



[The e-mail below is as from International Monetary Research Ltd. This will be the last e-mail under the International Monetary Research Ltd. logo. In 2017 a regular e-mail communication will be sent by the Institute of International Monetary Research to people and organizations interested in global money trends. It will be on the same lines as the e-mails in recent years from International Monetary Research Ltd., but is not to be regarded as investment research as such and will contain no specific investment advice.]

Monthly e-mail from Tim Congdon – 21st December, 2016

Global money round-up at the end of 2016

Brexit and Trumpquake have made 2016 a year of surprises, but these two events were not its only unexpected features. **Readers might be reminded that in January and February numerous commentators – taking their cue from the Bank for International Settlements, the Organization of Economic Cooperation and Development and other august authorities – forecast that 2016 would see another recession, perhaps even a recession as bad as that in 2008 and early 2009.** Still worse, they were anxious that policy-makers had “run out of ammo” because short-term interest rates were close to zero.

Emphasis must again be placed on a core message of economic theory which is substantiated by vast bodies of empirical evidence: the equilibrium level of national income is a function of the quantity of money. (And I will insist, as always, that the relevant quantity of money is broadly defined to include all bank deposits.) A simple point follows. **Sharp peacetime declines in economic activity are very unusual unless they are preceded or accompanied by large falls in the rate of change of real broad money.** Such large falls can occur either because of a crash in the rate of change of *nominal* broad money or because of a big rise in inflation. In early 2016 nominal broad money growth was very low by the standards of the previous 50 years in virtually all the key countries, while upward pressures on inflation were weak. Indeed, fears of deflation were being widely expressed. By implication, a large fall in the rate of change of real broad money was almost inconceivable. **It was therefore quite easy for any quantity-theory analyst to dismiss the recession mongering. (That is what I did, with my monthly e-mails of January and February 2016.) Much the same message comes out in late 2016, in assessing the 2017 prospect. 2017 is likely to be a year of roughly trend growth for the world economy, even as policy shifts in response to the changing political environment.**

Money trends in autumn 2016 in the main countries/jurisdictions

What are the latest money growth trends in the main countries? 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. For detail, it is recommended that the reader looks at the individual country comments below. Beneath the table I make an overall assessment.

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	0.4	3.7	Money growth down, due to ‘quantitative tightening’, but Trump to ease Dodd-Frank in 2017?
China	16.9	12.9	11.9	Money growth up in recent months in stable context..
Eurozone	11.9	2.0	4.4	Weak money growth in last two months probably a blip, QE otherwise working well.
India	7.1	10.5	11.5	Money growth weak by standards of recent years, but economy doing well..
Japan	4.3	4.1	3.4	Broad money growth moderate, but perhaps edging upwards.
UK	2.3	7.2	8.1	Money growth jump since Brexit vote due to misjudged QE. Bank credit to private sector may be slipping.

The main news this month is twofold, that the money growth deceleration in the USA has continued and is now accompanied by a money growth deceleration in the Eurozone. The decelerations are well-defined, but have not lasted long and may prove to be blips. But they need to be noted and will be important to the 2017 outlook if they persist. I don’t expect them to persist, but the American news serves as a corrective to all the talk of a Trump mini-boom/boom in 2017 on the back of infrastructure spending and so-called “fiscal reflation”. (Surely the lags are such that a boom in *early* 2017 is most unlikely.) My comments this month are under three headings, as I have a section at the end on the folly of debt-ism. (Debt-ism is the notion that levels of household debt relative to income *by themselves* are strongly relevant to the determination of national income and wealth, and hence the fluctuations in demand and output known as “the business cycle”.)

1. The US monetary situation and “quantitative tightening”

I explained the mechanics of “quantitative tightening” in this note last month. When bonds in the Fed’s portfolio of asset-backed securities mature, the bonds’ issuers make payments to the Fed from their bank deposits. The bank deposits, which are part of broad money, go down. The transactions enable the Fed to reduce its cash reserve liabilities to the commercial banks, which also go down. The Fed could offset the impact of such transactions on broad money by purchasing new securities and replenishing its portfolio. But it seems to have decided not to do that.

On 4th November 2015 banks’ cash reserves were \$2,765.6b., whereas on 2nd November 2016 (the latest available date at the time of my last note) they were \$2,220.4b. and on 7th December (the last available date) they were \$2,210.4b. The fall does not automatically translate into an identical fall in bank deposits held by the non-bank private sector. All the same, a movement of this kind and scale is likely to have been responsible for a significant drop in M3. If the negative impact on M3 was, say, \$400b., that would cause M3 growth to be about 2½ % lower than it would otherwise have been. The recent weakness in US money growth cannot be blamed on bank credit to the private sector. In the four months to November the annualised growth rates of “loans and leases in bank credit” (which roughly corresponds to “bank lending to the private sector” in UK parlance) were 4.0%, 5.5%, 6.3% and 2.1% respectively. (In other words, in August the stock of “loans and leases” went up by a bit over 0.3%, giving an annualised rate of increase of 4.0%, and similarly for the next three months.)

My verdict is that the dip in money growth in the USA in recent months is not yet something to worry about all that much. The annual rate of growth has come back to under 4%, but that is not disastrous. As long as bank credit to the private sector continues to expand at an annual rate of about 5%, broad money growth should in due course chug along at a similar figure, and the growth rates of real demand and output should be close to trend in a low-inflation context. QT, as opposed to QE, has happened because the Fed is not offsetting the monetary effect of the redemptions of asset-backed securities, and these redemptions seem to be bunched in the final months of calendar years. Nevertheless, the situation needs to be watched. Let it be remembered that the Fed itself is indifferent to the monetary effect of QT/QE operations and does not track broad money. (More fools them, but that is my current concern. In the four years to 2013 the Fed bothered itself over the alleged impact of QE on “credit conditions” and bond yields.)

Over the medium term, President-elect Donald Trump’s aversion to the Dodd-Frank legislation could be of massive importance to the US monetary situation. **If Dodd-Frank were repealed, or even diluted in a major way, and if the abrogation of Dodd-Frank were accompanied by US rejection of Basel III/Basel IV rules on bank capital, bank credit to the private sector might well grow very rapidly for a few years. It would certainly grow rapidly at a Fed funds rate of under 1%.** But no one yet knows for definite what lies ahead. The rise in bank stocks and the increase in Treasury bond yields since 9th November look appropriate in the circumstances. All the same, for the moment bank credit to the private sector is expanding at only a moderate pace, while QT has led to a *deceleration* in broad money growth.

2. Dip in Eurozone money growth, despite ECB’s commitment to QE

Eurozone M3 went up by only €6b. in October, after increases of €32b. in August and €34b. in September. The annualised rate of increase in the last three months was 2.6%, less than half the figure

of around 5% that has characterised most of the period since the start of quantitative easing in early 2015. Curiously, the slowdown in money growth has occurred despite quite strong increases in domestic bank credit to both the state sector (as a by-product of QE) and to the private sector. In the three months to October new bank credit to the two domestic sectors combined totalled €164b., implying an annualised growth rate in the stock of such credit of almost 4%. Normally the growth rates of broad money and domestic credit are similar. The gap in recent months reflected an outflow of money balances to the rest of the world, which must have been due to capital account movements as the Eurozone has a current surplus on the balance of payments. Large takeovers of non-Eurozone companies or purchases of assets in, for example, the USA or the UK might explain the capital outflows. **My view is that in the next few months the growth rate of broad money ought to return to a figure closer to the growth rate of domestic credit, while the annual growth rate of domestic credit will trundle along in a 3% - 5% corridor.** The ECB plans to reduce the volume of asset purchases it is making for its QE programme, but the QE programme will still be maintained. The much-publicised strains in the Italian banking system will certainly constrain the growth of bank credit *in Italy*, but Italy is only one member of the Eurozone. In Germany banks are in an expansionary mood and are adding mortgage loans to their assets at a much faster pace than has been typical in the last 20 years.

3. The mooted global recession of 2016 and the role of “debt-ism”

The introductory material to this e-mail covered the topic of “debt-ism” in some detail. As I said there, the theory of debt-ism seemed to justify much pessimism about the world economy in early 2016, with a *Financial Times* 5th February column by Martin Wolf telling readers to “prepare for a recession”. I have decided to reprint what I said in my January 2016 monthly e-mail, which now follows:

Financial markets have been spooked in the opening weeks of 2016 by talk of an imminent or probable recession. But two points must be emphasised,

- i. no one in central bank or regulatory officialdom, or in top political positions, in the main countries wants a recession in 2016 or even, frankly, a slowdown in growth from the rather meagre levels of the last four/five years, and,
- ii. with inflation at close to zero, and a widespread view that the latest bout of weak commodity prices signals outright deflation, policy-makers have ample scope to pursue expansionary monetary policies.

The concern seems to be that policy-makers are ‘running out of ammo’. This is baloney. The running-out-of-ammo argument rests on the idea that monetary policy is described – adequately and completely – by ‘the rate of interest’, where the phrase ‘the rate of interest’ means the money market rate set by the central bank. In the most extreme form of this kind of statement, no attention is paid at all to the quantity of money.

But it is a simple matter to assemble evidence which shows that the change in nominal national income and expenditure is much better correlated with the change in the quantity of money than with any interest rate concept. Further, the creation of money by the state is child’s play. All that is necessary is for,

- i. the government, or an agency of the state such as the central bank or a public sector institution, to borrow from the banking system, and
- ii. to use the loan proceeds to purchase something – anything – from the non-bank private sector.

It should be obvious that, by these means, the state expands the quantity of bank deposits held by non-bank private-sector agents, i.e., the quantity of money, broadly-defined. In other words, policy-makers have the ability to raise nominal national income by any extent they wish, if they adopt sufficiently expansionary monetary policies. The processes at work are so straightforward, and the mechanics of the operations can be so shockingly brazen, that many nations have monetary constitutions that try to deter money creation of this kind. For instance, while Germany still had the deutschemark as its national currency, the government was forbidden from borrowing on overdraft from the Bundesbank. (The Bundesbank was nevertheless free to purchase government securities in the market, perhaps from non-banks, which would have the effect of money creation.)

Misunderstandings about this subject are widespread. Take, for example, Martin Wolf's column in the *Financial Times* of 5th February, under the title 'Prepare for the next recession'. Its seventh and eighth paragraphs were contradictory. The seventh paragraph claimed that 'one instrument' would be 'the deleveraging of economies', with the 'forced conversion of debt into equity'. The eighth suggested that another instrument would be 'a still bigger scale of quantitative easing'.

I had to rub my eyes in astonishment. As I said in the introductory e-mail message, 'The growth of national expenditure, income and output in nominal terms is a function of the growth of the quantity of money, where the quantity of money is broadly-defined to include bank deposits.' The evidence in support of this proposition is clear and overwhelming for all countries over all historical medium and long runs.

What, then, is wrong with deleveraging? Banks do not own equities, as equity-type risk is always excessive given the high gearing in their balance sheets. Their assets are dominated by very safe securities or loans, where the banks take collateral (i.e., a claim on borrowers' assets) to ensure that borrowers will make every effort to repay. Loans are a form of debt, while most of the securities held by banks are debts of governments or companies in good credit standing. The effect of the 'forced conversion of debt into equity' would be to cause a contraction in banks' assets and hence in their deposit liabilities, i.e., in the quantity of money. *Deleveraging – understood as the removal of debt from an economy – is a deflationary policy. It is the sort of nuttiness that was implicit in Andrew Mellon's recommendation of 'liquidation' as the answer to the 1929 – 33 Great Depression.*

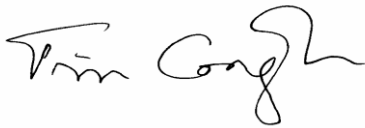
By contrast, QE is expansionary. (That is why the seventh and eighth paragraphs were contradictory.) I have no problem with the suggestion that more QE would avert another recession, although the operations do need to be calibrated properly and organized with the right intermediate target in mind. (They should focus on the quantity of money, broadly defined, not on the monetary base.) But Wolf seems to believe that, because QE operations have been enormous and have caused central bank balance sheets to balloon relative to GDP, they are reaching some kind of natural limit. No, the purpose of such operations is to increase the quantity of money, not the monetary base (i.e., the central bank's liabilities). It is not necessary for the central bank to be involved here at all. Instead of *the central bank* borrowing from the commercial banks and using the loan proceeds to buy government securities which are held in a central bank subsidiary, *the government* can borrow from either the central bank or the commercial banking system, and use the loan proceeds to buy government securities which it cancels. (There is no point in the government holding claims on itself.) When the government conducts operations of this sort, the result is to raise the banking system's claims on the government. If the transactions bypass the central bank, as they can easily do, there is no effect on the ratio of the central bank's balance sheet to GDP, and any disquiet about a very high such ratio is irrelevant.

The discussion is not at all theoretical. When the British government financed its expenditure in the Second World War it issued so-called 'Treasury deposit receipts' to the clearing banks and used the resulting deposits to purchase war material of all kinds. In 1945 TDRs were a very high proportion of banks' total assets. *But they did not appear on the Bank of England's balance sheet to anything like the same extent.* The UK commercial banking system has in the past, over extended periods, had claims on the state in excess of 60% of assets. We could easily return to that situation, if necessary.

The state can *never – repeat, never –* 'run out of ammo' in the conduct of expansionary monetary policy.

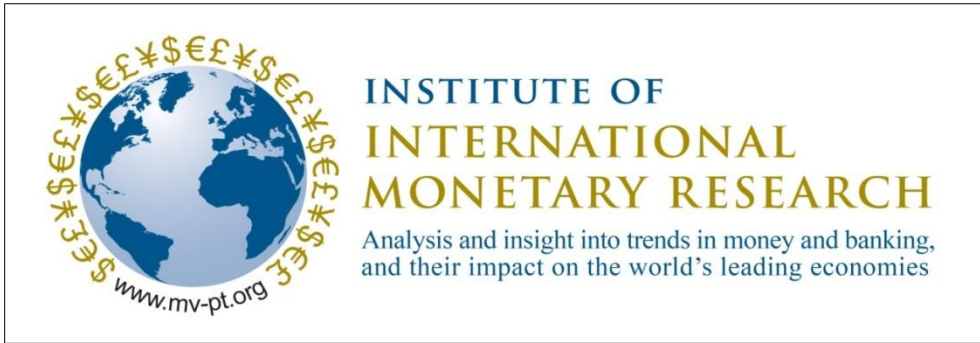
It is possible that debt-ist rubbish will reappear in the newspapers and elsewhere in early 2017, with yet another push from the BIS, the OECD etc. Although the edging-up of energy prices suggests that inflation is more of an issue than in early 2016, policy-makers generally have great freedom to implement expansionary monetary policy if they need to do so. Despite many muddles, most central bankers understand enough about QE to know that they can in fact pursue stimulatory action even if the money market rate is zero. **So participants in financial markets must not concern themselves with the remote and hypothetical (but actually impossible) situation in which policy-makers “have run out of ammo”.**

May I wish readers happy Christmas?

A handwritten signature in black ink, appearing to read "Tim Conger". The signature is fluid and cursive, with the first name "Tim" and the last name "Conger" clearly distinguishable.

29th December, 2016

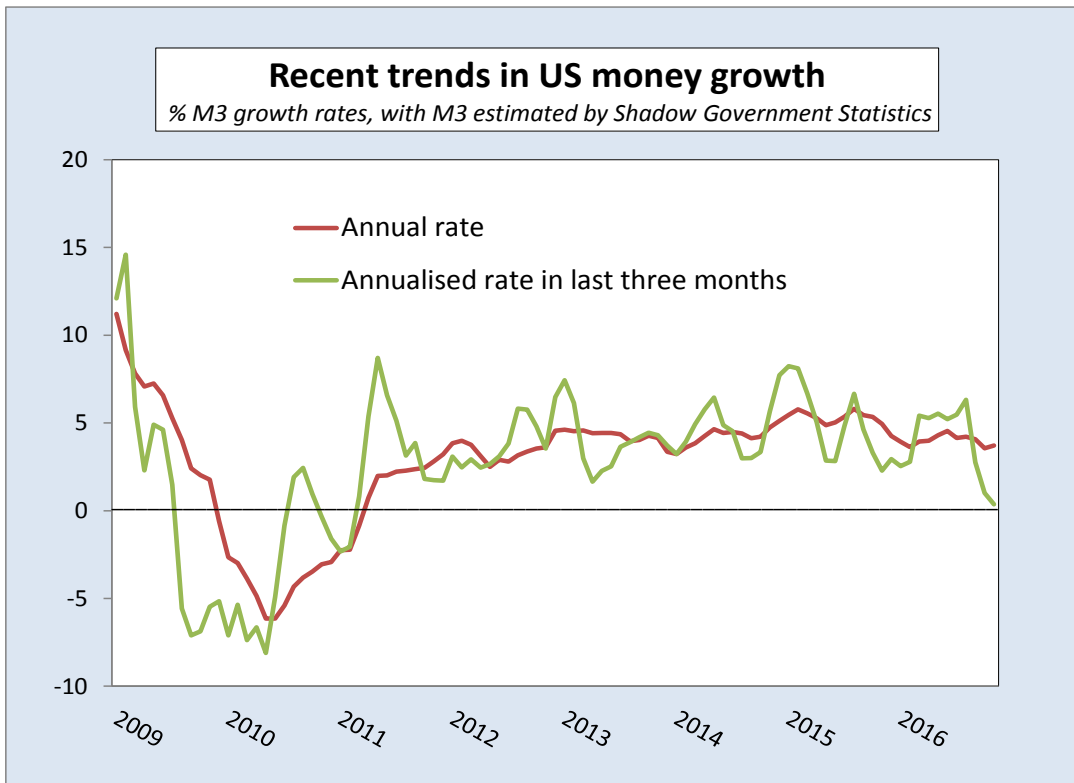
P.S. and N.B.: The next instalment of these communications will be sent from the Institute of International Monetary Research, not from International Monetary Research Ltd.



USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1959 - 2015	7.5	6.6
Four years to 2015	4.3	3.8
Year to November 2016	3.7	n.a
Three months to November 2016 at annualised rate	0.4	n.a.

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



M3 growth slowdown in recent months, due to “quantitative tightening”

Summary: In the three months to November US M3 grew at an annualised rate of 0.4%. The sharp fall in US money growth is clearly visible in the graph above. November’s figure is the lowest three-month annualised rate since late 2010/early 2011, when the figure was negative. It is too early to ring loud alarm bells, but the money slowdown cautions against expecting a buoyant early 2017 for the US economy. “Quantitative tightening”, as the Fed lets its stock of asset-backed securities run off, is the main reason for the money slowdown. (Our M3 data in this note are from the Shadow Government Statistics company.)

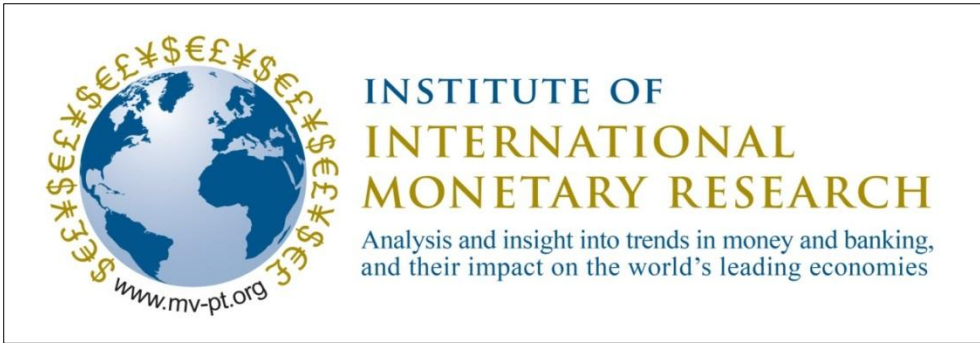
As far back as September 2015, these notes have mentioned how the Fed has been engaged in “quantitative tightening” (i.e., the reversal of quantitative easing) when it allows its stock of asset-backed securities to run off at maturity. The Fed can use proceeds from the maturing ABSs to reduce its cash reserve liabilities to the banks rather than to finance new, offsetting purchases of securities.

A significant amount of QT has occurred over the last year, although this development has received very little media coverage. The Fed’s large-scale asset purchases ended on 29th October 2014, with US commercial banks’ cash reserves peaking shortly afterwards at \$2,957.1b. on 26th November. Cash reserves were still \$2,765.6b. almost a year later on 4th November 2015. But the last available figure – for 7th December 2016 – is \$2,210.4b. The decline has been in two spasms, one in autumn 2015 and other in autumn 2016. Since the end of October, there is some evidence that this second spell of QT has paused. The negative monetary effect of the QT over the last year has been roughly the same as the positive effect of QE2, which involved \$600b. of purchases of government securities. But no formal announcement has emerged from the Fed, suggesting that QT is not a deliberate policy, but is happening by default. QT apart, the picture is reasonably positive. Banks continue to acquire other assets at a moderate rate. In the three months to November “loans and leases in bank credit” (which roughly equates to bank lending to the private sector in the UK) moved ahead by just over 1.1%, i.e., at an annualised rate of 4.5%. The growth in the stock of loans slowed during November, however, with both business and real estate lending stagnant.

With equilibrium national income being a function of the quantity of money, broadly-defined, this slowdown in M3 growth is potentially significant. Much depends on how long it lasts. A combination of further “QT”, slowing bank credit growth and more onerous capital requirements imposed on the banks will result in weak money growth persisting into 2017. Furthermore, with there being little interest in broad money among most Fed economists, M3 growth may be further inhibited by hikes in the Fed funds rate as a reaction to falling unemployment and rising inflation.

John Petley and Tim Congdon
23rd December, 2016

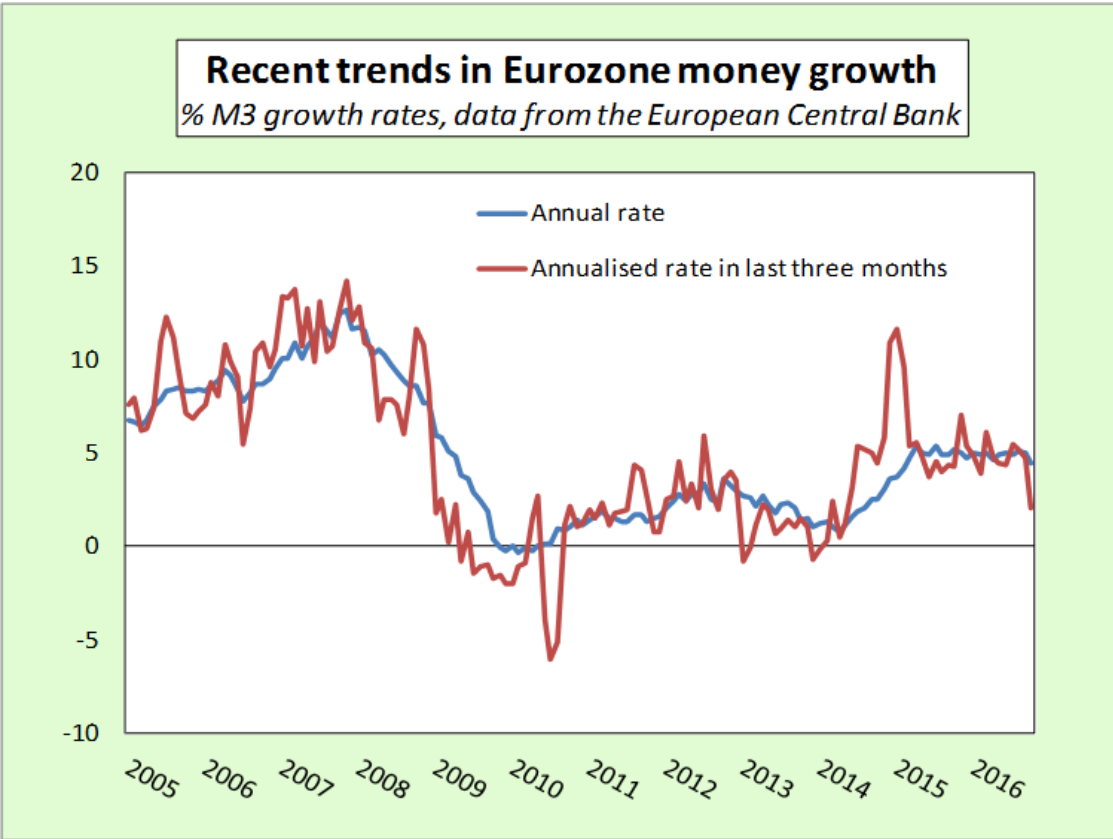
	% annual growth rate:	
	M3	Nominal GDP
1960 – 2014	7.6	6.7
1960 – 1970	7.7	7.7
1971 – 1980	11.4	10.7
1981 – 1990	7.7	7.7
1991 - 2000	5.6	5.6
2001 - 2010	7.1	3.9
Four years to 2015	4.3	3.8



Eurozone/Euroland

	% annual/annualised growth rate:	
	M3	Nominal GDP
1995 – 2015	5.3	3.1
Five years to 2015	3.0	1.6
Year to October 2016	4.4	n/a
Three months to October 2016 at annualised rate	2.0	n/a

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



Money growth falls but bank lending holds up

Summary: In the three months to October 2016, the Eurozone's M3 quantity of money grew at an annualised rate of just 2.0%. During October itself the quantity of money rose by a mere €6b. Interestingly, German M3 – which was bounding ahead in early 2016 – fell by €12b. The annual rate of broad money growth fell to 4.4%. Taken by itself, this figure is satisfactory, especially as inflation remains low, but it is the lowest annual growth rate since the start of QE. In spite of October's disappointing figures, however, bank lending to both households and businesses held up and it would be premature to dismiss the ECB's "quantitative easing" programme on the basis of one month's figures. Annual broad money growth remains much higher than the 2% average in the 2009-2013 period.

Besides combating weak demand growth, the ECB's QE programme was launched to fight off deflationary pressures and return the inflation level to the target of 2% or just below. The annual consumer price inflation rate stood at 0.6% in November 2016, a rise on October's 0.5% and the sixth consecutive month with a positive number. Some individual countries are still battling with deflation. However, of the major economies, only Italy saw prices fall in the year to October and this was followed by a 0.1% increase in November. On this basis the ECB's QE operations have been a success.

The announcement by ECB Governor Mario Draghi on 8th December to extend the monthly bond purchases beyond March 2017 comes as no surprise. The programme will continue for a further nine months but the asset purchase level will be reduced from €80b. to €60b, per month. In addition, the ECB can now buy government bonds yielding less than its deposit rate of -0.4%, such as German bunds. Draghi left open the option to extend the programme for longer and even to increase the asset purchases, if macro conditions deteriorated. He also stated that there had been a "very broad consensus" for the decision, suggesting it was not unanimous. It must be remembered that inflation is below target and the growth in the stock of bank lending is running at modest levels. QE is still needed.

The ECB's credit counterparts data show that both bank credit to general government and business lending *rose* during October. Mortgage lending was weaker than during the two previous months, but still growing at an annualised rate of 2.3%. The poor growth of broad money reflected negative external influences and may be just a blip. In spite of concerns about the levels of non-performing loans on the books of some Italian banks, the resignation of Italy's Prime Minister Matteo Renzi is unlikely to cause a calamity – at least for the time being – as another "technocrat" is likely to take over, as Mario Monti did in 2012. The single currency area still obviously has its problems but unless money growth slows further, the data suggest that on balance, the modest recovery looks likely to continue into 2017.

John Petley
8th December, 2016

	% annual growth rate:	
	M3	Nominal GDP
1995- 2015	5.3	3.1
1995 – 2000	4.5	4.0
2001 – 2010	6.7	3.4
Five years to 2015	3.0	1.6



China

	% annual/annualised growth rate:	
	M2	Nominal GDP
1991- 2014	20.3	15.8
2010 - 2014	15.2	12.8
Year to October 2016	11.9	n/a
Three months to October 2016 at annualised rate	12.9	n/a

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



Broad money growth continues at a respectable level

Summary: In the three months to October 2016 China's M2 expanded by 3.2% or at an annualised rate of 12.9%, which was unchanged on September's figures. The last three months has seen the highest annualised quarterly broad money growth so far this year. The annual growth rate rose from 11.6% in September to 11.9%. The Chinese government has set a target of 13% annual broad money growth. Recent figures suggest that this could be more or less met in 2016, if with a small shortfall. The People's Bank of China seems comfortable with the figures. Influential members of the ruling Communist Party continue to fret about too much debt.

China looks set to record the lowest GDP growth in over 25 years. Growth for each of the first three quarters has been 6.7%. Last year China's GDP grew by just under 7%. The lack of any monetary stimulus, such as a cut in interest rates, confirms the lack of concern in Beijing about the money figures. There would be some sort of response if there was any hint of a serious slowdown. Annual consumer price inflation rose to 2.1% in October, up on September's figure of 1.9%. Significantly, September saw the producer price index emerge from negative territory for the first time since January 2012, a trend which continued into October. Nonetheless, with the CPI increase still well below the official 3% target, there is scope for further monetary loosening if the Chinese authorities decide in favour.

Counselling against further monetary loosening is the strong growth in the housing market. Property prices in the 70 largest Chinese cities rose by an average of 12.3% in the year to October, a further rise on September's figure of 11.2%, with Beijing and Shanghai recording price growth of 27.5% and 31.1% respectively. These are the largest rises on record. The government has imposed curbs on mortgage lending in 20 cities due to concerns about the market overheating. Many commentators say its concerns are justified, but the revaluation of the housing stock signals much underlying domestic confidence in China despite much foreign disquiet about corruption and authoritarianism. A year ago, house prices were only 0.1% up on the previous 12 months. The number of new car registrations is also rising, reaching 2,344,100 in October, not far below December 2015's peak of 2,442,100. The annual growth of the stock of bank lending to the private sector is steady, at 13.0% in September and 13.1% in October.

The recent four-day plenum of the Chinese Communist Party in Beijing offered little hint of any change in economic policy. At least superficially, the transition from less investment and more consumption is working. Recent lay-offs in heavy industry do not seem to have had a major impact on the unemployment rate, which stands at barely 4%. Areas of concern persist, notably the incidence of non-performing loans in the banking system. Estimates of the percentage of non-performing loans range from 15% to 25% of the total of all banks loans. (With most major Chinese banks being owned by the state, the banks affected will not be allowed to collapse.) Recent money figures suggest that in spite of these concerns, the Chinese economy will enjoy reasonable growth into 2017.

John Petley
1st December, 2016

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



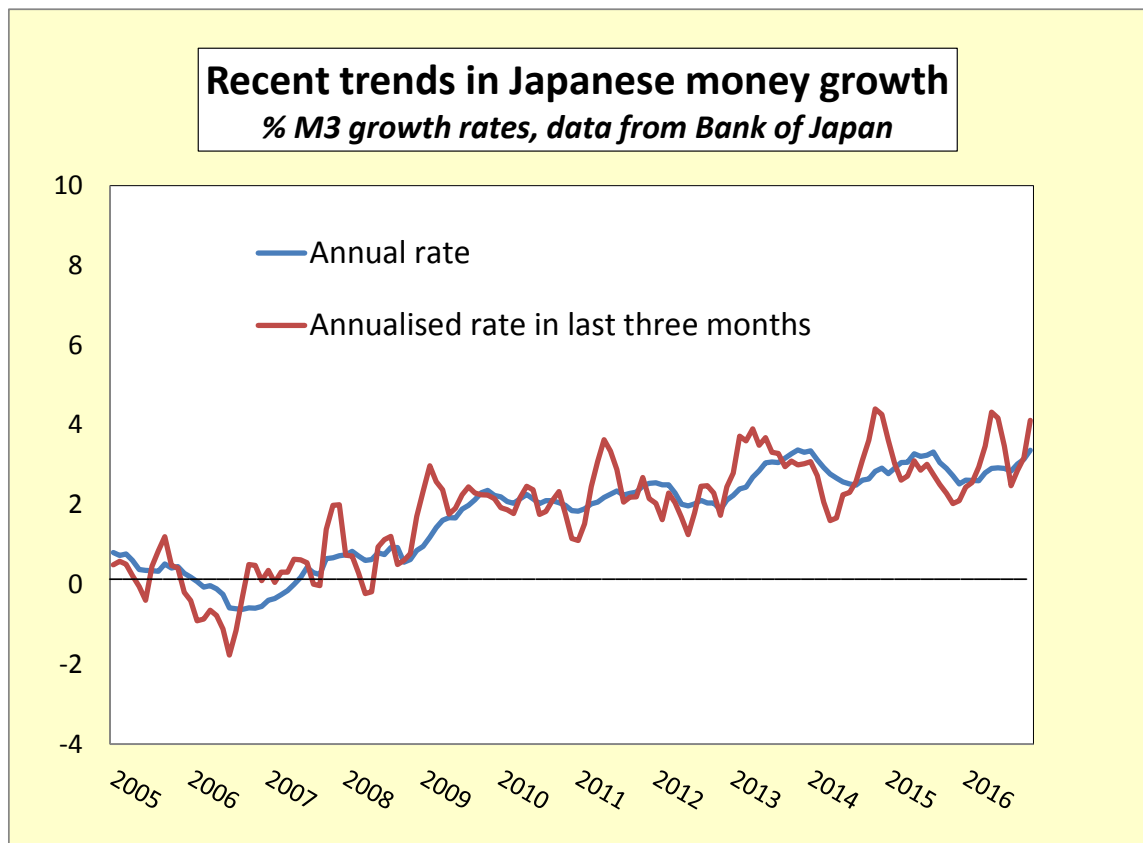
INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

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

Japan

	% annual/annualised growth rate:	
	M3	Nominal GDP
1971- 2015	6.3	4.3
Five years to 2015	2.7	0.4
Year to October 2016	3.4	n/a
Three months to October 2016 at annualised rate	4.3	n/a

Sources: Bank of Japan for M3 and IMF for GDP



Further rise in broad money growth

Summary: In the three months to November Japanese M3 grew at an annualised rate of 4.1%. While the annualised quarterly growth rate was slightly higher in May and June, it has only topped 4% on five occasions during the last decade. The annual growth rate, 3.4% is the highest for three years and remains unsurpassed in over a decade. As the chart above indicates, the programme of so-called “qualitative and quantitative easing” has done a little, but not much, to boost the rate of broad money growth since it was launched over three years ago. For most of the period since 2010 broad money has increased steadily at an annual rate between 2% and 3½%.

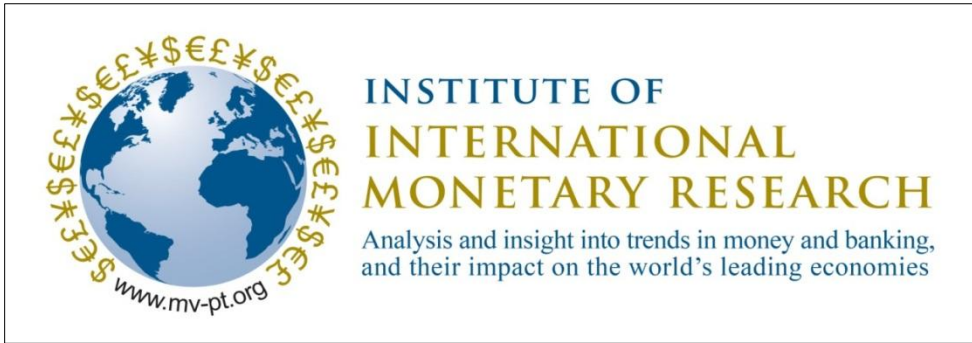
The central bank annual asset purchases have remained at 80 trillion yen (about \$650b.) since October 2014. Seeking to stimulate the economy (and inflation) further, the Bank of Japan then additionally brought in a policy of “negative interest rates” at the start of 2016. September saw the introduction of yet another measure, known as “yield curve control”, whereby the BOJ will buy as many 10-year government bonds as necessary to keep yields at their current level of 0%. (Apparently the BOJ thinks that this measure will stimulate bank lending, although to many observers the approach is baffling.)

The minutes from recent monthly BOJ monetary policy meetings consistently strike an upbeat note. In November’s minutes, Governor Kuroda set a new target date for hitting the 2% inflation target in 2018. (This is not the first time it has been deferred!) Unsurprisingly, given that yield curve control has only just been launched, no hints of any further measures were mentioned. The BoJ’s faith in boosting the monetary base as the key to reaching its inflation target has proved misguided. In theory, 80 trillion yen of asset purchases each month ought to boost M3 by about 6% a year. But much of the bond buying is from banks, with no immediate effect on non-banks’ deposits (i.e., M3 money). The excess bank cash reserves created by QQE have failed to generate any appreciable increase in bank lending. This month’s figures are slightly more positive than usual. It is possible that yield curve control will lead to heavy purchases of government bonds from non-banks in early 2017, which would be very helpful for asset markets and economic activity.

Consumer price inflation stood at 0.1% in the year to October, the first positive reading February. The recent increase in oil prices may keep inflation in positive territory for the rest of the year, given that petroleum products comprise over 25% of Japan’s imports, but this alone will not raise Japanese inflation to its target level. A slight pick-up in economic activity may have begun. Growth in the stock of bank lending, which has stood at between 2% and 2.2% for most of 2016, rose to 2.4% in September and remained at that level in October. Household spending continues to decline, but retail sales did bounce in October. The unemployment rate has continued to fall throughout 2016, now standing at 3.0%. Wages growth has been static for much of the year.

John Petley
9th December, 2016

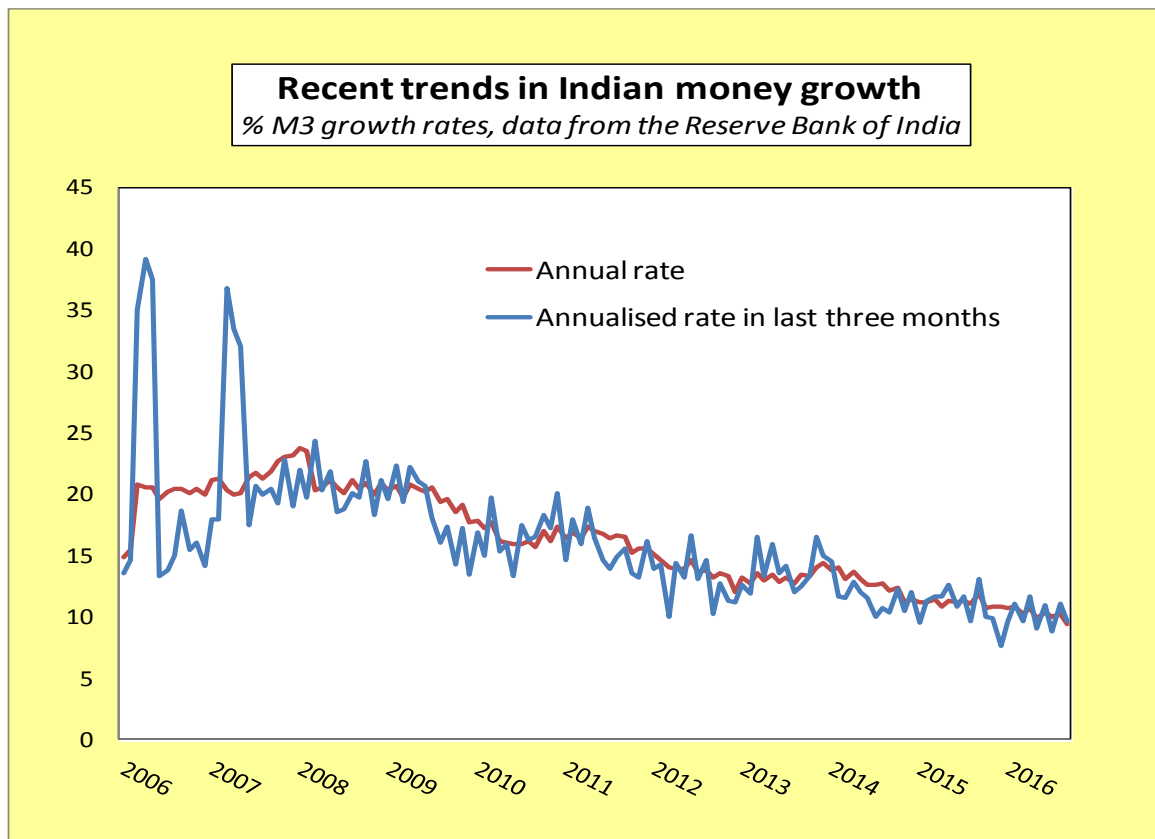
	% annual growth rate:	
	M3	Nominal GDP
1981 – 1990	9.2	6.2
1991 - 2000	2.4	1.3
2001 - 2010	1.1	-0.5
Five years to 2015	2.7	0.4



India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1991- 2014	16.5	13.8
2010 - 2014	14.2	14.4
Year to October 2016	11.5	n/a
Three months to October 2016 at annualised rate	10.5	n/a

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



Sluggish money growth continues

Summary: Indian broad money growth seems to be settling down at an annual rate of 10% – 11%. after some four years in the 11% - 14% corridor. The annualised growth rate for the three months to October stood at 11.5%, up from 9.9% the previous month. The annual growth rate also nudged upwards, from 9.6% to 10.5%, November's figures may be slightly affected by the decision to withdraw 500 and 1,000 rupee notes from circulation, purportedly to limit corruption. Some estimates suggest that India's "black economy" which was the target of this drastic measure, amounts to 20% of total GDP. Indians are now suffering considerable problems with cash flow, some spending hours queueing to exchange or deposit the old notes. Even in India, however, coins and banknotes in circulation comprise well under 15% of the total M3 measure. The long-run macro effects ought to be minor.

Apart from the short-term chaos due to the note withdrawal, the Indian economy has been performing well recently. GDP growth ran at 7.3% in the third quarter of the year. Urjit Patel, the new governor of the Reserve Bank of India, assumed office at a time when monetary conditions were accommodative. He reduced bank lending rates by 0.25% to 6.25% on 4th October, which was a surprise move. Following a good monsoon, food price inflation has fallen sharply since July. The annual consumer price inflation rate dropped from 6.1% to 4.2% in October, the lowest number in over a year.

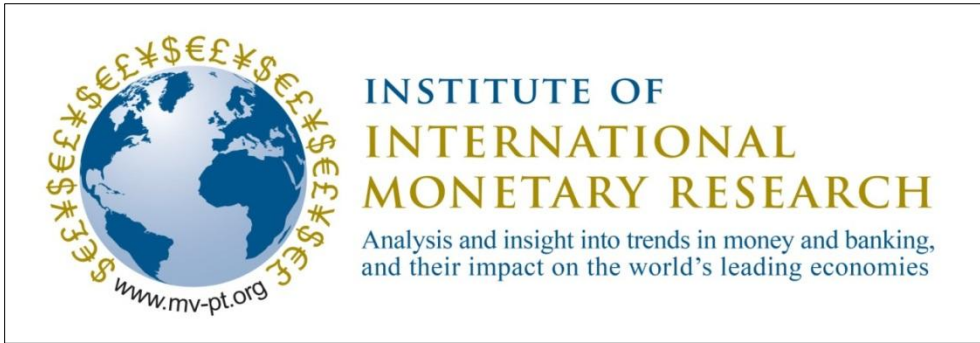
This cut in base rates coincided with a slowdown in bank lending growth. Like his predecessor, Raghuram Rajan, Patel is keen to "tidy up" the portfolios of Indian banks and in particular to tackle the problem of non-performing loans. It is estimated that the number of NPLs has doubled in the last year. One bank, Axis Bank Ltd, saw its profits fall by 83% in the second quarter of 2016 due to NPLs estimated to total Rs. 72.9b. However, good liquidity conditions need to be maintained if India is to continue to enjoy a high economic growth. Preliminary figures from early November indicate that the growth in the stock of bank lending has slowed to 7.9% after being as high as 10.4% in September, which in turn was well down on the 13% average for the 2012-16 period. The money figures will merit close watching in the coming months. The banknote fiasco may cause a blip in the next month or two, but if M3 growth – and bank lending – stay at the current levels once it is over, India's macroeconomic prospects still look positive going into 2017.

A further immediate cut in interest rates looks unlikely. The rupee has weakened slightly since early November, suggesting that inflation may pick up again. The economy may see some benefit from recent structural reform. The Modi government has swept away an elaborate system of local state-level taxes and border checkpoints in favour of a country-wide single economic area. Some estimates put the potential for GDP growth from this goods-and-services-tax legislation as high as 2%.

John Petley

1st December, 2016

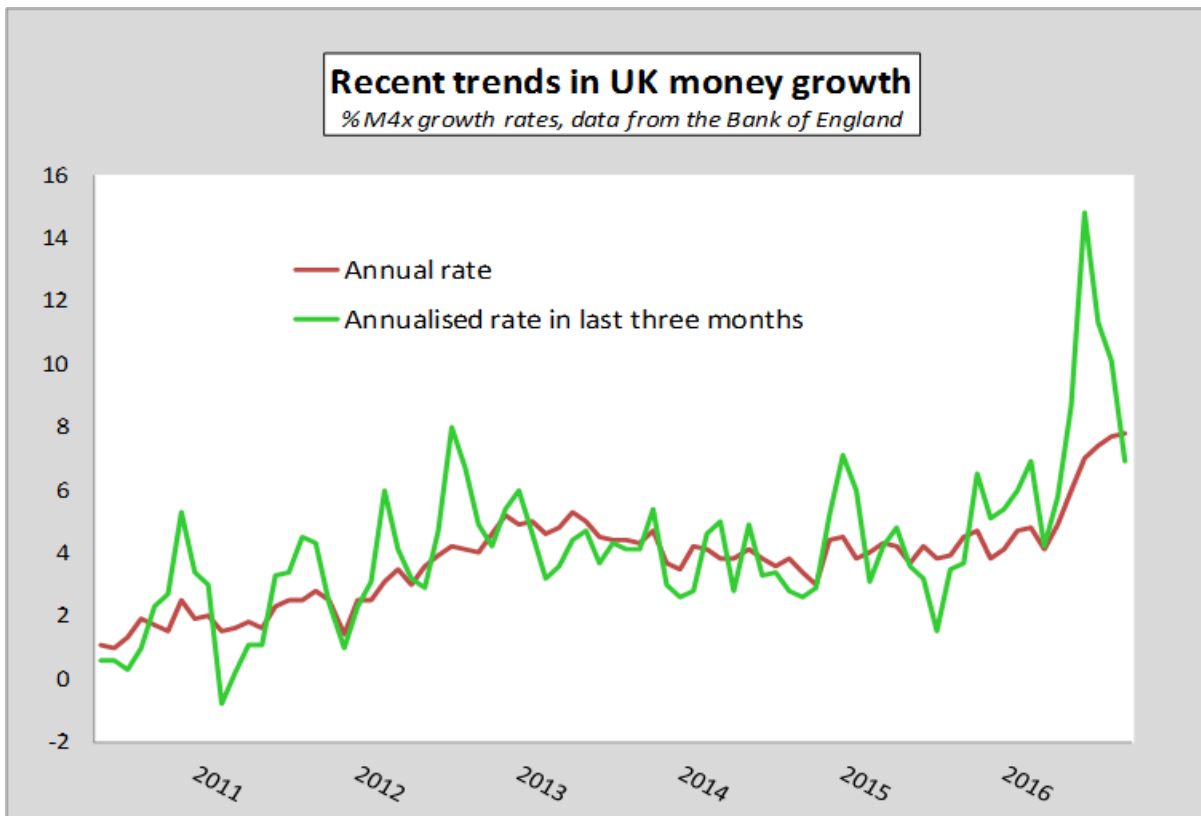
	% annual growth rate:	
	M3	Nominal GDP
1991 - 2000	16.9	14.4
2001 - 2010	17.3	13.6
Four years to 2014	13.4	12.9



UK

	% annual/annualised growth rate:	
	M4x/M4 before 1997	Nominal GDP
1964 – 2015	10.0	8.2
Five years to 2015	3.7	3.6
Year to October 2016	7.8	n/a
Three months to October 2016 at annualised rate	6.9	n/a

Sources: Bank of England and Office for National Statistics.



M4x growth slows but remains at a high level

Summary: In the three months to October 2016, UK broad money M4x grew by 6.9%. The quantity of money, broadly defined, increased by £11.7b. in October itself. Both June and July saw the much higher increases - over £25b. - which pushed the annualised quarterly growth rate as high as 14.8% in July. These months have now dropped out of the calculations, but UK broad money growth remains at a much higher level than at any period since the Bank of England began to use M4x as its key money gauge in 2009.

Two influences lie behind 2016's acceleration in M4x growth. The first is that UK banks, with the exception of Royal Bank of Scotland, have come through their period of convalescence following the Great Recession. They have met the new capital and liquidity requirements, and are now keener to expand risk assets and increase lending the private sector. Meanwhile, business has a renewed appetite for new loans. (New loans are lead to deposit creation, boosting the quantity of money.)

The second factor was the decision by the Bank of England on 4th August to boost its asset purchase programme by £60b., in association with a cut in base rates from 0.5% to 0.25%. The justification was concern that the Brexit referendum result vote would tip the economy into recession, although the precise mechanisms responsible for this drastic sequel were not spelt out. Following the fall in the pound that followed the 23rd June referendum, export order books have been somewhat stronger than on average since 2010. Retail sales in nominal terms were 7.8% higher at the end of October 2016 than 12 months earlier, a rate of advance well above that typically seen in recent years.

Bank lending data give a mixed message. Credit growth was strong in early 2016, with part of the motivation being that homebuyers wanted to complete transactions (which led to the drawdown of mortgage funds) before new taxes took effect. But the pace of new credit extension has faded. In October the stock of so-called M4x lending (i.e., lending that does not involve quasi-banks) fell slightly. In the three months to October it increased at an annualised rate of 2.3%. The corresponding figure for the three months to July was 9.0%.

Although the annual rate of consumer price inflation fell from 1.0% in September to 0.9% in October, it is unlikely if this benign inflationary environment will continue. The annual rate of producer price inflation, which was negative as recently as June, has risen to 2.1% in the space of four months. Given the fall in sterling, this increase is unsurprising. No doubt some of these price increases will be passed on to the consumer. With the unnecessary boost to QE adding fuel to the fire, above-target inflation looks highly likely in 2017. The post-referendum easing of monetary policy looks misjudged and inappropriate.

John Petley
1st December, 2016

	% annual growth rate:	
	M4/M4x	Nominal GDP
1964- 2015	10.0	8.2
1991 – 2000	7.5	5.9
2001 – 2010	7.0	4.2
Five years to 2015	3.7	3.6