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Monthly e-mail from Tim Congdon – 4th October, 2016

Global money round-up in autumn 2016

Political uncertainty is the big problem for monetary policy-makers right now. **The possibility of a Donald Trump victory in the US presidential election on 8th November hangs over financial markets, with no one being entirely sure what he might do. Given his attacks on the Federal Reserve, it has been suggested that its current chairman, Janet Yellen, might have to resign straightaway.** While that may be unduly alarmist, Trump's populism might result in attacks on several established institutions, not just in the USA, but globally, including the International Monetary Fund and the World Trade Organization, and perhaps the Bank for International Settlements. In the more likely result of Hillary Clinton becoming the next president, little change is to be expected in the world economy's (and the US economy's) institutional framework. **American money growth at present (at a 6.4% annualised rate in the three months to August) is fine, and is consistent with at least trend demand growth in the next few quarters.**

But it is not just Donald Trump who is unhappy with international institutions. **Last month German finance minister, Wolfgang Schaeuble, let the Basel Committee on Banking Supervision know, on behalf of Europe's bankers, that he is unhappy with the constant demands for extra capital which the BIS is making.** This is long overdue and may herald a pause in the bank capital push that has blighted the world economy since 2008. The ruckus over the potential \$14b. fine on Deutsche Bank may be part of the reason for Schaeuble's comment. **The wider importance of the debate here is that, with the proposed capital requirements, Europe's banks do not want to expand lending. Negligible money growth then ensues, unless the European Central Bank pursues "quantitative easing".**

Money trends in autumn 2016 in the main countries/jurisdictions

What are the latest money growth trends in the main countries? And what is the message for global economic activity over the next year or so, and for inflation/deflation over the medium term thereafter? The table below summarizes the key numbers. For detail, it is recommended that the reader looks at the individual country comments below. Beneath the table I make an overall assessment.

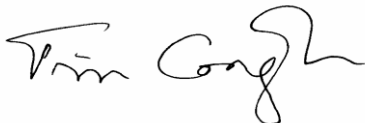
Name of country/ Jurisdiction	Share of world output, in purchasing-power-parity terms, %	Growth rate of broad money, in last three months at annualised rate, %	Growth rate of broad money, in last twelve months, %	Comment:
USA	16.1	6.4	4.2	Money growth rising, despite regulatory attack on banks.
China	16.9	13.8	11.4	Money growth up in recent months in stable context..
Eurozone	11.9	5.8	5.1	QE working well, with annual M3 growth at almost ideal 5% rate.
India	7.1	11.5	10.4	Money growth weak by standards of recent years, but economy doing well..
Japan	4.3	2.6	2.9	Broad money growth low, turning downwards recently.
UK	2.3	10.9	7.3	Money growth jumps. Much-criticised policy easing to avert supposed post-Brexit recession.

Money growth has *increased* over the summer months in five of the six jurisdictions followed in the above table. (Japan is the exception.) The increases have been small, with the exception of the UK, which will be discussed in the next paragraph. However, an important point follows. Nothing is apparent in global monetary trends to justify alarmism about the global economic outlook into early 2017, despite newspaper reporting of caution and nervousness from the IMF and other international bodies. The IMF was heavily complicit, along with the OECD and the BIS, in the warnings about excessive debt that were articulated, with far too much gloom and doom, at the start of 2016. Those warnings, along with the anxiety about a post-Brexit referendum recession, have turned out to be unfounded. If we put Donald Trump, Vladimir Putin, Kim Jong-un and other imponderables to one side, there are no grounds for worry that financial markets are about to suffer from a 2008-like banking-and-money-related cataclysm.

The UK is a bit special, because of the extreme positions that have been taken in the public debate over the EU membership referendum. The debate became overheated, not least because metropolitan liberal pundits (what else does one call them?) seemed to think that the sky would fall in on the morning after a majority of the British people indicated that they wanted to leave the EU. Forecasts of

a major post-referendum recession were made by Brexit's opponents, many of them in influential positions in the government machine and think-tanks. The Bank of England joined the hysteria, partly on the back of misleading opinion surveys in July. On 4th August Bank rate was cut to a mere ¼ per cent and, more important, £60b. of extra asset purchases were announced. The £60b. of asset purchases implied a big jump in broad money. But, as has been widely remarked, this additional stimulus was being envisaged when money growth was already rather high. In the three months to July the annualised rate of growth of M4x was 14.7%! In the event, money growth in August was less than in the previous two months and the annualised growth rate in the three months to August was a more reasonable 10.9%. Even so, the case for the asset purchases is far from compelling and there has to be a possibility that the MPC will revise down the asset purchases figure. Needless to say, the forecasts of a recession are being withdrawn.

More important for the long term, disagreements seem to be emerging between American and European policy-makers about bank capital standards. Indeed, the larger import of Schaeuble's protests last month against the latest round of BIS bank capital demands is that Europe's bankers are making their views known. (It seems that in Germany, as in India, bankers still have the means to influence policy thinking when central bank governors and associated parties attack their interests.)* The post-2008 drive for ever higher capital ratios implied major damage to their profitability and indeed their commercial viability. Certainly, Europe's banks could not expand their risk assets, which in turn meant (and means) that small companies were (and are) starved of external finance. If German hostility to the BIS bank capital push signals the end of that push, this is good news for a return to a more sensible and pragmatic capital regime for the banks, and the resumption over the medium term of banks' ability to lend and acquire new risk assets. For the time being, the American banking system is growing, despite the regulatory attack, while in the Eurozone QE is having the desired impact in boosting broad money growth. In the three months to August US M3 rose at a healthy annualised rate of 6.4%, while Eurozone M3 moved ahead on the same basis at a rate of 5.8%. As I said, these numbers support moderate or even rather high increases in nominal GDP, and are fine.



3rd October, 2016

* Let me make clear that I do not regard bankers as angels, saints, geniuses or even masters of the universe. But they ought to be able to make a profit for their shareholders, if they obey the law and comply with regulations. If they cannot do that, their businesses will eventually disappear from modern economies where people expect a positive rate of return on their investments. (Or they will come into government ownership, although evidence from everywhere shows that leads to poor outcomes all round.)



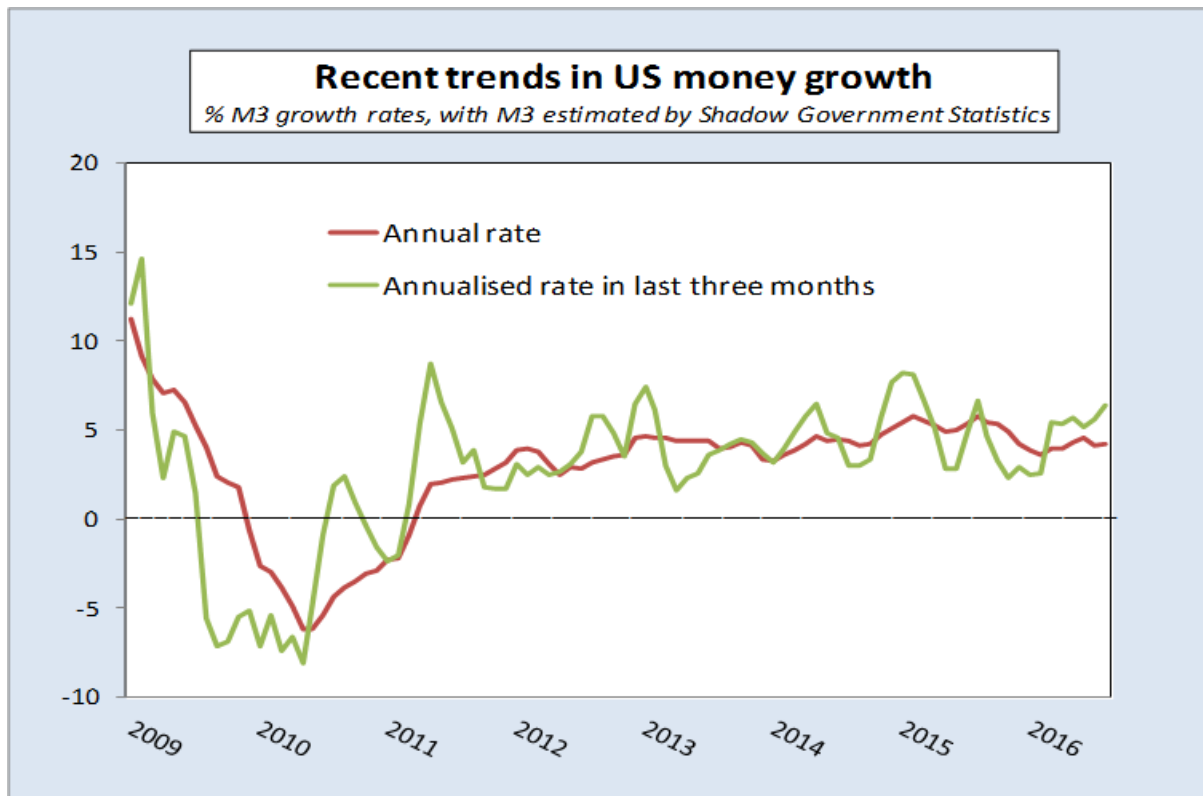
**INSTITUTE OF
INTERNATIONAL
MONETARY RESEARCH**

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

USA

	<i>% annual/annualised growth rate:</i>	
	M3	Nominal GDP
1959 - 2015	7.5	6.6
Four years to 2015	4.3	3.8
Year to August 2016	4.2	n.a.
Three months to August 2016 at annualised rate	6.4	n.a.

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



M3 growth has improved from late 2015 dip

Summary: In the three months to August 2016 US M3 grew at an annualised rate of 6.4%. August itself saw an increase in M3 of \$110b, well up on July's figure of \$61b which was below the recent average. After a dip in late 2015, caused by the Fed's preparedness to run down the stock of assets acquired in its "quantitative easing" operations, broad money growth is now running at satisfactory, even rather high levels. Bank credit to the private sector continues to be quite buoyant, despite the regulatory attack on big commercial banks. (Note that the M3 data used in this note are from the Shadow Government Statistics research company.)

The only legacy of the Fed's running off some of the assets acquired by the Fed in its QE programmes – so-called "quantitative tightening" – has been a shrinkage in US banks' cash assets. In October 2014, they amounted to almost \$3,000b. and still averaged \$2,759b. in October 2015. That figure had fallen to \$2,545.1b. by April of this year and it has continued on its downward path in the following three months, standing at \$2,430.5b, in August. However, provisional figures for the first half of September suggest that cash assets have finally started to grow again after this protracted decline.

"QT" notwithstanding, US money growth continues to be reasonably steady and stable. It is now approaching two years since the Fed exited its QE programme and the average annual money growth rate for the last 24 months has been 4.8%, with a low of 3.6% in February of this year and a high of 5.8% in both February and August 2015. This is below that long-term average for US broad money growth, but coupled with low consumer price inflation (currently running at 1.1% in the year to August), the conditions are favourable for steady growth.

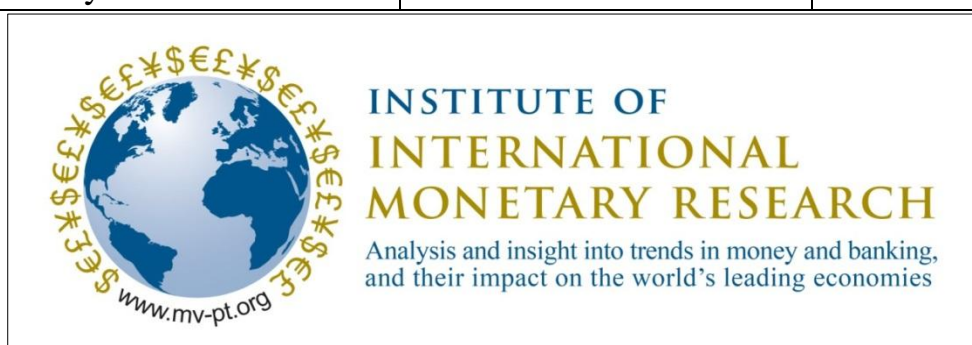
This is precisely what data from the Fed is indicating. Bank lending to the private sector has been the important driving force behind money growth for the last four years and the most recent figures indicate a continuation of this trend. The stock of mortgage lending rose at an annual rate of 6.4% in the year to August. There was a slowdown in business lending during August and the total monthly amount lent has remained fairly static for four months now, but it is still 8% higher than the figure for

August 2015. The unemployment rate still stands at 4.9%, after rising from 4.7% to 4.9% in June, 151,000 new jobs were created in August, which was quite a drop on the 275,000 created in July, but sufficient to keep the unemployment rate down to 5% or less for an 11th consecutive month.

The US economy has left the Great Recession behind and is performing well. With US house prices rising at an average annual rate of 5%, a further rise in the Fed Funds Rate looks likely at some point before the end of the year, but given the forthcoming election, it may not take place until December.

John Petley
28th September, 2016

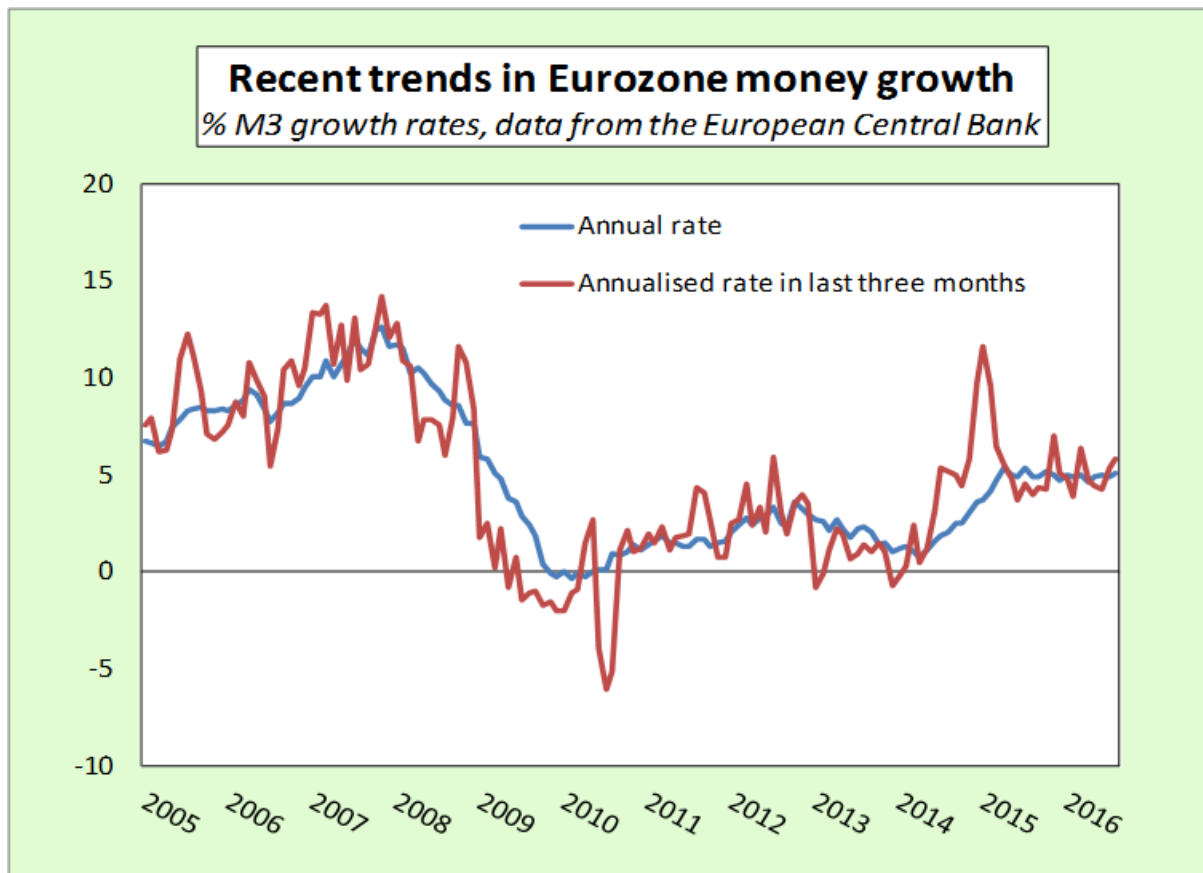
	% annual growth rate:	
	M3	Nominal GDP
1960 – 2014	7.6	6.7
1960 – 1970	7.7	7.7
1971 – 1980	11.4	10.7
1981 – 1990	7.7	7.7
1991 - 2000	5.6	5.6
2001 - 2010	7.1	3.9
Four years to 2015	4.3	3.8



Eurozone/Euroland

	% annual/annualised growth rate:	
	M3	Nominal GDP
1995 – 2015	5.3	3.1
Five years to 2015	3.0	1.6
Year to August 2016	5.1	n/a
Three months to August 2016 at annualised rate	5.8	n/a

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



Money growth still satisfactory as QE continues

Summary: In the three months to August 2016 the Eurozone’s M3 quantity of money grew at an annualised rate of 5.8%. Meanwhile the annual rate of broad money growth remains close to 5% - a more or less ideal number in view of nagging deflation fears – just as it has done since spring 2015. The ECB’s “quantitative easing” programme has been successful. Annual broad money growth has risen from its 2009 – 2013 average (of a mere 2% or so), helping the Eurozone to achieve a clear cyclical rebound. The German economy, in particular, has seen robust domestic demand in recent months.

The ECB’s QE programme was launched to combat weak demand growth and the associated deflation in some Eurozone member states. The annual consumer price inflation rate stood at 0.2% in August, the third consecutive month of positive data, albeit well below the figure of 2% which is the top of the ECB’s notion of “price stability”. Some individual countries, notably Italy and Greece, are still suffering deflation although Spain recorded its first positive inflation figures in 14 months in September. For all the criticism over the ongoing low inflation, however, the ECB’s QE programme has worked almost to perfection as far as money growth is concerned. Since its announcement in February 2015 the annual growth rate of M3 has moved up to 5% and stayed there with some consistency. In the five years to end-2014 the annual growth rate of M3 had averaged under 2%. The contrast in money growth between the pre- and post-QE-announcement periods is clear. Further, the credit counterparts data show that the money growth upturn reflects increased bank acquisition of government securities, just the pattern to be expected with a large-scale QE programme.

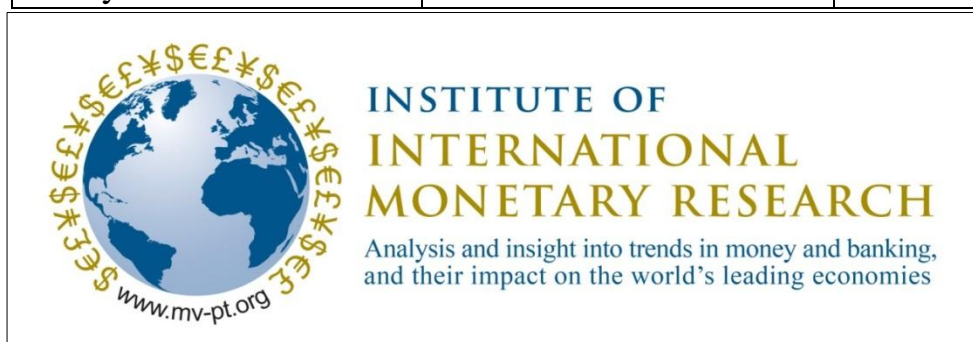
In August, M3 grew by €48b., down on the €63b. growth recorded in July but still above the average for the 18-month period since QE was launched. The ECB’s credit counterparts data show a slowdown in bank credit to general government and business lending, although the stock of mortgage lending

continues to grow. The drop in credit to government may be due to the ECB's difficulties in finding appropriate government securities to buy, an issue which has caused some recent discussion.

One feature of the first half of 2016 was the strong money growth in Germany compared with other Eurozone member states. In the year to July, Germany's M3 advanced by 7.4%, whereas it went up only 3.9% in the rest of the Eurozone. A month later, the figures were 7.2% and 4.7% respectively – still a significant divergence – but German M3 grew by only €1b. during the month, the smallest monthly increase since March 2014 when German M3 actually shrank. The figure may be a blip. German anti-inflation hawkish attitudes remain entrenched. Jens Weidmann, the Bundesbank president, insisted earlier this month that “the risks of ultra-loose monetary policy become larger the longer the phase of low interest rates lasts”. Any early scaling back of QE nonetheless looks unlikely. Fears remain about the level of non-performing loans at some Italian banks. At the moment, with inflation low and money growth at a satisfactory level overall, QE is keeping the Eurozone economy in reasonable shape, especially compared with the stagnation of 2012 and 2013.

John Petley
29th September, 2016

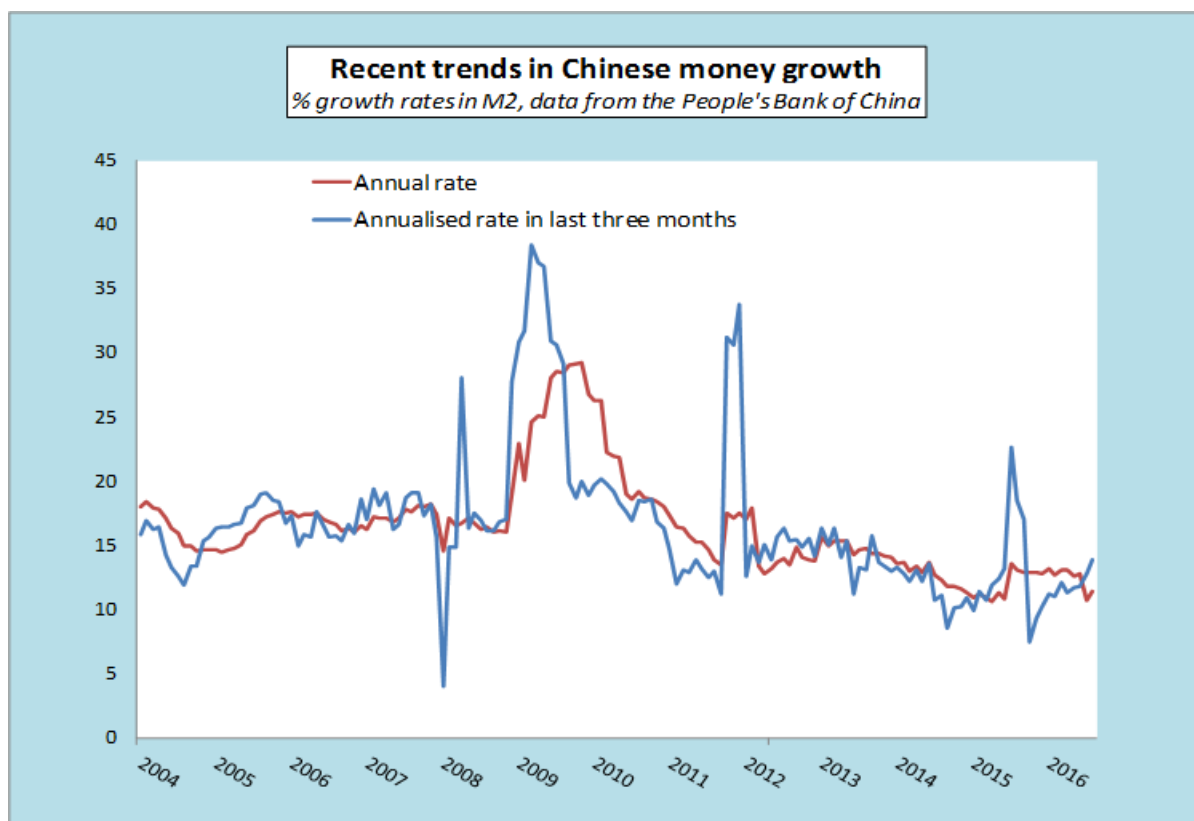
	% annual growth rate:	
	M3	Nominal GDP
1995- 2015	5.3	3.1
1995 – 2000	4.5	4.0
2001 – 2010	6.7	3.4
Five years to 2015	3.0	1.6



China

	% annual/annualised growth rate:	
	M2	Nominal GDP
1991- 2014	20.3	15.8
2010 - 2014	15.2	12.8
Year to August 2016	11.4	n/a
Three months to August 2016 at annualised rate	13.8	n/a

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



Broad money growth continues at a respectable level

Summary: In the three months to August 2016 China's M2 expanded by 3.4% or at an annualised rate of 13.8%. This is the highest figure recorded so far this year. The seasonally adjusted annual M2 growth rate also ticked up to 11.4%, after growing by a mere 10.7% in the year to July, the lowest figure in over a decade. The Chinese government has set a target of 13% annual broad money growth. While this looks unlikely to be met in 2016, the shortfall should be small. The People's Bank of China, the central bank, seems comfortable with the figures. It has held back from any further monetary stimulus for over six months now, perhaps reflecting concerns of key figures in the ruling Communist Party about too much debt.

China's leaders will unquestionably act if they feel the economy is slowing too much, as they do not want a recession. Last year China's GDP grew by just under 7%, the lowest figure in over 25 years. Growth for the first two quarters of 2016 has been lower still, at a reported 6½% or so. Annual consumer price inflation fell to 1.3% in August. But in the same month the annual change in the producer price index, which has been negative for over four years, recorded its smallest decline during this period of falling prices. Evidently, there is scope for further monetary loosening if the Chinese authorities decide in favour, especially as the CPI increase is well below the official 3% target.

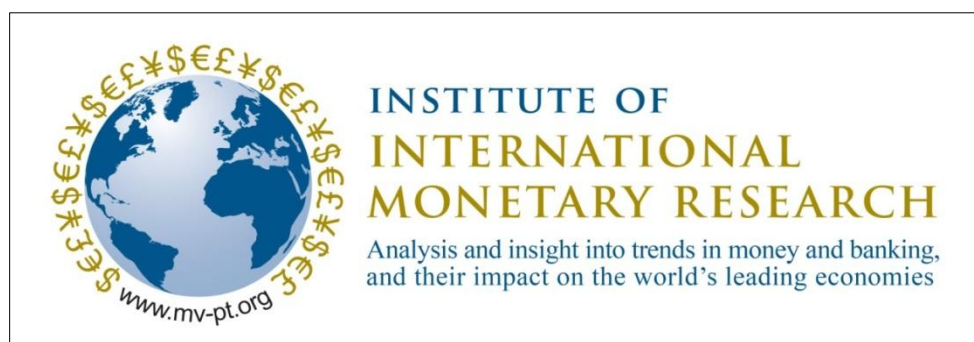
Counselling against further monetary loosening is the strong growth in the housing market. Property prices in the 70 largest Chinese cities rose by an average of 9.2% in the year to August, with Beijing and Shanghai recording price growth of 23.5% and 31.2% respectively. These gains have occurred, even though the government has imposed curbs on mortgage lending in several cities. This represents a further strengthening of the housing market during the month. In July, prices were either static or declining in 19 of these cities. In August, the number fell to six. The growth in private sector lending

also picked up slightly after falling from an annual rate of 14.3% to 12.9% in July. The number of new car registrations also rose during the month, although still under 75% of December 2015's peak of 2,442,100.

Media warnings about a sharp slowdown in China's economy have been doing the rounds for years. There are unquestionably areas of concern, from booming property prices on the one hand to non-performing loans on the other. The IMF recently estimated that the debt levels of Chinese businesses amount to 145% of the country's GDP. The recent money figures suggest that in spite of these concerns, a "hard landing" looks unlikely. The country ought to enjoy a respectable level of economic growth in the second half of 2016, although the Chinese authorities still face many challenges in their attempts to re-balance the economy away from investment towards consumption..

John Petley
29th September, 2016

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

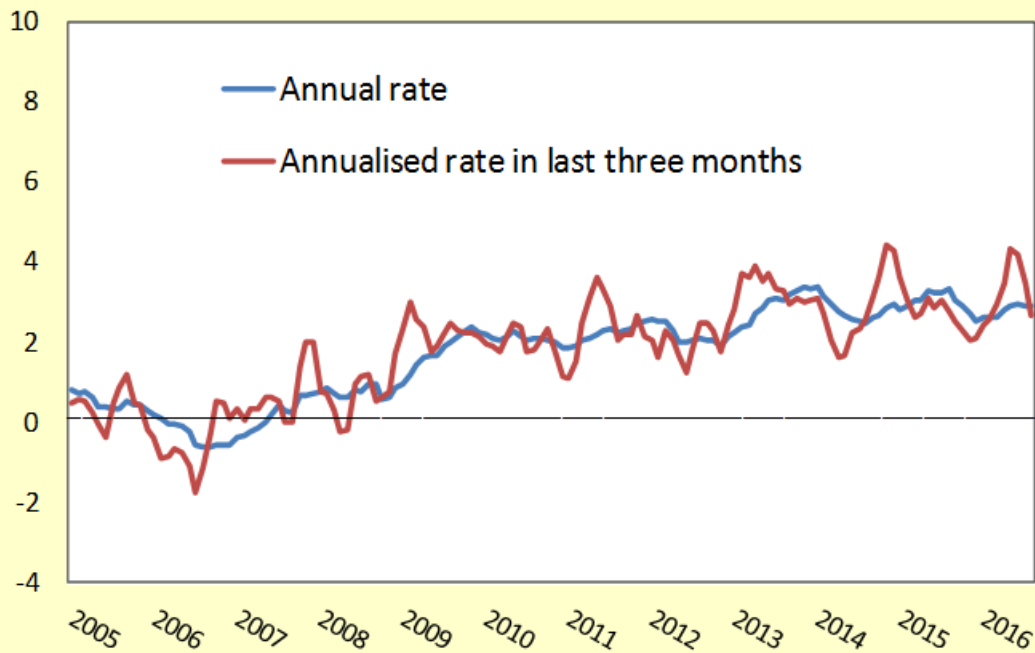


Japan

	% annual/annualised growth rate:	
	M3	Nominal GDP
1971- 2015	6.3	4.3
Five years to 2015	2.7	0.4
Year to August 2016	2.9	n/a
Three months to August 2016 at annualised rate	2.6	n/a

Sources: Bank of Japan for M3 and IMF for GDP

Recent trends in Japanese money growth % M3 growth rates, data from Bank of Japan



Broad money growth still moderate

Summary: In the three months to August 2016 Japanese M3 grew at an annualised rate of 2.6%. This marks the third consecutive month of declining growth after the annualised quarterly broad money growth rate hit 4.3% in May, the highest rate since December 2014. The annual rate of broad money growth has now remained unchanged at 2.9% for four consecutive months.

It is now over three years since the Bank of Japan launched its programme of so-called “quantitative and qualitative easing”, consisting mostly in central bank asset purchases. Seeking to stimulate the economy (and inflation) further, it then additionally brought in a policy of “negative interest rates” at the start of 2016. September saw the introduction of yet another measure in September, known as “yield curve control”, whereby the BOJ will buy as many 10-year government bonds as necessary to keep yields at their current level of 0%. (Apparently the BOJ thinks that this measure will stimulate bank lending, although to many observers the approach is baffling.)

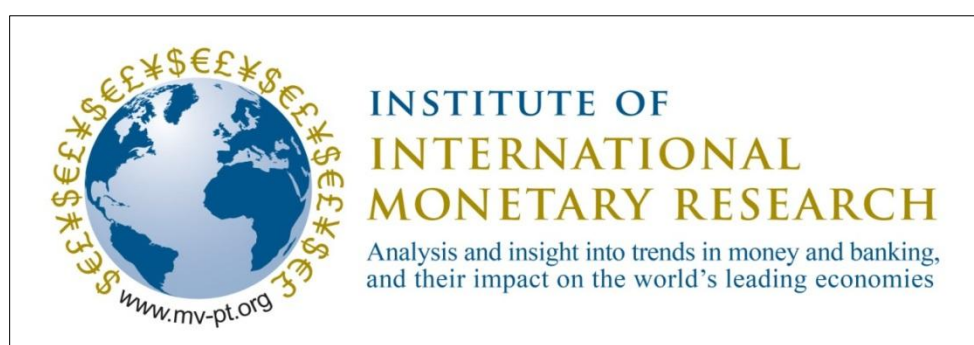
The announcement of this new strategy was accompanied by a statement from Governor Kuroda that the BOJ is determined to use every tool at its disposal to hit the 2% inflation target in 2017. In the minutes of the BOJ’s monetary meeting, which appeared on 8th August, strong hints were given that further measures were likely in September to try to reach the inflation target. However, right from the launching of the QQE programme, the Bank of Japan has repeatedly overestimated future inflation. The annual consumer price inflation rate turned negative in March, after two months at zero. It has remained in negative territory ever since, with prices falling by 0.4% in the year to July, the most recent month for which statistics are available.

The BOJ always hoped that increasing the monetary base, an approach which is understood to be one of the three “arrows” of “Abenomics”, would be the key to reaching its inflation target. The monetary base has indeed soared since the inception of the latest QQE programme in April 2013, but the

quantity of money as such (i.e., the broadly-defined M3 measure) has responded less than might have been expected. At first QE involved BOJ asset purchases of 60 – 70 trillion yen a year, but since October 2014 this has been increased to 80 trillion yen a year. This compares with a figure for total M3 of just over 1,260 trillion yen as at August 2016. On the face of it, 80 trillion of asset purchases ought to boost M3 by about 6% a year. A proportion of the 80 trillion yen asset purchases is indeed from non-banks, which directly boosts M3. But much of the bond buying is from banks, with no immediate effect on non-banks' deposits (i.e., M3 money). The excess bank cash reserves created by QE have not resulted in any significant increase in bank lending. Throughout the programme, Japanese banks have been sitting on their greatly-increased cash assets. In fact, growth in the stock of bank loans to the private sector has slowed since the start of 2016, standing at 2% in August compared with 2.5% or more in the second half of 2015. The asset purchase programme has had some stimulatory effect, but it would be far greater if broad money rather than the monetary base had been targeted.

John Petley
28th September, 2016

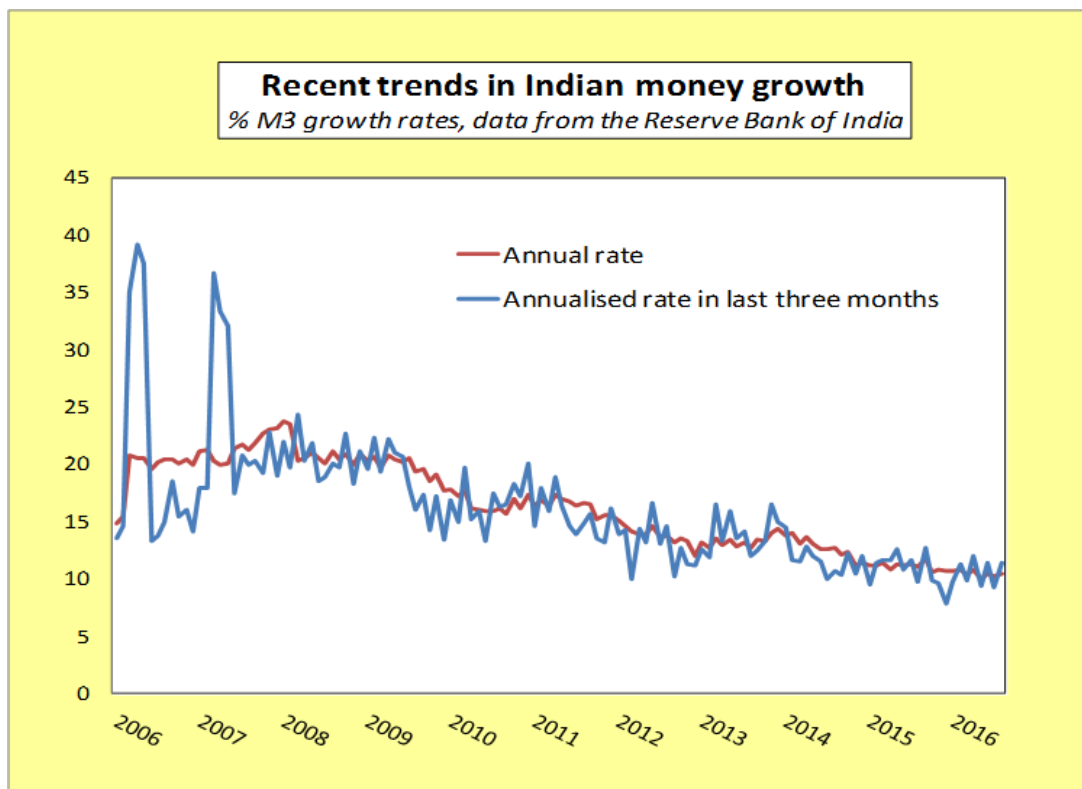
	% annual growth rate:	
	M3	Nominal GDP
1981 – 1990	9.2	6.2
1991 - 2000	2.4	1.3
2001 - 2010	1.1	-0.5
Five years to 2015	2.7	0.4



India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1991- 2014	16.5	13.8
2010 - 2014	14.2	14.4
Year to August 2016	10.4	n/a
Three months to August 2016 at annualised rate	11.5	n/a

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



New central bank governor takes over with money growth sluggish

Summary: The annual rate of Indian broad money growth – which has been mostly in an 11% - 14% corridor in recent years – is slowing. In August 2016 it stood at 10.4% while the annualised rate of increase for the three months to August stood at 11.5%. (This figure had fallen to 9.3% in July, one of the lowest growth rates recorded in over a decade.) Urjit Patel, the new governor of the Reserve Bank of India, is therefore beginning his term of office facing a challenging situation.

During the tenure of Patel's predecessor, Raghuram Rajan, the Reserve Bank of India pursued an anti-inflationary monetary policy. As interest rates were raised to bring the annual inflation rate down from 8% or more, so the M3 growth rate declined. (See the chart above.) The fall in commodity prices, especially oil, during the last two years, enabled Rajan to bring rates down again without reigniting inflation. M3 growth did not, however, accelerate. Happily, coupled with weak commodity prices, the slower rate of money growth has in 2016 been consistent with good growth in demand and output. Rajan also stabilised the rupee during his term of office.

In Rajan's final months, consumer price inflation began to rise again. Between March and July the annual price increase rose from 4.8% to 6.1%. Fortunately, a good monsoon this summer caused food price inflation to slow, helping to bring the overall annual inflation rate down to 5.1% in August. This has given Patel some breathing space. However, he will need to address the growing number of non-performing loans on the books of some Indian banks. One bank, the Export-Import Bank of India, saw its ratio of NPLs increase from 2.9% to 7.9% between March 2015 and June 2016 – a period of only 15 months. Rajan wanted to change the culture of Indian banks, which traditionally have been very relaxed about NPLs. (Bankers, from long experience, have found that rising land and equity values over time transform NPLs into performing assets.) His decision not to seek a second term as governor

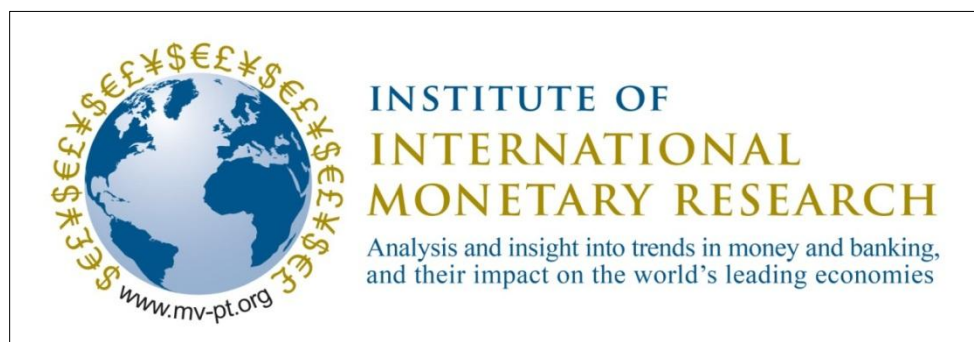
appears to have come about, among other reasons, because the banks resisted his demands for increased loan loss provision.

His successor, who also spent some time at the International Monetary fund, is widely expected to follow in his predecessor's footsteps and, in particular, to continue the battle against inflation. He will no doubt be pleased that in the short term, pressure for any monetary tightening has eased. The annual growth of the stock of bank lending has slowed in recent months, coming down to 9.8% at the end of August after beginning the year at around 11% - 11½%. One welcome boost to India's prospects occurred on 3rd August, when its parliament agreed to turn the country into a single economic area, sweeping away an elaborate system of local state-level taxes and checkpoints. Some estimates put the potential for GDP growth from this goods-and-services-tax legislation as high as 2%. Assuming that inflation does not reignite and broad money growth stabilises at the current level, India's macroeconomic prospects look good.

John Petley

29th September, 2016

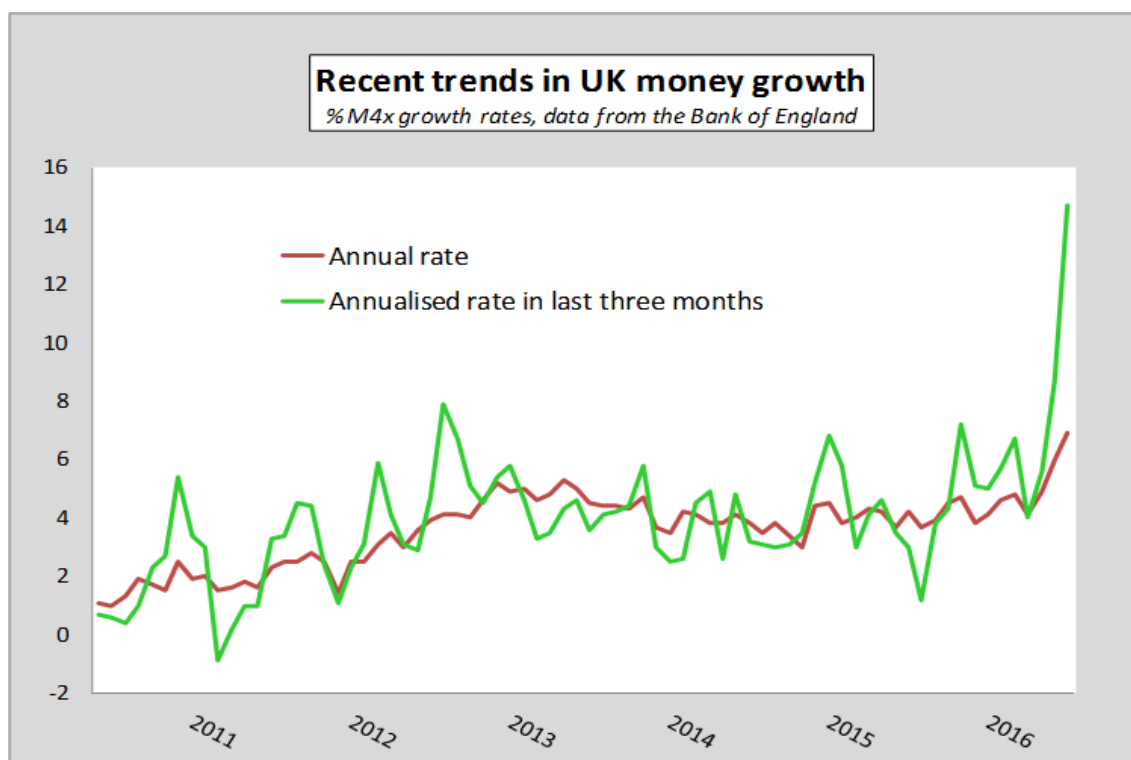
	% annual growth rate:	
	M3	Nominal GDP
1991 - 2000	16.9	14.4
2001 - 2010	17.3	13.6
Four years to 2014	13.4	12.9



UK

	% annual/annualised growth rate:	
	M4x/M4 before 1997	Nominal GDP
1964 – 2015	10.0	8.2
Five years to 2015	3.7	3.6
Year to August 2016	7.3	n/a
Three months to August 2016 at annualised rate	10.9	n/a

Sources: Bank of England and Office for National Statistics.



Bank of England's 4th August monetary easing was a mistake

Summary: In June and July, broad money M4x increased by almost £54b. Indeed, it grew faster in the two months either side of the EU referendum than it had done in the previous six months. This sent the annualised quarterly M4x growth rate up to 14.7% and the annual growth rate to 6.9%. As the graph above shows, no figures anywhere near this high have been recorded since the Bank of England began to use M4x as its key money gauge in 2009. (The August figure has come out since the first draft of this note was prepared, with a much smaller M4x increase.)

A central bank which respects the principle that “money matters” would respond to surging broad money growth by some policy tightening. But the Bank of England in a statement on 4th August did the opposite. Although money growth in early 2016 had been somewhat stronger than typical in recent years, it boosted its asset purchase programme by £60b. and cut base rates from 0.5% to 0.25%. The justification was concern that the Brexit referendum result vote would tip the economy into recession, although the precise mechanisms responsible for this drastic sequel were not clear.

The Brexit referendum fears have proved unfounded. The results of, for example, the latest Confederation of British Industry surveys (for July, August and September) contain no serious evidence of a slowdown in the economy. A conspicuous feature is that export order books were somewhat stronger than on average since 2010, reflecting the dip in the pound on 24th June. Given that the volume of retail sales jumped by 1.4% in July, and that retail sales constitute about 20% of aggregate demand, and given also that employment was fine in July, with the unemployment rate holding steady at 4.9%, the numerous forecasts of a Brexit-related recession look silly. One member of the Bank of England's Monetary Policy Committee, Kristin Forbes, has stated that she will not be voting to cut interest rates further this year.

The annual rate of consumer price inflation remains subdued, despite sterling's fall after the referendum result. In June it stood at 0.5%. Two months later, it had nudged up only to 0.6%. The Bank's £60b. of extra asset purchases add about 3% to M4x, which will boost asset prices and economic activity, with an impact on nominal GDP and the price level. Inflation alarmism is premature, but the 4th August policy easing increases risks above-target inflation in 2017 or 2018.

The Bank of England's latest data on lending again underline the stability of the economy in the immediate post-Brexit period. The stock of mortgage lending rose in both June and July, although the number of loan approvals fell to 60,912, the lowest level in over 18 months. The MPC's decisions at its August meeting suffered from an undue pessimism.

Tim Congdon and John Petley
3rd October, 2016

	<i>% annual growth rate:</i>	
	M4/M4x	Nominal GDP
1964- 2015	10.0	8.2
1991 – 2000	7.5	5.9
2001 – 2010	7.0	4.2
Five years to 2015	3.7	3.6