



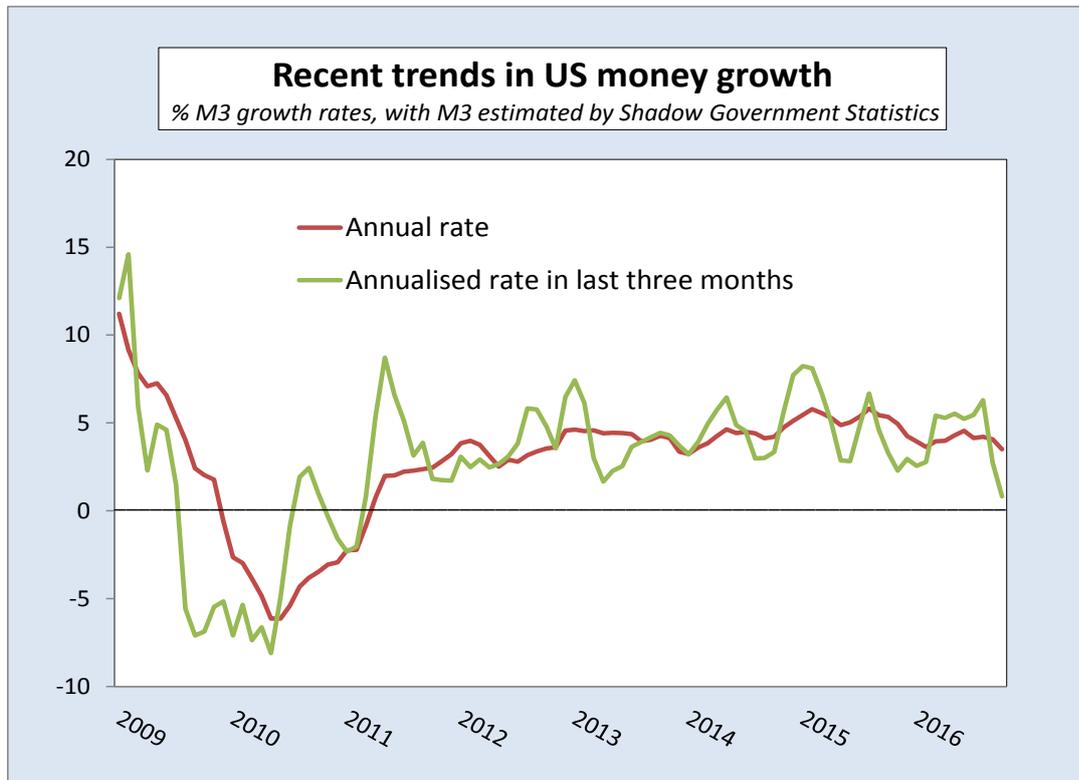
INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

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

USA

	% annual/annualised growth rate:	
	M3	Nominal GDP
1959 - 2015	7.5	6.6
Four years to 2015	4.3	3.8
Year to October 2016	3.5	n.a.
Three months to October 2016 at annualised rate	0.8	n.a.

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



M3 growth slowdown in recent months, due to “quantitative tightening”

Summary: In the three months to October US M3 grew at an annualised rate of 0.8%. This is the lowest three-month annualised rate since late 2010/early 2011, although it is too early to ring loud alarm bells. “Quantitative tightening”, as the Fed lets its stock of asset-backed securities run off, is the main reason for the money slowdown. (Our M3 data in this note are from the Shadow Government Statistics company.)

After the Trump victory in the presidential election, the talk is that the Fed will not raise its funds rate in December. Nevertheless, monetary policy has been more restrictive in recent months. As was pointed out in these notes in September 2015, the Fed is engaged in “quantitative tightening” (i.e., the reversal of quantitative easing) when it allows its stock of asset-backed securities to run off at maturity. The Fed can use proceeds from the maturing ABSs to reduce its cash reserve liabilities to the banks rather than to finance new, offsetting purchases of securities.

Undoubtedly, a significant amount of QT has occurred over the last year. The Fed’s large-scale asset purchases ended on 29th October 2014, with US commercial banks’ cash reserves peaking shortly afterwards at \$2,957.1b. on 26th November 2014. Cash reserves were still \$2,765.6b. almost a year later on 4th November 2015. But the last available figure – for 26th October 2016 – is \$2,184.3b. The decline has been in two spasms, one in autumn 2015 and other in the last few weeks. The negative monetary effect of the QT over the last year has been roughly the same as the positive effect of QE2, which involved \$600b. of purchases of government securities. But there has been no announcement from the Fed and no media attention. Banks continue to acquire other assets at a moderate rate. In the three months to September “loans and leases in bank credit” (which roughly equates to bank lending to the private sector in the UK) moved ahead by just over 1.5%, i.e., at an annualised rate of 6.4%.

How much does the broad money slowdown matter? Since equilibrium national income is a function of the quantity of money, broadly-defined, the answer is that it matters a lot, but it is too early to become hysterical about the impact of this development on financial markets and the real economy. Assuming broad money growth returns to an annualised rate of 5% or so soon, the current slowdown will be merely a blip. However, if the Fed keeps on running off its stock of ABS and governments, and if bank credit to the private sector weakens as regulators keep on tightening the noose (i.e., with more onerous capital requirements, etc.), weak money growth may persist into 2017. In general, significant changes in money trends that last more than six months alter the macroeconomic trajectory. The numbers must be watched, not least because Fed economists have zero interest in the behaviour of broad money, and do not understand the connection between it and other macro variables.

Tim Congdon
10th November, 2016

	% annual growth rate:	
	M3	Nominal GDP
1960 – 2014	7.6	6.7
1971 – 1980	11.4	10.7
1981 – 1990	7.7	7.7
1991 - 2000	5.6	5.6
2001 - 2010	7.1	3.9
Four years to 2015	4.3	3.8