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The Financial Crises of 1929 and 2008: What Lessons Learned from the COVID-19 Health Crisis?

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Reading the history of economic and financial crises bears witness to the unprecedented and unprecedented nature of the COVID-19 pandemic. To complete our reflection, we are discussing the impact of the COVID-19 pandemic in connection with macroeconomic instability. This short reflection answers the question of whether the lessons learned from the crises of the past can serve the major international financial players in the future.

Keywords: COVID-19, financial crisis, economy, GDP

The financial crises of 1929 and 2008 sparked a flood of commentary from many self-proclaimed "conjuncturists", often the main lesson to be learned from opportunism (Lebaron, 2010). Reinhart and Rogoff (2010) start from macroeconomic data mainly comprising gross domestic product, external and domestic debt, the trade balance, the interest rate and the exchange rate. They manage to bring them together over the last eight centuries for 66 countries representing on average no less than 90% of the world's gross domestic product (GDP). The two authors highlight the close correlation between capital mobility and the probability of banking crises occurring (Igor, 2011).

In addition, certain major players in international finance such as the major financial rating agencies have also been questioned, and the mechanisms of crisis propagation have both considerably amplified and become more complex (Reinhart and Rogoff, 2009). However,

Keynes (1934) draws two important lessons from the crisis of 1929. First, he recognizes the intrinsic instability of finance, due to the difficulty of anchoring the value of financial assets in "real" values and to the mimetic behaviors that this uncertainty generates. Then, the recognition of the vicious circles (economic crisis / financial crisis) which reciprocally deepen has led to the need for massive public interventions in the real sphere, financed by an increase in public debt.

The global financial crisis triggered by the coronavirus known as COVID-19 is not a simple replica of the financial crisis of 2008 and the great depression of 1929. However, its magnitude could be more serious, especially if governments do not come out of “Beaten track” and repeat past mistakes (Artus and Pastré, 2020). The COVID-19 pandemic is undoubtedly causing a serious economic and financial crisis which is reminiscent of the global crisis of 2008. The collapse of stock prices, the unsustainable indebtedness of the private sector, speculation on the sovereign debt of States vulnerable, the massive injection of liquidity by central banks and the costly backup plans concocted in a hurry by the States are warning signs of a possible global financial crisis.

The current crisis cannot be equated with a simple aftershock of the 2008 financial crisis. Nonetheless, containment measures imposed by governments to prevent the spread of the virus are preventing businesses from operating and employees from working. It is therefore no longer the bursting of a real estate bubble leading to a banking crisis, as in 2008, but a double shock of supply and demand resulting from the collapse of production and consumption (Carlsson et al, 2020; Hufbauer and Lu, 2020). This singularity leads some analysts to entertain the hope of a vigorous rebound in the economy that would automatically be generated by the end of the COVID-19 pandemic. According to Carlsson et al. (2020), it would therefore be a brutal but short-lived crisis, destined to disappear as soon as the COVID-19 pandemic has subsided. This means not only to come to terms quickly with this pandemic, but the singularity of the current crisis leaves us to fear lasting negative effects on the world economy (Artus and Pastré, 2020). The shock is indeed of rare violence, since several companies are forced to stop altogether their activities, which inevitably leads to an economic collapse which risks causing mass unemployment and a recession much deeper than the great recession of 2009 (Collins and Gagnon, 2020; Papava and Charaia, 2020).

Indeed, the history of the current COVID-19 pandemic allows us to learn other lessons to anticipate the future. Thus, can we summarize in four points the lessons drawn from the long history of the economic and financial crises of the past: a) currency crises, banking crises and stock market crises; b) a model of speculative crises exists, and it was

introduced by Kindleberger (1996). This model describes in a simplified way the genesis of a crisis, its contagion effects, and its propagation mechanisms; c) the responses to the various crises were defined posteriori mainly through regulation, regulation and strengthening of the surveillance of the various actors; d) the ability to anticipate and prevent crises has always been very limited and has not improved over time. To avoid past financial crisis situations, what would a COVID-19-induced recession looks like?

What remedies for the current financial crisis resulting from the COVID-19 pandemic?

Analysis by McKinsey & Company (2020) in partnership with Oxford Economics already predicted several scenarios on the economic effect of the COVID-19 pandemic depending on the combination of controlling the spread of the virus and the effectiveness of interventions. According to Carlsson et al, (2020), if countries could combine strict and rapid control of the spread of the virus with highly effective economic intervention, economic growth would rebound as the spread of the pandemic ceased. However, it is difficult to predict the nature of 21st century financial crises. While pre-World War I crises erupted in the context of macroeconomic difficulties, they were usually triggered by wars or other bouts of political violence, stemming from institutional failures and political instability (Mauro et al, 2006). The current COVID-19 pandemic with its many social and above all economic consequences (loss of jobs, permanent stoppage of activities, closure of borders and many businesses, etc.), can lead to a worsening of the current economic crisis. A return of contagion is therefore a prudent working hypothesis, hence the need to prepare for it at the national and international levels (Tatiana et al, 2006). Internally, many countries have moved forward by improving their economy and debt management, reducing their vulnerability and cushioning the shock in the event of a crisis. Internationally and as market failures and externalities require global governance and coordination. The debate revolves around the role of international or supranational financial institutions, for example in establishing liquidity mechanisms during a crisis. Regional groups of countries have pooled their foreign exchange reserves as a precaution (Tatiana et al, 2006).

In contrast, under partially effective and tight control, the economy would recover at a slower pace, and if the intervention were ineffective, the economy would suffer damage to the sector and lower long-term growth. In the case of an effective response, but with a resurgence of the COVID-19 pandemic and a very effective intervention policy, the economy returns to trend growth, while in partially effective and ineffective interventions, growth to long-term economy would be slow (Carlsson et al, 2020). In a worst-case scenario, with a lack of control over the spread of the virus

and ineffective intervention, the economy would experience a prolonged downturn without recovery (McKinsey and Company, 2020). In addition, effective interventions may improve conditions for recovery, but may still take too long. In the more optimistic countries, many countries will experience the biggest drop in their GDP in the second quarter since World War II. In our opinion, countries with strong and credible institutions will tend to rebound quickly towards economic levels after the crisis of the COVID-19 pandemic. Whether economists can avoid a recession or not, the return to growth under COVID-19 will depend on a range of factors, such as the degree to which demand is delayed or dropped. Whether the shock is really a peak or hard, or if there is structural damage. Carlsson et al. (2020), have presented three main scenarios that we describe as follows: V-U-L.

V-shaped: this scenario describes the "classic" shock of the real economy, a shift in production, but growth eventually rebounds. In this scenario, annual growth rates could fully absorb the shock. While this may sound optimistic in today's gloom, we think it is plausible. However, V-shaped recovery could occur with a high probability if the policy implemented and the control of the spread of the COVID-19 pandemic is very effective.

U-shaped: this scenario is V's “ugly brother”. The shock persists as the initial growth path resumes; there is a permanent loss of production. Here, growth resumes with some permanent loss of output in the short term and reaching stable pace in the medium term. U-shaped recovery can occur when control is effective but with the resurgence of the COVID-19 pandemic and the policy implemented is partially effective.

L-shaped: this scenario is the very poor relationship between V and U. For this to materialize, we will have to believe in the capacity of the COVID-19 pandemic to cause significant structural damage; That is, breaking something on the supply side of the economy, the labor market, capital formation or the productivity function. L-shaped recovery occurs when the government combines ineffective policy with poor control of the COVID-19 pandemic. In this case, the supply will suffer structural damage in the labor market and capital formation. Finally, the economy in this scenario is less likely even with the most pessimistic views.

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