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Democracy Dies in Darkness

Here comes the great deflation threat

By **Robert J. Samuelson**

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Just what kind of economic slump will this be? It's too early to know, but it's not too early to speculate. I've done a totally unscientific survey of economic forecasts. Some were solicited by me; others I received from regular emails. What follows is a quick summary of what I found. It doesn't attempt to forecast peak unemployment or the impact on the presidential election. My purpose is more modest: to clarify what we know and what we don't.

You'll recall the context. The coronavirus has turned into a job-killing machine. Businesses have closed by the thousands as firms lost customers and governments invoked lockdowns. Jobs, profits and the stock market have dropped dramatically. The next big worry may be deflation, a general fall of prices. It's already occurring in oil, where daily global demand has plunged from about 100 million barrels to 80 million. Prices have spiraled downward.

There's already a huge glut of jobless workers. Claims for government unemployment insurance have jumped by 3.3 million and 6.6 million in the past two weeks. The total of nearly 10 million is likely the fastest surge of joblessness since the Great Depression. If that 10 million were added to the preexisting joblessness, the unemployment rate (3.5 percent in February) would jump to more than 10 percent, a blog post by the Congressional Budget Office estimates.

That hasn't happened yet. When the Bureau of Labor Statistics (BLS) released the latest jobless figures on April 3, the official unemployment rate rose to only 4.4 percent in March. The gap between the 4 percent and the 10 percent has many causes, the BLS said: (1) Much of the employment survey occurred in early March, before the full impact of coronavirus layoffs was felt; (2) some workers on temporary layoff were misclassified as being employed; (3) some interviews "were suspended . . . for the safety of interviewers and respondents."

Confusion also surrounds gross domestic product (GDP), the economy's output. Some economists believe that GDP will suffer a double-digit decline in the second quarter. The CBO forecasts a drop of 28 percent. Whew! But this is a statistical fluke. The CBO actually expects GDP to decline by 7 percent during the second quarter. However, the data is presented on an annualized basis. So the 7 percent must be multiplied by four. Presto: 28 percent.

Many forecasters expect the economy to rebound in the summer. The pandemic will subside, and many people could return to work. Economists Nariman Behravesh and Elisabeth Waelbroeck-Rocha of IHS Markit, a forecasting firm, expect the U.S. GDP to drop 5.4 percent in 2020. Capital Economics, a consulting firm, thinks the pandemic by year's end will be "under control in much of the world, including the U.S. And we think that this will set the stage for a more lasting recovery." European stocks could advance 20 percent to 30 percent over the same period. Goldman Sachs expects the GDP to take a massive hit in the second quarter but then jump 19 percent in the third quarter, resulting in a 6.2 percent drop for the whole year.

But pessimists abound. There's no doubt that the slump will be severe. Many economists have identified surpluses of people and products. Desmond Lachman of the American Enterprise Institute fears the worst. "The coronavirus epidemic is triggering other economic crises in its wake," he writes. Among those crises is "the bursting of a global asset price bubble . . . a global credit crunch, and a major reversal of capital flows to the emerging market economies."

Economist Mark Zandi of Moody's Analytics is also downbeat. Households face lost income and wealth, he writes. "Some $10 trillion in stockholder wealth (depending on the day and hour) has evaporated in the past several weeks. A powerful wealth effect — the relationship between households' wealth and their spending — will soon take hold. We estimate the wealth effect in a down stock market to be 4.5 cents for every $1 decline in stock wealth; consumer spending will decline by almost a nickel in less than a year," he says. If continued, this would "crush consumer spending and the economy."

Deflation is a widespread fall in prices, just as inflation is a widespread increase in prices. In theory, modest deflation could aid an economic recovery by making goods and services cheaper. But rapid deflation could be self-defeating. Companies become even less profitable, and consumers delay purchases because prices will be even lower.

The Great Depression provides evidence of deflation's damaging effects. Agricultural prices collapsed, making it harder for farmers to pay their debts. Mortgages went into default by the thousands. Prices fell more than wages, raising labor costs and frustrating firms' efforts to resume production. Idle workers and idle machines pushed prices down, delaying the recovery. We cannot let it happen again.

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