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ECB MONETARY POLICY IS WORKING

Berenberg Macro Flash

The ECB's monetary stimulus is reaching the real economy. The further advance in loan growth in March points to firm consumer demand and more business investment ahead. At the same time, the still-rapid gains in M1 money supply show that companies and households have ample liquid balances to step up their spending for the foreseeable future. As inflationary pressures remain subdued, the additional spending will raise real GDP rather than prices. Note that the advance in core inflation (ex energy and food) from 0.7% in March to 1.2% yoy in April reflects largely the effect of the late Easter holiday, which pushed the expensive Easter travel season from March (hence core inflation of 0.7% in March instead of the 0.9% of the previous three months) into April, raising April core inflation well beyond its trend. We look for core inflation to normalise to 1.0% in May with a chance of 0.9% instead.

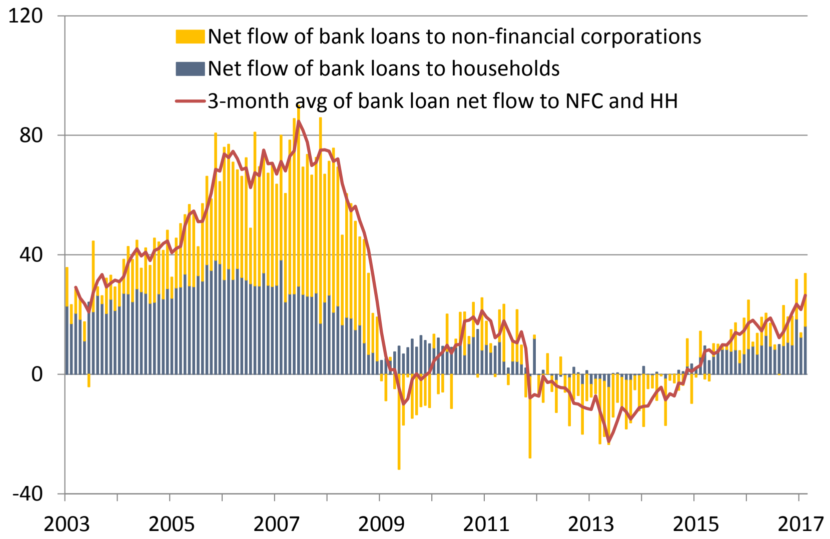
CREDIT CYCLE IS TURNING UP

Eurozone bank lending to the private sector rose 2.7% yoy in March after 2.3% in the previous month. Both households and businesses contributed to the gain. The annual growth rate of loans to households advanced to 2.4% in March 2017, the highest since April 2009 and up from 2.3% in March 2017. Bank lending to non-financial corporations also accelerated from 1.9% in February to 2.3% in March. The monthly net flow of bank loans to households and non-financial corporations (€33.7bn) was the highest since November 2008 (€33.8bn), with the 3-month average edging up to the highest since January 2009 (see chart 1). Data are adjusted for sales and securitisations to highlight the underlying trend. Of course, the late Easter holiday may have contributed slightly to the March gain in loan growth.

The ECB's cheap cash is slowly, but continuously making its way from the banks to the private sector: Unlike real M1 money supply, credit is a coincident rather than a leading indicator of economic activity, with loans to households usually slightly ahead and loans to companies slightly behind the overall business cycle. Bank lending followed the path of gradual recovery observed since the beginning of 2014, but annual growth of loans did not turn positive before May 2015. The global financial crisis and euro crisis have made businesses and households hesitant to borrow, invest and spend. This caution is gradually fading now. We expect bank lending growth to edge higher this year, with only small speed bumps along the way as French political risks and the risk of early elections in Italy, with its troubled banking sector are not negligible. The ECB's monetary policy measures since mid-2014 are supporting financing conditions for businesses and households and thereby credit flows across the Eurozone.

Both supply and demand drive credit: The bank lending survey for the first quarter of 2017 showed earlier this week that net loan demand has increased and bank lending conditions have further eased for households and businesses. Banks also report a positive impact of the ECB's accommodative monetary policy (low interest rates, asset purchases, forward guidance) on their liquidity position, financing conditions and lending volume. That banks also stress that the negative deposit rate weighs on net interest margins supports our view that the ECB may see less need to penalise banks for parking liquidity if bank lending continues to edge up. The ECB could ease the penalty rate on such bank deposits from -0.4% to -0.25% in late 2017. The varying loan dynamics across countries may be another reason for the ECB to lift its penalty rate – while bank lending in the Germany and France is growing nicely, it is weak or still negative in Italy, Spain and Portugal. The banking sector in Italy could benefit from a raise in the deposit rate. In the press conference after yesterday's ECB meeting, Draghi once again dodged the question of whether the ECB might raise the deposit rate before the end of asset purchases. Although Draghi's comments yesterday and in the weeks before do not point towards such a step, he at least left the door a little open.

Chart 1: Net flow of bank loans to non-financial sector



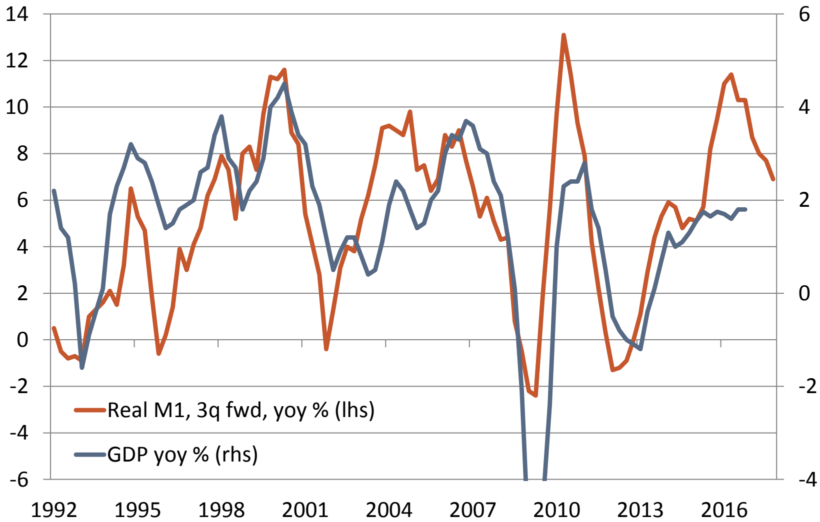
Net flow of bank loans, in €bn; from February 2009 onwards adjusted for loans sales, securitisations and notional cash pooling. Net flows to non-financial sector are 3/month moving average. Source: ECB, Berenberg

MONEY SUPPLY: AMPLE LIQUDITY TO FUEL GROWTH

Have money, will spend: Nominal M1 growth accelerated to 9.1% yoy in March, up from 8.4% in February, marking the highest rate of expansion since May 2016, the month when the UK voted itself out of the EU. Broad money (M3) growth also recovered from below 5% annual growth rates during the last 5 months and rose from 4.8% to 5.1% yoy. If a central bank makes it easy for households and businesses to raise their cash reserves and build up more overnight deposits, some of these liquid balances will eventually be spent, especially if the financial tensions – which may have initially boosted the demand for liquid reserves – subside over time.

Money matters: Real M1 money supply has been our favourite leading indicator for the Eurozone cycle for a long time. Major changes in real M1 money supply dynamics herald changes in GDP growth some three quarters in advance (see chart 2 for quarterly data). A rebound in M1 growth from mid-2012 onwards signalled the return to economic growth in spring 2013. The pace of real M1 gains increased sharply after the ECB started to loosen monetary policy again in June 2014, pointing to a major gain in cyclical dynamics from mid-2015 onwards. The economy followed suit, but only to a limited extent. As political risks weighed on growth, GDP did not do as well as real M1 and some other lead indicators had projected. If political risks fade now, still a big if 9 days ahead of the French presidential vote, GDP can expand into the upside potential which long-term indicators such as M1 have heralded for a while. The more concurrent indicators (economic sentiment, PMIs) suggest that this is happening now. As real GDP now has a lot of room to expand into the leeway created by buoyant real M1, real M1 growth need not accelerate further to lubricate the upswing. Even the current rate of expansion in real M1 remains compatible with real GDP growth above 2%, that is beyond our forecasts for gains of 1.8% in 2017 and 1.7% in 2018.

Chart 2: Eurozone real M1 versus GDP growth (yoy, in %)



Yoy changes in %, real M1 advanced by 3 quarters. Eurozone real GDP adjusted for the one-off statistical boost to Irish GDP in 2015. Source: Eurostat, ECB, Berenberg

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