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Why Our Economy May Be Headed for a Decade of Depression

By Eric Levitz @EricLevitz

The worst is yet to come? Photo: Spencer Platt/Getty Images

In September 2006, Nouriel Roubini told the International Monetary Fund what it didn't want to hear. Standing before an audience of economists at the organization's headquarters, the New York University professor warned that the U.S. housing market would soon collapse — and, quite possibly, bring the global financial system down with it. Real-estate values had been propped up by unsustainably shady lending practices, Roubini explained. Once those prices came back to earth, millions of underwater homeowners would default on their mortgages, trillions of dollars worth of mortgage-backed securities would unravel, and hedge funds, investment banks, and lenders like Fannie Mae and Freddie Mac could sink into insolvency.

At the time, the global economy had just recorded its fastest half-decade of growth in 30 years. And Nouriel Roubini was just some obscure academic. Thus, in the IMF's cozy confines, his remarks roused less alarm over America's housing bubble than concern for the professor's psychological well-being.

Of course, the ensuing two years turned Roubini's prophecy into history, and the little-known scholar of emerging markets into a Wall Street celebrity.

A decade later, "Dr. Doom" is a bear once again. While many investors bet on a "V-shaped recovery," Roubini is staking his reputation on an L-shaped depression. The economist (and host of a biweekly economic news broadcast) *does* expect things to get better before they get worse: He foresees a slow, lackluster (i.e., "U-shaped") economic rebound in the pandemic's immediate aftermath. But he insists that this recovery will quickly collapse beneath the weight of the global economy's accumulated debts. Specifically, Roubini argues that the massive private debts accrued during both the 2008 crash and COVID-19 crisis will durably depress consumption and weaken the short-lived recovery. Meanwhile, the aging of populations across the West will further undermine growth while increasing the fiscal burdens of states already saddled with hazardous debt loads. Although deficit spending is necessary in the present crisis, and will appear benign at the onset of recovery, it is laying the kindling for an inflationary conflagration by mid-decade. As the deepening geopolitical rift between the United States and China triggers a wave of deglobalization, negative supply shocks akin those of the 1970s are going to raise the cost of real resources, even as hyperexploited workers suffer perpetual wage and benefit declines. Prices will rise, but growth will peter out, since ordinary people will be forced to pare back their consumption more and more. Stagflation will beget depression. And through it all, humanity will be beset by unnatural disasters, from extreme weather events wrought by man-made climate change to pandemics induced by our disruption of natural ecosystems.

Roubini allows that, after a decade of misery, we may get around to developing a "more inclusive, cooperative, and stable international order." But, he hastens to add, "any happy ending assumes that we find a way to survive" the hard times to come.

Intelligencer recently spoke with Roubini about our impending doom.

You predict that the coronavirus recession will be followed by a lackluster recovery and global depression. The financial markets ostensibly see a much brighter future. What are they missing and why?

Well, first of all, my prediction is not for 2020. It's a prediction that these ten major forces will, by the [illegible] horter

[illegible] a V-shape

Of course the markets are going higher because there's a massive monetary stimulus, there's a massive fiscal stimulus. People expect that the news about the contagion will improve, and that there's going to be a vaccine at some point down the line. And there is an element "FOMO" [fear of missing out]; there are millions of new online accounts — unemployed people sitting at home doing day-trading — and they're essentially playing the market based on pure sentiment. My view is that there's going to be a meaningful correction once people realize this is going to be a U-shaped recovery. If you listen carefully to what Fed officials are saying — or even what JPMorgan and Goldman Sachs are saying — initially they were all in the V camp, but now they're all saying, well, maybe it's going to be more of a U. The consensus is moving in a different direction.

Your prediction of a weak recovery seems predicated on there being a persistent shortfall in consumer demand due to income lost during the pandemic. A bullish investor might counter that the

Cares Act has left the bulk of laid-off workers with as much — if not more — income than they had been earning at their former jobs. Meanwhile, white-collar workers who've remained employed are typically earning as much as they used to, but spending far less. Together, this might augur a surge in post-pandemic spending that powers a V-shaped recovery. What does the bullish story get wrong?

Yes, there are unemployment benefits. And some unemployed people may be making more money than when they were working. But those unemployment benefits are going to run out in July. The consensus says the unemployment rate is headed to 25 percent. Maybe we get lucky. Maybe there's an early recovery, and it only goes to 16 percent. Either way, tons of people are going to lose unemployment benefits in July. And if they're rehired, it's not going to be like before — formal employment, full benefits. You want to come back to work at my restaurant? Tough luck. I can hire you only on an hourly basis with no benefits and a low wage. That's what every business is going to be offering. Meanwhile, many, many people are going to be without jobs of any kind. It took us ten years — between 2009 and 2019 — to create 22 million jobs. And we've lost 30 million jobs in two months.

So when unemployment benefits expire, lots of people aren't going to have any income. Those who do get jobs are going to work under more miserable conditions than before. And people, even middle-income people, given the shock that has just occurred — which could happen again in the summer, could happen again in the winter — you are going to want more precautionary savings. You are going to cut back on discretionary spending. Your credit score is going to be worse. Are you going to go buy a home? Are you gonna buy a car? Are you going to dine out? In Germany and China, they already reopened all the stores a month ago. You look at any survey, the restaurants are totally empty. Almost nobody's buying anything. Everybody's worried and cautious. And this is in Germany, where unemployment is up by only one percent. Forty percent of Americans have less than $400 in liquid cash saved for an emergency. You think they are going to spend?

Graphic: Financial Times

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You're going to start having food riots soon enough. Look at the luxury stores in New York. They've either boarded them up or emptied their shelves, because they're worried people are going to steal the Chanel bags. The few stores that are open, like my Whole Foods, have security guards both inside and outside. We are one step away from food riots. There are lines three miles long at food banks. That's what's happening in America. You're telling me everything's going to become normal in three months? That's lunacy.

Your projection of a "Greater Depression" is premised on deglobalization sparking negative supply shocks. And that prediction of deglobalization is itself rooted in the notion that the U.S. and China are locked in a so-called Thucydides trap, in which the geopolitical tensions between a dominant and rising power will overwhelm mutual financial self-interest. But given the deep interconnections between the American and Chinese economies — and warm relations between much of the U.S. and Chinese financial elite — isn't it possible that class solidarity will take precedence over Great Power rivalry? In other words, don't the most powerful people in both countries understand they have a lot to lose financially and economically from decoupling? And if so, why shouldn't we see the uptick in jingoistic rhetoric on both sides as mere posturing for a domestic audience?

First of all, my argument for why inflation will eventually come back is not just based on U.S.-China relations. I actually have 14 separate arguments for why this will happen. That said, everybody agrees that there is the beginning of a Cold War between the U.S. and China. I was in Beijing in November of 2015, with a delegation that met with Xi Jinping in the Great Hall of the People. And he spent the first 15 minutes of his remarks speaking, unprompted, about why the U.S. and China will not get caught in a Thucydides trap, and why there will actually be a peaceful rise of China.

Since then, Trump got elected. Now, we have a full-scale trade war, technology war, financial war, monetary war, technology, information, data, investment, pretty much anything across the board. Look at tech — there is complete decoupling. They just decided Huawei isn't going to have any access to U.S. semiconductors and technology. We're imposing total restrictions on the transfer of technology from the U.S. to China and China to the U.S. And if the United States argues that 5G or Huawei is a backdoor to the Chinese government, the tech war will become a trade war. Because tomorrow, every piece of consumer electronics, even your lowly coffee machine or microwave or toaster, is going to have a 5G chip. That's what the internet of things is about. If the Chinese can listen to you through your smartphone, they can listen to you through your toaster. Once we declare that 5G is going to allow China to listen to our communication,

we will also have to ban all household electronics made in China. So, the decoupling is happening. We're going to have a "splinternet." It's only a matter of how much and how fast.

And there is going to be a cold war between the U.S. and China. Even the foreign policy Establishment — Democrats and Republicans — that had been in favor of better relations with China has become skeptical in the last few years. They say, "You know, we thought that China was going to become more open if we let them into the WTO. We thought they'd become less authoritarian." Instead, under Xi Jinping, China has become more state capitalist, more authoritarian, and instead of biding its time and hiding its strength, like Deng Xiaoping wanted it to do, it's flexing its geopolitical muscle. And the U.S., rightly or wrongly, feels threatened. I'm not making a normative statement. I'm just saying, as a matter of fact, we are in a Thucydides trap. The only debate is about whether there will be a cold war or a hot one. Historically, these things have led to a hot war in 12 out of 16 episodes in 2,000 years of history. So we'll be lucky if we just get a cold war.

Some Trumpian nationalists and labor-aligned progressives might see an upside in your prediction that America is going to bring manufacturing back "onshore." But you insist that ordinary Americans will suffer from the downsides of reshoring (higher consumer prices) without enjoying the ostensible benefits (more job opportunities and higher wages). In your telling, onshoring won't actually bring back jobs, only accelerate automation. And then, again with automation, you insist that Americans will suffer from the downside (unemployment, lower wages from competition with robots) but enjoy none of the upside from the productivity gains that robotization will ostensibly produce. So, what do you say to someone who looks at your forecast and decides that you are indeed "Dr. Doom" — not a realist, as you claim to be, but a pessimist, who ignores the bright side of every subject?

When you reshore, you are moving production from regions of the world like China, and other parts of Asia, that have low labor costs, to parts of the world like the U.S. and Europe that have higher labor costs. That is a fact. How is the corporate sector going respond to that? It's going to respond by replacing labor with robots, automation, and AI.

I was recently in South Korea. I met the head of Hyundai, the third-largest automaker in the world. He told me that tomorrow, they could convert their factories to run with all robots and no workers. Why don't they do it? Because they have unions that are powerful. In Korea, you cannot fire these workers, they have lifetime employment.

But suppose you take production from a labor-intensive factory in China — in any industry — and move it into a brand-new factory in the United States. You don't have any legacy workers, any entrenched union. You are going to design that factory to use as few workers as you can. Any new factory in the U.S. is going to be capital-intensive and labor-saving. It's been happening for the last ten years and it's going to happen more when we reshore. So reshoring means increasing production in the United States but not increasing employment. Yes, there will be productivity increases. And the profits of those firms that relocate production may be slightly higher than they were in China (though that isn't certain since automation requires a lot of expensive capital investment).

But you're not going to get many jobs. The factory of the future is going to be one person manning 1,000 robots and a second person cleaning the floor. And eventually the guy cleaning the floor is going to be replaced by a Roomba because a Roomba doesn't ask for benefits or bathroom breaks or get sick and can work 24-7.

The fundamental problem today is that people think there is a correlation between what's good for Wall Street and what's good for Main Street. That wasn't even true during the global financial crisis when we were saying, "We've got to bail out Wall Street because if we don't, Main Street is going to collapse." How did Wall Street react to the crisis? They fired workers. And when they rehired them, they were all gig workers, contractors, freelancers, and so on. That's what happened last time. This time is going to be more of the same. Thirty-five to 40 million people have already been fired. When they start slowly rehiring some of them (*not* all of them), those workers are going to get part-time jobs, without benefits, without high wages. That's the only way for the corporates to survive. Because they're so highly leveraged today, they're going to need to cut costs, and the first cost you cut is labor. But of course, your labor cost is my consumption. So in an equilibrium where everyone's slashing labor costs, households are going to have less income. And they're going to save more to protect themselves from another coronavirus crisis. And so consumption is going to be weak. That's why you get the U-shaped recovery.

There's a conflict between workers and capital. For a decade, workers have been screwed. Now, they're going to be screwed more. There's a conflict between small business and large business.

Millions of these small businesses are going to go bankrupt. Half of the restaurants in New York are never going to reopen. How can they survive? They have such tiny margins. Who's going to survive? The big chains. Retailers. Fast food. The small businesses are going to disappear in the post-coronavirus economy. So there is a fundamental conflict between Wall Street (big banks and big firms) and Main Street (workers and small businesses). And Wall Street is going to win.

Clearly, you're bearish on the potential of existing governments intervening in that conflict on Main Street's behalf. But if we made you dictator of the United States tomorrow, what policies would you enact to strengthen labor, and avert (or at least mitigate) the Greater Depression?

The market, as currently ordered, is going to make capital stronger and labor weaker. So, to change this, you need to invest in your workers. Give them education, a social safety net — so if they lose their jobs to an economic or technological shock, they get job training, unemployment benefits, social welfare, health care for free. Otherwise, the trends of the market are going to imply more income and wealth inequality. There's a lot we can do to rebalance it. But I don't think it's going to happen anytime soon. If Bernie Sanders had become president, *maybe* we could've had policies of that sort. Of course, Bernie Sanders is to the right of the CDU party in Germany. I mean, Angela Merkel is to the left of Bernie Sanders. Boris Johnson is to the left of Bernie Sanders, in terms of social democratic politics. Only by U.S. standards does Bernie Sanders look like a Bolshevik.

In Germany, the unemployment rate has gone up by one percent. In the U.S., the unemployment rate has gone from 4 percent to 20 percent (correctly measured) in two months. We lost 30 million jobs. Germany lost 200,000. Why is that the case? You have different economic institutions. Workers sit on the boards of German companies. So you share the costs of the shock between the workers, the firms, and the government.

In 2009, you argued that if deficit spending to combat high unemployment continued indefinitely, "it will fuel persistent, large budget deficits and lead to inflation." You were right on the first count obviously. And yet, a decade of fiscal expansion not only failed to produce high inflation, but was insufficient to reach the Fed's 2 percent inflation goal. Is it fair to say that you underestimated America's fiscal capacity back then? And if you overestimated the harms of America's large public debts in the past, what makes you confident you aren't doing so in the present?

First of all, in 2009, I was in favor of a bigger stimulus than the one that we got. I was not in favor of fiscal consolidation. There's a huge difference between the global financial crisis and the coronavirus crisis because the former was a crisis of aggregate demand, given the housing bust. And so monetary policy alone was insufficient and you needed fiscal stimulus. And the fiscal stimulus that Obama passed was smaller than justified. So stimulus was the right response, at least for a while. And then you do consolidation.

What I have argued *this* time around is that in the short run, this is both a supply shock and a demand shock. And, of course, in the short run, if you want to avoid a depression, you need to do monetary and fiscal stimulus. What I'm saying is that once you run a budget deficit of not 3, not 5, not 8, but 15 or 20 percent of GDP — and you're going to fully monetize it (because that's what the Fed has been doing) — you still won't have inflation in the short run, not this year or next year, because you have slack in goods markets, slack in labor markets, slack in commodities markets, etc. But there will be inflation in the post-coronavirus world. This is because we're going to see two big negative supply shocks. For the last decade, prices have been constrained by two positive supply shocks — globalization and technology. Well, globalization is going to become deglobalization thanks to decoupling, protectionism, fragmentation, and so on. So that's going to be a negative supply shock. And technology is not going to be the same as before. The 5G of Erickson and Nokia costs 30 percent more than the one of Huawei, and is 20 percent less productive. So to install non-Chinese 5G networks, we're going to pay 50 percent more. So technology is going to gradually become a negative supply shock. So you have two major forces that had been exerting downward pressure on prices moving in the opposite direction, and you have a massive monetization of fiscal deficits. Remember the 1970s? You had two negative supply shocks — '73 and '79, the Yom Kippur War and the Iranian Revolution. What did you get? Stagflation.

Now, I'm not talking about hyperinflation — not Zimbabwe or Argentina. I'm not even talking about 10 percent inflation. It's enough for inflation to go from one to 4 percent. Then, ten-year Treasury bonds — which today have interest rates close to zero percent — will need to have an inflation premium. So, think about a ten-year Treasury, five years from now, going from one percent to 5 percent, while inflation goes from near zero to 4 percent. And ask yourself, what's going to happen to the real economy? Well, in the fourth quarter of 2018, when the Federal Reserve tried to raise rates above 2 percent, the market couldn't take it. So we don't need hyperinflation to have a disaster.

In other words, you're saying that because of structural weaknesses in the economy, even modest inflation would be crisis-inducing because key economic actors are dependent on near-zero interest rates?

For the last decade, debt-to-GDP ratios in the U.S. and globally have been rising. And debts were rising for corporations and households as well. But we survived this, because, while debt ratios were high, debt-*servicing* ratios were low, since we had zero percent policy rates and long rates close to zero — or, in Europe and Japan, negative. But the second the Fed started to hike rates, there was panic.

In December 2018, Jay Powell said, "You know what. I'm at 2.5 percent. I'm going to go to 3.25. And I'm going to continue running down my balance sheet." And the market totally crashed. And then, literally on January 2, 2019, Powell comes back and says, "Sorry, I was kidding. I'm not going to do quantitative tightening. I'm not going to raise rates." So the economy couldn't take a Fed funds rate of 2.5 percent. In the strongest economy in the world. There is so much debt, if long-term rates go from zero to 3 percent, the economy is going to crash.

You've written a lot about negative supply shocks from deglobalization. Another potential source of such shocks is climate change. Many scientists believe that rising temperatures threaten the supply of our most precious commodities — food and water. How does climate figure into your analysis?

I am not an expert on global climate change. But one of the ten forces that I believe will bring a Greater Depression is man-made disasters. And global climate change, which is producing more extreme weather phenomena — on one side, hurricanes, typhoons, and floods; on the other side, fires, desertification, and agricultural collapse — is not a natural disaster. The science says these extreme events are becoming more frequent, are coming farther inland, and are doing more damage. And they are doing this now, not 30 years from now.

So there is climate change. And its economic costs are becoming quite extreme. In Indonesia, they've decided to move the capital out of Jakarta to somewhere inland because they know that their capital is going to be fully flooded. In New York, there are plans to build a wall all around Manhattan at the cost of $120 billion. And then they said, "Oh no, that wall is going to be so ugly, it's going to feel like we're in a prison." So they want to do something near the Verrazzano Bridge that's going to cost another $120 billion. And it's not even going to work.

The Paris Accord said 1.5 degrees. Then they say two. Now, every scientist says, "Look, this is a voluntary agreement, we'll be lucky if we get three — and more likely, it will be four — degree Celsius increases by the end of the century." How are we going to live in a world where temperatures are four degrees higher? And we're not doing anything about it. The Paris Accord is just a joke. And it's not just the U.S. and Trump. China's not doing anything. The Europeans aren't doing anything. It's only talk.

And then there's the pandemics. These are also man-made disasters. You're destroying the ecosystems of animals. You are putting them into cages — the bats and pangolins and all the other wildlife — and they interact and create viruses and then spread to humans. First, we had HIV. Then we had SARS. Then MERS, then swine flu, then Zika, then Ebola, now this one. And there's a connection between global climate change and pandemics. Suppose the permafrost in Siberia melts. There are probably viruses that have been in there since the Stone Age. We don't know what kind of nasty stuff is going to get out. We don't even know what's coming.

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