Key Questions

Is This 1929 All Over Again?

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While the outlook is extremely and unusually uncertain, policymakers are responding aggressively, increasing the odds of recovery as opposed to a more severe and long-lasting decline.

Several weeks ago, we wrote an essay comparing the coronavirus shock with that of the Great Financial Crisis (GFC) of 2008-2009. In that essay, while we professed that the legacy of COVID-19 is extremely and unusually uncertain and the impact caused by efforts to contain its spread would be painful, we also stated that the duration of the downturn would be less severe. And we fully acknowledged that an uncertain "next normal" will likely emerge.

Soon, we will explore the possible "next normal" scenarios in great depth. In summary, we envision certain themes playing out in the years ahead. These include a premium being placed on resiliency over efficiency, a focus on self-reliance (possibly at the expense of the sharing economy), and the likelihood of increased onshoring (at the expense of outsourcing to foreign suppliers).

For now, however, we will review the current economic environment against that of another stressful time— the Great Depression.

Since our earlier essay contrasting today's backdrop with that of the GFC, employment trends have worsened: In the last four weeks, 22 million Americans have filed unemployment claims -– an astonishing number.

Measured against a labor force of 152 million US workers as of February 2020 (just before the containment measures being imposed), this implies an unemployment rate of over 14%. (In March, this closely watched indicator jumped from 3.5% to 4.4% but will surely spike in April.)

In previous recessions, unemployment rates peaked at approximately 10%, thus prompting some to question: "Will unemployment again exceed 20% and is this 1929 all over again?" Our response is twofold: Sadly, it is possible that unemployment could again breach 20%, however, we do not believe such high levels of unemployment will remain elevated for a prolonged period. Hence, we do not think the Great Depression will be repeated.

Unlike during the Great Depression, the recent monetary and fiscal policy response has been swift, targeted, and strategically designed to stabilize markets and stem financial contagion and wealth destruction. Importantly, measures have been implemented to mitigate income and demand gaps to avert a more ominous economic decline. In short, while no two economic crises are identical, policymakers have learned from prior episodes and are applying remedies that have proven effective in the past while employing new measures with speed and vigor.

On the monetary front, the Federal Reserve has responded with massive interventions that include interest rate cuts, bond purchases, loan backing, direct lending, and broad asset purchases, including asset types beyond those purchased in prior crises. These have been put in place to support liquidity, stability, and confidence amidst contagious fear and uncertainty.

On the fiscal side, the response has been equally impressive and broad. With rare bipartisan support, several phases of legislation have been passed to bolster individuals, businesses, our healthcare system, and state and local governments.

In stark contrast, monetary policy was restrictive during the Great Depression -– interest rates were increasing, and money supply was contracting to slow the economy down following the Roaring Twenties. Tariffs and other taxes were being levied as balanced budgets were viewed as necessary at any cost, and our banking sector was far less sound.

Later criticized as contractionary, such policies did not cause the Great Depression, but they contributed to its painful duration and protracted recovery. To their credit, today's policymakers are drawing from these lessons and not repeating past mistakes.

Moreover, from the Great Depression, new safety net programs and economic stabilizers such as unemployment insurance and protections for workers were created. These remain an important bridge for many people in need during downturns.

The expedient application of expansive monetary and fiscal policy initiatives of the past month has bought our country precious time to stay the public health course, thereby increasing the odds of a successful recovery. Our country's goal is to find the proper balance between reopening the economy as safely and soon as is practicable while minimizing future adverse health events. With the ever-growing cost to incomes and GDP nationally, policy measures to contain further disruptions concurrent with a compassionate healthcare focus will prove challenging; our political and medical leaders will have to find the delicate balance.

Longer-term, returning to normal, or transitioning to the "next normal" as we prefer to label it, is conditioned on four variables in our opinion:

1. Adequate hospital capacity to care for the sick
2. Adequate testing
3. Appropriate surveillance and monitoring techniques
4. A vaccine

These all require our collective resources and resolve.

Longer-term, we will also be able to properly evaluate whether this current episode in history will be characterized as a slowdown, a recession, or something worse. While the outlook remains extremely and unusually uncertain, we believe that the timely, aggressive, and preemptive measures referenced earlier have increased the odds of a painful but relatively transient recession as opposed to a more severe and long-lasting decline.

Stay safe and be well.

For more information, please contact your Key Private Bank Advisor.

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