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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. – 15th January 2016

Global money round-up at the start of 2016

Some commentators seem anxious that early 2016 feels like early 2007. But banking systems are not over-stretched and do not face heavy loan write-offs because of bad debts, while inflation is exceptionally low. Governments and central banks can readily implement expansionary policies (such as QE) if they have to. The overall prospect is for steady, if rather slow, growth of banking systems in the major countries, and so for moderate growth of broad money, and also of nominal GDP. There are worries (e.g., the oil market), but the world economy is not characterized by major macroeconomic instabilities

In qualification, officialdom seems committed to imposing extra capital requirements on banks across the globe, in the belief that highly-capitalised banks are safe banks and that another Great Recession could not happen if all banks were 'safe'. Key central bankers and regulators seem not to understand that the Great Recession of 2008 – 10, like the Great Depression in the USA 1929 – 33, was caused by a collapse in the rate of change of the quantity of money. They seem further not to appreciate that the effect of tightening bank regulation will be to depress the rate of growth of the quantity of money, with wider disinflationary/deflationary consequences. Although oil prices must be expected to spike upwards at some point in the next three years (as Saudi Arabia again restricts production), underlying, ex-energy inflation will still be low/negligible in 2017 and early 2018. **Money growth has turned upwards in China and India in the last few months, which argues against too much pessimism about the global outlook for 2016.** A truly alarming message is that officialdom still cannot see the connections between regulatory tightening in the banking industry and weak broad money growth, and then between weak broad money growth and sluggish economic activity.

Money trends in late 2015 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. Beneath the table I make an overall assessment, and later make some comments on recent banking and monetary developments in the USA.

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	**2.6**	**4.5**	Annual money growth ok at 4.5%, but QT holding back M3 in recent months.
China	16.9	**8.3**	**13.2**	Major easing said to be under way, but policy seems confused.
Eurozone	11.9	**7.2**	**5.1**	QE has had positive effect on M3 growth, with best macro outlook since 2007.
India	7.1	**10.8**	**11.2**	Positive retail inflation, but falling producer prices. Monetary policy is steady.
Japan	4.3	**2.2**	**2.8**	Broad money growth low and wilting, with QQE to be continued.
UK	2.3	**5.9**	**4.5**	Money growth is moderate, with recent small upturn. .

For most of the post-war period "the West" – meaning the advanced countries with high incomes per head – was dominated by North America, Europe and Japan, plus the Australasian offshoots. On a current prices and current exchange rate basis (which is not the same as the purchasing-power-parity basis used in the table above), the USA, the Eurozone, Japan and the UK still account for almost half of world output. (On a PPP basis, the proportion is much less, at about 35%.) As the table above shows, the latest annual growth rates of broad money in the four jurisdictions are 4.5%, 5.1%, 2.8% and 4.5% respectively. These are not the lowest figures in recent decades, as even more modest growth rates or even outright declines in broad money were seen in the Great Recession. All the same, the numbers are very moderate and refute media scare stories about monetary excess, financial imbalances, etc. The monetary situation today is not at all similar to that ahead of the wrenching upheavals that occurred from mid-2008.

An interesting talking point is the Federal Reserve's attitude towards "quantitative easing" or its opposite, "quantitative tightening". I pointed out in September that US banks' cash reserve assets (which soared from mid-2008, as the Fed incurred these liabilities to the banks in order to purchase securities from non-banks and so increase the quantity of money) had been slipping in the preceding months. In early October the Fed made very large purchases of securities, and the cash reserve asset figure jumped. (It went up from $2,442b. on 30th September to $2,766b.on 7th October.) I was told that the Fed's policy is to keep the stock of QE assets stable.

I now have to point out the same issue again. From a local peak of $2,782b. on 21st October, US banks' cash reserves had slid to $2,455b. on 30th December. That fall of about $300b. off banks' assets implies a corresponding fall in deposit liabilities (i.e., money) and was the main influence, at least in terms of arithmetic, on a slowdown in US broad money growth in late 2015.

Let me say immediately that this may be a storm in a teacup. A high proportion of the QE securities held by the Fed may have had end-2015 redemption dates, explaining why they disappeared from balance sheets. The Fed may in January and February 2016 buy more securities to restore the stock of QE assets. There may be upward blips in broad money in January and February, as there was one in October. Well, good, if that is what happens. But it is the analyst's job to keep people on their toes and I have to say that I do wonder whether "the Federal Reserve" does in fact understand how QE affects the economy. ("The Federal Reserve" is written inside quotation marks, as it is a diverse and rather incoherent institution, with a multiplicity of views, attitudes, opinions and so on.) I gave a thumbnail sketch of QE in my November global round-up, as follows,

- in its purest form (i.e., asset purchases from domestic private sector non-banks financed by bank borrowing), QE adds pound for pound, dollar for dollar, and euro for euro to the quantity of money, and
- over the medium and long runs an *x*% rise in the quantity of money raises equilibrium national income (and national wealth *and hence asset prices*) by a more or less identical *x*%.

Although the details can be complex, the essence of QE's impact on money and the economy is as simple as that. But – unbelievably – the Fed stopped preparing data for M3 in February 2006, even though it is a broad money measure that is mostly relevant to macroeconomic analysis. (In my latest video, I do indeed use M3 – as calculated by the US research company, Shadow Government Statistics – to make statements about the connection between QE and the cyclical course of the American economy in the last few years.)

However, I am fairly confident that US money growth will be moderate (at about 5% a year) in 2016 and am sanguine that domestic demand in the world's largest economy will grow at a trend or above-trend rate. The numbers must be watched month by month.

15th January, 2016

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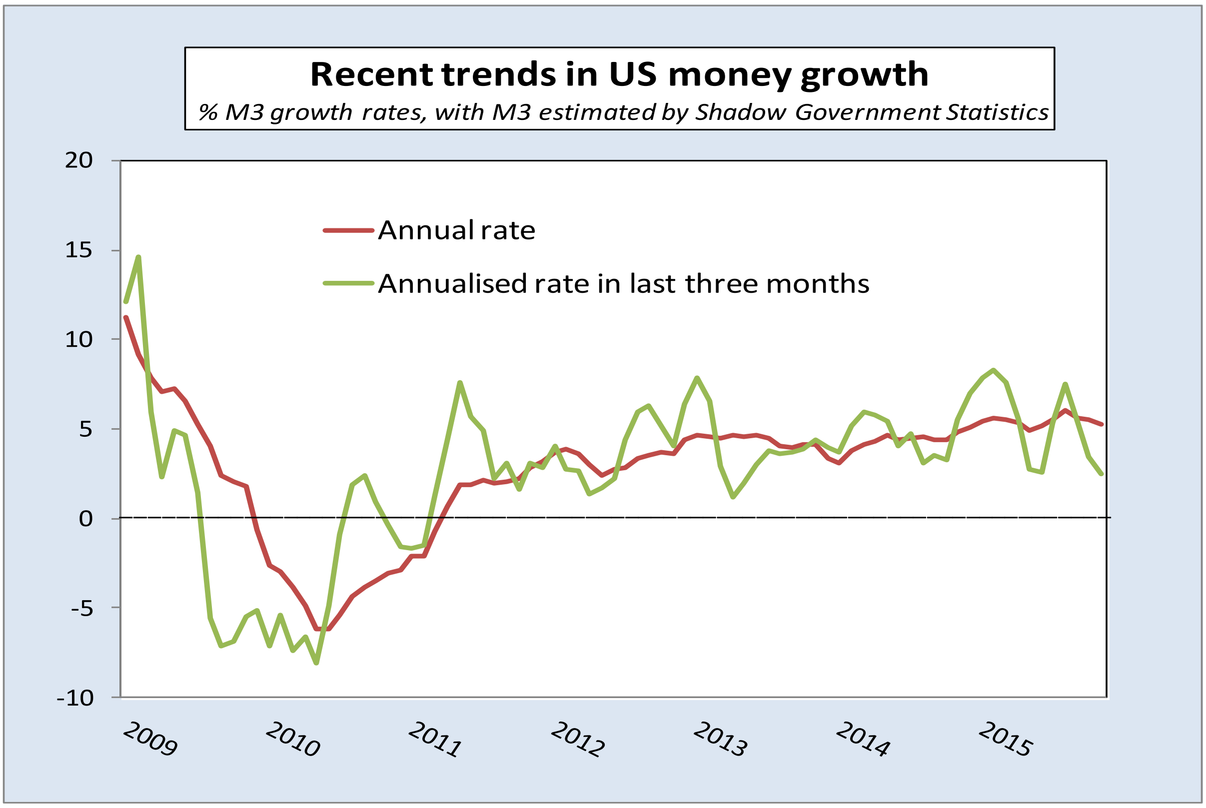
USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1960 - 2014	7.6	6.7
Four years to 2014	4.0	3.9
Year to December 2015	4.5	n.a
Three months to December 2015 at annualised rate	2.6	n.a.

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



M3 growth slows as Fed fund rate rises

Summary: **In the three months to December 2015 US M3 grew at an annualised rate of 2.6%, down from the 3.4% annualised growth recorded in October and the lowest three-month growth rate since May 2013. Annual M3 growth fell from 5.5% in November to 4.5%, in December, a figure which – with the annual inflation running at not much more than zero – is still positive for economic activity, but not by a wide margin. (Note that the M3 data used in this note are from the Shadow Government Statistics research company.)**

The drop in M3 in December followed two positive months and another drop in September of some $28b. The fall in December, like that in September, was due primarily to the redemption of a chunk of the assets acquired by the Fed in its QE programmes. (When a company redeems a maturing security in the hands of its bank, it pays a sum from its bank deposit, which disappears from the economy. So the quantity of money falls.) In October the Fed purchased assets on a big scale. However, concerns about premature "quantitative tightening" – which were expressed in our September commentary – have to be expressed. Banks' cash assets have fallen in recent months. They were almost $3,000b. in October 2014 and still averaged $2,759b. in October 2015, but on 30th December they had dropped to $2,454.8b. The explanation may be the bunching of redemptions of securities with end-year maturity dates, implying that the Fed will make large offsetting purchases in January and February. However, if we take the average level of banks' cash reserves over, say, the six months to February 2016, it will almost certainly be the case that this average is lower – by a few hundred billion dollars – that in late 2014. In that sense the Fed has allowed QT, the opposite of QE, to happen.

With bank credit to the private sector growing somewhat more quickly than broad money, it must be the behaviour of some other asset (i.e., cash, most obviously) that is damping down money growth. For the record, "loans and leases in bank credit" – a category in the US data which roughly corresponds with bank lending to the private sector in the UK – rose in November by over 0.7%, equivalent to an annualised rate of 8.8%, up on October's figure of 8.3%. Preliminary figures for December suggest that the figure for the final month of the year will be higher.

With the US unemployment rate down to 5%, the recent rise in Fed funds rate had an obvious justification in labour market conditions. Any Fed QT will restrain the US economy somewhat in 2016. The strong dollar is already a constraint on manufacturing.

Tim Congdon
11th January, 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 2014	**4.0**	**3.9**

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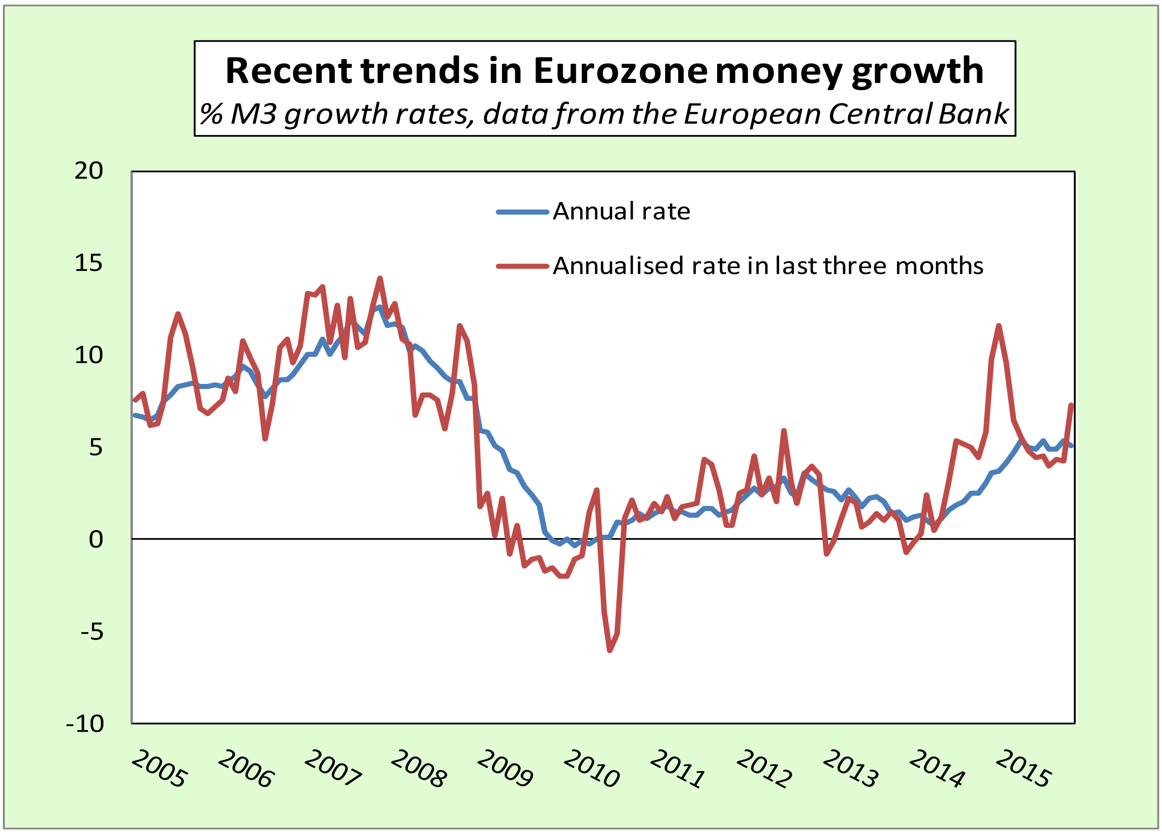
Eurozone/Euroland

	% annual/annualised growth rate:	
	M3	Nominal GDP
1995 – 2014	**5.3**	**3.1**
Four years to 2014	**2.6**	**1.3**
Year to November 2015	**5.1**	**n/a**
Three months to November 2015 at annualised rate	**7.2**	**n/a**

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



Money growth picks up in November

***Summary*: In the three months to November 2015 M3 in the Eurozone grew at an annual rate of 7.2%, a notable increase on the 4.3% recorded in the three months to both September and October. In October and November, the quantity of money rose by €76 billion and €61 respectively, up on September's €27 billion. The European Central Bank's "quantitative easing" programme has undoubtedly made a difference to broad money growth in the Eurozone. After a brief slowdown in the late spring and summer, such growth has now returned to the levels recorded at the beginning of the asset purchase scheme, where growth averaged more than €50 billion per month.**

In December, as widely expected, the ECB decided to extend its QE programme by a further six months, so it will now run until March 2017. The scale of the monthly asset purchases was, however, left unchanged at €60 billion. Broad money is now growing at a satisfactory rate, but it has taken several months of asset purchases to reach this point. The key influence restraining money growth was the weakness of bank credit to the private sector. As recently as September "credit to other (i.e., non-government or private sector) euro area residents" fell by an alarming €30 billion. The last two months have seen bank credit to the private sector increase by €28 billion and €18 billion respectively. The demand for loans from households and businesses has increased, although the overall annual growth rates for both remain below 2%.

December's inflation data have already appeared. The annual change in consumer prices across the 19-nation bloc has now been positive for each of the last three months. (In 2015 overall consumer prices rose by 0.2%.) Very few countries are still experiencing deflation. QE boosts the quantity of money relative to what it would otherwise have been, and over the medium and long runs the rate of change in prices depends on the excess of money growth over the growth in output. However, QE is unlikely to have an identifiable impact on inflation in a period of less than a year or two.

The ECB is doing the right thing, with its focus on broad money and purchases of securities from domestic non-banks (as well as banks and the foreign sector), but the effect on asset prices, balance sheets and demand will come through earlier than those on inflation. Furthermore, with world commodity prices showing little imminent sign of upward pressures, Mario Draghi's target of restoring inflation to the official ECB target of "just below" 2% looks unlikely to be achieved in 2016. Nonetheless, Eurozone broad money growth is now running at a healthy and sensible level. Banks remain vulnerable in countries like Greece, Cyprus and Portugal, and tighter bank regulation is another threat to moderate money and credit growth. On balance, however, the macroeconomic prospects for Europe's single currency look better now than at any time in the last five to six years.

John Petley
6th January, 2016

	% 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 October 2015	**13.2**	**n/a**
Three months to October 2015 at annualised rate	**8.3**	**n/a**

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

M2 growth slowing in October, after which....?

***Summary*: Chinese M2 grew by 8.3% in the three months to October, sharply down from the 18.6% in the third quarter of the year. After three months where the annualised quarterly growth rate, seasonally adjusted, had been 18.5% or higher, broad money growth slowed sharply in October. The People's Bank of China has not posted any further money update for over a month and a half. Before the October figures it appeared that money growth might be returning to stronger levels, ending the steady decline it had experienced in the preceding three years. The lack of a more recent update is frustrating given the turmoil in the Chinese stock markets in the first full week of 2016 trading.**

Last August stock market turbulence was countered by the PBOC making substantial loans to state-owned brokerages such as the China Securities Finance Corporation. The money was used to fund purchases of equities. Newspaper reports suggest that precisely the same thing has happened in the last week or two. The Chinese authorities are determined to preserve social stability, with avoidance of a recession a key element in their strategy. Whenever equities are bought from non-banks, the result is an exactly equivalent increase in broad money. It is therefore probable that M2 growth may pick up at the start of 2016. However, the details of the dip in the final months of 2015 cannot be known in the absence of further data from the PBOC.

The second half of 2015 saw the government continue in its attempts to rein in the shadow banking sector, although trying to avoid a collapse in bank lending. A regulatory attack on banks – even on shadow banks – is deflationary in its wider macroeconomic effects. Against that, October saw the prime lending rate cut for the fifth time, to a record low of 4.35%. Further, the government set its annual inflation target at 3% for the year, which implied policy loosening. The inflation rate had consistently undershot the target throughout the year and stood at 1.5% in November. Indeed, producer price inflation has now been negative for almost four years, with factory gate prices down by 5.9% in the year to November, the fourth consecutive month at this level. The rate cuts had the desired effect of reviving the flagging housing market, which had seen prices falling for much of the year. Although November was only the second month in 2015 of overall average house prices rises in China's 70 major cities, Shanghai saw a year-on-year price increase of 13.1%.

Although critical monetary data are not available, their very absence suggests that for all the powers at the government's disposal, a "hard landing" for China's economy cannot be ruled out. Further monetary easing remains a possibility with inflation so low. The leadership seems ready to weaken the yuan, possibly to bring five months of declining exports to an end. A larger tension arises from the ambition to liberalise markets, while seeking to maintain a tight control in many other aspects of the nation's life. The money figures in coming months will provide a guide to the short-term outlook for macroeconomic stabilization.

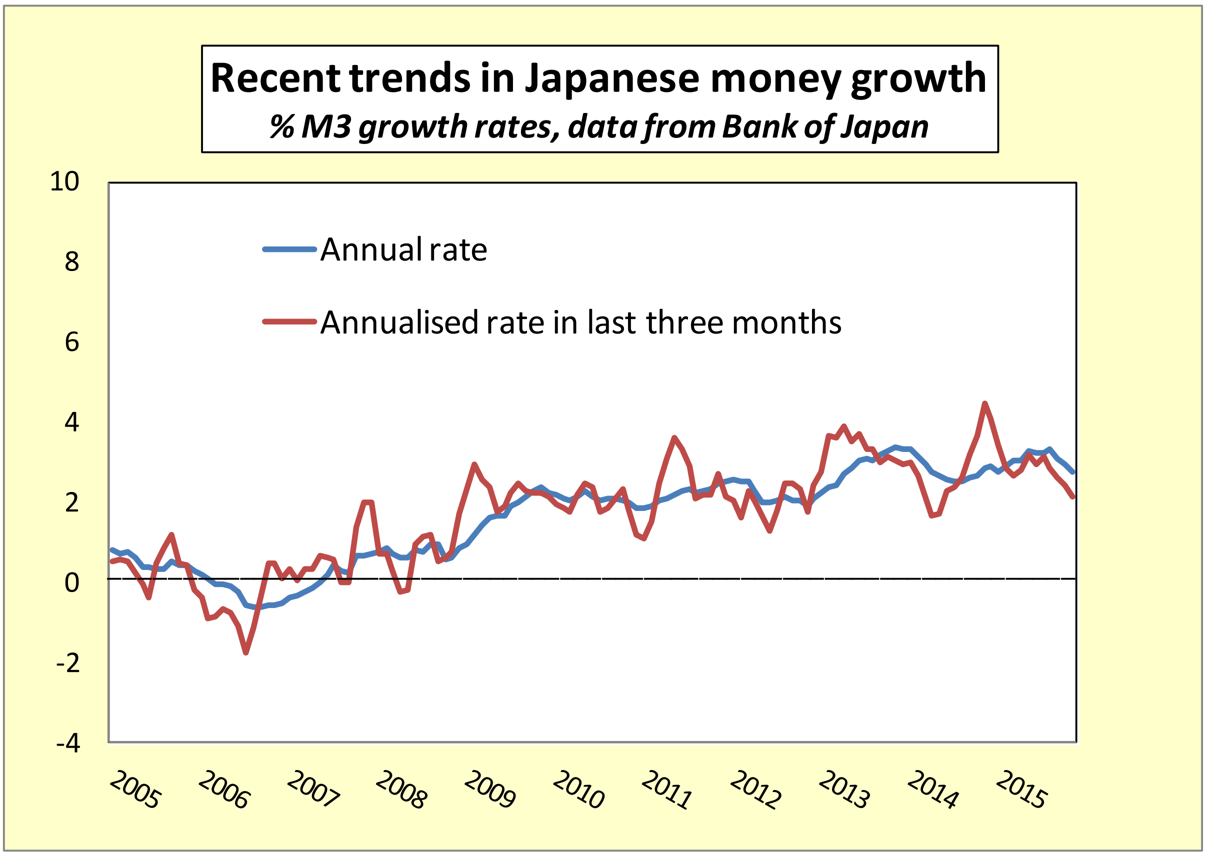
John Petley
8th January, 2016

	% 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 November 2015	**2.8**	**n/a**
Three months to November 2015 at annualised rate	**2.2**	**n/a**

Sources: Bank of Japan for M3 and IMF for GDP



Broad money growth slows further

Summary: **In the three months to November 2015 Japanese M3 grew at an annualised rate of 2.2%. This is a further decline on the 2.4% recorded in the three months to October and the lowest three-month growth rate for 18 months. At the end of 2014 annualised quarterly growth stood at about 4%. The highest figure recorded this year so far has been 3.4% in January and the growth rate has fallen in each of the last four months. The flaws in the so-called 'quantitative and qualitative easing' launched by the Bank of Japan in April 2013 have been much discussed, but it did raise broad money growth a bit, perhaps by 1% - 1½% a year. Even that effect is now fading from the figures.**

The recent QQE programme seems, like a precursor in the years from 2001 to 2006, to be failing to restore Japan's stagnant economy to growth. The BOJ focus in their QQE announcements have been on the monetary base and bank credit, not on the quantity of money, broadly-defined. But any unbiased observer can see from the evidence that broadly-defined money is the relevant aggregate to the determination of Japan's national income and output in nominal terms, just as it is in all countries.

After the 2001 – 06 QQE exercise Japan remained trapped in deflation. The current QQE programme was to bring deflation to an end. As recently as 21st July last year, the BOJ's Governor Kuroda stated that he expected inflation to pick up during the rest of the year, and thus saw no need to increase the QE programme or otherwise to alter monetary policy. His forecast was incorrect. Once the effects of April 2014's 3% hike in the sales tax had worked its way through the figures, the annual consumer price inflation rate drifted downwards from 0.6% in April to zero in September.

Japanese bank lending has been unresponsive to the excessive bank cash reserves created by the QQE operations. Throughout the programme Japanese banks have been sitting on their greatly-increased additional cash assets. The stock of bank lending was growing at an annualised rate of about 2% until October 2014. The following month, the growth rate shot up to 2.7%, but it has not yet improved on this figure, standing at 2.5% in the year to October 2015. Neither businesses nor households seem to be showing any increased appetite for risk, in spite of the accommodative monetary environment. In the summer there had been an increase in the number of housing starts, but the growth rate turned negative by October. The money numbers do not suggest any improvement in Japan's lacklustre economy into 2016. The BOJ's QQE programme has become a textbook illustration of the irrelevance of the monetary base *by itself* to the wider economy.

John Petley
22nd December, 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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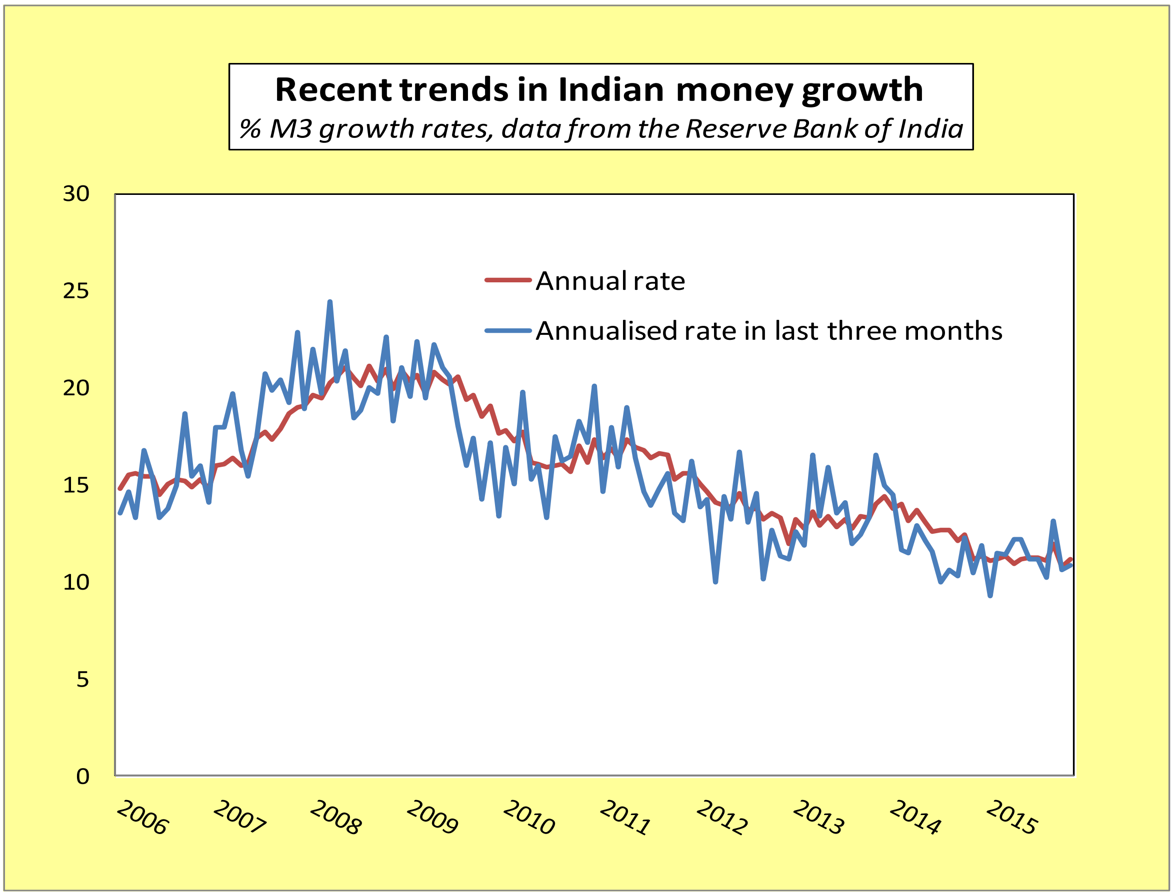
India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1991- 2014	**16.5**	**13.8**
2010 - 2014	**14.2**	**14.4**
Year to November 2015	**11.2**	**n/a**
Three months to November 2015 at annualised rate	**10.8**	**n/a**

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



M3 growth stable

Summary: **In the three months to November 2015 Indian M3 grew at an annualised rate of 10.8%, a slight increase on the 10.6% recorded in the three months to October. The annual growth rate stood at 11.2%, a modest increase on the 10.8% recorded October but identical to the annual growth rate recorded in four other months so far this year. Apart from September, both the annualised quarterly and annual growth rates during the past year have been stable, fluctuating within very narrow bands. As the graph above shows, this new norm for Indian M3 growth is down on the levels seen in 2013 and 2014. When coupled with relatively low inflation by recent Indian standards, the overall picture is one of healthy growth of real, inflation-adjusted money.**

Annual consumer price inflation has actually risen for four consecutive months after falling as low as 3.7% in July. In November it stood at 5.4%. This is nonetheless still well down on the 8% annual CPI which was the norm less than two years ago. The adverse numbers have been largely driven by higher food prices, reflecting a poor monsoon. However, neither this nor the recent weakening of the rupee by some 5% (from around Rs. 64 to over Rs. 67 to the USD) since August look likely to stoke inflation to the levels seen in 2013. Furthermore, producer prices have been falling sharply in India for over a year. That has led to a major debate about the significance of different price indices.

Having made four reductions to the benchmark interest rate in the space of a year, the Reserve Bank of India appears to be under little pressure to ease rates further, especially given the uptick in inflation since the most recent rate cut in September. The most recent data from the banks indicate that this monetary loosening has had a positive effect on their growth prospects. Deposit growth, which stood at 10.7% in the year to September, increased to 11.5% in the final quarter, according to provisional figures from the RBI. The annual rise in the stock of bank lending has also picked up a little. In June it fell to 9.3%, its lowest level in three years. Since then it has recovered gradually, rising to over 11% by the beginning of December. This is still down on the annual 14% loan growth recorded as recently as February 2014. An end-June report by the RBI attributed the slowdown in lending on the high levels of debt already incurred by large Indian companies. Non-performing loans remain a cause for concern, however, with some estimates suggesting they amount to over 11% of total bank lending.

The money figures are consistent with a respectable level of growth for India's economy in 2015 and early 2016. 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.

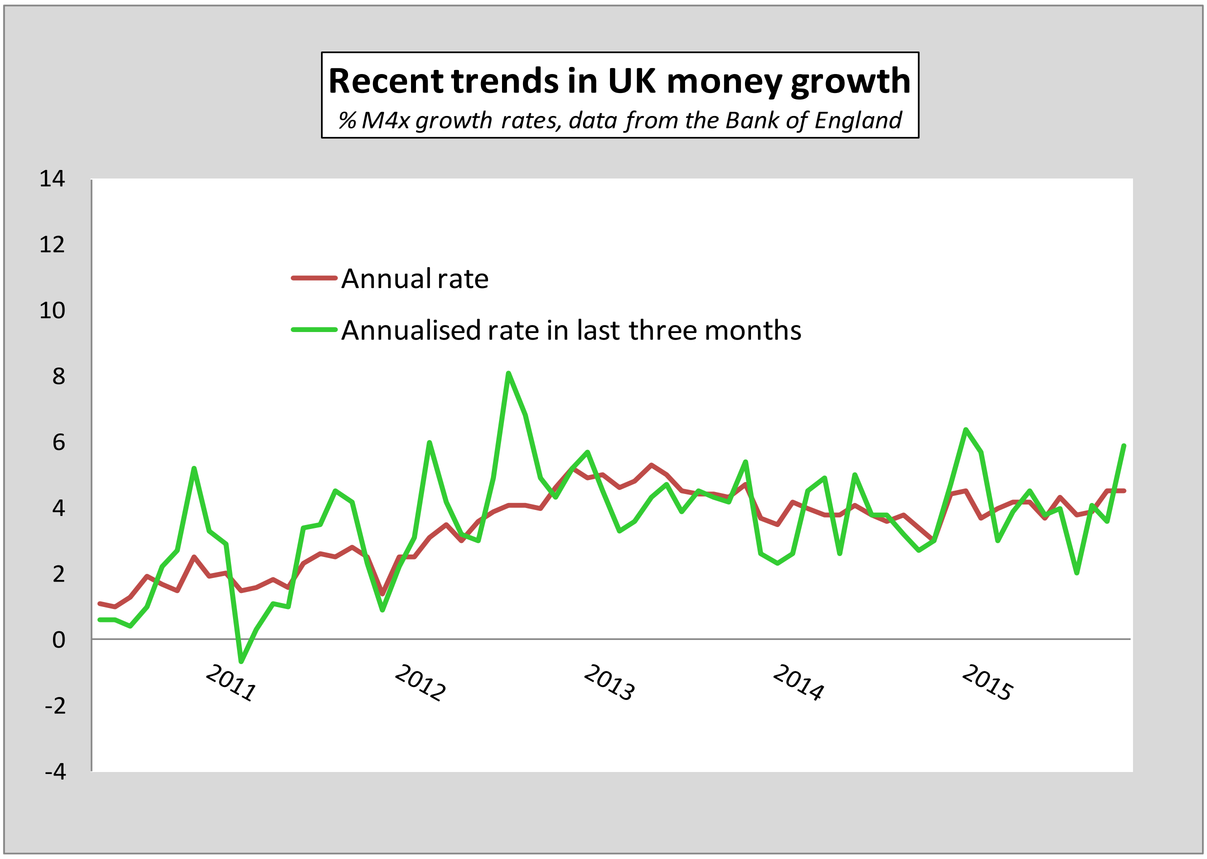
John Petley
11th November, 2015

	% 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 November 2015	**4.5**	**n/a**
Three months to November 2015 at annualised rate	**5.9**	**n/a**

Sources: Bank of England and Office for National Statistics.



Money growth picks up, but no interest rate rise imminent

***Summary*: In the three months to November 2015 the annualised rate of broad money growth rose to 5.9%, up from the 3.6% recorded in the three months to October. In October and November M4x increased by £7.1b. and £6b. respectively, less than the £12.8b. rise in September. After dipping in June and August, annualised quarterly growth rate is now back to – perhaps a little above – a level that might reasonably be associated with a 2% inflation target.**

Over the last five years the annual growth rate of the quantity of money, broadly-defined, has been consistently between 1% and 5%, apart from December 2012 and May 2013 when it rose above 5% for a month or two. The monetarist argument has always been that, if money growth were kept at a low and stable rate over the medium term, inflation would remain under control, and demand and output growth would be steady. It is thus not surprising that the increase in the consumer price index has remained below 5% since August 2011 and has not risen above 2% since the start of 2014. In fact, the last few years have seen the lowest increases in both nominal GDP and the price level, over a sustained period, since the 1930s. The weak money figures have also been fitted with a sluggish recovery from the Great Recession, although the underlying supply-side performance of the economy has been disappointing.

Growth of money depends on banks' ability to acquire assets, which usually means the ability to extend loans to the private sector. In late 2015 lending to businesses and financial institutions was on a downward trend, as it had been done for much of the year. George Osborne announced an increase on the tax to be paid by smaller banks from 2016 onwards in his Autumn Statement, which will eventually act as a further deterrent to bank lending. Only housing finance has shown signs of solid growth, with the stock of mortgage lending growing at an annualised rate of 3.5% in the three months to November, up a tad from 2.9% in the three months to August. The number of mortgage approvals rose from 61,100 in January to 70,410 in November, an increase of over 15%.

Monetary indicators suggest that the recovery will continue into 2016. The recent slight acceleration in money growth is not yet sufficiently meaningful to claim the recovery will gain momentum. A rise in interest rates is not imminent, but cannot be ruled out later in the year. The rate of unemployment fell steadily through the second half of 2015, from 5.6% in June to 5.2% in October. The Monetary Policy Committee pays more attention to labour market data than to the money supply and it cannot have overlooked that the proportion of working-age people actually in work is now the highest since records began in 1971. The inflation rate stood at only 0.1% in the year to November, while the latest fall in commodity prices has still to work its way through the supply chain. The core inflation rate, excluding food and fuel, has been rising, but still only stood at 1.2% in November.

Tim Congdon and John Petley
11th January, 2016

	% 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**