

Velocity of Money and Growth Deflation:

The demand for money can change without a change in transactions. Hence, the velocity or turnover rate of money is not necessarily a good measure of the desire to hold money vs. other goods.

In a closed economy, if some prices rise, say oil, other prices will fall unless the demand for money falls. Hence, general price inflation isn't due to supply shocks. If oil prices fall, more spending can occur on other goods, so no general deflation must result.

If productivity gradually allows supplies to increase, prices can be allowed to fall without dislocations. Hence the money supply need not be geared to create a stable price level, in fact doing just that produces dislocations in this instance.

From this, GDP can exhibit flat growth under expanding production if the money supply and demand is unchanged. A switch to more final goods production with money-credit easing can increase GDP without benefit to long run economic growth, likewise with capital consumption or unproductive activity as measured by standards of living (e.g. spending on certain wars).

Implications:

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In a closed economy, if some prices rise, say oil, other prices will fall unless the demand for money falls. Hence, general price inflation isn't due to supply shocks. If oil prices fall, more spending can occur on other goods, so no general deflation must result. But, if productivity gradually allows supplies to increase, prices can be allowed to fall without dislocations. Hence the money supply need not be geared to create a stable price level, in fact doing just that produces dislocations in this instance.

From this, GDP can exhibit flat growth under expanding production if the money supply and demand is unchanged. A switch to more final goods production with money-credit easing can increase GDP without benefit to long run economic growth (e.g. WWII).