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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Monthly e-mail from Tim Congdon and John Petley – 29th November, 2022

Global money round-up in autumn 2022

The quantity of money is now falling in the USA – and doing so at a rate similar, in real terms, to that in the Volcker double-dip recession of the early 1980s. Despite the bounce in US share prices in recent weeks, the outlook in the world's largest economy is for a few quarters of weak asset prices and a recession. Money growth has been more resilient in Europe. In the Eurozone the European Central Bank is reluctant to tighten policy, because an increase in interest rates will aggravate Italy's debt financing strains. The UK reported an extraordinary leap in M4x in September, but this was probably attributable to a temporary and soon-to-be-reversed burst of financial sector borrowing provoked by the confidence-sapping mini-Budget of 23rd September.

The main Asian nations are following their own financial destinies. Money growth in China has been higher in 2022 than in 2021, perhaps to offset the deflationary impact of an inept "zero covid" policy. In Japan money growth has slipped back to negligible levels, but this is not due to a new weakness in bank credit to the private sector. The explanation is rather that the Bank of Japan has intervened on the foreign exchanges, to counter exceptional yen weakness. The Reserve Bank of India has also intervened on the foreign exchanges to protect the external value of its currency, the rupee, and again this has dampened money growth. 2023 will be another difficult year for the world economy, with the American recession likely to cause world growth to be beneath the long-term trend. Moreover, that long-term trend growth rate is surely lower than in the 2010s, partly because of the return to state-directed centralization in China and the more widespread reversal of globalisation, and partly because of adverse demographic forces, particularly in Europe. Inflation will remain a policy problem in 2023, but recent slides in oil and gas prices suggest that the worst numbers in the current cycle have now been recorded. The growth of trade in liquefied natural gas has blunted the impact on European economies of Russia's withdrawal of gas exports.

Money trends in late 2022 in the main countries/jurisdictions

The Institute of International Monetary Research focuses on the relationship between trends in the growth of the quantity of money, broadly-defined, and macroeconomic outcomes. The Institute's consistent analysis from spring 2020 – that money growth acceleration would lead to an inflationary boom and an upturn in inflation – proved correct. Central banks in North America and Europe have tightened policy, but in Asia the picture is more mixed. Key ideas in understanding near-term macroeconomic developments are that,

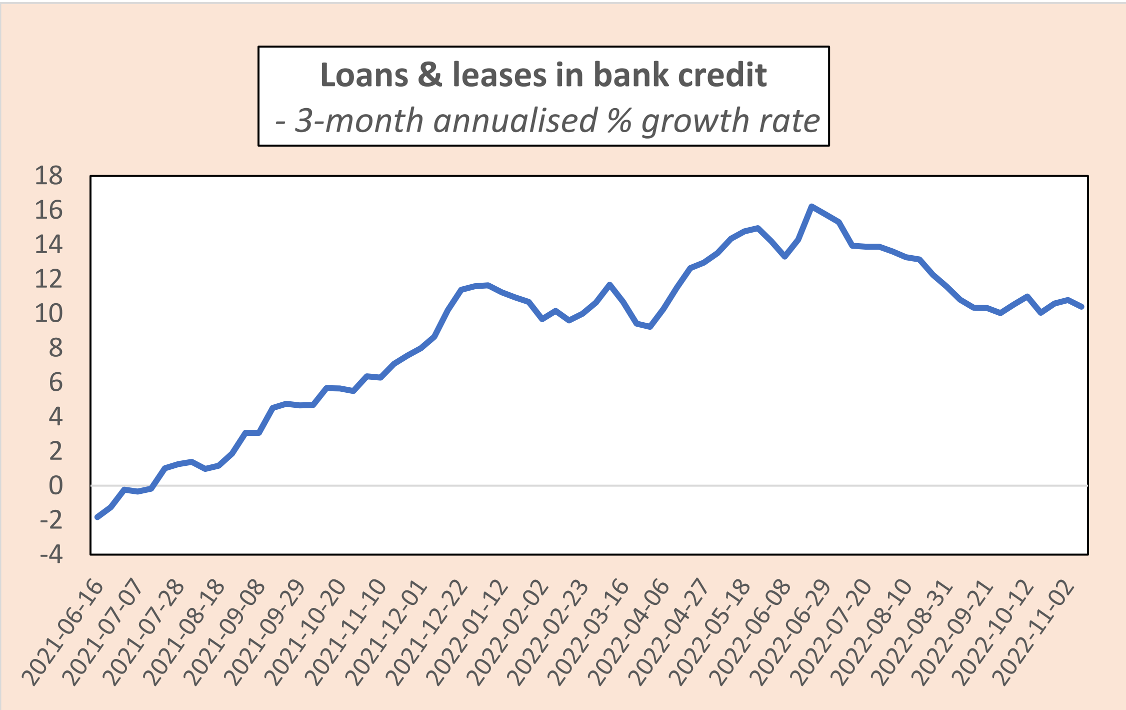
i. The rate of inflation is equal to the rate of increase in nominal GDP minus that of real GDP,
ii. Over the medium term, growth rates of broad money and nominal gross domestic product will be similar, although only rarely identical, and
iii. Just as a correlation holds between nominal money and nominal GDP, so one holds between real money and real output, and falls in real money are often associated with asset price weakness and recessions.

Much will depend on rates of broad money growth in coming months and quarters, with the table below summarizing recent patterns in the leading nations. The table shows money growth reductions in the developed countries from 2020 highs, although with no uniformity. The ECB in particular seems reluctant to squeeze money growth. China is following its own path, with money growth rising somewhat. In 2023 recessions in North America and Europe ought still to be reconciled with positive output growth at the global level. In the UK M4x growth was extraordinarily high in September.

Name of country/ jurisdiction	Share of world output in 2020		Growth rate of broad money		Comment
	In purchasing-power parity terms, %	In current prices and exchange rates, %	In last three months at annualised rate, %	In last twelve months, %	
USA	15.4	24.7	**-4.6**	**1.4**	Money growth stopped in spring 2022, implying severe squeeze on real money balances.
China	18.3	15.4	**11.3**	**11.8**	Money growth high, amid property bust scares. Policy being eased, no official inflation concern.
Eurozone	12.1	17.4	**8.4**	**6.3**	Money growth rather high, as ECB worries about widening sovereign debt spreads.
Japan	3.7	6.0	**1.6**	**2.6**	Credit and money growth down almost to nil, because of FX intervention.
India	6.8	3.1	**9.7**	**9.1**	Money growth moderate, as RBI seeks more capital in banking.
UK	2.2	3.3	**14.8**	**7.1**	Money growth erratic, big upward blip in September.

The recent fall in the quantity of money in the USA contrasts totally with the wild over-expansion of money in the early months of the Covid pandemic. The instability in money growth will be associated with instability in demand, output and employment. Money growth has slowed in the Eurozone and the UK relative to the excesses of 2020 and 2021, but upward blips in recent months differentiate them from American developments. During 2023, and particularly in 2024, inflation will come down towards levels closer to the norms of the 2010s. The recent falls in energy prices make continued consumer inflation above 10% unlikely in 2022 in both the USA and the Eurozone. The Ukraine tragedy has added awkward twists to the inflationary spiral, but its effects are best interpreted as one-off and reversible shocks to the price level. It is certainly not the fundamental cause of the inflation of the early 2020s. This inflation episode – like all the others – is to be attributed to excessive growth of the quantity of money (in the USA, the Eurozone, the UK, Canada and Australia), which was most marked in spring and summer 2020, but rolled on into 2021.

In 2022 the combination of falling growth in nominal money (and recent outright falls in the quantity of money in the USA) and still high inflation implies declines in *real* money balances. A standard cyclical pattern is that such declines are accompanied by weakness in both asset prices and aggregate demand, and all too often by recessions (i.e., falls in output lasting longer than six months). As noted here in recent months, crucial to money growth in the rest of 2022 will be the behaviour of bank lending to the private sector. In the two years to the first quarter of 2022 high or very high money growth in the main Western economies was almost entirely due to central bank asset purchases and monetary financing of budget deficits. The Institute's analysis has suggested that, as central bank asset purchases stop and budget deficits decline, money growth will decelerate *unless bank lending to the private sector revives strongly*. The decelerations in money growth are evidently occurring, but the patterns of bank asset acquisition have still to be monitored and assessed.



In the USA bank credit to the private sector has been growing briskly. Until summer this year interest rates were very low, while banks had ample capital to support balance sheet expansion and their low-return cash holdings were much too high. But the increases in Fed funds rates – combined with the surge in bond yields with effects on mortgage rates – are starting to check the boom. "Loans and leases in bank credit" (mostly bank lending to the private sector, and constituting over half of US commercial bank assets) were flat during the period of Covid-19 uncertainty in late 2020 and early 2021, but increased from June 2021. The accompanying chart – for which 9th November is the last value – shows the three-month annualised rate of increase in "loans and leases" since then; it suggests that there was a turning-point in June and July this year. Until then the pace of the credit boom was accelerating; subsequently it has been decelerating. If the deceleration continues and intensifies, that may remove an important positive influence on money growth.

Further, the intended Fed sales of securities (i.e., "quantitative tightening") – of as much as $95b. a month from September– could reduce the M3 quantity of money by perhaps $50b (about 0.2%) a month. Curiously, US banks' cash assets – which would register the impact of QT – rose sharply in the week to 9th November, although they are heavily down on a year ago. As already emphasized, the combination of money stagnation and persisting rather high inflation implies a squeeze on real money balances. A US recession in 2023 is now widely forecast, and understandably so.

Over the medium term the growth rates of real money and real output are similar, a feature of all economies that reflects the underlying stability of agents' money-holding behaviour. In the USA the velocity of circulation of money fell remarkably in 2020. But velocity is a mean-reverting series. Now, on schedule and in line with analyses from the Institute of International Monetary Research, it is rising at an exceptional pace. These developments are a clear vindication of ideas that have long been basic to the quantity theory of money, although recent speeches from top Federal Reserve officials hardly suggest they are interested in these ideas.

In the Eurozone the stock of credit to the private sector was 5.4% higher in September 2022 than a year earlier. The stock of loans for house purchase was up by 5.1% in the year to September, whereas loans to non-financial corporations (i.e., industry and commerce) advanced a buoyant 8.0% in the same period.

In Japan bank lending to the private sector surged in the opening months of the Covid pandemic, but the loans have been largely repaid with the return of medical normality. Lending to the private sector has been weak for most of 2022, but it has strengthened in the very latest months. This would be a logical response to the slide in the yen, if that slide were expected to continue. (It is of course profitable to incur liabilities in a depreciating asset.)

In the UK September was an extraordinary month. As widely discussed in the media, the Kwarteng mini-Budget on 23rd September broke established principles of fiscal rectitude, with unfunded tax cuts implying large increases in budget deficits and future debt interest bills. The mayhem was accompanied by falls in sterling against the pound and the euro. These falls were widely expected to gather momentum, provoking heavy borrowing by some financial institutions. (As just noted, it is profitable to incur liabilities in a depreciating asset.) M4 lending was almost as much in the one month of September as in the preceding eight months of 2022. In the event, the mini-Budget discredited the Truss government, and a new Prime Minister, Chancellor of the Exchequer and government quickly reversed course. Repayments of the rather speculative bank borrowings seem likely in the next few months, so that September's 2.7% jump in M4x will be replaced by offsetting declines.

By contrast, lending to mainstream corporates is weak. With inordinate amounts of capital required in commercial banking, banking groups have drawn up plans to allocate capital to other activities. Large banks are not hiding their reluctance to commit new capital to standard UK commercial banking. The problem is being made worse by decisions taken by the Financial Policy Committee and the Prudential

Regulation Authority, at the Bank of England. Banks must have a 2%-of-assets counter-cyclical capital buffer, with effect from July 2023.

The 2% rate is supposed to pre-empt future shocks to the economy. To quote from the Bank of England's *Financial Stability Report*, "the global and UK economic outlook has deteriorated significantly" since the end of 2021, when it announced the rate was to go from zero to 1% by the end of 2022. The imposition of the extra capital requirement is, in fact, deflationary. There is no doubt that the extra capital requirements associated with Basel III have resulted in a large fall in the ratio of banks' lending to companies to gross domestic product. The post-2008 regulatory environment has been particularly hard on lending to small- and medium-sized enterprises. (See the Institute's research paper no. 9 https://mv-pt.org/research-papers/ for more detail.)

To repeat the point I have been making here so far this year, in the rest of 2022 and 2023 the vigour – or lack of vigour – of bank credit to the private sector is a material influence on interest rate prospects. Interest rate rises have occurred in most developed countries, but may be nearing their peak for this cycle in the USA and the UK. As the ECB has been much slower to move, the peak in Eurozone interest rates is – almost certainly – further away in time. Central banks are now ending asset purchase programmes and in some instance – notably in the USA – are actively reducing their asset piles. A reduction in money growth is a condition of the return of moderate inflation. However, anxieties must be expressed that outright falls in the quantity of money may prove too harsh on output and jobs. In qualification, money growth in the Eurozone has been rising in the very latest months.

Robust bank lending to the private sector is in many ways desirable, because of its contribution to wider economic efficiency. But fast expansion of banks' loan portfolios will make it more difficult to deliver the needed reduction in money growth. If bank lending to the private sector were increasing at an annual rate of 5% or less, it will be easy for central banks to keep money growth under control. Pointers to future lending growth therefore deserve to be monitored carefully. Despite still low nominal interest rates, and indeed negative real interest rates, a sustained boom in private sector bank credit is not imminent in Japan or the UK. (But the currency depreciation scares have prompted a recent hurried drawdown of credit lines in both countries.) A strong recovery in such credit in the USA has occurred, but Fed interest rate rises and the wider change of mood may now be bringing the recovery to an end. In the Eurozone banks have been adding at a moderate pace to their risk assets, while the ECB is reluctant to sell off assets from its bloated assets pile.

25th November, 2022

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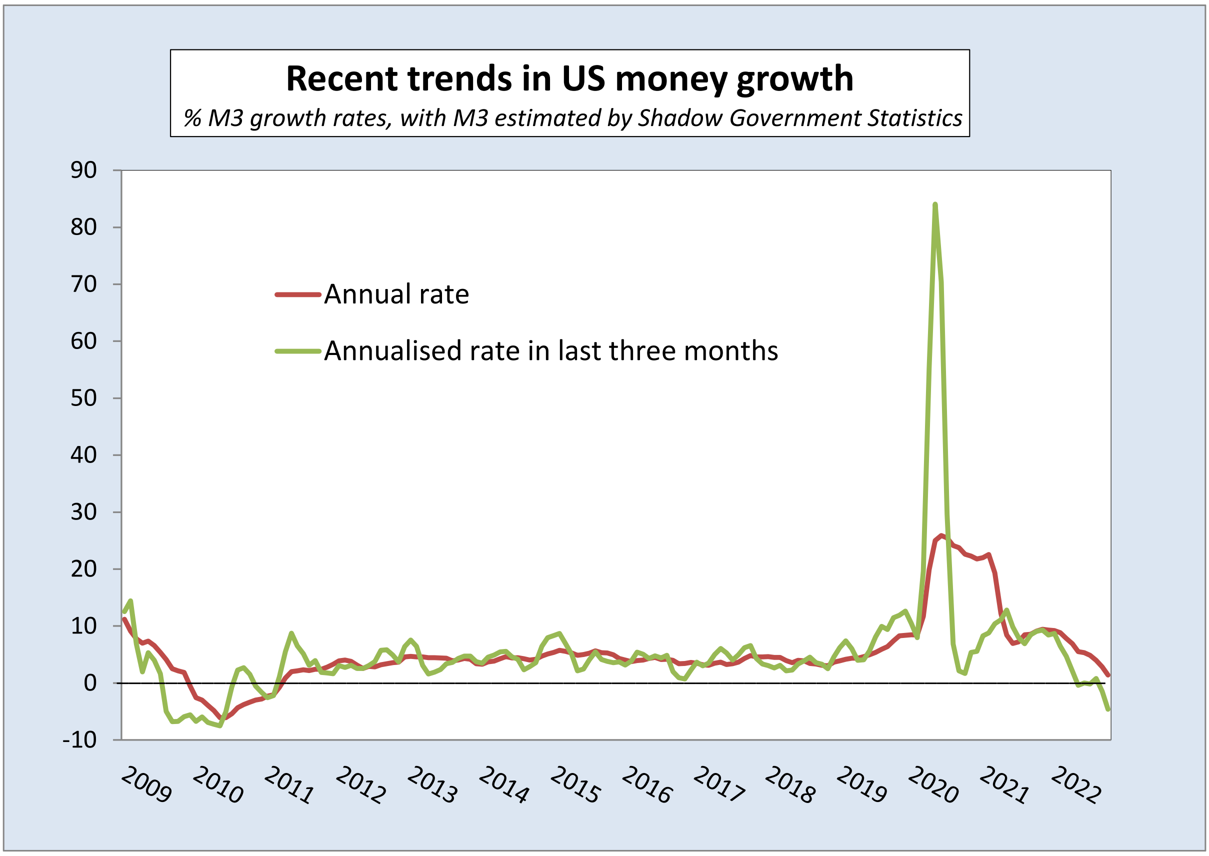
USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1961 – 2020	**7.7**	**6.3**
Ten years to 2020	**6.2**	**3.4**
Year to October 2022	**1.4**	**n.a**
Three months to October 2022 at annualised rate	**-4.6**	**n.a.**

Sources: Shadow Government Statistics research service for M3 after 2006 and US Bureau of Economic Analysis for GDP



US broad money stagnation becomes a contraction

Summary: **US broad money declined at an annualised rate of 4.6% in the three months to October. In September and October the M3 quantity of money fell by 0.6% and 0.7% respectively. The Great Recession of 2008-10 saw comparable periods of money contraction, in late 2009 and early 2010, but the economy was to some extent protected against the deflationary effect by the positive effect on demand of the slashing of Fed funds rate to zero. Now, by contrast, the economy must tackle the headwinds from a significant increase in Fed funds rate. (Our M3 data come from Shadow Government Statistics.)**

In the space of just over seven months, the Fed funds rate has been increased by 3.75% in total and now stands at 3.75% - 4%. Following the most recent meeting of the Federal Open Market Committee on 1st – 2nd November, Chairman Jay Powell hinted that further increases were likely, although subsequent comments by Fed officials suggest that future rate rises may be smaller, Along with these increases to Fed funds Rate, in September the Fed accelerated the run-off of the assets purchased in 2020 and 2021. In every subsequent month $60b. worth of maturing Treasuries and $35b. of mortgage-backed securities will no longer be reinvested. These notes predicted that such a move could cause broad money growth to decline by as much as $50b. per month – and so it has proved. Even the continued buoyancy in bank credit to the private sector has been unable to counteract the money contraction on which the Fed is now engaged.

Although a number of prominent business figures have warned that the USA faces a recession, neither the Fed nor the White House agree. Brian Deese, President Biden's senior economic advisor, recently insisted that the US economy has the "strength and resilience" to avoid a recession. Currently, the US retail sector is recording reasonable growth, while the unemployment rate stands at a mere 3.5%. These are all indicators to which both Mr Deese and the members of the FOMC pay far more attention that the quantity of money. They would not attach much significance to the falls in the quantity of money now being seen, which are largely to be attributed – in an arithmetical sense – to a huge drop in banks' cash assets. (They were $3,105.8b. in October this year, compared with $4,084.4b. a year earlier.)

Analysis and commentary are bedevilled by the lags that characterize the economy's adjustment to fluctuations in money growth. Inflation today reflects the excessive money growth in 2020 and 2021, and it will take a few quarters before it responds to the latest money numbers. A perhaps surprising aspect of the situation is that banks have been growing their loan portfolios strongly. "Loans and leases in bank credit" were $11,763.0b. in October, 12.0% up on a year earlier. If the surge in the creation of new credit halts as borrowing costs increase, the contraction in broad money may become sharper.

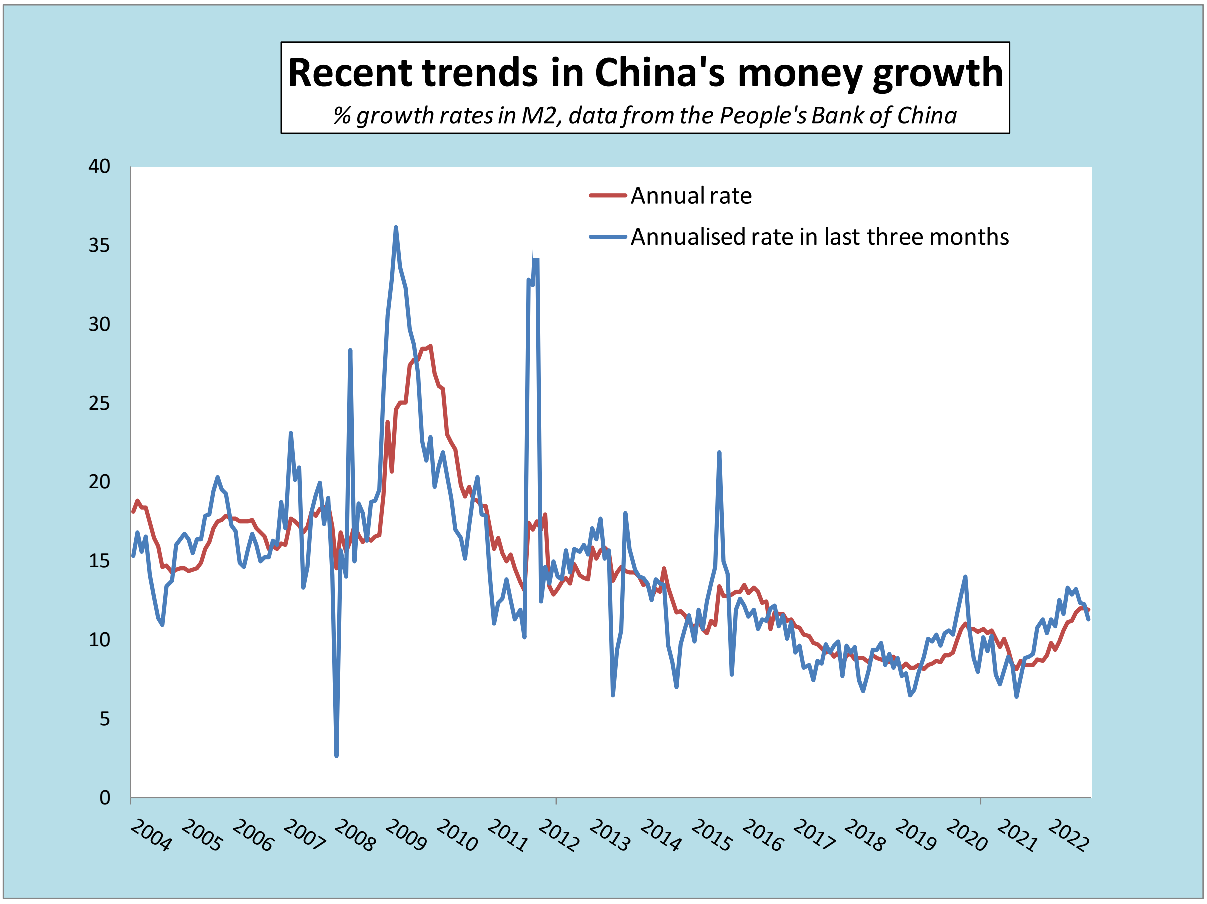
Tim Congdon and John Petley
25th November, 2022

	% annual growth rate:	
	M3	Nominal GDP
1961 – 2020	**7.7**	**6.3**
1961 – 1970	**8.0**	**7.1**
1971 – 1980	**11.4**	**10.3**
1981 – 1990	**7.7**	**7.7**
1991 - 2000	**5.6**	**5.6**
2001 - 2010	**7.1**	**3.9**
2011 - 2020	**6.2**	**3.4**

China

	% annual/annualised growth rate:	
	M2	Nominal GDP
1991- 2020	**18.4**	**14.5**
2011 - 2020	**11.7**	**10.0**
Year to October 2022	**11.8**	**n/a**
Three months to October 2022 annualised rate	**11.3**	**n/a**

Sources: People's Bank of China for M2, IMF and Institute's own estimates



Broad money growth declines, after being quite buoyant

***Summary*: In the three months to October 2022 China's seasonally adjusted M2 grew at an annualised rate of 11.3%. This is the slowest rate of growth on this particular measure since February and compares with September's reading of 12.3%. Broad money growth was on an upward trend from the latter part of 2020 until September. The slowdown has affected the annual rate of growth, which fell from 12.0% to 11.8%, the first deceleration in 10 months.**

In spite of efforts by the People's Bank of China (the central bank) to boost demand for credit, growth in the stock of loans by Chinese banks has been much lower in 2022 than in previous years. October saw banks lending an extra 11.1% compared with the same month last year. Loan growth of 11% or thereabouts has been the norm for the last six months. By contrast, for most of the previous decade, this statistic rarely fell below 13%. China's GDP grew by 3.9% in the third quarter of 2022 after recording a contraction of 2.7% in Q2. Overall GDP growth for 2022 is likely to fall short of the authorities' 5.5% target. A key retarding influence on the economy has been, and remains, China's "zero covid" policy, which involves locking down millions of people if a mere handful of positive cases are detected in any given city. The authorities have recently relaxed quarantine rules for inbound travellers, but there seems little sign of a change in the strict lockdown policy.

Consumer demand is unsurprisingly weak. Inflation fell from 2.8% in the year to September to 2.1% a month later, while the annual change in producer prices fell below zero for the first time in almost two years. Attempts to revive the struggling housing market have thus far had little effect, with prices falling for the fifth consecutive month on an annual basis. The PBoC has expanded the scope of a support package for troubled property developers to $27.6b., enabling these companies to complete some of their stalled building projects. The move follows on from the introduction of tax rebates to attract new homeowners in some cities.

For the first time since May 2020, October 2022 saw a decline in the volume of Chinese exports compared with 12 months earlier. This is partly a reflection of lower demand from overseas as consumers struggle with sharp increases in the cost of living. Sales of household appliances fell by more than 20%. Over the past year, the central bank has targeted its monetary loosening rather than cut interest rates across the board. The PBoC indicated on 30th October that further stimulatory measures will be implemented to address the sluggish state of the economy. Domestic demand, however, is unlikely to pick up if the tight lockdown policy is maintained. The recent congress of the Community Party ended with the elevation of several loyal supporters of Xi Jinping to senior positions in the Politburo. Xi was granted a third term a third term as president. Unlike his immediate predecessors, he is more interested in ideology and control than growth. He has already limited the involvement of private sector companies in the economy, instead favouring large state-owned enterprises.

John Petley
11th November, 2022

	M2	Nominal GDP
1991 - 2000	**24.5**	**18.5**
2001 - 2010	**18.4**	**15.2**
2011 - 2020	**11.7**	**10.0**

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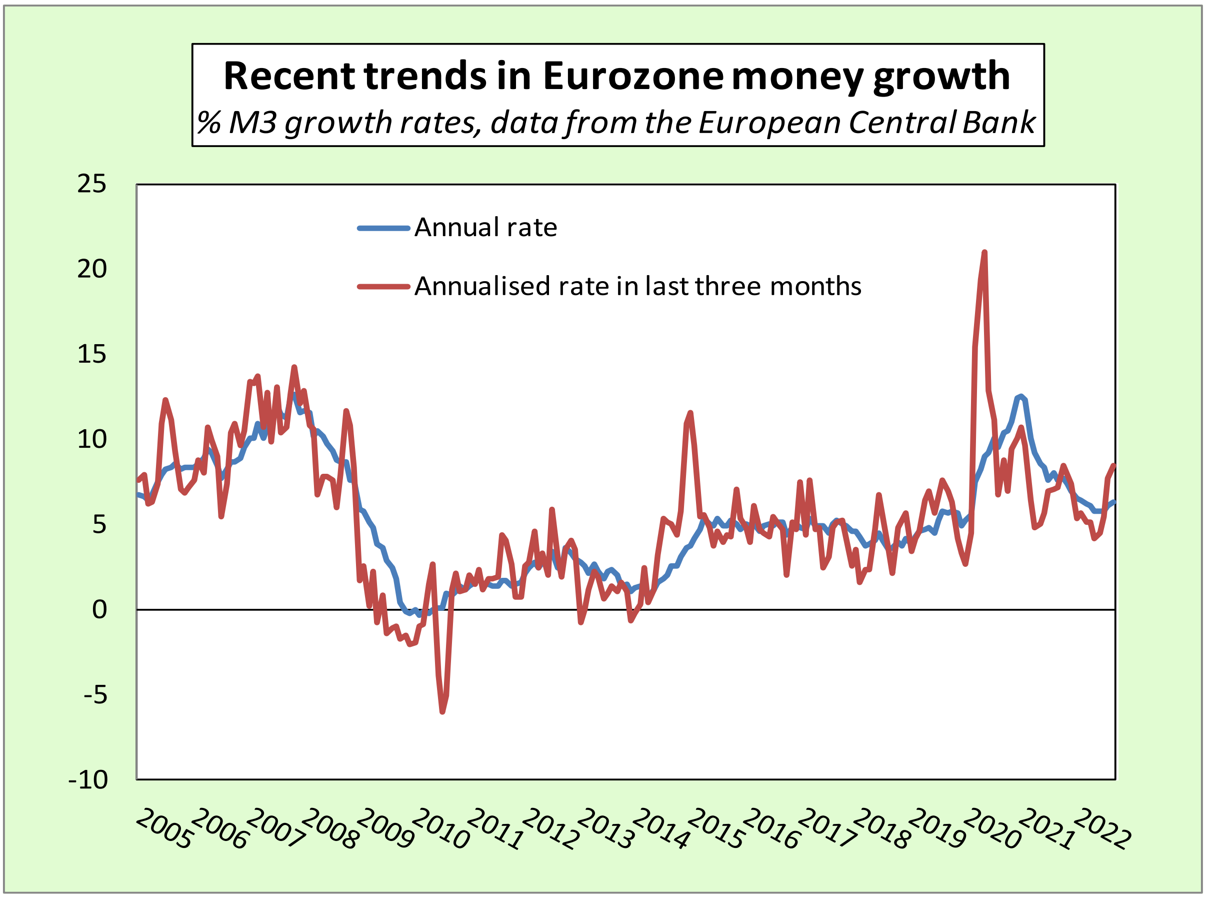
Eurozone

	% annual/annualised growth rate:	
	M3	Nominal GDP
1996 – 2020	**5.5**	**2.7**
Ten years to 2020	**4.6**	**1.6**
Year to September 2022	**6.3**	**n/a**
Three mos. to September 2022 at annualised rate	**8.4**	**n/a**

Sources: European Central Bank, Eurostat and the Institute's own estimates



Broad money growth *rising*, against international trend

***Summary*: In the three months to September 2022 the quantity of M3 broad money in the Eurozone grew at an annualized rate of 8.4%. This is the fourth consecutive period in which M3 growth has accelerated. (The figure had dropped to 4.1% in the three months to May.) Broad money grew by €113b. during September itself, following on from August's €152b. The annual rate of growth went up from 6.1% in August to 6.3%.**

For much of the year the ECB pursued a more accommodative monetary policy than many other central banks, in the apparent belief that the current inflation upturn was a particularly American phenomenon. It continued to purchase assets until the end of June and did not increase interest rates until 21st July; it also insisted that it did not intend to follow in the footsteps of the US Federal Reserve or the Bank of England in reducing its balance sheet. Perhaps not surprisingly, Eurozone money growth is not following the prevalent international trend at present towards a slowdown. A steady and persistent rise in consumer price inflation in recent months has resulted in a marked change in attitude. The squeeze on Russian energy supplies has been much of the trouble here and of course has not affected the USA to the same extent. He ECB's Governing Council voted to increase the cost of borrowing by 0.75% at both of its last two meetings, while President Christine Lagarde suggested that a further rise in interest rates was likely when the Governing Council next meets on 15th December.

The ECB had been hesitant to sell its assets out of concern that the Eurozone may face a repeat of the sovereign debt crisis it confronted in the early 2010s. In that crisis a widening spread in yields on the debt issued by the different member states' governments threatened the very existence of the single currency. The ECB has started to use the money from maturing bonds to buy further debt from the most indebted member states, such as Italy and Spain. This expedient has so far prevented yields spreads from widening too dramatically. However, in a speech on 4th November Lagarde announced that the December meeting will also include an announcement of plans to reduce the ECB's balance sheet. Once again this change in policy has been driven by concerns about high levels of inflation, which rose to a record 10.7% in the year to October. The tensions within the Eurozone have been symptomized by ever-increasing imbalances in the Target2 settlement system. In September the Bundesbank's credit balance reached €1,266.6b. and the Banca d' Italia's debit balance €714.9b. Both figures are new records. Sure enough, the substantial loan of cheap money to Italy has not hit the headlines in recent weeks, but German policy-makers cannot be happy that the numbers keep on growing.

Inflation is likely to remain well above the ECB's 2% target throughout 2023 and probably into 2024, regardless of the ECB's actions. Money growth has remained, for too long, well above the level of 3% - 4% a year compatible with annual inflation under 2%. The recent increases in the cost of borrowing have so far not made any impact on the demand for new bank credit to the private sector. Such credit has become the principal driver of broad money growth. Borrowing by Eurozone businesses was up by 8% in the year to September, with the housing market – and hence residential mortgage credit – is also in good shape, at any rate for the time being.

Tim Congdon and John Petley
25th November, 2022

	% annual growth rate:	
	M3	Nominal GDP
1996 – 2020	**5.5**	**2.7**
1996 – 2000	**4.6**	**4.1**
2001 – 2010	**6.8**	**3.1**
2011 - 2020	**4.6**	**1.6**

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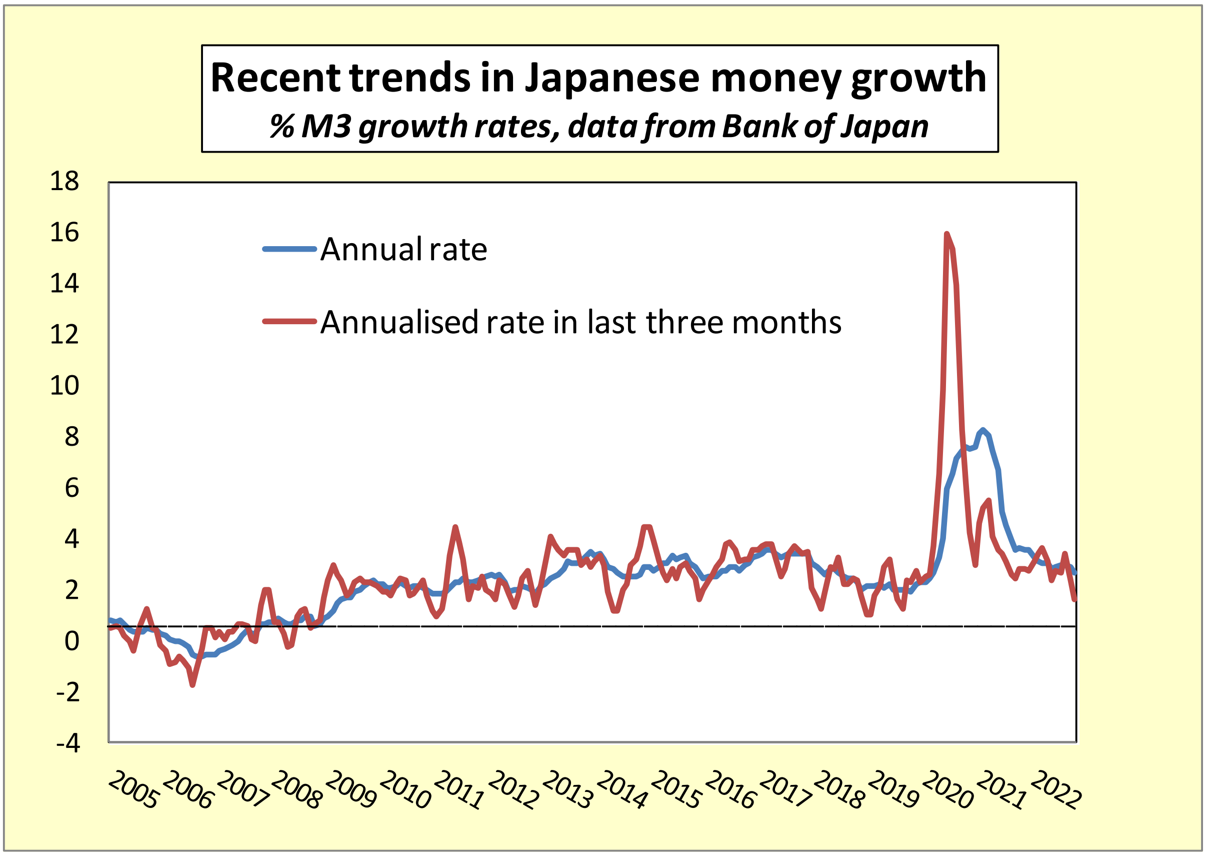
Japan

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2020	**3.9**	**1.7**
Ten years to 2020	**3.2**	**0.3**
Year to October 2022	**2.6**	**n/a**
Three months to October 2022 at annualised rate	**1.6**	**n/a**

Sources: Bank of Japan for M3 and IMF for GDP



Broad money growth slowdown intensifies

Summary: **The three months to October 2022 saw Japanese M3 increase at an annualised rate of 1.6%, lower than September's reading of 2.4% and the slowest rate of growth in over three years. The annual rate of growth fell back from 2.9% to 2.6%. Both these values are the lowest in their respective series since before the start of the coronavirus pandemic.**

On 28th October the Bank of Japan's policy board voted unanimously to continue with its ultra-loose monetary policy. Governor Kuroda has continued to insist that above-target inflation is a temporary phenomenon caused by the weakness of the yen. Since the start of November the Japanese currency has strengthened slightly against the US dollar, but is still trading at less than 80% of its December 2021 value. In spite of the yen's weakness with its resultant effect on the cost of imports, consumer inflation remained unchanged at 3.0% in the year to September. Meanwhile the increase in producer prices slowed from 10.2% to 9.1%, the lowest reading since January. Although inflation has been higher than the BoJ's 2% target for six consecutive months, it is still much lower than the figures for many other developed countries. Although the issue is controversial, much of the explanation lies in the relatively subdued increase in money growth in Japan in 2020. Furthermore, M3 growth had dropped back to levels typical of the previous decade by the middle of 2021. The money growth background – unlike the exchange rate weakness – argues that consumer price inflation could drop back towards or even below 2% by the second half of 2023. Recent weakness in oil prices points in that direction.

The BoJ's large scale purchases of 10-year Japanese government bonds has kept yields down to much lower levels than in other advanced economies. Although broad money growth has weakened since August, growth in the stock of lending by Japanese banks has been steadily picking up since May, when the annual growth rate was a mere 0.7%. October's figure was 2.7%, the highest figure in 18 months. The slowdown in M3 growth is due to foreign exchange intervention. Foreign exchange reserves have fallen by almost $100b. in the last two months. With the Federal Reserve likely to raise Fed funds rate still further before the end of the year, the Japanese currency is likely to remain under pressure, leading to a further decline in foreign currency reserves. This suggests that, even if the revival in bank credit continues, broad money growth could well remain rather sluggish during the rest of the year and possibly into 2023. The current government of prime minister Kishida has passed a number of so-called fiscal stimulus packages, but their effect has thus far been negligible. The Bank of Japan's ultra-loose monetary policy has so far not led to a marked increase in the quantity of money. Indeed, if inflation remains above 2%, the next move in interest rates is more likely to be a tightening than further easing. In summary, the money numbers suggest that the Japanese economy is going to flatline or grow only modestly in the short to medium term.

The Japanese economy contracted by 0.3% in the third quarter of 2022. Exports nonetheless continue to perform well, up 25.3% in October on a year previous. The retail sector also continues to record steady growth and the housing market has picked up since August.

John Petley
17th November, 2022

	% annual growth rate:	
	M3	Nominal GDP
1981 – 1990	**9.2**	**4.6**
1991 - 2000	**2.4**	**1.1**
2001 - 2010	**1.0**	**0.8**
2011 - 2020	**3.1**	**0.3**

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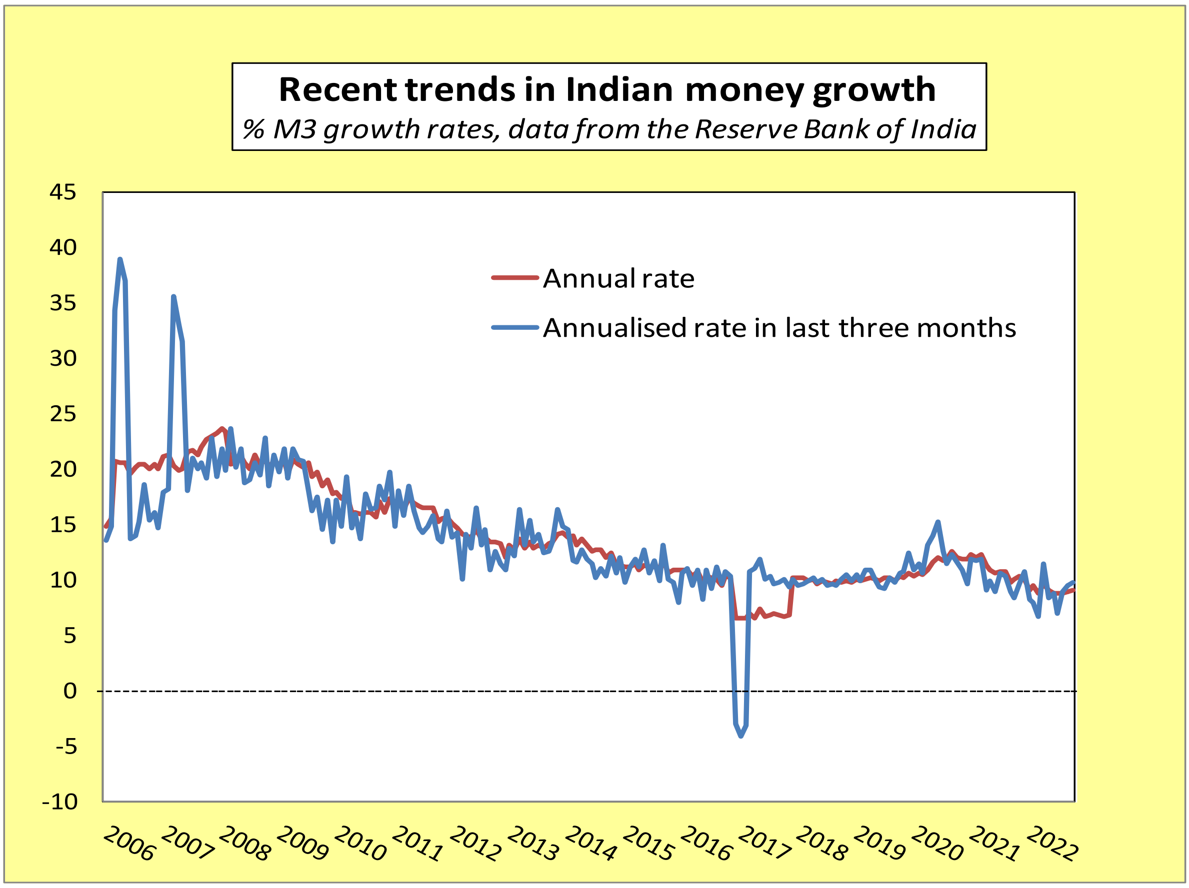
India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2020	**15.8**	**12.9**
Ten years to 2020	**11.3**	**9.8**
Year to October 2022	**9.1**	**n/a**
Three months to October 2022 at annualised rate	**9.7**	**n/a**

Sources: Reserve Bank of India for M3 and IMF for GDP



Broad money growth edging upwards

Summary: **In the three months to October 2022 India's seasonally adjusted M3 grew at an annualised rate of 9.8%. After falling to 7.0% in the three months to July, the rate of growth of broad money has picked up subsequently. But these figures are still below those typical in the 2010s, when broad money growth rarely fell below 10%. Annual growth rose from 8.9% in September to 9.1%.**

Indian banks are currently seeing very strong demand for credit. The stock of new loans grew by 17.9% in the year to October, the fastest rate of growth since 2013. The government has been determined to reform the banking sector and perhaps its efforts have paid off. Banks have tidied up their loan portfolios, with non-performing loans down to a seven-year low of 5.9% of total loan assets. However, if the authorities force Indian banks to operate with higher solvency ratios to conform to the norms of the Bank of International Settlements (the so-called Basel III rules), this could inhibit their ability to advance new credit. Inhibitions on credit extension would thus cause broad money growth to decelerate. This is particularly important as new bank lending now seems to be playing a greater role in boosting M3. In 2020 and 2021, monetization of government debt kept M3 growing when bank lending was weak. By contrast, in November 2022 Indian banks' net claims on the government are lower than they were a year ago.

Another factor which has resulted in broad money growth remaining at a subdued level in spite of the increase in bank credit is the weakness of the rupee, which hit a record low of 83 rupees against the US dollar in October. Since the start of 2022 India has reduced its foreign exchange reserves by over $100b. in an attempt to contain the slide of its currency. Although there was a slight recovery in its value in November, much depends on the actions of the US Federal Reserve when it next meets in December. Another significant rise in the Fed funds rate may put the Indian currency under further pressure. Thus far, since April, the cost of borrowing has increased by almost 190 percentage points without affecting Indian businesses' appetite for risk. The Reserve Bank of India (the central bank) stated on 5th April that it would prioritise control of inflation over growth.

Perhaps unsurprisingly, India's economy duly contracted in both the first two quarters of 2022. The RBI's current inflation target is 4%, with a permissible margin of 2% in either direction. October was the tenth consecutive month when the annual increase in consumer prices have exceeded 6% and, under its constitution, the RBI is required to provide the government with a series of proposed remedial actions to bring inflation down to target. October's reading, however, was 6.8%. This may have been a decline on September's figure of 7.4%, but it again required correction.

John Petley
18th November, 2022

	% annual growth rate:	
	M3	Nominal GDP
1981 - 1990	**17.3**	**14.7**
1991 - 2000	**17.2**	**14.1**
2001 - 2010	**17.3**	**13.6**
2011 - 2020	**11.6**	**9.9**

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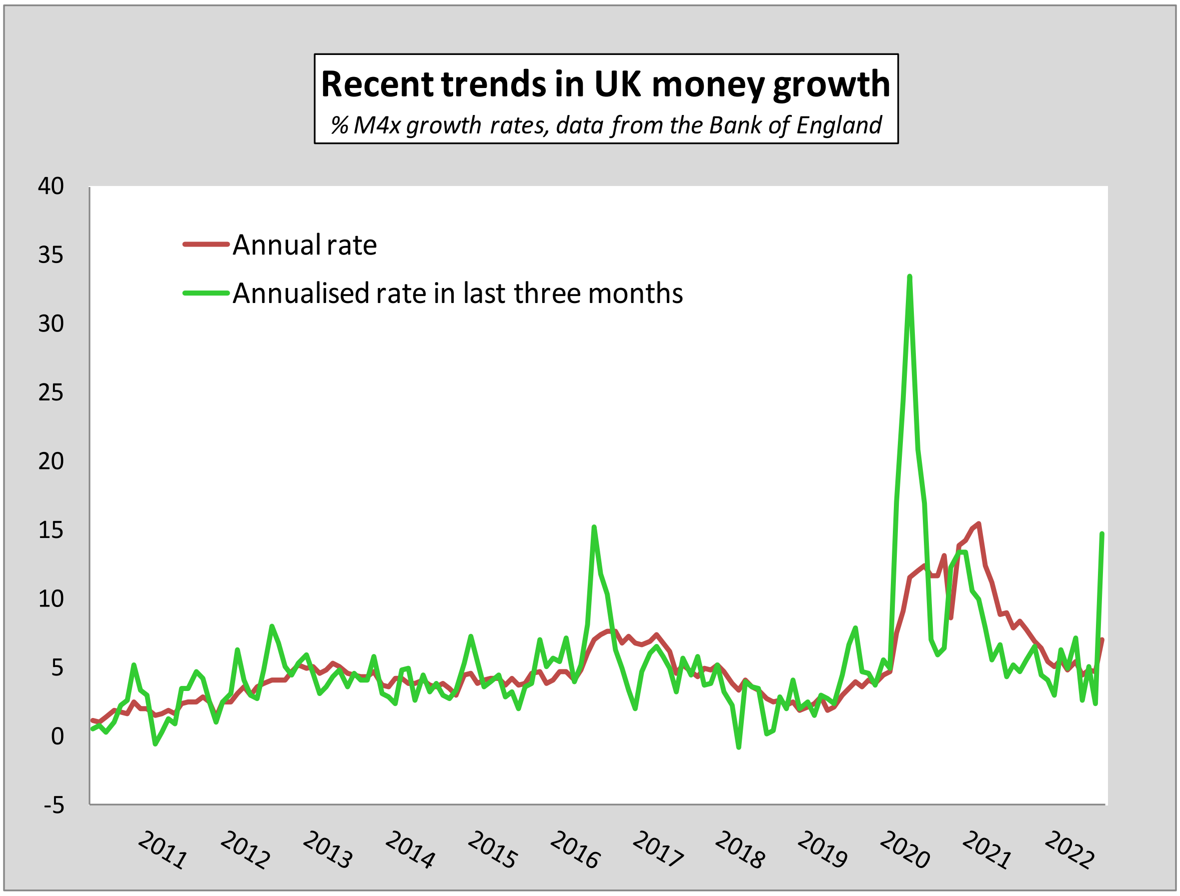
UK

	% annual/annualised growth rate:	
	M4x/M4 before 1997	Nominal GDP
1961 – 2020	**9.3**	**7.6**
Ten years to 2020	**5.2**	**2.3**
Year to September 2022	**7.1**	**n/a**
Three mos. to September 2022 at annualised rate	**14.8**	**n/a**

Sources: Bank of England and Office for National Statistics



Broad money growth blips sharply upwards – probably temporarily

Summary: **UK broad money increased at an annualised rate of 14.8% in the three months to September. This is a big increase on August's reading of 2.1%. It was driven by exceptionally high M4x money growth of no less than 2.7% (almost £75b.) in September. However, this is probably erratic and attributable to large drawdowns of credit lines, in effect "to short sterling" because of the disastrous confidence-sapping Kwarteng mini-Budget on 23rd September.**

This extraordinary spike in broad money growth has been primarily driven by significantly increased levels of borrowing by the financial sector. Much smaller-scale phenomena of a similar character occurred in March, May and July, but were reversed in later months. The upward blips may have been occasioned by large corporate finance developments in London or even by sizeable position-taking in the hedge fund industry. Sterling lending to the financial sector (excluding the awkward quasi-banks known to statisticians as "intermediate other financial corporations") was a remarkable £35.0b. in the month, on an August base of £287.1b. Sterling bank deposits held by the non-IOFC financial sector soared by no less than £67.8b., accounting for the great bulk of the month's money growth. Lending to non-residents was also buoyant. The key background influence was – almost certainly – the disastrous Kwarteng min-Budget on 23rd September. Unfunded tax cuts were widely interpreted as an irresponsible "dash for growth" which would undermine sterling on the foreign exchanges. By borrowing in sterling, hedge funds and large corporates could – in principle – take advantage of a supposedly inevitable market move. In fact, the pound has recovered since 23rd September. On that date it slipped to under $1.10, but at the time of writing it is worth over $1.20.

Almost certainly, October and November will see an unwinding of the position-taking, and repayments of the sterling borrowings. It is too early to determine whether September's blip will have any long-term effect on money trends. Indeed, if the financial sector is excluded, the picture is very different. Growth in new bank credit to the business sector slowed during September, while the number of new mortgage approvals fell by over 7,500 compared with August. (Note that house prices also declined by 0.4% during the month.) The retail sector is struggling too. Sales declined by 6.9% during the 12 months to September, the sixth consecutive 12-month period in which sales have fallen. The decision by the Bank of England's Monetary Policy Committee to raise the Bank Rate by 0.75% following its meeting on 3rd November could well further dampen activity in both the housing and retail sectors.

The repeated increases in the Bank rate since the start of the year have been motivated by concerns about inflation. Nevertheless, recent statements from the BoE suggest that the Bank rate might not rise as high as 5% out of concerns about the effect on the economy and the housing market in particular. Consumer price inflation hit a 41-year high of 11.1% in the year to October.

John Petley
16th November, 2022

	% annual growth rate:	
,	M4/M4x	Nominal GDP
1961 - 2020	**9.3**	**7.6**
1991 – 2000	**6.4**	**6.0**
2001 – 2010	**6.5**	**3.9**
2011 – 2020	**5.2**	**2.3**