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## MINSKY MOMENTS LAST A LONG TIME

My vote for the best economist never to win a Nobel Prize goes to Hyman Minsky, a student of Wassily Leontief and Joseph Schumpeter at Harvard and a very creative radical Keynesian. Minsky was definitely robbed of his Nobel only by his death in 1996, as his name has become synonymous with the state of the economy during the last year. The 'Minsky moment' has become the phrase of the hour, as everyone who is anyone knows that we are suffering one right now. There are those who would argue that Paul Krugman was a good choice for this year's Nobel, but Hyman Minsky truly deserved this one, and it is certain that the current paroxysm of economic panic will forever be attached with his name.

Many of Minsky's ideas combine to form his financial instability hypothesis, which argues that the economy is inherently unstable in that stability breeds instability over time. An economy left alone to run freely will eventually become unstable and collapse. The concept arises from the idea that human nature will always take more risks to advance its goals by accumulating more debt, as long as the current levels of debt have proven safe. Eventually human nature goes too far. In business, the process begins with the 'hedge' borrower, who takes out a loan for temporary cash needs that will be totally repaid, interest and principal, out of receivables; then advances to the 'speculative' borrower, who is not able to repay the loan principal but is able to pay the interest and assumes that the principal will be rolled over into a new loan; and finally reaches the highest risk level with the 'Ponzi' borrower, who can not even pay the interest much less the principal on the loan. The Ponzi borrower

assumes that he will borrow the interest payments and roll them plus the principal over into a new loan. Over a long period, the basis of the economy goes from domination by hedge borrowing to speculative borrowing and then to a growing percentage of Ponzi borrowings before it collapses. When the loans can't be paid back we have a Minsky moment, and today we are in one.

The one problem with the concept of the Minsky moment is that it takes years to complete. We could argue that this particular moment began when many of the sub-prime mortgage securities began to fail back in early 2007 and morphed into the first hedge fund collapses. At this time about 18 months since it began, our Minsky moment has destroyed the US investment banking business and seriously crippled every global bank. It has become a liquidity tornado, but it has just begun. We are now struggling with solvency questions – will the banks assets be enough to cover their liabilities? The slowdown in credit creation, resulting from the collapse of the banking structure assures a slowing economy, which will mean more unemployed and lower consumption, resulting in lower tax revenues and lower real estate valuations. These will result in several adverse feedback loops that will make it harder for each economic actor to repay its loans. The Minsky moment reaches its peak when almost no one can pay his liabilities. The pain suffered by borrowers will be passed to lenders, as financial assets are proved worthless. As this moment follows its course, we will all be poorer and the financial landscape will be restructured. In the future we'll say 'never a borrower nor a lender be.'

# CYCLICAL PERSPECTIVE

The general view among global economists, and almost everyone else with at least an elementary education, is that the US dollar is overvalued, and must decline. Any country that runs a current account deficit for 17 years in a row, with the most recent decade averaging over 5% of the GDP, needs to either drastically devalue or slam on the economic brakes to cut imports – or both. Economic theory also argues that a weakening economy will lead to a declining currency, as capital will tend to flow offshore when the prospects for domestic growth are low. As the US is heading into a recession and its current account deficit is sky high, it would seem very likely that the dollar would drop.

However, it is strengthening sharply and this has happened before. In the last 30 years, two times before, major economies have gone into severe recessions while their currencies responded by rallying for years and doubling in

value too. The US dollar rallied from about 1.70 Deutschemarks to over 3.45 marks between January 1980 and February 1985. During that period the US suffered two recessions and saw its current account deficit deteriorate significantly. The Japanese yen strengthened from about 160 to the dollar at the end of March 1990 to 80 in March 1995, while the equity market collapsed and their economy deteriorated. In both cases, powerful capital inflows strengthened the currencies even though the countries were wracked by recession. The driving force behind these inflows was a pullback of American and Japanese banks from international lending forced upon them by the recessions. Today, shrinking capital bases have forced US banks to scale back, which means that foreigners must buy dollars to repay loans. Deflation means a strong currency. 