

Press Points for Chapter 3: *From Recession to Recovery: How Soon and How Strong?*

World Economic Outlook, April 2009

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Key Points

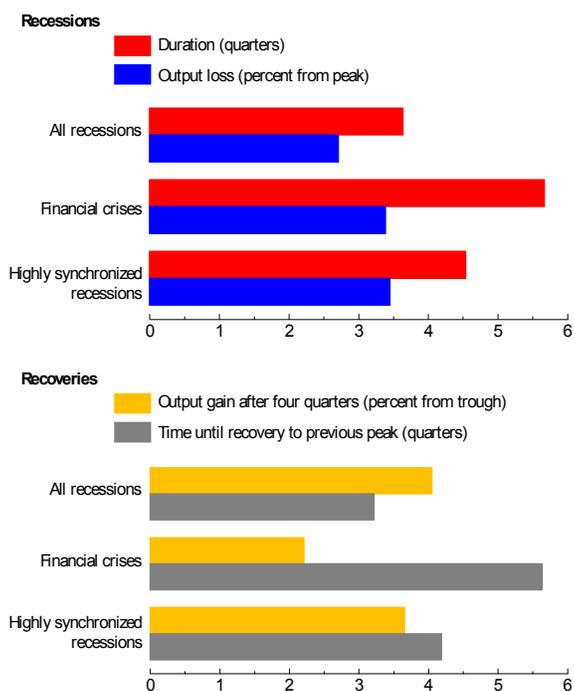
- **Recessions associated with financial crises tend to be severe. Recoveries from such recessions are typically slow. If such recessions are globally synchronized then they tend to last even longer and be followed by recoveries that are even weaker.**
- **Countercyclical policies can be helpful in ending recessions and strengthening recoveries. In particular, expansionary fiscal policies seem particularly effective. Monetary policy can help shorten such recessions, but is less effective than usual.**
- **These findings suggest that the current recession is likely to be unusually long and severe, and the recovery sluggish. However, strong countercyclical policy action, combined with action to restore confidence in the financial sector, could improve prospects for recovery.**

Chapter 3 examines the patterns of recessions and recoveries and the role of macroeconomic policies. It looks at business cycles in 21 advanced economies from 1960 to the present. Excluding current recessions, there are 15 recessions in this sample that can be associated with financial crises, and three episodes of globally synchronized recessions: 1975, 1980 and 1992.

Typically, recessions are short and recoveries are strong. A typical recession persists for about a year, while an expansion often lasts more than 5 years. Recoveries from recessions are strong, reflecting the presence of a bounce-back effect. Recessions and expansions in the advanced economies have changed over time--since the mid-1980s, recessions have become less frequent and milder, while expansions have become longer lasting.

But different shocks are associated with different macroeconomic and financial dynamics during recessions and recoveries. In particular,

Average Statistics for Recessions and Recoveries



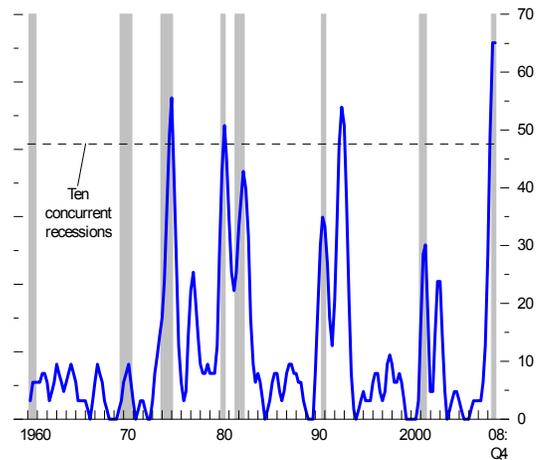
Source: IMF staff calculations.

recessions associated with financial crises have typically been severe and protracted. Financial crises typically follow periods of rapid expansion in lending and strong increases in asset prices. Recoveries from these recessions are often held back by weak private demand and credit reflecting, in part, households' attempts to increase saving rates to restore balance sheets. They are typically led by improvements in net trade, following exchange rate depreciations and falls in unit costs.

Globally synchronized recessions are longer and deeper than others. Excluding the present, there have been three episodes since 1960 during which 10 or more of the 21 advanced economies in the sample were in recession at the same time: 1975, 1980 and 1992. The duration of a synchronous recession is, on average, nearly 1½ time as long as the duration of the typical recession. Recoveries are usually sluggish, owing to weak external demand, especially if the United States is also in recession: during the 1975 and 1980 recessions, sharp falls in U.S. imports contributed to a significant contraction in world trade.

Highly Synchronized Recessions

(Percent of countries in recession; shaded areas denote U.S. recession)

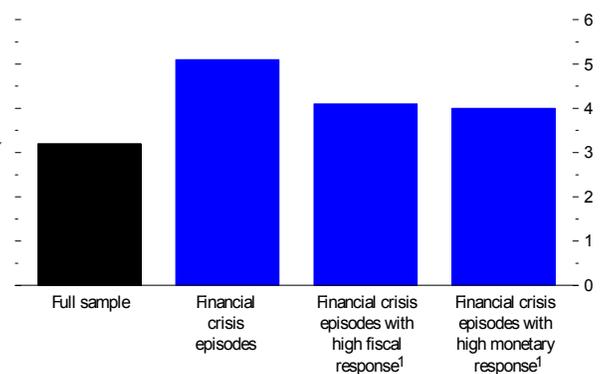


The analysis suggests that the combination of financial crisis and a globally synchronized downturn is likely to result in an unusually severe and long lasting recession. This combination is historically rare, and inferences should be drawn cautiously. Nonetheless, the fact that the current downturn is highly synchronized and associated with deep financial crises suggests that it is likely to be persistent, with a weaker-than-average recovery.

Macroeconomic policies can play a valuable role in reducing the severity of recessions and bringing forward recoveries. Monetary policy has typically played an important role in ending recessions and strengthening recoveries, although it is less effective during financial crises. Fiscal policy appears to be more reliably helpful in these episodes, consistent with evidence that fiscal policy is more effective when economic agents face tighter liquidity constraints. Fiscal stimulus is also associated with stronger recoveries; however, the impact of fiscal policy on the strength of the recovery is found to be smaller for economies that have higher levels of public debt.

Estimated Median Duration of Recessions

(Quarters)



Source: IMF staff calculations.

¹Refers to a one-standard-deviation increase in government consumption or decrease in real interest rates, respectively.

Dealing with the current global recession will require coordinated monetary, fiscal, and financial policies. Aggressive monetary and fiscal policy measures are needed to support aggregate demand in the short term. Even with such measures, one of the most important

lessons from episodes of financial crises is that restoring confidence in the financial sector is critically important for macroeconomic policies to be effective and for recovery to take hold.