

Presentation to the Shadow MPC Meeting

Tuesday, 14 April 2026

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International Monetary Monitor

“Monetary policy is not about interest rates. It is about the rate of growth of the quantity of money.” Milton Friedman, interviewed on NBC’s Meet the Press, October 24, 1976.

Outline



- **How resilient to inflation can key economies be in the face of large energy price increases?**

- Consensus view versus monetary view (and the transmission mechanism)
- Experience of the 1st and 2nd oil crises: US, UK & Japan
- Does “inflation resilience” follow from low import dependency or from other conditions?

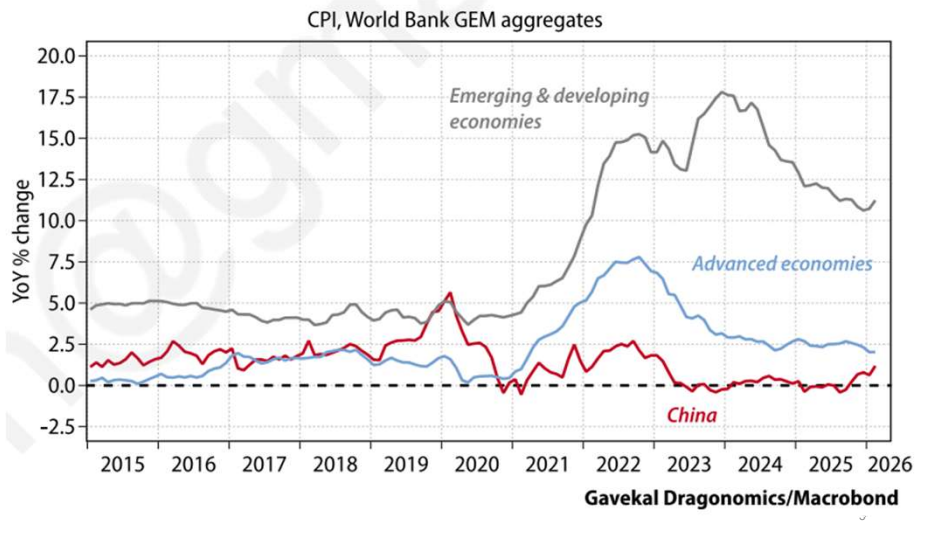
- **Applying $MV=PY$ to 16 economies**

- Recent monetary trends and their implications for spending around the world

- **Recent Performance of the UK economy**

- Monetary overhang; PCE & Retail Sales; Confidence; Wage Growth; Labour market; Inflation expectations; Real & Nominal GDP.

“Inflation in much of the world has shifted higher.” Will the US & Israeli war on Iran keep inflation high?



PART 1.

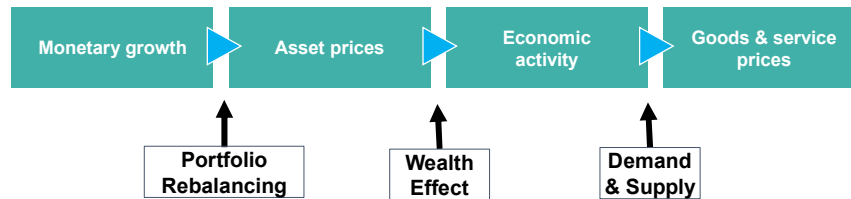
A typical current, consensus view of inflation is that it has “shifted higher” (as in the quotation shown in the chart above). For those who take this view, the squeeze on deliveries of oil and petroleum products such as refined oil, LNG gas, fertiliser and helium from the Persian Gulf can only mean yet higher prices.

In the advanced economies inflation has slowed from its Covid highs but in several major economies has not yet returned to the 2% p.a. norm of pre-Covid years and has become stuck at around 3%. In emerging and developing economies the story is similar, but both the Covid period and the on-going inflation rates were and are substantially higher than in developed economies.

China stands out as an exception because it suffered almost zero inflation during and after the Covid pandemic – presumably, in the consensus view, because the economy continues to produce a surplus of manufactured goods which act as a depressant on China’s domestic price level.

But is this interpretation of recent developments correct, or even plausible?

Understanding the Transmission Mechanism: Money Drives the Business Cycle



- *“Monetary policy is not about interest rates; it is about the rate of growth of the quantity of money.” (Milton Friedman, 1976)*
- This also means that most of the transmission of faster or slower money growth is mainly through **asset prices** (wealth effect), not interest rates.
- There is no upside limit to asset prices, but there is an upside limit to economic activity, so any excess money, after financing the production and distribution of goods and services, goes into goods & service prices (inflation).

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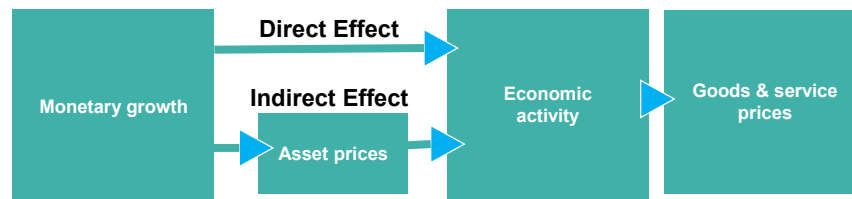
The monetarist view is that broad money is the primary driver of the business cycle. Occasionally there can be natural events, such as natural catastrophes, which can derail the business cycle. But, on the whole, those are rare. More normally it is monetary growth rather than anything else (e.g. fiscal spending) which drives the business cycle.

All of the features of the economic cycle are in some sense driven by broad money growth. If there is a **substantial and sustained** change in the rate of monetary growth, the first impact is on asset prices - everything from the bond markets to equity markets, to property prices and commodity prices. The next impact is typically on economic activity. Only after that, do we see an impact on goods and service prices, that is, on consumer price inflation.

The transition from monetary growth to asset prices is known as portfolio rebalancing, and the transition from asset price changes to economic activity is known as the wealth effect.

While rapid money growth can push up asset prices indefinitely, the level of economic activity is inherently limited by the size, productivity and employment level of the population. Therefore any excess money will eventually show up in goods and service prices after economic activity has reached its full potential.

Refining the Transmission Mechanism: Money Drives the Business Cycle



Broad Money is held by three groups: Households, Corporate Entities, and Non-bank Financial Intermediaries..

The **Direct Effect** occurs when new money created by the banking system (including the central bank) is transferred **directly** into the hands of Households or Corporate Entities and spent on consumption or investment goods and services.

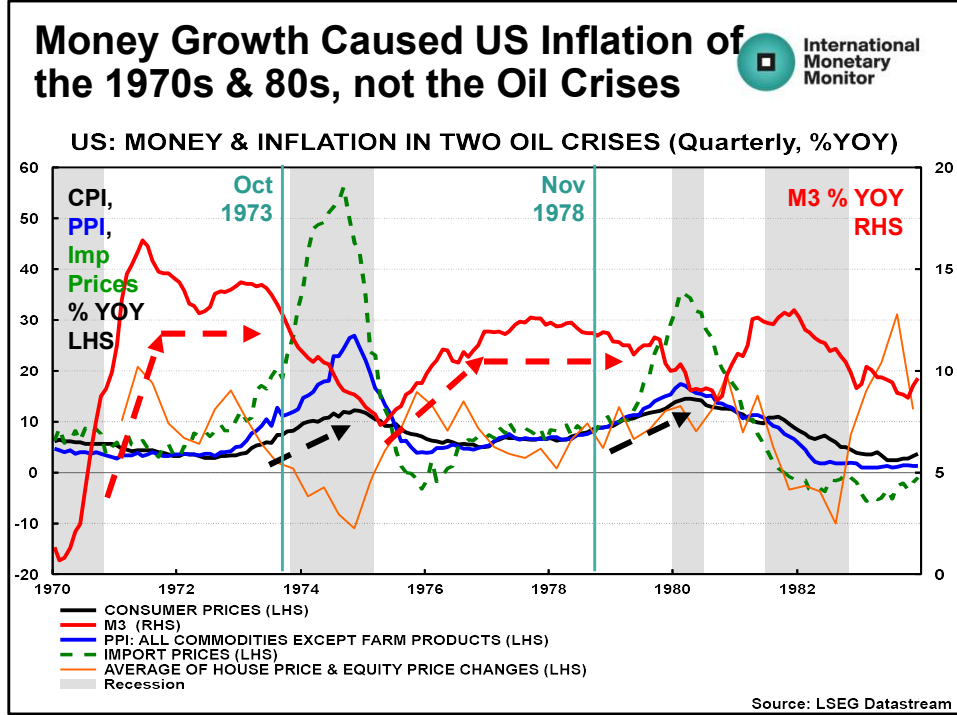
The **Indirect Effect** occurs when new money created by the banking system (including the central bank) is acquired by Households, Corporate Entities, or Non-bank Financial Intermediaries and used initially to purchase assets such as equities, bonds, property, or commodities, and only later to buy goods and services.

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In his latest book, “Money and Inflation at the Time of Covid” (2025), Tim Congdon has refined the transmission process slightly, using concepts from Keynes and Wicksell. Changes in broad money growth, he argues, are transmitted to the economy **directly** or **indirectly**.

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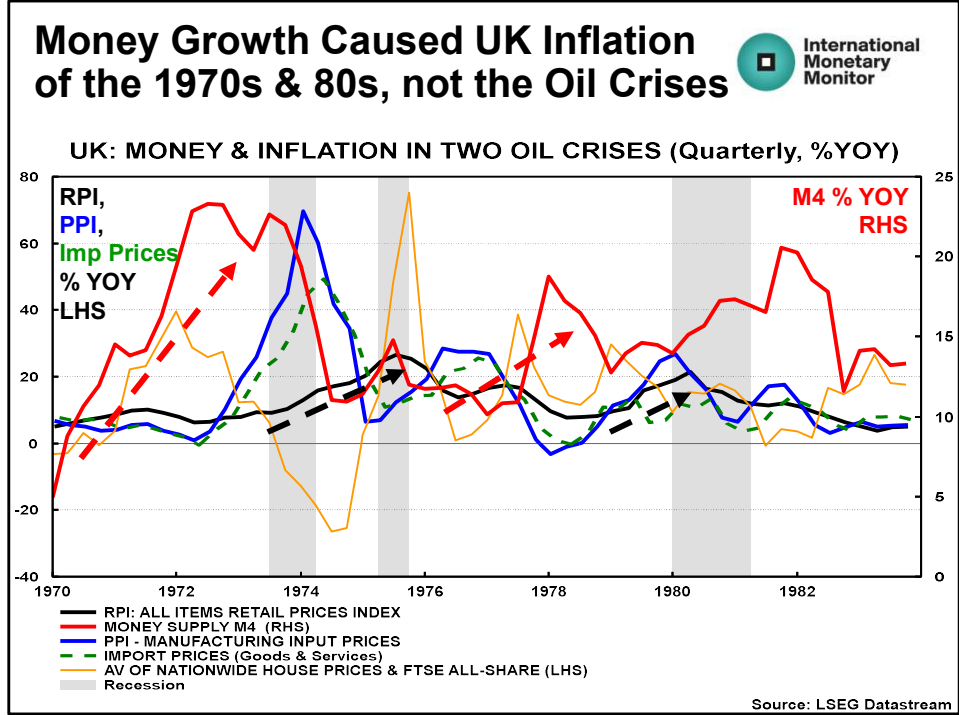


It is often said that the inflation of the 1970s and 1980s in the US and elsewhere was caused by the two oil crises of 1973-74 and 1979-80. As the chart above demonstrates, this is a false explanation.

In each case, the inflations of 1973-75 and 1979-81 were generated by surges in broad money (M3) growth in the three or four years preceding the outbreak of each inflationary episode. In the first case, there was sustained double-digit growth of M3 between July 1971 and June 1973, averaging 14.1% p.a. Similarly, between January 1976 and December 1978 M3 growth averaged 11.7% p.a., leading directly to the surge of inflation in 1979-81.

The broad connection between the surges in broad money (M3) growth and the surges of inflation are indicated by the dashed red and black arrows.

It is interesting to note that asset prices, shown by the pale gold line and compiled as a simple average of house price changes and stock price changes also conform to the flow chart model shown on the two preceding pages.

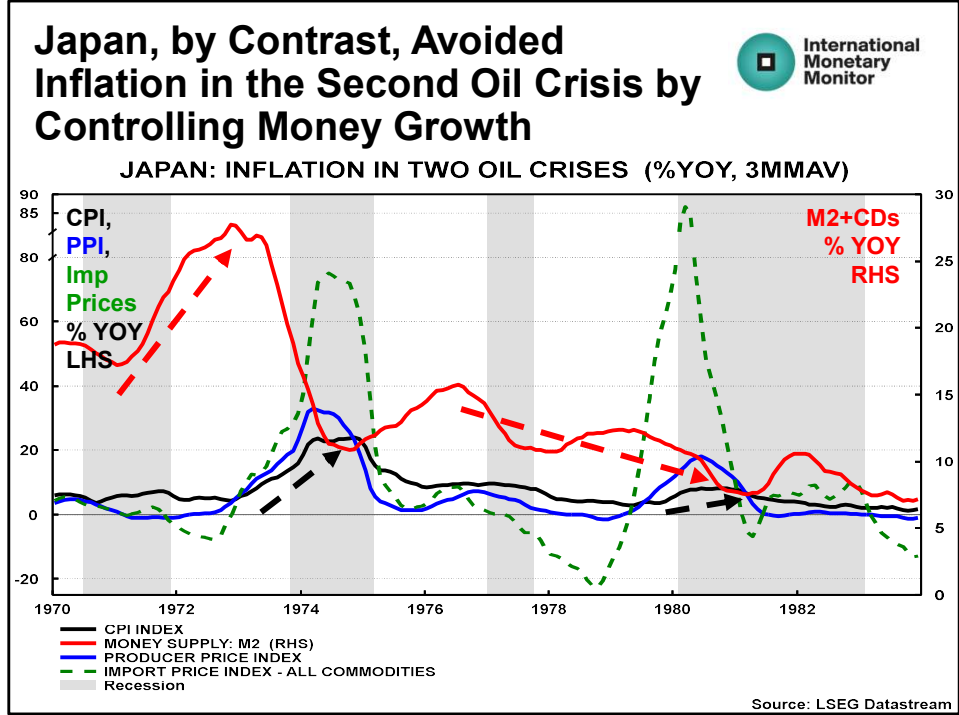


In the UK, as in the US, the fundamental source of the inflation in the 1970s and 1980s was excess broad money growth, not the oil price hikes of 1973-74 and 1979-80.

As the chart above shows, there was a huge surge of M4 money growth in 1971-73 associated with the “Heath-Barber Boom” (named after Edward Heath, Prime Minister, and Anthony Barber, Chancellor of the Exchequer at the time), and the launch of “Competition and Credit Control” (Sept. 1971). M4 grew at an average of 19.5% p.a. over the three years 1971-73. Not surprisingly, there was a huge boom in asset prices (shown by the pale gold line which is compiled from a simple average of Nationwide house prices and the FTSE All-Share Index). Consequently, when OPEC raised oil prices from October 1973, the price hikes were readily absorbed by the ample purchasing power available to businesses and households.

It was a similar story in the second oil crisis of 1979-80, although this time the M4 growth rate was not as extreme as it had been in the build-up to the first oil crisis. Over the four years 1977-1980, M4 averaged 14.5% p.a. – still far above what the UK economy requires for stable prices. Once again asset prices and RPI inflation surged and OPEC took advantage of buoyant demand in the world economy to raise prices further.

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Japan’s experience in the two oil crises was very different, demonstrating clearly the relationship between money growth and inflation. Whereas in the US and UK there was a failure to control money growth ahead of both oil crises, in the case of Japan the authorities learned from their experience in the first episode. In August 1971 President Nixon had announced the closing of the “gold window”, thereby initiating an abrupt appreciation of numerous foreign currencies including the Japanese yen against the US\$. Fearing this would seriously damage their export-led economy, the Japanese authorities embarked on an easy money policy, lowering interest rates and allowing money growth to accelerate to over 25% p.a. in 1972-73. The surge in money growth laid the ground for a big rise in asset prices, economic growth and inflation. The CPI jumped to 23% year-on-year in 1973 (see black dashed arrow).

After the crisis the Bank of Japan announced a plan to control M2 growth from July 1974. The chart shows how the growth rate of M2 gradually declined over the following decade. Consequently, when the second oil crisis occurred, although import and producer prices rose steeply, the overall CPI increased only mildly, peaking at 8.0% in September 1980, a rate judged modest in that era. In other words, while *relative prices* increased again, *overall inflation* remained moderate. There can be few more striking demonstrations of the effectiveness of monetary policy controlling inflation.

Conclusion on Resilience to Energy Price Increases



- The oil crises of 1973-74 and 1979-80 were accompanied by substantial and sustained surges of inflation – but only in those countries that allowed a prior, sustained rapid growth of broad money, thereby laying the groundwork for inflation.
- Japan, which changed its money growth policy after the first oil crisis (from July 1974), avoided high inflation in 1979-80. Even though the *relative* prices of imported oil etc increased sharply, *overall* prices rose only modestly.
- **Avoidance of inflation due to higher imported oil and gas prices, therefore, does *not* depend upon a country's degree of dependence on imported energy. It depends on the prior rate of broad monetary growth.**
- Following the Russian invasion of Ukraine in February 2022, the Governor of the Bank of England, Andrew Bailey, claimed that UK inflation was 80% due to the imported shocks from world energy markets which the Bank could not control.
- **He failed to mention, however, that between January 2020 and mid-2022 the BOE had presided over a 28% increase in broad money (M4x) growth. This was the true source of the Covid inflation.**

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Broad money predicts Nom GDP; MV=PY Primer



- **M** is best taken to be broad money.
- **PY** is the price level times output (= nominal GDP), which typically lags changes in money growth by 6-18 months.
- **V** is the ratio of nominal spending on final goods and services to broad money, or the inverse of the amount of money people want to hold in relation to their income. Generally, it has a stable downward trend, and the **change in velocity** is mean-reverting.
- With reasonably stable velocity (**V**), broad money (**M**) should be a good predictor of nominal GDP (**PY**).
- Under normal conditions, the downward slope of **V** means that money growth will exceed nominal GDP (**PY**) growth by a small margin (typically 1-2% p.a. for DMs; 2-3% p.a. for EMs).
- Discrepancies between changes in **M** and **PY** can occur due to financial or real shocks affecting aggregate output or income (e.g. credit crises or pandemics). Otherwise, **PY** will always adjust to changes in **M**, given the level or trend of **V**.

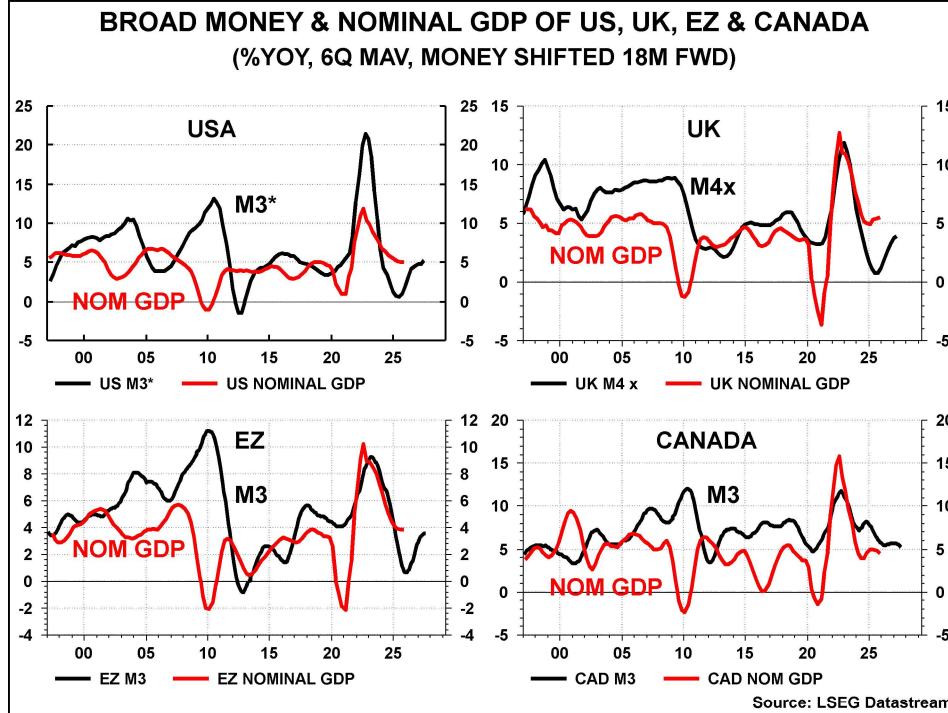
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In Part 2 of this presentation I propose to show the relation between broad money growth and aggregate spending (as measured by the growth of nominal GDP, or GDP in current prices) in 16 different economies.

The rationale for this approach is to be found in the quantity theory of money, $MV=PY$. The bare bones of the theory are set out in the slide above.

In all 16 charts I have used the broadest measure of money that was readily available for each economy. Money is measured as a moving 6-quarter (or 18-month) average of the year-on-year rate of change. I do this to try to proximate the 12-18 month lag between a change in money growth and its impact on nominal spending (nominal GDP). In addition, the series for broad money is shifted forwards by 18 months to make the peaks and troughs of the money and nominal GDP series appear more coincident. Nominal GDP is also measured as a moving 6-quarter average of the year-on-year rate of change.

With some exceptions, the two series move together, but money growth generally exceeds nominal GDP growth by the amount of the trend of income velocity. With the rate of growth of V falling (or negative), changes in M must exceed changes in PY .



In the US, following the egregious growth of broad money (M3*) during the Covid crisis and its subsequent steep fall, money growth (on our smoothed measure) has returned to a rate close to 5%. This suggests that nominal GDP growth, currently also 5%, will gradually slow to a rate slightly less than this – perhaps 3.5-4.0%.

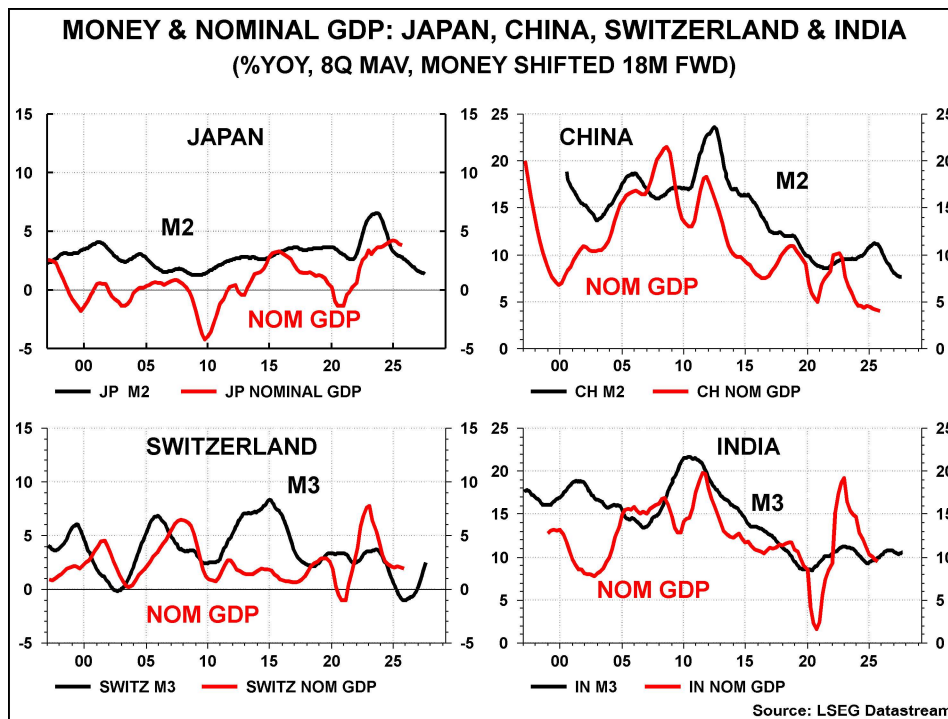
In the UK, M4x has slowed to 3.9% on our smoothed measure, implying that nominal GDP should slow from its current 5.5% to end up lower than money growth.

In the Eurozone, M3 growth surged during Covid, slowed sharply between 2022 and 2023, but has recovered to 3.6% on our smoothed measure. Meanwhile, nominal GDP has already slowed to 3.9%.

Canada, having experienced a sharp acceleration of M3 during Covid, has seen a gradual slowdown to 5.1%. Nominal GDP has followed a similar path, showing 4.5% growth in 2025 Q4 (again on our smoothed measure).

None of these economies are in the position that the US, UK or Japan were in ahead of the First Oil Crisis. In all 4 cases money growth has been moderate over the past 18 months, so we can predict that inflation will stay low.

M3 includes currency & checking accounts, time and savings deposits, plus Money Market Mutual Funds (Flow of Funds data, quarterly).* GL04



The four economies in this graphic have been selected as economies where the central bank did **not** engineer a huge monetary expansion during Covid. In each case, broad money growth (shown by the black lines) remained fairly stable. Nominal GDP fell abruptly during the pandemic as each economy was shut down, and then recovered strongly thereafter. In each economy, nominal GDP is now stabilizing.

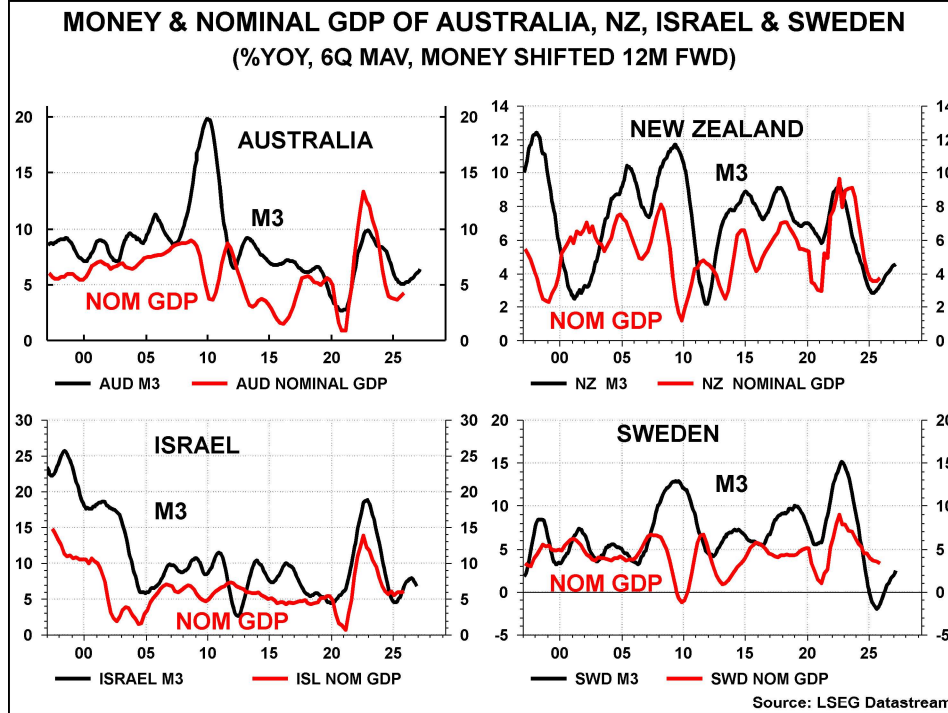
In Japan, the uptick in M2 came only after the BOJ embarked on a scheme to lend money to commercial banks provided they on-lent the funds to corporate borrowers. M2 growth accelerated from 3.1% in January 2022 to 6.5% by September 2023 (on our smoothed measure), pushing inflation up to just 4%. But M2 growth has now slowed to 1.4% over the past 18 months, suggesting that Japan will ultimately return to its pre-Covid, low inflation, low interest rate equilibrium.

China, which requires a faster broad money (M2) growth due to its faster real GDP growth rate, has experienced decelerating money growth for almost two years (on our smoothed measure). Not surprisingly, nominal GDP growth is also slowing. In my view, China is likely to experience further deflation ahead.

In Switzerland, M3 growth was very stable during Covid, and declined last year. The risk of inflation in China from the oil price spike must be regarded as negligible.

Finally, **India** has maintained very steady M3 growth, so although nominal GDP slumped due to the lockdowns and then spiked upward, it is now stabilizing.

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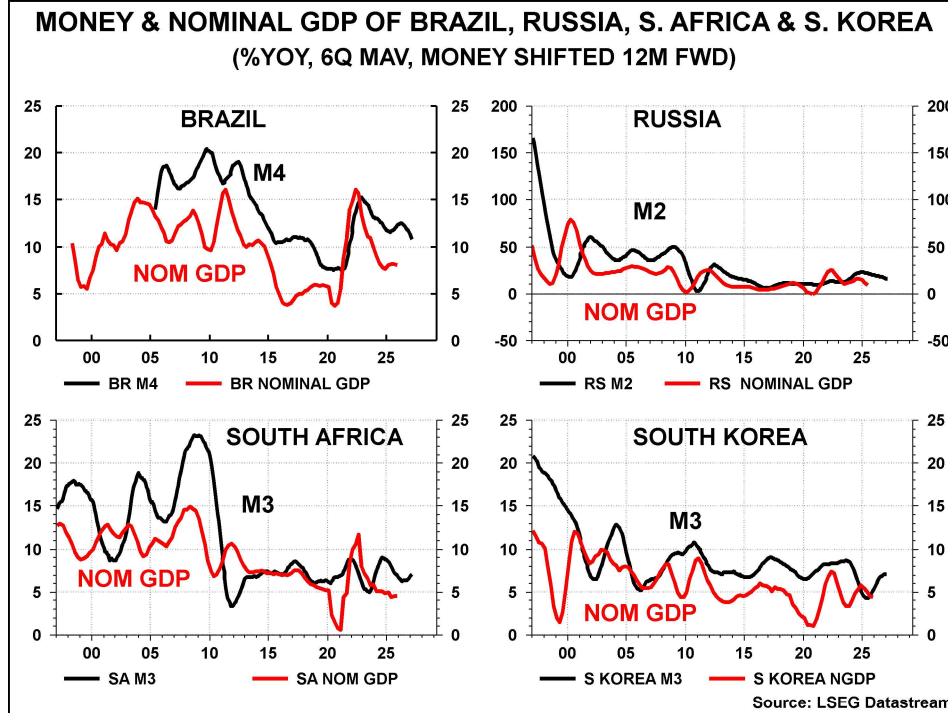


The four economies shown in the selection of charts above all responded to the onset of the Covid pandemic in much the same way as the US and UK central banks had done – by engaging in large-scale asset purchases. The result in all four cases was a surge in broad money growth, followed by a strong upswing in nominal GDP once the lockdown restrictions were lifted.

Inflation in each economy rose steeply in 2021-22, peaking at 7.9% year-on-year in 2022 Q4 in Australia, at 7.3% in 2022 Q2 in New Zealand, at 5.5% in January 2023 in Israel (up from a negative 1.7% in early 2020), and at 12.3% in Sweden in December 2022.

In all four cases broad money growth has subsequently slowed sharply and then recovered to a modest, single-digit growth rate. Thanks to recent moderate growth in broad money, none of the four economies can be regarded as vulnerable to an energy-price-led surge in inflation.

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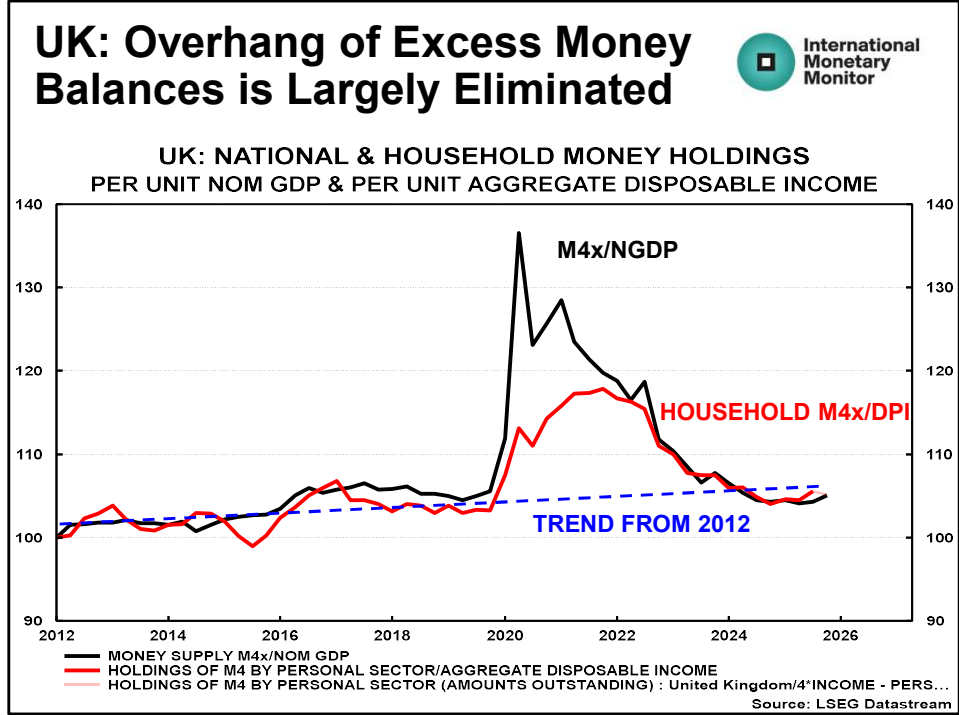
The four economies selected in the chart above have had widely differing inflation experiences since the start of the Covid pandemic.

In **Brazil** the central bank allowed broad money M4 to accelerate from 7.4% in January 2020 to 18.2% year-on-year in February 2021, and then maintained it at a high rate, which generated a peak CPI inflation rate of 12.1% by April 2022.

In **Russia**, M2 growth picked up briefly in 2020 from around 10% to 16%, but when the invasion of Ukraine began in February 2022 M4 accelerated to over 25% yoy in January and February 2023. Inflation rose steadily in 2020-21, but then spiked from 9.2% in February 2022 to 17.9% in April 2022. This was a case where the war in Ukraine really did cause a surge of inflation.

South Africa is a remarkable case of monetary restraint by the central bank. Although the Reserve Bank made liquidity available to commercial banks in the early stages of the pandemic, by the end of 2020 all the excess liquidity had been withdrawn. As a result, there was a brief upswing of M3 to 11.0% yoy by June 2020, followed by a downswing to 1% by June 2021. CPI inflation briefly increased to 7.8% in July 2022, but had fallen below 3% by October 2024.

South Korea saw only a very modest acceleration of M3 in 2020-21 (from 8% to 12%) and consequently inflation was similarly restrained, peaking at 6.3% in July 2022. All economies have reverted to more modest rates of broad money growth in 2025-26.



Part 3.

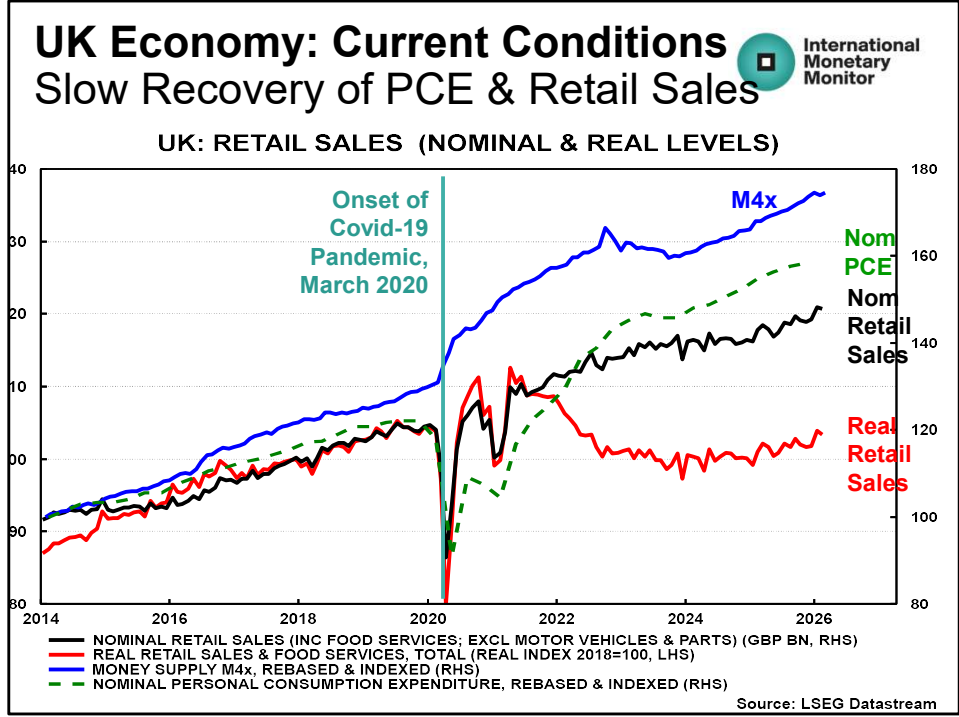
In this final part of the presentation I propose to review a few economic indicators relevant to the UK economy and its outlook.

The purpose here is not so much to determine the correct decision for the Shadow MPC (which should be based on monetary considerations), but to review the economic indicators to see whether they conform to what one might expect from the monetary background discussed in Part 2.

This first chart considers whether there is any remaining overhang of excess liquidity resulting for the Bank of England’s decision to “Go Big” in 2020 and inject an excess of M4x into the banking system. This is measured using total M4x compared with nominal GDP (in black), and household holdings of M4x compared with aggregate disposable personal income (in red). The same chart appeared in the BOE’s Monetary Policy Report, May 2025, Box D, Chart B.

<https://www.bankofengland.co.uk/monetary-policy-report/2025/may-2025>

The conclusion is that, based on the trend of the two ratios before 2020, any excess has now been largely used up in nominal spending, and therefore broad money growth, which is currently growing at about 4% p.a., is roughly in line with the longer term needs of the economy and the inflation target. This in turn implies no need to either raise or lower Bank Rate. Just keep money growth steady!

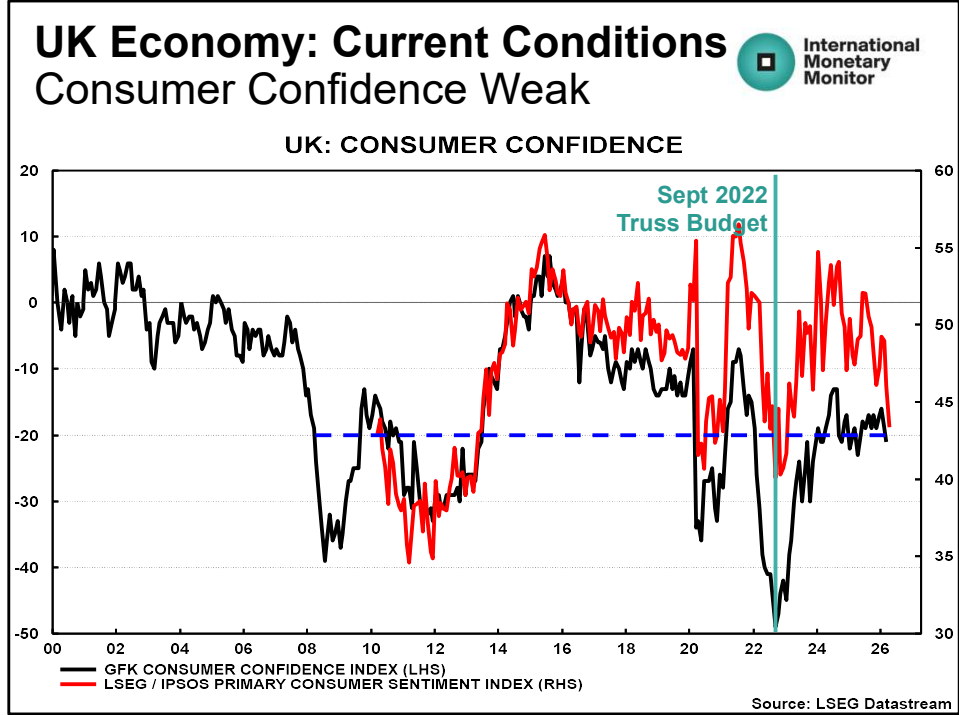


Except for the steep downturn in Personal Consumption Expenditures (PCE) due to the outbreak of the Covid pandemic in early 2020 and again in 2021, the level of M4x is normally a reasonably good guide to the level of nominal PCE.

Just as in the relation between broad money and nominal GDP there is a gradual divergence due to the small, annual positive growth of money balances (the inverse of income velocity), so there is a gradual divergence between M4x and nominal PCE. The current readings of these two variables do not suggest any need for an adjustment of M4x or any unexpected behaviour of nominal PCE. This reinforces our previous contention that the MPC should leave the monetary levers unchanged.

Nominal and real retail sales (in black and red respectively) had been growing at very similar rates before the pandemic. However, since late-2021 and 2022 real retail sales first plunged, and then stabilised before starting on a tentative recovery since early 2025. The divergence of these nominal and real measures of retail sales suggests that the deflator applied in 2021-22 was too large, probably because it includes services that are not included in the data for nominal retail sales.

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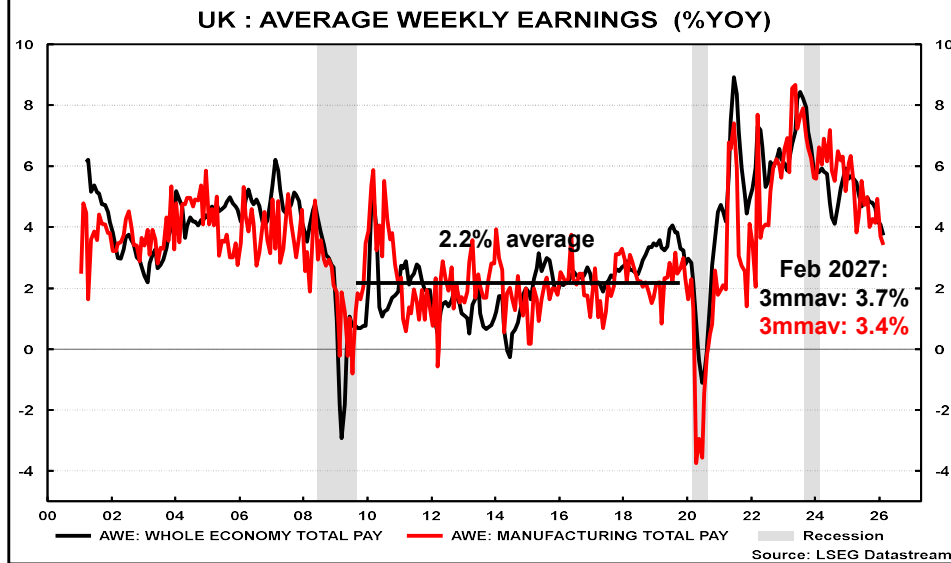


Like the US consumer, the UK consumer is exhibiting very low confidence in the current economic environment. While the current low measured levels, as indicated by the GFK Consumer Confidence Index (in black) and the Ipsos measure of Consumer Sentiment (in red), are not as low as during the GFC (2008-09), the post-GFC euro debt crisis (2011-12), or the onset of the pandemic (2020) and the Truss budget (September 2022), they are at significant lows (blue dashed line).

From a monetary policy standpoint, these indicators suggest that lagged inflation has continued to erode consumers’ nominal income. However, the correct monetary response in this type of situation is not to simply pump more stimulus into the system, but to wait until the inflation due to past excess money growth in 2020-22 (p. 15, the chart entitled UK: Overhang of Excess Money...) has fully worked its way out of the system, and then continue with the appropriate money growth rate, not to lower rates regardless.

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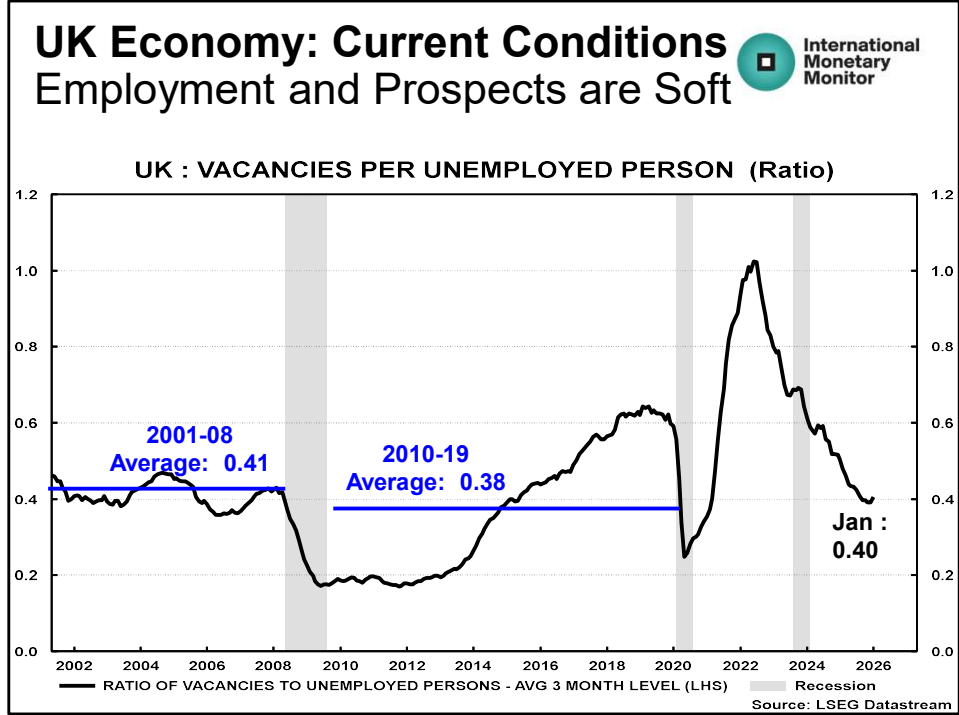
UK Economy: Current Conditions Wage Growth Slowing



Nominal wage growth for the whole economy (in black) is slowing gradually, and should slow further during 2026, bringing it back into line with the pre-Covid average of 2.2% p.a. Viewed from a monetary analysis standpoint, wages are a lagging indicator and the current slowdown simply reflects the end of a period of wage catch-up (following the Covid inflation) to a lower rate of growth. For 2026 and beyond this would imply a very small increase in real terms but given the anaemic growth in overall UK productivity and the Bank of England’s inflation goal of 2%, it would not be unreasonable to allow the current gradual slowdown to continue.

From the standpoint of the Bank of England’s aggregate demand-aggregate supply framework, MPC members will be more inclined to view wage growth as some kind of driver of the overall inflation rate and will be anxious to ensure that wage growth remains subdued. Until recently they had been concerned about the risks of a so-called “second round effect” from wage increases, but in my view the low rate of M4x growth precludes any surge of wage growth.

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More generally, the UK labour market is relatively loose, with more unemployed workers now looking for jobs than openings for them to fill. As the chart shows, the ratio of vacancies to the number of people unemployed has returned roughly to the averages seen during the pre- and post-GFC periods. However, there are underlying problems.

A key message of Milton Friedman’s famous presidential address to the American Economic Association in December 1969 was that the “natural” level of unemployment (or employment) was not something that could be affected - in the long run - by monetary policy. The “natural” level of unemployment is fundamentally determined by **real or institutional** factors such as the availability of job information, the level of skills and education, the degree of labour mobility, and the flexibility of the labour market. It would therefore be a mistake in monetary policy to try to engineer a higher level of employment or lower unemployment. Current data as shown in the chart might suggest – superficially – that the level of unemployment has returned to roughly at its normal level, but this is far from the full story. According to the Mayfield Report, there are some 2.8 million people out of work due to long-term sickness, amounting to one in five working-age adults. But these are not problems that can be solved by monetary policy. UK16A

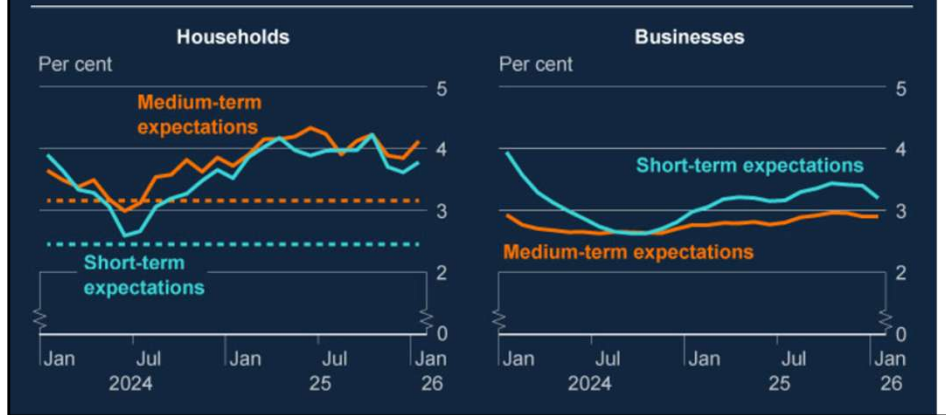
UK Economy: Current Conditions

BOE View of Inflation Expectations



Chart 1.8: Households' and firms' inflation expectations have eased a little but remain elevated

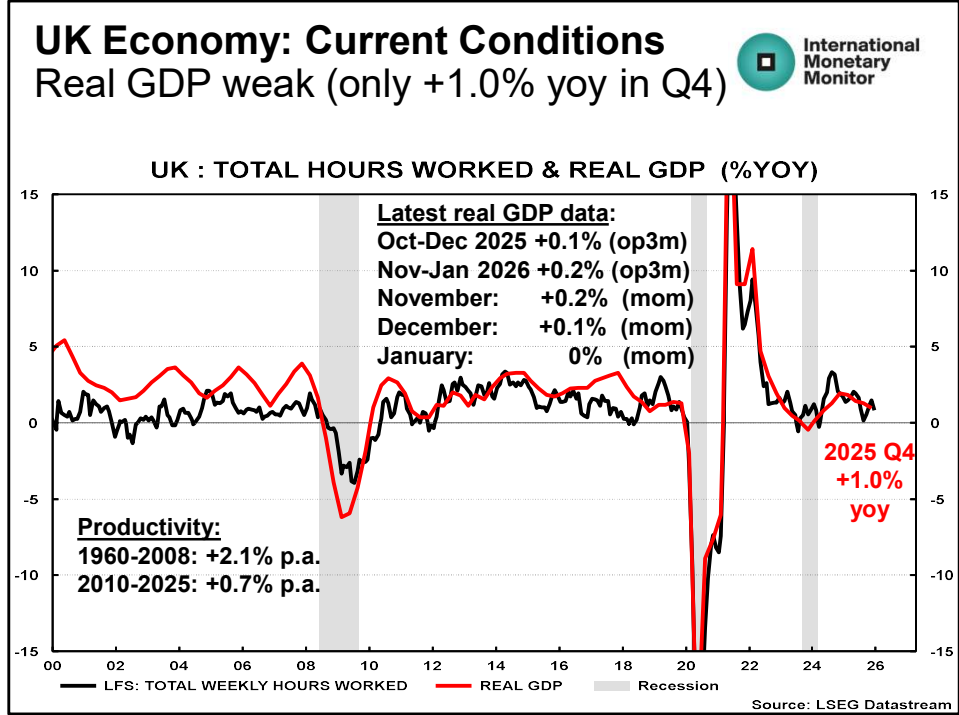
Survey-based measures of household (a) and business inflation expectations (b)



Source: <https://www.bankofengland.co.uk/monetary-policy-report/2026/february-2026>
 Sources: Citigroup, DMP Survey, YouGov and Bank calculations.

(a) Households. Data shown are from the Citi/YouGov survey and are based on responses to the questions: ‘How do you expect consumer prices of goods and services will develop in the next 12 months?’, and ‘And what do you think will happen to the prices of goods and services, on average, over the longer term – say five to ten years?’. Dashed lines represent the series averages over 2010–19. The latest data points are for January 2026.

(b) Businesses. Data shown are from the DMP Survey and are based on three-month averages of responses to the question: ‘What do you think the annual CPI inflation rate will be in the UK, one year from now and three years from now?’ The latest data points are for January 2026. The DMP Survey data have a short back-run, so no historical averages are shown.



A simple way to proxy real GDP growth is to use supply side data:
 Real GDP = Total hours worked x Average total productivity.

Since productivity does not vary much in the short run, changes in hours worked should give a reasonable snapshot of whether growth is likely to move up or down. The figures for productivity, printed in the lower left of the chart, have shown a marked slowdown from +2.1% p.a. in the period to 2008 to just +0.7% p.a. in the period since 2010.

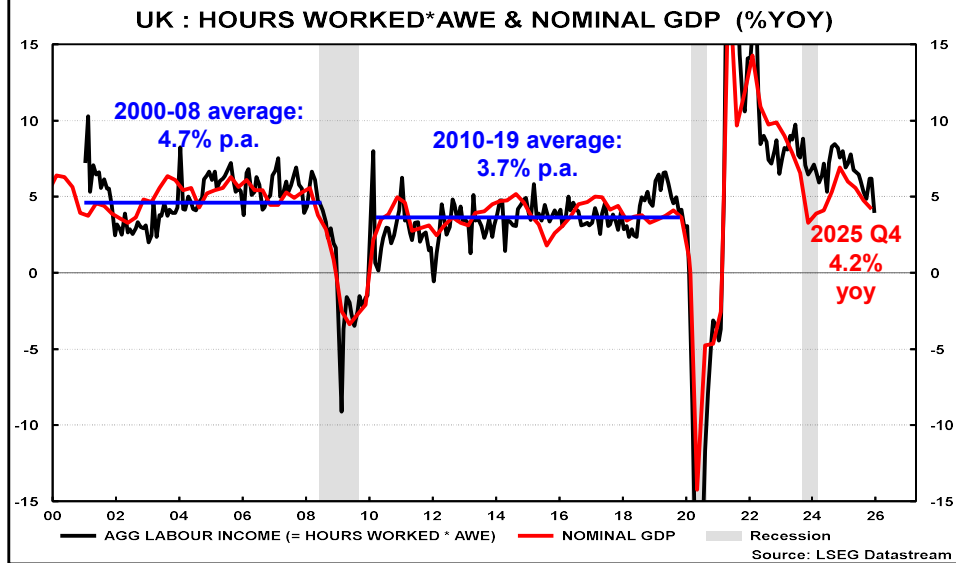
As can be readily seen, real GDP growth (in red) before the GFC significantly exceeded the growth in total hours worked (in black). However, since 2010 there has been much greater coincidence of the two series, confirming the decline in productivity growth.

With no sign that hours worked are suddenly going to surge or that productivity is going to correct its long-term slowdown, the growth outlook for the UK economy must be considered mediocre at best – and, again, something that cannot be fixed by monetary means.

UK16G

UK Economy: Current Conditions

Nominal Spending Slowing (Q4:+4.2%)



To arrive at a simple estimate of nominal GDP one can again take a supply-side view, measuring the total income earned by participants in the economy. Aggregate income consists of wages, profits, rents, interest, and other earnings. If we take hours worked as a proxy for everything except wages, we can say:

Nominal GDP = Hours worked x Average weekly earnings.

In the chart the red line shows nominal GDP on a year-on-year basis, while the black line shows the product of total hours worked and average weekly earnings.

On the basis of the latest data at the time of writing, the nominal GDP for 2025 Q4 was 4.2% year-on-year while the proxy was 3.8% in December and 5.2% in January. As in our previous charts, the picture is one of gradual slowdown towards a growth path which looks as though it will be somewhere between the 4.7% average of 2000-08 and the 3.7% average of 2010-19.

These findings reinforce the tentative conclusion that broad monetary growth (of M4x) is generally “on track” – i.e. neither too rapid nor too slow, and should therefore be allowed to continue at the current rate of growth.

UK16H

Global Economy: Current Conditions

More Resilient to Tariffs than Expected



Table 1.15: World GDP growth has been more resilient than expected to trade policy developments

UK-weighted world GDP growth and GDP growth in selected countries (a)



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Sources: LSEG Workspace and Bank calculations.

The diamonds in the chart show Bank staff projections for UK-weighted world quarterly GDP growth, and for quarterly GDP growth in China, the US and the euro area. The projections are for 2025 Q4 to 2026 Q2 for all of the areas. The preliminary flash estimate for 2025 Q4 euro-area GDP was published after the cut-off for incorporation into the forecast so the data point for that quarter is a projection. UK-weighted world GDP growth is constructed using real GDP growth rates of 188 countries weighted according to their shares in UK exports

IMF's World Economic Outlook: Real GDP Growth Projections



(Real GDP, annual percent change)	PROJECTIONS		
	2025	2026	2027
World Output	3.4	3.1	3.2
Advanced Economies	1.9	1.8	1.7
United States	2.1	2.3	2.1
Euro Area	1.4	1.1	1.2
Germany	0.2	0.8	1.2
France	0.9	0.9	0.9
Italy	0.5	0.5	0.5
Spain	2.8	2.1	1.8
Japan	1.2	0.7	0.6
United Kingdom	1.3	0.8	1.3
Canada	1.7	1.5	1.9
Other Advanced Economies	3.0	2.6	2.2
Emerging Market and Developing Economies	4.4	3.9	4.2

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The IMF's outlook for real GDP by area and country shown in the chart above was prepared in March and April 2026, soon after the start of the US-Israeli attacks on Iran. Inevitably, the forecasts contain much guesswork on the duration and severity of the war in the Middle East, and its consequences.

Except for the US and Germany whose figures are raised to higher levels than 2025, all estimates for 2026 are down except for Germany and France whose projections are for the same growth in 2026 and in 2025.

These data add to my conviction that even if the war with Iran is quickly resolved (which seems unlikely), the real GDP growth outlook for 2026 based **either** on the slowdown of broad monetary growth over the past two years **or** based on other more *ad hoc* methods of forecasting is modest at best, and unlikely to result in an unanticipated surge of inflation.