__Patterns of recession and recovery__

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The fall in output in the current recession has been sharp. In the United States, for example, in the most two recent quarters GDP fell at an annual rate just above 6 per cent. In Japan, GDP is down by nearly 9 per cent on its 2008 first quarter peak. The latest data for the UK suggest output is down nearly 6 per cent on a year ago, the sharpest fall since 1931.

The conventional wisdom is that the steepness of the fall means that the recession will be a long one, and that the recovery when it happens will be anaemic. NIESR, for example, despite having previously called the end of the recession in the March of this year, argued last week that GDP per head will take 5 years to get back to pre-recession levels.

In the US, the consensus amongst forecasters is that growth at or near trend will not be resumed until the second half of 2010, and the 2008 second quarter peak level will not be regained until the first half of 2011.

In the UK, the official government forecasts have been widely criticised as being too optimistic. After a projected fall in GDP of 3.5 per cent in 2009, the government predicts a rise of 1.25 per cent in 2010 followed by 3.5 per cent in 2011.

The historical evidence reveals a typical pattern of recession and recovery which suggests that, just as economic forecasters were far too optimistic about prospects for 2009 even as late as the autumn of 2008, they now seem too pessimistic about recovery profiles. Very few recessions last longer than two years. And most recoveries, once they do start, are strong.

Since the late 19th century, there have been 255 individual examples of recessions in the Western economies. Of these, 164 have lasted just one year and only 32 have lasted for more than 2 years. In other words, two thirds of recessions last for a single year, and only one in every eight lasts for more than two years. If we strip out the peculiar circumstances at the end of the two world wars, no fewer than 70 per cent of all recessions last for just one year.

The pattern of duration is virtually identical regardless of the size of the initial shock.

Even when the initial fall has been large, in excess of 6 per cent, 70 per cent of recessions have lasted just a single year. So the fact that this is approximately the recent annual rate of contraction in America, for example, does not necessarily indicate that the recession will be long lived. Even in the 11 examples in where the initial fall in GDP was more than 8 per cent in a year, 8 of them only lasted that single year.

This does not of course guarantee that the current recessions in Western economies will also be short-lived, but equally the speed of the fall does not by any means imply that the recessions will be long.

Focusing on recessions since the Second World War, analysis shows that for recessions with only short duration, the typical recovery pattern is rapid. The average growth rate in the year after the recession was 3.5 per cent, and in the subsequent year 3.8 per cent.

So in general once recovery starts it is strong. This is compatible with the view that short recessions are essentially inventory cycles. Once inventories are reduced to satisfactory levels, normal production levels resume, and fixed capital investment expenditures postponed during the recession are carried out.

The 4.8 per cent GDP growth rate projected by the UK government 2009 – 2011is the object of criticism for being too optimistic. It is in fact a rather modest recovery in this wider context.

Recovery was rapid even after the economic catastrophe of the Great Depression. The experience of the Great Depression itself varied enormously across countries, both in size and duration. The UK escaped relatively lightly with a 6 per cent fall in output spread over two years. In Japan, Denmark and Norway the recession lasted only a single year. But in Germany, Austria, Canada, and the US, the cumulative fall in output was between 25 and 30 per cent, with the recession lasting four years in the latter three countries and three in Germany.

However, once the recovery began – in different calendar years in different countries – the average rate of growth was strong. GDP growth in the first year after the Great Depression averaged 4.7 per cent, followed by 4.6 per cent in both the second and third years.

The caveat to all this is that the current circumstances are unusual. But so was the Great Depression. There is some evidence to suggest that, beyond a critical duration or cumulative size of recession, exit from the recession becomes harder and more sluggish.

Keynes' animal spirits become depressed. But it takes an awful lot to depress them for more than a couple of years. Capitalism seems a pretty resilient beast.

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