History Suggests we can Expect a Fast Recovery Once Covid-19 is Contained

I have mentioned in several past articles that anybody discussing recession suggesting 'This time it's different!' is simply wrong, and that recovery comes, and recession is only temporary.

The current pandemic-induced economic crisis is however, a little different to the financial crisis of 2008. They have very different causes, and the recovery will probably look very different too. It will be much quicker.

There is sound data showing that the first group of approved vaccines, regardless of developer, are working on the original strain of Covid-19, and there is increasing evidence that even one jab offers a decent amount of protection (from both the AstraZeneca and Pfizer vaccines).

AstraZeneca also suggest modified vaccines will be available in the coming months, capable of protecting against South African and other variants.

With the gearing-up of vaccination programmes (possibly delaying second jabs for up to 12 weeks, as the UK has done), people are being protected from Covid-19 at a rapidly increasing rate. Even so, it is still likely to be several months, or a year, before the level of inoculations enables economic recovery to start in any globally meaningful way.

- But what does it mean for the economy once it happens?
- And can we get back on our feet after a thump this hard?

The good news is that history gives grounds for optimism.

We're always fighting the last war

The last big recession and economic crisis that most of us will remember is the 2008 financial crisis and the subsequent eurozone crisis. Even if you're living in Greece, where a lengthy depression is a much more recent memory, it's still all part of the same broad crisis.

One thing about big horrible economic events, like big, horrible events of any nature, is that they imprint themselves on your mind. It is a survival mechanism. Your mind clings onto the memory, so that you can try to make sure it doesn't happen again, or that if it does, you're prepared.

As a result, when you see another big, horrible event, you tend to match the experience with what happened last time. It therefore follows that experience of 2008 and its consequences has a huge influence over how we perceive the current slump.

We see similar attitudes in people whose formative years were during the rampant inflation of the 1970s. Even as interest rates and inflation began their dramatic and long-term decline in the early 1980s, a damaging inflationary spike was always just around the corner for many people, economists and political leaders included.

Like many of our survival instincts, honed over millennia of evolution, this one becomes a problem when it comes to dealing with the abstract financial world, because not every financial crisis is quite the same. Usually, you don't get two of the same ones in a row, in part because the solutions to the first often help trigger the next.

This is relevant to today's situation.

I talk to many people incredulous at the idea that we might expect a big rebound once vaccine programs are fully rolled out, and economies begin to re-open. Even if they don't realise it, this is at least partly because they're being influenced by their memories of the 2008 collapse.

The 2008 crash took years to recover from (if we ever did), and in many ways this collapse was worse. It seems, at face value, we are unlikely to recover quickly from this one.

This is important. Investing for a world that will take another decade to get back to its feet is very different to investing for one that might rebound by the end of next year.

Particularly when you consider the fact that even more money has been printed during this crisis than was printed post-2008.

So why are we more likely to bounce back a lot faster from the Covid crisis than we did from 2008? The Banks!

Natalia Martin Fuentes and Isabella Moder, European Central Bank researchers, have produced an interesting document called "The scarring effects of past crises on the global economy".

They looked at what you could split into two broad types of economic crisis.

One was geopolitical crises: previous epidemics, major wars, and the 1973-1974 oil embargo of Western countries by oil cartel OPEC.

The other category is financial crises: economic collapses caused by the banking system being bankrupt.

Obviously, there's a lot of variation within these categories. Some geopolitical crises are much worse than others (most past epidemics have been more localised than this one), while banking crises vary in scale too.

Put simply, when geopolitical disaster hits, the economy takes a swift slap and falls down hard.

It then recovers and gets back to work. In other words, the economy bounces back quickly, and there tends to be 'no longer-lasting scarring effects'.

A financial crisis is very different. A financial crisis is more like a debilitating illness (forgive the analogy) - You go to bed feeling exhausted. You lie there for a day. You feel a bit better. You get up and do some work for an hour. You're exhausted. You go back to bed. Three weeks later you're still repeating the same cycle.

As Fuentes and Moder note, 'financial crises are associated with a very persistent downward shift in potential output'. The results for past financial crises suggest a loss of around 5% even after eight years." Clearly, the economy doesn't bounce back. If anything, it remains permanently weakened (there are "long-lasting scarring effects on the level of potential output".)

None of this is new, by the way. We've known all of this for a long time (certainly since before the last financial crisis).

It takes longer to recover from financial crises because they are created by the build-up of imbalances over a long period of time. The banking system topples over because there's too much debt in all the wrong places, and it's very hard to reconfigure and recover from that quickly. The banks end up sucking up all the spare capital and there's not much left for everyone else.

The external shocks are much quicker to recover from.

They happen, they do their damage, and then they go away, at which point everything bounces back. Covid-19 has been extraordinarily damaging, but it will go away. It is going away. It will change some things, but some of those changes might even make us more productive.

Already, we see there is greater use of digital technology. Forget the 'paperless office' we foresaw in the 1980's, we now have the officeless office. Vitally, medicine development has been accelerated to an incredible extent by the needs of Covid, and that must have a beneficial knock-on impact in future.

Meanwhile, governments have gone further than ever before to cushion the impact of this particular exogenous shock.

It is important to be clear - it has not been sunshine and roses for us all. As individuals, many have lost money, jobs, and saddest of all, loved ones. It is also fair to say that handling of this pandemic by governments and society has not been perfect – far from it.

However, a look at the bigger picture of the global economy, and relating that to crises through history, we should not expect a repeat of 2008. A much more rapid recovery seems most likely.