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Monthly e-mail from Tim Congdon and John Petley – 22nd November, 2021

Global money round-up in late 2021

Inflation numbers have been disappointing everywhere in 2021. In October the US consumer price index rose by 0.9%, taking the increase in the year to October to 6.2%. The CPI increase in the year to December could approach or even exceed 7%. The numbers in other economies have so far been less bad, but many forecasts are now being made that annual consumer inflation in the Eurozone will reach 5% and in the UK 6%. **An almost universal pattern is for inflation to be attributed to bottlenecks and supply shortages after the Covid pandemic, and hence as due to the pandemic. Further, influential economists in central banks and elsewhere take this analysis as justifying claims that the upturn in inflation will prove transitory and self-correcting. They see the rapid money growth of spring 2020 (which stemmed from the official response to Covid, particularly the central bank asset purchases) as of no great importance.**

An alternative position – developed in these notes over the last 18 months – is that the current inflationary boom is the result of the excessive money growth recorded in 2020. Sure enough, money growth has moderated from recent peaks, which provides reassurance that inflation is not on an explosive upward path. But the latest three-month annualised growth rates of broad money in the USA and the Eurozone are 9.4% and 7.1% respectively, which remain above levels consistent with low inflation of about 2%. To remind, the compound annual growth rates of M3 broad money in the decade to end-2019 were 4.1% in the USA and 3.3% in the Eurozone. It is numbers as low as this – or perhaps even lower, given that trend output growth rates may have weakened – that need to be seen again, if observers are to be confident that 2% inflation will return. Inflation numbers in the 5% - 10% band will be common in 2022, implying some rises in short-term interest rates. Beneath-trend growth experiences, or even recessions, are to be expected, probably in 2023, to combat inflation.

Money trends in late 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. Most of the last 18 months have been dominated by the Covid-19 medical emergency, but late 2022 should see medical normality. The Institute's consistent analysis since spring 2020 – that money growth acceleration implied an inflationary boom and an upturn in inflation – has proved correct. The new area of debate is the duration of above-normal inflation, with normality seen as an annual increase in consumer prices of 2% a year. The key principles here are that,

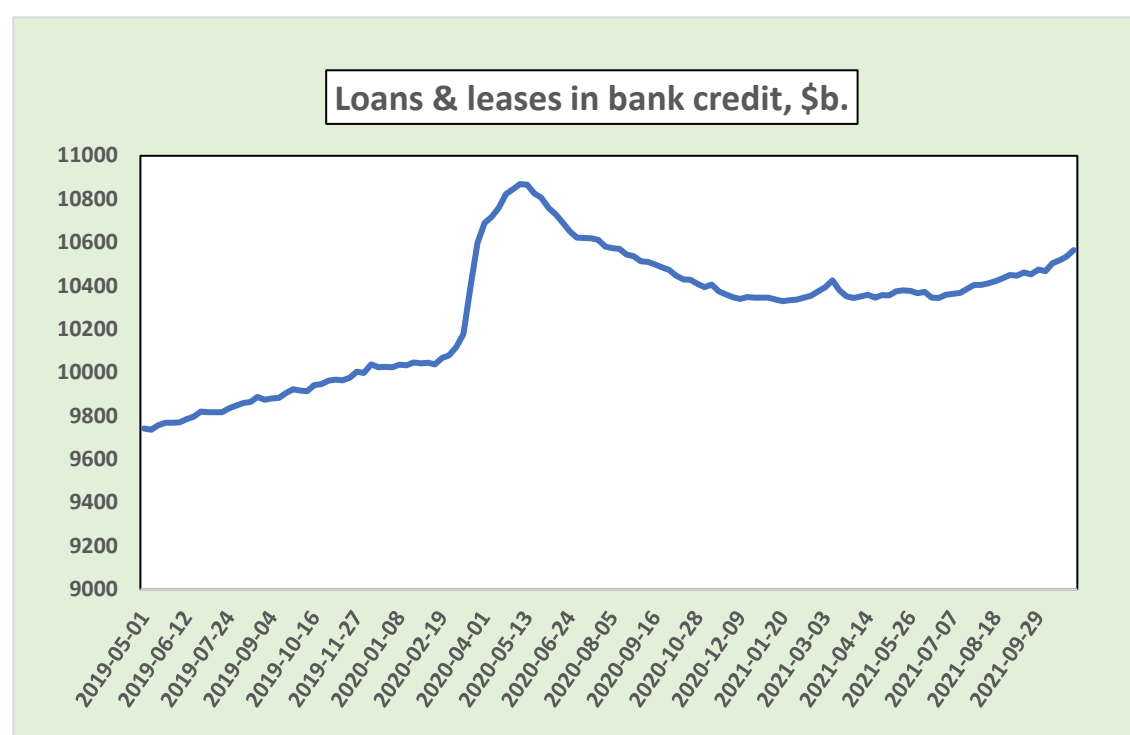
- i. The rate of inflation is roughly equal to the rate of increase in nominal GDP minus that of real GDP, and
- ii. Over the medium term, growth rates of broad money and nominal gross domestic product will be similar, although not identical.

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 that money growth slowdowns are now evident almost everywhere. However, in the USA and the Eurozone – although not Japan and the UK – the three-monthly annualised numbers are still above the typical figures before the pandemic and remain inconsistent with 2% inflation. Worries about inflation will persist and indeed intensify in 2022.

| 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 | 9.4 | 8.5 | Money growth has slowed cf. spring 2020, but is much too high for 2% Fed target. |
| China | 18.7 | 16.1 | 9.2 | 8.6 | Money growth moderate amid property bust scares. Talk of an easing package. |
| Eurozone | 10.6 | 16.4 | 7.1 | 7.9 | Money growth boosted by ECB asset purchases, still well above pre-Covid norms. |
| Japan | 4.2 | 5.9 | 2.9 | 3.7 | Credit and money growth slowing sharply, implying continuing negligible inflation in medium term. |
| India | 7.7 | 3.3 | 9.4 | 10.2 | Recent money growth just in single digits, with banks restrained by bad debt experience and losses. |
| UK | 2.2 | 3.4 | 5.5 | 8.6 | Money growth decelerating, bank loans to corporates <i>falling</i> recently. Talk of imminent interest rate rise. |

As noted here last month, crucial will be the behaviour of bank lending to the private sector. In the last 18 months high or very high money growth has been almost entirely attributable – in the main economies – to central bank asset purchases and monetary financing of budget deficits. As central bank asset purchases stop, money growth will decelerate unless bank lending to the private sector revives strongly.

In the USA some observers believe that bank lending to the private sector will soon rebound. On 8th November the Fed published the latest *Senior Loan Officer Opinion Survey on Bank Lending Practices*. The survey's editor was particularly interested to see if credit growth would return to the pace of late 2019 before Covid-19 became a problem. To quote, "The survey included a set of special questions inquiring about the current level of demand relative to pre-pandemic levels (defined as the end of 2019) for 'commercial and industrial' and credit card loans, as well as banks' outlook for demand for such loans over the next six months. On balance, banks reported weaker levels of demand for all queried C&I and credit card loan categories compared with the end of 2019, and that they expect stronger demand for both C&I and credit card loans over the next six months." The finding that – as of now – people and companies are not tapping bank finance on a greater scale than before Covid is notable. With interest rates so low, and inflation on the rise, stronger demand for bank credit might be expected.



The latest data fit with the reported pattern, more or less. The chart above is of the level of "loans and leases in bank credit", which corresponds roughly to bank lending to the private sector. It is of weekly data, with the last reporting date being 3rd November 2021, and extends two-and-a-half years back to May 2019. Steady growth was the main feature in late 2019, with the annualised growth rate in the second half of 2019 in fact being slightly under 5%. The onset of Covid worries caused people and companies to draw down bank lines while that was still possible, leading to a pronounced hump between January 2020 and May/June 2020. Some of the loans drawn down were not needed and were repaid, so that "loans and leases in bank credit" were *lower – indeed, almost 5% lower* – in June 2021 than a year earlier. Since July the stock of credit has started to climb once more. In fact, in the three months to the latest reported value (i.e., on 3rd November), the stock of these loans was up by just

above 1.5%, with an annualised growth rate of 6.3%. In other words, the senior loan officers are right that – so far in the post-Covid period (if I can use that expression) – the demand for bank credit has not been much different from that in late 2019. Given the loan repayments until spring 2021, they may even have the impression that it has been “weaker”. All the same, the stock of credit is now growing again and the rate of advance is increasing month by month. Bank credit to the private sector does seem to be gaining momentum. If very low interest rates and deteriorating inflation expectations cause the growth rate of bank credit to rise at an even faster rate, that will motivate higher money growth on the other side of banks’ balance sheets. The Fed may then have to raise interest rates to restrain credit growth. (I say nothing about the need to pay some attention – in interest-rate setting – to inflation rates of 6% or more!)

I remarked in this space last month that, in the USA, annual broad money growth of 7% and above is well ahead of the level consistent with 2% inflation. The Fed needs money growth of about 4% a year to maintain 2% inflation in the medium and long runs. That is a necessary and sufficient condition of 2% inflation, regardless of

- i. whether the Fed is managing the quantity of money or not, and
- ii. whether its research economists are interested in the quantity theory of money or not.

In the year to September M3 broad money rose by 8.5%, while in the three months to October the annualised rate of increase in M3 was 9.4%. On this basis, US money growth remains much too high and cannot be reconciled with an eventual return to 2% inflation.

In the Eurozone the stock of credit to the private sector was 3.4% higher in September 2021 than a year earlier. So banks have still been expanding their loan books during the pandemic, in contrast to the US situation. Mortgage lending has been dominant. The stock of loans for house purchase was up by 5.5% in the year to September, whereas loans to non-financial corporations (i.e., industry and commerce) advanced a mere 1.6% in the same period. It is well-known that European governments are trying to persuade the Bank for International Settlements that further large increases in banks’ capital requirements are unnecessary and would damage the ability of their financial systems to sustain the recovery.

The latest important development on this front is that the European Union’s official green agenda is now being applied to banking. On 6th July the European Commission launched its *Strategy for Financing the Transition to a Sustainable Economy* ([link is external](#)) and a proposed regulation on European green bonds; on the next day, 7th July, the European Central Bank (ECB) concluded its strategy review on the same subject and proposed significant changes. Crucially, capital weightings are to be much higher for loans to environmentally “dirty” industries (such as oil and gas development) than to the clean, renewable energy sectors. But even home mortgages will be affected. According to the ‘Climate Bonds’ website for 13th July, “Preferential green capital requirements are on the horizon for EU mortgages. The Commission [which will be working closely with the ECB] will consult the European Banking Authority on supporting tools for green retail loans and mortgages to promote their uptake by 2022.” Needless to say, spokespersons for the banking industry have said that it is not ready for this drastic upheaval in asset acquisition strategies.

Similar developments are likely to affect UK banks. Although the UK is no longer part of the EU, its government has just hosted the COP-26 summit. UK officialdom, including officialdom from the Bank of England, must therefore be participating in the international drive to oblige – should one say to force? – the financial system to participate in the drive for net zero carbon emissions. Mortgage

lending is still growing, but the stock of bank lending to the non-bank private sector was a touch lower in September than three months earlier. The stock of lending to corporates, both non-financial and financial, has declined in recent months. The pattern is curious, given the evident need to rebuild inventories after the coronavirus emergency and the deterioration in inflation prospects. One interpretation is that banks are being cautious about extending new credit, in view of the uncertainties about new capital requirements on “dirty” lending. (Note that the discussion is of the stock of lending *falling*; it is not about a decline in the growth rate of lending.)

To repeat the point made here last month, 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 – in 2022 and 2023 – once the pandemic-related weakness in aggregate demand lies in the past. Central banks may end asset purchase programmes first, but higher interest rates are widely foreseen. A reduction in money growth is a condition of the return of moderate inflation, while robust bank lending to the private sector will make it more difficult to deliver the needed reduction in money growth. But – if bank lending to the private sector is, even at virtually zero interest rates, increasing at an annual rate of 5% or less, or even contracting (as is happening at present to loans to UK corporates) – 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 interest rates, and indeed extremely negative real interest rates, a boom in private sector bank credit does not seem to be imminent anywhere. Having said that, US banks are more likely to grow loan books than banks on this side of the Atlantic. Of course, US banks would not tolerate the interventions in their balance-sheet decisions that now seem to be envisaged in the European Union (and perhaps the UK).

The coming debate about inflation and interest rates is likely to be particularly intense in Germany, where savers will be penalised (by negative real interest rates) for keeping their wealth in bank deposits. In truth, late 2021 and 2022 will see – in many countries – inflation rates above the meagre returns (often zero) on bank deposits and government bonds (usually under 2% nowadays). The inflation tax is being levied and will raise significant amounts to help pay for heavy government spending on anti-Covid measures in the last 18 months.



22nd November, 2021



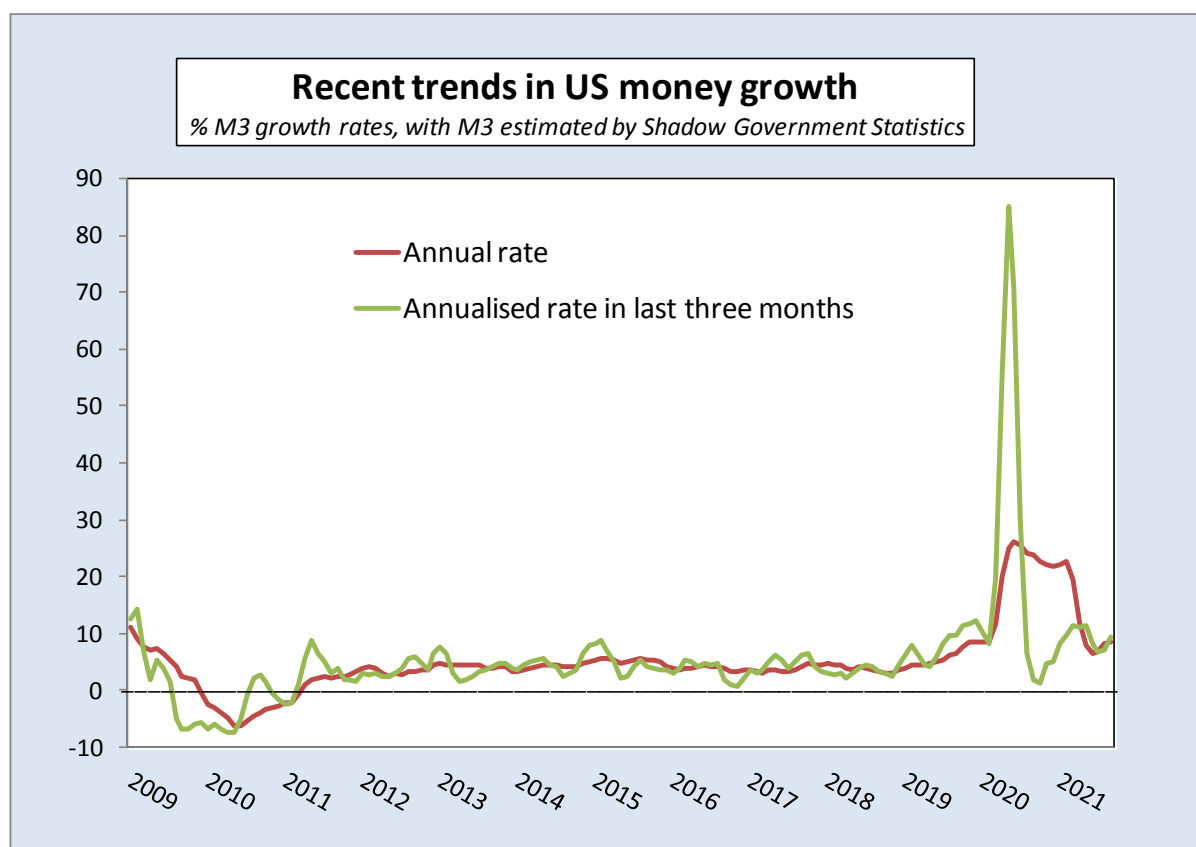
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USA

| | % annual/annualised growth rate: | |
|--|-------------------------------------|-------------|
| | M3 | Nominal GDP |
| 1961 – 2019 | 7.4 | 6.5 |
| Nine years to 2019 | 4.5 | 4.1 |
| Year to October 2021 | 8.5 | n.a |
| Three months to October 2021 at annualised rate | 9.4 | n.a. |

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



US broad money growth rises further, as inflation hits record levels

Summary: The annualised quarterly rate of broad money growth reached 9.4% in September, up significantly on August's reading of 7.2% and the highest rate of increase since May. M3 grew by \$172b. in September, notably less than August's \$289b. but still equivalent to an annual growth rate of 7.7%. The annual growth rate also climbed from 8.3% to 8.5%. (Our M3 data come from Shadow Government Statistics, www.shadowstats.com.)

Consumer inflation – as measured by the consumer price index – rose to a 30-year high of 6.2% in the year to October. (Note that the Federal Reserve focuses on a different measure of inflation, the deflator of personal consumption expenditures.) The CPI increase was 0.9% in the month of October by itself. These figures followed six consecutive months in which the annual rate of CPI inflation was above 5%. They were announced a week after the most recent meeting of the Federal Open Market Committee on 4th - 5th November. The press release after the FOMC meeting announced that the Fed would begin to taper its asset purchase programme, which has been running at \$120b. a month since spring 2020. November will see a cut of \$15b. from the \$120b. figure, followed by a similar reduction in December.

No definite commitments were made beyond then, as the FOMC will meet again on 14th-15th December. Chairman Jerome Powell acknowledged that inflation remained above target, but stuck to the now-familiar line that – once supply chain bottlenecks had been addressed – it would fall back towards target levels of slightly above 2%. In a speech on 8th November Fed vice-chair, Richard Clarida, suggested that an increase in the Fed funds rate could be on the cards by the end of 2022. He too insisted, however, that the current inflationary pressures would “dissipate over time”. But money trends give a different message. Given that the time lag between an increase in broad money and its impact on prices can often be as long as two years, it is likely that inflation will rise further during 2022.

Most senior figures at the Fed ignore the well-established link between the quantity of money, broadly defined, and nominal national income. As long as US broad money growth continues at current levels, inflation will remain considerably higher than the Fed's 2% target. The annual rate of money growth needs to be moderated to under 5%, if the Fed wants eventually to restore roughly 2% inflation. The modest tapering of asset purchases announced for November will reduce money growth, but is so small as to be unlikely to be enough to bring money growth down to a 5% annual figure. A key issue is whether bank credit to the private sector recovers strongly in coming months. According to data from the Fed, during a three-week period ending 3rd November “loans and leases in bank credit” increased by over \$60b. compared with a modest rise of only €29b. in the three months between April and July.

*John Petley
12th November, 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 October 2021 | 8.6 | n/a |
| Three months to October 2021 annualised rate | 9.2 | n/a |

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



Broad money growth now running at pre-pandemic levels

Summary: In the three months to October 2021 China's M2 grew at a rate below that of spring 2020, when fiscal and monetary stimuli were introduced to counteract the effects of the coronavirus pandemic. Chinese broad money growth has now reverted to levels typical of the years before Covid. A new issue is the adverse impact on the economy's trend growth of Xi Jinping's moves to centralize economic and social policy-making.

China is still recording new cases of the virus, but the numbers are relatively low and are dealt with by strict local lockdowns. The overall effect on the economy is said to be manageable. Nonetheless, after growing strongly in the first half of the year, Chinese GDP increased only by a modest 0.2% in the third quarter of 2021. The annual growth rate fell from 7.9% to 4.9%, lower than the 6% target set by the authorities for 2021. Both September and October saw the total value of Chinese exports rise above \$300b. for the first time, with exports up by over a quarter compared with a year previous.

The domestic economy is somewhat more muted, with retail sales increasing by only 4.9% in the year to October. House prices in China's 70 major cities rose by only 3.4% in the same period, the weakest advance since January 2016. Indeed, in October itself house prices fell. This slowdown is due at least in part to a crackdown on property speculation by the authorities, with the much-publicised financial woes of over-leveraged property developers a key contributory factor. In early November the huge Evergrande group avoided defaulting on interest payments of \$148m by selling off some of its assets. Large Chinese property management groups and home-builders are also struggling with debt issues, including Fantasia and the Kaisa group, which both failed to repay due debts in recent weeks. As only a small proportion of the creditors are based outside China, the government may take action of some sort to avoid outright default. Indeed, Asian stock markets are full of speculation that the authorities will take macroeconomic action, including an easing of money restraints, to help the property sector.

Growth in the stock of lending by Chinese banks stood at 11.9% in the year to October, the lowest reading in over a decade. Although consumer price inflation is currently below the government's 3% target, it picked up from 0.7% in the year to September to 1.5% a month later, while producer prices shot up from 10.7% to a 26-year high of 13.5% in the same period. China has been affected by supply chain issues and, in October, industry suffered from power cuts due to shortages of coal. But production in the country's mines has since been increased to address this problem. Although China's economy faces problems, these are different from those in more developed countries. As the chart above illustrates, the stimulus measures brought in during 2020 were relatively modest in scope and thus China is unlikely to see upward pressure on inflation like those in the USA or the UK, for example. In the medium term the current re-centralisation of economic management, plus the attack on the efficient private sector, will lower the trend rate of output growth, perhaps to little more than 3% a year. 8%-a-year money growth would then imply continuing inflation of perhaps 3% - 5% a year.

John Petley
15th November, 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 |



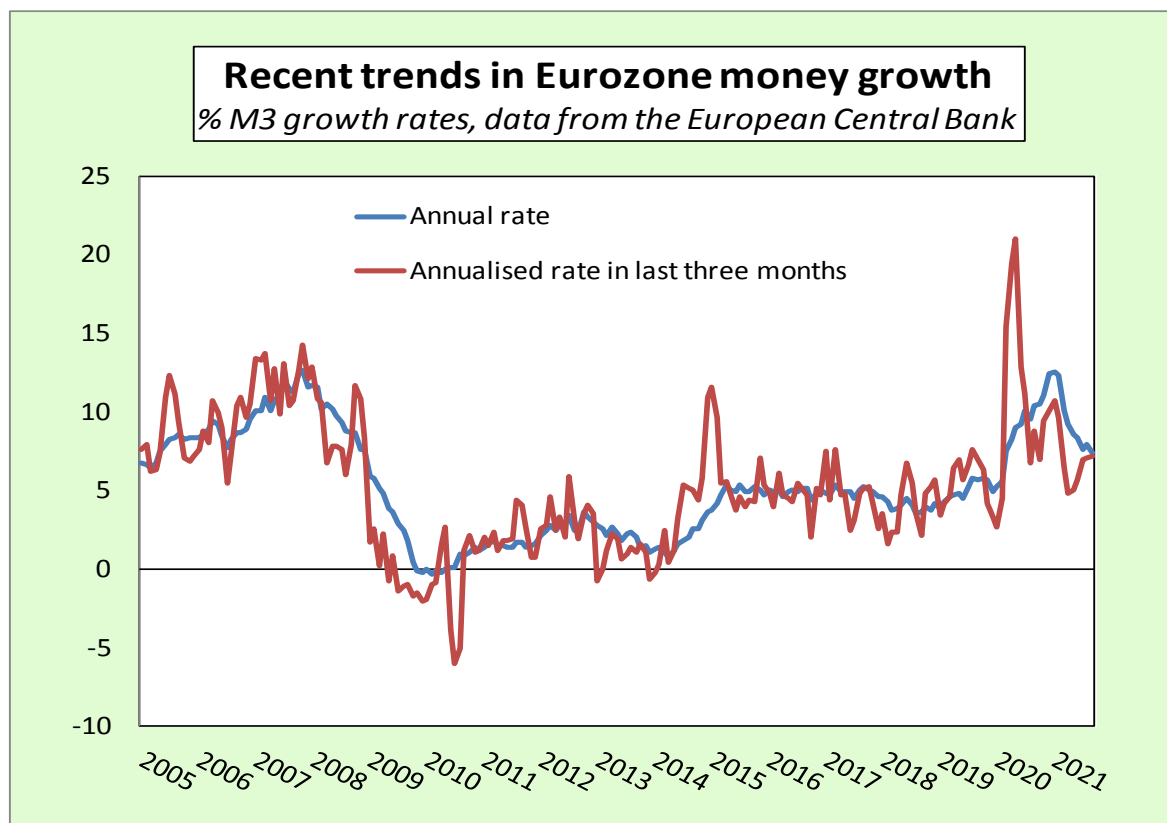
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Eurozone

| | % annual/annualised growth rate: | |
|---|-------------------------------------|-------------|
| | M3 | Nominal GDP |
| 1996 – 2019 | 5.2 | 3.1 |
| Nine years to 2019 | 3.8 | 2.5 |
| Year to September 2021 | 7.9 | n/a |
| Three months to September 2021 at annualised rate | 7.1 | n/a |

Sources: European Central Bank for M3, Eurostat for GDP



Broad money growth remains high

Summary: In the three months to September 2021 the quantity of broad money in the Eurozone grew at an annualized rate of 7.1%, unchanged on August's reading. September saw M3 grow by €97b., higher than the figure for August although still much lower than the figures for spring 2020, which saw a remarkable acceleration in the growth of money. The annual growth rate nudged down from 7.9% to 7.4%, the lowest value since the arrival of the coronavirus pandemic in March of last year.

The effects of over 18 months of unusually high money growth in the Eurozone are now being reflected in the inflation data. Prices across the 19-nation bloc rose by 4.1% in the year to September, the highest figure in 13 years. Given that producer prices rose by 16% during the same period and that October saw a surge in fuel prices, the headline rate of consumer inflation is likely to rise further. In the meeting of the ECB's Governing Council on 28th October, the inflationary pressures were acknowledged, including the likelihood that they would worsen in 2021's final quarter. Nonetheless, the ECB signalled its intention to continue with its asset purchase scheme until the planned termination date of March 2022. It offered only a slight concession to those worried about inflation: it may make an unspecified, but modest reduction in the volume of assets purchased each month. It also left open the possibility of buying less than the projected total of €1,850b.

ECB President Christine Lagarde admitted that inflation has been more persistent than she had originally expected, but her institution has seemed remarkably complacent about the inflation outlook. The ECB has apparently no plans to raise interest rates in 2022. On 3rd November, in an interview with the Spanish newspaper *El País*, chief economist Philip Lane stated that - while inflation was, in his words, "unexpectedly high at the moment" - he expected it to fall back sharply during 2022. Like other central bank officials around the world, he sees the inflation upturn as exceptional and non-recurring, due to supply bottlenecks after the Covid-19 pandemic. He insisted that in the medium term - by which he meant 2023 onwards - the ECB's main concern was that inflation would again fall below the 2% target. He therefore felt that an early curtailment to ECB asset purchases would be an over-reaction that could dampen the recovery. Such sentiments are not shared by German tabloid newspapers. Prices rose in Germany by 4.5% in the year to October, the highest inflation rate in 28 years. Mme Lagarde, whom the German media have labelled "Madame Inflation", is being blamed for making German savers and pensioners poorer. Inflation rates in other member states are higher still, with prices rising in Lithuania at an annual rate of 8% and in Estonia of 7%.

September saw a modest increase in the borrowing by businesses. Mortgage loans apart, growth in lending by Eurozone banks has been weak since the start of the pandemic. In the last 18 months money growth has largely been driven by the asset purchases of the PEPP (the Pandemic Emergency Purchase Programme), the separate and previous 2019 asset purchase programme, and the monetization of the national and EU-wide fiscal stimuli.

John Petley
12th November, 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 |



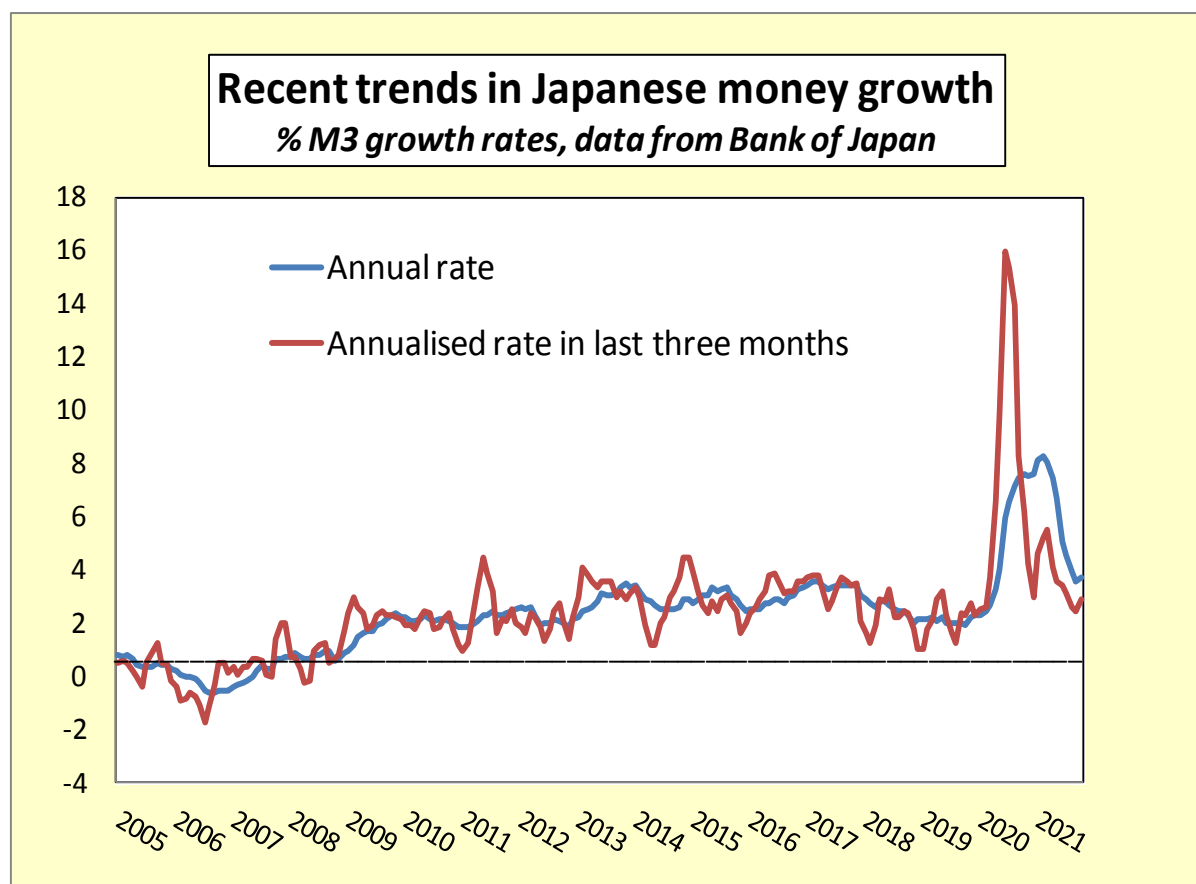
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Japan

| | % annual/annualised growth rate: | |
|--|-------------------------------------|-------------|
| | M3 | Nominal GDP |
| 1981- 2019 | 3.9 | 1.9 |
| Nine years to 2019 | 2.7 | 0.9 |
| Year to October 2021 | 3.7 | n/a |
| Three months to October 2021 at annualised rate | 2.9 | n/a |

Sources: Bank of Japan for M3 and IMF for GDP



Broad money growth picks up slightly

Summary: The three months to October 2021 saw Japanese M3 increase at an annualised rate of 2.9%. While this is higher than September's figure of 2.4%, that 2.4% was the lowest reported since December 2019. The annual growth rate ticked up slightly, from 3.5% to 3.7%, ending a seven-month downward trend following February's multi-decade high of 8.2%.

For the first time since August 2020, Japan's consumer prices rose on an annual basis in September. Given Japan's dependence on imported energy and the yen's recent decline against the dollar, inflation is likely to rise higher in October. Producer prices have been on the increase since February, with October registering an annual increase of no less than 8%. This was the highest number for 40 years. So far many of the cost pressures on the price level have been absorbed in the supply chain and have not yet reached the consumer. An inflation spike is inevitable in the next few months and the Bank of Japan may – at last – achieve its ambition of a 2% rise in consumer prices over a twelve-month period. On 15th November Governor Kuroda stated that he expected inflation to rise to 1% by the middle of next year. Like other central bank governors, he may be in for a surprise about the strength of the upward pressures on costs and prices as the world economy exits the coronavirus emergency.

Japanese industry has also been badly affected by supply shortages recently, with industrial production falling for three consecutive months from July to September. A shortage of computer chips has particularly affected car production, which fell by almost one third between July and August. Despite the problems in the automotive sector, overall Japanese exports rose by 13% overall in the year to September. All the same, thanks to a weak retail sector, a slowing in the housing market and the lack of any substantial boost from the Olympic Games (as spectators were banned from venues in Tokyo), Japan's economy shrank by 0.8% in the third quarter of 2021,

At its meeting on 28th October the Bank of Japan's Monetary Policy Committee announced that the current ultra-loose monetary policy will continue. Indeed, one MPC member, Goushi Kataoka, voted to reduce the current -0.1% interest rate, in the apparent belief that it would stimulate additional lending by Japanese banks. Japanese companies drew down bank borrowing facilities early in the pandemic, in order to ensure that they had ample buffers of liquidity. More recently they have been paying back the loans, so that bank credit has been very weak and so has broad money growth. Fumio Kishida, the new Prime Minister, has been widely reported as planning a fiscal stimulus package to boost the economy. It is unlikely to be on anything like the scale of the Biden "rescue plan" in the USA, but – if it too is largely financed by Japan's banks – it will create deposits and thus increase the quantity of money. On balance, it looks likely that Japan's economy will find itself in the 2020s to a similar position as in the previous decade, which was characterised by low broad money growth and only modest increases in nominal GDP.

Tim Congdon and John Petley
19th November, 2021

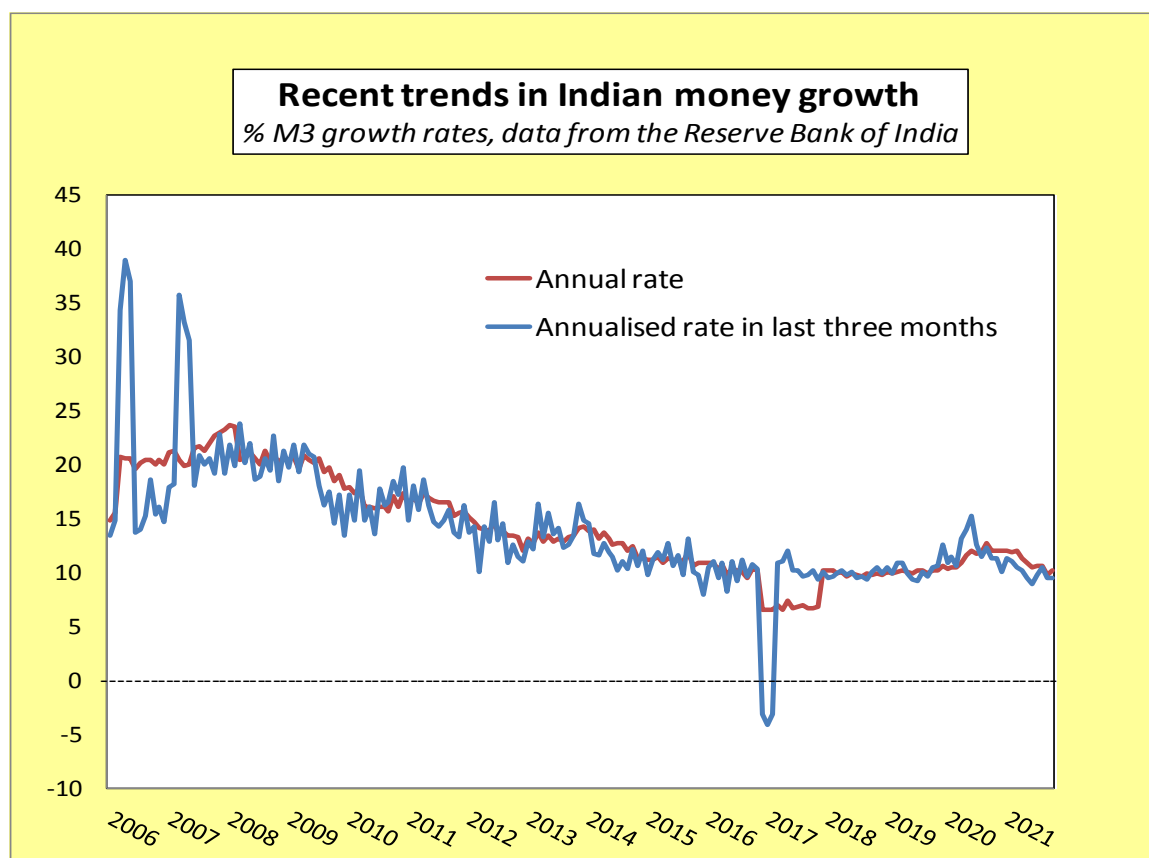
| | % annual growth rate: | |
|--------------------|-----------------------|-------------|
| | M3 | Nominal GDP |
| 1981 – 1990 | 9.2 | 4.6 |
| 1991 - 2000 | 2.4 | 1.1 |
| 2001 - 2010 | 1.0 | 0.8 |
| Nine years to 2019 | 2.7 | 0.9 |



India

| | % annual/annualised growth rate: | |
|---|----------------------------------|-------------|
| | M3 | Nominal GDP |
| 1981- 2019 | 15.8 | 13.4 |
| Nine years to 2019 | 11.2 | 11.9 |
| Year to October 2021 | 10.2 | n/a |
| Three months to October 2021 at annualised rate | 9.4 | n/a |

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



Broad money growth now back at pre-pandemic levels.

Summary: In the three months to October 2021 India's seasonally adjusted M3 grew at an annualised rate of 9.4%, a slight decrease from September's reading of 9.5% and the lowest figure since July 2019. The annual growth rate picked up from a three-year low of 9.7% to 10.2%. Broad money growth has reverted to levels typical of the period preceding the coronavirus outbreak.

The Indian economy is recovering strongly now that the worst of the pandemic seems to be over, with cases currently at their lowest level in over nine months. More attention will be paid by international investors to India in the next few years, amid a growing consensus that China's move to political authoritarianism foreshadows a sharp growth slowdown. (China also faces a demographic constraint on growth, as its working-age population declines. By contrast, India has decades of labour force growth ahead.) That is not to say that India's economy is trouble-free. An important issue in recent years has been the high incidence of bad debts in the banking system and concern that banks might then "go bust", creating the sort of strains seen in the Great Recession in the developed world. Non-performing loans are thought likely to approach 8% - 9% of total bank assets by the end of the 2021/22 financial year (i.e., at March 2022). The Reserve Bank of India has tried to combat the problem by demanding that banks maintain higher capital/asset ratios.

The result has been much slower growth in bank credit in the last two years than for much of the 2010s. In the two years to September 2021 credit "to the commercial sector" (as the RBI calls it, i.e., to the private sector) has grown at a compound annual growth rate of 5.8%, far less than might be regarded as normal in a dynamic developing country. A deceleration in money growth might therefore have been expected. But that has not happened. Instead money growth has stayed close to the double digits, at a % annual rate. Part of the explanation is that the government has borrowed more from the banks. With its budget deficit increased by Covid-related expenditures, the ability to borrow cheaply from the banks has been attractive. In the year to September 2020 this was indeed a feature, with bank credit to the government rising from under 37 trillion rupees (about \$480b., at the current exchange rate) to over 44 trillion rupees. But in the year to September 2021 the increase was much smaller, only a little more than 2 trillion rupees.

More fundamental is that Indian banks' external assets have climbed significantly in the Covid period. The banks' net foreign assets were negative in autumn 2019, but at the end of September 2021 they approached 2½ trillion rupees (over \$30b.). Meanwhile the RBI's foreign exchange reserves have soared. They were under \$400b. in mid-2018, but now are not far from \$650b.

Tim Congdon
20th November, 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 |



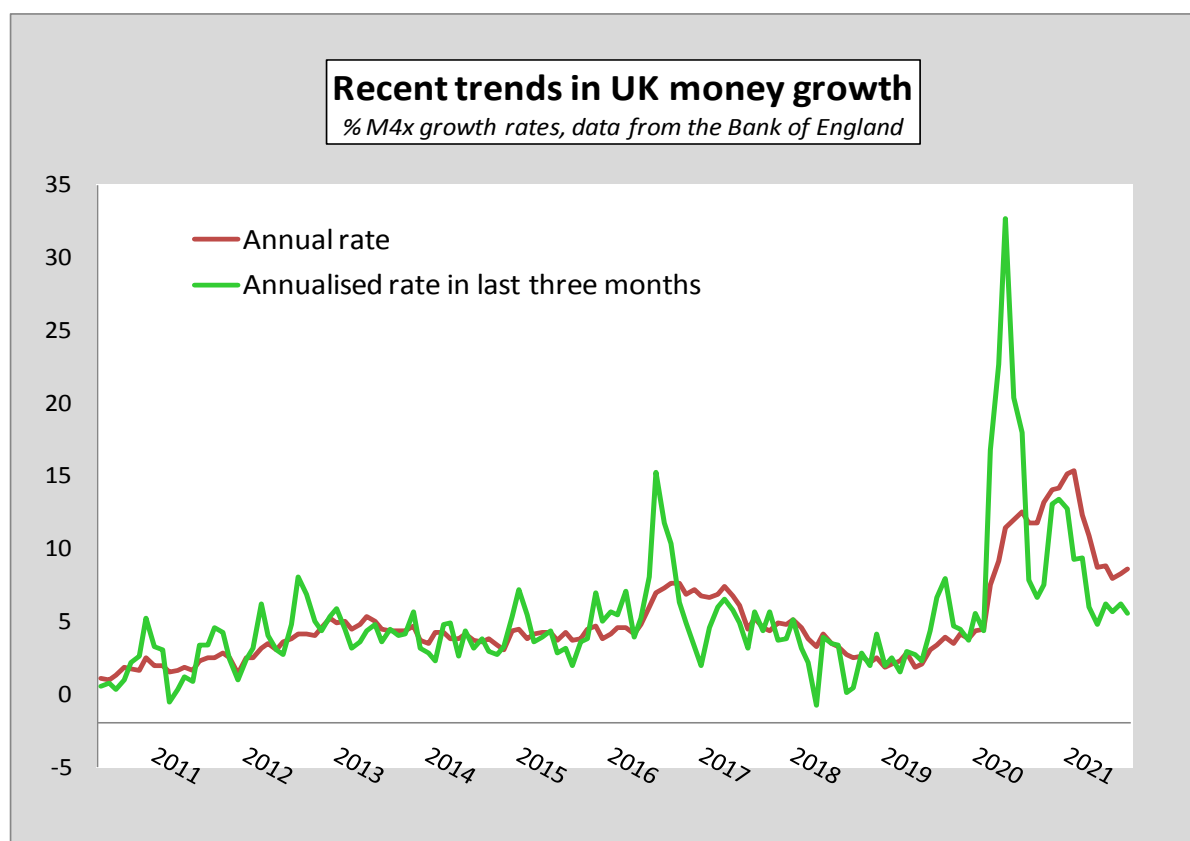
INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

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

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 September 2021 | 8.6 | n/a |
| Three months to September 2021 at annualised rate | 5.5 | n/a |

Sources: Bank of England and Office for National Statistics



Money growth may be falling to levels consistent with 2% inflation

Summary: In the three months to September 2021 UK M4x grew at an annualised rate of 5.5%, This is a reduction on August's figure of 6.2% and the second lowest number since February 2020. Bank credit to the private sector, particularly to companies, has been very weak recently. The banks continue to worry about tightening capital regulation, particularly on loans to allegedly "dirty" economic activities (for example, oil and gas development).

In the three months to September the UK's M4x measure of broad money increased by just above 1.3%, i.e., at an annualised rate of 5.5%. Given that the trend growth rate of UK output is probably under 1% a year at present, this is still too high to be consistent with the 2% inflation target. However, the UK has in recent months moved closer to a low-inflation money growth rate than, for example, the USA and the Eurozone. This has not been because of a halt to the Bank of England's asset purchases. Data on banks' credit counterparts show that the public sector contribution to money growth was positive by almost £25b. in the three months to September. Instead the important feature has been marked weakness in bank lending to the private sector. Indeed, in July the stock of bank loans to the private sector dropped by 0.6%. The stock of loans grew again in August and September, but at such pathetically low rates that in the three months to September there was still a drop in the lending total.

Closer inspection of the data shows that bank lending to households, predominantly for mortgages, is still expanding. But in the three months to September bank lending to non-financial corporates went down by almost 1% (or at annualised rate of 3.9%) and to non-intermediate financial corporates by roughly 4% (or at an annualised rate of 15.0%). These declines may partly reflect repayment of bank loans taken out at the start of the Covid period, in order to have a liquidity buffer. But more basic, almost certainly, is the continuing impact of the Basel III bank capital regime, and worries and uncertainties created by the amplification of that regime to encompass the official climate change agenda. Bluntly, banks will in future have to allocate so much capital to loans for oil and gas development that the loans are not commercially viable. Oil and gas companies will have to finance new development from either capital markets or foreign banking systems not subject to the Basel rules.

The tightening of the bank capital regime has major significance for the UK policy debate, as it does also for the debate in the Eurozone, where a similar policy shift is under way. It may be too sweeping to say that the extra rules are so burdensome that banks cannot grow their risk assets (apart from mortgages) at all, but a conjecture of this sort does not seem out of place. Very low interest rates may therefore be consistent with sub-5% annual money growth in the post-Covid environment. For the time being, money growth is still being sustained by the Bank of England's asset purchases and inflation is rising because of excessive money growth in the year to spring 2021.

Tim Congdon
19th November, 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 |