

# Recession or Depression

by George Friedman - June 16, 2020

In March, we declared [our 2020 forecast](#) null and void. The COVID-19 pandemic had essentially rendered it irrelevant. The question we posed in March was whether the disease and the steps taken to manage it would lead to [a recession or a depression](#). A recession is a cyclical financial process inherent in the business cycle. It is inevitable, stabilizing and somewhat painful. A depression is entirely different. It includes myriad financial dimensions as well as an added element of physical economic damage. It can destroy businesses and dramatically increase unemployment and thus transform our very existence. I would encourage you to read Studs Terkel's "Hard Times: An Oral History of the Great Depression." The greatest effect of a depression is on existential reality of daily life. In that sense, we must all care about what this is.

The answer has not yet emerged – I will explain why below – but the numbers are ominous. We are close to completing the second quarter of 2020 and the Federal Reserve Bank of Atlanta is predicting a 48.5 percent decline in gross domestic product. Others are speaking of a 30-40 percent decline. Unemployment is at 15 percent and climbing. Even the more optimistic numbers are staggering not simply because of the size of the contraction but because of the speed with which it is happening. In the United Kingdom, the economy contracted by 20 percent in May alone. Germany expresses the most confidence: a 10 percent contraction in the second quarter. Most countries are expecting more modest declines in the third quarter, and then recovery in the fourth quarter.

Numbers of this sort indicate massive dysfunction in the economy, but the question is whether it is recoverable, and how quickly. The airline industry, for example, dramatically curbed its operations, leaving many pilots, ticket agents, mechanics and baggage handlers out of work. But unless all these workers found employment elsewhere already, the industry will probably survive and probably rehire them as soon as the economy recovers. (The airlines were among the hardest hit businesses. The kind of economic damage they suffered may well affect other businesses later, but for now it's most visible in the airlines.)

An equally ominous but not quite clear force is the apparent increase in hospitalizations of COVID-19 cases in states that "opened up" in early June. There's a debate over whether the increases signal a new wave. I am certainly not an expert, but if the virus is as infectious, and if it is as deadly, then it would seem that ending sequestering would simply have the same effect now as before. And

if that's true, and people who know more than I do disagree, then we should see not another wave but the consequences of opening up.

The root of the economic crisis is based on the fact that medical research has so far yielded no vaccine nor much in the way of mitigation. **The only medical solution was sequestration.** That meant that people should avoid contact with other people, since they could be infectious without knowing they carried the disease. In a sense, the medical problem was not the cause. Medicine, except for helpful suggestions, was irrelevant. What drove the problem was that the only viable solution would hurt the economy. There is, after all, a social aversion to accepting deaths in return for a viable economy.

Therefore, if there's a chance that the disease will swell as reopening occurs, and that that will lead to the reimposition of sequestration, then we are heading to a depression. Or rather, we are in a depression according to the numbers, but we are protected temporarily from a full depression by the speed by which it is taking place. That speed buys time to make economic reconstruction possible. But it is a window that will close. Using March 1 as the starting date, we have now been in this cycle for nearly four months. If we assume that we will reverse in September, it would be seven months. That's a long time for a business with thin margins to survive without layoffs, and a long time for the unemployed to wait for reemployment.

The primary reason that forecasters are looking for a turnaround in the third or fourth quarter is the expectation that a vaccine will be developed. There are indications that there may be one by then, and even that production is already on the way. The problem is that it is unlikely to match demand (especially global demand) by then. As important, the logistics of distributing and administering the vaccine in the context of a massively disrupted economy will mean that at least two months will be required. You will recall how long it took to manufacture and distribute ventilators.

If my assumption is correct, and if an effective vaccine is released on, say, Sept. 15, then administering the vaccine would take until Nov. 15 at the earliest, which would be nearly nine months from the time the country was shut down. It also means five months of soaring unemployment and economic contraction on a global scale. It's hard to imagine that we would be able to rapidly reconstruct the economy by this point. Obviously, the government could print more money, and that would basically fulfill both John Maynard Keynes and Milton Friedman's prescription. Keynes called it increasing demand, and Friedman called it monetary management, but in both cases it uses increased money to prime demand.

However, in this case there is a difference. The foundation of economics is land, labor and capital.

The origin of this crisis is the shortage of labor. The problem is not lack of demand but lack of supply. What you get from that is inflation, as happened in Weimar Germany. There are two arrestors in this process. One is a massive shift in the public's willingness to accept the risk of disease. The second is a rapid medical solution.

A change in public attitude is possible for two reasons. The first is that time routinizes risks. People may be shifting their risk models. The second is that the meaning of depression has been abstract for them. We have not seen a depression for 80 years. I am old enough to have known some of those who lived through the Great Depression. I remember one clearly. He was in his second year of medical school during the Depression, but the money wasn't there to finish. He got a job in a Kosher deli on Jerome Ave. in the Bronx. Forty years later he was still there. The Depression robbed him of the life he dreamt of.

If you get a chance, read Terkel's book. Gambling with this virus is dangerous. But we all need to see that the economic problem isn't about banks and corporations. It is how the Great Depression destroyed lives.

Am I predicting a depression? I still can't. The ability of the American people to rally is enormous. The power of American science is remarkable. Still, the numbers we are seeing, if they pan out, are stunning.

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