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Monthly e-mail from Tim Congdon and John Petley – 19th May, 2022

Global money round-up in spring 2022

Hopes are being expressed that inflation will soon peak in the United States of America. However, the US economy continues to operate with severe over-heating in product and labour markets. Yardeni's NFIB Small Business Survey reports more companies planning to raise prices – or actually raising prices – than at any time since the survey began in 1974, which really means than since the Second World War and its immediate very inflationary aftermath. Another sign of froth is that US house prices, according to the Federal Housing Finance Agency, jumped by 2.1% in February, to take the increase in the last year to over 19%. It seems that the first quarter to report a rising unemployment rate (i.e., beneath-trend growth or falling output) will probably be the final quarter of 2022. The persistence of inflation will surprise US policy-makers, who have shown little understanding of the dynamics of the current cycle. Much the same is true in the Eurozone, where the European Central Bank was complacent in late 2021, believing that it did not face such a bad inflation shock as the USA. Unfortunately, Europe is closer to Ukraine and therefore more vulnerable to the interruption of energy supplies. At least in the UK the Bank of England has acknowledged the high risk of a double-digit inflation rate later this year or in early 2023.

Money growth is now falling in the USA, the Eurozone and the UK, as well as in significant countries like Canada and Australia. (In Japan money growth had dropped back to pre-Covid norms by the middle of last year.) Real money balances will contract for a few quarters, hitting asset prices, and undermining demand and output. A recession is likely in "the West" (Europe and North America) in 2023, but Asia will not follow suit. In China and Japan inflation is for the moment still under control, and fiscal and monetary policies remain biased towards ease. In China, for example, the annual rate of broad money growth has risen in recent months to just above 10%, *higher* than for most of 2021. World output will continue to grow in 2023, but at a slower rate than in 2021 and 2022.

Money trends in early 2022 in the main countries/jurisdictions

The Institute of International Monetary Research focuses on the relationship between trends in the growth of the quantity of money, broadly-defined, and macroeconomic outcomes. The significance of the Covid-19 epidemic is declining in most countries, although not China. The Institute's consistent analysis since spring 2020 – that money growth acceleration would lead to an inflationary boom and an upturn in inflation – has proved correct. The new areas of debate are the duration of above-normal inflation, with normality seen as an annual increase in consumer prices of 2% a year, and the risk that recessions will be needed to combat high inflation. Key principles here are that,

i. The rate of inflation is equal to the rate of increase in nominal GDP minus that of real GDP,
ii. Over the medium term, growth rates of broad money and nominal gross domestic product will be similar, although not identical, and
iii. Just as a correlation holds between nominal money and nominal GDP, so one holds between real money and real output, and falls in real money are often associated with asset price weakness and recessions.

Much will therefore depend on rates of broad money growth in coming months and quarters, with the table below summarizing recent patterns in the leading nations. The table shows that money growth reductions from the remarkable 2020 peaks are now evident. Money growth is falling in all the developed countries, while inflation accelerates. A squeeze on real money balances is incipient and will intensify. China is following its own path, with money growth rising slightly.

Name of country/ jurisdiction	Share of world output in 2020		Growth rate of broad money		Comment
	In purchasing-power parity terms, %	In current prices and exchange rates, %	In last three months at annualised rate, %	In last twelve months, %	
USA	15.4	24.7	**6.1**	**8.2**	Money growth has slowed cf. spring 2020 – and will slow further. Real money will contract.
China	18.3	15.4	**11.**3	**10.9**	Money growth rising, amid property bust scares. Policy being eased, no official inflation concern.
Eurozone	12.1	17.4	**5.1**	**6.3**	Money growth moderating, as ECB ends asset purchases. Target2 balances again an issue.
Japan	3.7	6.0	**3.6**	**3.2**	Credit and money growth back to pre-Covid norms, implying little inflation in medium term.
India	6.8	3.1	**13.5**	**10.4**	Money growth up in April, rupee weak despite FX intervention.

UK	2.2	3.3	**5.9**	**5.7**	Money growth blips up in March, after months of very weak bank lending to the private sector.

The recent moderation in money growth in the USA, the Eurozone, Japan and the UK implies that inflation will come down towards levels closer to the norms of the 2010s. However, the lags are such that both this year and 2023 will feature annual inflation rates typically above 5% and sometimes above 10%. The Ukraine tragedy will add some twists to the inflationary spiral, but it is certainly not the fundamental cause of the inflation of the early 2020s. This inflation episode – like all the others – is to be attributed to excessive growth of the quantity of money. The combination of falling growth in nominal money (and even the risk of outright falls in the quantity of money) and still high inflation implies declines in real money balances. A standard cyclical pattern is that such declines are accompanied by weakness in both asset prices and aggregate demand, and all too often by recessions (i.e., falls in output lasting longer than six months).

As noted here in recent months, crucial to money growth in the rest of 2022 will be the behaviour of bank lending to the private sector. In the two years to the first quarter of 2022 high or very high money growth in the main Western economies has been almost entirely due to central bank asset purchases and monetary financing of budget deficits. The Institute's analysis has suggested that, as central bank asset purchases stop and budget deficits decline, money growth will decelerate *unless bank lending to the private sector revives strongly*. The patterns of bank asset acquisition have to be monitored and assessed.

In the USA bank credit to the private sector is now growing briskly, although the data are erratic from month to month. "Loans and leases in bank credit" (mostly bank lending to the private sector, and constituting over half of US commercial bank assets) increased in the 13 weeks to 4th May at an annualised rate of 14.8%. The resumption of growth in credit to the private sector dates to the middle of last year. In the 45 weeks to 14th May "loans and leases" increased by 7.7% (or at an annualized rate of 8.9%). That 8.9% figure – and the latest double-digit three-month annualised number– are higher than before Covid. The evidence behind anecdotal reports of US banks' keenness to lend – and of US companies' eagerness to borrow both the rebuild inventory and to anticipate price rises – seems increasingly correct.

If the annual rate of credit growth stays in the 8% - 10% vicinity consistently, and certainly if it moves out towards 15% annualised, the message will be that money growth has its own momentum from the private sector's behaviour. So it would continue if the Fed left its assets stock stable in value. That will affect the size of the interest rate rise needed to bring annual money growth back down to the 3% to 5% band compatible with 2% inflation. The faster the credit growth, the larger will be the required move in Fed funds rate. The degree of dynamism of private sector bank credit must be carefully watched. (The chart above shows that in the USA "loans and leases in bank credit" was higher at 5th May – the last reported figure at the time of writing – than before Covid.)

Bearing in mind that Federal and state governments also have persisting deficits that must be financed, market fears of a rise in dollar interest rates in 2022 look plausible. Against that, the intended Fed sales of securities (i.e., "quantitative tightening") – of as much as $95b. a month – could reduce the M3 quantity of money by perhaps $50b a month. US banks' cash assets have fallen heavily in recent weeks. As far as the analyst is concerned, there is no alternative to checking the numbers month by month. *It needs to be emphasized that bank deposits in the US commercial banking system have been static in recent weeks. Such deposits – which constitute most of M3 broad money – were 0.6% lower on 4th May than on 9th March.*

In the Eurozone the stock of credit to the private sector was 4.2% higher in March 2022 than a year earlier. Mortgage lending was the only type of credit expanding during the worst of the pandemic, but that has now changed. The stock of loans for house purchase was up by 5.4% in the year to March, whereas loans to non-financial corporations (i.e., industry and commerce) advanced 3.4% in the same period. Loans to all corporations, financial and non-financial, increased by 1.3% (or at an annualized rate of 5.4%) in the three months to March. European governments are still doing their best to persuade the Basel-based Bank for International Settlements, and the European Commission, that further large increases in banks' capital requirements are unnecessary and would damage the ability of their financial systems to sustain the recovery. They seem to be having some success in these efforts, despite the concurrent drives by regulatory officialdom for greater "greenery", central bank digital currencies, better corporate governance and the like. The Ukraine crisis has led to a more tolerant attitude towards lending to the European oil and gas sector.

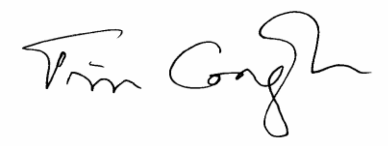
In Japan bank lending to the private sector surged in the opening months of the Covid pandemic, but the loans have been largely repaid with the return of medical normality. Lending to the private sector is now extremely weak.

UK bank regulators seem to believe that the higher are bank capital/ asset ratios, the safer is the banking system and the better is the outlook for the economy. With inordinate amounts of capital required in commercial banking, banking groups are allocating capital to other activities. Large banks are not hiding their reluctance to commit new capital to mainstream UK commercial banking. The problem is being made worse by a decision taken by the Prudential Regulation Authority, of the Bank of England, at the end of last year, to increase from December 2022 UK banks' counter-cyclical capital buffer to 1% from zero. As explained here last month, the imposition of the extra 1% capital is – by itself – deflationary. The argument can be made that regulation has destroyed the incentive for bank stakeholders to grow their loan portfolios. (See the Institute's recent research papers here and here – by David Llewellyn and myself – on these topics,)

However, it has to be said that the latest money numbers are a surprise. In the six months to March M4xL (i.e., bank lending excluding that to intermediate other financial corporations) averaged £5.6b. But in March itself the figure was £21.5b. The explanation was a jump in bank lending to the mainstream, non-intermediate financial sector of £13.9b., which contrasted with actual falls in the loans to this sector in the previous three months. While the surprise is welcome, the suspicion has to be that an exceptional, non-recurring transaction was responsible. A new trend has not been established.

To repeat the point I have been making here so far this year, in 2022 and 2023 the vigour – or lack of vigour – of bank credit to the private sector is crucial to interest rate prospects. The market consensus is that interest rate rises will occur in most developed countries once the pandemic-related weakness in aggregate demand lies in the past. Central banks are now ending asset purchase programmes and in some instance are starting to reduce their asset piles. A reduction in money growth is a condition of the return of moderate inflation. Robust bank lending to the private sector is in many ways desirable, because of its contribution to wider economic efficiency.

But fast expansion of banks' loan portfolios will make it more difficult to deliver the needed reduction in money growth. If bank lending to the private sector is, even at virtually zero interest rates, increasing at an annual rate of 5% or less, it will be easy for central banks to keep money growth under control. Pointers to future lending growth therefore deserve to be monitored carefully in the next few months. Despite very low nominal interest rates, and indeed extremely negative real interest rates, a big boom in private sector bank credit is not imminent in Japan or the UK. But a strong recovery in such credit in the USA has begun, and the Eurozone is seeing signs of life.



19th May, 2022

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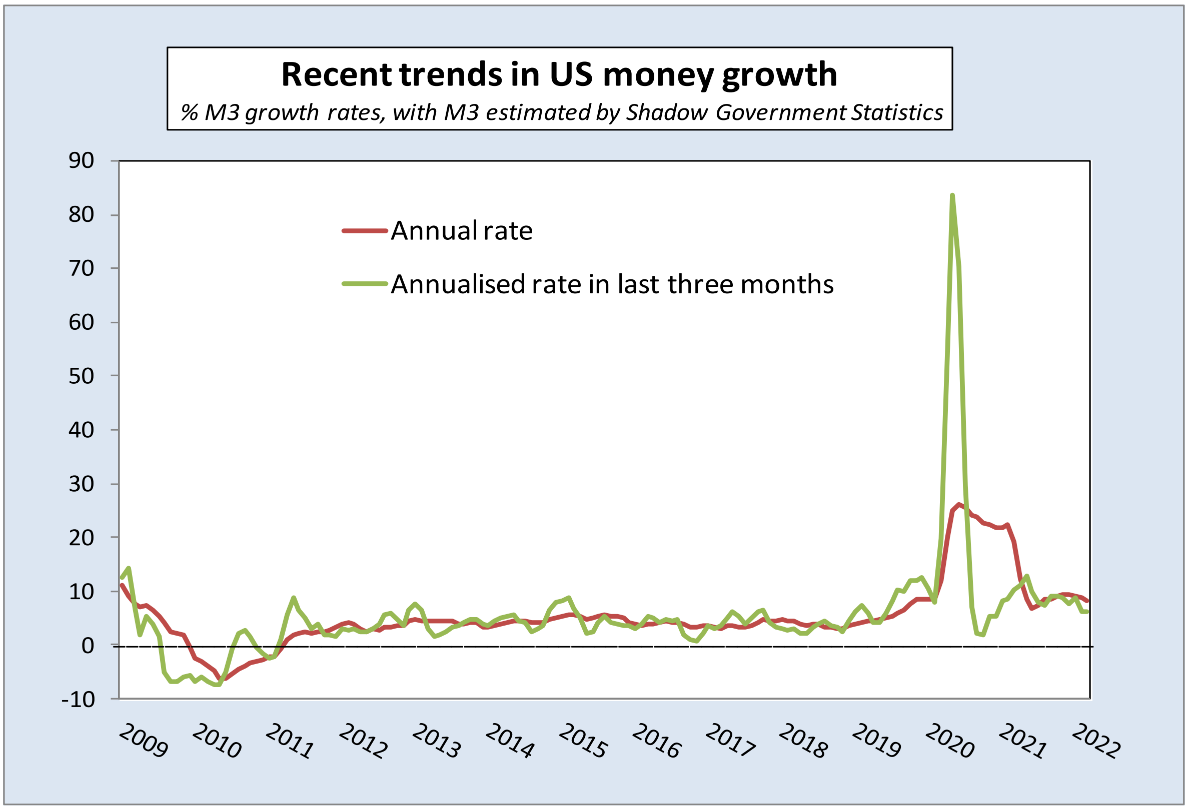
USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1961 – 2020	**7.7**	**6.3**
Ten years to 2020	**6.2**	**3.4**
Year to March 2022	**8.2**	**n.a**
Three months to March 2022 at annualised rate	**6.1**	**n.a.**

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



US broad money growth braking, perhaps to a halt

Summary: **US broad money grew at an annualised rate of 6.1% in the three months to March 2022. In March itself M3 grew by $89b. or 0.3%, slightly lower than February's increase of $103b. This is the sort of monthly increase, which – if sustained over several months – would be compatible with the Federal Reserve's 2% inflation target. The annual rate of growth fell from 8.8% in February to 8.2%. (Our M3 data come from Shadow Government Statistics.) Note also that, in the eight weeks to 4th May bank deposits at US commercial banks fell by 0.6%. The implication is probable stagnation in M3 in the two months, April and May.**

Having finally seen broad money growth drop back to more modest levels following the huge fiscal and monetary stimuli of 2020 and 2021, the Fed may go to the other extreme and tighten monetary policy too rapidly. *Nominal* broad money may contract over a significant period. In this context the information in the Fed's H.8 weekly press release, on the balance sheet of the US commercial banking system, is vital. The latest release shows that deposits in that system *fell* by 0.6% in the eight weeks to 4th May. Since such deposits are the principal component of M3, the likelihood has to be that – at best – M3 was flat in the two months, April and May. Deposits are stagnating even before the Fed has initiated asset sales on the full scale eventually planned, which is of $95b. a month. As noted in the discussion on pp. 3 – 4, the weakness in deposits coincides with an undoubted rebound in banks' lending to the private sector. Banks are losing cash on a massive scale, largely because of Fed operations. US banks' cash assets at 4th May were $735b. lower than at their peak as recently as November 2021.

The Federal Open Market Committee met in the first week in May and voted to raise the Fed funds rate by 0.5%, following a 0.25% increase in March also driven by concerns about the pace of rising prices. "Inflation is much too high, and we understand the hardship it is causing and we're moving expeditiously to bring it down," said Fed chair Jay Powell after the meeting. He added that further increases would be implemented before the end of the year. President Biden also claimed that inflation was his "top domestic priority". While a desire to bring inflation (and inflation expectations) under control is sensible, these hikes in borrowing costs will not have any noticeable effect on inflation in the short term. The slight drop in inflation from 8.3% in the year to April (as opposed to 8.5%) in March does not mean, as some commentators have claimed, that inflation has peaked.

The release of crude oil reserves by the US government has helped to cool fuel prices, but its effects on inflation are only transitory. Producer prices rose by 11.2% in the year to March, the highest reading for several decades.

Tim Congdon and John Petley
10th May,2022

	% annual growth rate:	
	M3	Nominal GDP
1961 – 2020	**7.7**	**6.3**
1961 – 1970	**8.0**	**7.1**
1971 – 1980	**11.4**	**10.3**
1981 – 1990	**7.7**	**7.7**
1991 - 2000	**5.6**	**5.6**
2001 - 2010	**7.1**	**3.9**
2011 - 2020	**6.2**	**3.4**

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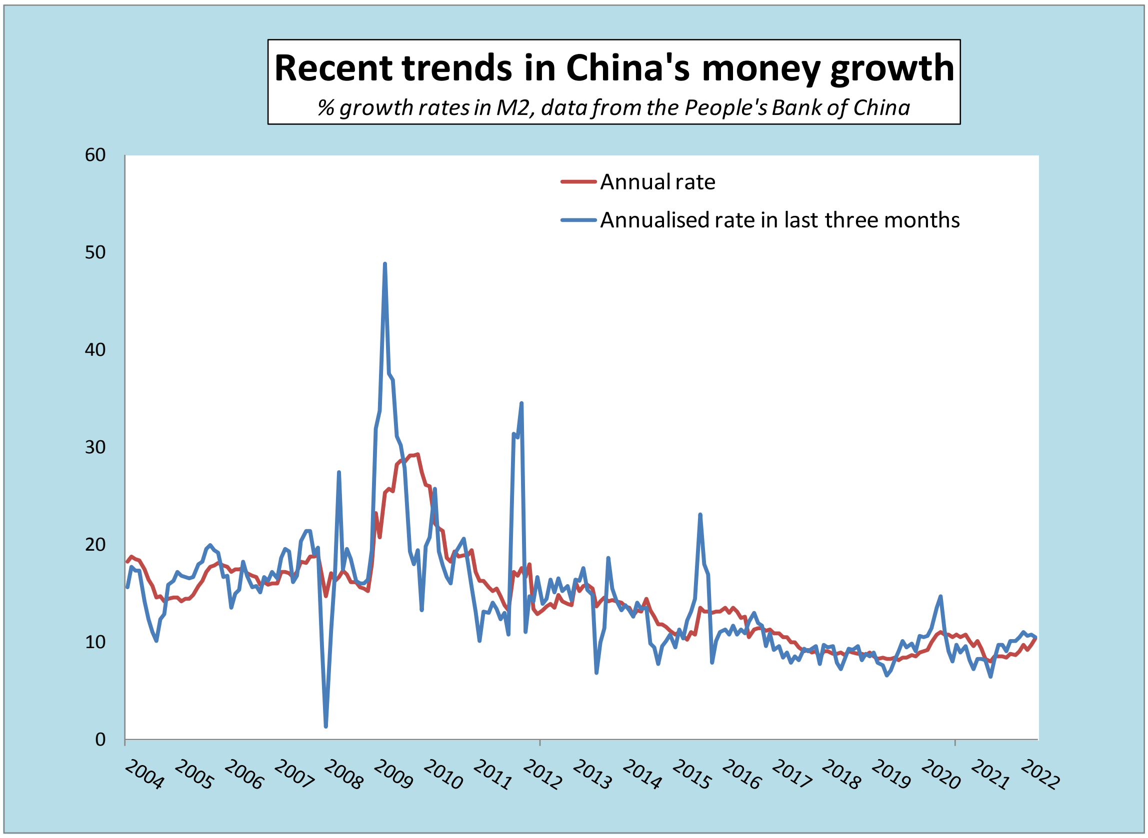
China

	% annual/annualised growth rate:	
	M2	Nominal GDP
1991- 2020	**18.4**	**14.5**
2011 - 2020	**11.7**	**10.0**
Year to April 2022	**10.3**	**n/a**
Three months to April 2022 annualised rate	**10.5**	**n/a**

Sources: People's Bank of China for M2, IMF for GDP



Broad money growth a bit stronger in recent months

***Summary*: In the three months to April 2022 China's seasonally adjusted M2 grew at an annualised rate of 10.5%. This much the same as March's number of 10.8%. (Money growth was weak in April itself.) This is the seventh consecutive three-month period when annualised broad money growth has been above 10%, suggesting that China macroeconomic trajectory is now quite different from that in "the West" (i.e., Europe and North America).**

While Western nations are tightening monetary policy, China is going in the opposite direction. Monetary ease may be partly motivated by an attempt to mitigate the effect of localised severe lockdowns. These lockdowns have hit demand, output and employment. Credit growth is weak, retail sales fell by 1.9% in March and industrial production slumped by 7.1% in April. Exports grew by 3.9% in the year to April, but this figure is sharply down on March's 14.7% increase.

The People's Bank of China (the central bank) has responded by reducing the cash reserve ratio for Chinese banks by 0.25% in April. It has also launched a new targeted re-lending facility worth 100b. yuan (US$15b,) for the transport, logistics and storage industries. This facility came a mere three days after allocating a similar figure for loans to the coal industry. In recent months, targeted easing has been preferred to more broad-based and non-discriminatory measures, as such measures are seen as potentially giving further stimulus to the already overheated housing market. This objective does seem to have been achieved. In the year to March house prices rose by only 1.5% in China's biggest 70 cities, the slowest rate of increase since November 2015. Indeed, following the highly publicised defaults by some large Chinese property developers and a 47% decline in property sales in the year to April, the authorities are now trying to stabilize the housing market. Mortgage rates for first time buyers were reduced by 0.2% on 16th May.

With consumer prices up by 2.1% in the year to March (below the Government's 3% target), the PBoC has room for further monetary loosening if necessary. Nevertheless, an upward trend in inflation, which stood at only 0.9% in the year to February, is apparent and may be causing concern among officials. Producer prices rose by 8.0% during the same period, but the rate of increase has been gradually slowing since October's peak of 13.5%, suggesting that companies have been able to absorb extra costs. Given the modest scale of its monetary stimuli in 2020 and 2021, China is unlikely to face surging inflation in coming months. That is so, even though its economy faces many of the same supply-chain issues as those in the West. Activity is likely to pick up in from May onwards, as Covid-related restrictions on movements are being eased in several large Chinese cities. While any future outbreaks of coronavirus are likely to be dealt with in the same way as before – strict. localised lockdowns – the country as a whole is probably over the worst, so further large-scale monetary and fiscal stimuli are unlikely to be introduced. This suggests that new bank credit, both to companies and households, should revive after April's very low reading. In summary, the money numbers suggest that the Chinese economy is likely to see reasonably stable growth in the coming months, but the rapid expansion of previous decades is now very much in the past.

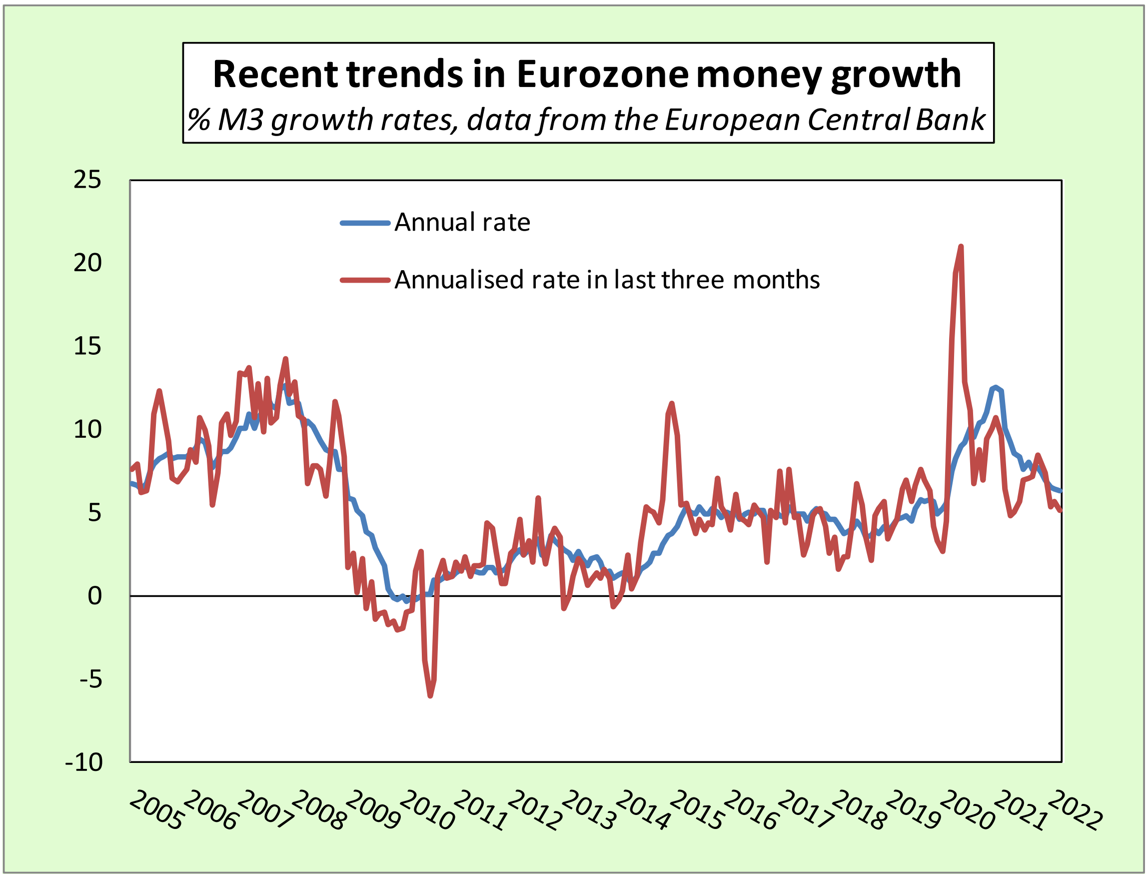
John Petley
16th May, 2022

	% annual growth rate:	
	M2	Nominal GDP
1991 - 2000	**24.5**	**18.5**
2001 - 2010	**18.4**	**15.2**
2011 - 2020	**11.7**	**10.0**

Eurozone

	% annual/annualised growth rate:	
	M3	Nominal GDP
1996 – 2020	**5.5**	**2.7**
Ten years to 2020	**4.6**	**1.6**
Year to March 2022	**6.3**	**n/a**
Three months to March 2022 at annualised rate	**5.4**	**n/a**

Sources: European Central Bank for M3, Eurostat for GDP



Broad money growth slows, as inflation continues to rise

***Summary*: In the three months to March 2021 the quantity of M3 broad money in the Eurozone grew at an annualized rate of 5.1%, lower than February's reading of 5.7% and indeed the weakest growth since May 2021. Broad money grew by €69b. during March, the highest monthly increase so far this year but less than December's €93b., which has dropped out of the three-month annualised calculation. The annual growth rate continued its steady decline, falling from 6.4% in February to 6.3%, the lowest figure since February 2020.**

The European Central Bank's governing council decided against raising interest rates at its meeting on 14th April. The Pandemic Emergency Purchase Programme (PEPP) was terminated as planned at the end of March. Further, the separate 2019 Asset Purchase Programme will soon be reduced in size and wound up. The ECB still plans – until at least the end of 2024 – fully to reinvest the money from maturing securities in its assets pile. Along with the Bank of Japan, it had become very much an outlier among the central banks of advanced economies by not raising interest rates. On May 11th, however, ECB president Christine Lagarde indicated that a rate rise was on the cards, saying that it could happen "a few weeks" after the asset purchases cease. The ending of asset purchases implies a further decline in money growth, towards an annualised rate of, say, 3% - 5%.

Banks can of course continue to grow their assets by extending loans to the private sector. Bank credit trends in the Eurozone are discussed above on p. 4. The stock of credit to the private sector was 4.2% higher in March 2022 than a year earlier, with loans to households for mortgages and corporate loans expanding at about 4% - 5% a year. With the stock of private sector credit being about 60% of banks' total assets, growth at these rates would keep broad money also increasing at, say, 2% - 3% a year. The banking system could also expand by acquiring more government securities. But this subject is plainly very controversial. Nations with high ratios of public debt to GDP – such as Italy – have benefited from ECB asset purchases. As the asset purchases are phased out, yield spreads in the sovereign bond market will widen out. Rising debt interest costs will again be a worry for the governments with large public debts.

GDP grew by only 0.2% in the first quarter of 2022, thanks partly to the lockdowns imposed in some member states. Inflation nevertheless continues on its upward path. This is primarily a legacy of the ECB's actions in 2020 and 2021, when it engineered excessive money growth, rather than a result of the war in Ukraine. Consumer prices rose by 7.5% in the year to April. This was only a modest increase on March's reading of 7.4%, but it was the fastest rate since the launch of the single currency. Across the individual member states, inflation rates vary, with prices rising at an annual rate of 18.8% in Estonia but only 5.8% in Finland. German inflation stands at 7.4%, a figure that is generating considerable criticism of ECB policy in Berlin.

Tim Congdon and John Petley
17th May, 2022

	% annual growth rate:	
	M3	Nominal GDP
1996 – 2020	**5.5**	**2.7**
1996 – 2000	**4.6**	**4.1**
2001 – 2010	**6.8**	**3.1**
2011 - 2020	**4.6**	**1.6**

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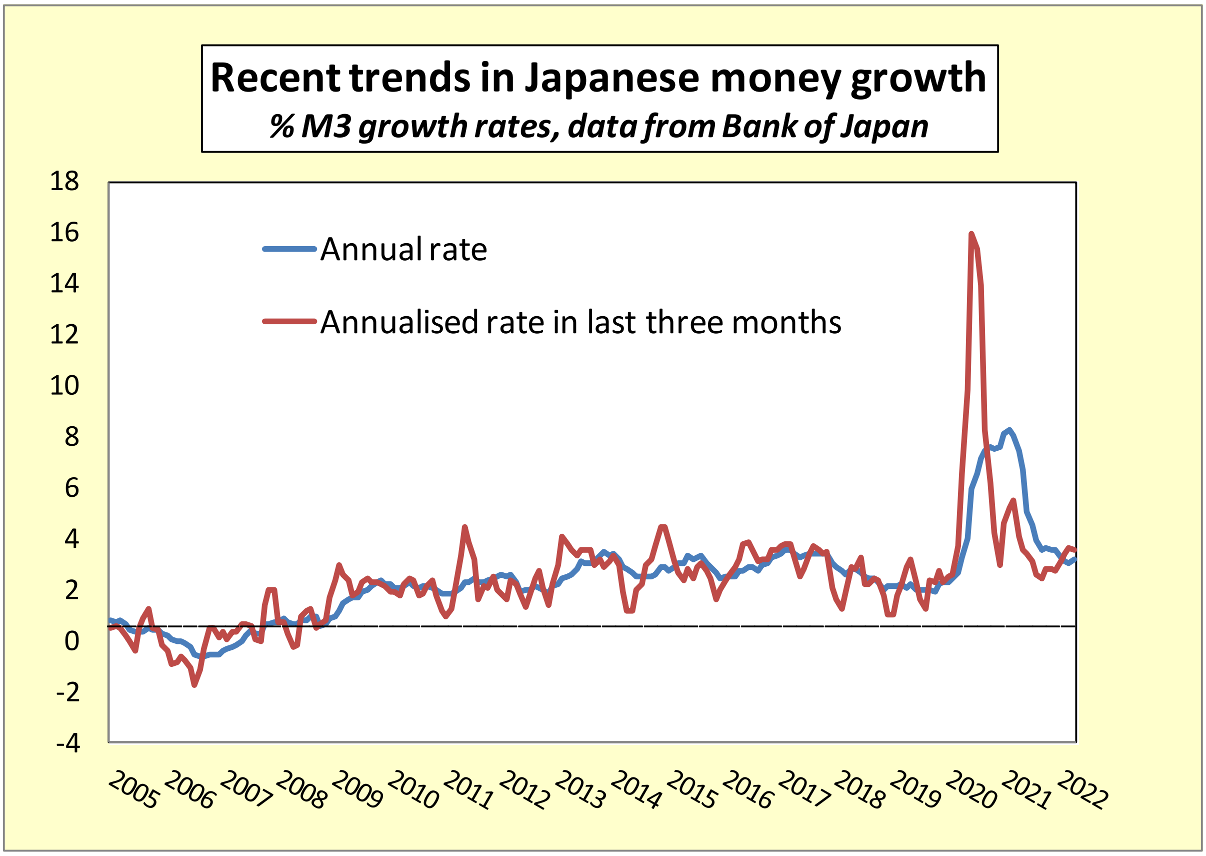
Japan

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2020	3.9	1.7
Ten years to 2020	3.2	0.3
Year to April 2022	3.2	n/a
Three months to April 2022 at annualised rate	3.8	n/a

Sources: Bank of Japan for M3 and IMF for GDP



Broad money growth a smidgeon above pre-pandemic levels

Summary: **The three months to April 2022 saw Japanese M3 increase at an annualised rate of 3.6%, the same as March's figure. Broad money growth has picked up since the start of the year, remaining above 3% (on the three-month annualised yardstick) for four consecutive months, something which did not often happen during the two decades before Covid. April's rise of 60 trillion yen (or 0.4%) was particularly high. The annual rate of growth edged up from 3.1% in March to 3.2%.**

On 28th April, the Bank of Japan's monetary policy committee reiterated its commitment to a very loose monetary policy, including the ongoing purchase of large quantities of 10-year Japanese government bonds in order to prevent the yield rising above 0.25%. With the BoJ now finding itself rather out of step with other central banks in not tightening monetary policy, the yen has weakened. It has fallen in value by over 10% against the US dollar since March.

Consumer prices rose by 1.2% in the year to March, the highest reading since October 2018. Producer prices have been increasing at an annual rate of 9% or more for five consecutive months now, implying significant cost pressures still in the pipeline. Inflation is likely to reach, or even to exceed, the BoJ's 2% target for the first time since 2015. But the prospect of double-digit inflation is remote. The ultimate cause of inflation is excessive money growth, as the last two years of experience in North America and Europe have demonstrated with marked clarity. Money growth did accelerate in Japan in 2020, but the annual rate of increase never much exceeded 8%. The contrast between still moderate inflation in Japan and the actual or virtual double-digit inflation in the West is being widely – and correctly – cited as partial validation of the quantity theory of money.

In order to stimulate inflation, the BoJ has decided to increase its bond purchases, which fell off during the coronavirus pandemic in the wake of comments by several MPC members that an ultra-loose monetary policy could not be continued indefinitely. The minutes of the most recent BoJ MPC meeting reaffirm its previous belief that inflation and indeed the wider economy can be stimulated by increasing the monetary base, even though its own statistics show that a sixfold increase in the monetary base since 2012 has done little more than keep deflation at bay and provide a modest boost to broad money. The current very small uptick in M3 growth is not being driven by any significant increase in credit to households or businesses. Growth in the stock of loans by Japanese banks was only 0.9% in the year to April and even this modest increase was by some way the most positive in the last six months. The BoJ's bond purchases and monetary financing of the budget deficit have instead been the key factors at work in creating new money balances.

John Petley
16th May, 2022

	% annual growth rate:	
	M3	Nominal GDP
1981 – 1990	**9.2**	**4.6**
1991 - 2000	**2.4**	**1.1**
2001 - 2010	**1.0**	**0.8**
2011 - 2020	**3.1**	**0.3**

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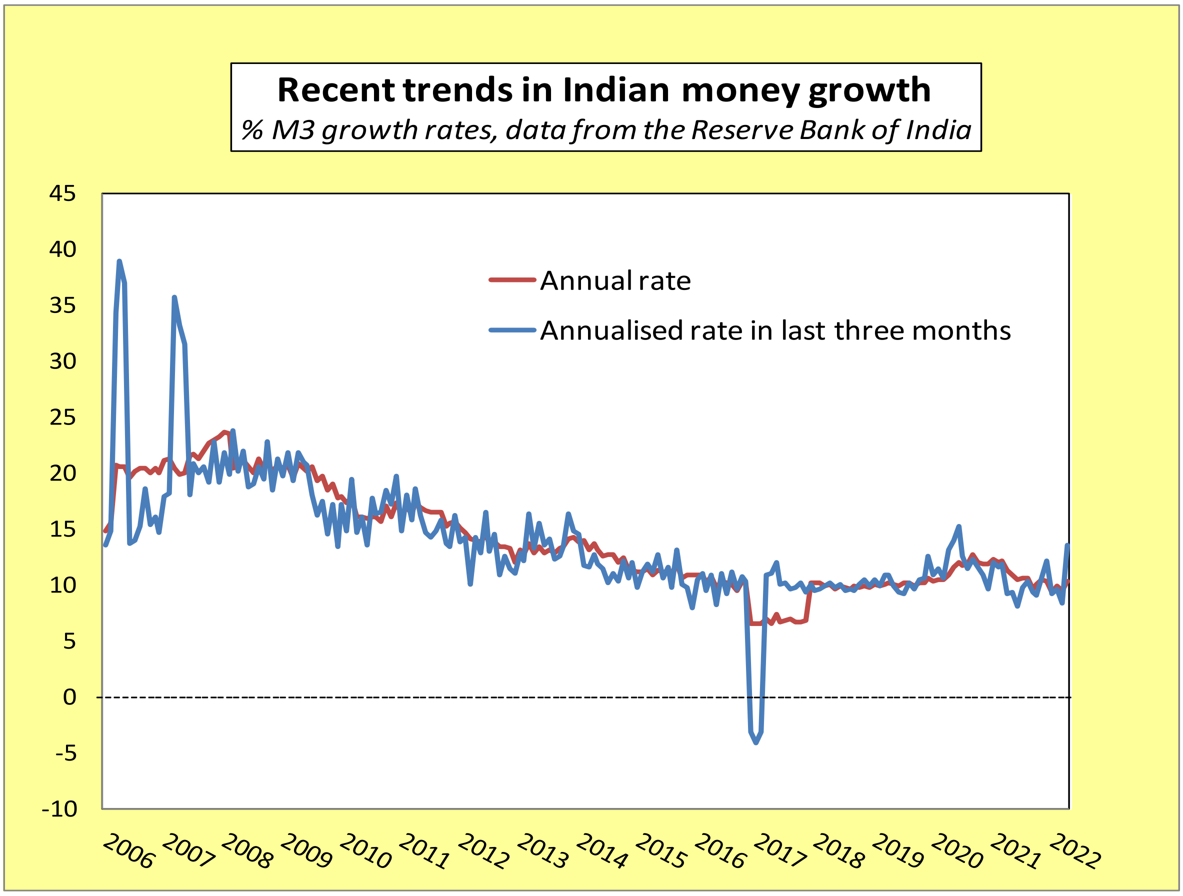
India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2020	**15.8**	**12.9**
Ten years to 2020	**11.3**	**9.8**
Year to April 2022	**10.4**	**n/a**
Three months to April 2022 at annualised rate	**13.5**	**n/a**

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



Money growth sharply higher in March, but this may be misleading

Summary: **In the three months to April 2022 India's seasonally adjusted M3 grew at an annualised rate of 13.5%. This is a substantial increase on March's reading of 8.4%; it may signal an end to the steady decline in broad money growth which has been under way since the start of the year. However, we must warn that the Institute conducts a seasonal adjustment process to the unadjusted data from the Reserve Bank of India, and the apparent acceleration must not be over-interpreted. However, the annual growth rate – unaffected by the seasonal adjustment issues – also rose significantly from 9.4% to 10.4%.**

One month's data do not constitute a trend. It remains to be seen whether the apparent surge in broad money in April is to be taken at face value. An influence on the large increase seems to be monetization of government debt. Fiscal expenditure has been rising steadily for the past year, driven largely by substantial infrastructure projects. In the 14 weeks to 22nd April Indian banks' net credit to the government sector climbed from 60,850b. rupees to 63,966b. rupees, or by 5.1%. The implied annualised rate of increase is no less than 20.4%. (60,850b. rupees – or 6085026 crore rupees, in India's terminology – is about $800b.) Also relevant is more dynamism in bank lending to the private sector. In the year to 22nd April 2022 so-called "bank credit to the private sector" – as the RBI calls it – was 10.5% up. By contrast, in the preceding year – to 23rd April 2021 – it grew more moderately, by 6.0%. For some years a key theme in commentary on Indian banks have been the persistence of demands from the RBI *both* that banks write off bad debts *and* that they operate with capital levels closer to international norms. These norms are in practice those in the Basel III rules from the Swiss-based Bank for International Settlements. India's bankers have resisted these pressures, in a highly political tussle between them and officialdom. They may have gained the upper hand, for the time being.

The combination of public debt monetization and increased credit extension to the private sector indicates that, overall, domestic credit expansion has been buoyant in recent months. The weakness of the rupee on the foreign exchanges this year may be partly due to expectations of higher dollar interest rates. All the same, the RBI has engaged in foreign exchange intervention to bolster the rupee exchange rate. Foreign exchange reserves remain ample, but they have dropped substantially in the last six months. Falls in the banking system's net foreign assets are a deduction from the quantity of money.

Consumer price inflation has also been rising steadily. In the 12 months to April the consumer price index was up by 7.8%, the highest reading in eight years. Producer prices rose by 14.6% in the year to March, suggesting that consumer inflation has further to rise, especially given India's dependence on oil imports coupled with the weakness of the rupee. The rupee fell to an all-time low against the US dollar on 9th May. The RBI responded to the situation by raising interest rates by 0.4% at an unscheduled meeting on 4th May, the first increase since 2020.

Tim Congdon and John Petley
17th May, 2022

	% annual growth rate:	
	M3	Nominal GDP
1981 - 1990	**17.3**	**14.7**
1991 - 2000	**17.2**	**14.1**
2001 - 2010	**17.3**	**13.6**
2011 - 2020	**11.6**	**9.9**

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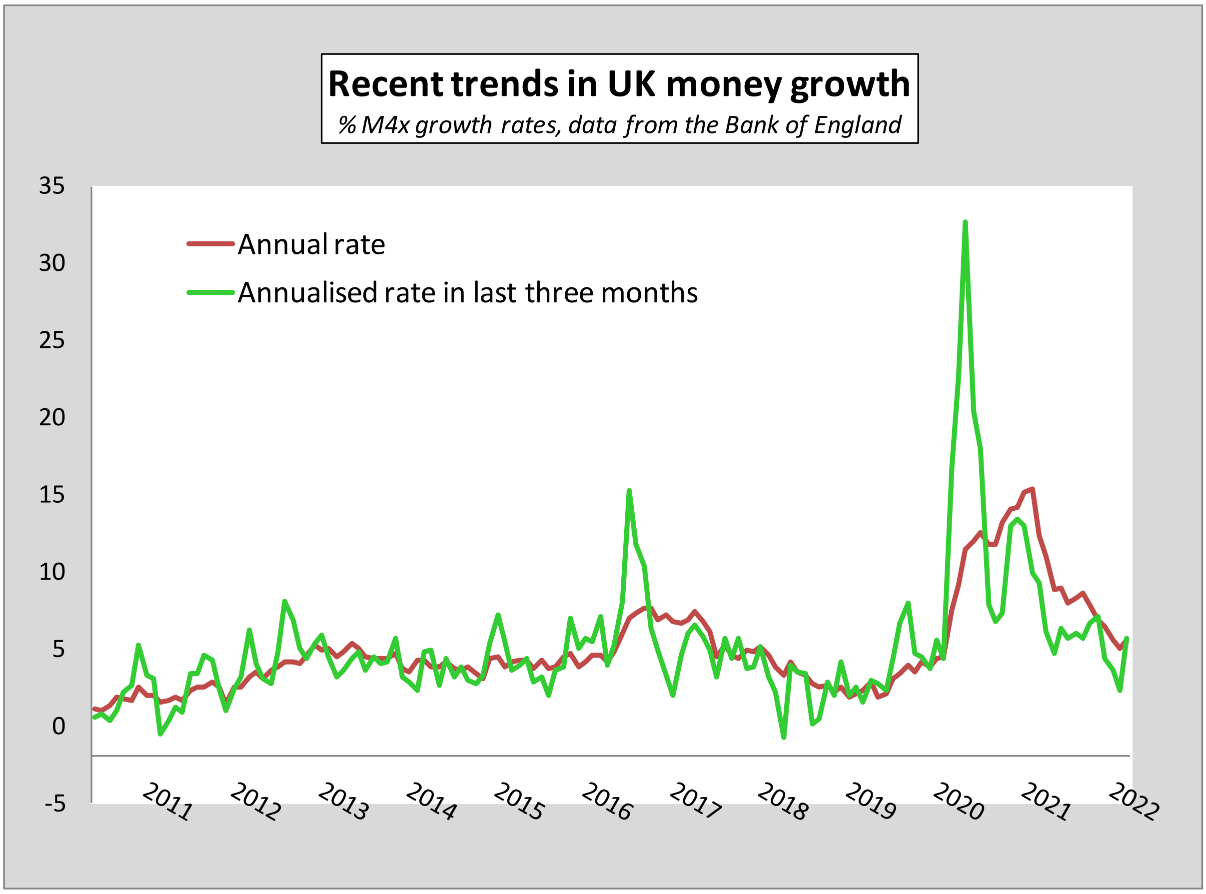
UK

	% annual/annualised growth rate:	
	M4x/M4 before 1997	Nominal GDP
1961 – 2020	**9.3**	**7.6**
Ten years to 2020	**5.2**	**2.3**
Year to March 2022	**5.5**	**n/a**
Three months to March 2022 at annualised rate	**5.7**	**n/a**

Sources: Bank of England and Office for National Statistics



Broad money growth up in March, but looks likely to slow further

Summary: **In the three months to March 2022, UK M4x broad money increased at an annualised rate of 5.7%. This is an increase compared to February's figure of 2.3% and arose from high broad money growth of over £22b. in March. The annual rate of growth also picked up, from 5.0% in February to 5.5%.**

With December's very weak growth (less than £0.3b.) dropping out of the calculations, the annualised quarterly figure was likely to rise, but such a significant boost was surprising. The main driver of broad money growth in March was bank lending to the financial sector, which came to £13.4b. Whether this was due to one large transaction or a number of smaller ones is important, but the Bank of England's press release is unhelpful on the matter. In the previous three months the stock of bank lending to the financial sector *fell*. The suspicion has to be that a large, one-off and exceptional transaction explains the development. No change in trend is therefore to be expected. Loan growth will remain low. Given that the Bank of England has stopped its asset purchases, money growth is likely to fall to under 5% at an annualised rate. The quantity of money may even fall over a period of a few months.

The Bank of England has been heavily criticised in recent weeks, as it has failed to keep inflation close to the official 2% target, and has shown itself inadequate in its analysis and forecasting of inflation. It seems determined to continue the tightening of monetary policy, with further rises in Bank rate. But the cause of the inflation upsurge in the UK – as in the USA and the Eurozone – has been the rapid growth of money in the year from spring 2020, which was due – above all – to the Bank's purchases of government securities. These purchases have now stopped and may now be replaced by sales of long-dated gilts. Money growth has fallen, and so will inflation after a lag. Between now and the closer-to-target inflation of, say, late 2024 and 2025 lies an inevitable recession. The sales of long-dated gilts will reduce the quantity of money, creating a serious risk that the monetary tightening will be excessive and that nominal money will contract.

The Bank's decision in March to delay the implementation of the remaining Basel III standards until January 2025 at least puts back one deterrent to new bank lending by two years, but a significant uptick to loans to businesses looks unlikely. UK GDP grew by 0.8% in Q1 2022, but in March itself, economic activity contracted. Retail sales fell for a second consecutive month while in April, consumer confidence fell to its lowest level since July 2008. With inflation rising to a 30-year high of 9% in the year to April and likely to rise further, such pessimism is well founded. The Bank of England takes little notice of the quantity of money when making its policy decisions and thus, in its attempts to curb inflation, especially after Andrew Bailey's grilling by MPs on 16th May, it may well fail to appreciate that its monetary tightening could have serious adverse implications for economic activity.

Tim Congdon and John Petley
18th May, 2022

	% annual growth rate:	
,	M4/M4x	Nominal GDP
1961 - 2020	**9.3**	**7.6**
1991 – 2000	**6.4**	**6.0**
2001 – 2010	**6.5**	**3.9**
2011 – 2020	**5.2**	**2.3**