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MONETARY RESEARCH LIMITED
Analysis and insight into trends in money and banking, and their impact on the world's leading economies

Monthly e-mail from Tim Congdon of International Monetary Research Ltd. – 7th August, 2015

Global money round-up at mid-2015

Money growth has slowed a little in the USA, Japan and the UK in recent months. Even in the Eurozone the three-month annualized growth rate of M3 is less than at the start of the year, despite the inception of 'quantitative easing' (i.e., central bank purchases of government securities from the private sector). With the Chinese authorities still reining in the shadow banking system, a fair comment is that money growth has generally been somewhat less than expected three or six months ago. However, inflation has also been lower than widely foreseen and shows no sign of a major imminent upturn. *Real* broad money growth in the main economies is therefore very healthy, implying trend or slightly above-trend growth in the world economy from mid-2015, but no boom. 2016 will see continued very low or negligible inflation in all the major countries.

The middle months of 2015 have seen marked and persisting commodity price weakness. A fading of the Chinese demand for metals and energy has been the main factor at work. Chinese broad money growth has dipped from the very high rates seen in 2009 and 2010, but the deceleration in money growth has been gradual. Officialdom's attempts to root out corruption have been associated with an attack on the 'shadow banks'. Meanwhile the mainstream banks are being forced to comply with international regulatory standards such as the Basel rules on bank capital. But the Chinese authorities do not want a recession and, in the extreme, could pursue monetary expansionism of the kind seen in early 2009. (Just over five years ago the three-month annualised growth rate of broad money briefly exceeded 40%.) Brazil, Russia, Venezuela and so on have their own woes, and will suffer from stagnation and/or falling output for some quarters. But they are a relatively small part of the world economy. (*Country notes from the website's World Money Map follow the introductory comment section. See below after page 4.*)

Money trends in 2015 in the main countries/jurisdictions

What have been money growth trends in the main countries in the first half of 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 offer some remarks on the contrast between the large and small banks in the USA, and attach detailed country notes for the USA, the Eurozone, China, Japan, India 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	16.1	**2.9**	**5.2**	Money growth down in recent months, but new bank credit to the private sector still rising at healthy rate.
China	16.9	**12.3**	**10.4**	Major policy easing said to be under way, to counter deflation, but 'shadow banks' being reined in.
Eurozone	11.9	**4.4**	**5.0**	Large-scale QE seems to have had positive effect on M3 growth, best macro prospects since 2007. .
India	7.1	**11.9**	**11.5**	India continues to have positive inflation, unlike other large countries, but money growth and inflation are falling.
Japan	4.3	**2.9**	**3.1**	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	2.3	**3.8**	**3.6**	Money growth is satisfactory, if only just, with tight regulation main factor holding back bank balance sheet growth.

A fair comment here is that money growth has been weaker, in general, in recent months than I expected in early 2015. To that extent, I have to temper my optimism about the global economic outlook from mid-2015. Perhaps part of the trouble is that the Chinese economy has been performing worse than one might have envisaged, given that broad money growth has slowed only marginally. The explanation may well be that the Chinese authorities have decided to curb the activities of the shadow banking system. This implies that the growth of a wider measure of liquidity (i.e., one that includes the money-like liabilities of the shadow banks as well as M2 broad money) may have seen a more pronounced deceleration in recent quarters than M2 by itself. I am not an expert on the Chinese monetary situation and banking institutions, and would welcome enlightenment.

It must also be emphasized that regulatory officialdom continues to press for tighter rules on banks' asset composition and capital provision, and that too may be part of the reason for the apparent rather sluggish money growth of recent months. *The Daily Telegraph* reported on 21st July that the biggest US banks had just been told 'to set aside an extra $200bn. in capital buffers to protect themselves and the wider economy against a future crash'. The usual suspects – JP Morgan, Citibank, Bank of America, Goldman Sachs and Morgan Stanley – all need more capital, apparently. Janet Yellen, Fed chairman, asserted that either they must raise more capital 'or else they must shrink their systemic footprint, reducing the harm that their failure would do to our financial system'. That means that the big banks are to have lower assets than they would like and also, critically, that broad money growth will be reduced. By contrast, some weeks ago Daniel Tarullo, the Fed's governor in charge of regulation, said that the USA ought to find ways to help 'community lenders', by which he meant banks with assets of under $10b. The Basle rules must be enforced for the larger institutions, but small banks ought to have partial exemption.

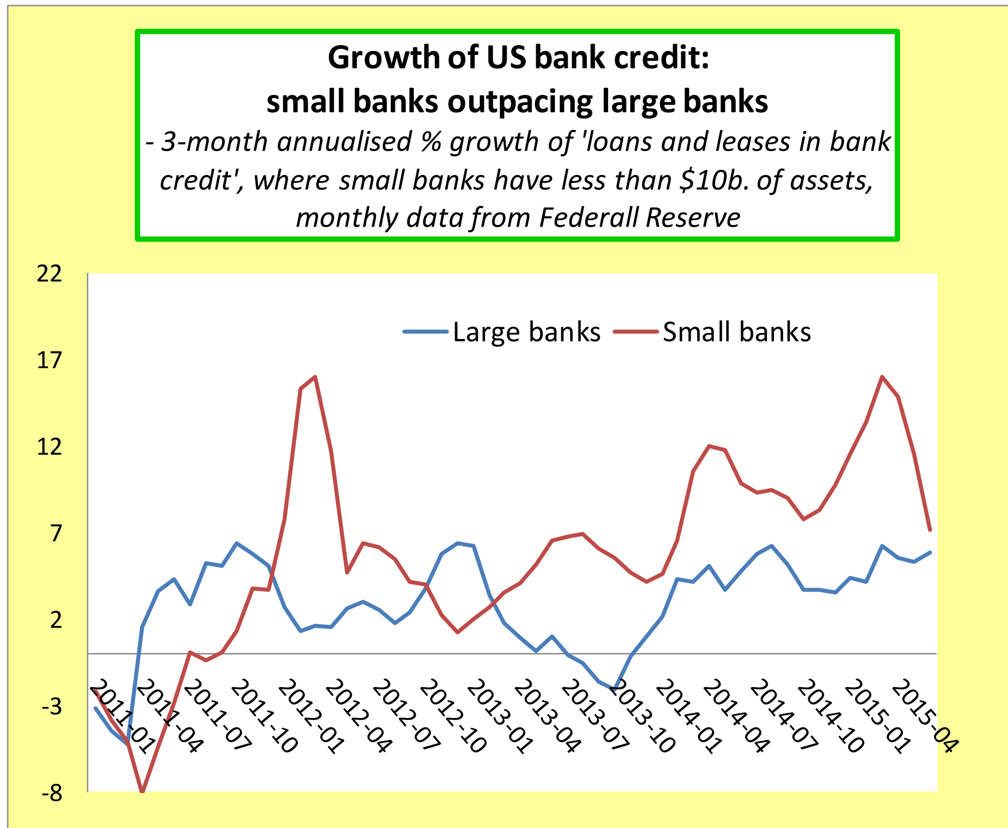
There is much more to say here. In my view, it should be obvious to everyone in this branch of public policy

- that large banks can have more diversified assets than small banks,
- that, for assets of the same typical quality, and assuming the same capital/asset ratio, the greater diversification implies that the likelihood of losses that wipe out capital is less for large banks than small, and
- that larger banks can safely operate with lower capital/asset ratios than small banks.

In past crises nations with highly concentrated banking systems (such as the UK and Canada) have had fewer serious bank failures than nations with dispersed banking systems, with hundreds/thousands of small banks in existence (for example, the USA). So the official drive towards higher capital ratios in 'systemically important financial institutions' is misguided, again in my view. Anyhow it has certainly affected the rates of asset growth in the US banking system, as the chart on the next page demonstrates.

'Loans and leases in bank credit' is a category that corresponds roughly to 'bank lending to the private sector' in the UK. It is the dominant asset category for the US banking industry, which has about $8,300b. of such assets compared with total assets of about $15,500b. The chart shows that – over the last three-and-a-half years – small banks have been growing their 'loans and leases' typically at about 8% a year, whereas the figure for the large banks is more like 3% a year. Two comments seem reasonable. First, the buoyancy of credit growth at the small US banks – relatively free from the burden of new regulation – is one reason for being optimistic that the overall US banking system, and hence broad money, will continue to expand. 'Loans and leases' at the small banks are just under

$2,800b., which of course is slightly less than a fifth of total US banking system assets. If this one category rises by 10% a year, that adds 2% to total banking system assets, which is helpful towards the desired 5%-or-so annual growth of the banking system. Secondly, regulation has hurt the banks subject to it. The new regulatory approach is, in effect, open discrimination against size and scale in American banking. The chart brings out that the approach has been affecting the growth rates of large banks relative to small. Further, it seems from Yellen's latest remarks that this discrimination has some distance still to go. Bluntly, this is an obvious distortion, only possible because of the strained and largely wrongly-headed public debate on US banking in the wake of the Great Recession.



One depressing final remark is necessary. Yellen was perfectly frank that the large US banks could shrink their businesses, if that was how they wanted to respond to the new capital rules. She apparently believes that banks are less of a threat to 'the system' if they are smaller. This is an entirely new theory of the origins and nature of financial crises, and I am not aware of any evidence or theory that supports it. However, to the extent that large banks reduce their balance-sheet size because of the continuing regulatory assault, the rate of growth of the quantity of money is reduced. National income (and national wealth) is undoubtedly a function of the quantity of money. So the Fed's hostility towards the large US banks contributes to the rather low money growth that has been a characteristic of the US economy since 2009.

7th August, 2015

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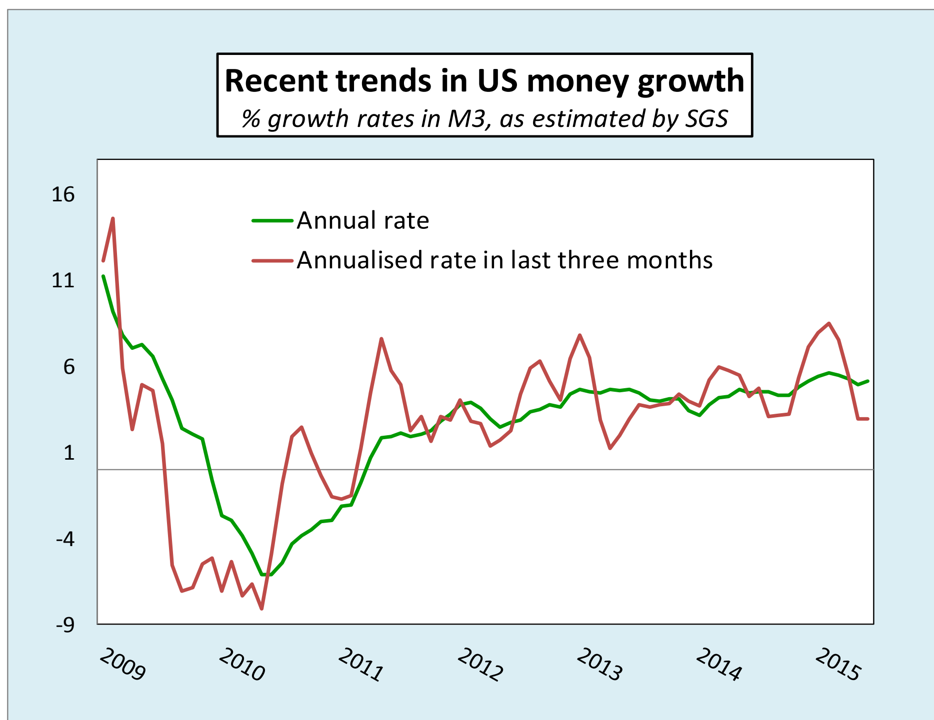
USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1960 - 2014	**7.6**	**6.7**
Four years to 2014	**4.0**	**3.9**
Year to June 2015	**5.2**	**3.3**
Three months to June 2015 at annualised rate	**2.9**	**n.a.**

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



M3 growth picking up again?

Summary: **US broad money growth picked up in June after a slowdown caused by unusually high tax payments during April and May.* With the quantity of money growing by only $25b. in April and $32 in May, annualised quarterly growth had fallen to 2.9%. June saw M3 growth rise to $59b., but – with the feeble two previous months – the annualised growth rate in the last quarter is still only 2.9%. Credit to the private sector remains resilient, implying that a return to approximate 5%-at-an-annualised rate money growth – which is ideal – should occur in coming months. (Note that the M3 data used in this note are from the Shadow Government Statistics research company.)**

US businesses and home buyers are borrowing money at a healthy rate. In the three months to June 'loans and leases in bank credit' rose by 1.6% or at annualised rate of 6.4%. However, it is of course banks' liabilities - which are money - that count in the determination of national income and wealth. Here the picture is satisfactory or even encouraging after a fall in total bank deposits of $10 billion during April. The last two months have seen deposit growth at US commercial banks of $42 billion and $45 billion respectively. These figures are lower than those for the first quarter of 2015, when the total stock of bank deposits grew by over $230 billion, but June's annualised deposit growth rate of 5% is consistent with steady growth of nominal GDP with low inflation.

The money figures suggest that the US economy is strong enough to cope with an increase in Fed funds rate. Janet Yellen, the Governor of the Federal Reserve, has suggested that the first rise in Fed funds rate may well take place before the end of the year. But a persisting concern must be the threat of additional regulation as proposed by the Financial Standards Board which would demand even higher capital-to-asset ratios and thus act as a further dampener on broad money growth. On balance, however, the monetary data still suggest that the solid and promising recovery will continue.

John Petley
22nd July, 2015

* When I pay taxes, my bank deposits fall and the government's deposit rises. The government's deposit is excluded from the quantity of money, on the grounds that its money balance has little effect on its behaviour. So high tax payments, in association with a net surplus on government finances, reduce the quantity of money.

	% annual growth rate:	
	M3	Nominal GDP
1960 – 2014	**7.6**	**6.7**
1960 – 1970	**7.7**	**7.7**
1971 – 1980	**11.4**	**10.7**
1981 – 1990	**7.7**	**7.7**
1991 - 2000	**5.6**	**5.6**
2001 - 2010	**7.1**	**3.9**
Four years to 2014	**4.0**	**3.9**

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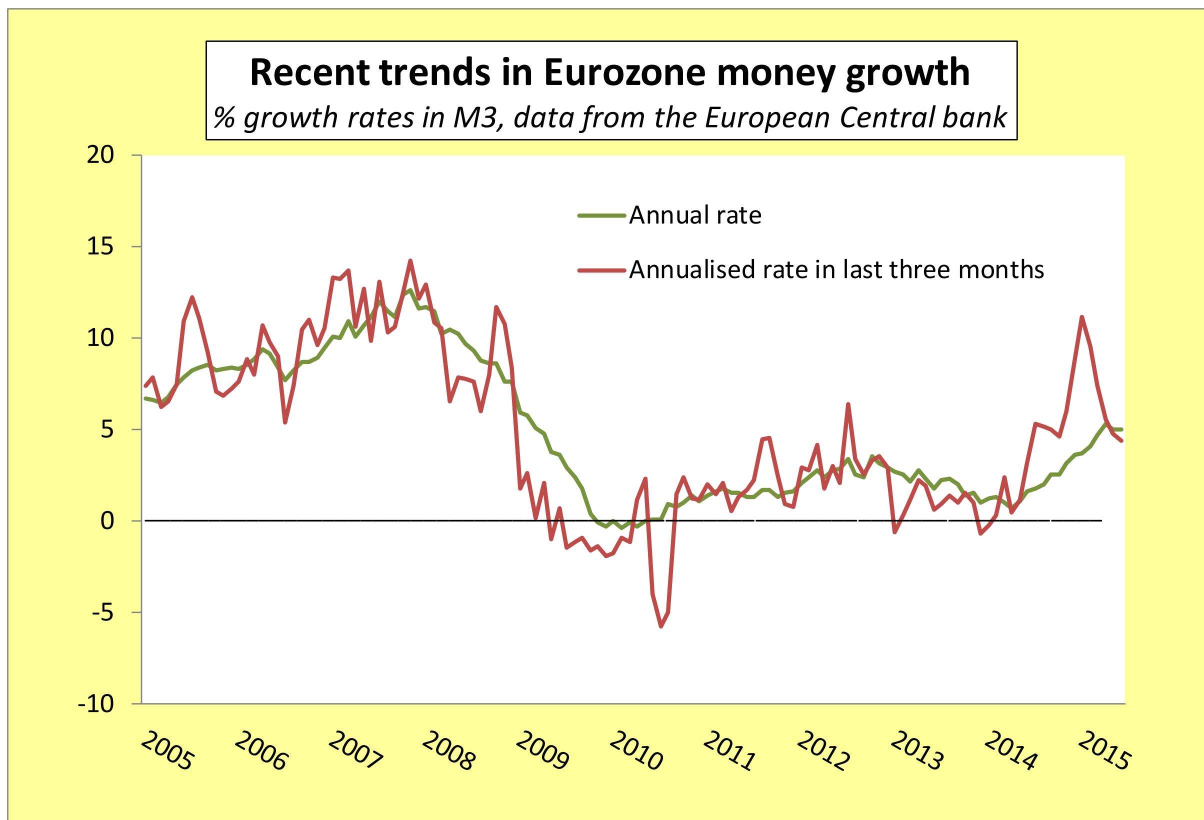
Eurozone/Euroland

	% annual/annualised growth rate:	
	M3	Nominal GDP
1995 – 2014	**5.3**	**3.1**
Four years to 2014	**2.6**	**1.3**
Year to June 2015	**5.0**	**n/a**
Three months to June 2015 at annualised rate	**4.4**	**n/a**

Sources: European Central Bank and International Monetary Research Ltd. estimates



Money growth satisfactory, but QE might have had stronger effect

***Summary*: Eurozone broad money growth seems to be running, with some consistency, at a higher rate than in the years immediately after the Great Recession. However, M3 growth in June itself was €34b., compared with €13b. in May and €67b. in April, leading to an annualised growth rate in the three months of 4.4%. This is satisfactory, but perhaps on the low side given that the ECB is now pursuing its 'quantitative easing' programme. Despite the hullabaloo about Greece, the macroeconomic prospect is more benign that at any time since the Great Recession.**

As the chart shows, Eurozone money growth has perked up over the last nine months or so. The period since the end of February has benefited from the QE programme, with its planned €60b. of securities purchases each month. However, money growth since end-February has been somewhat beneath that in the immediately preceding quarter, which is surprising and perhaps a little disappointing. The ECB press release notes that in the year to June M3 rose by 5.0%, with deposits in the hands of households and companies increasing slightly less than this. By implication, deposits held by long-term investing institutions have expanded faster – perhaps much faster – than M3 as a whole. This is part of the explanation for the buoyancy of European stock markets in 2015.

The QE operations started in March and ought to be identifiable in the ECB's balance sheet on the liabilities side of the balance sheet, as 'liabilities to euro area credit institutions' (i.e., banks' cash reserves). On 27th February the ECB had liabilities to euro area credit institutions of €292.0b. On 24th July (the last date available) these liabilities had soared to €503.8b., a movement of just over €211.8b. in the four months, which is slightly behind the ECB's objective of €60b. a month. As International Monetary Research has emphasized in several places, *the purchases of securities need to be from domestic non-banks, in order directly to boost broad money*. (Purchases of securities from banks expand banks' cash reserves, and that may cause the banks to seek extra assets and create more money. But this further stage [i.e., of money creation to lower the ratio of banks' cash to total assets] does not necessarily follow.)

Consumer prices ("prices in the shops") rose by 0.2% in the year to June, while producer prices fell. In that context Eurozone *real* (i.e., inflation-adjusted) money growth is the highest it has been since before the Great Recession. The media are full of *angst* about the Greek situation, but in fact Eurozone money trends have a more encouraging message for the macro outlook than for over eight years.

Tim Congdon
28th July, 2015

	% annual growth rate:	
	M3	Nominal GDP
1995- 2014	**5.3**	**3.1**
1995 – 2000	**4.5**	**4.0**
2001 – 2010	**6.7**	**3.4**
Four years to 2014	**2.6**	**1.3**

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China

	% annual/annualised growth rate:	
	M2	Nominal GDP
1991- 2014	**20.3**	**15.8**
2010 - 2014	**15.2**	**12.8**
Year to June 2015	**10.4**	**n/a**
Three months to June 2015 at annualised rate	**12.3**	**n/a**

Sources: People's Bank of China for M2 and International Monetary Research Ltd. estimates

Lower, but stabilizing M2 growth?

Summary**: Broad money growth has fallen significantly in China during the last two years, but it may be stabilising at a lower level. In June 2015, the seasonally adjusted quarterly annualised rate of M2 growth stood at 12.3%. This is the fastest growth rate since June 2014. For much of the intervening period, broad money growth has been growing at an annualised rate just above 10%. So June's data indicates a slight upturn. However, money growth has slowed notably compared with five or ten years ago.**

The stock of bank deposits grew by 10.6% in the year to June. In the last three/four months, the norm for annual deposit growth has been within the 10-11% band, which is a decent rate of growth if it can be maintained at this figure. Anecdotal evidence suggests that China's housing market is seeing some signs of growth in the biggest cities, following a fourth reduction in interest rates in the space of eight months on June 28th. The current record low benchmark one-year lending rate of 4.85% has been part of a number of measures by the Chinese government to revive its flagging property market. Some banks' reserve ratios have been reduced and the minimum down-payment required to buy a property was cut from from 60% to 40% of the purchase price at the end of March. Away from the big cities, these measures have seen only limited results on the housing market thus far, however. In addition, restrictions preventing pension funds and insurance companies investing in stocks were lifted in an attempt to boost the wider economy.

Inflation remains subdued. In the twelve months to June, annual consumer price inflation stood at 1.4%. While this figure represents an increase on the 1.2% recorded in the 12 months to May, consumer price inflation has remained below 2% for ten consecutive months now. There is little indication that it is likely to pick up, as the producer price index stood at -4.8% in the 12 months to May, with indications that June's figure is likely to be similar. If so, it would be the 39th consecutive month of falling prices at the factory gate. Such figures suggest that inflation will stay well below the Chinese government's 3% target for all of 2015. The Shanghai stock market, which had enjoyed strong growth up to the second week of June, has since fallen sharply. The monetary loosening at the end of June may well have been driven by the Chinese authorities' desire to slow this decline. Such volatility highlights the problems faced by the country as it seeks a smooth transition to a lower level of growth, of money, nominal GDP and real GDP. The recent M2 figures suggest that the sustained fall in money growth over the last two years is easing off, but further monetary loosening looks likely if China's economy weakens further.

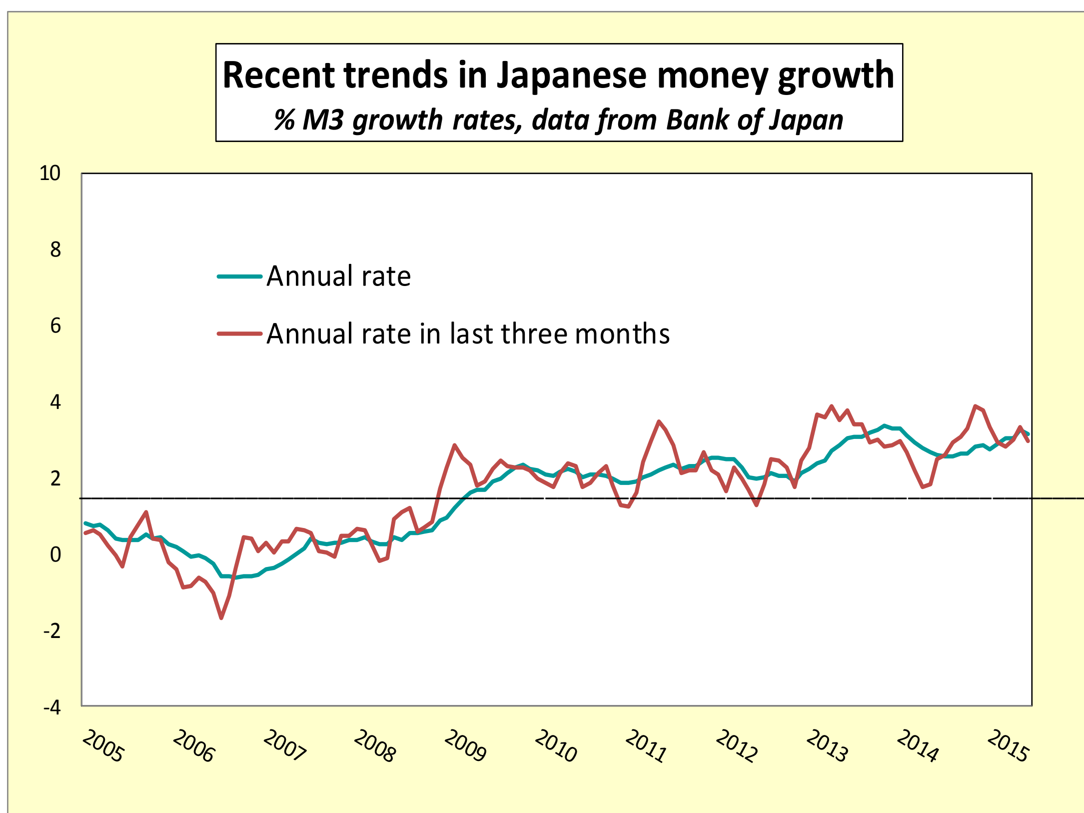
John Petley
28th July, 2015

	% annual growth rate:	
	M2	Nominal GDP
1991 - 2000	**20.3**	**15.8**
2001 - 2010	**15.2**	**12.8**
Four years to 2014	**14.1**	**11.6**

Japan

	% annual/annualised growth rate:	
	M3	Nominal GDP
1991- 2014	1.9	0.4
2010 - 2014	2.5	0.8
Year to June 2015	3.1	n/a
Three months to June 2015 at annualised rate	2.9	n/a

Sources: Bank of Japan for M3 and IMF for GDP



Broad money growth remains subdued

***Summary:* In the three months to June 2015, Japanese M3 grew at an annualised rate of 2.9%. This is a decline compared with the three months to May, when annualised broad money growth stood at 3.3%. As the graph below shows, the QE programme launched by the Bank of Japan last year has had only a very limited impact on Japanese money trend, with the growth rate in the two years to spring 2015 being only 1% - 1½% (i.e., at 3% - 4% a year instead of 2% a year) higher than in the two years before the asset purchase programme began.**

A statement by the BoJ's Monetary Policy Committee on 15th July stated that the QE programme "had been exerting its intended effects." However, that very same report contained evidence to the contrary. QE was meant to end Japan's deflation problem. Governor Kuroda initially hoped to see the annual inflation rate hit 2% by April 2015. The most recent statement, however, anticipated a CPI of only 0.7% by the end of the fiscal year in March 2016. (The current annual inflation rate is 0.5%.) Japanese bank lending has also been disappointing. For much of the first 18 months of the QE programme, Japanese banks sat on their greatly-increased additional cash assets and the stock of bank lending was growing at an annualised rate of between 2% and 2.3%. In November, the growth rate shot up to 2.7%, but this has been followed by seven months where lending to the private sector has remained more or less static, at a monthly level of between 420 and 425 trillion yen. Neither businesses nor households seem to be showing any increased appetite for risk.

Mr Kuroda relied on a two-pronged strategy to kick-start the Japanese economy. The first was a doubling of the monetary base; the second was merely to encourage his compatriots to avoid a negative attitude. Quoting J.M. Barrie's Peter Pan, he said, "The moment you doubt whether you can fly, you cease forever to be able to do it." Two years on from the launch of QE, the failure of Kuroda's plan is very apparent from the graph above. The ramping up of asset purchases from 60-70 to 80 trillion yen per month in October 2014 (in other words, 1.4% of GDP) has likewise had very little effect.

The money numbers do not, unfortunately, suggest any change to the performance of Japan's lacklustre economy in the third quarter of 2015. As long as the Bank of Japan concentrates on buying short-dated paper from the banks instead of buying assets from non-banks – in other words, targeting the monetary base rather than broad money – the economy will continue to do little better than muddle along.

John Petley
15th July, 2015

	% annual growth rate:	
	M3	Nominal GDP
1981 – 1990	9.2	6.2
1991 - 2000	2.4	1.3
2001 - 2010	1.1	-0.5
Four years to 2014	2.6	-0.3

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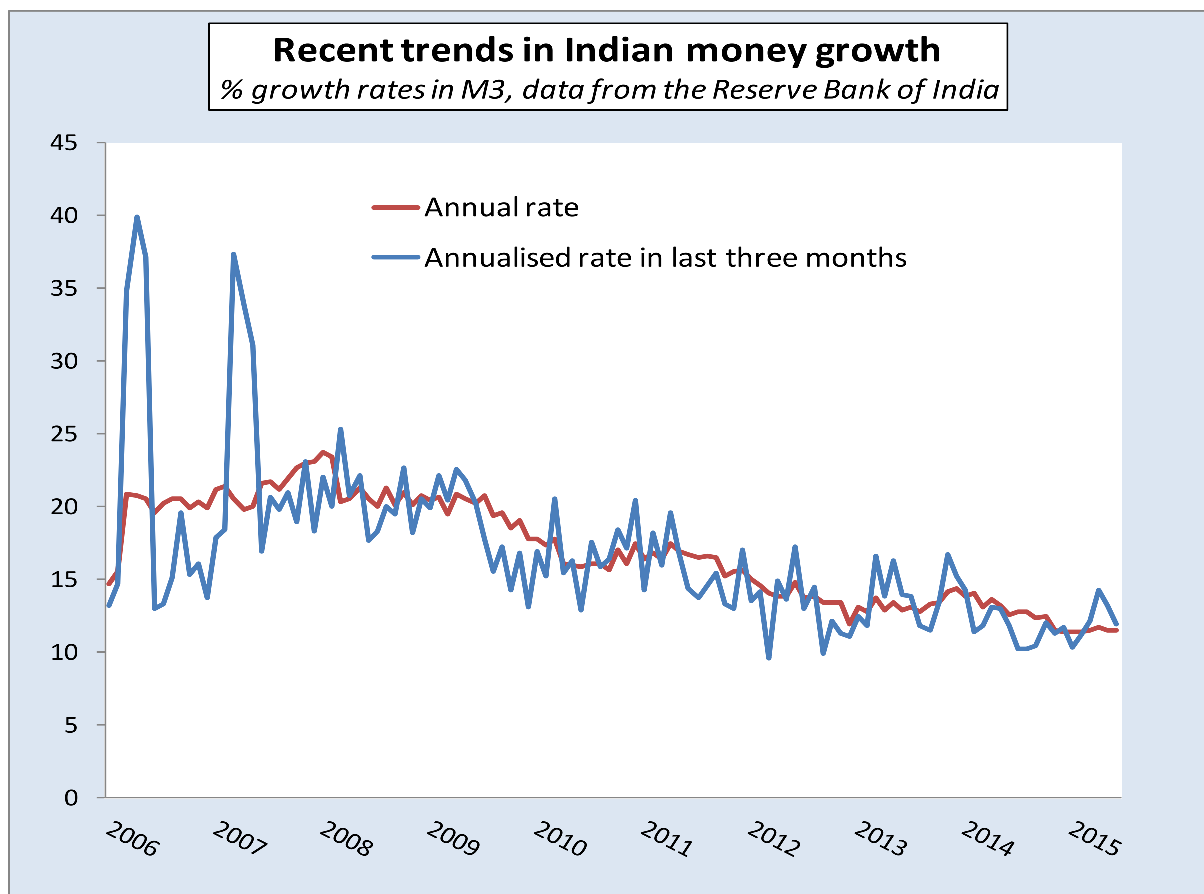
India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1991- 2014	**16.5**	**13.8**
2010 - 2014	**14.2**	**14.4**
Year to June 2015	**11.5**	**n/a**
Three months to June 2015 at annualised rate	**11.9**	**n/a**

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



Slower, but stable money growth

***Summary:* In the three months to June 2015, Indian M3 grew at an annualised rate of 11.9%. The annual growth rate was unchanged at 11.5%. The annualised quarterly growth rate has fallen in both the last two months, suggesting that what looked like a pick-up in the growth rate at the start of the second quarter of 2015 has proved short-lived. As the chart above shows, however, broad money growth is stabilising and the slowdown during the first half of 2014 has not continued into 2015.**

Furthermore, although M3 is now growing at a slower rate than a few years ago, India's economy is in a far more stable position. India has only recently emerged from a period of "stagflation", where broad money growth - and the overall economy - were slowing, while inflation remained stubbornly high. The annual consumer price inflation rate has now settled down on or near the 5% - 5.5% level for nine consecutive months after being as high as 8% barely a year ago. Exchange rate volatility, a particular problem in 2012-13 and a driver of inflation, has also largely subsided. Consequently, given an opportunity to address the slowdown in the economy with looser monetary policy, the Reserve Bank of India has cut the benchmark interest rate three times since December - on each occasion by 0.25%. There is no room for complacency, however, as two factors which helped drive inflation down - the worldwide fall in commodity prices and an abundant harvest last summer – may not necessarily be reflected in the inflation figures after the autumn.

Data from the banks give a mixed picture. As recently as February 2015, the stock of bank lending to businesses was rising by barely 10% per annum, a decline on the 14% recorded a year earlier. Deposit growth has accelerated since the middle of March. The rate of annualised quarterly deposit growth stood at over 13% in the three months to 12th June. This has not, however, been reflected in a corresponding growth in bank lending, which only rose at an annualised rate of approximately 8%. A report by the Reserve bank of India published at the end of June put the blame on the high levels of debt already incurred by large Indian companies. Provisional figures for the end of June suggest that there may have been a further slowing of both deposit growth and lending during the second half of the month.

It is therefore still premature to assume that India's economy is finally about to emerge from its lacklustre growth rate of recent years. But better macroeconomic management has succeeded in overcoming some of the problems (too much inflation, the slide in the rupee) that were causing so much concern two years ago.

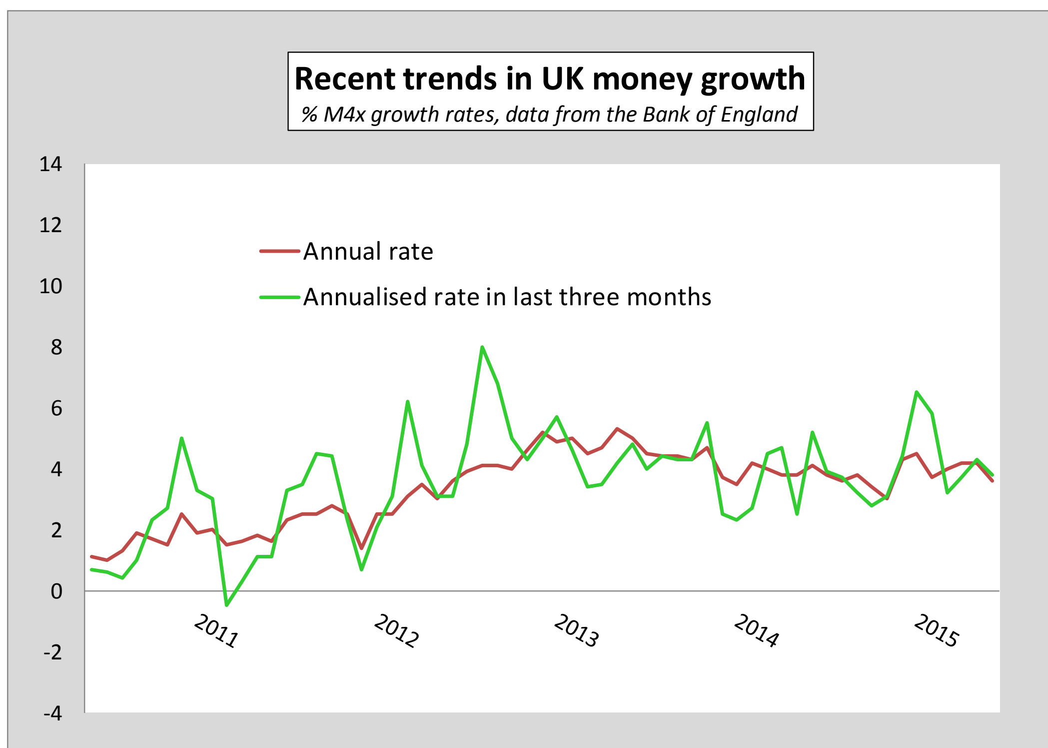
John Petley
30th July, 2015

	% annual growth rate:	
	M3	Nominal GDP
1991 - 2000	**16.9**	**14.4**
2001 - 2010	**17.3**	**13.6**
Four years to 2014	**13.4**	**12.9**

UK

	% annual/annualised growth rate:	
	M4x/M4 before 1997	Nominal GDP
1964 – 2014	**10.1**	**8.3**
Four years to 2014	**3.7**	**3.4**
Year to June 2015	**3.6**	**3½ ***
Three months to June 2015 at annualised rate	**3.8**	**n/a**

Sources: Bank of England and Office for National Statistics. Numbers with asterisks are International Monetary Research Ltd. estimates.



Money growth satisfactory, no need for much higher rates

***Summary*: Broad money growth has been stable at a low rate in 2015, with no sign of any acceleration in growth. In the last three months M4x has increased by 3.8%, which is more or less ideal in association with a 2% inflation target. Bank credit growth has *decelerated* this year. The monetary data do not support the case for an early increase in Bank rate. The tightening labour market may do so, but the argument is not obviously compelling.**

Over the last five years the annual growth rate of the quantity of money, broadly-defined, has been consistently between zero and 5%. The contrast to most previous post-war quinquenniums, in many of which money growth averaged over 10% a year, is sharp and definite. The monetarist argument has always been that, if money growth is kept at a low rate over the medium term, inflation will remain under control. That is exactly what has happened. The last few years have seen the lowest increases in nominal GDP and the price level, over a sustained period, since the 1930s.

But the talk is of an increase in interest rates later in 2015. A tightening of labour market conditions is usually cited as the main justification, and it is indeed true that job growth and the decline in the unemployment rate since 2010 have been impressive. However, the latest money numbers do not support the argument for an increase in Bank rate. M4x (i.e., broad money, excluding the balances held by 'intermediate other financial corporations' or quasi-banks) went up by only 0.2% in June, while the annualised growth rate in the three months to June was 3.8%. This was bang in line with the average in the last four years, and is consistent with the low inflation and moderate growth enjoyed in the period. The growth of credit to the private sector has *fallen* in 2015. In the three months to March the annualised growth rate of bank lending (again excluding IOFCs) was 3.9%; in the three months to June it was 0.9%.

The UK's banks are still being held back by more rigorous official regulation, while two banks – HSBC and Standard Chartered – are openly considering moving their headquarters from the UK. Most of the two banks' operations are abroad anyway, but their situation illustrates the importance of the official regulatory environment to banks' expansion strategies. For the time being, it is not clear that – at the current almost zero interest rates – broad money growth will rise so strongly as to threaten the 2% inflation target. Indeed, the latest indicators of costs and prices from business surveys suggest continued minimal inflation well into 2016.

Tim Congdon
29th July, 2015

	% annual growth rate:	
	M4/M4x	Nominal GDP
1964- 2014	**10.1**	**8.3**
1991 – 2000	**7.5**	**5.9**
2001 – 2010	**7.0**	**4.2**
Four years to 2014	**3.7**	**3.4**