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Covid-19: Reflections on a global crisis

The Covid-19 pandemic was unexpected in its arrival and unprecedented in its effect. Equity markets endured their worst 3-week period in history, while liquidity in the bond market evaporated. The extent of the market decline and the economic impact will take months to become fully apparent, and forecasts are dependent on how quickly and effectively the spread of the virus can be slowed.

In the UK it appears that we have just passed the peak in infection rates. Markets have rebounded in anticipation of a reopening of the economy. How soon this happens and how it is managed should become clearer in due course. It is highly unlikely we will return to the relative normality of 2019 so there is understandably much speculation about what the post recovery “new normal” will be.

The impact of Covid-19 is unprecedented in many ways. At no point in history have Governments intentionally and deliberately shut down their economies or forced businesses, factories, shops and restaurants to close. Nevertheless, it is perhaps inevitable that we look at history to find parallels with our current experience. The events surrounding the Great Financial Crisis of 2008 still feel fresh in our minds (probably because we have been living with them through the recent years of austerity). But the 1973 recession and the Great Depression of the 1930s seem more distant.

Nevertheless, it is the 1930’s Depression that seems to be drawing the biggest comparisons. There are certainly similarities between what we are witnessing now and the Great Depression, not least the gravity of both, the personal and economic cost and sadly the human tragedy. The stock market volatility and economic shocks could also be considered similar. March 2020 saw some of the biggest daily rises and falls in stock market history.

Impact on economic growth
As a result of the Covid-19 lockdown, the expected falls in economic activity are unprecedented outside the Great Depression. JP Morgan is forecasting US Gross Domestic Product (GDP) to fall 40% in Q2 2020 and unemployment in the US to rise to a staggering 20%, that’s one in five of the US workforce out of work.

Between 1929 and 1933 US GDP fell around 30% and in 1933 unemployment in the US peaked at around 25%. To put that into context the most recent peak in US unemployment in 2009 was ‘only’ 10%. So again, the similarities in terms of falls in economic output and enormous impact on the job market are similar.

These are worrying figures. Are we really about to live through the most profound economic depression in modern times?

Why the Covid-19 crisis is different from The Great Depression
When considering this question, it is worth looking at what caused the Great Depression, and perhaps contrary to popular belief there isn’t a singular event. Although it may have been a key catalyst for what followed, the Stock Market Crash of 1929 was not the cause of the 1930’s Great Depression.

The causes can now be seen as a series of policy errors that compounded the ever-worsening economic crisis which only ended with the outbreak of World War II.

Those policy errors are simply unthinkable in the current social and economic times. Central to US Government policy in the 1930s was the ‘Leave-it-alone Liquidation’ or ‘laissez-faire’ policy. This hands-off strategy was designed to “let the slump liquidate itself...it will purge the rottenness out of the system’ according to President Hoover’s later memoir of the time.

To ‘purge the system’ Government policy allowed the banking collapses, the corporate bankruptcies, the homelessness and the poverty to spiral out of control. By the time the US Government did try to intercede it was too late. The first attempts to support the Banking system weren’t until 1932 - by the end of the following year a third of all US Banks had collapsed.

The lessons from the past have been learnt. In this crisis, the Federal Reserve and the US Government have done entirely the opposite. Within days of the crisis unfolding, interest rates have been cut to zero. Trillions of dollars have been pumped into the financial system to ensure that the Banks have adequate liquidity. Not one Bank should collapse in this crisis.

Trillions of dollars are being spent to ensure workers will either be furloughed by their employers or if claiming unemployment benefit, in some cases will receive more than they received when working. The US and the UK for that matter have taken unprecedented steps to protect their economies and their people.

The real challenge in the Covid-19 crisis is the scale and speed of the downturn. The enforced closure of significant proportions of the economy results in an unprecedented fall in GDP in a very short space of time.

The risk, despite the bold and co-ordinated response from policymakers, is longer-term collateral damage, as businesses fail and joblessness rises. A significant rebound is likely during the second half of 2020, but may not be sufficient to overturn the decline.

Having said that, this will be temporary and this is the most important difference. At worst it will be months, but hopefully, it'll be weeks before the lockdown ends and economies can re-start. Even if it takes longer to overturn all the declines from the Covid-19 crisis, it is hard to imagine anything like the years of grinding economic decline and resultant personal destitution of The Great Depression.

This has been a very difficult period for ourselves and our clients. The scale and the tragic human cost of the Covid-19 crisis has caused many of us to reassess our priorities. It is inevitable that a crisis of this magnitude will be the catalyst for a period of self-reflection at an individual, national and global level. At an economic level it should be relatively simple to reboot the supply of goods and services but how will our demand as consumers have changed? Some sectors will survive and perhaps prosper in the post Covid-19 world, others will struggle. I imagine it will vary tremendously from one sector to the next.

It will be interesting to see whether people's experiences of the pandemic reinforce previous attitudes or whether these have been challenged. Will we be more open to alternative perspectives, lifestyles, futures or will the bunker mentality prevail. The investment industry reflects public trends, fashions and attitudes. The interest in ethical investing is not new but in the last 2-3 years there has been a significant increase in investment companies adopting a more ethical, sustainable and responsible approach in the way they do business and, in the products, they offer.

We have always been happy to discuss alternative investment strategies with our clients and in the 'new normal' that follows Covid-19 please let us know if you would like to consider strategies that incorporate an ethical dimension. I believe this can be done without compromising our main goal which is to help our clients achieve their financial objectives in the most cost/tax efficient, risk appropriate way.

At this difficult time, we wish you well. We look forward to speaking to you soon and in the meantime stay healthy and look after yourselves.

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