# The Myth of V-Shape US Economic Recovery

By Dr. Jack Rasmus
Global Research, April 29, 2020

Region: USA
Theme: Global Economy

*The spin is in! Trump administration economic 'message bearers', **Steve Mnuchin**, US Treasury Secretary, and **Kevin Hasset**, senior economic adviser to Trump, this past Sunday on the Washington TV talking heads circuit launched a coordinated effort to calm the growing public concern that the current economic contraction may be as bad (or worse) than the great depression of the 1930s.*

Various big bank research departments predicting a GDP contraction in the first quarter (January-March 2020) anywhere from -4% to -7.5%, and for the current second quarter, a further contraction from -30% to -40%:  Morgan Stanley investment bank says 30%. The bond market investment behemoth, PIMCO, estimates a 30% fall in GDP. Even Congress's Budget Office recently estimate the contraction in GDP could be as high as -40% in the 2nd quarter.

**Mnuchin-Hassett's New Old Normal**

Despite the flashing red lights on the state of the US economy, the Trump administration's key economic spokespersons are pushing the official line that the economy will soon quickly 'snap back'. On the near horizon is a V-shape recovery coming in the 3rd quarter (July-September) or, at the latest, the following 4th quarter. The economy may be particularly bad, they admit, but be patient folks a return to normal is on the way before year end!

Speaking on Fox News Sunday Treasury Secretary, Mnuchin, declared the US economy is about to open up in May and June and "you're going to see the economy really bounce back in July, August and September". And Hassett echoed the same, just a barely less optimistic viewing the snap back in the 4th quarter. Getting ahead of the bad news coming this Wednesday when 1st quarter US GDP numbers are due for release, Hassett admitted a big shock is coming on Wednesday, to be followed by "A few months of negative news that's unlike anything you've ever seen". But not to worry, according to Hassett, the 4th quarter "Is going to be really strong and next year is going to be a tremendous year".

Meanwhile, the administration's big banker allies were also making their TV news show rounds, singing the same 'happy days will soon be here again' tune. Bank of America's CEO, Moynihan, appearing on 'Face the Nation' show, predicted consumer spending had bottomed out and would soon rise nicely again in the 4th quarter, October-December, followed by double digit GDP growth in 2021!

The Trump administration is pressing hard to reopen the economy now! It knows if it doesn't the contraction of the economy could settle in to a medium to long term stagnation and decline.  Business interests are pushing Trump and Republicans to reopen quickly, regardless of the likely consequences for a second wave of the virus devastating national health and death rates. There is a growing segment of US business interests desperate to see a return to sales and revenue, without which they face imminent defaults and bankruptcies after a decade of binging on corporate debt.  A growing wave of defaults and bankruptcies could very well provoke an eventual financial crisis which would exacerbate the collapse of the real economy even further.

**The Fed's $9 Trillion May Not Succeed**

So far the Federal Reserve central bank has committed to $9 trillion in loans and financial backstopping to the banks and non-banks, in an unprecedented historic experiment by the Fed. Not just the magnitude of the Fed bailout in dollar terms, already twice that the central bank employed in 2008-09 to bail out the banks in that prior crash, but the Fed this time is not waiting for the banks to fail. It's pre-emptively bailing them out! Also new is the Fed is bailing out non-banks as well, trying to delay the defaults and bankruptcies at their origin, before the effects began hitting the banking system. Bailing out non-banks is new for the Fed as well, no less than the pre-emptive bank rescue and the $9 trillion—and rising—total free money being thrown at the system.  But it should not be assumed the Fed will succeed, despite its blank check to banks and businesses. Its historic, unprecedented experiment is not foreordained to succeed—for reasons explained below.

For the magnitude and rapidity of the shutdown of the real economy in the US is no less unprecedented.  Even during the great depression of the 1930s, the contraction of the real economy occurred over a period of several years—not months. It wasn't until 1932-33 that unemployment had reached 25%.

As of late April 2020, that 25% unemployment rate was already a fact. The official government data indicated 26.5m workers had filed for unemployment benefits. That's about 16.5% of the 165 million US civilian labor force.  Bank forecasts are 40 million jobless on benefits by the end of May. But respected research sources, like the Economic Policy Institute, recently estimated that as many as 13.9m more are actually out of work but have not yet been able to successfully file for unemployment benefits. So the 40 million jobless may already be here. And that's roughly equivalent to a 25% unemployment rate. In other words, in just a couple months the US economy has collapsed to such an extent that the jobless ranks are at a level that took four years to attain during the great depression of the 1930s!

A contraction that fast and that deep likely has dynamics to it that are unknown. It may not respond to normal policy like enhanced unemployment benefits, emergency income checks, and even grants and loans to businesses on an unprecedented scale such as being provided by the Fed.  The psychology of consumers, workers, businesses, and certainly investors may be so shocked and wounded that the money injections—by Congress and by the Fed—may not quickly result in a return to spending and production.  The uncertainty of what the future may bring may be creating an equally unprecedented fear of spending the money. Economists sometimes call this a 'liquidity trap'. But it may more accurately be called a 'liquidity chasm' out of which the climb back will prove very slow, very protracted, and the road strewn with economic landmines that could set the economy on a second or third collapse along the way.

Image on the right: Kevin Hasset (Source: Wikimedia Commons)

The V-shape argument is predicated on the assumption that the virus's negative effect will dissipate this summer. Those supporting the argument assume, openly or indirectly, that the economic collapse today is largely, if not totally, due to the virus. It's not really an economic crisis; it's a health crisis. And when the latter is resolved, the economic crisis will fade as well as a consequence.

But this assumes two things: first that the virus will in fact 'go away' soon and not hang like a dead weight on the economy. Second, that there were not underlying economic causes that were slowing the US (and global) economy already before the virus's impact. The virus is seen as the sole cause, in other words, and not as a precipitating factor that accelerated an already weak and fragile economy into a deep contraction. But the virus may be best understood as an event that precipitated and then accelerated the contraction of an economy already headed for a slowdown and recession.

These latter possible ways to understand the current economic crisis are of course ignored by the advocates of a V-shape recovery. In their view, it's just a health crisis. And the health crisis is about to end soon. And when it does, we'll return to the old 'normal' and the economy will snap back. But the depth and rapidity of the decline into what is, at least, a 'great recession 2.0' and perhaps something more like the even deeper and longer great depression of the 1930s, strongly suggests that forces of decline have been unleashed in the US economy that have a dynamic of their own now. And that dynamic is independent of the precipitating cause of the virus which, in any event, is not going away soon either. In all cases of such virus contagion, there has always been a second and even third wave of infection and death. And Covid-19 appears the most aggressive and contagious.

It's not just the 40 million and likely more unemployed that define the unprecedented severity of the current crisis.

Millions of small businesses have already shut down or gone out of business. More will soon follow. And many will never re-open again. The average number of days of cash on hand for small businesses before the virus impact was 27 days. Many small businesses are projected to run out of that by end of April. That's why we are not witnessing growing protests and refusals to abide by a 'sheltering in place' order announced by various state governors. Small businesses and their workers, both on the brink of bankruptcy are taking to the streets—encouraged of course by radical right forces, conservative business interests, and political allies right up to the White House.

The millions of workers who haven't been able to get through to successfully file and obtain unemployment benefits, and the millions of smallest businesses who have been squeezed out of the Small Business bailout program (called the Pay Protection Program) are fertile ground for right wing propaganda demanding the country reopen the economy immediately, even if it's premature in terms of suspending virus mitigation efforts and almost sure to result in a second wave of infection that will debilitate the economy again later in the year.

And the flow of funding from recent small business legislation passed by Congress has been bottled up by big banks gaming the system—first using the crisis to extract concessions from the federal government on further bank deregulation, getting guarantees by the government on liability protection, ensuring they receive lucrative fees and charges from the lending, and requiring the government to reimburse them for loans that might later default and fail.

In addition to the slow distribution of the loans by the big banks, the same big banks began re-directing the small business program loan funds first to their own largest and best customers. Thus the first $350 billion in Congress funding for small business was directed to the banks' best customers in less than two weeks. A second $320 billion supplement just added is reportedly already accounted for in less than half that time.

Despite the data on jobs, small business, and GDP much of the liberal economist establishment appear to be falling for the Trump administration official line and spin that there'll soon be a V-shape recovery.

**Liberal Economists Buy the Mnuchin-Hassett Line**

The dean of liberal economists, Paul Krugman, in one of his columns recently, says it's not an economic crisis but a disaster relief situation. Kind of like an economic hurricane, he added, that once it passes the sun will come out and shine again at the same economic intensity as before. And then there's Larry Summers, Harvard economics professor and advisor to Barack Obama in 2009, who agreed with Krugman, saying "it's possible to collapse and come back quite quickly." Or Robert Reich, Cal Berkeley professor and former member of Bill Clinton's cabinet, who declared in another TV interview recently, that the crisis wasn't economic but a health crisis and as soon as the health problem was contained (presumably this summer) the economy would 'snap back'.

Theirs is economic analysis by means of weather metaphors. And the error they all make is assuming that the fundamental cause of the crisis is not economic but the virus. They don't see the virus as only a precipitating cause, exacerbating and accelerating what was a basically weak US and global economy going into the crisis, but instead the virus is the sole, fundamental cause of the deep contraction.

Krugman and other proponents of the 'snap back' (V-shape recovery) thesis all deny the counter argument that the current deep and rapid economic decline is precipitated by the crisis and that there is an internal economic dynamic set in motion that is taking over that driving the economy into a downward spiral regardless of the initial health crisis effect.

As one partial example of that internal dynamic: once the contraction in the real economy accelerates and deepens, it inevitably leads to defaults and bankruptcies—among businesses, households, and even local governments. The defaults and bankruptcies then provoke a financial crisis that feeds back on the real economy, causing it to deteriorate still further. Income losses by businesses, households and local government thereafter in turn cause a further decline. Once negative mutual feedback effects within the economy begin, it matters little if the health crisis is soon abated. The economic dynamic has been set in motion. Krugman and friends should understand that but either don't, or are cautioned by their employers and political friends not to tell the whole truth lest it cause further concern, lack of business and consumer confidence, or even panic.

When mainstream economists don't understand what's actually happening, they hide behind their metaphors as a way to obfuscate their lack of understanding and ability to forecast the future. Or they employ the same metaphors to avoid telling the truth. But the truth is this isn't just a health crisis. And it won't quickly disappear even if the health issue were resolved in a matter of weeks or months.

Instead of pacifying the public with nice metaphors, they might just look at the recent past. No snap back economic recovery occurred after 2008-09, which was a contraction far weaker in relative terms than the present, with fewer job losses and a much smaller GDP decline.

**2008-09 Recovery Was No V-Shape**

Even after the less severe 2008-09 contraction, bank lending after 2009 did not return immediately or even normally. Only the largest, best customers of the big banks and their offshore clients received new loans from them. Bank lending to US small and medium businesses continued to decline for years after 2009. And jobs lost in 2008-09 did not recover to the levels of 2007 just before the recession began until 2015. Wages of jobs recovered from 2008 to 2015 was much lower compared to wages of 2007 jobs that were lost. The ratio between full time jobs and part time/temp/contract work deteriorated after 2009, with more of the latter hired and the former not rehired. Real wages still has not recovered to this day for tens of millions of workers at median income levels and below.

So one can only wonder what the Krugmans, Summers and Reichs are 'smoking' when they make ridiculous declarations about 'snap back' recovery. They should know better. All they had to do was look at the evidence of the historical record post-2009 that V-shape recoveries do not happen when there are deep and rapid contractions! And that's true not only for 2009, but even for 1933 when the great depression finally bottomed out.

Between 1929 and 1933 the US economy continued to contract. Not all at once, but in a kind of 'ratcheting down' series of lower plateaus as banking crises erupted in 1930, 1931, 1932 and then again in early 1933. When Roosevelt came into office in March 1933 he introduced a program aimed at bailing out the banks first, and then assisting business to raise prices. It was called the National Recovery Act. That program stopped the collapse but generated only modest recovery, and by mid-1934 that recovery had dissipated. It was then, in the fall of 1934, that Roosevelt and the Democrats proposed what would be called the New Deal, which was launched in 1935 after the mid-term 1934 Congressional elections. The US economy began to recovery rapidly in 1935 to 1937. In late 1937 Republicans and conservative Democrats in the South allied together and cut back New Deal social spending. The US economy relapsed back into depression in 1938 until Congress, fearful of the return to Depression, reinstated New Deal spending and the economy recovered again to where it was in 1937. The permanent recovery did not begin until 1940-41, as the US economy mobilized for war and government spending rose from 15%-17% of GDP to more than 40% in one year in 1942.

But mainstream economists are not very attentive to their own country's economic history. If they were they would understand that deep and rapid economic contractions always result in slow, protracted, and often uneven recoveries. There never is a 'snap back' when depression levels of contraction occur—or even when 'great recession' levels occur, as in 2008-09. It takes a long time for both business and consumers to restore their 'confidence' levels in the economy and change ultra-cautious investing and purchasing behavior to more optimistic spending-investing patterns. Unemployment levels hang high and over the economy for some time. Many small businesses never re-open and when they do with fewer employees and often at lower wages. Larger companies hoard their cash. Banks typically are very slow to lend with their own money. Other businesses are reluctant to invest and expand, and thus rehire, given the cautious consumer spending, business hoarding, and banks' conservative lending behavior. The Fed, the central bank, can make a mass of free money and cheap loans available, but businesses and households may be reluctant to borrow, preferring to hoard their cash—and the loans as well.

In other words, the deeper and faster the contraction, the more difficult and slower the recovery. That means the recovery is never a V-shape, but more like an extended U-shape.

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***Dr. Rasmus** is author of the just released book, The Scourge of Neoliberalism: US Economic Policy from Reagan to Trump', Clarity Press, January 2020; and the preceding book, 'Central Bankers at the End of Their Ropes: Monetary Policy and the Coming Depression', Clarity Press, August 2017. He blogs at jackrasmus.com. His twitter handle is @drjackrasmus and his website: http://kyklosproductions.com. He is a frequent contributor to Global Research.*

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*Articles by:* **Dr. Jack Rasmus**