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PAGE ONE

In Time of Tumult, Obscure Economist Gains Currency

Mr. Minsky Long Argued Markets Were Crisis Prone; His 'Moment' Has Arrived

By JUSTIN LAHART
August 18, 2007; Page A1

The recent market turmoil is rocking investors around the globe. But it is raising the stock of one person: a little-known economist whose views have suddenly become very popular.

Hyman Minsky, who died more than a decade ago, spent much of his career advancing the idea that financial systems are inherently susceptible to bouts of speculation that, if they last long enough, end in crises. At a time when many economists were coming to believe in the efficiency of markets, Mr. Minsky was considered somewhat of a radical for his stress on their tendency toward excess and upheaval.

RELATED READING

"The Financial Instability Hypothesis"[1] by Hyman P. Minsky, May 1992
"The Plankton Theory Meets Minsky"[2] by Paul McCulley, March 2007
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Hymen Minsky

Today, his views are reverberating from New York to Hong Kong as economists and traders try to understand what's happening in the markets. The Levy Economics Institute of Bard College, where Mr. Minsky worked for the last six years of his life, is planning to reprint two books by the economist -- one on John Maynard Keynes, the other on unstable economies. The latter book was being offered on the Internet for thousands of dollars.

Christopher Wood, a widely read Hong Kong-based analyst for CLSA Group, told his clients that recent cash injections by central banks designed "to prevent, or at least delay, a 'Minsky moment,' is evidence of market failure."

Indeed, the Minsky moment has become a fashionable catch phrase on Wall Street. It refers to the time when over-indebted investors are forced to sell even their solid investments to make good on their loans, sparking sharp declines in financial markets and demand for cash that can force central bankers to lend a hand.

Mr. Minsky, who died in 1996 at the age of 77, was a tall man with unruly hair who wore unpressed suits. He approached the world as "one big research tank," says Diana Minsky, his daughter, an art history professor at Bard. "Economics was an integrated part of his life. It wasn't isolated. There wasn't a sense that work was something he did at the office."

She recalls how, on a trip to a village in Italy to meet friends, Mr. Minsky ended up interviewing workers at a glove maker to understand how small-scale capitalism worked in the local economy.

Although he was born in Chicago, Mr. Minsky didn't have many fans in the "Chicago School" of economists, who believed that markets were efficient. A follower of the economist John Maynard Keynes, he died just before a decade of financial crises in Asia, Russia, tech stocks, corporate credit and now mortgage debt, began to lend credence to his ideas.

Following those periods of tumult, more investors turned to the investment classic "Manias, Panics, and Crashes: A History of Financial Crises," by Charles Kindleberger, a professor at the Massachusetts Institute of Technology who leaned heavily on Mr. Minsky's work.

Mr. Kindleberger showed that financial crises unfolded the way that Mr. Minsky said they would. Though a loyal follower, Mr. Kindleberger described Mr. Minsky as "a man with a reputation among monetary theorists for being particularly pessimistic, even lugubrious, in his emphasis on the fragility of the monetary system and its propensity to disaster."

At its core, the Minsky view was straightforward: When times are good, investors take on risk; the longer times stay good, the more risk they take on, until they've taken on too much. Eventually, they reach a point where the cash generated by their assets no longer is sufficient to pay off the mountains of debt they took on to acquire them. Losses on such speculative assets prompt lenders to call in their loans. "This is likely to lead to a collapse of asset values," Mr. Minsky wrote.

When investors are forced to sell even their less-speculative positions to make good on their loans, markets spiral lower and create a severe demand for cash. At that point, the Minsky moment has arrived.

"We are in the midst of a Minsky moment, bordering on a Minsky meltdown," says Paul McCulley, an economist and fund manager at Pacific Investment Management Co., the world's largest bond-fund manager, in an email exchange.

The housing market is a case in point, says Investment Technology Group Inc. economist Robert Barbera, who first met Mr. Minsky in the late 1980s. When home buyers were expected to have a down payment of 10% or 20% to qualify for a mortgage, and to provide income documentation that showed they'd be able to make payments, there was minimal risk. But as home prices rose, and speculators entered the market, lenders relaxed their guard and began offering loans with no money down and little or no documentation.

Once home prices stalled and, in many of the more-speculative markets, fell, there was a big problem.

"If you're lending to home buyers with 20% down and house prices fall by 2%, so what?" Mr. Barbera says. If most of a lender's portfolio is tied up in loans to buyers who "don't put anything down and house prices fall by 2%, you're bankrupt," he says.

Several money managers are laying claim to spotting the Minsky moment first. "I featured him about 18 months ago," says Jeremy Grantham, chairman of GMO LLC, which manages $150 billion in assets. He pointed to a note in early 2006 when he wrote that investors had become too comfortable that financial markets were safe, and consequently were taking on too much risk, just as Mr. Minsky predicted. "Guinea pigs of the world unite. We have nothing to lose but our shirts," he concluded.

It was Mr. McCulley at Pacific Investment, though, who coined the phrase "Minsky moment" during the Russian debt crisis in 1998.

Laurence Meyer, who served on the faculty with Mr. Minsky at Washington University in St. Louis, was a Federal Reserve Governor during those turbulent times. Mr. Meyer says that when he was an academic, Mr. Minsky's work didn't interest him very much, but that changed when he went into the real world. He says he grew to appreciate it even more when he was at the Fed watching financial crises unfold.

"Had Minsky been there, he probably would have been calling me and alerting me along the ride. And that would have been a good thing," Mr. Meyer says. "Every year that goes by, I appreciate him more. I hear myself sometimes and I think, oh my gosh, I sound like Hy Minsky."

Steven Fazzari, an economics professor at Washington University, says that Mr. Minsky would have supported the Federal Reserve's recent move to provide cash and cut the rate it charges banks on loans from its discount window to try to avert a financial crisis that could spill over to the economy. But he would probably be worried, too, that the moves might be bailing out investors who would all too soon be speculating again.

Having seen recent events unfold in the way his friend and former colleague predicted, Mr. Fazzari says, "I hope he's someplace saying, 'Aha, I told you so!'"

--Jon E. Hilsenrath contributed to this article.

Write to Justin Lahart at justin.lahart@wsj.com[4]

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