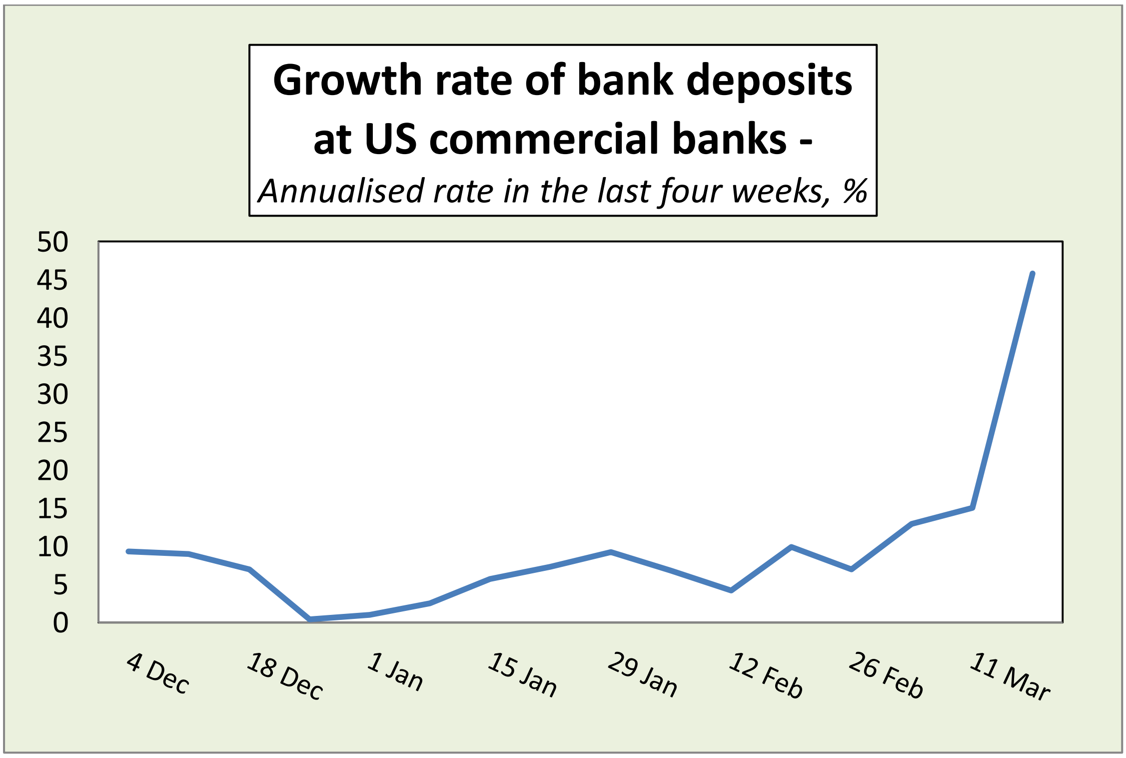
# Special e-mail of 30th March, on latest weekly US money growth

Dear fellow macroeconomists and monetary analysts,

Only a week has passed since my discussion of budget deficits and money growth trends in the usual monthly review of the main economies. But, in the context of the coronavirus pandemic and the policy response to it, a week is a long time in punditry.

I have to revise my view on the prospects for US money growth and inflation. First, the latest weekly H8 'Assets and Liabilities of Commercial Banks in the United States' press release from the Federal Reserve shows that the bank deposits in US commercial banks rose by 2.3% in the week to 18th March. (Let me clarify. I am not talking about a month of which the final week was the one that ended on 18th March. No, the 2.3% rise was *in a week*. The increase in the four weeks to 18th March, i.e., from 19th February, was 2.9% or, at an annualised rate, 45.0%. See the chart below.) Moreover, the Fed has announced that in one week it bought $625b. of securities in a restored programme of "quantitative easing". If about half of the purchases of securities were from non-banks, that would add about 2% by itself to the broadly-defined quantity of money. At least some of this effect ought to be registered in the weekly data for 25th March, due out on Friday.




Secondly, Congress and the administration have passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), with a fiscal cost of about $2,000b. One commentator (Ben Ritz, for *Forbes*) has suggested that – when an allowance is made for the loss of tax revenue due to the lockdown – the Federal deficit over the next 12 months or so might be $4,000b. or not far short of 20% of GDP. The market in US Treasuries may be the most liquid on the planet, but that does not mean it overrides the laws of supply and demand. Investment institutions' capacity to absorb that volume of debt – at current yield levels (in the 10-year area) of under 0.7% - must be in doubt. Sure enough, the Fed has committed to finance the government on its own balance sheet if markets are fickle. But we must be clear. Direct central bank financing of a government deficit leads, in the first round, to roughly similar additions to both the banks' cash reserves and the quantity of money. In the modern era of macro-prudential regulation, the quantity of money may not rise – in second, third and subsequent rounds – by a multiple of cash reserves. All the same, the danger of a textbook multiple expansion of bank balance sheets has to be noted.

A week ago I proposed that US money growth over the next year might be 10% - 12½%. A correlation does hold over the medium term between increases in the quantity of money and increases in nominal GDP. (See the note below for more on this.) Given that money and nominal GDP do track each other over time, it seemed plausible also to propose that inflation might reach 5% at some point in the next two/three years. I now feel that I was being too conservative. The annual rate of money growth to spring 2021 might be between 10% and 15%, perhaps even heading towards 20%. If so, the right sort of maximum inflation rate to expect in the next few years would be in the 5% - 10% band.

The story is evolving – and perhaps it is too early to make a strong forecast of an eventual inflationary boom and to pass judgement on policy-makers. As I said a week ago, "The stresses of the new few weeks and months will be easier to bear if people can be confident about a more buoyant prospect in 2021 and 2022." But the suspicion has to be that the Fed's top officials have been lulled by the benign inflation numbers of the past decade into thinking that the laws of economics are no longer operative. They may believe that the stubbornly low inflation since QE began in late 2008 means that QE on any scale does not result in more inflation. The truth is that – if the rate of increase in the quantity of money is well ahead of the trend rate of increase in goods and services – inflation is inevitable. As I also said a week ago, we may be about to see clear "confirmation of the continuing relevance and validity of the quantity theory of money".

With best wishes,

Professor Tim Congdon CBE

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*Special e-mail from Professor Tim Congdon – 30th March, 2020*

# *Prospects for US money growth in spring 2020*

The main point of this e-mail is to bring attention to a remarkable development in the US monetary scene. **Deposits at the US commercial banking system increased in the week to 18th March (yes, in the week, not in the month) by 2.3%, from \$13,500.3b. to \$13,805.4b., according to a Federal Reserve press release.** As these deposits are the principal element in the quantity of money, broadly-defined, it is likely that March and April will see extraordinarily high growth rates of money. The numbers need to be watched and can be erratic, **but US M3 broad money will probably rise in these two months by at least 4%, i.e., at an annualised rate of over 26%. Higher figures – of a 5% - 6% rise in a mere two-month period – are not to be ruled out.**

In my 24th March comment in the monthly global money round-up, I suggested that by late 2020 the annual rates of money growth in the four advanced jurisdictions would be as follows,

- The USA 10% - 12 ½%
- Eurozone 6% - 10%
- Japan 3% - 4 ½%
- The UK 8% - 10%

As far as the USA is concerned, **this projection has already been overtaken by events.** The 2.3% jump in a mere one-week period is part of the story, but perhaps even more important are i. the passage of the \$2,000b. stimulus package (i.e., the CARES legislation) and the Federal Reserve's preparedness to finance liberally the much-enlarged budget deficit, and ii. the announcement on 23rd March of Fed asset purchases in that week of \$625b., with no limit on future purchases. The \$625b. asset purchases might have been roughly half from the domestic non-bank sector, implying by itself perhaps another 2% on broad money, again in just one week.

## Money trends in the USA in 2020

Of course no one knows the exact effect of recent official decisions on US money growth in the next few weeks and months, but it is already evident that a major lurch towards monetary expansionism is under way. As just noted, my very recent suggestion – that broad money growth might be in the 10% - 12½% band by year-end – is now out-of-date. So much happened in the fortnight to Friday, 27th March, that by themselves these two weeks may have seen a 4% jump in the quantity of money, broadly-defined. Moreover, this jump has occurred *before*

i. the implementation of the massive hand-outs in the CARES legislation and
ii. the Fed's indication that it will finance the budget deficit on its own balance sheet, if markets are not prepared to do so at a low enough level of bond yields.

I am reluctant to give too many hostages to fortune, and the Fed and other policy-makers may have a rethink. Nevertheless, it seems entirely possible that by year-end US broad money will be 15% - 20% up on a year earlier. Are there any precedents? In the First World War some quarters had similar annual money growth rates, while in the Second World War the annual rate of M2 growth exceeded 25% in 1943 and was also briefly above 20% in late 1944/early 1945. But it is otherwise a struggle to find comparable figures in the historical record. (In the early 1970s – ahead of the notorious Great Inflation – the highest annual growth rates of M2 were just above 15%.)

In other words, 2020 may well see the highest growth rates of the quantity of money in American history, apart from some exceptional quarters in the world wars of the last century. Quite probably, money growth in 2020 will be the highest ever in peacetime.

| | *% annual growth rate:* | |
|---|---|---|
| | M3 | Nominal GDP |
| 1960 – 2018 | **7.4** | **6.5** |
| 1960 – 1970 | **7.7** | **6.8** |
| 1971 – 1980 | **11.4** | **10.3** |
| 1981 – 1990 | **7.7** | **7.7** |
| 1991 - 2000 | **5.6** | **5.6** |
| 2001 - 2010 | **7.1** | **3.9** |
| Eight years to 2018 | **4.0** | **4.0** |

Central to the Institute's work is the relationship between the growth rates of money and nominal gross domestic product. The regular monthly analysis for the six leading economics carries a table just beneath it, with the relevant figures. For the USA this is reproduced above. Notice that since 2006 the Federal Reserve has stopped preparing data on M3 and we have had to rely on numbers prepared by the economic consultancy, Shadow Government Statistics, which draws on banking data in the public domain. At any rate, the relationship between the two series is clear.

What then will be the consequences of the sharp money growth acceleration? When the coronavirus outbreak comes under control (as it surely will), the money created by the fiscal and monetary largesse of the last few weeks will still be in the economy. We are only a few months ahead of the next Presidential election, and neither senior figures in the administration nor the Fed top brass will be in any mood to withdraw the vast money stimulus. Inflation is being held down at present by the collapse in energy prices, while the annual inflation rates on which the media focus take some time to pick up any change in trend. (The increase in prices in the year to April 2021 includes the months of

April, May and June 2020, when inflation pressures may have been very different in strength from those in February and March 2021.)

The money stimulus will cause asset prices to recover, and demand and output to grow rapidly, at least for a few quarters until bottlenecks are reached. The initial public response to the better news will of course be excitement and applause, not least because the recovery will be such good news after the misery of March 2020. Killjoys and skinflints, and defenders of sound money, will be ignored in the public debate.

My conclusion is that the USA's economic policy response to the coronavirus outbreak will be very inflationary, even if the political situation and lags in the inflationary process will make this a concern more in 2021 (and perhaps 2022) than in 2020. Assuming that money growth does reach the 15% - 20% band for a few months, the message from history is that the annual increase in consumer prices will climb towards the 5% - 10% area and could go higher.

30th March, 2020