

The market's kneejerk reaction was driven by the sharper-than-expected cuts to forecasts, by the fact that the ECB felt compelled to announce TLTRO3 now rather than wait, and by sharp flattening of the yield curve which hits banks' net interest margins even harder than before. However, the announcements were not uniformly negative. The growth outlook is set to improve in the second half of this year, to a 1.5% annual rate. And the extension to forward guidance provides comfort that accommodative monetary policy will remain in place for the foreseeable future.

Bottom line. Although negative economic surprises do appear to have bottomed in the euro zone, our outlook remains cautious for now. A pick-up in activity in H2 still seems likely, as the impact of new emission standards fades for car production and fiscal stimulus begins to kick in. But yesterday's ECB announcements only serve to underline the need for a defensive stance at present.

Fewer negative surprises recently

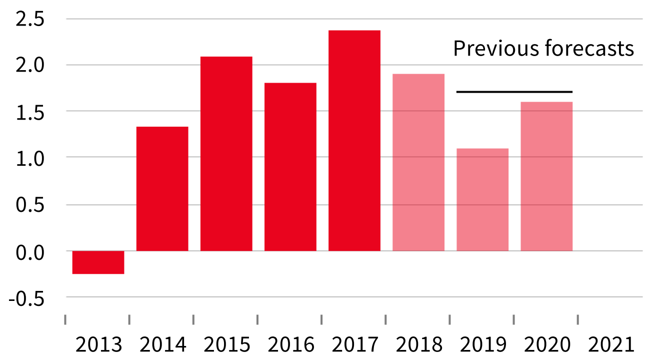
Citi economic surprise index for eurozone



Sources: Macrobond, Citi, 07/03/2019

The ECB has slashed its growth forecasts

Eurozone GDP growth rate (%)and ECB 2018-2021 projections



Sources: Macrobond, World Bank, ECB, 07/03/2019

OUR MACRO-COMMENTS

This week and next

EUROZONE

- The Sentix investor sentiment index ticked higher in March at -2.2 after -3.7 as *Expectations* improved for the 2nd straight month, offsetting the 7th fall in a row in the *Current Situation*.
- After two months at 51.2, February PMI confidence in *Services* surprised on the upside, jumping to 52.8 on revised data and sending the *Composite* reading to 51.9, up from 51.0.
- Retail sales rebounded from -1.4% MoM to +1.3% in January, their sharpest upswing in 14 months with +3.3% registered in Germany.
- Q4 GDP was revised down from 1.2% YoY to 1.1%, after 1.6% in Q3. Estonia recorded the highest growth (+2.2%) while Greece and Italy saw declines (-0.1%).

Next week's key events		Per.	Prev.	Cons.
11 Mar	German trade balance (€bn)	Jan	19.4	--
13 Mar	Industrial production YoY	Jan	-4.2%	-2.1%
15 Mar	Headline inflation YoY	Feb	1.4%	1.5%

UNITED KINGDOM

- PMI confidence in *Construction* fell from 50.6 to 49.5 in February, ending a 10-month run of expansion. The survey highlighted concerns over new commercial and civil engineering projects.
- On the other hand, PMI confidence in *Services* market a 4-month high, up from 50.1 to 51.3 in February, 1.4 points above expectations.
- According to the British Retail Consortium, February like-for-like domestic sales slowed -0.1% YoY after January's modest recovery with Brexit day looming large.

Next week's key events		Per.	Prev.	Cons.
12 Mar	GDP 3M/3M	Jan	0.2%	0.1%
12 Mar	Manufacturing output YoY	Jan	-2.1%	-2.0%
14 Mar	RICS housing survey	Feb	-22	-24

UNITED STATES

- Institute for Supply Management (ISM) non-manufacturing jumped 3 points to 59.7 in February after a cool off in January, outperforming expectations for 57.4. The 109th consecutive month of expansion was driven by strong improvement in *New Orders* (+7.5 points).
- December's trade deficit worsened from $49.3bn to $59.8bn, taking 2018's deficit to $621bn, a decade low.
- Private sector employment (ADP survey) increased by 183'000 in February, while job growth in January was revised from 213'000 to 300'000, a 13-year high.
- Nonfarm productivity rose 1.3% last year – the strongest since 2010 – after 1.1% in 2017. Unit labour costs increased 1.4% YoY, down from 2.2% in 2017 – a positive for corporate margins. Hourly compensation rose at 3.9% annualised in Q4, after 3.5% in Q3.

Next week's key events		Per.	Prev.	Cons.
11 Mar	Retail sales Ex Auto MoM	Jan	-1.8%	0.4%
12 Mar	Headline inflation YoY	Feb	1.6%	1.6%
15 Mar	Industrial production MoM	Feb	-0.6%	0.6%

ASIA & EMERGING COUNTRIES

- February PMI confidence in *Services* in Japan bounced back to December's 52.3 after 51.6 in January, underpinned by growth of new businesses and a slight pick-up in foreign demand.
- In China, Caixin PMI confidence in *Services* was 2.5 points lower in February than January's 53.6. This outweighed last week's rebound in *Manufacturing* and sent the *Composite* down from 50.9 to 50.7.
- Russian headline inflation rose from 5.0% YoY to 5.2% in February – a 2-year high.
- GDP growth in South Africa slowed from 1.4% in 2017 to 0.8% last year – the country suffered a recession in H1 2018 before recovering 2.6 % and 1.4% QoQ annualised in Q3 and Q4.
- PMI *Manufacturing* confidence in South Korea and Taiwan fell further in February, to 47.2 and 46.3, respectively.

Next week's key events		Per.	Prev.	Cons.
13 Mar	Japan: Machinery orders YoY	Jan	0.9%	--
14 Mar	China: Industrial output YoY	Jan	6.2%	5.5%
14 Mar	China: Retail sales YoY	Jan	9.0%	8.1%

Sources: DataStream, Bloomberg, 08 March 2019. Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, PMI = Purchasing Manager's Index.

Our 3-month targets for currencies and commodities

	Thursday close	3mth target
EUR/USD	1.12	1.13
GBP/USD	1.31	1.30
EUR/CHF	1.13	1.13
USD/JPY	111.6	112
Brent	$66.0	$68
Gold (oz.)	$1286	$1250

No change to our 3-month targets this week.

Forecast figures are not a reliable indicator of future performance.

MARKET PERFORMANCE

Past performance should not be seen as a guarantee of future returns.

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-36 bp	0 bp	→	-1 bp	-1 bp	0 bp
3mth Euribor (EUR)	-31 bp	0 bp	→	1 bp	0 bp	2 bp
3mth Libor (USD)	260 bp	-1 bp	↓	-17 bp	-21 bp	54 bp
3mth Libor (GBP)	84 bp	-1 bp	→	-6 bp	-7 bp	24 bp
10-year US Treasury bond	264 bp	-8 bp	↓	-21 bp	-6 bp	-25 bp
10-year German bond	7 bp	-12 bp	↓	-19 bp	-18 bp	-59 bp
10-year French bond	43 bp	-15 bp	↓	-26 bp	-29 bp	-48 bp
10-year UK bond	117 bp	-13 bp	↓	-10 bp	-10 bp	-32 bp

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0,4%	↑	2,5 %	2,2 %	1,4 %
BAML EURO Corp HY	0,1%	→	4,4 %	4,2 %	0,7 %
BAML GBP Corp IG	1,3%	↑	3,9 %	3,5 %	3,2 %
BAML US IG	0,5%	↑	3,8 %	3,0 %	3,4 %
BAML US HY	-0,3%	↓	3,9 %	6,1 %	4,3 %
BAML Global EM Sov. External Plus	-0,8%	↓	4,8 %	4,1 %	0,3 %

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1,12	-1,6 %	↓	-1,6 %	-2,4 %	-9,8%
EUR/CHF	1,13	-0,3 %	↓	0,4 %	0,5 %	-3,3%
GBP/USD	1,31	-1,3 %	↓	2,8 %	2,6 %	-5,9%
USD/JPY	111,6	0,2 %	↑	-1,0 %	1,8 %	5,2%
USD/BRL	3,87	3,2 %	↑	-1,0 %	-0,3 %	19,3%
USD/CNY	6,71	0,3 %	↑	-2,3 %	-2,4 %	6,2%
USD/RUB	66,3	0,5 %	↑	-0,2 %	-4,9 %	16,6%

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0,4 %	↑	1,8 %	0,7 %	3,8 %
United Kingdom (3-7yr)	0,6 %	↑	0,5 %	0,5 %	2,4 %
Germany (3-7yr)	0,4 %	↑	0,4 %	0,4 %	2,1 %
Japan (3-7yr)	0,0 %	→	0,1 %	0,0 %	0,1 %

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	498	-1,0 %	↓	5,7 %	9,7 %	-1,2 %
Eurostoxx 50	3 309	0,3 %	↑	8,7 %	10,6 %	1,6 %
DAX	11 518	0,0 %	→	6,8 %	9,1 %	-5,9 %
CAC 40	5 268	0,5 %	↑	9,7 %	11,4 %	4,9 %
S&P 500	2 749	-1,2 %	↓	4,9 %	10,1 %	2,9 %
FTSE 100	7 158	1,4 %	↑	6,8 %	7,5 %	4,5 %
SMI	9 325	0,4 %	↑	7,9 %	11,9 %	10,4 %
Topix	1 602	-0,4 %	↓	-1,0 %	7,3 %	-3,9 %
IBOV Brazil	94 340	-1,3 %	↓	7,1 %	7,3 %	10,4 %
MICEX Russia *	2 477	-0,4 %	↓	1,9 %	5,0 %	8,1 %
MSCI EM	1 044	-0,7 %	↓	6,9 %	8,3 %	-9,7 %
SENSEX 30 India	36 725	2,4 %	↑	3,1 %	1,9 %	12,6 %
Hang Seng (H-K)	28 779	0,5 %	↑	10,7 %	11,7 %	-1,3 %
Shanghaï Composite	3 106	5,6 %	↑	19,2 %	24,6 %	-5,1 %

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$66,0	0,0 %	→	4,8 %	24,2 %	1,1 %
Gold	$1 286	-2,3 %	↓	3,2 %	0,4 %	-3,1 %
Copper	$6 460	-1,5 %	↓	5,1 %	8,6 %	-6,5 %

Source: DataStream, on 07 March 2019.

1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7-year returns. Figures are rounded.

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