BEA東亞銀行

Economic Research

April 2021

Market Monitor – Eurozone

Europe still Plagued by Covid-19

Subdued domestic activity

Eurozone inflation picked up steam entering 2021. The final CPI reading in February was 0.9% year-on-year, compared with -0.3% in December. The core CPI year-on-year growth accelerated to 1.1%, up from 0.4% in December. The rebound in oil and commodities prices and the reversal of the value added tax cut in Germany were the major factors pushing up price levels.

Yet the increase is generally perceived by the market as ephemeral. While the manufacturing purchasing managers' index (PMI) showed a robust preliminary reading of 62.4 in March, the services sector was still in contractionary territory of 48.8. Retail sales were down by 5.9% month-on-month and 6.4% year-on-year in January 2021. Online sales showed a remarkable 39.1% annual increase, but this was not enough to offset the decline in physical stores. As such, wage growth is likely to remain subdued with significant labour market slack. The region's unemployment rate remained at 8.1% in January 2021, with Spain being the worst national performer at 16% unemployment.

Fresh Covid-19 outbreak

More seriously, the eurozone is seeing a new wave of Covid-19. France had over 25,000 daily infection cases in mid-March on a 7-day rolling average, while Italy saw about 22,000 new cases. Italy has tightened its anti-pandemic measures, with most part of the country – including Rome and Milan – closing shops, restaurants, and schools from 15th March. Residents are required to stay at home and there will be national lockdown during the Easter holidays.

- **Domestic economic activity remains lacklustre with slack in labour market and extended lockdowns.**
- **New Covid-19 wave has caused most countries to tighten lockdown measures and further delay economic recovery.**
- **European shares gained despite rising Covid-19 cases. Government bond yields fell after ECB meeting, while euro was weak against the US dollar.**

Germany is extending its lockdown until 18th April, France has imposed a 6 p.m. curfew, and Portugal has instituted a 1 p.m. curfew on weekends in infection hotspots. By contrast, the Spanish capital Madrid was much more relaxed, with an 11 p.m. curfew and no restrictions on people entering and exiting the city, in contrast to neighbouring cities.

Troubled vaccination progress

The EU had expected 90 million doses of the Oxford/AstraZeneca vaccine by the end of March, but AstraZeneca said it could only provide 30 million doses due to production problems and export restrictions. News that Italy blocked the export of 250,000 doses of the AstraZeneca vaccine to Australia has sparked considerable controversy and tainted the EU's image abroad. Meanwhile, Austria, Latvia, the Czech Republic, Bulgaria, Croatia, and Slovenia officially complained that EU vaccine distribution was disproportionate to their populations and raised their concern that some EU nations "would be able to reach herd immunity in a few weeks while others would lag far behind". Meanwhile, a number of European countries suspended the rollout of the Oxford/AstraZeneca vaccine over concerns that the jab might be linked to blood clots.

By27th March, the EU has administered Covid-19 vaccine doses equivalent to 15.3% of the population. At this pace, it will inoculate less than 40% of the total population by the end of August. The stubbornly high Covid-19 infections and the long duration of lockdown measures are weighing on the eurozone economic recovery.

European stocks see gains amid global economic revival

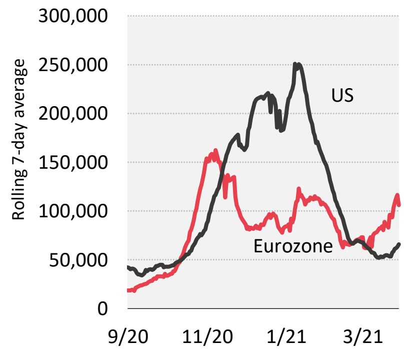
European shares gained with hopes of economic recovery, as international investors are seeking value stocks, with growing optimism about a swift economic recovery following an acceleration in vaccination progress by countries such as the US and UK. These stocks are considered to be trading below what they are worth, having been been hit hard by the pandemic and being sensitive to the economic cycle. According to the Wall Street Journal, the Stoxx 600 Index has financial companies weighting at 17%, industrials at 16%, and energy companies at 5%. Its weighting for technology communications is 10%, much lower than the 37% for the S&P 500.

The pan-European Stoxx 600 Index was up by 5.6% between end-February and 29th March. The German DAX Index was up 7.5%, while France's CAC Index was up 5.5%.

Government bond yields fall

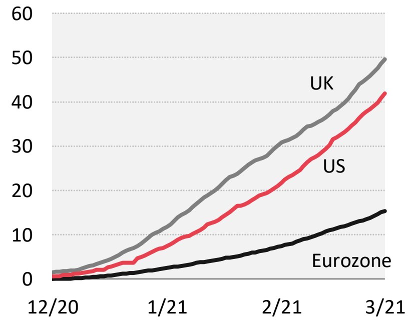
Eurozone government bond yields had been moving in parallel with rising yields of benchmark US Treasuries, but this ended after a monetary policy meeting of the European Central Bank (ECB). The ECB maintained interest rates unchanged, while stating that it would accelerate purchasing under its EUR 1.85 trillion bond-buying programme in Q2, after a slow rate of purchases in Q1, a move designed to counter the recent surge in bond yields. This surprise announcement provided clear guidance to the market, and eurozone bond yields fell as a consequence. By 29th March, German 10-year government bond yields had fallen to -0.318%, down from -0.26% at end-February.

Covid-19 Daily Confirmed Cases



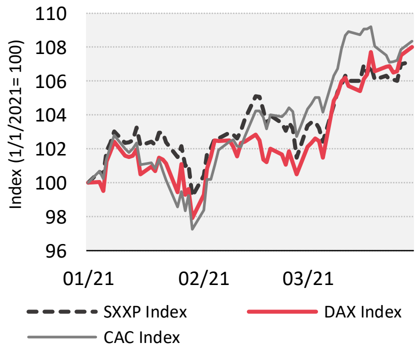
Source: Bloomberg, data as at 30/3/2021

EU Covid-19 Vaccine Doses per 100 People



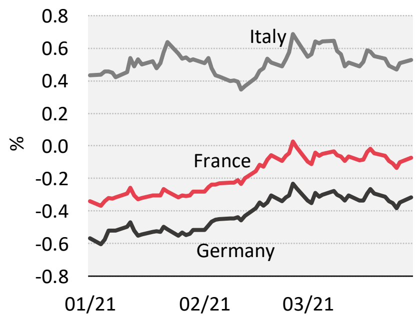
Source: Our World in Data, data as at 30/3/2021

Stock Market Indices



Source: Bloomberg, data as of 29/3/2021

10-Year Government Bond Yield



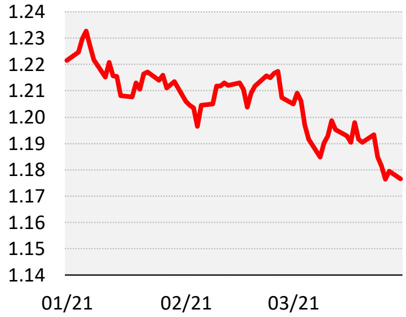
Source: Bloomberg, data of at 29/3/2021

By 29th March, the extra yield demanded by investors to hold 10-year Italian bonds rather than their German equivalents was about 0.85 percentage points, down from 0.9 percentage points at end-February.

Euro weakens as US dollar strengthens

The euro had dropped by 2.6% against the US dollar as of 29th March and was trading at USD 1.1765, compared with USD 1.2075 as at end-February. The fall was mainly due to the strong US dollar, with the USD index reaching 92.944 on 29th March. The market is again worried about rising inflation fuelled by economic recovery and large-scale fiscal stimulus in the US, pushing the US 10-year Treasury bond yield to rise above 1.7%, its highest in more than a year.

Euro against USD



Source: Bloomberg, data as of 29/3/2021

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