Box 6

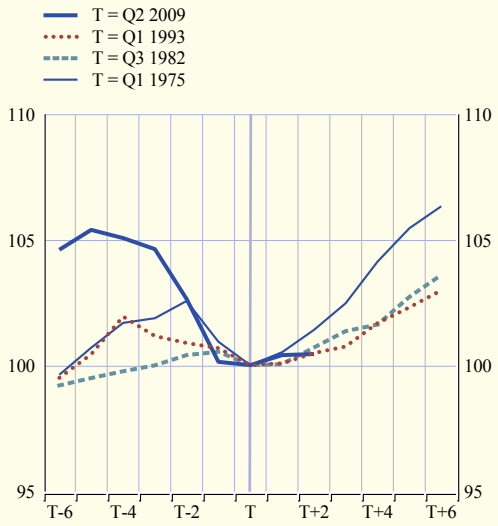
THE CURRENT EURO AREA RECOVERY ACROSS ECONOMIC SECTORS FROM A HISTORICAL PERSPECTIVE

Following the sharpest recession since the Second World War, euro area GDP bottomed out in the second quarter of 2009 and has recovered modestly since then. This box takes a closer look at developments in euro area GDP in this initial phase of the cyclical upswing and explores the extent to which these are comparable to those in previous recovery periods. It then examines how activity across economic sectors has evolved and contributed to the development of GDP in the past two quarters and identifies commonalities and differences vis-à-vis historical evidence.

Chart A provides a comparison of the development of GDP in the initial phase of the current recovery up to the fourth quarter of 2009 with those in the upturns following the three earlier euro area recessions since 1970, where T marks the respective cyclical troughs. It shows that, while the quarterly pick up in GDP in the third quarter of 2009 was among the higher initial growth rates following recession troughs, the stagnant GDP in the fourth quarter of 2009 made the current improvement the weakest at this stage of the recovery, although not one that is clearly outside the range of past experiences. The chart, however, also highlights the much sharper fall in GDP in the recent recession than in the previous ones. Measured from peak to trough, GDP fell by 5.2% in the 2008-09 recession, which is more than twice the decline observed in the next to sharpest recession since 1970. Compared with this loss in output during the recession, the pick up since the trough in the second quarter of 2009 appears very modest and GDP currently stands far below its pre-recession peak. This shows that, in contrast to the upturns following previous

Chart A Euro area GDP across recoveries

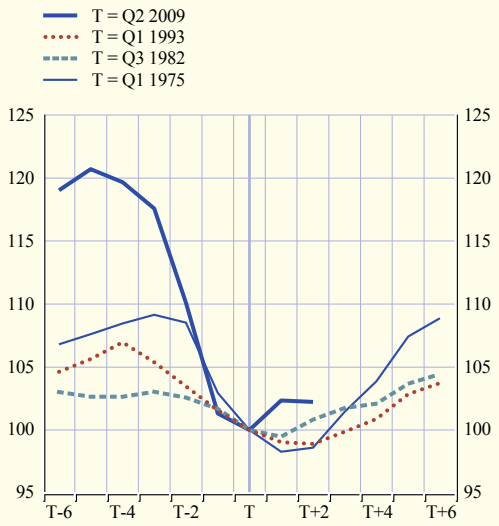
(index; T = 100; T represents the trough in GDP)



Sources: Eurostat, AWM database and ECB staff calculations.

Chart B Euro area industrial value added (excluding construction) across recoveries

(index; T = 100; T represents the trough in GDP)



Sources: Eurostat, ECB and ECB staff calculations.
Note: Before 1980, industrial value added data are approximated by industrial production (excluding construction) data.

euro area recessions, when GDP recovered to its pre-recession level within a few quarters, far more protracted output losses are to be expected in the ongoing recovery, as is typical for recoveries after financial crises.[1]

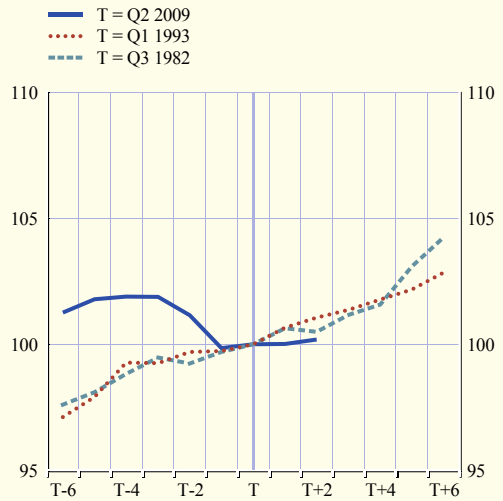
Past recovery periods have shown well-defined differences in the pattern of activity developments across economic sectors, which are also related to their characteristics during the preceding downswings (see Charts B to D). Activity in the highly cyclical industrial sector, which has shown the sharpest contractions in the past recessions, bounced back clearly during the subsequent upturns, although usually with a lag of one or two quarters relative to the trough in GDP. This temporal pattern is related to developments in services activity (for which data are available only as of 1980), which showed slower but sustained growth during past recessions and reaccelerated moderately during the subsequent upturns. Following the troughs in GDP during past recoveries, this accelerated pace of growth in the big services sector was large enough to outweigh the impact of the ongoing, albeit slowing, contraction in the far smaller industrial sector. An even greater delay in the recovery of activity relative to GDP is visible for the small construction sector (for which data availability again only starts in 1980) in the upturn following the 1992-93 recession, when activity continued to contract for three further quarters after the trough in GDP. The contemporaneous improvement in construction activity following the 1980-82 recession, however, highlights that this is not a common feature of developments in construction activity during upturns.

The charts also illustrate that, in contrast to previous upturns, the pick-up in GDP has thus far been driven largely by improvements in industrial activity. Industrial value added increased markedly up to the fourth quarter of 2009, more strongly than had been the case at that stage in previous

1 See, for example, S. Claessens, M. Klose and M. Terrones, "What Happens During Recessions, Crunches and Busts", *IMF Working Papers*, No 274, IMF, 2008; Chapter 3 of the April 2009 IMF World Economic Outlook; Chapter 4 of the October 2009 IMF World Economic Outlook; and the article entitled "The latest euro area recession in a historical context" in the November 2009 issue of the ECB's Monthly Bulletin.

Chart C Euro area services value added across recoveries

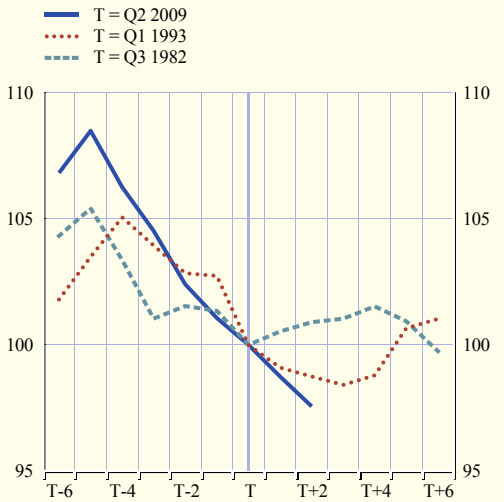
(index; T = 100; T represents the trough in GDP)



Sources: Eurostat and ECB staff calculations.

Chart D Euro area construction value added across recoveries

(index; T = 100; T represents the trough in GDP)



Sources: Eurostat and ECB staff calculations.

upturns, and an even more pronounced recovery in the industrial sector is revealed in the industrial production data available up to January 2010. The pick-up in global demand, in addition to the support from government packages (most notably the premiums for scrapping cars), contributed to this recovery. But, despite this increase, the level of activity in this sector is still significantly below its pre-recession peak (about 15%). In past recoveries, industrial activity had returned to its pre-recession levels within periods only slightly longer than those over which it had lost it. However, even if account is taken of the favourable signals from short-term indicators for industrial activity, it appears unlikely that such a path might also be recorded in the current upturn.

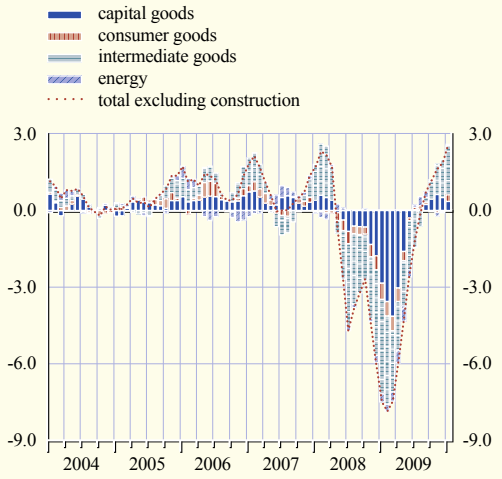
Another salient feature of the pick-up in industrial activity in the current recovery is its contemporaneous movement with GDP. This relates to the exceptional weakness in services value added both in the recent recession and also thereafter. In contrast to what occurred in previous recessions, when services value added had continued to grow, it contracted distinctly in the 2008-09 recession, thus contributing to the exceptional sharpness of this recession, and it has remained almost flat since then. Services activity was thus unable this time to counterbalance the slowing decline in industrial activity at the end of the recession and can be singled out as the main source of the rather modest current pick-up in GDP relative to those previously recorded. The breakdown into services sub-sectors reveals that the market services sub-sectors, i.e. trade and transportation services and financial and business services, were the source of the unusually weak performance of services activity both in the recent recession and in the subsequent upturn, with value added in the former remaining broadly flat since the second quarter of 2009 and that in the latter even falling below its level in the second quarter of 2009. Government-related services, by contrast, grew continually during the recent recession and the first quarters of the upturn, which is very much in line with previous experience, thereby representing the second source of growth in this upturn, besides the industrial sector. Overall, the weakness in services reflects the currently subdued domestic demand. Short-term indicators suggest that services activity may recover rather moderately in the near future.

The development of construction value added has been even more negative than that of services value added over the past few quarters, despite benefiting from the government support packages. It shows an ongoing contraction even after the trough in GDP. The comparison with developments in past recoveries highlights that, although this pattern is not without precedence, it is not a feature common to all recovery periods. The magnitude of the output losses in the construction sector since the pre-recession peak exceeds also in that sector that experienced in the two previous recessions. In the recovery following the 1992-93 recession, the contraction in construction activity continued over and beyond the current stage of the upturn in GDP, and conjunctural indicators suggest that such weakness will also persist in the current recovery.

The overall picture presented in this early stage of the unfolding recovery is thus one of a rather muted and uneven pick-up across economic sectors. While only industrial activity has thus far recovered faster than in previous upturns and construction activity has continued to contract in a relatively similar manner to the upturn following the 1992-93 recession but developed much more adversely than in that following the 1980-82 recession, almost stagnant services value added proves to have been the main source of the relative weakness of the current GDP upturn from a historical perspective. When account is taken of the magnitude of the previous losses in output, however, developments across all economic sectors appear to have remained comparatively weak thus far. Such a recovery path with extended output losses is in line with evidence on the patterns of past recoveries after financial crises.

Chart 28 Industrial production growth and contributions

(growth rate and percentage point contributions; monthly data; seasonally adjusted)



Sources: Eurostat and ECB calculations.
Notes: Data shown are calculated as three-month moving averages against the corresponding average three months earlier.

Chart 29 Industrial production, industrial confidence and the PMI

(monthly data; seasonally adjusted)

Sources: Eurostat, European Commission Business and Consumer Surveys, Markit and ECB calculations.
Notes: All series refer to manufacturing.
1) Three-month-on-three-month percentage changes.
2) Percentage balances.
3) Purchasing Managers' Index; deviations from an index value of 50.