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*Monthly e-mail from Tim Congdon and John Petley – 27th February, 2023*

# *Global money round-up in early 2023*

**Apart from China, money growth is dropping almost everywhere at present, and in three key jurisdictions (the USA, the Eurozone and the UK) the quantity of money has suffered outright falls in recent months. Admittedly, in all three places the ratio of money to gross domestic product remains higher than it was before Covid and in that sense a monetary overhang persists. The January nonfarm payrolls number (+517,000) in the USA challenges the recession prognosis. All the same, with the housing market and other leading indicators turning down in the USA and elsewhere, a recession has to be expected in 'the West' in 2023 and it may continue into early 2024.**

**China is in a quite different cyclical position. Money growth there was *higher* in 2022 than in 2023, while the demise of the 'zero Covid' policy would have resulted in a demand bounce-back anyway. Other large Asian economies (India, Korea, Indonesia) ought also to achieve resilient demand growth in coming quarters. 2023 will be a difficult year for the world economy. Output growth at the world level may still be recorded, but it will depend very much on the relative stability of demand growth in Asia. (Also, a possible geopolitical shock deserves mention. China may give military support to Russia in the Ukraine war, posing a direct challenge to the post-1945 US-led international order.)**

**Because of lags in the transmission mechanism, the marked money slowdowns now evident imply falling inflation *in 2024* as well as in 2023. The current inflation episode confirms, yet again, the validity of a monetary approach to the determination of national income and inflation. But central banks and finance ministries in the leading countries continue to focus on the labour market for clues about the direction of inflation. They have been lucky that inflation expectations have not responded too much to the fact of 2022's actual or virtual double-digit inflation, but in truth holders of non-index-linked government bonds have suffered large losses from the fall in the value of money.**

## Money trends in early 2023 in the main countries/jurisdictions

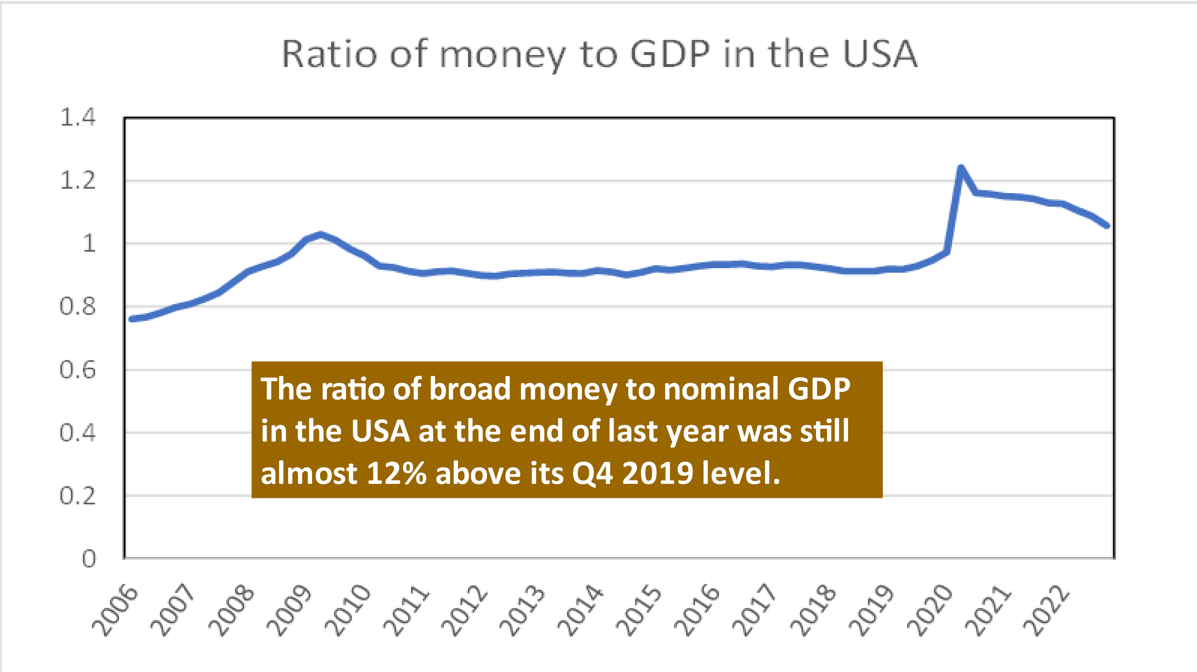
The Institute of International Monetary Research focuses on the relationship between trends in the growth of the quantity of money, broadly-defined, and macroeconomic outcomes. The Institute's consistent analysis from spring 2020 – that money growth acceleration would initially lead to strong asset prices, a boom and an upturn in inflation – proved correct. Central banks in North America and Europe have now 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. Eurozone money growth has slowed in the last three months, bringing it more into alignment with the USA. China is following its own path, with money growth quite buoyant in 2022. In 2023 recessions in North America and Europe ought still to be reconciled with positive output growth at the global level, because of demand resilience in Asia.

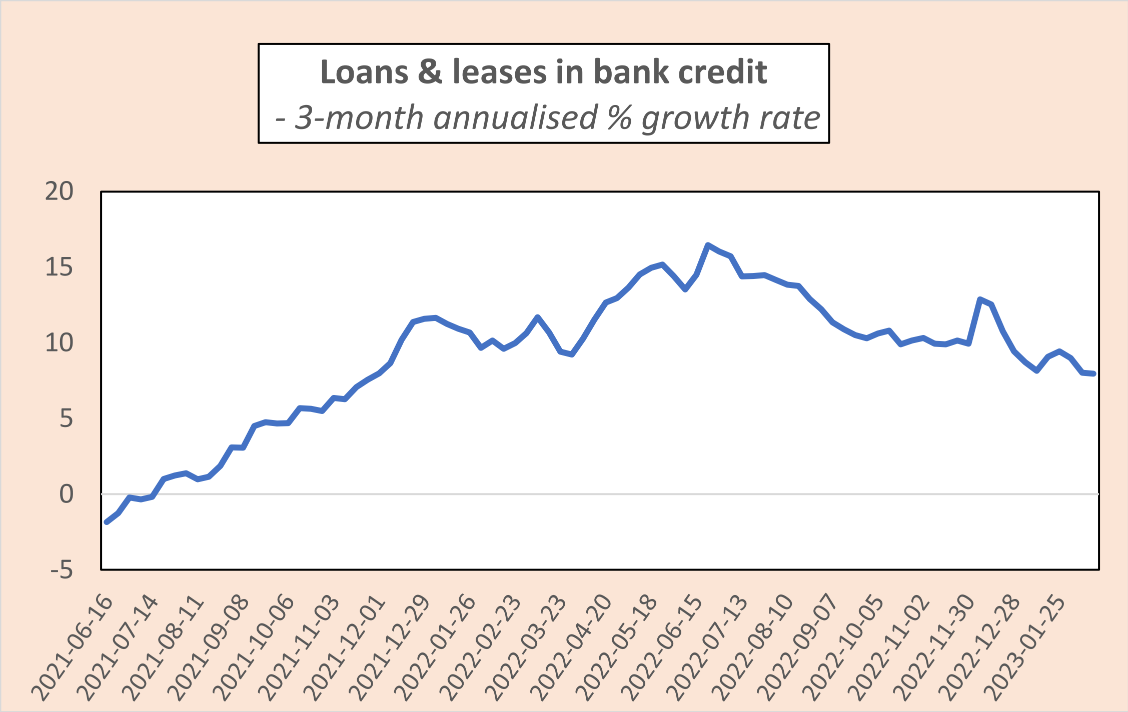
| Name of country/ jurisdiction | Share of world output in 2021 | | Growth rate of broad money | | Comment |
|---|---|---|---|---|---|
| | In purchasing-power parity terms, % | In current prices and exchange rates, % | In last three months at annualised rate, % | In last twelve months, % | |
| | | | | | |
| USA | 15.7 | 24.2 | **-3.9** | **-0.2** | Money growth stopped in spring 2022, implying severe squeeze on real money balances. |
| China | 18.6 | 18.4 | **13.1** | **12.5** | Money growth high, amid property bust scares. Policy being eased, no official inflation concern. |
| Eurozone | 11.9 | 15.1 | **-2.1** | **4.1** | Money growth slowing sharply, as ECB worries about widening sovereign debt spreads. |
| Japan | 3.7 | 5.1 | **1.9** | **2.3** | Credit and money growth down almost to nil, because of FX intervention. |
| India | 6.0 | 3.3 | **9.9** | **9.4** | Money growth quite strong, as RBI seeks more capital in banking. |
| UK | 2.3 | 3.2 | **-10.3** | **2.7** | Money patterns erratic, sharp fall in last three months. |

The recent fall in the M3 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 sharply in the Eurozone and the UK relative to the excesses of 2020 and 2021, with an upward blip in September followed by falls in broad money in the latest months. During 2023, and particularly in 2024, inflation will come down towards levels closer to the norms of the 2010s. The drop in energy prices since last autumn makes continued consumer inflation above 10% unlikely in 2023 in both the USA and the Eurozone. In qualification, all of the USA, the Eurozone and the UK still have a higher ratio of money to nominal GDP than at the end of 2019, before the Covid pandemic. Housing markets are a good leading indicator of the economy and they are in retreat in the main Western countries, but labour markets remain tight and pay settlements keep on edging upwards.




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 implied 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 2023 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 was growing briskly throughout 2022. Until summer last 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 – have checked 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 15th February 2023 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. The deceleration seems to be continuing. In the eight weeks to 15th February the figure for "loans and leases" was more or less flat. This removes a potentially important positive influence on money growth. Admittedly, the annualised rate of growth in the three months to 15th February was still quite high, at 8.0%, but the number has halved compared with the summer peak of over 16%.

Further, the Fed's sales of securities (i.e., "quantitative tightening") – now supposedly of as much as $95b. a month – 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 – have been stable in the last few months. Their level on 15th February was $3,140.2b., slightly *lower* than the value for the month of October ($3,141.8b.).

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. The January employment figures – showing a 517,000 gain in nonfarm payrolls – do not fit with this prognosis, but they may be erratic. Data from the Federal Housing Finance Agency, which indicated an extraordinary jump in house prices continuing even into mid-2022, are starting to show falls in house prices, and these must be expected to become more notable as 2023 proceeds.

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 4.1% higher in December 2022 than a year earlier. The comparable figures in October and November were 5.0% and 4.8% respectively. The stock of loans for house purchase was up by 4.4% in the year to December, while loans to non-financial corporations (i.e., industry and commerce) gained 5.5% in the same period. Bank lending to companies has been particularly weak in the last few months.

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 was weak in 2021 and early 2022. But it has strengthened subsequently, with the quarterly annualised rate of growth typically above 5% since spring of last year. 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.) The recent fall in money growth is attributable to a remarkable drop in banks' holdings of cash and "investment securities", where "investment securities" are dominated by Japanese government bonds. This drop in the second half of 2022 was large. The Bank of Japan has changed the rules of yield curve control, with it now trying to keep 10-year government bond yield under ½%, not zero. There has also been heavy foreign exchange intervention to check the yen's fall.

In the UK September 2022 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.

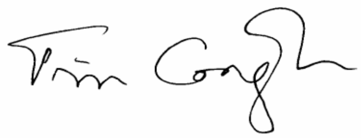
In our comment here in November, we said, "Repayments of the rather speculative bank borrowings seem likely in the next few months, so that September's 2.7% jump in M4x will be replaced by offsetting declines." That has now happened. The M4x money aggregate fell by 0.6% in October, 0.9% in November and 1.2% in December. The annual increase in M4x was 6.9% in September, but only 2.7% in December.

As has been emphasized here for some time, lending to UK 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 made throughout 2022, 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 we may be nearing their peak for this cycle in the USA and the UK. The ECB was slower to move, but is now catching up. The ECB refinancing rate – only 2% in mid-December – has been increased in two steps of 50 basis points and is now 3%. Central banks are also ending asset purchase programmes and in some instances – notably in the case of the USA's Federal Reserve – have made commitments to reduce their asset piles.

A reduction in money growth is a condition of the return of moderate inflation. That is now happening in the main Western economies and, in a sense, is to be welcomed. However, anxieties must be expressed that outright falls in the quantity of money may prove too harsh on output and jobs. The annualised pace of the growth of bank lending to the private sector is now coming down to under 5% everywhere in the main economies. Nominal interest rates may still be low by historical standards and are far beneath current inflation rates. All the same, such interest-rate-sensitive series as mortgage approvals and actual mortgage lending have turned down in all of the USA, the Eurozone and the UK. The peak in central bank interest rates is near, at least for the current cycle.



27th February, 2023

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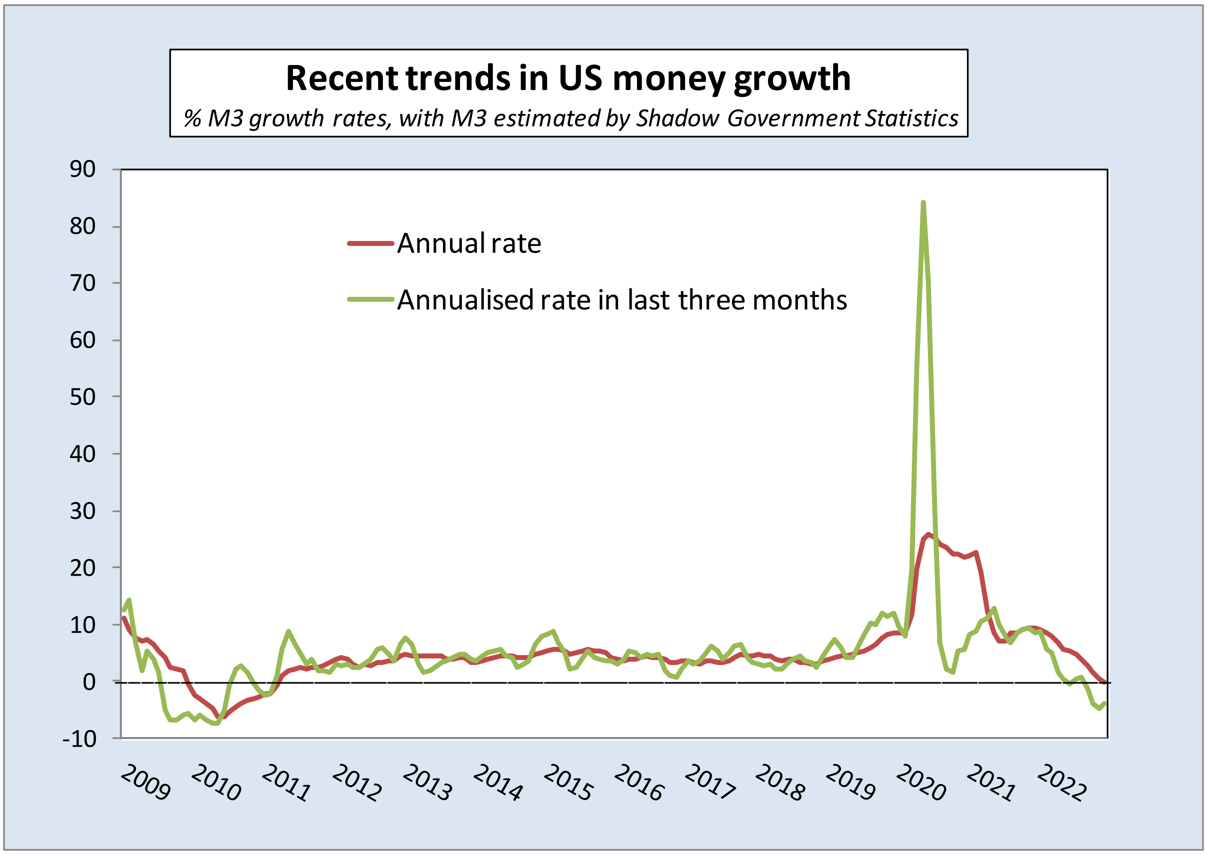
# USA

| | *% annual/annualised growth rate:* | |
|---|---|---|
| | M3 | Nominal GDP |
| 1961 – 2020 | **7.7** | **6.3** |
| Ten years to 2020 | **6.2** | **3.4** |
| Year to December 2022 | **-0.2** | **n.a** |
| Three mos. to December 2022 at annualised rate | **-3.9** | **n.a.** |

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



## US broad money contraction continues in December

***Summary:* US broad money declined by 1.0% in the final quarter of 2022, implying an annualised rate of fall of 3.9%. In all the four months from September to December inclusive, the M3 quantity of money went down. In October the drop was as much as $164b. or 0.6%. This is the sharpest decrease in broad money since the Great Recession. However, during that period the Fed funds rate was being cut whereas these falls in M3 are occurring when interest rates are rising. (Our M3 data come from Shadow Government Statistics.)**

Despite Fed data showing that bank deposits increased a bit in December, the estimate from SGS was that M3 dropped by $67b. in the month. This was sufficient to turn annual growth negative. The Fed's H8 releases now cover the period up to 15th February and imply that US bank deposits have resumed the downward trajectory they had for much of late 2022. The ratio of M3 to nominal GDP is still above its pre-Covid level, with the monetary overhang from the very rapid money growth in 2020 and 2021 not yet cancelled by the money stagnation of 2022. If 2023 sees the quantity of money unchanged and nominal GDP growth of about 10%, the ratio of M3 to GDP (i.e., the inverse of the velocity of circulation) would have returned to where it was in the final quarter of 2019. A crucial influence on money growth will be bank lending to the private sector, roughly measured by the category "loans and leases in bank credit" in Fed statistics. The stock of such loans and leases was booming in spring and summer 2022, but in the eight weeks to 15th February it rose at an annualised rate of only 3.1%.

The Federal Open Market Committee voted unanimously for a further increase in the Fed funds rate during its meeting on 31st January – 1st February. The hike was only 0.25%, the most modest since the Fed started tightening monetary policy in March 2022. All the same, the cost of borrowing is now at its highest level since 2007. US consumer price inflation fell to 6.4% in the year to January, the lowest reading since October 2021. This is nonetheless significantly higher than the Fed's 2% target. Fed chair, Jerome Powell, stressed after the FOMC meeting that further rate increases may be appropriate in coming months. Moreover, since May the Fed has been running off some of the assets purchased in 2020 and 2021, although not in recent months at the announced rate of $95b. per month.

Talk of "immaculate disinflation" is now widespread. The rate of unemployment fell to 3.4% in January, the lowest level since May 1969. But past experience demonstrates that a margin of labour market slack is needed to combat upward pressures on wages. Anyhow, many indicators suggest a slowdown. Existing home sales have now been declining for 11 consecutive months. Meanwhile house prices – as tracked by the Federal Housing Finance Agency's index – have reached an inflection point. After soaring through 2021 and early 2022, they were unchanged in October and dropped 0.1% in November.

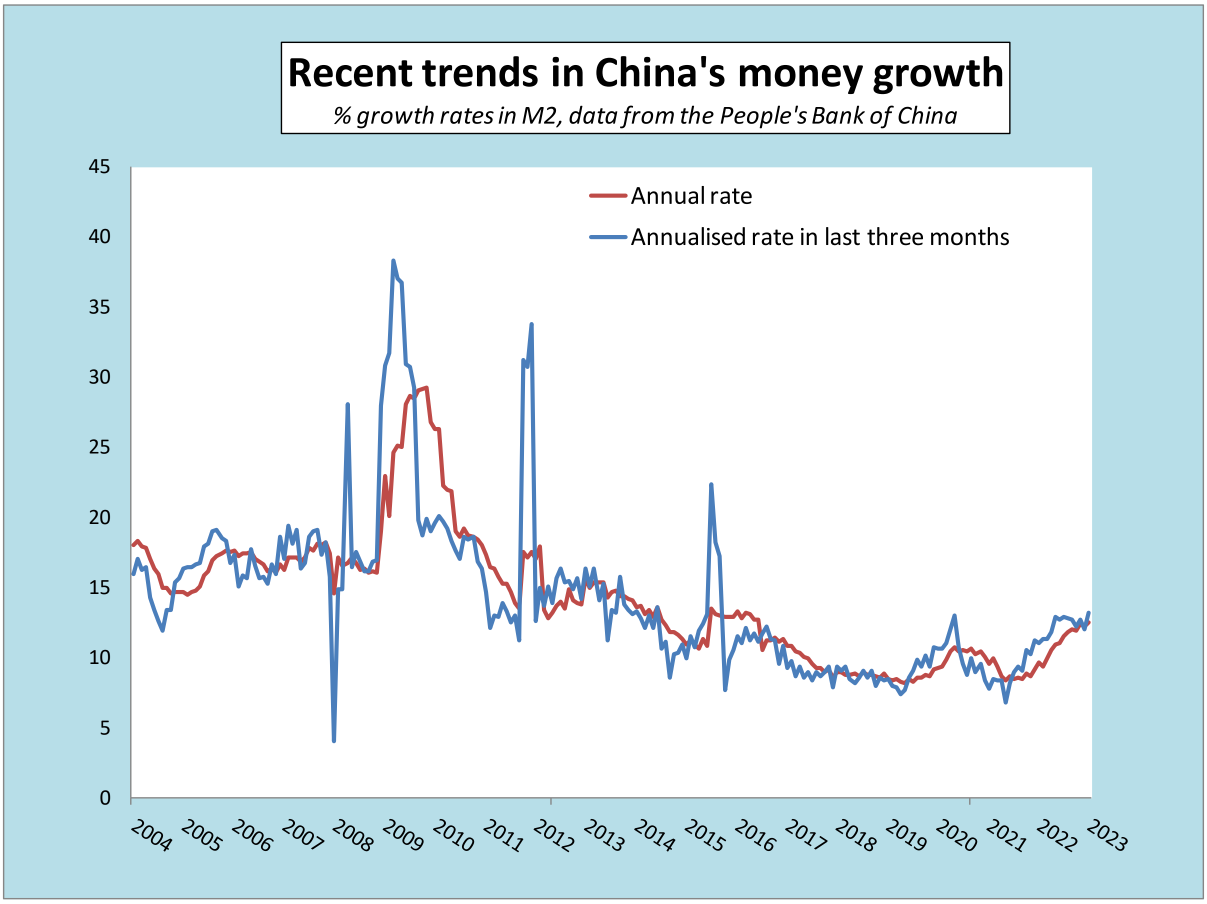
*Tim Congdon and John Petley*
*23rd February, 2023*

| | *% 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 January 2023 | 12.5 | n/a |
| Three months to January 2023 at annualised rate | 13.1 | n/a |

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



## Broad money growth accelerates, as restrictions ease

***Summary***: **In the three months to January 2023 China's seasonally adjusted M2 grew at an annualised rate of 13.1%. This was above December's figure, on the same measure, of 11.9%. it was indeed the most rapid annualised quarterly growth since September 2015. For much of 2022, broad money growth was on a steady upward trend. The annual rate of growth also picked up from 12.2% to 12.5%, a six-year high.**

This sudden upturn in broad money growth appears largely to have been driven by a significant rise in China's already substantial foreign exchange reserves, which climbed by US$56b. during January. There was a very modest increase in the growth of the stock of loans by Chinese banks during the month. But the most recent number for the annual rate of increase, at 11.3%, is below the norm for most of the last decade, when the statistic rarely fell below 13%. The stock of new loans to households declined in January, presumably reflecting the *malaise* in the housing market. This follows GDP growth of only 3% in 2022, which was the lowest rate of growth since 1976 apart from Covid-affected 2020.

This figure is well short of the authorities' 5.5% target. 2023 may surpass this figure thanks to the termination of the "zero covid" policy in November. The International Monetary Fund, which had a 4.4% 2023 growth forecast last October, has raised it to 5.2%, but any surprise is likely to be on the positive side. The end of lockdowns will enable industry to function more smoothly, while providing a considerable boost to the beleaguered retail sector. The housing market is also struggling, as the over-indebtedness of several large property developers constrains activity. Property sales fell by 26.7% in 2022 and the average house price in China's largest 70 cities was 1.5% lower in January 2023 than a year earlier. This was the ninth consecutive month of decline. Four years ago, by contrast, prices were rising at an annual rate of over 10%. Industrial production was also flat in the final three months of 2022.

The People's Bank of China (the central bank) was loosening monetary policy for much of 2022 in an attempt to stimulate the economy. Throughout this period, inflation remained below the government's 3% target. Producer prices meanwhile have been on the decline since October. While such figures would appear to offer further scope to stimulate credit growth, the PBoC has reduced neither interest rates nor banks' reserve ratio in recent months. It did, however, announce new measures in both November and December to improve developers' access to credit to allow at least some of the many unfinished housing projects to be completed. On 15th February 15th it also injected $73b. into the banking system via a medium term lending facility, with one-year loans at an interest rate of only 2.75%. The current acceleration in money growth ought to promote demand, output and employment. As the trend annual growth rate of Chinese output has probably dropped to the low single digits per cent, a money growth rate of over 12% signals rising inflation in future. The decline in China's economic dynamism is partly due to the increasingly authoritarian rule of premier Xi Jinping and his associates, who favour more state planning and withdrawal from the world economy.

*Tim Congdon and John Petley*
*23rd February, 2023*

| | 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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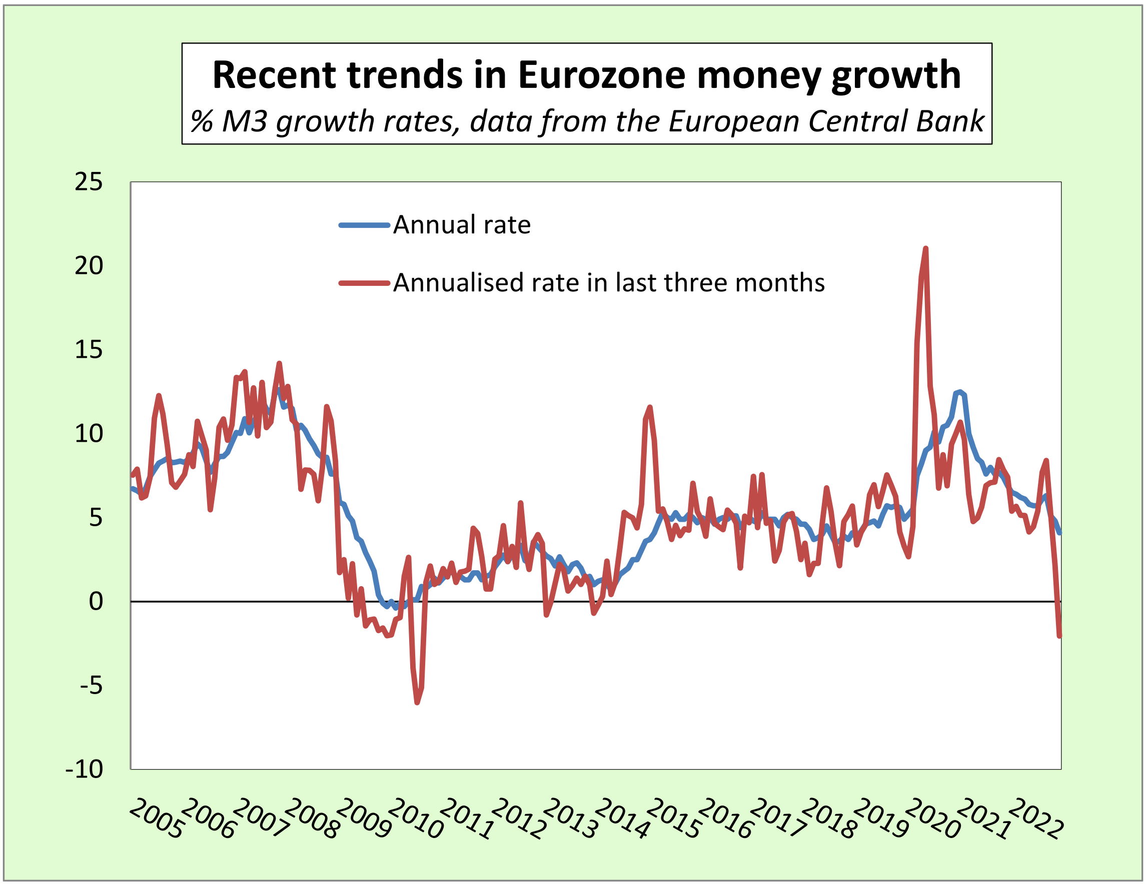
# Eurozone

| | *% annual/annualised growth rate:* | |
|---|---|---|
| | M3 | Nominal GDP |
| 1996 – 2020 | **5.5** | **2.7** |
| Ten years to 2020 | **4.6** | **1.6** |
| Year to December 2022 | **4.1** | **n/a** |
| Three mos. to December 2022 at annualised rate | **-2.1** | **n/a** |

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



## Broad money growth slowdown intensifies

***Summary*: In the final three months of 2022 Eurozone M3 broad money contracted at annualized rate of 2.1%. Since peaking at 8.4% in the three months to September, broad money growth has slowed sharply. The apparent change in trend has been indicated by falls in M3 of €67b. and €38b. during October and December respectively, a big contrast from September's €113b. increase. The annual rate of growth declined from 4.8% in November to 4.1%, the lowest such reading in four years.**

The strong demand for new bank credit, which was the main driver of broad money growth for much of 2022, has ground to a halt, In both November and December the stock of loans to business went down. The demand for new mortgages is also slowing in response to the higher interest rates now being implemented by the European Central Bank. This slowdown is likely to continue into 2023. At its first meeting of the year on 2nd February, the ECB's Governing Council voted to hike interest rates by a further 0.5% (i.e., 50 basis points). Since June the ECB's rate has increased by 3% (300 basis points) in total. At the press conference following the meeting, President Christine Lagarde stated that a further increase was likely in March and even then, "We know that we are not done."

The ECB has also announced that it will start to shrink its balance sheet. From March until June maturing assets from the 2019 Asset Purchase Scheme will be run off at a rate of €15b. per month. The figure will be reviewed in June, in the light of macroeconomic conditions at the time. There are currently no plans to run off the much larger stock of assets acquired under the Pandemic Emergency Purchase Programme (PEPP) before the end of 2024.

While the ECB has not engaged in as drastic a policy tightening as the US Federal Reserve, its latest announcements suggest that broad money growth in the Eurozone in 2023 is likely to be modest at best. An outright fall in the quantity of money is not to be precluded. Of course, monetary tightening measures are being carried out because the ECB, like many other central banks, believes that raising interest rates will bring inflation down. Inflation is indeed falling. The annual increase in the consumer price index has fallen from October's peak of 10.6% and was 8.5% in January this year. Although still massively higher than the 2% target, the ECB has deflected criticism by emphasizing the shock to energy prices from the Ukraine war. But the European wholesale price of gas is now lower than it was before late February 2022, when Russia started its invasion. As in the USA and the UK, the key causative influence on current inflation was the excessive growth of M3 in 2020 and 2021. In the two years to end-2021 M3 increased at a compound annual rate of 9.1%, much higher than the 3.3% figure recorded in the preceding decade. The latest numbers are a move in the right direction, but fears must be expressed that the ECB will be too restrictive in 2023 and 2024, and that the Eurozone will enter yet another recession. GDP increased by a mere 0.1% in the final quarter of 2022. (There may be a slight distortion to data in January 2023 due to Croatia's accession to the single currency bloc, but the statisticians are well-versed in the technical complexities.)

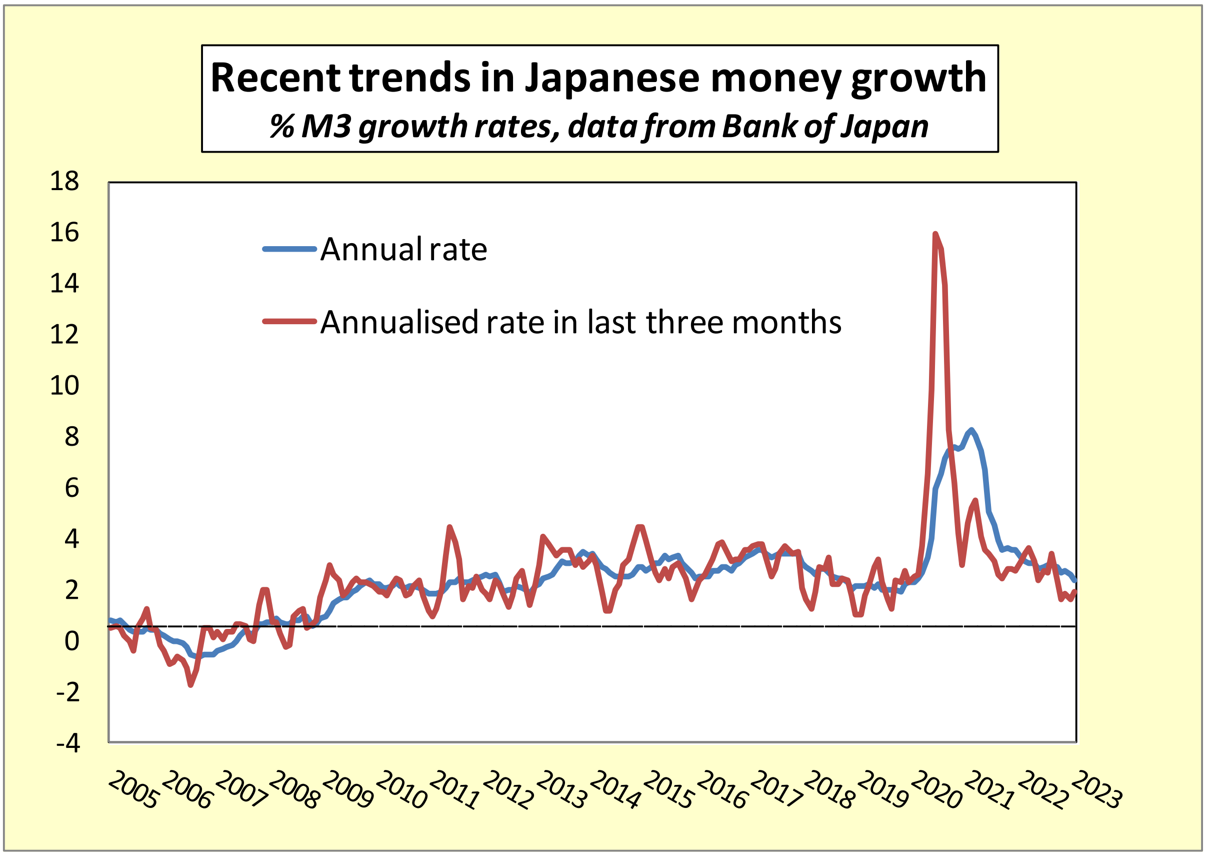
*Tim Congdon and John Petley*
*24th February, 2023*

| | *% 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** |

# Japan

| | % annual/annualised growth rate: | |
|---|---|---|
| | M3 | Nominal GDP |
| 1981- 2020 | 3.9 | 1.7 |
| Ten years to 2020 | 3.2 | 0.3 |
| Year to January 2023 | 2.3 | n/a |
| Three months to January 2023 at annualised rate | 1.9 | n/a |

*Sources:* Bank of Japan for M3 and IMF for GDP



## Broad money growth remains very low

***Summary:*** **Japanese M3 grew at an annualised rate of 1.9% in the three months to January 2023. This is a somewhat higher than December's reading of 1.6%, but the underlying story is of stability at a rate which is very low by long-run international standards. January itself saw an increase of 22 trillion yen, higher than December's very weak reading of 6.2 trillion, but lower than the average monthly increase in 2019 (which was 25.3 trillion). (A trillion yen is worth about $7½b. at the current exchange rate.) The annual rate of growth fell back from 2.6% to 2.3%, the lowest figure in this series since November 2019.**

On 14th February the Bank of Japan confirmed that Kazuo Ueda will succeed Haruhiko Kuroda as its governor. Mr Ueda, who will take over in April, has an academic background, although he served on the BoJ's policy board between 1998 and 2005. His initial comments after his appointment suggest that any large and immediate change in the BoJ's policy stance is unlikely. But he has a reputation of favouring reflation, which he confirmed by saying that "monetary easing must carry on given the current state". The yen proceeded to retreat against the US dollar. If the Bank of Japan were again to draw on foreign currency reserves to defend the yen, that would have a contractive effect on money growth.

The Bank of Japan is now an exception among central banks in retaining a negative rate in its dealings with commercial banks. It has also continued to purchase substantial quantities of 10-year Japanese government bonds in an effort to keep yields at 0.5% or lower. The programme amounts to "yield curve control", but has also been termed "qualitative and quantitative easing". The 10-year JGB yield moved up sharply in December to almost 0.6% after years of being under 0.3%, and commentators conjectured that the BOJ would let the 10-year JGB yield move towards 1.0%. But January again saw efforts by the JGB to prevent that. Bond yields are below inflation, even if inflation is lower in Japan than in other developed economies, reflecting many years of low money growth. Consumer prices rose by 4.0% in the year to December, the highest reading since January 1991. The December outturn may be close to the peak of inflation for the current cycle. The yen's depreciation on the foreign exchanges has led to increases in companies' costs, but only part of that has passed through to the consumer.

The Japanese economy has avoided recession since 2020, but GDP growth has been weak. The third quarter of 2022 recorded a 0.4% contraction, which was followed by growth of a modest 0.2% in the final quarter. The housing sector, which picked up at the start of 2022, is slowing again and industrial production also declined on an annual basis in the final months of 2022. Year-on-year exports from Japan increased by 3.5% in January 2023, but this was by some margin the softest rate of growth since February 2021. There have been some positives. The retail sector is picking up now that all restrictions have been lifted. Wage growth rose by 4.8% in the year to 2022, comfortably the biggest increase in average earnings in over 20 years. Growth in the stock of loans rose to 3.1% in the year to January, the highest reading since April 2021.

*John Petley*
*17th February, 2023*

| | *% 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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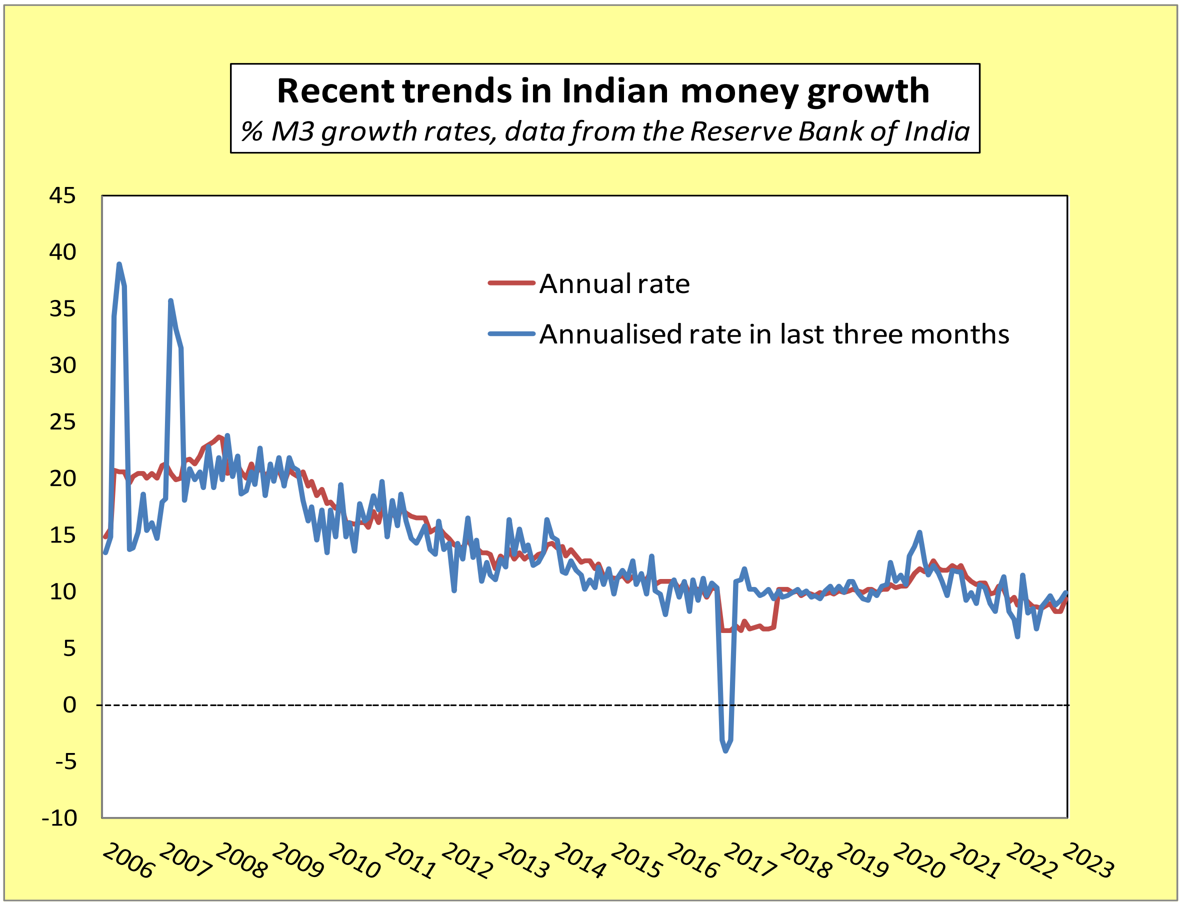
# India

| | *% annual/annualised growth rate:* | |
|---|---|---|
| | M3 | Nominal GDP |
| 1981- 2020 | **15.8** | **12.9** |
| Ten years to 2020 | **11.3** | **9.8** |
| Year to January 2023 | **9.4** | **n/a** |
| Three months to January 2023 at annualised rate | **9.9** | **n/a** |

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



## Broad money growth picks up slightly, amidst credit boom

***Summary:*** **In the three months to January 2023 India's seasonally adjusted M3 grew at an annualised rate of 9.9%, an increase on December's reading of 9.1%. The annual rate of growth rose from 8.2% in December to 9.4%, the highest reading since April 2022, although still below the typical values for the previous decade.**

The Reserve Bank of India raised the cost of borrowing by 0.25% at its February meeting. This was the sixth successive rate hike. In total, the interest rate increases have raised the cost of borrowing by 2.5% since May 2022. The RBI remains concerned about the high level of inflation. Increases in the cost of food were a causal influence on consumer prices rising by 6.5% in the year to January. (India's inflation target range is set at 4%, with a 2% band either way). After February's meeting Governor Shaktikanta Das hinted that further rate rises may follow. For much of 2022 the increases in the costs of borrowing did not dampen the appetite for credit by Indian businesses. The annual rate of loan growth rose from 7.9% in January to over 17.0% in October, the highest number on this metric in over a decade. So far 2023 has seen some cooling-off on this front. The reading for the first half of January was 14.9%.

It is too early to determine whether higher borrowing costs are acting as an effective deterrent to excess credit expansion. Indeed, the current level of new bank credit growth is still relatively strong by the standards of recent years. For much of 2022 the credit boom was associated with weakness of the rupee on the foreign exchanges. The RBI met these pressures partly by the interest rate increases mentioned above, but also by using its foreign exchange reserves for intervention purposes. The reserves fell heavily in the first nine months of 2022, but recovered in the final quarter. The latest signs are of renewed rupee depreciation and further reductions in the FX reserves. India, like other developing countries, is affected by the flow of funds into dollars as the Federal Reserve raises Fed funds rate. (The reduction in the FX reserves provides rupee finance to the government and so reduces broad money growth. The contraction in the Indian banking system's net external assets has meant that money growth has been lower than implied by the credit boom.)

The overall outlook for the Indian economy is positive. All coronavirus-related restrictions were lifted in April 2022. A combination of action by the central bank and legislation by the government has improved the performance of the banking system. The percentage of non-performing loans has halved since 2018. Moreover, no bank failures have been reported in the last two years following a period of 30 months between 2018 and 2020 when no fewer than five financial institutions were placed in special measures by the central bank. Well-publicised are the problems of the Adani Group, which has liabilities to Indian banks equivalent to $9b., but the failure of the Adani Group would not result in a systemic crisis. The determination of the Indian government to align the country's banks with the standards of the Bank of International Settlements (the so-called Basel III rules), could, however, inhibit their ability to advance new credit as it will require higher solvency ratios. This would inevitably slow broad money growth.

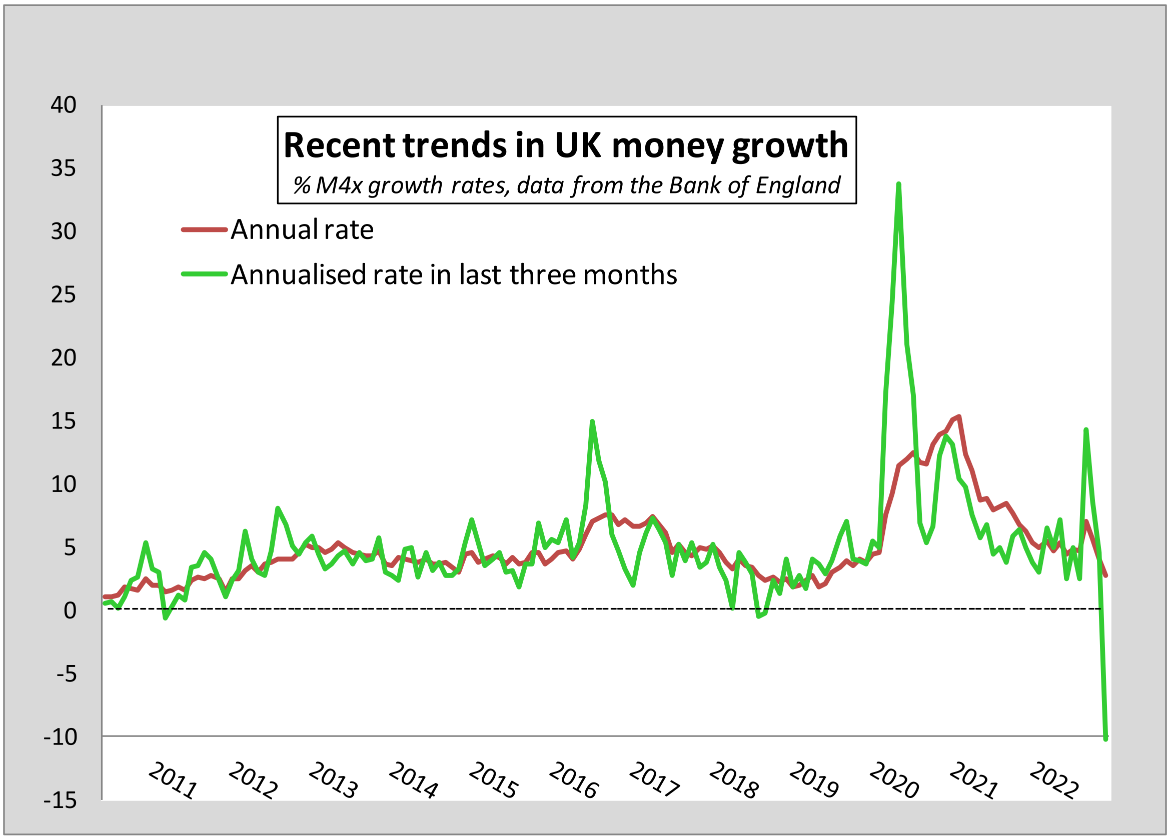
*Tim Congdon and John Petley*
*24th February, 2023*

| | *% 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** |

## 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 December 2022 | **2.7** | **n/a** |
| Three months to December 2022 at annualised rate | **-10.3** | **n/a** |

*Sources:* Bank of England and Office for National Statistics



## Broad money growth crashes after September's spike

***Summary*: UK broad money decreased at an annualised rate of 10.3% in the final three months of 2022. This extraordinary slide has been largely caused by the aftermath of a surge in borrowing by the financial sector during September, probably in an attempt to "short sterling" at the time of the disastrous Truss/Kwarteng mini-Budget. After the new Chancellor Jeremy Hunt cancelled the unfunded tax cuts, sterling recovered. The last three months saw much of the money repaid. Indeed, in December, £34.2b. was repaid by the financial sector, which contributed to a record overall fall in M4x of £34.7b. The annual growth rate declined from 4.2% to 2.9%, the lowest reading since June 2019.**

Even allowing for the mishap of the Kwarteng mini-Budget and its aftermath, broad money growth is slowing. Banks are increasingly constrained by onerous capital requirements, as in their lending to companies. The stock of loans to non-financial corporates was up by a mere 1.4% in the year to December. The Basel III capital regime has generally been less punitive on mortgage lending, but the rises in Bank rate have had the predictable consequence of discouraging borrowing to buy houses. The value of approvals for loans secured on dwellings was £25.7b. in September, but only £14.0b. in December. The number of approvals for house purchase had a recent peak of 107,095 in November 2020. By contrast, the number of such approvals last December was 68,221. Bank lending to the private sector – usually the main determinant of the growth of bank deposits– is likely to be weak in 2023.

The Bank of England's Monetary Policy Committee pressed ahead with a further 0.5% increase in Bank rate at its meeting on 2nd February, taking it to 4.0%. This was the tenth consecutive rate hike, with borrowing costs now at their highest level since 2008. Although the vote was not unanimous, the summary of the MPC's deliberations hinted strongly that a further rate increase may follow in March. Inflation, which still currently stands at over 10% on the consumer price index, has persisted at this very high level for longer than the MPC expected. (However, it does need to be said in qualification that energy prices have fallen back far more than envisaged in autumn 2022.) Another aspect of the policy tightening is that the Bank of England continues to reverse the asset purchases of 2020 and 2021. At the end of December over £30b.out of a total of £875b. had been run off and January saw a further reduction of over £30b. in the central bank's balance sheet.

Recent monthly money growth has been erratic. In the month of September M4x surged by £72.8b. or 2.6%, i.e., at an annualised rate of increase of 36.1%. This Institute suggested that abnormally high bank borrowing by the financial sector was responsible for this surprising development and that it would be reversed in following months. That is exactly what has happened, with the financial sector (excluding the quasi-banks categorized in the data as "intermediate other financial corporations") repaying £56.2b. of its sterling bank debt in the final quarter of 2022. Even so, the scale of the adjustment has been remarkable, implying that perhaps a change in regulations or something similar has been to blame.

*Tim Congdon and John Petley*
*24th February, 2023*

| | *% 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** |