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Monthly e-mail from Tim Congdon – 24th November, 2017

Global money round-up in late 2017

October's commentary here noted the tapering of "quantitative easing" in the Eurozone and the reversal of QE in the USA. It expressed concern that these developments presaged a slowdown in money growth in the two largest developed-country economies, which might in turn foreshadow beneath-trend growth in aggregate demand and output in the second half of 2018. This comment still applies, but it has to be said that – just for now – any such concern would be misplaced. In the three months to October US M3 grew by just above 1.5% (or at an annualised rate of 6.3%), while in the three months to September Eurozone M3 was up by slightly more than 1.2% (or at an annualised rate of 5.1%). Money growth in the USA and the Eurozone may slow in early 2018, but it is fine for the moment.

What will be the mood in early 2018? A late January ritual in recent years has been a recession warning from the Davos *World Economic Forum*, often based on reports from the Bank for International Settlements in Basel (a mere 150 miles away), about "building debt vulnerabilities". These warnings have been wrong, time and again. A mild withdrawal of central bank stimulus is in prospect next year, which does create some downward risks to the world economy. However, since the Second World War outright recessions (with falls in output lasting longer than two quarters) have occurred only after surges in inflation to unacceptable levels. At present inflation is low everywhere, which is hardly surprising after several years of unusually weak increases in the quantity of money. To express concern about a slowdown is not at all to pontificate in apocalyptic terms (like the BIS) about a big recession because "we" have been running up too much debt. 2018 is likely to be another year of steady growth at the world level, if perhaps slightly off from the 2017 figure. According to the International Monetary Fund, the six years to 2017 have seen world output growing every year within a band of between 3.2% and 3.6%. The money growth trends discussed in this note do not justify a radical change in prospect for 2018.

Money trends in late 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 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 in recent months, with the overall message being "stability in the immediate future, but with worries about the effect of the withdrawal of QE stimulus on money growth, and then on balance-sheet strength, and demand and output". Given the lags, any money slowdown would hurt demand and output only in mid- or late 2018. Worries can also legitimately be expressed that the regulatory attack on the banks (for promoting the growth of all that wicked new debt) may lead to a money slowdown in the closing months of 2017 and in early 2018 *in both China and India*. These countries seem to be importing the intellectual case for over-capitalised banking systems from the BIS and international economic officialdom more generally. But monetary policy could cause another recession only if it were grossly incompetent. Non-energy inflation prospects are benign into 2019.

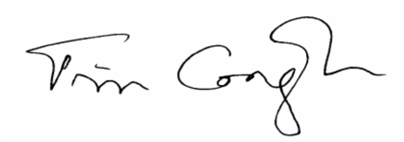
Name of country/ Jurisdiction	Share of world output, in purchasing-power-parity terms, %	Growth rate of broad money, in last three months at annualised rate, %	Growth rate of broad money, in last twelve months, %	Comment:
USA	15.3	6.3	4.8	Money growth uptick ahead of run-off of QE assets
China	18.3	9.4	9.3	Money growth slowing, in stable context.
Eurozone	11.6	5.1	5.1	Money growth at 5% rate ideal for recovery, but end of QE a worry for 2018
India	7.5	11.1	6.8	Regulatory attack on non-performing loans to herald money slowdown?
Japan	4.3	3.6	3.5	Broad money growth stable at rates high by Japanese standards
UK	2.3	4.3	4.6	Money growth slowing to acceptable levels

Overall the verdict for 2018 has to be that the world economy will experience trend or beneath-trend growth of demand and output, because

i. the withdrawal or cancellation of QE operations in the two big developed-world economies, and
ii. the apparent money slowdowns in China and India,

together mean that the monetary impetus to demand will be weaker than in recent years, but there are no grounds for expecting a big recession like that in late 2008 and early 2009. As I said here last month, a recession could happen in 2018 and early 2019 only if very stupid decisions were taken by national central banks and international regulatory officialdom. Sure enough, if policy-makers were to respond to the Kashkari proposal that banks should operate with double their present levels of capital, they might precipitate a plunge in money growth of the kind seen from autumn 2008. But even the most puritanical of the anti-debt regulatory fraternity do not seem enthusiastic about a radical change in banks' capital regime from now.

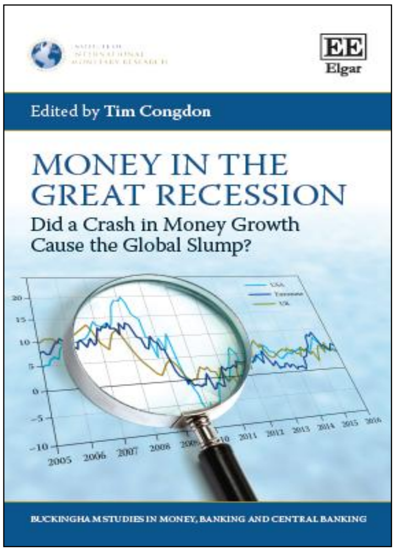
In its October *World Economic Outlook* the International Monetary Fund assesses likely world output growth at 3.6% in 2017 (slightly up from an average of 3.4% in the preceding five years), and then at 3.7% in all of 2018, 2019 and 2020, followed by 3.8% in 2021 and 2022). The justification for the mild acceleration in the trend growth rate is not obvious. The monetary analysis in the present note argues for a slowdown in demand growth next year, although not a big one. If supply conditions are becoming more favourable, the possible 2018 demand slowdown implies persisting weak inflation pressure into 2019. However, it is worth noting that the energy markets – which have been characterised by over-supply in recent years – are tightening, and that oil prices in particular are almost double their end-2015 lows.



24th November, 2017

P.S. As last month, I would like to bring to your attention to my new book.

Money in the Great Recession (edited by Tim Congdon) is being published by Edward Elgar Publishing in June



- The blurb on the back cover of *Money in the Great Recession* reads as follows,

No issue is more fundamental in contemporary macroeconomics than the causes of the recent Great Recession. The standard view is that the banks were to blame because they took too much risk, "went bust" and had to be bailed out by governments. But very few banks had losses in excess of their capital. **The counter-argument presented in this volume is that the Great Recession was caused by a collapse in the rate of change of the quantity of money.** The book's thesis echoes that made on the causes of the Great Depression by Friedman and Schwartz in their 1963 classic *A Monetary History of the United States.*

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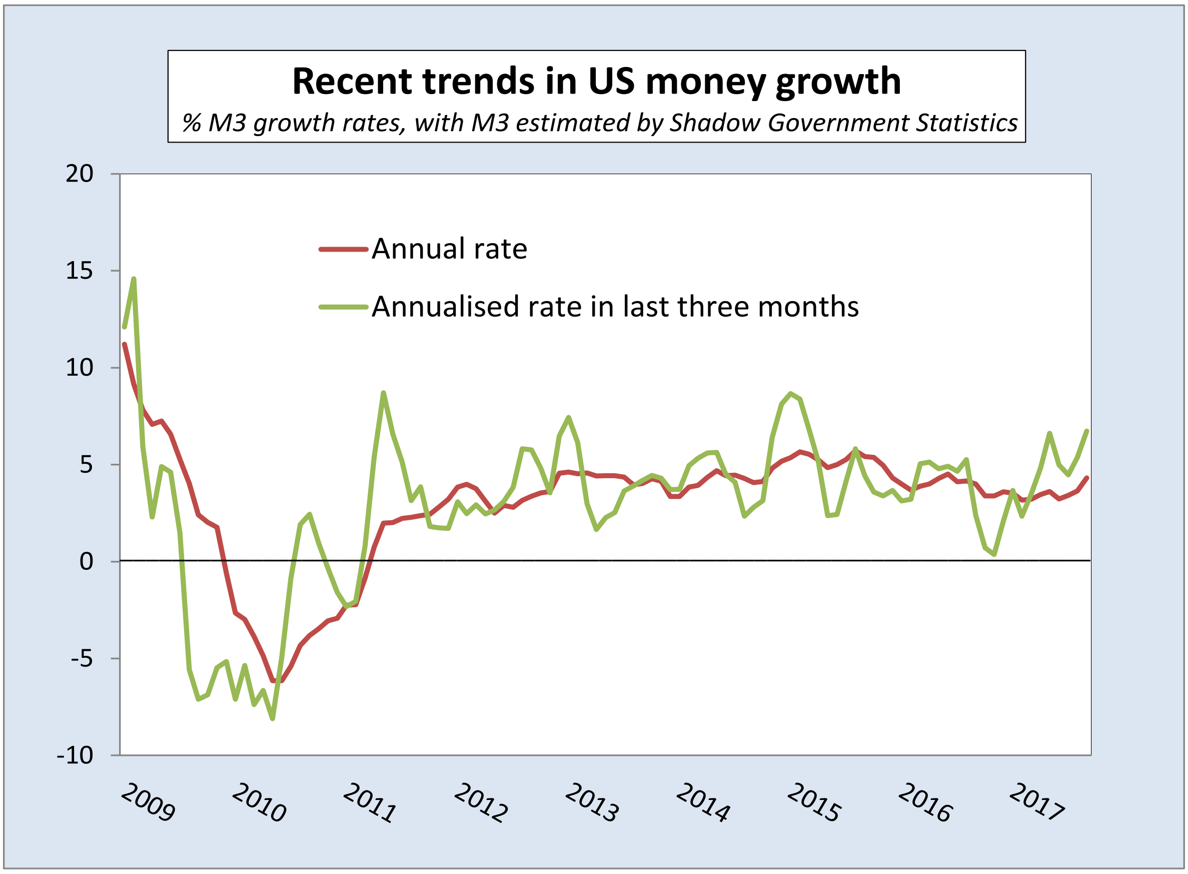
USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1960 – 2016	**7.5**	**6.5**
Six years to 2016	**4.0**	**3.7**
Year to October 2017	**4.8**	**n.a**
Three months to October 2017 at annualised rate	**6.3**	**n.a.**

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



M3 growth still buoyant for the time being

Summary: **Two months into the Fed's explicit reversal of 'quantitative easing' and US broad money is still growing at a satisfactory rate. In October, the M3 aggregate increased by $63b. following an increase of $81b. in September. The numbers are lower than the rise of $133b. in August, but still respectable. The annualised rate of growth in the three months to October was 6.3%, down from the 6.5% recorded the previous months but still above the average in recent years. It is by no means certain that money growth will remain at this level. A further rise in the Fed funds rate to 1½% looks likely in December, while the monthly rate of "quantitative tightening" will increase from $10b. to $20b. in January 2018. These two factors are likely to slow broad money growth, (It should be remembered that the Fed takes little notice of money in its decision-making. Our M3 data come from Shadow Government Statistics.)**

At this stage, the Federal Reserve is not selling bonds acquired in the QE exercises from 2008 to 2014, but merely allowing them to mature. This may change during 2018. The current plan is for the balance sheet to be run off at $20b. a month in Q1 2018, $30b. in Q2 2018, $40b. in Q3 2018 and $50b. in Q4 2018. Although not every maturing asset causes a reduction in the deposits of genuine US non-banks, a high proportion of the Fed's asset run-off does have this effect. A reduction in broad money growth of $20b.- $30b. a month is implied. If we compare that with the numbers above (of $63b. in October, etc.), that would be equivalent to between a third and a half of the current growth rate. In the earlier, unannounced spells of "QT", a slowing in broad money growth was mirrored in a reduction in US banks' cash assets on the other side of the balance sheet. Between May and August these rose by over $100b., but they have fallen by $32b, over the last two months.

The stock of mortgage lending by US banks grew by 4.2% in the year to October, the highest figure in three months. However, business loan growth slowed from 6.4% in the year to September to 0.7% in the year to October. This is still a better picture than the first quarter of 2017, when the stock of business lending was showing falls on a year earlier.

These are early days for the Fed asset run-off. In February Janet Yellen will be succeeded by Jerome ("Jay") Powell as chairman of the Federal Reserve, but this is unlikely to signify a radical policy shift. Powell has never dissented from any decision since joining the board of the Fed In 2012. With his background in investment banking rather than academia, it is unlikely that he will take any more note of the quantity of money than his two predecessors. 2018 looks likely to see a slowing in money growth, with trend or beneath-trend growth in demand and output emerging by the second half.

John Petley
15th November, 2017

	% annual growth rate:	
	M3	Nominal GDP
1960 – 2016	**7.5**	**6.5**
1960 – 1970	**7.7**	**6.8**
1971 – 1980	**11.4**	**10.3**
1981 – 1990	**7.7**	**7.7**
1991 - 2000	**5.6**	**5.6**
2001 - 2010	**7.1**	**3.9**
Six years to 2016	**4.0**	**3.7**

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China

	% annual/annualised growth rate:	
	M2	Nominal GDP
1991- 2016	**19.7**	**15.4**
2010 - 2016	**14.4**	**11.6**
Year to September 2017	**9.3**	**n/a**
Three months to September 2017 at annualised rate	**9.4**	**n/a**

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

Back to stability after China's broad money growth decline?

***Summary*: In the three months to September 2017, China's seasonally adjusted M2 expanded by 2.3% or at an annualised rate of just under 9.4%. While down on the 9.6% recorded in the three months to August, these numbers are still higher than in the preceding six months. The annual growth rate remains unchanged at 9.3%, the fifth consecutive month in which it has come in below 10%. As the chart above illustrates, Chinese broad money growth has not been experiencing the extreme fluctuations seen in previous years. A slow and steady fall began in early 2016, perhaps reflecting to some extent official concern about "too much debt" in China. This decline does seem to have halted in the last couple of months. Is a "new normal" of around 9.5% becoming established, going into 2018?**

The Chinese authorities appear unconcerned about broad money growth falling significantly short of their 12% target for the year. They have long appeared worried about rising levels of debt in the so-called "shadow banking system". After cracking down on this sector several years ago, they are now anxious about excessive levels of low-quality credit business in the larger state-run banks. With the level of non-performing loans at a mere 1.5% - 2% for Chinese banks, these concerns may be overblown. The current phobia about supposedly under-capitalised banks is a worldwide trend.

The stock of bank lending rose by 13% in the year to October, down from 13.1% in September, but once again within the narrow band of 12.9% - 13.2% where the annual rate of loan growth has remained through all but one of the last ten months. This stability has been maintained despite the housing boom cooling off. Prices in the 70 biggest Chinese cities rose by a mere 6.3% in the year to September, down from 8.3% in the year to August. At the end of 2016, prices in Shanghai and Beijing were rising at unsustainable levels, nearly 40% in the case of the former. The most recent figures are 0.5% for Beijing while prices are flat in Shanghai. This slowdown has been engineered deliberately by the authorities' imposition of lending restrictions in major cities.

The annual rate of consumer price inflation rose to 1.9% in October, the highest figure since January, but still well below the government's 3% target. China's GDP grew at an annual rate of 6.8% in the third quarter of 2017, which is slightly down on the 6.9% seen in the first two quarters but still higher than 2016's figures.

Overall, there is less reason to be concerned about the Chinese economy than some media reports have claimed. With Xi Jinping increasing his hold on power in China after the recent Communist Party congress, the recent emphases on stability and risk aversion are likely to continue. The transition from massive investment to a more balanced economy with greater levels of consumption will be pursued, but with the authorities guiding the process. As long as Xi remains in control, no major liberalisation can be envisaged. In such an environment, the current course of lower but steady money growth looks likely to be maintained into 2018 and possibly beyond.

John Petley
14th November, 2017

	% annual growth rate:	
	M2	Nominal GDP
1991 - 2000	**24.6**	**18.5**
2001 - 2010	**18.4**	**15.2**
Six years to 2016	**13.5**	**10.6**

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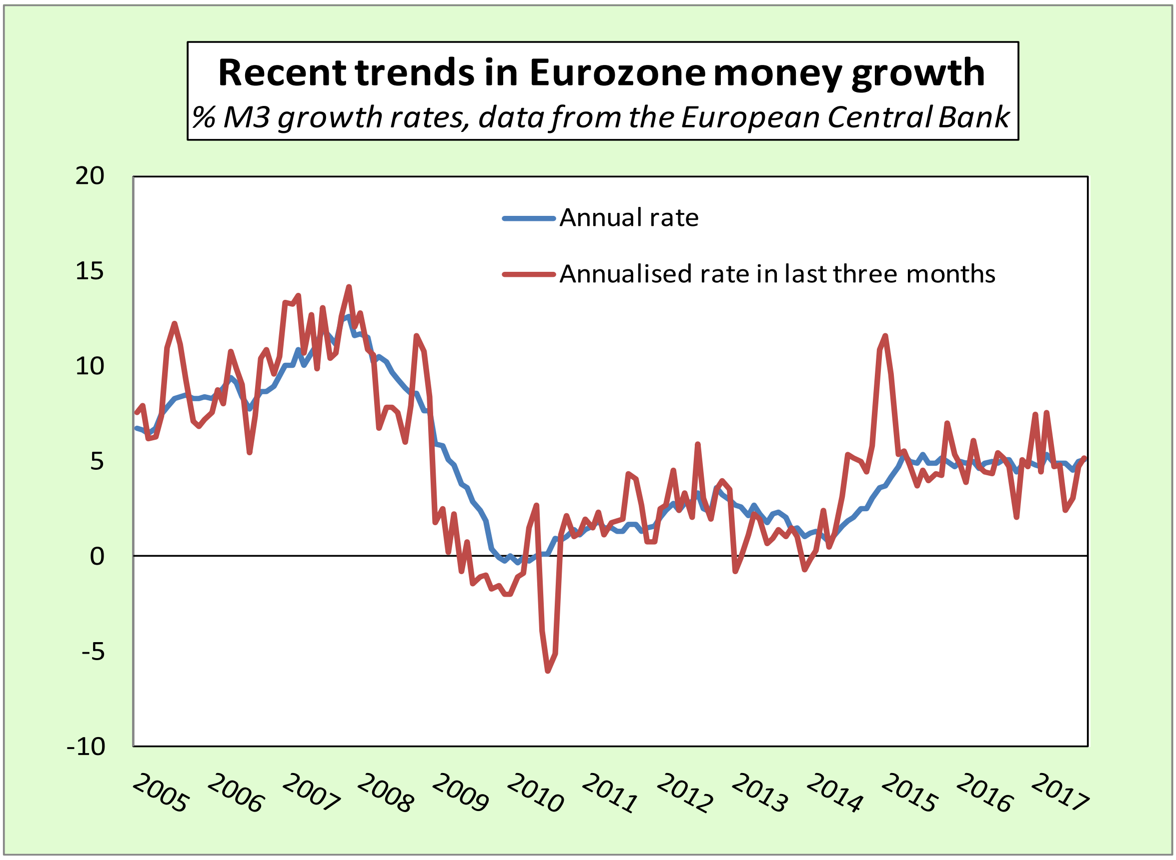
Eurozone/Euroland

	% annual/annualised growth rate:	
	M3	Nominal GDP
1996 – 2016	**5.3**	**3.0**
Six years to 2016	**3.4**	**2.0**
Year to September 2017	**5.1**	**n/a**
Three months to September 2017 at annualised rate	**5.1**	**n/a**

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



Money growth continues at a satisfactory level

***Summary*: Annual M3 growth in the Eurozone has remained within a narrow band between 4.4% and 5.3% consistently since April 2015. September's figures continued the trend, with both annual and annualised quarterly growth coming in at 5.1%, slightly up on August's figures. The "quantitative easing" programme initiated by the ECB's Governor Mario Draghi in late 2014 has had a beneficial effect on broad money growth, lifting it from a level of approximately 2% in 2012-14. Macroeconomic outcomes have improved, bringing down unemployment, ending the risk of deflation and boosting aggregate demand.**

The latest money figures also highlight another change in the Eurozone broad money situation since the introduction of QE. Before then, Germany was the principal driver of broad money growth, whereas in six of the last twelve months, annualised quarterly German M3 growth has been lower than the aggregate of other 17 countries which share the single currency. Overall Eurozone consumer price inflation stood at 1.4% in the year to September, roughly in line with the official target of "just under" 2%. A greater convergence of inflation rates has also been recorded, but with some outliers. Cyprus suffered deflation in September, while the "PIIGS" countries (Portugal, Italy, Ireland, Greece, Spain) have escaped from falling prices. Indeed, in Spain inflation has risen above the Eurozone average. This is not to imply that all is well with these countries' economies, especially their banks. The Target 2 settlement system still shows a huge credit position for German banks, and large net debit positions for Italian and Spanish banks.

The QE programme will continue until at least September, but at a lower rate, with asset purchases reduced from €60b. to €30b. per month. Moreover, while Mario Draghi's term of office as ECB president does not end until 2019, his successor will probably be chosen in 2018. Jens Weidmann of the Bundesbank has expressed interest in the job and, if chosen, his favoured policies would result in a slowing of money growth. However, it is far from clear that Weidmann would command majorities on the ECB Governing Council. The vulnerable Club Med nations depend on further QE to achieve positive money growth. A general election in Italy is scheduled for May, with the possibility that the Five Star Movement will press for a referendum on Italy's membership of the Eurozone.

For now the Eurozone enjoys reasonable macroeconomic stability. Draghi has not said that the ECB is deliberately targeting annual broad money growth of around 5%, but this is what has happened. Arguably, it has been the optimum figure. Banks continue to expand their asset portfolios, with – for example – the stock of mortgage lending growing by a satisfactory 3.4% in the year to September, Business lending, which grew by 1.5% in the same period, is less buoyant. At any rate, it is no longer falling. In the short term, slow but stable demand and output growth look likely for the 19-nation bloc. In the longer term political uncertainties and further demands from international officialdom for further rise in banks' capital/asset ratios may cause problems for some countries. QE has brought a recovery to the Eurozone, but some countries' banking systems remain too frail to grow without it.

John Petley
16th November, 2017

	% annual growth rate:	
	M3	Nominal GDP
1996 - 2016	**5.3**	**3.0**
1996 – 2000	**4.6**	**4.1**
2001 – 2010	**6.8**	**3.1**
Six years to 2016	**3.4**	**2.0**

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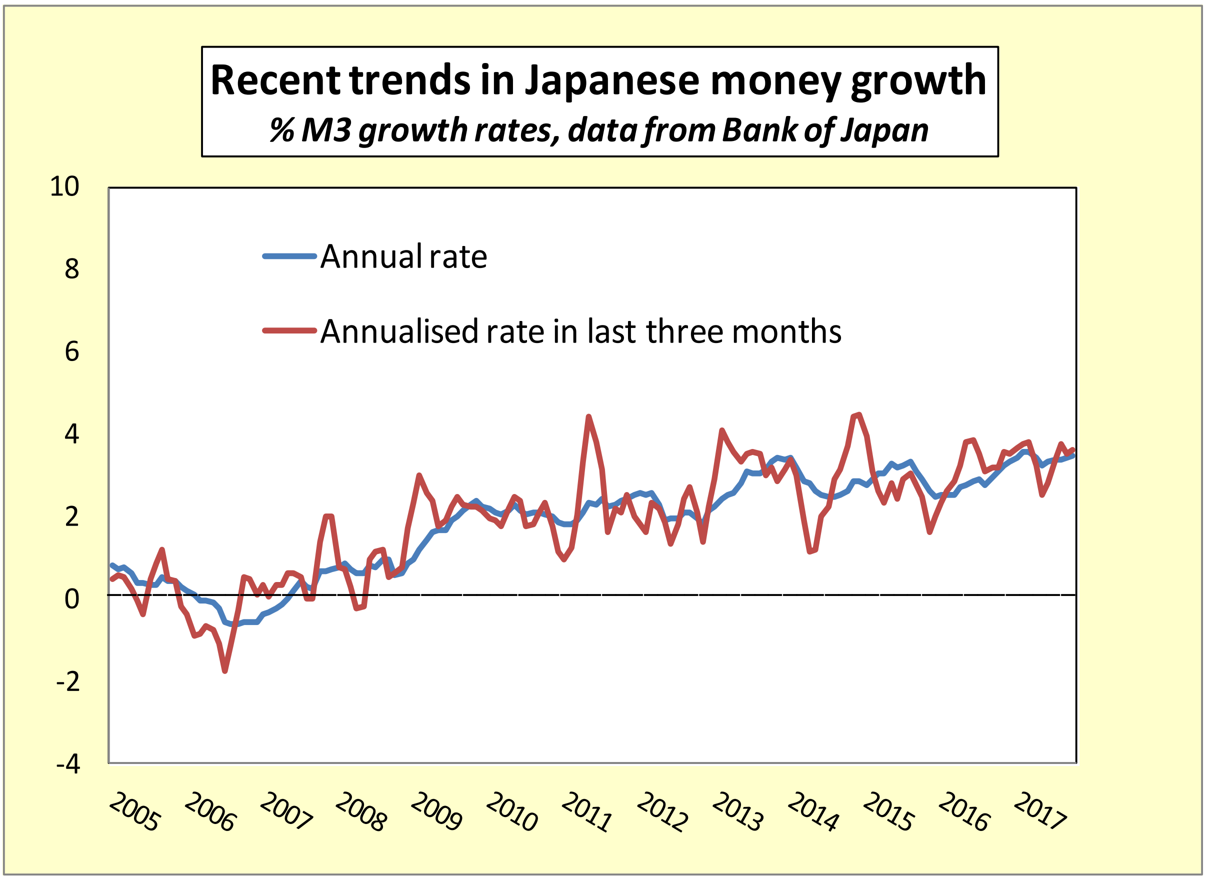
Japan

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2016	**4.0**	**1.9**
Six years to 2016	**2.9**	**0.6**
Year to October 2017	**3.5**	**n/a**
Three months to October 2017 at annualised rate	**3.6**	**n/a**

Sources: Bank of Japan for M3 and IMF for GDP



Moderate broad money growth continues

Summary: **In the three months to October 2017 Japanese M3 broad money grew at an annualised rate of 3.6%. After dropping below 3% in May and June, the annualised three-month growth rate has returned to the levels seen earlier in the year. For a nation with a trend rate of output growth of only ½% - 1% a year and seeking positive, but low inflation, a broad money growth rate of just above 3% a year is perfection. However, it is far from clear that the Bank of Japan thinks in these terms. Monetary policy is centred on a commitment to buy 10-year government bonds to keep yields at zero. The immediate macroeconomic outlook is stable.**

Although "QE" is being scaled back in the Eurozone and unwound in the USA, the Bank of Japan intends to continue on its path of monetary stimulus which, besides so-called "quantitative and qualitative monetary easing", also includes negative interest rates and "yield curve control". The Bank of Japan has bought so many 10-year government bonds that they now account for over 80% of its total assets. The last major statement relating to the bond-buying programme was made over three years ago, when the BOJ announced an expansion from 60 to 80 trillion yen a year. Since then, with no fanfare, the size of its monthly asset purchases has become more flexible. The objective is to maintain a yield of zero, while seeking to raise annual consumer price inflation to 2%.

The inflation target has constantly been undershot. Apart from a period in 2014-15 when inflation rose above 3% due to a one-off hike in the sales tax, consumer prices have failed to increase even at 1% per annum. The 0.7% increase seen in August and September is the highest this year. With energy prices increasing worldwide and Japan being a major importer of oil, this may well push inflation up in 2018. Otherwise there are no other strong upward pressures on commodity prices. Unsurprisingly in these circumstances, the BOJ's latest estimate for hitting the 2% inflation target has been pushed forward again, to 2019 at the earliest.

Nonetheless, the BOJ's actions have certainly helped asset markets and economic activity. It might have done better to have adopted a different approach, targeting broad money rather than buying bonds from commercial banks. The quantity of money will increase in the first round, only if purchases are from non-banks and/or represent direct financing of the budget deficit. Alternatively, the quantity of money grows when the banks increase their loans to the private sector. (The new loans create deposits, which are money, on the other side of the balance sheet.) Some positive signs emerged earlier this year, with the 3.3% annual growth in the stock of bank loans seen in June and July being the highest since the Great Recession. Since then growth has cooled, falling back to 2.8% in the year to October. Consumer spending has revived in 2017, although the housing sector is very weak, reflecting the country's demographics. The money figures suggest either continuity or possibly a slight improvement in the macroeconomic outlook going into 2018. The overall picture is unlikely to change dramatically.

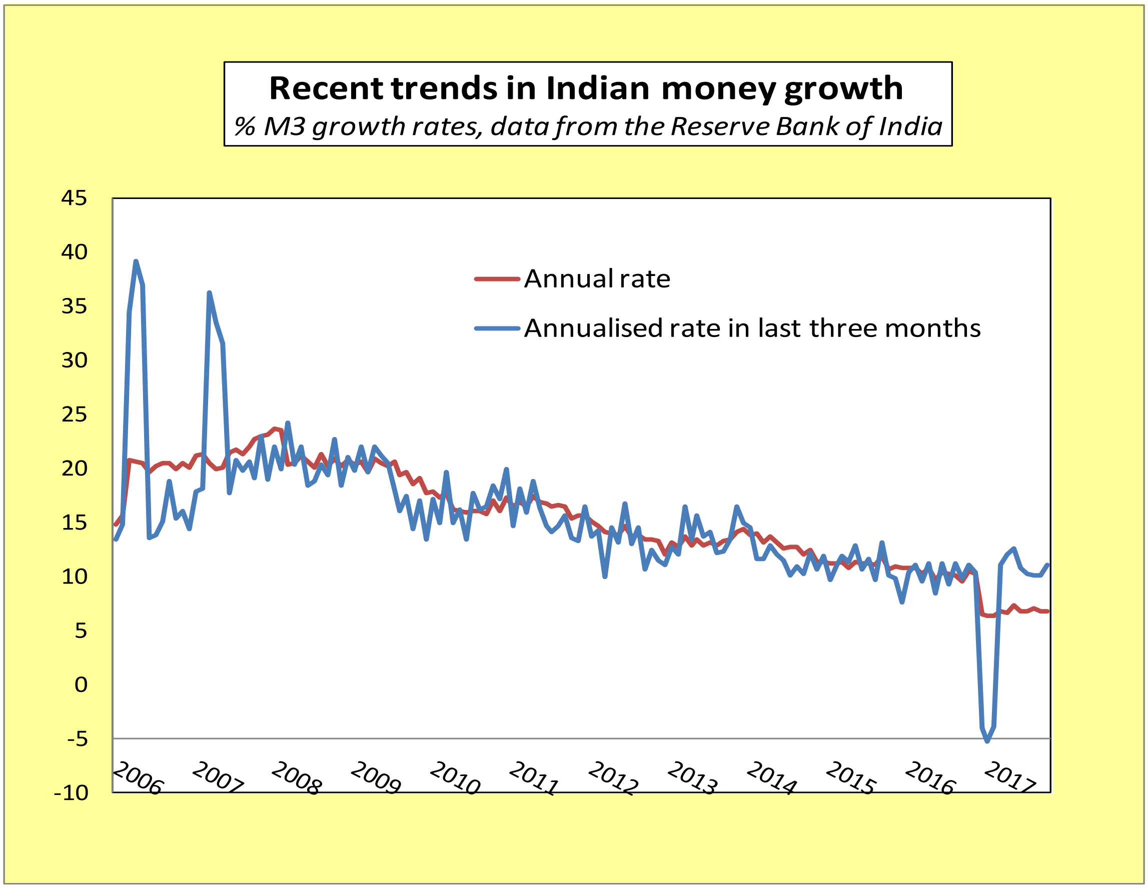
John Petley
17th November, 2017

	% annual growth rate:	
	M3	Nominal GDP
1981 – 1990	**9.2**	**4.6**
1991 - 2000	**2.5**	**1.1**
2001 - 2010	**1.1**	**0.8**
Six years to 2016	**2.9**	**0.6**

India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1991- 2016	**16.1**	**13.5**
2010 - 2016	**12.6**	**12.8**
Year to October 2017	**6.8**	**n/a**
Three months to October 2017 at annualised rate	**11.1**	**n/a**

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



Broad money growth improving, but still below pre-demonetisation levels

Summary: **In the three months to October 2017 India's M3 (seasonally adjusted) grew at an annualised rate of 11.1%, an increase on the 10.1% recorded in the three months to September and the highest figure since May. The annualised quarterly annual growth rate figures have now returned to the levels seen before India's de-monetisation exercise in November 2016, when a mass withdrawal of 500 and 1,000 rupee banknotes from circulation was implemented by officialdom and caused M3 to fall sharply. As the chart above shows, annual broad money growth, currently at 6.8%, remains well down on the levels seen before last November, although it is likely to rise to the 9-10% level in the New Year when the figures covering the de-monetisation exercise drop out of the calculations.**

Figures for Indian GDP growth in the third quarter of 2017 are still awaited, but annual growth rates of 6.1% and 5.7% in the first two quarters are disappointing. The de-monetisation episode is being mentioned as a possible influence. Growth in the stock of lending by India's banks slowed sharply in early 2017. In the period before the de-monetisation exercise, the annual growth rate stood at over 10%, but by March it was down to 4.1%. A slow but sustained recovery has seen loan growth rise above 7% in October. Perhaps this upturn in bank lending growth has been helped by a reduction in interest rates by 0.25% on 2nd August by the Reserve Bank of India, the central bank's first reduction since October 2016. The rate cut followed a fall in the annual inflation rate to 1.5% in June, the lowest number since the items used in calculating the index were revised in 2012. Since June inflation has rebounded, thanks to an increase in food and fuel prices. It stood at 3.6% in the year to October, still well down on the 8-10% inflation which was the norm until 2014. Further monetary loosening looks unlikely while inflation is on an upward trend.

The Indian government is keen to reform the country's economy. Indeed, the de-monetisation exercise was undertaken to reduce the amount of cash in circulation, and to encourage a greater use of bank deposits and electronic payments. If that was the objective, it could be regarded as a success. The new nationwide goods and services tax, introduced on 1st July, replaced a complex fragmented system. It was designed to establish a single nation-wide market, promoting the economy's trend growth rate. Another facet of the reform drive is that the RBI's governor, Urjit Patel, has jumped on the global bandwagon of increased bank capital. Indian banks' capital-to-assets ratio has increased from 5.7% in 2000 to 7.2% in 2015, higher than a number of developed economies. Nonetheless, with 9.6% of all loans by India's banks reported as non-performing, Patel is concerned about the "weak credit discipline" which had characterized the country's banking sector in recent years. New legislation is planned which will force troubled companies quickly to agree debt restructuring with their creditors. In reality, the major problem for India's banking system is not insufficient bank capital, but the large state-owned sector. Bank nationalization has led to inefficiency and poor credit allocation since it began in the 1970s. In spite of this month's improvement, the outlook for broad money growth in India is uncertain.

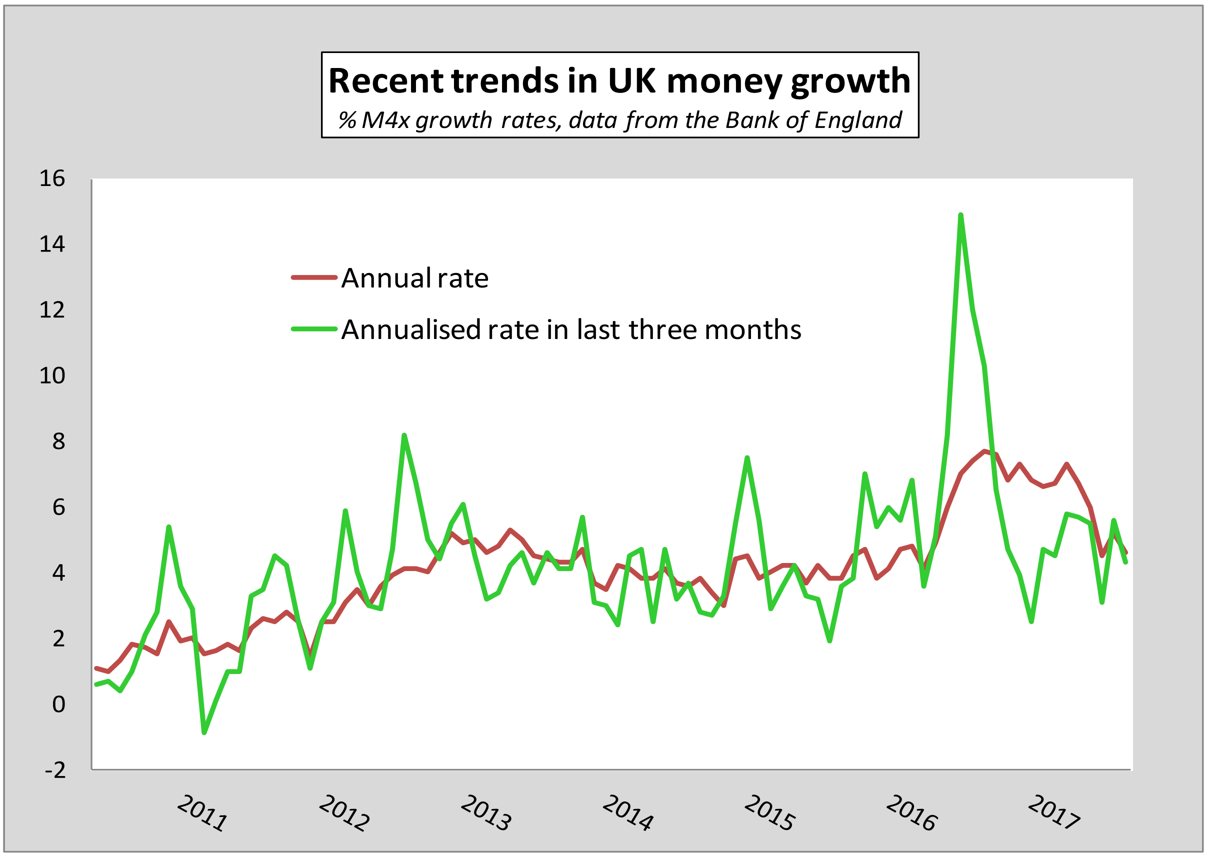
John Petley
17th November, 2017

	% annual growth rate:	
	M3	Nominal GDP
1991 - 2000	**17.4**	**14.0**
2001 - 2010	**17.3**	**14.0**
Six years to 2016	**11.8**	**11.6**

UK

	% annual/annualised growth rate:	
	M4x/M4 before 1997	Nominal GDP
1964 – 2016	**10.0**	**8.3**
Six years to 2016	**4.0**	**3.6**
Year to September 2017	**4.6**	**n/a**
Three months to August 2017 at annualised rate	**4.3**	**n/a**

Sources: Bank of England and Office for National Statistics



M4x growth falls, but inflation rises

***Summary*: UK broad money growth has returned a more satisfactory level after the excessive rises of mid-2016 followed by the unnecessary asset purchases by the Bank of England in the wake of the Brexit vote. In the third quarter of 2017 UK M4x grew at an annualised rate of 4.3% while the annual growth rate fell from 5.2% in August to 4.6%. As the graph above shows, UK broad money growth has now reverted to the more typical 3% - 5% annual rate seen before last year's surge.**

Since mid-2016 inflation has spiked upwards, following the fall in sterling in the aftermath of the Brexit vote. In early 2016 the annual rate of consumer price inflation was less than 0.5%. It is now at 3.0%, while the rise in the oil price may take the figure even higher in the next few months. Apart from oil, upward pressures on global commodity prices are not dramatic. Furthermore, sterling has stabilised recently. It has risen in value against the US dollar, although not the euro, over the last six months. Inflationary concerns nonetheless lay behind the decision by the Bank of England's Monetary Policy Committee to raise base rates by 0.25% at the start of November, the first rate rise in over a decade. The MPC also noted the tight labour market, with unemployment at a 40-year low of 4.3%. This has not, however, been accompanied by a surge in wage growth. At 2.2% in the year to September, the annual rate of wage increases is in fact lower than in 2016.

As well as raising base rates, the Bank of England has requested that commercial banks restrict unsecured lending, in particular for car purchases and credit cards. This may further dampen money growth. The latest money and credit statistics from the Bank of England paint a mixed picture. The stock of business lending grew by 2.6% in the year to September, down from 3.2% the previous month. However, the actual amount lent has fallen in both the last two months. The housing market remains robust, although the total number of new mortgages approved has fallen slightly in the last two months after hitting a 16-month high in July. So far, bank lending continues on a steady if modest, upward path, despite new regulations which are likely to impede balance sheet growth.

In the third quarter of 2017 UK GDP grew at an annual rate of 1.5%, unchanged on the figure for the second quarter. The final quarter is likely to be much the same. In October UK retail sales declined by 0.3% on an annual basis, the first fall since 2013. Uncertainties continue to be voiced about the effects of Brexit and the lack of a clear exit plan by the UK government may start to affect business investment shortly. So far, businesses have continued to borrow and invest, and exports have been particularly strong. September's export figures were the best on record. The money numbers will nonetheless merit close study in the coming months. The most likely macroeconomic outcome going into 2018 is for approximately trend growth..

John Petley
16th November, 2017

	% annual growth rate:	
	M4/M4x	Nominal GDP
1964- 2016	**10.0**	**8.3**
1991 – 2000	**7.1**	**5.0**
2001 – 2010	**6.7**	**3.9**
Six years to 2016	**4.0**	**3.6**