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Monthly e-mail from Tim Congdon and John Petley – 29th August, 2022

Global money round-up in summer 2022

Money growth is now falling is most advanced "Western" nations. A particularly sharp decline seems to be under way in the USA, where M3 broad money was more or less unchanged in the six months to July. So US money growth – which was at a post-war record high just over two years ago – has now been replaced by torpor. With inflation still rising, real money balances are being squeezed, and asset prices and economic activity are suffering. Reversals in housing market turnover and homebuilding are already large, even as much of the economy continues to experience excess demand. In the Eurozone the European Central Bank has to behave more gingerly than the Fed, because a large rise in interest rates would translate into higher government bond yields and result in much increased debt interest costs, notably in Italy. In the three months to June M3 increased at an annualised rate of 4.5%, much less than in 2020 but clearly still positive. The ECB does not intend to reduce the asset pile accumulated in the Covid period. Indeed, it has said that it may use redemption proceeds from maturing bonds to increase holdings of sovereign bonds, where yield differentials show signs of dangerous widening. The main European economies are – like the USA – suffering a squeeze on real money balances, but it is not so severe. (UK money growth fell back sharply in June. See pp. 16 – 17.)

The patterns in Asia are different. In China money growth is rising, perhaps to provide a friendly economic backdrop to the 20th National Congress of the Communist Party. Meanwhile the Bank of Japan is largely indifferent to the slide of the yen on the foreign exchanges and at its last meeting kept its interest rate at minus 0.1%. In the year to June Japan's M3 was up by a mere 2.9%. So the drift towards monetary policy tightening is not universal. 2023 may therefore see growth in output at the global level, although not much. The surge in natural gas prices from the Ukraine situation will cause a one-off jump in consumer prices in coming months, but it does not reflect underlying inflation pressure.

Money trends in mid-2022 in the main countries/jurisdictions

The Institute of International Monetary Research focuses on the relationship between trends in the growth of the quantity of money, broadly-defined, and macroeconomic outcomes. The Institute's consistent analysis since spring 2020 – that money growth acceleration would lead to an inflationary boom and an upturn in inflation – has proved correct. The new areas of debate are the duration of above-normal inflation, with normality seen as an annual increase in consumer prices of 2% a year, and the severity of the coming recession. Key principles here are that,

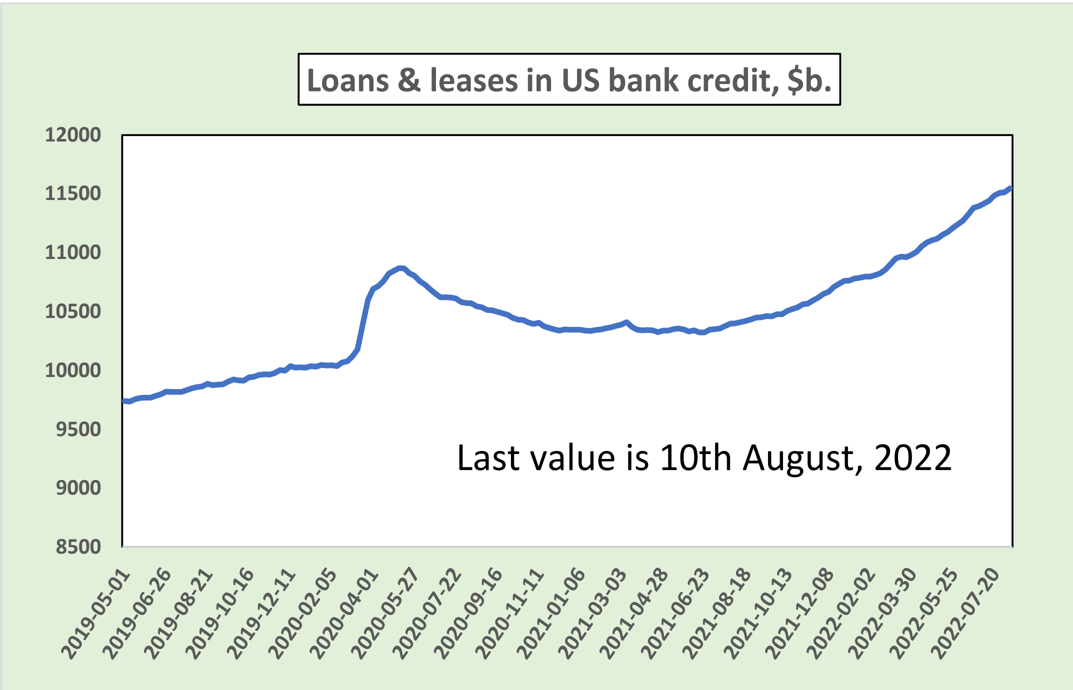
i. The rate of inflation is equal to the rate of increase in nominal GDP minus that of real GDP,
ii. Over the medium term, growth rates of broad money and nominal gross domestic product will be similar, although only rarely identical, and
iii. Just as a correlation holds between nominal money and nominal GDP, so one holds between real money and real output, and falls in real money are often associated with asset price weakness and recessions.

Much will therefore depend on rates of broad money growth in coming months and quarters, with the table below summarizing recent patterns in the leading nations. The table shows pronounced money growth reductions in the developed countries from the remarkable 2020 peaks. China is following its own path, with money growth rising slightly. In 2023 recessions in North America and Europe may still be reconciled with positive growth at the global level. In the UK M4x fell in June.

Name of country/ jurisdiction	Share of world output in 2020		Growth rate of broad money		Comment
	In purchasing-power parity terms, %	In current prices and exchange rates, %	In last three months at annualised rate, %	In last twelve months, %	
USA	15.4	24.7	**0**.8	**5.6**	Money growth stopped in spring 2022, implying severe squeeze on real money balances.
China	18.3	15.4	**13.3**	**11.7**	Money growth rising, amid property bust scares. Policy being eased, no official inflation concern.
Eurozone	12.1	17.4	**4.5**	**5.7**	Money growth moderating, as ECB worries about widening sovereign debt spreads.
Japan	3.7	6.0	**2.7**	**2.9**	Credit and money growth back to pre-Covid norms, implying little inflation in medium term.
India	6.8	3.1	**7.1**	**8.8**	Money growth moderating, as RBI seeks more capital in banking.
UK	2.2	3.3	**2.8**	**4.4**	Money fell in June as part of trend money growth slowdown.

The recent halt to money growth in the USA – and the moderation in money growth in the Eurozone, Japan and the UK – implies that inflation will come down towards levels closer to the norms of the 2010s. However, the lags are such that both this year and 2023 will feature annual inflation rates typically above 4%. Numbers above 10% remain possible in 2022, but a definite downward path in inflation is to be expected in 2023. The Ukraine tragedy has added awkward twists to the inflationary spiral, but it is best interpreted as a one-off and reversible shock to the price level. It is certainly not the fundamental cause of the inflation of the early 2020s. This inflation episode – like all the others – is to be attributed to excessive growth of the quantity of money (in the USA, the Eurozone, the UK, Canada and Australia), which was most marked in spring and summer 2020, but rolled on into 2021. In 2022 the combination of falling growth in nominal money (and even the risk of outright falls in the quantity of money) and still high inflation implies declines in *real* money balances. A standard cyclical pattern is that such declines are accompanied by weakness in both asset prices and aggregate demand, and all too often by recessions (i.e., falls in output lasting longer than six months).

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



In the USA bank credit to the private sector is now growing briskly, although the data are erratic from month to month. "Loans and leases in bank credit" (mostly bank lending to the private sector, and constituting over half of US commercial bank assets) increased in the 13 weeks to 10th August at an annualised rate of 14.9%. The resumption of growth in credit to the private sector dates to the middle of last year. In the year to 10th August "loans and leases" increased by 10.9%. That 10.9% figure is much higher than before Covid. The evidence gives substance to suggestions in late 2021 of US banks' keenness to lend, and of US companies' eagerness to borrow both to rebuild inventory and to anticipate price rises.

The puzzle here is that the double-digit annual growth of bank credit has been accompanied in the last six months with stagnation in broad money, i.e., the deposits on the liabilities side of banks' balance sheets. The balance-sheet data do show a large drop in banks' cash holdings. It has been emphasized here that, if the annual rate of credit growth stays in the 10% plus vicinity consistently, and certainly if it moves out towards 15% annualised, the message will be that money growth has its own momentum from the private sector's behaviour. So it would continue if the Fed left its assets stock stable in value. That will affect the size of the interest rate rise needed to bring annual money growth back down to the 3% to 5% band compatible with 2% inflation. The faster credit growth is, the larger will be the required move in the Fed funds rate. The degree of dynamism of private sector bank credit must be carefully watched.

Bearing in mind that Federal and state governments also have persisting deficits that must be financed, a significant rise in dollar interest rates in 2022 look plausible and is of course now under way. The intended Fed sales of securities (i.e., "quantitative tightening") – of as much as $95b. a month from September– could reduce the M3 quantity of money by perhaps $50b (about 0.2%) a month. As far as the analyst is concerned, there is no alternative to checking the numbers month by month. *It needs to be emphasized that bank deposits in the US commercial banking system have been static for almost six months. Such deposits – which constitute most of M3 broad money – were a tad lower (just over 0.1%) on 10th August than on 23rd February.*

Plainly, with inflation proceeding at close to double-digit annual rates, real money balances are falling sharply. The warning given above about the downward impact on asset prices and aggregate demand needs to be reiterated. Over the medium term the growth rates of real money and real output are similar, a feature of all economies that reflects the underlying stability of agents' money-holding behaviour. The velocity of circulation of money fell remarkably in 2020. But velocity is a mean-reverting series. Now, on schedule and in line with expectations, it is rising at an exceptional pace. These developments are a clear vindication of ideas that have long been basic to the quantity theory of money, although recent speeches from top Federal Reserve officials hardly suggest they are interested in these ideas.

In the Eurozone the stock of credit to the private sector was 5.2% higher in July 2022 than a year earlier. The stock of loans for house purchase was up by 5.3% in the year to July, whereas loans to non-financial corporations (i.e., industry and commerce) advanced 6.6% in the same period. Loans to all corporations, financial and non-financial, increased by 2.7% (or at an annualized rate of 11.2%) in the three months to May. By implication, if the ECB does not intend to reduce the asset pile built up in the last few years, bank credit to the private sector is strong enough to sustain an annual rate of money growth in the low single digits per cent. European governments are still doing their best to persuade the Basel-based Bank for International Settlements, and the European Commission, that further large increases in banks' capital requirements are unnecessary and would damage the ability of their financial systems to sustain the recovery. They seem to be having some success in these efforts, despite the concurrent drives by regulatory officialdom for greater "greenery", central bank digital currencies, better corporate governance and the like. The Ukraine crisis has led to a more tolerant attitude towards lending to the European oil and gas sector, and indeed has called into question the very expensive and almost sado-masochistic drive for "net zero".

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

In the UK bank regulators seem to believe that the higher are bank capital/ asset ratios, the safer is the banking system and the better is the outlook for the economy. With inordinate amounts of capital required in commercial banking, banking groups have drawn up plans to allocate capital to other activities. Large banks are not hiding their reluctance to commit new capital to mainstream UK commercial banking. The problem is being made worse by decisions taken by the Financial Policy Committee and the Prudential Regulation Authority, at the Bank of England. At its latest meeting the FPC decided that banks must have a 2%-of-assets counter-cyclical capital buffer, with effect from July 2023. The 2% rate is supposed to pre-empt future shocks to the economy. To quote from its latest *Financial Stability Report*, “the global and UK economic outlook has deteriorated significantly” since the end of 2021, when it announced the rate was to go from zero to 1% by the end of 2022. The imposition of the extra capital requirement is, however, deflationary in the first instance. It will discourage the growth of risk assets and hence of banks’ deposit liabilities. More generally, the argument can be made that regulation has destroyed the incentive for bank stakeholders to grow their loan portfolios. (See the Institute’s recent research papers – by David Llewellyn and myself – on these topics,

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Loan growth has been erratic in recent months. Bank lending to the mainstream, non-intermediate financial sector jumped in both March and May. It seems likely that exceptional, non-recurring transactions were responsible, as April and June saw offsetting falls. A new trend was not established. The stock of loans to non-financial corporates was *lower* in June 2022 than a year earlier. The stock of bank lending is growing in the UK, but not rapidly.

To repeat the point I have been making here so far this year, in 2022 and 2023 the vigour – or lack of vigour – of bank credit to the private sector is crucial to interest rate prospects. The market consensus is that interest rate rises will occur in most developed countries once the pandemic-related weakness in aggregate demand lies in the past. Central banks are now ending asset purchase programmes and in some instance are starting to reduce their asset piles. A reduction in money growth is a condition of the return of moderate inflation. Robust bank lending to the private sector is in many ways desirable, because of its contribution to wider economic efficiency. But fast expansion of banks’ loan portfolios will make it more difficult to deliver the needed reduction in money growth. If bank lending to the private sector were increasing at an annual rate of 5% or less, it will be easy for central banks to keep money growth under control. Pointers to future lending growth therefore deserve to be monitored carefully in the next few months. Despite very low nominal interest rates, and indeed extremely negative real interest rates, a big boom in private sector bank credit is not imminent in Japan or the UK. But a strong recovery in such credit in the USA has begun, and the Eurozone is seeing more signs of life.

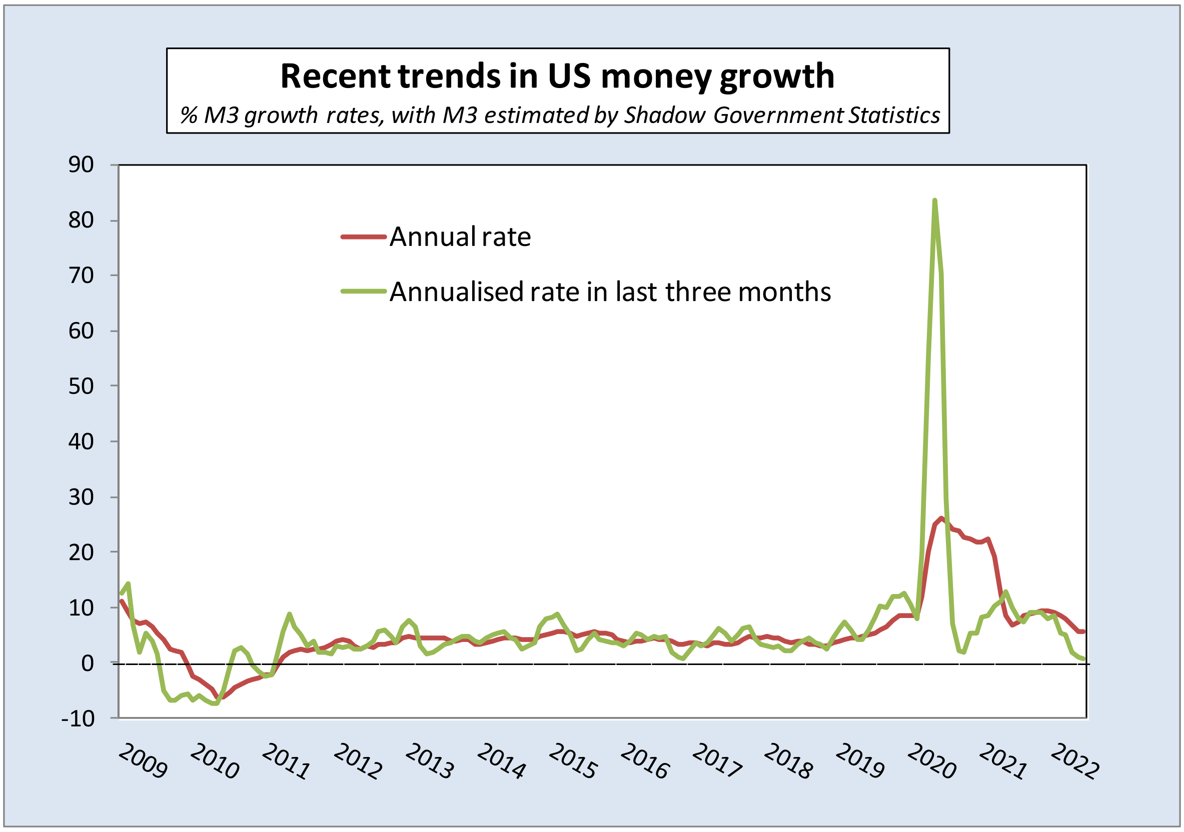
Tim Congdon

26th August, 2022

USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1961 – 2020	**7.7**	**6.3**
Ten years to 2020	**6.2**	**3.4**
Year to June 2022	**5.6**	**n.a**
Three months to June 2022 at annualised rate	**0.8**	**n.a.**

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



US broad money static for six months

Summary: **The quantity of money, on the broad definitions, stopped growing in February. According to data from Shadow Government Statistics, M3 was $27,938b. in February and only 0.3% up in June, at $28,014b. Meanwhile the latest H8 weekly release from the Federal Reserve shows that deposits at US commercial banks fell fractionally between June and July, from $18,082.9b. to $18,071.4b., and were flat in the first two weeks of August. So a fair conclusion is that money has shown no growth whatsoever for six months. As inflation has been rapid in the period, real money balances are being squeezed.**

The Federal Open Market Committee raised the Fed funds rate by 0.75% at its meeting on 26th-27th July, following on from June's 0.75% increase. Further increases are likely. Two weeks after the FOMC meeting, Charles Evans, the president of the Chicago Fed, stated that he expects the Fed funds rate to have risen to 3.75% - 4% by the end of the year. Although US consumer price inflation fell from 9.1% in the year to June to 8.5% a month later, thanks largely to lower oil prices, the message from the Fed is that it intends to tighten policy further. Moreover, on 1st June the Fed started to "run off" some assets purchased in 2020. Money from maturing Treasuries to the value of $30b. and mortgage-backed securities worth $17.5b. were not re-invested during the month, and a similar amount was "run off" in July. From 1st September these monthly quantities will be doubled. This action alone could result in a monthly reduction in broad money of as much as $50b.

Demand for new bank credit remains robust, with banks loaning a further $124b. in July. But the strength of credit extension to the private sector has not been enough in 2022 to outweigh the contractive influences on money growth. Deposits at US commercial banks were $18,077.6b. at 10th August, a touch lower than almost six months earlier – on 23rd February – when they were $18,104.7b. The other main form of money – balances at money market mutual funds – has also seen little expansion this year, partly because MMMFs have been subjected to new restrictions in recent years.

The Fed seems confident that the US economy is resilient enough to cope with the shock. In its defence it has pointed to the low unemployment rate, which fell to 3.5% in July after four consecutive months at 3.6%. Wages growth has picked up. Hourly earnings – which typically increased by 2½% a year in the 2010s – were 5.2% higher in July than a year earlier. Evidence has also emerged of a slowdown in the retail sector. Total sales grew by a modest 1% in June after a 0.1% drop in May. The effects of the money stagnation and the Fed's contractionary policy are already clear. Existing home sales have slumped in 2022, while new home sales have tumbled by over 40% from recent peaks in spring 2020.

Tim Congdon and John Petley
25th August, 2022

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

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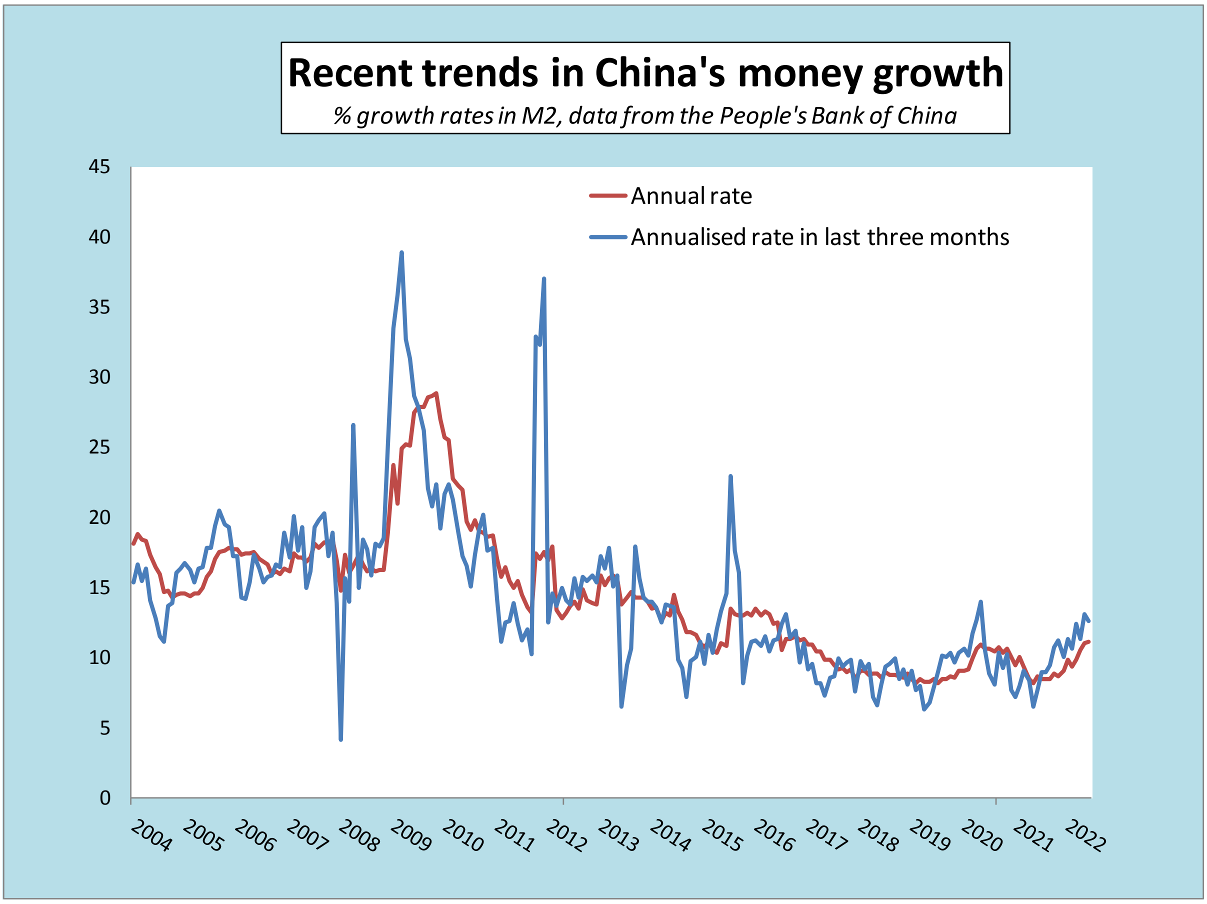
China

	% annual/annualised growth rate:	
	M2	Nominal GDP
1991- 2020	**18.4**	**14.5**
2011 - 2020	**11.7**	**10.0**
Year to July 2022	**11.7**	**n/a**
Three months to July 2022 annualised rate	**13.3**	**n/a**

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



Broad money growth remains strong

***Summary*: In the three months to July 2022 China's seasonally adjusted M2 grew at an annualised rate of 13.3%, the fastest rate of growth since May 2020. (The Institute carries out the seasonal adjustment, which is sometimes hazardous.) In nine of the last ten three-month periods, annualised broad money growth has been above 10%, contrasting with numbers below 10% for much of 2021. The annual increase rose from 11.1% to 11.7%, the highest value since June 2016.**

As many other countries tighten monetary policy, China is going in the opposite direction. On 15th August the People's Bank of China cut the rate for its one-year medium-term lending facility by 0.1%, reducing it to 2.75%. This targeted reduction of one lending rate rather than an across-the-board cut has been typical of PBoC policy recently, but the direction of travel has been consistent and clear. The PBoC has been moving towards a looser monetary policy. The explanation seems to be that policy makers want to help demand, as China's economy suffers from the maladroit handling of the Covid virus. GDP shrank by 2.6% in the second quarter of 2022, the first decline since Q2 2020 when a lockdown was imposed across parts of the country due to the coronavirus pandemic. In 2022 the contagious but milder Omicron variant is being tackled by a similar policy of tight lockdowns, with harmful economic effects on large cities such as Shanghai.

China is also struggling to prevent a collapse of its huge property market. As recently as 2019, house prices were rising at an annual rate of over 10% in the 70 largest cities. This boom is now over. Prices have fallen in recent months, with the rate of decline apparently accelerating. The PBoC will be setting up a fund worth $44b. to bail out property developers, many of which are seriously in debt. It also wants state-owned banks to provide $148b. to support them. Many homebuyers have stopped paying mortgages on unfinished apartments. This mortgage boycott has spread to affect at least 300 housing projects. In a further surprising display of defiance, there have also been protests outside rural banks in Henan and Anhui provinces. In April, four rural banks froze their customers' accounts. The police claim that these banks have been under the control of a criminal gang which has transferred bank deposits elsewhere, In response to demonstrations, the authorities have allowing depositors to withdraw money again, but many still cannot access their funds.

The authorities will no doubt be seeking to address these problems before the opening of the important 20th congress of the Chinese Communist Party, supposed to be held later this year, but with the date still not fixed. The extraordinary growth of output and living standards in the first 15 years of the 21st century now lies in the past, and the Communist Party has a constant task of self-justification. The annual rate of consumer price inflation was 2.7% in the year to July, the highest reading in two years, albeit still below the government's 3% target. The PBoC has promised to provide lending support for businesses and to keep liquidity "reasonably ample". However, in its quarterly monetary report, published on 10th August, it insisted that it will not be pumping huge amounts of liquidity into the economy to avoid raising the rate of inflation. Money growth is now well ahead of the trend rate of output increase.

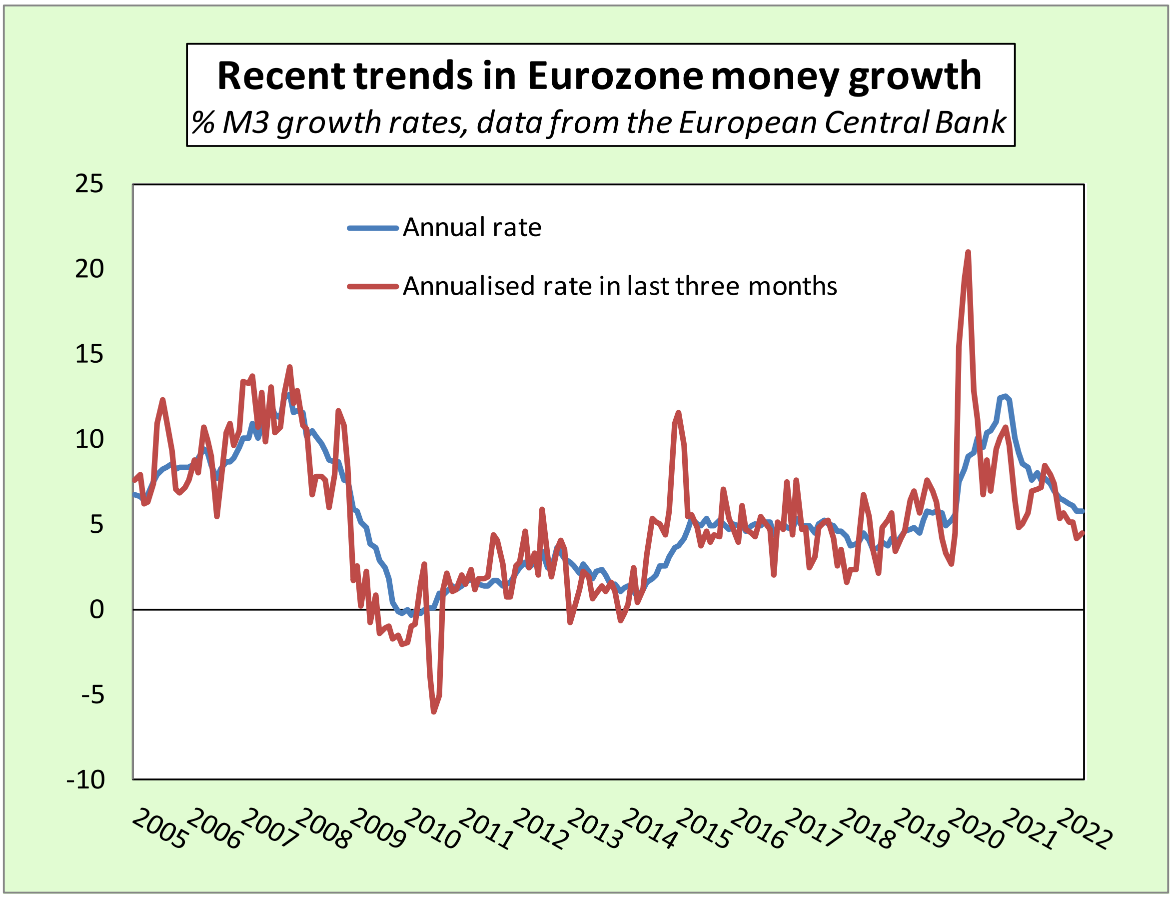
Tim Congdon and John Petley
25th August, 2022

	M2	Nominal GDP
1991 - 2000	**24.5**	**18.5**
2001 - 2010	**18.4**	**15.2**
2011 - 2020	**11.7**	**10.0**

Eurozone

	% annual/annualised growth rate:	
	M3	Nominal GDP
1996 – 2020	**5.5**	**2.7**
Ten years to 2020	**4.6**	**1.6**
Year to June 2022	**5.7**	**n/a**
Three months to June 2022 at annualised rate	**4.5**	**n/a**

Sources: European Central Bank for M3, Eurostat for GDP



Broad money growth likely to slow, as the ECB raises rates

Summary**: In the three months to June 2021 the quantity of M3 broad money in the Eurozone grew at an annualized rate of 4.5%, higher than May's revised reading of 4.1%. Broad money grew by €87b. during June, the largest monthly increase so far this year. The annual growth rate nonetheless continued its steady decline, falling from 5.8% in May to 5.7%, the lowest reading since February 2020.**

June's money figures will be the last to be boosted by asset purchases. The Pandemic Emergency Purchase Programme (PEPP) was wound up at the end of March and the separate 2019 Asset Purchase Scheme (APS), which has normally added €20b. to the ECB's balance sheet every month, was terminated on 1st July. The ECB implemented its first rate hike in 11 years, from 0% to 0.5%, after the Governing Council's meeting on 21st July. While a further increase could be announced as soon as the next meeting, scheduled for 8th September, the ECB does not intend to embark on any asset sales for the time being. Instead, it is re-investing the money from both PEPP and the APS in assets from countries under stress, mainly Italy and Spain. These purchases have come under the auspices of the Transmission Protection Instrument, a new *ad hoc* bond purchase scheme announced on 21st July. Its objective is to prevent the widening in sovereign bond yields which was a feature of the Eurozone debt crisis a decade ago. Bond yields have fallen across the board in the last month. Even so, Italy's 10-year bonds are currently yielding over 3.4% whereas the yield on 10-year German bunds fell back below 1% at the start of August (although it has since risen). Higher borrowing costs could widen this spread.

Although broad money growth may well slow without any asset purchases, the ECB's reluctance to follow the Bank of England or the US Federal Reserve in running off its asset purchases and its relative hesitancy to raise the cost of credit may somewhat ameliorate any future downturn. Inflation, which rose to a record high of 8.9% in the year to July, is likely to remain well above the ECB's 2% target for at least the rest of the year, especially given that broad money growth remained well above the 4%- 5% numbers that seemed to be consistent with 2% inflation in the late 2010s.

The sharp increase in producer prices, which rose by no less than 37.3% in the year to April, has slowed slightly, but still remains above 35%. Some of these extra costs will inevitably have to be passed on to consumers. So far, these higher costs have not slowed either the housing market or the demand for credit by businesses. Indeed, the stock of loans to companies across the 19-nation bloc grew by 6.8% in the year to June, the strongest reading since February 2021. Retail sales declined for the first time since the lifting of lockdown restrictions in early 2021, falling by 3.7% in the year to June. The steady decline in unemployment has also ground to a halt, with the rate unchanged at 6.6% since April. Several large EU member states, notably Germany, are very dependent on Russia for energy and are thus vulnerable to any action by Moscow to cut off supplies. This may be another factor behind the ECB's relatively cautious approach to raising the cost of borrowing. German industrial production declined in both March and May, although June saw a modest increase of 0.4% in output.

John Petley
16th August, 2022

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

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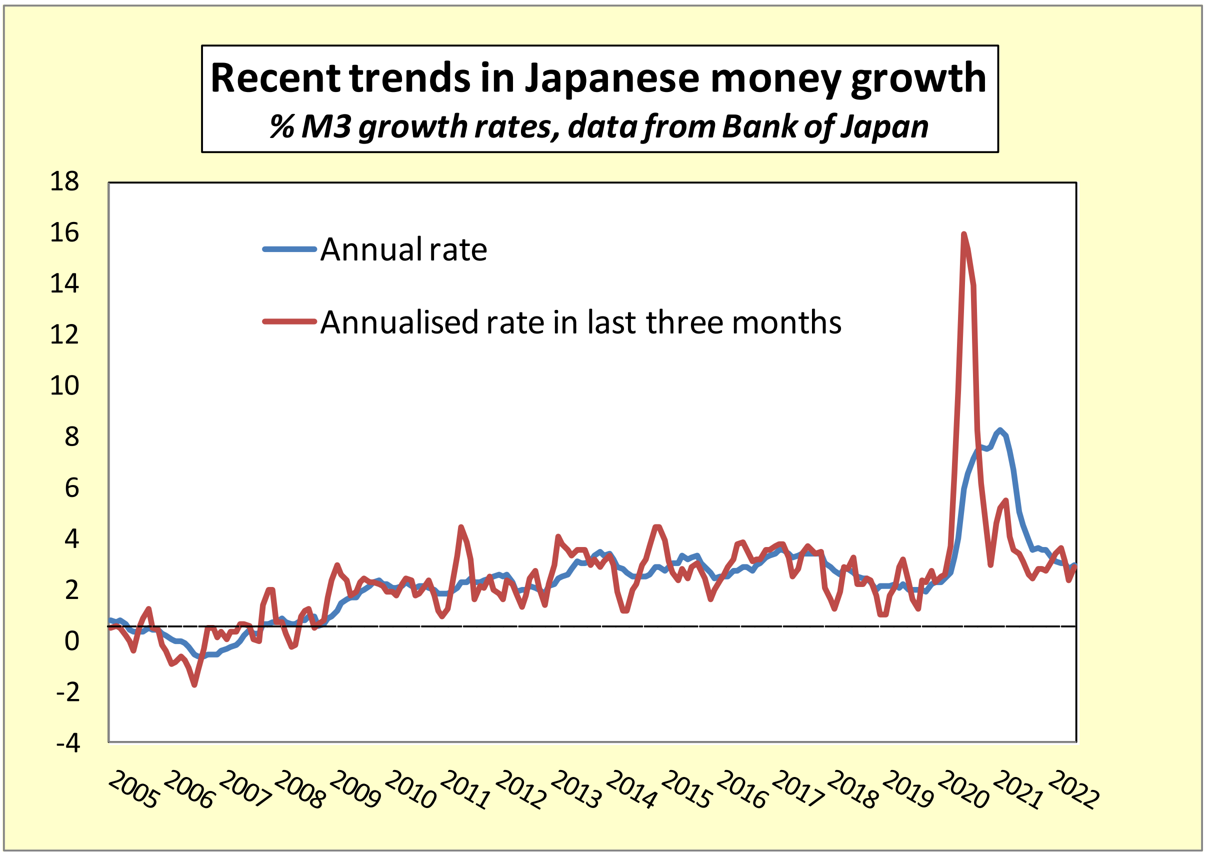
Japan

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2020	3.9	1.7
Ten years to 2020	3.2	0.3
Year to July 2022	2.9	n/a
Three months to July 2022 at annualised rate	2.7	n/a

Sources: Bank of Japan for M3 and IMF for GDP



Broad money growth remains sluggish

Summary: **The three months to July 2022 saw Japanese M3 increase at an annualised rate of 2.7%, unchanged from June's reading although lower than the figures for the first five months of the year. The annual rate of growth was also unchanged at 2.9%, which is only slightly higher than May's two-year low of 2.8%. In July itself, broad money grew by 42 trillion yen, a value fairly typical of the monthly increases during the last decade.**

Indeed, the macroeconomic picture in Japan looks very similar to the years prior to the coronavirus pandemic. Broad money growth fluctuated between 2% and 4% for much of this time. The only difference is the high level of consumer price inflation, by Japanese standards. Prices rose by 2.4% in the year to June, the third consecutive month when inflation has been above the Bank of Japan's 2% target. This figure is nonetheless slightly lower than May's reading of 2.6%. Producer prices rose by 8.6% in the year to June. Significantly, this is the smallest increase this year. Prices both for consumers and at the factory gate are increasing at a much more modest level than those of some other countries studied in these notes – notably the UK and the USA – in spite of the weakness of the yen, which has lost about 17% of its value against the US dollar since the start of March.

Given Japan's dependence on imported energy, including gas, the relatively moderate level of inflation raises serious questions about the claims of some central bankers such as the UK's Andrew Bailey that over 80% of the drivers of inflation are "external shocks." Although an annualised broad money growth rate of 16% in the three months to June 2020 was quite unprecedented in Japan, this peak was much lower than in many other developed countries and it was relatively short-lived. Annualised quarterly M3 growth had dropped to a mere 2.5% by August 2021.

For this reason, it is likely that Japanese inflation could well fall back below 2% in the coming months. The Bank of Japan has made it quite clear that it does not intend to raise its bank rate nor increase its yield control target. Since the end of March, it has purchased 10-year Japanese government bonds to the value of over 19 trillion yen in its determination to keep their yield below 0.25% and has thus far achieved its immediate objective. The effect of these purchases on the wider economy is somewhat limited as the BoJ's asset purchases have little effect on broad money growth. Perhaps a more positive signal is coming from Japanese commercial banks, which have recently seen something of a pick up in the demand for new credit. The value of new loans increased by 1.8% in the year to July, an increase from June's reading of 1.2% and indeed, the highest value since the height of the pandemic when a large number of companies took out loans to tide them over. Industrial production has nonetheless declined on an annual basis for the last four months and the retail sector is also going through a weak patch, with sales in June down by 1.4% compared with 12 months earlier.

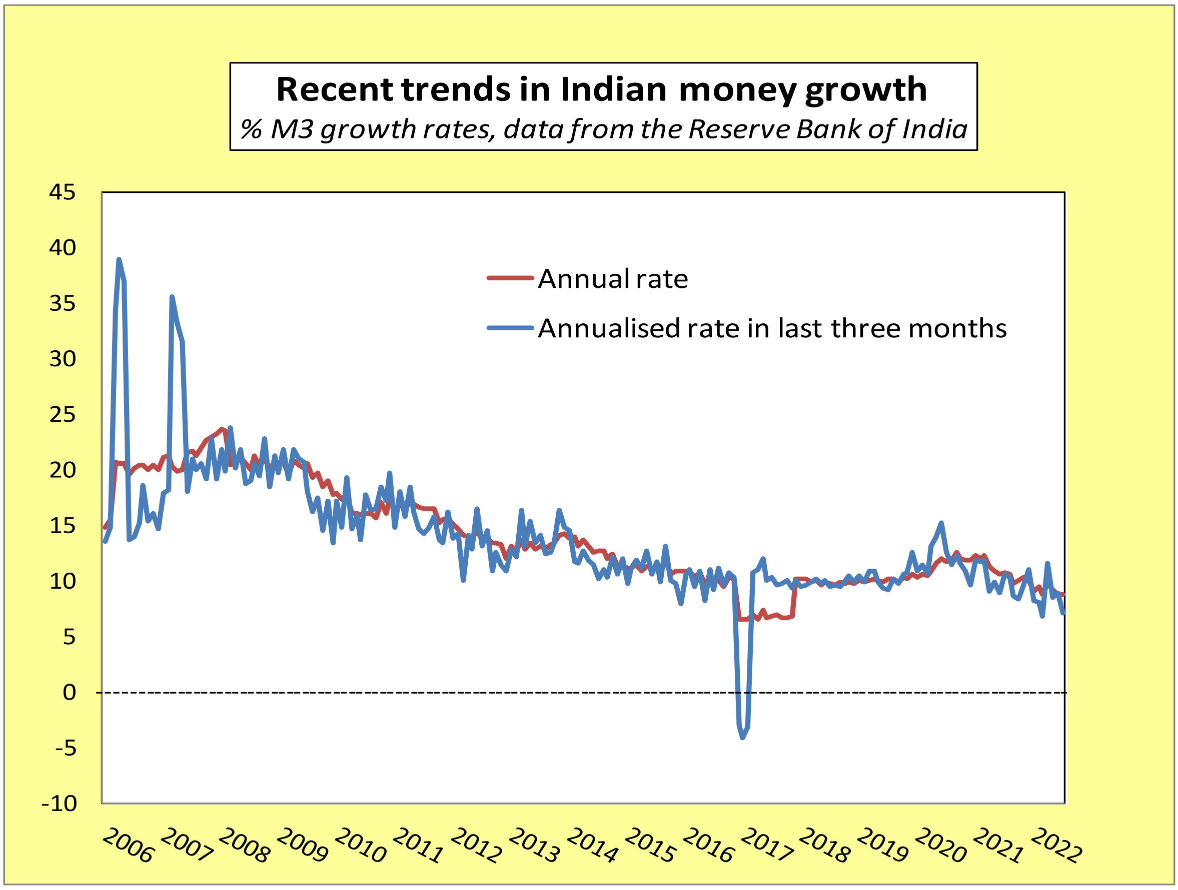
John Petley
17th August, 2022

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

India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2020	**15.8**	**12.9**
Ten years to 2020	**11.3**	**9.8**
Year to July 2022	**8.8**	**n/a**
Three months to July 2022 at annualised rate	**7.1**	**n/a**

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



Broad money growth slows, as RBI tightens policy

Summary: **In the three months to July 2022 India's seasonally adjusted M3 grew at an annualised rate of 7.1%, substantially lower than June's reading of 9.0% and the slowest rate of growth in five years. April's very strong growth has dropped out of the calculations, which goes far to explains why the growth rate has fallen. Conversely, it is likely to pick up next month because M3 growth in May (which will no longer feature in the calculation) was very weak. The erratic monthly changes cannot disguise a slowing of broad money growth. At 8.8%, July's annual rate of growth is lower than at any time since October 2017.**

The Reserve Bank of India (the central bank) has been worried for some time about high levels of inflation. It announced as far back as 5th April that it would prioritise bringing it down to the target figure of 4% although a 2% band is permitted either side of the 4%. It would concentrate on limiting inflation, even if this meant slower growth of demand and output. Since then the RBI's key policy rate (the repo rate) has risen from 4.0% to 5.4%, with the most recent rise of 0.5% being announced after the RBI's Monetary Policy Committee meeting in August. There seems little evidence thus far of a slowdown in demand for bank credit. The stock of credit was 14.5% higher in the first half of August than the corresponding period in 2021, the highest rate of advance reading since 2019.

Consumer prices rose by 6.7% in the year to July, the third consecutive month it has fallen after reaching 7.8% in April. The RBI still feels that this level of inflation is "uncomfortably high." The rupee has declined by about 8% against the US dollar since the start of the year, which will have contributed to inflation given India's dependence on imported energy. The exchange rate has stabilised over the last month, but the cost of defending the currency has been a drop of over $50b. (or 8%) in India's foreign reserves since March.

The most recent figures for India's GDP only cover the first quarter of the year, during which time the economy grew by 0.8%, or at an annual rate of 4.1%. A surge in cases of coronavirus resulted in some restrictions being imposed during this period, which have now been lifted. By and large, the economy is performing well. Industrial production was up by 12.3% in the year to June. After two years without any banking failures, however, on Wednesday 10th August, the RBI cancelled the banking licence of the Pune-based Rupee Cooperative Bank, claiming that it did not have sufficient capital or earnings prospects. Although a relatively small bank, its failure underscores the statement by Rajeshwar Rao, the RBI's deputy governor, on 16th June, that there were still "miles to go" in reforming India's banks. The RBI is keen for banks to restructure bad debts while at the same time looking to impose higher capital ratios. This desire for reform is understandable, but the net result could be a slowdown in the growth of credit. Still, broad money growth might be bolstered by the monetization of government debt.

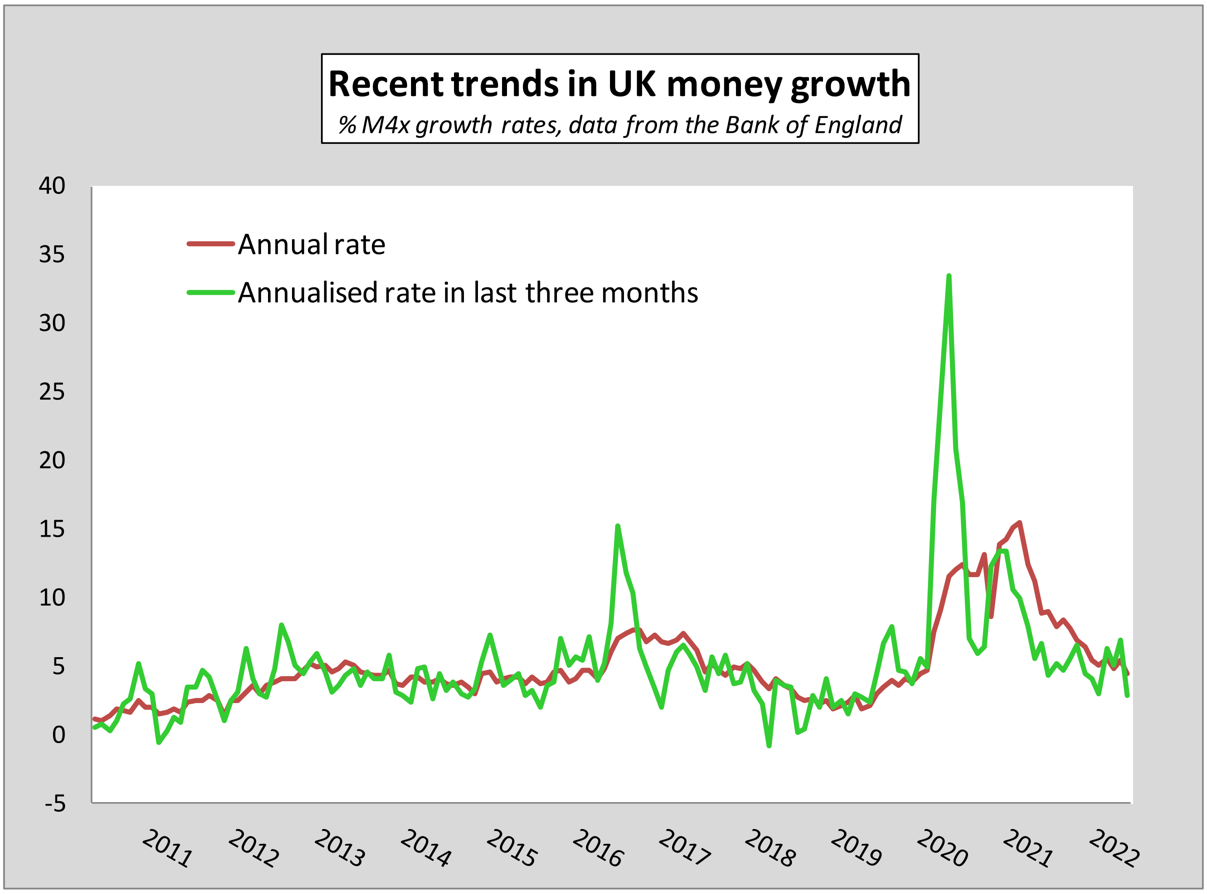
John Petley
18th August, 2022

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

UK

	% annual/annualised growth rate:	
	M4x/M4 before 1997	Nominal GDP
1961 – 2020	**9.3**	**7.6**
Ten years to 2020	**5.2**	**2.3**
Year to June 2022	**4.4**	**n/a**
Three months to June 2022 at annualised rate	**2.8**	**n/a**

Sources: Bank of England and Office for National Statistics



Broad money growth slows sharply

Summary: **UK broad money increased at an annualised rate of 2.8% in the second quarter of the year. In an arithmetical sense, the sharp decline from 6.9% in the three months to May reflected two factors, a contraction in M4x of £2.1b. in June and the effect of March's strong growth dropping out of the calculation. The annual growth rate, which picked up to 5.4% in May, fell back to 4.4%, the lowest reading since January 2020, that is, before the start of the pandemic.**

On 4th August, the Bank of England's Monetary Policy Committee raised the Bank Rate by 0.5%, the sixth consecutive increase and the largest thus far. After the meeting, the usual policy statement mentioned that a strategy for selling off some long-dated gilts will be announced after the next MPC meeting on Thursday 15th September. To date, the money from maturing assets to the value of £12b. has not been reinvested and assets worth a further £5.9b. will be run off on maturity next month. Governor Andrew Bailey has insisted that the Bank must stick to its mandate and return inflation to its 2% target in order to prevent inflation expectations becoming embedded.

Consumer prices rose by 10.1% in the year to July and he expects this figure to rise to a peak at just over 13% in the final quarter of this year. A week after the MPC meeting, Sir Dave Ramsden, the BoE's Deputy Governor, stated that the Bank rate was likely to be raised still higher. The Bank's asset sales would continue even if, at a later date, the Bank rate starts to be reduced. The combined effect of raising the Bank rate and simultaneously shrinking the BoE's balance sheet is plainly contractionary. In one sense, Bailey's prediction of that the UK economy is heading for the worst downturn since 2008 may not prove to be too wide of the mark, but the reasons behind his thinking do not take into account the likely collapse of M4x growth in the second half of the year. While the sharp increase in energy prices and the war in Ukraine have unquestionably had an impact on the economy, the exceptional growth of broad money in 2020 is the main reason why inflation is so high at the moment.

The UK economy is already showing signs of deceleration. GDP contracted by 0.1% in the second quarter of 2022. The retail sector is slowing, with sales down 6.1% in June compared with 12 months previous in spite of the month featuring the celebrations for the Queen's Platinum Jubilee. The number of new mortgage approvals fell to its lowest level in over a year and net mortgage lending fell from £8b. in May to £5.3b. Larger companies are still showing a reasonable appetite for risk, borrowing a further £1.3b. in June, but lending to the SME sector declined once again. Industrial output fell by 0.9% in the month. The money numbers do not offer much ground for hope that this decline is likely to be reversed in the coming months. Growth in the stock of bank loans is likely to be further inhibited by the decision last December by the Bank of England to raise commercial banks' countercyclical buffer (an additional cushion of capital to guard against potential losses) to 1%. It will rise further to 2% in July 2023, which will act as an additional inhibitor on new bank credit and thus further dampen broad money growth next year and possibly beyond.

John Petley
19th August, 2022

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