Week Ahead Economic Preview

Global overview

- **European Central Bank meeting**
- **US consumer sentiment and inflation**
- **UK Budget and GDP update**
- **German industrial health update**
- **IHS Markit Global Business Outlook Survey**

After worldwide PMI surveys showed the global economy contracting at the steepest rate since 2009 as the coronavirus disrupted supply chains and hit sectors such as travel, tourism and transport, markets will be watching keenly for remedial (or insurance) policy action from central banks and governments, either via fiscal or monetary stimulus.

With the US Fed cutting rates by 50 basis points in response to the developing outbreak, the coming week sees eyes turn to the European Central Bank's policy meeting. Room for policy manoeuvre is more limited in Europe than the US, but we expect an enhancement of liquidity provision, a 10bp deposit facility rate cut and a modest increase in the monthly pace of net asset purchases to be announced. There's a risk, however, that the Governing Council may struggle to agree on such a comprehensive package of measures.

Europe also sees some key data out of Germany which will add insight into the health of the eurozone's largest industrial sector at the start of the year, while in the UK the government sets out its post-Brexit spending and tax plans in its Spring Budget (page 4).

In the US, consumer confidence data are the pick of the bunch, highlighting the degree to which the coronavirus has affected households' willingness to spend. Inflation numbers are also updated, and should show price pressures easing (see page 3).

In Asia, investors will seek to gauge the potential of production recovery in mainland China by assessing the speed to which firms restart work. Data highlights include Taiwan's trade statistics, industrial output in India and Malaysia, inflation figures in mainland China and India, plus Japan's machinery orders (page 5).

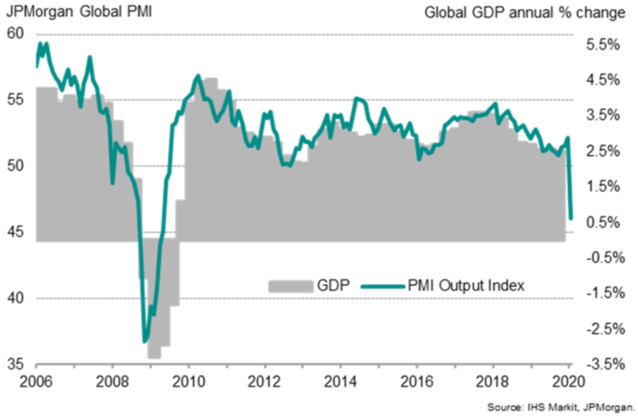
IHS Markit's triannual Global Business Outlook Survey will meanwhile provide insights into firms' expectations for the year ahead. Data were collected in late-February and will be published on Monday.

Special reports

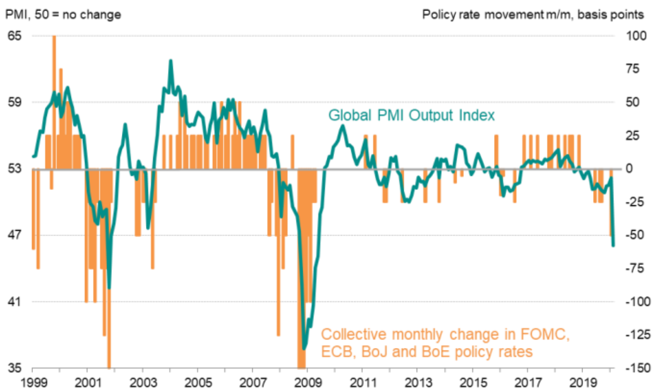
COVID-2019: COVID-19: Assessing the impact on manufacturing and services industries in China and the Asia-Pacific region. (**page 6**).

ECB: A look at the ECB's likely response to the COVID-19 outbreak, for which we expect the ECB to announce a package of measures on 12th March, including additional liquidity provision, a lower deposit facility rate and a step-up in the pace of net asset purchases (**page 11**)

IHS Markit's PMI surveys showed the global economy slumping at steepest rate since 2009 as the coronavirus hit supply chains and demand



Markets will be eagerly awaiting news from central banks and governments – notably the European central bank – on the policy response to the virus outbreak



Sources: IHS Markit, JPMorgan.

Chris Williamson

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Key diary events (UTC)

Monday 9 March

Japan Eco watchers survey (Feb)

Germany trade balance, industrial production (Jan)

Taiwan trade (Feb)

Tuesday 10 March

Worldwide release of IHS Markit Business Outlook surveys (Feb)

Australia business confidence (Feb)

Philippines trade (Jan)

China inflation (Feb)

France and Italy industrial production (Jan)

Euro area GDP, employment change (3rd Est, Q4)

Brazil industrial output (Jan)

South Korea unemployment rate (Feb)

Australia consumer confidence (Mar)

US democratic delegates voting

Wednesday 11 March

UK trade balance, industrial output, GDP (Jan)

UK Spring Budget 2020

Brazil inflation (Feb)

US inflation (Feb)

Thursday 12 March

Singapore jobless rate (Final, Q4), retail sales (Jan)

Euro area industrial output (Jan)

India industrial output (Jan), inflation (Feb)

ECB monetary policy decision

Friday 13 March

Malaysia industrial output, unemployment rate (Jan)

China vehicle sales, FDI (Feb)

India WPI (Feb)

Germany, France and Spain inflation (Final, Feb)

BoE FPC meeting

US Michigan consumer surveys (Mar)

Sat-Sun 14 – 15 Mar

15/3: Japan machinery orders (Jan)

15/3: France local elections

15/3: Germany regional elections

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United States Week Ahead

Inflation and IHS Markit Business Outlook

By Siân Jones
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The impact of the coronavirus outbreak on markets and the potential to dent economic growth pushed the FOMC to invoke an emergency rate cut. Recently published PMI data signalled a shock to the private sector, with activity dropping into contractionary territory for the first time for over six years in February. As such, the publication of business and consumer optimism will be watched with greater interest as uncertainty grows. Inflation data are also updated.

Inflation

The rate of consumer price inflation quickened for the fourth successive month in January to reach the fastest since October 2018. Price increases are, however, expected to soften in February. As signalled by recently released PMI data, the rate of inflation is set to ease closer to the 2% mark midway through the first quarter. Anecdotal evidence from the surveys suggested moderated inflationary pressures stemmed from less robust rises in input prices despite supplier shortages and delays. Core inflation (excluding volatile items such as food and energy), at 2.3%, is predicted to be broadly unchanged in February.

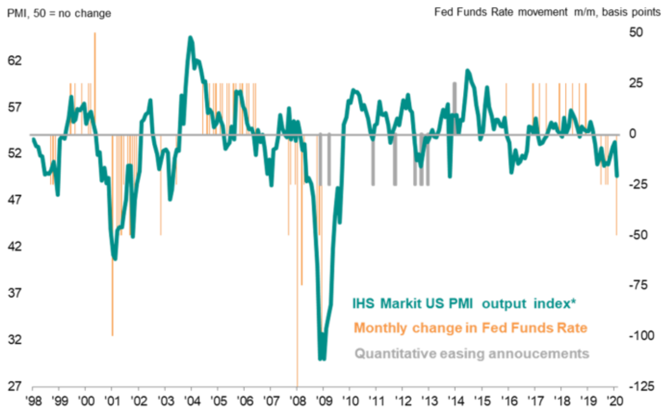
Sentiment surveys

The impact of the coronavirus outbreak will be keenly watched for in the University of Michigan consumer confidence surveys, especially as consumers have played an important role in sustaining US economic growth in recent months.

Also released are the latest IHS Markit Business Outlook data. The escalation of the coronavirus outbreak across the globe is likely to weigh on US firms' expectations for the coming 12 months. October 2019 data pointed to a reduction in optimism amid global trade tensions, a tight labour market and the upcoming election. February PMI data indicated a slight uptick in positive sentiment across the U.S. private sector amid hopes of an uptick in client demand. Nonetheless, the degree of confidence was historically muted and well below the series trend, suggesting sentiment may still be weighed down by challenging external demand conditions.

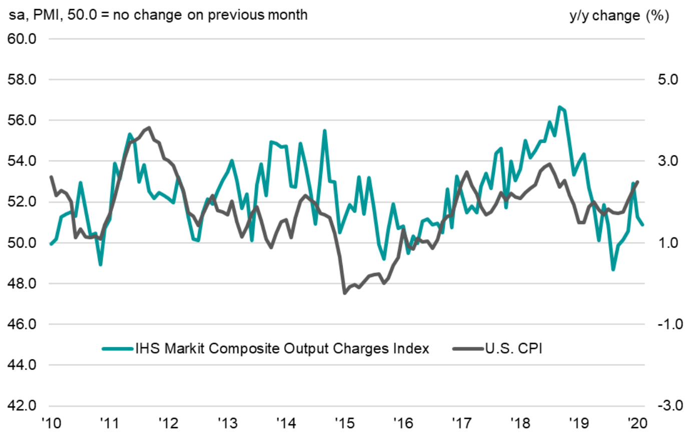
Updates to jobless claims, producer prices and export and import prices are also released.

FOMC rate cut comes alongside worst private sector performance for over six years



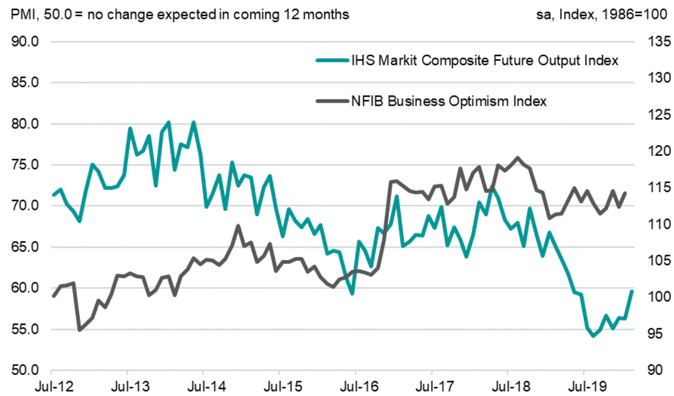
Sources: PMI uses IHS Markit post-2007 and ISM pre-crisis, Federal Reserve.

Inflationary pressure set to soften in February



Sources: IHS Markit, Bureau of Labour Statistics, U.S. Department of Labour

Business confidence relatively subdued amid ongoing uncertainty



Sources: IHS Markit, NFIB

Economic Research

9 March 2020

Europe Week Ahead

ECB meeting, UK GDP, euro area industrial output

By Joe Hayes

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Markets will look to the ECB for pledges of additional stimulus to insure against the economic impact of COVID-19 in the week ahead. UK GDP data for January are also due, as is the Spring Budget, which is expected to deliver an expansionary message. Elsewhere, signs of a rebound in industrial output data at the start of the year for the eurozone will be expected following December's severe decline.

European Central Bank

As we will explain in more detail in our special report this week, we expect the ECB to announce a package of measures at its next meeting in response to the COVID-19 outbreak, including additional liquidity provision, a lower deposit facility rate and a step-up in the pace of net asset purchases.

UK GDP

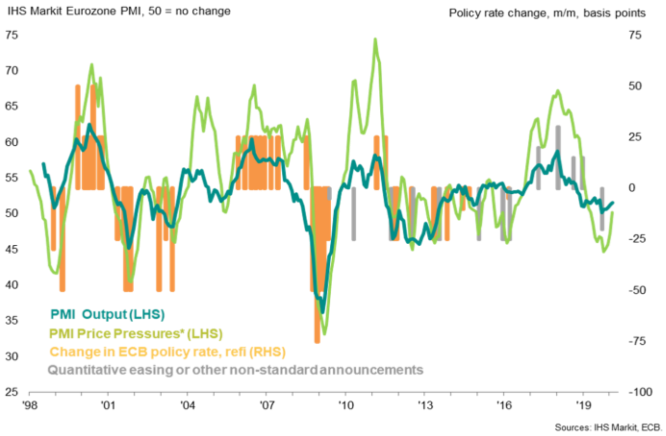
The UK has enjoyed a sustained recovery in economic activity so far in 2020, according to our PMI data. As such, the monthly GDP estimate for January looks set to solidify expectations of a return to economic growth in the first quarter. That said, while the COVID-19 outbreak at the time of writing has yet to significantly disrupt domestic activity in the UK, the impact on tourism, export demand and supply chains poses a threat to second quarter growth.

The Spring Budget will also be eagerly awaited in the UK. Expansionary fiscal policy will be expected given the conservative party's pre-election pledges and talk of a "Brexit dividend".

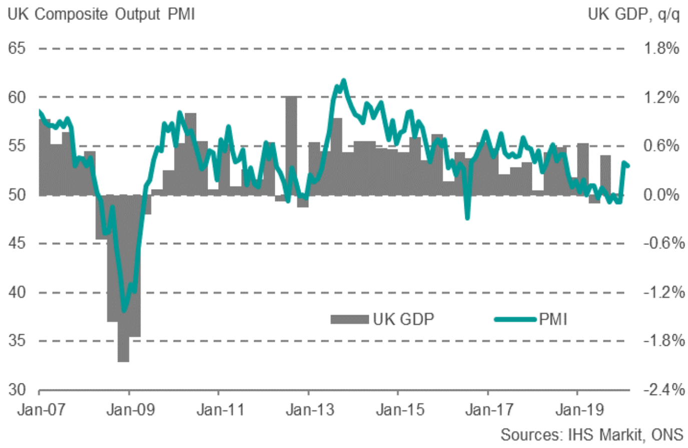
Eurozone industrial production

Severe weakness in manufacturing output at the end of last year came as a surprise given PMI data showing the industrial downturn had bottomed out (albeit continuing). However, we suspect that calendar-related distortions in Germany over the festive period have likely overstated the weakness, therefore opening the door for some compensating rebound in January. However, the downside risks for the eurozone's industrial sector have since picked up due to supply chain disruptions and the external demand shock from lower exports to China.

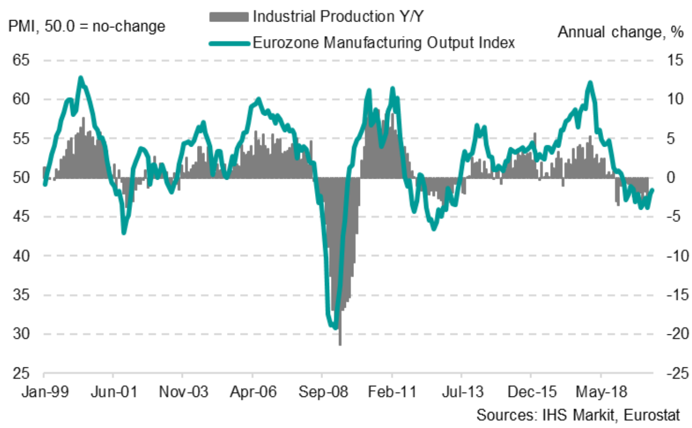
Despite Eurozone PMIs moving higher, the ECB could launch fresh stimulus to combat COVID-19 impact



UK economy has bounced back in 2020, boding well for first quarter growth prospects



Eurozone manufacturing downturn continued to ease



Economic Research

9 March 2020

Asia Pacific Week Ahead

Markets eye COVID-19 developments after Asia PMI series signal decline

By Bernard Aw

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With a relatively thin data calendar across Asia Pacific next week, markets will monitor further developments in the coronavirus situation after PMI data showed Asian manufacturing suffered the steepest downturn since 2009 due to the virus's impact on activity and demand. Investors will also keenly gauge the potential of production recovery by assessing the speed to which China's industrial firms restart work. IHS Markit's triannual business outlook surveys, in particular China, Japan and India, will also provide insights into private sector views about future activity. Data highlights in Asia include Taiwan's trade numbers, industrial output in India and Malaysia, inflation data in mainland China and India, plus Japan's machinery orders.

China data

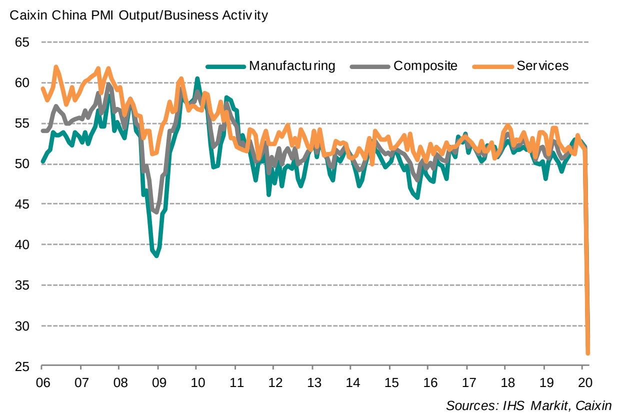
With Caixin surveys signalling a sharp deterioration in Chinese manufacturing conditions amid factory shutdowns and travel restrictions during February, analysts are anxious for more clues as to the health of the economy. In that respect, February updates to inflation and vehicle sales will be released, with the latter likely to reflect the effects of factory and dealership shutdowns, as only 37% of dealers resumed operations by 24th February.

Taiwan exports and Asian factory output

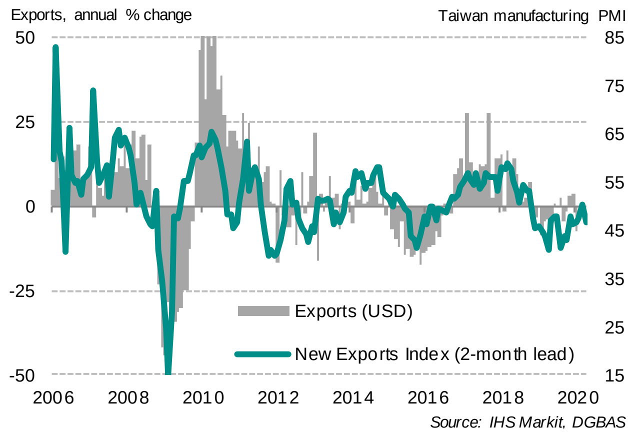
Export numbers in Taiwan, widely seen as a barometer of regional trade (particularly in electronics) will be scrutinised for clues on the state of Asian trading conditions amid the virus outbreak. Latest Taiwan PMI surveys continued to point at a soft export trend in the economy during February. In addition, coronavirus-related disturbances had led to supplier delivery times lengthening at the fastest pace for just over 14 years, contributing to a marked decline in output, owing in part to material shortages.

The January update to industrial output for Malaysia and India will be released in the same week. India had been relatively unscathed in February from the virus outbreak, being one of the handful to report manufacturing output growth. PMI results showed India maintaining a strong manufacturing sector expansion in February, benefitting from order book growth both home and abroad.

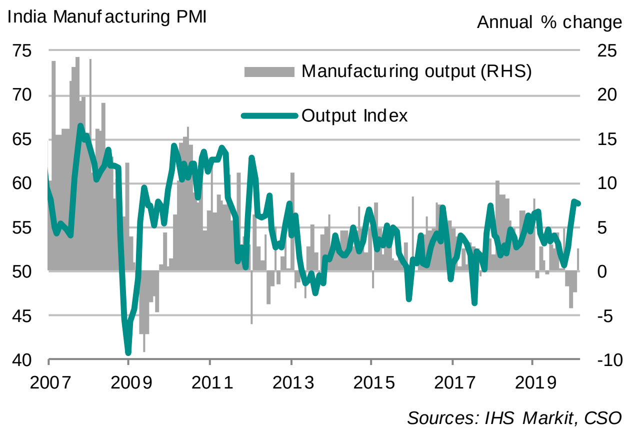
Caixin PMI signal record falls in Chinese business activity during February on coronavirus impact



Taiwan PMI and exports



India PMI and manufacturing production



Asia Pacific Special Focus

COVID-19: Assessing the impact on manufacturing and services industries in China and the Asia-Pacific region

By Rajiv Biswas
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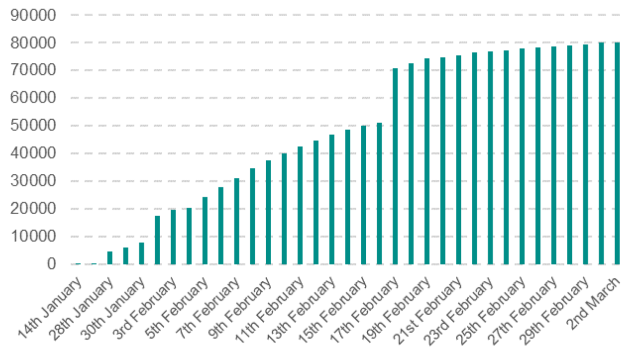
The outbreak of the COVID-19 epidemic in Wuhan in January 2020 has developed into a major economic shock to the Chinese economy and the broader Asia-Pacific region. Latest PMI survey data for manufacturing and services industries in the Asia-Pacific region have highlighted a significant contraction in business activity during February 2020, led by a record slump in output and new orders at China's factories due to their extended closures during the first half of February. The escalation of new COVID-19 cases in South Korea in recent weeks also increased fears that the COVID-19 epidemic may become more protracted and widespread, creating wider economic shockwaves in other Asia-Pacific economies.

COVID-19 impact on China's economy

The rapid escalation of COVID-19 cases in China during late January and early February has triggered considerable disruption of consumer spending as well as industrial production in China. The total number of confirmed coronavirus cases in China had reached 80,174 by 3rd March 2020. The number of confirmed cases is thus now already 15 times greater than the total number of SARS cases recorded in mainland China during that epidemic in 2003 (5,327 persons according to the WHO).

The virus has already caused significant negative shockwaves in the Chinese economy, affecting industrial production, retail trade, tourism and transport. In addition to restricting public transport movements in and out of certain badly impacted cities such as Wuhan, China has also banned all group-tourism travel sales by travel agencies in China for travel both within and outside of China, effective from 27th January. Chinese consumer spending has also been hit hard, with retail stores, restaurants, entertainment, tourism and aviation badly affected.

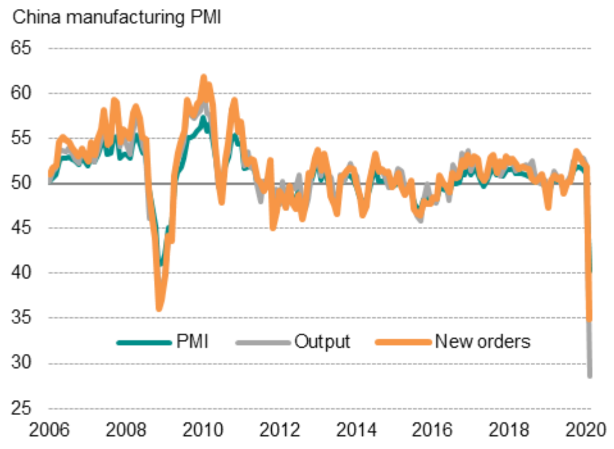
COVID-19 cases in China



*lab confirmed until 16th Feb, all diagnosis after
Source: IHS Markit, Chinese Government, UNWHO

Furthermore, China's State Council extended the Lunar New Year holiday period, originally scheduled from 24th to 30th January, until 10th February 2020. Although offices and factories have been gradually reopening in most provinces starting from 10th February, re-openings have been delayed even further in some of the worst-affected areas, notably Hubei Province at the centre of the epidemic.

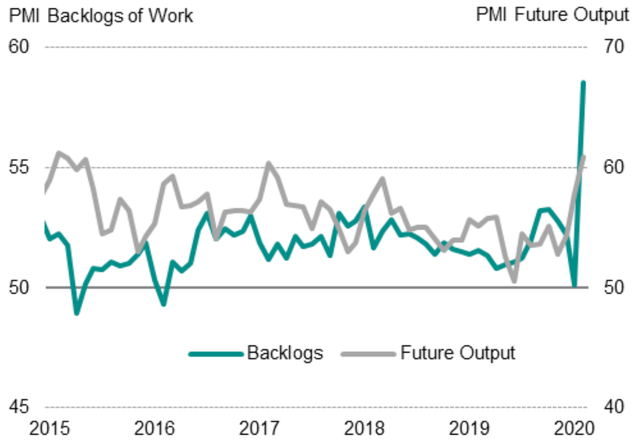
Caixin PMI showed Chinese manufacturing conditions worsening sharply amid factory shutdowns and travel restrictions



Sources: IHS Markit, Caixin

The COVID-19 outbreak had a severe impact on China's manufacturing sector in February due to the efforts made to contain the spread of the coronavirus, according to the latest Caixin PMI data (compiled by IHS Markit). Extended Lunar New Year work suspensions and factories operating well below capacity caused production volumes and new order intakes to plunge at survey-record rates. Supply chains were disrupted as a result, causing backlogs of work to accumulate sharply. However, firms anticipate a rebound of output in coming months, as firms gradually restore productive capacity during March. This was indicated by the Future Output Index, a measure of business confidence, rising to a five-year high.

Chinese manufacturers expect a rebound in output once coronavirus-related restrictions are lifted



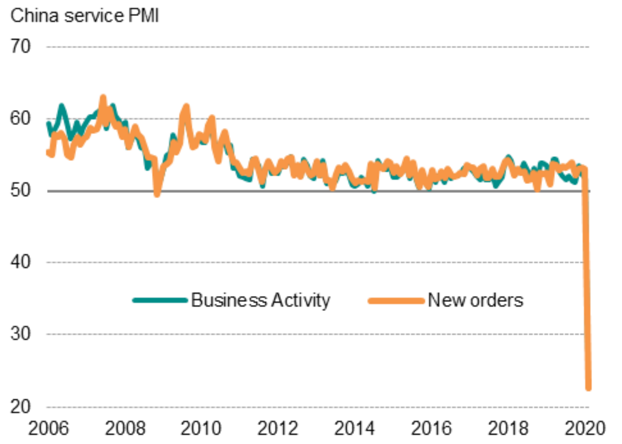
Sources: IHS Markit, Caixin

A key industrial sector that has been badly hit by the delayed restart of manufacturing production is the automotive sector. Supply chain disruptions due to the extended closure of Chinese plants producing auto parts have also begun to disrupt auto production in other countries. Hyundai Motor Co temporarily closed some car production lines in South Korea, and Nissan temporarily closed its operations in Kyushu, Japan, because of supply chain disruptions of auto parts from China.

With consumption spending having become the most important growth driver for the Chinese economy in recent years, recent survey data highlight the extent to which the negative impact on consumer confidence represents a key near-term risk if the coronavirus epidemic is not brought under control soon. The headline activity index from the Caixin China General Services PMI fell over 25 index points from 51.8 in January to 26.5 in February. This marked a sharp decline in business activity that was also the first recorded since the survey began over 14 years ago. The vast majority of panel members identified the outbreak of the coronavirus as the key driver of reduced activity, with firms facing extended company closures after the Chinese New Year and strict travel restrictions.

As had been the case seen in the manufacturing sector, the amount of uncompleted work at Chinese service providers rose at a survey-record pace. However, business confidence was down to a survey low, hinting that the effects of the virus outbreak may be longer lasting in the service sector than manufacturing.

Coronavirus outbreak leads to record drop in Chinese services activity and demand



Sources: IHS Markit, Caixin

Economic impact on the APAC region

The negative impact on the global economy and rest of the Asia-Pacific region from such a severe shock to the mainland Chinese economy will be much greater today than during the SARS epidemic in 2002–03. Mainland China's economy was the sixth largest in the world in 2002, accounting for 4.2% of world GDP; it is now the second-largest economy in the world, accounting for 16.3% of world GDP. In 2002, China contributed 23% of world GDP growth, while in 2019 China contributed an estimated 38% of the world's growth.

In the past two decades, the rapid economic growth of China has made it a key export market for many Asia-Pacific nations. However, China's growing importance in Asia-Pacific trade and investment flows has also created considerable vulnerability for the Asia-Pacific region to this type of unpredictable "black swan" event.

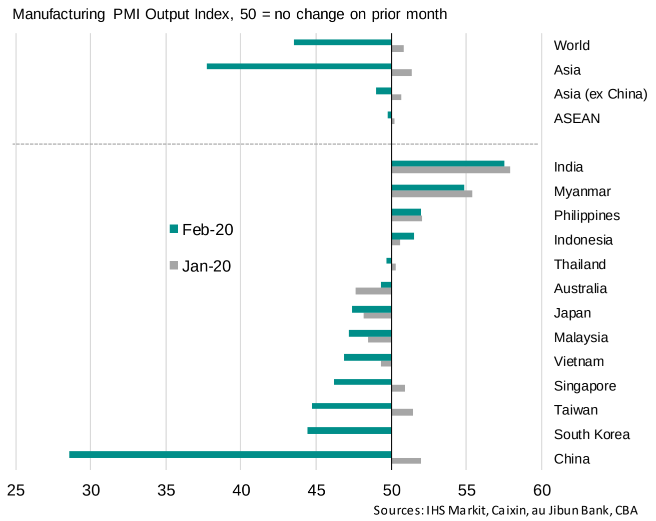
The negative shock waves to the rest of APAC from a significant slowdown in mainland China's economic growth rate in 2020 would be severe, as many APAC economies are heavily reliant on China as a key export market for goods and services.

Indeed, February PMI data showed Asia manufacturing contracting at the fastest rate for nearly 11 years as the coronavirus epidemic disrupted supply chains and hit demand. The Asia manufacturing PMI, compiled from IHS Markit's surveys in 13 markets in Asia, fell to its lowest since the depths of the global financial crisis, signalling a steep deterioration in the health of Asian manufacturing. Both output and new orders across Asia fell at even sharper rates than the headline PMI, with the latter in part reflecting the largest drop in Asian export sales for over 10 years.

The manufacturing downturn signalled by the PMI surveys was led by the record slump in activity at China's factories. If we exclude China from the calculations, the Asia manufacturing PMI merely fell marginally, indicating stagnation rather than a decline.

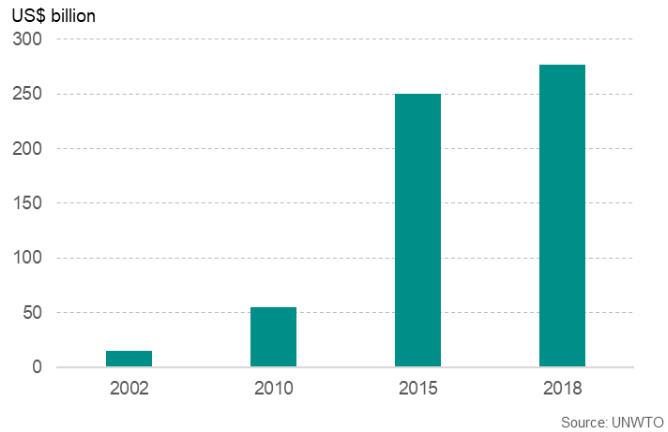
That said, anecdotal comments from the PMI surveys highlighted that production has yet to restart or running well below capacity at many firms towards the end of February. The prospect of a protracted disruption to supply chains bodes ill for production in many countries around the Asia Pacific region and globally.

Manufacturing PMI across Asia Pacific

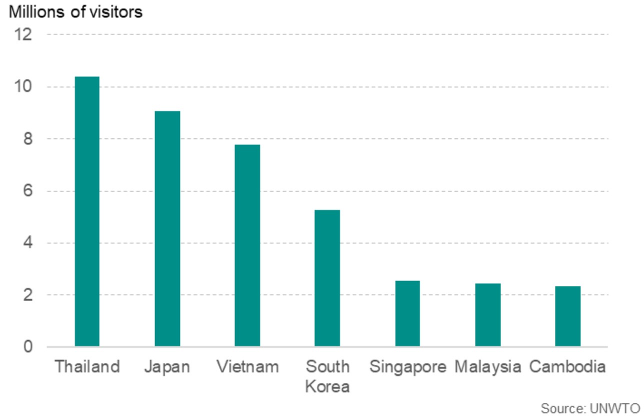


Tourism meanwhile is one of the key transmission channels for this negative economic shock, due to the high dependency of many APAC markets on tourism visits from mainland China. Other transmission channels include supply chain linkages within APAC, and falling import demand for major commodities like coal, oil, and base metals from the world's largest customer for those products.

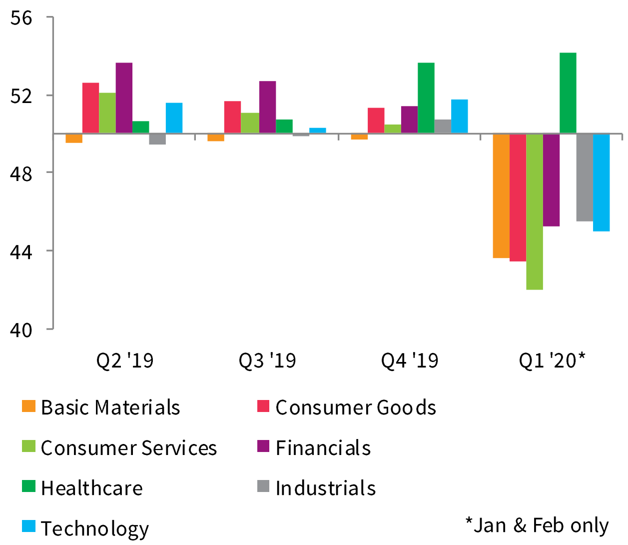
Mainland Chinese International Tourism Spending



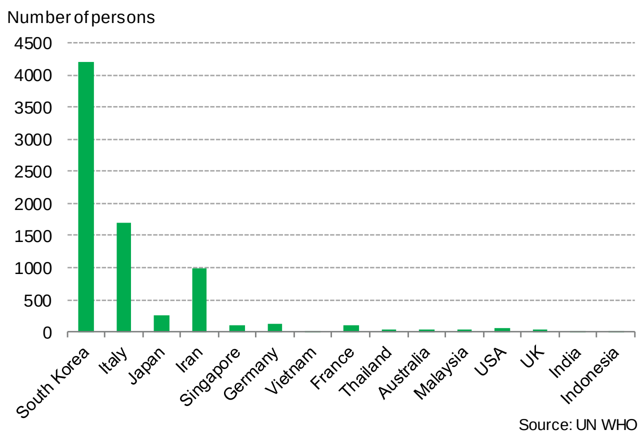
Top APAC destinations for Chinese tourism, 2018



Asia Sector PMI showed Consumer Services the worst performing sector so far Q1 as the COVID-19 outbreak hits tourism.



Global COVID-19 cases to 2nd March 2020



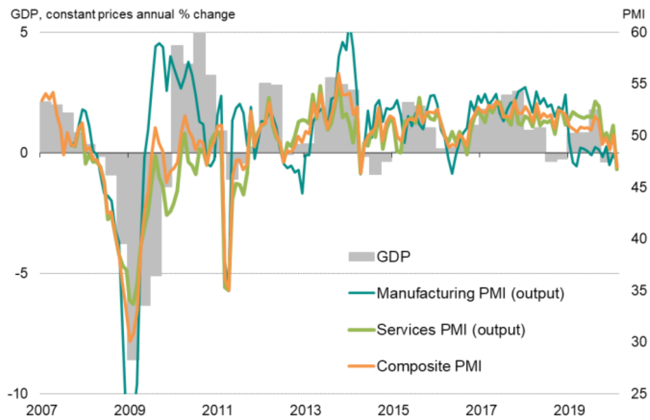
The widening number of COVID-19 cases in other countries worldwide has also increased the potential negative shocks to global and APAC growth from the coronavirus epidemic. Globally, the number of confirmed coronavirus cases reported outside mainland China had reached 8,774 as of 2nd March 2020, with cases having been identified in a growing number of countries around the world.

Governments in the APAC region are continuing to roll out new defensive measures such as travel bans to limit the spread of the virus. Many nations have completely banned the entry of visitors from China, including Australia, India, Indonesia, Singapore, and New Zealand. Some APAC countries have put in place more limited restrictions on travel from China, including Malaysia and Thailand.

Besides the severe implications for travel and tourism industry in the APAC region, the economic implications of the coronavirus epidemic also relate to the key role that mainland China plays in the global economy today as a major export market and a key supplier and intermediary in many global supply chains. Due to the rapid growth of exports from many Asia-Pacific economies to mainland China over the past decade, any significant slowdown in Chinese economic growth will have negative transmission effects to the rest of the APAC region. Among APAC economies, Hong Kong SAR, Australia, Taiwan, Singapore, South Korea and Japan have the highest share of total exports into the mainland Chinese market, and therefore are potentially the most vulnerable to a slowdown in China's economic growth.

Japan, which is the second largest economy in the APAC region after China, had already been experiencing an economic downturn even before the COVID-19 epidemic. In Q4 2019, Japanese GDP contracted by 1.6% quarter-on-quarter, mainly due to the impact of the consumption tax hike from 8% to 10% in October 2019.

Japan PMI signals deepening downturn



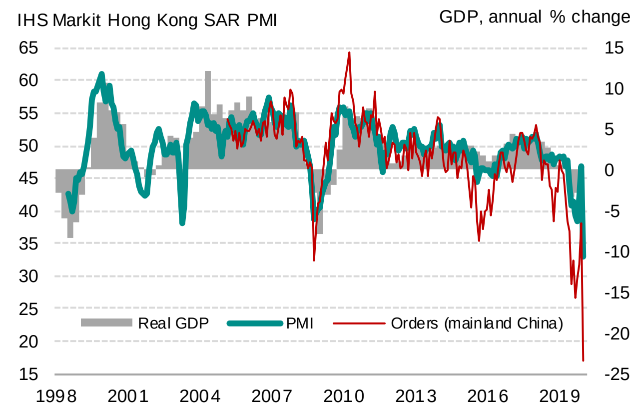
Sources: IHS Markit, Jibun Bank

With China being a key export market for Japan, accounting for 19% of total Japanese exports, the massive economic shock to Chinese consumption and industrial production in Q1 2020 has hit Japan's export orders as well as its tourism economy, with China having become the most important source of international tourist visits in recent years.

The initial impact of the COVID-19 outbreak appears to have hit Japan's service sector activity the hardest. Services companies in Japan have not recorded such a drop in output since April 2014, when the consumption tax hike to 8% took effect. New business fell sharply in February 2020, as Chinese tourism visits slumped. In some cases, firms reportedly closed their stores as incoming workloads were insufficient.

Amongst other East Asian economies, both the Hong Kong SAR and the Singapore PMIs slumped in February, as the coronavirus outbreak severely hampered distribution networks, reduced export demand and heightened uncertainty among domestic clients.

Hong Kong SAR PMI signals deepest economic slump on record amid coronavirus impact



Sources: IHS Markit, C&SD

Monetary policy response

A number of APAC central banks and governments have already rolled out monetary and fiscal policy stimulus measures to mitigate the impact of the COVID-19 epidemic on their economies.

The People's Bank of China has implemented a number of monetary policy stimulus measures, including having lowered the seven-day reverse repo rate to 2.0% from 2.50% on 3rd February. Bank Indonesia cut its policy rate by 25 basis points (bps) on 20th February to help mitigate the impact of the COVID-19 economic impact on Indonesia's external sector, notably on exports of commodities and tourism. Bank of Thailand also cut its policy rate by 25bps on 5th February due to the significant economic shock expected from lower tourism visits to Thailand.

Both the Reserve Bank of Australia and Bank Negara Malaysia cut their policy rates by 25bps on 3rd March, to help support their economies from the external shock to exports from the COVID-19 epidemic and China's sharp slowdown in the first quarter of 2020.

The decision by the US Federal Reserve to cut the Fed Funds rate by 50bps on 3rd March 2020 is expected to facilitate a further round of monetary policy easing by a number of APAC central banks in coming weeks.

Fiscal measures

On the fiscal policy front, several APAC governments have already announced budget stimulus packages to mitigate the impact of the coronavirus, with other governments in the region expected to act soon to help dampen the negative shock from the COVID-19 epidemic.

As the COVID-19 epidemic escalates in South Korea, the government announced a USD 9.8 billion supplementary budget stimulus package on 4th March. The package includes significant new funding for healthcare spending measures to contain the epidemic.

In response to the COVID-19 economic shock, which has occurred at a time when the Hong Kong SAR economy was already in recession, the Hong Kong Special Administrative Region (SAR) government announced a record high budget deficit for the 2020 fiscal year in its Budget on 26th February. The fiscal deficit is projected to reach 4.8% of GDP in for the fiscal year to end March 2021.

The Singapore government announced a range of measures in its annual Budget on 18th February 2020, to help mitigate the impact of the coronavirus economic shock, pushing the projected fiscal deficit for 2020 to SGD 10.9 billion, compared with SGD 1.7 billion deficit in 2019. Singapore's Ministry of Trade and Industry (MTI) downgraded its GDP forecast for 2020 to a range of -0.5% to +1.5% due to the economic impact of the COVID-19 epidemic.

The Thai Finance Ministry is preparing a new stimulus package to help boost tourism, investment and consumption. The package is expected to be proposed to the Thai Cabinet in mid-March, and if approved, implemented by April.

The Malaysian government announced a Ringgit 20 billion stimulus package in its February 2020 Budget, including a wide range of measures to assist industries hit by the economic impact of the COVID-19 epidemic. The government's GDP growth target was lowered to a range of 3.2% to 4.2%.

Near-term outlook

The rapidly escalating COVID-19 epidemic poses a significant downside risk to the near-term Asia-Pacific economic outlook in 2020, particularly if the epidemic continues to spread to other Asia-Pacific economies and escalates in other regions in coming weeks. A key risk to regional trade is from the transmission effects to the Asia-Pacific supply chain from weaker Chinese economic growth momentum in the first half of 2020, since mainland China is by far the largest economy in the Asia-Pacific region.

Several key service sector industries in the Asia-Pacific region, notably tourism and travel, are already being severely hit, as Chinese outbound tourism has slumped sharply. The retail trade, restaurants, and entertainment sectors are also highly vulnerable to a downturn in consumer confidence, as consumers become more apprehensive about coronavirus contagion risks. However, online sales, which have already been growing very rapidly in many Asian economies during recent years, notably in China, are expected to be strongly boosted while the epidemic persists.

In South Korea, the escalating epidemic also could hit consumer spending in the near-term, posing a significant risk to the 2020 economic outlook.

For many global multinationals, the severe disruption of China's industrial output during February has highlighted the vulnerability of their global supply chains to excessive reliance on China. The experience of the coronavirus epidemic will likely further accelerate efforts over the medium-term by global firms to diversify their supply chains to other manufacturing hubs in Southeast and South Asia, including Vietnam, Thailand, Indonesia and India, as well as to other major emerging markets manufacturing hubs, notably Brazil and Mexico. As occurred during the US-China trade war when high US tariffs on Chinese goods triggered trade diversion, the protracted shutdown of Chinese factories will also encourage global manufacturers to increase production from their plants in other manufacturing hubs worldwide while Chinese output is disrupted

Europe
Special Focus

Eurozone: ECB policy easing on the way, but how much and how soon?

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We expect the ECB to announce a package of measures on 12th March, including additional liquidity provision, a lower deposit facility rate (DFR) and a step-up in the pace of net asset purchases.

This will mitigate some of the financial market spillover effects but given the nature of the COVID-19 shock, it will make little difference to the near-term fall-out on the eurozone economy. Sentiment data will tumble from March, with a contraction in GDP to follow.

ECB opens the door

The commentary from the ECB has shifted markedly in tone recently given the increase in the spread of the COVID-19 virus and the potential economic and financial fall-out. The initial scepticism over the questionable effectiveness of monetary policy in the current circumstances has been superseded by an eagerness to demonstrate a willingness to act, reflected in the ECB's unusual decision to publish a statement by president Christine Lagarde on 2nd March (see below).

> ***Statement by the President of the ECB***
>
> 2nd March 2020
>
> *The coronavirus outbreak is a fast developing situation, which creates risks for the economic outlook and the functioning of financial markets. The ECB is closely monitoring developments and their implications for the economy, medium-term inflation and the transmission of our monetary policy. We stand ready to take appropriate and targeted measures, as necessary and commensurate with the underlying risks.*
>
> *As the situation is indeed fast moving, policy options were left open. Still, the references to "appropriate and targeted measures" were noteworthy. The statement could have repeated the mantra that the ECB "continues to stand ready to adjust all of its instruments". That it did not suggests some reluctance to deploy all tools, probably reflecting the reluctance of some Governing Council members to sign up to additional unconventional measures and uncertainty about their effectiveness, with fiscal stimulus seen as a more appropriate response.*

The term "targeted" hints that liquidity assistance will be prominent, with the ECB likely to make some enhancements to its "targeted long-term refinancing operations" to account for the severity of the shock to parts of the eurozone (including small businesses).

The broader question is whether the ECB will stop there. While we expect more than just liquidity-focused measures to be announced on 12 March, we do acknowledge the risk that the ECB might only respond to the shock in stages. Given internal divisions, it could favour waiting a little longer to accumulate more evidence of the economic and financial impact.

The pros and cons

There are numerous arguments being made against the ECB easing policy beyond liquidity-based measures at March's meeting. These include:

- Monetary policy cannot fix a supply-side shock. Fiscal policy would be a more appropriate response for various reasons.
- There is little room for manoeuvre on policy rates and asset purchases without inflaming tensions on the Governing Council.
- The new president favours a consensus-driven approach. Plus, she may be diverted by other matters, including the monetary policy strategy review.
- Declines in equity markets matter less to eurozone household sector behaviour than in the US and UK.
- Central banks ought to refrain from intervening every time equity markets correct, given moral hazard concerns.
- The sense of alarm rattling markets will subside but it will be difficult to take back the additional policy accommodation once delivered.
- The eurozone economy has been on an improving trajectory and survey data to February have been resilient so far (see first chart). Underlying inflation has also been picking up.
- More time is needed to properly assess the economic and financial outlook.

Some of these arguments have merit, not least that the nature of this shock means that monetary policy is clearly not going to be a panacea. That said, there are various counter arguments in favour of a swift, broad-based monetary policy response which we feel tip the balance in favour of imminent action. They include:

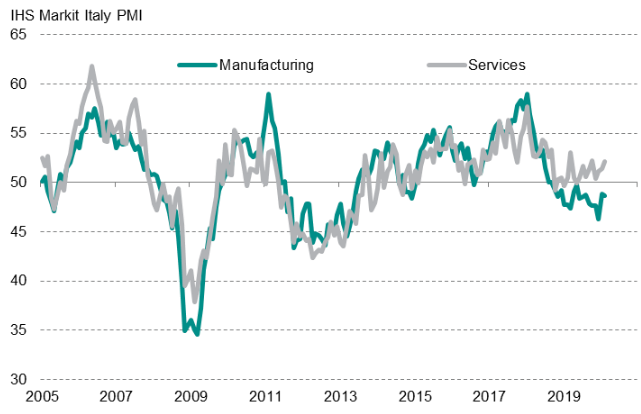
- There are costs associated with inaction irrespective of whether monetary policy is the most appropriate tool.
- Markets have priced in a swift response and disappointing those expectations will see equity prices tumble, risk premia rise and euro appreciation continue, tightening financial conditions.
- Fiscal responses are often slow and uncoordinated and there are significant constraints on fiscal space across many parts of Europe.
- The eurozone household sector may have a relatively low sensitivity to equity market gyrations but they matter to corporate sentiment and investment which has the capacity to exacerbate the likely slump in economic activity.
- The hitherto low growth rates in the eurozone leave it highly vulnerable to adverse shocks.
- Inflation expectations have started to slide from already uncomfortably low levels (see second chart).
- The ECB already has an easing bias in its forward guidance.
- If the economic outlook and risk distribution changes materially, majority support on the Governing Council can easily achieved.
- Monetary accommodation can complement other policy levers, shoring up confidence and preventing a negative feedback loop.
- Some of the additional policy stimulus (e.g. a higher pace of net asset purchases) can be swiftly unwound as the situation improves.

The timing

The long lists of pros and cons illustrate that our forecast that a package of measures will be announced on 12th March is not a straightforward call. That the policy meeting takes place so soon is a complication, given the lack of economic data available to gauge the economic effects.

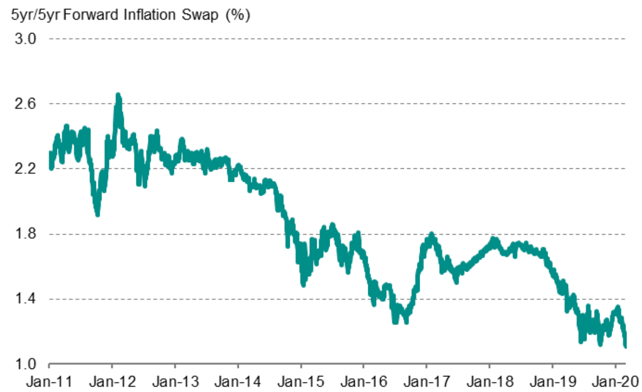
The latest available information – various surveys for February, including IHS Markit's PMIs – have been resilient, including in Italy where the spread of the virus, and containment measures, have been most intense. That said, the manufacturing PMIs showed clear signs of supply disruption in the near record-rise in supplier's delivery times (see chart) which artificially inflated the headline figures. Plus, even though the surveys have been holding up, they remain indicative of rather low growth rates in the eurozone.

Italian PMIs up to February resilient so far



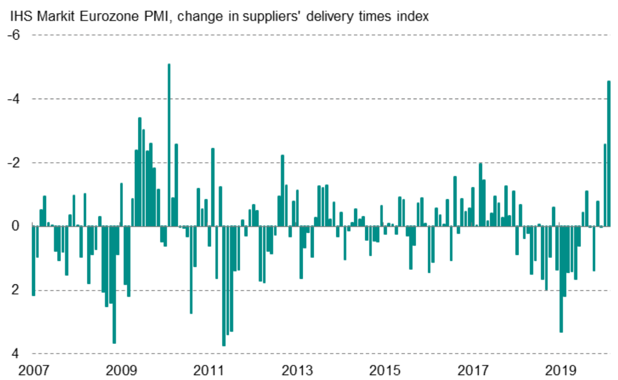
Source: IHS Markit

Worryingly low eurozone inflation expectations



Source: IHS Markit

Exceptional lengthening of suppliers' delivery times



Source: IHS Markit

Moreover, the situation has changed dramatically in the last few days and there are lags before the adverse news filters through to the survey and hard activity data. Given the likely spillovers from the extreme economic disruption in China, increasing difficulties elsewhere and the recent spread of the virus in Europe, sentiment is likely to tumble from March onwards.

March's ECB meeting will include another update and review of staff macroeconomic projections. But the cut-off point for the technical inputs to those projections is mid-February so they won't include the full effects of the shakeout in financial markets or the lower oil price. In effect, the new projections will be redundant before they are even published. Still, the ECB has had to deal with similar sequencing issues before and the preference has generally been to react to the evolution of the risks surrounding the projections rather than the projections themselves.

For several months now, the ECB has concluded that while risks to growth remain to the downside, they have become "less pronounced". The risk assessment is clearly going to have to change now, reinforcing the case for imminent action.

The FOMC's 50bp inter-meeting rate cut is also important. One perspective is that the underwhelming negative equity market reaction to the move should make the ECB wary of following suit. We doubt that this will be the dominant thinking, however. Rather, the ascent of the euro is adding to the pressure on the ECB to act (see fourth chart). As we have previously highlighted, the euro's already elevated level in trade-weighted terms raises the ECB's sensitivity to appreciation against the dollar and other dollar-linked currencies. The ECB's subsequent scheduled policy meeting is not until 30 April which implies a long wait absent inter-meeting moves (which the ECB has generally preferred to avoid).

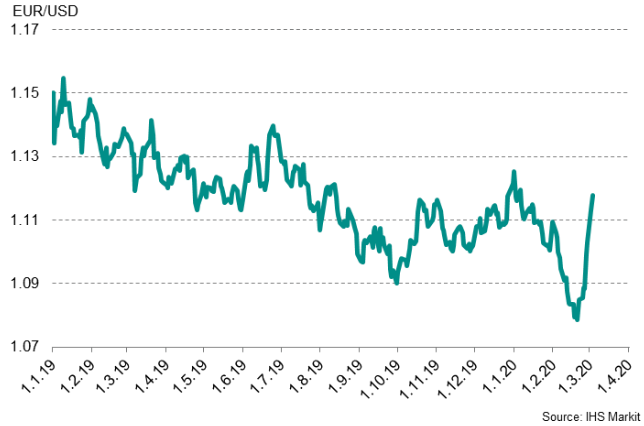
The method

Liquidity-related policies are the least contentious for the Governing Council to agree on and look very likely to be announced on 12th March in some form or other. But what about the other, more market-relevant options?

We continue to believe it is less contentious, on balance, for the ECB to agree to trim its deposit facility rate than to raise the pace of monthly net asset purchases. Lowering the DFR is not a straightforward decision, though, as the cost to banks threatens to damage the successful transmission of monetary policy. But September 2019's decision to introduce a tiering procedure allows the ECB to mitigate those effects by raising the amount of reserves which are exempt from the deeper negative interest rate.

Another potential constraint is the perception of other central banks that by pushing the boundaries of negative rates, the ECB is pursuing a policy of competitive devaluation. This is less of an issue, however, if the ECB is cutting by less than some other major central banks. All five DFR cuts below zero since 2014 have been of 10bp and we expect the same this time (to -0.60%). We also expect the easing bias to be maintained in the ECB's forward guidance.

Upward pressure on EUR/USD exchange rate



The arguments against stepping up the pace of monthly net asset purchases are varied but generally centre on objections to the blurring of boundaries between monetary and fiscal policy, adverse incentives for highly indebted governments to postpone necessary reforms, shortages of available assets and perceived legal constraints. Some of these objections could be overcome by a modest step up of the run-rate, however, from the current EUR20bn per month (by EUR10-20bn, say), though this would potentially dilute the market impact.

One tactical argument in favour of a higher pace of asset purchases is that this can be reversed relatively easily once the risks dissipate. This is harder to do with policy rates given the ECB's fear that an initial rate hike will be interpreted by markets as the first of a series. The ECB's forward guidance reduces that risk but makes it difficult to take a rate cut back quickly without the guidance becoming too complicated.

Another argument for additional asset purchases is to lean against the rise in sovereign yield spreads which is undermining effective monetary transmission. It would also provide more fiscal space, though this would be anathema to the Governing Council's hawks. On that issue, a decision to step up the run rate of monthly purchases is unlikely to secure unanimous support unless the economy is plunging and deflation risks have materially increased.

All things considered, we see a good case for the ECB both cutting the DFR and stepping up its asset purchases at the upcoming meeting. The risk though is that the broader the package of measures, the higher the level of dissent on the Governing Council. With the new president seemingly having a preference for consensus-building, this could lead to some measures being held back. If so, the likely adverse market reaction to a limited announcement on 12th March would cement the case for additional action subsequently.

The bottom line

We expect an enhancement of liquidity provision, a 10bp DFR cut and a modest increase in the monthly pace of net asset purchases (probably EUR10-20bn) to be announced on 12th March. We see a risk, however, that the ECB might fall short (temporarily), disappointing market expectations.

Even a wide-ranging package of measures will make little difference to the near-term fall-out on the economy from the spread of the virus. At best, it will mitigate some of the financial market spillover effects.

We doubt the pressure on the ECB to ease further will diminish quickly even if a range of measures is announced shortly. We will follow up on the prospects for monetary policy beyond this month after the upcoming announcement.