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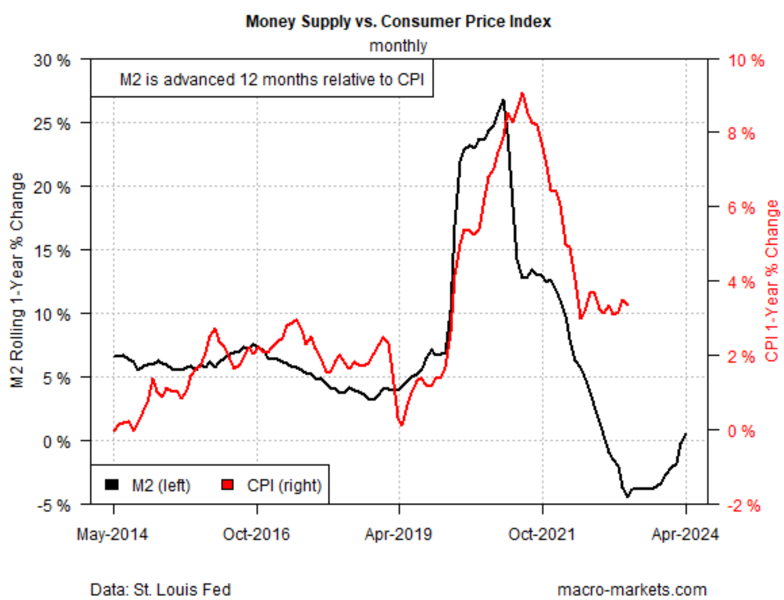
US Money Supply Trend Is Rising Again, But This Indicator Is Still Forecasting Disinflation

Key Points:

- *A broad measure of US money supply (M2) posted a modest year-over-year gain in April 2024, rising 0.5% vs. year year-earlier level – the first annual increase since November 2022.*

- *Monetary policy works with a lag and so the recent period of decreasing year-over-year changes in M2 money supply implies that US inflation will continue to ease in the months ahead.*

- *The return of M2 money supply to a positive trend profile in April suggests that the disinflation bias for US monetary policy is ending, which in turn anticipates that monetary policy's inflation-taming influence will start to fade.*



"Inflation is always and everywhere a monetary phenomenon," the economist Milton Friedman famously observed. The dismal science in recent years has revised its thinking on the details, but the basic premise remains persuasive, based on the empirical record. As shown in the chart at left, broad money supply (M2) tends to anticipate consumer inflation in year-over-year terms. Using this relationship generates an implied forecast that suggests disinflation in some degree will persist for the near term.

The wide gap between the current annual rate of CPI (3.3%) vs. M2 (0.5%) suggests that the spread will soon narrow. The question is whether it will close due to softer inflation or a revival in money supply growth. Even taking the conservative view and assuming a bit of both still leaves room for expecting more disinflation in the foreseeable future.

Advancing the 12-month changes in M2 to the year-ahead position implies that the current 3.3% rise in consumer prices will drop by more than a trivial degree. The risk for that outlook is that while money supply is a key factor in inflation, it's not the only factor. Nonetheless, history suggests that even a cautious assumption about money supply's influence on future pricing pressure strongly suggests that disinflation will persist.

The caveat is that money supply is no longer contracting in year-over-year terms. For the first time in 2-1/2 years, M2 is rising, albeit slightly. It remains to be seen if the return to money supply growth persists, which favors an inflationary bias. If it does, it will mark a significant change in the Federal Reserve's policy stance. In turn, the window for further disinflation may be starting to close.