

Rapid Growth Of The Money Supply Has Fostered Inflation - Economic Overview

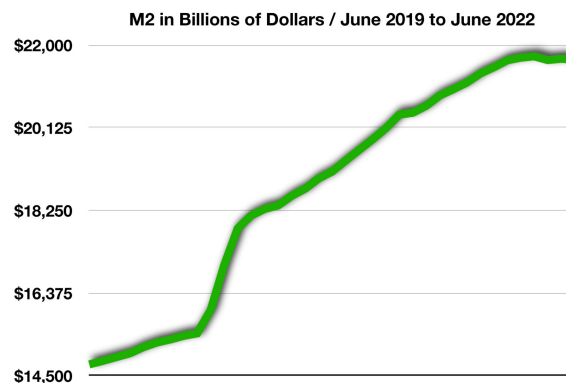
Since the start of the COVID-19 Pandemic, the U.S. money supply has grown at an above-average rate. M2, which measures the supply of U.S currency in circulation, is important to analyze why there has been a jump in the money supply. Economists view an increase in the money supply as an indication of rising inflation and conversely an indicator of deflation when M2 decreases.

M2 includes M1, which is currency held by the public, checkable deposits, and travelers' checks, plus savings deposits and shares in money market mutual funds.

M2 has risen by \$6.3 trillion since the start of 2020 of which \$4.8 trillion has come directly from the Federal Reserve and a net \$1.5 trillion has come from banks. M2 has increased an astounding 41% in only 2½ years, meaning an average annual growth rate of 16.3%. In fact, in 2020-2021, the growth rate of U.S. currency jumped a historical 26%, which is the largest jump in the money supply since 1943. To put that into perspective, M2 grew, on average, around 5% between 2010 and 2019.

Since this historic jump, the M2 growth rate has been severely constrained, with a swift 20% drop in growth. From its 2020-2021 peak of around 26%, it has fallen to 6% as of April 2022. In its strategy to raise rates and begin quantitative tightening, the Fed has, in the three months before June, allowed M2 growth to plunge to an anemic annualized growth rate of 0.1%. When broad money supply growth falls, then spending contracts which historically has led to recessionary environments.

Sources: Federal Reserve Bank of St. Louis; Board of Governors of the Federal Reserve System (US); M2 [M2SL] Federal Reserve Bank of St. Louis: <https://fred.stlouisfed.org/series/M2SL>, July 28, 2022.



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