



Velocity of Money as a Macro Choke

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Friday, April 16, 2004, Econ 002

Subject: Velocity of money as a macro choke

Reading: “Macroeconomic Chokes,” p.8 ff., III, Spending. (Note, we return to this for more detail in Syllabus, V, B.)

Spending is Money (M) x Velocity (V)

Old fear of “hoarding,” aka oversaving, underconsumption, and slow V.

- A. Determination of V is systemic or “endogenous.”
- B. Early Keynesians assumed V tends to fall.
- C. More recently it has been rising.
- D. Factors affecting V. The following influences make it rise:

- 1. More M
- 2. Low prices
- 3. Anticipated higher prices (note contrast with #2)
- 4. High interest rates (i.r.)
- 5. Anticipated lower i.r. (note contrast with #4)

Digression to explain “capitalization,” the process by which prices of durable assets vary inversely with i.r. That means that #4 above, high i.r., mean LOW asset prices, so #4 is parallel with #2; and ANTICIPATED lower i.r. (#5 above) mean anticipated HIGHER asset prices, so #5 is parallel with #3.

Once you master that, it cuts down on what you need to remember. Remember #2 and #3. Then treat #4 as though it were #2B; and treat #5 as though it were #3B.

- 6. Technical advances in transferring money. (These keep coming faster and faster.)
- 7. Steadier flows of revenues and spending (these lower needs to hold cash for contingencies)
- 8. Money substitutes (they keep coming at us)
- 9. Getting richer (thus improving your credit)
- 10. Increasing trust and confidence
- 11. Fewer transactions
- 12. More vertical integration of industry
- 13. Probably others. Can you think of more?

- E. Decline of real turnover—a real problem.