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.