

**Closing Dinner Remarks**  
**The Hyman P. Minsky Summer Seminar**  
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*The Levy Institute's Summer Seminar provides a rigorous discussion of both the theoretical and the applied aspects of Hyman P. Minsky's economics, with an examination of meaningful prescriptive policies relevant to the current economic and financial crisis. The Seminar is attended by economics graduate students, and those at the beginning of their academic or professional careers, from around the world. The teaching staff includes well-known economists who have dedicated themselves to concentrating on and expanding Minsky's work.*

Sadly, I never knew Hyman Minsky during his lifetime. But as with many others, most of yourselves included, his insights have proven vital to me in filling in the gaps between that which is known and that which is commonly believed in the social science of economics—often demonstrating that such gaps between knowledge and belief cannot be filled at all, and thereby debunking that which is supported by misplaced faith alone.

I am grateful to those in academic leadership here at the Levy Institute, Dimitri [Papadimitriou], Jan [Kregel], Randy [Wray] and others, who have offered to share with me their own insights and scholarship. As a markets guy, I may be able to contribute a bit here and there, but you—gentlemen—have been invaluable to me in placing whatever it is I bring to the table into the context of the discipline of political economics. I am honored to have you as mentors and, if I may daresay, as friends. And thank you, as his students and adherents, for bringing Professor Minsky's work to life for me.

Minsky had the rarely seen ability to stand back from all he had learned—even at times from his own mentors—and not only see and articulate what was misunderstood, what wasn't working, but also to explain why conventional wisdom is often not always all that wise and why markets often proceed in delusional fashion. And by this I mean not merely the often irrational animal spirits of markets, nor the Keynes' casino, nor his beauty contest, but an almost collective agreement to ignore the most obvious of fact-pictures staring right back at us. And often, to ignore them because they force consideration of exogenous variables that aren't readily incorporated into existing mainstream models, to ignore them because they are too heterodox to be considered by those who have invested their lives work in developing and interpreting mainstream theory, or to overlook them because they involve understanding the often obtuse complexities of actual market operations that go beyond ivory tower theories of market behavior.

Hyman Minsky saw and wrote clearly about these unpopular things that *he* could not ignore.

So what is it that I believe Minsky would have seen today? What is it that he could not, today, ignore? Well, certainly, he would have—well before the global financial crisis, I believe—been pounding the drum even more loudly than he ever did on such subjects as financial instability, market inefficiency, money manager capitalism and others.

But it seems to me that that, based upon the history of the past decade, Professor Minsky would have insisted that the profession re-examine the roots of inflation and deflation. That is, as Minsky already knew, that secular price changes are not principally the result of changes in the quantity of money, but rather the consequence of the relationship between aggregate demand and aggregate supply. Further, I think it would occur to Minsky that recent monetary policy has, in any event, destroyed the money-price level relationship for a long time to come and that to understand what has occurred and where we are going requires rigorous analysis of both endogenous and exogenous aggregate demand and aggregate supply—with a nod to deteriorating velocity of money thrown in for good measure.

Minsky was, given the time he wrote, focused on inflation. Today his emphasis would be on deflation, and I would not be surprised if he addressed himself to the altered state of global macroeconomics that has prevailed since the beginning of the post-socialist period, the antecedents of which—the fall of the Berlin Wall and the Tiananmen incidents—we have the 25th anniversary of this very year.

But the post-socialist period was barely out of the gate when we lost Professor Minsky. He never got to see the full effect on advanced economies of the emergence of the hugely competitive and mercantilist, post-socialist nations. He never had the opportunity to consider unprecedented phenomena, such as reverse capital flows from poorer countries to rich ones. And boy-oh-boy, would he have had a lot to add on the modern day reinterpretations of Hansen's secular stagnation meme.

I can't, of course, know exactly what Minsky's conclusions would have been about all this—or whether he would have thought it important at all. But I will fill in the gaps between what is known and what I believe, as best I can.

Last year, I had a book published with an intentionally controversial title: “The Age of Oversupply: Overcoming the Greatest Challenge to the Global Economy.” I chose to describe the circumstances we find ourselves in presently as being derived from a condition of “oversupply,” rather than from its mirror image—inadequate demand. Because while the credit bubble and its resulting crisis certainly presented us with a Fisher-style, debt-related throttling of demand, the crisis and even the bubble that preceded it can be most directly chalked up to the relatively sudden explosion in global production. I argue that this explosion was so massive as to, for the time being at least, set theories of money quantity and marginal utility on their heads and has overwhelmed the ability of markets (or, more accurately, the desires of market participants) to clear, based on price mechanisms alone. The magnitude of present imbalances does not trash Walrasian/Paretian equilibria and efficiencies, but so sufficiently overpowers the ability of markets to achieve them, that cyclical considerations must be set aside for the long duration of time it has and will take to absorb these secular imbalances.

The principal imbalance is the sudden rise in free market industrial labor. It's hard to imagine a comparable parallel in economic history, since the population of the world doubled overnight with the creation of Eve from Adam's rib. No other event in history really compares with the populations of China—the Soviet Union and its satellites—India—and other new and vast pools of labor being hooked into the mainline bloodstream of global trade within the span of roughly a decade. We've had famines, wars, and natural disasters that have suddenly changed the composition of demand—but a rapid and multi-fold increase in the supply of labor, productive capacity and, ultimately, global capital, has no analog.

There have been smaller, regional situations with similar attributes—but nothing on the scale of countries with collective populations of nearly 3.5 billion people suddenly emerging into trade competition with the 800 million or so people in the developed economies.

My book goes into considerable detail on the issue of oversupply and how it has touched on pretty much every troublesome global macroeconomic issue of the past ten years in advanced nations: from credit bubbles to busts, from hyper-low inflation to zero interest rates, and from accelerating inequalities of income and wealth to, yes, even dysfunctional governance in many democracies.

I will not go into all of that this evening. Rather, I will devote the rest of this talk to recent trends in monetary policy outcomes, labor and prices that have continued to confound market participants, economists, and policy makers alike. Let's start with monetary policy.

In September 2012, the U.S. Federal Reserve Bank announced and—shortly thereafter implemented—its third, and by far largest, installment of “quantitative” monetary easing. “QE3,” has resulted in the Fed acquiring over \$1.4 trillion in U.S. government and agency securities through Q1 2014, and it is expected to generate aggregate purchases of over \$1.5 trillion through the anticipated end of the program a few months from now.

QE3, in both size and duration, went well beyond the Fed's two earlier rounds of quantitative easing—QE1, from November 2008 to June 2010, and QE2, from November 2010 to June 2011. The rationale behind QE3 can best be described as “shock and awe,” an effort to shock the U.S. economy into reflation and growth by flooding it with awe-inspiring amounts of cash, while attempting to bring long-term interest rates back near historic lows seen in mid-2012 and perhaps attempting to force down the value of the dollar to make U.S. exports more competitive and imports less attractive.

However, by those measures, QE3 was less than successful. Inflation in the United States continued to fall during the implementation of the policy, reaching lows unseen since the Great Recession itself. Per capita real disposable income barely budged, falling well off its trajectory from 2010 through the commencement of QE3. Long-term interest rates, while falling back a bit initially, ultimately rose well past their 2012 lows, sending bond markets tumbling even before the announcement of the Fed's tapering back its purchases—which sent long-term interest rates well above levels before QE3 began. Needless to say, for a variety of reasons, the dollar did not tank.

What was “successful” about QE3, at least in the eyes of some, was what happened in the financial economy (as opposed to the “main street” economy). Hyper-easy money policy continued speculation in risk assets. The Fed's interventions over three rounds of quantitative easing flooded the economy with liquidity, initially to avoid lock-up of the financial economy, made it very inexpensive to borrow, and, ultimately, made “risk-free” assets very unattractive to own by virtue of the parsimonious returns thereon. Commodities—especially gold, having seriously burned speculators in a spectacular collapse after its run up resulting from QE1 and QE2, and non-monetary metals and oil, having been overvalued by speculators during those prior rounds, relative to end demand—were no longer seen as safe.

Excess liquidity finally flocked to public equities, especially those easily leveraged with cheap money, which have run up to valuations that by some measures (such as Bob Shiller's CAPE ratio) make them more expensive than anytime other than during the market bubbles of 2008, 2000 and 1929. From the announcement of QE3 to date, the S&P 500 Index has appreciated by some 36 percent.

U.S. housing, which did not reach its post-bubble statistical low valuation until early 2012 (a fact that seems forgotten two years later), took off as well—rising gradually at the start of the historically low bond yields that were reached between QE2 and QE3 and then accelerating greatly during QE3. By the end of 2013, U.S. housing prices had, on average, retraced nearly half the value lost since their bubble-era peak. Housing prices rose, fueled by the

same low interest rates that fueled the stock markets, but were driven higher still by the post-crises anomaly of, on the one hand, rates of household formation (and thus incremental demand) that continued at levels lower than at any time since the Great Depression—and that's in nominal, non-population-adjusted terms—and, on the other hand, tight inventories of for-sale housing, despite the former factor.

Looking back at the recovery in home prices that occurred simultaneously with QE3, we saw a continuation of inventories constrained by homeowners remaining underwater relative to their bubble-era mortgages and thus unable, or unwilling, to sell their homes—combined with those with very low levels of home equity, insufficient to afford the sales costs of their existing home and a down payment on a new home and therefore de facto non-sellers. We also experienced a large number of purchases of homes by investors able to access low cost capital to acquire the limited inventory that was available, and “pay up” for it when necessary

One cannot find a more classic example of a market unable to find a true “clearing” price level, because of policy-related influences, than the U.S. housing market.

But in elevating price levels for U.S. housing and sending public equity markets to new historic highs, the Fed’s impact on the real economy—demand for goods, services, labor, and new capacity (plants and equipment)—was far less than anyone could have possibly expected from such a massive expansion in the quantity of money.

Ultimately, the rapid appreciation of financial assets (and I include real estate as a financial asset) in 2013 created a “wealth effect” recovery in which the small percentage of Americans owning stocks—and a far more substantial number owning homes—were, and felt, richer and supported a modest recovery in consumption. This, for a while at least, spilled over into the economies of other developed and developing exporting nations. But as events seem to have demonstrated earlier this year, wealth effect–created demand is, at best, unstable in the age of oversupply.

One of the most obvious reasons why wealth effect–reliant demand is unsustainable is that the inflated price of equities influences the consumption patterns of only a small, but very wealthy, number of consumers. A more disturbing reason is that in an age in which real wages are not growing, the wealth effect has been transmitting to consumers who were made exuberant by rising home prices, chiefly by means of rising consumer debt. Outstanding consumer debt hit new post-bubble highs this year resulting in the renewed exacerbation of the already low U.S. household savings rate. The ability of households to continue to consume by taking on more debt has rather unpleasant limits, as we saw in 2007. Lastly, in a world of inadequate global demand for labor, production and capital relative to the supply thereof, there is a tendency for businesses, consumers, and investors to materially misread improvements in one nation’s economic results when other competitive nations are showing downwardly trending performance.

In a nearly fully globalized economy for goods, and even for some services, strength in the United States that comes with concomitant weakness in China and other emerging producers (or in Germany that comes at the expense of the European periphery and emerging producers), as we saw in the second half of 2013, can only be sustained for a very limited time, until the price levels offered by those deprived of demand for their own output are lowered to recapture such demand. We have seen this, in 2014, with falling import prices in the U.S. This would not be the case in an environment in which supply and demand were more evenly matched, but in the age of oversupply what we get instead is the tossing around of the “hot potato” of inadequate demand among nations and regions, yielding disinflationary tendencies around the world.

Thus, financial asset price appreciation, the resulting wealth effect, and short-term rises in business activity fail to result in the advanced economies reaching “escape velocity” where increased consumption produces a virtuous demand for additional domestic capacity and labor, which in turn sets wages and prices on a reflationary path. As 2014 dawned, the reality of the Fed’s exiting the policy that sustained financial asset appreciation set in. The Fed is exiting QE precisely because it has come to see little sustainable benefit to the real economy from quantitative

easing—and potentially problematic distortions therefrom. Global stock markets—first in the emerging nations and then in advanced nations—this year initially reacted to the ending of QE with dread.

The failure of QE3 to ignite price and wage reflation was writ large in 2013, during which U.S. goods prices actually deflated from twelve months earlier. While services rose in price, the principal contributor to price inflation in services was, unsurprisingly, inflation in the cost of housing. Housing costs comprise some 41 percent of the U.S. Consumer Price Index and shelter alone is over 52.5 percent of the services component of the CPI. The peculiar confluence of easy money and structural anomalies in the U.S. housing market, discussed previously, resulted not only in price appreciation of owner-occupied homes, but also restricted inventories thereof. These factors, together with an enormous rise in the number of households that—since the Great Recession—no longer qualify for mortgages, saw many more families thrust into the conventional rental housing market, causing U.S. rents to rise by 2.9 percent over the course of 2013.

Add inflation in medical services during 2013 (which fluctuated somewhat late last year, but is again on the rise) and you have the vast majority of 2013's anemic 1.6 percent core U.S. inflation. As further housing price inflation is unlikely to prove sustainable in the absence of wage growth, and with prices of imports (and both the prices and volumes of exports) falling with global oversupply, where is price inflation to come from in 2014?

In the first quarter of 2014 the bias continued to be disinflationary. Over the past several months, we have seen headline CPI numbers somewhat elevated. But again, this is not generalized inflation. Perishable foodstuffs has risen in price as a result of severe drought conditions in the western U.S. and energy prices have risen with global instability in the Ukraine and, now, Iraq. Even with 0.4% headline CPI growth in May, core commodities were down in price year over year, and rose less than 0.1% for the month. Fed Chair Yellen, in her press conference this week, was right on target in saying that recent inflation data contained a lot of “noise.” For these reasons, I believe the bias going forward is far more likely to continue to be to the downside.

During the course of 2013, especially after the Fed announced its intention to taper its asset purchases, the conventional bond market wisdom was that interest rates on U.S. treasury securities would rise as a result of the planned change in policy. The benchmark ten-year yield increased by over 1.25 percent from its 2013 low to its high at the end of the year. At year end, expectations were that they would rise further still. But as I wrote in Q2 2013, and in my book, and have reiterated publically numerous times since, with the confluence of ultra-low inflation (tending towards deflation in the absence of the factors previously discussed), a global “oversupply” of demand for high-quality, hard-currency sovereign debt, and with both domestic and global growth data continuing to be unimpressive, there simply is nothing underpinning a more precipitous rise in U.S. sovereign debt yields.

What there was, at year-end 2013, was a collective fear of what financial market participants call a “falling knife.” The perception that Fed buying of U.S. long obligations had been materially influencing the prices at which those bonds were trading (and, perhaps just as importantly, the perception that all market participants shared that notion) overwhelmed the above underlying economic fundamentals. Sure enough, as the Fed reasserted that it would proceed with QE despite soft economic data at the beginning of 2014, instead of rising, interest rates fell such that the trading range of 10 year bonds has declined by almost 50 basis points.

Quantitative easing had proven so disruptive of market pricing mechanisms that even the normally staid and sensible bond market didn't know which end was up.

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I have spoken and written recently about 2014 being the year in which economic “cyclicalists”—those believing that the Great Recession and its aftermath have just been the result of a very severe decline in the business cycle—and the “secularists”—who believe that what we continue to experience is the outcome of profound shifts in the way the domestic and global economy is working, relative to its behavior in the past. Secularists, myself included, believe



that positive cyclical phenomena—while still of course present—are now both muted in amplitude and of short duration. I expect this will continue to be the case for some time, until the global secular issues of oversupply of labor, productive capacity and capital are either addressed more aggressively, or until the imbalances I have discussed—gradually, and likely painfully—resolve themselves over a protracted period of time.

The failure of monetary policy alone to revive robust growth in the United States and the European Union (which admittedly has limited monetary tools available to it because of the Euro regime) has become evident to their central bankers. The euphoria that greeted the Bank of Japan's massive QE program—part of its government's forceful effort to reverse deflationary pressures, known as “Abenomics”—has subsided. It is becoming apparent that Japan's domestic reflation to date has come almost entirely from the currency market's devaluation of the yen and the resulting rise in import prices (almost entirely energy related), as opposed to inflation in wages or prices for domestically produced goods. Such a condition is unsustainable, and I believe Abenomics will ultimately join previous Japanese reflationary efforts in failing to reverse the disinflationary trend that, since the Great Recession, has seen the rest of the developed world join Japan's fate.

Thus far in 2014, the U.S. economy has seen a continuation of weak wage growth. Core inflation, less shelter, hovered at only 1.3% year over year as of May. Furthering limits on wage growth has been the failure of the U.S. congress to extend long-term unemployment insurance benefits. This will pose ongoing challenges. We, thus far, have seen this reflected in perhaps temporarily declining labor force participation rates. Retaining unemployment benefits requires that you actively look for work, and I believe some of the fall-off in the LFPR in 2014 has been underpinned by the long term unemployed no longer saying that they are looking for work because they have lost their unemployment benefits anyway. I am particularly concerned, therefore, that many folks coming off long-term benefits will, before long, be forced into taking jobs at whatever wage they can find, and this will prevent the rise of, or exert further downward pressure on, U.S. real wages. Of some alarm in Q1 2014 was data demonstrating falling unit labor costs with a contemporaneous rise in productivity (although that has reversed itself to an extent in Q2). Rising productivity that comes from weakness in wages and exploitation of excess capacity is a far cry from the version of productivity that comes from technological advancement at optimal levels of employment. The declining labor force participation rate in the United States—notwithstanding the decline in the headline unemployment rate—if it holds, would be particularly ominous in this regard. I note that only a portion of the decline in the LFPR is attributable to the demographic shifts that are often named as the principal culprit.

I wrote *The Age of Oversupply* in order to suggest to those perplexed and frustrated, by present circumstances in advanced nations, a comprehensive explanation of why the credit bubble, the Great Recession, and the ensuing lack of full recovery evidence a situation that is truly apart from past economic tribulations. Shortly after the September 2013 hardcover release of my book, Larry Summers gave a well-followed speech at the IMF on Secular Stagnation. Summers, with whom I have had many disagreements during his terms in government, but who I credit with having seen the light after his departure from the Obama administration at the end of 2010, pretty much hit the nail on the head in that speech. Summers noted that even before the global financial crisis, something was clearly amiss—he said:

“If you go back and study the economy prior to the crisis, there is something a little bit odd. Many people believe that monetary policy was too easy. Everybody agrees that there was a vast amount of imprudent lending going on. Almost everybody agrees that wealth, as it was experienced by households, was in excess of its reality. Too easy money, too much borrowing, too much wealth. Was there a great boom? Capacity utilization wasn't under any great pressure; unemployment wasn't under any remarkably low level; inflation was entirely quiescent, so somehow even a great bubble wasn't enough to produce any excess in aggregate demand.”

Even though, in my opinion, Summers' IMF remarks presented an incomplete case for causality, in that it does not articulate the global oversupply argument, I think his general understanding was spot on. This time in global

macroeconomics truly *is* different and requires thinking outside the boxes imposed on us by the ideological limitations of the past several decades. Those differences and limitations are also responsible for the failure of policy since the Great Recession to produce a resurgence of growth, as Summers concluded in his IMF address:

“... it does seem to me that four years after the successful combating of the crisis, there is really no evidence of growth that is restoring equilibrium. One has to be concerned about a policy agenda that is doing less with monetary policy than has been done before, doing less with fiscal policy than has been done before, and taking steps whose basic purpose is to cause there to be less lending and borrowing than there was before.”

I believe Hyman Minsky would have put all these disparate threads together in a way far more effective than what I have been capable of...and surely a heck of a lot earlier than Professor Summers did.

Thank you.

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