ECB review: A commitment to keep the policy accommodative

- **The European Central Bank (ECB) maintained status quo, and made the change to its forward guidance on policy rates on expected lines**
- **The new forward guidance provided an even stronger signal from the Central Bank, that policy rates will be kept at current levels, for a prolonged period of time**
- **While there was some acknowledgement that growth could pick-up, inflation was expected to continue to undershoot in the medium to long-term. The ECB also said that it will remain watchful on the risks posed by the delta variant of the virus**
- **Hence, we see the ECB continuing with its Pandemic Emergency Purchases Program (PEPP) till Mar 2022. After which, it is expected to increase the size of its open-ended Quantitative Easing (QE) programme from EUR 20 per month to EUR 50-60 bn per month, over 2022**
- **We remain bearish on the EUR/USD pair, reflecting ongoing divergence in growth and monetary policy, between the US economy and the Euro-zone**
- **We see a steepening bias taking hold in the European yield curves over the medium-term.**

ECB changes its forward guidance…: The ECB introduced a new forward guidance for policy rates to take in to account the revised framework that was made in conclusion to the strategic review.

The ECB revised its guidance to state that *'the key ECB interest rates will remain at their present or lower levels until it sees inflation reaching two per cent well ahead of the end of its projection horizon, and durably for the rest of the projection horizon, and it judges that realised progress in the underlying inflation, is sufficiently advanced to be consistent with inflation stabilising at two per cent over the medium term. This may also imply a transitory period in which inflation is moderately above target'.*

This compares to the previous guidance of *'the key ECB interest rates, which will remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.'*

The changes made along with the guidance provided from the Governor, imply that the Central Bank will want to ensure that inflation reaches the 2% mark, well ahead of the end of the projection horizon that is currently at 2023. As we understand, this would mean that the ECB would not hike rates, even if its forecast is for inflation to reach 2% at the end of the forecast horizon. Instead, it would want to ensure that it averages 2% over the period. In the latest round of projections released for June, the ECB forecasts CPI inflation at 1.4% for end 2023 and average of 1.6% for the period. Hence, by altering its forward guidance, the ECB has committed to keeping rates low for a fairly long period of time. The ECB is due to release its forecasts for 2024 in its December policy meeting. The Central Bank also made it clear that it will look through any temporary overshoots, as would be the case in 2021.

…but keeps policy framework unchanged: While changes were made to the forward guidance, other components of the policy were not altered.

- The ECB kept policy rates unchanged
- The size of the pandemic emergency purchases programme of EUR 1850 bn was kept unchanged, with the programme set to expire on Mar 2022. The Central Bank will continue to reinvest in maturing securities under the programme, up to at least the end of 2023. It also reiterated that it will continue maintaining a significantly higher pace of purchases in Q3 2021, as compared to what was witnessed in the first few months of 2021. The ECB Governor said that any talk about tapering of purchases under PEPP was premature at the current juncture
- It kept the size of its open-ended monthly quantitative easing programme at EUR 20 bn per month unchanged, and will continue to reinvest in maturing securities under the programme.

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

23-July-2021

Commentary on the economy was relatively unchanged: The post policy statement for the July policy meeting was similar to the previous one in June.

- **On growth, the ECB acknowledged that momentum should pick-up in Q3 2021 on the back of vaccinations and reopening of the economy. Risks to the growth outlook were described as being balanced.** However, the ECB governor did warn about the risks from the pick-up in spread of the delta variant of the virus
- **On inflation, guidance remained unchanged.** While inflation could remain high in the near-term, driven by temporary factors, it was expected to remain soft in the medium-term. On several occasions during the press conference, the ECB Governor emphasised that the outlook for inflation in the medium-term remains fairly subdued or benign. She also emphasised that inflation is forecasted to undershoot target levels at the current juncture
- The only constructive statements provided was the commentary on investments. The ECB said that there was strong evidence of an investment related pick-up, that was visible in credit data and the Central Bank's bank lending survey.

Monetary policy on auto-pilot mode: The changes that were made to the forward guidance and tone of the Governor's press conference make us believe that the ECB will keep policy accommodative for a prolonged period of time. We expect the ECB to end its PEPP programme on schedule on Mar 2022. Given ongoing concerns about inflation undershooting target levels, we maintain that the ECB will increase the size of its open-ended QE programme from EUR 20 bn per month to EUR 50 bn to EUR 60 bn per month going in to 2022. With the ECB altering its guidance to indicate that rates will remain low for a longer period of time, in theory that should imply that the risk of an abrupt unwinding of QE is unlikely.

Market impact: The effect on the EUR/USD pair and the European rates market was fairly modest given that the policy reconfirms that the accommodative monetary environment will remain in place for a considerable period of time.

We maintain our bearish medium-term call on the EUR/USD pair. We see it trading in the 1.17-1.20 range in Q3 2021 followed by a move to 1.15-1.16 by end-2021, reflecting monetary divergence between the US economy and the Euro-zone, respectively.

We see the Euro-zone sovereign yield curve steepening in the medium-term. Short-term yields are likely to remain flat, reflecting guidance on policy. On the other hand, longer-end yields could gradually drift higher in Q42021 and H12022 responding to improvement in the growth outlook. We see the German 10-year bund going from -0.10% to -0.20% in Q3 2021, to 0% by end-2021, and 0.05% in Q1 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
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
Sarbartho Mukherjee	Research Analyst	(+91-22) 2653-1414 (ext. 7249)	sarbartho.mukherjee@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		

Disclaimer

This document is issued solely by ICICI Bank Limited ("ICICI Bank'). Any information in this e-mail should not be construed as an offer, invitation, solicitation, solution or advice of any kind to buy or sell any securities, financial products or services offered by ICICI Bank) or any other entity, unless specifically stated so. The contents of this document do not take into account your personal circumstances. Before entering into any transaction, you should take steps to ensure that you understand the transaction and have made an independent assessment of the appropriateness of the transaction in light of your own objectives and circumstances, including the possible risks and benefits of entering into such transaction and should seek your own financial, business, legal, tax and other advice regarding the appropriateness of investing in any securities. ICICI Bank (including its branches, affiliates of ICICI Bank) do not provide any financial advice, and is not your fiduciary or agent, in relation to the securities or any proposed transaction with you unless otherwise expressly agreed by us in writing.

The information, opinions and material in this document (i) are derived from sources that ICICI Bank believes to be reliable but the reliability or accuracy of which have not been independently verified (ii) are given as part of ICICI Bank's internal research activity and not as manager of or adviser in relation to any assets or investments and no consideration has been given to the particular needs of any recipient; and (iii) may contain forward looking statements, which may be materially affected by various risk, uncertainties and other factors. The opinions contained in such material constitute *the judgment of ICICI Bank in relation to the matters which are the subject of such material as at the date of its publication, all of which are expressed without any responsibility on ICICI Bank's part and are subject to change without notice. ICICI Bank has no duty to update this document, the opinions, factual or analytical data contained herein. ICICI Bank and/or its affiliates make no representation as to the accuracy, completeness or reliability of any information contained herein or otherwise provided and hereby disclaim any liability with regard to the same. The recipient of the information should take necessary steps as they deem necessary prior to placing reliance upon it. Nothing contained in this publication shall constitute or be deemed to constitute an offer to sell/purchase or as an invitation or solicitation to do so for any securities or financial products/ instruments of any entity.*

This document is intended solely for customers of ICICI Bank and may contain proprietary, confidential or legally privileged information. No part of this report may be copied, disseminated or redistributed by any recipient for any purpose without ICICI Bank's prior written consent. If the reader of this message is not the intended recipient and has received this transmission in error, please immediately notify ICICI Bank, Economic Research Group, E-mail: erg@icicibank.com or by telephone at +91-22-2653-7233 and delete this message from your system.

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 Authorised 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, authorised 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.

For more detailed disclaimer, please visit https://www.icicibank.com/disclaimer/disclaimertnc.html