Harry's Take

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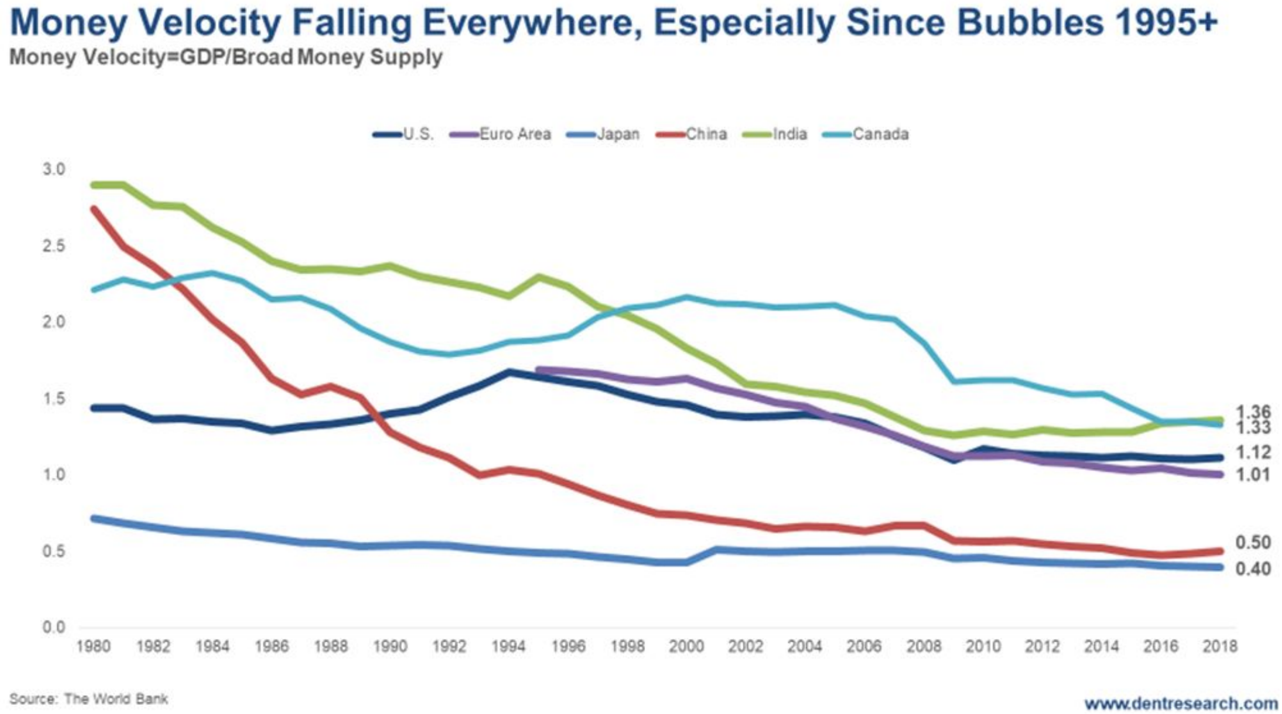
Money Velocity, a Simple Indicator of Productive Investment, Is Down Since Bubbles Hit

Money velocity is simply defined as GDP divided by money supply. It tells us how well money invested in the economy generates profits and reinvestment. Most people don't understand completely how money velocity works, because economists aren't that good at explaining it… and perhaps because it has been falling for decades and no one wants to talk about that.

I have noticed that certain key factors adversely affect money velocity. I'll mention high real estate prices first, as that is something that most countries value, especially my Aussie audiences. High real estate prices actually raise the costs of business and wages and make a country less competitive and productive. The Australians and the Chinese are in two of the greatest real estate bubbles in the world, and their money velocities have fallen the most, from high peaks in the early 1980s. China's money velocity is among the lowest overall, at 0.50, beat only by Japan at 0.40 and Hong Kong at 0.26.

The second factor that affects money velocity adversely is bubbles in financial assets like real estate and stocks. Note on this chart of key countries how money velocity generally has been declining since 1994–1995, right when the first major stock and tech bubble started. That bubble was followed by the first real estate bubble, from 2000–2006, and then both stocks and real estate bubbled a second time, from around 2013 to present. Bubbles encourage people to become stock traders and house flippers. Those are not productive investments, generally.



Slowing demographic trends make investment opportunities more challenging. That's why Japan's money velocity was never very high and why China's started strong and has fallen the most. China is now the first emerging country to see falling workforce trends, which will go on for decades.

At a certain point, high debt ratios weigh on an economy. Japan has the highest debt ratio in the developed world and the lowest money velocity. China has the highest debt ratio in the emerging world (and is responsible for the greatest amount of debt creation). Its debt ratio is far higher than that of other major competitors like India, which boasts a higher money velocity of 1.36. Also, China takes the title for unproductive investment, with 22% of its condos in urban areas sitting empty.

And guess who is the best house in a bad neighborhood in the developed world, beat only by Canada? The U.S. Our money velocity is higher than in Europe, Japan, and even Australia, despite its better demographic trends. It's not that the U.S. doesn't have excessive bubbles, debt, and slowing demographic trends, it’s just that we have less of a problem in these areas.

As bad as the great crash ahead is destined to be given the extremes in bubbles and debt, the U.S., Australia, and Canada will weather that crash best in the developed world—which is good news for our subscribers, who are concentrated in these countries. China should fare among the worst in the emerging world. But India and the countries of Southeast Asia will emerge as leaders in the next global boom. Those regions will lead next in urbanization and demographic trends, and China and East Asia will fade after dominating the great boom and bubble that has been ramping up since 1982 and is peaking currently.

Money velocity is a simple indicator that warns of waning investment productivity and a deflationary crisis that will deepen in the years ahead. We still have not reached the lows of 1933 and 1946… and such levels actually mean deflation in prices ahead, not just falling inflation rates! That means we’ll get a depression with extensive debt deleveraging, not a normal recession.

Harry

Got a question or comment? You can reach us at info@hsdent.com.