Box 5

THE CURRENT EURO AREA RECOVERY FROM A HISTORICAL PERSPECTIVE

The current recovery of the euro area economy, following the protracted period of slow growth experienced from mid-2001 to mid-2003, has been rather modest compared with those seen in the early 1980s and the early 1990s. The purpose of this box is to place the latest recovery in a historical perspective and to discuss the role of some important factors that partially account for the relatively weak recovery that has been experienced to date.

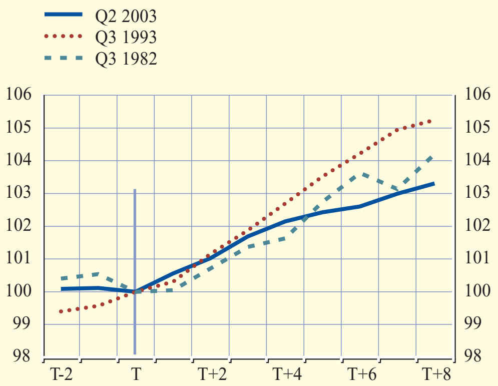
Real GDP growth across recoveries

Although there is no universally accepted dating of the euro area business cycle, the Centre for Economic Policy Research (CEPR) established a Business Cycle Dating Committee in 2003 to identify peaks and troughs in the euro area's business cycle.[1] On the basis of turning points in the early 1980s and early 1990s identified by this Committee (more precisely, the troughs in the third quarters of 1982 and 1993), it is possible to draw comparisons with the recent recovery. No trough has yet been identified for the latest recovery, but for the purposes of this analysis it is assumed to have started in the third quarter of 2003, when quarter-on-quarter real GDP growth returned to significantly positive values (having been negative in the second quarter).

On the basis of these dates, the pace of the recent recovery appears to be relatively weak as compared with the previous two recoveries. For example, eight quarters after the trough in the third quarter of 2003, real GDP had increased by 3.3% overall, 1.8 percentage points lower than the corresponding increase recorded in the recovery of the early 1990s and 0.9 percentage point lower than that observed in the recovery of the early 1980s (see Chart A). The recovery in the early 1980s seems to be relatively similar to the recent recovery in terms of overall growth dynamics. However, while growth tended to strengthen during the course of the recovery in the early 1980s (with quarter-on-quarter growth being on average 0.4% in the first year and 0.6% in the second year of the recovery), the opposite was the case in the most recent recovery (with quarter-on-quarter growth being on average 0.5% in the first year and 0.3% in the second year of the recovery).[2]

Chart A Euro area real GDP across recoveries

(levels, index numbers with trough equal to 100)



Sources: ECB calculations based on data from the European Commission and, for the 1980s, from the publication "An area-wide model (AWM) for the euro area", by G. Fagan, J. Henry and R. Mestre, ECB Working Paper No. 42, January 2001).
Note: The recovery starts in T+1, i.e. one quarter after the trough (T) as defined by the CEPR.

It is also of interest to identify the dynamics of the largest euro area countries that underlie the above-mentioned euro area patterns. In order to do so, it is necessary to compare the recent upturns for the individual euro area countries with those in the early 1980s and early 1990s. However, important caveats need to be kept in mind when comparing upswings across the five largest euro area countries. In particular, the recovery periods above have been selected on the basis of the evidence for the euro area as a whole. Clearly, there are differences in the business cycles of the individual countries. For example, by contrast with several other euro area countries which experienced a recession in 2003, there was only a slight deceleration in economic activity in Spain. Similar considerations apply to the Netherlands in 1993, which saw a mild slowdown of economic activity but never entered a contraction phase. Keeping in mind these differences across countries, the table below compares the development of real GDP from the troughs in the third quarters of 1982 and 1993 and the second quarter of 2003 for the five largest euro area countries. This

1 The CEPR Euro Area Business Cycle Dating Committee announced its decision regarding turning points in September 2003 (see http://www.cepr.org/data/Dating/).
2 Although distortions arising from working-day adjustment practices affect the growth rates for the fourth quarter of 2004 and the first quarter of 2005, the picture remains of a weakening growth.

Real GDP across recoveries in the five largest euro area countries

(cumulative percentage change)

	Accumulated growth of real GDP – four and eight quarters after the euro area trough											
	Euro area		Germany		France		Italy		Spain		The Netherlands	
	t+4	t+8	t+4	t+8	t+4	t+8	t+4	t+8	t+4	t+8	t+4	t+8
Q3 1982	1.6	4.2	2.0	6.0	1.6	2.8	1.9	4.8	1.5	3.6	2.9	5.0
Q3 1993	2.7	5.2	2.6	4.7	1.9	3.8	3.2	5.7	2.2	6.8	2.6	5.8
Q2 2003	2.1	3.3	1.6	2.2	2.8	4.0	1.2	1.3	3.1	6.6	1.8	2.8

Sources: see Chart A.

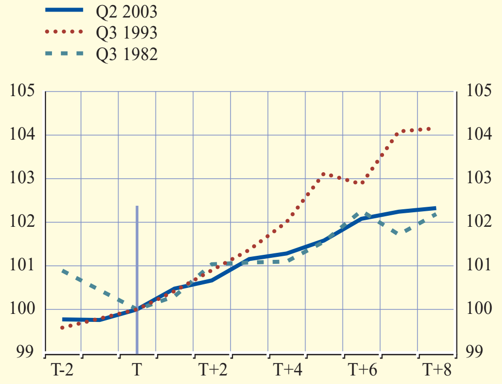
shows that the current recovery has been much milder than the previous two recoveries for Italy, Germany and the Netherlands. By contrast, GDP growth in France and Spain has been stronger since the third quarter of 2003, as compared with the average of the two previous upswings.

The contribution of expenditure components to growth during the recoveries

Comparing the development of various demand components during the upturns, the contribution from domestic demand during the current recovery has been significantly weaker than in the 1990s recovery, but not weaker than in the recovery of the early 1980s (see Chart B). Similar conclusions can be drawn for private consumption and investment. By contrast, recently the contribution from net exports has been similar to that of the 1990s recovery, but weaker than in the early 1980s (see Chart C).

Chart B Euro area real (final) domestic demand contributions to real GDP across recoveries

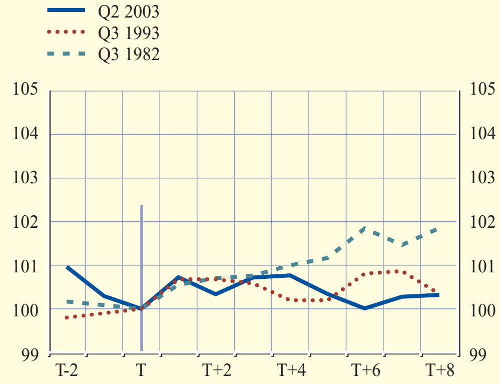
(levels, index numbers with trough equal to 100)



Sources: see Chart A.
Note: The recovery starts in T+1, i.e. one quarter after the trough (T) as defined by the CEPR.

Chart C Euro area real net export contributions to real GDP across recoveries

(levels, index numbers with trough equal to 100)

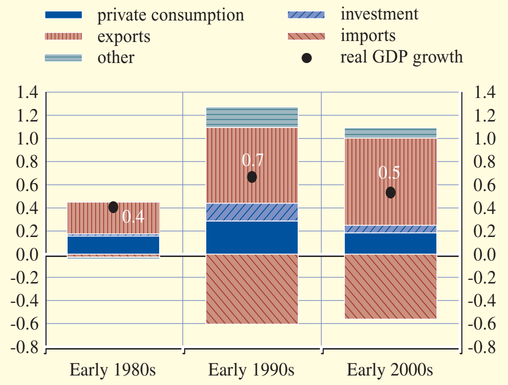


Sources: see Chart A.
Note: The recovery starts in T+1, i.e. one quarter after the trough (T) as defined by the CEPR.

Looking at the pattern of the expenditure components, it can be seen that the relative contribution of some components changed over the course of the recovery. In this respect, the most striking feature is that the average contribution from export growth in the latest recovery

Chart D Average contributions to quarter-on-quarter real GDP growth during the first year of euro area recoveries

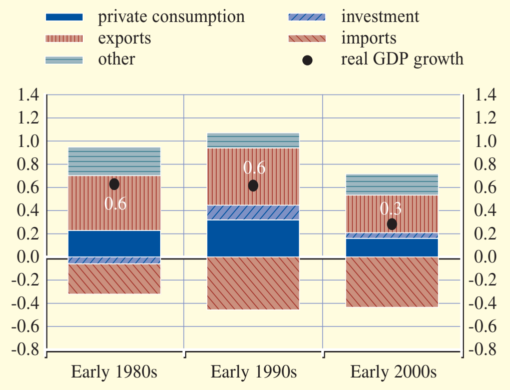
(contributions to growth, percentages)



Sources: see Chart A.
Note: Figures in the chart indicate average quarter-on-quarter real GDP growth.

Chart E Average contributions to quarter-on-quarter real GDP growth during the second year of euro area recoveries

(contributions to growth, percentages)



Sources: see Chart A.
Note: Figures in the chart indicate average quarter-on-quarter real GDP growth.

declined markedly from 0.8% in the first to 0.3% in the second year (see Charts D and E). During previous recoveries, by contrast, it either increased slightly (early 1980s) or declined (early 1990s).

While the upswing in the early 1990s was characterised by relatively strong and homogeneous recoveries in private consumption in the largest countries, the current upswing has so far failed to feed into private consumption growth in a number of these countries, most notably Germany and the Netherlands. From this point of view, the most recent recovery is more similar to that in the early 1980s, which was also characterised by weak private consumption in a number of countries. In addition, France, Italy and Spain have experienced very modest export growth in the latest recovery compared with the previous two recoveries.

Possible reasons for the sluggishness of the current recovery

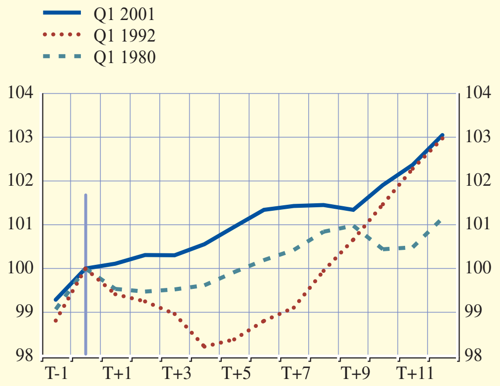
Several factors could help to explain the weakness of the most recent upturn as compared with past recoveries in the euro area. First, by contrast with previous recoveries, the current recovery has been marked by a combination of adverse shocks, such as the recent oil price increases and the significant appreciation of the euro. The latter factor, in particular, may explain the relative weakness of export growth observed in the second year of the recovery. Second, there is some evidence that trend potential output growth has been lower in recent years as compared with the 1980s and 1990s.[3] In this respect, the uncertainty relating to the timing and extent of the implementation of structural reforms in some euro area countries may also have contributed to consumer confidence remaining at a low level. Finally, it needs to be taken into account that the slowdown preceding the current recovery was relatively shallow (see Chart F). Hence, to the extent that the strength of the rebound tends to depend on the depth of the previous downturn, it is not totally surprising that the current recovery is to some extent less dynamic than previous recoveries.

3 See the box entitled "Trends in euro area potential output growth" in the July 2005 issue of the Monthly Bulletin.

Looking at the individual euro area countries, differences in their relative performances can be explained by a number of factors. Lagged effects of past changes in price and non-price competitiveness in some countries may to a large extent help to explain differences in their export performances. In addition, varying degrees of structural reforms undertaken in the past – as well as uncertainty about future reforms – may explain some of the differences in domestic demand patterns. Finally, differences across countries' performances may partly reflect catching-up processes towards higher GDP per capita levels in some cases.

Chart F Euro area real GDP across slowdowns

(levels, index numbers with peak equal to 100)



Sources: see Chart A.
Note: The slowdown starts in T+1, i.e. one quarter after the peak (T) as defined by the CEPR.