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METHODS

# The end of rational and magic finance: the minsky moment

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## Introduction

"If I may be allowed to appropriate the term speculation for the activity of forecasting the psychology of the market, and the term enterprise for the activity of forecasting the prospective yield of assets over their whole life, it is by no means always the case that speculation predominates over enterprise. As the organization of investment markets improves, the risk of the predominance of speculation does, however, increase.

Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done." (Chapter 12. The State of Long-Term Expectation, J.M. Keynes).

Now, we are facing the same situation but in a global depression and with a financial system totally detached from the real economy after the end, in 1971, of the "Gold exchange standard."

Today, we are confronted with this enormous financial mass that is unconnected to quantifiable reality, totally virtual, yet with a concentration of power and global inequality unmatched in human history. This finance has nothing underlying it and is progressively becoming an infinite bubble without regulations or scientific foundations. Yet, it is able to control countries' political and social choices for higher interests. Unlike in the past, when the adversary could be physically seen, an elusive danger might be felt in today's virtual environment without knowing where it comes from because no deployed forces can be seen. Money and its use are possibly the most direct symbol of the eternal war that rages within the human soul, torn between solidary cooperation and individualism as a means to an end, which is the antechamber of death. Human history goes hand in glove with the history of money that can symbolically represent an instrument of solidarity but also cruel domination.

## Hyman minsky moments: history always presents the bill

Hyman Minsky was regarded as one of the most enlightened scholars of the 20th century for his versatility and intuition in the field of economics and finance, but he was also regarded as dangerous for his ideas on financial capitalism's inherent instability as a result of dominant, dangerous, and suicidal speculation. His thought was therefore obscured, yet recovered now that the facts have confirmed it. Before him, Nikola Tesla, inventor of the alternating current, remote transmission, and superior by intuition to Edison, made his fortune with the Westinghouse patents but was then forsaken for his perilous inventions on the use of energy as an alternative to oil, and now his name recurs in that of the car manufacturer. The first of the geniuses condemned for subverting the truth was Galileo, declared a heretic by Cardinal Robert Bellarmine. Galileo would only be formally rehabilitated by the Church in 1993. With his discovery, Galileo had begun to separate science from religion, which until then had been one, and at the end of the century, Newton's discovery opened the separation that would allow the Enlightenment and rational man to emerge in the following century; man became overman—Nietzsche's Übermensch—and master of the world, preparing the era for the domination of technology.

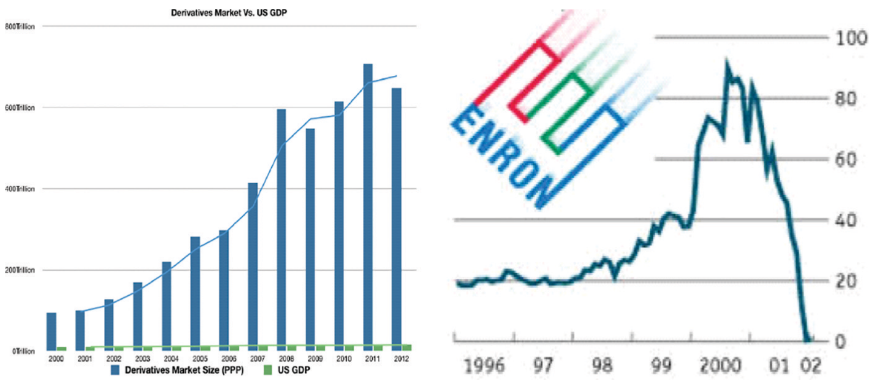



FIGURE 1 |

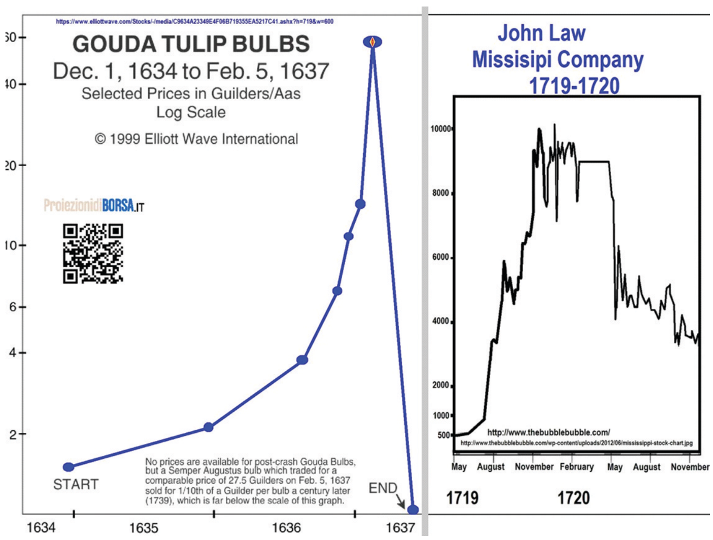



FIGURE 2 |

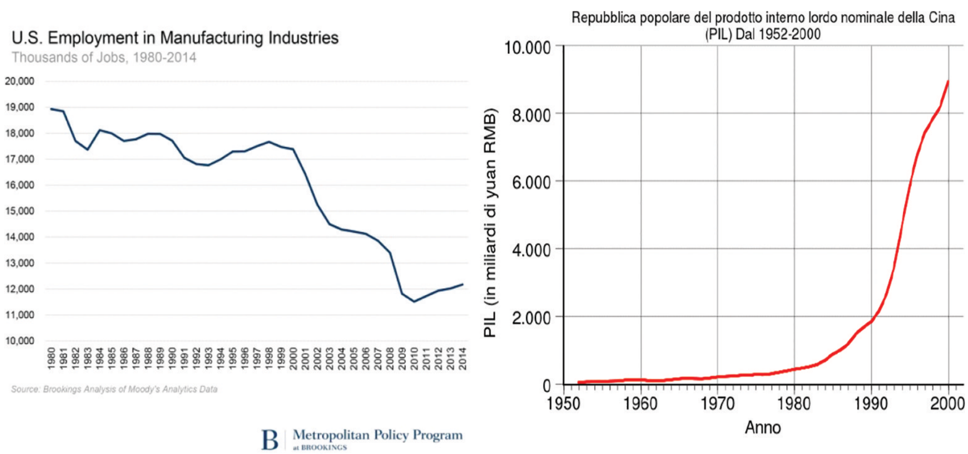



FIGURE 3 |

The heretic Minsky questioned the rationality of economic and financial models that ignored the intrinsic instability of financial capitalism with a reinterpretation of Keynes' "Treaty," highlighting that it is the financial system that regulates, in an expansive or restrictive sense, investment trends. The moral of Keynes' message was that the financial system governs the performance of the entire economy ((1), "Keynes and the instability of capitalism"). Minsky observed that financial markets—the role of banks in granting or not granting loans—and the non-neutrality of

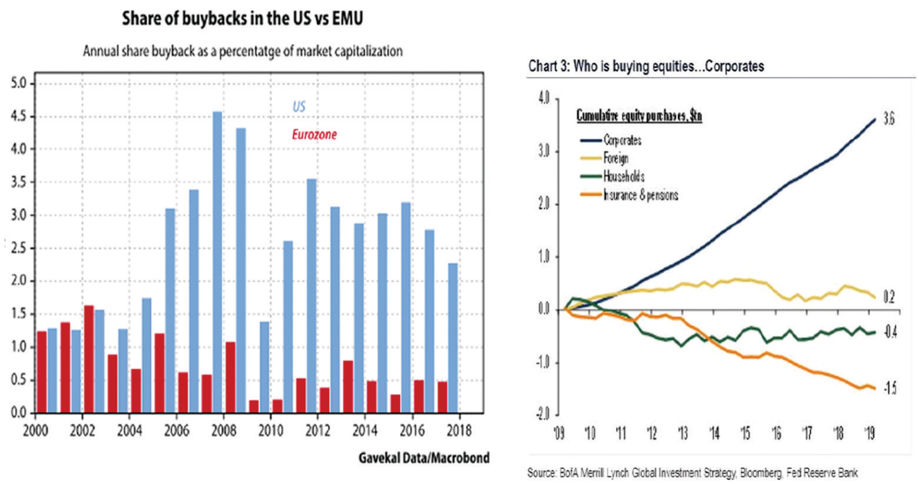
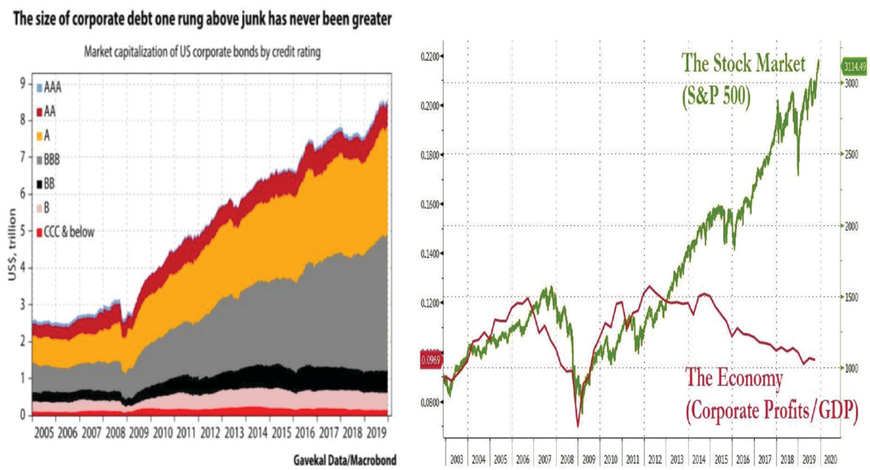



FIGURE 4 |

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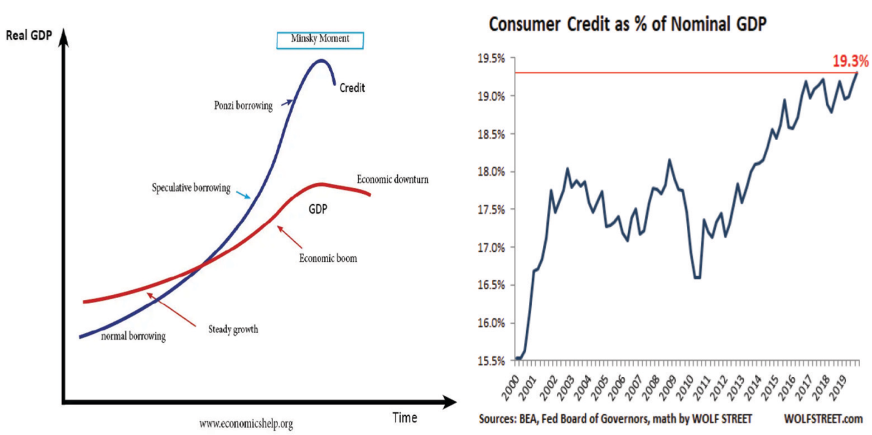


FIGURE 6 |

money intrinsically determine fluctuations and instabilities. Financial instability is cyclical, and after positive trends that lead to risk and debt positions created by more emotional than rational expectations (expectations are not knowledge even if it is convenient to think so), the balance sheets of companies and banks become more fragile and exposed to financial crises that are repeated more intensely until they generate increasingly disastrous financial bubbles. Speculative positions, in these phases, spiraled upward in a sort of Ponzi scheme far from reality, until confidence

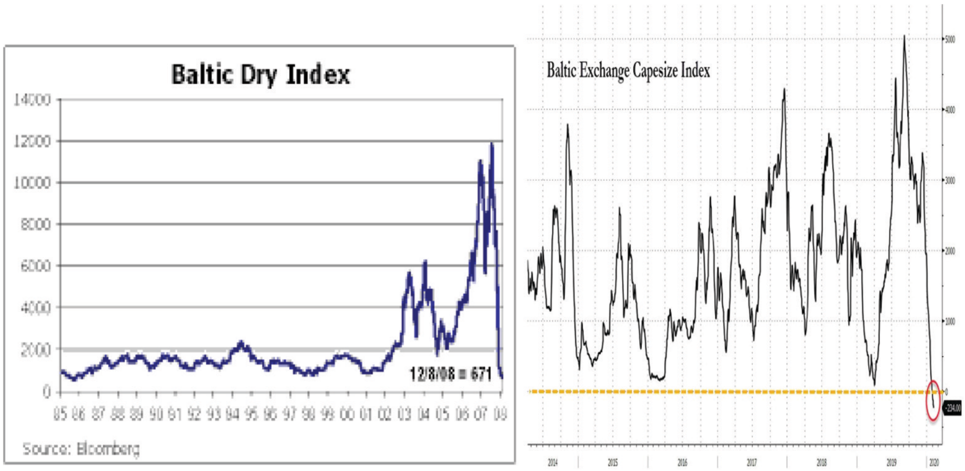


FIGURE 7 |

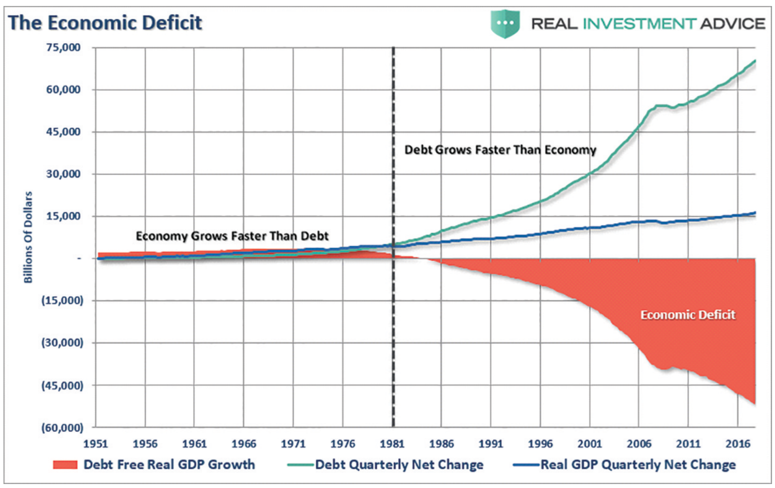


FIGURE 8 |

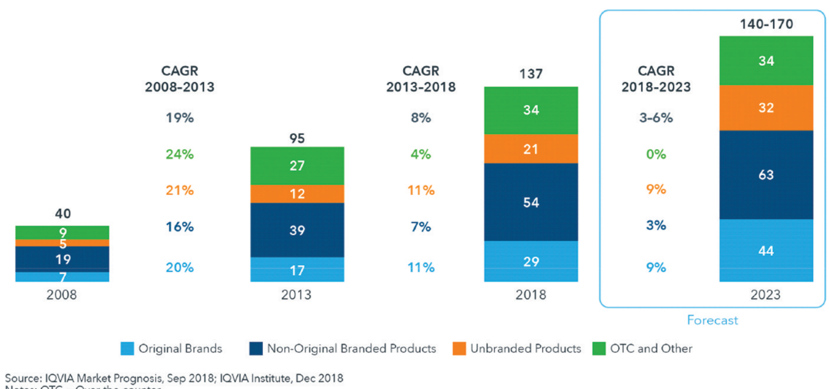


FIGURE 9 |

cracked, the climate of opinion changed abruptly, and operators were no longer able to finance their uncovered positions in the face of a price collapse. The liquidity crisis turned into a solvency crisis, and the system broke down. The Lehman crisis of 2008 was described in these terms by the Washington Post only the day before, with its main columnist, Donald Luskin, claiming there were no problems whatsoever.

History, however, proved Minsky right. He passed away in 1996 in the midst of the financialization of the real economy that would lead us to today's disasters and the Nobel prizes that sanctified finance: in 1994, the markets

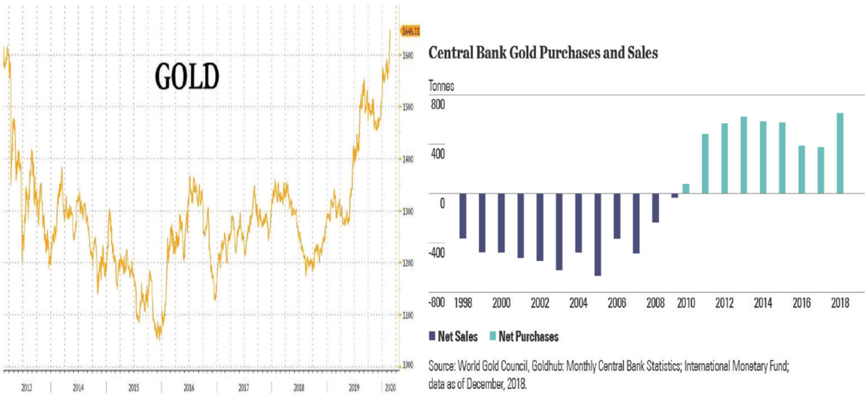


**FIGURE 10 |**

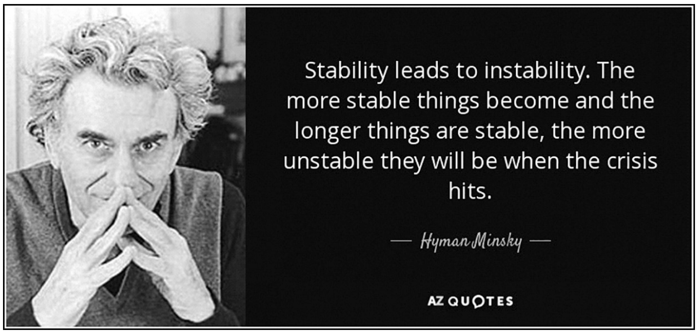


**FIGURE 11 |**

with Lucas became rational, such as never to make mistakes, and in 1997, derivatives began the race to infinity with the Nobel prizes for Merton and Scholes, who would fail only a year later with the institution that operated according to their intuitions. The illusion of infinite wealth was cloaked as absolute truth, moving from saving investments to debt consumption. This was followed by the first dot.com bubble in 1999, the same year that Greenspan wholly deregulated the derivatives market and opened the doors to the wolves of Wall Street. The Enron disaster occurred in the new century, in December 2001, the year of the Twin Towers; the $85 shares were worth 25 cents in just 1 month. Then, the subprime bubble was ready, but everything slipped away. Everything in finance happens in the short or very short term, in a world far from the neglected real economy.

The removal of the dollar from an underlying asset in 1971 permitted the beginning of the enormous Pied Piper hallucination, which distorted reality and history while removing the antitrust restrictions that had previously regulated the markets. In fact, the separation of the dollar from gold signaled a return to the theories of John Law, who did the same thing at the start of the 18th century, thinking he could link its issuance to land, but the failure of the East India Company in 1726, following the tulip bubble in 1630, was the first huge financial bubble at the dawn of a new history, as we see in the following graph:

The "Midas syndrome" is in the human spirit, who would like to have infinite wealth as Virgilio in Eneide describe as "Auri sacra fames."

The quest for the maximum personal profit would lead to the relocation of labor, the consequent loss of earnings from the real economy, the increase in debt consumption that generated growing insolvency, creating shareholder value led to China's becoming a world factory by wiping out jobs in manufacturing and relocating them to the Celestial Empire, and now they might understand the nemesis, as the following graphs show:

Between 1990 and 1999, the US relocated most of its manufacturing to China for lower costs and saw its GDP grow exponentially, which in previous years had been lower than that of Chad; a severe depression hit the great American agricultural industry, now in ruins.

Certainly, the delocalization phenomenon led many other countries toward this path, including Italy; the problems are now coming to the fore and the big fashion manufacturers, who have long been accustomed to making money on price differentials, have to deal with the lack of production with effects on sales and on their ability to cover costs.

The stock market has become a casino based on speculation that buys and sells continuously; high-frequency "trading" becomes e-commerce based on mathematical models that make the decisions, and competition is played out on the speed with which operations are executed, leaving the real world outside of any scheme. Corporations become endless bubbles created by expectations of illusory results, and to create value, accounting standards allow accepting results based on expectations of future earnings; the higher values attributed by the market lead to greater indebtedness, but the value of shares becomes the result of manipulation with buybacks and the liquidity of quantitative easing, which according to Bloomberg generated surplus value of 60%. The following graphs show the buyback effect and the perception of the distance between finance and the real economy:

The curve of financial assets becomes steeper and steeper, but the real economy is held back, and unemployment does not allow debt positions to settle, and "the fall in the level of prices and wages tends to trigger a deflationary process that reduces the amount of money, which only aggravates the situation in the labor market: flexible prices and wages have destabilizing effects" (Minsky, op. cit.). The more the stock market indexes grow, the worse the real economy becomes; the two indicators are going in completely different directions; the system spirals toward the "Minsky moment."

Even in the face of the evidence of the facts, the "mainstream" of the rational financial culture that sanctifies the absolute exactitude of the markets continued to justify the growing asymmetry, blaming man's emotionality that prevents us from understanding the sophisticated formulations of computers that, in the absence of emotionality, are able to interpret reality in a fairer and more aseptic way. Notwithstanding this clash between man and artificial intelligence, we can understand Emanuele Severino's thought when he affirmed that technology is the master of the world. Man's passive and ill-advised subjection to this challenge is a further demonstration of the cultural challenge that Stanley Kubrik first represented in the visionary film "2001: A Space Odyssey," in which at the end, the cunning astronaut David Bowman got the better of Hal 9000, the on-board computer, which was never wrong. Ultimately, computers live on man-made models, but they can never possess man's imagination and cunning. In other words, they can never replace, ideologically, the cunning Ulysses and invent the Trojan horse. The following graph again shows the dramatic asymmetry between unreal finance and the real world, but sooner or later, man will have to come to terms with his insipience and overkill; it is always the ancient Greek "Hybris" who ends up betraying man who, just like Icarus, wants to challenge the sun but ends up defeated.

Finally, the dramatic coronavirus pandemic in China has been an explosive "trigger," reducing production, consumption, and revenue expectations, while increasing the risk of insolvency. Everything becomes a rollercoaster game against the evidence of reality, and the case of Tesla is an example.

The real evidence of the facts is given by less manipulable indicators such as the "Baltic Dry Index," the index of the trend of the maritime transport, and freight rates of the main categories of dry bulk cargo ships. It collects information on cargo ships carrying "dry," hence non-liquid (oil, chemicals, etc.), and "bulk" materials. With reference to the transport of raw materials or agricultural commodities (coal, iron, wheat, etc.), it is also an indicator of the level of supply and demand for these goods, signaling economic trends. The observation of its trend is dramatic; the related graphs show a drop of 80% in 5 months from the peak in September 2019 to date:

The consequences are evident from the blockade of trade, production, and consumption, increasing the debt positions of companies more exposed to relocations and trade with China and also with neighboring countries. Credit companies see the level of fragility of part of their credit worsen, and the financial system has to deal with the endlessly created bubble. In the desire to cut costs, relocation has prevented "thinking" of a sort of beautiful exit from the trap of the single producer and consumer, the income trap triggering the tripwire: Apple has reduced its sales forecasts (iPhones are assembled in China); the German automotive industry has 40% of its production in China, as does Boeing; and American supermarkets are full of Chinese products. The debt of American families has exceeded $18,000 bn/$ and US debts $23,000 bn/$; the subprime game for cars is playing out, and yet stock market values are rising dangerously in the real world. The growth of debt is asymmetrical to the growth of the economy and becomes unsustainable when the perception of the risk of a collapse of the stock market, already drugged to the maximum, becomes less sensitive to the enthusiastic declarations of the always new maximums reached by the Stock Exchange, it will begin to dispose of the shares of companies more in crisis. The "Minsky moment" becomes increasingly threatening.

In the same way, the following graph shows the asymmetry between debt growth and the economic growth deficit. The two trends are irreversible in the short term, as are the positions taken by the Trump administration toward China with the increase in tariffs to cover part of the growing deficit and the unfeasible commitment made by China itself to purchase American products. In essence, in a context of confusion, the position of the Fed also increasingly seems to be that of Buridan's ass, equally hungry and thirsty, hence unable to choose whether to eat or drink. It had to increase the rates but then ended up knocking them down and flooding the money market with QE (quantitative easing), despite the evidence that you cannot cure a junkie by increasing his doses. By now, we are at the end of the cycle, and the debt and economic deficit are not repairable in the short term.

However, if the virus were to continue spreading to other countries, the US would also find itself in greater difficulty with regard to the healthcare system. To reduce costs, pharmaceutical companies have relocated 50% of the production of generic drugs that will be unobtainable in hospitals, as well as the masks to be used as a deterrent to contagion. In the past 30 years, the US pharmaceutical industry has relocated much of its production abroad; the US is currently no longer able to produce generic antibiotics used to treat ear infections, sore throats, pneumonia, urinary tract infections, venereal, and other diseases. The last penicillin factory was closed in 2004. China, the world's leader in low-cost products, has filled the gap. Today, China produces 40% of the active ingredients in American drugs and 80% of those used by India, the leading global supplier of generic drugs. On a practical level, it would mean that if the US stopped sourcing from China, within a couple of months, American pharmacies would be empty. Today, the most purchased Made in China medicines on the other side of the Pacific range from antidepressants to birth control pills, HIV/Aids, diabetes, Parkinson's disease, and epilepsy. The following graphs highlight the growth of the drug industry in China:

The lack of an alternative strategy to relocation linked only to the "lower price" logic but far from the social, cultural, and political variables of supplier countries is the most evident example of the short-term vision of finance, everything, and immediately; the lack of a political culture in the US is not only but always that of aggression and military threat. Actions dictate the consequences, but it seems that we never want to see them in the suicidal illusion that time and history have stopped to fulfill our desires. But when the dream ends after a period that was thought, fatuously, to never end, the reaction is always to find a scapegoat guilty of the inability to read history. The dynamics of clashes, of "back and forth" on foreign policy in the autistic search for enemies and continuous clashes—Assad, Russia, North Korea, Maduro, Iran, Egypt, China, etc.,—are the evident manifestation of dangerous political confusion and are incapable of looking within where instead the greatest dangers lie.

## Conclusion: the end of fiat money and the return to the gold exchange standard

The collapse in September 2008 may have been an admission that the system was coming to an end, as well as an admission of the dramatic consequences of generating not just a financial but also a social bubble, which would lead to a tragic path of a malicious crisis. The only financial culture was one of liquidity flooding the markets in order to make them manageable and manipulatable in order to serve the interests of those who wished to benefit. Toxic relationships among academia, politics, and finance continued to mislead about the basics of a subject that had been turned into a casino, such as economics. The "media," who slavishly devoted themselves to represent rational markets as a magical and irrefutable entity, elevated the design endorsed by an inadequate and impotent political elite that cared only about survival to a dogma. However, as a result of increased awareness of the situation, numerous governments have increased their gold holdings, even transferring them to the coffers of others, as can be seen from the following graphs showing the return to the gold as a reserve value facing the financial big bubble. Return to the gold as the central banks are doing:

In the late Professor Emanuele Severino's words, "We are on a stormy sea and we do not want to see it," but "history, in a sort of nemesis, always presents the bill."

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