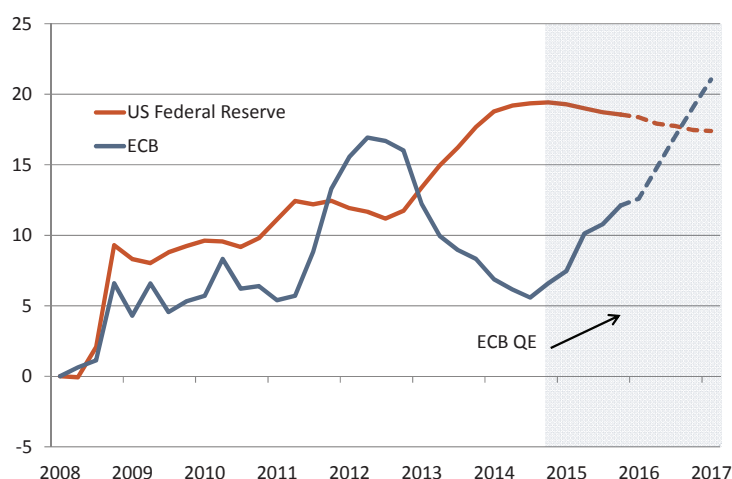


11 March 2016

Good news: ECB catching up with the Fed

Increase in central bank balance sheets since 2008, in % of GDP



Increase in ratio of central bank balance sheet to GDP, in percentage points of GDP since Q1 2008. Dotted lines: projecting a stable nominal balance sheet for the Fed and an increase in the ECB balance sheet by €80bn of asset purchases per month from April 2016 onwards. LTRs could add to that. Source: ECB, Bloomberg, Berenberg calculations

- A succession of scares haunted global markets in the first six weeks of 2016:** China is heading for a crash, low oil prices will hurt oil producers by more than they benefit consumers, the US could plunge into recession and the Eurozone may be facing another systemic banking crisis. The economic basis for these concerns always looked very flimsy. One by one, these concerns are now being debunked by reality and policy makers.
- China – no hard landing:** The Chinese authorities face serious problems. Trend growth is slowing down as the economy matures and shifts towards less investment-driven and more service-led growth. Past efforts to stimulate demand have left a legacy of debt, especially at the municipal level. But China's 6.5% growth target suggests that the authorities remain willing to use all required levers to keep demand growth close to its underlying trend even through an industrial stagnation. The modest decline in FX reserves by \$30bn in February after monthly outflows of \$100bn before shows that China still retains ample room for manoeuvre.
- Oil prices – no reason to worry:** After the big plunge, oil prices have recovered modestly, helped by signs of co-operation between major oil producers. With US supply likely to decline later this year as some rigs run dry while fewer new rigs are being drilled, chances are that oil prices will not fall dramatically again for a sustained period of time. Of course, sharp short-term moves remain possible. That outlook for oil prices should allay some of the overdone concerns of early this year about the potential damage of low oil prices. And, in the end, affordable oil at prices between \$30 and \$50 per barrel are good for the world, especially for western consumers.
- US – on track:** Far from falling into a new recession, the US economy continues to expand at a satisfactory pace, driven by consumer demand and the ongoing rebound in housing construction. The recovery has legs. Significant increases in employment and real disposable incomes, as well as pent-up demand for housing, point to further gains in domestic demand that will continue to offset a modest drag from net exports.
- ECB – good for banks, good for the economy:** The ECB did not just exceed expectations with its comprehensive policy package of 10 March. Its new stimulus is designed to ease the much overdone concerns about the banking system. One aspect of the package apparently irritated markets for a while: the ECB increased the penalty for banks to park deposits at the ECB by just 10bp from -0.3% to -0.4% and suggested that it is reluctant to go into more negative territory for rates. But that is good rather than bad news for banks. The ECB more than offset the small extra penalty for excess deposits by its cut in the refi rate, the scaling up of its asset purchases and the very generous design of its new four-year injections of long-term liquidity. The ECB has shown that it will do its utmost to prevent even a whiff of a new banking crisis and get the economy back to trend growth. Do not bet against Draghi.

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