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Are we headed for a depression? Economists weigh in

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Another day, another surprise for the economic forecasters: a record 6.6 million people filed for unemployment last week. Oxford Economics in an email called it an "incomprehensible jump" that may be "the new normal." Joe Brusuelas, chief economist for middle market audit and advisory firm RSM, wrote that such "tectonic shifts" imply a "real-time unemployment 10.1% at a minimum."

There is so much uncertainty in the world right now that economic forecasters are downgrading their predictions almost as fast as they can make them. Within a few weeks, Goldman Sachs downgraded its second quarter GDP estimates from –2% to –24% to –32%.

Predictions are pretty clear that a recession, and maybe a very bad one, is in the offing. But given how quickly the situation is changing, is there a chance the country is heading for a depression?

Fortune discussed the issue with 10 economists and financial market experts. Most at this point consider a recession essentially a given. And a depression? That's where opinions start to diverge wildly.

After all, out of the 22 recessions since 1900, according to the National Bureau of Economic Research, only one was dire enough to warrant such a title: the Great Depression. There had been four in the preceding 19th century.

Right now there appear to be two camps. Those in the first say economic fundamentals have been essentially sound and that a depression is almost unthinkable. The other group says that a depression is very much a possibility.

What is a depression?

Unlike a recession—two consecutive quarters of negative GDP growth—there is no compact universal definition of a depression.

Absent an official definition, economists have a variety of working ones. According to some, "in a depression, you have to have a decline in GDP of two or more years," said Shahid Hamid, professor of finance and chair of the finance department at Florida International University. "Another is if the GDP decline is greater than 10% [for two years]. A third is if unemployment is more than 10%," again for two years.

Then there are economists who take a more relative approach. "Some people say it has to be a year [of severe economic contraction]," said Derek Horstmeyer, an associate professor of finance at the George Mason University School of Business. "Some people push it further."

There is even a question as to whether it must be obvious to everyone at the same time. "It is possible for one sector of a society to be trapped in an economic trough—a depression—while another sector is feeding from the trough and living the high life," said Michael Merrill, an economist, professor of professional practice, and director of the Labor Education Action Research Network in the Rutgers School of Management and Labor Relations. "Traditional Middle America has known exactly such a situation since the mid-1970s, and African-Americans have known it for even longer. The effects are evident in every health, economic, and social welfare statistic one might want to consult."

Or, as goes the old saying that James Cassel, cofounder and chairman of investment banking firm Cassel Salpeter & Co., mentioned: "When your friend's out of a job, it's a recession. When you're out of a job, it's a depression."

As with recessions, depressions are typically diagnosed in retrospect, after the data is in. But that typically comes after events have happened and not as they are occurring, unlike in many other aspects of American life.

"We actually have data for minute-by-minute listeners to major radio shows," said Usha Haley, W. Frank Barton distinguished chair in international business, professor of management, and director of the Center for International Business Advancement of Wichita State University. "We know who's going to buy products and what's going to happen. Here, for the first time, we don't have [the economic data we need to forecast]." The changes are so swift and large that forecasters can't build projections from patterns in the recent past. "This [pandemic] scenario is very new, and economists don't have a good model to predict how the recovery would be," Hamid said.
There is also an inherent issue in how economists measure GDP. They usually look at change between quarters and then project that out into an annual growth rate. When a forecast projects that GDP will be –32% in the second quarter, it's really saying that if the change between the first and second quarter kept up all year, it would be like losing 32% of GDP over that year.

That can get confusing for a lay audience when trying to understand the state of things. "The way the quarter-over-quarter math works, if it goes down a lot in quarter one and it stays at that low level of activity in quarter two, [the rate is] zero," said Steven Blitz, chief U.S. economist of TS Lombard. Suddenly the rate economists and the media mention is 0%, which sounds far better than –32%, but it means things are still as bad.

Between all these factors, trying to pinpoint whether we're heading for a depression is extremely difficult.

The optimists

The optimists, if you can call them that, cite a basically strong economy, the noneconomic nature of the pandemic, and the presumption of pent-up demand once things are back to normal as evidence that as quickly as we fell into this hole, we can pull out of it.

Florida International University's Hamid is among those who think a depression is "very, very unlikely" given the economy's performance coming into the crisis. Haley at Wichita State University agreed. "We're in the center of it all," she said. "We're on the battlefield. Once that is over, we will recoup."

In an email to Fortune, Kundan Kishor, a professor of economics at the University of Wisconsin–Milwaukee, saw a depression as only a "one out of 100 chance." He sees two potential likely scenarios. One is a large drop in the economy and rapid recovery in the third and fourth quarters. The other is a "double-dip recession" if the pandemic reemerges in the fall.

If an economic fall happens and continues for months, the situation becomes more grave, thinks Sevin Yeltekin, a professor of economics at Carnegie Mellon University's Tepper School of Business. "But if we can restart, even a staggering restart, we're not really destroying capital," she said. "We're not destroying labor. The ramping up should happen quite quickly," putting danger at a distance.

"When you recognize that the contraction of economic activity was imposed [as a response to the pandemic] and therefore can be lifted, that makes this very different from your plain-vanilla ordinary recession in which policy missteps turned into a depression," explained TS Lombard's Blitz.

The pessimists

And then there is the other view. "Most economic models now point to a 25% to 30% unemployment rate in Q2," said George Mason's Horstmeyer, who focuses more on the degree of contraction and not the length. "The numbers we're seeing trickling in are very bad. This projection is worse than anything we saw in the Great Depression. So we can certainly call this a depression even if it only lasts for a quarter or two."

Alessandro Rebucci, an associate professor of finance at the Johns Hopkins Carey Business School, also stressed the depth of the collapse that his research shows using current indirect measures of activity, like energy use and traffic patterns.

"This [recession] poses formidable challenges and could be more prolonged and more severe, possibly worse than the Great Recession of 2008 to ’09, which lasted six quarters and saw the unemployment rate reaching 10% of the labor force," he said. "Current estimates put it at two to four times as severe, making it more profound than the Great Depression."

Rebucci also points to cascading effects that will stretch through the economy. "People will start to lose jobs, which means they will lose houses," he said. "We're used to thinking of recession driven by shocks that are short-lived. This is not only a shock that will last a while but will have long-term effects. What is shocking is that institutions continue to forecast moderate output declines, which has to do with the fact that they don't want to sound the alarm."

"The odds of a depression are quite high," says Merrill of Rutgers—in fact he thinks we might already be in one. While the stimulus packages will "slow the decline somewhat," changing the direction of the economy means addressing the pandemic and bringing it under control, and then restoring confidence afterward. "As long as people remain afraid of getting deathly ill and maybe dying every time they go to a mall, grocery store, or barber shop, the economy will not recover," he said.

Avoiding the danger

For the U.S. to avoid a depression, says Blitz, three things must occur.

First, the Federal Reserve must do everything in its power to ensure that "credit contagion doesn't cascade through the system." The Fed has taken many extraordinary steps not seen since the 2008 collapse, which hopefully will keep the global financial systems operating. If there are additional liquidity problems, however, the Fed may have reached the end of its options.

Second, the federal government needs a large enough fiscal response of the right type. The $2 trillion aid package is enormous, but Blitz thinks it may not offer the best approach. "The problem with giving people money to spend [is that] you have to be balancing that against the fact that you have social distancing rules preventing people from spending money," Blitz said. "I'd rather them front-load a trillion dollars of spending by all the various nondefense government agencies."

The biggest question is Blitz's third point—that the shutdown of activity needs to end quickly. "You need to stop the imposition of social distancing sooner [rather] than later, and government has to realize that the lifting of this can't be a six- to 12-month process," he said. "Then they have to encourage people to go out and live their lives. Once government takes this power to shut things down, they're very reluctant to give it up."

Although Donald Trump has said that he'd like to end isolation by the end of April at the earliest, the mathematical models the administration is using suggest that social distancing may have to continue through at least May. And that aggravates the problem.

Because while scientists are working to make strides on treatments and vaccines for coronavirus, economists are still searching for their magic bullet: a way to bring an economy out of a depression.