The Balance Sheet

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Where the Money Really Comes From

Bank credit, house prices and the hidden engine of Australia's cost of living

An empirical analysis of money creation, global liquidity, the ASX and consumer prices, 2007–2026

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Abstract

Market commentary routinely attributes asset prices to global liquidity, citing correlations of 95 per cent and higher between money measures and equity indices. This analysis tests the proposition against Australian data and traces where Australia's own liquidity is created. Three findings stand out. First, the headline correlation method is statistically unsound: a randomly generated series correlates with global central bank assets (r = 0.86) more strongly than Australian shares do (r = 0.83); measured properly, in growth rates, the ASX shows only a weak, lagged link to offshore liquidity (r ≈ 0.25). Second, Australia's money is created at home: roughly nine in ten Australian dollars are commercial bank deposit money issued through lending, and 62 per cent of that lending finances housing. Third, broad money growth leads Australian CPI inflation by about 18 months (r ≈ 0.58 since 2012). Over the decade to 2026, broad money rose about 90 per cent, house prices 41 to 100+ per cent, coffee prices 60 to 75 per cent, and CPI just 33 per cent, consistent with a two-step mechanism in which mortgage credit inflates land prices which then leak into consumer prices through rents, construction costs and wages.

Key numbers	
Share of broad money created by bank lending	**~91%**
Housing share of total bank credit (Apr 2026)	**62%**
Broad money (M3) level, April 2026	**A$3,449bn (record)**
Broad money growth, y/y	**+8.2%**
Investor housing credit growth, y/y	**+10.2%**
ASX vs G3 liquidity, growth-rate correlation (9–12m lead)	**r ≈ 0.25**
M3 growth leading CPI by 18 months, 2012–2025	**r ≈ 0.58**

1 The question

What actually sets the price of things in Australia: shares, houses, and the weekly shop? One popular answer, common in global market commentary, is liquidity: the total pool of money created by the world's central banks, which is said to price all assets at the margin. Another answer, closer to home, holds that Australia's cost of living is a product of its own housing system, in which mortgage lending creates most of the nation's money and property absorbs most of its credit.

These explanations are usually argued past each other. This analysis puts both to the data. It asks three questions. Does the Australian sharemarket track global central bank liquidity? Where is Australia's own money supply created? And is there measurable evidence that housing-driven money creation feeds through to consumer prices, from rents and groceries to the price of a flat white?

2 Data and method

Global liquidity is proxied by the combined balance sheets of the US Federal Reserve, the European Central Bank and the Bank of Japan, converted to US dollars at monthly exchange rates (2007–2026, monthly, via FRED). Australian share prices use the OECD share price index (monthly, 2007–April 2026)

supplemented with verified ASX 200 month-end closes for 2024–2026. Australian broad money uses the OECD M3 series (to November 2023) and RBA Financial Aggregates (April 2026 release). Inflation uses the OECD quarterly CPI series and the ABS monthly CPI (May 2026). House prices use Cotality (CoreLogic) Home Value Index publications; coffee prices use the Gilkatho Cappuccino Price Index and industry surveys.

Correlations are computed two ways: on index levels, replicating the method behind the headline claims heard in market commentary, and on growth rates (year-on-year and month-on-month changes), which remove shared trends. As a control, the levels method is also applied to a computer-generated random walk with upward drift. A caveat applies throughout: a G3 central bank proxy is one definition of global liquidity among several; broader measures add China, shadow banking and collateral chains, and definitional choices move these correlations materially. That sensitivity is itself a finding: single precise correlation figures for 'global liquidity' depend on the definition chosen to produce them.

3 The correlation illusion

On levels, Australian shares and G3 liquidity correlate at r = 0.83 (r^2 = 69 per cent) from 2009, superficially confirming the liquidity story. The control experiment dissolves the result: a meaningless random-walk series correlates with G3 liquidity at r = 0.86, higher than the real relationship. Any two series that broadly rise over time will produce correlations in the 0.8–0.99 range. Statisticians have described this artefact since Yule (1926); correlations quoted on trending levels, including the 95-per-cent-plus figures common in market commentary, are largely uninformative.

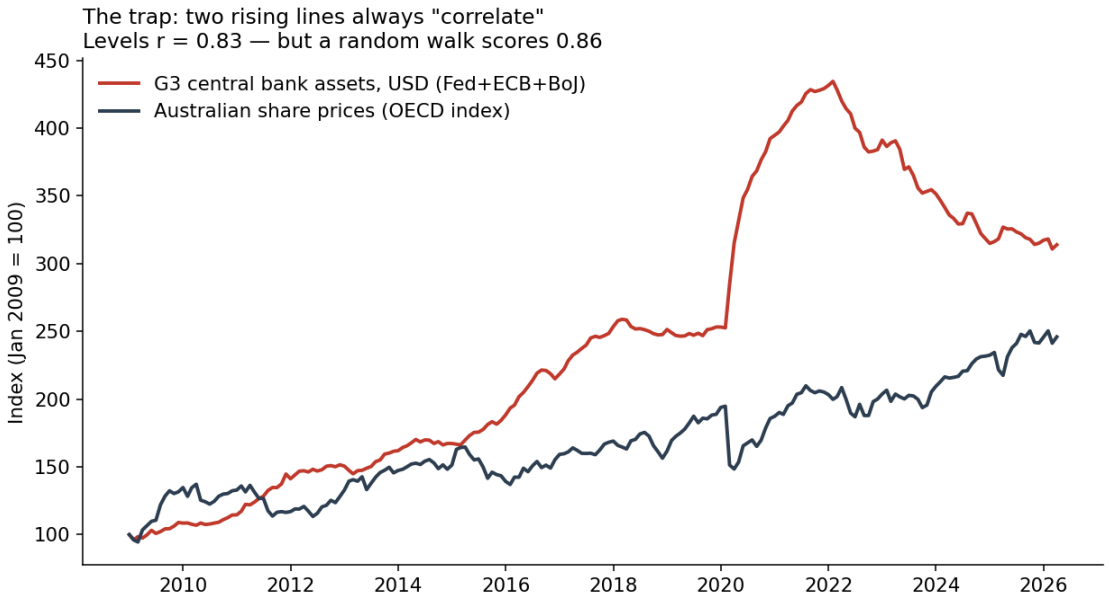


Figure 1. G3 central bank assets (USD) and Australian share prices, indexed to January 2009. The levels correlation of 0.83 is below the 0.86 scored by a random control series. Note the divergence after 2022: shares rose to records while measured liquidity fell.

In growth rates the relationship is real but modest. Contemporaneous year-on-year changes correlate at –0.22; the correlation turns positive only when liquidity is given a nine-to-twelve-month lead, peaking near r = 0.25. Over 2024–2026 the two series moved in opposite directions: the ASX 200 reached a record 9,202.9 in February 2026 while the G3 balance sheet in dollars sat near decade lows, before the index fell 10.2 per cent in the March war-shock correction.

4 Why the ASX marches to a different drum

Three structural features explain the ASX's low sensitivity to offshore liquidity. First, composition: the index is dominated by banks and resource companies, with little of the long-duration technology exposure that makes US growth indices responsive to discount rates and money growth. Second, its miners respond to Chinese credit conditions and commodity demand rather than to G3 central banks; the People's Bank of China matters more to Pilbara iron ore than the Federal Reserve does. Third, its banks respond to domestic credit growth, which continued at about 8 per cent per year through 2025–26 even as offshore liquidity flattened.

One offshore shift deserves attention: Federal Reserve assets bottomed at about US$6.54 trillion in December 2025 and have since risen roughly US$190 billion, ending more than three years of quantitative tightening. Chinese liquidity injections, interrupted earlier this year, also appear to be stabilising. Whether these inflections show up in Australian asset prices over the coming year, with the lags measured here, is a live test of the whole framework.

5 Australia's money is mortgage money

The strongest findings in this analysis concern where Australian liquidity originates. RBA aggregates for April 2026 put broad money (M3) at a record A$3,449 billion against a money base of A$293 billion. Roughly nine in every ten dollars is therefore commercial bank deposit money, created when banks extend loans; physical cash is about 3 per cent of the total. This is not a heterodox claim: it is the standard description of money creation used by the RBA and the Bank of England alike.

Housing dominates the lending that creates this money. Mortgages account for approximately A$2.4 trillion of A$3.9 trillion in total credit, or 62 per cent, against 34 per cent for business and 4 per cent for personal lending. In 1991 housing was about 30 per cent of bank lending; the share has doubled in a generation. Growth has re-accelerated: broad money rose 8.2 per cent in the year to April 2026, housing credit 7.5 per cent, and investor housing credit 10.2 per cent, the first double-digit reading since 2015. APRA imposed debt-to-income limits on new mortgage lending from February 2026 in response.

6 Money growth leads inflation by about 18 months

Quarterly tests of M3 growth against CPI inflation show the strongest relationship when money leads by twelve to twenty-four months. Since 2012 the correlation at an eighteen-month lead is approximately 0.58. The pandemic episode is the clearest case: M3 growth peaked above 12 per cent in early 2021, and CPI inflation peaked at 7.8 per cent almost exactly eighteen months later. The current configuration fits the same template, with money growth above 8 per cent against headline inflation of 4.0 per cent and core inflation of 3.6 per cent and rising.



Figure 2. Broad money growth advanced eighteen months (red) against CPI inflation (navy), 2012–2025. r ≈ 0.58.

The honest qualification: between 2012 and 2019, M3 grew at 6–10 per cent a year while inflation stayed under 2 per cent, and the full-sample correlation is a more modest 0.34. Money growth is informative when it moves violently; in quieter periods the marginal dollar flowed into asset prices rather than the consumer basket. That asymmetry is itself the bridge to the housing question.

7 The decade scoreboard: houses, coffee and the CPI

Between roughly 2015 and 2026, the consumer price index rose about 33 per cent. Broad money rose about 90 per cent. Melbourne dwelling values gained 41 per cent, the weakest capital-city result, while Brisbane, Perth and Adelaide roughly doubled. The Gilkatho average cappuccino rose from $3.43 in 2015 to between $5.50 and $6.00, an increase of 60 to 75 per cent, with $7 cups forecast for 2026. Money grew about three times faster than consumer prices; the gap went into asset prices, principally land.

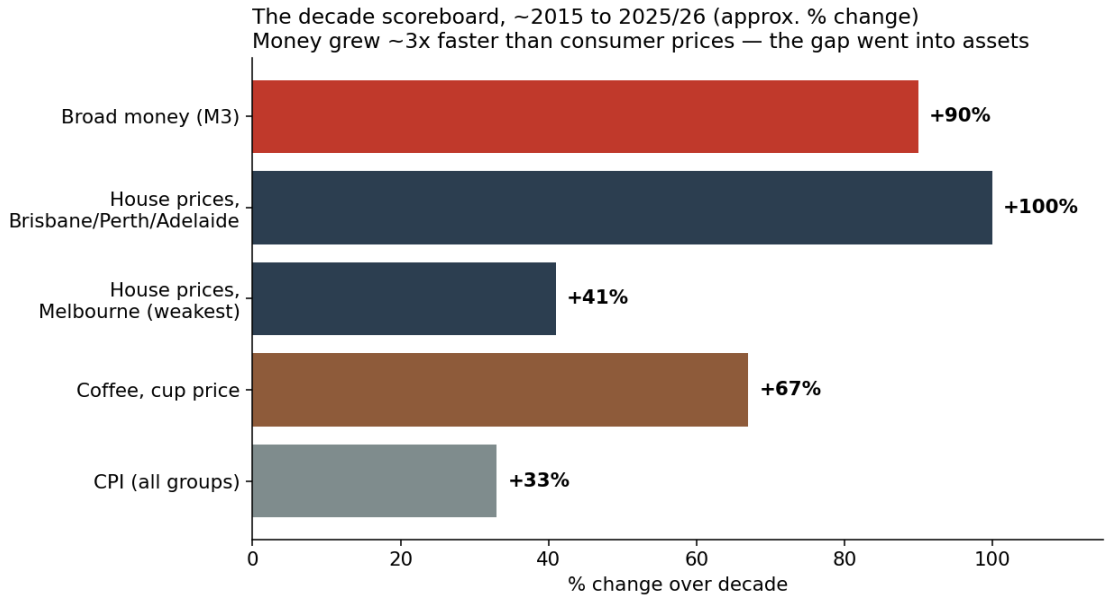


Figure 3. Approximate percentage change, ~2015 to 2025/26. Sources: ABS, RBA, Cotality, Gilkatho.

Consumer prices most exposed to the housing cost stack rose fastest. ABS data show domestically generated inflation (non-tradables) at 4.7 per cent against 2.5 per cent for imported goods, with housing the largest CPI contributor at 6.5 per cent. A café's cost base is saturated with land: commercial rent, staff who must live within commuting distance, insurance priced off rebuild costs, and fit-outs priced off construction. The academic literature supports this two-step chain. Richard Werner's disaggregated credit theory, with supporting econometrics, finds that mortgage credit causes house price inflation; BIS research links property credit booms to broad economic costs. Credit created for asset purchases inflates asset prices first, and consumer prices only indirectly.

8 Limitations and counter-arguments

Three qualifications constrain the thesis. First, the CPI is designed not to observe housing assets: mortgage interest was removed from the index in 1998 and land purchases are excluded as asset transactions, so any mortgage-money effect on measured inflation must travel indirectly through rents (currently +3.6 per cent, below headline), new-dwelling costs (+5.6 per cent) and business rents. Second, the current 4 per cent headline owes much to supply shocks: electricity rose 21.1 per cent after rebate withdrawals, and the Iran conflict pushed fuel up 7.7 per cent year on year. Third, coffee specifically carries record global green-bean prices and award wage increases; commercial rent is one input among several. The defensible claim is that housing-driven money creation sets the domestic cost floor over the medium term, not that it explains any single price in any single year.

9 Conclusions

The imported version of the liquidity story does not survive contact with Australian data: correlations quoted on trending levels are statistical artefacts, and the ASX's genuine link to offshore liquidity is weak and lagged. But a stronger, local version emerges from the same exercise. Australia operates a money creation system in which the overwhelming share of new money is issued by commercial banks against residential property, at a pace currently double the inflation target ceiling. That system inflated asset prices for a decade while measured inflation slept, and the eighteen-month lead from money growth to CPI suggests the current inflation problem was visible in the aggregates well before it reached the shopping basket. The liquidity that sets the price of Australian assets, and eventually the price of a flat white, is created closer to home than global market commentary implies.

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