Recession of 2019 Q4-2020 Q2

PEAK: 2019 Q4 | TROUGH: 2020 Q2 | DURATION: 2 QUARTERS | AMPLITUDE: 19.16%

This was the most severe recession in the Portuguese economy since the start of the dating chronology (1980), coming as a result of the SARS-CoV-2 pandemic, an external shock to the global economy. The reactions of economic agents to the health emergency and the disruptions imposed on economic activity explain the largest recorded fall in real GDP per capita, concentrated in consumption and in international trade, followed by a vigorous recovery that started as early as Q3 2020.

ENVIRONMENT

The Portuguese economy expanded for 27 quarters between Q2 2013 and Q4 2019, with real GDP per capita growing at an average of 0.6% per quarter. This was the second shortest contraction since 1980. After the peak of economic activity in Q4 2019, real GDP per capita fell 19.2% in the following two quarters, making it the most severe contraction as well.

On March 2, 2020, the first case of SARS-CoV-2 infection was confirmed in Portugal. News of the virus immediately led to voluntary isolation and great uncertainty about public health. On March 19, the first state of emergency was declared in Portugal, lasting until May 2, 2020. The state of emergency included a set of measures restricting social contacts, such as limitations on public circulation, total closure of schools, closure of services with public attendance, mandatory teleworking and the reinstatement of land borders. After May, the country entered a state of calamity, with restrictions on economic activity being gradually lifted at different times and places.

The global health crisis had a notably contractionary effect. By the end of May 2020, the World Health Organisation reported infections in at least 83 countries, including all of Portugal's major economic partners. International trade in goods and services recorded the largest decline in value and volume since World War II,.

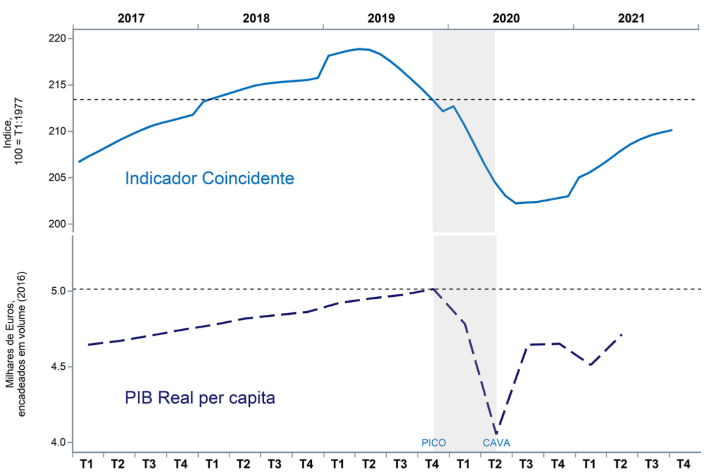
Internal policies attempted to cushion the decline in household income through a simplified layoff system, which subsidised salaries for over 110,000 companies between March and June 2020 (an expense estimated at 890 million euros). Of note on the financial policy side was a credit moratorium system, which started in March and reached more than 750,000 contracts, covering loans worth 48 billion euros (August 2020).

CALIBRATING THE PEAK AND TROUGH[1]

Real GDP per capita (smoothed) reached a local maximum in 2019:Q4 (Figure 1). Despite some variables pointing towards a deceleration as early as the end of 2019 (when Banco de Portugal's (BdP) coincident indicator reached its historical maximum), the majority of indicators clearly reversed their trend between the middle and end of 2020:Q1.

Although the state of emergency was only imposed in Portugal near the end of March, international trade was already contracting by February and voluntary isolation had begun in early March. This had clear effects on the industrial production index (Figure 3) and the BdP's coincident indicator (Figure 1). The Portuguese economy was already in recession in the second half of the quarter.

Figure 1. Banco de Portugal's Coincident Indicator (monthly) & real GDP per capita (quarterly)



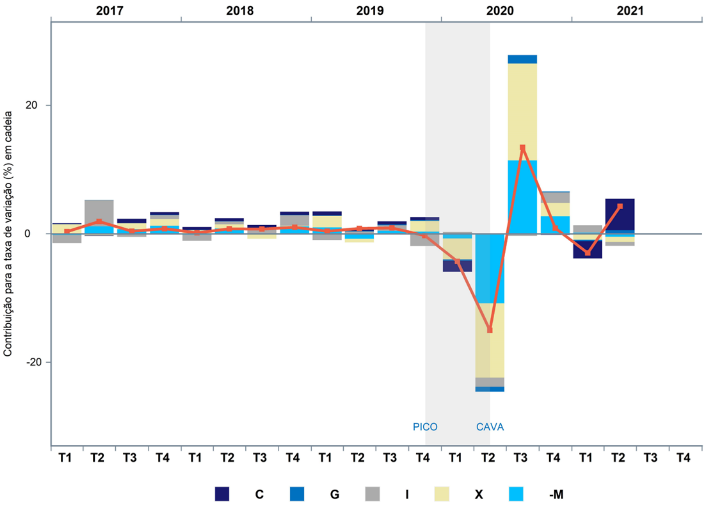
Source: BdP, Committee

Note: the horizontal dotted lines represent the value of the indicators at the peak defined by the Committee.

[1] The Committee bases its decisions on a subjective, multidimensional strategy, relying on a set of monthly and quarterly economic activity indicators, several computational algorithms and the assessments of its members. The evaluation is performed on a quarterly basis with a focus on output. For further details, please see the Methodological Notes.

Figure 2. Breakdown of the quarter-on-quarter rate of change in real GDP – expenditure approach **(quarterly)**

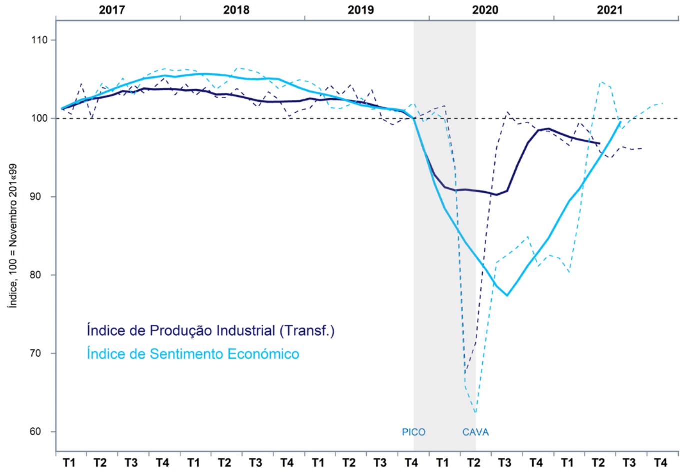
Source: BdP



Note: Positive contributions from imports (M) reflect negative rates of change in this aggregate.

Figure 3. Industrial production index and economic sentiment indicator **(monthly)**

Source: Statistics Portugal, Eurostat



Note: seasonally adjusted (dotted line) and smoothed (solid line) series, by using a centred 9-month moving average. Both are indexed to 100 in the month before the peak quarter, for interpretation.

Economic sentiment recorded a 40% drop between March and May 2020, reflecting the great uncertainty of the time (Figure 3). In May 2020, the expectations of trade and industry leaders regarding the development of demand in the following three months reached historical lows. This recession is characterised by a wave of fear and uncertainty among economic agents.

In terms of macroeconomic aggregates, the unusual nature of this recession is visible in its composition (Figure 2). It came as a result, firstly, of a slowdown in imports and exports, with the fall in international trade causing recessions in almost all regions of the world, especially in small open economies like Portugal. With the closure of borders, followed by their reopening a quarter later, GDP initially fell, only to rise again, mainly due to imports and exports. Secondly, there was a contraction in household consumption as a result of an increase in precautionary savings, voluntary isolation and lockdown policies. Investment, which is traditionally the most volatile element and the largest contributor to the economic cycle, remained stable.

Another characteristic of this recession relates to sectoral heterogeneity. The sharp decline in activity in industries associated with tourism particularly affected the Portuguese economy. For example, the monthly number of overnight stays in the national hotel industry had not fallen below 100,000 since 1987. The recovery was significantly slower in services than in goods. In industry, the production of consumer goods suffered more significant declines than that of investment goods. Unlike in normal recessions, the construction industry barely contracted.

Labour market dynamics were unusual in this downturn (Figure 3). Due to public policy responses, such as the simplified layoff system, many workers remained employed, although not working. Therefore, the unemployment rate was not informative in the calibration of this recession and output and labour were disconnected. Only after 2020:Q2, when the state of emergency ended, did unemployment gradually begin to reflect the slowdown in economic activity. Total employment and hours worked turned out to be more sensitive to the cycle and are consistent with the trough calibration in 2020:Q2.

The trough in this recession preceded the highest quarter-on-quarter real GDP growth on record (around 15%). The Committee considers the minimum level of economic activity in 2020:Q2 to be unequivocal. However, the expansion that followed was different, as it was sensitive to the course of the pandemic and the severity of the health policies adopted.

INDICATORS AND ADDITIONAL FACTORS

In 2021:Q1, there was a slight drop in real GDP per capita, associated with a new variant of the virus, which led to a return to the state of emergency between November 9, 2020 and April 30, 2021. With the tightening of health policies, real GDP per capita fell by 3% in that quarter but fully recovered in the following one (Figure 1). Again, all the changes in GDP during this quarter were due to the components of international trade and consumption. At the sector level, tourism and services were also the most severely affected here, with construction remaining stable.

Figure 4. Labour market – employment and unemployment indices and unemployment rate (quarterly)

Source: BdP, Committee

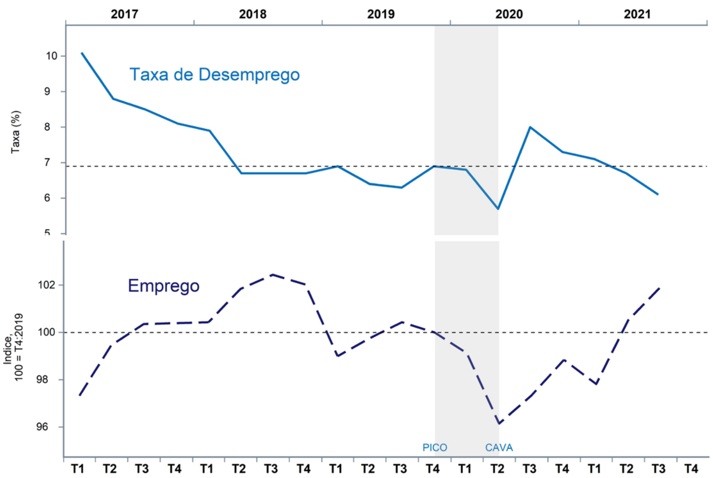
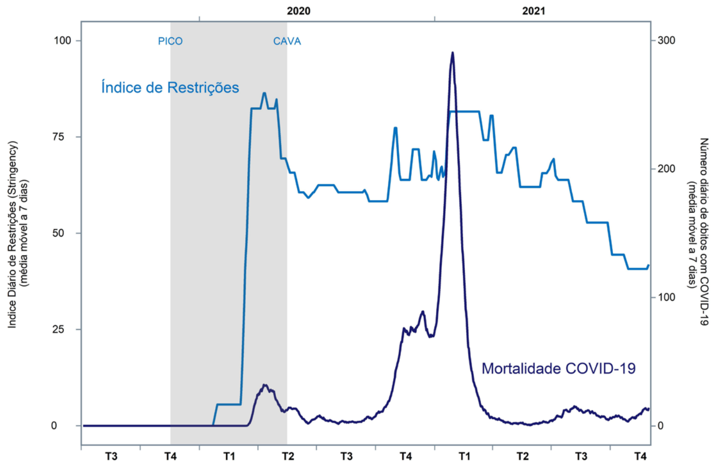


Figure 5. Intensity of lockdown policies (and other restrictions) and COVID-19 mortality (daily)

Source: Directorate-General for Health, Oxford University



Qualitatively, the 2021:Q1 contraction was similar to that of 2019:Q4-2020:Q2. Quantitatively, however, the changes in economic activity in these two periods were quite different. Not only was the amplitude of the oscillation much smaller, but the duration was also shorter. Therefore, 2021:Q1 does not qualify as a recession.

As Figure 5 shows, the health crisis was more serious. In 2020:Q4, mortality was already at higher values than in the recession quarters. The peak of the new wave of infections in 2021:Q1 was of an order of magnitude higher than that seen during the recession (the "first wave"). The restrictions imposed by the lockdown measures were as intense and even more prolonged than those in place during the recession.

Despite a more severe crisis and similar policy responses, this wave of the pandemic did not produce a recession, but only a “hiccup” in the recovery process. In 2021, economic agents were less uncertain about the health and economic implications of the virus. Production processes had already adjusted to lockdown policies. Workers were already routinely in teleworking mode. Optimism and confidence in the health measures were greater, sustained by the start of vaccination of the most vulnerable population.

Every recession is different, and almost all result from shocks that are, at least partially, unexpected. Comparing the 2019:Q4-2020:Q2 recession with the hiccup in the recovery in 2021:Q1 shows that this recession was particularly unexpected in the type of shock, its effect and the policies adopted. The uncertainty surrounding it was enormous, but it quickly diminished with more information about the virus and the discovery of a vaccine. Therefore, the recession was severe, but at the same time, short.

CONCLUSION

As is the case with many of Portugal's recessions, the shock behind the 2019:Q4-2020:Q2 contraction had an origin external to the national economy. This time, the shock was global and external to economic life, a virus that brought enormous uncertainty and concern for public health. Voluntary isolation and lockdown policies produced a drop in effective work, production, consumption, imports and exports, particularly centred on hotels and restaurants, while investment and the construction industry were little affected. The recovery was as swift as the crash had been. The slight drop in economic activity in 2021:Q1, after a health crisis more severe than the previous one and similarly restrictive public policies, shows that, as soon as the economy had some time to adjust, it was possible to respond with more resilience to the effects of the virus, thus avoiding a further recession.