

14 January 2021

ECB Preview

Taking stock

- The ECB meeting next week (21 January) is set to be an uneventful one. We largely expect it to be a stocktaking meeting without any new policy signals. As the euro area economy is still in lockdown and is likely to be through all of Q1, the services sector is set to continue to drag the economy lower, but with the rollout of the vaccines and improvement in the weather conditions, economic activity is set to pick up. We expect this ray of optimism (as well as the approval of the Recovery Fund) to be conveyed at the press conference.
- The recalibration of the ECB's policy instruments in December has been well absorbed by markets, which means there is no urgency for the ECB to signal a new policy stance. We expect the ECB to refrain from commenting on a potential taper discussion, which has started in the US.
- The 'new' enforced flexible implementation of the PEPP will keep financing conditions and bond yields low. We do not expect markets to react strongly to the press conference (Bunds within 2bp) and continue to be comfortable with the -60bp to -40bp German Bund range in the near future. We expect the ECB to counteract any sell-off or steeper curves in anticipation of improvements in the economic data. There is a clear difference between the UST and the EGB outlook and 10Y US-DE spread widening should be in scope to around 200bp (from current 164bp) this year. The ECB's view of being on hold is neutral for spot currency. Near term, Italian politics could potentially bog down the EUR but for now, we view this as a non-event from a currency perspective.

Focus on the Q&A session

We have only had very few ECB GC speakers on the wires since the last monetary policy meeting in December. On Tuesday, ECB board member Schnabel conveyed that a mechanical increase of the inflation outlook will not change the monetary policy stance, while on Wednesday, ECB president Lagarde said that the current staff projections from December are still 'very clearly plausible'. This means that the focus next week is expected to be on the Q&A, although we expect this to be relatively uneventful as well.

- **Fed tapering discussion.** While some FOMC has opened the discussion on potential changing / tapering the bond purchases, we expect Lagarde to dismiss any such idea. With the PEPP envelope of potential net purchases until March 2022, the embedded flexibility allows ECB to implicit taper purchases without an actual announcement. This is our base case for when it happens, but this is clearly premature now.
- **FX.** We expect Lagarde to repeat the awareness of the FX developments and repeat that it feeds into the inflation outlook, without further commenting on this. She will signal readiness to act, while repeating that FX is 'not part of the mandate'.
- **Inflation outlook.** We expect the ECB to look through the mechanical upswing in inflation, as its mandate is 'oriented towards a medium-term horizon'.
- **Strategic review.** We do not expect new signals for the strategic review. Lagarde said on Wednesday that the ECB is about half way on the review.

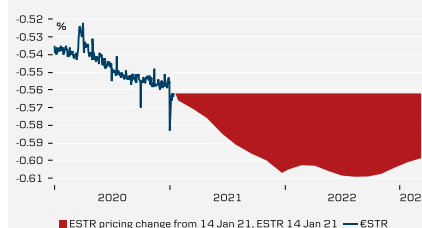
Euro Area Financial Conditions Index



Note: Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.

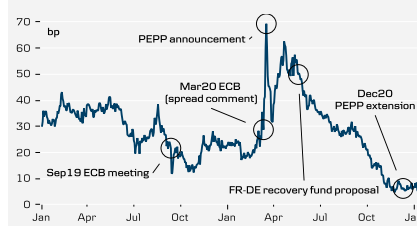
Source: Bloomberg, Macrobond Financial, Danske Bank

Front-end pricing still inverted



Source: Macrobond Financial, Danske Bank

10Y GDP EA weighted spread to EONIA



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank

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Nevertheless, while disagreement has been visible in the GC for the first time since Lagarde took office one year ago, we expect the ECB GC to keep its backstop option to the economy.

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Ad hoc.

Date of first publication

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