Recession of 2010:Q3 – 2013:Q1

PEAK: 2010:Q3 | **TROUGH:** 2013:Q1 | **DURATION:** 10 QUARTERS | **AMPLITUDE:** 6.9%

The longest recession in Portugal since the dating committee started (1980) was part of the sovereign debt crisis that affected several countries in the Eurozone, particularly Portugal. It occurred after a short expansion of only six quarters and was marked by a request for external aid. Private consumption fell more than in any other recession, while in contrast, the balance of trade cushioned the impact. The unemployment rate reached a historical maximum, but after the trough, there was a positive inflection in employment, which had been declining since 2008.

ENVIRONMENT

The Portuguese economy had a brief period of growth between 2009:Q1 and 2010:Q3, with real GDP per capita rising by 2.7%. In the ten subsequent quarters of recession, the longest period of contraction since 1980, real GDP per capita fell 6.9% from its peak.

On the external front, the Eurozone was in recession between 2011:Q3 and 2013:Q1. In particular, Spain went into a recession in 2010:Q4, which lasted until 2013:Q2, and, in April 2010, Greece requested a financial bailout from the troika, consisting of the International Monetary Fund (IMF), the European Commission and the European Central Bank (ECB), followed by Ireland in November. The US did not go through any recession. This was a European crisis that had Portugal and other peripheral countries at its roots.

The genesis of the European crisis was the convergence of several factors. First, public deficits during the previous recession led to an unusually high level of debt in the periphery, which was largely external as a result of high external deficits in the previous decade. Second, the financial crisis led to an increase in risk aversion, resulting in capital flight from the European periphery towards the centre, seeking safety. Finally, it became clear that, in compliance with the Maastricht Treaty, if there was a bailout of peripheral countries by European institutions or other European Union countries, it would be accompanied by particularly harsh adjustment requirements.

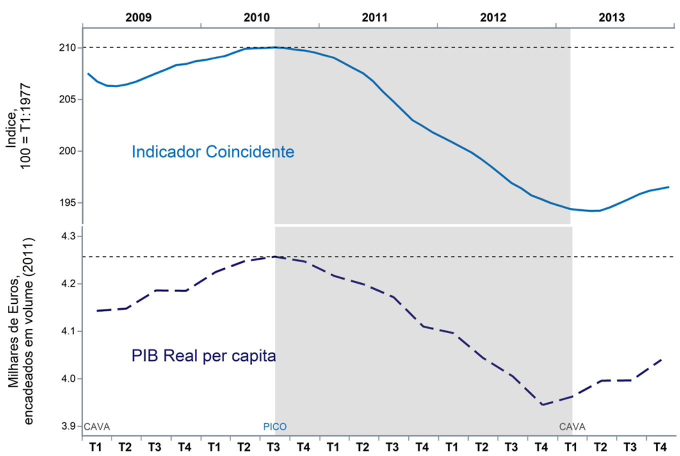
As a result of these factors, public debt interest rates in the periphery increased rapidly and significantly. This debt crisis quickly spread to the banking system, becoming amplified in its interaction with this and causing strong contractions in credit and restrictive fiscal policies, with cuts in spending and increases in tax rates. At the same time, the "sudden stop" in financing to the peripheral economies led to collapses in investment and consumption, requiring internal devaluation to rebalance the balance of payments.

Internally, the restrictive fiscal policy began in March 2010, with the approval of the Stability and Growth Pact (SGP-1), aiming to reduce expenses with personnel by 10% of GDP and implement a series of privatisations. In July, VAT, personal income tax rates and corporate income tax rates increased. After successive increasingly restrictive revisions, the failure to approve "SGP-4" led to the resignation of the government in March 2011. Despite these measures, the spread of 10-year public debt (relative to Germany) continued to rise continuously and rapidly, from 2.9% at the beginning of 2010:Q3, to a historical high of 10.6% in July 2011.

Before that, in April, the outgoing government requested economic and financial assistance from the troika. Agreed in May, the Economic and Financial Assistance Programme (EFAP) offered credit of 78 billion euros and imposed a package of structural measures aimed at reducing production costs, promoting competition and increasing productivity. The new government took office in June and implemented the programme, which officially ended in 2014:Q2.

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

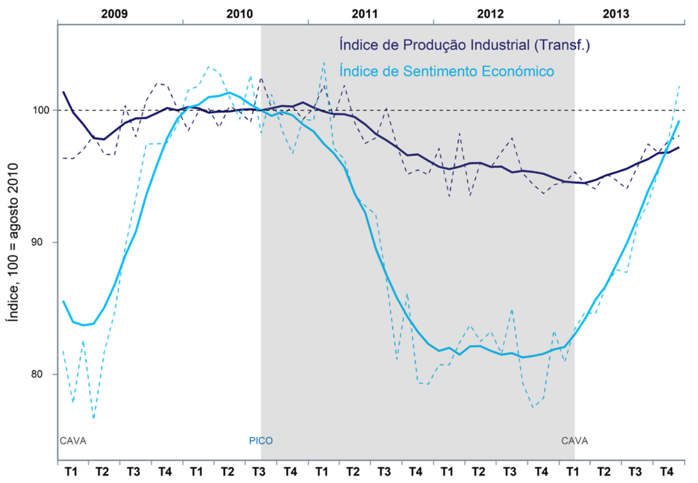
Source: Banco de Portugal, Committee



Note: the horizontal dotted lines represent the value of the indicators at the peak defined by the Committee (2010:Q3).

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

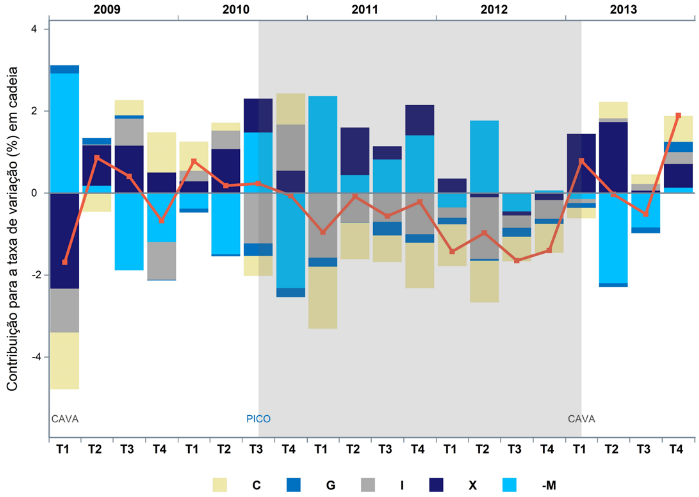
Source: Statistics Portugal, Eurostat



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.

CALIBRATING THE PEAK AND TROUGH[1]

As shown in Figure 1, real GDP per capita reached a local maximum in 2010:Q3 and the same was the case with the coincident indicator, whose local maximum occurred in August.

Economic sentiment, on the upswing since 2009:Q1, peaked in 2010:Q2 – coinciding with the announcement of the Greek bailout – and then fell by around 20% between 2010:Q3 and 2012:Q4 (Figure 2). Industrial production, after a few quarters of stagnation that continued on from the previous expansion, fell only from 2011:Q1.

In terms of macroeconomic aggregates, almost all components contributed to the recession (Figure 3). The fall in consumption and investment was consistent with the reversal of economic sentiment and in line with previous recessions. Exceptional, on the negative side, was the drop in private consumption, which fell by 11% between the peak and the trough, the biggest fluctuation recorded since the beginning of dating. Notable, on the positive side, was the adjustment of the balance of trade, with positive net contributions from the balance of trade (X-M) to real GDP growth in seven of the ten quarters of the recession.

Maintaining the labour market trend that began in the last recession, unemployment continued to increase between the trough of the last recession in 2009:Q1 and 2013:Q1 (Figure 4). If there was an inflection, it would have appeared almost in the middle of the recession, around 2011:Q3. Variations were similar on the employment side (in the opposite direction), but slightly more dramatic, as a result of the decrease in the working population due to emigration.

The trough occurred somewhere between 2012:Q4 and 2013:Q1. The real GDP per capita and the economic sentiment indicator recorded a minimum in 2012:Q4. The coincident indicator and the industrial production index fell until 2013:Q2. In the labour market, the unemployment rate reached an all-time high of 17% in 2013:Q1, falling thereafter. It was also in March that a protest demonstration with more than 800,000 people was held in Lisbon. Using more monthly and sector-disaggregated indicators, the Committee established 2013:Q1 as the trough of this recession.

INDICATORS AND ADDITIONAL FACTORS

The short expansion between 2009:Q1 and 2010:Q3 raises the question of whether this recession was nothing more than a continuation of the previous one or if it was a new business cycle. In this sense, it should be noted that only in 2017:Q1 would the national GDP per capita return to the values of 2008:Q1, that is, 9 years later

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

Source: Banco de Portugal, Committee

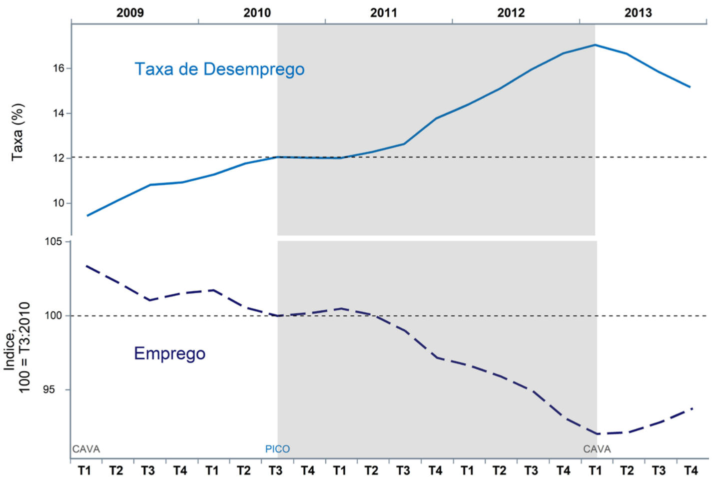
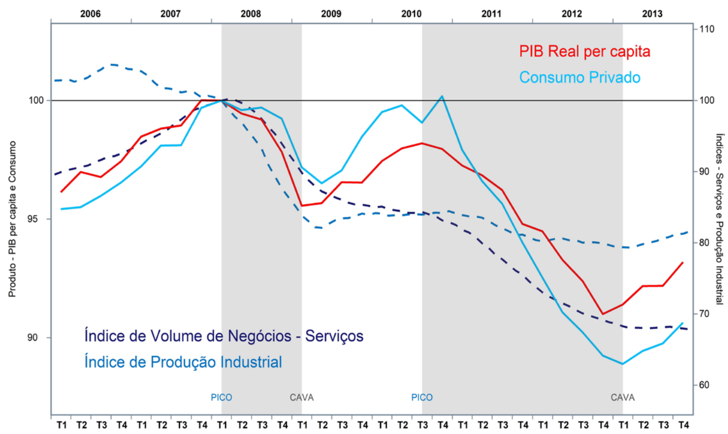


Figure 5. Real Output per capita and Private Consumption (quarterly) & Sectorial Indexes (monthly)

Source: Banco de Portugal, Committee



One argument in favour of there being two distinct business cycles is their correspondence to the two cycles in the Eurozone. Portugal stood out by going into this recession a year earlier than the Eurozone, being at the forefront of countries affected by the sovereign debt crisis. Its expansion was therefore shorter but aligned with the expansion in the Eurozone.

Second, the two recessions have distinct causes and mechanisms. The 2008:Q1-2009:Q1 recession was triggered by the Great Financial Crisis in the US and spread throughout the developed world, while the 2010:Q3-2013:Q1 recession had its roots in the European sovereign debt crisis and affected only the European continent. The fiscal policy responses to the two crises were diametrically opposite, expansionary in the first and contractionary in the second. Industrial production played a more predominant role in the first recession, while private consumption fell significantly in the second recession.

Finally, Figure 5 shows four output indicators, after the trend is removed, centred on the expansion and flanked by the two recessions. Although the recovery of real GDP per capita in the expansion was incomplete, private consumption returned to 2008:Q1 levels. This partially reflected a strongly expansionary fiscal policy, with the largest wage increases of the decade in the public sector and a wide-ranging programme of public investment and spending.

It was private investment and the balance of trade that countered these trends, producing the incomplete output recovery. The weak investment was a result of the uncertain climate generated by the financial crisis and the poor state of the banking system. The negative balance of trade was the result of the increase in imports generated by the stimulation of domestic demand.

Figure 5 also shows that a turning point came in 2009:Q1, for industrial production in particular and for the volume of service businesses only slightly. Both indicators stabilised after this trough date, with industrial production registering a slight, but visible, recovery. After the 2010:Q3 peak, services fell again. The recovery was thus modest and unequal between different sectors, but sufficiently significant to mark the end of one business cycle and the beginning of another.

CONCLUSION

Following an incomplete economic recovery, this recession originated in the Eurozone and in the sudden halt in financing to the Portuguese economy. It was the deepest recession in this Committee's analysis period (since 1980), with a 6.9% fall in output. National circumstances, with economic stagnation since the beginning of the century, high levels of indebtedness and a strong link between banks and the State – which led to a major contraction in credit during the crisis – together with weaknesses in the institutional design of the Eurozone, resulted in a contractionary fiscal policy, a significant drop in output and, in particular, in consumption (11%). In the opposite direction, the balance of trade saw a particularly notable adjustment. The depth of this recession marked a turning point in the labour market, halting the increase in unemployment that had started in 2008:Q1. The recovery of real GDP per capita levels in 2010:Q3 would only come six years later, in 2016:Q3.