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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Is a global recession to be expected in 2023?: The West versus the rest

A presentation by Professor Tim Congdon CBE,

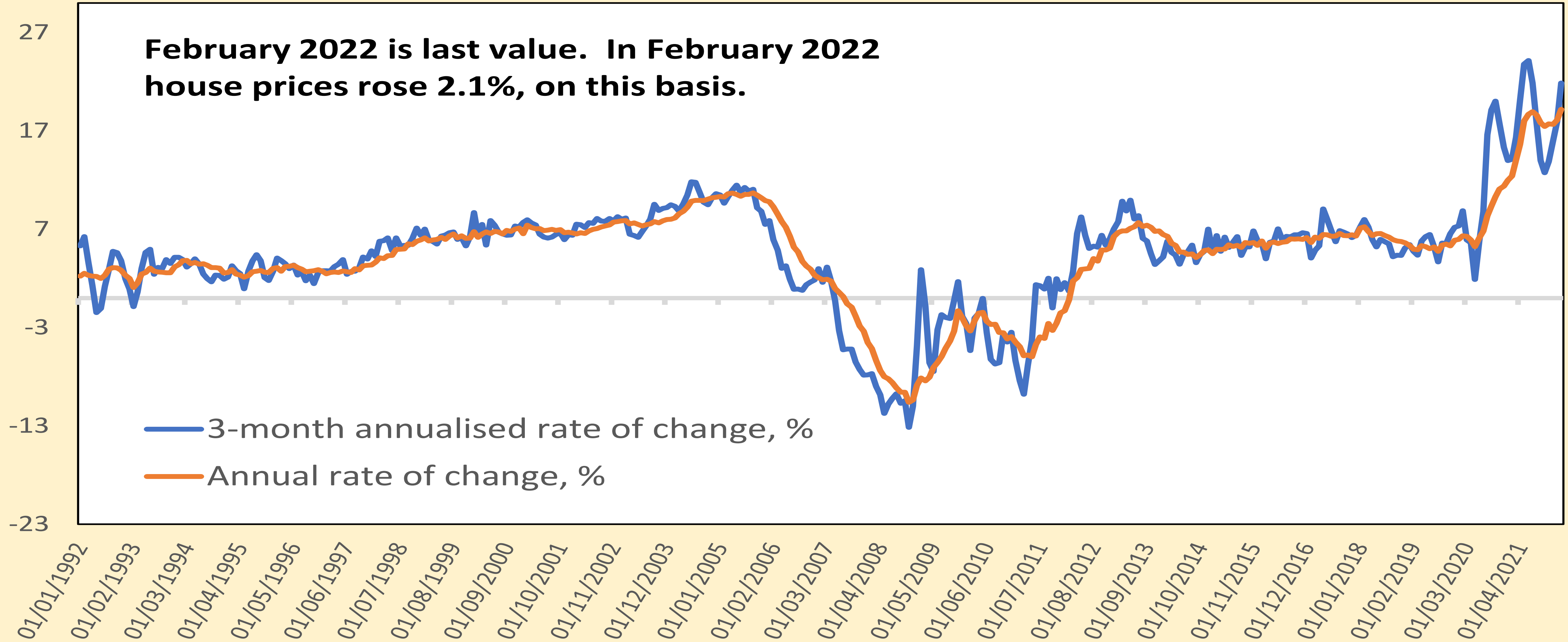
Chair of the Institute of International Monetary Research,

in May 2022

US house price inflation: current boom bigger than that before the Great Recession

*Changes in purchase-only **house price index**, monthly data*

Source: Federal Finance Housing Agency



How is the surge in house prices to be explained? – Credit vs. money

- US broad money, on the M3 measure, rose by **44.3%** in the three years to February 2022.
- US house prices, as measured by the Federal Housing Finance Agency's purchase only index, rose by **42.4%** in the three years to February 2022.
- US commercial banks' residential real estate loans increased by **only 1.6%** in the three years to 23rd February 2022.

HOUSE PRICE INFLATION IS AN ASPECT OF WIDER ASSET PRICE INFLATION, BECAUSE PEOPLE CAN SWITCH BETWEEN ASSETS. THE ALMOST 45% SURGE IN THE QUANTITY OF MONEY HAS CREATED A SITUATION OF 'TOO MUCH MONEY CHASING TOO FEW ASSETS'.

Asset price inflation – and general inflation

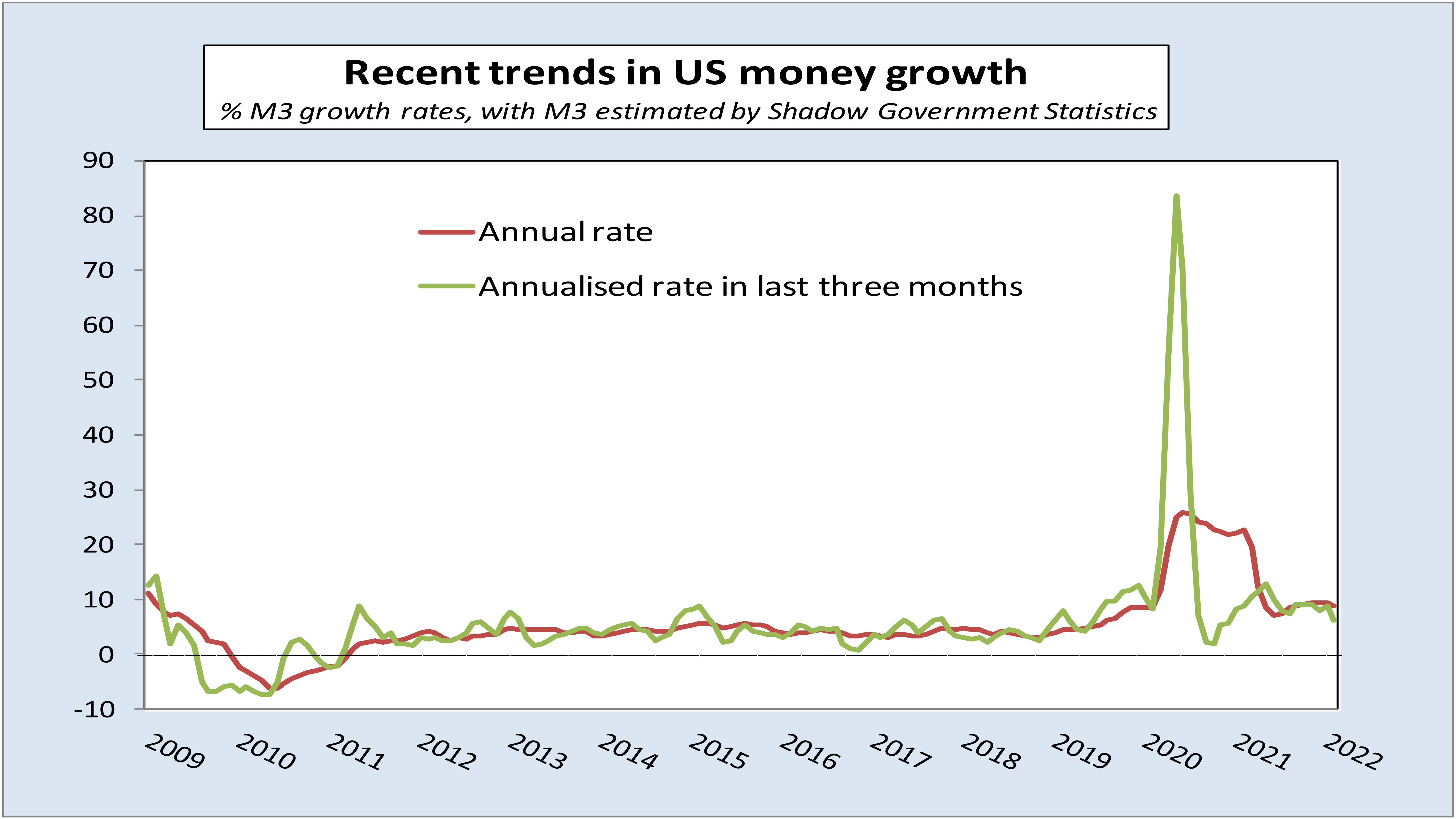
- The current US inflation is being widely blamed on a succession of one-off, exceptional, ‘transitory’ shocks, such as the surge in energy prices, the shortage of semi-conductors, the lack of shipping capacity, the inability of the timber industry to supply enough lumber to the housing industry, etc. – and now of course the Ukraine war.
- **But it is preposterous to say that inflation in house prices – and indeed in asset prices more generally – can be explained by this succession of ‘transitory’ supply-side shocks in recent quarters. Most housing transactions are in houses that were built years – and in many cases decades – ago.**

Asset price inflation – and general inflation

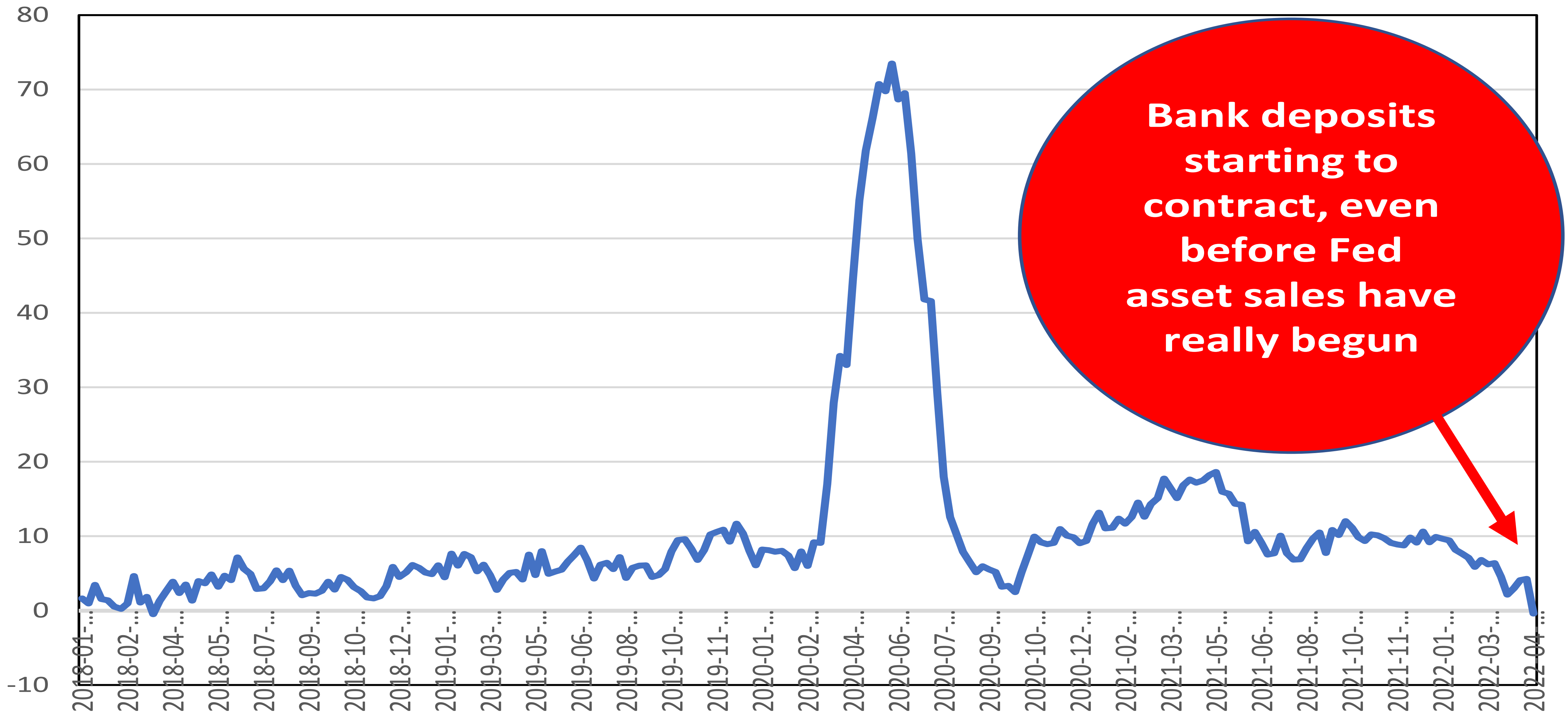
- The pattern of causation in the current cycle – as in many past cycles – is that the Federal Reserve has bungled monetary policy. In particular, it engineered in 2020 and 2021 extraordinarily high growth of the quantity of money, broadly-defined, by means of its asset purchases.
- Fed economists did not think the quantity of money mattered to anything (I mean this) and – quite simply – did not know how to calibrate the asset purchases. **The asset purchases were much, much too large – and were the main reason that M3 broad money shot up by about 45% in the three years to Q4 2021/Q1 2022.**

Asset price inflation – and general inflation

- Excess money balances soon drove large increases in stock prices in 2020 and early 2021 – as well as in the prices of such items as works of art and classic autos. **The economy boomed, with severe local labour shortages in some areas. House rentals then climbed strongly, providing part of the rationale for the house price inflation.** In any case wealthy individuals could switch from equities into housing assets.
- Every general inflation is associated with supply-side shortages of one kind or another. These shortages are ***symptoms*** of the inflation; they are ***not the cause*** of it.

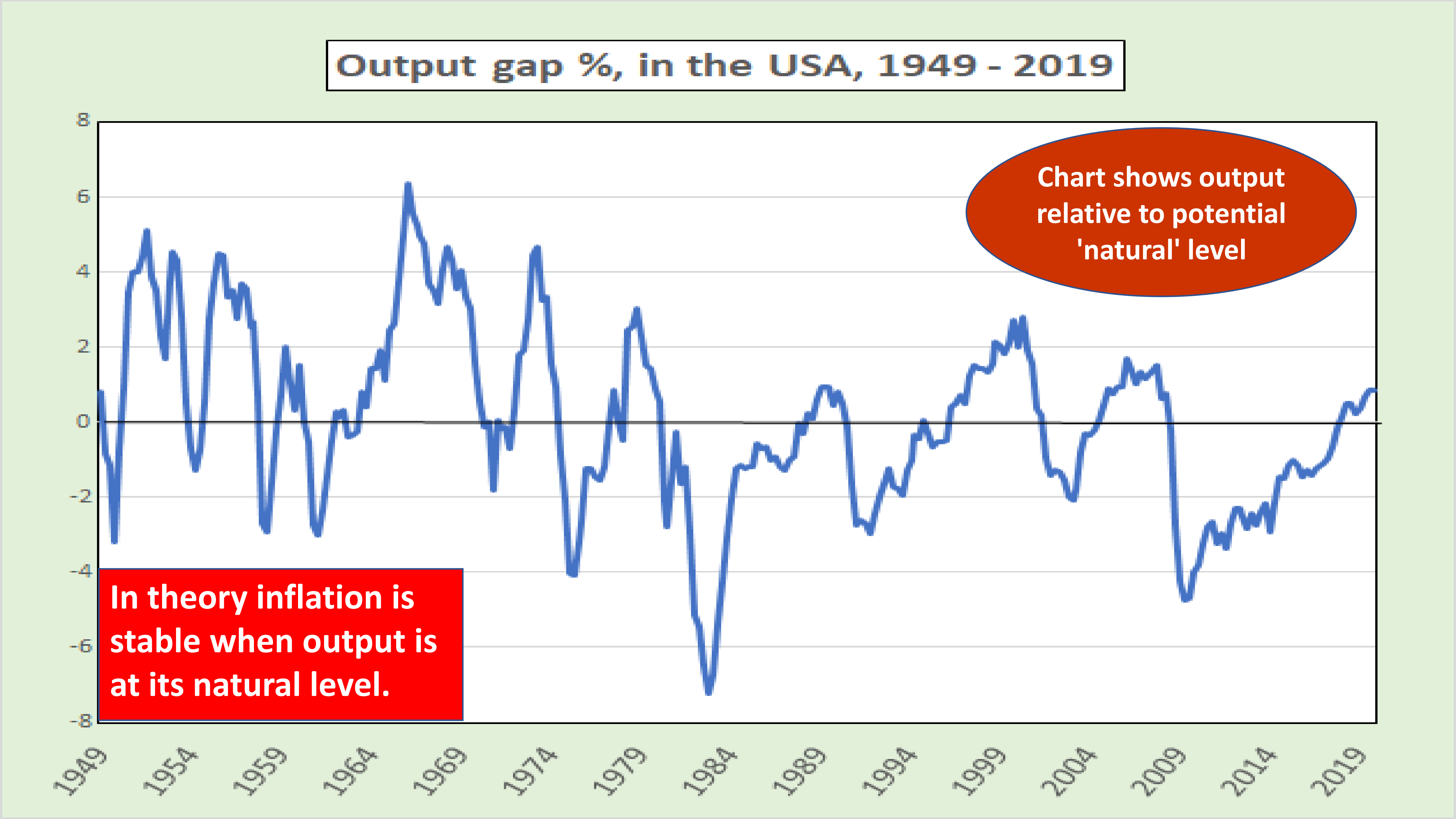

Recent trends in US money growth
% M3 growth rates, with M3 estimated by Shadow Government Statistics
Annual rate
Annualised rate in last three months
90
80
70
60
50
40
30
20
10
0
-10
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022

Three-month annualised growth rate of US bank deposits, % - 2017 to now

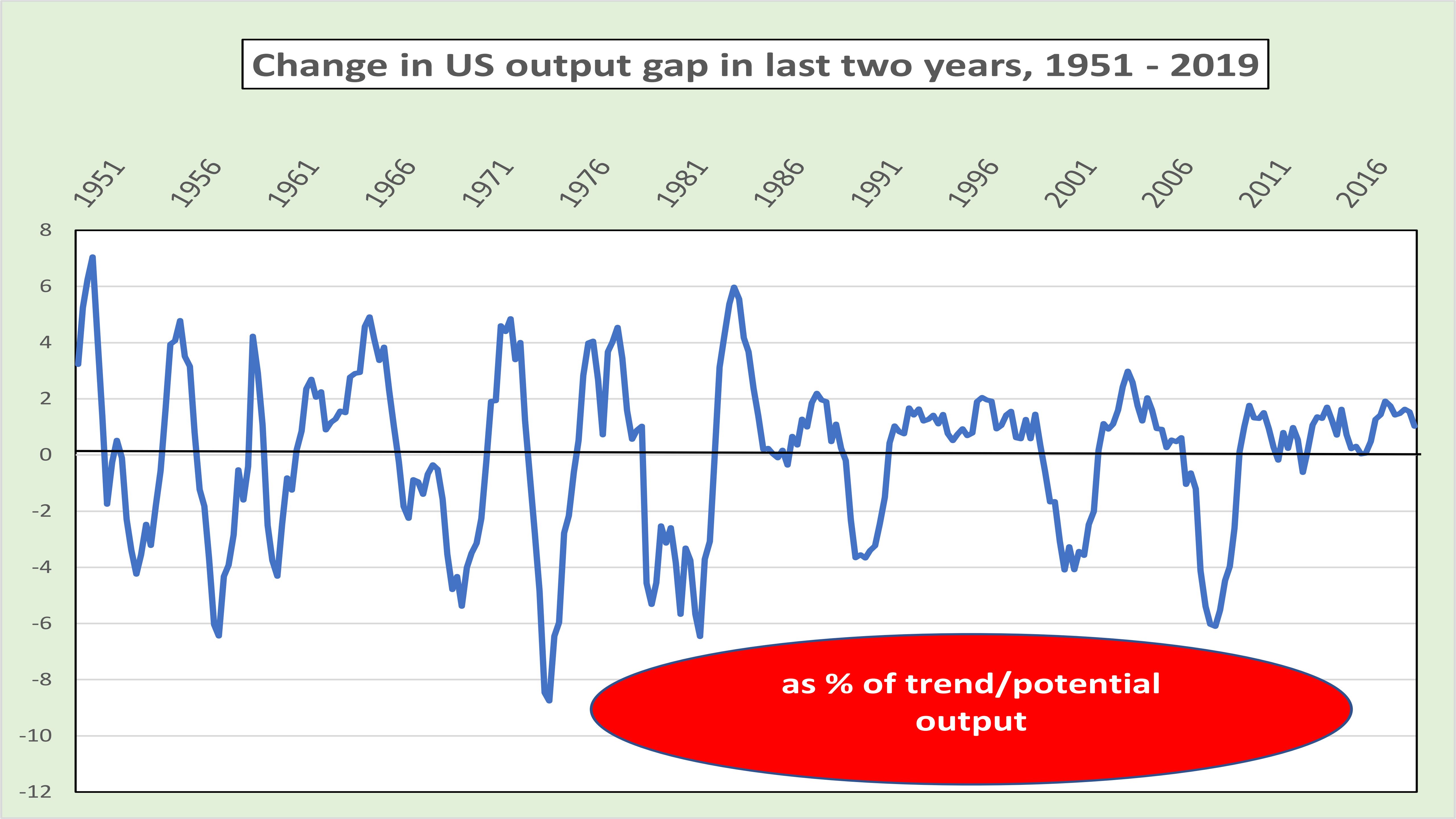


The Federal Reserve's incompetence

- Over-heating in labour and product markets will persist in the USA for at least two/three quarters. Demand and activity will not immediately turn down with the announcements of Fed tightening.
- Inflation will continue to rise towards double-digit levels in the next few months.
- The Fed's understanding of the relationship between its actions and the quantity of money is so poor that **the quantity of money may fall in the second half of 2022 and in early 2023**.
- **The combination of falling nominal money and still high inflation implies a marked contraction in real money balances. That will be bad for asset prices, and will undermine confidence and reduce expenditure. A recession is likely.**



Output gap %, in the USA, 1949 - 2019
8
6
4
2
0
-2
-4
-6
-8
1949
1954
1959
1964
1969
1974
1979
1984
1989
1994
1999
2004
2009
2014
2019
Chart shows output relative to potential 'natural' level
In theory inflation is stable when output is at its natural level.



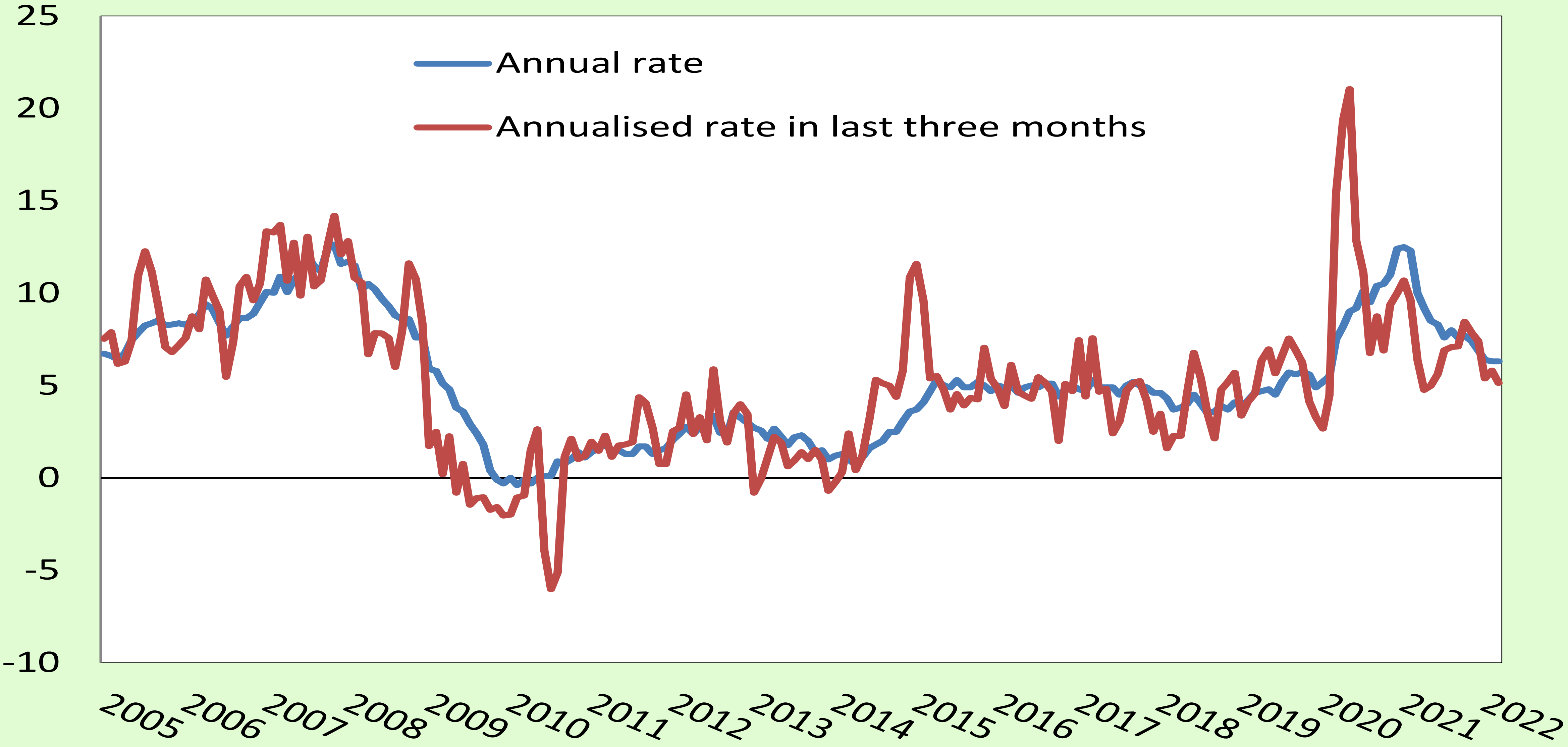
Change in US output gap in last two years, 1951 - 2019
1951
1956
1961
1966
1971
1976
1981
1986
1991
1996
2001
2006
2011
2016
8
6
4
2
0
-2
-4
-6
-8
-10
-12
as % of trend/potential output

The Federal Reserve's incompetence

- **Timing of the recession?** The low level of inventories argues that the next two/three quarters should still have rising output.
- So the negative two/three quarters will be in 2023.
- **Severity?** Business surveys suggest that labour shortages are as severe as at any time in the last 50 or so years, **i.e., that output is at least 3% above trend – and perhaps 4% above trend.**
- **To curb inflation, output needs to be beneath trend.** Take it that trend growth is 2% a year. **Then output needs to contract relative to the trend line by, say, 4% - 5%, perhaps 5% - 6%.** If inflation control is to be effective by, say, 2024, than US output needs to fall in 2023 by 2%. The drop from the last quarter of positive growth to the last quarter of contraction might be 3% - 4%. This is all very conjectural and uncertain. (Past recessions from severe over-heating argue for a worse recession.)

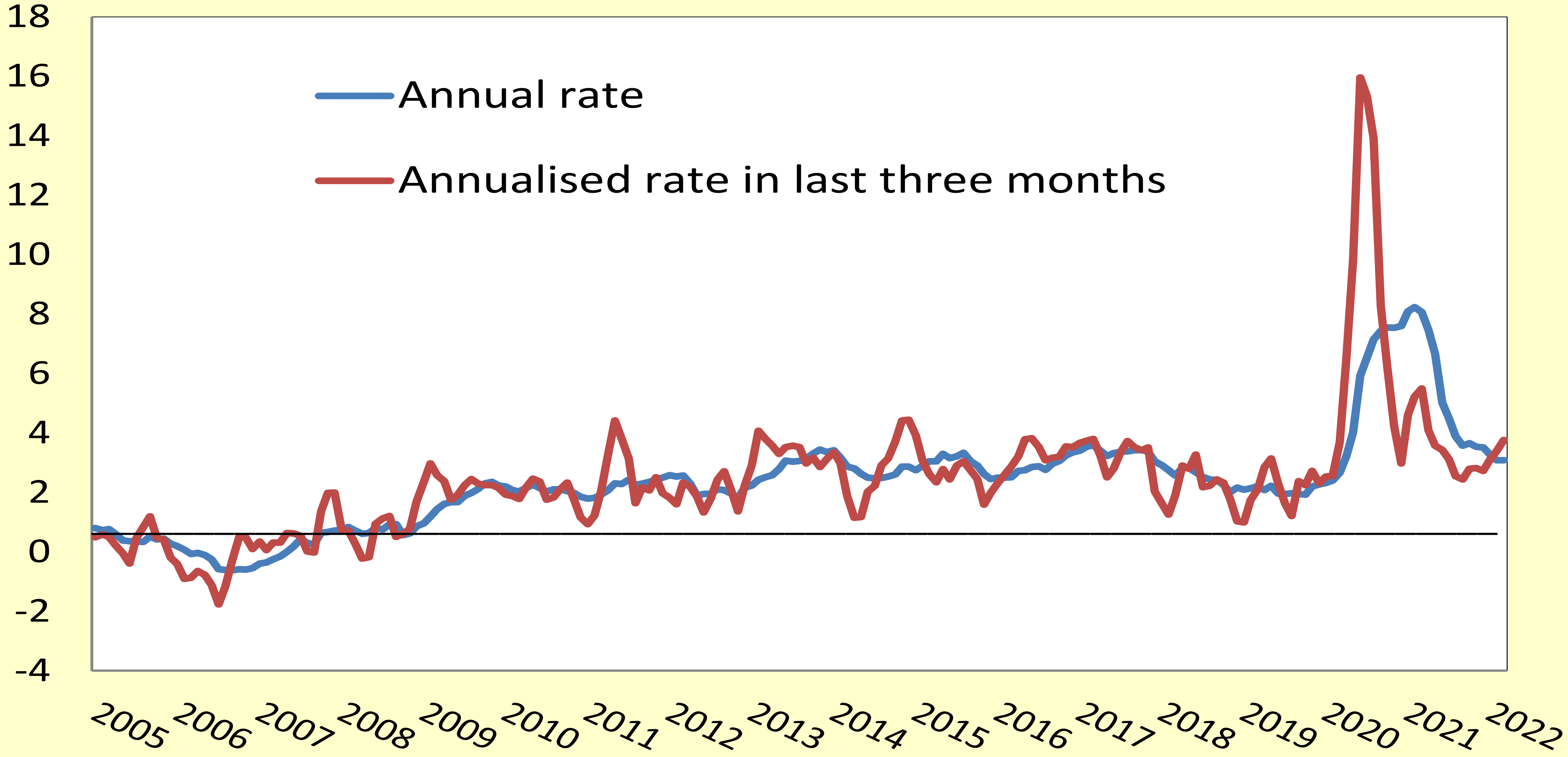
Recent trends in Eurozone money growth

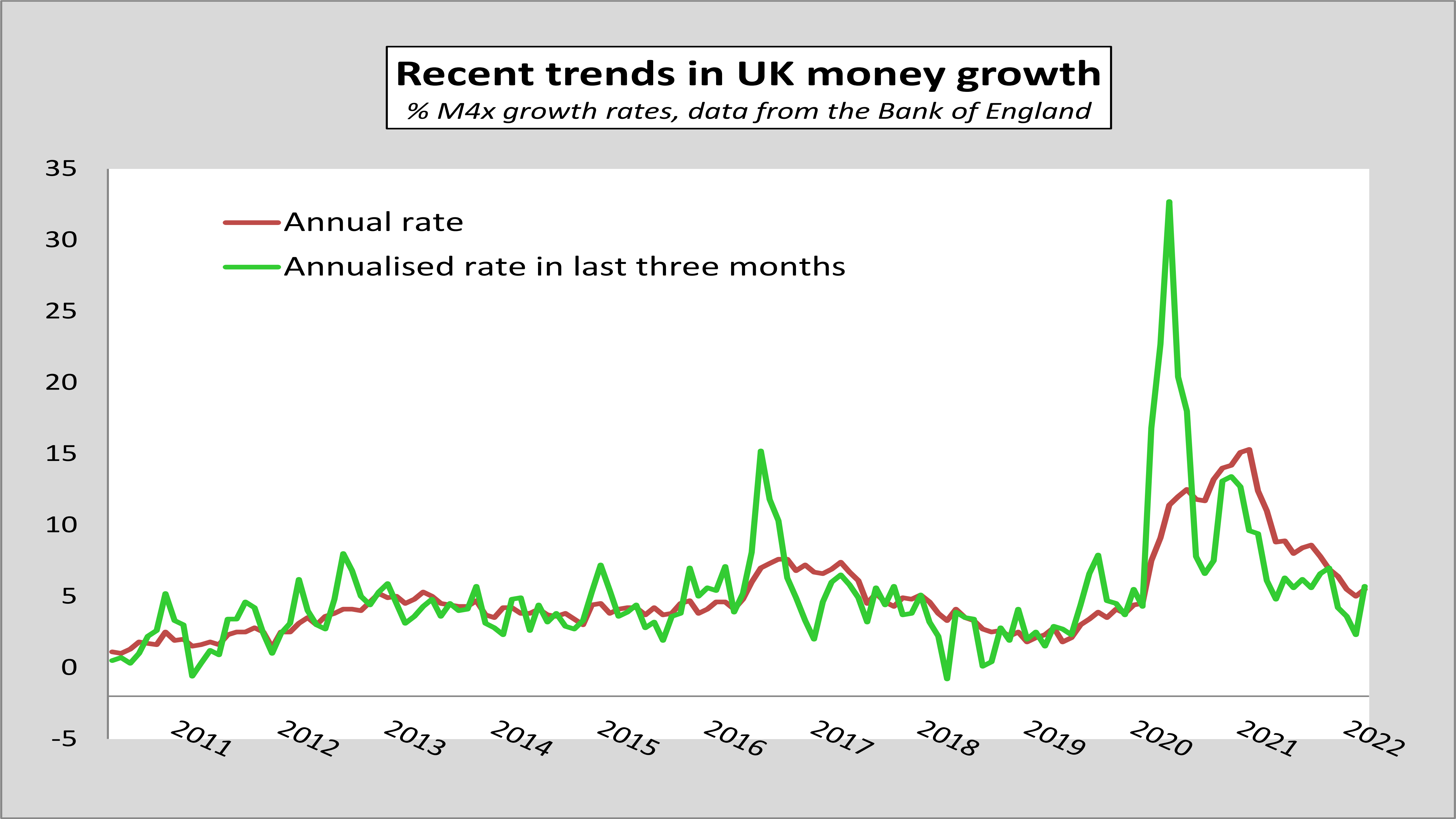
% M3 growth rates, data from the European Central Bank



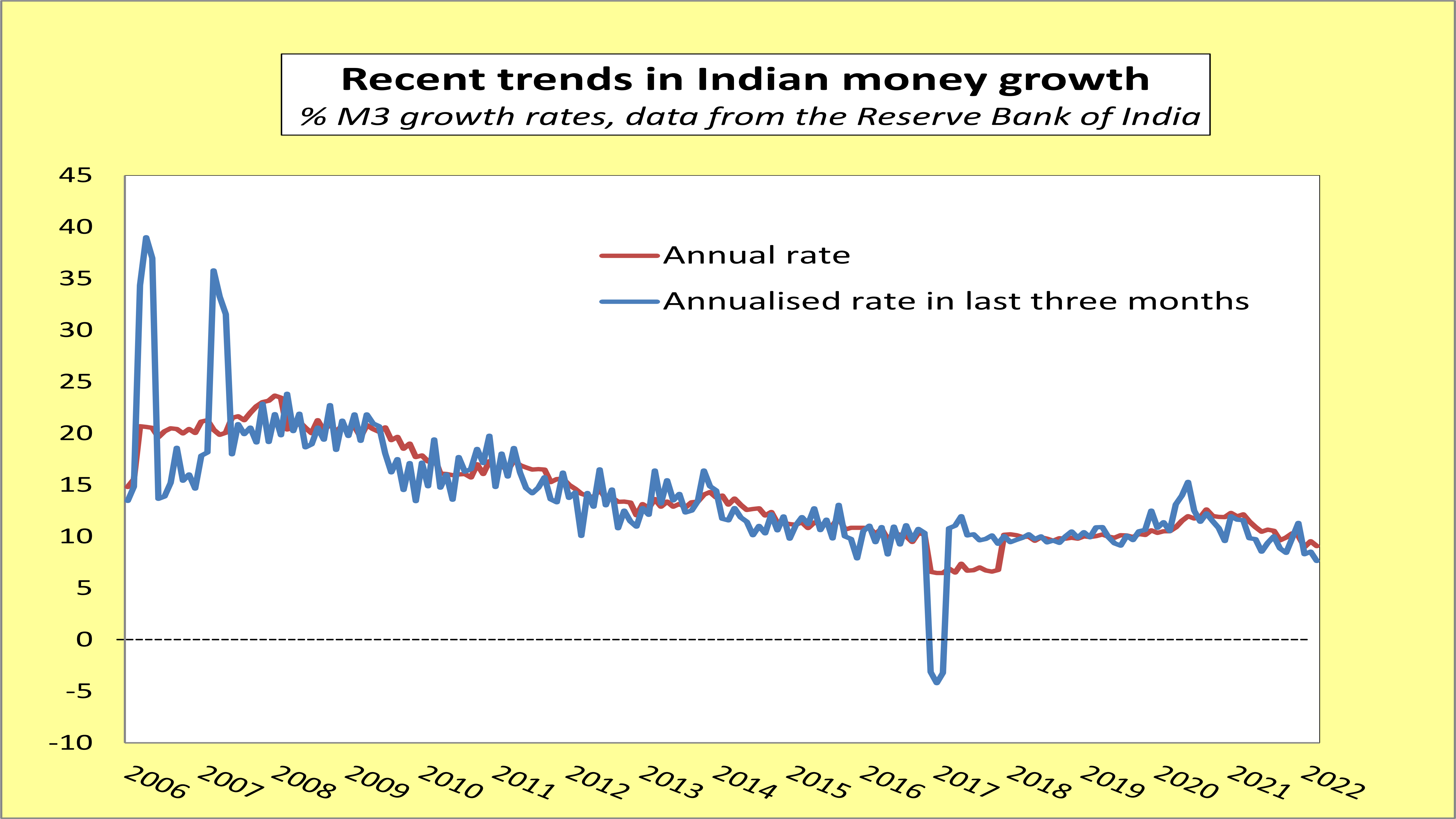
Recent trends in Japanese money growth

% M3 growth rates, data from Bank of Japan




Recent trends in UK money growth
% M4x growth rates, data from the Bank of England
Annual rate
Annualised rate in last three months
35
30
25
20
15
10
5
0
-5
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022


Recent trends in China's money growth
% growth rates in M2, data from the People's Bank of China
Annual rate
Annualised rate in last three months
45
40
35
30
25
20
15
10
5
0
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022


Recent trends in Indian money growth
% M3 growth rates, data from the Reserve Bank of India
45
40
35
30
25
20
15
10
5
0
-5
-10
Annual rate
Annualised rate in last three months
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022

Conclusions: the prospect for 2023

- World growth in 2022 is put by the IMF at about 3½%, with a similar figure in 2023. (I would use a 2022 figure of under 3%.)
- **In 2023 the USA could have a year like 1982 or 2009, although quite a lot depends on policy decisions yet to be taken. In other words, output might be down 2% on 2022, although with a larger movement between the last positive quarter and the last negative quarter. Europe also is likely to suffer a drop of output.**

Conclusions: the prospect for 2023

- **I suggest a world growth rate of ½% - 1% for 2023, with continued low growth in Asia just outweighing recessions in North America and Europe.** World output should continue to grow, despite all the current trials and tribulations in so many countries.
- Is it a condition of falling general inflation that commodity prices must fall? Falling commodity prices have been part of past major inflation slowdowns. But – for the moment at least – many commodity prices seem to be supported by supply shock issues specific to them.