

The “Roaring ‘20s” revisited

Be careful what you wish for

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Economics - Global

- ◆ Coming out of a pandemic, some are hopeful...
- ◆ ...that we could see a re-run of the Roaring Twenties...
- ◆ ...but those years weren't all they were cracked up to be

Repeating the roar?

The end of a pandemic, the spread of new technologies, a transport revolution and a booming stock market. All these were features of America in the Roaring Twenties. Arguably, they may also be features of the 2020s.

In hindsight, it wasn't so great

The 1920s were fine for some. Real-life Gatsbys made their fortunes, either through the stock market or via more nefarious means (speakeasies had to source their liquor from somewhere). For the US economy as a whole, however, economic growth was distinctly ordinary. Many rural citizens were left behind. Meanwhile, an inexperienced Federal Reserve struggled to cope with a combination of low inflation and surging stock prices. When it all came crashing down, depression followed.

Policy parallels

Policymakers face similar challenges today. Wall Street has surged even as Main Street has suffered. Zero rates (and, in some countries, negative rates) together with QE have encouraged a huge flow of liquidity into financial assets even as consumers during lockdowns have been prevented from spending their incomes. As lockdowns end and spending increases, the risk of policy error is likely to rise.

Inequality parallels

The pandemic has shone a spotlight on the inequalities of vulnerability that permeate western societies, ranging from issues of race in the US to incidences of poverty in sub-regions of London. From the perspective of the “left-behind” or the “suddenly-vulnerable”, a surging stock market offers cold comfort.

Political parallels

The 1920s sowed the seeds for the terrible things that followed. Benito Mussolini, Europe's first major fascist leader – and a classic populist – came to power as early as 1922, enjoying widespread international support in the years that followed. The rules of the international game broke down as countries chose to ignore the League of Nations. The UK's demise as the world's dominant power created a vacuum that only added to international instability. Today, we have populists, competing political systems and challenges to US, rather than UK, leadership. Yes, there is lots that can go right but we shouldn't be blinded to the things that can go wrong.

This is a redacted version of a report by the same name published on 27-Jan-21. Please contact your HSBC representative or email AskResearch@hsbc.com for information.



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- ◆ Hopes of a modern rerun of events a century ago...
- ◆ ...are all very well given apparent similarities (notably in the US)...
- ◆ ...but nostalgia for times past is often badly misplaced

Are we on the verge of another “Roaring Twenties” and, if so, should we be cheering or weeping? Superficially, comparisons between where we are now and where the world was a century ago are tempting. Major pandemic? Tick. A technology revolution? Tick. A booming stock market? Tick. Political polarisation? Tick. New international rivalries? Tick. Admittedly, there are major differences, most obviously that we fortunately haven’t had to experience a world war. Equally, there is a sense that, after the pandemic – as with the 1918-1920 Spanish flu – the world economy is set to bounce back dramatically from what has, frankly, been a thoroughly miserable moment in human history.

Gangsters and Gatsby

The Roaring Twenties, immortalised in movies and books ranging from *Some Like It Hot* to *The Great Gatsby*, mostly relate to the US. Hemlines were rising, flappers were dancing, women were voting. The Jazz Age was pulsing, the speakeasies were heaving, prohibition was biting. Horses were vanishing, the Model T was trundling, planes were flying. Consumer credit was surging, electricity was fizzing, the radio was entertaining. And, towards the end of the decade, movies were talking.

1920s America arguably resonates today for the simple reason so much of what emerged then is still with us now: we still drive cars, we still listen to the radio (or, increasingly, podcasts) and, COVID-19 allowing, we still go to the (Hollywood) movies. It is as if the modern age began just as the 1918-20 Spanish Flu came to an end. Emerging, blinking, from COVID-19-enforced lockdowns in the months ahead, it’s not difficult to imagine that, with advances in robotics and AI in recent years increasingly being harnessed one way or another by all of us (from Zoom calls to home deliveries, and from the internet of things to electric cars), we could be on the verge of another great economic transformation.

Not much of a roar after all

A quick look at the actual data, however, reveals that the Twenties didn’t roar in quite the way that we typically imagine. Table 1 shows increases in GDP per capita between 1920 and 1929, the year in which the party came to end (at least on Wall Street, if not Main Street – the Great Depression occurred about two years after the Wall Street Crash). During those nine years, living standards rose 17.7% in the US. Only a handful of major economies did worse: GDP per capita fell in both Mexico and New Zealand while Australia and India saw only modest gains. The UK, which had to impose austerity in response to the bizarre decision (by Winston Churchill,

of all people) to return to the Gold Standard at the pre-Great War exchange rate, still managed to experience a bigger increase in living standards than the US. Even more impressive, however, were Germany (up 44.9%), France (up 46.0%), Austria (up 53.3%) and the Soviet Union (up 140.9%).

1. Increase in living standards between 1920 and 1929

Country	% increase in real GDP per capita	Country	% increase in real GDP per capita
Argentina	25.7	Japan	23.2
Australia	10.4	Mexico	-5.0
Austria	53.3	Netherlands	34.8
Canada	31.2	New Zealand	-6.7
France	46.0	Soviet Union	140.9
Germany	44.9	Spain	28.6
India	14.6	United Kingdom	25.0
Italy	29.0	United States	17.7

Source: Maddison Project Database (MPD) 2020

Nor was the US growth experience between 1920 and 1929 out of the ordinary compared with equivalent nine-year “stretches” in other decades. Indeed, table 2 shows that the Roaring Twenties were distinctly normal, nothing like as weak as the years spanning the Great War and the Great Depression but nothing like as strong as the 1960s through to the 1990s.

2. Nine-year stretches: the Roaring Twenties in context

Year	% annualised increase in US real per capita GDP in the nine years to end year	Year	% annualised increase in US real per capita GDP in the nine years to end year
1909	2.2	1969	3.3
1919	0.9	1979	2.5
1929	1.8	1989	2.4
1939	0.5	1999	2.1
1949	1.9	2009	0.6
1959	1.8	2018	1.5

Source: Maddison Project Database (MPD) 2020

To be fair, European nations and, in particular, the Soviet Union mostly grew more quickly than the US in the 1920s for the simple reason that they had suffered far more during the Great War and its aftermath (Germany and Austria succumbed to hyperinflation in the early 1920s while, following the 1917 Bolshevik revolution, Russia entered its civil war). With few wartime (and peacetime) scars, there was less room for the US to bounce back. Table 3 corrects for these effects by showing increases in living standards since 1913. The US ends up in the middle of the pack, no longer an obvious laggard but, equally, not an obvious outperformer.

3. Increases in living standards between 1913 and 1929

Country	% increase in real GDP per capita	Country	% increase in real GDP per capita
Argentina	15.0	Japan	50.8
Australia	2.1	Mexico	21.0
Austria	6.8	Netherlands	40.5
Canada	13.9	New Zealand	2.1
France	35.2	Soviet Union	-2.0
Germany	11.0	Spain	36.1
India	8.1	United Kingdom	6.8
Italy	20.5	United States	18.3

Source: Maddison Project Database (MPD) 2020

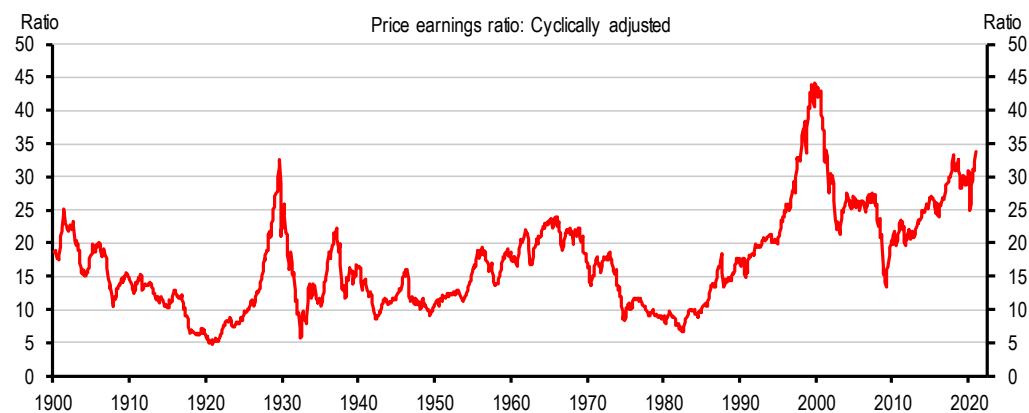
Rich but unequal

On one metric, however, the US scores particularly well. Its growth rate may not have been particularly impressive but US living standards throughout the 1920s were persistently higher than those in most other parts of the developed world. At the turn of the 20th Century, the US had already overtaken the UK – the dominant economy in the second half of the 19th Century – in terms of per capita incomes. By 1920, the gap was enormous – on average, American incomes were 45% higher than their British equivalents – with only a modest narrowing over the next nine years. The early decades of the 20th Century marked very much the beginnings of a new, Washington-led, international economic dominance. The US economy may not have grown particularly quickly in the 1920s but it did more than enough to maintain an economic supremacy already established in earlier decades.

For all of its apparent success, however, the US still had many weaknesses. Chief among them was a very unequal society, thanks in part to a still heavy dependence on agriculture as a source of income and employment. In 1920, 26.6% of all US employment was on the farm. The UK labour market's agricultural dependence was roughly half that. In 1929, farming's share of US employment had dropped to 22.8%, still double the equivalent UK position. At the time, many US farms were small, inefficient, unproductive and, as immortalised in John Steinbeck's *The Grapes of Wrath*, both hugely indebted and hopelessly vulnerable in the light of sudden economic shocks.

At the same time, the financial system was expanding beyond what might be deemed sustainable. If anything was roaring in the 1920s, it was the stock market. Valuations ascended to the stratosphere (chart 4), levels only surpassed thereafter in 2000 (at the peak of the dot.com bubble) and (worryingly) now. Pay in the financial sector had surged relative to the rest of the economy, as had the complexity of financial roles, helped in part by a vast amount of deregulation in the financial sector. The incentive to pursue a career in, say, chemistry was dwindling because, put simply, financial alchemy offered far greater rewards. Meanwhile, there was no shortage of Gatsbys. Wealth wasn't quite as concentrated as it had been in the UK – America wasn't known for its landed gentry – but, nevertheless, the rich got richer: the share of wealth accruing to America's richest 1% rose from 36% in the early 1920s to around 48% on the eve of the Wall Street Crash.

4. By the end of the 1920s, the US stock market was eye-wateringly expensive



Source: Robert Shiller and Yale School of Management

The role of monetary policy

The monetary regime helped. Following Churchill's decision to rejoin the Gold Standard at the pre-WW1 exchange rate in 1925, sterling's exchange rate was hopelessly overvalued, placing tremendous pressure on the UK balance of payments. In effect, gold held in the vaults of the Bank of England was (ironically) being "virtually" transferred to the US. The result was downward pressure on sterling and corresponding upward pressure on UK interest rates. Exactly the opposite effects applied in the US. For the US, this was far from ideal: consumer credit rose 50% between 1925 and 1929, an indication that financial conditions might have been too loose and that Washington's own Gold Standard commitment had left interest rates too low.

To be fair, other indicators were incredibly well-behaved. If anything, the 1920s were a decade of modest deflation: US consumer prices in 1929 were no higher than they had been earlier in the decade. The absence of price pressures may have led to a degree of complacency on the part of an inexperienced Federal Reserve (it was only founded in 1913) which didn't want to be blamed by the British or, indeed, anyone else for destroying a Gold Standard resurrected after the Great War (after all, no other international monetary system at the time was easily imaginable: most policymakers did not agree with John Maynard Keynes's view that the Gold Standard was a 'barbarous relic'). Interest rates could remain low for the simple reason that inflation was well-behaved, even if the stock market was climbing ever higher.

Eventually, however, the Federal Reserve acted. The "easy money" of the mid-1920s slowly came to an end, thanks in part to worries about a stock market that, to some, was beginning to look like a speculative bubble. To this day, economic historians are divided over whether the Fed's actions were necessary. We now know, for example, that US economic growth was bumpy in the late-1920s: per capita GDP rose 4.5% in 1926 but then contracted in 1927 and 1928 before rising a further 4.4% in 1929. We also know that the Fed's tighter monetary stance may have had a more negative impact than intended for the simple reason that higher US interest rates under the Gold Standard forced interest rates up everywhere else, an early example, perhaps, of what might today be called a global taper tantrum.

The monetary tightening eventually worked rather too well: in the last days of October 1929, the Wall Street Crash – as it quickly became known – saw massive selling of stocks on Black Thursday, Black Monday and Black Tuesday. Between September and November 1929, the US stock market lost a third of its value. The following year, the economy duly collapsed, with per capita GDP contracting more than 10%.

Now, as then

We mentioned at the beginning that, superficially, there were similarities between the 1920s and where we are now, particularly with regard to the advance of technology and increasingly stretched stock market valuations. Admittedly, it would be foolish to suggest that history repeats itself. Yet, from a policy perspective, some of the challenges that emerged then are in danger of being repeated now.

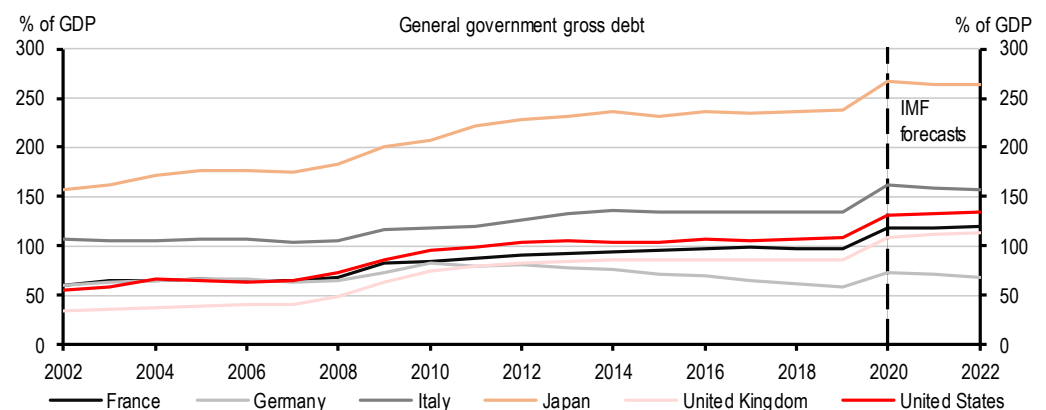
Monetary policy conflicts

The most obvious similarity relates to potential monetary policy conflicts. Back then, domestic price and financial stability were ultimately subservient to the Gold Standard. The result, as we have seen, was overly loose monetary conditions in the mid- to late-1920s which may have fuelled the stock market boom. Put slightly differently, had the Fed been able to focus on domestic conditions alone, perhaps greater financial stability would have been achieved.

There's no guarantee, however, that the Fed would have delivered the right results. Tighter monetary policy might have been difficult to maintain with inflation so low. With or without the Gold Standard, delivering both financial and price stability might have been an impossible task.

Monetary policy may be similarly compromised today. There is no Gold Standard to worry about (even if the Eurozone sometimes appears to behave like a latter-day Gold Standard) but there can be no doubt that the Federal Reserve sets monetary conditions not just for the US but for many other countries besides. More importantly, the conflict between domestic price and financial stability is, once again, very much in evidence. Inflation may be very low and, for the most part, well-behaved but, at least on the Shiller measure (chart 4), the US stock market looks to be, if anything, more expensive than it was in the late-1920s. Admittedly, a strong post-COVID-19 economic rebound might help justify such elevated prices but, to date, those owning stocks have emerged as some of the big winners during the pandemic, even if the economy itself has persistently disappointed. The triumph of financial hope over economic reality is oddly reminiscent of the 1920s.

5. Surging government debt may limit central bank actions



Source: IMF

There's another potential conflict today, this time between monetary and fiscal policy. The huge increases in public debt witnessed in recent years – initially after the global financial crisis but, more recently, during the pandemic – have left governments vulnerable in the light of future interest rate increases (chart 5). Admittedly, such increases may never materialise – Japan is a case in point – but there are good reasons to take the risk seriously. Unlike the global financial crisis, the pandemic has forced private savings up to unusually high rates: in the US, notably,

the personal saving ratio hit levels earlier last year never seen before (chart 6). It is reasonable to assume that when we finally emerge from lockdown, currently “repressed” demand will return. While this may be good news for government revenues, it may also place significant upward pressure on interest rates. Admittedly, under pressure from governments keen to minimise their debt service costs, central banks could choose not to respond, a decision that would risk either higher inflation or higher asset prices (or possibly both). The latter outcome, however, would be reminiscent of the late-1920s and, more recently, both the dot.com bubble and the pre-global financial crisis housing bubble.

6. US citizens have hugely increased savings out of current income during the pandemic



Source: Federal Reserve Bank of St. Louis

Unequal societies

As we have seen, the Roaring Twenties only roared for some. The same is true today. During the pandemic, issues of race have come to the fore, notably in the US. Table 7 shows US unemployment rates by race in the final quarter of 2020 relative to the (pre-pandemic) final quarter of 2019. All races have seen big increases in unemployment but, if you happen to be white, your risk of job loss has been lower than it has been for African Americans, Asians and Hispanics.

7. US unemployment by race/sex during the pandemic

Age and sex	Total, Q4 2019	Total, Q4 2020	White, Q4 2019	White, Q4 2020	African American, Q4 2019	African American, Q4 2020	Asian, Q4 2019	Asian, Q4 2020	Hispanic, Q4 2019	Hispanic, Q4 2020
Total	3.3	6.5	3.0	5.8	5.4	9.9	2.6	6.7	4.0	8.7
16-19	11.4	13.5	10.7	12.7	18.1	19.6	5.2	6.5	14.3	15.9
20+	3.0	6.2	2.7	5.5	5.0	9.6	2.5	6.7	3.5	8.3
Men	3.4	6.7	3.1	6.0	5.6	11.0	2.6	6.0	3.6	8.5
16-19	12.8	14.4	12.3	13.7	19.1	21.3	7.1	6.0	14.1	17.2
20+	3.1	6.4	2.8	5.7	5.2	10.6	2.5	6.0	3.1	8.2
Women	3.3	6.3	2.9	5.5	5.2	8.9	2.6	7.4	4.6	8.8
16-19	10.1	12.6	9.0	11.5	17.1	18.2	3.1	7.0	14.5	14.3
20+	3.0	6.1	2.6	5.3	4.8	8.6	2.6	7.4	4.1	8.5

Source: US Bureau of Labor Statistics

Even before the pandemic, those with significant financial wealth were doing very well thanks in part to the impact on asset prices of quantitative easing. Although stocks lurched down in the second quarter of 2020 as investors temporarily liquefied their assets, the subsequent actions of central banks and finance ministries helped put the whole process in reverse. QE and negative rates ensured there was no shortage of liquidity while supportive tax policies and cash handouts of one sort or another safeguarded the futures of listed companies, even if lockdowns had led to a temporary collapse in demand. The result was a strong rebound in asset values even as GDP in many countries was falling at its fastest ever rate.

Meanwhile, regional inequalities have only become more apparent during the pandemic. In London, for example, the number of COVID-19 infections varies by sub-region based largely on levels of income per capita. Put simply, the poorer the area, the higher the incidence of COVID-19. Time will tell as to why this is, but among the more plausible explanations are cramped living conditions and a prevalence of people who cannot easily work from home.

In the 1920s, political responses to inequality varied from country to country. An increasingly isolationist US chose to distance itself from the international rules of the game – famously, Congress ruled out joining the League of Nations, even though President Wilson had been its chief sponsor – while tightening its immigration laws, such that the numbers coming into the US dropped to a mere trickle. In Germany, revolution and putsch from both left (in the form of Karl Liebknecht and Rosa Luxemburg, both executed in 1919) and right (Adolf Hitler) threatened the emergence of democratic stability while, in a foretaste of today's "strong man" politics, Benito Mussolini – with support from thuggish paramilitaries – became Italy's leader in 1922. For some parts of the world, the parallels have, at times, been uncanny. A robust stock market is no guarantee of political tranquillity.

Unstable global environment

The interwar years were hardly a triumphant period for democracies. Assorted American politicians and business leaders (and more than a few of their British peers) pandered to Mussolini, a man who "made the trains run on time": later, some had no difficulty in reaching out to Nazi Germany. The catastrophic Smoot-Hawley Tariff Act, passed in 1930, undermined the international trading system and reinforced a sense of American isolationism. The British government responded in 1932 with the imposition of a particularly tough version of what had become known as Imperial Preference, with its emphasis on "home producers first, empire producers second, and foreign producers last". The international rules of the game – supposedly enforced by the League of Nations – looked increasingly irrelevant as countries pursued their own, distinct, agendas: Germany joined the League in 1926 but withdrew following Hitler's ascent to power in 1933; Italy was one of the League's founding members but withdrew over the Abyssinian crisis in 1937 (while still being wooed by a French government increasingly fearful – with good reason – about the Nazis next door). The Soviet Union joined in 1934 only to be expelled in 1939 following its invasion of Finland.

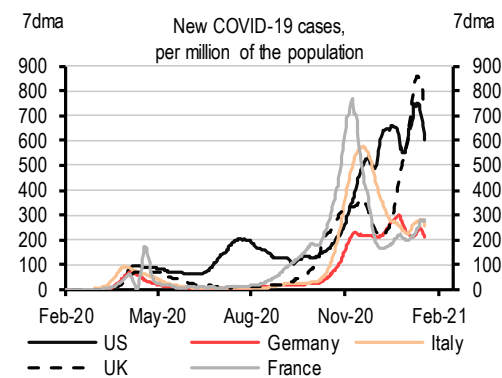
Thankfully, we are not facing quite the same conditions today. Still, history sometimes resonates. The first wave of globalisation – associated with a dominant British Empire – was brought to a terrible end with the outbreak of war in 1914. The chaotic 1920s and 1930s represented a period of competing international rivalries with no obvious global leader. The same, arguably, has been true in recent years.

At the beginning of the 20th Century, the previously dominant economic power – the UK – was in relative decline. Both Germany and the US were snapping at its heels. Some think the same is true of the US today. Certainly, there's every chance that China will soon supplant the US as the world's largest economy, even if the Middle Kingdom is still a long way from being the world's richest economy. As the Chinese economy's gravitational pull increases, so Beijing's ambition to shape the world will likely bump into Washington's own international aspirations.

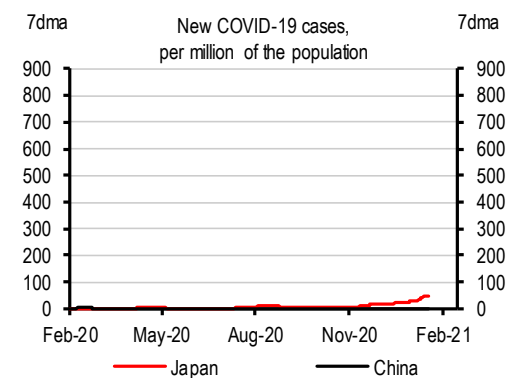
And just as the Great Depression led many to spurn western democratic values and embrace the apparent attractions of either European-style fascism or Soviet-style Communism (conveniently ignoring Stalin’s abuses) so, today, there’s a risk that western democracies come under increasing pressure from rising inequality, their uneven management of the pandemic and the increasing amount of social media-generated “fake news” (how can democracy flourish when people cannot even agree on the basic facts of debate?).

Charts 8 and 9 show rates of infection for what might loosely be described as the “West” and the “East”. Whether authoritarian or democratic, Eastern nations with their prior experience of SARS and their emphasis on social harmony rather than individual freedoms have to date had a “good crisis”, at least compared with the West. Social distancing has been easier to achieve in some nations than in others (being a distant island – as with Australia and New Zealand – also appears to help). This doesn’t mean to say that the Western model is broken. It does suggest, however, that there is more room for debate than seemed plausible when the Berlin Wall came down in 1989 and Francis Fukuyama, the American political scientist, declared the *End of History*.

8. The West’s infections...



9...compared with the East’s



Gatsby revisited (spoiler alert)

Jay Gatsby superficially had everything: he was wealthy, successful and handsome. Yet he couldn’t have Daisy, the woman he thought he loved (in Gatsby’s mind, Daisy was perfect, but this was more his fantasy than the reader’s “reality”). At least some of his wealth had, to say the least, dubious provenance. And he came from a poorer background than he cared to admit. F Scott Fitzgerald’s creation embodied the 1920s: apparently successful yet unable to buy happiness, the love of his life impossibly out of reach (because, in reality, she didn’t really exist), and a self-destructive willingness to sacrifice everything – his life included – when he realised that his great wealth could not be a source of contentment. The Twenties may have roared for some and Spanish flu might have been tamed but the decade ultimately paved the way for unimaginable political, financial and, in Gatsby’s case, personal upheaval. By all means cheer at the resilience of the stock market and the possibility of a post-pandemic economic bounce. But also prepare yourself for the possibility that it all ends in tears.

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