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Monthly e-mail from Tim Congdon and John Petley – 10th January, 2019

Global money round-up in early 2019

Forecasters are now generally agreed that 2019 will suffer a slowdown compared with 2017 and early 2018, but that it will be a “growth slowdown”, not a recession. This has for some time been the view taken by the Institute of International Monetary Research in our analysis, mostly because we have been expecting money growth to weaken in the leading economies, particularly the United States of America and the Eurozone.

The latest US figures do not altogether agree with the arguments we have been presenting. M3 growth bounced back strongly in December, taking the three-month annualised growth rate to 6.3% and the annual growth rate to 4.9%. We have been expecting the Fed's asset run-off – now at \$50b. a month – to cause money growth to be lower than this. The asset run-off is undoubtedly having a contractive effect on US commercial banks' balance sheets: their cash assets dropped from \$2,427.6b. to \$1,977.1b. in the year to November and a movement in cash registers the relevant transactions with the Fed. The counter-vailing force seems to be strong growth in bank credit to the private sector by smaller US banks, benefiting to some extent from the easing of Dodd-Frank legislation. We have no alternative to watching the data month by month and pointing out unexpected developments.

Eurozone M3 growth was also higher than expected in autumn 2018, but that was due partly to a squeeze on money balances pulling in money from the rest of the world. Domestic credit expansion in the Eurozone is very weak and is likely to remain so in 2019. The UK and Japan both have extremely weak growth of credit and money at present. (See pp. 10 – 11 and 14 – 15 below.) At least the Chinese authorities are taking active steps to promote bank balance sheet expansion, while in India banks continue to grow at double-digit annual % rates.

Money trends at the end of 2018 in the main countries/jurisdictions

What are the latest money growth trends in the main countries? And what is the message for global economic activity over the next year or so, and for inflation/deflation over the medium term thereafter? The table below summarizes key numbers. The latest figures for the USA are a surprise, indicating a bounce-back in money growth in December, but otherwise the numbers for the *developed* countries justify caution about early 2019. In the Eurozone, Japan and the UK the annual growth rate of the quantity of money is under 4%, and in the cases of Japan and the UK the current trends are for a deceleration in growth to negligible figures. The two big *developing* countries followed in these notes – China and India – still enjoy positive money growth not far from a double-digit annual rate. But in China the authoritarian stance being increasingly taken by the Xi Jinping government seems to be accompanied by reluctance in the banking system to take new risks. The People’s Bank of China has cut reserve requirements repeatedly to encourage bank balance-sheet expansion.

The resilience of money growth in the USA is largely due to strong expansion in bank credit to the private sector by smaller banks. In the year to November “loans and leases in bank credit” advanced by 8.0% at banks that the Federal Reserve regards as “small”. By contrast, the comparable figure for the large banks was 2.6%. There could hardly be clearer evidence of the differential impact of bank regulation, with the small banks less constrained by the imposition of the Basel III capital rules and the Dodd-Frank legislation. At any rate, if the USA’s boom in small bank credit continues in 2019, it may be possible to combine moderate money growth with the Fed’s asset run-off. There is no alternative to watching the data on a month-by-month basis.

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	3.6	3.8	Easing of Dodd-Frank to boost credit expansion, but the Fed’s asset sales reduce broad money.
China	18.7	16.1	8.2	8.7	Concern about excessive debt has not stopped the PBOC easing reserve requirements.
Eurozone	10.6	16.4	4.8	3.9	Broad money growth moderate, risk of stagnation when ECB asset purchases stop.
Japan	4.2	5.9	2.4	2.3	Credit and money growth not far from the 3% figure seen for much of last decade, but on weak side
India	7.7	3.3	10.2	9.8	Robust high credit and money growth, despite worries about non-performing loans and fraud.
UK	2.2	3.4	2.3	2.6	Money growth slipping, a worrying backdrop to Brexit. Slowdown may be inadvertent. .

The UK situation remains perplexing. As it is outside the Eurozone and the UK is indeed leaving the European Union, the Bank of England has far more freedom than any of the Eurozone's central banks. But money growth is still sliding, with no evident policy justification. In the three months to November the annualised rate of M4x growth was a mere 1.7%. The M4x increase in the twelve months to November was 2.2%, the lowest figure since 2011. Financial sector money was lower than a year earlier, which went some way to explain the disappointing UK stock market in 2018 and the fall in London house prices. The macroeconomic background to Brexit (on 29th March, although it may be changed because of continuing political shenanigans) could have been better.

In the big *developing* countries – China and India – money growth has recently been quite steady at an annual rate of about 10%. The Chinese authorities are plainly making a big effort to sustain growth, having cut banks' cash reserve requirements four times since the start of 2018. In India a pre-election spat between the government and the central bank may signal an irresponsible credit surge in the next few months. Fortunately, with inflation very low everywhere, most central banks can reverse their current tightening posture if the slowdown becomes too marked. (A speech by Jay Powell, Fed chairman, on 4th January confirmed that the Fed can adjust flexibly to signs of too pronounced an economic slowdown.) A recession is unnecessary and ought to be avoided. It is not to be ruled out that late 2019 might see policy easing in the USA and elsewhere. The big uncertainty remains the Eurozone, where money growth could tumble in 2019 when the ECB stops buying assets altogether.

A handwritten signature in black ink, appearing to read "Tim Conger". The signature is fluid and cursive, with a large, stylized 'C' at the end.

7th December, 2018



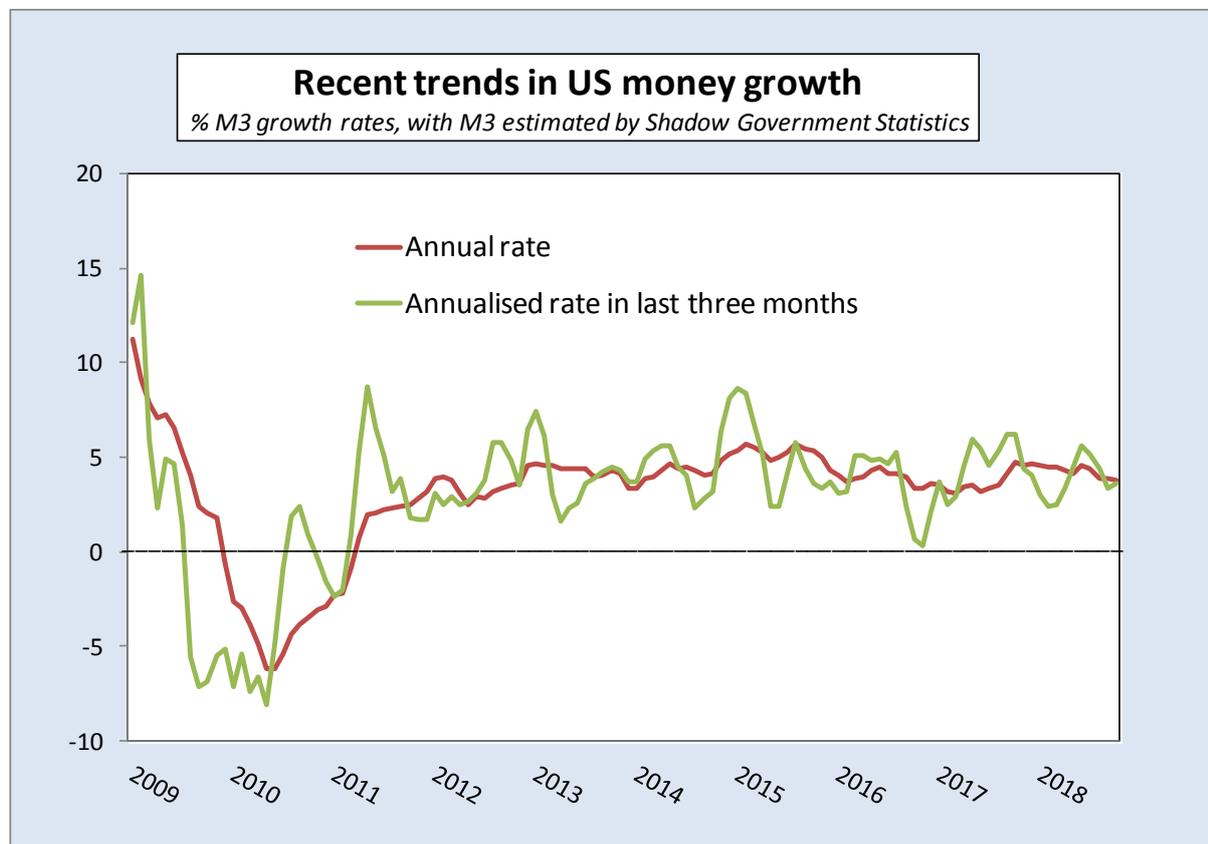
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USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1960 – 2017	7.4	6.5
Seven years to 2017	4.1	3.8
Year to December 2018	4.9	n.a
Three months to December 2018 at annualised rate	6.3	n.a.

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



M3 growth bounces back, despite Fed asset run-off

Summary: In the three months to December 2018 US M3 broad money grew at an annualised rate of 6.3% after a bounce upwards of 1.0% in the month of December itself. An acceleration in broad money growth has occurred, despite the Fed's asset run-off now running at \$50b. a month. It seems that the contractive effect of the Fed's asset run-off on the quantity of money is being offset by positive other influences, such as buoyancy in credit extension by small banks. (Our M3 data come from Shadow Government Statistics.)

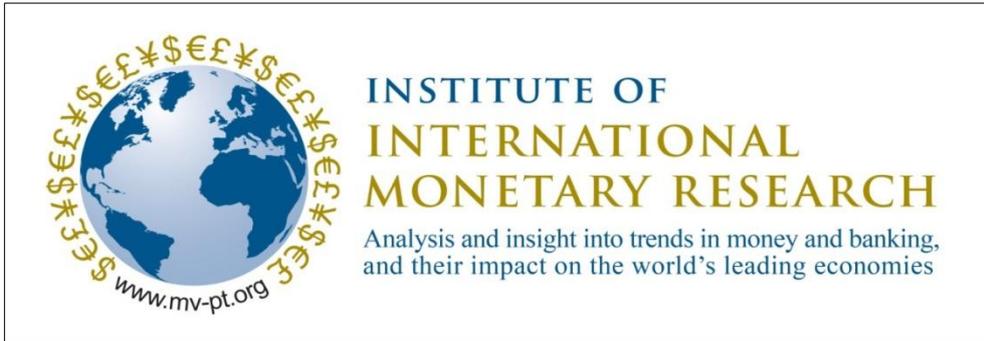
The Fed's monthly asset run-off increased to \$50b. in October and is scheduled to continue at this rate until at least the end of 2019. According to the Fed, the asset run-off is "on autopilot". For much of 2018 Federal Reserve decisions have been driven by a conviction that the US economy has now recovered from the Great Recession and policy should therefore be "normalised". Interest rates should return to levels closer to those seen before the collapse of Lehman Brothers in 2008, while the bloated Fed balance sheet is to be reduced in size. Specifically, the Fed is seeking to lower its assets – which expanded substantially between 2008 and 2014 as a result of the "quantitative easing" programmes of asset purchases – from a peak of \$4.5 trillion to under \$3 trillion by end-2020. The risk is that contraction of its own balance sheet will be accompanied by contraction of deposits held by non-banks at the US commercial banking system, which are part of the quantity of money.

Fortunately, growth in lending to the private sector by US commercial banks remained healthy in 2018. (When banks grant new loans, they create new deposits.) Such credit has been particularly buoyant at small banks. In the year to November the small banks' stock of "loans and leases in bank credit" (i.e., loans to the private sector) advanced by 8.0%, well ahead of the large banks. As is well-known, the small banks have been more successful than the large in lobbying to neutralize the adverse effects of the Basel III rules for their businesses.

On 19th December, the Fed funds rate was raised by 0.25% to 2.25-2.5%. The decision by the FOMC was unanimous, driven by concerns about the tight labour market. The FOMC plays little attention to money numbers, not least because its M1 and M2 measures have become misleading. (The FOMC does not look at the M3 measure on which our analysis is focussed.) Unemployment remains low at close to 50-year lows, even though it rose slightly in December. Wage growth shows signs of increasing. We remain concerned that the asset run-off could lead to money growth deceleration in 2019, but so far our fears have been wrong. Note that Democrat Maxine Waters, who fears that looser bank regulation runs the "risk of another financial crisis", is now chair of the House Financial Services Committee. Further regulatory easing, which could help money growth, looks unlikely.

Tim Congdon
9th January, 2019

	% annual growth rate:	
	M3	Nominal GDP
1960 – 2017	7.4	6.5
1960 – 1970	7.7	6.8
1971 – 1980	11.4	10.3
1981 – 1990	7.7	7.7
1991 - 2000	5.6	5.6
2001 - 2010	7.1	3.9
Seven years to 2017	4.1	3.8



China

	% annual/annualised growth rate:	
	M2	Nominal GDP
1991- 2017	19.2	15.1
2010 - 2017	13.6	11.2
Year to November 2018	8.6	n/a
Three months to November 2018 at annualised rate	8.7	n/a

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



Broad money growth remains stable

Summary: The three months to November saw China's seasonally adjusted M2 grow by 2.2% or at an annualised rate of 8.7%. This was an increase on October's figure of 8.2% and in line with the average until then in 2018, which also stood at 8.7%. Broad money growth has been fairly stable at recent rates – of 8% - 10% annualised – in the last 18 months, suggesting that the authorities are comfortable with these levels. They may be markedly lower than the 20% plus figures seen in the boom decades of the 1980s and 1990s but satisfactory for an economy in which the trend growth rate of output has dropped from double-digit % annual rates to a mid-single-digit % annual rate.

Growth in the stock of lending by China's banks was unchanged at 13.1% in the year to November. Indeed, the rate has stood at either 13.1% or 13.2% since July and has remained within the 12.5%-13.5% band since 2016. This stability has come about as a result of management by the Chinese authorities. The People's Bank of China base rate has remained at 4.35% since 2016, but 2018 has seen three reductions in reserve requirements. In early October the PBOC said that it would maintain "sufficient liquidity" to help banks in supplying credit to smaller businesses; it hoped to "optimise the liquidity structure" of commercial banks. On 21st December, the PBOC announced that it was to introduce a "Targeted Medium-term Loan facility" (TMLF), a scheme to provide additional support to the SME sector. On 3rd January 2019 new measures were announced to exempt a greater number of small businesses from reserve ratio calculations, making it easier for them to borrow money.

These announcements suggest that the authorities are keen to ensure that the current level of growth in the banking system is at least maintained. With annual consumer price inflation falling back from 2.5% in October to 2.2% in November (below the government's 3% target), there is scope for further monetary loosening if necessary. Upward pressures on the price level have come largely from 2018's surge in oil prices, which has been mostly reversed since October. The annual increase in producer prices continues to slow. The rate has fallen in recent months, standing at a mere 2.7% in November.

The Chinese housing market is showing signs of overheating, less than two years after a boom which saw prices rising at an annual rate of almost 40% in one city, Shanghai. Tighter restrictions on mortgage lending were imposed in the most popular cities and property prices remain flat in both Shanghai and Beijing. Taking China's 70 biggest cities overall, however, prices have been on an upward trend since May, with annual price growth rising from 4.7% to 9.3%.

Meanwhile, in the year to November retail sales grew by 8.1% and exports recorded their best month of the year even though the renminbi has stabilised against the US dollar after falling steadily in value between May and September. Chinese growth has been disappointing in recent quarters, but to some extent the slowdown reflects a lower trend rate of output growth due partly to demographic constraints on labour force growth. However, recent money growth data and monetary policy announcements looks to be helpful for the Chinese economy in 2019.

John Petley
24th December, 2018

	% 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



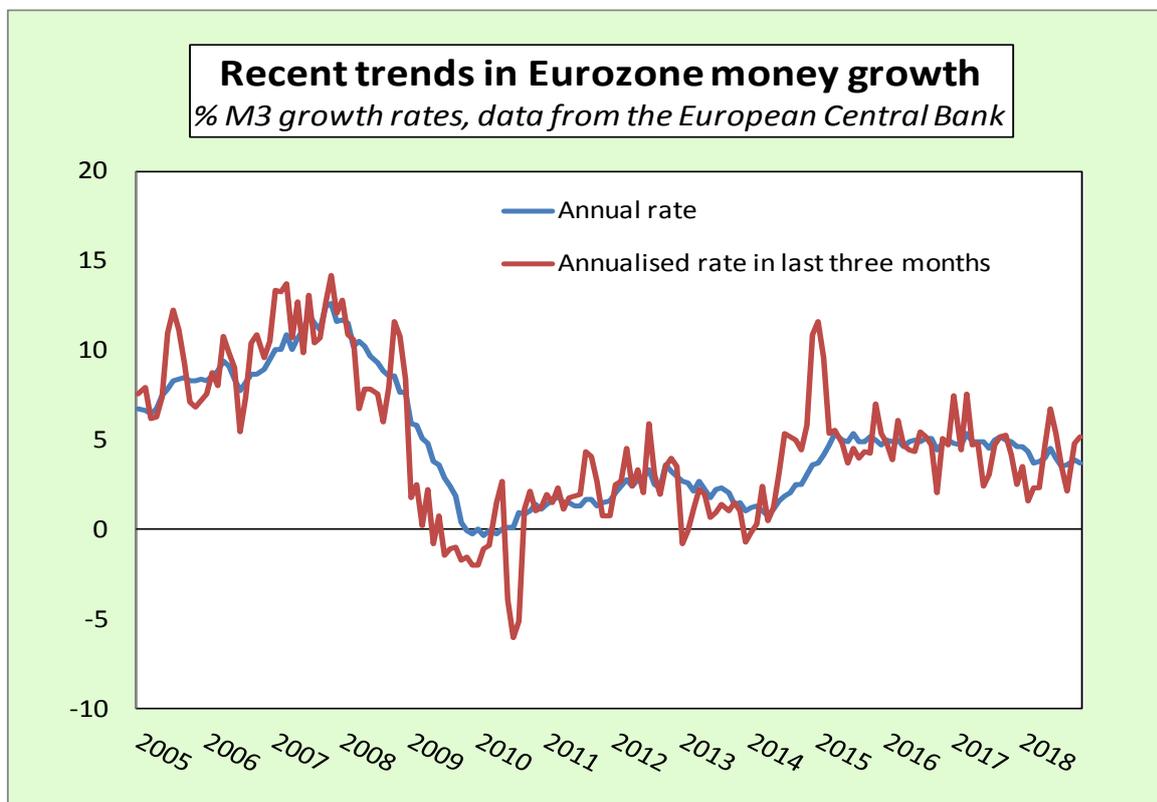
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Eurozone/Euroland

	<i>% annual/annualised growth rate:</i>	
	M3	Nominal GDP
1996 – 2017	5.2	3.1
Seven years to 2017	3.6	2.4
Year to November 2018	3.7	n/a
Three months to November 2018 at annualised rate	5.2	n/a

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



Money growth modest in the run-up to the end of QE

Summary: In the three months to November 2018, broad money growth in the Eurozone was resilient. M3 was up at an annualised rate of 5.2% in the quarter, stronger than the 4.8% recorded in the three months to October and a paltry 2.1% in the three months to September. The annual M3 growth rate fell slightly from 3.9% to 3.7%. This is down from the average of 4.0% for the first 11 months of 2018 and lower than the 4.9% average for the last three years.

The ECB ended its QE programme at the end of 2018, having reduced the monthly asset purchases from €30b. to €15b. in October. A deceleration in money growth has been seen over the last year, with the scaling-back of the asset purchases being the main influence at work. So the complete cessation of asset purchases in 2019 is likely to cause money growth to fall further. However, money growth has been more resilient than might have been expected, with banks in the better-placed Eurozone economies being able to expand their loan books. Indeed, bank lending to the private sector has been steady through 2018, with the stock of loans typically advancing by ¼% a month (i.e., at an annualised rate of about 3%). It remains to be seen whether credit continues to advance in 2019, with banks in Italy, Spain, Portugal and Greece challenged by the probable ending of their ECB loan facilities in mid-2020. Even so ECB President, Mario Draghi, has expressed confidence that ending QE will not be a problem, because “M3 growth is increasingly supported by bank credit creation.”

At least the ECB has specifically committed itself to maintain its balance sheet at the current level. Unlike the US Federal Reserve, there will be no early run-off of assets. Moreover, interest rates are to be kept at their record low level through to the summer of this year at least.

The Eurozone has other worries. Italy’s new government may have backed down from implementing a budget in breach of the budget deficit limit, but the country’s banks are still in difficulties. The Genoa-based Banca Carige, Italy’s tenth largest bank, went into administration on 2nd January after an attempt by the financial authorities to organise a market-led recapitalisation failed. This latest banking failure is by far from being Italy’s only problem. Prices fell between September and November (the most recent months for which data are available), unemployment rose in October and consumer spending fell in the third quarter of the year. Elsewhere, Ireland has returned to deflation, 47.8% of loans by Greek banks were classified as non-performing in 2018 and proposed structural reforms by France’s President Macron have stalled in the face of widespread public protests.

In summary, twenty years after the Euro came into being (albeit initially only in scriptural form), the macroeconomic prospects for the bloc do not look promising. Money growth has in fact been higher than implied by the withdrawal of most of the asset-purchase programme. But crucial to that has been the influx of money balances from overseas, to offset the weakness of domestic credit expansion. In the three months to November the growth of the Eurozone banks’ “net external assets” added €106b. to their balance sheets, equivalent to almost 1% of M3.

John Petley
3rd January, 2019

	% annual growth rate:	
	M3	Nominal GDP
1996 – 2017	5.2	3.1
1996 – 2000	4.6	4.1
2001 – 2010	6.8	3.1
Seven years to 2017	3.6	2.4



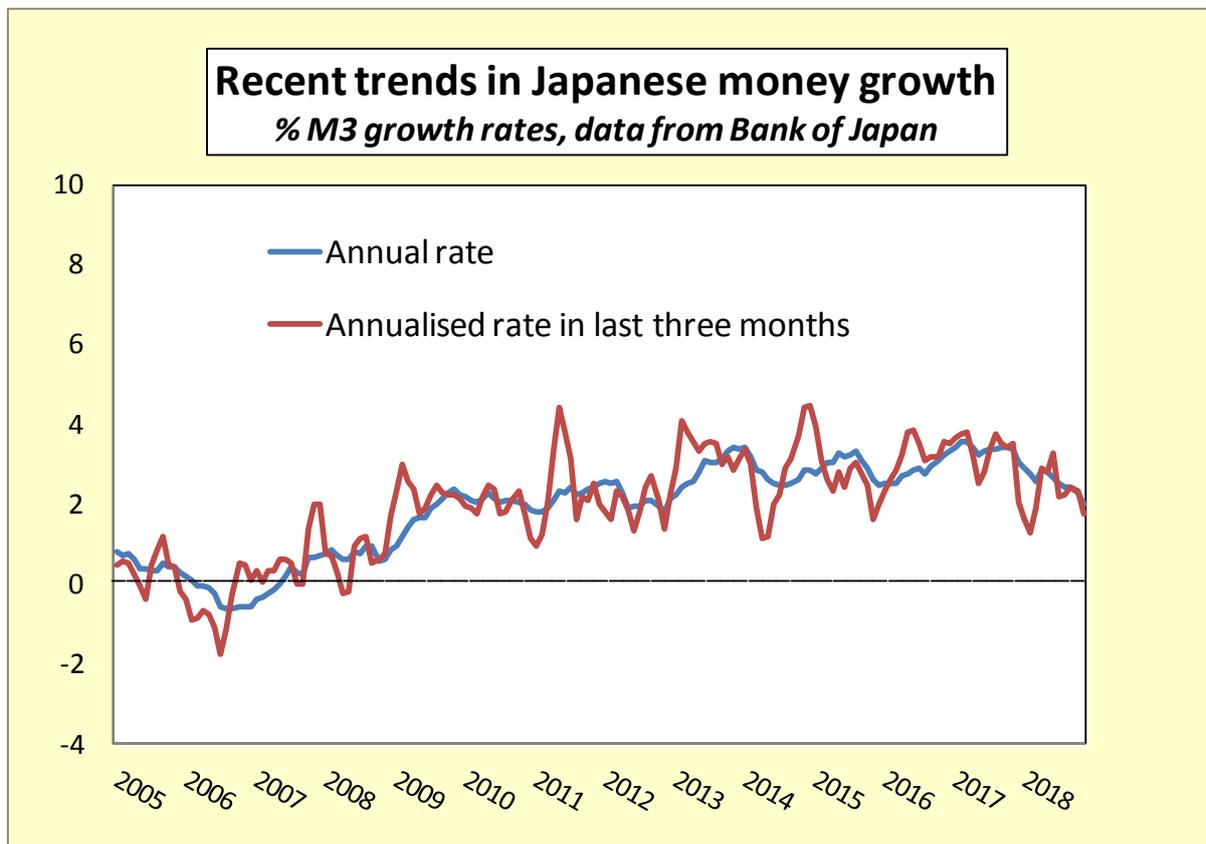
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Japan

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2017	4.0	1.9
Six years to 2017	2.9	0.5
Year to November 2018	2.0	n/a
Three months to November 2018 at annualised rate	1.7	n/a

Sources: Bank of Japan for M3 and IMF for GDP



Broad money growth slows further

Summary: In the three months to November 2018, Japanese M3 broad money grew at an annualised rate of a mere 1.7%, a significant decline on October's figure of 2.3% and the slowest growth rate since February. In 2017 the average figure was 3.3%, but for the second half of 2018 the highest figure so far available was 2.4% in September. In October itself broad money grew by a mere 500b. yen, the lowest monthly growth since November 2012. Coincidentally, the annual growth figure – 2.0% – was also the lowest since November 2012. Each new set of monthly figures argues that Japanese broad money may be entering a period of lower growth, with the annual growth rate now down by more than 1% compared with the 2015 – 17 average.

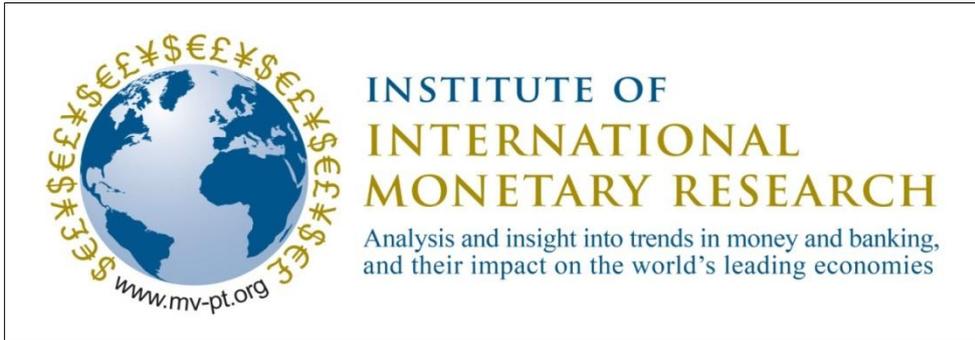
The slowdown in broad money growth has unsurprisingly been accompanied by stagnation in the Japanese economy. Japan's real GDP showed no year-on-year growth in the third quarter of 2018. The Bank of Japan's Monetary Policy Committee insists that Japan's economy is seeing "a virtuous cycle from income to spending operating", but the facts do not bear this out. From time to time one sector of the economy records some positive growth, but then stagnation returns. For example, wages rose at an annual rate of 3.3% in the year to June, only to fall back to an annual growth rate of 0.8% three months later. In December 2017 retail sales were 3.6% up on a year earlier, but five months later the figure was a mere 0.6%. October's retail sales reading (of +3.5% compared with a year earlier) was encouraging in itself, but it was no guarantee of a sustained upward trend. Consumer confidence is at its lowest level in almost two years.

Further evidence casting doubt on the MPC's optimism comes from the figures on bank lending. The stock of bank loans grew by 2.3% in the year to September, but this figure fell to 2.1% in November. By contrast, in 2017 loan growth averaged more than 2.6% and rose above 3% in the middle of the year. Prices rose by a mere 0.8% in the year to November after a 1.4% rise in the year to October. There is little sign of inflation reaching the BOJ's 2% target being reached in the near future.

On 7th December, Haruhiko Kuroda, the governor of the BOJ, told the Diet that there was no intention to exit its programme of stimulatory measures (negative interest rates, substantial purchases of Japanese government bonds and "Yield Curve Control" [setting a level of bond purchases which will keep 10-year yields at their current level of 0%]). Sayuri Shirai, a former member of the MPC, expressed concern that it could prove difficult to exit these measures as it would undermine the stock market. It might also be pointed out that withdrawing the measures would cause money growth to go down further. The targeting of the monetary base rather than broad money by the BoJ has resulted in its stimulatory measures being less effective. Although money growth is slowing, Japan's economy is widely expected to grow in 2019. The dip in money growth argues that inflation will be minimal and real growth rather weak.

John Petley
14th December, 2018

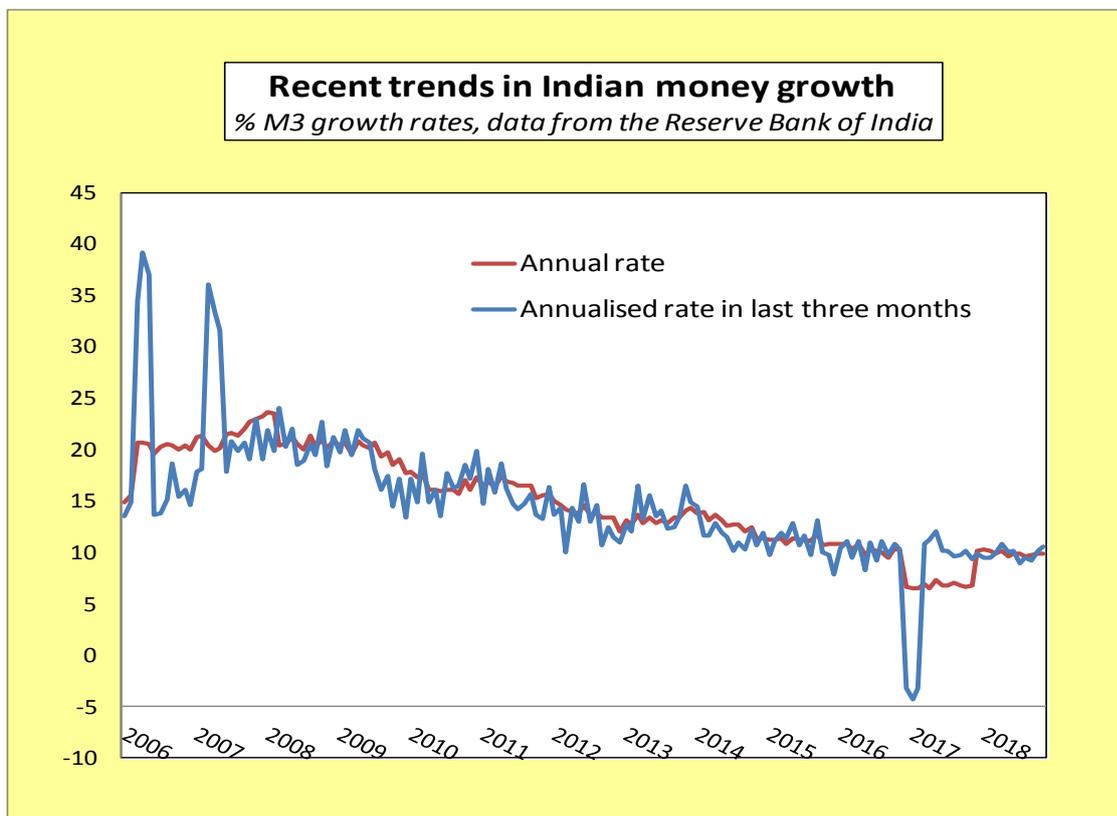
	% annual growth rate:	
	M3	Nominal GDP
1981 – 1990	9.2	4.6
1991 - 2000	2.5	1.1
2001 - 2010	1.1	0.8
Seven years to 2017	2.9	1.3



India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1991- 2017	15.8	12.5
2010 - 2017	12.1	7.3
Year to November 2018	9.9	n/a
Three months to November 2018 at annualised rate	10.8	n/a

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



Broad money growth rises, amid fierce debate on RBI independence

Summary: In the three months to November 2018 India's M3 (seasonally adjusted) grew by 2.7% or at an annualised rate of 10.8%. This was the highest reading since April and an increase on October's figure of 10.1%. The annual M3 growth rate ticked up from 9.8% to 9.9%. This is comfortably within the 9.5% - 11% band in which broad money growth stood during 2018 and, indeed, for much of 2016 before the de-monetisation exercise in November 2017.

The Reserve Bank of India has kept interest rates at 6.5% since 1st August. The last rate rise was driven by concerns about inflation, but since then inflation has fallen sharply. Food prices in particular have dropped, despite an indifferent monsoon in the summer. With consumer prices only 2.3% higher in November 2018 than a year earlier, there seems little likelihood of further rate rises in the near future. The increase in the producer price index also slowed in November. Indian inflation will benefit from the recent decline in oil prices, although the rupee has resumed its retreat on the foreign exchanges after a period of several weeks when it rose against the US dollar.

Bank lending continues to be buoyant. In the second half of November the stock of loans was up 14.9% on a year earlier and in the first half of December the figure was 15.1%. This was the strongest pace of credit advance since 2012. India's GDP, however, grew at an annual rate of only 7.1% in the third quarter of the year, down on the 8.2% of the previous quarter.

Healthy economic news from India has to be qualified by tension between the central bank and the Narendra Modi government, which culminated in the resignation of Governor Urjit Patel on 10th December. Patel had threatened to resign on 31st October in protest against plans to use central bank funds to finance government spending. This was not the only source of conflict. Patel was also keen to reform the supervisory system for India's banks. In particular, he sought greater powers to manage the loan portfolios of state-owned banks if their level of non-performing loans reached levels that the RBI regarded as excessive. The RBI already has powers to intervene with private banks, with its actions successfully reducing the amount of NPLs for the first time in several years. In turn, the Indian government criticised the RBI for failing to prevent fraud at the state-owned Punjab National bank.

The deputy governor of the RBI, Viral Acharya, delivered a speech in October strongly defending the concept of central bank independence. Patel's resignation suggests that the warning has fallen on deaf ears. His successor, Skantikanta Das, a Modi ally, has reversed his predecessors' policy on restructuring bad loans. With a general election due soon, the ruling BJP party is keen that its campaign will not be launched against a backdrop of falling investment. On the face of it, the government has attacked central bank in order to fund a politically-motivated spending spree. As the figures indicate, the stock of lending by India's banks was growing rapidly even before the BJP meddling. In spite of the conflict between the central bank and the government, India benefits at present from considerable underlying growth dynamism, because of its young and growing population, and enormous scope for catch-up growth. Prospects going into 2019 remain positive.

John Petley
14th December, 2018

	% annual growth rate:	
	M3	Nominal GDP
1991 - 2000	17.2	14.0
2001 - 2010	17.3	14.9
Seven years to 2017	11.3	6.8



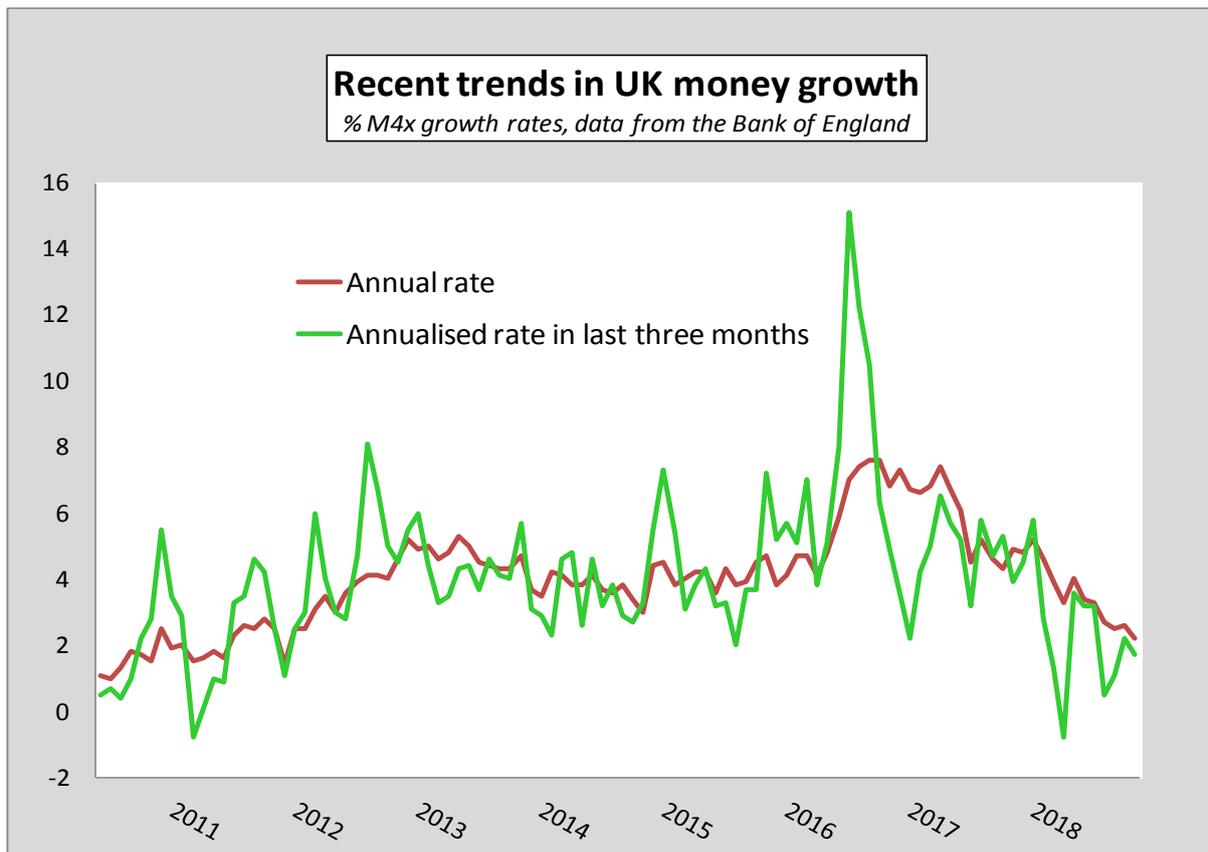
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UK

	% annual/annualised growth rate:	
	M4x/M4 before 1997	Nominal GDP
1964 – 2017	9.8	8.2
Seven years to 2017	3.8	3.6
Year to November 2018	2.2	n/a
Three months to November 2018 at annualised rate	1.7	n/a

Sources: Bank of England and Office for National Statistics



Broad money growth slows again

Summary: In the three months to November 2018 annualised quarterly UK M4x growth fell from 2.2% to 1.7%. This may have been better than the figures for August and September, which were 0.5% and 1.1% respectively, but it was still disappointingly low. November itself saw broad money grow by a mere £3.2b., lower than October's figure of £7.8b., but at least the figure was positive. The quantity of money fell in five of the eleven months of 2018 for which numbers are so far available. November's modest M4x growth resulted in the annual growth rate falling from 2.6% to 2.2%, the lowest figure since December 2011. With Brexit now less than three months away, the figures are worrying.

Unsurprisingly in view of the Brexit uncertainties, the Bank of England's Monetary Policy Committee decided not to increase Bank rate at its last 2018 meeting. Further upward moves from the current ¾% level are unlikely until the final shape of Brexit becomes clearer, especially as the annual rate of inflation fell from 2.4% in October to 2.3% in November, the lowest inflation rate since March 2017. Interest rate stability is welcome for the banks, as the withdrawal of official pro-credit schemes in early 2018 resulted quickly in a deceleration in lending growth. (But lending was in fact strong in the three months to November.)

Broad money growth has been weaker than expected, given that overall bank lending both to individuals and businesses picked up slightly during November. Part of the reason for sluggish money growth is that the Bank of England in late 2017 and for much of 2018 ran off assets purchased during the quantitative easing programmes from 2009 to 2012. Banks' net claims on the public sector have fallen from a peak in August 2017, but it has to be said not much of the fall occurred in autumn 2018. Careful inspection of the data shows that the smallness of the November rise in M4x was largely down to foreign customers' heavy repayment of loans from British banks, which was erratic.

Recent UK money figures suggest that Brexit will coincide with below-trend growth in the economy. A number of reasons for concern have been discussed in the media, but it is safe to discount the more lurid claims by Bank's Governor, Mark Carney, of economic meltdown if the current Withdrawal Agreement is voted down by Parliament. Logically, the remaining weeks ahead of 29th March should see buoyant stock-building ahead of possible tariff changes. However, it seems that Brexit and/or changes in tariff levels between the EU and the UK may be postponed until a date long after 29th March. Stock-building ought to bring growth forward to the first quarter of 2019, offset by lower growth in later quarters. The absence of much stock-building would be consistent with easy business adjustment to the Brexit event, contrary to much cliff-edged commentary.

John Petley
5th January, 2018

	% annual growth rate:	
	M4/M4x	Nominal GDP
1964- 2017	9.8	8.2
1991 – 2000	6.7	5.3
2001 – 2010	7.1	4.1
Seven years to 2017	3.8	3.6