



ECB Balance Sheet: Sterilization and Stimulus

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David Malpass
dmalpass@encimaglobal.com

212.876.4400

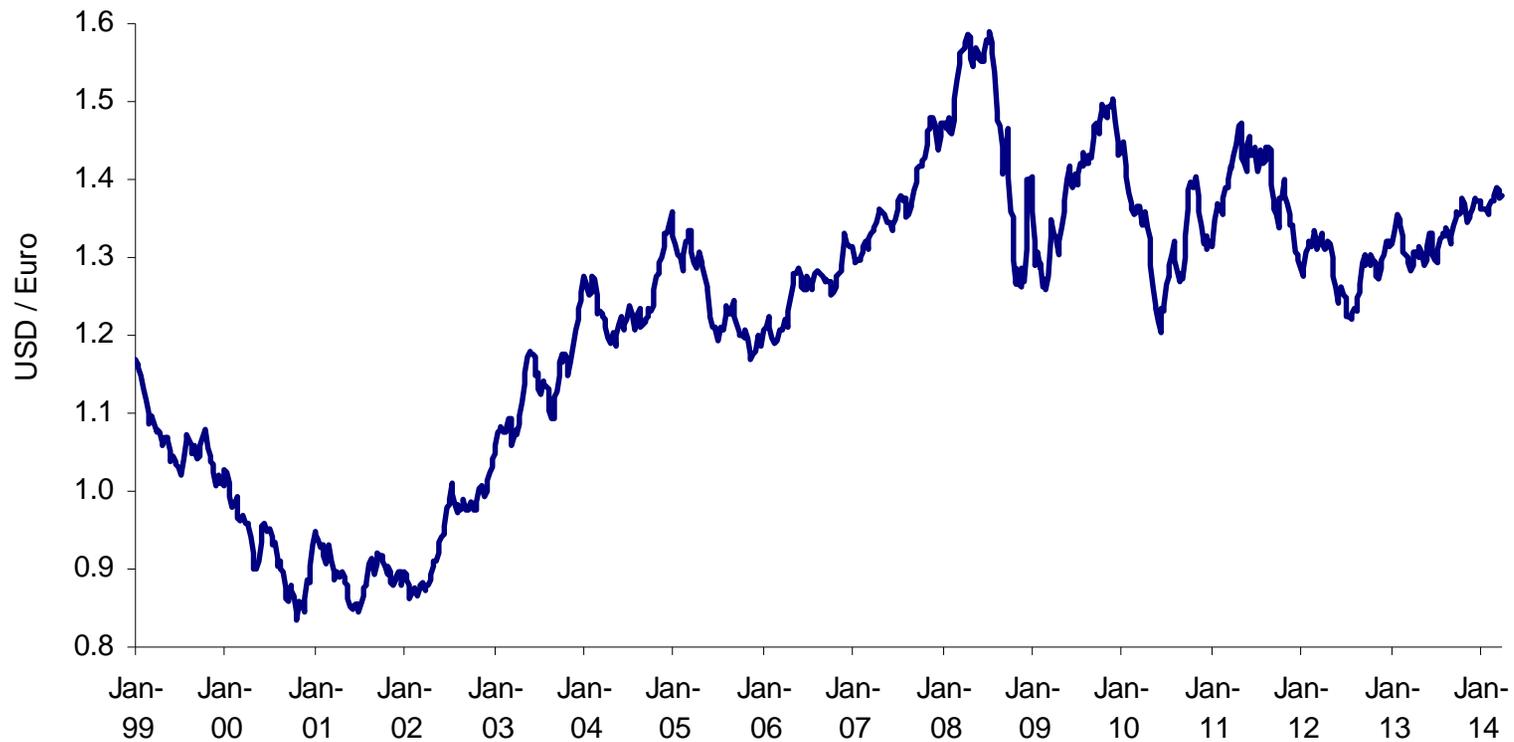
Please read the important disclosure information in the Addendum section of this presentation.

Euro Survived in 2011 and 2012

- **The ECB took major steps forward in 2011 and 2012 to reinforce the euro and reduce bond yields in the periphery.**
- **With Mario Draghi as president, the ECB cut the policy rate to 1.25% on 11/3/11 and 1% on 12/8/11. (It's now 0.25%.)**
- **The ECB lent over 700 billion euros to banks using two long-term 3-year refinancing operations.**
- **Encouraged by the ECB, the European Banking Authority reduced pressure on banks to raise equity capital. Unicredit conducted one of the last capital raises (January 2012) prior to the new forbearance.**
- **On July 26, 2012, Draghi said he would do “whatever it takes” to preserve the euro.**

Euro Up 15% Since Mid-2012 Vs \$, More Vs. Gold

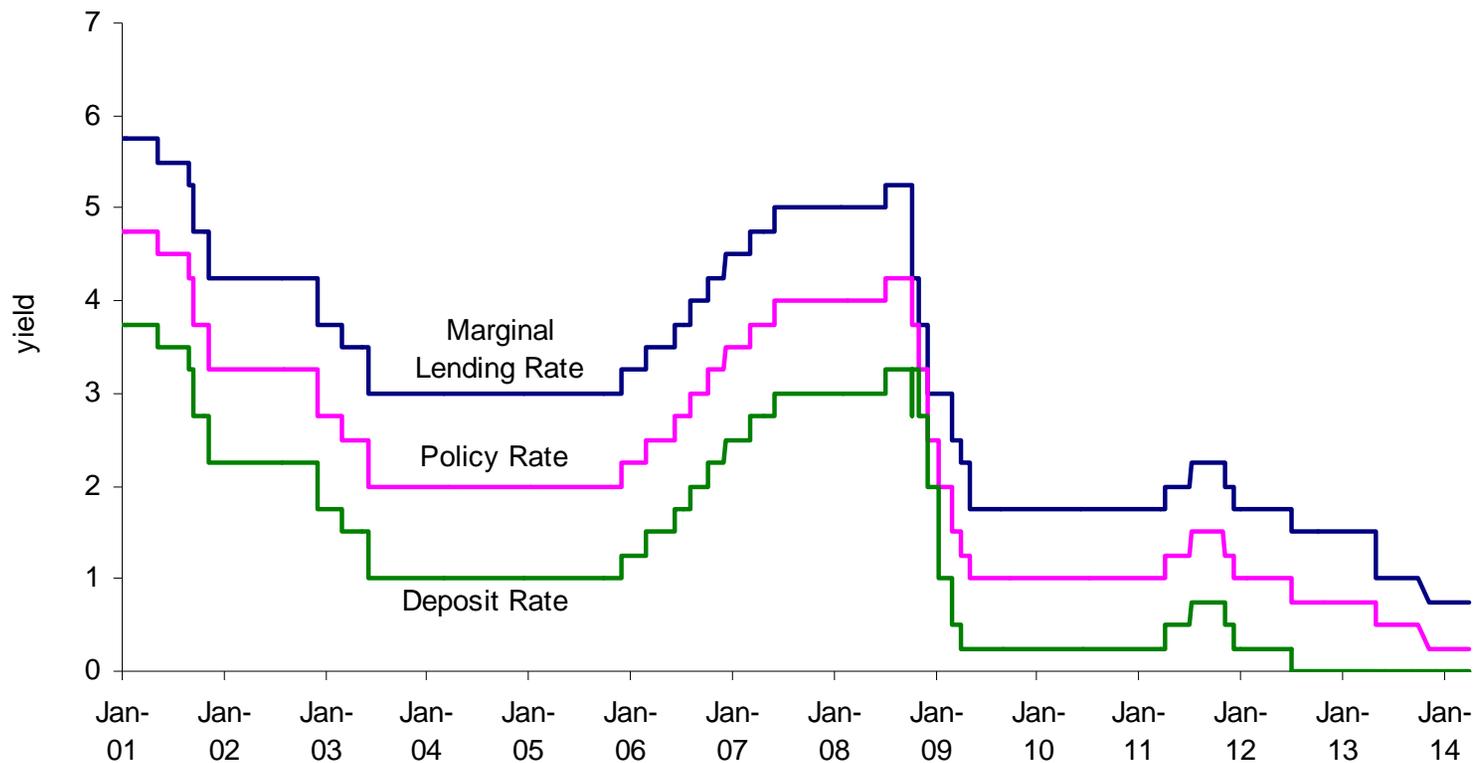
(U.S. Dollars per Euro; last obs. April 2, 2014)



Source: Federal Reserve; Encima Global

ECB Policy Rate 0.25%, Deposit Rate 0%

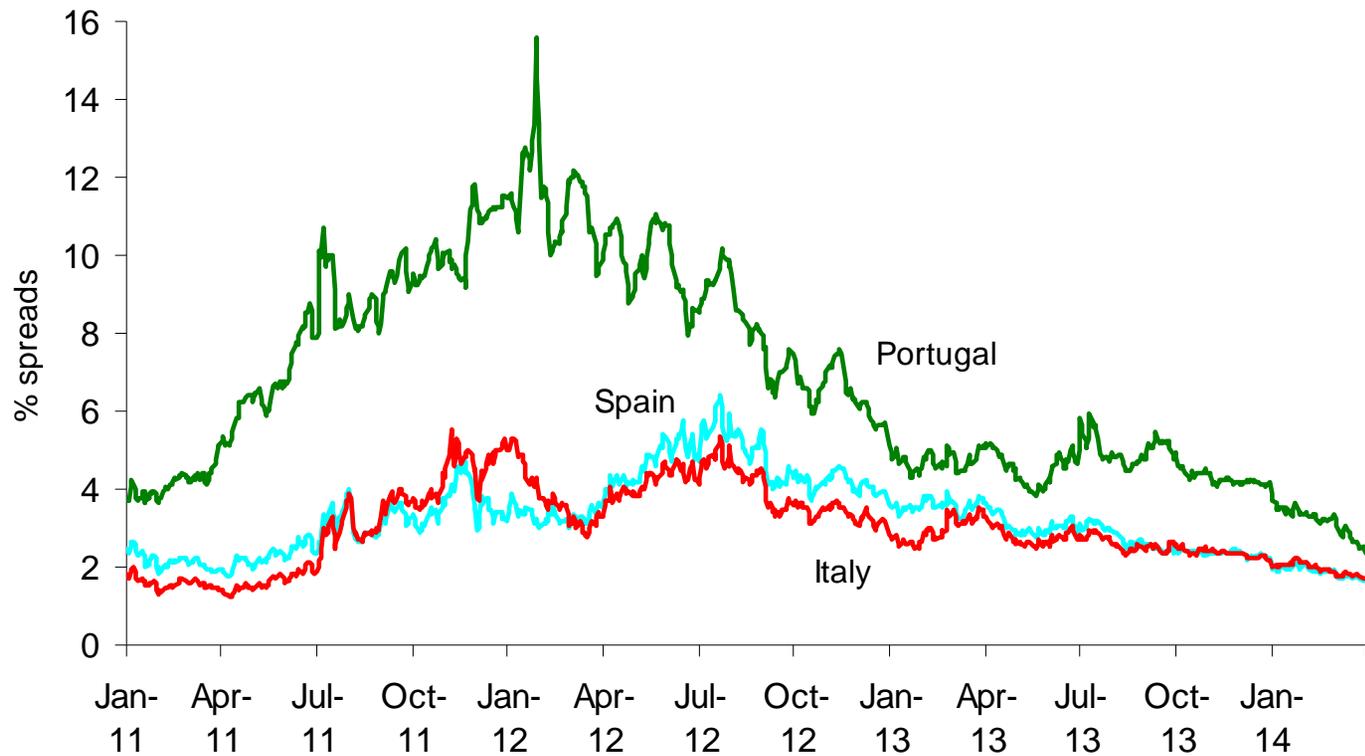
(last obs. April 2, 2014)



Source: Bloomberg; Encima Global

Periphery Bond Yields Fell Sharply in 2012-2013

(last obs. April 2, 2014)



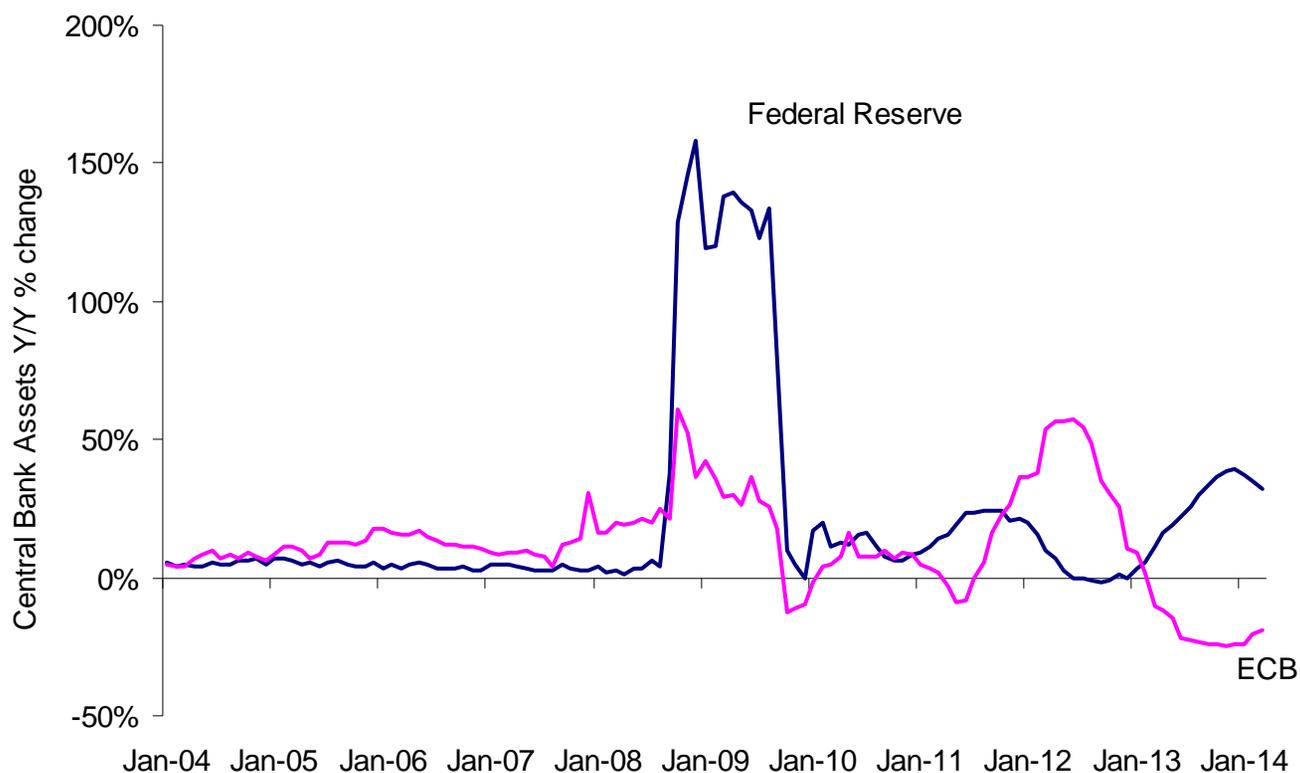
Source: Bloomberg; Encima Global

ECB/Fed Balance Sheet Comparison

- The ECB's balance sheet differs significantly from the Federal Reserve's in both size and composition.
- The ECB's assets and liabilities have shrunk back to 2011 levels, whereas the Fed's balance sheet is still growing.
- The ECB's assets have more credit and market risk than the Fed's and much less maturity. ECB not likely to pursue Fed-style QE (buying long-duration riskless assets to achieve "portfolio balancing".)
- ECB's bank reserves have almost normalized (179 billion euros) while the Fed's will reach \$3T in 2014. Both central banks have worked to diversify their liabilities: the ECB uses 0.25%-yielding 7-day deposits and the 0%-yielding deposit facility while the Fed is rapidly expanding its reverse repo program.

ECB's Balance Sheet Growth Muted; Fed's Not Muted

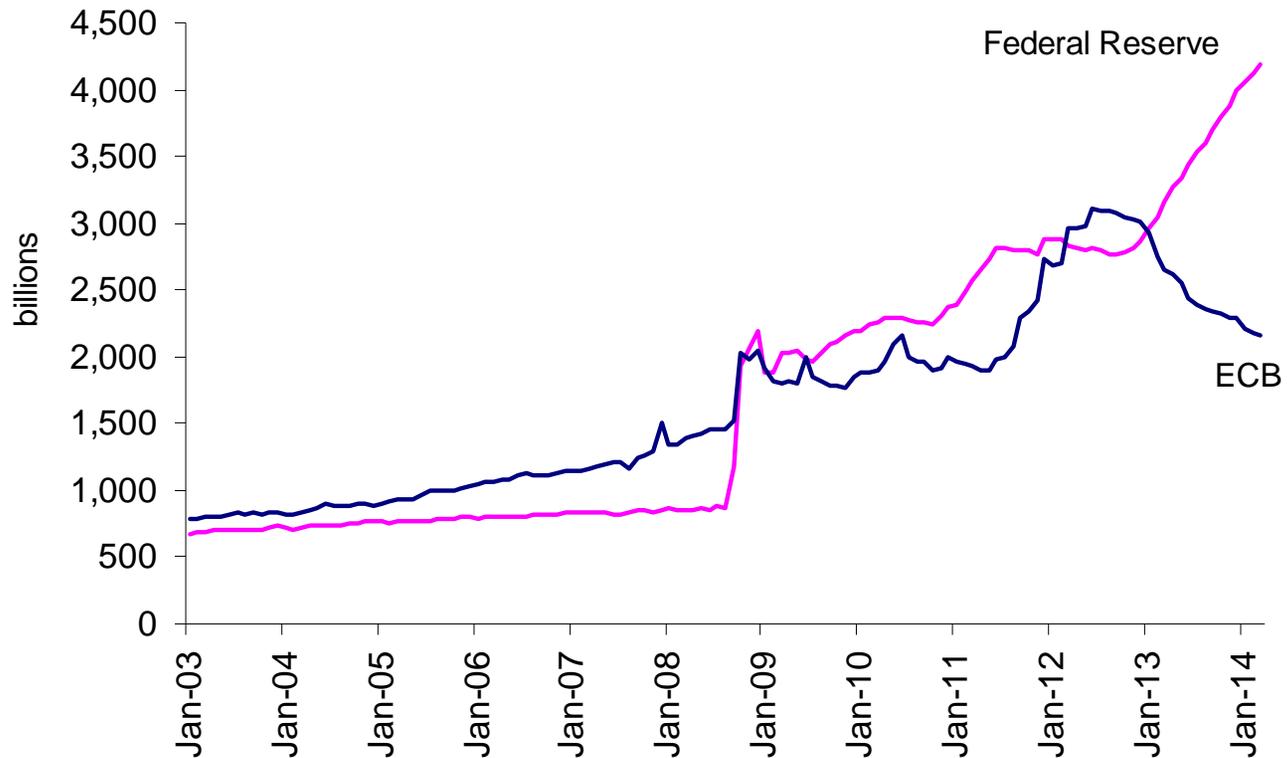
(last obs. March 2014, Fed 32%, ECB -18%)



Source: ECB; Federal Reserve; Encima Global

Focus on ECB and Fed Liabilities

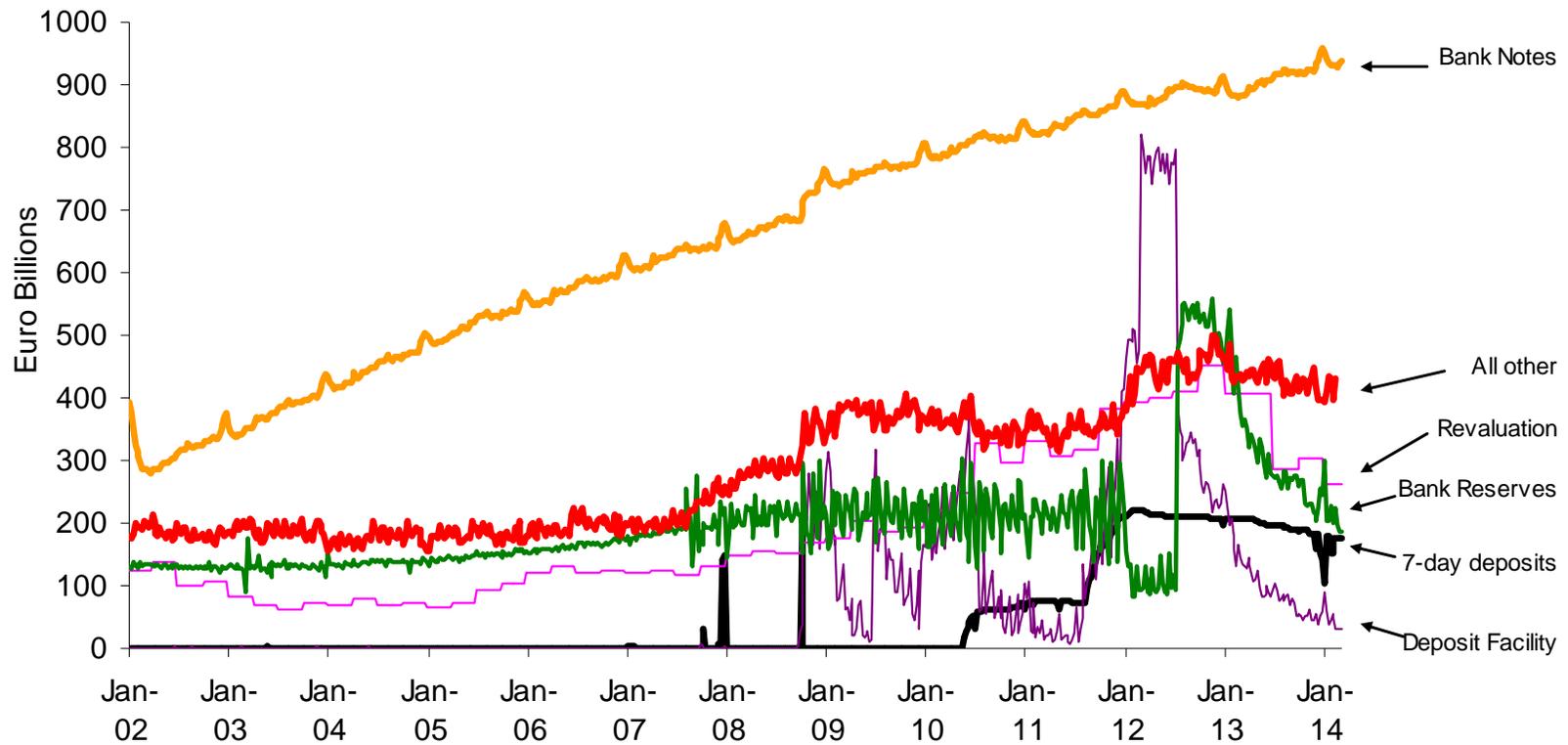
(in local currency, last obs. March 2014)



Source: ECB; Federal Reserve; Encima Global

ECB Liabilities (2.2 trillion euros)

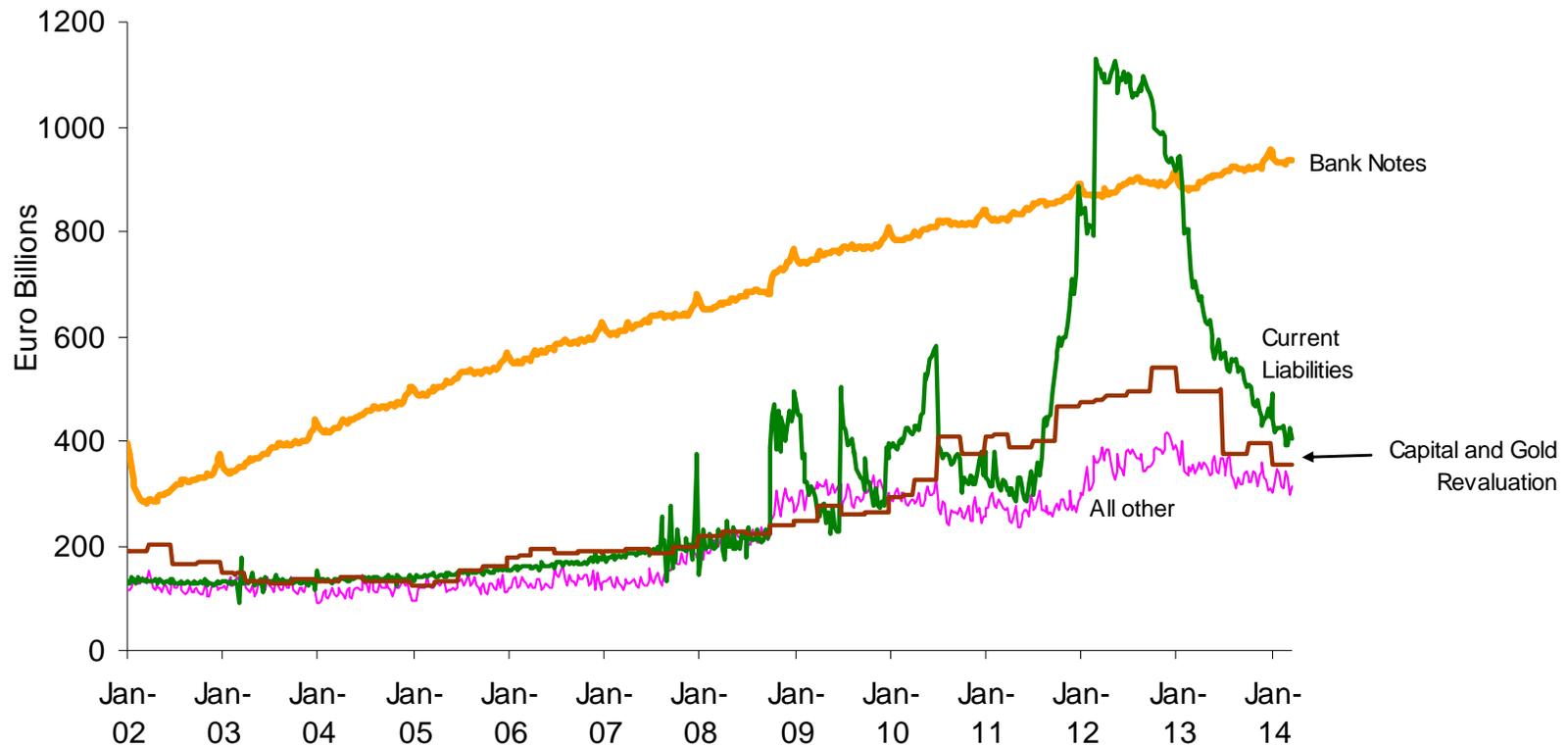
(last obs. March 28, 2014)



Source: ECB; Encima Global

ECB's Short-Term Liabilities Normalizing

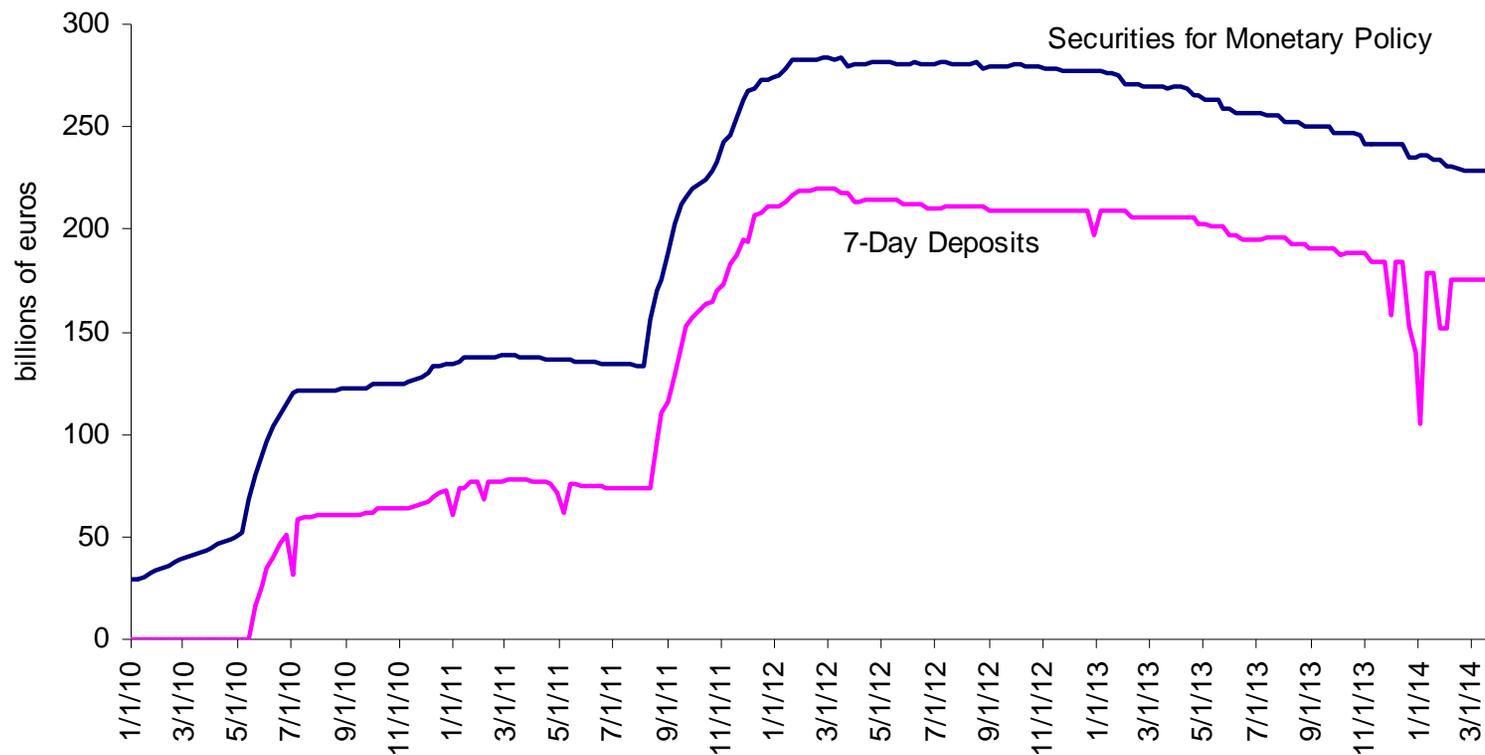
(last obs. March 28, 2014, 2.2 trillion euros)



Source: ECB; Encima Global

ECB SMP and Sterilization

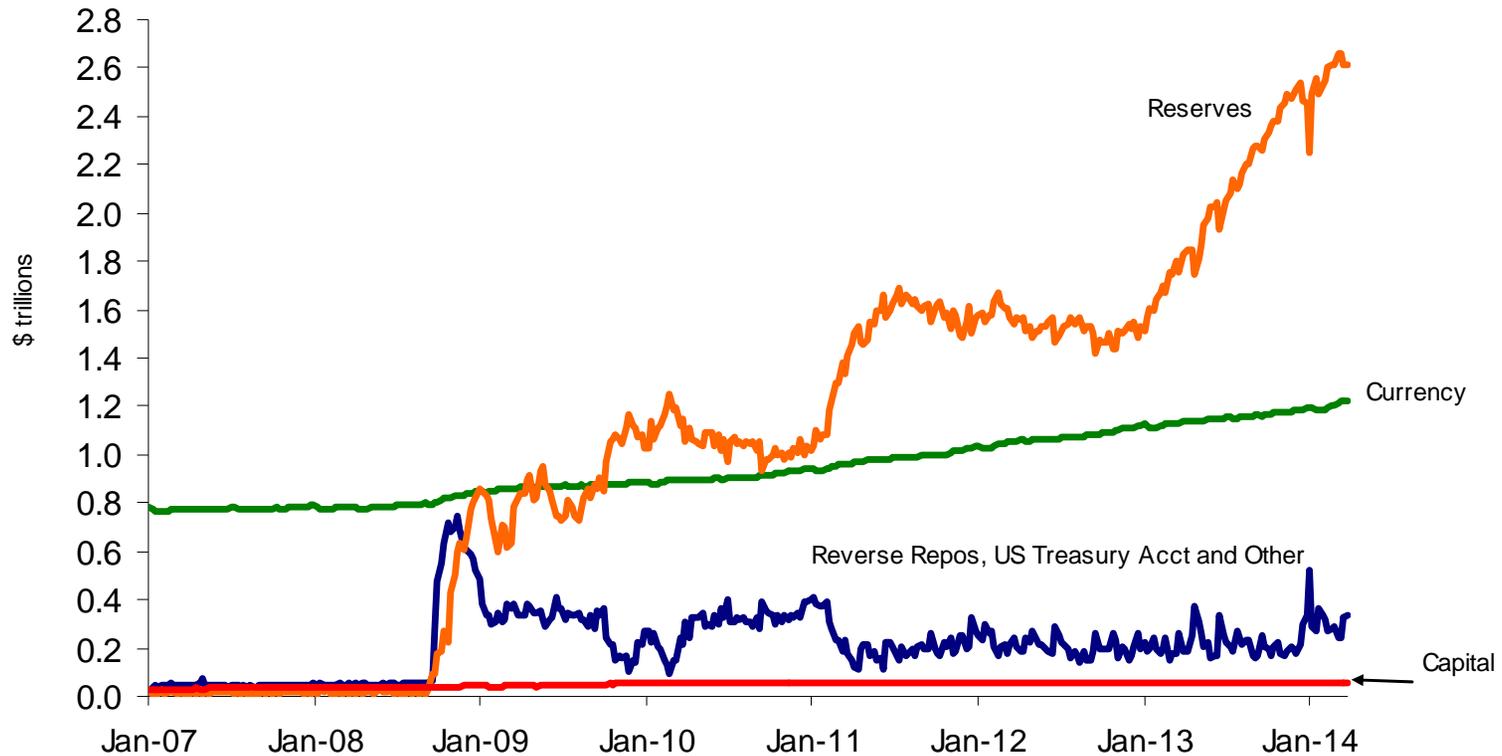
(last obs. March 28, 2014)



Source: ECB; Encima Global

Fed's Liabilities, now \$4 Trillion, Will Peak at \$4.5T

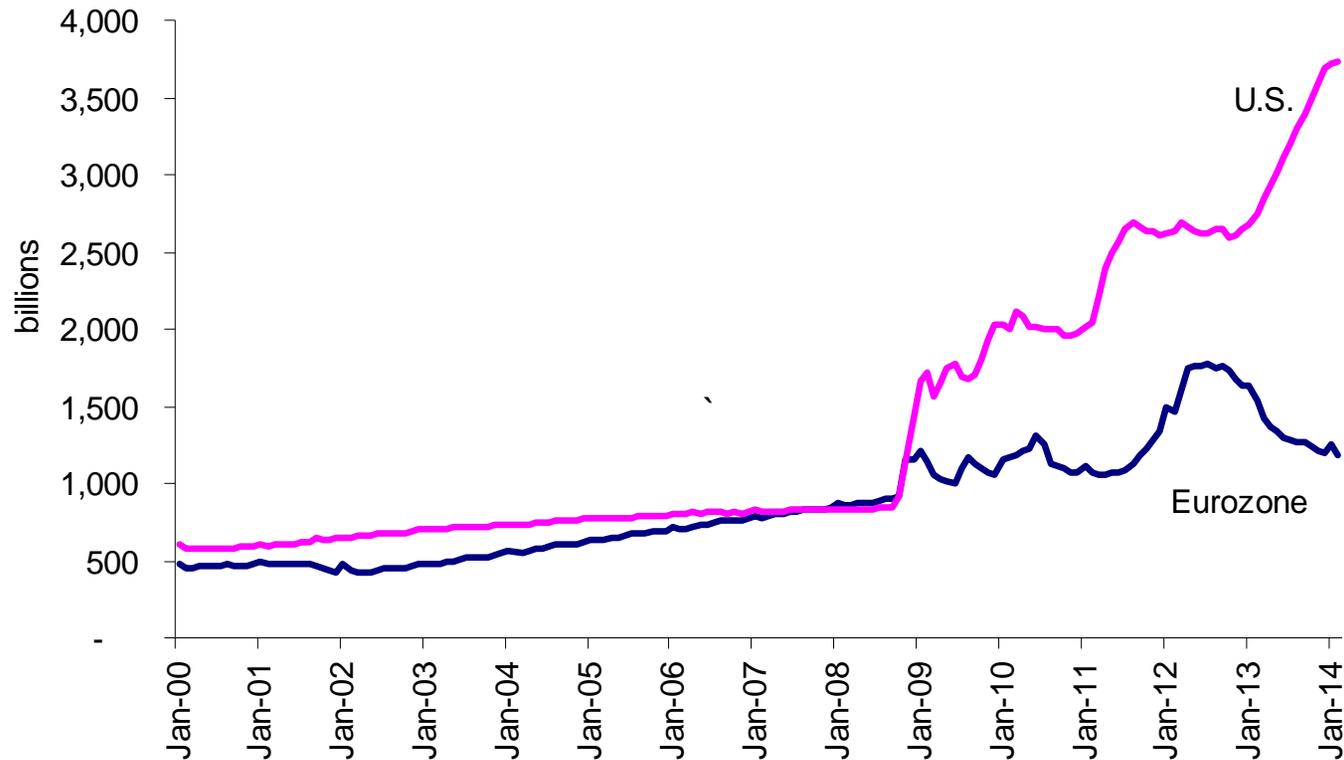
(last obs. March 26, 2014, Reserves \$2.6 trillion, Currency \$1.2T, Capital \$0.56T)



Source: Federal Reserve; Encima Global

Eurozone and U.S. M0 Monetary Base (in local currency)

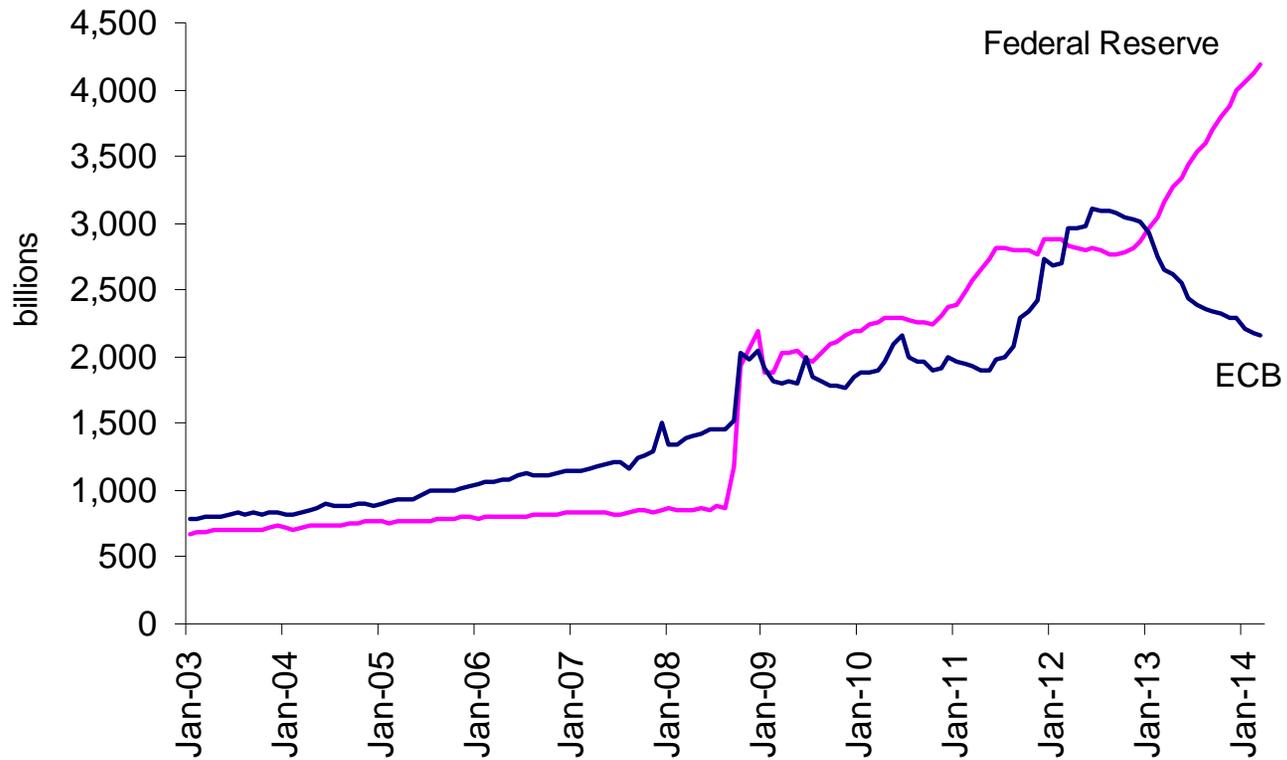
(last obs. March 2014)



Source: ECB; Federal Reserve; Encima Global

ECB and Fed Assets

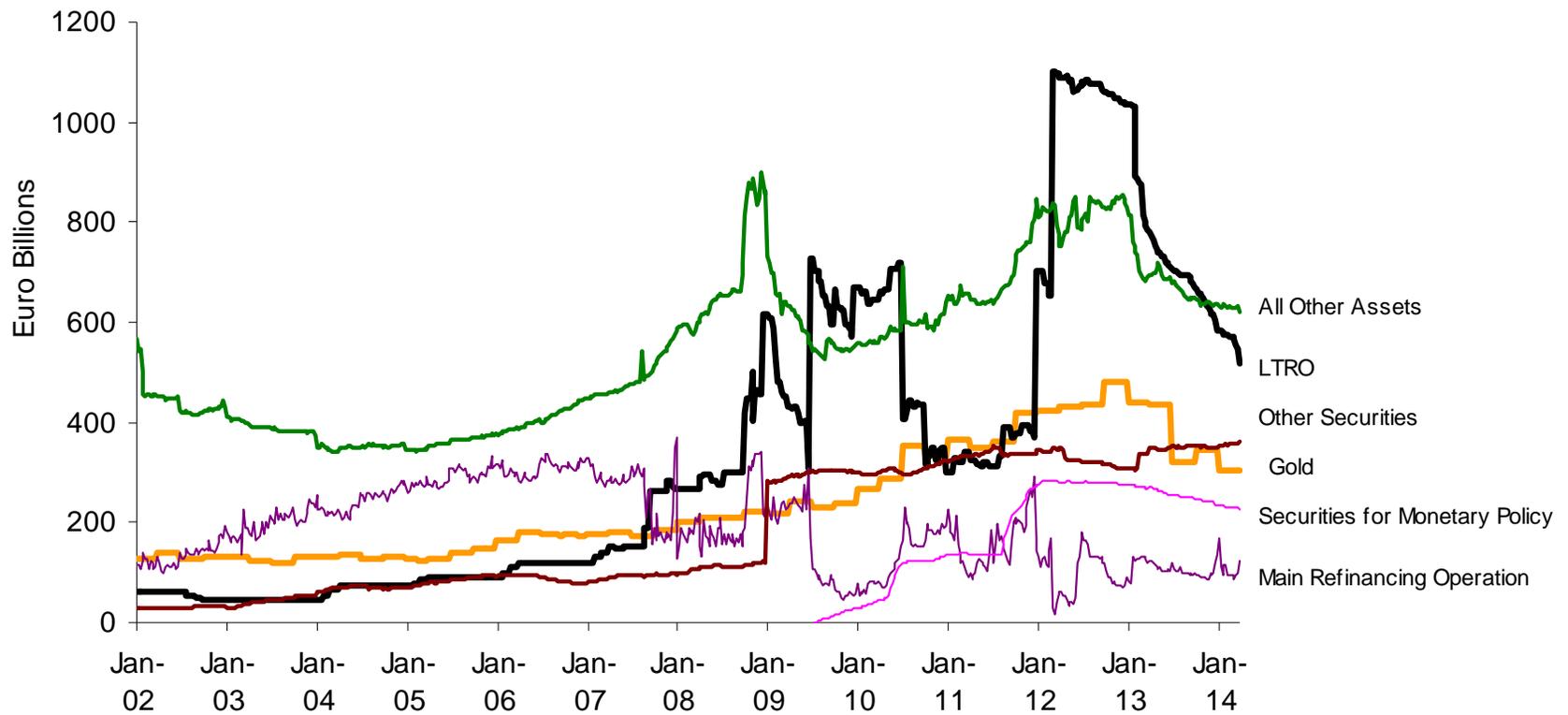
(in local currency, last obs. March 2014)



Source: ECB; Federal Reserve; Encima Global

ECB Assets 2.2T Euros Mostly Short-Term

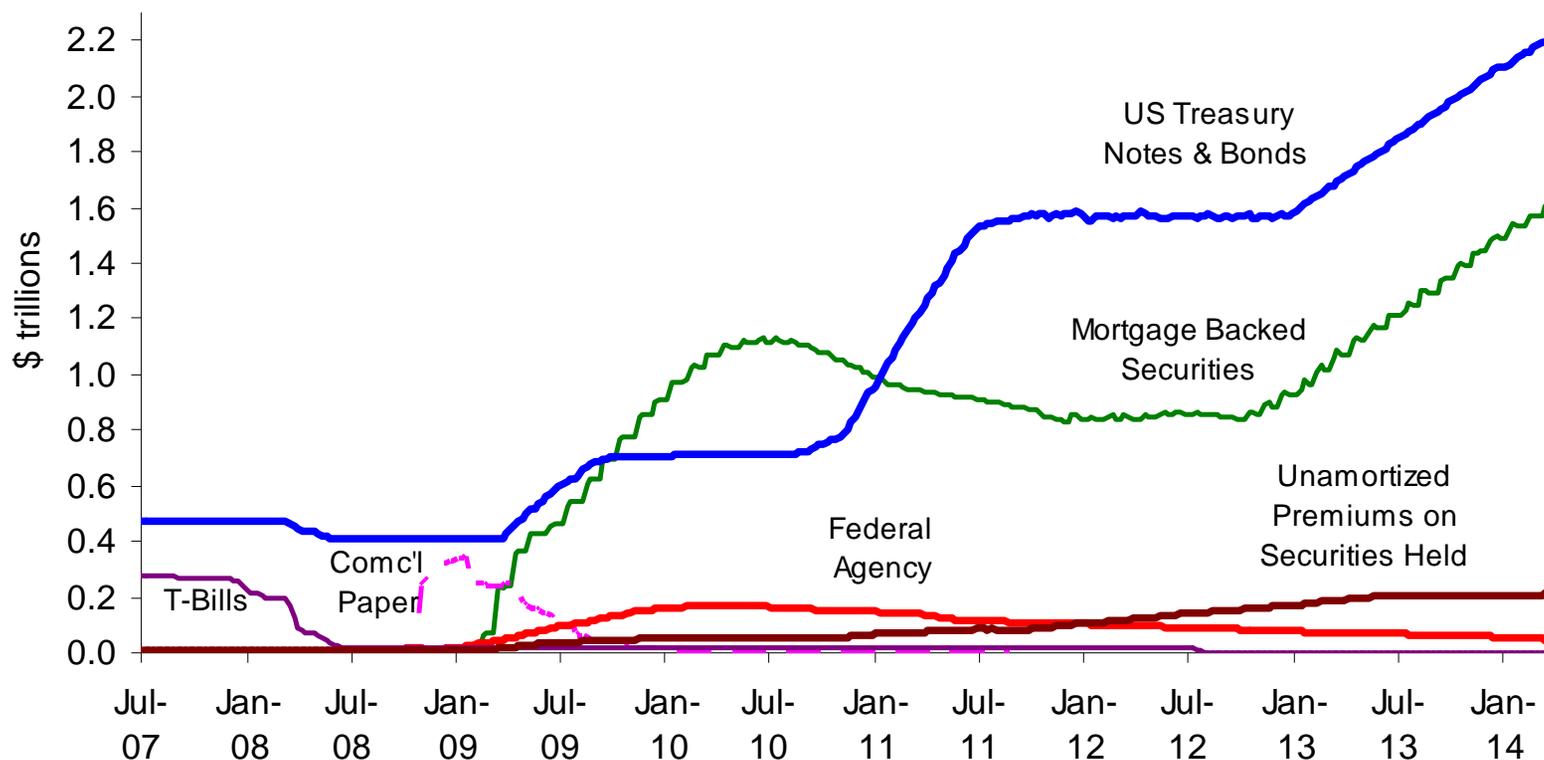
(last obs. March 28, 2014, 2.2 trillion euros)



Source: ECB; Encima Global

Fed Assets Include \$2.2T in Treasuries, \$1.6T in MBS

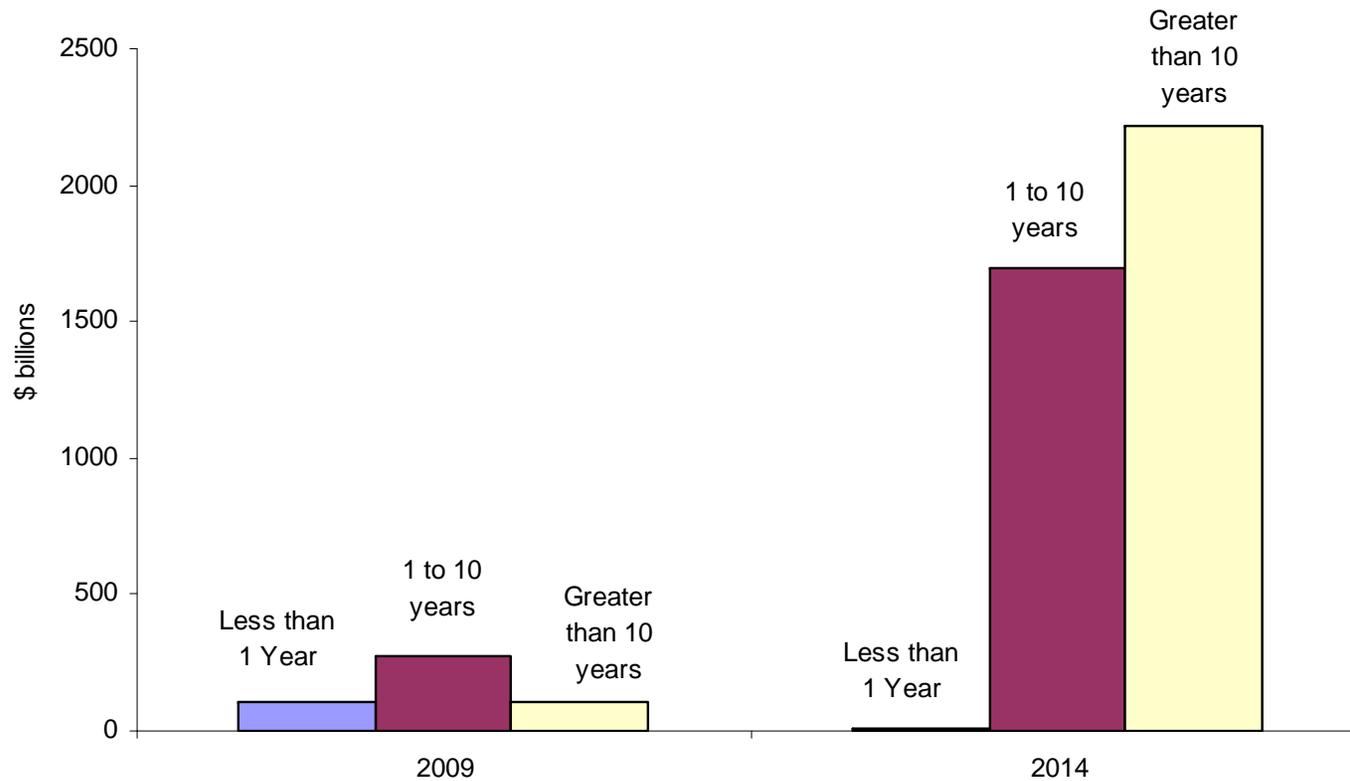
(last obs. March 26, 2014, \$4.2 trillion)



Source: Federal Reserve; Encima Global

Much Longer Maturity of Fed's Securities

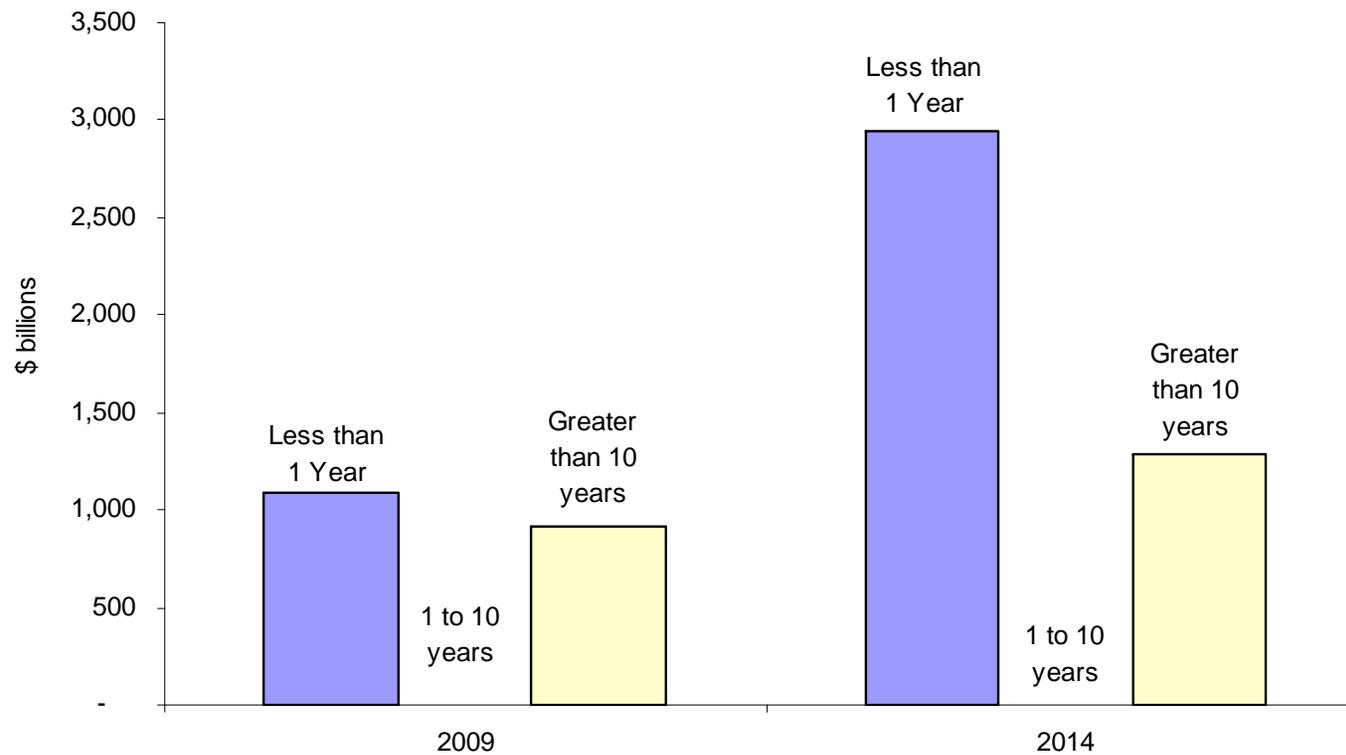
(last obs. March 26, 2014)



Source: Federal Reserve; Encima Global

Maturity of Fed's Liabilities

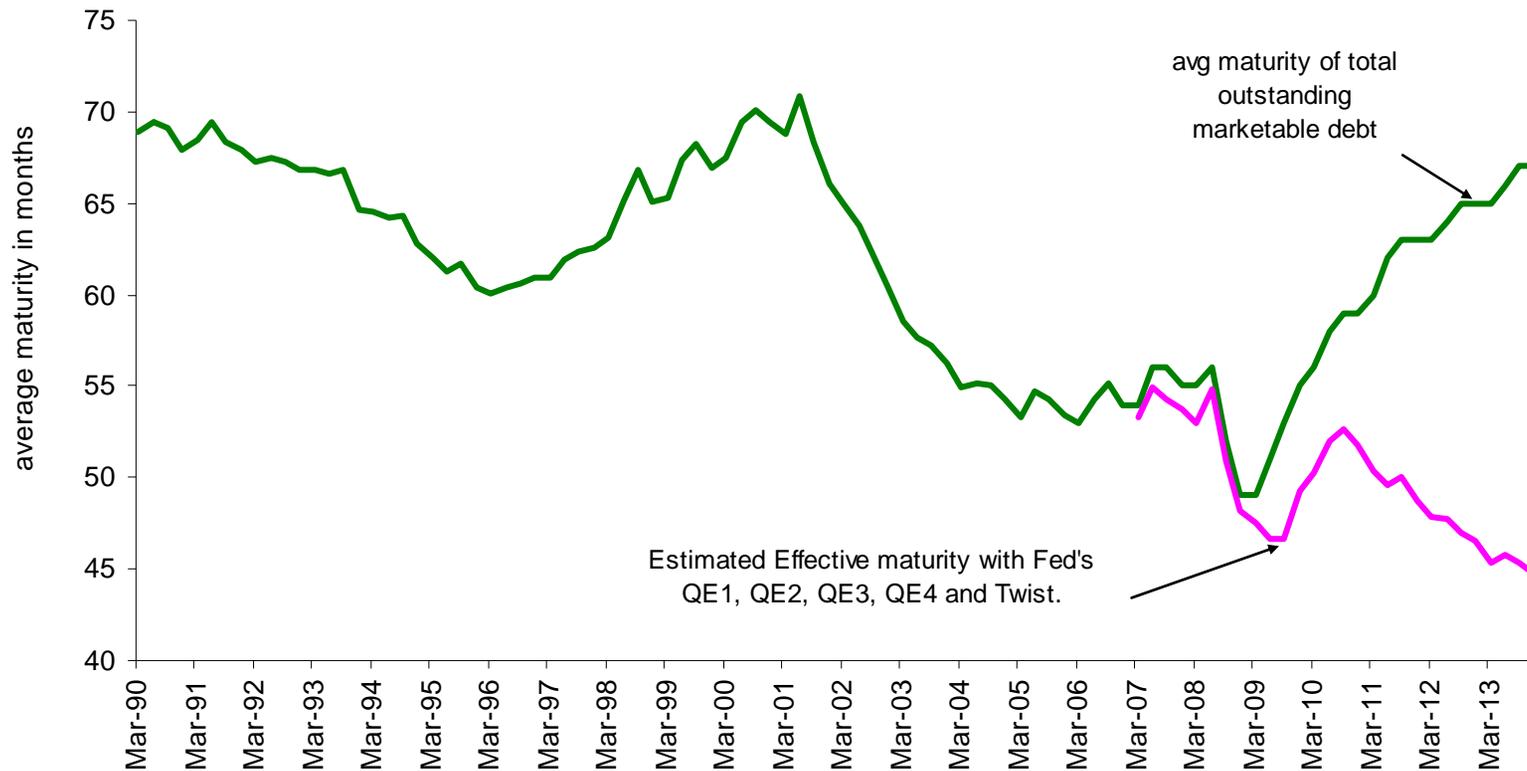
(last obs. March 26, 2014)



Source: Federal Reserve; Encima Global

Effective Maturity of U.S. Government Debt

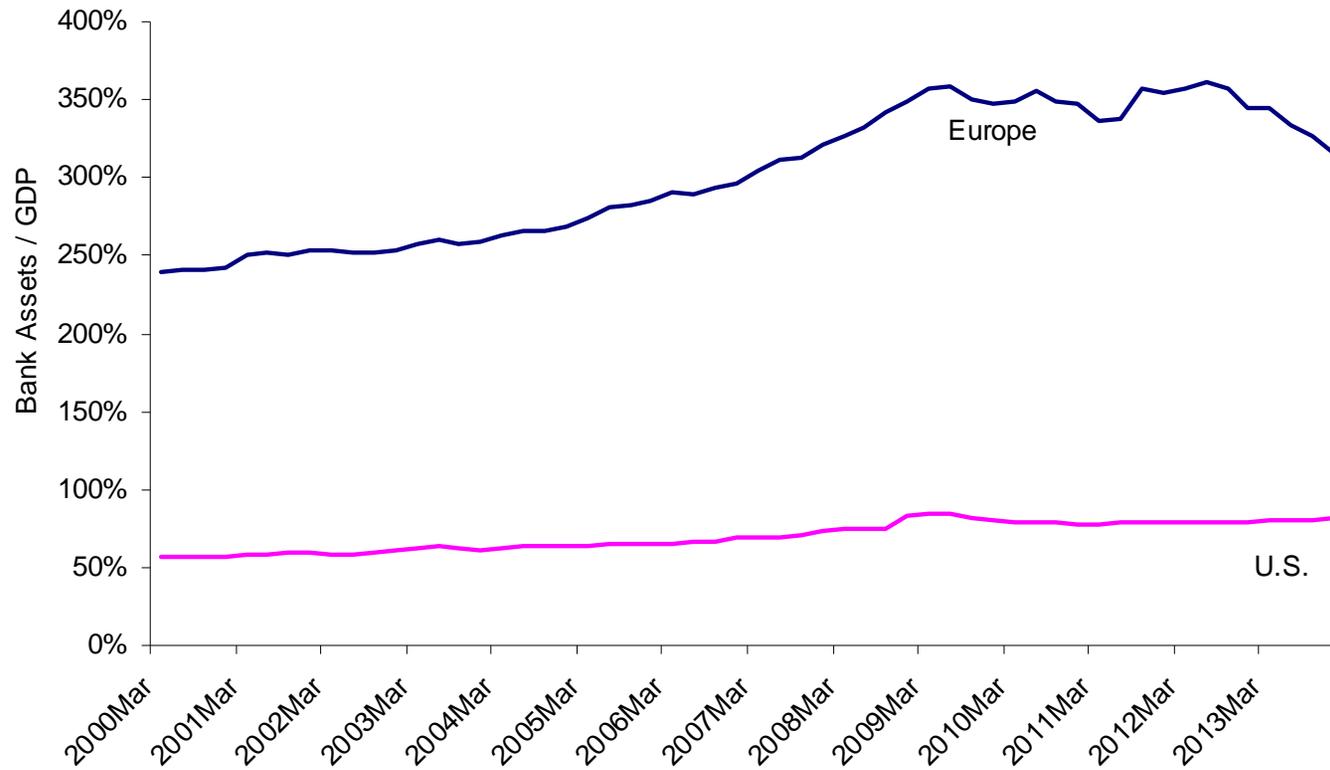
(last obs. Q4 2013)



Source: U.S. Treasury; Federal Reserve; Encima Global

Europe and U.S. Bank Assets / GDP

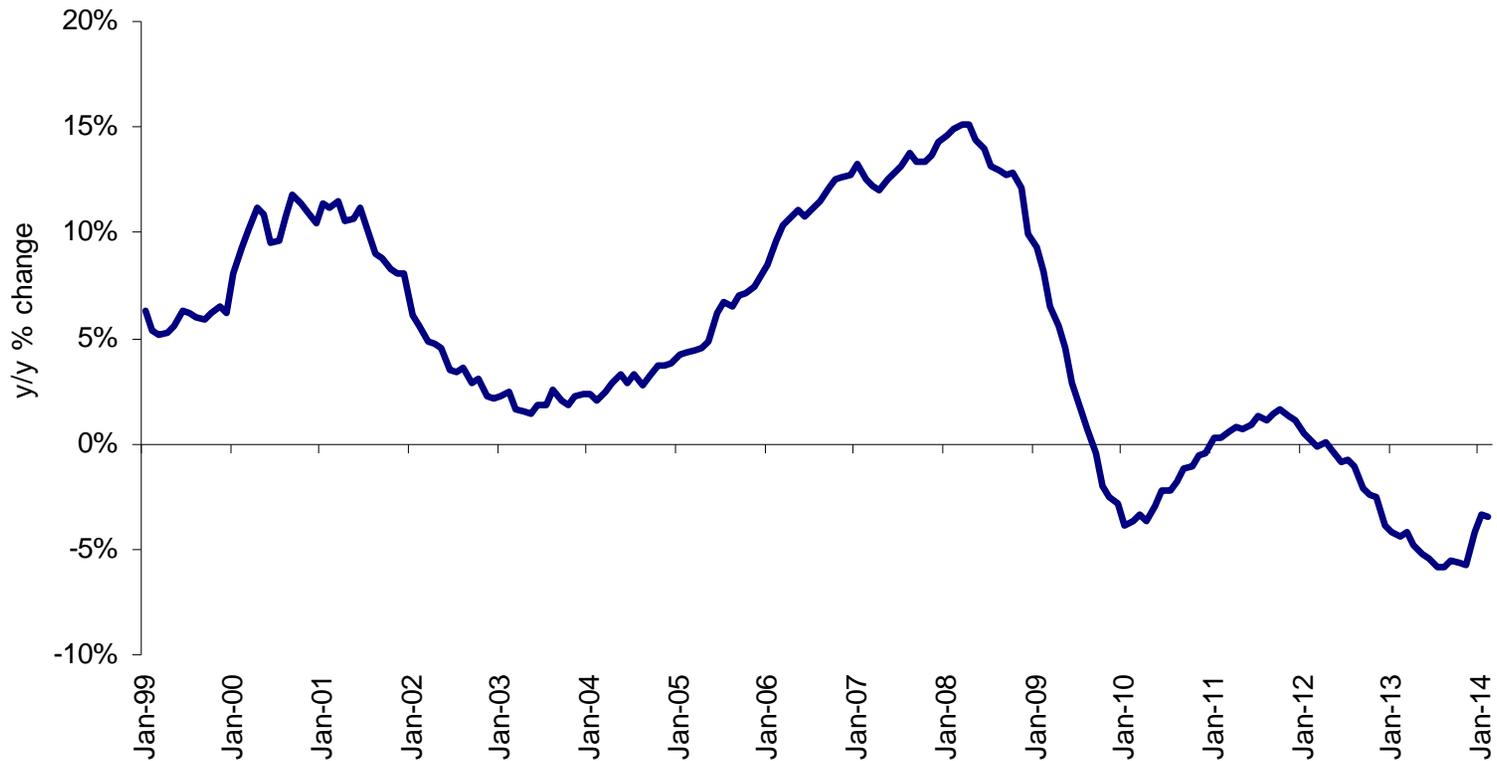
(in local currency, last obs. March 2014)



Source: ECB; Federal Reserve; Encima Global

Euro-zone Bank Lending Y/Y

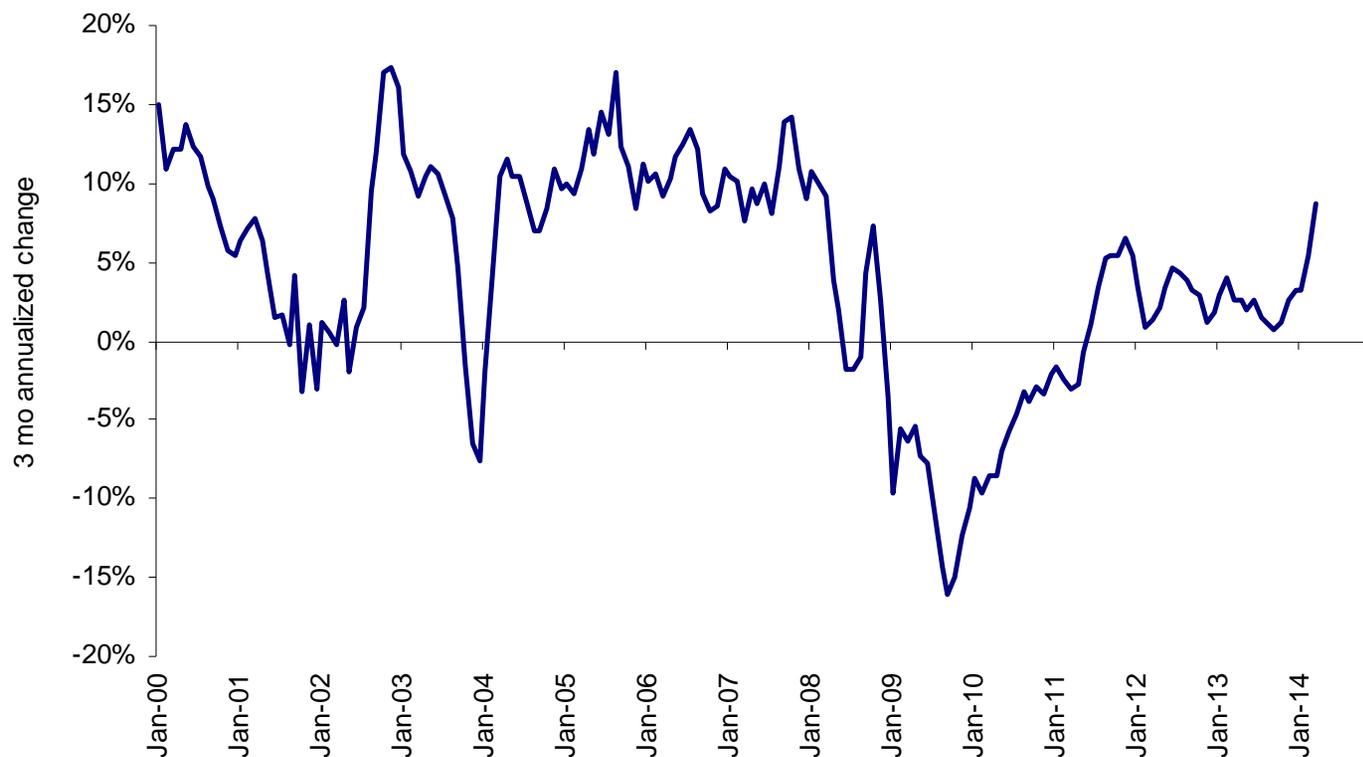
(last obs. February 2014, -3.5%)



Source: Eurostats; Encima Global

U.S. Bank Loans and Leases Hit Record \$7.53 Trillion

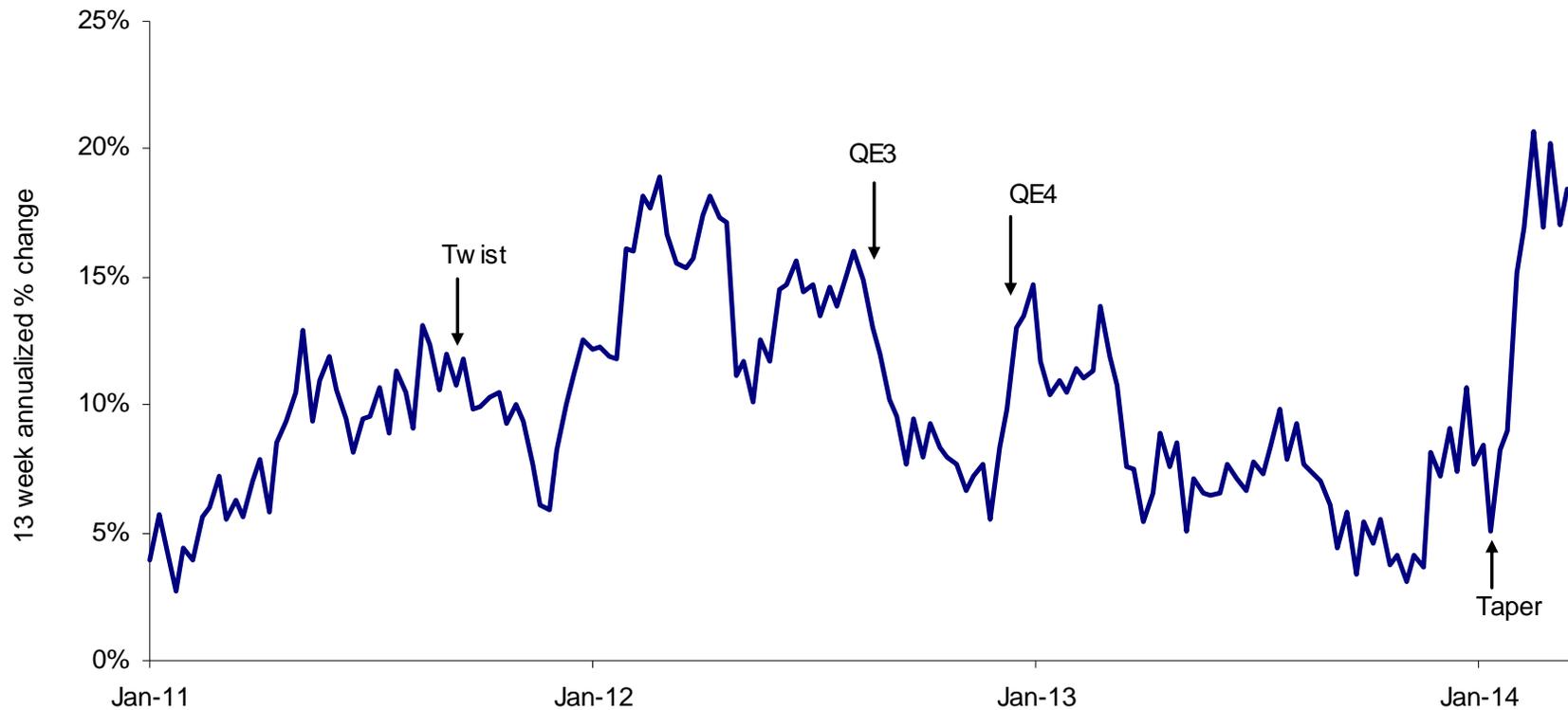
(last obs. \$7.53T March 2014, up 8.7% 3-mo annualized break adjusted)



Source: Federal Reserve; Encima Global

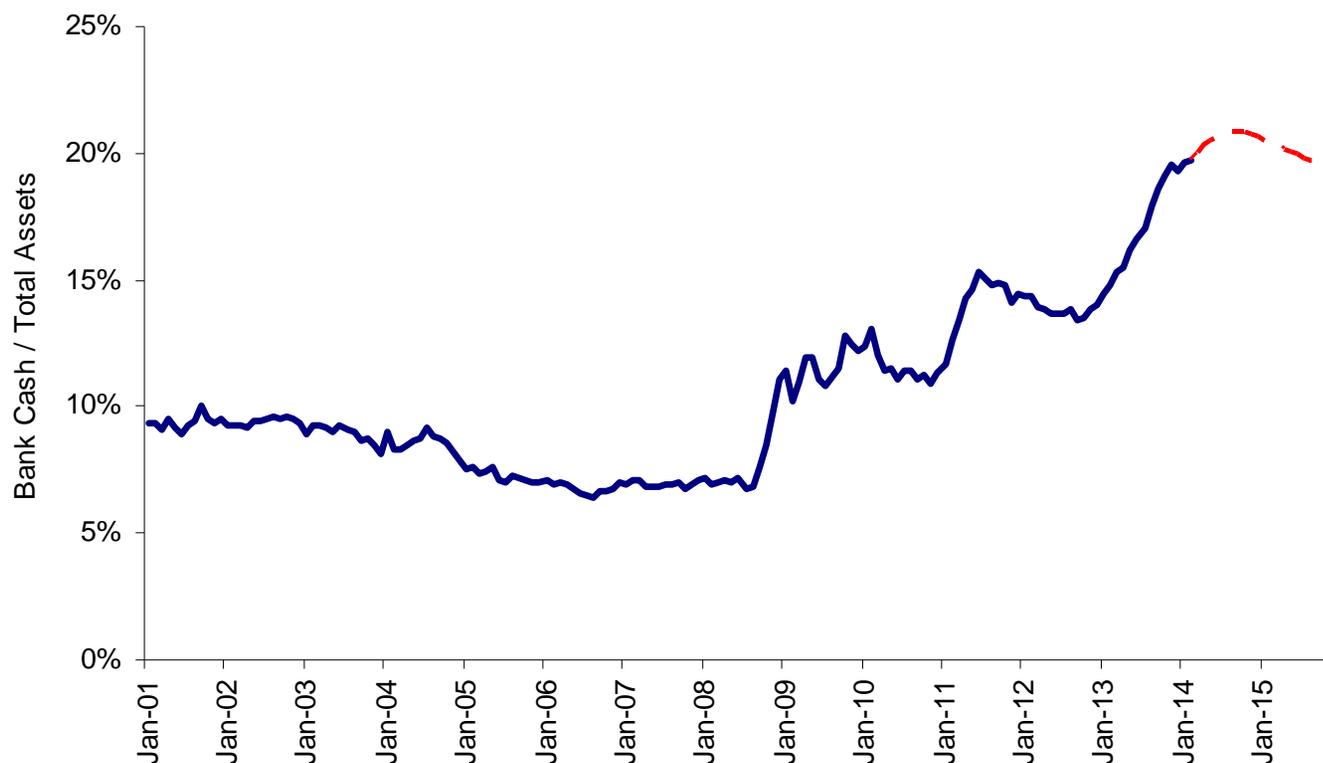
U.S. C&I Loans Rising at an 18% Annual Rate

(last obs. March 19, 2014, \$1.7 trillion, up 18% 13 wk annualized change)



U.S. Bank Cash / Total Assets Will Top 20%

(last obs. February 2014, 19.7%, project to December 2015)



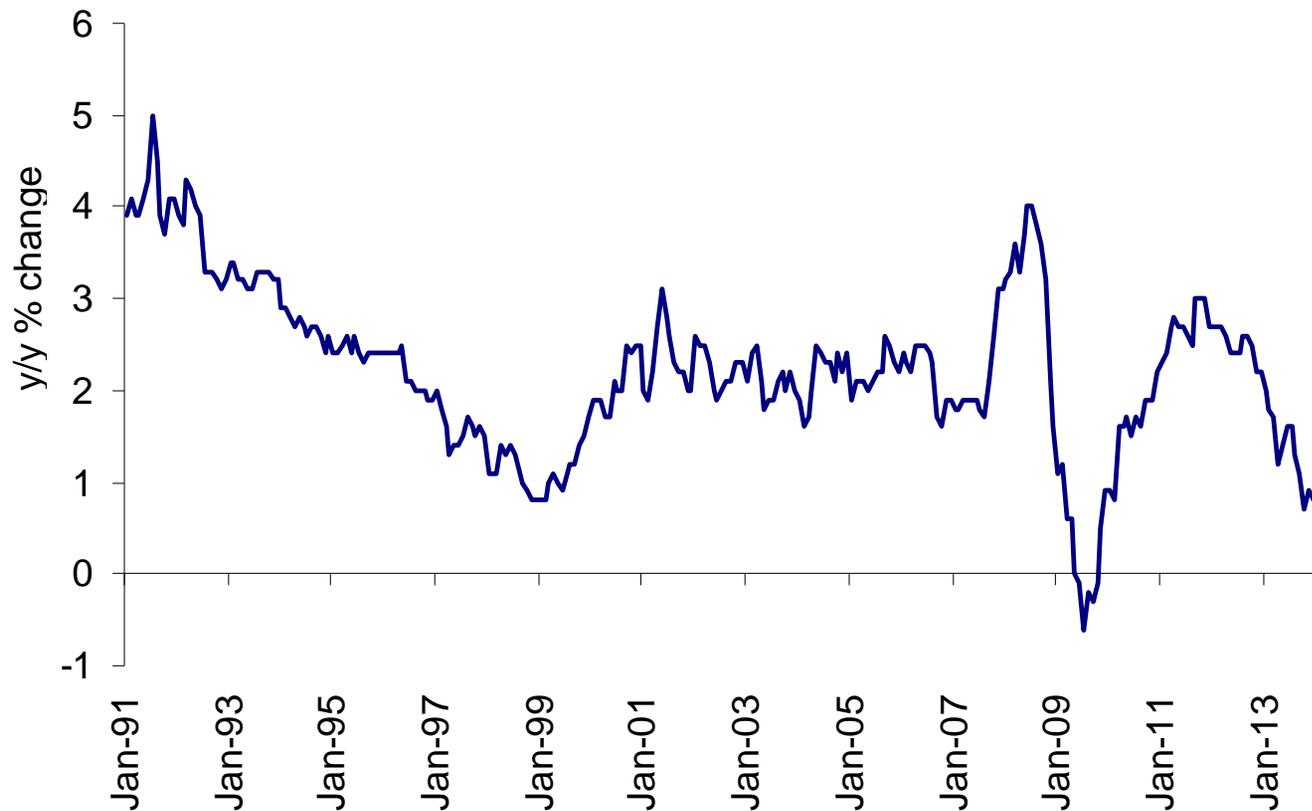
Source: Federal Reserve; Encima Global

ECB Sterilization and Stimulus

- **In the March 6 press conference, Draghi said the ECB had discussed a number of tools but had decided not to use them. The ECB has been encouraged to take several options to ease monetary policy:**
 - **reduce the 0.25% interest rate (Draghi is holding this tool in reserve);**
 - **extend LTRO lending; the ECB will probably allow this program to wind down at maturity because it's not on target;**
 - **add techniques that encourage small-business lending;**
 - **stop “sterilizing” the SMP Securities Markets Program with 7-day auctions; on March 6, Draghi said the benefits would be small, and there was no justification;**
 - **There has been discussion of imposing negative interest rates. We note that the deposit facility (and excess bank reserves) are small, so a cut would be mostly symbolic, adding to bank costs.**

Euro-zone CPI Y/Y Falling (Internal Devaluation?)

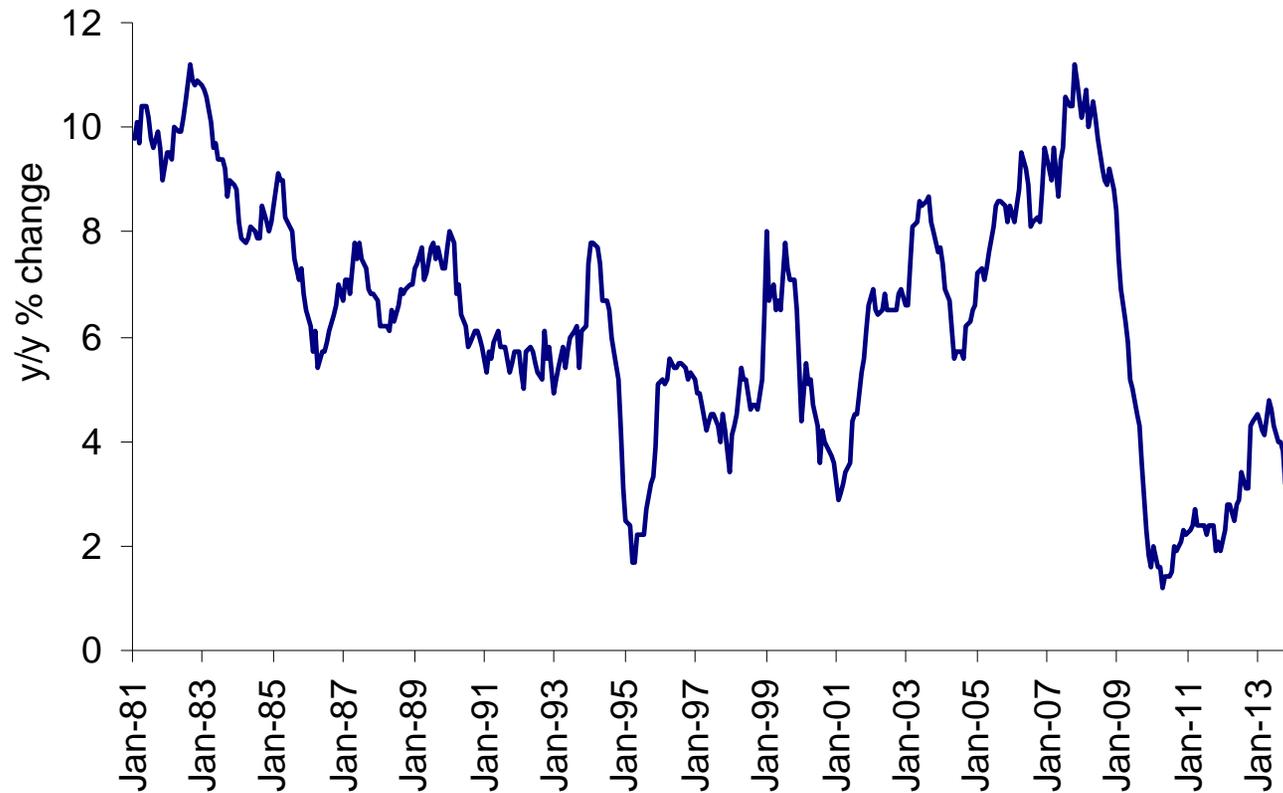
(last obs. March 2014, 0.5%)



Source: Eurostats; Encima Global

Slow Euro-zone M2 Growth Y/Y

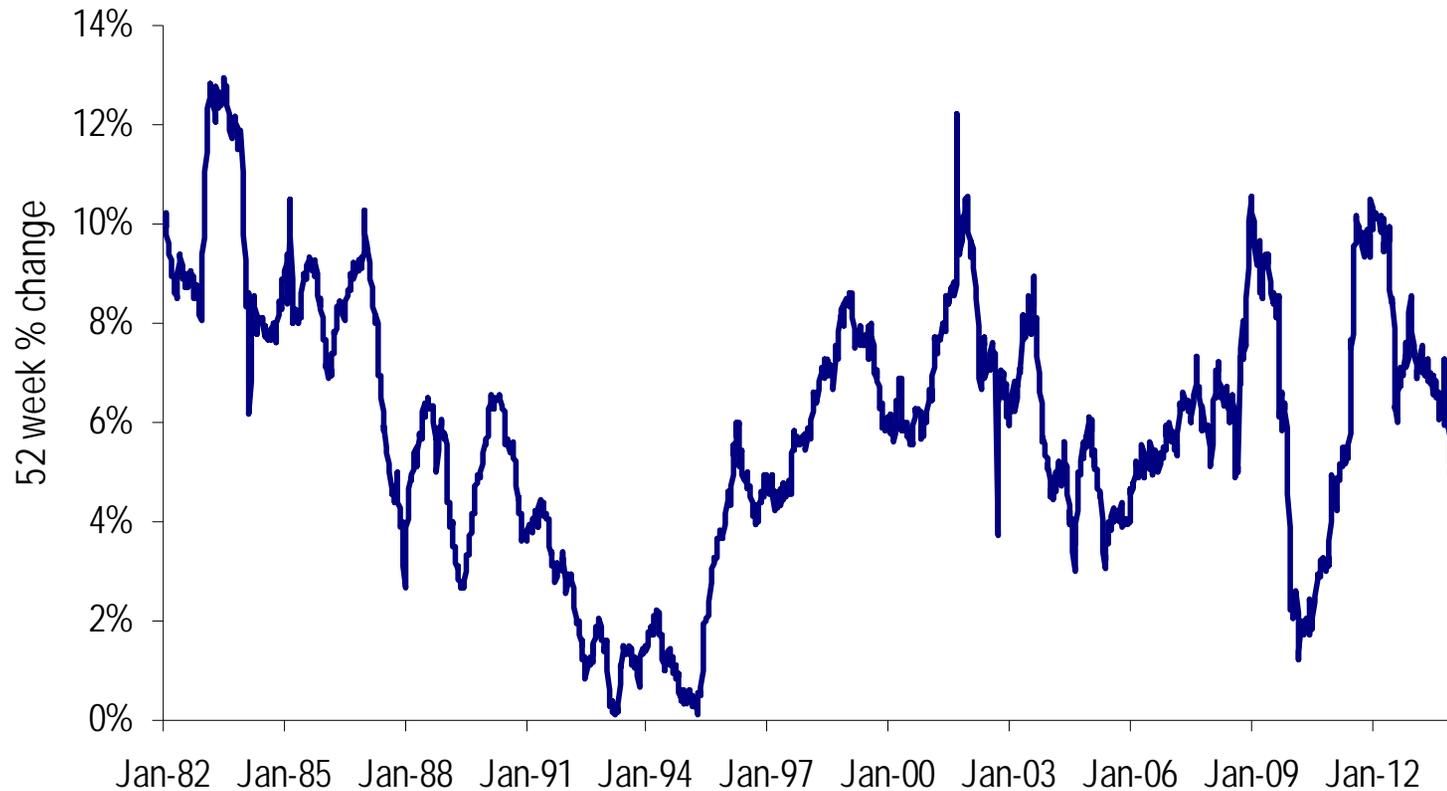
(last obs. February 2014, 2.4%)



Source: Eurostats; Encima Global

U.S. M2 Money Supply Up 6.2% Y/Y

(last obs. March 17, 2014)



Source: Federal Reserve; Encima Global

Conclusion

- **Europe has stabilized after the 2011 crisis due in large part to extraordinary ECB policies to protect the euro and kick the can in the absence of structural reforms.**
- **For Europe, bank asset quality and banking union are the key issues. For the U.S., the Fed normalization process and the handling of excess reserves through credit policy are key.**
- **Europe has seen a reduction in riskless duration due to sovereign credit downgrades. Fed policy has caused a shortening in the riskless duration available to U.S. lenders.**
- **Europe's primary policy on competitiveness has ended up being internal devaluation rather than growth-oriented structural reforms. This leaves Europe heavily dependent on the U.S. for growth.**



If you have questions related to this presentation or would like to learn more about Encima Global please contact us at:

Encima Global
645 Madison Avenue, 5th Floor
New York, NY 10022
(212) 876 4400

info@encimaglobal.com

www.encimaglobal.com

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