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The big difference between the Great Depression and COVID-19

Global economic activity has grounded to a halt, prompting fears the world is in for a re-run of The Great Depression. While there might be similar scenes, the parallels are not as strong as you may think.

Without a doubt, countries worldwide are in for sharp, deep recessions as they rightly sacrifice economic growth in the name of healthcare. This includes the world's largest economy, the United States.

Huge as the gravity of this situation is, and as devastating as it is for people and economies the world over, there are things missing from the social and economic setting which were pivotal in the makings of the Great Depression.

This is not the roaring 1920s

The run up to the Great Depression was characterised by a massive boom, where a surging economy in the United States made way for excess and mass consumerism. A boom often leads to a bust, where excesses – like debt – are unwound.

"We haven't had a boom, we've been talking about slow growth for years," said AMP Capital's chief economist and head of investment strategy, Dr Shane Oliver.

"The concern has been lack of growth, not excessive growth," he said.

"We've had no inflation problem, and haven't had the central banks hitting the brakes. Yes, there are pockets of excess. But nothing like what we saw prior to the Great Depression."

2020s economics is different to 1920s economics

The post-war period has served as an important lesson in precisely what not to do, and what to do, in avoiding a depression. In the Great Depression, countries did exactly the wrong thing. Since then, we all know what to when a recession or depression is threatened, that is; monetary and fiscal stimulus.

Prior to the Great Depression in the 1920s, we saw a massive trade war globally, tariff hikes in the US and other countries did the same thing. We saw monetary and fiscal tightening in various countries across the world going into it, which made things worse.

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There was a view that the way to fix up a budget deficit was to just raise taxes and cut spending, which is not so good when you're going into a slump, that made the whole thing worse. This time around you're seeing the exact opposite. You're seeing monetary easing on a massive scale, and of course massive fiscal stimulus. This is very different to what we saw at the time of the Great Depression.

The disruption is huge, but it should be temporary

The coronavirus has been a sudden, severe disruption to economic activity and regular social functioning. It's clear with the Great Depression, with the benefit of hindsight, that there was a long lead up of factors which led to the eventual and devastating slump. The trajectories for the two events are quite different.

No doubt, COVID-19 can move to a point of out of control – we've seen that in Italy, and there are worrying patterns forming in the US. But there is nothing to suggest it's a situation that can't be controlled, using known methods of success that governments worldwide are replicating.

The bottom line is that while we may see the biggest hit to global GDP since the 1930s thanks to the shutdowns, there are big differences compared to the Great Depression, suggesting that a long and drawn-out global downturn is not inevitable.

Basically, it's a disruption to normal activity caused by the need to stay at home. In fact, growth could rebound quickly once the virus is under control and policy stimulus impacts.
Of course, at this point we are still waiting for convincing evidence that markets have bottomed. And the key is that the number of new cases of the coronavirus starts to slow and that collateral damage from the shutdowns are kept to a minimum.

Source: AMP