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Monthly e-mail from Tim Congdon – 28th March, 2017

Global money round-up in early 2017

While the growth of the quantity of money, broadly-defined, determines the growth of nominal GDP in the long run, leading indicator indices and business surveys are better guides to the short-run behaviour of the economy. At present LLIs and business surveys are giving a positive, or even very positive, message about 2017. It has to be said that monetary trends are more mixed and less enthusiastic. Two big countries have less than encouraging news. In the USA broad money growth has slowed since last August, with a recent dip in new bank credit to the private sector worth mentioning. (This dip may be related to another round of regulatory tightening, even though one of President Trump's priorities is supposed to be a relaxation of financial regulation.) In India the withdrawal of 500 and 1,000 rupee notes from circulation has been negative for short-term economic activity, whatever the long-term case for stamping out "black" transactions.

Elsewhere the situation is more satisfactory. The consensus is increasingly that the Eurozone's "quantitative easing" programme has been a success, not just in ending deflation but also in facilitating a period of mildly above-trend growth. Although the European Central Bank's asset purchases may be trimmed this year, an approximate 5% broad money growth rate is now being recorded and is perfect as a moderate monetary stimulus. In recent quarters Japan has had the highest broad money growth rate for many years, although it is only in the 3½% - 4% range. China has announced a broad money target for 2017 a mere 1% down on the 2016 figure and ought to be able to meet it. In the UK money growth has fallen back sharply from the extraordinarily high rates of mid-2016. Overall the verdict must be a steady year for the world economy, with underlying inflation still weak despite the impact of higher oil prices on headline price indices.

Money trends at the start of 2017 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. It is much the same as the late February 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	**2.3**	**3.1**	Money growth weak, Trump boom in 2017 unlikely.
China	16.9	**11.3**	**11.3**	Money growth at moderate rate in stable context.
Eurozone	11.9	**4.9**	**7.5**	Money growth back up to ideal 5% annual rate, after downward blip in autumn.
India	7.1	**-4.1**	**6.3**	Attack on cash 'black economy' mishandled, adverse short-term effect on growth.
Japan	4.3	**3.7**	**3.6**	Broad money growth moderate.
UK	2.3	**1.8**	**6.6**	Money jump due to misjudged post-Brexit QE may be fading.

Talk of a strong global economy in 2017 is starting to fade, although – it must be emphasized – money trends generally are satisfactory. Conjectures about a boom are misplaced, while alarmism about a bust is unjustified. The prospect is for another year of steady growth with weak underlying inflation pressures, even if the oil price rise is giving an upward nudge to overall price indices at present.

An emerging feature is increasing reportage and comment on the slowdown in bank credit growth in the USA. (See, for example, Ambrose Evans-Pritchard 'Sudden drop in US lending brings fears of new slump', in *The Daily Telegraph* of 27th March. The text of the story is more sensible than the headline, with its silly reference to a "slump".) Forecasts of first-quarter growth (at an annualised rate) in the USA are being reduced from 3% to 1%, which will reduce the base level for subsequent quarters and make it difficult for 2017 to be a particularly buoyant year for growth. Excitement about the "Trump boom" is yesterday's story.

Another major monetary negative for the world outlook are the implications through 2017 of the shock de-monetisation measures in India. In its October 2016 *World Economic Outlook* the International Monetary Fund envisaged growth of gross domestic product running at 7.6% in 2017, after the same figure in both 2015 and 2016. But the 500 and 1,000 rupee notes were withdrawn in

November, and have caused much dislocation, as well as a dip in money growth and a reverse for the economy. In January the IMF issued a new analysis, proposing 2017 growth of 6.6% instead of 7.6%. It does indeed seem to the case that some “black economy” money-holders splurged (on other stores of value, gold, diamonds and the like) in the final days of the legal validity of the 500 and 1,000 rupee notes, and that would have been helpful for the economy for some period. Nevertheless, broad money growth has fallen.

If anything, the balance of positive cyclical news is moving towards the Eurozone, where (as I suggested in my commentary last month) it is now widely accepted that the European Central Bank’s “quantitative easing” programme has been a success. In Japan broad money growth – on both annual and three-month annualised bases – remains at under 4%. But money growth has been so weak for the last 20 years that these are among the highest money growth rates for a generation! The Chinese authorities have announced for 2017 a broad money target that is 1% down (at 12%) on the 2016 number. This is evidently a slight tightening of policy, but hardly amounts to a revolution.

As noted here last month, in 2015 national output fell by 3.8% in Brazil and 3.7% in Russia, and in 2016 it went down by 3.3% in Brazil and 0.8% in Russia. Negative and exceptional supply-side shocks (the Petrobras scandal in Brazil, international sanctions on Russia after the invasion of the Ukraine) were to blame. The impact was to take 0.4% off global growth in 2015 and 0.2% in 2016. Both economies are expected to return to growth in 2017, and that is one reason that most projections are for higher world growth this year.

Overall the prospect is for steady, roughly trend growth (3% - 3½%) of the world economy in 2017, and there is – as yet – no obvious reason for taking a different view of 2018.

28th March, 2017

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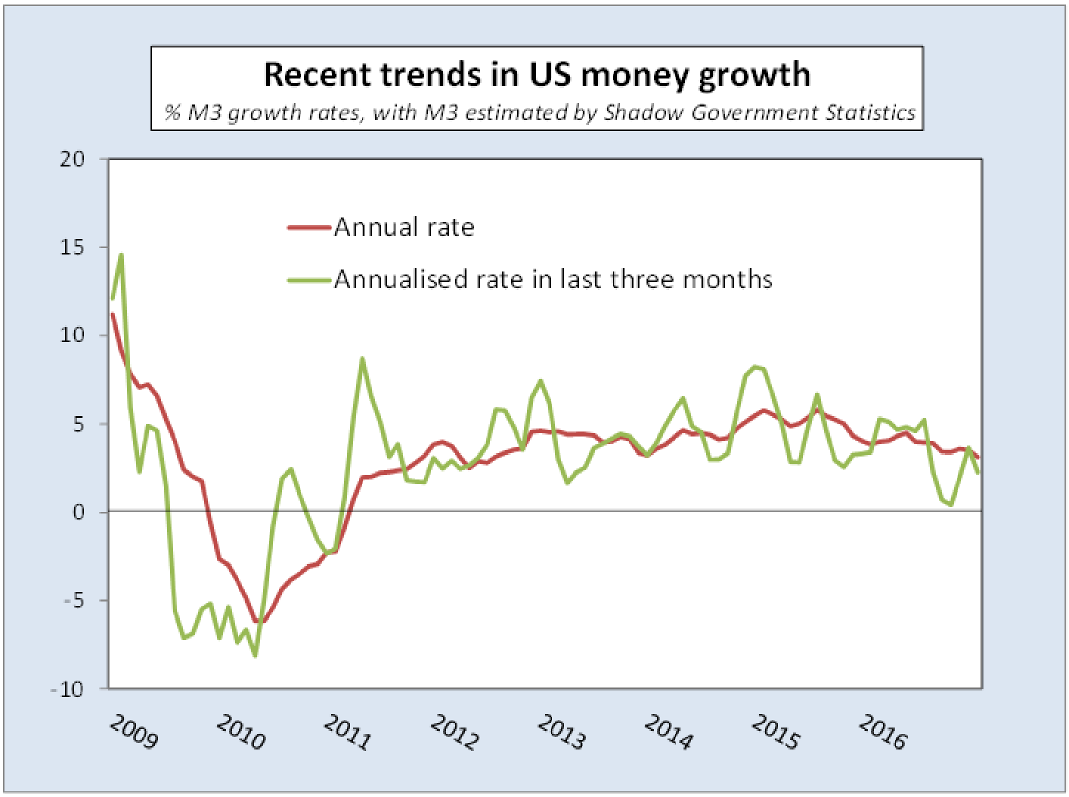
USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1959 - 2016	**7.4**	**6.6**
Four years to 2016	**3.2**	**3.5 ***
Year to February 2017	**3.1**	**n.a**
Three months to February 2017 at annualised rate	**2.3**	**n.a.**

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



M3 growth still weak, now due to feeble bank credit to the private sector

Summary: **In the three months to February 2017, US M3 grew at an annualised rate of 2.3%. Sluggish money growth has now persisted for six months. (In the six months from August 2016, M3 rose by just over 0.6% or at an annualised rate of 1.3%; in the preceding six month it advanced at an annualised rate of 5.0%.) With energy prices moving up after the OPEC deal at end-2016, the increase in *real* broad money (i.e., after inflation adjustment) has been virtually nil since last summer. This weakness implies that 2017 will not see a "Trump boom". The money slowdown is partly due to less new bank credit to the private sector than in 2015 or early 2016. (Our M3 data in this note are sourced from the Shadow Government Statistics research company.)**

The stock of "Loans and leases in bank credit" (a category which roughly corresponds to bank credit to the private sector) increased at an annualised rate of 6.8% in 2014, 7.8% in 2015 and 6.8% in the first three quarters of 2016. As new bank loans are associated with the creation of bank deposits, the buoyancy of bank credit was the key reason for the reasonably high rate of money growth in the same period. But since November US banks have *reduced* their "loans and leases" assets. This may be a blip, but it may reflect a new round of regulatory tightening by the Fed and other agencies.

At any rate, in the latest few months it has been the apparent pause in banks' credit extension that lies behind slow money growth. This contrasts with the pattern in autumn 2016 when a dip in money growth was mostly due to the Fed's preparedness to let its QE-related bond portfolio run off as the bonds matured. (The Fed's practice was called "quantitative tightening" in these notes.) The important wider point is that the US economy has now had weak money growth for a period sufficiently long to affect macroeconomic outcomes. A check to the economy is made all the more plausible by the current rise in inflation, related to the resurgence in oil prices as OPEC's production cutbacks take effect. In the long run the growth rates of real money and real output are closely aligned in most economies, so that a neutral annual rate of real broad money growth in the USA is 2% - 3%. In early 2016, with annual M3 growth heading towards 5% and negligible inflation, real money growth was rising at an annual rate of 5%. Now real money is flat. Normally asset price adjustments are a vital element in the transmission mechanism. On the face of it, the strength of the US stock market so far in 2017 is at variance with the monetary trends.

The position may change radically if President Trump delivers the repeal of the Dodd-Frank Act and a major reversal of the regulatory tightening which has marked the post-Great Recession years. But nothing substantive has happened as yet on this front.

Tim Congdon
22nd March, 2017

	% 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**

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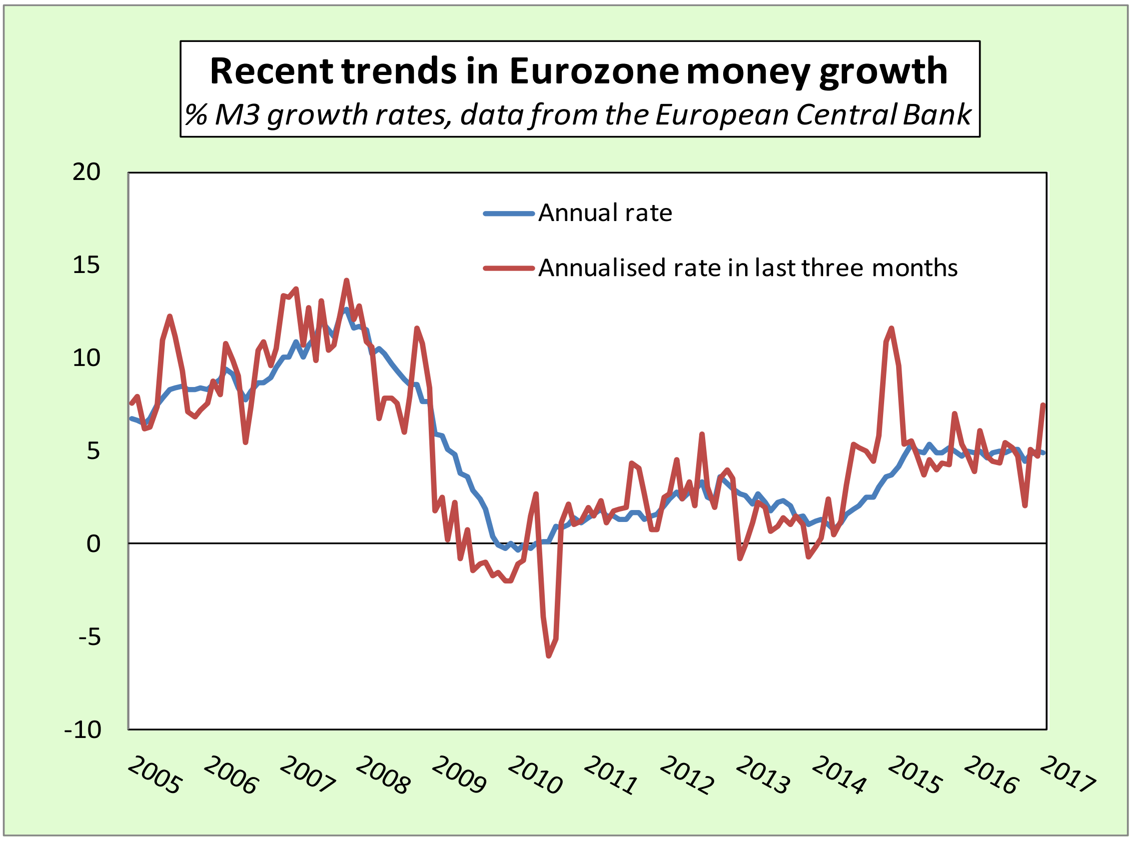
Eurozone/Euroland

	% annual/annualised growth rate:	
	M3	Nominal GDP
1995 – 2015	**5.3**	**3.1**
Five years to 2015	**3.0**	**1.6**
Year to January 2017	**4.9**	**n/a**
Three months to January 2017 at annualised rate	**7.5**	**n/a**

Sources: European Central Bank and Institute of International Monetary Research estimates



Money growth rises – as does inflation

***Summary*: In the three months to January 2017, the Eurozone's M3 money measure grew at an annualised rate of 7.5%, the highest rate for two years and up on the 4.7% in the final three months of 2016. This rise in the growth rate is a result of M3 growing by €67b. in January as opposed to €31b. the previous month. The single currency area begins 2017 with annual broad money growth very close to the 5% figure that, almost certainly, was intended when the "quantitative easing" programme began two years ago. It appears that October's disappointing M3 increase of only €9b. (and a fall in the quantity of broad money in Germany) were nothing more than a blip. The ECB's QE programme continues to strengthen asset prices and balance sheets, and so to boost aggregate demand. The annual rate of money growth under QE has been well ahead the 2% average during the 2009-2013 period.**

With the first February inflation figures being posted at time of writing, the QE programme can now be said to have achieved its prime objective when it began in early 2015. This was to defeat fears of chronic deflation, and to boost inflation to the official target of 2% or just below. Consumer prices across the bloc as a whole rose by a full 2.0% in the year to February, which – if anything – is above the target rate. Some countries' annual inflation rates are significantly higher. For example, Spain's and Belgium's numbers both stand at 3.0%. Also significant is how quickly inflation is rising in some countries. Italy's annual inflation rate was negative as recently as October 2016. Four months later, it had risen to 1.5%.

With inflation rising, doubts have been raised about whether the QE programme ought to be further extended. On current plans, March is the final month before the asset purchases are scaled back from €80b. to €60b, per month, while the programme is scheduled to wind up at the end of 2017. Much depends on whether broad money growth can be sustained at an annual rate of about 3% - 4% without QE. Crucial will be whether bank lending to the private sector starts to revive at current interest rates.

Mario Draghi, the ECB President, is not pushing for any speedy monetary tightening. The rise in inflation and broad money has not been accompanied by any significant increase in the stock of bank lending. Mortgage lending continues to grow steadily, with the annual rate of 2.7% in January unchanged from December. But bank lending to business is still rather sluggish, with the annual growth rate falling from 1.9% in December to 1.7% in January. Political jitters, especially the upcoming elections in France and Italy, may have dampened business sentiment, even if the likelihood of an anti-establishment party gaining overall power looks remote. Concerns about Greece remain, but the Eurozone economy is strong enough to contain any shocks from what is, at the end of the day, a fairly minor player. While a political upheaval cannot be totally ruled out, monetary trends are consistent with a stable, even positive macroeconomic outlook.

John Petley
6th March, 2017

	% 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**

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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 January 2017	**11.3**	**n/a**
Three months to January 2017 at annualised rate	**11.3**	**n/a**

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

Broad money growth continues at a respectable level

***Summary*: In the three months to January 2017 China's M2 expanded by 2.8% or at an annualised rate of 11.3%. This is a respectable figure, roughly in line with on the 11.7% recorded in the final quarter of 2016. The Chinese authorities have set a target of 12% annual broad money growth for 2017, down from 2016's 13% target and will not be too worried about a modest undershoot.**

An un-named government source told Reuters "A money supply rise of 11% should be enough for supporting growth, but we probably need to have some extra space, considering risks in the process of deleveraging." January's annual broad money growth rate of 11.3% will therefore raise no concern in Beijing. The Chinese government is reportedly more concerned about containing debt levels than seeking growth at any cost. (It should be emphasized that the foreign commentariat's hullabaloo about Chinese internal debt is hardly justified by the facts.)

GDP growth for 2016 stood at 6.7%, down on 2015's figure of 6.9% and the lowest in over 25 years. The government's target for 2017 is lower still at 6.5%, again consistent with its desire to check the supposedly excessive growth of credit and debt. There has been no change in interest rates in over a year, although the People's Bank of China (the central bank) raised the interest rate it charges on short-term open market operations by 0.1% on 3rd February. The move suggests that the next big change in interest rates, whenever it comes, is likely to be upward. But a change is unlikely any time soon, as the annual rate of consumer price inflation fell sharply from 2.5% in December to 0.8% the following month. The 0.8% figure is the lowest annual inflation rate in two years. The slowing was driven by a fall in food prices and does not necessarily imply that inflation is likely to fall further, especially as prices at the factory gates are rising. After over four years in negative territory, the producer price index rose by 0.1% in September 2016. The annual change in the PPI has been accelerating upwards in subsequent months, reaching 7.8% in February 2017. Such a significant increase suggests that consumer inflation is likely to track upwards later in the year.

In the second half of 2016 the Chinese housing market experienced a continuing boom, while the number of new car registrations also reached record levels. In January the number of new car registrations fell by 17% to 2.2 million and the housing boom showed signs of slowing. In the 70 largest Chinese cities, prices rose on average at an annual rate of 12.2%, down from 12.6% in the year to November 2016. Government-imposed curbs on mortgage lending in 20 cities may be having an effect. The strong housing market indicates underlying domestic confidence in China, despite much foreign disquiet about corruption and authoritarianism. The stock of bank lending rose by 13% in the year to January, the eighth consecutive month it has been within the 12.5%-13.5% band. The Chinese government's determination to preserve stability should ensure that China's current course of lower but steady growth will be maintained.

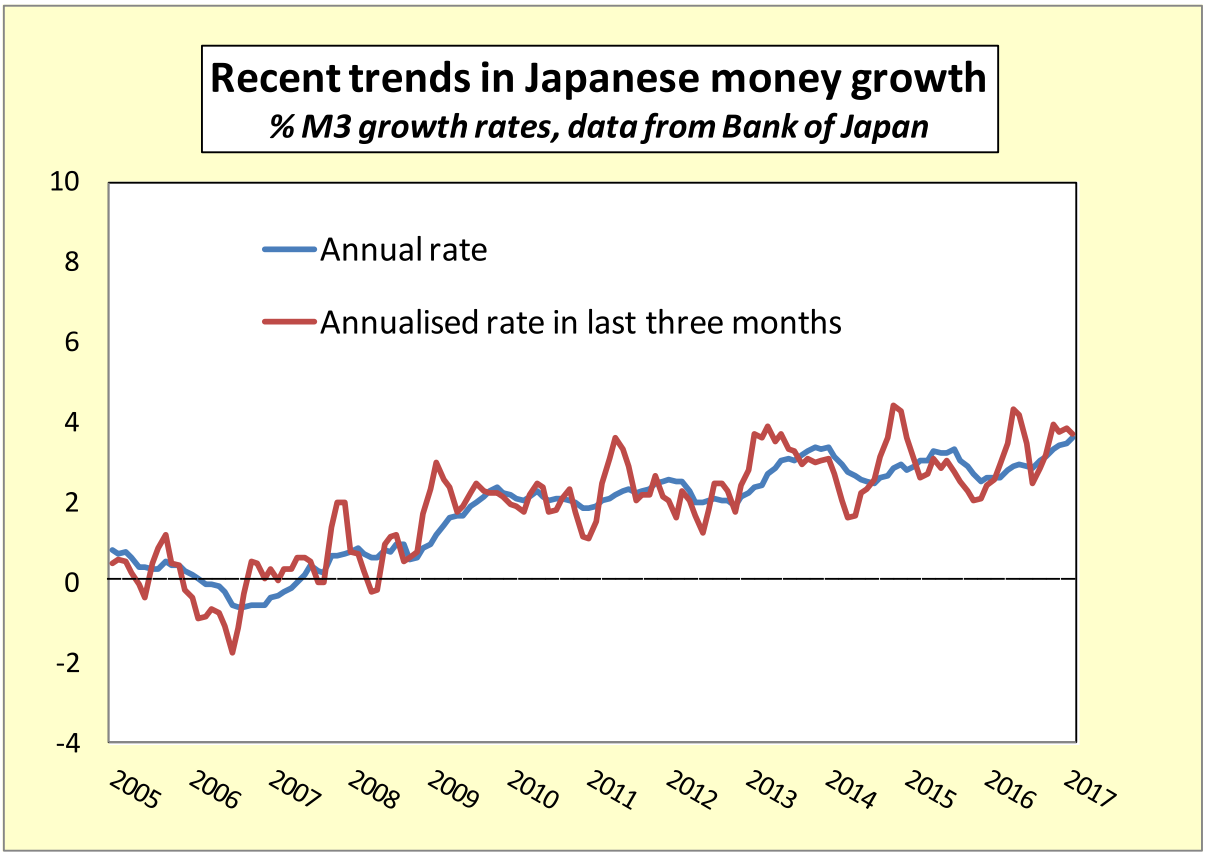
John Petley
10th March, 2017

	% 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
1971- 2015	6.3	4.3
Five years to 2015	2.7	0.4
Year to February 2017	3.6	n/a
Three months to February 2017 at annualised rate	3.7	n/a

Sources: Bank of Japan for M3 and IMF for GDP



Broad money growth improvement continues

Summary: **In February 2017, the annual growth rate of Japanese M3 broad money is – at 3.6% - higher than the average of recent years. Indeed, as the graph above indicates, it is at its highest level in over a decade. Meanwhile the annualised rate of increase in the last three months is a fairly buoyant 3.7%. Even if this represents a slight fall on the 3.8% recorded in the three months to January, by recent Japanese standards both of these figures are positive. The amelioration in the rate of broad money growth reflects the Bank of Japan's asset purchase programme, its so-called "qualitative and quantitative easing". For most of the period since 2010 broad money has increased steadily at an annual rate between 2% and 3½%, but the latest numbers are stronger.**

During 2016 the central bank monthly asset purchases of 80 trillion yen (about $6½b.) continued, supplemented by additional measures seeking to stimulate the economy (and inflation) further. These included "negative interest rates" at the start of the year and "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%) from September. These measures are having a beneficial effect. Not only have the BOJ purchases had a direct effect in increasing the quantity of money, but this has coincided in recent months with an increase in bank lending. The stock of bank loans grew by 2.8% in the year to February, the best figure in over a year. In the first eight months of 2016, the annual growth rate hovered at around 2.0% - 2.2%, but a revival began in October when it rose to 2.4%. Yield curve control will lead to heavy purchases of government bonds from non-banks in early 2017, which will add to money balances, and be helpful for asset markets and economic activity.

In spite of the improvement in activity, the latest minutes from the BOJ's Monetary Policy Committee strike a downbeat tone. The stated objective of the QQE programme is not being met in full. This was to raise inflation well into definitely positive territory. At the close of 2016, annual consumer price inflation stood at a mere 0.3%. In January 2017 the rate rose to 0.4% and the producer prices index turned positive for the first time in 21 months. Even so, the money figures do not point to a significant acceleration in inflation in the short term. All the same, progress has been made and the money trend are compatible with at least trend demand and output growth in 2017.

Japan's economy grew by 1.0% during 2016. Positive net exports were the main driver of GDP growth in the final quarter, aided by a fall in the value of the yen. Domestic consumption remains weak for the moment, although retail sales may at last be improving. Unemployment levels remain static at just over 3% and pay growth is anaemic. The money figures nonetheless suggest that this year could bring a further slow advance to Japan's economy. Certainly, if the three-month annualised rate moves to 5% in the next few months, Japan could surprise on the upside.

John Petley
13th March, 2017

	% 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**

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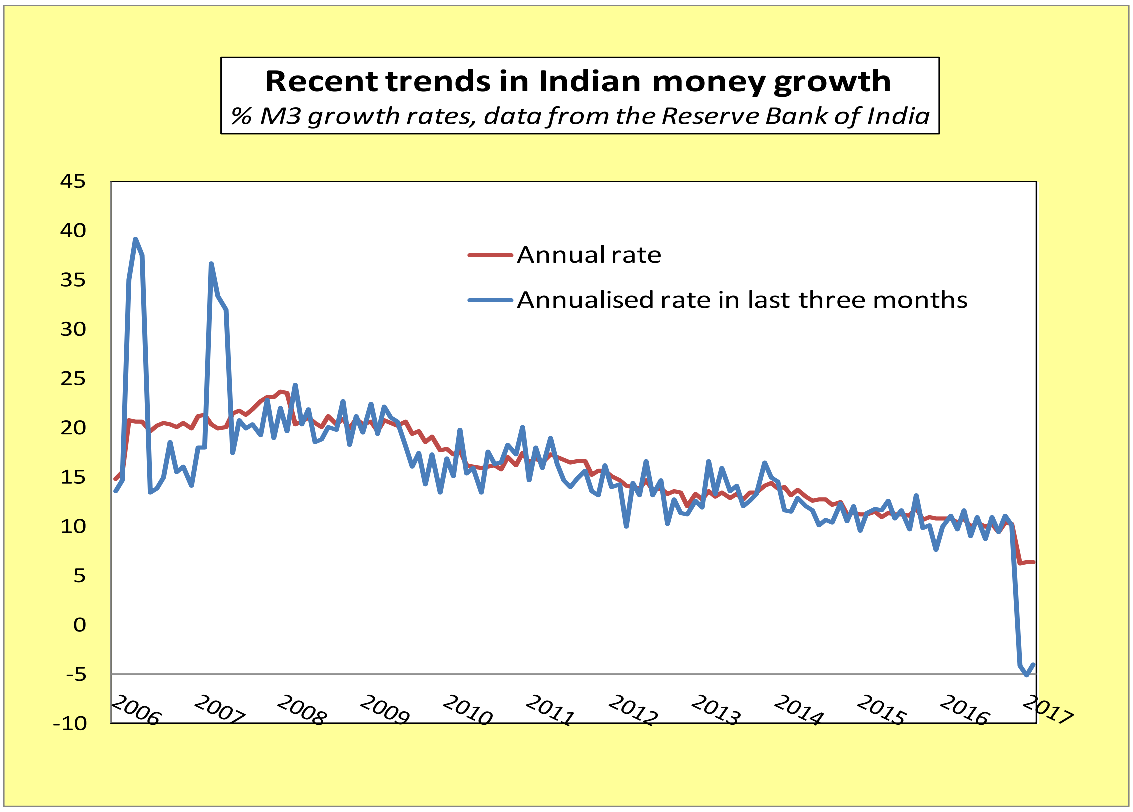
India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1991- 2014	16.5	13.8
2010 - 2014	14.2	14.4
Year to February 2017	6.3	n/a
Three months to February 2017 at annualised rate	-4.1	n/a

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



A protracted recovery from the demonetisation chaos

Summary: **In the three months to February 2017, Indian M3 shrank at an annualised rate of 4.1%. This is an improvement on the 5.1% contraction in the three months to January and came about as a result of unadjusted broad money growing by over Rs. 1,500b. The annual growth rate was unchanged at 6.3%. Next month, the annualised quarterly broad money growth rate will shoot up significantly, as the fall of over Rs. 3,000b in November will drop out of the calculations. The annual growth rate will remain subdued for several more months, however, and the knock-on effects to the India economy may last even longer. The sudden fall in the money supply was caused by the mass withdrawal 500 and 1,000 rupee notes from circulation in November, purportedly to limit tax evasion and corruption in the black economy.**

Indian Government sources claim that demonetisation had little effect on the economy, with consumer spending rising by over 10% in the final quarter of the year. It is possible that quite a few Indian consumers went on a spending binge to rid themselves of the old banknotes before they became worthless. This month's upturn in broad money growth money also suggests that the new notes are being produced somewhat faster than expected, although the February increase in the aggregate was not exceptionally high by recent standards. At this stage it is hard to estimate how much money has been destroyed as a result of the old banknotes becoming completely worthless, but the scale of the drop in the quantity of money points to other issues – such as a shift of quasi-black money out of the banking system into trade credit or other channels – as being partly responsible. A number of individuals have been prosecuted recently for using the old banknotes in illegal transactions.

The demonetisation shambles is not the only problem facing India's economy. The growth in the stock of bank lending has continued to fall. The annual growth rate stood at over 10% as recently as October 2016. By the end of February, this had fallen to 4.8%, the slowest growth rate in at least five years. Deposit growth, which fell in January, continued to fall in the first weeks of February.

The fall in bank lending is linked to the growth of non-performing loans. Sources are not agreed on the percentage of bank loans which may never be repaid. The consensus is a minimum of 10% and rising, with the figure being as high as 20% for some banks. Furthermore, a recent article in *The Economist* claimed that Indian companies are unable to pay the interest on 40% of all loans. The same article also states that the Indian government is planning to create a "bad bank" to take over the banks' bad loans. In this context the lack of appetite for new loans is unsurprising. The RBI made no attempt to stimulate bank lending by cutting interest rates last month, even though annual consumer price inflation rate fell to 3.2%, the lowest number in five years. This fall was driven by a sharp slowdown in food price rises rather than demonetisation. In summary, while the determination of the Indian authorities to clean up the economy is to be commended, the country's short-term macroeconomic prospects look difficult at the moment.

John Petley
10th March, 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**

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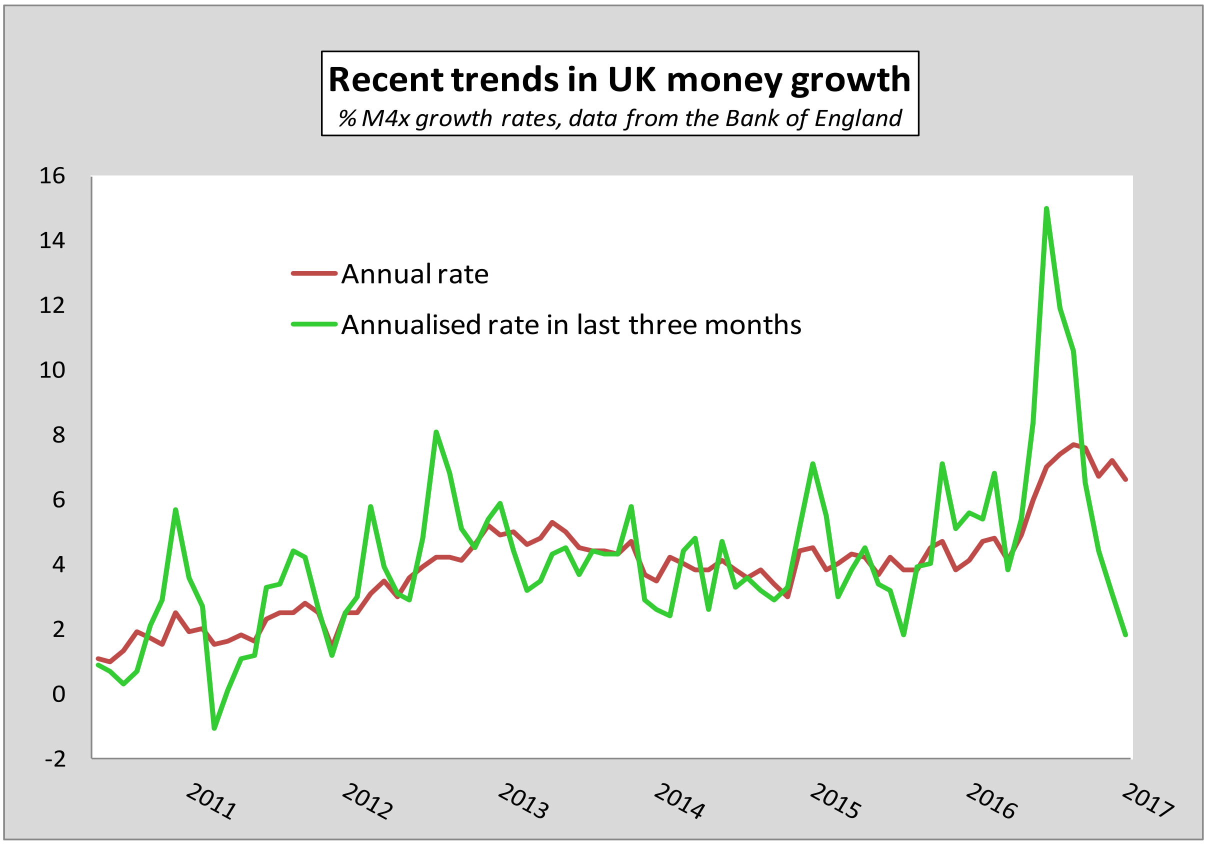
UK

	% 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 January 2017	**6.6**	**n/a**
Three months to January 2017 at annualised rate	**1.8**	**n/a**

Sources: Bank of England and Office for National Statistics.



M4x growth slows, cautioning against too rosy view of 2017 UK economy

Summary: **In the three months to January 2017, UK broad money M4x grew at an annualised rate of 1.8%, the slowest growth rate since August 2017 and a huge fall from the 15% recorded in the three months to July 2016. A fall in M4x of nearly £5b. in November is the main reason for the slower quarterly growth, although January's rise of a mere £2.5b, is also rather disappointing. The annual pace of broad money expansion (still a high 6.6% in January) will return to the typical levels (3% - 5%) seen in the last four years, once the rapid growth between April and July last year drops out of the calculation.**

The UK consumer inflation is rising. January's inflation rate was 1.8%, the highest since June 2014. The figure will increase further. The unnecessary quantitative easing last autumn was one reason for the concurrent fall in the pound, although Brexit took most of the flak. The fall in the pound has contributed to inflation. However, it is striking that prices are rising at a similar rate in the Eurozone, which has not seen such a large and sudden fall in value of its currency. With UK unemployment falling below 5% last May and inflation rising, the argument for raising interest rates has become more persuasive. But the deceleration in money growth evident in the latest data needs to be weighed in the balance too. It is possible that banks are still restricting balance-sheet growth to meet regulatory restrictions, with worries about the implementation of the FRS9 accounting standard being another headache for banks' management. The rate of wage growth, which reached 2.8% in the year to November, moderated to 2.6% in December, the most recent month for which statistics are available.

The explanation for the money slowdown lies partly in the strength of the public finances in recent months. M4x is dominated by bank deposits. When the government runs a budget surplus, as it did in January, tax payments from the private sector's bank deposits exceed receipts from government spending. So bank deposits fall. Another relevant development is an apparent slowdown in lending the private sector. (New loans boost the quantity of money by creating new deposits.) Annual business loan growth fell from 3.6% at the end of 2016 to 2.9% in January. Mortgage lending, however, continues to recover, with January's total of 69,928 new mortgage approvals being the highest for 10 months and overall lending to individuals is a respectable 4% higher than twelve months ago.

The precise reasons for the current weakness in bank lending are not obvious. Indeed, it may to some extent be a statistical illusion. The Bank of England's data on the credit counterparts to *M4*, not *M4x*, reported a surge in lending of over £40b. in January. Evidently, there was a big loan – or there were a number of big loans – from banks to "intermediate other financial corporations", although the Bank declined to offer a wider clarification. Overall, in spite of the litany of gloom during the Brexit campaign and indeed its aftermath, the UK economy has continued to perform well. Several GDP growth estimates for 2017 have been revised upwards, with the OECD being the latest to join the queue. Recent monetary data caution against too rosy a view on the 2017 economic prospect.

John Petley
8th March, 2017

	% 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**