



# CENTER FOR FINANCIAL STABILITY

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## Falling Money and the Fed

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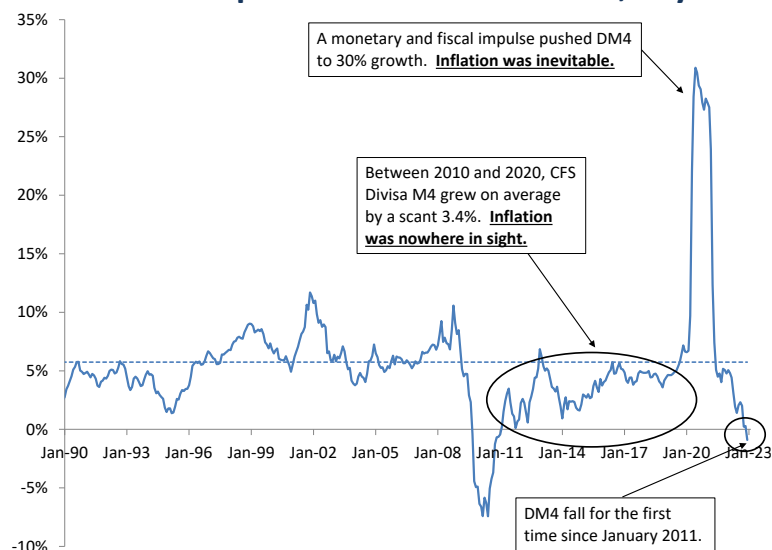
January 31, 2023

- CFS Divisia M4 (DM4) declined by 0.9% in December 2022, on a year-over-year basis – the 14th largest on record since 1968.<sup>1</sup>
- The implication is that inflation and growth are slowing more dramatically than many believe.
- Over years and cycles, our data and analytics offer paths for investors to profit and officials to conduct policy in a way to limit inflation and promote growth in a less volatile financial environment.

### The Data

Yesterday's plunge in Center for Financial Stability (CFS) Divisia money<sup>2</sup> is critical for future investment strategies and Fed policy. CFS Divisia M4 (DM4) declined by 0.9% in December 2022, on a year-over-year basis. In contrast, DM4 increased by 4.8% in December 2021 over the preceding year (see Figure 1).

**Figure 1. Inflation Impulse and CFS Divisia M4, % year-over-year**



Source: Center for Financial Stability.

<sup>1</sup> CFS Divisia data are freely available as part of the Advances in Monetary and Financial Measurement (AMFM) program. State of the art advances in monetary and financial measurement account for differences in the degree with which various assets serve as money ([https://centerforfinancialstability.org/amfm/Divisia\\_Dec22.pdf](https://centerforfinancialstability.org/amfm/Divisia_Dec22.pdf))

<sup>2</sup> William A. Barnett, "Getting It Wrong: How Faulty Monetary Statistics Undermine the Fed, the Financial System, and the Economy, MIT Press, 2012.

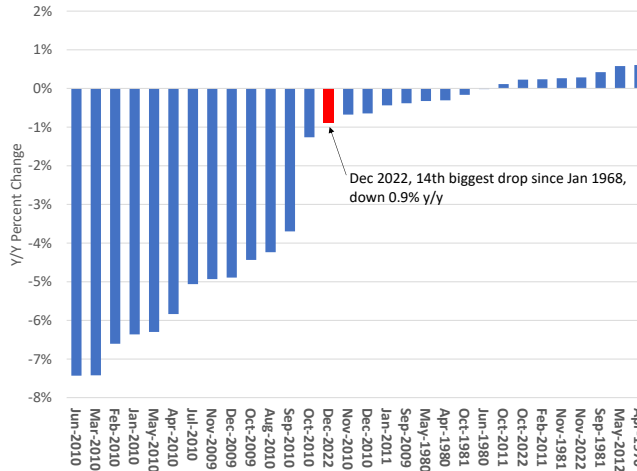


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The December data represents the first fall in DM4 since January 2011. More importantly, the monetary contraction now dwarfs the largest declines during the Volcker Fed’s tightening. For instance, the drop represents the 14th largest on record since 1968, whereas the largest fall after the Volcker policy shift on October 6, 1979 registered the 19th biggest historic decline (see Figure 2).

Figure 2. The Bottom 30 CFS Divisia M4 Growth Rate Months



Source: Center for Financial Stability.

The implication is that inflation and growth are slowing more dramatically than many expect.

Financial system flows highlight a consumer with more limited spending power. For instances, liquid deposit accounts, such as savings, are being rapidly reduced. These drawdowns are partially due to a redistribution from accounts with low interest rates relative to the Federal funds rate. Yet, flows into higher yielding time deposit and money market accounts fall far short of accounting for the drop in liquid deposits (see Figure 3).

In other words, swollen balances from fiscal largess and monetary ease have run their course.

Figure 3. Components of CFS Divisia M4 – Highlights for December 2022

Components in this table build from the narrowest aggregate at the top to the broadest at the bottom. For example, the darkest green in the left column includes components of DM1. The next tier shows the components included in DM2, but not within DM1.

|                                  | Weighted Contribution To DM4 Money Annual Growth Rate* | Divisia Growth-Rate Weights (Average of Last 12 Months) | Unweighted Year-Over-Year Percentage Growth Rate |
|----------------------------------|--|---|--|
| <b>DM1</b>                       |  |   |  |
| Currency                         | 0.3%   | 8.4%  | 3.7%   |
| Demand Deposits                  | 1.4%   | 19.3%   | 7.9%   |
| Other Liquid Deposits            | -4.8%  | 48.7%   | -8.8%  |
| <b>Added into DM2</b>            |  |   |  |
| Retail Money-Market Funds        | 0.2%   | 1.8%  | 19.4%  |
| Small-Denomination Time Deposits | 1.2%   | 0.5%  | 311.6%   |
| <b>Added into DM3</b>            |  |   |  |
| Institutional Money-Market Funds | -0.4%  | 5.7%  | -5.3%  |
| Large Time Deposits              | 1.0%   | 5.3%  | 19.0%  |
| Repurchase Agreements            | 0.3%   | 3.7%  | 11.1%  |
| <b>Added into DM4-</b>           |  |   |  |
| Commercial Paper                 | 0.1%   | 1.2%  | 17.6%  |
| <b>Added into DM4</b>            |  |   |  |
| T-Bills                          | -0.1%  | 5.5%  | -1.7%  |

Source: Center for Financial Stability.



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### The Fed and Investments

**Now, Fed communications and actions should continue to incorporate inflation vigilance. But, the Fed should pivot by shifting its analytic framework to more actively incorporating monetary quantities.**

**The key issue is that money metrics matter for investment strategies and monetary policy. Beware of falling money!**

*A message on markets, analytics and policy implications will follow next week.*

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