INSTITUTE OF
INTERNATIONAL
MONETARY RESEARCH

Analysis and insight into trends in money and banking,
and their impact on the world's leading economies

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Dear fellow macroeconomists and monetary analysts,

Last Friday the Federal Reserve published another week of data on the US commercial banks' assets and liabilities, completing the month of April. Deposits rose by 0.9% in the week to 29th April, so that the sequence of weeks since the start of March is as given in the table below.

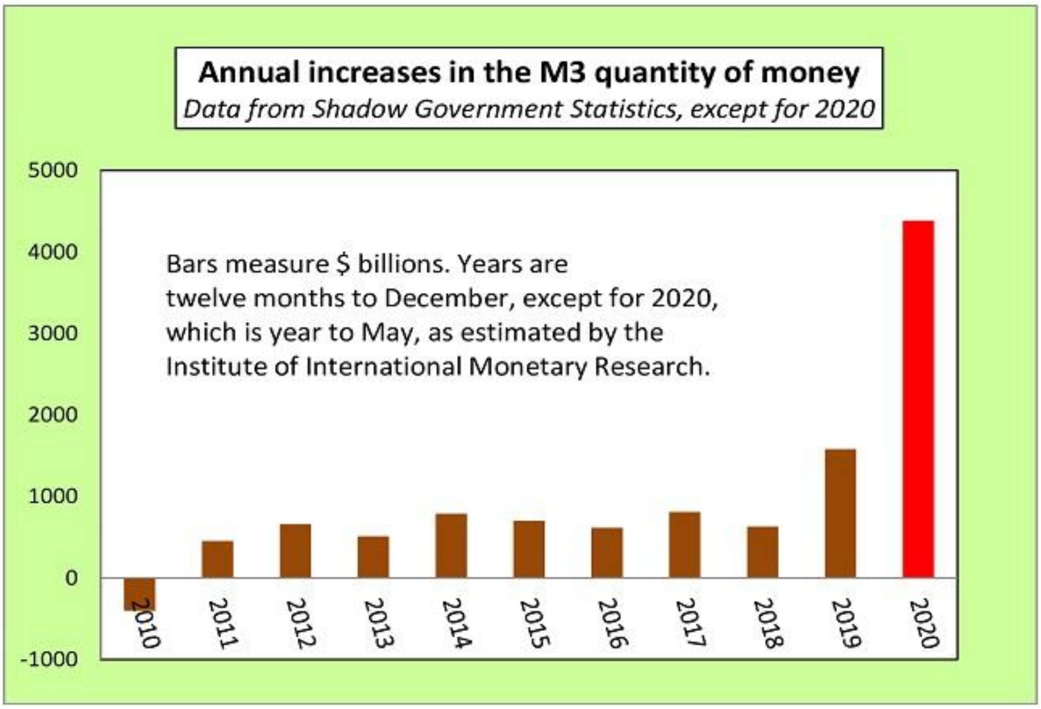
**Recent % weekly increases in deposits at US comercial banks**

| | | |
|---|---|---|
| Week to | 4th March | 0.7 |
| | 11th March | 0.2 |
| | 18th March | 2.2 |
| | 25th March | 2.5 |
| | 1st April | 1.0 |
| | 8th April | -0.1 |
| | 15th April | 2.6 |
| | 22nd April | 2.0 |
| | 29th April | 0.9 |
| Cumulative increase in the nine weeks | | 12.5% |
| Average weekly increase since February | | 1.3% |
| Annualised rate, implied by 1.3% a week | | 95.7% |

The latest figures enable the analyst to estimate the increase in bank deposits between March and April. In the USA the monthly change in a money aggregate is derived by comparing the average of the weekly values in one month with the average in the previous month. On this basis the increase in deposits between March and April was 6.6%. Bank deposits are not the only constituent of the quantity of money, broadly defined, but they dominate it. My initial suggestion was therefore that M3 increased in April by at least 5½% and probably by 6½%. This would have been significantly higher than my surmises – of a rise between 4% and 5% – in earlier communications on the topic.

Shadow Government Statistics in fact produced an April estimate last week, and came up with a 7.5% increase. (Yes!) The main difference between bank deposits and M3 is that M3 also includes money market mutual funds, held mostly by financial institutions and large corporates. It does in fact make sense that the Shadow Government Statistics' figure for M3 is higher than mine (using Fed data) for bank deposits, because the MMMF balances would have been boosted by Fed asset purchases – i.e., "quantitative easing" – directed at the financial sector in the first instance.

If during May bank deposits were unchanged on their value in the final week of April, their weekly average would be 2.9% higher than in April. (The explanation is the big rise between the first and final weeks of April.) In practice, recent announcements signal that continued growth in bank deposits is likely from week to week. Let us assume that the rise in the four weeks to the final May value – on 27th May – is the same as on average each week since February, i.e., 1.3% (only – if "only" is the right word – 1.3% in a month). Let us assume, in other words, a sharp deceleration in money growth from here. Then in May bank deposits would be on average 3.7% up on April. The growth of M3 broad money ought to be similar, although it may not be identical. So for the sake of argument we would have – in the months of March, April and May – increases in the quantity of money, broadly-defined, of 3.9%, 7.5% and 3.5% respectively. The chart below shows that US money growth trends have changed dramatically in recent quarters and – as has been emphasized in these special e-mails – particularly in the last two months




I have decided to increase my concern about these developments and propose the following:

- 2020 will see the highest annual % increase in the broadly-defined quantity of money in the USA in peacetime, with the peak figure above 20% and possibly even above 25%,
- Exceptionally high money growth will be accompanied and followed by an inflationary boom, even if the precise quarter-by-quarter changes in output, employment and prices are difficult to assess at this stage and will depend (among other considerations) on the medical situation, and
- Consumer inflation at annual double-digit % rates is very likely at some point in the next two/three years, and – without a radical change in monetary policy that dampens money growth – the inflation outbreak will not be easy to bring under control.

An understandable tendency in the current strange circumstances is to propose that the rise in inflation will become apparent only when the lockdown restrictions are removed, and when output, employment and aggregate demand return to some sort of normality. The weakness in oil prices strengthens that point of view. But at present the lockdown is disrupting supply chains and preventing production in many sectors, so that demand is being met from inventories. Not surprisingly, inventories of some products have been depleted and shortages are being reported. Inflation may start to climb, even while unemployment is well above pre-epidemic levels. (For example, a bottleneck in meat production – because people work in close proximity in meat-packing factories, which have consequently had to be closed – could result in beef and pork prices rising by 20% from 2019 levels.)

Similar fiscal and monetary patterns are emerging in other countries, but the USA is experiencing the highest and most extreme rates of money growth. They will be discussed in more detail in our usual monthly analysis, which we plan to circulate on Tuesday, 26th May. Given the long-run relationships that prevail between rates of growth in the quantity of money and in nominal gross domestic product (and then inflation), it has to be expected that the USA will in the next few years also suffer the highest inflation among the developed countries

With best wishes,

Professor Tim Congdon

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