

## Box 1.2. The Global Recovery: Where Do We Stand?

The recovery from the Great Recession has been unusually uneven: very weak in many advanced economies but surprisingly strong in many emerging and developing economies. The trajectory of the ongoing recovery in advanced economies has so far displayed some disturbing similarities with the sluggish recovery following the much shallower 1991 global recession. More recently, the recovery in advanced economies has weakened, raising concern about the pace and durability of the global recovery. This box explores three major questions to put the ongoing recovery in historical perspective. How different is the current global recovery from past recoveries? How do developments in advanced and emerging economies compare with those during earlier episodes? And where do we stand in the recovery process? To address these questions, this box briefly examines the main features of global recoveries during the past 50 years and the experiences of advanced and emerging market economies during these episodes.

A global recovery is defined as a period (usually the first three years) of increasing economic activity following a global recession. This box focuses on the recoveries that followed the global recessions of 1975, 1982, 1991, and 2009, which involved declines in world real GDP per capita.<sup>5</sup> The 2009 episode stands out as the most severe and synchronized global recession during the postwar period. This raises the question of whether the recovery from the Great Recession differs much from past recoveries. To analyze the dynamics of the global recovery, the behavior of a set of macroeconomic

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<sup>5</sup>These global recessions are identified by applying at the global level the two standard methods of dating peaks and troughs in individual country business cycles—statistical procedures and discretionary methods such as the one used by the National Bureau of Economic Research for the United States. Both methods yield the same turning points in global activity (Kose, Loungani, and Terrones, 2009). A per capita measure of global GDP is considered to account for the heterogeneity in population growth rates across countries—in particular, emerging and developing economies tend to have faster GDP growth than advanced economies, but they also have higher population growth.

and financial variables during the current recovery is compared with that of the previous three episodes.

### *How Similar? How Different?*

The ongoing global recovery has several similarities with previous ones but also exhibits some important differences. At the global level, real GDP, trade, credit, and house and equity prices have not displayed an unusual pattern during the current recovery (Figure 1.2.1). In fact, GDP, consumption, and investment have rebounded more strongly than after most past global recessions. However, the declines were much deeper in 2009, and an unprecedented degree of macroeconomic policy expansion has helped drive the current recovery (Figure 1.2.2).<sup>6</sup> Despite the strong rebound in global economic activity, the level of unemployment has remained much higher than during previous episodes. These aggregate observations mask, however, important differences between the recoveries experienced by advanced economies and emerging market economies.

One distinguishing feature of the current recovery is its uneven nature. As documented in Box 1.1 of the October 2010 *World Economic Outlook*, emerging market economies have performed better than in past episodes. In fact, they account for the lion's share of world growth since 2009, driven largely by buoyant domestic demand, vibrant asset markets, strong capital inflows, and expansionary policies.<sup>7</sup> The strong performance of emerging markets reflects in part some structural improvements such as better-regulated financial systems and stronger macroeconomic frameworks that allowed them to pursue more credible and effective countercyclical policies. Notable exceptions are the emerging European economies, which suffered a financial shock qualitatively similar to the shock in many advanced economies.

In contrast, the current recovery in advanced economies has been extremely weak, reflecting in

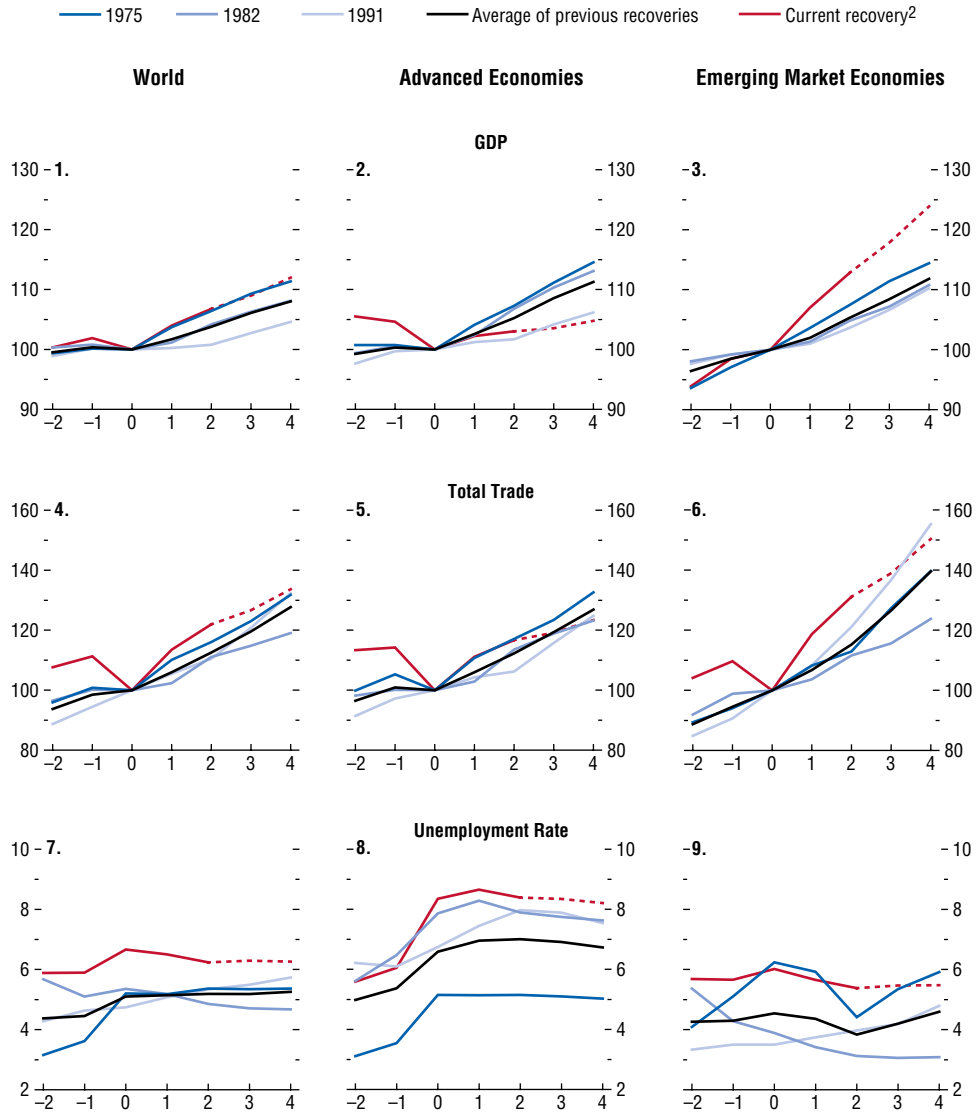
<sup>6</sup>For a discussion of the scope of expansionary macroeconomic policies following the recent global recession, see Dao and Loungani (2010).

<sup>7</sup>Kose, Otrok, and Prasad (forthcoming) present a detailed account of many differences in cyclical performance between advanced and emerging market economies in recent years.

Box 1.2. (continued)

Figure 1.2.1. Dynamics of Global Recoveries: Selected Variables<sup>1</sup>

(Years on x-axis; t = 0 in the year of the trough; indexed to 100 at the trough; in real terms unless noted otherwise)

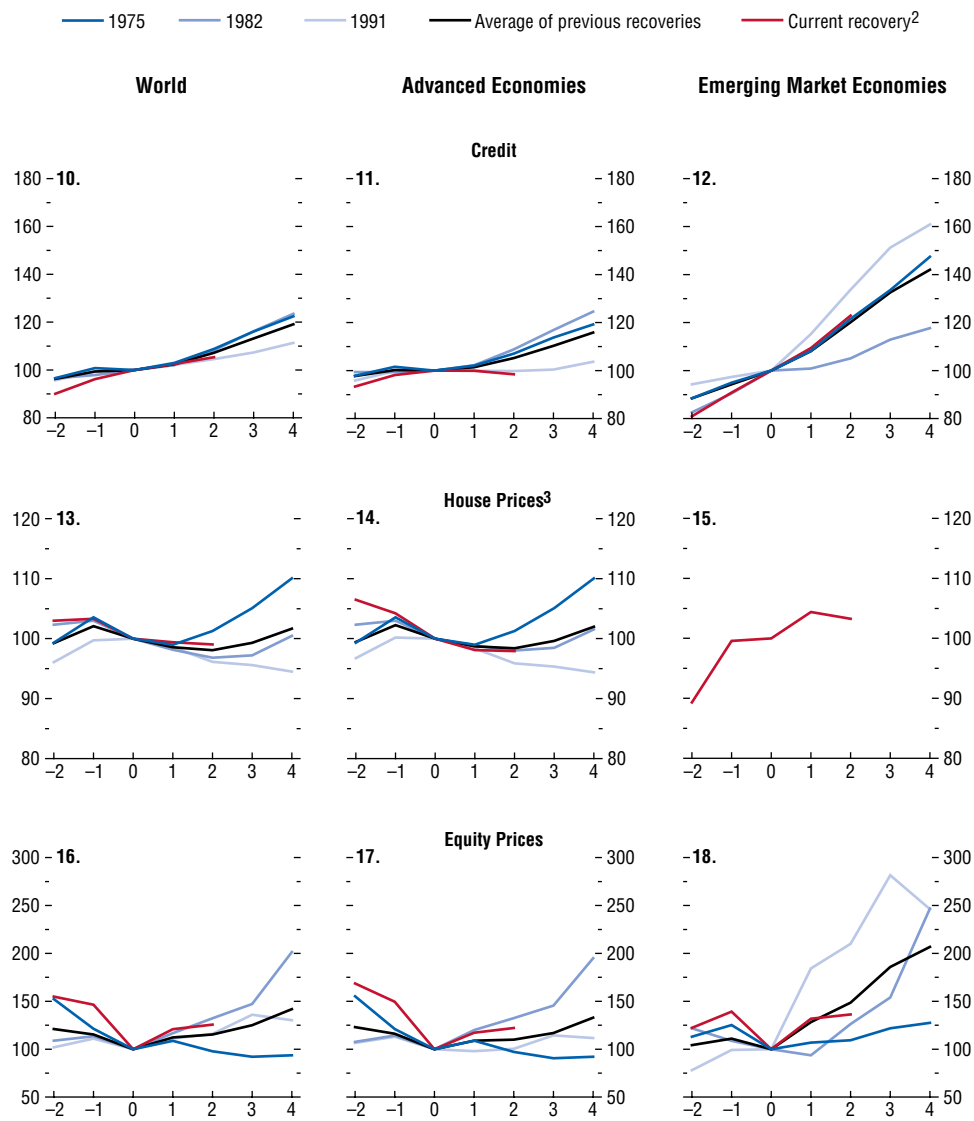


(figure continues)

**Box 1.2. (continued)**

**Figure 1.2.1. Dynamics of Global Recoveries: Selected Variables<sup>1</sup>(concluded)**

(Years on x-axis; t = 0 in the year of the trough; indexed to 100 at the trough; in real terms unless noted otherwise)



Source: IMF staff estimates.

<sup>1</sup>Aggregates for GDP are purchasing-power-parity-weighted per capita real GDP indices. Aggregates for total trade are trade-weighted real trade indices. Aggregates for unemployment rate are labor-force-weighted unemployment rates in percent. Aggregates for real credit, real house prices, and real equity prices are market-weighted by GDP in U.S. dollars.

<sup>2</sup>Dashed lines denote WEO forecasts, where available.

<sup>3</sup>House price series for the previous global recoveries are not available for emerging market economies.

**Box 1.2. (continued)**

part the legacy of the global financial crisis, particularly the ongoing need for balance sheet repair in the household and financial sectors.<sup>8</sup> Specifically, the 2012 forecast of economic activity, if realized, would mean that the current recovery is the weakest for advanced economies during the postwar era. In a number of advanced economies, output has not yet rebounded to the levels observed before the recession, unemployment remains well above historical norms, and cumulative growth in consumption and investment has been much smaller.

Another distinct feature of the current recovery is a sharp and sustained contraction in investment in structures in advanced economies. The severity of the contraction can be traced to deterioration in the credit and housing markets. Still, developments in these market segments have thus far not been significantly worse than after the 1991 recession.

Interestingly, equity markets have performed better on average than after previous recessions. One explanation is that many nonfinancial corporations now operate on a global level and have benefited from the overall improvement in global activity, particularly in emerging markets—which, as noted, have recovered better than after previous worldwide recessions.

**Advanced Economies: Reliving the Early 1990s?**

Despite the fact that the Great Recession was markedly more severe than the 1991 global recession, the underlying causes of these two episodes and the evolution of activity during the succeeding recoveries are remarkably similar for the advanced economies.

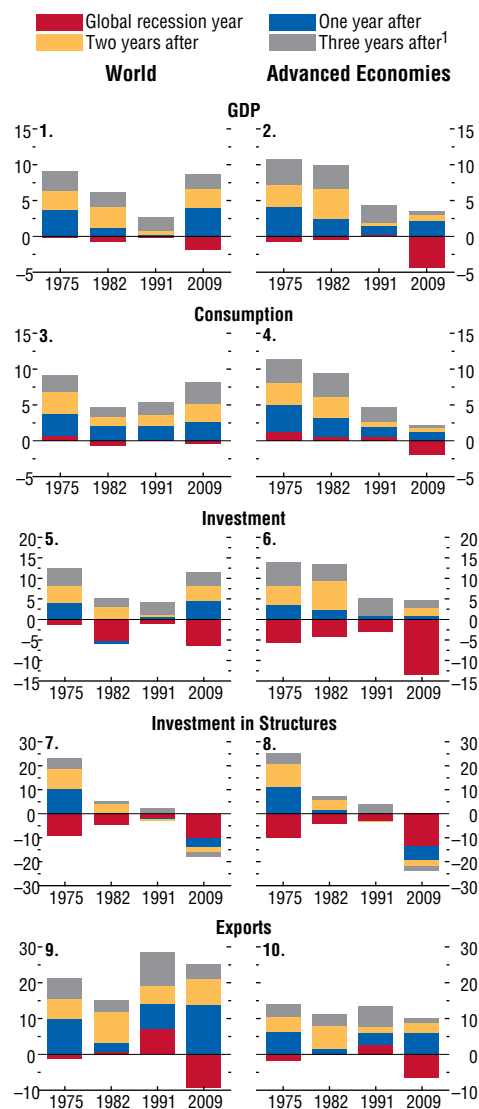
- These two recoveries were preceded by recessions associated with a bust in credit and housing markets in key advanced economies.<sup>9</sup> In particular, the 1991 recession was associated with disrup-

<sup>8</sup>In many ways, this outcome was expected. For example, Claessens, Kose, and Terrones (forthcoming) present evidence suggesting that recoveries following turmoil in financial markets tend to be weaker. They also find that recoveries associated with rapid growth in credit and house prices are often stronger.

<sup>9</sup>Before both the 2008–09 global financial crisis and the ERM crisis, advanced economies experienced highly synchronized credit booms (Mendoza and Terrones, forthcoming).

**Figure 1.2.2. Growth during Global Recessions and Recoveries: Selected Variables**

(Annual percent change; in real terms)



Source: IMF staff estimates.

Note: Each bar represents the percent change in the respective variable in the years of the global recessions and recoveries.

Growth rates of all variables, except exports, are per capita and weighted for purchasing power parity. Investment in structures includes both residential investment and other buildings and structures. Export growth is weighted by the U.S. dollar value of total trade as a share of the group's total trade.

<sup>1</sup> Figures for 2012 (global recession year 2009) are forecasts.

**Box 1.2. (continued)**

tions in credit and asset markets in the United States and Japan. Similarly, the Great Recession involved severe problems in credit and housing markets in the United States and a number of other advanced economies, including Ireland, Spain, and the United Kingdom.

- Both recoveries were slowed down in part by challenges in Europe. The earlier recovery episode was shaped by downturns in many European economies during the European Exchange Rate Mechanism (ERM) crisis of 1992–93. Interest rates had to be raised during that period to defend the exchange rate arrangement, and several advanced European economies were forced to reduce their large fiscal deficits. This suppressed economic activity and further depressed credit and housing markets in the region. Currently, high sovereign risk premiums are inflicting similar or even worse damage on fiscal balances and growth. In both cases, lack of a timely, credible, and coordinated policy strategy heightened the financial turmoil.
- The trajectories of the two recoveries were quite similar because advanced economies experienced meager growth in both cases. In part, this is a result of the disappointing growth in domestic consumption and investment driven by the legacy of the financial crisis—balance sheet repair, weak credit expansion, and lingering problems in housing markets—and loss of competitiveness in some economies. Both episodes are also marked by persistently high unemployment.<sup>10</sup> However, considering the

<sup>10</sup>Loungani (2012) discusses evidence for the theory that the drop in output through aggregate demand channels

deep fall in output in 2009, the rise in unemployment has been more limited. This is particularly true in Europe and may well reflect policies involving more job-friendly wage setting and greater labor hoarding in some of these economies.

**Conclusions**

Although the strong rebound in world output during this global recovery is comparable with previous episodes, the divergence of advanced and emerging market economies' fortunes sets the current recovery apart. Emerging market economies have rebounded strongly and have been the engine of world growth during this recovery. The robust performance of these economies can be explained in part by their strong macroeconomic frameworks and structural reforms.

In contrast, for advanced economies, the current recovery is predicted to be the weakest of the postwar era. The trajectory of the ongoing recovery in advanced economies has so far paralleled the recovery following the 1991 recession to a surprising degree. Both of these recoveries were hampered by housing and financial market problems in these economies. These problems are likely to continue sapping the strength of the recovery unless policymakers adopt stronger policies to address them.

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explains much of the increase in unemployment in advanced economies. For the United States, labor market slack could be better reflected in the persistent drop in the employment-to-population ratio.