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- stressed the endogenous character of PEPP by referring to a holistic and flexible set of financing conditions;
- leaked fears of a credit market fragmentation.

CMB MONACO

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At its January meeting, the ECB made no policy changes, leaving both the interest rate corridor (-0,50% for deposits, 0% for main refinancing operations and +0,25% for marginal refinancing operations) and the other quantitative monetary policy instruments unchanged, as well as its forward guidance.

The ECB also reconfirmed its economic scenario assessment, reiterating that the economic projections, on which the December strategy was calibrated, should still be considered valid despite the improvement in some economic data (especially manufacturing data - Fig.1) and some positive (start of the euro area-wide vaccination campaigns, Brexit agreement, euro area manufacturing recovery, agreement reached on the EU budget) and negative (renewed surge in coronavirus infections and tightening of containment measures, slowdown in the services sector and persistent weakness in inflation) developments in the economic scenario. On the inflation side, President C. Lagarde reconfirmed a modest recovery path in the coming months, on the back of both the rising energy component and the ending of the temporary German VAT reduction, while she neglected to stress that these are transitory factors and not signs of an inflationary strength in the Euro Area (Fig.2). Risks to growth and inflation remain tilted to the downside "but less pronounced".

Fig. 1: Activity in the manufacturing sector continues to hold up well, but service sector is being severely curbed.

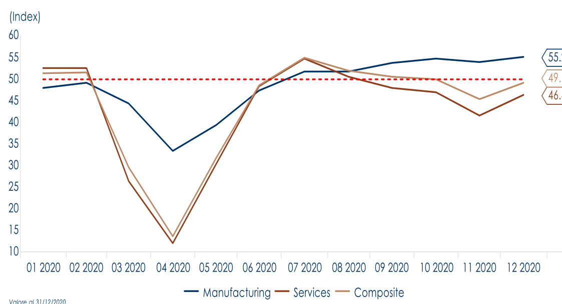
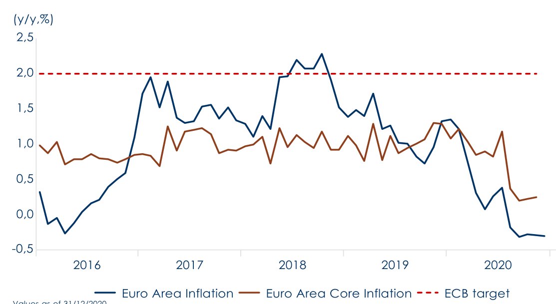


Fig. 2: Euro Area Inflation remains muted



Regarding the monetary policy future evolution, Lagarde reiterated during the press conference that "the presence of the ECB on the markets will be there for a long time", and at least until the end of March 2022. Moreover, the ECB will be ready to recalibrate all the monetary policy instruments as the economic scenario changes in both directions, either by strengthening them in the event of financial conditions tightening, or in the opposite direction, by not using the entire PEPP envelope if it is no longer necessary. Indeed, the ECB has chosen to render more explicit that PEPP flexibility can go in both directions and that the Pandemic Emergency Purchase Programme (PEPP) is endogenous. It was in order to reaffirm its ongoing market presence and flexible approach that what at first glance should be an uneventful meeting turned into an opportunity to deepen the understanding of accommodative financial conditions. Christine Lagarde stated that the ECB follows a holistic, flexible, and multifaceted approach to preserve and foster accommodative financial conditions and to assess whether further action is needed to offset undue tightening of market rates. However, the President did not make explicit what should or could be the trigger for further ECB action.

A holistic approach is not driven by any single indicator, but takes into account the complexity of the financial conditions for households, businesses and the public sector and, therefore relies on a wide range of indicators (sovereign yields, credit conditions, rates and quantity of loans to households and businesses, spreads on corporate bonds).

Lagarde also made it clear that accommodative financial conditions require not only an accommodative monetary policy stance but also a well-functioning transmission mechanism to prevent any possible credit market fragmentation within the Euro Area. This statement seems to hark back to the new bank lending survey for Q4 2020. The survey reported both a decline in bank credit demand and a tightening in bank lending standard driven by a heightened risk perception among banks concerned about the Government loan guarantees expiration in a context of continued uncertainty about the economic recovery and concerns about borrower's creditworthiness. The ECB's lending survey clarifies that without government guarantees on loans, credit standards would have been much tighter. Tightening credit standards is now a concern, forming part of the ECB's holistic definition of financial conditions, and this should mean that the ECB may be forced to do more in the spring, especially in the event of negative shocks stemming from the pandemic.

WEEKLY MARKET RECAP

NAME	LEVEL		Δ WEEK
MSCI World AC	2 755,66	▲	1,5%
S&P 500	3 841,47	▲	2,0%
NASDAQ Composite	13 543,06	▲	4,2%
SX5E	3 602,41	▲	0,1%
DAX	13 873,97	▲	0,6%
CAC 40	5 559,57	▼	-0,9%
FTSEMIB	22 088,36	▼	-0,9%
IBEX 35	8 036,40	▼	-2,3%
FTSE 100	6 695,07	▼	-0,6%
MSCI Emerging	1 392,85	▲	2,6%
CSI 300	5 625,92	▲	2,0%

Strategic View

The extensive liquidity provided by central banks, the tax stimulus measures and potential inflows could support the positive trend of the equity markets.

EQUITY MARKETS

Profit taking or awareness raising?
After the first days' gains, last week has been characterized by take profits and fears of increased contagion. Vaccination rates remain below expectations. The increase in new cases of Covid in China and South East Asia, as well as fears of new restrictions, put stock markets on edge in the final sessions. In France, the Health Minister, Olivier Véran, is concerned about the variant of the virus and its proliferation on European territory, which could lead to further lockdowns. In the Eurozone/UK, important developments are reported: in Germany, the agreement for tax relief of € 11bln between the central and federal states; in France, Finance Minister LeMaire sees concerns with the problematic growth target of 6% in 2021; in Italy, a complete political confusion and risk of new elections; in the UK, the government is ready to launch a new aid plan to support workers affected by pandemic. In addition, macro PMI data showed signs of weakening. The dovish tone was also maintained by the ECB, which by through bearing widening on spreads confirmed the markets' dependence on monetary policies. Overseas, there was a little more euphoria as stock markets rallied on expectations of the US fiscal plans and their impact on the economy and corporate earnings. The US stock market celebrated Biden's inauguration with a new record high for the S&P on the Inaugural Day and the Nasdaq was up 2%, driven by Netflix and chipmakers... "Made in All of America!" Among the first executive orders signed by the new President, it is noteworthy the return of the US to the Paris Agreement on climate change. The ESG theme has been the catchphrase of 2020 and will continue to be so in 2021 with 42% of global equity flows into ESG funds. According to the last BofA ML's Fund Manager Survey (FMS) update: highs in EPS/yield/inflation/EM and an 8-year record low in cash held in portfolio (<4%), synonymous with "bullish" sentiment; BitCoin and Tech the most crowded trades with major tail risks being the vaccine rollout (39%) and the Wall Street Bubble (18%). SXXE at +0,1% with Auto&Parts and Tech +4% vs Travel&Leisure and Banks -3%.

NAME	LEVEL		Δ WEEK
Gold	1 856	▲	1,5%
Silver	25,49	▲	2,9%
WTI	52,27	▼	-0,3%
Brent	55,41	▲	0,6%

NAME	LEVEL		Δ WEEK
VIX (S&P 500)	21,91%	▼	-10,0%
V2X (SX5E)	21,32%	▼	-5,0%

COMMODITIES AND VOLATILITY

Oil traded at around $53 per barrel during the week. API's (American Petroleum Institute) weekly inventories saw an unexpected build-up of over 2,5 million barrels. A figure that confirms the latest weak global oil demand estimates for 2021: The International Energy Agency lowered its forecasts for global oil demand as renewed lockdowns measures dampen the recovery expected this year. The IEA cut its consumption estimate for this quarter by 600000 barrels per day, projecting a slight decline from the end of last year. However, the world's swelling oil inventories are set to fall by 100 million barrels over the three-month period as Saudi Arabia and other OPEC+ nations curb supplies.

WEEKLY MARKET RECAP

NAME	LEVEL		Δ WEEK
US 10-year Yield	1,09%	▲	0,2 bp
GER 10-year Yield	-0,51%	▲	3,1 bp
FRA 10-year Yield	-0,28%	▲	4,1 bp
ITA 10-year Yield	0,75%	▲	13,8 bp

Strategic View

US Treasuries. The Fed's massive expansive monetary policy has brought government bond yield far below 1% on the main maturities. Our view remains neutral in light of the current volatility.
Euro government bonds. Despite the monetary easing, we do not see value in this asset class given the significant negative yields, particularly on triple-A issues.

NAME	LEVEL YTW		Δ WEEK
USD Invest. Grade	1,86%	▼	-0,1%
EUR Invest. Grade	0,25%	▼	-0,1%
USD High Yield	4,15%	▲	0,1%
EUR High Yield	3,31%	▲	0,3%
Emerging Local ccy	3,23%	▼	-0,2%
Emerging Hard ccy	3,30%	▲	0,3%

NAME	LEVEL		Δ WEEK
Itraxx Main	48,88	▼	-2,1 bp
Itraxx Xover	253,564	▼	-4,6 bp
Itraxx Sub Fin.	116,12	▼	-3,9 bp
CDX North Am. IG	51,078	▼	-0,9 bp
CDX North Am. HY	305,12	▲	1,1 bp

Strategic View

Corporate IG: monetary easing could further support the asset class to opt for, especially in Europe, over the most speculative segment (high yield) and government bonds, as corporate IG presents a more interesting risk/return ratio at this stage in which it is difficult to predict how the scenario risks will evolve
HY Corporate: although a further deterioration in the baseline scenario could impact the weaker issuers by bringing default rates back to higher levels, the scale of monetary and fiscal policies are likely to stabilise.

GOVERNMENT BOND MARKETS

The week, led by President Biden's Inauguration, offered no major news in the sovereign bond market. Government bonds yields in the major developed countries remained stable.
In the US, markets are currently focusing on interpreting President Biden's fiscal ambitions and the right mix of fiscal and monetary stimulus. For 2021, the US has already committed to almost 5% stimulus (the $900 bn package from December) and is looking to upsize this by another $1,9tn. The amount of support should be able to close the output gap and support the recovery.
In Europe, the focus was on the ECB policy meeting and the latest ECB's lending survey, showing progressively tighter credit conditions. Following the ECB meeting, market reaction shows that many investors interpreted the policy statement and press conference as hawkish. European government bond yields rose and sovereign spreads widened, probably driven by both the US rate dynamics and a radical interpretation of Lagarde's words on endogeneity and flexibility of the PEPP. As no new measures were announced, the market's attention was largely focused on the ECB's position on the PEPP, particularly on the fact that 'the EUR 1850bn envelope may not be fully utilized by March 2022'. Lagarde described the ECB's position on the PEPP as "a balancing act", and markets seem to have reacted to this definition as a more hawkish comment than the ECB's broadly accommodative stance. Provided the PEPP is not fully utilized, this could translate into a risk for sovereign spreads and in particular the BTP, given the recent political instability in the country. However, the economic scenario, downside risks, the low level of inflation and the pandemic evolution suggest that the most realistic assumption is that the PEPP will be fully utilized, if not expanded.

CORPORATE BOND MARKETS

The credit market week closed on a negative tone and it was characterized by both a volatility resumption and spreads widening due to reports of growing Covid-19 infection rates globally and more lockdowns as vaccination rates remain below expectations. The trouble for the Italian government majority weighed on the peripheral issuers: Italy's Prime Minister Giuseppe Conte survived a key vote of confidence in the Senate Tuesday with a thin majority. In addition, the ECB meeting failed to support peripheral spreads although President Lagarde confirmed expansionary monetary stance.
IG credit markets indexes closed negative (with -0,07% in Europe and -0,04% in the US). Despite the weak close, HY indexes ended higher both in Europe +0,26% and in the US +0,07%.
European CDS indices tightened slightly during the week with the Main (IG) -2bps and Xover (HY) -5bps. In th US they were essentially flat.

EXCHANGE RATES

NAME	LEVEL		Δ WEEK
Dollar Index	90,24	▼	-0,6%
EUR/USD	1,2171	▲	0,7%
GBP/USD	1,3686	▲	0,7%
EUR/GBP	0,8898	▲	0,1%
EUR/CHF	1,0776	▲	0,1%
USD/JPY	103,78	▼	-0,1%

Strategic View

As the outlook for the global economy darkens, the US dollar will take advantage of its safe haven role.

The US dollar weakening trend resumed during the past week. The greenback lost ground against all the G10 currencies and almost all the Emerging Markets' currencies. Real rates in US returned below -1% and this move was partially responsible for the weakness of the US Dollar.

On Thursday, Christine Lagarde delivered an uninspired speech, signaling the desire of the central bank to be "reactive" rather than "proactive" during the period that should see the European economy exits the pandemic crisis. This attitude by the ECB may further push the euro higher, in particular against USD. The FED, thanks to the new approach (average inflation targeting), will maintain monetary accommodation for much longer than in the past, supporting a weaker dollar. The just announced fiscal package in US (worth about 1,9 trillion USD) will contribute to the weakening of the currency.

Emerging market currencies may be the main beneficiaries of a weaker USD. However, vaccination plans around the globe remain crucial: any significant delay in distribution means restrictions will remain in place longer than expected, harming the global recovery

THE WEEKS AHEAD: UPCOMING DATA

Europe: The Q4 GDP string publication for the different countries will start this week. Germany will publish the IFO confidence index. In addition, the EC surveys should be able to add details to the picture provided by the PMI indices and M3 report will also be instructive as the quantitative measure of the warning signals from the last bank lending survey.

United States: The FOMC meeting will be the main event of the week, outside of President Biden's administration taking shape. On the macro data front, data on unemployment claims and consumer confidence will be released, as well as new mortgage applications. Personal income reports will help capture December's fiscal impulse.

Asia: Japan will publish data on industrial production and inflation, as well as the unemployment rate.

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