

WHAT THE ECONOMISTS SAY

Tackling the halt in money growth

QE has been needed to prevent deflation, writes **Tim Congdon**

The closure of the international inter-bank market in August 2007 was a watershed in the world's post-war economic history. Most countries had large public debt in the immediate aftermath of the second world war. As a result, their banking system's assets were dominated by claims on the state, while the stock of bank lending to the private sector was low relative to national income. Over the next 60 years this pattern changed radically, with bank lending to the private sector having a recurrent tendency to grow faster than national income. For much of this 60-year period the money growth arising from the monetisation of private credit was so high as to cause inflation. Particularly in the 1970s and 1980s, inflation ran at politically intolerable levels that had to be countered by dear money.

But the long-running boom in bank lending to the private sector has been reversed since August 2007. Partly because they have had difficulty funding their assets, and partly because of new regulations such as

Basel 3, banks have been shedding risk assets. Money growth came to a sudden halt in late 2008 or early 2009 in the main advanced countries, and an intense recession followed. The purpose of QE has been to sustain the growth of money (i.e. banks' deposits, mostly), while their claims on the private sector have been falling. The banks' claims on the state – in the form of government securities and cash – have been growing more strongly because of QE. This has been a positive and necessary development to prevent deflation.

Nevertheless, the growth of money on the broad definitions remains very low almost everywhere in the developed world. The current upward blip in inflation is indeed only a blip and does not justify a tightening of policy. In the developed world (North America, Europe, Japan) inflation will be lower in the next two years than in the past two years.

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