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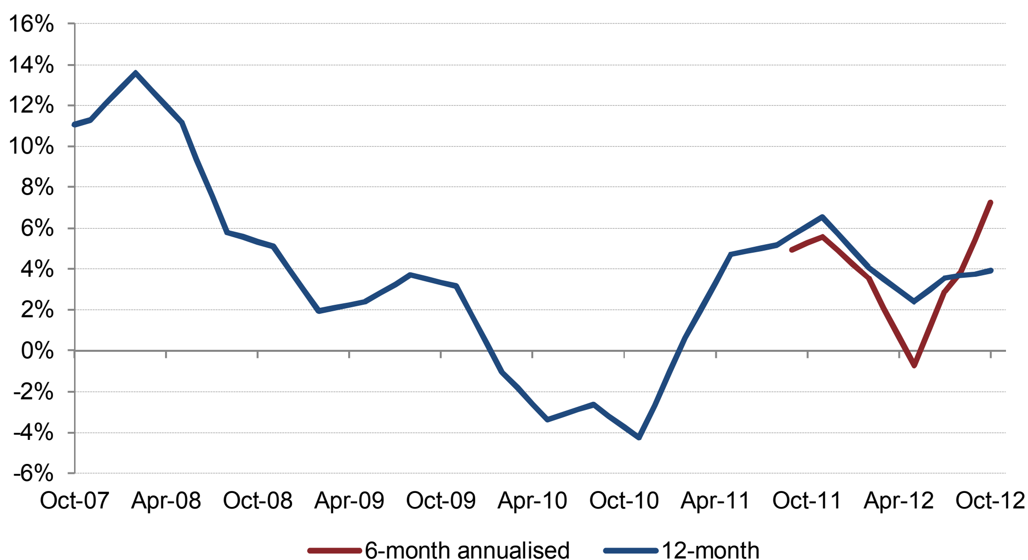
US: money, credit and QE4

Fed unwillingness to look at money could cause unnecessary QE4

Recent US broad money and credit numbers paint an interesting picture. The two measures – broad money growth vs credit growth – are diverging. Broad money[1] grew by 3.9% in the year to October 2012, up from 2.4% in May. This translates into a six-month annualised growth rate of 7.3%, up from -0.7% in May. Although one has to be careful in basing interpretations of money supply data on one or even a few months, given the 'long and variable lags' with which monetary developments translate into activity, this is clearly a good number. The weakness in broad money that was visible over the autumn of 2011 and the spring of 2012 has hopefully been put behind us. Broad money growth is still weaker than would be ideal (ie, in current circumstances a twelve-month growth rate somewhere at the higher end of the 5-10% range), but at least it is headed in the right direction. Crucially, the data points to continued positive US output growth over coming quarters even if there may be a brief hiccup in early 2013 related to the fiscal cliff and how that is – or is not – dealt with.



However, as we know, the Fed does not look at broad money. The Fed looks exclusively at credit. From that perspective, the numbers are less attractive. The growth of total bank credit to the private sector slowed to 1.1% in the year to October, down from a not very high 1.5% in July. Looking at the weekly data, the thirteen-week (ie, three-month) annualised change in the key credit categories from commercial

[1] Broad money refers to my own recreation of the M3 broad money measure that the Fed discontinued in March 2006.

Stein Brothers (UK) Ltd.
Telephone: +44 (0)7768 094 340
Email: gabriel.stein@steinbrothers.co.uk

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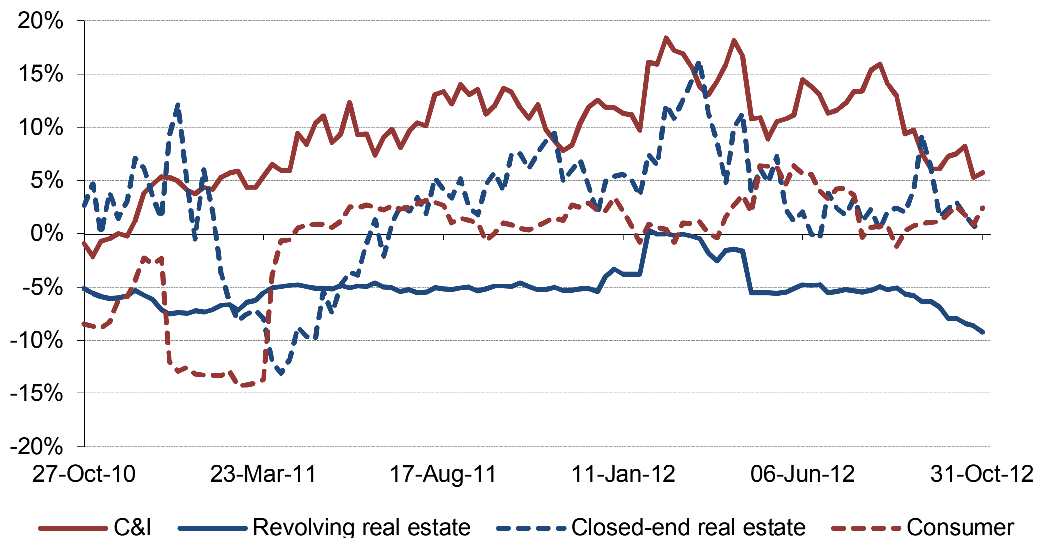
banks shows some even less attractive trends. Real estate loans are barely growing, nor is consumer credit and only commercial and industrial (c&i) loans are showing some expansion – although even their growth rate is down to 5% from more than 10% over much of the past year.

Credit from commercial banks by category
thirteen-week annualised rate of change, %



In terms of impact on the economy, in my view, the weak credit data is not terribly important. Household spending is unlikely to be a main driver of growth as households still have some need to deleverage (although considerably less than in past years); while non-financial companies tend to be flush with cash and in any case seem to bypass the banking system for any external funds, preferring right now to borrow directly from markets. Rather, the data confirms the story from other sources (eg, regional Fed surveys) that company cap-ex activity is likely to remain subdued.

Stein Brothers (UK) Ltd.
Telephone: +44 (0)7768 094 340
Email: gabriel.stein@steinbrothers.co.uk

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However, where the data may still be important, is in its impact on Fed policy. The numbers show that credit growth remains anaemic. Given the Fed's fixation on credit, rather than on money, they therefore constitute a powerful incentive to further extend and possibly expand the easy monetary policy over coming months, whether in the shape of new ideas (QE4?) or simply extending current policies. But the money data imply that it should by now no longer be necessary to do so; and it therefore would increase the longer-term risks of keeping interest rates ultra-low as I highlighted in last week's Comment. Of course, for the near future, it would still be good news for bonds.

Gabriel Stein
gabriel.stein@steinbrothers.co.uk

Gabriel Stein is Managing Director of Stein Brothers (UK) Ltd and Chief Economic Advisor to OMFIF. The views expressed are his own.

Stein Brothers (UK) Ltd.
Telephone: +44 (0)7768 094 340
Email: gabriel.stein@steinbrothers.co.uk

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