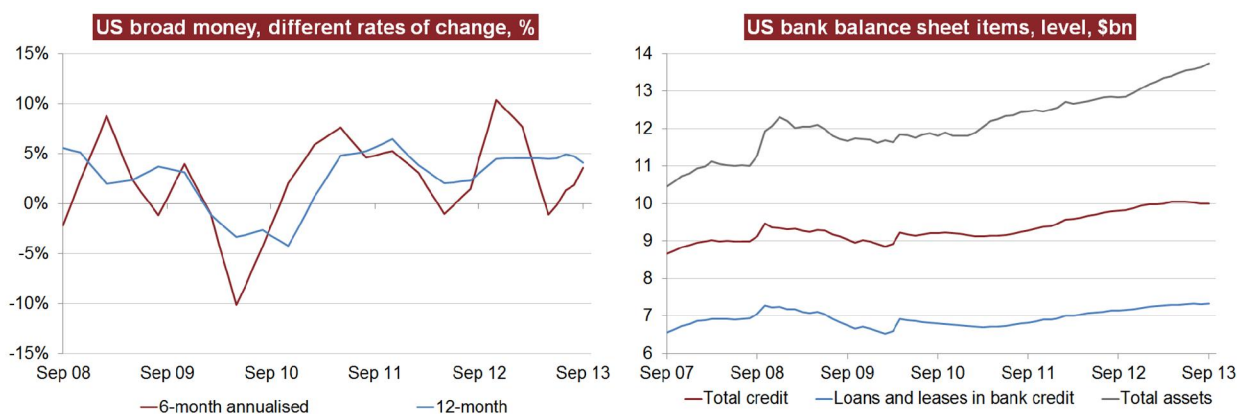


Weak US broad money growth => growth outlook revised down

- **US broad money growth may now be less than 4%**
- **Total bank credit growth is also weak**
- **The economic outlook looks like below-trend growth in H2 2013 and H1 2014**

The publication of the US Financial Flows at the end of September made it possible to update and adjust US broad money up to the end of Q2¹. Meanwhile, data released over the weekend – fortunately, this is not a release affected by the government shutdown – brought the numbers up to September. The figures show broad money growing by 4.1% in the year to September. This is the lowest twelve-month growth rate since last autumn. Somewhat more worryingly, the monthly change in deposit liabilities of commercial banks, which is used to update broad money between the quarterly releases of the Financial Flows, tends to exaggerate the rate slightly. It is therefore possible that broad money growth has slipped below 4%. Admittedly, the six-month annualised rate of change, which is a better guide to recent trends, shows that this was a phenomenon relating to the spring of 2013 and that broad money growth has since picked up again. But, even on this measure, it is still only at 3.6%, implying that the annual change will remain subdued in coming months.



This is already of some concern. The impression in the early summer was that broad money was growing slightly in excess of 6% and accelerating, which would have been enough to support the view that US activity was likely to pick up over the course of H2 and into 2014. Current broad money growth rates do not support more than a forecast of continued growth at or somewhat below trend.

A second cause for concern is the development of US banks' balance sheets. The good news is that balance sheets continue to expand, rising by 7% in the year to September (and by 6% on a six-month annualised basis); and that lending to the private sector is also expanding, although by somewhat less

¹ As ever, 'broad money' refers to my recreation of the M3 broad money series that the Fed ceased to publish in March 2006. The full series is posted on the Stein Brothers website, www.steinbrothers.co.uk



(2.4% from a year earlier, 1.4% on a six-month annualised basis). But this is still weak. By contrast, in previous cycles, the growth of credit would five years after a recession be in or near double digits. Moreover, total credit, which includes banks' holdings of Government and Agency paper, is shrinking on a monthly basis (although still growing by 1.8% from a year earlier; while there was no growth over the past six months).

Part of the reason for the weaker credit growth is also that it remains cheap to borrow directly from markets. However, while helpful to companies, from a macroeconomic perspective when a company borrows from a bank, there is no restriction on the spending of others, since the bank creates money. When it borrows directly from markets, there is no increase in money supply, meaning that the lenders are foregoing spending in order to lend the funds in question.

One cause of some of the movements in banks' balance sheets is the Fed's quantitative easing. While one reason for the fall in the balance of Government and Agency paper held by the banks is the rise in bond yields since May, which lowers their value (since they are being marked to market); another and more important reason is the Fed's purchases of bonds. This has led to bonds being replaced by cash with banks' cash holdings – the counterpart to their reserves with the Fed – growing by 22% over the past year. However, in spite of its inaction in September, the Fed is likely to start tapering QE some time over the next few months. When it does, one major source of balance sheet expansion for US banks will begin to dry up. At the same time, there is still regulatory pressure on banks to boost their capital, which is a further brake on broad money growth.

If it were only broad money that was developing less than hoped for, it could be argued that that this was perhaps to some extent related to uncertainty connected with the current fiscal debate in the US (and, indeed, thirteen-week annualised weekly credit numbers show growth slowing further in recent weeks). However, other US data has also shown some weakness over the past few weeks, including consumer sentiment and car sales, to pick but two. The housing market remains reasonably strong; and any form of at least near-reasonable (define!) agreement over the government shutdown and Federal debt ceiling should quickly boost both business and consumer confidence. But where previously the US economy looked set to grow at trend (ie, around 2½%) in H2 2013, and accelerating into 2014, a more likely forecast is now below-trend throughout 2013 and most likely the first half of 2014 as well.

US growth prospects are still good from an international perspective – but that is because the international environment remains unattractive (with a few spots admittedly brightening, notably the UK and – less fundamentally – Japan.) This means that US equities should remain attractive, although the outlook of a weaker dollar diminishes somewhat from the attraction for a non-US based investor.

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