CENTER FOR FINANCIAL STABILITY
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BASED ON DATA RELEASED AT 9:00 A.M. ET, OCTOBER 16, 2013

SOFT SPOT FOR FINANCIAL INSTITUTIONS AND ECONOMY: CFS MONEY SUPPLY STATISTICS

DATA FOR SEPTEMBER 2013

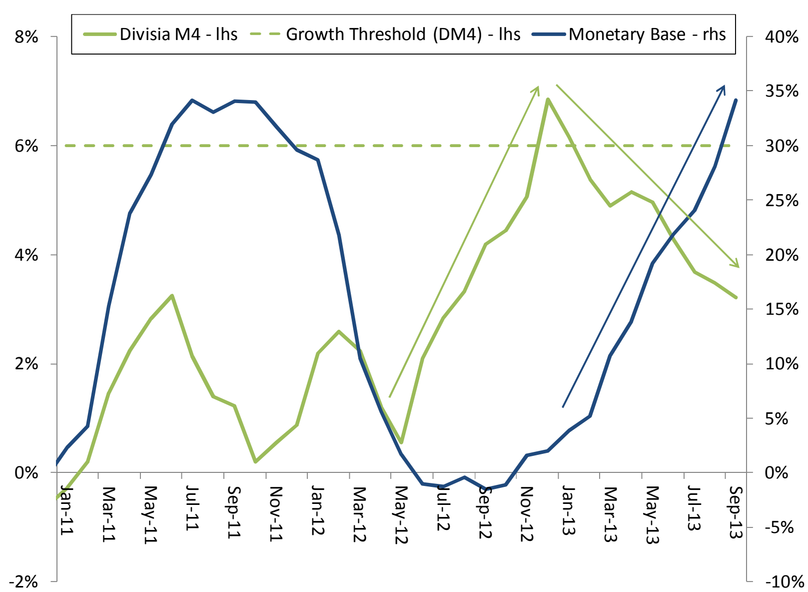
- CFS monetary and financial data suggest that the US economy is losing momentum,
- The economy appears less responsive to injections of money in 2013 and to QE3,
- The swell of reserves into the banking system represents a future risk to asset values,
- A breakdown of the financial system into traditional and shadow banking reveals stress in each.

Slowing Economy, Despite Monetary Ease

Today, the Center for Financial Stability (CFS) monetary and financial data suggest that the US economy is losing momentum. CFS Divisia M4 – the broadest measure of the money supply – grew by 3.2% in September 2013 on a year-over-year basis. This contrasts with an increase of 4.2% in September 2012 over the previous year.

Trends are noteworthy, despite our reporting precise data points. From September 2012 through the balance of the year, the financial system - as measured by CFS DM4 – expanded on a consistent basis reaching a peak of 6.8% in December. Not surprisingly, the US economy logged its best annual performance since the financial crisis, gaining 2.8% in real terms during the year. Interestingly, the visible benefits in the economy and financial system occurred during a hiatus from quantitative easing (QE).[1]

Figure 1. Financial System Slide, Despite QE3 (year-over-year)



Source: Bloomberg LP and Center for Financial Stability.

[1] Extraordinary monetary policies were operative during 2012 with the Federal Reserve intervening in financial markets via the purchase of long dated Treasury bonds with roughly equal offsets via the sale of shorter dated Treasury instruments – Operation Twist.

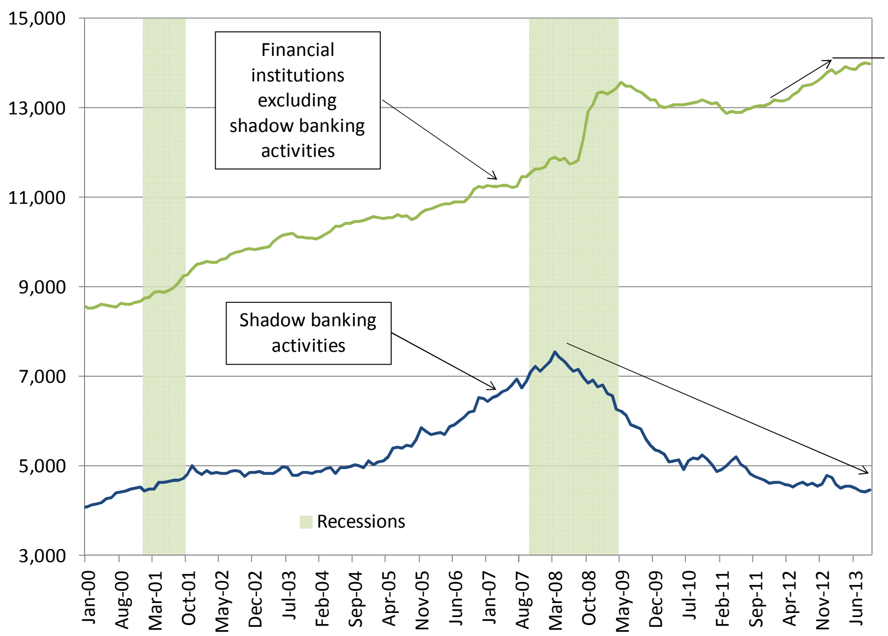
At present, the financial system and economy appear increasingly less responsive to future injections of money in 2013 and to QE3. Growth in the financial system – as measured by DM4 – is sliding from a peak in December 2012 to a trough of 3.2% registered with the latest observation available for September 2013. At the same time, the monetary base is again on the ascent with an increase of less than 5% on a year-over-year basis escalating to 34% by September.

In addition to a slowing economy, concern is legitimate regarding future disturbances and distortions from the injection of reserves into the banking system over the last nine months.

Measuring Shadow and Traditional Financial Activities

A breakdown of the financial system into traditional and shadow banking reveals stress in each. The CFS measure of the shadow banking system is down a stunning 40% in real terms from its peak in March 2008. Although pejorative sounding in title, the shadow banking system has contributed to the US economy since the early 1970s with institutional money market funds, commercial paper, and repurchase agreements providing fuel for growth. Sadly, the system provided a vehicle for excessive leverage and risk. Nonetheless, the present drop in real terms dwarfs prior recession induced slides. At the moment, the shadow banking system shows signs of stabilization, but no recovery.

Figure 2. CFS Shadow and Banking System (Real, September 2013 billions $)



Source: Bloomberg LP and Center for Financial Stability.

The banking system – as measured by financial institutions excluding shadow banking activities – paints a somewhat brighter picture with a clear contribution to output in 2012. Yet, financial institution activities seem to have stabilized in 2013.

Figure 3. Major CFS Monetary Aggregates and Reserve Balances, % year-over-year

	2007	2008	2009	2010	2011	2012	Apr-13	May-13	Jun-13	Jul-13	Aug-13	Sep-13
CFS DM4	7.3%	8.4%	-4.9%	-0.6%	0.9%	6.8%	5.1%	5.0%	4.3%	3.7%	3.5%	3.2%
CFS DM4-	7.3%	2.6%	-5.1%	-0.5%	2.7%	6.8%	5.2%	5.4%	4.8%	4.2%	4.0%	4.1%
CFS DM3	8.1%	3.0%	-2.4%	0.2%	3.5%	6.8%	5.2%	5.4%	4.9%	4.6%	4.4%	4.1%
Reserves	0.6%	818%	35.0%	-5.3%	46.5%	-2.1%	18.2%	26.8%	31.4%	34.7%	41.7%	52.6%
Monetary Base	1.2%	97.0%	20.8%	-0.4%	29.6%	2.1%	13.9%	19.1%	21.8%	24.0%	28.1%	34.1%

Source: Center for Financial Stability and Federal Reserve Board (total reserves of depository institutions).

About CFS Money Supply

CFS Divisia monetary measures were developed under the direction of Professor William A. Barnett - one of the world's leading experts on monetary and financial aggregation theory. CFS money supply data are essential, especially since the Federal Reserve ceased production of M3 in 2006. Similarly, Divisia measures are superior, as they accurately weight various classifications of money from cash to leverage in the shadow banking system.

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Additional information: www.CenterforFinancialStability.org