The Unpredictable White Swan

The financial crisis of 2008, an unexpected but foreseeable crisis, succeeded in providing the tools to overcome future concerns such as the one that only pandemic theorists had loosely predicted. So, of course, today, it seems easy to say that the stock market crash that occurred at the end of the first decade in the third millennium was predictable. However, like all crises, it was not. But the danger signs were all there: high prices, a booming real estate market, easy credit issuance, extreme financialization of economies. The economist Hyman Minsky[1] had practically identified all of them. However, for the world of finance, COVID-19 was not so much a black swan as a white swan sleeping on a snowy mountain.

The central banks responded to the financial crisis with an extreme dose of financing: meagre interest rates (even in negative territory) and bond purchases aimed to inject further liquidity into the shaky banking system. The inadequacy of politicians, incapable of making quick decisions in a globalized world, has forced the central banks to act, experiment and thus, learn. Knowing that they had entered unchartered territory, they also started drafting tools to be used in the event of a second shock wave. As a result, in February-March 2020, at the height of the pandemic, central banks found themselves prepared and almost immediately flooded the world with further liquidity, without inhibition. As the former Federal Reserve Governor Ben S. Bernanke predicted, to fight extreme cases of deflation, one could use a helicopter and throw money out the window to everyone, precisely what happened in recent months. Moreover, unlike in 2008, politicians were able to react quickly and coordinate with the issuing institutions.

On a theoretical level, the Modern Monetary Theory, which advocates for monetary and fiscal interventions (at least

[1] Minsky H.P., *Potrebbe ripetersi? Instabilità e finanza dopo la crisi del '29*, Giulio Einaudi Editore, Torino 1984.

as long as they do not produce inflation), has gained traction in recent years. From a bipartisan perspective, being even theoretically encouraged to increase public debt appeals to many politicians in the race for re-election. The rise of such a theory is not only thanks to the popularity of economist Stephanie Kelton[2] but it is also due to contradicting signals, namely inflationary pressures in financial assets and the deflationary pressures in the real economy. Even the orthodox Bundesbank has therefore had to capitulate with regards to its historic rigour in fighting inflation. Banks realized that setting 2% as an insurmountable target for the inflation rate was itself a deflationary message since it discourages those who want to open themselves up to greater demand, and hence to higher prices. It is no coincidence that the Federal Reserve has long since announced that it is prepared to tolerate an upper limit if the causes are primarily cyclical and not structural.

By now, thanks mainly to vaccines and the renewed commitment of politicians, COVID-19 seems, at least for the time being, under control in established economies. The combination of pent-up demand, frozen by lockdowns, and abundant liquidity are, however, restarting the cycle: inflation, after years, seems ready to start again. The US consumer price index (CPI) reached 5% YoY in May, a level not seen since 2008, while in the Eurozone, it was only up to 2%, like in October 2018. Asia even saw the highest pace of price growth in more than a decade. The markets sensed the danger, and in March, the US ten-year rate rose to 1.74% (0.9% in January). The fear that after the pandemic, we would have to live permanently with higher inflation seemed to be imposing itself: that month, the stock markets, in particular the Nasdaq, the queen of technology, was re-discounting future profits with a correction. But then falling rates allayed the fear: the Treasury rate even fell below 1.5%, as did five- and ten-year inflation expectations. What happened? As Bernanke used to say, "monetary policy is 98% talk and 2% action. And the difference is even more important when short-term interest rates hover around zero and it becomes critical

[2] Kelton S., *The Deficit Myth, Modern Monetary Theory and How to Build a Better Economy*, Ed. John Murray, Londra 2020.

to influence expectations of future interest rates."[3] Fed Chairman Jerome Powell repeatedly intervened to explain that inflation is temporary given the sudden recovery of pent-up demand. As a result, European Central Bank (ECB), along with the world's major central banks, did the same.

At Least, for now, markets seem to be buying Jerome Powell's story. In June, the Nasdaq rose by almost 5.5%, the S&P followed suit with a 2.2% increase, the Eurostoxx50 rose by 1.8%, and finally, the SMI rose by 5%. Although normality seems close, a few things have changed in the post-pandemic era. First, there has been an apparent acceleration towards a digitized and sustainable economy. From a geopolitical standpoint, the US is trying to slow China down in an attempt to bring cutting-edge tech production back home. How? Joe Biden reinstated the creation of a multilateral approach with Europe that indirectly included Russia. Although this strategy is needed to challenge China's rise as the most prominent global power, the new president will have to deal with higher production costs. In terms of the main goals for Biden, the implementation of his infrastructure plan (even if scaled back) represents an attempt by the president to bring the real economy back in the spotlight. As a result of such essential investments, demand is expected to increase, and thus prices as well. In terms of environmental advancements, the detox from the cheapest energy source, oil, will be expensive. Europe, following a similar path, keeps advancing with its recovery plan (Next Generation EU). Historically, the return of politics and a well-defined state presence has been expensive. But, on the other hand, a highly digitized economy is capable – like mentioned by Jeremy Rifkin[4] – of producing at near-zero marginal costs, an inherently deflationary phenomenon. As mentioned earlier, the markets are – at least for the moment – listening to the whispering signals issued by Powell. The 10-year Treasury, stuck at 1.5%, is momentarily slowing the dollar down (at least against the euro). A central bankers' dream is succeeding in having

[3] Bernanke S. Ben, *Mémoires de crises*, Seuil, Paris 2015, p. 518.

[4] Rifkin J., *La società a costo marginale zero. L'internet delle cose, l'ascesa del commons collaborativo e l'eclissi del capitalismo*, Mondadori, Milano 2014.

inflation (which would entail a new demand) combined with growth rates higher than inflation itself and a constant delay in interest rate manipulation. For now, this seems to be the case, but the market is still doubtful. Sooner or later, words may not be enough anymore. As mentioned by Bernanke in his memoirs, "a solid monetary policy can support a healthy economy, but it cannot create one. In the long term, raising the quality of life for future generations hinges on the youth's opportunities to acquire economic competencies and a proper higher education simultaneously. Nothing matters more."[5] Theoretically, both the EU and US recovery plans trend in that direction. Through market monitoring, we will be able to assess the effectiveness of such measures in practice. Overall, we need to understand if the white swan has finally started flying or if the melting of the snow has revealed its presence.

[5] Bernanke. S. Ben, op. cit.