

# Beware of the Parallels Between Today and the Great Depression

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There is an interesting paradox occurring today where the current economic and market environment is described as 'unprecedented,' yet there are consistent parallels drawn between the present circumstances and the Great Depression of the early twentieth century. Comparisons with the Great Depression are common headlines in the media as it makes for an attention-grabbing story to say 'not since the Great Depression,' but that just causes people to extrapolate that things must be as bad as the Great Depression and risks inciting panic. In its latest forecast, the International Monetary Fund's estimate of a 3% decline in economic activity indicates that the global economy will suffer its worst year since the Great Depression. With bleak comparisons such as this, it's only natural to look for a roadmap to guide you for the future journey.

It is true many things have occurred over the past few months that are truly unrivaled in history – for example the response to this global pandemic was an unprecedented self-induced global economic shutdown with social distancing measures implemented worldwide to allow health care systems to cope with COVID-19 related cases. We experienced a historic correction in equities – with the fastest 30 percent drawdown in stock prices on record in March. Then stocks experienced a rapid recovery which was technically the start of a new bull market as many equity markets surged by more than 20 percent (a bull market is commonly defined as a 20% increase). Recently, we also saw commodity benchmarks for West Texas Intermediate oil futures trade at a negative value – also an unprecedented market event.

It is also true that there may be similarities in terms of extreme market moves and plunging economic data experienced in the Great Depression era, but there are a lot of important distinctions in how the economic shock started and the extensive actions being taken by policy-makers worldwide to bridge the economic gap and support a strong economic recovery. These actions are what chart a very different roadmap to recovery out of this current crisis, compared with the Great Depression.

## Similar symptoms

The Great Depression was the longest and deepest downturn in the history of the modern industrial economy. We are going to see an unprecedented fall in our economy this quarter. Unemployment will also climb at what may be the fastest rate in history. Earnings are also expected to fall significantly for many companies as the economic shutdown brings consumption and manufacturing to a standstill in many sectors of the global economy.

However, in our opinion, the similarities end there. The Great Depression started with a collapse of the stock market followed by reduced consumer spending and trade that devastated the world economy for more than a decade. Unemployment levels peaked at almost 25% in 1933, rising from a low of 3.2% in 1929. This time around, the economic lockdown was self-induced to fight COVID-19, which means we already know the cure – re-opening the economy when it's safe to do so.

## Two important treatment distinctions

Two distinctions are important to highlight between now and then. In 1929, central bank policy was a relatively new concept without experience or testing what was needed to support an economic recovery from a severe downturn. As a result, there

was no coordinated central bank response, so no material action took place to enact easy monetary policy and support the financial system through asset purchases (Quantitative Easing). Contrast that with today where you had central bankers acting swiftly to cut interest rates and purchase assets to support liquidity in our financial system. The Quantitative Easing that was used effectively in 2008 was a result of the learnings from the depression era financial system collapse. The lack of central bank policy response in the Great Depression contributed to the bank failures that are marked by this period in history.

The second distinction is that, during the Great Depression, governments were so focused on achieving balanced budgets that they waited years before they enacted fiscal stimulus, in effect delaying the potential for any recovery. The economy only recovered once the government instituted The New Deal, a series of programs and projects instituted by President Franklin D. Roosevelt beginning in 1933 that utilized fiscal spending without requiring an offset in the form of increased taxation.

Contrast that with the recent period where over the past month, governments around the world moved quickly to make trillions of dollars in relief available to individuals and businesses to bridge the economic gap in the current economic shutdown.

Today central bankers and governments have provided unprecedented levels of fiscal and monetary support over the past few months and a general commitment to do whatever it takes to support the global economy and the financial system.

Looking at the Great Depression may be illustrative merely for the magnitude of the economic downturn we are about to see unfold, but the epic policy failures and lack of a social safety net exacerbated the impact and prolonged the time to recovery. Examining other historic recessions such as the Global Financial Crisis helps us to see the impact that Quantitative Easing can have on maintaining proper functioning of our financial system. The post 9/11 economic downturn and recovery provides a playbook for how an economy can recover from an exogenous shock that shatters consumer confidence. Rarely are there two periods that are exactly the same, but understanding the parallels and the distinctions between all of these periods is important to help us understand how the road to recovery may unfold.

The response to the coronavirus-induced economic shock thus far has shown that policy-makers have no interest in repeating history, as they have shown a willingness to support economies through swift and decisive co-ordinated action.



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