Global Markets Daily: EUR — A Roadmap for the Rebound (Cahill/Dacic)

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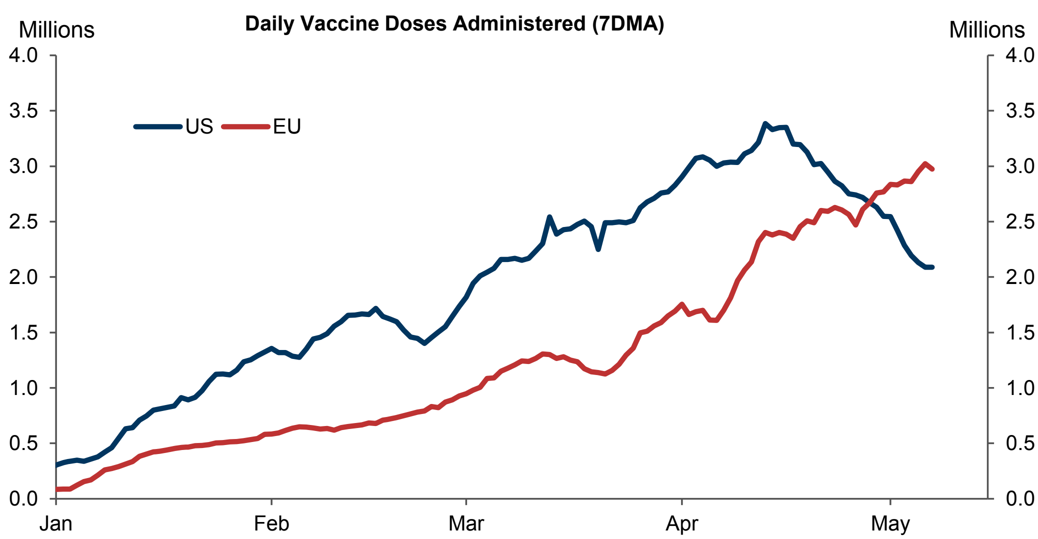
- A month ago, our economists wrote that they had "rising confidence in the European rebound," and we wrote about the best trades to get "ready for a rebound" in European FX markets—topside EUR/USD and long CE-3 currencies, particularly CZK. Since then, markets have moved only tentatively towards pricing a convergence, but our confidence has increased that the recovery is around the corner and result in further Euro appreciation.
- Most notably, the much-maligned European vaccination process has now accelerated meaningfully after the slow start, and actually exceeded our expectations for the month of April. In fact, we now expect that the US and EU will reach the milestone of vaccinating 50% of the population *around the same time* (mid-June). That effectively closes what we had thought would be about a 6-week gap.
- This underpins our confidence in the coming rebound. With this in mind, we review current mitigation measures in force in the EMU-4, and when they are expected to be eased. Some restrictions have already started to be pared back over the last couple of weeks, but the recovery should accelerate over the next 2-3 weeks with the return of outdoor dining in some cases as well as some tourism. Restrictions are expected to continue to ease through the month of June, in time for the bulk of tourist season.

Focus: EUR — A Roadmap for the Rebound

A month ago, our economists wrote that they had "rising confidence in the European rebound," and we wrote about the best trades to get "ready for a rebound" in European FX markets—topside EUR/USD and long CE-3 currencies, particularly CZK. Since then, markets have moved only tentatively towards pricing a convergence, but our confidence has only increased that the recovery is around the corner and it should lift EUR/USD to 1.25 in 3m.

Most notably, the much-maligned European vaccination process has now accelerated meaningfully after the slow start, and the pick-up actually exceeded our expectations in April. In contrast, there are signs that vaccine hesitancy is slowing demand in the US a little sooner than we had expected, which largely explains why vaccinations in the US slowed more than we had initially penciled in. The net result is that the EU is now vaccinating more people per day than the US (Exhibit 1). Putting this together, while the US is currently well ahead, we now expect that the US and EU will reach the milestone of vaccinating 50% of the population *around the same time* (mid-June). That effectively closes what we had thought would be about a 6-week gap, and differs from downbeat views in markets about Europe's vaccination campaign.

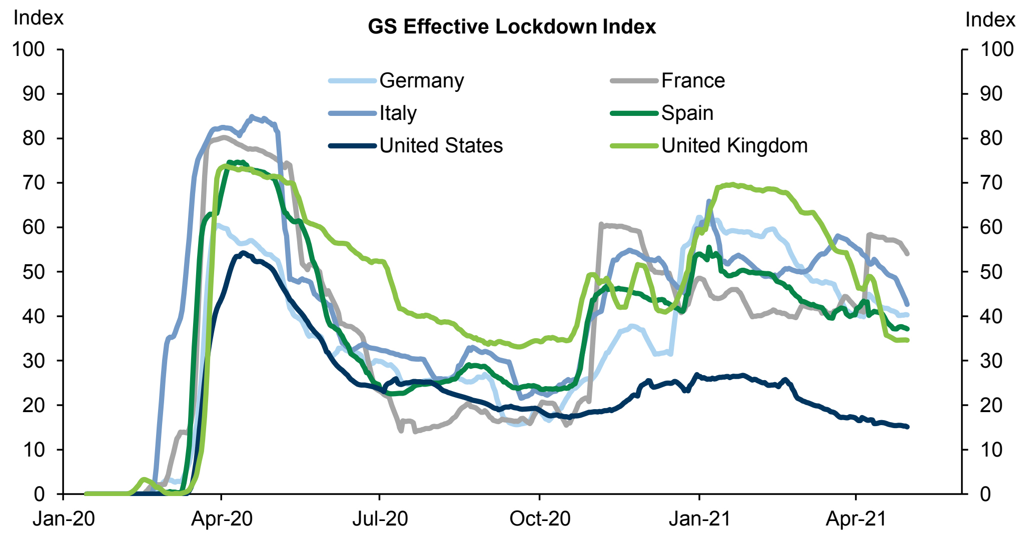
Exhibit 1: Daily vaccinations in the EU have accelerated



Source: Our World in Data

While the vaccination data is encouraging, likely a good portion of the remaining investor caution lies in the fact that much of the Euro area service sector economy is still under some form of lockdown, and easing those measures have now been delayed several times. As a rough approximation, we use our Effective Lockdown Index, which has eased slightly across the EMU-4 in recent weeks, but not nearly to the same extent as in the UK and is meaningfully tighter than last summer. In fact, our EMU-4 ELIs are still almost as tight as the peak of lockdown measures in the US (Exhibit 2).

Exhibit 2: Europe still faces tight restrictions on activity relative to the US and UK



Source: Goldman Sachs Global Investment Research, University of Oxford (covidtracker.bsg.ox.ac.uk), Google COVID-19 Community Mobility Reports

With this in mind, we provide a brief overview of the status of containment measures in the EMU-4, and when they are expected to be reassessed:

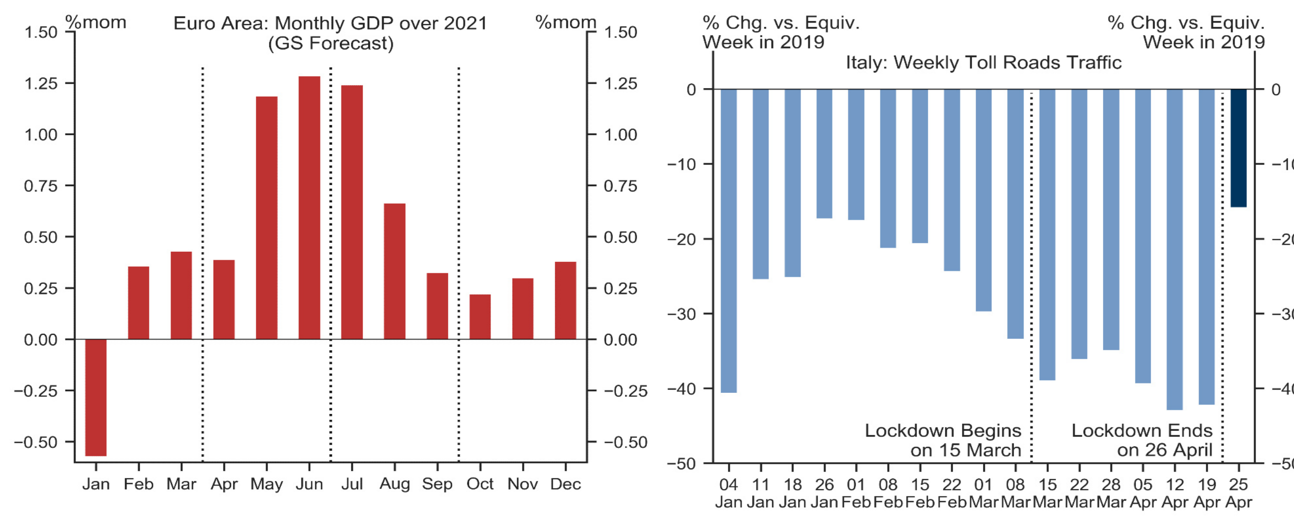
- **Germany.** States with a 7-day incidence rate above 100 new cases per 100k residents must implement "emergency brake" lockdown measures. These include closing or restricting access to many stores and a 10pm curfew. However, the national rate has declined to 129/100k (from 160 2 weeks ago), with a few states now falling below the threshold. Parliament just passed a bill so fully vaccinated or previously-infected individuals will be excluded from some of the rules. We estimate that about 40% of the population would meet this standard. Officials have said they do not expect the rules to be lifted before the **end of May**, so the degree of easing over the next few weeks will depend on meeting the built-in brake.
- **France.** Schools reopened this week as the first stage in a 4-step process to reopen the economy by July from a strict lockdown imposed in early April. Restaurants have been closed since the end of October, but are expected to reopen for outdoor service **on May 19** with a slightly later curfew (9pm instead of 7pm). Non-essential stores, as well as movie theaters and the like, will be permitted to reopen with capacity constraints. In the next stage, on June 9, officials expect to allow foreign tourists and large outdoor events, both on the condition of providing a "health pass." In the final stage, the curfew will be lifted completely and all but the most high-risk activities should be allowed to resume.
- **Italy.** Italy started easing restrictions **two weeks ago**, with outdoor dining in areas with lower infection rates (yellow and white zones) and entertainment venues are allowed to operate with capacity constraints. The plan is to allow domestic travel and some higher risk businesses to reopen in the **second half of May**, and welcome international tourists a month later—in time for the bulk of summer activity.
- **Spain.** The nationwide "state of alarm" that has been in place since late October is

set to expire on **May 9.** That would move the power to set restrictions to regional authorities, and open the possibility of challenges to those restrictions. Some states are already preparing plans to ease restrictions at that point. Restrictions currently vary from region-to-region (with Madrid accelerating the reopening quite aggressively), but generally involve some form of nighttime curfew and restrictions on travel and large gatherings.

Overall, restrictions have started to ease a bit over the last few weeks, and that is expected to accelerate over the next 2-3 weeks with the aid of the accelerating vaccinations and, not to be underestimated, a strong political will to reopen for the summer season. This combination is clear in the European Commission's recent proposal to allow vaccinated tourists to travel. The UK government's plan to allow non-essential foreign travel to some parts of Europe from **May 17** will also be important to watch.

With this in mind, we expect sequential growth to accelerate sharply over May-July (Exhibit 3, left), consistent with firms' expectations (including in services) of future output growth close to historical highs. The May flash PMIs will likely coincide with the start of more meaningful reopening and provide an early indication of stronger orders in the service sector. In the meantime, we are watching high-frequency indicators, which have already started to improve in some cases (Exhibit 3, right). We will also keep an eye on the national business surveys for insight on the small business sector.

Exhibit 3: Peak growth over the summer as lockdowns ease



Source: Atlantia, Goldman Sachs Global Investment Research

Against this backdrop, our economists anticipate that the combination of reopening momentum and still-favorable financing conditions will allow the ECB to pare back the pace of PEPP purchases for Q3 at the June 10 meeting. Even though this follows shortly after reopening is expected to get underway in force, it should still be ample evidence for the ECB to decide that the reopenings embedded in its assumptions are broadly on track, with scope for growth upgrades also on the back of US fiscal stimulus measures. This would be similar to the BoE's reliance this week on high frequency data and surveys to reinforce its decision to upgrade its outlook. However, even though the timeline appears a little tight, we should stress that the ECB decision plays only a supporting role in our outlook at this point, so would not meaningfully change our view if that was pushed into September.

The bottom line is that the market still seems skeptical that European growth can accelerate, but we think there should be significant convergence over the next few weeks, and that should boost the Euro. This is especially important in the context of today's disappointing US payrolls report, which should calm calls for the Fed to quickly change its stance into the June meeting, dampening one of the Dollar's remaining supports.

TRADE IDEAS

Best Trade Ideas Across Assets

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1. Stay in 2s10s IRS steepeners in CZK, KRW, and THB, opened on September 9, 2020 at 0.49%, with a revised target of 1.00%, and a revised stop of 0.79%, currently trading at 0.84%.
2. Stay in 3Y CGBs, opened on September 25, 2020 at 2.83% and USD/CNY at 6.83 (indexed at 100), with a revised total return target of 108.5, and a revised total return stop of 105, currently trading at 107.76.
3. Stay long MYR vs short THB, opened on October 21, 2020, at 7.52, with a target of 8.0, and a stop of 7.15, currently trading at 7.58.
4. Stay long SGD vs short TWD, opened on October 29, 2020, at 20.95 (indexed at 100), with a total return target of 106, and a revised stop of 103, currently trading at 104.49.
5. Stay long High Yield vs. Investment Grade in the USD cash market at 1 to 1.15x notional ratio, opened on November 11, 2020, at 0%, with a target of 2% and a stop of -2%, currently trading at 1.51%.
6. Stay long 10y EONIA vs 10y CHF, opened on December 18, 2020, at 0.05%, with a target of 0.20% and a stop of -0.05%, currently trading at 0.07%.
7. Stay long an equal-weighted basket of MSCI Brazil and MSCI Mexico relative to MSCI Taiwan (in USD terms), indexed to 100 on Jan 22, 2021, with a target of 120, and a stop at 90, currently trading at 104.61.
8. Stay short JPY vs KRW, opened on February 09, 2021, at 10.65 (indexed at 100), with a total return target of 108, and a revised stop of 101, currently trading at 103.72.
9. Stay long CMBX 6 BBB- vs. CDX HY index at a 1 to 1.25x notional ratio, opened on February 10, 2021, at 0%, with a target of +10% and a stop of -10%, currently trading at -5.31%.

10. Stay long EM HY Sovereign Oil Exporters (an equally weighted basket of USD bonds in Angola, Nigeria, Ghana, Brazil, Bahrain, Oman, Gabon, and Azerbaijan) vs. the EMBI Global Diversified index, opened on March 1, 2020, at 0bp, with a target of -30bp of outperformance, and a wider stop of +30bp of underperformance, currently trading at +9bp.
11. Stay long 1y5y5y USD payers, opened on March 5, 2021, at 2.47%, with a total return target of 25bp, and a stop of -15bp, currently trading at -7bp.
12. Stay long 3y7y breakeven wideners, opened on March 5, 2021, at 2.09%, with a target of 2.40%, and a 10bp trailing stop of 2.21%, currently trading at 2.31%.
13. Stay long 20y JPY swaps, opened on March 5, 2021, at 0.39%, with a target of 0.55%, and a stop of 0.30%, currently trading at 0.38%.
14. Stay positioned for wider 10-year POLGBs bond-swap spreads, opened on March 19, 2021, at -26bps, with a target of 10bp and a stop of -55bp, currently trading at -21bp.
15. Stay long South Africa and Russia equities, indexed to 100 on March 26, 2021, with a target of 115 and a stop of 92, currently trading at 102.79.
16. Stay short 5y GBP real yields, opened on April 2, 2021, at -3.26%, with a target of -2.80%, and a stop of -3.45%, currently trading at -3.24%.
17. Stay long 10y30y USD payers, opened on April 9, 2021, at 0bp, with a total return target- of 15bp, and a stop of -10bp, currently trading at -3bp.
18. Stay long CLP versus an equal-weighted basket of the five currencies with the largest weights in Chile's TWI (CNY, USD, EUR, BRL and JPY), opened at a level of 100 on April 13, 2021, with a total return target of 106, and a revised stop of 100.50, currently trading at 103.04.
19. Stay long USD 3m forward 5s30s conditional bear steepeners, opened on April 16, 2021, at 1.01%, with a target of 1.21%, and a stop of 0.91%, currently trading at 1.02%.
20. Stay short 30y bunds, opened on April 16, 2021, at 27 bps, with a target of 52bp, and a stop of 12bp, currently trading at 34bp.
21. Stay long EUR vs USD, opened on April 16, 2021, at 1.20, with a target of 1.25, and a stop of 1.175, currently trading at 1.21.
22. Stay long 5-year TIIE receivers, opened on April 23, 2021, at 5.89%, with a target of 5.30%, and a stop of 6.35%, currently trading at 5.91%.
23. Stay long INR versus TWD, opened on April 23, 2021, at 0.374 (indexed at 100), with a target of 108 and a stop of 96, currently trading at 101.78.
24. Stay long 7y swaps on the 2s7s30s spread fly, opened on April 30, 2021, at 0.07%, with a target of 0.15%, and a stop of 0.02%, currently trading at 0.08%.
25. Stay long 2y1y/5y5y AUD swap curve steepeners, opened on April 30, 2021, at 2.07%, with a target of 2.30%, and a stop of 1.90%, currently trading at 1.99%.

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