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Monthly e-mail from Tim Congdon and John Petley – 29th April, 2021

Global money round-up in spring 2021

An upward blip in inflation in 2021 is now expected in all countries, as the price drops in spring 2020 (due largely to a big oil price fall) are replaced by price increases in spring 2021 (due, to a significant extent, to price gains in oil and other commodities). But another almost universal pattern is for central banks to attribute 2021's inflation upset to a non-recurring, once-for-all adjustment to the off-on pattern of the Covid-19 pandemic. They expect annual inflation rates to be lower in 2022 and 2023 than in late 2021. The analysis and evidence prepared by the Institute of International Monetary Research generate a very different conclusion. In brief, our message is that the economic policy response to Covid-19 has been too expansionary in most countries. Inflation therefore has some way yet to rise. Annual growth rates of the quantity of money, broadly defined, are in double digits in all the major jurisdictions, except China and Japan. Business surveys are already buoyant, ahead of the post-Covid-19 boost to activity in summer and autumn 2021. The size of the boost will vary between countries, but everywhere vaccination programmes are being rolled out, and lockdown and social distancing restrictions are coming to an end.

The combination of large fiscal deficits and monetary ease is most remarkable in the USA. In the first quarter of 2021 the M3 money measure rose by 2.4% or at an annualised rate of 10.3%. Given that 2020 had the highest money growth since the Second World War, the Fed's insouciance about inflation is remarkable. By contrast, the government of China – with the world's second largest economy and still quite high trend output growth – is taking a cautious approach to macroeconomic decision-taking. Money growth in recent months has been at annualised rates similar to the average of the late 2010s. (In the five years 2015 – 19 inclusive the average annual growth rate of M3 was 10.1%.)

Money trends in spring 2021 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. Vaccination programmes are now under way in the main countries, although EU member states and Japan are well behind *both* the UK and the USA, *and* several small developed states such as Israel, Chile and Singapore. By late 2021 and early 2022 the standard drivers of demand and output will again be pre-eminent in macroeconomic assessment. The table below shows recent money growth patterns in leading nations. The main points argued in the Institute's research since spring 2020 have been that

- the policy response to Covid-19 has resulted in marked accelerations in money growth in many nations, particularly in the world's leading economy, that of the USA,
- given an eventual return to normal levels of the velocity of circulation, reflecting the long-run stability of households' and companies' money-holding preferences (for which the evidence of overwhelming), the accelerations in money growth will be followed by similar accelerations in the growth of nominal national income, and
- given further that the world's underlying productive capacity has not been helped by Covid-19 (and may in fact have been somewhat impaired by it), much higher growth of nominal national income must lead to faster inflation than had been standard in the last 20/30 years.

Name of country/ jurisdiction	Share of world output		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	15.1	23.3	**10.3**	**19.1**	Re-acceleration in recent months, with fiscal stimulus to be monetised and TGA drawdown.
China	18.7	16.1	**9.3**	**9.6**	Money growth stable, after brief early 2020 spurt due to pandemic-related stimulus measures..
Eurozone	10.6	16.4	**9.6**	**12.3**	Money growth boosted by ECB asset purchases, annual rate into double digits.
Japan	4.2	5.9	**5.6**	**8.1**	Money growth moderate by international standards, but highest for 30 years.
India	7.7	3.3	**12.0**	**12.5**	Money growth remains in double digits at annual rate and.annualized recent rates.
UK	2.2	3.4	**9.7**	**15.2**	Annual money growth at very high 15% and to stay high for some months because of more QE. .

The evidence in favour of our analysis is increasing as the months go by. By contrast, the prevalent view from central bank research departments a year ago – that Covid-19 would have disinflationary effects into the medium term (and even “for many years”, to recall a phrase in minutes from the Federal Open Market Committee) – has lost all credibility. However, central banks continue to see their task as being to promote a strong recovery from Covid-19. According to Reuters, in a 8th April letter to Senator Rick Scott, the Federal Reserve chair, Jay Powell, said that, “We do not seek inflation that substantially exceeds 2%, nor do we seek inflation above 2% for a prolonged period." Nevertheless, Powell reiterated that, “we are fully committed to both legs of our dual mandate - *maximum employment* and stable prices.” (my italics)

It seems plausible that Powell is not familiar with the academic literature – much of it dating from the late 1960s and 1970s – arguing that no long-run trade-off prevails between employment and inflation, and that central banks should concentrate on price stability. On this basis, complacency about inflation arises from – what might charitably be called – “loss of social memory”. In the 1980s and 1990s most top central bankers were aware of Milton Friedman and his warnings that money growth affected inflation after lags that were often “long and variable”. They had also lived through the take-off of inflation in the 1970s and were only too conscious of the criticisms that had been directed against their organizations. But it seems that in the 2020s few “movers and shakers” – meaning such people as Jay Powell and Christine Lagarde – read history books, even books on the modern history of the institutions which they lead. Santayana’s remark – “those who cannot learn the lessons of history are condemned to repeat it” – is repeated so often that it has become a cliché. But, unhappily, the remark does seem applicable at the top levels of today’s central banks.

No doubt Powell and Lagarde are conscientious and hard-working, and read all the papers that come to them from their research departments. It is therefore important to know the beliefs and attitudes of the key research staff, and to notice in this context,

i. the virtual disappearance of monetarism (and/or approaches based on the quantity theory of money) from central bank research, and
ii. the rise and current ascendancy of New Keynesianism.

The New Keynesians do of course have a theory of inflation. In this theory underlying actual inflation depends on inflation expectations, while the supply-demand conditions in labour and product markets determine wages and prices in the first instance. If there is excess demand/supply in labour and product markets, inflation rises/falls. The balance between demand and supply is judged in terms of the so-called “output gap” (i.e., the level of output relative to trend). Estimation of the output gap is complex and awkward, but central banks appeal to business survey data as well as to the latest numbers on gross domestic product and – when thinking about the future – on the results of macroeconomic forecasts.

At least two problems stem from this approach. The first is that labour market developments are, notoriously, a lagging indicator of the economy. Whereas policy needs to be founded on forward-looking, leading indicators, New Keynesianism relies on analysis of backward-looking variables. The second is that, given how central bank research is conducted, the forecasts of inflation are only as good as the macroeconomic forecasts. Insufficient cross-check comes from alternative analytical methods, such as requiring nominal GDP growth to be related over the medium term to the quantity of money. Standard macroeconomic forecasts tend to rely on so-called “Keynesian income-expenditure models”. These models overlook that every economy has transactions in assets as well as transactions in the income-expenditure circular flow. The track record of these models is in fact quite poor, particularly in spotting turning points.

Neither the New Keynesian survey-based method nor old-fashioned Keynesian income-expenditure models integrate money and banking, and asset markets, into the story. These omissions – which reflect doctrinal disputes in macroeconomics that go back decades – were disastrous in the 1960s and 1970s, and arguably they are about to prove so once more today. In a story in the *Financial Times* on 22nd April, the Governor of the Bank of England, Andrew Bailey, is quoted as saying "last month" that, while he understood the forces likely to take inflation back to 2% in summer 2020, there was "no evidence" to support the view that inflation might move up to 4% or 5%.

An open contradiction seems clear between Bailey's position and that of Andrew Haldane, the Bank of England's former chief economist, who on 26th February publicly called inflation a "tiger (that) has been stirred by the extraordinary events and policy actions of the past 12 months". Further, in Haldane's words in an online speech, "[p]eople are right to caution about the risks of central banks acting too conservatively by tightening policy prematurely. But, for me, the greater risk at present is of central bank complacency allowing the inflationary (big) cat out of the bag." On 13th April it was announced that Haldane is leaving the Bank of England, where he had worked for 30 years, to become chief executive of the Royal Society of Arts. A possible interpretation of the difference of views between Bailey and Haldane is that Haldane felt uncomfortable having to defend the Bank's conduct of monetary policy. (Let me emphasize that I have no inside information about the matter and my interpretation may be wrong.)

On 20th April a letter appeared in the *Financial Times*, signed by ten members of the Shadow Monetary Policy Committee (including myself), under the title, "BofE must end its asset purchases to avoid stoking inflation." The letter noticed that M4x growth was the highest since 1998, the first date for which estimates of the M4x aggregate had been prepared. The SMPC members were worried about above-target inflation, although they were not precise about its exact timing. 5% inflation was likely, but – in the letter's words – "in the next few years". (Reviewing the then money growth numbers, I said in a 31st October 1986 article in *The Times* that "inflation will accelerate in the next few years, perhaps to as much as 10%". That proved right, but almost *four* years later, in summer 1990. In line with Friedman's formula, the lags were indeed "long and variable". In the late 1980s excessive monetary growth drove asset price inflation and much above-trend growth in domestic demand. But the inflationary impact of excess demand was mitigated by its diversion to foreign suppliers and a widening of the current account deficit on the balance of payments. In July 2006 the SMPC wrote a letter warning about rising inflation – and that too was correct. But again above-target inflation numbers were still coming through in 2011 and 2012, after a long and very eventful lag.)

29th April, 2021

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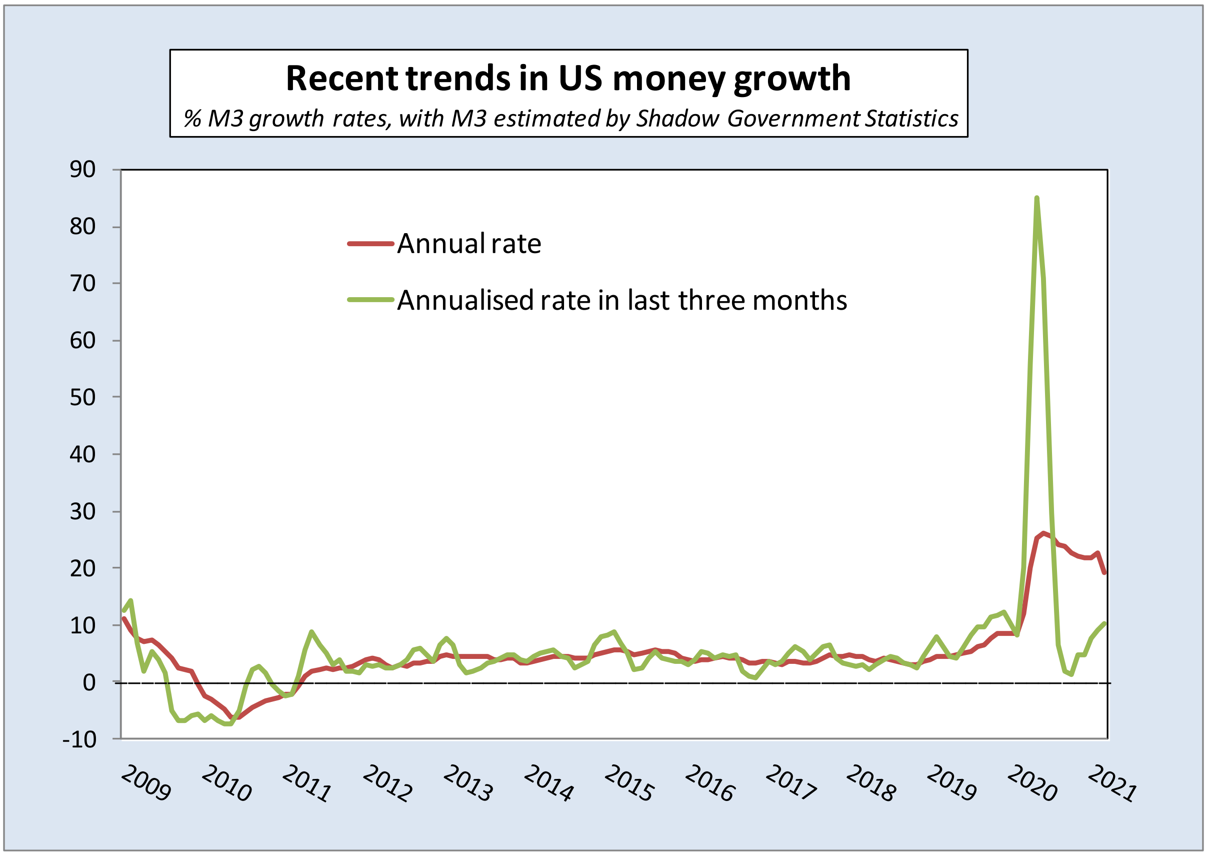
USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1961 – 2019	**7.4**	**6.5**
Nine years to 2019	**4.5**	**4.1**
Year to March 2021	**19.1**	**n.a**
Three months to March 2021 at annualised rate	**10.3**	**n.a.**

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



US broad money growth strengthens further

Summary: A re-acceleration of money growth has become clear in early 2021, reflecting – among other factors – the payment of stimulus cheques after promises made in November's Presidential election. In the three months to March 2021 the annualized rate of growth of US M3 broad money was 10.3%, compared with 9.2% in the previous three months and low figures in the second half of 2020. In March itself, the quantity of money grew by $188b, or 0.73%, which equates to 9.1% a year. The annual growth rate fell from 22.5% to 19.1%, as the remarkably high increase in March 2020 ($1,621b.) left the calculations. (Our M3 data come from Shadow Government Statistics.)

In the three months to March consumer prices rose by 1.3% or at an annualised rate of 5.3%. Admittedly, the dominant influence on the rise in March itself was a jump in gasoline prices, which will not recur on the same scale. Factory gate prices are advancing even more dramatically. In the three months to March the producer price index (final demand) went up by 2.8% or at an annualised rate of 11.8%. The annual rate of increase in the PPI was 4.2% in March, but will move through the 5% level with the April number. (The PPI fell by 1.1% in April 2020. Given what is known about commodity price pressures, including – for example – a surge in lumber prices, a rise of at least 0.5% in April 2021 looks plausible.).

Retail sales increased by no less than 27.7% in the year to March. (February's figure was 6.7%.) Meanwhile February saw the biggest monthly increase in consumer credit since November 2017, of $27.6b. These remarkable figures are being reported at a time when the US economy remains partly subject to lockdown restrictions. Full-scale boom seems inevitable in summer and autumn 2021.

All these indicators strongly support the predictions in these notes since last spring that the extraordinary growth in broad money during 2020 will result in consumer inflation above 5% later this year. The Federal Reserve nonetheless believes that President Biden's so-called "American Rescue Plan" will most likely have only a "small and transitory" effect on inflation, to quote from a recent paper published by the Chicago Fed. This study, by Bianchi, Fisher and Melosi, used four different models to predict inflation. Not one of them mentions the quantity of money. Instead significant emphasis is placed on inflation expectations, in the apparent belief that – if agents do not expect high inflation – it will not happen. This conclusion is contradicted by much evidence, as summarized in the table below. Broad money growth may not again match the astonishing leap in spring 2020, when M3 climbed 18.9% in the five months to June. But – as pointed out in the preamble – a re-acceleration of money growth has been evident so far in 2021. Note that the annual rate of growth will fall in the next few months, as the large increases in March, April and May 2020 drop out of the twelve-month comparison.

Tim Congdon and John Petley
28th April, 2021

	% annual growth rate:	
	M3	Nominal GDP
1961 – 2019	**7.4**	**6.5**
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**
Nine years to 2019	**4.5**	**4.1**

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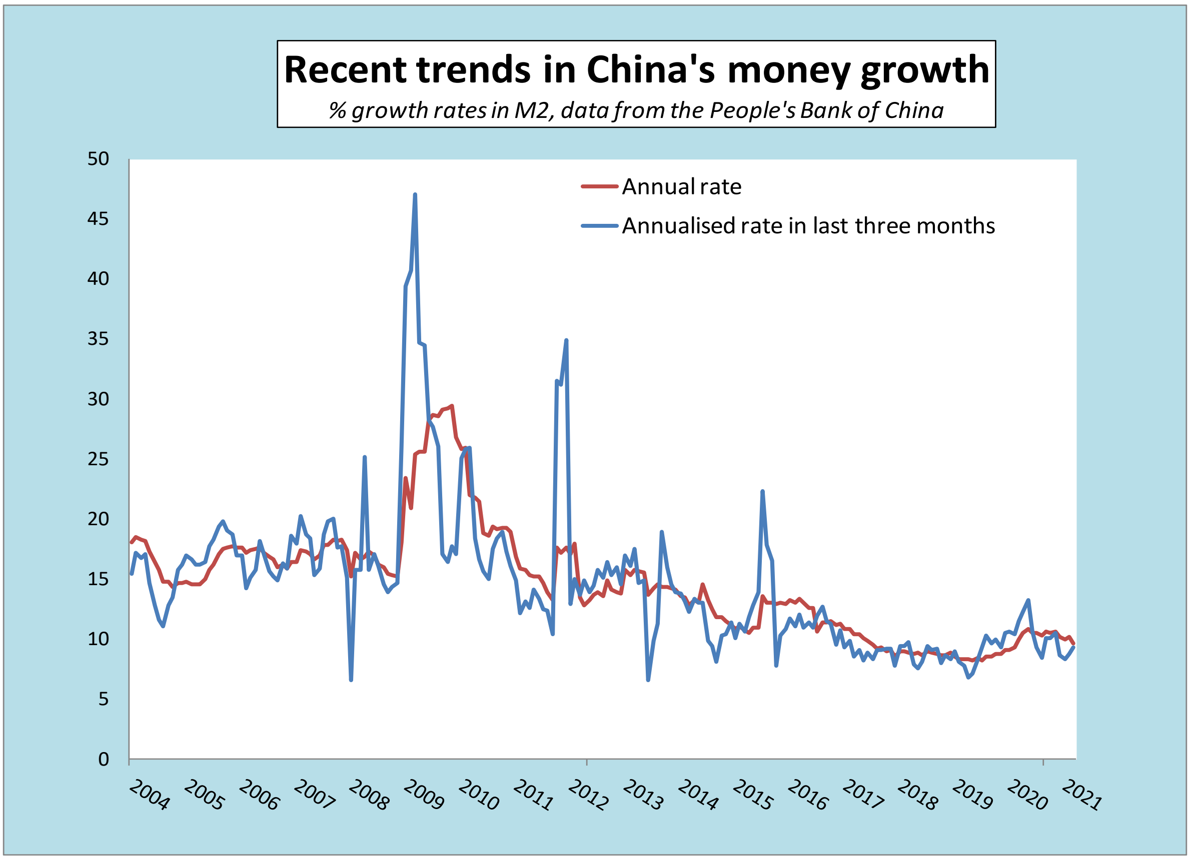
China

	% annual/annualised growth rate:	
	M2	Nominal GDP
1991- 2019	**18.7**	**14.8**
2011 - 2019	**11.9**	**10.4**
Year to March 2021	**9.6**	**n/a**
Three months to March 2021 annualised rate	**9.3**	**n/a**

Sources: People's Bank of China for M2, IMF and IIMR estimates.



Broad money growth slows to pre-Covid 19 levels

***Summary*: In the three months to March 2021 China's M2 grew by 2.3% or at an annualised rate of 9.3%. This is higher than February's reading of 8.7%, but not a figure that would have been regarded as exceptional in the period preceding the coronavirus pandemic. The annual growth rate fell from 10.2% to 9.6%. With no reason for policy-makers to take new stimulatory measures at the moment, M2 growth is likely to remain below 10%.**

Officially, China has defeated the Covid-19 virus and returned to normal. In mid-April about 10 – 20 new cases of coronavirus were typically reported each day and no one had died from it for several months. In the first quarter of 2021 China's economy grew by 0.6%, a rather modest figure under these circumstances. The 6% GDP growth target for 2021 could nonetheless still be met. Export volumes are higher than the figures for the months before the pandemic, although year-on-year comparisons are fairly meaningless at the moment due to the collapse in global demand in March and April 2020. Consumer demand is robust, with retail sales increasing by 1.8% in the month of March. Consumer prices only rose by 0.4% in the year to March, a legacy of the disproportionate effect of an outbreak of African swine fever in 2019-20 on pork prices. The benign inflation scenario may not last much longer, however, as producer prices increased by 4.4% over the same period, after having been below zero for most of 2020. This increase has been driven both by an increase in commodity prices from late 2020 onwards and a shortage of shipping capacity.

Consumer credit is at an all-time high yet backward-looking inflation measures are currently low. The Chinese housing market is picking up again. Average prices in China's 70 largest cities rose by 4.6% in the year to March, the biggest annual gain since September. This is nonetheless well below late 2019's double digit growth. The stock of loans by Chinese banks grew by 12.6% in the year to March. This is the lowest reading in over a year, but is only a modest slowing and at this stage not particularly significant. In China's tightly controlled economy, the authorities do not hesitate to act if economic stability is threatened. The lack of any change to interest rates and banks' cash reserve ratios in nearly a year suggests that the People's Bank of China (the central bank) is not worried about the state of the economy. Indeed, it has actually reduced its balance sheet since the start of the year, suggesting that the stimulatory measures introduced to combat the coronavirus a year ago are now in abeyance. The money figures do not suggest that China is likely to experience a serious inflation problem in the wake of the pandemic, unlike some other countries studied in these notes.

The PBoC is concerned about the health of the Chinese banking sector. It announced that in 2021 it will stress test each of the country's 4,024 banks to identify "high risk institutions, high risk areas and system risks". A report published in November 2020 identified rural banks as being the most likely to suffer bad debt problems. For some time, the authorities have sought to keep a tight rein on informal finance or "shadow banking", with further regulations to improve loan quality in the pipeline. Many smaller businesses rely on these institutions for credit and it may be harder for them to borrow in future if tighter conditions are imposed.

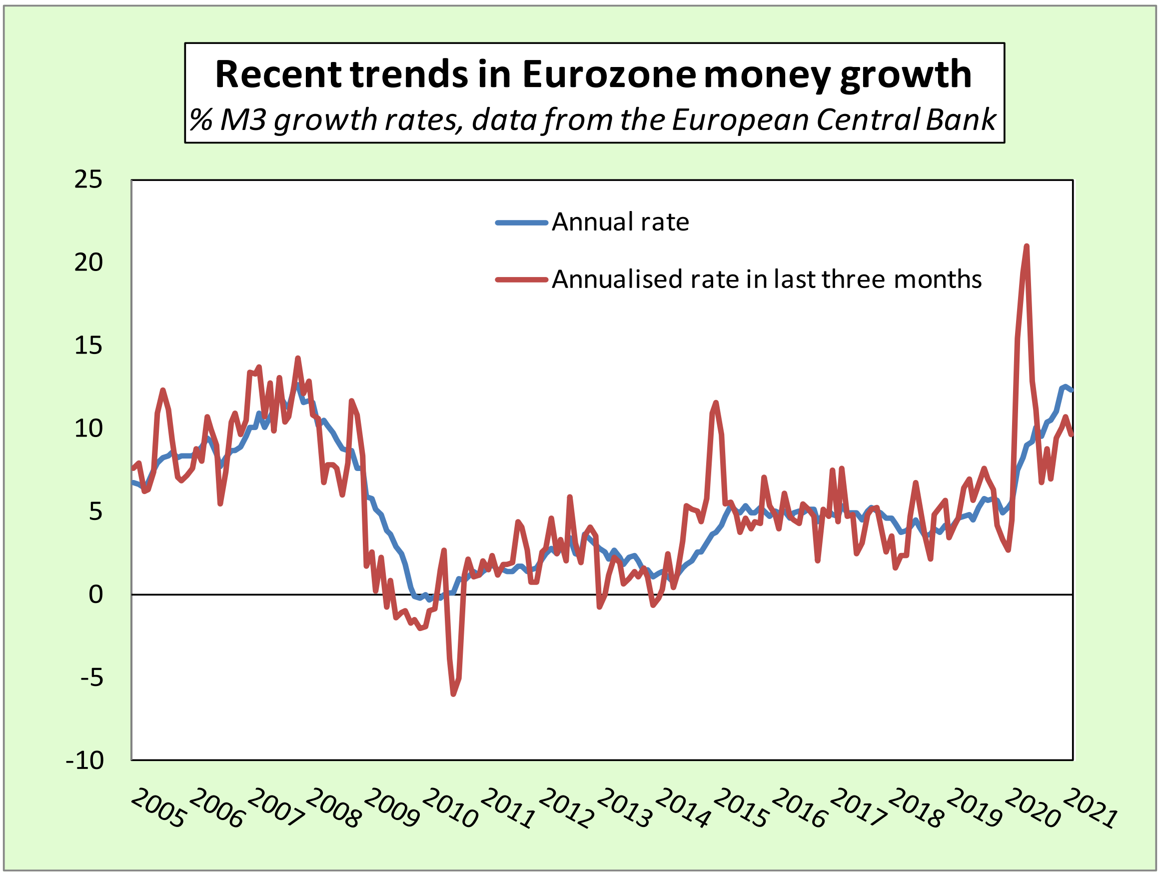
John Petley
21st April, 2021

	% annual growth rate:	
	M2	Nominal GDP
1991 - 2000	**24.5**	**18.4**
2001 - 2010	**18.5**	**15.2**
Seven years to 2017	**12.8**	**10.3**

Eurozone

	% annual/annualised growth rate:	
	M3	Nominal GDP
1996 – 2019	**5.2**	**3.1**
Nine years to 2019	**3.8**	**2.5**
Year to February 2021	**12.3**	**n/a**
Three months to February 2021 at annualised rate	**9.6**	**n/a**

Sources: European Central Bank, IMF and IIMR estimates.



Broad money growth at highest levels for almost 15 years

Summary: **In the three months to February 2021 annualised M3 broad money growth in the Eurozone stood at 9.6%. This figure is lower than January's reading of 10.7%. The annual growth rate also fell slightly, from 12.5% in January to 12.3%. In February itself M3 grew by €60.0b., the lowest reading since October. This figure is nonetheless higher than the average monthly growth rate in 2019.**

Although the annual M3 growth rate is likely to decline from March onwards, as the exceptionally high reading from March 2020 (€326b.) will drop out of the calculations, the annualised quarterly figure is likely to increase in the coming months. At its latest meeting on 22nd April, the Governing Council of the European Central Bank committed itself to stepping up the purchase of assets under the €1,850b. pandemic emergency purchase programme (PEPP). It should be stressed that setting an overall figure for an asset purchase programme does not tie the ECB to a fixed weekly (or monthly) purchase schedule and the ECB purchased €131.6b. only in assets in the two month period to 31st March.

Senior figures in the ECB continue to express their concern about the low levels of inflation. On 11th April Fabio Panetta, a member of the Executive Board, told the Spanish newspaper *El Pai*s that the ECB should "accept no further delay" in lifting inflation back to its target of 2% or just below. He went on to say that the ECB has "failed to reach its aim for too many years already" and warned that it could be very hard to "re-anchor inflation expectations". He expressed his dissatisfaction over the ECB's current projections that inflation across the 19-member bloc would stand at only 1.4% in 2023. He was taking a similar line to fellow Executive Board member, Isabel Schnabel, who on 26th February urged Eurozone governments to design new fiscal policies specifically to boost inflation. Panetta urged Eurozone governments to ramp up fiscal support, even though they have only just begun to implement a €1.8 trillion pandemic recovery fund. The most recent inflation figures indicate that – thanks primarily to an increase in the cost of energy – consumer prices rose by 1.3% in the year to March, only 0.1% below the forecast figure for 2023. This increase has occurred in spite of a depressed level of economic activity in the Eurozone due to tight restrictions, including lockdowns, in a number of member states, notably France and Germany. Furthermore, given that factory gate prices rose by 1.5% in the year to February after over 18 months of decline, all the indicators point to a rise in inflation. Admittedly, some senior figures at the ECB, including its President, Christine Lagarde, have stated that there could be an increase in inflation over the medium term, but most of the top brass expect it to be only a temporary blip. The money numbers strongly suggest that this will not be the case and that the worries about below-target inflation are likely to be short-lived. Fiscal and monetary stimuli remain in place and will keep money growth at an elevated level until at least March 2022.

Since the start of 2021 the euro has declined against the US dollar after several months of appreciation in value. In the first three months of the year share prices have moved ahead. (The Euro Stoxx 50 index value was 3,571.6 on 30th December, compared with 4,014.4 on 27th April.) Mortgage lending remains relatively strong, but consumer spending is subdued, Industrial production fell by 1% in February. However, the number of infections seems to have peaked so a recovery is likely in Q2, but to repeat, this will most likely be accompanied by a rise in inflation.

John Petley
19th April, 2021

	% annual growth rate:	
	M3	Nominal GDP
1996 – 2019	**5.2**	**3.1**
1996 – 2000	**4.6**	**4.1**
2001 – 2010	**6.8**	**3.1**
Nine years to 2019	**3.8**	**2.5**

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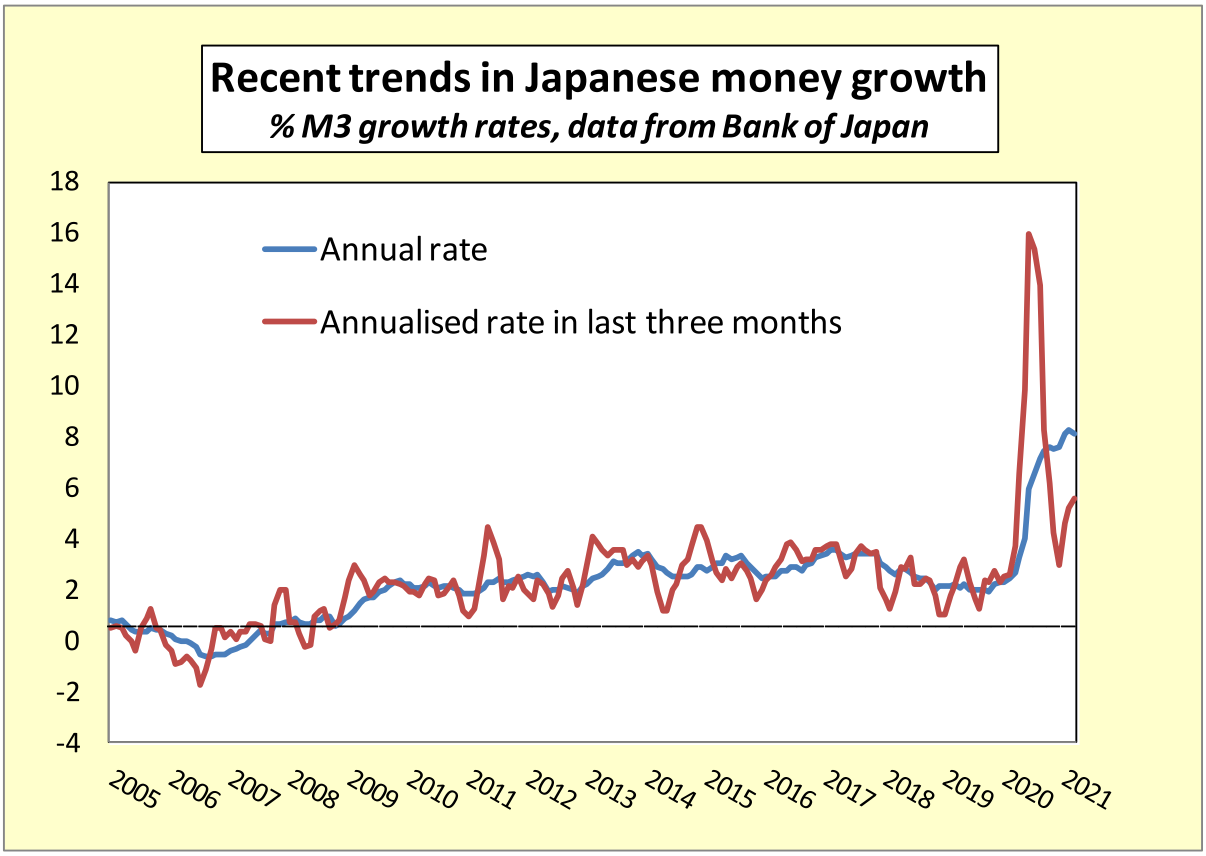
Japan

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2019	**3.9**	**1.9**
Nine years to 2019	**2.7**	**0.9**
Year to March 2021	**8.1**	**n/a**
Three months to March 2021 at annualised rate	**5.5**	**n/a**

Sources: Bank of Japan for M3 and IMF for GDP



Strong broad money growth – by Japan's standards – continues

Summary: **The three months to March 2021 saw Japanese M3 grow at an annualised rate of 5.5%. The figure has edged up since the start of the year. In January the annualised quarterly rate was + 3.0% and in February +4.6%. In March itself, the quantity of money grew by 4.3 trillion yen. This is much lower than the record 25.2 trillion increase in June 2020, but still much higher than the average monthly reading for 2018-19. The annual growth rate fell back a smidgeon to 8.1% after February's 30-year high of 8.2%.**

In 2020 Japan suffered remarkably few infections or deaths from the coronavirus pandemic. Businesses stayed open. Although some restrictions were imposed, they fell a long way short of a full-blown lockdown. Even so, the economy contracted by 4.8% in spite of both fiscal and monetary stimuli. Since January 2021, the number of Covid-19 cases has been rising. In April Tokyo and three western prefectures were placed under a further "state of emergency", less than two months after a previous series of restrictions were lifted. At the start of the year, a new fiscal package worth 73.6 trillion yen ($708b., at an exchange rate of 104 yen to the $) was unveiled. These measures are most likely being financed by Japanese banks and the resultant deposits are helping to boost the quantity of money. Money growth is also being promoted thanks to the stock of lending by Japanese banks growing by over 6% per annum every month since May of last year. (Before the pandemic, this figure was typically 2% - 3%.). Allegedly, some of these loans were taken out by companies to tide them over through the pandemic. Both the housing market and consumer spending remain subdued.

The Bank of Japan does not expect the fiscal and monetary stimuli to have much of an effect in raising inflation to its desired 2% target, but it may well be wrong. (See the final paragraph below.) For eight years, the BoJ has been trying to raise inflation, reducing interest rates to -0.1%, boosting the monetary base through substantial purchases of Japanese government bonds and enforcing "yield curve control". These measures have prevented deflation and been accompanied by impressive macroeconomic stability. But no clear relationship has held between the monetary base, which has trebled since the end of 2013, and any of the quantity of money, national wealth, national income or the price level. Like other central banks, the Bank of Japan research department takes little notice of broad money. Interestingly, the coronavirus-related fiscal and monetary stimuli of 2020 may have helped to pushed up M3 growth to levels not seen in 30 years. But the dominant causal influence at work has been the greater strength of bank lending to the private sector, as noted above.

Signs of rising inflation are evident. In the four months to March the producer price index increased by 2.3% or at annualised rate of 7.1%. Some of this reflected the extraordinary surge in global commodity prices in that period and will not be repeated at the same intensity. But two months of falls in 2020 – in April and May – are about to drop out of the annual comparison. If the PPI rises by 0.2% a month from March to November, the annual increase in the PPI will reach 3.6% in May and 4.0% in November. Consumer inflation of 2% or more is much more likely than it has been for many years.

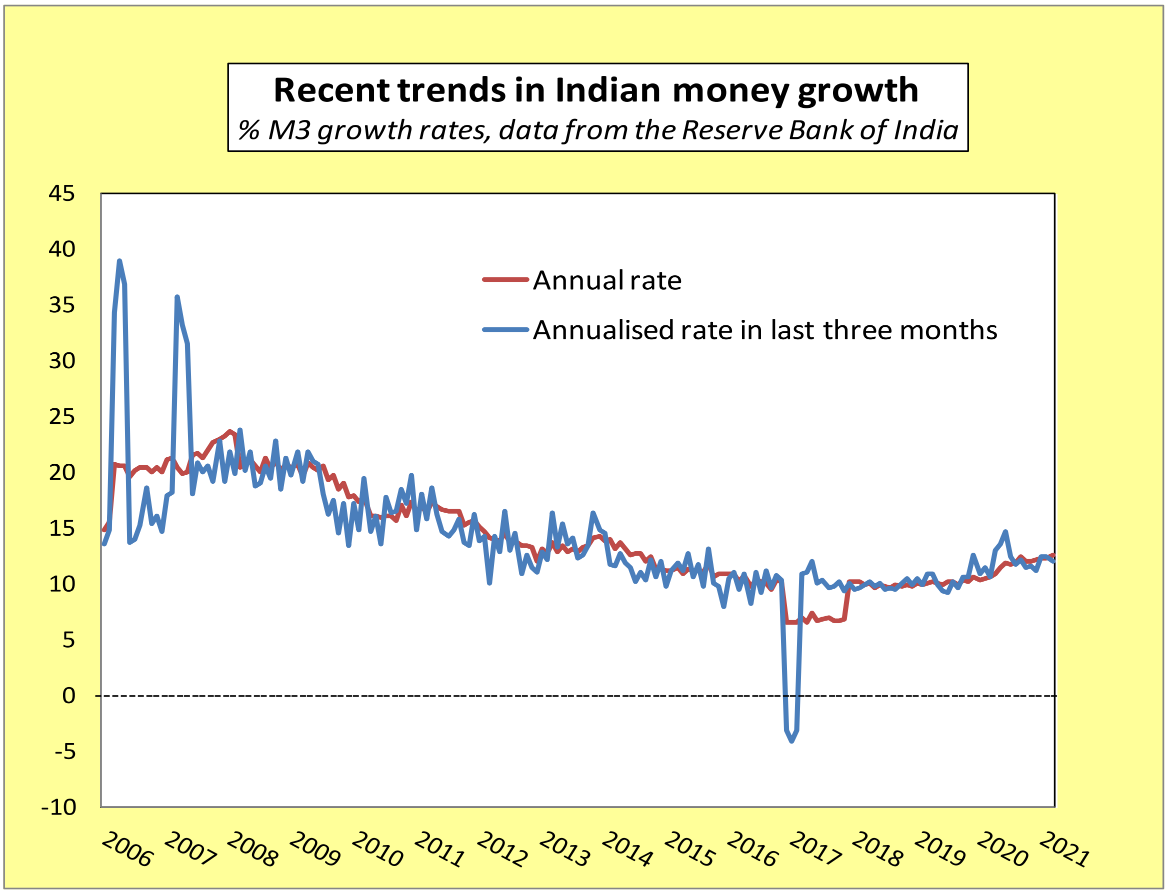
Tim Congdon and John Petley
22nd April, 2021

	% annual growth rate:	
	M3	Nominal GDP
1981 – 1990	**9.2**	**4.6**
1991 - 2000	**2.4**	**1.1**
2001 - 2010	**1.0**	**0.8**
Nine years to 2019	**2.7**	**0.9**

India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2019	**15.8**	**13.4**
Nine years to 2019	**11.2**	**11.9**
Year to March 2021	**12.5**	**n/a**
Three months to March 2021 at annualised rate	**12.0**	**n/a**

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



Broad money growth remains at an elevated level

Summary: **In the three months to March 2021 India's seasonally adjusted M3 grew by 2.9% (i.e., at an annualised rate of 12.0%). This is a slight decline on February's reading of 12.3% but still higher than the figures from 2018-19, before the coronavirus pandemic, which were typically between 9% and 11%. The annual growth rate rose to a 6½ year peak of 12.5%.**

India's economy remained open for most of 2020, with the government abandoning a very strict lockdown after only a few weeks. Given the size of the country's population, the infection and death rates from coronavirus had not been particularly high. Indeed, in early March India's health minister that the country was "in the endgame" with the pandemic. However. a sudden spike in infections since the start of April – attributable to a variant virus – has come as a shock. Parts of the country, including Mumbai, were locked down on 14th April and Delhi following four days later. The Monetary Policy Committee of the Reserve Bank of India, the country's central bank, met in the first week of April and rather surprisingly tightened monetary policy. The cash reserve ratio for Indian banks was increase by 0.5% as from 16th April, with a further 0.5% rise to come into force in May.

Even before the surge in infections from the virus, the country was facing serious economic problems. The economy contracted by 6.9% during the 2020 and tax revenues plummeted. Even though India's fiscal and monetary response was relatively modest in scale, the ratio of government debt to GDP rose by almost 10% between April and September 2020, while last year the RBI's balance sheet expanded by over 40%. As with other countries, 10-year bond yields have increased since the start of 2021. India's strong money growth has been driven by purchases of government debt by banks and central banks rather than by growth in the stock of lending, which has been much slower since the pandemic. The annual growth rate of lending was 5.6% in April 2021, the lowest figure thus far in 2021. Banks are currently sitting on a huge liquidity surplus, thanks to a combination of the central bank's QE programme and sluggish loan growth. This means that the increases in banks' reserve ratio requirements can be easily absorbed.

Nonetheless, the Modi government and the RBI remain concerned about the health of the commercial banking sector. Four more banks, which have been placed under the control of the Reserve Bank of India due to concerns about non-performing loans, have issued $2 billion in zero-coupon bonds so that the proceeds can keep them afloat. The Indian stock market, which rose to a record high in February 2021, partly thanks to the high levels of money growth, has fallen back since then. Since February, India's industrial output has been in contraction. April's figures have not been published, but the negative trend is likely to have accelerated. Prices moderated at the end of 2020, but have risen since the start of the year, with the annual CPI rate standing at 5.5% in March. Producer prices meanwhile rose by 7.4% in the same period. In summary, even if the current wave of infections is quickly brought under control, the country faces a difficult year economically. Any further fiscal response likely to cause a further deterioration in the government finances and raise inflation further.

John Petley
19th April, 2021

	% annual growth rate:	
	M3	Nominal GDP
1981 - 1990	**17.1**	**14.7**
1991 - 2000	**17.4**	**14.1**
2001 - 2010	**17.3**	**12.9**
Nine years to 2019	**11.2**	**11.9**

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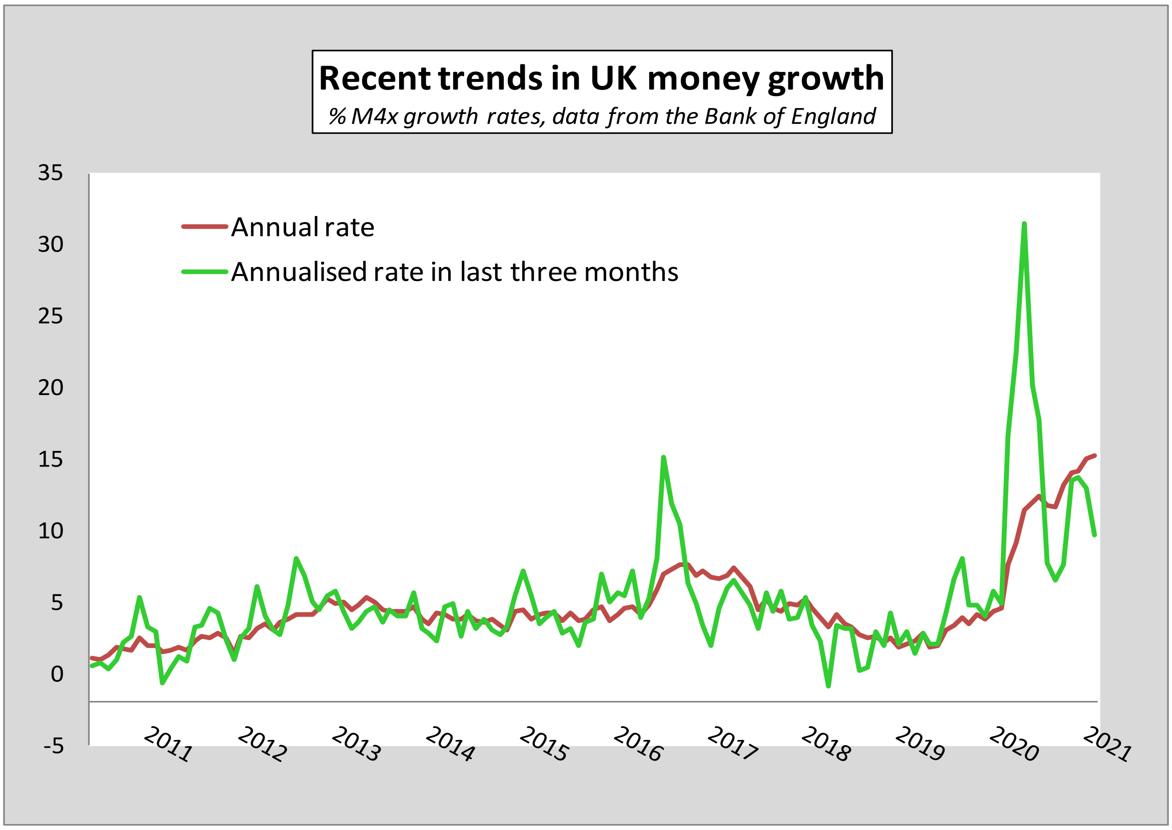
UK

	% annual/annualised growth rate:	
	M4x/M4 before 1997	Nominal GDP
1964 – 2019	**9.6**	**8.0**
Nine years to 2019	**4.0**	**3.7**
Year to February 2021	**15.2**	**n/a**
Three months to February 2021 at annualised rate	**9.7**	**n/a**

Sources: Bank of England and Office for National Statistics



Broad money growth continues on an upward trend

***Summary*: In the three months to February 2021 UK M4x grew at an annualised rate of 9.7%, lower than January's reading of 13.0% but still exceptionally high by the standards of the last decade. In February itself UK broad money grew by £15.0b., down on January's figure of £31.5b., but over twice the average monthly figure for 2019. The annual M4x growth rate rose from 15.0% to a 30-year peak of 15.2%. This measure is likely to decline after next month, as March 2020's exceptionally strong growth will drop out of subsequent calculations.**

The most recent data reflect the opening-up of the UK economy as Covid-19-related restrictions are eased. Consumer price inflation rose from 0.4% in the year to February to 0.7% a month later, Producer prices rose by 1.9% in the same period, after being in negative territory for much of 2020. This is a reflection on the surge in commodity prices which began in mid-2020. Inflation is therefore likely to rise further, especially as restrictions were eased for the hospitality and retail sectors on 12th April, enabling consumers to spend more of their excess money balances. The UK economy grew by 0.4% in February, despite the country being partly locked down. In March the number of new car registrations rose sharply, with the increase driven by fleet sales, a reflection of growing business confidence. Retail sales rose above pre-crisis level for the first time in March and wage growth also remains strong, although the annual increase fell back from a 12 year high of 4.8% in January to 4.5% a month later. The housing market has slowed since the start of 2021, but the number of job vacancies has risen to its highest level since the outbreak of the pandemic.

Given figures like this, there therefore seems no reason for further monetary stimulus from Bank of England, which has expressed optimism at the signs of a growing recovery. Indeed, it is hard to find any justification for the £150b. addition to the asset purchase programme last November. Broad money growth is likely to remain high, as there is no indication that the BoE intends to pause its asset purchases, let alone reverse them. Government spending is likely to remain well above the levels in the decade before Covid-19. The large resulting deficit is being largely by the banking system, particularly by the Bank of England itself. As a direct consequence new money balances are being created. The very sharp rise in 10-year bond yields in January and February has halted, but borrowing costs for the government have increased. Overall government borrowing remains very high, with March's £28 billion raising the overall total for the 2020-21 financial year to a record £303.1b.

Members of the Bank's Monetary Policy Committee have expressed less concern about low inflation than their European and American counterparts. Quite the contrary, as Andrew Haldane, then the Bank's chief economist, made clear in an online speech in February that he shared some outside commentators' concerns that policy was too expansionary. Fortunately, there are no signs of any further additional fiscal stimuli from the government. However, the majority view of Bank senior staff is that any rise in inflation will be transient. Haldane resigned from his chief economists position on 13th April, as discussed elsewhere in this document.

John Petley
20th April, 2021

	% annual growth rate:	
,	M4/M4x	Nominal GDP
1964 - 2019	**9.6**	**8.0**
1991 – 2000	**6.4**	**6.0**
2001 – 2010	**6.5**	**3.9**
Nine years to 2019	**4.0**	**3.7**