

# **Title: Banking Behaviour and Margins of Safety in a Minskyan Business Cycle**

*Author: Luiz F. R. Paula, University of Oxford*

## **ABSTRACT**

The principal aim of the article is to analyse the role of the banks and the state of confidence in Minsky's business cycle. Particularly, it shows that the compatibility between the Minsky's financial fragility hypothesis and the dynamics of the business cycle depends on the evolution of the economic agents risk perception during the cycle. In this sense, business cycle can be characterized by an apparent paradox: the microeconomic risk and the macroeconomic fragility walk in contrary direction. This happens because when the economy is growing the economic units (financial and non-financial firms) tend to decrease the margins of safety without any reference with a change in their individual preferences between 'risk and return'. The optimism – in a Post Keynesian approach – appears in the decreasing of the economic units risk perception that depends on the changes in their state of confidence. Paradoxically, the changes in financial attitudes of the economic agents along the business cycle are not perceived by them at the same time that financial fragility of the economy increases. This occurs because the dynamic of the business cycle depends on the evolution of the perceived risk by the economic agents and this perception changes during the different phases of the cycle.

The paper is divided basically in two sections. In the first one we analyse the banking behaviour *vis-à-vis* the changes in their expectations about the future, built under non-probabilistic uncertainty. In the second one we analyse the constitution of the banking expectation in the business cycle and their relationship with Minsky's financial fragility hypothesis.

**Keywords:** Business cycle; Banking behaviour; Minsky; Post Keynesian theory