

# From a COVID-19 Recession to COVID-19 Depression?

by George Friedman - August 4, 2020

It's been roughly five months since COVID-19 lockdown measures were first put in place. That means that come September, we will have gone two quarters like this with no end in sight.

Masks and social distancing contained the spread of the virus somewhat but could never eliminate it. Yet that is the only containment strategy we had. The only real solution is a vaccine. Many have already claimed that a vaccine is coming soon, but even if comes to market in September, producing, distributing and administering it to billions of people will be a time-consuming and logistically fraught process. Obviously, the number of people vulnerable will decline over time, but it is not clear that social distancing or quarantining will be suspended simply because a vaccine will be available. They will likely continue.

**I have argued** that unless a solution is found by September, the probability that the recession could turn into a depression would mount. A recession is a normal part of the economy, a primarily financial event that imposes disciplines on an overheated economy. A depression, from a geopolitical standpoint, involves the physical destruction of the economy, something that lays waste to businesses, dislocates labor and vaporizes capital. A recession is the economy cycling. A depression is an economy breaking.

I chose September because two quarters of intense economic contraction is instructive. Economists' definition of a recession is two successive quarters of negative growth (also known in English as decline). This is generally enough time to understand how resilient an economy is. Uncoincidentally, it is also the point at which economies begin to recover in normal cycles. Under normal circumstances, basic economic structures remain intact during recessions so financial stimulus measures can restart the system.

There's no evidence that the economies of the United States and Europe – the center of gravity of the global economy – are recovering. Last week, the EU reported that its economy contracted by 8.3 percent, the largest contraction since it started keeping records. In the U.S., some 20 million jobs were lost in April, and there has been no dramatic reversal in unemployment. Brick and mortar retail stores across the nation are shuttering. Many argue that COVID-19 merely speeded up the

inevitable. But even if that is true – and it may be – simultaneous collapses of an economic sector should not be regarded lightly. It's unclear just how many businesses have gone under because of delays in reporting, backlogs in the legal system, and so on. But it seems to me that retail collapse was merely the most visible sign of a tidal wave of bankruptcies not yet measured by the system, locking the unemployed into a difficult position.

So far, a depression has been delayed by massive government intervention. The United States spent trillions of dollars to stabilize the economy and avoid economic destruction. It did not reverse the collapse of March and April, but it blunted the damage by infusing capital into businesses, provided that they retain their employees. The problem was that demand fell not just for a lack of money but because of a lack of will to go purchase goods.

There was a contraction of effective demand, not only from lack of money but also because trips to the store became heroic undertakings. The stimulus could not continue. Lack of demand led to business failures, which led to unemployment. This is what the beginning of a depression looks like.

The European stimulus, which came later, was more complex but the basic economic principle is the same: At a certain point, the value of the currency declines as supply surges, making cash injections unsustainable. Weimar Germany is a good example – think about that iconic, if possibly staged, picture in the 1920s of a man with a wheelbarrow full of deutsche marks going to buy a loaf of bread. The danger of the collapse of a currency vastly compounds economic failure. It cuts off investment at a time when it alone could stabilize the system.

The past two quarters have been a time of coming to terms with the medical reality and, more important, with life lived under the only **medical mitigation** there was: masks and isolation. There was a sense developing since June that this was simply what we would live with, and for many, it was a tolerable solution. What I think was less understood was that the economy had not reached a stable if unpleasant plateau, but was being held in place by inertia and government stimulus, and that the economy was fragmenting under the surface, past the point where government stimulus and patience would keep it together. In other words, the relative safety of the plateau afforded by the medical solution was being undermined and eaten away by unemployment and bankruptcies.

As we move into September, business failures will begin to mount, unemployment will soar, and underemployment may be even worse. It will be a time of instability and unpredictability. In past depressions, there was vast social unrest reflected in political fragmentation between those who suffered the most and those who didn't. Sometimes the system can balance it, but usually it cannot, giving birth to a powerful political movement championing the dispossessed. In Europe, it was

usually right-wing parties crushing the left. We are far from that point, but the coming U.S. election will be a harbinger of what might come.

Depression scares me. It creates not only vast human suffering but also political monstrosities. It is clear at this point that the current medical solution will remain in place until there is a vaccine. It is also clear that even with the best of luck a vaccine will not be fully produced, distributed and injected to a degree necessary or in time for the current solution to be improved. By that time, the economy will be in a very dangerous condition, if it is still salvageable. But the sooner a vaccine is found the less the danger will be. It should be remembered that after the European and American depressions of the 1920s and 1930s, there was not only political extremism but also war. History does not repeat itself, which is a great comfort – save that, as Mark Twain pointed out, it does rhyme.

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