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Bloomberg Article on Velocity of Money

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Michael Goldberg Signature Track · 15 days ago

interesting read. Equating US low inflation to all time low rates of velocity of money due to expansionary monetary policy.

"With all the money the Fed has pumped into the economy, GDP would have to grow almost 10 percent annually for money velocity to keep pace with the money supply...this also explains why all that new money hasn't triggered inflation: if it's not getting spent, it's not raising prices."

Article also discusses different types of money which was from week #4.

http://www.businessweek.com/articles/2014-01-17/the-recovery-and-the-speed-of-money

2 · flag

Christopher Bassett · 15 days ago

Thanks for posting. In my opinion this comment which is posted beneath the article sums it up.

"Lowest velocity since 1959 is a dire sign. The cause is concentration of wealth, globalization, declining wages, and lack of reinvestment in America by the private and public sectors. Deflation and depression are the results of low velocity. No matter how much the money supply is expanded, inflation is only latent until velocity picks up. Inflation will heal a lot of debt legally and practically without filling up the courts, but they can't make it happen until there is wage inflation and full employment."

There is too much money in the hands of too few who have no interest in investing in the US at this time. The off-shore profits made by multinational corporations from global expansion will not be invested domestically as long as those profits are taxed when brought back to the US and the cost of labor in the US exceeds that of foreign labor.

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Michael Goldberg Signature Track · 15 days ago

Yes Yes Yes. Agreed. Need to relax tax regulations on repatriated offshore cash US companies are holding.

However, the article does go on to talk about how Velocity, historically, has picked up ~5 years after each recession seen before. Time will tell.

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+ Comment

Darah Kehnemuyi · 15 days ago

Interesting article.

Money isn't turning over because the money the Fed pumped into the economy has stayed on investment banks' balance sheets...see Richard Koo talking about "balance sheet repair", various videos, INET and YouTube. The belief that the bank bailout would somehow result in increased lending was a "fantasy" (or fable?) of the Bush Administration which pushed TARP. The bailout continued under the current Administration and is still going on to the extent that the government is buying toxic assets (RMBS) from investment banks.

While I'm not sure how velocity is calculated, it seems to me that there is a difference between velocity of overnight borrowing from money markets by asset managers and investment banks on the one hand and then on the other hand money moving by dint of sales to households (i.e. consumption, previously 70% of GDP). Velocity as a symptom of household spending should be a sign of a healthy economy. That said the money lent by the US government so far has not been sufficient to resuscitate that productive economy, but again has gone to repair the balance sheets of banks holding over-valued toxic assets.

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Anonymous · 5 days ago

The way I understand the QEs , Feds sold treasury for QE1, bought MBS for QE2, MBS and long bonds for QE3. Are you saying investment bankers are holding treasury/currency on their balance sheet?

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Darah Kehnemuyi · 5 days ago

It is my understanding that TARP "money" was held by investment banks on their balance sheets and not loaned out. There were reports that during his initial years in office President Obama was expecting this money to be transferred to the productive economy, and was surprised when that did not happen (crocodile tears perhaps?). In any event if you look on YouTube or INET you can find video of economist Richard Koo, (and others) discussing balance sheet repair, which was the purpose for which the bailout "money" was really used.

Banks held the assets on their balance sheets. As to more recent Fed actions, I'm not sure how much of the "money" transferred is finding its way into long-term physical capital investment.

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Donald E. Davis · 2 days ago

The cash holdings of profitable US corporations are at all time highs. One factor not mentioned is business psychology. It is not that there are not profitable investments to be made. It is more that those available domestically do not meet 'profit expectations' that were formed during the boom. Expectations of double digit returns lead the wealthy to 'invest' (speculate) on 'investments' in emerging markets, etc. Initially, an inflow of 'hot money' will raise prices, (think real estate), in an emerging market economy, but this produces inflation and the attempts by national authorities tends to cause an outflow of 'hot money' which crashes the local economy. Foreign 'investors' who are insufficiently well informed and/or nimble get burned but the big boys and insiders make out.

The problems of 'globalization' which are cited as reasons not to invest in the USA were largely created by the US government and Congress at the urging and through the political contributions of interested US parties. The path to a resolution is blocked by a widespread consensus that the government can't do anything right. This attitude was partly purchased through widespread deliberate efforts to discredit activist government financed by wealthy conservatives and reinforced by 'reforms' to dismantle effective government regulations and open up opportunities for private sector looting. Too many scandals like this, during the Bush 43 Administration, historically always a problem, tended to reinforce the idea that government can't be trusted and the attitude has become a self fulfilling prophesy.

A government backed and financed renewable energy infrastructure investment program and associated program to upgrade decaying public transportation infrastructure could provide enough stimulus to put enough people back to work so that inflation at least rose to a healthy 3-4%, 5% would be even better, and, as the author of the Bloomberg article notes, this would help deal with the massive bad debt that we refuse to write down. The renewable energy would prepare us for a situation where fossil fuel prices stall the economy further and would constitue a massive import substitution program, reducing our trade deficit, but it hurts fossil fuel interests who would happily see future generations condemned to a +4C increase in average global temperatures and an eventual rise of sea levels by about 200 feet in a world without ice.

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Darah Kehnemuyi · 2 days ago

Don, good post. The debt and deficit do not matter. If you have access to YouTube, search for Warren Mosler and/or Stephanie Kelton. Mosler's INET interview is a good start. Take care.

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Donald E. Davis · 2 days ago

Good to see you again, Darah.

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Darah Kehnemuyi · 2 days ago

And you also, Don.

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+ Comment

Andy · 15 days ago

@Michael

Thank you for the Bloomberg article and the timing is just right for the Week 5 topic of inflation.

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+ Comment

Fan Li Signature Track · 15 days ago

Thanks for the article. It feels great to be able to correlate this article with what we learned from this course.

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Darah Kehnemuyi · 14 days ago

In today's Financial Times online:
“Less QE = less liquidity for EM corporations”, http://on.ft.com/1bLpack.

What is the connection, if any, between the "velocity" of money and liquidity for financial markets ? Sales of goods and services to households ? Financial markets to sales ?

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Christopher Bassett · 14 days ago

I don't have access to the article but it's possible that QE's effect on interest rates could result in changes in liquidity. The bond purchases reduce interest rates which results in a decrease in the value of the dollar and increases exports.

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+ Comment

 Simon Hovmark Jensen · 14 days ago

I think Irving Fisher explanation about what causes the velocity of money to go down is pretty solid. He argued that high debt causes velocity to fall because debt is an acceleration of future consumption. He also argued that depression comes with over-indebtness and deflation - much similarly to the situation in Japan.

Hoisington Mgt wrote about it in their quarterly review: http://www.hoisingtonmgt.com/pdf/HIM2013Q3NP.pdf

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John H. Seiler Signature Track · 6 days ago

Thanks for the link Mike, much appreciated!

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Darah Kehnemuyi · 5 days ago

Interesting article. Point made is that Fed's purchase of investment bank assets (residential mortgage backed securities, asset-backed commercial paper, etc.) much of which is deemed to be toxic, does not stimulate the productive economy, and in fact represses growth in the productive economy. Question unanswered is why this happens, and how would we better encourage growth ? Let me shift the question: if I were an investment bank why would I put my "money" into long-term physical capital as opposed to short-term (daily) speculation and arbitrage ? The article makes this point in a slightly different way. So how do we move short-term speculative "money" into long-term investment in productive capital ?

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Donald E. Davis · 2 days ago

" So how do we move short-term speculative "money" into long-term investment in productive capital ?"

The simplest way is to tax that money and spend it for them, IF we could get the political consensus to do so. A financial transaction tax, or Tobin tax, is one way. Increasing estate taxes and closing loopholes on estates over a few million is another way to pay for such productive investments.

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Gregory Kozol · 5 days ago

According to a Bloomberg article in January, large global businesses sat on $4.5 trillion in cash at the end of 2012, up 73 percent from the start of the recession. The largest cash pile is in the U.S.
It's hard to see the benefits of the Fed's monetary expansion when large quantities of that money are not being spent in the domestic economy (consumption and investment). The Fed's recent tapering process has hurt emerging economies, suggesting that much of this added money has fled the U.S. in favor of higher returns offshore.
What will it take to rekindle 'animal spirits?' Apparently, not a cash pile.

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Christopher Bassett · 4 days ago

"What will it take to rekindle 'animal spirits?"

An elimination of taxes on repatriated profits from offshore investments.

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Andy · 5 days ago

I am quite interested to watch Bloomberg global news, particularlly those illegal political chaos:

Current news video: Ukraine Is Now a Battle of Nerve

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Andy · 5 days ago

Although it was not related to the title of this thread (velocity of money), this news is the concern of the economics of money.

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Anonymous · 17 hours ago

I think this is the simple answer. It is because the Fed is pulling the Interest Rate down to near zero. The traditional banking system is just expanding their balance sheets, and the shadow banks are contracting their balance sheets.
Nixon

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