

# Week Ahead

Focus: ECB Governing Council, IT government crisis, EZ PMI, New US fiscal package

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## How will ECB assess situation?

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The ECB Governing Council meets next week. A change in monetary policy is not on the agenda. It was only in December that a series of additional measures were decided, which was a reaction to the sharp rise in the number of COVID-19 infections in autumn. Since then, the overall situation in the Eurozone has deteriorated. Containment measures have been prolonged and, with the emergence of new mutations of the virus, the risks of a renewed increase in infections have increased. At the same time, however, vaccinations have begun. So the key question for the ECB is how much more economic damage will be done before vaccinations and warmer weather contain the pandemic and whether further central bank action is necessary.

*To be sure, the Governing Council will again point to the high level of uncertainty and the downside risks to the economy. But a general change in assessments is unlikely. The clearest indication of this was statements by the ECB president this week that the ECB's economic forecasts (from December) were still very plausible. It is impossible to quantify how the meeting participants will weigh up the extension of containment measures on the one hand and progressive vaccination on the other. What is clear, however, is that in other areas the environment has developed better than the ECB economists had assumed. They had assumed hard Brexit in December and had not taken into account the USD 900bn stimulus package in the US that was agreed at the end of last year. For meeting participants, the outlook for another massive US stimulus package will be added next week, with positive implications for the Eurozone economy. Thus, there is some buffer to compensate for deeper than expected effects of the pandemic in the Eurozone.*

*At the same time, however, the minutes of the December meeting showed that the ECB Governing Council is ready to step up monetary policy in case of a dramatic deterioration of the situation. The PEPP purchase program and the TLTROs for bank financing were indeed highlighted as the best means to combat the crisis. At the same time, however, it was emphasized that it would be closely monitored as to whether the measures would be sufficient to ensure that the inflation target would be achieved. If not, all tools would be up for discussion, including an interest rate cut. But this should not be an issue at next week's meeting.*

*Finally, the Governing Council will make its displeasure with the euro exchange rate known through the president, but without any consequences.*

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Note: Past performance is not necessarily indicative of future results

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## IT - will government crisis trigger new elections?

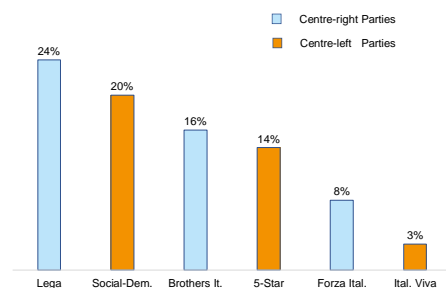
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Only a few days into 2021, the resignation of two female ministers belonging to the small party Italia Viva triggered the first government crisis in Italy. This

was caused by differing views on the content of the reconstruction plan and the question of whether or not to take advantage of additional loans from the European Stability Mechanism.

After Italia Viva left the government, Prime Minister Conte has no majority in the parliament. He can now try to win over another small party or individual non-party MPs to work with him. A coalition with large right-wing groups such as the Lega, the Brothers of Italy or Forza Italia is very unlikely. In case of emergency, a government of experts led by ex-ECB president Draghi is being discussed as well.

**IT – Poll data January 2021**

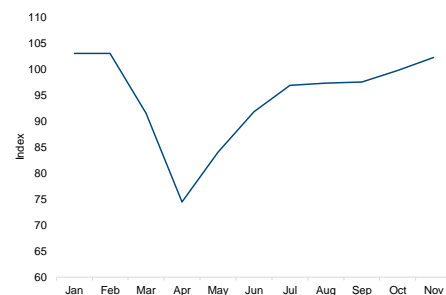


Source: Politico, Erste Group Research

Despite the muddled situation, new elections in the near future are currently unlikely (partly because President Mattarella rejects this). However, in view of the high government debt ratio (160% of GDP), the capital market is following the political situation in Italy closely. In the event of new elections, current polls suggest that the next government would consist of a right-wing coalition led by Salvini (Lega) and Meloni (Brothers of Italy). The Lega's last participation in government in 2018 led to uncertainty on the capital market due to significant differences with Brussels. However, the environment has changed. With the EU recovery plan, the Commission has already met one of the Lega's key demands for a substantial fiscal stimulus to improve Italy's long-term growth prospects.

**EZ - Divergence between industry and services should continue**

**EZ – industry production index (Jan. – Nov. 2020)**

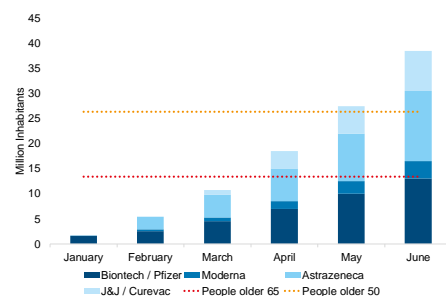


Source: Eurostat, Erste Group Research

Sentiment data from Eurozone purchasing managers will be the first important data point in 2021 from an economic perspective next week (January 22). In 4Q20, there was strong divergence between the industrial and services sectors. Industrial production continued its recovery unabated despite new restrictive measures. In November, the level of industrial production in the euro area was only about 1% below pre-crisis levels. Industry continues to benefit from the continuation of the global upswing. On the other hand, in view of the tightening of containment measures, retail sales in the Eurozone already slumped by 6% in November compared to October.

We expect industrial sentiment to stabilize in January. In services, sentiment could deteriorate slightly again in January, given the prospect of prolonged restrictions in many countries. The speed with which the vaccine is rolled out in the individual countries will be decisive for the course of the Eurozone's recovery in 2021. Taking France's vaccination schedule as an example, and assuming that AstraZeneca's vaccine receives regulatory approval for the EU by February, vaccination coverage for all French citizens over 65 would be possible by April. In spring, warmer temperatures and the widespread use of simple rapid tests should also help contain the virus. Based on these assumptions, we expect the current restrictions to be gradually lifted during 2Q. As a result, we expect a dynamic recovery of the Eurozone economy to begin in the course of the second quarter.

**France COVID-19 vaccination plan**



Source: French government, Erste Group Research

**US borrows way out of crisis**

Last night, President-elect Biden announced plans for his first stimulus package. The proposed size is USD 1.9tn, more than double the USD 900bn package agreed by the US Congress at the end of last year. The most important points are one-time payments to individuals of USD 1,400

(probably again with an income cap), which, together with the already agreed package amounts to USD 2,000. In addition, the additional weekly support for the unemployed shall be increased from USD 300 to 400 and extended from March to September. The package also includes support for states and municipalities. Finally, funding for COVID-19 control (vaccination, testing, and tracking) is to be increased. Schools and universities are also to receive additional funding.

*President-elect Biden also needs the approval of Republican senators to implement the package. At least for the one-time payments and the spending to fight COVID-19, the chances are good. These points are enough to give the US economy strong support relatively quickly, which would just come in addition to the package already passed. The markets have so far reacted cautiously to the announcement of the package. Expectations in this regard had already risen after the election victory of Democratic candidates in the Senate elections in Georgia and, at least at first glance, were not over-fulfilled. However, this does not detract from the fact that the US will continue its course of massive public spending to support the economy and thus a strong increase in public debt 2021 as well.*

## Economic calendar

Ctry	Date	Time	Release	Period	Consens	Prior
<b>Eurozone</b>						
FR	22-Jan	9:15	PMI Index	Jan P		51.1 Index
DE	22-Jan	9:30	PMI Index	Jan P	57.1 Index	58.3 Index
EA	22-Jan	10:00	PMI Index	Jan P	55.1 Index	55.2 Index

### USA

### China

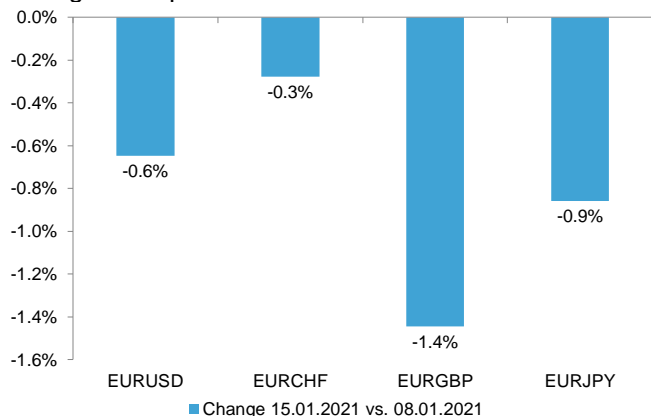
## Central bank events

	Date	Time	Event
<b>ECB</b>	21-Jan	13:45	ECB's Governing Council monetary policy decision
	21-Jan	14:30	Christine Lagarde, press conference
<b>Fed</b>			No events relevant for monetary policy

Source: Market Data Provider, ECB, Federal Reserve, Erste Group Research

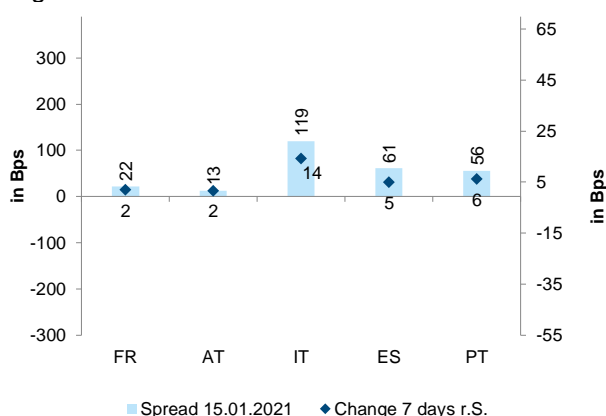
## Forex and government bond markets

**Exchange rates EUR: USD, CHF, GBP and JPY**  
 Changes compared to last week



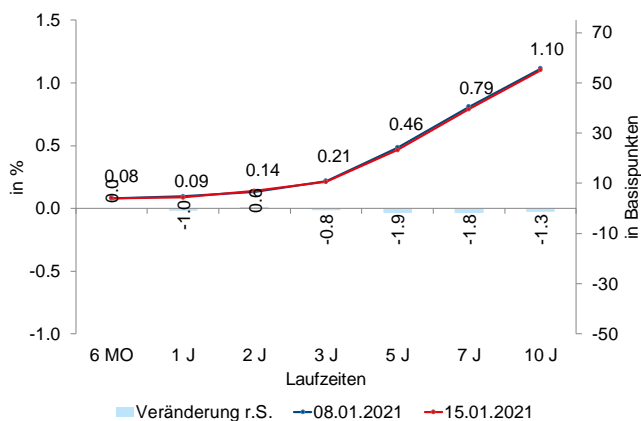
Source: Market Data Provider, Erste Group Research

**Eurozone spreads vs. Germany**  
 10Y government bonds



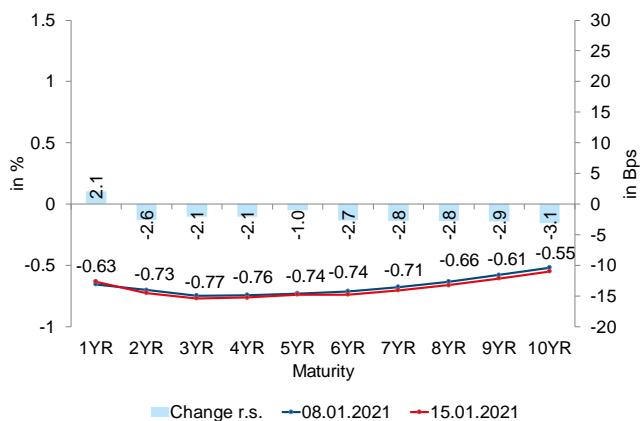
Source: Market Data Provider, Erste Group Research

**US Treasuries yield curve**  
 Changes compared to last week



Source: Market Data Provider, Erste Group Research

**DE Bund yield curve**  
 Changes compared to last week



Source: Market Data Provider, Erste Group Research

## Forecasts<sup>1</sup>

<b>GDP</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
<b>Eurozone</b>	1.3	-7.6	4.5	2.5
<b>US</b>	2.3	-3.5	4.2	2.6

<b>Inflation</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
<b>Eurozone</b>	1.2	0.2	1.0	1.2
<b>US</b>	1.8	1.2	2.0	1.7

<b>Interest rates</b>	<b>current</b>	<b>Mar.21</b>	<b>Jun.21</b>	<b>Sep.21</b>	<b>Dec.21</b>
<b>ECB MRR</b>	0.00	0.00	0.00	0.00	0.00
<b>3M Euribor</b>	-0.55	-0.55	-0.55	-0.55	-0.55
<b>Germany Govt. 10Y</b>	-0.55	-0.40	-0.30	-0.20	-0.10
<b>Swap 10Y</b>	-0.24	-0.10	0.00	0.10	0.20

<b>Interest rates</b>	<b>current</b>	<b>Mar.21</b>	<b>Jun.21</b>	<b>Sep.21</b>	<b>Dec.21</b>
<b>Fed Funds Target Rate*</b>	0.09	0.13	0.13	0.13	0.13
<b>3M Libor</b>	0.24	0.25	0.25	0.25	0.25
<b>US Govt. 10Y</b>	1.10	1.00	1.20	1.20	1.30
<b>EURUSD</b>	1.21	1.22	1.22	1.23	1.24

\*Mid of target range

*In case of changes to our forecasts compared to the previous issue, arrows show the direction of the change.  
 Source: Market Data Provider, Erste Group Research*

<sup>1</sup> Note: In accordance with regulations, we are obliged to issue the following statement:  
 Forecasts are not a reliable indicator of future performance.

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