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Original Paper

Deflation and the Decoupling of Economy and Financialization

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Abstract

Certo! Ecco un riassunto formale del documento "Deflation and the decoupling of economy and financialization":

The paper discusses the decoupling between the real economy and financialization, highlighting how the financial crisis of 2008-2009 has shown that the development of financialization is not irreversible. Despite the perception of zero risk and out-of-market real estate values, the crisis has revealed the weakness of the real economy. Deflation is identified as a new enemy, appearing when debt exceeds income, depressing the value of capital and creating problems for production and sale. Olivier Blanchard's proposal on Eurobonds aims to strengthen the euro and improve the EU's financial stability but presents political and fiscal challenges. Financial speculation, fueled by private debt, weakens the real economy and creates a decoupling between the financial market and the real economy. The financial crisis of 2008-2009 did not solve the problem but only mitigated the impact of private debt. The resistance of economic systems to speculative play depends on the decline of global economic development and the ability to absorb downward shocks in financial values. As regards the future prospects, it is essential that economic policies focus on reducing private debt and stabilizing financial markets in order to avoid further crises. In addition, the implementation of instruments such as Eurobonds could help strengthen the European economy, but it requires significant political and fiscal commitment. The main challenge will be to find a balance between economic growth and financial stability, ensuring that the real economy is not sacrificed in favor of financial speculation.

Keywords

Social rapports, constant & coordinated development, collectivity reason, speculation waves

At the dawn of the new millennium, the year 2000, economic fortunes of the world of economics seemed to be going well, not because of the usual common impulse of many in favor of mannered optimism. No, no push for optimism but a new opportunity seemed to open up in the daily prospects for families and businesses. Yet, a new invisible enemy was preparing to conquer the global scenario. So even after the serious financial crisis of 2008-2009 that hit the economy - after a long holiday of (speculative) growth that had conquered and turned the world into a gambling den. The certainty that the development of the financialization of society was irreversible and that the ongoing process would lead to new goals. Therefore, a widespread feeling of zero risk, despite the off-market values of real estate, which had deceived even the most important central Banks, the Fed in the lead. (Brendan, 2022) The crisis - after the unscrupulous virtual financial increase - does not arise from the reasonable feeling of having exceeded the limits, and therefore of a return to the judgment of the majority. Far from it. The mechanics of the endless ascent are accepted as a possible event also because of the development times of the speculative process, which has led to monetary advantages and (virtual) values that are nevertheless out of the market in the real economy.

I would add that the community, dragged into this caravan management of growing financial values, accepts the improbable thesis that the rise in financial values is a symptom of the good performance of the real economy.

A serious mistake, of course. Because during the hallucinatory cycle of the speculative race, the real economy is weak and struggling. On the other hand, at the outbreak of the financial crisis, the enormous damage of the implosion of the debt half that had subsidized the cycle poisoned by the false prospect of endless growth, will fall entirely on families and businesses, while the mass of debt money that fueled the race is deflated by insolvency. How speculative enthusiasm is extinguished is another link that binds the economy to the laws that govern the universe. In other words, in this phase in which we are gradually returning to normal on risk; Well, there is no man of science or organization or government who intervenes to cool the excitement and ambition of individuals.

However, the process cannot continue indefinitely, that is, towards the endless catastrophe of the world of the human economy, without the possibility of recovery. The economic system has in itself blockers of non-reversible rules that do not allow an irreversible end, but to the financial crisis which, by demolishing the mountain of borrowed capital that fueled the bacchanal, put an end to the excursion of imploding financial values. Therefore, there is certainly an insurmountable limit in the financial climb beyond which the process runs aground and closes in on itself with damage to the real economy. We will see as far as possible in the following pages a potential explanation of the speculative emergency and the financial reasons that are the main accomplices. (Piketty, T., 2013)

In the meantime, the priority theme seems to try to understand why, after thirty years of common struggles against rampant inflation, when the inflationary phenomenon died down, a new enemy of the community appeared on the horizon of the global economy. It will also have to be clarified why the monetary phenomenon experienced in the first decade of the century, deflation, is the mother of many troubles even if the natural laws that regulate human civilization do not allow groups or entire collectives to self-destruct out of greed and the impossible hope that the economy does not have a limit to the unraveling against which it is impossible to go. (Cossiga, 2018a)

The truth seems to be that we have reached the beginning of the century with the victory over inflation behind us, which had raged on the path of humanity for over thirty years, and which was absorbed with the clairvoyance of J Volcker, appointed chairman of the American Fed, who focused on the role of interest rates to definitively remove the worm for inflation in the economy (Note 1). Now not all the main G7 countries have followed the example of inflexibility offered by the FED in the late eighties and early nineties of the last century, always in an attempt to navigate (badly) the dormant growth of the economy and slowly regressing inflation. This reflection on the sunset of the long history of global inflation takes us directly to the years 1987, which greeted the first Black Monday of the last century, but others would come in the following years until the catastrophic financial crisis of 2008-2009.

It is undoubtedly a series of events that over the years to come from Black Monday give the picture of the world economy the stamp of deflation, as a monetary disease that seems almost the opposite of inflation. But it is not really the opposite. So much so that the two champions of monetary discontinuity cannot coexist in the same space and time. Needless to say, deflation could be used to fight inflation. It is a heresy. They are events that have no human patronage that nature of the laws of the universe govern on the sidelines of the evolution of human civilization, with cautious but inexorable actions, and in no way can be a rational of human beings. They have the characteristic of proposing a regular motion that becomes accelerated over time to awaken -where necessary- (like the geese of the capitol in the days of Rome) (Note 2) the collectivities that things are going badly in the economy and that the majority of the community must therefore act for a change in the government of the economy, both in democratic countries and in authoritarian countries.

But let's go back to Black Monday of the last century when, that is, inflation was defeated but a new enemy was preparing to put a spoke in the wheels of human development. Deflation, in fact, is self-generated in an economic system when it accumulates a common, public and proven debt that reaches and exceeds the total income of humanity. Also in this case, the adopted model of natural control tends to depress the value of monetary capital, because today's cost may be lower tomorrow, creating problems for production and sale. Deflation is perhaps even greater than inflation fever. In fact, the characteristic (falling cost of living) is often watered down by inflation due to rising international costs, as has been happening for some time in terms of oil and natural gas. In fact, inflation like natural deflation can coexist with rising prices for *international reasons*, which are due to human decisions and are overlapping. So, the drop in the prices of the cost of living is watered down with the sum of prices falling due to deflation and prices rising due to inflation on the international front.

Figure 1. Indice FTSE 100 della Borsa di Londra (dal 19 giugno 1987 al 19 gennaio 1988)

Source: https://upload.wikimedia.org/wikipedia/commons/7/7c/Black_Monday_FTSE.svg

Before any other consideration, it must be pointed out that the citizens or, rather, their majority, are the first to announce the state of the economy and therefore decide whether the nets should be laid out or withdrawn in order to accelerate or slow down the pace of development. So, it is the communities that intuit in advance of the timing of statistics and things are going well or badly. Citizens have an excellent nose for the fate of the economy in the making. However, they are not the owners of the development of the human economy. Also, in this case we do not have a human deus ex machina or anything else that decides whether or not we can run on the road to economic development. The rule of the development of civilization is written in the universal laws that regulate the universe and at the same time the capacity for economic growth of human civilizations. a potential that is assigned to all humanity, without distinction to the highest level allowed by the evolution of the planet that welcomes us and of the universe of which we are sons. Just to say that optimal development is not an acceleration but a growing and constant but cautious motion, for the respect of the burdens that humanity has towards the universe that welcomes us.

1. The Relation between the Global Private Debt and the as so Global Public Debt in a Financializaton World

For this **reason**, attempts to interfere with the constraint of the economic development of the territories seem perhaps able to induce a certain worsening of the status quo. With the result of placing on the scenario of the economy, global or only partial, the stigmata of errors in human management, which we can perhaps also define as correctors of the development process to mitigate the pressures to relaunch growth or to contain the considered unlimited development of financial values with the relative compression of the real economy. In the first case, inflation demotivates the desires. In the second case, which we will deal with later, deflation discourages the global over-indebtedness that is the engine of deflation.

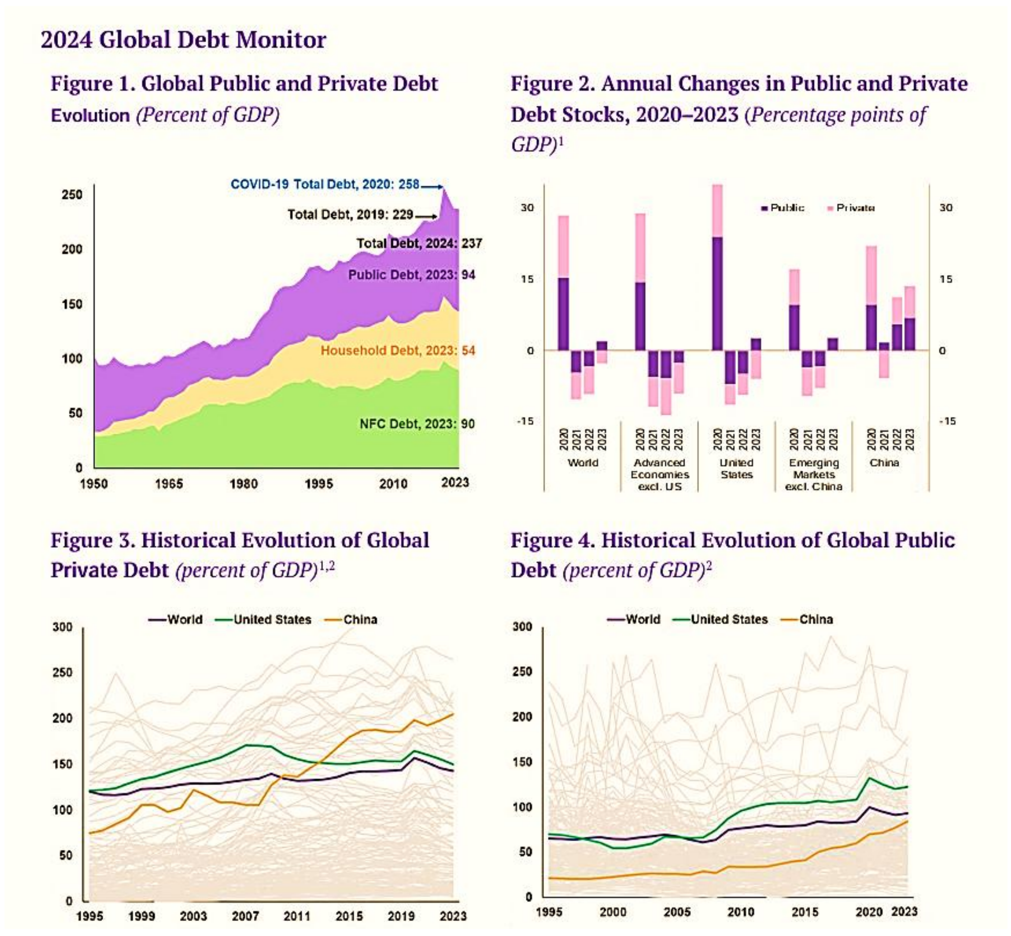

Figure 2X. GLOBAL Debt Monitor 2024

Source: Fiscal Affairs Department / International Monetary Fund 2024

Therefore, deflation discourages indebtedness at a global level. Yet from the data that can be obtained from Figure 2X it is evident that the phenomenon, far from decreasing, receives a strong push in the 2000s to increase both private and public debts. In particular, public debt shows downward tension (see in the contest figure 2X the Historical Evolution of Global Public Debt), partly supported by upward pressure from China, grappling with various economic themes, after a long half-century of accelerated development. The distinction between the different courses of private/public debt becomes useful if not necessary when we look at the reasons that drive each component of global debt.

Both private/public debt have the common fate of having to be repaid or, in the event of a financial crisis post-speculative bubble, of remaining unpaid at least in part as a consequence of the financial breakdown of the equilibrium. The two debts have different origins. Public debt, due to the gap between finance and the real economy, shows a tendency to reduce, for the oppressive pressure exerted by private debt, which is the deus ex machina that drags the drive for the development of financial values and, at the same time, seems to stem the pace of public debt. In a nutshell, when financial values push up global private debt, the turnaround in public debt plays as an antagonist to the development of the global debt system. The divergence between the two debts could be interpreted as a natural reaction to the global debt overhang, or rather as a necessity to make volatility in financial values still possible.

On this subject, Blanchard has proposed a mechanism intended to transform Eurobonds into a true common European debt. It therefore aims to strengthen the international role of the euro, improving the financial stability of the area and making the currency more competitive globally (Note 3). Some exceptions have been made to the model, although the objectives are shared. From our point of view, which concerns the formation of speculative movements with the financialization of the economy, the novelty is represented by the increase in global private debt and the parallel regression of global public debt. Since the phenomenon of the decline in global public debt is a foreshadowing of the stock exchange lottery race, what effects could an implementation of the Blanchard hypothesis have? In essence, during the climb of new highs in private financial values, the potential consequences are not seen, due to the rain of advantages that the rise in values brings to speculators.

Consequences that could instead be felt with clarity in the event of a temporary interruption of the speculative movement and a rapid regression in the value of securities involved in the roulette of upward values. Yet, the swinging discipline of risk will not be enough to stem the speculative tension. To better interpret this aspect, i.e. sudden interruption of the upward climb, let's go back to Figure 1 which shows the performance of the *London Stock Exchange (from 19 June 1987 to 19 January 1988).* The so-called Black Monday of the last century is the first of the aftershocks that the world stock exchanges have suffered and the first of the last century. Shocking news triggered a convulsive cycle of selling on the world stock exchanges, which then suffered a generalized drop in prices not to the point of igniting a serious financial crisis, but after a few months of uncertainty, at the beginning of 1988 the rise in prices resumed to new highs.

Well, what happens in the period of hard decline in prices, particularly on the *world stock* exchanges. With the sales, a lot of liquidity was freed up, which is invested in public securities. Therefore, the large amount of liquidity that is released on the market due to the collapse of stock market values tries to find a fallback in public securities, waiting for a possible revival of financial values and the upward climb can be resumed. These pauses that are frequent in the sip of the 2000s are to be interpreted as a sort of failed financial crisis, which takes on the meaning of a pause for the release towards new highs in the race of stock market values. The failed crisis therefore has no other purpose than the missed objective, but it does not improve the condition of excess private debt, which will have to wait for the final outcome of these unsuccessful maneuvers, that is, until the financial crisis now matures may hit the real economy hard. In other words, any occasion of uncertainty in the financial securities market could be the right (better, malicious) time to submit to the penalization of the real economy, with a serious downturn in the economic cycle due to the seriousness of the state of finances. However, they can be a gain for the financialized market, confirming the pre-existing deflation and presence of common companions, such as the increase in private debt and the climb of virtual securities and assets.

On the subject of the current repeated crises that have failed, how can we interpret Blanchard's proposal to create a large and liquid Eurobond market? Let us examine it only from our point of view of the status quo with recurrent attempts at unsuccessful financial crises. Well, the proposal leaves one point undetermined, that is, what happens with the nominal increase in global private debt due to the transformation of the public debt of the EU area, at least in part, into generic private debt? Since private debt is the ground on which the financial mechanism that relaunches, endless speculation takes root, a nominal increase in global private debt could be the impetus for the next fall in financial values to start the financial crisis we experienced in 2008-2009. MAYBE NOT. With this doubt, let's move on to consider the mechanism that leads financial market operators to pursue pressure on stock market securities and assets. On the one hand, the mass of global private debt costs money, for the interest due to the banks, on the other hand, we must admit that operating on the financial market offers not only the money to pay the private debt but also for the personal advantage of the operators. So, if the corrective maneuver, triggered by an unexpected event, fails and after a few months the march of prices resumes, it must mean that the avoided danger is due in part to the refuge in public securities of excess liquidity. The passage of speculation from the orbit of the values of the world Stock Exchanges to that of public securities is therefore identified, which at least allows it to withstand the pressure of the wave of liquidity in search of employment and short-term remuneration.

2. The Financial Crisis Is Seriously Damaging the Economy, but Unsuccessful Financial Crises Do not Hurt Speculative Pressures

Continuing our reasoning on the speculative mechanism that prevails in the phases of deflation of the economic world, we can say that the speculation that wins during the phases of deflation of economic systems is held up because through the financial market operators are able to finance enormous masses of private debt that otherwise could not be financed. A gap is therefore created between financial market events and the real economy, which is experiencing a decoupling with an unavoidable weakening of the real economy. Let it be clear that, when the tornado of the financial crisis arrives, it means that the mechanism that supports the evolution of global private debt encounters his limits. Therefore, with the collapse of financial values due to an unexpected serious event, it is not possible to restore the relationship between stock market values and the size of global public debt even after a few months, with the consequence that operators are unable to pay the huge interest on the debt due to the exhaustion of the supply of speculative securities.

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Figure 3. Dow Jones Industrial Average trend, U States, NYSE – 2010.2025

Source: Investing.com

This could be the signal that the story is about to end due to the lack of fruit on the financial values marketed. On a theoretical level, there is no doubt that there is a non-severable link between the trend of the financialization of stock market prices and the utilities linked to the purchase and sale of securities on the stock exchange. On the basis of this concise reasoning, it would be possible to predict in statistical or mathematical terms whether and when the breakdown of the mechanism of speculative profits has reached the goal of the serious financial crisis that will have the task of lightening the private debt due to the inability of creditors to pay the banks the interest for the debts contracted. With very serious damage to the real economy on which all the unresolved burdens of financial prices will fall. I would add that the financial crisis of the beginning of the current century has certainly not solved any problem of the strange relationship between finance and speculation due to the deflation of economic systems. In the sense that the only advantage (disadvantage) of the financial crisis is not that of removing the speculative inspiration of the deflated economy, but modestly that of mitigating the abrupt impact of private debt, with the partial and temporary cancellation of the same. As can be seen in Figure 3, in the aftermath of the serious financial crisis of 2008-2009 and throughout the following fifteen years, the upward pace of financial values continued according to the aforementioned mechanism, with price tensions that herald recurrent attempts at an unsuccessful crisis.

We must affirm that the mechanism of rising financial values – stock market speculation is linked to the deflation of economic systems and that the process of rising private debt will not stop, until the central banks decide on a borderless war on deflation. The tolerance of central banks regarding the scenario of deflation prevailing in economic systems at a global level is perhaps due to the trend of consumer prices fluctuating at their lows, also due to the already reported interference of inflation from international prices that continuously floats the cost of living. Statistically and mathematically, it is certainly possible to distinguish between basic deflation and international price inflation, which show variations that are generally the sum of the deflated basic figure and the international price inflation figure. I say this because the two components of cost of living interfere with the real economy in different ways. Since it are added up algebraically (deflation and international inflation), there is a misunderstanding, a confusion about the real state of the financialized economy. I add that central banks have not yet found a methodology to unseat deflation from the grip of the economy. With a corresponding excess of global private debt that tries through speculation on financial securities to be able to manage a growing mass of global private debt and maintain insane equilibrium of speculative market.

Having made this parenthesis, although necessary, let us ask ourselves whether on a statistical level we can have acceptable information on the state of maturity of the anomalous financial circuit of deflation. If that was, we will have reached an excess of private debt such that it no longer allows the growing burden of debt remuneration to be remunerated through the speculative litany. That said, the possibility that – even in a deflationary climate – the growth capacity of global private debt is so elastic as to withstand prolonged upward pressure is to be excluded. Just to say that sooner or later there will be a break between the size of global private debt and the possibility of remunerating this debt tail. Drawing on the experience in progress (see figure 3) after the serious speculative crisis of 2008-2009, there have been numerous shocks that have imposed a temporary stop to the growing trend of speculative rise of the stock exchanges in the world. However, not to the point of imposing a new financial crisis at the end of the first decade of the century. One might think that the temporary shocks that block the upward movement of financial values could be interpreted as an escape valve that decompresses the system both by stemming the increase in speculative momentum and by curbing the increase in global private debt, for non-payment of partial interest on the loan. This hypothesis does not seem negligible, because it justifies the fifteen years of relative calm in a deflationary context.

But in evidence they were not enough to justify the outbreak of a financial crisis, which does not run aground with the placebo of part of the private debt canceled for unpaid charges, but which in order to redeem itself has developed multiple economic reversals, extended to the global economy. We can therefore suppose that the singular capacity of resistance developed by economic systems to the speculative game between the increase in private debt and the increase in virtual financial values may depend on the progressive decline of global economic development. So that the real economy's ability to react to the mechanism imposed by global deflation on economic systems has been weakened, which therefore react with waves of fall financial values less accentuated than the fall imposed by the financial crisis of the first decade. A latter topic, i.e. the acceleration that prices on the NASDAQ circuit have undergone over the last decade (Note 4) compared to the S&P 500 circuit (See figure 4). A capacity for the development of financial values, such as that exercised by the NASDAQ over the last decade, in the face of the parallel and alternating development of the Standard & Poor's 500, which may be able to absorb the temporary downward shocks of financial values given the almost double multiplication rate of the NASDAQ, with an ultra-high increase in speculative incomes. (Milanović, 2013)

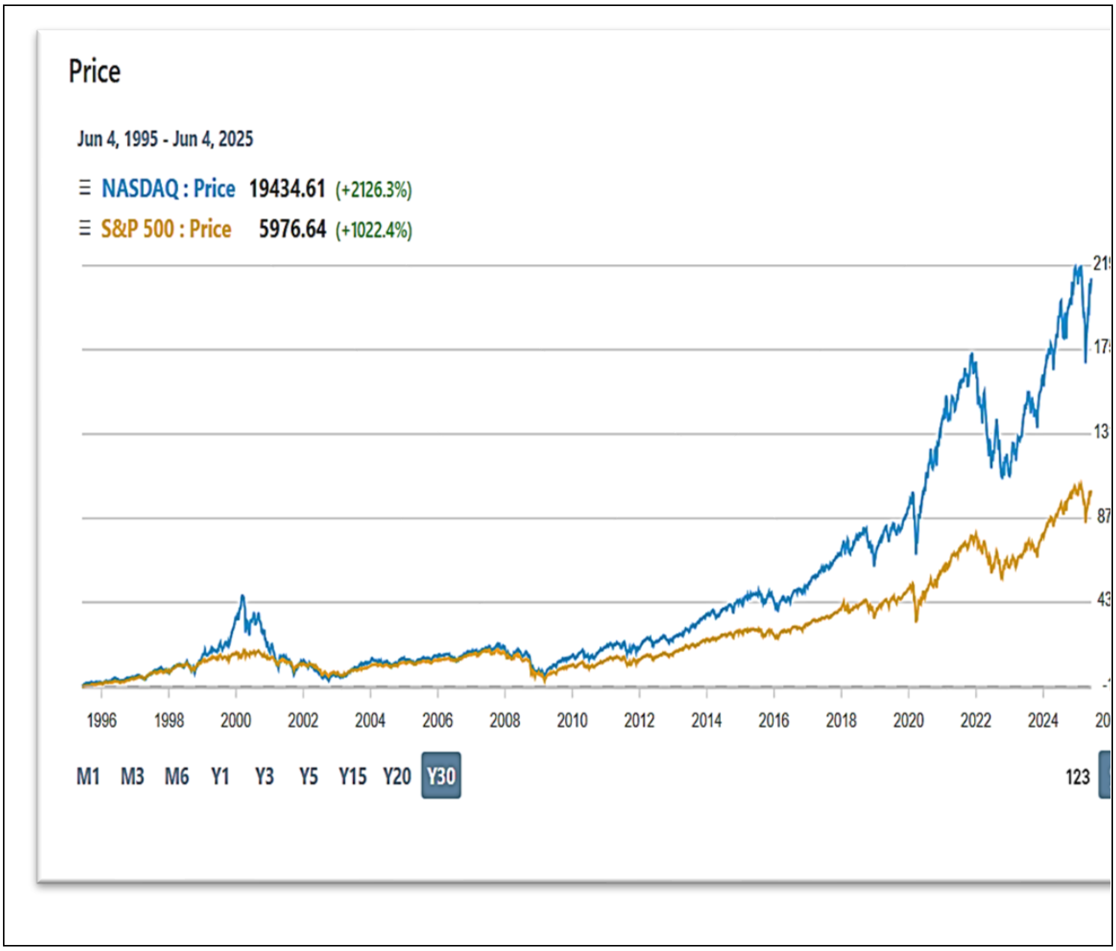

Figure 4. Comparing the performance of the NASDAQ e the S&P 500 for the decade 1995.2025

Source: NASDAQ Composite Index Quote, Top Stocks & Latest News

3. Conclusions

So, what are the prospects for the world of economics grappling with deflation by more than twenty years and with a private debt load that continues to increase in parallel with the trend in financial values. For now, there is no change in sight and the struggle between economy and finance still sees the economy as Cinderella grappling with the overdoing of speculation. (Cossiga, 2022) The Federal Reserve's resistance to lowering the interest rate in the US, demanded in a hegemonic tone by President Trump worried about the collapse of the US dollar against the main world currencies, bodes well. Not only and not so much because of a presumable increase in inflation in the United States. But rather, because the main weapon for controlling long-term deflation is the resilience of monetary policy, which is therefore opposed to cheap credit. It is not a trivial battle because, as with the fight against inflation, it has achieved the goal of defeating inflation after more than twenty years from its appearance in Europe and the USA. I repeat that there are not many ways available to achieve the goal of defeating disease-deflation. As in the case of long-term inflation, the twenty-year deflation that characterizes us also requires the strength and courage shown in the late seventies by Fed Chairman Paul Volcker. That is, keep monetary policy rigid for the time necessary to force inflation to volatile and disappear, the same must be done with deflation, that is, to support firm monetary policy from the world's main central banks, even at the cost of suffering a recession in the global economy as fifty years ago. (Kissinger, 2022)

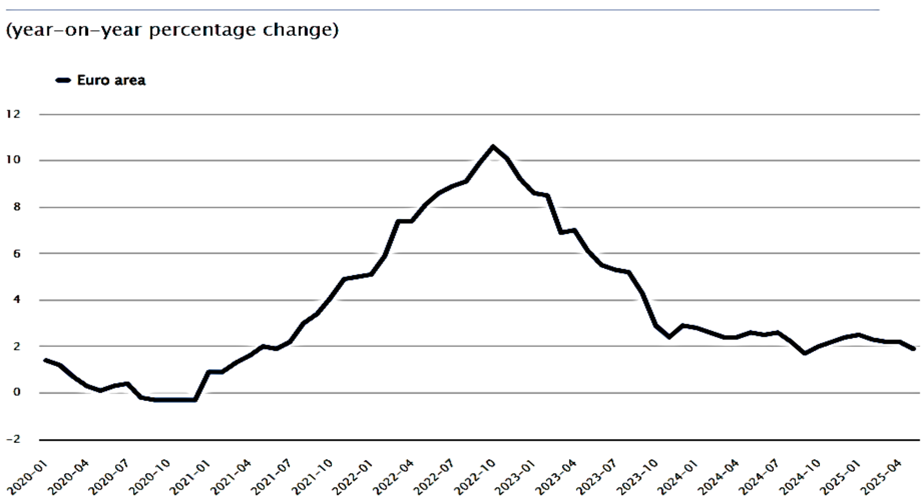

Figure 5 A. Inflation Rate /HICP) In Area Euro 2020-2025

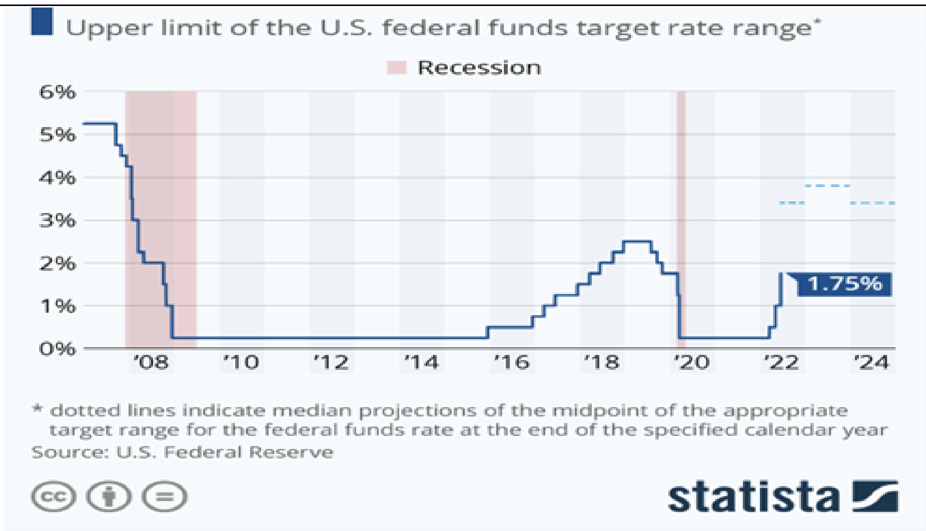

Figure 5 B. FED Issue most Aggressive rate Hoke Since 2008

Source: Statista

I would add that in 2025 the European Central Bank has decided to adjust interest rates downwards in Europe, in possible response to the now real threat of tariffs that Trump continues to impose left and right, with a seesaw of conflicting decisions. The idea that cutting interest rates can help companies under the pressure of the wave of tariffs is wrong. I repeat that the weakness of monetary policy, far from improving the economy in monetary crisis, can on the contrary fuel the requests for cheap credit to be thrown into the growing cauldron of private debt and speculation. The outlook for the economy remains ambiguous not only because of President Trump's inappropriate interventions but also because of the weakness of the economy itself, whose vitality is partly sucked up by the fearsome pair: global private debt and financialization. That said, what would need to be done to be able to beat the fearsome influence of deflation?

First of all, it seems essential not to judge the gains that come from speculation as sober and correct, especially if with private debt. It is the burning hopes of easy money and the acceleration of financial values as underlined by the performance of the NASDAQ (figure 4) that offer opportunities that go against the interests of the population. It must be remembered that they are virtual values that have no support in the market of the economy and that in the event of a serious financial crisis they will suffer a precipitous fall.

To avoid dramas in the future (Diamandis, 2014) and in the meantime a perverse decoupling between the real economy and finance, which are the enemies fueled by deflation, I believe it is appropriate that the following corrective measures be implemented to correct monetary distress:

1) to decide at the UN level on a universal tax on the income earned through speculation on the stock exchanges of the whole world, not less than 20% of the earnings themselves, so that the sum of the tax burden and the financial cost of loans will finally contain the propensity to make easy money through speculation.
2) Advise central banks around the world not to lower rates below the standard quota of 5%, which at this stage of the fight against deflation can constitute an obstacle to the deflation process underway globally. Lowering rates is essentially an aid to both speculation and the increase in private debt, the enemies to be fought coram populo.
3) Don't worry if the economic cycle turns downwards. It is deflation, as we have said, that induces the development of the economy to contract, it is the normal natural defense response that must not be hindered but rather allowed because to strangle deflation it is necessary for the global economic system to correct itself, without intrusions to support the cycle of the economy.
4) To verify that in this corrective phase of global deflation it can be seen that both global public debt and global private debt finally show no longer a tendency to multiply but a collapse on both fronts. An important sign is that the ongoing deflation containment strategy is being successfully developed.

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Notes

Note 1. Paul Volcker, a Democrat, was appointed chairman of the Federal Reserve in August 1979 by President Jimmy Carter [3] and was re-elected in 1983 by President Ronald Reagan who replaced him with Alan Greenspan only halfway through his second term in 1987. After the inevitable initial negative consequences, which drove unemployment to over 10%, sparked widespread protests due to the effects of high interest rates on the construction, agriculture and industrial sectors with farmers parading their tractors on C Street NW in Washington and blocking the Eccles Building, they also produced disastrous effects on Latin American debt largely at floating rates, the Fed achieved the desired goal: price stability was achieved and the US economy began to grow again after an easing of monetary policy in 1982. Inflation, which had reached 13.5% in 1981, after a rise in the prime rate to 21.5%, fell to 3.2% in 1983. Source: Paul Volcker - Wikipedia, the free encyclopedia

Note 2. One night Marcus Manlius, a soldier who slept near the temple of Juno, heard the geese squawking: they were the geese sacred to the goddess and for this reason spared by the Roman soldiers despite extreme hunger and famine.

Marcus Manlius got up and ran to the walls of the fortress of the Capitol. He collided with a Rooster who together with the others were climbing the rock: he confronted the first and tore out his fingers. Meanwhile the geese continued to squawk and woke up the whole army who rushed to lend a hand to Marcus Manlius. The Gaules were thus repulsed

Note 3. Olivier Blanchard's proposal on Eurobonds has significant implications for the European economy, both in terms of financial stability and strategic autonomy.

- Key implications

Increased financial stability: Creating a large and liquid Eurobond market could reduce the EU's financial fragmentation and offer a safe alternative to global investors.

European strategic autonomy: Blanchard argues that Europe must strengthen its financial independence, reducing dependence on US markets and creating a competitive system with the dollar.

Reduction of the cost of debt: A well-structured Eurobond market could lower financing costs for member countries, improving access to capital for public and private investments.

-Policy and fiscal challenges: Implementation would require strong political consensus and effective governance to avoid imbalances between member states.

-Possible resistance from Germany: Blanchard acknowledges that Germany has historically hindered the adoption of Eurobonds, fearing an increase in fiscal risk for the most virtuous countries (Source; Copilot)

Note 4. The NASDAQ, or National Association of Securities Dealers Automated Quotations, is a global electronic marketplace for buying and selling securities. It was the world's first electronic stock market and is known for its high concentration of technology and internet-based companies. The NASDAQ Composite Index, which includes over 3,000 stocks listed on the NASDAQ exchange, is a widely followed benchmark for U.S. technology stocks.