

ARTICLE

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Output and expenditure in the last three UK recessions

SUMMARY

This article describes the main features of the last three UK recessions using the output and expenditure measures of Gross Domestic Product (GDP) to reflect supply and demand activity in the economy. The most recent recession saw a similar peak to trough fall in GDP as the early 1980s recession. Both these recessions, which coincided with a period of downturn in the global economy, were more severe than the early 1990s recession where the peak to trough fall in output was relatively modest. The services sector made a larger contribution to the latest recession than before, perhaps reflecting the growing share of the sector in total UK output and its strong growth in the years leading up to the downturn. Falling output of business and financial services were a particular feature of the most recent recession. Looking at the expenditure side, gross fixed capital formation, and in particular business investment, was a greater contributor to the fall in GDP in the most recent recession than in the early 1980s and early 1990s recessions.

The latest Preliminary estimate of Gross Domestic Product (GDP) reported that the UK economy grew by 1.1 per cent in the second quarter of 2010 – the third successive quarter of positive growth. This follows the severest recession since the Second World War, when between 2008 Q1 and 2009 Q3, GDP contracted for six successive quarters as the level of output fell from peak to trough by 6.4 per cent. Now that it appears a recovery is underway, and following recent publication of the Blue Book where National Accounts are benchmarked to more reliable annual data sources, it seems a good time to take stock of what happened in the latest recession.

This article compares the features of the recent UK recession with those experienced in the early 1980s and 1990s. The focus is on a description of the output and expenditure measures of GDP, which relate to measures of supply and demand in the economy. In doing so, chained volume measures (CVM) are used, which are the methodologically preferred estimates of real (that is adjusted for price changes) activity. Other aspects of the UK economy, such as the labour market, inflation and financial and asset prices are not part of the article's scope. In fact, three articles on the performance of the labour market in the recession (see Jenkins 2010, Gregg and Wadsworth 2010a and Gregg and Wadsworth 2010b) and one on the impact of the recession on households (see Howell, Leaker and Barrett) are published in this edition of *Economic & Labour Market Review*.

Of course, dating recessions is an

incomplete science, and here much depends on the definition being applied. Data revisions can also complicate matters by changing the perceived history of economic time series, meaning that dates of past cycles may also change over time. For these reasons dating business cycles is often a precarious task, even with the benefit of hindsight. The Business Cycle Dating Committee, based at the National Bureau of Economic Research (NBER) which is the leading association of academic economists in the US and considered to be a global authority on business cycle dating, still updates the start and end point of the early 1980s recession even though almost three decades have passed. **Box 1** describes how the NBER defines a period of economic recession.

Recessions compared: GDP

GDP is the total output or expenditure in an economy, with economic growth referring to changes in GDP. Although there is no universally accepted definition of a recession, a technical definition based on two successive quarters of falling GDP, has gained some broad appeal. If a recession is a sustained fall in output, then the 'two quarters' rule would, in effect, rule out idiosyncratic shocks that have a one-off, temporary and short-term impact on GDP being classed as recessions. Only if those shocks generate a persistent downturn, would they be described as recessionary.

However, the two quarters rule may not always provide a clear cut prognosis of when a recession has occurred. For

Box 1

Recessions: how are they defined?

The Business Cycle Dating Committee (BCDC) at NBER defines a recession as 'a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales'. In terms of dating - 'a recession begins just after an economy reaches a peak of activity and ends as the economy reaches its trough. Between trough and peak, the economy is in an expansion. Expansion is the normal state of the economy; most recessions are brief and they have been rare in recent decades'.

Because a recession influences the economy broadly, and is not just confined to one sector, the BCDC emphasises economy-wide measures of economic activity. For this reason, real GDP is regarded as the best single measure of aggregate economic activity. In determining whether a recession has occurred and in identifying the approximate dates of the peak and trough the BCDC usually places considerable weight on estimates of real GDP.

However, the BCDC also tries to maintain a monthly chronology of the US economy and GDP is only available quarterly. For this reason, a variety of monthly indicators are also used to determine the monthly peaks and troughs. Two monthly measures across the entire economy are given particular emphasis:

- personal income less transfer payments in real terms
- employment

In addition, two further indicators are considered:

- industrial production
- volume of sales of the manufacturing and wholesale retail sectors adjusted for price changes

Most recessions identified by the BCDC fit into the 'at least two quarters of falling GDP' rule. However, this need not always be the case. If a recession is characterised as 'a significant decline in economic activity' then depth as well as duration of the recession is also considered. Also a broader array of indicators than just GDP are used, although there are no fixed rules as to how data other than real GDP are weighted as part of the assessment. However, unemployment is considered to be a lagging indicator so of less use than direct output-based measures of economic activity.

The BCDC also makes clear that recessions are defined as a period of diminishing rather than diminished activity - hence why dates are based on the peak to trough calculation. Diminished activity is essentially when the level of activity is below normal (trend), so obviously part of the expansion will be when the economy is below trend as well as part of the contraction being when the economy is above trend.

A final and important feature of the BCDC is that they are very patient about calling the start and finish of recessions, typically waiting 6 to 18 months in each case so as to leave the peak and trough dating in as little doubt as possible. This will also allow for revisions to early estimates of GDP to be made.

example, in 1979 Q3 the UK economy contracted by 2.4 per cent before rebounding by 1.0 per cent in the next. The economy then contracted for the next five successive quarters. Here, strict implementation of the two quarters rule would start the recession in 1980 Q1, but on a peak to trough basis, the recession started in 1979 Q3.

Box 2 looks back at the history of UK economic growth, showing there to have been many instances when the economy has contracted for one or two quarters. These occurrences have become less common in recent decades as the quarterly path of GDP has become less volatile. There are several reasons why these very short term falls in GDP are seen less frequently. First, the relative contribution of the production sector in total output has steadily declined. As the output of these industries is more lumpy, sensitive to overseas demand and significantly influenced by changes in stock holdings, it tends to be more erratic than services output. Second, economic policy has changed, with less aggressive intervention by government policy attempting to influence economic output. Instead, active demand management has

given way to policy designed to promote nominal or inflation stability.

In this article, recessions have been defined as the periods in which the peak to trough fall in output or expenditure are observed. This is broadly consistent with the NBER approach described in Box 1, but in doing so, it is not intended to argue that this approach is necessarily superior to other ways of defining recessions. It just gives an operational basis for defining the periods of economic downturn. Other descriptions, perhaps based on the persistence of a downturn or the time it takes output to fully recover are often used. Wider ranges of variables, often focussing on labour market outcomes like employment or unemployment, are also popular in emphasising the more social aspects of a recession.

Figure 1 plots an index of output during the most recent recession and compares it to output indices for two previous recessions of the early 1980s and early 1990s. In each case, the peak level of output prior to the recession is indexed equal to 100. Between 2008 Q1 and 2009 Q3, GDP fell by a total of 6.4 per cent over six successive quarters. In contrast, the peak

to trough fall in GDP between 1990 Q2 and 1992 Q2 of 2.5 per cent was less severe, although it took eight quarters for GDP to eventually reach a trough. Based on the magnitude of the drop in GDP, the latest recession is more similar to that of the early 1980s. From 1979 Q2 to 1981 Q1, GDP saw a peak to trough fall over seven quarters of about 5.9 per cent.

Having reached a trough, the output indexes in Figure 1 are then extended until GDP reaches its pre-recession level (that is an index of 100). Obviously, the current level of GDP is still below its level in 2008 Q1, so for the latest recession this tracker only extends up to the latest published data. But for the previous two episodes it can be seen how long it took for output to fully recover.

Although the fall in output was not as severe in the early 1990s recession, the economy remained near the trough for a number of quarters before starting to recover. GDP eventually surpassed its 1990 Q2 level in 1993 Q3. While the 1980s recession was much deeper, the rebound was also much sharper. However, due to the depth of the recession, it still took 10 quarters until 1983 Q3 for GDP to fully

Box 2

A brief history of UK downturns

There have been four major UK recessions in the post Second World War period. As well as the three identified in this article, there was a fourth in 1973-75. This was effectively two recessions within a recession (double dip). Initially the UK economy contracted from by 3.4 per cent from 1973 Q2 to reach a trough in 1974 Q1. After two quarters of relatively strong growth in 1974 Q2 and Q3, but before the pre-recession level of output was reached, the economy then contracted for three of the next four quarters reaching a further trough in 1975 Q3 where the level of GDP was 3.3 per cent lower than in 1973 Q2.

Previous recessions were much more short lived- and often neighboured by quarters of strong growth.

The UK economy experienced three successive quarters of negative growth between 1956 Q1 and 1956 Q3, registering a peak to trough fall in output of 1.4 per cent.

There have been two periods where the economy has contracted

for two successive quarters. In 1957 Q2 and 1957 Q3 the level of GDP shrunk by a total of 0.9 per cent, and in 1961 Q3 and 1961 Q4 the level of GDP fell by a total of 0.7 per cent.

There have been 12 occasions when the UK has experienced a single quarterly fall in GDP that was not part of a longer downturn. These were 1958 Q2, 1960 Q2, 1962 Q4, 1965 Q1, 1966 Q4, 1968 Q2, 1970 Q1, 1971 Q1, 1976 Q2, 1977 Q2, 1979 Q1 and 1984 Q2. However, in some of these instances the single quarter contraction in GDP was actually larger than the two or three quarter falls in output. For example, in 1958 Q2 GDP fell by 2.6 per cent, and in 1960 Q2 it fell by 1.1 per cent. It should be noted though that, in both of these two cases, the quarter of significant contraction was neighboured by periods of strong quarterly growth.

Table 1 provides a summary of UK recessions and single quarters of contractions in GDP.

Box 2 Table 1
UK recessions and single quarters of contraction

UK recessions						Percentages				
						Single quarters				
Quarter	GDP growth (per cent)	Peak to trough fall (per cent)	Quarter	GDP growth (per cent)	Peak to trough fall (per cent)	Quarter	GDP growth (per cent)	Peak to trough fall (per cent)	Quarter	GDP growth (per cent)
1956 Q1	-1.1	-1.4	1979 Q3	-2.4	-5.9	2008 Q2	-0.3	-6.4	1958 Q2	-2.6
1956 Q2	-0.2		1979 Q4	1		2008 Q3	-0.9		1960 Q2	-1.1
1956 Q3	-0.1		1980 Q1	-0.9		2008 Q4	-2.1		1962 Q4	-0.4
			1980 Q2	-1.8		2009 Q1	-2.3		1965 Q1	-0.3
1957 Q2	-0.1	-0.9	1980 Q3	-0.2		2009 Q2	-0.7		1966 Q4	-0.4
1957 Q3	-0.8		1980 Q4	-1.1		2009 Q3	-0.3		1968 Q2	-0.7
			1981 Q1	-0.7					1970 Q1	-0.9
1961 Q3	-0.6	-0.7							1971 Q1	-1.2
1961 Q4	-0.2		1990 Q3	-1.2	-2.5				1976 Q2	-0.8
			1990 Q4	-0.6					1977 Q2	-0.5
1973 Q3	-0.8	-3.3	1991 Q1	-0.1					1979 Q1	-0.8
1973 Q4	-0.2		1991 Q2	-0.3					1984 Q2	-0.7
1974 Q1	-2.5		1991 Q3	-0.4						
1974 Q2	1.9		1991 Q4	0.1						
1974 Q3	1		1992 Q1	0.1						
1974 Q4	-1.2		1992 Q2	-0.2						
1975 Q1	0.3									
1975 Q2	-1.6									
1975 Q3	-0.2									

Source: GDP Preliminary estimate

recovery to its pre-recessionary level. The shape of the recent downturn, so far, is similar to that of the early 1980s. As a benchmark, for the economy to recover at the same rate (that is reach its 2008 Q1 level by 2012 Q2), it would have to grow at an average quarterly rate of 0.6 per cent from here onwards. Despite three quarters of positive growth, GDP in 2010 Q2 is still 4.7 per cent below its 2008 Q1 level.

When thinking about the severity of a recession the term 'loss in output' is often used. Peak to trough falls give

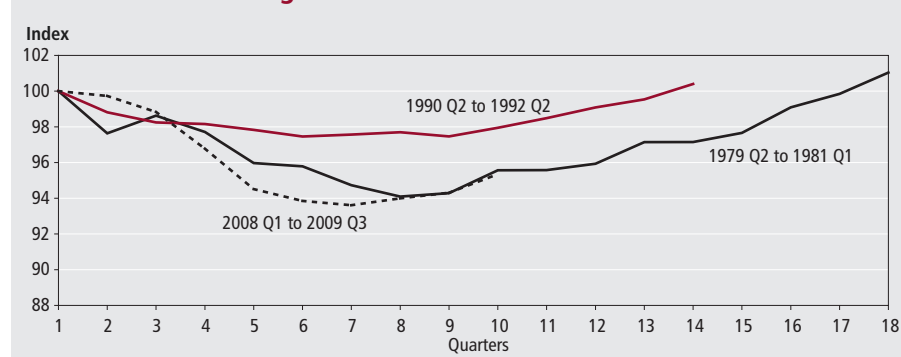
one interpretation of this, describing the magnitude of the total fall in output. However, loss of output could also refer to the persistence as well as depth, measuring the cumulative loss relative to the pre-recession, or perhaps trend, level.

If the cumulative or total loss of output is judged relative to the pre-recession (quarterly) level it would be shown in the area above the output index line but below the Index = 100 part of the recession tracker. For example, the cumulative loss in output during the 1980s recession was

around 53 per cent (that is the average depth of the recession was 3.3 per cent below the pre-recession level of output in 1979 Q2 for a total of 16 quarters). For the early 1990s recession, the cumulative loss in output was 22 per cent, based on an average depth of 1.8 per cent below the pre-recession level of GDP in 1990 Q2 for a total of 12 quarters. So far, the cumulative loss in output relative to the 2008 Q1 level is 39 per cent.

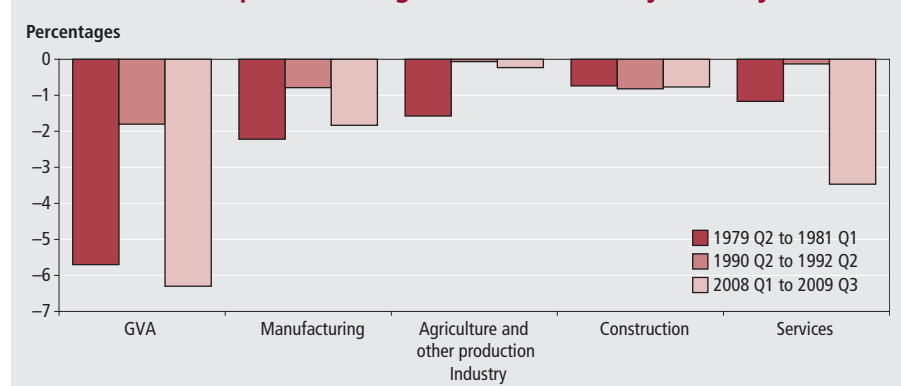
A variant of this approach, which has been used by several organisations

Figure 1
UK recession tracking: Gross Domestic Product



Source: GDP Preliminary estimate

Figure 2
Contributions to peak to trough falls in UK GDP by industry



Source: GDP(O) database

Table 1
Average quarterly growth in value-added, 1992 Q3 to 2008 Q1

Sector	Average growth rate (per cent)
GVA/GDP	0.7
Agriculture	-0.1
Total production	0.2
Mining and quarrying	-0.2
Manufacturing	0.2
Electricity, water and gas	0.5
Construction	0.5
Total services	0.9
Wholesale and retail distribution	0.7
Transport and communications	1.5
Business services and finance	1.3
Government and other services	0.4

Source: GDP(O) database

including the International Monetary Fund, is to judge the depth and duration of a recession against the trend rather than the pre-recession level of output. That is against what it otherwise would have been had the economy kept moving along its long-term trend path. This makes a potentially large difference. The position from which an economy starts to contract is often above trend, so therefore the 'loss of output' commences later as the initial fall in output is simply a trend correction. However, the persistence of the downturn

becomes more important. As the trend level of output is assumed to keep growing, the longer the economy remains below trend the higher the level of output the economy has to eventually recover to. An added complication here is the difficulty in forming trend growth assumptions, for which judgement is usually required. Furthermore the trend growth rate may undergo a structural change due to the downturn having persistent effects on economic activity. For example, if an increase in long term unemployment

during a recession leads to lower job search intensity and skill degradation there may be persistent effects for labour market outcomes and the supply side of the economy (hysteresis).

Comparing UK recessions: output measures

Breakdowns of the peak to trough falls in Gross Value Added (GVA which is the production-based measure of GDP¹) during the last three UK recessions, by main industrial sector, are presented in **Figure 2**. These confirm the relative severity of the recent and early 1980s recessions compared to the early 1990s recession. However, although peak to trough falls in GDP were around 6 per cent in the two recessions, 1979 Q2 to 1981 Q1 and 2008 Q1 to 2009 Q3, the composition was different. The earlier recession appears to have been more concentrated in production (including manufacturing), whereas recently, it has been the services sector that has driven the downturn.

To some extent, this reflects the large structural change in the composition of UK output over the last three decades towards services. According to 2006 weights the services sector accounts for 76 per cent of total Gross Value Added (GVA), compared to 58 per cent in the 1985 weights – an 18 percentage point increase in 21 years. As more UK output is accounted for by the services sector, it is unsurprising it will play a larger role in any downturn than previously.

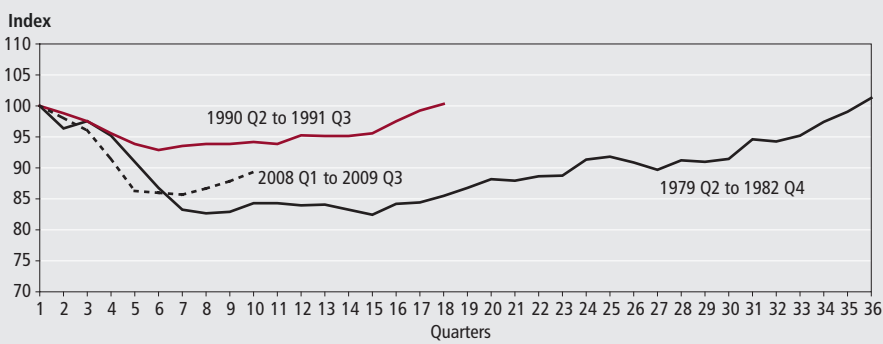
Contributions to the downturn may also partly reflect the speed at which sectors grew beforehand. As **Table 1** shows, Britain's long economic expansion between 1993 and 2008 was largely concentrated in the services sector. If an economy is above trend as it starts to contract, the sectors that exhibited the fastest growth in the lead up to the downturn may be more prone to correction, especially if they invested significantly in extra capacity on the proviso that strong growth would continue unabated.

UK recessions compared: manufacturing output

Indices tracking manufacturing output through the recent and past recessions are shown in **Figure 3**.

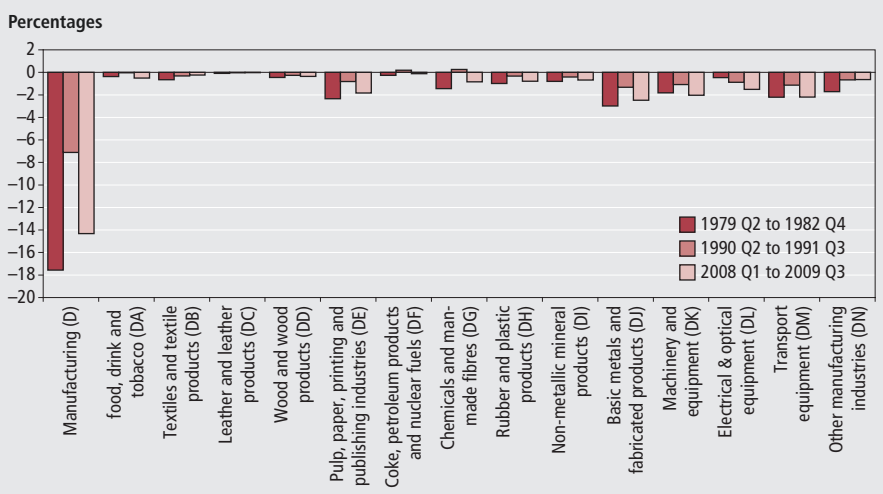
Between 1979 Q2 and 1982 Q4, manufacturing output fell sharply, registering a peak to trough fall of 17.6 per cent. In line with the smaller drop in GDP, manufacturing output fell from peak to trough (1990 Q2 to 1991 Q3) by a smaller

Figure 3
UK recession tracking: manufacturing output



Source: GDP(O) database

Figure 4
Contributions to peak to trough falls in UK manufacturing



Source: GDP(O) database

every sector contributing to the overall decline. The patterns of falling output have also been similar, with the largest contributions stemming from the fabricated and metal products (DJ) and the allied and engineering industries (machinery (DK), electrical and optical (DL) and transport (DM)).

These four categories of manufactures are the primary inputs into capital goods. Fabricated metal products are the main component into building structures. Machinery, electrical and optical equipment constitute a major part of plant and machinery investment. And transport equipment is largely, although not exclusively vehicles. Spending on these items, tending to be lumpy and irreversible, are very sensitive to the economic outlook. Therefore the sharp fall in fixed investment expenditure during recessions will pass through in lower orders for these capital goods producing industries.

Similar trends, albeit on a lower magnitude, were also reported during the early 1990s recession as domestic investment spending contracted. However, the fall in manufacturing output during this recession was not uniform. Small positive contributions to growth came from the coke, petroleum and nuclear fuels (DF) and the chemicals and man-made fibres (DG) industries.

Figure 2 shows, that following the early 1980s recession, manufacturing output took a long time to completely recover to its pre-recession level. It was not until 1988 Q1, over five years after the end of the recession, that output fully recovered. This recession had a profound impact on the structure of the UK economy, prompting large shift away from manufacturing to services. Therefore, much of the output lost during the recession was lost forever, partly explaining why the drop in output was so persistent. In fact, output in a number of UK manufacturing sectors have failed to reach their pre 1980s recession level, indicating that movements in manufacturing output over the last three decades have been structural as well as cyclical.

Within the manufacturing sector there have been large structural shifts in the composition of output between the eve of the 1980s recession (1979 Q2) and the eve of the latest recession (2008 Q1). As shown in Table 2, the overall level of output was 18.6 per cent higher but there were large variations at lower industry levels. For example, output in the chemicals and man-made fibres and electrical and optical equipment approximately

7.1 per cent in the early 1990s recession. In the most recent recession, manufacturing output fell by 14.3 per cent between 2008 Q1 and 2009 Q3.

A factor very pertinent to manufacturing output, which differentiates the early 1990s recession from the other two, is the extent that recessions are global. Both the recent and early 1980s UK recessions coincided with a global economic downturn, with the majority of industrialised countries entering a synchronised recession. As a result, global trade fell sharply and because a large proportion of manufacturing output tends to be traded, this sector is then more severely affected. In the early 1990s, the UK recession did not coincide with a world-wide downturn. In fact, growth in the rest of the world was fairly robust over the period. So although output weakened in line with domestic demand, it continued to be supported, to a degree, by external demand.

A noticeable feature is that the peak to trough falls in manufacturing output tend to be significantly larger than the corresponding drops in GDP. Therefore,

manufacturing output accounts for a relatively large part of the change in output during the cycle given its share in the level of GDP. One factor at play here is stockbuilding. The manufacturing sector holds stocks of inventories, which are raw materials, semi-finished goods and finished goods. As the economy enters recession, expecting future output to fall, firms meet existing orders by running down stocks rather than through production. Consequently, production falls quickly, often abruptly. On the other hand, as the economy emerges from recession and begins a sustained recovery, production will rise sharply to meet higher expected future orders and also to rebuild stock levels. The workings of what is commonly termed as the 'stocks cycle' tends to amplify cyclical movements in manufacturing output.

Figure 4 decomposes the total peak to trough fall in manufacturing output in each recession to the respective contributions of each industry. Clearly the large output falls during the recent and early 1980s recessions have been broad-based, with

Table 2
Structural change in UK manufacturing

Industry	Output index (2008 Q1)
Total manufacturing	118.6
Food, drink and tobacco	118.6
Textiles and textile products	42.5
Leather and leather products	23.8
Wood and wood products	91.5
Pulp, paper, printing and publishing	119.7
Coke, petroleum and nuclear fuels	94.3
Chemicals and man-made fibres	199.6
Rubber and plastics	144.6
Mineral processing	103.4
Metals and fabricated goods	85.9
Machinery and equipment	90.7
Electrical and optical equipment	201.1
Transport equipment	133.4
Other manufacturing	77.2

Source: GDP(O) database

might simply accelerate change in this direction. Buisan et al (2006) report the UK's increasing share in global manufacturing exports in medical, pharmaceuticals, radio, television, office machinery and computers. But the shares in global exports of manufactures including motor vehicles, clothing and footwear have fallen. Chamberlin (2008) argues that this has also been reflected in the significant improvement in the UK's terms of trade, particularly over the last 15 years. Import prices in more basic manufactured goods have fallen, driven by increasing competition from low cost producers in emerging markets. At the same time export prices in services and more specialised manufactured goods, where the UK's comparative advantage lies and quality matters as much as price for competitiveness, have actually been growing.

UK recessions compared: construction output

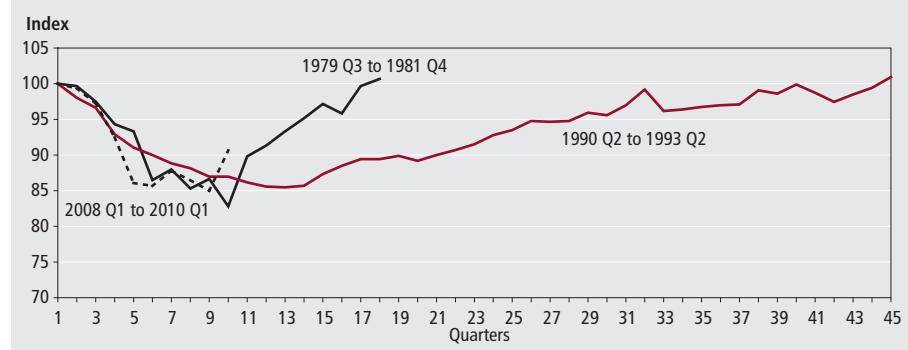
In the three previous recessions, peak to trough falls in construction output have been fairly similar (see Figure 5). This is also shown in Figure 2 where the contributions of the construction sector to the overall fall in GVA were close to 0.8 percentage points each time.

Between 2008 Q1 and 2010 Q1 output fell by 15.0 per cent, similar to the 14.5 per cent fall recorded between 1990 Q2 and 1993 Q2. In the early 1980s, construction output registered a peak to trough fall of 17.2 per cent between 1979 Q3 and 1981 Q4. Although this recession was deeper, the recovery was quicker. In comparison, the length of time it took construction output to recover from the early 1990s downturn was particularly striking. Output remained below its pre-recession level for a total of 44 quarters, finally exceeding the 1990 Q2 level in 2000 Q2.

The contributions of each category of construction output to the total peak to trough falls are shown in Figure 6. Note, that this slightly differs from the National Accounts measures in Figure 5 as the data corresponds to Great Britain rather than the UK.

Falling output in 'new work' generally accounts for most of the peak to trough falls. In the early 1980s recession this was more concentrated in the house building sector (specifically public housing), whereas in the latter two recessions falling new work in the private commercial sector and house building sectors have been more significant. The importance of the

Figure 5
UK recession tracking: construction output



Source: GDP Preliminary estimate

Figure 6
Contributions to peak to trough falls in GB construction



Source: Output in the construction industry

doubled. There were also notable increases in rubber and plastics and transport equipment. Significant reductions though were recorded in the textile industries, basic metals and fabricated products, other manufacturing and machinery and equipment.

Longer term trends in UK manufacturing output have tended to reflect the UK's comparative advantage in international trade – shifting away from assembly and basic manufactures towards petrochemicals and more advanced optical and electronic equipment. An economic downturn

commercial construction sector in the last two recessions probably reflects the growing importance of services, especially business, finance and retailing, in the overall economy.

This figure though tends to underplay falls in private house building output, as in this segment the peak to trough fall tends to lead the rest of the sector. For example, between 1988 Q2 and 1991 Q1 private house building registered a peak to trough fall of 53.8 per cent, but this period only slightly overlaps the period 1990 Q2 to 1993 Q3 when construction output as a whole saw its peak to trough fall. In contrast, peak to trough falls in private house building output were 40 per cent between 1978 Q2 and 1981 Q4; and 44.2 per cent between 2006 Q4 and 2009 Q3.

In the last two recessions there have been clearer associations between house prices and activity in the construction sector and the wider economy, with house price movements generally preceding the latter.

According to the Nationwide house price index, average house prices increased by 12.3 per cent between 1979 Q2 and 1982 Q2 (although in real terms they actually fell by 17.0 per cent due to high inflation at the time). The next two recessions though exhibited strong falls in both *nominal* and *real* house prices. Between 1989 Q3 and 1993 Q1 Nationwide house prices were down by 20.2 per cent in nominal terms (33.2 per cent in real terms). Based on the same index, house prices fell by 18.7 per cent between 2007 Q3 and 2009 Q1 (20.2 per cent in real terms due to relatively low inflation).

The latter two recessions though occurred in a very different financial environment to that of the early 1980s. Financial markets deregulation in the early and mid 1980s prompted a significant easing in the availability of credit, which has strengthened the rapid rate of house price increases in the upturn, but also resulted in larger nominal falls in the downturn. This implies that the credit cycle is pro-cyclical, strengthening the role of the housing market in the overall business cycle. Between 1986 Q1 and 1989 Q3 nominal prices had risen by 76.1 per cent; and between 1996 Q1 and 2007 Q3 nominal prices were 258.5 per cent higher. Furthermore, in this second period general inflation was relatively low, meaning there was also a spectacular increase in real prices.

Volatility in house prices appears to have been strongly transmitted into housing demand and then construction. Rising

prices encourages demand, and mortgage lenders become more willing to lend due to the rising prices of property on which the loans are secured. One of the hallmarks of the last two housing market booms has been a financial sector that has supported stronger lending even as the ratio of house prices to income grows. Numbers of mortgage approvals and property transactions have moved in tandem over the last two decades (see Chamberlin 2009a). Naturally, rising prices and demand encourages the house building sector, and as discussed in **Box 3**, there was a surge in new dwelling completions during the up phase of the market.

In the down phase of the cycle though these dynamics can change direction rather abruptly, with prices and construction output falling quickly. **Box 3** also identifies the increased cyclicity in new dwelling completions in the post financial deregulation era. This may also contribute to the long protracted slump in construction output experienced after the early 1990s recession as portrayed in **Figure 5**. Surges in house building and prices increases both the stock of houses available and also the level of debt (secured) held on the balance sheets of the household sector. Both of these may then generate a significant hangover in a subsequent downturn, weighing on supply and demand for a considerable period of time while stocks are cleared and balance sheets strengthened.

When looking at construction output it is also important to bear in mind that just under half the level reflects repair and maintenance work. As **Figure 6** shows, this also contributed negatively to the peak to trough fall in output, especially in the early 1990s recession, but the impact is less than new work. In fact, repair and maintenance work tends to be more stable over the cycle. It is natural to assume that in a downturn, when faced with reduced cash flow and tighter credit conditions, households and businesses may choose to delay repair and maintenance spending. However, efforts to economise may also generate some substitution in construction demand towards the repair and maintenance of existing buildings and away from new projects.

UK recessions compared: services output

As shown in **Figure 7**, the decline in services sector output has been more pronounced in the most recent recession than before.

Between 1979 Q2 and 1980 Q4 service sector output fell by 2.4 per cent. The largest negative contribution came from the distribution sector, where output of wholesale and retail distribution fell by a total of 13.3 per cent (**Figure 8**), and the other services category which includes a number of miscellaneous services including personal recreation and culture. These trends are consistent with the sharp drop in consumer spending during the period. However, the business services and finance sector made a strong positive contribution to services output during this period, up 5.3 per cent..

The fall in service sector output in the early 1990s recession was relatively small. Peak to trough, the total decline was 1.0 per cent between 1990 Q1 and 1991 Q1 based broadly across the consumer and business sectors. Wholesale and retail distribution output fell by 4.2 per cent and business services and finance output fell by 1.1 per cent.

The most recent recession differs to those previously in that the service sector has made the largest contribution to the fall in GDP (see **Figure 2**). Between 2008 Q2 and 2009 Q3, services output fell by 4.6 per cent. Business and financial services over this period contracted by 7.6 per cent, much stronger than in earlier downturns, making the largest single contribution to the fall. Although consumer services have also weakened, with wholesale and retail distribution contracting by 6.2 per cent, business to business services have been a larger part of this recession than experienced before.

To a large extent this is reflective of the changing structure of the UK economy and the recent drop in business activity is fairly small compared to the strong and sustained rise in output between 1993 and 2007 (see **Table 1**) when the UK economy registered 64 consecutive quarters of positive growth. **Table 3** shows how output in the services sector has changed since before the early 1980s recession up until the eve of the most recent downturn. Total service output has more than doubled during this period, but in the business services and finance sector output grew almost five-fold.

Figure 8 also shows that a number of services sectors continued to make small but positive contributions to growth in each of the last three recessions. Ownership of dwellings predominately reflects the implicit rents that owner-occupiers pay themselves to live in their own properties. This is required so that GDP can be compared across countries on consistent

Box 3

New dwellings completions

Data on construction output for housing is corroborated with the numbers of completed dwellings reported in each year by the Department for Communities, Housing and Local Government (see **Figure 1**).

Between 1978 and 1982 the number of completed dwellings fell strongly by 36.7 per cent from 289,000 to 183,000. However, this largely represented the continuation of a long term trend in falling completions by local authorities following the surge in new completions in the period immediately after the War. New completions by private enterprise reported a more modest fall of 15 per cent over the period.

Since 1982, the longer term trend in new housing completions has been broadly flat, despite a growing population and an even larger increase in the number of households as an

aging population and changing family structures mean more households are formed out of the same population. However, this top level trend masks two features observed in the more disaggregated data.

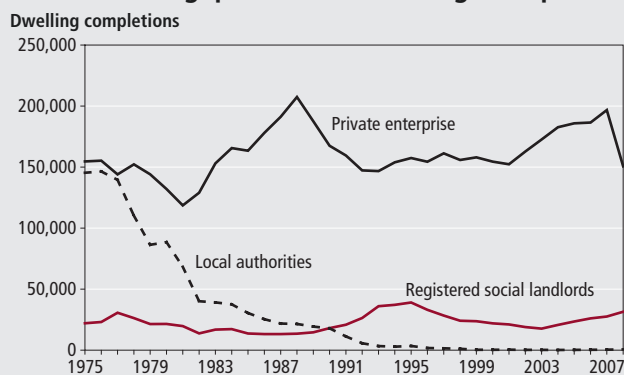
First, local authority housing completions have drifted towards zero while this has been offset by growing completions from registered social landlords (such as housing associations). Therefore, over the last three decade new dwelling completions from public or social construction have been broadly flat. The majority of new dwellings completions since the start of the 1980s have come from private enterprise. Here, the longer term trend in new completions is also flat, but this trend is punctuated by a pronounced cyclical pattern that is strongly associated with movements in UK house prices.

Between 1988 and 1993 the total number of completed dwellings fell by 23.2 per cent, driven by a 29.3 per cent fall in completed dwellings from private enterprise. However, the level of house building had picked up strongly since the beginning of the 1980s. In 1988 over 207,000 houses were completed by private enterprise, the highest number since 1968 and a level which has not been surpassed since.

In 2008 the total number of completed dwellings fell by 18.9 per cent, driven by a 23.5 per cent fall from private enterprise. In this year just over 150,000 new dwellings were completed by private enterprise, the lowest number since 1993 which represented the previous trough. Once again, prior to the slump, there had been a sustained increase in completions between 2001 and 2007. In 2007, nearly 200,000 new dwellings were completed, the highest number since the previous peak in 1988.

Box 3 Figure 1

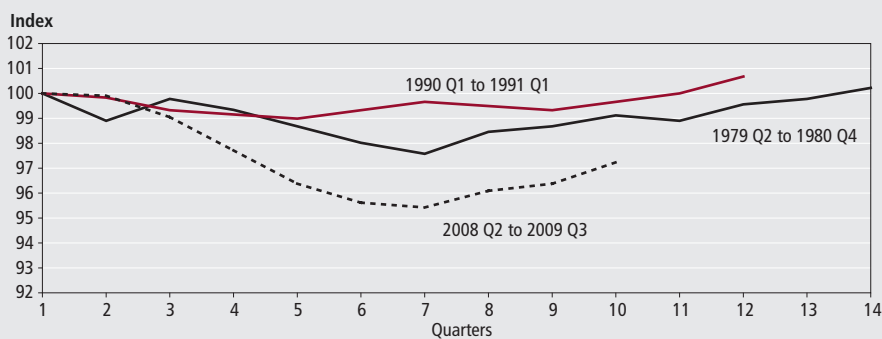
House building: permanent dwellings completed



Source: Department for Communities, Housing and Local Government

Figure 7

UK recession tracking: services output



Source: GDP Preliminary estimate

basis when there are different proportions of the resident population in rented or owner-occupied accommodation. Although this sector accounts for a fairly large part of the level of services output, growth tends to be very stable and hence the contributions to changes in output are relatively mild. In the last three recessions, starting with the earliest, the contribution to growth during the periods of peak to trough falls in GDP

were +0.2, +0.1 and +0.1 percentage points respectively.

The public administration and defence, education and health and social services sectors all consist of a high proportion of government (public sector/service) output. These all tend to be fairly immune from cyclical variations that impact on the rest (market sector) of the economy, making a small contribution to growth throughout

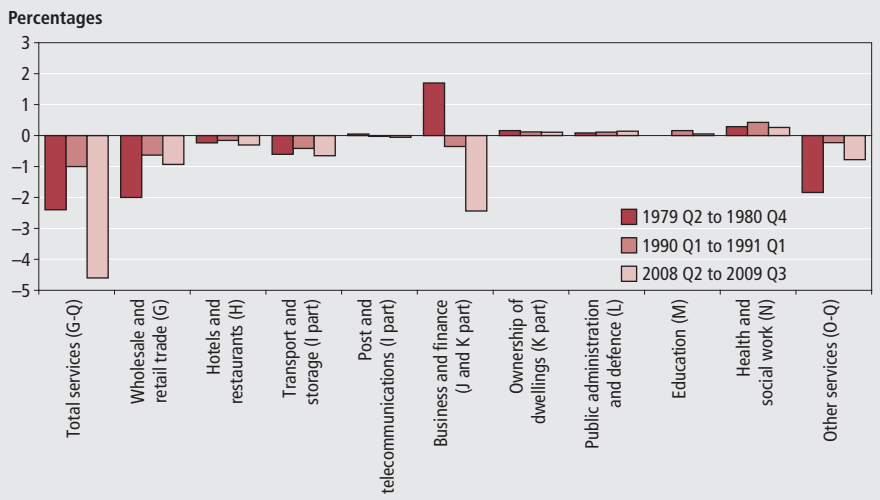
the previous three recessions. During periods of peak to trough falls in GDP, these sectors made respective contributions of +0.4, +0.7 and +0.5 percentage points in the 1980s, 1990s and most recent recessions.

Comparing UK recessions: expenditure measures

Output and expenditure are inescapably linked through the circular flow of income – which is the basic idea of stock and flow relationships that underlie the structure of modern National Accounts. Output produced by an economy is sold, and in generating that output income is earned which funds expenditure. Therefore, while output measures describe the supply side of economic activity, expenditure measures are the flip side in describing the demand side of the economy.

Figure 9 presents the same peak to trough falls in GDP shown in Figure 2, but this time split between the contributions made by the main categories of expenditure. Compared to previous recessions,

Figure 8
Contributions to peak to trough falls in UK services¹



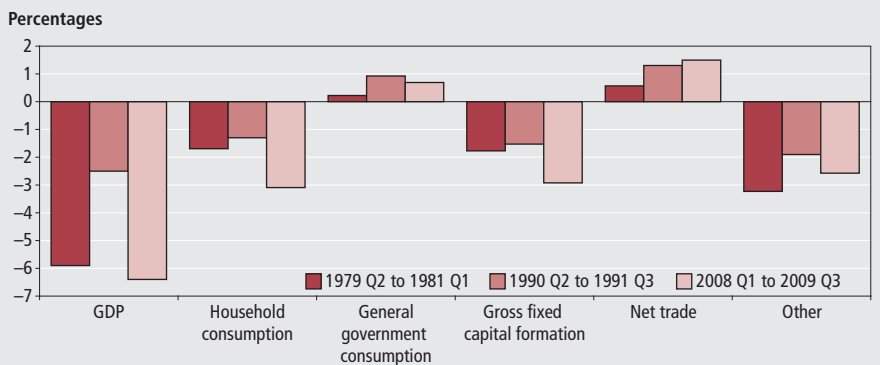
Note: Source: GDP Preliminary estimate
1 Other services calculated as a residual.

Table 3
Structural change in UK services

Industry	Index (1979 Q2 = 100)
Total services	231.1
Wholesale and retail distribution	201.0
Retail distribution	227.8
Hotels and restaurants	168.0
Transport	207.8
Air transport	429.9
Communications	707.5
Business services and finance (ex letting of dwellings)	480.7
Financial intermediation (ex insurance and pension funding)	565.2
Business services, computer activities and auxiliary finance	637.4
Ownership of dwellings	143.2
Public administration and defence	99.2
Education	131.2
Health	211.7
Sewage and refuse disposal	364.5
Recreation and cultural services	212.1

Source: GDP(O) database

Figure 9
Contributions to peak to trough falls in UK GDP by expenditure¹



Note: Source: GDP Quarterly National Accounts
1 Other calculated as a residual.

household consumption and fixed investment have contracted more sharply. However, the contributions of net trade and general government consumption have partially offset these falls.

The 'other' component consists of Non Profit Institutions Serving Households (NPISH), valuables and most importantly – inventories. While only a small part of the level of total demand, inventories or stockbuilding can account for a relatively large part of swings in GDP, especially over the course of an economic cycle. It also helps to explain why manufacturing output accounts for a disproportionate part of the fall in GDP relative to services (see Figure 2).

UK recessions compared: household consumption

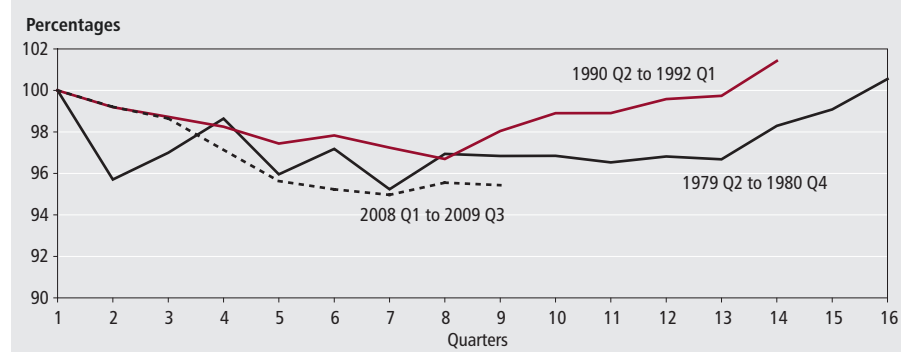
Household consumption is the largest component of total expenditure, and as such, plays an important role in accounting for GDP movements. Indices describing the movement of this variable over the course of the last three recessions are plotted in Figure 10.

Peak to trough falls of household consumption in the last three UK recessions have been broadly similar in magnitude. Between 1979 Q2 and 1980 Q4, household consumption fell by 4.8 per cent. In the early 1990s recession, household consumption fell by 3.3 per cent from 1990 Q2 to 1992 Q1. And in the latest recession, there was a drop of 5.0 per cent in household consumption between 2008 Q1 and 2009 Q3. The rising share of household consumption in total expenditure though means that it made a larger contribution to the most recent downturn than in the previous two episodes (Figure 9).

The general patterns of falling consumption have also been fairly consistent over previous recessions (see Figure 11). The transport sector, and in particular the purchase of motor vehicles, has generally made the largest contribution to falling consumption. In the periods of peak to trough falls in household consumption, purchases of new motor vehicles fell by 34.3 per cent in the early 1980s recession, by 22.6 per cent in the early 1990s recession, and by 23.3 per cent in the most recent recession. As large, durable purchases, often dependent on the availability of finance, it is not surprising that this category of spending is sensitive to the economic cycle.

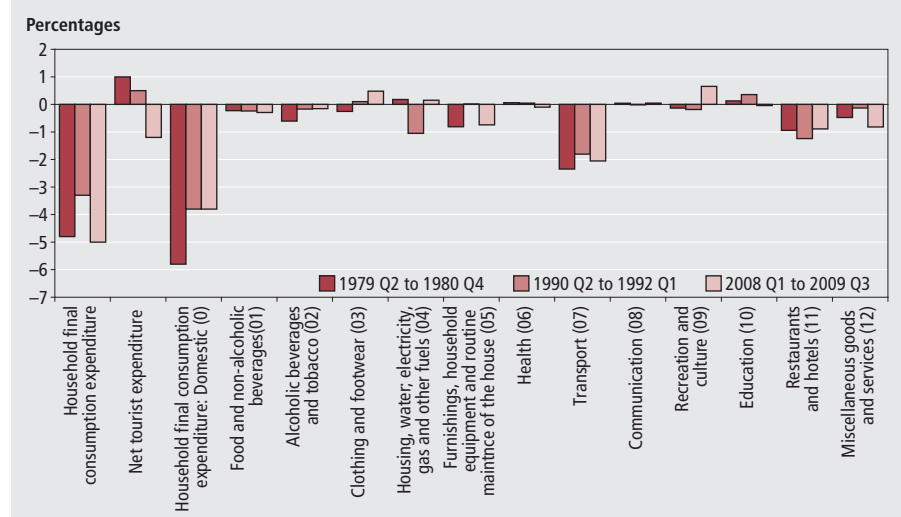
It is difficult to isolate the possible effects of the vehicle scrappage scheme, without which, the contraction in motor vehicle purchases may have been even worse. In

Figure 10
UK recession tracking: household consumption



Source: GDP Quarterly National Accounts

Figure 11
Contributions to peak to trough falls in UK household consumption



Source: GDP Quarterly National Accounts

addition, low interest rates may also have provided some support to spending in the recent recession, compared to the previous two when they were raised in order to control inflation. In the final quarter of 2009 the purchase of motor vehicles rebounded to almost its pre-recession level (up by 21.6 per cent on the previous quarter), providing some evidence of a late surge in order to take advantage of the temporarily lower rate of VAT before it increased to 17.5 per cent on 1 January 2010. Although motor vehicle purchases fell back a little in the first quarter of 2010, they were only 10.5 per cent lower before the recession (2008 Q1). Incidentally, this was the final quarter of the vehicle scrappage scheme which may have helped to sustain expenditure.

Net tourist spending though has fallen heavily in the latest recession – that is the difference between spending overseas by UK residents and foreign residents' spending in the UK. The average spend by inbound and outbound tourists hasn't shown any significant change, so recent

trends have been driven by visitor numbers. While numbers of foreign tourist visitors to the UK have been fairly robust, UK tourist-based visits overseas have fallen markedly – especially to Europe. These movements may have been influenced by the near 25 per cent depreciation in sterling in the second half of 2008, making visits to the UK from overseas relatively cheaper, and overseas visits by UK residents relatively more expensive. An article looking at the impact of the global recession on tourists' spending in the UK in this edition of *Economic & Labour Market Review* (see Webber, Buccellato and White 2010) finds evidence of a 'staycation' effect – where UK residents substitute foreign for domestic travel. Furthermore, this component of spending now has a higher weight than in previous recessions as international travel becomes more and more popular, so its contribution to the change in spending will be greater.

Discretionary areas of spending, such as hotels and restaurants; and furniture and household appliances have shown general

falls in all three recessions. However, in the latest downturn there have been pockets where spending, in real terms, have been supported by strong discounting (such as clothing and footwear) and also rapid technological advances (as in audio visual and information processing equipment).

The impact of the recession on household balance sheets, including the household saving ratio, is discussed in more detail in a previous edition of *Economic & Labour Market Review* (see Davies, Fender and Williams 2010). The saving ratio typically rises in a recession, as households concerned about uncertain future income, cut back on spending as a proportion of their disposable income. Saving can therefore strengthen balance sheets by paying down debts or building buffers to protect against future income shocks.

Since financial market deregulation in the early 1980s, the saving ratio has shown a stronger cyclical pattern. This is because movements in household spending have been amplified by the cyclical demand and availability of consumer credit. Between 1988 Q3 and 1992 Q1 the household saving ratio rose from 3.3 per cent to 12.2 per cent; and between 2008 Q1 to 2009 Q3 it increased from -0.9 per cent to 8.5 per cent. Both these periods were also synonymous with a sharp fall in unsecured lending (consumer credit), down by 62 per cent and 133 per cent respectively.

Although there is little evidence that secured borrowing funds a significant proportion of consumer spending (through mortgage equity withdrawal such as remortgaging, see Chamberlin 2009b) there could have been some substitution in recent years from more expensive unsecured to cheaper secured borrowing. However, the hiatus in mortgage lending as the UK housing market went into reverse, meant that this form of lending fell by 39 per cent between December 1990 and December 1993 and by 73 per cent between December 2006 and December 2009.

The impact of the recession on the household sector can also be seen in certain stress indicators such as housing arrears and repossessions and personal insolvencies and bankruptcies. Despite the sharp downturn in the housing market, the percentage of properties taken into possession in the recent recession has not increased to the same extent as the early 1990s recession, rising to 0.42 in 2009 compared to 0.77 in 1991. The percentage of mortgages more than 12 months in arrears was 0.6 per cent in 2009 compared to a spike of 1.5 per cent in 1993.

Personal insolvencies and bankruptcies have also increased sharply in each recession. Between 1979 and 1984 these rose from 3,500 to 8,229. Between 1989 and 1993 the increase was from 9,365 to 36,703. And between 2007 and 2009 the increase was from 106,643 to 134,142. Interpreting these numbers though requires a good deal of care, as bankruptcy and insolvency laws and facilities have changed over time. Numbers surged with the introduction of Individual Voluntary Arrangements in 1986, making it easier for households to voluntarily renegotiate debts that might otherwise eventually lead to bankruptcy orders against them.

There have been two key supporting factors to the household sector in the latest recession. First, pressures on household balance sheets have been mitigated by sharp reductions in interest rates, making it easier to fund current debt levels. During the early 1980s recession, Bank of England base rates averaged over 10 per cent as part of the fight against inflation. In the recession of the early 1990s, interest rates were also maintained at high levels to also fight against double-digit inflation and support the value of sterling within the European Exchange Rate Mechanism (ERM). In October 1990 the Bank of England base rate was 13.9 per cent, although this had fallen to 9.9 per cent by May 1992. It was not however until after sterling had left the ERM, and that the economy had started to recover that they were reduced to below 6.0 per cent in January 1993. But by then the economy had already begun to emerge from recession after a protracted downturn. In contrast, Bank of England base rate was 5.25 per cent on the eve of the latest downturn in February 2008. As the recession began to take hold this was cut sharply, falling to 0.5 per cent by March 2009 where it has since been maintained.

Secondly, pass through from output to the labour market has been more muted this time around. Between April–June 1979 and March–May 1984, unemployment rose from 5.3 per cent (1.4 million) to 11.9 per cent (3.3 million). The number of jobs between 1979 Q4 and 1983 Q1 fell by 2.0 million (-7.3 per cent).

Between April–June 1990 and December–February 1993 unemployment also increased substantially, from 6.9 per cent (2.0 million) to 10.7 per cent (3.0 million). The number of jobs fell heavily, recording a peak to trough fall of 1.95 million (-6.7 per cent) from 1990 Q2 to 1992 Q4.

In the latest downturn, the rise in

unemployment has been less strong and has shown some indication of stabilising at an earlier stage. Unemployment grew from 5.2 per cent (1.6 million) in January–March 2008 to 8.0 per cent (2.5 million) in January–March 2010. The peak to trough fall in the number of jobs was also less severe, declining by 1 million (-2.3 per cent) between 2008 Q2 and 2009 Q4.

Several reasons have been proposed as to why the labour market appears to be performing better in the latest recession compared to the previous two. There is some evidence that workers have accepted moderation in pay settlements and shorter working hours in order to preserve their employer's cash flow and sustain their own employment. Research published by the Bank of England (see Hackworth 2009) found that pay settlements averaged below 2 per cent in 2009 – with the recession and weak labour demand a key influence on settlements. Although there were relatively few instances of employees being forced to accept pay cuts, around 35 per cent in the private sector experienced a pay freeze in the last year. Walling and Clancy (2010) report on the increasing incidence of time-related underemployment in the current recession and the increasing share of part-time employees unable to find full-time work.

Businesses may also have held on to labour to a greater extent. In the services sector, which accounts for a growing share of total GVA, skilled labour inputs are relatively important. Therefore, in the downturn firms have to judge the extent to which labour might be cut in relation to spare capacity against the expected difficulty and cost in hiring and training skilled labour once business conditions improve. Sharp reductions in interest rates may have aided this form of labour hoarding by reducing the costs of servicing debts and supporting cash flows – relieving pressure to cut the wage bill. Furthermore, the incentive to push employees into early retirements has become less attractive by large deficits in corporate pension schemes that have to be reported in greater detail in published company accounts.

UK recessions compared: GFCF

GFCF, or fixed investment spending, typically exhibits sharp falls in recessions. Businesses, facing low and uncertain future demand, will be reluctant to invest in additional capacity. And because the capital output ratio, that is the amount of capital required to produce a unit of output, usually exceeds unity (standard assumption

in economic models is that it is around three), the fall in capital spending will tend to significantly exceed the fall in GDP.

Even if a firm wishes to undertake investment, constraints may arise due to the availability of finance. Internal finance, from retained profits, generally falls in a recession due to the impact of lower sales volumes on operating surpluses. Furthermore, firms operating at lower rates of capacity utilisation see their unit costs rise, further lowering profitability. External financing is also constrained, or becomes more expensive to reflect the riskier economic environment.

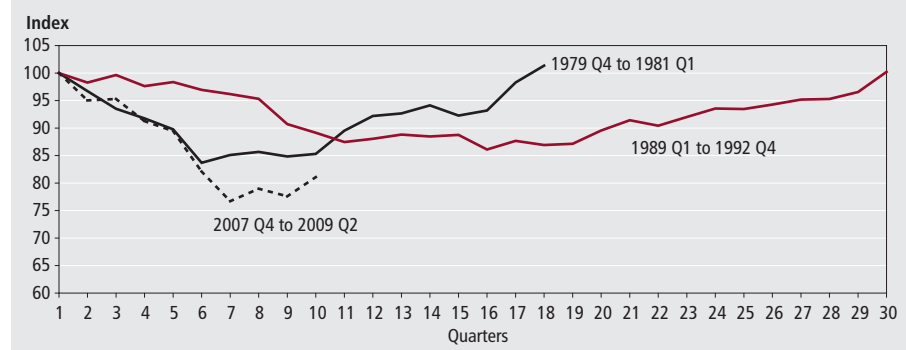
In the recession of the early 1980s, fixed investment spending fell by 16.3 per cent from 1979 Q4 to 1981 Q1, and between 1989 Q1 and 1992 Q4 GFCF declined by 13.9 per cent (see **Figure 12**). In the latest recession, the fall in GFCF has been even larger, with a 23.3 per cent contraction recorded from 2007 Q4 to 2009 Q2.

The contribution of business investment has been particularly important in the latest recession (see **Figure 13**). The recorded 25.1 per cent fall during this period was approximately twice the 13.6 per cent in the early 1990s and the 11.3 per cent fall in the early 1980s, relating to a much sharper downturn in plant and machinery spending than in previous downturns. This suggests that business confidence and uncertainty over the economic outlook, plus restrictions in the availability of finance, have had a severe impact on capital spending.

Investment in dwellings has also fallen significantly during recessions. In line with the evidence on construction output, these falls have been broadly similar across recessions at -27.1 per cent in the early 1980s, -33.5 per cent in the early 1990s and -27.7 per cent in the most recent recession. The contribution to total change in GFCF in the different recessions therefore reflects the particular share of this capital spending at each point in time.

The 'other' component primarily consists of transfer costs associated with the sale of fixed assets and public sector investment. The first of these would be expected to fall during recessions, reflecting lower turnover in residential and commercial property markets as well as falling prices (transfer fees are often a proportion of the sale price). Public sector investment though tends to be more stable than its business sector counterpart, and often makes a small contribution to growth. In the most recent recession the Government has brought forward some of its scheduled investment as part of the fiscal stimulus

Figure 12
UK recession tracking: gross fixed capital formation



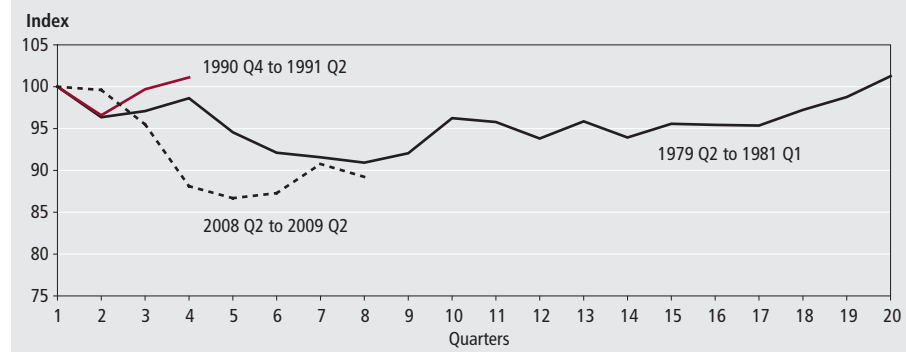
Source: GDP Quarterly National Accounts

Figure 13
Contributions to peak to trough falls in UK GFCF



Source: GDP Quarterly National Accounts

Figure 14
UK recession tracking: exports



Source: ONS UK Quarterly National Accounts

package introduced in the 2009 Pre-Budget Report.

Assessing the extent to which credit restrictions have impacted on fixed investment is difficult, as the reported fall in lending to the private non-financial sector (PNFC) may also reflect lower demand from businesses who are unwilling to add more debt to their balance sheets at a time of weak and uncertain sales. Between December 1989 and December 1993, lending to the PNFC sector fell by 116 per cent. A fall in excess of 100 per cent obviously implies that the sector has switched from being a net borrower to a net

lender and seeking to pay down its debts. In the most recent recession, lending to the PNFC sector fell by a similar magnitude of 114 per cent.

Nor has the rise in company insolvencies been particularly marked compared to previous recessions. Between 1979 and 1982 these rose by just under 8,000 from 4,537 to 12,067. Between 1989 and 1992 the annual number rose more dramatically, increasing by around 12,000 from 10,456 to 24,425. In the latest recession, company insolvencies rose by approximately 6,500 from 12,507 in 2007 to 19,077 in 2009. Of these, the majority were voluntary

creditor agreements (such as entering administration) rather than compulsory bankruptcies as in previous downturns. Significant falls in interest rates may have supported corporate sector balance sheets in the most recent recession compared to the two previous, and perhaps explains the lower number of company insolvencies.

Therefore, it seems that uncertainty over future demand has been the major driver of falling business investment in the latest recession. This has meant that the UK corporate sector has become an increasing net-lender, that is the saving the sector generates increasingly exceeds its capital spending. Increasing its cash reserves may be a deliberate move to protect against future uncertainty, not just to the economic outlook but also concerning commodity prices and the funding of pensions deficits.

UK recessions compared: exports, imports and net trade

Figure 9 shows that net trade, the difference between exports which add to GDP and imports which subtract, has contributed positively to growth during the last three recessions. In the latest recession though the contribution was relatively large, perhaps reflecting the larger fall in domestic spending (household consumption and GFCF) and the higher share of imports and exports in GDP as the UK economy continues to be more open to international trade.

Although contributions to growth have generally been positive, the circumstances behind them have been different. The patterns of exports over the past three recessions are shown in **Figure 14**. Peak to trough falls in exports have been greater when the global economy has also been in recession, representing a fall in overseas demand for UK output. Between 1979 Q2 and 1981 Q1 there was a peak to trough fall of 9.1 per cent in the level of exports; and between 2008 Q2 and 2009 Q2 the peak to trough fall was 13.5 per cent. By contrast, there was no real fall in exports during the recession of the early 1990s.

These trends tally with global conditions prevailing at the time. Estimates of the global output gap, provided by the IMF, were -4.4 per cent in 1982, -0.61 per cent in 1992 and -4.6 per cent in 2009, showing the relative severity of the global recession in each period. Further data on global and regional growth rates in each period of recession are presented in **Table 4**.

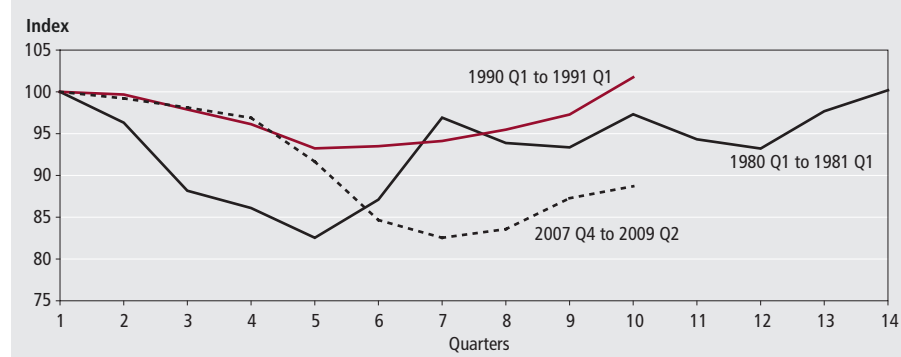
For imports, the magnitude of peak to trough falls bear strong resemblance to the associated peak to trough falls in GDP.

Table 4
Global growth rates during the last three UK recessions

Region or country	Annual growth rates								
	1981	1982	1983	1990	1991	1992	2007	2008	2009
World	2.3	0.9	2.9	3	1.5	2	5.2	3	-1.1
Major advanced	2	-0.06	3.2	2.9	1.1	2.1	2.2	0.3	-3.6
European Union	-0.1	0.9	2	2.4	0.8	0.7	3.1	1	-4.2
Developing Asia	5.9	5.6	7	5.4	6.1	8.9	10.6	7.6	6.2
UK	-1.33	2.09	3.6	0.8	-1.4	0.1	2.6	0.7	-4.4
USA	2.5	-1.9	4.52	1.9	-0.2	3.4	2.1	0.4	2.7
China	5.3	9	10.9	9.2	14.23	14	13	9	8.5
Germany	0.1	-0.8	1.6	5.7	5	2.3	2.5	1.3	5.3

Source: IMF World Economic Outlook

Figure 15
UK recession tracking: imports



Source: ONS UK Quarterly National Accounts

As **Figure 15** shows, falling imports were greater in the most recent and early 1980s recessions. Between 1980 Q1 and 1981 Q1, the level of imports to the UK declined by 17.5 per cent; and between 2007 Q4 and 2009 Q2 the peak to trough fall was also 17.5 per cent. In the early 1990s, the level of imports fell by a relatively modest 6.8 per cent between 1990 Q1 and 1991 Q1.

Therefore, the positive contribution of net trade in the most recent and early 1980s recessions reflected a sharper fall in imports than in exports, especially in the most recent case when the UK entered recession with a large and persistent trade deficit. In the early 1990s, although, the fall in imports was relatively modest, stronger demand in the rest of the world meant that exports remained fairly robust throughout the recession period.

Exchange rates have a direct impact on the competitiveness of UK goods and services in both domestic (through the competitiveness of imports) and foreign (through the competitiveness of exports) markets. Conventional wisdom argues that an exchange rate depreciation makes imports relatively more expensive in the domestic market and exports relatively cheaper in overseas markets. Exchange rate appreciation would, conventionally, have the opposite effect.

Between January 1979 and October 1980 sterling actually appreciated by about 20 per cent against both the US Dollar (\$US) and German Deutschmark (DM). However, sterling then began a long five year fall against the US dollar almost reaching parity in early 1985, which may have provided some fillip to net trade during the recovery.

In the recession of the early 1990s, sterling's parity was semi-fixed by its membership of the Exchange Rate Mechanism. Therefore, between January 1990 and August 1992 (just prior to Black Wednesday when the UK suspended sterling's membership of the ERM) the sterling effective exchange rate was broadly unchanged (rise of about 5 per cent). After leaving the ERM the sterling effective exchange rate depreciated by just under 20 per cent up until February 1993. It then remained fairly constant at this new level until September 2006 when it appreciated again, eventually rising above its ERM effective rate in July 2007. This long sustained fall in the value of sterling has been attributed as one of the most important drivers of growth as the UK recovered from the early 1990s recession.

Sterling depreciation in the second half of 2008 was even greater than when the UK exited the ERM, with the effective rate

falling by almost 25 per cent. However, there has been little evidence that this has stimulated an improvement in the UK's net trade position. In fact, during the second half of 2009 net trade made a negative contribution to GDP growth as imports rebounded more strongly than exports as the domestic and global economies emerged from recession. Weaker sterling may be expected to support net trade through the rest of the year, and of course, the contribution of net trade to GDP in the second half of 2009 may have been even worse had it not been for depreciation.

Conclusion

This article has set out to compare the main features of the last three UK recessions. The peak to trough fall in GDP between 2008 Q1 and 2009 Q3 of 6.4 per cent marks the recession since the Second World War – and is much closer in magnitude to the recession of the early 1980s than the last recession in the early 1990s.

Both the most recent and early 1980s recessions were part of global downturns. The doubling of oil prices in 1979, the second major oil price shock in that decade, generated significant inflation in the major economies, which was countered by a severe tightening in monetary policy. The build up to the latest recession though was altogether more different, with the world experiencing low inflation and interest rates for well over a decade – a period of unprecedented stability referred to as the 'Great Moderation'. However, this masked the effects of growing global imbalances and a full-blown credit cycle- the downside of which led to the near collapse of the global banking system, a hiatus in lending and a sharp reduction in asset prices.

Although the falls in aggregate GDP were broadly similar, the impact on the composition differed. On the output side, the services sector, in particular business services and finance, contributed more to the downturn than before – a reflection of the sectors strong growth in the decade before and the changing structure of the UK economy. On the expenditure side, gross fixed capital investment, and business investment in particular, contributed more to the fall in GDP in the latest recession than in the previous two – suggesting that confidence in the corporate sector was most adversely affected by the uncertain economic outlook and credit crunch. The household sector, although also facing a balance sheet recession which has prompted a rise in the saving ratio, has at least been buoyed by a sharp reduction in interest

rates and a less severe pass through to the labour market than expected.

The recession in the early 1990s was shallower and more reflective of domestic than global economic conditions as interest rates were raised to control inflation and as a result bursting the bubble in house prices. The large build up in housing investment prior to the collapse though generated a large hangover in the construction sector, where output took around a decade to fully recover. The collapse in the housing market also weighed on growth in household consumption and gross fixed capital formation, which rebounded far slower than in the early 1980s recession despite much lower peak to trough falls.

Notes

1. Gross Value Added is measured in basic prices (sometimes referred to as factor cost) whilst Gross Domestic Product is measured in market prices. The difference between the two is called the basic price adjustment (BPA), and reflects the impact of taxes and subsidies on market prices. In chain volume measures the effects of the BPA should be reflected in the respective deflators constraining GVA and GDP volume growth to each other. However, it is not uncommon for differences to occur as appears to be the case when

looking at the peak to trough changes in GVA compared to GDP. This may merit some further investigation.

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