

Monday – December 1st

This week in Finance: The “velocity of money is dying”

It's hard to understate just what a historic day last Friday was in the markets. As well as a further fall in oil, leaving it down 40% since June, just looked at what happened in the bond markets. 10 year sovereign bond yields at an all time low in each of the following countries:

- Germany: 0.70%
- France: 0.98%
- Italy: 2.03
- Spain: 1.86%
- Netherlands: 0.81%
- Portugal: 2.80%
- Switzerland: 0.31%
- Japan 0.41%

What do these historic lows mean?

The bond market is signaling that global growth expectations are collapsing and that these countries are all suffering from severe deflationary pressures, partly as a result of collapsing commodity prices. Equity markets in the meantime are surging in the hope that central banks will respond with further stimulus and rate cuts.

However, this is disastrous economic policy. Driving interest rates to zero and even negative to create asset price inflation does not create economic growth. It does not improve wages or incomes and it does not encourage households to spend. Japan is testimony to this. Central banks are not creating wealth by printing money out of thin air and monetizing government debt. Instead they are transferring wealth from savers, pensioners and middle income families in order to bail out the indebted.

Deflation is also disastrous for debt since it increases the value of that debt and leads to default. In a world where global debt has now increased to 100 trillion dollars, this is the reason why central banks are terrified of deflation. However, deflation is not the cause of the problem. It is merely a symptom of too much debt, the failure of governments to restructure their economies and get to grips with their finances. This in turn means that households have stopped spending, and money is not moving through the global economy in the way that it should.

Economists call this the "velocity of money". In the U.S., Europe and Japan, the velocity of money has collapsed, leading to falling prices in some areas. Instead of money going into investment and production it is being used to pay down debt and supporting companies and industries that normally would fail. It's a bubble economy.

Eventually the U.S. equity market will come to terms with the fact that new all time highs are not the same as economic growth. When it does start to realize that this great central bank experiment has failed, it will react violently to the downside. There are warning signs flashing red everywhere including the crash in commodity prices and bond yields, collapsing currencies some of which are now at all time lows against the USD and surging high yield credit spreads which are signaling distress in the U.S. junk bond market, a result of deteriorating company balance sheets, especially in the energy sector (see falling commodity prices are not universally good!).

The aging bull market in U.S. equities is coming to an end. It's hard to know exactly when or what will be the trigger but this bubble caused by excess central bank liquidity will end the same as every other central bank induced bubble in history.

Peter Lewis – Program co-host, Money For Nothing on RTHK Radio 3

Events to look out for this week

This week will see a significant acceleration in the pace of first-tier economic data and risk events around the globe:

- **China's PMI**, the Eurozone's final readings on manufacturing and services sectors and Bank of England mortgage approval figures due Monday
- US Beige book report due for release on Wednesday
- European Central Bank's policy announcement on Thursday. Analysts are speculating on whether the ECB president Mario Draghi will commit to more unconventional monetary measures.
- Australia's and India's central bank decisions on monetary policy