

## **GIAM Macro & Market Research - Market Commentary**

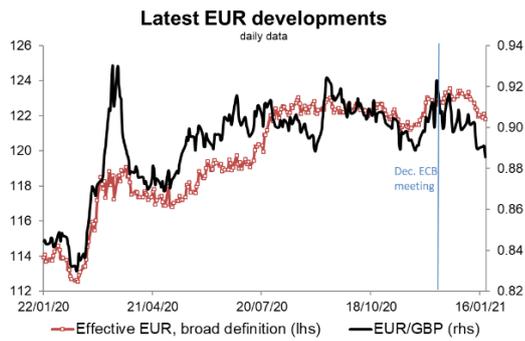
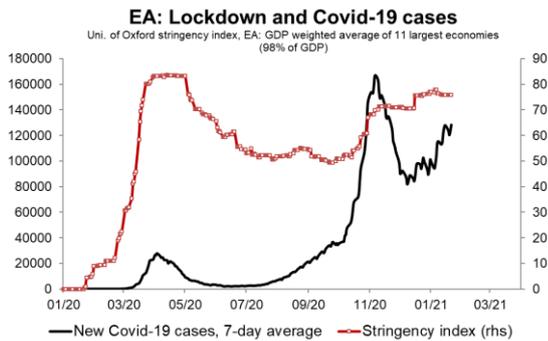
January 21, 2021

### **ECB sees current situation broadly in line with its expectations and maintains course**

- **As expected, at today's meeting the Governing Council did not take any policy action and maintained its long-held easing bias.**
- **While short-term risks related to the pandemic were acknowledged the Governing Council still sees the situation broadly in line with the economic scenario painted at the last meeting.**
- **The EUR strength remains a matter of concern and the ECB watches exchange rate developments "very carefully".**
- **All in all, further monetary policy action is not on the table for the time being. Instead the importance of fiscal policy action and of the Recovery and Resilience Facility was emphasized. Looking further ahead, the evolution of the pandemic and of lockdown measures beyond Q1/21 is key.**

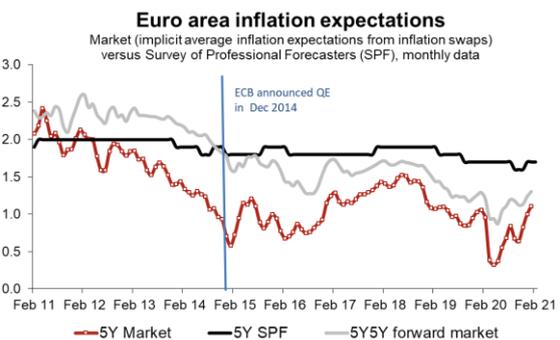
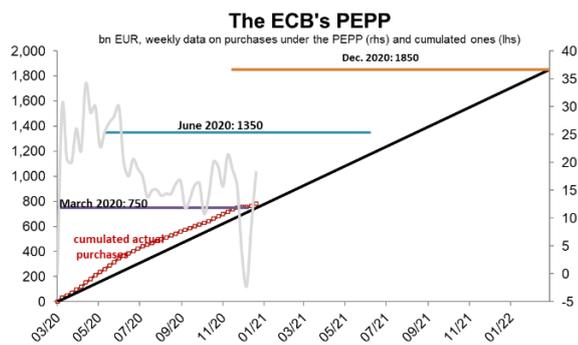
**ECB sees no reason to change economic assessment:** The pandemic situation worsened, and lockdown measures intensified as of late. Still, the ECB sees no reason to alter the outlook it provided at the last meeting in December. As President Lagarde elaborated in the Q&A session also various positive developments need to be considered: Most importantly, the start of the vaccination campaign was mentioned. Moreover, various risks have disappeared as the last hurdles to the next EU budget and the Recovery and Resilience Facility (RRF) were removed and US election uncertainty is over. Unlike to the ECB's expectation in December an EU-UK trade agreement was finally reached and the manufacturing sector is on an expansionary path. These factors roughly outweigh the worsening of the pandemic situation, the expected decline of activity in Q4 2020 and the extremely weak inflation. As a result, the December projections are still seen as "*broadly valid*". It is worth remembering that these projections foresee for 2021 positive growth rates in all quarter and an annual growth rate of 3.9%.

**Risks remain on the downside and EUR still in focus:** That said the ECB continues to see the risks on the downside and primarily related to the evolution of the pandemic. We think that an extension of the current degree of lockdown measures well into the second quarter would trigger a reassessment of the economic situation, something that Mrs Lagarde suggested in a recent interview. Moreover, although the strength of the EUR lost momentum since the last policy meeting it is still a matter of concern for the central bank. President Lagarde became very explicit about it in the press conference stating the ECB will monitor exchange rates "*very carefully*" and be "*very attentive*" to them.



**Hurdles for further policy action seem high:** As in the last meetings the Governing Council reiterated that it stands “*ready to adjust all instruments*” thereby maintaining its easing bias. However, additional policy action seems to be rather distant. First, the macro assessment is still in line with the one in December when a bold package was launched. Second, in the Q&A session Mrs Lagarde again praised the merits of the PEPP emphasizing its flexibility suggesting that purchases could be frontloaded. Moreover, she warned to look at only some indicators but pointed out that the Governing Council takes a holistic approach to financing conditions and assessed them as “*broadly favourable*”. Third, President Lagarde suggested that the ball was now again in the field of the governments. A fast implementation of the RRF and generally the maintenance of a supportive fiscal policy stance was necessary. Last, regarding the exchange rate she stated that “*all instruments can be adjusted and nothing is off the table*”. However, we view this rather as barking than the announcement of biting in order to cap any potential resurgence of EUR strength.

**Significant worsening of pandemic major risk:** The major risk to the self-imposed wait-and-see stance is a significant worsening of the pandemic situation resulting in severe lockdown measures well beyond the second quarter of the year and the postponement of the expected back-to-normal well into the second half of the year. In this case the PEPP would very likely be extended again.



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