Monthly e-mail from Tim Congdon of International Monetary Research Ltd. – 8th May, 2015

Global money round-up approaching mid-2015

In a note sent out on 18th March I argued, 'Clear upturns in the rate of growth of broad money are now being seen in both the USA and the Eurozone. With major price indices falling due to the oil price crash, the growth rate of real broad money is at the highest level in both 'countries' (if we regard the Eurozone as a country) since 2008. Past relationships suggest that strong growth of real broad money should be associated with *both* buoyant and rising asset prices, *and* above-trend growth in demand and output…Overall, a fair verdict is that above-trend growth in demand and output – in both the USA and the Eurozone – is likely in the year from mid-2015.'

Do another two months of data require any change to that assessment? The short answer is 'no', with continuing evidence of a marked revival of bank credit to the private sector in the USA. More tentative, but also important, is that bank credit to the private sector has at least stabilized (i.e., stopped falling) in the Eurozone and may even have started to grow, *ahead of the positive effects of QE on broad money, asset prices, demand, etc.* So I stick to my view that the year from mid-2015 will see above-trend growth in world output. However, there are some disappointments to report. First, broad money growth in Japan has slowed, despite all the media excitement about Abenomics. Secondly, UK banks – bullied by officialdom, of course – do not seem to be major participants in the current upsurge in cross-border merger activity and face weaker mortgage demand at home because of yet more regulation. So bank lending to the private sector remains sluggish and broad money growth has slipped a bit. Thirdly, each of China, India, Brazil, Russia and so on has its own quirks and peculiarities, but one has to concede that – on the whole – banking systems are growing more slowly than has been normal over the past decade or two. My overall conclusion is that the year from mid-2015 will be a good one for the world economy (with 3% - 4% growth), but will not see a 'boom' (i.e., 5% plus growth).

Money trends so far in 2015 in the main countries/jurisdictions

What have been money growth trends in the main countries so far in 2015? And what is the message for global economic activity over the next year or so, and for inflation/deflation over the medium term thereafter? The table below summarizes the key numbers. In addition to the very brief comment in the right-hand column, I venture remarks under three headings – China and India; the USA; and the Eurozone, Japan and the UK.

Name of country/ jurisdiction	Share of world output, in purchasing-power-parity terms, %	Growth rate of broad money, in last three months at annualised rate, %	Growth rate of broad money, in last twelve months, %	Comment:
USA	19.2	**7.4**	**5.6**	Money growth rising strongly in recent months, with new bank credit to the private sector the main influence at work.
China	16.1	**10.5**	**9.6**	Major policy easing seems to be under way, to counter deflation, after/with attempts to rein in 'shadow banks'.
Eurozone	12.8	**5.9**	**4.6**	Bank credit to private sector stable, with banks still trying to meet regulatory capital targets. Large-scale QE from March should now boost M3 growth.
India	6.0	**11.5**	**12.1**	India continues to have clearly positive inflation, unlike other large countries, but money growth and inflation are falling.
Japan	5.3	**1.6**	**2.6**	Broad money growth *slowing* in recent months, with Bank of Japan mistakenly targeting monetary base instead of quantity of money in its QE operations.
UK	2.7	**2.5**	**4.1**	Money growth is satisfactory, if only just, with tightening regulation still main factor holding back bank balance sheet growth.

China and India – developing countries, where the banking systems and money growth were little affected by the Great Recession and tighter financial regulation

China and India have the highest money growth rates, but that is misleading. They remain developing countries with high trend rates of output growth and, in the Indian case, entrenched expectations of continuing inflation. *For most of the last 20 years or so money growth in China and India has run at annual rates in the 15% - 25% vicinity, **and current growth rates of about 10% represent a marked deceleration.*** As far as China is concerned, the deceleration may be interpreted as part of a more general move to slower, but higher-quality economic growth, which is being guided – very deliberately – by officialdom in the ruling Communist Party. The Chinese authorities have been seeking less corruption, less environmental waste and pollution, and better resource allocation, as the working-age population peaks and the huge exodus from the low-productivity countryside comes to an end. Even so, the deceleration in money growth is curious, when set against reports that the People's Bank of China wants an easing of monetary policy. Unlike China, India has had unduly high inflation in the last couple of years, and the money slowdown may be welcome in tending to dampen inflation pressures. The jury is out on the BJP government's drive to boost the supply-side of the Indian economy, but a combination of more moderate money growth and a higher trend rate of output growth would imply a big decline in inflation over the medium term.

The USA - the developed country that, on the data, has escaped from the check to money growth arising from the Great Recession's tightening of financial regulation

Broad money growth in the USA has accelerated in recent months, while – even more remarkably – that acceleration has owed nothing to expansionary asset purchases by the Federal Reserve (i.e., to 'quantitative easing'). In fact, US banks' cash holdings have been falling – if quite slowly – from a peak last September, a peak which reflected a build-up from the Fed's previous asset purchases. **The upturn in money growth is due entirely to stronger bank credit to the private sector.** A reasonable guide to the behaviour of such credit is given by the category 'Loans and leases in bank credit' in the Fed's weekly banking statistics. In the three months to March 2015 it grew by 2.1%, i.e., at an annualized rate of 8.7%. In 2010 'loans and leases in bank credit' dropped by 5.7%, and in the following three year they went up on average by only 2.2% a year. So the latest numbers are in a different ballpark, consistent with the American banking system being in good health and keen to expand despite the persisting barrage of extra regulation. (In other occasional notes this year, I have pointed out the boom in bank credit from small US banks. The boom continues. In the three months to March 'loans and leases in bank credit' from small domestically chartered banks soared at an annualized rate of 15.8%.)

The credit boom is attributable, in part, to a return of corporate takeover activity, in line with previous cyclical patterns. Shell's acquisition of BG is – strictly speaking – a European event, but US banks and dollar financing will play some role. Meanwhile takeovers of pharmaceuticals and biotechnology companies often include an element of bank finance. A big growth area in corporate finance in the next years will be media and telecoms, as the emerging giants try to globalize their reach, and again there will be implications for bank credit and money growth.

US economic activity in the first quarter was disappointing. All the same, the stock market has kept on hitting new peaks and leading indicator indices are solid. With the overall price level falling because of the drop in energy prices, real (i.e., inflation/deflation-adjusted) money growth is very high. My verdict remains that the USA will see above-trend growth in demand and output in the year from mid-2015, and worries about rising inflation will return in 2017 and 2018.

The Eurozone, Japan and the UK – developed-world jurisdictions that have not fully escaped from the check to money growth arising from the Great Recession's tightening of financial regulation and/or poor demographics

The Eurozone's money numbers for March were the first affected by QE operations. It has to be said that the impact of the open market operations on bank balance sheets is not obvious – or at any rate not yet obvious – from the statistics. There ought to have been a jump in the rate of banks' acquisition of claims on the public sector/governments of the Eurozone, but that doesn't emerge from the numbers. In March banks' credit to general government rose by only €20b., not much more than in earlier months and much less than the planned monthly amount of €60b. However, these are early days and it may take a few months for QE to get into its stride. Also important is that bank credit to the private sector has stopped falling. The ECB's monthly press release reports that bank credit to 'other Euro area resident' (i.e., other than general government, which means the private sector, more or less) was positive by €13b. in January, €7b. in February and €18b. in March. So in the first quarter of 2015 it rose altogether by €38b., or at an annualized rate of 1.4%. This might be dismissed as pretty meagre and unimpressive. However, if Eurozone banks over the next year are increasing their claims on the private sector by, say, €15b. a month and QE is adding perhaps €30b. a month to their claims on government, then Eurozone M3 ought to be climbing by about €40b. - €45b. a month, giving an annual rate of advance of approaching 5%. **With the price level flat or falling, that implies 5% plus growth of real broad money. Compared with the past five or so years, this would be stimulatory and very positive for economic activity.**

I wish I could be equally upbeat about Japan. The Japanese authorities have made a great fuss about large-scale QE as one of three arrows of Abenomics. However, as I have repeatedly observed, they are targeting the wrong concept of money, namely the monetary base. The aggregate that matters to macro outcomes is the quantity of money, broadly-defined. Further, contrary to many textbooks, a precise link between changes in the base and changes in the quantity of money does not necessarily hold. There is no point labouring the argument again just here, but it is vital to the Japanese macro outlook that – as in the previous QE episode from 2001 to 2006 – a huge surge in the base is *not* being accompanied by a corresponding surge in broad money. On the contrary, M3 growth in Japan has slowed recently. As the table above shows, in the last three months M3 has gone up about ½% and at an annualized rate of a mere 1.6%, which is plainly less than the typical rate of increase in the last year to 18 months. But there is some comfort in the fact that Japanese broad money is at least growing.

The UK – which now accounts for less than 3% of world output – is the least significant of the economies surveyed in terms of the global impact of its monetary policy decisions. Nevertheless, British banks have in the relatively recent past been important players in major international corporate transactions. No doubt they will be involved to some degree in the current revival in cross-border takeover and merger activity. That revival is likely to be particularly in such areas as media and telecoms (where the prodigious cash flows of Google and Apple feed globalizing ambitions, and the rationales for globalization – scale economies, in particular – are compelling), pharmaceuticals and biotechnology, and energy (e.g., the Shell bid for BG), and much of the negotiation, book-building and so on will be in London. At any rate, for the moment sterling bank lending to the private sector is subdued and mortgage lending is being discouraged by yet more government intervention and higher regulatory hurdles. The latest money data may not be very weak, but they are disappointing, with M4x up at annualized rate of only 2.5% in the three months to March. Anyhow, with prices falling, real money growth is positive. Roughly trend growth of demand and output (i.e., 2 ½% or so) might be expected in the year to mid-2016.

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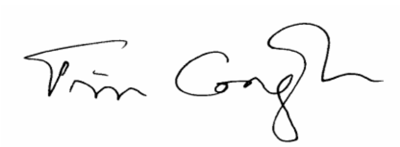
My conclusion from the above is that the world economy will have above-trend growth in the year from mid-2015, but there will not be a global boom. The American banking system has definitely turned the corner and, at more or less zero interest rates, it will grow strongly, taking broad money growth, balance-sheet strength, etc., along with it. Meanwhile the Eurozone is improving markedly and, even without QE, was anyhow probably at the start of 2015 on the threshold of a cyclical rebound. In China policy-makers are anxious about deflation and are easing monetary policy, although the banking system's growth is in fact decelerating just for now. The story in such diverse places as India, Japan and the UK, and in the more unhappy Brazil and Russia, is mixed, and it has to be said that the money slowdowns in Japan and the UK are setbacks, if minor in the global context. Overall I remain bullish on the world economy from mid-2015 and continue to believe that bond yields, particularly dollar bond yields, are too low.

On a house-keeping note, the Institute of International Monetary Research is now established and we have a website www.mv-pt.org and enquiries can be addressed to enquiries@mv-pt.org. I will be sending out another e-mail about the launch party for the Institute, as well as other matters, next week.



8th May, 2015