TECHNICAL SCOOP
CHART OF THE WEEK

Charts and commentary by David Chapman

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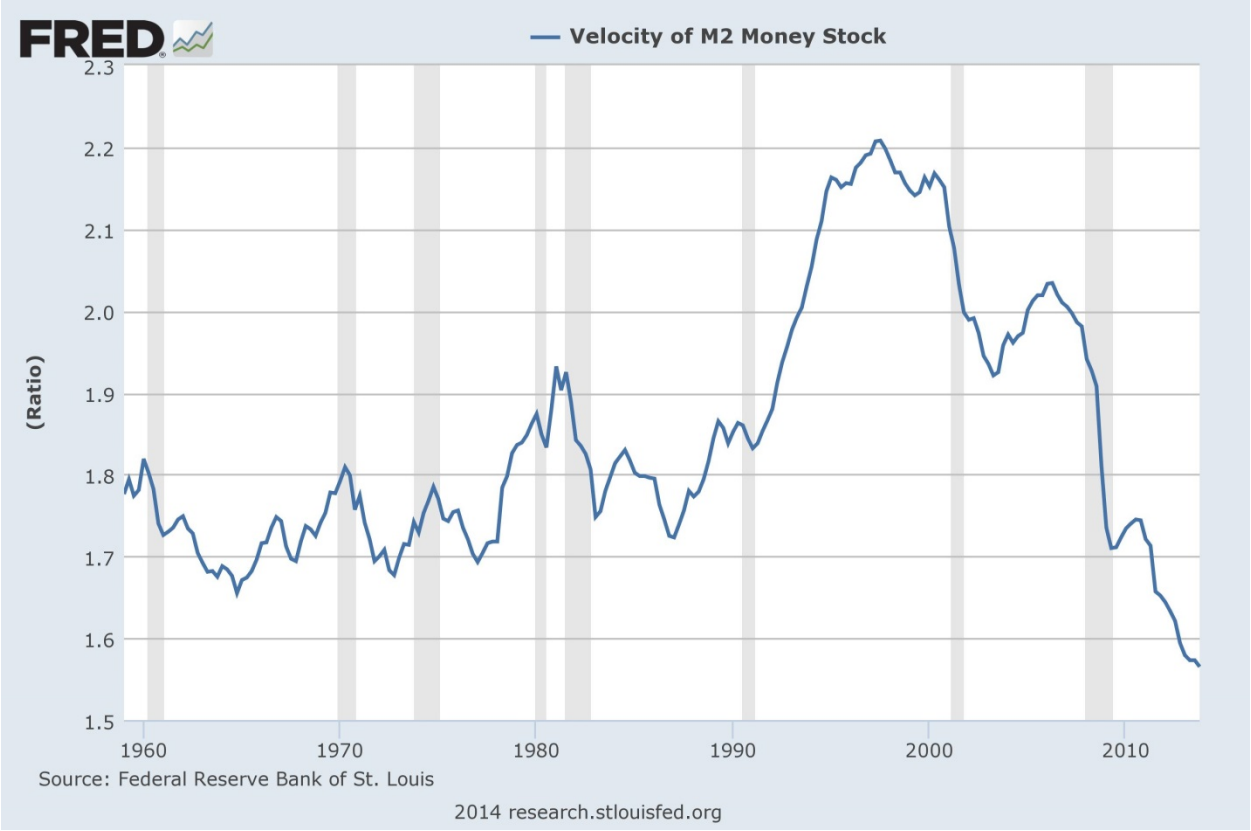
All that money but where's the beef!

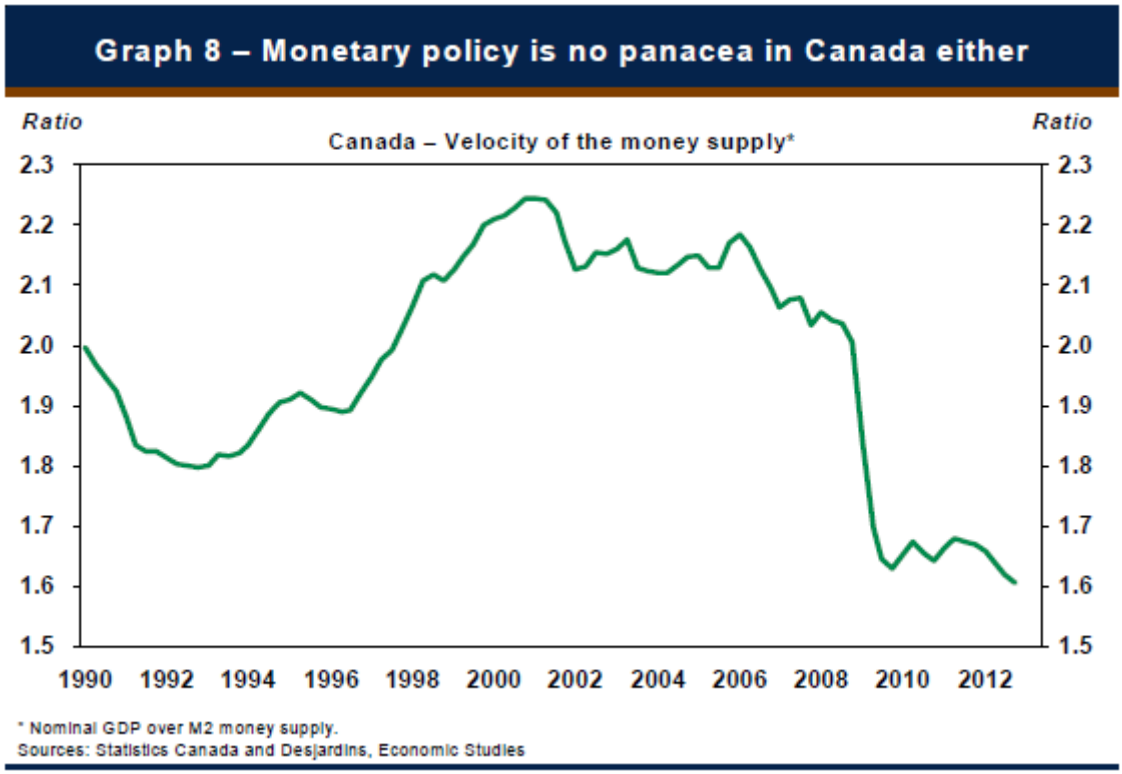


Source: www.stlouisfed.org

This is a picture of the "Velocity of Money" (US M2). In many respects, this is not a pretty picture. I suppose nothing that has been falling for upwards of 16 years can be considered a sound investment. The velocity of money has broken lows set upwards of 50 years ago. But this is not an investment. So what is the velocity of money?

The velocity of money is the frequency at which one unit of currency is used to purchase domestically-produced goods and services within a given time period. In other words, it is the number of times one dollar is spent to buy goods and services per unit of time. If the velocity of money is increasing, then more transactions are occurring between individuals in an economy and the GDP should be rising.

With falling velocity of money it would appear that fewer and fewer transactions are occurring. It would appear to suggest that consumers and business are saving their money rather than investing it. The above chart is for the US. The picture is the same in Canada, as the chart below would appear to indicate. The velocity of money has also been falling in the EU and Japan.



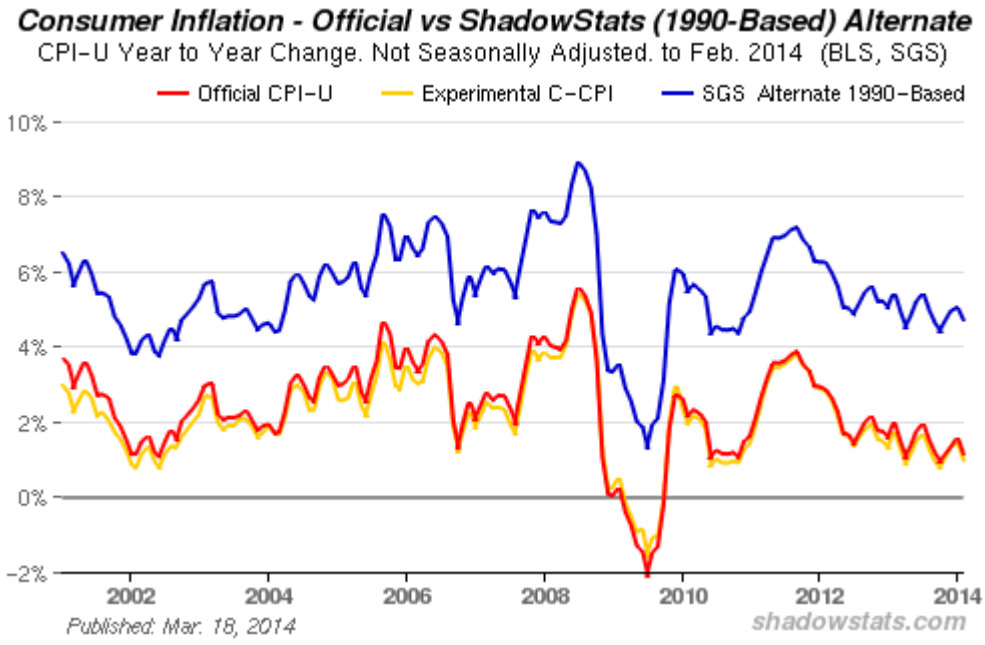
Source: Statistics Canada www.statcan.gc.ca, Desjardins Economics www.desjardins.com/ca/economic-studies/

So what's wrong? Why is the velocity of money falling? It could just simply be fear, or a lack of confidence in the economy or simply that there isn't any good place to invest. US corporations are estimated to be sitting on $1.6 trillion in cash. In Canada, the corporate cash hoard is estimated at close to $600 billion. One would think that with all that cash around that the economy would be booming but that has not been the case. The US and Canadian economies have been sluggish at best since the High Tech/Internet crash of 2000-2002. The financial crash of 2008 only added to the woes. The velocity of money topped in 1998 and has been on a downward swing ever since.

It all seems counterintuitive that the velocity of money should be falling even as the ECB, The Fed, the BOJ and the BofC have been maintaining low interest rates for years in order to encourage borrowing and keep the cost of money low. The central banks have also pumped billions of dollars into the economy through QE and other stimulative measures. The result has been an explosion in the monetary base, a sharp rise in M1 but lower growth for M2 and sluggish M3. In an economies that are weighed down with

debt, banks are reluctant to lend, consumers and corporations are unwilling to borrow so what happens the money instead has been used for speculation primarily going into risk assets such as the stock market. Corporations instead of investing in new plants and investment are sitting on cash hoards or buying back their own shares. Both are non-productive.

The situation in the EU is probably more dire than in the US. Austerity and tax hikes have more than offset QE. The result has seen a deflationary spiral where prices have been falling. Inflation has remained low in both Canada and the US as well. Or at least the headline rate of inflation has remained low. But even that may be bogus as Shadow Stats suggests www.shadowstats.com. The chart below shows the headline official CPI vs. the SGS alternate where inflation is calculated using the methodologies of 1990. Official inflation has been falling for years. The CPI is used to calculate all sorts of cost of living agreements and others. With an official lower rate of inflation, it has been used to suppress wages, pensions and many others and in turn, it has saved corporations and governments billions of dollars in payments they might otherwise have had to make.



Source: www.shadowstats.com

The cry of many is that all that money printing is going to cause hyperinflation. So far, it has been the opposite that has been the case especially in Europe. It has been deflation in Italy, Spain, Portugal and Greece. If the money is not going into the economy then the likelihood of hyperinflation is low. On the other hand, it can show up in the form of asset inflation where stocks markets in the EU, Japan, the US and Canada have been on a five-year rise.

The EU for the most part is in a recession having had to bail out Greece, Spain, Ireland and others. Those countries have been in a depression. Bringing in Ukraine could just add to the EU's woes. Japan seems to be in a perpetual recession. The US and Canada have been in a low growth environment since 2000 at least according to the headline GDP numbers. Shadow Stats US GDP numbers suggest that the US has, like Japan, been in an almost perpetual recession since 2000.

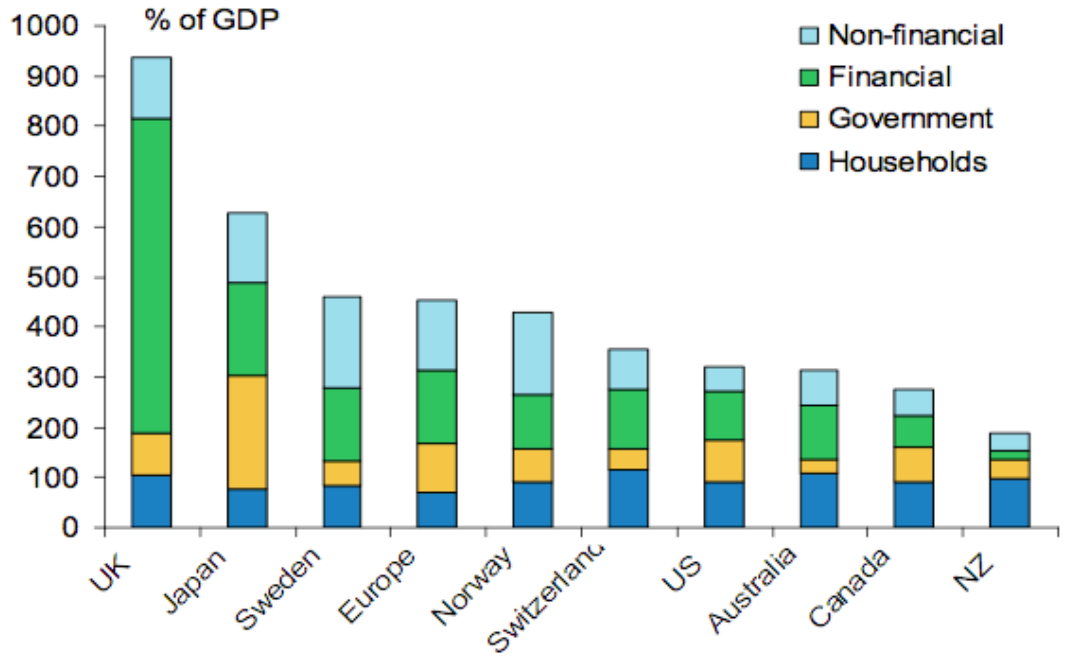
One of the perverse effects following years of money pump priming, low interest rates and recessionary conditions is that the US$ has been falling while the Euro has been rising. Since peaking in June 2001 the US$ Index has fallen 34% while the Euro has gone up in value by 63%. Since Richard Nixon took the world off the gold standard in 1971 the US$ has gone through two earlier crisis of confidence. The first crisis went from 1971 to 1979 while the second crisis lasted from 1985 to 1995.

The first US$ crisis ended when Fed Chair Paul Volker hiked interest rates to 19%, the IMF intervened and after that incoming President Reagan slashed taxes and cut regulations. The second US$ crisis ended when Japan agreed to slash interest rates, pump money into its moribund economy and lower the value of the Yen. In both instances the US$ was under attack and its position as the world's reserve currency was being questioned. It is the same today where many are questioning the US$ as the world's reserve currency and are challenging the position.

This has become especially true since the outbreak of the Russia/Ukraine crisis and the slowing of the Chinese economy. Because of sanctions Russia has threatened to drop use of the US$ for payment of its oil and gas. China has for years been in the process of setting a Yuan trading zone and recently they devalued their currency raising the ire once again of the US accusing them of being currency manipulators. The world has faced major currency crisis in the past including 1914 (British Pound Sterling), 1939 and 1971. Each crisis was followed by a tumultuous period of inflation or deflation and in the case of 1914 and 1939 global war.

Exhibit 1

G10 Debt Distribution



Source: Haver Analytics, Morgan Stanley Research

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For years the western economies have been pumping money into the financial system, maintaining artificially low interest rates and the result has been deflation in the EU and Japan against the backdrop of recessionary economies, low inflation in the US and Canada and sluggish economies, and a falling US$ and rising Euro. All are saddled with huge debts from government, corporations, financial institutions and the consumer.

The chart above shows the G10 distribution of debt. In some respects, it is staggering. By comparison, to the UK and Japan whose total debt to GDP ratio is around 900% and 600% respectively, the US's total debt to GDP ratio around 300% seems paltry. The chart dates from 2011 so the current situation is most likely worse. All that money but where's the beef.

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