INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

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

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Monthly e-mail from Tim Congdon and John Petley – 19th October, 2022

Global money round-up in autumn 2022

Money growth has fallen in North America and Europe. By contrast, China – still afflicted by Covid-19 and an inept official response to it – is seeing credit relaxation and an acceleration in money growth, and Japan has kept monetary policy unchanged despite a collapse in the yen. Money tightening is particularly severe in the USA, where M3 broad money probably contracted in September and is likely to fall also in October. The surge in US money growth in 2020 and 2021 is now being reversed. With inflation still high, real money balances are being squeezed, and asset prices and economic activity are suffering. The Federal Reserve has also engineered increases in Fed funds rate which are large by the standard of the period since the Great Recession of 2008 and 2009. 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 7.7%, much less than in 2020 but clearly still positive. The main European economies are – like the USA – suffering a squeeze on real money balances, but it is not so severe. UK money growth is volatile from month to month, but seems at present to lie in the middle between stagnation/contraction in the USA and moderate-to-high growth in the Eurozone.

Persisting budget deficits in the Eurozone are so large that they may oblige the ECB – or at any rate its constituent central banks – to monetary financing, even if this is the result of purchases in the secondary market rather than in the direct form of overdrafts. The focus of worry here must be Italy. As recent events in the UK have shown, governments must pay attention to the consequences of budget deficits for their debt interest bills and medium-term fiscal sustainability. One encouraging development is that European natural gas prices have tumbled, with market forces (notably trade in liquefied natural gas) narrowing the gap between gas prices in Europe and the rest of the world.

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,

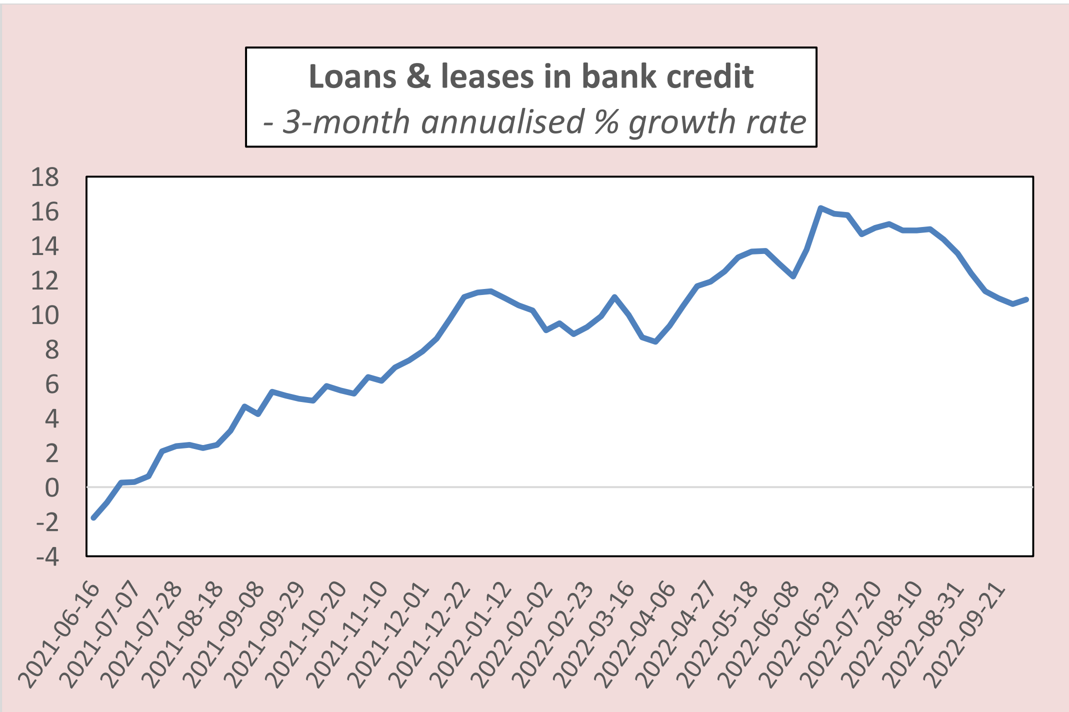
i. The rate of inflation is equal to the rate of increase in nominal GDP minus that of real GDP,
ii. Over the medium term, growth rates of broad money and nominal gross domestic product will be similar, although only rarely identical, and
iii. Just as a correlation holds between nominal money and nominal 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 money growth reductions in the developed countries from 2020 highs, although with no uniformity. The ECB in particular seems reluctant to squeeze money growth. China is following its own path, with money growth rising somewhat. In 2023 recessions in North America and Europe may still be reconciled with positive output growth at the global level. In the UK M4x growth was negligible in August.

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	**1.8**	**4.3**	Money growth stopped in spring 2022, implying severe squeeze on real money balances.
China	18.3	15.4	**12.3**	**12.0**	Money growth rising, amid property bust scares. Policy being eased, no official inflation concern.
Eurozone	12.1	17.4	**7.7**	**6.1**	Money growth stays high, as ECB worries about widening sovereign debt spreads.
Japan	3.7	6.0	**2.5**	**2.9**	Credit and money growth back to pre-Covid norms, implying little inflation in medium term.
India	6.8	3.1	**8.8**	**9.0**	Money growth moderating, as RBI seeks more capital in banking.
UK	2.2	3.3	**2.2**	**4.7**	Money growth erratic from month to month, but mostly moderating.

The recent halt to money growth in the USA – and the moderation in money growth in the Eurozone, Japan and the UK – imply that during 2023, and particularly in 2024, inflation will come down towards levels closer to the norms of the 2010s. However, the lags are such that 2022 will feature annual inflation rates typically above 4%. The recent falls in energy prices make continued consumer inflation above 10% unlikely in 2022 in both the USA and the Eurozone. 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 still to be monitored and assessed.



In the USA bank credit to the private sector has been growing briskly. Interest rates have been very low, while banks have ample capital to support balance sheet expansion and their low-return cash holdings have been much too high. But the increases in Fed funds rates – combined with the surge in bond yields with effects on mortgage rates – are starting to check the boom. "Loans and leases in bank credit" (mostly bank lending to the private sector, and constituting over half of US commercial bank assets) were flat during the period of Covid-19 uncertainty in late 2020 and early 2021, but increased from June 2021. The accompanying chart shows the three-month annualised rate of increase in "loans and leases" since then. Although it may be too early to draw a conclusion, the chart suggests that there was a turning-point in June and July this year. Until then the pace of the credit boom was accelerating; subsequently it has been decelerating. If the deceleration continues and intensifies, that may remove an important positive influence on money growth.

A particularly interest-rate-sensitive part of the US economy – as of most economies – is housing, meaning both housing finance and its related activities, and house-building. The latest release from the Mortgage Bankers Association has a passage, "The Market Composite Index, a measure of mortgage loan application volume, decreased 2.0 percent on a seasonally adjusted basis from one week earlier. On an unadjusted basis, the Index decreased 2 percent compared with the previous week. The Refinance Index decreased 2 percent from the previous week and was 86 percent lower than the same week one year ago. The seasonally adjusted Purchase Index decreased 2 percent from one week earlier. The unadjusted Purchase Index decreased 2 percent compared with the previous week and was 39 percent lower than the same week one year ago." The reductions compared with a year ago – of 86% on the refinance index, and 39% on the purchase index – are eye-opening and disturbing.

Further, 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. The combination of money stagnation and persisting rather high inflation implies a squeeze on real money balances. As so often in past cycles, that has been accompanied by weak asset markets and a slackening in demand growth. With the Fed pushing up interest rates, dearer money is another check to the economy. A recession in 2023 is now widely forecast, and understandably so.

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. In the USA 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 5.5% higher in August 2022 than a year earlier. The stock of loans for house purchase was up by 5.2% in the year to August, whereas loans to non-financial corporations (i.e., industry and commerce) advanced a buoyant 7.8% in the same period. One interesting feature of the latest monetary press release from the ECB is that in August a *reduction* of €36b. in the banking system's holdings of government securities was a contractive item in the money arithmetic. That was so, although the ECB has said that – for the present – it has no plans to reduce its assets pile. (Note that in August significant governments drew down their deposits – which are not part of M3 – by a significant €88b. By making payments to the private sector, they increased private sector deposits and M3.)

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.

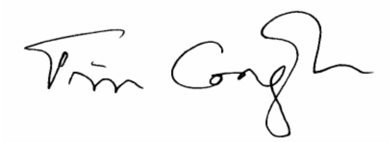
In the UK bank regulators seem to believe that the higher are bank capital/ asset ratios, the safer is the banking system and the better is the outlook for the economy. With inordinate amounts of capital required in commercial banking, banking groups have drawn up plans to allocate capital to other activities. 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. There is no doubt that the extra capital requirements associated with Basel III have resulted in a large fall in the ratio of banks' lending to companies to gross domestic product. The post-2008 regulatory environment has been particularly hard on lending to small- and medium-sized enterprises.

Loan growth has been erratic in recent months. UK bank lending to the mainstream, non-intermediate financial sector jumped in March, May and July. It seems likely that exceptional, non-recurring transactions were responsible, as April, June and August saw offsetting falls. A new trend was not established. The stock of loans to non-financial corporates was only a touch higher in August 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 the rest of 2022 and 2023 the vigour – or lack of vigour – of bank credit to the private sector is crucial to interest rate prospects. Interest rate rises have occurred in most developed countries, but may be nearing their peak for this cycle in the USA and the UK. As the ECB has been much slower to move, the peak in Eurozone interest rates is – almost certainly – further away in time. 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. In qualification, money growth in the Eurozone has been rising in the very latest months.

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. A strong recovery in such credit in the USA has occurred, but Fed interest rate rises and the wider change of mood may now be bringing the recovery to an end. In the Eurozone banks have been adding at a moderate pace to their risk assets, while the ECB is reluctant to sell off assets from its bloated assets pile.



17th October, 2022

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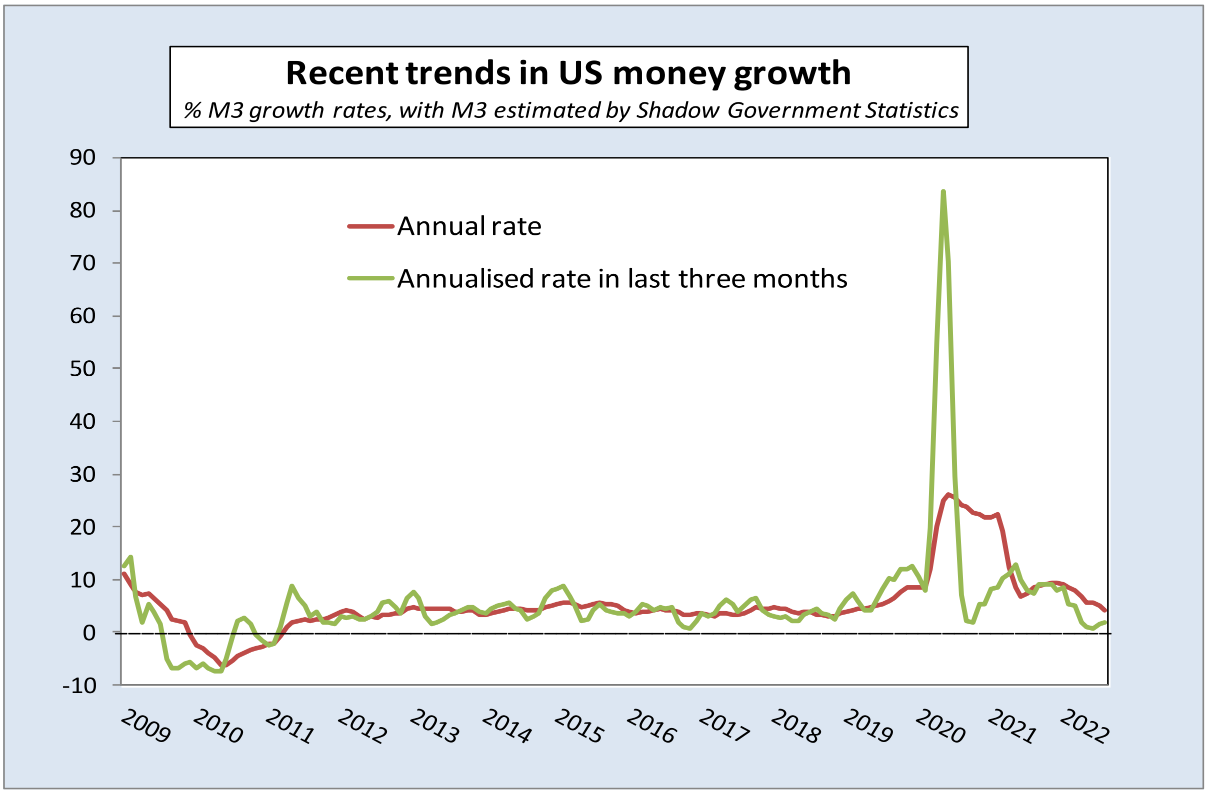
USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1961 – 2020	**7.7**	**6.3**
Ten years to 2020	**6.2**	**3.4**
Year to August 2022	**4.3**	**n.a**
Three months to August 2022 at annualised rate	**1.8**	**n.a.**

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



Stagnation in US broad money continues, with contraction risks

Summary: **US broad money grew at an annualised rate of only 1.8% in the three months to August 2022. This was above June's reading of 0.8% but 1.8% is still an extremely modest rate of growth by the standards of recent years. Further, in September and early October bank deposits in US commercial banks dropped by over 1%. Since such deposits account for the bulk of M3 money, the new risk of outright contraction in money balances must be highlighted. (Our M3 data come from the Shadow Government Statistics consultancy.)**

In the space of just over six months, the Fed funds rate has been increased by 300 basis points and now stands at 3% - 3.25%. Following the most recent meeting of the Federal Open Market Committee, Chairman Jay Powell hinted that further increases were likely. "We have got to get inflation behind us. I wish there were a painless way to do that. There isn't," was his blunt warning. Most observers expect Fed funds rate to be increased by altogether 125 basis points in the two remaining FOMC meetings in 2022, with a probable peak in Fed funds rate of 5% or so in 2023.

Until the summer higher borrowing costs did not seem to be deterring American companies or households from applying for new loans. Fed statistics indicate a significant acceleration in the growth of "loans and leases in bank credit" in early and mid- 2022. In the year to 5th October "loans and leases" rose by 11.8%. However, closer inspection suggests that higher interest rates are already having a deterrent effect. In the three months to 22nd June loans and leases climbed at an annualised rate of 16.2%; in the three months to 5th October the figure had dropped to 10.9%.

The Fed has announced a programme of sales from the huge asset pile accumulated in successive "quantitative easing" operations since late 2008. If the sales are to non-banks, bank deposits held by the non-banks (i.e., money) decline. Unless banks expand their balance sheets in other ways, the implication is a contraction of the quantity of money and the risk of eventual deflation. That may sound extraordinary when public concern is very much about excessive inflation. However, the money data must be watched at all times. The Fed's H8 release tracks banks' balance sheets on a weekly basis and is more up-to-date than the monthly money stock release. In September deposits at US commercial banks dropped 0.6% from their August level, while on 5th October deposits – at $17,772.3b. – were 0.9% down on the September monthly figure. If deposits were to fall by $30m. a week in the next three weekly make-up days in October, October's bank deposits would be almost 1¼% lower than in September. For perspective, the Great Depression of the 1930s was associated – roughly speaking – with 1%-a-month declines in the quantity of money. The Fed seems to be confident that the US economy can withstand the current drastic tightening of monetary policy.

Tim Congdon and John Petley
17th October, 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 September 2022	**12.0**	**n/a**
Three months to September 2022 annualised rate	**12.3**	**n/a**

Sources: People's Bank of China for M2, IMF and Institute's own estimates

Broad money growth remains strong

***Summary*: In the three months to September 2022 China's seasonally adjusted M2 grew at an annualised rate of 12.3%, similar to August's figure of of 12.5%. Here is confirmation of the acceleration in broad money growth which began late last year. (For much of 2021 M2 was growing at an annualised rate of under 10%.) The annual rate of increase rose to 12.0%, the highest reading since June 2016.**

The 20th National Congress of the Chinese Communist Party, which runs from 16th to 22nd October, is widely expected to grant Xi Jinping a third five-year term as president. Every effort has been made to ensure that the economy is in good shape ahead of this important event. The very strict policy of locking down if necessary entire cities in an attempt to contain the spread of Covid-19 has, however, made the authorities' task much harder. On 10th October, less than a week before the Congress, nearly 200 million people were facing various levels of restriction.

The "Zero Covid" policy has caused GDP to contract by 2.6% in the second quarter of the year and the Q3 figures are unlikely to be much better. In August, the rate of growth in the stock of loans by Chinese banks fell to 10.9%, a ten-year low. September's figure was 11.2%, slightly higher but nonetheless very modest by the standards of recent years. The People's Bank of China (the central bank) has introduced a number of measures to stimulate demand for credit. Inflation has remained below the government's 3% target throughout 2022, allowing some scope for monetary easing, although a 10% decline in the value in the yuan since March is starting to cause concern. It may limit the PBoC's scope for action in the future. So far, it has opted for targeted, limited cuts rather than an across-the-board reduction in its main lending rates. On 30th September, it allowed mortgage rates to be reduced in some cities to attract first-time buyers. It has also offered tax rebates to new homeowners in order to support the ailing housing market. The average cost of a new home in China's 70 largest cities fell by 1.3% in the year to August, the fourth consecutive month of decline. Three years ago, house prices were rising at an annual rate of over 10%, but the collapse of several large property developers has brought this boom to an end. The PBoC has set up a fund worth $44b. to bail them out. As the property market amounts to between a quarter and a third of domestic output, according to some estimates, the authorities' desire to revive it is understandable. So far, however, their initiatives have had little effect. The retail sector is also struggling thanks to the lockdown policy. Sales declined in August and the imposition of further restrictions in September could well prolong this slowdown.

The money numbers suggest that the Chinese economy will revive. Money growth is now far ahead of the trend rate of growth of output, implying an eventual upturn in inflation. Whether this becomes evident in the data is moot, since the government of China is increasingly erratic and dysfunctional, and official statistics may become rather less than the truth. It is probable that Chinese GDP will grow by much less than the government's 5.5% target this year. Tighter state control and a preference for state-owned companies will inevitably stifle innovation and deter foreign investment, leading to lower growth in the future.

Tim Congdon and John Petley
17th October, 2022

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

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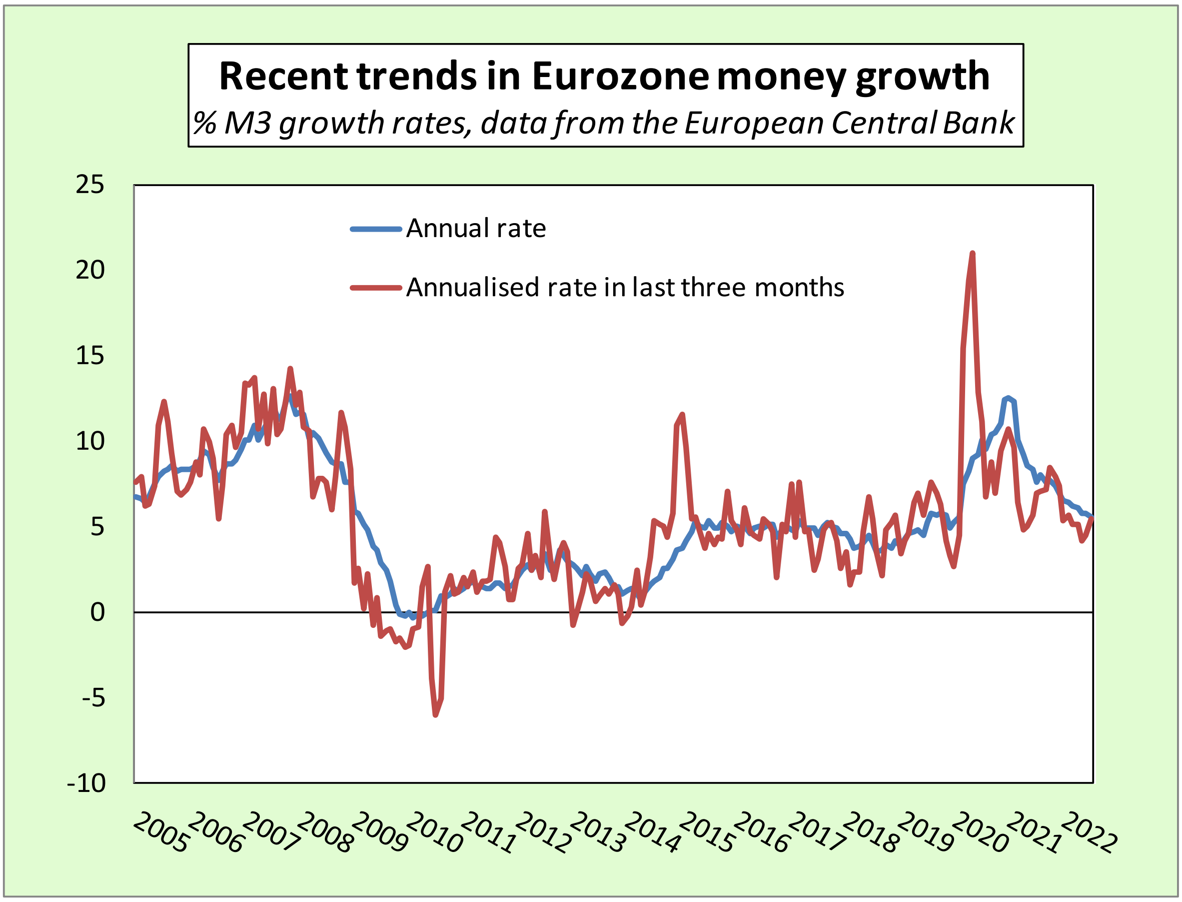
Eurozone

	% annual/annualised growth rate:	
	M3	Nominal GDP
1996 – 2020	**5.5**	**2.7**
Ten years to 2020	**4.6**	**1.6**
Year to August 2022	**6.1**	**n/a**
Three months to August 2022 at annualised rate	**7.7**	**n/a**

Sources: European Central Bank, Eurostat and the Institute's own estimates



Broad money growth continues to accelerate

***Summary*: In the three months to August 2022 the quantity of M3 broad money in the Eurozone grew at an annualized rate of 7.7%, the third consecutive occasion in which M3 growth – on this yardstick – has accelerated. (The comparable number in May was 4.1%.) Broad money was up by €146b. during August itself, by far the largest monthly increase so far this year. The annual growth rate climbed from 5.7% in July to 6.1%.**

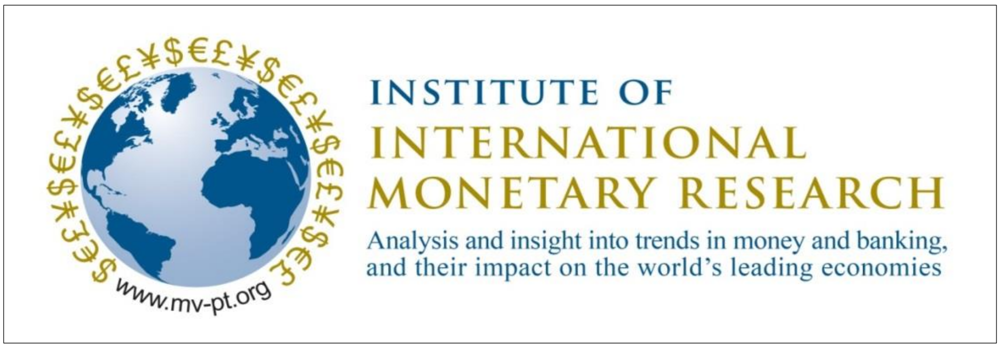
August's acceleration in broad money growth was all the more noteworthy as the ECB not only purchased no assets during the month, but also raised the cost of borrowing by 0.5% on 21st July. The recent strength of money growth is striking and contrasts sharply with recent developments in the USA. Banks lent an extra €69b. to businesses during the month. Indeed, in the three months to August the stock of banks' lending to Eurozone non-financial corporates went up by 3.1%, implying an annualised rate of increase of 13.1%. This smartly outpaced the growth of mortgage lending in the same period. The more general message is that Eurozone banks are at present able to expand their loan books at about 5% - 6% a year, despite the persisting constraint of the Basel III capital regime.

Money growth will depend partly on banks' ability to boost their portfolios of loans to the private sector, partly on the European Central Bank's policy towards its assets pile and partly on Eurozone governments' ability to finance their still large budget deficits outside the banking system. On 26th September, the ECB President Christine Lagarde stated that the ECB will not start selling off the assets it purchased during 2019-22 until policy rates have returned to "normal", The ECB recently launched its Transmission Protection Instrument, a new *ad hoc* bond purchase scheme designed to prevent a large spread between different member states' bond yields. Under this arrangement, the ECB would buy government debt from the most indebted states such as Italy and Spain using money from maturing assets rather than running them off. .Thus far, the effect of the ECB's new scheme has been rather limited. Bond yields are climbing across much of the world and even German 10-year bunds have risen to over 2.3%, the highest figure in over a decade. Italian 10-year bond yields, however, have risen above 4.7% and the figure for Greek government debt is higher still.

The risk of high government borrowing from banks is most salient at present in Italy. According to the International Monetary Fund, the budget deficit will be 6.0% of gross domestic product in 2022, while the primary deficit (i.e., the deficit that would remain if debt interest costs were excluded) will be 3.0% of GDP. As Italy regularly had a primary surplus in the 2010s, the underlying deterioration in its public finances – largely attributable to Covid and the related shocks - is evident. If bond yields moved up to 6^, 7% or more, the Italian government would have to enforce economies in public spending or raise taxes to prevent a debt explosion. But the political situation is delicate, with some elements in the right-wing coalition under prime minister Giorgia Meloni threatening to rebel against further belt-tightening. The Italian crisis partly explains the ECB's reluctance to raise interest rates and to tighten monetary policy, despite the highest inflation rate since the introduction of the euro in 1999.

Tim Congdon and John Petley
17th October, 2022

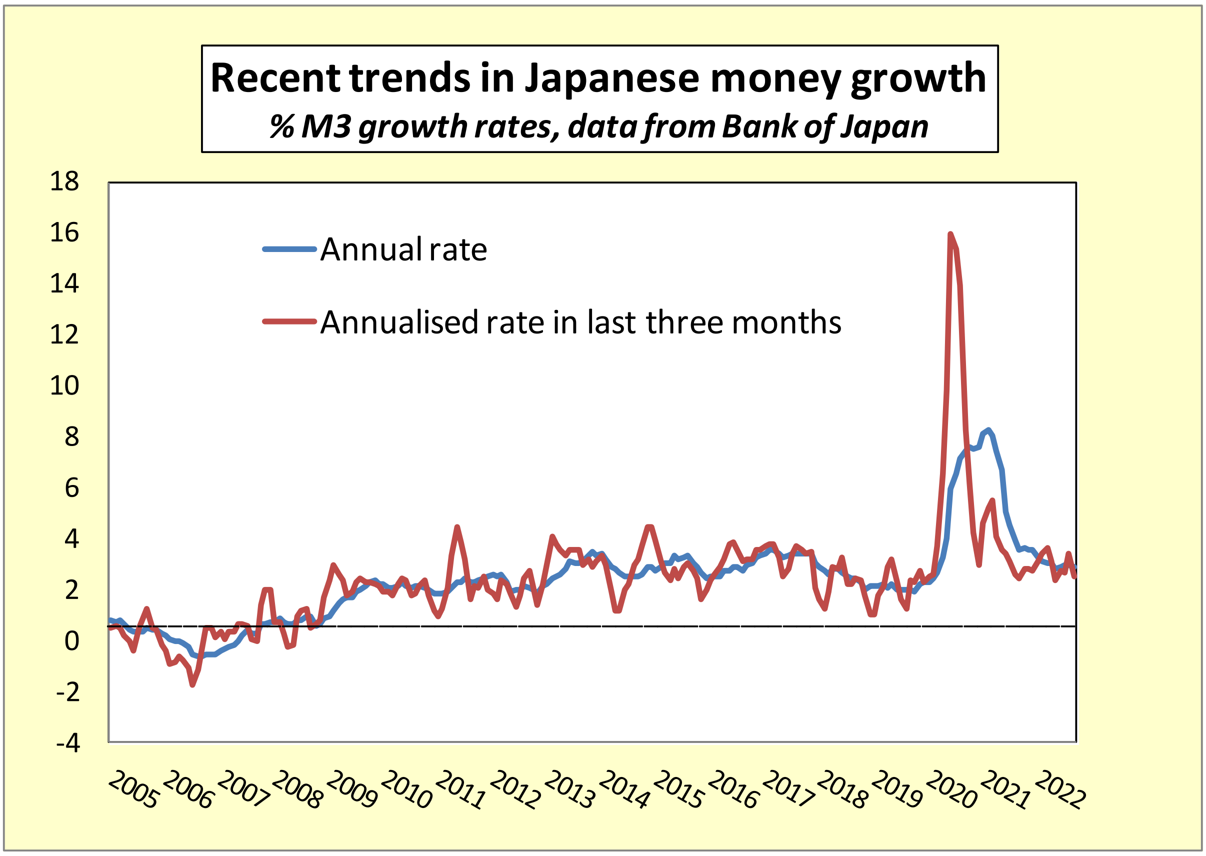
	% annual growth rate:	
	M3	Nominal GDP
1996 – 2020	**5.5**	**2.7**
1996 – 2000	**4.6**	**4.1**
2001 – 2010	**6.8**	**3.1**
2011 - 2020	**4.6**	**1.6**



Japan

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2020	3.9	1.7
Ten years to 2020	3.2	0.3
Year to September 2022	2.9	n/a
Three months to September 2022 at annualised rate	2.5	n/a

Sources: Bank of Japan for M3 and IMF for GDP



Broad money growth remains slow

Summary: **The three months to September 2022 saw Japanese M3 increase at an annualised rate of 2.5%, lower than July's reading of 3.5% and the slowest rate of growth since May. The annual rate of growth fell back from 3.0% to 2.9%. These values are very similar to the typical level of broad money growth during the last decade, before the temporary upward blip in 2020.**

As many of the world's central banks continue to tighten monetary policy, the Bank of Japan has insisted that it will not follow suit. It continues to purchase large quantities of 10-year government bonds to prevent the yield rising above its 0.25% target and has continued to keep its interest rate at minus 0.1%. One result has been a sharp decline in the value of the yen, which has fallen to a 32-year low (almost 148 to the $) against the American currency. Since the beginning of March, the decline in the yen's value against the dollar has been over 25%. With Japan being a major importer of energy, this has resulted in increased costs for Japanese industry. Producer prices rose by 9.7% in the year to September. The rate of increase in consumer prices is much lower. Even so, September's reading of 3.0% is the highest since 2014 when inflation was stoked by an increase in Japan's sales tax.

That period of high inflation proved to be short lived. The latest set of money numbers – with the % annual rate of M3 growth still in the low single digits – does not suggest that Japan will experience a prolonged inflationary episode now. Indeed, Japan at present provides an interesting laboratory experiment in the relevance of different macroeconomic variables to inflation. It is important to remember that the Japanese response to Covid-19 in 2020 was much more modest and measured in scope than in other industrial countries. Money growth did blip upwards, but the annual rate of increase never exceeded 10%. Broad money growth had returned to levels typical of the pre-pandemic period by mid-2021 when it was still running at an elevated level in many other countries due to ongoing asset purchases by central banks. Broad money growth in Japan may pick up in coming months as a result of an increase in bank credit. After two years of very sluggish credit growth, the stock of loans by Japanese banks grew at an annual rate of 2.3% in September, the fourth successive month of acceleration. (May's reading was only 0.7%). This is still lower than the peak of over 3% during the years 2017-19. Besides the increasing cost of imported raw materials, this increase is also in part due to activity in the corporate finance sector which usually only gives a short-term blip to money growth.

In spite of the increase in inflation, retail sales increase at an annual rate of 4.1% in August. On a monthly basis, however, household spending fell by 1.7%, no doubt at least in part to rising consumer prices. Housing starts unexpectedly increase by 4.6% in the year to August after three months of decline while construction orders were up by 17.9% year-on-year. Given the weakness of the yen, strong performance by Japan's exporters is no surprise. Shipments rose by 22.1% in the year to August. Overall, Japan's GDP grew by 0.9% in the second quarter of 2022 with the annual growth rate for the same period coming in at 1.6%.

John Petley
14th October, 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**

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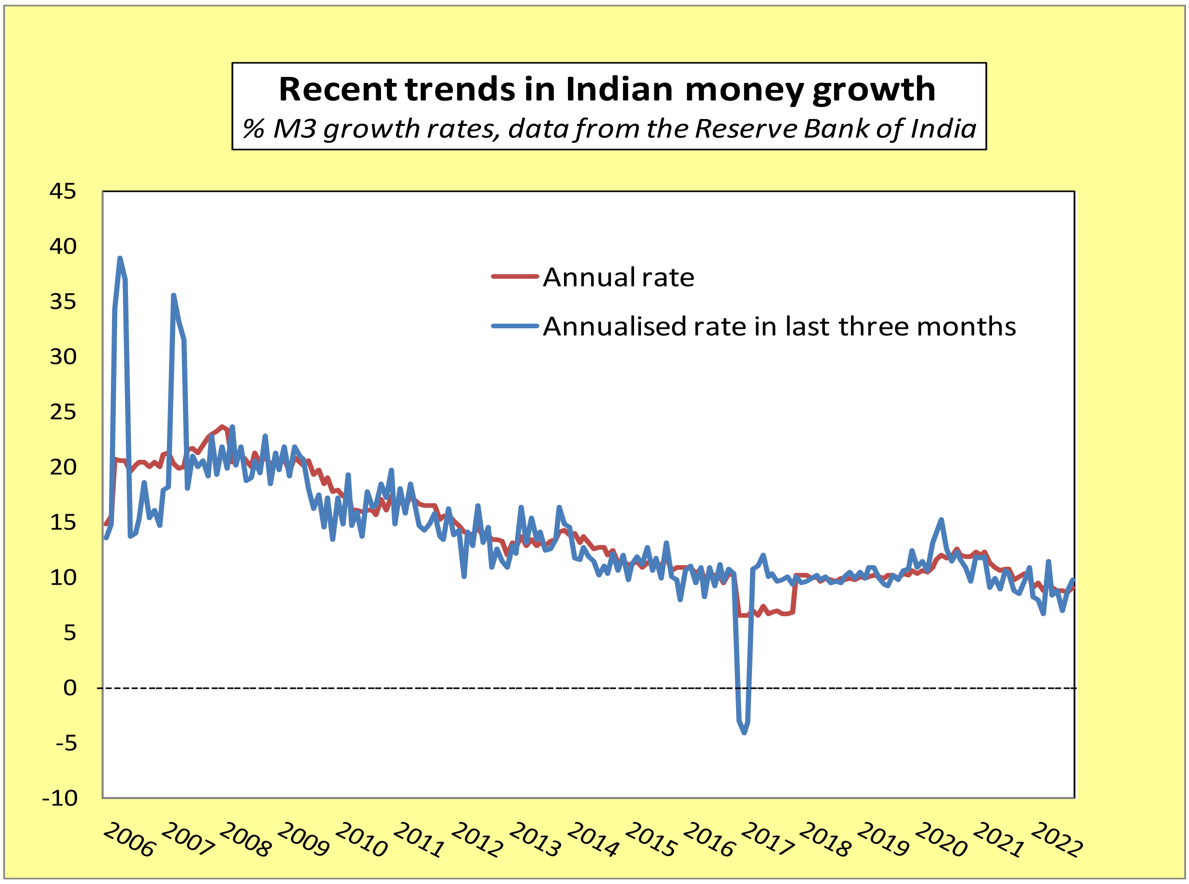
India

	% annual/annualised growth rate:	
	M3	Nominal GDP
1981- 2020	**15.8**	**12.9**
Ten years to 2020	**11.3**	**9.8**
Year to September 2022	**9.0**	**n/a**
Three months to September 2022 at annualised rate	**8.8**	**n/a**

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



Underlying deceleration in money growth, but with fluctuations

Summary: **In the third quarter of 2022 India's seasonally adjusted M3 grew at an annualised rate of 9.8%. After falling to 7.0% in the three months to July, the rate of growth of broad money has picked up. All the same, it remains significantly lower than the typical readings of the previous decade, when broad money growth rarely fell below 10%. The annual rate of growth rose from a four-year low of 8.7% in August to 9.0%.**

The upturn in growth of Indian M3 is occurring despite a steadily increasing cost of credit. The Reserve Bank of India (the country's central bank) implemented a fourth consecutive rate rise in September. The key repo rate has risen from 4.0% to 5.9% at the time of writing. On 5th April, the RBI insisted that it would prioritise fighting inflation over growth. India's inflation target currently stands at 4%, with a 2% band either side. Since the start of the year consumer prices have been consistently risen at a faster rate than the 6% permitted maximum, with the figure for the 12 months to September being a five-month high of 7.4%. This year has seen an erratic monsoon, with droughts in some areas and floods elsewhere. This has impacted crop yields and thus food prices.

More fundamentally, the decline of the rupee has contributed to India's inflation problems. The currency has declined by over 10% against the US dollar since January, hitting record lows in early October, The RBI is deemed to have "failed" if inflation remains outside the 2%- 6% tolerance range for nine consecutive months and is required to submit a report to the government explaining why it has been unable to meet its inflation mandate. It has to provide details of its proposed remedial actions to bring it down to target. Sources close to the government suggest that it is now adopting a more relaxed attitude to high inflation, from fears that further monetary tightening may result in a slowdown. India's GDP contracted by 1.1% in both the first two quarters of 2022, although the annual growth rate was strongly positive as India was particularly badly affected by the coronavirus pandemic in 2021.

The deteriorating exchange rate is problematic for Indian industry, given the country's dependence on imported energy. Nevertheless, businesses are still keen to borrow. The value of loans by Indian banks was 16.4% higher in the first half of September compared with 12 months previous (The RBI reports bank lending on a bi-monthly basis.) This is the strongest reading in nine years. The resultant new deposits have boosted money growth, but the decline in India's foreign exchange reserves have had the opposite effect. Since reaching a peak of almost $650b. in late 2021, these reserves have shrunk by over $100b. in an attempt to defend the rupee. The likelihood of further increases to the US Fed funds rate before the end of the year could put the rupee under further pressure. Nonetheless, the money numbers suggest that India's economy will grow, albeit slowly. The Indian government is looking to update the country's banking system and has begun to sell off its banks to private investors. (They have performed badly and are losing money.) The process for selling IDBI, the first such bank, has already begun. A more efficient banking system will benefit India's economy, although plans to raise their capital levels along "Basel III" lines could inhibit risk incurrence and credit extension.

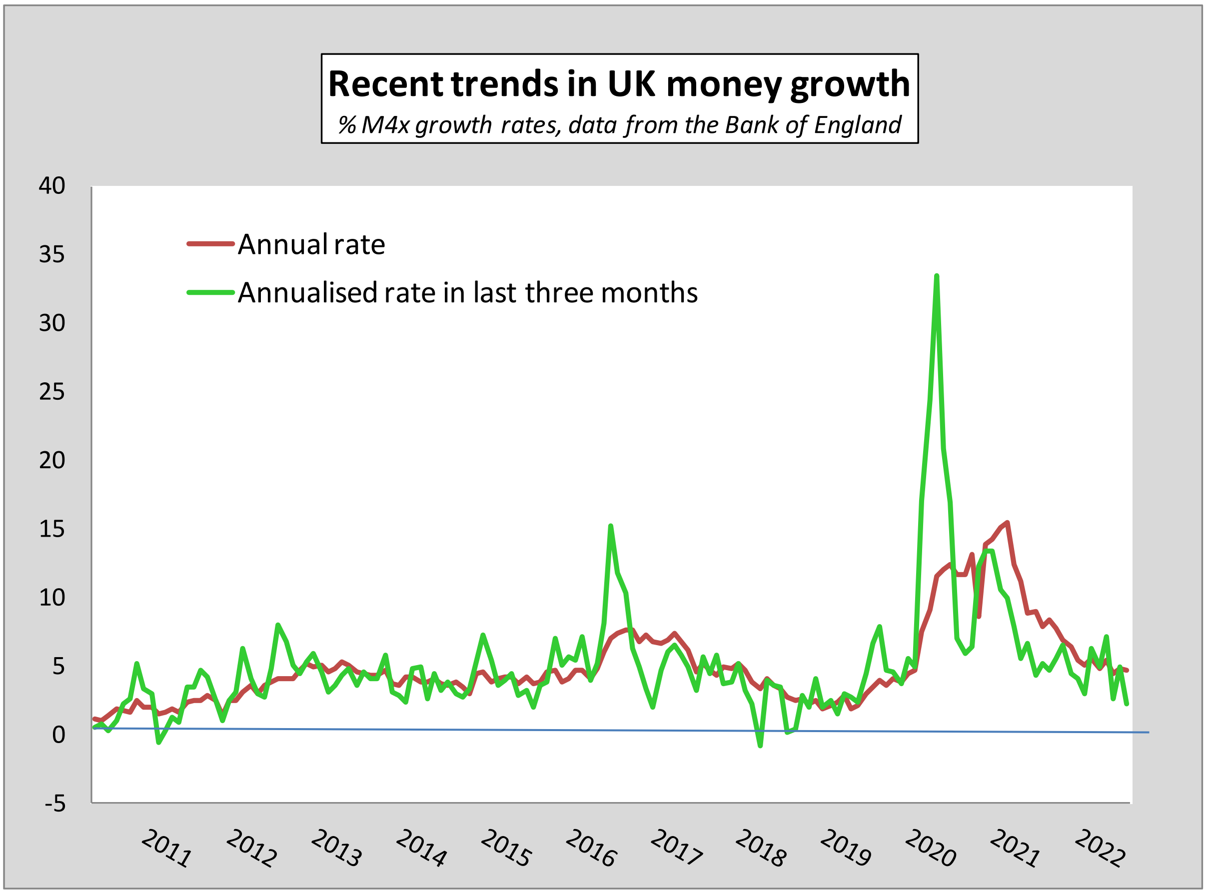
John Petley
13th October, 2022

	% 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 August 2022	**4.7**	**n/a**
Three months to August 2022 at annualised rate	**2.2**	**n/a**

Sources: Bank of England and Office for National Statistics



Broad money growth falls back

Summary: **UK broad money increased at an annualised rate of 2.2% in the three months to August This sharp drop from 4.9% in July is a result of May's exceptionally high reading (£22.1b) dropping out of the calculations. August, by contrast, recorded M4x growth of a meagre £4.2b. The annual growth rate dropped back from 4.8% to 4.7%.**

Broad money growth has been on an underlying downward trend since the start of the year. In March, May and July, the numbers were boosted by unusually high levels of borrowing by the financial sector. These upward blips seem to have been related to large corporate finance developments in London and were sometimes reversed soon afterwards. Indeed, in August itself the stock of loans to non-intermediate financial corporations dropped.

The larger picture is that banks have been expanding their claims on the private sector, but at a feeble rate. In the year to August the stock of lending by banks and building societies to the mainstream private sector went up by 3.4%, but lending to households – mostly for mortgages – was the strongest element in this. Lending to companies was more or less flat in the same period. Banks are very much constrained by the Basel III capital regime and the UK authorities' interpretation of it. Particularly noteworthy at present is the 2% counter-cyclical buffer imposed by the Bank of England's Financial Policy Committee and due to be met, by UK banks, by July 2023. As has been explained elsewhere in this publication, top UK banking groups despair of making decent returns from commercial banking in their own country, and are trying to develop non-banking businesses and/or activities outside the UK.

The size of banks' balance sheets – and hence of the deposit liabilities which constitute M4x broad money – depends also on their claims on the state. These claims consist at present of their substantial cash reserves at the Bank of England, and their holdings of short-dated government bonds and Treasury bills. Official policy is theoretically for the Bank to reduce its own asset facility by £80b. in the year from September. However, sharp rises in gilt yields, and related fears about turmoil in financial markets and the solvency of pension funds, led to the interruption of these sales on 28th September. Instead of selling gilts, the Bank has – on a temporary basis - purchased gilts in order to maintain an orderly market. The wider question is the ability of the UK savings pool – and indeed the pool of interested international investors – to acquire more UK government debt, at present yields. The apparent insouciance of the UK government – when Kwasi Kwarteng was Chancellor of the Exchequer – to its own medium-term solvency was a profound shock to sentiment. The surge in gilt yields – with the 10-year yield increasing from little more than 2% to over 4% in a matter of weeks – implies a large increase in debt interest costs over the medium term. The inflation rate fell from 10.1% in the year to July to 9.9% in August. The increase in "factory gate" prices also slowed, from 17.1% in the year to July to 16.1% a month later. Consumer confidence continues to plumb new lows and UK GDP shrank by 0.3% in August.

Tim Congdon and John Petley
17th October, 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**