Recession of 2008:Q1-2009:Q1

PEAK: 2008:Q1 | TROUGH: 2009:Q1 | DURATION: 4 QUARTERS | AMPLITUDE: 4.4%

The 2008-2009 recession coincided with a deep international recession stemming from the Great Financial Crisis. The fall in international trade affected all small open economies, including Portugal, with an impact on investment, trade and economic sentiment. The end of the recession came with a turning point in the GDP, but not in the labour market, where the trend changed. The recovery was short-lived, with another recession starting at the end of 2010.

ENVIRONMENT

Between the trough of the last recession in 2003:Q2 and the peak detected in 2008:Q1, real GDP per capita increased by an average of 1.5% per year, in a phase of reduced growth in the Portuguese economy. In this initial, already depressed context, this recession was particularly severe, with real GDP per capita falling by 4.4% in just four quarters.

Externally, the recession affected almost all countries with a significant weight in international trade, somewhere between the end of 2007 and the first half of 2008. In the US, the peak occurred in December 2007, while in the Eurozone, the recession began in 2008:Q1. With some lag, the peak was recorded in Spain in 2008:Q2.

The origin of the recession was the Great Financial Crisis It began in the summer of 2007, with problems in US subprime housing loans, and reached its height with the bankruptcy of Lehman Brothers in September 2008. The fall in the value of financial assets, reducing the value of credit guarantees, and the distrust in the interbank system contributed to a significant reduction in financing to the economy and in the credit necessary for international trade. Global exports declined by 19% between 2007 and 2009. The fragility of the Portuguese financial system reflected itself in one bank having its assets nationalised and another one receiving state guarantees in 2008.

In Europe, there was a coordinated fiscal stimulus plan. In Portugal, in December 2008, an extraordinary package of stimulus measures was announced, budgeted at EUR 2.18 billion euros and, in January 2009, a rectifying state budget expanded the stimulus. Given the Portuguese budgetary position, public debt grew from 72.7% of GDP in 2007 to 87.8% in 2009. Monetary policy was also expansionary, with the ECB reducing the key interest rate by 175 basis points between October 2008 and January 2009.

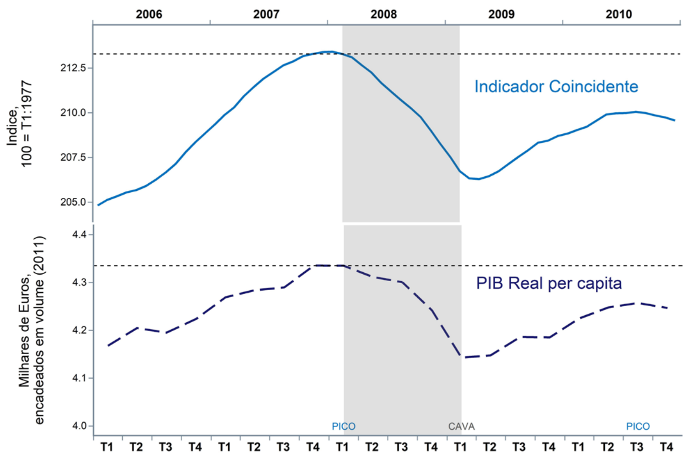
At domestic level, citizens went to the polls three times in 2009: European elections (April), general election (September) and local elections (October). The general election resulted in the re-election of the previous government, with a relative parliamentary majority.

CALIBRATING THE PEAK AND TROUGH[1]

The real GDP per capita reached a local maximum between 2007:Q4 and 2008:Q1 (Figure 1). The coincident indicator reached a maximum in January, indicating 2008:Q1 as the peak.

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

Source: Banco de Portugal, Committee

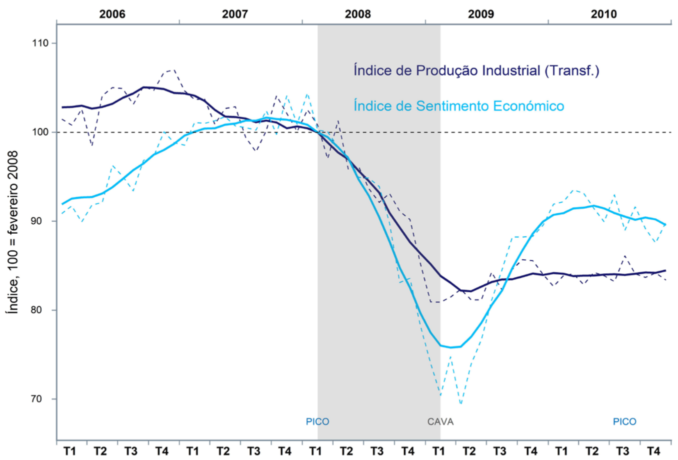


Note: the horizontal dotted lines represent the value of the indicators at the peak defined by the Committee. (2008:Q1).

[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, pleaes see the Methodological Notes.

Figure 2. Industrial production index and economic sentiment indicator **(monthly)**

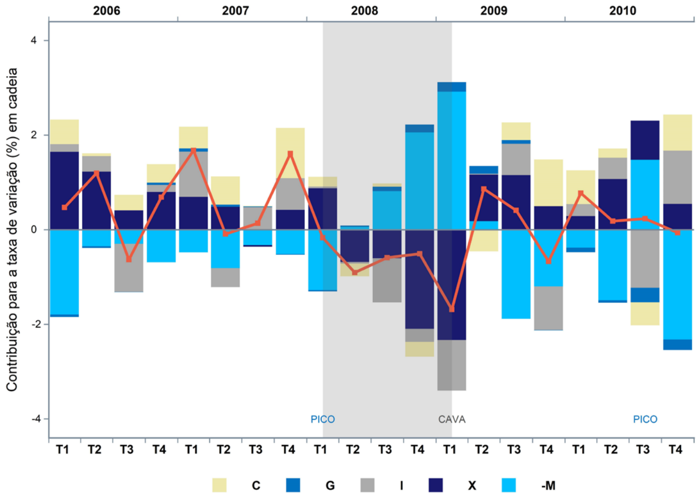
Source: Statistics Portugal, Eurostat



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

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.

Industrial production (Figure 2) was stagnant during 2007 and started to clearly fall from December. The breakdown of economic sentiment anticipated the calibration of the peak, consistent with the uncertainty resulting from the turbulence that was beginning to be seen in financial markets.

In terms of macroeconomic aggregates (Figure 3), the international dimension of the crisis led to a contraction in exports from 2008:Q2. This was compounded by a drop in private investment, which was not fully compensated by the increase in public investment. The contribution of private and public consumption to the contraction of the GDP was less significant in this recession.

The unemployment rate (Figure 4) only rose slightly in the first three quarters of the recession. However, it did show a slight inflection, with a local minimum in 2008:Q1, consistent with the dating of the peak from the output perspective. Likewise, total employment started to fall in 2008:Q2.

The calibration of the trough is common to all indicators: real GDP per capita, coincident indicators, industrial production and economic sentiment. All of them showed a clear inflection point in 2009:Q1. However, the pace of recovery is quite different according to different indicators. At one extreme, economic sentiment recovered quickly and sharply. At the other extreme, industrial production, which fell 20% between peak and trough in one of the largest cycles in the Portuguese economy post-1980, showed no recovery, but rather was roughly stagnant after the trough.

GDP per capita and the coincident indicator grew after the recession, but at a slower pace than in the years preceding the recession. One difficulty in dating the trough in this recession is that the next peak occurred only six quarters later. Therefore, the next peak occurred before the level of the previous peak was reached. It was not a robust expansion of the economy because a second shock, of European and internal origin, would hit shortly afterwards, as happened in the rest of the Eurozone. However, from the output perspective followed by the Committee, there was a clear inflection in the economy after the trough.

The behaviour of the labour market was more unusual in this episode, requiring additional explanations.

INDICATORS AND ADDITIONAL FACTORS

The dating of the trough in 2009:Q1, based on the output indicators, did not correspond to the labour market indicators in this recession (Figure 4). At the end of the recession, instead of recovering, employment fell more dramatically. The unemployment rate rose 2.4 percentage points between the trough in 2009:Q1 and the subsequent peak in 2010:Q3. Although the GDP recovered, the labour market showed no signs of economic expansion.

Figure 4. Labour market – employment index and unemployment rate (quarterly)

Source: Banco de Portugal, Committee

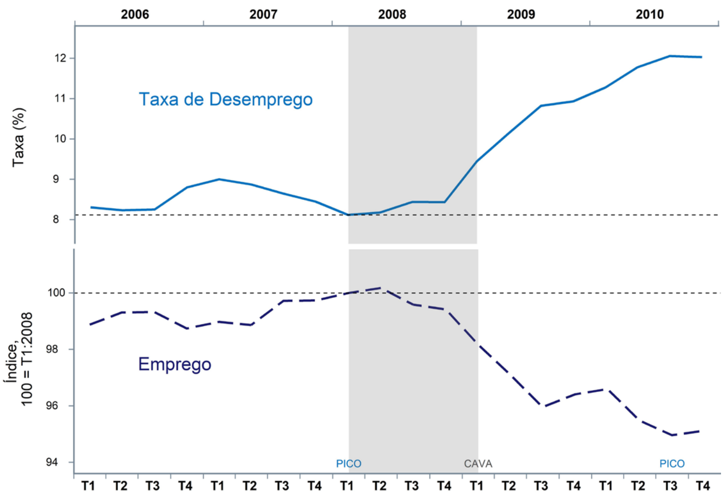


Figure 5. Employment trend (quarterly)

Source: Banco de Portugal, Committee

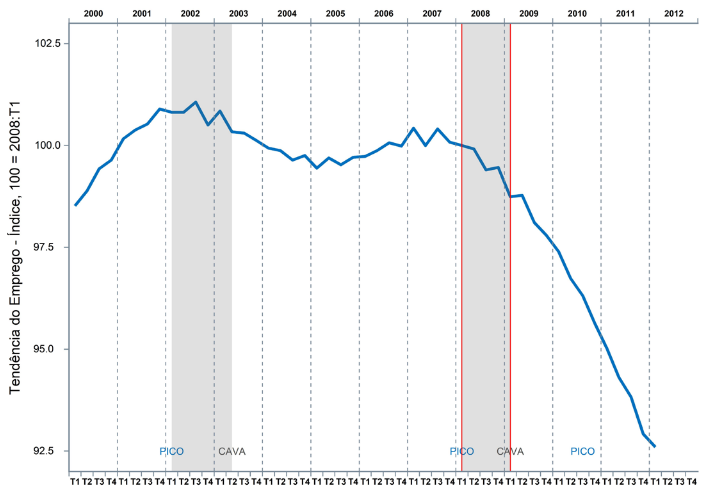


Figure 5 shows the employment trend, smoothed from fluctuations, since 2000. Despite the growth observed until 2002, the rest of the decade witnessed a moderate reversal of the trend, followed by some stagnation, until the end of 2007. From 2008 onwards, employment in Portugal fell continuously. The period of economic expansion between 2009:Q1 and 2010:Q3 presented a positive gap in employment — the difference between employment and its post-2009 trend — as would be expected in an expansionary period. However, the decline in the trend led to a decrease in total employment.

The same point applies to the unemployment rate, with the structural trend dominating the business cycle. Some disaggregated labour market indicators, more cyclical and therefore more immune to trend changes, confirm this explanation. In particular, after the trough, there was a decrease in the number of newly unemployed registered and job offers increased.

CONCLUSION

Triggered by a financial crisis that produced a confidence and international trade crisis, this recession affected all small open economies in the developed world. Portuguese banking credit was not immune to financial problems and the main markets of Portuguese companies underwent strong contractions. Thus, despite a considerable fiscal stimulus, private investment and trade recorded a sharp contraction. Only in 2017:Q1 would the level of real GDP per capita recover values from 2008:Q1 (nine years later), already after the subsequent recession. This recession also marked a structural change in the Portuguese labour market, after the one that occurred in the product market in 2002, with a new downward trend in total employment.