## PERSPECTIVES ON A RECOVERY

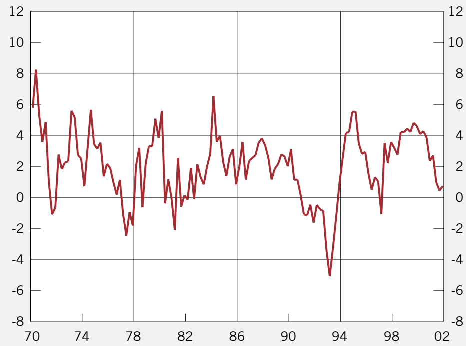
How and when demand will recover are key issues for the formation of monetary policy. This can warrant a comparison of earlier experiences with the recovery that is assumed to occur during 2002.

Since 1970 there have been five slowdowns in the Swedish economy, in 1971, 1977, 1981, 1993 and 1997 (Fig. B11).[25] The usual characteristics of a slowdown – many different economic variables moving in a similar pattern and the level of activity deviating from the trend for a considerable period – were evident in those years.[26]

### HISTORICAL PATTERNS

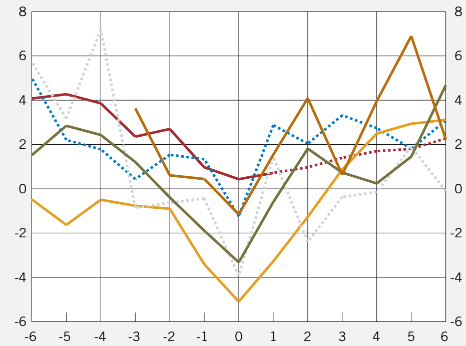
The cyclical slowdowns in the past three decades have differed in their causes as well as their paths.[27] So it is hardly surprising that they lack a cyclical pattern that is repeated mechanically. Neither have the different slowdowns come from the same GDP components. And

**Figure B11. Sweden's GDP growth 1970–2001. Per cent year-on-year**



Sources: Statistics Sweden and the Riksbank.

**Figure B12. Sweden's GDP growth in the six quarters before and after cyclical lows. Per cent year-on-year**




Note. Seasonally-adjusted series. The curves show the growth rates in the six quarters before and after the low for the slowdown in question; see the text for further information.

Source: The Riksbank.

25 Some signs of a slowdown were also discernible in 1974 and 1985–86 but they have not been included in the present comparison because there was no permanent deviation from trend GDP (growth was 3.3 and 2.0 per cent, respectively) and a number of major GDP components were unaffected (in 1974 consumption growth was very strong and unemployment fell, while manufacturing output, net exports and investment slowed; in 1985–86 consumption was strong and unemployment fell, while manufacturing output and net exports slowed).

26 See e.g. Diebold, F.X. & Rudebusch, G.D. (2001), Five questions about the business cycles, *FRBSF Economic Review*, pp. 1–15; Bergman, M. Bordo, M. & Jonung, L. (1998), Historical evidence on business cycles: the international experience, in Fuhrer, J.C. & Schuh, S. (ed.), Beyond shocks: what causes business cycles? *FRBB Conference Series* 42; Espinosa-Vega, M.A. & Gau, J-T. (2001), On business cycles and countercyclical policies, *FRBA Economic Review* 4, pp. 1–11; Perry, G.L. & Schultze, C.L. (1993), Was this recession different? Are they all different?, *Brookings Papers on Economic Activity*, pp. 145–211; or Zarnowitz, W. (1985), Recent work on business cycles in a historical perspective: a review of theories and evidence, *J. of Economic Literature* 23, pp. 523–581.

27 Cyclical developments in Sweden are discussed in e.g. Englund, P., Persson, T., Svensson, L.E.O. (1992), Swedish business cycles: 1861–1988, *J. of Monetary Economics* 30, pp. 343–371; Englund, P., Vredin, A. & Warne, A. (1994), Macroeconomic shocks in an open economy: a common trends representation of Swedish data, 1871–1990, in Bergström, V. & Vredin, A.m *Measuring and Interpreting Business Cycles*, Clarendon Press; Finansdepartementet (2001), *Finans- och Penningpolitiska Beslut för 1990-talet* (Sweden's Finance Ministry, Fiscal and monetary policy account for the 1990s), annex 5 to Government Bill 2000/01:100; Hassler, J., Lundvik, P., Persson, T. & Söderlind, P. (1994), The Swedish business cycle: stylised facts over 130 years, in Bergström, V. & Vredin, A. *idem*; Jonung, L. (1999), *Med Backspegeln som Kompass – om Stabiliseringspolitiken som Läroprocess* (With the rear mirror as a compass – stabilisation policy as a learning process), Ds 9; Lindbeck, A. (1998), *Det Svenska Experimentet* (The Swedish experiment), SNS Förlag; or Vredin, A. (1991), Vad är konjunkturcykeln? (What is the business cycle?), in Bergman, L. et al., *Ekonomi och Samhälle 2: Ekonomiskt Tillväxt och Utveckling* (Economy and society 2: economic growth and development), SNS Förlag. Reports from the National Institute of Economic Research on the economic situation 1970–2000 have also been used.

**Table B4. The 1971 slowdown.**

| | High | Low | Trend | High |
|---|---|---|---|---|
| GDP, y/y % | -4 | 71:3 | +2 | +6 |
| Private cons., y/y % | -4 | 71:1 | +2 | +4 |
| Investment, y/y % | -4 | 71:2 | +2 | +3 |
| Net exports, contr. % | — | 70:1 | +4 | +4 |
| Unemployment, level % | -7 | 72:1 | +8 | +13 |
| Inflation, % | -5 | 72:1 | +6 | +20 |
| Real eff. exchange rate, y/y % | — | 71:3 | +8 | +10 |

Source: The Riksbank.

**Table B5. The 1977 slowdown.**

| | High | Low | Trend | High |
|---|---|---|---|---|
| GDP, y/y % | -11 | 77:4 | +2 | +7 |
| Private cons., y/y % | -8 | 77:4 | +4 | +6 |
| Investment, y/y % | -8 | 76:1 | +2 | +3 |
| Net exports, contr. % | -11 | 75:3 | +7 | +9 |
| Unemployment, level % | -10 | 78:3 | +3 | +6 |
| Inflation, % | -4 | 79:1 | +3 | +7 |
| Real eff. exchange rate, y/y % | -5 | 76:1 | +2 | +3 |

Source: The Riksbank.

**Table B6. The 1981 slowdown.**

| | High | Low | Trend | High |
|---|---|---|---|---|
| GDP, y/y % | -4 | 81:1 | +7 | +11 |
| Private cons., y/y % | -2 | 80:4 | +5 | +24 |
| Investment, y/y % | -7 | 81:4 | +4 | +10 |
| Net exports, contr. % | -6 | 79:2 | +5 | +7 |
| Unemployment, level % | -7 | 78:3 | +3 | +7 |
| Inflation, % | -7 | 80:4 | +4 | +20 |
| Real eff. exchange rate, y/y % | -12 | 83:1 | +4 | +5 |

Source: The Riksbank.

**Table B7. The 1993 slowdown.**

| | High | Low | Trend | High |
|---|---|---|---|---|
| GDP, y/y % | -21 | 93:1 | +4 | +8 |
| Private cons., y/y % | -24 | 93:1 | +5 | +7 |
| Investment, y/y % | -18 | 93:4 | +3 | +7 |
| Net exports, contr. % | -15 | 89:4 | +4 | +10 |
| Unemployment, level % | -17 | 93:3 | +18 | +31 |
| Inflation, % | -11 | 90:3 | +4 | +8 |
| Real eff. exchange rate, y/y % | -18 | 93:3 | +5 | +9 |

Source: The Riksbank.

**Table B8. The 1997 slowdown.**

| | High | Low | Trend | High |
|---|---|---|---|---|
| GDP, y/y % | -6 | 97:1 | +1 | +10 |
| Private cons., y/y % | -2 | 97:1 | +1 | +14 |
| Investment, y/y % | -6 | 97:1 | +4 | +6 |
| Net exports, contr. % | -3 | 96:1 | +1 | +6 |
| Unemployment, level % | -9 | 97:1 | +4 | +15 |
| Inflation, % | -7 | 97:1 | +2 | +3 |
| Real eff. exchange rate, y/y % | -6 | 97:2 | +4 | +4 |

Source: The Riksbank.

as there have been only five downturns in a period when both the composition of stabilisation policy and the functioning of the economy have changed substantially, it would be hazardous to draw conclusions about the future.

The courses of the slowdowns studied here are presented in Tables B4 – B9. With the low as the reference quarter, the tables show the number of quarters between this and other features of the cycle (– and + indicate before and after). The interval between high and low refers to the variable in question; for investment, for example, the number of quarters is measured between the investment cycle's high and low, not the GDP cycle's. The numbers under High indicate the quarter in which growth (measured as the change from the same quarter a year earlier) was strongest in the period before or after the slowdown, while those under Low are the quarter in which growth was weakest.[28] The numbers under Trend show how many quarters it took for GDP, consumption, investment and so on to climb back to the average growth rate for the period 1970–98.[29]

In the five slowdowns, growth in the quarter when demand was weakest averaged –2.5 per cent from the same quarter a year earlier (–1.7 per cent if 1993 is excluded). The slowdowns also entailed negative growth over a number of quarters (ranging from 11 in 1993 to 1 in 1997). In the slowdowns in Sweden since the 1970s, growth has been negative for an average of 4 quarters (2.5 quarters if 1993 is excluded).

A look at the cyclical paths of the main GDP components shows that on several occasions net exports initiated the upturn, often several quarters before GDP growth had reached its low. In all these cases a weakening of the exchange rate contributed to the strengthening of demand. However, the devaluations coincided with or occurred after the GDP low and also came after net exports had bottomed out.

Consumption and GDP follow much the same pattern (1971, 1977, 1993 and 1997), but while consumption's contribution to growth was large after

28 Cyclical highs and lows can also be defined in other ways, for example in terms of the output gap or changes in this. In order to provide for comparisons with the Riksbank's forecasts for 2002–03, slowdowns are characterised here from non-trend adjusted series. For unemployment, a cyclical peak is represented by the lowest quarterly rate as a percentage of the labour force and a trough as the highest rate.

29 The trend for net exports is defined as the average contribution to GDP growth in the period 1970–98. For unemployment, inflation and the real effective exchange rate the trends are the average for the latest 12 quarters.

the slowdowns in 1971, 1977 and 1997, it was smaller after 1981 and 1993. The pattern for investment is less clear but on some occasions the reaction has come after a longer lag (1981, 1993 and 1997). Investment's contribution to the recovery was strongest after the slowdowns in 1970 and the 1990s and weaker on the other occasions.

On a number of occasions inflation fell to its lowest level about two to four quarters after the GDP low (1971, 1977 and 1981). Otherwise there is no recurrent pattern in inflation, no doubt partly because policy in this respect has changed appreciably.

A number of the slowdowns after periods characterised by major imbalances, such as impaired competitiveness for exports, high inflation, current-account deficits and budget deficits, naturally took a more serious turn (1977, 1981 and 1991).

Deviations from the 'normal' pattern are liable to be considerable. In 1971, for instance, consumption and investment were strong but net exports remained weak. The upswing after the crisis in the early 1980s continued for the rest of the decade. After the crisis in 1993 there was an unusually long period before consumption picked up, partly because fiscal as well as monetary policy was highly restrictive for a long time.

On most occasions (the exceptions are the crises in 1981 and 1993), GDP and consumption climbed back to their trends comparatively quickly. On some occasions, growth was in line with the long-term average only one to two quarters after the low (1971, 1977 and 1997).

### THE RECOVERY IN 2002

The cyclical upturn that the main scenario assumes will occur during 2002 has some characteristics in common with earlier recoveries. The forecast implies that the lows for GDP and consumption occur about six quarters after the previous high (as in 1977, 1981 and 1997) and that the next GDP high comes about eight quarters after the low (as in 1970, 1977, 1993 and 1997). Growth returns to the trend rate after about three quarters (as in 1971, 1977 and 1997).

In other respects the upturn according to the main scenario differs from earlier recoveries. The most marked difference is perhaps that the downward and upward phases are both expected to be less pronounced than the historical pattern. There is no quarter during the slowdown in 2001 when growth is assumed to be negative. In other words, growth bottoms out at a higher

**Table B9. The 2001 slowdown.**

| | High | Low | Trend | High |
|---|---|---|---|---|
| GDP, y/y % | -6 | 2001:4 | +3 | +8 |
| Private cons., y/y % | -5 | 2001:3 | +2 | +5 |
| Investment, y/y % | -11 | 2002:3 | +2 | +8 |
| Net exports, contr. % | -4 | 2000:1 | +2 | +5 |
| Unemployment, level % | -4 | 2002:4 | +1 | +9 |
| Inflation, % | -4 | 2002:3 | +1 | +7 |
| Real eff. exchange rate, y/y % | -4 | 2001:2 | +4 | +6 |

Source: The Riksbank.

level than in the recent slowdowns. The reason for this is not that growth was higher before the slowdown; the high (4.8 per cent in 1999 Q3) was somewhat less than the average of such peaks (in 1977 Q1, 1974 Q3, 1980 Q1, 1984 Q1, 1987 Q4, 1995 Q3 and 1999 Q3).

The moderate fall-off is explained instead by paths for consumption, investment and net exports that are more favourable than the historical pattern. One reason for this is that real interest rates have been notably low in a historical perspective.[30] Another reason is that real disposable income is rising 3.0 and 4.3 per cent in 2001 and 2002, respectively, whereas it fell in 1981, 1993 and 1997 and rose only slightly in 1971 and 1977. To some extent this has to do with fiscal policy's appreciable contribution to household purchasing power without there being a rapidly growing budget deficit that makes households uneasy about the sustainability of the government finances in the longer run, as was the case on a number of occasions in the past (1977, 1981 and 1991). Neither is the labour market deteriorating appreciably in connection with the current slowdown, partly thanks to the strong employment trend in domestic sectors. The upward shift in unemployment amounts to less than 0.5 per cent of the labour force, whereas the increases associated with earlier slowdowns averaged 2 per cent (1.2 per cent if 1993 is excluded).

The fall in investment is countered by the limited drop in aggregate demand. Moreover, the forecast assumes that in certain sectors (e.g. telecom infrastructure, housing and services) investment continues to develop favourably. The forecast on this occasion presupposes that, in contrast to some earlier slowdowns, investment activity does not go on weakening for one to two quarters after the GDP low.

The paths of the exchange rate and net exports also deviate markedly from the historical pattern. On this occasion the exchange rate weakened unusually early in the cycle. In previous slowdowns, the exchange rate low (measured as the change in the real effective rate) coincided with or occurred some years after the GDP low (1971, 1981, 1993 and 1997), whereas the depreciation this time was greatest two quarters before the GDP low. This may be one explanation for the appreciably higher level at which net exports have bottomed out compared with earlier slowdowns even though

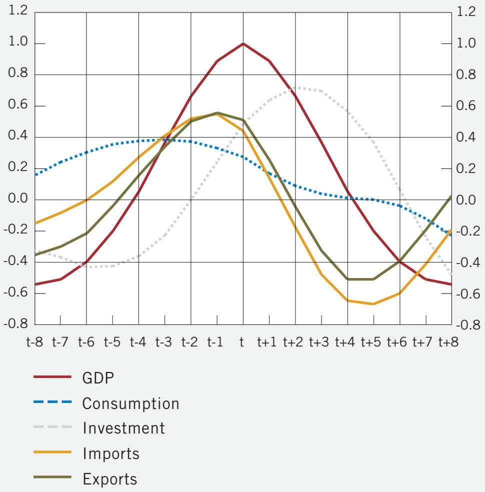
30 A comparison with the 1970s and '80s is complicated in that the fixed interest market was controlled at that time and the tax system was different. There is also a lack of comparable series for inflation expectations.

the depreciation during 2001 was smaller than on those occasions.

On the whole, moreover, the expected upturn 2002–03 looks comparatively cautious. Growth reaches a high of just over 3 per cent towards the end of 2003. The main driving force comes from domestic demand. Characteristics of the upward phase are a normalisation of consumption, a positive GDP contribution from stockbuilding and an upswing for investment. Opposing factors include the krona's less marked depreciation compared with earlier slowdowns and the appreciation that is assumed during the recovery. Moreover, the assumed appreciation this year and next is larger than in several earlier recoveries (1971, 1977, 1981 and 1997).

A major factor behind the assessment that the present slowdown will be less pronounced than usual in recent decades is economic policy's stabilising influence on this occasion. Real interest rates have been low, the exchange rate weakened early in the downturn and fiscal policy has been expansionary. Moreover, the slowdown started with a slackening of external demand and on this occasion the Swedish economy has not been burdened by appreciable imbalances in the form of household or corporate debt, public sector deficits or a persistent erosion of competitiveness. Against this background, households and firms have not had cause to fundamentally alter their view of either the future development of incomes and profits or how the economy is functioning That means that more self-stabilising forces in the economy (e.g. household saving or the automatic stabilisers in the government finances) have been in a position to counter the cyclical fluctuation.

**Figure B13. Correlations between GDP components in the economic cycle. Percentage annual change 1993–2001**




Source: The Riksbank.