

Box 5

THE CURRENT RECOVERY FROM A HISTORICAL PERSPECTIVE

Given the strong acceleration in euro area GDP in the first quarter of this year, the current economic recovery, which had thus far lagged behind those observed in all previous recovery periods since 1970, has caught up relative to the two previous ones. The strength of the current recovery, from its onset in the second quarter of 2009 through to the first quarter of 2011, is comparable to that seen in the initial seven quarters of the upturns in the early 1980s and 1990s, but falls short of that in the mid-1970s.

This comparison does not take into account, however, the fact that the latest recession was much deeper than every other recession since 1970, as it was triggered by a major global financial crisis. Past experience indicates that economies tend to recover only slowly from a financial crisis, owing to the need for extensive balance sheet repairs and deleveraging, as well as to the prolonged impaired functioning of the banking sector, which in turn hampers the recovery in business activity.¹ Indeed, seven quarters into the recovery, GDP is still significantly below its pre-recession peak (-2.1%), while it had already clearly exceeded that level by the same stage in past recoveries. This box compares the growth patterns of the ongoing recoveries in the euro area and in the four largest euro area economies with those of previous recoveries since 1970.

Euro area-wide developments

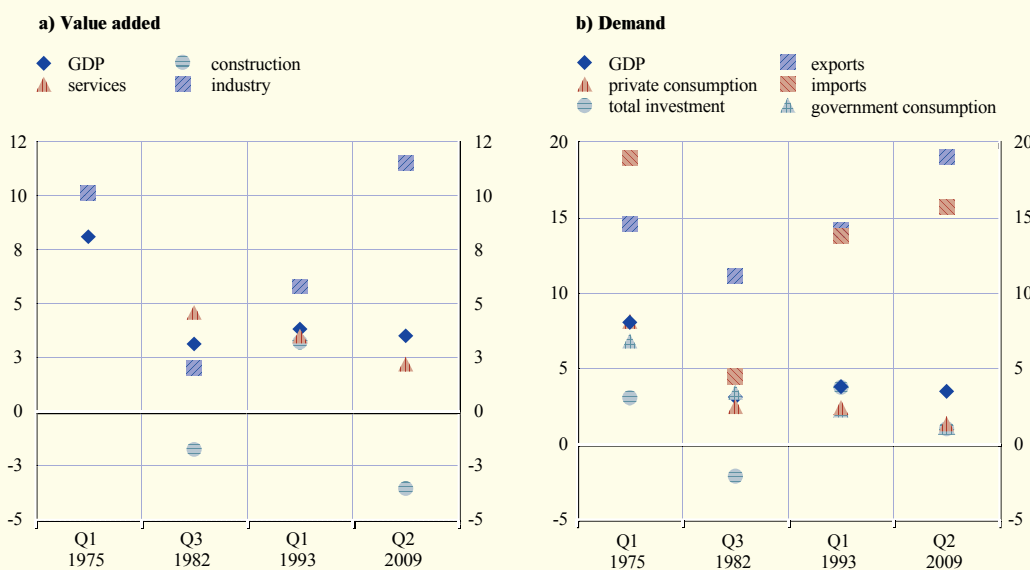
The fact that the strength of the current euro area recovery has been similar to that observed in the previous two upturns conceals contrasting developments in both sectoral activity and demand components (see Chart A).² In terms of sectoral value added, the ongoing pick-up in industrial value added since the trough in GDP has been the strongest by historical comparison. However, industrial value added had also dropped much more sharply than in

1 See the article entitled “The latest euro area recession in a historical context”, *Monthly Bulletin*, ECB, November 2009.

2 See also the box entitled “The current euro area recovery across economic sectors from a historical perspective”, *Monthly Bulletin*, ECB, April 2010, and the box entitled “The current euro area recovery across expenditure components from a historical perspective”, *Monthly Bulletin*, ECB, February 2011.

Chart A Recoveries in euro area GDP and its components: cumulative changes after seven quarters of recovery

(percentage changes)



Sources: Eurostat, OECD and ECB calculations.

Note: The last observation refers to the first quarter of 2011. The timing of the troughs in GDP after the respective recessions is indicated on the x-axis.

previous recessions and remained around 8% below its pre-recession peak in the first quarter of 2011. Services value added has shown its weakest recovery compared with the past. The same applies to the construction sector, where activity has been particularly weak, owing mainly to the bursting of housing bubbles in some euro area countries. While services value added has meanwhile reached its pre-crisis level, construction value added is still about 10% down on its pre-crisis peak.

A similar picture can be observed on the demand side.³ The current recovery has shown the strongest export growth by historical comparison, and import growth has also been more robust than in most of the previous recoveries. However, this also needs to be viewed against the fact that euro area trade contracted more markedly during the recent recession than in the past, in line with the unprecedented decline in world trade.⁴

The strong export growth contrasts with a modest rebound in both private and government consumption, which has been the weakest since 1970. The moderate growth in consumer spending can be largely explained by increased uncertainty about the implications of the crisis, in particular with regard to the labour market. The currently less supportive role being played by government consumption appears to be related to higher debt and deficit levels in the run-up to the recent recession in comparison with the past, which forced earlier fiscal consolidation than during previous recoveries. With regard to total investment, the strength of

3 Inventories have also contributed notably to the current euro area recovery. However, given the residual nature of inventories and the particularly high uncertainty surrounding backdata for this component, the historical comparison for the demand components of GDP does not include this series.

4 See the article entitled "Recent developments in global and euro area trade", *Monthly Bulletin*, ECB, August 2010.

growth over the seven quarters since mid-2009 was similar to that seen at the same stage during previous recoveries (in the current upturn it remained 13% below its pre-crisis peak level up to the first quarter of 2011). However, this masks contrasting developments across its components, i.e. a more pronounced weakness in construction investment over the past two years and stronger growth in non-construction investment compared with previous recoveries.

Developments in the four largest euro area economies

In addition to divergent developments across the economic sectors and demand components of the euro area as a whole, significant differences between the strength of the current upturn and that of past recoveries are also evident across the four largest euro area economies.⁵ While the latest recession was the deepest for all countries, the subsequent recovery in GDP has proven to be weaker than all previous upturns since 1970 in France, Italy and Spain, but stronger than previous recoveries (except that of the 1970s) in Germany⁶ (see Chart B).

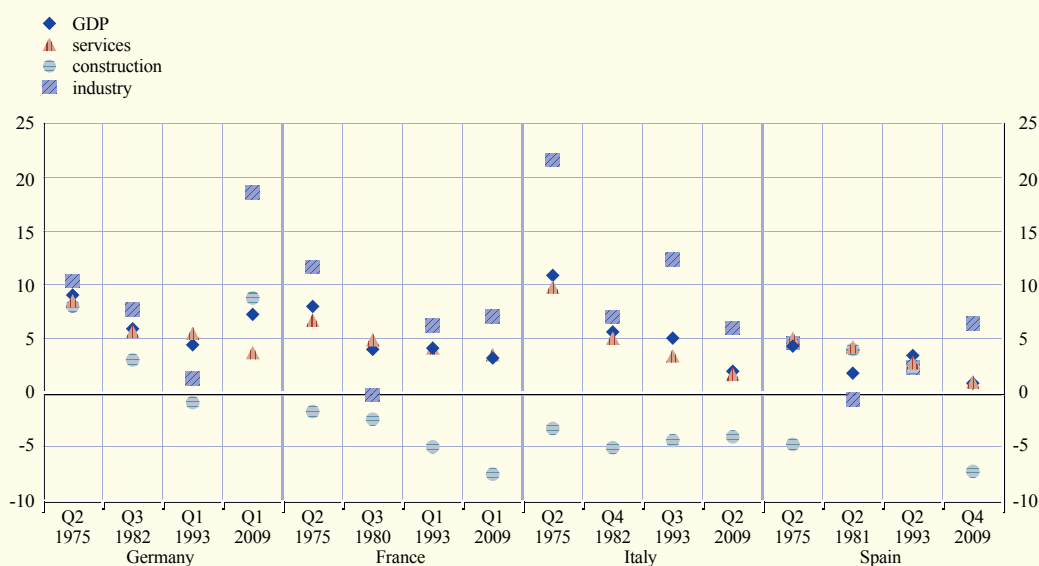
Despite the differences across countries in the strength of the current recovery by historical comparison, the pattern of the relative strength of growth across economic sectors and demand components observed for the euro area as a whole in the current upturn is broadly shared by the four largest euro area economies. In terms of sectoral value added, similar to the euro area results, services and construction value added across countries have generally been moderate during the current recovery relative to previous recoveries, with developments in construction

5 For reasons of comparability, the analysis refers to country-specific recovery periods. The recovery periods considered cover eight quarters in Germany and France, seven in Italy and five in Spain.

6 The comparisons for Germany prior to 1991 refer to West Germany.

Chart B Recoveries in GDP and sectoral value added in the largest euro area economies: cumulative changes since the country-specific GDP troughs

(percentage changes)

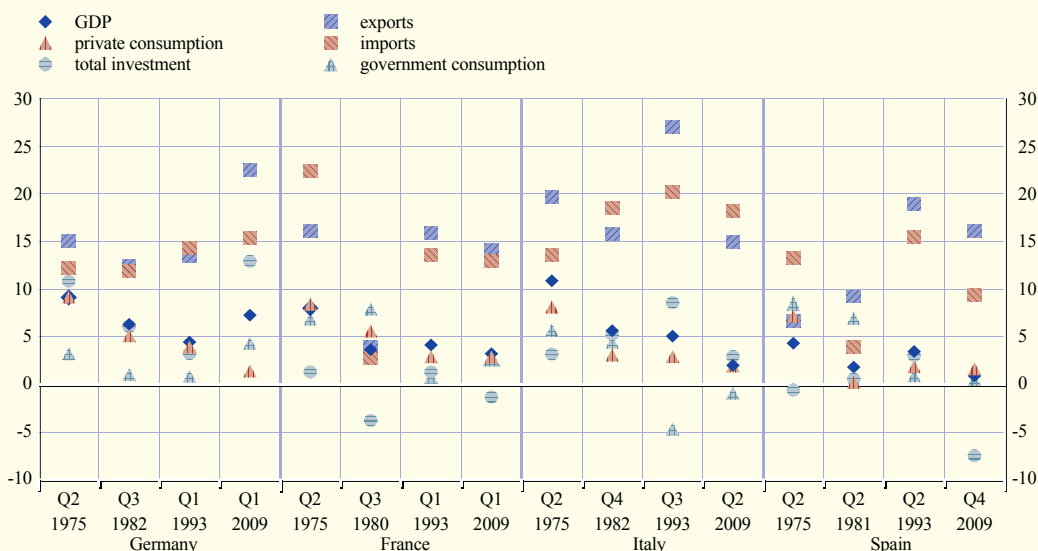


Sources: Eurostat, OECD and ECB calculations.

Note: The last observation refers to the first quarter of 2011. Data for Germany prior to 1991 refer to West Germany. The timing of the country-specific GDP troughs is indicated on the x-axis. The recovery periods considered cover eight quarters in Germany and France, seven in Italy and five in Spain.

Chart C Recoveries in GDP and demand components in the largest euro area economies: cumulative changes since the country-specific GDP troughs

(percentage changes)



Sources: Eurostat, OECD and ECB calculations.
Note: See note to Chart B.

value added being particularly weak in France and Spain, but more favourable in Germany. By contrast, in the industrial sector, the current pick-up in value added has been strong compared with previous upturns across most countries, but particularly in Germany. The exception is Italy, where developments in industrial value added have been slightly more modest than in all previous recoveries. Nevertheless, it is worth noting that, despite rebounding strongly, value added in the industrial sector is still significantly below its respective pre-recession peak in all countries, whereas, in previous recoveries, it had generally returned to that level by the same stage of the upturn.

On the demand side, the trade variables in most countries have recorded relatively strong growth compared with previous recoveries – with the recovery in German trade having been particularly strong – although Italian exports are an exception (see Chart C). Following substantial declines during the recent recession, exports have returned to, or are now close to, their pre-recession peaks in all countries except Italy. By contrast, the current recovery in private consumption has been weak in all four countries, while that in government consumption has also been modest across countries by historical comparison, except in Germany.

The picture is somewhat more diverse with regard to investment, where the current recovery has been broadly comparable with previous upturns in France, but more subdued in Spain and Italy, while it has entailed the strongest growth since 1970 in Germany. With regard to the sub-components of investment, in France and Spain the current recovery in construction investment has been very weak, as is also broadly reflected in the developments in construction value added in these countries (see Chart B).

The similarity in the growth patterns of the four largest euro area economies across both demand and supply components reflects important common determinants of economic activity, in addition

Euro area and country shares in both GDP and value added

(percentages)

	Euro area	Germany	France	Italy	Spain
Demand components					
Private consumption	58	58	58	60	58
Government consumption	22	19	25	21	21
Investment	19	18	19	19	22
Exports	41	46	25	27	26
Imports	39	41	28	28	28
Branches of activity					
Agriculture	2	1	2	2	3
Industry	19	24	13	19	16
Construction	6	4	6	6	10
Services	74	71	80	73	72

Sources: Eurostat and ECB calculations.
Note: Data refer to 2010.

to country-specific factors. For most countries, strong foreign demand, which has resulted in robust export growth, has been an even more important driver of growth during the current recovery than during most of the previous upturns, while domestic demand has generally played a smaller role than in the past. This is visible in the subdued developments in private consumption, for example. Furthermore, given the generally strong interlinkages between industrial activity and foreign demand, and between services value added and domestic demand, these influences are also apparent in developments on the supply side of the economies.

The differences in the strength of GDP growth in the current recovery between the four largest euro area economies are attributable in part to differences in their economic structures. The table shows that the booming exports in the current upturn account for a far bigger share of GDP in Germany (46%) than in the other large euro area economies (25% to 27%) and, while the same applies to imports, Germany is the only net exporting economy among these countries.

On the value added side, the more rapidly growing industrial sector (excluding construction) during the current recovery represents a much higher share in total value added in Germany (24%) than in the other large euro area economies (between 13% and 19%). Other relevant differences between the broad economic structures of the four largest euro area economies are the higher relative weight in total value added of the more slowly growing services sector in France (80%) and of the weak construction sector in Spain (10%). On the demand side, this is reflected in a larger share of government consumption in the case of France (25%) and investment in the case of Spain (22%). These structural features highlight the higher reliance on the relatively sluggish domestic demand components in these countries during the current recovery, implying weaker overall GDP growth compared with previous recoveries.

Differences in the growth dynamics between countries, however, also exist with respect to economic sectors. A noteworthy example is the much stronger growth in industrial activity in Germany than in the other large euro area economies during the current upturn. This can also be attributed to Germany's stronger specialisation in the more cyclical capital and intermediate goods industries, which are currently growing much more rapidly than the less cyclical consumer and energy goods industries. Moreover, the more marked export orientation of the German industrial sector is contributing to the stronger growth in that sector in Germany.

While these broad sectoral structures can to a notable extent explain the recent differences in growth performance across the four economies, differences with respect to other determinants may also be important. Noteworthy differences may exist with regard to, for example, the even more detailed sub-structures of the main branches of activity, the concrete product specialisation, the countries' competitiveness, their degree of competition with low-cost producing countries and differences in the main export destinations. Such factors, for instance, are likely to be of relevance in understanding the relative weakness of the Italian recovery, as it cannot easily be explained by the country's broad economic structures.

Overall, when measured up to the first quarter of 2011, the strength of the current recovery in euro area GDP has come into line with that of the two recoveries of the 1980s and the 1990s, although there are notable differences in the composition of growth across economic sectors and demand components. In particular, this is due to the fact that the current euro area recovery has been driven by foreign demand to a greater extent than past recoveries, which has benefited the four largest euro area economies to varying degrees. Part of this is attributable to differences in the broad economic structures across countries, but other factors, such as the need to correct past imbalances and restore countries' competitiveness, may also be important determinants.