The Coming Greater Depression of the 2020s

April 28, 2020
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While there is never a good time for a pandemic, the COVID-19 crisis has arrived at a particularly bad moment for the global economy. The world has long been drifting into a perfect storm of financial, political, socioeconomic, and environmental risks, all of which are now growing even more acute.

NEW YORK – After the 2007-09 financial crisis, the imbalances and risks pervading the global economy were exacerbated by policy mistakes. So, rather than address the structural problems that the financial collapse and ensuing recession revealed, governments mostly kicked the can down the road, creating major downside risks that made another crisis inevitable. And now that it has arrived, the risks are growing even more acute. Unfortunately, even if the Greater Recession leads to a lackluster U-shaped recovery this year, an L-shaped "Greater Depression" will follow later in this decade, owing to ten ominous and risky trends.

The first trend concerns deficits and their corollary risks: debts and defaults. The policy response to the COVID-19 crisis entails a massive increase in fiscal deficits – on the order of 10% of GDP or more – at a time when public debt levels in many countries were already high, if not unsustainable.

Worse, the loss of income for many households and firms means that private-sector debt levels will become unsustainable, too, potentially leading to mass defaults and bankruptcies. Together with soaring levels of public debt, this all but ensures a more anemic recovery than the one that followed the Great Recession a decade ago.

A second factor is the demographic time bomb in advanced economies. The COVID-19 crisis shows that much more public spending must be allocated to health systems, and that universal health care and other relevant public goods are necessities, not luxuries. Yet, because most developed countries have aging societies, funding such outlays in the future will make the implicit debts from today's unfunded health-care and social-security systems even larger.

A third issue is the growing risk of deflation. In addition to causing a deep recession, the crisis is also creating a massive slack in goods (unused machines and capacity) and labor markets (mass unemployment), as well as driving a price collapse in commodities such as oil and industrial metals. That makes debt deflation likely, increasing the risk of insolvency.

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