GRANT'S
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So many statistics: What do they mean?

The facing pages at the center of *Grant's* sketch the causes and consequences of credit creation (we borrow the images of sowing and reaping from Jean-Francois Millet).

To begin with, a pair of definitions: Credit is the promise to pay money, i.e., debt. Money is that contrivance which discharges debt.

Money is a very long story. From the founding of the Republic until 1971, gold and/or silver were money. Value was intrinsic in them. A dollar was defined as a certain number of grains of fine gold—25.8 grains under the Gold Standard Act of 1900. Paper dollars were exchangeable into gold and derived their value from gold.

The age of paper money dawned in 1971. To the post-1971 dollar, value is imparted, not intrinsic. It is imparted by the words that the Bureau of Engraving and Printing stamps on the face of each unit of green currency: "This note is legal tender for all debts, public and private."

The thoughtful reader pauses at the word "note." A note is a credit instrument, a promise to pay. Yet, under law, Federal Reserve notes are money. What is the nature of this promise? The truth is that it is no promise at all, but an artifact from the era of convertibility. Until 1933, $20.67 could be converted into, or redeemed for, one ounce of gold. The dollar was said to be anchored by gold. As there was only so much metal, there could only be so many dollars. The late John Exter, banker and monetary thinker, acidly described the modern-day Federal Reserve note as an "IOU nothing."

All of which is preface to the promised translation. We begin at the top of the left-hand column of figures describing the balance sheet of America's central bank.

The Federal Reserve is a bank—highly leveraged and government-dominated, but, still, a bank—and it produces a weekly balance sheet. Highlights of this document we present in our center section.

The Fed, unlike an ordinary bank, is constrained neither by its capital nor by deposits. Leveraged more than 50:1, it acquires Treasury securities and federally insured mortgage-backed securities with newly created dollars. Literally, the Fed materializes those dollars, which constitute most of its liabilities; Treasurys and mortgage-backed securities make up the bulk of its assets. Highlights from the Federal Reserve's balance sheet are shown on the upper left-hand corner of page 6.

Foreign central banks, too, get into the money-materializing act. Every issue of Grant's features a miniature balance sheet of one of the Fed's principal foreign counterparts. Taken together

these institutions own even more U.S. government securities and MBS than the Fed itself. Some $3.3 trillion of this foreign-owned hoard sits in custody at the Federal Reserve Bank of New York.

Since early 2008, central banks have created unprecedented volumes of paper money. What effects this outpouring has had on the alignment of interest rates ("movement of the yield curve", page 6), on the level of commodity prices, on money-supply growth and financing activity are reflected in the line items on page 7.

Devotees of the quantity school of money would have expected a rather bigger bang for the trillions of post-2008 bucks than the effects documented in these pages. But though the central banks may propose, they do not dispose. At the close of 2012, more than $1.4 trillion in idle reserve balances lay fallow on the Fed's balance sheet. Banks could, if they chose, mobilize those dollars in the work of creating new credit. But, in the wake of the crisis, would-be borrowers are not so keen to run up their debts, and bankers, beset by new rules and capital requirements, are not so eager to lend. Data describing the recent deceleration in the rate of turnover, or velocity, of money appear at the lower right on page 7.

"Inflation," according to the monetary adage, "is too much money chasing too few goods." But trillions of idle dollars may be too fearful to give chase. Besides, inflation is not so cut-and-dried as the adage suggests. Between Jan. 2002 and April 2006, house prices (as measured by the Case Shiller 20 City Composite Index) climbed by 70.3%, while over the same span of years, the CPI was up just 12.9%. So there was not much inflation—or was there?

We revise the monetary adage thus: "Inflation is too much money or credit. What the redundant increment of dollars may choose to chase varies from cycle to cycle. It may be goods and services, or it may be stocks and bonds and commodities. It all depends."

While some of the line items in the centerfold presentation are self-explanatory, others may not be. For some of these others, explanations follow:

Federal Reserve Bank credit– the sum of the Fed's earning assets: securities held outright, loans, special crisis facilities such as Maiden Lane, currency swaps with other foreign central banks and other assets at the Federal Reserve. Fed credit, in accounting jargon, is the "source" of the monetary base, which is defined as the sum as currency and bank reserves.

Primary dealer repurchase agreements – the Federal Reserve uses repurchase agreements to make collateralized loans to primary dealers in order temporarily to add reserves to the banking system. Most repurchase agreements are overnight, although the Fed can conduct operations as long as 65 days. So doing, the central bank can affect the amount and cost of liquidity at its charges, the commercial banks, without altering the size of its own balance sheet.

Asset-backed commercial paper –the sum of promissory notes with maturities of 270 days or less and collateralized by other financial assets, such as trade receivables or consumer loans; a measure of non-bank credit growth.

M1 –a broad tally of funds that are readily accessible for spending. M1 includes currency, traveler's checks, demand deposits and other checkable deposits such as negotiable order of withdrawal accounts.

M2 –a broader measure of funds held primarily by households. In addition to including the components of M1, M2 also includes savings deposits, small-denomination time deposits (accounts with less than $100,000) and retail money market mutual funds.

MZM –a measure of all of the components of M2 less small-denomination time deposits, but with the addition of institutional money funds.

FTSE Xinhua A 600 Banks Index –a sub-index of the bank stocks that are in the FTSE China A 600 Index, i.e., the 600 largest companies by market capitalization on the Shanghai Exchange. Something to watch for any concerned about China's financial system.

CUSIP requests—a measure of the vibrancy of the financial markets. A CUSIP is a nine-character alphanumeric code that is used to identify financial securities—bonds, asset-backed securities, equities—for clearing and settlement. The rise or fall in CUSIP requests is a sign of the supply of, and demand for, new securities.

ECRI Future Inflation Gauge—an index that attempts to look forward at peaks and troughs in overall inflation. The index is created by the Economic Cycle Research Institute.

Rogers International Commodity Index – an index of commodities consumed in the global economy, ranging from agricultural to energy to metal products. The index measures the price action of raw materials worldwide.