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HIGHLIGHTS

BASED ON DATA RELEASED AT 9:00 A.M. EST, JANUARY 16, 2013

NEW FED TARGETS AND MONEY: CFS MONEY SUPPLY STATISTICS

DATA FOR DECEMBER 2012

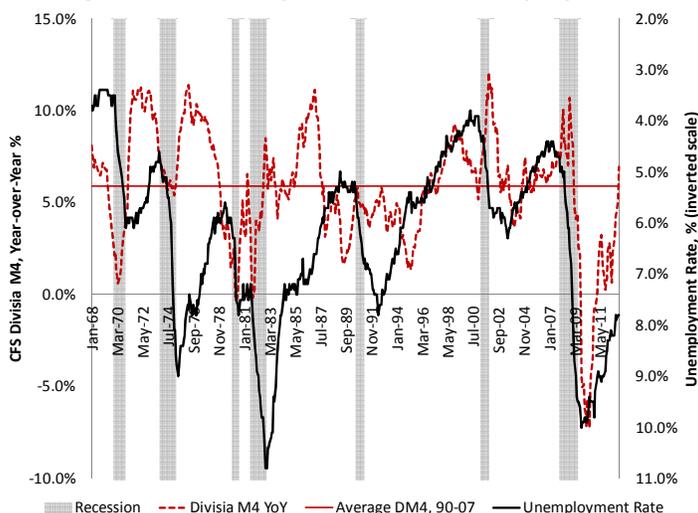
Today, CFS monetary data decisively demonstrate that the US economy is gaining momentum. This presents a contrast to our last three consecutive months that clearly signaled the economy bottomed.

Despite worries surrounding the fiscal cliff, the broadest measure of money (CFS Divisia M4) gained 6.9% in December 2012 on a year-over-year basis. This represents the most rapid expansion in broad money in the economy since 2008. CFS Divisia M4 gained 5.1% on a year-over-year basis in the previous month and a scant 0.9% in December 2011. So, the financial system and the economy are on the mend.

Unemployment Target and Money

In the last Federal Open Market Committee (FOMC) meeting, the Fed critically altered its trigger for a shift in monetary policy from a specified date¹ to the unemployment rate.² So, the Fed is now set to preserve an accommodative monetary stance “as long as the unemployment rate remains above 6½% and forward looking inflation is “no more than a half percentage point above the Committee’s 2 percent longer run goal.”

Figure 1. Monetary Growth and Unemployment



Source: Bureau of Labor Statistics, Federal Reserve, and Center for Financial Stability.

Interestingly, our monetary data suggest that the unemployment rate may reach 6½% earlier than presently being anticipated by the FOMC. The chart (Figure 1) highlights a close relationship between

¹ Goodman, Lawrence, “The Fed’s Intertemporal Game” - Center for Financial Stability, September 21, 2012 and William A. Barnett, “Fed’s Current Stance is Tragically Wrong” - *Kansas City Star*, November 6, 2012.

² Minutes of the Federal Open Market Committee, Federal Reserve Board, December 11-12, 2012.



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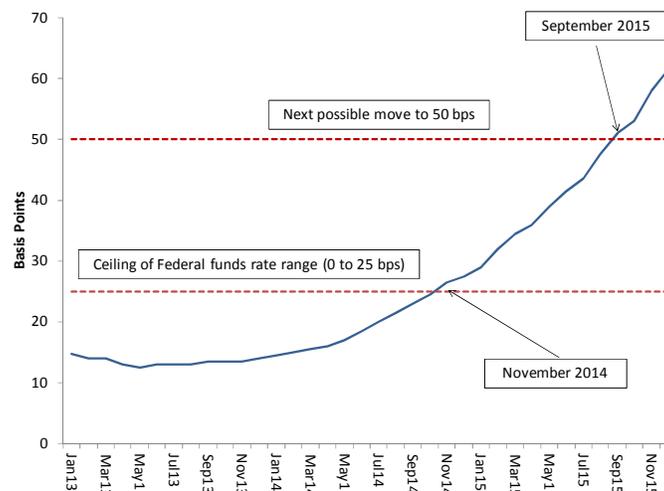
the broad money and unemployment. Over the years, there has been a very well documented time delay between changes in monetary growth and final targets of policy. This “causality” relationship has been evident under all Fed operating regimes, with strong causality of money to GDP with lags extending back at least two years.³ Our chart displays a similar lagged influence of monetary growth on unemployment – up until around 1992, after which time the delay seems to have disappeared.

Based on trends present in the CFS data, the unemployment rate may head toward the 6½% level earlier than anticipated by the Fed. At present, the Federal Reserve Board members and presidents of the regional Federal Reserve banks expect the unemployment rate to reach 6½% some time in 2015. The Board estimates a central tendency forecast range of 6.0 to 6.6% for 2015.

The Markets

The markets similarly expect a higher funds rate in 2015, with the probability of a rate hike escalating after November 2014 and an actual move occurring around September 2015. Our data suggests the timing may be even earlier. The unemployment rate and money will be key factors to watch.

Figure 2. Future Federal Funds Rate Implied by Futures Contracts



Source: Bloomberg LP and Center for Financial Stability.

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

	2007	2008	2009	2010	2011	Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12
CFS DM4	7.3%	8.3%	-4.9%	-0.8%	0.9%	2.9%	3.3%	4.3%	4.4%	5.1%	6.9%
CFS DM4-	7.2%	2.5%	-5.0%	-0.6%	2.7%	2.5%	2.5%	3.7%	3.9%	4.5%	6.9%
CFS DM3	8.1%	3.0%	-2.3%	0.1%	3.6%	3.6%	3.3%	4.3%	4.5%	4.9%	6.9%
Reserves	0.0%	1802%	38.8%	-5.4%	48.2%	-6.6%	-5.1%	-7.7%	-6.9%	-2.8%	-1.8%

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

³ Barnett, William A. and Apostolos Serletis (1990), “A Dispersion-Dependency Diagnostic Test for Aggregation Error: With Applications to Monetary Economics and Income Distribution,” *Journal of Econometrics*, vol. 43, pp. 5-34; reprinted in William A. Barnett and Apostolos Serletis (2000), *The Theory of Monetary Aggregation*, Elsevier, Amsterdam, chapter 9.



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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

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