EUROPEAN CENTRAL BANK

EUROSYSTEM

Christine LAGARDE
President

Mr Gunnar Beck
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 30 October 2020

L/CL/20/287

Re: Your letter (QZ-055)

Honourable Member of the European Parliament, dear Mr Beck,

Thank you for your letter on the growth rate of M1 in relation to real GDP, which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 28 September 2020.

The narrow monetary aggregate M1 is the most liquid monetary aggregate for the euro area and comprises overnight deposits and currency in circulation. Between the first quarter of 2000 and the second quarter of 2020, the ratio between M1 and real GDP increased from 22.6 to 101.2 in the euro area, from 8.6 to 30.1 in the United States and from 62.0 to 186.9 in Japan. Over the same period, the ratio between M1 and nominal GDP increased from 29.4 to 94.3 in the euro area, from 11.1 to 26.7 in the United States and from 54.1 to 179.3 in Japan. This was mainly due to monetary expansion, as economic growth was more subdued in all three economic areas, in part reflecting the lasting scars of the Global Financial Crisis that escalated in 2008, and in the case of the euro area the subsequent sovereign debt crisis as well, and most recently the deep contraction in economic activity due to the COVID-19 pandemic.

The divergence in the growth rates of real activity and M1, which emerges as a pervasive feature across advanced economies, is consistent with the secular decline in the general level of interest rates observed over this period. This decline has reflected structural factors in the economy which have suppressed the natural rate of interest – the unobservable rate that brings desired saving and investment into balance – and thereby pushed down the level of observed interest rates that are consistent with price stability. This decline

Address
European Central Bank
Sonnemannstrasse 20
60314 Frankfurt am Main
Germany

Postal address
European Central Bank
60640 Frankfurt am Main
Germany

Tel: +49-69-1344-0
Fax: +49-69-1344-7305
Website: www.ecb.europa.eu

in interest rates has in turn lowered the opportunity costs of holding liquid assets and thereby supported higher growth rates of M1.

The pandemic shock has had opposite effects on economic activity and money growth. Euro area activity has taken a serious hit: in the second quarter of 2020, euro area real GDP dropped by 11.8% quarter-on-quarter due to the pandemic. At the same time, the elevated uncertainty and abrupt stopping of corporate cash flows has pushed up firms' demand for liquidity and the propensity of households to save has reached unprecedented levels on account of precautionary motives and reduced spending opportunities. The annual growth rate of M1 was around 5 percentage points higher than before the COVID-19 outbreak. It has remained at elevated levels and stood at 13.2% in August 2020, down from 13.5% in July. The increase in money growth was also supported by monetary and fiscal policies, as well as the actions taken by regulatory and supervisory authorities, that have safeguarded the supply of liquidity in the extraordinary circumstances brought about by the pandemic.

The monetary policy measures that we have taken since early March are providing crucial support to underpin the recovery of the euro area economy and to safeguard medium-term price stability. In particular, they support liquidity and funding conditions in the economy, help to sustain the flow of credit to households and firms, and contribute to maintaining favourable financing conditions for all sectors and jurisdictions.

Yours sincerely,
[signed]
Christine Lagarde

Address
European Central Bank
Sonnemannstrasse 20
60314 Frankfurt am Main
Germany

Postal address
European Central Bank
60640 Frankfurt am Main
Germany

Tel. +49-69-1344-0
Fax: +49-69-1344-7305
Website: www.ecb.europa.eu