Recession of 1983:Q1-1984:Q1

PEAK: 1983:Q1 | TROUGH: 1984:Q1 | DURATION: 4 QUARTERS | AMPLITUDE: 2.7%

This recession reflected a delayed adjustment of the Portuguese economy to the rise in oil prices, combined with the impact of an IMF-supervised adjustment programme. The programme was the result of the accumulation of deficits in the balance of payments in previous years. A restrictive fiscal policy and a reduction in investment balanced the external accounts, at the cost of a recession caused by a contraction in domestic demand.

ENVIRONMENT

The Portuguese economy experienced a brief period of growth after the macroeconomic stabilisation implemented in the first IMF technical and financial assistance programme in 1978-1979. Real GDP per capita grew 6.1% between 1980:Q1 and 1983:Q1. In the following four quarters of the recession, real GDP per capita fell 2.7% relative to the peak.

Externally, this recession reflects, to some extent and with a lag, the 1979 oil shock. At that time, many developed economies adopted restrictive monetary policies to contain inflation. The US was in recession between 1981:Q3 and 1982:Q4, while the 11 original Eurozone members (and Greece) experienced a particularly long recession between 1980:Q1 and 1982:Q3, marked not so much by a decrease in output, which was stagnant, but rather by a reduction in employment and investment. Spain, which had suffered more immediately from the shock, experienced a period of industrial transformation that, despite political instability, resulted in expansion.

Internally, the government implemented expansionary fiscal and monetary policies starting in 1980. On the one hand, this led to a rise in inflation. Price controls were used to contain inflationary trends, but they affected the financial health of many firms. On the other hand, expansionary policies, together with the availability of external financing, led to external imbalances, with the balance of payments deficit reaching 13% of GDP in 1982 (Figure 5).

A restrictive macroeconomic policy package was implemented in 1982, with interest rate hikes and the upfront sale of gold reserves. But it would be the central bloc government, formed after the April 1983 general election, which would resort to an IMF programme between October 1983 and February 1985. Among the various measures, there was a devaluation of the escudo by 12% in June 1983, a reduction in investment by public companies, the imposition of credit limits and an increase in the tax burden. As a whole, these measures generated social upheaval, with several strikes and demonstrations taking place.

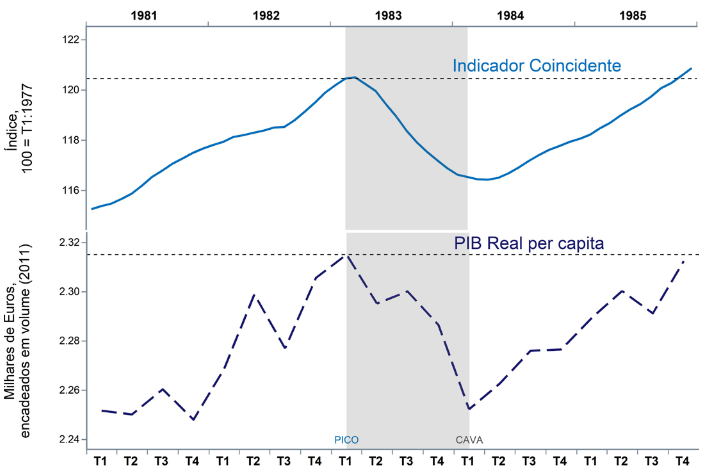
CALIBRATING THE PEAK AND TROUGH [1]

As illustrated in Figure 1, real GDP per capita reached a local maximum in 1983:Q1. The coincident indicator, which peaked in March, has an even more pronounced inflection than that of real GDP per capita.

Industrial production (Figure 2) also registered a clear peak in 1983:Q1, with a 4% fall until 1984:Q1.

Figure 1. Coincident Indicator (monthly) and Real GDP per capita (quarterly)

Source: Banco de Portugal, Committee

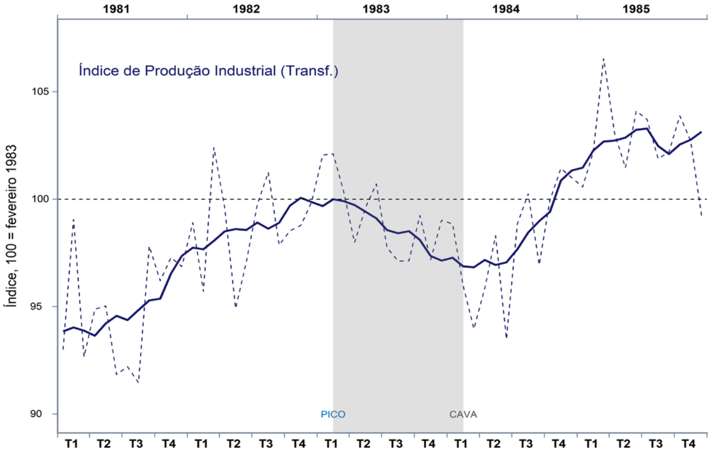


Note: the horizontal dotted lines represent the value of the indicators at the peak defined by the Committee. (1983:Q1).

[1] The Committee bases its decisions on a subjective, multidimensional strategy, relying on a set of monthly and quarterly economic activity indicators, several computational algorithms and the assessments of its members. The evaluation is performed on a quarterly basis with a focus on output. For further details, please see the Methodological Notes.

Figure 2. Industrial Production Index **(monthly)**

Source: Statistics Portugal, Eurostat



Note: seasonally adjusted (dotted line) and smoothed (solid line) series, by using a centred 9-month moving average. The latter is indexed to 100 in the month before the peak, for interpretation.

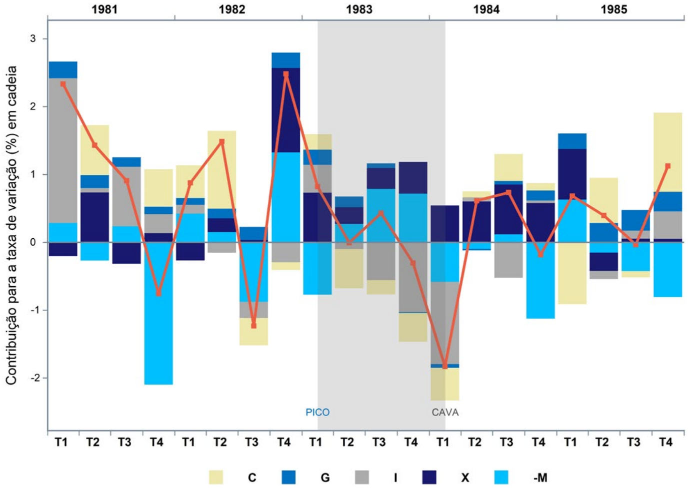
In terms of macroeconomic aggregates (**Figure 3**), the external adjustment was particularly evident in 1983:Q2-1983:Q4, with a reduction in imports and an increase in exports. The combination of the external context, credit constraints and cuts in public investment contributed to sharp declines in private investment and private consumption.

The unemployment rate was rising and employment had been falling since 1982:Q2-Q3 (**Figure 4**), one year before the peak considered by the Committee, which follows the output approach. However, it should be noted that employment statistics for this period contain some noise.

The calibration of the trough in 1984:Q1 is corroborated by real GDP per capita, the coincident indicator and the industrial production index. The industrial sector recovered the level of the previous peak in less than a year, grounded in a quick export-based adjustment driven by the currency devaluation. Finally, employment once again lagged, with a local minimum in 1983:Q2.

Figure 3. Breakdown of the quarter-on-quarter rate of change in Real GDP – Expenditure Approach **(quarterly)**

Source: Banco de Portugal



Note: positive contributions from imports (M) reflect negative rates of change in this aggregate.

INDICATORS AND ADDITIONAL FACTORS

The data series considered by the Committee for formulating its decisions starts in 1980:Q1. Although some data point to a small recession of two or three quarters in 1980 – associated with the previous year's oil shock – the Committee considered that there was no reason to declare a recession at this time. On the one hand, its reduced amplitude, with a close to zero change in real GDP per capita, together with measurement errors at the beginning of the sample, makes it impossible to separate the signal from the noise. On the other hand, Portugal was, at the time, a relatively closed economy and therefore less affected by external shocks. At the same time, the pursuit of expansionary policies allowed the impact of the oil shock to be postponed until 1983, when it was amplified by the adjustment programme.

Figure 4. Labour market – Employment Index and Unemployment Rate (quarterly)

Source: Banco de Portugal, Committee

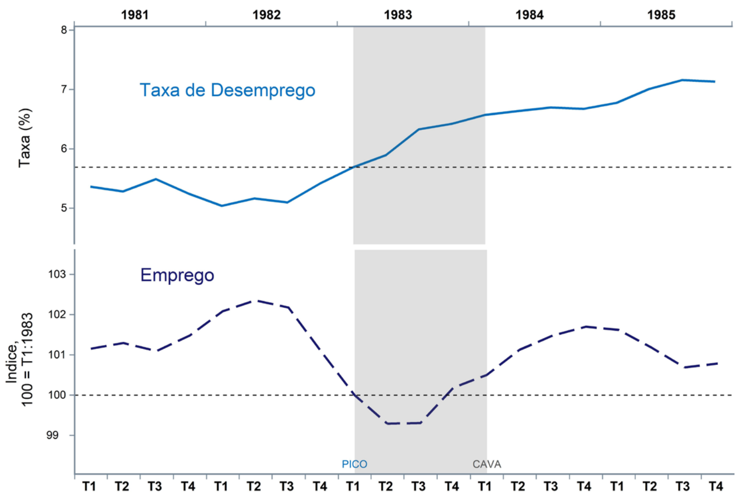


Figure 5. Balance of Payments, Internal Savings and Investment (annual)

Source: Banco de Portugal

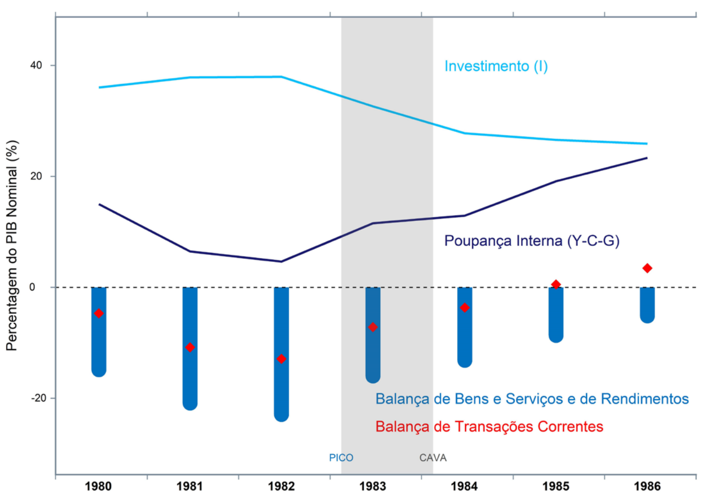


Figure 5 shows the developments in the balance of payments, the current account and the breakdown of the latter into domestic savings and investment. The deterioration of both balances between 1980 and 1982 is clearly visible, mainly due to the fall in domestic savings, consistent with the expansionary policies of the time. This external indebtedness made it possible to sustain high levels of consumption (Figure 3), despite adverse international conditions.

In 1983, with the adjustment programme, the sudden contraction of the external deficit is visible. The devaluation of the escudo made imports more expensive and exports cheaper, producing a rapid correction in the balance of goods and services.

Domestic savings soon recovered from 1982 onwards given that, in addition to the fall in output, consumption decreased even more significantly (Figure 3). The largest share of the external debt adjustment occurred on the investment side, whose sharp drop particularly marked this recession. This behaviour is typical of recessions linked to external adjustments.

CONCLUSION

This year-long recession was relatively severe, with an amplitude of 3% of real GDP per capita. In the context of an external adjustment programme, the currency was devalued, public investment was cut, credit was limited and prices were frozen, reducing private investment. The external accounts were rebalanced, contracting internal demand. Real GDP per capita would recover to its peak level in 1986:Q2, a little over two years after the trough.