Bank of England

Lord Bridges of Headley MBE
Economic Affairs Committee
House of Lords
London
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Andrew Bailey
Governor

6 July 2023

Dear George,

Money supply and credit creation

The Chart below shows the annual growth rates of sterling broad money ($M4^{ex}$) and sterling net lending ($M4L^{ex}$), including the latest data points for May 2023.

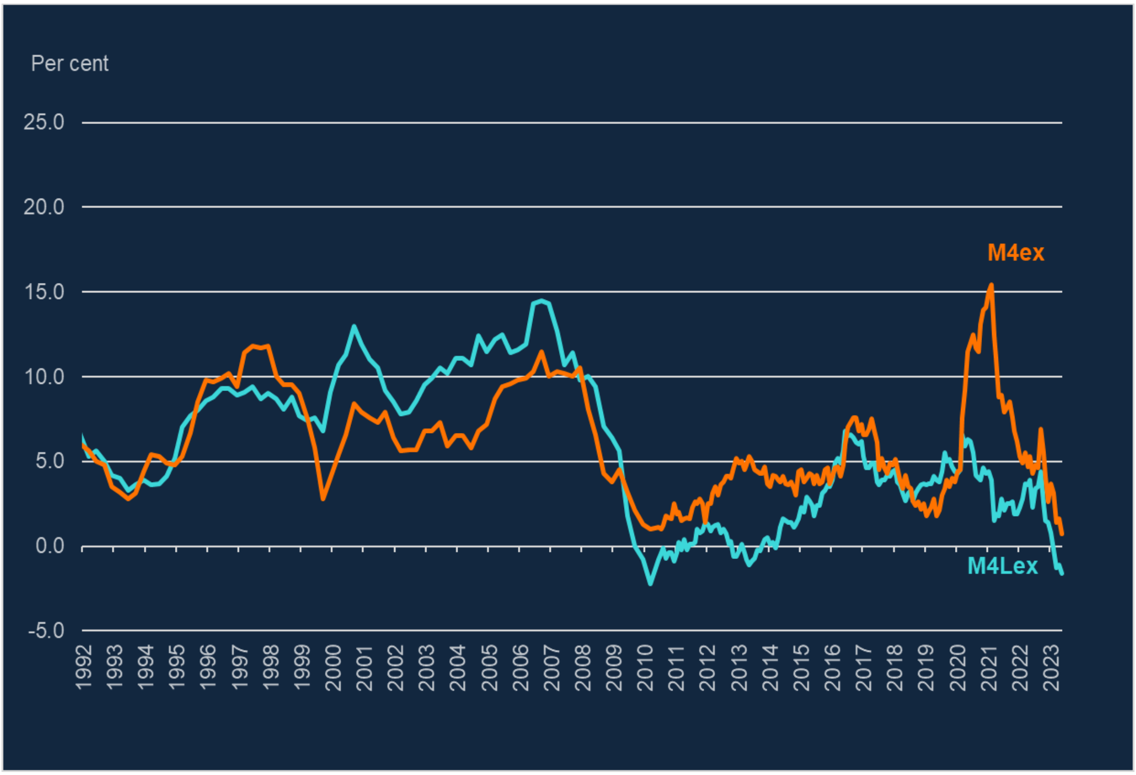
As can be seen, normally the two series display a reasonably close relationship. This is not surprising. The creation of inside money originates from bank loans being made, the proceeds of which are then held in deposit accounts and take the form of monetary holdings. Thus, $M4L^{ex}$ leads to a change in $M4^{ex}$.[1]

Two things stand out during the Covid period, both of which were closely watched by the Monetary Policy Committee (MPC).

First, $M4^{ex}$ grew rapidly. This was the product of the Bank's quantitative easing (QE) operations, designed to stabilise rates further along the interest rate curve and provide support to economic activity at a time when an unprecedented fall caused inflation to be well below the target. The rate of growth of $M4^{ex}$ peaked in late 2020 and then fell rapidly.

[1] 'Money creation in the modern economy' is described in the Bank's Quarterly Bulletin 2014Q1: https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2014/money-creation-in-the-modern-economy

Chart: 12-month growth rates of M4^{ex} and M4L^{ex}



Note: Chart shows the 12-month growth rates of sterling broad money (M4^{ex}) and sterling net lending (M4L^{ex}) measured on a monthly basis since June 2010. Prior to this, the data is measured on a quarterly basis. Final datapoints on the chart are May 2023. *Source:* Bank of England.

The second point is that there was no pick-up in M4L^{ex}. This is consistent with the limited recovery of economic activity – both the levels of GDP and consumption remain no larger than there were immediately before Covid – and the build-up of savings by households and companies.

Subsequently, the real value of these savings has declined, and recently household deposits have contracted in nominal terms. This is consistent with the weakness of M4^{ex} seen in the Chart.

Currently, the monetary aggregates point to a weak and weakening outlook. The MPC has to judge this alongside the evidence of potential persistence of inflation.

I hope this brief assessment is useful and helps to put into context the evidence on monetary aggregates.

Yours sincerely

Andrew Bailey