INTERNATIONAL MONETARY RESEARCH LIMITED

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

Monthly e-mail from Tim Congdon of International Monetary Research Ltd. – 4th September, 2015

Global money round-up in autumn 2015

August 2015 was an awkward month for financial markets, with many participants perplexed by the plunge in China's stock market. Putting China to one side, leading equity markets are 10% - 20% down from their April 2015 highs. But two points stand out. First, money trends are fine in all the big 'countries' apart from China. These are reviewed in the following pages, with developments in the Eurozone being perhaps the most positive at present. (And what a change that makes from the last few years!) Second, the Chinese authorities emphatically do not want a recession and, because inflation is tame, they can take action to boost economic activity.

In one respect the commodity price falls of recent weeks have been very healthy and encouraging. They mean that inflation will be very low or negligible in the main countries out to spring 2016 and perhaps even longer. The survey of money growth trends in the next few pages argues that *real* money growth (i.e., money growth adjusted for inflation) will be the highest since 2007 or 2008 in most of the big economies. The historical record is clear, that above-trend growth in real money balances is associated with buoyant asset markets and above-trend growth in real output. Yes, sooner or later above-trend growth of real money and output have to give way to trend growth or perhaps even beneath-trend growth rates or declines. But the slide in oil prices, and the persisting weakness in iron ore, copper and so on, are telling us that the bad news is 'later', not 'sooner'. (In any case, with broad money in the mature industrial nations generally in the vicinity of 3% - 5% at an annual rate, I don't feel the 'bad news' on inflation – when it comes in 2018 or 2019 – will be bad at all compared with the sort of numbers seen in the 1970s and 1980s. Of course, if the money growth accelerates, I will change my tune. But there is no need for that yet.)

(*Country notes from the website's World Money Map follow the introductory comment section. See below after page 4.*)

Money trends in 2015 in the main countries/jurisdictions

What are the latest money growth trends in the main countries? And what is the message for global economic activity over the next year or so, and for inflation/deflation over the medium term thereafter? The table below summarizes the key numbers. In addition to the very brief comment in the right-hand column, I offer some remarks on the contrast between the large and small banks in the USA, and attach detailed country notes for the USA, the Eurozone, China, Japan, India and the UK.

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	**5.7**	**5.5**	Money growth roughly at ideal 5% rate, but tighter regulation on big banks.
China	16.9	**23.1**	**13.3**	Major policy easing said to be under way, with big July upward blip in M2.
Eurozone	11.9	**5.2**	**5.3**	Large-scale QE seems to have had positive effect on M3 growth, best macro prospects since 2007. .
India	7.1	**11.9**	**11.5**	India continues to have positive inflation, unlike other large countries, but money growth and inflation are falling.
Japan	4.3	**3.4**	**3.3**	Broad money growth steady at low rate, with Bank of Japan reviewing options after QE programme ends. .
UK	2.3	**3.7**	**4.2**	Money growth is satisfactory, with tight regulation still main factor holding back banks' balance sheet growth.

August 2015 was an interesting month, with stock markets often in turmoil and much anxiety that the Chinese slowdown would hit commodity prices further. But money growth in fact blipped upwards in China, recovered a bit in the USA and the UK, and now shows clear signs in the Eurozone of responding to the official QE programme. The monetary environment is positive for world growth over the next year to 18 months.

I am now going to change the subject! One element in the UK policy debate in recent years has been the relentless assault on 'quantitative easing' from journalists at the Telegraph Media Group. (An honourable and brilliant exception here has been Ambrose Evans-Pritchard, international business editor on *The Daily Telegraph*.) Liam Halligan, the economics columnist on *The Sunday Telegraph*, has been the most outspoken, but Jeremy Warner has also been critical of QE and Allister Heath was been at best neutral, while occasional contributors such George Trefgarne have complained about too much 'money printing' and voiced inflation fears. James Delingpole, a columnist for *The Spectator* and one of the world's top political bloggers, made a fuss about QE in 2012, but has subsequently gone quiet.

In my latest column in *Standpoint* magazine I again attacked Halligan's line. Halligan said at the start of 2011 that I was on 'the losing side' of the argument about monetary easing, because UK inflation at that time was somewhat above target and would remain so for much of 2012 and 2013. But I expected broad money growth to stay down and that the UK's medium-term inflation prospects were alright. It is clear that over the next 18 months or so, UK inflation will be moderate, either at or beneath target. By the end of 2016 almost eight years will have elapsed since the start of QE in March 2009. In the period of a bit more than six years since March 2009 the average increase in the UK's consumer price index has been about 2½%. What will the average rate of UK CPI inflation be in December 2016? My surmise is that it will be almost exactly 2.0%, bang in line with the official target. I submit that Halligan (and his Telegraph Media Group colleagues) have been on the losing side of this inflation bet, and that I have been on the winning side.

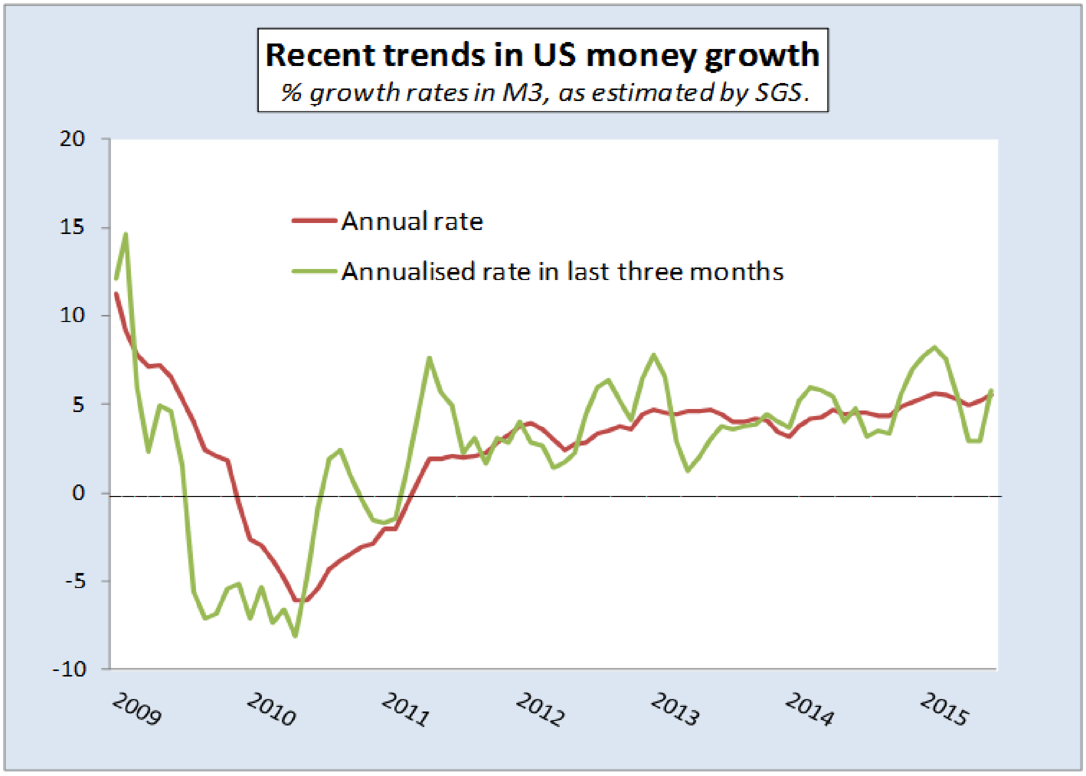
This may all seem rather petty. Well, alright, but fundamental issues of economic theory and monetary policy-making are at stake. I will return to this subject, and explain why Halligan & Co. have been wrong. The heart of the answer is easy, that they think inflation depends on 'the quantity of money', where the quantity of money is the amount 'printed by the central bank'. No, life is not that simple. The correct monetary theory of inflation must incorporate *all* money balances, including – particularly – the bank deposits created by commercial banks. To be continued….

4th September, 2015

USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1960 - 2014	**7.6**	**6.7**
Four years to 2014	**4.0**	**3.9**
Year to July 2015	**5.5**	**n.a**
Three months to July 2015 at annualised rate	**5.7**	**n.a.**

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



M3 growth picking up again?

Summary: **US broad money growth picked up further in July after a slowdown caused by unusually high tax payments during April and May.* The quantity of money grew by only $25b. in April and $32 in May, causing annualised quarterly to fall to 2.9% in May and June. However, M3 rose by $62b. in June and no less than $139b. in July, which helped the annualised growth rate to rise from 2.9% to 5.7%. Credit to the private sector remains resilient and US money growth has now returned to the 5%-at-an-annualised rate money growth – solid, but not spectacular. (Note that the M3 data used in this note are from the Shadow Government Statistics research company.)**

US businesses and home buyers are borrowing money at a healthy rate. In the three months to June 'loans and leases in bank credit' rose by just over 1.6% or at annualised rate of 6.8%. However, it is of course banks' liabilities - which are money - that count in the determination of national income and wealth. Here the picture is satisfactory or even encouraging after a fall in total bank deposits of $9 billion during April. June and July saw deposit growth at US commercial banks of $46 billion and $48 billion respectively. These figures are lower than those for the first quarter of 2015, when the total stock of bank deposits grew by over $230 billion, but July's annualised deposit growth rate of just under 5.2% is consistent with steady growth of nominal GDP with low inflation.

The money figures suggest that the US economy is strong enough to cope with an increase in Fed funds rate. Janet Yellen, the Governor of the Federal Reserve, has suggested that the first rise in Fed funds rate may well take place before the end of the year. Alongside the worries - probably overblown – about a downturn in China, a more serious concern is the threat of additional regulation as proposed by the Financial Standards Board which would demand even higher capital-to-asset ratios and thus act as a further dampener on broad money growth. On balance, however, the monetary data still suggest that the solid and promising recovery will continue.

John Petley
1st September, 2015

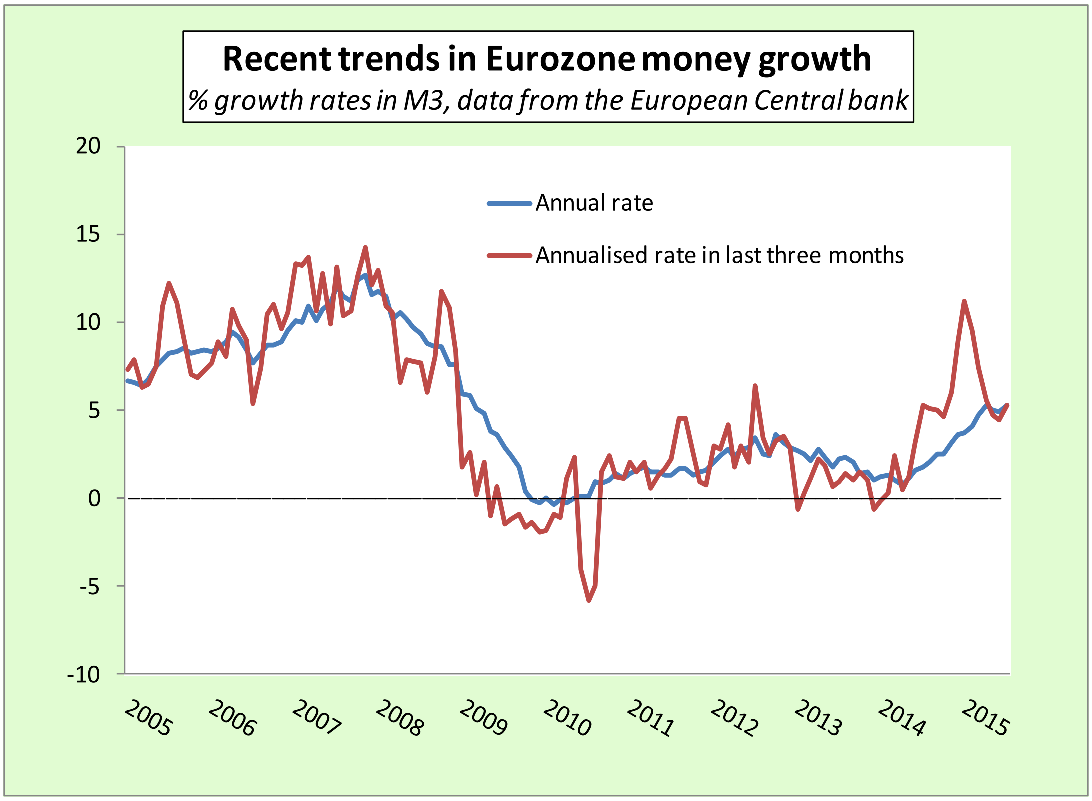
* When I pay taxes, my bank deposits fall and the government's deposit rises. The government's deposit is excluded from the quantity of money, on the grounds that its money balance has little effect on its behaviour. So high tax payments, in association with a net surplus on government finances, reduce the quantity of money.

	% annual growth rate:	
	M3	Nominal GDP
1960 – 2014	**7.6**	**6.7**
1960 – 1970	**7.7**	**7.7**
1971 – 1980	**11.4**	**10.7**
1981 – 1990	**7.7**	**7.7**
1991 - 2000	**5.6**	**5.6**
2001 - 2010	**7.1**	**3.9**
Four years to 2014	**4.0**	**3.9**

Eurozone/Euroland

	% annual/annualised growth rate:	
	M3	Nominal GDP
1995 – 2014	**5.3**	**3.1**
Four years to 2014	**2.6**	**1.3**
Year to July 2015	**5.3**	**n/a**
Three months to July 2015 at annualised rate	**5.2**	**n/a**

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



Money growth shows that QE is having an effect

***Summary*: In the three months to July 2015, M3 in the Eurozone grew at an annual rate of 5.2%. Eurozone broad money growth seems to be running, with some consistency, at a higher rate than in the years immediately after the Great Recession. In July, M3 itself increased by €90b., sharply up on the €30b. growth seen in June, when the annualised quarterly growth rate stood at 4.8%. The ECB's 'quantitative easing' programme which initially appeared to be having less effect than expected, is now boosting money growth in several major Eurozone economies, notably France and Germany. The macroeconomic prospect across the single currency area is more benign that at any time since the Great Recession.**

As the chart shows, Eurozone money growth began to perk up even before the beginning of March when the ECB launched its QE programme, with a planned €60b. of securities purchases each month, However, the effects of QE on money growth has, until recently, been a little disappointing. July's data suggest that a corner is being turned. Deposits by businesses rose by 5.5% in the year to July, significantly up on the 4.2% growth in the year to June, although the annual household deposit growth only rose very modestly from 3.0% to 3.1% in the same period. Until July, deposits held by businesses were growing more slowly than M3 as a whole, but this is no longer the case. The latest ECB press release finally indicates some decent growth in the stock of business loans, with the annual growth rate finally turning positive, albeit only 0.4%. Household borrowing, particularly mortgage lending, has been increasing for several months now. All in all, the figures are indicating a rise in confidence across the region, with much less concern about the health of the region's banks.

The QE operations started in March and are currently scheduled to last until September 2016. Unlike the Bank of Japan, the ECB is purchasing securities from domestic non-banks and it is having a positive effect on money growth and on the wider economy. However, Mario Draghi has not come anywhere near his stated objective of raising the annual inflation rate to 2%. Consumer prices ("prices in the shops") rose by 0.2% in the year to August, the third consecutive months of annual consumer price inflation at this level. In that context Eurozone *real* (i.e., inflation-adjusted) money growth is the highest it has been since before the Great Recession and the weak inflation data therefore should not pose any problems to an economy which is finally on the mend. The Greek situation still remains hard to predict, but with this caveat, Eurozone money trends have a more encouraging message for the macro outlook than for over eight years.

John Petley
1st September, 2015

	% annual growth rate:	
	M3	Nominal GDP
1995- 2014	**5.3**	**3.1**
1995 – 2000	**4.5**	**4.0**
2001 – 2010	**6.7**	**3.4**
Four years to 2014	**2.6**	**1.3**

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China

	% annual/annualised growth rate:	
	M2	Nominal GDP
1991- 2014	**20.3**	**15.8**
2010 - 2014	**15.2**	**12.8**
Year to July 2015	**13.3**	**n/a**
Three months to July 2015 at annualised rate	**23.1**	**n/a**

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

M2 growth higher in July

Summary: **Broad money growth rose significantly in July, with the annualised quarterly rate hitting 23.1% after standing at only 11.7% in the three months to June. This is the highest growth rate since December 2012. The annual growth rate also increased to 13.3%, the first month in which it has bettered the Chinese government's 12% target. Annualised quarterly growth was rising gently in April, May and June, but such a big spike in growth in a single month is unprecedented after over three years of steadily declining money growth until early 2015.**

A noticeable increase in the growth in the stock of Chinese bank deposits occurred during July. Deposits were up by 12.9% in the year to July, compared with 10.6% in the year to June. In the previous three/four months, the annual rate of deposit growth lay within a 10% - 11% band. A statement from the People's Bank of China on 12th August insisted that July's large fluctuation in M2 was "temporary and tractable", but did not give an explanation of its cause. Media reports of PBOC action to check the stock market fall include references to loans to China Securities Finance Corporation to fund purchases of equities. To the extent that equities were bought from non-banks, the result would be an exactly equivalent increase in broad money. On 9th July a *Financial Times* reporter impishly described the operations as "quantitative easing with Chinese characteristics". Earlier in the summer the PBOC was said to have intervened in financial markets, to help local governments roll over their debts at reasonable yields. (Over-supply had been pushing the yields upwards.) Again, purchases of local government paper from non-banks (or from local governments which then made payments to non-banks) would boost broad money.

The stock market turbulence seems out of all proportion to the economic data. Although the Chinese authorities are continuing their crackdown on the shadow banking sector, lending by the official banks grew by 14.4% in the year to July. Anecdotal evidence suggests that China's housing market is seeing some signs of recovery, at least in the biggest cities. Chinese GDP reportedly grew by 1.7% in the second quarter of 2015, up from 1.4%, although the data are widely viewed as suspect. PBOC cut interest rates for the fifth time in less than a year on 25th August. The current benchmark one-year lending rate is now at a record low of 4.6% and a further cut of 0.5% in banks' reserve ratio requirements will come into force on 6th September. Further monetary easing may be in prospect, as consumer inflation remains well below the governments' 3% target.

The Chinese authorities' priority is to preserve social stability. They do not want a recession. The PBOC is likely to take a relaxed view of an upturn in broad money growth, if that is an implication of its recent activities.

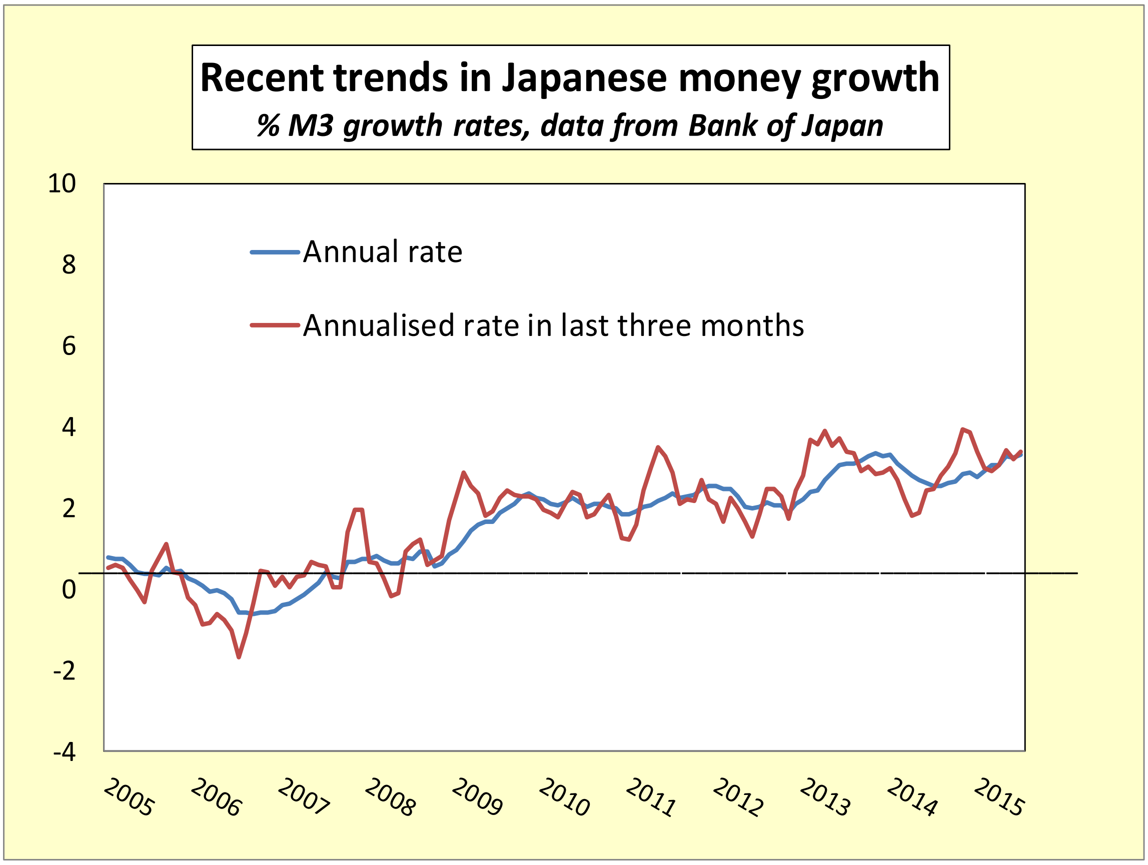
John Petley
2nd September, 2015

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

Japan

	% annual/annualised growth rate:	
	M3	Nominal GDP
1991- 2014	1.9	0.4
2010 - 2014	2.5	0.8
Year to July 2015	3.3	n/a
Three months to July 2015 at annualised rate	3.4	n/a

Sources: Bank of Japan for M3 and IMF for GDP



Broad money growth remains subdued

***Summary:* In the three months to July 2015, Japanese M3 grew at an annualised rate of 3.4%. This is a slight improvement on the three months to June, when annualised broad money growth stood at 3.2%. As the graph above shows, the QE programme launched by the Bank of Japan last year has had only a very limited impact on Japanese money trend, with the growth rate in the two years to spring 2015 being only 1% - 1½% (i.e., at 3% - 4% a year instead of 2% a year) higher than in the two years before the asset purchase programme began.**

The BoJ's Governor Kuroda stated on 21st July that he expected inflation to pick up during the rest of the year and thus saw no need to increase the QE programme. He based his hopes on the tight conditions in Japan's labour market, where the level of unemployment has fallen below 3.5% since the start of the year. With a decline in the working-age population, however, there is no guarantee that low unemployment necessarily heralds upward pressure on wages or prices. Kuroda had pinned his hopes on QE to end Japan's deflation problem, initially aiming for a 2% target by April 2015. The most recent statement, however, anticipated a CPI of only 0.7% by the end of the fiscal year in March 2016. (The current annual inflation rate is 0.4%, down from 0.5% in the year to June.) Japanese bank lending has also shown little response to QE. For much of the first 18 months of the programme, Japanese banks sat on their greatly-increased additional cash assets and the stock of bank lending was growing at an annualised rate of between 2% and 2.3%. In November, the growth rate shot up to 2.7%, but this has been followed by eight months where lending to the private sector has remained more or less static, at a monthly level of between 420 and 426 trillion yen. Neither businesses nor households seem to be showing any increased appetite for risk, in spite of the accommodative monetary environment. Since the start of the year, the number of housing starts has begun to increase, but there is little other positive news.

The money numbers do not, therefore, suggest any significant change to the performance of Japan's lacklustre economy during the remainder of 2015. As long as the Bank of Japan concentrates on buying short-dated paper from the banks instead of buying assets from non-banks – in other words, targeting the monetary base rather than broad money – the economy will continue to do little better than muddle along. Money growth is higher than it was before Kuroda was appointed and there has been no deflation for almost two years, but given that the scale of asset purchases amount to 1.4% of GDP each month, this modest improvement to Japan's economic performance hardly justifies the initial euphoria over "Abenomics".

John Petley
15th July, 2015

	% annual growth rate:	
	M3	Nominal GDP
1981 – 1990	**9.2**	**6.2**
1991 - 2000	**2.4**	**1.3**
2001 - 2010	**1.1**	**-0.5**
Four years to 2014	**2.6**	**-0.3**

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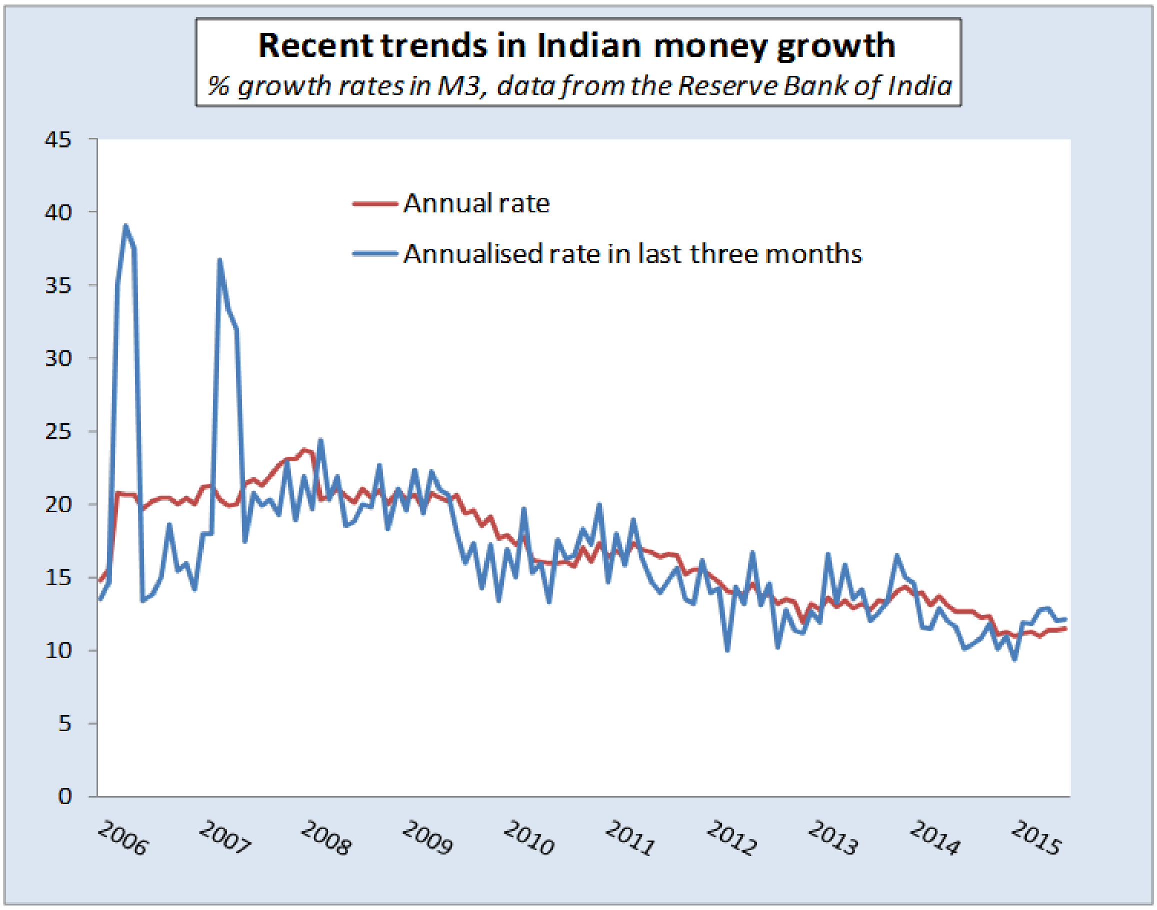
India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1991- 2014	**16.5**	**13.8**
2010 - 2014	**14.2**	**14.4**
Year to June 2015	**11.5**	**n/a**
Three months to June 2015 at annualised rate	**11.9**	**n/a**

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



Slower, but stable money growth

Summary: **In the three months to July 2015, Indian M3 grew at an annualised rate of 12.1%. The annual growth rate rose from 11.4% to 11.5%. The annualised quarterly growth rate is unchanged from June's figure, which was down on 12.9% recorded in the three months to May. This suggests that what looked like a pick-up in the growth rate at the start of the second quarter of 2015 has proved short-lived. As the chart above shows, however, broad money growth is reasonably stable and the slowdown during the first half of 2014 has not continued into 2015.**

Furthermore, although M3 is now growing at a slower rate than a few years ago, India's economy is in a far more stable position. India has only recently emerged from a period of "stagflation", where broad money growth - and the overall economy - were slowing, while inflation remained stubbornly high. Consumer price inflation fell to 3.8% in the year to July 2015, the lowest figure for several years and a fall of over 1.5% in the figure for the 12 months to June. This lower inflation rate may not persist as the rupee has weakened since the start of August. However, the Reserve Bank of India is under pressure from the government to take advantage of the current drop in inflation to cut the benchmark interest rate further, following three reductions since December - on each occasion by 0.25%.

Data from the banks give a mixed picture. As recently as February 2015, the stock of bank lending to businesses was rising by barely 10% per annum, a decline on the 14% recorded a year earlier. Deposit growth, after accelerating in the second quarter, has fallen back since June, with annual deposit growth for all banks standing at 11% in the year to 7th August. The annual growth in bank lending is lower still, running at just under 9.5% over the same period. A report by the Reserve bank of India published at the end of June put the blame on the high levels of debt already incurred by large Indian companies.

The money figures suggest that India's economy has improved on its lacklustre growth rate of recent years. Better macroeconomic management has succeeded in overcoming some of the problems (too much inflation, the slide in the rupee) that were causing so much concern two years ago, but there is scope for further improvement.

John Petley
2nd September, 2015

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

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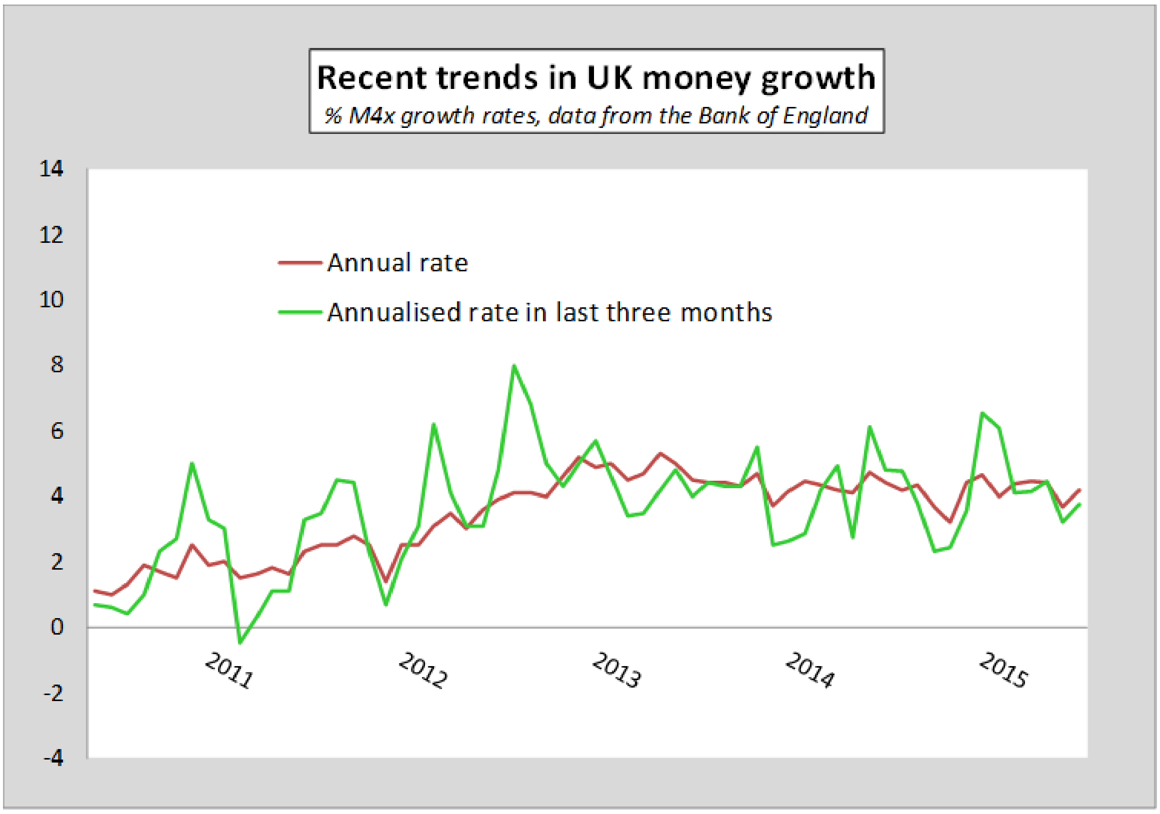
UK

	% annual/annualised growth rate:	
	M4x/M4 before 1997	Nominal GDP
1964 – 2014	**10.1**	**8.3**
Four years to 2014	**3.7**	**3.4**
Year to June 2015	**4.2**	**3½ ***
Three months to July 2015 at annualised rate	**3.7**	**n/a**

Sources: Bank of England and Office for National Statistics. Numbers with asterisks are International Monetary Research Ltd. estimates.



'Steady as she goes', with no obvious need for higher rates

***Summary*: Broad money growth has been stable at a low rate in 2015, with no sign of any acceleration in growth. In the last three months M4x has increased by 3.8%, which is more or less ideal in association with a 2% inflation target. Bank credit growth has been sluggish this year, although it perked up a bit in July. Data for unused credit commitments are weak. Money numbers do not support the case for an early or large increase in Bank rate. The tightening labour market may do so, but the argument is not obviously compelling.**

Over the last five years the annual growth rate of the quantity of money, broadly-defined, has been consistently between zero and 5%. The contrast to most previous post-war quinquenniums, in many of which money growth averaged over 10% a year, is sharp and definite. The monetarist argument has always been that, if money growth is kept at a low rate over the medium term, inflation will remain under control. That is exactly what has happened. The last few years have seen the lowest increases in nominal GDP and the price level, over a sustained period, since the 1930s.

But the talk is of an increase in Bank rate in early 2016. (The recent commodity price weakness and dips in the stock market have discouraged an earlier move.) A tightening of labour market conditions is usually cited as the main justification, and it is indeed true that job growth and the decline in the unemployment rate since 2010 have been impressive. However, the latest money numbers do not support the argument for an increase in Bank rate. M4x (i.e., broad money, excluding the balances held by 'intermediate other financial corporations' or quasi-banks) went up by 0.5% in July, but the annualised growth rate in the three months to July was 3.7%. This was bang in line with the average in the last four years, and is consistent with the low inflation and moderate growth enjoyed in the period. The growth of credit to the private sector has been sluggish so far in 2015, although July (with an increase in M4Lx of 0.5%) was a relatively strong month. For all the official talk of the benefits of lending to small- and medium-sized enterprises, UK banks' unused credit commitments are lower now than a year ago. Indeed, the change in bank taxation in George Osborne's latest Budget has increased uncertainty and will have discouraged banks from being too adventurous with their capital.

Nevertheless, the shift in the incidence of the bank tax towards smaller banks seems to have had some effect on HSBC and Standard Chartered, which have openly threatened to move their headquarters from the UK. Most of the two banks' operations are abroad anyway, but their situation illustrates the importance of the official regulatory environment to banks' expansion strategies. For the time being, it is not clear that – at the current almost zero interest rates – broad money growth will rise so strongly as to threaten the 2% inflation target. Indeed, the latest indicators of costs and prices from business surveys suggest continued minimal inflation well into 2016.

Tim Congdon
2nd September, 2015

	% annual growth rate:	
	M4/M4x	Nominal GDP
1964- 2014	**10.1**	**8.3**
1991 – 2000	**7.5**	**5.9**
2001 – 2010	**7.0**	**4.2**
Four years to 2014	**3.7**	**3.4**