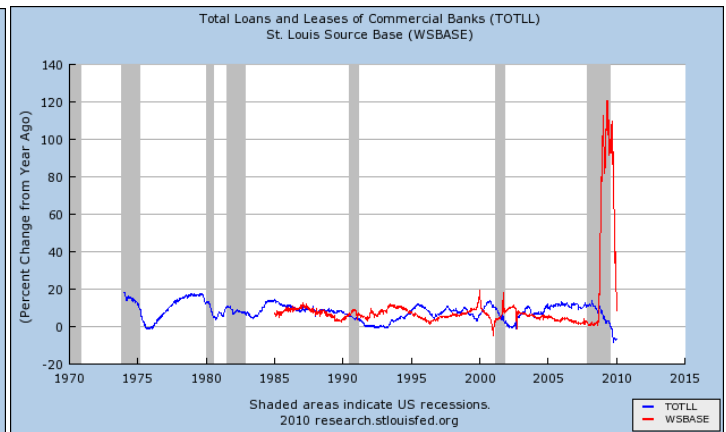
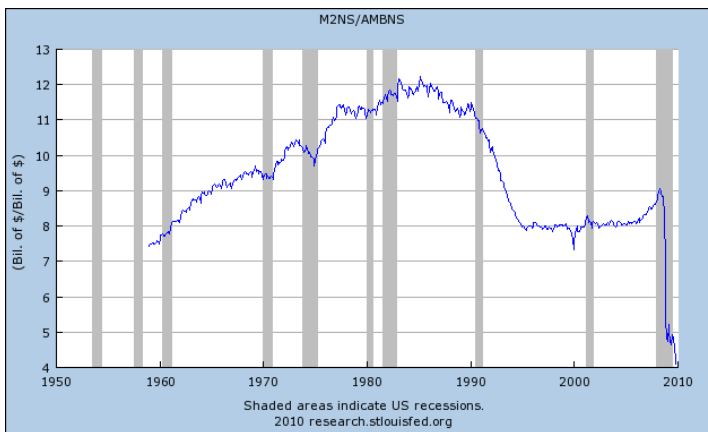


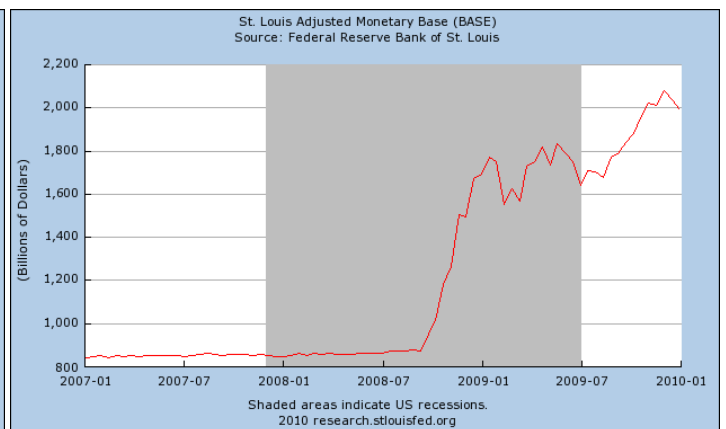
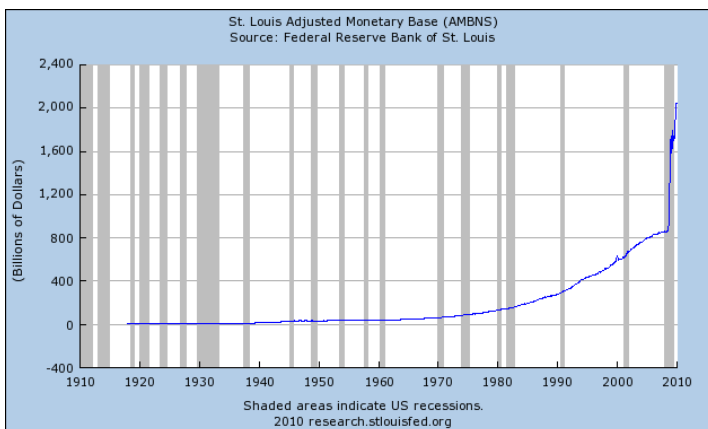
Anticipating Inflation via Money Velocity and Bank Credit

The charts below provide a look at the stratospheric rise in monetary base, money supply, excess reserves, but the two charts that I would like to focus your attention on are i) Money Velocity (derived by dividing the money supply by the monetary base) and ii) Loans & Leases in Bank Credit plotted against the Monetary Base (% of yoy change). In my opinion, these two graphs are key to anticipating inflation because once the money velocity increases (i.e. the average frequency with which money is spent) and the loans and leases in bank credit (i.e. the blue line in the second graph) both rise (*the second and fourth graphs also show that as monetary base has increased, it has not resulted in inflation because banks have held a higher amount of excess reserves, partly due to Federal Reserve paying interest on those reserves and partly due to corporate and consumers deleveraging, which means their appetite for borrowing has decreased; this case was also seen in Japan when banks, contrary to popular belief, were willing to lend but appetite was non-existent due to the deleveraging of non-financial firms and consumers*[1]), this will result in money being spent and credit being lent out, respectively, in the economy, thus giving rise to inflation.

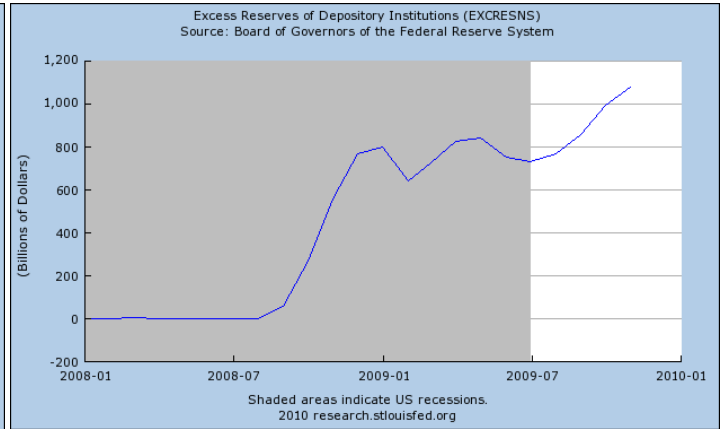
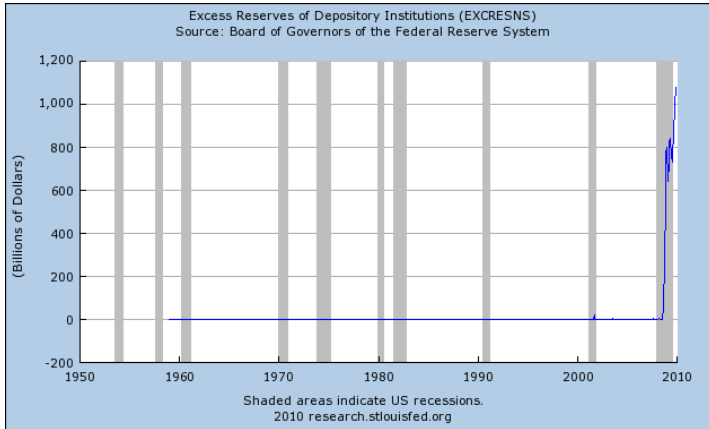
Money Velocity (1959 to YTD) and Total Loans & Leases of Commercial Banks (1974 to YTD)



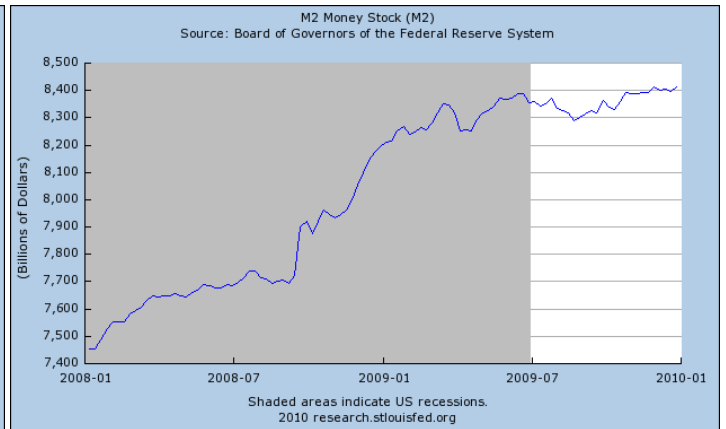
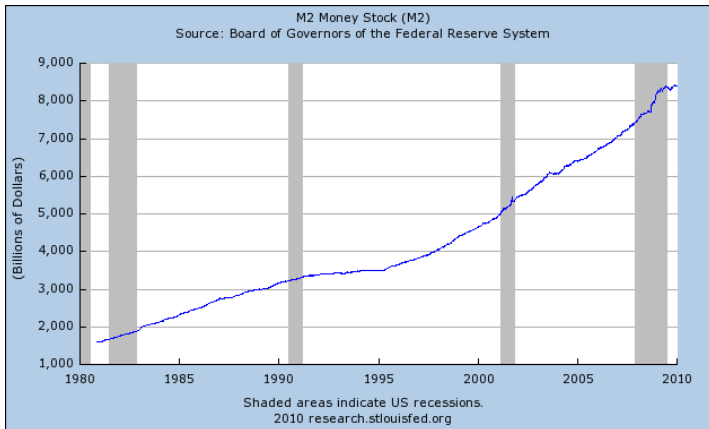
Monetary Base (1918 to YTD and 2008 to YTD)



Excess Reserves at Depository Institutions (1959 to YTD and 2008 to YTD)



Money Supply (1981 to YTD and 2008 to YTD)



By Yaser Anwar (January 12, 2010)

[1] – Koo, Richard. The Holy Grail of Macroeconomics: Lessons from Japan’s Great Recession. Singapore, Asia: Wiley, 2009 (page 46)