ECB reiterates the need for accommodation to fight the pandemic

- **The ECB maintained status quo on expected lines but focus for the market was more on the messaging provided**
- **While the ECB has acknowledged risks of a 'W' shaped recovery as service sector activity is expected to slow over Q42020-Q12021, the outlook remains favourable on the assumption that the vaccine will help in building 'herd immunity'. Other positive developments such as the passage of the EU recovery fund, 'Brexit deal' and reduced political uncertainty in the US were also acknowledged**
- **The ECB mildly upgraded its economic outlook by stating that the 'risks to the outlook remain to the downside but were somewhat less pronounced' than was the case in the previous policy meeting**
- **Substantial emphasis was placed on the need for continued fiscal and monetary support to fight off the pandemic. Hence, we expect the ECB to maintain its accommodative framework over 2021 with the Pandemic Emergency Purchases Program working as the main tool to support the economy and financial conditions**
- **While the ECB maintained that it is watching developments 'on the exchange rate' in terms of its effect on underlying price pressures, we do not anticipate any action to be taken at the current juncture to influence the exchange rate**
- **We think that the EUR/USD pair will continue to move in sync with the global reflation trade**

ECB: maintains status quo: At the conclusion of its policy meeting on 21-January-2021, the ECB maintained status quo on expected lines.

Policy rates were kept unchanged with the continued guidance that the current rate configuration will remain in place until the inflation objective of around 2% YoY is close to being achieved.

The QE purchases program of EUR 20 bn per month along with the Pandemic Emergency Purchases Program (PEPP) with an envelope of EUR 1850 bn that was increased back in December-2020 by EUR 500 bn is expected to continue. The PEPP program will remain flexible and is in place to fight off the effects of the pandemic that will remain in place until at least March-2022. Maturing proceeds from the QE will continue to remain in place for as long as necessary while maturing proceeds under the PEPP program will continue till at least end-2023. The manner in which the PEPP will be used will remain contingent on the evolution of financial conditions and credit market conditions.

At the same time, liquidity support to the financial system will continue to be provided via TLTROs.

In short, the accommodative framework will remain in place in order to continue fighting off the pandemic, but that was largely priced in by investors. Instead, focus was on the messaging provided.

Economic outlook: reducing downside risks? We draw on the following important takeaways on the central bank's assessment on the economy:

- **The ECB took note of the fact that near-term outlook remains challenged from the persistence of the pandemic.** Hence, output on a sequential basis is expected to contract in Q42020 resulting in a 'W' shaped recovery pattern. Concerns were also expressed about the new variant of the COVID-19 virus that appears to be more contagious.

- The ECB expects economic activity to remain weak going in to Q12021 as well, given that restrictions are expected to remain in place.

- However, most of the hit to economic activity over Q42020 to Q12021 was expected to come from weakening service sector output. Manufacturing sector performance was expected to be better than previously expected and so far is not showing signs of being greatly hindered by the pick-up in infections. Improving trade flows is also working as an important tailwind for the sector.

Shivom Chakravarti
shivom.chakravart@icicibank.com
Phone number: 022-4008-6273

22-January-2021

- Besides, some confidence was expressed on the effect that the vaccine would have on improving medium-term growth outlook. However, it might take some-time for 'herd immunity' to build up, which could take up to end-2021.

- Other favourable developments that were discussed by the ECB Chair during the press conference were: (a) the 'Brexit' deal, (b) passage of the EU recovery fund and (c) reduced uncertainty about the US political environment.

- The ECB Chair also continued to emphasize the need for continued dual fiscal and monetary support required to fight off the effects of the pandemic and negative output gaps that remain firmly in place.

Hence, risks to the outlook were still expressed as being to the downside, but were considered 'less pronounced' as compared to the previous policy meeting, reflecting some of the positive developments that have taken place over the interim period.

Inflation concerns remain firmly in place: On several occasions, the ECB Chair indicated that the central bank remained concerned about the medium-term inflation outlook. **In this regard, references continued to be made about 'monitoring the exchange rate'.** Price pressures in the region are being held back by negative output gaps and tax cuts that have been imposed as part of the fiscal support program delivered by Germany in 2020. However, inflation pressures are expected to remain below the ECB's target level of 'just under 2%' over the forecast horizon of 2021-2023. Some acknowledgement was made about the pick-up in market based inflation expectations but that still remains subdued and well below the target level of the central bank.

ECB: On auto pilot mode: Our outlook on the Euro-zone is fairly similar to the one described by the ECB. We see a soft-patch over Q42020-Q12021 followed by an improvement from Q2201 onwards as mobility picks up, driving service sector activity higher. The EU recovery fund should also support the rebound in economic activity. Hence, we see the Euro-zone recovering from -7.5% YoY contraction in 2020 to 4.4% YoY expansion in 2021. **Even as we are constructive on the outlook for the region, we expect the current monetary policy framework to remain in place over 2021 with asset purchases under PEPP and QE to be complemented by the reinvestment of maturing proceeds. ECB's focus in H12021 will remain on the need to fight off the pandemic.**

Indeed, several references were made to the fact that the PEPP program was an 'open ended' scheme and the fact that it could be adjusted depending on the manner in which the pandemic pans out. However, we think that the size of the program will remain unchanged until mid-2021 and a decision on what to do next will be taken contingent on the effectiveness of the vaccine in building 'herd immunity'. Our base case will be for the ECB to use the full size of the PEPP program.

We do not anticipate any changes to be made in the interest rate structure either. However, if concerns about exchange rate appreciation intensify, we think that the ECB's main recourse will be to engineer an interest rate cut to reduce the rate arbitrage between the Euro-zone and the US. We do not think that stage has been reached as yet. Hence, we see status quo on policy rates.

EUR/USD: Moving more in sync with global risk sentiment: Over the last week, the global reflation trade has returned on expectations that the new US administration will move forward with a fiscal stimulus package as well as a more proactive response to COVID-19. Hence, the USD is starting to trade on the back foot again.

We expect the EUR/USD pair to trade in the 1.20-1.23 range over Q12021. We maintain that we see more upside potential in the pair over the course of 2021 reflecting: (a) the persistence in the global reflation trade and (b) pick-up in Euro-zone economic activity on the back of the vaccine as well as the implementation of the recovery fund. We expect the EUR/USD pair to move to the 1.25-1.27 range by end-2021.

ICICI Bank Global Markets

ICICI Bank: ICICI Bank Towers, Bandra Kurla Complex, Mumbai- 400 051. Phone: (+91-22) 2653-1414

Economics Research Group			
Economics Research			
Shivom Chakravarti	Senior Economist—Global markets	(+91-22) 4008-1414 (ext 6273)	shivom.chakravarti@icicibank.com
Anushri Bansal	Senior Economist—Domestic markets	(+91-22) 4008-1414 (ext 6220)	anushri.bansal@icicibank.com
Sumedha Dasgupta	Economist	(+91-22) 2653-1414 (ext. 7243)	sumedha.dasgupta@icicibank.com
Aniket Gaikwad	Research Analyst	(+91-22) 2653-1414 (ext. 8161)	aniket.gaikwad@icicibank.com
Kaushal Aryan	Research Analyst	(+91-22) 2653-1414 (ext. 7249)	kaushalkumar.aryan@icicibank.com
Asha Sasikumar	Research Analyst	(+91-22) 2653-1414 (ext. 7249)	asha.sasikumar@icicibank.com
Jyoti Sharma	Research Analyst	(+91-22) 2653-1414 (ext. 7249)	sharma.jyoti@icicibank.com
Tanisha Ladha	Research Analyst	(+91-22) 2653-1414 (ext. 7309)	tanisha.ladha@icicibank.com
Nihal Kumar	Research Analyst	(+91-22) 2653-1414 (ext. 7309)	nihal.kumar@icicibank.com

Treasury Desks			
Treasury Sales	(+91-22) 6188-5000	Currency Desk	(+91-22) 2652-3228-33
Gsec Desk	(+91-22) 2653-1001-05	FX Derivatives	(+91-22) 2653-8941/43
Interest Rate Derivatives	(+91-22) 2653-1011-15	Commodities Desk	(+91-22) 2653-1037-42
Corporate Bonds	(+91-22) 2653-7242		

ICICI Bank Global Markets

Please also note that ICICI Bank (including its branches, and affiliates) is unable to exercise control or ensure or guarantee the integrity of/over the contents of the information contained in e-mail transmissions and / or attachments and that any views expressed in this e-mail and / or attachments are not endorsed by/binding on ICICI Bank. Before opening any attachments please check them for viruses and defects and please note that ICICI Bank accepts no liability or responsibility for any damage caused by any virus that may be transmitted by this email and/ or attachments thereto.

DISCLAIMER FOR DUBAI INTERNATIONAL FINANCIAL CENTRE ("DIFC") CLIENTS:

This marketing material is distributed by ICICI Bank Limited., Dubai International Financial Centre (DIFC) Branch, a category 1 Authorized Firm and regulated by the Dubai Financial Services Authority. This marketing material is intended to be issued, distributed and/or offered to a limited number of investors who qualify as 'Professional Clients' pursuant to Rule 2.3.3 of the DFSA Conduct of Business Rulebook, or where applicable a Market Counterparty only, and should not be referred to or relied upon by Retail Clients and must not be relied upon by any person other than the original recipients and/or reproduced or used for any other purpose.

DISCLOSURE FOR RESIDENTS IN THE UNITED ARAB EMIRATES ("UAE"):

Investors should note that any products mentioned in this document, any offering material related thereto and any interests therein have not been approved or licensed by the UAE Central Bank or by any other relevant licensing authority in the UAE, and they do not constitute a public offer of products in the UAE in accordance with the Commercial Companies Law, Federal Law No. 8 of 1984 (as amended) or otherwise.

DISCLOSURE FOR RESIDENTS IN HONGKONG

*This document has been issued by ICICI Bank Limited in the conduct of its Hong Kong regulated business (i.e. type 1 license) for the information of its institutional and professional investor (as defined by Securities and Future Ordinance (Chapter 571 of Laws of Hong Kong) (the "**SFO**")) customers; it is not intended for and should not be distributed to retail or individual investors in Hong Kong. Any person who is not a relevant person should not act or rely on this document or any of its contents. This document has not been reviewed, authorized or approved by any regulatory authority.*

ICICI Bank and/or its affiliates are full service financial institutions engaged in various activities which may include securities trading, commercial and investment banking, financial advice, investment management, principal investment, hedging, financing and brokerage activities. As a result, you should be aware that a conflict of interest may exist. In accordance with the regulatory requirements and its own conflicts of interest policies, ICICI Bank has in place arrangements, internal policies and procedures to manage conflicts of interest that arise between itself and its clients and between its different clients. Where it does not consider that the arrangements under its conflicts of interest policies are sufficient to manage a particular conflict, it will inform you of the nature of the conflict so that you can decide how to proceed.

DISCLOSURE FOR RESIDENTS IN SINGAPORE

*ICICI Bank Limited, India ("**ICICI India**") is incorporated under the laws of India and is regulated by the Reserve Bank of India. ICICI Bank Limited, Singapore branch ("**ICICI**") is regulated by the Monetary Authority of Singapore.*

As mentioned, ICICI India is regulated by the Reserve Bank of India. Hence, in relation to your dealing with ICICI India, you understand that your interest will be subject to protection of local laws and regulations in India, which may offer different or diminished protection than available under Singapore laws and regulations. You also understand that the Monetary Authority of Singapore will be unable to compel the enforcement of the rules of the local regulators.