Output volatility following financial crises

Prior to the recent financial crisis there had been five systemic banking crises in advanced economies: in Spain in the late 1970s, Norway in the late 1980s, Finland and Sweden in the early 1990s and Japan during the 1990s. Charts A and B provide different perspectives on the growth profile following the crises. Chart A shows rolling estimates (over an eight-quarter horizon) of the standard deviation of GDP quarter-on-quarter growth rates before and after the recessions.

that followed the crises, aligned around the recession trough. To provide a comparison with cycles not associated with financial crises, the average cyclical path, found by averaging across countries and cycles in a sample of advanced economies since 1970, is also shown. Recent euro area developments are also shown. Chart B illustrates the length of expansions following financial crises, showing the number of quarters before the economy fell back into recession (defined as two periods of negative quarter-on-quarter growth) across the sample of cycles. Overall, the charts suggest that the profile of growth following periods of severe financial turmoil does not differ considerably from that of other recoveries: there is little evidence that GDP was significantly more volatile in the aftermath of the five systemic episodes, and expansions following financial crises were typically not shorter than those following other recessions.

At the same time, even if the length of the expansions is not different, economies may experience more periods of negative growth following a crisis. That would be consistent with the tendency for a decline in the average pace of growth following banking crises – the same volatility around a lower average growth rate would tend to mean more observations of negative quarter-on-quarter growth. Indeed, this appears to be the case: in the five years after the crises, countries saw a slightly higher number of quarterly GDP falls than in the same period before the recession.

Recent volatility in the euro area

For most euro area countries, the recession did not end until 2009, providing only a relatively small window to judge post-crisis volatility in the euro area. In general, the volatility of GDP growth (measured by the standard deviation of quarterly growth rates) has not been noticeably higher in euro area countries since then. GDP volatility increased substantially in the largest euro area countries during the recession, reflecting the deep trough in output in many countries, but has since fallen back. Euro area output volatility since the end of the recession (in the second quarter of 2009) has been broadly similar to the two-year period before the recession and lower than the average volatility since the beginning of monetary union (see Chart C). The standard deviation of output volatility has also been more modest in most large euro area countries since the end of

---


the recession than in the past. The exception is Germany, where output has been more volatile. But that mainly reflects the impact of two very cold winters in 2010 and 2011, which resulted in significant changes in construction investment from quarter to quarter. Excluding construction sector output, volatility in Germany since the end of the recession in mid-2009 has been below the average between 1999 and 2007.

To sum up, previous experience suggests that output growth is typically not more volatile following financial crises, although there has been a tendency for more frequent instances of negative quarterly growth during the recovery phase. In general, the volatility of GDP growth has not been noticeably higher in most euro area countries since the end of the recent recession. As in previous financial crises, however, the pace of the recovery has varied across countries and has been relatively subdued for the euro area overall.