Special Feature B

Recessions and Recoveries in Asia: Lessons from the Past

by Dmitriy Rozhkov[1]

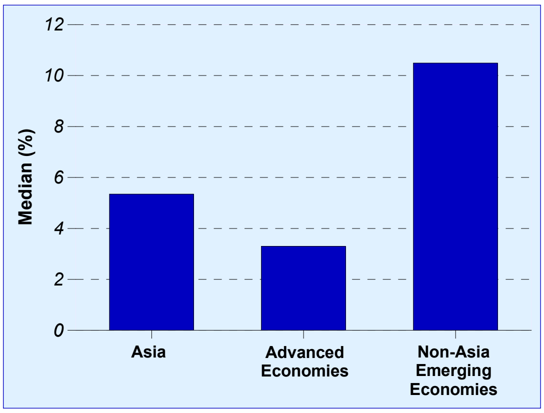
Introduction

Asia entered a major downturn in late 2008. Real GDP in many Asian economies is set to decline sharply in 2009, and forecasters expect a slow recovery in the period ahead. In this context, three key questions emerge: how long and how deep the current recession is likely to be, and how vigorous the recovery will be. This Special Feature summarises the results of a recent study by Souvik Gupta and Jacques Miniane from the IMF that looked into past recessions and recoveries in Asia to shed some light on these questions. (IMF, 2009)

Past Recessions: An Overview

The IMF study identified 33 recessions in 11 Asian economies since 1980, excluding the current crisis. (Table 1) During this period, recessions in Asia have typically not been very long – with a median duration of about three quarters, about the same as elsewhere – nor have they been very deep. However, Asian episodes have been more costly than those in advanced economies. The median cumulative loss of output in Asia was 5% of peak GDP compared with 3% in advanced economies, but Asian recessions have been less costly than those in other emerging markets, where the median cumulative loss has been about 10% of peak GDP. (Chart 1) As might be expected, the correlation between the incidence of recessions in Asia and global recessions appears to have increased over the past decade, a likely reflection of Asia's deepening integration with the global economy.

Chart 1
Cumulative Output Loss from Peak GDP in Previous Recessions since 1980



Source: IMF staff estimates

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Table 1
Previous Recessions in Asia since 1980

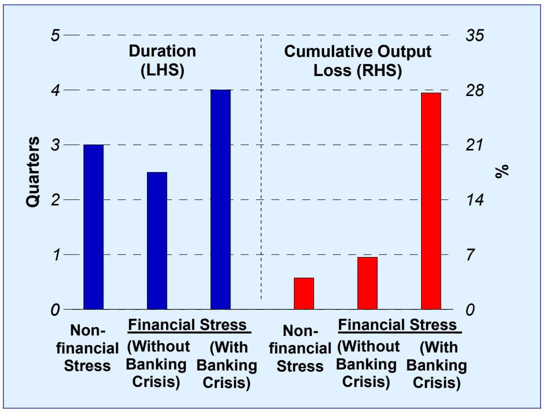
		Recessions Identified with		
	Recession Episodes	**Financial Stress**	**Domestic Banking Crisis**	**Export Demand Shock**
Japan	Q2 1992 – Q3 1992	√		
	Q2 1997 – Q1 1999	√	√	
	Q2 2001 – Q4 2001			
Australia	Q4 1981 – Q2 1983	√		
	Q2 1990 – Q3 1991	√		
New Zealand	Q4 1982 – Q1 1983	√		
	Q2 1985 – Q1 1986			√
	Q3 1989 – Q2 1990			
	Q1 1991 – Q2 1991	√		
	Q4 1997 – Q1 1998	√		
Hong Kong SAR	Q1 1982 – Q2 1982	√		
	Q1 1989 – Q2 1989			
	Q2 1995 – Q3 1995			
	Q4 1997 – Q4 1998	√		
	Q1 2001 – Q4 2001			√
	Q1 2003 – Q2 2003			
Korea	Q3 1979 – Q2 1980			
	Q4 1997 – Q2 1998	√	√	
Singapore	Q2 1985 – Q4 1985			√
	Q4 1997 – Q3 1998	√		
	Q1 2001 – Q3 2001			√
	Q3 2002 – Q2 2003			
Taiwan	Q4 2000 – Q3 2001			√
	Q1 2003 – Q2 2003			
Indonesia	Q1 1998 – Q4 1998	√	√	
Malaysia	Q1 1998 – Q3 1998	√	√	
	Q1 2001 – Q2 2001			√
Philippines	Q3 1983 – Q3 1985	√	√	
	Q4 1990 – Q2 1991	√		
	Q1 1992 – Q2 1992			
	Q1 1998 – Q2 1998	√	√	√
	Q4 2000 – Q1 2001			√
Thailand	Q4 1996 – Q3 1998	√	√	

Sources: Laeven and Valencia (2008); Cardarelli *et al.* (2009); and IMF staff estimates

The Deadly Effects of Financial Stress

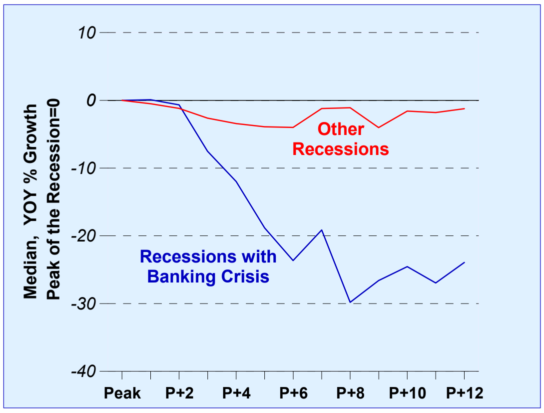
These median statistics mask an important fact: a substantial number of recessions in Asia have been both long and very deep. Those recessions tended to be associated with domestic banking crises. In fact, recessions associated with global financial stress but not accompanied by a domestic banking crisis are different in their severity from recessions with no financial stress. Recessions associated with banking crises are much more severe, entailing a 20% of GDP higher median cumulative output loss. (Chart 2) Bank impairment amplifies recessions through credit curtailment and, in the case of Asia, credit growth typically plummets during banking crises. (Chart 3) This deprives firms of working capital and consumers of the means to smooth consumption, explaining why investment and consumption fall substantially more during banking crises.

Chart 2
Previous Recessions in Asia since 1980 (Median)



Source: IMF staff estimates

Chart 3
Credit to the Private Sector in Asia during Previous Recessions since 1980



Source: IMF staff estimates

Does Export Dependence Hurt?

Asian countries with high export dependence appear to be more vulnerable to export shocks because their domestic demand is less autonomous from the export cycle.[2] (Chart 4) Indeed, not only does GDP fall by more in these countries during export-led recessions, consumption and investment also fall more sharply.

Can Exports Alone Drive the Recovery?

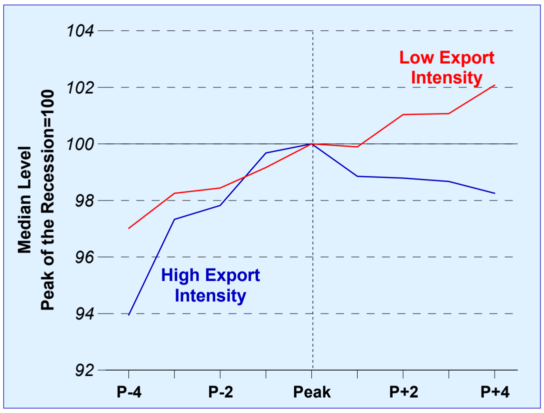
The recovery pattern in Asia is more homogeneous than the pattern of recession, and tends to be characterised by a strong rebound in exports and a relatively weak contribution from domestic demand. In particular, many recoveries in Asia have been "investment-less", with investment remaining flat post-trough for about

2 In Asia, countries with high export intensities are the newly industrialised economies (NIEs, comprising Hong Kong, Korea, Singapore and Taiwan) and Malaysia. Countries with low export intensities are Australia, Indonesia, Japan, New Zealand, the Philippines, and Thailand. This classification uses data on Asian countries' direct and indirect export exposure to the United States and the Eurozone presented in the IMF's *Regional Economic Outlook: Asia and Pacific*, April 2008.

three quarters, and then picking up very gradually. Exports, in comparison, have been the main engine of recovery in the region. (Chart 5)

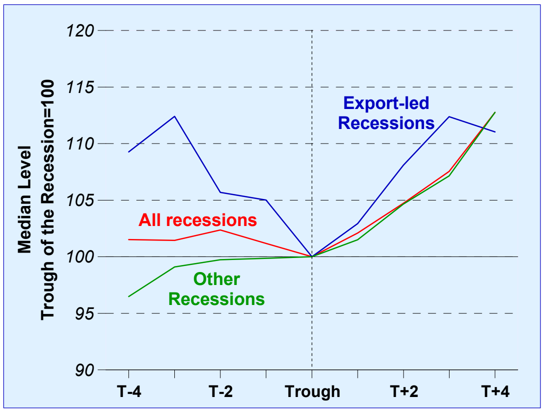
In the post-1980 sample, 60% of recoveries were led by exports, 30% by consumption, and only 10% by investment. Export rebounds appear to have been helped by currency depreciations, a common by-product of Asian downturns. Furthermore, most export rebounds in the sample occurred when growth in the United States and Europe was strong. A good example is the post-2001 rebound in Asian exports, which coincided with the recovery in the G2 from their own recessions. It is not surprising, therefore, that the more export-dependent economies in Asia have experienced sharper recoveries. This happened because their rebound in exports was sharper and because the recovery in exports translated into a stronger recovery in total domestic demand. At the same time, because recoveries in Asia have typically relied on a single engine, they have tended to be weaker than in other regions.

Chart 4
Real GDP during the 2000-01 Recession in Low and High Export Intensity Countries*



Source: IMF staff estimates
* Includes countries that were not in recession in 2000-01, excluding China and India.

Chart 5
Asia's Real Exports of Goods and Services during Previous Recessions since 1980



Source: IMF staff estimates

Sum-up

Minimising the depth and duration of the current recession means essentially two things for Asia: preserving the stability of core banking systems, and putting less emphasis on an export recovery. As shown above, history suggests that weaknesses in the banking sector could worsen an already painful recession. Although financial systems in Asia remain well-capitalised and capable of intermediating credit, cyclical stress in the corporate sector and rising job losses mean that banks may experience a further deterioration in asset quality. Also, the Asian model of relying on exports to lead the recovery may not be as successful as in the past, given the weak expected recovery in the G2. It is reassuring that countercyclical monetary and fiscal policies are being deployed to a greater extent than in past recessions. Furthermore, structural reforms, such as the expansion of social safety nets and the deepening of domestic financial markets, will help Asia to cope better with future downturns.

References

Cardarelli, R, Elekdag, S and Lall, S (2009), "Financial Stress, Downturns, and Recoveries", *IMF Working Paper* WP/09/100.

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