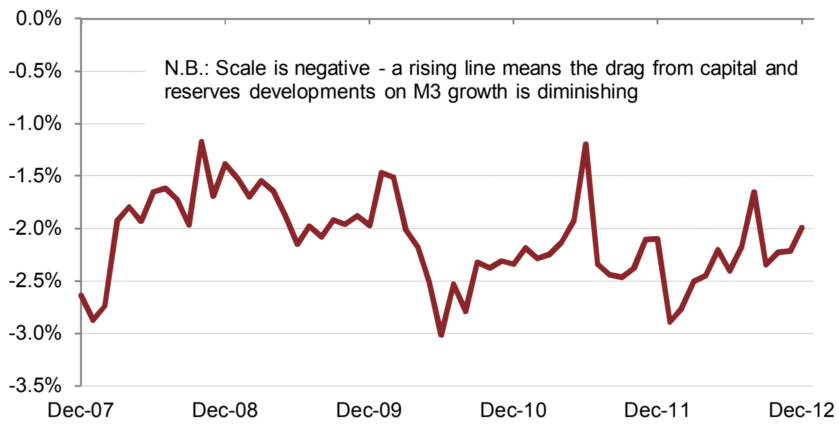
Some good news in EA money

Past the worst, but a long hard slog ahead

Euro area broad money growth slowed to 3.3% in the year to in December from 3.8% in November; but the three-month moving rightly average favoured by the ECB rose to 3.7%. Broad money growth in the EA is hardly spectacular; but there are some positive pointers in the data – as well as some less positive ones. For one thing, the overall trend of M3 growth is still up, if weakly. The average rate of M3 growth in 2 2012 was 3.4%. For the year as a whole it was 3%, after 1.5% in 2011 and 0.4% in 2010. Recent M3 growth is still below the 7-10% that would currently be desirable, but it is at least headed in the right direction. For another, the drag from banks' build-up of capital is slowing.

The contribution of capital and reserves to EA 12-month M3 growth, percentage points



Moreover, the headline figure masks substantial intra-EA differences. German broad money growth slowed in December (and the stock of broad money fell in both November and December) but one or two months' data can be highly volatile and the average growth of the German contribution to EA M3 in H2 has been a very healthy 7.7%. By contrast, French broad money growth is slowing sharply, hovering between 2% and 3% in H2 2012.

A perhaps more unexpected development is occurring in the periphery countries. One of the key signs of concern about the Greek, Spanish and Irish (etc) banking systems, has been the drain of deposits, as the private sector fled to safe havens abroad. Since the deposits of the private sector are by far the greatest component of broad money, this meant broad money was under severe pressure in the countries involved. In the case of Greece, the stock of broad money began to contract in October 2009. By June 2012, Greek M3 (excluding currency in circulation) had shrunk by 36%. Irish M3 contracted by 26% from

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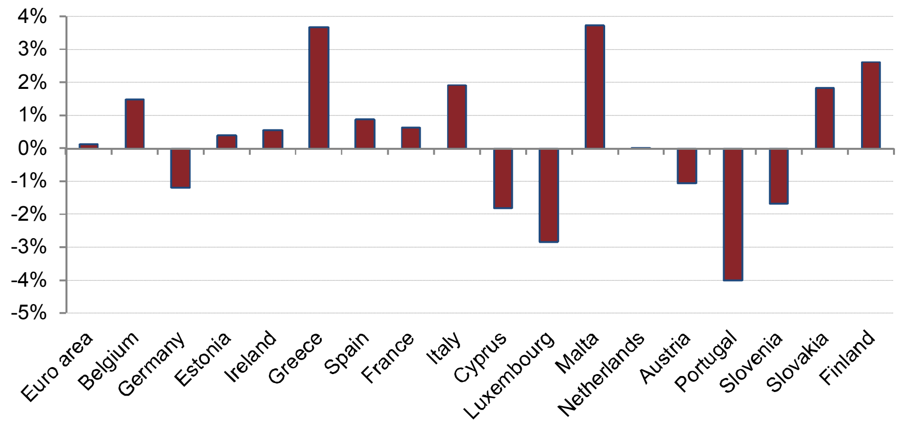
August 2007 to November 2012; and Spanish by 12% from November 2009 to August 2012. Bear in mind that normally – by the standards of the post-war world – broad money grows, if at a faster or slower pace.

However, over the past four or five months, there has been a change. On a seasonally adjusted basis, Greek bank deposits (to be specific, deposits held by 'other general government and other EA residents') have expanded. Spanish and Irish bank deposits are also picking up; and, not unrelated, deposits in some EA countries in the 'safe north' (Germany, France, Benelux) are edging down as money is repatriated. (Cypriot bank deposits are falling, to no one's surprise).Greek bank deposits continue to fall on a twelve-month basis; but December was the first month in which the twelve-month fall in deposits was less than 10% since October 2010. The numbers show some return to confidence in the sustainability of the banking system, coupled with large-scale investor inflows as faith, possibly premature, is restored in the ability of the EA to surmount is current crises.

Deposits of other general government/other euro area residents, cumulative % change August-December 2012



There are a number of caveats. It is early days. The EA fiscal crises are not solved and could flare up again, in a country already in trouble or elsewhere. Confidence could take a hit and money flow out. Spain, which is singularly failing to achieve its fiscal targets and where Commissioner Rehn has already hinted at a relaxation of budget targets, is a case in point. On a twelve-month basis, broad money in the crisis countries is still contracting; and even where it is not, it remains well below growth rates consistent with a strong economic recovery.

Finally and perhaps most importantly, they do not tell us that the underlying problems of the euro are solved. Southern Europe remains uncompetitive. And it remains the case that the euro, in order to survive as a monetary union between roughly equal-sized economies, must either constantly be policed by the strongest economy; or move towards a political union. The former is probably not acceptable to the Germans, who would have to undertake and at the last instance enforce the economic/financial policing,

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and is certainly not acceptable to anyone else, much though they like German money. The latter is not on the cards for the moment, nor is it likely that it will be acceptable to the voter/taxpayer in the creditor countries of northern Euroland, if the southern debtors are in, since a political union by necessity would mean joint and several responsibility for all debt.

Nevertheless, these monetary developments, weak though they are, are positive signs. They at least give some hope that the outlook is not deteriorating any more. And, finally, they combine with better monetary data elsewhere, notably in the United States (to be covered in a further comment in February), to hint that the world economy, including the advanced economies, may be beginning to exit from its drawn-out crisis, slowly so in 2013, more strongly in 2014.

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